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PAPER II: Financial Accounting
Unit : I-VII

SCHOOL OF OPEN LEARNING
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UNIT-I

Lesson 1

ACCOUNTING

Definition of Accounting: Before attempting to define accounting, it may be added that there is no unanimity among accountants as to its precise definition. However, some of the definitions are as given below.

According to L.C.Copper, "Book-keeping may be described as the science of recording transactions in money or money's worth in such a manner that, at any subsequent date, their nature and effect may be clearly understood, and that, when required, a combined statement of their result may be prepared".

R.N. Carter defines Book-keeing as "Book-keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money's worth".

Yet another definition is given by A.H. Rosenkampff. According to him, "Book-keeping is the art of recording business transactions in a systematic manner".

Out of the above and many more others, the most acceptable one is that given by American Institute of Certified Public Accountants (AICPA) Committee on Terminology. According to AICPA "Accounting is the art of recording, classifying and summarizing 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 ".

Book-keeping is a subject of profound-importance to all kinds of business enterprises.

It is of great importance, for example, to manufacturing concerns, trading concerns, banks, transport companies and insurance companies. They have to follow a proper accounting system if they want to know as to whether they are earning, profits or incurring losses and how much; whether or not all the transactions have been recorded fully and accurately; the amount they owe to their creditors as well as the amount owed to them by their debtors.

Thus the objects of accounting are to enable the businessman to ascertain accurately and easily.

1. The amount of gain or loss during a particular period, and
2. The amount of his assets and liabilities and capital in the firm at a particular point of time.

Double Entry Principle: In the present era double entry system of book-keeping is considered to be the best, common and universal system, because it is modem, scientific, and complete. It fulfils all the objects of a businessman. It originated in western countries and so it is also called western system of accounting. It is also called mercantile system of accounting because according to this system cash and credit transactions can be recorded.

Double entry system has been defined differently by different authorities. Some of which are as follow:

According to Carter, "The modem system of Accounting in use is known as Double Entry". Double Entry is a system of Book-keeping by means of both personal and impersonal accounts."

M.J. Keller defines Double Entry System as follows: "The most common system of accounting data for an enterprise is the Double Entry System. As the name implies, the entry made for each transaction is composed of two parts, a 'Debit' and a 'Credit'."

Each business transaction that result in transfer of money or money's worth involves a two-fold aspect, (a) the yielding or giving of a benefit, and (b) the receiving of that benefit. In other words every business transaction involves exchange of value for value, or inter-change of money or money's worth or every business transaction involves receiving something having value and giving something which has value. According to Double Entry System, both these aspects of the transaction, the receiving aspect and the giving aspect, are recorded. Thus, if Building is bought from Mukesh, Building Account receives and Mukesh's Account gives. There must, therefore, be double entry to have a complete record of each transaction.

For a clear understanding of the principles of double entry system, it is necessary to first carefully bear in mind that certain transactions are common to almost every business. These common transactions are as follows:

1. The businessman enters into business dealings with a number of persons or firms;

2. He must have some assets or properties in which or with the help of which he carries on the business; and

3. He must incur certain expenses such as office rent, salaries, advertising, etc. for carrying on the business, and that he must have some sources form which the income of the business is derived.

It follows, therefore, that in order to keep a complete record of all the business transactions, it will be necessary to keep the following accounts

(i) The account of each person or firm with whom the firm has to deal;

(ii) The account of each asset or property in the business; and

(iii) The account of each head of expense or source of income.

The accounts which come under first group are called Personal Accounts, those which come under second group are called Real Accounts, and those coming under the third group are called Nominal accounts.

Since words 'debit and credit', and 'Account' have been used in the above definitions and discussion, it will be better if we first understand the meaning of these words and then proceed to discuss the rules of double entry system.

The double entry system divides the page into two equal halves. The left hand side of each page is called the debit side, while the right hand side is called the credit side. There was no rational reason in the way in which the sides, were chosen to represent different items, and the credit side could have easily been the left-hand side and the debit the right hand side. The Venetion merchants who were the 'first known businessmen to use double entry just happened to select the left hand or debit side for the assets and opposite side to represent capital and liabilities, and so it has remained ever since.

An Account is a classified and chronological record in which the money values (some times also the quantities or the money values and quantities together) of all the benefits given or received by a particular party (which may be a human being or a personified object) are arranged in two separate columns on the right and left sides respectively of each sheet of paper or each page or folio of the book in which it is written. There will be a debit side as well as credit side to every account. This is indicated by writing "Dr" and "Cr" on the left-hand side and right-hand side margin respectively of the account. All entries in the Dr. side are preceded by the word 'To', meaning that the account of which the record is being prepared is a debtor to the account the name of which appears in the entry. On the other hand, all entries in the credit side are preceded by the word 'By', so that each entry may mean that the account of which the record is being prepared is credited by the account the name of which appears in the entry. The title of the account is written across the top of the account at the centre.

The account of the party that gives a benefit is called a "Creditor" and that of the party that receives it is called a "Debtor". As a general rule the value of each benefit received by an account is entered on the left-hand column of the account and the account is said to have been 'debited' with such value; on the other hand, the value of each benefit given by an account is entered on the.right-hand column of the account and the account is said to have been 'credited' with such value. These are called debit and credit entries respectively.

Having understood the meaning of the words "Debit and Credit", and "Account", let us now proceed with the explanation of rules of double entry system.

Rules of Double Entry System: For debiting or crediting a particular account, we have first to see which class of account are affected by the transaction which is entered into by the businessman. After ascertaining that, the following rules of debit and credit will have to be followed:

(1) *Personal Accounts:* In the case of personal accounts we debit the person or the firm with the benefits received by him or by the firm and credit the person or the firm with the benefits imparted by the person or the firm. In short we can say that –

Debit the Receiver (of benefits): and

Credit the Giver (imparting the benefits)

(2) *Real Accounts:* Real accounts are debited with the incomings and are credited with the outgoings or,

Debit what comes in the business; and

Credit what goes out (of the business)

(3) *Nominal Accounts:* All amounts expended or lost are debited and all amounts gained are credited to nominal accounts

In other words:

Debit all expenses and losses; and

Credit all incomes and gains.

It should be kept in mind that these rules never vary and will have to be rigidly followed under all conceivable conditions. It should also be noted that the above mentioned phenomenas like 'giver' and 'receiver', 'coming in' and 'going out' etc. are to be judged not from the proprietor's point of view but from .the point of view of the business.

In addition to the above rules of double entry system, there are certain basic concepts and conventions of accounting which must be known before actual book-keeping and accounting work is started. These concepts are discussed here-in-after.

Accounting As An Information System

Accounting is often referred to as the language of business. The primary aim of a language is to serve as a means of communication. Accounting is used to communicate financial and other information to people, organizations, Governments etc., about various aspects of business and non-business entities. Accounting information is used when Mr. A applies for a loan at a bank or when A submits his .income-tax returns. Business enterprises use accounting for their day-to-day activities and to report the result of these activities to their owners, creditors, employees and Governmental agencies. The accounting is, therefore, also an information system. In today's society, many of persons and agencies outside the accounting information; (i) Accountant may supervise the work of book-keeper's recording work but the book-keepers have no role in accountant's work of interpretation; (ii) the work of book-keeper is routine and clerical in nature and is increasingly being done by computers. But the work of accountant is technical in nature and requires higher level of knowledge, conceptual understanding and analytical skill; (iii) **Book-keeping** is done in accordance with basic concepts and conventions for all types of organizations. But the methods and procedures adopted by **accountants** in the analysis and interpretation of financial reports may not be same for all the firms.

Functions of Accounting

Financial Accounting performs the following nature functions:

(i) Maintaining systematic records: Business transactions are properly recorded, classified under appropriate accounts and summarized into financial statements– income statement and the balance sheet.

(ii) **Communicating the financial results:** Accounting is used to communicate financial information in respect of net profits (or loss), assets, liabilities etc., to the interested parties.

(iii) **Meeting legal needs:** The provisions of various laws such as Companies Act, Income Tax and Sales Tax Acts require the submission of various statements, i.e., annual account, income tax returns, returns for sales tax purposes and so on.

(iv) **Protecting business assets:** Accounting maintains proper records of various assets and thus enables the management to exercise proper control over them with the help of following information regarding them: (a) How much is balance of cash in hand and cash at bank? (b) What is the position of the inventories? (c) How much money is owed by the customers? (d) How much money is owing to the creditors? (e) What is the position of various fixed assets and how these are being used?

(v) **Accounting assists the management In the task of** planning, control and coordination of business activities.

(vi) **Stewardship:** In the case of limited companies, the management is entrusted with the resources of the enterprise. The managers are expected to act true trustees of the funds and the accounting helps them to achieve the same.

(vii) **Fixing responsibility:** Accounting helps in the computation of the profits of different departments of an enterprise. This would help **in fixing the responsibility of departmental heads.**

Advantages of Accounting

(i) **Assistance to management:** The accounting information helps the management to plan its future activities by preparing budgets in respect of sales, production, expenses, cash, etc. Accounting helps in coordination of various activities in different departments by providing financial details of each department. The managerial control is achieved by analyzing in money terms the departures from the planned activities and by taking corrective measures to improve the situation in future.

(ii) **Records rather than memory:** It is not possible at all to do any, business by just remembering the business transactions which have grown in size and complexity. Transactions, therefore, must be recorded early in the books of accounts so that necessary information about them is available in time and free from bias.

(iii) **Intra-period .comparisons:** Accounting information when recorded properly can be used to compare the results of one year with those of previous year(s).

(iv) **Aid in legal matters:** Systematically recorded accounting information can be produced as an evidence in a court of law.

(v) **Help in taxation matters:** Income Tax and Sales Tax authorities could be convinced about the taxable income or actual turnover **(sales),** as the case may be with the help of written records.

(vi) **Sale of a business:** In case, a sole trader or a partnership firm or even a company wants to sell its business, the accounting information can be utilized to determine proper purchase price.

Limitations of Accounting

(i) Accounting information is expressed in terms of money. Non-monetary events or transactions, however important they may be, are completely omitted.

(ii) Fixed assets are recorded in the accounting records at the original cost, that is, the actual amount spent on them plus, of course, a incidental charges. In this way the effect of inflation (or deflation) is not taken into consideration. The direct result of this practice is that balance sheet does not represent the true financial position of the business.

(iii) Accounting information is sometime based on estimates; estimates are often inaccurate. For example, it is not possible to predict with any degree of accuracy the actual useful life of an asset for the purpose of depreciation expense.

(iv) Accounting information cannot be used as only test of managerial performance on the basis of more profits. Profits of a period of one year can readily be manipulated by omitting such cost of advertisement, research and development, depreciation and soon.

(v) Accounting information is not neutral or unbiased. Accountants calculate income as excess of revenue over expenses. But they consider only selected revenues and expenses. They do not, for example, include cost of such items as water or air pollution, employee's injuries etc.

(vi) Accounting like any other discipline has to follow certain principles which in certain cases are contradictory. For example current assets (e.g., stock of goods) are valued on the basis of cost or market price whichever is less following the principle of conservatism. Accordingly the current assets may be valued on cost basis in some year and at market price in other year. In this manner, the rule of consistency is not followed regularly.

The Users of Accounting Information

Financial accounting is primarily concerned with preparation of accounting information for the outsiders who do not have direct excess to the accounting records. They obtain accounting information of business enterprises from their annual reports, data published by Government departments and information published in financial newspapers, e.g., the Economic Times, Financial Express etc., or business magazines e.g., Business India, Business World, The Economist, etc. In the following paragraphs, the users of accounting information have been grouped into a number of major headings and the requirements for each considered therein:

Creditor and short-term lenders : Creditors include suppliers of goods and services on credit. Short-term such as commercial banks supply money for short period to business organizations. Bankers and suppliers inspect the accounting information before making loans or granting credit.They want to know whether or not the enterprise will be able to meet its financial repayment obligations in time. Their specific interest lies in solvency, liquidity and profitability positions of the business enterprise. Accounting serves their purpose by disclosing true and fair view of current assets in the balance sheet and profitability position in the income statement so as to assure the creditors and lenders that their debts would be paid in time.

Investors : Under this category are included the existing shareholders and future shareholders. Basically they will be interested in the dividends that are paid. They are also interested about the future prosperity of their enterprise. But the income statement and the balance sheet of one year will not be helpful to guide the investors about the future prospects. So the accounting information must provide the details of the profits and financial position of business so that the investors can find out the progress of the past few years and it may be assumed that this progress will be maintained in future as well. At present such information is generally given in the published accounts. The statement of the chairman in the annual reports also provides some indication about the future progress.

Long-term lenders : This category of users include debenture holders and those providing long-term loans, say; industrial banks, financial institutions, etc. They are interested in knowing that they will get the interest due to them and that the same will be paid when it is due and payable. They will also see to it that their principal amount is also paid on due date. So their main interest is in the profitability for interest payments and liquidity for the repayment of the loan amount. The availability of cash flow statements in addition to income statement and balance sheet has considerably helped users to evaluate the liquidity position of a business enterprise.

Management : The owners are not the only persons within the business enterprise who are interested in various aspects of the operations of a business. With the separation of management and ownership

(particularly in a limited company), the managers are responsible for carrying on the operations of the business enterprises. The type of accounting information needed by managers may vary with the size of the enterprise. The manager of a small business may need relatively little accounting information. As the business enterprises grows in size, the manager loses direct contact with daily operations. As a result, information about the various aspects of the business enterprise must be supplied by accounting. Some of their needs for accounting information relate to: (i) setting objectives or targets for future periods and devising methods to attain those objectives; (ii) observing and measuring the performance of the various departments of the business as also the enterprise as a whole; (iii) evaluating the performance in relation to the targets set up; highlighting the deviations from the planned targets; and (iv) taking such corrective action as may be necessary to overcome the shortfalls.

Employees (Labour unions) : In .this category are included both individual employees and groups of them represented by labour unions. Employees want more salary and other benefits such as overtime payments, bonus, housing, medical facilities and so on. The bargaining power of the unions is increased if workers' demands are based on facts and figures. In addition, some companies regularly issue certain reports containing financial information about the employers for a better understanding of the business by the employees. These reports highlight what the companies are doing for the welfare of their employees and what they intend to do in future.

Government and regulatory agencies : In recent years, the government has become one of the most important users of accounting information. The central, state and local governments have the responsibility of allocating the resources for different uses. Naturally they are interested in the activities of business enterprises such as sales, profits, dividend policies, investments, etc. Moreover, the Government activities are financed through the collection of tax. Thus, the accounting information about business activities is very helpful in the collection of income tax, excise duties, custom's duties, sales tax, etc. Each tax requires a special tax return based on necessary accounting information of various business enterprises. Any distortion in the accounting information needed by the Government agencies would adversely affect the welfare policies of various types of governments. Similarly a number of regulatory agencies like Securities and Exchange Board of India (SEBI), the Insurance Regulatory Authority, the Reserve Bank of India etc., need accounting information for the efficient operation of capital markets.

Individuals and society : People arc affected by the operations of a business enterprise in their localities. They want to know through the accounting information the trends in the prosperity of the enterprise and also the range of activities. This would enable them to assess the employment opportunities in their local areas. Society as a whole is concerned with the environment pollution. The accounting information would disclose how much money has been allocated to control such pollution. This has come to be known as social responsibility accounting.

Branches of Accounting

Accountants tend to specialize in various types of accounting work and this has resulted in the development of different branches of accounting. Some of these divisions of accounting are given as:

(i) **Financial Accounting :** Accounting designed for outsiders (persons other than owners and managers) is known as financial accounting. It is concerned with the recording of business transactions and periodic preparation of balance sheets and income statement from such records. In this manner, the financial accounting is useful for the ascertaining profit or loss made during a given period and financial position at the end of the period.

(ii) **Management Accounting :** It is concerned with the interpretation of accounting information to guide the management for future planning. decision-making control, etc. Managment Accounting, therefore, serves the information needs of the insiders, e.g. owners, managers and employees.

(iii) **Cost Accounting:** It has been developed to ascertain the cost incurred for carrying out various business activities and to help the management to exercise strict cost control.

(iv) **Tax Accounting:** This branch of accounting has grown in response to the difficult tax laws such as relating to income tax, sales tax, excise duties, custom duties, etc. An accountant is required to be fully aware of various tax legislations.

(v) **Social Accounting :** This branch of accounting is also known as social reporting or social responsibility accounting. It discloses the social benefits created and the costs incurred by the enterprise. Social benefits include such facilities as medical, housing, education, canteen, provident fund, so on while the social costs may include such matters as extra hours worked by employees without payment, environment pollution, unreasonable terminations, etc.

(vi) **Human Resource Accounting :** It is concerned with the human resources of an enterprise. Accounting methods are applied to identify human resources and its evolution is done in money terms so that the society might judge the total work of the business enterprises including its non-human net assets. It is, therefore, an accounting for the people of the organization. Unfortunately no objectively verifiable measure has been developed for universal application.

(vii) **National Accounting** means the accounting for the nation as a whole. It is generally not concerned with the accounting of individual business entities and is not based on generally accepted accounting principles. It has been developed by the economists and the statisticians.

Basis of Accounting

The business enterprises use accounting to calculate the profit from the business activities at the end of given period. There are two basis of calculating the profit, namely, the cash basis and accrual basis.

(i) **Cash basis of accounting :** In this basis of accounting, the income is calculated as the excess of actual cash receipts in respect of sale of goods, services, properties, etc., over actual cash payments regarding purchase of goods, expenses on rent, electricity, salaries, etc. Credit transactions are not considered at all including adjustments for outstanding expenses and accrued income items. This method is useful for professional people like doctors, engineers, advocates, chartered accountants, brokers and small traders. It is simple to adopt because there are no adjustment entries. But this basis does not disclose the true profits because it does not consider the income and expense items which relate to the accounting period but not paid in cash. Moreover, this method is not applicable where the number of transactions is very large and expenditure on fixed assets is high. The income or profit is calculated with the help of receipts and payments account.

(ii) **Accrual basis of accounting :** Under this method the items of income (revenue) are recognized when they are earned and not when the money is actually received later on. Similarly expense items are recognized when incurred and not when actual payments are made for them. It means revenue and expenses arc taken into consideration for the purpose of income determination on the basis of the accounting period to which they relate. The **accrual basis** makes a distinction between actual receipts of cash and the right to receive cash for revenues and the actual payments of cash and legal obligations to pay expenses. It means that income accrued in the current year becomes the income of current year whether the cash for that item of income is received in the current year or it was received in the previous year or it will be received in the next year. The same is true of expense items. Expense item is recorded if it becomes payable in the current year whether it is paid in the current year or it was paid in the previous year or it will be paid in the next year. The advantages of this system are: (a) it is based on all business transaction of the year and, therefore, discloses thc'current profit or loss; (b) the method is used in all types of business units; (c) it is more scientific and rational application; (d) it is most suitable for the application of matching principle. The **disadvantages** are: (a) it is not simple one and requires the use of estimates and personal judgement; (b) it fails to disclose the actual cash flows.

(iii) **Mixed or Hybrid basis of accounting:** Under this method revenues (items of income) are recognized on cash basis while the expenses are recorded on accrual basis. The purpose is to remain cautious, safe and hundred per cent certain for revenues items and make adequate provisions for expenses.

Accounting Concepts and Conventions

Accounting in the past was mainly used to (1) keep control over property and assets of the business concerned and (2) ascertain and report about the profit or loss and the financial position relating to the various periods. But now a days accounting is used not only for the above mentioned purposes but also for collecting, analysing and reporting of information to the management and others at the required points of time to facilities rational decision making. Moreover, the accounts in the past were prepared mainly for the use of proprietor. Today financial statements are required by the proprietors, creditors, potential investors, Government and many others. The proprietors study the financial statements to know about the profitability of their business. Creditors study them to ascertain the solvency of the business. Perspective investors are interested in them for the ascertainment of the correct earning potential of the business. Government makes use of these statements for finding out the net contribution that a business can make the economic well-being of the country.

To satisfy the diverse and complex needs of those who use accounting, one needs something more than the clerical procedures, journalising, posting, taking out trial balance and closing the books etc. The accountant should have 'guides to action' or 'principles' for completing his work of a wide dimensions. The usefulness of accounting will be maximized only if there exist some generally accepted concepts regarding the nature and measurement of liabilities, assets, revenues and expenses. There must also be some widely supported standards of disclosure and reporting. There will be widespread understanding of and reliance on accounting statements only if they are prepared in conformity with generally accepted accounting principles. If there is no common agreement on accounting matters then complete chaotic conditions prevail as in that case every businessman and/or every accountant could follow his own definition of revenue and expense.

Definition : The rules conventions of accounting are commonly referred to as 'principles'. A universal definition of the 'accounting principles' is difficult to give. However, 'accounting principles' can be defined in the following two ways :

1. Accounting Principle is a "General Truth" or 'fundamental belief. This definition implies a scientific bias and therefore, its application in the face of ever changing socio-economics factors which affect the very basis of a business is doubtful.
2. Accounting principle may be defined as a 'rule of action or conduct'. This definition finds favour with the American Institute of Certified Public Accountants as it refers to changing character of rules of action or conduct due to the changes in business practices etc. According to AICPA, accounting principle is a general law or rule adopted or processed as a guide to action. The accounting principles do not prescribe one way of doing things. They recognize that there are a number of ways in which one thing can be done. The accountant has considerable latitude and choice within the generally accepted accounting principles in which to express his own idea as to the best way of recording and reporting is specified account. The practice of recording and reporting may thus differ from company to company.
3. It should be noted that it would be incorrect to suggest that accounting principles are a body of basic laws like those found in natural sciences like Physics and Chemistry. Accounting principles are man made and hence are more properly associated with such items as concepts, conventions and standards. Accounting principles were not deducted from basic axtoms, not is their validity verifiable by observation and experiment in a laboratory. Accounting principles are constantly evolving, being influenced by business practices, the needs of statement users, legislation

and governmental regulations the opinions and actions of shareholders, labour unions, creditors and management; and the logical reasoning of accountants. The sum total of all such influences finds its expression first in accounting theory. Some theories are accepted while some others are rejected. *Theory becomes an accounting principle only when it is generally accepted.*

A distinction between Fundamental Accounting Assumptions and 'Accounting policies' has been made by the International Accounting Standards Committee (1ASC). Fundamental Accounting assumptions or postulates according to the ISC underlie the preparation of financial statement. They need not be specifically stated on the face of such statements. Their acceptance and use is assumed in the preparation of financial statements. Disclosure with full reasons, however, must be made in case they are not followed- Accounting policies on the other hand encompass the principles, basis, conventions, rules and procedures adopted by management in preparing and presenting financial statements. There are, as stated above, many different accounting and applying those which in the circumstances of the enterprise, are best suited to present properly its financial position and the results of its operations.

Essential Features of Accounting Principles

The general acceptance of an accounting principle or practice depends on its capacity to meet the criteria of relevance, objectivity and feasibility.

An accounting principle should be relevant, i.e. the use of it should result in information that is meaningful and useful to the financial statement users.

In other words only those accounting rules which increase the utility of the business records to its readers will be accepted as an accounting principle by them.

It should be objective. The accounting information obtained should not be influenced by the personal bias or judgement of the statement makers. Objectivity can notes reliability or trustworthiness. It means that there must be means of ascertaining the correctness of the information reported in a financial statement.

A principle is feasible to the extent that it can be implemented without undue cost or complexity. The accounting principles may be adopted to the needs of business quickly and easily. It means the accounting principles should be flexible, i,e. they should not be static. They should be capable of being changed with the changes in business methods and procedures.

The accounting principles generally combine all the above mentioned features or criteria, but sometimes we may have to give up one criterion in favour of another or we may place greater importance on one and lesser importance on the other. For example while valuing the fixed assets at cost or Balance Sheet purposes we give up the criterion of objectivity and usefulness in favour of feasibility. The fixed assets are valued at cost and not at market price even though the cost figure is not of much use of the reader because of changes in the value of rupee, a measuring rod. This is done because of the following two reasons.

1. The market price or replacement value of the assets is difficult to ascertain.
2. The market price of the replacement value of the fixed assets even if one is able to ascertain will be less objective in nature.

Thus in developing new principles, the essential problem is to strike the right balance between objectivity and feasibility on the one hand and relevance on the other.

Definition of Accounting Conventions : Accounting conventions mean and dignify customs or traditions relating to accounting. Thus they differ from accounting concepts which are used to connote accounting postulates. In other words, we can say that accounting conventions relate to the practical side of accounting.

After understanding the meaning of accounting concepts and conventions let us now discuss each one of these concepts and conventions in some detail.

(1) ***Going Concern Concept:*** Kohler defines going concern as, "A Business enterprise in operation with the prospects of continuing operation in the future; its assets, liabilities, revenues, operating costs, personnel policies and prospectus; a concept basic to accounting, of importance in the valuation of intangible assets and the depreciation of tangible and intangible assets." (Kohler, E.L.: *A* ***Dictionary for Accountants,*** Prentice-Hall Inc. Engle Wood Cliffs, N.I., 1963)

Simply stated accounting assumes that the business will continue to operate for an indefinitely long period in the future. In other words the accounting unit is considered to have a greater life expectancy than that of any asset which it now owns. This necessitates the making of a distinction between capital expenditure and revenue expenditure. Though every expenditure is a revenue expenditure in the long run, this distinction is important because accounts of a business supposed to run for a long period of time, are usually prepared for a short period say, a year.

If this assumption is not made, the generally accepted accounting principles that have been developed and that are applied in the process of accounting for the financial affairs of a business entity and which are, in many instances, appropriate only for a going concern will become redundent or useless. If the business is failing and its assets are subject to forced sale, the conventional accounting approach, although acceptable for a going concern, would often result in wrong or inadequate financial information.

Under this assumption a business is viewed as an Economic or financial system for adding value to the resources it uses. Its success is measured by comparing the value of its output with the cost of the resources used in producing that output. The difference in the value of its output and the costs of the resources used to produce that output is called profit. Resources purchased but not yet used in production are called assets. They are shown not at current value to an outside buyer, but at heir cost. Their current resale value is not relevant, since it is assumed that they will be used in the creation of future output values rather than being sold.

Thus, the accountant does not try to measure at all times what the business is currently worth to a potential buyer. He does not show in the balance sheets the value, the assets will fetch of the company goes into voluntary liquidation. He rather values the assets used for business purposes at cost. For a going concern that intends to continue using such assets for business purposes, forced sale or current market value is not particularly relevant. But if the business is winding up its affairs and must sell its assets to satisfy the claims of its creditors, the original cost of the assets is no indicator of realizable value.

The fact should be kept in mind while preparing the account of a concern if it is clear that the life expectancy of such business is very sort. It is only because of this that in the case of contracts, assets purchased are debited entirely to the contract account and not treated as an asset.

(2) ***The Business Entity Concept:*** For accounting purposes the business is treated as a complete unit or entity separate from those who own it or give credit to it. The owner or proprietor is considered to be separate and distinct from the business he owns or controls. Accounts are maintained For business entities as distinct from the persons who own them, operate them, or are otherwise associated with the business. For accounting purposes even the proprietor will be treated as creditor to the extent of his capital. The proprietor's private affairs are thus not allowed to be mixed up with those of the business. It is only because of this concept that we are able to present a true picture of the firm. The entity concept is applicable to all forms of business organizations. For accounting purposes even the sole trader or partner is considered to be an entity different from the business he owns although even in law there is no distinction between the financial affairs of the business and those of the people who own it; a creditor of the business can use and if successful collect from the owner's personal resources as well as from the resources of the business.

The field of this concept has now been extended. It is now also applied for finding out the results of various departments of the same organization separately with a view to fixing the responsibility for the results thereof.

"There follows from the distinction between the business entity and the outside world that an important purpose of financial accounting is to provide the basis for reporting on stewardship. The managers of a business are entrusted with funds supplied by owners, banks and others. Management is responsible for the wise use of these funds, and financial accounting reports are in part designed to show how well this responsibility or stewardship, has been discharged". *(Management Accounting Principles* by Robert N. Anthony)

(3) *Money Measurement Concept :* Accounting records only those facts which could be expressed in terms of money. This concept ignores the records of events on which precise money values can not be put, even if they are very important. In other words, we cannot express qualitative events with the help of accounting unless they can be measured in terms of money with a fair degree of accuracy. This enables us to deal arithmeticaly (added, subtracted, divided or multiplied) with things of diverse nature, e.g., cost of use of plant and machinery and use of skilled labour can be aadded up. This is so because money provides a common denominator by means of which heterogeneous facts about a business can be expressed in terms of numbers that can be dealt with arithmetically.

This concept imposes severe limitations on the scope of accounting statements. The Accounts of Gupta & Company, for example, do not reveal that a competitor has introduced an improved service to the customers; they do no report that a strike is beginning or for that matter they do not record the fact that the production manager is not on speaking terms with the Sales Manager because all these events cannot be expressed in terms of money. Thus accounting does not give a complete picture of what is happening in the business or that of the conditions prevailing in the business.

It should, however, be noted that money is expressed in terms of its value at the time an event is recorded in the accounts. Change in the purchasing power of money due to inflation or deflation in future years are not taken note of.

To sum up we can say that while money is probably the only practical common denominator, the use of money implies homogeneity, a basic similarity between Re. 1 and another. This homogeneity does not, however, exist in periods of inflation or deflation.

(4) *Dual Aspect Concept:* Dual aspect is perhaps the most important of all the concepts. We require use of this recoding in each and every business transaction. To understand this concept fully we must know the meaning of the words (i) Assets and (ii) equities. Assets mean the resources owned by a business, e.g., Land, Building, Plant machinery, Stock of goods and so on, Equities on the other hand mean the claims of various parties against these assets. Equities can be divided into two broad categories (a) Owner's equity (or capital) which is the claim of the owner or proprietor of the business and (b) creditors equity, i.e., the claim of creditors of the business. Thus from the above discussion it follows that the amount of the assets of the business will always be equal to the amount of owners' equity and creditors' equity. This is so because all the assets of a business are claimed by someone, either by the creditors of the business, and also because the total of these claims can never exceed the amount of assets to be claimed. To put it in the form of an equation we can say that Assets=Equities (Owners' equities as well as Creditor's equities)

OR

Capital + Liabilities = Assets

In its most expanded form it will be Capital + Revenue + Liabilities = Assets + Expenses.

"Accounting systems are set up in such a way that a record is made of two aspects of each event that affects these records and in essence these aspects are changes in assets and changes in equities".

Every event that is recorded in the accounts affects at least two items; there is no conceivable way of making only a single change in the accounts. Accounting is thereof properly called a "Double Entry System" (Robert N. Anthony-Management Accounting Principles, Page 26)

(5) *Realisation Concept:* Accounting is a historical record of transaction. It records what was happened. If does not anticipate events, though it usually records adverse effects of anticipated events that have already taken place. Profit it considered to have been earned on the date at which it is realized or on the date when goods or services are furnished to the customers for some valuable consideration or when the third Party becomes legally liable to make payment for goods and services rendered to them. For tangible goods profit is recognized as and when goods are shipped or delivered to the customers and not when either a sales order is received or when a contract is signed or/and not even when goods are manufactured to meet the order.

This concept stops business firms from inflating their profits by recording sales and incomes that are likely to take place in future.

There are certain exceptions to this general rule–(a) The revenue is recognized as realised on an earlier date in case where it can be objectively measured earlier than the date of exchange between the seller and the buyer. For example, in case of mining revenue is recognized when the metal is mined, reather than when it is sold. This is so because the metal always has a specifited value and hence no market exchange or sale is necessary to establish this value.

(b) In case of Hire purchase and instalment selling, revenue may be recognized only when the instalment payments are received and not when goods are delivered due to the doubt about the actual amount that will be received from the hirer.

(c) Not full revenue or profits, if the contract of sale stipulates after sale service agreement. Probable cost of adequate provision for repairs in such cases be made out of realized profits to arrive the net revenue figure.

(d) In a business where mere production leads to the earning of profits as sales require no effort on the part of the manufacturer, profits are assumed to have been realized as and when goods are manufactured and not when they are actually sold.

(6) ***Accrual Concept:*** According to accrual concept, income or profit arises only when there has been an increase in the owner's equity or increase in the owner's share of the assets of the firm but not if such increase results from money contributed by the owner himself.

"Any increase in owner's equity resulting from the operations of the business is called a revenue. Any decrease is called an expense. Income is therefore the excess of revenue over expenses. (If expenses exceed revenue, the difference is called a loss).

It is extremely important to recognize that income is associated with change in owner's equity and that it has no necessary relation to change in cash. Income connotes. 'Well-offness'. Roughly speaking the bigger the income, the better off are the owners. An increase in cash, however, does not necessarily mean that the owners are better off and that their equity is increased. The increase in cash may merely be offset by a decrease in some other asset or an increase in liability with no effect on owner's equity at all". (Robert N. Anthony, Management Accounting Principles, 8th Ptg., Page 45)

Thus the profit is said to have arisen only when the total revenues or incomes exceed total expenses or losses. Settlement, in cash, of transactions already entered into is immaterial for calculating or taking into account the expenses, losses or gain etc. It is enough if they are incurred or earned during the period for which profit is being calculated.

(7) ***Verifiable objective evidence concept:*** According to this concept all the entries recorded in the books of account should be supported by business documents known as vouchers. No entry be passed in the books unless it is supported by the proper voucher which could also be verified later on as and when it becomes necessary to check the correctness of the accounts. The only limitation to this general rule is entries with regard to non-cash charges, e.g., Depreciation on fixed assets, provision for bad and doubtful debts and so on.

(8) ***Cost Concept :*** According to the cost concept which is closely related to Goig Concern Concept the assets or resources owned by a business are entered on the accounting recoreds at cost or the Price paid to acquire them. According to the same concept the cost of the asset is the basis for all subsequent accounting for the asset.

Thus the accounting measurement of assets does not normally reflecd the worth of assets except at the moment they are purchased because it is assumed that the purchaser is a prudent businessman and that he will, therefore, not pay more for an asset or service that it is worth at the time. This being so the historical cost is presumed to be equal to the fair value of the asset required. In other words it means, that the accountant observing this concept does not ordinarily record the changes in the real worth of an asset which might have occurred wilh passage in time or due to changes in the value of money, a measuring rod. For example, a building if purchased for Rs. 1,00,000 will be recorded in the books of accounts at Rs. 1,00,000. Subsequent changes in the worth or in the market value of this building would not ordinarily be recorded in the accounts books. The change in the market price of this building, say Rs. 2,00,000 on the date of preparation of the balance sheel will not be considered.

It be noted lhat not all assets, but only fixed assets, are recorded according to this concept. 'There may be certain assets called current assets, in case of which there may well be a correspondence between accounting measurements and their real market values, cash, for example, is always shown not at its original cost but at its aclual worth. Similarly, marketable securities and stock held for resale are generally shown at their near actual worth figure, i.e. at cost or market value which ever is lower. It is because of this fact that it is said that subsequent changes in the market value of assets would *ordinarily* not be reflected by changes in the accounts.

However, it should also be noted that cost concept does not mean that all assets remain in the accounting records at their historical or original cost so long as the company owns them. The cost of a fixed asset, such as a building, that has a long but nevertheless a limited life is systematically reduced over the life of the asset by the process called depreciation. It is because of the process of changing depreciation that the asset disappears from the balance sheet when its economic or useful life is over.

"Another important conequencc of the concept is that if the company pays nothing for an item it acquires, this item will usually not appear in the accounting records as an asset. The knowledge, skill and expertise of an electronic company's research and development team does not appear in the company's balance sheet as an asset". (An insight into management accounting First Ed., by John Size; Page 42.) Following this the goodwill appears in the accounts of the company only when the company has purchased an intangible and valuable property right and paid for it. Even then it is shown at its purchase price even though the management may believe that its real value is considerably higher. No amount for "goodwill" or any other asset for that matter will be shown in the accounts if the company does not actually purchase such intangibles or assets.

It also follows from the cost concept that an event may effect the value of a business without having any effect on the accounting records. To take an extreme case, suppose that several key excecutives are killed in a plane accident. To the extent that "an organization is but the lengthened shadow of a man, the real value of the company will change immediately, and this will be reflected in the market price of the company's stock, which reflects investor's appraisal of value. The accounting records however, will not be affected by this event.

The cost concept provides an excellent illustration of the problem of applying the three basic criteria... relevance, objectivity and feasibility. If the only criterian were relevance, then the cost concept would not be defensible. Clearly, investors and others are more intereseted in what the business is actually worth today rather than what the assets cost originally.

But who knows what a business is worth today ? The fact is that any estimate of current value is just that—an estimate and informed people will disagree on what is the right estimate. Furthermore, accounting reports are prepared by the management of a business, and if they contained estimates of what the business is actually worm, these would be management's estimates. It is quite possible that such estimates be biased.

The cost concept, by contrast, provides arelatively objective foundation of accounting. It is not purely objectives, for ..... judgements are necessary in applying it. It is much more objective, however than the alternative of attempting to estimate current values. Essentially, the reader of an accounting report must recognize that it is based on cost concept, and he must arrive at his own estimate of current value, partly by analyzing the information in the report and partly by using non-accounting information.

Further more a "market value" or "current worth" concept would be difficult to apply, because it would require that the accountant attempt to keep track of the ups and downs of the market prices. The cost concept leads to a system that is much more feasible.

In summary, "adherance to the cost concept indicates a willingness on the part of those who developed accounting principles to sacrifice some degree of relevance in exchange for greater objectivity and greater feasibility." (Robert N. Anthony-Management Accounting Principles, Eighth Print., Page 25).

(9) ***Accounting Period Concept***—The net income being the defference between value assets at the time of commencement of business and at the time of liquidation of the business, is easier to calculate when the business comes to an end. But only a few business ventures have a small life. Generally, the business houses last for a very long period of time. Moreover, accountants assume an indefmite life of the business houses (Going concern concept). But the management and other parties will not like to wait for a very long period of time, until, the business has terminated, to obtain information on how much income has been earned or loss suffered by such businesses. It would be too late then to take any corrective steps at that time if the final accounts report that the business was incurring losses. Therefore, they need to know at frequent intervals as to how things are going. The accountant, therefore, measures the income or loss not for the entire life of the business but only for a convenient segment of time. The time interval chosen is called the accounting period. Realisation concept and accrual concept are the main or basic guides for sorting out the transactions occurring during an accounting year with a view to measure the income of that period.

It should, however, be noted that more frequent reports, called the interim reports, be prepared and sent to management for their perusal and action, if necessary.

"Business are living, continuing organisms. The act of chopping the stream of business events into time periods is therefore somewhat arbitrary since business activities do not stop or change measurably as one accounting period ends and another begins. It is this fact which makes the problem of measuring income in an accounting period the most difficult problem of accounting" (Pobert N. Anthony. Management Accounting Principles, Eighth Print., Page 44).

(10) ***Matching Concept***—The main motive of doing business now a days is to maximize profits. The proprietors want their accountants to ascertain the profit or loss made by their businesses. The accountants in turn are, therefore, busy most of their time in finding out techniques of measuring profits. For finding out the profits they have to match the revenues of a particular period with the expenses or cost which can be assigned to earning such revenues.

Thus the problem is of matching revenues of the period with the cost of securing that revenue to ascertain the profit for a particular period. It should be noted here that the problem is that of matching the expenses. It means the first step is to ascertain what revenues are to be recognized in a given accounting period. The second step, of course, is to determine the expenses that are associated with these revenues. Some difficulties in measuring the revenue for the artificial accounting year are raised because business is as said above, a continuous process.

(a) *Measurement of Revenue*—Revenues are measured in accordance with the accrual concept. According to accrual concept the revenues accrue in the accounting year in which they are earned. It is immaterial whether equivalent cash received in that year or not.

Cash basis of determining income has, however, considerable appeal to many people. This is so because it is not only simple but also appears to be realistic. Moreover it is verifiable and based upon convention of conservatism. It satisfies those businessmen who think that their profit is equal to the excess of current bank balance over the beginning bank balance. According to this basis income is equal to cash received during the year and expense is equal to cash paid out during the same period. Exceptions are, however, made of additional investments by the owners and creditors. These investments are regarded as non-income transactions.

The cash basis of determining income for the year is deficient in many respects. Therefore, the accountant generally rejects this basis and adopts accrual basis of determining income which rests on the concept of realization. According to this basis a careful distinction must be made between revenues and cash receipts as revenues need not result in an equivalent amount of cash. It is possible that revenue may be earned this year even though payment is not received until next year. The balance sheet of this year in such a case will show the amount outstanding either as debtors or as accrued revenue. It may also be possible that the business receives cash in the current years which creates a liability to render a service in some future period. The examples of such cases may be subcription received in advance by a magazine publisher or insurance premium received in advance by an insurance company. Similarly it may still happen that the firm may have received cash last year which become revenue in this year as the services promised then are rendered now. The balance sheet of last year in such a case will show cash received in advance as a liability under the head deffered revenue or precollected (received in advance) revenues.

Revenue is considered to have been earned on the date when goods or services are furnished to the customer in exchange for cash or some other valuable consideration. Barring a few exceptions the revenues are not considered as being earned when an order is received or when goods are manufactured to meet the order or when a contract is singed. Accountants generally recognise revenues only when goods are dispatched to customers.

Measurement of Expenses—Expenses are the costs incurred in connection with the earning of revenue. The term 'expenses' 'connotes' 'Sacrifices made', 'the cost of services or benefits received' or 'resources consumed' during in accounting period. The term 'Cost' is not synonymous with 'Expenses'.........Expenses means a decrease in owner's equity that arises from the operation of a business during a specified accounting period, whereas cost means any monetary sacrifice whether or not the sacrifice affects the owner's equity during a given accounting period; (Robert N. Anthony, Management Accounting Principle, Eighth Print, Page 46).

The AAA (American Accounting Association) committee gives the following definition of expenses— "Expense is the expired cost directly or indirectly related to given fiscal period of the flow of goods or services into the market and of related operations.. ...Recognition of cost expiration is based either on a complete or partial decline in the usefulness of assets or on the appearance of a liability without a corresponding increase in assets." It describes the recognition of expenses as, 'Expense is given recognition in the period in which there is (a) a direct identification or association with the revenue of that period, as in the case of merchandise delivered to customers; (b)an indirect association with the revenue of the period, as in the case of office salaries or rent: (c) a measurable expiration of assets costs even though not associated with the production of revenue for the current period, as in the case of losses from flood or fire."

It should also be noted that the words expenses and expenditure connote different meanings. An expenditure takes place when we purchase an asset or service. It may be made by cash or by incurring a liability or by the exchange of another asset. There may not necessarily be a correspondence between expenses and expenditure made by a concern become expense or in other words there are no expenses that are not represented by an expenditure.

According to the definition of the word expense given by the AAA Committee expense of the current year include the cost of the products sold in this year, though purchased or manufactured in a prior year. Similarly, other expenses like salaries of salesman who sold these goods and the cost of other services like telephone and electricity etc. consumed or used during the year whether paid or not in the current year shall also be included in the expenses of the current year. Thus we can say that—

(a) There may be some expenditure which may become expenses also in the same year because the benefit of the same is consumed in the same year. Such expenses will be recognised as an expense of the current year.

(b) There may be other expenditures which were paid in previous year/years but become expense in the current year as the benefit thereof is consumed in the current year, insurance protection is one such item. The premium is paid in advance but the insurance protection is received later in the year. Till then the amount paid by way to premium is an asset. It becomes an expense in the accounting period when such protection is received.

(c) Some expenditure incurred now may become expenses next year as the goods bought now will be sold next year. These will be shown as an asset on the balance sheet of the current year and will be treated as an expense when these goods are sold.

(d) Some expenditure may not be paid for in the current year although goods and services were purchased and consumed during the current year. These will be treated as expenses of the current year. The amounts outstanding will be shown as a liability in the balance sheet of the current year.

In contrast to accrual basis, in cash basis an expense is said to have been incurred as and when cash is disbursed. Results of this approach are far from being satisfactory and so the accountant makes a distinction between an incurred cost, a disbursement, and the expiration of a cost. He pinpoints the events of expiration to determine the period to be charged.

ACCOUNTING CONVENTIONS

(i) ***Convention of Consistency :*** Accounting is not composed of a set of rules which prescribe the 'one way that things can be done'. There are many different ways in which items may be recorded in the accounts. For example, there are several methods of computing yearly depreciation. Then firm should, within these limits, select the methods which give the most equitable importance that the method selected be applied consistently year after year. Successive, periodical financial statements would not be comparable, if the accountant continuously changed the method of accounting for certain expenses or assets though each method might be fully acceptable. For example, the profit figure can be changed significantly by changing the methods of depreciation. The user of the statement may be misled and think that the earnings had improved. Whereas in reality the increase was solely due to change in the methods of depreciation. Change in net income reported in successive statement should be due to changes in business conditions or management effectiveness and not simply due to changes in accounting methods.

However, it does not bind the firm to follow the same method until the firm closes down. A firm can changes the method used, but such a change is not effected without the deepest consideration. It means that the accontant can change the method if he thinks that the results of operations and the financial position of the business would more fairly be reflected by such a change. When such a change occurs, then either in the profit and loss account itself or in one of the reports accompanying it, the effect of the change should be stated.

It should, however, be noted here that the word consistency used here has a narrow meaning. It does not refer to logical consistency at a given moment of time rather it refers to different categories of transactions should be consistent with each other. It only means that the transaction of the same category must be treated consistently from one accounting period to another. Thus there will be no inconsistency involved if different categories of assets are valued on different basis, e.g., if stock is valued at cost or market value, whichever is lower and fixed assets are valued at cost.

Consistency offers the following advantages to the users of the statements—

(1) ***Intra-Firm comparisons are made possible***—'Financial statements are most meaningful as source of information about a particular business unit when statements made at several different times are compared with each other. Trends can be discerned, for example, only when the balance sheets of three or more years are placed side by side. To provide optimum comparability, transactions must be analysed and recorded in the same way from one period to another. Items included under one caption on one balance sheet or operating statement should he included under the same caption on another statement. The virtue of consistency is so great that even incorrect procedures consistently applied may produce useful results."

(2) *Inter-Firm comparisons are made possible*— Another use of financial statements is in the comparison of the one business with another business. Some consistency of treatment within an industry would therefore enhance the value of accounting reports. Consistency then, is one objective of generally accepted accounting principles.

(II) *Convention of Conservatism—It is the policy of* "Playing safe". Financial statements are drawn upon rather a conservative basis. Window dressing in preparing the financial statements is not permitted. This convention is particularly applicable when matters of opinion or estimate are involved. In cases of doubt the accountant choose to under late the owner's equity rather than overstate them. This could also be said. "Anticipate no profit and provide for all possible losses."

Business men are generally inclined to be optimistic. The bankers, creditors, investors and other who use financial statements may be misled as assets in many cases be overstated or liabilities understated in the absence of this convention.

To take an example, the provision for doubtful debts is a matter of estimates. Most accounistus prefer leaning in the direction of over statement rather than under-statement of the allowance for bad and doubtful dents. The consequences of overstatement of assets and net income are more serious than those of understatement.

Balance sheet conservatism was once regarded as the most important of all the accounting principles. But this position of the cenvention of conservatism is questioned now. Accountants are now becoming increasingly aware that adherence to this principle may result in incorrect statement or sometimes in unconservative statement.

Charging expense accounts with expenditure which would more properly be charged to fixed asset accounts or to make excessive provision for depreciation may be conservative from the balance sheet stand point, but it would result in mis-statement of net income. Moreover, the net income for periods in which no depreciation will be charged to income statements will be overstands. The income statements for these years will be unconservative to that extent.

Thus we can say that the conservatism can be regarded as a virtue if, as its consequence, income statements and balance sheets do fairly present the result of operations and the financial position stretching this convention to excessive lengths will imply creation of secret reserves which is in direct conflict with the doctrine of full disclosure."

"It was probably this convention that led to accountants being portrayed as being rather miserable by nature; they were used to favouring looking on the black side of things and ignoring the bright side. However, the convention has been considerable changes in the last few decades and there has been a shift along the scale away from the gloomy view and more towards the desire to paint a brightrer picture when it is warranted." (Business Accounting By Frank Wood, First edition. Page 43)

(III) ***Convention of full disclosure***—"The accountant proposes to make disclosure of all material facts necessary to complete understanding by third parties-or relevant to any decision which might be based on accounting statements." (Smith and Ashbume, Financial and Administrative Accounting, second edition page 53). The accountant is supposed to prepare the accounts honestly and to disclose all material information. The Companies Act makes ample provision for the disclosure of material information in company accounts. It has prescribed standard form of balance sheet and a sheathe of contents of revenue statement. These forms are so designed that the disclosure of all relevant facts had become compulsory.

Disclosure prompts the accountant to report the realisable value of stock or marketable securities, for example, when that value is substantially different from cost. Disclosure calls for the details of each type of capital stock, such as the par of stated value per share, the preference attached to this issue, the number of shares authorized and the number outstanding and any other fact which would be an important consideration for the present or potential shareholders. If the business entity faces a possible liability or loss that is not definite in amount at the time of preparing statements, but reasonably certain of happening, the accountant is obliged to report the facts as accurately as he can.

It should however, be noted that the convention of disclosure does not imply that any one's or everyone's desire with regard to disclosure shall be fulfilled. It only implies full disclosure of accounts which are of interest to the owners, creditors and present or prospective investors of business. Disclosure of minor details is neither possible nor desirable.

(IV) *Convention of Materiality*—Materiality should be interpreted negatively. In its nagetive sense it means the information, the non-disclosure of which would vitiate the true and fair character of financial statement. The decision with regard to materiality of an information or amount depends upon the magnitude of the amount or the importance of the information for the statements users. Thus, as to what is or is not material depends on the nature and size of the firm and on the accountants' Judgement.

American Accounting Association defines the term 'materiality' as "An item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor."

According to this convention less important items are left out whereas mention by way of a footnote or otherwise is made of more important items. Thus if a bottle of ink was bought it would be used up over a period of time and this cost is used up every time some one dips his pen into ink. It is possible to record this as an expense everytime it happens, but obviously the price ofa bottle of ink is so little that it is not worthy recording it in this fashion. The bottle of ink is not a material item and therefore, would be charged as an expense in the period it was bought irrespective of the fact that it could last for more than one accounting period.

However, the effect of change in the profit or loss of a business due to change in the method of charging depreciation on fixed assets, provision for gratuity, basis of valuation of stock, etc. are considered to be material and hence the fact of the change and the extent of its effect on the profit or loss of the concern need to be disclosed.

Based on this principle, the most modern published accounts usually avoid to mention the fraction of the rupee in the statements and reports. But in any case actual accounting entries are always exact.

"The materiality concept is important in the process of determining the expenses and revenues for a given accounting period. Many of the expense items that are recorded for a accounting period are necessarily estimates, and in some cases they are very close estimates, and in some cases they are not so. There is a point beyond which it is not worth while to attempt to refine these estimates. Telephone expense is a familiar example. Telephone bills although rendered monthly often do not coincide with a calender month. It would be possible to analyse each bill and classify all the calls according to the month in which they were made. This would be following the accrual concept precisely. Few companies bother to do this, however. They simply consider telephone bills as an expense of the month in which the bill is received on the grounds that a system that would ascertain the real expense would not be justified by the accuracy gained. Since in many businesses the amount of the bills is likely to be relatively stable from one month to another, no significant error may be involved in this practice. Similarly, very few businesses attempt to match the expenses of making telephone calls to the specific revenues that might have been produced by these Calls." (Robert N. Anthony—Managements Accounting Prinicplcs — Eighth Print Page 56)

Lesson 2

ACCOUNTING STANDARDS

Accounting standards codify the generally accepted accounting principles. They lay down the norms of accounting policies and practices by way of codes or guidelines to direct as to how the items appearing in the financial statements should be dealt with in the books of account and shown in the financial statements and annual reports. They present the general principles to be put to application using professional judgement.

The main purpose of accounting standards is to provide information to the user as to the basis on which the accounts have been prepared. They make the financial statements of different business unit or the financial statements of the same business unit comparable. In the absence of accounting standards, comparison of different financial statements may lead to misleading conclusions. Accounting standards bring about uniformity of assumptions, rules and policies adopted in financial reporting and thus they ensure consistency and comparability in the data published by the business enterprises. To be useful, an accounting standard must be capable of being well understood and it must be able to reduce significantly the degree of manipulation of the reported data.

Utiliity of Accounting Standards

The management of every business house is interested in reliable accounting data so that it may get the required information for making correct decisions and discharge its functions efficiently. Then, there are shareholders, investors, creditors, workers, Governments, researchers etc. who are also interested in reliable accounting data. Accounting standards play a very significant role; they make it possible that the people get the reliable and comparable accounting data. Thus, they help the investor to make more informed investment decisions. The Government officials can use the accounting data for planning etc. with greater confidence. The researchers can make better analysis and draw more reliable conclusions. Even the job of Chartered Accountants is made easy. They can guide their clients much betler and refuse any demand by clients to accept data which are not in conformity with accounting standards.

Sometimes, there is a conflict of financial interests among the various groups that rely upon published financial statements. For example, potential shareholders and existing shareholders may have opposite interests in assessing the profitability and the net worth of a company. Accounting standards help in resolving such a conflict because financial statements which have been prepared on the basis of accounting standards will be acceptable to all the parties. If follows that accounting standards must be such as may command the greatest possible credibility among all those who use accounting data.

Accounting Standards in India

Realising that there was a need of accounting standards in India and keeping in view the international developments in the field of accounting, the Council of the Institute of Chartered Accountings of India constituted the Accounting Standards Board (ASB) in April, 1977. The Accounting Standards Board is performing the function of formulating the accounting standards. While doing so, it takes into account the applicable laws, customs, usages and business environment. It gives adequate representation to all the interested parlies; the Board consists of representatives of industries, Central Board of Direct Taxes and the Comptroller and Auditor General of India.

To start with, ASB finalised the procedure to be followed in the formulation of standards. The "Preface to the Standards of Accounting Standards" was issued in January, 1979. The preface outlines scope and functions of ASB, the scope of accounting standards, the procedure to be followed by ASB in formulating the standards and the phased manner in which the compliance with the standards will be encouraged by the Institute.

Procedure of Preparing Accounting Standards

The Accounting Standards Board determines the broad areas in which accounting standards are to be formulated and the priority which is to be given to each one of the selected areas. In the task of preparation of accounting standards. ASB is assisted by different study groups constituted to conisider specific subjects. In the formation of study groups, care is taken that there is wide participation by members of the Institute of Chartered Accountants and other bodies. A dialogue is held with the representatives of the Government, the public sector undertakings, industries and other organisations to ascertain their views. Then, an exposure draft of the proposed accounting standard is prepared and issued for comments by the members of the Institute and the public at large. The draft is sent to various outside bodies like **FICCI, ASSOCHAM, SCOPE, C&AG, ICWA1, 1CSI, CBDT** etc. for their views. The draft includes the following points :

(i) A statement of concepts and fundamental accounting principles relating to the standard,

(it) Definitions of the terms used in the standard.

(iii) The manner in which the accounting principles have been applied for formulating the standard.

(iv) The presentation and disclosure requirements in complying with the standard. .

(v) Class of enterprises to which the standard will apply,

(vi) Date from which the standard will be effective.

After taking into the consideration the comments received from different quarters, the draft of the proposed standard is finalised by the Accounting Standards Board and submitted to the Council of the Institute of Chartered Accountants of India for the latter's approval. The Council considers the draft and if found necessary, modifies it in consultation with the Accounting Standards Board. Finally. the accounting standard is issued under the authority of the Council. Initially, the standard is made recommendatory and after some time it is made mandatory.

Propagation of Accounting Standards

The following measures have been taken to propagate the accounting standards :

(i) Information regarding the current status of the various project relating to the accounting standards and drawing the attention of the members to the standards already issued is published in the journal of the Institute of Chartered Accountants of India.

(ii) Discussions on the accounting standards issued by the 1CAI are arranged in the continuing education programmes organized by the ICAI and its Regional Councils and Students' Associations.

(iii) There is regular communication with universities, colleges, business management institutes, public and private sector undertakings etc. with a view to keeping them informed about the issuance of different accounting standards from time to time and seeking their co-operation in the implementation of these accounting standards.

