



**CHANDIGARH
UNIVERSITY**

Discover. Learn. Empower.

**INSTITUTE OF
DISTANCE & ONLINE LEARNING**

**BACHELOR OF BUSINESS ADMINISTRATION /
BACHELOR OF COMMERCE**

BASIC ACCOUNTING

BBA101/BCM101

Self Learning Material

R101

**BACHELOR OF BUSINESS
ADMINISTRATION/
BACHELOR OF COMMERCE
BASIC ACCOUNTING**

BBA101/BCM101

Dr. M.A. Arulanandam



**CHANDIGARH
UNIVERSITY**

Discover. Learn. Empower.



CHANDIGARH UNIVERSITY
Institute of Distance and Online Learning

Course Development Committee

Chairman

Prof. (Dr.) R.S. Bawa

Vice Chancellor, Chandigarh University, Punjab

Advisors

Prof. (Dr.) Bharat Bhushan, Director, IGNOU

Prof. (Dr.) Manjulika Srivastava, Director, CIQA, IGNOU

Programme Coordinators & Editing Team

Master of Business Administration (MBA) Co-ordinator – Prof. Pragma Sharma	Bachelor of Business Administration (BBA) Co-ordinator – Dr. Rupali Arora
Master of Computer Applications (MCA) Co-ordinator – Dr. Deepti Rani Sindhu	Bachelor of Computer Applications (BCA) Co-ordinator – Dr. Raju Kumar
Master of Commerce (M.Com.) Co-ordinator – Dr. Shashi Singhal	Bachelor of Commerce (B.Com.) Co-ordinator – Dr. Minakshi Garg
Master of Arts (Psychology) Co-ordinator – Ms. Nitya Mahajan	Bachelor of Science (Travel & Tourism Management) Co-ordinator – Dr. Shikha Sharma
Master of Arts (English) Co-ordinator – Dr. Ashita Chadha	Bachelor of Arts (General) Co-ordinator – Ms. Neeraj Gohlan
Master of Arts (Mass Communication and Journalism) Co-ordinator – Dr. Chanchal Sachdeva Suri	Bachelor of Arts (Mass Communication and Journalism) Co-ordinator – Dr. Kamaljit Kaur

Academic and Administrative Management

Prof. (Dr.) Pranveer Singh Satvat Pro VC (Academic)	Prof. (Dr.) S.S. Sehgal Registrar
Prof. (Dr.) H. Nagaraja Udupa Director (IDOL)	Prof. (Dr.) Shiv Kumar Tripathi Executive Director (USB)

© No part of this publication should be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording and/or otherwise without the prior written permission of the author and the publisher.

SLM SPECIALLY PREPARED FOR
CU IDOL STUDENTS

Printed and Published by:

Himalaya Publishing House Pvt. Ltd.,

E-mail: himpub@bharatmail.co.in, **Website:** www.himpub.com

For:

CHANDIGARH UNIVERSITY

Institute of Distance and Online Learning



CU IDOL SELF LEARNING MATERIAL (SLM)



Basic Accounting

Course Code: BBA101/BCM101

Credits: 3

Course Objectives:

- To discuss accounting framework and role of accounting in business.
- To apply accounting principles, concepts and conventions to record business transactions culminating into final accounts.
- To formulate the applicability of GST and accounting procedure in the organization.

Syllabus

- Unit 1 - Introduction to Accounting:** Introduction, Meaning of Book-keeping and Accounting, Difference between Book-keeping and Accounting, Branches or Types of Accounting; Utility and Disadvantages of Accounting, Users of Accounting Information.
- Unit 2 - Introduction to Accounting:** Double Entry System: Meaning, Classification of Account, Stages or Parts of Double Entry System, Advantages and Disadvantages of Double Entry System.
- Unit 3 - Accounting Principles:** Types of Accounting Principles, Basic Concepts, Principles and Modifying Principles, Importance and Limitations.
- Unit 4 - Accounting Standards:** Meaning and Scope, Accounting Standards Issued by ICAI Accounting Equation.
- Unit 5 - Recording of Accounting Transactions:** Rules of Journalizing, Ledger: Meaning, Need and Importance, Proforma of Ledger, Distinction between Journal and Ledger.
- Unit 6 - Trial Balance:** Meaning, Features, Objectives of Trial Balance and Type of Errors.
- Unit 7 - Depreciation, Provision and Reserves:** Meaning, Causes, Objectives of Providing Depreciation, Different Methods of Providing Depreciation.
- Unit 8 - Capital and Revenue Items:** Classification of Capital and Revenue, Capital and Revenue Expenditure, Capital and Revenue Receipts.

Unit 9 - Joint Venture: Concept and Objectives of Joint Venture, Accounting Treatment, Difference between Joint Venture and Partnership.

Unit 10- Final Accounts: Preparation of Trading Account, Format, Preparation of Profit and Loss Account and Format, Balance Sheet, Drafting of Balance Sheet.

Unit 11- Final Accounts with Adjustment: Adjustment, Closing Stock, Outstanding Expenses, Prepaid Expenses, Depreciation, Bad Debts, Provision for Bad and Doubtful Debts.

Unit 12- Accounting for Goods and Services Tax: Meaning of GST, Tax Merged into GST, GST Tax Structure, Objectives or Advantages of GST, Types of Tax under GST and Accounting Procedure.

Text Book:

1. Gupta, R.L. and Radhaswamy, M. (2012), *Advanced Accountancy*, New Delhi, Sultan Chand & Sons.

Reference Books:

1. Maheswari, S.N. (2018), *Introduction to Accounting*, New Delhi, Vikas Publishing House.
2. Shukla, M.C., Grewal, T.S. and Gupta, S.C. (2007), *Advanced Accounts*, New Delhi, S. Chand & Co. Ltd.



CONTENTS

Unit 1:	Introduction to Accounting – I	1 - 17
Unit 2:	Introduction to Accounting – II	18 - 31
Unit 3:	Accounting Principles	32 - 49
Unit 4:	Accounting Standards	50 - 64
Unit 5:	Recording of Accounting Transactions	65 - 88
Unit 6:	Trial Balance	89 - 116
Unit 7:	Depreciation, Provision and Reserves	117 - 158
Unit 8:	Capital and Revenue Items	159 - 170
Unit 9:	Joint Venture	171 - 198
Unit 10:	Final Accounts	199 - 228
Unit 11:	Final Accounts with Adjustments	229 - 272
Unit 12:	Accounting for Goods and Services Tax	273 - 289

UNIT 1 INTRODUCTION TO ACCOUNTING - I

Structure:

- 1.0 Learning Objectives
- 1.1 Introduction
- 1.2 Meaning of Book-keeping and Accounting
- 1.3 Difference between Book-keeping and Accounting
- 1.4 Branches or Type of Accounting
- 1.5 Utility of Accounting
- 1.6 Disadvantages of Accounting
- 1.7 Users of Accounting Information
- 1.8 Summary
- 1.9 Key Words/Abbreviations
- 1.10 Learning Activity
- 1.11 Unit End Questions (MCQ and Descriptive)
- 1.12 References

1.0 Learning Objectives

After studying this unit, you will be able to:

- Discuss about the basic introductory part of accounting
- Explain the meaning of book-keeping and accounting



- Discuss the difference between book-keeping and accounting
- Analyse the branches or type of accounting
- Analyse the utility and disadvantages of accounting
- Explain the uses of accounting information

1.1 Introduction

This unit will help you to understand the basic introductory part of accounting, the meaning of book-keeping and accounting, the difference between book-keeping and accounting, the branches or type of accounting, the utility and disadvantages of accounting and the users of accounting information.

1.2 Meaning of Book-keeping and Accounting

1.2.1 Meaning of Book-keeping

Book-keeping is a record maintaining process or a record keeping process. Book-keeping maintaining or keeping the record of business transactions, in a systematic manner by observing certain principles of accounting and the rules of debiting accounts and creating accounts, made for the purpose of maintaining or keeping books of accounts.

Books used for recording business transactions are called 'Books of Accounts'. Books of accounts is a collection or a set of all the books used for recording business transactions. For example, Journal, Ledger, Subsidiary Books, etc. Thus, book-keeping is a record of systematic record of business transactions. It helps in finding the amount of profit and the amount of loss made by a business.

Book-keeping is the work of keeping a record of business accounts. A person who keeps a record of business transactions is called a book-keeper. It is an art of recording business transactions in a systematic manner.

Definition of Book-keeping

J.R. Batliboi: "Book-keeping is an art of recording business dealings in a set of books".



1.2.2 Meaning of Accounting

Accounting is an art of recording, classifying summarising the financial transactions and interpretation of summarised results and finally communicating the results to the interested parties, that is, the users of accounting information.

Account starts where book-keeping ends. Account has a wider scope. Book-keeping has a narrow scope.

Meaning and Scope of Accounting

Accounting is nothing but a means of communicating the results of business operations to various parties interested in or connected with the business, viz., the owner, creditors, investors, Government, financial institutions and other agencies. Accounting is, therefore, rightly called as the language of business. The basic purpose of a language is to serve as a means of communication. Accounting also serves this purpose. Accounting is not only associated with business but also with everybody who is interested in keeping an account for the money received and money spent.

Definitions

Definition of Accounting: The American Accounting Association defines accounting as the “process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of the information.” The American Institute of Certified Public Accountants defines accounting as the “art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof.”

An analysis of the above definitions will bring out the following functions of accounting:

(1) Recording: The basic function of accounting is recording the monetary aspect of all the transactions of the business in an orderly manner for the purposes of memory and reference in a future period. Recording is done in the book called ‘Journal.’ This book is further divided into eight different subsidiary books for convenience of recording.

(2) Classifying: The transactions recorded in the 'Journal' or the subsidiary books are classified and posted to the main book of account known as 'Ledger.' This book contains individual account heads under which all monetary transactions of a similar nature are collected. For example, in A's Account in the Ledger all transactions of the businessman that are connected with A are posted so that what is ultimately due to A or due from A can be ascertained.

(3) Summarising: The transaction recorded in the Ledger will be summarised and the balance in each Account will be ascertained and list of such balances called 'Trial Balance' will be prepared at the end of the accounting period. This becomes the basis for the preparation of the final accounts and the balance sheet.

(4) Interpreting: The final stage in the Accounting process is analysing and interpreting the financial data contained in the final accounts and balance sheet so that parties concerned with the business can make a meaningful judgement about the profitability, liquidity and solvency position of the business unit. This will help in planning for the future in a better way.

Definition of Book-keeping: Book-keeping may be defined as the mere art of recording the business transactions in the books of accounts in an orderly manner. A Book-keeper keeps a record of the business transactions and his work is of a clerical nature.

Accounting, on the other hand, is the science that is concerned with the principles of keeping accounts and designing the systems of recording, classifying, summarising and interpreting the financial data for the end-users. Accounting professes and book-keeping practises. Accounting is a more broader term and it includes book-keeping.

The objects of book-keeping are: (1) to have a permanent record of all business transactions and (2) to show the effect of each transaction and the combined effect of all transactions upon the financial position of the trader. If all the transactions are properly recorded in the books, the trader can find out (i) the amount of his profit or loss during the period; (ii) his financial position as on a date; (iii) how much he owes to others or how much others owe him; and (iv) the details of his various incomes, expenses, gains, losses, assets and liabilities so that he can make rational decisions and informed judgements leading to success in his venture.

1.3 Difference between Book-keeping and Accounting

Book-keeping	Accounting
<p>1. Meaning</p> <p>Book-keeping is the process of recording business transactions in the books of accounts in a systematic manner. Book-keeping records and classifies the business transactions. Recording is done in Journal or Subsidiary books and classification is done in the ledger.</p>	<p>Accounting is concerned with summarising the transactions (preparing the trial balance, profit and balance sheet), interpreting the summarised results and communicating the results to the users.</p>
<p>2. Stage</p> <p>Book-keeping is the first stage and it comes immediately after a transaction. Book-keeping is the basic for accounting.</p>	<p>Accounting is the next or secondary stage after book-keeping. Accountancy comes after recording and classification. Accounting begins where book-keeping ends.</p>
<p>3. Objective</p> <p>Book-keeping aims at keeping the record of business transactions and provides primary information.</p>	<p>Accounting aims at finding the profits or losses and gives the financial position of the business.</p>
<p>4. Responsibility</p> <p>Junior staff is responsible for keeping records called book-keepers.</p>	<p>Senior staff is responsible for keeping accounts called accountants.</p>
<p>5. Results</p> <p>Book-keeping results in Journal, Subsidiary books and Ledger.</p>	<p>Accounting results in profit and loss account and balance sheet.</p>
<p>6. Period</p> <p>Book-keeping gives day to day details of business transactions.</p>	<p>Accounting gives details of the entire year.</p>
<p>7. Scope</p> <p>Book-keeping has limited or narrow scope because it is concerned with recording and classifying the business transactions.</p>	<p>Accounting has a wider scope as compared to book-keeping because accountancy is concerned with recording, classifying the transactions, summarising the classified transactions, interpretation of summarised results and communication of results to the users.</p>

<p>8. Analytical Skill</p> <p>Book-keeping does not require analytical skill.</p>	Accounting requires analytical skill.
<p>9. Managerial Decision Making</p> <p>Based on information given by book-keeping, management cannot take decision.</p>	Important business decision can be taken by the management, based on information provided by accounting.
<p>10. Job Nature</p> <p>Book-keeping job is routine and clerical.</p>	Accountant job is analytical.
<p>11. Level of Knowledge</p> <p>A book-keeping does not require higher level of knowledge in comparison to as accountant.</p>	An accountant requires higher level of knowledge as compared to a book-keeper.
<p>12. Supervision and Checking</p> <p>A book-keeper does not supervise and check the accountant work.</p>	An accountant supervises and check the work of a book-keeper.
<p>13. Legal formalities</p> <p>It does not help in fulfilling legal formalities.</p>	It helps in fulfilling legal formalities.
<p>14. Branches</p> <p>It has no branches.</p>	It has different branches like cost accounting, management accounting, financial accounting etc.

1.4 Branches or Type of Accounting

- (i) **Financial accounting:** Financing accounting records business transactions in the books of accounts, in a systematic manner, to ascertain the profit or loss of an accounting period by preparing profit and loss account (income statement) and to present the financial position of the business, on a particular date, by preparing the balance sheet (position statement), for the information of the various interested person or parties like shareholders, investors, creditors, banks, financial institution, etc.

Financing Accounting keeps systematic records to ascertain financial performance (profit or loss) and financial position (assets and liabilities) and to communicate the accounting

information to the interested parties, through annual accounts, annual reports, graphs, diagrams, etc.

The financial statements show them the manner in which the business operations have been carried out, during a particular accounting period.

- (ii) **Cost Accounting:** Cost Accounting is concerned with ascertainment of cost of manufacturing a product or the cost of providing a service and the ways in which cost can be controlled, in respect of the elements of cost i.e., material labour and overheads. It communicates information about cost to management for decision making like price fixing, how to control cost (reduce cost).
- (iii) **Management Accounting:** The term 'management accounting' refers to accounting for the management, i.e., accounting which provides necessary information to the management for performing or discharging its management functions, effectively.

The functions of management are planning, organising, directing, staffing, controlling, reporting and budgeting.

Thus, management accounting provides information to the management, so that, the management functions can be done in an orderly and effective manner, Management Accounting supplies all information that management need for taking decisions.

Management Accounting uses accounting data collected with the help of financial accounting and cost accounting, for taking decisions and performing management functions.

1.5 Utility of Accounting

The utility of accounting can be pointed out as follows:

1. **Systematic record keeping:** Accounting keeps a systematic record of business transactions in the book of accounts. This record is of use for various stakeholders, for their relevant decision making. Accounting replaces human memory which is short lived by keeping a complete and systematic record of financial transaction.

2. **Accounting is the language of business:** Accounting is the language of business. Accounting communicates the results of business operations to various stakeholders like the owners, partners, proprietors, shareholders, investors, creditors, suppliers, consumers, government, public, etc. Accounting reveals a true and correct picture of the business.
3. **Know the financial performance:** The financial performance of an organisation is known by preparing the income statement i.e., the trading account and profit and loss account. The trading account shows the gross profit or gross loss of the business. The profit and loss account shows the net profit or net loss of the business. To find the profit or loss for an accounting period the expenses or costs are compared with the revenue/income of that accounting period. If the income or revenue is more than the expenses or costs, the business has earned profit. If the costs or expenses are more than the revenue or income, then the business has suffered a loss.
4. **Know the financial position of business:** The position statement i.e., the balance sheet helps to know the financial position of the business. The balance sheet is a statement showing the assets and liabilities of the business, as on a particular date.
5. **Fulfill legal requirements:** Accounting helps to comply with legal requirements, which require an organisation to keep books of accounts. For e.g., Sec. 44AA of the Income Tax Act 1961 requires certain persons to keep specified books of accounts. As per Sec. 209 of the Companies Act, 1956, companies have to keep proper books of accounts on accrual basis.
6. **User can take decisions:** The various stakeholders or parties or groups or users can take their respective decisions on the basis of accounting information communicated to them through annual reports, annual accounts, etc. The various users are short term creditors, long term creditors present investors, potential investors, employees, consumers, tax authorities, government regulatory agencies, public etc.
7. **Legal proof:** In case of disputes, proper and systematically kept books of accounts act as legal proof in the court of law.
8. **Getting loans and credit facility:** Banks, financial institutions, suppliers can give loans or grant credit facility, by giving them part and projected financial statements.

9. **Comparative Study:** Accounting helps to make the following comparative studies:

- (a) **Inter-firm comparison** i.e., comparison of actual figures one firm with those of another firm from the same industry
- (b) **Intra-firm comparison** i.e., comparison of actual figures of one period with those of another period, for same firm.
- (c) **Pattern comparison** i.e., comparison of actual figures of one firm with those of industry, to which the firm belongs.
- (d) **Comparison** of actual figures, with standard figures for the same period and the same firm.

1.6 Disadvantages of Accounting

The disadvantages of accounting are as follows:

1. **Records only monetary transactions:** Accounting records only monetary transactions i.e., transactions which can be measured in terms of money. Quantitative elements like efficient management, labour force quality, labour strike etc., are not recorded in accounting.
2. **Ignore price level changes:** In the accounting books, accounting transactions are recorded at cost. The effect of price level changes is not considered. Therefore, comparison of different years is difficult.
3. **Not free from bias of accountant:** Personal judgement of the accountant influences the accounting statements. The accountant may select any method of depreciation or any method of stock valuation. Financial statements are not free bias due to subjectivity is personal judgement. Thus, financial statement analysis is not free from bias.
4. **Window dressing danger/risk:** The management may decide to artificially increase or decrease the profit figures, assets and liabilities by entering incorrect figures. Then the income statement will not show a true and fair picture of the financial performance of the organisation and the Balance Sheet will not show a true and fair picture of the financial position of the organisation. Real test of managerial performance is not available.

5. **No realistic information:** Since accounting statements are prepared by following basic accounting concepts and conventions, accounting information may not be realistic. For example, the financial statements will not show the true business position, by following the principle of conservation.
6. **Allows alternative treatments:** Within generally accepted accounting concepts and conventions, accounting allows alternative treatments. For example, closing stock may be valued by F.I.F.O. (First-in-First-out) or L.I.F.O. (Last-in-First-out) or average price method. Similarly, depreciation may be charged by fixed instalment method or reducing balance method or some other method. Different results are given by use of different methods, which may not be comparable.
7. **Historical in nature:** Accounting is historical in nature. It does not reflect the current/present financial position or worth of a business. Normally, accounting gives information in the form of Profit and Loss Account and Balance Sheet, at the end of the year. Thus, the information given is of historical interest and only gives a postmortem analysis of the past accounting information. Financial accounting does not give quick and timely information, which is required by the management for control and planning purposes.

1.7 Users of Accounting Information

Internal and External Users of Accounting

The importance of accounting is to provide meaningful information about a business enterprise to those persons who are directly or indirectly interested in the performance and financial position of a business enterprise.

It is helpful to category users of accounting information on the basis of their relationship to the business concern. Internal users, primarily the proprietors or managers are involved in the daily affairs of the business. All other groups are external users. Internal users are those who use accounting information for their own sake and external users are those who use information not for their own sake but for the sake of others (e.g.: creditors, investors, employees, Government, public research scholars ... etc.)



Internal Users

The owners or managers of a business concern is in a position to obtain financial information in a way that best suits his needs. Suppose, a production manager needs to know how much it costs to produce a product, this information exists in the accounting system and can be prepared. In this particular situation the cost accountant is required to assemble and interpret cost data for the use of management, in controlling current operations and in planning the future.

If a department supervisor wants to find out if monthly expenditures are more or less than the budgeted amount, a report can be generated to provide the answer. 'Management Accounting' is the branch of accounting concerned with providing Internal users with information to facilitate the planning and control functions. The ability to produce management accounting reports is limited on by the extent of the data available and the cost involved in generating the relevant information.

External Users

External users, are those not involved directly in the operations of a business, need information that differs from that needed by internal users. In addition, the ability of external users to obtain the information is more limited. Without the day-to-day contact with the affairs of the business, outsiders must rely on the information presented to them by the management of the business concern. External users (Stake holders) must rely on general purpose financial statements for their information 'Financial accounting' is the branch of accounting concerned with the preparation of general purpose financial statements for use of outsiders.

1. Short term creditors (supplier of new materials or goods, given of short-term loans):

Creditors are interested to know the credit worthiness of a company before granting credit facility or before giving loan. They want assurance that the amount which is due to them or the principal loan amount and the interest will be paid to them on time by the trade debtors and loan debtors. So, based on accounting information the trade or editors and loan creditors can take decisions regarding granting credit or giving loans.

2. Investors (Present investors [Shareholder] and potential investors [Future Investors]):

Investors, present and potential for their investment decisions, regarding

investing in shares of companies, are dependent upon accounting information. They can decide whether to buy the share, how much to buy, when to buy or sell off their shares. Investors want a good return on their investment and safety of their investment.

3. **Employees:** Employees need accounting information because their financial benefits depends upon the financial health of the company.
4. **Tax authorities:** Tax authorities need accounting information to find the amount of tax a business organisation has to pay the tax authorities.
5. **Customers:** Customers are interested in information about the stability of an organisation, if they have a long-term involvement with an organisation or they are dependent on the organisation.
6. **Researchers:** Researchers for their research work are dependent upon accounting information, which is provided by the financial statements, annual reports etc.
7. **Public:** The public is interested in accounting information since the locality's prosperity depends on business's prosperity. The public can find and whether the company is discharging its social obligations.
8. **Managers:** Managers require accounting information for their decision-making. Manager have to manage the organisation in an efficient manner, by showing good financial performance.

1.8 Summary

Book-keeping is an art of recording business transactions in the book of accounts in a systematic manner.

Accounting is an art of recording, classifying, summarising the financial transactions and interpretation of summarised results and finally communicating the results to the interested parties i.e., the users of accounting information. Accounting starts, where book-keeping ends. Accounting has a wider scope. Book-keeping has a narrow scope.

The **points of difference between book-keeping and accounting** are meaning, stage, objective, responsibility, results, period, scope, analytical skill, managerial decision-making, job nature, level of knowledge, supervision and checking, legal formalities and branches.

The **branches of accounting** are financial accounting, cost accounting, management accounting etc.

The **utility of accounting** is it keep a systematic record, accounting is the business language, financial performance and financial position can be known, fulfill legal requirements, users can take decisions, legal proof, getting loans and credit facility, comparative study.

The **disadvantages of accounting** are it records only monetary transactions, ignores price level changes, not free from personal bias of accountant, risk of window dressing, no realistic information, allows alternative treatments and it is historical in nature.

The **users of accounting information** are creditors, investors, employees, tax authorities, customer, researchers, public, manager, etc.

1.9 Key Words/Abbreviations

- **Book-keeping:** Book-keeping is an art of systematic recording of business transactions, in the books of account.
- **Accounting:** Accounting is an art of recording, classifying summarising the financial transactions, interpretation of summarised results and finally communicating the results, to the various users of accounting information.
- **Cost accounting:** Cost accounting is concerned with ascertainment of cost of manufacturing a product or cost of providing a service and the ways in which cost can be controlled in respect of the elements of cost i.e., material, labour and overheads.
- **Financial accounting:** Financial accounting keeps a systematic record of business transactions in the books of accounts, to ascertain the financial performance of the business, by preparing the Profit and Loss Account (Income Statement showing profit or loss) and to ascertain the financial position of the business, by preparing the Balance

Sheet (Position statement showing assets and liabilities as on particular date) and it communicate the accounting information to the various users or interacted parties.

- **Management accounting:** Management accounting means accounting which provides necessary information to the management for performing its management function of planning, organising, staffing, directing, leading, communicating, controlling, co-ordinating, reporting and budgeting effectively.
- **Accounting users:** The various users of accounting information are owners, creditors, investors, shareholders, employees, customers, researchers government, tax authorities, public, managers.
- **Accounting utility:** The utility of accounting is it keeps a systematic record of business transactions, accounting is the business language, one can know the financial performance and financial position of the business, it fulfills legal requirements, users can take their respective decisions, it is a legal proof, it is used for getting loans and credit facility and it is used for comparative study.
- **Accounting disadvantages:** Accounting has disadvantages like it records only monetary transactions, it ignores price level changes, it is not free from personal bias of accountant, there is risk of window dressing, no realistic information, it allows alternative treatments and it is historical in nature.

1.10 Learning Activity

1. Find the other branches of accounting, besides the three branches mentioned in this chapter.

2. According to you, what is the utility of accounting?



3. According to you, what are the disadvantages of accounting?

4. According to you, what are the various users of accounting information?

1.11 Unit End Questions (MCQ and Descriptive)

A. Descriptive Types Questions

1. What is book-keeping?
2. What is accounting?
3. Distinguish between book-keeping and accounting.
4. Explain the branches or types of accounting.
5. Explain the utility of accounting.
6. Explain the disadvantages of accounting.
7. Explain the users of accounting information.
8. Write short note on:
 - (a) Difference between book-keeping and accounting.
 - (b) Branches of accounting.
 - (c) Utility of accounting.
 - (d) Disadvantages of accounting.
 - (e) Users of accounting information.



B. Multiple Choice/Objective Type Questions

1. _____ is an art of recording business transactions in the books of accounts in a systematic manner.
(a) Accounting (b) Book-keeping
(c) Costing (d) Management accounting
2. _____ is an art of recording, classifying, summarising, interpretation and communication of results to the interested parties.
(a) Book-keeping (b) Accounting
(c) Cost accounting (d) Management accounting
3. Book-keeping is the _____ stage.
(a) First (b) Second
(c) Third (d) Fourth
4. Accounting is the _____ stage.
(a) First (b) Second
(c) Third (d) Fourth
5. _____ accounting is useful for management for discharging the management functions.
(a) Financial (b) Cost
(c) Management (d) Social responsibility
6. _____ accounting deals with finding of cost of a product or service and controlling cost.
(a) Cost (b) Financial
(c) Management (d) Social responsibility

Answer: 1. (b), 2. (b), 3. (a), 4. (b), 5. (c), 6. (a)

1.12 References

1. M.C. Shukla, T.S. Grewal and S.C. Gupta, “*Advanced Accounts*”, S. Chand and Co. Ltd., New Delhi.
2. S.N. Maheshwari, S.K. Maheshwari, (2004), “*An Introduction to Accountancy*”, Vikas Publishing House, New Delhi.
3. S.P. Jain, K.L. Narang (1999), “*Advanced Accountancy Part I*”, Kalyani Publishers, Ludhiana.

UNIT 2 INTRODUCTION TO ACCOUNTING - II

Structure:

- 2.0 Learning Objectives
- 2.1 Introduction
- 2.2 Double Entry System: Meaning
- 2.3 Classification of Account
- 2.4 Stage or Parts of Double Entry System
- 2.5 Advantages and Disadvantages of Double Entry System
- 2.6 Summary
- 2.7 Key Words/Abbreviations
- 2.8 Learning Activity
- 2.9 Unit End Questions (MCQ and Descriptive)
- 2.10 References

2.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the meaning of double entry system.
- Describe the classification of accounts
- Elaborate the stages or parts of double entry system
- Discuss the advantages and disadvantages of double entry system
- Explain the practical question entries



2.1 Introduction

This unit will help you to understand the meaning of double entry system, know the classification of accounts, know the stages or parts of double entry system, know the advantages and disadvantages of double entry system and to explain the practical question entries.

2.2 Double Entry System: Meaning

There are two different systems of Accounting for recording the business transactions:

(a) Cash System of Accounting: Under this system, only actual cash received and cash paid are recorded. No entry is made for a receipt which is merely due; however, any payment outstanding will be accounted for. Government accounting is based on the cash system only. Professional people like lawyers, Chartered Accountants, etc., maintain accounts under this system.

(b) Mercantile System or Accrual System of Accounting: Under this system of accounting, entries are made not only for actual receipt or payment of cash but also for amounts having become due for payment or receipt. In other words, both cash transactions and credit transactions are recorded in the books of accounts. All commercial establishments and even non-trading concerns follow this system only.

Further, Accounting records can be prepared under any one of the following systems:

(i) Single-entry System: Under this system only the personal aspects of the transactions are recorded in the books and the impersonal aspects are ignored. It is not based on the 'dual' aspect concept and is incomplete, inaccurate and unscientific.

(ii) Double-entry System: It is the most common system of keeping records whereby the two aspects of every transaction — the giving aspect and the receiving aspect — are recorded in the books of accounts. Each aspect will be recorded in one account and this method of writing every transaction in two accounts is known as Double-entry system of book-keeping. This is the most scientific, complete and accurate system of accounting.

2.3 Classification of Account

There are three types of accounts, namely, Personal Account, Real or Property Account and Nominal Account opened in the books of Accounts to keep a complete record of the financial transactions of the business.

Every transaction of the business has two aspects and if a transaction is to be recorded in the books, both the aspects should be recorded. The two aspects are (i) 'Receiving' aspect otherwise known as 'Debit' aspect and (ii) 'Giving' aspect otherwise known as 'Credit' aspect. For example, if goods are sold for cash, the two aspects involved are:

- (i) Receiving benefit in the form of Cash-Debit aspect, and
- (ii) Giving benefit in the form of Goods-Credit aspect.

The value of cash received is exactly equal to the value of goods given. In other words, the debit is always followed by a credit and the value of debit is equal to the credit. Thus, the basic rule for Double-Entry is that *'for every debit there is a corresponding and equal credit.'*

However, there are separate rules for debit and credit in respect of Personal, Real and Nominal Accounts which are based on the above-given basic rules:

1. Personal Accounts: Personal Accounts are meant for recording transactions with persons or firms. A person may be either a receiver of benefit or giver of benefit. For example, if cash is paid to Rama, Rama is a receiver. If goods are purchased from Mohan, Mohan is the giver. The rule is:

Debit the Receiver; and
Credit the Giver.

Applying this rule to the above examples, Rama is to be debited since he is a receiver of benefits and Mohan is to be credited since he is the giver of benefit.

2. Real or Property Accounts: Real accounts are meant for recording transactions connected with assets. When an asset is received, it is to be debited and when an asset goes out of the business, the asset account is to be credited. The rule is:

Debit what comes in; and Credit what goes out.

Example 1: Goods are sold for cash; cash comes in and goods go out. The transaction, thus, has two aspects and to record it we need two accounts, namely, the Cash Account and the Goods Account. Applying the above rule, Cash Account is debited since cash comes in and Goods Account is credited since goods go out.

Example 2: Goods are sold to Rama on credit. Here two accounts are involved: (i) Rama's Account and (ii) Goods Account. Rama's Account is a Personal Account and Goods Account is a Real Account. Rama is a receiver; Goods go out of the business. Thus, applying the above two rules for Personal Accounts and Real Accounts, Rama's Account is to be debited and Goods Account is to be credited.

3. Nominal Accounts: These accounts are opened in the books to simply explain the nature of the transactions. They do not really exist. For example, in a business, salary is paid to the Manager. It means cash goes out on account of Salary. It is real, but salary as such does not exist. A Salary Account is maintained just to explain how cash has been spent. In the absence of such an account, it may be difficult for the person concerned to explain how the cash at his disposal was utilised. Hence, these accounts are also known as *Fictitious Accounts*. These accounts are meant for recording incomes and gains or expenses and losses. The rule is:

Debit all expenses and losses; and Credit all gains and incomes.

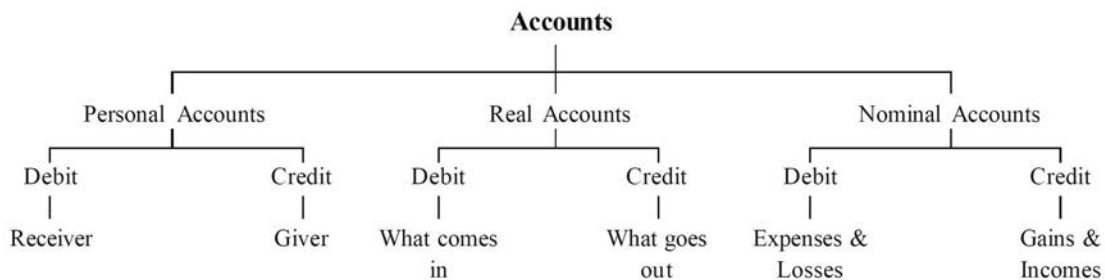
Example 1: Rent paid is an expense. Cash goes out. The accounts involved are Rent Account and Cash Account. Applying the rules for Real Accounts and Nominal Accounts, Rent Account is to be debited and Cash Account is to be credited.

Example 2: Commission received is an income. Cash comes in. Cash Account is to be debited and Commission Account is to be credited.

The students may note that when some prefix or suffix is added to a Nominal Account, it becomes a Personal Account, as shown below:

Nominal Account	Personal Account
1. Salary Account	Outstanding Salaries Account; Prepaid Salaries Account.
2. Rent Account	Outstanding Rent Account; Prepaid Rent Account.
3. Interest Account	Outstanding Interest Account; Prepaid Interest Account; Interest received in Advance Account.

The rules of double-entry are shown in the following chart:



To make a correct record of the transactions, find out in the order shown below:

- (i) What are the two aspects of the transaction?
- (ii) What are the two accounts in which these aspects are to be recorded?
- (iii) To which category these accounts belong — Personal, Real or Nominal?
- (iv) What rules of debit and credit are applicable to the accounts involved?
- (v) What account should be debited or credited?

Example: From the following transactions find out the nature of account and also state which account should be debited and which account should be credited :

- (a) Wages paid; (b) Dividends received; (c) Buildings purchased for cash; (d) Furniture sold;
- (e) Outstanding rent; (f) Received cash from Balan; and (g) Proprietor introduced capital.

Solution:

Transaction	Accounts involved	Nature of Accounts	Debit/Credit
(a) Wages paid	Wages Account	Nominal	Debit
	Cash Account	Real	Credit
(b) Dividend received	Cash Account	Real	Debit
	Dividends Account	Nominal	Credit
(c) Buildings Purchased	Buildings Account	Real	Debit
	Cash Account	Real	Credit
(d) Furniture sold	Cash Account	Real	Debit
	Furniture Account	Real	Credit
(e) Outstanding Rent	Rent Account	Nominal	Debit
	Outstanding Rent Account	Personal	Credit
(f) Received cash from Balan	Cash Account	Real	Debit
	Balan Account	Personal	Credit
(g) Capital introduced	Cash Account	Real	Debit
	Capital Account	Personal	Credit

2.4 Stage or Parts of Double Entry System

The following are the three stages of a complete system of Double-Entry:

- First, all transactions should be recorded in the Journal or in the Subsidiary Books as and when they take place. These books are called *Books of Original Entry*. This process is known as '*entering*.'
- All entries in the Journal or Subsidiary Books should be posted to the appropriate ledger accounts to find out the total effect of all such transactions in a particular account. This is known as '*Posting*.' Accounts are closed at the end of a period to find out its balances and a list of such balances is prepared, known as *Trial Balance*.
- The last stage is to prepare a *Profit and Loss Account* to ascertain the trading result of the business and a *Balance Sheet* to show its financial position.

2.5 Advantages and Disadvantages of Double Entry System

Advantages

1. This system gives full accounting information about the business transactions because both the aspects of each transaction are recorded;
2. The accuracy of accounting records can be verified by preparing a Trial Balance at the end;
3. The correct trading results can be ascertained by preparing the final accounts; and
4. The values of assets and liabilities can be known at any time by constructing the Balance Sheet.

Factors Common to every Business

There are certain factors which are common to every business:

(1) Every business normally enters into transactions with a number of persons or firms such as the customers or the suppliers in the course of its activities. To record the transactions with these persons, accounts are to be opened in the name of such person or firm. Such accounts are known as *Personal Accounts*. Examples: Mohan's Account, Rama Ltd. Account, etc.

(2) Every business must necessarily have certain assets such as buildings, stocks, cash, etc., for carrying on its activities. For each such asset a separate account is opened and such accounts are known as *Real or Property Accounts*.

(3) Every business earns incomes and gains in various ways and incurs expenses and losses of different types to carry on its activities. Therefore, an account of each expense and loss and income or gain is opened in the books. Such accounts are known as *Nominal or Fictitious Accounts*. Examples: Rent Account, Commission Account, etc.

Disadvantages

1. Double entry system is *expensive* since various records or a number of books of accounts have to be kept.

2. Double entry system needs the keeping of various books of accounts, which is *not practical in small concerns*.
3. In spite of the trial balance agreement, there is *no assurance of complete correctness* of the books of accounts.
4. Double entry system does not reveal all the errors made in the books of accounts certain types of errors, are not revealed by the trial balance, prepared under double entry system.

2.6 Summary

The method of writing every transaction in two accounts is called ***double entry system***. Accounts are classified into ***Personal Accounts*** and ***Impersonal Accounts***. Impersonal accounts are classified into ***Real Accounts and Nominal Accounts***. ***Personal Accounts*** are accounts in the name of a person, institution, firm, organisation, enterprise, bank, company, society, club, etc. The sale for personal account is debit the receiver and credit the giver. ***Real accounts*** are accounts of assets or properties like building, land, machinery, furniture, cash, motor car, investment etc. The sale for real account is debit what comes in and credit what goes out. ***Nominal accounts*** which are also known as ***Fictitious accounts*** are accounts of expenses and losses, income and gain. The rule for nominal accounts is Debit all expenses and losses, Credit all income and gains.

The ***advantages*** of double entry system are complete accounting information, accurate accounting records, correct trading results and knowing the values of assets and liabilities.

The ***disadvantages*** of double entry system are it is costly not practical in small firms, no guarantee of complete accuracy, and does not disclose all errors.

2.7 Key Words/Abbreviations

- **Double Entry System:** The method of writing every transaction in two accounts is called double entry system.
- **Personal Account:** Personal account includes the accounts of persons, with whom the business deals.



- **Real Account:** Real account are the accounts of assets or properties owned by a business.
- **Nominal Account:** Nominal account are the accounts of expenses and losses of the business and income and gain of the business.

2.8 Learning Activity

I. Analyse the following transactions into account affected, type of accounts, how each aspect is affected, rule applicable, account to be debited and account to be credited.

1. Commenced started business with cash ₹ 150.
2. Purchased goods for cash ₹ 2,000.
3. Sold goods for cash ₹ 15,000.
4. Purchased goods from Lalit for ₹ 25,000.
5. Sold goods to Rupesh for ₹ 50,000.
6. Purchased machinery for cash ₹ 50,000.
7. Sold furniture for cash ₹ 21,000.
8. Purchased motor can on credit from Ritu ₹ 1,00,000.
9. Sold computer on credit to Dinesh ₹ 75,000.
10. Paid rent ₹ 5,000
11. Received commission ₹ 2,000.
12. Paid salary by cheque ₹ 15,000.
13. Received interest by cheque ₹ 12,000.
14. Goods withdrawn for personal use ₹ 500.
15. Cash withdrawn for private use ₹ 2,000.
16. Cash sales ₹ 5,000.
17. Cash purchases ₹ 7,000.
18. Cash deposited into bank ₹ 9,000.

19. Cash withdrawn from bank ₹ 8,000.
20. Withdrawn from bank for domestic use ₹ 250.
21. Withdrawn from bank for office use ₹ 350.
22. Goods distributed or free suppliers ₹ 500.
23. Paid Mona by cheque ₹ 5,000.

II. Classify the following accounts into Personal account, Real account and nominal account:

1. Mohan's a/c
2. Priti's a/c
3. Rent a/c
4. Interest a/c
5. Commission a/c
6. Dividend a/c
7. Cash a/c
8. Machinery a/c
9. Furniture a/c
10. Laptop a/c
11. Loss on sale of machinery a/c
12. Copyright a/c
13. Goodwill a/c
14. Patent a/c
15. Depreciation a/c
16. Trading a/c
17. Profit and loss a/c
18. Bank of India a/c
19. Adarsh Co-operative Housing Society a/c

20. Pritesh a/c
21. Cartage a/c
22. Printing and Stationery a/c
23. Wages a/c
24. Salary a/c
25. Octroi duty a/c
26. Customs duty a/c
27. Goodwill a/c
28. Putcuts a/c
29. Postage and Telegram a/c
30. Conveyance a/c
31. Travelling expenses a/c
32. Carriage a/c
33. Carriage inward a/c
34. Carriage outward a/c
35. Capital a/c
36. Drawing a/c
37. Taxes a/c
38. Advertisement a/c
39. Debtors a/c
40. Creditors a/c
41. Investment a/c
42. Bad debts a/c
43. Leasehold Property a/c
44. Freehold Property a/c

45. Debenture a/c
46. Share a/c
47. Prepaid wages a/c
48. Outstanding commission a/c
49. Rent received in advance a/c
50. Audit fees a/c

2.9 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is double entry system?
2. Give the classification of account.
3. Give the Golden Rules of account.
4. What are the stages or parts of double entry system?
5. Explain the advantages and disadvantages of double entry system.

B. Multiple Choice Questions

1. The method of writing every transaction in two accounts is called _____ entry system of book-keeping.
(a) Single (b) Double
(c) Triple (d) Cash
2. The most scientific, complete and accurate accounting system is _____ entry system.
(a) Single (b) Double
(c) Triple (d) Accrual

3. _____ accounts are meant for recording transactions with persons or firms.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
4. _____ accounts are meant for recording transactions connected with assets.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
5. _____ accounts are accounts of expenses losses and incomes and gains.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
6. _____ accounts are also known as fictitious accounts.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
7. The last stage in double entry system is _____
- (a) Entering
(b) Posting
(c) Trial balance
(d) Preparing Profit and Loss a/c and Balance Sheet
8. Debit the receiver, credit the gives, is the sale of _____ account.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
9. Debit what comes in, credit what goes out, is the rule of _____ account.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal

10. Debit all expenses and losses, credit all incomes and gains is the rule of _____ account.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal

Answers:

1. (b), 2. (b), 3. (a), 4. (b), 5. (c), 6. (c), 7. (d), 8. (a), 9. (b), 10. (c).

2.10 References

1. Dr. M.A. Arulanandam and Dr. K.S. Raman, (2019), “*Advanced Accountancy*” Vol. I and Vol. II, Himalaya Publishing House Pvt. Ltd., Mumbai.
2. S.N. Maheshwari and S.K. Maheshwari, (2004), “*An Introduction to Accountancy*”, Vikas Publishing House Pvt. Ltd., New Delhi.

UNIT 3 ACCOUNTING PRINCIPLES

Structure:

- 3.0 Learning Objectives
- 3.1 Introduction
- 3.2 Accounting Principles – Meaning/Concept
- 3.3 Types of Accounting Principles
- 3.4 Principles and Modifying Principles
- 3.5 Importance and Limitations of Accounting Principles
- 3.6 Summary
- 3.7 Key Words/Abbreviations
- 3.8 Learning Activity
- 3.9 Unit End Questions (MCQ and Descriptive)
- 3.10 References

3.0 Learning Objectives

After studying this unit, you will be able to:

- Elaborate the meaning/concept of accounting principles.
- Explain the types of accounting principles.
- Explain the principles (detailed concepts and conventions) and modifying principles.
- Discuss the importance and limitations of accounting principles.



3.1 Introduction

This unit will help you to understand the meaning/concept of accounting principles, know the types of accounting principles, know the principles (detailed concepts and conventions) and modifying principles, know the importance and limitations of accounting principles.

3.2 Accounting Principles – Meaning/Concept

If accounting has to serve its purpose of communicating the result of a business to the outside world, it should be based on certain uniform and scientifically laid down principles or postulates (also termed as ‘Accounting Standards’).

Accounting principles may be defined as those rules of conduct or procedure which are adopted by the accountants universally, while recording the accounting transactions. Following these principles while recording the transactions will ensure uniformity, clarity and understanding.

Identification of Transaction: Identification implies determining what transactions are to be recorded i.e. items of financial character are to be recorded. For example, goods purchased for cash or on credit will be recorded. Items of non financial character such as changes in managerial policies etc., are not recorded in the books of accounts.

Measurement of transaction: Measurement means quantification of business transactions into financial terms by using monetary unit. If an even cannot be quantified in monetary terms, it is not considered fit for recording in books of the firm. That is why important items like appointment, signing of contracts etc., are not shown in the books of accounts.

3.3 Types of Accounting Principles

The Accounting Principles can be classified into two categories: (i) Accounting Concepts and (ii) Accounting Conventions.

(i) Accounting Concepts

- (a) Business Entity Concept
- (b) Dual Aspect Concept



- (c) Accounting Period Concept
- (d) Revenue Match Concept
- (e) Going Concern Concept
- (f) Cost Concept
- (g) Money Measurement Concept
- (h) Realisation Concept
- (i) Rupee Value Concept

(ii) Accounting Conventions

- (a) Conventions of Conservatism
- (b) Convention of Consistency
- (c) Convention of Full Disclosure
- (d) Convention of Materiality

3.4 Principles and Modifying Principles

The principles and modifying principles are briefly discussed as below.

Accounting Concepts: Accounting concepts mean and include those basic assumptions or conditions upon which the science of accounting is based. The following are the important accounting concepts:

(i) Business Entity Concept: In accounting, business is treated as an entity different from the proprietor. The transactions that take place affect the business and not the proprietor. This concept makes it possible to keep the business affairs strictly free from the effect of private affairs of the proprietor. Thus, when a person invests ₹ 20,000 in his business, it is deemed that the owner has given that much money to the business which will be shown as a 'liability' for the business. If he withdraws, say, ₹ 2,000, it will be charged to his account and the net amount due to him will be only ₹ 18,000.

The concept of separate entity applies to all forms of business organisation, whether it is a sole trader, partnership or a company. The entity concept has thus, three major implications for accounting:

1. It limits the area to be covered by accounting records and reports. For example, personal transactions of the sole proprietor is not to be recorded in his business accounts as business expenses; they are simply treated as drawings.
2. All transactions are recorded from the point of the entity itself and not from the point of other parties such as owners, managers or customers. For example, when a firm sells goods to customers, this is recorded as sales by the firm and not as purchases by the customers.
3. The entity concept underlines the accounting concept of profits in which a sharp distinction is made between the expenses of operating the business and payment to the owners. All payments to the owners take the form of repayment of capital or loan, or a distribution of profits. They are not treated as business expenses.

(ii) Dual Aspect Concept: According to this concept, every business transaction has a dual effect. For example, if Arul starts business with cash of ₹ 20,000 and furniture of ₹ 5,000, there are two aspects of these transactions. On the one hand, the business acquires asset on ₹ 25,000, and on the other, it has to pay the proprietor a sum of ₹ 25,000, which is the proprietor's Capital invested in the business in the form of cash and furniture. Thus,

$$\begin{array}{ll} \text{Capital (Equities)} & = \text{Assets (Cash + Furniture)} \\ \text{₹ 25,000} & = \text{₹ 25,000} \end{array}$$

$$\begin{array}{ll} \text{If the business borrows ₹ 10,000, then Capital + Liabilities = Assets} & \\ \text{₹ 25,000 + ₹ 10,000} & = \text{Furniture ₹ 5,000 + Cash ₹ 30,000} \end{array}$$

The term 'Assets' denotes the resources owned by a business while the term 'Equities' denotes the claim of various parties against the assets. Equities are of two types. They are owners' equity and the outsiders' equity. Owners' equity (Capital) is the claim of the owners against the assets of the business while outsiders' equity (Liability) is the claim of the outside parties such as creditors or debenture-holders against the assets of the business. Hence, the total of the assets will be equal to total of liabilities. Thus,

$$\begin{aligned} \text{Equities} &= \text{Assets} \\ \text{or Capital + Liabilities} &= \text{Assets} \\ \therefore \text{Capital} &= \text{Assets} - \text{Liabilities} \end{aligned}$$

In other words, for every transaction there are two aspects: for every debit there is a corresponding and equal credit. This is the basis of the entire system of double-entry book-keeping.

(iii) Accounting Period Concept: According to this concept, though the business is a continuous affair, the life of the business is divided into suitable accounting periods, say, a period of one year each, so that the transactions of this period can be analysed and summarised to ascertain the net results of the business. At the end of each accounting period an Income Statement (Profit and Loss) and a Balance Sheet are prepared. The income statement discloses the profit or loss made by the business for the accounting period and the Balance Sheet depicts the financial position of the business as on the date of account closing. Thus, this concept is simply intended for a periodical ascertainment and reporting of the results of the working of the business.

(iv) Revenue Match Concept: This concept is based on accounting period concept. In order to determine profit or loss in a particular accounting period, it is necessary that expenses of the period should be matched with the revenues of that period. The term ‘matching’ means appropriate association of related revenues and expenses. Therefore, income made by the business during a period can be ascertained only when the revenue earned during a period is compared with the expenditure incurred for earning that revenue. Accordingly, adjustments should be made for all outstanding expenses, accrued income, unexpired expenses and unearned income etc. while preparing the final accounts at the end of the accounting period.

(v) Going Concern Concept: This concept assumes that the business will continue for a long time to come and it is not likely to be liquidated in the near future. Hence, the accountants while valuing the business assets do not take into account the realisable value or the present market value of the asset. Assets are valued at the cost at which they were originally acquired less depreciation till date, which is charged on the basis of the original cost only and not on the market value.

The concept presumes that the business will continue in operation long enough to charge against income, the cost of fixed assets over their useful lives, to amortize over appropriate periods the other costs which have been deferred and to pay the liabilities when they become due for payment.

(vi) Cost Concept: This concept is based on the 'Going Concern Concept.' According to this concept, assets acquired are ordinarily entered in the accounting books at the cost at which they are acquired and this cost is the basis for all subsequent accounting for the asset. The market value is immaterial for accounting purpose since the business is not going to be liquidated but is to be continued for a long time to come.

Cost concept has the advantage of bringing objectivity in the preparation and presentation of financial statements. In the absence of this concept, figures shown in accounting records would be subjective and questionable. But, due to inflationary tendencies, the preparation of accounts and statements on the basis of historical costs has made the statements thoroughly unreliable and irrelevant for judging the true financial position of the business.

(vii) Money Measurement Concept: Money measurement concept holds that accounting is a measurement and communication process of the activities of the firm that are measurable in monetary terms. According to this concept, accounting records only those transactions which can be expressed in terms of money. Events or transactions which cannot be expressed in terms of money cannot find a place in the books, however important they may be. For example, the skill of the manager, the good employer-employee relationship, etc., cannot be shown in the books of the business. This makes the financial statements incomplete.

Any unit of measurement over a period of time has its own drawbacks. Though a universally acceptable measure of value, money suffers from territorial limitations. It gets affected seriously by economic differences between various territories as well as political and social differences. Again, within a territory its value changes over a period of time. In some cases this change is rapid as well as violent. The system of accounting treats all units of money as the same irrespective of their time dimension. This has created doubts about the utility of the accounting data, leading to the introduction of inflation accounting. But even inflation accounting is done in terms of money, the only difference being that historical amounts may be changed.

(viii) Realisation Concept: According to this, revenue is recognised only when the sale is made, whereas strictly speaking revenue earning is only a gradual process and it starts when the raw materials are purchased for production and ends with the sale. If no sale takes place, no revenue is considered. However, there are certain exceptions to this concept. Examples: Hire-purchase/Sale, Contract Accounts, etc.

(ix) Rupee Value Concept: This concept assumes that the value of rupee is constant. In fact, due to inflationary pressures, the value of rupee goes on declining. The declining value of rupee is ignored for accounting purposes and accounts are prepared on the basis of historical costs only. For example, an asset acquired in 2010 for ₹ 20,000 is added with the assets purchased in 2016 for ₹ 30,000 and is shown as ₹ 50,000 in the Balance Sheet, ignoring the difference in the real values of the two assets. Further, depreciation is charged on the cost only. Thus, this concept results in underestimation of depreciation and consequently overstatement of profit and under-valuation of the asset in the Balance Sheet resulting in both the Profit and Loss Account and Balance Sheet unrealistic.

Accounting Conventions: Accounting conventions are those customs or traditions that are being followed by the accountants for a long time while preparing the accounting statements. The following are the important conventions:

(i) Conventions of Conservatism: According to this convention, accountants are expected to be conservative in their approach while preparing the accounts and they are expected not to take into account 'anticipated profits' but provide for all possible 'anticipated losses.' In other words, the accountant has to follow the policy of 'playing safe.' This practice of the accountants acts as a guard against the 'personal judgement' of the accountant in preparing the accounts and statements. It is only on account of this convention, the inventory is valued at 'cost price or market price whichever is lower.' Similarly, provision for bad and doubtful debts is made in the books before ascertaining the profit. In contract business only a reasonable amount of profit shown by the books alone is taken as profit year after year and not the entire book profit.

(ii) Convention of Consistency: According to this convention, accounting practices should remain unchanged for a fairly long time and should not be changed unless it becomes absolutely essential to change them. For example, if a particular method of charging depreciation is followed for a particular asset, the method should be consistently followed. However, consistency does not forbid introduction of improved accounting techniques or methods. This convention aims at a continuity in the accounting methods and practices followed so that comparison may be meaningful.

(iii) Convention of Full Disclosure: Accounting reports should give full disclosure of the information which they are expected to provide. Accounting reports are meant for the use of various parties and these reports would not serve the purpose unless they disclose fully what is material.

The company law itself makes it obligatory on the part of companies to prepare their Profit and Loss Account and Balance Sheet in the prescribed form so that maximum possible disclosure can be made. The practice of giving footnotes, references, and parentheses in the statements is in pursuant of this convention only.

(iv) Convention of Materiality: Accountants should report only what is material and ignore insignificant details while preparing their final accounts and Balance Sheet. If this is not done, the whole accounting process would become cumbersome and meaningless. What is material depends upon the circumstances and the discretion of the accountant. It is because of this convention, the cost of an asset or its written down value alone is shown in the Balance Sheet and not the other information about the asset.

‘Materiality’ is a subjective term and information becomes material if the knowledge of it would influence the decision of the informed investor. According to Kohler’s Dictionary of Accountants, ‘Materiality means the characteristic attaching to a statement, fact or item whereby its disclosure or method of giving it expression would be likely to influence the judgement of a reasonable person.’

Para 17 of AS-1 states that financial statements should disclose all material items. The Companies Act, 1956 also recognises the need for separate disclosure of material items. Part II of Schedule VI states that any item of expense which exceeds 1% of the total revenue of the company or ₹ 5,000, whichever is higher, should be shown as a separate and distinct item against an appropriate head in the profit and loss account.

Modifying Principles

The basic assumptions and Principles have to be modified, to make the accounting information useful. The modifying principles are as follows:

(a) Cost-Benefit Principle

The cost benefit principles states that the cost of applying, an accounting principle, should not be more than its benefit. The benefit to be received, from giving additional accounting information, should be more, than the costs of giving additional accounting information. It does not mean, that no or very little information should be given to users, to sure costs. The information should be sufficient for the users for their relevant and correct decision making. The benefits should be measured from the point of view of users.



(b) Materiality Principle

According to materiality principle, all material/important/significant/relevant accounting information which influences the decision of the users of financial statements, should be revealed in the financial statements.

Which information is more relevant than others, is a matter of judgement. Materiality depends upon the amount of item the business size, type of information, level of the person who makes the judgement regarding materiality.

Materiality concept is a relative concept. What accounting information is material for one person/ or a small company may be immaterial for another person/or a large company.

(c) Consistency Principle

According to consistency principle, in order to have a meaningful comparison of the accounts of one accounting period, with the accounts, of another accounting period, there should be consistency, in following the accounting methods or practices. For example, it stock is valued on LIFO basis, then it should be valued on LIFO basis year after year. If fixed assets are depreciated as per fixed installment method, then fixed installment method of depreciation should be followed from one year to another. This principle does not prohibit charges.

Inter-firm comparison and Intra-firm comparison and trend analysis can be meaningfully compared, if there is consistency in following the accounting methods/practices of a company/firm, from one accounting period to another accounting period.

(d) Timelines

Accounting information should be made available to the users on time, for the accounting information to be useful or of relevance. Latest and updated accounting information should be given to the users, for their correct decision making.

If the accounting information is not provided on time, it becomes outdated, which leads to wrong decision making by the users.

(e) Conservation Principle

“Anticipate no profits, but provide for all future probable losses” is the essence of their principle of conservation. Due to their principle of conservation closing stock is valued at cost price or market price, whichever is lower and provision is made for bad and doubtful debts.

As per the conservation principle, anticipated losses should be taken into account and anticipated profits should not be taken into account, till the profits are actually earned.

Conservation principle require that in doubt/uncertainty situation, the business transactions should be recorded in a way that the profits and assets are not overstated.

Conservation principle conflicts with the consistency principle, when the stock is valued at cost price in one accounting period and at market price in another accounting period.

Conservation principle conflicts with the principle of disclosure, when excess provision is made is for bad doubtful debts, and depreciation is charged, it results in the creation of secret reserves.

Conservation principle conflicts with the objectivity principle, since problem losses estimation is a subjective judgement.

(f) Industry Practice

The unique characteristics of an industry, requires the use of different accounting methods and procedures, to have realistic and useful financial reporting. For example, in some companies, the inventory is valued at cost, instead of lower of cost and market! In the farm industry, crops are reported at market value rather at cost because it is expensive to get correct cost figure on individual crops.

3.5 Importance and Limitations of Accounting Principles

(a) Importance:

Financial Statements are used by different persons for their respective decision making like owners/proprietors/partners, creditors, bankers, lenders, financial institutions, suppliers, trade unions, customers, researchers, prospective investors and investors etc. There has to be a common framework or an established practice for preparing financial statements, containing the required accounting information.



The following points state the importance of accounting principles

- (a) There is uniformity in presentation of financial statements.
- (b) It provides proper information to the various stakeholders.
- (c) It makes financial statements reliable.
- (d) There is objectivity in financial statements.
- (e) A generally acceptable basis for measurement is provided.
- (f) The various stakeholders believe that the assumptions on which financial statements are based are valid and appropriate.

(b) Limitations:

The limitations of accounting principles are as follows:

(1) No complete set of accounting principles

There is no set list of accounting principles which should be followed by every organisation, under all situations. Every time, the organisation faces new situations. The accountant devises new principles, to deal with the complexities and problems of the business.

Past happenings are the basis for the principles, which we see today. Certain agencies are making efforts to bring out lists of generally accepted accounting principles, but still, there is no complete list of accounting principles, which should always be used.

(2) Absence of General Agreement

Accounting principles are not universally accepted. The accounting principles which are followed are generally accepted principles and not principles accepted by everyone because the nature of business activities is different, different problems are faced by different concerns, and the management thinking is also different.

Sometimes, two concerns of the same type of business, do not use common principles. Convenience and suitability are seen for using the accounting principles.

(3) Differences in the application of accounting principles

Even if similar accounting principles are used by different concerns, the application of these principles will be different. The same principles are used differently by different accountants. The principles may also give different conclusions. Though depreciation may be provided on the basis of cost of the assets, but there are different methods used for charging depreciation which will give different results.

Similarly, methods used for stock valuation may be different. F.I.F.O (First In First Out) method will give a different value of stock when compared with L.I.F.O (Last In First Out) method.

During periods of inflation, profits will be more if stock is valued with LIFO method. Thus, even if the principles used are similar, but the application of these principles is one's own way, may give different results.

3.6 Summary

Accounting is the language of business. **Accounting principles** are the rules of action adopted by the accountants, universally, while recording accounting transactions. The type of accounting principles are accounting concepts and accounting convention. **Accounting concepts** are the basic assumptions or conditions, upon which accounting is based. **Accounting conventions** are the customs or traditions followed year together, by the accountants to prepare the financial statements. The **various accounting** concepts are entity concept, going concern concept, accrual concept, dual aspect concept, cost concept, realisation concept, matching concept, money measurement concept and accounting period concept. The **various accounting** conventions are convention of conservation, convention of consistency, convention of materiality and convention of disclosure. The modifying principles are cost benefit, timeliness, industry practice, etc.

The **importance** of accounting principles are uniformity in presentation provides proper information, objectivity, generally acceptable basis for measurement, valid and appropriate assumptions.

The **limitations** of accounting principles are: no complete set, no general agreement and differences in the application of accounting principles.

3.7 Key Words/Abbreviations

- **Accounting Principles:** Accounting principles are the rules of action, adopted universally by the accountants, while recording accounting transactions.
- **Accounting Concepts:** Accounting concepts means basic assumptions or conditions upon which accounting is based.
- **Accounting Conventions:** Accounting conventions are the customs or traditions, which are followed years together, to prepare accounts of the business concern. They act as a guide to the accountant for the preparation of financial statement.
- **Entity Concept:** The business unit is separate from its owner or owners is the entity concept.
- **Going Concern Concept:** According to the concept of going concern, every business organisation has an endless life. When a business is started, the purpose is to run the business forever, continuously for an indefinite period.
- **Cost Concept:** According to cost concept, an assets is recorded in the books accounts, at the price paid, at the of time of its purchase (acquisition) and this price (cost) is the basis for all subsequent accounting for the assets.
- **Realisation Concept:** Realisation concept determines the point of time, when the revenue or income is realised or earned.
- **Matching Concept:** Matching Concept is applied while calculating profit or loss for an accounting period. If expenses for an accounting period are more than the income for that accounting period, there is a loss and vice versa.
- **Dual Aspect Concept:** In this concept, every transaction has two fold effect i.e., the benefit receiving effect and the benefit giving effect. Both the effects are recorded in the books of accounts, as per the rules of debit and credit.
- **Accrual Concept:** Outstanding or accrued income and outstanding or unpaid expenser are required to be recorded in the books of accounts for the respective accounting period, otherwise the Profit and Loss Account will not show the correct figure of profit or loss, for an accounting period.

- **Accounting Period Concept:** Accounting period concept states that the life of the business is broken into smaller period (usually one year), in order to measure the business performance, at regular intervals.
- **Modifying Principles:** The basic assumptions and principle have to be modified, to make the accounting information useful.
- **Conservation:** The essence of convention of conservatism is to “Anticipate no profits, but provide for all possible losses”. Anticipated losses should be recorded in the books of accounts, but all anticipated profits should not be recorded in the books of accounts, till the profit are actually earned.
- **Consistency:** According to the convention of consistency, there should be consistency in following the same accounting method, inform one accounting period to another accounting period, to have a meaningful comparison of the financial results of one year with the financial results of other years.
- **Materiality:** According to the convention of materiality, whether something should be disclosed or not in the financial statements, depends whether it is material or immaterial. All material details useful to various users of financial statements for their respective decision making, should be disclosed in the financial statements.
- **Disclosure:** According to the convention of disclosure, every accounting information, which is useful or of relevance for the parties interested in the business should be disclosed. The information disclosed should be understandable, relevant, reliable and comparable.

3.8 Learning Activity

- I. Mention the name of the relevant accounting assumption or principle applied here in.**
1. Preparation of financial statement is a prescribed format.
 2. Disclosure of market value of investment.
 3. Making provision for bad and doubtful debts.

4. Used cash for personal use ₹ 5,000
5. Cash sale ₹ 50,000
6. Purchased building on credit ₹ 20,00,000
7. Concept applied when finding profit or loss for an accounting period.

II. Mention the name of the relevant accounting assumption or principle applied herein

1. Valuation of closing stock at cost price or market price, whichever is less.
2. Valuing crops at market value.
3. Following the straight line method of depreciation year after year.
4. Revenue is generally recognised at the point of sale.
5. Appending notes to the financial statements.
6. Classification of assets into fixed assets and current assets.
7. Accounting of a small pocket calculator as an expense or not as an asset.
8. The quality of management team is not disclosed in the balance sheet.
9. The business will continue for an indefinite period.
10. The life of the business is broken into smaller parts and financial statements are prepared for each part/period.
11. Income is recognised when it is earned and expenses are recognised when incurred.
12. The business unit is separate from its owner or owners.
13. Assets are recorded in the books, at the cost incurred for purchase of asset.
14. Advance received from a customer is not considered as income from sale.

3.9 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What are accounting principles?
2. Explain the types of accounting principles.
3. Explain the various accounting concepts.
4. Explain the various accounting conventions.
5. Explain the modifying principles of accounting.
6. Explain the importance of accounting principles.
7. Explain the limitations of accounting principles.
8. Write short notes on
 - (a) Entity concept
 - (b) Going concern concept
 - (c) Cost concept
 - (d) Revenue recognition/Realisation Concept
 - (e) Matching concept
 - (f) Dual aspect concept
 - (g) Modifying principles
 - (h) Importance of accounting principles
 - (i) Limitations of accounting principles.
 - (j) Money Measurement concept
 - (k) Accrual concept
 - (l) Accounting period concept

B. Multiple Choice Questions

1. _____ is the language of business.
 - (a) Commerce
 - (b) Accounting
 - (c) Science
 - (d) Art

2. _____ are the rules of action adopted by the accountants, universally, while recording accounting transactions.
 - (a) Accounting Principles
 - (b) Depreciation Methods
 - (c) Stock Valuation methods
 - (d) Ledger balances

3. _____ means basic assumptions or conditions upon which accounting is based.
 - (a) Accounting principles
 - (b) Accounting concepts
 - (c) Accounting Conventions
 - (d) Double Entry accounting

4. _____ are the customs or traditions which are followed years together, by the accountants, to prepare the financial statements.
 - (a) Accounting principles
 - (b) Accounting concepts
 - (c) Accounting Conventions
 - (d) Single Entry Accounting

5. As per the _____ concept, a business unit is separate from its owner or owners.
 - (a) Accrual
 - (b) Entity
 - (c) Dual aspect
 - (d) Realisation

6. According to the _____ concept, every business organization has an endless life.
 - (a) Entity
 - (b) Realisation
 - (c) Matching
 - (d) Going Concern

7. Outstanding income and outstanding expenses are to be recorded in the books of accounts as per _____ concepts.
- (a) Accrual (b) Accounting period
(c) Dual aspect (d) Matching

Answers:

1. (b), 2. (a) , 3. (b), 4. (c), 5. (b), 6. (d), 7. (a)

3.10 References

1. R.L. Gupta and M. Radhaswamy (1999), “*Advanced Accounting*’ Vol. I”, Sultan Chand & Sons New Delhi.
2. Dr. Jawahar Lal, (2013), “*Accounting Theory and Practice*”, Himalaya Publishing House, Mumbai.
3. L.S. Porwal, (2008), “*Accounting Theory An Introduction*”, Tata Mc Graw Hill Publishing Co. Ltd. New Delhi.
4. P.C Tulsian, (2003), “*Financial Accounting*”, Tata McGraw Hill Publishing Co. Ltd., New Delhi.
5. <http://www.yourarticlelibrary.com/accounting/financialstatement/accounting principles>

UNIT 4 ACCOUNTING STANDARDS

Structure:

- 4.0 Learning Objectives
- 4.1 Introduction
- 4.2 Meaning of Accounting Standards
- 4.3 Scope of Accounting Standards Issued by I.C.A.I.
- 4.4 Accounting Equation
- 4.5 Objectives of GAAP Principle
- 4.6 Unsolved Sums
- 4.7 Summary
- 4.8 Key Words/Abbreviations
- 4.9 Learning Activity
- 4.10 Unit End Questions (MCQ and Descriptive)
- 4.11 References

4.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the meaning of Accounting Standards
- Discuss the scope of Accounting Standards issued by ICAI
- Describe the Accounting Equation
- Analyses the objectives of GAAP Principle



4.1 Introduction

This unit will help you to understand the meaning of Accounting Standards, know the scope of Accounting Standards issued by ICAI, know the Accounting Equation, know the objectives of GAAP Principles.

4.2 Meaning of Accounting Standards

In the words of **Kohler** “Accounting Standards are a code of conduct imposed on an accountant by custom, law and a professional body”.

Accounting Standards are the guidelines for accounting policies and practices, to be adopted and followed in accounting and presentation of financial statements. It ensures consistency, reliability, comparability, uniformity, accuracy and quantitative improvement of financial statements.

The accounting body of the country, which is India is, The Institute of Chartered Accountants of India (ICAI) issues the Accounting Standards, which are generally accepted accounting principles. The accounting standards have to be followed by the accountants and the companies, for preparing and presenting financial statements. These accounting standards (except AS30, 31 and 32) are recognised by the Companies Act 2013 and they must be followed by all companies in preparing and presenting their financial statements.

4.3 Scope of Accounting Standards Issued by I.C.A.I.

Issued by I.C.A.I.

The Institute of Chartered Accounts of India (I.C.A.I.) constituted Accounting Standards Boards (A.S.B.) on 21st April, 1977 in order to harmonise accounting policies and practices used in India. The main function of A.S.B. is to formulate the standards, after considering the applicable laws, customs, usages and business environment.

The A.S.B. is constituted in such a manner that it would give sufficient representation to all interested parties and that ensure participation of all concerned, in the formulation of standards



and their implementation. The Institute of Chartered Accounts of India (I.C.A.I.) has so far issued thirty-two accounting standards. They are as follows:

Scope of accounting standards issued by ICAI

Number of the Accounting Standards (AS)	Title of the Accounting Standards	Date from which mandatory (accounting periods commencing on or after)	Enterprises to which applicable
AS-1	Disclosure of Accounting Policies	1-4-1993	All
AS-2 (Revised)	Valuation of Inventories	1-4-1999	All
AS-3 (Revised)	Cash Flow Statement	1-4-2001	Level-1 and Non SMC
AS-4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date	1-4-1998	All
AS-5 (Revised)	Net Profit or Loss for the Period. Prior Period Items and Changes in Accounting Policies	1-4-1996	All
AS-6 (Revised)	Depreciation Accounting	1-4-1995	All
AS-7 (Revised)	Construction Contracts	1-4-2002	All
AS-8	Withdrawn and included in AS-26	–	–
AS-9	Revenue Recognition	1-4-1993	All
AS-10	Accounting for Fixed Assets	1-4-1993	All
AS-11 (Revised-2003)	The Effects of Changes in Foreign Exchange Rates	1-4-2004	All
AS-12	Accounting for Govt. Grants	1-4-1994	All
AS-13	Accounting for Investments	1-4-1995	All
AS-14	Accounting for Amalgamations	1-4-1995	All
AS-15 (Revised-2005)	Employees Benefit	1-4-2006	All
AS-16	Borrowing Costs	1-4-2000	All
AS-17	Segment Reporting	1-4-2001	Level-I and Non-SMC

AS-18	Related Party Disclosures	1-4-2001	Level-I, II and all companies
AS-19	Leases	1-4-2001	All
AS-20	Earning Per Share	1-4-2001	All
AS-21	Consolidated Financial Statements	1-4-2001	See Note 1
AS-22	Accounting for taxes on Income	1-4-2001 1-4-2002 1-4-2006	For Listed Companies Companies other than listed All
AS-23	Accounting for Investment in Associates in Consolidated Financial Statements	1-4-2002	See Note - 1
AS-24	Discontinuing Operations	1-4-2004	Level-I, II and all companies
AS-25	Interim Financial Reporting	1-4-2002	Note 2
AS-26	Intangible Assets	1-4-2003	All
AS-27	Financial Reporting of Interests in Joint Ventures	1-4-2002	See Note - I
AS-28	Impairment of Assets	1-4-2004 1-4-2006 1-4-2008	Level-I } and all Level-II } companies Level-III
AS-29	Provisiors, Contingent Liabilities and Contingent Assets	1-4-2004	All
AS-30	Financial Instrument – Recognition and Measurement	To be announced	Non SME
AS-31	Financial Instruments – Presentation	To be announced	Non SME
AS-32	Financial Instruments – Disclosures	To be announced	Non SME

Note 1:

AS-21, AS-23 and AS-27 are required to be complied with by an entity if the entity pursuant to the requirements of a statute or voluntarily prepares and presents consolidated financial statements.

Note 2:

If an entity is required or elect to prepare and present an interim financial report, it should comply with this standard.



4.4 Accounting Equation

An accounting equation is a mathematical expression, which shows that the assets of a business are always equal to the liabilities of a business. Accounting equation is the basis for double entry system of book-keeping. Total assets of a firm are financed by the creditors, lenders and owners. Thus, total assets of a firm are equal to its total liabilities, at any point of time.

The liabilities or claims, also known as equities, are of two types:

- (a) Owner's Equity or Capital and
- (b) Liabilities or amounts due to outsiders (Outsiders Equity)

The accounting equation can be expressed as under:

Total Assets = Total Equities (Total Claims)

OR

Total Assets = Total Liabilities (Owner Equity or Capital + Outside Liabilities)

OR

Assets = Liabilities + Capital

OR

Liabilities = Assets – Capital

OR

Capital = Assets – Liabilities

Steps involved in developing or preparing an Accounting Equation

1. Analyse the transaction in terms of variables like assets, liabilities, capital revenues and expenses.
2. Decide the effect of the transaction in terms of increase or decrease in variable like asset, liabilities capital, revenues and expenses.

3. Record the effect on the relevant side of the equation and ensure that the total of right hand side is always equal to the total of left hand side.

Examples

1. Aniket commenced business with cash ₹ 1,00,000

The accounting equation will be

$$\begin{array}{rcl}
 \text{Assets} & = & \text{Capital} \quad + \quad \text{Liabilities} \\
 \text{Cash} & = & \text{Capital} \quad + \quad \text{Liabilities} \\
 ₹ 1,00,000 & = & ₹ 1,00,000 \quad + \quad 0 \\
 ₹ 1,00,000 & = & ₹ 1,00,000
 \end{array}$$

2. Aniket brought furniture from Lucky Furniture for ₹ 20,000

The accounting equation will be

$$\begin{array}{rcl}
 \text{Assets} & = & \text{Capital} \quad + \quad \text{Liabilities} \\
 \text{Cash} + \text{Furniture} & = & \text{Capital} \quad + \quad \text{Sundry Creditors} \\
 ₹ 1,00,000 + ₹ 20,000 & = & ₹ 1,00,000 \quad + \quad ₹ 20,000 \\
 ₹ 1,20,000 & = & ₹ 1,20,000
 \end{array}$$

Illustration - 1

From the following transaction show the accounting equation:

- | | |
|----------------------------------|----------|
| (a) Amio commenced business with | ₹ 30,000 |
| (b) Purchased goods on credit | ₹ 10,000 |
| (c) Withdrew for private use | ₹ 1,500 |
| (d) Purchased goods for cash | ₹ 2,000 |
| (e) Paid Wages | ₹ 500 |
| (f) Paid to Creditors | ₹ 1,000 |
| (g) Sold goods on credit | ₹ 2,000 |

(h) Sold goods for Cash (Cost Price 1,500)	₹ 2,000
(i) Outstanding Salary	₹ 500
(j) Paid rent in advance	₹ 1,000

Solution

- (a) This transaction brings in cash ₹ 30,000 does not result in any liability; results in a capital of ₹ 30,000. So the equation will be -

$$\text{Assets (₹)} = \text{Liabilities (₹)} + \text{Capital (₹)}; \quad 30,000 = 0 + 30,000$$

- (b) This transaction affect the liability and assets not capital. So the equation will be -

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + \text{Stock} = \text{Creditors}; \quad 30,000 + 10,000 = 10,000 + 30,000$$

- (c) This transaction reduce cash and capital. So equation will be -

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$(\text{Cash} - \text{drawings}) + \text{Stock} = \text{Creditors}$$

$$(30,000 - 1,500) + 10,000 = 10,000 + (30,000 - 1,500)$$

$$28,500 + 10,000 = 10,000 + 28,500; \quad 38,500 = 38,500$$

- (d) It will reduce the cash by ₹ 2,000 and increase the stock by ₹ 2,000. Equation will be

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + \text{Stock of goods} = \text{Creditor}$$

$$(28,500 - 2,000) + (10,000 + 2,000) = 10,000 + 28,500; \quad 38,500 = 38,500$$

- (e) This transaction reduce the cash by ₹ 500 and reduce the capital because it reduces the profit as an expenditure (i.e., reducing capital) Equation will be -

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + \text{Stock of goods} = \text{Creditor}$$

$$(26,500 - 500) + 12,000 = 10,000 + (28,500 - 500)$$

$$26,000 + 12,000 = 10,000 + 28,000; \quad 38,000 = 38,000$$

- (f) This transaction will reduce the cash by ₹ 1,000 and reduce the creditor by ₹ 1,000.

Equation will be

Assets = Liabilities + Owner's Capital

Cash + Stock of goods = Creditor

$$(26,000 - 1,000) + 12,000 = (10,000 - 1,000) + 28,000$$

$$25,000 + 12,000 = 9,000 + 28,000; \quad 37,000 = 37,000$$

- (g) This transaction brings assets (i.e., Debtors) for ₹ 2,000 and reduces Stock of goods. The equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock of goods + Debtor = Creditors

$$25,000 + (12,000 - 2,000) + 2,000 = 9,000 + 28,000$$

$$37,000 = 37,000$$

- (h) This transaction will reduce the stock and increase capital and cash. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Stock + Debtor = Creditor

$$(25,000 + 2,000) + (10,000 - 1,500) + 2,000 = 9,000 + 28,000 + 500$$

$$27,000 + 8,500 + 2,000 = 9,000 + 28,500$$

$$37,500 = 37,500$$

- (i) This transaction will increase the liability by ₹ 500 and reduces capital because outstanding salary reduce the profit. Equation will be-

Assets = Liabilities + Owner's Capital

Cash + Stock + Debtor = Creditor

$$27,000 + 8,500 + 2,000 = 9,000 + 500 + 28,500 - 500$$

- (j) This transaction will reduce the cash ₹ 1,000 and brings a new assets called prepaid rent.

Equation will be:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + \text{Stock} + \text{Debtor} + \text{Prepaid Rent} = \text{Creditor}$$

$$(27,000 - 1,000) + 8,500 + 2,000 + 1,000 = 9,500 + 28,000$$

Illustration - 2

From the following transaction show the accounting equation:

- Rahim commenced business with ₹ 10,000
- Purchased a furniture for Cash ₹ 5,000
- Depreciation on furniture by ₹ 1,000
- Investment ₹ 5,000 in cash.
- Purchased a Building for ₹ 10,000 giving ₹ 5,000 in cash and the balance through a loan
- Received cash towards commission ₹ 1,000

Solution:

- (a) This transaction affects the assets and brings capital. Equation will be-

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$(\text{Cash}) 10,000 = 0 + 10,000$$

- (b) This transaction will bring a new assets (Furniture) and reduce cash. Equation will be

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + \text{Furniture} = 0 + 10,000$$

$$(10,000 - 5,000) + 5,000 = 10,000$$

- (c) This transaction will reduce the asset by ₹ 1,000 and reduce the capital. Equation will be-

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital}$$

$$\text{Cash} + (\text{Furniture} - 1,000) = 0 + 10,000 - 1,000$$

$$5,000 + (5,000 - 1,000) = 10,000 - 1,000$$

- (d) This transaction brings in cash of ₹ 5,000 and result in a capital of ₹ 5,000.

Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture = 0 + 9,000 + 5,000

$(5,000+5,000) + 4,000 = 9,000 + 5,000$

- (e) This transaction brings in Building of ₹ 10,000 and reduces the cash by 5,000 and increase the Liabilities by ₹ 5,000. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture + Buildings = 5,000 + 14,000

$(10,000 - 5,000) + 4,000 + 10,000 = 19,000$

- (f) It increase the cash by ₹ 1,000 and capital by ₹ 1,000 because it is an income. Equation will be -

Assets = Liabilities + Owner's Capital

Cash + Furniture + Building = 5,000 + 14,000 + 1,000

$(5,000 + 1,000) + 4,000 + 10,000 = 20,000$

4.5 Objectives of GAAP Principle

Generally Accepted Accounting Principles (GAAP) are the commonly followed and accepted set of ruler, procedures and guidelines for reporting the financial statements.

The GAAP are followed for preparing the financial statement, for its uniform understanding GAAP are a combination of authoritative standards and simply the commonly accepted way of recording and reporting accounting information. GAAP are supported and implemented by the accounting bodies such as the ICAI.

Generally Accepted Accounting Principles (GAAP) is defined by the **American Institute of Certified Public Accountants (AICPA)** as follows:



“Generally Accepted Accounting Principles incorporated the consensus at any time as to which economic resources and obligations should be recorded as etc and liabilities, which changes in than should be recorded, when there changes should be recorded, how the recorded assets and liabilities and changes in then should be measured, what information should be disclosed and how it should be disclosed, and which financial statements should be prepared”.

- GAAP gives clarity and ensures the minimum level of consistency, one should follow, while reporting the financial statements.
- It helps the investor and the management to analyse the information and helps in the decision making
- It helps in comparing the financial statements of two different companies.
- The information provided should be helpful to the investors, creditors, and all the other users for making strong decisions about investments, credit and other financial policies.
- The information should be help to the creditors and the potential investors in evaluating the amount, time, certainty or uncertainty, of their expected cash receipts.
- It should be helpful in making financial, long-term and important decisions.
- GAAP is useful to the top management, leaders and common people, in understanding and interpreting the financial statements, hence making accurate judgements.
- The frame of GAAP is to ensure the transparency, accountability, consistency, presentability of the financial statements, especially for the readers to get a clear understanding of the information contained therein.

4.6 Unsolved Sums

Q.1. Give the accounting equation for the following transactions:

1. Anil started business with cash ₹ 50,000.
2. Purchased machinery from Sunil ₹ 30,000.
3. Purchased goods from Mohan ₹ 10,000.
4. Paid for salaries ₹ 5,000.
5. Goods sold for cash ₹ 6000.



Q.2. Give the accounting equation for the following transaction.

1. Minal commenced business with cash ₹ 60,000.
2. Purchased goods from Amit ₹ 10,000.
3. Purchased furniture from Goodwill furniture ₹ 80,000.
4. Withdrew cash for personal use ₹ 5000.
5. Sold goods costing ₹ 24,000 at a profit of ₹ 4000.

Q.3. Give the accounting equation for the following transactions.

1. Mitesh started business with ₹ 44,000.
2. Purchased stationery ₹ 6000.
3. Paid wages ₹ 1000.
4. Purchased mobile for business ₹ 10,000.
5. Withdrew cash for personal use ₹ 500.
6. Received interest ₹ 200.

Q.4. Give the accounting equation for the following transactions:

1. Swain started business with cash ₹ 1,00,000.
2. Cash Purchases ₹ 50,000.
3. Cash sales ₹ 20,000.
4. Received dividend ₹ 1000.
5. Purchased laptop for office use ₹ 20,000.
6. Goods destroyed by fire ₹ 500
7. Deposited cash into bank ₹ 5000.
8. Withdrew cash for office use ₹ 200.
9. Received commission from Vinesh ₹ 500.
10. Paid telephone bill ₹ 2500.

4.7 Summary

Accounting standards are the guidelines for accounting policies and practices, to be adopted and followed practices, to be adopted and followed in accounting and preparation of financial statements.

The **ICAI** has so far issued **32 accounting standards**.

Accounting equation is a mathematical expression which shows that business assets are always equal to business liabilities.

GAAP are the commonly followed and accepted set of rules, concepts, procedures and guidelines for reporting the financial statements.

4.8 Key Words/Abbreviations

- **AS (Accounting Standards):** Accounting Standards are a code of conduct imposed on an accountant by custom, law and a professional body.
- **ICAI:** The Institute of Chartered Accountants of India. The ICAI has so far issued 32 Accounting Standards.
- **AICPA:** American Institute of Certified Public Accountants
- **GAAP:** Generally Accepted Accounting Principles

4.9 Learning Activity

1. Go to the website of ICAI and find the details of the Accounting Standards issued by ICAI.

2. Go through reference books, to find examples of Accounting Equations.



4.10 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What are Accounting Standards?
2. Explain the scope of Accounting Standards issued by ICAI.
3. What is Accounting Equation?
4. What are the objectives of GAAP?

B. Multiple Choice Questions

1. _____ are a code of conduct imposed by an accountant by custom, law and a professional body.
(a) Accounting principles (b) Accounting concepts
(c) Accounting convention (d) Accounting standards
2. The _____ constituted the Accounting Standards Board in India
(a) ICWAI (b) ICSI
(c) ICAI (d) None of the above
3. Capital = Assets – _____.
(a) Cash (b) Liabilities
(c) Debtors (d) Bank loan
4. _____ is a mathematical expression which shows that the business assets are always equal to business liabilities.
(a) Accounting equation (b) Accounting principles
(c) GAAP (d) Accounting standards
5. _____ are the guidelines for accounting policies and practices, to be adopted and followed in accounting and presentation of financial statements.
(a) Accounting equation (b) Accounting principles
(c) Accounting standards (d) GAAP

UNIT 5 RECORDING OF ACCOUNTING TRANSACTION

Structure:

- 5.0 Learning Objectives
- 5.1 Introduction
- 5.2 Rules of Journalizing
- 5.3 Ledger – Meaning
- 5.4 Need and Importance of Ledger
- 5.5 Proforma of Ledger
- 5.6 Distinction between Journal and Ledger
- 5.7 Unsolved Sums
- 5.8 Summary
- 5.9 Key Words/Abbreviations
- 5.10 Learning Activity
- 5.11 Unit End Questions (MCQ and Descriptive)
- 5.12 References

5.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the ruler of journalizing
- Elaborate the meaning of ledger



- Discuss the need and importance of ledger
- Explain the proforma of ledger
- Discuss the distinction between journal and ledger

5.1 Introduction

This unit will help you to understand the rules of journalizing, the meaning of ledger, know the need and importance of ledger, the proforma of ledger and distinction between journal and ledger.

5.2 Rules of Journalizing

The Journal records all business transactions in the order in which they occur. A Journal may, therefore, be defined as the book of original entry containing a chronological record of the transactions from which posting to the Ledger is made. The process of recording transaction in a Journal is termed as 'Journalising.' The proforma of a Journal is shown below:

Journal

Date	Particulars	L.F.	Debit ₹	Credit ₹
1	2	3	4	5
Year	Name of Account to be debited	—	—	—
Month	Name of Account to be credited	—	—	—

- 1. Date:** The date on which the transaction takes place is entered here.
- 2. Particulars:** The name of the account to be debited is written in the first line and the abbreviation 'Dr.' is written against it. In the second line, the account to be credited is written preceded by the word 'To.' An explanation of the entry known as 'narration' is also given in this column, giving a brief explanation of the narration.
- 3. L.F.:** LF stands for Ledger Folio which means the page number in the Ledger in which the entry is posted.
- 4. Debit:** In this column the amount to be debited against the 'Dr.' Account is entered.
- 5. Credit:** In this column, the amount to be credited against the 'Cr.' Account is entered.

If two or more transactions of a similar nature occur on the same day and either the debit account or the credit account is common, such transactions can be conveniently entered in the Journal in the form of a combined journal entry instead of making a separate entry for each transaction. Such type of entry is a compound journal entry.

5.3 Ledger – Meaning

As seen already, Journal records all business transactions separately and as per the order of date of the transactions. The transactions pertaining to a particular person, asset or expense are recorded at different places in the journal as they occur on different dates. Hence, journal fails to bring the similar transactions together and it is not useful for any reference. In order to have a consolidated view of the similar transactions, the transactions entered in the journal will have to be posted to the Ledger Accounts. Ledger is the book of Main entry and it contains various accounts such as Personal Accounts, Real Accounts and Nominal Accounts. A ledger account is nothing but a summary statement of all transactions relating to a person, asset, expense or income which have taken place during a given period of time showing their net effect.