(iv) The institute uses the compliance with the accounting standards an important criterion in deciding about the awards which the Institute gives every year for the best presented accounts and the Institute has been drawing attention of the companies and corporations to this fact.

The following is the text of Preface to the Statements of Accounting Standards issued by the Institute of Chartered Accountants of India in January, 1979:

Preface To The Statements of Accounting Standards

1. Formation of the Accounting Standards Board

The Institute of Chartered Accountants of India, recognising the need to harmonise the diverse accounting policies and practices at present in use in India, constituted an Accounting Standards Board (ASB) on 21" April, 1977.

2. Scope and Functions of Accounting Standards Board

2.1 The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India. While formulating the accounting standards, ASB will take into consideration the applicable laws, customs, usages and business environment.

2.2 The Institute is one of the Members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC. While formulating the Accounting Standards, ASB will give due consideration to International Accounting Standards, issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

2.3 The Accounting Standards will be issued under the authority of the Council. ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statement. ASB will issue guidance notes of the Accounting Standards and give clarifications on issues arising therefrom. ASB will also review the Accounting Standards .at periodical intervals.

3. Audited Financial Statements

3.1 For discharging the above functions, ASB will keep in view the purpose and limitations of published financial statements and the attest function of the auditors. ASB will enumerate and describe the basic concepts to which accounting principles should be oriented and stale the accounting principles to which the practices and procedures should conform.

3.2 ASB will clarify the phrases commonly used in such financial statements and suggest improvements in the terminology wherever necessary. ASB will examine the various current alternative practices in vogue and identify such alternatives which should be preferred.

3.3 The Institute will issue the Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term "General Purpose Financial Statements" includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large References to financial statements in this Preface and in the Standards issued from time to time will be construed to refer to General Purpose Financial Statements.

3.4 Responsibility for the preparation of financial statements and for adequate disclosure is that of the management of the enterprise. The Auditor's responsibility is to form his opinion and report-on such financial statements.

4. Scope of Accounting Standards

4.1 Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. However, if due to subsequent amendments in the law, a particular Accounting Standard is found to be not in conformity with such law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law.

4.2 The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in our country. However, the Institute will determine the extent of disclosure to be made in financial statements and the related Auditor's reports. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore, need not be treated as adverse comments on the related financial statements.

4.3 The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Standard will be made clear by the Institute from time to time.

That date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the Institute. However, no standard will have retroactive application, unless otherwise stated.

4.4 The Institute will use its best endeavours to persuade the Government, appropriate authorities, industrial and business community to adopt these Standards in order to achieve uniformity in the presentation of financial statements.

4.5 In carrying out the task of formulation of Accounting Standards, the intention is to concentrate on basic matters. The endeavour would be to confine Accounting Standards to essentials and not to make them so complex that they cannot be applied effectively and on a nation-wide basis. In the years to come, it is to be expected that Accounting Standards will undergo revision and a greater degree of sophistication may then be appropriate.

5. Procedure for Issuing Accounting Standards

Broadly, the following procedure will be adopted for formulating Accounting Standards :

5.1 **ASB** shall determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

5.2 In the preparation of Accounting Standards. **ASB** will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.

5.3 **ASB** will also hold a dialogue with the representatives of the Government, public sector undertakings, industry and other organisations for ascertaining their views.

5.4 On the basis of the work of the Study Groups and the dialogue with the organisations referred to in 5.3 above, an exposure draft of the proposed standard will be prepared and issued for comments by members of the Institute and the public at large.

5.5 The draft of the proposed standard will include the following basic points :

5.5.1 A statement of concepts and fundamental accounting principles relating to the Standard.

5.5.2 Definitions of the terms used in the Standard.

5.5.3 The manner in which the accounting principles have been applied for formulating the Standard.

5.5.4 The presentation and disclosure requirements in complying with the Standard.

5.5.5 Class of enterprises to which the Standard will apply.

5.5.6 Date from which the Standard will be effective.

5.6 After taking into consideration the comments received, the draft of the proposed Standard will be finalised by **ASB** and submitted to the Council of the Institute.

5.7 The Council of the Institute will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with **ASB**. The Accounting Standard on the relevant subject will then be issued under the authority of the Council.

6. Compliance with the Accounting Standards

6.1 While discharging their attest functions, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations.

6.2 In the initial years, the Standards will be recommendatory in character and the Institute will give wide publicity among the users and educate members about the utility of Accounting Standards and the need for compliance with the above disclosure requirements. Once an awareness about these requirements is ensured, steps will be taken, in course of time, to enforce compliance with the accounting standards in the manner outlined in para 6.1 above.

6.3 The adoption of Accounting Standards in our country and disclosure of the extent to which they have not been observed will, over the years, have an important effect, with consequential improvement in the quality of presentation of financial statements.

Indian Accounting Standards

The Institute of Chartered Accountants of India has so far issue twenty two accounting standards. They are as follows—

				Mandatory- from accounting period beinning an or after
(i)	AS-1	—	Disclosure of Accounting Policies.	1.4.1991
(ii)	AS-2 (Revised)	—	Valuation of Inventories.	1.4.1999
(iii)	AS-3 (Revised)	—	Cash Flow Statements	
(iv)	AS-4 (Revised)	—	Contingencies and Events Occuriring after the Balance Sheet Date.	1.4.1995
(v)	AS-5 (Revised)	—	Net Profit or Loss for the Period. Prior Period Items and Changes in Accounting Policies	1.4.1996
(vi)	AS-6 (Revised)	—	Deprecation Accounting	1.4.1995
(vii)	AS-7	—	Accounting for Construction Contracts.	1.4.1991
(viii)	AS-8	—	Accounting for Reaserch and Development	1.4.1991
(ix)	AS-9	—	Revenue Recognition	1.4.1991
(x)	AS-10	—	Accounting for Fixed Assets.	1.4.1991
(xi)	AS-11 (Revised)	—	Accounting for the Effects of Changes in Foreign Exchange Rates	1.4.1995
(xii)	AS-12	—	Accounting for Governments Grants	1.4.1994
(xiii)	AS-13	—	Accounting for Investment.	1.4.1995
(xiv)	AS-14	—	Accounting for Amalgamations	1.4.1995
(xv)	AS-15	—	Accounting for Retirement Benefits in the Financial Statements of Employers.	1.1.1995
(xvi)	AS-16	—	Borrowing costs	1.4.2000
(xvii)	AS-17	—	Segment Reporting	1.4.2001
(xviii)	AS-18	—	Related Party Disclosures	1.4.2001
(xix)	AS-19	—	Leases	1.4.2001
(xx)	AS-20	—	Earnings Per Share	1.4.2001
(xxi)	AS-21	—	Consolidated Financial Statements	1.4.2001
(xix)	AS-22	—	Accounting for Taxes on Income`	1.4.2001

The **IASC** and the **ICAI**. both consider Going Concern, Accrual and Consistency as fundamental. In other words, it will be assumed, without the fact having to be stated, that the financial statements have been drawn up on accrual basis, without any change in the accounting policies and without there being any necessity or intention to liquidate or wind up the firm or a substantial part of it. The going concern assumption is very important; only on its basis can fixed assets be stated at cost less depreciation and their realisable value can be ignored. Also, some liabilities (such as gratuities, retrenchment compensation) arise only when the firm is liquidated. These can be ignored as long as the firm is a going concern. One can see that if the going concern assumption is not valid, the financial statements as ordinarily drawn up, will not be true at all.

It is recognised that since the circumstances governing each firm differ, it should have the right of choosing the accounting policy that is appropriate to it. The **IASC** and the **ICAI** state that the choice should be made on the basis of prudence, materiality and substance over form. In other words, the real state of affairs (not merely sticking to, say, strict legal interpretation) and the information disclosed should be material from the point of view of appraisal of the profitability and the financial position of the firm; insignificant information should not be disclosed separately. Further, it is recommended that the accounting policy chosen should be disclosed.

As I issued by the **ICAI** in November, 1979 is given below. The standard has become mandatory with effect from 1.4.1991.

Accounting Standard 1 (AS-1)

Disclosure of Accounting Policies

The following is the text of Accounting Standard 1 (AS-1) issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on "Disclosure of Accounting Policies". The Standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

Introduction

1. This statement deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.
2. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.
3. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by law in some cases.
4. The Institute of Chartered Accountants of India has, in Statements issued by it, recommended the disclosure of certain accounting policies, *e.g.,* translation policies in respect of foreign currency items.
5. In recent years, a few enterprises in India have adopted the practice of including in their annual reports to shareholders a separate statement of accounting policies followed in preparing and presenting the financial statements.
6. In general, however, accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the Notes on the Accounts, descriptions of some of the significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and the non-corporate sectors and between units in the same sector.
7. Even among the few enterprises that presently include in their annual reports a separate statement of accounting policies, considerable variation exists. The statement of accounting policies forms part of accounts in some cases while in others it is given as supplementary information.
8. The purpose of this statement is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and

the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

Explanation

Fundamental Accounting Assumptions

9. Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

10. The following have been generally accepted as fundamental accounting assumptions:—

(a) *Going Concern*

The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially scale of the operations.

(b) *Consistency*

It is assumed that accounting policies are consistent from one period to another.

(c) *Accrual*

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this statement).

Nature of Accounting Policies

11. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

12. There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles'acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise.

13. The various statements of the Institute of Chartered Accountants of lndia combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternatives particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

Areas in which differing accounting policies are encountered

14. The following are examples of the areas in which different accounting policies may be adopted by different enterprises :

- Methods of depreciation, depletion and amortisation
- Treatment of expenditure during construction

- Conversion or translation of foreign currency items
- Valuation of inventories
- Treatment of goodwill
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts
- Valuation of fixed assets
- Treatment of contingent liabilities

15. The above list of examples is not intended to the exhaustive.

Considerations in the Selection of Accounting Policies

16. The primary consideration in the selection of Accounting Policies by an enterprise that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the profit or loss for the period ended on that date.
17. For this purpose the major considerations governing the selection and application of accounting policies are :

(a) *Prudence*

In view of the uncertainly attached to future events; profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

(b) *Substance over Form*

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

(c) *Materiality*

Financial statements should disclose all "material" items, *i.e.,* items the knowledge of which-might influence the decisions of the user of the financial statements.

Disclosure of Accounting Policies

18. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
19. Such disclosure should form part of the financial statements.
20. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.
21. Examples of matters in respect of which disclosure of accounting policies adopted will be required are contained in paragraph 14. This list of examples is not, however, intended to be exhaustive.
22. Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

23. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Accounting Standard

(The Accounting Standard comprises paragraphs 24-27 of the Statement. The Standard should be read in the context of paragraphs 1-23 of this Statement and of the Preface to the Statements of Accounting Standards).

24. **All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.**
25. **The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.**
26. **Any change in the accounting policies which has material effect in the current period of which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.**
27. **If the fundamental accounting assumptions, *viz.* Going Concern, Consistency and Accrual are followed in financial statements specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.**

AS 22—Accounting For Taxes on Income

In this Accounting Standard, the standard portions have been set in **Bold** type. These should be read in the context of the background material which has been set in normal type, and in the context of the 'Preface to the Statements of Accounting Standards.'*

Accounting Standard (AS) 22, 'Accounting for Taxes on Income', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 01-04-2001. It is mandatory in nature** for :

(a) All the accounting periods commencing on or after 01.04.2001, in respect of the following :

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a regonised stock exchange in India as evidenced by the board of directors resolution in this regard.

(ii) All the enterprises of a group, if the parent presents consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

(b) All the accounting periods commencing on or after 01.04.2002. in respect of companies not covered by (a) above.

(c) All the accounting periods commencing on or after 01.04.2003, in respect of all other enterprises.

The Guidance Note on Accounting for Taxes on Income, issued by the Institute of Chartered

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* Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards the intended to apply only to material items.

** This implies that, while discharging their attest function, it will be the duty of the member of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard. it will be their duly to make adequate disclosure in their audit reports so that the users of financial statements may be aware of such deviations.

Accountants of India in 1991, stands withdrawn from 01.04.2001. The following is the text of the Accounting Standard.

Objective

The objective of this Statement is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income.

Scope

1. **This Statment should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.**
2. For the purposes of this Statement, taxes on income include all domestic and foreign taxes which are based on taxable income.
3. This Statement does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprises.

Definitions

4. **For the purpose of this Statement, the following terms are used with the meanings specified: *Accounting income (loss)* is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.**

   ***Taxable income (tax loss)* is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.**

   ***Tax expense (tax saving)* is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.**

   ***Current tax* is the amount of income tax determined to be payable (recoverable) In respect of the taxable income (tax loss) for a period.**

   ***Deferred tax* is the tax effect of timing differences.**

   ***Timing differences* are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.**

   ***Permanent differences* are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.**
5. Taxabale income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ from the accounting policies

applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

6. The differences between taxable income and accounting income can be classified into permanent differences and timing differences. Permanent difference are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.
7. Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not include with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other example of timing differences arising under the Indian tax laws are given in Appendix 1.
8. Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence.

Recognition

9. **Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.**
10. Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate. Such matching may result into timing differences. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities in the balance sheet.
11. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961. This timing difference will reverse when the deduction of that expense is allowed under Section 43B in subsequent year (s). An example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961, compared to the depreciation provided in the statement of profit and loss. In subsequent year, the difference will reverse when comparatively lower depreciation will be allowed for tax purposes.
12. Permanent differences do not result in deferred tax assets or deferred tax liabilities.
13. **Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.**

14. This Statement requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occuring in that period.

15. **Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.**

16. While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

17. Where an enterprise has unabsorded depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convicting evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed.

Re-assessment of Unrecognised Deferred Tax Assets

19. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

Measurement

20. Current tax should be measured at the amount expected to be paid (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

21. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

22. Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the Government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.

23. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

24. Deferred tax assets and liabilities should not be discounted to their preset value.

25. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would

result in deferred tax assets and liabilities which would not be comparable between enterprise. Therefore, this Statement does not require or permit the discounting of deferred tax assets and liabilities.

Review of deferred tax assets

26. The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprises should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (sec paragraphs 15 to 18), that sufficient future taxable income will be available.

27. An enterprise should offset assets and liabilities representing current tax if the enterprise :

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends to settle the asset and the liability on a net basis.

28. An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment.

29. An enterprise should offset deferred tax assets and deferred tax liabilities if:

(a) The enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(b) The deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

30. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

32. the nature of the evidence supporting the recognition of deferred tax assets should be disclosed, If an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Transitional Provisions

33. **On the first occasion that the taxes on income are accounted for in accordance with this Statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Statement as deferred tax assets/liability with a correspending credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Statement had been in effect from the beginning.**

34. For the purpose of determining accumulated deferred tax in the period in which this Statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects

of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences and timing differences. For example, in the year in which an enterprise adopts this Statement, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the enterprise applied written down value method of depreciation for calculating taxable income whereas for accounting purposes straight line method is used. This difference will reverse in future when depereciation for tax purposes will be lower as compared to the depreciation for accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of Rs. 16 [(Rs. 100 - Rs. 60) x 40%] would be recognised. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrance but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purpose and the balance (which is nil for accounting purposes would be a timing difference which will reverse in future when this expenditure would be allowed for tax purposes. Therefore, a deferred tax asset would be recognised in respect of this difference subject to the consideration of prudence.

Example of Timing Differences

Note : *This appedix is illustrative only and does not form part of Accounting Standard. The purpose of this appendix is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to section in the Income-tax Act. 1961, as amended by the Finance Act, 2001.*

1. Expenses debited in the statement of profit and losses for accounting purposes but allowed for tax purposes in subsequent years, *e.g;*
   - (a) Expenditure of the nature mentioned in Section 43 B *(e.g..* taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis but allowed for tax purposes in subsequent years on payment basis.
   - (b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed lor tax purposes under Section 40 (a) (i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.
   - (c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.
2. Expense amortized in the books over a period of years but are allowed for tax purpose wholly in the first year *(e.g.,* substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period *(e.g.,* preliminary expenses under section 35D, expenses incurred for amalgamation under Section 35DD, prospecting expenses under Section 35E).
3. Where book and tax depreciation differ. This could arise due to :
   - (a) Differences in depreciation rates.
   - (b) Differences in method of depreciation *e.g.,* **SLM** or **WDV**.
   - (c) Differences in method of calculation *e.g.,* calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.
   - (d) Differences in composition of actual cost of assets.
4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under

a permitted deposit scheme *(e.g.,* tea development account Scheme under Section 33 **AB** or site restoration fund scheme under Section 33 **ABA**) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.

5. Income credited to the statement of profit and loss but taxed only in subsequent years *e.g.,* conversion of capital assets into stock in trade.
6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

Lesson 3

ACCOUNTING PROCESS

Book keeping began with the entry of all transactions into one book which recorded the details of transactions. This book was called a book of prime entry or Journal. The transactions were copied from Waste Books or Memorandum Book into the Journal in a chronological order.

This work of entering every transaction into the Journal first and then posting to ledger, however, was soon found to be tedious and cumbersome as well as lacking facilities for ready and easy reference. With the result the Journal was sub-divided into various subsidiary journals to record accounting transactions of similar nature date-wise. First of all the cash transactions were separated and used to be dealt with in another book. Then the transactions relating to credit purchases and credit sales were separated and started to be recorded separately. Thus the use of journal in its original form became obsolete, and the book itself was superseded by the books of prime-entry or subsidiary books.

Subsidiary books can also be termed as 'Books of original entry' because transactions are entered there in the first instance in a chronological order or in the order they take place. Subsidiary books can be defined as 'Books of original entry wherein we record transactions of one particular type or nature in order to obviate unnecessary clerical labour'

These subsidiary books or journals can be classified as under:

(a) Sales Book

(b) Purchases Book

(c) Purchases Returns Book or Returns outwards Book

(d) Sales Returns Book or Return Inward Book

(e) Cash Book

(f) Bills Receivable Book

(g) Bills Payable Book

If the needs of business so require, a few more of these subsidiary books such as Consignment Book, Advertisement Book, Sale or return book, etc., may also be kept.

The use of subsidiary books for writing the transactions in the first instance has certain obvious advantages over the system of recording the transactions directly into the ledger of T form. These are:

1. ***Check over errors :*** The chances of errors increase unless the transaction is debited and credited simultaneously in two different accounts in the ledger.
2. ***Subsidiary books record are supported by vouchers :*** Whereas the records in subsidiary books are always supported by vouchers such as Invoice, Credit Note, Debit Note, Cheques.

   Pay-in-slips, Statement of creditors, etc., the ledger accounts are not supported by any such vouchers.
3. ***Legal point of view :*** The records in subsidiary books are better evidence in a legal suit as compared directly into the records.
4. ***Chronological order :*** The transactions are not recorded in a chronological order if they are recorded directly into the ledger.

5. ***Common nature transactions :*** The transactions of common nature can be recorded at one place if we record transactions in the subsidiary books.
6. ***Facilities posting :*** Keeping of subsidiary books facilities posting the transactions into the ledger because all the transactions of common nature are recorded at one place.
7. ***Promotes division of labour****:* Subsidiary books-keeping promotes division of labour as the work of recording the transactions can be divided amongest various accounts clerks.
8. ***Chances of errors and frauds are minimised:*** With the introduction of division of labour the work of one accounts clerk will automatically be checked by author accounts clerk. This will minimise the chances of errors and frauds at the recording and posting stage itself.
9. ***Quick management decisions** :* The management can take decisions quickly as the accounting work is completed in time (due to division of labour) and also because they can have the benefit of trend and distributional pattern in planning and decision making as the transactions of common nature are recorded at one place.
10. ***Saving of clerical labour****:* By recording transactions of common nature through separate subsidiary books, a considerable saving of clerical labour in posting is effected. Only the periodical totals of subsidiary books will be posted into the ledger instead of recording each separate transactions.
11. ***Future reference facilitated****:* The future reference to any particular item is considerably facilitated because of grouping together of the transactions of common nature.

Details Contained in Subsidiary Books

The day books or subsidiary books are mainly concerned with showing details of invoices and other documents relating to transactions. Thus they will show details of:

(a) Prices per article and the appropriate quantity.

(b) Trade discount representing a reduction in the price of goods.

(c) Extra charges made for packing material and/or carriage charged on the goods.

After studying the advantages of having separate subsidiary books for transactions of common nature, let us now study about each of them in some details.

Journal : Journal is the most important to all the subsidiary books. It lays down the foundation of the entire book-keeping work of a business concern. Originally, all the business transactions used to be recorded in journal. The word 'Journal' is derived from one French Word 'Jour' which means 'day'. The transactions which took place during a day used to be recorded in the Journal in order of date from waste book or a Memorandum book.

Thus "A journal is a choronological record of accounting transactions showing the names of accounts that are debited or credited, the amount of debits and any useful supplementary information about the transaction". (Robert N. Anthony ; **Management Accounting Principles**, English Print page 70).

It be noted here that due to the difficulties, discussed later in this lesson, involved in writing each and every entry in journal, the use of journal now a days is restricted to recording of the following only—

(1) Opening Entries, (2) Closing Entries, (3) Writing Off of bad debts (4) Writing off of depreciation (5) The correction of errors (6) Adjustment entries (7) Compound entries (8) Transfer entries and other entries of special nature.

The common transactions are generally recorded in other special purpose subsidiary books.

In other words, Journal can be used for recording such entries as cannot conveniently be made or recorded in any other subsidiary book or which are not sufficiently large in number to require a special subsidiary book being maintained for them.

Form : While passing a Journal entry the debit entry is listed first. The debit amount appears in the first of the two amount columns. The amount to be credited appears below the debit entry. The amount of this entry appears in the second of the two amount columns. Ledger Folio (L.F.) column is provided to facilitate a ready reference of the page in the ledger on which that particular column is provided to facilitate a ready reference of the page in the ledger on which that particular account appears. This reference is inserted at the time of recording the entry in the ledger. The presence of this reference indicates that the entry has been posted in the ledger. Every entry requires a brief explanation at the foot of each entry. This brief explanation is technically known as "narration".

Purchase book *:* Purchase book is "used to record only credit purchases of goods, i.e., to record credit purchases of those commodities only in which the firm deals. Thus the purchases of nylon sarees on credit by a firm dealing in sweets will not be recorded in purchase book. Purchase book is also called the 'Bought Book', 'Bought Day Book', 'Purchases Day Book', or 'Invoice Book'.

The rulings *vary* from the ordinary two columns for details an total respectively to the several columns in use in those business where owing to the complexity of the transactions, analysis becomes imperative if the system of book-keeping is to furnish really satisfactory information.

The transactions recorded in the purchase book are daily posted into the ledger to the credit of the different parties from whom the goods have been purchased on credit. At intervals of generally a month the total value of all the purchases are cast. This total amount is posted to the debit of purchases account in the ledger. This completes the double entry at the end of each interval.

The treatment of trade discount necessitates special attention. Trade discount is an allowance from the catalogue price of goods. It should be deducted from the invoices which will be entered **net** in the Purchase Book. Cash discount allowed, if any, will be based upon the true figure, i.e., after deducting trade discount.

Illustration I. From the following particulars prepare the Purchase Book of M/s Adesh Kumar, a dealer in Electrical goods.

Sept. 1,1993	:	Bought from M/s Om Prakash & Company.
		10 Usha Diplomat fans @ Rs. 200/- per fan.
		600 Phillips Lamps @ 2.50 per Lamp.
		Packing charges Rs. 100/-:
Sep. 10	:	Purchased from M/s Kiran & Company.
		3 Kassels Fans-48" @ Rs. 250/- per fan.
		30 Bundles of PVC wire @ Rs. 100/- per bundle.
		Trade discount allowed @ 10%.
Sep. 30	:	Purchased from M/s Anand and brothers.
		10 Immersion Heaters @ Rs. 30/- each..

4 table lamps (Ashok) @ Rs.25/- each.

Solution

	Purchase Book of M/s Adesh Kumar			
Date	**Particulars**	**LF**	**Details Rs.**	**Amount Rs.**
1993	***M/s Om Prakasli and Company***			
Sept. 1	10 Usha Diplomat Fans			
	@ Rs. 200/- per fan		2,000.00	
	600 Phillips Lamps			
	@ Rs. 2.50 per lamp		1,500.00	
	Packing Charges		100.00	3,600.00
	M/s Kiran* and *Company			
Sept. 10	3KesselsFans–48"			
	@ Rs. 250/- per fan		750.00	
	30 Bundles of PVC wire			
	@Rs. 100/- per Bundle		3.000.00	
			3,750.00	
	Less Trade Discount 10%		375.00	3,375.00
	M/s Anand and Company			
Sept. 30	10 Immerssion Heaters			
	@ Rs.30/-each		300.00	
	4 Table Lamps (Ashok)			
	@ Rs. 25/- each		100.00	400.00
				7.375.00

Sales Book: Sales Book is used to recording only the credit sales of goods in which the firm ordinary deals. Cash sales of goods and sales of assets of the firm are not recorded in the Sales Book**.** It is known by various names, e.g., 'Day Book' 'Sold Day Book' and 'Sales Day Book'

The rulings may be the ordinarily two columns or it may be the columner form if it is desired to know the goodswise details of sales.

The Sales Book is also treated in a similar way in respect of the credit sales, the individual transactions are debited to the different parties to whom goods have been sold and the total at the end of each interval is posted to the credit of the Sales Account in the ledger. Thus the double entry is completed in the ledger.

Illustration 2. Enter the following transactions in the books of M/s Naurang Lal Chuttan Lal of Sikandarabad.

1993

Sept. 3 : Sold to M/s Satya Prakash & Co.
10 kg. of Tea @ Rs. 22.50 per kg.
15 kg. of Cocoa @ Rs. 15 per kg.

		Trade Discount @ 10%.
Sep. 13	:	Sold to M/s Gyan Prakash & Bros.
		18 kg.Tea@ Rs.25/-per.kg.
		35 kg. Coffee @ Rs. 40/- per kg.
Sept. 26	:	Sold to M/s Shiv Prakash
		10 Boxes of Biscuits each of 10 kg. @ Rs. 10/- per kg.
		60 Boxes of Sweets each of 15 kg, @ Rs. 5/- per kg.

Solution

Sales Book of M/s Naurang Lal Chhuttan Lal, Slkandrabad

Date	Particulars	LF	Details Rs.	Amount Rs.
1993				
Sept. 3	***M/s Satya Prakash and Co.***			
	10 kg. of Tea @ 22.50 per kg.		225.00	
	15 kg. of Cocoa @ Rs. I5/- per kg.		225.00	
			450.00	
	Less Trade Discount 10%		45.00	405.00
Sept. 13	***M/s Gyan Prakash & Bros.***			
	18 kg. Tea @ Rs. 25/- per kg.		450.00	
	35 kg. Coffee @ Rs. 40/- per kg.		1,400.00	1,850.00
Sept. 25	***M/s Shiv Prakash***			
	10 Boxes of Biscuits of 10 kg.			
	each @ Rs. 10/-per kg.			1,000.00
	60 Boxes of Sweets each			
	of 15 kg. @Rs. 5/- per kg.		4,500.00	5,500.00
				7,755.00

Note : The trade discount of the selling price should be deducted on the invoice on the net sale carried out and posted into the ledger only.

Purchases Returns Book : Sometimes goods purchased may be returned by us to the suppliers due to their being of the wrong kind, or not upto the sample, or because they are damaged. These returns are recorded in the "Purchases Returns Book" or "Returns outward Book". Allowance claimed for short weight, overcharge, breakage, etc., are usually also dealt with in the same book.

The person from whom allowances are claimed or to whom goods are returned is debited and the "Purchase Returns and Allowance Amount" credited at the end of each month with the monthly total of Purchase Returns Book. Some accountants make a distinction between returns and allowances. The total of allowances then will be posted to the credit of Allowances Account which shall be closed to trading account through the Purchases Account.

The ruling of this book similar to that of Purchase Book and Sales Book.

The treatment of trade discounts will be similar to that in the case of Purchase Book and Sales Book. The amount to be entered will be the net figure, i.e., after deduction of trade discount.

Illustration 3. Enter the following in the books of M/s Banwari Lal Kaka & Sons. Delhi.

1993

Sept. 4	:	Returned to M/s Rekha & Co. 5 New Style of General English @ 3/- per copy. 2 New Style Arithmetic @ Rs. 3.50 pr copy Trade Discount @ 10%
Sept 14	:	Returned to M/s Sunita & Co. 3 New Style co-ordinate Geometry @ Rs. 5/- per copy. 7 New Style Memory-@ Rs. 2/- per copy.
Sept 24	:	Returned to M/s Usha & Co. 15 New Style Geometry @ Rs.7/- per copy. 19 New Style Book-keeping @ Rs. 5/- per copy, Packing Charges Rs. 10/-

Solution

Puchases Returns Book of M/s Banwari Lal Kaka and Sons

Date	Particulars	LF	Details Rs.	Amount Rs.
1993	***M/s Rekha & Co..***			
Sept. 4	5 New Style of General Eng. @ 3/- per copy		15.00	
	2 New Style Arthmetic @ Rs. 3.50/- per copy		7.00	
			22.00	
	Less : Discount 10%		2.20	19.80
Sept. 14	***M/s Sunita & Company.***			
	3 New Style Co-ordinate @ Rs. 5/-per copy		15.00	
	7 New Style Memory @ Rs. 2/- per copy		14.00	29.00
Sept 24	***M/s Usha and Co.***			
	15 New Style Geometry @ Rs. 7/- per copy		105.00	
	19 New Style Book-Keeping @ 5/- per copy		95.00	
			200.00	
	Packing Charges		10.00	210.00
				258.80

Sales Returns Book : Sales Returns Book is used for the purpose of recording returns of all goods sold. The goods may be returned by the customer due to their not being of the correct description, of being inferior quality or being damaged in transit. This book is also called Returns Inwards Book is debited to the Returns Inward Account. The double entry is thus completed.

Allowances claimed in respect of short delivery, overcharge or breakage in transit, etc., are usually included in the Sales Returns Book. Some accountants prefer to keep a separate “Allowances Account” in addition-to a Sales Returns Account. Allowances Account is closed to Trading Account through the Sales Account.

Treatment of trade discount will be similar to that in the case of sales, i.e., the amount to be entered will be net figure after deduction of trade discount.

Illustration 4. Prepare Sales Returns book of M/s Sharda & Co. and enter the following transactions therein:

1993		
Sept. 5	:	M/s Naresh Kumar & Co. returned. 2 kg. Sugar @ Rs. 4/- per kg. 1 kg. Tea @ Rs. 26/- per kg.
Sept. 15	:	M/s Rajesh Kumar & Co. returned. 1 Box of Biscuits @ Rs. 50 per Box. Trade discount 10%
Sep. 25	:	M/s Mukesh Kumar and Co. returned. 10 kg. Cocoa @ 6/- per kg.
Sept. 29		M/s Rama & Co. returned. 2 kg. Coffee @ Rs. 30/- per kg. 5 kg. Sweets @ Rs. 12/- per kg.

Solution

Sales Returns Book of M/s Sharda & Co.

Date	Particulars	LF.	Details Rs.	Amount Rs.
1993				
Sept. 5	***M/s Naresh Kumar & Co.***			
	2 kg. Sugar @ Rs 4/- per kg.		8.00	
	1 kg. Tea @ 26/- per kg.		26.00	34.00
Sept. 15	***M/s Rajesh Kumar & Co.***			
	1 Box Biscuits @ Rs. 50/- per box		50.00	
	Less : Trade discount @ 10%		5.00	45.00
Sept. 25	***M/s* Mukesh *& Co.***			
	10 Kg. Cocoa @ 6/- per kg.		60.00	60.00
Sept. 29	***M/s Rama & Co.***			
	2 kg. Coffee @ Rs. 30/- per kg.		60.00	
	5 kg. Sweets @ Rs. 12/- per kg.		60.00	120.00
				259.00

These above-mentioned books are kept in a columnar form. Separate columns are ruled for :-

(1) the date of each transaction, (2) the name of the other party to the contract with a short description of goods dealt with (3) the number of page in the ledger where the account of the party appears (4) the amount of each transaction. As stated earlier, separate columns for each class or group of commodity can be added to Day Books and separate ledger accounts for the purchase and sale of each group commodity can be prepared if the commodities dealt if could be subdivided.

Bills Receivable Book *:* Usually the business firms record entries for bills receivables in the journal but where they receive a large number of bills during a year, a Bills Receivable Book is used for dealing with bills drawn or received. It may be incorporated in the double entry system, if desired. In that case it will be nothing but a journal in modified form.It cannot dispense with the journal entries if not incorporated in the double entry system.

Necessary particulars regarding the names of the drawer and acceptor, the date of the bill, the amount and due date of the bill etc., are recorded in the Bills Receivable Book as and when a bill is received by the firm.

Bills Receivable Book may be used as a Memorandum Book only or a part of the double entry system. If it is used as a part of the double entry system, then the account of the person, not necessarily the acceptor from whom the of the amount of all the bills received during month is posted to the debit of Bills Receivable Account. The entries for Bills Receivable will flow through the usual channel, i.e:, the Journal if the Bills Receivable Book is kept as a Memorandum Book only.

The remarks column in the Bills Receivable Book is employed for recording of necessary observations pertaining to discounting, dishonouring and renewal of the bills, etc.

Bills Payable Book: Like Bills Receivable Book, Bills Payable Book also is kept by the Business concern only where the dealings in bills payables are very frequent; otherwise records of bills payable are kept through the Journal. It is kept to record full details of all the bills accepted by the firm. It thus affords a convenient medium for posting Bills Payable transactions.

Bills Payable Book is ruled and employed in the same manner as the Bills Receivable Book is ruled and employed.

The personal account of the person for whom the bill is accepted is credited individually and the Bills Payable Account is credited with the monthly total amount of the Bills Payable Book.

(See rulings of Bills Payable Book on the next page.)

***Cash Book**:* Cash transaction, in any business are by far the largest in number. The number of such transactions is so large that a special book, called the 'Cash Book' is set apart for recording cash transactions. If every cash transaction were recorded in the journal first, and enormous amount of clerical labour would be entailed in debiting or crediting cash account every time cash is received or paid. This labour could be avoided by keeping a separate Cash Book to record all cash transactions. This makes the cash book the most important of all the other subsidiary Books of Account.

It is sometimes asked: Is cash book a subsidiary Book of Account or a part of ledger ?

Cash Book is generally treated as a book of Original Entry because all the entries pertaining to cash transactions are recorded direct into it. No other subsidiary book is kept for recording such transactions. But really speaking it is nothing else but a part of the Ledger, bound separately. This is so because *(a)* it is written in the form of a ledger account and (*b*) no separate cash account, in addition to a Cash Book, is maintained in the ledger. Thus it is nothing more or less than the Cash and Bank account taken out of the ledger and bound separately for the sake of greater convenience. This becomes clear when we remember that the balances of Cash Book are entered in the Trial Balance and Balance Sheet like all other ledger balances. However, it be noted that though Cash Book is a part of ledger, the use of a subsidiary book in this connection is often done away with and the double entry is completed by direct transfer from Cash Book to the other Ledgers.

Types *:—* The Cash Book may be of various types; the most common types being the following:

1. Simple of single column Cash Book.
2. Single Bank column Cash Book.
3. Cash Book with double, either Cash and Discount or Bank and Discount columns.
4. Three—Cash, Bank and Discount column Cash Book.
5. Petty Cash Book.
6. Multi-columner Cash Book.
7. Subsidiary Cash Book.

In addition to the above types, cash book is sometimes also divided into *(a)* Receipt Journal and *(b)* Payments Journal.

***Simple Cash Book**:* Simple Cash Book makes record of Cash transactions only. It is just like Cash Account. It will have the same rulings as a Ledger Account, there being columns for date, particulars, folio and the amount on Ihc either side of the account. All the cash receipts are recorded on the debit side {left hand side) and all the cash payments are recorded on the Credit side (right hand side). Both

Bills Receivable Book

No. of Bill	Date when received	From whom received	Drawer	Acceptor	Endorser	Where payable	Term	Due Date including days of grace	Ledger folio	Amount	Date of disposal	To Whom sent	Remarks

Bills Payable Book

No. of Bill	Date of acceptance	To whom sent	Drawer	Payee	Where Payable	Date of bill	Term	Due Date including days of grace	Ledger folio	Amount			Remark

the sides debit and credit, have four columns. The first column is used for recording the date, the second column (particulars column) is used for recording the source of receipt of payment. The third column stands for the reference of page number of the Ledger where the account concerned appears. The last column is for the amount of the receipt or payment concerned.

Illustration 5. Prepare simple cash book of Mr. Shiv Singh from the following transactions:

1993

				Rs.
June	1	Started business with cash	...	10000
	4	Paid for purchases	...	4000
	7	Received from Cash sales	...	3200
	8	Paid to Shri Raj Kumar	...	700
	9	Received from Shri K.Kumar	...	900
	16	Paid for stationery	...	137
	25	paid for office furniture	...	595
	29	Received from Cash Sales	...	1200
	30	paid for salaries to staff	...	600
		paid for office rent	...	350

Solution

M/s Shiv Singh

Dr. **Cash Book** **Cr.**

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1993				1993			
June1	To Capital		10,000	June 4	By purchases		4,000
7	To Sales		3,200	8	By Raj Kumar		700
9	To K.Kumar		900	16	By Stationery		137
29	To Sales		1,200	25	By Off. furniture		595
			30		By Office rent		350
			30		By Salaries		600
			30		Balance c/d		8,918
			15,300				15,300
July 1	To Balance b/d		8,918				

Cash Boole with Cash and Discount Columns: Cash Book with Cash and Discount columns is one in which and additional amount column of 'Cash Discount' on each side is provided.

Cash Discount is a deduction from the amount paid or received. Such cash discount can either be 'discount allowed' or ' discount received'. It will be 'discount received' if the trader pays his account promptly or within the period of credit. It will be 'discount allowed' if he receives the payment from his own customers promptly. Since discount is received or allowed at the time of receipt or payment of Cash, it is necessary to record this fact at the same place and time where and when cash transaction is recorded. This is why the Cash Book usually contains two additional amount columns, one on each side. Discount columns on the debit side records Cash discount allowed by a businessman whereas the discount column on the credit side records discount received by him.

Cash discount should, however, be distinguished from trade discount. Cash discount is allowed or leceived for prompt settlement of account or for settlement of account within the period of credit. The trade discount on the other hand, is an allowance made by a wholeseller to a retailer on the catalogue or invoice price. The object of the trade discount may be either to encourage large scale buying by the retailer or to enable the retailer to sell the goods at the price mentioned in the catalogue or Price List issued by the wholeseller. The trade discount is deducted from the invoice itself and the entry in the books is made with the net amount, i.e., after deducting the trade discount.

Certain important points in connection with the cash discount be noted:

(1) The Discount columns are not to be balanced. This is so because the total of the debit side discount columns represents total discount allowed whereas the total of the credit side discount column represents the total discount received.

(2) Discount columns do not serve the purpose of Discount Account because they are only the memorandum columns. A discount account will be opened in the ledger and the total of these columns will be posted therein.

(3) The rules for recording discounts allowed and received in the personal accounts are:

(a) Debit the creditor's account with the amount of discount received while debiting his account with the amount of cash paid, and

(*b*) Credit the debtor's account with the amount of discount allowed together with cash received from him.

(4) The total of the discount column appearing in the debit side of the Cash Book will be posted on the debit side of the Discount Allowed Account and the total of the discount column appearing on the credit side of the Cash Book will be posted on the credit side of the Discount Received Account in the ledger.

This is at first sight appears to be incorrect. How can a debit total be transferred to the debit of an account ? Here one must look at the entries for discounts in the personal account. Discount allowed have been entered in the credit of the individual personal accounts. The entry of the total in the expense account of discount allowed must, therefore, be on the debit side to preserve double entry balancing. The converse applies to discounts received.

The sides on which the two types of discounts are entered in the discount accounts in the ledger can be easily reconciled if discounts allowed are seen as an expense of attracting money. As an expense they will be found as a debit in the discount allowed account. Similarly discounts received may be seen as income received for prompt payment of account, and as income will, therefore, appear on the credit side in the discounts received account.

(5) Discount account being a nominal account, the following rule should be applied while recording discounts.

Debit all losses and expenses (Discount allowed)

Credit all gains and incomes (Discount Received)

Illustration 6. You are requested to prepare double column (Cash and Discount Columns) Cash Book of M/s Suresh Kumar and Company.

1993			Rs.
Jully	1	Opening balance of cash in hand	9000
	5	Received from Nirmal	780s
		Allowed him discount	20
	9	Paid to Nasir	560
		He allowed us discount	40
	13	Sold goods for cash	700
	17	Purchased goods for cash	520

21	Paid for Electricity	78
25	Paid for Advertisement	22
29	Received from Umeshwar	947
	Allowed him discount	53
31	Paid Rent	250
	Paid Salaries	450

Solution

M/s Suresh Kumar & Co.

Cash Book (Cash & Discount columns)

Date	Particulars	L. F.	Discount Rs.	Amount Rs.	Date	Particulars	L. F.	Discount Rs.	Amount Rs.
1993					1993				
July 1	To Balance b/d			9,000	July 9	By Nasir		40.00	560
5	To Nirmal		20.00	780	17	By Purchase			520
13	To Sales			700	21	By Electricity			78
29	To Umeshwar		53.00	947	25	By Advt.			22
					31	By Rent			250
						By Salareis			450
						By Balance			9,547
			73.00	11.427				40.00	11.427
Aug. 1	To Balance b/d			9,547					

Triple column Cash Book : In this type of Cash Book, three amount columns are provided on either side. Three columns are for (a) Discounts (b) Cash (c) Bank. Triple column cash Book is generally used by big business houses which have numerous bank transactions. No bank account need be opened because the bank columns themselves represent debit and credit sides of the Bank Account. The businessmen are thus able to save their time in posting.

The method of recording in this type of Cash Book is similar to the one adopted in case of the columner Cash Book. But contra entries involving Cash and Bank deserve special attention. When cash is deposited into the bank or cash is withdrawn form the bank, the transactions is to be recorded in the cash column on one side and the bank column on the other side. If cash is withdrawn from the bank, the amount will be debited in the cash column and will be credited in the bank column. Similarly, when we deposit the cash in the bank, an entry will be made on the credit side of the cash book in the bank column; and the corresponding entry will be made on the credit side of the cash book in the ledger column. Such entries are known as contra entries. A small letter (c) is written in ledger folio column to indicate that this is a contra entry. No further posting of contra entries is required in the ledger as both the aspects, Debit and Credit, are recorded in the Cash Book itself.

Illustration 7. Prepare triple column Cash Book of M/s Gyan Chand Kasturi Lal.

1993			Rs.
Aug.	1	Blance in hand	920.00
		Balance at Bank	4,748.00
	6	Sold goods to Shri Om Prakash and received cheque	1,200.00

11	Pruchased goods from Shri Jitender Kumar	780.00
16	Paid to Mr. Jagdish- Prashad by cheque	1,650.00
	He allowed us discount	50.00
21	Received from Sh. Raghvendra	183.00
	Allowed him discount	17.00
27	Received from Shri Sunil by cheque	292.00
	Allowed him discount	8.00
28	Withdraw from Bank	3,000.00
30	Paid for Eleclricity	412.00
	Deposited in Bank	3,000.00
31	Shri Om Prakash's cheque dishonoured	1,200.00

Solution : (Please see next page)

Petty Cash Book : Many firms often have numerous small items of expenditure to meet, and to ease the burden of work and entries in the Cash Book they keep what is known as a Petty Cash Book, based on a system in which one person is made responsible for these small disbursements against documents referred to as Petty Cash Vouchers. If these numerous expenses involving small amounts are recorded in the main Cash Book, it will become unmanageable. By recording these transactions into the Petty Cash Book we save the Cashier from making numerous entries for all the petty payments in the main Cash Book which remains handy and does not become cumbersome.

Petty Cash Book can be conveniently maintained in a columner form because the items to be posted in it fall easily into some well defined classes. One column is left unnamed or is named as 'Miscellaneous Expenses' for the recording of such expenses which are small but not so frequent to justify a separate column for each of them.

Example 9

Receipts Side

Date	Particulars	Sales	B/R	Debtors	Rent	Loan	Dividend	Interest	Miscellaneous Receipts	

Payment Side

Date	Particulars	Purchases	B/P	Creditors	Rent	Wages	Interest	Salary	Miscellaneous Payments	

The Petty cash book has two sides—Receipts Side and Payments Side. Payments Side occupies for greater space than the Receipts Side because it has to have many amount columns as stated above.

The Petty Cash Book is just like the Cash Book. The amount received by the Petty Cashier is entered on the debit side and payments are entered on the credit side. The difference between the totals of the two sides represents the unspent balance of petty cash, with the Petty Cashier. The expenditure is analysed under appropriate headings, and the analysis is copied into the main Cash Book from where it is posted to the ledger. Sometimes a Petty Cash Account is opened in the Ledger, and the monthly summary journalised and posted to the debit of the accounts concerned. Corresponding Credit is given to the Petty Cash Account.

The best method of keeping the Petty Cash Book is Imprest system of Petty Cash. The head cashier, under this system, advances a certain sum of money to the Petty Cashier in the beginning. The Petty Cashier goes on making payments out of this advance throughout the month. At the end of the month the head cashier checks the Petty Cash Book puts his initials; and gives a cheque for the exact amount spent, so that imprest amount is always in hand at the beginning of each month.

Illustration 8. Mr. Chander Mohan receives Rs. 100 from his head Cashier to keep petty Cash Book on Imprest system. He makes the following payments.

1993			Rs.
Sept.	1	Purchased Postage Stamps	10.00
	9	Taxi fare given to Shri Sudharashan Kumar	12.00
	16	Tea and lunch to auditors	37.00
	24	Telegram to Shri Anil Kumar	3.00
	27	Paid for stationery	2.00
	28	Paid to Mr. Krishan Kumar for Cyclostyling	9.00
		Prepare Petty Cash Book	

Solution : (Please see the next page).

Subsidiary Cash Book : Thi The main Cash Book, just like Journal, also can be sub-divided into for example, Petty Cash Book, Receipts from debtors Cash Book, Payments to Creditors Cash Book and so on. Such divided cash books are called Subsidiary Cash Books. The total of such Subsidiary Cash Book is taken to the main Cash Book.

Multi-Columner Cash Book : When the triple columner Cash Book does not satisfy the business requirements, the Cash Book on each side is divided into as many columns as there are frequent heads of receipts and payments. The recurring items of receipts and payments are recorded in the suitable columns. This saves the labour of sorting out similar items at the end of the period. The total of the various columns are posted to the concerned accounts in the Ledger. It is very much in use now-a-days.

Double Column with Bank and Discount Column : This type of Cash Book is maintained in a business house where all the transactions are through Bank. The recording of transactions is done in the same manner as is done in the case of double column Cash Book.

Single Bank Columssn Cash Book : This type of cash book represents only the Bank Account. The businessman makes use of this type of cash book when he does not handle any cash but settles every transaction through cheque. Such Cash Book can, unlike other Cash Books, have credit balance also. It might happen so because of overdraft facilities granted by bank.

Solution (Example 7)

***M/s* Gyan Chand Kastur Lal**
Triple Column Cash Book

Date	Particulars	LF.	Discount	Cash Rs.	Bank Rs.	Date 1993	Particulars	LF	Discount Rs.	Cash Rs.	Bank Rs.
1993											
Aug. I	To Balance b/d			920	4.748	Aug. 1 1	By Purchases			780	
6	To Sales				1.200	16	By Shri Jagdish Prasad		50.00		1.650
21	To Sh. Raghvendra	17.00		183	28	By Cash	C				3,000
27	To Sh. Sunil		8.00		292	30	By Electricity			412	
28	ToBank	C		3.000		30	By Bank	C			2.100
30	To cash	C			2.100	31	By Om Prakash				1.200
							By Balance c/d			628	2,673
			25.00	3,920	8,523				50.00	3.920	8.523
Sept. 1	To Balance b/d			628	2.673						

Solution (Example 8)

Petty Cash Book

Amount Received Rs.	Date	Particulars	Vouc her No.	Total Rs.	Postage and Tele-gram Rs.	Carriage and Cartage Rs.	Con-vey-ance Rs.	Station-ery Rs.	Cyclo-styling Rs.	Sund ries Rs.	Remarks
100.00	1993 Sept 1	To Bank									
	1	By Postage and stamp	1	10.00	10.00						
	9	By Taxi Fare	2	12.00			12.00				
	16	By Tea and Lunch to Auditors	3	37.00						37.00	
	24	By Telegram	4	3.00	3.00						
	27	By Stationary	5	2.00				2.00			
	28	By Cyclostling	6	9.00							
				73.00	13.00		12.00	2.00	9.00	37.00	
	30	By Balance c/d		27.00							
100.00				100.00							
27.00	Oct.	To Balance b/d									
73.00		To Bank									

TRIAL BALANCE

Ledger : One of the objects of accounting is to ascertain, with the least amount of trouble and cost, what the dealer owes to hisss creditors, what is owed to him by his customers, what are his expenses and incomes and so on. It is also clear that this information can not readily be obtained by recording the transactions into the journal alone. Suppose one wants to find out the amount owed to or owed by Mr. X to him then he will have to search through all the journal entries relating to Mr.. X because he must have purchased goods several times from him and must have paid him money at different times. If this process is followed in order to ascertain one's position with every person or firm one deals with, the object of accounting will be only partly realized. Moreover, it will mean unnecessary wastage of time, energy and money. Some simpler means of bringing together the entries referring to each person or firm must, therefore, be found. This is done by collecting and condensing all the entries in another book, called the Ledger. All the entries relating to each person which so far stand dispersed through the journal are collected and condensed at one particular place called the account.

The Ledger according to the Batliboi is the *chief book of accounts,* and it is in this book that all the business transactions would ultimately find their place under their respective accounts in a duly classified form.

According to Pickles the ledger is the most important book of the account is the "destination of the entries made in the subsidiary books. It is essentially a collection of the three types of account Real, Personal and Nominal.

From the above discussion it becomes fully evident that the Ledger is not a book of prime entry because no entry is made direct into this book. It is first passed through the subsidiary books. This, however, is a book of primary importance. It contains the accounts relating to all the transactions that take the place in a business concern. Generally, one page of the ledger is devoted to one account, though there is no such hard and fast rule. This is done so to avoid mistakes and clumsiness of the entire writing.

If the number of accounts be very large then it may not be possible for all the accounts to be contained in one ledger. In such a case ledger may be divided into several sections of volumes. As pointed out in your pervious lesson Cash Book is only a sub-division of ledger containing cash transactions.

One way of dividing the ledger is to divide it into Personal and Impersonal of General Ledger. The Personal-Ledger can further be sub-divided into Sold Ledger and Bought Ledger. Similarly, the Impersonal Ledger can also be sub-divided into Real (containing the Accounts of assets and properties of the firm} and Nominal Ledger (containing all other accounts except the Personal Accounts and Real Accounts). Sometimes a private Ledger is maintained to keep capital Account and Drawing Account. No such Ledger, however, is kept in the case of a company.

It should be noted that the methods of sub-dividing the ledger as mentioned above, however, is not only method. The methods of division, if any division is all required, will always depend upon the circumstances of each particular case.

Every ledger has an index in the very beginning. It is usually an alphabetically index. One page of the index is allotted to one alphabet and the names commencing with that alphabet arc written in the page allotted to that alphabet. The page number on which the account appears in the ledger is written against each account in the index.

Rulings of Ledger-Many different rulings are met with in business. The most common have columns for date, particulars of transacs tions, folio and amount. Additional amount columns could be added if the business needs so require.

An alternative form or ruling, which is adopted by banks and some business organizations is that entire page of the Ledger is divided into six columns. These 6 columns are (1) Date (2) Particulars (3) Folio (4) Dr. Amount (5) Cr. Amount (6) Balance.ss

The advantage of this alternative ruling is that the balance of an account can automatically be found out after transaction. There is no need to wait till the end of the period for ascertaining the balance.s

A specimen with each type of ruling is given below

Alternative—1

.. Account

Date	Particulars	Folio	Amount Rs.	P.	Date	Particulars	Folio	Amount Rs.	P

Alternative—2 **.. Account**

Date	Particulars	Folio	Dr. Amount Rs.	P	Cr. Amount Rs.	P.	Balance Rs.	P.

Posting: The process of making entries in the ledger from journal or other subsidiary books is known as posting. The entries recorded in the journal and other subsidiary books form the basis of entries in the Ledger. The work of posting does not require any specialised skill as it is routine type of works.

Let us now take a few examples to show how posting is made from each of the subsidiary books mentioned in our previous lesson.

Posting from the journal: The transactions should be posted to ledger after they have been recorded in the journal. Posting of journal is easier as compared to posting of other subsidiary books. In this case the amount which are entered in the debit amount column of the journal are posted to the debit of the account concerned and those entered in the credit amount column of the journal are posted to the credit of the account concerned in the Ledger. The names of the account will be interchanged in the particular column of the Ledger-the name of the account in which the amount is debited in the journal will be written in the particulars column on the credit side of the other account in the Ledger, and vice versa. It could be illustrated with the help of the following example :

Illustration 9. Journalise the following transactions and post them to Ledger.

1993			Rs.
Dec.	1	Commenced business with Cash	6,000
	2	Deposited into Bank	2,000
	4	Bought goods for Cash	1,100
	6	Sold gods to Abha	600
	8	Received from Abha	594
		Allowed her discount	6
	10	Paid wages by cheque	200
	15	Cash Sales	418
	20	Rent due to Landlord	150
	25	Interest on Capital	30

Solution

Jurnal

Date		Particulars	Ledger Folio	Dr. Amount Rs. P.	Cr. Amount Rs. P.
1993					
Dec.	1	Cash Account ......Dr.		6,000.00	
		To Capita] Account			6,000.00
		(Being the amount introduced as Capital)			
	2	Bank Account ......Dr.		2,000 .00	
		To Cash Account			2,000.00
		(Being the amount deposited in the Bank)			
	4	Purchases Account ......Dr.		1,100.00	
		To Cash Account			1,100.00
		(Being the amount of Cash Purchases)			
	6	Abha's Account ......Dr.		600.00	
		To Sales Account			600.00
		(Being the amount of Credit Sales to Abha)			

	8	Cash Account ......Dr.		594.00	
		Discount Account ......Dr.		6.00	
		To Abha's Account			600.00
		(Being the amount received and discount and discount allowed to Abha)			
	10	Wages Account ......Dr.		200.00	
		To Bank Account			200.00
		(Being the payment of wages by cheque)			
	15	Cash Account ......Dr.		418.00	
		To Sales Account			418.00
		(Being the amount of Cash Sales)			
	20	Rem Account ......Dr.		150.00	
		To Rent Outstanding			150.00
		(Being the amount of renldue to Landlord)			
	25	Interest Account ......Dr.		3 0.00	
		To Capital Account			30.00
		(Being the amount of Interest on Capital)			
		TOTAL		11,098.00	11,98.00

CASH BOOK

Date	Particulars	L.F	Discount Rs.	Bank Rs.	Office Rs.	Date	Particulars	L.F	Discount Rs.	Bank Rs.	Office Rs.
1993							1993				
Dec. 1	To Capital Account				6,000	Dec 2	By Bank A/c				2,000
Dec.2	To Cash Account	C		2,000		Dec 4	By Purchase A/c				1,100
Dec.8	To Abha's Account		6		594	Dec 10	By Wages Account			200	
Dec. 5	To Sales Account				418	Dec.3	By Balance c/d			1,800	3,912
			6	2,000	7,012					2,000	7,012
1994											
Jan 1	To Balance b/d			1,800	3,912						

Capital Account

Date	Particulars	Folio	Amount	Date	Particulars	Folio	Amount
1993				1993			
Dec. 31	To Balance c/d		6,030.00	Dec. 1	By Cash		6,000.00
				" 28	By Interest		30.00
			6,030.00			6,030.00	
				1994			
				Jan. 1	By Balance b/d		6,030.00

Dr. **Purchases Account** **Cr.**

1993				1994			
Dec. 4	To Cash		1,100.00	Dec. 31	By Trading Account Transfer		1.100.00
			1.100.00				1.100.00

Dr. **Abhas's Account** **Cr.**

1993				1993			
Dec. 6	To Sales		600.00	Dec. 8	By Cash		594.00
			………		By Discount		6.00
			600.00				600.00

Dr. **Sales Account** **Cr.**

1993				1993			
Dec. 31	To Trading A./c Transfer		1,018.00	Dec. 6	ByAbha		600.00
				" 15	By Cash		418.00
			1,018.00				1,018.00

Dr. **Wages Account** **Cr.**

1993				1993			
Dec. 10	To Bank		200.00	Dec: 31	By Trading A./c Transfer		200.00

Dr. **Rent Account** **Cr.**

1993				1993			
Dec. 20	To Rent Outstanding		150.00	Dec. 31	By Profit & Loss A/c Transfer		150.00

Dr. **Rent Outstanding Account** **Cr.**

1993				1993			
Dec. 31	To Balance c/d		150.00	Dec. 20	By Rent		150.00
				1994			
				Jan. 1	By Balance b/d		150.00

Dr.		Interest Account					Cr
1993				1993			
Dec. 25	To Capital A/c		30.00	Dec. 31	By Profit & Loss A/c Transfer		30.00

Posting from Purchase Journal - A separate account for each supplier of goods is opened in the **Ledger.** The amount of each purchase would be credited to its respective Personal Account normally daily. The double entry of this book shall be completed by debiting the Purchases Account with the total of the period (normally one month).