5.4 Need and Importance of Ledger

Need of Ledger

The need of ledger can be understand from the following points:

- (a) A ledger is a main part of books of accounts.
- (b) A ledger provides classified information to the management of various accounts like assets, liabilities, capital etc.
- (c) Based on information available from ledger, decisions are made in business.
- (d) Preparation of trial balance, profit and loss account and balance sheet is based on ledger.
- (e) A ledger helps to find out what are the main items of revenues and expenses.
- (f) It helps to find out, what are the assets and what are their values.
- (g) It helps to find out, what are the liabilities and what are their amounts.
- (h) It helps in preparing the final accounts.

Importance of Ledger

The importance of ledger is as follows:

1. Financial Information

Ledger provides financial information about various assets and liabilities, to judge the financial position of an organisation.

2. Information of Debtors and Creditors

Ledger provides information about debtors and creditors of an organisation.

3. Account wise Information

All the transaction pertaining to an account and available at one place in the ledger.

4. Preparation of Trial Balance

A trial balance can be prepared, with the help of ledger balances, to ascertain arithmetical accuracy of the accounts.

5. Preparation of Trading and, Profit and Loss Account

With the help of trial balance, trading account and profit and loss account can be prepared.

5.5 Proforma of Ledger

The rulings of each account in the ledger is as follows:

NAME OF ACCOUNT

Dr.

Cr.

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	To Name of Credit Account				By Name of Debit Account		

Each account in the ledger is divided into two equal parts. The left hand side is the debit side and the right hand side is the credit side. Each of the two sides is further divided into four columns for recording the date of the transactions, the name of the account to be credited or debited, folio and the amount of the transaction. J.F. stands for folio (page number) in the journal or the subsidiary books from where the posting to the account is made.

Head of Account

Dr.

Cr.

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹

5.6 Distinction between Journal and Ledger

Journal		Ledger	
1.	Journal is called the book of original/first/prime entry because business transactions are first recorded in the journal by passing journal entry for every business transactions followed by narration, in a chronological orders.	1.	Ledger is called the book of secondary entry because the journal entries recorded in the journal are posted to their respective accounts in the ledger.
2.	The transactions are recorded in the journal in a chronological order, that journal is a daily record.	2.	Posting from the journal into the ledger is done periodically i.e., weekly or fortnightly etc.
3.	Journal entry is written with narration.	3.	Narration is not required in ledger.
4.	Debit and credit are recorded together in journal.	4.	A particular ledger account records the debit and credit entries on different pages.
5.	There is no cross reference in journal.	5.	Ledger provides cross reference.
6.	In journal, two columns are totalled.	6.	In ledger, two sides are balanced.
7.	Recording of transactions in journal is called 'journalising'.	7.	Recording of entries in ledger is called posting.
8.	It is prepared on the basis of source documents of transactions.	8.	It is prepared on the basis of journal.
9.	Recording in the journal is the first stage.	9.	Recording in the ledger is the second stage.
10.	In journal, there are five columns. They are date, particulars, ledger folio, debit amount, credit amount.	10.	In ledger, there are similar four columns on debit side and credit side. They are date, particular of journal folio, amount.

Illustration - 1

Journalise the following transactions

2010 January

- 1st Rajini started business with a Capital of ₹ 50,000
- 2nd She purchased furniture for ₹ 5,000
- 3rd She bought goods on credit from Vinod for ₹ 8,000
- 14th She sold goods to Suresh for ₹ 5,000
- 15th She received cash from Suresh ₹ 3,000
- 18th She purchased goods for cash ₹ 12,000
- 25th She sold goods for cash ₹ 8,000
- 28th She paid rent ₹ 1,200
- 31st She paid Vinod ₹ 3,000 on account.

Solution:**Journal in the books of Rajini**

Date	Particulars	LF	Debit	Credit
2010 Jan-1	Cash Account Dr. To Capital Account (Being started business by Rajini)		50,000	50,000
2	Furniture Account Dr. To Cash Account (Being purchase for Cash)		5,000	5,000
3	Purchases Account Dr. To Vinod Account (Being purchased goods on credit)		8,000	8,000
14	Suresh's Account Dr. To Sales Account (Being credit sales made)		5,000	5,000

15	Cash Account To Suresh's Account (Being cash received)	Dr.		3,000	3,000
18	Purchase Account To Cash Account (Being bought goods for cash)	Dr.		12,000	12,000
25	Cash Account To Sales Account (Being cash sales)	Dr.		8,000	8,000
28	Rent Account To Cash Account (Being rent paid)	Dr.		1,200	1,200
31	Vinod's Account To Cash Account (Being cash paid to him)	Dr.		3,000	3,000
				95,200	95,200

Illustration - 2

Journalise the following transactions in the books of Suresh.

2014 July

- 1st Commenced business with cash borrowed from Vijaya Bank ₹ 6,000
- 8th Bought goods worth ₹ 4,000 from P. Setty and paid cash ₹ 2,500
- 13th Received an account payee cheque from Dwaraknath ₹ 1,800
- 16th Goods worth ₹ 3,200 sold to Rajani and received cash of ₹ 2,000
- 20th Paid to Mahesh ₹ 1,400 and received discount ₹ 100
- 25th Sent money order Jayanth ₹ 1,000 and paid commission ₹ 50
- 27th Bank charges charged by Bank 150
- 30th Paid rent ₹ 800 and salary ₹ 1,500 by cheque.

Solution:**Journal in the books of Suresh**

Date	Particulars	LF	Debit	Credit
2014 July-1	Cash Account Dr. To Capital Account (Being started business by Suresh)		6,000	6,000
8	Purchase Account Dr. To P. Setty's Account To Cash Account (Being purchase for Cash and credit)		4,000	1,500 2,500
13	Bank Account Dr. To Dwaraknath Account (Being cheque received an account)		1,800	1,800
16	Cash Account Dr. Rajani's Account Dr. To Sales Account (Being credit and cash sales made)		2,000 1,200	3,200
20	Mahesh Account Dr. To Cash Account To Discount Account (Being cash paid and allowed discount)		1,500	1,400 100
25	Jayanth Account Dr. Commission Account Dr. To Cash Account (Being cash send to Jayanth)		1,000 50	1,050
27	Bank Charges Account Dr. To Bank Account (Being Bank account debited with bank charge)		150	150
30	Rent Account Dr. Salary Account Dr. To bank Account (Being rent and salary paid)		800 1,500	2,300

Illustration - 3

Journalise the following transactions in the books of Mr. Sudhir.

January 2014

- 1 Mr. Sudhir commenced business with
 - Cash in hand ₹ 70,000
 - Cash at Bank ₹ 2,00,000
- 5 Paid into Bank ₹ 60,000
- 7 Brought goods from Prashanth ₹ 50,000
- 12 Sold goods to Raman ₹ 90,000
- 15 Drew for office use ₹ 12,000
- 20 Bought office furniture ₹ 15,000
- 22 Paid rent ₹ 3,500
- 23 Paid Salaries ₹ 20,000
- 25 Paid electricity charges ₹ 1,500
- 27 Returned goods to Prashanth ₹ 1,000
- 28 Raman returned goods ₹ 1,500
- 30 Bank charges ₹ 500
- 31 Bank allowed interest on deposit ₹ 600

Solution:**Journal Entries**

Date	Particulars	LF	Debit	Credit
Jan-1	Cash Account	Dr.	70,000	
	Bank Account	Dr.	2,00,000	
	To Capital Account			2,70,000
	(Being the proprietor introduced cash and Bank balance for starting business)			

5	Bank Account To Cash Account (Being paid cash into bank)	Dr.		60,000	60,000
7	Purchases Account To Prashanth's Account (Being goods purchased from Prashanth on credit)	Dr.		50,000	50,000
12	Raman's Account To Sales Account (Being sold goods to Raman on credit)	Dr.		90,000	90,000
15	Cash Account To Bank Account (Being cash withdrawn from Bank for office use)	Dr.		12,000	12,000
20	Furniture Account To Cash Account (Being bought furniture for cash)	Dr.		15,000	15,000
22	Rent Account To Cash Account (Being paid rent)	Dr.		3,500	3,500
23	Salaries Account To Cash Account (Being paid salary)	Dr.		20,000	20,000
25	Electricity charges Account To Cash Account (Being paid electricity charges)	Dr.		1,500	1,500
27	Prashanth's Account To Purchase returns Account (Being goods returned to Prashanth)	Dr.		1,000	1,000
28	Sales returns Account To Raman's Account (Being Raman returned goods to us)	Dr.		1,500	1,500
30	Bank charges Account To Bank Account (Being the Bank charges charged by the Bank)	Dr.		500	500

31	Bank Account To Interest on deposits A/c (Being interest allowed by the Bank on deposits)	Dr.		600	600
				5,25,600	5,25,600

Illustration - 4

Journalise the following transactions in the books of Mr. Topon.

May 2014

1 Mr. Topon commenced business with the followings:

Cash in hand ₹ 3,00,000

Cash at Bank ₹ 1,00,000

Furniture ₹ 5,000

Building ₹ 1,00,000

3 Purchased goods from Polash ₹ 60,000

4 Sold goods to Satish ₹ 50,000

7 Paid for repairing Machine ₹ 1,500

10 Invested in National Savings Certificates ₹ 1,000

12 Bought stamps ₹ 150

15 Cash purchases ₹ 20,000

18 Received cash from Shatabdi ₹ 49,800 on settlement of ₹ 50,000

20 Paid cash to Polash ₹ 59,850, and received discount from him ₹ 150.

22 Paid life insurance premium ₹ 10,000

23 Office furniture stolen ₹ 500

25 Sold old furniture to Kumar ₹ 1,500 for cash.

26 Drew for office use ₹ 5,000

27 Received loan from Rani ₹ 70,000

- 28 Paid rent ₹ 6,000
 29 Paid salaries ₹ 16,000
 30 Drew for personal use ₹ 2,000
 31 Till taking for the month ₹ 1,70,000

Solution:**Journal Entries**

Date	Particulars	LF	Debit	Credit
2014 May-1	Cash Account Dr. Bank Account Dr. Furniture Account Dr. Buildings Account Dr. To Capital Account (Being the proprietor introduced cash, Bank balance, furniture, building for starting his business)		3,00,000 1,00,000 50,000 10,00,000	14,50,000
3	Purchases Account Dr. To Polash's Account (Being goods purchased from Polash on credit)		60,000	60,000
4	Satish's Account Dr. To Sales Account (Being sold goods to Satish on credit)		50,000	50,000
7	Repairs Account Dr. To Cash Account (Being cash paid for repairs)		1,500	1,500
10	Investment Account Dr. To Cash Account (Being the cash invested in National Saving Certificates)		1,000	1,000
12	Postages Account Dr. To Cash Account (Being bought stamps)		150	150

15	Purchases Account To Cash Account (Being purchased goods for cash)	Dr.		20,000	20,000
18	Cash Account Discount Account To Satish's Account (Being cash received from Satish and allowed her discount)	Dr. Dr.		49,800 200	50,000
20	Polash's Account To Cash Account To Discount Account (Being paid cash to polash and received discount)	Dr.		60,000	59,850 150
22	Drawings Account To Cash Account (Being paid proprietor's life insurance premium)	Dr.		10,000	10,000
23	Loss of furniture by theft A/c To Furniture Account (Being stolen the office furniture)	Dr.		500	500
25	Cash Account To Furniture's Account (Being sold old furniture)	Dr.		1,500	1,500
26	Cash Account To Bank Account (Being the cash withdrawn from Bank for office use)	Dr.		5,000	5,000
27	Cash Account To Rani's Loan Account (Being loan received from Rani)	Dr.		70,000	70,000
28	Rent Account To Cash Account (Being paid rent)	Dr.		6,000	6,000
29	Salaries Account To Cash Account (Being paid salary)	Dr.		16,000	16,000

30	Drawings Account To Cash Account (Being the cash withdrawn for personal use)	Dr.		2,000	2,000
31	Cash Account To Sales Account (Being sold goods for cash for the month)	Dr.		1,70,000	1,70,000
				19,73,650	19,73,650

5.7 Unsolved Sums

Q. 1. Journalise the following transactions in the books of Jackson.

2019	
June 1	Started business with cash ₹ 5,00,000.
June 2	Purchased goods for cash ₹ 50,000.
June 3	Deposited cash into bank ₹ 1,00,000.
June 5	Withdrew cash from bank ₹ 10,000.
June 6	Sold goods for cash ₹ 80,000.
June 7	Purchased furniture on credit from Geeta ₹ 20,000.
June 8	Received commission ₹ 500
June 9	Borrowed loan from bank ₹ 25,000.
June 10	Paid rent ₹ 1,000.
June 11	Inverted in shares of Bajaj Co. Ltd. ₹ 25,000
June 12	Paid salary ₹ 10,000
June 14	Withdrew from bank for personal use ₹ 1,000.
June 15	Cash sales ₹ 30,000.
June 16	Cash purchases ₹ 20,000.
June 17	Paid audit fee by cheque ₹ 1,000.
June 18	Paid for postage and telegram ₹ 500.

Q. 2. Journalise the following transactions in the books of Kalpesh.

2019	
Sept. 1	Commenced business with cash ₹ 10,00,000; Goods ₹ 50,000. Computer ₹ 75,000; Furniture ₹ 50,000 and Machinery ₹ 1,00,000.
Sept. 2	Purchased goods from Ketan on credit ₹ 20,000 less 5% trade discount.
Sept. 4	Sold goods to Payal ₹ 40,000 at 10% trade discount.
Sept. 5	Paid into bank ₹ 45,000.
Sept. 7	Goods distributed as free samples ₹ 1,500.
Sept. 8	Paid for printing and stationery ₹ 1,000.
Sept. 9	Goods worth ₹ 1,500 lost by theft.
Sept. 10	Interest paid ₹ 500 by cheque.
Sept. 11	Received cash ₹ 3,500 from Priti.
Sept. 12	Goods withdrawn for personal use for 500.
Sept. 14	Purchased furniture ₹ 6,00,000 in cash from Dipti.
Sept. 15	Sold machinery ₹ 50,000.
Sept. 16	Paid wages ₹ 5000.

Q. 3. Pass Journal entries for the following transactions and show only Cash Account.

2019	
Aug. 1	Cash Balance ₹ 20,000.
Aug. 5	Purchased goods ₹ 5,000.
Aug. 8	Received cash from Sudhir ₹ 6,000.
Aug. 10	Paid to Mitesh ₹ 4,000.
Aug. 16	Cash sales ₹ 14,000.
Aug. 20	Paid salary ₹ 7,000.

Q.4. Journalise the following transactions in the books of Urmi traders, open the required ledger accounts and prepare a trial balance as on 31st March 2019.

2019	
April 1	Verma commenced business with cash ₹ 1,00,000, Cash in Bank of Baroda ₹ 10,000 and Furniture ₹ 50,000.
April 2	Purchased goods from Ritesh ₹ 20,000 less 10% T.D.
April 5	Sold goods to Jani ₹ 5,000 less 5% T.D.
April 6	Deposited cash into Bank of Baroda ₹ 20,000.
April 8	Purchased machinery from Vinit on credit ₹ 40,000.
April 10	Paid to Vinit by net banking ₹ 20,000.
April 12	Paid for printing ₹ 500
April 15	Received interest ₹ 600
April 18	Withdrew cash from bank by ATM ₹ 5,000.
April 20	Paid for advertisement ₹ 6,000.

Q.5. Journalise the following transactions, post them in the ledger and balance the accounts as on 31st December, 2018.

2018	
Dec. 1	Rajini started business with a capital of ₹ 50,000.
Dec. 2	He purchased furniture for ₹ 5,000.
Dec. 3	He bought goods on credit from Vinod for ₹ 8,000.
Dec. 14	He sold goods to Suresh for ₹ 5,000.
Dec. 15	He received cash from Suresh ₹ 3,000.
Dec. 18	He purchased goods for cash ₹ 12,000.
Dec. 27	He sold goods for cash ₹ 8,000.
Dec. 28	He paid Rent ₹ 1,200.
Dec. 31	He paid Vinod ₹ 3,000 on account.

Q. 6. Journalise the following transactions in the books of Gery:

2018 Jan.	₹
” 1 Started business with cash	4,500
” 1 Paid into bank	2,500
” 2 Goods purchased for cash	1,500
” 3 Purchase of furniture and payment by cheque	500
” 5 Sold goods for cash	600
” 8 Sold goods to Arvind	400
” 10 Goods purchased from Amrit	700
” 12 Goods returned to Amrit	100
” 15 Sold goods to Ram Swaroop for cash	250
” 18 Cash received from Arvind ₹ 396 and discount allowed to him ₹ 4	
” 21 Withdrew from bank for private use	100
” 21 Withdrew from bank for use in the business	500
” 25 Paid telephone rent for one year	40
” 28 Cash paid to Amrit in full settlement of his account	594
” 30 Paid for: Stationery	20
Rent	100
Salaries to staff	250

Q. 7. Journalise the following transactions in the books of a trader:**2018**

- April 1 Debit balances: Cash in hand ₹ 8,000; Cash at Bank ₹ 25,600; Stock of Goods ₹ 20,000; Furniture ₹ 4,000; and Buildings ₹ 10,000.
- ” 1 Debtors: Vijay ₹ 2,700; Anil ₹ 1,500; Ashwani ₹ 2,000; Arvind ₹ 1,800; and Madhu ₹ 100.

Creditors: Anand ₹ 5,400; Arya & Co. ₹ 7,700; and Balwant Rai ₹ 5,200;
Mrs. B's Loan ₹ 10,000.

- ” 1 Purchased goods worth ₹ 5,000 less 20% trade discount and 5% cash discount.
- ” 3 ₹ 2,646 received from Vijay and allowed him discount ₹ 54.
- ” 5 Bought 100 shares in Bharat Ltd. @ ₹ 15 per share, brokerage paid ₹ 30.
- ” 8 Goods worth ₹ 500 were damaged in transit; a claim was made on the railway authorities for the same.
- ” 10 Cash ₹ 5,292 paid to Anand and discount allowed by him ₹ 108.
- ” 13 Received cash from the railway in full settlement of claim for damages in transit.
- ” 15 Arvind is declared insolvent and a dividend of 50 paise in the rupee is received from him in full settlement.
- ” 18 Sold 40 shares in Bharat Ltd. @ ₹ 18 per share, brokerage paid ₹ 15.
- ” 20 Bought a horse for ₹ 2,000 and a carriage for ₹ 1,000 for delivering goods to customers.
- ” 22 Paid for: Charity ₹ 101
Postage ₹ 200
Stationery ₹ 199
- ” 30 One month's interest on Mrs. B's Loan @ 12% p.a. became due but could not be paid.
- ” 30 The horse bought on April 20 died, its carcass was sold for ₹ 50.
- ” 30 Received from travelling salesman ₹ 3,000 for goods sold by him, after deducting his travelling expenses ₹ 150.
- ” 30 Paid for: Salaries ₹ 3,500
Rent ₹ 1,500
- ” 30 Sold goods worth ₹ 10,000 less 10% trade discount.

5.8 Summary

The process of recording transaction in a Journal is termed as ‘Journalising.’

1. Date, 2. Particulars, 3. L.F., 4. Debit, 5. Credit

Ledger is the book of Main entry and it contains various accounts such as Personal Accounts, Real Accounts and Nominal Accounts. A ledger account is nothing but a summary statement of all transactions relating to a person, asset, expense or income which have taken place during a given period of time showing their net effect.

Need of Ledger

A ledger helps to find out what are the main items of revenues and expense. It helps to find out, what are the assets and what are their values.

Importance of ledger-- Financial information, information of debtors and creditors, account wise information, preparation of trial balance, preparation of trading, profit and loss account.

5.9 Key Words/Abbreviations

- **Journal:** Journal is a book of account. It is a book of original/first/prime/primary entry, in which business transactions are first recorded in a chronological order.
- **Ledger:** Ledger is a book of accounts. It is a book of secondary entry. It is a bound book, which contains various accounts of the business, personal a/c, real a/c and nominal a/c.
- **Journalizing:** The process of recording the business transactions is the journal by passing the journal entry its called journalizing.
- **Posting:** The process of transforming the entire from the journal into the ledger is called posting.
- **Journal Folio:** It is the third and seventh column in the ledger. The short form of Journal Folio is J.F. Folio means page number. In the J.F. Column, we have to write the page number of the journal, from where the entry is posted.
- **Ledger Folio:** It is the third column of the journal. Folio means page number ledger of the ledger while recording the business transaction in the journal, nothing has to be entered in their column. The transaction recorded in the journal are perfect to the ledger.

The page number of the ledger, on which the two account appear are entered in their column.

5.10 Learning Activity

1. Journalise the following transactions in the books of Rajesh, August 2019.

- 1st August – Sold goods for cash ₹ 500.
- 2nd August – Bought goods for cash ₹ 300.
- 3rd August – Sold goods on credit to Ashok for ₹ 800.
- 4th August – Purchased goods from Rohan ₹ 400.
- 5th August – Received cash from Nikhil ₹ 600.
- 6th August – Paid cash to Ahmed ₹ 900.
- 7th August – Received commission ₹ 100.
- 8th August – Purchased furniture from living room for cash ₹ 15,000.
- 9th August – Received interest ₹ 250.
- 10th August – Withdrew cash for personal use ₹ 150.
- 11th August – Received from Ismail ₹ 850.
- 12th August – Paid to Salim ₹ 700.
- 13th August – Paid salary ₹ 4,000.
- 14th August – Paid for advertisement ₹ 5,000.

2. Journalise the following transactions in the books of Dinesh, March 2019.

- 1st March – Started business with cash ₹ 20,000.
- 2nd March – Cash purchased ₹ 1,000
- 3rd March – Cash sale ₹ 2,000
- 4th March – Withdrew cash from Bank of India ₹ 500
- 5th March – Deposited cash into Bank of India ₹ 2,000

- 6th March – Paid rent by cheque ₹ 5,000
7th March – Received commission by cheque ₹ 200
8th March – Goods withdrawn for domestic use ₹ 200
9th March – Goods distributed as free samples ₹ 600
10th March – Purchased machinery for cash ₹ 8,000
11th March – Purchased furniture from Ideal Furniture ₹ 4,000

3. Journalise the following transactions in the books of Akshay, 2019.

- Aug. 1 – Akshay started business with cash ₹ 90,000
Aug. 2 – Purchased furniture from Mohan and issued him a cheque of ₹ 10,000
Aug. 3 – Paid insurance premium on life of Akshay ₹ 4,000
Aug. 4 – Paid house rent ₹ 2,500
Aug. 5 – Goods worth ₹ 900 burnt by fire.
Aug. 7 – Purchased shares of ₹ 15,000 of ICICI Bank.
Aug. 8 – Placed an order of goods ₹ 7,000 to Veeru.
Aug. 10 – Veeru executed the order which was placed on Aug 8
Aug. 11 – Goods costing ₹ 1,100 distributed as free samples.
Aug. 12 – Received goods as free samples ₹ 2,000.
Aug. 13 – Purchased furniture ₹ 30,000 and carriage paid ₹ 300.
Aug. 14 – Borrowed from Saraswati ₹ 8,000.
Aug 16 – Received an order for goods ₹ 1,000 from Ramesh.
Aug. 17 – Bought a horse for ₹ 5,000
Aug. 18 – Paid personal tax by cheque ₹ 10,000.
Aug. 19 – The college fees of Akshay's son paid by cheque ₹ 5,000.

4. Journalise the following transactions in the books of Akash:

2nd Jan – Started business with cash ₹ 5,000, goods worth ₹ 7,000 and furniture worth ₹ 4,000.

3rd Jan. – Paid salaries ₹ 1,000, Rent ₹ and wages ₹ 200.

4th Jan. – Received ₹ 700 from Desai and ₹ 400 from Mehta.

5th Jan. – Sold goods worth ₹ 1,000 to Amit and he paid us ₹ 600 on account.

6th Jan. – Purchased goods from Dinesh worth ₹ 5,000 and paid ₹ 3,000 on account (part payment)

7th Jan. – Exchanged furniture worth ₹ 5,000 by receiving goods worth ₹ 3,000 and the balanced in cash.

10th Jan. – Drew from business for personal use, cash ₹ 700 and goods ₹ 300.

5. Journalise the following transactions in the books of Mr. Aniket and post them into ledger accounts**2019**

Sept. 1 – Started business with cash ₹ 1,20,000; goods ₹ 50,000; Furniture ₹ 1,00,000 and Machinery ₹ 2,00,000.

Sept. 5 – Purchased a laptop for cash ₹ 45,000

Sept. 8 – Purchased goods from Amit ₹ 5,000

Sept. 10 – Sold goods to Dilip ₹ 5,000

Sept. 15 – Received cash from Dilip ₹ 4,950, in full settlement of ₹ 5,000

5.11 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is Journal and Journalising?
2. State the rules of journalising.
3. What is ledger?



4. Explain the need and importance of ledger.
5. Give the proforma of Journal and Ledger.
6. Distinguish between Journal and Ledger.

B. Multiple Choice Questions

1. _____ is a book of original/price entry.
(a) Journal (b) Ledger
(c) Cash Book (d) Purchase
2. _____ is a book of secondary entry
(a) Journal (b) Ledger
(c) Saler Book (d) Cash Book
3. The process of recording business transaction in the journal is called _____.
(a) Positing (b) Costing
(c) Balancing (d) Journalizing
4. The process of transferring entries from the journal into the ledger is called _____.
(a) Totalling (b) Posting
(c) Balancing (d) Journalizing
5. Finding the difference between the debit total and credit total of an account is called _____.
(a) Totalling (b) Posting
(c) Balancing (d) Journalizing
6. While recording business transaction in the journal, general is recorded in _____ column.
(a) Date (b) Particular
(c) Folio (d) Ledger Folio

7. When debit side total of an account, is more than the credit side total of an account, the account has a _____ balance.
- (a) Debit (b) Credit
(c) Nil (d) Zero
8. When credit side total of an account, is more than the debit side total of an account, the account has a _____ balance.
- (a) Debit (b) Credit
(c) Nil (d) Zero

Answers:

1. (a), 2. (b), 3. (d), 4. (b), 5. (c), 6. (d), 7. (a), 8. (b)

5.12 References

1. P.C. Tulsian, (2003), "*Financial Accounting*", Pearson Education, Delhi.
2. M.A. Arulanandam and K.S. Raman (2019), "*Advanced Accountancy*", Himalaya Publishing House Pvt., Ltd., Mumbai.

UNIT 6 TRIAL BALANCE

Structure:

- 6.0 Learning Objectives
- 6.1 Introduction
- 6.2 Meaning of Trial Balance
- 6.3 Features of Trial Balance
- 6.4 Objectives of Trial Balance
- 6.5 Types of Errors
- 6.6 Unsolved Sums
- 6.7 Summary
- 6.8 Key Words/Abbreviations
- 6.9 Learning Activity
- 6.10 Unit End Questions (MCQ and Descriptive)
- 6.11 References

6.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the meaning of trial balance
- Discuss the features of trial balance
- Analyse the objectives of trial balance
- Analyse the types of errors



6.1 Introduction

This unit will help you to understand the meaning of trial balance, know the features of trial balance, objectives of trial balance and the types of errors.

6.2 Meaning of Trial Balance

The balances standing in the various accounts in the ledger at the end of a period are listed down in the form of a statement, showing debit balances in one column and the credit balances in the other, known as a '*Trial Balance*.' The '*Trial Balance*' is nothing but a summary of the various transactions entered in the Books of Accounts and its preparation is based on the rule that 'for every debit there is a corresponding and equal credit.' Therefore, if the above rule is strictly followed, the total of the debit balances will be equal to the total of the credit balances. If this is so, we say that the trial balance has agreed and the books are arithmetically accurate. For example, with the balances in the ledger accounts prepared in Illustration 3, the Trial Balance can be prepared as follows:

Trial Balance as on December 31, 2017

<i>Name of Account</i>	<i>Debit</i>	<i>Credit</i>
	₹	₹
Cash Account	39,800	
Rajini's Capital Account		50,000
Furniture Account	5,000	
Purchases Account	20,000	
Sales Account		13,000
Vinod Account		5,000
Suresh Account	2,000	
Rent Account	1,200	
	68,000	68,000

Thus, the Trial Balance agrees and it means that the books of accounts are arithmetically accurate.

6.3 Features of Trial Balance

The features of trial balance are as follows:

- (a) A trial balance is a list of debit balances and credit balances of the various ledger accounts. It is a statement of debit and credit balances.
- (b) A trial balance is not an account. It is only a statement of account.
- (c) A trial balance is prepared to establish arithmetical accuracy of the transactions recorded in the books of accounts.
- (d) It is not a part of the process of accounts.
- (e) It does not prove accounting accuracy, which can be determined by audit.
- (f) A trial balance is the basis for preparation of final accounts.
- (g) It serves as a link between books of accounts and the Profit and Loss Account and Balance Sheet.
- (h) It is usually prepared at the end of the year. But it can also be prepared any time, as and when required e.g., monthly, half yearly or quarterly.

6.4 Objectives of Trial Balance

1. Trial Balance is a summary of all the transactions entered in the ledger accounts and reveals the net position at a glance.
2. Agreement of the Trial Balance is an indication of the arithmetical accuracy of the books of accounts. In other words, it means that the double-entry rule has been correctly followed while recording the transactions.
3. Trial Balance forms the basis for preparing the financial statements such as Profit and Loss Account and Balance Sheet.

6.5 Types of Errors

We have explained in the earlier pages that the transactions which are entered in the subsidiary books will be posted to ledger account and the ledger account would be closed at the end of an accounting period and a list of balances would be prepared known as the Trial Balance. The agreement of the Trial Balance is a proof as to the arithmetical accuracy of the books of accounts. Agreement of the Trial Balance is not a final and conclusive proof of accuracy of books of accounts. It simply assures that for every debit there is a corresponding and equal credit. It means that in spite of an agreed trial balance, there may be errors in the books of accounts. If trial balance does not agree, it is a clear indication of the fact that there are certain errors in the books of accounts. Thus, errors may be committed while recording, classifying or summarising the financial transactions whether the Trial Balance agrees or does not agree.

Classification of Errors: Errors can be broadly classified into the following four types, depending upon its nature: (i) Errors of Omission; (ii) Errors of Commission; (iii) Errors of Principles; and (iv) Compensating Errors.

(i) Errors of Omission: When a transaction is completely omitted to be recorded from the books of accounts, it is called an error of omission. For example, if a credit purchase from Ram for ₹ 1,000 is omitted to be entered in the Purchases Book, it would be omitted in the Ledger also since what is found in the Subsidiary Book alone will find a place in the ledger. Consequently, the transaction would not be found in the Trial Balance also. Such a complete omission of a transaction is known as an Error of Omission. Such errors cannot be located out very easily. They generally come to the notice of the businessman when statement of accounts are received from or sent to creditors or debtors as the case may be.

Such type of errors can be rectified by means of rectification journal entries made in Journal Proper since making the correction in the concerned subsidiary book may not be possible at the time of locating the error. The rectification entry necessary for correction would be the normal journal entry that would have been made for the transaction that is so omitted. The correcting journal entry when posted to the concerned ledger accounts would correct the error.

Example 1: A credit purchase from Ram for ₹ 1,000 was omitted to be entered in the Purchases Book. The rectification entry would be:

Purchases Account	Dr.	1,000	
			To Ram's Account
			1,000

(Being the error of omission of credit purchases
from Ram rectified)

Example 2: A Bill Receivable for ₹ 2,000 received from Sunil has been omitted from the Bills Receivable Book.

The rectification entry would be:

Bills Receivable Account	Dr.	2,000	
			To Sunil
			2,000

(Being the error of omission rectified)

Since an error of omission affects both sides of the accounts, it can be always rectified by means of a rectifying entry.

(ii) Errors of Commission: When a transaction is entered in the books of accounts but if it is entered partially or incorrectly, it becomes an error of commission. This type of error generally arises due to the negligence of the accountant and hence may be known as errors of inadvertance. It may be of different types:

(a) Entering a Wrong Amount in the Correct Subsidiary Book : A transaction may be entered in the correct subsidiary book but with a wrong amount. The same error will be carried forward to the Trial Balance through the ledger. The Trial Balance will agree since the error affects both aspects equally. Such an error can be rectified only by means of a suitable rectification entry.

Example 1: Sales to Mohan for ₹ 5,000 entered in the Sales Book as ₹ 5,500.

Here, the amount is entered in the Sales Book as ₹ 5,500 instead of ₹ 5,000. It will be posted to the debit of Mohan's account in the ledger and to the credit of the Sales Account as ₹ 5,500. That means that there is an excess of debit of ₹ 500 in Mohan's Account and an excess credit of ₹ 500 in Sales Account.

The error can be rectified by the entry:

Sales Account	Dr.	500	
			500
	To Mohan's Account		

(Being the posting of the wrong amount corrected)

Example 2: Sales to Mohan for ₹ 5,500 entered in the Sales Book as ₹ 5,000.

Here, Mohan's Account, when posted, will show a short debit and Sales Account short credit. Hence, the rectification entry would be:

Mohan's Account	Dr.	500	
			500
	To Sales Account		

(b) Recording a Correct Amount to Wrong Subsidiary Book : A transaction may be entered in a wrong subsidiary book. For example, a credit purchase from Ram may be passed through the Sales Book instead of through the Purchases Book. In such a case, strictly speaking, there are two errors: (i) omitting a transaction from the appropriate subsidiary book and (ii) passing it through another subsidiary book. Hence, both the errors will have to be rectified and it requires two rectification entries.

Example: A credit purchase of ₹ 1,000 from Ram entered through the Sales Book.

The transaction, if correctly entered, would have been posted to the debit of Purchases Account and to the credit of Ram's Account in the Ledger. Since it has been entered in the Sales Book, it would have been actually posted to the debit of Ram's Account and credit of Sales Account. Thus, there are two errors. The rectification entries would be:

(i) To cancel the wrong entry already made:

Sales Account	Dr.	1,000	
			1,000
	To Ram's Account		

(Wrong entry cancelled)

(ii) To rectify the omission in the accounts:

Purchases Account	Dr.	1,000	
To Ram's Account			1,000
(Omission rectified)			

Instead of making two such entries, it may be combined and passed in the form of one single entry:

Sales Account	Dr.	1,000	
Purchases Account	Dr.	1,000	
To Ram's Account			2,000

(c) Posting a wrong amount to the correct side of the account: Sometimes, a wrong amount may be posted to the correct side of an account. For example, purchases from Ram on credit for ₹ 1,000 though correctly entered in the Purchases Book may be posted to the credit of Ram's account as ₹ 1,100. It means that there is an excess credit of ₹ 100 in Ram's account. This is an arithmetical error and affects only one aspect and hence makes the trial balance disagree. Whenever an error affects only one aspect of the transaction, it cannot be rectified by means of a journal entry. Instead a suitable amount will have to be posted to the appropriate side of the account to correct the mistake. In this case, an amount of ₹ 100 should be posted to the debit of Ram's account to cancel the excess credit in it. No journal entry is required.

Ram's Account

	₹		₹
To Adjustment	100	By Purchases	1,100

(d) Posting a correct amount to the wrong side of the account: To rectify such errors, double the amount should be posted in the opposite side.

Example: Rent paid ₹ 100 posted to the credit side of the Rent Account. ₹ 200 should be posted to the debit side of the rent account. It is an arithmetical error and does not require a journal entry for rectification. It can be rectified as given below:

Rent Account

	₹		₹
To Adjustment	200	By Cash	100

The net effect will be a debit of ₹ 100 in Rent Account.

(e) Making double posting: Sometimes an amount may be posted twice in the same account. This can be rectified by posting the amount equal to the amount of transaction in the opposite side of the account. No journal entry is required.

(f) Posting to the wrong account of the same class: For cash received from A ₹ 100, A & Sons Account may be credited. To rectify such an error, the following entry would be made:

A & Sons Account	Dr.	100
To A's Account		100

(Being the wrong credit given to A & Sons corrected and the correct credit given to A)

(g) Errors arising in totalling, carrying forward, balancing etc. are also called Errors of Commission.

(iii) Errors of Principle: Errors of Principle are committed because of the ignorance of the principles of accounting. It may be committed in different ways.

(a) Errors due to inability to make a distinction between revenue and capital items, i.e., a capital expenditure is taken as a revenue expenditure or vice versa. Similarly, a capital receipt may be taken as a revenue receipt.

Example 1: Sale of old furniture for ₹ 500 credited to Sales Account. It is a capital receipt but is treated as a revenue receipt. The error does not affect the agreement of the trial balance because some account is debited and some other account is credited for an equal amount and thus the double-entry rule is satisfied. It is an error of principle and it can be rectified by means of a journal entry as follows:

Sales Account	Dr.	500	
To Furniture Account			500

Example 2: Repairs to Building ₹ 1,000 debited to Building Account. It is an expenditure of a revenue nature but is treated as Capital expenditure. The correcting entry would be:

Repairs to Building Account	Dr.	1,000	
To Building Account			1,000

(b) Errors due to inability to make a difference between business expenses and personal expenses.

Example: Proprietor's Life Insurance premium ₹ 225 paid debited to Insurance Account. It is a personal expense and ought to have been debited to Drawings Account of the proprietor but is wrongly debited to Insurance Account treating it as a business expenditure. The correcting entry would be:

Drawings Account	Dr.	225	
To Insurance Account			225

(c) Errors due to inability to make a difference between productive expenses and unproductive expenses.

For example, wages paid for production may be debited to Salaries Account or Salaries paid to office employees may be debited to Wages Account.

(iv) **Compensating Errors:** Compensating errors are those errors which compensate each other. It means that the effect of one error is offset by that of another error, ultimately, resulting in the agreement of the trial balance. For example, if rent paid ₹ 100 is debited in the rent account as ₹ 150 and commission received ₹ 200 is credited in the commission account as ₹ 250, the excess debit in rent account is compensated by an excess credit of ₹ 50 in commission account. Hence, the presence of this type of errors will not be revealed by the trial balance. Further, it is not a single error but a combination of more than one error. The component errors will have to be identified and rectified one by one, till all the errors are corrected.

Errors can also be classified into two types from the point of view of locating them:

- (a) Errors which do not affect the agreement of the trial balance.
- (b) Errors which affect the agreement of the trial balance.

(a) **Errors which do not affect the agreement of the trial balance:** As stated earlier, all errors of omission, all errors of principle, all compensating errors and some of the errors of omission will not affect the agreement of the trial balance. Locating such errors is, therefore, a difficult process. Such errors can always be rectified by means of journal entries.

(b) **Errors which affect the agreement of the trial balance:** Many of the errors of commission such as posting a wrong amount, posting to the wrong side of an account, double posting, mistakes in totalling, balancing, carrying forward etc. would affect only one side of an account and, therefore, would be revealed in the trial balance by the disagreement of the trial balance.

Illustration 1

Rectify the following errors:

- (i) ₹ 150 relating to purchase of office stationery has been wrongly debited to the personal account of the owner.
- (ii) Goods bought from Jones on credit for ₹ 525 were not passed through the subsidiary book.
- (iii) The total of the Discount column on the debit side of the cash book has been cast short by ₹ 30.
- (iv) A Bill Receivable for ₹ 500 received from Jamal was passed through the Bills Payable book.
- (v) An invoice received from Chand for ₹ 819 was entered in the original book as ₹ 890.
- (vi) A gas engine costing ₹ 5,200 had been debited to Purchases Account.
- (vii) Cash received from C. Mathew was debited to G. Mathew ₹ 100.
- (viii) ₹ 6,000 owed by a customer had been omitted from the schedule of debtors.

- (ix) While carrying forward the total from one page of the Purchases Book to the next, the amount of ₹ 2,134 was written as ₹ 2,314.
- (x) General expenses paid ₹ 19 was posted to the credit of the account as ₹ 90.

Solution:

		₹	₹
(i) Printing & Stationery Account	Dr.	150	
To Drawings Account			150
(Being the wrong debit to the personal account of the owner for purchase of office stationery rectified)			
(ii) Purchases Account	Dr.	525	
To Jones Account			525
(Being the omission of credit purchases rectified)			
(iii) This is an arithmetical error, since the total of the discount column on the debit side of the cash book has been cast short by ₹ 30, the discount allowed account in the ledger to which this total is posted, would show a short debit by ₹ 30. Hence, a further debit of ₹ 30 should be given to the discount allowed account and the total of the discount column in the cash book also should be corrected. No journal entry is necessary.			
(iv) Bills Receivable Account	Dr.	500	
Bills Payable Account	Dr.	500	
To Jamal Account			1,000
(Being the Bills Receivable passed through Bills Payable book rectified)			

(v) Chand Account Dr. 71
 To Purchases Account 71
 (Being the excess debit and credit in the concerned account cancelled)

(vi) Plant and Machinery Account Dr. 5,200
 To Purchases Account 5,200
 (Being the wrong debit to Purchases Account for gas engine purchased rectified)

(vii) This is also an arithmetical error. Instead of crediting C. Mathew for cash received, it has been wrongly debited to G. Mathew's Account. This wrong debit should be cancelled by a credit for an equal amount and C. Mathew also should be credited with ₹ 100. This requires two separate postings as shown below and no journal entry is required.

G. Mathew

To Cash	100	By Adjustment	100
---------	-----	---------------	-----

C. Mathew

		By Adjustment	100
--	--	---------------	-----

(viii) This is an arithmetical error. The omission is in the Sundry debtors list and not in the books of accounts. Hence, the error appears in the Trial Balance only. It can be corrected by debiting ₹ 6,000 to the Sundry Debtors Account. No journal entry is required.

(ix) This is also an arithmetical error. When the total of the Purchases Book is overcast, the Purchases Account in the ledger also would show an excess debit to that extent, *i.e.*, ₹ 180. Hence, the Purchases Account in the ledger should be credited with ₹ 180 and the error in the Purchases Book also should be corrected. No journal entry is required.

(x) It is also an arithmetical error. Instead of debiting the General Expenses account with ₹ 19 it was credited to that account as ₹ 90. So the General Expenses account should be debited

with the total amount, *i.e.*, ₹ 19 + 90 = ₹ 109. So the wrong credit of ₹ 90 would be cancelled and the account would show the correct debit of ₹ 19. No journal entry is required.

Illustration - 2

From the following ledger balances, prepare a Trial balance as on 31st January 2014.

<i>Particulars</i>	₹
Capital	51,000
Commission received	800
Furniture	4,000
Manufacturing expenses	600
Machinery	12,000
Purchases	26,000
Sales	1,72,000
Buildings	1,20,000
Opening Stocks	14,000
Wages	10,000
Factory Rent	3,000
Advertisement	50,000
Salaries	10,000
Carriage inwards	800
Carriage outwards	1,400
Discount allowed	800
Discount received	400
Bad and doubtful debts reserve	800
Sundry debtors	45,000
Sundry creditors	91,200
Cash at Bank	12,000
Cash in hand	1,600

Solution:**Trial Balance as on 31st Jan. 2014**

<i>Details</i>	<i>LF Amount</i>	
	<i>Dr.</i>	<i>Cr.</i>
Capital		51,000
Commission received		800
Furniture	4,000	
Manufacturing expenses	600	
Machinery	12,000	
Purchases	26,000	
Sales		1,72,000
Buildings	1,20,000	
Opening stocks	14,000	
Wages	10,000	
Factory Rent	8,000	
Advertisement	50,000	
Salaries	10,000	
Carriage inwards	800	
Carriage outwards	1,400	
Discount allowed	800	
Discount received		400
Bad debt and doubtful debt reserve		800
Sundry Debtors	45,000	
Sundry Creditors		91,200
Cash at Bank	12,000	
Cash in hand	1,600	
	3,16,200	3,16,200

Illustration - 3

From the following balances, prepare a Trial Balance.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Drawings	2,000	Sales	68,000
General expenses	4,740	Purchases	40,000
Buildings	20,000	Bank Overdraft	10,000
Stock	16,540	Capital	?
Wages	8,515		
Debtors	6,280		
Creditors	2,500		
Bad Debts	550		
Loan to Ravi	7,880		

Solution:**Trial Balance**

<i>Heads of Accounts</i>	<i>LF</i>	<i>Debit</i> (₹)	<i>Credit</i> (₹)
Drawings		2,000	—
General Expenses		4,740	—
Buildings		20,000	—
Stock		16,540	—
Wages		8,515	—
Debtors		6,280	—
Creditors		—	2,500
Bad debts		550	—
Loan to Ravi		7,880	—
Sales		—	68,000
Purchases		40,000	—
Bank overdraft		—	10,000
Capital (balancing figure)		—	26,005
		1,06,505	1,06,505

Practical Questions

Q-1. Re-write the following Trial balances to correct the same Trial balance on 31st March 2014.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Wages	10,720	Capital	4,000
Salaries	2,080	Sales	1,24,320
Carriage	200	Discount received	480
Building	48,040	Rent Paid	2,000
Bank Overdraft	1,880	Light Charges	640
Cash in hand	240	Suppliers	32,000
Customers	5,960	Opening stock	37,040
		Furniture	13,000

Q-2. Habib Bank a client of yours with whom Book -keeping is not a strong point, asked you to Audit the account for the year ending 31st December 2014 on which date the closing stock was valued at ₹ 28,700 on the basis of your audit. The Bank furnishes you the following statement.

Trial Balance as on 31st December 2014

<i>Details</i>	<i>LF</i>	<i>Debit</i>	<i>Credit</i>
Habib Bank's Capital			44,800
Habib Bank's drawings		28,200	
Lease hold premises		37,050	
Sales			1,37,800
Due from customer			26,500
Purchase		63,400	
Purchase return		13,200	
Cash from Bank			33,000
Creditors			12,500
Trade and office expenses		26,400	
Cash at bank		39,200	
Bill payable		7,100	
Salaries		5,000	
Stock (1st January)		29,900	
Rent			13,200
Returns		23,250	4,900
		2,72,700	2,72,700

If you don't approve this statement amend it.

Q-3. From the following Balance prepare Trial Balance of Mr. Sawpon as on 31st March 2014.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Salaries	4,106	Purchase	33,189
Mr. Sawpon Capital	1,50,000	Land and Buildings	55,000
Plant and Machinery	85,000	Furniture and Fixtures	2,500
Motor Vans	15,750	Bills Receivable	4,000
Factory wages	5,000	General expenses	12,200
Salaries to staff	4,500	Rent and Taxes	1,700
Lighting and Power	900	Coal and Fuel	600
Trade expenses	575	Commission	2,700
Duty and Clearing charges	1,260	Stock on 1st April 2004	50,450
Purchases	96,000	Sales	1,65,000
Returns inwards	1,800	Returns outwards	2,100
Bank charges	125	Travelling expenses	3,750
Advertising	2,115	Repairs to Plant	1,070
Loan from Jai Gopi	25,000	Interest on loan	960
Cash at Bank	6,400	Cash on hand	300
Petty cash balance	75	Mr. Sawpon's Drawings	6,000
Sundry Debtors	85,420	Sundry Creditors	88,650

Q-4. From the following list of balances extracted from the books of Ravila, prepare a Trial balance as on 31st March, 2014.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Capital	28,810	Bills Receivable	10,000
Drawings	3,000	Salaries	4,000
Free hold premises	11,600	Bank Loan	4,800
Purchases	63,000	Sales	85,00
Sundry Debtors	13,500	Stock (1st April 2004)	20,000
Sundry Creditors	8,500	Bills payable	6,850
Furniture and Fittings	5,000	Carriage on purchases	300
General expenses	3,250	Wages	1,570
Returns inward	900	Bank Charges	300
Postage and Stationery	250	Carriage on sales	350
Discount allowed	840	Discount received	280
Cash at Bank	2,400	Cash in hand	480

Q-5. From the following balances prepare a Trial balances of Robin as on 31st March 2014.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Furniture	20,000	Stationery	500
Wages	1,500	Interest on loan	200
Opening stock	25,000	Drawings	1,32,600
Salaries	7,000	Capital	3,00,000
Purchase	2,00,000	Machinery	1,20,000
Sales	2,40,000	Postage	300
Sundry Debtors	10,000	Power and Fuel	1,200
Sundry Creditors	15,000	Trade Expenses	500
Bills Receivable	41,000	Bad debts	200
Reserve for doubtful debts	2,000	Bills Payable	3,000

Q-6. From the following prepare a Trial balance as on 31st March 2013.

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Capital	80,00,000	Discount allowed	4,000
Debtors	47,85,000	Sales return	45,000
Drawings	32,60,000	Sales	50,69,000
Bad debts	1,00,000	Machinery	36,00,000
Bills Payable	2,10,000	Trade Expenses	30,000
Creditors	20,25,000	Bank overdraft	1,57,000
Purchase	30,87,000	Purchase Return	35,000
Stock	2,45,000	Rent	36,000
Cash	1,21,000	Salary	85,000
Outstanding Expense	1,27,000	Stationery	4,58,000
Reserve for bad debts	2,25,000		

Q-7. From the following Prepare a Trial Balance:

<i>Name of Account</i>	₹	<i>Name of Account</i>	₹
Cash in hand	20,000	Machinery	50,000
Furniture	20,000	Bank Balance	10,000
Drawings	5,000	Goodwill	10,000
Rent	1,500	Trade Expenses	2,500
Bills Receivable	4,500	Purchase	10,000
Stock	500	Investment	10,000
Sales return	2,000	Capital	10,000
Bills Payable	6,000	Bank overdraft	10,000
Outstanding expenses	2,000	Creditors	28,000
Debtors	20,000	Loan from Amit	20,000

Q-8. Prepare a Trial Balance from the following:

<i>Particulars</i>	₹	<i>Particulars</i>	₹
Salaries	36,954	Purchases	2,98,701
Bank	62,208	Wages	63,972
Stock	1,02,501	Expenses	85,257
Reserve or bad debts	80,604	Capital	1,08,000
Plant and Machinery	90,900	Rent	30,402
Depreciation	6,750	Sales	5,36,040

While preparing trial balance the following information ascertained:

- (i) Debtors ₹ 73,971 and creditors ₹ 44,802 has been omitted.
- (ii) Bank balance was bank overdraft.
- (iii) Purchase included ₹ 28,701 towards purchase return.
- (iv) Salary includes ₹ 7,020 for drawings
- (v) Wages should have been 64,620.

Q-9. Pass the Journal entries of the following transactions and post them in Ledger and show the Trial balance.

2012 Mar -1 Mustafizur started business with cash ₹ 60,000 and with goods ₹ 20,000

- 4 Sold goods to Narayan ₹ 6,000
- 8 Purchased goods from Nihar ₹ 8,000
- 9 Sold goods to Achinta ₹ 2,000
- 12 Sold good for cash ₹ 4,000
- 15 Purchased goods for cash ₹ 12,000

- 17 Narayan returned goods ₹ 800
 19 Purchased good from Pradeep ₹ 4,800
 20 Received from Narayan ₹ 5,040 and discount allowed ₹ 160.
 23 Achinta paid in full settlement of ₹ 1,860
 25 Sold good for Cash ₹ 4,000
 25 Paid to Ranjit ₹ 4,800
 27 Paid to Pradeep in full settlement of ₹ 4,600.
 28 Withdraw for personal use ₹ 6,000
 29 Paid wages ₹ 200
 29 Paid Salaries ₹ 800
 30 Paid Rent ₹ 400

Q-10. From the following Prepare a Trial Balance:

<i>Name of Account</i>	₹
Cash in hand	40,000
Machinery	1,00,000
Furniture	40,000
Bank Balance	20,000
Drawings	10,000
Goodwill	20,000
Rent	3,000
Trade Expenses	5,000
Bills Receivable	9,000
Purchase	20,000
Stock	1,000
Investment	20,000
Sales return	4,000
Capital	20,000
Bills Payable	12,000
Bank overdraft	20,000
Outstanding expenses	4,000
Creditors	56,000
Loan from Amit	40,000
Debtors	40,000

6.6 Unsolved Sums

Q. 1. Rectify the following errors

1. Goods sold to Pritesh for ₹ 5,000 on credit were not entered in the Sales Book.
2. Repairs for building was debited to Building account ₹ 5,000.
3. ₹ 3,500 received as interest, was credited to Commission account.
4. Cash received from Dinesh ₹ 1,500 was credited to Dilip.
5. Sale of old machinery ₹ 25,000 treated as sale of goods.

Q. 2. Rectify the following errors

1. Payment of salaries ₹ 25,000 to Siddhesh was wrongly debited to his personel account in the ledger.
2. ₹ 700 paid for repairs to machinery was wrongly posted to Machinery account.
3. Sales of ₹ 30,000 to Vinit was not entered in the Sales Book.
4. Old furniture sold for ₹ 7,000 was entered in the Sales Book.
5. Cash paid to Anuj ₹ 90,000 was debited to Anitas account.

Q. 3. Rectify the following errors

1. Salary of ₹ 4,500 paid to Vinita was debited toher personal account.
2. Carriage paid ₹ 2,000 on purchase of a machine was debited to carriage account.
3. Commission received ₹ 400 has been posted to the debit of commission account.
4. A cheque for ₹ 600 issued to Rita, has been wrongly entered in the cash column of the cash book.
5. Life insurance premium of proprietor paid ₹ 7,000 wrongly debited to Insurance account.

6.7 Summary

Trial balance is a statement showing the debit balances and credit balances of the various ledger accounts.

The feature of trial balance are it is a list, it is a statement and not as account, it establishes arithmetical accuracy and not accounting accuracy not a part of the accounting process, it is a basis for preparing the final accounts it is a link between books of accounts and profit and loss a/c and balance sheet, it is usually prepared at the end of the year.

The objects of trial balance are it is a summary of all the transactions entered in the ledger accounts trial balance agreement indicator arithmetical accuracy, it is a basis for preparing financial statements.

The types of errors are errors of omission, errors of commission, errors of principle and compensating errors.

6.8 Key Words/Abbreviations

- **Trial Balance:** Trial balance is a statement showing the debit balance and credit balance of the various ledger account.
- **Error of omission:** A transaction, if completely or partially, is omitted from being recorded in the books of accounts, it is called an error of complete partial omission.
- **Error of commission:** They are error which arise due to wrong recording, wrong posting, wrong balancing, wrong carrying forward, wrong casting etc.
- **Error of principle:** Error of principle arises when a transaction is recorded in contravention of accounting principles.
- **Compensating errors:** They are those errors in which the effect of one error is nullified by the effect of another error.

6.9 Learning Activity

I. Identify the type of errors committed in the following situation.

1. Commission paid for purchase of land is debited to commission account instead of land account.
2. Machinery purchased on credit wrongly recorded in purchase book instead of journal proper.
3. Goods sold on credit to Dinesh not recorded in sales book.
4. A credit sale of goods to Ram recorded in sales book, but not posted in Amir a/c.
5. Goods of ₹ 15,000 purchased on credit from Mitesh are recorded in the purchase book as ₹ 1,15,000.
6. Purchase book is totalled as ₹ 20,000 instead of ₹ 2,00,000.
7. Sita's a/c was debited with ₹ 200 instead of ₹ 2,000 while Ketan's a/c was debited with ₹ 2,000 instead of ₹ 200.

II. From the balance given below extracted from the books of Smita, Prepare a Trial Balance as on 31st March 2011.

Particulars	Amount (₹)
Cash in Hand	200
Cash at bank	2,500
Capital	50,000
Drawings	5,000
Sales	35,000
Purchases	30,000
Debtors	32,000
Creditors	15,000
Discount Allowed	500
Commission Received	1,000
Wages	3,000

Salaries	1,200
Rent and Taxes	2,000
Purchase Return	200
Sales Return	300
Machinery	15,000
Loan taken	20,000
Furniture	15,500
Travelling expenses	7,000
Carriage inward	5,000
Carriage outward	5,000

III. From the following information prepare a Trial Balance as on 31st March 2011.

Particulars	Amount (₹)
Motor Cycle	3,000
Loss by fire	850
Bad debts	140
Return outward	130
Cash	20
Discount received	150
Loan taken	500
Creditors	2,500
Purchases	5,000
Capital	3,680
Investment	280
Sales	5,200
Debtors	3,000
Interest received	130

IV. From the following Ledger balance extracted from the book of Mr. Gopal. Prepare a Trial Balance as on 31st March 2011.

Particulars	Amount (₹)
Capital	15,000
Land and Building	15,600
Bank Overdraft	2,500
Cash in Hand	680
Purchases	7,200
Sales	17,370
Audit fees	1,250
Postage and Telegram	700
Advertisement	210
Rent and taxes	160
Insurance	40
Discount allowed	300
Repairs to Building	6,210
Interest and discount received	500
Debtors	6,620
Creditors	4,100
Legal charges	500

V. Re-draw correctly the Trial Balance as on 31st March 2011.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital		8,000
Commission recived		250
Creditors		1,250
Return outward		350
Bank overdraft		1,570
Rent	350	
Salaries	850	
Printing and Stationery	300	

Cash in hand	2,660	
Purchases	11,880	
Debtors	7,580	
Bank deposit	2,750	
Discount allowed	40	
Drawings	600	
Return inward	450	
Sales		14,690
Bank loan		1,350
Total	27,460	27,460

6.10 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is trial balance?
2. What are the features of trial balance?
3. What are the objectives of trial balance?
4. Explain the types of errors.

B. Multiple Choice Questions

1. _____ is a statement showing the debit balances and credit balances of ledger accounts.

(a) Journal	(b) Ledger
(c) Subsidiary book	(d) Trial balance
2. When a transaction is completely omitted to be recorded in the books of accounts, it is called a/an _____.

(a) Error of omission	(b) Error of commission
(c) Compensating error	(d) Error of principle

3. Errors of _____ occur when accounting principles are not observed.
- (a) Omission (b) Commission
(c) Principle (d) Compensating
4. When a transaction is entered in the books of accounts, but it is entered partially or incorrectly, it is called an error of _____.
- (a) Commission (b) Omission
(c) Principle (d) Compensating
5. When the effect of one error is offset by the effect of another error, it is an error of _____.
- (a) Omission (b) Commission
(c) Principle (d) Compensating
6. A trial balance is a list of _____ accounts.
- (a) Personal (b) Real
(c) Nominal (d) Ledger
7. The trial balance shows only _____ accuracy.
- (a) Arithmetical (b) Accounting
(c) Financial (d) Historical
8. A trial balance is a _____.
- (a) Statement (b) Journal
(c) Ledger (d) Subsidiary
9. Trial balance provides the base for preparation of _____.
- (a) Debit note (b) Credit note
(c) Voucher (d) Final accounts

10. Total of all debit balance must be _____ to the total of all credit balance.
- (a) Equal (b) Different
(c) More (d) Loss
11. A trial balance is generally prepared at the end of each _____.
- (a) Month (b) Half year
(c) Quarter (d) Financial year

Answer:

1. (d), 2. (a), 3. (c), 4. (a), 5. (d), 6. (d), 7. (a), 8. (a), 9. (d), 10. (a), 11. (d)

6.11 References

1. A. Mukherjee and M. Hanif, (2010), “*Modern Accountancy -Vol. I*”, Tata McGraw Hill, New Delhi.
2. S.N. Maheshwari and S.K. Maheshwari, (2004), “*An Introduction to Accountancy*”, Vikas Publishing House Pvt. Ltd., New Delhi.

UNIT 7 DEPRECIATION, PROVISION AND RESERVES

Structure:

- 7.0 Learning Objectives
- 7.1 Introduction
- 7.2 Meaning of Depreciation
- 7.3 Provision and Reserve
- 7.4 Causes of Depreciation
- 7.5 Objectives of Providing Depreciation
- 7.6 Different Methods of Providing Depreciation
- 7.7 Summary
- 7.8 Key Words/Abbreviations
- 7.9 Learning Activity
- 7.10 Unit End Questions (MCQ and Descriptive)
- 7.11 References

7.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the meaning of depreciation.
- Discuss the meaning of provision and reserves.



- Analyse the cause of depreciation
- Explain the objective of providing depreciation
- Discuss the different methods of providing depreciation

7.1 Introduction

This unit will help you to understand the meaning of depreciation, know the meaning of provision and reserves, know the cause of providing depreciation, know the objectives of providing depreciation, know the different methods of providing depreciation.

7.2 Meaning of Depreciation

Depreciation means a reduction in the value of a Fixed Asset used in the business due to wear and tear and effluxion of time. The value of an asset may decrease due to so many reasons, like wear and tear, effluxion of time, obsolescence, accidents, fall in market value etc. The reduction in value of an asset is termed as depreciation, treated as a revenue loss and the same is transferred to the profit and loss account in order to arrive at a correct profit or loss made from the operation of the business. The life of an asset expires gradually and the rate of reduction is directly connected with the use of the asset. For example, the life of the mine depends on the quantum of material taken out from the mine every year. In the same manner certain equipments can work effectively up to a particular number of hours and the depreciation is directly proportionate to the number of hours used in a particular year.

7.3 Provision and Reserve

Provision and Reserve: Nowadays risks and uncertainties are common in every business and in order to save the business from the above it is necessary on the part of the business to make provisions and reserves.

Provision: Provision is a charge against profit. It is provided for the purposes like meeting a known loss, *e.g.*, doubtful debts and an outstanding liability for expenses already incurred, *e.g.*, Salaries, income-tax and other accrued expenses. The exact amount involved is not known while

creating this amount in certain cases like Provision for repairs and Provision for taxes. It is provided irrespective of the profit or loss made by business.

Reserve: Reserve is an appropriation of profit. It may be created for a specific purpose, *e.g.*, Debenture Redemption Fund, or for a general purpose. Reserve is created for the purpose of meeting the future losses, or strengthening the financial position. During the lean period a uniform rate of dividend can be declared by using this reserve. Surplus of the reserve can be invested in good outside securities, which will be an added advantage to the business. In such a case the reserve will be called “Reserve Fund” and the investments as ‘Reserve Fund Investments.’ Reserve can be broadly classified into (a) Capital Reserve and (b) Revenue Reserve.

(a) Capital Reserve: Any reserve which is created out of Capital Profit is known as Capital Reserve. Except in certain cases, it is not available for declaring dividend to the shareholders. Examples for capital profits are, profit prior to incorporation, profit on reissue of shares, profit on redemption of debentures and share premium collected.

(b) Revenue Reserve: Any reserve which is otherwise available for dividend is called revenue reserve. General Reserve, dividend equalisation reserve and investment fluctuation reserve are some of the categories of the revenue reserve.

Distinction between Provision and Reserve

1. Provision is a charge against profit and reserve is an appropriation of profits.
2. Provision is made to fulfil the legal requirement whereas the reserve is created to strengthen financial position of the business.
3. Provision is created to meet some known expenditure or loss whereas the reserve is created for any purpose other than to meet the known expenditure or loss.
4. Since provision is created to meet specific expenditure or loss, the proprietor has no claim on it. As the reserve is created by setting apart a portion from distributable profit, proprietor has a claim on it.
5. Provision may be shown on the liability side of the balance sheet or it can be shown as a deduction from the concerned asset account on the asset side whereas reserve is shown always on the liability side of the balance sheet, under the head ‘Reserves and Surplus.’

7.4 Causes of Depreciation

The causes of depreciation are as follows:

- (a) **Wear and Tear:** When the fixed assets are used, the value of fixed assets decreases.
- (b) **Passage of Time:** Even if the fixed assets are not used, their value decrease with the passage of time due to weather, winds, rain etc.
- (c) **Obsolescence:** When new and improved machines are introduced, old machines have to be discarded. Old machines have to be replaced by new machines, which are more efficient. Thus, the value of old machines reduces due to technological advancement.
- (d) **Exhaustion/Depletion:** Wasting assets like quarries, mines, oil wells etc. Gets physically exhausted by the removal of its contents. It is the reduction in the value of natural deposits as resources have been extracted.
- (e) **Natural Calamities:** When natural calamities like floods, earthquakes, storms, cyclones, fire, accidents take place, the assets get damaged and thereby their value decreases.

7.5 Objectives of Providing Depreciation

Strictly speaking, depreciation is a loss sustained due to wear and tear of an asset used in the business. The treatment of that loss may differ from one asset to another and from one business to the other.

The purpose of charging depreciation in the books is

1. to ascertain the true profit of the business,
2. to show the asset at its true value in the balance sheet, and
3. to provide funds for replacement of the asset.

In general the factors involved in calculating the depreciation are:

1. The cost of the asset,
2. Estimated scrap value at the end of its life, and
3. Estimated life of an asset.

7.6 Different Methods of Providing Depreciation

The various methods under which the loss (depreciation) can be provided are as follows:

- (a) Straight Line Method
- (b) Reducing Instalment Method
- (c) Annuity Method
- (d) Depreciation Fund Method
- (e) Insurance Policy Method
- (f) Revaluation Method
- (g) Depletion Method
- (h) Machine Hour Rate Method
- (i) Repairs Provision Method
- (j) Sum of the Digits Method.

Straight Line Method: Under this method, the depreciation is charged by deducting the scrap value from the original cost of an asset and the balance is divided by the number of years estimated as the life of the machine. This method is followed where the repair charges are almost uniform throughout the life of the asset.

	₹
Example: Cost of the Machine	₹ 10,000
Erection charges	₹ 1,000
Estimated scrap value at the end	₹ 1,000
Estimated life of the machine	10 years

Thus, the depreciation charged every year being arrived at as follows:

$$\frac{\text{Original Cost} - \text{Scrap Value}}{\text{Estimated Life}} = \frac{11,000 - 1,000}{10} = ₹ 1,000$$

i.e., 10% on ₹ 10,000 on every year.

Reducing Instalment Method: Under this method, the amount to be written off by way of depreciation is arrived at after deducting the scrap value and a fixed percentage as depreciation is written off on the opening balance of the asset every year. This method is followed where the initial repair charges are less and the repair charges are gradually increasing in the years to come. The depreciation charged in the first year is high and gradually the depreciation amount is reduced. Under this method, the total of the two, *i.e.*, the depreciation written off and the repair charges will be almost uniform throughout the life of the machine.

Of the two methods, straight line method and the reducing instalment method, the latter is preferable because under the second method the depreciation amount is gradually decreasing and the total of the two (depreciation and repair charges) will be almost uniform. In the case of straight line method the depreciation amount is constant and the repair charges are also gradually increasing. So, the total of the two (depreciation and repair charges) is gradually increasing.

Example: Original cost of the machine ₹ 11,000
 Scrap Value at the end ₹ 1,000
 Depreciation is to be charged at 10% on the W.D.V. Method.

Answer:	Original cost of the Machine	11,000
	Less: Scrap Value at the end	1,000
		10,000
	Depreciation for the first year	
	10% of ₹ 10,000	1,000
		9,000
	Depreciation for the 2nd year	
	10% of ₹ 9,000	900
		8,100

Accounting Entries:

1. Depreciation Account Dr.
 To Asset Account
 (or)
2. Depreciation Account Dr.
 To Provision for Depreciation Account

In the case of first entry, the depreciation account is closed by transferring the same to the profit and loss account and the asset value is reduced to that extent.

Provision for Depreciation: In the case of the alternative entry a separate account is opened known as provision for depreciation account and the yearly depreciation is credited to that account instead of crediting the asset account. The depreciation charged may be on straight line method or on written down value method, the procedure is same. The accumulated balance of this provision for depreciation account is deducted from the concerned asset in the asset side of the balance sheet. By maintaining the provision for depreciation account, the asset account is maintained at its original cost throughout its life-time.

Illustration 1

A firm purchased plant and machinery on 1st July, 2015, for ₹ 90,000 and incurred ₹ 10,000 on its erection expenses. Depreciation is written off at the rate of 10 per cent. The firm closes its books on 31st December each year.

Show the plant and machinery account up to 31st December, 2017, under

- (a) Straight Line Method
- (b) Reducing Instalment Method
- (c) Straight Line Method where provision for depreciation account is maintained and
- (d) Reducing Instalment Method where provision for depreciation account is maintained.

Solution: (a and b)

Plant and Machinery Account

<i>Date</i>	<i>Particulars</i>	<i>Fixed Instalment Method</i>	<i>Reducing Instalment Method</i>	<i>Date</i>	<i>Particulars</i>	<i>Fixed Instalment Method</i>	<i>Reducing Instalment Method</i>
2015 July 1	To Bank (Including Erection Exp.)	₹ 1,00,000	₹ 1,00,000	2015 Dec. 31	By Depreciation Balance c/d	₹ 5,000 95,000	₹ 5,000 95,000
		1,00,000	1,00,000			1,00,000	1,00,000
2016 Jan. 1	To Balance b/d	95,000	95,000	2016 Dec. 31	By Depreciation " Balance	10,000 85,000	9,500 85,500
		95,000	95,000			95,000	95,000
2017 Jan. 1	To Balance b/d	85,000	85,500	2017 Dec. 31	By Depreciation " Balance c/d	10,000 75,000	8,550 76,950
		85,000	85,500			85,000	85,500
2018 Jan. 1	To Balance b/d	75,000	76,950				

(c) Straight Line Method where provision for depreciation account is maintained.

Plant and Machinery Account

2015 July 1	To Bank	₹ 1,00,000	2015 Dec. 31	By Balance c/d	₹ 1,00,000
		1,00,000			1,00,000
2016 Jan. 1	To Balance b/d	₹ 1,00,000	2016 Dec. 31	By Balance c/d	₹ 1,00,000
		1,00,000			1,00,000
2017 Jan. 1	To Balance b/d	1,00,000	2017 Dec. 31	By Balance c/d	1,00,000
		1,00,000			1,00,000
2018 Jan. 1	To Balance b/d	1,00,000			

Provision for Depreciation Account

2015		₹	2015		₹
Dec. 31	To Balance c/d	5,000	Dec. 31	By Depreciation	5,000
		5,000			5,000
2016			2016		
Dec. 31	To Balance c/d	15,000	Jan. 1	By Balance b/d	5,000
		15,000	Dec. 31	” Depreciation	10,000
					15,000
2017			2017		
Dec. 31	To Balance c/d	25,000	Jan. 1	By Balance b/d	15,000
		25,000	Dec. 31	” Depreciation	10,000
					25,000
			2018		
			Jan. 1	By Balance b/d	25,000

(d) Reducing Instalment Method where provision for depreciation account is maintained.

Plant and Machinery Account is maintained at its original cost, and the same is shown already.

Depreciation is calculated as usual and the same is credited in the provision for depreciation account.

Provision for Depreciation

2015		₹	2015		₹
Dec. 31	To Balance c/d	5,000	Dec. 31	By Depreciation (for six months)	5,000
		5,000			5,000
2016			2016		
Dec. 31	To Balance c/d	14,500	Jan. 1	By Balance b/d	5,000
		14,500	Dec. 31	By Depreciation (10% on 95,000)	9,500
					14,500
2017			2017		
Dec. 31	To Balance c/d	23,050	Jan. 1	By Balance b/d	14,500
		23,050	Dec. 31	By Depreciation (10% on 85,500)	8,550
					23,050
			2018		
			Jan. 1	By Balance b/d	23,050

Sale of Asset : If an asset is discarded and disposed of, the sale value is credited to the asset account. Depreciation is charged for the period of use during the relevant year. Balance in the asset account, if any being profit or loss, is transferred to the profit and loss account. When a portion of the asset is disposed of, it is better to open a separate account called 'Machinery Disposal Account' and this account is debited with the value of the asset disposed of and the concerned asset account is credited. Where the asset is maintained at its cost and a separate provision for depreciation account is maintained then the steps are:

1. Machinery Disposal Account is debited with the cost of the discarded portion of the asset and the concerned asset account is credited.
2. The accumulated depreciation for the discarded asset is transferred from the provision for depreciation account to the machinery disposal account by debiting the provision account and crediting the machinery disposal account.
3. Depreciation is charged in Machinery Disposal Account for the period (during the year the asset was used).
4. The sale proceeds are credited and the balance being profit or loss is transferred to the profit and loss account.

Illustration 2

Continuing the previous illustration, on 30th June, 2018, part of the plant and machinery purchased on 1st July, 2015, for ₹ 50,000 sold for ₹ 30,000. Show the Plant and Machinery Account for the year 2018.

Solution:

(a) Under Straight Line Method

Plant and Machinery Account

2018 Jan. 1	To Balance b/d	₹ 75,000	2018 June 30	By Depreciation	₹ 2,500
				" Bank	30,000
				" Profit and Loss (Loss transferred)	5,000
			Dec. 31	" Depreciation	5,000
				" Balance c/d	32,500
		75,000			75,000
2019 Jan. 1	To Balance b/d	32,500			

Workings:

$$\text{Depreciation on 30th June} = 50,000 \times \frac{10}{100} \times \frac{6}{12} = 2,500$$

Loss on Sale:	Value of the asset disposed of on June 30, 2018 = $\frac{75,000}{1,00,000} \times 50,000 =$	37,500
	<i>Less</i> : Depreciation written off	2,500
		35,000
	<i>Less</i> : Sales value realised	30,000
	Loss on sale of Machinery	5,000

(b) Under Reducing Instalment Method

Plant and Machinery Account

2018		₹	2018		₹
Jan. 1	To Balance b/d	76,950	June 30	By Depreciation	1,924
				” Bank	30,000
				” Profit and Loss (Loss transferred)	6,551
			Dec. 31	” Depreciation 10% on 38,475	3,848
				” Balance c/d	34,627
		76,950			76,950

Workings:

Present Value of the asset disposed of:	$\frac{76,950}{1,00,000} \times 50,000$	=	38,475
<i>Less</i> : Depreciation at 10% for 6 months:	$38,475 \times \frac{10}{100} \times \frac{6}{12}$	=	1,924
			36,551
<i>Less</i> : Sale Proceeds realised			30,000
			6,551
	Loss on Sale of Asset		

(c) Under Straight Line Method Where Provision for Depreciation Account is Maintained.

Plant and Machinery Account

2018		₹	2018		₹
Jan. 1	To Balance b/d	1,00,000	June 30	By Provision for Depreciation	12,500
				Depreciation Account	2,500
				” Bank	30,000
				” Profit and Loss	
				(Loss transferred)	5,000
			Dec. 31	” Balance c/d	50,000
		1,00,000			1,00,000
2019					
Jan. 1	To Balance b/d	50,000			

Provision for Depreciation Account

2018		₹	2018		₹
June 30	To Plant and		Jan. 1	By Balance b/d	25,000
	Machinery Account	12,500	Dec. 31	” 10% on ₹ 50,000 for 1 Year	5,000
	” Balance c/d	17,500			
		30,000			30,000
			2019		
			Jan. 1	” Balance b/d	17,500

Workings:

1. Depreciation transferred on 30th June from provision for Depreciation Account to the Plant and Machinery Account for the item sold.
Depreciation Charged upto 31st December, 2017

	₹
$\frac{25,000}{1,00,000} \times 50,000 =$	12,500
Depreciation from 1st Jan. 2018 to 30th June, 2018	
$50,000 \times \frac{10}{100} \times \frac{6}{12} \times =$	2,500
2. Loss on Sale of Plant and Machinery	
Original Cost of the Machine	50,000
Less: Depreciation Charged upto 30th June, 2018	15,000
	35,000
Less: Sale Valued realised	30,000
	5,000

(d) Under Reducing Instalment Method Where Provision for Depreciation Account is Maintained.

Plant and Machinery Account

2018		₹	2018		₹
Jan. 1	To Balance b/d	1,00,000	June 30	By Provision for Depreciation A/c	11,525
				Depreciation	1,924
				” Bank	30,000
				” Profit and Loss	
				(Loss transferred)	6,551
Dec. 31				” Balance c/d	50,000
		1,00,000			1,00,000
2019					
Jan. 1	To Balance b/d	50,000			

Provision for Depreciation Account

2018		₹		₹	2018
June 30	To Plant and Machinery Account	11,525	Jan. 1	By Balance b/d	23,050
Dec. 31	" Balance c/d	15,373	Dec. 31	" Depreciation	3,848
		26,898			26,898
			2019		
			Jan. 1	By Balance b/d	15,373

Workings:

- Depreciation transferred on 30th June from provision for depreciation account to the Plant and Machinery account for the item sold.

Depreciation Charged upto 31st Dec. 2017

$$\frac{23,050}{1,00,000} \times 50,000 = 11,525$$

- Depreciation from 1st Jan., 2018 to 30th June, 2018 for the asset disposed of ₹

$$(50,000 - 11,525) \times \frac{10}{100} \times \frac{6}{12} = 1,924$$

- Loss on sale of Plant and Machinery:

Original Cost of the Machine	50,000
<i>Less:</i> Depreciation Charged upto 30th June, 2018	13,449
	36,551
<i>Less:</i> Sale Value realised	30,000
	6,551

Illustration 3

On 1.1.2016 machinery was purchased for ₹ 80,000. On 1.1.2017 additions were made to the amount of ₹ 40,000. On 31.3.2018 machinery purchased on 1.1.2017, costing ₹ 12,000, was

sold for ₹ 11,000 and on 30.6.98 machinery purchased on 1.1.2016 costing ₹ 32,000 was sold for ₹ 26,700. On 1.10.2018 additions were made to the amount of ₹ 20,000. Depreciation was provided at 10% p.a. on the diminishing balance method.

Show the Machinery Account for the three years 2016 to 2018 (year ended on December 31).

(ICWA, Inter)

Solution:

Machinery Account

2016 Jan. 1	To Bank	₹ 80,000	2016 Dec. 31	By Depreciation	₹ 8,000
			Dec. 31	" Balance c/d	72,000
		80,000			80,000
2017 Jan. 1	To Balance b/d	72,000	2017 Dec. 31	By Depreciation	11,200
Jan. 1	" Bank	40,000	Dec. 31	" Balance c/d	1,00,800
		1,12,000			1,12,000
2018 Jan. 1	To Balance b/d	1,00,800	2018 Mar. 31	By Depreciation	270
	" Profit and Loss (Profit transferred)	470	June 30	" Bank	11,000
	" Profit and Loss (Profit transferred)	2,076	Dec. 31	" Depreciation	1,296
Oct. 1	" Bank	20,000		" Bank	26,700
		1,23,346		" Depreciation	6,908
				" Balance c/d	77,172
					1,23,346
2019 Jan. 1	To Balance b/d	77,172			

Workings:

1. Machinery purchased on 1.1.2017	₹	12,000
Less: Depreciation for 2017		1,200
Balance on 1.1.2018		<u>10,800</u>
	₹	
Less: Depreciation for 3 months in 2018		270
		<u>10,530</u>
Sold for ₹ 11,000, profit being ₹ 470, i.e., (11,000 – 10,530)		

2. Cost of the machinery on 1.1.2016	32,000
<i>Less:</i> Depreciation for the year 2016	3,200
Balance on 1.1.2017	<u>28,800</u>
<i>Less:</i> Depreciation for the year 2017	2,880
Balance on 1.1.2018	<u>25,920</u>
Depreciation for the year 2018 (6 months) at 10%	1,296
	<u>24,624</u>

Sold for ₹ 26,700, resulting in a profit of ₹ 2,076, *i.e.* (26,700 – 24,624)

Calculation of Depreciation for the remaining assets:

Book value of the assets on 1.1.2018	1,00,800
Book value of the assets on 1.1.2018 sold during the year (10,800+25,920)	36,720
	<u>64,080</u>
Depreciation for the old assets	6,408
Depreciation for the new asset purchased on 1.10.2018 10% on ₹ 20,000 for 3 months	500
	<u>6,908</u>

Illustration 4

The cost of the machinery in use with Raju & Co. on 1st Jan., 2018, was ₹ 3,00,000 against which the depreciation provision stood at ₹ 1,00,000 on that date. The firm provided depreciation at 10% on the diminishing value.

On 1st July, 2018, a machine costing ₹ 40,000 purchased on 1st Jan., 2016, was sold for ₹ 30,000 and on the same date another machine was purchased for ₹ 50,000.

Show the following accounts in the books of Raju & Co. for the year 2018:

1. Machinery Account
2. Provision for Depreciation Account
3. Machinery Disposal Account.

Solution:

Machinery Account

2018		₹	2018		₹
Jan. 1	To Balance b/d	3,00,000	July 1	By Machinery Disposal	40,000
July 1	” Bank	50,000	Dec. 31	” Balance c/d	3,10,000
		3,50,000			3,50,000
2019					
Jan. 1	”Balance b/d	3,10,000			

Provision for Depreciation Account

2018		₹	2018		₹
July 1	To Machinery Disposal	7,600	Jan. 1	By Balance b/d	1,00,000
Dec. 31	” Balance c/d	1,11,660	Dec. 31	” Depreciation	19,260
		1,19,260			1,19,260
			2018		
			Jan. 1	” Balance b/d	1,11,660

Machinery Disposal Account

2018		₹	2018		₹
July 1	To Machinery Account	40,000	July	By Provision for Dep.	7,600
				” Depreciation	1,620
				” Bank	30,000
				” Profit & Loss — Loss transferred	780
		40,000			40,000

Workings:

1. Depreciation provided for the machine disposed of on 1st Dec. 31, 2017: Depreciation provided

	₹	₹
Value of the Machine on 1.1.2016	40,000	
Depreciation for 2016	<u>4,000</u>	4,000
	36,000	

Depreciation for 2017	3,600	3,600
	<u>32,400</u>	
Depreciation for 6 months $(32,000 \times \frac{10}{100} \times \frac{6}{12})$	1,620	1,620
	<u>30,780</u>	<u>9,220</u>

Loss of sale of machine ₹ 780, *i.e.* (30,780 – 30,000)

Depreciation provided for the machine being ₹ 9,220.

2. Depreciation on the machinery in use:

	<i>Original Cost</i>	<i>Depreciation provided</i>
On 1.1.2018	3,00,000	1,00,000
Less: Value of the asset sold	<u>40,000</u>	<u>7,600</u> (upto Dec. 31, 2017)
	2,60,000	92,400
Depreciation at 10% on 1,67,600, <i>i.e.</i> (2,60,000 – 92,400)	16,760	
Add : Depreciation for 6 months on 50,000 (addition)	2,500	
	<u>19,260</u>	

Change in Method of Depreciation: A firm may change the method of charging the depreciation from the Straight Line Method to the Diminishing Balance Method or vice versa. In such cases the change may be effected from the current year onwards or retrospectively. If the change is purely from the current year onwards then depreciation for the current year is charged on the changed method. In case, the change is with retrospective effect, then the depreciation is calculated according to the revised basis for the retrospective period and the total depreciation under the new method is compared with the depreciation charged so far on the old basis and the excess or short depreciation is reversed or charged in the books of accounts by crediting or debiting the profit and loss account as a separate item.

Illustration 5

Nachiar & Co. depreciates its machinery at 10% on Diminishing Balance Method, had on 1st Jan., 2016, ₹ 4,05,000 to the debit of Machinery Account. During the year 2016, part of the machinery purchased on 1st Jan., 2014 for ₹ 1,00,000 was sold for ₹ 75,000 on 1st July, 2016, and a new machinery at a cost of ₹ 1,00,000 was purchased and installed on the same date. The firm decided to change its method of depreciation from Diminishing Balance Method to Straight Line Method with effect from 1st January, 2014, and adjust the difference in the accounts for 2016. The rate of depreciation remains the same as before. Show the Machinery Account for the year 2016.



Solution:

Machinery Account

		₹				₹	
2016				2016			
Jan. 1	To Balance b/d	4,05,000		July 1	By Depreciation	4,050	
July 1	" Bank	1,00,000			" Bank	75,000	
					" Profit & Loss Account (Loss on Sale transferred)	1,950	
				Dec. 31	" Profit and Loss Account (Excess Dep. charged)	4,000	
					" Depreciation	45,000	
					" Balance c/d	3,75,000	
		5,05,000				5,05,000	
2017							
Jan. 1	To Balance b/d	3,75,000					

Working Notes:

1. Calculation of the book value of the asset on 1st Jan., 2014

$$4,05,000 \times \frac{100}{81} = 5,00,000$$

2. Calculation of the Profit/Loss on machinery sold on 1st July, 2016

		₹	
Value on 1.1.2014		1,00,000	
Less :	Depreciation for 2014 at 10% p.a.	10,000	
		90,000	
Less :	Depreciation for 2015	9,000	
		81,000	
Less:	Depreciation for 6 months during 2016 at 10% p.a.	4,050	
		76,950	
	Sale Proceeds	75,000	
	Loss on Sale	1,950	

3. Calculation of the difference of Depreciation to be charged or reversed

	<i>Under Diminishing Balance Method</i>	<i>Under Straight Line Method</i>
Value on 1.1.2014	4,00,000	4,00,000
Less : Depreciation for 2014	40,000	40,000
	3,60,000	3,60,000
Less: Depreciation for 2015	36,000	40,000
Value on 1.1.2016	3,24,000	3,20,000

The excess depreciation to be charged to the machinery account ₹ 4,000, i.e. (80,000 - 76,000) being the difference of depreciation under Straight Line Method (₹ 80,000) and the Diminishing Balance Method (₹ 76,000).

4. Calculation of depreciation for 2016	₹
10% of the Original Cost of the asset remains in the business ₹ 4,00,000	40,000
For the additional Machinery 10% of ₹ 1,00,000 for 6 months	<u>5,000</u>
	<u>45,000</u>

Annuity Method

Under Straight Line Method and the Reducing Instalment Method the interest lost on the amount invested on the asset is not included while calculating the amount of depreciation. So, under annuity method where the loss of interest is due to the investment made in the form of an asset is considered while calculating the depreciation. For example, if a lease is taken for five years at ₹ 2,000, the loss is not only ₹ 2,000, but it is something more than ₹ 2,000. So to say, if the amount is not invested in the lease and invested in securities it would have earned an income called interest and that notional income is also included and treated as loss while calculating the depreciation under this method. The exact amount that would be written off as depreciation by including the interest factor (at a given rate of interest for a particular year) can be calculated with the help of annuity table.

Accounting Entries:

- | | |
|-------------------------|-----|
| 1. Depreciation Account | Dr. |
| To Asset Account | |
| 2. Asset Account | Dr. |
| To Interest Account | |

Annuity Table

Periodic payment required to amortize ₹ 1 and Interest.

$$\left(\frac{i}{1 - \frac{1}{(1+i)^n}} \right)$$

Period	3%	4%	5%	6%
1	1.030000	1.040000	1.050000	1.060000
2	.522611	.530196	.537805	.545437
3	.353530	.360349	.367209	.374110
4	.269027	.275490	.282012	.288591
5	.218355	.224628	.230975	.237396
6	.184598	.190762	.190717	.203363
7	.160506	.166610	.172820	.179135
8	.142456	.148528	.154722	.161036
9	.128434	.134493	.140690	.147022
10	.117231	.123291	.129505	.135868
15	.083767	.089941	.096342	.102963
20	.067216	.073582	.080243	.087185
25	.057428	.064012	.070952	.078227
30	.051019	.057830	.065051	.072649
35	.046539	.053577	.061072	.068974
40	.043262	.050523	.058279	.066462
45	.040785	.048262	.056262	.064701
50	.038866	.046550	.054777	.064344

Illustration 6

A Lease is purchased on 1st January, 2011, for a term of 5 years by payment of ₹ 40,000. It is proposed to depreciate the lease by the annuity method charging 5 per cent interest. If annuity of ₹ 1 for 5 years at 5% is 0.230975, show the Lease Account for the full period.

Solution:

To write off ₹ 40,000, the amount to be written off every year is ₹ 9,239, *i.e.*, $0.230975 \times 40,000$.

Lease Account

Dr.			Cr.		
2011		₹	2011		₹
Jan. 1	To Bank	40,000.00	Dec. 31	By Depreciation	9,239.00
Dec. 31	" Interest	2,000.00		" Balance c/d	32,761.00
		42,000.00			42,000.00
2012			2012		
Jan. 1	To Balance b/d	32,761.00	Dec. 31	By Depreciation	9,239.00
Dec. 31	" Interest	1,638.05		" Balance c/d	25,160.05
		34,399.05			34,399.05
2013			2013		
Jan. 1	To Balance b/d	25,160.05	Dec. 31	By Depreciation	9,239.00
Dec. 31	" Interest	1,258.00		" Balance c/d	17,179.05
		26,418.05			26,418.05
2014			2014		
Jan. 1	To Balance b/d	17,179.05	Dec. 31	By Depreciation	9,239.00
Dec. 31	" Interest	858.95		" Balance c/d	8,799.00
		18,038.00			18,038.00
2015			2015		
Jan. 1	To Balance b/d	8,799.00	Dec. 31	By Depreciation	9,239.00
Dec. 31	" Interest	440.00			
		9,239.00			9,239.00

Sinking Fund Method

Under this method, an amount equal to the amount written off as depreciation is invested in outside securities in order to facilitate to replace the asset at the expiry of its life period. In this method the amount of depreciation is calculated by eliminating the interest factor which will be earned by the investment made by the organisation. For example, if a lease is purchased for 5 years by paying ₹ 40,000, the depreciation charged would not be ₹ 8,000 but a sum below ₹ 8,000 because the investment plus interest put together will be almost equal to ₹ 40,000 at the end. In this method interest factor is eliminated from the total value of the asset to be written off. But under Annuity method interest factor is included with the total value of the asset and then it is written off.