Illustration 10

Taking the example No. 1 given in the previous Lesson post the transaction to Ledger.

Solution:

Dr. **Purchases Account** **Cr.**

Date	Particulars	L.F.	Amount Rs. P.	Date	Particulars	L.F.	Amount Rs. P.
1993 Sept. 30	To Sundries as Per Purchase Book		7,375.00				

Dr. **M/s Om Parkash & Co.** **Cr.**

			1993 Sept. 1	By Purchases	3,600.00

Dr. **M/s Kiran & Co.** **Cr.**

			1993 Sept 10	By Purchases	3,375.00

Dr. **M/s Anand & Brothers** **Cr.**

			1993 Sept 10	By Purchases	400.00

Posting from Sales Bok— A separate account will have to be opened for each customer in the Ledger. Sales of goods to individulas is normally posted daily. Individual customer's account will be debited with the amount of sales. The Sales Account will be credited with the monthly total of the credit sales. The Double Entry of the Book shall thus be completed.

Illustration 11. Ledger Account of Example 2 of the previous lesson would appear as folllows:-

M/s Naurang Lal Chuttan Lal

Dr. **M/s Satya Prakash Co.** **Cr.**

Date	Particulars	L.F.	Amount Rs. P.	Date	Particulars	L.F.	Amount Rs. P.
1993 Sent.. 3	To Sales		405.00				

Dr. **M/s Gyan Prakash & Brothers** **Cr.**

1993 Sept. 13	To Sales		1.850.00				

Dr. **M/s Shiv Prakash** **Cr.**

1993 Sept. 13	To Sales		5,500.00				

Dr. **Sales Account** **Cr.**

				1993 Sept. 30	By Sundries as per Sales Book for the Month of Sept.		7,755.00

Posting from Purchase Returns Book— Each person to whom goods have been returned is debited in the ledger, at the end of the month, the total of the returns for the period is credited to the Returns Outwards Account in the Ledger.

Illustration 12. Ledger posting of Example No. 3 of the previous lesson will be as under :

Dr. **M/s Rekha & Company** **Cr.**

Date	Particulars	L.F.	Amount Rs. P.	Date	Particulars	L.F.	Amount Rs P
1993 Sept. 4	To Returns Outwards A/c		19.80				

Dr. **M/s Sunita & Company** **Cr.**

1993							
Sept. 14	To Returns Outwards Accounts		29.00				

Dr. **M/s Usha & Company** **Cr.**

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1993 Sept. 24	To Returns Outwards Accounts		210.00				

Dr. **Returns outwards Account** **Cr.**

				1993 Sept. 30	By Sundries as per Returns Outwards Book for the month of Sept		258.80

Posting from Sales Returns Book—Each customer who returns the goods is credited, and, at the end of the month, the total of Returns Inwards Book is debited to the Returns Inwards Account

Illustration 13. Ledger accounts of Example No. 4 of the previous lesson would appear as follwos:

M/s Sharda & Co.

Dr.	M/s Naresh & Co.						Cr.
Date	Particulars	L.F.	Amount R.P	Date	Particulars 1993	L.F.	Amount
				Sept, 15	By Returns Inwards A/c		34.00

Dr.	M/s Rajesh Kumar & Co.						Cr.
				1993 Sept. 15	By Returns Inwards A/c		45.00

Dr.	M/s Mukesh Kumar & Co.						Cr.
				1993 Sept. 15	By Returns Inwards A/c		60.00

Dr.	M/s Rana & Co.						Cr.
				1993 Sept. 30	By Returns Inwards A/c		120.00

Dr.	Return Inwards Account						Cr.
1993 Sept. 30	To Sundries as per Returns Inwards Book for the month of Sept.		259.00				

Note: The Purchases Account, the Sales Account, the Returns Inwards Account, and Returns Outwards Account are closed at balancing time to the Trading Account.

Posting from Cash Book

All items in the Cash Book (excepting balnaces and contra entries) are posted into the ledger. The receipts on the debit side of the Cash Book are posted to the credit of the ledger account concerned, “By Cash”, “By Discount” and “By Bank”. The payments on the credit side of the Cash Book are posted to the debit side of the ledger accounts concerned, "To Cash”, "To Discount” and "To Bank”. The total of the discount column on the debit side of-the Cash Bok is posted to the debit of the Discount Account in the ledger, as the items have been posted to the credit of the individual personal accounts. The total of the discount column on the credit of the Cash Book is posted to the Discount Account in the-ledger, the items having been posted individually to the debit of the Personal Accounts.

Illustration 14. Posting of Example 7 of previous lesson will be made as follows:

Dr.	Sales Account						Cr.
Date	Particulars	L. F.	Amount Rs. P.	Date	Particulars	L.F	Amount Rs. P.
1993 Aug. 1	To Trading A/c Transfer		1,200.00	1993 Aug. 6	By Bank		1,200.00

Dr. **Shri Raghvendera** **Cr.**

				1993			
				Aug. 27	By Bank		183.00
					By Discount		17.00

Dr. **Shri Sunita's Account** **Cr.**

				1993			
				Aug. 27	By Bank		292.00
					By Discount		8.00

Dr. **Purchase Account** **Cr.**

1993							
Aug. 11	To Cash		780.00				

Dr. **Shri Jagdish Prashed** **Cr.**

1993							
Aug. 16	To Bank		1,650.00				
	To Discount		50.00				

Dr. **Electricity Account** **Cr.**

199							
Aug.30	To Cash		412.00				

Dr. **Shri Om Prakesh** **Cr.**

199							
Aug.30	To Bank		1,200.00				

Posting from Bills Receivable Book—The account of the person, from whom each bill is received, is credited with the amount of the bill. Monthly total amount of the bills received is debited to Bills Receivable account in the ledger.

Posting from Bills Payable Book—The account of the person, to whom the bill is given, is debited with the amount of the bill. Monthly total amount of the bills given is credited to Bills Payable Account in the Ledger.

Posting from the petty Cash Book—At periodical intervals, the analysis of the petty expenses as indicated by the analytical column of the Petty Cash Book is journalised, each nominal account concerned being debited with its respective total and the Petty Cash Account being credited with the total payments during the period.

Balancing the Account

Personal Account—To find out whether there is any amount due to particular person or is due from a particular person, it is necessary to balance his personal account. This process is known as 'Balancing the Account'.

To find out the balance of an account, the two sides (debit and credit) are added up. If the debit and credit totals are unequal, the difference is inserted on the shorter side, to make the two sides equal. The difference thus form for inserting on the shroter side is known as balance of the account.

The balance will fall on the credit side with the words “By Balance carried down” if the total of the debit side is heavier than the total of the credit side. The balance in such a case will be termed as “Debit Balance”. This balance is brought down on the debit side while opening the account next year. Reverse is true in case the total of the credit side is heavier than that of the debit side.

Real Accounts—Real Accounts represent the assets and properties of the business. These accounts are balanced to find out the amount of the assets and properties held by the business on the date of the Balance Sheet. These are balanced in the manner the personal account are balanced. It should be noted, however, that the Real Accounts always have a debit balance or at the most no balance, *i.e.,* they can never have a credit balance.

Nominal Accounts—Nominal Accounts deal with the expenses, losses, incomes or profit of the business. These are not balanced. Rather they are closed by transfering them either the Trading Account or the Profit and Loss account as the ease may be.

Note : When balancing/closing the accounts ensure that the two totals are written on a level with one another. If accounts contain only one entry, it is unnecessary to enter the total. A double line ruled under the entry will mean that the entry is its own total. Similarly, if an acccount contains one entry on each side which are equal to one another, totals are again unecessary.

Trial Balance—As stated in a previous lesson, one method of book-keeping in use is that of double entry method, every debit entry needing a corresponding credit entry, and vice-versa. From this it is obvious that the total of all the credit entries made in the books should equal the total of all the debit entries. As a corollary to this, the debit balances must equal the total credit balances. This, however, should be irrespective of the number of accounts opened in the ledger or the number of postings made in accounts.

This being so the accountant will like to try whether he has transferred all the entries from the original records i.e.. Subsidiary books into the ledger after he has entered all the transactions for a particular period in the books and properly posted them into the ledger. For this purpose he will prepare a Trial Balance. In other words we can say that to see if the two totals are equal, or in accounting terminology to see if the sides of the-books ‘balance' a Trial Balance may be drawn up periodically. The Trial Balance being an epitome of the Ledger is also used as material for preparing the Final Accounts, i.e., Trading and Profit and Loss Account and Balance Sheet.

According to Carter and Carter, “A Trial Balance is schedule or list of balances, both debit and credit, extracted from the accounts in the ledger, and including the cash and Bank balances from the Cash Book.”

Pickles defines a Trial Balance as, “At the end of the financial period (or at some other date) the balances of the accounts are extracted from the ledger are extracted, and a “schedule prepared in Journal form to test whether in fact, the total debits equal total credits. Such a schedule of balances is called a Trial Balance.”

“A Trial Balance may thus be defined as statement of debits and credit extracted from the ledger with a view to test the arithmetical accuracy of the book” (J.R. Botliboi)

***Methods of Preparing a Trial Balance*—**A Trial Balance can be prepared in two ways, (1) by means of total, (2) by mean of balances.

The first method is sometimes called as ‘Total Posting Method’. Under this method the debit and credit sides of each ledger Account is totalled up as at the date of the Trial Balance and grand totals of all debits and credits taken out. If the books are correct, the debit total will equal the credit total.

However, this is not the normal method of drawing up a Trial Balance, but il is the easiest to understand in the first instance. Usually a trial balance is a list of balances only, arranged as to whether they are debit balances or credit balances. One should remember to include the Cash Balance and Bank Balance as indicated by the Cash and Bank columns of the Cash book white preparing the Trial Balances. The reason for their inclusion is that these columns represent cash and Bank Accounts kept separctely in the form of Cash Book for the sake of convenience. This form of Trial Balance is the easiest to extract when there are more than a few transactions during the period.

Some business concerns, however, prepare the Trial Balance in a compound form. i.e. the totals and balances side by side. This reveals the compensating errors, becuase the total of the debit columns of the Trial Balance in such a case must agree with the total of those subsidiary books which are posted to the debit of accounts in the ledger together with the closing Cash Balance but comitting the opening balance of cash. Similarly, the total of the credit column of the Trial Balance in such a case must agree with the total of those subsidiary books that are posted to the credit of Ledger Accounts.

Illustration I5. From the following balances of Shri Ram Chander's ledger prepare a Trial Balance as on 31 st Dec., 93

	Rs.		Rs.
Building	5,000	Bills payable	4,000
Capital	50,000	Investment	5,200
Purchases	90,000	Printing & Stationery	1000
Sales	1,00,000	Cash in Hand	6,500
Returns (cr.)	8,000	Plant & Machinery	11,000
Salary	1,500	Drawings	5.000
Debtors	15,200	Bank (cr.)	10,000
Insurance	400	Returns (cr.)	10,000
Bills Receivable	4,800	Stock	25,000
Commission (cr.)	600	Rent	800
Int. Receivable	200	Salary payable	1,200
Carnage	3,000	Creditors	11,000
		Advertisement	600

Trial Balance of Shri Ram Chander as on 31st Dec. 1993

Name of the Account	L.F.	Dr. Rs.	Cr. Rs.
Building		5,000	
Capital			50,000
Purchases		90,000	
Sales			1,00,000
Returns (cr.)			8,000
Salary		1,500	
Debtors		15,200	
Insurance		400	
Bills Receivable		4,800	
Commission (cr.)			600
Int. receivable			200
Carriage		3,000	
Bills payable			4,000
Investments		5,200	
Printing & Stationery		1,000	
Cash in Hand		6,500	
Plant & Machinery		11,000	
Drawings		5,000	
Bank			10000

Returns		10,000	
Stock		25,000	
Rent		800	
Salary payable			1,200
Creditors			11,000
Advertisement		600	
Total		1,85,000	1,85,000

Objects: From the above discussion it is quite clear that objects of preparing a Trial Balance are two: namely:

1. Checking arithmetical accuracy of the books of accounts.
2. Ascertaining whether or not both the aspects of each transaction have been recorded.

UNIT-II

Lesson 1

THE FINAL ACCOUNTS

Distinction Between Capital and Revenue Expenditure

Before we proceed to the preparation of Profit and Loss accountand the Balance Sheet, it is necessary to distinguish between two types of expenditure-Capital and Revenue Expenditure. An expenditure incurred to acquire an asset or a benefit, which will be available for a long time, is capital expenditure. When the earning capacity of a business is increased it is also capital expenditure. Examples are money spent to acquire machinery, repair expenses of second hand machinery purchased, purchase of goodwill of a running business, etc. expenditure whose benefit is available only for the present is revenue expenditure. Examples are, payment of the wages, salaries, rent and expenditure on advertising etc.

Capital expenditure is an asset, revenue expenditure is an expense. Out of current income expenses should be met, but in respect of assets only the diminution in their value should be met, out of current income.

Remember also that when assets (except goods) are sold the proceeds are not to be treated as sales in the ordinary sense. The proceeds are "Capital Receipts". If the asset has been sold at a price higher than its book-value or recorded value, the difference can be treated as profit. Similarly, if the amount received by its sale is less than its recorded value, the difference must be treated-as a loss.

Distinction between capital and revenue is very Important but is not always easy. But a golden rule is: if an expenditure results in increased capacity for business or reduced costs in producing goods or, of course, in the acquisition of an asset, it is capital expenditure. Otherwise, it is revenue expenditure, making new exits in a cinema house is revenue expenditure because capacity is not increased. But making a gallery to seat more people is capital expenditure.

Deferred Revenue Expenditure. Sometimes a very heavy expenditure of revenue nature is incurred. If its benefit will be available for three or four years (as in case of heavy advertising to launch a new product) the expenditure is deferred Revenue Expenditure.

Self Check Test

Point out whether the following expenditure is capital revenue:

1. Second hand furniture purchased for Rs.9,000 and Rs 1000 spent on repairing and polishing it.
2. Rs.20,000 paid to obtain licence to run a cinema.
3. Fire Insurance premium Rs.9,000.
4. Rs.3,390 spent on dismantling, removing, to a better site and reinstalling plants.
5. Before removal to the new site a machinery standing in the books at Rs. 1,800 sold for Rs.600, A new Machine purchased for Rs.3,200, Rs.250 spent on installation.

Key

1. Capital Expenditure
2. Capital Expenditure.
3. Revenue Expenditure.
4. Deferred Revenue Expenditure
5. Rs. 1,200 Revenur Loss and Rs.3,450 Capital expenditure

Trading account

At the end of a period, it is necessary to find out the result of trading, that is say, the profit earned or loss suffered. This is done in two stages. Firstly, purchases of goods (adjusted for opening and closing stocks) are compared with sales. If sales exceed purchases, there is a gross profit. There is gross loss if purchases exceed sales. Secondly from the gross profit expenses and losses for the period are deducted. (These will be added to gross loss). If gross profit exceeds total of expenses and losses, the difference is net profit. There is net loss when expenses and losses exceed gross profit.

Now consider the following transactions:

2000		
January		Rs.
1	Assets, cash in hand	
	Cash at bank	120
	Stock of goods	4,700
	Bingo Little	3,000
	Lord Oargoyle	1,180
	Furniture and Equipment	2,000
2	Liability Bud & Blossom	3,000
	Withdrawn from bank	4,000
3	Paid Salaries and wages	1,000
4	Cash sales	780
	Sold to Laural & Hardy on credit	320
	20 pairs gents shoes @ Rs. 11	
	30 pairs ladies shoes @ Rs. 12	
5	Purchased a typewriter from Remington Rand Inc.	840
6	Bingo little Pays by cheque in full settlement	1,150
7	Cash purchases	200
	Purchased from Bud and Blossom	
	24 pairs chappals @ Rs. 5	
	20 pairs sandals @ Rs. 10	
9	Paid Bud & Blossom on account by cheque	2000
10	Raised a loan from Aunt Agatha, paid into bank	10000
	Purchased Machinery and paid by cheque	8,000
11	Bingo Little's cheques returned dishonoured by bank	
12	Purchased from Nagendra & Puri	
	15 pairs gent shoes @Rs. 15	
	20 pairs children's shoes @ Rs. 5	
14	Sold to Lord Gardgoyle;	
	10 Pairs ladies shoes @ Rs. 18	
	15 Pairs sandal @Rs. 12	
16	Received cheque from Lord Gargoyle and deposited in bank	1,980
	Allowed him discount	20
2000		
January		
17	Lord Gargoyle returns goods:	
	2 pairs ladies shoes @ Rs. 18	
	5 pairs sandals @ Rs. 12	

18	Nagendra & Puri give us special allowance, for certain defects in goods purchased from them	50
19	Cash sales made Jo M/sGart& Carter	120
20	Cash purchases from M/s Horse & Cart	200
21	Old Newspaper sold for Cash	20
23`	One old almirah sold to M/s Ravi Bros. On Credit	1,000
25	Bingo little is declared bankrupt, a first and final dividend of eight annas in the rupee received from his estate	200
25	Paid Rent by cheque	300
26	Goods withdrawn for private use One pair gents shoes @ Rs. 15 and One pair ladies shoes @ Rs. 18 taken for domestic use	
30	Paid for stationary and postage	50
32	One month's interest due to Aunt Agatha at the rate of 6% per annum	75

The Goods Account, for the above transactions appears as under (dates omitted):

Dr. **Goods Account** **Cr.**

	Rs.		Rs.
To Balance b/d	3,000	By Nagendra & Puri	50
To Cash	200	By Cash	320
To Cash	200	By Cash	150
To Purchases as per Purchase book	645	By Drawing Account	33
To Returns Inwards Lord Gargoyle	96	By Sales as per Sales Book	940

The debit side represents total of purchases made (including stock of goods already on hand on 1st January, and including returns from Lord Gargoyle). It totals Rs. 4,141. The credit side (total Rs. 1,493) represents sales made; including Rs. 50 special allowance from Nagendra & Puri. To find out gross profit. We will have to put on the credit side the value of goods still in hand. Suppose value of stock still in godown is Rs. 3,500. Then there is a gross profit Rs. 852 thus-

			Rs.
	Total sales, etc		1493
	Stock of goods still in hand		3500
			4,993
Less:	Stock of goods on hand	3,000	
	Purchases, etc., made	1,141	
			4,141
	Gross Profit		852

The Goods Account will now appear as under:

Dr.	Goods Account		Cr.
	Rs.		**Rs.**
To Balance b/d	3,000	By Nagendra *& Pan*	50
To Cash	200	By Cash	320
To Cash	200	By Cash	150
To Purchases	645	By Drawing Account	33
To Returns Inwards	96	By Sales	940
To Gross Profit	852	By Balances c/d (Closing Stock)	3,500
	4,993		4,993
To Balance b/d	3,500		

* *This figure of closing stock is not provided by ledger accounts. The stock at the end is counted and valued.*

In actual practice Goods Account is not prepared but is split into so many parts. The following are the usual accounts resulting from split:

1. Opening Stock account (Showing balance of goods on hand in the beginning of the period)
2. Purchases account (Showing total purchases made)
3. Sales account (Showing total sales made)
4. Returns Outwards A/c (Showing value of goods returned to suppliers)
5. Returns Inwards A/c (showing value of goods returned by customers)

Accounts No. 1,2 and *5* show a debit balance and account No. 3 and 4 show a credit balance.

In order to find out gross profit, a Trading Account is opened and all the above noted accounted are transferred to it Nos. 1,2 and 5 on the debit side and 3 and 4 on the credit side the journal entries are:

1. Trading Account.......Dr.

    To Opening Stock Account

    To Purchases Account

    To Returns Inwards Account .

2. Sales Account..........Dr.

    Returns Outwards account..... .Dr.

    To Trading Account

Thus, the Trading account will be opened and all the other accounts closed; another entry will be required for closing stock. It will be:

3. Closing Stock-Dr.

    To Trading Account

Closing Stock account will be opened and debited with the value of closing stock and the Trading account will be credited. The Trading account will now show gross profit (if its credit side is bigger than its debit side) or gross loss (if its credit side is less than its debit side). Gross profit or gross loss will be transferred to a newly opened Profit & Loss Account. *The entry for gross profit is:*

4. Trading Account.................Dr.

    To profit & Loss A/c

    The entry will be reversed for Gross Loss.

Illustration 1.

Prepare Trading Account from the following:

	Rs.		Rs.
Opening Slock	30,000	Purchase	2,000
Purchases	29,000	Closing Stock	37,700
Sales Returns	500		
Sales	35,400		

Solution

Trading Account of ....

For the year ended ....

Dr.			Cr.
	Rs.		Rs.
To Opening Stock	30,000	By Sales	35,400
To Purchaes	29,000	By Purchase Returns	2,400
To Sales Returns	500	By Closing Stock	37,700
To Gross Profit			
(Balancing figure)	16,000		
	75,500		75,500

It is belter to show net purchases (i.e. purchases less returns outwards) and net sales (i.e. sales less returns inwards). Therefore, Trading Account in the above Case should be as follows:

		Rs.			Rs.
To Opening Stock		30,000	By sales	35,400	
To Purchaes	29,000		Less Returns		
Less Returns			Inwards	500	34,900
Outwards	2,400	26,600			
			By Closinsg Stock		37,700
To Gross Profit					
(Balancing Figure)		16,000			
		72,600			72,600

In manufacturing concerns, in addition to accounts mentioned above, there are other Accounts which show expenses incurred to make or produce the goods. Some of these expenses are:

Freight on Purchase or carriage inwards

Wages

Factory Rent and Rates

Factory Salaries

Power and Fuel, etc.

All these accounts will be transferred to the Trading Account-these accounts will be credited (and thus closed) the Trading Account will be debited. Gross profit (or gross loss) can be ascertained only if this is done in addition to entries No. 1,2 and 3 given above.

Valuation of Closing stock is most important. If it is not valued correctly, gross proift will be inflated or deflated. Suppose, in the above example, the value of closing stock is Rs. 47,000. The Gross Profit will then be Rs. 6,000. Thus closing stock must be valued correctly and properly.

At the close of a year goods lying in godown are listed together with quantiy on hand each item is then valued at cost or market price whichever is lower. This principle is adopted to take posible loss into account but not profit (which has not yet been earned by making a sale)

Other points to be noted while preparing accounts for a year (Say 2000)

(1) See the all purchases made in 1999 have been entered in book.

(2) Goods taken into stock must not be treated as a sale *(e.g..* when an invoice is prepared but goods despatched).

(3) All goods despatched during the year should be invoiced and entered in the Sales Book.

(4) Entries must be passed for goods returned by customers and taken into stock.

(5) Entries must be passed for goods not returned to supplies and taken into stock.

Profit & Loss account

You know that Trading account reveals gross profit or gross loss. This is transferred to the Profit and Loss account.

In a trial Balance you will find a number of accounts showing expenses and a few showing income or gains. Some of these expenses have already been transferred to the Trading Account. The remaining accounts showing expenses and gains arc transferred to the profit & loss account. The entries may look like the following :

1. Profit & Loss Account ....Dr.

    To Office Salaries

    To Office Rent

    To Advertising

    To Freight Outwards

    To Interest Paid

    To Discount Allowed, etc.

2. Discount Received..................... Dr.

    Interest Received, etc..... ..Dr.

    To Profit & Loss A/c

These accounts will then stand closed. When all losses, expenses, and gains have been transferred to the Profit and Loss Accounts, this account will reveal net profit or net loss.

Credit Side—Debit side = Net Profit (when credit is greater than debit side)

Debit side—Credit side= Net Loss, (when debit side is greater than credit side)

Both net profit and net loss are transferred to the Capital Account (which you Know, is the account of the Proprietor). The entry is:

3. Profit and Loss account..........Dr.

    To Capital account

Reverse entry is passed for net loss.

The following points must be remembered for preparing a Profit & Loss account:

(i) All expenses even if unpaid, relating to the period concerned (say year) must be taken into account. For instance, if the accounts are being prepared for the year ending on March 31, 2000 and if rent for the month of March has not yet been paid, we must treat unpaid rent of March as expense of current year. This entry to be passed will be:

    Rent A/c .... Dr.

    To Rent Outstanding A/c*

    Thus the amount standing to the debit of rent' A/c will be increased.*

Rent Outstanding account indicates the liability for rent unpaid.

** The Rent Outstanding A/c is a personal A/c because rent outstanding really means that this rent has not been paid to a person (i.e. land-lord). This personal account is known as representative personal account.*

(ii) Only these expenses that relate to the period concerned should be considered for determining the profit or loss of the period. Suppose the year closes on June 30,1996. on 1st October, 1999 fire insurance premium for one year amounting to Rs. 500 was paid. It is clear that Rs.725 of the premium relates to three months after June 30,2000, i.e., to next year. This year's fire insurance premium is Rs 375. Since the benefit of the remaining Rs. 125 will be received next year, it is a sort of asset on 30th June 2000. The entry is:

insurance Prepaid A/c........Dr.

To Insurance A/c

Insurance Prepaid A/c will be a new account showing debit balance and representing benefit still to be received. It is an asset Insurance A/c will show a reduced debit balance and will be treated as expense to be transferred to the debit side of the Profit and Loss account.

(iii) All income of the year must be brought in into the account. Suppose the firm holds 4% Rs. 10,000 Government securities. Interest upto l[st] September has been received. Accounts are to be closed on 31[st] December.

It is clear that the firm can receive Rs, 100 interest for three months-

1st October to 31 December. This entry to be passed is-

Rs.		Rs.	Rs.
Interest Accrued A/c	Dr.	100	
To interest A/c			100

Interest accured Account represents still to be received. It is an asset. The credit balance of the interest A/c will be increased by the above entry, it is an income and will be transferred to the credit side of the Profit and Loss Account.

(iv) Income (Which may have been received in cash) but relating to past or future years must not be treated as current year's income. Suppose part of the premises were sublet on 1st October, 1978 at Rs. 300 Per month. The tenant pays rents for full in advance. The accounts are closed on 30 June, 1978. on receipt of rent the following entry must have been passed :

		Rs.	Rs.
		Rs.	Rs.
Cash A/c	Dr.	3,600	
To Rent Account			3,600

But out ot the above, three months' rent (1st July, 1978 to 30th September, 1978) relates to next year, Rs. 900, therefore is next year's income. The entry to be passed is—

		Rs.	Rs.
Rent Account	Dr.	900	
To Rent Received in Advance A/c			900

The credit balance of Rent Account is reduced. The reduced balance (Rs. 2,700) will be transferred to the credit side of the Profit & Loss Account Rent Received in Advance account is a liability because it represents benefit to be given by the firm next year without payment.

Bad Debts and Provisions for Bad and doubtful Debt.

The customers who do not pay are known as bad debts. Those in respect of whom there is doubt arc known as doubtful debts. Bed Debits are losses. The entry is:

Less :

Bad debts A/c Dr.

To Customer A/c

Usually firms make an estimate of bad debts expected to arise next year out of current debtors. This is an expected loss and is properly debited to current year's Profit and Loss Account. The entry is:

Profit and Loss account Dr.

To Provision for Bad and Doubtful Debts A/c

Next Year

(1) Actual bad debts will be transferred to the debit side of provision for Bad and doubtful Debts.

(2) Another estimate will be made regarding the necessary provision to meet bad debts in future.

(3) The Provision for Bad and doubtful Debts will be increased (by means of the entry shown above) suitably to show balance equal to the estimate as in**(2)**

Illustration 2.

On Ist January, 2000 the Provision for Bad Debts stood at Rs. 1,500. During 1996 debts written off were Rs., 1,100. On 31st December, 2000 debtors totalled Rs. 35,000. The Provision for Bad Debts is to be maintained at 5%.

Out of the Provision on Ist January, 2000 of Rs. 1,500; Rs 1,100 are used up because of bad debts. This leaves a balance of Rs. 400. the Provision required on 31St December. 2000 is Rs. 1,750, i.e.. 5% of Rs. 35,000. Since Rs. 400 is already there, another Rs. 1,350 must be transferred from Profit and Loss account of the Provision account. The journal entries are:

2000		Rs.	Rs.
Dec. 31	Provision for Bad Debts A/c Dr.	1,100	
	To Bad Debts Account	1,100	
	(Transfer of Bad Debts to the provision)		
	Profit & Loss Account Dr.	1,350	
	To Provision for Bad Debts A/c		1,350
	(The amount required to make the Provision equal to Rs. 1.750)		

Dr. Provision for Bad Debts Account Cr.

2000		Rs.			Rs.
Dec. 31	To Bad Debts Account	1,100	2000	By Balance (c/d)	1,500
	To Balance c/d	1,750	Jan. 1	By Profit & Loss A/c	
	(Prov. required).		Dec. 31	(Balancing figure	1,350
		2,850			2,850
			2001		
			Jan. 1	By Balance b/d	1,750

Note: when there is Provision for Bad Debts A/c, bad Debts are transferred not to the Profit & loss account but to this account.

If the opening balance of the Provision is more than the bad debts written off and the new provision required (combined) the balance will be transferred to the credit side of Profit & Loss Account. The entry is;

Provision for Bad Debts A/c **Dr.**

To Profit & Loss Account

Provision for Discount *is* maintained exactly like Provision for Bad Debts. However, the amount required is calculated by deducting the Provision for Bad Debts from the total debtors. Thus in the example given above, a provision lor Discount is to be maintained 2% of the debtors. The required amount will be 2% of Rs. .13,250 (i.e., Rs, 35,000 less Rs. 1,750) or Rs. 665. The entry will be.

Profit & Loss Account Dr. Rs.665

To Provision for discount A/c Rs.665

Next year (1) Actual discounts allowed will be debited to the Provision for discounts A/c and

(2) Further amount will be credited to the Profit & Loss A/c to make the Provision equal to the required amount.

Provision for discount on Creditors. Some firms like to take credit for discount expected to be received from creditors. The entry is:

Provision for Discount on Creditors A/c Dr.

To Profit & Loss Account

Next year (1) Actual discounts received will be transferred to the credit side of the provision for discount on Creditors A/c

(2) Further amount will be credited to the Profit & Loss A/c to make the balance in the Provision equal to discounts expected to be received.

Illustration 3.

On 1st January, 2000 the Provision for Discount on Creditors stood at Rs. 800. Discount received during 2000 were Rs. 1,100. Creditors on 31st December, 2000 totalled Rs. 30.000 on which it is desired to create a Provision @ 2%.

2000		Rs.	Rs.
Dec. 31	Discount Received A/c Dr.	1,110	
	To Provision for Discount on Creditors A/c		1,110
	(Transfer of Discounts received to the Provision)		
Dec. 31	Provision for Discount on Creditors A/c Dr.	900	
	To Profit & Loss A/c		900
	(The amount transferred to the Profit & Loss A/c to leave a balance of Rs. 600). (i.e.. 2% on Rs. 30.000 in the Provision)		

** This is deducted because a firm does not give discount to debtors who are either bad or doubtful Account*

Dr. Provision For Discount On Creditors A/c Cr.

2000		Rs.	2000		Rs.
Jan.	To Balance b/d	800	Dec.31	By .Discount Received A/c	1,100
Dec. 1	To Profit & Loss A/c (balancing fig.)	900	"	By Balance c/d (balance required)	600
		1,700			1,700
2001					
Jan.	To balance b/d	600			

Depreciation :The diminution in the value of assets is a loss. It must be taken into account for determining profit and Loss. The entry is:

Depreciation account Dr.

To Assets (say machinery A/c)

Depreciation is a loss and will be transferred to the debit side of Profit & Loss A/c. The above entry will reduce the amount of the assets.

Note:(1) Entries to adjust the amount of expenses and incomes to make them suitable for entry in the Trading of profits & loss Accounts are known as adjusting entries.

(2) Entries to close books of account, that is to transfer various accounts to the trading and Profit and Loss accounts are known as Closing Entries.

We will now take a comprehensive illustration. The following is a trial balance from which the Trading and Profit & Loss accounts are to be prepared after making various Adjustments given below. Please see how the adjusting entries have changed some accounts and have created new accounts.

Trial Balance Of Aatma Ram As At Dec. 31, 2000

	Dr. Rs.	Cr. Rs.
Atmaram's Capital Account		80,000
Atmaram's Drawing Account	6,000	
Plant & Machinery (balance 1st Jan. 2000	20,000	
(additions on lst July 2000.)	5,000	
Stock on 1st Jan., 2000	15,000	
Purchases	82,000	
Returns Inwards	2,000	
Sundry Debtors	20.600	
Furniture & Fixturers	5,000	
Freigth & Duty	2.000	
Carriage Outwards	500	
Rent, Rates & Taxes	4,600	
Printing & Stationery	800	
Trade Expenses	400	
Sundry Creditiors		10,000
Sales		1,20,000
Returns Outwards		1,000
Postage & Telegrams	800	
Provision for doubtful debts		400
Discount A/c		800
Rent of Premises sublet, for one year to 30th June 2001		1,200
Insurance Charges	700	
Salaries	21,300	
Cash in hand	6,200	
Cash in Bank	20,500	
	2.13,400	2,13,400

Adjastment

(1) Stock on 31st December, 2000 was valued at Rs. 14.000.

(2) Write off Rs. 600 as bad Debts.

(3) The Provision for Doubtful Debts is to be maintained at 5 per cent on Sundry Debtors.

(4) Create a Provision for discount on Debtors and discount on Creditors at 2 per cent.

(5) Provide for depreciation on Furniture and Fixtures at 5 per cent per annum and on Plant and Machinery at 20 per cent per annum.

(6) Insurance prepaid was Rs. 100.

(7) A fire occurred on 25th December, 2000 in the godown and stock of the value of Rs. 5,000 was destroyed. It was fully insured and the Insurance Company admitted the claim in full.

Solution

Journal

	Adjusting Entries		Dr. Rs.	Cr. Rs.
2000	Closing Stock A/c	Dr.	14,000	
	To Trading Account			14,000
	(The value of Stock at the end of the year)			
Dec.31	Bad Debts A/c	Dr.	600	
	To Sundry Debtors			600
	(Amount written off as Bad Debts)			
Dec.31	Provisions for Doubtful Debts A/c	Dr.	600	
	To Bad Debts A/c			600
	(Transfer of Bad Debts to the Provisions A/c)			
Dec.31	Profit & Loss Account	Dr.	1,200	
	To Provisions for Doubtful Debts A/c			1200
	(The amount required to make the balance in the Provision A/c equal to 5% of Rs. 20.000 viz. Rs. 1.000)			
Dec.31	Profit & Loss Account	Dr.	380	
	To Provisions for Discount on Debtors			380
	(Account required as Provision for Dis count @ 2% on Rs. 19.000(20.000—1000).			
Dec.31	Provisions for discount on Creditors A/c	Dr.	200	
	To Profit & Loss Account			200
	(Discount expected to be earned on Creditors-—20% on-Rs. 10,000).			
Dec.31	Depreciation A/c	Dr.	4,750	
	To Furniture & Fixture A/c			250
	To Plant & Machinery A/c			4,500
	(Depreciation written off—5% on Furniture & Fixture (Rs. 5,000) Rs. 250-20% on Plant & Machinery on Rs. 20,000 for one year and for six month on Rs. 5.000).			
Dec.31	Insurance prepaid A/c	Dr.	1,000	
	To Insurance Charges A/c			1,000
	(Insurance prepaid brought into A/c)			
Dec.31	Insurance Co. A/c	Dr.	5,000	
	To Trading A/c			5,000
	(The amount recoverable from insurer for goods destroyed)			
Dec.31	Rent of Premises Sublet A/c	Dr.	600	
	To Rent Received in Advance A/c			600
	(The Rent, for period falling after 31st December. 2,000)			

Closing Entries

Date	Particulars		Rs.	Rs.
2000				
December				
Dec. 31	Trading Account	Dr.	1.01,000	
	To Stock Account			15,000
	To Purchases Account			82,000
	To Return Inwards A/c			2,000
	To Freight & Duly A/c			2,000
	(Transfer of balance in the above account to Trading Account)			
Dec. 31	Sales Account	Dr.	1,18,000	
	Returns Outwards Account		1,000	
	To Trading Account			
	(Transfer of balance in these account to Trading Account)			1,19,000
Dec. 31	Trading Account	Dr.	39,000	
	To Profit & Loss Account			39,000
	(Transfer of gross profit)			
Dec. 31	Profit & Loss Account		33,750	
	To Salaries & Wages A/c			21,300
	To Insurance Charges A/c			600
	To Postage & Telegrams A/c			800
	To Trade Expenses A/c			400
	To Printing & Stationary A/c			800
	To Rent, Rates & Taxes A/c			4,600
	To Carriage Outwards A/c			500
	To Depreciation A/c			4,750
	(Transfer of various expenses to the debit side of - Profit & Loss Account			
Dec. 31	Rent of Premises Sublet A/c	Dr.	600	
	Discount A/c	Dr.	800	
	To Profit & Loss A/c			1,400
Dec. 31	Profit & Loss A/c			
	To Atmaram's Capital Account		5,270	
	(Transfer of net Profit)			5,270
Dec.31	Atmaram's Capital A/c	Dr.	6,000	
	To Atmaram's Drawings Account			
	(Transfer of Drawing to Capital A/c)			6,000

Ledger Accounts

Dr. Atmaram's Capital Accounts **Cr.**

2000		Rs.	2000		Rs.
Dec. 31	To Atmaram's Drawing A/c	6000	Jan.	By Balance b/d	80,000
	To Balance c/d	79,270		By P& LA/c	
				net profit	5,270
		85,270			85,270
			2001		
			Jan	By Balance b/d	79,270

Atmaram's Drawing Account

2000			2000		
Dec. 31	To Cash	6000	Dec.31	By Atmaram's Capital A/c	6,000

Plant and Machinerv Acconnt

2000			2000		
Jan.l	To Balance b/d	20.000	Dec. 31	By Depreciation A/c	4,500
July 1	To Cash	5,000		By Balance b/d	20,500
2001		25,000			25,000
Jan. 1	To Balance b/d	20,500			

Stock Account

2000			2000		
Jan. 1	To Balance b/d	15,000	Dec. 31	By Trading A/c	15,000
				Transfer	

Purchases Account

2000			2000		
	To Sundries	82,000	Dec. 31	By Trading A/c Transfer	82,000

Return Inwards Account

2000			2000		
	To Sundry Dcblor	2,000	Dec. 31	By Trading A/c Transfer	2,000

Sundry Debtors Account

Dr. Cr.

2000			2000		
Dec.31	To Balance b/d	20,600	Dec.31	By Bad Debts A/c	600
			Dec. 31	By Balance c/d	20,000
		20,600			20,600
2001					
Jan. 1	To Balance b/d	20,000			

Furniture and Fixtures Account

2000			2000		
Jan. I	To Balance b/d	5,000	Dec.31	By Depreciation A/c	250
				By Balance c/d	4,750
		5,000			5,000
2001					
Jan. I	To Balance b/d	4,750			

Freight & Duty Account

2000	To Cash	2,000	2000 Dec.31	By trading A/c Transfer	2,000

Carriage Outwards Account

2000			2000		
	To Cash	500	Dec.31	By Profit & Loss A/c Transfer	500

Rent Rales & Taxes Account

2000	To Cash	4,600	2000 Dec. 31	By Profit & Loss A/c—Transfer	4,600

Printing & Stationery Account

2000	To Cash	800	2000 Dec.31	By Profll & Loss A/c— Transfer	800

Trade Expenses Account

2000	To Cash	400	2000 Dec. 31	By Profit & Loss A/c—Transfer	400

Sundry Creditors Account

Dr. **Cr.**

2000		Rs.	2000		Rs.
	To Balance c/d	10,000		By Sundries	10,000
			2001	By Balance c/d	10,000

Sales Account

2000		Rs.	2000		Rs.
Dec. 31	To Tradine Transfer	1,20,000		By Sundries	1,20,000

Returns Outwards Account

2000			2000		Rs.
Dec.31	To Trading A/c Transfer	1,000		By Sundry Creditor	1,000

Postage & Telegram Account

2000			2000		Rs.
			Dec.31		
	To Cash	800		By Profit & l.oss	
				A/c — Transfer	800

Provisions for Doubtful Debts Account

	2000		2000		Rs.
Dec. 31	To Bad Debts A/c	600	Jan. 1	By Balance b/d	400
	To Balance c/d	1,000	Dec. 31	By P & L A/c	1,200
		1,600			1,600
			2001		
			Jan. 1	By Balance b/d	1,000

Discount Account

2000			2000		Rs.
Dec. 31	To Profit & Loss A/c				
	Transfer	800		By Sundry Creditors	800

Rent of Premises Sublet Account

2000		Rs.	2000		Rs.
Dec. 31	To Renl Received in Advanced A/c	600	June 30	By Cash	1,200
	To Profit & Loss A/c Tranfer	600			
		1,200			1,200

Salaries Account

2000		Rs.	2000		Rs.
	To Cash	21,300	Dec.31	By Profit & Loss A./c Transfer	21,300

Insurance Charges Account

2000		Rs.	2000		Rs.
	To Cash	700	Dec.31	By Insurance Prepaid A/c	100
				By Profit & Loss A/c Transfer	600
		700			700

Cash in Hand Account

2000		Rs.	2000		Rs.
Dec. 31	To Balance b/d	6,200	Dec.31	By Balance b/d	6,200
2001					
Jan. 1	To Balance b/d	6,200			

Cash at Bank Account

2000			2000		
Dec.31	To Balance	20,500	Dec.31	By Balance b/d	20,500
Jan. 1	To Balance b/d	20.500			

New Accounts resulting from adjusting entries Closing Stock Account

2000			2000		
Dec.31	To Trading A/c	14.000	Dec. 31	By Balance c/d	14.000
2001					
Jan.1	To Balance b/d	14,000			

Bad Debts Account

2000		Rs.	2000		Rs.
Dec.	To S. Debtors A/c	600	Dec.31	By Provisions for Doubtful Debts A/c Transfer	600

Provision for Discount on Debtors Account

2000 Dec.	To Balance c/d	380	2000 Dec.31 2001 Jan. 1	By Profit & J.oss A/c By Balance c/d	380 380

Provision for Discount on Creditors Account

2000 Dec. 2001 Jan. 1	To Profit & Loss To Balance b/d	200 200	2000 Dec. 31	By Balance c/d	200

Depreciation Account

2000		2000			Rs.
Dec. 31	To Furniture	250	Dec. 31	By Profit & Loss A/c	4,750
Dec. 31	To Plant &. Machinery	4,500			
		4,750			4,750

Insurance Prepaid Account

2000		2000			Rs.
Dec. 31	To Insurance Charges A/c	100	Dec.31	To balance b/d	100
2001					
Jan.1	To Balance b/d	100			

Insurance Co. Account

2000			2000		Rs.
Dec. 31	To Trading A/c	5.000	Dec.31	To Balance b/d	5.000
2001					
Jan.1	To Balance b/d	5.000			

Rent Received in Advance Account

2000			2000		
Dec.31	To Balance c/d	600	Dec.31	By Rent of Premises Sublet A/c	600
			2001		
			Jan.1	By Balance b/d	600

Final Account

Trading and Profit and Loss Accounts of A. Atmarma's
for Ihe year ended 31st December 2000

		Rs			Rs.
To Opening Stock		15.000	By Sales	1.20,000	
To purchases	82.000		Less Returns inwards		
Less Returns	1,000	81,000		2.000	1,18.000
To Freight and duty		2.000	By Insurance Co		5,000
To Gross Profit to P&l		39000	By Closing Stock		14.000
		1,37,000			1,37,000

To Salaries & Wages	21,300	By Gross Profit b/d	39,080
To Insurance Charges	600	By Rent of Premises Sublet	600
To Postage &Telegrams	800	By Discounts	800
To Trade Expenses	400	By Provision for Discount on Creditors	200
To Printing & Stationery	800		
To Rent, Rates & Taxes	4,600		
To Carriage Outwards	500		
To Depreciation :			
Furniture 250			
Plant & Machinery4.500	4,750		
To Provisions for Doubtful Debts :			
Required 1,000			
Add Bad Debts 600			
1,600			
Less Existing			
Provision 400	1,200		
To Provision for Discount on Debtors	380		
To Net Profit to Capital A./c	5,270		
Total	40,600	Total	40,600

Balance Sheet of Atma Ram as on 31.12.1980

Liabilities		Rs.	Assets		Rs.
Atma Ram's Capital A/c		79,270	Cash in hand		6,200
Rent Received in advance		600	Cash at Bank		20,500
Creditors	10,000		Closing Stock		14,000
Less : Prov. for Disc.	200	9,800	Prepaid Insurance		100
			Insurance Co.		5,000
			Sundry Debtors	20,000	
			Provision for Bad debt	1,000	
			provision for DBC	380	18,620
			Furniture & Fixture		4,750
			Plant & Machinery		20,500
		89,670			89,670

Lesson 2

FINAL ACCOUNTS OF NON-FOR-PROFIT ORGANISATIONS

Clubs, schools, hospitals and other non-profit making institutions usually do not keep a full-fledged accounts staff because of the expenses involved. They generally maintain the cash book only. But a Cash book cannot tell us about the financial slate of affairs. For this purpose it is necessary to compare current expenses with.current incomes ascertain which is more: and prepare the balance sheet. This will not be dificult if all accounts are maintained and a trial balance is taken out. But if only a cash book is there, it will first be necessary to prepare a Receipt and Payments Account.

Receipts and Payment Account: The Receipt and Payment Account is nothing but a summary of the Cash book. All that appears in the cash book appears in this account also, hence-

(1) This account starts with the opening balance of cash in hand und cash at bank (whether as fixed deposit or in current account).

(2) It records all receipts of cash including receipts into bank. Whether the receipt is of capital or revenue nature or whether the receipt relates to the previous, present or future year, it will be entered in the cash book, and hence in the Receipts and payments Account. Building may be sold, Subscriptions may be received for past, present or future years. All proceeds will be entered in this account.

(3) Similarly all payments, to whichever period they belong and whether of capital or revenue nature, will be recoreded in the Receipts and Payments account.

(4) The balance in the account wilt represent actual cash or bank balance in hand at the end of the financial period. Usually the receipt of cash are more than payments. The following is a specimen of the Receipts and Payments Account:

The Calcutta Sports Club -

Receipts and Payments Account Tor the year ending December 31, 2000

Receipts	*Rs.*	*Payments*	*Rs.*	
To Opening Balances :		By Upkeep of playing fields		2,500
In Hand	850	By Expenses on teams		1,900
At Bank	7,230	By Cricket Expenses		2,000
To Subscriptions for		By Tennis Expenses		4,500
1999	600	By Investment		3,000
2000	11.500	By Office Expenses		1,200
2001	300	By Postage & Stationary		250
To Entrance Fees	1,000	By Audit Fee		200
To Life Memberships	3,000	By Balance c/d		
To Contributions tor Trainings	1,500	In hand	910	
To Sale of Furnituie	600	At Bank	10,320	
To Sales of Old Balls	200			11,230
	26,780			26,780

The Receipts and Payments Account DOES NOT give any indication whether current (revenue) expenses are being met out of current (revenue) incomes. There can be a big cash balance, for instance, if the building are sold. But that does not mean that the subscriptions received are sufficient to meet the salaries and other expenses. It is necessary to compare current expenses and current incomes. Continued solvency of any institution, charitable or otherwise, can be ensured only if the receipts are sufficient to meet revenue expenses. As Charles Dickens put it, if income is 20 shillings and exependiture 20 S 6 D., the result will be unhappiness. This is true for all persons and institution. One must not live upon one's capital.

The account which compares current incomes and expenses is known as **Income and Expenditure Account.** This is a summary of incomes and expenditures of the complete year. This account is prepared on the same lines as a profit and loss account-with incomes on the credit side and expenses on the debit side. If the credit side exceeds the debit side, the difference is known as "surplus" or *excess of income over? expenditure.* If the debit side exceeds the credit side the difference is "deficit" or *Excess of expenditure over income.*The words profit or loss are not used in the case of charitable institutions. In the absense of a trial balance, the Receipts and Payments Account will be the basits for preparing Income and Expenditure Account.

Difference between the Receipts and Payments Account and Income and Expenditure Account

(1) Type—Receipts and Payments Account is a real Account whereas the income and Expenditure Account is a nominal account.

(2) Object–The object of Receipt and Payment Account is to show the summary of all cash transactions pretaining to a particular period, whereas the object of an Income and Expenditure Account is to show the net results of transactions and workings pertaining to the particular period.

(3) Nature—Receipts and Payments Account is virtually a cash book, but Income and Expenditure Account is like a trading and profit and loss Account.

(4) Content—Receipts and payment Account records receipts and Payments of both Capital and Revenue nature, whereas Income and Expenditure Account records income and expenditure of only revenue nature.

(5) Form—Debit side of the Receipts and Payments Accounts records receipts and credit side records payments. But Income and Expenditure Account's debit side records expenses and losses, and its credit side records income and gains.

(6) Commencement—The balance in the beginning of Receipts and Payments Account represents cash in hand in the beginning, whereas in Income and Expenditure Account there is no balance in the beginmg.

(7) Balance at the end—The balance at the end of Receipts and payments Account show the cash in hand or cash over spent but in Income and Expenditure Account the balance at the end shows excess income over expenditure or vice versa.

(8) Outstanding Items—Receipts and Payment Account does not show the income received in advance or outstanding, whereas in the income and expenditure Account, all the incomes and expenditures of the current year are taken into account.

(9) Balance Sheet—With Receipts and Payments Account Balance Sheet is not prepared whereas with income and expenditure Account, preparation of the balance sheet is a must.

(10) Receipt—Receipts and payments account is the Summary of Cash Book, so it is not necessarily a part of the Double Entry System, but Income and Expenditure Account is neccessarily a part of the Double Entry System.

Steps to Prapare Income and Expenditure Account from Receipts and Payments Account—

(a) Ignore the opening and closing cash and bank balance.

(b) Ignore capital expenditure and capital receipts. For example, if cash has been realised by sale of investments, the amount will not be credited to Income and Expenditure Account.The amount will be deducted from investments for balance sheet purpose. Of course, if some profit or loss has emerged from the sale of investments, it will be shown in the Income and Expenditure Account. If investments costing Rs 5,000 are sold for Rs. 5,400, Rs. 5,000 will be deducted from investments and Rs. 400 will be credited to Income and Expenditure Account. Similarly, if money has been spent to acquire an asset, say, furniture, the amount will be shown in the balance sheet and not debited to the Income and Expenditure Account.

(c) Revenue receipts or current incomes will be found on the receipts side of the Receipts and Payments Account. These will be credited to the Income and Expenditure Account subject to the following :

(i) Current income relating only to the year concerned will be credited to Income and Expenditure A/c. For example, if in 2000 subscriptions have also been received for 1999 and 2001 these amounts should not be credited to the Income and Expenditure A/c. The amount for 1999 will extinguish a debt owing to the institution and one for 2001 will be "Subscriptions Received in advance" and will be shown as a liability in the balance sheet. The amount will be treated as income in 2001.

(ii) The amount which is due but not yet received in cash should be brought into account. The amount is added to the income and treated as an asset, cash for which will be received next year.

Illustration 1.

In 2000 the amount actually received for subscriptions was Rs.16,800. From the following further informations show what amount should be credited to the Income and Expenditure Account as Subscriptions,

	Rs.
Subscriptions Outstanding (for due) on 31st Dec., 1999	1500
1,500 Subscriptions Outstanding (for due) on 31st Dec., 2000	1,700
Subscription Received in Advance as on 31st Dec., 2000.	600
Subscriptions for 2001 received in 2000	500

Answer:

The amount to be credited as subscription to the Income and Expenditure Account is Rs. 17,100 arrived at as follows :

		Rs.
Subcriprion actually received		16,800
Add : Subscription for 2000 received in advance in 1999.	600	
Subscription for 2000 still due	1,700	2,300
		19,100
Less : Subscriptions for 1999 received in 2000	1500	
Subsciptions for 2001 received in 2000	500	2000
Subscription for 2000		17,100

The journal entries* concerned will be as under:

* *Will the student prepare the subscription acccount?*

Journal

Date	Particulars		Dr.	Cr.
2000				
Dec.31	Subscriptions Received in Advance A/c	Dr.	600	
	To Subscriptions Account			600
	(2000 Subscriptions received in 1999 now crdited to Subscriptions A/c)			
	Subscriptions A/c	Dr.	1500	
	To Subscriptions Outstanding Account			1500
	(Subscriptions Outstanding Account brought forward from 1999 transferred to the debit of Subscriptions Account)			
	Subscriptions Outstanding Account	Dr.	1700	
	To Subscriptions Account			1700
	(Subscriptions due at the end of 2000 but not yet received brought into accounts)			
	Subscriptions Account	Dr.	500	
	To Subscriptions Received in Advance A/c			500
	(2001 Subscriptions received in 2000 credited to subscriptions Received in Advance Account.)			

(d) Revenue expenses will be found on the payments side of the Receipts and Payments Account. These will be taken to the debit side of the Income and Expenditure Account; only expenses relating lo the current year should be so debited.

(ii) Expenses which have *been* incured but not yet paid for (expenses due or unpaid or outstanding) should be added to the expenses and also treated as a liability to be shown in the balance sheet.

Illustration 2.

General expenses paid in 2000 totalled Rs. 9,300. The following additional information is supplied to you.

	Rs
Expenses unpaid on 31st Dec. 1999	800
Expenses prepaid on 31st Dec. 1999	400
Expenses unpaid on 31st Dec, 2000	900
Expenses for 2001 paid in 2000	600

Show the amount of expenses for 2000

Answer :

The expenses for 2000 is Rs, 9,200 calculated as under :

		Rs.	Rs.
	Expenses actually paid in 2000		9,300
Add:	Expenses for 2000 paid in 1999	400	
	Expenses for 2000 not yet paid	900	1,300
			10,600
Less:	Expenses for 2001 paid in 2000	600	
	Expenses for 1999 paid in 2000	800	
			1,400
	Expenses relating to 2000		9,200

The Journal entries (the student will please supply the narration) and ledger account will appear as follows :

Journal

			Rs.	Rs.
2000 Dec.31	Expenses Account	Dr.	400	
	To Prepaid Expenses A/c			400
	Expenses Outstanding A/c		800	
	To Expenses Account			800
	Expenses Account	Dr.	900	
	To Expenses Outstanding A/c			900
	Expenses Prepaid A/c	Dr.	600	
	To Expenses A/c			600

Ledger

Expenses Prepaid Account

2000		Rs.	2000		Rs.
Jan. 1	To Expenses b/d	400	Dec. 31	By Expenses A/c	
Dec.31	To Expenses A/c	600		Transfer	400
		1,000	Dec. 31	By Balance c/d	600
					1.000
2001					
Jan. 1	To Balance b/d	600			

Expenses Outstanding Account

2000		Rs.	2000		Rs.
Dec. 31	To Expenses A/c	800	Jan. 1	By Balaace b/d	800
Dec. 31	To balance c/d	900	Dec. 31	By Expenses A/c	900
		1,700			1,700
			2001		
			Jan. 1	By Balance b/d	900

Expenses Account

2000	Rs.	2000			Rs.
Dec. 31	To Cash	9,300	Dec.3	By Expenses Outstanding A/c	800
Dec. 31	To Expenses Prepaid	400		By Expenses Prepaid A/c	600
Dec. 31	To Expenses Outstanding A/c	900		By Income & Expenditure A/c Transfer	9,200
		10,600			10,600

Illustration 3. — Calculate the amount to be written in the expenditure side the following information.

	Rs.
Stock of stationary on 1-1-2000	300
Creditor for stationary in 1-1-2000	200
Advances paid for stationary on 31-12-1999	20
Paid for stationary during 2000	1,080
Stock of stationary on 31-12-2000	50
Creditors of stationary on 31-12-2000	130
Advance paid for Stationary in 31-12-2000	30

Solution

		Rs.
Stock of stationary in 1-1-2000		300
+ Stationary received during the year 2000		
Payments made during 2000	1080	
—For last year	–200	
	880	
+Payment made in 1999 though, Stationary received in 2000	+20	
	900	
+ Creditors on 31-12-2000	+130	
	1030	
—Payment made in advance on 31-12-2000	—30	
		1000
Total Stationary		1300
—Stock of stationary on 31 -12-2000		—50
Amount to be transferred to Income and Expenditure A/c		1250

(e) Receipt of non-recuring nature (e.g., life membership) should not be credited to Income and Expenditure Account.

(f) Depreciation and other losses should be ascertained and debited to the income and Expenditure Account.

(g) Total the two sides and put the differences on the shorter side as surplus (if it is to be writen on the debit side) or deficit. Surplus is added to the capital fund, deficit is deducted.

Preparation of Balance Sheet: Charitable institutions should prepare a balance sheet also in order to know the financial state of affairs at the end of every year. Balance sheet will not be difficult to prepare if there is a trial balance. But in its absense, take the following steps :

1. Take the previous year's balance sheet. Adjust the figures for fixed assets, for new acquistions (ascertained by pursuing the payments side of the Receipts and Payments Account) and for sale (ascertained by looking at the receipts). The figure should be further adjusted for depreciation. The figure now resulting will appear in the balance sheet.
2. Go through the receipts and payments and Income and Expenditure accounts and ascertained the amounts of subscriptions and other incomes outstanding (that is due but not yet received) and expenses prepaid. These will be put on the asset side.
3. The amount of cash in hand and bank balance at the end of the year as disclosed by the

Receipts and Payments Account will naturally be entered on the assests side.

4. Compare the amount of liabilities as per the previous balance sheet with payments made. If there is any amount still to be paid, it should be entered on the liability side of the balance sheet.
5. Go through the Receipts and Payments and Income and Expenditure Account and asertain incomes received in advance and expenses outstanding. These should appear on the liability side.
6. Special receipts as disclosed by the Receipts and Payments Account should be shown in the balance sheet as a liability.
7. To the capital fund disclosed by the previous balance sheet, add the surplus (or deduct the defict), membership fees and entrance fees, if not already entered in the income and expenditure account. (If, in examinations, capital fund is not given, it can be ascertained by deducting liabilities from assets, on the relevant date).

Illustration 4.

The following was Receips and Payments account prepared by the Treasurer Delhi Cricket Club for the year ended December 31, 2000.

	Receipts	Rs.		Payments	Rs.
2000		Rs.	2000		Rs
Jan. 1	Cash in hand	100	Dec.	Groundsman's fee	750
	Balance at Bank as per			Mowing Machine	1.500
	Pass Book :			Rent of Ground	250
	Deposit Account	2,230		Cost of teas	250
	Current Account	600		Fares	400
	Bank Interest	30		Printing & Office Expenses	280
Dec. 31	Donations & Subscriptions	2,600		Repairs to equipment	500
	Receipts from teas	300		Honorariun to Secretary &	
	Contributions to fares	100		Treasurer for 1999	400
	Sale of Equipment	80		Balance at Bank as per	
	Net Proceeds of Variety			Pass Book :	
	Entertainments	780		Deposit A/c	2,090
				Current A/c	150
				Cash in hand	250
		6,820			6,820

You are given the following additional information :

	On Jan 1,2000	On Dec.31,2000
(1) Subscriptions due	Rs. 150	Rs. 100
(2) Sums due for printing etc.	100	80
(3) Liabiltiy for repairs	300	360
(4) Interest on Deposit A/c not Entered in Pass Book		20
(5) Estimated value of Machinery and equipment	800	1750

(6) For the year ended Dec. 31.2000 the honorariun to the Secretary and

Treasurer arc to be increased by-
a total of Rs. 200 and the groundsman
is to receive a bonus of Rs. 200

You are required to prepare the Income and expenditure account of the year ended December 31, 2000 and Balance Sheet on that date-

Solution:

Notes

(1) Capital fund as on 1st Jan. 2000

Liabilities	Rs.	Assets	Rs.
Honorariun	400	Cash in hand	100
Printing etc.	100	Deposit in Bank	2,230
Amount due for repairs	300	Current A/c	600
Capital Fund (balancing		Subscriptions outstanding	150
figure)	3,080	Equipment	800
	3,880		3,880

(2) Depreciation

Cost of Equipment on Jan. 1,2000		800
Additions		1500
Less : Equipment sold	80	
Value of equipment on hand	1750	
		1830
		470

(3) Repairs Rs. 560 i.e. (500 + 360 – 300)

The Delhi Cricket Club

Income & Expenditure Account for the Year ending Dec., 31 2000

Expenditure		Rs.	*Income*		Rs.
To Groundsman's fees			By Donation & Subscription :		
Paid	750				
Add Bonus due	200	950	Received	2,600	
			Less for 1999	150	
To Rent of Ground		250		2,450	
To Cost of tea		250		2,450	
To Fares		400	Add Outstanding for 2000	100	
					2,550
To Printing & OfficeExpenses			By Receipts from teas		300
Paid	280		By contribution to fare		100
Unpaid	80		By proceeds of variety entertainment780		
	360		By Interest on Deposit		50
Less for 1995	100	260			
To Repairs to Equipment		560			

To Honorarian to Secretary and Treasurer	600		
To Depreciation of Equipment	470		
To Surplus — Excess of Income over expenditure	40		
	3,780		3,780

Balance Sheet of the Delhi Cricket club *a* on December 31,2000

Liabilities		Rs.	*Assets*		Rs.
Expenses Unpaid :			Cash in hand		250
Printing etc.	80		Bank Balances		
Repairs	360		Deposit A/c	2,090	
Bonus to Groundsman	200		Current A/c	150	2,240
Honorariun to Secretary	600	1,240	Interest due		20
Capital Fund :			Subscriptions Outstanding		100
Balance on			Equipment		1,750
1st Jan.	3,080				
Add Surplus	40	3,120			
		4,360			4,360

Illustration 5. Prepare Income & Expenditure Account for the year ending 31-12-2000 and Balance -Sheet as on that date from the following :

Receipts and Payments Account

for the year ended 31-12-2000

Receipts	Rs.	Payments	Rs.
To Balance b/d	2,100	By Printing and Stationary	1,300
To Subscription		By Advertisements	800
1999 (estimated at Rs. 460)		500 By Investment in Govt. Securities at	
2000	5,000	5% On 1 st Nov. 2000 (Interest, payable	
2001	200	on 1st) May and 1st Nov.	8,000
To Donation for Building	5,500	By Building Construction	2,500
To Sports Material		200 By Match Expenses	900
To Rent	1,300	By Creditors for 1999 estimated	
To Entrance Fees	300	at Rs. 750, in full settlement	650
To Match Fund	10,000	By Salaries	1,750
To Locker Rent	350	By Sports Materials	3,000
To Lecture Hall	200	By Honorarium	430
		By Electricity	275
		By Balance c/d	6,045
	25,650		25,650

Additional Information:

	31-12-199 Rs.	31-12-2000 Rs.
Sports Material	430	750
Printing Materials (Dr.)	50	80
Creditors for Printing	80	....
Rent received in advance for 2001	.....	100
Salary of treasurer outstanding	.....	250
Surplus from House Account including Refreshment outstanding		150

Solution :

Income and Expenditure Account for the year ending 31-12-2000

Expenditure		Rs.	*Income*		Rs.
To Printing and Stationary	Rs.		By Subscription		
Payment	1,300		2000	5,000	
Opening bal.	50		1999 Excess received	40	5,040
	1,350		By Sports Material		200
Closing balance	80		By Rent	1 ,300	
	1,270		Advance	100	1,200
Creditors for printing	80	1,190	By Locker Rent		350
To Avertisement		800	By Interest on Govt. Securities		67
To Salaries	1,750		(8000xlxJJ		
Treasurer Salary outstanding	250	2,000	By Income from Lecture Hall	200	
To Sports Material			By Income on final settlement of creditors		100
Opening Balance	430		By Surplus from House A/c		150
+ Purchases	3,000		By Excess of Expenditure over Income (deficit)		68
Less	3430				
Closing balance	750	2,680			
To Honourariuin		430			
To Electricity		275			
		7,375			7,375

Balance Sheet

As on 31-12-2000

Liabilities		Rs.	*Assets*	Rs.
Subscrition in Advance		200	Cash	6,045
Rent received in Advance		100	Sports Material	750
Salary outstanding		250	Printing Material	80
Donation for Building		5.500	Surplus from House A<c outstanding	150
Match Fund	10,000			
Less Expenses	900	9,100	Investment in Govt. Securities	8,000
Entrance fees		300	Interest from Govt. Securities	67
Capital fund	2,210		Building	2.500
Less Deficit	68	2,142		
		17,592		17,592

Working Note

Balance Sheet as on 1-1-2000

	Rs.		Rs.
Creditors	750	Cash	2,100
Creditiors for printing.	80	Subscription outstanding	460
Capital Fund Balancing figure	2,210	Sports Material	430
		Printing Material	50
	3,040		3,040

Illustration 6.

The receipts and payments Account and Income and Expenditure Account of the South Library, South Delhi for the year ended 31 st December, 2000 are as follows :

Receipts and Payment Account

for the year ended 31st December, 2000

Receipt		Rs.	Payments	Rs.
To Balance b/d		700	By Books purchased	1,500
To Subscriptions			By Printing and Stationary	150
1999	400		By Salary	1,250
2000	3,500	3,900	By Advertisement	100
To Interest		400	By Miscellaneous Expenses	320
To Donations for Special Fund		150	By Balance c/d	2,220
To Rent				
1999	260			
2000	130	390		
		5,540		5,540

Income and Expenditure Account for the year ending 31st December 2000

Expenditure	Rs.	Income	Rs.
To Insurance	120	By Interest	380
To Salary	1,300	By Subscription	3,800
To Miscellaneous Expnenses	320	By Rent	260
To Depreciation on Buildings	750		
To Printing & Stationary	150		
To Advertisements	90		
To Excess of Income Over expenditure	1,710		
	4,440		4,440

On enquiry, you were told that Library's assets on I January 2000 included :

Buildings Rs. 17,000, BooksRs. 15,000, Furniture Rs. 1000and Investments Rs.5,000. There were no liabilities on that date.

You are asked to prepare the Balance sheet of the library as on 31-12-1999 and 31-12-2000.

Solution and Notes

1. In Receipts and Payment Accounts there are items pertaining to 1999 and 2000. Since items of revenue nature relating to 2000 will appear in the Income and Expenditure account of 2000, the items relating to 1999 must appear in (he Balance Sheet of 1999.
2. Similary, items of Capital nature will appear in the Balance Sheel of either 1999 or 2000 e.g. Opening Balance of Cash will appear in 1999, Balance Sheet whereas Closing Balance of Cash will find place in Balance Sheet of 2000
3. Items appearing in Receipts and Payments account bul not appearing in Income and Expenditure account are:
   (i) Either receipts in advance or payments in advance, or
   (ii) receipts for previous year or payments for previous year, such items need adjustments (e.g. advertisement)
4. Assets at the end should be taken with their due appreciation in the closing Balance sheet but with the given figures in the Opening Balance Sheet.
5. Capital Fund should be ascertained by preparing Opening Balance Sheet or Closing Balance Sheet should be started with such Capital Fund.

Balance Sheet of South Library, South Delhi

as on 31-12-1999

Liabilities	Rs.	*Assets*	Rs.
Capital Fund	39,360	Cash in hand	700
		Outstanding Subscription	400
		Outstanding rent	260
		Investments	5,000
		Books	15,000
		Furniture	1,000
		Buildings	17,000
	39,360		39,360

Balance Sheet of South Library, South Delhi

as on 31-12-2000

Liabilities		Rs.	*Assets*		Rs.
Capital Fund	39360		Cash in hand		2,220
Add Excess of Income			Outstanding Subscription		300
over Expenditure	1,710	41,070	Outstanding Rent		130
Donations to Special Fund		150	Prepaid Advertisment		10
Outstanding Insurance		120	Investment		5,000
Outstanding Salary		50	Book-Balance	15,000	
Interest received in Advance		20	Add Purchase	15,00	16,500
			Furniture		1,000
			Building	17,000	
			Less Depection	750	16,250
		41,410			41,410

Preparation of Receipts and Payments form Income Expenditure and other Information:

The Receipts and Payments are prepared on the basis of receipts and disbursements made during the year.

Illustration 7.

From the following income and Expenditure and additional information, prepare Receipts and Payments A/c.

Income and Expenditure A/c 31-12-200

Expenditure	Rs.	Income	Rs.
To Salaries	4750	By Subscription	7500
To Audit Fees	500	By Entrance fees	250
To secretaries Honorarium	1000	By Rent of Hall	500
To Printing and Stationary	450		
To Depreciation on Equipment	300		
To surplus	1250		
	8250		8250

Additional Information:

(i) Cash in hand on 31-12-2000 was Rs. 1600

(ii) The salaries outstanding in the begining and end of 2000 were Rs. 400 and Rs. 450 respectively.

(iii) Audit fees for 2000 still due Rs. 60

(iv) The club had equipment in the beginning Rs 2600. At the end of the year, it amount Rs. 2700 after deprecition.

(v) Rent of Hall still due at the end of 2000 Rs. 100

(vi) Subscription due at the end of 1999 and 2000 were 600 and 750

(vii) Subscription received in advance on 1999 and 2000 were 450 and 270

Receipts and Payments A/c

For the year ending 31-12-2000

Receipts		Rs.	Payments		Rs.
To balance b/d		770	By Salaries	4,750	
(balancing figure)			Add outstanding	400	
To Rent of Hall		400		5,150	
To Entrance fee		250	Less outstanding at the and of 2000	450	4,700
To Subcriptions	Rs.		By Audit fees	500	
	7,500		Less for 2000 due	60	440
Add for 1999	600		By Printing and stationery		450
	8,100		By Equipment		400
Less for 2000	750		By Secretary's Honorarium		1,000
	7350		By Balance c/d		1,600
Less for 1999	450				
	6900				
Add for 2000	270				
		7,170			
		8.590			8.590

Working Notes

Equipment A/c

Receipts	Rs.	Payments	Rs.
To balance b/d	2,600	By Depreciation	300
To Cash (purchases)	400	By Balance c/d	2700
Balancing Figure	3000		3000

Illustration 8.

From the following information, calculate the Income from subscriptions for the year ending December, 2000 and Show them in Income & Expenditure account and Balance Sheet of a Club,

Receipts			Payments
For The year ending Dec.31, 2000			
To subscription ;			
1999	5,000		
2000	30.000		
2001	6,000	41,000	

Additional Information *Rs.*

		Rs.
(i)	Subscriptions outstanding on Dec. 31, 1999	6000
(ii)	Subscription outstanding on Dec. 31.2000	5000
(iii)	Subscription Received in Advance on Dec. 31. 1999	6000

Solution

Income & Expenditure A/c

for the year ending dec. 31, 2000

	Amount Rs.			Amount Rs.
		By Subscription		
		Received	30,000	
		Add Due	4,000	
		Add Received in Advance in 1999	6,000	40,000

Balance Sheet As on 31-12-99

Liabilities	Amount Rs.	Assets	Amount Rs.
Subscriptions Received in Advance	6,000	Subscriptions due	6.000

Balance Sheet As on 31-12-2000

Liabilities	Amount Rs.	Assets		Amount Rs.
Subcriptions Received in Advance6,000		Subscription due		
		1995	1,000	
		1996	4,000	5.000

Lesson 5

ACCOUNTS FROM INCOMPLETE RECORDS : SINGLE ENTRY SYSTEM

Definition : Single entry system of book-keeping is not a system at all. It means recording transactions not according to well defined rules but according to mere convenience. Under the Double Entry System a transaction must be recorded with both the aspects. If there is debit, there must be a credit and *vice-versa.* It is not under the single entry syslem. Debit and credit may be completed in transactions, while no record at all may be there in respect of a number of transactions. Most transactions are recorded only once without completed double entry. It is all a matter of convenience. Accounts are not maintained. While there is no hard and fast rule; usually only the cash account, bank (sometimes the pass book is treated as sufficient for this purpose) and personal account (that is, account of customers and creditors) are kept. Generally, there will be no accounts to show purchases, sales, assets, incomes and losses and expenses. *There can be no trial balance.*

This Single Entry system has the following disadvantages:

1. Since there is no trail balance, there is no proof of accuracy.
2. Profit or losses cannot be ascertained properly because of lack of information about purchases, sales, expenses, etc.
3. Since accounts relating to assets (furniture, office equipment, etc.) are not maintained, there is no control over such assets. This may result in wastages and misappropriation.
4. The Balance Sheet (called Statement of Affairs here) can be prepared only with difficulty and that loo without sufficient accuracy.
5. Useful comparison for the guidance of management cannot be made because relevant information will generally be missing.

Joint stock companies cannot keep books on the Single Entry System under law, but sole proprietorships and partnerships may, if they so wish, adopt this system. But unless the firm is very small, it is not desirable to do so.

How to ascertain profit ? Ascertainment of-psrofit or loss under this system is really simple. "Suppose I start a business on 1st January, 2002 with Rs. 20,000. On 31st December 2002 I find that may capital is Rs.25,000 (for finding out capital see below). This surely means that I have made a profit of Rs.5,000, the capital could not have grown otherwise. But suppose I brought an additional Rs.4,000 as capital during the year. This explains the increases in capital to this extent. This brings down the profit to Rs. 1,000. One thing more I must have drawn some money for private use. Suppose the figure is Rs.500 per month or Rs.6,000 for the year. Had this money not been drawn, the capital would have been Rs.31,000 and the profit earned would have been Rs.7,000. The formula to find out profit, therefore, is:

		Rs.
Capital at the end of the year		25,000
Add: Drawings during the year		6,000
		31,000
Less: Flesh Capital introduced	4,000	
Capital in the beginning of the year	20,000	24,000
Profit during the year		7,000

How to ascertain capital ? Capital is really assets minus liabilities. Under the Single Entry System also, capital is ascertained in this manner. Statement of Affairs (not at all different from balance sheet) is prepared and assets and liabilities put on the proper sides. The difference between assets and liabilities is capital. Personal account and cash account are usually maintained and hence the amount of sundry debtors, cash balance, bank balance and sundry creditors will be readily available. The amount of other assets can be ascertained only by physical inspection.

Statement of Profit for the year ending on......

			Rs.
Capital at the end			
	Add :	Drawings during the year	
	Less :	Additional Capital introduced during the year	
(A)		Adjusted Capital at the end of the year ...	
(B)		Less : Capital at the beginning ...	
		Profit or loss...	

Illustration-1

A keep his books by single entry system. From the following information find out the profit earned by him during 2002

	Rs.	Rs.
Bank Balance	740 (Cr.)	400 (Dr.)
Cash in hand	....	10
Debtors	5,300	8,800
Creditors	1,500	1,950
Stock	1,700	1,900
Plant	2,000	2,000
Furniture	140	140

On 30th, June, A brought in Rs. 600 as additional capital and without Rs. 300 for private use. A provision for doubtful debts 5% is necessary. plant and Furniture are subject to depreciation 5% interest on capital is to be changed at 5%.

Solution.

Statement of Affairs as at 1st January, 2002

Liabilities	Rs.	Assts	Rs.
Bank overdarft	740	Sundry Debtors	5300
Sundry Creditors	1.500	Stock	1700
Capital (Balancing figure)	6.900	Plant	2000
		Furniture	140
Total	9,140	Total	9,140

Statement of Affairs as at 31st December, 2002

Liabilities	Rs.	Assts		Rs.
Sundry Creditors	1,950	Cash in Hand		10
Capital (Balancing Firure)	10,753	Cash at Bank		400
		Sundry Debtor	8,800	

		Less Provision for doubtful debts 440		8,360
		stock		1,900
		Plant	2,000	
		Less Depreciation	100	1,900
			......	
		Furniture	140	
		Less Depreciation	7	133
Total	12,703		Total	12,703

		Rs.
Profit : Capital as al Dec . 3 1 , 2002		10,753
Add: Drawings		300
		11,053
Less: Fresh Capital	600	
Capital on 1- 2002	6.900	
Interest	360*	7,860
Profit earned		3,193

Conversion into Double Entry. If the books are maintained on Single Entry basis, they can be converted into double entry basis but with good deal of effort. Assuming that accounts of cash, bank, customers and suppliers have been maintained, the following steps will be necessary:

1. Take the statement of affairs at the end of previous year. Open all accounts (except those already opened) with proper balances.
2. Go through the cash book (or cash and bank accounts). Excepting transaction, with customers and suppliers (these transaction must have been posted already) others should be posted to proper accounts.
3. Analyse all personal accounts (a) Analysis of accounts of customers will reveal the following:—

	Entry Now
Credit Sales	Credit Sales A/c
Bills Dishonoured	Credit B/R A/c
Charges debited to them	Credit Charges A/c
Cash recieved	Debit Cash A/c
Discount allowed to them	Debit Discount A/c
Sales Returns	Debit Sales Return A/c
Bad Debts written off	Debit Bad Debts A/c
Bills Receivable received	Debit Bills Rceivable A/c

* *Interest* on *Rs. 6.900 for one year and on Rs. 600 for 6 months.*

(b) Analysis of accounts of suppliers will reveal the following:

	Entry Now
Credit PurchasesDebit Purchases A/c	
Bills Payable Dishonoured	Debit Bills Receivable A/c
Cash Paid	Credit Cash A/c

Purchase Returns	Credit Returns Outwards A/c
Discount Received	Credit Discount A/c
Bills Payable Issued	Credit Bills Payable A/c

4. Go through the waste book and see if any transaction still remains to be recorded. For instance, interest may be due on loan. The entry to be passed is:

Interest A/c To Loan Creditor	...	....	Dr.

Preparation of Trading and Profit and Loss A/c From Single Entry Records. If Single Entry books have been converted into Double Entry books, a trial balance can then be taken out. From the trial balance, final accounts can be easily prepared. However, a short cut is also possible. This short cut will be available only of the summary of cash transaction is prepared.

Students will remember that for preparing the Trading Account the following informations is necessary:

Opening Stock	(available form previous statement of affairs.)
Purchases	(always ascertained by making an inventory.)
Wages, etc.	
Sales	
Closing Stock	

Purchase and sales are ascertained on commonsense basis. If I owe Rs. 50/- to the grocer on Ist April, pay him Rs.90 during the month ans still owe him Rs. 40 at the end of the month. I must have purchased from him goods for Rs. 80, i.e. Rs. (90+40) –50. Similarly, the grocer can calculate the sale to me.

In business firms credit purchases and credit sales are found by preparing accounts of total Creditors and total Debtors. Consider the Following:

Dr. **Total Creditors A/c** **Cr.**

	Rs.		Rs.
ToCash (as per CashBook)	43,000	By Balance c/d (given as per previous Statement of affairs)	9,000
To Discounts (as per analysis)	800	By Credit Purchases (balancing figure)	44,000
To Returns	1,100		
To Balance c/d (as per schedule of Creditors)	8,500		
	53,400		53,400

Items on the debit side total Rs. 53400 of this Rs. 9000 is the opening balance. Therefore, the balancing figure or Rs. 44400 must be the credit purchases. Cash purchases, must have been recorded on the credit side of the Cash Book and will be taken form there. Thus total purchases can be found out.

Can you find out the credit sales from the following?

	Rs.
Total Debtors on Ist Jan. 2002	15,600
Cash Received during 2002 form Drs.	68,200
Discount allowed to them	1,800
Bad Debts written off	600
Returns Inwards	2,500
Bills Reveivable received form them	11,000
Bills Dishonoured	1,500
Total Debtors on Ist Dec., 2002	14,300

Make the total debtors A/c. The debit side will be short: The balancing figure will be credit sales. Thus–

Dr. **Total Debtors Account** **Cr.**

	Rs.		Rs.
To Balance b/d	15,600	By Cash	68,200
To B/R (Dishonoured)	1,500	By Discount	1,800
To Credit Sales		By Bad Debts	600
(Balancing figure)	81,300	By Return Inwards	2,500
		By B/R	11,000
		By Balance c/d	14,300
	98,400		98,400
To Balance b/d	14,300		

Net credit sties will be (Rs.81,300 less Rs.2,500 (Returns) Rs.78,800.

Cash sales will be on the debit side ot the Cash Book. Credit Sales plus Cash Sales give you total sales. Examination of the credit side of the Cash Book will also reveal wages, carnage inwards, etc., which will be debited to the Trading Account.

Thus all information to prepare Trading Account becomes available and gross profit will be ascertained. This is put on the credit side of the Profit and Loss Account. Credit side of the Cash Book reveals expenses. These expenses after proper adjustments (for expenses prepaid or outstanding) will be debited to the Profit and Loss A/c. Debit side of the Cash Book will reveal income (such as sale of old newspapers.) These will be put on the credit side of the Profit and Loss A/c. The profit and Loss A/c should also be debited with any depreciation which has to be written off. Thus net profit or net loss can be ascertained. Thus will be transferred to the Capital Account.

Balance Sheet—Preparation of Balance Sheet is easy. The previous Statement of Affairs will reveal the various assets. The assets adjusted for depreciation and disposal (see debit side of Cash Book) and new acquisition (see credit side of the Cash Book) will be put in the Balance sheet at the end of the year. The balance for cash, debtors, slock and creditors will be given as at the end of the year. These will put down in the Balance Sheet. Capital will be as per previous Statement of Affairs adjusted for net profit or net loss and drawings (see credit side of Cash Book).

Illattratlon 2

The following information is given:

	1st January, 2002	31st December, 2002
	Rs.	Rs.
Total Debtors	19,300	20,500
Total Creditors	9,800	8,100
Stock	11,600	12,300
Plant and Machinery	30,000	—
Furniture	1,500	—

Summary of Cash Book

	Rs.		Rs.
To Balance b/d	5,000	By S. Creditors	31,000
To Receive From Debtors	78,000	By Wages	15,000
To Cash Sales	15,000	By Salaries	12,000
To Sales of Old Machinery	4,000	By Machinery	10,000
To Sales of Old Packing Boxes	600	By Inestments	6,000

		By Drawings	6,000
		By General Exps.	17,000
		By Balance c/d	5,600
	1,02,600		1,02,600

Bad Debts written off during the year were Rs. 1500. Discount allowed were Rs. 2000 and received were Rs. 600. Depreciation on Machinery is to be 10% on the value of machinery on 31st December, 2001. Furniture is to be depreciated at 5%. Interest @6% is to be allowed on capital.

Prepare Trading Account,Profit and Loss Account for 2002 and Balance Sheet as at December 31,2002

Solution:

We must first find (1) Capital in the beginning, (2) Credit Sales and (3) Credit Purchases.

(1) Capital

Stamement of Affairs as at 1st January,2002

Liabilities	**Rs.**	**Assets**	**Rs.**
Sundary Creditors	9,800	S.Debtors	19,300
Capital (Balancing Figure)	57,600	Stock	11,600
		Plant and Machinery	30,000
		Furniture	1,500
		Cash	5,000
	67,400		67,400

(2) Credit Sales:

Total Debtors Account

Dr.			**Cr.**
	Rs.		**Rs.**
To Balance b/d	19300	By Cash	78000
To Credit Sales		By Bad Debts A/c	1500
(Balancing Figure)		By Discounts	2000
		By Balance c/d	20500
	1,02,000		1,02,000
To Balance b/d	20500		

(3) Credit Purchases:

Total Creditors Account

Dr.			**Cr.**
	Rs.		**Rs.**
To Cash	31,000	By Balance b/d	9,800
To Discounts recd.	600	By Credit Purchases	
To Balance c/d	8,100	(Balancing figure)	29,900
	39,700		39,700
		By Balance b/d	8,100

Trading and Profit and Loss Account
for the year ending Dec. 31,2002

Dr.					**Cr.**
	Rs.				Rs.
To Opening Stock	11,6000	By Sales:			
To Purchases	29,900	Credit		82,700	
To Wages	15,000	Cash		15,000	97,700
To Gross Profit c/d	53,500	By Closing Stock			12,300
	1,10,000				1,10,000
To Salaries	12,000	By Gross Profit b/d			53,500
To General Expenses	17,000	By Sale of Old Packing boxes			
600					
To Discount allowed	2,000	By Discount Recd			600
To Bad Debts	1,500				
To Depreciation					
Machinery–					
10%on Rs. 36,000	3,600				
Furniture–					
5%on Rs. 1,500	75				
To Interest on Capital–					
6% on Rs. 57,600	3,456				
To Net profit–					
Transferred to Capital A/c	15,069				
Total	54,700			Total	54,700

Balance Sheet of
as at December 31, 2002

Liabilities		**Rs.**	**Assets**		**Rs.**
Sudry Creditors		8100	Cash		5,600
Capital			Sundry Debtors		20,500
Balance on I-2002	57,600		Stock		12,300
			Investments		6,000
Add Interest	3,456		Furniture	1,500	
Profit	15,069		Less Depreciation	75	1,425
			Plant and Machinery		
	76,125		Balance on 1-2002	30,000	
Less Drawing	6,000		Additions	10,000	
				40,000	
		70125	Less Sales	4,000	
				36,000	
			Less Sales	4,000	
				36,000	
			Less Depreciation		
			@10%	3,600	

			32,400
Total	78,225	Total	78,225

Illustration-3

A and B share profits and losses in the raito of 3:2. Prepare Trading A/c: Profit and Loss A/c and Balance Sheet from the following:

1. *Cash Book:* Bank Balance on 1st Jan.. 2001 Rs. 8000: A's drawing 9000: B's drawing Rs. 6000 paid to trade creditors. Rs. 60,000. paid against B/P Rs. 16,000: Wages Rs. 22,000: Salaries Rs. 10,000; Other trade expenses, Rs. 26,510; Received from trade debtors. Rs. 91,200; Received against B/P 16,090; Receipts from cash sales 31,620: cash in hand. Rs. 400. (On 31st December, 2002). There was no cash in hand on 1st Jan., 2002
2. *Particulars of Assets and Liabilities*

	1.1.2001	31.12.2002
	Rs.	Rs.
A/s Capital	80,000	?
B's Capital	20,000	?
Stock	39,600	50,000
Creditors	50,000	38,710
Debtors	44,000	14,000
B/R	10,000	14,000
B/P	6,000	nil
Premises	40,000	40,000
Furniture	2,400	2,400

3. *Other Information:* A and B will pay interest on drawing as Rs. 120 and Rs. 60. A and B are entitled to 5% interest on capital. B will get 6% Commission on the net profits remaining after such commission.

Allow 5% depreciation on premises and furniture and create a reserve for bad debts amounting Rs. 2650.

Trading and Profit and Loss A/c
for the year ending Dec. 31, 2002

	Rs.	Rs.		Rs.	Rs.
			By sales:		
To Stock		39,600	Credit	1,00,000	
To Purchases		4,0000	Cash	31,620	1,31,620
To Wages		22,000		....	
To Gross Profit c/d		80,020	By Clsing Stock		50,000
		1,81,620			1,81620
To Salaries		10000	By Gross profit b/d		80,020
To Trade Exp.		26,510	By Interest on Drawings:		
			By Dep: A	120	
Premises	2000		B	60	180
Furniture	120	2,120			
To Reserve for bad debts		2,650			
To Int. On Cap:					

A	4000			
B	1,000	5,000		
To B/s Commission $\frac{33920\times 6}{106}$		1,920		
To Net Profit				
A	19,200			
B	12,800	32,000		
		80,200		80,200

Balance Sheet of A & B, Ason Dec. 31, 2002

Liablities			Rs.	Assts		Rs.
Creditors			14,000	Stock		50,000
Bank overdraft			3,000	Debtors	38,710	
	A	B		Less provision	2,650	36,060
Cap. A/c	80,000	20,000				
+Int.	4,000	1,000		B/R		14,000
+Net Profit	19,200	12,800		Cash		400
	1,03,200	33,800		Premises	40,000	
+Commission		1,920		Less dep.	2,000	38,000
	1,03,200	35,720		Furniture	2,400	
Less Drawings	9000 94200	6000 29720		Less depreciation	120	2,280
Less Int. on			94,080			
Draw.	120 94080	60 29660	29660 140740	Less depreciation		1,40,740

Working notes:

Cash A/c

	Rs.		Rs.
To Balance	8,000	By A/s Drawings	9,000
To Debtors	91,200	By B/s Drawings	6,000
To B/R	16,090	By Trade Crs.	60,000
To Cash sales	31,620	By B/P	16,000
To Bank Overdraft	3,000	By Wages	22,000
		By Salaries	1,000
		By Trade Exp.	26,510
		By Balance (Cash)	400
	149,910		149,910

Total Debtors A/c

	Rs.		Rs.
To Balance b/d	50,000	By Cash	91,200

To Sales (bal.fig)	1,00,000	By B/Ro	20,090
		By Balance c/d	38,710
	1,50,000		1,50,000

B/R

	Rs.		Rs.
To balance b/d	10,000	By Cash	16,090
To S.drs. (Bal. Fig.)	20,090	By Balance c.d	14,000
	30,090		30,090

B/R

	Rs.		Rs.
To Cash	16,000	By Balance b/d	6,000
		By S.Crs. (bal.fig)	10,000
	16,000		16,000

B/P

	Rs.		Rs.
To B/P	10,000	By Balance b/d	44,000
To Cash	60,000	By Purchases	40,000
To Balance C/d	14,000		
	84,000		84,000

Exercise: From the following particulars, ascertain the opening balance of sundry debtors and closing balance of sundry creditors :

	Rs.
Sundry Creditors (31-03-2001)	20,600
Sundry Debotors (31-03-2002)	37,400
Stock (31-03-2001)	50,000
Stock (31-03-2002)	40,000
During 2001-2002:	
Purchase	1,40,000
Discount allowed to creditors	800
Discount allowed to customers	1000
Cash paid to sundry creditors	1,05,000
Bills payabe in used to them	20,000
Bills receivable received from custormers	35,000
Cash received from them	1,60,000
Bills receivable dishonoured	2000

The rate of gross profit 25% on selling price of the total sales Rs. 35,000 for cash.

UNIT–III

DEPRECIATION ACCOUNTING

Depreciation means diminution in the value of an asset, specially fixed asset, due to wear and tear, obsolescing, etc. We must provide for such diminution or loss in our accounts for two reasons:

(a) to calculate profits or loss correctly;

(b) to retain funds for replacement of the assets when it is no longer srerviceable.

To take the first point first, suppose a machine costing Rs. 50,000 is purchased in 1980 and profits without taking depreciation into account for 10 years are Rs. 70,000. Is it not right to say that the profit is Rs. 20,000 only viz. Rs. 70,000 less cost of the machine used up? It would have been far better to recognize from the very beginning that every year we are losing Rs. 5,000 because of wear and tear or depreciation of the machine. Therefore, profit, for each year should have been calculated after taking into account this depreciation.

Now to take the second point, if we have made a profit of Rs. 70,000 in the 10 years, we are likely to use this up for own private purchase. When the replacement of the machine is due, we will have no funds. But if we remember that the profit is only Rs. 20,000, then out of Rs. 70,000, Rs. 50,000 will be left in the business and only Rs. 20,000 is likely to be drawn for private use. Thus at the time of the replacement, funds will be available.

Factors that cause depreciation are as under :–

(a) Wear and tear due to actual use.

(b) Efflux of time; where passage of time makes machinery old and fit for replacement.

(c) Obsolescence; if a new and more efficient machine comes into the market, old one has to be replaced.

(d) Accident, and

(e) Fall in market value.

Almost all assets, with very few exception like old painting or art pieces, depreciate.

For determining the amount to be written off every year, basically three things have to be remembered.

They are:

(a) Cost, including cost of installation.

(b) Estimated scrap value at the end of life, that is the amount expected to be released by the sale of the old asset, and,

(c) Effective life—Effective life means the number of years during which the asset *will be* used (and not can be physically used) by the firm.

So much has to be written off every year that at the end of the effective life, the amount of the asset shows a balance equal to the estimated scarp value.

Provision for Depreciation

Depreciation may also be recorded with the help of provision for depreciation account as well. The necessary entries are:

(i) **For Charging depreciation**

Depreciation Account	Dr.	(with the amount of depreciation)
To Provision for depreciation Account		

(ii) **For closing depreciation account**

Profit and Loss Account Dr. (same amount as in (i))

To Depreciation Account

Under this method the asset account is not affected by the amount of depreciation and the asset appears in the ledger and balance sheet at its original cost until sold or discarded. The amount in the credit side of the provision for depreciation account shows the total amount of depreciation accumulated to date. However when the asset is sold or discarded or exchanged for a new asset, he total depreciation for that asset in the provision for depreciation account is transferred to that asset account with the help of following journal entry:

Provision for Depreciation Account

To Relevant Asset Account

Thus the balance in the provision for depreciation account always indicates the total depreciation on the unsold assets.

In the balance sheet, the asset account is shown at its original cost *less* accumulated balance in the provision of or depreciation account, e.g.,

Assets Side	**Rs.**	**Rs.**
Machinery	1,000,000	
Less: Provision for Depreciation	20,000	80,000

However some accountants show the asset at the original cost and provision for depreciation in the liabilities side until the depreciation provision is equal to the original cost of the asset.

It is relevant to highlight the points of difference in the two accounting procedures as given below:

When Depreciation Directly Affect The Asset Account	**When Provision for Depreciation Account is Maintained**
(i) The asset is shown in the balance sheet at cos/book value *less* depreciation of The relevant accounting period only.	(i) The asset always appears at its original cost in the ledger.
(ii) It is not possible to know the total amount of depreciation written off from one balance sheet.	(ii) The balance in the provision account show the total amount of depreciation written off upto the latest balance sheet date.
(iii) In the absence of details it is not possible to know whether the asset is new or old.	(iii) It is easy to find out the age of the asset simply with the help of cost of asset and accumulated depreciation.

Method of Depreciation :

There are a number of methods for writing off depreciation. These are the following :

(a) Fixed percentage on the original cost (also known as the Straight Line Method or the Fixed Instalment Method).

(b) Fixed percentage on the diminishing balance (also known as the Reducing Instalment method).

(c) Annuity Method.

(d) Depreciation Fund Method.

(e) Insurance Policy Method.

(f) Machine Hour Rate Method.
(g) Depletion Method.
(h) Revaluation Method.

(a) *Fixed Percentage on Original Cost.* As the same implies, every year a suitable percentage of the original cost is written off. Suppose, the cost Is Rs. 60,000 and 80% is to be written off; every year 8% of Rs. 60,000, i.e., 4,800 will be written off. Depreciation Account will be debited, Machinery Account will be credited.

The amount to be written off each year may also be determined as :

$$\frac{\text{Cost} - \text{Estimated scrap Value}}{\text{Estimated Effective Life}}$$

One should remember while writing off depreciation (under all method) that if the asset concerned has been used only for part of a year, depreciation should be provided only for that part of the year. If the asset has to be discarded before the expiry of its life, the amount realised should be credited to the account of the asset and the remaining amount should be written off as a loss.

The book value of the machine is found by deducting the total accumulated depreciation from the cost.

Advantages: The following points may be listed in favour of this method: (i) This method is easy to use. Mathematical calculations are not required. (ii) This method realistically matches cost and revenues. (iii) There is not change either in the rate or amount of depreciation over the useful life of the asset. Such a procedure provides sound basis for comparison. (iv) This method is recognised by the Accounting Standard (AS)-6 issued by the Institute of chartered Accountants of India and also by the Companies Act. 1956. (v) The valuation of the asset each year in the balance sheet is reasonably fair.

Disadvantages: (i) it does not take into consideration the interest on the amount invested with the fixed asset. (ii) It is illogical because depreciation is considered a function of time rather than a function of use. (iii) It is based on the wrong assumption of equal utility of the asset during its useful life. (iv) The maintenance of the asset is generally costly in the later yeas with the result that maintenance cost and depreciation would be greater in later years than in the earlier years. (v) This method is not recognished by the Income Tax Act. 1961. (vi) If an additional asset is purchased, the amount of depreciation on that asset has to be recalculated. Hence a separate calculation has to be made for each item because of difference in useful life and scarp value.

Suitability: This method is suited in the following cases: (i) Where the useful life of the asset can be estimated accurately; (ii) when repairs/maintenance expenses are uniform for each accounting period; (iii) Where use of the asset is consistent from period to period and therefore each period benefits equally from the use of the asset e.g., furniture, leases, copyright, trade mark etc. and (iv) Where the asset is not likely to become obsolete.

Illustration–1 (Straight Line Method)

Soloman purchases a machine for Rs. 1,00,000 and 1 January 2,000. Its estimated useful life is 5 years and scarpt Values Rs. 10,000. It is decided to write off depreciation under straight lien method. Pass necessary journal entries for five years and open necessary account in the ledger for the same period. The accounting period ends on 321 March every years.

Solution:

Annual Depreciation $= \dfrac{\text{Rs.}1,00,000 - \text{Rs.}10,000}{5}$ = Rs. 18,000 per year

Rate of Derpreciation $= \dfrac{18,000}{1,00,000} \times 100$ = 18%

Journal Entries

Date	Particulars		Debit Rs.	Credit Rs.
2000				
Jan. 1	Machinery Account	Dr.	1,00,000	
	To Bank Account			1,00,000
	(Purchase of machine)			
31 Mar.	Depreciation Account	Dr.	4,500	
	To Machinery Account			4,500
	(Depreciation on machinery for 3 months)			
	Profit and Loss Account	Dr.	4,500	
	To Depreciation Account			4,500
	(Depreciation charged to profit and loss A/c)			
2001				
31 Mar.	Depreciation Account	Dr.	18,000	
	To Machinery Account			18,000
	(Depreciation of machinery for one year)			
31 Mar.	Profit and loss account		18,000	
	To depreciation Account			18,000
	(Depreciation chargess transferred to profit and loss account)			
2002				
31 Mar.	Depreciation Account	Dr.	18,000	
	To Machinery Account			18,000
	(Annual Depreciation charges			
	Profit and Loss Account	Dr.	18,000	
	To Depreciation Account			18,000
	(Depreciation charges transferred to profit and loss account)			
2003				
31 Mar.	Depreciation Account	Dr.	18,000	
	To Machinery Account			18,000
	(Annual depreciation charges)			
	Profit and Loss account		18,000	
	To Depreciation Account			18,000
	(Transfer of annual depreciation to profit and loss account)			
2004				
31 Mar.	Depreciation Account	Dr.	18,000	
	To Machinery Account			18,000
	(Annual depreciation charges)			

	Profit and loss Account Dr.	18,000	
	To Depreciation Account		18,000
	(Transfer of depreciation charges to profit and loss account)		
31 Dec.	Bank Account Dr.	10,000	
	To Machinery Account		10,000
	(Machinery sold for Rs. 10,000 as scrap)		
2005			
21 Mar.	Depreciation Account Dr.	13,500	
	To Machinery Account		13,500
	(Depreciation charges for 9 months on Rs. 1,00,000 @ 18%)		
31 Mar.	Profit Loss Account Dr.	13,500	
	To Depreciation Account		13,500
	(Transfer of depreciation account to profit and loss account)		

Dr. **Machinery Account** **Cr.**

1 Jan. 2000	**Rs.**	**31 March 2000**	**Rs.**
To bank Account	1,00,000	By Depreciation Account	4,500
		By Balance c/d	95,500
	1,00,000		1,00,000
1 April 2000		**31 March 2001**	
To Balance b/d	95,500	By Depreciation Account	18,000
		By Balance c/d	77,500
	95,500		95,500
1 April 2001		**31 March 2002**	
To Balance b/d	77,500	By Depreciation Account	18,000
		By Balance c/d	59,500
	77,500		77,500
1 April 2002		**31 March 2003**	
To Balance b/d	59,500	By Depreciation Account	18,000
		By Balance c/d	41,500
	59,500		59,500
1 April 2003		**31 March 2004**	
To Balance b/d	41,500	By Depreciation Account	18,000
		By Balance c/d	23,500
	41,500		41,500
1 April 2004		**31 December 2004**	
To Balance b/d	23,500	By Bank Account (Scrap)	10,000
		31 March 2005	
		By March 2005 **(for 9 months)**	13,500
	23,500		23,500

Illustration-2

A firm purchased a machine on 1st April, 1998 for Rs. 37,000 and spent Rs. 3,000 on its installation. Depreciation is written off at the rate of 10% on the original cost. Accounts are closed on 31st December every year. On 30th June, 2002 the machine was disposed off for Rs. 20,000. Write up the Machinery Account from 1998 to 2002.

Dr. **Machinery Account** **Cr.**

		Rs.			Rs.
1998			1998	By Depreciation A/c	
April	To Cash	37,000	Dec. 31	10% on Rs. 40,000	
	To Cash	3,000	" "	for 9 months	3,000
				By Balance c/d	37,000
		40,000			40,000
1999			1999		
Jan. 1	To Balance b/d	37,000	Dec. 31	By Depreciation A/c	4,000
			" "	By balance c/d	33,000
		37,000			37,000
2000			2000		
Jan. 1	To Balance b/d	33,000	Dec. 31	By Depreciation A/c	4,000
			" "	By Balance c/d	29,000
		33,000			33,000
2001			2001		
Jan. 1	To Balance b/d	29,000	Dec. 31	By Depreciation A/c	4,000
				By Balance c/d	25,000
		29,000			29,000
2002			2002		
Jan. 1	To Balance b/d	25,000	June 30	By Depreciation A/c	2,000
				By Cash	20,000
				By P & L A/c (Loss)	3,000
		25,000			25,000

(b) ***Reducing Instalment System.*** In this case the depreciation is written off on the basis of the balance in the account of the asset. If a machine is acquired at a cost of Rs. 20,000 and depreciation is written off at the rate 10% p.a. the depreciation for the first year will be Rs. 2,000 i.e., 10% of Rs. 20,000 and for the second year it will be Rs. 1,800 i.e., 10% of Rs. 18,000 (Rs. 20,000 minus Rs. 2,000).

Illustration-3

Work out the illustration given above under Reducing instalment method.

Dr.		Machinery Account			Cr.
		Rs.			Rs.
1998			1998		
April 1	To Cash	37,000	Dec. 31	By Depreciation A/c	3,000
	To Cash	3,000	” ”	By Balance c/d	37,000
		40,000			40,000
1999			1999		
Jan. 1	To Balance b/d	37,000	Dec. 31.	By Depreciation A/c	3,700
			” ”	By Balance c/d	33,300
		37,000			37,000
2000			2000		
Jan. 1	To Balance b/d	33,300	Dec. 31	By Deprecation A/c	3,330
			” ”	By Balance c/d	29,970
		33,300			33,300
2001			2001		
Jan. 1	To Balance b/d	29,970	Dec. 31	By Depreciation A/c	2,997
			” ”	By Balance c/d	26,373
		29,970			29,970
2002			2002		
Jan. 1	To Balance b/d	26,973	June 30	By Depreciation A/c	1,349
			” ”	By Cash	20,000
			” ”	By P & L A/c	5,624
		26,973			26,973

Advantages : (i) The higher depreciation is charged in the earlier years when the machine is most efficient. This matches higher cost with larger revenues resulting from the mereased production. (ii) The obsolescence problem is given due care because the major part of the depreciation is charged in the earlier years and the management has no difficulty in replacing the asset. (iii) The problem of higher maintenance or repair charges is solved since the depreciation expense in later years is lower than the depreciation expense of early years. (iv) The asset will never be completely written off with the result that management can keep a track of the asset. (v) All items including additions are added together and depreciated at the same rate. So no recalculation is necessary when additional assets are purchased. (vi) The method is recognised by AS-6 and Companies Act. 1956 and is applicable for income tax purposes. Purchased (vi) The method is recognised by AS-6 and Companies Act. 1956 and is applicable for income tax purposes.

Disadvantages : (i) This method requires much figure work. (ii) Such a method involves the use of mathematical tables where the arithmetic is difficult. (iii) It does not take into consideration the interest on the amount invested int he fixed assets. (iv) It takes very long time to write off the asses unless a very high rate of depreciation is applied. The result is that the asset cannot be replaced at the earliest. (v) If the life of the asset is short, the depreciation charge in the earlier years is more having adverse impact on the net profit. Hence this method is not applied for assets with a very short life. (vi) The depreciation is neither based on the use of the asset nor distributed evenly throughout the useful life of the asset.

Suitability : Inn general this method is suitable to plant and machinery where repairs are heavy in the later years and additions, extensions and substitution are frequent. And also where the possibilities of obsolescence are frequent.

Difference between Straight Line Method And Diminishing Balance Method

Points of difference	Straight Line Method	Diminishing Balance Method
1. Computation Method	The depreciation is charged at a fixed rate on the original cost of the asset.	The depreciation is charged at a fixed rate on the original cost in the first year and on the written down value (cost minus total depreciation) in the subsequent years.
2. Amount of Statement	The amount of depreciation remains the same in all the years of useful life of the asset.	The amount of depreciation goes on decreasing year after year.
3. Effect on Income Statement	The total burden on the profit and loss account is more in the later years because the repair charges increase while the amount of depreciation is same.	The total burden on the profit and loss account is same in the early years as well as in the later years because of more depreciation *plus* repairs cost in the beginning and *less* depreciation *plus* more repairs cost in the later years.
4. Book Value	The book value of the asset becomes zero or equal to scrap value.	The book value never becomes zero.
5. Calculation	It is easy to calculate the rate of depreciation.	It requires the use of mathematical tables.
6. Recognition	Not accepted by Income tax law.	Recognised under Income Tax Act.
7. Suitability	Where repair charges are less and obsolescence is not frequent.	Repair charges are more in later year and also obsolescence.

(c) *Annuity Method.* The first methods ignore interest lost because of money spent on acquiring the asset. Strictly speaking, depreciation charge should also include the interest thus lost. The Annuity System enables one to calculate depreciation on this basis. Annuity thus lost. The Annuity System enables one to calculate depreciation on this basis. Annuity tables are available which show the amount to be written off every year to make an asset of nit value after adding interest at specified rate in a specified period.

(d) *Depreciation Fund Method.* Should the firm desire to have cash for buying new asset when the old one becomes useless. It will have to set aside a certain sum every year, invest in readily saleable securities and reinvest the interest. This process is known as creation of depreciation Fund or Sinking Fund. Sinking Fund Tables are available showing how much has to be invested every year so that after a given period and at given rate of interest it will accumulate to the required figure.

(c) *Insurance Policy Method* : Under this method, the funds for replacements of an asset are ensured by taking out an insurance policy. A premium is paid to the insurance company every year (in the begining) and at the end of the stated period, the insurer pays the fixed sum. The steps are as follows :

1. Every year in beginning, debit Depreciation Fund Policy Account and credit cash with the amount paid. Carry down the balance in the Dep. Fund Policy a/c from year to year.
2. At the end of each year, Debit Depreciation Account (or Profit and Loss Account) and credit Depreciation Fund Account. Carry down the balance in the Dep. Fund Account from year to year.
3. At the end of the fixed period and on receipt of the amount of the policy, debit cash and credit Depreciation Fund Policy Account. The balance remaining in this account is transferred to the Depreciation Fund Account.
4. Transfer the balance in the asset account (which will appear at cost in all these three year) to the Depreciation Fund Account by debiting this account and crediting the asset account.

(f) *Machine Hour Rate Method.* Under this method the life of a machine is estimated in term of hours and not in terms of years. The depreciation to be charged each year will then depend upon the number of hours worked actually in that year. Suppose a machine is purchased for Rs. 15,000 and it is estimated that it will work for 25,000 hours. Then the depreciation per hour will be Rs. 15,000/25,000 or 60 P. per hour. If in the first year the machine works for 1,800 hours the depreciation will be 1800 × 60 or Rs.1,080. If next year the number of hours are 2,000 the depreciation to be written of will be Rs. 1,200.

(g) *Depletion Method* is useful for mines, quarries, etc., wherefrom a certain quantity of material is expected. Payment for a mine is made on the expectation that a certain quantity of minerals will be available. This quantity is estimated and the cost of the mine is divided by it, thus giving a rate of depreciation of so many rupees for say, a tonne of minerals. Annual depreciation will depend on the quantity of output. Suppose a mine is purchased at a cost of Rs. 5,00,000 and it expected that the total quantity of minerals to be obtained will be 1,00,000 tonnes. This gives a rate of Rs. 5 per tonne. If in one year the quantity produced is 8,000 tonnes, the depreciation to be charged will be Rs. 40,000 i.e., Rs. 8,000 × Rs. 5.

(h) *Revaluation Method* is used to generally for livestock and loose tools. Every year a valuation is made and depreciation is calculated accordingly. Suppose loose tools on 1st January 1998 were Rs. 5,000 and on 31st December, 1998 the value placed is Rs. 4,100. A depreciation of Rs. 900 will then be written off.

(For depreciation on fixed assets, joint stock companies have to follow the provisions of the Companies

Act as amended to date.)

Change of Method of Depreciation As Per Accounting Standard (As)-6 (Revised)

Once a firs selects a certain method and rate of depreciation, the same are used consistently to provide comparison the results of operations of a business enterprise from period to period. However sometimes, it may be decided to change the existing method of depreciation and or the rate of depreciation.

According to accounting Standard (AS)-6, the method of depreciation may be changed in the following circumstances :

(i) When the adoption of new method is required by statute (i.e. law) : or

(ii) When the adoption of new method is required for compliance with an accounting standard or :

(iii) When it is considered that the change would result in a more appropriate preparation or presentation of the financial statements.

Preparation or presentation of the financial statements.

Effective date of change : If the method of depreication has been changed, then the change, should be applied with retrospective effect, that is, the date when the asset was put to use and not prospectively.

It may therefore be noted that

(i) Change in method would be from the date the asset was put to use.

(ii) Change in the method would be applied only to the existing assets and not to the assets which have been sold or discarded or destroyed.

(iii) the same conditions apply to the change in the rate also

Procedure : The procedure for recording the change of method and rate of depreciation from the back date may be noted as under :

(i) Calculate the total depreciation on the existing assets from the back date (i.e., when the assets were put to use) at the new method and rate.

(ii) compare it with the total depreciation already charged on the existing assets.

(iii) In case the change results in deficiency (shortage) in depreciation in respect of past years, the deficiency is debited (charged) in the profit and loss account.

(iv) In case, the change results in surplus, the surplus is credited to profit and loss account.

Illustration 4 (Change of Method)

Goodluck Ltd. purchased on 1 January 1997, certain machinery for Rs. 1,94,000 and spent Rs. 6,000 on its erection. On 1 July 1997 additional machinery costing Rs. 1,00,000 was pruchased. On 1 July and 1999, the machinery purchased on 1 January 1997 has been auctioned for Rs. 1,00,000 and on the same date, new machinery was purchased at a cost of rs. 1,50,000. Depreciation was provided annually on 31 December at the rate of 10% pa.a. on the original cost. No depreciation need be charged during the year of sale of machinery for that part of the year when the machine was used. In 2001, however the company has changed the method of depreciation to written down value method at the rate of 15% p.a. from the straight line method. Show the machinery account for the period from 1997 to 2001.