The depreciation under this method can be calculated with the help of a sinking fund table for a particular period at a given rate of interest.

The very purpose of following the sinking fund method is to replace the asset at the expiry of its life but in practice due to inflationary trend it is very difficult to replace the asset with the funds available by adopting this method.

Accounting Entries

First Year:

For Purchase of Asset	1. Asset Account	Dr.
	To Bank Account	
For Providing the Depreciation	2. Depreciation Account	Dr.
	To Depreciation Fund Account	
For Investing the amount	3. Depreciation Fund Investment Account	Dr.
	To Bank Account	

Subsequent Years:

For Receipt of Interest	1. Bank Account	Dr.
	To Interest on Depreciation Fund Investment Account	
For Transferring the Interest	2. Interest on Depreciation Fund Investment Account	Dr.
	To Depreciation Fund Account	
For Providing the Depreciation	3. Depreciation Account	Dr.
	To Depreciation Fund Account	
For Investing the amount	4. Depreciation Fund Investment Account	Dr.
	To Bank Account	

7	.130506	.126610	.122820	.119135
8	.112456	.108528	.104722	.101036
9	.098434	.094493	.090690	.087022
10	.087231	.083291	.079505	.075868
15	.053767	.049941	.046342	.042963
20	.037216	.033582	.030243	.027185
25	.027428	.024012	.020952	.018227
30	.021019	.017830	.015051	.012649
35	.016539	.013577	.011072	.008974
40	.013262	.010523	.008278	.006462
45	.010785	.008262	.006262	.004701
50	.008866	.006550	.004777	.003444

Illustration 7

A lease is purchased on 1st Jan., 2011, for a term of 5 years by payment of ₹ 40,000. The lease is to be renewed at the end of 5 years for which purpose a sinking fund is established. It is expected that securities will earn 5 per cent interest. Sinking Fund tables show that ₹ 0.180975 invested each year will produce ₹ 1 at the end of 5 years at 5 per cent. Investments are made in multiples of rupees ten.

On December 31, 2015, the investments were sold at a profit of 10 per cent. On 1st Jan. 2016, the same lease is renewed for a further period of 5 years by payment of ₹ 45,000.

Show journal entries and give the important ledger accounts to record the above.

Solution:**Journal**

2011			₹	₹
Jan. 1	Lease Account	Dr.	40,000	
	To Bank Account			40,000
	(Purchase of Lease)			
Dec. 31	Depreciation Account	Dr.	7,239	

		To Depreciation Fund Account (Depreciation provided $40,000 \times 0.180975$)		7,239
	" "	Depreciation Fund Investment Account Dr.	7,240	
		To Bank Account (Investment purchased)		7,240
2012				
Dec.31		Bank Account Dr.	362	
		To Interest on Depreciation Fund Investment Account (Interest received at the rate of 5% on ₹ 7,240)		362
	" "	Interest on Depreciation Fund Investment Account Dr.	362	
		To Depreciation Fund Account (Interest transferred to Depreciation Fund Account)		362
	" "	Depreciation Account Dr.	7,239	
		To Depreciation Fund Account (Depreciation provided)		7,239
2012		Depreciation Fund Investment Account Dr.	7,600	
Dec. 31		To Bank ($362 + 7,239 = 7,601$ purchase of investment for the annual instalment plus interest received)		7,600
2013				
Dec.31		Bank Account Dr.	742	
		To Interest on Depreciation Fund Investment Account		742
	" "	Interest on Depreciation Fund Investment Account Dr.	742	
		To Depreciation Fund Account (Interest transferred to Depreciation fund Account)	742	
	" "	Depreciation Account Dr.	7,239	
		To Depreciation Fund Account (Depreciation provided)		7,239

	” ”	Depreciation Fund Investment Account Dr.	7,980	
		To Bank Account		7,980
		(742 + 7,239 = 7,981 purchase of investment for the annual instalment plus interest received)		
2014				
Dec. 31		Bank Account Dr.	1,141	
		To Interest on Depreciation Fund Investment Account		1,141
		(Interest received at the rate of 5% on ₹ 22,820)		
	” ”	Interest on Depreciation Fund Investment Account Dr.		1,141
		To Depreciation Fund Account		1,141
		(Interest transferred to Depreciation Fund Account)		
	” ”	Depreciation Account Dr.	7,239	
		To Depreciation Fund Account		7,239
		(Depreciation provided)		
	” ”	Depreciation Fund Investment Account Dr.	8,380	
		To Bank Account		8,380
		(1,141 + 7,239 = 8,380 purchase of investment for the annual instalment plus interest received)		
2015				
Dec. 31		Bank Account Dr.	1,560	
		To Interest on Depreciation Fund Investment Account		1,560
		(Interest received at the rate of 5% on ₹ 31,200)		
	” ”	Interest on Depreciation Fund Investment Account Dr.		1,560
		To Depreciation Fund Account		1,560
		(Interest transferred to Depreciation Fund Account)		
	” ”	Depreciation Account Dr.	7,239	
		To Depreciation Fund Account		7,239
		(Depreciation provided)		
	” ”	Bank Account Dr.	34,320	
		To Depreciation Fund Investment Account		34,320
		(₹ 31,200 investments sold at a profit of 10%)		

2015	Depreciation fund Investment Account	Dr.	3,120	
Dec. 31	To Depreciation Fund Account (Profit on sale of investment transferred to Depreciation Fund Account)			3,120
" "	Depreciation Fund Account	Dr.	40,000	
	To Lease Account (Lease being expired transferred to the Depreciation Fund Account)			40,000
" "	Depreciation Fund Account	Dr.	3,120	
	To Profit and Loss Account (Balance in the Depreciation Fund Account transferred to Profit and Loss Account)			3,120
2016	Lease Account	Dr.	45,000	
Jan. 1	To Bank (Lease renewed for a further period of 5 years)			45,000

Lease Account

2011		₹	2011	₹	
Jan. 1	To Bank	40,000	Dec. 31	By Balance c/d	40,000
2012			2012		
Jan. 1	To Balance b/d	40,000	Dec. 31	By Balance c/d	40,000
2013			2013		
Jan. 1	To Balance b/d	40,000	Dec. 31	By Balance c/d	40,000
2014			2014		
Jan. 1	To Balance b/d	40,000	Dec. 31	By Balance c/d	40,000
2015			2015		
Jan. 1	To Balance b/d	40,000	Dec. 31	By Dep. Fund Account	40,000

Lease Account (New)

2016		₹			
Jan. 1	To Bank	45,000			

Depreciation Fund Account

2011		₹	2011		₹
Dec. 31	To Balance c/d	7,239	Dec. 31	By Depreciation Account	7,239
		7,239			7,239
2012		2012			
Dec. 31	To Balance c/d	14,840	Jan. 11	By Balance b/d	7,239
			Dec. 31	” Interest on DFI	362
				” Depreciation Account	7,239
		14,840			14,840
2013		2013			
Dec. 31	To Balance c/d	22,821	Jan. 1	By Balance b/d	14,840
			Dec. 31	” Interest on DFI	742
				” Depreciation	7,239
		22,821			22,821
2014		2014			
Dec. 31	To Balance c/d	31,201	Dec. 1	By Balance b/d	22,821
			Dec. 31	” Interest on DFI	1,141
				” Depreciation	7,239
		31,201			31,201
2015		2015			
Dec. 31	To Lease Account	40,000	Jan. 1	By Balance b/d	31,201
	” Profit and Loss	3,120	Dec. 31	” Interest on DFI	1,560
				” Depreciation	7,239
				” DFI Profit Transferred	3,120
		43,120			43,120

Depreciation Fund Investment Account

2011		₹	2011		₹
Dec. 31	To Bank	7,240	Dec. 31	By Balance c/d	7,240
2012			2012		
Jan. 1	To Balance b/d	7,240	Dec. 31	By Balance c/d	14,840
Dec. 31	To Bank	7,600			
		14,840			14,840
2013			2013		
Jan. 1	To Balance b/d	14,840	Dec. 31	By Balance c/d	22,820
Dec. 31	" Bank	7,980			
		22,820			22,820
2014			2014		
Jan. 1	To Balance b/d	22,820	Dec. 31	By Balance c/d	31,200
Dec. 31	" Bank	8,380			
		31,200			31,200
2015			2015		
Jan. 1	To Balance b/d	31,200	Dec. 31	By Bank	34,320
Dec. 31	" Dep. Fund	3,120			
		34,320			34,320

Interest on Depreciation Fund Account

2012		₹	2012		₹
Dec. 31	To Dep. Fund Account	362	Dec. 31	By Bank	362
2013			2013		
Dec. 31	To Depreciation Fund Account	742	Dec. 31	By Bank	742
2014			2014		
Dec. 31	To Depreciation Fund Account	1,141	Dec. 31	By Bank	1,141
2015			2015		
Dec. 31	To Depreciation Fund Account	1,560	Dec. 31	By Bank	1,560

Depreciation Account

		₹		₹	
2011			2011		
Dec. 31	To Depreciation Fund Account	7,239	Dec. 31	By Profit & Loss Account	7,239
2012		2012			
Dec. 31	To Depreciation Fund Account	7,239	Dec. 31	By Profit & Loss Account	7,239
2013		2013			
Dec. 31	To Depreciation Fund Account	7,239	Dec. 31	By Profit & Loss Account	7,239
2014		2014			
Dec. 31	To Depreciation Fund Account	7,239	Dec. 31	By Profit & Loss Account	7,239
2015			2015		
Dec. 31	To Depreciation Fund Account	7,239	Dec. 31	By Profit & Loss Account	7,239

Insurance Policy Method: Under this method an insurance policy is taken for required sum for replacing the asset to be written off. A fixed premium is paid at the beginning of every year. At the end of the stipulated period, the insurance company will pay the agreed sum (policy value) and the amount will be used for purchasing a new asset.

Accounting Entries:

(a) First and subsequent years (including the last year)

(1) In the beginning of the year — For the premium paid

Depreciation Insurance Policy Account	Dr.
To Bank	

(2) At the end of the accounting year — For providing the depreciation

Profit & Loss Account	Dr.
To Depreciation Reserve Account	

(b) At the end of the Last Year — in addition to the above two entries.

(1) On receiving the money from the insurance company

Bank Account	Dr.
To Depreciation Insurance Policy Account	

Depreciation Reserve Account

2014		₹	2014	₹	
Dec. 31	To Balance c/d	19,000	Jan. 1	By Profit and Loss Account	19,000
2015			2015		
Dec. 31	To Balance c/d	38,000	Jan. 1	By Balance b/d	19,000
			Dec. 31	" Profit and Loss Account	19,000
		38,000			38,000
2016			2016		
Dec. 31	To Lease Account	60,000	Jan. 1	By Balance b/d	38,000
			Dec. 31	" Profit and Loss Account	19,000
				" Depreciation Insurance Policy Account	3,000
		60,000			60,000

Depreciation Insurance Policy Account

2014		₹	2014	₹	
Jan. 1	To Bank — Premium	19,000	Dec. 31	By Balance c/d	19,000
2015			2015		
Jan. 1	" Balance b/d	19,000	Dec. 31	" Balance c/d	38,000
Jan. 1	" Bank — Premium	19,000			
		38,000			38,000
2016			2016		
Jan. 1	To Balance b/d	38,000	Dec. 31	By Bank	60,000
Jan. 1	" Bank — Premium	19,000			
Dec. 31	" Depreciation Reserve Account Profit transferred	3,000			
		60,000			60,000

Revaluation Method

This method is followed where the value of the asset being small in nature (rarely it is high) like cattle (livestock) or loose tools and difficult to maintain the account for each and every item. Moreover calculation of depreciation for every unit is a tedious process. So, the depreciation on these assets is calculated by comparing the opening value of the asset, additional purchases if any and the closing value of such item, for example, the opening value of the loose tools being ₹ 2,000 and during the year ₹ 1,000 worth of tools were purchased, and at the end of the year the tools are considered worth of ₹ 2,500, the depreciation written off being ₹ 500, *i.e.*, ₹ 2,000 + 1,000 - 2,500. In case of cattle though there is a possibility for appreciation in value it is not at all considered.

Illustration 9

(a) A company manufactures loose tools for its own use. At the end of each year depreciation is charged on revaluation method. From the following particulars, show the Loose Tools Accounts:

Year ended 31.12.2011 — Loose tools manufactured: ₹ 5,000

(revalued on 31.12.2011: ₹ 4,100)

Year ended 31.12.2012 — Loose tools manufactured: ₹ 2,700

(revalued on 31.12.2012: ₹ 5,700).

Year ended 31.12.2013 — Loose tools manufactured: ₹ 1,000

(revalued on 31.12.2013: ₹ 6,000)

Year ended 31.12.2014 — Loose tools manufactured: ₹ 1,500

(revalued on 31.12.2014: ₹ 5,100).

The value as on 31.12.2014 is after considering the sale of old tools of the book value ₹ 1,200 (as on 31.12.2014) for ₹ 950.

(ICWA Inter, Dec., 95)

Loose Tools Account

Dr.

Cr.

Date	Particulars	L.F.	₹	Date	Particular	L.F.	₹
2011	To Cost of Production Account		5,000	2011	By Depreciation (Balancing figure)		900
					”Balance c/d		4,100
			5,000				5,000
2012	To Balance b/d		4,100	2012	By Depreciation Account (Balancing figure)		1,100
	” Cost of Production Account		2,700		” Balance c/d		5,700
			6,800				6,800
2013	To Balance b/d		5,700	2013	By depreciation Account (Balancing figure)		700
	” Cost of Production Account		1,000		” Balance c/d		6,000
			6,700				6,700
2014	To Balance b/d		6,000	2014	By Bank Account (Sales Proceeds)		950
	” Cost of Production Account		1,500		”Profit & Loss Account (Loss on Sale ₹ 1200–₹ 950)		250
				2014	By Depreciation Account (Balancing figure)		1,200
					” Balance c/d		5,100
			7,500				7,500
2015	To Balance b/d		5,100				

Depletion Method

This method is followed in case of mines, quarries etc. where the total quantity of the mineral available is estimated in advance and the output may vary every year during the life of the mine or quarry. The depreciation is calculated on the basis of the output for every year. For example, if a mine is purchased for ₹ 10,00,000 and its estimated mineral content being 5,00,000 tonnes, the

depreciation per tonne of output comes to ₹ 2, *i.e.*, $\frac{10,00,000}{5,00,000}$. If the output in the first year is 20,000 tonnes, the depreciation to be written off in the first year will be $20,000 \times 2$, *i.e.*, ₹ 40,000. In the same manner the depreciation is written off in the subsequent years on basis of the output extracted every year.

Machine Hour Rate Method

This method is more or less similar to the depletion method. Under this method the effective life of the machine is estimated in number of hours utilised every year. If the cost of a machine is ₹ 5,00,000 and the effective life is 1,00,000 hours the hourly depreciation is $\frac{5,00,000}{1,00,000}$ or ₹ 5. If the machine runs for 10,000 hours in a year, the depreciation charged is $10,000 \times 5 = ₹ 50,000$.

$$\text{Depreciation} = \frac{\text{Original cost of the machine} - \text{Scrap Value}}{\text{Effective Life of the Machine in Hours}}$$

Sum of Years Digits Method

This method is similar to the diminishing balance method. Under this method, the amount of depreciation to be charged to the Profit and Loss Account will be decreasing every year. The depreciation is calculated by using the following formula:

$$\frac{\text{Remaining Life of the Asset (including the Current year)}}{\text{Sum of all the digits of the life of the asset in years}} \times \text{Cost of the Asset}$$

For example, if the cost of an asset is ₹ 15,000 and its effective life being 5 years, the amount of depreciation to be written off each year will be calculated as follows:

The sum of all the digits is 15, *i.e.*, $1 + 2 + 3 + 4 + 5$

By applying the formula,

$$\begin{aligned} \text{Depreciation for the 1st year} &= \frac{5}{15} \times 15,000 = 5,000 \\ \text{for the 2nd year} &= \frac{4}{15} \times 15,000 = 4,000 \end{aligned}$$

Depreciation is calculated in the same manner for the 3rd, 4th and 5th years.

Repairs Provision Method

Under this method a composite yearly charge is made to cover repairs, maintenance and depreciation. Yearly amount to be written off for depreciation, repairs and maintenance is explained in the following example:

Example:

Cost of the machine	₹ 1,10,000
Estimated Scrap Value	₹ 10,000
Estimated amount for repairs, and maintenance during the life of the machine	₹ 50,000
Estimated life of the machine	10 years

Answer: Cost of the Machine	₹ 1,10,000
Less: Estimated Scrap Value	₹ 10,000
	1,00,000
Add: Estimated amount for repairs and maintenance	50,000
	1,50,000
Amount to be charged in 10 years	1,50,000
Amount to be charged each year	$\frac{1,50,000}{10 \text{ years}} = 15,000$
Entry: Profit and Loss Account	Dr. 15,000
To Depreciation Provision Account	10,000
To Repairs Provision Account	5,000

(Out of the total amount of ₹ 15,000, ₹ 5,000 is charged to repairs provision, *i.e.*, $50,000 \div 10$ and the balance to the depreciation provision.)

Repairs Provision Account	Dr.
To Bank Account	
(For the Actual Repairs)	

7.7 Summary

Depreciation is a slow, gradual, continuous, permanent decline/decrease/reduction in the value of fixed assets due to wear and tear, efflux of time, natural calamities exhaustion/depletion, obsolescence/outdated etc.

Provision is a charge against profits, provided for the purposes of meeting a known loss like doubtful debts, an unpaid liability for expenses already incurred. It is provided irrespective of profit or loss made by the business.

Reserve is an appropriation of profit, created for a specific purpose like Debenture Redemption Fund. Reserves are classified into Capital Reserve and General Reserve.

The **objectives** of providing depreciation are to find the true profit or loss of the business to show the asset at its right value in the balance sheet and to provide funds for asset replacement.

The different methods of providing depreciation are:

- (a) Straight Line Method
- (b) Reducing Installment Method
- (c) Annuity Method
- (d) Depreciation Fund Method
- (e) Insurance Policy Method
- (f) Revaluation Method
- (g) Depletion Method
- (h) Machine Hour Rate Method
- (i) Repair Provision Method and
- (j) Sum of the Digits Method.

7.8 Key Words/Abbreviations

- **Depreciation:** Depreciation is a gradual, continuous and permanent decline in the value of fixed assets due to passage of time, obsolescence, exhaustion, wear and tear etc.
- **Exhaustion:** Wasting assets like quarries, miner oil wells get physically exhausted, by the removal of its contents. It is the reduction in the value of natural deposits, as resources have been extracted.



- **Obsolescence:** Obsolescence means outdatedness. when new and improved machines with better features are introduced, old machines become outdated or obsolete and have to be discarded and replaced by new machines, which are more efficient.
- **Provision:** Provision is a charge against profits, provided for meeting a known loss like doubtful debts, an unpaid, liability for expenses already incurred. It is provided whether there is profit or loss in the business.
- **Reserve:** Reserve is an appropriation of profit, created for a specific purpose like Debenture Redemption Reserve/Funds.
- **Fixed Instalment Method:** In fixed instalment method of providing or charging depreciation, depreciation is provided on the original cost of the asset. The depreciation amount is constant or fixed in this method.
- **Reducing Balance Method:** In reducing balance method of providing depreciation, in the first year depreciation is charged on the original cost of the asset and in the subsequent years, depreciation is charged on the written down value of the asset, at the beginning of each subsequent years. The depreciation amount goes on reducing in this method.
- **Annuity Method:** Under annuity method, where the loss of interest is due to the investment made in the form of an asset is considered, while calculating the depreciation.
- **Depreciation Fund Method:** In this method, an amount equal to the amount written off depreciation is invested in outside securities, in order to help in replacing the asset, at the end of its life period.
- **Depletion Method:** This method is followed in case of miner, quarries, oil wells etc. where the total quantity of the mineral available is estimated in advance and the output may vary every year during the life of the mine or quarry or oil well. The depreciation is calculated on the basis of the output of every year.
- **Insurance Policy Method:** In this method, an insurance policy is taken for required amount for replacing the asset to be written off. A fixed premium is paid at the beginning of every year. At the end of the stipulated period, the insurance company will pay the agreed sum (policy value) and the amount will be used for purchasing a new asset.

- **Repairs Provision Method:** In this method, a composite yearly charge is made to cover repairs, maintenance and depreciation.
- **Machine Hour Rate Method:** In this method, the effective life of the machine is estimated in number of hours used every year.
- **Sum of the digits Method:** In this method, the formula for calculating depreciation is as follows:

$$\frac{\text{Remaining Life of the asset (including the current year)}}{\text{Sum of all the digits of the life of the asset in years}} \times \text{Cost of Assets}$$

7.9 Learning Activity

1. On 1st April, 2004 Messrs Heera & Co. Kalyan purchased machinery for ₹ 80,000 and spent ₹ 5,000 on its installation. On 1st October in the same year. they purchased another machine for ₹ 60,000.

On 31st March, 2006 the machinery purchased on 1st April, 2004 was sold for ₹ 68,000. On 1st April, 2006 a new machine was installed at a cost of ₹ 70,000.

Messers Heera & Co. charge depreciation @ 10% p.a. on the original cost. The accounts are closed on 31st March every year.

Show Machinery Account and Depreciation Account for the year 2004-05, 2005-06 and 2006-07.

2. Arun Traders, Mumbai purchased machinery on 1st October, 2004 for ₹ 14,000 and decided to depreciate the machinery at 10% p.a. under Straight Line Method.

On 1st April, 2005, a new machinery was purchased for ₹ 20,000. On 1st October, 2006, a machinery purchased on 1st October, 2004, was sold for ₹ 10,000 and on 31st March, 2007, a new machinery was purchased for ₹ 25,000.

Prepare Machinery A/c and Depreciation A/c for the years 2004-05, 2005-06 and 2006-07 assuming that the financial year ends on 31st March every year.

3. Ameet Traders, Mumbai, Purchased furniture on 1-4-04 for ₹ 15,000. In the same year on 1st October additional furniture was purchased for ₹ 8,000.

On 1-10-05, the furniture purchased on 1-4-04 was sold for ₹ 10,000 and on the same day new furniture was purchased for 12,000.

The firm charged depreciation at 10% p.a. on Reducing Balance Method. Prepare-Furniture A/c and Depreciation A/c for the years ending on 31st March 2005, 2006 and 2007.

7.10 Unit End Questions (MCQ and Descriptive)

A. Descriptive Types Questions

1. What is depreciation?
2. What is provision and what are reserves?
3. Explain the causes of depreciation.
4. State the objectives of providing depreciation.
5. Explain in brief, the different method of providing depreciation.
6. Explain the straight line method of charging depreciation.
7. Explain the diminishing balance method of providing depreciation.

B. Multiple Choice/Objective Type Questions

1. _____ is a gradual and permanent decline in the value of fixed assets.
(a) Depreciation (b) Appreciation
(c) Amortization (d) None of these
2. Depreciation is charged on _____ assets.
(a) Current (b) Fixed
(c) Intangible (d) Floating

3. Depreciation account is _____ account.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
4. In fixed installment method, the depreciation amount is _____.
- (a) Fixed (b) Reducing
(c) Increasing (d) Decreasing.
5. In reducing balance method, the depreciation amount is _____.
- (a) Increasing (b) Decreasing
(c) Fixed (d) Constant

Answer:

1. - (a), 2. - (b), 3. - (b), 4. - (a), 5 - (b).

7.11 References

1. S.P Jain and K.L. Navang, (1999), "*Advanced Accountancy*", Part I, Kalyani Publishes, Ludhiana.
2. P.C. Tulsian (2003), "*Financial Accounting*", Tata McGraw Hill, New Delhi.

UNIT 8 CAPITAL AND REVENUE ITEMS

Structure:

- 8.0 Learning Objectives
- 8.1 Introduction
- 8.2 Classification of Capital and Revenue
- 8.3 Capital and Revenue Expenditure
- 8.4 Capital and Revenue Receipts
- 8.5 Accounting Treatment
- 8.6 Summary
- 8.7 Key Words/Abbreviations
- 8.8 Learning Activity
- 8.9 Unit End Questions (MCQ and Descriptive)
- 8.10 References

8.0 Learning Objectives

After studying this unit, you will be able to:

- Discuss the classification of capital and revenue
- Analyse what is capital and revenue expenditure
- Describe what is capital and revenue receipts
- Explain their accounting treatment

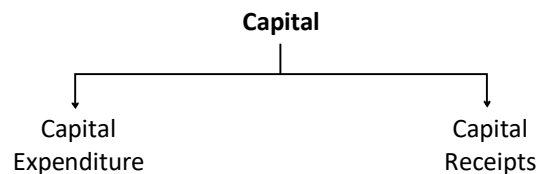


8.1 Introduction

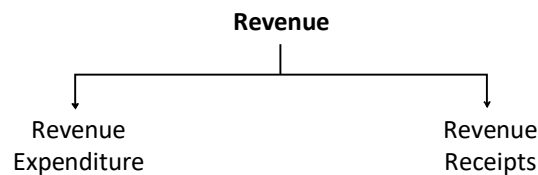
This unit will help you to understand the classification of capital and revenue, know what is capital and revenue expenditure, know what is capital and revenue receipts, know their accounting treatment.

8.2 Classification of Capital and Revenue

- Capital is classified into capital expenditure and capital receipt.



- Revenue is classified into revenue expenditure and revenue receipt.



8.3 Capital and Revenue Expenditure

Capital Expenditure

It is the expenditure, the benefit of which is enjoyed not only for the year in which it is incurred, but for many years. It is the expenditure which results in purchase of fixed assets like land, building machinery, etc. which are used for many years. Capital expenditure is of non-recurring nature or non-repetitive nature. Property purchased or acquired with the help of capital expenditure is used by the business for a long time and thereby it earns revenue or income. The main purpose of capital expenditure is to earn income over a period of years or to increase the earning capacity of the business.

Examples of capital expenditure:

1. Expenditure which results in purchase of fixed assets like purchase of land, construction of building, purchasing of machinery, purchasing of computer, etc.
2. Expenditure in connection with the purchase or installation of fixed assets, such as, wages paid to the workers for installing the machine, carriage paid on purchase of imported machinery, legal charges paid for preparing purchase agreement of fixed assets like land.
3. Expenditure which increases the earning capacity of fixed assets, such as, amount spent on increasing the seating capacity in the cinema hall.
4. Expenditure incurred on the purchase of second hand assets and on putting such assets into working condition.
5. All amount spent up to the point an asset is put to use is treated as capital expenditure. Interest paid on loans taken to purchase or acquire the asset, for the period, before the asset is put to use is capital expenditure and is added to the cost of the asset.

Revenue Expenditure

Any expenditure, the benefit of which is received during the current year itself is called revenue expenditure. Such expenditure does not result in an increase in the earning capacity of the business, but only help, in maintaining the existing earning capacity. Revenue expenditure is recurring or repetitive in nature. Revenue expenditure is incurred for meeting the day to day requirements of the business.

Examples of revenue expenditure:

1. Expenditure incurred for the purpose of day to day running of the business, such as, manufacturing expenses, administrative or office expenses, selling and distribution expenses.
2. In the case of a trader, payment for goods, purchased for resale.

3. In the case of a manufacturer, purchase of raw materials, for converting it into finished goods.
4. Interest on loan for the period, after the asset is put to use.

Deferred Revenue Expenditure

It is a revenue expenditure, but the benefit of this expenditure is received not only for the current year, but for a number of years. Sometimes, a revenue expenditure the benefit of which, is not exhausted in the current year, in which it is incurred is called deferred revenue expenditure.

In such cases, a part of such expenditure is shown in the profit and loss account and the remaining unused part is shown on the asset side of the balance sheet. This accounting treatment is continued, till the expenditure is completely written off.

Examples of deferred revenue expenditure:

Heavy advertising expenditure incurred to introduce a new product, heavy legal expenses, preliminary expenses (expenses incurred in the formation of a new company), etc. A firm incurred an advertising expenditure of ₹ 2 lakhs and the benefit is to be received for 5 years.

Capital Expenditure	Revenue Expenditure
1. It is incurred for purchasing fixed assets, which are meant for use in the business for a long period.	1. It is incurred for acquiring or producing goods for resale.
2. It pertains to inviting activity.	2. It pertains to business activity.
3. It helps to purchase new asset.	3. It helps to maintain an asset.
4. The benefit of capital expenditure is for more than one year.	4. The benefit of revenue expenditure is for one year (current year) only.
5. It is non-recurring in nature.	5. It is recurring in nature.
6. It is not a loss to a concern.	6. It is a loss to a concern.
7. It is shown as an asset in balance sheet.	7. It is show as an expense, on the debit side of profit & loss a/c.
8. It is intended to extend or improve the existing fixed assets.	8. It is intended to maintain the fixed assets in good working condition.

9. It increases revenue earning capacity of a business.	9. It does not increase revenue earning capacity of a business.
10. It reduces funds, but may increase profit in future, from use of assets.	10. It reduces both funds and profits of the current year.
11. Buying fixed assets like machinery, furniture, computers etc. are example of capital expenditure.	10. Purchase of goods, payment of expenses etc. are examples of revenue expenditure

8.4 Capital and Revenue Receipts

Capital Receipts

They are receipts which are not received in the course of normal business activities. Examples are capital from owners loan taken from banks, amount received from sale of fixed assets. Capital receipts are shown on the liabilities side of the Balance Sheet.

Revenue Receipts

They are receipts which arise from business operation. The amount received from revenue receipts is not to be refunded or repaid. Some examples are amount received from sale of goods, fees received, interest received etc. It is shown on the credit side of Profit & Loss a/c.

Capital Receipts	Revenue Receipts
1. It arises out of financing activity.	1. It arises out of business activity.
2. It is non-recurring in nature.	2. It is recurring in nature.
3. It appears on the liabilities side of Balance Sheet.	3. It is shown as an income on the credit side of Profit & Loss a/c.
4. They are not gains to the concern.	4. They are gains to the concern.
5. Capital receipts, which are liabilities are to be repaid.	5. Revenue receipts are not to be repaid, as they are not liabilities.
6. Some capital receipts like deposits received, loans are liabilities.	6. Revenue receipts are not liabilities.
7. Money obtained from sale of fixed assets or investments of shares, debentures, money received from loan taken are example of capital receipt.	7. Money obtained in the course of business are revenue receipts. Examples are money obtained from the sale of goods, interest or deposits dividends.

8. It may decrease funds and profits in future.	8. It increase funds and profits of the current year.
---	---

8.5 Accounting Treatment

Q.1 Classify the following into capital expenditure or revenue expenditure:

1. Purchase of fixed assets like land, machinery computers etc.
2. Wages paid to workers for creation of machine.
3. Carriage paid on machinery.
4. Increase the seating capacity in a cinema hall.
5. Legal charges paid to lawyer for preparing purchase agreement of land.
6. Buying of second hand machinery and putting the machinery into working condition.
7. Interest paid on loan taken to purchase an asset, before the asset is put to use.
8. Expenditure incurred for the purpose of day to day running of the business.
9. Payment for goods, purchased for resale.
10. Purchase of raw materials, for converting it into finished goods.
11. Interest on loan taken to acquire an asset, and after the asset is put to use.

Ans. Capital Expenditure: 1, 2, 3, 4, 5, 6, 7

Revenue Expenditure: 8, 9, 10, 11

Q.2. Classify the following into capital expenditure and revenue expenditure

1. Amount paid as compensation to employees who were retrenched.
2. Amount spent on obtaining a licence for starting a factory.
3. Amount spent on servicing the company's car.
4. Amount spent on painting the factory.
5. Cost of air conditioning the general manager office.
6. Amount spent on replacement of worn-out part of a machine.

7. customs duty paid on raw materials purchased.
8. Wages paid to carpenter for making furniture.
9. Brokerage paid on purchase of land.
10. Payment for stationery purchased.
11. Repayment of a loan taken.
12. Providing depreciation on furniture.
13. Payment of audit fees.
14. Payment of insurance premium.
15. Interest paid on bank overdraft
16. Preliminary expenses paid.
17. Carriage outward paid.
18. It carry repairs to building roof, for protection against rains.
19. Cost of goodwill

Ans. Capital Expenditure: 2, 5, 8, 9, 11, 18, 19

Revenue Expenditure: 1, 3, 4, 6, 7, 10, 12, 13, 14, 15, 16, 17

Q.3. Classify the following into capital receipt and revenue receipt.

1. Capital contributed by the owner(s).
2. Secured or unsecured loans taken.
3. Receipts from the sale of fixed assets.
4. Cash received due to sales.
5. Discount and commission received.
6. Received interest and dividend on investment.
7. Transfer fees.
8. Amount received due to issue of fresh share capital.
9. Deposits received.

10. Premium on shares and debentures.
11. Rent received.
12. Machinery costing ₹ 20,000 sold for ₹ 25,000.
13. Term loan taken from bank
14. Commission received on sales.
15. Amount received due to issue of equity share capital.

Ans. Capital Receipt: 1, 2, 3, 8, 9, 10, 12, 13, 15

Revenue Receipt: 4, 5, 6, 7, 11, 14

8.6 Summary

Capital is classified into capital expenditure and capital receipts.

Revenue is classified into revenue expenditure and revenue receipts.

Capital expenditure is the expenditure, the benefit of which is to be received for a number of years, it is non-recurring in nature and the main purpose is to earn income for many years or to increase the earning capacity of the business.

Revenue expenditure is the expenditure, the benefit of which is received only for the current year. It is recurring in nature and it only helps in maintaining the existing earning capacity of the business.

Capital receipts are receipts, which are not received in the course of normal business activation.

Revenue receipts are receipts, which arise from business operation.

8.7 Key Words/Abbreviations

- **Capital Expenditure:** Capital expenditure is the expenditure which is non-recurring and the benefit of which is to be received for a number of year and the purpose is to earn income for many years or to increase the earning capacity of the business.



- **Revenue Expenditure:** Revenue expenditure is the expenditure which is recurring and the benefit of which is enjoyed only for the current year in which it is incurred. It helps in maintaining the existing earning capacity of the business.
- **Deferred Revenue Expenditure:** Deferred revenue expenditure is the expenditure which is revenue in ----- but the benefit of which will be enjoyed for a number of years.
- **Capital Receipts:** Capital receipts are receipts, which are not received, in the course of normal business activities.
- **Revenue Receipts:** Revenue receipts are receipts, which arise from business operations.

8.8 Learning Activity

1. Out of the following which are capital expenditure, Revenue expenditure and Deferred revenue expenditure?
 - (a) Amount spent on repairs of machine.
 - (b) Expenses to move the stock of goods from one place to another place.
 - (c) Paper purchased for use as stationery.
 - (d) Adding more seats to a cinema hall.
 - (e) Renovation of cinema hall.
 - (f) Brokerage paid in relation to land purchase.
 - (g) Amount spent on overhaul of second hand machine purchased.
 - (h) Preliminary expenses.
 - (i) Heavy amount spent on advertising, for product launching.
2. State whether the following are Capital receipts or Revenue receipts
 - (a) Money raised by issue of equity shares.
 - (b) Setting of old Machinery for ₹ 10,000.
 - (c) Cash of ₹ 5,00,000 brought in the business by the proprietor/owner
 - (d) Amount received on sale of shares held as investment.

- (e) Loan received from bank.
- (f) Interest on loan given.
- (g) Dividend received on shares.
- (h) Recovery of a debt written off as bad debt earlier.
- (i) Amount received from sale of goods.

8.9 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is Capital Expenditure?
2. What is Revenue Expenditure?
3. What is Capital Receipts?
4. What is Revenue Receipts?
5. What is Deferred Revenue Expenditure?
6. Distinguish between Capital Expenditure and Revenue Expenditure.
7. Distinguish between Capital Receipts and Revenue Receipts.

B. Multiple Choice Questions

1. Amount spent on purchase of fixed assets is a _____.
 - (a) Capital expenditure
 - (b) Revenue expenditure
 - (c) Deferred revenue expenditure
 - (d) None of the above
2. Wages paid for creation of machinery is a _____.
 - (a) Capital expenditure
 - (b) Revenue expenditure
 - (c) Deferred revenue expenditure
 - (d) None of the above
3. Legal charges paid for preparing purchase agreement of land is _____.
 - (a) Capital expenditure
 - (b) Revenue expenditure
 - (c) Deferred revenue expenditure
 - (d) None of the above

4. Any expenditure the benefit of which is received only for the current year is _____.
- (a) Capital expenditure (b) Revenue expenditure
(c) Deferred revenue expenditure (d) None of the above
5. _____ is recurring in nature.
- (a) Capital expenditure (b) Revenue expenditure
(c) Deferred revenue expenditure (d) None of the above
6. Payment for goods purchased for resale is _____.
- (a) Capital expenditure (b) Revenue expenditure
(c) Deferred revenue expenditure (d) None of the above
7. Preliminary expenses are as example of _____.
- (a) Capital expenditure (b) Revenue expenditure
(c) Deferred revenue expenditure (d) None of the above
8. Depreciation of fixed assets is a _____.
- (a) Capital expenditure (b) Revenue expenditure
(c) Deferred revenue expenditure (d) None of the above
9. _____ are not received in the course of normal business activities.
- (a) Capital receipts (b) Revenue receipts
(c) Sale of goods (d) None of the above
10. _____ arise from business operations.
- (a) Capital receipts (b) Revenue receipts
(c) Sale of fixed assets (d) None of the above

Answers:

1. (a), 2. (a), 3. (a), 4. (b), 5. (b), 6. (b), 7. (c), 8. (b), 9. (a), 10. (b).

8.10 References

1. A. Mukharjee, M. Hanit (2010), “*Modern Accountancy*” Vol. I, Tata McGraw Hill Education Pvt. Ltd., New Delhi.
2. S.N. Maheshwari, S.K. Maheshwari (2004), “*An Introduction to Accountancy*”, Vikas Publishing House Pvt. Ltd., New Delhi.
3. T.S. Grewal’s “*Double Entry Book-keeping*” (2019), Sultan Chand and Sons (P) Ltd., New Delhi.

UNIT 9 JOINT VENTURE

Structure:

- 9.0 Learning Objectives
- 9.1 Introduction
- 9.2 Concept of Joint Venture
- 9.3 Objectives of Joint Venture
- 9.4 Accounting Treatment
- 9.5 Difference between Joint Venture and Partnership
- 9.6 Summary
- 9.7 Key Words/Abbreviations
- 9.8 Learning Activity
- 9.9 Unit End Questions (MCQ and Descriptive)
- 9.10 References

9.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the concept of Joint Venture
- Discuss the objectives of Joint Venture
- Analyse the accounting treatment of Joint Venture.
- Explain the difference between Joint Venture and Partnership



9.1 Introduction

This unit will help you to understand the concept of Joint Venture, know the objectives of joint venture, know the accounting treatment of joint venture and to know the difference between joint venture and partnership.

9.2 Concept of Joint Venture

Joint Venture is a short term business undertaken jointly by two or more persons who share the profits and losses in an agreed ratio. If there is no agreement concerning the sharing of profits or losses, it is shared equally by all the parties. The parties who have agreed to undertake the joint venture are called co-venturers or Joint Venturers.

Joint Venture may be described as a temporary partnership without the use of firm name. Such temporary partnership comes to an end on the completion of the venture undertaken.

Joint Venture is generally confined to a single deal such as construction of Building, Underwriting of Shares and debentures, Consignment of goods etc.

9.3 Objectives of Joint Venture

The objectives of joint venture are as follows:

- (a) To enter foreign market and even new or emerging market
- (b) To reduce the risk a factor for heavy investment
- (c) To make optimum use of resources
- (d) To gain economics of scale
- (e) To achieve synergy.

9.4 Accounting Treatment

The joint venture accounts can be maintained in any one of the following methods:

Method 1

Each co-venturer is maintaining a joint venture account and other co-venturers' account in his own books of accounts. Every co-venturer records all the transactions in his books in connection with the joint venture.

Accounting entries:

When Separate Set of Books are not Maintained

When separate set of books are not maintained by the co-venturers for joint venture transactions, they make record of the same in their own books. There are two methods of recording in their own books namely:

- (a) When each co-venturer keep record of all transactions.
- (b) When each co-venturers keep record of own transactions only.

When each Co-venturer keep record of all transactions

Under this method, each or more co-venturers make a record of all the transactions. Each Co-venturer gets a copy of the statement of transactions effected by the other co-venturers and makes entries in his books for his own transactions and transactions effected by all the other co-venturers. The accounts prepared under this method are as follows:

Joint Venture Account

Joint Venture account is prepared to ascertain the profit or loss on Joint Venture. It is nominal account in nature. All the expenses relating to Joint Venture are debited to Joint venture account. Sale proceeds and collections are credited to this account.

The balance in this account is the profit or loss which is transferred to the personal accounts of the co-venturers in the agreed ratio.

Personal Accounts of Co-venturers

Personal accounts of all other Co-venturers are also prepared in the books of each party recording the Joint Venture transactions. Each co-venturer's account is credited with material supplied by him to Joint venture and expenses relating to Joint venture paid by him. Debit is given to the co-venturer's account for the sale proceeds and other collections relating to Joint venture received by him. When Final amount is settled each co-venturer's account is closed.

When venturers maintain full records of Joint Venture, the following journal entries are necessary.

1. When goods supplied to Joint Venture from own business stock	Joint Venture Account To Purchases Account	Dr
2. When Joint Venture expenses paid	Joint Venture Account To Cash/Bank Account	Dr
3. When the Material supplied to or expenses paid for Joint venture by other co-venturers	Joint Venture Account To Co-venturer's Account	Dr
4. When the sales made	Cash/Bank Account To Joint Venture Account	Dr
5. When the sales made by other Co-venturers	Co-venturer's Account To Joint Venture Account	Dr
6. When the Venture Profit	Joint Venture Account To Profit and Loss Account (own share) To Co-venturer's Account	Dr
7. When the Venture loss	Profit and Loss Account (Own Share) Co-venturer's Account To Joint Venture Account	Dr Dr
8. When the Final Settlement to co-venturers	Co-venturers Account	Dr
(a) When amount is paid to co-venturers	To Cash/Bank Account	
(b) When amount is received from co-venturers	Cash/Bank Account To Co-venturer's Account	Dr

Illustration 1:

A and B entered into a joint venture in timber. B is to be allowed a commission on sales at 10% and profits are to be shared in the ratio of A 2/3 and B 1/3. A provides timber from stock for ₹ 10,000



and incurs expenses amounting to ₹ 1,000. B pays ₹ 1,000 for unloading and other non recurring expenses. A drew upon B for ₹ 6,000. The draft was accepted and A got it discounted for ₹ 5,760. B sold 90 per cent of the timber for ₹ 15,000 and took over the remaining timber at cost plus 20 per cent. B settles his account by bank draft. Give the Journal Entries and the relevant accounts in the books of both the parties.

Solution:**Books of A
Journal**

<i>Sl.No.</i>	<i>Particulars</i>	<i>LF</i>	<i>₹</i>	<i>₹</i>
1.	Joint Venture Account Dr. To Purchase Account To Bank Account (Goods sent to B Expenses incurred for Joint Venture)		11,000	10,000 1,000
2.	Joint Venture Account Dr. To B Account (Expenses incurred by B)		1,000	1,000
3.	Bills Receivable Account Dr. To B Account (Bill drawn accepted by B)		6,000	6,000
4.	Bank Account Dr. Joint Venture Account (Discount) Dr. To Bills Receivable Account (Bill discounted)		5,760 240	6,000
5.	B Account Dr. To Joint Venture Account (Sale proceeds on joint venture received by B)		15,000	15,000
6.	Joint venture Account Dr. To B Account (For commission)		1,500	1,500
7.	B Account Dr. To Joint Venture Account (Unsold goods (timber) taken by B at cost plus 20%)		1,440	1,440
8.	Joint Venture Account Dr. To Profit and Loss Account To B Account (Profit transferred)		2,700	1,800 900
9.	Bank Account Dr. To B Account (Balance received from B)		7,040	7,040

Joint Venture Account

Dr.