(B.Com. March 2003)

Solution

Dr.		Machinery Account			Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1997			1997		
Jan. 1	To Bank Account	1,94,000	1997	By Depreciation A/c	25,000
	To Bank Account	6,000	Dec. 31	(20,000 + 5,000)	
July 1	To Bank Account	1,00,000		By Balance c/d	2,75,000
		3,00,000			3,00,000
1998			1998		
Jan. 1	to Balance b/d	2,75,000	Dec. 31	By Depreciation A/c	30,000
				(20,000 + 10,000)	
				By Balance c/d	2,45,000
		2,75,000			2,75,000
1999			1999		
Jan. 1	To Balance b/d	2,45,000	July 1	By Bank Account	1,00,000
July 1	To Bank A/c	1,50,000		By Profit and Loss Account (Loss on sale of machine)	60,000
			Dec. 31	By Depreciation A/c	17,500
				(10,0000 + 7,500)	
				By Balance c/d	2,17,500
		3,95,000			3,95,000
2000			2000		
Jan. 1	To Balance b/d	2,17,500	Dec. 31	By Depreciation A/c	25,000
				(10,000 + 15,000)	
				By Balance c/d	1,92,500
		2,17,500			2,17,500
2001			2001		
Jan. 1	To Balance b/d	1,92,500	Dec. 31	By Depreciation A/c	28,875
				(15% of Rs. 1,92,500)	
				By Balance c/d	1,63,625
		1,92,500			1,92,500

As per Accounting Standard (AS) : 6, the change in method of depreciation must be effective with retrospective effect on the existing machines. Accordingly the position would be :

2001		Rs.	2001		Rs.
Jan. 1	To Bank b/d	1,92,500	Dec. 31	By Profit and Loss Account **(Additional depreciation)**	17,757
				By Depreciation 15% on Rs. 1,74,743. (**1,92,500** – 17,757)	26,212
				By Balance c/d	1,48,531
		1,92,500			1,92,500

Working Notes

Machine II

	S.L.M. (10%) Rs.	W.d. V. (15%) Rs.
Cost	1,00,000	1,00,000
Depreciation for 1997	5,000	7,500
	95,000	92,500
Depreciation per 1998	10,000	13,875
	85,000	78,625
Depreciation for 1999	10,000	11,794
	75,000	66,831
Depreciation for 2,000	10,000	10,025
	65,000	56,806
Total Depreciation	**35,000**	**43,194**

Machine III

	SlM (10%)	W.D.V. (10%)
Cost	1,50,000	1,50,000
Depreciation for 1999	7,500	11,250
	1,42,500	1,38,750
Depreciation for 2000	15,000	20,813
	1,27,500	1,17,937
Total Depreciation	**22,500**	**32,063**

Calculation of Additional Depreciation

Total Depreciation on Machines II and III	**Rs.**
as per Written down Value Method	
(43,194 + 32,063)	75,257
Less : Total depreciation on two machines as per Straight Line Method	
(35,000 + 22,500)	57,500
To be charged to Profit and Loss Account	17,757
Depreciation for 2001	**Rs.**
Written down value on 1-1-2001	1,92,500
Less : Additional depreciation	17,757
Depreciation to be charged @ 15% on 1,74,743	1,74,743
	26,212
	1,48,531

Verification

Machine I

Depreciated value on 31-12-2001	**Rs.**
(1,00,000 – 7,500 – 13,875 – 11,794 – 10,025 – 8,521) =	
	48,285
Machine II	
Depreciated value on 31-12-2001	
(1,50,000 – 11,250 – 20,813 – 17,691)	1,00,246
	1,48,531

Calculation of Loss on Sale

Cost	2,00,000
Less : Depreciation **(20,000 + 20,000)**	40,000
	1,60,000
Less : Sale Price	1,00,000
	60,000

No Depreciation is to be charged in the year on sale.

Illustration 5 (Change in Method)

Voltas Ltd. bought a truck on 1 January, 2000 for Rs. 60,000 and a sum of Rs. 20,000 was spent for various accessories. On 1 July, 2001 another vehicle was purchased for Rs. 52,000. On 1 July 2002, the first truck was sold for Rs. 60,000. On the same date, another truck was purchased for Rs. 50,000. On 1 July 2003, the second vehicle was sold for Rs. 46,000. Rate of depreciation was 10% on the original cost annually on 31 December. In 2002 the method of charging depreciation has changed to diminishing value method, on the balance existing on 31-12-2002 the rate being 15%, p.a Prepare Truck Account for 2000, 2001, 2002 and 2003.

Solution

Dr.		Truck Account			Cr.
2000		**Rs.**	**2000**		**Rs.**
Jan. 1	To Cash	60,000	Dec. 31	By depreciation Account	8,000
	To Cash **(Accessories)**	20,000		By Balance c/d	72,000
		80,000			80,000
2001			**2001**		
Jan. 1	To Balance b/d	72,000	Dec. 31	By Depreciation Account	
July 1	To Cash **(Truck II)**	52,000		Truck I 8,000	
				Truck II 2,600	10,600
				By Balance c/d	1,13,400
		1,24,000			1,24,000
20002			**2002**		
Jan. 1	To Balance b/d	1,13,400	July 1	By Cash **(Sale of Truck I)**	60,000
July 1	To Cash **(Truck III)**	50,000	Dec. 31	By Depreciation Account **(1)**	4,000
				By Depreciation Account **(2)**	11,160
				By Balance c/d	88,240
		1,63,400			1,63,400
2003			2003		
Jan. 1	To Balance b/d	88,240	July 1	By Cash **(Sale of Truck II)**	46,000
July 1	To Profit & Loss A/c	7,160	Dec. 31	By Depreciation **(for 6**	
				months) (3)	3,150
				By Depreciation (Truck III) (4)	6,938
				By Balance c/d	39,312
2004		95,400			95,400
Jan. 1	To Balance b/d	39,312			

Working Notes

(1) Though As-6 requires that change in method and rate must take place with retrospective effect, but according to the words used in the illustration the change in the rate and method of depreciation would be introduced from December 31,2002.

		Rs.
(2)	**Depreciation Written off in 2002**	
	Book value of Second Truck on Jan. 1,2002	
	Rs. 49,400 **(52,000-2,600)**. Depreciation @ 15%	7,410
	Depreciation on Truck II @ 15% on 50,000 for 6 months	3,750
		11,160
(3)	**Depreciation written off in 2003 and Profit on Sale**	
	Truck II : Book Value on : 1.1.2002	49,400
	Less : Depreciation for 2002	7,410
	Book Value on 1.1.2003	41,990
	Depreciation in 2003 for 6 months	3,150
	Depreciated value on the date of sale`	38,840
	Profit	7,160
	Sale Proceeds (Given)	**46,000**
(4)	**Truck III:** Book Value (1.7.2002)	50,000
	Depreciation in 2002 **(for 6 months)** @ 15%	3,750
		46,250
	Depreciation in 2003 @ 15%	6,938
	Book Value on 1.1.2004	39,312

Illustration 6 (Change in Method)

The book value of Plant and Machinery on 1-1-2004 was Rs. 2,00,000. New machinery for Rs. 10,000 was purchased on 1-10-2004 and for Rs. 20,000 on 1-7-2005. On 1-4-2006, a machinery whose book value had been Rs. 30,000 on 1-1-2004 was sold for Rs. 16,000. Depreciation had been charged at 10% p.a. since 2004 on straight line method. It was decided in 2006 that depreciation at the rate of 20% p.a. on diminishing balance method should be charged with retrospective effect since 1-1-2004. Show Plant and Machinery Account upto 31-12-2006. Give detailed workings.

Dr. **Plant and Machinery Account** **Cr.**

2004		**Rs.**	**2004**		**Rs.**
Jan. 1	To Balance b/d	2,00,000	Dec. 31	By Depreciation Account	20,250
Oct. 1	To Cash Account	10,000		**(20,000 + 250)**	1,89,750
				By Balance c/d	1,89,750
		2,10,000			2,10,000
2005			**2005**		
Jan. 1	To Balance b/d	1,89,750	Dec. 31	By Depreciation Account	22,000
		20,000		**(20,000 + 1,000 + 1,000)**	
				By Balance c/d	1,87,750
		2,09,750			1,09,750

2006			**2006**		
Jan. 1	To Balance b/d	1,87,750	April 1	By Depreciation Account	750
				By Cash Account	16,000
				By Profit and Loss Account	7,250
			Dec. 31	By Depreciation Account **(Additional)**	29,350
				By Depreciation Account **(2006)**	26,880
				By Balance c/d	1,07,520
		1,87,750			1,87,750

(i) Calculation of loss on machine sold **Rs.**

Cost of the machine	30,000
Less : Depreciation for 2004 and 2005	
(3000 × 2)	6,000
Depreciation for 3 months in 2006	750
Book value on 1-4-1996	23,250
Less : Sale Price	16,000
Loss on Sale	7,250

(ii) Calculation of Additional Depreciation

Depreciation on all machines except the one sold on 1 April, 2006 (i.e., Rs., 30,000) is shown below :

	Straight Line Method (10%)	**Diminishing Balance Method (20%)**
	Rs.	Rs.
Depreciation for 2004 (on Rs. 1,70,000 for one year on Rs. 10,000 for 3 Months)	17,250	34,500
Depreciation for 2005 (on Rs. 1,80,000 for one year and on Rs. 20,000 for 6 months)	19,000	
(On Rs. 1,45,500 (1,80,000 – 34,500) for one year and on Rs. 20,000 for 6 months @ 20% p.a.)		31,100
	36,250	65,600

Additional depreciation : Rs. 65,600 – Rs. 36,250 = Rs. 29,350

Depreciation for 2006

Written down value of machines in use = 1,34,400

(1, 80,000 – 34,500 + 20,000 – 31,100)

Depreciation for 2006 : 20% on Rs. 1,34,400 = Rs. 26,880

Illustration 7 (Provision For Depreciation, Sale of Asset and Change in Method From the Back Date)

On 1 April, 1998 a new plant was purchased for Rs. 80,000 and a further sum of Rs. 4,000 was spent on its installation. On 1 October, 2000 another plant was acquired for Rs. 50,000. Due to an accident on 2 January, 2001 the first plant was totally destroyed and was sold for Rs. 2,000 only. On 21.1.2002 a second hand plant was purchased for Rs. 60,000 and a further sum of Rs. 10,000 was spent for bringing the same to use on and from 15.3.2002. Depreciation has been provided at 10 per cent on straight line bases. It was a practice to provide depreciation for full year on all acquisitions made at any time during any year and to ignore depreciation on any item sold or disposed or during the year. None of the assets were insured. The accounts are closed annually to 31 March. It is now decided to follow the rate of 20 per cent on diminishing balance method with retrospective effect in respect of the existing items of plant and to make the necessary adjustment entry on 1 April, 2002. Required : (i) A plant Account; (ii) Provision for Depreciation Account. (ii) Journal Entries, where necessary.

Dr. **Plant Account** **Cr.**

1998		**Rs.**	**1999**		**Rs.**
1 April	To Cash Account	80,000	31 March	By Balance c/d	84,000
1 April	To Cash Account	4,000			
		84,000			84,000
1999			**2000**		
1 April	To Balance b/d	84,000	31 March	By Balance c/d	84,000
2000			**2001**		
1 April	To Balance b/d	84,000	3 Jan.	By Cash Account	2,000
1 Oct.	To Cash Account	50,000	31 March	By Provision for Depreciation Account	16,800
				By Profit & Loss Account **(Loss)**	65,200
				By balance c/d	50,000
		1,34,000			1,34,000
2001			**2002**		
1 April	To Balance b/d	50,000	31 March	By Balance c/d	1,20,000
2002					
21 Jan.	To Cash Account	60,000			
	To Cash Account	10,000			
		1,20,000			1,20,000

Journal entry

2002		**Rs.**	**Rs.**
April	Depreciation Account	15,000	15,000
	To Provision for Depreciation Account		
	(Being the provision for additional depreciation made due to change in the rate and method with retrospective effect.)		

Working Notes

Depreciation @ 20% on Diminishing Balance Method

Plant Purchased	Original Cost	Depreciation		Total
		2000–01	**2001-02**	
	Rs.	**Rs.**	**Rs.**	**Rs.**
2000-01	50,000	10,000	8,000	18,000
2001-02	70,000	—	14,000	14,000
		10,000	22,000	32,000
Provision already made				17,000
Additional Depreciation required				15,000

Dr. Provision For Depreciation Account Cr.

Year		**Rs.**	**Year**		**Rs.**
1999			**1999**		
31 March	To Balance c/d	8,400	31 March	By Depreciation A/c	8,400
2000			**1999**		
31 March	To Balance c/d	16,800	1 April	By Balance b/d	8,400

Provisions, Reserves And Reserve Funds

A *Provision* is an estimated amount set aside to meet unexpected Loss or liabilities. If the amount is definitely known, a definite liability is created but where the amount is not certain, the amount is estimated and the relevant Provision Account is credited. For example, a customer demands Rs. 5,000 as damages for late supply of goods and files a suit for it. It is expected that some amount will have to be paid but the exact amount is not known. The amount will be estimated, debited to Profit and Loss Account and credited to Provision for damages Account. Provision for Doubtful Debts is another example. Usually provisions mean reduction of profit.

A *Reserve* is a portion of profits set aside. The purpose is not to meet a loss or liability but to strengthen the financial position. Amounts set aside as reserves remain at the disposal of the firm. It is an appropriation of profits.

A Reserve Fund is a reserve where an equal amount is invested in outside securities. Where there is not such investment, it is merely a reserve and not a reserve fund.

Types of Reserve

Revenue Reserves are reserves built out of ordinary profits, profits which can be used for declaring dividends. Examples are General Reserve and Dividend Equalisation Reserve (a reserve to make dividends uniform from year to year). A *Specific* reserve is created for definite purpose. A general reserve is created to make position better generally.

Capital Reserves are reserves built out of capital (or extraordinary) profits—profits not available for dividends. Such profiles are :–

(a) Profit Prior to incorporation.
(b) Preminum on issue of shares or debentures.
(c) Profit on redemption of debentures.
(d) Amount untilised out of profits to redeem redeemable preference shares.
(e) Profit on forfeiture of shares.
(f) Profit on sale or revaluation of fixed assets.

Capital profits may be used to issue bonus shares

Secret Reserves. Reserves (accumulation of profits) which are not disclosed in accounts are known as secret reserves. Secret reserves mean that the actual financial position is much better than that show in the Balance Sheet. Such reserves are created by suppressing profits, like.

(a) writting off excessive depreciation;
(b) treating an asset as an expense (i.e., charging capital expenditure to revenue);
(c) under valuation of closing stock;
(d) suppression of sales; and
(e) crediting revenue receipts to an asset.

Secret reserves are the reverse of window dressing (which showing a better position that it is). Both are against the provisions of the Companies act which require that the Balance Sheet and Profit and Loss Account should exhibit a true an fair position.

Sinking Funds. A sinking fund is a fund built up by regular contribution and the interest received by investing the amount so contributed and the interest itself. The purpose of a sinking fund may be either payment of a liability on a certain day in future or accumulation of funds to replace a wasting asset. In fact the depreciation fund method discussed above is an example of a sinking fund.

There are, however some differences in a sinking fund to replace a wasting asset and the one the repay a liability.

1. In case of sinking fund to replace a wasting asset (in short depreciation fund) the annual contribution is in the nature of depreciation and is, therefore a charge against profits and is, as such, debited to Profit and Loss Account. In case of the sinking fund to repay a liability, the annual contribution is debited to Profit and Loss Appropriation Account. It stands to reason that when a loan is repaid, there is no profit or loss (money was received previously, now it is paid off) and hence the annual instalment can not be treated as a charge against profits (expense).
2. At the end of the stipulated period the Depreciation Fund investment (or Sinking Fund Investments) will be realised to provide funds to buy a new asset in case of the Sinking Fund to replace a wasting asset). The old asset will be written off by transfer to Depreciation (or Sinking Fund). Thus in place of an old asset a new asset is acquired But in case of Sinking Fund to repay a liability, the amount realised by sale of investments will be to pay off the liability. This will close the investments account and also the liability account. The Sinking Fund Account will remain. The balance of this account is transferred to General Reserve.

UNIT–IV

Lesson 1

CONSIGNMENT

Consignment—What is it?

Quite often it happens that a manufacturer or a wholesale dealer who does not find ready market in his own place becomes desirous of seeking a good market elsewhere. Even when there is a good market for his goods in his own place, he is often anxious to make his goods popular elsewhere. For this purpose the merchant employs a leading dealer at the place where he wants to push his goods to act as his agent and sell goods *on his behalf and risk as agent on commission.* Goods so sent to a person are known as Consignment. The person who sends such goods is known as the Consignor and the person to whom the goods are sent is known as the consignee. Such goods sent to the Consignee remain the property of the Consignor. The Consignee to whom the goods are sent does not buy them, but, merely undertakes to sell them on behalf of the consignor. He is not responsible for any loss or damage to the goods, if such loss or damage is caused for no fault of the Consignee.

Such a shipment of the goods by the Consignor cannot be treated as ordinary sale and such transactions require special treatment in the books of accounts.

Difference between a Sale and a Consignment

1. When goods are sold by one to another, the property in the goods immediately passes to the buyer, whereas when goods are sent on Consignment, the property in the goods remains with the consignor. Only the possession is transferred to the consignee.
2. When goods are sold by one to another, it becomes a relationship of a buyer and seller or a Debtor and a Creditor between the two persons, whereas when goods are Consigned by one to another, it becomes a relationship of a Principal and an Agent between the Consignor and the Consignee.
3. When goods are sold, the buyer cannot return the goods to the seller whereas when goods are sent on Consignment the goods are returnable, if they remain unsold.
4. The risk in the goods is not transferred to the consignee despite the transfer of possession of goods. Any damage or loss to the goods is therefore borne by consignor. But in the case of sale, the risk is immediately transferred to the buyer even when the goods are still in the possession of the seller.
5. The expenses, in respect of freight, cartage, insurance, etc. are met by the consignor in a consignment transaction, but in the case of sale the expense are borne by the purchaser unless otherwise provided in the agreement.
6. The transfer of possession (i.e. delivery of goods) is essential in a consignment transaction. In a sale, however, the goods may be delivered at a later date.

The consignee will be treated as a debtor only when goods or part of them have been sold by him. But if goods remain unsold, the consignee will send them back to the Consignor and the Consignor will pay the Consignee all the expenses he has incurred in keeping the goods in safety and in attempting to push the goods in the market.

Note:— Strictly speaking the term consignment implies the despatch or shrpping of goods to an agent in a foreign country for sale on commission basis. In business circles, however, the term is used for despatch of goods to an agent in different parts of the same country as well.

Commission or Consignee's Remuneration

When the goods are sold by the consignee, he is paid a commission for his services at a fixed rate on the proceeds of the goods sold by him. In addition to this commission, he is to be reimbursed for all expenses incurred by him in connection with the consignment sales. Usually these expenses are in the nature of dock charges, custom duties, carriage, godown rent, advertisement, insurance of the goods while in his possession etc.

Del Credere Commission. Usually the consignor advises the consignee to sell the goods consigned to him for cash only, because if such goods are sold on credit by the consignee and if any amount becomes irrecoverable from the debtors the loss will fall upon the consignor. As the consignee acted as an agent only in effecting the sales, he does not become responsible for any debts. But sometimes an arrangement is made between the consignor and the consignee whereby the later guarantees payment and undertakes responsibility for bad debts. For this the consignee receives an additional commission known as "Del Credere Commission" on the total sales. When del-credere commission is given to the consignee, the consignee will make payment to the consignor, whether he himself receives the payment or not from the purchaser(s).

Over-riding Commission : This type of commission is allowed to the consignee in addition to the normal commission (as distinct from Del credere commission). The idea seems to be to provide addition incentive to the consignee for the purpose of creating market for new products.

Proforma Invoice :

When goods are despatched, the consignor makes out a 'Pro-Forma Invoice' giving indication of the price of the goods at which the consignee ought to sell the goods. Pro-Forma Invoice is a statement which is similar to that of an invoice, but it is called proforma because it does not make the consignee responsible to pay the amount named therein.

The consignor generally mentions a higher price than his cost so that consignee does not know the profit of the consignor.

Advance against Consignment :

Until the goods are sold by the consignee, he is not indebted to the consignor and is not expected to pay for them. This results in a part of the consignor's Capital being locked up for a period. To overcome his difficulty, the consignee often remits a sum of money in advance to the consignor. This may be done in the form of an acceptance of a Bill of Exchange drawn by the consignor on the Consignee or a simple bank draft. An advance is readily sent against consignment by the consignee to the consignor when the consignment goods have become popular in the consignee's place.

Account Sales :

Periodically, the consignee will send statements of sales and expenses incurred, commission earned and the consequent amount due to the consignor. Such a statement is made in a form known as "Account Sales". An Account Sales may be defined as a "statement prepared and sent by the consignee to the consignor at periodical travels, say three months or six moths detailing therein the goods payable and the net amount due from the consignee after deducting the advances, if any, paid already." The following is a specimen :—

Accounts Sales

Account Sales of 65 cases of Fancy goods ex. S.S. Vikram sold by Messers A. Dutt & Co., Colombo, Ceylon on account and risk of Messers Thankers & Co., Delhi, India.

Particulars	Amount Total	Rs. P.	Rs. P.
2002	35 Cases of fancy goods @ Rs.150 per case	5,250.00	
March 5.	30 Cases of fancy goods @ Rs.200 per case	6,000.00	
			11,250.00
Less Charges and Expenses :			
	Dock Dues 350.00		
	Custom Duty 250.00		
	Insurance 100.00		
	Storage 200.00		
	Commission at 10% 1,125.00		
			2,025.00
			9,225.00
	Less advance		5,000.00
	Balance of Bank draft enclosed		4,225.00

Signed

E. & O.E. ....

Colombo the 30th June; 2002 for messers A. Dutta & Co.

Accounting treatment

Entries in the Books of the Consignor

		Rs.	Rs.
1. ***On Despatch of Goods :***			
Consignment Outward A/c	Dr.	?	
or			
Consignments to such and such Person or Place A/c	Dr.		
To Goods sent on Consignment A/c			?
(With either the cost of the goods consigned or with the amount of the higher price charged Consignment.)			

Here Sales Account is not credited because sending goods on consignment does not mean actual sales. These goods are returnable by the Consignee if it cannot effect sale. Hence a new account "Goods sent on Consignment" is opened.

2. ***On Paying Expenses (by the Consignor) :***

Consignment Outward A/c Dr.

To Case (or bank) A/c

(For amount spent on carriage, freight, insurance, etc., at the time of despatching the goods.)

3. ***(On Receipt of an Advance from the Consignee :***

Case (or Bank or Bills Receivable) a/c Dr.

To Consignee's Personal A/c

(An advance of rs....received against consignment from the Consignee).

4. ***If the Advance is in the form of a Bill Receivable and the same is discounted by the Consignor*** :

Cash (or bank) A/c Dr.

*Discount A/c Dr.

To B/R A/c

(No further entry is made in the books of the Consignor till an Account Sales is received from the Consignee.)

5. ***On Receipt of Account Sales :***

(i) Consignee's Personal A/c Dr.

To Consignment Outward A/c

(With the gross proceeds of the Account sales.)

(ii) Consignment Outward A/c Dr.

To Consignee's Personal A/c

(With the expenses incurred by the Consignee plus commission payable to the Consignee as per Account Sales.)

6. ***On Receipt of Remittance from the Consignee :***

Cash (or Bank or Bills Receivable) A/c Dr.

To Consignee's Personal A/c

7. ***For unsold Stock (if any) with the Consignee***

Stock on Consignment A/c Dr.

To Consignment outward A/c

8. ***Entry for Profit & Loss :***

If all the goods dent have been sold, and the cosignment account to such and such person or place was debited with the cost price of the goods, the Consignment Outward Account will now reflect profit or loss. In case it results in a profit, the entry will be :

Consignment Outward A/c Dr.

To Profit and Loss A/c

(The profit earned on Consignment to such and such place transferred to Profit & Loss A/c.)

In case the consignment deal results in loss, the entry will be reverse, i.e.,

Profit & Loss A/c Dr.

To Consignment Outward A/c

(The loss of Consignment A/c transferred to Profit & Loss A/c.)

Adjustment of Proforma Invoice Price :

But if the goods were consigned at a price in excess of cost and the Consignment Outward Account was debited and Goods sent on Consignment A/c credited at the excess price, then an adjustment entry will have to be made, before ascertaining the profit or loss on Consignment. The adjustment entry will be :

Goods sent on Consignment A/c Dr.

To Consignment Outward A/c

(With the amount of excess price charged on Consignment A/c)*

Note:— The discount charge is financial expense and discount acount therefore is transferred to profit and loss account and not to consignment account.

Lastly, the "Goods sent on consignment A/c" will be transferred to the Purchase or Trading A/c. The journal entry will be ;

Goods sent on Consignment A/c Dr.
To Trading A/c

Unsold Stock of Consignment Goods : Its Valuation :

If a part of the goods sent to the Consignee has remained unsold, the unsold stock with the Consignee must be valued and brought into the books before profit or loss can be ascertained. This unsold stock is valued at cost price or market price, whichever is lower of the two. *The cost price here should not mean merely the cost at which the goods were invoiced but should include such proportionate expenses as normally increase the value of the goods consigned.* Such expenses are freight, custom duties, dock dues, insurance-in-transit, loading and unloading charges, etc. It does not matter whether these expenses are paid by the Consignor himself or by the Consignee. But the expenses incurred by the Consignee in effecting sales, such as advertisement, travellers commission, storage, insurance against fire or theft, are not included in determining the cost price of the unsold stock. In other words it can be said that all direct expense or all expenses made whether by the consignor or by the consignee in placing the goods in a saleable condition (all expenses till the goods reach the godown of the consignee) will be taken into account while valuing the closing stock.

Example : Suppose the Consignor sends to the Consignee, 1,00 units at Rs.25 per unit and pays costa duty, Rs.1,000; marine insurance, Rs.500. The Consignee pays, at the time of taking delivery, unloading charges of Rs.250. The Consignee also pays godown rent Rs.550 and advertisement Rs.250.

If 200 units (1/5th of the total goods) remain unsold. They will be valued as :—		Rs.P.
1/5th of 1000 units, i.e., 200 Radios @ Rs.25	.....	5,000.00
1/5th of Rs.500, Marine Insurance	.....	100.00
1/5th of Rs.250, unloading charges paid by the Consignee	.....	50.00
Total value of unsold Stock		5,350.00

The rule regarding valuation is cost or market price whichever is lower.

In the market price of the unsold stock is more than Rs.5,350, it will be valued at Rs.5,350. If however, the market price is less than Rs.5,350, it will be valued at the market price. *Any loss or depreciation of stock should be duly taken into account.*

The unsold stock valued in the above manner will now be brought into books by passing an entry, as

Stock on Consignment A/c Dr.
To Consignment Outward A/c ?

Note : If the proforma invoice was made out at a price higher than the cost, stock will also be valued at invoice and not at cost. But it is wrong to show unsold stock in Balance Sheet at a figure higher than the cost. Hence for the difference (i.e., difference between value of stock at invoice price and value of stock at cost) reserve must be created, Entry is :

Consignment Outward A/c Dr.
To Stock Reserve A/c ?

The Stock on Consignment will appear as an asset in Balance Sheet of the Consignor.

Entries in the Books of the Consignee :

As has already been pointed out, the Consignee receives the goods of the Consignor as an agent and sells them on behalf of the principal. These goods do not belong to him, so he is not to make any entry

Note:— This entry is the everse of the ntry paswsed at the time when goods ae sent on Consignment to the Consignee.

till he incurs expenditure on them and sells them at his place. But he must keep a detailed note of the receipt of these goods, otherwise they are mixed with his own goods.

The Entries are

1. *On Receipt of Goods :*

No Entry. Only a detailed note is maintained.

2. *Expenses of the Consignee :*

Consignor's Personal A/c Dr.

To Cash (or Bank) A/c

(Custom-duty, dock charges, unloading charges at the time of receiving the goods and later on, advertisement, godown rent, etc., paid)

3. *When (and if) an Advance is given :*

Consignor's Personal A/c Dr.

To Cash (r Bank or Bills Payable) A/c

4. *When goods are sold :*

(i) For Cash .... (i) Cash (or bank) A/c..... Dr.

Consignor's Personal A/c

(ii) On Credit .... (ii) Debtors A/c .... Dr.

To Consignor's Personal A/c

(iii) If Purchased by the.... (iii) Purchase A/c..... Dr.

Consignee himself To Consignor's Personal A/c

5. *For Commission Earned :*

Consignor's Personal A/c....... Dr.

To Commission A/c.

6. *On Settling the account of the Consignor :*

Consignor's Personal A/c .... Dr.

To Cash (or Bank or B/P) A/c

Det Credere Commission :

Sometimes the consignor allows a special commission to the consignee, called the Del Credere Commission, by which the loss arising on bad debts on credit sales is borne by the Consignee. Thus if the Consignee is paid Del Credere Commission and if any amount due from Debtors (to whom Consignment goods have been sold on credit) becomes irrecoverable, the bad debts will be Consignee's loss. The entry then will be :

Commission A/c........ Dr.

To Bad Debts A/c

The Balance of Commission earned will then be transferred to the Profit and Loss Account.

Thus :

Commission A/c....... Dr.

To Profit and Loss A/c*

(Specimen of) Consignment Account

	Amount Rs.		Amount Rs.
To Consignment stock (opening balance if any)		By Consignee's Personal Account (amount of gross proceeds (sales) realised by the Consignee)	
To Goods Sent on Consignment		By Goods Sent on Consignment (Difference in cost of goods sent and the proforma Invoice price)	
To Cash/bank (Expenses incurred by the consignor)		By Abnormal loss (Whether insured or not)	
To Consignee's Personal Account (Expenses paid by the Consignee– total amount) (Commission, including del-credere payable to the consignee)		By Goods sent on Consignment (Returned by the Consignee) By Stock Reserve (Difference between the cost and pro forma invoice price on the opening balance of consignment	
To Stock Reserve (Difference in the value of closing stock marked at Pro stock) forma invoice or loaded price)		By General Profit and Loss Account* (For consignment loss)	
To Goods Sent On Consignment (Difference between cost price and Proforma invoice price on the goods returned by the consignee)			
To General Profit and Loss Account (For Consignment profit)			
*Either of the two.			

Illustration-1

D. Dogra of Delhi sent to his agent, M. Monga of Madras, 500 articles costing Rs.15/- per article at an invoice price of Rs.20 per article. The following payments were made by D. Dogra in this connection: freight and carriage Rs. 450, miscellaneous exp. Rs. 50. M. Monga sent a bank draft for Rs.3,000 as an advance against the Consignment M. Monga sold 300 articles at a flat rate of Rs.28 per article and sent an Account Sales showing deduction for storage charges Rs.550 insurance Rs.550 and his Commission of 3% plus 2% Del Credere on gross sale proceeds, and remitted the amount due on consignment. M. Monga also informed D. Dogra that 50 articles were damaged in transit and thus they were valued at Rs.550

Record the above transactions in the books of the consignor and consignee.

Solution : (Entries made on Cost Price Basis)

Books of D. Dogra (Consignor)
Journal

		Dr.	Cr.
		Rs.	Rs.
(1)	Consignment to madras A/c To Goods sent on Consignment A/c (500 articles sent to M. Monga, Agent, Cost being Rs.15 per article).	7,500	7,500
(2)	Consignment to Madras A/c To Bank Account (Expenses incurred on the Consignment) Freight & Carriage Rs. 450 Miscellaneous Exp. Rs. 50 500	500	500
(3)	Bank Account To M. Monga (Advance received from the Agent in the form of Bank Draft.)	3,000	3,000
(4)	M. Monga To Consignment to Madras A/c (Sales affected by M. Monga as per Account Sales.)	8,400	8,400
(5)	Consignment to Madras A/c Dr. To M. Monga (Expenses incurred by M. Monga Rs.150 and Commission due to him, Rs.550 (5% of Rs.8,400).	570	570
(6)	Bank Account Dr. To M. Monga (Amount due from the consignee received.)	4,830	4,830
(7)	P & Loss A/c Dr. To Consignment to Madras A/c (Abnormal Loss on 50 damaged Articles)	350	350
(8)	Stock on Consignment A/c Dr. To Consignment to Madras A/c (Value of stock unsold at Madras) Rs. 150, goods articles, @ Rs.20 2,250 Add: Expenses Rs.150 150 50 damaged articles 450 2,850	2,850	2,850

(9)	Consignment to Madras A/c To Profit & Loss Account (Profit on consignment transferred to Profit & Loss Account)	Dr.	3030	3030
(10)	Goods sent on Consignment A/c To Trading Account (Goods sent on consignment A/c closed by transfer to trading Account)	Dr.	7,500	7,500

Note—(Figures in brackets denote sequence of entries

Ledger

Consignment to Madras Account

Dr. **Cr.**

		Rs.		Rs.
To Goods sent on Consignment A/c		7,500	By M. Monga	
To bank A/c (expenses)		500	(Sale proceeds)	8,400
To M. Monga				
Expenses	150		By Stock on	
Commission	430		Consignment A/c	2,850
		570		
To P & L A/c (Transfer)		3,030	By Profit & Loss A/c	
			(Abnormal Loss)	350
		11,600		11,600

M. Monga

	Rs.		Rs.
To Consignment to madras A/c	8,400	By Bank A/c	3,000
		By Cosignment to Madras A/c	570
		By Bank A/c	4,830
	8,400		8,400

Bank Account

Dr. **Cr.**

	Rs.		Rs.
To M. Monga	3,000	By Consignment to Madras A/c	500

Goods sent on Consignment Account

	Rs.		Rs.
To Trading A/c Transfer	7,500	By Consignment to Madras A/c	7,500

Profit & Loss A/c

	Rs.		Rs.
To Consignment to Madras A/c	350	By Consignment to Madras A/c	3,030

Books of M. Monga (Consignee)

Journal

	Dr.	Cr.
	Rs.	Rs.
D. Dogra	3,000	
To Bank Account		3,000
(Advance sent to the Consignor against consignment)		
D. Dogra	150	
To Bank Account		150
(Expenses incurred on the Consignment on behalf of D. Dogra		
Storage 50		
Insurance 100		
150		
Bank Account	8,400	
To D. Dogra		8,400
(Sale of 300 articles @ Rs.28 each out of the Consignment.)		
D.Dogra	420	
To Commission Account		420
(5% Commission on Sales made on half of D. Dogra; 3% Commission + 2% Del Credere Com.)		
D. Dogra	4,830	
To Bank Account		4,830
(Amount due to D. Dogra remitted).		

Ledger

D.Dogra

Dr. Cr.

	Rs.		Rs.
To Bank A/c (Advance)	3,000	By Bank A/c (Sale proceeds)	8,400
To Bank A/c (Expenses)	150		
To Commission A/c	420		
To Bank A/c (amount remitted)	4,830		
	8,400		8,400

Bank Account

	Rs.		Rs.
To D. Dogra	8,400	By D. Dogra	3,000
		By D. Dogra	150
		By. D. Dogra	4,830

Commission Account

		By D. Dogra	420

Entries made on Invoice Price basis. If it is desired to make entries on the basis of invoice price, the following will be the changes as compared to the solution given above :

Instead of entry No. 1 there will be the following entry ;

		Rs.	Rs.
1.	Consignment to Madras A/c To Goods sent on consignment A/c (500, articles consigned at an invoice price of Rs.20 each (cost Rs.15)	10,000	10,000
	Entries No.(2) to (6) will remain unchanged. The following will be other entries—No.(7) onwards :		
		Rs.	Rs.
7.	Stock on Consignment A/c To Consignment to Madras A/c Value of Stock at Madras Rs. 150 goods articles @ Rs.20 3,000 proportionate expenses 150 50 damaged articles 450 3,600	3,600	3,600
8.	Goods sent on Consignment a/c To Consignment to Madras A/c (Excess amount included in invoice price of articles sent to Madras (Rs.5 each) credited on consignment A/c)	2,500	2,500
9.	Consignment to Madras A/c To Stock Reserve Account (Reserve credited equal to excess amount above cost (Rs.5 per articles) included in valuation of stock)	750	750
10.	Consignment to Madras A/c To Profit and Loss Account (Transfer of Profit on Consignment)	3030	3030
11.	Goods sent on Consignment A/c To Trading Account (Goods sent on Consignment A/c closed by transfer to Trading A/c)	7,500	7,500

The Ledger Accounts relating to M. Monga, bank and Profit and Loss will be same as shown already. The other accounts will now appear as under :—

Dr. Consignment to Madras Account Cr

	Rs.		**Rs.**
To Goods sent on Consignment A/c	10,000	By M. Monga	8,400
To Bank A/c (expenses)	500	by Stock on Consignment	
To M. Monga	570	Account	3,600
To Stock Reserve A/c	750	By Goods sent on Consignment	
To Profit and Loss A/c	3,030	A/c (Loading)	2,2500
		By Profit & Loss A/c	
		(Abnormal Loss)	350
	14,850		14,850

Dr. Goods sent on Consignment Account Cr.

	Rs.	Rs.	
To Consignment to Madras A/c	2,500	By Consignment to	
		Madras A/c	10,000
To Trading A/c	7,500		
	10,000		10,000

Dr. Stock on Consignment Account Cr.

	Rs.		
To Consignment to Madras a/c	3,600		

Dr. Stock on Consignment Account Cr.

			Rs.
		By Consignment to Madras Account	750

In the Balance Sheet the stock on consignment will be shown at Rs.2,850 i.e., Rs.3,000 minus the reserve of Rs.750.

Abnormal Loss. In the illustration, it has been mentioned that 50 articles have been damaged and have been valued at Rs.450 Had there been no damage, the value (at cost) would have been Rs.800.

Cost @ Rs.15	Rs.750
Proportionate Expenses	Rs.50
	Rs.800

Thus, there is a loss of Rs.350, i.e., Rs.800 less Rs.450 In the absence of such loss, the profit on consignment would have been Rs.2,680 + Rs.350, i.e., Rs.3,030 This is a better measure of the profit on consignment. To ensure that the Consignment Account shows true consignment profit, such a loss would be recorded by means of the following entry ;

Profit and Loss Account	Dr.	350	
To Consignment Account			350

This entry will no doubt increase the profit shown y the consignment account ut will not inflate profits because the amount concerned is being debited in the Profit and Loss Account.

Loss of Stock

In case the goods sent on consignment are lost or damaged in transit or otherwise, the loss is that of the consignor and not of the consignee. Accordingly the consignor will have to make the entries for such loss. There may be two types of losses viz. *Normal loss and Abnormal loss.*

Normal Loss:—Normal loss is natural, unavoidable and inherent in the nature of goods or commodities or articles sent on consignment. This type of loss is a part of the cost of the consignment, so the consignor does not make separate entry for such a loss. However, the normal loss has to be taken into consideration while valuaing the unsold consignment stock in the hand of the consigne.

The accounting treatment of normal loss is to charge the total cost of the goods to the remaining goods after the normal loss. In other words, the value of the unsold stock is calculated in proportion to the total cost of the goods consigned.

$$\text{Value of unsold stock} = \frac{\text{Total Cost of the goods sent}}{\text{Total quantity sent} - \text{quantity of normal loss}} \times \text{unsold quantity}$$

Suppose 10,000 tones of coal are despatched. The cost of 1 tonne of coal is Rs.80 and the freight incurred is Rs.36,000. To the Consignor the total cost comes to rs.8,35,000. In the nature of coal some shortage is unavoidable. Suppose the Consignee receives only 9,500 tonnes. It is legitimate to say that the cost is Rs.8,36,000 for 9,500 tonnes.

In that case the Consignor can properly say that the cost of 1 tonne of coal is $\frac{\text{Rs.8,36,000}}{9{,}500}$ or Rs.88. If 2,000 tonnes of coal are left unsold with the Consignee, the value of stock will e 2,000 × 88 i.e. Rs.1,76,000.

Illustration 2 :

Mr. Datta Consigned to hatt 10,000 kgs of flour, costing Rs.33,000. He spent Rs.550 as forwarding charges. 12% of the Consignment was lost in weighning and handling. Mr. Bhatta sold 8,200 kgs. of flour at Rs.6 per kg, his selling expenses being Rs.3,300 and Commission 5% on sales. Prepare the Consignment Account.

Solution :

Ledger of Mrs. Datta

Consignment Account

		Rs.		Rs.
To Goods sent on Consignment Account		3,3000	By Bhatt (Sales) (8,200×6)	49,200
To Bank (forwarding Charges)		880	By Stock on	
To Consignee's A/c			Consignment*	2,310
	Rs.			
Selling Expenses	3,300			
Commission				
@5% on Rs.49,200	2,460	5,760		
To Profit & Loss Account		11,870		
		51,510		51,510

Working Notes :

(i) Calculation of Closing Stock :

Total Quantity of Flour Consigned		10,000 kgs.
Less : Normal Loss 12%	1,200 kgs.	
Sales	8,200 kgs.	
		9,400 kgs.
Closing Stock		600 kgs.

*(ii) Valuation of Closing Stock:

$$\frac{\text{Total Cost of the goods sent + The non recurring expensses}}{\text{Units of Goods sent − Normal losses (units)}} \times \text{Closing Stock (units)}$$

$$= \frac{\text{Rs. }33{,}000 + \text{Rs. }880}{10{,}000 - 1{,}200} \times 600$$

$$= \frac{33{,}880}{8{,}800} \times 600 = 2{,}310$$

Abnormal loss:- It arises due to abnormal factors or circumstances such as fire, theft Pilferage, sabotage etc. In case of abnormal loss the price is not inflated at all. This loss is calculated y adding proportionate direct expenses incurred by the consignor and the consignee as the case may be to the original cost of the goods.

The accounting Entry is :

Debit Abnormal Loss A/c

Credit Consignment A/c

In case the stock is insured, the amount of claim admitted by the insurance company should be reduced from the Abnormal loss and only the net loss amount should be debited to Abnormal loss or P&L A/c.

The entry will be :

Debit : Insurance Company A/c (with the amount of claim admitted)

Debit : Profit and Loss (Abnormal Loss A/c) (with the amount of loss)

Credit: Consignment A/c (with the amount of Total Abnormal loss)

The procedure for calculating the Abnormal loss and the valuation of the remaining stock is summarised as under :

(i) Calculation of Abnormal loss :

Add	Cost of goods Lost
	Proportionate Expenses of the goods lost
Less	any amount of claim
	(if any received from the insurance company)

(ii) Valuation of Closing Stock

(1) *Cost of the* goods – $\frac{\text{Closing Stock}}{\text{Total goods consigned}} \times$ Cost of total goods consigned

Add. Proportionate Non-recurring (direct) expenses incurred before the loss –

$$\frac{\text{closing stock}}{\text{Total goods consigned}} \times \text{Expenses incurred before the loss}$$

Add: Proportionate expenses (Direct only)

incurred after the loss : $\frac{\text{quantity unsoid}}{(\text{Total quantity sent} - \text{goods Lost})} \times$ Expenses incurred after the loss.

Illustration 3 :

Philips Radio of Calcutta despatched 1,000 transistors at Rs.700 each to Mohan Bros. of Delhi, the consignors paid freight Rs.7,500, cartage Rs.500 and insurance Rs.2,500 Mohan Bros. received only 900 sets and incurred he following expenses.

	Rs.
Octroi and other Expenses	1,00,000
Cartage	5,000
Sales expenses	6,000

The consignee sold 600 sets only. You are required to calculate the value of closing stock.

Solution :

Calculation of the value of unsold stock

Sets received 900-sets sold 600 = unsold stock 300

					Rs.
(i)	Cost of unsold stock		300 × 700	=	2,10,000
(ii)	Add: Proportionate Expenses Paid by consignor				
			$(7500 + 500 + 2500)\frac{3}{10} \times 10{,}500$	=	3,150
(iii)	Add: Proportionate Expense	Octroi	1,00,000		
	paid by consignee	Cartage	5,000		
			$\frac{1,05,000}{900} \times 300$	=	35,000
					2,48,150

Illustration 4 :

S of Bombay consigned 10,000 kg. of oil to D of Calcutta. The cost of oil was Rs.2 per kg. S paid Rs.5,000 as freight and insurance. During transit 250 kg were accidentally destroyed for which the insurers paid directly to the consignors Rs.450 if full settlement of the claim.

D reported that 7,500 kg were sold @ Rs.3 per kg. The expenses being on godown rent Rs. 200 on advertisement Rs.1,000 and on salesman salary Rs.2,000 D. is entitled to a commission of 3% plus 1.5% del credere. D reported a loss of 100 kg. due to leakage. D. settled the accounts by bank draft. Prepare the accounts is the books of S.

Consignment to Calcutta A/c

Dr.	Rs.		Cr. Rs.
To Goods on Consignment A/c	20,000	By Bank (Ins. Co.)	450
To Bank—Freight & Insurance	5,000	By P & L A/c (abnormal loss	175
To D—Expenses	3,200	By D—(Sale proceeds)	22,500
To D—Commission		By Consignment Stock A/c	5,431
Rs.		By P & L A/c—Loss	657
Ordinary 3% 675			
Del Credere 1.5% 338	1,013		
	29,213		29,213

Goods Sent on Consignment A/c

Dr.	Rs.		Dr. Rs.
To Trading A/c	20,000	By Consignment to Calcutta A/c	20,000

Consignment Stock A/c

Dr.	Rs.		Dr. Rs.
To Consignment Calcutta A/c	5,431	By Balance c/d	5,431

D

Dr.	Rs.		Dr. Rs.
To Consignment to Calcutta A/c —(sale proceeds)	22,500	By Consignment to Calcutta A/c (Exp.)	3,200
		By Consignment to Calcutta A/c (commission)	1,013
		By Bank	18,287
	22,500		22,500

Working Notes :

(A) *Cost of Goods destroyed*	Rs.
Cost of 10,000 kg.@Rs.2	20,000
Freight	5,000
Total cost of 10,000 kg.	25,000

(B) *Value of Stock still unsold Kg.*

Quantity received by D	=	9,750 (excluding accidental loss)
Less Normal leakage	=	100
		9,650

Cost of 9,650 kg = Rs.25,000-625 = Rs.24,375

Cost of 2,150 kg. = $\frac{100}{125} \times 2150$ = Rs.5,431

Illustration 5 (Valuation of Stock):

A company sends 300 bales of cotton to its consignee at profit 20% on sale. The cost of each bale to company is Rs.600 per bale. The following are the expenses incurred in connection with this consignment :

(a) Rs.900 paid by the consignor for despatching goods.

(b) Rs.2,000 paid by the consignee by way of freight, duty and landing charges.

(c) Rs.1,000 paid by the consignee by way of godown rent, salaries of salesman.

Required :

The Valuation of stock at the end (at invoice price) if the consignee sells away 2/3rd of the consignment.

Solution :

Total bales sent	300	
Less bales sold 2/3rd or 300	200	
Bales unsold	100	
Cost price of 100 ales at Rs.550 per bale		60,000
Add Profit at 20% on sale or 25% on cost		15,000
Add 1/3rd direct expenses :		75,000
Expenses paid by Consignor	900	
Expenses paid by Consignor	2,000	
1/3rd thereof	2,900	967
Stock at the end **(at Invoice Price)**		75,967

Note : In the consignment account, stock reserve account will appear at Rs.15,000 on the debit side.

Illustration 6 (Calculation of Stock at the end) :

Deepak sold goods on behalf of Geep Sales Corporation on consignment basis. On 1 January 2002 he had with him a stock of Rs.20,000 on consignment. During the year he received goods worth Rs.2,00,000.

Deepak had instructions to sell goods at cost plus 25% and was entitled to a commission of 4% on sales in addition to 1% del credere commission.

During the year ended 31 December 2002 cash sales were Rs.1,20,000; credit sales Rs.1,05,000; Deepak's expenses relating to consignment Rs.3,000 being salaries and insurance bad debts amounted to Rs.3,000.

Prepare necessary accounts in the books of Geep Sales Corporation.

Solution :

In the books of Geep Sales Corporation

Consignment Account

Dr.			Cr.
	Rs.		Rs.
To Consignment Stock b/d	20,000	By Deepak	
To Goods sent on Consignment Account	2,00,000	Cash Sales 1,20,000	
To Deepak (Commission)	9,000	Credit Sales 1,05,000	2,25,000
To Deepak (Commission)	2,250	By Consignment Stock c/d	40,000
To Deepak (expenses)	3,000		
To Profit & Loss Account			
Profit)	30,750		
	2,65,000		2,65,000

Deepak's Account

Dr.			Cr.
	Rs.		Rs.
To Consignment account (Sales)	2,25,000	By Consignment account	
		(Commission)	9,000
		By Consignment Account	
		(Commission)	2,250
		By Consignment Account	
		(Exp.)	3,000
		By Balance c/d	2,10,750
	2,25,000		2,25,000

Working Notes :

(1) Calculation of Consignment Stock

Sale Price = 100 + 25 = 125

$$\text{Cost of Sales} = \text{Sales} \times \frac{100}{125} = 2,25,000 \times \frac{100}{125} = \text{Rs.}1,80,000$$

Cost of the goods available for sale = Rs. 20,000 + Rs.2,00,000 = Rs.2,20,000

Hence stock at the end = Rs.2,20,000 - Rs.1,80,000 = Rs.40,000

(2) Since Deepak is paid del-credere commission, bad debts of Rs.3,000 would be borne by him.

Illustration 7 :

Messrs. Sundar & Company consigned 1,000 tins of Ghee costing Rs.60 per tin to their agents, Bansal Stores, at Calcutta. The agents sold 400 tins at Rs.80 per tin for cash, 400 tins at Rs.82 per tin on credit and they took over the balance to their own stock at Rs.82 per tin. Messrs. Sundar & Company paid freight and carraige Rs.500 and miscellaneous expenses Rs.200. They drew on Bansal Stores at 3 Months for Rs.45,000, which was duly accepted by the later. The expenses incurred by the Bansal Stores were :

Carriage	Rs.50
Octroi	Rs.40
Storage	Rs.110
Miscellaneous	Rs.100

They were entitled to 5% commission and 2% del credere commission on total gross sale proceeds. They sent their account sales to their principal showing as a deduction there from their commission and the various expenses incurred by them a month later. All the debtors except one who owed Rs.200 paid cash and the bansal Stores remitted the amounts due on consignment.

Show the journal entries in the books of the consignor and the consignee's account and consignment account in the consignor's ledger. Show also the entries relating to consignment inwards and the consignor's personal accounts at it would appear in the consignee's ledger.

Journal Entries

(In the books of Consignor)

			Rs.	Rs.
(1)	Consignment Account	Dr.	60,000	
	To Goods sent on consignment account			60,000
	(being the goods sent on consignment)			
(2)	Consignment Account	Dr.	700	
	To Bank Account			700
	(being the expenses incurred by consignor on account of consignment)			
(3)	Consignmet Account	Dr.	300	
	To Bansal stores account			300
	(being the expenses incurred by consignee on account of consignment)			
(4)	Bansal store account	Dr.	81,200	
	To Consignment account			81,200
	(being the sale effected by the consignee)			
(5)	Consignment account	Dr.	5,684	
	To bansal stores account			5,684
	(being the commission on sales)			
(6)	Consignment account	Dr.	14,516	
	To Profit & Loss account			
	(being the profit on consignment transferred to profit ad loss account)			
(7)	Goods sent on consignment account	Dr.	60,000	
	To Purchase account			60,000
	(being the value of goods sent on consignment)			
(8)	Bills Receivable account	Dr.	45,000	
	To Bansal stores account			45,000
	(being the bill drawn on consignment)			

Ledger

Consignment of Calcutta Account

	Rs.		Rs.
To Goods sent on consignment account	60,000	By Bansal store :	
To Bank-Expenses	700	Cash sales	
To Bansal store account-Expenses	300	(400 × 80) = 32,000	32,000
To Bansal stores account—Commission	5,684	Credit sales	
		(400 × 82) = 32,800	32,800
		Balance of stock taken	
To profit & Loss A/c	14,516	(200 × 82)	16,400
	81,200		81,200

Illustration 8 (Abnormal Loss) :

On January 1, 2002, A of delhi sent on consignment to B of Bombay 200 packets of coffee costing Rs.80 each invoiced **pro forma** at Rs.100 each. The freight and other charges paid by A amounted to Rs.640. A sent the documents through Bank and drew upon B a bill for Rs.10,000 and discounted the same with the Bank for Rs.9,800. The bill was met on maturity.

On march 15, B sent Account sales (together with the amount due) showing that 150 packets had realised Rs.100 each and 25 packets Rs.110 each and 25 packets were shown as unsold stock. B incurred Rs.400 as expenses for the entire consignment. B is entitled to a commission of 6%.

On March 31 B informed A that 15 packets were damaged due to bad packing and it was estimated that the selling price of the damaged packets would be about Rs.20 per packet.

Both A and B close their books on March 31. Prepare ledger accounts in the books of A and B.

Solution :

Books of A, Delhi

Consignment of BOmbay Account

2002 Jan. 1	Rs.	2002 March 15	Rs.
To Goods sent on consignment	20,000	By B (sales)	17,750
To Bank (Expenses)	640	By Goods sent on consignment (loading)	4,000
To B. Exp.	400	March 31	
To B (Commission)	1,065	By Abnormal Loss (1)	648
To Stock Reserve Account	200	By Stock on Consignment (2)	1,032
To Profit and Loss Account	1,725	By Stock of damaged goods	600
	24, 030		24,030

B's Account

	Rs.		
2002 March 15	Rs.	2002 Jan. 1Rs.	
To Consignment Account Sales	17,750	By Bills Receivable	10,000
March 31		March 15	
To Balance c/d		By Consignment Account-Expenses	400
	500	By Consignment Account-Commission	1,065
		March 31	
		By Bank	6,785
	18,250		18,250
		April 1 By Balance b/d	500

Goods sent of Consignment Account

2002 March 31	Rs.	2002 Jan. 1	Rs.
To Consignment account Loading	4,000	By Consignment Account	20,000
To Purchase Account Transfer	16,000		
	20,000		20,000

Books of B

2202 Jan. 1	Rs.	2002 March 15	Rs.
To Bills Payable	10,000	By Bank	17,750
To bank-Expenses	400	By Balance c/d	500
March 15			
To Commission Account	1,065		
March 31			
To Bank	6,785		
	18,250		18,250
April 1 To Balance b/d	500		

Note:

(i)	**Stock at the end** (At Invoice Price)	Rs.
	10 Packets @ Rs.100 (Invoice Price)	1,000
	Add Proportionate expenses incurred by A i.e. 1/20th of Rs.640	32
		1,032
(ii)	**Abnormal Loss**	
	Cost of 15 packets damaged	1,200
Add	Proportionate expenses $\frac{640}{200}\times 15$	48
		1,248
Less	Value of 15 packets @ Rs.20 Per Packet	600
		648

(iii) Since 10 Packets are still in the stock-in-hand, advance to that extent has not been adjusted. Hence Rs.500 is carried forward i.e.

$$10{,}000 \times \frac{10}{200}$$

Illustration 9 (Normal and Abnormal Loss) :

Vegetables Oils Ltd., Pune, consigned 10,000 kg. of Ghee costing Rs.20 per Kg. to Ramesh and Company of Madras on 1st January 2002. Oils Ltd. paid Rs.50,000 as freight and insurance. 250 Kgs. of ghee were destroyed on 10-1-2002 in transit. The insurance claim was settled at Rs.4,500 and was paid directly to the consignors.

Ramesh and Co. took delivery of the consignment on 20th January 2002 and accepted a bill drawn upon them by Oils Ltd. for Rs 1,00,000 for 3 months. On 31st March 2002 Ramesh and co. reported as Follows.

(i) 7,500 Kg. were sold at Rs.30 per Kg.

(ii) Other expenses were : godown rent Rs.2,000; Wages Rs.20,000 Printing and Stationary including advertising Rs.10,000

(iii) 250 Kg. were lost due to leakage.

Ramesh and Co. are entitled to a commission of 4.5% on all the sales affected by them. They paid the amount due in respect of consignment on 31st March itself.

Show the consignment account, the account of Ramesh and Co. and loss-in-transit account in the books of consignor for the year ended 31st March 2002.

Solution :

Books of Oils Ltd., Pune.

Consignment to Madras Account

2002 Jan 1	Rs.	2002 Jan. 10	Rs.
To Goods sent on Consignment		By Loss-in-transit	6,250
Account	2,00,000	March 31	
To Bank-Expenses	50,000	By Ramesh and Co.—Sale	2,25,000
March 31		By Stock on Consignment A/c	51,316
To Ramesh and Co. Account		By Profit & Loss Account (Loss)	9,559
Expenses and Commission			
(2,000+20,000+10,000+10,125)	42,125		
	2,92,125		2,92,125

Loose-in-Transit Account

2002 Jan.10	Rs.	2002 March 31	Rs.
To Consignment Account	6,250	By Insurance Co.	4,500
		By Profit & Loss Account	1,750
	6,250		6,250

Ramesh and Co.

	Rs.		Rs.
2002 March 31		2002 Jan. 20	
To Consignment account	2,25,000	By Bill Receivable	1,00,000
To Balance c/d	20,000	March 1	
		By Consignment Account	
		Expenses and Commission	42,125
		By Bank	1,02,875
	2,45,000		2,45,000

Working Notes :

(1) **Cost of ghee destroyed in transit**

		Rs.
Cost of 10,000 Kg. of ghee @ Rs. 20		2,00,000
Freight and Insurance		50,000
Total cost of 10,000 Kg.		2,50,000
Cost of 250 Kg. $\frac{(2,50,000 \times 250)}{10,000}$		6,250
Cost of 9,750 k.g. of ghee		2,43,750

(2) **Value of stock at the end**

Quantity of ghee received by the consignee	9,750 Kg.	
Less : Quantity lost through leakage (Normal Loss)	250 Kg.	
Quantity Available for sale	9,500 Kg.	
Total Cost of 9,500 Kg.		2,43,750
Cost of 2,000 Kg. $\frac{2,43,750 \times 2,000}{9,500}$		51,316

(3) Since 2000 Kg. of ghee has not been sold.

Proportionate amount of advance is (100,000×1/5) is Rs.20,000 will not be adjusted.

Exercise :- Shah sends goods on consignment to Rao. The terms are that Rao will receive 10% commission on the invoice price (which is cost plus 25%) and 20% of any price realised above the invoice price. Rao will meet his expenses himself, goods to be sent freight paid.

Shah sent goods costing Rs.1,60,000 and septum Rs.15,000 on freight forwarding etc. Rao accepted a bill of exchange for Rs.1,60,000 immediately on receiving the consignment. His expenses were Rs.2,000 as rent and Rs.1,000 as insurance. Rao sold 3/4 of the goods for Rs.1,95,000. Half of the sales were on credit and one customer failed to pay Rs.4000.

Give consignment account and Rao's Account in the books of Shah and important ledger accounts in the books of Rao.

Lesson 2

JOINT VENTURES

Joint Venture What is it?

A Joint venture is a contract between two or more persons who agree to do a small piece of commercial undertaking jointly. It is a *temporary partnership*, without the use of a firm name limited or restricted to a particular venture in which the two or more persons agree to contribute a specific amount of capital and to share profits or losses either in equal proportions or in any other agreed proportion.

Nature of Joint Venture

A Joint venture may be in connection with a joint cosignment of goods, and under-writing* of shares or debentures of a new joint stock company, speculation in shares, the construction of a building jointly, the purchase and sale of a particular plot of land or any other similar temporary or seasonal business enterprise. Once the joint undertaking is complete and over; the joint venture or limited partnership ends and no liability will then attach to any party.

Advantages of a Joint Venture

Sometimes a party may be in a position to buy goods at a much lower cost and on far better terms than others. a second party may be in a position to sell the same at an exceptionally good price. Or, it may so happen that merchandise is bought cheap at one place by one party and when sent to another place it can be sold at a higher price by the second party. A third party may have financial resources but may not be in a position either to buy at lower price or to sell at higher price. A combination of all these parties in a common venture may result in a successful and remunerative business.

Consignment VS. Joint Venture

The points of difference between the two may be stated as under :—

Points of Difference	Consignment	Joint Venture
1. Relationship	The Consignor is principal-while the consignee is agent.	Relationship between Coventures is that of the Partners.
2. Nature of Business	Agent is not necessarily a partner, hence it is not a partnership.	It is a partnership (Though temporary) since Co-venturers are partners.
3. Powers	Consignee being an agent is simply a servant and has to obey the instructions of the Principal	Co-ventures enjoy full powers as to sale and purchase of goods and collections of dues etc.

*Underwritng means undertaking the responsibility that shares or debentures issued by company will be taken up by the public. If the public does not take them, the underwriters agree to take up the shares or debentures.

4. Scope	Consignment is concerned only with the sale of movable goods.	Joint Venture may be undertaken for any type of legal business e.g. construc-ction of roads, building etc. in addition to purchase and sale of goods.
5. Finance	Consignor (Principal) provides the funds.	Funds are provided by the Co-Ventures.
6. Profits and commission	The Consignee is entitled to receive only commission and reimbursement of his expenses. No share in the profits or liability for losses.	Profits (or losses) are shared by the Co-ventures in the predetermined ratios or equally in the absense of an agreement. Commission may or may not be granted to Co-ventures.
7. Number of Persons	There are normally two parties namely the principal and the agent.	The number of Co-venturers will be at least two though it may be more than two with equal status i.e. that each is a principal and agent at the same time like partners.

Record of Transactions

No Separate sets of Books :

It may be arranged that one of the parties will alone manage the joint venture, that is he alone will look after the buying and the selling on joint account. He may, for this service, be allowed certain commission by other parties to the joint venture. Under such a circumstance he will open a Joint Venture Account with such and such person'' in his books. The Joint venture account will be debited with the cost of goods and with expenses incurred by him, his cash account will be credited. If he is entitled to a commission, joint venture account will be debited and commission account will be credited. When he sells goods on joint account, joint venture account will be credited and cash or debtor's account will be debited. Each party may remit his proportion of cost, which will be placed to the credit of the party's account. This amount plus the share of profit will then be repaid to that party. The joint venture account will then be balanced. The balance of this account will represent either profit or loss which proportionately be credited or debited respectively to the other party's account. The amount due to other parties will then be remitted to them by the party recording account of joint venture dealings.

But it may so happen that each party to the joint venture might effect transactions independent of others. Under such a case each party would record in his own books the transaction that has entered into on joint account. That it has own book, each will open one, ''Joint Venture Account with such and such person.'' He will debit the joint venture account and credit cash for goods purchase and expenses incurred by him on joint venture. If he supplies goods from his own stock, he will debit joint venture account and credit goods or sales account. When the venture is complete each party will sent to the other details of the transactions effected by him and as they appear in the joint venture account in his own books. On receipt of such a statement the other party will make suitable entries indicated below.

The joint venture account in each party's books, will be debited with the cost of the goods purchased and expenses incurred by the other party or parties, the corresponding credit being given to the personal account of the other party or parties. Similarly, the other party's account will be debited with sale proceeds received by him, the corresponding credit being given to the joint venture account. The joint venture account will not be closed in each party's books the balance indicating either profit or loss which will be credited or debited proportionately to the other party's personal account and to his own profit and loss account (his share). The balance on the personal accounts of the other parties will then indicate their relative position with each other.

Where No Separate Set of Books is Maintained

(A) Recording in the Books of Each Party?

Under this method Co-Venture will prepare two accounts namely (i) Joint Venture Account and (ii) The Personal Account of other Co-Ventures.

Notes : (a) Joint Venture account, being a nominal account, is prepared to find out profit of loss of the Venture. Personal account(s) of the other Co-Venture's) is prepared to find out the amount due from or amount due to him.

(b) It must be made clear that each Co-Ventures has his own separate business and these transactions are in addition to what he records in respect of his independent business.

A summary of accounting entries in respect of joint venture transactions in the books of any co-venture is given below :—

(a) Transaction of the person recording the same.

1. Cash Contributed or Goods Purchased in Cash for Joint Venture :

Joint Venture Account Dr.
 To Cash/Bank Account

2. Goods Supplied from own stock for Joint Venture

Joint Venture Account Dr.
 To Purchase Account

Note : If the goods are supplied at a price other than cost price, then Sales Account will be credited.

3. For Paying Expenses

Joint Venture Account Dr.
 To Cash/Bank Account

4. For Sale of Goods for Cash

Cash Account Dr.
 To Joint Venture Account

5. For Sale on Credit

Debtor's Account Dr.
 To Joint Venture Account

6. Cash received from Debtors

Cash/Bank Account Dr.
 To Debtors Account

7. Discount allowed or bad debts

Joint Venture Account Dr.
 to Debtors account

8. Cash or Bills Receivable received from other Co-Venturer(s)

Cash/Bank/Bills receivable Account Dr.

To (Other) Co-Venture's Personal Account

9. Cash or Bills Payable given to Co-Venture

(Other) Co-Venture's Personal Account Dr.

To Cash/Bank/Bills Payable Account

10. Commission/Salary etc. Receivable

Joint Venture Account Dr.

To Commission/Salary etc. Account

11. Unsold Stock of Joint Venture taken into Stock

Purchase Account Dr.

To Joint Venture Account

(b) Transaction of the other Co-Venturer.

12. Cash Contributed or goods contributed or goods purchased for Cash or on Credit for Joint Venture.

Joint Venture Account Dr.

To (Other) Co-Venturer's Account

13. Any Expenses paid or discount allowed by him or any bad debts incurred by him for joint Venture.

Joint Venture Account Dr.

To (Other) Co-Venture's Account

14. Goods sold for cash or on Credit by other Co-Venturer(s).

(Other) Co-Venturer's Account Dr.

To Joint Venture Account

15. Commission or Salary payable to Co-Venturer

Joint Venture Account Dr.

To (Other) Co-Venturer's Account

16. Unsold Stock taken by Co-Venturer(s)

(Other) Co-Venturer's Account Dr.

To Joint Venture Account

17. Profit or Loss on Joint Venture

(c) (i) **For Profit**

Joint Venture Account Dr.

To Profit and Loss Account

(For the person recording the transaction)

To (Other) Co-Ventures Account

(For the share of other Co-Venturer)

(ii) **For Loss**

Profit And Loss Account Dr.

(For the share of self)

(Other) Co-Ventures Account Dr.

(For the share of other co-venturer)

To Joint Venture Account

(d) **Final Settlement of account**

(i) **For Cash or Bill Receivable received**

Cash or Bills Receivable Account Dr.

To (Other) Co-Venturers Account

(ii) **For Cash or Bills Payable Given**

(Other) Co-Venturers Account Dr.

To Cash or Bills Payable Account

Important :

(a) When any co-venturer receives cash from debtors for credit sales there is no entry in the books of other Co-Venturers(s).

(b) When one Co-Venturer allows cash discount to and/or incurs bad debts on debtors, the entry is :

Joint Venture Account Dr.

To (other) Co-Venturer's Account

(c) The procedure adopted for valuing the closing stock is similar to the valuation of consignment stock. Accounting treatment for unsold stock is :

(i) When Joint Venture account is only closed (though Joint Venture business is continuing), closing stock is credited to Joint Venture Account as By balance c/d.

(ii) When Joint Venture Account business is finally closed the unsold stock is taken over by co-venturer(s) at agreed value. But if the examination problem is silent as to its distribution by co-ventures at agreed values it should be distributed in the profit sharing ratio by debiting the purchase account and co-venturer's account and crediting the Joint Venture Account.

Example of a Joint Venture where no Separate Set of Bok's are Needed :

Illustration-1

A of Ahemdabad and B of Bombay enter into a joint venture to consign 100 bales of cotton to C of Ceylon to be sol by the latter on the joint risk of A and B, sharing in proportion of 3/5 and 2/5 respectively. A sends 60 bales at Rs.1,3000 each, paying freight and other charges amounting to Rs.900 B sends 40 bales at Rs.1,250 each and pays for freight and other charges Rs.800. All the bales are sold by the consignee for rs.1,50,000 out of which he deducts Rs.1,600 for his expenses and his commission at 3 per cent. He remits a bank draft for rs.70,000 to A and the balance to B in a separate draft.

Give the necessary ledger account to record these transaction in the books of A and B.

A's Ledger

Dr. Joint Venture account with B Cr.

	Rs.		Rs.
To Goods A/c	78,000	By cash (recd. from C)	70,000
To Cash (Exps.)	900	By B (recd. from C*)	73,900
To B (Goods)	50,000		
To B (Expenses)	800		
To B (Profit)	5,680		
To P & L A/c	8,520		
	1,43,900		1,43,900

*It is never called as B's Capital A/c since A and B are not partners.

Dr.	B's A/c		Cr.
	Rs.		Rs.
To Joint Venture A/c (Cash recd. from C)	73,900	By Joint Venture A/c —Goods	50,000
		By Joint Venture A/c—exps.	800
		By Joint Venture A/c—Profit	5,680
		By Balance c/d	17,420
	73,900		73,900
To Balance b/d	17,420		

		Rs.
Total Sales By C =		1,50,000
Less=his expenses	1,600	
Less-his commission 3% of 1,50,000	4,500	
		6,100
Balance		1,43,900
Less amount sent to A		70,000
*Amount received by B		73,900

B's Ledger

Dr.	Joint Venture Account with A		Cr.
	Rs.		Rs.
To Goods A/c	50,000	By Cash (received from C)	73,900
To Cash (Exps.)	800	By A (received from C)	70,000
To A (Goods)	78,000		
To A (Expenses)	900		
To A (Profit)	8,520		
To P & L A/c	5,680		
	1,43,900		1,43,900

Dr.	A		Cr.
To Joint Venture A/c (From C)	70,000	By Joint Venture A/c—Goods	78,000
To Balance c/d	17,420	By Joint Venture A/c—Exps.	900
		By Joint Venture A/c—Profit	8,520
	87,420		87,420

Alternative Method :

On receipt of details of transactions effected by other parties, each party may prepare, in his books, a "Memorandum Joint Venture Account (Memorandum Joint Venture is similar to Joint venture A/c) by combining all this information received from other parties. The memorandum joint venture account is prepared only to find out the profit or loss made. It is not a part of accounts. As part of accounts, only the account of the other party under the style, say, Joint Venture with "B" A/c" is opened. This account is debited with expenditure incurred venture this account is credited. The share of profit (as ascertained by the memorandum joint venture account) is debited to this account and credited to Profit and Loss A/c. This account will then show the amount due to or by the other party and will be closed by remittance from one to the other party.

The above illustration is now worked out according to this method.

A's Ledger

Joint Venture with 'B' Account

Dr.			Cr.
	Rs.		Rs.
To Goods A/c	78,000	By Cash	70,000
To Cash (Exps.)	900	By Balance c/d	17,420
To Profit & Loss A/c	8,520		
	87,420		87,420
To balance b/d	17,420		

B's Ledger

Joint Venture with 'A' Account

Dr.			Cr.
	Rs.		Rs.
To Goods A/c	50,000	By Cash	73,900
To Cash	800		
To Profit & Loss A/c	5,680		
To Balance c/d	17,420		
	73,900		73,900
		By balance b/d	17,420

Memorandum Joint Venture A/c

	Rs.		Rs.
To A (goods)	78,000	By A Cash	70,000
To A (Exp)	900	By B Cash	73,900
To B (goods)	50,000		
To B Exp.	800		
To Profit A	8520		
B	5680		
	1,43,900		1,43,900

*It is never called as B's Capital A/c since A and B are not partners.

Illustration-2

A of delhi and B of Bangalore entered into a Joint Venture for purchases and sales of one lot of Mopeds. The cost of each Moped was Rs.3,000 and the fixed retail selling price Rs.3,000 The following were the recorded transactions :

2002

Jan. 1

A Purchase 100 Mopeds paying Rs.72,000 in cash on account.

A raised a loan from Canara Bank for Rs.50,000@ 18% p.a. interest, repayable with interest on 1.3.2002.

A forwarded 80 Mopeds to B incurring Rs.2,880 as forwarding and insurance charges.

Jan.7

B received the consignment and paid Rs.720 as clearing charges.

Feb.1

A sold 5 Mopeds for Cash

B sold 20 Mopeds for Cash

B raised a loan of Rs.1,50,000 from Union Bank repayable with interest at 18% p.a. on 1.3.2002.

B telegraphically transferred Rs.1,50,000 to A incurring charges of Rs.50 A paid balance due for the Mopeds.

Feb. 26

A sold the balance Mopeds for Cash

B sold the balance Mopeds for Cash

A paid selling expenses Rs.5,000

B paid selling expenses Rs.20,000

March. 1

Accounts settled between the venturers and loans repaid. Profit being appropriated equally.

You are required to show :

(1) The Memorandum Joint Venture Account.

(2) Joint Venture with B Account in A's Books.

(3) Joint Venture with A Account in B's Books.

You are to assume that each venturer recorded only such transactions concluded by him.

Solution :

Memorandum Joint Venture Account

For the period between Jan 1 to March 2002

To **A**	Rs.	By Sales	Rs.
Cost of Mopeds	3,60,000	A (20 × 4,500)	90,000
Forwarding and Insurance	2,880	B (80 × 4, 500)	3,60,000
Interest on Bank Loan	1,500		
Selling Expenses	5,000		

To **B**			
Clearing Charges	720		
Interest on Bank Loan	2,250		
Sundry Expenses			
(Telegraphic transfer Charges)	50		
Selling Expenses	20,000		
To Net **Profit**			
A 28,800			
B 28,800	57,600		
	4,50,000		4,50,000

Books of 'A'

Joint Venture with B Account

To Bank (Part payment of Cost)	72,000	By Bank (Sale proceeds)	22,500
To Bank (Forwarding Charges)	2,880	By Bank (Remittance from B)	1,50,000
To Bank (Balance cost of purc-		By Bank (Sale proceeds)	67,500
hase)	2,88,000	By Bank (Cash recovered	1,58,180
To Bank (Selling expenses)	5,000	in settlement)	
To Bank (Interest on Bank Loan)	1,500		
To Profit and Loss A/c			
(Share of profit)	28,800		
	3,98,180		3,98,180

Books of 'A'

Joint Venture with A Account

To Bank (Clearing Charges)	720	By Bank (Sale	
To Bank (Remittance plus telegraphics		proceeds 20 Mopeds)	90,000
transfer charges)	1,50,050	By bank (Sale proceeds of	2,70,000
To bank (Selling expenses)	20,000	60 Mopeds)	
To Bank (Interest on Bank Loan)	2,250		
To Profit and Loss Account			
(Share of profit)	28,800		
To Bank (payment in settlement)	1,58,180		
	3,60,000		3,60,000

Separate Books for Joint venture :

A complete set of separate books is opened to record the joint venture transactions when buying and selling on account of joint venture is managed by one of the parties and all the transactions are recorded at the place of business. In this case the recorded of transactions does not differ in any way from ordinary partnership transactions. The parties to the joint venture usually contribute their share of money to carry out the joint venture dealings. This money is put in a joint banking account. The parties' personal accounts are credited and the joint banking account debited. The joint venture account will be debited with the cost of goods purchased, and expenses incurred and for this the joint banking A/c will be credited. Joint banking account is debited. The joint venture account will be debited with the cost of goods purchased, and expenses with the sale proceeds and the joint venture A/c will be credited. Finally, if any stock remains unsold, it may be taken over by one of the parties. The party's A/c will then be debited and the joint venture A/c will be credited with the agreed value. The joint venture A/c will then be balanced and the profit or loss will be transferred to the parties' personal accounts. The amount due to each will be paid out from the joint bank A/c and thus the books of account will be closed.

"Summary of Journal Entries"

(1) **Amount contributed or invested by the Co-Venturers.**

Joint Bank Account Dr.

To Co-Venturer's Capital Accounts (Individual)

(2) **Goods or any other item contributed by a co-venturer or expenses paid by him.**

Joint Venture Account Dr.

To Co-Venturer's Capital Account

(3) **For purchase of goods for cash.**

Joint Venture Account Dr.

To Joint Bank Account

(4) **For purchase of goods on Credit.**

Joint Venture Account Dr.

To Creditor's (Suppliers) Accounts

(5) **For expenses on Joint Venture.**

Joint Venture Account Dr.

To Joint Bank Account

(6) **For good sold (Cash).**

Joint Bank Account Dr.

To Joint Venture Account

(7) **Sale on Credit**

Debtor's (Consumers) Account Dr.

To Joint Venture Account

(8) **Payment to creditors in cash or issue Bills payable.**

Creditors Account Dr.

To Joint Bank Account

To Bills Payable Account

(9) **Cash or Bills Receivable received from debtors.**

Joint bank Account Dr.

Bills Receivable account Dr.

To Debtor's Account

(10) **Any Commission, salary, interest etc. payable to any Co-Venturer.**

Joint Venture Account Dr.

To Co-Venturer's Account

(11) **Part of the stock taken by Co-Venturer**

Co-Venturer's Account Dr.

To Joint venture Account

(12) **For profit on joint venture.**

Joint Venture Account Dr.

To Co-Venturer's Account

(13) **For loss on joint venture.**

Co-Venturer's Account Dr.

To Joint venture Account

(14) **Settlement of the account of each party.**

Co-Venturer's Account Dr.

To Joint Bank Account

Note: Discount received should be Debited to Creditor's account and Credited to Joint Venture Account. Similarly discount allowed and bad debts should be Debited to Joint Venture Account and Credited to Debtor's Account.

Illustration-3 (Construction of a building)

A and B entered into a joint Venture to construct a building for a newly started **Tools India. Ltd**. The Contract price was fixed at Rs.20 Lakhs to be settled as follows :—

Rs.8 lakhs in cash

Rs. 2 lakhs in fully paid preference shares.

A joint bank account is opened in which A and B deposited Rs.2,50,000 and rs.1,50,000 respectively. The profit or loss is to be shared in the ratio of 2 : 1 after providing for interest on Capital at 10%.

The details of their transaction are :

Plant Purchased	2,00,000	
Wages Paid	1,00,000	
Material Purchased	7,00,000	
Material supplied by A from his own stock		50,000
Material supplied by B from his own stock		40,000
Architect's fees paid By A		20,000

The contract was completed and the price was received as stipulated. Half of the plant was taken over by A for Rs.80,000 and half was sold for Rs.1,10,000.

Joint Venture Account was closed by A taking up all the shares at an agreed valuation of Rs.1,60,000 and B taking up the stock of material at an agreed valuation of Rs.30,000 separate books were maintained for the Joint Venture. Give ledger accounts.

Solution

Joint Venture Account

To Joint Bank (Plant)	2,00,000	By Joint Bank Account	
To Joint Bank (Wages)	1,00,000	(Contract Price)	8,00,000
To Joint Bank (materials)	7,00,000	By Share Account	
To A (Stock)	50,000	(Contract Price)	2,00,000
To B (Stock)	40,000	By A (1/2 Plant takeover)	80,000
To A (Architect's fees)	20,000	By Joint Bank Account	
To A (Interest)	25,000	(1/2 Plant sold)	1,10,000
To B (Interest)	15,000	By B (Materials tekenover)	30,000
To Share's Account (Loss)	40,000		
To A (2/3 Share of profit)	20,000		
To B (1/3 Share of profit)	10,000		
	12,20,000		12,20,000

Joint Bank Account

To A's Account	2,50,000	By Joint Venture Account	
To B's Account	1,50,000	(Plant)	2,00,000
To Joint Venture Account		By Joint venture Account	
(Contract Price)	8,00,000	(Wages)	1,00,000
To Joint Venture Account		By Joint Venture Account (Materials)	7,00,000
(Sale of Plant)	1,10,000	By A (Refund of Capital)	1,25,000
		By B (Refund of Capital)	1,85,000
	13,10,000		13,10,000

A's Account

To Joint Venture		By Joint Bank (Capital)	2,50,000
(Plant taken over)	80,000	By Joint Venture (Stock)	50,000
To Shares	1,60,000	By Joint Venture (Architects's	
To Joint bank	1,25,000	fees)	20,000
		By Joint Venture (Interest)	25,000
		By Joint venture (Profit)	20,000
	3,65,000		3,65,000

B's Account

To Joint Venture (Material)	30,000	By Joint bank	1,50,000
To Joint bank	1,85,000	By Joint Venture (Stock)	40,000
		By Joint Venture (Interest)	15,000
		By Joint Venture (Profit)	10,000
	2,15,000		2,15,000

In the books of 'A'
Joint Venture Investment Account

To Cash (Capital)	2,50,000	By Bank Account	1,25,000
To Cash (Architect's fees)	20,000	By Shares	1,60,000
To Stock	50,000	By Plant taken over	80,000
To Interest	25,000		
To Profits	20,000		
	3,65,000		3,65,000

In the books of 'B'
Joint Venture Investment Account

To Cash	1,50,000	By Materials taken over	30,000
To Stock	40,000	By Bank	1,85,000
To Interest	15,000		
To Profits	10,000		
	2,15,000		2,15,000

Notes : (1) Joint Venture transactions are recorded in a separate set of books meant for Joint Venture and not in the books of either of the co-venturers.

(2) Though plant is an asset it is simply transferred to Joint Venture Account to be used for Joint Venture. The depreciation value of the plant is recorded on the credit side of the Joint Venture Account. However, in this illustration since half of the plant is taken over by Co-Venturer (A) and the other half is sold, the amounts are credited to Joint Venture account, and A's Account and Joint bank Account are debited respectively.

(3) Interest on Capital is calculated @ 10% for one year.

Construction of Building, Bridges, Roads etc.

Such works are usually undertaken for joint stock companies which become contractee. Price is usually received partly in cash and partly in the form of shares and debentures. The joint venturers have to sell these shares/debentures in order to determine the overall profits/loss of the Venture. The shares/ debentures may be either sold in the market or one or more co-venturers may take them at an agreed price. The additional entries, then are made as follows :

(1)	**For Contract price becoming due**	Contractee's (Company's) Account To Joint Venture Account	Dr.
(2)	**On receipt of contract price**	Joint Bank Account Shares Account To Contractee (Company)	Dr. (for cash) Dr. (for shares/debentures
(3)	**On Sale of shares/ debentures**	Joint Bank Account Co-Venturers Account To Shares/Debentures Account	Dr. Dr.
(4)	**For profit on sale of shares/debentures**	Shares/Debentures Account To Joint Venture Account	Dr.
(5)	**For Loss on sale of shares/debentures**	Joint Venture Account To shares/Debentures Account	Dr.

Illustration-4 (Construction of a Building)

A, B and C enter into a joint venture for supervision of the construction of a multistory building for a joint stock company for a contract price of Rs.1,00,000.

Incidental expenses might have to be paid by the Venturers but as per agreement they are entitled to be re-imbursed to the extent of actual such expenditure or Rs.5,000 whichever is less. In this way A spends Rs.4,000; B Rs.5,000 and C Rs.6,000. The Venturers are to share profits and losses equally but C being a technical person, is entitled to a special commission of 10% of the profit of the venture after charging such commission. They open a joint bank account to which A contributes Rs.20,000, B Rs.15,000 and C Rs.15,000. B also gives his own plant to the venture for which he charges Rs.8,000. Materials are purchased for Rs.20,000 and wages amount to Rs.30,000.

At the end of the Venture the company paid the agreed contract price (keeping Rs.10,000 as retention money) to the extent of Rs.30,000 in cash and the balance in equity shares of the company of Rs.10 at an agreed value of Rs.12 per share. The shares are subsequently sold in the market @ Rs. 13 per share. Unused materials costing Rs.2,000 are taken over by A at Rs.1,000. The plant is taken back by B at an agreed value of Rs.2,000 C takes up the retention money at Rs.7,000.

Show necessary ledger accounts in the books of the venturer.

Solution :

Joint Venture Account

		Rs.		Rs.
To A	4,000		By Joint Bank Account	30,000
B	5,000		By Shares Account	60,000
C	5,000	14,000	By Shares Account	
To B (Plant)		8,000	(Profit on sale)	5,000
To Joint Bank Account			By A (Unused materials)	1,000
Materials	20,000		By B (Plant	2,000
Wages	30,000	50,000	By C (Retention money)	7,000
To C (Commission)	3,000			
10% of Rs.	30,000			
1/11 of Rs.	33,000	3,000		
To Net Profit :				
A	10,000			
B	10,000			
C	10,000	30,000		
		1,05,000		1,05,000

A's Account

			Rs.
To Joint Venture		By Joint Venture	
(Unused materials)	1,000	(Incidental expenses)	4,000
To Joint Bank Account	33,000	By Joint Bank	20,000
		By Joint Venture—Profits	10,000
	34,000		34,000

B's Account

To Joint venture (Plant)	2,000	By Joint Venture	
To Joint Bank	36,000	(Incidental expenses)	5,000
		By Joint Bank Account	15,000
		By Joint Venture Plant	8,000
		By Joint Venture-Profit	10,000
	38,000		38,000

C's Account

To Joint Venture (Retention money)	7,000	By Joint Venture (Incidental expenses)	5,000
To Joint Bank Account	26,000	By Joint Venture (Commission)	3,000
		By Joint bank Account	15,000
		By Joint Venture-profits	10,000
	33,000		33,000

Joint Bank Account

To A	20,000	By Joint Venture		
To B	15,000	Materials	20,000	
To C	15,000	Wages	30,000	50,000
To Joint Venture (Contract Price)	30,000	By A	33,000	
To Shares Account (sale of shares)	65,000	By B	36,000	
		By C	26,000	95,000
	1,45,000			1,45,000

Illustration-5 (Development of land state)

A and B enter into a joint venture to purchase and develop certain lands as Industrial Estate. For that purpose, a Joint bank Account was opened wherein A deposited Rs.60,000 and B deposited Rs.40,000. A piece of land measuring 18,000 sq. meters was purchased at Rs.3 per sq. meter. The following expenses were paid from the Joint Bank Account :

	Rs.
Cost of earth filling to level land	14,000
Compensation paid to a human dweller for vacating possession	5,000
Municipal Taxes	2,000
Cost of barbed fire fence	3,000
Architect's fees for plans	1,000
Stamp duty and Solicitor's fees	6,000
General expenses	2,000
Income from sale of timber	2,000

It was decided to sell land in smaller plots of 500 sq. metres each. One sixth of the area was left over for public lands. 10 plots were sold at Rs.20 per sq. metre through the brokers who were paid 2% brokerage on the sale price of land.

A retained one plot for his personal use at an agreed price of Rs.3,000 The remaining plots were sold at a consolidated price of Rs.76,200 directly. A and B shared profits (or losses) of the Joint Ventures in the proportion of the amounts invested by them. All transactions have been effected through the bank.

Prepare joint venture account, joint bank account and accounts of A and B assuming that all accounts are settled.

Solution :

Total land purchased	18,000	sq. meters
Less: 1/6th left for public roads	3,000	sq. meters
land available for sale of 30 plots.	15,000	sq. meters
Each plot measures 500 sq. metres		

hence, there are $\frac{15,000}{500}$ = 30 plots.

(2) Sales

(a)	10 plots i.e. 10 × 500 sq. metres	
	= 5,000 sq. metres @ Rs.20 per sq. metre	
	= Rs. 60,000 less 2% of this as brokerage	
	= 60,000—1,200	58,800
(b)	One plot to A for Rs.	5,000
(c)	Remaining 19 plots sold for	76,200
		1,40,000

Joint Venture Account

		Rs.		Rs.
To Joint Bank :			To Joint Bank :	
Cost of land	54,000		Sale of timber	2,000
Cost of levelling	14,000		By Joint bank :	
Compensation	5,000		Sale of 10 plots	
Municipal taxes	2,000		less brokerage	58,800
Cost of fence	3,000		By Proceeds of 19 plots	76,200
Architect's fees	1,000		By A's Account-plot taken over	5,000
Stamp duty etc.	6,000			
General expenses	2,000	87,000		
To A's Account—(3/5 profit)		33,000		
To B's Account—(2/5 profit)		22,000		
		1,42,000		1,42,000

Joint Bank Account

	Rs.		Rs.
To A	60,000	By Joint Venture A/c	
To B	40,000	(cost of land and other	
To Joint Venture-sales	1,35,000	expenses)	87,000
To Joint Venture-sale	2,000	By A	88,000
		By B	62,000
	2,37,000		2,37,000

A

To Joint Venture-cost of plot	5,000	By Joint Bank (Investment)	60,000
To Joint Bank (Settlement)	88,000	By Joint Venture (Profit)	3,000
	93,000		93,000

B

	Rs.		Rs.
To Joint bank (settlement)	62,000	By Joint Bank (Investment)	40,000
		By Joint Venture (profits)	22,000
	62,000		62,000

Under writing of Shares :

When the co-venturers agree to under write the share of a limited company, they become entitled to underwriting commission which may be received partly in cash and partly in shares. As per the nature of the underwriting business the underwriters will have to take up the shares received as commission and the shares not subscribed by the public. The shares are ultimately sold or taken over by co-venturers at an agreed price in order to calculate the overall profit or loss on joint-venture. The additional entries are given below :

(1) **On receiving the commission**

Joint Bank Account — Dr. (for cash)

Shares Account — Dr. (for shares)

To Joint Venture account

(2) **For subscription of shares not taken over by public**

Shares Account — Dr.

To Joint Bank Account

To Co-Venturers Account

(3) **For sale of shares**

Joint Bank Account — Dr.

Co-Venturers Account — Dr.

To Shares Account

(4) **For profit on sale**

Shares Account Dr.

To Joint Venture Account

Entry No. 4 will be reversed in case of loss.

Illustration - 6

A and B enter into a joint venture for guaranteeing the subscription at par of 1,00,000 shares of Rs.20 each of a joint stock company. They agree to share profits and losses in the ratio of 2 : 3. The terms with the company are : 4½% commission in cash and 6,000 fully paid up shares of the company.

The public take up 88,000 of the shares and the balance shares of the guaranteed issue are taken up by A and B who provide cash equally. The commission in cash is taken by the partners in the ratio 4 : 5.

The entire share holding of the Joint Venture is then sold through brokers : 25% at a price of Rs.9; 50% at a price of Rs.8.75; 15% at a price of Rs.8.0 and the remaining 10% is taken over by A and B equally at Rs. 8 per share.

Prepare a joint venture account and the separate accounts of A and B showing the adjustment of final balance between A and B. Ignore interest and income tax.

Joint Venture Account

	Rs.		Rs.
To Share (Loss on sale)	24,750	By Joint Bank (Commission)	45,000
To A's Account	32,100	By Shares (Commission)	60,000
To B's Account	48,150		
	1,05,000		1,05,000

A's Account

	Rs.		Rs.
To Joint Bank (Cash Commission)	20,000	By Joint Bank	
To Shares	7,200	(Contribution)	60,000
To Joint bank-Final settlement	64,900	By Joint Venture	
		(Profit)	32,100
	92,100		92,100

B's Account

	Rs.		Rs.
To Joint Bank (Cash Commission)	25,000	By Joint Bank (Contribution)	60,000
To Shares	7,200	By Joint venture (Profit)	48,150
To Joint bank) Final Settlement	75,950		
	1,08,150		1,08,150

Shares Account

	Rs.		Rs.
To Joint Bank (Shares purchased)	1,20,000	By Joint Bank (25%)	40,500
To Joint Venture (Commission)	60,000	By Joint Bank (50%)	78,750
		By Joint Bank (15%)	21,600
		By A's A/c (5%)	7,200
		By B's A/c (5%)	7,200
		By Joint Venture (Loss on Sale)	24,750
	1,80,000		1,80,000

Joint Bank Account

	Rs.		Rs.
To A (Contribution)	60,000	By Shares (purchased)	1,20,000
To B (Contribution)	60,000	By A	20,000
To Joint Venture (Commission)	45,000	By B	25,000
To Shares		By A (Final settlement)	64,900
25%	40,500	By B (Final settlement)	75,950
50%	78,750		
15%	21,600		
	3,05,850		3,05,850

Illustration-7

X and Y undertake jointly to build for a newly stated joint stock company for a contract price of Rs.1,000,000 payable as to Rs.80,000 by instalments in cash and Rs.20,000 in fully paid shares of the new company. A banking account is opened in the joint name, X contributing Rs. 25,000 and Y Rs,15,000. They have to share profits and losses in the proportion of 2/3 and 1/3 respectively. Their transactions were as follows :

Paid wages	Rs.30,000
Bought materials	Rs.79,000 on credit from Z.
Paid architect's fees	Rs.3,000

The contract was completed and the price dully received: Z's dues were dully paid off. The joint venture was closed by X taking up all the shares of the company at an agreed valuation of Rs.16,000 and Y taking up unused stock of materials for Rs.3,000 as mutually valued.

Prepare the necessary accounts to record the above transactions.

Solution :

Joint Bank Account

Dr.	Rs.		Cr.
To X (Capital contributed)	25,000	By Joint venture A/c—Wages	30,000
To Y (Capital contributed)	15,000	By Joint Venture A/c—Architect-fees	2,000
To Joint Venture A/c (Amount Received from contractee)	80,000	By Z	79,000
		By X (Amount returned)	1,000
		By Y (Amount returned)	8,000
	1,20,000		1,20,000

Z

	Rs.		Rs.
To Joint Bank Account	79,000	By Joint Venture Account	79,000

Joint Venture Account

Dr.	Rs.		Cr. Rs.
To Joint bank A/c—Wages	30,000	By Joint Bank A/c (Amount received From-contractee)	80,000
To Z—Materials	79,000	By Share A/c	20,000
To Joint Bank A/c (Architect's fees)	2,000	By Y (Materials Taken over)	3,000
To Share's A/c—Loss	4,000	By Loss transferred to : X 2/3 8,000; Y 1/3 4,000	12,000
	1,15,000		1,15,000

Shares Account

Dr.	Rs.		Cr. Rs.
To Joint Venture Account	20,000	By X	16,000
		By Joint Venture A/c—Loss	4,000
	20,000		20,000

X's A/c

To Joint Venture A/c Loss	8,000	By Joint Venture A/c	25,000
To Shares a/c	16,000		
To Joint Bank A/c	1,000		
	25,000		25,000

Y's A/c

To Joint Venture A/c		By Joint venture A/c	15,000
(Material)	3,000		
To Joint venture A/c			
Loss	4,000		
To Joint Bank A/c	8,000		
	15,000		15,000

Illustration-8

A and B enter into a Joint Venture sharing profit and loss equally. A purchased goods for Rs. 5,000 and B spent Rs.3,000 for freight on 1st jan. 2002. On the same day B bought goods worth Rs.10,000 on credit. Further expenses were incurred as follows :

On 1-2-2002—Rs.1,500 By B

On 1-3-2002—Rs.500 By A

Sales were made against cash as follows :

15-1-2002—Rs.3,000 By A

31-1-2002—Rs.6,000 By B

15-2-2002—Rs.3,000 By A

1-3-2002—Rs.4,000 By B

Creditors for goods were paid as follows :

1-2-2002—Rs.5,000 By A

1-3-2002—Rs.5,000 By B

On 31st March 2002 the balance stock was taken over by B at Rs.9,000 The accounts between the venturers were settled by cash payment on this date. The venturers are entitled to interest at 12% per annum.

Prepare necessary ledger accounts in the books of Venturers.

Solution

Memorandum Joint Venture Account

	Rs.		Rs.
To Cost of goods ;		By Sales A	6,000
A	5,000	B	10,000
B	10,000	By Interest B	50
To Freight-B	1,000	By B-Stock	9,000
To Expenses-A	500		
B	1,500		
To Interest-A	135		
To profit—A	3,457		
B	3,458		
	25,050		25,050

A's Ledger

Joint Venture with B Account

2002		Rs.	2002		
Jan.1.	To Bank (Purchase)	5,000	Jan 15	By Bank (sale proceeds)	3,000
Feb.1.	To bank (Creditors)	5,000	Feb 15	By bank (sale proceeds	3,000
Mar.1.	To Bank (Expenses)	500	Mar.15	By Bank (amount	
" 31	To Interest A/c	135		received in settlement)	8,902
	To Profit & Loss account-share of profit	3,457			
		14,092			14,092

B's Ledger

Joint Venture with A Account

2202		Rs.	2002		Rs.
Jan.1	To bank (freight)	1,000	Jan 31	By Bank (sale)	6,000
	To Creditors (goods bought- on credit	10,000	Mar.31	By Creditors paid by co-venturer	5,000
Feb 1	To bank (expenses)	1,500		By Bank (sale)	4,000
Mar.31	To Profit & Loss account (share of profit)	3,458	Mar.31	By Stock account stock taken over	9,000
	To bank (amount paid to A in settlement	8,092		By Interest account	50
		24,050			24,050

Calculation of Interest

Payment by A

Date	Amount	Month	Int. Till 31-3-2002 @1% p.m.
	Rs.		Rs.
1-1-2002	5,000	3	150
1-3-2002	500	1	5
1-2-2002	5,000	2	100
			255

Amount received by A

Date	Amount	Month	Int. Till 31-3-2002 @1% p.m.
	Rs.		Rs.
15-1-2002	3,000	2½	75
15-2-2002	3,000	1½	45
			120
			Net Interest due to A 135

Payment by B

Date	Amount	Month	Int. Till 31-3-2002 @1% p.m.
1-1-2002	1,000	3	30
1-2-2002	1,500	2	30
1-3-2002	5,000	1	50
			110

Amount received by B

Date	Amount	Month	Int. Till 31-3-2002 @1% p.m.	
31-1-2002	6,000	2	120	
1-3-2002	4,000	1	40	160
			Net Interest due from B	50

Conversion of Consignment into Joint venture :

Some times the consignor and consignee may decide to convert the consignment into Joint Venture with retrospective effect i.e. from the date of the original consignment agreement. In such a case the accounts will have to be prepared both on consignment basis and Joint Venture basis to be paid out :

(i) The amounts due to other party by way of commission on consignment basis; and

(ii) By way of profit on the basis of Joint Venture arrangement.

If the other party is entitled to more under the Joint Venture arrangement the following entry is to be made :

Profit and Loss account Dr.

To Co-Venturer's Personal Account

The above entry will be reversed if the co-venturer has already received more than what is due to him under Joint Venture arrangement.

Illustration-9 (Conversion of Consignment to Joint Venture)

On the 1st January of 2002 Singh of Amritraj, a manufacturer of sports goods, sent a Consignment of 100 cricket bats to Bose of calcutta to be sold on consignment basis at a commission of 20%, such commission to cover the consignee's expenses but not the freight charges of the goods to Calcutta. The cost of each bat is Rs.100 but is invoiced to Bose at Rs.150 each. A case containing 10 cricket bats was lost against which the consignor lodged a claim and collected from the insurance company Rs.800. The consignee paid Rs.540 as freight charges and spent a further sum of Rs.400 as sales expenses. Consignor's expenses amounted to Rs.500. The consignee accepted a bill of exchange drawn by Singh for 3 months (beginning with the date of despatch) for Rs.10,000 which bill was discounted at 6% p.a. with the bankers. Bose sold 75 bats at Rs.200 each and on 30th June 2002 remitted the balance due from him.

After making up accounts on 30th June 2002 the parties decide to convert their relationship to that of a Joint Venture on the terms that the cost of a bat would be taken at Rs.350, Singh to get an interest of 8% p.a. on his investment and Bose to get a commission of 10% on sales. Venturers are to share profit and losses equally.

Prepare the necessary accounts in the books of Singh and indicate the adjustment entry required on conversion of the terms of despatch.

Solution :

Consignment to Calcutta Account

	Rs.		Rs.
To Goods sent on consignment	15,000	By Bose (Sale proceeds)	15,000
To Bank (expenses)	500	By Goods sent on consignment (Loading)	5,000
To Bose (Freight)	540		
To Stock reserve (15 × 50)	750	By bank (Insurance Claim)	800
To Bose-Commission	3,000	By Abnormal loss	250
To Profit & Loss Account (Profit on consignment)	3,675	By Stock on consignment	2,415
	23,465		23,465

Notes : (1) It is assumed that freight was paid only on 90 bats.

(2) Valuation of closing Stock at Invoice Price

15 bats @ Rs. 150 each	Rs.	2,250
Proportionate freight $\frac{540\times15}{90}$	Rs.	90
proportionate Expenses (Consignor) $\frac{540\times15}{100}$	Rs.	75
	Rs.	2,415

(3) **Abnormal Loss**

	Rs.	
Cost of bats 10 × 100	Rs.	1,000
Proportionate expenses $\frac{500\times15}{100}$	Rs.	50
	Rs.	1,050
Less : Amount of Claim		800
		250

Memorandum Joint venture Account

	Rs.		Rs.
To Goods sent on Joint Venture	15,000	By Sales	15,000
To Expenses : Singh	500	By Insurance Claim	800
Bose	940	By Stock 15 bats	2,415
To Interest : Investments 8% on Rs.15,000 for 6		By Loss : Singh 163	
months	600	Bose 162	325
To Commission (Bose)	1,500		
	18,540		18,540

Notes : (1) Interest has been allowed on investment in goods only; the question of expenses and of claim received cancelling out one another.

(2) For the purpose of Joint Venture no stock reserve is required.

(3) Adjustment is required as under :

Amount already received by Bose (Commission)		Rs.3,000
Amount receivable by Bose as co-Venturer :		
Commission	1,500	
Expenses	400	
	1,900	
Less : Loss to be debited to him	162	1,738
		1,262

Entries on Conversion into Joint Venture

	Rs.	Rs.
(1) Bose	Dr. 1,262	
To Profit and Loss Account		1,262

(Amount due to Bose under the Joint Venture Arrangement being Rs.3,000 whereas he previously received Rs.3,000 amount now adjusted)

(2) Profit and Loss Account	Dr. 375	
To Stock Reserve		375

(Our share of the unrealised profit on unsold stock 50% of Rs.3,000

Exercise :

(1) Das, Bose and Gupta undertake to erect a five storied mansion for National Housing Trust Ltd. The contract price is agreed at Rs.25,00,000 to be paid in cash Rs.22,00,000 by four equal instalments and the balance amount in 13% debentures of the company. They agreed to share equally the profits and losses. They opened a joint banking account with the cash contributed as stated below :

Das Rs.3,00,000; Bose Rs.3,75,000; and Gupta Rs.2,00,000. Das arranges the preparation of the building plan etc. and pays Rs.32,000 as architects's fees; Bose brings a concrete Mixer and other implements valued at Rs.80,000 and Gupta brings a Motor Lorry valued at Rs.75,000.

They paid out of joint banking account for the following : Materials Rs.12,26,800; Wages Rs.7,32,200; Sundry expenses Rs.20,000 and plant Rs.60,000.

On Completion of the venture, concrete mixer is sold for Rs.50,000 and plant and other implements are sold as scarp for Rs.10,000. Gupta Takes back the Motor Lorry at Rs.40,000. Das took over the Debentures at a valuation of Rs.2,80,000.

Show the necessary accounts for the joint venture.

(Ans. Profit on joint venture Rs.3,54,000; Final payments: Dass Rs.1,70,000; Bose Rs.5,73,000 and Gupta Rs.3,53,000.

(2) S and R carrying on a business separately as contractors, jointly take up the work of constructing a building at an agreed price of Rs.3,50,000 payable in cash Rs.2,40,000 and in fully paid shares of a company for the balance of Rs.1,10,000. A bank account is opened in which S and R paid Rs.75,000 and Rs.50,000 respectively. The following costs were incurred in completing the constructions and the contract price was duly realised :

(i) Wages paid Rs.90,000

(ii) Material purchased for Cash Rs.2,10,000

(iii) Materials supplied by R from his stock Rs.27,000.

(iv) Consulting Engineer's fees paid by S. Rs.3,000

The accounts were closed, S taking up all the shares of the company at an agreed valuation of Rs.48,000, treating loss on shares as joint venture loss and R taking the remaining stock of materials at Rs.9,000

Prepare and close the joint venture accounts and personal accounts of S and R assuming that a separate set of books are opened for this purpose and that the net result of the venture is shared by s and R in ratio of 2 :1.

(Ans. Loss on Joint venture Rs.36,000; Amounts brought in by S. Rs.9,000 and R Rs.56,000)

(3) Shyam took a contract for Rs.1,62,000 for supply of material in connection with tube wells. He entered into a joint venture contract with Ashok. It was agreed to share profit and losses equally. Following were the terms of the joint venture :

Shyam will contribute Rs.1,50,000 as capital on which he will get interest at 4% p.a. This amount was given to Ashok on 1 January 2002 Shyam was entitled to a commission of 2% on the contract price. Ashok being a technician will be entitled to a salary of Rs.400 per month. He will also get Rs1,500 because his plant will be used on the contract.

Ashok made the following payments : Raw Materials Rs.50,000; Wages Rs.60,000; Repairs of Machinery Rs.5,000 and Establishment expenses Rs.4,500.

Contract was complete on 30 September 2002 Shyam received the amount from Ashok.

Open Joint Venture Account, Shaym's Account and Cash Account in the books of Ashok.

(Ans. Joint Venture Profit Rs.36,000; Payment to Shyam Rs.1,72,825)

(4) B of Bombay and C of Calcutta enter into a joint venture to consign scrap iron A of agra, to be sold on their risk. They share profit or losses equally. A is entitled to a commission of 10% of the net proceeds after charging such commission.

B sends 50 tonnes costing Rs.3,000 per tonne and pays freight and other expenses of Rs.30,000. C sends 70 tonnes costing Rs.3,000 per tonne and pays freight and other expenses of Rs.40,000.

All the scraps are sold by A @ Rs.10,000 per tonne and he pays selling expenses of Rs.12,000. he remits Rs.5,00,000 to B and the balance of net proceeds to C by bank draft.

You are required (a) to show accounts in the books of B and C to record their own transactions and (b) to prepare a Memorandum Joint Venture Account.

(Ans. Profit on Joint venture Rs.4,45,000; final settlement for Rs.32,500)

UNIT–V

HIRE PURCHASE SYSTEM

If you purchase a TV for cash, you pay, say, Rs.15,000. But if you wish to make the payment by instalments of say, Rs.3,000 each, every year, you may be required to pay four instalments, that is Rs.20,000 in all. The extra amount of Rs.3,000 is for interest. If you choose the latter mode of the payment, you should debit Rs.5,000 to interest and treat the TV as valued at Rs.15,000 (and not at Rs.20,000). In case payment is to be made by instalments, there may be two kinds of arrangements. Each instalment may be treated as a 'hire' the purchaser becoming the owner only if he pays all the instalments. In other words, property does not pass to him even if one instalment remains unpaid. The seller will have the right to take away the goods in case of default in respect of any instalment. This is known as 'Hire Purchase' system.

The other arrangement may be that property passes immediately on the signing of the contract. The seller will not have the right to repossess the goods in case an instalment is not paid. His right will be to sue the purchaser for the money due. This is known as the Instalment System.

Interest : In either case (hire purchase or instalment) interest must be separated from the principal sum due. Since payments continue over two or more financial years interest must be calculated for each year separately. Usually information is available regarding cash price and the rate of interest. Calculation of interest then becomes easy. Just prepare the account of one of the parties on ordinary lines and charge interest on the balance due. Suppose on 1st January, 2000 A purchases from B machinery whose cash price is Rs.36,000; Rs.5,000 is to be paid down, that is on signing of the contract, and Rs.4,000 is to be paid at the end of each year for 3 years. Rate of interest is 10% p.a. If we prepare B's account (on a memorandum basis) in A's books, we shall know the interest for each year.

A's Books

Dr. **B's Account** **Cr.**

		Rs.			Rs.
2000			2000		
Jan.1	To Cash	5,000	Jan.1	By Machinery A/c	15,000
Dec.31	To Cash	4,000	Dec.31	By Interest A/c	1,000
,,	To balance c/d	7,000		(10% on Rs.36,000;	
		16,000			16,000
2001			2001		
Dec.31	To Cash	4,000	Jan.1	By Balance b/d	7,000
	To Balance c/d	3,700	Dec.31	By Interest A/c	
				(10% on Rs.15,000.	700
		7,700			7,700
2002			2002		
Dec.31	To Cash	4,000	Jan.1	By Balance b/d	3,700
			Dec.31	By Interest A/c*	300
		4,000			4,000

If the rate of interest is not given, the interest for each year will be in proportion to amount outstanding in each year. In the example given above, the total sum payable is Rs.17,000 out of which Rs.5,000 is paid immediately. This leaves Rs.12,000 as outstanding throughout the first year at the end of which Rs.4,000 is paid. In the second year Rs.8,000 is outstanding and in the third year Rs.4,000 is due. The total interest is Rs.2,000. i.e., Rs.17,000. minus Rs.15,000. The interest should be apportioned over the 3 years in the ratio of amounts outstanding, that Rs.12,000; Rs.8,000 and Rs.4,000 or in the ratio of 3 : 2 :1. The interest for the first year is Rs.1,000 : for the second year it is Rs.670 and for the third year it is Rs.333. Note that the amount cannot be the same as worked out when the rate of interest is given.

To ascertain Cash Price, rate of interest and instalments being given. Sometimes the cash price is not given. Since the asset cannot be debited with more than the cash price, it must be ascertained. The process is to take the last year first and separate interest from principal out of the total sum due. In the example given above, Rs.4,000 is due at the end of 2002. The rate of interest is 10%. If in the beginning of 2001 Rs.100 was due, Rs.10 would be added making Rs.110 as due at the end of 2002. Thus, out of the sum due at the end of the year, one-eleventh is interest; rest is principal. We can proceed year by year like this.

Thus :—

	Rs.
Amount due on 31-12-2001	4,000
Interest @ 1/11	364
Amount due on 1-1-2002 or 31-12-2001	3,636
Paid on 31-12-2001	4,000
Total amount due on 31-12-2001	7,636
Interest @ 1/11	694
Amount due on 1-1-96 or 31-12-2000	6,942
Paid on 31-12-2000	4,000
Total amount due on 31-12-2000	10,942
Interest @ 1/11	995
Amount due on 1-1-2000	9,947
Paid Cash down on 1-1-2000	5,000
Cash Price	14,947

The interest for three years is Rs.995, Rs.694 and Rs.364 respectively.

Entries In Books

Actual Cash Price Paid Method

This method follows a technical approach and does not treat the hire purchaser as owner until he makes the payment of last instalment. Under this method, the asset is recorded at the cash price actually paid.

* *In the last year, the interest is equal to the difference between the amount due and the opening balance. It is not calculated in the usual way.*

Journal Entries Under Actual Cash Price Paid Method

The various accounting entries in the books of the hire purchaser and hire vendor are shown below.

Journal Entries Under Actual Cash Price Paid Method

	Case	***In the Books of Hire Purchaser***	***In the Books of Hire Vendor***	***Amount with which debited or credited***
A.	On making down payment due	Asset A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To Hire Purchase Sales A/c	(With the amount of down payment)
B.	On making Down payment	Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c	(With the amount of down payment)
C.	On making principal part of the instalment due	Asset a/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To Hire Purchase Sales A/c	(With the amount of principal part of the instalment)
D.	On making interest due on unpaid balance	Interest A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To Interest A/c	(With the interest due on unpaid balance)
E.	On making payment of instalment	To Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c	(With the amount of instalment)
F.	On providing depreciation	Depreciation A/c Dr. To Asset A/c	No Entry	(With the amount of (depreciation)
G	On closure of Depreciation A/c	Profit & Loss A/c Dr. To Depreciation A/c	No entry	(With the amount of depreciation)
H.	On closure of Interest A/c	Profit & Loss A/c Dr. To Interest A/c	Interest A/c Dr. To Profit & Loss A/c	(With the amount of interests)

Note : *Depreciation is charged on full cash price of the asset and Interest is calculated on total outstanding balance.*

Disclosure In Balance Sheet Under Actual Cash Price Paid Method

At the end each accounting period, the relevant accounts appear in the Balance Sheet as shown below:

Disclosure In Balance Sheet Under Actual Cash Price Paid Method

Balance Sheet of Hire Purchaser				Balance Sheet of Hire Vendor			
Liabilities	Rs.	Assets	Rs.	Liabilities	Rs.	Assets	Rs.
		Fixed Assets : Asset (at actual cash) price paid) *Less :* Depreciation till date	 xxx xxx xxx			No disclosure is required	

Hire Purchase

Books of the Vendor. The vendor follows no special method for recording sales on hire purchase, specially in case of sale of large items. He debits the purchaser with the cash price and credits him with the amount received. Every year the interest due is debited. We illustrate this below.

Illustration-1

Based on particulars given below calculate Interest under the hire purchase system

(a) X & Co.—purchaser Y & Co.-Seller

Date of purchase—Jan. 1, 1999

cash price—Rs.74,500.

Intalments Rs.20,000 on signing of the agreement. Rest in three instalments of Rs.20,000 each.

Rate of Interest—5%. Depreciation 10% on the diminishing Balance.

(b) All particulars as above except that the rate of interest is not given.

(c) All particulars as in (a) above except that the cash price is not given.

Solution :

(a) Calculation of Interest

		Rs.
Jan.1, 1999	Cash Price	74,500
	Less-Cash down	20,000
	Balance Due	54,500
	Interest @ 5% for 1999	2,725
Dec.31, 1999	Total	57,225
	Amount paid	20,000
Jan.1, 2000	Balance Due	37,225
	Interest for 2000 @ 5%	1,861
Dec.31, 2000	Total	39,086
	Amount paid	20,000
Jan.1,2001	Balance due 2001	19,086
	Interest for (balancing figure) 2001	914
Jan.1,2002	Amount paid	20,000

(b) Calculation of interest when the rate of interest is not given :

Hire Purchase Price	80,000
Cash Price	74,500
Total interest	5,500

Year	Amount Outstanding	Ratio	Interest	Rs. Rs.
1	60,000	3	3/6 x 5,500	2,750
2	40,000	2	2/6 x 5,500	1,833
3	20,000	1	1/6 x 5,500	917

(c) Calculation of cash price, rate of interest being given :

Instalment	Amount due at the end of the year (after payment of Inst.)	Instalment paid	Total amount due at the end of the year (before payment of instalment)	Interest @ 1/21	Principal due in the beginning
	Rs.	Rs.	Rs.	Rs.	Rs.
3	Nil	20,000	20,000	952	19,408
2	19,048	20,000	39,048	1,859	37,189
1	37,189	20,000	57,189	2,723	54,466
				5,534	

Cash Price : 54,466 + cash down, Rs.20,000 or Rs.74,466.

Illustration-2

Y & Co. sold machinery whose cash price is Rs.74,500. to X and Co., on hire purchase basis on 1st January, 2000. Payment was to be made as Rs.20,000 down and Rs.20,000 every year for three years. Rate of interest was 5% x & Co. charged depreciation @ 10% p.a. on the diminishing balance. Give ledger accounts in the books of Y & Co.

Ledger of Y & Co.

Dr. **X & Co.** **Cr.**

		Rs.			Rs.
2000			2000		
Jan.1	To Sales	74,500	Jan.1	By Cash	20,000
Dec.31	To Interest A/c		Dec.31	By Cash	20,000
	(5% on Rs.36,000)	2,725		By Balance c/d	37,225
		77,225			77,225
2001			2001		
Jan.1	To Balance b/d	37,225	Dec.31	By Cash	20,000
Dec.31	To Interest A/c	1,861		By Balance c/d	19,086
		39,086			39,086
2002			2002		
Jan.1	To balance b/d	19,086	dec.31	By Cash	20,000
Dec.31	To Interest A/c	914			
		20,000			20,000

Dr.	Sales Account		Cr.
	2000 Jan. 1	By X & Co.	Rs.15,000.

Interest Account

Dr.				Cr.
2000 Dec.31 to P & L A/c	2,725	2000 Dec.31	By X & Co.	2,725
2001 Dec.31 to P & L A/c	1,861	2001 Dec.31	By X & Co.	1,861
2002 Dec.31 to P & L A/c	914	2002 Dec.31	By X & Co.	914

Books of Purchaser—First Method. The purchaser can also follow the system adopted by the vendor and make entries like ordinary purchase of an asset. Only, he should credit the vendor with interest due every year and debit him with cash as and when paid. The above given example can be worked out in the following way (ledger accounts.) :—

Dr. Machinery account Cr.

		Rs.			Rs.
2000 Jan.1	To Y & Co.	74,500	2000 Dec.31	By Depreciation A/c	7,450
				By Balance c/d	67,050
		74,500			74,500
2001 Jan.1	To Balance b/d	67,050	2001 Dec.31	By Depreciation A/c	6,705
				By Balance c/d	60,345
		67,050			67,050
2002 Jan.1	To Balance b/d	60,345	2002 Dec.31	By Depreciation A/c	6,035
				By Balance c/d	54,310
		60,345			60,345
2003 Jan.1	To Balance b/d	54,310			

Y & Co.

		Rs.			Rs.
2000			2000		
Jan.31	To bank A/c	20,000	Jan.1	By Machinery A/c	74,500
Dec.31	To Bank A/c	20,000	Dec.31	By Interest A/c	2,725
”	To Balance c/d	37,225			
		77,225			77,225
2001			2001		
Dec.31	To Bank A/c	20,000	Jan.1	By Balance b/d	37,225
’ ’	To balance c/d	19,086	Dec.31	By Interest A/c	1,861
		39,086			39,086
2002			2002		
Dec.31	To Bank A/c	20,000	Jan.1	By Balance b/d	19,086
			Dec.31	By Interest A/c	914
		20,000			20,000

The student should prepare accounts relating to Interest and Depreciation.

Second Method. Under the second method, entries are passed only when payment is due or made. At this time, the vendor is credited with the amount due. Interest for the period is debited to interest Account and the balance (principal) is debited to the Asset Account. On payment, of course, the vendor is debited and Cash (or Bank) credited. The two entries are :

1. Debit Asset Account
   Debit Interest Account
   Credit (hire) Vendor
2. Debit (Hire) Vendor.
   Credit Cash or (Bank)

Depreciation has to be charged according to the cash price of the asset

We give below the journal entries and ledger accounts in the books of X & Co., the purchaser, in the example given above.

Journal of X & Co.

		Dr. Rs.	Cr. Rs.
2000 Jan.1	Machinery Account Dr.	20,000	
	To Y & Co.		20,000
	(Amount due to Y & Co. as down payment for purchase of machinery on hire purchase basis.)		
Jan.1	Y & Co. Dr.	20,000	
	To Bank Account		20,000
	(Payment made to Y & Co. down)		

Dec.31	Machinery Account Dr. Interest Account Dr. To Y & Co. (The amount due to Y & Co. under the hire purchase contractRs.3,000 being for interest (and debited as such) and the balance treated as payment for machinery.)	17,275 2,725	 20,000
Dec.31	Y & Co. Dr. To Bank A/c (Payment made to Y & Co.)	20,000	 20,000
Dec.31	Depreciation Account Dr. To Machinery Account (Depreciation for one year-10% on Rs.74,500)	7,450	 7,450
2001	Machinery Account Dr. Interest Account Dr. (Amount due to Y & Co., Rs.350, for interest the balance charged to Machinery A/c.)	18,139 1,861	 20,000
2001 Dec.31	Y & Co. Dr. To Bank Account (Payment made to Y & Co.)	20,000	 20,000
Decc. 31	Depreciation Dr. To Machinery Account (Depreciation for the second year 10% on Rs.67,050; i.e. Rs.74,500. minus Rs.7,450).	6,705	 6,705
2002 Dec.31	Machinery Account Dr. Interest Account Dr. To Y & Co. (Amount due to Y & Co. in respect of interest and the principal sum.)	19,086 914	 20,000
Dec.31	Y & Co. Dr. To Bank Account (Payment made to Y & Co.)	20,000	 20,000
Dec.31	Depreciation Account Dr. To machinery Account (Depreciation @ 10% of the diminishing balance charged for the thirds years).	6,035	 6,035

Ledger

Dr. **Machinery Account** **Cr.**

		Rs.	2002		Rs.
2000	To Y & Co.	20,000	Dec.31	By Depreciation	7,450
Jan.1	To Y & Co.			By Balance c/d	29,825
Dec.31	(20,000—2,725)	17,275			37,275
		37,275			
2001			2001		
Jan.1	To balance b/d	29,825	Dec.31	By Depreciation A/c	6,705
	To Y & Co.		,,	By Balance c/d	41,259
	(20,000—1,861)	18,139			
		47,964			47,964
2002			2002		
Jan.1	To Balance b/d	41,259	Dec.31	By Depreciation A/c	6,035
Dec.31	To Y & Co.	19,086	,,	By Balance c/d	54,310
		60,345			60,345
2002					
Jan.1	To Balance b/d	54,310			

Dr. **Interest Account** **Cr.**

2000		Rs.	2000	
Dec.31	To Y & Co.	2,725	Dec.31 By P & L A/c	2,725
2001			2001	
Dec.31	To Y & Co.	1,861	Dec.31 By P & L A/c.	1,861
2002			2002	
Dec.31	To Y & Co.	914	Dec.31 By P & L A/c	914

Dr. **Y & Co.** **Cr.**

2000		Rs.		2000	Rs.
Jan.1	To Bank A/c	20,000	Jan.1	By Machinery A/c	20,000
Dec.31	To Bank A/c	20,000	Dec.31	By Sundries—	
				Machinery 17,275	
				Interest 2,725	20,000
		40,000			40,000
2001			2001		
Dec.31	To Bank A/c	20,000	Dec.31	By Machinery A/c	18,139
				By Interest A/c	1,861
		20,000			20,000
2002			2002		
Dec.31	To Bank A/c	20,000	Dec.31	By Machinery A/c	19,086
				By Interest A/c	914
		20,000			20,000

Depreciation Account

2000		Rs.	2000		Rs.
Dec.31	To Machinery A/c	7,450	Dec.31	By P & L A/c	7,450
2001			2001		
Dec.31	To machinery A/c	6,705	Dec.31	By P & L A/c	6,705
2002			2002		
Dec.31	To Machinery A/c	6,035	Dec.31	By P & L A/c	6,035

Default And Repossession

If a hire purchaser fails to pay an instalment on the stipulated date, the hire purchaser is said to be at default. In case of default by, the hire purchaser, the hire vendor may repossess the goods. Repossession mean taking back the possession of goods by the hire vendor. Subject to agreement, the repossession may be either complete or partial.

Complete Repossession

In case of complete or full repossession the hire vendor takes back the possession of all the goods. All entries till the date of default are passed the usual manner. The additional treatment is as follows :

Books of Hire Purchaser	*Books of Hire Vendor*
(a) For Closing Hire Vendor's Account Hire Vendor's A/c Dr. To Asset A/c **Note :** *This entry is passed with the* amount due to the hire vendor. **(b) For Closing Asset Account** (i) If the Book Value of the Asset exceeds the amount due to Hire Vendor Profit & Loss A/c To Asset A/c (ii) If the amount due to Hire Vendor exceeds the book Value of the asset Asset A/c Dr. To Profit & Loss A/c	**(a) On Repossession of goods** Goods Repossessed A/c Dr. To Hire Purchaser's A/c **Note :** *This entry is passed with the* revalued amount of goods repossessed. **(b) For amount spent on reconditioning of Goods Repossessed.** Goods Repossessed A.c Dr. To Cash A/c/Bank A/c **(c) For sale of Goods Repossessed** Cash A/c/bank A/c Debtors A/c Dr. To Goods Repossessed A/c **(d) For Loss on sale of Goods Repossessed** Profit & Loss A/c Dr. To Goods Repossessed A/c **Note :** *In case of profit, a reverse* entry will be passed.

Illustration-3

A purchased from B two machines of Rs.15,000. each on hire purchase system. The payment was to be made Rs.6,000 down and the remainder in three equal isntalments of Rs.5,000 each together with interest. A writes off depreciation at 10% on written down value. A could not pay the second instalment. It was agreed that the vendor would leave one machine with the purchaser, adjusting the value of the other against due, treating the machines at 20% depreciation on W.D. value.

Show machines A/c and B's A/c in the books of A.

Machines A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
Beginning of 1 Year	To b's A/c	21,000	End of yr.	By Depreciation	2,100
				By Balance c/d	18,900
		21,000			21,000
Beginning of II yr.	To Balance b/d	18,900	End of II yr.	By Depreciation	1,890
			End of II yr.	By B's A/c	6,720
			End of II yr.	By P & L A/c (Bal Fig.)	1,785
				By Bal. c/d	8,505
		18,900			18,900

B's A/c

		Rs.			Rs.
1 yr.	To Cash	6,000	End of I yr.	By Machine	21,000
End of I yr.	To Cash	5,750	End of I yr.	By Interest	750
	To Balance c/d	10,000			
		21,750			21,750
End of II yr.	To Machine	6,720	Beginning of I yr.	By Balance c/d	10,000
	To Balance c/d	3,780	End of II yr.	By Interest	500
		10,500			10,500

Working Notes

Value of which machine is taken over by B

	Rs.
Cost of one machine	10,500
Less 20% dep. for I year.	2,100
	8,400
Less 20% dep. for next year	1,680
	Rs. 6,720

W.D.V. of machines left with A

	Rs.
Cash price of one machine	10,500
Less dep. for I year	1,050
	9,450
Less dep. for II year	945
	8,505

Illustration-4

On 1st January 20XI, Ashok acquired furniture on the hire purchase system from Real Aids Ltd., agreeing to pay four semi-annual instalments of Rs.800, each commencing on 30th June 20XI. The cash price of the furniture was Rs.3,010 and interest of 5% per annum at half yearly rest was chargeable. On 30th September 20XI, Ashok expresses his inability to continue and Real Aids seized the property. It was agreed that Ashok would pay the due proportion of the instalment upto the date of seizure and also a further sum of Rs.200 towards depreciation. At the time of repossession, Real Aids valued the furniture at Rs.1,500. The company after incurring Rs.200 towards repairs of the furniture, sold the items for Rs.1,800 on 15th October 20XI. Prepare the Ledger accounts in the books of the Vendor and the Purchaser presuming that the purchaser charges depreciation @ 10% p.a.

Solution :

Books of Ashok :

Dr. Furniture Account Cr.

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
01.01.XI	To Real Aids Ltd.	3,010.00	30.09.XI	By Depreciation A/c (10% on Rs.3,000 for 9 months)	225.75
				By Real aids Ltd.	1,713.82
				By Profit & Loss a/c (Loss)	1,070.43
		3,010.00			3,010.00

Dr. Real Aids Ltd.'s Account Cr.

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
30.06.XI	To Cash A/c	800.00	01.01.XI	By Furniture A/c	3,010.00
30.09.XI	To Cash A/c (Rs. 400 + Rs.200)	600.00	30.06.XI	By Interest A/c	75.25
			30.09.XI	By Interest (on Rs. 2,285.25 @ 5% p.a.)	28.57
30.09.XI	To Furniture A/c	1713.82			
		3,113.82			3,113.82

Interest Account

Date	Particulars	Rs.P.	Date	Particulars	Rs.P.
30.06.XI	To Real Aids	75.25		By Profit & Loss A/c	103.82
30.09.XI	To Real Aids Ltd.	28.57			
		103.82			103.82

Dr. An Extract of Profit and Loss Account of Ashok Cr.

Particulars	Rs. P.	Particulars		Rs.P.
To Interest	103.82			
To Loss on seizure of goods	1070.43			
To Depreciation on Furniture	225.75			
	1,400.00			

Books of Real Aids Ltd. :

Dr. **Ashok's Account** **Cr.**

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
01.01.XI	To Hire Purchase Sales A/c	3,010.00	30.06.XI	By Bank A/c	800.00
			30.06.XI	By Bank A/c	600.00
30.06.XI	To Interest A/c (on Rs.3,010)	75.25	30.09.XI	By Profit And Loss A/c (Loss on valuation of goods repossessed)	213.82
30.09.XI	To Interest A/c (on Rs.2,285.25)	28.57			
			30.09.XI	By H.P. Goods Repossessed A/c	1,500.00
		3,113.82			3,113.82

Dr. **Hire Purchase Goods Repossessed Account** **Cr.**

Date	Particulars	Rs. P.	Date	Particulars	Rs. P.
30.09.XI	To Ashok	1,500	15.10.XI	By Cash A/c (Sales)	1,800
30.09.XI	To Cash (Expenses)	200			
15.10.XI	To Profit and Loss A/c (profit on sale of repossessed goods)	100			
		1,800			1,800

Dr. **An Extract of Profit and Loss account of Real Aids Ltd.** **Cr.**

Particulars	Rs. P.	Particulars	Rs. P.
To Loss on valuation of goods repossessed	213.82	By Interest on H.P. Sales	103.82
		By Hire Purchase Goods Repossessed A/c (Profit)	100.00

Partial Repossession

In case of partial repossession, the hire vendor takes back the possession of a part of the goods. All entries till the date of default are passed in the usual manner. The additional treatment is as follows :

Books of Hire Purchaser	*Books of Hire Vendor*
(a) For transfer of the agreed value of Goods Repossessed Hire Vendor's A/c Dr. To Asset A/c **(b) For Transfer of loss on default** Profit & Loss A/c Dr. To Asset A/c	**(a) On repossession of Goods at agreed value** H.P. Goods Repossessed A/c Dr. To Hire Purchaser's A/c (b), (c), (d)—Same entries as in case of complete repossession

Notes :	
(i) Loss on default— Book Value of Goods Repossessed as on date of repossession less Agreed Value of Goods Repossessed (ii) In case of profit on default, the reverse entry will be passed.	

Illustration-5 (Full repossession)

X purchased from Y three cars costing Rs.1,00,000 each on hire purchase system. Payment was to be made; Rs.60,000 down and balance in three equal instalments together with interest at 15% per annum. X provides depreciation at 20% per annum on diminishing balance method. X paid the first instalment at the end of the first year but could not pay the second instalment, Y took possession of all the three cards. He spent Rs.18,000. on repairs and sold them for Rs.1,50,000.

Show the necessary ledger account in the books of both the parties.

[Delhi, B.Com. (Pass), 1995 (Supple.)]

Solution :

In the books of Hire Purchaser.

1. Cars Account

Date	Particulars	Rs.	Date	Particulars	Rs.
I yr.1.1	To Hire Vendor A/c	3,00,000	I yr.31.12	By Depreciation	60,000
				By balance c/d	2,40,000
		3,00,000	II yr.		3,00,000
II yr. 1.1	To Balance b/d	2,40,000	31.12	By Depreciation	48,000
				By Hire Vendor A/c	1,84,000
				By P & L A/c (Loss on sale)	8,000
		2,40,000			2,40,000

2. Hire Vendor Account

Date	Particulars	Rs.	Date	Particulars	Rs.
I yr.			I yr.		
1.1	To Cash A/c	60,000	1.1	By Cars A/c	3,00,000
	To Cash A/c (80,000 + 36,000)	1,16,000	31.12	By Interest A/c	36,000
	To Balance c/d	1,60,000			
		3,36,000			3,36,000

II yr.				II yr.	
1.1	To Cars A/c	1,84,000	31.12	By Balance b/d	1,60,000
			31.12	By Interest A/c	24,000
		1,84,000			1,84,000

In the books of Hire Vendor

Hire Purchaser A

Date	Particulars	Rs.	Date	Particulars	Rs.
I yrs.1.1			I yr.		
1.1	To Cars A/c	3,00,000	1.1	By Cash A/c	60,000
31.12.	To Interest A/c	36,000	31.12	By Cash A/c	1,16,000
				By Balance c/d	1,60,000
		3,36,000			3,36,000
II yr.			II. yr.		
1.1	To Balance b/d	1,60,000	31.12	By Goods Repossessed A/c	1,84,000
	To Interest	24,000			
		1,84,000			1,84,000

Goods Repossessed Account

Date	Particulars	Rs.	Date	Particulars	Rs.
II yr.			II yr.		
31.12	To Hire Purchase A/c	1,84,000	31.12	By Cash (Sale)	1,50,000
	To Cash (Repairs)	18,000		By Profit & Loss A/c (Loss)	52,000
		2,02,000			2,02,000

Illustration-6 (Partial Repossession)

A Company Purchased two machines of Rs.15,000. each on hire purchase system. Paying Rs.6,000 down and remainder in three equal instalments of Rs.5,000 each together with interest at 5% p.a. The company writes off depreciation at 10% p.a. according to Diminishing Balance Method.

The company could not pay the second instalment. The vendor left one machine with the company adjusting the value of the other against amount due taking the machine at 20% depreciation at Diminishing Balance Method.

Prepare Ledger Account in the company's books.

[Delhi, B.Com. (Pass), 1990]

Solution :

In the books of Hire Purchaser

Machines Account

Date	Particulars	Rs.	Date	Particulars	Rs.
I[st] year			I[st] year		
At the	To Hire Vendor A/c	21,000	At the end	By Depreciation A/c	2,100
Beginning				By balance c/d	18,900
		21,000			21,000
2[st] year	To Balance b/d	18,900	2[st] year	By Depreciation A/c	1,890
At the			At the end	By Hire Vendor A/c	6,720
Beginning				(P & L A/c)	1,785
				(Loss on A/c of seizure)	
				By balance c/d (2)	8,505
		18,900			18,900

Hire Vendor Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1[st] year			1[st] year		
At the	To Cash A/c	6,000	At the		
Beginning	To Cash A/c	5,750	Beginning	By machinery A/c	21,000
At the end	To Balance c/d	10,000	At the end	By Interest A/c 5% on Rs.15,000	750
		21,750			21,750
2[st] year			2[st] year		
At the end	To Machine A/c(1)	6,720	At the	By Balance A/c	10,000
	To Balance c/d	3,780	Beginning		
			At the end	By Interest A/c	500
		10,500			10,500

Working Notes :

	Rs.
1. Revised price of 1 Machine seized	
Cash Price of each Machine	10,500
(–) Depreciation for 1 year @ 20% on W.D.V.	2,100
	8,400
(–) Depreciation for II year @ 20%	1,680
on W.D.V.	6,720

		Rs.
2.	Value of 1 machine retained	
	Cash Price of Machine	10,500
	(–) Depreciation for I year	1,050
		9,450
	(–) Depreciation for II year	945
	Value of Machine I retained	8,505

Illustration-7 (Partial Repossession)

Kanpur Transport Ltd. purchased from Delhi Motors three trucks costing Rs.50,000 each on the hire purchase system. Payment was to be made Rs.30,000 down and the remainder in three qual instalments together with interest @ 9%.

Kanpur Transport Ltd. Wrote off depreciation @ 20% on the diminishing balance. It paid the instalment due at the end of the first year but could not pay the next. Delhi Motors agreed to leave one truck with the purchaser, adjusting the value of the other two trucks against the amounts due. The trucks were valued on the basis of 30% depreciation (diminishing value) annually. Show the necessary accounts in the books of Kanpur transport Ltd. for two years.

[Delhi, B.Com. (Pass). 1993, 2002]

Solution :

In the books of Kanpur Transport Ltd.

Trucks Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1st year				1st year	
Jan.1	To Hire Vendor A/c	1,50,000	Dec.31	By Depreciation A/c (P & L A/c)	30,000
			Dec.31	By Balance c/d	1,20,000
		1,50,000			1,50,000
2st year			2st year		
Jan.1	To Balance b/d	1,20,000	Dec.31	By Depreciation A/c (P & L A/c)	24,000
			Dec.31	By Hire Vendor A/c	49,000
			Dec.31	Profit & Loss A/c(1)	
			Dec.31	(Loss on seizure)	15,000
			Dec.31	By Balance c/d(3)	32,000
		1,20,000			1,20,000

Delhi Motors Ltd. Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1^{st} year			1^{st} year		
Jan.1	To Cash A/c	30,000	Jan.1	By Trucks A/c	1,50,000
Dec.31	To Cash A/c	50,800	Dec.31	By Interest A/c	10,800
	To balance c/d	80,000			
		1,60,800			1,60,800
2^{st} year			2^{st} year		
Dec.31	To Trucks A/c	49,000	Jan.1	By Balance b/d	80,000
	To Balance c/d		Dec.31	By Interest A/c	7,200
	(31,000 + 7,200)	38,200			
		87,200			87,200

Working Notes :

1. Revised price of 2 seized trucks :

		Rs.
Cash price 50,000 each for 2		1,00,000
(–) Depreciation @ 30% for Ist year		30,000
		70,000
(–) Depreciation for 2nd year		21,000
		49,000

2. Balance outstanding for retained truck :

		Rs.
Cash price for all 3 trucks		1,50,000
(–) Cash paid at the signing	Rs. 30,000	
instalment	40,000	
Revised price of 2 seized trucks	49,000	1,19,000
		31.000

3. Depreciation of the retained truck :

	Rs.
Cash price	50,000
(–) Depreciation for Ist year	10,000
W.D.V.	40,000
(–) Depreciation for 2nd year @ 20%	8,000
Valued at the end of 2nd year	32,000

In the books of Kanpur Transport Ltd. - Second method based on Actual Payments.

Trucks Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st year			1st year		
Jan.1	To delhi Motors	30,000	Dec.31	By Depreciation	
Dec.31	To Delhi Motors	40,000		20% on 1,50,000	30,000
			Dec.31	By Balance c/d	40,000
		70,000			70,000
2nd year			2nd year		
Jan.1	To Balance b/d	40,000	Dec.31	By Depreciation	
	To Delhi Motors(2)	31,000		(20% on Rs.1,20,000)	24,000
			Dec.31	By P & L A/c (Loss on seizure)	
				(Balancing figure)	15,000
			Dec.31	By Balance c/d (3)	32,000
		71,000			71,000

Delhi Motors

Date	Particulars	Rs.	Date	Particulars	Rs.
1st year			1st year		
Jan.1	To Cash A/c	30,000	Jan.1	By Trucks A/c	30,000
Dec.31	To Cash A/c	40,000	Dec.31	By Trucks A/c	40,000
	To Cash A/c	10,000	Dec.31	By Interest A/c@ 9% p.a.	10,800
		80,000			80,000
2nd year			2nd year		
Dec.31	To Balance (31,000+7,200)	38,200	Dec.31	By Interest @ 9% p.a.	7,200
				By Trucks A/c (2)	31,000
		38,200			38,200

Illustration-8 (Partial Repossession)

X Transport Ltd. Purchased for Manish Motors, 3 Tempos costing Rs.1,00,000 each on hire purchase basis on 1.1.2005, 20% of the cost was to be paid down and the balance in 3 equal instalments together with interest @ 9% at the end of each year. X Transport Ltd. Paid the instalment due on 31st December 2005 but could not pay thereafter. Manish Motors agreed to leave one tempo with the purchaser on 31.12.2006 adjusting the value of two other tempos against the amount due on that date. The tempos recovered were valued on the basis of 30% depreciation annually. X Transport Ltd. charged depreciation on tempos @ 20% on diminishing balance method.

Manish Motors incurred Rs.10,000 on repairs of tempos repossessed and sold them at a profit of 5% on total cost. Write up necessary ledger, accounts in the books of both parties giving effect to the above transactions.

[Delhi B.Com. Pass., 1997]

Solution

Books of X Transport Ltd.

sset (Tempo) Account

Dr. Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2005			2005		
Jan.1	To Manish Motors (1,00,000×3)	3,00,000	Dec.31	By Depreciation A/c (3,00,000 × 20/100)	60,000
				By Balance c/d	2,40,000
		3,00,000			3,00,000
2006			2006		
Jan.1	To Balance b/d	2,40,000	Dec.31	By Manish (1)	98,000
			Dec.31	By Profit & Loss A/c	30,000
			Dec.31	By Depreciation A/c (2,40,000 × 20/100)	48,000
			Dec.31	By Balance c/d	64,000
		2,40,000			2,40,000
2007					
Jan.1	To balance b/d	64,000			

Manish Motors

Dr. Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2005			2005		
Jan.1	To Cash A/c (down payment)	60,000	Jan.1	By Asset (Tempo) A/c	3,00,000
			Dec.41	By Interest A/c (2,40,000 × 9%)	21,600
Dec.31	To Cash A/c (80,000 + 21,600)	1,01,600			
Dec.31	To Balance c/d	1,60,000			
		3,21,600			3,21,600
2006					
Dec.31	To Asset (Tempo)	98,000	Jan.1	By Balance b/d	1,60,000
Dec.31	To Balance c/d	76,400	Dec.13	By Interest A/c	14,400
		1,74,400			1,74,400
			2007 Jan.1	By Balance b/d	21,800

Working Notes :

		Rs.
Value of 2 Tempos taken away		
Cost Price of Tempos 1,00,000 × 2		2,00,000
Less:	Depreciation @ 30% on 2,00,000	60,000
	Value of Tempos taken away at the beginning of second year	1,40,000
	(–) Depreciation for second year	42,000
	Value of Tempos taken away	98,000
Value of Tempo left with the buyer		
	Cost price	1,00,000
Less :	Depreciation @ 20%	20,000
	Tempo	80,000
	Depreciation for 2nd year @ 20%	16,000
		64,000

In the Books of Manish Motors (Vendors)

X Transport Ltd.

Dr. Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2005			2005		
Jan.1	To Hire Purchase sales	3,00,000	Jan.1	By Cash (Down)	60,000
Dec.31	To Interest A/c	21,600	Dec.31	By Cash (First Instalment)	1,01,600
			Dec.31	By Balance c/d	1,60,000
		3,21,600			3,21,600
2006			2006		
Jan.1	To balance b/d	1,60,000	Jan.1	By Goods Repossessed	98,000
Dec.31	To Interest	14,400	Dec.31	By Balance c/d	76,400
		1,74,4000			1,74,400
2007					
Jan.1	To Balance b/d	76,400			

Goods Repossessed Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2006			2006		
Jan.1	To X Transport Ltd.	98,000	Jan.1	By Cash A/c	1,13,400
Jan.1	To Cash A/c (Repairs)	10,000			
Jan.1	To Profit & Loss A/c	5,400			
		1,13,400			1,13,400

Total cost of Two tempos repossessed :	
Repossessed at	Rs.15,000.
+ Repairs charges	Rs.10,000
Total cost	Rs.1,08,000

Profit @ 5% on total cost = $\frac{5}{100} \times 1,08,000$ = Rs. 5,400

Exercises (Partial Repossession)

X purchased five trucks on 1st October, 2005. The Cash Price of each truck was Rs.5,50,000. X was to pay 20% of Cash Price at the time of delivery and 25% Cash Price at the end of each of the subsequent four half-yearly periods beginning from 31st March, 2006.

On X's failure to pay the instalment due on 30th September, 2006, it was agreed that x could keep three trucks, on the condition that value of two trucks would be adjusted against the amount due, the trucks being valued at cost less 25% depreciation.

Show the necessary ledger accounts in the books of X, assuming that his books are closed on 31st March each year and he charges depreciation @15% on original cost of trucks.

[Delhi, B.Com (Pass) 2003, 2006(B)]

UNIT–VI

INLAND BRANCH ACCOUNTS

A firm, having branches, would like to know the profits earned or losses incurred at each branch. The system of accounting adopted by the firm (known as Head Office) will will depend on the type of branch. The branches may be classified as under :

(i) Branches receiving goods only from the head office, selling goods only for cash, remitting all cash received to the head office, expenses being met out of remittance from the head office.

(ii) The branches similar to (i) above, except that the goods are sold both for cash and credit.

(iii) The branches similar to (ii) except that the head office sends to the branches goods at invoice price.

(iv) Branches functioning as an autonomous unit.

(v) Foreign Branches.

Accounts for the first three types of branches are kept by the head office. The last two types of branches maintain an independent set of books of account.

Under the category (iii) the goods are invoiced to the branch at selling price (invoice price) by the H.O. To ascertain correct profit, necessary adjusting entries are recorded to reduce the selling price to cost price. Similarly closing stock is valued at invoice price. Now for reducing closing stock, stock reserve is created. Thus the following journal entries will be passed in the books of H.O.

(i)	Branch a/c	Dr.	Invoice value of goods sent.
	To goods sent to Branch A/c		
(ii)	Branch A/c	Dr.	Cash sent for expenses.
	To Bank A/c		
(iii)	Bank A/c	Dr.	Cash remitted by the branch to the H.O.
	To Branch A/c		(Cash consists of sales and receipts from Drs.)
(iv)	Branch Stock A/c	Dr.	Branch stock (at invoice Price) and branch
	Branch Debtors A/c	Dr.	debtors at the end of the year.
	To Branch A/c		
(v)	Goods Sent to Branch A/c	Dr.	Invoice price on goods sent to branch adjusted.
	To Branch A/c		(Loading on the goods sent)
(vi)	Branch A/c	Dr.	Invoice value of closing stock adjusted.
	To Branch Stock Reserve A/c		
(vii)	Branch A/c	Dr.	Profit at branch
	To Profit and Loss A/c		
(viii)	Goods sent to Branch A/c	Dr.	Goods sent to Branch Transferred.
	To Trading A/c		

Take an example. A new branch is opened and goods costing Rs.40,000. are sent to it. Further, Rs.5,000 are sent by the H.O. to the branch for expenses. The branch remits Rs.51,000. as sale proceeds to the H.O. All the goods sent by H.O. has been sold by the branch. Thus it is clear that the branch has made a profit of 51,000-45,000 = Rs.6,000. This will be recorded in the books of H.O. as follows (without narrations)

		Rs.	Rs.
Branch A/c	Dr.	40,000	
To Goods Sent to Branch A/c			40,000
Branch A/c	Dr.	5,000	
To Bank			5,000
Bank A/c	Dr.	51,000	
To Branch A/c			51,000
Branch A/c	Dr.	6,000	
To P & L A/c			6,000

In the above example, there was no unsold stock. If there is closing stock, it should be valued on the basis of well-accepted principle, i.e. Cost or market Price, whichever is lower of the two. The journal entry of the unsold stock will be :

Branch Stock A/c	Dr.
To Branch A/c	

In case, the branch sells goods on credit, the entry for closing debtors will be :

Branch Debtors A/c	Dr.
To Branch A/c	

The closing stock and closing Debtors will be shown in the Balance Sheet and transferred to the Branch A/c next year. It should further noted that Branch is credited when it remits Cash to H.O. This cash consists of Cash sales and collected from debtors. Branch accounts should not be debited.

Illustration-1 : A Limited opened a branch at Shimla in 2002. Goods were invoiced at cost plus 25%. From the following prepare ledger accounts in the books of A Limited.

	Rs.
Goods sent to Simla (Invoice Price)	40,000
Sales at Simla :	
Cash Sales	21,000
Credit Sales	16,000
Cash collected from debtors	14,500
Discount allowed	200
Cash sent to Branch for expenses	4,000
Stock at Branch, 31st Dec.2002 (Invoice Price)	3,200

Solution

A. Ltd's Books

Shimla Branch A/c

Dr. **Cr.**

		Rs.			Rs.
2002	To Goods sent to Branch A/c	40,000	2002	By Bank (Remittance) Cash sales 21,000 Cash Form Drs. 14,500	35,500
Dec.31	To Bank (Expenses)	4,000			
	To Bank stock Reserve A/c	640	Dec.31	By Branch Stock A/c	3,200
				By Branch Debtors A/c	1,300
	To P & L A/c transfer	3,360		By Goods sent to Branch A/c (loading)	8,000
		48,000			48,000

Goods sent to Branch A/c

2002		Rs.	2002		Rs.
Dec.31	To Shimla Branch A/c (Loading)	8,000		By Shimla Brach A/c	40,000
	To Trading A/c (transfer)	32,000			
		40,000			40,000

Branch Debtors A/c

2002		Rs.	2002		Rs.
	To Sales A/c	16,000		By Cash	14,500
				By Discount	200
				By Balance c/d	1,300
		16,000			16,000

Branch Stock A/c

		Rs.			Rs.
2002			2002		
Dec.31	To Shimla Branch A/c	3,200	Dec.31	By Balance c/d	3,200
2003 Jan.1	To Balance b/d	3,200			

Branch Debtors A/c

		Rs.			Rs.
2002			2002		
Dec.31	To Shimla Branch A/c	1,300	Dec.31	By Balance c/d	1,300
2003 Jan.1	To Balance b/d	1,300			

Branch Stock Reserve A/c

		Rs.			Rs.
2002			2002		
Dec.31	To Balance c/d	640	Dec.31	By Shimla Branch A/c	640
			2000		
			Jan.1	By Balance	640

Stock and Debtors System :

When goods are sent by head office to branch at an invoice price, then this system can be used to ascertain profit or loss of the branch. Under this system, the following ledger account are opened :

(1) Branch Stock Account

(2) Branch Debtors Account

(3) Branch expenses Account

(4) Branch Adjustment Account, Or
Branch Profit and Loss Account

The Head Office keeps branch assets' account as usual.

Entries to be made by the Head Office.

(1) When goods are sent by Head Office to branch at Invoice price.

S.No.	Particulars	L.F.	Rs.	Rs.
	Branch Stock A/c Dr. To Goods Sent to Branch A/c (Goods sent to branch at an invoice price)			

(2) If goods are returned by the branch then

	Goods Sent to Branch A/c Dr. To Brach Stock A/c (Goods returned by the branch)			

(3) When branch expenses are paid by the head office.

	Branch Expenses A/c Dr. To Cash A/c (Branch expenses paid by head office)			

(4) Sales of goods by branch

	Cash A/c Dr. To Branch Stock A/c (Cash sales at branch)			

(5) In case of credit sales by the branch

	Branch Debtors A/c Dr. To Branch stock A/c (Credit sales at branch)			

(6) Cash receipts from branch debtors

	Cash A/c Dr. To Branch debtors A/c (Cash received form branch debtors)			

(7) When any amount is spent or discount etc. is allowed on debtors of the branch.

	Branch Expenses A/c Dr. Branch Discount A/c Dr. To Branch Debtors A/c (Expenses on branch debtors)			

(8) If there is shortage/loss of stock, then

	Branch adjustment A/c Dr. To Branch Stock A/c (Loss in Stock at branch)			

(9) Entry for difference in price i.e. invoice price and cost relating to opening stock at branch goods sent to branch.

	Branch Stock A/c Dr. Goods Sent to branch A/c Dr. To Branch adjustment A/c (Difference in value passed)			

(10) In case of closing stock at branch, reverse entry of the above is to be passed i.e.

	Branch Adjustment A/c Dr. To Branch Stock A/c (Difference in value passed)			

(11) Branch expenses are transferred to branch adjustment account i.e.

	Branch Adjustment A/c Dr. To Branch Expenses A/c (Branch expenses transferred)			

(12) Transfer of balance of branch adjustment account to general profit and loss account, then

	Branch Adjustment A/c Dr. To General Profit & Loss A/c (Balance being profit transferred)			

Note : In case of loss at branch, reverse entry to be passed.

(13) Goods sent to branch is transferred to Purchases account if it is a trading concern and in Trading account if it is a manufacturing concern.

Illustration-2

A Ltd. has a branch in Calcutta. Goods are invoiced at cost plus 25%.

Opening Balance	**2002**
Stock	3,200
Debtors	1,300
Goods sent to Branch (Invoice price)	75,000
Sales at Calcutta	
Cash Sales	32,000
Credit Sales	38,000
Cash collected from Debtors	33,400
Discount allowed	400
Bad Debts written off	250
Cash sent to Branch for expenses	5,500
Stock at end	7,900

Branch Stock A/c

2002			2002		
Jan.1	To Balance b/d	3,200		To Cash Sales	32,000
	To goods sent to Branch A/c	75,000		By Branch Debtors	38,000
				By Branch Adjustment A/c	300
				By Balance c/d	7,900
		78,200			78,200

Goods sent to Branch A/c

2002			2002		
Dec.31	To br. Adjustment A/c (loading)	15,000		By Br. Stock A/c	75,000
	To Trading A/c (Transfer)	60,000			
		75,000			75,000

Branch Stock Reserve A/c

2002			2002		
Dec. 31	To Br. Adjustment A/c	640	Jan.1	By Balance b/d	640
	To balance c/d	1,580	Dec.31	By Branch Adj. A/c	1,580

Branch Debtors Account

2002			2002		
Jan.	To Balance b/d	1,300	by Cash	33,400	
	To Branch Stock			By Branch Exp. A/c	
	(cr. Sales)	38,000		Discount 400	
				Bad Debts 250	650
			Dec.31	By Bal. c/d	5,250
		39,300			39,300

Branch Adjustment A/c

2002			**2002**		
Dec.31	To Be Stock Reserve		Dec.31		
	(closing stock) A/c	1,580		By Stock Reserve	640
	To br. Stock A/c	300		(opening stock)	
	(shortage)				
	To Br. Exp. A/c	7,150		By Goods sent to br. A/c	15,000
	To P & L A/c	6,610			
		15,640			15,640

Branch Expenses A/c

2002	To Cash	6,500	2002	By Branch Adjustment A/c	7,150
	To branch Dr.s A/c		Dec.31		
	Discount 400				
	Bad Debts 250	650			
		7,150			7,150

* This is the balancing figure.

Illustration-3

Agra head office supplies goods to its branch at Alwar at invoice price which is cost plus 50%. All Cash received by the branch is remitted to Agra and all branch expenses are paid by the head office. From the following particulars related to Alwar Branch for the year 2006, prepare Branch debtors account

Branch stock account and Branch Adjustment Account in the books of the head office so as to find out the gross profit and net profit made by the branch.

		Rs.
Stock with Branch on 1.1.2006 (at invoice price)		66,000
Branch Debtors on 1.1.2006		22,000
Petty cash balance on 1.1.2996		500
Goods received from head office (at invoice price)		2,04,000
Goods returned to Head Office		6,000
Credit Sales		87,000
Sales Returns		3,000
Allowance to customer on selling price		
(already adjusted while invoicing)		2,000
Cash received from debtors		93,000
Discount allowed to debtors		2,400
Expenses (cash paid by Head Office)		
	Rs.	
Rent	2,400	
Salaries	24,000	
Petty Cash	2,000	28,400
Cash Sales		1,06,000
Stock with Branch on 31.12.2006 (at invoice price		69,000
Petty Cash balance on 31.12.2006		100

[Delhi B.Com. (Pass) 2001]

Solution

In the books of Agra Head Office

Alwar branch debtors accounts

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	22,000	By Branch Cash A/c	93,000
To Branch stock A/c		By Branch Expenses A/c	
(credit sales)	87,000	(Discount allowed to Debtors)	2,400
		By Sales Returns	3,000
		By Balance c/d	10,600
	1,09,000		1,09,000

Dr.	Alwar Branch Stock Account		Dr.
To balance b/d	66,000	By branch A/c-cash sales	1,06,000
To Goods sent to Branch A/c	2,04,000	By Branch Debtors A/c-credit sales	87,000
To Branches Debtors A/c		By Branch Adjustment A/c	
Sales Return	3,000	Allowance to customer	
		On selling price (already	
		Adjusted while invoicing)	2,000
		By Goods sent to branch A/c	
		Returns to H.O.	6,000
		By Shortage-in-stock A/c	3,000
		By Balance c/d	69,000
	2,73,000		2,73,000

Alwar Branch Adjustment Account

Dr.				Cr.
To Stock reserve A/c		23,000	By stock reserve A/c	
To Goods sent to Branch A/c			(66,000 × 50/150)	22,000
(6000 × 50/150)		2,000	By Goods sent to Branch A/c	
To Branch stock A/c		2,000	(2,04,000 × 50/150)	68,000
To Shortage (Load)		1,000		
To Gross profit c/d		62,000		
		90,000		90,000
To Branch expenses A/c			By Gross profit b/d	62,000
Rent	2,400			
Salaries	24,000			
Petty exp.	2,400	28,800		
(500 + 2000 - 100)				
To Branch debtors A/c discount		2,400		
To Shortage (cost)		2,000		
To Net profit		28,800		
		62,000		62,000

Illustration-4

Delhi Head Office supplies goods to its branch at Kanpur at Invoice Price which is cost plus 50%. All Cash received by the branch is remitted to Delhi and all branch expenses are paid by the head office. From the following particulars related to Kanpur branch for the year 2006 prepare :

(i) Branch Account, and

(ii) Branch Stock Account, Branch Debtors Account, Branch expenses A/c and Branch Adjustment account in the books of the head office so as to find out the gross profit and net profit made by the branch.

			Rs.
Stock with branch on 1.1.06 (at invoice price)			60,000
Branch Debtors on 1.1.06			12,000
Petty Cash balance on 1.1.06			10
Goods received from head office (at invoice price)			1,86,000
Goods returned to head office			3,000
Credit sales less returns			84,000
Allowances to customer at selling price (already adjusted while invoicing)			2,000
Cash received from Debtors			90,000
Discount allowed to Debtors			2,400
Expenses (Cash paid by head office):			
	Rent	2,400	
	Salaries	24,000	
	Petty Cash	1,000	27,400
	Cash sales	1,04,000	
Stock with Branch on 31.12.06 (at invoice price)			54,000
Petty Cash balance on 31.12.06			100

[Delhi, B.Com. (Hons.) 1 Yr. 1889]
[Delhi, B. Com. (Pass), 1997]

Branch Debtors Accounts

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	12,000	By Cash Received	90,000
To Credit Sales	84,000	By Discount Allowed	2,400
		By balance c/d	3,600
	96,000		96,000

Branch Stock Account

Dr. Cr.

To Balance b/d	60,000	By Cash Sales	1,04,000
To Goods Sent to Branch	1,86,000	By Credit sales	84,000
		By Goods Sent to H,P. (Returned)	3,000
		By Shortage (Loss)	1,000
		By balance (Given)	54,000
	2,46,000		2,46,000

Kanpur Branch Account

Dr. Cr.

Particulars	Rs.	Particulars		Rs.
To Stock	60,000	By Cash-Remittance		
To Branch Cash	12,000	Cash Sales	1,04,000	
To Petty Cash	10	Cash from Debtor	90,000	1,94,000
To Goods Sent to Branch	1,86,000	By Goods Sent to H.O. (Returns)		3,000
To Reserve for returns (1/3 of		By Stock Reserve (1/3 of 60,000)		20,000
3,000)	1,000	By Reserve for Goods Sent (1/3 of 1,86,000)		62,000
To Stock Reserve (1/3 of		By Stock at Branch (Given)		54,000
54,000)	18,000	By Branch debtors A/c		3,600
To Branch Expenses	27,400	By Petty Cash		100
To Cash (Petty expenses)	90			
To Profit transferred to Gen. P & L A/c	32,200			
	3,36,700			3,36,700

Branch Adjustment Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Reserve for returns	1,000	By Stock Reserve	20,000
To Stock reserve	18,000	By Reserve for Goods Sent	62,000
To Shortage	333		
To Profit transferred to P & L A/c	62,667		
	82,000		82,000

Branch Expenses Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Cash	27,310	By Profit & Loss A/c	27,310

Branch Profit and Loss A/c

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Branch Expenses	27,400	By Profit & Loss A/c	62,667
To Branch debtors (Discount A/c)	2,400		
To Loss (Shortage)	667		
To Net Profit	32,200		
	62,667		62,667

UNIT–VII

DISSOLUTION OF A PARTNERSHIP

When a partnership comes to an end, it is said to be dissolved according to the Indian Partnership Act, a firm may be dissolved in any of the following ways :

A. Dissolution by agreement

If all the partners give their consent for the dissolution of the firm or in accordance with the contract between them, the firm may be dissolved.

B. Compulsory Dissolution

The firm is dissolved compulsorily under the following conditions :—

1. Adjudication as insolvent of all the partners but one, or
2. By the happening of an event which makes it unlawful for the business of the firm to be carried on or for the partnership.

C. Contingent Dissolution :

A firm is dissolved on the happening of the following events subject to the agreement among the partners :—

1. If a firm is constituted for a fixed term it will be dissolved on the expiry of that term; or
2. If constituted for a particular venture, on the completion thereof; or
3. On the death of a partner; or
4. Of the adjudication of a partner as insolvent.

D. Dissolution by Notice

If the partnership business is carried on at will, the firm may be dissolved by ay partner giving notice in writing to all the partners of his intention to do so. The firm is dissolved as from the date mentioned in the notice as the date of dissolution. If no date is mentioned, the firm is dissolved as from the date of communication of the notice.

E. Dissolution by Court :

If any of the partners files a suit in the court, the court may order dissolution of the firm on the following ground

1. That a partner other than the partner suing has become of unsound mind, or has, become in any way permanently incapable of performing his duties as partner.
2. That a partner other than the partner suing is guilty of conduct which is likely to affect adversely the carrying on of the business.
3. That a partner other than the partner suing or wilfully or negligently and persistently commits breach of agreement relating to the management of the firm.
4. That a partner other than the partner suing has transferred the whole of his interest in the firm or a substantial part thereof to a third party or his share has been attached.
5. That the business of the firm cannot be carried on except at loss.
6. 'Lastly, if the court think it "*just and equitable*" that the firm should be dissolved.

The partners are the right person to take charge of the assets and liabilities of the affairs of the partnership. In the process of winding up each partner has the power to bind the firm with his deeds. If, after dissolution by the court, the partners do not agree at the winding up, the court appoints a receiver, and if necessary, a manager for the purpose of dissolution. In case the partnership is dissolved due to the death or insolvency of one of the parters, the continuing or solvent partners are entitled to wind up the affairs of the firm.

In the settlement of accounts of the firm for dissolution, the Goodwill, subject to contract between the partners, is included in the assets. It may be sold either separately or along with the other assets of the firm. Similarly, subject to the agreement by the partners, all the accounts of the firm on dissolution must be settled according to following rules :—

1. Loss including deficiencies of capital shall be paid, first out of profit, next out of capital and lastly, if necessary by the partners individually in the proportion in which they were sharing profits and losses.
2. The assets of the firm including any amount or amounts contributed by the partner to make good deficiencies of capital shall be applied in the following order :—
   (a) In paying debts and liabilities of the firm to persons who are not partners of the firm.
   (b) In paying to the partner rateably, what is due to him as advances as distinguished from capital (that is to say, partners' loans have to be paid after paying off outsiders).
   (c) In paying each partner rateably what is due from the firm to him in respect of capital.
   (d) lately, if there is any surplus it shall be divided among the partners in proportions in which they were entitled to share profits.

On dissolution, the normal business of the firm comes to an end and the first thing the firm has to do is to settle the accounts with the third parties as well as among the partners themselves. For this purpose, the assets of the firm would be disposed off and cash realised. The cash so obtained will be first used for meeting all outside liabilities of the firm. If there is any left, it will be distributed among the partners. To sum up, the money available will be applied or used in the following manner.

(1) Payment of expenses on disposing of the assets and collecting the debts due to the firm.
(2) Payment of outside liabilities of the firm, e.g. creditors, borrowings, bank overdraft, bills payable, the loan from partners' wives etc.
(3) Repayment of the loans received from the partners.
(4) Repayment of the capital contribution of the partners.
(5) If there is still any surplus left after meeting the claims stated in *1* to *4* it will be shared by the partners in their Profit sharing Ratio.

All the above rules should be strictly followed in the solution of accounting problems on dissolution.

Dissolution Accounts

To find out the result of dissolution a special account is prepared which is termed as Realisation Account. This account serves as a total of assets and liabilities account and all balance other than cash, capitals and profit and losses are transferred to this account. An up-to-date Balance Sheet showing the exact state of affairs of the firm is necessary. *To close the books of a firm the following steps are taken* :

1. All the assets except *Cash and bank* are transferred to the Realisation Account at their Book Values. For this purpose, Realisation Account is debited and individual assets accounts are credited. The effect of this entry is that all the accounts of different assets excluding Cash and Bank, are closed in the books of the firm.

Notes (I)

1. The following items on the asset side of the balance sheet are not transferred to the Realisation A/c—

(i) Cash in hand and cash at Bank

(ii) Debit balance of partner's current Accounts

(iii) Debit balance of profit and loss A/c.

(iv) Balance of deferred revenue expenditure such as prepaid expenses, advertisement, etc. which have no realisable value.

(v) Fictitious asses like value less patents, trademark etc.

These items (ii to v) will be transferred to capital/current accounts of the partners.

(II).1. Assets against which a provision or reserve exists, should be transferred to the realisation account at the gross figure and the provisions or reserve Accounts shall be transferred to the credit side of the realisation A/c.

2. Similarly, all the liabilities except partners' capitals, reserves and undistributed profits and their loans to the firm, are transferred to the credit side of the Realisation Account. This is done by means of a journal entry, debiting the individual liabilities accounts ad crediting Realisation Account.

3. When all the assets are sold for cash, the Cash Account or Bank Account is debited and the Realisation Account credited. If any assets is taken over by a partner, the capital account of the concerned partner is debited and Realisation Account is credited.

4. Expenses of realisation are paid out of the Cash or Bank; for this the Realisation Account is debited and Cash/Bank Account is credited. Sometimes, a partner may be paid commission at a certain rate calculated on the amount of assets realised and he is required to bear all expenses of realisation. In such a case the Journal entry will be—

Realisation A/c Dr.

To partner's current/capital Accounts

Generally of entry is made for the actual expenses paid by the partners. However, the actual expenses incurred by the partner may be treated as drawings by the partner in which case, the entry would be :—

Partner's current A/c/Capital Account Dr.

To Bank A/c.

Undisclosed or unrecorded assets and liabilities :

Some assets might have bee completely written off yet they are physically present in the business on dissolution these assets might be either sold or taken over by any partner or a creditor at agreed price.

Such asset would never be transferred to realization account, but the entries would be as under :—

(i) When sold for cash — Bank A/c Dr.

To Realisation A/c

(ii) When taken over by a partner — Partner's Capital A/c

To Realisation A/c

(iii) No entry if taken over by a creditor

Similary unrecorded liability will not be recorded in realisation A/c only the payment made will be shown as :

Realisation a/c Dr. when paid in cash

To Bank A/c

Realisation A/c Dr. When take over or paid by a partner

To Partner's capital A/c

5. The amount paid to settle liabilities already transferred to the Realisation Account is debited to the Realisation Account, crediting the Cash (or bank) Account.
6. The Realisation account is then balanced. The balance represents either loss or profit. Whatever the case may be, the balance is trasnsferred to the capital accounts of partners *in their profit sharing ratio*. The Realisation Account is thus closed.
7. If there is a loan by a partner, the same will be paid out of the cash. Partner's Loan Account will be debited and Cash Account credited.
8. If there is a General Reserve or an accumulated balance or profit in the books of partnership, it is transferred to the credit of partners' capital accounts in their profit sharing ratio.
9. If there is a deficiency in any partners' capital accounts he will be liable to make it up by bringing in cash.
10. When all the above steps are taken, the only accounts not closed as yet are the cash Account and Partner' Capital Accounts. The due balances of the partners are now paid in cash. The partner's capital accounts are debited and the Cash Account is credited with the actual amount of cash paid to them. In this way all the accounts are finally closed.

Payment of liabilities through surrender of assets — If any asset has been taken over or accepted by any creditor in full or part payment of the amount due to him, then the agreed value of the asset will be deducted from the amount due to the creditor and the payment will be nil, in case of full settlement or payment will be restricted to the balance amounts

Illustration-1

The following is the Balance Sheet of M/s Akbar and Aggarwal, who share profits in the ratio 3 : 2 as on 31st March, 2002

Liabilities	Rs.	*Assets*	Rs.
Sundry Creditors	1,800	Cash	2,000
Reserve Fund	2,000	sundry Debtors	3,700
Agarwal's Loan	2,000	Stock	10,100
Akbar's Capital	8,000	Furniture and Fixtures	2,000
Agarwal's Capital	8,000	Lease	4,000
	21,800		21,800

On that date they agreed to dissolve their partnership. Stock was sold for Rs.9,200. Lease for Rs.2,400, Furniture and Fixture realised Rs.2,200. The creditors were paid Rs.1,720, in full and final settlement of their accounts. The expenses of realisation amounted to Rs.400 Rs.3,600 was received from debtors.

Pass the necessary journal entries and make relevant ledger Accounts.

Solution

(Dates omitted)

Journal

		Rs.	Rs.
Realisation A/c	Dr	19,800	
To S. Debtors A/c			3,700
To Stock A/c			10,100
To Furniture and Fixture A/c			2,000
To Lease A/c			4,000
(Being the transfer of assets to Realisation A/c.)			
Sundry Crditors A/c	Dr.	1,800	
To Realisation A/c			1,800
(Being the transfer of creditors to Realisation A/c.)			
Bank A/c	Dr.	17,400	
To Realisation A/c			17,400
(Being the amount realised on the sale of assets.)			
Realisation A/c	Dr.	400	
To Bank A/c			400
(Being the Realisation expenses paid.)			
Realisation A/c	Dr.	1,720	
To Bank A/c			1,720
(Being the Creditors paid)			
Akbar's Capital A/c	Dr.	1,632	
Agarwal's Capital A/c	Dr.	1,088	
To Realisation A/c			2,720
(Being the loss on Realisation transferred to partner's Capital Accounts.)			
Reserve Fund A/c	Dr.	2,000	
To Akbar's Capital A/c			1,200
To Agarwal's Capital A/c			800
(Being the distribution of Reserve fund among partners.)			
Agarwal's Load A/c	Dr.	2,000	
To Bank A/c			2,000
(Being payment of Agarwal's Loan.)			
Akbar's Capital A/c	Dr.	7,568	
Agarwal's Capital A/c	Dr.	7,712	
To Bank A/c			
(Being the payment of each partners.)			15,280

Dr.	Ledger Realisation Account		Cr.
	Rs.		Rs.
To Sundry Assets	19,800	By Sundry Creditors	1,800
To Cash (Exp.)	400	By bank A/c (assets realised)	17,400
To Bank (Crs).	1,720	By Akbar's Capital	1,632
		By Agarwal's Capital	1,088
	21,920		21,920

Agarwal's Loan A/c

	Rs.		Rs.
To Bank A/c	2,000	By Balance c/d	2,000
	2,000		2,000

Akbar's Capital A/c

	Rs.		Rs.
To Realisation A/c (Loss)	1,632	By Balance b/f	8,000
To Bank A/c	7,568	By Reserve Fund	1,200
	9,200		9,200

Agarwal Capital A/c

	Rs.		Rs.
To Realisaton A/c (Loss)	1,088	By Balance b/f	8,000
To Bank A/c	7,712	By Reserve Fund	800
	8,800		8,800

Bank Account

To Balance b/f	2,000	By Realisation (Exp.)	400
To Realisation A/c	17,400	By Realisation A/c (Creditors)	1,720
		By Agarwal's Loan A/c	2,000
		By Akbar Loan's A/c	7,568
		By Agarwal Capital's A/c	7,712
	19,400		19,400

Illustration-2

Krishan, Kishore and Kumar are in partnership sharing profit and losses 1/2, 1/4, 1/4 respectively. They resolve to wind up the business standing as on 31st March, 2002 as follows :

	Rs.		Rs.
Sundry's Creditors	1,550	Cash 1,000	
Krishan's Capital	2,500	Stock in Trade	3,000
Kishore's Capital	1,500	Sundry Debtors	1,500
		Kumar's Capitals (Deficit)	50
	5,550		5,550

The stock was sold for Rs.2,500 and the Book Debts were realised in full except on owing Rs.150. Cost of realisation amounted to Rs.50

Prepare necessary Ledger Accounts to close the books.

Solution

Ledger Realisation Account

	Rs.		Rs.
To Sundry Assets	4,500	By Sundry Creditors	1,550
To Bank (Exp.)	50	By Bank (Proceed of Assets)	3,850
To Bank (Crs.)	1,550	By Loss :—	
		Krishan's Capital A/c	350
		Kishore's Capital A/c	175
		Kumar's Capital A/c	175
	6,100		6,100

Bank Account

	Rs.		Rs.
To Balance b/f	1,000	By Realisation (Exp.)	50
To Realisation A/c	3,850	By Realisation (Crs.)	1,550
To Kumar's Capital	225	By Krishan	2,150
		By Kishore	1,325
	5,075		5,075

Kishore's Capital A/c

	Rs.		Rs.
To Realisation A/c (Loss)	350	By Balance b/f	2,500
To Bank A/c	2,150		
	2,500		2,500

Kishore's Capital A/c

	Rs.		Rs.
To Realisation A/c (Loss	175	By balance b/f	1,500
To Bank A/c	1,325		
	1,500		1,500

Kumar's Capital A/c

	Rs.		Rs.
To Balance b.a.	50	By Bank A/c	225
To Realisation A/c	175		
	225		225

Insolvency of a Partner—Garner vs. Murray Decision

Before the decision in Garner vs. Murray, any loss, arising from insolvency of any partner, was borne by the solvent partners in the same proportion as they had shared profits and losses of the business. But after the decision of justice Juice in the case of garner vs. Murray, the loss arising by default of an insolvent partner is to be borne by the solvent partners in proportion to their *respective capitals* instead of their Profit sharing ratio. *It should be noted that this rule is applied only where there is no agreement on this point.*

The Realisation account is prepared as usual whether this rule is to be applied or not. The insolvent partner asked to pay whether he can, towards his debit balance. The final balance in the solvent partners in the *ratio of their capital as they stood before dissolution*. The application of ruling of Garner vs. Murray may be the excluded by the expressed agreement among the partners.

Fixed and Fluctuating Capitals : In Garner vs. Murray the ratio of capital prior to dissolution formed the basis for writing off the deficiencies of insolvent partner. In this connection it is important to note when the capital accounts are fixed; the original capitals form the ratio to distribute the loss caused by the default of an insolvent partner. But if the capitals are fluctuating, first of all relevant adjustment regarding Reserve and business profit and losses are made; capitals, thus but without any adjustment for realisation loss or profit or taken over of an assets or liability by a partner form the basis for distribution of loss due to the insolvency of a partners

Illustration : 3

P, Q and R are partners sharing profits and losses as 4 : 3 : 2. Thier Balance Sheet on 31st December, 2002 and as follows :

Liabilities	Rs.	*Assets*	Rs.
Sundry Creditors	7,200	Cash	3,200
Capitals :		Sundry Debtors	2,000
P	8,000	Stock	4,000
Q	4,000	Plant and Machinery	11,000
R	1,000		
	20,200		20,200

On that date partners agree to dissolve the firm. Mr. Q takes over the stock for Rs.3,000 and debtors for Rs.1,400 The Plat and Machinery are sold for Rs.3,000

Prepare necessary ledger accounts to close the books of the firm Mr. R is insolvent and cannot contribute anything towards his deficiency.

Solution

Ledger Realisation Account

	Rs.			Rs.
To Sundry Acts	17,000	By Sundry Creditors		7,200
To bank (Crs.)	7,200	By Q's Capital A/c		4,400
		By Bank (assets sold)		5,400
		By Loss transferred:—		
		P	3,200	
		Q	2,400	
	24,200	R	1,600	7,200
				24,200

P's Capital A/c

	Rs.		Rs.
To Realisation A/c (Loss)	3,200	By Balance b/d	8,000
To R's Capital A/c	400		
To Bank A/c	4,400		
	8,000		8,000

Q's Capital A/c

	Rs.		Rs.
To Realisation (Loss)	2,400	By Balance b/d	4,000
To R's Capital	200	By Bank A/c	3,000
To Realisation A/c (assets taken over)	4,400		
	7,000		7,000

R's Capital A/c

	Rs.		Rs.
To Realisation (Loss)	1,600	By Balance b/d	1,000
		By P's Capital (8/12)	400
		By P's Capital (8/12)	200
	1,600		1,600

Bank Account

	Rs.		Rs.
To Balance b/d	3,200	By Realisation A/c	7,200
To Realisation	5,400	By P's Capital A/c	4,400
To Q's Capital	3,000		
	11,600		11,600

Illustration-4

White, Red and Black are partners sharing profits and losses equally. On 31st December, 2002 they decided to dissolve the firm, when their Balance Sheet was as under :

	Rs.		Rs.
Sundry Creditors	10,000	Cash	3,000
White's Capital	12,500	Stock in Trade	10,000
Red's Capital	7,500	Book Debts	10,000
Reserve Fund	7,500	Plant and Machinery	10,000
		Black's Capital (over drawn)	4,500
	37,500		37,500

Book debts realised 7,250. Stock was sold for Rs.8,000 and Plant & Machinery for Rs.7,000 The expenses of realisation amounted to Rs.1,250. Black is declared insolvent and only Rs.1,000 were obtained from his estate.

Solution

Ledger Realisation Account

	Rs.		Rs.
To Sundry Assets	30,000	By Creditors	10,000
To Cash (Expenses)	1,250	By bank A/c (Assets realised)	22,250
To bank (Creditors)	10,000	By Loss on Realisation	
		transferred to Capital	
		Accounts : White	3,000
		Red	3,000
		Black	3,000
	41,250		41,250

White's Capital A/c

	Rs.		Rs.
To Realisation A/c (Loss)	3,000	By Balance b/d	12,500
To Black's Capital A/c	2,500	By Reserve Fund	2,500
To Bank A/c	9,500		
	15,000		15,000

Red's Capital Account

	Rs.		Rs.
To Realisation A/c (Loss)	3,000	By Balance b/d	7,500
To Black's Capital A/c	1,500	By Reserve Fund	2,500
To Bank A/c	5,500		
	10,000		10,000

Black's Capital Account

	Rs.		Rs.
To Balance b/d	4,500	By Reserve Fund	2,500
To Realisation (Loss)	3,000	By Bank	1,000
		By White's Capital A/c	2,500
		By Red's Capital	1,500
	7,500		7,500

Bank Account

	Rs.		Rs.
To Balance b/d	3,000	By Realisation A/c (Exp.)	1,250
To Realisation A/c	22,250	By Realisation 9Crs.)	10,000
To Black's Capital	1,000	By White's Capital	9,500
		By Red's Capital	5,500
	26,250		26,250

Note:— Assuming the Capitals are fixed, Black's deficiency is borne by White and Red in the ratio of their original capital i.e.; 12,500 and 7,500 respectively

Illustration : 5

Bose, ghosh and Roy were partners in a business sharing profits and losses equally. On 1st April, 2002, Roy became insolvent and is unable to contribute anything and on that date their Balance Sheet stood as follows :

		Rs.		Rs.
Creditors		38,000	Debtors	97,000
B/P		9,000	Stock	24,000
Capital Account			Furniture	3,800
Bose	60,000		Cash at Bank	6,200
Ghosh	30,000		C's Drawing A/c	30,000
Roy	10,000	1,00,000		
Drawing Account :				
Bose		7,000		
Ghosh		7,000		
		1,61,000		1,61,000

The partnership is dissolved. Debtors, stock and Furniture realise only Rs.1,03,800. Prepare the necessary Ledger Accounts to close up the books of the firm.

Solution

Ledger Realisation Account

To Debtors	97,000	By Creditors	38,000
To Stock	24,000	By B/P	9,000
To Furniture	3,800	By Bank	1,03,800
To Bank (Creditors)	38,000	By Loans transferred to	
To Bank (B/P)	9,000	Drawing Accounts	
		Bose	7,000
		Ghosh	7,000
		Roy	7,000
	1,71,800		1,71,800

Bank Account

	Rs.		Rs.
To Balance b/d	6,200	By Realisation A/c	38,000
To Realisation A/c	1,03,800	By Realisation A/c	9,000
To Bose's Drawings	7,000	By Bose's Capital A/c	49,000
To Ghosh's Drawings	7,000	By Ghosh's Capital A/c	28,000
	1,24,000		1,24,000

Bose's Capital A/c

	Rs.		Rs.
To Drawing A/c (Transfer)	11,000	By Balance b/d	60,000
To Bank	49,000		
	60,000		60,000

Bose's Drawings A/c

	Rs.		Rs.
To Realisation A/c	7,000	By Balance b/d	7,000
To Roy's Capital A/c	18,000	By Bank A/c	7,000
		By Capital A/c (Transfer)	11,000
	25,000		25,000

Ghosh's Capital A/c

	Rs.		Rs.
To Drawing A/c (Transfer)	2,000	By balance b/d	30,000
To Bank	28,000		
	30,000		30,000

Ghosh's Drawings A/c

	Rs.		Rs.
To Realisaton A/c	7,000	By Balance b/d	7,000
To Roy's Capital A/c	9,000	By Bank A/c	7,000
		By Capital A/c (Transfer)	2,000
	16,000		16,000

Roy's Capital A/c

	Rs.		Rs.
To Drawing A/c (transfer)	37,000	By Balance b/d	10,000
		By Bose's Drawing A/c	18,000
		By Ghosh's Drawing A/c	9,000
	37,000		37,000

Roy's Drawing A/c

	Rs.		Rs.
To Balance b/d	30,000	By Capital A/c (Transfer)	37,000
To Realisation A/c	7,000		
	37,000		37,000

Illustration-6

Ram, Shyam and Ghanshyam are partners sharing profits and losses in the ratio of 4 : 2 : 3. On 1st January 2002, they agreed to dissolve the partnership, when their Balance Sheet was as follows :

Liabilities		Rs.	*Assets*	Rs.
Capital Accounts :			Buildings	45,000
Ram	68,000		Machinery	15,000
Shyam	46,000		Furniture	3,700
Ghanshyam	3,000	1,17,000	Stock	19,400
			Debtors	31,000
Ram's Loan		4,000	Investments	24,000
Creditors		9,000	Bills Receivable	5,600
Bills Payable		4,100	Cash at Bank	6,500
Reserve Fund		12,600	Cash in Hand	1,000
Profit and Loss Account		4,500		
		1,51,200		1,51,200

1. The assets realised as under :

Investments Rs.20,400; Bills Receivable and Debtors Rs.28,200; Stock Rs.14,550; Furniture Rs.2,050; Machinery Rs.8,600. Building Rs.26,400.

2. All the liabilities were paid off.

3. The cost of realisation was Rs.600.

4. Ghanshyam had become bankrupt and Rs.1,024 only recovered from his estate once and for all.

5. Partners were finally paid off.

Required :

(i) Realisation Account.

(ii) The Bank Account.

(iii) Partner's Capital Accounts :

(a) When the Capitals are fixed.

(b) When the Capitals are floating.

Solution :

Realisation Account

	Rs.			Rs.
To Buildings	45,000	By Creditors		9,000
To Machinery	15,000	By Bills Payable		4,100
To Furniture	3,700	By bank-Assets Realised		
To Stock	19,400	Investments	20,400	
To Debtors	31,000	B/R & Debtors	28,200	
To Investments	24,000	Stock	14,550	
To Bills Receivable	5,600	Furniture	2,050	
To Bank (Creditors)	9,000	Machinery	8,600	
To Bank (BP)	4,100	Building	26,400	
To Bank (Expenses)	600			1,00,200
		By Loss on Realisation :		
		Ram $\frac{4}{9}$		19,600
		Shyam $\frac{2}{9}$		9,800
		Ghanshyam $\frac{3}{9}$		14,700
	1,57,400			1,57,400

Note : Realisation Account is common whether the capitals are fixed or floating.

(a) When Capitals are fixed :

Ram's Current Account

	Rs.		Rs.
To Realisation Account	19,600	By Reserve Fund	5,600
To Ghanshaym's Capital A/c	2,968	By Profit and Loss A/c	2,000
To Ram's Capital Account transfer	4,632	By Bank	19,600
	27,200		27,200

Ram's Capital Account

	Rs.		Rs.
To Bank	72,632	By Balance b/d	68,000
		By Ram's Current Account	4,632
	72,632		72,632

Shyam's Current Account

	Rs.		Rs.
To Realisation Account-loss	9,800	By Reserve Fund	2,800
To Ghanshaym's Capital A/c	2,008	By Profit and Loss Account	1,000
To Shyam's Capital account-transfer	1,792	By bank	9,800
	13,600		13,600

Shyam's Capital Account

	Rs.		Rs.
To Bank	47,792	By Balance b/d	46,000
		By Shyam's Current Account	1,792
	47,792		47,792

Ghanshyam's Current Account

	Rs.		Rs.
To Realisation Account-Loss	14,700	By Reserve Fund	4,200
		By Profit and Loss Account	1,500
		By Ghanshyam's Capital Account transfer	9,000
	14,700		14,700

Ghanshyam's Capital Account

	Rs.		Rs.
To Ghanshyam's Current A/c	9,000	By Balance b/d	3,000
		By Bank	1,024
		By Ram's Current Account	2,968
		By Shyam's Current Account	2,008
	9,000		9,000

Bank Account

	Rs.		Rs.
To Balance b/d	7,500	By Realisation A/c (Bills Payable)	4,100
To Realisation Account	1,00,200	By Realisation A/c (Creditors)	9,000
To Ram's Current A/c	19,600	By Realisation Account-Exp.	600
To Shyam's Current A/c	9,800	By Ram's Capital Account	72,632
To Ghanshyam's Capital A/c	1,024	By Shyam's Capital Account	47,792
		By Ram's Loan	4,000
	1,38124		1,38,124

(b) When capitals are Fluctuating or Floating :

Ram's Capital Account

	Rs.		Rs.
To Realisation Account	19,600	By Balance b/d	68,000
To Ghanshyam's Capital A/c	3,000	By Reserve Fund	5,600
To Bank	72,600	By Profit and Loss account	2,000
		By Bank	19,600
	95,200		95,200

Shyam's Capital Account

	Rs.		Rs.
To Realisation account	9,800	By Balance b/d	46,000
To Ghanshyam's Capital A/c	1,976	By Reserve Fund	2,800
To Bank	47,824	By Profit and Loss Account	1,000
		By Bank	9,800
	59,600		59,600

Ghanshyam's Capital Account

	Rs.		Rs.
To Realisation Account	14,700	By Balance b/d	3,000
		By Reserve Fund	4,200
		By Profit and Loss A/c	1,500
		By Bank	1,024
		By Ram's Capital A/c (756/1,253)	
		By Shyam's Capital A/c (498/1,254)	1,976
	14,700		14,700

Bank Account

	Rs.		Rs.
To Balance b/d	7,500	By Realisation a/c-Expenses	600
To Realisation A/c	1,00,200	By Realisation A/c (Sundry Creditors)	9,000
To Ram's Capital A/c	19,600	By Realisation A/c (Bills Payable)	4,100
To Shyam's Capital A/c	9,800	By Ram's Capital Account	72,600
To Ghanshyam's Capital A/c	1,024	By Shyam's Capital Account	47,824
		By Ram's Loan A/c	4,000
	1,38,124		1,38,124

Illustration-7

A, B, C and D were partners sharing profits and losses in the ratio of 33 : 2 : 2 respectively. The following is their Balance Sheet as at 31st December 2002.

		Rs.			Rs.
Creditors		31,000	Cash in hand		4,000
A's Loan	20,000		Debtors	32,000	
Capital accounts :			*Less* : Reserve	1,000	31,000
A	40,000		Stock		20,000
B	30,000	70,000	Furniture		8,000
			Car		14,000
			Capital Accounts :		
			C	12,000	
			D	32,000	
					44,000
		1,21,000			1,21,000

It was decided to dissolve the firm with effect from 31st December 2002 and B was appointed to liquidate the assets and pay the creditors. He was entitled to receive 5% commission on the amount finally paid to other partners including loans if any. He was to bear the expenses of realisation which amounted to Rs.500. The assets realised Rs.54,000. Creditors were paid in full. In addition a sum of Rs.5,000 was also paid to staff on retrenchment in full settlement of their claim.

D was insolvent and the partners accepted Rs.7,400 from his estate in full settlement. Applying the rule in Garner v. Murray, prepare necessary ledger accounts.

Solution

Readlisation Account

	Rs.		Rs.
		By Creditors	31,000
To Debtors	32,000	By Provision for doubtful debts	1,000
To Stock	20,000	By Bank—Assets Realised	54,000
To Furniture	8,000	By Capitals	
To Car	14,000	A	7,200
To Bank A/c (Compensation)	5,000	B	7,200
To Bank A/c (Creditors)	31,000	C	4,800
		D	4,800
	1,10,000		1,10,000

A's Capital Account

	Rs.	Rs.	
To Realisation Account	7,200	By Balance b/d	40,000
To D's Capital Account	16,800	By Loan Account	20,000
To B's Capital Account		By Bank	7,200
(Commission)	1,714		
To Bank	41,486		
	67,200		67,200

B's Capital Account

	Rs.		Rs.
To Realisation Account	7,200	By Balance b/d	30,000
To D's Capital Account	12,600	By Bank	7,200
To Bank	19,114	By A's Capital Account	
		Commission	1,714
	38,914		38,914

C's Capital Account

	Rs.		Rs.
To Balance b/d	12,000	By Bank	16,800
To Realisation Account	4,800		
	16,800		16,800

D's Capital Account

	Rs.		Rs.
To Balance b/d	32,000	By Bank	7,400
To Realisation Account	4,800	By A,sCapital Account	16,800
To Bank	19,114	By B's Capital Account	12,600
	36,800		36,800

Bank Account

	Rs.		Rs.
To Balance b/d	4,000	By Realisation A/c (Creditors)	31,000
To Realisation account	54,000	By Realisation Account	5,000
To A's Capital Account	7,200	(Compensation)	
To B's Capital Account	7,200	By A's Capital Account	41,486
To C's Capital Account	16,800	By B's Capital Account	19,114
To D's Capital Account	7,400		
	96,600		96,600

Notes : (i) Since C has a debit balance in his capital account on the date of dissolution he is not required to bear the deficiency in the capital account of D, the insolvent partner. Only A and B would have to share the deficiency of D in the ratio of 4 : 3. However, C has paid his own deficiency since he is solvent.

(ii) The actual expenses on realisation paid by B have been assumed to have been met by B privately. Hence the amount of expenses has been ignored in the accounts.

(iii) Cash representing loss on realisation brought in by solvent partners is credited in partner's capital accounts.

(iv) Commission payable to B has been calculated as under :

Amount due to 'A' before charging commission	43,200
Less : Cash brought in, being realisation loss.	7,200
	36,000

Commission : $\frac{36,000 \times 5}{105}$ = Rs. 1, 714 (Approx)

Loan from wife of a partner— A loan from wife if assumed to be given by her from her personal property *Stridhan,* her position is like that of a creditor. If it is proved that the loan given by the wife out of money given to her husband then her position is not at par with the creditors. The amount contributed in such a case is taken as the Capital of the proprietor.

Insolvency of all the Partners

When a firm is unable to pay its debts, all its partners are said to have become involvement. Under such cases, creditors do not get back their money fully. The creditors get the money which is available after selling its assets and provided by partners and paying of its expenses of selling assets.

The creditors are not transferred to Realisation A/c. Creditors accounts is closed by transferring to Profit and Loss Account or Deficiency A/c. The deficiency of partners is also transferred to this Profit and Loss Account or Deficiency Account.

Illustration : 8

The following is the Balance Sheet of X & Y.

Liabilities	Rs.	*Assets*	Rs.
X's Capital	1,200	Machinery	2,950
Creditors	7,800	Furniture	800
		Debtors	1,000
		Stock	1,250
		Cash 600	
		Y's Capital	2,400
	9,000		9,000

The assets realised as follows :

Furniture Rs.350, Stock Rs.350, Debtors Rs.1,000; Machinery Rs.3,000 The realisation expenses amounted to Rs.550 X cannot pay anything from his private estate whereas Y can bring only Rs.550 from his private estate. Prepare the necessary accounts.

Solution :

Realisation account

	Rs.				Rs.
To machinery	2,950	By Cash (Sale proceeds of assets)			3,500
To Furniture	800	By Loss on Realisation			
To Debtors	1,000	transferred to—			
To Stock	1,250		X's Capital	1,400	
To Cash (Real. Exp.)	300		Y's Capital	1,400	2,800
	6,300				6,300

Cash Account

	Rs.		Rs.
To Balance b/f	600	By Realisation (Exp.)	300
To Realisation (assets realised)	3,500	By Creditors	3,900
To Y's Capital	100		
	4,200		4,200

Creditors Account

	Rs.		Rs.
To Cash	3,900	By Balance b/c	7,800
To Deficiency a/c	3,900		
	7,800		7,800

X's Capital

	Rs.		Rs.
To Realisation (Loss)	1,400	By Balance b/f	1,200
		By Deficiency A/c	200
	1,400		1,400

Y's Capital

	Rs.		Rs.
To Balance b/f	2,400	By Cash	100
To Realisation	1,400	By Deficiency A/c	3,700
	3,800		3,800

Deficiency A/c

	Rs.		Rs.
To X's Capital	200	By Creditors	3,900
To Y's Capital	3,700		
	3,900		3,900

Illustratio-9

Rahim, Zaidi ad Tahir shared profits ad losses in the ratio 5: 3 : 2 respectively. On 31st December, 2007, their Balance Sheet was as follows :

Liabilities	Rs.	*Assets*	Rs.
Trade Creditors A/c	30,000	Furniture A/c	11,000
Bank Loa A/c	10,000	stock A/c	48,000
Rahim's Capital Account	30,000	Cash A/c	1,000
Zaidi's Capital Account	20,000	Profit and Loss Account	40,000
Tahir's Capital Account	10,000		
	1,00,000		1,00,000

The Bank had a charge on all the assets. Furniture realised Rs.3,000 while the entire stock was sold for Rs.25,000. Zaidi's private estate realized Rs.6,000; his private creditors were Rs.5,000. Tahir was unable to contribute anything, Rahim paid one third of what was finally due from him taking the payment also into account, except on account of other partners.

Prepare Realization Account, Cash Book and Partner's Capital Accounts, passing all matters relating to realization of assets and payment of liabilities through the Realization Account. Clearly show your calculation regarding cash brought in Rahim.

[Delhi, B.Com. (Hons.) 1 Year 1986, 1997]

Solution

Realization Account

Particulars	*Rs.*	*Particulars*		*Rs.*
To Furniture A/c	11,000	By Realization A/c		10,000
To Stock A/c	48,000	By Trade Creditors A/c		30,000
To Cash (Bank Loan repaid)	10,000	By Furniture (Cash realized)		3,000
To Cash (Trade creditors)	20,200	By stock (Cash) A/c		25,000
		By Loss on Realization a/c		
		Rahim	10,600	
		Zaidi	6,360	
		Tahir	4,240	21,200
	89,200			89,200

Cash Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance b/d	1,000	By Realization A/c	
To Realization a/c		(Repayment of bank loan)	10,000
Sale of Stock A/c	25,000	By Realization A/c	
Sale of Furniture A/c	3,000	(Repayment to creditors	20,200
To Zaidi Capital A/c	1,000		
To rahim's Capital A/c	200		
	30,200		30,200

Partner's Capital Accounts

Particulars	Rahim	Zaidi	Tahir	Particulars	Rahim	Zaidi	Tahir
To Profit & Loss A/c	20,000	12,000	8,000	By Balance b/d	30,000	20,000	10,000
To Loss on Realization	10,600	6,360	4,240	By Cash (6,000-			
To Tahir's Capital A/c	–	2,240	–	5,000)	–	1,000	–
To Rahim's Capital A/c	–	400	–	By Cash	200	–	–
				By Zaidi's Cap. A/c	400	–	2,240
	30,600	21,000	12,240		30,600	21,000	12,240

Note :

1. Cash available is given to sundry creditors i.e. Total cash is Rs.30,200. i.e. 1,000 balance (opening) + Rs. 28,000. from realization + Rs. 1,000 excess recovered from private estate of Zaidi & Rs.200 paid by Rahim out of which Rs. 10,000 was paid to bank. Rest to creditors.

2. Calculation by cash brought in by Rahim.

   1/3 of due is X, then amount payable to sundry creditors will be Rs. 20,000 + X. Loss on relaization will be 59,000 + 10,000 + 20,000X – 68,000 = 21,000 + X

   Rahim's share will be 1/2 of (21,000 + X) or 10,500 = 1/2X

   Total debit in Rahim's Capital A/c willbeRs. 20,000 + 10,500 + 1/2 X

   Total credit in Rahim's capital A/c is Rs.30,000 so net debit balance will 500 + 1/2X

   Then 3X = 500 + ½X

   6X = 1000 + X OR 5X = Rs. 200.

Illustration-10

X, Y and Z carrying on business since 2003 decided to dissolve their partnership on 30th June 2006 when their balance sheet was as under.

Liabilities		*Rs.*	*Assets*	*Rs.*
Creditors		34,000	Cash	25,000
Capital Account			Debtors	62,000
X	1,20,000		Stock	37,000
Y	90,000		Tools	8,000
Z	60,000	2,70,000	Motor cars	12,000
			Machinery	60,000
			Freehold building	1,00,000
		3,04,000		3,04,000

Y and Z agreed to form a new partnership to carry the business and it is agreed that they shall acquire from the old firm the following assets at amounts shown hereunder :

Stock Rs. 40,000; Tools Rs. 5,000. Motor Cars Rs. 25,000; Machineries Rs. 78,000; Freehold Building 84,000, goodwill Rs.60,000.

The partnership deed of X, Y and Z provided that trading profits or losses shall be divide in the ratio of 3 : 2 : 1 and capital, Profits & Losses shall be divided in proportion of their capital.

Debtors realize Rs. 59,000. ad discount amount to Rs. 720 are secured on payments due to creditors.

Prepare the necessary account of X, Y and Z giving effect to these transactions and prepare the opening Balance Sheet of Y and Z who bring the necessary cash in the ratio of 3 : 2 to pay to X.

In the books of X, Y and Z.

Realization Account

Particulars	*Rs.*	*Particulars*		*Rs.*
To Debtors A/c	62,000	By Sundry Creditors A/c		34,000
To Stock A/c	37,000	By New Firm		
To Tools A/c	8,000	Stock A/c	40,000	
To Motors Cars A/c	12,000	Tools A/c	5,000	
To Machineries A/c	60,000	Motor Cars A/c	25,000	
To Freehold Building A/c	1,00,000	Machineries A/c	78,000	
To Cash (sundry creditors) A/c	33,280	FreeholdBuilding A/c	84,000	
To Profit Realizatio A/c		Goodwill A/c	60,000	2,92,000
transferred in the ratio 4 : 3 : 2	72,720	By Cash (debtors) A/c		59,000
	3,85,000			3,85,000

Partners' Accounts

Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)	Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)
To Cash	1,52,320	–	–	By Balance b/d	1,20,000	90,000	60,000
To Balance c/d		1,75,200	1,16,800	By Realization	32,320	24,240	16,160
				By Cash a/c		60,960	40,640
	1,52,320	1,75,200	1,16,800		1,52,320	1,75,200	1,16,800

Cash Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance b/d	25,000	By Realization (Creditors) A/c	33,280
To Realization (Debtors) A/c	59,000	By X's Capital A/c	1,52,320
To Y's Capital A/c	60,960		
To Z's Capital A/c	40,640		
	1,85,600		1,85,600

In the books of X, Y and Z.
Balance Sheet
(as on 30th June 2006)

Particulars		*Rs.*	*Assets*	*Rs.*
Capital accounts:			Stock A/c	40,000
Y	1,75,200		Tools A/c	5,000
Z	1,16,800	2,92,000	Motor cars A/c	25,000
			Machineries A/c	78,000
			Freehold building A/c	84,000
			Goodwill A/c	60,000
		2,92,000		2,92,000

Illustration-11

A, B and C had the following balace sheet on 31st December, 2006.

Particulars		*Rs.*	*Assets*	*Rs.*
Creditors		40,000	Fixed Assets	40,000
Loan from Mrs. A		15,000	Debtors	24,000
(with a charge on stock)			Stock	20,000
Loan from A		10,000	Cash at Bank	1,000
Capital Accounts ;			Loss	30,000
A	Rs. 20,000			
B	Rs. 20,000			
C	Rs. 10,000	50,000		
		1,15,000		1,15,000

The firm was dissolved. Stock realized Rs.10,000. and fixed assets and debtors realized Rs.30,000 in all. The private position of the partners was as under;

	Private estate	Private Liabilities
	Rs.	Rs.
A	10,000	15,000
B	8,000	6,000

C was able to pay 50 paise in the rupee of what was payable on his own account to the partership. The partners shared profits and losses in the ratio of 4:3:3 respectively.

The loss on reaslization is to be determined after considering the amount finally paid to the creditors.

You are required to close the books of the firm by preparing the necessary ledger accounts.

[Delhi, B.Com. (Hons.) 1994 (Modified)]

Solution

Realization Account

Particulars	*Rs.*	*Assets*		*Rs.*
To Fixed Assets A/c	40,000	By Creditors A/c		40,000
To Debtors A/c	24,000	By Loan from Mrs. A A/c		
To Stock a/c	20,000	By Cash (Sale of assets) A/c		
To Cash (Mrs. A's loa) A/c	10,000	(10,000 + 30,000)		40,000
To Cash A/c	38,059	By Loss on Realization		
		A	14,823	
		B	11,118	
		C	11,118	37,059
	1,32,059			1,32,059

Cash Account

Particulars	*Rs.*	*Assets*	*Rs.*
To Balance b/d	1,000	By Realization A/c	10,000
To Realization A/c	40,000	(Mrs. A's Loan)	
(Sale of Assets)		By Realization A/c (Creditors)	38,059
To B's Capital A/c	2,000		
(Excess of private estate)			
To C's Capital A/c	5,050		
	48,059		48,059

Partner's Capital Accounts

Particulars (Rs.)	A (Rs.)	B (Rs.)	C	Particulars (Rs.)	A (Rs.)	B (Rs.)	B
To Loss	12,000	9,000	9,000	By Balance b/d	20,000	20,000	10,000
To Realizatio A/c	14,823	11,118	11,118	By A's Loan A/c	10,000	–	–
To C's Capital A/c	3,177	1,882	–	By Cash (Exercise of private estate)	–	2,000	
				By Cash (1)	–	–	5,059
				By A's Capital	–	–	3,177
				By B's Capital	–	–	1,882
	30,000	22,000	20,118		30,000	22,000	20,118

Working Notes :

(1) Cash brought i by C is calculated as follows :

1/2 of due is x (say), then amount available to Sundry Creditors will be
Rs. (1,000 + 40,000 + 2,000 + x – 10,000)
Or (43,000 + x – 10,000) = Rs.33,000 + x)

Loss on Realization = 84,000 + 10,000 + 33,000 + x – 95,000
= 1,127,000 – 95.000 + x
= Rs.32,000 + x

Thus, C's share of loss on relization = $\frac{3}{10}$(32.000 + x),and

Deficiency of C from his share = $\frac{3}{12}$(32.000 + x) –[Rs. 10,000 – 9,000]

= $\frac{3}{12}$(32.000 + x) – 1.000

or 2x = $9,600 + \frac{3}{10}x - 10,000$

or 20x = 96,000 + 3x – 10,000

or 17x = 86,000

x = 5,059 Rs.

This Question paper contains 16+2 printed pages]

5350

Your Roll No. ....

आपका अनुक्रमांक ....

B.Com./I/NS **H1**

Paper II–FINANCIAL ACCOUTING

(NC–Admission of 2006 onwards)

Time : 3 Hours *Maximum Marks :* 75

समय : 3 घण्टे पूर्णांक : 75

(Write your Roll No. on the top immediately on recept of this quesitn paper.)

(इस प्रश्न-पत्र के मिलते ही ऊपर दिए गए निर्धारित स्थान पर अपना अनुक्रमांक लिखिए।)

Note:— Answers may be written either in English or in Hindi; but the same medium should be used theroughout the paper.

इस प्रश्न-पत्र का उत्तर अंग्रेजी या हिंदी किसी एक भाषा में दीजिए; लेकिल सभी उत्तरों का माध्यम एक ही होना चाहिए।

Attempt All questions.

Show your workings clearly.

सभी प्रश्न कीजिए।

कार्यविधि को स्पष्टतः दर्शाइये।

1. Write a note on the significasnce of accounting standards. Are all Indian Accounting Standards mandatory form the very beginning?

लेखाकरण मानकों के महत्त्व पर एक टिप्पणी लिखिए। क्या सभी भारतीय लेखाकरण मानक एकदम शुरू से ही अधिदेशात्मक होते हैं?

Or

(अथवा)

Recognising that the values of land have been increasing in the recent years, Anil, owner of Anil Constructions Ltd. increased the balance sheet amount of land from 50 lac rupees to 6 crore rupees. Explain the accounting concept which has been violated.

यह मानते हुए कि हाल के वर्षों में भूति का मूल्य बढ़ रहा है, अनिल कन्स्ट्रक्शन्स लि. के स्वामी अनिल ने भूमि के तुलन-पत्र की राशि को 50 लाख रु. से 6 करोड़ रु. कर दिया। स्पष्ट कीजिए कि कौनसी लेखाकरण संकल्पना का अतिक्रमण हुआ है?

2. The following is the Trial Balance of Mr. Ram Lal as at 31st December, 2006 :

Particulars	**Rs. (Dr.)**	**Rs. (Cr.)**
Ram Lal's Captial	—	86,690
Stock on 1-1-2006	46,800	—
Purchases and Sales	3,21,700	3,89,600
Returns	8,600	5,800
Freight and carriage	18,600	—
Rent and Taxes	5,700	—
Salaries and Wages	9,300	—
Sundry debtors and Creditors	24,000	14,800
Bank loan @ 6% p.a.	—	20,000
Bank Interest on loan	900	—
Printing and Advertising	14,600	—
Miscellaneous Income	—	250
Cash at Bank	8,000	—
Discount	1,800	4,190
Furniture and Fittings	5,000	—
General Expenses	11,450	—
Insurance	1,300	—
Postage and Telegrams	2,330	—
Cash in hand	380	—
Traveling Expenses	870	—
Drawings	40,000	—
	5,21,330	5,21,330

This following adjustmetns should be made:

(i) Included amongst the Debtors is Rs. 3,000 due from Suresh Kumar and included among the creditors Rs. 1,000 due to him.

(ii) Provision for Bad and Doubtful Dets be created at 5% and Reserve for Discount @ 2% on Sundry Debtors.

(iii) Depreciate Furniture and Fittings by 10%.

(iv) Personal Purchases amounting to Rs. 600 had been included in the Purchases Day Book.

(v) Interst on Bank Loan shall be provided for the whole year.

(vi) One quarter of the amount of Printing and Advertising is to be carried forward to next year.

(vii) Credit purchase invoice amounting to Rs. 400 had been omitted from the books.

(viii) Stock on 31st December, 2006 was Rs. 78,600.

Prepare Trading and Profit & Loss Account for the year ended 31st December, 2006 and Balance Sheet as on that date.

श्री रामलाल का 31 दिसम्बर, 2006 को शेष परीक्षण इस प्रकार था :

विवरण	रु. (नाम)	रु. (जमा)
रामलाल की पूँजी	–	86,690
1-1-2006 को स्टॉक	46,800	–
खरीद और बिक्री	3,21,700	3,89,600
वापसी	8,600	5,800
भाड़ा और ढुलाई	18,600	–
किराया और कर	5,700	–
वेतन और मजदूरी	9,300	–
विविध देनदार और लेनदार	24,000	14,800
बैंक ऋण (6 वार्षिक)	–	20,000
ऋण पर बैंक ब्याज	900	–
मुद्रण और विज्ञापन	14,600	–
विविध आय	–	250
बैंक में रोकड़	8,000	–
बट्टा	1,800	4,190
फर्नीचर और फिटिंग	5,000	–
सामान्य व्यय	11,450	–
बीमा	1,300	–
डाक खर्च और तार	2,330	–
हाथ में रोकड़	380	–
यात्रा व्यय	870	–
आहरण	40,000	–
	5,21,330	5,21,330

निम्नलिखित समायोजन किए जाने चाहिए :

(i) देनदारों में सुरेश कुमार से प्राप्य 3,000 रु. शामिल हैं और लेनदारों में उसे देय 1,000 रु. शामिल हैं।

(ii) डूबत और संदिग्ध ऋणों के लिए 5 पर प्रावधान और विविध देनदारों पर 2% पर छूट के लिए आरक्षण किया जाए।

(iii) फर्नीचर और फिटिंग को 10% पर मूल्यह्रसित कीजिए।

(iv) खरीद रोजनामचे में 600रु. की निजी खरीद भी शामिल है।

(v) बैंक ऋण पर पूरे वर्ष ब्याज की व्यवस्था की जाए।

(vi) मुद्रण और विज्ञापन की राशि के एक-चौथाई को अगले वर्ष के लिए अग्रनीत किया जाए।

(vii) पुस्तकों से 400 रु. का उधार क्रय बीजक छूट गया है।

(viii) 31 दिसम्बर, 2006 को स्टॉक 78,600 रु. था।

31 दिसम्बर, 2006 को समाप्त वर्ष के लिए व्यापार और लाभ-हानि लेखा तथा उसी तारीख का तुलन-पत्र तैयार कीजिए।

Or

(अथवा)

From the information given ahead relating to Delhi Sports Club, prepare the Balance Sheet as on 1-1-2006 and 31-12-2006.

(i) Assets and liabilities on 1-1-2006 are : Club Grounds and Pavilion : Rs. 50,000; Sports Equipment : Rs. 30,000; Furniture : Rs. 7,000 and Subscription in arrears on that date : Rs. 1,000. Creditors for stationery Rs. 1,000.

(ii) **Receipts and Payments Account**

for the year ending on 31-12-2006

Dr. **Cr.**

Receipts	**Rs.**	**Payments**	**Rs.**
Balance b/d	5,000	Printing & Stationery	3,000
Subscription ;		Salaries	11,000
2005	900	Advertising	2,000
2006	18,000	Fire Insurance	1,500
2007	500	Furniture	2,000
Sale of old newspapers	300	Investment	18,000
Rent Received	2,200	Balance c/d	1,400
Applications fees	12,000		
Applications Fees	38,900		38,900

(iii) **Income and Expenditure Account**

for the year ending on 31-12-2006

Dr. **Cr.**

Expenditure	**Rs.**	**Income**	**Rs.**
Printings and Stationery	2,800	Subscription	19,000
Salaries	12,000	Application fees	12,000
Advertising	2,000	Rent Received	2,400
Fire Insurance	1,200	Sale of old newspapers	300
Audit fees	500		
Depreciation on :			
Sports Equipment			
Furniture	800		
Excess of Income over			
Expenditure	8,400		
	33,700		33,700

दिल्ली स्पोर्ट्स क्लब से संबंधित निम्निलिखित सूचना से 1-1-2006 और 31-12-2006 का तुलन-पत्र तैयार कीजिए :

(i) 1-1-2006 को परिसंपत्तियाँ और देयताएँ हैं : क्लब मैदान और पैविलियन : 50,000 रु.; खेल सामान : 30,000 रु.; फर्नीचर : 7000 रु.; और उस तारीख पर बकाया चंदा : 1,000 रु.; स्टेशनरी के लिए लेनदार :1,000रु. :

(ii) 31-12-2006 को समाप्त वर्ष के लिए प्राप्ति-भुगतान लेखा

Dr. **Cr.**

प्राप्ति	**रु.**	**भुगतान**	**रु.**
अग्रनीत शेष	5,000	मुद्रण और लेख सामग्री	3,000
चंदा :		वेतन	11,000
2005	900	विज्ञापन	2,000
2006	18,000	अग्नि बीमा	1,500
2007	500	फर्नीचर	2,000
पुराने अखबारों की बिक्री	300	निवेश	18,000
प्राप्त किराया	2,200	शेष अग्रनयन	1,400
आवेदन शुल्क	12,000		
	38,900		38,900

(iii) 31-12-2006 को समाप्त वर्ष के लिए आय-व्यय लेखा

Dr.			Cr.
व्यय	रु.	आय	रु.
मुद्रण और लेखनसामग्री	2,800	चंदा	19,000
वेतन	12,000	आवेदन शुल्क	12,000
विज्ञापन	2,000	प्राप्त किराया	2,400
अग्नि बीमा	1,200	पुराने अखबारों की बिक्री	300
लेखापरीक्षा शुल्क	500		
मूल्यह्रास : खेल सामान पर	6,000		
फर्नीचर पर	800		
व्यय से अधिक आय	8,400		
	33,700		33,700

M/s Hot and Cold commenced business on 1st April., 2002 when they purchased a new machinery costing Rs. 8,00,000. On 1st Oct., 2003, they purchased another machinery for Rs. 6,00,000 and again on 1st Jully, 2006, machinery costing Rs. 15,00,000 was purchased. They adopted a policy of charging @ 20% p.a. on diminishing balance basis.

On April 1, 2006, they, however, changed the method of providing depreciation and adopted the method of writing off the machinery account at 15% p.a. under straight line method with retrospective effect from 1st April, 2002, the adjustment being made in the accounts for the year ended 31st March, 2007.

`Show the Machinery Account for the year ending 31st March, 2007. 14

मेंसर्स हॉट और कोल्ड ने 1 अप्रैल 2002 को 8,00,000 रु. की लागत की नई मशीनरी खरीद कर अपना कारोबार प्रारम्भ किया। 1 अक्टूबर, 2003 को 6,00,000 रु. की एक अन्य मशीनरी खरीदी, और 1 जुलाई 2006 को 15,00,000 रु. की मशीनरी खरीदी। उन्होंने ह्रसमान शेष के आधार पर 20% वार्षिक की दरा से प्राभार की नीति अपनाई।

1 अप्रैल, 2006 को उन्होंने मूल्यह्रास लगाने की विधि को बदल दिया और ऋजुरेखा विधि के अंतर्गत 1 अप्रैल 2002 से पूर्वव्यापी प्रभाव से 15% वार्षिक की दर पर मशीनरी लेखे को बट्टे खाते डालने की विधि अपनाई। 31 मार्च, 2007 को समाप्त वर्ष के लेखे में समायोजन कर दिए गए।

31 मार्च, 2007 को समाप्त वर्ष के लिए मशीनरी लेखा दिखाइए।

Or

(अथवा)

From the following particulars, ascertain the amount of credit sales and credit purchases for the year ended 31st March, 2006 : 14

	Rs.
Total Credites 1-4-2005	4,00,000
Total Debtors 1-4-2005	7,00,000
Cash received from customers	14,50,000
Received for Billa Receivable	80,000
Paid to Sundry Creditors	5,60,000
Bills Payable met	1,20,000
Discount allowed to Customers	20,000
Discount earned	10,000
Sales Returns	60,000
Purchases Returns	80,000
Bad debts	30,000
Total Creditors 31-3-2006	9,20,000
Total Debtors 31-3-2006	8,80,000
Bills Receivables 1-4-2005	60,000
Bills Payable 1-4-2005	1,40,000
Bills Receivable 31-3-2006	1,80,000
Bills Payable 31-3-2006	1,00,000

निम्नलिखित विवरणों से 31 मार्च, 2006 को समाप्त वर्ष के लिए बिक्री और उधार खरीद की राशि अभिनिश्चित कीजिए:

	रु.
कुल लेनदार 1-4-2005	4,00,000
कुल लेनदार 1-4-2005	7,00,000
ग्राहकों से प्राप्त रोकड़	14,50,000
प्राप्य विलों के लिए प्राप्त	80,000
विविध लेनदारों को भुगतान	5.60,000
देय बिलों का भुगतान	1,20,000
ग्राहकों को दी गई छूट	20,000
अर्जित बट्टा	10,000
बिक्री वापसी	60,000

खरीद वापसी		80,000
डूबत ऋण		30,000
कुल लेनदार	31-3-2006	9,20,000
कुल लेनदार	31-3-2006	8,80,000
प्राप्य बिल	1-4-2005	60,000
देय बिल	1-4-2005	1,40,000
प्राप्य बिल	31-3-2006	1,80,000
देय बिल	31-3-2006	1,00,000

4. A,B and C jointly undertake to construct a building for a company at a contract price of Rs. 15,00,000 to be paid as to Rs. 12,00,000 in cash by instalments and Rs. 3,00,000 in fully paid shares of the company. They agreed to share profit or loss equally. They open a joint bank account and contribute :

A Rs. 1,80,000

B Rs. 2,00,000 and

C Rs. 1,30,000.

Agets the plan prepared and pays Rs. 20,000 for it. B brings into the joint venture machinery of Rs. 60,000 and C brings into the venture a truck of the value of Rs. 1,50,000. They also purchansed materials worth Rs. 7,50,000 and wages paid were Rs. 4,95,000.

On completion of the venture, A takes over unused materials, of the values of Rs. 35,000, B takes back machinery at Rs. 70,000 and C agrees to take back truck at a valuation of Rs. 1,20,000. A slo agreed to take over shares of the company at a valuation of Rs. 2,60,000.

Prepare necessary ledger accounts assuming that a separate set of account books is maintained.

A, B और C ने एक कम्पनी के लिए एक भवन-निर्माण का संयुक्त रूप से ठेका लिया, ठेके की राशि 15,00,000 रु. थी जिसमें से 12,00,000 रु. का भुगतान किश्तों में नकद किय जाएगा और 3,00,000 रु. का कम्पनी के पूर्व प्रदत्त शेयरों द्वारा। उन्होंने लाभ और हानि को बराबर बाँटना तय किया। उन्होंने एक संयुक्त बैंक खाता खोला जिसमें इस प्रकार अंशदान किया :

A : 1,80,000 रु.

B : 2,00,000 रु. और

C : 1,30,000 रु.

A ने नक्शा तैयार करवाया और उसके लिए 20,000 रु. का भुगतान किया। B संयुक्त उद्यम के लिए 60,000 रु. की मशीनरी लाया और C संयुक्त उद्यम के लिए 1,50,000 रु. मूल्य का ट्रक लाया। उन्होंने 7,50,000 रु. मूल्य की सामग्री भी खरीदी और 4,95,000 रु. मजदूरी के दिए।

उद्यम के पूरा होने पर A ने 35,000 रु. की अप्रयुक्त सामग्री ले ली, B ने 70,000 रु. पर मशीनरी वापस ले ली और C ने 1,20,000 रु. के मूल्यन पर ट्रक वापस लेना स्वीकार कर लिया। A ने 2,60,000 रु. के मूल्यन पर कंपनी के शेयरों को भी लेना स्वीकार कर लिया।

यह मानकर कि लेखा पुस्तकों का पृथक सेट रखा गया है, अपेक्षित खाता लेखा तैयार कीजिए।

Or

(अथवा)

Narayanji of Bawar sent their famous Till Paur valving Rs. 80,000 to M/s Patwari Mishthan Bhandar of Ghaziabad. The consignor paid Rs. 3,000 on cartage and freight and Rs. 2,000. forinsurance The consignee sent an advance of Rs. 30,000. The consignee's expenses comprised of Rs. 1,200 for nadvertising and Rs. 800 for selling expenses. Patwaris sold goods costing Rs. 60,000 for Rs. 1,22,000 (Rs. 86,000 for cash and Rs. 36,000 on credit). Patwaris took over goods for their own use costing Rs. 6,000.

The consignee is entitled to commission of 5% on cash sales and 4% on credit sales. For goods taken over by the consigee, the valuation would be cost plus 10% and the consignee would not be entitled to any commission over the same. Creditors paid Rs. 35,000 in full and final settlement. At the end balance amount was remitted.

Prepare Consignment Account and Consignee's Account in the boks of consignor.

ब्यावर के नरायनजी ने गाजियाबाद के मैसर्स पटवारी मिष्ठान भण्डार को 80,000 रु. मूल्य के अपने प्रसिद्ध तिल-पापड़ भेजे। परेषक ने ढुलाई और भाड़े पर 3,000 रु. का भुगतान किया और 2,000 रु. बीमा पर। परेषिती ने 30,000 रु. पेशगी भेजे। परेषिती के व्यय में विज्ञापन पर 1,200 रु. और विक्रय पर 800 रु. का खर्च शामिल था। पटवारी ने 60,000 रु. के माल को 1,22,000 रु. में बेचा (86,000 रु. नकद और 36,000 रु. उधार पर)। पटवारी ने अपने उपयोग के लिए 6,000 रु. लागत का माल लिया।

परेषिती नकद बिक्री पर 5% और उधार बिक्री पर 4% के कमीशन का हकदार है। परेषिती द्वारा लिए गए माल के लिए, मूल्यांकन लागत जमा 10% था और परेषिती उस पर किसी कमीशन का हकदार नहीं था। लेनदारों ने पूर्ण और अंतिम निपटान के लिए 35,000 रु. का भुगतान किया। अंत में शेष राशि भेज दी गई।

परेषक की पुस्तकों में परेषण लेखा और परेषिती लेखा तैयार कीजिए।

A treder has its branch at Mumbai to which goods are invoiced at cost plus 20%. Prepare Branch Account in the books of the head office after taking into consideration the following information also.

	Rs.
Opening stock at branch	72,000
Cash sales at branch	52,500
Credit sales at branch	1,23,000
Collections from branch debtors	1,13,700
Goods received from head office	90,000
Branch expenses :	
Paid by head office	9,000
Paid by branch	18,000
Expenses unpaid	4,200
Closing stock at branch	54,000
Closing balance of branch debtors	27,480
Goods sent from head office to branch remaining in transit on closing day	10,800

एक व्यापारी की मुम्बई में एक शाखा है जिसे वह लागत जमा 20% पर बीजक पर माल भेजता है। अग्रलिखित सूचना को ध्यान में रखते हुए मुख्यालय की पुस्तकों में शाखा लेखा तैयार कीजिए।

	रु.
शाखा पर प्रारंभिक स्टॉक	72,000
शाखा पर नकद बिक्री	52,500
शाखा पर उधार बिक्री	1,23,000
शाखा देनदारों से वसूली	1,13,700
मुख्यालय से प्राप्त माल	90,000
शाखा व्यय :	
मुख्यालय द्वारा संदत्त	9,000
शाखा द्वारा संदत्त	18,000
असंदत्त व्यय	4,200
शाखा पर अंतिम स्टॉक	54,000
शाखा देनदारों का अंतिम शेष	27,480
अंतिम दिन पारवहन में शाखा को मुख्यालय से भेजा गया माल	10,800

Or

(अथवा)

A. Ltd. Purchased a machine on hire-purchae system from B. Ltd., on 1st jan. 2002, paying immediately Rs; 20,000 and agreeing to pay three instalments of Rs. 20,000 each on 31st December every year. The cash price of the machine is Rs. 74,500 and vendors charge interest at 5% p.a. Depreciation is charged @ 20% p.a. on diminishing balance method. Calculate the amount of interest paid by buyer to the seller every year and also prepare important Ledger Accounts in the books of A. Ltd.

A Ltd. ने 1 जनवरी 2002 करे B Ltd. से भाड़ा-क्र पद्धति पर एक मशीन खरीदीए जिसके लिए 20,000 रु. का तुरंत भुगतान किया गया और प्रति वर्ष 31 दिसम्बर को 20,000 रु. प्रति किश्त के हिसाब से तीन किश्त देना तय हुआ। मशीन का नकद मूल्य 74,500 रु. है और विक्रेता 5ध्ः वार्षिक पर ब्याज लेता है। ह्यासमान शेष विधि पर 20% वार्षिक की दर से मूलयह्यास लगाया जाएगा। क्रेता द्वारा विक्रेता को प्रति वर्ष दिए गए ब्याज की राशि का परिकलन कीजिए और ALtd. की पुस्तकों में महत्त्वपूर्ण खाता लेखा भी तैयार कीजिए।

A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. On 31st March, 2006, their Balance Sheet was as follows :

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	1,54,000	Cash in Hand and		
Bills Payable	1,36,000	at Bank		35,000
A's Loan Account	1,00,000	Stock		1,98,000
General Reserve	1,20,000	Debtors	1,50,000	
Capital Account :		Less Provision	10,000	1,40,000
A 2,00,000		Joint Life Policy		40,000
B 1,60,000		Furniture		1,00,000
C 80,000	4,40,000	Machinery		4,37,000
	9,50,000			9,50,000

The firm was dissolved on 1st April 2006. Joint Life Policy was taken by 'A' at 125 %. Stock realised 1/11th less. Debtors realised 90%. Furniture fetched 26% less while machinery was sold for 105 %. In addition one bill for Rs. 50,000 under discount was dishonoured and had to be taken up by the firm. Expenses of realisation totalled Rs. 20,000.

A, B और एक फर्म में साझेदार थे जो 3 : 2 : 1 के अनुपात में लाभ-हानि का सहभाजन करते थे। 31 मार्च 2006 को उनका तुलन-पत्र इस प्रकार था :

देयताएँ	रु.	परिसंपत्तियाँ		रु.
विविध लेनदार	1,54,000	हाथ और बैंक में		35,000
देय बिल	1,36,000	रोकड		35,000
A का ऋण लेखा		1,00,000	स्टॉक	1,98,000
सामान्य आरक्षण	1,20,000	देनदार	1,50,000	
पूँजी लेखा :		घटाया प्रावधान	10,000	1,40,000
A 2,00,000		संयुक्त बीमा पॉलिसी		40,000
B 1,60,000		फर्नीचर		1,00,000
C 80,000	4,40,000	मशीनरी		4,37,000
	9,50,000			9,50,000

1 अप्रैल 2006 को फर्म का विघटन कर दिया गया। संयुक्त जीवन पॉलिसी को A ने 125% पर ले लिया। स्टॉक से 1/11 कम वसूल हुआ। देनदारों से 90% वसूल हुआ। फर्नीचर पर 26% कम मिला और मशीनरी 105% पर बिक्री। इसके अतिरिक्त बट्टे के अंतर्गत 50,000 रु. की एक हुंडी अस्वीकृत हो गई, जिसे फर्म को लेना पड़ गया। वसूली पर कुल 20,000 रु. खर्च हुए।

फर्म की पुस्तकों को बंद करने के लिए अपेक्षित खाता लेखा प्रस्तुत कीजिए।