Cr.

	₹		₹
To Sundries		By B Account – Sales	15,000
Goods	10,000	” B Account – Goods taken	1,440
Expenses	1,000		
” B Account Expenses	1,000		
” B Account (Commission)	1,500		
” Discount Account	240		
” Profit and Loss Account	1,800		
” B Account (1/3)	900		
	16,440		16,440

B Account

	₹		₹
To Joint Venture Account – Sales	15,000	By Bills Receivable	6,000
” Joint Venture Account – Goods taken	1,440	” Joint venture Account — Exp.	1,000
		” Joint Venture Account — Commission	1,500
		” Joint Venture Account — Profit	900
		” Bank Account	7,040
	16,440		16,440

Calculation of Timber taken by B

1/10th of Cost	1,000
1/10th of A's Expenses	100
1/10th of B's Expenses	100
	1,200
Add: 20% of ₹ 1,200	240
	1,440

In the Books of B Journal

Sl.No.	Particulars	Dr.	LF	₹	₹
1.	Joint Venture Account To A Account (Goods supplied by A and expenses incurred)	Dr.		11,000	11,000
2.	Joint Venture Account To Cash Account (Expenses incurred for Joint Venture)	Dr.		1,000	1,000

3.	A Account To Bills Payable Account (Bill accepted drawn by A)	Dr.	6,000	6,000
4.	Joint Venture Account To A Account (Discount on bill discounted – borne by A charged to Joint Venture Account)	Dr.	240	240
5.	Cash Account To Joint Venture Account (Goods sold and proceeds received)	Dr.	15,000	15,000
6.	Joint Venture Account To Commission Account (10% commission on ₹ 15,000 charged to Joint Venture Account)	Dr.	1,500	1,500
7.	Purchase Account To Joint Venture Account (Unsold goods taken)	Dr.	1,440	1,440
8.	Joint Venture Account To Profit and Loss Account To A Account (Profit transferred)	Dr.	2,700	900 1,800
9.	A Account To Bank Account (Balance due to A settled by a bank draft)	Dr.	7,040	7,040

Joint Venture Account

To A – Goods	₹ 10,000	By Cash – Sale Proceeds	₹ 15,000
Expenses	1,000	” Purchase – Goods taken	1,440
” Sundries –			
Expenses	1,000		
Commission	1,500		
” A – Discount	240		
” Profit and Loss Account (1/3)	900		
” A Account (2/3)	1,800		
	16,440		16,440

A Account

To Bills Payable Account	₹ 6,000	By Joint Venture Account – Goods	₹ 10,000
” Bank Account	7,040	” Joint Venture Account – Exp.	1,000
		” Joint Venture Account – Discount	240
		” Joint Venture Account – Profit	1,800
	13,040		13,040

Illustration 2:

A and B entered into a joint venture of underwriting the subscription at par of the entire share capital of the Copper Mines Ltd. consisting of 1,00,000 equity shares of ₹ 10 each and to pay all expenses upto allotment. The profits were to be shared by them in the ratio of 3 : 2. The consideration in return for this agreement was the allotment of 12000 other shares of ₹10 each to be issued to them as fully paid. A provided the funds for registration fees ₹ 12,000, advertising expenses ₹ 11,000, expenses on printing and distribution of prospectus ₹ 7,500 and other printing and stationery expenses ₹ 2,000. B contributed towards payment of office rent ₹ 3000, legal charges ₹ 13,750, salary to clerical staff ₹ 9,000 and other petty disbursements ₹ 1,750. The prospectus was issued and applications fell short of the issue by 15,000 shares. A took these over on joint account and paid for the same in full. The venturers received the 12,000 fully paid shares as underwriting commission. They sold the entire holding at ₹ 12.50 less 50 paise brokerage per share. The net proceeds were received by A for 15,000 shares and B for 12,000 shares.

Write out the necessary accounts in the books of both the parties showing the adjustment.

(LCWA, Inter, June, 96)

Solution:

Book of A
Joint Venture with B Account

Dr.

Cr.

To Bank (Registration fees)	₹ 12,000	By Bank (sale proceeds of	₹ 1,80,000
” Bank (Advertising expenses)	11,000	15000 Shares @ ₹ 12 net)	
” Bank (Printing & dist. of Prospectus)	7,500		

" Bank (printing & stationery)	2,000	" B's Account (sale proceeds of	
" B's Account (office rent)	3,000	12000 shares @ ₹ 12 net)	1,44,000
" B's Account (legal charges)	13,750		
" B's Account (salaries)	9,000		
" B's (petty disbursements)	1,750		
" Bank (cost of 15000 shares at /₹ 10 each)	1,50,000		
" Net Profit transferred to:			
Profit & Loss Account	68,400		
B's Account	45,600		
	1,14,000		
	3,24,000		3,24,000

B's Account

Dr.

Cr.

	₹		₹
To Joint Venture Account	1,44,000	By Joint Venture Account	3,000
		" Joint Venture Account	13,750
		" Joint Venture Account	9,000
		" Joint Venture Account	1,750
		" Joint Venture Account	45,600
		(share of profit)	
		" Bank (final payment)	70,900
	1,44,000		1,44,000

**Book of B
Joint Venture with A's Account**

Dr.

Cr.

	₹		₹
To A's Account (Registration fees)	12,000	By A's Account (sale proceeds of	1,80,000
" A's Account (Advertising expenses)	11,000	15000 Shares @ ₹ 12 net)	
" A's A/c (Printing & dist.of prospectus)	7,500	" Bank Account (sale proceeds of	1,44,000
" A's Account (Print & stationery)	2,000	12000 shares @ ₹ 12 net)	

" Bank Account (office rent)	3,000		
" Bank Account (legal charges)	13,750		
" Bank Account (salaries)	9,000		
" Bank Account (petty disbursements)	1,750		
" A's Account (cost of 15000 share at ₹ 10 each)	1,50,000		
" Net Profit transferred to:			
Profit & Loss Account	45,600		
A's Account	68,400		
	1,14,000		
	3,24,000		3,24,000

A's Account

Dr.

Cr.

To Joint Venture Account (sale proceeds of 15000 shares)	₹ 1,80,000	By Joint Venture Account	₹ 12,000
		" Joint Venture Account	11,000
		" Joint Venture Account	7,500
		" Joint Venture Account	2,000
	₹		₹
To Bank (final payment)	70,900	By Joint Venture Account (cost of 15000 shares)	1,50,000
		" Joint Venture Account (share of profit)	68,400
	2,50,900		2,50,900

Method 2: Memorandum Joint Venture Method

Under the memorandum Joint Venture Account Method each co-venturer will record only those transactions relating to the joint venture which are directly concerned with him, and not those of others. Under this method each co-venturer opens a Joint Venture Account including the name of the other co-venturer. For example, if A and B are partners in a joint venture, then in the books of A it

will be termed as 'Joint Venture with B Account' and in the books of B it will be termed as Joint Venture with A Account'. Each co-venturer will record only such transactions which are actually effected by him. For example, if goods are purchased by A for the joint venture, it will be record only by A and not by other co-venturers. Similarly, if goods are sold by B, it will be recorded in the books of B only. This account is in the nature of a personal account and, therefore, will not disclose the profit or loss of the venture. For that purpose, we prepare an additional account called 'Memorandum Joint Venture Account'.

Following are the accounts opened under this method.

(a) Memorandum Joint Venture Account:

When Co-venturers do not maintain record of all the transactions concerning the joint venture, then a Memorandum Joint Venture account is prepared to ascertain the profit or loss on Joint Venture. It is prepared on the basis of own transactions and the information collected from other co-venturers through periodical statement. It is called Memorandum Joint Venture Account because the account is prepared not from ledger balances but on the basis of the informatlon collected from other co-venturers.

Preparation of Memorandum Joint Venture Account is similar to the preparation of Joint Venture Account. All the venture expenses are debited and all the receipts are credited to this account. **You must remember that transactions which do not relate to an item of expense or income are to be excluded from this memorandum Joint Venture Account.** The balance in the Memorandum Joint Venture Account is the profit or loss and is transferred to the co-venturers account in the agreed ratio.

(b) Joint Venture with co-venturer Account:

Joint Venture with co-venturer Account is a personal account is prepared in which all own transactions concerning Joint Venture are entered by the co-venturer making the entries. The material supplied, expenses paid and any payment to the other co-venturer are debited to this account. Sale proceeds received and other co-venturer are credited to this account. Profit earned by him is debited and share of loss due to him is credited to the account. The balance in this account will be the amount due to or amount due from the other venturer. When the final payment is made, the account is closed.

The journal entries made in the books of the venture in case he records only own transactions are given below.

1. Goods supplied to Joint Venture from business stock	Joint Venture Account To Purchases Account	Dr
2. When Joint Venture expenses paid	Joint Venture Account To Cash/Bank Account	Dr
3. When the sales made	Cash/Bank Account To Joint Venture Account	Dr
4. When own share in the Joint Venture profit	Joint Venture Account To P&L Account	Dr
5. When own share in the joint venture loss	P&L Account To Joint Venture Account	Dr
6. When cash received from other co-venturer	Cash/Bank Account To Joint Venture Account	Dr
7. When cash remitted to other co-venturer	Joint venture Account To Cash/Bank Account	Dr
8. When the Final Settlement	Joint Venturers Account	Dr
(a) When amount is paid to co-venturers	To Cash/Bank Account	
(b) When amount is received from co-venturers	Cash/Bank Account To Joint Venturer's Account	Dr

Illustration 3:

Illustration 1 is done under the 2nd Method.

Solution:

Memorandum Joint Venture Account

	₹		₹
To A – Goods	10,000	By B – Sales	15,000
Expenses	1,000	By B – Goods taken	1,440
Discount	240		
B – Expenses	1,000		
Commission	1,500		
A – Profit	1,800		
B – Profit	900		
	16,440		16,440

**Books of A
B in Joint Venture with A**

	₹		₹
To Purchases	10,000	By Bill Receivable Account	6,000
” Cash — Expenses	1,000	” Bank Account	7,040
” Discount	240		
” Profit and Loss Account	1,800		
	13,040		13,040

**Books of B
A in Joint Venture with B**

	₹		₹
To Bills Payable	6,000	By Cash – Sales	15,000
” Cash — Expenses	1,000	” Purchase – Goods taken	1,440
” Commission	1,500		
” Profit and Loss Account	900		
” Bank Account	7,040		
	16,440		16,440

Illustration 4:

On January 31, 2017, Pandey and Parker entered into a Joint Venture to consign goods to Parekh to be sold on their joint risk. They agreed to share profits and losses in the ratio of 3 : 2.

On April 15, 2017, Pandey consigned goods to the value of ₹ 36,000 and incurred expenses amounting to ₹ 3,000. On 31st July, 2017, Parker also consigned goods to the value of ₹ 22,000 and incurred expenses amounting to ₹ 1,800.

On November, 15, 2017 Parekh sold 80% of the total goods of ₹ 60,000 and remitted the proceeds to Pandey after deducting 5% commission on sales. On December 31, 2017, on which date accounts were prepared, an interim settlement was effected between Pandey and Parker.

On 15th August, 2018, Parekh sold the remainder of the total goods for ₹ 8,000 and remitted the proceeds to Parker, less 5% commission on sales. On October 31, 2018, a financial settlement was effected between Pandey and Parker..

You are required:

1. To show the account in the books of each co-venturer to record his own transactions, and
2. To prepare Memorandum Joint Venture Account. (LCWA, Inter)

Solution:

Memorandum Joint Venture Account

2017 April 15 To Pandey Goods Supplied 36,000 Expenses Paid 3,000 July 31 " Parker Goods supplied 22,000 Expenses paid 1,800 Nov. 15 " Parekh — Commission 3,000 Dec. 31 " Profit 3/5 Pandey 4,056 2/5 Parker 2,704 <hr style="width: 100%;"/> <p style="text-align: right;">72,560</p>	₹	Nov. 15	2017 By Sales – Parekh 60,000 Stock Unsold Dec. 30 Balance c/d 12,560 <hr style="width: 100%;"/> <p style="text-align: right;">72,560</p>	₹
2018 Jan. 1 To Balance b/d Unsold Stock Aug. 15 " Parekh's Commission <hr style="width: 100%;"/> <p style="text-align: right;">12,960</p>	₹		2018 Aug. 15 By Sales – Parekh 8,000 Oct. 31 " Loss Pandey 2,976 Parker 1,984 <hr style="width: 100%;"/> <p style="text-align: right;">4,960</p>	₹
				12,960

Books of Pandey Parker in Joint Venture Account

2017	April 4 To Purchases – Goods supplied " Cash Expenses " Profit and Loss Account (Profit) " Cash-Balance paid <hr style="width: 100%;"/> <p style="text-align: right;">64,536</p>	₹	2017 Nov. 15 By Cash – Sale Proceeds Less Commission received (60,000-3,000) " Balance c/d for unsold stock <hr style="width: 100%;"/> <p style="text-align: right;">64,536</p>	₹
2018	Jan. 1 To Balance b/d Unsold stock <hr style="width: 100%;"/> <p style="text-align: right;">7,536</p>	₹	2018 Oct. 31 By Profit and Loss Account – Loss " Cash Balance received <hr style="width: 100%;"/> <p style="text-align: right;">7,536</p>	₹
				7,536

**Books of Parker
Pandey in Joint Venture Account**

2017 July 31 To Purchase – Goods Supplied " Cash Expenses " Profit and Loss Account – (Profit)	₹	2017 Dec. 31 By Cash received from Pandey " Balance c/d (for unsold stock)	₹
	22,000		21,480
	1,800		5,024
	2,704		
	26,504		26,504
2018 Jan. 1 To Balance b/d Unsold Stock " Cash – Balance paid	₹	2018 Aug. 15 By Cash – Sale Proceeds Less Commission received (8,000-400) " Profit and Loss Account (Loss)	₹
	5,024		7,600
	4,560		1,984
	9,584		9,584

Notes: Valuation of unsold stock on Dec. 31, 2017.

	₹
Pandey – Goods	36,000
Expenses	3,000
Parker – Goods	22,000
Expenses	1,800
	62,800
Less: Sold 80%	50,240
	12,560
Pandey's Share 3/5ths of 12,560, ₹ 7,536	
Parker's Share 2/5ths of 12,560, ₹ 5,024	

The co-venturers' portion of the unsold stock is considered as their contribution for the venture for the next year, i.e., on 1st Jan., 2018.

Method 3: Separate Books

1. When separate set of books are maintained:

Generally separate set of books are maintained when the joint venture transactions are large in number. Following are the accounts opened under this method. (i) Joint Bank Account (ii) Joint Venture Account (iii) Personal Accounts of the co-venturer's Accounts.

- (i) **Joint Bank Account:** The co-venturers open on separate bank account for the venture transactions by making initial contributions. The bank account is generally operated jointly. Expenses are met from this account. Also sales or collections from transactions are deposited to this account. On completion of the venture the Joint Bank Account is closed by paying the balance to co-venturers.
- (ii) **Joint Venture Account:** This account is prepared for the purpose of ascertainment of venture profit. This account is debited for all venture expenses and is credited for all sales or collections. Venture profit or loss is transferred to co-venturer's accounts.
- (iii) **Co-venturer's Accounts:** Personal accounts of the venturers are maintained to keep record of their contributions of cash, goods or meeting venture expenditure directly and direct payment received by them on venture transactions. This account is closed simultaneously with the closure of Joint Bank Account.

Following are the journal entries to be made when separate set of books are maintained.

1. When the contribution made by the co-venturers	Joint Bank Account To Co-venturers' Account	Dr.
2. When the expenses paid through Joint Bank account	Joint Venture Account To Joint Bank Account	Dr.
3. When the expenses paid or materials supplied by the co-venturers from private account	Joint Venture Account To Co-venturer's Account	Dr.
4. When the sale proceeds or collections	Joint Bank Account To Joint Venture Account	Dr.
5. When the collections received by co-venturers	Co-venturers' Account To Joint Venture Account	Dr.
6. When the assets taken over by the co-venturers	Co-venturers' Account To Joint Venture Account	Dr.

7. When the liabilities taken over by the co-venturers	Joint venture Account To co-venturers' Account	Dr.
8. When there is profit on Joint venture	Joint Venture Account To Co-venturer's Account	Dr.
9. When there is loss on joint venture	Co-venturer's Account To Joint Venture Account	Dr.
10. When the final settlement made to co-venturers	Co-venturer's Account To Joint Bank Account	Dr.

Illustration 5:

A and B, both contractors, undertook a Joint Venture involving the construction of a building. A Joint Bank Account was opened in which A deposited ₹ 75,000 and B deposited ₹ 37,500. The contract price was ₹ 3,75,000. The result of Joint Venture was to be shared as to A $\frac{2}{3}$ and B $\frac{1}{3}$. The details of the transactions were as follows:

	₹
Wages paid	89,000
Materials Supplied by A	13,500
Materials Supplied by B	12,000
Materials purchased	1,65,000
Salaries	12,000
Cartage	18,500
Architect's fee paid by A	10,000
Concrete Mixer plant purchased	38,500

The stock of materials on the completion of the contract, valued at ₹ 16,500, was taken over by A. Concrete Mixer plant was taken over by B for ₹ 30,000. A was to be paid ₹ 18,000 per annum against establishment expenses, to be charged to the Joint Venture Account. The contract lasted for 8 months. Prepare Joint Venture Account, Joint Bank Account and Accounts of A & B.

(A.C.S., Prel.)

Solution:

<i>Sl. No.</i>	<i>Particulars</i>	<i>LF</i>	<i>₹</i>	<i>₹</i>
1.	Joint Bank Account Dr. To A Account To B Account (Amount contributed by A and B)		1,12,500	75,000 37,500
2.	Joint Venture Account Dr. To Joint Bank Account (Wages paid)		89,000	89,000
3.	Joint Venture Account Dr. To A Account To B Account (Materials supplied by A and B)		25,500	13,500 12,000
4.	Joint Venture Account Dr. To Joint Bank Account (Materials Purchased)		1,65,000	1,65,000
5.	Joint Venture Account Dr. To Joint Bank Account (Salaries paid)		12,000	12,000
6.	Joint Venture Account Dr. To Joint Bank Account (Cartage paid)		18,500	18,500
7.	Joint Venture Account Dr. To A Account (Architect's fees paid by A)		10,000	10,000
8.	Joint Venture Account Dr. To Joint Bank Account (Concrete Mixer plant purchased)		38,500	38,500
9.	Joint Bank Account Dr. To Joint Venture Account (Contract price received)		3,75,000	3,75,000
10.	A Account Dr. To Joint Venture Account (Unused materials taken over by A)		16,500	16,500
11.	B Account Dr. To Joint Venture Account (Concrete Mixer plant taken over by B)		30,000	30,000
12.	Joint Venture Account Dr. To A Account (Establishment expenses allowed for A for 8 months, <i>i.e.</i> , $18,000 \times 8/12$)		12,000	12,000

Joint Venture Account

	₹		₹
To A Account – Establishment	12,000	By Joint Bank	3,75,000
” Joint Bank – Wages	89,000	Contract price received	
A Account – Material	13,500	” A Account – Unsold material taken	16,500
B Account – Material	12,000	” B Account – Concrete mixer plant taken	30,000
” Joint Bank – Material	1,65,000		
” Joint Bank – Salaries	12,000		
” Joint Bank – Cartage	18,500		
To A Account – Architect fees	10,000		
” Joint Bank – Concrete Mixer	38,500		
” Profit – A (2/3) 34,000			
” Profit – B (1/3) 17,000	51,000		
	4,21,500		4,21,500

A Account

	₹		₹
To Joint Venture – Materials taken	16,500	By Joint Bank Account	75,000
” Joint Bank	1,28,000	” Joint venture –	
		Material	13,500
		Architect fees	10,000
		Establishments	12,000
		Profit	34,000
	1,44,500		1,44,500

B Account

	₹		₹
To Joint Venture – Concrete		By Joint Bank Account	37,500
Mixer plant taken	30,000	” Joint Venture Account – Material	12,000
” Joint Bank	36,500	” Joint Venture (Profit)	17,000
	66,500		66,500

Joint Bank Account

	₹		₹
To A Account	75,000	By Joint Venture	
” B Account	37,500	” ” Wages	89,000
” Joint Venture Contract Price	3,75,000	” ” Material	1,65,000
		” ” Salary	12,000
		” ” Cartage	18,500
		” ” Concrete Mixer	38,500
		” A Account	1,28,000
		” B Account	36,500
	4,87,500		4,87,500

Illustration 6:

Menon sent goods to Gupta to be sold on Consignment basis at 5% commission. Goods costing ₹ 4,00,000 were sent and ₹ 40,000 expenses were incurred. Gupta had to incur ₹ 10,000 expenses for landing and 75% of the goods were sold out for ₹ 4,80,000. Gupta sent the amount due from him with the Account Sale, but wanted to return the balance of goods as he was not agreeable to carry on as commission agent. He was, however, persuaded to continue on Joint Venture basis for 1/3 Profit. ₹ 2,00,000 worth of goods was further despatched by Menon. All the goods (except ₹ 20,000 which were taken over by Gupta for the same amount) were sold out for ₹ 5,00,000. Menon incurred ₹ 20,000 expenses and expenses of Gupta amounted to ₹ 17,000. Show the necessary account in the books of both the parties.

(L. C. W.A.)

Solution:

Books of Menon Consignment Account

	₹		₹
To Goods sent on Consignment	4,00,000	By Gupta Sales	4,80,000
” Bank Expenses	40,000	” Stock on Consignment	1,12,500
” Gupta Expenses – landing charge	10,000	$\left(4,50,000 \times \frac{25}{100}\right)$	
” Gupta Commission	24,000		
” Profit and loss – Profit	1,18,500		
	5,92,500		5,92,500

Goods Sent on Consignment Account

To Purchase Account	₹	By Consignment	₹
	4,00,000		4,00,000
	4,00,000		4,00,000

Gupta Account

To Consignment Account – Sales	₹	By Consignment Account – Expenses	₹
	4,80,000	” Consignment – Commission	10,000
		” Bank Account	24,000
			4,46,000
	4,80,000		4,80,000

On Conversion into Joint Venture

Joint Venture Account

To Stock on Consignment – goods lying with the consignee	₹	By Gupta (Sales)	₹
” Purchases – Goods	1,12,500	” Gupta (Goods taken)	5,00,000
” Bank Expenses	2,00,000		20,000
” Gupta Expenses	20,000		
” Profit and loss	17,000		
Gupta	1,13,667		
56,833	1,70,500		
	5,20,000		5,20,000

Gupta Account

To Joint Venture (Sales)	₹	By Joint Venture – Expenses	₹
” Joint Venture (Goods taken)	5,00,000	” Joint Venture – Profit	17,000
	20,000	” Bank	56,833
			4,46,167
	5,20,000		5,20,000

Illustration 7:

A, B and C enter into a Joint Venture to share profits and losses as 5:3:3. No separate set of books are maintained. Amounts contributed and received by different Venturers are as follows:

	<i>A</i>	<i>B</i>	<i>C</i>
	₹	₹	₹
Cost of Material	40,000	20,000	10,000
Expenses	6,000	4,000	2,000
Sale proceeds received	17,000	34,000	68,000
Stock taken over	3,000	6,000	9,000

Prepare (a) Memorandum Joint Venture Account and (b) "Joint Venture with ... Account" in the books of all the three parties.

Solution:**Memorandum Joint Venture Account**

To A – Material	₹ 40,000	By A – Sales	₹ 17,000
Expenses	6,000	Stock taken over	3,000
B – Material	20,000	B – Sales	34,000
Expenses	4,000	Stock taken over	6,000
C – Material	10,000	C – Sales	68,000
Expenses	2,000	Stock taken over	9,000
Profits			
A 5/11 – 25,000			
B 3/11 – 15,000			
C 3/11 – 15,000			
	55,000		
	1,37,000		1,37,000

Books of A**Joint Venture with B and C Account**

To Purchases – Material	₹ 40,000	By Bank – Sale Proceeds	₹ 17,000
Bank – Expenses	6,000	Purchases – Stock taken over	3,000
Profit and loss Account – profit (Cheque Received)	25,000	Bank – Settlement (Cheque Received)	51,000
	71,000		71,000

Books of B
Joint Venture with A and C Account

To Purchases – Material	₹ 20,000	By Bank – Sale Proceeds	₹ 34,000
Bank – Expenses	4,000	Purchases – Stock taken over	6,000
Profit and loss Account – profit	15,000		
Bank – Settlement (Cheque issued)	1,000		
	40,000		40,000

Books of C
Joint Venture with A and B Account

To Purchases Material	₹ 10,000	By Bank – Sale proceeds	₹ 68,000
Bank Expenses	2,000	Purchases – Stock taken over	9,000
Profit and loss Account – Profit	15,000		
Bank – Settlement (Cheque issued)	50,000		
	77,000		77,000

9.5 Difference between Joint Venture and Partnership

<i>Joint Venture</i>		<i>Partnership</i>	
1.	It is carried on without a firm's name.	1.	It is carried on with firm's name.
2.	The parties in joint venture are called co-ventures.	2.	The parties in partnership are called partners.
3.	The minimum number of co-ventures are two and there is no limit on maximum.	3.	The minimum number is two and maximum number is ten in banking business and twenty in other business.
4.	The profit or loss is found out for each venture.	4.	The profit or loss is found out annually.
5.	There is no special Act for joint venture.	5.	The Indian Partnership Act, 1932 is applicable for partnership.
6.	Co-ventures have no implied authority.	6.	Partners have implied authority.
7.	It is temporary in nature because it is formed for a particular purpose and it ceases to exist on completion of the specific venture.	7.	It is a continuous business.

8.	There is no joint and several liabilities, unless there is special agreement.	8.	There is joint and several liabilities on partners.
9.	It is not necessary to keep separate and permanent record of accounts.	9.	It has to keep a separate set of books of accounts, on a permanent basis.
10.	Co-ventureres are free to have their own independent business of the same type.	10.	Partners cannot independently undertake a business of similar type.
11.	Minor is generally not admitted.	11.	A minor can be admitted only for benefits.

9.6 Summary

A joint venture is a temporary partnership, which is formed for a specific purpose or venture or task,. As soon as the venture gets over, the joint venture comes to an end. The persons who enter into a joint venture are called co-ventures.

The objectives of joint venture are to enter foreign market, new and emerging market, to reduce the risk factor in heavy investment, optimum use of resources, gain economics of scale and achieve synergy.

The accounting treatment of joint venture is as follows:

1. When separate set of books are not maintained/kept. In this there are two methods:
 - (a) When each co-ventures keeps record of all transactions.
 - (b) When each co-ventures keeps record of own transaction only.
2. Memorandum Joint Venture Method.
3. When separate set of books are maintained.
4. There is a difference between Joint Venture and Partnership.

9.7 Key Words/Abbreviations

- **Joint Venture:** Joint venture is a temporary partnership, which is formed for a specific purpose/task/venture. As soon as the venture gets completed, the joint venture comes to an end.

- **Co-ventures/Joint venturers:** The partner or persons who enter into a joint venture business are called co-venturers/joint venturers.
- **Partnership:** Partnership is the relation between persons, who here to agreed to share the profits of a business, carried on by all, or any of them acting for all.
- **Accounting Treatment in Joint Venture:** The accounting treatment in joint venture is under three methods:
 - (a) When separate set of books are maintained.
 - (b) When separate set of books are not maintained.
 - (c) Memorandum Joint Venture method.

9.8 Learning Activity

1. Suresh and Sudhir entered into joint venture to share profits and losses equally. The following transactions took place.
 - (a) Suresh purchased goods costing ₹ 3,80,000 and expenses incurred thereon ₹ 2,376.
 - (b) Sudhir implied goods of ₹ 12,500 from his stock and paid ₹ 250 for carriage.
 - (c) Sudhir sold some of the goods for ₹ 43,500. He paid sales commission of ₹ 799.
 - (d) Suresh paid storage and other expenses of ₹ 950.
 - (e) Suresh sold the remaining goods for ₹ 23,750 and he also paid ₹ 2,375 for commission and carriage.

You are required to prepare:

1. Joint venture a/c in the books of Suresh and
2. Suresh's a/c in the books of Sudhir.

2. Girish, Manish & Rajnish undertake construction of an office building at a contract price of ₹ 10,00,000. The contract price is to be received ₹ 600,000 in cash and ₹ 400,000 is fully paid shares of that company. They decide to share profits and losses equally.

They open a Joint Bank A/c and contribute the following amounts.

Girish	₹ 300,000
Manish	₹ 300,000
Rajnish	₹ 200,000

Girish pays ₹ 10,000 towards the fees of the Architect, Manish brings into the venture mixer of ₹ 25,000, Rajnish brings into the venture the motor truck worth ₹ 55,000.

The following transactions were made from the Joint Bank Account:

Purchase of Materials	₹ 4,50,000
Purchase of Plant	₹ 30,000
Freight and wages	₹ 1,50,000

At the close of the venture, Girish took over the unused material worth ₹ 8,000, Manish took back minor worth ₹ 15,000 and Rajnish took back the truck worth ₹ 35,000. The scrap value of the plant was realised ₹ 6,000. The contract price was received in full and Manish took over the shares at a value of ₹ 4,10,000. Prepare the Joint Venture Account and Co-venturers Accounts.

3. Nanda of Nanded and Deepa of Delhi entered into a joint venture to buy and sell motor cars. Profits and losses were to be shared 40% and 60% respectively.

The details of purchases, sales and expenses of Nanda are as follows:

Purchased 4 motor cars in all, out of which 3 purchased for ₹ 1,60,000 and 1 car for ₹ 30,000.

Expenses are ₹ 19,000 for repairs and ₹ 15,000 for colouring.

She sold all the 4 cars for ₹ 2,50,000.

The details of purchases sales and expenses of Deepa are as follows:

Purchased 3 cars for ₹ 88,000 and sold them for ₹ 1,15,000. She incurred the expenses of repair ₹ 4,000, colouring ₹ 3,000 and sales expenses ₹ 3,000.

The venture was closed down by setting the accounts between co-venturers.

Open:

1. Joint Venture a/c and Deepa's a/c in the books of Nanda.
2. Joint Venture a/c and Nanda's a/c in the books of Deepa.

9.9 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type: Short Answer Type Questions

1. What is Joint Venture?
2. What are the objectives of joint venture.
3. Distinguish between Joint Venture and Partnership

B. Multiple Choice/Objective Type Questions

1. Joint Venture is a _____ partnership.
(a) Permanent (b) Temporary
(c) Semi-temporary (d) Semi-permanent
2. The persons who enter into a joint venture are called _____.
(a) Partners (b) Owners
(c) Shareholders (d) Co-ventures.
3. Joint Venture account is a _____ account
(a) Personal (b) Real
(c) Nominal (d) Impersonal

4. Co-ventures account is a _____ account.
- (a) Personal (b) Real
(c) Nominal (d) Impersonal
5. The co-ventures open a _____ account to record joint venture transactions.
- (a) Joint bank (b) Salary
(c) Expenses (d) Income

Answer

1. (b), 2. (d), 3. (c), 4. (a), 5. (a).

9.10 References

1. R.S.N. Pillai, Bagavathi, S. Uma (2006), "*Fundamentals of Advanced Accounting*" Vol. I, S. Chand, New Delhi.
2. S.N. Maheshwari and S.K. Maheshwari, (2004), "*An Introduction to Accountancy*", Vikas Publishing House Pvt. Ltd., New Delhi.
3. <https://businessjavgons.com/jointventure>

UNIT 10 FINAL ACCOUNTS

Structure:

- 10.0 Learning Objectives
- 10.1 Introduction
- 10.2 Preparation of Trading Account and Format
- 10.3 Preparation of Profit and Loss Account and Format
- 10.4 Balance Sheet – Drafting of Balance Sheet
- 10.5 Summary
- 10.6 Key Words/Abbreviations
- 10.7 Learning Activity
- 10.8 Unit End Questions (MCQ and Descriptive)
- 10.9 References

10.0 Learning Objectives

After studying this unit, you will be able to:

- Analyse the preparation of trading account and its format
- Explain the preparation of profit and loss account and its format
- Discuss the balance sheet and drafting of balance sheet



10.1 Introduction

This unit will help you to understand the preparation of trading account and its format, the preparation of profit and loss account and its format, the balance sheet and drafting of balance sheet.

10.2 Preparation of Trading Account and Format

The main objective of business is to earn profits.

Every businessman wants to know the **financial results/performance** of his business i.e., whether he was earned profit or suffered loss during a particular accounting period. In order to know this, he has to prepare **Trading A/c.** and **Profit & Loss A/c.**

Besides knowing financial results, the businessman also wants to know the **financial position** of his business for which **balance sheet** is prepared.

Final accounts are the accounts which are prepared at the end of an accounting year. It is a group of two accounts i.e., Trading Account and profit and loss account and one statement i.e., balance sheet.

Final accounts are the financial statements prepared, at the end of an accounting year, to show the financial performance and financial position of the business.

Final accounts consist of

1. Trading a/c.
2. Profit & Loss A/c and
3. Balance Sheet

1. Trading Account

Trading account is a nominal account which is prepared on the basis of direct expenses and direct income. Trading a/c. is prepared to find out Gross Profit or Gross Loss of the business.

Gross Profit or Gross Loss is the difference between net sales and cost of goods sold.

Gross Profit: Net sales – Cost of Goods Sold

Gross Loss: Cost of Goods Sold – Net Sales

Net Sales: Total Sales (cash sales + credit sales) – Sales Return / Return inward.

$$\begin{aligned}\text{Cost of Goods Sold} = & \text{Opening Stock} + \text{Net Purchases (Total Purchases [cash \& credit] -} \\ & \text{Purchase Return / Return Outward)} \\ & + \text{Direct Expenses} - \text{Closing stock}\end{aligned}$$

Opening Stock means goods lying unsold with the businessman at the beginning of an accounting year.

Closing Stock means goods lying unsold with the businessman at the end of an accounting year.

Direct expenses in a **trading concern** refers to these expenses which are incurred on the goods purchased.

Direct expenses in a **manufacturing concern** refers to those expenses incurred on the raw materials purchased and expenses incurred on conversion of raw materials into finished goods.

Debit Side of a Trading Account

The items that usually appear on the debit side of the trading account are as under.

- 1. Opening Stock:** Stock means goods lying unsold on a particular date. Opening stock is a stock of goods with a business at the beginning of accounting year this figure is available from the trail balance.
In the first of business, there is no opening stock.
- 2. Purchases:** The purchase figure in the trial balance represents the total purchases made during the year. It includes both cash and credit purchases.
- 3. Return outward (Purchase return):** If goods purchased are returned to the sellers. It is called purchase return.

Purchase return should be deducted from the amount of total purchases and only the amount of net purchases is shown in the outer column.

4. Wages: Wages paid to workers in the factory should be debited to Trading A/c.

Wages may be manufacturing (productive wages) or non manufacturing (unproductive wages).

Manufacturing wages are paid to workers for the manufacture of finished goods. Manufacturing wages should be debited to trading account.

- Only '**wages**' should be taken as manufacturing wages and debited to the **trading account**. Sometimes only one account may be kept for salaries and wages.
- When the amount of wages is very small, **salaries and wages** should be **debited to profit and loss account**.
- **Wages and salaries** should be **debited to trading account**, since the amount of wages forms a major part of the total.

5. Customs duty and Octroi duty: When goods are purchased from a foreign country, customs duty will have to be paid. When goods are purchased from another city or state, the municipal corporation charges octroi duty.

Since these expenses relate to the purchase of goods, they are debited to trading account.

6. Carriage inward *Carriage on purchases): Expenses incurred on purchase of goods should be debited to trading account.

7. Power and Coal: Electricity used for running machines is known as **power** and the amount paid for it has to be **debited to the trading account**. Similarly, if production is carried on with the help of steam, coal will be used. The **cost of coal** used will also be **debited to the trading account**.

8. Lighting: The amount spent upon electricity used for **lighting the factory** purchases will be treated as a manufacturing expense and therefore, **debited to the trading account**. But, **lighting of office** should be **debited to the profit and loss account**.

9. **Rent and Rates:** Rent paid for the **factory** premises will be **debited to trading account** and so also taxes paid to municipal authorities in respect of the factory building, Municipal taxes are often known as rates.
10. **Excise duty:** Excise duty is a tax charges by the government. Sometimes, it is charged on production and sometimes on sales.

If the **excise duty** is charged on **production**, it will be treated as a manufacturing expense and **debited to trading account**. But, if it is charged on **sales**, it will be debited to the **profit and loss account**.

Credit Side of a Trading Account

The items that generally appear on the credit side of a trading account are as follows:

1. **Sales:** The sales figure in the trial balance represents the total sales made during the year. It includes both cash sales and credit sales.
2. **Return Inward (Sales Return):** When goods are returned by customers, they are known as sales return. Sales return are subtracted from the total sales to show the net sales, in the outer column.
3. **Closing Stock:** It means the value of goods which remain unsold at the end of the financial year.

Balancing of Trading Account

After transferring the above items to the trading account, it is to be closed. If the total of the credit side of the trading account is heavier than the debit side, it represents a gross profit in the reverse case, there is a gross loss.

The balance of the trading account is to be transferred to the profit and loss account.

The gross profit will be transferred to the credit side of the profit and loss account and the gross loss, of any, will be transferred to the debit side of the profit and loss account.

Format of Trading Account is given below

Dr. **Trading Account for the year ended 31st March....** Cr.

Particulars	Amt. ₹	Amt ₹	Particulars	Amt. ₹	Amt. ₹
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales Return	xxx	xxx
Less: Purchase Return	xxx	xxx	(Return inward)		
(Return outward)			By Goods destroyed by		xxx
To Wages		xxx	fire/theft		
To Wages and salaries		xxx	By Goods withdrawn for		xxx
To Freight		xxx	personal use (I.e. Drawings)		
To Carriage inward		xxx	By Goods distributed		xxx
To Octroi		xxx	as free sample		
To Import Duty		xxx	By Closing stock		xxx
To Customs Duty		xxx	By Gross Loss transferred		xxx
To Dock charges		xxx	to Profit and Loss A/c		
To Works Manager salary		xxx			
To Power, Fuel, Oil		xxx			
To Coal, Gas, Water		xxx			
To Royalty		xxx			
To Factory rent		xxx			
To Factory Insurance		xxx			
To Motive power		xxx			
To Heating and lighting		xxx			
To Trade expenses		xxx			
To Gross Profit transferred		xxx			
To Profit and Loss A/c					
		xxx			xxx

Illustration - 1

Prepare a Trading Account of Mr. Prashanth for the year ending 31st March 2014 from the following particulars:

Particulars	Amount
Stock of goods on 1-4-2013	3,50,000
Stock of goods on 31-03-2014	4,00,000
Purchases	4,50,000
Sales	6,00,000
Purchases return	70,000
Sales return	90,000
Carriage inward	10,000
Wages	5,000

Solution: (Vertical Form)

**Trading Account of Mr. Prashanth for the year ended
31st March 2014**

Particulars	Amount	Amount
Net Sales Revenue		
[Sales – Sales returns] (6,00,000 – 90,000)		5,10,000
Less: Cost of Goods Sold		
Opening stock	3,50,000	
Net purchases (4,50,000 – 70,000)	3,80,000	
Carriage inwards	10,000	
Wages	5,000	
	7,45,000	
Less: Closing stock	4,00,000	
Cost of Goods Sold		3,45,000
Gross Profit		1,65,000

Solution: (Horizontal Form)**Trading Account of Mr. Prashanth for the year ended****Dr. 31st March 2014 Cr.**

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	3,50,000	By Sales	6,00,000
To Purchases	4,50,000	Less: Returns	90,000
Less: Returns	70,000	By Closing Stock	4,00,000
To Carriage inward	10,000		
To Wages	5,000		
To Gross Profit	1,65,000		
(Transfer to Profit & Loss A/c)			
	9,10,000		9,10,000

Illustration - 2

Prepare a Trading Account of Mr. Murali for the year ending 31st March 2014 from the following particulars.

Particulars	Amount
Purchases of Materials	2,50,000
Carriage on Purchases	6,000
Wages	70,000
Stock of goods on 1-04-2013	3,60,000
Stock of goods on 31-03-2014	3,80,000
Sales	6,50,000
Sales return	80,000
Purchases return	30,000
Duty and Clearing charges	70,000
Factory Rent and Lighting expenses	30,000
Factory Salaries	20,000

Solution: (Vertical Form)**Trading Account of Mr. Murali for the year ended
31st March 2014**

Particulars	Notes	Amount	Amount
Net Sales Revenue			
[Sales – Sales returns] (6,50,000 – 80,000)			5,70,000
Less: Cost of Goods Sold			
Opening stock		3,60,000	
Net purchases (2,50,000 – 30,000)		2,20,000	
Carriage inwards		6,000	
Wages		70,000	
Duty and Clearing charges		70,000	
Factory Salaries		20,000	
Factory Rent and Lighting expenses		30,000	
		7,76,000	
Less: Closing Stock		3,80,000	
Cost of Goods Sold			3,96,000
Gross Profit or Gross Loss			1,74,000

Solution: (Horizontal Form)**Trading Account of Mr. Murali for the year ended
31st March 2014**

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	3,60,000	By Sales	6,50,000
To Purchases	2,50,000	Less: Sales return	80,000
Less: Returns	30,000	By Closing Stock	3,80,000
To Carriage Inward	6,000		
To Wages	70,000		
To Duty and Clearing charges	70,000		
To Factory Salaries	20,000		

To Factory Rent and Lighting expenses	30,000		
To Gross Profit (Transfer to Profit & Loss A/c)	1,74,000		
	9,50,000		9,50,000

10.3 Preparation of Profit and Loss Account and Format

The trading account only tells the gross profit or gross loss made by a business.

It does not tell the actual profit (net profit) or actual loss (net loss) of the business.

Trading account does not take into account the other operating expenses incurred by a businessman, during the course of running the business. For example, office or administrative expenses, selling and distribution expenses, financial expenses etc. All such indirect expenses are debited to the profit and loss a/c.

Beside, a businessman may have incomes other than sales. For example, a business man may receive rent from some of his business properties. He may have invested surplus funds of the business in shares, debentures and fixed deposits. He will get dividend and interest from such investments. All such indirect incomes are credited to the Profit & Loss A/c.

Profit and Loss account it is nominal account.

Profit and loss a/c. is prepared to find the **net profit** earned or **net loss** suffered by a business concern during an accounting year.

All expenses like

- **Office/Administrative expenses** like staff salaries, printing and stationery, postage and telegram, office rent, office insurance, legal expenses audit.
- **Selling and Distribution expenses** like advertisement, salesman's salary and commission, travelling expenses, showroom expenses, exhibition expenses.

- **Financial expenses and losses** like interest on loan taken, discount allowed, bad debts, loss due to fire, theft are **debited to the profit & loss a/c**.

All incomes other than sales like rent received, commission received discount received, interest received, dividend received, bad debts recovered are **credited to Profit & Loss A/c**.

Importance Points or Items Regarding Profit and Loss Account

1. **Gross profit or gross loss:** The figure of gross profit or gross loss is brought down from the trading account. Of course, there will be only one figure i.e., either of gross profit or gross loss.

2. **Salaries:** Salaries are debited to profit and loss account.

3. **Discount:** Discount allowed is an expense, to be debited to the profit and loss account.

Discount earned or received is an income to be credited to the profit and loss account.

4. **Commission:** Commission allowed is an expense to be debited to the profit and loss account.

Commission received or earned is an income to be credited to the profit and loss account.

5. **Interest:** When a businessman takes a loan and pays interest on it, it is an expense, it is to be debited to the profit and loss account.

When a businessman gives loan and receives interest on it, it is an income, it is to be credited to the profit and loss account.

Interest paid on capital brought by the proprietor is also a business expenditure. Interest paid on capital is to be debited to the profit and loss account.

6. **Bad debts: Bad debts are the debts which are not recoverable/irrecoverable.**

When a customer to whom goods were sold on credit does not pay the amount due from him, inspite of being send several reminders, it becomes a bad debt.

Bad debt is a loss to the business. Therefore, it is debited to profit and loss account.

Bad debts recovered is a gain of the business. Therefore, it is credited to the profit and loss account.

7. **Advertisement:** Advertisement is an expense to be debited to the profit and loss account.
8. **Printing and Stationery:** It is an expense to be debited to the profit and loss account.
9. **Depreciation:** It means permanent decrease or decline or fall in the value of an asset due to its constant use, passage of time, outdatedness, etc. For example, A machinery purchased gets depreciated because of its constant use. On account of new inventions, old assets become outdated and they have to be replaced by new assets.
- Depreciation is a loss for the business and it is debited to profit and loss account.
10. **Insurance Premium:** Insurance Premium paid to the insurance company is an expense. The premium paid on a fire insurance policy of the office is debited to profit and loss account. The premium paid on a fire insurance policy of the factory is debited to trading account.
11. **Apprentice Premium:** Some concerns train persons in different trades like turner, fitter, welder, etc. for which they charge certain fees which are called apprentice premium. It is an income of the concern and hence, it is credited to profit and loss account.
12. **Carriage outward (Carriage on sales):** It is to be debited to profit and loss account.

Balancing of Profit and Loss Account

If the total of the credit side is more than the total of the debit side, there will be net profit and in the reverse case, there will be net loss. The net profit from the profit and loss account is to be added to the amount of capital in the balance sheet and the net loss from the profit and loss account is to be deducted from the amount of capital in the balance sheet.

Format of Profit and Loss account is given below:

Dr. Profit and Loss Account for the year ended 31st March.... Cr.

Particulars	Amt. ₹	Amt ₹	Particulars	Amt. ₹	Amt. ₹
To Gross loss b/d (Transferred from Trading A/c)		xxx	By Gross Profit b/d (Transferred from Trading A/c)		xxx
To Salaries		xxx	By Interest received		xxx
To Salaries and Wages		xxx	By Discount received		xxx

To Unproductive wages		xxx	By Commission received		xxx
To Office expenses		xxx	By Dividend received		xxx
To General expenses		xxx	By Rent received		xxx
To Sundry expenses		xxx	By other receipts		xxx
To Printing and stationery		xxx	By Profit on sale of Asset		xxx
To Postage and Telegram		xxx	By Interest on Investments		xxx
To Telephone charges		xxx	By Old R.D.D.	xxx	
To Electricity charges		xxx	Less: Old Bad debts	xxx	
To Legal charges		xxx	Less: New Bad debts	xxx	
To Interest paid		xxx	Less: New R.D.D.	xxx	xxx
To Warehouse rent		xxx	By Interest on Drawings		xxx
To Rent, Rates and Taxes		xxx	By Net loss transferred to capital		xxx
To Insurance		xxx			
To Trade Expenses		xxx			
To Travelling expenses		xxx			
To Discount allowed		xxx			
To Advertisement		xxx			
To Export duty		xxx			
To Carriage outward		xxx			
To Packing charges		xxx			
To Conveyance		xxx			
To Bad debts	xxx				
Add: New Bad debts	xxx				
Add: New R.D.D.	xxx				
	xxx				
Less: Old R.D.D.	xxx				
To Repairs and renewals		xxx			
To Interest on capital		xxx			
To Interest loan		xxx			
To Net Profit transferred to capital account		xxx			
		xxx			xxx

Illustration - 3

From the following information, prepare the Profit and Loss Account of Archita for the year ending 31st March 2014.

Particulars	₹
Gross Profit	7,39,000
Salaries	60,000
Wages	25,000
Carriage inwards	15,000
Carriage outwards	50,000
Discount allowed	8,000
Discount received	8,000
Factory expenses	22,000
Miscellaneous incomes	2,000
Miscellaneous expenses	14,000
General expenses	10,000
Commission paid	4,000
Commission received	14,000
Interest paid	7,000
Interest received	10,000
Rent paid	14,000
Rent Received	16,000

Solution: (Vertical Form)**Profit & Loss Account for the year ended 31st March 2014**

Particular	₹	₹
Gross Profit		7,39,000
Less: Operating expenses		
Administrative expenses:		
Salaries	60,000	
Rent paid	14,000	

General expenses	10,000	
Miscellaneous expenses	14,000	
Selling and Distribution expenses:		
Carriage Outwards	5,000	
Discount Allowed	8,000	
Commission Paid	4,000	1,15,000
		6,24,000
Add: Operating Incomes		
Discount Received	8,000	
Commission Received	14,000	
Miscellaneous Income	2,000	24,000
Operating Profit		6,00,000
Add: Non-operating Incomes		
Rent Received	16,000	
Interest Received	10,000	26,000
		6,26,000
Less: Non-operating Expenses		
Interest Paid		7,000
To Net Profit (Transferred to Capital Account)		6,19,000

Note: Wages, Factory expenses and Carriage inward appears in trading account.

Illustration - 4

From the following information, prepare the Profit and Loss Account for the year ending 31st March 2014.

Particulars	₹	Particulars	₹
Gross Profit	3,00,000	Bad debts	7,000
Salaries and wages	1,25,000	Telephone Expenses	3,000
Discount allowed	15,000	Packing expenses	10,000
Discount received	10,000	Bank charges	800

Interest received	2,000	Loss by Fire	7,000
Interest on loan paid	4,500	Loss on sale of fixed assets	2,500
Commission to Paid	5,000	Profit on sale of fixed assets	10,000
Commission received	8,000	Dividend received on shares	18,000
Rent received	3,000	Income from investment	8,500
Rent, Rates and Taxes paid	24,000	Audit Fees	20,000
Fire insurance premium	5,000	Miscellaneous expenses	4,000
Advertising and Publicity	15,000		
Sales Promotion expenses	1,000		
Repairs and Maintenance	1,000		
Printing and Stationery	500		
Travelling expenses	2,000		
Entertainment expenses	10,500		

Solution: (Vertical Form)**Profit & Loss Account for the year ended 31st March 2014**

Particular	₹	₹
Gross Profit		3,00,000
Less: Operating Expenses		
Administrative expenses:		
Salaries and Wages	1,25,000	
Rent, Rates and Taxes	24,000	
Fire Insurance Premium	5,000	
Repairs and Maintenance	3,000	
Printing and Stationery	2,500	
Telephone expenses	3,000	
Bank charges	800	
Loss by Fire	7,000	
Miscellaneous expenses	4,000	

Audit Fee	20,000	
Selling and Distribution expenses:		
Discount allowed	15,000	
Commission to Paid	5,000	
Travelling expenses	12,000	
Entertainment expenses	10,500	
Advertising and Publicity	15,000	
Sales Promotion expenses	9,000	
Bad debts	7,000	
Packing expenses	10,000	2,77,800
		22,000
Add: Operating Incomes		
Discount received	10,000	
Commission received	8,000	18,000
Operating Profit		40,200
Add: Non-operating incomes		
Interest received	2,000	
Rent received	3,000	
Profit on sale of fixed assets	10,000	
Dividend Received on Shares	18,000	
Income from Investment	8,500	41,500
		81,700
Less: Non-operating expenses		
Interest on loan paid	4,500	
Loss on sale of fixed assets	2,500	7,000
To Net Profit (transferred to capital account)		74,700

10.4 Balance Sheet – Drafting of Balance Sheet

After knowing the net profit or net loss, from preparing the profit and loss account, the businessmen would like to know the financial position of the business (what are the assets and liabilities of the business). For this purpose, he prepares a statement of assets and liabilities of the business as on a particular date. Such a statement is termed as the “Balance Sheet”.

Balance Sheet is a part of final accounts, but balance sheet is not an account. Therefore, it does not have debit side and credit side.

The balance sheet has two sides. On the left side, the liabilities of the business are shown, while on the right side, the assets of the business are shown.

**Balance sheet of M/s.....
As on 31st March.....**

Liabilities	Amt. ₹	Amt ₹	Assets	Amt. ₹	Amt. ₹
Capital A/cs	xxx		Goodwill		xxx
– Drawings	xxx		Land and Building		xxx
+ Interest on capital	xxx		Freehold Property		xxx
– Interest on drawing	xxx		Leasehold Property		xxx
+ Net Profit			Plant and Machinery		xxx
– Net Loss	xxx	xxx	Furniture and Fixtures		xxx
			Patents		xxx
Sundry Creditors		xxx	Copy-rights		xxx
Bills Payable		xxx	Trade Mark		xxx
Bank overdraft		xxx	Motor Vehicles		xxx
Bank loan		xxx	Investments		xxx
Partner’s loan		xxx	Provident fund investment		xxx
Others loan		xxx	Interest accrued on investment		xxx
Outstanding expenses		xxx	Loans and advances		xxx
Pre-received incomes		xxx	Loose Tools		xxx
(Income received in advance)			Sundry Debtors		xxx
Reserve fund		xxx	Bills Receivable		xxx

Provident fund		xxx	Closing Stock		xxx
			Stock of Stationery		xxx
			Cash at bank		xxx
			Stock of Postal Stamps		xxx
			Prepaid expenses		xxx
			Outstanding Incomes (Incomes receivable)		xxx
			Insurance claim receivable		xxx
Total		xxx			xxx

Illustration - 8

From the following information, prepare a Balance Sheet of Mr. Sumit as on 31st March 2014 on horizontal format.

Particulars	₹	Particulars	₹
Furniture and Fixtures	75,000	Plant and Machinery	2,85,000
Prepaid Expenses	1,000	Accrued Income	6,000
Income received in advance	6,000	Outstanding expenses	3,000
Bills payable	12,000	Bills receivable	6,000
Sundry Debtors	3,00,000	Sundry Creditors	2,97,000
Bank overdraft	27,000	Investment in Shares of X Company	60,000
Long-term Loan from Bank	3,00,000	Closing Stock	2,25,000
Capital	6,00,000	Building	2,70,000
Land	30,000	Goodwill	60,000
Drawings	60,000	Net Profit	2,10,000
Cash in Hand	15,000	Cash at Bank	60,000

Solution: (Vertical Form)**Balance Sheet as on 31st March 2014**

Capital and Liabilities	₹	₹
Capital		
Capital	6,00,000	
Net Profit	2,10,000	
	8,10,000	
Less: Drawings	60,000	
Adjusted Capital		7,50,000
Non-current Liabilities		
Secured Loans:		
Unsecured Loans:		
Long-term loan from Bank		3,00,000
Current Liabilities		
Sundry Creditors	2,97,000	
Bills Payable	12,000	
Bank Overdraft	27,000	
Out Standing Expenses	3,000	
Income Received in advance	6,000	3,45,000
Total		13,95,000
Assets		
Non-current Assets		
Fixed Assets:		
Goodwill	60,000	
Land	30,000	
Building	2,70,000	
Plant and Machinery	2,85,000	
Furniture and Fixture	75,000	
		7,20,000

Investments:		nil
Shares in 'X' Company		60,000
Current Assets:		
Closing Stock	2,25,000	
Sundry Debtors	3,00,000	
Bills Receivable	6,000	
Cash at Bank	60,000	
Cash in hand	15,000	
Pre-paid Expenses	3,000	
Accrued Income	6,000	6,15,000
Total		13,95,000

Illustration - 9

From the following particulars prepare a Balance Sheet for the year ended 31st May, 2014.

Particulars	₹
Land and Building	80,000
Capital	1,90,000
Plant and Machinery	1,20,000
Net Profit	20,000
Sundry Creditors	48,000
Cash at Bank	10,000
Bills Payable	9,000
Sundry Debtors	20,000
Bills Receivable	7,000
Cash in hand	30,000

Solution: (Horizontal Form)**Balance Sheet for the year ended 31st May, 2014**

Liabilities		Amount	Assets		Amount
Capital	1,90,000		Land and Building	80,000	
Add: Net Profit	20,000	2,10,000	Plant and Machinery	1,20,000	
Sundry Creditors		48,000	Bills Receivable	7,000	
Bills Payable		9,000	Cash at Bank	10,000	
			Cash in hand	30,000	
			Sundry Debtors	20,000	
		2,67,000		2,67,000	

Practical Questions

Q-1. On December 31, 2010 the following information was available from the books of Sri Mukul Rao.

Stock (01-01-2010)	1,20,000
Purchase made during the year	2,50,000
Sales	3,00,000
Carriage inwards	10,000
Return inwards	20,000
Return outwards	30,000
Wages	8,000
Import duty	12,000
Stock (31-12-2010)	1,70,000
Motive power	3,000

Prepare the Trading account for the year 2010

Q-2. From the following Trial balance of M/s Ranga & Sons co., Prepare Trading and Profit & Loss account for the year ended 31st March 2011.

Particulars	Debit	Credit
Ranga & Sons capital		62,000
Stock (01-04-2010)	23,000	
Purchases & Sales	32,000	53,700
Sales and Purchase Returns	2,000	1,500
Wages	1,800	
Land & Building	52,000	
Freight & Carriage	2,700	
Trade expenses	1,300	
Advertisement	1,500	
Interest		800
Debtors and Creditors	28,000	32,000
Cash in hand	1,200	
Salaries	2,500	
Office expenses	2,000	
	1,50,000	1,50,000

Adjustments: Stock on 31st March 2011 was valued at ` 30,000

Q-3. From the following particulars, prepare a Balance Sheet on 31st December 2010.

Particulars	Amount	Particulars	Amount
Capital	1,25,000	Closing Stock	43,000
Drawing	20,000	Net Profit	75,000
Long term loan (cr.)	2,00,000	Sundry Creditors	80,000
Machinery	75,000	Bills Receivable	15,000
Land & Building	1,56,000	Bank Overdraft	35,000
Sundry Debtor	55,000	Cash in hand	21,000
Bills Payable	10,000	Cash in Bank	50,000
Investment	90,000		

10.5 Summary

Final accounts consist of

1. Trading account
2. Profit and loss account
3. Balance sheet

1. Trading Account

- Trading account is a nominal account.
- Trading account is prepared to find out the Gross Profit or Gross Loss of the business.
- If the debit side of Trading Account is more than the credit side of Trading Account, there will be Gross Loss.
- Gross Loss will be transferred to the debit side of the Profit and Loss account.
- If the credit side of Trading Account is more than the debit side of Trading Account, there will be Gross Profit.
- Gross Profit will be transferred to the credit side side of the Profit Loss account.

2. Profit and Loss Account

- Profit and Loss Account is Nominal account.
- Profit and Loss Account is prepared to find out the Net Profit or Net Loss of the business.
- If the Debit side of the Profit and Loss account is more than the credit side of Profit and Loss account, there will be Net Loss.
- The Net Loss will be subtracted from the owners capital, account in the Balance Sheet.
- If the Credit side of the Profit and Loss account is more than the debit side of Profit and Loss account, there will be Net Profit.
- The Net Profit will be added to the owners capital, account in the Balance Sheet.

3. Balance Sheet

- Balance Sheet is not an account.
- Therefore it does not have debit or credit side.
- The left hand side of balance sheet is called 'Liabilities side'
- The right hand side of balance sheet is called 'Assets side'
- Balance sheet is a statement showing the assets and liabilities of the business, as on a particular date.
- Balance sheet is a statement showing the financial position of the business.

10.6 Key Words/Abbreviations

- **Final account:** Final accounts are the accounts (financial statements) which are prepared, at the end of an accounting year, to reveal the financial performance, by preparing the Trading account and the Profit and Loss account and the financial position of the business, by preparing the Balance Sheet (a statement showing assets and liabilities of the business as on a particular date)
- **Trading account:** Trading account is a nominal account, which is prepared on the basis of direct expenses and direct income like sales (Cash credit sales) It is prepared to find the gross profit or gross loss of the business.
- **Profit and loss account:** Profit and loss account is a nominal account, which is prepared on the basis of indirect expenses and indirect income. It is prepared to find the net profit or net loss of the business
- **Balance sheet:** Balance Sheet is a statement of assets and liabilities showing the financial position of the business as on a particular date.
- **Gross profit:** When the credit side of Trading Account is more than the debit side, there is gross profit.
$$\text{Gross profit} = \text{Net sales} - \text{Loss of goods sold}$$
- **Gross loss:** When the debit side of Trading account, is more than the credit side, there is gross loss.

Gross Loss = Loss of goods sold – Net sales

- **Net profit:** When the credit side of profit and loss account, is more than the debit side, there is net profit.
- **Net loss:** When the debit side of profit and loss account, is more than the credit side, there is net loss.
- **Direct expenses:** Direct expenses means expenses directly related to production of goods and purchase of goods
- **Direct income:** Direct income is the income received from sales (cash and credit sales)
- **Indirect expenses:** Indirect expenses are the expenses incurred after production of goods like office and administrative expenses, selling and distribution expenses and financial expenses
- **Indirect income:** Indirect incomes includes income other than sales like non-trading incomes of commission rent interest discount, dividend received.

10.7 Learning Activity

I. Given below is the Trial Balance of Mrs. Kalpana as on 31st March, 2019

Trail Balance as on 31-3-2019

Debit Balance	Amt. ₹	Credit Balance	Amt. ₹
Cash in hand	6,000	Bank Loan	20,000
Sundry Debtors	23,300	Sunday Creditors	15,000
Bills Receivable	10,000	Sales	65,800
Opening Stock	16,000	Purchase Return	3,700
Purchases	37,900	Bills Payable	8,000
Sales Returns	800	Discount Received	2,500
Salaries	11,000	Capital	55,000
Wages	2,000		
Advertisement	3,200		
Discount Allowed	1,000		
Machinery	40,000		

Carriage	2,500		
Insurance	1,800		
Drawings	2,500		
Octroi Duty	800		
Furniture	8,000		
Office Rent	3,200		
	1,70,000		1,70,000

Adjustments :

1. Closing stock of goods on 31.03.2019 was valued at ₹ 21,000.
2. Depreciate Furniture by 5% and Machinery by 10% p.a.
3. Outstanding salary ₹ 1,000 and wages ₹ 500
4. Prepaid insurance ₹ 300

Prepare Trading and profit and Loss A/C for year ending 31.03.2019 and Balance sheet as on that date.

II. From the following Trial balance of Aniket you are required to prepare Final Accounts for the year ending on 31 st March, 2019

Debit Balance	Amt. ₹	Credit Balance	Amt. ₹
Opening Stock	2,40,000	Capital	13,00,000
Purchases	8,50,000	Sundry Creditors	1,20,000
Returns Inward	15,000	Bills Payable	60,000
Wages	29,000	Sales	25,00,000
Power and Fuel	21,800	Return Outward	8,000
Travelling Expenses	14,700	Discount	2,000
Audit fees	7,000	Bank Overdraft	1,54,000
Royalty	72,000	Reserve for Bad and doubtful debts	8,000
Discount	1,750		
Postage	13,500		
Bad debts	3,000		

Sundry Debtors	5,20,000		
Furniture	1,20,000		
Plant and Machinery	15,00,000		
Freehold Premises	7,02,000		
Rent, Rates and Insurance	42,250		
	41,52,000		41,52,000

Adjustments:

1. Insurance is prepaid to the extent of ₹ 2,250.
2. Closing stock is valued at ₹ 3,80,000 cost price and ₹ 4,00,000 as Market price.
3. Outstanding Expenses are wages ₹ 6,000 and Rent ₹ 5,000.
4. Write off further bad debts ₹ 1,500 and provide 5% Reserve for doubtful debts.
5. Depreciation on Furniture and plant and Machinery at 10% p.a. and on freehold premises at 15% p.a.

III. Prepare the format of Trading Account.

IV. Prepare the format of Profit and loss”

V. Prepare the format of Balance sheet

10.8 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is trading account? Give its format.
2. What is profit and loss account? Give its format.
3. What is balance sheet? Give its format.

B. Multiple Choice Questions

1. Trading account is a/an _____ account.

(a) Personal	(b) Real
(c) Nominal	(d) Impersonal

2. Profit and loss account is a/an _____ account.
- (a) Personal (b) Nominal
(c) Real (d) Impersonal
3. Balance is a/an _____.
- (a) Account (b) List
(c) Statement (d) Ledger
4. _____ account is prepared to find the gross profit or gross loss of the business.
- (a) Trading (b) Profit and loss
(c) Cash (d) Goods
5. _____ account is prepared to find the net profit or net loss of the business.
- (a) Trading (b) Profit and loss
(c) Furniture (d) Machinery
6. _____ is a statement showing the assets and liabilities of the business, as on a particular date.
- (a) Balance (b) Trading account
(c) Profit and loss account (d) Trial balance
7. _____ is a list showing the debit balance and credit balance of the ledger account.
- (a) Trial balance (b) Trading a/c
(c) Profit and loss a/c (d) Balance sheet
8. All direct expenses are debited to _____.
- (a) Profit and loss a/c (b) Balance sheet
(c) Trading a/c (d) Trial balance
9. All indirect expenses are debited to _____.
- (a) Trading a/c (b) Profit and loss a/c
(c) Balance sheet (d) Trial balance

10. If debit side of trading a/c is more than the credit side of trading a/c, there to _____.
- (a) Gross profit (b) Net profit
(c) Gross profit (d) Net loss
11. If credit side of trading a/c it more than the debit side of trading a/c there is _____.
- (a) Gross profit (b) Gross loss
(c) Net profit (d) Net loss
12. It debit side of profit and loss a/c is more than the credit side of profit and loss a/c, there is _____.
- (a) Gross profit (b) Net profit
(c) Gross loss (d) Net loss
13. If credit side of profit and loss a/c is more than the debit side of profit and loss a/c, there is Gross loss _____.
- (a) Gross profit (b) Net loss
(c) Net profit (d) Gross loss

Answers:

1. (c), 2. (b), 3. (c), 4. (a), 5. (b), 6. (a), 7. (a), 8. (c), 9. (b), 10. (c), 11. (a), 12. (c), 13. (c)

10.9 References

1. Dr. M.A. Arulanandam and Dr. K.S. Raman (2019), “*Advanced Accountancy*” Vol. I & II, Himalaya Publishing House Pvt. Ltd., Mumbai.
2. R.S.N. Pillai, Bagavathi, S. Uma (2006), “*Fundamentals of Advance Accounting*”, Vol. I, S. Chand & Co. Ltd., New Delhi.

UNIT 11 FINAL ACCOUNTS WITH ADJUSTMENTS

Structure:

- 11.0 Learning Objectives
- 11.1 Introduction
- 11.2 Adjustments of Final Account
- 11.3 Summary
- 11.4 Key Words/Abbreviations
- 11.5 Learning Activity
- 11.6 Unit End Questions (MCQ and Descriptive)
- 11.7 References

11.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the various adjustments in final accounts, their meaning and accounting effects.
- Analyse to adjust the port balance sheet date transactions affecting final accounts.

11.1 Introduction

This unit will help you to understand the various adjustments in final accounts, their meaning and accounting effects, know how to adjust post balance sheet date transactions affecting final accounts.



11.2 Adjustments of Final Account

(a) Closing Stock

Closing stock is the stock of goods which remains unsold at the end of the accounting year. Closing stock is to be valued at cost price or market prices, whichever is lower, as per the accounting convention of conservation.

Effects of closing stock

1. Trading account - Credit side
2. Balance sheet - Assets side

(b) Outstanding Expenses (Unpaid Expenses)

Expenses which are due but not paid are called outstanding expenses. They are expenses which are incurred but not paid during the current years.

Effects of outstanding expenses

1. Add to respective expenses on debit side of trading a/c or profit & loss a/c
2. Balance sheet - Liabilities side

Example - 1

How to treat outstanding expenses in final account?

From the following prepare a Trading Account, Profit & Loss Account and Balance Sheet.

Salary ₹ 5,000

Wages ₹ 2,000

Rent ₹ 3,000

Adjustment: Outstanding Salary ₹ 1,000 Outstanding Wages ₹ 500 Outstanding Rent ₹ 1,500

Solution:**Trading Account**

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Wages	2,000		
Add: Outstanding	500		
	2,500		

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Salary	5,000		
Add: Outstanding	1,000		
	6,000		
To Rent	3,000		
Add: Outstanding	1,500		
	4,500		

Balance Sheet

Liabilities	Amount	Assets	Amount
Outstanding Wages	500		
Outstanding Salary	1,000		
Outstanding Rent	1,500		

(c) Prepaid Expenses (Unexpired Expenses) (Expenses Paid in Advance)

Expenses which are paid in advance or expenses paid for unexpired period are called prepaid expenses.

Effects of prepaid expenses

1. Less from the respective expenses on debit side of Trading a/c or profit & loss a/c.
2. Balance sheet - Assets side

Example - 2

How to treat any prepare expenses in Final Account?

From the following prepaid Trading, Profit & Loss and Balance Sheet.

Trial Balance

Wages	2,000
Salary	4,000
Rent	3,000

Adjustment: Prepaid wages ₹ 1,000 Prepaid Salary ₹ 1,500, Prepaid Rent ₹ 1,200

Solution:

Dr.		Trading Account		Cr.	
Particulars	Amount	Particulars	Amount		
To Wages	2,000				
Less: Prepaid Wages	1,000		1,000		

Dr.		Profit & Loss Account		Cr.	
Particulars	Amount	Particulars	Amount		
To Salary	4,000				
Less: Prepaid Salary	1,500		2,500		
To Rent	3,000				
Less: Prepaid Rent	1,200		1,800		

Dr.		Balance Sheet		Cr.	
Liabilities	Amount	Assets	Amount		
		Prepaid Rent	1,200		
		Prepaid Wages	1,000		
		Prepaid Salary	1,500		

Note: All Prepaid expenses should be deducted from the expenses on debit side of trading or profit & loss account and entered on the assets side of balance sheet.

(d) Depreciation

Depreciation is a gradual, permanent continuous decline in the value of fixed assets due to wear and tear, obsolescence, exhaustion or depletion, passage or efflux of time, natural calamities etc. Depreciation is charged or provided only on fixed assets like machinery, furniture, computer etc. Reduction in the value of fixed assets is a loss, which is debited to profit & loss a/c.

Effects of depreciation

1. Profit & loss a/c - Debit side
2. Deduct from the respective asset which is depreciated, on the assets side of Balance sheet.

(e) Bad Debts

Amount which is irrecoverable or not recoverable from debtors, is known as bad debts. Bad debt is a loss for the business, which is debited to profit & loss a/c. If old bad debts are given in the trial balance, it is shown on the debit side of profit & loss a/c. If additional new bad debts are given in the adjustment, there are two effects of new bad debts.

Effects of bad debts adjustment

1. Add to old bad debts in profit and loss a/c - Debit side.
2. Deduct from sundry debtors in balance sheet - Assets side

(f) Provision for Bad and Doubtful Debt (R.B.D.D.)

Bad debts are the debts which are not recoverable from debtor.

Doubtful debts are the debts which may or may not be recovered from debtors.

R.B.D.D. Is the provision for bad and doubtful debts on debtors. If R.D.D./R.B.D.D. Is given in the trial balance, it is old R.D.D./R.B.D.D. which is shown on the debit side of profit and loss a/c. If R.D.D./R.B.D.D. is given as adjustment, then it is new R.D.D./R.B.D.D.

Effects of new R.D.D./R.B.D.D.

1. Add to old bad debts in profit & loss a/c - Debit side
2. Deduct from sundry debtors in balance sheet - Assets side

Example - 4

From the following show how to treat the Bad debts and Reserve for doubtful debts:

Trial Balance

Paritculars	Dr. (₹)	Cr. (₹)
Debtors	1,00,000	
Bad Debts	5,000	
Reserve for doubtful debts	4,000	

Adjustment: Create new Bad debts by 10% and Reserve for doubtful debts by 8%

Solution:

Dr.		Profit & Loss Account		Cr.	
Particulars	₹	Particulars	₹		
To Bad debts	5,000				
Add: New Debts $(1,00,000 \times 10\%)$	10,000				
	15,000				
Add: New Reserve	7,200				
$(1,00,000 - 10\% \times 8\%) (90,000 \times 8\%)$	22,200				
Less: Reserve for doubtful debts	4,000		18,200		

If Provision/Reserve for doubtful debts given in Trial Balance (i.e., 4,000 is more than total of Bad debts new + New Reserve). Then it should be given in the credit side of the profit and loss account.

In profit and loss account, the effect of old bad debts (as given in trial balance), new bad debts (as given in adjustment), new R.D.D./R.B.D.D.) (as given in adjustment and old R.D.D./R.B.D.D.) (as given in trial balance are given below.)

Dr. Profit & Loss A/c for the year ended 31st March..... Cr.

Particular	Amt. ₹	Amt. ₹	Particular	Amt. ₹	Amt. ₹
To old bad debts (as given in trial balance)	xxx		By old R.D.D./R.B.D.D.	xxx	
Add: New bad debts (as give in adjustment)	xxx		Less: Old bad debts	xxx	
Add: New R.D.D./R.B.D.D. (as given in trial balance)	xxx		Less: New bad debts	xxx	
	xxx		Less: New R.D.D./R.B.D.D.	xxx	xxx
Less: Old R.D.D./R.B.D.D. (as given in trial balance)	xxx	xxx			
		xxx			xxx

Note: If old R.D.D./R.B.D.D. on the debit side is more than the total of old bad debts, new bad debts and new R.D.D./R.B.D.D. on the debit side, then it is shown on the credit side of profit and loss a/c

Illustration - 1

From the following Trial Balance, show the journal entries and Amount of Profit and Loss Account, Balance sheet as on 31st Dec. 2014

Particulars	Debit	Credit
Capital Account		2,03,000
Drawings Account	15,000	
Freehold Land and Premises	90,000	
Plant and Machinery	40,000	
Loose Tools	3,000	
Bills Receivable	3,000	
Stock	40,000	
Materials Purchased	51,000	
Wages	20,000	
Carriage Inwards	1,000	
Carriage Outwards	500	

Coal and Coke	5,000	
Salaries	5,000	
Rent, Rates and Taxes	2,800	
Discounts and Allowances	1,500	
Bills Payable		3,800
National Bank	25,000	
Cash in hand	400	
Sundry Debtors	45,000	
Sundry Creditors		40,000
Repairs and Replacements	1,800	
Purchases Returns		2,650
Works Extensions Account	7,500	
Bad Debts	1,200	
Advertisements	500	
Goods Sold		1,15,00
Sales Returns	2,000	
Gas and Water	200	
Oil, Grease, and Waste	600	
Furniture and Fixtures	1,200	
General Expenses	800	
Printing and Stationery	450	
	3,64,450	3,64,450

Write depreciation of Plant and Machinery at 5%, Loose Tools at 15% and Furniture at 5%. The Stock on hand on 31st December, 2014 amounted to ₹ 60,000. Provide for 5% discount on sundry debtors and 5% for doubtful debts. ₹ 1,500 were due for wages and ₹ 450 for salaries for the month of December 2014. The last bill of ₹ 400 for taxes was for the half-year ending 31st June 2014.

Solution:**Journal Entries**

Particulars	LF	Debit	Credit
Depreciation Account Dr.		2,510	
To Plant & Machinery			2,000
To Furniture and Fixtures			60
To Loose Tools			450
(Being 5 per cent Depreciation on Plant, Machinery, Furniture and Fixtures and 15 per cent on Loose Tools written off)			
Profit and Loss Account Dr.		2,250	
To Reserve for Doubtful Debts			2,250
(Being 5 per cent provision or Doubtful Debts on Sundry Debtors)			
Discounts and Allowances Dr.		2,137	
To Reserve for Discounts			2,137
(Being 5 per cent provision for Discounts on Debtors).			
Wages Account Dr.		1,500	
Salaries Account Dr.		450	
To Outstanding Creditors			1,950
(Being the outstanding liability in respect of Wages and Salaries brought into account)			
Expenses Prepaid Dr.		200	
To Taxes			200
(Being the amount of Prepaid Taxes carried forward)			
Trading Account Dr.		1,21,300	
To Stock in Trade			40,000
To Materials Purchased			51,000
To Returns Inwards			2,000
To Wages			21,500
To Coal and Coke			5,000
To Carriage Inwards			1,000

To Oil, Grease and Waste			600
To Gas and Water			200
(Being the transfer of the above items to Trading Account).			
Sales Account	Dr.	1,15,000	
Returns Outwards	Dr.	2,650	
To Trading Account			1,17,650
(Being the transfer of the above items to Trading Account)			
Stock-in-Trade	Dr.	60,000	
To Trading Account			60,000
(Being the incorporation of Closing Stock)			
Profit and Loss Account	Dr.	18,947	
To Salaries			5,450
To Rent, Rates and Taxes			2,600
To Repairs and Replacements			1,800
To General Expenses			800
To Carriage Outwards			500
To Advertisements			500
To Printing and Stationery			450
To Discounts and Allowances			3,137
To Bad Debts			1,200
To Depreciation			2,510
(Being the transfer of the above items to Profit and Loss Account)			
Profit and Loss Account	Dr.	22,653	
To Capital Account			22,653
(Being the transfer of Net Profit)			

Vertical Format**Trading and Profit & Loss Account for the year ended 31st December, 2014**

Particular	Amount	Amount	Amount
Net Sales			
[1,15,000 – 2,000]			1,13,000
Less: Cost of Goods Sold			
Opening Stock		40,000	
Net Purchases [51,000 – 2,650]		48,350	
Wages [20,000 + 1,500]		21,500	
Coal and coke		5,000	
Carriage inwards		1,000	
Oil, grease and waste		600	
Gas and water		200	
		1,16,650	
Less: Closing Stock		60,000	
Cost of Goods Sold			56,650
Gross Profit			56,350
Less: Operating expenses			
Administrative expenses:			
Salaries		5,450	
Rent, rate and taxes		2,600	
Repairs and Replacements		1,800	
General expenses		800	
Printing and allowances		450	
Distribution and allowances		1,500	
Depreciation on plant and machinery		2,000	
Depreciation on furniture and fixture		60	
Depreciation on loose tools		450	
Selling and Distribution Expenses:			

Carriage outwards		500	
Advertisement		500	
Bad debt	1,200		
Add: New reserve for doubtful debts	2,250	3,450	
Discount on debtors		2,137	21,697
			34,653
Add: Operating incomes			Nil
Operating Profit			34,653
Add: Non-operating incomes			Nil
Less: Non-operating expenses			Nil
Net Profit			34,653
[transferred to capital account]			

Balance Sheet as on 31st December, 2014

Capital and Liabilities	Amount	Amount	Amount
Capital:			
Capital		2,03,000	
Net Profit		34,653	
		2,37,653	
Less: Drawings		15,000	
Adjusted Capital			2,22,653
Liabilities:			
Non-current Liabilities:			
Secured loans:			nil
Unsecured loans:			nil
Current Liabilities:			
Bills Payable		3,800	
Sundry Creditors		40,000	

Outstanding salary		450	
Outstanding wages		1,500	45,750
Total			2,68,403
Assets			
Non-Current Assets:			
Fixed Assets:			
Freehold Land and Premises		90,000	
Plant and Machinery [40,000 - 2,000]		38,000	
Loose tools [3,000 - 450]		2,550	
Furniture and fixtures [1,200 - 60]		1,140	1,31,690
Investments:			nil
Current Assets:			
Closing Stock		60,000	
Work extention		7,500	
Sundry Debtors [45,000 - (2,250 + 2,137)]		40,613	
Bills receivable		3,000	
Advanced tax paid		200	
National Bank		25,000	
Cash in hand		400	1,36,713
Total			2,68,403

Horizontal Format**Trading and Profit & Loss Account for the year ended 31st December, 2010**

Particulars		Amount	Particulars		Amount
To Opening Stock		40,000	By Sales	1,15,000	
To Purchases	51,000		Less: Returns	2,000	1,13,000
Less: Returns	2,650	48,350	By Closing Stock		60,000
To wages	20,000				

Add: Outstanding wages	1,500	21,500		
To Coal and Coke		5,000		
To Carriage Inwards		1,000		
To Oil, Grease and Waste		600		
To Gas and Water		200		
To Gross Profit c/d		56,350		
		1,73,000		1,73,000
To Salaries		5,450	By Gross Profit b/d	56,350
To Rent, Rate and Taxes		2,600		
To Repairs and Replacements		1,800		
To General Expenses		800		
To Carriage Outwards		500		
To Advertisements		500		
To Printing & Allowances		450		
To Discounts and Allowances		1,500		
To Bad Debts		1,200		
To Reserve for Doubtful Debts		2,250		
To Depreciation :				
Plant & Machinery 5%		2,000		
Discount on debtors		2,137		
Furniture & Fixtures 5%		60		
Loose Tools 15%		450		
To Net Profit		34,653		
		56,350		56,350

Balance Sheet for the year ended 31st Dec. 2010

Liabilities		₹	Assets		₹	
Capital	2,03,000	2,22,653	Freehold land & premisses		90,000	
Add: Net profit	34,653		Plant & machinery	40,000		
	2,37,653		Less: Depreciation	2,000	38,000	
Less: Drawings	15,000		Loose Tools	3,000		
Outstanding expenses:			Less: Depreciation	450	2,550	
Salary	450		Furniture & Fixtures	1,200		
Wages	1,500		Less: Depreciation	60	1,140	
Bills payable			Closing stock		60,000	
Sundry creditors			Work extension		7,500	
			National Bank		25,000	
		Bills receivable		3,000		
		Cash in hand		400		
		Sundry debtors	45,000			
		Less: Reserve forbad debts	2,250			
			42,750			
		Less: Discount	2,137	40,613		
		Advance Tax paid		200		
		2,68,403			2,68,403	

Illustration - 2

Prepare final accounts from the following. Trial Balance and other adjustments.

Particulars	Dr. (₹)	Cr. (₹)
Machinery	78,000	
Furniture	2,000	
Capital	-	1,00,000
Purchases and Sales	60,000	1,27,000
Return	1,000	750

Stock	30,000	-
Discount	425	800
Debtors and Creditors	45,000	25,000
Salaries	7,550	
Wages	10,000	
Carriage outwards	1,200	
Provision for bad debts	-	525
Rent	10,000	
Advertisement	2,000	
Cash	6,900	
	2,54,075	2,54,075

Adjustments:

- (1) Closing stock ₹ 34,220
- (2) Provision for bad debts is to be kept at ₹ 600
- (3) Allow interest on capital at 10% p.a.
- (4) Depreciate machinery by 10% and furniture by 5%
- (5) Outstanding salary ₹ 550

Solution: (Vertical Form)**Trading and Profit & Loss Account**

Particular	Amount	Amount	Amount
Net Sales			
[1,27,000 – 1,000]			1,26,000
Less: Cost of Goods Sold			
Opening Stock		30,000	
Net Purchases [60,000 – 750]		59,250	
Wages		10,000	
		99,250	

Less: Closing Stock		34,220	
Cost of Goods Sold			65,030
Gross Profit			60,970
Less: Operating expenses			
Administrative expenses:			
Salaries [7,550 + 550]		8,100	
Rent		10,000	
Depreciation on machinery		7,800	
Depreciation on furniture		100	
Selling and Distribution Expenses:			
Advertisement	2,000		
Carriage outwards	1,200		
Discount allowed	425		
New reserve for doubtful debts	600		
Less: Old reserve for doubtful debts	525	75	29,700
			31,270
Add: Operating incomes			
Discount received		800	800
Operating Profit			32,070
Add: Non-operating incomes			nil
Less: Non-operating Expenses			
Interest on capital	10,000		10,000
Net Profit/Net Loss			22,070
[transferred to capital account]			

Balance Sheet as on...

Capital and Liabilities	Amount	Amount	Amount
Capital:			
Capital		1,00,000	
Interest on capital		10,000	

Net Profit		22,070	
Adjusted Capital			1,32,070
Liabilities:			
Non-current Liabilities:			
Secured loans:			nil
Unsecured loans:			nil
Current Liabilities:			
Creditors		25,000	
Outstanding salary		550	25,550
Total			1,57,620
Assets			
Non-Current Assets:			
Fixed Assets:			
Machinery [78,000 - 7,800]		70,200	
Furniture [2,000 - 100]		1,900	72,100
Investments:			nil
Current Assets:			
Debtors [45,000 - 600]		44,400	
Cash		6,900	
Closing Stock		34,220	85,520
Total			1,57,620

Illustration - 3

From the following Trial balance of Mr. Siman as on 31-12-2014 prepare Final accounts as on the above date:

Particulars	Dr. (₹)	Cr. (₹)
Capital Account		1,20,000
Drawings	15,000	
Bills Receivable	22,000	

Machinery	20,000	
Debtors and Creditors	60,000	58,000
Wages	39,000	
Purchase and Sales	2,52,000	3,55,000
Commission		5,500
Rent and Taxes	6,000	
Stock on 1-1-2014	90,000	
Salaries	10,500	
Travelling Expenses	2,000	
Insurance	600	
Repairs	3,400	
Bad debts	3,500	
Furniture	9,000	
Returns	5,000	2,000
Cash in hand and Bank	2,500	
	5,40,500	5,40,500

Adjustments:

- (1) Stock on hand 31-12-2014 was ₹ 1,00,000
- (2) Create 5% provision on debtors for doubtful debts.
- (3) Prepaid insurance amounted to ₹ 100
- (4) Wages outstanding was ₹ 1,000
- (5) Depreciate Machinery by 5% and Furniture by 10% p.a.

Solution: (Vertical Form)**Trading and Profit & Loss Account of Mr. Siman as on 31-12-2014**

Particular	Amount	Amount	Amount
Net Sales			
[3,55,000 – 5,000]			3,50,000
Less: Cost of Goods Sold			

Opening Stock		90,000	
Net Purchases [2,52,000 – 2,000]		2,50,000	
Wages [39,000 + 1,000]		40,000	
		3,80,000	
Less: Closing Stock		1,00,000	
Cost of Goods Sold			2,80,000
Gross Profit			70,000
Less: Operating expenses			
Administrative expenses:			
Salaries		10,500	
Repairs		3,400	
Rent and taxes		6,000	
Insurance [600 - 100]		500	
Depreciation on machinery		1,000	
Depreciation on furniture		900	
Selling and Distribution Expenses:			
Travelling expenses		2,000	
Bad debt	3,500		
Add: New reserve for doubtful debts	3,000	6,500	30,800
			39,200
Add: Operating incomes			
Commission received			5,500
Operating Profit			44,700
Add: Non-operating incomes			Nil
Less: Non-operating expenses			Nil
Net Profit			44,700
[transferred to capital account]			

Balance Sheet as on 31-12-2014

Capital and Liabilities	Amount	Amount	Amount
Capital:			
Capital		1,20,000	
Net Profit		44,700	
		1,64,700	
Less: Drawings		15,000	
Adjusted Capital			1,49,700
Liabilities:			
-current Liabilities:			
Secured loans:			nil
Unsecured loans:			nil
Current Liabilities:			
Creditors		58,000	
Outstanding wages		1,000	59,000
Total			2,08,700
Assets			
Non-Current Assets:			
Fixed Assets:			
Machinery [20,000 - 1,000]		19,000	
Furniture [9,000 - 900]		8,100	27,100
Investments:			nil
Current Assets:			
Closing Stock		1,00,000	
Sundry Debtors [60,000 - 3,000]		57,000	
Prepaid insurance		100	
Bills receivable		22,000	
Cash in hand and bank		2,500	1,81,600
Total			2,08,700

Illustration - 4

From the following Trial Balance of Mr. Avinash as at 31st December 2014 prepare the Final Accounts after considering the necessary adjustments.

Trial Balance

Particulars	Dr. (₹)	Cr. (₹)
Capital account		30,000
Drawings account	2,600	—
Plant and Machinery	12,000	—
Stock on 1st Jan 2014	5,000	—
Purchases	35,000	—
Sales	—	50,000
Returns inwards	2,000	—
Returns outwards	—	1,000
Sundry Debtors	8,000	—
Sundry Creditors	—	6,000
Carriage inwards	500	—
Carriage outwards	500	—
Wages	3,000	—
Salaries	2,000	—
Factory Rent	200	—
Office Rent	500	—
Insurance	500	—
Discount received	—	600
Discount allowed	300	—
Furniture	2,000	—
Bad debts	400	—
Commission	300	—
Building	8,000	—
Bills Payable	—	2,000

Cash in hand	200	—
Cash at Bank	600	—
Bills Receivable	6,000	—
	89,600	89,600

Adjustments:

- Closing stock ₹ 20,000
- Prepaid Insurance ₹ 200
- Interest on Capitals at 5%
- Office Rent outstanding ₹ 400
- Depreciation is to be provided at 10% on Furniture and Plant and Machinery.

Solution: (Vertical Form)**Trading and Profit & Loss Account of Mr. Avinash as on 31st Dec. 2014**

Particular	Amount	Amount	Amount
Net Sales			
[50,000 – 2,000]			48,000
Less: Cost of Goods Sold			
Opening Stock		5,000	
Net Purchases [35,000 – 1,000]		34,000	
Carriage inwards		500	
Wages		3,000	
Factory rent		200	
		42,700	
Less: Closing Stock		20,000	
Cost of Goods Sold			22,700
Gross Profit			25,300
Less: Operating expenses			
Administrative expenses:			

Salaries		2,000	
Office Rent [500 + 400]		900	
Insurance [500 - 200]		300	
Depreciation on plant and machinery		1,200	
Depreciation on furniture		200	
Selling and Distribution Expenses:			
Carriage outwards		500	
Discount paid		300	
Bad debt		400	
Commission paid		300	6,100
			19,200
Add: Operating incomes			
Discount received			600
Operating Profit			19,800
Add: Non-operating incomes			Nil
Less: Non-operating expenses			
Interest on capital			1,500
Net Profit			18,300
[transferred to capital account]			

Balance Sheet as on 31-12-2014

Capital and Liabilities	Amount	Amount	Amount
Capital:			
Capital		30,000	
Add: Interest on capital		1,500	
Add: Net Profit		18,300	
		49,800	
Less: Drawings		2,600	
Adjusted Capital			47,200

Liabilities:			
Non-current Liabilities:			
Secured loans:			nil
Unsecured loans:			nil
Current Liabilities:			
Creditors		6,000	
Bills Payable		2,000	
Outstanding office rent		400	8,400
Total			55,600
Assets			
Non-Current Assets:			
Fixed Assets:			
Building		8,000	
Plant and Machinery [12,000 - 1,200]		10,800	
Furniture [2,000 - 200]		1,800	20,600
Investments:			nil
Current Assets:			
Closing Stock		20,000	
Debtors		8,000	
Prepaid insurance		200	
Bills receivable		6,000	
Cash at Bank		600	
Cash in hand		200	35,000
Total			55,600

Illustration - 5

From the following Trial Balances of Mr. Nagaraj prepare the Final Account for the year ended 31st March, 2014 and the Balance sheet as at that date:

Particulars	Debit	Credit
Land and Buildings	50,000	-
Purchases	1,10,000	-
Stock	40,000	
Returns	1,500	500
Wages	10,000	-
Salaries	9,000	-
Office expenses	2,400	-
Carriage Inwards	1,200	-
Carriage Outwards	2,000	-
Discounts	750	1,200
Bad debts	1,200	-
Sales	-	2,05,000
Capital Account	-	1,30,000
Insurance	1,500	
Commission		1,500
Plant and Machinery	50,000	-
Furniture and Fixtures	10,000	-
Bills Receivable	20,000	
Sundry Debtors	40,000	
Sundry Creditors	-	25,000
Cash in hand	1,500	-
Cash at Bank	4,500	-
Office Equipment	12,000	-
Bills Payable	-	2,350

The following adjustments are required:

- (1) Closing Stock amounted to ₹ 60,000
- (2) Outstanding liabilities: Wages ₹ 2,000, Rent ₹ 3,000
- (3) Depreciate Land and Buildings at 5% and Plant and Machinery at 10%, Office Equipments and Furniture and Fixtures at 10%.
- (4) Raise a Bad and doubtful debts Reserve at 5% on sundry debtors.
- (5) Insurance Premium prepaid ₹ 200
- (6) Provide Interest on Capital at 5%

Solution: (Vertical Form)

Trading and Profit & Loss Account of Mr. Nagaraj as on 31st Dec. 2014

Particular	Amount	Amount	Amount
Net Sales			
[2,05,000 – 1,500]			2,03,500
Less: Cost of Goods Sold			
Opening Stock		40,000	
Net Purchases [1,10,000 – 2,500]		1,07,500	
Carriage inwards		1,200	
Wages [10,000 + 2,000]		12,000	
		1,60,700	
Less: Closing Stock		60,000	
Cost of Goods Sold			1,00,700
Gross Profit			1,02,800
Less: Operating expenses			
Administrative expenses:			
Salaries		9,000	
Office expenses		2,400	
Insurance [1,500 - 200]		1,300	

Outstanding rent		3,000	
Depreciation on land and building		2,500	
Depreciation on plant and machinery		5,000	
Depreciation on office equipment		1,200	
Depreciation on furniture and fixtures		1,000	
Selling and Distribution Expenses:			
Carriage outwards		2,000	
Discount paid		750	
Bad debt	1,200		
Add: New reserve	2,000	3,200	31,350
			71,450
Add: Operating incomes			
Discount received			1,200
Commission received			1,500
Operating Profit			74,150
Add: Non-operating incomes			Nil
Less: Non-operating expenses			
Interest on capital			6,500
Net Profit			67,650
[transferred to capital account]			

Balance Sheet as on 31-12-2014

Capital and Liabilities	Amount	Amount	Amount
Capital:			
Capital		1,30,000	
Add: Interest on capital		6,500	
Add: Net Profit		67,650	
Adjusted Capital			2,04,150
Liabilities:			
Non-current Liabilities:			

Secured loans:			nil
Unsecured loans:			nil
Current Liabilities:			
Creditors		25,000	
Bills Payable		2,350	
Outstanding wages		2,000	
Outstanding rent		3,000	32,350
Total			2,36,500
Assets			
Non-Current Assets:			
Fixed Assets:			
Land and Building [50,000 - 2,500]		47,500	
Plant and Machinery [50,000 - 5,000]		45,000	
Furniture and fixtures [10,000 - 1,000]		9,000	
Office equipment [12,000 - 1,200]		10,800	1,12,300
Investments:			nil
Current Assets:			
Closing Stock			
Debtors [40,000 - 2,000]		38,000	
Bills receivable		20,000	
Prepaid insurance		200	
Cash at Bank		1,500	
Cash in hand		4,500	1,24,200
Total			2,36,500

Practical Questions

Q-1. On December 31, 2010 the following information was available from the books of Sri Mukul Rao.

Stock (01-01-2010)	1,20,000
Purchase made during the year	2,50,000
Sales	3,00,000
Carriage inwards	10,000
Return inwards	20,000
Return outwards	30,000
Wages	8,000
Import duty	12,000
Stock (31-12-2010)	1,70,000
Motive power	3,000

Prepare the Trading account for the year 2010

Q-2. From the following Trial balance of M/s Ranga & Sons co., Prepare Trading and Profit & Loss account for the year ended 31st March 2011.

Particulars	Debit	Credit
Ranga & Sons capital		62,000
Stock (01-04-2010)	23,000	
Purchases & Sales	32,000	53,700
Sales and Purchase Returns	2,000	1,500
Wages	1,800	
Land & Building	52,000	
Freight & Carriage	2,700	
Trade expenses	1,300	
Advertisement	1,500	
Interest		800
Debtors and Creditors	28,000	32,000
Cash in hand	1,200	
Salaries	2,500	
Office expenses	2,000	
	1,50,000	1,50,000

Adjustments: Stock on 31st March 2011 was valued at ₹ 30,000

Q-3. From the following particulars, prepare a Balance Sheet on 31st December 2010.

Particulars	Amount	Particulars	Amount
Capital	1,25,000	Closing Stock	43,000
Drawing	20,000	Net Profit	75,000
Long term loan (cr.)	2,00,000	Sundry Creditors	80,000
Machinery	75,000	Bills Receivable	15,000
Land & Building	1,56,000	Bank Overdraft	35,000
Sundry Debtor	55,000	Cash in hand	21,000
Bills Payable	10,000	Cash in Bank	50,000
Investment	90,000		

Q-4. From the following balances of Mr. Sajal Kumar prepare Trading Account, Profit & Loss Account for the year ending 31st December 2010 and Balance Sheets as on that date.

Particulars	Amount	Particulars	Amount
Purchases	14,000	Commission received	1,000
Sales	28,800	Debtors	5,000
Opening Stock	3,000	Salaries	4,800
Machinery	8,000	Insurance	1,200
Cash	2,000	Buildings	15,000
Creditors	1,500	Bills Payable	2,000
Wages	3,000	Furniture	500
Printing & Stationery	1,700	Interest received	800
Capital	25,000	Patents	4,000
Factory Rent	300	Bank Overdraft	3,400

Adjustments:

- (i) Closing Stock ₹ 5,500
- (ii) Outstanding Printing charges ₹ 300
- (iii) Insurance paid in advance ₹ 200

- (iv) Unpaid Wages ₹ 500
- (v) Commission received in advance ₹ 100
- (vi) Interest accrued but not received ₹ 200

Q-5. The following Trial balances was extracted from the books of Mr. Arjun as on 31st March 2010

Particulars	Dr. ₹	Cr. ₹
Capital account		1,00,000
Plant and Machinery	78,000	
Furniture	2,000	
Sales		1,27,000
Purchases	60,000	
Returns	1,000	750
Opening stock	30,000	
Discount	425	800
Sundry Debtors and Creditors	45,000	25,000
Salaries	7,550	
Wages	10,000	
Carriage Outwards	1,200	
Provision for Bad debts		525
Rent and Rates	10,000	
Advertisement	2,000	
Cash	6,900	
	2,54,075	2,54,075

Prepare Trading and Profit & Loss Account for the year ended 31st March 2010 and a Balance sheet as on that date after taking into account the following adjustments:

- (a) Closing stock was valued at ₹ 34,220
- (b) Provision for Bad debts is to be kept at ₹ 500
- (c) Allow Interest on Capital at 10% per annum.

- (d) Depreciate Plant and Machinery by 10% and Furniture by 5%.
- (e) Outstanding Salary ₹ 550, and prepaid Rent ₹ 1,000
- (f) Goods worth ₹ 1,000, distributed as samples.
- Q-6. From the following Trial balance of Rajanigantha Jewellers, prepare the Trading and Profit & Loss Account for the year ended 31-3-2010, and a Balance Sheet as on that date;

Particulars	Dr. (₹)	Cr. (₹)
Purchases and Sales	24,000	56,000
Returns	400	200
Discount	100	580
Debtors and Creditors	5,000	2,000
Bills Receivable and Payable	4,000	1,000
Drawing and Capital	6,000	20,000
Buildings	18,000	
Furniture	4,000	
Opening Stock	14,000	
Salaries	3,100	
Sundry Income		220
Office expenses	400	
Bad debts	200	
Advertising	800	
	80,000	80,000

Adjustments:

- (1) Closing Stock ₹ 24,200
- (2) Depreciate Building at 5% and Furniture at 10%
- (3) Unpaid Salaries- ₹ 600
- (4) Outstanding Advertising ₹ 100
- (5) Create reserve for Doubtful debts at 10% on Debtors.
- (6) Calculate Interest on Capital and drawings at 5%.

Q-7. From the following Trial balance of Mr. Chandu as on 31st Dec. 2005 prepare the Trading and Profit&Loss account for the year ended 31st Dec, 2010 and Balance sheet on that date:

Particulars	Dr.	Cr.
Capital		90,500
Stock on 1st Jan.2010	46,000	
Purchases	2,44,000	
Returns Inward	8,600	
Freight	19,500	
Sales		2,90,000
Returns Outwards		6,800
Rent	5,700	
Salaries	9,300	
Outstanding Salaries		200
Sundry Debtors	24,000	
Sundry Creditors		19,800
Cash at Bank	8,200	
Printing and Stationery	14,500	
Investments	5,000	
Interest on Investments		300
Furniture	5,000	
Insurance	500	
Postage and Telegrams	950	
Discount	3,300	1,600
Cash in hand	350	
Drawings	10,000	
Sundry Expenses	4,300	
Total:	4,09,200	4,09,200

The following adjustments are required.

- (1) The stock on 31st December, 2010 was ₹ 80,000
- (2) Provide for depreciation on Furniture at 5% p.a.
- (3) Outstanding Interest on Investments amounted ₹ 100
- (4) Write off ₹ 500 as Bad debts out of sundry Debtor.
- (5) The manager is entitled to a Commission of 5% on the net profit before charging such commission.

Q-8. From the following Trial balance of M/s. States as on Dec. 31, 2010 prepare the Trading and Profit & Loss Account for the year ending Dec. 31, 2010 and Balance Sheet as on that date.

Particulars	Debit balances	Credit balances
Capital		1,08,000
Opening Stock	46,800	
Sales & Sales Returns	8,600	2,89,690
Purchases & Purchases returns	2,43,100	5,800
Freight	18,600	
Rent & Taxes	5,700	
Salaries & Wages	9,300	
Sundry Debtors	24,000	
Sundry Creditors		14,800
Bank loan at 6%		20,000
Bank interest	900	
Printing & Advertising	14,600	
Cash at Bank	8,200	
Discount received		3,940
Investment	5,000	
Discount allowed	7,350	
General Expenses	3,600	
Bad debts	570	
Insurance	1,600	

Travelling expenses	2,130	
Cash in hand	380	
Machinery	30,000	
Drawings	10,000	
Furniture	1,800	
	4,42,230	4,42,230

Additional Information:

- (1) The stock on December 31, 2010 was ₹ 80,000.
- (2) 50% of printing and advertising is to be carried forward as a charge in the following year.
- (3) Depreciate Furniture by 10% and Machinery by 5%
- (4) Create 5% provision on Debtors, 2.5% provision for discount on Debtors and Creditors.

11.3 Summary

Adjustment in Final Accounts

As per accrual concept, all expenses and losses of the current accounting year only, whether paid or not paid, should be brought into the book of accounts. All incomes and gain of the current accounting year, whether received or not, should be brought into the books of accounts.

Incomes and expenses of the previous year or next year, will have to be deducted from the total amount received during the year. Unless they are adjusted, the final accounts will not give a true and fair view of the business.

Closing stock is the stock of goods lying unsold with the business at the end of the accounting year. Closing stock is valued at cost price or market price whichever is less. The effects of closing stock are trading account-credit side and balance sheet-assets side.

Outstanding expenses or unpaid expenses are expenses which are due but not paid. The effects are add to the respective expense which is unpaid on the debit side of trading a/c or profit & loss a/c and show it on the liabilities side of balance sheet.

Prepaid expense are expenses which are paid in advance. The effects are minus from the expense which is prepaid in the debit side of trading a/c or profit and loss a/c and show it on the assets side of balance sheet.

Depreciation is charged only on fixed assets. It is a gradual and permanent or continuous fall in the value of fixed assets due to wear and tears efflux of time, exhaustion, obsolescence etc. Depreciation account is a nominal accounts, which is a loss for the business.

The effects of depreciation are the amount of depreciation is to be deducted from the respective asset which is to be depreciated, or the assets side of balance sheet and the amount of depreciation is shown on the debit side of profit & loss a/c.

Bad debts are the amounts which are not recoverable from debtors, which is a loss for the business.

Doubtful debts are debts which may or may not be recovered from debtors.

11.4 Key Words/Abbreviations

- **Closing stock:** Closing stock is the stock of goods lying unsold with the business, at the end of an accounting years.
- **Outstanding or unpaid expenses:** Outstanding or unpaid expenses are expenses which are due, but not paid.
- **Prepaid expenses or Expenses paid in advance:** Expenses which are paid in advance or expenses paid for unexpired period are called prepaid expenses.
- **Depreciation:** Depreciation is a gradual and permanent or continuous, decline/fall in the value of fixed assets due to wear and tear, passage of time, obsolescence, exhaustion, natural calamities etc.
- **Bad debts:** Bad debts are the amounts which cannot be recovered from debtors and it is a loss for the business.

- **Provision for bad and doubtful debts:** When a business make provision for bad and doubtful debts, the business makes provision for anticipate losses or per the convention of conversation.

Bad debts are the debts which are irrecoverable from debtor.

Doubtful debts are the debts which may or may not be recovered from debtors.

11.5 Learning Activity

1. Give the accounting effects of the following adjustment in final accounts:
 - (a) Closing stock
 - (b) Depreciation
 - (c) Bad debts
2. Give the accounting effects of the following adjustments in final account:
 - (a) Outstanding expenses
 - (b) Prepaid expenses
 - (c) Provision for bad and doubtful debts

Practical Problems

1. Following is the Trial Balance of Mr. 'A' as on 31st December, 1996. Prepare 'Trading Account and Profit and Loss Account for the year ended 31st December 1996 and a Balance Sheet as on 31-12-1996.

Trial Balance as on 31st December, 1996

Particulars	Debit ₹	Credit ₹
Land and Building	55,000	
Machinery	40,000	
Salary and Wages	21,000	
Cash at Bank	45,000	
Cash in Hand	1,100	

Office Expenses	1,000	
Motor Van	18,000	
Capital		1,78,000
Carriage	5,000	
Purchases & Sales	2,20,000	2,80,000
Purchase Return		5,500
Sales Return	2,000	
Bad Debts	1,000	
Debtors and Creditors	32,800	35,000
Rent	1,100	
Bank Overdraft		33,000
Printing and Stationery	1,500	
Travelling Expenses	5,500	
Opening Stock (1.1.1996)	30,000	
Insurance	1,500	
Discount	8,000	
Advertisements	12,000	
Furniture	30,000	
Total	5,31,500	531,500

Adjustment:

1. Closing stock is valued at ₹ 20,000.

2. Following is the Trial Balance of M/s. Alva Enterprises. You are required to prepare a Trading Account and Profit and Loss Account for the year ended 31st December 2010 and a Balance Sheet as on that date.

Trial Balance as on 31st December, 2010

Particulars	Debit ₹	Credit ₹
Opening Stock	32,000	
Purchases	75,000	
Sales		4,00,000
Purchase Return		5,000
Sales Return	10,000	
Capital		90,000
Power and Fuel	9,000	
Machinery	35,000	
Factory Rent	3,000	
Office Insurance	5,000	
Drawings	10,500	
Printing and Stationery	4,800	
Postage and Telegram	5,200	
Wages	30,400	
Salaries	40,900	
Cash in Hand	95,000	
Cash in Bank	92,000	
Debtors	35,000	
Creditors		56,000
Carriage Inward	2,100	
Discount		900
Furniture	67,000	
Total	5,51,900	5,51,900

Adjustments:

1. Closing stock is valued at ₹ 25,000/-.
2. Depreciate Machinery by 10% p.a. and furniture by 7.5% p.a.
3. Prepaid Insurance ₹ 100/-.
4. Outstanding wages ₹ 200/-.

3. Following is the Trial Balance of M/s. Alpha Enterprises. You are required to prepare a Trading Account and Profit and Loss Account for the year ended 31st March 2009 and a Balance Sheet as on that date.

Trial Balance as on 31st December, 2010

Particulars	Debit ₹	Credit ₹
Opening Stock	64,000	
Capital		1,00,000
Furniture	50,000	
Purchase	85,000	
Purchase Return		2,500
Sales		3,50,000
Sales Return	1,750	
Power and Coal	5,552	
Rent	2,248	
Insurance	600	
Drawings	4,500	
Bad Debts	725	
Advertisement	675	
Cash in Hand	31,000	
Salaries	24,000	
Wages	12,500	
Cash at Bank	92,000	
Debtors	92,000	
Creditors		72,550

Carriage Outward	6,000	
Commission		500
Machinery	54,000	
Total	5,25,550	5,25,550

Adjustments:

1. Stock on 31st March 2009 is valued at ₹ 20,000/-
2. Unpaid salaries ₹ 550/-.
3. Insurance paid in advance ₹ 100/-.
4. Depreciate Machinery at 7.5% p.a. and furniture at 10% p.a.
4. **Following is the Trial Balance of Milton as on 31st December, 2008.**

Trial Balance as on 31st December, 2008

Particulars	Debit ₹	Credit ₹
Capital		25,000
Drawings	750	
Building	20,000	
Plant and Machinery	6,000	
Cash at Bank	550	
Purchases	47,500	
Sales		75,500
Purchase Return		1,000
Sales Return	1,500	
Carriage Inward	350	
Opening Stock	11,000	
Wages	6,000	
Debtors	17,600	
Creditors		12,600
Salaries	2,500	
Postage and Telegram	200	
Rent	400	

Discount	350	800
Advertisement	300	
Interest		100
Total	1,15,000	1,15,000

Adjustments:

1. Stock on 31st December 2008 was valued at ₹ 8,000/-.
2. Depreciate Building at 5% p.a. and machinery at 10% p.a.
3. Prepaid wages ₹ 1,000/-.
4. Outstanding salaries amounted to ₹ 500/-.

Prepare Trading Account and Profit and Loss Account for the year ended 31st December, 2008 and Balance sheet as on that date.

11.6 Unit End Questions (MCQ and Descriptive)

A. Descriptive Type Questions

1. What is closing stock and depreciation? What are their accounting effects, as adjustments in final accounts?
2. What are outstanding (unpaid) expenses and prepaid expenses (expenses paid in advance)? What are their accounting effects, as adjustments in final accounts?
3. What are bad debts are provision for bad and doubtful debts? What are their accounting effects, as adjustments in final accounts?

B. Multiple Choice Questions

1. Goods lying unsold with the businessman at the end of the accounting year are called _____.
 (a) Opening stock (b) Closing stock
 (c) Stock (d) Middle
2. Expenses which are due but not paid are called _____.
 (a) Prepaid expenses (b) Outstanding expenses
 (c) Unexpired expenses (d) Direct expenses

3. Expenses which are paid in advance are called _____ expenses.
- (a) Prepaid (b) Unpaid
(c) Outstanding (d) Indirect
4. _____ is a gradual and permanent decline in the value of fixed assets.
- (a) Appreciation (b) Depreciation
(c) Amortization (d) Depletion
5. Depreciation is provided in _____ assets.
- (a) Current (b) Fixed
(c) Floating (d) Intangible
6. _____ are debts which are not recoverable.
- (a) Good debts (b) Bad debts
(c) Doubtful debts (d) Recoverable debts
7. _____ is a debt which may or may not be recovered.
- (a) Good debts (b) Bad debts
(c) Doubtful debts (d) Recoverable debts

Answers:

1. (b), 2. (b), 3. (a), 4. (b), 5. (b), 6. (b), 7. (c)

11.7 References

1. T.S. Grewal, (1997), "Introduction to Accountancy", S. Chand and Co. Ltd., New Delhi.
2. R.S.N. Pillai, Bagarathi, S. Uma, (2006), "Fundamentals of Advanced Accounting (Financial Accounting)" Vol. I, S. Chand and Co. Ltd., New Delhi.
3. S.N. Maheshwari & S.K. Maheshwari (2004), "An Introduction to Accountancy", Vikas Publishing House Pvt. Ltd., New Delhi.

UNIT 12 ACCOUNTING FOR GOODS AND SERVICE TAX

Structure:

- 12.0 Learning Objectives
- 12.1 Introduction
- 12.2 Meaning of GST
- 12.3 Tax Merged into GST
- 12.4 GST Tax Structure
- 12.5 Objectives or Advantages of GST
- 12.6 Type of Tax under GST and accounting procedure
- 12.7 Summary
- 12.8 Key Words/Abbreviations
- 12.9 Learning Activity
- 12.10 Unit End Questions (MCQ and Descriptive)
- 12.11 References

12.0 Learning Objectives

After studying this unit, you will be able to:

- Explain the meaning of GST
- Discuss the taxes merged into GST
- Analyse the GST Tax structure



- Explain the objectives or advantages of GST
- Describe the type of tax under GST and accounting procedure

12.1 Introduction

This unit will help you to understand the meaning of GST, know the taxes merged into GST, know the GST tax structure, know the objectives or advantages of GST, understand the type of tax under GST and accounting procedure.

12.2 Meaning of GST

- **GST** stands for goods and services tax. GST is an indirect tax imposed on goods and services, by the central Government of India from 1st July, 2017. Before GST, every state had variety of taxes (different types of taxes) levied (charged) at different stages of trading.
- Taxes that existed before were Excise Duty, custom Duty, VAT, Entertainment Tax. Central Sales Tax, services Tax, Octroi, etc.
- All these taxes are subsumed/ included under GST, that is why GST in one Nation, One Tax, One Market.
- GST is started (is in effect) from 1st of July 2017.
- The **two components of GST are CGST and SGST**.
- **CGST** is central goods and services Tax which is to be paid to the Central Government.
- **SGST** is state Goods and services tax which is to be paid to the state Government.
- **CGST and SGST** is levied on intra-state (within the state) supply (sale) **IGST** (Integrated goods and services Tax) is levied on Inter-state (outside the state supply (sale)).
- **GST** paid by the purchaser of goods and/or services is **Input GST** (Categorised into CGST and SGST). For the person purchasing goods and/or services GST paid is input GST.

- **GST collected by the seller** of goods and/or services is output GST (categorised into CGST and SGST). GST charged by the person selling goods and/or rendering services is output GST.
- In the tax invoice for goods, there is **HSN Code. (Harmonized System of Nomenclature)**.
- All goods are classified by giving numerical code called HSN code.
- In the tax invoice for services, there is **SAC code (Service Accounting Code)**
- All services are classified by giving special code number, called SAC code.

12.3 Tax Merged into GST

The following Central taxes and State taxes have been merged (subsumed) into GST

(A) Central Taxes

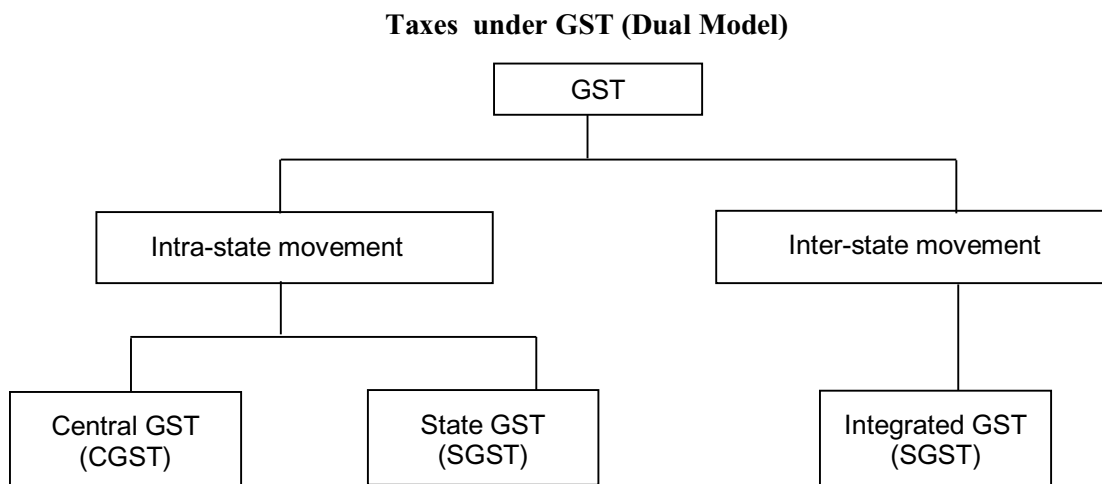
- (a) Central Excise Duty
- (b) Duties of Excise (Medicinal and Toilet Preparations)
- (c) Additional Duties of Excise (Goods of special Importance)
- (d) Additional Duties of Excise (Textile and Textile products)
- (e) Additional duties of custom known as countervailing duty (CVD)
- (f) Special Additional Duty of customer (SAD)
- (g) Service Tax
- (h) Central Sales Tax
- (i) Central surcharges and cesses so far as they relate to supply of goods and services.

(B) State Taxes

- (a) State VAT/Sales Tax
- (b) Luxury Tax
- (c) Entry Tax (all forms)

- (d) Entertainment and Amadement tax (expect when levied by the local bodies)
- (e) Taxes on advertisements
- (f) Purchase Tax
- (g) Taxes on lottery, belting and gambling
- (h) State surcharge and cesses so far as they relate to supply of goods and services.

12.4 GST Tax Structure



GST Regime

1. **Broad Scheme:** There will be only one such law because GST shall subsume the central and state indirect taxes.
2. **Tax on goods and services:** There will be no differentiation between a good and a service. Both are subject to one tax.
3. **Tax rates:** There will be one SGST rate add a uniform rate of SGST across all states for local supplier and Integrated GST (IGST) for all interstate supplies.
4. **Point of levy:** At all supply points, GST in levied
5. **Point of taxation:** GST is a destination based tax collected on final consumption

6. Cascading effect: The cascading effect (tax on tax effect) will not arise as CST concept is being eliminated, with introduction of IGST
7. **Tax Burden:** In GST, tax burden is expected to reduce, because all taxes are integrated which make it possible that burden is split equitably between manufacturing and services.
8. **Tax credit:** Input credit set-off to be available for intra-state and inter-state transactions.
9. **Cost burden on consumers:** Cost burden on consumer is reduced as GST mechanism removes such effect by providing credit
10. **Tax compliance:** Tax compliance would be easier, as only law, subsuming other taxes, needs to be followed.
11. **Taking power of the Government (current power):** Both Centre and State are given the power to make law on GST by virtue of proposed article 246A of the constitution.
12. **Transparent Tax Administration:** GST is levied only at final destination of consumption and not at various points. This brings more transparency and corruption free tax administration.

12.5 Objectives or Advantages of GST

Objectives of GST

The objectives of GST are as follows:

1. To ensure that the cascading effect of tax on tax will be eliminated/removed.
2. To improve the competitiveness of the original goods and services, thereby improving also the GDP rate.
3. To ensure the availability of input credit across value chain.
4. To reduce the complications in tax administration and compliance.
5. To make a unified law involving all the tax bases, laws and administration procedures across the country.
6. To decrease the unhealthy competition among the states, due to taxes and revenues.

7. To reduce the tax slab rates, to avoid further classification issues.
8. To increase the tax base and raise compliance.
9. To have free movement of goods across the country, without any additional tax.

Advantages of GST

The advantages of GST are as follows

1. **Eliminating cascading (Tax on Tax) Effect:** Previously, several taxes were imposed/levied on the same product, that increased the price of the product with the introduction of GST, it will eliminate/remote the tax on tax (cascading) effect, by providing credit for the taxes paid.
2. **Product Identification:** Under the previous regimes classification of products into different categories caused a lot of confusion and was a litigious issue. GST aims solve the issue by bringing in Harmonised System of Nomenclature (HSN), which is an eight digit code to identify products according to international standards.
3. **One Tax:** Instead of several taxes being levied by state and central government, GST imposes only one tax. GST will replace ---- hidden taxes that were imposed by state government and it will improve case of doing business.
4. **Decrease in price of products:** GST will be charged at the manufacturing cost and collected at the point of sale, which means that the price will come down, that will benefit the consumers. Once the prices come down the consumption of consumer will increase which will benefit the companies.
5. **Easy compliance:** All the compliance like registration returns, payments etc. under the GST system will have to be done online which will make compliance under the GST system hassle-free and transparent.
6. **Regulation of unorganized sector:** In India, there are certain industries which are still unorganized. The GST provisions will help to streamline the process of online compliance and payment and thus helps in regulation of unorganized sector.

7. **Uniform tax structure:** GST harmonizes the laws, procedures and tax rates across the country, resulting in a simplified tax structure.
8. **Revenue Increase:** GST is replacing 17 indirect taxes with single tax. Thus, it will result in increase in product demand which will increase the central and state government revenue.

12.6 Type of Tax under GST and accounting procedure

Type of Tax under GST

The type of tax under GST would be a dual GST, with the centre and the states simultaneously levying it on a common base.

- (a) **Central GST** – is the GST to be levied by the central government CGST stands for central goods and services tax.
- (b) **State GST**- is the GST to be levied by the state governments including Union territories with legislature.
SGST state for state goods and services tax.
- (c) **UTGST** – is to be levied by Union territories without legislature UTGST stands for Union Territory Goods and Services Tax
- (d) **IGST** – It stand for Integrated Goods and Services Tax. It would be levied on Inter-state supply of goods or services (including stock transferor). This would be collected by the centre, so that the credit chain is not disrupted.

12.7 Summary

- GST stands for goods and service tax. GST is an indirect tax on goods and services except alcoholic liquor for human consumption. GST is paid by the supplier but ultimately base by the consumer. GST is a comprehensive destination based tax levied where goods/services are consumed. GST is in effect from 1st July 2017.

- The two component of GST are CGST and SGST.
- Different Central Taxes and State Taxes have been merged/subsumed into GST.
- There is a dual GST tax structure for intra-state movement there is CGST and SGST.
- For inter-state movements there is IGST.
- The different objectives of GST are to improve the competitiveness of the original goods and services, ensure the availability of input credit across the value chain, reduce complications in tax administration and compliance etc.
- The advantages of GST are eliminating cascading effect, product identification one tax, decrease in price of products, easy compliance, regulation of unorganized sector, uniform tax structure, increase in revenue.

The type of tax under GST are CGST, SGST, IGST and UTGST.

12.8 Key Words/Abbreviations

- **GST:** GST stands for goods and service Tax. GST is a comprehensive indirect tax imposed on goods and services, each time the goods are sold and for services are rendered except on the exempted goods and services. It is imposed by central government of India from 1st July 2017.

GST Categories

The following are the three categories of GST.

- (a) **CGST** (Central Goods and Services Tax) which is levied on intra-state (within the state) supply (rule).
- (b) **SGST** (State Goods and Services Tax) which is levied on intra-state (within the state) supply (rule).

(c) **IGST** (Integrated Goods and Services Tax) which is levied on inter-state (outside the state) supply (sale). It is charged on the goods and services supplied from one state to another.

Intra-state supply (sale): Intra-state supply (sale) is if the supply (sale) is made within the state.

Inter-state supply (sale): Inter-state supply (sale) is, if the supply (sale) is made outside the state.

- **CGST:** CGST is Central Goods and Services Tax which is to be paid to the central government
- **SGST:** SGST is State Goods and Services Tax, which is to be paid to the state government
- **Input GST:** GST paid by the purchaser of goods and /or services is Input GST (Categorised into CGST and SGST). For the person, purchasing goods and services, GST paid is Input GST.
- **Output GST:** GST collected by the seller of goods and/or services is output GST (Categorised into CGST and SGST). For the person selling goods and/or rendering services, GST charged is output GST.
- **HSN code:** In the tax invoice for goods, there is HSN code (Harmonized system of Nomenclature). All goods are classified, by giving numerical code called HSN code.
- **SAC code:** In the tax invoice for services, there is SAC code (Service Accounting codes). All services are classified, by giving special code number, called SAC code.
- **GSTIN:** GSTIN is GST identification number. A GSTIN is a 15-digit PAN based unique identification number, allotted to every registered person under GST.

A unique code known as GSTIN is assigned to each tax payer, which will be state wise and pan based. The breakdown of the 15-digit GSTIN is as follows:

- (a) The first two digits represent the state code as per Indian Census 2011. Every state or union territory has a unique code. For example 09 is for Uttar Pradesh and 27 is for Maharashtra.
- (b) The next ten digits are the PAN number of the taxpayer of business house.
- (c) The 13th digit indicates the number of registrations in a state for the same PAN. It will be alpha-numeric digit (first 1-9 and then A-Z)
- (d) The 14 digit will be alphabet 'Z' by default.
- (e) The last digit will be a check code to detect errors. It can be an alphabet or a number.

- **Members of GST council**

The GST council shall consist of the following member, namely:

- (a) The Union Finance Minister as the chairperson.
- (b) The Union Minister of State in charge of Revenue or Finance as a member.
- (c) The Minister in charge of Finance or Taxation or any other Minister nominated by each state government as the member.

12.9 Learning Activity

1. Purchased Laptop from Jalaram and company worth ₹ 50,000/- at 18% GST and amount paid by cheque.

Working Note:

Cost of Laptop	₹ 50,000
Add: CGST 9%	₹ 4,500
Add: SGST 9%	₹ 4,500
Net Value	₹ 59,000

Journal Entry

Date	Particulars	LF	Debit Amount ₹	Credit Amount ₹
Year	Laptop A/C. Dr.		50,000	
Month/Date	Input CGST A/C Dr.		4,500	
	Input SGST A/C Dr.		4,500	59,000
	To Bank A/C (Being purchased Laptop by cheque at 18% GST)			

2. Sold Motor Car for ₹ 1,00,000 at 28% GST and amount received by cheque.

Working Note:

Cost of Motor Car	₹ 1,00,000
Add: CGST 14%	₹ 14,000
Add: SGST 14%	₹ 14,000
Net Value	₹ 1,28,000

Journal Entry

Date	Particulars	LF	Debit Amount ₹	Credit Amount ₹
Year	Bank A/C. Dr.		1,28,000	
Month/Date	To Motor Car A/C.			1,00,000
	To Output CGST A/C.			14,000
	To Output SGST A/C.			14,000
	(Being sold Motor Car and amount received by cheque at 28% GST)			

3. Purchased goods from Ram of ₹ 50,000 at 18% GST for cash.

Working Note:

Purchased of Goods	₹ 50,000
Add: CGST 9%	₹ 4,500
Add: SGST 9%	₹ 4,500
Net Value	₹ 59,000

Journal Entry

Date	Particulars	LF	Debit Amount ₹	Credit Amount ₹
Year	Purchase A/C. Dr.		50,000	
Month/Date	Input CGST A/C. Dr.		4,500	
	Input SGST A/C. Dr.		4,500	59,000
	To Cash A/C.			
	(Being purchased goods for cash at 18% GST)			

4. Sold goods to Rakesh of ₹ 70,000 at 18% GST for cash.

Working Note:

Sale of Goods	₹ 70,000
Add: CGST 9%	₹ 6,300
Add: SGST 9%	₹ 6,300
Net Value	₹ 82,600

Journal Entry

Date	Particular	LF	Debit Amount ₹	Credit Amount ₹
Year	Cash A/C. Dr.		82,600	
Month/Date	To Sales A/C.			70,000
	To Output CGST A/C.			6,300
	To Output SGST A/C.			6,300
	(Being sold goods to Rakesh for cash at 18% GST)			

5. Purchased goods from Mohan of ₹ 1,00,000 at 12% GST.

Working Note:

Purchase of Goods	₹ 1,00,000
Add: CGST 6%	₹ 6,000
Add: SGST 6%	₹ 6,000
Net Value	₹ 1,12,000

Journal Entry

Date	Particular	LF	Debit Amount ₹	Credit Amount ₹
Year	Purchase A/C. Dr.		1,00,000	
Month/Date	Input CGST A/C. Dr.		6,000	
	Input SGST A/C. Dr.		6,000	1,12,000
	To Mohan's A/C. (Being purchased goods from Mohan on credit at 12% GST)			

6. Sold goods to Neha of ₹ 30,000 at 18% GST

Working Note:

Sale of Goods	₹ 30,000
Add: CGST 9%	₹ 2,700
Add: SGST 9%	₹ 2,700
Net Value	₹ 35,400

Journal Entry

Date	Particular	LF	Debit Amount ₹	Credit Amount ₹
Year	Neha's A/C. Dr.		35,400	
Month/Date	To Sales A/C.			30,000
	To Output CGST A/C.			2,700
	To Output SGST A/C.			2,700
	(Being sold goods to Neha on credit at 18% GST)			

12.10 Unit End Questions (MCQ and Descriptive)

A. Descriptive Types Questions

1. What is GST?
2. What are the taxes merged into GST?
3. Explain the GST tax structure
4. State the objective of GST

5. Explain the advantages of GST
6. What are the types of taxes under GST?

B. Multiple Choice/Objective Type Questions

1. GST stands for _____
 - (a) Government sales tax
 - (b) Government service tax
 - (c) Goods and services tax
 - (d) Goods and simple tax
2. GST is in effect from _____
 - (a) 1st July 2017
 - (b) 1st July 2018
 - (c) 1st August 2017
 - (d) 1st August 2018
3. SAC code stands for _____
 - (a) Straight Accountancy Code
 - (b) Single Accountancy Code
 - (c) State Accountancy Code
 - (d) Service Accountancy Code
4. HSN code stands for _____
 - (a) Hindustan steel number
 - (b) Himachal state number
 - (c) Hindustan shipyard number
 - (d) Harmonized system of Nomenclature
5. GST structure in India is _____ in nature.
 - (a) Single
 - (b) Dual
 - (c) Triple
 - (d) (a) and (b) both
6. GST is based on the principle of _____ based consumption.
 - (a) Origin
 - (b) Destination
 - (c) Source
 - (d) Production
7. GST is charged on _____ of goods or services
 - (a) Manufacture
 - (b) Consumption
 - (c) Supply
 - (d) Demand

8. The chairperson of the GST council is _____
- (a) Union Finance Minister
 - (b) Union Minister of state in charge of revenue
 - (c) Minister in charge of Finance taxation
 - (d) One elected person among the state Finance Minister's
9. The Vice-chairman of the GST council is _____ .
- (a) Minister is charge of Finance or Taxation
 - (b) Union Finance Minister
 - (c) Union Minister of state in charge of revenue
 - (d) One elected person amongst the state Finance Minister's
10. GST is a comprehensive tax regime covering _____.
- (a) Goods
 - (b) Services
 - (c) Both goods and service
 - (d) None of the above
11. Alcoholic liquor for human consumption subject to _____ .
- (a) CGST
 - (b) SGST
 - (c) IGST
 - (d) None of the above
12. In IGST 'I' stand for _____ .
- (a) International
 - (b) Internal
 - (c) India
 - (d) Integrated
13. On Intra-state supply of goods and/or services _____ is levied.
- (a) SGST
 - (b) CGST
 - (c) IGST
 - (d) Both (a) and (b)
14. On Inter-state supply of goods and /or service _____ is levied.
- (a) CGST
 - (b) SGST
 - (c) IGST
 - (d) both (a) and (b)

15. On Intra-state supply of goods and/or services in Union territory is levied
- (a) CGST (b) SGST
(c) UTGST (d) IGST
16. GST is no levied on which of the following _____
- (a) Immorable property
(b) Fire Petroleum product
(c) Alcoholic liquor for human consumption
(d) All of above
17. GST is administered by _____
- (a) GST council (b) State Government
(c) Central Government (d) Both central and state government
18. Export of goods is dealt under _____ Act.
- (a) Central GST (b) State GST
(c) Integrated GST (d) All of the above
19. Under GST Act, tax payer is allowed to take input tax credit of _____ .
- (a) SGST (b) IGST
(c) CGST (d) All of the above
20. _____ is not subsumed into GST.
- (a) VAT (b) Service Tax
(c) Customer Duty (d) Central Excise Duty
21. _____ is not part of GST council
- (a) Prime Minister (b) Union Finance Minister
(c) Minister of State (Revenue) (d) State Finance Taxation Minister

22. _____ is not exempted from GST.
- (a) Natural gas (b) Alcohol
(c) Tobacco product (d) Petroleum product
23. _____ is the threshold exemption for special category states.
- (a) 20 lakhs (b) 5 lakhs
(c) 10 lakhs (d) 15 lakhs
24. GSTIN is a _____ digit pan based identification number.
- (a) 14 (b) 15
(c) 16 (d) 17
25. GST would be applicable on _____ of goods on services.
- (a) Production (b) Consumption
(c) Manufacturing (d) Supply

Answers:

1. (c), 2. (a), 3. (d), 4. (d), 5. (b), 6. (b), 7. (c), 8. (a), 9. (d), 10. (c), 11.(d), 12.(d), 13. (d),
14. (c), 15. (c), 16. (d), 17. (d), 18. (c), 19. (d), 20. (c), 21. (a), 22. (c), 23. (c), 24. (b),
25. (d)

12.11 References

1. Swain Anil, Agrawal, Gopal. (2018) “*GST Concept and Applications*”, Himalaya Publishing House Mumbai
2. T.J. Thoomkuzhy, Jaya Jacob M, C.M. Chacko (2017), “*GST the Essentials of Goods and Services Tax*”, Himalaya Publishing House, Mumbai
3. [https:// www. Quota. Com.](https://www.Quota.Com)
4. [https:// chalkstreet. Com.](https://chalkstreet.Com)
5. T.S. Creawal’s (2019) “*Double Entry Book-keeping*”, Sultan Chand and Sons (p) Ltd. New Delhi.



**CHANDIGARH
UNIVERSITY**

Discover. Learn. Empower.

www.cuidol.in

1800-1213-88800

INSTITUTE OF DISTANCE & ONLINE LEARNING

NH-95, Chandigarh-Ludhiana Highway, Gharuan, Mohali (Punjab)

Phone:- 7527009635 | Email: info@cuidol.in

FOLLOW US ON:

