BCOC-131
Financial Accounting

Indira Gandhi
National Open University
School of Management Studies

Block

1

THEORETICAL FRAMEWORK

PROGRAMME DESIGN COMMITTEE B.COM (CBCS)

COURSE DESIGN COMMITTEE

COURSE PREPARATION TEAM

Dr. Sunil Kumar (Unit-4)

Prof. M.S.S. Raju (Course Coordinator & Editor)
Dr. Sunil Kumar (Course Coordinator & Editor)

Preparatory Course in Commerce: PCO-01 (Unit-1, 2 and 3 Revised by Dr. Sunil Kumar)
Prof. J. Satyanarayan, Osmania University, Hyderabad
Prof. V. Vishwanadham, Osmania University, Hyderabad
Dr. D. Obul Reddy, Osmania University, Hyderabad
Shri M. Satyanarayana, Badruka College, Hyderabad

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-06-5

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 1 THEORETICAL FRAMEWORK

This block will introduce you to the core area in Commerce. In order to appreciate the need for accounting, You have to practice accounting and require a clear understanding of the nature and scope of accounting, the language used in accounting and the principles that guide the accountant. This block also deals with basic rules of double entry system and accounting standards which provides the basis for accounting policies in order to prepare the financial statements. This block is structured to cover these and other related aspects. It is hoped that this block will provide you the necessary theoretical background to understand and appreciate accounting in the right perspective. It covers four units.

Unit 1 explains the nature and scope of accounting and the importance of accounting information to various parties.

Unit 2 analyse the basic rules of double entry system and their application.

Unit 3 presents some of the terms commonly used in accounting and the basic concepts underlying accounting.

Unit 4 deals with Accounting Standards which provides the basis for accounting policies and for preparation of financial statements.

UNIT 1 NATURE AND SCOPE OF ACCOUNTING

Structure

1.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the need for accounting;
- identify the objectives of accounting;
- describe accounting as an information system;
- outline the scope and bases of accounting;
- distinguish between book-keeping, accounting and accountancy;
- identify the parties interested in accounting information;
- describe the functions and important branches of accounting;
- describe the advantages and limitations of accounting; and
- state the qualitative characteristics of accounting.

1.1 INTRODUCTION

In this unit, we shall discuss the functions, branches, advantages, limitations, and bases for accounting. In this unit, we also intend to elaborate on the need for accounting and then discuss the nature, scope and importance of accounting.

1.2 NEED FOR ACCOUNTING

Let us elaborate on need for accounting. Suppose you are given ten rupees to purchase vegetables and asked to account for the amount. You have purchased the vegetables— 1 kg of tomatoes for Rs. 4, 1 kg of potatoes for Rs. 3, and 1 kg of brinjalsfor Rs. 2. The total amount spent is Rs. 9 and the balance of amount with you is Re 1. Thus, you have rendered the account for Rs. 10. This is one time affair. Therefore, you could remember what you have spent.

Suppose, you are given Rs. 2,000 and asked to manage the home for a month and render the account for the money at the end of the month. You will be purchasing groceries, milk, vegetables, paying for electricity, school/college fees, etc. You will be spending almost everyday. In that case, is it possible to remember all the payments you are making everyday and render account at the end of the month? No, it is not possible to remember, especially when the number of payments is more. Not only that, it is not even advisable to depend on memory. Therefore, it is better to write down (or record) whatever payments you have made. Further, it is advisable to obtain receipts or bills for the payments you have made, so that you can render the account, beyond doubt.

The above example is a simple one, where you have one receipt of money i.e., Rs. 2,000 and a number of payments. But the case of business is different. In business, you may have to purchase and sell hundreds and thousands of times over a period of time. You will have a number of receipts and a number of payments (known as transactions). Will it be possible for you to remember hundreds and thousands of transactions which have taken place in your business, that too over a period of time, say a year? It is not humanly possible to remember all transactions which have taken place in business over a period of time. Even if you remember all the transactions, you will find it impossible to calculate the net effect of all such transactions i.e., profit. It, therefore, becomes necessary to record all the transactions that have taken place in business.

Further, it is not possible for the businessman to sit at the cash counter throughout the day. Sometimes his family members may be asked to sit at the cash counter. As the size of the business grows, it becomes necessary to employ people to assist the businessman. In such cases, theft of goods or cash is possible or all the sale proceeds may not be put into the cash box. Hence, it becomes necessary to maintain accounting records for the purpose of control, especially when outsiders are employed. It can, thus, be seen that there is need for proper accounting records even in case of a sole proprietorship concern. It is all the more important in the case of other forms of business organisation.

In case of a partnership firm, all the partners may or may not be actively participating in the day-to-day management of the business. It is, therefore, necessary to record all the transactions in order to satisfy all the partners. In case of a company, it is not possible for the owners (shareholders) who are too large in number to take part in the day-to-day management of the company. Generally, the management of the company is entrusted to paid managers. Hence, there is a need for recording all transactions.

Information about the business is required for both internal and external use. For example, the management needs a lot of information (for their internal use) for planning, controlling and evaluating the operations of the business. Information is also needed by some outsiders, banks, creditors, etc. For example, it is required for filing sales tax, income tax, and other tax returns with appropriate tax authorities. When a firm approaches the bank for loan or the creditors for supply of goods on credit, the bank or creditors like to know the firm's financial position (whether it is financially sound or not) and its profit earning capacity. The question is how to obtain all such information. A systematic accounting record is the only answer.

Accounting is necessary in not only business organisations, but also 'non-business' organisations like schools, colleges, hospitals, libraries, etc.

1.3 OBJECTIVES OF ACCOUNTING

From the above discussion, the objectives of accounting can be stated as follows:

i) **To keep systematic records:** Accounting is done tokeep a systematic record of financial transactions, like purchase of goods, sale of goods, cash receipts and cash payments. Systematic record of various assets and liabilities of the business is also to be maintained.

ii) **To ascertain the net effect of the business operations i.e., profit or loss of business:** Weknow that the primary objective of business is to make profit and the businessman is very much interested in knowing the same. A proper record of income and expenses facilitates the preparation of the profit and loss account (income statement). The profit and loss account reveals the profit earned or loss incurred by the business firm during a particular period.

iii) **To ascertain the financial position of the business:** The businessman is not only interested in knowing the operating results, but also interested in knowing the financial position of his business i.e., where it stands. In other words, he wants to know when the business owes to others and what it owns and what happened to his capital – whether the capital increased or decreased or remained constant. A systematic record of various assets and liabilities facilitates the preparation of a statement known as 'balance sheet' (position statement) which answers these questions.

iv) **To provide accounting information to interested parties:** Apart from the owners, there are various other parties who are interested in knowing about the business firm, such as the management, the bank, the creditors, the tax authorities, etc. For this purpose, the accounting system has to furnish the required information.

Check Your Progress A

1. Give five points in support of the need for accounting.

....

....

....

....

2. State the main objectives of accounting.

....

....

....

3. What is profit?

....

....

....

4. What do you understand by ‘Financial Position?

....

....

....

1.4 DEFINITION AND SCOPE OF ACCOUNTING

Accounting has been defined in different ways by different authorities on the subject. Accounting is a comprehensive discipline and it is difficult to explain satisfactorily through any single definition. However, two definitions are given below. This should help you to understand the nature and scope of accounting.

The American Accounting Association defines Accounting as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. This definition stresses three aspects viz., identifying, measuring and communicating economic information.

In the words of the Committee on Terminology appointed by the American Institute of Certified Public Accountants, ‘‘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 financial character and interpreting the results thereof ’’. This is a popular definition of accounting and it outlines the nature and scope of accounting activity.

A business is generally started with proprietor’s funds i.e., capital. The proprietor may also acquire additional funds from outsiders like banks and creditors. These funds are utilised to acquire the assets needed for business and also to carry out other business activities. In the process many transactions and events take place. The accountant has to identify all such transactions and events, measure them in terms of money, and record them in appropriate books of account. Then, he has to classify them under separate heads of accounts, summarise periodically in the form of Profit and Loss Account and Balance Sheet; and analyse, interpret and communicate the results thereof to the interested parties. Accounting can thus be broadly defined as follows;

Accounting is the process of identifying, measuring, recording, classifying, summarising, analysing. interpreting, and communicating the financial transactions and events in monetary terms.

The above definitions clearly bring out the scope of accounting. This can now be outlined as follows:

1. Accounting is concerned with financial transactions and events which bringabout a change in the resources (or wealth) position of the business firm. Such transactions have to be **identified** first, as and when they occur. It is not difficult because, there will be proof in the form of a bill or receipt (called vouchers). With the help of these bills and receipts, identification of a transaction is easy. For example, when you purchase something you get a bill, when you make payment, you get a receipt.

2. These transactions are to be **measured** or expressed in terms of money, if not done already. Generally, this problem will not arise, because the statement of proof expresses the transaction in terms of money. For example, if ten books are purchased at the rate of Rs. 20 each, then the bill is prepared for Rs. 200. But, if an event cannot be expressed in monetary terms, it will not come under the scope of accounting.

3. The transactions which are identified and measured are to be recorded in a book called journal or in one of its sub-divisions.

4. The recorded transactions are to be **classified** with a view to group transactions of similar nature at one place. The work of classification is done in a separate book called ledger. In the ledger, a separate account is opened for each item so that all transactions relating to it can be brought to one place. For example, all payments of salaries are brought to salaries account.

5. The recording and classification of many transactions will result in a mass of financial data. It is, therefore, necessary to **summarise** such data periodically (at least once a year), in a significant and meaningful form. The summarisation is done in the form of profit and loss account which reveals the profit made or loss incurred, and the balance sheet which reveals the financial position.

6. The summary results will have to be **analysed,** interpreted (critically explained) and communicated to interested parties. Accounting information is generally communicated in the form of a 'report'. Big organisations generally present printed reports, called published accounts.

1.5 BOOK-KEEPING, ACCOUNTING AND ACCOUNTANCY

Very often you will come across terms like bookkeeping, accounting, and accountancy in the literature on accounting. We propose to explain them in the following paragraphs:

You know Accounting involves a series of activities, as listed out in the scope of accounting. These activities are; (1) identifying, (2) measuring. (3) recording, (4) classifying, (5) summarising, (6) analysing, (7) interpreting, and (8) communicating, the financial transactions and events. –

Book-keeping is a narrow term, which means record keeping or maintaining books of account. It only covers the first four activities (1 to 4 above) of accounting.

The term 'Accountancy' refers to a systemiatised knowledge of accounting and is regarded as an academic subject like economics; statistics, chemistry, etc. It explains 'why to do' of various aspects of accounting. In other words, when accounting refers to the actual process of preparing and presenting the accounts, Accountancy tells us why and how to prepare the books of account and how to summarise the accounting information and communicate it to the interested parties. Thus Accountancy is a science, a body of systematised knowledge, whereas Accounting is the art of putting such knowledge intopractice.

In general usage, however, Accountancy and Accounting are used as synonyms (meaning the same thing). But, of late, the term accounting is becoming more and more popular.

Cheek Your Progress B

1. Define accounting.

   ....

   ....

   ....

2. What do you mean by book-keeping?

   ....

   ....

   ....

3. What is accountancy?

   ....

   ....

   ....

4. Accounting involves a series of activities. List them.

   ....

   ....

   ....

1.6 USERS OF FINANCIAL ACCOUNTING INFORMATION

You have learnt that many groups of people are interested in accounting information which may help them:

i) to understand the present position of the enterprise

ii) to compare its present performance with that of its past years

iii) to compare its present performance with that of similar enterprises.

Now, let us see who such parties are and how accounting information is useful to various parties.

Owners: Ownerscontribute capital and assume the risk of business. Naturally, they are interested to know the amount of profit earned by the business and so also its financial position. If however, the management of the business is entrusted to paid managers, the owners also use the accounting information to evaluate the performance of the managers.

Managers: Accounting information, supplemented by other information, is of immense use to managers. It helps them to plan, control and evaluate the operations of the business. They also need such information for various decision-making.

Lenders : The funds are provided by the owners initially, but if the business requires more funds they are provided by banks and other lenders of money. Before they lend money, they would like to know the solvency (i.e.., capacity to repay debts) of the enterprise, so as to satisfy themselves that their money will be safe and that they can expect repayment on time.

Creditors: Those who supply goods and services on credit are called creditors. Like lenders, they too want to know about solvency of the enterprise, so as to decide whether credit can be granted or not.

Prospective investors: A person who wants to become a partner in a partnership concern or a person who wants to become a shareholder of a company, would like to know how safe and rewarding the proposed investment would be.

Tax authorities: Tax authorities of the Government are interested in the financial statements so as to assess the tax liability of the enterprise.

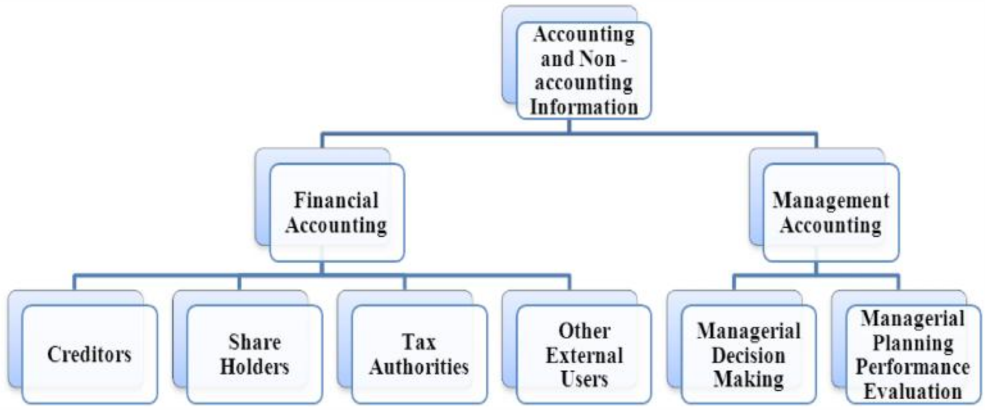
Employees: The employees of the enterprise are also interested in knowing the state of affairs of the organisation in which they are working, so as to know how safe their interests are in that organisation.

1.7 ACCOUNTING AS AN INFORMATION SYSTEM

Accounting is part of an organization's information system, which includes both financial and non-financial data. Accounting is the process of identifying, measuring and communicating economic information to permit judgment and decisions by users of the information. The main objective of accounting is to provide information to the users. Accounting is also required to serve some broad social obligations since the accounting information is used by a large body of people such as customers, employees, investors, creditors and government.

Accounting is commonly divided into (1) Financial Accounting, and (2) Managerial Accounting. Financial accounting refers to the preparation of general purpose reports for use by persons outside an organization. Such users include shareholders, creditors, financial analysts, labour unions, government regulations etc. External users are interested primarily in reviewing and evaluating the operations and financial status of the business as a whole.

Managerial accounting, on the other hand, refers to providing of information to managers inside the organization. For example a production manager may want a report on the number of units of product manufactured by various workers in order to evaluate their performance. A sales manager might want a report showing the relative profitability of two products in order to pinpoint selling efforts. The financial reports are available from the libraries or company themselves whereas managerial accounting reports are not widely distributed outside because they often contain confidential information. The following figure shows that accounting is part of an organization system which includes both financial and non financial data:



Accounting as an information system

Uses of Accounting Information

Accounting provides information for the following three general uses:-

1) Managerial decision making: Management is continuously confronted with the need to make decisions. Some of these decisions may have immediate effect while the others have in the long run. Decisions regarding the price of the product like make or buy the product or to drop it, to expand its area of operations etc., are some of the examples of decisions making. Management Accounting provides necessary information to arrive at right conclusions.

2) Managerial planning, control and internal performance evaluation: Managerial accounting plays an important role in the planning and control. By assisting management in the decision making process, information is provided for establishing the standard. Accounting also provides actual results to compare with projections.

For example, where a marketing manager is given a target of sales revenues of Rs. 10 crores, the amount of Rs. 10 crores will serve as a standard for evaluating the performance of the marketing manager. If annual sales revenues vary significantly from Rs. 10 crores, steps will be taken to ascertain the causes for the difference. When the factors leading to the variance are not under the control of the marketing manager, then the marketing manager would not be held responsible for it. On the other hand the cause for variance is under the control of marketing manager then he will be held responsible in evaluating the performance of marketing manager. Accounting provides necessary information to measure the variance in the actual performance.

3) External financial reporting: Accounting has always been used to supply information to those who are interested in the affairs of the company. Various laws have been passed under which financial statements should be prepared in such way that required information is supplied to shareholders, creditors, government etc. For example, the investors may be interested in the financial strength of the business, creditors may require information about the liquidity position, government may be interested to collect details about sales, profit, investment, liquidity, dividend policy, prices etc. in deciding social and economic policies. Information is required in accordance with generally accepted accounting principles so that it is useful in taking important decisions.

1.8 BRANCHES OF ACCOUNTING

Accounting, as we know it today, has evolved over many centuries in response to the changing economic, social and political conditions. The development of modern accounting was influenced by a number of factors such as industrial revolution, growth of large enterprises like companies, introduction of compulsory audit of companies, legal regulations, establishment of professional organisations like the Institute of Chartered Accountants of India, the Institute of Cost and Works Accountants of India, American Institute of Certified Public Accountants, etc Economic development and technological improvements have resulted in an increase in the scale of business operations and the advent of company form of organisation. This has made management function more and more complex. These factors have increased the importance of accounting and have given rise to special branches of accounting. The important branches of accounting are briefly explained below:

Financial Accounting: The purpose of this branch of accounting is to keep a record of financial transactions and events so that:

a) the net result of the operations of the business (profit or loss) during an accounting period can be ascertained;

b) the financial position (assets, liabilities and capital position) of the business as at the end of the period can be ascertained; and

c) relevant financial information can be provided to management and other interested parties.

Cost Accounting: The purpose of cost accounting is to analyse the expenditure so as to ascertain the cost of each product, operation, service, etc. The price of an article is nothing but the cost plus a certain amount of profit. Unless cost is known, price cannot be fixed rationally. Cost accounting helps not only in ascertaining the costs but also assists the management in controlling the costs.

Management Accounting: The purpose of management accounting is to assist the management in taking rational policy decisionsand to evaluate the impact of its decisions and actions. Examples of such decisions are: pricing decisions, capital expenditure decisions, etc. This branch of accounting is primarily concerned with presenting information that may be needed by management in such decision-making.

In this course, we are concerned with financial accounting only.

Check Your Progress C

1. Mr. Agarwala started Agarwala Electricals shop with a capital of Rs. 1,00,000. As this amount is insufficient, he has borrowed Rs. 50,000 from Syndicate Bank. As he is not keeping good health, he appointed Mr. Ram Naresh to look after the business on a salary of Rs. 1,000 per month. Pavan Electrical Works supplies electrical goods to Agarwala Electricals

on credit. Mr. Mirchand, Mr. Sabir and Mr. Wilson are the other persons working in Agarwals Electricals, as salesmen. Mr. Agarwals wants to expand the business. He is not in a position to invest more money. Mr. Shyamlal wants to join as a partner. From this, identify the names of the following parties and write the answer in theblank space provided.

		Name
i)	Business firm	....
ii)	Owner	....
iii)	Manager	....
iv)	Lender	....
v)	Creditor	....
vi)	Prospective Investor	....
vii)	Employees	....

2. Complete the following sentences:

   i) Accounting is the process of identifying, measuring and ……………… economic information to permit informed judgements.

   ii) Accounting designed to serve external parties to provide information relating to the operating activities of the business is termed as ………………………

   iii) Accounting designed for operational needs of business is termed as ……………………………………..

   iv) ……………………….. Accounting is more or less compulsory for every business.

1.9 ADVANTAGES OF ACCOUNTING

The following are the advantages of a properly maintained accounting system:

1) **Replaces memory:** Since all the financial events are recorded in the books, there is no need to rely on memory. The books of account will serve as historical records. Any information required at any time can be had from these records.

2) **Provides control over assets:** Accounting provides information regarding balance of cash in hand and at bank, the stock of goods in hand, the amount receivable from various parties, the amount invested in various other assets, etc. Information about these matters help owner(s) and management to make use of the assets in the best possible way.

3) **Facilitates the preparation of financial statements:** With the help of information contained in the accounting records, financial statements viz., Profit and Loss Account and Balance Sheet can be easily prepared. These statements enable the businessman to know the net result of the business during an accounting period and its financial position.

4) **Meets the information requirements:** Various interested parties such as owners, management, lenders, creditors, etc. get the necessary information at frequent intervals which help them in their decision-making.

5) **Facilitates a comparative study:** The financial Statements prepared will enable the enterprise to compare its present position with that of its past, and with that of similar organisations. This helps them to draw useful conclusions and improve its performance.

6) **Assists the management in many ways:** It is possible to identify reasons for the profit earned or loss suffered. The identification of reasons helps in taking necessary steps to increase profits further, or to avoid losses. Accounting information will also help in planning and controlling the activities of the business.

7) **Difficult to conceal fraud or theft:** It is difficult to conceal fraud, theft, etc..as there is an automatic check in the form of periodic balancing of books of account. Further, in big organisations, the record keeping work is divided among many persons. so that chances of committing fraud are minimised.

8) **Tax matters :** The Government levies various taxes such as customs duty, excise duty, sales tax, and income tax. Properly maintained accounting records will help in the settlement of tax matters with the tax authorities.

9) **Ascertaining value of business:** In the event of sale of a business firm, the accounting records will help in ascertaining the value of business.

1.10 LIMITATIONS OF ACCOUNTING

The accounting information is used by various parties who form judgments about the profitability and the financial soundness of a business on the basis of such information. It is, therefore, necessary to know about the limitations of accounting. These are as follows:

1. They do not record transactions and events which are not of a financial character. Hence. They do not reveal a complete picture because facts like quality of human resources, licences possessed, locational advantage, business contacts, etc. do not find any place in books of account.

2. The data is historical in nature. The accountants adopt historical cost as the basis in valuing and reporting all assets and liabilities. They do not reflect current values, it is quite possible that items like land and buildings may have much more value than what is stated in the balance sheet.

3. Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgements. Hence, they do not reveal the true picture. In many cases, estimates may be used to determine the value of various items. For example, debtors are estimated in terms of collectability, inventories are based on marketability, and fixed assets are based on useful working life. All these estimates are materially affected by personal judgements.

4. Data provided in the financial statements is insufficient for proper analysis and decision making. It only provides information about the overall profitability of the business. No information is given about the cost and profitability of different activities.

1.11 BASES OF ACCOUNTING

There are two bases of accounting: (i) cash basis, and (ii) accrual basis. These are explained below:

1.11.1 Cash Basis of Accounting

In this system, the accounting entries are made on the basis of cash received or cash paid. In other words, transactions are recorded only when cash is received or paid. The incomes earned but not yet received (accrued income) or the expenses incurred but not yet paid (expenses outstanding) are completely ignored while preparing the final accounts. For example, rent for the month of December, 2017 is paid in January, 2018. This is taken into the Profit and Loss Account of 2018 even though the benefit of that payment (accommodation) is enjoyed in 2017 itself.

1.11.2 Accrual Basis of Accounting

This system of accounting attempts to record the financial effects of transactions in the period in which they occur and not in the period in which the amount is received or paid to the enterprise.

Accrual accounting is also called ‘Mercantile System of Accounting’. It recognises that buying, selling and all other operations of an enterprise during a period may not coincide with the period during which the related cash receipts and cash payments take place. In other words, all revenues earned in a year may or may not have been received in cash in that year. Similarly, all expenses incurred in a year may or may not have been paid in the same year. Accrual accounting attempts to relate the revenues and expenses to year in which they are actually earned or incurred. For example, rent for the month of December, 2017 is paid in January, 2018. As per the accrual principle, it would be taken to the Profit and Loss Account of the year 2017 and not 2018. This is more logical because the benefit of payment is enjoyed in the year 2017 and not in 2018.

The main difference between accrual accounting and cash basis of accounting is the recognition of revenues, gains, expenses and losses. The objective of accrual accounting is to account for the effects of transactions and events to the extent that their financial effects are recognisable and measurable in the periods in which they occur. The adjustments made in the final accounts in respect of prepaid expenses (prepaid insurance, salaries paid in advance, etc.), income received in advance (rent received in advance, interest received in advance, etc.), income earned but not yet received (interest receivable, commission receivable, etc.) are based on accrual accounting.

Sometimes, a business adopts a combination of both the above systems. In that case it is called ‘Mixed or Hybrid System’. For example, the business may consider income in cash receipt basis and expenses on accrual basis. This is considered most conservative. In practice, most enterprise adapt the accrual basis of accounting.

1.12 QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

Business owners can use accounting information to conduct a financial analysis of business operations. Accounting information often has quantitative and qualitative characteristics. Quantitative characteristics refer to the calculation of financial transactions. Qualitative characteristics include the business owner's perceived importance of financial information. Business owners often require financial information when making business decisions. Incorrect or inappropriate information can hamper decision-making or cause business owners to make incorrect assessments about their companies. Some of the qualitative characteristics of accounting information are as follows:

(i) **Understandable**

Accounting information must be understandable. This is an important qualitative characteristic for small business owners. Many small business owners do not have a strong accounting background. Financial information that is too technical or cannot be understood by a layperson can be ineffective for business owners. Small business owners often use professional accountants to complete various accounting functions. Business owners should choose an accountant who can prepare information in an easily understandable manner.

(ii) **Usefulness**

Business owners need accounting information that is applicable to the business decision at hand. They can request financial statements, accounting schedules, reconciliations or cost-benefit analysis. For example, cost allocation reports may not provide sufficient information for business owners who must make a decision on hiring employees. Cost allocation usually refers to applying business costs to goods or services produced by the company, which has very little to do with human resources. Business owners should carefully request and review accounting information to ensure that it provides the most useful information for the decision-making process.

(iii) **Relevance**

Accounting information should relate to a specific time period or contain information regarding individual business functions. Business owners often conduct a trend analysis when reviewing financial information. The trend analysis compares historical financial information to the company's current accounting period information. Irrelevant historical information can severely distort the trend analysis process. For example, reviewing the production process for budgets requires relevant information on the cost of materials for budgets. Cost information on the materials to produce COGS would be irrelevant.

(iv) **Reliability**

Accounting information must be reliable, so that business owners can be reasonably assured that accounting information presents an accurate picture of the company's financial health. Business owners often use accounting information to secure external financing for their business. Information that is not reliable or accurate may cause lenders and investors to question the business's management ability. Business owners may also struggle to secure external financing with poor accounting information.

(v) **Comparable**

Comparability allows business owners to review their company's accounting information against that of a competitor. Business owners use comparison to gauge how well their companies operate under certain market conditions. Owners often use the leading company of an industry for the comparison process. These companies usually have the most efficient and effective business operations. Non-comparable accounting information can make this a difficult process. For example, business owners should consider preparing financial statements according to standard accounting principles. The statements can then be compared to other company's financial standard prepared in a similar manner.

(vi) **Consistent**

Consistency refers to how business owners and accountants record financial information in a company's general ledger. Business owners need to ensure that financial transactions are handled the same way. Inventory purchases should be recorded the same way as yesterday, today and tomorrow. This helps companies create accurate historical records and limit the amount of financial accounts or journal entries included in their general ledgers.

1.13 FUNCTIONS OF ACCOUNTING

Functions of Accounting involves the creation of financial records of business transactions, flows of finance, the process of creating wealth in an organization, and the financial position of a business at a particular moment in time. The progress and reputation of any business big or small is build up on sound financial footing. There are number of parties who are interested in accounting information relating to a business. Financial Accounting communicates financial information of the business concern to various parties. Financial accounting provides information regarding the status of a business and results of its operation. Here are the functions of accounting:

(i) Recording

This is the basic function of accounting. It is essentially concerned with not only ensuring that all business transactions of financial character are in fact recorded but also that they are recorded in an orderly manner. Recording is done in the book "Journal".

(ii) Classifying

Classification is concerned with the systematic analysis of the recorded data, with a view to group transactions or entries of one nature at one place. The work of classification is done in the book termed as "Ledger".

(iii) Summarizing

This involves presenting the classified data in a manner which is understandable and useful to the internal as well as external end-users of accounting statements. This process leads to the preparation of the following statements: (1) Trial Balance, (2) Income statement (3) Balance Sheet.

(iv) Analysis and Interprets

This is the final function of accounting. The recorded financial data is analyzed and interpreted in a manner that the end-users can make a meaningful judgment about the financial condition and profitability of the business operations. The data is also used for preparing the future plan and framing of policies for executing such plans.

(v) Communicate

The accounting information after being meaningfully analyzed and interpreted has to be communicated in a proper form and manner to the proper person. This is done through preparation and distribution of accounting reports, which include besides the usual income statement and the balance sheet, additional information in the form of accounting ratios, graphs, diagrams, funds flow statements etc.

1.14 LET US SUM UP

1. Business has a series of transactions. It is not possible to remember all the transactions which have taken place over a period of time, and calculate the net effect of all such transactions i.e., profit or loss. Hence, the need for accounting takes place.

2. Information about the business enterprise is required for both internal and external use. To get the required information, a systematic record is necessary.

3. The objectives of accounting are: to keep systematic records; to ascertain the profit or loss and also the financial position; and to provide accounting information to interested parties for rational decision-making.

4. Accounting is the process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the financial transactions and events.

5. The series of activities mentioned above, explain the nature and outline the scope of accounting.

6. Book-keeping is a part of accounting. It is the record keeping function of accounting and is limited upto the classifying stage.

7. Accountancy is the systematic knowledge, while accounting is the practice of the knowledge i.e., the actual maintenance of books of account and provide accounting information.

8. Many groups of people like owners, management, lenders, creditors, investors, tax authorities, employees, etc., are interested in the accounting information of the enterprise.

9. Changes in economic environment and the increasing complexity of management function have given rise to specialised fields of accounting such as financial accounting, cost accounting and management accounting.

10. There are many advantages of a properly maintained accounting system.

1.15 KEY WORDS

Accountancy: The science of measurement of wealth. It is the systematic knowledge of accounting.

Accounting: Process of identifying, measuring, recording, classifying, summarising and communicating business transactions and events in terms of money.

Accounting Year : A period of 12 months at the end of which the financial results of the enterprise are generally ascertained.

Accrual Basis of Accounting: A basis of accounting which takes into account all incomes, gains, expenses and losses in the year in which they are earned or incurred, and not when they are received or paid.

Book-keeping: Systematic recording of business transactions in the books of account.

Balance Sheet: A statement prepared for ascertaining the financial position of the business as at the end of the accounting period.

Cash Basis of Accounting: A basis of accounting in which accounts are prepared on the basis of cash received or cash paid. No accruals -are considered.

Cost Accounting: A branch of accounting concerned with measurement and control of costs.

Financial Accounting: It is primarily concerned with record keeping directed towards preparation of financial statements and other accounting reports.

Financial Position: Position of assets and liabilities of a business at a given point of time.

Financial Statements: Summary of accounting information such as Profit and Loss Account and Balance Sheet.

Final Accounts : Financial statements prepared at the end of the accounting period for ascertaining the profit or loss and the financial position of the business. They include Profit and Loss Account and the Balance Sheet.

Management: It is used in two senses:

i) to mean the process of management or managing the business, for example, the day-to-day management is entrusted to paid managers; and

ii) to mean the persons who are incharge of carrying out the business activity i.e., managers, for example, management wants this information. Report has to be submitted to the management.

Management Accounting: It is concerned with the supply of information which is useful to the management in planning, controlling and decision-making.

Profit: Excess of income over expenses.

Profit and Loss Account: A statement showing all incomes and expenses for the accounting period. It is prepared for ascertaining the operational result of the enterprise.

1.16 SOME USEFUL BOOKS

Bièrman, Harold & Drebin, *Allan R., Financial Accounting: An Introduction* (Philadelphia: W.B. Saunders Company, 1998).

Briston, R.J., *Introduction to Accountancy & Finance* (London: The Macmillan Press Ltd., 1991).

Maheshwari, S.N., *Principles and Practice of Book-Keeping* (New Delhi: Arya Book Depot, 2018).

Matulich, S. & Heitger, *L.E., Financial Accounting* (New York: McGraw Hill Book Company, 1990).

Patil, V.A. & Korlahalli, Principles and Practice of Book-Keeping (New Delhi: R. Chand & Co., 2018).

1.17 ANSWERS TO CHECK YOUR PROGRESS

C 1. i) Agarwala Electricals Shop
 ii) Mr. Agarwala
 iii) Mr. Ram Naresh
 iv) Syndicate Bank
 v) Pawan Electrical Works
 vi) Mr. Shyamlal
 vii) Mr. Mirchand, Mr. Sabir and Mr. Wilson.

2. i) Communicating
 ii) Financial Accounting
 iii) Management Accounting
 iv) Financial

1.18 TERMINAL QUESTIONS

1. Outline the need for accounting and briefly describe the objectives of accounting.
2. Define accounting and explain its scope.
3. Name the different parties interested in accounting information, and explain why do they want it.
4. What are the qualitative characteristics of accounting information? Briefly Explain.
5. Describe the advantages and limitations of accounting.
6. Briefly discuss the functions of accounting.
7. Define accounting. Explain the need for accounting.

8. Write short notes on the following:
   a) Book-keeping
   b) Accountancy
   c) Accounting
9. Distinguish between cash basis and accrual basis of accounting with examples.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 2 ACCOUNTING PROCESS AND RULES

Structure

2.0 OBJECTIVES

After studying this unit, you should be able to:

- identify the different stages of accounting;
- classify accounts;
- analyze the dual effect of each transaction; and
- apply the rules of accounting, and determine the account to be debited and the account to be credited.

2.1 INTRODUCTION

So far you have learnt the definition of accounting, its objects, advantages, the terms commonly used in accounting, and the basic accounting concepts relevant to record keeping. You know accounting is the art of recording, classifying and summarising the business transactions, and interpreting the results thereof. So, the accounting process starts with recording of transactions and ends with the preparation of financial statements and their analysis. In this unit, we shall first identify the different stages involved in the accounting process and then discuss different classes of accounts, the principle of double entry, and the rules of debit and credit which you are expected to master.

2.2 ACCOUNTING PROCESS

The accounting process consists of the following four steps:

i) Recording the Transactions

ii) Classifying the Transactions

iii) Summarising the Transactions

iv) Interpreting the Results

Recording the Transactions

The accounting process begins with recording of transactions in the books of original entry. The book used for the original entries is called 'Journal'. Business transactions are recorded in the journal as and when they occur in the order of dates. You will learn the method of recording a transaction in the journal in Unit 5. Entries in the journal are made on the basis of various vouchers such as cash memos, invoices, receipts, etc.

Classifying the Transactions

The second step is to group the transactions of similar nature and post them in different accounts in another book called the 'Ledger'. For example, all transactions relating to cash are brought together and are recorded at one place in Cash Account in the ledger. Similarly, dealings with different persons are recorded separately in the account of each person. The accounts so prepared are totaled and balanced periodically to know the net effect of related transactions. We shall discuss the process of posting into ledger and balancing of accounts in detail in Unit 5.

Summarising the Transactions

The next step is to prepare a year-end summary known as 'Final Accounts. But before final accounts are prepared, we prepare a statement called 'Trial Balance' to test the arithmetical accuracy of the work done. In other words, the trial balance is prepared to find out whether the Principle of Double Entry has been strictly followed or not, while recording the transaction. Then, with the help of the trial balance and some other relevant information we prepare the final accounts. The objectives of preparing the final accounts are: (i) to know the net result of business activities, and (ii) to know the financial position of the business. The final accounts consist of an income statement called 'Trading and Profit and Loss Account', and a position statement called 'Balance Sheet'. The Trading and Profit and Loss Account is prepared to know whether the business unit has earned profit or incurred loss. The Balance Sheet is prepared to know the financial position of the business, i.e., what the business owns and what it owes.

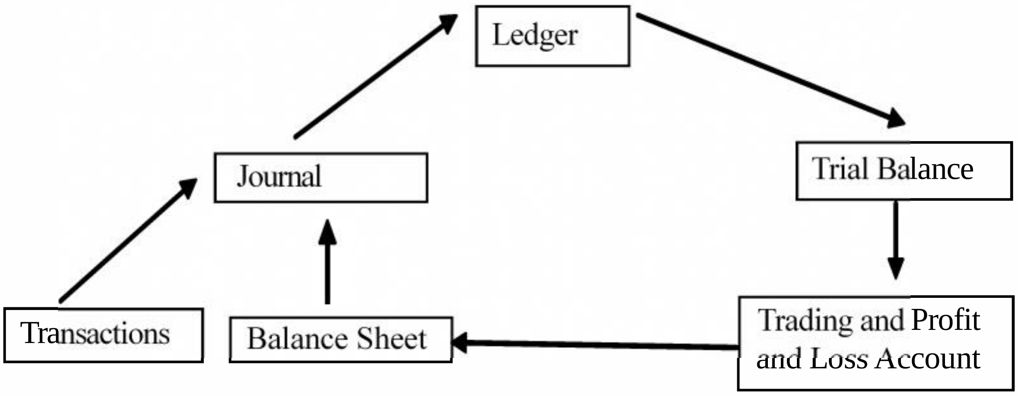
Interpreting the Results

The results are then analysed and interpreted with a view to assess the performance of the business, its future profit-earning capacity and its ability to pay short-term and long-term debts. The results and conclusions thus arrived at are reported to the interested parties like investors, management, bankers, creditors, tax authorities, etc.

The balances on various accounts shown in the Balance Sheet will then be transferred to the new books of account for the next year. The process of recording transactions for the next year is again started, this continuous process of accounting is referred to as the 'Accounting Cycle' because it repeats itself regularly and in the same order. The Accounting Cycle is presented in Chart 2.1.

Chart 2.1

ACCOUNTING CYCLE



2.3 WHAT IS AN ACCOUNT?

We have seen that an account is a summarised record of the effect of all transactions relating to a particular person or an item. Let us now learn more about this term.

An account is vertically divided into two halves and resembles the shape of the English alphabet 'T' as under:

Name of the account

Dr. **Cr.**

The left hand side is called the 'debit side'. It is indicated by writing 'Dr.' (abbreviation for debit) on the left hand top corner of the account. The right hand side known as the 'credit side' is indicated by writing 'Cr.' (abbreviation for credit) on the right hand top corner of the account. The name of the account is written at the top in the centre. The word 'Account' or its abbreviation 'A/c' is added to the name of the account. The rules of recording the transactions on the debit and credit sides shall be discussed later in this unit.

2.4 CLASSIFICATION OF ACCOUNTS

All business transactions broadly be classified into three categories: (i) those relating to persons, (ii) those relating to property (assets), and (iii) those relating to incomes and expenses. Hence, it becomes necessary to keep an account for each person, each asset, and each item of income and expense. Thus, three classes of accounts are maintained for recording all business transactions. They are: (i) Personal Accounts, (ii) Real Accounts, and (iii) Nominal Accounts. Real and Nominal Accounts taken together are called Impersonal Accounts.

Personal Accounts

Accounts which show dealings with persons are called 'Personal Accounts'. Such dealings may relate to credit purchases of goods or credit sales of goods or loans taken, etc. A separate account is kept in the name of each person for recording the benefits received from, or given to, the person in the course of dealings with him. Examples are: Krishna's Account, Gopal's Account, Loan from Ratanlal Account, etc.

Personal accounts also include accounts in the names of institutions or companies called artificial persons) such as Indian Bank Account. Nagarjuna Finance Limited Account, the Andhra Pradesh Paper Mills Limited Account, etc.

The accounts which represent expenses payable, expenses paid in advance, incomes receivable and incomes received in advance are also personal accounts, though impersonal in name. For example, when salaries are due to the employees, but not paid before closing of the books of account for the year, an account called 'Salaries Outstanding Account' will be opened in the books. The Salaries Outstanding Account is regarded as a personal account representing the employees to whom salaries are payable by the business. Such a personal account is called Representative Personal Account' as it represents a particular person or a group of persons. Other examples of representative personal accounts are: Interest Outstanding Account, Prepaid Insurance Account, Rent Received in Advance Account, Commission Outstanding Account. etc.

Capital Account and Drawings Account are also treated as personal accounts as they represent dealings with the owner of the business.

Real Accounts

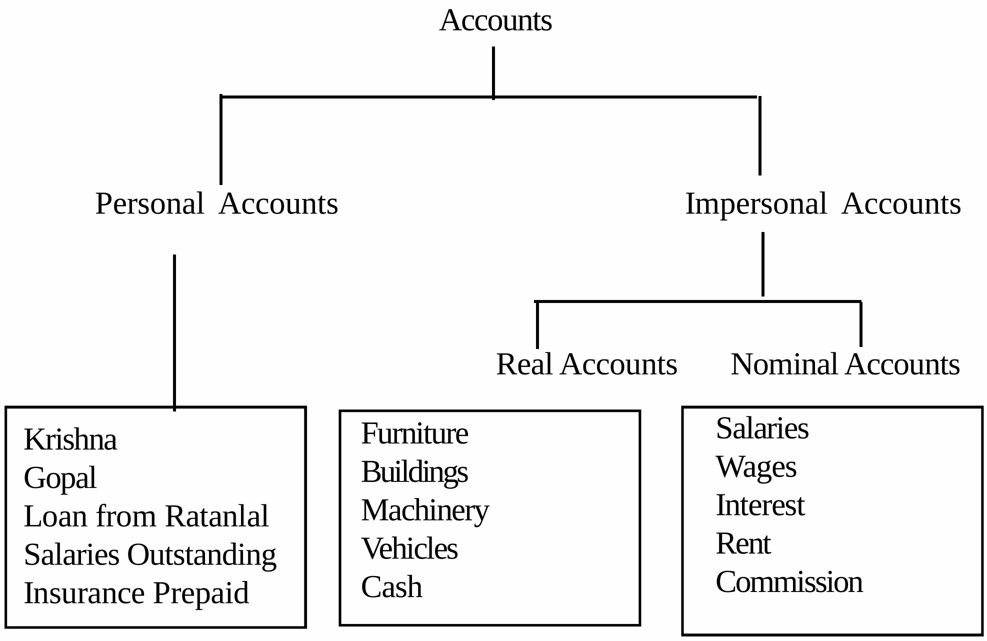
Accounts relating to properties or assets are known as 'Real Accounts'. Every business needs assets such as Machinery, Furniture, etc., for running its activities. In. book-keeping, a separate account is maintained for each asset owned by the business. Dealings relating to purchase or sale of the asset are recorded through this account. Furniture Account, Machinery Account, Building Account, etc., are some examples of real accounts. Cash Account which shows receipts and payments of cash is also a real account. They are known as real accounts because they represent things of value owned by the business.

Nominal Accounts

Accounts relating to expenses, losses, incomes and gains are known as 'Nominal Accounts'. Every business unit incurs certain expenses such as payment of salaries to employees, payment of wages to workers, etc., while carrying out its activities. It may also suffer losses such as loss by fire, loss by theft, etc. It may also earn certain incomes and gains such as receipt of commission, receipt of-interest, profit on sale of an asset, etc. A separate account is maintained for recording each item of expense, loss, income or gain. Thus, Wages Account, Salaries Account, Commission Received Account, and Interest Received Account are all nominal accounts. Classification of accounts is presented in Chart 2.2.

CHART 2.2

CLASSIFICATION OF ACCOUNTS



Check Your Progress A

1. State whether each of the following statements is **True** or **False.**

   a) First recording of transactions is done in Journal.
   b) Summarising of all business transactions is done in Ledger.
   c) Interpretation of the results is done by preparing Trial Balance.
   d) Right hand side of an account is called credit side.
   e) Personal accounts include accounts of persons with whom the business deals.
   f) Accounts which represent an item of asset is called Representative Personal Accounts.
   g) Accounts relating to assets held in the name of the firm are called Nominal Accounts.

2. Names of some accounts are given below, classify them into Personal, Real or Nominal.

Name of Account	Class of Account
a) Bank A/c	
b) Interest A/c	
c) Interest Outstanding A/c	
d) Patents A/c	
e) Loan from Gopal Das A/c	
f) Loose Tools A/c	
g) Commission Received in Advance A/c	
h) Prepaid Salaries A/c	
i) Stationery A/c	
j) Electricity Charges A/c	

3. State whether the following classification of accounts is correct or not. Give the correct classification, wherever necessary.

Name of Account	Class of Account	If correct, put a tick mark. If wrong, state the correct class of account
a) Fixtures A/c	Nominal Account	
b) Discount Received A/c	Personal Account	
c) Discount Received in advance A/c	Nominal Account	
d Ram & Co. A/c	Personal Account	
e) Goodwill A/c	Personal Account	
f) Office Expenses A/c	Real Account	
g) Office Equipment A/c	Nominal Account	
h) Cash A/c	Real Account	
i) Cartage A/c	Real Account	
j) Import Duty/A/c	Real Account	

2.5 PRINCIPLE OF DOUBLE ENTRY

You have learnt earlier that a transaction results in the transfer of money or money's worth i.e., goods or services. Hence, every business transaction involves a transfer and as such consists of two aspects: (i) the receiving aspect, and (ii) the giving aspect. It is necessary to note that these two aspects go together, as receiving necessarily implies giving and vice versa. For example, let us consider a transaction where machinery is purchased for cash. In this case, the receiving aspect is machinery (as machinery comes in) and giving aspect is cash (as cash goes out). Similarly, in a transaction where wages are paid to workers, the receiving aspect is the service of the workers and the giving aspect is cash. The receiving and giving take place between two parties or the accounts representing those parties. Thus, in the first example discussed above, from the point of view of the business, Machinery Account is receiving the benefit and Cash Account is giving the benefit. In the second example, Wages Account is receiving the benefit in the form of service and Cash Account is giving the benefit. These two aspects are represented in every account by the terms 'Dr'. and 'Cr.'. The 'Dr.' represents the receiving aspect and the 'Cr.' the giving aspect. The record of any business transaction will be complete only when both of these aspects are recorded. This recording of the two aspects of each transaction is known as 'Double Entry' and the system is called 'Double Entry System'.

Thus, every transaction affects two accounts and according to Double Entry system entries will be made in both of them on the debit side (left hand side) in one account and on the credit side (right hand side) in the other. In case of the first example (machinery purchased for cash), entries will be made on the debit side of Machinery Account and the credit side of Cash Account. In the case of second example (wages paid to workers), entries will be made on debit side of Wages Account and the credit side of Cash Account. Hence, for every debit there must be a corresponding credit for an equal amount and vice versa. This is known as the 'Principle of Double Entry, and all business transactions are recorded in books of account according to this principle.

In order to develop a clear understanding of the receiving and giving aspects of various business transactions and the accounts affected thereby study Table 2.1 carefully.

Table 2.1: Dual Aspect of Transactions and the Account Affected

Transaction	First Aspect		Second Aspect	
	Receiving Receiver	Account affected	Giving/Giver	Account affected
1. Commenced business with Rs. 50,000 as capital.	Cash	Cash A/c	Proprietor	Capital A/c
2. Bought goods for cash Rs. 5,000	Goods	Goods A/c	Cash	Cash A/c
3. Bought goods from Ramesh & Co. on credit Rs. 10,000	Goods	Goods A/c	Ramesh & Co.	Ramesh & Co. A/c
4. Sold goods for cash Rs. 12,000	Cash	Cash A/c	Goods	Goods A/c
5. Sold goods to Ajay on credit Rs. 2,500	Ajay	Ajay's A/c	Goods	Goods A/c
6. Paid cash to Ramesh & Co. Rs. 5,000	Ramesh & Co.	Ramesh & Co. A/c	Cash	Cash A/c
7. Received Cash from Ajay Rs. 1,000	Cash	Cash A/c	Ajay	Ajay's A/c
8. Paid rent Rs. 1,000	Benefit of accommoda tion	Rent A/c	Cash	Cash A/c
9. Purchased Typewriter Rs. 4,500	Typewriter	Typewriter A/c	Cash	Cash A/c
10. Paid interest on loan Rs. 1,200	Benefit of using the loan	Interest A/c	Cash	Cash A/c

Check Your Progress B

Manohar had the following transactions. Determine the two aspects of each transaction and the accounts affected.

Transaction	First Aspect		Second Aspect	
	Receiving Receiver	Account affected	Giving/Giver	Account affected
a) Purchased machinery for Rs. 60,000				
b) Purchased goods from Karim & Co. on credit Rs. 10,000				

c) Sold goods for cash Rs. 2,400				
d) Loan taken from bank Rs. 25,000				
e) Travelling expenses paid to salesman Rs. 122				
f) Paid electricity charges Rs. 110				
g) Received Cash from Shanker Rs 1,200				
h) Paid cash to Karim & Co. Rs. 2,000				
I) Cash drawn for personal expenses Rs. 500				
j) Paid cash into bank Rs. 5,000				

2.6 ACCOUNTING RULES

We have already seen that every transaction affects two accounts and this effect will have to be entered in both of them, on the debit side in one account and on the credit side in the other account. It is, therefore, necessary to find out which of the two accounts is to be debited and which is to be credited. For this purpose, one has to first identify the class to which these two accounts belong i.e., personal, real or nominal; and then certain rules known as 'rules of debit and credit' are applied. These rules are as follows:

1. **For Personal Accounts:** The account of the person receiving the benefit (receiver) of the transaction (from the business) is debited and the account of the person giving the benefit (giver) of the transaction (to the business) is credited.

2. **For Real Accounts:** When an asset is coming into the business, the account of that asset is debited. When an asset is going out of the business, the account of that asset is credited.

3. **For Nominal Accounts:** When an expense is incurred or loss suffered, the account representing the expense or the loss is debited because the business receives the benefit thereof. When any income is earned or gain made, the account representing the income or the gain is credited. This is because the business gives some benefit.

The above rules have been shown in Table 2.2

Table 2.2 : Rules of Debit and Credit

Class of Account	Debit	Credit
Personal Accounts	The Receiver	The Giver
Real Accounts	What comes in	What goes out
Nominal Accounts	Expenses and Losses	Income and Gains

We shall now see the application of these rules, taking a few transactions.

Example 1: Paid cash to Ramesh & Co. Rs. 5,000.

In this case, the two accounts affected are Ramesh & Co.'s Account and Cash Account. Ramesh & Co.'s Account is a personal account and Cash Account is a real account. Ramesh & Co. has received the benefit (cash Rs. 5,000) from the business and, therefore, it has to be debited as per the first part of the rule for personal accounts 'debit the receiver'. As cash has gone out, Cash Account will be credited according to the second part of the rule for real accounts 'credit what goes out'.

Example 2: Received cash from Ajay Rs. 1,000.

In this case, Cash Account and Ajay's Account are the two accounts affected. Cash Account is a real account and Ajay's account is a personal account. As cash has come in, Cash Account will have to be debited according to the first part of the rule for real accounts 'debit what comes in'. Ajay has given the benefit (cash Rs. 1,000) to the business and, therefore, his account will have to be credited as per the second part of the rule for personal accounts 'credit the giver'.

Example 3: Paid rent Rs. 1,000.

In this case, the accounts affected are Rent Account and Cash Account. Rent Account is a nominal account and Cash Account is a real account. As per the first part of the rule for nominal accounts, 'debit expenses and losses', Rent Account will have to be debited as it is an expense to the business. As cash has gone out, Cash Account will have to be credited according to the second part of the rule for real accounts 'credit what goes out'.

Example 4: Received Rs 400 as commission.

In this case, Cash Account and Commission Account are the two accounts affected. Cash Account is a real account and Commission Account is a nominal account. As cash has come in, Cash Account will have to be debited according to the first part of the rule for real accounts 'debit what comes in'. As per second part of the rule for nominal accounts, 'credit incomes and gains', Commission Account will be credited as it is an income to the business.

You have seen that the three rules of debit and credit explained above, make it possible to analyse the transaction and identify the account to be debited and the account to be credited. Even though it has been explained that there are three different rules for the three classes of accounts, it is to be noted that these three rules, in reality, are a manifestation of the dual aspect concept. In other words, the account that receives the benefit of the transaction is to be debited and the account that gives the benefit is to be credited, irrespective of the class of account involved.

Let us now apply these rules to the transactions given in Table 2.1 and ascertain which account is to be debited and which account is to be credited. This has been analysed in Table 2.3. You may go through it carefully and grasp the application of the Rules of Debit and Credit.

Table 2.3 : Analysis of Accounts Affected

Transaction	Accounts affected Accounts	Class of Credit	Debit/	Reasons
1. Commenced business with Rs. 50,000 as capital	i) Cash A/c ii) Capital A/c	Real Personal	Debit Credit	Cash comes in Proprietor gives benefit
2. Bought goods for cash Rs. 5,000	i) Goods A/c ii) Cash A/c	Real Real	Debit Credit	Goods come in Cash goes out
3. Bought goods from Sohan credit Rs.10000	i) Goods A/c ii) Sohan A/c	Real Personal	Debit Credit	Goods come in Giver
4. Sold goods for cash Rs. 1,500	i) Cash A/c ii) Goods A/c	Real Real	Debit Credit	Cash comes in Goods go out
5. Sold goods to Vijay on credit Rs. 2,500	i) Vijay A/c ii) Goods A/c	Personal Real	Debit Credit	Receiver Goods go out
6. Purchased furniture Rs. 4,000	i) Furniture A/c ii) Cash A/c	RealReal	Debit Credit	Furniture comes inCash goes out
7. Sold old typewriter Rs. 500	i) Cash A/c ii) Typewriter A/c	RealReal	Debit Credit	Cash comes in Typewriter goes out
8. Purchased postage stamps Rs. 50	i) Postage A/c ii) Cash A/c	Nominal Real	Debit Credit	Postage is an expenseCash goes out
9. Paid salaries Rs. 6,000	i) Salaries A/c ii) Cash A/c	Nominal Real	Debit Credit	An expense Cash goes out
10. Received interest Rs. 200	i) Cash A/cii) Interest A/c	Real Nominal	Debit Credit	Cash comes in An income

2.7 LET US SUM UP

1. The accounting process starts with recording of transactions in the journal. From the journal, they are posted to ledger accounts. Then, a trial balance is prepared to verify the accuracy of the work done and the final accounts are prepared to know the profit or loss made and the financial position of the business. Finally, the results are analysed and reported to the interested parties.

2. Accounts are classified as Personal, Real, and Nominal Accounts. Accounts showing dealings with persons are called personal accounts. Accounts relating to assets are known as real accounts and those relating to expenses, losses, incomes and gains are known as nominal accounts.

3. Every transaction consists of two aspects: (i) the receiving aspect and ii) the giving aspect. The recording of this two-fold effect of each transaction is called ‘Double Entry’. The principle of double entry is, for every debit there must be an equal and a corresponding credit and vice versa.

4. Certain rules are followed for recording business transactions. In the case of personal accounts, the rule is, ‘Debit the receiver and Credit the giver. For real accounts, the rule is, ‘Debit what comes in and Credit what goes out’, and for nominal accounts the rule is, ‘Debit expenses and losses and Credit incomes and gains’.

2.8 KEY WORDS

Account: A summarised record which shows the effect of the transactions relating to a particular person or thing.

Credit: Credit represents the giving aspect of a transaction.

Debit: Debit represents the receiving aspect of a transaction.

Double Entry Principle: Principle of recording both the receiving and the giving aspects of each transaction.

Nominal Accounts: Accounts relating to expenses, losses, incomes and gains.

Personal Accounts: Accounts which relate to persons.

Real Accounts: Accounts which relate to assets.

2.9 SOME USEFUL BOOKS

Briston, R.J., Introduction to Accountancy and Finance, (London: The Macmillan Press Ltd., 2017).

Birman, Harold & Derbin, Allan R., Financial Accounting: An Introduction, (Philadelphia: W.B. Saunders Company, 2008).

Grewal, T.S., Double Entry Book-Keeping, (New Delhi: Sultan Chand & Sons, 2018)

Maheshwari, S.N., Principles & Practice of Accountancy Part-I, (New Delhi: Arya Book Depot, 2018).

Patil V.A. & Korlahalli, J .S., Principles and Practice of Book-Keeping, (New Delhi R. Chand & Co., 2018).

2.10 ANSWERS TO CHECK YOUR PROGRESS

A 1. a) True b) False

c) False d) True

e) True f) False

g) False

2. a, c, e, g, h are Personal Accounts.

d and f are Real Accounts.

b, i, j are Nominal Accounts.

3. a) Real Account b) Nominal Account

c) Personal Account d) Correct

e) Real Account f) Nominal Account

g) Real Account h) Correct

i) Nominal Account j) Nominal Account

B

Transaction	First Aspect		Second Aspect	
	Receiving/Receiver affected	**Account**	**Giving/Giver affected**	**Account**
a)	Machinery	Machinery A/c	Cash	Cash A/c
b)	Goods	Goods A/c	Karim & Co.	Karim & Co. A/c
c)	Cash	Cash A/c	Goods	Goods A/c
d)	Cash	Cash A/c	Bank	Bank Loan A/c
e)	Benefit of service (Transport)	Travelling Expenses A/c	Cash	Cash A/c
f)	Benefit of service (Electricity)	Electricity Charges A/c	Cash	Cash A/c
g)	Cash	Cash A/c	Shanker	Shanker's A/c
h)	Karim &Co.	Karim & Co. A/c	Cash	Cash A/c
i)	Proprietor	Drawings A/c	Cash	Cash A/c
j)	Bank	Bank A/c	Cash	Cash A/c

2.11 TERMINAL QUESTIONS/EXERCISES

Questions

1. Discuss the various stages involved in the accounting process.
2. What is an Account? Describe the various classes of accounts with examples.
3. What do you understand by the Principle of Double Entry? Give the rules of debit and credit with suitable examples.

Exercises

I. From the following transactions, determine the accounts affected, classify them and state whether it is to be debited or credited.

		Rs.
a)	Purchased typewriter for cash	5,000
b)	Purchased furniture from R & Co. on credit	50,000
c)	Interest received	300
d)	Paid wages	800
e)	Received cash from A	2,000

f) Additional capital introduced into the business 5,000

g) Paid cash to B 1,500

h) Paid carriage 200

i) Purchased goods from F & Co. on credit 12,000

j) Sold goods for cash 1,400

Answer:

Transaction	**Account to be debited**	**Nature of account**	**Account to be credited**	**Nature of account**
a)	Typewriter A/c	Real	Cash A/c	Real
b)	Furniture A/c	Real	R & Co. A/c	Personal
c)	Cash A/c	Real	Interest A/c	Nominal
d)	Wages A/c	Nominal	Cash A/c	Real
e)	Cash A/c	Real	A's A/c	Personal
f)	Cash A/c	Real	Capital A/c	Personal
g)	B's A/c	Personal	Cash A/c	Real
h)	Carriage A/c	Nominal	Cash A/c	Real
i)	Goods A/c	Real	F & Co. A/c	Personal
j)	Cash A/c	Real	Goods A/c	Real

2. Ram had the following transactions. Determine the accounts to be debited and credited:

		Rs.
a)	Command business with cash	1,00,000
b)	Purchased goods for cash	15,000
c)	Paid for advertisement	600
d)	Bought goods from P & Co. on credit	20,000
e)	Sold goods for cash	6,000
f)	Sold goods to Z on credit	12,000
g)	Paid commission	900
h)	Paid salaries	8,000
i)	Paid rent	600
j)	Loan taken from Hiralal	50,000

Answer:

Transaction	Account to be debited	Account to be credited
a)	Cash A/c	Capital A/c
b)	Goods A/c	Cash A/c
c)	Advertisement A/c	Cash A/c
d)	Goods A/c	P & Co. A/c
e)	Cash A/c	Goods A/c
f)	Z A/c	Goods A/c
g)	Commission A/c	Cash A/c
h)	Salaries A/c	Cash A/c
i)	Rent A/c	Cash A/c
j)	Cash A/c	Loan from Hiralal A/c

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 3 ACCOUNTING PRINCIPLES

Structure

3.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of some basic terms of accounting;
- identify assets, liabilities, incomes and expenses;
- explain the need for the nature of accounting concepts;
- develop familiarity with the basic concepts to be kept in mind at the recording stage;
- decide what type of transactions are to be recorded in books of account;
- ascertain the amount of capital, liabilities and assets from the accounting equation; and
- describe about the two systems of book-keeping.

3.1 INTRODUCTION

In Unit 1, you learnt about the nature, scope and importance of accounting. You know accounting is often called the 'Language of Business'. Language is the means of communication. Accounting also serves this function. It communicates the results of business operations to interested parties. Let us understand this language first. In this unit, we intend to explain some of the terms which are commonly used in accounting and also the basic concepts underlying the accounting system.

3.2 SOME BASIC TERMS

Entity: The word entity literally means a thing that has a definite individual existence. Business entity means a specifically identifiable business enterprise like Khanna Jewellers, Prakash Pipes Ltd., etc. An accounting system is devised for a specific business entity (also called 'accounting entity').

Event and Transaction: Anything that brings about a change in the financial position of an entity is called an 'event'. In other words, an event is a happening of consequence to an entity. A transaction is a particular kind of event involving some value between two or more entities. In other words, it is any dealing between two or more persons involving exchange of goods or services for a consideration usually in money.

Transactions are of two kinds (i) cash transactions and (ii) credit transactions. Cash transaction are those in which cash is involved in the exchange. For example, purchase of goods for cash, purchase of vehicle for cash, payment of rent etc. In case of credit transactions cash is not paid immediately, the settlement is postponed to a later date. For example, goods are purchased on credit on April 15, 2018 and the cash is to be paid on August 1, 2018.

Goods: The term 'goods' refers to articles in which the business deals. Only those articles which are purchased for the purpose of sale are called goods. Other articles which are purchased for the purpose of using them in the business are not called goods. For example, in case of a fans dealer, fans are goods. He may be having tables and chairs. But they are not goods for him. In case of a furniture dealer, tables and chairs are goods. He may be having fans, but they are not goods for him.

Debtor: A debtor is one who owes some amount to the business. For example, a customer who purchases goods on credit from the business, is a debtor to the business.

Creditor: A creditor is one to whom the business owes some amount. One who supplies goods or provides some services on credit to the business is a creditor.

Books of Account: These are the different sets of records, whether in the form of bound books or loose sheets wherein the various business events and transactions are recorded e.g., journal and ledger. If necessary, the journal and also the ledger may be sub-divided into a number of books.

Entry: The recording or entering a transaction or event in the books of account is called an entry.

Journal: Journal is the book of prime entry. It is used for recording all transactions and events of a business entity in the first stage.

Ledger: The transactions recorded in the journal are transferred to a separate book called ledger. In this book, a separate account is opened and maintained for each item. For example, Capital Account, Salaries Account, Furniture Account, Building Account, etc. Ledger is the main book for accounting information and, hence, it is sometimes called the .'king of books of account'.

Account: An account is a classified statement of transactions relating to a person or a thing or any other subject. It is vertically divided into two parts in T shape (alphabet T). The benefits received by that account are recorded on the left hand side (technically called the 'debit side') and the benefits given by that account are recorded on the right hand side (technically called the 'credit side'). This type of recording helps in knowing the net result i.e., whether that account has received more or given more.

To debit an account: It means making an entry for a transaction on the debit side (left hand side) of an account.

To credit an account: It means making an entry for a transaction on the credit side (right hand side) of an account.

On account: It refers to a part receipt or a part payment of money in respect of earlier credit transaction(s). For example, Mr. X owes Rs. 5,000, of which he pays Rs. 3,000. This may be termed as, 'received Rs. 3,000 from Mr. X on account'.

Assets: Assets are things of value or economic resources (property) owned by the enterprise. In other words, cash or any thing which enables the business entity to get cash or a benefit in future is an asset. Land, buildings, machinery, vehicles, furniture, stock of goods, cash, etc., are some examples of assets.

Expenditure: Expenditure means the spending of money or incurring a liability for some benefit/ service received by the business entity. Purchase of machinery, purchase of furniture, payment of salaries, rent, etc., are some examples of expenditure. If the benefit of an expenditure is limited to one year, it is treated as an expense (also called revenue expenditure) such as payment of salaries and rent. On the other hand, if the benefit of an expenditure is available for more than one accounting year, it is treated as an asset (also called capital expenditure) such as purchase of furniture and machinery.

Equities: All claims or rights over the assets of a business firm are called equities. Equities are of two types : (i) creditors' equity, and (ii) owners' equity. The claims of the outsiders are called creditors, equity or liabilities. The claim of the owner is called owner's equity or capital.

Liabilities: Liabilities (also called creditors' equity) are the amount owed by the business firm to outsiders other than the owner(s). Loan from a bank, creditor for goods supplied, rent payable, salaries payable, interest payable to the lenders are some examples of liabilities.

Capital: Capital is the amount invested by the owner(s). It represents the owner's claim on the firm's assets and is known as owner's equity. It is also called net assets or net worth.

Drawings: Drawings refer to the amount withdrawn or the value of goods taken by the proprietor for personal use from the business.

Profit: Profit is the excess of income over expenditure during a period of time. It is owner's equity.

Loss: In one sense, loss means money or money's worth lost without receiving any benefit. For example, cash or goods lost by theft or fire accident. In the context of Profit and Loss Account, loss represents to the excess of expenditure over income during a period of time. In either case, loss decreases the owner's equity.

Income: Income, also called revenue, is the amount earned by a business entity resulting from operations which constitute its major or central activities. For example, sale of goods or services.

Gain: Gain is a profit that arises from events or transactions which are incidental to business, such as sale of an asset, winning a court case, appreciation in the value of land and buildings, etc.

Trade discount: It is a common practice these days to print the price of an article on its package. The price so mentioned on the article is called the 'catalogue price' or 'list price'. When you buy an article, the seller may agree to give you some concession and charge a price which is less than the list price. Such concession or reduction in price is called 'trade discount'. This, is an allowance given by the seller to the buyer on the list price at the time of sale. Trade discount is generally given by the manufacturer to the wholesaler and by the wholesaler to the retailer. Suppose a bookseller buys 10 copies of a book 'Principles and Practice of Accountancy' by R. Sriram, priced at Rs. 25. The publisher allows a discount of 10% and charges Rs. 225 net (list price Rs. 250 minus discount of Rs. 25). The buyer pays only the net price. Recording in books of account is also made for the net amount only. No specific entry is required for the trade discount.

Cash discount: When goods are sold on credit, the buyer is expected to pay the amount on or before the due date. However, if the buyer makes the payment before the due date, the seller may allow him some reduction in the amount due and settle the account. Such an allowance is called 'cash discount'. It is allowed at the time of payment. It motivates the debtor to make prompt payment. Suppose, the books worth Rs. 225 (net amount) were sold on February 1, 2018 on credit for one month. The due date is March 1, 2018. The bookseller offers to make the payment on February 15, 2018. The publisher accepts Rs. 220 in settlement of the account. The balance amount of Rs. 5 is the cash discount allowed. Cash discount must be recorded in the books of account in order to show that the party account stands cleared and nothing more remains due from him.

Voucher: A documentary (written) evidence of a transaction is called a voucher. For example, if we buy goods for cash we get cash memo; if we buy on credit we get an invoice; and so on. Entries in books of account are made with the help of such vouchers.

Solvent: A person who is in a position to pay his debts as they become due.

Insolvent: A person who is not in a position to pay his debts in full and is so declared by the court.

Bad debts: The amount of debt which is unrealisable from a debtor who became insolvent.

Stock: The amount of goods lying unsold or unused. It also includes stock of raw materials and semi-finished goods.

Check Your Progress A

1. Fill in the blanks :

   i) A person who owes money to the firm is ………………………

   ii) A person to whom the firm owes money is a ………………………

   iii) All articles that are purchased for resale are called ………………………

   iv) The property of the business in the form of land and buildings, machinery, etc. is called ………………………

v) Drawings refer to the withdrawal of cash or goods by the owner for ………………………

vi) The amount of debt…………………………………… from the debtor is termed as bad debts.

vii) The amount invested by the owner in business is called ………………..

viii) The amount received in part is called receipt on …………..

2. State in each case whether the item shall be regarded as goods or an asset

i) Furniture purchased by Rama Furnishers for resale.

ii) Furniture purchased by Krishna Stationery Mart.

iii) Machinery purchased by Abdul Engineering Company for use in their factory.

iv) Electric motors purchased by Punjab Machinery Stores who deal in machinery.

v) Power looms manufactured by KCP Ltd., for sale to a textile company.

3. Mr. Rakesh started Rakesh Trading Company with a capital of Rs. 30,000. The company also borrowed Rs. 10,000 from the State Bank of India. The firm purchased a delivery van for Rs. 20,000, furniture for Rs. 5,000, typewriter for Rs. 6,000, account books and other stationery for Rs. 500. It has purchased goods on credit from M/s Gurucharan Singh & Co., for Rs. 4,000, and from M/s Lalwani Traders for Rs. 3,000. It has sold goods for cash to Mr. Peter for Rs. 2,000 and Mr. Ali for Rs. 4,000. It has also paid Rs. 300 for electricity charges, Rs. 1,000 for salaries, and Rs. 500 for rent. From the above information, list out the assets, liabilities, incomes and expenses.

Assets : ....

....

....

Liabilities : ....

....

....

....

Incomes : ....

....

....

Expenses : ....

....

....

3.3 ACCOUNTING PRINCIPLES

Accounting is a system evolved to achieve a set of objectives as stated in Unit 1.2. The objectives identify the goals and purposes of financial record keeping and reporting. In order to achieve the goals, we need a set of rules or guidelines. These guidelines are termed here as 'Basic Accounting Concepts'. The term 'concept' means an idea or thought. Basic accounting concepts are the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting. These concepts are also termed as 'Generally Accepted Accounting Principles'. These are the broad working rules of accounting activity, developed and accepted by the accounting profession. They are evolved (and are still evolving) over a period in response to the changing business environment and the specific needs of the users of accounting information.

The concepts guide the identification of events and transactions to be accounted for, their measurement and recording, and the method of summarising and reporting to interested parties. The concepts, thus, help in bringing about uniformity in the practice accounting.

An indepth understanding of these concepts will place the student in a better position to appreciate accounting system. Of course, it may be difficult to comprehend all these concepts at a stretch. We, therefore, advise you to re-visit these concepts, after giving at least one reading of this course material.

These concepts may be classified into two broad groups:

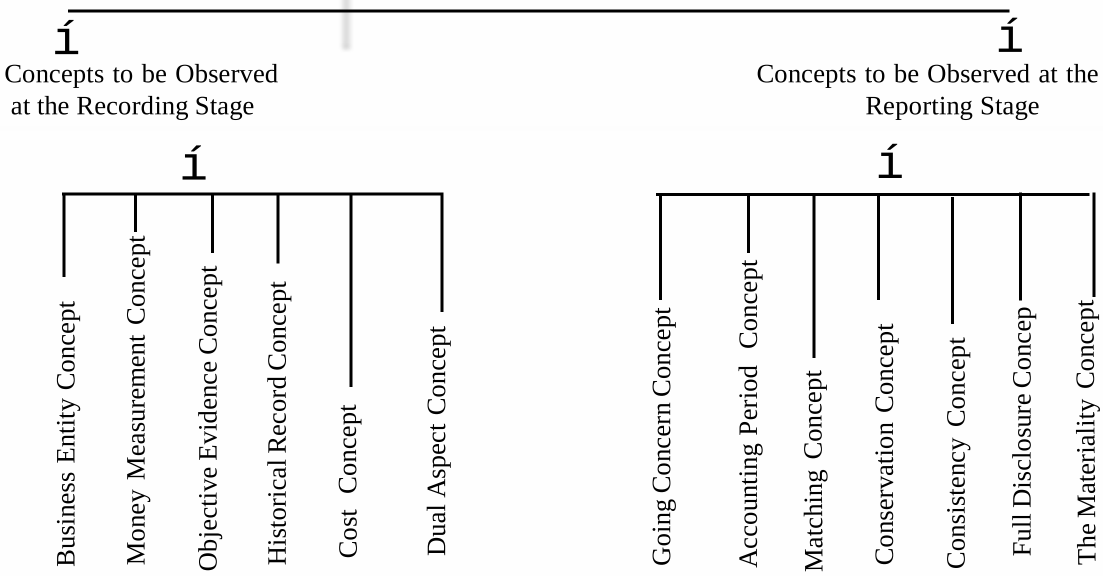
i) concepts to be observed at the recording stage i.e., while recording the transactions, and

ii) concepts to be observed at the reporting stage, i.e., at the time of preparing the final accounts.

It must, however, be remembered that some of them are overlapping and even contradictory. They are listed out in Chart 3.1.

Chart 3.1

ACCOUNTING CONCEPTS



3.3.1 Concepts to be Observed at the Recording Stage

The following concepts will guide us in identifying, measuring and recording transactions.

Business Entity Concept

Business entity means a unit of organised business activity. In that sense, a provision store, a cloth dealer, an industrial establishment or electricity supply undertaking, a bank, a school, a hospital, etc. are all business entities.

From the accounting point of view, every business enterprise is an entity separate and distinct from its proprietor(s)/owner(s). The accounting system gives information only about the business and not about its owner(s). In other words, we record those transactions in the books of account which relate only to the business. The owner's personal affairs (his expenditure on housing, food, clothing, etc.) will not appear in the books of account of his business. However, when personal expenditure of the owner is met from business funds it shall also be recorded in the business books. It will be recorded as drawings by the proprietor and not as business expenditure.

Another implication of business entity concept is that the owner of business is to be treated as a creditor who also has a claim over the assets of the business. As such, the amount invested by him (capital) is regarded as a liability for the business.

The business entity concept is applicable to all forms of business organisations. This distinction can be easily maintained in the case of a limited company because the company has a legal entity of its own. But such distinction becomes difficult in case of a sole proprietorship or partnership because in the eyes of the law, the partner or the sole proprietor are not considered separate entities. They are personally liable for all business transactions. But, for accounting purposes, they are to be treated as separate entities. This enables them to ascertain the profit or loss of business more conveniently and accurately.

Money Measurement Concept

Usually, business deals in a variety of items having different physical units such as kilograms, quintals, tons, metres, litres, etc. If the sales and purchases of different items are recorded in terms of their physical units, adding them together will pose problems. But, if these are recorded in a common denomination, their total becomes homogeneous and meaningful. Therefore, we need a common unit of measurement. Money does this function. It is adopted as the common measuring unit for the purpose of accounting. All recording, therefore, is done in terms of the standard currency of the country where business is set up. For example, in India, it is done in terms of Rupees, in USA it is done in terms of US Dollars, and so on.

Another implication of money measurement concept is that only those transactions and events are to be recorded in the books of account which can be expressed in terms of money such as purchases, sales, payment of salaries, goods lost in accident, etc., other happenings (non- monetary) like death of an efficient manager or the appointment of an accountant, howsoever important they may be, are not recorded in the books of account. This is because their effect is not measurable of quantifiable in terms of money.

This approach has its own drawbacks. The value of money changes over a period of time. The value of rupee today is much less than what it was in 1961. Such a change is nowhere reflected in accounts. This is the reason why the accounting data does not reflect the true and fair view of the affairs of the business.

Hence, now-a-days, it is considered desirable to provide additional data showing the effect of changes in the price level on the reported income and the assets and liabilities of the business.

Check Your Progress B

1. Mr. Ghansyamlal carries on ready made garments business. A few transactions are given below. Identify the transactions to be recorded in the books of his business.

   a) Purchased a typewriter for Rs. 6,000 for office use.

   b) Paid salary to the office typist at Rs. 350 per month.

   c) Bought a show case for Rs. 2,000.

   d) Sold old domestic furniture for Rs. 500.

   e) Purchased cloth for garments for Rs. 10,000.

   f) A shirt worth Rs. 250 is taken home for his son.

   g) Entered into an agreement to rent a shop in Sadar Bazar.

   h) Paid Salaries to his salesmen, Rs. 1,000.

   i) Paid Salary to his domestic servant, Rs. 100.

   j) Appointed Satish as an assistant in the shop.

   k) Borrowed Rs. 5,000 from Mr. Dyanchand for business purpose.

   l) Mr. Rakesh, one of the salesmen, met with an accident.

2. Present the following in the form of an Accounting Equation.

Machinery	Rs. 20,000
Cash	Rs. 5,000
Capital	Rs. 20,000
Creditors	Rs. 5,000

3. The assets and liabilities of Rupak Store are given below. Find out the amount of capital.

   Cash Rs. 1,800; Stock Rs. 3,000; Debtors Rs. 2,000;

   Furniture Rs. 1,200: Creditors Rs. 2,500: Wages payable Rs. 500

Objective Evidence Concept

The term objectivity refers to being free from bias or free from subjectivity. Accounting measurements are to be unbiased and verifiable independently. For this purpose, all accounting transactions should be evidenced and supported by documents such as bills, invoices, receipts, cash memos, etc. These supporting documents (vouchers) form the basis for making entries in the books of account and for their verification by auditors afterwards. As for the items like depreciation and the provision for doubtful debts where no documentary evidence is available, the policy statements made by management are treated as the necessary evidence.

Historical Record Concept

You know that after identifying the transactions and measuring them in terms of money, we record them in the books of account. According to the historical record concept, we record only those transactions which have actually taken place and not those which may take place (future transactions). It is because accounting record presupposes that the transactions are to be identified and objectively evidenced. This is possible only in the case of past (actually happened) transactions. The future transactions can hardly be identified and measured accurately. You also know that all transactions are to be recorded in chronological (datewise) order. This leads to the preparation of a historical record of all transactions. It also implies that we simply record the facts and nothing else.

As you will study later we make provision for some expected losses such as doubtful debts. This may be contrary to what is stated in historical record concept. But this is done only at the time of ascertaining the profit or loss of the business. It is not a routine item. This is done in accordance with another concept called Conservatism Concept about which you will study later.

Cost Concept

Business activity, in essence, is an exchange of money. The price paid (or agreed to be paid in case of a credit transaction) at the time of purchase is called cost. According to the cost concept, all assets are recorded in books at their original purchase price. This cost also forms an appropriate basis for all subsequent accounting for the assets. For example, if the business buys a machine for Rs. 80,000 it would be recorded in books at Rs. 80,000. In case its market value increases later on to Rs. 1,00,000 (or decreases to Rs. 50,000) it will continue to be shown at Rs. 80,000 and not at its market value.

This does not mean, however, that the asset will always be shown at cost. You know that with passage of time, the value of an asset decreases. Hence it may systematically be reduced from year to year by charging depreciation and the asset be shown in the balance sheet at the depreciated value. The depreciation is usually charged as a fixed percentage of cost. It bears no relationship with changes in its market value. In other words, the value at which the assets are shown in the balance sheet has no relevance to its market value. This, no doubt, makes it difficult to assess the true financial position of the business. It is, therefore, regarded as an important limitation of the cost concept. But this approach is preferred because, firstly it is difficult and time consuming to ascertain the market values, and secondly there will be too much of subjectivity in assessing the current values. However, this limitation has been overcome with the help of inflation accounting.

Check Your Progress C

1) Mr. Vinod Pandey started business. State which of the following transactions, and with what amount, are to be recorded in the books of his business.

   a) He purchased a machine from Bombay for Rs. 10,000. He paid for railway freight Rs.200 and total transport Rs 100.

   b) He sold goods worth Rs. 1,000 to Mr. Rakesh.

   c) Mr. Ramana, a friend of Mr. Pandey promised to purchase goods worthRs. 10,000 after three months.

   d) He purchased a building for his business from his friend for Rs. 25,000. Its market value is Rs. 30,000.

   e) Due to scarcity of raw materials, he paid Rs. 5,000 for materials worth Rs. 3,000.

Dual Aspect Concept

This is the basic aspect of accounting. According to this concept, every business transaction has a two-fold effect. In commercial context, it is a famous dictum that "every receiver is also a giver and every giver is also a receiver". For example, if you purchase a machine for Rs. 8,000 you receive machine on the one hand and give Rs. 8,000 on the other. Thus, this transaction has a two-fold effect i.e., (i) increase in one asset and (ii) decrease in another. Similarly, if you buy goods worth Rs. 500 on credit it will increase an asset (stock of goods) on the one hand and increase a liability (creditors) on the other. Thus, every business transaction involves two aspects: (i) the receiving aspect, and (ii) the giving aspect. In case of the first example you find that the receiving aspect is machinery and the giving aspect is cash. In the second example the receiving aspect is goods and the giving aspect is the creditor. If complete record of transactions is to be made, it would be necessary to record both the aspects in books of account. This principle is the core of double entry book-keeping and if this is strictly followed, it is called 'Double Entry System of Book-keeping' about which you will learn in detail later.

Let us understand another accounting implication of the dual aspect concept. To start with, the initial funds (capital) required by the business are contributed by the owner. If necessary, additional funds are provided by the outsiders (creditors). As per the dual aspect concept all these receipts create corresponding obligations for their repayment. In other words, a contribution to the business, either in cash or kind, not only increases its resources (assets), but also its obligations (liabilities/equities) correspondingly. Thus, at any given point of time, the total assets and the total liabilities must be equal.

This equality is called 'balance sheet equation' or 'accounting equation'. It is stated as under:

Liabilities (Equities) = Assets

or

Capital + Outside Liabilities = Assets

The term 'assets' denotes the resources (property) owned by the business while the term 'equities' denotes the claims of various parties against the business assets. Equities are of two types: (1) owners' equity, and (ii) outsiders' equity. Owners' equity called capital is the claim of the owners against the assets of the business. Outsiders' equity called liabilities is the claim of outside parties like creditors, bank, etc. against the assets of the business. Thus, all assets of the business are claimed either by the owners or by the outsiders. Hence, the total assets of a business will always be equal to its liabilities.

When various business transactions take place, they effect the assets and liabilities in such a way that this equality is always maintained. Let us take a few transactions and see how this equality is maintained.

1. **Mr. Gyan Chand started business with Rs. 50,000 cash.** The cash received by the business is its asset. According to the business entity concept, business and the owner are two separate entities. Hence, the capital contributed by Mr. Gyan Chand is a liability to the business. Thus

   Capital = Assets

   Rs. 50,000 = Rs. 50,000 (cash)

2. **He purchased goods on credit from Chakravarthy for Rs. 5,000.** This increases an asset (stock of goods) on the one hand and a liability (creditors) on the other. Now the equation will be

   Capital + Liabilities = Assets

   Rs. 50,000 + Rs. 5,000 = Rs. 5,000 + Rs. 50,000

   Capital Creditors Stock Cash

3. **He purchased furniture worth Rs. 10,000 and paid cash**. This increases one asset (furniture) and decreases another asset (cash). Now the equation will be:

   Capital + Liabilities = Assets

   Rs. 50,000 + Rs. 5,000 = Rs. 10,000 + Rs. 5,000 + Rs. 40,000

   Capital Creditors Furniture Stock Cash

This equation can be presented in the form of a Balance Sheet (a statement of assets and liabilities) as follows:

Gyan Chand's Balance Sheet

Capital and Liabilities	Rs.	Assets	Rs.
Capital	50,000	Furniture	10,000
Creditors (Mr. Chakravarthy)	5,000	Stock of goods	5,000
		Cash	40,000
	55,000		55,000

Note that the totals on both sides of the Balance Sheet are equal. This equality remains valid irrespective of the number of transactions and the items affected thereby. It is so because of their dual effect or the assets and liabilities of the business.

Check Your Progress D

1. Find out the missing amounts on the basis of the accounting equation:

   Capital + Liabilities = Assets

   a) Rs. 10,000 + Rs. 15,000 = Rs ………………

   b) Rs. 25,000 + Rs……….. = Rs. 60,000

   c) Rs……….. + Rs. 30,000 = Rs. 50,000

2. Show the dual effect of the following business transaction on assets and liabilities of a business unit.

   a) Purchased goods for cash for Rs. 500

   b) Purchased goods on credit for Rs. 800

   c) Paid Rs. 300 to a creditor

   d) Received Rs. 500 from a debtor

3.3.2 Concepts to be Observed at the Reporting Stage

The following concepts have to be kept in mind at the time of preparing the final accounts. Let us discuss them one by one:

i) Going concern concept

ii) Accounting period concept

iii) Matching concept

iv) Conservatism concept

v) Consistency concept

vi) Full disclosure concept

vii) Materiality concept

Going Concern Concept

Normally, the business is started with the intention of continuing it indefinitely or at least for the foreseeable future. The investors lend money and the creditors supply goods and services with the expectation that the enterprise would continue for 1ong. Unless there is a strong evidence to the contrary, the enterprise is normally viewed as a going (continuing) concern. Hence, financial statements are prepared on a going concern basis and not on liquidation (closure) basis.

Certain expenses like rent, repairs, etc., give benefits for a short period, say less than one year. But the benefit of some other expenditure like purchase of a building, machinery, etc., is spread over a longer period. The expenditure whose benefit is limited to one accounting year is fully charged to the Profit and Loss Account of the year. But the cost of the items whose benefit is available for a number of accounting years, their cost must be spread over a number of years. Hence, only a portion of such expenditure is charged to the Profit and Loss Account every year. The balance is shown in the Balance Sheet as an asset. Let us take an example. Suppose a firm purchased a delivery van for Rs. 60,000 and its expected life is 10 years. It means the business will use the van for a period of 10 years. So, the accountant has to spread the cost of the van over 10 years. He would charge Rs. 6,000 (1/10 of its cost) every year to the Profit and Loss Account in the form of depreciation, and show the balance in the Balance Sheet as an asset. This is based on the assumption that the business will continue for long and the asset will be used for its expected life. Thus, this concept is regarded as the basic assumption in accounting according to which the fixed assets are valued at historical cost less depreciation and not at its realisable value.

Accounting Period Concept

You know the going concern concept assumes that the business will continue for a long period, almost indefinitely. But the businessmen cannot postpone the preparation of financial statements indefinitely. Therefore, he prepares them periodically. This will also enable other interested parties such as owners, investors, creditors, tax-authorities to make periodic assessment of its performance. So, the life of the business enterprise is divided into what are called accounting periods'. The profit or loss and the financial position at the end of each such accounting period is regularly assessed.

Conventionally, duration of the accounting period is twelve months. It is called an 'accounting year'. Accounting year can be a calendar year i.e., January 1 to December 31 or any other period of twelve months, say, April 1 to March 31 or Dewali to Dewali.

Normally, the final accounts are prepared at the end of each accounting year. The Profit and Loss Account is prepared for the year so as to ascertain the profit earned or loss incurred during that year, and the balance sheet is prepared as at the end of the year, so as to show the financial position as on that date. However, for internal management purposes, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

Check Your Progress D

1. What is the assumption under Going Concern Concept?

   ....

   ....

   ....

2. What is the accounting implication of Going Concern Concept?

   ....

   ....

   ....

3. What is the significance of an Accounting Period?

   ....

   ....

   ....

4. What is the purpose of preparing the Profit and Loss Account?

....

....

....

....

5. What does Balance Sheet reveal?

....

....

....

....

Matching Concept

This is also called 'Matching of Costs against Revenues Concept'. To work out profit or loss of an accounting year, it is necessary to bring together all revenues and costs pertaining to that accounting year. In other words, expenses incurred in an accounting year should be matched with the revenues earned during that year. The crux of the problem, therefore, is that appropriate costs must be matched against appropriate revenues. For this purpose, first we have to recognise the inflows (revenues) during an accounting period and the costs incurred in securing those inflows. Then, the sum of the costs should be deducted from the sum of the revenues to arrive at the net result of that period. Let us now understand how to recognise the revenues and costs in relation to an accounting period. For this purpose, the following rules are followed:

The Timing of Revenue Recognition

Revenue is recognised in the period in which it is earned or realised. The revenue recognition is primarily based on realisation principle which clearly states that in identifying revenues with a specific period one must look to when the various transactions occurred rather than to the period in which cash inflow occurred. Thus,

i) In case of the sale of goods (or services) revenue is regarded as realised when sales actually take place and not when cash is received. In other words, credit sales are treated as revenue when sales are made and not when money is received from the debtors.

ii) Income such as rent, interest, commission etc. are recognised on a time basis. The revenue from such items is taken to the Profit and Loss Account of the year during which it is earned. Let us assume that the business purchased some government securities on October 1, 2018 for Rs. 20,000 carrying interest at 12 per cent. The interest is payable half yearly on April 1 and October 1 every year. The first instalment of interest (Rs. 1,200) is received on April 1, 2019. The Profit and Loss Account is being prepared for the year 2018 (January 1, 2018 to December 31, 2018). The interest amounting to Rs. 600 earned during. October 1 to December 31 must be shown as the income from interest on investments in the Profit and Loss Account for 2018 though the amount has not been received in 2018.

The Timing of Costs Recognition

The matching principle holds that the expenses should be recognised in the same period as the associated revenues. Thus,

i) The cost of goods have to be matched with their sales revenue. This means that while preparing the Profit and Loss Account for a particular year, you should not take the cost of all the goods produced during that year, but consider only the cost of goods that have actually been sold during that year. The cost of goods sold is arrived at by deducting the cost of closing stock from the cost of goods produced.

ii) Expenses such as salaries, wages, interest, rent, insurance, etc., are recognised on time basis. In other words, they are related to the year in which the service is obtained or the expense is incurred, whether paid immediately or payable at a later date.

iii) Costs like depreciation on fixed assets are also allocated on time basis.

Thus, all revenue earned during an accounting year, whether received or not, and all costs incurred, whether paid or not have to be taken into account while preparing the Profit and Loss Account for the year. Similarly, any amount received or paid during the current year which actually relates to the previous year or the following accounting year, must be eliminated from the current year's revenue and costs. This gives rise to another aspect viz., the accrual basis of accounting about which you will learn later.

The Matching Concept thus has the following implications for the ascertainment of profit or loss during a particular period.

1. We should ensure that costs should relate to the same accounting period as the revenues. For example, when we prepare the Profit and Loss Account for 2017, we shall take into account all those incomes that were earned during 2017, and similarly consider only those costs which were incurred in 2017. Any costs or incomes which relate to 2018 shall be excluded.

2. We should ensure that all costs incurred during the accounting period (whether paid or not) and all revenues earned during that year (whether received or not) are fully taken into account.

3. We should consider only those costs which relate to the revenue taken into account. This is the reason why we consider only the cost of goods sold, and not the cost of goods produced during that period.

Check Your Progress E

1. What is the main implication of the Matching Concept?

   ....

   ....

   ....

2. Name three items of revenues.

   ....

   ....

   ....

3. Name three items of costs.

....

....

....

....

4. Fill in the blanks.

i) Profit is the excess of revenue over ……………………………

ii) Costs incurred during an accounting year should be matched against

……………………………………….

iii) Revenue realisation does not mean that revenue must be realised in……………………………..

iv) Cost of goods are matched with their sales revenue......................?

v) Revenue such as interest, commission, etc., are recognised as earned with reference to …………………………………….

i) Expenses such as wages, rent, etc., are recognised on …………..basis.

Conservatism Concept

This is also known as Prudence Concept understatement of assets or revenues, and overstatement of liabilities or costs. This is in accordance with the traditional view which states 'anticipate no profits but anticipate all losses'. In other words, you should account for profits only when they are actually realised. But in case of losses, you should take into account even those losses which may be a remote possibility. This is why closing stock is valued at cost price or market price whichever is lower. Provision for doubtful debts and provision for discounts on debtors are also made according to this concept.

Consistency Concept

The principle of consistency means 'conformity from period to period with unchanging policies and procedures'. It means that accounting method adopted should not be changed from year to year. For example, the principle of valuing closing stock 'at cost price or market price whichever is lower' should be followed year after year. Similarly, if depreciation on fixed assets is provided on straight line basis, it should be followed consistently year after year. Consistency eliminates personal bias and helps in achieving comparable results.

If this principle of consistency is not followed, the accounting information about an enterprise cannot be usefully compared with similar information about other enterprises and so also within the same enterprise for some other period. Consistent use of the same methods and bases from one period to another, enhances the utility of the financial statement.

However, consistency does not prohibit change. Desirable changes are always welcome. But such changes should be completely disclosed while presenting the financial statements.

Full Disclosure Concept

You know the financial statements are the basic means of communicating financial information to all interested parties. These statements are the only source for assessing the performance of the enterprise for investors, lenders, suppliers, and others. Therefore, financial statements and their accompanying foot-notes should completely disclose all relevant information of a material nature which relate to the profit and loss and the financial position of the business. This enables the users of the financial statements to make correct assessment about the profitability and financial soundness of the enterprise. It is therefore, necessary that the disclosure should be full, fair and adequate.

Materiality Concept

This concept is closely related to the Full Disclosure Concept. Full disclosure does not mean that everything should be disclosed. It only means that all relevant and material information must be disclosed. Materiality primarily relates to the relevance and reliability of information. An item is considered material if there is a reasonable expectation that the knowledge of it would influence the decision of the users of the financial statements. All such material information should be disclosed through the financial statements and the accompanying notes. For example, commission paid to sole selling agents, if any, should be disclosed separately in the Profit and Loss Account. Similarly, if there is a change in the method or rate of depreciation, this fact must be duly reported in the financial statements.

A strict adherence to accounting principles is not required for items of little significance or of non-material nature. For example, erasers, pencils, scales, etc., are used for a long period, but they are not treated as assets. They are treated as expenses. This does not affect the amount of profit or loss materially.

Similarly, while showing the amounts of various items in the financial statements, they can be approximated up to paise. Even if they are shown to the nearest rupee or hundreds, there may not be any material effect. For example, if an amount of Rs. 1,45,923.28 is shown as Rs. 1,45,900 it does not make much difference for assessment of the performance of the enterprise.

However, there are no specific rules for ascertaining material or non-material items, It is just a matter of personal judgement.

Check Your Progress F

1. What is the aim of Conservatism Concept ?

   ....

   ....

   ....

2. What do you mean by the Principle of Consistency?

   ....

   ....

   ....

   ....

3. Why is full disclosure of relevant information considered necessary?

....

....

....

4. How do you make a distinction between material and non-material items?

....

....

....

3.4 SYSTEMS OF BOOK-KEEPING

Book-keeping as explained earlier is the art of recording business transactions in a systematic manner. Broadly, there are two systems of book-keeping:

i) Double Entry System, and

ii) Single Entry System.

3.4.1 Double Entry System

Under the dual aspect concept you learnt that every business transaction has two aspects: (i) the receiving aspect, and (ii) the giving aspect. For example, when you purchase goods for cash, goods come in and cash goes out. Thus, a transaction affects two items (also called accounts) at the same time. When you record the transaction in the books of account of a business, it would be better if you record the effects relating to both the items. In the above example, the items affected are goods and cash, stock of goods increases and cash decreases. So, we should record the increase in stock of goods and also the decrease in cash. This involves two entries, one in Goods Account and the other in Cash Account. This method of recording business transactions is called 'Double Entry System'. It recognises and record both the aspects of every transactions. According to this system, the account which involves receiving aspect is debited and the account which involves giving aspect is credited. Thus, for every debit there will be an equivalent credit. For this purpose certain rules have been framed. These are discussed in Unit 5.

Advantages of Double Entry System

This system has the following advantages:

i) It provides complete and reliable record of all business transactions because it records both effects.

ii) It supplies full information about the incomes and expenses, assets and liabilities of the business. It, thus, helps the management in taking appropriate decisions.

iii) The arithmetical accuracy of the books of account can be ascertained by preparing a trial balance.

iv) The financial result of the operations of the business i.e., profit or loss, can be easily ascertained.

v) The financial position of the business can also be ascertained at any point of time.

3.4.2 Single Entry System

Single entry system does not mean that only one aspect of a transaction is recorded. An incomplete or defective double entry system is generally called single entry system. Under this system, all transactions are not recorded and all accounting records are not maintained. The two aspects of a transaction are recorded in certain cases, but in certain cases only one aspect is recorded. Certain transactions are ignored, they are not even recorded. The single entry system is thus a mixture of double entry, single entry and no entry. The accounts maintained under this system are incomplete and unsystematic and, therefore, not reliable. The main defect of this system is that the arithmetical accuracy of the books of account cannot be checked, because a trial balance cannot be prepared. The profit and loss account and balance sheet also cannot be prepared. This system is normally followed by small business firms.

3.5 LET US SUM UP

1. There are number of terms commonly used in accounting. The understanding of these terms is necessary for preparing accounting records.
2. Accounting involves identifying, measuring, recording, summarising and communicating events and transactions. For this purpose, certain guidelines or ground rules are necessary. Basic accounting concepts or generally accepted accounting principles guide the accountant in record keeping and reporting.
3. Certain principles or concepts have been agreed upon. Some are observed at the recording stage while others are relevant at the reporting stage.
4. According to business entity concept, the business enterprise and its proprietor are treated as two separate entities, distinct from each other.
5. According to money measurement concept, all the transactions should be recorded in terms of the standard currency of the country.
6. According to the historical record concept, only those transactions which have actually taken place should be recorded in the order of their occurrence i.e., date-wise.
7. The cost concept states that the amount actually received or paid for any goods or service should be recorded and not its value.
8. As per the dual aspect concept, every transaction has two aspects. Both the aspects are to be recorded in the books of account.
9. Double entry is a system which recognises and records both aspects of a transaction.
10. Single entry system is an incomplete record of business transactions.
11. For ascertaining the profit and loss and the financial position of the business, two financial statements are prepared: (i) Profit and Loss Account, and (ii) Balance Sheet. These are called final accounts.

12. Final accounts are prepared at the end of each accounting year.
13. While preparing the final accounts, nine basic accounting concepts have to be observed.
14. According to the Going Concern Concept, the firm should be considered as a continuing unit and not as one closing down.
15. According to the Matching Concept, appropriate costs have to be matched against the appropriate revenues for the accounting period.
16. The Concept of Conservatism implies that while calculating the profit for an accounting period, take all losses into account but include only those incomes which have actually arisen.
17. The Concept of Consistency implies that there should be consistency in all accounting methods followed from period to period so as to ensure possibility of meaningful comparisons.
18. According to Full Disclosure Concept financial reports should disclose fully all relevant information of material nature, so that the users of those reports can draw rational conclusions about the enterprise.
19. The Materiality Concept implies that while measuring income of a business for an accounting period the non-material facts can be ignored.
20. There are two bases of accounting viz., cash basis and accrual basis. The accrual basis of accounting is considered more rational.

3.6 KEY WORDS

Account: A classified statement of transactions relating to a person or a thing or any other subject.

Assets: Anything which has economic value.

Business Entity: A business enterprise.

Capital: Owner's investment or equity in a firm.

Cash Discount: An allowance given by the creditor to the debtor on the amount due for prompt payment.

Creditor: One to whom the business owes some amount.

Debtor: One who owes some amount to the business.

Drawings: Amount withdrawn by the owner from the business for personal use.

Equity: The claim or right over the assets of the firm. It includes both the owner's and the creditor's claims.

Expenditure: Spending of money or incurring a liability for some benefit or service received by the business.

Gain: Profit arising from peripheral or incidental transactions.

Goods: Goods are the mercantile things in which the business deals.

Income: It is the amount earned through business operations.

Revenue: Amount realised for the goods sold or services rendered.

Stock: Raw materials, semi-finished goods and finished goods lying in stores.

Trade Discount: An allowance given by the seller to the buyer on the list price at the time of sale.

Transaction: Transfer of money or money's worth between two entities is called a transaction.

3.7 SOME USEFUL BOOKS

Bierman, Harold & Drebin, Allan R., Financial Accounting: An Introduction (Philadelphia: W.B. Saunders Company, 1998)

Briston, R.J., Introduction to Accounting and Finance. (London: The Macmillan Press Ltd., 1991) Part-B. Fank Wood : Book-Keeping and Accounts. (London : Pitman, 1996)

Maheshwari, SN., Principles and Practice of Accountancy, Part I. (New Delhi : Arya Book Depot, 2018)

Paul V.A. & Korlahalli, J.S., Principle and Practice of Accountancy. (New Delhi : S. Chand & Co., 2018)

3.8 ANSWERS TO CHECK YOUR PROGRESS

A 1. (i) Debtor (ii) Creditor (iii) Goods (iv) Assets (v) Personal use (vi) Unrealisable (vii) Capital (viii) Account

2. (i) Goods (ii) Asset (iii) Asset (iv) Goods (v) Goods

3. Assets :Delivery van, furniture, typewriter, cash in hand, stock of goods not yet sold.

   Liabilities: Bank loan. M/s. Gurucharan Singh & Co., M/s. Lalwani Traders.

   Income **:** Amounts received from Mr. Peter and Mr. Ali.

   Expenses : Account books and stationery. electricity charges, salaries and rent.

B 1. Except d, g, i, j and l all other transactions are to be recorded.

2. C + L = A

   Capital: Rs. 20,000 + Creditors Rs. 5,000 = Machinery Rs. 20,000 + Cash Rs. 5,000

3. Capital = 1800+3000+2000+1200–2500-500 = Rs. 5000

C. Except 'c' all other transactions have to be recorded in the business books with the following amounts:

a) Rs. 10,300 b) Rs. 1,000

d) Rs. 25,000 e) Rs. 5,000

D 1. a) Rs. 25,000 b) Rs. 35,000 c) Rs. 20,000.

2. a) Stock increases and cash decreases

b) Stock increases and creditors increase

c) Cash decreases and creditors decrease

d) Cash increases and debtors decrease

3.9 TERMINAL QUESTIONS/EXERCISES

1. What do you mean by double entry system? Distinguish it from single entry system.

2. What do you mean by accounting concepts? Briefly explain the accounting concepts which guide the accountant at the recording stage.

3. Krishna has invested a capital of Rs. 80,000 on June 30, 2018. He purchased goods from Suresh on credit, amounting to Rs. 20,000. Find out the value of assets. (Ans: Rs. 1,00,000)

4. The assets of a business on December 31, 2018 are Rs. 50,000 and capital is Rs. 30,000. Find out the amount of liabilities. (Ans: Rs. 20,000)

5. The following is the assets and liabilities position of Srinivasa Traders on October 1, 2018:

   Assets: Cash Balance Rs. 3,000; Furniture Rs. 5,000;

   Building Rs. 50,000; Debtors Rs. 22,000.

   Liabilities: Bank Loan Rs. 10,000; Creditors Rs. 15,000.

   Find out the amount of capital on that date. (Ans: Rs. 55,000).

6. Write short notes on the following:

   a) Going Concern Concept

   b) Accounting Period Concept

7. What do you understand by matching costs against revenue? Explain briefly the importance of the Matching Concept.

8. Explain briefly the following concepts:

   a) Conservatism

   b) Consistency

c) Full Disclosure

d) Materiality

9. Distinguish between cash basis and accrual basis of accounting with examples.

10. Explain briefly the main accounting concepts to be observed at the time of preparing final accounts.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 4 ACCOUNTING STANDARDS

Structure

4.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the concept of the accounting standards;
- discuss the benefits of accounting standards;
- discuss the procedures of issuing accounting Standards in India;
- describe International Financial Reporting Standards, GAAP, IAS etc;
- develop the insights about the need and procedure of issuing IFRS;
- understand how Indian economy is converging towards implementing IFRS.
- make comparison between Indian AS and International AS;
- describe the procedure for measuring business income;
- explain the accounting concepts that are relevant to measurement of business income; and
- state the objectives of measurement of business income of business income.

4.1 CONCEPT OF ACCOUNTING STANDARDS

Accounting is the language of business. All financial information (i.e. nature of financial activities, financial position, financial results, present trend and further prospects etc.) are available through accounting. The so-called financial information is communicated to the users (both internal as well as external) of accounting information by preparing and presenting the financial statements. As such, it becomes necessary to develop some Generally Accepted Accounting Principles (GAAP) while preparing the financial statements by which the language of the business can be communicated to the users.

As per section 129 of Companies Act, 2013 the financial statements of a company must present a true and fair view of the income and financial position of the company. However, it does not define what constitutes a true and fair view of a company. Since the beginning of accounting, a number of Generally Accepted Accounting Principles have been developed consisting of accounting concepts and conventions so as to bring comparability and uniformity in the financial statements of various business organizations. However, even these GAAP allow many alternatives for the treatment of same item that can be followed by the business organizations while preparing financial statements which leads to lack of consistency, uniformity and comparability among the financial statements of different originations. In addition, there must not be any ambiguity and uncertainty relating to the facts, figures and terms which are contained in the financial statements and will be presented to the users of accounting information.

Hence, there is a need to develop some standards which must be followed by all the organizations so as to achieve uniformity in the financial statements. For this purpose, International Accounting Standards Committee (IASC) was established on 29th June, 1973. The Institute of Chartered Accountants of India and Institute of Cost Accountants of India are members of IASC. ICAI is also developing its own accounting standards patterned on International Accounting Standards modified to the requirements of Indian accounting community.

Definition

In the words of Kohler, an accounting standard may be defined as 'a code of conduct imposed on accountants by custom, law or professional body.'

Thus, accounting standards may be defined as the accounting principles and rules which are to be followed for various accounting treatments while preparing financial statements on uniform basis and which will reveal the same meaning to all the interested groups who will use the same. Thus, the Standards are considered as a guide for maintaining and preparing accounts.

Nature of Accounting Standards

On the basis of forgoing discussion, we can say that accounting standards are guide, dictator, service provider and harmonizer in the field of accounting process.

Serve as a guide to the accountants: Accounting standards serve the accountants as a guide in the accounting process. They provide basis on which accounts are prepared. For example, they provide the method of valuation of inventories.

Act as a dictator: Accounting standards act as a dictator in the field of accounting. Like a dictator, in some areas accountants have no choice of their own but to opt for practices other than those stated in the accounting standards. For example, Cash Flow Statement should be prepared in the format prescribed by accounting standard.

Serve as a service provider: Accounting standards comprise the scope of accounting by defining certain terms, presenting the accounting issues, specifying standards, explaining numerous disclosures and implementation date. Thus, accounting standards are descriptive in nature and serve as a service provider.

Act as a harmonizer: Accounting standards are not biased and bring uniformity in accounting methods. They remove the effect of diverse accounting practices and policies. On many occasions, accounting standards develop and provide solutions to specific accounting issues. It is thus, clear that whenever there is any conflict on accounting issues, accounting standards act as harmonizer and facilitate solutions for accountants.

4.2 BENEFITS OF ACCOUNTING STANDARDS

There are many benefits of accounting standards. Let us discuss the main benefits of Accounting Standards one by one.

1) **Standardized Accounting:** Perhaps the most important advantage of the FASB standard setting for businesses is the uniform set of accounting principles it promotes. The FASB clearly states the generally-accepted accounting principles that businesses must follow to avoid confusion. For example, the FASB prevents businesses from using one method for calculating inventory at the beginning of a fiscal year and finishing the year with another method. Without the accounting standards set forth by the FASB, businesses could use accounting methods that portray financial data inaccurately to investors.

2) **Problem Identification:** The FASB standard setting provides a framework upon which potential accounting problems are identified and corrected. Because all businesses in the US use the same accounting principles, any problems or inadequacies in the accounting process are quickly identified and reported to the FASB. The FASB then investigates the problem and, if needed, modifies or writes a new accounting rule for the accounting process. For example, if businesses find that reporting a certain type of liability on their income statement unfairly lowers their net income, they can appeal to the FASB so that it can identify problems with the standard setting.

3) **Private Regulation:** The FASB is a private entity with no affiliation to the US government. Despite this, the Securities and Exchange Commission relies on the FASB to set the accounting rules that all companies in the US must follow. The SEC can technically create an accounting oversight board or government agency to set accounting rules. However, using the FASB eases the burden on the US government and lets the private sector dictate accounting rules.

4) **International Accounting Standard:** The FASB is advantageous because it actively promotes an internationally recognized set of accounting rules. Globalization has deeply connected foreign financial markets; a standard set of accounting rules would make financial reporting more accurate and fair between countries. One of the goals of the FASB is to make financial reporting more uniform globally with the cooperation of the International Accounting Standards Board (IASB).

4.3 PROCEDURE FOR ISSUING AS IN INDIA

There is a set procedure for issuing AS in India. Let us discuss this prodedure in detail.

1) **Determination of the need of an AS**

   First, the Accounting Standard Board determines the broad areas in which accounting standards needs to be formulated.

2) **Constituting Study Group**

   Study Group will be constituted consisting the members of the Institute of Chartered Accountants of India. The motive behind constitution of this group is to assist the accounting Standard Board in its activities.

3) **Drafting the Standard**

   The Study Group Prepares draft of the proposed Standard. The proposed draft enlists the following areas:

   a) Objective of the standard.

   b) Scope of the Standard.

   c) Definitions of the terms used in the standard

   d) Recognition & Measurement Principles

   e) Presentation & Disclosure requirements.

4) **Analyzing the Draft**

   ASB in this stage considers the Preliminary draft prepared by the Study Group. In case anything needs to be revised than Accounting Standard Board takes the following steps.

   a) ASB makes the revision

   b) ASB refers the same to the study Group

5) **Circulation of the Draft**

   In this step, the ASB circulates the AS draft to the council members of the Institute of Chartered Accountants of India and the following specifies bodies for their comments.

   a) The Institute of Works & Cost Accountants of India

   b) The Institute of Company Secretaries of India.

   c) Ministry of Company Affairs.

d) Comptroller & Auditor General of India

e) Central Board of Direct Taxes

f) Standing Committee of Public Enterprises

g) Reserve Bank of India

h) Indian Banks Association.

i) Securities & Exchange Board of India.

j) Associated Chamber of Commerce & Industry, Confederation of Indian Industry and Federation of Indian Chambers of Commerce & Industry.

k) Any other body considered relevant by the ASB.

6) Holding Discussion and Finalizing Exposure Draft

ASB holds meeting with the representatives of above mentioned bodies for the purpose of determining their views on the Draft Accounting Standard. Based on analyses of the discussion, ASB finalizes the exposure draft of proposed accounting standards.

7) Circulation of Exposure Draft

The exposure Draft of the proposed standards is issued for comments the members of the ICAI and the public.

8) Finalizing the Exposure Draft

Based on the comments received, the ASB finalizes the draft of the proposed standards. Finally ASB submits the same to the council of the ICAI.

9) Modifying & Issuing the Accounting Standard

The council of the ICAI then considers the finalized draft standard and if necessary modifies the same in consultation with the ASB. The ICAI then issues the Accounting Standard after modification if any on the relevant subject.

4.4 SALIENT FEATURES OF FIRST TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS (Ind-AS):101

Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS. It prescribes the various requirements to be fulfilled during the transition period when a company adopts Ind-AS for the first time, i.e., when it moves from making the financial statements in accordance with Accounting Standards (Indian GAAP) to make them in accordance with Ind-AS.

Conceptually, the accounting under Ind-AS should be applied retrospectively at the time of transition of companies from applying Accounting Standards (Indian GAAP) to Ind-AS. However, for and easy transition, Ind-AS 101 has provided some exemptions for retrospective application of Ind-AS. The exemptions are clearly categorised into those which are mandatory in nature (i.e., cases where the company is prohibited to apply Ind-AS retrospectively) and those which are voluntary in nature (i.e., it is upto the company to apply or not to apply certain requirements of Ind-AS retrospectively).

Ind-AS 101 also lists out presentation and disclosure requirements to explain the transition to the users of financial statements. It also requires a company to explain how the transition will affect its reported balance sheet, financial performance and cash flows. It does not provide any exemption from the disclosure requirements in other Ind-AS.

Objective of Ind-AS 101

The objective of Ind-AS 101 is to ensure that the entity's first Ind-AS Financial Statements, and its interim financial reports for the period covered by those financial statements, contain high quality information that:

1. Is transparent for users and comparable over all periods presented,
2. Provide a suitable starting point for accounting in accordance with the Indian Accounting Standards (Ind-AS), and
3. Can be generated at a cost that does not exceed benefits.

Scope of Ind-AS 101

An entity shall apply the Indian Accounting Standard-101 (first time adoption of Indian Accounting Standards) in:

a) First Financial Statements after implementing Ind-AS.

b) Each Interim Financial Report in accordance with Ind-AS 34 *Interim Financial Reporting* for the part of the period covered by its first Ind-AS financial Statements.

4.5 CURRENTLY PREVAILING ACCOUNTING STANDARDS IN INDIA

Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2016 there are 32 accounting standards specified by ICAI, all of which are mandatory to be complied by the companies. Following is the list of these standards:

- AS 1 Disclosure of Accounting Policies
- AS 2 Valuation of Inventories
- AS 3 Cash Flow Statements
- AS 4 Contingencies and Events Occurring after the Balance Sheet Date
- AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies
- AS 6 Depreciation Accounting
- AS 7 Construction Contracts (revised 2002)
- AS 8 Accounting Policies, Chanages in Accounting estimates and Errors.

- AS 9 Revenue Recognition
- AS 10 Accounting for Fixed Assets
- AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003),
- AS 12 Accounting for Government Grants
- AS 13 Accounting for Investments
- AS 14 Accounting for Amalgamations
- AS 15 Employee Benefits (revised 2005)
- AS 16 Borrowing Costs
- AS 17 Segment Reporting
- AS 18 Related Party Disclosures
- AS 19 Leases
- AS 20 Earnings Per Share
- AS 21 Consolidated Financial Statements
- AS 22 Accounting for Taxes on Income.
- AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
- AS 24 Discontinuing Operations
- AS 25 Interim Financial Reporting
- AS 26 Intangible Assets
- AS 27 Financial Reporting of Interests in Joint Ventures
- AS 28 Impairment of Assets
- AS 29 Provisions, Contingent Liabilities and Contingent Assets
- AS 30 Financial Instruments: Recognition and Measurement
- AS 31 Financial Instruments: Presentation
- AS 32 Financial Instruments: Disclosure

Check Your Progress A

1. Define the term ‘Accounting Standard’.

   ....

   ....

   ....

2. What are the main objectives of accounting standards?

   ....

   ....

   ....

3. Discuss the procedure of issuing accounting standards in India.

   ....

   ....

   ....

4. Give any three limitations of accounting.

....

....

....

4.6 INTERNAT1IONAL FINANCIAL REPORTING STANDARDS

Accounting provides companies, investors, regulators and others with a standardized way to describe the financial performance of an entity. Accounting standards present and prepares of financial statements with a set of rules to abide by when preparing an entity's accounts, ensuring this standardization across the market. Companies listed on public stock exchanges are legally required to publish financial statements in accordance with the relevant accounting standards.

International Financial Reporting Standards (IFRS) is a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis — by developed, emerging and developing economies. Thus, providing investors and other users of financial statements with the ability to compare the financial performance of publicly listed companies on a like-for-like basis with their international peers.

IFRS are now mandated for use by more than 100 countries, including the European Union and by more than two-thirds of the G20. The G20 and other international organisations have consistently supported the work of the Board and its mission of global accounting standards.

4.7 NEED AND PROCEDURE OF IFRS

With the increasing globalization of financial markets and of companies, the use of a single set of financial reporting standards across countries is viewed as having increased the comparability of financial statements across borders. It also reduces the cost of preparing the consolidated financial statements of groups made up of companies conducting business all around the world.

Financial reporting standards have been in the spotlight since the banking crisis, more specifically those requiring the measurement of financial assets and liabilities at fair value. In September 2009, G20 leaders in Pittsburgh asked the accounting standard setters IASB and, its US counterpart, the FASB to work towards a single set of high quality global accounting standards by June 2011. Convergence, however, is proving challenging and is likely to be pushed back.

Initially, IFRS begun as an academic project aimed at creating a single set of global standards, their actual use was kick-started by the European Union.

An EU regulation requires listed companies in Europe to adhere to International Financial Reporting Standards (IFRS) from financial years commencing on or after 1 January 2005 when preparing their consolidated accounts. In implementing this in UK legislation, the Government has not yet made the use of IFRS compulsory for any further categories of accounts, but the legislation permits all companies to use them for individual and consolidated accounts if they wish.

Changes have been made to UK tax legislation to accommodate these new rules for tax purposes.

International Financial Reporting Standards (IFRS) are developed through an international consultation process, the “due process”, which involves interested individuals and organisations from around the world.

The due process comprises six stages, with the Trustees of the IFRS Foundation having the opportunity to ensure compliance at various points throughout:

1. Setting the agenda
2. Planning the project
3. Developing and publishing the Discussion Paper, including public consultation
4. Developing and publishing the Exposure Draft, including public consultation
5. Developing and publishing the Standard.
6. Procedures after a Standard are issued.

The IFRS issued by IASB and the corresponding Ind- AS are given below:

S. No.	IFRS No.	Title	Corresponding converged Ind-AS
1)	IFRS 1	First-time Adoption of Indian Accounting Standards	Ind-AS 101
2)	IFRS 2	Share based Payment	Ind-AS 102
2)	IFRS 3	Business Combinations	Ind-AS 103
3)	IFRS 4	Insurance Contracts	Ind-AS 104
4)	IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	Ind-AS 105
5)	IFRS 6	Exploration for and Evaluation of Mineral Resources	Ind-AS 106
6)	IFRS 7	Financial Instruments: Disclosures	Ind-AS 107
7)	IFRS 8	Operating Segments	Ind-AS 108
8)	IFRS 9	Financial Instruments	Exposure Draft Issued
9)	IFRS 10	Consolidated Financial Statements	Exposure Draft Issued
10)	IFRS 11	Joint Agreements	Exposure Draft Issued
11)	IFRS 12	Disclosure of Interests in Other Entities	Exposure Draft Issued
12)	IFRS 13	Fair Value Measurement	Exposure Draft Issued

4.8 CONVERGENCE TO IFRS

For a country, there are two alternatives available for compliance and implementation of the IFRS, which are (i) Adoption, (ii) Convergence

Adoption: It means acceptance of IFRS in its original form. If a country adopts IFRS in its original form, then it is not allowed to make any change in the language or format of the IFRS formed by IASB.

Convergence: It means implementing IFRS with modification wherever necessary so as to suit the requirements of a particular country.

India has decided to converge it existing accounting standards to IFRS. In India, the converged accounting standards are called Ind-AS

As per the road-map announced by Ministry of Corporate Affairs (MCA) in March 2010, the Indian Accounting Standards (Ind-AS) converged with International Financial Reporting Standards (IFRS) were to be applied to specified class of companies in phases beginning with the financial year 1 April 2011. Audit observed that MCA could not notify the date of implementation of Ind-AS as per its notified road-map. Slippages in the implementation of Ind-AS were discussed in Chapter 4 of Audit Report No. 2 of 2014.

Subsequently, in pursuance of the Budget Statement of the Finance Minister in February 2014, MCA after consultations with various stakeholders and regulators, issued a press note on 2 January 2015 wherein a revised Road map for implementation of Ind-AS converged with IFRS was laid down for companies other than Banking Companies, Insurance Companies and Non-Banking Finance Companies (NBFC). The Ind-AS shall be applicable to the companies as follows:

(i) On voluntary basis for financial statements for accounting periods beginning on or after 1 April 2015, with the comparatives for the periods ending 31 March, 2015 or thereafter;

(ii) On mandatory basis for the accounting periods beginning on or after 1 April 2016, with comparatives for the periods ending 31 March 2016, or thereafter, for the companies specified below:

   a) Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth of Rs. 500 crore or more.

   b) Companies other than those covered in (ii) (a) above, having net worth of Rs.500 crore or more.

   c) Holding, subsidiary, joint venture or associate companies of companies covered under (ii) (a) and (ii) (b) above.

(iii) On mandatory basis for the accounting periods beginning on or after 1 April 2017, with comparatives for the periods ending 31 March, 2017, or thereafter, for the companies specified below:

   a) Companies whose equity and/or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than Rs. 500 crore .

b) Companies other than those covered in paragraph (ii) and paragraph (iii)(a) above that is unlisted companies having net worth of Rs. 250 crore or more but less than Rs. 500 crore.

c) Holding, subsidiary, joint venture or associate companies of companies covered under paragraph (iii) (a) and (iii) (b) above.

However, companies whose securities are listed or in the process of listing on SME exchanges shall not be required to apply Ind-AS. Such companies shall continue to comply with the existing Accounting Standards unless they choose otherwise.

(iv) Once a company opts to follow the Ind-AS, it shall be required to follow the Ind-AS for all the subsequent financial statements.

(v) Companies not covered by the above roadmap shall continue to apply existing Accounting Standards prescribed in Annexure to the Companies (Accounting Standards) Rules, 2006.

Companies Act, 2013 specified that the financial statements shall comply with accounting standards notified by Central Government and shall be in form or forms as may be provided for class or classes of companies. This would facilitate implementation of Ind-AS in phases. Accordingly, MCA vide its notification dated 16 February 2015 notified the Companies (Indian Accounting Standards) Rules 2015 specifying 39 Ind-AS to be implemented as per the above road-map. The Ind-AS have been formulated by MCA in consultation with National Advisory Committee on Accounting Standards (NACAS).

Challenges to convergence

1. As Ind-AS are essentially based on the concept of fair value measurement of assets and liabilities, corresponding standards under the Income Tax Act are essential to ensure smooth and harmonised transition. Draft Income Computation and Disclosure Standards released by Ministry of Finance in this regard in January 2015 are under finalisation.

2. Banks and Insurance Companies have been kept out of the proposed road map for transition to Ind-AS in view of the specific needs and concerns of these two sectors.

3. Issues such as cost of compliance, capacity building, managing two sets of standards (one for entities that seek transition and the other for those which do not) and the impact of exceptions or ‘carve outs’ on the achievement of objectives of convergence would need to be addressed through a well-coordinated mechanism among MCA, DPE and ICAI.

4.9 DISTINCTION BETWEEN INDIAN AS AND INTERNATIONAL AS

The detail of difference between Accounting Standards and Ind- AS is enormous. Also, the impact of these differences vary from industry to industry and even from company to company. However, the major differences are listed below. Let us discuss them in defant.

Basic of Distinction	Accounting Standards(AS)	Ind-AS
Need	When businesses were not that complicated and accounting was done at local level, then accounting standards based on local GAAP were enough.	Today, businesses have become complicated and a globalised world is in the need of a comprehensive accounting standards that can be consistently applied globally and facilitate compatibility. Introduction of Ind-AS is the need of the hour for India to compete in this globalised world
Objective	The basic objective of Accounting standards is to remove variation in the treatment of several accounting aspects and to bring about standardization in presentation. They intent to harmonize the diverse accounting policies in the preparation and presentation of financial statements by different reporting enterprises so as to facilitate intra-firm and inter-firm comparison.	Ind-AS are Indian version of IFRS because it will be impractical to just adopt the IFRS blindly without taking into consideration the current Indian scenario. International Financial Reporting Standards are principles based standards, interpretation and the framework adopted by the International Accounting Standards Board (IASB). Since India is a member country so it has to adopt these standards. However, any changes in these IFRS would have an impact on books of Indian companies to adopt these IFRS as and when amended. So to fill the difference, Ind-AS have been introduced which is nothing but IFRS. These standards have been made applicable to Indian companies through a road map i.e., in a systematic manner. The benefit of these standards is that any change in IFRS would not impact Ind- AS directly. The Ministry of corporate affairs can analysis such changes and incorporate the same in Ind-AS if it thinks it is suitable.
Pervasiveness	AS are not so pervasive or widespread.	Ind-AS are pervasive and cover every area comprising reported revenues, expenses, assets, liabilities and equity.
Basis	AS are driven by ‘legal’ form in a number of areas and are rule based.	Ind-AS focus on ‘substance’ rather than the legal form. They are principal based, Ind-AS will also result in accounting which more closely reflects the underlying business rationale and true economics of transaction.
Disclosure requirements	Disclosure requirements are comparatively less detailed.	Disclosure requirements are more comprehensive and multifold under Ind-AS to enhance the transparency and accountability of financial statements.

The government of India has issued notification regarding Ind- AS. Following is the list of Ind-AS notified:

1) Ind-AS 1 Presentation of Financial Statements
2) Ind-AS 2 Inventories
3) Ind-AS 7 Statement of Cash Flows
4) Ind-AS 8 Accounting Policies, Changes in Accounting Estimates and Errors
5) Ind-AS 10 Events after the Reporting Period
6) Ind-AS 11 Construction Contracts
7) Ind-AS 12 Income Taxes
8) Ind-AS 16 Property, Plant and Equipment
9) Ind-AS 17 Leases
10) Ind-AS 18 Revenue
11) Ind-AS 19 Employee Benefits
12) Ind-AS 20 Accounting for Government Grants and Disclosure of Government Assistance
13) Ind-AS 21 The Effects of Changes in Foreign Exchange Rates
14) Ind-AS 23 Borrowing Costs
15) Ind-AS 24 Related Party Disclosures
16) Ind-AS 27 Consolidated and Separate Financial Statements
17) Ind-AS 28 Investments in Associates
18) Ind-AS 29 Financial Reporting in Hyper-inflationary Economies
19) Ind-AS 31 Interests in Joint Ventures
20) Ind-AS 32 Financial Instruments: Presentation
21) Ind-AS 33 Earnings per Share
22) Ind-AS 34 Interim Financial Reporting
23) Ind-AS 36 Impairment of Assets
24) Ind-AS 37 Provisions, Contingent Liabilities and Contingent Assets
25) Ind-AS 38 Intangible Assets
26) Ind-AS 39 Financial Instruments: Recognition and Measurement
27) Ind-AS 40 Investment Property

Check Your Progress B

1. Define the term 'IFRS'.

....

....

....

2. What is the need of forming IFRS?

....

....

....

3. What are the challenges of converging accouniting standards to IFRS in India?

....

....

....

4. Describe the difference between AS and Ind-AS?

....

....

....

....

4.10 MEASUREMENT OF BUSINESS INCOME

One of the most significant accounting concepts is "**Concept of Income**". Similarly, measurement of a business income is also an important function of an accountant. In General term, payment received in lieu of services or goods are called income. But we are here more concerned for a business income. Surplus revenue over expenses incurred is called as "Business Income.

Measurement of Business Income

There are following two factors which are helpful in the estimation of an income –

- **Revenues** - Sale of goods and rendering of services are the way to generate revenue. Therefore, it can be defined as consideration, recovered by the business for rendering services and goods to its customers.
- **Expenses** - An expense is an expired cost. We can say the cost that have been consumed in a process of producing revenue are the expired cost. Expenses tell us - how assets are decreased as a result of the services performed by a business.

Measurement of Revenue - Measurement of the revenue is based on an accrual concept. Accounting period, in which revenue earned, is the period of revenue accrues. Therefore, a receipt of cash and revenue earned are the two different things. We can say that revenue is earned only when it is actually realized and not necessarily, when it is received.

Measurement of Expenses

- In case of delivery of goods to its customers is a direct identification with the revenue.
- Rent and office salaries are an indirect association with the revenue.

There are four types of events (given below) that need proper consideration about as an expense of a given period and expenditure and cash payment made in connection with those items –

- Expenditure, which are expenses of the current year.
- Some expenditure, which are made prior to this period and has become expense of the current year.
- Expenditure, which is made this year, becomes expense in the next accounting periods. For example, purchase of fixed assets and depreciation in next up-coming years.
- Expense of this year, which will be paid in next accounting years. For example, outstanding expenses.

4.11 OBJECTIVES OF MEASUREMENT OF BUSINESS INCOME

The measurement of income is useful for more than one purpose and therefore its objectives may be studied form different points of view:

i) **As a guide to future investment**: The current income positively influences the expectations about the future. The prospective investor looks to the income of the business enterprise as a guide to his investments decisions of the future. The investors attempt to maximize their returns on their investments and their decisions will be guided by income. So the allocation of investment funds and selections of securities depend upon income levels of an enterprise.

ii) **As a tax base**: Though the Income Tax Act does not define yet it does specify what is taxable and what is deductible in arriving at the taxable income. Accounting income provides income of a business enterprise. The tax authorities can conveniently mobilize the revenues through taxes which are one of the main sources of the Government's income.

iii) **As a guide to dividend policy**: The dividend policy at present is directed to determine the proportion of the current income which should be retained and the proportion which should be distributed as dividends. So long as dividends are aid out of current income, the rights of the creditors are adequately protected since other resources of the business enterprise would not be used to pay dividends. There are clear rules for measurement of distributable profits in the Companies Act with a view to protect the interests of the creditors.

iv) **As an indicator of managerial efficiency**: The efficiency of management as decision makers and as trustees of resources is judged by the reported income of the current year. The auditors therefore certify that the income statement presents true and fair view of operational results. The measurement of business income therefore provides a suitable criterion for the efficiency of management in a competitive economy.

v) **As a measure of overall efficiency and credit worthiness**: Income is the lifeblood of any business enterprise and therefore it provides that basic standard by which the overall efficiency of the business is assessed. For creditors, profitable enterprise faces no difficulty in making timely payment on its debts. Banks and other credit institutions too depend upon current income levels as a guide about a firm's ability to repay loan out of future income.

4.12 APPROACHES FOR MEASURING INCOME

In order to measure income, four main methods or approaches can be used: the operation approach, activities approach, balance sheet approach, or value added approach. Let's take a look at each of these.

Transaction/Operation Approach

Transactions are mostly related to production or the purchase of goods and the sale of goods and all these transactions directly or indirectly related to the revenue or to the cost. Therefore, surplus collection of the revenue by selling goods, spent over for production or purchasing the goods is the measure of income. This system is widely followed by the enterprises where double entry system adopted.

The Balance Sheet or value added Approach: Comparison of the closing values (Assets minus outsider's liabilities) of a firm with the values at the beginning of that accounting period is called as Balance Sheet approach. In above value, an addition to capital will be subtracted and addition of drawings will be added while computing the business income of a firm. Since, income is calculated with the help of Balance Sheet hence called as Balance Sheet approach.

4.13 ACCOUNTING CONCEPT THAT IS RELEVANT TO MEASUREMENT OF BUSINESS INCOME -REALIZATION CONCEPT

Realization concept in accounting, also known as revenue recognition principle, refers to the application of accruals concept towards the recognition of revenue (income). Under this principle, revenue is recognized by the seller when it is earned irrespective of whether cash from the transaction has been received or not.

In case of sale of goods, revenue must be recognized when the seller transfers the risks and rewards associated with the ownership of the goods to the buyer. This is generally deemed to occur when the goods are actually transferred to the buyer. Where goods are sold on credit terms, revenue is recognized along with a corresponding receivable which is subsequently settled upon the receipt of the due amount from the customer.

In case of the rendering of services, revenue is recognized on the basis of stage of completion of the services specified in the contract. Any receipts from the customer in excess or short of the revenue recognized in accordance with the stage of completion are accounted for as prepaid income or accrued income as appropriate.

Example: Motor Hundai is a car Dealer. It receives orders from the customers in advance against 20% down payment. Motor PLC delivers the cars to the respective customers within 30 days upon which it receives the remaining 80% of the list price. In accordance with the revenue realization principle, motor Hundai must not recognize any revenue until the cars are delivered to the respective customers as that is the point when the risks and rewards incidental to the ownership of the cars are transferred to the buyers.

Importance

Application of the realization principle ensures that the reported performance of an entity, as evidenced from the income statement, reflects the true extent of revenue earned during a period rather than the cash inflows generated during a period which can otherwise be gauged from the cash flow statement. Recognition of revenue on cash basis may not present a consistent basis for evaluating the performance of a company over several accounting periods due to the potential volatility in cash flows.

4.14 LET US SUM UP

1. Accounting Standards are defined as written statements of accounting rules and guidelines or practices for preparing the uniform and consistent financial statements.
2. Objectives of issuing accounting standards are to provide information, to harmonise different accounting processes and to facilitate uniformity, consistency and comparability.
3. Benefits of accounting standards – (i) true and fair financial position, (ii) easy comparability, (iii) enhances the value of accounting information, (iv) efficiency of management, (v) useful to accountants and auditors and (vi) enhances credibility and reliability.
4. The authority to make accounting standards in India is Accounting Standard Board. It follows the prescribed procedure to issue an accounting standard.
5. Procedure for issuing accounting standards-ASB assisted by study group-exposure draft- circulation- ASB after incorporating suggestions submit to ICAI. After that ICAI will issue standard.
6. Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS. It prescribes the various requirements to be fulfilled during the transition period in moving from Accounting Standards (Indian GAAP) to Ind-AS.
7. Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2016 there are 32 accounting standards specified by ICAI, all of which are mandatory to be complied by the companies.
8. International Financial Reporting Standards is a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis.

9. With the increasing globalisation of financial markets and of companies, the use of a single set of financial reporting standards across countries is viewed as having increased the comparability of financial statements across borders.

10. India has decided to converge its existing accounting standards to IFRS. In India, the converged accounting standards are called Ind-AS.

4.15 KEY WORDS

Accounting Standards: Accounting Standards are defined as written statements of accounting rules and guidelines or practices for preparing the uniform and consistent financial statements.

ASB: The board constituted by ICAI to concieve, formulate, examine and review the accounting standards.

GAAP: Generally Accepted Accounting Principles consist of accounting concepts and conventions so as to bring comparability and uniformity in the financial statements of various business organizations.

International Financial Reporting Standards: IFRS is a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis.

ICAI: Institute of Chartered Accountants of India- the apex body of accounting professionals of India.

Ind-AS: In India, the converged accounting standards are called Ind-AS. **Ind-AS 101:** Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS.

4.16 SOME USEFUL BOOKS

Monga, J.R., 2018. "Financial Accounting: Concepts and Applications", Mayoor Paper Backs, New Delhi.

Maheshwari, S.N. and S.K. Maheshwari, 2018. "Financial Accounting", Vikas Publishing House, New Delhi.

Sehgal, Ashok, and Deepak Sehgal, 2018. "Advanced Accounting", Part-I, Taxmann Applied Services, New Delhi.

Tulsian, P.C., 2018. "Advanced Accounting", Tata Mc Graw Hill, New Delhi. Materiality, Full Disclosure, Conservatism and Consistency.

Gupta & Chaturvedi., 2018. ''Financial Accounting'', Shree Mahavir Book Depot (Publishers), 2603, Nai Sarak New Delhi.

Goel D. K., 2018. Accountancy (Arya Publications), 1569/30 Naiwala, Karol Bagh, New Delhi 110 005.

Maheshwari, S.N., 2018. Introduction to Accounting, Vikas Publishing House: New Delhi.

Gupta, R.N. & M.Radhaswamy, 2018. Advanced Accountancy, Sultan Chand and Sons: New Delhi.

4.17 TERMINAL QUESTIONS

1. What are Accounting standards? What is the need of issuing accounting standards?
2. Describe the procedure of issuing AS in India.
3. Explain the concept of IFRS.
4. Describe the convergence of AS to Ind-AS.
5. What is business income? Why income should be computed?
6. What are the principles that govern the measurement of accounting income?
7. What are the features of Ind-AS 101?

Indira Gandhi
National Open University
School of Management Studies

BCOC-131
Financial Accounting

Block

2

ACCOUNTING PROCESS

COURSE PREPARATION TEAM

Preparatory Course in Commerce: PCO-01
(Unit-4, 5 and 6 Revised by Dr. Sunil Kumar)
Prof. J. Satyanarayan, Osmania University, Hyderabad
Prof. V. Vishwanadham, Osmania University, Hyderabad
Dr. D. Obul Reddy, Osmania University, Hyderabad
Shri M. Satyanarayana, Badruka College, Hyderabad

Prof. M.S.S. Raju
(Course Coordinator & Editor)
Dr. Sunil Kumar
(Course Coordinator & Editor)

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-07-2

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 2 ACCOUNTING PROCESS

This block introduces you to the initial stages of recording business transactions in the books of account. It consists of three units as follows:

Unit 5 deals with the first stage of recording transactions in the books of account i.e., Journalising and it is also devoted to the second stage of recording transactions in the books of account i.e., posting into ledger.

Unit 6 identify the need for sub-division of journal and specifies the subsidiary books usually maintained by business. It concentrates on the preparation of the most important subsidiary book called Cash Book. It also describes the nature of various banking transactions as related to business and their recording in the Three Column Cash Book. It also covers the preparation of the remaining subsidiary books viz., Purchases Journal, Purchases Returns Journal, Sales Journal, Sales Returns Journal etc. It also describes the method of posting these books into related ledger accounts.

Unit 7 deals with the preparation of Trial Balance and discusses its role in ascertaining the arithmetical accuracy of the books of account. It also describes the methods of rectification of errors and their effect on profits.

The three units together constitute the basic steps in accounting and facilitate the initiation into the fundamental recording process.

UNIT 5 JOURNAL AND LEDGER

Structure

5.0 OBJECTIVES

After going through this unit, you will be able to:

- explain what journal is;
- analyse a business transaction and identify the accounts affected;
- apply rules of debit and credit, and formulate journal entries;
- prepare journal;
- post the journal entries in the respective ledger accounts;
- balance a ledger account and explain the significance of balance in an account;
- prepare a trial balance to test the arithmetical accuracy of recording in the books of account; and
- post an opening entry.

5.1 INTRODUCTION

You are aware that every business transaction involves transfer of money or money's worth between two accounts. Recording of transaction is considered as complete only when both the receiving and the giving aspects are recorded in the books of account. This recording takes place in two stages. In the first stage, the transactions are recorded through a book called 'Journal' and in the second stage they are entered in the other book called 'Ledger'. You have learnt about the different stages of accounting, different classes of accounts, and the rules of debit and credit. With this background, you will now be able to analyse the transactions and record them in the book of original entry i.e., Journal. In this unit, we intend to explain how exactly the entries are made in the journal. All business transactions are recorded in the books of account in two stages: (1) Journalising, and (2) Posting into Ledger. In this unit, you will learn about recording in the ledger. This involves posting journal entries into various accounts in the ledger, balancing the accounts periodically, and preparing a Trial Balance to check the arithmetical accuracy of all accounting entries.

5.2 WHAT IS JOURNAL ?

A Journal is called a book of prime entry (also called book of original entry) because all business transactions are entered first in this book. The word 'Journal' means a daily record. The transactions are recorded in this book in the order in which they occur i.e., they are entered in a chronological order. In this book, both aspects i.e., the receiving aspect and the giving aspect of the transaction, are recorded. The process of recording a transaction in the journal is called Journalising. The entries made in the journal are called 'journal entries'.

5.3 FORM OF THE JOURNAL

We shall now study the form of the journal. The form is given in Figure 5.1.

JOURNAL

Date (1)	Particulars (2)	L.F. (3)	Dr. Amount (4)	Cr. Amount (5)

Fig. 5.1

The journal is provided with five columns. Each of these columns is meant for recording a specific detail of the transaction.

Column (1) is used for recording the date of the transaction i.e., the date on which the transaction has occurred. It is customary to write the year at the top of the column. In the next line, the month is written below the year and the date of the transaction is entered immediately after the month as follows:

(Year)	**2018**
(Month,date)	**Jan. 1**

Note that the year and the month are not repeated for every transaction. Ditto **(")** mark is placed below the month to indicate that the month is the same. Similarly when two or more transactions have taken place on the same day, ditto mark is placed below the date.

Column (2) is called Particular's column. This column is meant for recording the names of the two accounts which are involved in the transaction. This is also used for writing a brief description about the transaction called 'narration'. Let us note carefully the method of writing in this column.

The same of the amount to be debited is written very close to the left hand side line i.e., the line demarcating the date column and the particulars column. The abbreviation 'Dr' for debit is written on the same line against the name of the account. The name of the account which is to be credited is written in the next line preceded by the word 'To'. Note that it is not written immediately below the name of the account which has got the debit but a few spaces towards the right. It is not necessary to write 'Cr.' after the name of the account to be credited. Then, in the next line, a brief description (narration) of the transaction is given within brackets. The narration would generally begin with a word like 'Being' or 'For'. After completing narration, a line must be drawn across the entire 'particulars' columns to separate one entry from the other.

Let us take an example: **Sold goods for cash, Rs. 500 on May 2, 2018.** In this transaction, the two accounts are Cash Account and Goods Account. You know, as per rules, Cash Account is to be debited and Goods Account is to be credited. This transaction will be shown in the journal as follows:

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
			Rs.	Rs.
2018	Cash Account Dr.	–	500	
May 2	To Goods Account			500
	(Being cash Sale of goods)			

Column (3) is known as the L.F. (Ledger Folio) Column. Folio means page number, so it is meant for writing the number of the page in the Ledger on which the particular account appears. The account to be debited and the account to be credited are likely to be on different pages in the Ledger. The page numbers on which these accounts appear are indicated against the name of each account in this column. This column is filled at the time of posting into the ledger.

Columns (4) and (5) are called amount columns. Column (4) is called the debit amount column and column (5) is called the credit amount column. The amount to be debited is entered in the debit amount column against the name of the account, and the amount to be credited is entered in the credit amount column against the name of the account. Both the amounts will always be equal, as you have observed in the case of the above example.

5.4 STEPS IN JOURNALISING

In recording various business transactions in the journal, the most important aspect is the entry in the 'Particulars' column. Any mistake in this regard would lead to incorrect accounting. Hence, you should analyse the transaction carefully before making such entries. The following steps shall help you to do such analysis:

1. Take up the transaction, one by one. Read and analyse the transaction carefully from the business entity point of view, and identify the two accounts that are being affected by the transaction.

2. You are aware that accounts have been classified as personal, real and nominal accounts. Hence, after identifying the two accounts that are affected by the transaction, you must determine, in respect of each account, whether it is a personal account or a real account or a nominal account.

3. Each class of account has its own rule of debit and credit, which you have already learnt. Now, apply the relevant rules and decide which account is to be debited and which is to be credited.

The three steps explained above will have to be repeated in respect of every transaction. We have simply reinforced the point here to help you to journalise correctly.

Besides identifying the accounts to be debited and credited, you should be equally careful about the date of the transaction and the amounts with which each account is to be debited or credited. Now let us take a transaction, analyse it and see how a complete journal entry will be made.

Sold goods to Saran Brothers on credit for Rs. 500 on January 3, 2018

Step 1: From the business point of view, it is **a** sale of goods on credit. In this case, the receiving aspect is Saran Brothers (as they receive the goods) and the giving aspect is Goods (as goods go out). So, the two accounts affected are 'Saran Brothers' Account' and 'Goods Account'.

Step 2: The next step is to classify the accounts identified in the Step 1. You are aware that Saran Brothers' Account is a personal account because it relates to persons, and Goods Account is a real account as it relates to property of the business.

Step 3: The rule for personal accounts is 'debit the receiver and credit the giver'. Saran Brothers receive the goods. So, Saran Brothers' Account will be 'debited'. The rule for real accounts is 'debit what comes in and credit what goes out'. Goods go out of business. So, Goods Account will be credited.

Having identified that Saran Brothers' Account is to be debited and Goods Account is to be credited, the entry will be recorded in the journal as follows:

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
			Rs.	Rs.
2018	Saran Brothers Dr.	–	500	
Jan. 3	To Goods Account			500
	(Being goods sold on credit)			

Check Your Progress A

1. State whether the following are **True** or **False:**

   a) Journal is a book of original entry.

   b) Journal records all transactions in a business in the order in which they occur.

   c) The process of recording a transaction is called posting.

   d) In the journal entry 'Dr.' must be written against the name of the account debited, and 'Cr.' against the name of the account credited.

   e) Narration must be written for every transaction entered in the Journal.

2. What are the steps to be followed in journalising the business transaction?

   ....

   ....

   ....

   ....

5.5 TRANSACTIONS OF DIFFERENT TYPES

Study carefully the following illustrations where entries for particular type of transactions are presented. Later, some comprehensive illustrations will be given which shall include transactions of all types.

5.5.1 Transactions Relating to Purchase and Sale of Goods for Cash

Most common transactions in business relate to buying and selling of goods. Purchase and sale of goods can take place either on cash basis or on credit basis. In illustration 1, we take up transactions relating to purchase and sale of goods for cash.

Illustration 1

Enter the following transactions in the journal.

2018 Jan.	1.	Bought goods for cash	38,000
	2.	Sold goods for cash	2,500
	3.	Purchased goods for cash from Ajeet	8,000
	4.	Sold goods to Kishan for cash	3,500

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
			Rs.	Rs.
2018 Jan. 1	Goods Account Dr. To Cash Account (Being cash purchase of goods)		38,000	38,000
" 2	Cash Account Dr. To Goods Account (Being cash sale of goods)		2,500	2,500
" 3	Goods Account Dr. To Cash Account (Being cash purchase of goods)		8,000	8,000
" 4	Cash Account Dr. To Goods Account (Being cash sale of goods)		3,500	3,500

If you carefully go through the four transactions given above, you will notice that in the first two transactions, there is no mention of the names of the parties with whom the transactions took place. In the other two transactions, the names of the parties concerned are clearly given. However, it has not made any difference in the journal entries. They remain the same, because while recording cash purchase or cash sale it is not necessary to involve personal accounts of the parties concerned. For the business, the dual effect of such transactions is only on (i) cash account, and (ii) goods account.

5.5.2 Transactions Relating to Purchase and Sale of Goods on Credit

In case of purchase and sale of goods on credit, cash is not paid immediately. The settlement of the account is postponed to a later date. Hence, while recording such transactions, it is necessary to involve the personal accounts of the parties concerned. In case of credit sale, the personal account of the buyer is debited. He becomes a debtor, signifying that the party is under an obligation to pay later. Similarly, in case of credit purchase, the personal account of the party is credited. He becomes a creditor, signifying that the business is under an obligation to pay them at a later date.

Now let us consider some transactions of purchase and sale of goods on credit and understand how they are recorded in journal.

Illustration 2

Journalise the following transactions:

2018			Rs.
March	1	Sold goods to Anand on credit	18,000
"	4	Bought goods on account from Ram	48,000
"	6	Purchased goods from Shyam	13,000

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
			Rs.	Rs.
2018 March 1	Anand's Account Dr. To Goods Account (Being goods sold on credit)		18,000	18,000
March 4	Goods Account Dr. To Ram's Account (Being goods purchased on credit)		48,000	48,000
March 6	Goods Account Dr. To Shyam's Account (Being goods purchased on credit)		13,000	13,000

You have seen that it is necessary to involve the personal account of the party, when purchase or sale of goods is on credit. You must have noticed that terms like 'on credit' and 'on account' indicate that it is a credit transaction. It is not always necessary to use such terms. For example, transactions can be worded as 'Bought goods from Mahesh', 'Sold goods to Suresh', without using the terms 'on 'on credit' or 'on account'. These are also credit transactions.

Sometimes a transaction may merely read as 'bought goods' or 'sold goods'. Here it is not clearly stated whether these are cash or credit transactions. Remember that in case of a credit transaction, the name of the party concerned is always given. In the above transactions, names of the parties concerned are not stated. Hence, these shall be treated as cash transactions.

Check Your Progress B

1. Explain the distinction between cash and credit transactions.

   ....

   ....

   ....

2. Some transactions are given below. State whether they are cash transactions or credit transactions.

Transaction	State whether a cash transaction or a credit transaction
a) Bought from Rahul, goods worth Rs. 10,000	.
b) Purchased goods for Cash, Rs. 5,000 from Tagore	
c) Bought on account from Bose, goods for Rs. 8,000	
d) Bought goods for Rs. 16,000	
e) Sold goods to Chatterjee Rs. 2,000	

f)	Sold goods to Trivedi for cash Rs. 3,000	
g)	Sold goods to Lal on account, Rs. 4,000	
h)	Sold goods Rs. 6,000	

5.5.3 Transactions Relating to Return of Goods

Goods may be returned for various reasons. When goods are returned by a customer, his liability to that extent gets reduced. Hence, it is necessary to give him a credit for the goods returned. Similarly, when the business returns some goods to its supplier, the liability of the business stands reduced to that extent. Hence, the supplier's account will be debited.

Illustration 3

Journalise the following transactions:

2018		Rs.
April 10	Anand returned goods	500
" 12	Returned goods to Ram	700

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
			Rs.	Rs.
2018	Goods Account Dr.		500	
April 10	To Anand's Account			500
	(Being goods returned by Anand			
April 12	Ram's Account Dr.		700	
	To Goods Account			700
	(Being goods returned by Anand)			

Note: In illustrations 1, 2 and 3 above you find that all transactions relating to goods (be it purchase, purchase return, sale or sale return) have been recorded through the Goods Account. However, it would be more purposeful and convenient to record different types of transactions relating to goods, through separate accounts. This helps you to ascertain the amount of purchase and sale for a given period more quickly and correctly. Hence, in practice, instead of one Goods Account, five separate accounts are maintained, as shown below:

i) For recording all cash and credit purchases of goods—Purchases Account.

ii) For recording all cash and credit sales of goods—Sales Account.

iii) For recording goods returned to suppliers—Returns Outward Account or Purchase Returns Account.

iv) For recording goods returned by customers—Returns Inward Account or Sales Returns Account.

v) For goods in stock as at the end of the year—Stock Account.

In the comprehensive illustrations 9 and 10, entries have been made according to the above practice. Purchase of goods has been debited to Purchases Account, and sale of goods has been credited to Sales Account, and so on.

5.5.4 Transactions Relating to Purchase and Sale of Assets

Assets like machinery, furniture, vehicles, etc. are brought for use in the business and not for resale. Hence, when an asset is bought, the particular asset account is debited. Similarly, when an asset is sold, the account of that asset is credited.

Assets may also be bought for cash or on credit. You have already noted the difference in the treatment of transactions relating to cash and credit purchases. The same treatment is followed in case of transactions relating to purchase and sale of assets.

Illustration 4

Journalise the following transactions:

2018			Rs.
May	1	Purchased buildings	1,75,000
"	4	Sold old machinery to Joshi	1,500
"	8	Bought furniture from Gopal & Company for cash	1,10,000
"	9	Bought motor vehicles from Allied Motors	90,000

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
	Rs.		Rs.	
2018 May 1	Building Account Dr. To Cash Account (Being building purchased)		1,75,000	 1,75,000
" 4	Joshi's Account Dr. To Machinery Account (Being machinery sold to him)		1,500	 1,500
" 8	Furniture Account Dr. To Cash Account (Being furniture purchased)		1,10,000	 1,10,000
" 9	Motor Vehicle Account Dr. To Allied Motor's Account (Being motor vehicles purchased)		90,000	 90,000

5.5.5 Transactions Relating to Expenses and Incomes

You know the expenses and incomes are generally paid/received in cash. So in case of expenses, we debit the concerned expense account and credit cash account. In case of incomes, we debit cash account and credit the concerned income account. Now let us take some examples of such transactions.

Illustration 5

Journalise the following transactions:

2018			Rs.
April	2	Paid salaries	18,000
"	3	Paid rent to landlord Rajesh	2,000
"	6	Received interest on investments	1,300
"	7	Received commission from Mahesh	1,900

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
May 2	Salaries Account Dr.		18,000	
	To Cash Account			18,000
	(Being salaries paid)			
May 3	Rent Account Dr.		2,000	
	To Cash Account			2,000
	(Being rent paid)			
May 6	Cash Account Dr.		1,300	
	To Interest Received Account			
	(Being interest received			1,300
	on investments)			
May 7	Cash Account Dr.		1,900	
	To Commission Received			
	Account		1,900	
	(Being commission received)			

In the second transaction in the above illustration, rent was paid to Rajesh, the landlord, but the debit has been given to the nominal account (Rent Account) and not to the personal account of Rajesh. Similarly, when commission was received from Mahesh (fourth transaction), it is the Commission Received Account that has been credited and not the personal account of Mahesh who paid the commission. This is so because these are cash transactions, and no debtor/creditor relationship is created as there is no obligation yet to be fulfilled.

There is another point to be noted in this context. In illustration 5, you have seen that when rent is paid, Rent Account has been debited (it is an expense) and when interest is received, Interest Received Account has been credited (it is an income). In business, certain nominal accounts like Salaries Account, Wages Account, and Postage Account would involve only payments, as these will always be expenses. But certain other items like interest, commission, rent, etc., can sometimes be an expense, sometimes an income. In such case, it is better to maintain separate accounts for their payments and receipts.

5.5.6 Transactions Relating to other Receipts and Payments of Cash

Apart from cash purchase, cash sale, payment of expenses, and receipt of incomes, there are many other transactions which involve movement of cash. For example, the business may receive cash from its debtors (customers from the goods were sold on credit), pay cash to creditors (suppliers of goods on credit), receive or repay loan, etc. In the earlier illustrations, you have learnt that whenever cash is paid, Cash Account is credited, and whenever cash is received, Cash Account is debited. The same treatment will be applicable to the other cash transactions as given in illustration 6

Illustration 6

Enter the following transactions in the journal:

2018		Rs.
April 1	Received cash from Anand, on account	9,000
" 2	Paid to Ram on account	6,000
" 3	Took a loan from Chetan	30,000

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
April 1	Cash Account Dr. To Anand's Account (Being cash received on account)		9,000	 9,000
" 2	Ram's Account Dr. To Cash Account (Being cash paid on account)		6,000	 6,000
" 3	Cash Account Dr. To Loan from Chetan Account (Being loan taken)		30,000	 30,000

In business, sometimes loans are taken to augment the capital invested by the proprietor. In such cases, the word 'loan' is added to the name of the party concerned to distinguish this account from the other accounts. For example, in illustration 6, a loan was taken from Chetan, the credit was given to Loan from Chetan Account and not to Chetan's Account.

Similarly, a business unit may give a loan. In such a case, also the word loan is added to the name of the account. For example, a business unit has given loan to Sohan, the debit will be given to Loan to Sohan Account, and not to Sohan's Account.

5.5.7 Transactions Relating to Receipts and Payments by Cheque

So far, all payments and receipts which have been discussed were in the form of cash. But you know that payments and receipts are also made through cheque. Although we intend to discuss the various banking transactions later. You must at this stage, learn about the journal entries for payments and receipts by cheque.

When payment is made by cheque the credit will be given to Bank Account because the bank balance will be reduced. Similarly, when payment is received by cheque, the amount will be debited to Bank Account as the cheque is deposited in the bank which increases the bank balance. Some examples are given in illustration 7.

Illustration 7

Journalise the following transactions:

2018		Rs
April 2	Paid to Ram on Account by cheque	9,000
" 4	Received cheque from Shiva on account	6,000

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
April 2	Ram's Account Dr.		9,000	
	To Bank Account			9,000
	(Being paid to him by cheque)			
" 4	Bank Account Dr.		6,000	
	To Shiva's Account			6,000
	(Being ammount received from him by cheque)			

5.5.8 Transactions with the Proprietor

You have already learnt that the business and its proprietor are treated as separate entities. This necessitates maintaining of separate accounts in the ledger for recording the transactions between the proprietor and the business. Whatever the proprietor brings into the business is treated as capital and is credited to the Capital Account. Similarly, when the proprietor withdraws cash from the business for his personal use he is debited with the amount withdrawn. Such debit is given to a separate account called Drawings Account. Drawings Account is also debited when the proprietor takes goods from business for his domestic use.

As explained earlier, both the Capital Account and the Drawings Account are treated as personal accounts belonging to the proprietor. Some examples of transactions with the proprietor are given in illustration 8.

Illustration 8

Enter the following transactions in the Journal:

2018			Rs.
May	1	Ganesh commenced business with a capital of	1,00,000
"	2	He withdraw cash for personal use	7,000
"	3	He introduced additional capital	18,000
"	4	He took goods for domestic use	1,000

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
May 1	Cash Account Dr.		1,00,000	
	To Capital Account			1,00,000
	(Being capital bought in)			
" 2	Drawings Account Dr.		7,000	
	To Cash Account (Being cash ithdrawn for personal use)			7,000
" 3	Cash Account Dr.		18,000	
	To Capital Account (Being additional capital brought in)			18,000
" 4	Cash Account Dr.		1,000	
	To Capital Account			1,000
	(Being additional capital brought in)			

5.5.9 Transaction Relating to Cash Discount

You have learnt earlier about two types of discounts allowed to customers: (i) trade discount, and (ii) cash discount. Trade discount is not shown in the books of account since it is adjusted in the invoice itself and the entry in the books of account is made for the net amount only. But the case of cash discount is different. At the time of sale, the buyer is debited with the net amount of the invoice. Later if cash discount is allowed at the time of payment, it must be adjusted in the personal account of the debtor. This would show that his account stands cleared, and nothing more remains due.

When cash discount is allowed to the debtor, it is a loss to the business and so debited to Discount Allowed Account and credited to the personal account of the debtor. Similarly, when cash discount is allowed by the creditor, it is a gain to the business so it is credited to Discount Received Account and debited to the personal account of the creditor.

The entries relating to cash discount shall be illustrated under compound journal entry.

5.5.10 Transactions Relating to Bad Debts

When a debtor becomes insolvent, the business shall not be able to realise full amount due from him. A part of it will remain unrealised. The unrealised amount is called 'bad debt'. It is a loss to the business and so debited to Bad Debts Account, and credited to the personal account of the debtor.

If the amount treated as bad debts is recovered later on, the same shall be a gain to the business. Hence, it will be credited to Bad Debts Recovered Account and debited to Cash Account. Note that the bad debts so recovered shall not be credited to the personal account of the debtor.

Look at journal entry from transaction on April 10 under illustration 12 and see how bad debts are recorded.

Illustration 9

Ramesh commenced business on January 1, 2018. His transactions for the month are given below. Journalise them.

2018			Rs.
Jan.	1	Commenced business with a capital of	1,50,000
"	2	Bought goods from Ajeet and Co.	35,000
"	3	Sold goods for cash	6,000
"	4	Purchased furniture	6,000
"	7	Purchased goods on account from Gautam & Co.	18,000
"	8	Returned goods to Gautam & Co.	600
"	8	Paid for advertisement	1,000
"	10	Cash sales	5,000
"	13	Sold goods to Venkat	6,000
"	14	Venkat returns goods	400
"	19	Paid Ajeet and Co. on account	18,000

" 25	Paid office expenses	300
" 26	Received from Venkat on account	3,000
" 31	Paid salaries	5,000
" 31	Drew cash for private expenses.	3,000

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018		Rs.	Rs.	
Jan. 1	Cash Account Dr.		1,50,000	
	To Capital Account			1,50,000
	(Being capital bought in)			
" 2	Purchase Account Dr.		35,000	
	To Ajeet and Co's Account			35,000
	(Being credit purchase)			
" 3	Cash Account Dr.		6,000	
	To Sales Account			6,000
	(Being cash sales)			
" 4	Furniture Account Dr.		8,000	
	To Cash Account			8,000
	(Being furniture purchased)			
" 7	Purchase Account Dr.		18,000	
	To Gautam & Co's Account			18,000
	Being credit Purchases)			
" 8	Gautam & Co's Account Dr.		600	
	To Returns Outwards Account			600
	(Being goods returned to Gautam & Co.)			
" 8	Advertisement Account Dr.		1,000	
	To Cash Account			1,000
	(Being payment, for advertisement)			
" 10	Cash Account Dr.		5,000	
	To Sales Account			5,000
	(Being cash sales)			
" 13	Venkat's Account Dr.		6,000	
	To Sales Account			6,000
	(Being credit sales)			
" 14	Returns Inwards Account Dr.		400	
	To Venkat's Account			400
	(Being goods returned by Venkat			
" 19	Ajeet Co's Account Dr.		18,000	
	To Cash Account			18,000
	(Being cash paid on account)			

" 25	Office Expenses Account Dr. To Cash Account (Being office expenses)		300	300
" 26	Cash Account Dr. To Venkat's Account (Being cash received on account)		3,000	3,000
" 31	Salaries Account Dr. To Cash Account (Being salaries paid)		5,000	5,000
" 31	Drawings Account Dr. To Cash Account (Being cash withdrawn for personal use)		3,000	3,000

Illustration 10

Journalise the following transactions:

2018			Rs.
June	1	Cash sale to Ashok	1,800
"	2	Bought goods from Vinod	10,000
"	3	Old newspapers sold	100
"	4	Paid Municipal taxes by cheque	900
"	4	Paid for repairs to machinery	600
"	8	Received commission by cheque	1,700

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
June. 1	Cash Account Dr. To Sales Account (Being cash sales)		1,800	1,800
" 2	Purchase Account Dr. To Vinod's Account (Being credit purchase)		10,000	10,000
" 3	Cash Account Dr. To Miscellaneous Income Account (Being the income received by sale of old newspaper)		100	100
" 4	Municipal Taxes Account Dr. To Bank Account (Being Municipal taxes paid by cheque)		900	900
" 4	Repairs Account Dr. To Cash Account (Being repairs to machinery)		600	600
" 8	Bank Account Dr. To Commission Account (Being commission received by cheque)		1,700	1,700

Check Your Progress C

1. Name the accounts which are maintained in lieu of Goods Account.

   i) ....

   ii) ....

   iii) ....

   iv) ....

   v) ....

2. Select the best answer.

   a) The amount bought in by the proprietor in the business, should be credited to :

      i) Proprietor's Account

      ii) Drawings Account

      iii) Capital Account

   b) Purchase of furniture should be debited to

      i) Furniture Account

      ii) Goods Account

      iii) Equipment Account

   c) Return of goods to a supplier should be credited to

      i) Goods Account

      ii) Returns Outward Account

      iii) Supplier's Account

   d) Wages paid to Billu should be debited to

      i) Billu's Account

      ii) Cash Account

      iii) Wages Account

   e) Loan taken from Krishna should be credited to

      i) Krishna's Account

      ii) Loan from Krishna Account

      iii) Bank Account

   f) Payment made by cheque should be credited to

      i) Bank Account

      ii) Cheque Account

      iii) Cash Account

g) Cash discount allowed to a debtor should be debited to

 i) Customer's Account

 ii) Allowances Account

 iii) Discount Allowed Account

h) In case of bad debts, the amount should be debited to

 i) Debt Account

 ii) Bad debts Account

 iii) Discount Allowed Account

3. Distinguish between trade discount and cash discount.

....

....

....

....

4. What is bad debt?

....

....

....

5. How do you deal with the amount treated as bad debt which is recovered later on?

....

....

....

5.6 COMPOUND JOURNAL ENTRY

You have seen transactions which involve only two accounts. Sometimes, a transaction may involve more than two accounts. Sometimes, there may be more transactions of the same nature taking place on the same date. In such situations, if we pass separate journal entries, it may take more time and also require more space. Hence, such transactions may be recorded by means of a single journal entry. Such an entry is called a 'compound journal entry'. It may be recorded in the following three ways:

a) by debiting one account and crediting two or more accounts; or

b) by debiting two or more accounts and crediting one account; or

c) by debiting several accounts and crediting several accounts.

Take, for example, the following transactions:

a) **Paid cash to Ganesh Rs. 490. He allowed Rs. 10 as discount and settled his account.** This transaction involves three accounts: (i) Ganesh's Account, (ii) Cash Account, and (iii) Discount Received Account. The journal entry will be:

		Rs.	Rs.
Ganesh's Account	Dr.	500	
To Cash Account			490
To Discount Received Account			10

(Being cash paid to him in full settlement of the account)

b) **Sold goods to Rao & Sons Rs. 800 and Sharma Bros. Rs. 500, on May 5, 2018.**

These two transactions are of the same nature and have taken place on the same date. Their entries can be combined by passing the following compound journal entry.

		Rs.	Rs.
Rao & Sons Account	Dr.	800	
Sharma Bros. Account	Dr.	500	
To Sales Account			1,300
(Being sale made)			

c) **A running business with the following assets and liabilities was purchased from Tularam for Rs. 64,000**

Building	**Rs. 40,000**	**Furniture**	**Rs. 12,000**
Stock	**Rs. 20,000**	**Creditors**	**Rs. 8,000**

The journal entry will be:

		Rs.	Rs.
Building Account	Dr.		40,000
Furniture Account	Dr.		12,000
Stock Account	Dr.		20,000
To Creditors		8,000	
To Tularam's Account			64,000

(Being assets and liabilities taken over)

5.7 OPENING ENTRY

When a new accounting year begins, the previous year's balances in different accounts are brought forward to the new books of accounts. This is done by means of a journal entry called 'opening entry'. In this entry, all assets accounts are debited and liabilities accounts (including owner's capital account) are credited. If, however, capital account balance is not given, it can be worked out by deducting other liabilities from the total assets. This will become clear from illustration 11.

Illustration 11

Mr. Avinash has the following balances of assets and liabilities on December 31, 2018.

Cash in hand	Rs. 2,500	Stock of goods	Rs. 22,500
Furniture	Rs. 5,000	Bank Loan	Rs. 10,000

Pass the opening entry on January 1, 2019.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2019			Rs.	Rs.
June. 1	Cash Account Dr.		2,500	
	Stock Account Dr.		22,500	
	Furniture Account Dr.		5,000	
	To Bank Loan Account			10,000
	To Capital Account (Being balances brought forward from the previous year)			20,000

Check Your Progress D

1. What is a Compound entry ?

   ....

   ....

   ....

2. Complete the following sentences:

   a) A compound entry is passed for transactions involving …………

   b) A compound entry is passed if there are more transactions of same nature on…………………………………

   c) A compound entry can be passed by debiting one account and crediting……………..

   d) A compound entry can be passed by crediting one account and debiting…………

   e) In opening entry, all assets are debited and all are credited … ………

3. On December 31, 2018, the assets and liabilities of Chemico Industries were as follows:

Machinery	Rs. 11,000	Furnitur	Rs. 3,000
Stock	Rs. 24,000	Debtors	Rs. 17,000
Cash	Rs. 3,000	Creditors	Rs. 29,600
Loan	Rs. 5,400		

   Calculate the capital of M/s Chemico Industries as on January 1, 2019 to enable you to pass an opening entry.

5.8 CASTING AND CARRY FORWARD

Journal is totalled periodically (daily or weekly), depending upon the volume of business and the number of transactions. Totalling is called 'casting'. You have to total both the debit amount column and the credit amount column. Since every debit has an equal and corresponding credit, the totals of the two columns should always be equal. If, however, they do not tally, it implies that there is some error. In that case, you must go through the entire work and locate the error and get the correct total.

When the transactions during a particular period are many and cannot be journalised in the same page, then it would be necessary to total the two amount columns on that page and carry forward the total to the next page. This is done by writing 'Total c/f' against the totals in the particulars column and entering the amount in both amount columns. These totals are then brought forward on the next page by writing 'Total b/f' in the particulars column and entering the amount in both the amount columns. You must draw a line in the particulars column before making the remaining entries in the journal.

Illustration 12

Enter the following transactions in the journal:

2018

April	1	Bought an almirah for Rs. 450, and paid Rs. 30 for cartage.
"	2	Proprietor took away goods worth Rs. 200 for personal use.
"	3	Gave goods worth Rs. 100 in charity.
"	4	Sold an old machine for Rs. 2,000.
"	5	Paid insurance premium Rs. 90.
"	6	Purchased goods worth Rs. 5,000 for cash less 20 trade discount.
"	7	Received Rs. 980 from Kisan Chand, and allowed him Rs. 20 cash discount.
"	8	Rs. 500 were due to Ghanshyam. Paid Rs. 480 in full settlement of his account.
"	9	Cash of Rs. 560 was stolen from the cash box.
"	10	Han Singh, a debtor became insolvent. He owed Rs. 400. A final composition of 50 paise in a rupee was received.
"	11	Sold goods to Karim Rs. 800.
"	12	Paid into bank Rs. 400.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
June.1	Furniture A/c Dr.		480	
	To Cash A/c (Being Purchase of an almirah for Rs. 450, Cartage paid Rs. 30)			480
" 2	Drawings A/c Dr.		200	
	To Purchases A/c (Being goods taken away by the proprietor for personal use)			200
" 3	Charity A/c Dr.		100	
	To Purchases A/c (Being goods given in charity)			100
" 4	Cash A/c Dr.		2,000	
	To Machinery A/c (Being sale of old machinery)			2,000
" 5	Insurance A/c Dr.		90	
	To Cash A/c (Being payment of insurance premium)			90
" 6	Purchase A/c Dr.		4,000	
	To Cash A/c (Being purchase of goods)			4,000
" 7	Cash A/c Dr.		980	
	Discount Allowed A/c Dr.		20	
	To Kishan Chand (Being cash received from him, discount allowed Rs. 20)			1000
" 8	Ghanshyam Dr.		500	
	To Cash A/c			480
	To Discount Received A/c (Being cash paid to him, discount received Rs. 20)			20
" 9	Loss by Theft A/c Dr.		560	
	To Cash A/c (Being loss by theft)			560
" 10	Cash A/c Dr.		200	
	Bad Debts A/c Dr.		200	
	To Hari Singh (Being cash received from him, discount allowed Rs. 20)			400
" 11	Karim Dr.		800	
	To Sales A/c (Being credit sales)			800
" 12	Bank A/c Dr.		400	
	To Cash (Being cash paid into bank)			400
			10,530	10,530

The following clarifications with regard to Some transactions will help you to understand their journal entries.

Transaction 1. Rs. 30 paid as cartage have been included in the cost of the furniture purchased and debited to Furniture Account. You know, furniture is a fixed asset. Any expenditure incurred in relation to the purchase of a fixed asset is included in the cost of the fixed asset and as such debited to that asset itself.

Transaction 2. When goods are taken away by the proprietor for his personal use, it is treated as his drawings and so debited to Drawings Account. Further, the proprietor can be charged with only the cost of the goods taken and not the selling price. Hence, it is considered appropriate to reduce the purchases of the business by the amount of goods taken by him, as if the goods were purchased partly for the business and partly for the proprietor.

Transaction 3. The argument applicable to transaction 2 also holds good for the goods given in charity.

Transaction 5. Note that the amount paid as insurance premium is debited to Insurance Account and not to Insurance Premium Account. The premium is just an instalment for an insurance policy taken to cover the risk. The head of account is insurance.

Transaction 6. The entry has been made for the net amount only. Nothing has been debited to Discount Account. You have learnt that debit to Discount Account is needed only in case of cash discount and not in case of trade discount.

Transaction 10. Hari Singh became insolvent. Only half the amount due could be recovered from him. The balance is bad debt. It is a loss to the business and so has been debited to Bad Debts Account.

You would observe a few more points in the above illustration

a) Instead of writing full word ‘Account’ its abbreviation ‘A/c’ has been used. This is what we normally do. In fact the current practice is not to write anything, just the name of the account is enough.

b) The word ‘Account’ or its abbreviation ‘A/c’ has not been used against personal names. This again is a common practice. Writing ‘A/c’ is confined to real and nominal accounts only.

c) While carrying forward the total from one page to another, no lines have been drawn below the totals. A line is drawn only in the particulars column after writing ‘Total b/f’.

5.9 WHAT IS LEDGER?

Ledger is a book which contains all accounts affected by various transactions in a business. Ledger can be termed as a classified and summarised record of business transactions relating to all personal, real and nominal accounts.

All transactions which are first recorded in the journal, must invariably be posted into the concerned accounts in the ledger. This is necessary because Journal is just a chronological record of transactions, identifying the accounts to be debited and credited. It does not help us to know the net effect of various transactions affecting a particular account. This can only be achieved by recording the effect of all transactions on each account at one place. Let us illustrate this. Suppose, Mohan Brothers have been selling goods on credit to Suresh. Suresh is allowed to make part payments and make further purchases even before the old balance is cleared. No doubt, all transactions relating to the goods sold to him and the amounts received from him would be duly recorded in the journal (or its sub-divisions). But the journal, by itself, will not be in a position to readily provide information as to whether Suresh, at a given point of time, owes them any money and if so, how much. This is because the entries for transactions with him have been made at different places in the journal and you will have to go through all entries to obtain the required information. If however, all sales made to Suresh and the amounts received from him are shown at one place, say, in Suresh's Account in the ledger, the required information would be readily available. This is true of all accounts, be they personal accounts, real accounts or nominal accounts.

Ledger, thus is a book where all accounts are maintained and into which all journal entries are posted. As all transactions must ultimately be recorded in the respective accounts, the ledger is called the 'Book of Final Entry'. it is also called the 'Principal Book of Accounts'. In fact transactions can even be directly recorded into various ledger accounts. But, normally, this is not done because in that case we will not have any date wise record of all transactions and the details thereof. Such record is necessary for future reference.

To sum up (i) the ledger contains all the personal, real and nominal accounts, (ii) the ledger is a permanent, ultimate and up-to-date record of all transactions, and (iii) the ledger provides a means of easy and ready reference.

The ledger is a bound volume with the pages numbered consecutively. Alphabetical index is also shown at the beginning so that the page in which an account appears can be easily ascertained. In certain modern business, loose-leaf ledgers are maintained, instead of one bound volume. Banks maintain loose-leaf ledgers for customer's deposit accounts.

5.10 FORM OF A LEDGER ACCOUNT

As stated earlier, an account is the summarised record of all the transactions relating to a particular person or an item. The form of an account is given below:

NAME OF THE ACCOUNT

Dr. **Cr.**

Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
			Rs.				Rs.

You are already familiar with 'T' form of an account. A page is folded vertically in the middle to make it into two halves. Actually, folding is not necessary as usually pre-printed books are available. Sometimes, two pages are taken together as a unit. In that case, the entire page on the left hand side is considered as the debit side and the other page on the right hand side is treated as the credit side.

The columns in ledger account are very much similar to those in journal. In the journal, you have two amount columns because the dual aspect of each transaction has to be analysed and presented side by side. In the ledger account, the first three columns of the journal, viz., date, particulars and folio, appear on both the debit and the credit side and so also the amount column. However, the column meant for entering the page number in ledger is merely called .'folio', whereas in the journal it is called 'ledger folio'. It is important to note this similarity at the outset, as it would make ledger posting an easy task.

Let us look at the form of ledger account once again. In the middle of the top of the account, the 'Name of the Account' is given. It will be written as 'Shyam's Account', or 'Furniture Account' or 'Rent Account', as the case may be. You also find that Dr. and Cr. appear at the two extreme ends of the top line of the account. The left hand side is designated as debit side and is indicated by writing 'Dr.' on the left hand top corner. Similarly, 'Cr.' is written on the right hand top corner to indicate the credit side. When an account is to be debited, the entry is made on the debit side and when it is to be credited, the entry is made on the credit side.

5.11 POSTING IN TO LEDGER

The journal entries form the basis for recording in the ledger accounts, and the process of entering transaction in the ledger is called 'Posting'. When a journal entry has to be posted in the concerned ledger accounts, the following procedure is adopted.

1. Every journal entry will have to be posted into all those accounts which have been debited and credited in the journal entry. For example, for cash sales, Cash Account is debited and Sales Account is credited in the journal. When this entry is posted in the ledger, it must be posted in Cash Account as well as in Sales Account.

2. Posting will be made on the debit side of the account which has been debited in the journal, and the credit side of the account which has been credited in the journal. In case of above example of the cash sales, posting will be made on the debit side of Cash Account, as it has been debited in journal and the credit side of Sales Account, as it had been credited in the journal.

3. Whether the posting is made on the debit side or the credit side, first of all the date of the transaction (as given in the journal) will be entered in the date column. The method of recording the date in the ledger account is the same as in journal.

4. While posting on the debit side of an account, in the particulars column, we shall write the name of the account which had been credited in the journal and add the word 'To' before the name. Similarly while posting on the credit side of an account, we shall write the name of the account which has been debited in the journal and add the word 'By' before the name. In case of the above example, we shall write 'To Sales A/c' in particulars column on the debit side of Cash Account and 'By Cash A/c' in particulars column on the credit side of the Sales Account.

5. The journal entries contain 'narration'. But it is not required in the ledger accounts. Similarly, there is no need to draw a line between the two entries in an account as is done in the journal. Note that posting in the ledger account is considered complete only when both the debit and the credit aspects of all journal entries have been posted.

6. In the folio column, we shall mention the page number of the journal where the concerned journal entry appears. At the same time, the page number of the ledger accounts will be entered in the 'L.F.' column in the journal so as to complete the cross reference.

7. The amount involved in the journal entry shall be entered in amount columns of both the accounts.

Now let us take a transaction, Journalise it, and then show how the posting is done in the ledger.

Illustration 13

Purchased machinery for cash, Rs. 50,000 on April 4, 2018. This transation will appear in the journal and the ledger as under:

JOURNAL

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
Apr.4	Machinery A/c Dr.		50,000	
	To Cash A/c			50,000
	(Being machinery purchased)			

LEDGER

Machinery Account

Dr. **Cr.**

Date	Particulars	Folio	Amount	Date	Particular	Folio	Amount
2018			Rs.				Rs.
April 4	To Cash A/c		50,000				

Cash Account

Dr. **Cr.**

Date	Particulars	Folio	Amount	Date	Particular	Folio	Amount
2018			Rs.	2018			Rs.
				April 4	By Machinary		50,000

Now we take a few more transactions and illustrate further the ledger posting aspect of the transactions, from the journal entries.

Illustration 14

Journalise the following transactions and post them into the ledger.

2018 April		Rs.
2"	Cash Sales	15,000
2"	Paid Salaries	6,000
6"	Sold goods to Pankaj	10,000
10"	Cash purchases	5,000
13"	Paid for stationery	100
18"	Goods taken by proprietor for personal use	1,000
23"	Bought goods from Manoj	13,000
25"	Received from Pankaj on account	4,000
27"	Sold goods for cash	4,000
30"	Received interest on investments	1,400

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
2018 April 2	Cash Account Dr. To Sales Account (Being cash sales)	Rs.	Rs. 15,000	15,000
" 2	Salaries Account Dr. To Cash Account (Being salaries paid)		6,000	6,000
" 6	Pankaj's Account Dr. To Sales A/c 10,000 (Being goods sold to Pankaj on credit)		10,000	10,000
" 10	Purchases Account Dr. To Cash Account (Being cash purchase)		5,000	5,000
" 13	Stationery Account Dr. To Cash Account (Being stationery purchased)		100	100
" 18	Drawings Account Dr. To Purchases Account (Being goods taken for personal use)		1,000	1,000
" 23	Purchases Account Dr. To Manoj's Account (Being goods purchased fromManoj on credit)		13,000	13,000

“ 25	Cash Account Dr. To Pankaj’s Account (Being the amount received)		4,000	4,000
“ 27	Cash Account Dr. To Sales Account (Being cash sales)		4,000	4,000
“ 30	Cash Account Dr. To Interest Account (Being interest received on investments)		1,400	1,400

LEDGER

Cash Account

Dr. **Cr.**

Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
2018			Rs.	2018			Rs.
April 2	To Sales A/c		15,000	April 2	By Salaries A/c		6,000
“ 25	To Pankaj’s A/c		4,000	“ 10	By Furniture A/c		5,000
“ 27	To Sales A/c		4,000	“ 13	By Stationery A/c		100
“ 30	To Interest A/c		1,400				

Sales Account

				2018			Rs.
				April 2	By Cash A/c		15,000
				“ 6	By Pankaj’s A/c		10,000
				“ 27	By Cash A/c		4,000

Salaries Account

2018			Rs.				
April 2	To Cash A/c		6000				

2018			Rs.	2018			Rs.
April 6	To Sales A/c		10,000	April 25	By Cash A/c		4,000

Purchase Account

2018			Rs.	2018			Rs.
April 10	To Cash A/c		5,000	April 18	By Drawings A/c		1,000
“ 23	To Manoj’s A/c		13,000				

Stationery Account

2018			Rs.				
April 13	To Cash A/c		100				

Drawings Account

2018			Rs.				
April 18	To Purchases A/c		1,000				

Manoj's Account

				2018 April 23	By Purchase A/c		Rs. 13,000

Interest Account

				2018 April 30	By Cash A/c		Rs. 1,400

5.12 POSTING A COMPOUND JOURNAL ENTRY

Normally we post a journal entry into two accounts, on the debit side of one account and the credit side of the other account. This is because most journal entries have only two accounts. But it is not so in case of a compound journal entry which involves more than two accounts. A compound entry will be posted on the debit side of two or more accounts and the credit side of one account, or on the debit side of one account and credit side of two or more accounts. This will depend upon the number of accounts that have been debited and credited in the journal entry. Take, for example, a journal entry for the following transactions:

On May 31, 2018 Mohan, a customer, paid cash Rs. 950 in settlement of his account of Rs. 1,000.

The journalentry for this transaction will be:

2018			Rs.	Rs.
May 31	Cash A/c Dr.		950	
	Discount Allowed A/c Dr.		50	
	To Mohan (Being amount received in full settlement)			1,000

In this journal entry, two accounts have been debited and one account has been credited. It will be posted in the debit side of both Cash Account and Discount Allowed Account, and the credit side of Mohan's Account. In the Particular column of the debit side of Cash Account and Discount Allowed Account we shall write 'To Mohan'. On the credit side of Mohan's Account, in Particulars column we shall write 'By Cash A/c', and then in the next line 'By Discount Allowed A/c' and show the respective amounts in the Amount column. See the posting of this compound journal entry as given below:

Cash Account

2018 May 31	To Mohan	Rs. 950			

Discount Allowed Account

2018 May 31	To Mohan	Rs. 50			

Mohan's Account

			2018 May 31 " 31	By Cash A/c By Discount Allowed A/c	Rs. 950 50

Alternatively, in Mohan 's Account we can simply write 'By Sundries' in Particulars column and show full amount in the Amount column.

The above example should help you to also correctly post a compound journal entry where one account has been debited and two or more accounts have been credited, or where many accounts have been debited and many accounts have been credited.

Check Your Progress E

1. What is Ledger?

   ....

   ....

   ....

2. What is posting?

   ....

   ....

   ....

3. State whether each of the following statements is **True** or **False**.

   a) Posting is done in the journal.

   b) Posting will be made on the debit side of an account which had been debited in the journal.

   c) The word 'To' is used with the name of an account while making posting on the credit side of an account.

   d) No narration is written while posting into ledger accounts.

   e) Every journal entry will be posted only into those accounts which have been debited in the journal.

   f) Compound journal entry is posted to more than two accounts.

5.13 BALANCING LEDGER ACCOUNTS

In the above illustration, you have seen that many transactions are likely to involve a particular account, and there are a number of entries on both sides of an account. At the end of a day, a week or a month, it would be necessary to know the net effect of various transactions entered in an account. For example, it would be important and useful to know as to what is still due from a customer. We can get this information by working out the difference between the total of debit entries and the total of credit entries in customer's account. This process is termed as 'balancing of an account. For example, look at the Pankaj's Account in illustration 14. You find that there are two transactions, one on each side. Pankaj has been debited with Rs. 10,000 for credit sales to him, and credited by Rs. 4,000 for the amount paid by him. The difference between the amount debited and the amount credited is Rs. 6,000. This amount of Rs. 6,000 is the 'balance' in his account which he still owes to the business. Where the debit side total is more than the credit side total, as in this case, it is called a debit balance. It is shown, in particulars column, on the credit side by writing 'By

Balance c/d' and totals on both sides made equal. After totaling the two sides of the account, the same balance is shown on the debit side, on the next date, by writing 'To Balance b/d' in particulars column. The term c/d is an abbreviation for carried down and b/d is for brought down. Such balancing of accounts is done periodically, say, daily (as in the case of cash account), weekly, monthly or at any other convenient time, as and when needed.

Let us see the balancing of Pankaj's Account.

Pankaj's Account

Dr. Cr.

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F. Rs.	Amount
2018 April 6	To Sales A/c		10,000	2018 April 25	By Cash A/c		4,000
				" 30	By Balance c/d		6,000
			10,000				10,000
May 1	To Balance b/d		6,000				

In another situation, the total of the credit side may be more than the total of the debit side. In that case, it will be called credit balance. It will be shown on the debit side by writing 'To Balance c/d' in particulars column and the totals of the two sides made equal. After totalling the two sides of the accounts, the same balance will be shown on the credit side on the next date, by writing 'By Balance b/d' in particulars column.

Let us now explain the procedure of balancing an account stepwise.

1. Total both the amount columns (debit and credit) and ascertain the difference in two totals (use a separate rough sheet for this purpose). If there is no difference between the totals of the two sides, it means there is nil balance on this account. This means, the account is closed. However, if there is some difference in the two totals, such difference is called the 'balance'. **If the debit side total is more than the credit side total (as in Pankaj's Account), the difference is called debit balance. If, on the other hand, the total of the items on the credit side is greater than the total of the debit side, the difference is called credit balance.**

2. Put the difference between the two sides on the side showing a smaller total.

3. Enter the date on which balancing is being done, in the date column. Note that balancing is not a transaction, as this does not involve any transfer between two accounts.

4. If the balance is entered on the debit side, then write in particulars column 'To Balance c/d'. In case, the balance is entered on the credit side, write in particulars column 'By Balance c/d' (c/d stands for carried down).

5. Now total both the amount column. There might be more entries on one side, as compared to the other. Even then, the totals must be written on the same horizontal line. Draw one line across both the amount columns, on the same horizontal line. Draw one line across both the amount columns, on the same

horizontal line. Put the totals on both the sides, which will now be identical and then draw line immediately beneath the totals.

6. The closing balance (which was carried down) has now to be brought down on the side which was showing the bigger total. In other words, at the beginning of the next period, the debit balance is shown on the debit side and credit balance on the credit side of the account. It is called opening balance, The balance brought down is usually given the date following the balance date. After entering the date in the date column, if the balance brought down is on the debit side, write 'To Balance b/d' in particulars column. Similarly, if the balance brought down is on the credit side, write 'By Balance b/d' (b/d stands for brought down), particulars column. Suppose an account was balanced on June 30, and the closing balance was entered on the credit side as 'By Balance c/d'. On July 1, this balance would be entered on the debit side as 'To Balance b/d' below the total.

You have now understood the method of balancing an account. Usually a page is allotted to an account and all transactions affecting that account are posted there. Sometimes, when transactions are numerous, more number of pages can be set apart for such an account. When the balance is proposed to be brought down on the same page, then the abbreviations, c/d and b/d are used. However, when there is not much space in the same page, and the balance has to be carried forward either to the next page, or some other page, the abbreviations 'c/f' (carried forward) and 'b/f' (brought forward) are used in place of 'c/d' and 'b/d'. The page numbers are entered in the Folio columns to show as to where the balance has been carried forward and from where it has been brought forward.

Sometimes, there may be no difference between the totals of the two sides. In such cases, there will be no closing balance and no opening balance. However, to signify that the balancing has been done, totals are entered on both the sides and the account is closed.

Now let us take up comprehensive illustration and reinforce what you have learnt so far regarding journalising, posting into ledger and balancing the accounts.

Illustration 15

Journalise the following transactions, post them into ledger and balance the accounts:

2018		Rs.
March 1	Ashok commenced business with cash	1,20,000
" 2	Purchased furniture for cash	24,000
" 2	Purchased goods from Vijay	36,000
" 3	Sold goods	4,800
" 4	Paid rent	3,000
" 6	Sold goods to Arun	9,000
" 7	Arun returned goods	450
" 10	Bought goods from Dinesh	24,000
" 11	Returned goods to Dinesh	600
" 14	Paid for advertising	1,500

“	15	Paid for stationery	300
“	17	Drew for personal use	2,400
“	20	Cash Sales	9,600
“	21	Received from Arun	2,550
“	23	Paid to Vijay	12,000
“	24	Sold goods to Sanjay	15,000
“	28	Cash sales	6,000
“	31	Paid salaries	6,000
“	31	Paid municipal taxes	1,200
“	31	Paid printing charges	1,500

Solution:

JOURNAL

Date	Particulars	L. F.	Dr. Amount	Cr. Amount
2018			Rs.	Rs.
March 1	Cash Account Dr		1,20,000	
	To Capital Account			1,20,000
	(being Capital brought in)			
“ 2	Furniture Account Dr.		24,000	
	To Cash Account			24,000
	(Being furniture purchased)			
“ 2	Purchases Account Dr.		36,000	
	To Vijay’s Account			36,000
	(Being credit purchases)			
“ 3	Cash Account Dr.		4,800	
	To Sales Account			4,800
	(Being cash sales)			
“ 4	Rent Account Dr.		3,000	
	To Cash Account (Being rent paid)			3,000
“ 6	Arun’s Account Dr.		9,000	
	To Sales Account			9,000
	(Being credit sales)			
“ 7	Returns Inwards Account Dr.		450	
	To Arun’s Account			450
	(Being goods returned by Arun)			
“ 10	Purchases Account Dr.		24,000	
	To Dinesh’s Account			24,000
	(Being credit purchases)			
“ 11	Dinesh’s Account Dr.		600	
	To Returns Outwards Account			600
	(Being goods returned to Dinesh)			

" 14	Advertising Account Dr. To Cash Account (Being the amount paid for advertising)		1,500	1,500
" 15	Stationary Account Dr. To Cash Account (Being the payment for stationery)		300	300
" 17	Drawings Account Dr. To Cash Account (Being cash withdrawn for Personal use)		2,400	2,400
" 20	Cash Account Dr. To Sales Account (Being cash sales)		9,600	9,600
" 21	Cash Account Dr. To Arun's Account (Being the amount received from Arun)		2,550	2,550
" 23	Vijay's Account Dr. To Cash Account (Being the amount paid to Vijay)		12,000	12,000
" 24	Sanjay's Account Dr. To Sales Account (Being credit sales)		15,000	15,000
" 28	Cash Account Dr. To Sales Account (Being Cash sales)		6,000	6,000
" 31	Salaries Account Dr. To Cash Account (Being salaries paid)		6,000	6,000
" 31	Municipal Taxes Account Dr. To Cash Account (Being municipal taxes paid)		1,200	1,200
" 31	Printing Charges Account Dr. To Cash Account (Being Printing charges paid)		1,500	1,500

LEDGER

Cash Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		Rs.	2018		Rs.
March 1	To Capital A/c	1,20,000	March 2	By Furniture A/c	24,000
March 3	To Sales A/c	4,800	March 4	By Rent A/c	3,000
March 20	To Sales A/c	9,600	March 14	By Advertising A/c	1,500
March 21	To Arun A/c	2,550	March 15	By Stationery A/c	300

" 28	To Sales A/c	6,000	" 17	By Drawings A/c	2,400
			" 23	By Vijay A/c	12,000
			" 31	By Salaries A/c	6,000
			" 31	By Municipal Tax A/c	1,200
			" 31	By Printing Charges A/c	1,500
			" 31	By Balance c/d	91,050
		1,42,950			1,42,950
Apr. 1	To Balance b/d	91,050			

Sales Account

2018		Rs.	2018		Rs.
Mar. 31	To Balance c/d	44,400	Mar.3	By Cash A/c	4,800
			" 20	By Arun A/c	9,000
			" 24	By Cash A/c	9,600
			" 28	By Sanjay A/c	15,000
		44,400		By Cash A/c	6,000
					44,400
			Apr. 1	To Balance b/d	44,400

Arun's Account

2018		Rs.	2018		Rs.
Mar. 6	To Sales A/c	9,000	Mar. 7	By Returns Inwards	450
			" 21	By Cash A/c	2,550
			" 31	By Balance c/d	6,000
		9,000			9,000
Apr. 1	To Balance b/d	9,000			

Return Inward Account

2018		Rs.	2018		Rs.
Mar. 7	To Arun A/c	450	Mar. 31	By Balance c/d	450
Apr. 1	To Balance b/d	450			

Dinesh Account

2018		Rs.	2018		Rs.
Mar.11	To Return Outward A/c	600	Mar. 10	By Purchase A/c	24,000
" 31	To Balance c/d	23,400			24,000
		24,000	Apr. 1	By Balance b/d	23,400

Return Outward Account

2018		Rs.	2018		Rs.
Mar.31	To Balance c/d	600	Mar.11	By Dinesh's	600
			Apr. 1	By Balance b/d	600

Advertising Account

2018		Rs.	2018		Rs.
Mar.14	To Cash A/c	1,500	Mar. 31	By Balance c/d	1,500
Apr. 1	By Balance b/d	1,500			

Capital Account

2018		Rs.	2018		Rs.
Mar. 31	To Balance c/d	1,20,000	Mar. 1	By Cash A/c	1,20,000
			Apr. 1	By Balance b/d	1,20,000

Furniture Account

2018		Rs.	2018		Rs.
Mar. 2	To Cash A/c	24,000	Mar. 31	By Balance c/d	24,000
Apr. 1	To Balance b/d	24,000			

Purchase Account

2018		Rs.	2018		Rs.
Mar. 2	To Vijay's A/c	36,000	Mar. 31	By Balance c/d	60,000
" 10	To Dinesh's c/d	24,000			
		60,000			
Apr. 1	To Balance b/d	60,000			

Vijay's Account

2018		Rs.	2018		Rs.
Mar. 23	To Cash A/c	12,000	Mar. 2	By Purchase A/c	36,000
" 31	To Balance c/d	24,000			36,000
		36,000	Apr. 1	To Balance b/d	24,000

Rent Account

2018		Rs.	2018		Rs.
Mar. 4	To Cash A/c	3,000	Mar. 31	By Balance c/d	3,000
Apr. 1	To Balance b/d	3,000			

Stationery Account

2018		Rs.	2018		Rs.
Mar.15	To Cash A/c	300	Mar. 31	By Balance c/d	300
Apr. 1	To Balance b/d	300			

Drawings Account

2018		Rs.	2018		Rs.
Mar.17	To Cash A/c	2,400	Mar. 31	By Balance c/d	2,400
Apr. 1	To Balance b/d	2,400			

Sanjay's Account

2018		Rs.	2018		Rs.
Mar.24	To Sales A/c	15,000	Mar.31	By Balance c/d	15,000
Apr. 1	To Balance b/d	15,000			

Salaries Account

2018		Rs.	2018		Rs.
Mar.31	To Cash A/c	6,000	Mar.31	By Balance c/d	6,000
Apr. 1	To Balance b/d	6,000			

Municipal Taxes Account

2018		Rs.	2018		Rs.
Mar.31	To Cash A/c	1,200	Mar.31	By Balance c/d	1,200
Apr. 1	To Balance b/d	1,200			

Printing Charges Account

2018		Rs.	2018		Rs.
Mar.31	To Cash A/c	1,500	Mar. 31	By Balance c/d	1,500
Apr. 1	To Balance b/d	1,500			

Note : Nominal Accounts are balanced for the purpose of preparing the Trial Balance which is being explained in the next section.

5.14 SIGNIFICANCE OF BALANCE

You have learnt that the 'balance in an account signifies the net effect of all transactions related to it during a given period. It may be a debit balance or a credit balance or a nil balance depending upon whether the debit or the credit total is higher. Let us now understand the significance of a balance in respect of the various types of accounts in the ledger.

Personal Accounts

Personal accounts are more frequently balanced as compared to any other class of accounts. Balance in a personal account indicates whether the party concerned owes to the business or the other way round. When it shows a debit balance, it means that the party owes that amount to the business. In other words, he is a debtor to the business. Similarly, when it shows a credit balance, it would mean that the business owes that amount to him i.e., he is creditor of the business if however, the account shows a nil balance, it means that the account has been cleared, nothing is due to him or due from him.

Real Accounts

Real accounts are normally balanced at the end of the accounting period primarily for the purpose of preparing the final accounts. The cash account, however, is balanced everyday because the actual cash is to be verified and confirmed with the closing balance shown by CashAccount. All real accounts show a debit balance as there are assets (property) accounts.

Nominal Accounts

Nominal accounts are not usually balanced, but closed by transfer to Profit and Loss Account, at the time of preparing the final accounts (at the end of the accounting period). However, to start with, for the purpose of understanding the procedure involved, nominal accounts have also been balanced. Even otherwise, the difference between the debit side and credit side totals have to be worked out for preparing the trial balance (you will learn about the trial balance later). The accounts which relate to expenses or losses will show a debit balance; whereas those relating to incomes and gains will have a credit balance. This is because all expenses and losses are debited and all incomes and gains are credited.

Check Your Progress F

1. Why do you balance an account ?

   ....

   ....

   ....

2. Explain the procedure for balancing a ledger account.

   ....

   ....

   ....

3. Name the types of accounts that are balanced.

   ....

   ....

   ....

5.15 POSTING AN OPENING ENTRY

So for, you have learnt about the opening entry which is passed in the journal for all assets and liabilities brought from the previous year. The posting of the opening entry is very different from the posting of other journal entries. We open the concerned accounts in the new ledger for all items that appear in the opening entry. Then, in the accounts which have been debited in the opening entry we shall write 'To Balance b/f in the Particulars column on the debit side of those accounts and show the respective amount in the Amount column. Similarly, in the accounts that have credited in the opening entry, we shall write 'By Balance b/f in the particulars column on the credit side of those accounts and show the respective amount in the Amount column. Thus, the posting is complete.

As a matter of fact, the account which have been debited or credited in the opening entry merely represent the closing balances of various personal and real accounts from the previous year. These are now entered in the ledger accounts of the current year as opening balances through the opening entry. Illustration 16 should help you to understand the posting of the opening entry.

Illustration 16

Post the following opening entry into ledger:

2018			Rs.	Rs.
Jan. 1	Cash A/c	Dr.	5,000	
	Stock A/c	Dr.	20,000	
	Furniture A/c	Dr.	2,000	
	Shah & Co.	Dr.	2,000	
	Prem Chand	Dr.	1,500	
	To Ramesh Lal			3,000
	To Rakesh			1,000
	To Capital A/c			26,500
	(Being and opening entry for assets and liabilities b/f from last year)			

Solution :

Cash Account

2018		Rs.			
Jan. 1	To Balance b/f	Rs.5,000			

Stock Account

2018		Rs.			
Jan. 1	To Balance b/f	20,000			

Furniture Account

2018		Rs.			
Jan. 1	To Balance b/f	2,000			

Shah's Account

2018		Rs.			
Jan. 1	To Balance b/f	2,000			

Prem Chand's Account

2018		Rs.			
Jan. 1	To Balance b/f	1,500			

Ramesh Lal's Account

			2018		Rs.
			Jan. 1	By Balance b/f	3,000

Rakesh's Account

			2018		Rs.
			Jan. 1	By Balance b/f	1,000

Capital Account

			2018		
			Jan. 1	By Balance b/f	26,500

5.16 LET US SUM UP

1. The journal is the book of prime entry in which all business transactions must be carried first. Each transaction is analysed so that the two-fold aspect of each transaction is clearly presented in the form of a 'Journal Entry'.

2. While journalising the transaction, it is necessary to remember the difference between the treatment of cash and credit transaction, as it is necessary to decide whether the personal account of the party concerned is to be involved or not.

3. Entries relating to Goods Account are made in five separate accounts depending upon the nature of the transactions. These accounts are:

   (i) Purchase Account, (ii) Sales Account, (iii) Purchase Returns Account, (iv) Sales Returns Account, and (v) Stock Account.

4. A compound journal entry is one where two or more accounts receive the debit (or the credit, as the case may be) and the corresponding credit (or the debit, as the case may be) is given to the other account (or accounts).

5. An opening entry is one which is passed at the beginning of the year to bring forward the previous year's balances of assets and liabilities.

6. Ledger'is a book which contains all the accounts affected by various transactions.

7. Journal by itself does not help us to know the net effect on the various transactions affecting a particular account. Hence, all journal entries are posted into ledger accounts.

8. Posting is made on the debit side of the accounts which have been debited in the journal, and the credit side of the accounts which have been credited in the journal.

9. As various transactions are posted to different accounts during a particular period of time, it is necessary to ascertain the net effect of all the posting made. This is done by balancing an account.

5.17 KEY WORDS

Balance: The difference between the total of debits and total of credits appearing in an account. It signifies the net effect of the transactions posted to that account.

Compound Entry: A journal entry involving more than two accounts.

Journal: A book of original entry where achronological record of transactions is first made.

Journal Entry: An entry made in the journal.

Journalising: The process of recording the business in the journal.

Ledger: A book which contain all accounts affected by various transactions in business.

Opening Entry: A journal entry passed at the beginning of the year to bring forward the previous year's assets and liabilities.

Posting: A process of entering transactions into ledger accounts.

5.18 ANSWERS TO CHECK YOUR PROGRESS

A 1. a) True b) True c) False d) False e) True

B 2. a) Credit b) Cash c) Credit d) Cash e) Credit f) Cash g) Credit h) Cash

C 2. a Capital A/c

b) Furniture A/c

c) Returns Outwards A/c

d) Wages A/c

e) Loan from Krishna A/c

f) Bank A/c

g) Discount Allowed A/c

h) Bad Debts A/c

5. Credit to Bad Debts Recovered A/c

D 2. a) More than two accounts

b) the same date

c) two or more accounts

d) two or more accounts

e) liabilities

3. Rs. 23,000

E 3. a) False b) True c) False d) True e) False f) True

5.19 TERMINAL QUESTIONS/EXERCISES

Questions

1. Give the form of journal.
2. What is a journal entry?
3. Explain the steps to be followed in journalising.
4. What is narration?
5. Explain as to why the journal is called a book of original entry.
6. What is a compound journal entry? Give examples.
7. What is an opening entry? Show how is it recorded?
8. Explain the rules regarding posting of journal entries into ledger accounts.
9. What is Balancing an Account? Explain how an account is balanced?

Exercises

1. Journalise the following transactions:

2018		Rs.
Feb. 1	Purchased goods for cash	18,000
" 2	Purchased goods on credit from Mithun	37,000
" 5	Sold goods to Mahesh	10,000
" 8	Cash sales	8,000
" 9	Cash sales to Jayant	7,000
" 11	Returned goods to Mithun	4,000
" 12	Mahesh returned goods	1,000

2. Give journal entries to record the following transactions:

2018		Rs.
March 1	Purchased furniture from Jay for cash	38,000
" 2	Bought plant and machinery on credit from Satish	1,10,000
" 5	Sale of old furniture	1,800
" 6	Paid to Raman	3,700
" 8	Received from Suresh	2,500
" 11	Paid salaries	1,500
" 13	Purchased stationery	250
" 15	Paid rent	2,250
" 17	Received commission	400

3. Journalise the following transactions :

2018		Rs.
April 1	Tarun started business with Cash	8,00,000
" 2	Bought plant and machinery	1,00,000
" 2	Bought furniture from Naveen	50,000
" 3	Purchased typewriter	3,000
" 4	Purchased goods	70,000
" 6	Paid wages	8,000
" 8	Bought loose tools	3,000
" 9	Cash Sales	15,000
" 10	Sales to Anil	20,000
" 12	Paid wages	8,000
" 13	Purchased goods from Uday	40,000
" 15	Returned goods to Uday	2,000
" 18	Purchased stationery	400
" 20	Bought postage stamps	150
" 23	Paid insurance premium	600
" 25	Paid miscellaneous charges	600
" 26	Paid printing charges	500
" 29	Paid salaries	20,000
" 30	Paid to Naveen	25,000

4. The following are the transactions of Gurunath for the month of January. Journalise the transactions:

2018		Rs.
Jan 1	Cash paid into bank	20,000
" 2	Bought stationery	100
" 3	Bought goods for cash	8,500
" 4	Sold goods for cash	4,500
" 5	Bought office furniture from Pramod & Bros. and paid Rs. 100 as cartage	2,500
" 6	Sold goods to Maneesh	3,000
" 8	Received cheque from Maneesh	3,000
" 9	Paid Pramod & Bros. by cheque	1,500
" 11	Sold goods to Anil	2,500
" 15	Bought goods from Sinha & Co.	3,000
" 16	Bought goods for cash	1,000
" 19	Sold goods to Praveen	1,300
" 22	Received from Praveen Rs. 1,250 in full ettlement of his account	1,250
" 24	Paid salaries	2,000
" 26	Drew for private expenses	1,000
" 31	Paid rent	1,000

5. Journalise the following transactions and post them into the Ledger.

2018		Rs.
Jan. 1	Manoj commenced business with cash	48,000
" 2	Deposited into bank	36,000
" 3	Purchased goods for cash	2,000
" 4	Bought furniture for office use	5,600
" 10	Drew from Bank for office use	4,000
" 13	Goods sold to Rahul	2,400
" 15	Bought goods from Anil	1,600
" 18	Paid trade expenses	400
" 19	Received cash from Rahul	2,400
" 25	Paid wages	200
" 28	Paid Anil in full settlement	1,590
" 30	Paid rent	400
" 31	Interest on capital	400

6. Enter the following transactions in the journal of Harnath and post them into the Ledger.

2018		Rs.
Feb. 1	Commenced business with cash	60,000
" 2	Bought goods from Madhan	30,000
" 2	Purchased fittings for cash	4,800
" 2	Sold goods to Chetan	9,600
" 3	Paid Madhan on account	18,000
" 4	Sold goods to Pradeep	12,000
" 5	Received cheque from Chetan in full settlement of his account	9,550
" 6	Paid wages	480

"	8	Bought goods for cash	3,600
"	9	Sold goods to Ravi	20,400
"	10	Purchased goods from Promod	15,600
"	11	Paid Madhan in final settlement	12,000
"	12	Paid carriage on goods sold	240
"	13	Paid wages	480
"	14	Bought goods from Mahesh	18,000
"	16	Sold goods to Shyam	21,600
"	17	Shyam paid on account	24,000
"	18	Purchased goods from Hareesh	9,000
"	19	Sold goods for cash	9,600
"	20	Paid wages	480
"	21	Sent cheque to Hareesh	9,000
"	22	Sold goods to Sunil	15,600
"	23	Bought goods from Amar	28,800
"	24	Bought goods for cash	8,400
"	25	Sent cheque on account to Amar	28,000
"	26	Received from Sunil on Account	15,600
"	27	Paid wages	500
"	28	Paid rent	1,100

7. Enter the following transactions in journal, and post them into the ledger.

2018		Rohan commenced his business with the following assets.	Rs.
Mar. 1		Plant and Machinery	1,00,000
		Stock	36,000
		Furniture	26,000
		Cash	2,500
		His transactions for the month were	
"	2	Sold goods to Sanjay	16,000
"	3	Bought goods from Murari	26,000
"	4	Sanjay paid cash	10,000
"	6	Returned damaged goods to Murari	720
"	10	Paid Murari on account	11,280
"	15	Bought goods from Govind	21,600
"	18	Sold goods to Krishna	30,000
"	20	Received cash from Krishan	24,000
"	20	Krishna returned damaged goods	1,600
"	26	Paid to Govind	14,400
"	31	Paid salaries	3,000
"	31	Paid rent	1,000

5.20 SOME USEFUL BOOKS

Grewal T.S. Double Entry Book-Keeping (New Delhi: Sultan Chand & Sons, 2018)

Maheshwari, S.N. Principles and Practice of AccountancyPart-I (New Delhi: Arya Book Depot, 2018)

Patil, V.A. &Korlahalli, S. Principles and Practiceof Book-Keeping (Ne 36 Delhi: R. Chand & Co., 2018)

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 6 SUBSIDIARY BOOKS

Structure

6.0 OBJECTIVES

After studying this unit, you should be able to:

- appreciate the need for special journals;
- sub-divide the journal into various special journals;
- identify the type of transactions recorded in special journal;
- prepare simple cash book and balance it;
- post cash book entries into ledger;
- prepare cash book with discount column;
- post discount column entries into ledger;
- describe imprest system;
- prepare petty cash book and post it into ledger;
- describe the functions of a bank;
- explain the advantages of opening a bank account;
- describe how to open bank account;
- explain the functions of pay-in-slip book, cheque book and the pass book;
- appreciate the importance of crossing and endorsement;
- record banking transactions in a three column cash book;
- post three column cash book into ledger;
- prepare purchases and purchases returns journals and post them into ledger;
- prepare sales and sales returns journals and post them into ledger;
- prepare bills books and post them into ledger; and
- state various transactions recorded in journal proper.

6.1 INTRODUCTION

You learnt how to record the business transactions in journal and then post them into ledger. You know that journal is a book of prime entry in which all transactions are to be recorded first. But, in practice, the number of transactions happens to be so large that it becomes difficult to record them in one book. Hence, the journal is sub-divided into a number of special journals, called subsidiary books. In this unit, you will learn about the most important subsidiary book called Cash Book. We shall discuss various types of cash books, study how transactions are recorded in the Single Column Cash Book, Two Column Cash Book and Three Column Cash Book and how they are posted into ledger. You shall also learn about the Imprest System and the preparation, posting and balancing of Petty Cash Book.

Further, you will learn how to record cash transactions in Single Column Cash Book, Two Column Cash Book and Three Column Cash Book and post them into ledger. In three column cash book, we have an additional column for banking transactions. As a prelude, we shall first discuss how to open an account in a bank, the advantages of opening a bank account, the functions of pay-in-slip, cheque book and pass book, and the importance of crossing and endorsement of cheques. Then, we shall learn how various transactions with a bank are recorded in the Three Cash Book and posted into ledger.

In this unit, we also intend to take up the books like: (i) Purchases Journal, (ii) Purchases Returns Journal, (iii) Sales Journal (iv) Sales Returns Journal, (v) Journal Proper. You will also learn how transactions are recorded in each of these books and how they are posted into ledger.

6.2 NEED FOR SUB-DIVISION OF JOURNAL

The system of having only one book of prime entry may work for a small organisation where the number of transactions is usually small. But, when the number of transactions are large, it is practically impossible to record all the transactions through one journal. It is because:

i) the journal can be handled by only one person and the work becomes too heavy for him;

ii) the transactions may not be recorded promptly, as all transactions have to be recorded in the same book; and

iii) the journal becomes bulky and voluminous.

In order to overcome these difficulties and to facilitate speedy recording of various transactions, the journal is sub-divided into a number of special journals called ‘Subsidiary Books’.

6.3 SUBSIDIARY BOOKS

Before we list various books into which the journal is sub-divided, let us understand the basis for its sub-division. You may adopt any basis. But, the principle generally followed is that transactions of the same nature are to be recorded at one place. For example, the cash receipts and cash payments may be grouped into one category and recorded in a separate book. Similarly, all credit purchases of goods may be grouped into one category, all credit sales of goods into another category and recorded in separate books.

In practice, the journal is sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number. In any large business, the following subsidiary books are generally used.

1. **Cash Book:** It is used for recording all receipts and payments of cash, including cash purchases and cash sales of goods.

2. **Purchases Journal:** It is used for recording credit purchases of goods only.

3. **Purchases Returns Journal:** It is used for recording goods returned to suppliers.

4 **Sales Journal:** It is used for recording credit sales of goods only.

5. **Sales Returns Journal:** It is used for recording goods returned by the customers.

6. **Bills Receivable Journal:** It is used for recording bills of exchange and promissory notes received from the debtors.

7. **Bills Payable Journal:** It is used for recording bills of exchange and promissory notes accepted by the business in favour of creditors.

8. **Journal Proper:** This book is used for recording all such transactions which are not covered by any of the above mentioned special journals, for example, credit purchases of fixed assets, opening entry, rectification entries, etc.

It must, however, be noted that there is no rigidity as to the number of special journals. Depending on the necessity, the number of journals may be increased or decreased.

6.4 ADVANTAGES OF SUBSIDIARY BOOKS

The following are the advantages of having a number of subsidiary books:

i) **Classification of transactions becomes automatic:** As there is a separate book for each type of transactions, the transactions of same nature are automatically. Brought at we place. For example all credit purchase of goods are recorded in the purchses book.

ii) **Reference becomes easy:** If any reference is required, it can be traced easily by referring to the appropriate subsidiary book. You do not have to go through all the transactions recorded in the journal.

iii) **Facilitates division of work:** The division of journal into various subsidiary books facilitates division of work among many persons. This, in turn, facilitates prompt recording of transactions and saves a lot of time.

iv) **More particulars:** More details about the transactions can be given in subsidiary books than would be possible in one book.

v) **Responsibility can be fixed:** The work of maintaining a particular book can be entrusted to a particular person. He will be responsible for keeping it up-to-date and in order.

vi) **Facilitates checking:** When the Trial Balance does not agree, the location of errors will be relatively easy.

Check Your Progress A

1. Write the number of correct alternative in the box.

   a) A separate journal is kept for

      i) each transaction

      ii) each type of transactions

      iii) each type of transactions which are repetitive in nature and sufficiently large in number

   b) Cash Book contains

      i) all receipts and payments of cash

      ii) all receipts only

      iii) all payments only

   c) Journal Proper is meant for recording

      i) credit purchase of fixed assets

      ii) return of goods

      iii) all such transactions for which no special journal has been kept by the business

   d) Purchases Journal is kept to record

      i) all purchases of goods

      ii) all credit purchases of goods

      iii) all credit purchases

   e) Sales Journal is used to record

      i) cash sales

      ii) credit sales of assets

      iii) credit sales of goods

6.5 CASH BOOK

Having outlined various subsidiary books, we shall now discuss the most important subsidiary book called 'Cash Book'. In any business there would be numerous cash transactions which involve either receipts or payments of cash. Cash sales, receipt of cash from debtors, cash purchases, payments to creditors, payment of various expenses such as salaries, wages, rent, taxes, etc., are some examples of transactions involving cash. All these are recorded in cash book, receipts on one side and payments on the other.

Every business unit, small or big, maintains a cash book. It enables the businessman to know and verify the amount of cash in hand from time to time. As a matter of fact, cash book plays a dual role. It is a book of prime entry and also serves the purpose of a Cash Account. It is designed in the form of a ledger account and records cash receipts on the debit side and payments on credit side. It is also balanced in the same way. Hence, when cash book is maintained, there is no need to have a Cash Account in the ledger.

There are different types of cash books maintained by the business. These are:

1. Simple or Single Column Cash Book
2. Two or Double Column Cash Book
3. Three or Triple Column Cash Book

We shall now consider them one by one and learn how they are prepared and posted into ledger.

6.6 SINGLE COLUMN CASH BOOK

Look at the proforma of a Single Column Cash Book shown in Figure 6.1. Doesn't it look like a ledger account? Yes, it does. In fact a Single Column Cash Book is nothing but a Cash Account. It is used for recording all cash receipts and cash payments and serves the purpose of Cash Account as well. It is called Single Column Cash Book just because it has only one amount column on each side.

Single Column Cash Book

Dr. Cr.

Date	Particulars	L.F.	Amount	Date	Particular	L.F.	Amount
			Rs.				Rs.
	To (write the name of the account to be credited)				To (write the name of the account to be debited)		

Fig. 6.1

6.6.1 Recording in Single Column Cash Book

You know that Cash Account is a real account. According to rules, Cash Account is to be debited when cash is received and credited when cash is paid. Hence, the debit side of the cash book is used for recording all cash receipts and the credit side for all cash payments. Let us now discuss how entries are made in this book.

As explained above, whenever cash is received, it is to be recorded on the debit side. The date on which it is received is recorded in the date column. The name of the account from which it is received is mentioned in the particulars column. In the L.F. (Ledger Folio) column the page number of the account in the ledger, where the posting is made, is to be recorded at the time of posting. The amount column is meant for recording the amount received. Similarly, whenever cash is paid, it is recorded on the credit side. Here, in particulars column, we write the name of the party to whom payment is made, and complete the other columns in the same manner as on the debit side.

6.6.2 Posting the Single Column Cash Book

As said earlier, Cash Book also serves the purpose of a Cash Account, so there is no need to open a Cash Account in the ledger. When a cash transaction is recorded in the cash book, posting of the cash aspect of the transaction in Cash Account stands fully covered. What remains to be posted is the other aspect of the transaction. The posting of this aspect will complete the double entry. The rules of posting therefore are:

i) for all transactions entered on the debit side of the cash book, credit the concerned accounts in the ledger individually by writing 'By Cash Account'.

ii) for all transactions entered on the credit side, debit the concerned accounts in the ledger individually by writing 'To Cash Account'.

Thus, the posting into the ledger accounts is completed. Note that the transactions entered on the debit side of the cash book are to be posted on the credit side of the accounts in the ledger and vice versa.

6.6.3 Balancing the Single Column Cash Book

You have already learnt how to balance a ledger account. The cash book is balanced just like any other ledger account. The cash book will always show a debit balance. This is because the cash payments can never exceed the amount of cash available. For example, if you have Rs. 10 in your pocket, can you pay Rs 15? You cannot. So the total of the debit side in the cash book will always be more than the total of the credit side. This difference indicates the cash in hand. It shall be entered on the credit side by writing 'By Balance c/d' in particulars column and showing the amount in the amount column. Now total the amount columns and you will find that the two sides are equal.

After closing the cash book, the balance is shown on the debit side by writing 'To Balance b/d'. It becomes the opening balance of cash for the next period. Note that the cash book shall generally show a debit balance and occasionally a nil balance. Look at illustration 1. It shows the recording, posting and balancing of a Single Column Cash Book.

Illustration 1

From the following particulars of M/s Naveen & Co., prepare a Simple Cash Book and balance the same. Also show postings into the ledger accounts.

2018			Rs.
July	1	Naveen started business with a capital of	25,000
"	2	Opened a bank account and deposited	20,000
"	5	Purchased goods for cash	3,000
"	6	Sold goods for cash	4,000
"	8	Purchased furniture	1,000
"	10	Purchased goods from Ramlal on credit	2,500
"	12	Sold goods to Chhotelal on credit	3,000
"	16	Sold goods for cash	1,000
"	17	Paid to Ramlal on account	2,500
"	19	Received from Chhotelal	2,000
"	22	Withdrawn cash from bank	3,000
"	25	Paid electricity bill	50
"	28	Paid rent to the landlord	350
"	31	Paid salary to the clerk	500

Solution:

Cash Book of Naveen & Co.

Dr. **Cr**

Date	Particular	I.F.	Amount	Date	Particular	I.F.	Amount
2018			Rs.	2018			Rs.
July, 1	To Capital A/c		25,000	July, 2	By Bank A/c		20,000
" 16	To Sales A/c		4,000	" 5	By Purchases A/c		3,000
" 19	To Sales A/c		1,000	" 8	By Furniture A/c		1,000
" 22	To Chhotelal		2,000	" 17	By Ramlal		2,500
	To Bank A/c		3,000	" 25	By Electricity Charges A/c		50
				" 28	By Rent		350
				" 31	By Salaries A/c		500
				" 31	By Balance c/d		7,600
			35,000				35,000
Aug.1	To Balance b/d		7,600				

Note: Transactions of July 10 and 12 are credit transactions. So they are not recorded in the cash book.

LEDGER

Capital Account

Dr. Cr.

			2018		Rs.
			July 1	By Cash A/c	25,000

Sales Account

			2018		Rs.
			July 6	By Cash A/c	4,000
			" 16	By Cash A/c	1,000

Chhotelal's Account

			2018		Rs.
			July 19	By Cash A/c	2,000

Bank Account

2018		Rs.	2018		Rs.
July, 2	To Cash A/c	20,000	July 22	By Cash A/c	3,000

Purchase Account

2018		Rs.			
July, 5	To Cash A/c	3,000			

Furniture Account

2018		Rs.			
July, 8	To Cash A/c	1,000			

Ramlal's Account

2018		Rs.			
July, 17	To Cash A/c	2,500			

Electricity Charges Account

2018 July, 25	To Cash A/	Rs. 50			

Rent Account

2018 July, 28	To Cash A/c	Rs. 350			

Salaries Account

2018 July, 31	To Cash A/c	Rs. 500			

Check Your Progress B

1. Fill in the blanks:

   a) All ……… … …………….transactions are recorded in the cash book.

   b) Cash receipts are recorded on the ……........………side of the cash book and cash payments are recorded on the .... side of the cash book.

   c) Cash book also serves the purpose of … …… ……….. ………………

   d) Transactions entered on the debit side of the cash book are to be posted on the ……………………….side of the accounts in the ledger.

   e) Cash book always shows a …………………………….balance.

   f) Cash book balance reflects ………………………………….in hand.

2. Why does cash book always show a debit balance?

   ....

   ....

   ....

6.7 TWO COLUMN CASH BOOK

Previously you learnt about the cash discount. When cash is received from a debtor, some discount may be allowed to him. Similarly, when payment is made to a creditor, some discount may be allowed by him. This is termed as Cash Discount and it has to be recorded in the books of account. While making compound journal entries for such transactions, you learnt that cash and discount go together. You know that receipts from debtors and payments to creditors are to be recorded in the cash book. Now the question arises as to how to record the cash discount. One method is to record the discount aspect separately in the journal. But this would be cumbersome, and the possibility of failing to record can also happen. Hence, accountants have developed a practice of recording the discount aspect in the cash book itself. For this, an extra amount column is added on both sides of the cash book. Look at the proforma shown in Figure 6.2. The discount allowed to debtors is recorded on the debit side and the discount received from creditors is recorded on the credit side. Thus, now there are two amount columns on both sides of the cash book, one for discount and the other for cash. It is called 'Two Column Cash Book'.

Two Column Cash Book

Dr. **Cr.**

Date	Particulars	L.F.	Discount Allowed	Cash	Date	Particulars	L.F.	Discount Received	Cash
			Rs.	Rs.				Rs.	Rs.

Fig. 6.2

6.7.1 Recording in Two Column Cash Book

Recording of cash transactions in a Two Column Cash Book is similar to Single Column Cash Book. As for cash discount, it is entered on the debit side if allowed to the debtor and on the credit side if received from the creditor. Study cash book entries for transactions of August 7 and 12 in illustration 2.

6.7.2 Posting the Two Column Cash Book

The entries in the cash columns of Two Column Cash Book are posted to the ledger accounts in the same way as we did in the case of Single Column Cash Book. The entries in the discount columns are also to be posted to the respective personal accounts. The entries in discount allowed column will be posted to the credit side of the respective personal accounts by writting 'By Discount Allowed A/c'. Similarly, the entries in the discount received column will be posted to the debit side of the respective personal accounts by writing 'To Discount Received A/c'. For example,

Cash received from Devi Traders Rs. 490, and discount allowed Rs. 10: This transaction will be entered in particulars column on the debit side of the cash book by writing 'To Devi Traders A/c'. An amount of Rs. 10 will be shown in discount allowed column and Rs. 490 in cash column. Its posting into Devi Traders' Account in the ledger will be made as follows:

Devi Traders Account

Dr.					Cr.
					Rs.
				By Cash A/c	490
				By Discount Allowed A/c	10

As for the transactions relating to cash, the double entry is complete as soon as postings have been made to the respective personal accounts. But it is not so for the discount aspect. The cash book does not serve the purpose of discount account. We have to open 'Discount Allowed Account' and 'Discount Received Account' in the ledger. The total of discount allowed columns on the debit side of the cash book is posted to the debit side of the 'Discount Allowed Account' in the ledger by writing 'To Sundries'. Similarly, the total of discount received column on the credit side of the cash book is posted to the credit side of the 'Discount Received Account' in the ledger by writing 'By Sundries'. This will complete the double entry in respect of discount allowed and discount received. Note that the postings in the two discount accounts are made only for the totals and not for the individual transactions. Thus, we save time and labour.

6.7.3 Balancing the Two Column Cash Book

In case of Two Column Cash Book, only the cash columns are balanced. Procedure is similar to Single Column Cash Book. The discount columns are not balanced, they are simply totalled. This is because the two discount columns relate to two separate accounts—the Discount Allowed Account and the Discount Received Account.

Study illustration 2 carefully. You will understand how transactions are recorded in the Two Column Cash Book and posted to the ledger accounts.

Illustration 2

From the following transactions of M/s. Joshi & Sons, prepare Cash Book and show the ledger postings:

2018		Rs.
Aug.1	Cash in hand	4,270
" 5	Purchased an old typewriter for	1,500
" 7	Received cash from Singh & Co. Rs. 1,980 and allowed discount of	20
" 10	Cash Sales	5,500
" 12	Paid to Ram Narain Rs. 2,970 and he allowed a discount of	30
" 14	Sold old newspapers for Rs. 60.	
" 16	Received from Prasad Rs. 985 in full settlement of his account for	1,000
" 18	Purchased goods worth from Sanjeev Bros. at a trade discount of 10% and paid cash.	2,000
" 20	Sold goods worth for cash at a trade discount of 5%.	1,000
" 24	Settled the account of Tiwari of by paying the necessary amount after deducting a discount of 3%.	500
" 30	Paid rent	500
" 30	Deposited in the bank the cash in excess of	1,490

Notes:

Solution :

Joshi & Sons
Cash Book (With Discount and Cash Columns)

Date	Particular	L.F.	Discount Allowed	Cash Rs.	Date	Particula	L.F.	Discount Received	Cash Rs.
2018			Rs.	Rs.	2018			Rs.	Rs.
Aug.1	To Balance b/d			4,270	Aug. 5	By Typewriter A/c			1,500
" 7	To Singh & Co.		20	1,980	" 12	By Rain Narain		30	2,970
" 10	To Sales A/c			5,500	" 18	By Purchases A/c			1,800
" 14	To Old News-papers A/c			60	" 24	By Tiwari		15	485
					" 30	By Rent A/c			500
" 16	To Prasad		15	985	" 30	By Bank A/c			5,000
" 20	To Sales A/c			950	" 31	By Balance c/d			1,490
			35	13,745				45	13,745
Sep. 1	To Balance b/d			1,490					

1. The cash in hand on August 1, 2018 is not a transaction but the balance brought down from the previous month. It has been shown on the debit side of the cash column as 'To Balance b/d'. No posting to any account is necessary for the balance.

2. The transactions of August 18 and 20 are recorded at net amounts i.e., after adjusting trade discount. Earlier you learnt that trade discount is not to be shown in the books.

3. Cash in excess of Rs 1,490 is deposited in the bank. It means the closing balance of cash is Rs 1,490. The actual difference between the debit and credit cash columns would work out at Rs 6,490. Hence, the amount deposited in the bank is Rs 5,000 (6,490-1,490).

LEDGER

Singh & Co. Account

Dr. **Cr.**

			2018		Rs.
			Aug. 7	By Cash A/c	1,980
			" 7	By Discount Allowed	20

Sales Account

			2018		Rs.
			Aug 10	By Cash A/c	5,500
			Aug. 20	By Cash A/c	950

Old Newspapers Account

			2018		Rs.
			Aug. 14	By Cash A/c	60

Prasad's Account

			2018		Rs.
			Aug. 16	By Cash A/c	985
			Aug. 16	By Discount Allowed	15

Typewriter Account

2018		Rs.			
Aug. 5	To Cash A/c	1,500			

Ram Narain's Account

2018		Rs.			
Aug. 12	To Cash A/c	2,970			
Aug. 12	To Discount Received A/c	30			

Purchases Account

2018		Rs.			
Aug. 18	To Cash A/c	1,800			

Tiwari's Account

2018		Rs.			
Aug. 24	To Cash A/c	485			
Aug. 24	To Discount Received	15			

Rent Account

2018		Rs.			
Aug. 30	To Cash A/c	500			

Bank Account

2018		Rs.			
Aug. 30	To Cash A/c	5,000			

Discount Allowed Account

2018		Rs.			
Aug. 31	To Sundries A/c	35			

Discount Received Account

			2018		Rs.
			Aug. 31	By Sundries A/c	45

Check Your Progress C

1. How are the cash discount transactions normally recorded in the Cash Book?

   ....

   ....

   ....

2. A few statements are given below. Mention against each whether it is **True** or **False.**

   a) Trade discount is not recorded in the books of account. ....

   b) Cash discount can be recorded through Journal or through Cash Book ....

   c) Two Column Cash Book has an extra column for discount on the debit side. ....

   d) No posting is required in personal accounts for cash discount ....

   e) Discount columns in the Cash Book are not balanced, they are merely totalled. ....

3. How do you post entries from the discount allowed and discount received columns to the Discount Allowed Account and Discount Received Account in the ledger?

   ....

   ....

6.8 PETTY CASH BOOK

In every business, there will be numerous small payments in cash such as payments for postage, telegrams, stationery, cartage, conveyance, entertaining the customers, minor repairs, etc. If all these petty payments are recorded in the cash book along with other payments, the cash book will be overloaded. Hence, a separate book called 'Petty Cash Book' is maintained for recording all such small (petty) payments. A person called petty cashier is entrusted with the work of making the small payments and maintaining the Petty Cash Book. The sum of money given to the petty cashier for making small payments is called petty cash.

6.8.1 Imprest System

Generally, Petty Cash Book is maintained on Imprest System. Under this system, an estimate is made of the amount required for petty payments for a certain period, say a week or a month. This amount is handed over to the petty cashier in advance. The petty cashier is required to obtain vouchers for all expenses he incurs. At the end of the period, the petty cashier presents the Petty Cash Book together with the vouchers to the chief cashier. The chief cashier verifies the entries in the Petty Cash Book and pays to the petty cashier a sum equal to the amount spent by him. The original amount of the petty cash with which the petty cashier had started is thus restored. This system of advance at the beginning and reimbursing the amount spent from time to time is called 'Imprest System'. For example, on June 1, Rs. 200 is given as advance for petty payments to the petty cashier. He spent Rs. 185 on various items during the month. The chief cashier, after verifying the expenses with the vouchers, would pay Rs 185 to him. Thus on July 1, the petty cashier would again have Rs. 200 (Rs. 185 paid by the chief cashier plus the old balance of Rs. 15), the imprest amount. This system provides an adequate check on petty payments.

6.8.2 Recording, Posting and Balancing the Petty Cash Book

Look at illustration 3. You will find only one column each for receipts, cash book folio, date, particulars, and voucher no. But, it provides a number of amount columns for recording the payments of various petty expenses. This facilitates the analysis of payments under different heads and their posting to appropriate expense account. The headings under which petty expenses are generally categorised are: (i) printing and stationery, (ii) postage and telegrams, (iii) cartage, (iv) conveyance (v) entertainment, and (vi) miscellaneous.

When the head cashier advances money to the petty cashier, either in cash or by cheque, an entry is made in the cash or bank column of the main cash book on the credit side by writing 'By Petty Cash A/c'. The petty cashier, on receiving the cash, records it in the particulars column of the Petty Cash Book by writing 'To Cash A/c' (if cash is received) or 'To Bank A/c' (if cheque is received) and enters the amount in receipts column. When he makes payments, each payment is entered in the particulars column by writing the name of expense incurred. The amount is first entered in the total payments column and then in the column specified for the concerned expense.

The Petty Cash book is balanced periodically, say weekly or monthly. The various expense accounts in the ledger are individually debited with the periodic totals (as per Petty Cash Book) by writing 'To Petty Cash A/c'. The Petty Cash Account in the ledger is credited with the total expenditure incurred during the period by writing By Sundries as per Petty Cash Book'. The Petty Cash Account is then balanced. It will normally have a debit balance which will be equal to the actual cash with the petty cashier. Illustration 3 shows recording in Petty Cash Book and its posting into the ledger.

Illustration 3

		Rs.
2018		
Aug		
“ 1	Received a cheque from head cashier	250.00
“ 2	Paid to printing of letter heads	40.00
“ 4	Purchased postal stamps	15.00
“ 5	Paid for cartage on goods purchased	9.00
“ 7	Paid auto fare	6.00
“ 9	Tea expenses for customers	4.75
“ 12	Sent telegram to Calcutta	8.50
“ 14	Paid for stationery	16.25
“ 15	Paid taxi fare	12.75
“ 17	Paid for postage	42.50
“ 19	Paid tips to office boys	8.00
“ 20	Paid for cartage	14.50
“ 22	Paid for cold drinks offered to customers	6.00
“ 25	Payments made to coolies	9.75
“ 27	Purchase of postal envelopes	3.60
“ 28	Rickshaw charges	3.00
“ 30	Cartage on goods purchased	10.00

Balance the Petty Cash Book at the end of August and show the amount of the cheque to be issued to the petty cashier on September 1, 2018. Also show the ledger postings.

Solution

Petty Cash Book

Receipts	Cash Book Folio No.	Date	Particulars Particulars	Voucher No.	Payments	Printing & Stationery	Postage & Telegram	Cartage	Conveyance	Entertainment	Miscellaneous	Remarks
Rs.		2018				Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
250.00		Aug. 1	To Bank A/c									
		“ 2	By Letter heads		40.00	40.00						
		“ 4	By Postal stamps		15.00		15.00					
		“ 5	By Cartage		9.00			9.00				
		“ 7	By Auto fare		6.00				6.00			
		“ 9	By Tea expenses		4.75					4.75		
		“ 12	By Telegram		8.50		8.50					
		“ 14	By Stationery		16.25	16.25						
		“ 15	By Taxi fare		12.75				12.75			
		“ 17	By Postage		42.50		42.50					
		“ 19	By Tips to office boy		8.00						8.00	
		“ 20	By Cartage		14.50			14.50				
		“ 22	By Cold drinks		6.00					6.00		
		“ 25	By Coolies		9.75			9.75				
		“ 27	By Envelopes		3.60		3.60					
		“ 28	By Rickshaw		3.00				3.00			
		“ 30	By Cartage		10.00			10.00				
			Total Payments		209.60	56.25	69.60	43.25	21.75	10.75	8.00	
		“ 31	By Balance b/d		40.40							
250.00			Total		250.00	L.F.	L.F.	L.F.	L.F.	L.F.	L.F.	
40.40		Sept 1	To Balance b/d									
209.60		“ 1	To Bank A/c									

LEDGER

Petty Cash Account

Dr.					Cr.
2018		Rs.	2018		Rs.
Aug. 1	To Bank A/c	250.00	Aug. 31	By Sundries as per Petty Cash Book	209.60
			" 31	By Balance c/d	40.40
		250.00			250.00
Sept 1	To Balance b/d	40.40			
" 1	To Bank A/c	209.60			

Bank Account

			2018		
			Aug. 1	By Petty Cash A/c	250.00
			Sept.1	By Petty Cash A/c	209.60

Printing and Stationery Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	56.25	

Postage and Telegram Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	69.60	

Cartage Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	43.25	

Conveyance Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	21.75	

Entertainment Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	10.75	

Miscellaneous Expenses Account

2018		Rs.	
Aug. 31	To Petty Cash A/c	8.00	

6.9 WHAT IS A BANK?

You might have heard the names of State Bank of India, Andhra Bank, Allahabad Bank. You may also be having an account with some bank. Now, let us have an idea what exactly a bank is and what it does. Bank is an organisation which deals in money by accepting deposits and lending to those who need it. Accepting deposits is the primary function of a bank. It accepts demand deposits and time deposits. Demand deposits are those deposits which are payable on demand, and time deposits are those which are repayable after a specified period. The bank pays interest on the deposits (except deposits on current account).

Lending of money is another important function of a bank. It lends money to needy persons and organisations in the form of short-term advances, term loans, and overdraft facility. The bank collects interest on the amount lent.

The bank also renders various other services to its customers such as (i) collecting amounts due to the customer like interest, dividends, etc., (ii) making payments on behalf of the customer; (iii) issuing letters of credit, (iv) providing travellers cheques (v) providing safe deposit lockers for safe custody of valuables, and (vi) tarnishing guarantee on behalf of customers. etc. The bank charges some amount for the services rendered to its customer.

6.10 TYPES OF BANK ACCOUNTS

There are broadly three types of accounts: (i) savings bank account, (ii) current account, and (iii) fixed deposit account. In case of savings bank account, there are certain restrictions on the number and amount of withdrawals. It is mainly intended to encourage savings. Hence, it is not considered suitable for business purposes.

Business firms generally open current account. There are no restrictions on the number and amount of withdrawals in case of a current account. Any amount can be withdrawn any number of times from a current account.

Fixed deposit account is meant for deposits for a fixed period. Withdrawal of fixed deposits is allowed only on maturity. It is used by people generally for long term savings.

6.10.1 Advantages of Having a Bank Account

Now-a-days, every business firm has an account with a bank. The business generally retains a small sum of money with itself for immediate use and deposits the rest in a bank. The money deposited in a bank is as good as money on hand. There are various advantages of maintaining an account with the bank. These are:

1. Money is safe and it also earns some interest.
2. The bank provides various types of loans.
3. It is easy and safe to make payments by issuing cheques.
4. Money can be sent or transferred to other places at a nominal charge through a bank.
5. The bank helps in collection of bills, cheques, etc., on behalf of its customers.

6 If 'standing instructions' are given to the bank, it collects interest on debentures, dividend on shares, etc., and makes payment of insurance premium, pension, subscriptions, etc., on behalf of its customers.

6.10.2 How to Open and Operate a Bank Account?

If you want to open a bank account you have to apply to the bank on a prescribed form. You are also required to be introduced to the bank by a person known to the bank (possibly an account holder). The banker, after satisfying himself about the applicant, accepts the initial deposit in cash and opens an account in your name. Thus, you become a customer of the bank. Your account is given a number for easy identification. When an account is opened, the banker gives to its customer (i) a pass book, (ii) a pay-in-slip book and (iii) a cheque book.

i) **Pass Book:** The pass book is a copy of the customer's account as maintained by the bank. In other words, it is nothing but a true copy of the transactions with the bank, as they appear in the customer's account in the bank's ledger. In case of a current account, the bank may not issue a pass book. In that case, it would furnish a statement of account from time to time. Whether it is a pass book or a statement of account, the proforma is as given in Figure 6.3.

Pass Book

Date	Particulars	Dr. Withdrawals	Cr. Deposits	Dr. or Cr. Balance	Initials
		Rs.	Rs.	Rs.	

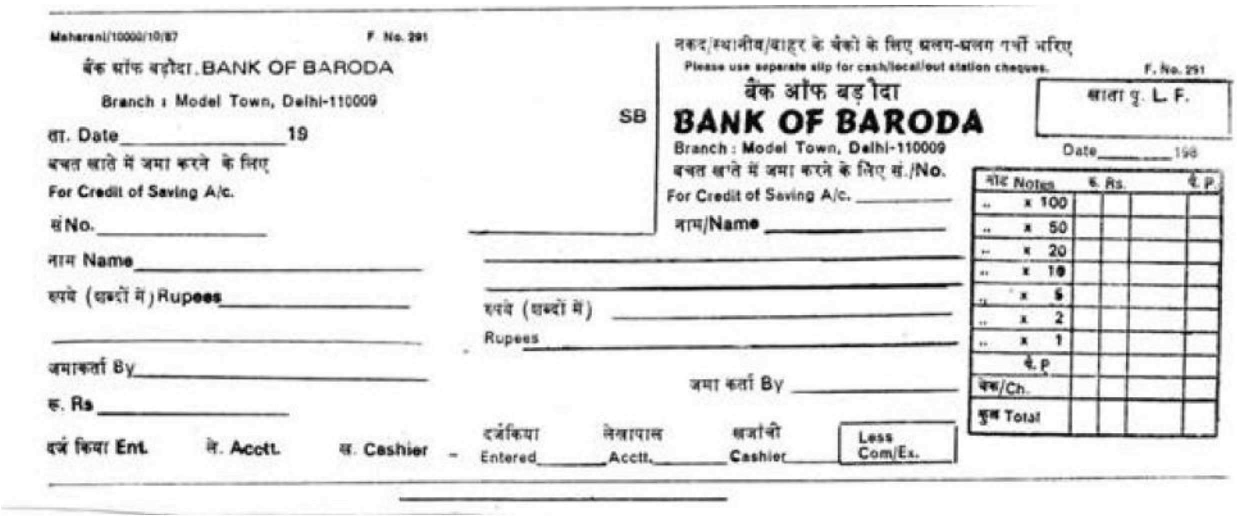
Fig. 6.3

When an amount is deposited in the bank, it is entered in the deposit column (Cr.). When an amount is withdrawn, it is entered in the withdrawal column (Dr.). After every deposit or withdrawal, the balance is worked out and shown in the balance column in the pass book. It is also indicated whether it is a Dr. balance or a Cr. balance. Usually, the pass book shows a credit balance, which means the customer has money in his account. But when the customer has withdrawn more than what he has deposited, the pass book shows a debit balance called overdraft.

ii) **Pay-in-Slip Book:** It contains printed forms which are used for depositing cash and cheques into the bank. Look at the form of a pay-in-slip as shown in Figure 6.4.

The first part is called counterfoil and the second part is the main pay-in-slip. When you submit it to the bank along with the amount to be deposited, the bank will stamp and sign the counterfoil and give it back to you. The main pay-in-slip is retained by the bank for further processing. The counterfoil is for your own record and future reference. The cash book entry for deposit is also made with the help of the counterfoil.

Specimen of Pay-in-Slip


Maharani/10000/10/87 F. No. 291
बैंक ऑफ बड़ौदा. BANK OF BARODA
Branch : Model Town, Delhi-110009
ता. Date ______ 19
बचत खाते में जमा करने के लिए
For Credit of Saving A/c.
सं No. ______
नाम Name ______
रुपये (शब्दों में) Rupees ______
जमाकर्ता By ______
रु. Rs ______
दर्ज किया Ent. ले. Acctt. ख. Cashier
SB
Please use separate slip for cash/local/out station cheques. F. No. 291
बैंक ऑफ बड़ौदा
BANK OF BARODA
Branch : Model Town, Delhi-110009
For Credit of Saving A/c. ______
नाम/Name ______
खाता पृ. L. F.
Date ______ 198
रुपये (शब्दों में) Rupees ______
जमा कर्ता By ______
दर्जकिया Entered ______ लेखापाल Acctt. ______ खजांची Cashier ______ Less Com/Ex.

नोट Notes	रु. Rs.	पै. P.
.. x 100		
.. x 50		
.. x 20		
.. x 10		
.. x 5		
.. x 2		
.. x 1		
पै. P		
चैक/Ch.		
कुल Total		

Fig. 6.4

iii) **Cheque Book:** A cheque book contains a number of leaves (10 to 20 or 50 leaves) called cheques. A cheque is an instrument used for withdrawing money from the bank. It is an unconditional order on the bank made by its customer, instructing the bank to pay the amount specified therein to the person named in the cheque or to his order. The person who draws a cheque is called 'drawer'. The bank on whom the cheque is drawn is called 'drawee'. The person in whose favour the cheque is drawn (or to whom it is payable) is called 'payee'. Look at Figure 6.5 for specimen of a cheque. In this cheque, Mr. S. Jain is the drawer. He has drawn and signed the cheque. The Bank of Baroda on whom the cheque is drawn, is the drawee. Mr. P. Ram Dev is the payee as the cheque is payable to him.

While writing a cheque, care must be taken to write the date, the name of the party to whom payment has to be made, and the amount to be paid both in words and figures. It must be signed by the account holder. The signature on the cheque must tally with the specimen signature which the bank has.

A cheque can be a bearer cheque or an order cheque. In case of a bearer cheque, the bank pays the amount to any person who presents it at the counter of the bank without much fuss. But, in case of an order cheque, identification of the party claiming payment is necessary, specially if he wants payment at the counter.

Specimen of Cheque

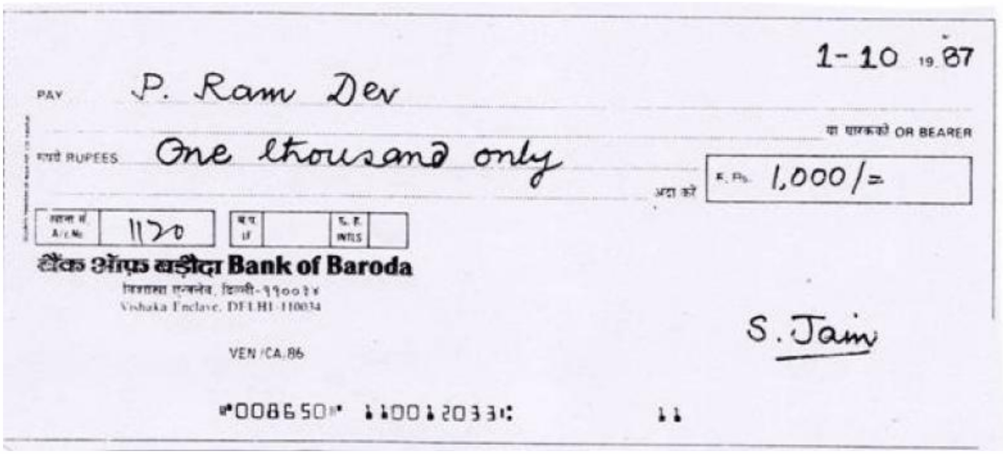

1-10 19 87
PAY P. Ram Dev
या धारक को OR BEARER
रुपये RUPEES One thousand only
रु. Rs. 1,000/=
खाता सं. A/c. No. 1120
बैंक ऑफ़ बड़ौदा Bank of Baroda
Vishaka Enclave, DELHI-110034
VEN/CA.86
S. Jain
⑈008650⑈ 110012033⑆ 11

Fig. 6.5

6.11 CROSSING OF CHEQUES

If two parallel lines are drawn on the left hand top corner of the cheque, it is called 'Crossing', and such a cheque is called a 'Crossed Cheque'. A crossed cheque cannot be encashed directly at the counter. It has to be deposited in an account with a bank This makes it safe, as the party to whom the payment is made can be easily identified.

Crossing can be 'General Crossing' or 'Special Crossing'. General crossing is one where two parallel lines are drawn across the cheque with or without the words '&Co.', 'Not Negotiable', 'A/c Payee' as shown in Figure 6.6. In case of special crossing, the name of a particular bank is also mentioned. This implies that the amount of cheque is payable only to the bank named in the crossing. Look at Figure 6.6. The name of 'Bank of Baroda, Agra' is written within the two parallel lines. Payment of this cheque can be collected only through Bank of Baroda, Agra.

Crossing of a Cheque

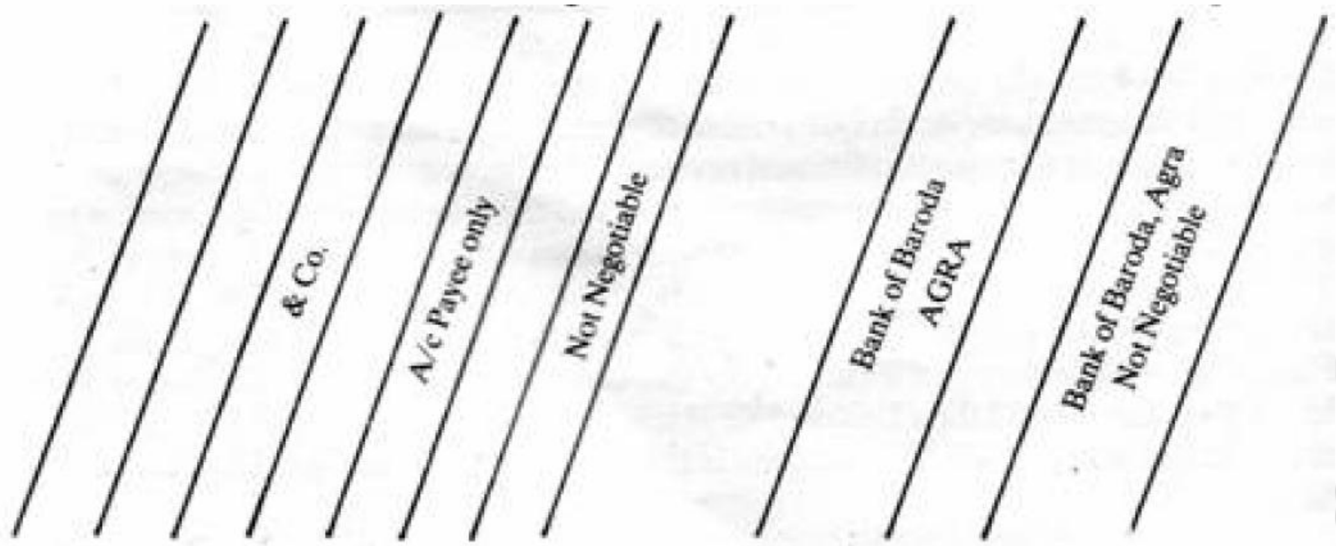


Fig. 6.6

In case of general crossing, payment can be made to any bank which present the cheque for payment. The use of words 'A/c Payee Only' means that the cheque can be paid only into the account of the payee named in the cheque. The words 'Not Negotiable' provide further safeguard against stolen and forged cheques. But '& Co.' has no special connotation.

6.12 ENDORSEMENT AND DISHONOUR OF CHEQUES

A cheque is a negotiable instrument. It can be transferred to another person by 'endorsement' (except in case of a bearer cheque which can be transferred by mere delivery). The endorsement is done by signing at the back of the cheque and writing the name of the party to whom it is to be transferred. For example, if a cheque payable to Mr. P. Ram Dev is to be endorsed in favour of Mr. Kishan Lal, Mr. P. Ram Dev will write at the back of the cheque as follows:

Pay to Kishan Lal or Order
P. Ram Dev
(Signature)

Thus, endorsement can be defined as signing at the back of the cheque for the purpose of negotiation. The person who endorses the cheque is called endorser (P. Ram Dev in this example) and the person to whom it is endorsed is called endorsee (Kishan Lal in this example). Kishan Lal can now collect payment of this cheque.

Dishonour of Cheques : When a cheque is presented for payment, there are two possibilities. It may be paid or the payment may be refused. When the payment of a cheque is refused, it is said to be dishonoured. The bank refuses the payment for the following reasons:

1. When no date is written on the cheque, or a future date is written, or it is more than three months old.
2. If the amount written in words differs from the amount written in figures.
3. When the cheque is not signed or when the signature on the cheque does not tally with the specimen signature with the bank.
4. When the drawer does not have sufficient balance in his account.
5. When the drawer requests the bank in writing to stop payment on that cheque.
6. If the bank has come to know about the death of the drawer or his becoming insolvent or insane.

Check Your Progress D

1. List the main functions of a bank.

   ....

   ....

   ....

2. What is a pass book?

   ....

   ....

   ....

3. What is a pay-in-slip?

   ....

   ....

   ....

4. What is a cheque ?

   ....

   ....

   ....

5. What do you mean by crossing a cheque?

   ....

   ....

   ....

6 What do you understand by endorsement?

....

....

....

6.13 THREE COLUMN CASH BOOK

Generally, business firms deposit the day's collections in a bank, retaining only a small amount for immediate use. They prefer to make payment by cheque as it is more safe and convenient. So, bank transactions are more numerous than cash transactions.

The bank transactions can also be recorded in the cash book along with cash transactions. It is done by providing an additional column for bank on both sides of the cash book. Look at the proforma of a Three Column Cash Book in Figure 6.7. A bank column in the cash book, also serves the purpose of a bank account and avoids the need to have a 'Bank Account' in the ledger. The bank column on the debit side records all deposits made in the bank and the bank column on the credit side records all withdrawals from the bank. We shall now have three amount columns, one each for discount, cash and bank. Hence, it is called a Three Column or Triple Column Cash Book.

Three Column Cash Book

Dr. **Cr.**

Date	Particulars	L.F.	Discount Allowed	Cash	Bank	Date	Particulars	L.F.	Discount Received	Cash	Bank
			Rs.	Rs.	Rs.				Rs.	Rs.	Rs.

Fig. 6.7

6.13.1 Recording in Three Column Cash Book

All receipts of cash or cheques are to be recorded on the debit side: When payment is received in cash, the amount is recorded in the cash column. If it is by cheque, it is recorded in the bank column. The date on which it is received, and the name of the person from whom it is received, are recorded in the date and particulars columns respectively.

If any discount is allowed to a party on receipt of cash or cheque, it is recorded on the debit side in the discount allowed column as usual.

All cash and cheque payments are to be recorded on the credit side: When payment is made by cash, the amount is recorded in the cash column. If it is made by cheque, it is recorded in the bank column. The date on which payment is made, and the name of the person to whom payment is made, are recorded in the date and particulars columns respectively,

Discount received, if any, at the time of making payment is to be recorded on the credit side in the discount received column as usual.

Contra Entry: The word 'contra' means 'the other side'. if the double entry of a transaction is complete in the cash book itself such entry is called 'contra entry'. Contra entry arises only when cash account and bank account are simultaneously involved in a transaction. It happens only when either cash is deposited in the bank or cash is withdrawn from it. In both cases, entries have to be made in cash as well as bank columns. When cash is deposited in the bank, it is recorded (i) in bank column on the debit side of the cash book, and (ii) in cash column on the credit side of the cash book. Similarly, when cash is withdrawn from the bank, it is recorded on the (i) debit side in cash column, and (ii) on the credit side in bank column. It must, however, be noted that if cash is withdrawn from bank for personal use of the owner, it is recorded only on the credit side of cash book in bank column as drawings.

In order to denote contra entries, the capital letter 'C' is written in the L.F. column on both sides of the cash book. It means that the corresponding aspect of the transaction is entered on the other side (contra) of the same page of the cash book. The letter 'C' also indicates that the relevant entry need not be posted into the ledger, as the double entry is complete in the cash book itself.

6.13.2 Posting the Three Column Cash Book

All the entries recorded in the Three Column Cash Book are to be posted to their respective ledger accounts, except the contra entries. For posting the entries recorded on the debit side of the cashbook, credit the accounts concerned in the ledger by writing 'By Cash A/c' if the entry is in cash column, and 'By Bank A/c' if the entry is in bank column. If discount is also involved, credit the concerned personal account by writing 'By Discount Allowed A/c'. Totals of the discount allowed and discount received columns shall be posted to the respective discount accounts the same way as for Two Column Cash Book.

6.13.3 Balancing the Three Column Cash Book

The cash and bank columns are balanced separately like any other ledger account. As stated earlier, the Cash Account always shows a debit balance. The bank account also normally shows a debit balance. But, sometimes it may show a credit balance which indicates a bank overdraft. It reflects the amount withdrawn from the bank in excess of what is deposited in the bank.

The procedure of recording the closing and opening balances is the same as in Two Column Cash Book. Note that the discount columns will not be balanced. They are simply totalled.

Study illustration 4 carefully. You will follow the recording, posting and balancing of a Three Column Cash Book.

Illustration 4

Enter the following transactions in the Three Column Cash Book of Galaxy Enterprises and show the ledger postings:

2018			
July	15	Cash in hand	800
“	15	Balance in bank account	4,500
“	16	Purchased goods and issued cheque	3,000
“	17	Cash sales	4,000
“	18	Received from Saniad in full settlement of his account Rs.4,000 cheque	2,000
		cash	1,950
“	20	Cash deposited into bank	5,000
“	21	Paid Rama Krishna by cheque	2,970
		Received discount	30
“	22	Received from Bose	1,680
		Discount allowed	20
“	24	Cash withdrawn for office purpose	2,000
“	25	Paid Mahantha in cash	3,000
		Discount allowed by him	40
“	26	Paid for stationery	100
“	28	Deposited cash into bank	2,000
“	30	Cash withdrawn from bank for personal use of proprietor	500

Solution :

Joshi & Sons

Cash Book (With Discount and Cash Columns)

Rs. **Rs.**

Date	Particular	I.F.	Discount Allowed	Cash		Date	Particula	I.F.	Discount Received	Cash	Bank
2018				Rs.	Rs.	2018			Rs.	Rs.	
July.15	To Balance c/d			800	4,500	July 16	By Purchase A/c				3,000
“ 17	To Sales A/c			4,000		“ 20	By Bank A/c	C		5,000	
“ 18	To Samad		50	1,950	2,000	“ 21	By Rama Krishna		30		2,970
“ 20	To Cash A/c	C			5,000	“ 24	By Cash A/c	C			2,000
“ 22	To Bose		20	1680		“ 25	By Mahanta		40	3000	
“ 24	To Bank A/c	C		2,000		“ 26	By Stationery A/c			100	
“ 28	To Cash A/c	C			2,000	“ 28	By Bank A/c	C		2,000	
						“ 30	By Drawings A/c				500
						“ 31	By Balance c/d			330	5,030
			70	10,430	13,500				70	10,430	13,500
Aug. 1	To Balance b/d			330	5030						

LEDGER

Sales Account

			2018	
			July 17 By Sales A/c	4,000

Sanad's Account

			2018		
			July 18	By Discount Allowed	50
			" 18	By Cash A/c	1,950
			" 18	By Bank A/c	2,000

Bank Account

			2018		
			July 22	By Discount Allowed	20
			" 22	By Cash A/c	1,680

Purchase Account

2018		Rs.			
July 16	To Bank A/c	3,000			

Rama Krishna's Account

2018		Rs.			
July 21	To Discount allowed	30			
" 21	To Bank A/c	2,970			

Mahendra'sAccount

2018		Rs.			
July 25	To Discount Received A/c	40			
" 25	To Cash A/c	3,000			

Stationery Account

2018		Rs.			
July 26	To Cash A/c	100			

Drawings Account

2018		Rs.			
July 30	To Bank A/c	500			

Discount Allowed Account

2018		Rs.			
July 31	By Sundries as per Cash book	70			

Discount Received Account

			2018		
			July 31	By Sundries as per Cash book	70

In illustration 4, you will notice that the total of bank column on the debit side is more than the total of bank column on the credit side of the cash book. This indicates that there is money in the bank. If, however, the total of bank column on the debit side is less than the total on the credit side, it will reflect an overdraft in the bank. You will find this in Illustration 5.

6.13.4 Special Points Regarding Cheques Received

Generally, cheques received from various parties are deposited in the bank on the same day. However, for some reason, if a cheque is not sent to the bank on the day of receipt, it can be entered in the cash column, treating the cheque as cash. Then, the day it is sent to the bank, it can be recorded in the cash book as cash deposit in the bank in the form of a contra entry. For example, on April 8, a cheque for Rs. 500 is received from Rao and it is sent to the bank on April 11. The entries in cash book will appear as follows:

Banking Transactions and Three Column Cash Book

Cash Book

(Cash and Bank Column only)

Dr. **Cr.**

Date	Particulars	L.F.	Cash	Bank	Date	Particulars	L.F.	Cash	Bank
			Rs.	Rs.				Rs.	Rs.
2018 Apr. 8	To Rao		500		2018 Apr. 11	By Bank a/c	C	500	
“ 11	To Cash A/c	C		500					

Normally, this procedure is avoided. The entry is made directly in the bank column on the day the cheque is deposited in the bank. In the absence of any specific instructions, it can be presumed that the cheque received from a party was sent to the bank for collection on the same day.

Sometimes, a cheque received by the firm may not be deposited in the bank but may be endorsed to a third party. In that case, the cheque received will be recorded first in the cash column on the debit side of the cash book and then on its credit side in the cash column. This ensures entries in the personal accounts of (i) the party from whom it is received, and (ii) the party to whom it is endorsed. For example, on April 12, a cheque for Rs. 800 was received from Ganpati and it was endorsed on April 14, in favour of Shiva, a creditor of the firm. The entries in cash book will appear as follows:

Cash Book

(Cash Column only)

Dr. **Cr.**

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2018 Apr. 12	To Ganpati		Rs. 800	2018 Apr. 14	By Shiva a/c		Rs. 800

Sometimes, a cheque sent to the bank for collection may be dishonoured. In that case, the bank will return the cheque along with the advice stating the cause of dishonour. Whatever the firm may do to realise its payment from the concerned party, the entry for dishonour of the cheque must immediately be recorded in the cash book. The entry will be made on the credit side in bank column. This nullifies the effect of the entry made earlier at the time of receiving and depositing the cheque in the bank. For example, on April 16, a cheque for Rs. 750 was received from Yogesh and sent to bank for collection on the same day. The bank dishonoured the cheque and returned it on April 20. The entries in the cash book will appear as follows:

Cash Book
(Bank Column only)

Dr. **Cr.**

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
2018 Apr. 16	To Yogesh		Rs. 750	2018 Apr. 20	By Yogesh		Rs. 750

Check Your Progress E

Fill in the blanks.

1. All deposits into the bank are recorded in bank column on the………………… side of the cash book.
2. All withdrawals from the bank are recorded in bank column on the ………… …………… side of the cash book.
3. If debit as well as the credit aspects of a transaction are recorded in the cash book itself it is called…………………
4. When a cheque received on a particular date is not deposited the same day into bank, it is entered in .... column on the debit side of the cash book.
5. When a cheque received is endorsed, it is recorded in cash column on…… …………… sides of the cash book.
6. When a cheque is returned dishohoured, it is recorded on the………………… side of the cash book in bank column.

Illustration 5

Record the following transactions in Three Column Cash Book of Balaji Agencies and balance the same.

2018			Rs.
July	1	Cash in hand	40,000
"	2	He opened a current account with a bank	36,000
"	3	Purchased goods for cash	600
		and by cheque	1,500
"	5	Sold goods for cash	800
"	6	Sold goods to Mohan and received a cheque for the same	1,200
"	8	Deposited Mohan's cheque in the bank	1,200
"	9	Purchased stationery by cheque	200
"	10	Cash sales	2,000

“	11	Issued cheque for cash purchase of furniture to Woodland	2,500
“	12	Deposited cash in the bank	3,000
“	13	Misra paid directly into bank account	1,000
“	15	Received from Madhu cash	1,000
		cheque	1,400
		Allowed him discount	50
“	16	Paid to Ravi in cash	500
		cheque	2,500
		Received discount	40
“	17	Received a cheque from Joseph	1,500
“	18	Withdrew cash from the bank for office use	1,500
“	20	Balaji paid his son’s college fees in cash	400
“	22	Paid Subhan & Co. by cheque	975
		Received discount	25
“	24	Joseph’s cheque returned dishonoured	1,500
“	25	Received a cheque from Gagan. It was endorsed to Ram	700
“	26	Withdrew from bank for personal use	1,600
“	27	Issued cheque for purchase of machinery	40,000
“	28	Paid sundry expenses in cash	200
“	30	Paid rent by cheque	600
“	31	Deposited Cash in excess of	500

Balaji Agencies Cash Book

Date	Particulars	L.F.	Discount Allowed	Cash	Bank	Date	Particulars	L.F.	Discount Received	Cash	Bank
2018			Rs.	Rs.	Rs.	2018			Rs.	Rs.	Rs.
July 1	To Balance b/d			40,000		July 2	By Bank A/c	C		36,000	
“ 2	To Cash A/c	C			36,000	“ 3	By Purchases A/c			600	1,500
“ 5	To Sales A/c			800		“ 8	By Bank A/c	C		1,200	
“ 6	To Sales A/c			1,200		“ 9	By Stationery A/c				200
“ 8	To Cash A/c	C			1,200	“ 11	By Furniture A/c				2,500
“ 10	To Sales A/c			2,000		“ 12	By Bank A/c	C		3,000	
“ 12	To Cash A/c	C			3,000	“ 16	By Ravi		40	500	2,500
“ 13	To Misra				1,000	“ 18	By Cash A/c	C			1,500
“ 15	To Madhu		50	1,000	1,400	“ 20	By Drawings A/ c			400	
“ 17	To Joseph				1,500	“ 22	By Subhan & Co		25		975
“ 18	To BankA/c	C		1,500		“ 24	By Joseph				1,500
“ 25	To Gagan			700		“ 25	By Ram			700	
“ 31	To Cash A/c	C			4,100	“ 26	By Drawings A C				1,600
“ 31	To Balance c/d				4,675	“ 27	By Machinery A/c				40,000
						“ 28	By Sundry exp.A/c			200	
						“ 30	By Rent A/c				600
						“ 31	By Bank A/c	C		4,100	
						“ 31	By Balance c/d			500	
		50	47,200	52,875				65	47,200	52,875	
Aug.1	To Balance b/d			500		Aug.1	By Balance b/d				4,675

Note :

1. When cheques are received from parties, unless otherwise specified, it is assumed that they are deposited in the bank on the same day. But, in case of the transaction dated July 6, the cheques was received on July 6, but was deposited in the bank on July 8. Hence on July 6, it is recorded as the cash column on the debit side, and on July 8, it is shown as cash deposit through a contra entry.

2. On July 17, Joseph gave a cheque for Rs. 1,500 which was duly entered on the debit side. On July 24, the cheque was returned dishonoured. When a cheque is dishonoured, the rule is to reverse the entry made earlier. Hence, on July 24, an entry has been passed on the credit side in the bank column. This nullifies the entry made on July 17.

3. On July 25, a cheque was received from Gagan which was endorsed to Ram. It has been first entered in the cash column on the debit side on July 25, and then on the credit side on the same date.

4. The credit side total of the bank column is Rs 52,875 and the debit side total is Rs 48,200. It means that there is a credit balance of Rs. 4,675 in the bank account. As you know this is a case of overdraft. On July31, it has been shown on the debit side of the cash book making two sides equal, and then on August 1, it is recorded on the credit side of the bank column.

6.14 PURCHASES JOURNAL

While studying sub-division of journal, you learnt that Purchases Journal is used for recording credit purchases of goods and raw materials. The goods or raw materials can be purchased either on cash basis or on credit basis. When they are purchased on cash basis, the entry is made in the cash book. But when they are purchased on credit, they are recorded in the Purchases Journal. Note that the credit purchases of fixed assets like typewriter, vehicle, etc., are not recorded in this book. They are recorded in Journal Proper about which you will learn later. The Purchases Journal is also called 'Purchases Book', 'Purchases Day Book', and 'Invoice Book'.

6.14.1 Invoice

When you purchase something from a shop, you receive a bill Such bill is called 'invoice'. It contains the details pertaining to the quantity, description, price, total amount, and trade discount, if any. Thus, an invoice is a business document giving full details of the goods purchased. It is a 'Purchase Invoice' or 'Inward invoice' for the purchaser and a 'Sales Invoice' or 'Outward Invoice' for the seller. Entries in the Purchases Journal are made on the basis of the purchase invoices received (inward invoices). Look at Figure 6.8 for a specimen of an invoice.

Invoice			
Book Lovers Private Limited **Hyderabad**			
No.3891 To M/s. Book Paradise, Nagpur			Date: 15-7-2018
Quantity	**Particulars**	**Rate per unit**	**Total**
		Rs.	Rs.
10 Copies	Principles and Practice of Accountancy by R. Srirani	25.00	250.00
	Less: Discount 10%		25.00
	(Rupees two hundred and twenty five only)		225.00
			xxxxx For Book Lovers Private Limited

Fig. 6.8

6.14.2 Recording in the Purchases Journal

Look at Figure 6.9. It shows the Proforma of a Purchases Journal.

Purchases Journal

Date (1)	Name of the supplier (2)	Inward invoice Number (3)	L.F. (4)	Amount (5)	Remarks (6)
				Rs.	

Fig. 6.9

The Purchases Journal has six columns.

Column 1: It is meant for writing the date of purchase.

Column 2: In this column, you write the name and address of the supplier.

Column 3: The inward invoice number is recorded in this column. As stated earlier, when you purchase goods on credit, you get an invoice from the supplier. Although it bears a number, you have to accord your own serial numbers to all inward invoices for easy reference. It is this serial number which will be entered in the inward invoice column of the Purchase Journal.

Column 4: In this column, you will write the page number of the account in ledger where posting is done.

Column 5: In this column, the amount payable to the supplier is recorded. You must note that the amount payable is arrived at after deducting the trade discount, if any. For example, see the invoice given in Figure 6.8. The amount payable is Rs. 225. If, some sales tax is also involved, the amount payable should include that also.

Column 6: Any other relevant information is to be recorded in this column. Information such as the date on which the amount of the bill is payable and the date on which it is actually paid may be noted in this column.

6.14.3 Posting the Purchases Journal

The transactions recorded in the Purchases Journal are to be posted to their respective personal accounts in the ledger. When a purchase is made on credit, the supplier becomes the creditor for the firm. Hence, every credit purchase recorded in the Purchases Journal is posted on the credit side of the personal account of the supplier by writing 'By Purchases A/c' in particulars column. The Purchases Journal is totalled periodically, say, weekly or monthly. This total is posted to the debit side of Purchases Account in the ledger by writing 'To Sundries—as per Purchases Journal'.

Thus, you observe that posting of Purchases Journal involves two steps: (i) posting each purchase to the credit of the respective personal accounts of suppliers, and (ii) posting the total purchases to the debit of the Purchases Account. With this, double entry for credit purchases is complete. Look at illustration 6 for recording i the Purchases Journal and its posting into ledger.

Illustration 6

Record the following transactions in the Purchases Journal of M/s. Dharam Chand & Co., and show the ledger postings.

2018		Rs.
July 1	Bought goods from Shreedhar	5,000
" 2	Purchased goods from Shreekant	4,000
" 3	Purchased from Shreenivas goods worth	2,500
" 4	Shreedhar sold us goods	1,500
" 5	Purchased goods from Shreenivas subject to a trade discount of 10%	3,000
" 6	Bought from Shreekant goods worth with discount of 20%	3,500

Dharam Chand & Co.
PURCHASES JOURNAL

Date	Name of the supplier	Inward invoice number	L.F.	Amount	Remarks
				Rs.	
2018	Shreedhar	25		5,000	
July 1	Shreekant	26		4,000	
" 2	Shreenivas	27		2,500	
" 3	Shreedhar	28		1,500	
" 4	Shreenivas	29		2,700	
" 5	Shreekant	30		2,800	
" 6	Total			18,500	

Note: i) The inward invoice numbers are imaginary.

ii) Sometimes, the particulars of items purchased can also be given with each entry.

But it is considered unnecessary because the details are available in the invoice, the serial numbers of which are duly given in the Purchases Journal.

LEDGER

Shreedhar's Account

Dr. **Cr.**

			2018		Rs.
			July 1	By Purchases A/c	5,000
			" 4	By Purchases A/c	1,500

Shreekant's Account

			2018		Rs.
			July 2	By Purchases A/c	4,000
			" 6	By Purchases A/c	2,800

Shreenivas's Account

			2018		Rs.
			July 3	By Purchases A/c	2.500
			" 5	By Purchases A/c	2,700

Purchases Account

2018		Rs.			
July, 31	To Sundries - as per Purchase Journal	18,500			

6.15 PURCHASES RETURNS JOURNAL

In any business, sometimes goods purchased may have to be returned to the supplier either partly or fully. This may become necessary when they are found to be defective, damaged in transit, inferior quality, short weight, received too late (off season), or not in conformity with the order given. If the number of such returns is small, they can be recorded in the journal itself. But, if it is large, a separate book called 'Purchases Returns Journal' should be used for recording these transactions. This book is also called 'Returns Outwards Journal'.

6.15.1 Debit Note

When you return goods to supplier, a statement called 'Debit Note' is sent to the supplier. It informs the supplier that his account has been debited to the extent of the value of goods returned. You know that when goods were purchased, the supplier's account was credited. Debiting his account now means that the amount payable to him has been reduced by the value of goods returned. The debit note also contains other particulars such as the name and address of the supplier, the description of the goods returned, etc. The specimen of a debit note is shown in Figure 6.10.

Debit Note

Book Paradise **Nagpur** **Debit Note**		
No. 587		Date: 20-7-18
To M/s. Book Lovers Pvt. Ltd. Hyderabad. WE HAVE DEBITED YOUR ACCOUNT FOR GOODS RETURNED AS FOLLOWS		
	Rs. Ps.	Rs. Ps.
2 Copies of 'Principles and Practice of Accountancy' by Sriram @ Rs, 25 each	50.00	
Less: Trade discount allowed by you @ 10%	5.00	
(Rupees forty five only)		45.00
		xxxxx For Book Paradise

Fig. 6.10

6.15.2 Recording in the Purchases Journal

Look at Figure 6.11. It shows the Proforma of a Purchases Returns Journal.

Purchase Returns Journal

Date (1)	Name of the supplier (2)	Inward invoice Number (3)	L.F. (4)	Amount (5)	Remarks (6)
				Rs.	

Fig. 6.11

Like the Purchase Journal, the Purchases Returns Journal also has six columns. As usual, the date on which the goods are returned is recorded in the first column. The name and address of the supplier to whom goods are returned are entered in the second column. Write the serial number of the debit note in the third column. The page number of the account in the ledger where posting is done will be entered in the L.F. column. In the fifth column, the value of goods returned is entered. At the time of original purchase, if some trade discount had been given, the same should also be adjusted so as to arrive at the value of goods returned. If there is any other relevant information, the same may be recorded in the remarks column.

6.15.3 Posting the Purchases Returns Journal

The transactions recorded in the Purchases Returns Journal are to be posted to their respective personal accounts in the ledger. Separate accounts in the name of each supplier already exists in the ledger (opened at the time of purchase). The entries made in the Purchases Returns Journal will be posted to the debit of each supplier's account by writing To Purchases Returns A/c'.

The total of the Purchases Returns Journal is posted to the credit side of the Purchases Returns Account' in the ledger by writing 'By Sundries—as per Purchases Returns Journal'.

Look at illustration 7 for the procedure of recording in the Purchases Returns

Journal and its posting into the ledger.

illustration 7 (Continuation of illustration 6)

Enter the following transactions in the Purchases Returns Journal of M/s. Dharam Chánd and Co. and show the ledger postings.

2018		Rs.
July 5	Returned goods to Shreekant (vide invoice No. 26)	200
" 10	Returned goods to Shreenivas (vide invoice No. 29)	90
" 12	Returned goods to Shreekant (vide invoice No. 30)	120

Dharam Chand & Co.

PURCHASES RETURNS JOURNAL

Date	Name of the supplier	Debit note number	L.F.	Amount	Remarks
2018				Rs.	
July 5	Shreekant	16		200	
" 10	Shreenivas	17		90	
" 12	Shreekant	18		120	

" 31	Total			410	
-				---------	

Note : Debit Note numbers are imaginary.

LEDGER
Shreekant's Account

2018		Rs.	2018	Rs.	
July 5	To Purchases Return A/c	200	July 2	By Purchases A/c	4,000
" 12	To Purchases Return A/c	120	" 6	By Purchases A/c	2,800

Shreenivas's Account

2018		Rs.	2018		Rs.
July10	To Purchases Return A/c	90	July 3	By Purchases A/c	2,500
			" 5	By Purchases A/c	2,700

Purchase Returns Account

			2018		Rs.
			July 31	By Sundries – as per Purchase Returns Journal	410

6.16 SALES JOURNAL

This book is used for recording only the credit sales of goods. Note that the cash sale of goods or sale of fixed assets (cash or credit) are not recorded in this book. The Sales Journal is also called 'Sales Day Book', or 'Sales Book'.

6.16.1 Recording in the Sales Journal

The ruling of the Sales Journal is similar to that of Purchases Journal. The difference is only with regard to the second column. In Purchases Journal, the second column is used for recording the name of the supplier. But, in case of Sales Journal, it is used for writing the name of the customer.

When goods are sold on credit, an invoice is given to the buyer. The seller generally has a bound invoice book. It contains consecutively numbered invoices in duplicate. While the original copy is given to the buyer, the duplicate remains in the book itself. The entries in the Sales Journal are made with the help of the duplicate copies which are duly numbered. The procedure for recording in the Sales Journal is similar to that of the Purchases Journal.

6.16.2 Posting the Sales Journal

All entries made in the Sales Journal are posted to the respective personal accounts in the ledger. In a credit sale, the customer becomes a debtor to the firm. Hence, every credit sale recorded in the Sales Journal is posted on the debit side of the personal account of individual customers by writing 'To Sales A/c' in particulars column. Then, the total of the Sales Journal is posted on the credit side of the Sales Account by writing 'By Sundries—as per Sales Journal'.

Look at illustration 8 and study how credit sales of goods are recorded in the Sales Journal and how they are posted into ledger.

Illustration 8

Prepare the Sales Journal of M/s. Bharat Furniture Works, Delhi from the following transactions:

2018

Aug. 1 Sold to Doulath Furniture House, Delhi

50 Chairs @ Rs. 150 each

10 Tables @ Rs. 500 each

At a trade discount of 10%

" 4 Supplied the following furniture, as per the order, to Kesav Memorial School, Mehraulli

100 Chairs @ Rs. 135 each

40 Tables @Rs. 450 each

2 Almirahs @Rs. 750 each

5 Black boards @ Rs. 800 each

" 10 Supplied on credit to Pyarelal Furniture Palace, Okhla

10 Sofa sets @ Rs. 800 each

10 Dining tables @ Rs. 500 each

5 Cots @ Rs. 600 each

5 Dining tables @ Rs. 800 each

Trade discount 10%

Solution :

Bharat Furniture Works

Sales Journal

Date	Name of the supplier	Debit note number	L.F.	Amount	Remarks
2018				Rs.	
Aug. 1	Doulath Furniture House, Delhi	107		11,250	
" 4	Kesav Memorial School, Mehrauli	108		37,000	
" 10	Pyarelal Furniture Palace, Okhla	109		18,000	
" 31	Total			66,250	

Note: i) Invoice numbers are imaginary,

ii) Sometimes, the particulars of items sold can also be given with each entry, but it is considered unnecessary because the details are available in the invoices and the serial numbers of which are duly given in the Sales Journal.

LEDGER

Daulath Furniture House Account

Dr. **Cr.**

2018		Rs.			
Aug 1	To Sales A/c	1,250			

Kesav Memorial School, Mehrauli

2018		Rs.			
Aug 4	To Sales A/c	37,000			

Pyarelal Furniture Palace

2018 Aug 10	To Sales A/c	Rs. 18,000			

Sales Account

			2018 Aug 31	By Sundries – as per Sales Journal	Rs. 66,250

6.17 SALES RETURNS JOURNAL

When customers return the goods to the business, it will be recorded in a separate book called 'Sales Returns Journal'. Normally, if the number of such returns is small, they can be recorded in the journal itself. But if their number is large, it is better to maintain a separate book called Sales Returns Journal. This book is also called 'Returns Inwards Journal'.

6.17.1 Credit Note

When a customer returns goods, a statement called 'Credit Note' is sent to him. The credit note informs the customer that his account has been credited to the extent of the value of goods returned. You know that when goods were sold, the customer's account was debited. Now crediting his account means the amount payable by him stands reduced by the value of goods returned. The credit note also contains other information such as the name and address of the customer, description of the goods returned, etc. The credit notes are consecutively numbered and are prepared in duplicate. The original is sent to the customer and the duplicate is carefully filed. The specimen of a credit note is shown in Figure 6.12.

Credit Note

Book Lovers Private Limited
Hyderabad

No.698 Date: 25-7-2018

M/s. Book Paradise
Nagpur

WE HAVE CREDITED YOUR ACCOUNT FOR GOODS RETURNED AS FOLLOWS

	Rs. Ps.	Rs.Ps.
2 Copies of 'Principles and Practice of Accountancy'		
by Shriram @Rs. 25 each	50.00	
Less: Trade discount allowed @ 10%	5.00	
(Rupees forty five only).		45.00

xxx
For Book Lovers Pvt. Ltd

Fig. 6.12

Note: Normally the customer, while returning the goods, may also send a debit note. But quite often they do not do so. Hence, the seller always prepares a credit note for his record. If debit note is also received, it may be filled along with the respective credit note.

6.17.2 Recording in the Sales Returns Journal

The ruling of the Sales Returns Journal is similar to that of Purchases Returns Journal. The difference is only with regard to the second column. In Purchases Returns Journal, the second column is used for recording the name of the supplier. But in case of Sales Returns Journal, it is used for writing the name of the customer. The Procedure for recording in the Sales Returns Journal is also similar to that the Purchases Returns Journal. The entries in the Sales Returns Journal are made with the help of duplicate copy of the credit notes.

6.17.3 Posting the Sales Returns Journal

The transaction recorded in the Sales Returns Journal are posted to the respective personal accounts in the ledger. Separate accounts in the name of each customer already exist in the ledger (opened at the time of sale). Credit the customers' accounts individually by writing 'By Sales Returns A/c'. Then post the total of the Sales Returns Journal to the debit side of the Sales Returns A/c by writing 'To Sundries—as per Sales Returns Journal'.

Look at illustration 9 and study how sales returns have been recorded in the Sales Returns Journal and posted into ledger.

Illustration 9 (Continuation of illustration 8)

2018

Aug. 5 Received a debit note along with one chair and a table from Doulath Furniture House, Delhi, saying that the legs of the chair and table are broken (remember, each chair was sold at Rs. 150 and each table at Rs. 500 with a trade discount of 10%).

10 Received 2 chairs and 2 tables along with a letter from Kesav Memorial School, Mehrauli, saying that they were damaged (chairs were sold at Rs. 135 each and tables at Rs. 450 each).

16 Received a debit note from M/s. Pyarelal Furniture Palace, Okhla, stating that the mirrors of two dressing tables were found defective and so returned.

Enter the above transactions in the Sales Return Journal of M/s Bharat Furniture Works, Delhi, and show the ledger postings.

Bharat Furniture Works
SALES RETURNS JOURNAL

Date	Name of the supplier	Credit note number	L.F.	Amount	Remarks
2018					
Aug.5	Doulath Furniture House, Delhi	56		585	
" 10	Kesav Memorial School, Mehrauli	57		1,170	
" 16	Pyarelal Furniture Palace, Okhla	58		200	
" 31	Total			1,955	

Note : Credit Note numbers are imaginary.

LEDGER

Doulath Furniture House Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2018 Aug 1	To Sales A/c	11,250	2018 Aug 5	By Sales Returns A/c	585

Kesav Memorial School Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2018 Aug 4	To Sales A/c	37,000	2018 Aug 10	By Sales Returns A/c	1,170

Pyarelal Furniture Palace Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2018 Aug 10	To Sales A/c	18,000	2018 Aug 16	By Sales Returns A/c (Allowance granted)	200

Sales Returns Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2018 Aug 31	To Sundries - as per Sales Returns Journal	1,955			

These postings were made from Sales Journal, when goods were sold (refer illustration 9).

Check Your Progress F

1. What is an invoice?

   ....

   ....

   ....

2. What is a debit note?

   ....

   ....

   ....

3. What is a credit note?

   ....

   ....

   ....

   ....

4. Fill in the blanks

    a) Purchases Journal records credit purchase of ………..only.

    b) Sales Journal records all …………..sales of goods.

    c) A …………is sent to a customer when he returns the goods.

    d) Total purchases are posted to …………Account at the end of every month.

    e) Total of Sales Journal is posted on the .... side of Sales Account at the end of every month.

    f) Sales Returns are also called ....

    g) Purchase Returns are also called……………..

    h) Debit Note is sent to the supplier when the goods are …................…… …….. to him.

6.18 JOURNAL PROPER

By now, you know what a journal is and what its sub-divisions are. You also know that the special journals discussed earlier take care of certain types of transactions which are repetitive and numerous. However, there are a number of transactions which do not occur frequently and hence do not warrant preparation of special journals. But they have to be recorded somewhere. For them, the proper place is the original journal itself, which is now called 'Journal Proper'. Thus all events and transactions which cannot be recorded in any of the special journals maintained by the firm, shall be recorded in the Journal Proper. Examples of such transactions are:

a) Opening Entry

b) Closing Entries

c) Transfer Entries

d) Adjustment Entries

e) Rectification Entries

f) Miscellaneous Entries

a) **Opening Entry:** An opening entry is passed in the journal for opening a new set of accounts. This may be needed at the time of the commencement of business or at the commencement of new accounting year.

    If a person commences business only with cash, there is no need to pass a journal entry. The cash brought in is just entered in the cash book. But, if he also brings some other assets, then an opening entry is passed in Journal Proper, debiting the concerned assets accounts and crediting the Capital Account.

    In case of a running business, an opening entry is passed at the commencement of a new accounting year to incorporate various balances of assets and liabilities brought forward from the previous year into current year's books.

b) **Closing Entries:** At the end of the accounting year, when final accounts are prepared, the nominal accounts are closed by transferring them to Trading

Account or Profit and Loss Account. The journal entries passed for this purpose are called 'Closing Entries'.

c) **Transfer Entries:** When an amount is to be transferred from one account to another, you have to pass an entry in the Journal Proper in order to effect the transfer. Such entries are called 'Transfer Entries'. Suppose, you want to transfer proprietor's total drawings made during the year to his Capital Account. The proprietor's total drawings appear in Drawings Account which shows a debit balance. You will transfer the balance of Drawings Account to Capital Account by passing the following entry in the Journal Proper.

Capital Account	Dr.
To Drawings Account	
(Transfer entry)	

d) **Adjustment Entries:** At the time of preparing the final accounts, it is necessary to bring into the books of account certain unrecorded items like closing stock, depreciation on fixed assets, interest on capital, expenses incurred but not yet paid, income earned but not yet received, etc. Entries passed in the Journal Proper to record such items are called 'Adjustment Entries'. These entries are explained in detail later.

e) **Rectification Entries:** You may commit errors while recording transactions in various books, and while posting, totalling, balancing, etc. Such errors are generally corrected through entries in Journal Proper and are known as 'Rectification Entries'.

f) **Miscellaneous Entries:** In addition to the entries mentioned above, if there is any transaction which cannot be recorded in any of the special journals, it will be entered in the Journal Proper. Example of such transactions are:

i) Credit purchases of fixed assets, investments, etc.

ii) Credit sales of fixed assets, investments etc.

iii) Withdrawal of goods from the business by the owner for his personal use.

iv) Loss of goods by theft, accident, fire, etc.

v) Special allowances received from suppliers or given to customers.

vi) Endorsement or dishonour of bills.

vii) Writing off bad debts.

Look at illustration 10 for entries of such transactions in the Journal Proper.

Illustration 10

Enter the following in the Journal Proper of Rajani Enterprises.

2018

Aug. 3 Sold office van on credit for Rs. 15,000 to Ahmed Ali.

" 8 The owner has taken away goods worth Rs. 1,000 for his domestic use.

" 15 Fire broke out in the premises and goods worth Rs. 5,000 were destroyed.

“ 21 Bill drawn on Singh returned dishonoured when presented for payment, Rs. 2,000.

“ 25 Amount due Rs. 500 from Bahadur is irrecoverable, as he has been declared insolvent.

“ 28 Misra, a customer, informed that some goods were damaged in transit. An allowance of Rs. 50 was granted to him for repairs.

Solution :

JOURNAL PROPER

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2018 Aug. 3	Ahmed Ali Dr. To Office Van A/c (Being the credit sale of office van to Ali)		15,000	15,000
“ 8	Drawing A/c Dr. To Purchases A/c (Being the withdrawal of goods By the owner for domestic use)		1,000	1,000
“ 15	Loss by Fire A/c Dr. To Purchases A/c (Being loss of goods by fire accident)		5,000	5,000
“ 21	Singh Dr. To Bills Receivable A/c (Being the dishonour of bill by Singh)		2,000	2,000
“ 25	Bad Debts A/c Dr. To Bahadur (Being the amount irrecoverable from Bahadur)		500	500
“ 28	Allowances A/c Dr. To Misra (Being an allowance granted for repair of goods damaged in transit		50	50

6.19 LET US SUM UP

1. Journal is the book of original entry in which normally all transactions are recorded. But when transactions are numerous, there are many difficulties in recording all of them in one journal. Hence, the need for sub-division of journal arises.

2. In business many transactions are of repetitive nature. The journal is therefore sub-divided in such a way that a separate book is used for each category of transactions which are repetitive in nature and are sufficiently large in number.

3. Depending on the requirements of business, the special journals used are:

   (i) Cash book (ii) Purchases Journal, (iii) Sales Journal, (iv) Purchase Returns Journal (v) Sales Returns Journal (vi) Journal Proper

4. All cash transactions are recorded in cash book. There are different types of cash books. The most commonly used are: (i) Single Column Cash Book, (ii) Two Column Cash Book, and (iii) Three Column Cash Book.

5. The Single Column Cash Book has only one amount column on both sides. All cash receipts are recorded on the debit side and all cash payments on the credit side.

6. The Two Column Cash Book has an additional amount column for cash discount on both sides. The discount allowed is recorded on the debit side and the discount received on the credit side.

7. Petty Cash Book is prepared for recording payments of various petty expenses. This saves a lot of labour and time.

8. The main functions of a bank are to accept deposits and lend money to business. It also provides various other services to its customers.

9. There are three types of accounts available in the bank. The businessman generally opens current account.

10. When an account is opened in the bank, the depositor receives a pass book, a pay-in-slip book, and a cheque book.

11. A cheque is an instrument used for withdrawal of money from the bank. It can also be used for making payments to other parties.

12. For safety, the cheques can be crossed. Crossing can be general or specific.

13. The Payee of a cheque can endorse it to a third party by putting his signature at the back of the cheque.

14. The bank can refuse payment of a cheque. Refusing to pay is called dishonouring the cheque.

15. The Three Column Cash Book has three amount columns on each side. One of these three columns is for recording banking transactions of the firm.

16. All deposits into the bank are recorded in the bank column on the debit side of the cash book, and all withdrawals on the credit side.

17. The bank column in the cash book serves the purpose of bank account. Hence, there is no need to open bank account in the ledger.

18. Purchases Journal is meant for recording all credit purchase of goods. Inward invoice is the basis for recording in the Purchases Journal.

19. Purchases Returns Journal is used for recording goods returned to the suppliers. Debit note is the basis for recording in Purchases Returns Journal.

20. Sales Journal is meant for recording all credit sales of goods. Outward invoice is the basis for recording in the Sales Journal.

21. Sales Returns Journal is used for recording goods returned by the customers. Credit note is the basis for recording in it.

22. All transactions which cannot be recorded in any of the special journals will be recorded in the journal itself, which is now called Journal Proper.

6.20 KEY WORDS

Adjustment Entry : An entry passed to bring into account certain unrecorded items like closing stock, outstanding expenses and incomes, at the time of preparing final accounts.

Bearer Cheque : A cheque payable at the counter of the bank without identification.

Cash Book : A special journal used for recording all cash receipts and cash payments.

Cash Discount : An allowance given by the creditor to the debtor for prompt payment.

Closing Entries : Entries passed at the end of each accounting year to close the nominal accounts by transferring them to Trading and Profit and Loss Account.

Credit Note : A statement sent by the seller to his customer informing that his account is credited to the extent of the goods returned by him or allowance granted to him.

Cheque : An instrument used for withdrawing money from the bank.

Crossed Cheque : A cheque on which two parallel lines have been drawn. It is not payable at the counter.

Contra Entry : When both the debit and credit aspects of a transaction are recorded in the cash book itself.

Debit Note : A statement sent by the purchaser to his supplier informing that his account is debited to the extent of the goods returned or allowance claimed.

Dishonour : Refusal to pay the cheque by the bank

Endorsement : A written statement signed by the payee at the back of the cheque for its transfer.

Imprest System : A system of advancing a fixed amount to the petty cashier periodically.

Invoice : A bill or a statement issued by the seller to the purchaser giving details of goods sold.

Opening Entry : An entry passed to open a new set of accounts.

Order Cheque : A cheque in respect of which identification of the payee is necessary.

Pass Book : A book or a statement supplied by the bank to its customer showing his transactions with the bank.

Pay-in-slip : A slip or a challan used for depositing cash or cheques in the bank.

Petty Cash Book : A cash book prepared for recording small payments of cash.

Subsidiary Book : Any special journal used for recording a particular category of transactions.

Special Crossing : A crossing specifying the name of bank through whom the cheque can be presented for payment.

Transfer Entry : An entry passed to transfer an amount from one account to another account.

6.21 ANSWERS TO CHECK YOUR PROGRESS

A a) iii b) i c) iii d) ii e) iii

B a) Cash b) debit, credit c) Cash Account d) credit e) debit f) cash

C 2. a) True b) True c) False d) False e) True

E 1) Debit 2) Credit 3) Contra entry 4) Cash 5) Both 6) Credit

F 4. (a) goods (b) credit (c) credit note (d) Purchases (e) credit (f) returns inwards (g) returns outwards (ii) returned

G 6. (a) True (b) False (c) False (d) True (e) False (f) False (g) True (h) False

6.22 TERMINAL QUESTIONS / EXERCISES

Questions

1. Why is journal sub-divided? Name the special journals and state the type of transactions entered in each of them.

2. Explain the following in about 10 lines each.

   a) 'Cash Book is both a journal and a ledger'

   b) Imprest system

   c) Types of Cash Books

   d) Posting of Two Column Cash Book.

3. What are the advantages of maintaining a Petty Cash Book? Explain the method of balancing and posting the Petty Cash Book.

4. Explain the following in about ten lines each.

   a) Bank Column in cash book serves the purpose of a Bank Account in the ledger

   b) Advantages of having a bank account.

   c) Effect of crossing a cheque.

   d) Contra Entry.

5. State the reasons for the following:

   a) All entries in Three Column Cash Book are not posted into the ledger.

   b) The total in the cash column on the debit side of the cash book is always more than its credit side, but it is not true of the bank column.

   c) When a cheque received is endorsed to a third party, it must be entered on both sides of the cash book.

6. Why is a cheque dishonoured? How do you record it in the cash book?

7. Give the proforma of Purchases Journal. Explain the method of recording the transactions in the Purchases Journal and its posting into ledger.

8. How does Debit Note differ from Credit Note? Discuss the utility of these notes.

9 Write short notes on the following:

   a) Returns Inward Journal

   b) Returns Outward Journal

10. What is a Journal Proper? List the transactions recorded in the Journal Proper.

Exercises

1. Enter the following transactions of Motilal Stores in the Single Column Cash Book and balance the same.

2018		**Rs.**
Jan.1	Motilal started business with a capital	20,000
" 2	Purchased furniture	5,000
" 2	Purchased goods	3,000
" 3	Paid cartage	75
" 5	Sold goods for cash	2,800
" 10	Paid to Ratan Lal	2,000
" 18	Sold goods for cash	1,000
" 25	Paid wages	225
" 28	Paid rent	500
" 30	Purchased goods	2,000

(**Answer:** Cash in hand Rs. 11,000)

2. From the following transactions of Mani Ram Agencies, prepare a Single Column Cash Book, balance it, and post it into ledger.

2018		**Rs.**
Jan. 1	Mani Ram started business with cash	40,000
" 2	Opened a bank account and deposited	15,000
" 5	Purchased furniture	8,000
" 8	Purchased goods	12,000
" 10	Sold goods for cash	7,000
" 15	Sold goods on credit to Rajan	6,000
" 20	Purchased electrical fan	450
" 25	Received cash from Rajan	6,000
" 28	Paid rent	550
" 29	Deposited into the bank	10,000
" 31	Paid wages	1,500

Hint: Credit sales are not a cash transaction. Hence, not recorded in the Cash Book.

(Answer: Cash in hand Rs. 5,500)

3. Enter the following transactions of Gupta Emporium in Two Column Cash Book and balance it.

2018		
Apr.	1	Cash in hand Rs. 3,000
“	3	Paid to S.K, Basu Rs. 580 and received discount Rs. 20.
“	5	Purchased goods for cash Rs. 2,000
“	8	Received from N.K. Prasad Rs. 960, and allowed him discount of Rs. 40
“	15	Sold goods on credit to Adinarayan Rs. 2,000
“	20	Cash sales Rs. 600 -
“	25	Paid to Narayan Rs. 1,150 in full settlement of his account of Rs. 1,200
“	28	Received from Adinarayan Rs. 1,950 in full settlement of his account
“	29	Rent paid Rs. 600
“	30	Took cash for personal use Rs. 500

(**Answer:** Cash balance Rs. 1,680. Discount allowed total Rs. 90, Discount received total Rs. 70).

4. Prepare Two Column Cash Book of M/s. Sanjay Enterprises from the following transactions. Also show the ledger postings.

2018			**Rs.**
Apr.	1	Cash in hand	3,000
“	3	Purchased goods	800
“	5	Paid to Gupta	600
		Discount allowed by him	40
“	7	Sold goods	1,000
“	9	Received from Pannalal	1,960
		Discount allowed to him	40
“	12	Received cash from Nagesh in full settlement of his account Rs. 1,000	970
“	15	Paid to Rakesh after deducting 2.5% discount	1,170
“	18	Received from Shanker	590
		Discount allowed to him	10
“	24	Paid wages	100
“	27	Paid for stationery	60
“	29	Paid to Kartar Singh in full settlement of his account Rs. 800	780
“	30	Deposited cash into bank in excess of	800

(**Answer:** Amount deposited in the bank Rs. 3,210. Discount allowed total Rs. 80. Discount received total Rs. 90).

5. Prepare a Petty Cash Book on the Imprest System from the following particulars of M/s. Preetam Industries.

2018			Rs.
July	1	Received a cheque for petty cash	150.00
"	2	Paid bus charges	1.50
		Paid cartage	5.00
"	3	Paid for postage and telegrams	15.25
		Paid wages to casual workers	10.00
"	4	Paid for Stationery	4.75
"	5	Paid for repairs of chairs	15.00
		Bus Charges	1.00
"		Cartage	4.50
"	6	Purchased locks	35.00
"	7	Tea expenses to customers	4.00
"	15	Repair to typewriter	7.00
"	20	Paid tanga charges	6.00
"	24	Paid taxi fare to manager	18.00
"	26	Purchased stamps	5.00
"	29	Auto charges	7.00

(**Answer:** On August 1, 2018, petty cashier will be given a cheque for Rs. 139)

6. Enter the following transactions in the Three Column Cash Book of M/s. Shreelekha & Co.

2018			Rs.
May	1	Cash in hand	1,134
"	1	Cash at bank	25,350
"	2	Deposited into bank	1,000
"	4	Received from Ram Lal	1,580
		and discount allowed	20
"	8	Purchased furniture for cash	500
"	11	Paid to Jai Kishan by cheque	1,490
"		received discount	10
"	15	Received from Gopal by cheque	1,000
"	16	Cash sales	1,570
"	20	Deposited into bank	2,000
"	21	Purchased an old motor car for office and paid by cheque	10,480
"	22	Paid by cheque to Ranganath	734
		and received discount	6
"	24	Withdrew from bank for office use	500
"	27	Purchased goods for cash	600
"	28	Withdrew from bank for personal use	1,000
"	31	Paid establishment expenses through bank	900

(**Answer:** Discount allowed Rs. 20; Discount Received Rs. 16; Cash Balance Rs. 684; Bank Balance Ps. 14,246.)

7. Record the following transactions in Three Column Cash Book of M/s Modern Commercials, and post them into ledger.

2018		Rs.
Jan. 1	Cash balance	700
	Bank balance (overdraft)	1,400
" 2	Cash sales	900
" 3	Paid into bank	1,000
	Paid to Alag by cheque	1,225
" 5	Discount allowed by him	25
" 10	Paid to Prasad	150
" 14	Paid wages	250
" 16	Received a cheque from Dasgupta in full settlement of a claim of Rs	980
" 20	Paid for stationery	150
" 21	Purchased by cheque	600
" 23	Received a cheque from Ram. It was endorsed to Shyam	800
" 24	Paid Ranga by cheque	245
	and discount received	5
" 29	Withdrew from bank for office use	250
" 31	Cash drawn for personal use	150

(**Answer:** Discount Allowed Rs. 20; Discount Received Rs. 30; Cash Balance Rs. 150; Bank Overdraft Rs. 1,740.)

8. Prepare a Three Column Cash Book from the following transactions and post them into ledger.

2018		Rs.
Aug 1	Cash in hand	700
" 1	Cash at bank	10,000
" 3	Cash sales	6,000
" 5	Paid rent by cheque	2,400
" 9	Cash deposited in the bank	6,000
" 10	Wages paid	100
" 11	Purchased stationery	180
" 13	Received cheque from Roy	780
	Discount allowed	20
" 15	Purchased goods	400
" 16	Withdrawn from bank for office use	2,000
" 18	Issued cheque to Gagan	1,340
	Received discount	60
" 20	Withdrew cash for personal use	400
" 20	Received cheque from Nath	1,000
" 24	Nath's cheque dishonoured	1,000

" 26	Issued cheque for furniture purchased	600
" 28	Received interest on securities by cheque	300
" 30	Paid salaries	480

(**Answer:** Discount Allowed Rs. 20; Discount Received Rs. 60; Cash Balance Rs. 1,140; Bank Balance Rs. 10,740.)

9 From the following particulars, prepare the Purchases Book of Devi Stationers and also show the ledger postings.

2018

Aug. 5 Purchased from Madan Mohan & Sons on credit 5 reams of white paper @ Rs. 75 per ream,

10 Purchased from Gopikrishna Bros. 5 dozen ink bottles @ Rs. 52 per dozen at a discount of 10%.

14 Purchased from Avanti Pen Stores 3 dozen ball pens @ Rs. 15 per dozen at a discount of 20%.

18 Purchased 100 pencils from Muralidhar & Co. @ Rs. 0.75 each.

25 Purchased a typewriter on credit from Office Equipment Limited for Rs. 4,500.

28 Purchased one dozen pen stands @ Rs. 100 per dozen for cash.

30 Purchased 5 dozen of note books on the credit from Rama & Co. @ Rs. 24 per dozen.

(**Hint:** Transactions dated August 25 and 28 are not to be entered in Purchases Book.)

(**Answer:** Total of Purchases Book Rs. 840)

10. Enter the following in the Purchases Returns Book of Lakshmi Traders. Also show their ledger postings.

2018		Rs.
June 2	Returned goods to Sharma Bros.	350
" 4	Returned goods to Eswar & Sons.	500
" 6	Returned goods to Venkat & Co. on which a discount of 10% was received.	600
" 8	Allowance claimed from Ranga & Co. for goods damaged.	450
" 10	Goods returned to Suryanarayana	200

(**Answer:** Total of Purchases Returns Book Rs. 2,040)

11 Write up the Sales Book of Kiran Associates, wholesale cloth dealers, from the following transactions and post them into ledger.

2018

Aug.16 Sold to Patel Nanded:

100 metres of silk @ Rs. 45 per metre.

75 metres of velvet @ Rs. 12 per metre.

" 18 Sold to Hassen, Gulbarga:

60 pieces of two by two cloth @ Rs. 10 per piece.
100 pieces of velvet @ Rs. 8 per piece.

“ 20 Sold to Shankaraiah, Vikarabad:
50 pieces of dhoties @ Rs. 50 per dhoti.
40 towels @ Rs. 8 per towel.

“ 25 Sold to Koteswara Rao, Vijayawada:
100 metres of shirting cloth @ Rs. 40 per metre.
60 sarees @ Rs. 75 per sari.

“ 28 Krishna Murthy, Warangal, purchased from us:
100 metres of long cloth @ Rs. 15 per metre.
100 metres of coarse cloth @ Rs. 9 per metre.

(Answer: Sales Book Total Rs. 20,520)

12. From the following particulars of Sriram Stationers, prepare the Sales Returns Book and show their ledger posting.

2018

July 5 M/s Sridevi Stationers returned:
4 dozens 100 page note books @ Rs. 18 per dozen.
2 dozens 200 page note books @ Rs. 30 per dozen.

“ 10 Ramakrishna & Bros. returned @
3 dozen ink bottles @ Rs. 30 per dozen.
1 dozen gum bottles @ Rs. 20 per dozen.
2 dozen erasers @ Rs. 6 per dozen.

“ 15 Sanjeev & Co. returned:
5 dozen pencils @ Rs. 12 per dozen.
2 dozen reflis @ Rs. 5 per dozen.

(Answer: Sales Returns Book Total Rs. 336)

13. Enter the following transactions in proper subsidiary books of Chekra Enterprises.

2018			Rs.
Aug.	1	Sold goods to Ram Singh	2,550
“	2	Bought goods from Dhillon	1,200
“	3	Sold goods to Gopinath	2,500
“	4	Purchased goods from Habeeb	3,600
“	5	Ram Singh returns goods	350
“	6	Goods returned to Dhillon	200
“	9	Gopinath returned goods	150
“	10	Returned goods to Habeeb	260
“	12	Bought goods from Sanyal	4,750
“	13	Sold goods to Sailo	6,200
“	14	Sold goods to Michael	4,850
“	15	Purchased goods from Anthony	3,940
“	18	Returned goods to Sanyal	320
“	19	Sailo returned us goods	230

" 22	Michael returned goods	150
" 25	Returned goods to Anthony	250
" 27	Sold goods to Solanki	5,340
" 28	Purchased goods from Gopalan	4,670
" 29	Sold goods to Harbinder Singh subject to trade discount of 5%	2,000
" 30	Purchased goods from Bhandari subject to a trade discount of 10%	1,000

(**Answer**: Totals of Purchases Book Rs. 19,060, Purchases Returns Book Rs. 1,030, Sales Book Rs. 23,340, and Sales Returns Book Rs. 880)

14. The following are the bill transactions of Saptagiri Agencies, Hyderabad. All bills accepted by Saptagiri Agencies are payable at the Andhra Bank, Hyderabad. Prepare Bills Receivable and Bills Payable Journals and post them into ledger.

2018

Aug. 3 A bill is drawn on Ram Narayan of Hyderabad, payable after three months for Rs. 5,000. It was duly accepted by him on the same day, payable at State Bank of India, Hyderabad.

" 5 Accepted a bill dated August 1, 2018 drawn by Agarwal of Lucknow, payable after 60 days, for Rs. 3,000.

" 8 Drew a bill on Milkha Singh of Chandigarh for Rs. 4,000 payable after 2 months at Punjab National Bank, Chandigarh. The bill is received on August 16, duly accepted.

" 12 Accepted a bill dated August 6, 2018 drawn by Ghanshyam Oza of Rajkot, payable after one month, for Rs. 2,500.

" 18 Received an acceptance dated August 12, 2018 from N. Mirdha of Jaipur, payable at State Bank of Bikaner, Jaipur 90 days after date, for Rs. 6,000. It was endorsed to S. Sakeecha of Bhopal on the same day.

" 22 Accepted the bill dated July 14, 2018 drawn by P. Obul Reddy, Tirupathi, for Rs. 3,500, payable after 2 months.

" 23 A bill is drawn on S. Mukherjee of Calcutta for Rs. 9,000 payable at Allahabad Bank, Calcutta, 90 days after date. The bill was received duly accepted on August 28, 2018, and was discounted with Andhra Bank, on the same day.

" 30 Accepted the bill dated August 25, 2018 drawn by Paleirio of Panaji, for Rs. 2,800, payable after 30 days.

(**Answer**: Total of Bills Receivable Book Rs. 24,000. Bills Payable Book Rs. 11,800)

> **Note** : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 7 TRIAL BALANCE

Structure

7.0 OBJECTIVES

After studying this unit, you should be able to:

- define trial balance;
- prepare trial balance from a given set of balances;
- explain the causes of disagreement of a trial balance;
- describe the procedure for locating the errors;
- describe the types of errors which remain undisclosed by the trial balance;
- explain the advantages and limitations of trial balance;
- rectify errors before preparing the final accounts;
- explain the use of suspense account;
- prepare the suspense account;

- rectify errors located during subsequent accounting years; and
- compute the effect of rectifying errors on profits.

7.1 INTRODUCTION

You have learnt the method of recording transactions in journal and its sub-divisions. You have also learnt their posting to various accounts in the ledger. This process of recording and posting continues throughout the year. At the end of the year it becomes necessary to check the arithmetical accuracy of the books of account before the final accounts can be prepared. For this purpose, we prepare a statement called Trial Balance. In this unit, you will study about the preparation of Trial Balance and the extent upto which it can be relied upon for testing the accuracy of accounts. You will also learn about the errors that will be disclosed by Trial Balance and the method of locating such errors.

You know that Trial Balance is prepared to verify the arithmetical accuracy of accounting records. When the Trial Balance does not tally, it means there are errors in the books of account and you will also learn about the errors that affect the Trial Balance and also study the procedure for locating such errors. In the process of rechecking, a number of errors are detected. These errors must be rectified before preparing the final accounts. In this unit, you will also learn about the method of rectifying various errors and study the effect of the rectification on the profit of the business. You are advised to go through this unit once again and note the errors that are usually committed in the process of recording various transactions in subsidiary books and their postings.

7.2 WHAT IS A TRIAL BALANCE ?

Numerous transactions take place in business everyday. They are first recorded in some books of original entry i.e., Journal Proper or one of its sub-divisions. Then they are posted to the appropriate accounts in the ledger. Each ledger account is balanced periodically so as to ascertain the net effect of various transactions posted therein. In the process, some accounts may get closed, while the others may show a debit or a credit balance. Based on these balances, the final accounts are prepared for ascertaining the profit or loss and the financial position of the business. The quality and reliability of the results obtained depend largely on the correctness of the entries made in various books of account. Hence, it is necessary to ascertain the accuracy of these entries before we proceed with the preparation of final accounts. For this purpose, we prepare a statement called 'Trial Balance', which shows balance of all ledger accounts. The ruling of trial balance is similar to that of journal. We write the name of each account in the particulars column. If the account shows a debit balance, its amount is entered in the debit balances column and if it shows a credit balance the amount is entered in the credit balances column. You know that the total of the debit balances column must tally with the total of the credit balances column, because for every debit there is a corresponding credit and vice versa. When the two totals tally, it is considered as a preliminary proof of the arithmetical accuracy of entries in the books of accounts. It is an assurance that posting into ledger has been correctly done and that equality between debits and credits has been maintained throughout. If, however, the two totals do not tally it implies that there are errors in the books of account.

Trial Balance can thus be defined as a statement (or a schedule) listing, in separate columns, the debit and credit balances of all ledger accounts on a particular date. It indicates whether or not the books of account have been written in accordance with the rules of double entry and ensures, to a great extent, the arithmetical accuracy of accounting entries.

7.3 PREPARATION OF A TRIAL BALANCE

At the outset, it is necessary to note that Trial Balance is a statement of balances. Its preparation does not involve passing of any journal entries. We simply balance various accounts in the ledger and list all accounts which show some balance, whether it is debit or credit. You are aware that when cash book is maintained, the ledger does not contain cash and bank accounts. Hence, cash and bank balances are taken from the cash book. If the number of personal accounts is large, you may prepare separate statements of balances for all debtors and creditors and show only the total debtors and total creditors in the trial balance.

Let us now take a comprehensive example covering all types of transactions, record them in appropriate books, post them into ledger, and prepare a trial balance. Look at illustration 1. It shows the accounting process right upto the preparation of Trial Balance.

Illustration 1

The following is the Balance Sheet of Kapil Dev as on March 31, 2018.

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital	50,000	Cash in hand	15,000
		Stock	50,000
Loan from bank	8,000	Due from Khanna	1,500
Due to Saluja Bros.	15,000	Due from Mittal	2,500
		Furniture	4,000
	73,000		73,000

The following transactions took place during April, 2018:

			Rs.
April	2	Paid wages and salaries	6,000
"	2	Cash sales of bicycles	3,000
"	3	Purchased 20 bicycles on credit from Mehra Cycle Co. @ Rs. 600 per bicycle	12,000
"	5	Sold 30 bicycles to Mittal @ 900 per bicycle	27,000
"	8	Paid to Saluja Bros. in full settlement of their account	14,600
"	10	Received from Mittal 2 bicycles as defective, and sent him a credit note	1,800
"	13	Paid rent	1,750
"	15	Purchased from Saluja Bros. on credit	
		20 cycle rims @ Rs. 100 each	2,000
		20 cycles hubs @ Rs. 20 each	400

"	18	Sold to Rao 10 bicycles © Rs. 800 per bicycle	8,000
"	20	Returned to Saluja Bros. 10 cycle hubs being cracked	200
"	21	Rao returned 2 bicycles, and sent him credit note	1,600
"	22	Mittal Paid	14,000
"	24	Purchased one typewriter on credit from Kutub Typewriter Co.	6,500
"	25	Cash sales	3,500
"	28	Khanna paid; no hope of getting the balance	1,000
"	30	Rao paid	6,200
		Discount allowed	200
"	30	Paid to Mehra Cycle Co. on accoun	10,000

Prepare Journal Proper and the subsidiary books involved. Show their postings into ledger and prepare a Trial Balance.

Cash Book

Dr. **Cr.**

Date	Particulars	L.F.	Discount	Cash	Date	Particulars	L.F.	Discoun	Cash
2018			Rs.	Rs.	2018			Rs.	Rs.
Apr. 1	To Balance b/d			15,000	Apr.2	By Wages and Salaries A/c			6,000
" 2	To Sales A/c			3,000	" 8	By Saluja Bros.		400	14,600
" 22	To Mittal			14,000	" 13	By Rent Alc			1,750
" 25	To Sales A/c			3.500	" 30	By Mehra Cycle Co.			10,000
" 28	To Khanna			1,000	" 30	By Balance c/d			10,350
" 30	To Rao		200	6,200					
			200	42,700				400	42,700
May 1	To Balance b/d			10,350					

PURCHASES JOURNAL

Date	Particulars	Invoice No.	L.F.	Amount
2018				Rs.
Apr. 3	Mehra Cycle Co.			12,000
" 15	Saluja Bros.			2,400
" 30	Total			14,400

PURCHASES RETURNS JOURNAL

Date	Particulars	Debit Note No.	L.F.	Amount
2018				Rs.
Apr. 20	Saluja Bros.			200
" 30	Total			200

SALES JOURNAL

Date	Particulars	Invoice No.	L.F.	Amount
2018				Rs.
Apr. 5	Mittal			27,000
" 18	Rao			8,000
" 30	Total			35,000

SALES RETURNS JOURNAL

Date	Particulars	Credit Note No.	L.F.	Amount
2018				Rs.
Apr.10	Mittal			1,800
" 21	Rao			1,600
" 30	Total			3,400

JOURNAL

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
2018				Rs.	Rs.
Apr. 1	Cash A/c	Dr.		15,000	
	Stock A/c	Dr.		50,000	
	Khanna	Dr.		1,500	
	Mittal	Dr.		2,500	
	Furniture A/c	Dr.		4,000	
	To Capital A/c				50,000
	To Bank Loan A/c				8,000
	To Saluja Bros.				15,000
	(Opening balances of assets and liabilities being brought in on April 1, 2018				
" 24	Typewriter A/c	Dr.			
	To Kutub Typewriter Co.			6,500	
	(Being purchase of typewriter on credit)				6,500
" 28	Bad Debts A/c	Dr.		500	
	To Khanna				500
	(Being amount still due from Khanna, now written off as bad debt)				
" 30	Total			80,000	80,000

LEDGER

Capital Account

Dr.					Cr.
2018		Rs.	2018		Rs.
Apr. 30	To Balance c/d	50,000	Apr. 1	By Balance b/d	50,000
			May 1	By Balance b/d	50,000

Saluja Bros Account

2018		Rs.			Rs.
Apr. 8	To Cash A/c	14,600	Apr, .1	By Balance b/d	15,000
" 8	To Discount A/c	400	" 15	By Purchases A/c	2,400
" 20	To Returns Outward A/c	200			
" 30	By Balance c/d	2,200			
		17,400			17,400
			May 1	By Balance b/d	2,200

Bank Loan Account

2018		Rs.	2018		Rs.
			Apr, 1	By Balance b/d	8,000
Apr. 30	To Balance c/d	8,000			
		8,000	May 1	By Balance b/d	8,000

Mehra Cycle Co. Account

2018		Rs.	2018		Rs.
Apr. 30	To Cash A/c	10,000	Apr. 3	By Purchases A/c	12,000
" 30	To Balance c/d	2,000			
		12,000			12,000
			May 1	By Balance b/d	12,000

Khanna's Account

2018		Rs.	2018		Rs.
Apr. 1	To Balance b/d	1,500	Apr, 28	By Cash A/c	1,000
			" 30	By Bad Debts A/c	500
		1,500			1,500

Mittal's Account

2018		Rs.	2018		Rs.
Apr. 1	To Balance b/d	2,500	Apr. 10	By Return Inward A/c	1,800
" 5	To Sales A/c	27,000	" 22	By Cash A/c	14,000
			" 30	By Balance c/d	13,700
		29,500			29,500
May 1	To Balance b/d	13,700			

Rao's Account

2018		Rs.	2018		Rs.
Apr. 18	To Sales A/c	8,000	Apr. 21	By Return Inward A/c	1,600
			" 30	By Cash A/c	6,200
			" 30	By Discount A/c	200
		8,000			8,000

Furniture Account

2018		Rs.	2018		Rs.
Apr. 1	To Balance b/d	4,000	Apr. 30	By Balance c/d	4,000
May 1	To Balance b/d	4,000			

Typewriter Account

2018		Rs.	2018		Rs.
Apr. 24	To Kutub Type Writer Co.	6,500	Apr. 30	By Balance c/d	6,500
May 1	To Balance b/d	6,500			

Stock Account

2018		Rs.	2018		Rs.
Apr. 1	To Balance b/d	50,000	Apr. 30	By Balance c/d	50,000
May 1	To Balance b/d	50,000			

Sales Account

2018		Rs.	2018		Rs.
			Apr, 2	By Cash A/c	3,000
			" 25	By Cash A/c B	3,500
			" 30	By Sundries as per Sales Book	35,000

Purchase Account

2018		Rs.			
Apr. 30	To Sundries as per Purchase Book	14,400			

Return Outwards Account

			2018		Rs.
			Apr, 30	By Sundries as per Returns Outward Book	200

Return Inwards Account

2018		Rs.			
Apr, 30	To Sundries as per Returns Inward Book	3,400			

Wages & Salaries Account

2018		Rs.			
Apr. 2	To Cash A/c	6,000			

Rent Account

2018		Rs.			
Apr. 13	To Cash A/c	1,750			

Bad Debts Account

2018		Rs.			
Apr. 28	To Gupta	500			

Discount Account

2018		Rs.	2018		Rs.
Apr.30	To Sundries - as per Cash Book	200	Apr. 30	By Sundries - as per Cash Book	400

Kutub Typewriter Co.

2018		Rs.	2018		Rs.
Apr. 30	To Balance c/d	6,500	Apr, 24	By Typewriter A/c	6,500
			May 1	By Balance b/d	

Trial Balance as on April 30, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Cash in hand		10,350	
Capital			50,000
Saluja Bros.			2,200

Bank Loan			8,000
Mehra Cycle Co.			2,000
Kutub Typewriter Co.			6,500
Mittal		13,700	
Furniture		4,000	
Typewriter		6,500	
Stock		50,000	
Sales			41,500
Purchases		14,400	
Returns Outwards			200
Returns Inwards		3,400	
Wages & Salaries		6,000	
Rent		1,750	
Bad Debts		500	
Discount Allowed		200	
Discount Received			400
Total		1,10,800	1,10,800

Note: 1. You should know that the Trial Balance can also be prepared on the basis of the totals of all debits and credits in various accounts. But, this method is not followed any more. Hence it has not been discussed.

2. In this illustration, you will find that some accounts have not been balanced. It is because these are all nominal accounts which are to be closed by transfer to the Trading and Profit & Loss Account.

7.4 PREPARATION OF TRIAL BALANCE FROM A GIVEN LIST OF BALANCES

Normally when a trial balance is to be prepared, you have full details of ledger accounts with you. You can, therefore, easily ascertain whether a particular account has a debit balance or credit balance, and prepare the Trial Balance without any difficulty. But, sometimes, you are given only a list of balance. The nature of each balance is not mentioned. In other words, it is not clearly indicated whether the account is showing a debit balance or credit balance. Can you prepare a Trial Balance in such a situation? No you can't unless you know the nature of each balance. You will not know whether to show a particular balance in the debit column or in the credit column of the Trial Balance.

Hence, when you are asked to prepare a Trial Balance from a given list of balances and it is not clearly indicated whether a particular account has a debit balance or credit balance, you will first have to determine the nature of each balance. In this exercise, your knowledge of rules of debit and credit should help you. For example, you are aware that in case of nominal accounts all expenses and losses are debited and all incomes and gains are credited. Hence, accounts like salaries, wages, etc., will show debit balances and the accounts like interest received, discount received, etc., will show credit balances. Similarly, you know the rules for real and personal accounts. The accounts of assets like cash in hand, machinery, etc., will show debit balances and accounts like capital, creditors, etc., will show credit balances. For convenience, however, a few guidelines may help you to determine quickly the nature of each balance. These are:

a) All accounts of expenses (including purchases) and losses will be debit balances.

b) All accounts of incomes (including sales) and gains will be credit balances.

c) All accounts of assets will be debit balances.

d) All accounts of liabilities will be credit balances.

e) Capital Account will normally be a credit balance.

f) Drawings Account will be a debit balance.

The difficulty may arise with regard to items like commission, discount, rent and interest, because these can take the form of expenses as well as incomes. In such cases, the nature of balance is usually indicated by mentioning (Dr.) or (Cr.) against each item, or the word 'received' or 'paid' is usually added. So you can treat them correctly without much difficulty. If, however, there is one item for which no such indication is given and you find it difficult to identify the nature of its balance, you just proceed with the preparation of Trial Balance. At the time of totalling the amount columns in the trial balance, you will find that the total of one column is less than the other. This implies that the unindicated balance pertains to the column which is short. For example, there is an item of commission Rs. 300. But it is not indicated whether it is paid or received. When you prepare the trial balance, you find that the debit total is short by Rs. 300. This means that Commission Account has a debit balance. Now, if you show it as such in the Trial Balance, it will tally.

Look at illustration 2. The Trial Balance has been prepared from a given list of balances where the nature of each balance is not indicated. Study illustration carefully and note how each item has been shown in the Trial Balance.

Illustration 2

Prepare a Trial Balance from the following balances taken from the books of Sudhakaras on March 31, 2018.

	Rs.		Rs.
Capital	1,80,000	Discount Received	360
Stock (1-4-2017)	49,200	Bills Payable	12,270
Sales	2,43,600	Sundry Creditors	31,110
Gas & Water	2,520	Returns Outwards	19,200
Land & Buildings	60,000	Bank Charges	3,000
Machinery	55,470	Drawings	14,550
Debtors	1,07,400	Trade Expenses	2,970
Commission (Dr.)	4,410	Cash	2,400
Plant	30,810	Bank	15,780

Carriage	3,370	Purchases	96,480
Rent Received	1,290	Rates & Taxes	2,520
Insurance	3,180	Furniture	3,750
Returns Inwards	5,970	Bills Receivable	4,410
Salaries	19,640		

Solution :

Trial Balance as on March 31, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Capital		—	1,80,000
Stock (1-4-2017)		49,200	—
Sales		—	2,43,600
Gas and Water		2,520	—
Land & Buildings		60,000	—
Machinery		55,470	—
Debtors		1,07,400	—
Commission (Dr.)		4,410	—
Plant		30,810	—
Carriage		3,370	—
Rent Received		—	1,290
Salaries		19,640	—
Insurance		3,180	—
Returns Inwards		5,970	—
Discount Received		—	360
Bills Payable		—	12,270
Sundry Creditors		—	31,110
Returns Outwards		—	19,200
Bank Charges		3,000	—
Drawings		14,550	—
Trade Expenses		2,970	—
Cash		2,400	—
Bank		15,780	—
Purchases		96,480	—
Rates & Taxes		2,520	—
Furniture		3,750	—
Bills Receivable		4,410	—
Total		4,87,830	4,87,830

In illustration 2, the Trial Balance has tallied i.e., the total of debit balances is equal to the total of credit balances. This implies that each balance has been entered in the appropriate amount column.

However, you require constant practice to determine the correct nature of items. Hence, another illustration is given where the accountant has not been able to correctly place the balances and, consequently, the Trial Balance does not tally. Look at illustration 3. The total of debit balances (Rs. 10,83,600) is different from the total of credit balances (Rs. 7,16,400). It is because a number of balances have been entered in the wrong amount columns. To cite one example, stock (an asset) is a debit balance but it has been wrongly entered in the credit column. Now, go through all items and identify those which have not been correctly shown in the given Trial Balance. Then, study the Revised Trial Balance and note how they are actually shown. This should help you gain clarity about the nature of various balances.

Illustration 3

Given below is a Trial Balance prepared by an inexperienced accountant and the Trial Balance has not tallied. Rewrite the Trial Balance.

Trial Balance of Buddhu & Co. as on December 31, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Capital		—	1,12,600
Buildings		1,70,000	—
Motor Car		—	30,000
Sales		6,00,000	—
Purchases		—	3,40,000
Furniture		25,000	—
Stock		—	44,000
Bank Overdraft		12,000	—
Cash		3,000	—
Interest on Bank Loan		—	4000
Discounts Received		2,600	—
Discounts Allowed		—	4,600
Salaries		14,000	—
Wages		—	12,000
Printing & Stationery		4,000	—
Investments		10,000	—
Advertisement		6,000	—
Legal Charges		2,000	—
Audit Fees		1,000	—
Bad Debts		3,000	—
Debtors		2,31,000	—
Creditors		—	1,72,800
Total		10,83,600	7,16,400

Revised Trial Balance of Buddhu & Co.
as on December 31, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances	Remarks
		Rs	Rs.	
Capital		—	1,12,600	—
Buildings		1,70,000	—	Asset Dr.
Motor Car		30,000	—	Asset Dr.
Sales		—	6,00,000	Income Cr.
Purchases		3,40,000	—	Expense Dr.
Furniture		25,000	—	Asset Dr.
Stock		44,000	—	Asset Dr.
Bank Overdraft		—	12,000	Liability Cr.
Cash		3,000	—	Asset Dr.
Interest on Bank Loan		400	—	Expense Dr.
Discounts Received		—	2,600	Income Cr.
Discounts Allowed		4,600	—	Expense Dr.
Salaries		14,000	—	"
Wages		12,000	—	"
Printing & Stationery		4,000	—	"
Investments		10,000	—	Asset Dr.
Advertisement		6,000	—	Expense Dr.
Legal Charges		2,000	—	"
Audit Fees		1,000	—	"
Bad Debts		3,000	—	"
Debtors		2,31,000	—	Asset Dr.
Creditors		—	1,72,800	Liability Cr.
Total		9,00,000	9,00,000	

Check Your Progress A

1. Define Trial Balance

   ....

   ....

   ....

2. Mention against each item whether it will generally show a debit balance or a credit balance.

Item	Nature of Balance (Debit or Credit)
a) Opening Stock	....
b) Bad Debts	....
c) Carriage Inwards	....

d) Carnage Outwards ....
e) Returns Inwards ....
f) Returns Outwards ....
g) Loan from Bank ....
h) Drawings ....
i) Goodwill ....
j) Bill Payable ....
k) Cash at Bank ....
1) Interest on Loan ....
m) Discount Allowed ....
n) Freehold Premises ....
o) Insurance ....
p) Salaries Payable ....

7.5 CAUSES FOR THE DISAGREEMENT OF A TRIAL BALANCE

As mentioned earlier, when the Trial Balance does not tally, it means that there are errors in the books of account. Let us now analyse the errors which usually affect the Trial Balance and lead to its disagreement.

1. **Omission of posting in one account:** You are aware that both the debit and credit aspects of a transaction have to be posted in the ledger accounts. If you post it to the debit of one account and forget its posting to the credit of the other concerned account, it is bound to affect the Trial Balance. For example, an amount of Rs. 200 received from Ali, correctly entered on the debit side of the cash book but is not posted to the credit side of Ali's Account. This error shall result in the lower credit and hence the Trial Balance will not tally.

2. **Double posting in one account:** If by mistake you post an entry two times to the debit or to the credit of an account it would result in extra debit or credit and as such cause disagreement in the Trial Balance. If, however, the whole entry is posted twice i.e., both the debit and the credit aspects are posted twice, it won't affect the Trial Balance. It is because both the debit and the credit sides will be equally affected.

3. **Posting on the wrong side of an account:** When an entry is posted on the wrong side of an account i.e., instead of debit side it is posted on the credit side, it would also cause disagreement in the Trial Balance. In such a situation, the difference will be for double the amount. For example, Rs. 300 received from Khan which is correctly entered on the debit side of the Cash Book, but while posting it to Khan's Account, it is wrongly posted to the debit side instead of the credit side. This would mean that a debit of Rs. 600 (Rs. 300 in Cash Account and Rs. 300 in Khan's Account) has no corresponding credit. So, in the Trial Balance, the credit side will be lower by Rs. 600.

4. **Posting wrong amount in an account:** If you post an entry to the correct side of an account but commit an error in writing the amount, this would affect the Trial Balance. Suppose, in the above example you post the entry

correctly on the credit side of Khan's Account but the amount is wrongly put as Rs. 200. It would cause a difference of Rs. 100. In the Trial Balance, the credit side will be lower by Rs. 100.

5. **Wrong totalling of the subsidiary book**: If any subsidiary book is overcast or undercast, it affects the concerned account in ledger. Suppose the correct total of Sales Journal is Rs. 5,600, but it is actually totalled as Rs. 5,300. You know that the total of Sales Journal is posted to the credit side of the Sales Account. So, the Sales Account will be short by Rs. 300, and the Trial Balance will not tally.

6. **Omitting to post the total of a subsidiary book:** If the total of a subsidiary book is not posted to the concerned account, it would affect the Trial Balance. Such mistake relates only to the account where posting was to be done and as such affects only one account. Take for example, the Sales Journal. If its total of Rs. 18,900 is not posted to the credit of Sales Account, the credit side on the Trial Balance will be lower by Rs. 18,900.

7. **Wrong totalling or balancing of an account:** When an account is wrongly totalled or wrongly balanced, this would affect the Trial Balance. Suppose the debit side of Shyam's Account is totalled as Rs. 1,300 instead of Rs. 1,100. It would lead to wrong balance in Shyam's Account. Consequently, the debit total in the Trial Balance will be higher by Rs. 200. Similarly, if the totalling is correctly done but a mistake is committed in balancing the account, it would also cause a difference in the Trial Balance.

8. **Omission of an account from Trial Balance:** You know that all accounts which show some balance must be included in the Trial Balance. If you forget to write the balance of any account in the Trial Balance, it will not tally. In practice, cash book balances are often omitted from Trial Balance.

9. **Writing the balance of an account on the wrong side of the Trial Balance:** If the balance of an account which is to be shown in the debit column of the Trial Balance is actually shown in the credit column, the Trial Balances will not tally. It will be affected by double the amount. You noticed such error in respect of many items in illustration 3.

10. **Wrong totaling of the Trial Balance :** If a mistake is committed in totalling the Trial Balance amount columns of the Trial Balance itself, the Trial Balance will not tally. Thus, you learn about various errors which may cause differences in the Trial Balance. Note that these errors affect only one aspect (debit or credit). This upsets the debit-credit correspondence leading to the disagreement of the Trial Balance.

7.6 LOCATING ERRORS WHEN THE TRIAL BALANCE DISAGREES

When a Trial Balance disagrees, an attempt must be made to locate the errors and rectify them. If all errors are rectified and the Trial Balance is revised, it will tally.

The following routine procedure is usually adopted for locating the errors.

a) Check the totals of both the debit and the credit columns of the Trial Balance.

b) If the difference still persists, ascertain the exact amount of difference; and then

i) See whether an account having that balance has been omitted from the Trial Balance. Suppose the debit column in Trial Balance is short by Rs. 630, it is just possible that an account with a debit balance of Rs. 630 has not been entered in the Trial Balance.

ii) Check whether an account with a balance equal to that difference has been entered twice in the Trial Balance.

iii) Take the half amount of difference, see whether there is any account with such balance in the Trial Balance and, if so, check whether it is entered in the correct column or not. If an account with a debit balance of Rs. 315 has been entered in the credit column, the debit column becomes short by Rs. 630.

c) Verify whether (i) the balances of all the accounts are included in the Trial Balance, (ii) they are entered in the correct column, and (iii) their amounts have been correctly written. If no errors are found upto this stage, or the errors located have been duly corrected, but still the Trial Balance does not tally, there is need to take further action. You may take the following steps:

d) Check the totals of the lists of sundry debtors and sundry creditors.

e) Check the totals and balances of all accounts in the ledger.

f) Check the totals and the postings of all subsidiary books.

g) Check the postings of all amounts equal to the difference in Trial Balance. It is possible that a posting has been omitted. Similarly, check the postings of all amounts equal to half the difference. It is possible that the amount has been posted on the wrong side of the concerned account.

h) See that correct amounts have been brought forward from the previous pages.

i) Verify that all opening balances have been correctly entered in various accounts.

j) Compare the current year's Trial Balance with that of the previous year. Any variation noticed should be carefully checked.

The procedure outlined above, if carefully followed, should normally reveal all the errors. The errors are then rectified and a Revised Trial Balance is prepared. If no other errors exist, the Revised Trial Balance is likely to tally. However, if the Revised Trial Balance also does not tally, there is no alternative but to recheck the entire accounting work done during the year. Sometimes, all these efforts fail to reveal the errors. In such a situation, the difference may be placed to the debit or credit of a Suspense Account (as the case may be) and you may proceed with the preparation of the final accounts. Later on, as and when the errors come to light, they will be corrected through proper rectifying entries in the journal.

7.7 ERRORS NOT DISCLOSED BY TRIAL BALANCE

As stated earlier, the Trial Balance is only a reasonable proof (not a conclusive proof) of the arithmetical accuracy of accounting entries. There is no guarantee that when the Trial Balance has tallied, there will be no errors left. As a matter of fact, there are a number of errors which do not affect the Trial Balance at all. They are:

1. **Errors of Principle:** When a transaction has not been recorded as per the rules of debit and credit, or some other accounting principle has been ignored, the errors so arising are called 'Errors of Principle'. Example of such errors are:

   i) A credit purchase of a fixed asset recorded in the Purchases Journal instead of the Journal Proper: This results in debiting the Purchases Account instead of the concerned fixed asset account. It means that a capital expenditure has been treated as a revenue expenditure. This is an error of principle. This does not disturb the debit-credit correspondence. Hence, the Trial Balance will not be affected.

   ii) An expenditure incurred on repairs of machinery debited to Machinery Account: As per rules it should have been debited to Machinery Repair Account, as it is a revenue expenditure. Debiting to Machinery Account amounts to treating it as a capital expenditure. It is therefore an error of principle. This also does not affect the Trial Balance because the debit has been duly recorded, though in the wrong account.

   iii) Salary paid to Shyam recorded in the Cash Book as a payment to Shyam: This results in debiting Shyam's personal account instead of the Salaries Account. This is also an error of principle and does not affect the Trial Balance.

2. **Errors of Omission:** When a transaction is completely or partially omitted to be recorded in books of account, it is called an 'Error of Omission'. If the transaction is omitted to be recorded in the subsidiary books or its posting is completely omitted, it is called an 'Error of Complete Omission'. If, however, the posting is done in one account, but omitted to be done in the other, it is called an 'Error of Partial Omission'. For example, if a credit purchase of goods from Shyam is not recorded in the Purchases Journal or a credit purchase of furniture from Ram is duly recorded in the Journal Proper but no posting is done in any of the two accounts involved, then these will be termed as errors of complete omission. If the purchase of goods from Shyam is recorded in the Purchases Journal but is omitted to be posted in Shyam's Account, it will be called an error of partial omission. Other examples of partial omission are: omission in carrying forward the total from one page to the other, omission to balance an account, and so on.

   The errors of complete omission do not, affect the Trial Balance. But the errors of partial omission would certainly cause disagreement of the Trial Balance because they would lead to either short debit or short credit.

3. **Some Errors of Commission:** When an error is committed in recording a transaction in the subsidiary book with a wrong amount, or is committed in posting it to a wrong account or to the wrong side of an account, it is called an 'Error of Commission'. Errors like double posting, wrong totalling of an account, wrong carry forward, wrong balancing, etc., are also regarded as errors of commission. Such errors will generally affect the Trial Balance. But, if an error of commission is committed while recording a transaction in

any of the subsidiary books, it shall not affect the Trial Balance because both the debit and the credit are equally affected. Suppose, a machine of Rs. 5,000 purchased on credit from Gautam is recorded in the journal for Rs. 5,500. It means both the debit and the credit have been recorded for Rs. 5,500. Hence, the Trial Balance remains unaffected.

4. **Compensating Errors:** Those errors which nullify the effect of each other are called 'Compensating Errors'. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of another error or errors. Such errors do not affect the Trial Balance. For example, while posting an entry of Rs. 200 to the debit of Ram's personal account, we wrongly wrote Rs: 400. Then, while posting an entry of Rs. 500 to the debit of some other account we wrote Rs. 300. The first error will result in a higher debit of Rs. 200 whereas the second error will result in a lower debit of Rs. 200. Thus, the effect of the first error is nullified by the effect of the second error. So the Trial Balance will not be affected. Take another example. The Purchases Journal is overcast by Rs. 1,000 which means the Purchases Account will be debited in excess by Rs. 1,000. The sales fournal also, by mistake, is overcast by Rs. 1000 which means the sales account will be credited in excess by Rs. 1000. These two mistakes together result in excess debit of Rs. 1,000 as well as an excess credit of Rs. 1,000. Thus, they cancel out each other and the Trial Balance remains unaffected.

Check Your Progress B

1. Select one of the following alternatives and tick the correct answer.

a) Overcastting of Purchases Journal would affect:

   i) Sales Account ( )

   ii) Purchases Account ( )

   iii) Supplier's Account and Purchases Account ( )

b) Sales to Benson Rs. 500 posted to his account as Rs. 50 would affect:

   i) Sales Account ( )

   ii) Benson's Account ( )

   iii) Cash Account ( )

c) Sales to Gill recorded in Purchases Journal would affect:

   i) Sales Account ( )

   ii) Sales Account, Purchases Account and Gill's Account ( )

   iii) Purchases Account and Gill's Account ( )

d) Purchases made on credit not recorded at all would affect:

   i) Purchases Account ( )

   ii) Supplier's Account ( )

   iii) Purchases Account and Supplier's Account ( )

e) Amount paid to Billu posted to the credit side of his account would affect:

i) Billu's Account ( )

ii) Cash Account ( )

iii) Cash Account and Billu's Account ( )

f) Amount received from Sita Ram posted to the credit of Mela Ram would affect:

i) Sita Ram's Account ( )

ii) Mela Ram's Account ( )

iii) Sita Ram's Account and Mela Ram's Account ( )

2. Give two examples of errors of principle.

....

....

....

3. Give two examples of compensating errors.

....

....

....

4. A few errors committed in Ahluwalia's books of account are given below. State which errors would affect the Trail Balance.

a) Sales of Rs. 950 to Ram completely omitted from books of account.

b) Purchases of Rs. 720 from Shyam entered in the Purchases Journal as Rs.700.

c) Purchases Journal is overcast by Rs. 1,000.

d) Sales Returns Journal is undercast by Rs. 200.

e) Amount paid to Agarwal wrongly posted to the debit of Mittal's Account.

f) Bank overdraft shown under debit column in the Trial Balance.

g) Sales of Rs. 500 to Sadiq entered in Sales Journal as sales to Mushtaq.

h) Wages paid for installation of machinery debited to Wages Account.

7.8 ADVANTAGES OF A TRIAL BALANCE

The following advantages accrue from a Trial Balance:

1. It is a reasonable proof of the arithmetical accuracy of accounting entries. If the two sides of a Trial Balance tally, it is an indication that the books of account are arithmetically correct. Of course, there may still be some errors left.

2. It contains the balances of all ledger accounts on a particular date. Thus it serves as a summary of the results of all transactions during the period. The position of each account can be judged simply by looking at the Trial Balance. The ledger may be referred only if some further details are required in respect of a particular account.

3. It acts as a basis for preparing the final accounts i.e., Profit & Loss Account and the Balance Sheet. Of course, one can prepare these statements even by taking each balance directly from the ledger. But, that will be too cumbersome.

4. Regular preparation of a trial balance ensures that the accounting staff will work carefully. They will keep the accounts up to date and strive hard to avoid mistakes.

7.9 LIMITATIONS OF A TRIAL BALANCE

The following can be considered as the limitations of Trial Balance:

1. Trial balance does not disclose all types of errors. Certain types of errors remain undetected even when the Trial Balance tallies. Hence, it is not a conclusive proof of the accuracy of the books of account.

2. A Trial Balance does not provide any additional information. You can not have any idea about the net result of the trading activity or about the financial position directly from the Trial Balance. Thus, the Trial Balance serves a limited purpose only.

   Notwithstanding the limitations expressed above, the Trial Balance serves a useful purpose as a preparatory step in the preparation of final accounts.

7.10 RECTIFICATION OF ERRORS

Any error when located must be rectified. However, the rectification should not be made by overwriting or by striking off the wrong entry. This would destroy the authenticity of the books of account. Hence, the errors should always be corrected by making suitable entries called rectifying entries. For purposes of rectification, the errors are divided into two categories: (i) one-sided errors, and (ii) two-sided errors.

One-sided Errors : Certain errors affect only one side of an account, either the debit side or the credit side. Such errors are called 'one-sided errors'. Examples of one-sided errors are:

i) Rs. 100 received from Deshmukh was posted to his account as Rs. 10. It means Deshmukh's Account has been credited with Rs. 10 instead of Rs. 100 and there is no mistake in the Cash Book. Thus, this error has affected only one side of an account.

ii) Thw Purchase Book is overcast by Rs. 1000. This will affect the debit side of Purchases Account where the total of the Purchases Book is posted, and no other account is affected.

Two-sided Errors : Certain errors may affect two or more accounts. Such errors are called 'two-sided errors'. Examples of two-sided errors are:

i) A credit sale of Rs. 1,080 to Anand was wrongly recorded in the Sales Book for Rs. 1,800. This error will affect two accounts viz., Anand's Account and Sales Account. Anand's Account has been debited by Rs. 1,800 instead of Rs. 1,080. The Sales Account has also been credited by an additional amount of Rs. 720 (Rs. 1,800—Rs. l,080),because the Sales Book shows a higher total.

ii) A sale of Rs. 500 made to Kamal has been posted on the debit side of Kishore's Account. This error will affect two accounts viz., Kamal's Account and Kishore's Account. An entry of Rs. 500 does not appear on the debit side of Kamal's Account whereas Kishore's Account has been wrongly debited with that amount.

7.10.1 Rectification of One-sided Errors

Generally errors are corrected by passing suitable journal entries. You know passing a journal entry means debiting one account and crediting another. But in the case of one-sided error only one account is involved. So it cannot be corrected by passing journal entry. It is rectified by noting the correction on the appropriate side. Take the first example of one-sided error. Deshmukh's Account was credited short by Rs. 90. This will be corrected by an additional entry for Rs. 90 on the credit side of his account as follows:

Deshmukh's Account

Dr. **Cr.**

		By Difference in amount received from him posted on	Rs. 90

In the second example of one-sided error, the Purchases Account is debited in excess by Rs. 1,000. This will be corrected by crediting the Purchases Account with Rs. 1,000 as follows:

Purchases Account

Dr. **Cr.**

		By Overcasting of Purchases Book for the month of	Rs. 1,000

The wrong total in the Purchases Book will be circled with red ink and the correct total entered above or below the circle. The person doing the rectification will also put his initials.

Let us take a few more examples of one-sided errors and study how they will be rectified.

1. **The Sales Returns Book for the month of June was undercast by Rs. 10 :** You know the periodical total of the Sales Returns Book is posted to the debit side of Sales Returns Account. So, a mistake in totalling the Sales Returns Book will affect only the Sales Returns Account. It has been debited short by Rs. 10. So, this error can be corrected by an additional entry for Rs. 10 on the debit side of Sales Returns Account as shown below:

Sales Returns Account

Dr. **Cr.**

To Undercasting of Sales Returns Book for the month of June	Rs. 10		

2. **A payment of Rs. 1,000 towards interest was posted twice to Interest Account :** You know when interest is paid it is recorded on the credit side of the Cash Book and posted On the debit side of Interest Account. The error lies in repeating the posting to interest Account. Thus, it has affected only the Interest Account which now shows an excess debit of Rs. 1,000. This will be corrected by crediting the Interest Account with Rs. 1,000 as follows:

Interest Account

Dr. **Cr.**

		By Double posting from Cash Book on …… now, rectified	Rs. 1,000

3. **A receipt of Rs. 300 towards commission was omitted to be posted** : You know receipt of commission is recorded on the debit side of the Cash Book and posted on the credit side of the Commission Account. The error lies in omitting to post. Hence, it has not been credited by Rs. 300. This error can be corrected by making the posting now as shown below:

Commission Account

Dr. **Cr.**

		By Omission of posting from Cash Book ………….	Rs. 300

4. **A credit sale for Rs. 1,000 to Tiwari was posted to the credit side of his account:** You know a credit sale is entered in the Sales Book and posted on the debit side of the customer's account from the Sales Book. This error relates to posting on wrong side of Tiwari's Account. His account should have been debited and not credited. To correct this error, we have not only to remove the wrong credit of Rs. 1,000 from his account but also give a debit of Rs. 1,000 to his account. Hence, the error can be rectified by debiting Tiwari's Account with double the amount i.e. Rs, 2,000 as shown below:

Tiwari's Account

Dr. **Cr.**

To Posting of sales made to him on credit side on ……. Now rectified	Rs. 2,000		

Check Your Progress C

1. What do you understand by one-sided error?

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

2. The following errors have been committed in the books of account.

   i) Purchase Book was overcast by Rs. 500.

   ii) Sales Book was undercast by Rs. 600.

iii) Payment made to Krishna has not been posted to his account.

iv) Rs. 675 received from Rahul was posted to the debit of his account.

v) A total of Rs. 67 in the discount allowed column of the Cash Book was posted to the Discount Allowed Account as Rs. 76.

vi) Payment of Rs. 750 towards salaries was posted twice to Salaries Account.

3. You are required to answer the following questions.

a) State the name of the account affected by each error.

i) ....

ii) ....

iii) ....

iv) ....

v) ....

vi) ....

b) State how you will rectify each error.

i) ....

ii) ....

iii) ....

iv) ....

v) ....

vi) ....

7.10.2 Rectification of Two-sided Errors

You have learnt that one-sided errors are corrected by noting the Correction on the appropriate side of the account affected by the error. These cannot be rectified by suitable journal entries because only one account was involved. But, the two-sided errors are mostly rectified by journal entries. It is because such errors affect two or more accounts and in most cases the debit and credit are equally affected. Take the case of first example of two-sided errors given earlier. A credit sale of Rs. 1,080 to Anand was wrongly recorded in the Sales Book as Rs. 1,800. The two accounts affected are: (i) Anand's Account which shows an excess debit of Rs. 720, and (ii) Sales Account which stands credited in excess by Rs. 720. To rectify this error, we must credit Anand's Account with Rs. 720 and debit the Sales Account with Rs. 720. So, a journal entry can be passed as follows:

	Rs.	Rs.
Sales Account Dr.	720	
To Anand		720

(Being sales of Rs. 1,080 to Anand wrongly recorded in the Sales Book as Rs. 1,800, now rectified)

Take the second example of two-sided errors given earlier. A sale of Rs. 500 made to Kamal was posted to the debit side of Kishore's Account. The two accounts affected are: (i) Kamal's Account which has not been debited by Rs. 500, and (ii) Kishore's Account which has been wrongly debited with Rs. 500. To rectify this error we have to debit Kamal's Account with Rs, 500 and credit Kishore's Account with Rs. 500. So, journal entry for the rectification of this error will be as follows:

		Rs.	Rs.
Kamal	Dr.	500	
To Kishore			500
(Being rectification of wrong debit to Kishore for sale made to Kamal)			

Now let us take a few more examples of two-sided errors and see how they will be rectified

1. **Sale of old machinery to Chakraborty for Rs. 600 was wrongly entered in the Sales Book.** You know the correct entry for this transaction would be as follows:

		Rs.	Rs.
Chakraborty	Dr.	600	
To Machinery Account			600

Instead of the above entry, the transaction was recorded as

		Rs.	Rs.
Chakraborty	Dr.	600	
To Sales Account			600

Thus, debit to Chakraborty's Account is correctly given. But is has affected two other accounts (i) Machinery account: which has not been credited, and (iii) Sales Account which has been wrongly credited. This can be rectified by debiting the Sales Account since it has been wrongly credited, and crediting the Machinery Account which has not been credited. Hence, a rectifying entry can be passed

		Rs.	Rs.
Sales Account	Dr.	600	
To Machinery Account			600

(Being rectification of wrong credit to sales for the sale of old machinery)

2. **A credit sale of Rs. 7,600 to Sharma was recorded in the Sales Book for Rs. 6,700:** It means the entry in the Sales Book has been made with Rs. 900 (Rs. 7,600 – Rs. 6,700) short. So, this error has affected two accounts: (i) Sharma's Account which is having a short debit of Rs. 900, and (ii) the Sales Account which is having a short credit of Rs. 900. It can be rectified by debiting Sharma's Account and crediting Sales Account. The rectifying journal entry will be as follows:

		Rs.	Rs.
Sharma	Dr.	900	
To Sales Account			900

(Being the rectification of a credit sale for Rs. 7,600 wrongly recorded as Rs. 6,700)

3. **A credit sale of Rs. 2,000 to Sinha was wrongly passed through the Purchases Book.** This should have been recorded in the Sales Book and the correct entry would have been:

		Rs.	Rs.
Sinha	Dr.	2,000	
To Sales Account			2,000

Since it was wrongly passed through Purchases Book, the effective entry is:

		Rs.	Rs.
Purchases Account	Dr.	2,000	
To Sinha			2,000

By comparing the above two entries, you will notice that:

i) Sinha's Account which should have been debited with Rs. 2,000 is actually credited with Rs. 2,000. So, to rectify this error in his account. You have to debit Sinha's Account with double the amount—Rs. 2,000 to cancel the wrong credit and another Rs. 2,000 to give the correct debit.

ii) Sales Account has not been credited with Rs. 2,000. So, to rectify error, the Sales Account should now be credited with Rs. 2,000.

iii) Purchases Account has been wrongly debited with Rs. 2,000. So, to rectify this error, the Purchases Account should be credited with Rs 1000.

After identifying the three accounts involved and nature of correction required in each account, you can easily make out the rectifying journal entry. This will as follows:

		Rs.	Rs.
Sinha	Dr.	4,000	
To Purchases Account			2,000
To Sales Account			2,000

(Being the rectification for a credit sale wrongly passed through the Purchases Book)

4. **Repairs to machinery amounting to Rs. 400 was wrongly debited to Machinery Account :** You know when routine repairs are made, such expenditure is debited to Repairs Account and not to the concerned asset account. So, in this case the debit should have gone to Repairs Account and not to Machinery Account. To rectify this error, we should now debit the Repairs Account and credit the Machinery Account. Thus, the rectification entry will be:

		Rs.	Rs.
Repairs Account	Dr.	400	
To Machinery Account			400

(Being the rectification of wrong debit to Machinery Account for routine repairs)

Illustration 4

How would you rectify the following errors in the books of Kiran & Co.?

1. The Sales Returns Book has been undercast by Rs. 500.

2. The total of the Bills Receivable Book amounting Rs. 4,500 has been posted to the credit of Bills Receivable Account.

3. While posting Purchases Book to the ledger, the personal account of Kumar has been credited with Rs. 221 instead of Rs. 212.

4. Rs. 10,000 paid for the purchase of a TV set for the proprietor is debited to General Expenses Account.

5. An amount of Rs. 1,000 paid by Pran has been credited to the account of Praneet.

6. Goods sold to Inder for Rs. 1,200 have been entered in the Purchases Book.

Solution:

1. This error will be rectified by entering Rs. 500 on the debit side of Sales Returns Account by writing "To Undercasting of Sales Returns Book for. the Month of ………………..Rs. 500".

2. This error will be rectified by entering an amount of Rs. 9,000 on the debit side of Bills Receivable Account by writing "To Wrong posting of the total of Bills Receivable Book on the opposite side …………………… Rs. 9,000".

3. Kumar's Account has been credited with an excess amount of Rs. 9 (Rs. 221— Rs. 212). This error will be rectified by debiting his account with Rs. 9 by writing "To Difference in amount posted from the Purchases Book on ………………………Rs. 9".

4. The following journal entry is required for rectification:

		Rs.	Rs.
Drawings A/c	Dr.	10,000	
To General Expenses A/c			10,000
(Being rectification of purchase of TV wrongly debited to General Expenses A/c)			

5. The following journal entry is required for rectification:

		Rs.	Rs.
Praneet	Dr.	1,000	
To Pran (Being rectification of wrong credit to Praneet for the amount paid by Pran)			1,000

6. The following journal entry is required for rectification:

		Rs.	Rs.
Inder	Dr.	2,400	
To Purchases A/c			1,200
To Sales A/c			1,200
(Being rectifying entry for sale to Inder wrongly entered in the Purchases Book)			

Illustration 5

How would you rectify the following errors:

1. Rs. 3,000 received from the sale of old machinery has been wrongly posted to Sales Account.
2. Rs. 600, the cost of repairing the machinery has been wrongly charged to Machinery Account.
3. Goods purchase for Rs. 500 from Sanjay has been wrongly debited to Furniture Account.
4. A sales of Rs. 600 has been wrongly credited to the customer's account.
5. A payment of Rs. 460 on account of rent has been posted twice to the Rent Account.
6. An item of Rs. 197 has been debited to a personal account as Rs. 179.

Solution:

1. The following journal entry is required for rectification:

		Rs.	Rs.
Sales A/c	Dr.	3,000	
To Machinery A/c			3,000
(Being rectifying entry for sale of old machinery credited to Sales A/c)			

2. The following journal entry is required for rectification:

		Rs.	Rs.
Repairs A/c	Dr.	600	
To Machinery A/c			600
(Being rectification of wrong debit to Machinery A/c instead of Repairs A/c)			

3. The following journal entry is required for rectification:

		Rs.	Rs.
Purchases A/c	Dr.	500	
To Furniture A/c			500
(Being rectifying entry for purchase wrongly debited to Furniture A/c)			

4. This error will be rectified by debiting the customer's account with Rs. 1,200 (double of Rs. 600) by writing "To Wrong posting from Sales Book on the credit side on ……………. Rs. 1,200"
5. This error will be rectified by entering Rs. 460 on the credit side of the Rent Account by writing "By Double posting from Cash Book on ….Rs. 460 "
6. The personal A/c has been debited Rs. 18 short (Rs. 197-179). To rectify this error, the personal A/c will be debits with the difference by writing "To Difference in amount posted on …………………….. Rs. 18".

Check Your Progress D

1. Following errors have been detected:

a) A credit purchase of goods from Chetan amounting to Rs. 15,000 has been wrongly passed through the Sales Book.

b) A Sale of an old Typewriter for Rs. 800 was passed through the Sales Book.

c) Rs. 700 withdrawn for personal use has been debited to General Expenses Account.

d) A credit sale of Rs. 2,300 to Zatin was omitted from Sales Book.

e) Purchase of a wooden cupboard for Rs. 3,000 has been passed through the Purchases Day Book.

You are required to answer the following questions.

1. In case of each error name the accounts affected.

a) i) ....

ii) ....

b) i) ....

ii) ....

c) i) ....

ii) ....

d) i) ....

ii) ....

e) i) ....

ii) ....

2. In case of each error, write the effect on the accounts involved.

a) i) ....

ii) ....

b) i) ....

ii) ....

c) i) ....

ii) ....

d) i) ....

ii) ....

e) i) ....

ii) ....

7.11 SUSPENSE ACCOUNT AND RECTIFICATION

You have learnt the method of rectifying the errors. This method is used for rectifying the errors located before preparing the final accounts. After the corrections have been made, a revised Trial Balance is prepared which should normally tally. But, if it does not tally, it means there are still some errors which have not been detected. As considerable time and effort have already been spent in locating and rectifying the errors, it may not be possible to wait any longer because it will delay the preparation of final accounts. Hence, in such situation the usual practice is to place the difference to Suspense Account and tally the Trial Balance for the time being. If the total of the debit column in the Trial Balance is more than the total of its credit column, the difference is placed to the credit of Suspense Account and the Trial Balance will tally. Similarly, if the credit column total is more than the debit column total, the difference is placed to the debit of Suspense Account. The Suspense Account thus created is shown in the Balance Sheet and is carried forward to the next year.

Note that the Suspense Account is not the result of any transaction. It merely represents the net effect of errors which still remain undetected. Therefore, during the next accounting year, after the errors are located and rectified, the Suspense Account will get closed. Let us now understand how errors will be corrected during the next year. As for the two sided errors, there is no change in the method of rectification. These errors do not affect the agreement of Trial Balance and hence do not involve the Suspense Account. They are rectified by means of the journal entries as usual. This is not the case in respect of one-sided errors. When one-side errors were to be corrected before preparing the Trial Balance we did it by writing an appropriate note in the concerned account. But, when they are to be corrected during the next year i.e., after Suspense Account has been created, the rectification will be through an appropriate journal entry. The one-sided error usually affects only one account. So to pass a journal entry for rectification of such error, we shall now take Suspense Account as the other account involved. For example, Rs. 580 received from Shyam were posted to his account as Rs. 850. It means Shyam's Account is to be debited with Rs. 270. You can now pass the following journal entry to rectify this error:

		Rs.	Rs.
Shyam A/c	Dr.	270	
To Suspense Account (Being rectification entry)			270

Thus all errors, whether they are two-sided or one- sided will now be rectified by means of journal entries.

Let us assume that a businessman could not tally his Trial Balance. The difference of Rs. 1 between the totals of the two columns was put against the Suspense Account on its debit side and the Trial Balance was made to tally temporarily. The Suspense Account was carried forward to the next accounting year. The following errors were then located:

1. An amount of Rs. 99 was omitted to be posted to the credit of a customer's account from the Cash Book.
2. The Sales Book was overcast by Rs. 100.

The first error involved the omission of posting to the credit of customers account. So, to rectify this error, you will have to credit customer's account with Rs. 99. As the Suspense Account is in existence, the corresponding debit would be given to the Suspense Account. Thus, the journal entry will be:

		Rs.	Rs.
Suspense A/c	Dr.	99	
To Customer's A/c			99
(Being the rectification of omission in posting)			

The second error refers to Sales Book being overcast by Rs. 100. It means that the Sales Account has been credited with Rs. 100 in excess. To rectify this error, the Sales Account will have to be debited with Rs. 100. The corresponding credit would be given to Suspense Account. The rectifying entry will be:

		Rs.	Rs.
Sales A/c	Dr.	100	
To Suspense A/c			100
(Being the rectification of overcastting in Sales Book)			

The Suspense Account, after posting the two rectification entries, would appear as follows:

Suspense Account

Dr.	Rs.		**Cr.** Rs.
To Difference in Trial Balance	1	By Sales A/c	100
To Customer's A/c	199		
	100		100

With the posting of the two rectification entries the Suspense Account got closed. Note that the opening balance in Suspense Account simply shows the net effect of these errors. **Sometimes, the balance of Suspense Account is not given. In that case it can be worked out after completing the posting of the rectification entries.**

Suppose in the above example, the amount with which the Suspense Account was opened was not given. Leave the first line blank on both the debit and credit sides of the Suspense Account and post the rectification entries. The difference between the totals of two sides will be considered as the balance with which the Suspense Account was opened. This is based on the assumption that there are no more errors remaining undetected.

Look at illustrations 6, 7 and 8 and study how errors are rectified when Suspense Account is in existence.

Illustration 6

The Trial Balance of Siva did not tally. The credit side exceeded by Rs. 1,455. This amount was entered in the debit column against Suspense Account and the Trial Balance was made to tally.

Later, the following errors were discovered.

1. Goods worth Rs. 1,250 were sold to Mahesh on credit. This was entered in the Sales Book but was not posted.
2. Goods worth Rs. 313 were returned by Ahmed. The amount was credited to his account but was not recorded in the Returns Inwards Book.

3. Manoj paid Rs. 670 but his account was wrongly credited with Rs. 607.

4. An amount of Rs. 375 owed by Dinesh was omitted from the schedule of Sundry Debtors.

5. The Sales Book was undercast by Rs. 420.

   Rectify the errors and show the Suspense Account.

Solution:

JOURNAL

			Rs.	Rs.
1.	Mahesh To Suspense A/c (Being sales to Mahesh not posted)	Dr.	1,250	1,250
2.	Returns Inwards A/c To Suspense A/c (Being goods returned not recorded in Returns Inwards Book though credited to personal account)	Dr.	313	313
3.	Suspense A/c To Manoj (Being Cash paid by Manoj underposted)	Dr.	63	63
4.	Sundry Debtors A/c To Suspense A/c (Being Dinesh's debit omitted from the list of Sundry Debtors)	Dr.	375	375
5.	Suspense A/c To Sales A/c (Being rectification of overcasting in Sales Book)	Dr	420	420

Suspense Account

Dr. **Cr.**

	Rs.		Rs.
To Difference in Trial Balance	1,455	By Mahesh	1,250
To Manoj	63	By Returns Inwards A/c	313
To Sales A/c	420	Sundry Debtors A/c	375
	1,938		1,938

Illustration 7

Kishan, the accountant, found certain errors in the books. He transferred the difference in the Trial Balance to the credit of a Suspense Account. Subsequently, the following errors were discovered. Pass the necessary journal entries to rectify the errors and show the Suspense Account.

1. An amount of Rs. 300 paid as Commission was not posted to Commission Account.

2. Rs. 3,400 paid towards rent was wrongly entered in the Rent A/c as Rs. 4,300.

3. Discount Received column of the Cash Book was undercast by Rs. 100.
4. Cash sales not posted to the Sales Account amounted to Rs. 1,000.

Solution:

JOURNAL

			Rs.	Rs.
1.	Commission A/c To Suspense A/c (Being the omission of posting to commission A/c rectified)	Dr.	300	300
2.	Suspense A/c To Rent A/c (Being excess debit to Rent Account now rectified)	Dr.	900	900
3.	Suspense A/c To Discount Received A/c (Being rectification of undercasting in the discount received column of the Cash Book)	Dr.	100	100
4.	Suspense A/c To Sales A/c (Being the omission of posting to sales account now rectified)	Dr.	100	100

Suspense Account

Dr. **Cr.**

	Rs.		Rs.
To Rent A/c	900		
To Discount Received A/c	100	By Balance b/d (balancing figure)	1,700
To Sales A/c	1,000	By Commission A/c	300
	2,000		2,000

Illustration 8

Rectify the following errors assuming that a Suspense Account was opened.

1. A purchase made from Anthony & Co. for Rs. 8,000 was not entered in the Purchases Book.
2. An amount of Rs. 500 received from Mr. Roy was credited to Ray's A/c.
3. A sale of Rs. 600 to Gopal was debited to his account as Rs. 6,000.
4. Salaries paid amounting to Rs. 1,000 was wrongly debited to Wages Account.
5. Rs. 450 received on account of interest stands wrongly credited to Commission Account.

6. The total of Returns Outwards Book amounting to Rs. 560 was hot posted in the ledger.

7. A credit sale of Rs. 250 to Rakesh was wrongly credited to his Account.

8. A credit sale of Rs. 520 to Madhu debited to him as Rs. 250.

9. A credit purchases from Kailash of Rs. 400 was debited to him.

10. In Cash Book, the total of Discount Allowed column of Rs. 304 has been carried forward as Rs. 403.

JOURNAL

			Rs.	Rs.
1.	Purchases A/c To Anthony & Co. (Being the omission of credit purchases, now rectified)	Dr.	8,000	8,000
2.	Ray To Roy (Being credit given to Ray's account instead of Roy's account, now rectified)	Dr.	500	500
3.	Suspense A/c To Gopal (Being excess debit given to Gopal's A/c, now rectified)	Dr.	5,400	5,400
4.	Salaries A/c To Wages A/c (Being debit to Wages A/c instead of Salaries A/c, now rectified)	Dr.	1,000	1,000
5.	Commission A/c To Interest A/c (Being credit given to Commission A/c instead of interest A/c, now rectified)	Dr.	450	450
6.	Suspense A/c To Returns Outwards A/c (Being the omission of posting total of Returns Outwards Book, now rectified)	Dr.	560	560
7.	Rakesh To Suspense A/c (Being wrong credit given to Rakesh, now rectified)	Dr.	500	500
8.	Madhu To Suspense A/c (Being short amount debited to Madhu now rectified)	Dr.	270	270

9.	Suspense A/c To Kailash (Being debit given to Kailash instead of credit, now rectified)	Dr.	800	 800
10.	Suspense A/c To Discount Allowed A/c (Being excess amount carried forward in Cash Book, now rectified)	Dr.	99	 99

Suspense Account

Dr. **Cr.**

	Rs.		Rs.
To Gopal	5,400	By Balance b/d (balancing figure)	6,089
To Returns Outward A/c	560	By Rakesh	500
To Kailash A/c	800	By Madhu	270
To Discount Allowed A/c	99		
	6,859		6,859

Check Your Progress E

1. The following errors were found in the books of Raghavan. The Trial Balance was out by an excess credit of Rs. 3,720. The difference has been placed to the debit of Suspense Account.

   a) The discount column of the Cash Book on the debit side has been overcast by Rs. 25.

   b) A credit sale of Rs. 1,525 to Rajesh has been wrongly posted to the credit of his account.

   c) The total of the Purchases Returns Book has been overcast by Rs. 605.

   d) A sum of Rs. 784 received from Nagesh has been posted to his account as Rs. 874.

S. No.	Account to be debited	Account to be credited
a)	....	....
b)	....	....
c)	....	....
d)	....	....

7.12 EFFECT OF RECTIFYING ENTRIES ON PROFITS

You have seen that the creation of Suspense Account helps in tallying the Trial Balance and avoiding delay in the preparation of final accounts. The errors still remain to be detected and rectified. So, the Profit and Loss Account prepared from such Trial Balance is subject to the undetected errors. The profit thus arrived at may be less or more than the actual profits. Similarly, when the errors are detected and rectified during the next year, the rectifying entries will have their effect on the profit of the next year.

The profit is affected only if the errors involve accounts which usually appear in the Trading and Profit and Loss Account (nominal accounts) and not those which appear in the Balance Sheet (real and personal accounts).

Let us understand it with the help of an example. Suppose Rs. 24,000 paid for salaries during 2017 was posted to the Salaries Account as Rs. 20,400. This error has resulted in short debit of Rs. 3,600 to Salaries Account and so the salaries charged to Profit and Loss Account are short by Rs. 3,600. This would overstate the profits of 2017. When this error will be detected in 2018 and the rectifying entry passed, Rs. 3,600 will be added to salaries of 2018 and so the profit of 2018 will be decreased by Rs. 3,600. Thus, both the errors and the rectifying entries affect the profit. The effect of rectifying entries will be the reverse of the effect of errors.

The effect of errors and their rectification on the profits has been presented in a summarised form in Table 7.1.

Table 7.1: Effect of Errors and Rectifying Entries on Profits

Nature of Error in Nominal Accounts	Effect of Error on Profit	Effect of Rectifying Entry on Profit
Excess debit	reduces	increases
Excess credit	increases	reduces
Short debit	increases	reduces
Short credit	reduces	increases
Omission of debit	increases	reduces
Omission of credit	reduces	increases

Look at illustration 9. It shows rectifying entries and their effect on profits.

Illustration 9

A businessman finds that he could tally his Trial Balance of 2017 only by opening a Suspense Account. During 2018, he discovered the following errors:

1. The Discount Allowed column of the Cash Book was overcast by Rs. 25.
2. Sale of old machinery amounting to Rs. 550 had been credited to Sales A/c.
3. A Sale of Rs. 780 to Ahmed had been debited to his account as Rs. 870.
4. The total of Bill Payable Book amounting to Rs. 4,000 for the month of June was not posted into the ledger.

Rectify the above errors and prepare the Suspense A/c. Also explain the effect of rectifying errors on the profits of 2018.

Solution:

JOURNAL

		Rs.	Rs.
1.	Suspense A/c Dr. To Discount Allowed A/c (Being the rectifying entry for overcasting of discount allowed column)	25	25
2.	Sales A/c Dr. To Machinery A/c (Being the rectifying entry for sales of Machinery wrongly credited to Sales Account)	550	550
3.	Suspense A/c Dr. To Ahmed (Being rectifying entry for excess debit to Ahmed's Account)	90	90
4.	Suspense A/c Dr. To Bill Payable A/c (Being the rectifying entry for omission of posting of the total of Bills Payable Book)	4,000	4,000

Suspense Account

Dr. **Cr.**

	Rs.		Rs.
To Discount Allowed A/c	25	By Balance b/d (balancing figure)	4,115
To Ahmed	90		
To Bills Payable A/c	4,000		
	4,115		4,115

Effect on Net Profit of 2018

	Rectifying Entry	**Increases**	**Decreases**
		Rs.	Rs.
1.	Credit to Discount Allowed A/c	25	—
2.	Debit to Sales A/c	—	550
3.	No nominal A/c is involved A/c	—	—
4.	No nominal account is involved	—	—
		25	550
	Net decrease in Profits		525

In the above illustration, you observed that errors were committed during 2017 and the rectifying entries were passed in the books of 2018. This unnecessarily affected the profits of 2018. In order that the profits of the year in which rectifying entries are passed is not affected, a new account called Profit and Loss Adjustment Account is opened. Now, all amounts which are to be debited or credited to nominal accounts in the rectifying entries will be debited or credited to the Profit and Loss Adjustment Account. The balance of the Profit and Loss Adjustment Account is directly adjusted in Capital. The current year's profit will thus remain unaffected.

The rectifying entries 1 and 2 of illustration 9 which involve debit and credit to nominal accounts can now be shown as follows:

JOURNAL

			Rs.	Rs.
1.	Suspense A/c To Profit and Loss Adjustment A/c (Being the rectification of overcasting the discount allowed column)	Dr.	25	25
2.	Profit & Loss Adjustment A/c To Machinery A/c (Being the rectification for wrong credit given to Sales Account)	Dr.	550	550

The Profit and Loss Adjustment Account will be as follows:

Profit and Loss Adjustment Account

Dr. **Cr.**

	Rs.		Rs.
To Machinery A/c	550	By Suspense A/c	25
		By Capital A/c (Transfer)	525
	550		550

Check Your Progress F

1. State how the rectification of the following errors will effect the profits. Assume that a Suspense Account has been created.

   i) The total of the discount allowed column of the Cash Book, amounting to Rs. 40, had been posted to the credit of Discount Received Account.

   ....

   ....

   ii) The total of the Purchases Book has been overcast by Rs. 100.

   ....

   ....

   iii) The Returns Outwards Book has been overcast by Rs. 80.

   ....

   ....

   iv) Rs. 105 spent on repairs to furniture had been debited to Furniture Account.

   ....

   ....

v) A cheque for Rs. 100 received from Mohinder, had been recorded in the Cash Book, but it was not posted to Mohinder's Account.

....

....

....

7.13 LET US SUM UP

1. It is necessary to prepare a Trial Balance before preparing the final accounts. It verifies the arithmetical accuracy of the books of account.
2. When a Trial Balance does not tally, it means that there are errors in books of account. A series of steps are taken to locate errors.
3. There are certain errors which affect the Trial Balance and there are some which do not.
4. Errors of principle, errors of complete omission, certain errors of commission in subsidiary books, and the compensating errors are not disclosed by the Trial Balance.
5. Though the Trial Balance has its limitations, it is useful in ensuring the arithmetical accuracy of the books of account.
6. When the Trial Balance does not tally it means that there are errors in the books of account. Attempts are made to locate the errors and rectify them.
7. One-sided errors which affect only one account are rectified by means of a suitable note on the relevant side in the concerned account.
8. Two-sided errors, involving two or more accounts, are rectified by means of journal entries.
9. If the Trial Balance does not tally even after the detected errors have been rectified, the difference is put against a Suspense Account to avoid delay in preparing the final accounts.
10. The Suspense Account is carried forward to the next accounting year and as and when the errors are located, they are rectified.
11. When the Suspense Account is in existence, all errors are rectified by means of journal entries.
12. When all the errors are rectified, the Suspense Account gets closed.
13. When errors are rectified during the next account year, the rectification entries involving nominal accounts affect the profits of the next year. To avoid such effect, Profit and Loss Adjustment Account can be opened and its balance is directly adjusted in capital.

7.14 KEY WORDS

Compensating Errors : A group of errors wherein the effect of an error is counter-balanced (or compensated) by the effect of one or more errors, as a result of which the agreement of Trial Balance remains unaffected.

Errors of Principle An error committed by ignoring or misapplying some principles of accounting while recording a transaction in the books of account.

Errors of Complete Omission: An error committed in completely omitting to record a transaction in the books of account.

Errors of Partial Omission : An error committed in omitting to post one aspect of an entry in the ledger.

Errors of Commission : A clerical error committed while recording or posting of a transaction.

One-sided error : An error which affects the debit or credit side of one account only.

Profit and Loss Adjustment Account : An account opened for avoiding the effect of rectifying entries in respect of previous year's errors on the profit or loss of the current year.

Suspense Account : An account opened to make the Trial Balance tally temporarily. It represents the net effect of undetected one-sided errors.

Two-sided errors : An error which involves two or more accounts and both the debit and credit aspects.

7.15 SOME USEFUL BOOKS

Frank Wood**.** Book-keeping and Accounts (London: Pitman, 1996)

Greweal. TS. Double Entry Book-keeping (New Delhi: Sultan Chand & Sons, 2018)

Maheshwari, S.N. Principles and Practice of Accountancy (New Delhi: Arya Book Trial **Balance** Depot, 2018)

Frank Wood, 1996. Book-keeping and Accounts, Pitman Publishing Limited: London.

Grewal, T.S. 2018. Double Entry Book-keeping, Sultan Chand & Sons: New Delhi.

Maheshwari, S.N. 2018. Principles and Practice of Accountancy, Arya Book Depot: New Delhi.

Patil, V.A., and Korlahalli, J.S. 2018. Principles and Practice of Book-keeping, R. Chand & Co.: Delhi.

7.16 ANSWERS TO CHECK YOUR PROGRESS

A 2 (a) Debit (b) Debit (c) Debit (d) Debit (e) Debit (f) Credit (g) Credit (h) Debit (i) Debit (j) Credit (k) Debit (l) Debit (m) Debit (n) Debit (o) Debit (p) Credit

B 1 (a) i (b) ii (c) ii (d) iii (e) i (f) ii

B 4 Errors (c), (d) and (f) would affect the Trial Balance

C 2 a) i) Purchases Account

ii) Sales Account

iii) Krishna's Account

iv) Rahul's Account

v) Discount Allowed Account

vi) Salaries Account

b) i) Credit Purchases Account with Rs. 500

ii) Credit Sales Account with Rs. 600

iii) Debit Krishna's Account

iv) Credit Rahul's Account with Rs. 1,350

v) Credit Discount Allowed Account with Rs. 9

vi) Credit Salaries Account with Rs. 750

D 1 a) i) Chetan's Account

ii) Purchases Account

iii) Sales Account

b) i) Typewriter Account

ii) Sales Account

c) i) Drawings Account

ii) General Expenses Account

d) i) Zatin's Account

ii) Sales Account

e) i) Furniture Account

ii) Purchases Account

2 a) i) Chetan's Account debited with Rs. 15,000 instead of being credited.

ii) Purchases Account not debited with Rs. 15,000

iii) Sales Account credited in excess with Rs. 15,000

b) i) Typewriter Account not credited

ii) Sales Account credited in excess

c) i) Drawings Account not debited

ii) General Expenses Account debited in excess

d) i) Zatin's Account not debited

ii) Sales Account not credited

e) i) Furniture Account not debited

ii) Purchases Account debited in excess

E a) i) Debit Suspense Account

ii) Credit Discount Allowed Account

b) i) Debit Rajesh's Account

ii) Credit Suspense Account

c) i) Debit Purchases Returns Account

ii) Credit Suspense Account

d) i) Debit Nagesh's Account

ii) Credit Suspense Account

F1 i) Profit will decrease by Rs. 80 because the rectifying entry will involve debiting Rs. 40 to Discount Allowed Account and Rs. 40 to Discount Received Account.

ii) Profit will increase by Rs. 100.

iii) Profit will decrease by Rs. 80.

iv) Profit will decrease by Rs. 105.

v) No effect on profit.

The net effect will be a decrease in the Profits by Rs. 165.

7.17 TERMINAL QUESTIONS/EXERCISES

Questions

1. Why do you regard Trial Balance as a test of the arithmetical accuracy of the books of account? List the errors that will be disclosed by the Trial Balance.

2. If the Trial Balance does not tally, it means there are some errors in books of account. How are these errors located? Describe the procedure fully.

3. Is the Trial Balance a conclusive proof of the accuracy of the books of account? Discuss the errors not disclosed by the Trial Balance.

4. What are the different types of errors that are usually committed in recording transactions? Explain with examples.

5. State the advantage of preparing a Trial Balance. Also give its limitations, if any.

6. What are one-sided errors? Give five examples. Explain the method of rectifying one-sided errors.

7. What are two-sided errors? Give five examples and show how two-sided errors are corrected?

8. What is a Suspense Account? When is it opened? How do you rectify the error when a Suspense Account that has already been opened?

9. Does rectification of errors in a subsequent accounting period always affect the trading result of the current accounting period? Explain with examples.

Exercises

1. On January 1, 2018 the balance of Tanali Traders stood as follows:

   Cash in hand Rs. 2,000; Cash at bank Rs. 12,300; Stock in trade Rs. 51,700; Furniture Rs. 8,200; Debtors Rs. 6,600 (Shyam Rs. 3,500, Shanker Rs. 2,600, Laxman Rs. 500); Creditors Rs. 7,100 (Reddy & Co. Rs. 3,020, Kishore Rs. 4,080); Capital Rs. 73,700.

Their transactions during the month of January were as follows:

2018			Rs.
Jan.	1	Borrowed from Globe Finance Co	10,000
"	2	Bought goods for cash	2,300
"	2	Purchased from Reddy & Co	5,500
"	3	Paid into bank	9,000
"	5	Received cheque from Shyam	3,500
"	6	Sold goods for cash	1,200
"	7	Sold to Shanker	8,700
"	8	Paid Kishore by cheque	2,000
		Discount received	100
"	9	Received cheque from Shanker on account	5,000
"	9	Received credit note from Reddy & Co. for goods returned to them	380
"	10	Sold goods to Thomas	10,000
"	10	Drew cash from the bank	1,000
"	12	Purchased postage stamps	300
"	14	Bought of Bose & Sons	9,300
"	16	Paid Globe Finance & Co. by cheque in part payment of loan	5,000
"	17	Received cash from Laxman	500
"	21	Paid Reddy & Co. by cheque	6,000
"	23	Carriage paid	100
"	24	Withdrew cash for private expenses	1,500
"	28	Paid salaries in cash	800
"	30	Rent due to landlord	500
"	31	Purchased furniture on credit from Joseph	600
"	31	Paid interest to Globe Finance Co.	100

Enter the above transactions in the appropriate books, post them into ledger and prepare a Trial Balance.

(**Answer:** Cash in hand Rs. 600, Cash at bank Rs. 15,800, Trial Balance Total Rs. 1,13,600.)

2. From the details given below prepare a Trial Balance as at March 31, 2018.

	Rs.		Rs.
Purchases	80,000	Salaries & Wages	42,500
Discount (Dr.) .	6,500	Sales	1,50,000
Travelling Expenses	2,500	Carriage Outwards	225
Carriage Inwards	1,375	Repairs	1,500
Insurance	750	Miscellaneous Expenses	275
Commission Paid	1,625	Buildings	20,000
Rent and Rates	2,500	Machinery	7,500
Cash in hand	125	Horses and Carts	2,500
Cash at bank	13,625	Stock in Trade (1-4-2017)	29,500
Sundry Debtors	16,025	Capital	68,525
Sundry Creditors	10,500		

(**Answer:** Total of Trial Balance Rs. 2,29,025.)

3. From the following details, prepare a Trial Balance as on June 30, 2018.

	Rs.		Rs.
Opening Stock	40,000	Drawings	10,000
Purchases	4,10,000	Wages	7,300
Sales	4,29,000	Salaries	11,000
Purchase Returns Sales	1,250	Outstanding Expenses	1,000
Returns	2,500	Prepaid Expenses	750
Carriage Inwards	1,500	Postage	900
Carriage Outwards	2,500	Discount Received	375
Bank Overdraft	21,000	Discount Allowed	1,000
Cash	4,000	Bed Debts	750
Capital	1,27,750	Sundry Debtors	1,00,000
Sundry Creditors	37,500	Interest	3,500
Loans	41,375	Interest Received	300
Investments	10,000	Provisions for Bad Debts	1,750
Accrued Income	600	Furniture & Fixture	7,500
Machinery	47500		

(**Answer:** Total of Trial Balance. Rs. 6,61,300.)

4. The following Trial Balance is incorrectly drawn up and shows a difference of Rs. 5,180. Rewrite it correcting the errors.

Lakshman Singh & Co.
Trial Balance as on December 31, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Bank Overdraft		600	..
Depreciation		---	330
Bank		3,300	---
Wages		---	160
Insurance		--	270
Fixtures		1,700	---
Capital		20,200	---
Stock(1-1-18)		---	550
Rates		200	---
Cash		120	---
Stock (3 1-12-18)		900	----
Sales		---	8,600
Purchases		---	5,200
Drawings		---	350
Premises		---	16,980
Insurance		300	..
Difference		5,180	..
Total		32,500	32,500

(**Answer:** Total of Trial Balance Rs. 29,460.)

(Hint: Stock (31-12-18) will not be shown in the Trial Balance.)

5. Owing to three obvious errors, the following Trial Balance does not agree. Correct the errors and prepare a Trial Balance as on March 31, 2018

	Rs.		Rs.
Stock on 1-4-2017	20,000	Loan Account	30,000
Purchases	98,000	Debtors	84,000
Wages Rent,	30,000	Capital	1,00,000
Rates & Taxes	2,000	Provision for Bed Debts	5,600
Salaries	16,000		
General Expenses	1,800		
Discount Allowed	1,000		
Plant and Machinery	30,000		
Creditors	40,000		

Cash at Bank	16,000	
Furniture & Fixtures	10,000	
Sales	2,57,200	
Returns on Sales	4,000	
Cost of Lease	1,20,000	
	6,46,000	2,19,600

(**Answer:** Total of the Trial Balance Rs. 4,32,800.)

6. An inexperienced accountant provides you with the following Trial Balance. In case you find it to be incorrect, prepare it again so as to remove its defects.

Trial Balance as on June 30,2018

Name of Account	**LF.**	**Dr. Balances**	**Cr. Balances**
		Rs.	**Rs.**
Stock (opening)		10,500	
Building		31,500	
Bills Payable		1,800	
Bank Overdraft		1,500	
Capital			45,000
Furniture			12,000
Discount Allowed		90	
Sales		39,000	
Loan from Suresh		2,400	
Carriage Inwards		270	
Bills Receivable			3,000
Purchases			24,000
Salaries			3,300
Investments		3,000	
Interest on Investments			1,650
Returns Inwards		900	
Returns Outwards		300	
Insurance Premium		360	.
Interest on Loan		30	
Advertisement			1,200
Drawings			1,500
		91,650	91,650

(**Answer:** Total of Trial Balance Rs. 91,650)

7. From the following transactions of Shanker, write up Journal Proper and the other subsidiary books involved. Show their postings into ledger and prepare a Trial Balance.

2018			Rs.
Mar.	1	**Assests:**	
		Cash in hand	1,000
		Cash at bank	34,000
		Stock of goods	20,000
		Machinery	50,000
		Furniture	5,000
		Sudhir owes	5,000
		Naveen owes	12,500
		Liabilities:	
		Loan	20,000
		Sum owing to Samuel	10,000
"	2	Bought goods on credit from Naresh	5,000
"	3	Cash sales	2,000
"	4	Sold goods to Raman	5,000
"	5	Received from Sudhir in settlement of his account	5,000
"	6	Payment made to Samuel by cheque, in full settlement	9,950
"	9	Old furniture sold for cash	500
"	10	Cash purchases	4,000
"	11	Naveen pays by cheque which was deposited into ban	12,500
"	11	Paid for repairs to machinery	500
"	13	Purchased goods from Shyam	5,000
"	13	Paid carriage on these goods	250
"	16	Received cheque from Raman	5,000
"	17	Paid to Shyam by cheque	5,000
"	18	Bank intimates that cheque of Raman has been returned unpaid	
"	19	Cash sales	3,000
"	21	Cash deposited into bank	2,500
"	25	Paid municipal taxes in cash	500
"	26	Old newspaper sold	50
"	28	Paid for advertisements	500
"	31	Paid rent by cheque	600

(**Answer:** Cash in hand Rs. 2,800; Cash at bank Rs. 33,450; Total of Trial Balance Rs. 1,32,600.).

Hint: Find out the opening capital before working on the problem.

8. Rectify the following errors:

   a) Goods amounting to Rs. 3,000 sold to Pran, were correctly entered in the Sales Book, but posted to his account as 30,000.

   b) The total of the Sales Book for the month was undercast by Rs. 5,000.

   c) Rs. 6,000 paid for the cash purchase of furniture was not posted to the Furniture Account.

   d) A credit purchase of Rs. 9,000 from Arjun was wrongly passed through the Sales Book.

9. Rectify the following errors:

   a) Rs. 690, the amount of rent paid to the landlord, was debited to his personal account.

   b) Goods purchased for the personal use of the proprietor, costing Rs. 600, was debited to the Purchases Account.

   c) Rs. 1,080 paid as wages for construction of a room was debited to the Wages Account.

   d) Total of Purchases Book of one page was carried forward to the next page as Rs. 876 instead of Rs. 786.

   e) Discount allowed amounting to Rs. 25 had been credited to Discount Received Account.

   f) Total of Sales Book of one page was carried forward to the next page as Rs. 872 instead of 782.

10. Rectify the following errors:

    a) Rs. 700 received on account of a bad debit written off earlier, credited to customer’s personal account.

    b) Goods returned by Murari amounting to Rs. 250 has been entered in the Returns Outwards Book.

    c) An amount of Rs. 800 withdrawn by the proprietor for his personal use has been debited to General Expenses Account.

    d) Discount allowed to Kurien amounting to Rs. 47 has not been entered in the discount column of the Cash Book, but it has been posted to the Customer’s personal account.

    e) A cash sale to Ashok for Rs. 690 was recorded in the Cash Book and also in the Sales Book. Postings were made from both the books.

    f) The Bank Column on the credit side of the Cash Book was overcast by Rs. 50.

11. Rectify the following errors:

    a) A credit purchase of goods from Manoj, amounting to Rs. 1,800, has been wrongly passed through the Sales Book.

    b) A credit sale of Rs. 600 to Anand was posted to his credit.

c) The Returns Inwards Journal has been undercast by Rs. 1,800.

d) Rs. 1,450 paid as commission was wrongly debited to Interest Account.

e) Rent paid for proprietor's residence amounting to Rs. 2,000 was debited to the Rent Account.

f) A credit sale of Rs. 1,400 to Roshan was entered in the Returns Outwards Book.

12. Correct the following errors found in the books of Rohit, whose Trial Balance was out by Rs. 1,746 (excess debit), and the difference was posted to a Suspense Account. Also show Suspense Account.

a) The Sales Returns Book has been totalled Rs. 54 short.

b) The Purchases Book has been totalled Rs. 150 more.

c) Goods purchased amounting to Rs. 750 has been posted to the debit of Supplier's (Srinath) Account.

d) The Sales Book has been totalled Rs. 150 short.

(**Answer :** Suspense Account gets closed).

13. On taking out a Trial Balance, a book-keeper finds an excess credit of Rs. 2,460. Being desirous of closing the books, he places the difference to a Suspense Account, which is carried forward. In the next period, he discovers the following errors. Pass the rectifying entries and prepare the Suspense Account.

a) The total of Returns Inwards Book has been totalled Rs. 400 short.

b) A sum of Rs. 4,800 written off as depreciation on machinery, has not been posted to the Depreciation Account.

c) A discount of Rs. 1,000 allowed to a customer has been posted to his account as Rs. 100.

d) The Sales Book was undercast by Rs. 4,000.

e) Purchase of Rs. 480 was posted as Rs. 840 in the supplier's account.

(**Answer :** Suspense Account still shows a debit balance of Rs. 1,800)

14. A book-keeper failed to balance his Trial Balance. He places the difference to a newly opened Suspense Account which is carried forward. The following errors were subsequently discovered. Give journal entries to rectify these errors and show the Suspense Account.

a) The total of Purchases Day Book had been undercast by Rs. 200.

b) Purchase of a Typewriter on credit from Harnath for Rs. 9,600 was entered in the Purchases Book.

c) Goods returned by Hari amounting to Rs. 2,000 has been entered in the Returns Outwards Book, however, the posting was done correctly to Hari's Account.

d) A Cash sales of Rs, 2,500 to Sommnath, correctly entered in the Cash Book was posted to the credit of his personal account.

e) A cheque received from Mahinder for Rs. 8,160 had been debited in the Cash Book, but the double entry had not been completed.

(**Answer :** Suspense Account was started with a credit balance of Rs. 3,960)

15. The Trial Balance prepared by Dhanraj did not tally and the difference was transferred to a Suspense Account. Subsequently, the following errors were found. Rectify the errors and show the Suspense Account. Also explain the effect of rectifying entries on the profits.

 a) A sale of Rs. 1,600 to Kamalnath was posted to Karunanath.

 b) Insurance paid amounting to Rs. 250 was posted twice.

 c) A sale of Rs. 1,500 for old machinery was passed through the Sales Book.

 d) A Purchase of Rs. 600 from Kamesh was not passed through the books.

 e) Rs. 80, the debit balance of Commission Account was omitted from the Trial Balance.

 f) The Purchases Returns Book was undercast by Rs. 700.

(**Answer :** Suspense Account was started with a credit balance of Rs. 870; Profit will decrease by Rs. 1,230).

> **Note** : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

BCOC-131
Financial Accounting

Indira Gandhi
National Open University
School of Management Studies

Block

3

FINAL ACCOUNTS

COURSE PREPARATION TEAM

Accountancy-I: ECO-02

(Unit-7, 8 and 20 Revised by Dr. Sunil Kumar)
Dr. N.K. Kakkar, Ramjas College
University of Delhi, Delhi
Prof. V. Vishwanadham, Osmania University, Hyderabad
Dr. P.C, Maheshwari, St. John's College, Agra
Dr. A. S Chawla, Punjabi University, Patiala

Prof. M.S.S. Raju
(Course Coordinator & Editor)

Dr. Sunil Kumar
(Course Coordinator & Editor)

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 3 FINAL ACCOUNTS

After recording and posting all business transactions in the appropriate books of account and testing the arithmetical accuracy of these records with the help of Trial Balance, we prepare a summary at the end of the accounting year. The purpose is to ascertain the profit or loss and the financial position of the business. The summary is prepared in the form of a Profit and Loss Account (also called Income Statement) and a Balance Sheet (also called Position Statement). These two financial statements are termed as Final Accounts. This block consists of 3 units (Unit 8 to 10) deals with the concepts to be observed for ascertaining the profit or loss and the financial position of the business, and the method of preparing the final accounts.

Unit 8 discusses the causes and objectives of providing depreciation, the factors influencing the amount of depreciation to be charged and the two commonly used methods of providing depreciation.

Unit 9 describes the method of preparing simple final accounts involving no adjustments. It also explains the preparation of a Manufacturing Account which may be prepared by manufacturing establishments.

Unit 10 deals with the adjustments required in respects of certain expenses and incomes at the time of preparing the final accounts and explains how they are incorporated in the Profit and Loss Account and the Balance Sheet.

UNIT 8 DEPRECIATON

Structure

8.0 OBJECTIVES

After going through this unit you should be able to:

- define depreciation;
- distinguish depreciation from other related concepts;
- state the causes of depreciation;
- describe the objectives of providing depreciation;
- state the factors influencing the amount of depreciation;
- explain the methods of recording depreciation;
- list various methods of providing depreciation; and
- prepare accounts under fixed instalment and diminishing balance methods of providing depreciation.

8.1 INTRODUCTION

While preparing final accounts you have to provide for depreciation on all fixed assets so as to work out the correct amount of profit or loss for the accounting period. Adjustments usually contain an item asking you to charge depreciation on various fixed assets at some given rate and you know how to show it in final accounts In this unit we shall have a detailed discussion on depreciation and study the basic factors influencing the amount of depreciation and various methods of providing and accounting for the same.

8.2 WHAT IS DEPRECIATION ?

You are already familiar with the distinction between revenue expenditure and capital expenditure. You are aware that when the benefit of an expenditure is available beyond the accounting year (for one or more years) such an expenditure is treated as capital expenditure and it often results in acquisition of an asset. Since many accounting years are likely to receive benefits on account of the use of such an asset, the cost of investment must necessarily be allocated over the period of its useful life and charged to the Profit and Loss Account. **Allocation of the appropriate amount to each period is called depreciation which represents the expire portion of the cost of an asset.**

It would be useful to discuss different definitions given by various authorities in the subject for a proper appreciation of the meaning of depreciation.

Pickles defined depreciation as "the permanent and continuous diminution in the quality, quantity or value of an asset."

According to Spicer and Pegler, "Depreciation may be defined\as a measure of the exhaustion of the effective life of an asset from any cause during a given period."

These definitions refer to certain basic aspects like permanent and continuous diminution, exhaustion of effective life but they are not comprehensive. Let us see some more definitions.

According to ICMA (Institute of Cost and Management Accounts, London) terminology, "Depreciation is the diminution in intrinsic value of the asset due to use and/or lapse of time."

According to Walter B. Meigs and others, "The concept of depreciation is closely linked to the concept of business income. Since part of the service potential of the depreciable asset is exhausted in he revenue getting process each period, the cost of these services must be deducted from revenue in measuring periodic income; the expired cost must be recovered before a business Is considered as well off as at the beginning of the period. Depreciation is a measure of this cost."

According to the institute of Chartered Accountants in Austria, "Depreciation represents that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally put out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the assets and is not dependent upon the amount of profit cleared."

From the above definitions it is clear that depreciation refers to that part of the cost of fixed asset which has expired on account of its usage and or the passage of time. It is thus the 'lost usefulness', 'expired utility', or 'reduction in the intrinsic value' of a fixed asset.

Depreciation is charged on almost all fixed assets, possible exceptions being land, antiques, etc. Usually the value of land and antiques appreciates over a period of time, because they do not have finite economic life as in the case of machinery or furniture,

8.3 DEPRECIATION AND OTHER RELATED CONCEPTS

Sometimes the terms depletion, amortisation etc., are used interchangeably with depreciation. These terms in fact are used in a different context. Let us understand the distinction between depreciation and such related concepts.

Depreciation and Depletion : The term 'depletion' is used in respect of the extraction of natural resources from wasting assets such as quarries, mines, etc. and refers to, the reduction in the available quantity of the material. As a matter of fact, depletion is regarded as a method of computing the depreciation on wasting assets. Thus, it has a limited application. Depreciation, on the other hand, Is a wider term and refers to a reduction in the value of all kinds of fixed assets arising from their wear and tear.

Depreciation and Amortisation : The terms 'amortisátion' refers to writing off the proportionate value of the intangible assets such as copyrights, patents, goodwill, etc., while depreciation refers to the writing off the expired cost of the tangible assets like machinery, furniture, building etc.

Depreciation and Obsolescence: Obsolescence refers to the decrease in usefulness arising on account of the external factors like change in technology, new inventions. change of style, etc. Thus, it is caused mainly on account of the asset becoming out of date, and old fashioned. Deprecation on the other hand, is a functional loss generally arising on account of wear and tear, Obsolescence, in fact, is regarded as one of the causes of depreciation.

Depreciation and Fluctuation : Fluctuation refers to an increase or decrease in the market price of an asset. Such a change is. usually temporary. Depreciation differs from fluctuation in the following respects.

i) Depreciation is concerned with book value of asset while fluctuation is related to the market value.

ii) Depreciation refers only to the decrease while fluctuation refers to either increase or decrease.

iii) Depreciation reflects a permanent decrease while fluctuation is only a temporary phenomenon.

8.4 CAUSES OF DEPRECIATION

The causes of depreciation can be stated as follows:

1. **Wear and Tear :** Wearing out of the asset on account of its constant use is called wear and tear. This causes a definite reduction in the value of the asset and is regarded as the major source of depreciation.

2. **Lapse of Time :** Normally, the passage of time also causes some reduction in the value of fixed assets because as they become old their value stands reduced. That is why the depreciation is usually charged on time basis. in case of certain assets like lease, patents, etc., the value decreases with passage of time as they generally have a fixed number of years of legal life. For example, a building is taken on lease for a period of 10 years costing **Rs.** 1,00,000. The yearly

depreciation of lease will amount to Rs. 10,000 (1/10 of Rs. 1,00,000) and charged as such to the Profit and Loss Account every year.

3. **Obsolescence:** The acquisition of an improved model may render the existing machine obsolete. As the new machine performs the same operation more quickly and/or more economically existing machine is said to have become out of date or obsolete. This causes a drastic reduction in the value of existing machinery and the amount of depreciation is bound to be heavy.

4. **Depletion:** Some assets are of a wasting character. For example mines, quarries, oil wells etc.. Due to continuous extraction of materials the natural resources get depleted. Depreciation, in case of such assets is often computed on the basis of actual depletion. For example, a coal mine has the coal deposits of 200 million tons. In the first year we extract 10 m. tons of coal. The depreciation in the first five years shall amount to 10/200 of the cost of mine.

On the basis of the causes mentioned above, it can be said that depreciation is a permanent and continuous reduction in the value of an asset due to wear and tear, passage of time, obsolescence, depletion or any other cause.

8.5 OBJECTIVES OF PROVIDING DEPRECIATION

You know depreciation is treated as a loss and is chargeable to the Profit and Loss Account every year. The justification for charging depreciation can be explained as follows

1. **Ascertaining the true profits:** Depreciation represents the expired cost of a fixed asset caused by its usage hi business, This cost is a part of the total expenses incurred in earning the revenue during an accounting period and must be taken into account for arriving at the correct amount of profit or loss for the period. If depreciation is not charged, the expenses and losses will understand and the Profit and Loss Account will show higher profits making the concern pay higher taxes.

2. **Ascertaining the true cost of production :** Depreciation on machinery and other fixed assets in the factory is an important component of the cost of production specially when the unit is not labour intensive. So if no provision is made for depreciation, the cost calculations will be incorrect.

3. **Presentation of true financial position:** The value of fixed assets reduces from year to year on account of their usage and passing of time. They must be shown in the Balance Sheet at their reduced values otherwise it will not reflect the true financial position of the business. Hence depreciation must be taken into account. It will enable the concern to show fixed assets at their proper values in the Balance Sheet.

4. **Funds for replacement of assets :** Charging depreciation reduces the profits available for distribution It enables the. concern to retain a part of its profit and thus accumulate funds for the replacement of the assets as and when necessary.

Check Your Progress A

1. What is depreciation?

....

....

....

2. How is depreciation different from amortisation ?

....

....

....

3. State whether the following statements are **True** or **False.**

   i) Depreciation is charged also on current assets.

   ii) Profits will be overstated if depreciation is not charged.

   iii) Expenses will be understated if depreciation is not charged

   iv) If adequate maintenance expenditure is incurred, depreciation need not be charged.

   v) Depreciation is charged to reduce the value of asset to its market value,

   vi) Depreciation is charged only on the original purchase price of the asset.

   vii) When market value of an asset is higher than book value, depreciation is not charged.

   viii) The main cause of depreciation is wear and tear caused by its usage.

8.6 FACTORS INFLUENCING DEPRECIATION

The amount of depreciation to be charged to the Profit and Loss Account in respect of a particular fixed asset is affected by following factors:

1. **Cost of the asset :** Cost of the asset should include purchase price and all other costs incurred to bring the asset to usable condition like transportation costs, erection charges, etc. It is to be noted that financial charges, such as interest on loan taken for the purchase of the asset is not to be included in the original cost of an 'asset.

2. **Estimated working life of the asset:** The useful or economic life of the asset can be stated in terms of time i.e., years, months, hours or in terms of quantity, i.e., number of units of output or any other operating measure such as kilometres in the case of lorries, motor vans, etc.

3. **Estimated Scrap value :** Scrap Value (also called salvage value, residual value) refers to the estimated amount expected to be realized when the asset is sold to the end of its useful life. While the original cost of an asset can be correctly determined, useful life and salvage value can only be estimated, based on certain assumptions.

The total amounts of depreciation to be written off during the life time of an asset is calculated as follows

	Rs.
Total Cost of Asset	…..
Less Estimated Scrap Value	…..
Total amount of Depreciation to be written off during its useful life	…..

For example, a machine was bought for Rs. 1,00,000 and a sum of Rs. 24,000 was spent towards its transportation and erection charges. It was estimated that the machine has a useful life of 10 years and that the residual value expected to realise at the end of its useful life is Rs. 14,000. The total amount of depreciation to be written off during the economic life of an asset can be calculated as shown below:

	Rs.
Original cost of the asset	1,00,000
Add Transportation and erection charges	24,000
	1,24,000
Less Estimated residual value	14,000
Total amount of depreciation to be written off during its useful life	1,10,000

After determining the total amount of depreciation to be written off during the life time of an asset the next step is to decide the amount of depreciation to be charged every year. In the above situation the annual amount of depreciation to be written off may be considered s 1/10 of the total amount of depreciation because its estimated life is 10 years.

However, there are various methods of calculating the amount of depreciation to be charged from year to year.

8.7 METHODS OF RECORDING DEPRECIATION

There are essentially two methods of recording depreciation in the books of account:

(1) when Provision for Depreciation Account is maintained, and (2) when Provision for Depreciation Account is not maintained. Under the first method, the amount of depreciation is credited to the 'Provision for Depreciation Account' every year and the concerned asset account continues to appear at its original cost. Of course, while preparing the Balance Sheet, the accumulated balance of the Provision for Depreciation Account is shown by way of deduction from the cost of the asset. Under the second method, no Provision for Depreciation Account is opened. The amount of depreciation is directly credited to the concerned asset account every year. The asset account would thus appear in books at the depreciated value (written down value). Of course, it will be shown in the Balance Sheet giving the details of the opening balance, purchase and sale of the asset, and the depreciation provided during the year.

The following are the journal entries passed for the related transactions under the two methods.

1. **When Provision for Depreciation Account is maintained**

   a) For charging depreciation:

   Depreciation Account Dr.
   To Provision for Depreciation Account
   (Being depreciation provided)

   b) For transferring depreciation to Profit and Loss Account:

   Profit and Loss Account Dr.
   To Depreciation Account
   (Being transfer of depreciation)

c) **When the asset is sold:**

i) Bank Account Dr.
To Asset Account
(Being the sale proceeds)

ii) Provision for Depreciation Account Dr.
To Asset Account
(Being transfer of provision for depreciation on the asset sold)

iii) Asset Account Dr.
To Profit and Loss Account
(Being transfer of profit on sale of the asset)
or
Profit and Loss Account Dr.
To Asset Account
(Being transfer of loss on sale of the asset)

2. When Provision for Depreciation Account is not maintained

a) For charging depreciation:
Depreciation Account Dr.
To Asset Account
(Being depreciation provided)

b) For transferring depreciation to Profit and Loss Account
Profit and Loss Account Dr.
To Depreciation Account
(Being transfer of depreciation)

c) When the asset is sold:

i) Bank Account Dr.
To Asset Account
(Being sale proceeds)

ii) Asset Account Dr.
To Profit and Loss Account
(Being transfer of profit on sale of asset)
or
Profit and Loss Account Dr.
To Asset Account
(Being transfer of loss on sale of the asset)

A firm can adopt any method for recording depreciation. But in practice, most of the firms follow the second method under which provision for Depreciation Account is not opened and all entries are made directly in the concerned asset account. Hence, we shall follow this method for the treatment of depreciation.

8.8 METHODS FOR PROVIDING DEPRECIATION

As stated earlier there are various methods of calculating the amount of depreciation to be charged from year to year. Different methods are adopted to suit the nature of each asset. It is also possible that different concerns may follow different methods for depreciating the same asset. The following are the principal methods for providing depreciation.

1. Fixed Instalment Method
2. Diminishing Balance Method
3. Annuity Method
4. Depreciation Fund Method
5. Insurance Policy Method
6. Revaluation Method
7. Depletion Method
8. Machine Hour Rate Method

Of the above eight methods used for providing depreciation, the first two viz., Fixed Instalment Method and Diminishing Balance Method are the most commonly used methods. These are taken up in this unit and the remaining method shall be discussed in Unit 21.

8.8.1 Fixed Instalment Method

This method is also called 'equal instalment method' or 'straight line method'. Under this method. a fixed and equal amount is charged as depreciation every year during the life time of an asset. When this amount of depreciation is presented on a graph paper it would show a straight line parallel to the X-axis, and hence the alternative name 'straight line method'. This method writes off a fixed percentage of the original cost of the asset every year so that the asset is reduced to zero or its salvage value at the end of its working life. The annual amount of depreciation to be charged under this method can be calculated with the help of the following formula:

$$\text{Annual Depreciation} = \frac{\text{Original Coat - Scrap Value}}{\text{Life of the Asset in number of years}}$$

Or $D = \dfrac{C-S}{N}$

Look at illustration 1 and see how the amount of annual depreciation has been calculated and the concerned asset account prepared from year to year.

Illustration 1

Ravikiran & Sons purchased machinery on January 1, 2015 for Rs. 22,000 and spent Rs. 3,000 on its erection. The asset is expected to last for four years after which its break up value is estimated to Rs. 5,000. Find out the amount of depreciation to be charged every year and show how the Machinery Account would appear for four years assuming that the machine is sold for Rs. 1,000 at the end. Also show how the balance of Machinery Account would appear in the Balance Sheet.

Solution:

The annual depreciation is calculated as follows :

$$D = \frac{C-S}{N}$$

$$= \frac{(22,000 + 3,000 - 5,000)}{4}$$

$$= \frac{20,000}{4}$$

= Rs. 5,300

Machinery Account

Dr.					Cr.
2015		Rs.	2015		Rs.
Jan. 1	To Bank A/c	22,000	Dec. 31	By Depreciation A/c	5,000
Jan. 1	To Cash A/c (erection charges)	3,000	" 31	By Balance c/d	20,000
		25,000			25,000
2016			2016		
Jan. 1	To Balance b/d	20,000	Dec. 31	By Depreciation A/c	5,000
			" 31	By Balance c/d	15,000
		20,000			20,000
2017			2017		
Jan.1	To Balance b/d	15,000	Dec. 31	By Depreciation A/c	5,000
			" 31	By Balance c/d	10,000
		15,000			15,000
2018			2018		
Jan. 1	To Balance b/d	10,000	Dec. 31	By Depreciation A/c	5,000
			" 31	By Bank A/c	1,000
				By Balance c/d	4,000
		10,000			10,000

Balance Sheet as on December, 31, 2015

			Rs.
	Machinery	22,000	
	Add : Erection charges	3,000	
		25,000	
	Less : Depreciation	5,000	20,000

Balance Sheet as on December, 31,2016

	Machinery	20,000	
	Less : Depreciation	5,000	
			15,000

Balance Sheet as on December, 31,2017

	Machinery	15,000	
	Less : Depreciation	5,000	
			10,000

Balance Sheet as on December, 31,2018

	Machinery	10,000	
	Less : Depreciation	5,000	
		5,000	
	Less : Sale proceeds	1,000	
		4,000	
	Less : Write off	4,000	

In practice, the purchase and sale of an asset, is a continuous exercise. Hence, you should know how the calculation of depreciation will be made in such situations and the transactions recorded in the concerned asset account. Look at illustration 2 and study how the asset account appears in such situations.

Illustration 2

Arivind & Co. purchased a plant worth Rs. 2,00,000 on January 1, 2017. On June 30, 2017 an additional plant was bought for Rs. 50,000. On December 31, 2018 a part of the plant bought on January 1, 2017 costing Rs. 4,000 was sold for Rs. 3,000.

Prepare Plant and Machinery Account for years 2017 and 2018 providing depreciations at 10% per annum on fixed instalment method. The accounts are closed on December 31, every year.

Solution:

Plant and Machinery Account

Dr. Cr.

2017		Rs.	2017		Rs.
Jan. 1	To Bank A/c	2,00,000	Dec. 31	By Depreciation A/c	22,500
Jan. 1	To Bank A/c (erection charges)	50,000	" 31	By Balance c/d	2,27,500
		2,50,000			2,50,000
2018					
Jan. 1	To Balance b/d	2,27,500	2018		
			Dec. 31	By Bank A/c	3,000
			" 31	By Depreciation A/c	25,000
				By P & L A/c	200
				By Balance c/d	1,99,300
		2,27,500			2,27,500

Working Notes:

1.	**Depreciation for 2017**	Rs.
	On Rs. 2,00,000 for one year (10/10,00 of 2,00,000)	20,000
	On Rs. 50,000 for six months ($10/100 \times 50,000 \times 6/12$)	2,500
		22,500
2.	**Depreciation for 2018**	
	On Rs. 2,50,000 for one year (10/100 of 2,50,000)	25,000
3.	**Loss on Sale of Plant**	
	Depreciated value of plant sold as on December 31, 2018 (Rs. 4,000-Rs. 800)	3,200
	Less : Sale Proceeds	3,000
	Loss on Sale	
		200

Advantages

1. It is easily understandable and is simple to apply.
2. Amount of depreciation does not vary from year to year.
3. Under this method the book value of asset is reduced either to zero or scrap value as the case may be.
4. In this method deprecation charge spreads equally over the entire period of its anticipated working life. Therefore, it is considered particularly suitable for those assets which get depreciated more on account of lapse of time such as lease-holds, patents etc.

Disadvantages

1. It does not reflect the correct charge on account of depreciation when the effective utilisation of the asset varies from year to year.
2. It does not recognise the reality that as an asset becomes older, the amount spent for repairs and renewals goes on increasing. It is common knowledge that when the asset is brand new, repair bill would be either nil or very small. But, as the machine is progressively subjected to wear and tear, the repairs bill would increase considerably. Thus the combined charge on account of depreciation and repairs will not be uniform throughout the life of the asset. The increasing repairs bill unjustifiably burden the later years of asset life with heavier combined charges.
3. It does not take into account the loss of interest on the money invested in the asset. Certain other methods (annuity method) while calculating depreciation also take interest aspect into account.

8.8.2 Diminishing Balance Method

Under this method, though the rate of depreciation is fixed, it is calculated on the written down value of the asset. Consequently the amount of depreciation to be charged goes on reducing from year to year. For example, a machine was purchased on January 1, 2016 for Rs. 10,000. It is to be depreciated at 15% per annum under the diminishing balance method. In this case, the depreciation for 2016 would be Rs. 1,500 (15% of 10,000), for 2017 it would be Rs. 1,275 (15% of 8,500), and for 2018 it would work out as Rs. 1,084 (15% of 7,225). Thus you will notice that the annual depreciation goes on reducing. Hence, it is also known as ‘reducing insta1met method’. This method is considered better than the fixed instalment method because with reducing instalments of depreciation the combined effect of repairs and depreciation will be more or less uniform throughout the life of the asset.

Look at illustration 3 and see how the amount of depreciation is computed every year and recorded in the concerned asset account.

Illustration 3

Kishore Ltd. purchased a tractor costing Rs. 1,00,000 on January 1, 2014. The rate of depreciation to be charged was fixed at 20% per annum. Write up Tractor Account for five years ending December 31, 2018, under diminishing balance method.

Tractor Account

Dr.					Cr.
2014		Rs.	2014		Rs.
Jan. 1	To Bank A/c	1,00,000	Dec. 31	By Depreciation A/c	20,000
			Dec. 31	By Balance c/d	80,000
		1,00,000			1,00,000
2015			2015		
Jan. 1	To Bank A/c	80,000	Dec. 31	By Depreciation A/c	16,000
			Dec. 31	By Balance c/d	64,000
		80,000			80,000
2016			2016		
Jan. 1	To Bank A/c	64,000	Dec. 31	By Depreciation A/c	12,800
			Dec. 31	By Balance c/d	51,200
		64,000			64,000
2017			2017		
Jan. 1	To Bank A/c	51,200	Dec. 31	By Depreciation A/c	10,240
			Dec. 31	By Balance c/d	40,960
		51,200			51,200
2018			2018		
Jan. 1	To Bank A/c	40,960	Dec. 31	By Depreciation A/c	8,192
			Dec. 31	By Balance c/d	37,768
		40,960			40,960

Now look at illustration 4. It deal with the situation when additions and disposals are made during the course of the year and a part of the asset is replaced.

Illustration 4

Harinath purchased on January 1, 2016, a plant for Rs. 50,000. On July 1, 2016 an additional plant worth Rs. 20,000 was purchased and on July 1. 2017, the plant purchased on January 1, 2016 having become obsolete is sold off for Rs. 20,000. On July 1, 2018, a new plant was purchased for Rs. 60,000 and the plant purchased on July 1, 2016 was sold for Rs. 15,000. Depreciation is to be provided at 10% p.a. on the written down value every year. Show the Plant Account.

Plant Account

Dr. Cr.

2016		Rs.	2016		Rs.
Jan. 1	To Bank A/c	50,000	Dec. 31	By Depreciation A/c	6,000
Jan. 1	To Bank A/c (erection charges)	20,000	" 31	By Balance c/d	64,000
		70,000			70,000
2017			2017		
Jan. 1	To Balance b/d	64,000	July, 1	By Bank A/c	20,000
			Dec. 31	By P & L A/c (loss on sale)	22,750
			Dec. 31	By Depreciation A/c	4,150
			Dec. 31	By Balance c/d	17,100
		64,000			64,000
2018			2018		
Jan. 1	To Balance b/d	17,100	July, 1	By Bank A/c	15,000
Jan. 1	To Bank A/c	60,000	Dec. 31	By P & L A/c (loss on sale)	1,245
			Dec. 31	By Depreciation A/c	3,855
			Dec. 31	By Balance c/d	57,000
		77,100			77,100

Working Notes:

1. Depreciation for 2016

	Rs.
10% on Rs. 50,000 for one year	5,000
10% on Rs. 20,000 for six months	1,000
	6,000

2. Depreciation for 2017

10% on Rs. 45,000 for six months (upto June 30, 2017)	2,250
10% on Rs. 19,000 for one year	1,900
	4,150

3. Loss on plant sold on July 1, 2017

Depreciated value as on 2017	
50,000 — 5,000 — 2,250	42,750
Less : Sale proceeds	20,000
Loss on sale	22,750

4. Depreciation for 2018

10% on Rs. 17,100 for six months	855
10% on Rs. 60,000 for six months	3,000
	3,855

5 . Loss on plant sold on July 1, 2018

Depreciated value as on 1.7.2018	
20,000 — 1,000 — 1,900 — 855	16,245
Less: Sale proceeds	15,000
Loss on sale	1,245

Advantages

This method is also simple to understand and easy to follow, though calculation of depreciation is slightly complicated. It ensures a fairly even charge to Profit and Loss Account on account of both depreciation and repairs. This is possible because the amount of depreciation decreases year after year while the charge for repairs goes n increasing year after year.

Disadvantages

One of the important limitations of this method is that the value of an asset cannot be brought down to zero. Hence, even after the asset is put out of use it may have certain book value. This method also does not take into account the loss of interest on the money invested in the asset. The determination of a suitable rate of depreciation is also difficult under this method. The formula generally used for this purpose is as follow:

$$\text{Rate of Depreciation} = 1 - n\sqrt{\frac{\text{Scrap Value}}{\text{Original Cost}}}$$

This looks quite complicated as compared to the fixed installment method. This method is considered suitable for assets like plant and machinery where the repairs are insignificant in earlier years but increase considerably in later years. It is popularly known as 'written down value method' because the depreciation is computed on the written down value every year. There are however, other methods of computing depreciation under the diminishing balance method such as 'sum of year digits method' and 'double declining balance method'. These are also called accelerated depreciation method, because under all these methods the amount of depreciation charged in earlier years is more compared to that of the later years.

8.8.3 Difference between Fixed Instalment Method and Diminishing Balance Method

The difference between the fixed instalment method and the diminishing balance method can be summarised as follows:

Fixed Instalment Method	Diminishing Balance Method
1. Depreciation is calculated on the original cost	Depreciation is calculated written down value
2. Depreciation instalment is the same every year.	Depreciation instalment goes on reducing every year.
3. The balance in the asset account will reduce to zero at the expiry of the working life of the reduce to zero. asset.	The balance in the asset account will never reduce to zero.
4. The combined cost on account of depreciation and repairs is low during the initial years and high during later years.	The combined cost on account of depreciation and repairs is more or less equal throughout.
5. Calculation of the rate of depreciation is easy.	Calculation of the rate of depreciation is difficult
6. It is suitable for assets which get depreciated more on account of the expiry of time	It is suitable for assets which require heavy repairs in later years of their working life.

Check Your Progress B

1. List the factors influencing the amount of depreciation.

   ....

   ....

   ....

2. Name various methods of computing depreciation.

   ....

   ....

   ....

3. State whether the following statements are True or False.

   i) Depreciation is a temporary change in the value of an asset.

   ii) While calculating depreciation, the scrap value (salvage value) must be taken into account.

   iii) Under fixed instalment method of providing depreciation the combined effect of repairs and depreciation is uniform over the year

iv) Under the diminishing balance method it would be possible to reduce the value of an asset to zero.

v) The interest involved in the investment on assets purchased is ignored under both the fixed instalment and the diminishing balance methods.

vi) When a Provision for Depreciation Account is maintained, the asset is shown at the original cost in the Balance Sheet

8.8.4 Change of Method

Sometimes a firm may decide to change the method of depreciation it had adopted i.e., it may change the method of depreciation from fixed instalment method to reducing instalment method or vice versa. If it decides to implement the change with prospective, effect, there is no problem because no adjustment is necessary in respect of depreciation charged in earlier years. All that is necessary is to charge depreciation from that year onwards according to the new method decided.

However, when it is decided to change the method with retrospective effect i.e., with effect from a prior date (usually from the date of acquisition of an asset) it would be necessary to adjust the depreciation charged till date. Suppose a firm was depreciating its machinery under the fixed instalment method during the past three years. It has now decided to change the method to written down value method with retrospective effect. In such a case it would be necessary to take the following steps:

1. Calculate the amount of depreciation already charged till the date of change according to old method.

2. Calculate the amount of depreciation that would have been charged under the new method now proposed to be adopted.

3. If the amount of depreciation under the new method is more than what was charged under the old method, such difference should be credited to the asset account in current year and debited to the Profit and Loss Account.

4. If, on the other hand, the amount of depreciation under the new method is less than what was charged under the old method such a difference should be debited to the asset account in current year and credited to the Profit and Loss Account.

5. As the difference in depreciation amount is adjusted to the current value of asset in the asset account, the asset account will appear at its new value, from the date of change and depreciation will be charged according to the new method in subsequent years.

Look at illustration 6. It will help you to clearly understand the procedure to be followed when a change of method is desired with retrospective effect.

Illustration 5

Sharat & Sons purchased a car for Rs. 1,00,000 on January 1, 2015. The car was depreciated at 10% under the written down value method. On January1, 2018 they wanted to change the method of depreciation from reducing instalment method to straight line method without & changing the rate. Show the asset account from 2015 to 2018.

Solution:

Car Account

Dr. Cr.

2015		Rs.	2015		Rs.
Jan. 1	To Bank A/c	1,00,000	Dec. 31	By Depreciation A/c	10,000
			Dec. 31	By Balance c/d	90,000
		1,00,000			1,00,000
2016			2016		
Jan. 1	To Bank A/c	90,000	Dec. 31	By Depreciation A/c	9,000
			Dec. 31	By Balance c/d	81,000
		90,000			90,000
2017			2017		
Jan. 1	To Bank A/c	81,000	Dec. 31	By Depreciation A/c	8,100
			Dec. 31	By Balance c/d	72,900
		81,000			64,000
2018			2018		
Jan. 1	To Bank A/c	72,900	Dec. 31	By P & L A/c (diff.)	2,900
			Dec. 31	By Depreciation A/c	10,000
			Dec. 31	By Balance c/d	60,000
		72,900			72,900
2019					
Jan. 1	To Balance b/d	60,000			

Notes: 1. If the firm had followed the fixed instalment method right from the beginning (1.1.2015), the value of car as on 1.1.2018 would be Rs. 70,000 worked out as follows:

	Rs.
Original cost	1,00,000
Less: Depreciation for years at Rs. 10,000 p.a. (10% of 1,00,000)	30,000
Value of Car as on 1.1.2018	70,000

But from the Car Account you find that the opening balance on 1.1.2018 is Rs. 72,900. This means that under the written down value method the amount of depreciation charged during the three years was Rs. 27,100 (1,00,000 — 72,900) as against Rs. 30,000 required under the fixed instalment method. Hence. the difference between the two amounts i.e., Rs. 2,900 (30,000 — 27,100) must be charged as additional depreciation so as to adjust the asset account.

2 The depreciation to be charged for the year 2018 would be Rs. 10.000 i.e., 10% on Rs. 1,00,000 as required under the fixed instalment method. From this year onwards Rs. 10,000 will be charged as depreciation every year.

8.9 LET US SUM UP

Depreciation is a permanent and gradual diminution in the value of an asset caused by usage and effusion of time.

It represents the expired cost of a fixed asset which mist be charged to the Profit and Loss Account and deducted from the value of the asset concerned Unless it is so treated, the Profit and Loss Account will not show true profit or toss for the year and the Balance Sheet will not reflect the correct financial position. The amount of depreciation to be charged is determined by taking into account: (i) the cost of asset, (ii) the estimated useful life, and (iii) the estimated salvage value.

There are essentially two methods of recording the depreciation in books of a account (i) By maintaining a Provision for Depreciation Account, and (ii) Without maintaining a Provision for Depreciation Account.

When a provision for Depreciation Account is maintained the depreciation is credited to this account from year to year. Its accumulated balance is transferred to the asset account only at the end of the life of the asset or when the same is sold. But when provision for Depreciation Account-is not maintained, the depreciation is directly credited to the asset account every year. Of course, in the Balance Sheet the asset will always be shown at the depreciated value.

There are various methods of calculating the amount of depreciation. Of these, the two most common methods are : (i) fixed instalment method, and (ii) diminishing balance method, Under the fixed instalment method an equal amount is charged as depreciation year after year while under the diminishing balance method the amount of depreciation goes on reducing year after year. Both have their merits and demerits. But, the diminishing balance method is considered better because the combined cost on account of depreciation and repairs is uniformly distributed over the working life of an asset. Although the amount of depreciation under these two methods differ, the method of recording it in the books of account is the same.

Sometimes, a concern may decide to change the method of depreciation. If the change is to take effect from current years, it does not involve much problem. But if it is with retrospective effect, it would require the calculation of depreciation according to both the methods and the difference will have to be adjusted before the depreciation cap be charged according to changed method.

8.10 KEY WORDS

Amortisation: Writing off the expired cost of an intangible asset.

Depreciation: Permanent and gradual diminution in value of a fixed asset.

Obsolescence: Becoming out of date, a cause for depreciation in value of asset.

Residual Value: Expected realisable amount, when the asset is sold out at the end of its useful life.

Salvage Value: Same as residual or scrap value.

Written Down Value: Book value of an asset after deducting depreciation from the original cost. It is also called depreciated value.

8.11 SOME USEFUL BOOKS

Gupta R.L and M. Radhaswamy, 2018. Advanced Accountancy, Volume 1, Sultan Chand & Sons, New Delhi.

Maheshwari S.N., 2018. Introduction to Accounting, Vikas Publishing House: New Delhi.

Path, V.A. and J. S. Korlahalli, 2018. Principles and Practice of Accounting,

R. Chand & Co., New Delhi.

Shukla, M.C. and T.S. Grewal, 2018. Advanced Accounts, S. Chand & Co., New Delhi.

William Pickles, 1992. Accountancy, E . L. B .S. and Pitman, London.

8.12 ANSWERS TO CHECK YOUR PROGRESS

A 3. i) False ii) True iii) True iv) False v) False vi) False vii) False viii) True

B 3. i) False ii) True iii) False iv) False v) True vi) False.

8.13 TERMINAL QUESTIONS/EXERCISES

Questions

1. Define depreciation. Distinguish it from depletion, amortisation and obsolescence.

2. Explain the need and significance of depreciation. What factors should be considered for determining the amount of depreciation?

3. Enumerate the methods of calculating depreciation. Discuss the advantages and disadvantages of fixed instalment method.

4. What are the merits and demerits of written down value method? Distinguish it from the straight line method.

5. Describe the methods of recording depreciation in books of account. How is the balance of the Provisions for Depreciation Account shown in the Balance Sheet?

Exercises

1, A cold storage plant was purchased on July 1, 2016 for Rs. 1,00,000. Show the V plant Account under (a) the Straight Line Method and (b) the..Written Down Value Method. Rate of depreciation charged is 20%. What is the balance of plant at the end of the third year?

(Answer : Balance at the end of the third year (a) under Straight Line Method Rs. 40,000; and (b) under Written Down Value Method: Rs. 51,200).

2. Suresh purchased plant and machinery for Rs. 50,000 on July 1, 2014. The asset was to be depreciated at the rate of 10 per cent per annum on written down value basis. The machinery was sold on January 1, 2018 for Rs. 32,000. Write up Machinery Account assuming accounting year to end on December 31 every year.

   (**Answer:** Loss on sale Rs. 2,627)

3. On 1-8-2016, a machine was purchased by a manufacturing concern for Rs. 60,000 and it spent for its overhaul and installation Rs. 10,000. Its effective life was estimated to be ten years and residual value at the end of its life time was estimated to be Rs. 10,000. Show Machine Account for the first three years assuming that the concern decided to depreciate it under the fixed instalment method. The accounting year ends on December 31.

   (**Answer:** Balance of Machine Accounts as on January 1, 2019: Rs. 55,000)

4. Ashok Ltd has bought machinery for Rs. 1,00,000 including a boiler worth Rs. 10,000. The Machinery Account has been credited for depreciation on the written down value method for the past four years at the rate of 10%. During the fifth year the boiler became useless on account of damage to some of its vital parts; the damaged boiler is sold for Rs. 5,000. Write up the Machinery Account.

   (**Answer:** Loss on sale of machinery Rs. 1,561; Balance of Machinery Account as at the end of fifth year Rs. 59,049.)

5. Navrang & Co., whose accounting year is the calendar year, purchased machinery costing Rs. 60,000 on July 1, 2016. It purchased further machinery on September 1, 2016 costing Rs. 30,000. On January 1, 2018 one-third of the Machinery installed on June 1, 2016 became obsolete and was sold for Rs. 5,000. Depreciation is being written off on fixed instalment system, at 10% per annum. Prepare the machinery account as would appear in the ledger of the company for the years 2016, 2017 and 2018.

   (**Answer: B**alance of Machinery Account as on January 1, 2019 : Rs. 53,000).

6. On October 1, 2016 Raghavan & Sons purchased machinery for Rs. 30,000 and spent Rs. 3,000 on installing it. On January 1, 2017, the firm purchased another machinery for Rs. 20,000. On June 30, 2018 the machinery purchased on January 1, 2017 was sold for Rs. 16,000 and on the same date a fresh plant was installed at a cost of Rs. 25,000.

   The company writes off 10% depreciation on the diminishing balance method. The accounts are closed every year on December 31. Show the Machinery account for the years 2016, 2017 and 2018.

   (**Answer :** Balance of Machinery Account as on January 1, 2019: Rs. 39,950)

7. On July 1, 2015, a company purchased a plant for Rs. 2,00,000. Depreciation was provided at 10% per annum on straight line method on December 31, every year. With effect from January 1, 2017 the company decided to change the method of depreciation to diminishing balance method @ 15% per annum with retrospective effect. On July 1, 2018, the plant was sold for Rs. 1,20,000. Prepare Plant Account from 2015 to 2018).

   (**Answer :** Loss on sale of plant: Rs. 3,637.

8. Work out problem No. 7 assuming that (a) the asset was originally depreciated on written down value method at 20% and that (b) now it is desired to change the method to fixed instalment method with retrospective effect, rate of depreciation remaining same.

   (**Answer:** Profit on sale of plant Rs. 40,000).

Note :	These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 9 FINAL ACCOUNTS-I

Structure

9.0 OBJECTIVES

After studying this unit, you will be able to:

- explain the purpose of preparing final accounts;
- prepare a trial balance from a given list of balances;
- prepare trading and profit and loss account;
- prepare balance sheet;
- prepare manufacturing account and calculate cost of goods produced; and
- present the final accounts in vertical form.

9.1 INTRODUCTION

You know that the final accounts are primarily prepared for ascertaining the operational result and the financial position of the business. They consist of (1) Profit and Loss Account, and (ii) Balance Sheet. The Profit and Loss Account reveals the profit earned or loss incurred (operational result) during the accounting year and the Balance Sheet indicates the financial position as at the end of the year. In this unit, you will learn about the basic framework of final accounts including their presentation in vertical form.

9.2 FINAL ACCOUNTS AND TRIAL BALANCE

You know final accounts are prepared with the help of a Trial Balance which shows all the ledger balances as at the end of an accounting period. Generally, when you are asked to prepare final accounts, you are given a properly prepared Trial Balance and you have no difficulty in identifying the items of incomes, expenses, assets, and liabilities. But, sometimes you may not be given a proper Trial Balance. You may simply be asked to prepare the final accounts from the list of closing balances extracted from the books of some firm. In such a situation, it will be helpful if you first prepare the Trial Balance and then the final accounts. Hence it is important that you should know how to prepare the Trial Balance from a given list of balances.

Normally when a Trial Balance is to be prepared, you have full details of ledger accounts with you. You can easily ascertain whether a particular account has a debit balance or a credit balance, and prepare the Trial Balance without any difficulty. The problem arises when you are given a list but it is not indicated whether the account has a debit balance or a credit balance. Under such a situation you will have to determine the nature of each balance before you prepare the Trial Balance. In this exercise, your knowledge of rules of debit and credit will help you. For example you know that in case of nominal accounts all expenses and losses are debited and all incomes and gains are credited. Similarly, you know the rules for real and personal accounts according to which the account of assets like cash, machinery debtors, etc. will show debit balances while accounts like capital, creditors, etc. will show credit balances. For convenience however, a few guidelines should help you. They are

a) All accounts of expenses (including purchases) and losses will be debit balances.

b) All accounts of Income (including sales) and gains will be credit balances.

c) All accounts of assets will be debit balances.

d) Allaccounts of liabilities will be credit balances.

e) Capital Account will normally be a credit balance.

f) Drawings Account will be a debit balance.

However, the problem may arise with regard to some items like rent, discount, commission and interest as they can be expenses as well as incomes. In such cases, the nature of the balance is usually indicated by mentioning (Dr.) or (Cr.) against each item, or the word ‘received’ or ‘paid’ is written after each item. This helps you to treat the item correctly. But, if there is only one item for which no such indication is given you can proceed with the preparation of Trial Balance and work out the totals of both the columns. You will find that the total of one column will be less than the other. This means that the unidentified balance pertains to the column which is short. For example, there is an item of commission of Rs. 300 appearing in the list of balances and it is not indicated whether it is paid or received. When you prepare the Trial Balance you will find that the debit total is short by Rs. 300. This would mean that the Commission Account has a debit balance. Now if you show it as such in the Trial Balance, it will tally.

Look at illustration 1 and see how the Trial Balance has been prepared from a given list of balances where the nature of each balance has not been indicated.

Illustration 1

Prepare a Trial Balance from the following balances extracted from the books of Sudhakaras on March 31, 2018.

	Rs.		Rs.
Opening Stock	40,000	Drawings	10,000
Purchases	4,10,000	Wages	7,300
Sales	4,29,000	Salaries	11,000
Purchases Returns	1,250	Outstanding Expenses	1,000
Sales Returns	2,500	Prepaid Expenses	750
Carriage Inwards	1,500	Postage	900
Carriage Outwards	2,500	Discount Received	375
Bank Overdraft	21,000	Discount Allowed	1,000
Cash	4,000	Bad Debts	750
Capital	1,27,750	Sundry Debtors	1,00,000
Sundry Creditors	37,500	Interest	3,500
Loans	41,375	Interest Received	3 00
Investments	10,000	Provision for Bad Debts	1,750
Accrued Income	600	Furniture & Fixture	7,500
Machinery	47,500		

Solution:

Trial Balance to Sudhakar as on March 31, 2018

Particulars	**Dr. Balances**	**Cr. Balances**
	Rs.	**Rs.**
Opening Stock	40,000	
Purchases	4,10,000	
Sales		4,29,000
Purchases Returns		1,250
Sales Returns	2,500	
Carriage Inwards	1,500	
Carriage Outwards	2,500	
Bank Overdraft		21,000
Cash	4,000	
Capital		1,27,750
Sundry Creditors		37,500
Loans		41,375
Investments	10,000	
Accrued Income	600	
Machinery	47,500	
Drawings	10,000	
Wages	7,300	

Salaries	11,000	
Outstanding Expenses		1,000
Prepaid Expenses	750	
Postage	900	
Discount Received		375
Discount Allowed	1,000	
Bed Debts	750	
Sundry Debtors	1,00,000	
Interest	3,500	
Interest Received		300
Provision for Bad Debts		1,750
Furniture & Fixture	7,500	
Total	6,61,300	6,61,300

In illustration 1, the Trial Balance has tallied i.e, the total of debit balances column is equal to the total of credit balances column. This would mean that each balance has been entered in the appropriate amount column of the Trial Balance. This is not always true. It is quite possible that even when the Trial Balance has tallied, some balances may not have been entered in the correct columns. Look at illustration 2. You will find that the Trial Balance has tallied (the totals of both Dr. balancesand Cr. balances is the same i.e., Rs. 91,650 but there are a number of items which have been shown in the wrong columns. For example, bank overdraft which should have been shown in the Cr. balances column has been included in the Dr. balancescolumn and Furniture which should have appeared in Dr...balancescolumn has been shown in the Cr. balances column. So, the Trial Balance has been rewritten and all items shown correctly. Such situation arises on account of the compensating effect of the errors which is very rare.

Illustration 2

An inexperienced accountant provides you with the following Trial Balance. In case you find it to be incorrect,1 prepare it again so as to remove its defects.

Trial Balance as on June 30, 2018

Name of Account	**L.F.**	**Dr. Balances**	**Cr. Balances**
Stock (Opening)		Rs.	Rs.
Buildings Bills		10,500	
Payable Bank		31,500	
Overdraft		1,800	
Capital		1,500	
Furniture			45,000
Discount Allowed			12,000
Sales		90	
Loan from Suresh		39,000	

Carriage Inwards		2,400	
Bills Receivable		270	3,000
Purchases			24,000
Salaries			3,300
Investments		3,000	
Interest on Investments			1,650
Returns Inwards		900	
Returns Outwards		300	
Insurance Premium		360	
Interest on Loan		30	
Advertisement			1,200
Drawings			1,500
Total		91,650	91,650

Solution:

Revised Trial Balance as on June 30, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Stock (opening)		10,500	
Buildings		31,500	
Bills Payable			1,800
Bank Overdraft			1,500
Capital			45,000
Furniture		12,000	
Discount Allowed		90	
Sales			39,000
Loan from Suresh			2,400
Carriage Inwards		270	
Bills Receivable		3,000	
Purchases		24,000	
Salaries		3,300	
Investments		3,000	
Interest on investments			1,650
Returns Inwards		900	
Returns Outwards			300
Insurance Premium		360	
Interest on Loan		30	
Advertisement		1,200	
Drawings		1,500	
		91,650	91,650

Check Your Progress A

1) Mention against each item whether it will generally show a debit balance or a credit balance.

Items		Nature of Balance Debit or Credit
i)	Sales Returns	....
ii)	Carriage Inwards	....
iii)	Carriage Outwards	....
iv)	Capital	....
v)	Loss by fire	....
vi)	Overdraft	....
vii)	Drawings	....
viii)	Returns Outwards	....
ix)	Bills Receivable	....
x)	Goodwill	....
xi)	Rent Paid	....
xii)	Commission Received in Advance	....

9.3 TRADING AND PROFIT AND LOSS ACCOUNT

You know the Profit and Loss Account is prepared for ascertaining the profit or loss of the business. This is worked out in two stages. In the first stage, we work out the gross profit or gross loss and in the second stage, the net profit or net loss. Hence, the profit and Loss Account is divided into two sections. The first section is called Trading Account. It reveals the gross profit or gross loss. The second section is called Profit and Loss Account which shows the net profit or net loss.

9.3.1 Trading Account

As stated above, the Trading Account is prepared for ascertaining the gross profit or gross loss. The gross profit is defined as the excess of sales revenue over cost of goods sold. This can be presented in the form of an equation as follows.

Gross Profit = Net Sales — Cost of Goods sold

Where i) Net Sales = Total Sales — Sales Returns

ii) Cost of Goods Sold = Opening Stock + Net Purchases + Direct Expenses — Closing Stock

You know the terms 'Opening Stock' and 'Closing Stock' refer to the value of unsold goods as at the beginning of the year and at the end of the year respectively. Such stock may also include the semi-finished goods and raw materials. In order to arrive at the cost of goods sold. the opening stock is added to the net purchases while the closing stock is deducted. The term 'Direct Expenses' refer to those expenses which are incurred on the goods purchased till they are brought to the place of business for sale These include expenses such as freight, insurance, import duty, dock dues, clearing charges, octroi duty, carriage, cartage, etc. The administrative expenses, selling and distribution expenses, interest paid, etc. are termed as indirect expenses and therefore, are excluded from the cost of goods sold.

Look at illustrations 3 and 4 and study how Cost of Goods Sold and the Gross Profit are computed.

Illustration 3

The following figures have been extracted from the books of a firm. Calculate the Cost of Goods Sold.

	Rs.
Stock as on 1.1.2018	1,00,000
Purchases for 2018	15,00,000
Purchases Returns	40,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
Stock as on 31.12.2018	1,70,000

Solution:

Opening Stock	1,00,000
Add: Net Purchases	
(Purchases Rs. 15,00,000	
Purchases Returns Rs. 40,000)	14,60,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
	16,75,000
Less: Closing Stock	1,70,000
Cost of Goods Sold	15,05,000

Illustration 4

On January 1, 2018 a firm had stock of goods valued at Rs. 20,000. During the year the following transactions took place.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Carriage Inwards	3,000
Freight Inwards	5,000
Sales Returns	10,000
Clearing charges	22,000
Purchases Returns	5,000

The closing stock of goods on December 31, 2018 is Rs. 40,000.

Solution:

	Rs.	Rs.
Sa1e	5,00,000	
Less: Sales Returns	10,000	
Net Sales		4,90,000
Less: Cost of Goods Sold		
Opening Stock	20,000	
Add: Purchases	3,00,000	
	3,20,000	
Less: Purchases Return	5,000	
	3,15,000	
Add:		
Carnage Inwards	3,000	
Freight Inwards	5,000	
Clearing Charges	22,000	
	3,45,000	
Less: Closing Stock	40,000	
		3,05,000
Gross Profit		1,85,000

Form of Trading Account : The Equation for Gross Profit is also known as Trading Account Equation. This equation forms the basis of preparing the Trading Account. The Trading Account, like any other account in the ledger, has two sides—debit and credit. The opening stock,purchases (less returns) and all direct expenses are shown on the debit side of the Trading Account while sales (less returns) and the closing stock on the credit side. The gross profit appears as the last item on the debit side which, in fact is the excess of the total of credit side over the total of debit side. If however, the total of the debit side exceeds the total of the credit side, it will be treated as gross loss. This is shown as the last item on the debit side of the Trading Account. The gross profit/gross loss thus worked out is transferred to the Profit and Loss Account. Look at the Figure 9.1 for the form of Trading Account.

Fig. 9.1
Form of Trading Account

Trading Account of
(Day, Month and Year)

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		.....	By Sales	.....	
To Purchases	.....		Less: Sales Returns	.....	
Less Purchases Returns	.....	.....			
To Direct Expenses (specify individually)		.....	By closing Stock		.....
To Gross Profit					
(Transferred to Profit		.....			
and Loss Account)		.....			.....

Based on the data given in illustration 4, the Trading Account will be prepared as follows.

Trading Account of . ... .

for the year ending December 31, 2018

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		20,000	By Sales	5,00,000	Rs.
To Purchases	3,00,000		Less: Returns	10,000	4,90,000
Less: Returns	5,000	2,95,000			
To Carriage Inwards		3,000	By Closing Stock		40,000
To Freight		5,000			
To Clearing Charges		22,000			
To Gross Profit		1,85,000			
(Transferred to (P&L A/c)					
		5,30,000			5,30,000

Some Important Points

1. **Purchases :** This item refers to the goods purchased for resale and includes both cash and credit purchases. The purchases of assets which are meant for permanent use in business such as machinery furniture, etc., are not included in the purchases. The amount taken to Trading Account will be the net amount of purchases (after deducting purchase returns/returns outwards.) If the proprietor has taken away some goods from the business for his personal use, the same should also be deducted from the total purchases.

2. **Sales:** It includes both cash and credit salesof goods and refers to the net amount of sales (after deducting sales returns-returns inwards). Sales of old furniture, car, machinery, etc. are not included in the sales. Similarly, sales of old newspapers etc. are also excluded from sales. Such items are shown as miscellaneous income in the Profit and Loss Account.

3. **Wages:** Wages are usually treated as a direct expense and so shown in the Trading Account. The difficulty arises when wages are clubbed with salaries (an indirect expense) and the Trial Balance includes a single amount for 'Wages and Salaries'. In such a situation, the amount may be shown in the Trading Account. It is based on the assumption that the item includes the salaries of the supervisory staff in the factory itself. But, if the item in the Trial Balance reads 'Salaries and Wages' it will be taken to the Profit and Loss Account on the assumption that the item includes wages of the office staff only. It should be noted that wages paid in connection with the purchases of fixed assets or the construction of building should not be charged to Trading Account. They are to be included in the cost of the concerned fixed asset. There is another important aspect in relation to wages which must be clarified. If a Manufacturing Account is prepared the wages paid to the factory labour is debited to Manufacturing Account about which you will learn later in this unit.

4. **Freight, Carriage and Cartage:** When paid in connection with purchases of goods, they are shown in the Trading Account. Such freight and carriage are also termed as 'Freight Inwards' and 'Carriage Inwards' respectively. 'Freight Outwards' and 'Carriage Outwards' relate to sales and therefore taken to the debit of Profit and Loss Account.

5. **Royalties:** Royalties refer to the payments made for the use of copyright or a patent. The amount of royalty is generally based on the quantity produced. It is, therefore, treated as a direct expense and charged to Trading Account. But if it is calculated on the basis of quantity sold as in case of books, it is shown in the Profit and Loss Account. Royalties are also paid to the Government for extraction of minerals such as coal, diamond, gold, etc. These are charged to the Profit and Loss Account of the mining companies. You will learn about the accounting of such royalties later under a separate course.

9.3.2 Profit and Loss Account

After ascertaining the gross profit by preparing the Trading Account, the businessman proceeds to prepare the Profit and Loss Account in order to work out the net profit/ net loss. You know the net profit is the excess of gross profit and other incomes over the indirect expenses and losses. So, while preparing the Profit and Loss Account, we show gross profit and other incomes such as rent received, discount received, commission received, interest and dividends etc. on the credit side, and all indirect expenses and losses on the debit side. Indirect expenses include all administrative, selling and distribution expenses such as salaries, rent and taxes, postage and stationery, insurance, depreciation, interest paid, office lighting, advertising, packing carriage outwards, etc., while losses refer to items like loss by fire, loss by theft etc. The difference between the two sides of the Profit and Loss Account represent either the net profit or net loss. If the total of the credit side is higher than the total of the debit side, the difference is called net profit and if the debit side total exceeds the credit side total, the difference is called net loss. The net profit/net loss belongs to the proprietor and it is therefore transferred to his Capital Account. Look at figure 9.2. It shows various expenses, losses, incomes, etc., which usually appear in the Profit and Loss Account

Fig. 9.2

Profit and Loss Account …………………..

for the period ended …………………

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Gross Loss, if any, (Transferred from Trading Account)		By Gross Profit, if any (Transferred from Trading Account)	
To Salaries		By Interest Received	
To Rent, Rates and Taxes		By Discount Received	
To Postage and Telegrams		By Rent Received	
To Telephone Charges		By Commission Received	
To Printing and Stationery		By Dividend Received	

To Legal Expenses To Insurance To Office Lighting To Bad Debts To Depreciation To Advertising To Travelling Expenses To Carriage Outwards To Trade Expenses To Discount Allowed To Interest Paid To Repairs and Renewals To Loss by Fire To Loss by Theft To Other Expenses and Losses, if any To Net Profit (Transferred to Capital Account)		By Other Incomes and Gains By Net Loss (Transferred to Capital Account)	

Notes:

1. The heading for the Profit and Loss Account, as in the case of the Trading Account, indicates the name of the business or proprietor and the period for which it is being prepared.

2. In addition to the items shown in the above form, there are certain items such as depreciation, bad debts, provision for doubtful debts, interest on capital, interest on drawings, etc., which appear in the Profit and Loss Account as a result of the adjustment entries. We shall discuss them in Unit 10.

Some Important Points

1. **Rent, Rates and Taxes:** These are charges levied by the municipal bodies on the house property. It is a common item of indirect expenses debited to the Profit and Loss Account.

2. **Insurance:** Generally, assets are insured to cover the risk of loss, say, by fire. Premium paid to the insurance company should be treated as a business expense. When assets such as factory building, factory machinery, etc. are insured, the insurance premium should be debited to Trading Account. If on the other hand, the premium is paid for insurance of assets in the office building, office furniture, etc., it should be charged to Profit and Loss Account.

3. **Bad Debts:** Bad debts denote the amount which could not be recovered from the debtors to whom the goods were sold on credit. It is a loss and so debited to the Profit and Loss Account. You will learn more about their treatment in Unit 9.

4. **Depreciation:** Depreciation means decrease in the value of fixed assets due to normal wear and tear. You know that every fixed asset such as machinery, furniture, vehicle, etc. depreciates in value on account of its constant use. Such reduction in their value is a loss to the business and so charged to the Profit and Loss Account. If, however, a Manufacturing Account is also prepared, depreciation on machinery and factory building is charged to the Manufacturing

Account, while depreciation on office building, office furniture, office equipment, etc. is charged to the Profit and Loss Account.

5. **Trade Expenses:** This item represents various small expenses incurred in the business. They are also called General Expenses, Sundry Expenses or Miscellaneous Expenses.

6. **Packing:**The cost of packing materials such as polythene bags, wrapping materials, etc. for delivery is a distribution expense and hence charged to Profit and Loss Account. Where packing is essential to make the products fit for sale in the market as in the case of cigarettes, biscuits, medicines, oil, etc. it is called 'packaging' and such expenditure is charged to the Trading Account.

7. **Samples:** Generally, samples of goods are distributed free of charge to increase sales. The cost of such samples should be treated as a selling expense and so debited to Profit and Loss Account.

8. **Income Tax:** It is the tax payable by a person on his income. In the case of a sole trading concern, the tax paid by the proprietor on the profits of the business is treated as a personal expense. Hence, it should be added to drawings or directly deducted from capital.

Illustration 5

Prepare Profit and Loss Account from the following balance extracted from,the books of a business for the year 2018.

	Rs.
Gross Profit	1,85,000
Salaries	20,000
Rent and Rates	5,000
Stationery	1,000
Postage	500
Insurance	2,000
Repairs	1,500
Depreciation	5,000
Advertisement	5,000
Discount (Dr.)	500
Commission of Salesmen	5,000
Bad Debts	2,000
Loss by Fire	2,000
Interest on Investments	2,500
Profit on sale of Investments	2,000

Solution:

Profit and Loss Account of …………..…
for the year ending December 31, 2018

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Salaries	20,000	By Gross Profit	1,85,000
To Rent and Rates	5,000	(Transferred from	
To Stationery	1,000	Trading A/c)	

To Postage	500	By Interest on Investments	2,500
To Insurance	2,000	By Profit on Sale of	
To Repairs	1,500	Investments	2,000
To Depreciation	5,000		
To Advertisement	5,000		
To Discount	500		
To Commission to Salesmen	5,000		
To Bad Debts	2,000		
To Loss by Fire	2,000		
To Net Profit			
(Transferred to			
Capital Account)	1,40,000		
	1,89,500		1,89,500

In Practice, the Trading Account and the Profit and Loss Account are combined and one account called 'Trading and Profit and Loss Account' is prepared. This account is divided into two parts. The first part shows the Gross Profit and the second part shows the Net Profit.

Look at illustration 6 and see how combined Trading and Profit and Loss Account will be prepared.

Illustration 6

From the following figures, prepare Trading and Profit and Loss Account of Lakshmi & Co. for the year ended December 31, 2018.

	Rs.
Stock on January 1, 2018	40,000
Purchases	98,000
Commission Received	650
Rent, Rates and Taxes	8,600
Salaries & Wages	12,000
Sales	1,62,100
Returns Inwards	2,400
Returns Outwards	3,000
Sundry Expenses	2,500
Bank Charges	50
Discount Received	750
Carriage on Purchases	2,000
Discount Allowed	530
Carriage on Sales	1,700
Lighting and Heating	2,200
Postage	300
Income from Investments	500
Commission Paid	1,000
Interest paid on a bank loan	550

The stock on December 31, 2018 was valued at Rs. 26,000

Solution:

Trading and Profit & Loss Account of Lakshmi & Co.
for the year ended December 31, 2018

Dr. **Cr.**

Particulars		Amount	Particulars		Amount
To Opening Stock		40,000	By Sales	1,62,100	
To Purchases	98,000		Less: Returns	2,400	1,59,700
Less: Returns	3,000	95,000	By closing Stock		26,000
To Carriage on Purchase		2,000			
To Gross Profit c/d		48,700			
		1,85,700			1,85,700
To Rent. Rates and Taxes		8,600	By Gross Profit b/d		48,700
To Salaries and Wages		12,000	By Commission Received		650
To Sundry Expenses		2,500	By Discount received		750
To Bank Charges		50	By Income from Investments		500
To Discount Allowed		530			
To Carriage on Sales		1,700			
To Postage		300			
To Commission Paid		1,000			
To Interest paid on loan		550			
To Lighting & Heating		2,200			
To Net Profit		21,170			
		50,600			50,600

9.3.3 Closing Entries

You learnt that all nominal accounts which represent items of expenses and incomes are closed at the end of the accounting year by transfer to either the Trading Account or the Profit and Loss Account. The journal entries passed for such transfer are called closing entries. You also know that accounts relating to expenses and losses always show debit balances while those representing incomes show credit balances. In order to close an account which shows a debit balance and is to be transferred to the Trading Account we credit the account concerned with an amount equal to its balance and debit the Trading Account, For example, the Carriage Inwards Account Shows a debit balance of Rs. 6,000. The closing entry for this will be as follows:

		Rs.	Rs.
Trading A/c	Dr.	6,000	
To Carriage Inwards A/c			6,000

Similarly, an account which shows a credit balance, will be closed by debiting it with an amount equal to the balance and crediting the Trading Account or Profit and Loss Account, as the case may be. The closing entries are passed in the Journal Proper and it is necessary to pass such entries for preparing the Trading and Profit and Loss Account. The entries required for the items which are to be transferred to the Trading Account are as follows:

1. Trading Account Dr.
   To Stock Account (opening)
   To Purchases Account
   To Sales Returns Account
   To Direct Expenses Accounts (to be credited individually)

2. Sales Account Dr.
   Purchases Returns Account Dr.
   Stock Account (closing) Dr.
   To Trading Account
   Trading Account
   To Profit and Loss Account
   (for Gross Profit)

Note: If there is gross loss, the closing entry will be just the reverse of the above.

When the closing entry is passed for gross profit or gross loss, the Trading Account stands closed.

The entries required for items to be transferred to the Profit and Loss Account are as follows:

1. Profit and Loss Account Dr.
   To Expenses/Losses Accounts
   (to be credited individually)

2. Incomes/Gains Accounts Dr.
   (to be debited individually)
   To Profit and Loss Account

3. Profit and Loss Account Dr.
   To Capital Account
   (for Net Profit)

Note: If there is net loss, the closing entry will be just the reverse of the above.

Let us see how closing entries for the items given in illustration 4 will be passed. These are as follows:

JOURNAL

	Name of Account	**L.F.**	**Dr. Balances**	**Cr. Balances**
2018			Rs.	Rs.
Dec. 31	Trading A/c Dr.		1,42,400	
	To Opening Stock A/c			40,000
	To Purchase A/c			98,000
	To Sales Returns A/c			2,400
	To Carnage Inwards A/c			2,000
	(Being closing entry)			
Dec. 31	Sales Ac Dr.		1,62,100	
	Purchases Returns A/c Dr.		3,000	
	Closing Stock A/c Dr.		26,000	
	To Trading A/c			1,91,100
	(Being closing entry)			

Dec. 31	Trading A/c Dr.		48,700	
	To Profit and Loss A/c			48,700
	(Being transfer of gross profit)			
Dec. 31	Profit and Loss A/c Dr.		29,430	
	To Rent, Rates & Taxes A/c			8,600
	To Salaries &Wages A/c			12,000
	To Sundry Expenses A/c			2,500
	To Bank Charges A/c			50
	To Discount Allowed A/c			530
	To Carriage Outwards A/c			1,700
	To Postage A/c			300
	To Commission Paid A/c			1,000
	To Interest Paid A/c			550
	To Lighting &Heating A/c			2,200
	(Being closing entry)			
Dec. 31	Commission Received A/c Dr.		650	
	Discount Received A/c Dr.		750	
	Income from Inv. A/c Dr.		1,500	
	To Profit and Loss A/c			2,900
	(Being closing entry)			
Dec. 31	Profit and Loss A/c Dr.		21,170	
	To Capital A/c			21,170
	(Being transfer from NP)			

Check Your Progress B

1. Distinguish between Direct and Indirect Expenses.

....

....

....

2. What is the purpose of preparing a Trading Account?

....

....

....

....

3. State whether the following statements are **True**or **False.**

   i) The gross profit is the difference of total sales and credit sales ………………………………………..………….

   ii) Direct expenses are those expenses which are directly attributable to purchase of goods for resale …………………… ……….

   iii) Stock is valued at cost or market price whichever is lower …….. ....……….

iv) The net profit is the excess of gross profit and other incomes over the indirectexpenses and losses …… …………………..…………

v) Income tax paid in case of a proprietary x concernischarged to Profitand Loss Account ……………………….…………..….

vi) Trade Expensesarecharged to Trading Account …………………….…

4 Fill in the blanks:

i) CarriageOutwardsisan example of ……………. expenses.

ii) Cost of goods sold is equal to opening stock plus ………less ....

iii) Cost of samples distributed free of cost are treated as …………expenses.

iv) All direct expenses are debited to …………….Account.

v) Loss on Account of theft is ……………… to Profit and Loss Account.

vi) Wages and salaries are charged to…………… ….…………..

5 Ascertain the cost of goods sold from the following data:

	Rs.
Direct Expenses	8,000
Opening Stock	12,000
Purchases	80,000
Interest Paid	500
Closing Stock	10,000

9.4 BALANCE SHEET

After ascertaining the net profit or net loss by preparing the Trading and Profit and Loss Account, the final step in preparing final accounts is the preparation of Balance Sheet. The purpose of Balance Sheet is to ascertain the financial position of a business i.e., to know what the business owes and what it owns on a certain date. Hence it shows all assets and liabilities of the business as at the end of the accounting year.

You know that final accounts are prepared from the Trial Balance. All items of expense and income appearing in Trial Balance are transferred to the Trading and Profit and Loss Account. The remaining items which represent the balances of personal and real accounts are shown in the Balance Sheet. The accounts showing debit balances represent assets and those showing credit balances represent liabilities.

Look at Figure 9.3 and note how various assets and liabilities appear in the Balance Sheet.

Table 9:3 : Balance Sheet of ………..
as on ……………..

Dr. **Cr.**

Liabilities	**Amount**	**Assets**	**Amount** .
Current Liabilities	Rs.	**Current Assets**	Rs.
Bank Overdraft	………	Cash in hand	………
Bills Payable	………	Bills Receivable	………
Sundry Creditors	………	Cash at bank	………

		Sundry Debtors	....
Long-term Liabilities		Closing Stock	....
Loan	....	**Investments and**	
Mortgages	....	**Fixed Assets**	
Capital Balance		Vehicles	....
Add: Net Profit		Furniture	....
		Plant & Machinery	....
Less: Drawings	....	Land & Buildings	....
		Goodwill	....
	....		....

You should know that the Balance Sheet is prepared to ascertain the financial position at a particular point of time and not for a period. Hence the heading of the Balance Sheet will always read 'Balance Sheet as on ....'(usually last date of the accounting year).

The total of assets should always be equal to the total of liabilities. If however, they do not tally, it would mean that some errors have been committed while preparing the final accounts. You must recheck the treatment of all items including the arithmetical aspect, and make the corrections where necessary so that the Balance Sheet tallies.

Assets: The term 'assets' denote the economic resources (property) of the business and includes all current and fixed assets. You know current assets are those assets which are likely to be realised within a period of one year (or during the normal operating cycle) and includes cash, stock, debtors, bills receivable, short-term investments, etc. The fixed assets, on the other hand, are those assets which are acquired for use in the business over a long period. They may be tangible like machinery and furniture, or intangible like goodwill, patents, etc. The assets also include certain expenses and losses which have not been written off in full. Examples of such expenses are: formation expenses, expenses incurred on issue of shares and debentures, unwritten amount of expenditure on advertising, etc. These are shown as the last item under 'Assets' in the Balance Sheet.

Liabilities: The term 'liabilities' denote all claims against the assets of the business whether those of the outsiders (creditors) or those of the owners of the business. The outsider's claim may be sub-divided into (i) current liabilities, and (ii) long-term liabilities. These are shown separately in the Balance Sheet (see Figure 9.3). The current liabilities are those obligation which are likely to be met within one year (or during the normal operating cycle). The long-term liabilities refer to item like loans which are not to be paid in the near future. The owner's claim is shown as capital after adjusting it with the amount of net profit and drawings during the year.

Look at illustration 7 and see how Balance Sheet is prepared from given list of balances.

Illustration 7

From the following balances extracted from the books of Deepak Brothers, prepare Balance Sheet as on December 31, 2018.

	Rs.		Rs.
Capital	12,00,000	Bills Payable	40,000
Net Profit for 2018	6,00,000	Debtors	2,50,000

Land & Buildings	7,00,000	Bills Receivable	50,000
		Loan	1,60,000
Plant & Machinery (after depreciation)	4,00,000	Bank Overdraft	20,000
		Cash in hand	60,000
Furniture (afterdepreciation)	50,000	Loose Tools	50,000
Investment	3,50,000	Goodwill	1,00,000
Creditors	2,00,000	Closing stock	1,85,000
Trade marks	25,000		

Solution:

Balance Sheet of Deepak Brothers as on December 31, 2018

Liabilities		Amount	Assets	Amount
Current Liabilities		**Rs.**	**Current Assets**	**Rs,**
Bank Overdraft		20,000	Cash in Hand	60,000
Bills Payable		40,000	Bills Receivable	50,000
Sundry Creditors		2,00,000	Sundry Debtors	2,50,000
			Stock in Hand	1,85,000
			Investments	3,50,000
Long-term Liabilities				
Loan		1,60,000		
Capital			**Fixed Assets**	
Balance as on			Loose Tools	50,000
Jan. 1, 2018	12,00,000		Furniture	50,000
Add: Net Profit	6,00,000	18,00,000	Plant & Machinery	4,00,000
			Land & Buildings	7,00,000
			Trade Marks	25,000
			Goodwill	1,00,000
		22,20,000		22,20,000

Now Look at illustration 8. It shows how the Trading and Profit and Loss Account and the Balance Sheet are prepareed from a given Trial Balance.

Illustration 8

From the following Trial Balance of Gupta & Sons, prepare Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	
Purchases	5,00,000	
Purchase Returns		15,000
Inventory on 1.1.2018	60,000	
Land &Pilings	4,00,000	
Plant & Machinery	2,50,000	

Furniture	1,00,000	
Wages	50,000	
Carriage Inwards	10,000	
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		85,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in Hand	50,000	
Bank Overdraft		10,000
Discount Allowed	4,500	
Depreciation on Plant & Machinery	50,000	
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Bad Debts	5,000	
	18,85,000	18,85,000

The inventory on December 31, 2018 was valued at Rs. 1,00,000.

Solution:

Trading and Profit & Loss Account of Gupta & Sons
For the year ended December 31, 2018

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Inventory (Opening)	60,000	By Sales 10,00,000	
To Purchases 5,00,000		Less: Returns 25,000	9,75,000
Less: Returns 15,000	4,85,000	By Inventory (Closing)	1,00,000
To Wages	50,000		
To Carriage Inwards	10,000		
To Cartage	5,000		
To Gross Profit c/d	4,65,000		
	10,75,000		10,75,000
To Carriage Outwards	5,000	By Gross Profit b/d	4,65,000
To Salaries	40,000	By Interest on Investment	5,000
To General Expenses	20,000		
To Rent and Rates	10,000		
To Discount	4,500		
To Bad debts	5,000		
To Depreciation	50,000		

To Interest on Bank overdraft	500		
To Net Profit (Transferred to Capital Account)	3,35,000		
	4,70,000		4,70,000

Balance Sheet of Gupta & Sons as on December 31, 2018

Liabilities		Amount	Assets	Amount
		Rs.		Rs.
Capital	5,00,000			
Add: Net Profit	3,35,000	8,35,000	Goodwill	60,000
Loan		2,60,000	Land & Building	4,00,000
Creditors		85,000	Plant & Machinery	2,50,000
Acceptances		10,000	Furniture	1,00,000
Bank Overdraft		10,000	Investment	50,000
			Inventory (closing)	1,00,000
			Debtors	1,50,000
			Bills Receivables	40,000
			Cash in Hand	50,000
		12,00,000		12,00,000

Note: In the above Balance Sheet all assets and liabilities have been shown ü' the order of permanence.

9.5 VERTICAL PRESENTATION OF FINAL ACCOUNTS

The Trading and Profit and Loss Account and the Balance Sheet have so far been presented as a two-sided statement.But, in practice, it is not necessary to present the final accounts in this form. Nowadays many firms present them in a simpler and more intelligible form which is called a 'narrative style' or 'vertical presentation'. According to this style the Trading and Profit and Loss Account as well as the Balance Sheet are shown in the form of vertical statements. This form of presentation is adopted by many companies for publication of their final accounts. It helps the users of financial statements to appreciate the significance of different items without any difficulty. They can easily interpret the data and judge the profitability and the financial position of the company.

Look at Figure 9.4 and study how various items are shown in the Trading and Profit and Loss Account and the Balance Sheet in vertical form.

Table 9.4 : Trading and Profit and Loss Account of ....for .... the year ended ....

	Rs.	Rs.
SALES		………
Less Cost of Goods Sold:		
Opening Stock	………	
Add: Purchases	………	
Add: Direct Expenses	………	

	………	
Less Closing Stock	………	
		………
GROSS PROFIT		………
Add Other incomes		………
Less Indirect Expenses :		
Salaries	………	
Rent	………	
Sundry Expenses	………	
Insurance	………	………
NET PROFIT		………

Balance Sheet of……………
as on …………

Fixed Assets:			
Land and Buildings		………	
Plant and Machinery		………	
Furniture and Fixtures		………	
Vehicles		………	………
Current Assets:			
Stock-in-hand		………	
Debtors		………	
Cash at bank		………	
Cash in hand		………	
		………	
Less Current Liabilities:			
Creditors	…………..		
Bills Payable	…………..	………	
Working Capital			………
Financed by:			
Capital:			
Balance as on 1.1.2018		………	
Add Net Profit for the year		………	
		………	
Less: Drawings		………	………
Loans			………
			………

Look at illustration 9 and study how Trading and Profit and Loss Account and the Balance Sheet have been prepared for vertical presentation.

Illustration 9

From the information given in illustration 6, prepare Trading and Profit and Loss Account and the Balance Sheet in the vertical form.

Solution:

Trading and Profit and Lass Account of Gupta & Sons
for the year ended December 31, 2018

	Rs.	Rs.
Sales Less Returns		
(Rs. 10,00,000—Rs. 25,000)		9,75,000
Less: Cost of Goods Sold:		
Inventory (beginning)	60,000	
Add: Purchases less Returns		
(Rs. 5,00,000—Rs. 15,000)	4,85,000	
Add: Wages	50,000	
Add: Carriage Inwards	10,000	
Add: Cartage	5,000	
	6,10,000	
Less: Inventory (ending)	1,00,000	5,10,000
GROSS PROFIT		4,65,000
Add: interest on Investments		5,000
		4,70,000
Less: Indirect Expenses:		
Cartage	5,000	
Salaries	40,000	
General Expenses	20,000	
Rent and Rates	10,000	
Discount	4,500	
Bad Debts	5,000	
Interest on Bank Overdraft	500	
Depreciation	50,000	
		1,35,000
NET PROFIT		3,35,000

Balance Sheet of Gupta & Sons as on December 31, 2018

Fixed Assets:		
Goodwill	60,000	
Land & Building	4,00,000	
Plant & Machinery	2,50,000	
Furniture	1,00,000	
Investments	50,000	
		8,60,000
Current Assets:		
Inventory (ending)	1,00,000	
Debtors	1,50,000	
Bills Receivables	40,000	
Cash in hand	50,000	
	3,40,000	

Less: Current Liabilities:			
Creditors	85,000		
Acceptances	10,000		
Bank overdraft	10,000	1,05,000	2,35,000
Working Capital			10,95,000
Financed by:			
Capital Balance on 1.1.2018		5,00,000	
Add: Net Profit		3,35,000	8,35,000
Long Term Loans			2,60,000
			10,95,000

Check Your Progress C

1. What is a Balance Sheet?

   ....

   ....

   ....

2. Why firms use vertical form of presenting the final accounts?

   ....

   ....

   ....

3. Complete the following sentences choosing one of the two alternatives given within brackets.

   i) Assets represent ………..balances of personal and real accounts. (debit! credit)

   ii) All liabilities which become due within one year are classified as ……….liabilities. (long-term/current)

   iii) Unwritten off amount of a deferred revenue expenditure is shown on the ………….side of the Balance Sheet. (asset/liabilities)

   iv) Totals of assets and liabilities are always …………..(different/equal)

   v) Loose Tools are classified as ………..assets. (fixed/current)

   vi) Mortgages are classified as …………..liabilities. (current/long-term)

9.6 MANUFACTURING ACCOUNT

In case of trading concerns you can find out the cost of goods and the gross profit by preparing a Trading Account. But a manufacturing concern has to first prepare another account called Manufacturing Account with the help of which it works out the cost of goods produced. The cost of goods produced is then transferred to the Trading account for ascertaining the cost of goods sold and the gross profit.

A manufacturing concern purchases raw materials from the market and converts them into finished goods for sale. The cost of goods produced thus includes two major costs: (i) cost of raw materials consumed, and (ii) cost of conversion. These are explained below.

Cost of Raw Materials Consumed: This represents the cost of rawmaterials used in course of manufacture which can be worked out by adjusting the opening and closing stocks of raw materials in the purchases of raw materials. For example, a firm purchased raw materials worth Rs. 6,50,000 during 2018, and its stock of raw materials on January 1, 2018 (opening stock) was Rs. 70,000 and on December 31, 2018 (closing stock) Rs. 90,000. The cost of raw materials consumed during 2018 will be worked out as follows:

	Rs.
Opening Stock of Raw Materials	70,000
Add: Purchases of Raw Materials	6,50,000
	7,20,000
Less: Closing Stock of Raw Materials	90,000
Cost of Raw Materials Consumed	6,30,000

The direct expenses incurred on the purchases of raw materials such as freight, import duty, dock dues, cartage, etc. can also be included in the cost of raw materials consumed. But the usual practice is to show them separately on the debit side of the Manufacturing Account.

Cost of Conversion:This includes all expenses incurred in the factory such as wages paid to labour, salaries of supervisory staff, factory rent and rates, motive power, repairs to plant and machinery, depreciation on plant and machinery, etc. All these expenses are debited to the Manufacturing Account.

Look at Figure 9.5 for the performing of a Manufacturing Account.

Manufacturing Account of Fig. 9.5 for the period end ....

Dr. Cr.

Particulars	**Amount**	**Amount**	**Particulars**	**Amount**	**Amount**
	Rs.	Rs.		Rs.	Rs.
To Work-in progress at the beginning		......	By Sale of Scrap		....
To Raw Materials Consumed: Opening Stock of Raw Materials	......		By Work-in-Progress at the end		....
Add: Purchases of Raw Materials	......		By Cost of Goods Produced (Transferred to Trading Account)		....
Less: Closing Stock of Raw Materials	......	......			
To Carriage Inwards		......			
To Freight, Import Duty, Dock Dues, etc.		....			
To Manufacturing Wages		......			
To Motive Power		......			

To Coal, Gas and Water		......			
To Oil and Grease		......			
To Factory Lighting & Heating		......			
To Factory Insurance		......			
To Repairs to Factory Building		......			
To Repairs to Plant and Machinery		......			
To Depreciation on Factory Buildings		......			
To Depreciation on Plant		......			
and Machinery		......			......

Some Important Points

Scrap: The term 'scrap' is used for waste materials coming out of the manufacturing process. Cuttings of cloth in readymade garments factory and metal cuttings in engineering factories are some examples of scrap. Any amount realised from the sale of scrap must be adjusted in the cost of goods produced. Hence, it is credited to the Manufacturing Account.

Work-in-Progress: It is quite likely that at the end of the year, there may be certain goods which are still in the process of manufacture. Such goods are called 'semi-finished goods' or 'work-in-progress'. There will always be some work-in- progress at the beginning as well as at the end of the accounting year. Their cost must be adjusted while working out the cost of goods produced. Hence the opening work-in-progress is shown on the debit side of the Manufacturing Account while the closing work-in-progress s shown on its credit side.

Stock of Finished Goods: Besides the stock of raw materials and semi-finished goods every firm will have the stock of finished goods. This is to be adjusted in the cost of goods sold and not in the cost of goods produced. Hence, it is not shown in the Manufacturing Account. As you learnt earlier, it will be shown in the Trading Account.

Look at illustration 10 and see how Manufacturing Account is to be prepared.

Illustration 10

Prepare Manufacturing Account from the following particulars relating to the year 2018.

	Rs.
Purchases of Raw Material	1,00,000
Stock on 1.1.2018	
Raw Materials	10,000
Work-in-Progress	5,000
Finished goods	25,000
Factory wages	15,000
Factory Rent	5,000
Fuel & Power	2,000
Carriage Inwards	1,000
Repairs of Plant	2,000
Depreciation on Plant	5,000
Sale of Scrap	500

Stock on 31.12.2018	20,000
Raw Materials	7,500
Work-in-Progress	30,000
Finished Goods	

Solution:

Manufacturing Account for the year ended December 31, 2018

Particulars		Amount	Particulars	Amount
		Rs.		Rs.
To Work-in-Progress at the beginning		5,000	By Sale of Scrap	500
To Raw Materials Consumed			By Work-in-Progress at the end	7,500
Opening Stock	10,000		By Cost of Goods Produced (transferred to Trading Account)	1,17,000
Add: Raw Purchased	1,00,000			
	1,10,000			
Less: Closing Stock	20,000	90,000		
To Factory Wages		15,000		
To Factory Rent		5,000		
To Fuel & Power		2,000		
To Carriage Inwards		1,000		
To Repairs of Plant		2,000		
To Depreciation on Plant		5,000		
		1,25,000		1,25,000

You will observe that the stock of finished goods has not been shown in the Manufacturing Account. As stated earlier, it is to be taken to the Trading Account. Now, suppose the sales for the year 2018 were Rs. 1,60,000. The Trading Account will appear as follows

Trading Account of for the year ending December, 31 2018

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Opening stock of Finished Goods	25,000	By Sales	1,60,000
To Cost of Goods Produced (Transferred from Mfg. A/c)	1,17,000	By Closing stock of Finished Goods	30,000
To Gross Profit (Transferred to Profit & Loss A/c)	48,000		
	1,90,000		1,90,000

You have learnt that a manufacturing concern has to prepare Manufacturing Account before preparing the Trading and Profit and Loss Account. Though considered desirable but many firms do not do so because it is not compulsory. You will also generally be asked to prepare only the Trading Account without preparing the

Manufacturing Account. In such a situation you will show all items of Manufacturing Account in the Trading Account itself. In other words, cost of raw materials consumed, expenses on purchases of raw materials, all manufacturing expenses, the opening and closing work-in-progress, sale of scrap, etc. will also be shown in the Trading Account. But, as per common practice, the items like depreciation and repairs to plant and machinery and factory building will be shown in the Profit and Loss Account and not in the Trading Account.

9.7 LET US SUM UP

At the end of the accounting year the businessman prepares the final accounts with the help of a Trial Balance. The final accounts consist of (i) Profit and Loss Account and (ii) Balance Sheet. The Profit and Loss Account is prepared for ascertaining the net profit/net loss of the business during the year and the Balance Sheet is prepared for ascertaining its financial position as at the end of the year.

The Profit and Loss Account is divided into two sections. The first section called Trading Account reveals the gross profit or gross loss and the second section called Profit and Loss Account shows the net profit or net loss. Gross profit is defined as the excess of sale revenue over the cost of goods sold which also includes the direct expenses. The net profit is worked out by-crediting the Profit and Loss Account with the amount of gross profit and other incomes and debiting it with all indirect expenses and losses. In practice, we usually prepare a combined Trading and Profit and Loss Account. It is also necessary to pass closing entries for transferring all expenses and incomes to the Trading and Profit and Loss Account.

The Balance Sheet shows all assets and liabilities of the business. The assets represent the debit balances of the real and personal accounts plus the unwritten off amounts of deferred revenue expenses. The liabilities, on the other hand, represent the credit balances of real and personal accounts including capital. The total assets should always be equal to the total of liabilities.

The manufacturing concerns may also prepare a Manufacturing Account for ascertaining the cost of goods produced, which is then transferred to the Trading Account for ascertaining the cost of goods sold and the gross profit. This, however, is not compulsory. Most manufacturing concerns prepare the Trading Account directly y showing all-expenses incurred in the factory (including cost of raw materials consumed) in the Trading Account itself.

9.8 KEY WORDS

Closing Stock: Goods remaining unsold at the end of the accounting year.

Cost of Conversion: Expenses incurred in the factory (for converting raw materials into finished goods.)

Cost of Goods Sold: Difference between the cost of goods available for sale and the cost of goods in stock.

Cost of Production: It is the cost of goods produced which includes cost of raw materials consumed and all manufacturing expenses.

Current Assets: Assets which are likely to be realised within a period of one year or during the operating cycle. They are also called floating assets.

Current Liabilities: Liabilities which are likely to be paid within one year or during the operating cycle. They are also called short-term liabilities.

Direct Expenses: Expenses incurred on the goods purchased till they are brought to the place of business.

Fictitious Assets: Expenses and losses not yet written off and shown as assets in the Balance Sheet.

Fixed Assets: Assets acquired for use in the business for a long period. They are also called non-current assets.

Gross Profit: Excess of sales revenue over the cost of goods sold.

Indirect Expenses: All expenses other than direct expenses. These include expenses incurred in connection with general administration, financial matters and selling and distribution of goods.

Intangible Assets: Assets in the form of rights which cannot be seen or touched such as goodwill, patents, etc.

Net Profit: Excess of gross profit and other incomes over the indirect expenses and losses in the business.

Non-Current Liabilities : Liabilities payable after a long time. They are also called long-term liabilities.

Owner's Capital: Claim of owners against the assets of the business. It is also called owner's equity and is equal to excess of assets over outside liabilities.

Opening Stock: Stock of goods as at the beginning of the accounting year.

Scrap: Waste material which arises in the course of manufacture.

Tangible Assets: Assets which have physical form and can be seen and touched such as buildings, machinery, etc.

Work-in-Progress: Goods in respect of which some work still remains to be done. They are also called semi-finished goods.

9.9 SOME USEFUL BOOKS

Maheshwari, S.N. 2018. Introduction to Accounting, Vikas Publishing House: New Delhi.

Patil, V.A. and J.S. Korlahalli. 1986. Principles and Practice of Accounting, R. Chand & Co., New Delhi.

William Pickles. 1992. Accountancy, E.L.B:s. and Pitman: London.

Gupta, R.L. and M. Radhaswamy. 2018. Advanced Accountancy; Sultan Chand & Sons: New Delhi.

Shukla, M.C. and T.S. Grewal. 2018. Advanced Accountancy, S. Chand & Co.: New Delhi.

9.10 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) Debit ii) Debit iii) Debit iv) Credit v) Debit
vi) Credit vii) Debit viii) Credit ix) Debit x) Debit
xi) Debit xii) Credit

B 3. i) False ii) rue iii) True iv) True v) False vi) False.

4. i) indirectii) purchases, closing stock iii) selling iv) Trading v)debited

vi) Trading Account

5. Rs. 90,000

C 3. i) debit ii) current iii) asset iv) equal v) fixed vi) long-term

9.11 TERMINAL QUESTIONS/EXERCISES

Questions

1. Distinguish between:
   a) Cost of Goods Sold and Cost of Goods Processed
   b) Gross Profit and Net Profit
   c) Direct Expenses and Indirect Expenses
   d) Trading Account and Manufacturing Account
   e) Profit and Loss Account and Balance Sheet
2. Give closing entries for Trading and Profit and Loss Account.
3. What is a Balance Sheet? Describe different methods of arranging assets and liabilities.

Exercises

1. Find out the Cost of Goods Sold from the following figures extracted from the books of Allied Ltd. for the year 2018:

	Rs.
Stock (1.1.2018)	50,000
Purchases	10,00,000
Sales	15,00,000
Purchases Returns	50,000
Stock (31-1-2018)	70,000
Direct Expenses	60,000
Indirect Expenses	1,00,000

(**Answer:** Rs. 9,90,000)

2. Find out the Cost of Goods Sold and Gross Profit from the following figures:

	Rs.
Inventory in the beginning	60,000
Purchases Less Returns	6,00,000
Carriage Inwards	20,000
Cartage Outwards	30,000
Cartage and Freight	10,000
Wages	50,000
Sales Less Returns	12,00,000
Inventory at the end	40,000

(**Answer:** Cost of Goods Sold Rs, 7,00,000; Gross Profit Rs. 5,00,000.)

3. From the data given in Question No. 2 prepare Trading Account

4. From the following balances of Shyam Sunder, prepare Profit and Loss Account for the year ended March 31, 2018.

	Rs.
Office Expenses	5,280
Advertising	3,000
Legal Charges	5,000
Postage and Telephone Charges	6,400
Salaries and Wages	60,000
Travelling Expenses	2,500
Interest Received	600
Rent, Rates and Taxes	20,800
Insurance	2,400
Office Lighting	1,500
Stationery	1,200
Repairs	920
Miscellaneous Income	800
Commission Paid	4,000
Bank Charges	200

The Gross Profit for the year was Rs. 73,000

(**Answer:** Net Loss Rs. 38,000)

5. The following balances have been extracted from the books of Plaza Electricals Ltd. for the year 2018.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Return Inwards	10,000
Return Outwards	15,000

Opening Stock	30,000
Wages	20,000
Carnage Inwards	5,000
Carriage Outwards	3,000
Salaries	25,000
General Expenses	10,000
Rent and Rates	4,000
Advertisement	5,000
Bad debts	3,000
Insurance	3,000
Trade Expenses	2,000
Depreciation	5,000

It was further given that the value of stock on December 31, 2018 was Rs. 50,000. You are required to prepare Trading and Profit and Loss Account of Plaza Electrical Ltd. for the year ending December 31, 2018.

(**Answer:** Gross Profit Rs. 2,00,000; Net Profit Rs. 1,40,000)

6. From the following data pertaining to the transactions of Mehta Bros. for the year 2018, prepare Trading and Profit and Loss Account for the year ending December 31, 2018.

	Rs.
Sales	10,00,000
Purchases	6,00,000
Sales Returns	20,000
Purchases Returns	10,000
Inventory (beginning)	40,000
Wages	50,000
Carriage Inwards	20,000
Carriage Outwards	15,000
Trade Expenses	10,000
Cartage and Freight	5,000
Salaries	30,000
General Expenses	10,000
Insurance	6,000
Rent & Rates	5,000
Distribution Expenses	6,000
Discount Received	1,000
Discount Allowed	2,000
Bad Debts	2,000
Depreciation	8,000
Interest on Investments	20,000
Interest on Bank Deposits	1 ,000
Interest on Bank Overdraft	500
Loss of Goods by Fire	2,500

It was further given that the value of Inventory on December 31, 2018 was Rs. 80,000

(**Answer:** Gross Profit Rs. 3,55,000: Net Profit Rs. 2,80,000,

7 . From the following balances of Hitesh, prepare a Balance Sheet as on December 31, 2018

	Rs.
Hitesh's Capital	41,000
Drawings	6,100
Wife's Loan	4,000
Sundry Creditors	45,000
Cash in Hand	250
Cash at Bank	4,000
Sundry Debtors	40,500
Patents	2,000
Plant and Machinery	20,000
Land and Building	26,000
Stock in Hand	36,500

Net Profit for the year was Rs. 45,350

(**Answer:** Balance Sheet Total Rs. 1,29,250)

8. From the following Trial Balance of Sameer, prepare Trading and Profit and Loss Account for the year ended September, 30, 2018, and Balance sheet as on that date.

Trial Balance as on September 30, 2018

Name of Account	**Dr. Balances Rs.**	**Cr Balances Rs**
Capital		40,000
Drawings	7,500	
Stock on July 1, 2017	8,000	
Purchases	47,250	
Sales		90,000
Carriage Inwards	2,300	
Returns .Inwards	2,000	
Returns Outwards		1,500
Wages	7,000	
Plant and Machinery	30,000	
Furniture and fittings	7,500	

Coal, Gas and Water	2,100	
Power	2,000	
Salaries	9,000	
Discount Allowed	750	
Discount Received		600
Office Rent	2,400	
Factory Rent	3,000	
Postage and telephone	900	
Insurance	250	
Sundry Expenses	800	
Trade Debtors	20,000	
Trade Creditors		27,150
Cash in hand	700	
Cash at Bank	4,100	
Carriage Outwards	1,700	
	1,59,250	1,59,250

The Stock on September 30, 2018 was valued at Rs. 9,250.

(**Answer:**Gross Profit Rs. 27,100; Net Profit Rs. 11,900; Balance Sheet Total Rs. 71,550)

9. The following figures have been extracted from the books of a manufacturer.

	Rs.
Stock 1.1.2018	
Raw Materials	25,000
Work-in-Progress	10,000
Finished Goods	50,000
Purchases of Raw Materials	3,00,000
Factory Wages	40,000
Factory Rent	5,000
Fuel & Power	5,000
Carriage Inwards	2,500
Repairs of Plant	25,000
Depreciation on Plant	25,000
Sale of Scrap	2,000
Stock on 31.12.2018	
Raw Materials	40,000
Work-in-Progress	15,000
Finished Goods	60,000

You are required to prepare a Manufacturing Account and ascertain the Cost of Goods Produced.

(**Answer:**Cost of Goods Produced: Rs. 3,75,500)

10. From the following Trial Balance, prepare Manufacturing Account and the Trading and Profit and Loss Account for the year ended March 31, 2018, and

Balance Sheet as at the end of the year.

Name of Account	Dr. Balances	Cr Balances
	Rs.	Rs
Opening Stock of Raw Materials	60,000	
Opening Stock of Finished Goods	32,000	
Opening Stock of the Work-in- Progress	10,000	
Capital		1,44,000
Purchase of Raw Materials	5,00,000	
Sales		8,00,000
Purchase of Finished Goods	16,000	
Carriage Inwards	8,000	
Wages	1,00,000	
Salaries (75% Factory)	52,000	
Commission	6,000	
Bad Debts	4,000	
Insurance	8,000	
Rent, Rates and Taxes (50% Factory)	24,000	
Postage and Telegram	5,600	
Miscellaneous Expenses	3,200	
Travelling and Conveyance (50% Factory)	7,000	
Carriage Outwards	5,200	
Machinery	80,000	
Furniture	10,000	
Debtors	1,20,000	
Creditors		1,07,000
	10,51,000	10,51,000

The Closing Stocks are as follows:

Raw Materials	80,000
Work-in-Progress	24,000
Finished Goods	16,000

(**Answer:** Cost of Production Rs. 6,26,750; Gross Profit Rs. 1,41,250; Net Profit Rs. 79,000; Balance Sheet Rs. 3,30,000.

> **Note** : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 10 FINAL ACCOUNTS-II

Structure

10.0 OBJECTIVES

After studying this unit you should be able to:

- explain why adjustment entries are necessary at the time of preparing the final accounts;
- list the items in respect of which adjustments are usually made;
- pass the necessary adjustment entries; and
- prepare final accounts with adjustments.

10.1 INTRODUCTION

In Unit 8 you learnt about the preparation of simple final accounts. They did not involve any adjustments. In practice, however, you are always required to make some adjustments while preparing the final accounts. It is because there may be many expenses and incomes relating to the current year which are still to be brought into the books of account. Then there may be certain items recorded in current year's books which actually relate to the previous year or the next year. Unless such items are duly adjusted in the books of account, the final accounts will not reveal the true and fair view of the state of affairs of the business. In this unit you will learn about all items which require adjustments and study how such adjustments are made in books of account and how they are incorporated in the final accounts.

10.2 NEED FOR ADJUSTMENTS

You know that the financial reporting requires the summarisation of business operations for a specific accounting period. It is quite possible that certain transactions recorded in current year's books may partly relate to the previous year or to the following year. It is also possible that certain expenditure incurred during the current year has not yet been paid and so not recorded. Similarly, there may be certain incomes earned during the current year which have not been recorded because they have not yet been received; If such items are not adjusted or brought into current year's books of account, the summary presented in the form of final accounts will not reveal the true picture. Let us take the example of an amount of Rs. 600 paid on July 1, 2018 towards insurance premium. You know any general insurance usually covers a period of twelve months. Suppose the accounting year is ending on December 31, 2018 it would mean that half the amount of insurance premium paid on July 1, 2018 pertains to the next accounting year i.e., 2019. Therefore, while preparing the final accounts of 2018, the expenditure on insurance premium that should be debited to the Profit and Loss Account is Rs. 300 (Rs. 600 paid Rs. 300 pertaining to 2019). The remaining amount of Rs. 300 will be carried forward and charged to the Profit and loss Account of 2019. Take another example. The wages of workers for the month of December, 2018 were paid on January 7, 2019. This means the Wages Account of 2018 does not include the wages for the month of December 2018. Such unpaid wages termed as 'Wages outstanding' have to be brought into the books and debited to the Trading Account along with the wages already paid. Similarly, adjustment may also become necessary in respect of certain incomes received in advance or those which are outstanding as at the end of the accounting year. Apart from these, there are certain items which cannot be recorded on day-to-day basis such as depreciation, interest on capital, etc. They are generally adjusted at the time of preparing the final accounts.

All items which need alteration or which are to be brought into books at the time of preparing final accounts are called 'adjustments'. The purpose of making various

adjustments is to ensure that the final accounts reveal the true financial position of the business. Therefore, when you are to prepare the final accounts of any business, you are provided with a Trial Balance and some additional information in respect of the adjustments to be made.

10.3 TREATMENT OF ADJUSTMENTS IN FINAL ACCOUNTS

There are several items which need adjustment at the time of preparing the final accounts. Some of the important and common adjustments are listed below:

1. Closing Stock
2. Outstanding or Accrued Expenses
3. Prepaid or Unexpired Expenses
4. Outstanding or Accrued Incomes
5. Incomes Received in Advance (Unearned Income)
6. Depreciation
7. Interest on Capital
8. Interest on Drawings
9. Interest on Loan
10. Bad Debts
11. Provision for Bad Debts
12. Provision for Discount on Debtors
13. Provision for Discount on Creditors
14. Manager's Commission
15. Abnormal Loss
16. Drawing of Goods by the Proprietor

Let us now discuss the nature of each item of adjustment and its treatment in the final accounts. In this connection you must remember that the general principle of. double entry has to be fully followed. Hence, for bringing any item into the books of account or adjusting the amount of any expense or income, you have to ensure that theamount is debited to one account and credited to another; and while showing it in the final accounts the item should appear at two places, one representing the debit and the other representing the credit, otherwise the Balance Sheet will not tally. Usually, each adjustment will first appear in the Trading and Profit and Loss Account and then in the Balance Sheet.

10.3.1 Closing Stock

You know that all goods purchased or produced during the year are not completely sold out by the end of the year. Some goods always remain unsold as at the end of the year which are called 'Closing Stock'. The Closing Stock does not usually appear in the Trial Balance. It is mostly given in the form of additional information. Since Gross Profit/Gross Loss cannot be worked out without accounting for the closing stock it is brought into books by means of the following adjustment entry.

Closing Stock A/c Dr.

To Trading A/c

The closing stock is treated in the final accounts as follows:

i) On the credit side of Trading Account: shown as a separate item, and

ii) On the assets side of the Balance Sheet: shown as a separate item under Current Assets.

Adjusted Purchases and Closing Stock: Sometimes the closing stock may be giver in the Trial Balance itself. This would mean that both the opening and the closing stocks have been adjusted in the purchases. In such a situation, the opening stock will not appear in the Trial Balance. The Trial Balance will show only the figures of adjusted purchases and the closing stock. The adjusted purchases are in fact the cost of goods sold. They have been worked out by adding the opening stock to purchases and subtracting the closing stock therefrom. Hence, the adjusted Purchases are shown on the debit side of the Trading Account. In such a situation there is no need to show closing stock in the Trading Account as it already stands adjusted in purchases. It will be shown only on the asset side of the Balance Sheet.

10.3.2 Outstanding Expenses

Outstanding expenses are those expenses which have been incurred during the current accounting year but have not been paid till the end of the year. They are also called 'expenses accrued'. The common examples of such expenses are the salaries, wages and rent for the last month of the accounting year paid in the first month of the next year. Since they remained unpaid as at the end of accounting year, no entry might have been passed in the books of account. So, they must be taken into account while preparing the Trading and Profit and Loss Account otherwise it will not reveal the correct amount of profit or loss. The following adjustment entry is passed in respect of outstanding expenses.

Concerned Expense A/c Dr.
To Outstanding Expenses A/c

The outstanding expenses will be treated in final accounts as follows:

i) Added to the concerned expenses in the Trading and Profit and Loss Account, and

ii) Shown on the liabilities side of the Balance Sheet as a separate item under Current Liabilities.

10.3.3 Prepaid Expenses

Sometimes, the benefit of some expenses will be available not only in the current accounting year but also during the next year. That portion of expense the benefit of which is yet to be received is called 'prepaid expense'. It is also called 'unexpired expense'. Examples of such expenses are unexpired insurance, interest paid in advance, etc. In such situations it is necessary to find out the unexpired portion and ad just it in the concerned expense, Thefollowing adjustment entry is passed in respect of the prepaid expenses:

Prepaid Expenses A/c Dr.
To Concerned Expense A/c

The Prepaid expenses will be treated in final accounts as follows:

i) Subtracted from concerned expense in the Trading and Profit and Loss Account, and

ii) Shown on the assets side of the Balance Sheet as a separate item under Current Assets.

10.3.4 Accrued Income

Accrued Incomes are those incomes which have been earned during the current accounting year but have not been received till the end of the year. They are also called 'outstanding incomes' or 'incomes earned but not yet received'. Examples of such incomes are commission receivable, income on investments due but not yet received, etc. The following adjustment entry is passed in respect of accrued income.

Accrued Income A/c	Dr.
To Concerned Income A/c	

The Accrued income is treated in final accounts as follows:

i) Added to the concerned income in the Profit and Loss Account, and

ii) Shown on the asset side of the Balance Sheet as a separate item under Current Assets.

10.3.5 Income Received in Advance

Any income which belongs to the next accounting year but has been received during the current accounting year is called 'income received in advance' or 'unearned income. It is the income in respect of which the service is yet to be provided. Examples of such incomes are rent received in advance, interest received in advance, etc. In such a situation, the unearned portion of the income will have to be adjusted while preparing the final accounts. The following adjusting entry is passed in respect of the unearned income.

Concerned Income A/c	Dr.
To Income Received in Advance A/c	

The unearned income is treated in final accounts as follows:

i) Deducted from the concerned income in the Profit and Loss Account, and

ii) Shown on the liabilities side of the Balance Sheet as a separate item under Current Liabilities.

Look at illustration 1 and see how adjustments are made in the final accounts in respect of outstanding expenses, prepaid expenses, outstanding incomes and incomes received in advance.

Illustration 1

Show how you will record the following items in the Profit and Loss Account and the Balance Sheet.

The Trial Balance showed the following balances as on December 31, 2018:

	Rs.
Salaries	10,000
Wages	20,000
Rent Received	6,600
Commission Received	2,000
Interest on Investments	6,000

Additional Information

i) Salaries amounting to Rs. 2,000 are outstanding.

ii) Wages include Rs. 1,560 paid in advance.

iii) Interest on investment includeRs. 1,200 for the months of January, February and March, 2019.

iv) Rent for the month of December amounting to Rs. 600 is not yet received.

Gross profit for the year is Rs. 40,000 and other expenses amounted to Rs. 10,000

Profit and Loss Account for the year ended December 31, 2018

Particulars		Amount	Particulars		Amount
		Rs.			**Rs.**
To Salaries	10,000		By Gross Profit b/d		40,000
Add: Outstanding	2,000	12,000	By Rent Received	6,600	
To Wages	20,000		Add: Outstanding	600	
Less: Prepaid	1,500	18,500			7,200
To Other Expenses		10,000	By Commission Received		2,000
To Net Profit (Transferred to Capital A/c)		13,500	By Interest on Investments	6,000	
			Less: Received in Advance	1,200	4,800
		54,000			54,000

Balance Sheet
As on December 31, 2018

Liabilities	Amount	Assets	Amount
Current Liabilities:	Rs.	**Currents Assets:**	Rs,
Salaries Outstanding	2,000	Wages Prepaid	1,500
Interest Received in Advance	1,200	Rent Outstanding	600

10.3.6 Depreciation

Depreciation means decrease in the value of fixed assets due to their usage and the passage of time. You know the fixed assets are used for the purpose, of earning revenue. Therefore, the fall in their value should be considered as an expense or loss incurred in realising such revenue and should be charged to the Profit and Loss Account. Depreciation is not recognised on day-to-day basis. It is brought into the books only at the end of the accounting period by passing the following journal entry.

Depreciation A/c Dr.
To Concerned Asset A/c

Depreciation is treated in final accounts as follows:

i) On the debit side of the Profit and Loss Account: shown as a separate item giving details of depreciation on each fixed asset, and

ii) Deducted from the concerned asset in the Balance Sheet.

Sometimes depreciation is given in the Trial Balance itself. This is possible only if the entry in respect of depreciation has already been passed in the books of account. **In**

such a situation depreciation will be shown in the Profit and Loss Account only. It need not be adjusted in the fixed assets in the Balance Sheet because the fixed assets already stand reduced by the amount of depreciation.

Depreciation is generally calculated at the given rate for the period for which the asset has been used in the accounting year. Thus, if an-asset is purchased during the current year the depreciation should be calculated from the date of acquisition till the end of the year. If the date on which the additions were made is not given, you should calculate depreciation on additions also for the full year. In the case of old assets, depreciation is calculated on the opening balance. Look at illustration 2 and study how depreciation is treated at the time of preparing the final account.

Illustration 2

The following are the balances of assets as on January 1, 2018:

	Rs.
Plant and Machinery	1,20,000
Furnitur	18,000

A new machinery costing Rs. 30,000 was acquired on July, 1, 2018. Depreciation is to be provided on Plant and Machinery at 10% and on furniture at 5% per annum. Show how depreciation will be shown in the final accounts.

Solution :

Calculation of Depreciation

		Rs.
On Furniture at 5% on Rs. 18,000		900
On Plant and Machinery:		
10% on Rs. 1,20,000 for one year	12,000	
10% on Rs. 30,000 for six months	1,500	13,500
		14,400

Solution:

Treatment in Final Accounts

Particulars		Amount	Particulars	Amount
		Rs.		Rs.
To Depreciation :				
Plant and Machinery	13,500			
Furniture	900	14,400		

Balance Sheet as on December 31, 2018

Particulars	Amount	Particulars		Amount
	Rs.			Rs.
		Fixed Assets:		
		Plant and Machinery	1,20,000	
		Add: New Machinery	30,000	
			1,50,000	
		Less: Depreciation	13,500	1,36,500
		Furniture	18,000	
		Less: Depreciation	900	17,100

10.3.7 Interest on Capital

You know thefinds provided by the proprietor to the business constitute capital. Sometimes, the proprietor may like to know the profits made by the business after taking into consideration the interest on this capital. In such a situation interest is allowed at a certain rate on the capital. It is calculated on the capital at the beginning of the year. If, however, any additional capital is introduced during the year, interest on additional capital will also be calculated from the date on which it was brought into Final Account, the business. Such interest is treated as an expense for the business and the following adjustment entry is passed to bring it into the books of account.

Interest on Capital A/c Dr.

To Capital A/c

Interest on capital is treated in final accounts as follows:

i) On the debit side of Profit and Loss Account: shown as a separate item of expense and

ii) Added to Capital on the liabilities side of Balance Sheet. You should note that normally no interest on capital is to be provided.

10.3.8 Interest on Drawings

In case interest is allowed to the proprietor on his capital, it is a usual nractice to also charge interest on his drawings. Interest on drawings will be a gain for the business and the following adjustments entry is passed to bring it into the books of account.

Capital A/c or Drawings A/c Dr.

To Interest on Drawings A/c

Interest on Drawings is treated in final accounts as follows:

i) On the credit side of Profit and Loss Account: shown as a separate item, and

ii) Deducted from Capital on the liabilities side of Balance Sheet.

Interest on drawings is calculated at a given rate from the date of withdrawal till the end of the year. In case no date is mentioned, the interest is charged for six months assuming the amounts were drawn evenly throughout the year. Look at illustration 3 and see how interest on drawings is calculated when the amount and the dates of withdrawal are given.

Illustration 3

	Rs.
Feb. 1	4,000
Apr. 1	6,000
Jul. 1,	6,000
Oct 31	2,000
Dec. 31	5,000

Calculate the interest chargeable to the proprietor if the rate of interest on drawings is 15% per annum.

Solution:

Date (1)	Amount (2)	Months upto December 31 (3)	Product 2 ò 3 (4)
Feb. 1	4,000	11	44,000
Apr. 1	6,000	9	54,000
Jul. 1	3,000	6	18,000
Oct. 31	2,000	2	4,000
Dec. 31	5,000	0	0
			1,20,000

$$\text{Interest on Drawings } = \frac{15}{100} \times 1,20,000 \times \frac{1}{12} = \text{Rs.}1,500$$

Another way of calculating interest on drawings is to calculate it individually on each withdrawal and then add them.

10.3.9 Interest on Loan

If the firm has taken some loan, it has to pay interest thereon. Hence, when we notice a loan Account in the Trial Balance, we must find out whether the full amount of due on loan has been paid or not. The rate of interest and the date on which the loan was taken is usually given. If, however, the date on which loan was taken is not given, it means that it is an old loan and full year's interest has to be provided. In any case, you should calculate the exact amount of interest due and find Out from the Trial Balance whether the same has been paid or not. Generally, you will find that the interest has been paid but it is less than what is due. In such a situation, the difference is regarded as outstanding interest and the same must be adjusted at the time of preparing the final accounts. Suppose there is an item of 10% loan (taken on April 1, 2018) of Rs. 20,000 appearing in the Trial Balance. Assuming the accounting year ends on December 31, the total interest on loan will work out as Rs. 1,500 (at 10% on Rs. 20,000 for nine months). On going through the Trial Balance you find that the interest paid is Rs. 1,000 only. It means Rs. 500 (Rs. 1,500— Rs. 1,000) is the outstanding interest. This must be shown in final accounts accordingly i.e., Rs. 1,500 (Rs. 1,000 + Rs. 500 outstanding) as interest on loan on the debit side of the Profit and Loss Account and Rs. 500 as outstanding Interest under current liabilities in the Balance Sheet.

It is possible that the adjustments given outside the Trial Balance already include this item. But, if they do not even then you have to account for it. This is called an implied adjustment.

Check Your Progress A

1. Fill in the blanks

   i) Every adjustment has a .... effect.

   ii) Closing stock is shown on the side .... of the Balance Sheet.

iii) Prepaid expenses are also called .... expenses.

iv) Income received in advance is .... for the business.

v) .... is a decrease in the value of a fixed asset due to wear and tear.

vi) Interest on Drawings is from .... the capital in the Balance Sheet.

2 State whether the following statements are True or False.

i) Every adjustment affects either Trading and Profit and Loss Account or the Balance Sheet.

ii) Outstanding expense is first added to the relevant expense account and then shown on the liabilities side of the Balance Sheet.

iii) Interest on loan is an income for the business.

iv) Depreciation is deducted from the relevant fixed asset in the Balance Sheet and Profit and Loss Account

v) Proprietor is always entitled to interest on the capital invested.

10.3.10 Bad Debts

Sometimes, a debtor may fail to pay his debt either partially or completely. The amount of debt which cannot be recovered from the debtor is called Bad Debts and it will be a loss to the business. The following journal entry is passed when a debt becomes bad.

Bad Debts A/c Dr.
To Concerned Debtor's A/c

The effect of this entry will be (i) debtor's personal account stands, closed, and (ii) a new account called 'Bad Debts Account is opened in the books.

The total amount of bad debts incurred during the year appears as a separate item in the Trial Balance and the sundry debtors appear at the reduced amount. The bad debts like any other expense or loss are charged to the Profit and Loss Account.

Bad Debts given outside the Trial Balance: Sometimes, the bad debts to be written off may be stated outside the TrialBalance as an adjustment item, It means that such bad debts have not yet been written off. In other words, the entry for such bad debts has not been passed. It is necessary to record such bad debts at the time of preparing the final accounts. This is done by passing the following adjustment entry:

Bad Debts Account Dr.
To Sundry Debtors

Such additional bad debts usually called 'further bad debts' are treated in finalaccounts as follows:

i) On the debit side of Profit and Loss Account: shown as addition to bad debts already written off, and

ii) On the assets side of the Balance Sheet: shown as deduction from Sundry Debtors.

It is important to remember the difference between the treatment of bad debts given inside the TrialBalance and the bad debts given outside the Trial Balance. The bad debts given inside the Trial Balance and also those given outside the Trial Balance will be shown in the Profit and Loss Account. But only those bad debts will be deducted from Sundry Debtors in the Balance Sheet which are given outside the Trial Balance.

10.3.11 Provision for Bad Debts

In any business where goods are sold on credit, bad debts usually occur. When it is certain that a debt will not be recovered, the amount is written off as bad debt. But, it is also likely that some of the remaining debts may not be recovered in full. From experience we know that certain percentage of amounts due from debtors may not be recovered. This will be a loss to the business. You have learnt that accordingly to 'conservatism concept' all possible losses must be provided for. Hence, it is a common practice to make a suitable provision for doubtful debts at the time of preparing the final accounts. Otherwise, the Profit and Loss Account will not reveal the correct amount of profit or loss and the Balance Sheet will not show the true position of sundry debtors. The Provision for doubtful debts is usually calculated as a certain percentage of the total amount due from sundry debtors after writing of all known bad debts.

Provision for doubtful debts is also called 'Provision for Bad Debts' or 'Provision for Bad and doubtful Debts. Such a provision is made by debiting the amount of doubtful debts to the Profit and Loss Account. Thus, the journal entry for creating such provision will be as follows:

Profit and Loss A/c Dr.
To Provision for Bad Debts A/c

You will notice that when a debt is irrecoverable it is written off by crediting it to the personal account of the respective customer. But, when a debt is doubtful of recovery, the personal account of the customer will not be credited as the recovery is still possible. Hence, the creation of provision for bad debts does not affect the balance of debtors personal accounts. However, while showing sundry debtors in the Balance Sheet the amount of such provision is subtracted therefrom.

When provision for bad debts already exists in the books, the provision created for doubtful debts at the end of a particular year will be carried forward to the next year and it will be used for meeting the loss due to bad debts incurred during the next year. The provision for bad debts brought forward from the previous year is called 'opening provision' or 'old provision'. When such provision already exists, the loss due to bad debts during the current year will be adjusted against the Same, and while making provision for bad debts required at the end of the current year called 'new provision' the balance of old provision should also be taken into account. Let us take an example and understand how these adjustments are done. Suppose old provision on January 1, 2018 was Rs. 1,000. The bad debts written off during 2018 amounted to Rs.600 and the new provision required on December 31, 2018 is Rs. 1,500. In such a situation, the

Profit and Loss Account will be debited with Rs. 1,100 as calculated below:

	Rs.
Existing Provision for Bad Debts	1,000
Less: Bad Debts	600
Surplus provision available	400
Provision required at the end of the year	1,500
Less: Surplus of old provision	400
Amount to be debited to Profit and Loss Account	1,100

The above aspects will be shown on the debit side of the Profit and Loss Account as follows:

Profit and Loss Account of the year ended………

Dr. Cr.

		Rs.		Rs.
To Provision for Bad Debts				
Bad Debts	600			
Add: New Provision	1,500			
	2,100			
Less: Old Provision	1,000	1,100		

If however, the total of new provision and the actual bad debts are less than the old provision, the details will be shown on the credit side of the Profit and Loss Account as follows:

Profit and Loss Account for the year ended……….

Dr. Cr.

	Rs.			Rs.
		By Provision for Bad Debts		
		Old Provision	…….	
		Less: Bad Debts	…….	
		Less: New Provision	…….	

In this connection you should note the following points.

1. If some bad debts are given in adjustments (further bad debts) they should also be taken into account.
2. The new provision should be calculated on sundry debtors after adjusting the amount of further bad debts.
3. In Balance Sheet only the further bad debts as given in adjustments and the new provision for bad debts should be subtracted from sundry debtors.

The following are the journal entries required when the provision for bad debts exists in the books:

a) Forwriting off further bad debts given outside the Trial Balance:

Bad Debts A/c Dr.
  To Sundry Debtors

b) For transferring the total bad debts to the provision for Bad Debts Account:

Provision for Bad debts A/c Dr.
  To Bad Debts A/c

c) For debiting the Profit and Loss Account with the excess of the new pr' the total bad debts over the old provision:

Profit and Loss Account A/c Dr.
To Provision for Bad Debts A/c

d) For crediting the Profit and Loss Account with excess of the old provision over the total baddebts plus new provision:

Provision for Bad Debts A/c Dr.
To Profit and Loss A/c

Look at illustration 4 and see how bad debts and provision for bad debts are recorded in the final Accounts.

Illustration 4

An extract from a Trader's Trial Balance on December 31, 2018 is given below:

Name of the Account	**Dr.**	**Cr.**
	Rs.	Rs.
Sundry Debtors		
Band Debts	64,000	
Provision of Bad Debts	4,000	7,000

Adjustments: Write off further bad debts Rs. 2,000 and create a provision for doubtful debts at 5% on debtors. Pass the necessary journal entries and show Bad Debts and Provision for Bad Debts Accounts. Also show their treatment in the final accounts.

Journal

2018		Rs	Rs.
Dec. 31	Bad Debts A/c Dr.	2,000	
	To Sundry Debtors		2,000
	(Being bad debts written off)		
" 31	Provision for Bad Debts A/c Dr.	6,000	
	To Bad Debts A/c		6,000
	(Being bad debts transferred to Provision for Bad Debts Account)		
" 31	Profit and Loss A/c Dr.	2,100	
	To Provision for Bad Debts A/c		2,100
	(Being the Provision required for doubtful debts)		

Bad Debts Account

2018		Rs.	2018		Rs.
Dec. 31	To Balance b/d	4,000	Dec. 31	By Prov. Fro Bad Debts	6,000
Dec. 31	To Sundry Debtors	2,000			
		6,000			6,000

Provision for Bad Debts Account

2018		Rs	2018		Rs.
Dec. 31	To Bad Debts A/c	6,000	Dec. 31	By Balance b/d	7,000
" 31	To Balance c/d	3,100		By Profit and Loss A/c	2,100
		9,100	2019		9,100
			Jan. 1	By Balance b/d	3,100

Note : The new provision for bad debts has been calculated at 5% on Rs. 62,000 (sundry debtors Rs. 64,000 – further bad debts Rs. 2,000)

Profit and Loss Account
For the year ended December 31, 2018

		Rs.		Rs.
To Provision for Bad Debts				
Bad Debts	4,000			
Add : Further Bad Debts	2,000			
Add : New Provision	3,100			
	9,100			
Less : Old Provision	7,000	2,100		

Balance Sheet
as at December 31, 2018

	Rs.			Rs.
		Current Assets :		
		Sundry Debtors	64,000	
		Less : Further Bad Debts	2,000	
			62,000	
		Less : Provision Bad Debts	3,100	58,900

10.3.12 Provision for Discount on Debtors

You know cash discount is allowed to debtors as an incentive for prompt payment. When the discount is allowed it is recorded through the Cash Book and posted to the credit side of the concerned debtor's personal accounts. But, in the case of debts outstanding at the end of the current year, discounts will be allowed in the next year if the debtors make prompt payments. So, as in the case of anticipated loss on account of doubtful debts, a provision must be made for the discount likely to be allowed to the debtors in the next year, such a provision is known as the 'Provision for Discount on Debtors' it is also calculated as a percentage on the net sundry debtors (remaining after subtracting the provision for bad debts and further bad debts). For example, if Sundry Debtors amount to Rs. 40,000 and the firm wants to create a provision for bad debts at 5% and a provision for discount at 2% on the debtors they will be calculated as follows:

i) The Provision for bad debts will be calculated at 5% on Rs. 40,000. It will amount to Rs. 2,000.

ii) The Provision for discount at 2% will be calculated on the debtors after subtracting the provision for bad debts i.e., on Rs. 38,000 (Rs. 40,000— Rs. 2,000). It will amount to Rs. 760.

Note that when both provision for bad debts and provision for discount on debtors are to be calculated, the provision for bad debts is calculated first and then provision for discount is worked out on debtors after subtracting the provision for bad debts.

The adjustment entry for provision for discount on debtors is as follows:

Profit and Loss A/c Dr.
To Provision for Discount on Debtors A/c
(Being the Provision made for discount on debtors)

The Provision for discount on debtors will be shown in the final accounts as follows:

i) On the debit side of Profit and Loss Account: shown as a separate item, and

ii) On the assets side of Balance Sheet: shown as a deduction from Sundry Debtors.

The balance of the provision for Discount on Debtors Account will be carried forward to the next year and the discounts allowed if any, in the next year will be set off against the provision for itself. The method of dealing with discounts allowed and provision for discount on debtors in the next year is similar, to the method followed in case of bad debts and provision for bad debts.

10.3.13 Provision for Discount on Creditors

When prompt payment is received we allow cash discount to debtors. Similarly, we receive discount from the creditors when prompt payments are made by us. So the expected gain on account of discounts receivable from creditors in the next year should also be taken into account at the time of preparing the final accounts. Such a provision is called 'Provision for Discount on Creditors'.

It is calculated as a percentage on Sundry Creditors. The creation of such a provision, however, goes against the Conservatism Concept. Hence, it is usually avoided in practice. But you must learn how it is treated in final accounts if such a provision is required.

The adjustment entry for provision for discount on creditors is passed as follows:

Provision for Discount on Creditors A/c Dr.
To Profit and Loss Account
(Being the Provision made for discount on creditors)

The provision for discount on creditors will appear in the final accounts as follows:

i) On the credit side of Profit and Loss Account: shown as a separate item, and

ii) On the liabilities side of the Balance Sheet: shown as a deduction from Sundry Creditors.

The balance of the Provision for Discount on Creditors Account will also be carried forward to the next year and the discount received, if any, will be adjusted against the provision itself.

10.3.14 Manager's Commission

Sometimes, the manager may also be entitled to a commission on profits earned by the business. Such commission is usually calculated as a fixed percentage on profits. Suppose the Net Profit of a firm after taking into consideration all expenses except the manager's commission is Rs. 60,000 and the manager is entitled to a commission of 5% on profits before charging such commission. His commission will work out as Rs. 3,000. However, it is still to be paid and therefore should be treated as an outstanding expense. It will be debited to Profit and Loss Account and also shown as a current liability in the Balance Sheet.

In the above example, manager's commission has been calculated on profits before charging the commission. But, sometimes, it is to be calculated on profit after charging such commission. In such a situation, the commission will be calculated by the following formula:

Percentage of Commission

$$\frac{\text{Percentage of Commission}}{100 + \text{Percentage of Commission}} \times \text{Net Profit before Commission}$$

If, in the above example, the manager's commission were to be calculated on profits after charging such commission, it will be as follows.

$$\frac{5}{100+5} \times 60,000 = \frac{5}{105} \times 60,000 = \text{Rs. } 2,857$$

The above amount can also be verified. After charging manager's commission the Net Profit will work out to Rs. 57,143 (Rs. 60,000—Rs. 2,857). Now calculate 5% on Rs. 57,143. It works out to Rs. 2,857 which means the amount of commission calculated by the given formula is correct.

10.3.15 Abnormal Loss of Stock

In the course of business some loss of stock may also occur. It may occur in transit or at the godown. Such loss of stock may be normal or abnormal. Normal loss is due to inherent characteristics of goods such as evaporation, subdivision, drying up of goods, etc. On the other hand, if the loss occurs on account of reasons which are accidental or very rare, the loss is termed as abnormal loss. The examples of such losses are theft of goods, destruction of goods by fire, etc.

The abnormal loss does not require any special treatment in the books of account. It is absorbed by the remaining units whose cost is inflated by such loss. But, the abnormal loss has to be shown separately in the books of account. After the amount of such loss is ascertained, the following adjustment entry is passed.

Loss by Fire A/c Dr.
To Trading Account
(Being stock lost by fire)

To avoid the burden of loss due to abnormal circumstances the businessmen may get the stock insured. Thus, the loss may be

1. Uninsured,
2. Fully insured, or
3. Partially insured.

Let us see what will be the accounting treatment in the above three situations.

1. When the stock's is not insured: In case the stock is not insured the total abnormal loss will be transferred to the Profit and Loss Account and the following entry will be passed.

   Profit and Loss A/c Dr
   To Loss by Fire A/c

2 When the stock Isfully Insured: When the stock is fully insured, the total amount of loss is paid by the insurance company. In that case the company does not suffer fly loss.

   So, nothing is debited to the Profit and Loss Account. The journal entry passed is as follows.

   Insurance Company Dr.
   To Loss by Fire A/c

3. When the loss is partially insured: In case the loss is partially insured the amount of insurance claim is debited to Insurance Company's Account and the remaining loss (the amount to be borne by the business) is debited to Profit and Loss Account. The following journal entry is passed.

   Insurance Company Dr.
   Profit and Loss A/c Dr.
   To Abnormal Loss A/c

Thus, the treatment of abnormal loss in final accounts is as follows.

a) Credit the Trading Account with the total loss.

b) i) In case of uninsured stock debit Profit and Loss Account with full amount.

   ii) In case of fully insured loss, insurance claim will be shown as an asset in the Balance Sheet.

   iii) In case of partially insured loss, the amount of insurance claim is shown as an asset in the Balance Sheet and the remaining amount of loss is debited to the Profit and Loss Account.

Look at illustration 5 and see how abnormal loss is treated in the books of account.

Illustration 5

On December 30, 2018 the stock worth Rs. 40,000 was destroyed by fire. The stock was insured and the insurance company admitted a claim of Rs. 30,000 only. Pass the necessary journal entries and show how it will be treated in final accounts.

Journal

Date	Particulars		Dr. Amount	Cr. Amount
2018 Dec.31	Loss by Fire A/c To Trading A/c (Being stock lost by fire)	Dr. Rs.	40,000	 40,000

" 31	Insurance Company	Dr.	30,000	
	Profit and Loss A/c	Dr.	10,000	
	To Lossby Fire A/c			40,000

Trading Account
For the year ended December 31, 2018

Dr. Cr.

			Rs.
		By Loss of Fire	40,000

Profit and Loss Account
For the year ending December 31, 2018

Dr. Cr.

		Rs.		Rs.
To Loss by fire	40,000			
Less: Insurance claim	30,000	10,000		

Balance Sheet
As at December 31, 2018

For the year ending December 31, 2018

Dr. Cr.

			Rs.
	.	**Current Assets:**	
		Claim due from insurance company	30,000

10.3.16 Drawing of Goods by the Proprietor

You know when the proprietor takes away some goods from the business for his personal use it is recorded in books of account by passing the following journal entry.

Drawings Account Dr.
 To Purchases Account

So, if you find that it has not been recorded in the books of account, you have to make the necessary adjustment in final accounts. The treatment in final accounts will be as follows:

i) On the Debit side of the Trading Account: Deduct it from Purchases.

ii) On the Liabilities side of the Balance Sheet: Deduct it from capital either as a separate item or by including it in drawings.

Check Your Progress B

1. Why do you create a provision for bad debts?

....

....

....

2. Why provision for discount on creditors is regarded against the Conservatism Concept?

....

....

....

3. The Trial Balance shows the following balances.

	Rs.
Debtors	20,000
Bad Debts	100
Provision for had Debts	200

Adjustments:

a) Bad Debts of Rs. 200 not yet written off.

b) Create a provision for Doubtful Debts at 5% on Debtors

c) Discount on Debtors is to be provided at 2%.

Calculate the provision for Bad Debts and provision for Discount on Debtors.

4. Stock worth Rs. 20,000 was lost by fire. Insurance claim was admitted for three-fourth of the value of goods lost. What amount you will (1) credit to the Trading A/c, (ii) debit to the Profit & Loss A/c, and (iii) show on the asset side of the Balance Sheet.

10.4 PREPARATION OF FINAL ACCOUNTS WITH ADJUSTMENTS

You know there are various items which require adjustment at the time of preparing the final accounts. You have learnt how each adjustment is recorded in books through a journal entry and how it is reflected in the final accounts. However, while preparing the final accounts with adjustments you should remember that there is no need to pass the journal entries for any adjustment unless specifically asked to do so. All adjustments must be shown directly in the final accounts. Look at illustration 6 and 7 and see how final accounts are prepared with adjustments.

Illustration 6

From the following Trial Balance of Gupta & Sons, prepare Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debit Balances	Credit Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	

Purchases	5,00,000	
Purchases Returns		15,000
Inventory as on 1.1.18	60,000	
Land & Buildings	4,00,000	
Plant & Machinery	3,00,000	
Furniture	1,00,000	
Wages	50,000	-
Carriage Inwards	10,000	
Provision for Bad Debts		7,000
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		70,000
Rent		8,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in hand	50,000	
Bank Overdraft		10,000
Discount	4,500	
Bad Debts	5,000	-
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Total	18,85,000	18,85,000

Additional Information

1. The value of inventory on December 31, 2018 was Rs. 1,00,000.
2. Depreciation is to be provided on: Land & Building @ 5% p.a. Furniture @ 10% p.a. Plant & Machinery Rs. 50,000.
3. Provision for Bad Debts is to be maintained @ 5% on debtors.
4 Wages are outstanding to the extent of Rs. 4,000 and Salaries to the extent of Rs. 3,000.
5. Rent and Rates are prepaid to the extent of 1/4th of the amount paid.
6. Interest on Investment outstanding is Rs. 1,000.
7. Rent to the extent of Rs. 2,000 has been received in advance.

Solution:

Trading & Profit and Loss Account
for the year ended December 31, 2018

Dr. Cr.

Particulars		Amount	Particulars		Amount
		Rs.			**Rs.**
To Inventory as on 1.1.18		60,000			
To Purchases	5,00,000		By Sales	10,00,000	
Less: Purchases Returns	15,000	4,85,000	Less: Sales Returns	25,000	9,75,000
To Wages	50,000		By Inventory as on 31.12.18		1,00,000
Add: Wages Outstanding	4,000	54,000			
To Carriage Inwards		10,000			
To Cartage		5,000			
To Gross Profit c/d		4,61,000			
		10,75,000			10,75,000
To Carriage Outwards		5,000	By Gross Profit b/d		4,61,000
To Salaries	40,000		By Rent	8,000	
Add: Outstanding	3,000	43,000	Less: Received in advance	2,000	6,000
To General Expenses		20,000			
			By Interest on Investment	5,000	
To Rent & Rates	10,000		Add: Outstanding	1,000	6,000
Less: Prepaid	2,500	7,500			
To Discount Allowed		4,500			
To Bad Debts	5,000				
Add: New Provision	7,500				
	12,500				
Less: Old Provision	7,000	5,500			
To Depreciation on Plant & Machinery		50,000			
To Interest on Overdraft		500			
To Depreciation					
Land & Building	20,000				
Furniture	10,000	30,000			
To Net Profit (Transferred to Capital A/c)		3,07,000			
		4,73,000			4,73,000

Balance Sheet as on December 31, 2018

Liabilities		Amount	Assets		Amount
		Rs.			**Rs.**
Capital			**Fixed Assets**		
Balance	5,00,000		Goodwill		60,000
Add: Net Profit	3,07,000	8,07,000	Land & Building	4,00,000	
			Less: Depreciation	20,000	3,80,000

Long Term Liabilities				
Loan	2,60,000	Plant & Machinery	3,00,000	
		Less: Depreciation	50,000	2,50,000
Current Liabilities				
Creditors	70,000	Furniture	1,00,000	
Acceptances	10,000	Less: Depreciation	10,000	90,000
Bank Overdraft	10,000	Investments		
Wages Outstanding	4,000	**Current Assets**		
Salaries Outstanding	3,000	Cash in hand		50,000
Rent Received in Advance	2,000	Debtors	1,50,000	
		Less: Provision for Bad Debts	7,500	1,42,500
		Bills Receivable		40,000
		Closing Stock		1,00,000
		Prepaid Rent & Rates		2,500
		Interest on Investment Outstanding		1,000
	11,66,000			11,66,000

Illustration 7

From the following balances extracted from the book of Aristo Ltd., prepare a Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debit Balances Rs.	Credit Balances Rs.
Capital		2,00,000
Sales		5,00,000
Sales Returns	10,000	
Purchases	2,40,000	
Purchases Returns		10,000
Stock on 1.1.2018	40,000	
Land & Buildings	2,00,000	
Plant & Machinery	1,00,000	
Wages	25,000	
Furniture	50,000	
Provision for Bad Debts		5,000
Salaries	25,000	
Debtors	82,000	
Creditors		1,00,000
Bad Debts	3,000	
Bills Payable		30,000

Investments	50,000	
General Expenses	20,000	
Cash in hand	5,000	
Cash at bank	15,000	
Depredation on Land & Buildings	20,000	
	8,45,000	8,45,000

Additional Information

1. The inventory on 31.12.18 has been valued at Rs. 80,000. The inventory of the value of Rs 20,000 was destroyed by fire on 1.12.18 and a claim of Rs. 15,000 was admitted by the insurance company.
2 Depreciation is to be provided on Plant & Machinery and furniture at 10% per annum.
3. Debtors are bad to the extent of Rs. 2,000. Provision for bad debts is to be made at 5% on debtors and a provision for discount on debtors at 2%.
4. Wages for outstanding to the extent of Rs. 5,000.
5. Salaries are prepaid to the extent of Rs. 2,000.
6. Create a provision for discount on creditors at the rate of 1%.
7 Create a provision for repairs to the extent of Rs. 4,000.

Trading & Profit and Loss Account for the year ended December 31, 2018

Particulars		**Amount**	**Particulars**		**Amount**
		Rs.			Rs.
To Opening Stock		40,000	By Sales	5,00,000	
			Less: Sales Returns	10,000	4,90,000
To Purchases	2,00,000				
			By Closing Stock		80,000
Less: Purchases Returns	10,000	1,90,000			
To Wages	25,000		By Loss by Fire		20,000
Add: Outstanding	5,000	30,000			
To Gross Profit c/d		3,30,000			
		5,90,000			5,90,000
To Salaries	25,000				
Less: Prepaid	2,000	23,000	By Gross Profit b/d		3,30,000
			By Provision for		
			Discount on Creditors		1,000
To Bad Debts	3,000				
Add: Further Bad Debts	2,000		.		
Add: New Provision	4,000				
	9,000				
Less: Old Provision	5,000	4,000			
To General Expenses		20,000			
To Depreciation on Land & Buildings		20,000			
To Loss by Fire		5,000			

To Depreciation on Plant & Machinery	10,000		
To Depreciation on Furniture	5,000		
To Provision for Discount on Debtors	1,520		
To Provision for Repairs	4,000		
To Net Profit (Transferred to Balance Sheet)	2,38,480		
.	3,31,000		3,31,000

Balance Sheet as on December 31, 2018

Particulars		Amount	Particulars		Amount
		Rs.			Rs.
Capital	2,00,000		Land & Buildings		2,00,000
Add: Net Profit	2,38,480		Plant & Machinery	1,00,000	
		4,38,480	Less: Depreciation	10,000	90,000
Creditors	1,00,000		Furniture	50,000	
Less: Provision for Discount	1,000	99,000	Less: Depreciation	5,000	45,000
Bills Payable		30,000	Investments		50,000
Wages Outstanding		5,000	Cash in Hand		5,000
Provision for Repairs		4,000	Cash at Bank		15,000
			Closing Stock		80,000
			Debtors	82,000	
			Less: Further Bad Debts	2,000	
			Less: Provision for Bad	80,000	
			Debts @ 5%	4,000	
				76,000	
			Less: Provision for Discount	1,520	74,480
			Insurance Claim Outstandings		15,000
			Salaries Prepaid		2,000
		5,76,480			5,76,480

Notes:

1. Depreciation on Land & Buildings is given in the Trial Balance. Hence, it is shown in the Profit and Loss Account only.
2. Provision for Bad Debts has been calculated at 5% on debtors after subtracting further bad debts.
3. Provision for Discount on Debtors has been calculated at 2% on debtors after subtracting further bad debts as well as provision for bad debts.
4. Loss by fire has been charged to Profit and Loss Account after taking into consideration the claim from insurance company.

10.5 ADJUSTMENTS GIVEN IN TRIAL BALANCE

You know that the adjustments are usually given outside the Trial Balance and they are shown at two places in the final accounts. But, sometimes a few adjustment items appear in the Trial Balance itself. In illustration 7 you noticed it in respect of depreciation on Land & Buildings. It is possible that items like outstanding or prepaid insurance also appear in the Trial Balance. This happens when the journal entry in respect of an adjustment has already been passed and the same has been posted into the concerned ledger accounts. For example, when you pass journal entry for the adjustment for outstanding salaries, you will debit Salaries Account and credit Salaries Outstanding Account. The Salaries Account already exists in the ledger and the amount of outstanding salaries is also posted thereto. This leads to an increased balance in Salaries Account. But the Salaries Outstanding Account does not exist in the ledger. This will have to be opened and the outstanding amount credited thereto. When the Trial Balance is prepared, it will show the increased balance of Salaries Account in the debit balances column and the balance of Sal:- vies Outstanding Account in the credit balances column. Now the question arises how to treat it in the final accounts. In such a situation, you will simply show Salaries Outstanding in the liabilities. No addition will be made to salaries in the Profit and Loss Account because salaries given in Trial Balance already include this amount. Thus, when salaries outstanding appear in the Trial Balance it is shown in final accounts only at one place. This applies to all items of adjustments when they are included in the Trial Balance.

In actual practice all adjustment items with the exception of closing stock are invariably incorporated in the Trial Balance before preparing the final accounts. The Trial Balance so prepared is called ‘Final Trial Balance’ or ‘Adjusted Trial Balance’.

Look at Chart 10.1 and note how each item of adjustment is treated in final accounts. (i) if it is given outside the Trial Balance, and (ii) if it appears in the Trial Balance itself.

Chart 10.1

Treatment of Adjustment Items in Final Accounts

S.No.	Item	Treatment In Final Accounts	
		If given in Adjustments	**If given in Trial Balance**
1.	Closing Stock	i) Credit side of Trading A/c : Shown as a separate item ii) Assets side of Balance Sheet : Shown as a separate item under Current Assets	Assets side of Balance Sheet only
2	Outstanding Expenses	i) Debit side of Trading A/c or Profit and Loss A/c: Added to the concerned expense ii) Liabilities side of Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.

3.	Prepaid Expenses	i) Debit side of Profit and Loss A/c: Deducted from the concerned expense ii) Assets side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
4.	Outstanding incomes	i) Credit side of Profit and Loss A/c: Added to the concerned income ii) Asset side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
5.	Income Received in Advance	i) Credit side of Profit and Loss A/c: Deducted from concerned income ii) Liabilities side of Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.
6.	Depreciation	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Assets side of Balance Sheet: Deducted from the concerned fixed asset	Debit side of Trading & Profit and Loss Account only.
7.	Interest on Capital	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Added to Capital	Debit side of Profit and Loss Account only.
8 .	Interest on Drawings	i) Credit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Deducted from Capital	Credit side of Profit and Loss Account only.
9.	Interest on Loan	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Added to Loan.	Debit side of Profit and Loss Account only.
10.	Bad Debts	i) Debit side of Profit and Loss A/c: Added to Bad Debts ii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Debit side of Profit and Loss Account only.
11.	Provision for bad debts	i) Debit side of Profit and Loss A/c: shown as a separate item ii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Deduct from sundry debtors assuming it is a closing balance.

12.	Provision for Discount on Debtors	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Debit side of Profit and Loss Account only.
13.	Provision for Discount on Creditors	i) Credit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Deducted from Sundry Creditors	Credit side of Profit and Loss Account only.
14.	Manager's Commission	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Shown as a separate item	Liabilities side of Balance Sheet only.
15.	Abnormal Loss	i) Credit side of Trading A/c: Shown as a separate item with full amount of loss ii) Debit Profit & Loss A/c with the uncovered Loss iii) Insurance claim will be shown on Assets side of Balance Sheet under Current Assets	Debit side of Profit and Loss Account only.
16.	Drawing of Goods by the Proprietor	i) Debit side of Trading A/c: Deducted from purchases ii) Liabilities side of Balance Sheet: Deducted from capital	Deduct from Capital.

Illustration 8

From the following Trial Balance of Pitam Stores prepare Trading and profit and Loss Account for the year ended December 31, 2018 and the Balance Sheet as on that date.

Trial Balance

Account	**Debit Balances**	**Credit Balances**
	Rs.	**Rs.**
Capital		60,000
Drawings	5,000	
Purchases	1,00,000	
Sales		2,10,000
Opening Stock	20,000	
Wages	15,000	
Wages Outstanding		5,000
Carriage Inwards	2,000	
Salaries	13,000	
Insurance	1,500	

Insurance Prepaid	1,500	
Income from Investments		30,000
Accrued Income from Investments	10,000	
Machinery	50,000	
Buildings	95,000	
Cash in hand	2,000	
Debtors	35,000	
Creditors		60,000
Depreciation on Buildings	5,000	
Rent	10,000	
	3,65,000	3,65,000

Additional Information : The value of stock on December 31, 2018 was Rs. 40,000.

Solution:

Trading and Profit and Loss Account for the year ended December 31, 2018

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Opening Stock	20,000	By Sales	2,10,000
To Purchases	1,00,000	By Closing Stock	40,000
To Wages	15,000		
To Carriage Inwards	2,000		
To Gross Profit c/d	1,13,000		
	2,50,000		2,50,000
To Salaries	13,000	By Gross Profit b/d	1,13,000
To Insurance	1,500	By Income from	
To Rent	10,000	Investments	30,000
To Depreciation on Building	5,000		
To Net Profit			
(Transferred to Capital A/c)	1,13,500		
	1,43000		1,43,000

Balance Sheet as on December 31, 2018

Dr				Cr.
Liabilities	**Amount**		**Assets**	**Amount**
	Rs.			Rs.
Capital	60,000		Building	95,000
Add: Net Profit	1,13,500		Machinery	50,000
	1,73,500		Closing Stock	40,000
Less: Drawings	5,000	1,68,500	Debtors	35,000
Creditors		60,000	Cash in Hand	2,000
Wages Outstanding		5,000	Insurance Prepaid	1,500
			Accrued Income from Investments	10,000
		2,33,500		2,33,500

10.6 LET US SUM UP

At the time of preparing the final accounts a number of items need adjustments. It is because certain expenses may relate to two or more accounting years or certain expenses incurred during the current year may still remain to be paid. Unless Such adjustments are made, the final accounts will not reveal the true picture. Such items are usually given outside the Trial Balance and are shown at two places in the final accounts so as to complete the double entry.

Adjustment entries can be passed in the journal for each item of adjustment. But, normally they are directly adjusted in the final accounts. In practice the adjustment entries are always passed for such items and a revised Trial Balance called 'Adjusted Trial Balance' or 'Final Trial Balance' is prepared. In such a situation, the adjustments will appear in the Trial Balance itself. Any item of adjustment which appears in the Trial Balance is shown only at one place in the final accounts.

10.7 KEY WORDS

Abnormal Loss: Loss caused by abnormal causes.

Adjustment Entry: Journal entry passed to make an adjustment in the relevant accounts.

Adjustment Item: An item given outside the Trial Balance which requires adjustment at the time of preparing final accounts.

Adjusted Purchases: Amount of purchases after adjusting both the opening and closing stocks.

Adjusted Trial Balance: Trial balance prepared after incorporating various adjustments.

Depreciation: A permanent decrease in the value of a fixed asset caused by wear and tear or the passage of time.

Doubtful Debts: Debts of doubtful recovery.

Outstanding Expenses: Expenses incurred during the accounting year but not yet paid.

Outstanding Incomes: Incomes earned during the accounting year but not yet received.

Prepaid Expenses: Expenses paid but the benefit of which is yet to be received.

Unearned Income: Income in respect of which the services are yet to be rendered

10.8 SOME USEFUL BOOKS

Maheshwari, S.N., 2018. Introduction to Accounting, VikasPublishing House: New Delhi.

Patil, V.A. and J.S. Korlahalli, 2018. Principles and Practice of Accounting, R. Chand & Co., New Delhi.

William Pickles. 1992. Accountancy, E.LB.S. and Pitman, London.

Gupta, R.L. and M. Radhaswamy, 2018. Advanced Accountancy, Sultan Chand & Sons, New Delhi.

Shukla, M.C. and T.S. Grewal, 2018. AdvancedAccountancy, S. Chand & Co., New Delhi.

10.9 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) dual ii) asset iii) unexpired iv) liabilityv) Depreciation vi) subtracted

2. i) False ii) True iii) False iv) True v) False

B 3. Provision for Bad Debts Rs. 990
Provision for Discount on Debtors Rs. 376.20

4. i) Rs. 20,000 ii) Rs. 5,000 iii) Rs. 15,000

10.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. Why some adjustments become necessary at the time of preparing the final accounts? Name any two items of adjustment and explain how they are shown in the final accounts?

2. Distinguish between:

   a) Outstanding Expenses and Unexpired Expenses

   b) Provision for Discount on Debtors and Provision for Discount on Creditors

   c) Normal Loss and Abnormal Loss

Exercises

1. Give journal entries for the following adjustments:

i)	Interest received in advance	Rs. 600
ii)	Interest on drawings	Rs. 1,200
iii)	Provision for discount on creditors	Rs. 200
iv)	Loss of goods by theft	Rs. 8,500
v)	Drawings of goods by the proprietor	Rs. 750

2. The following information is extracted from the books of a businessman:

Debtors as on 31.12.2018	Rs. 25,000
Bad Debts during 2018	Rs. 1,000

Provision for Bad Debts is to be maintained at 5% of debtors.

A Provision for discount on debtors is also to be made at 2%. You are required to calculate the amounts to be set aside in respect of provision for bad debts and provision for discount on debtors respectively.

(**Answer:** Provision for Bad Debts Rs. 1,250; Provision for Discount on Debtors Rs. 475)

3. The Proprietor withdrew the following amounts during the year ended

December 31, 2018.	Rs.
Feb. 28	4,000
May 1	6,000
Aug. 31	5,000
Nov. 1	2,000
Dec. 1	1,000

Calculate interest on drawings if the rate is 6% per annum.

(**Answer:** Rs. 565)

4. From the following Trial Balance of Puri & Sons as on June 30, 2018, prepare Trading and Profit and Loss Account and the Balance Sheet.

Trial Balance

Name at the Account	Debit	Credit
	Rs.	Rs.
Capital		1,00,000
Drawings	5,000	
Purchases less returns	2,00,000	
Sales less Returns		5,00,000
Inventory (beginning)	50,000	
Wages	20,000	
Carriage Inwards	3,000	
Salaries	25,000	
Freight	2,000	
Trade Expenses	5,000	
Rent		20,000
Packing Charges	2,000	
Land & Buildings	2,00,000	
Plant & Machinery	2,50,000	

Furniture	50,000	
Bad Debts	5,000	
Debtors	75,000	
Creditors		80,000
Cash in hand & at bank	5,000	
Bills Receivable	3,000	
Loan	2,00,000	
Total	9,00,000	9,00,000

Additional Information :

i) Inventory (ending): Rs.. 30,000.

ii) Depreciation is to be provided as follows:

Land&building @ 5%p.a.

Plant & Machinery @ 4% p.a.

Furniture @ 10% p.a.

iii) Debtors are bad to the extent of Rs. 5,000

iv) Salaries are outstanding to the extent of Rs. 5,000.

v) Wages are prepaid to the extent of Rs. 2,000.

vi) Rent received in advance Rs. 3,000.

(Answer: Gross Profit Rs. 2,57,000; Net Profit Rs. 2,02,000; Balance Sheet total Rs. 5,85,000)

5. From the following Trial Balance of Kawatra stores, prepare Trading and Profit and Loss Account for the year ended December 31, 2018, and a Balance Sheet as on that date.

Trial Balance

Name at the Account	Debit	Credit
Capital		
Drawings	20,000	
Purchases	4,00,000	
Purchases Returns		10,000
Sales		7,00,000
Sales Returns	20,000	
Inventory (beginning)	1,00,000	
Land & Building	3,00,000	
Plant & Machinery	1,50,000	
Goodwill	50,000	
Trade Marks	30,000	
Wages.	40,000	
Trade Expenses	20,000	
Furniture	50,000	
Provision for Bad Debts		10,000
Debtors	1,07,000	

Bad Debts	3,000	
Salaries	60,000	
Creditors		1,00,000
Acceptances		80,000
Investments	10,000	
Rent	15,000	
Distribution Expenses	5,000	
Cash in hand and at bank	10,000	
Depreciation on Furniture	10,000	
Total	4,00,000	4,00,000

Additional information:-

i) The inventory on December 31, 2018 was valued at Rs. 1,50,000. Inventory of the value Rs. 10,000 was destroyed by fire on 1.12.2018. It was fully insured and a claim of Rs. 10,000 was admitted by the insurance company.

ii) Depreciation is to be provided on the following assets:

Land & Buildings @ 5% p.a.

Plant &Machinery @ 12½% p.a.

iii) Debtors are bad to the extent of Rs. 2,000. Provision of 5% on debtors is to be created in respect of bad debts and a provision for discount on debtors is to be created at 2% of debtors.

iv) Wages are outstanding to the extent of Rs. 10,000.

v) Rent is prepaid to the extent of Rs. 5,000.

vi) The general manager is to be provided a commission of 2% on net profits before charging such commission.

(**Answer:** Gross Profit Rs. 3,00,000; Net Profit Rs. 1,55,887;
Balance Sheet total Rs. 8,29,005)

6. From the following Trial Balance of V. Ramana, prepare his final accounts for the year ended December 31, 2018

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		70,000
Drawings	10,000	2,95,000
Adjusted Purchases	2,32,500	2,95,000
Sales		
Cash in hand	3,800	
Cash at bank	12,800	
Salaries	18,000	
Freight	1,200	
Advertising	800	
General Expenses	5,400	
Furniture	10,800	
Expenses Outstanding		2,500
Depreciation	2,200	
Building	39,000	
Discount	700	
Insurance	600	
Prepaid Insurance	300	
Rent Received		6,000
Rent Received in Advance		3,000
Trade Debtors	14,100	
Trade Creditors		24,000
Loss by Fire	2,000	
Commission		1,500
Stock on December 31, 2017	49,200	4,03,000
Total	4,03,000	4,03,000

7. The Trial Balance of S Karim as on December 31, 2018

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		1,10,000
Drawings	15,000	
Gross Profit earned during 2018		32,000
Salaries and Wages	22,000	
Rent and Taxes	8,400	
Cash in hand	2,300	
Bank Overdraft		8,600
Sundry Debtors and Creditors		36,000
Insurance (including premium of	41,000	

Rs.400 per annum paid upto	1,000	
March 31, 2018)	5,000	
Loose Tools	500	800
Bad Debts		
Provision for Bad Debts	300	
Entertainment Expenses		2,100
Commission	2,600	
General Charges	12,000	
Furniture and Fixtures	60,000	
Plant and Machinery	19,800	
Stock on December 31, 2017		
	1,89,000	1,89,000

Prepare the Profit and Loss Account for the year ending December 31, 2018 and the Balance Sheet as on that date.

(**Answer :** Net Loss Rs. 11,100: Balance Sheet total Rs. 1,30,500

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

Indira Gandhi
National Open University
School of Management Studies

BCOC-131
Financial Accounting

Block

4

HIRE PURCHASE AND INLAND BRANCHES

PROGRAMME DESIGN COMMITTEE B.COM (CBCS)

Prof. Madhu Tyagi
Director, SOMS, IGNOU

Prof. R.P. Hooda
Former Vice-Chancellor
MD University, Rohtak

Prof. B. R. Ananthan
Former Vice-Chancellor
Rani Chennamma University
Belgaon, Karnataka

Prof. I. V. Trivedi
Former Vice-Chancellor
M. L. Sukhadia University
Udaipur

Prof. Purushotham Rao (Retd.)
Department of Commerce
Osmania University, Hyderabad

Prof. R. K. Grover (Retd.)
School of Management Studies
IGNOU

Prof. D.P.S. Verma (Retd.)
Department of Commerce
University of Delhi, Delhi

Prof. K.V. Bhanumurthy (Retd.)
Department of Commerce
University of Delhi, Delhi

Prof. Kavita Sharma
Department of Commerce
University of Delhi, Delhi

Prof. Khurshid Ahmad Batt
Dean, Faculty of Commerce & Management
University of Kashmir, Srinagar

Prof. Debabrata Mitra
Department of Commerce
University of North Bengal
Darjeeling

Faculty Members
SOMS, IGNOU
Prof. N V Narasimham
Prof. Nawal Kishor
Prof. M.S.S. Raju
Dr. Sunil Kumar
Dr. Subodh Kesharwani
Dr. Rashmi Bansal
Dr. Madhulika P Sarkar
Dr. Anupriya Pandey

COURSE DESIGN COMMITTEE

Prof. Madhu Tyagi
Director, SOMS, IGNOU

Prof. A.A. Ansari
Jamia Millia Islamia, New Delhi

Ms. Surbhi Gupta
Vivekananda College
University of Delhi, Delhi

Faculty Members
SOMS, IGNOU
Prof. N. V. Narasimham
Prof. Nawal Kishor
Prof. M.S.S. Raju
Dr. Sunil Kumar
Dr. Subodh Kesharwani
Dr. Rashmi Bansal
Dr. Madhulika P. Sarkar
Dr. Anupriya Pandey

COURSE PREPARATION TEAM

Accountancy-II: ECO-14
(Unit-1, 2, 4, 5 and 6 Revised by Dr. Sunil Kumar)
Prof. S. N. Mehrotra, Banaras Hindu University, Varanasi
Prof. T.P. Maitin Patna University, Patna
Prof. R. K. Grover (Retd.), SOMS, IGNOU
Mr. Amitabh K. Nag Chartered Accountant, Calcutta

Prof. N V Narasimham, Editor
Prof. M.S.S. Raju
(Course Coordinator & Editor)
Dr. Sunil Kumar
(Course Coordinator & Editor)

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 4 HIRE PURCHASE AND INLAND BRANCHES

Now a days it is quite common to sell goods on the basis of payment in instalments. This may take the form of hire purchase or instalment payment system. In both cases, the price charged by the vendor is higher than the cash price because it would include the amount of interest for deferment of payment. Hence, while recording such transactions in books of account, one has to keep this aspect in view. The accountants have developed suitable methods for recording all transactions relating to such purchases and sales. In this block, you will study the methods of recording these transactions in the books of the seller as well as the buyer in Unit 11 and Unit 12.

Large business houses usually operate through a network of branches spread over a wide area. To ensure operational efficiency, each branch is treated as a separate profit centre. Hence, there is need for devising suitable system of branch accounting.

In this block, Unit 13 and Unit 14 deal with the systems of accounting for branches.

Unit 11 deals with the hire purchase system and its accounting treatment in the books of the vendor and the buyer, where goods sold on hire purchase basis are of substantial sales value.

Unit 12 describes the accounting treatment in case of default and repossession of goods by the vendor under the hire purchase agreement. It also discusses the accounting treatment when goods are sold under the instalment payment system. It also explains the method of maintaining basic record for transactions relating to goods of small value sold on hire purchase, and discusses the systems of ascertaining profit or loss on such business during an accounting period.

Unit 13 deals with the accounting system for dependent branches which do not keep full accounting records.

Unit 14 explains the accounting system of independent branches (excluding foreign branches) which keep full accounting records.

UNIT 11 HIRE PURCHASE ACCOUNTS-I

Structure

11.0 OBJECTIVES

After studying this unit, you should be able to:

- explain what a hire purchase agreement is;
- describe the legal position to a hire purchase agreement;
- calculate interest and cash price in relation to a hire purchase agreement; and
- pass the basic accounting entries in the books of both purchaser and vendor.

11.1 INTRODUCTION

When the goods are sold, the purchaser may either make the full payment at one time or may defer the payment. When the payment is deferred, the amount may be paid in monthly, quarterly or yearly instalments. When the price of an article is paid by instalments, the total amount paid is higher than the actual cash price of the article. The excess price is the charge for interest and the risk involved. This arrangement of making the payment in instalments is beneficial to both the seller and the buyer. The seller is able to sell more goods and the buyer can buy expensive items with his limited resources. There are two systems of deferred payments, namely, (i) Hire Purchase System, and

(ii) Instalment Payment System. In this unit, we will learn in detail about the Hire Purchase System.

11.2 NATURE OF HIRE PURCHASE AGREEMENT

A hire purchase agreement is one under which the buyer takes delivery of goods, promising to pay the price in certain number of instalments and until full payment is made, to treat the payment as hire charges for using the said goods. In fact, a hire purchase agreement stipulates that (i) the delivery of goods will be given by the owner of goods to the hire purchaser, (ii) payment will be made in instalments, (iii) each instalment will be treated as hire charge so that if default in respect of payment of even the last instalment is made, the seller will be entitled to take away the goods without compensating the hire purchaser in any form, and (iv) if all instalments are paid and the other conditions are fulfilled, the ownership of the goods will pass to the buyer.

Therefore in case of hire purchase, the seller i.e., the vendor gives only the possession of the goods and retains the ownership with him until the last instalment is paid. In other words, the hire purchaser is only the user of the goods and not the owner. In case, he fails to pay the instalments, the vendor will take his goods back. Apart from that, the vendor will not pay back the amount received from the purchaser. Such an amount will be treated as hire charge for the goods. Therefore, till the last instalment is paid, the hire purchaser has got an option, whether to purchase that particular article or not.

As mentioned earlier, the payment made by the hire purchaser under this system is always more than what he pay if he decide to go for cash purchase. The reason is that, apart from the cash price, the hire purchase price includes:

i) interest for payment being made over a period of time,

ii) the payment for the risk taken by the seller,

iii) expenditure on the registration, insurance and delivery of goods, etc.

11.3 LEGAL POSITION

11.3.1 Definition

According to Section 2(c) of the Hire Purchase Act. 1972, the hire purchase agreement is an agreement under which the goods are let on hire and the hirer has an option to purchase them in accordance with the terms of the agreement under which:

i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments,

ii) the property in the goods is to pass to such person on the payment of the last such instalments, and

iii) such person has a right to terminate the agreement at any time before the property so passes.

11.3.2 Characteristics of Hire Purchase Agreement

Following are the characteristics of the hire purchase agreement.

i) It must be in writing and must he signed by all the parties thereto (Section 3)

ii) According to Section 4 of Hire Purchases Act, 1972, the agreement must state

   a) the hire purchase price of the goods to which the agreement relates;

   b) the cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;

   c) the date on which the agreement shall be deemed to have commenced;

   d) the number of instalments by which the hire purchase price is to be paid, the amount of each of those instalments and the date (the mode of determining the date upon which it is payable) and the person to whom and the place where it is payable; and

   e) the goods to which the agreement relates, in a manner sufficient to identify them.

Apart from the above mentioned conditions, a full description of the amount to be paid in cash or by cheque, if any, should be given in the agreement.

11.3.3 Rights of Hirers

As per the Hire Purchase Agreement, the hirer has got the right to return the goods to the vendor. Apart from this, the Hire Purchase Act gives the following rights to the hirer.

1) The owner (or the vendor) cannot terminate the hire purchase agreement for default in payment of hire or due to an unauthorised act or breach of expressed conditions unless a notice in this regard in writing is given to the hirer. The notice period is (i) one week where the hire is payable at weekly or less than that interval, and (ii) two weeks in other cases.

2) In the following cases, the right to repossess the goods will not exist unless it is sanctioned by the court.

   i) Where the hire-purchase price is less than Rs. 15, 000 and one half of the hire purchase price has been paid.

   ii) Where the hire purchase price is higher, three-quarters of the hire purchase price has been paid. However, the right of repossession will lapse in case of motor vehicles where the hire purchase price is less than Rs. 5,000 and one-half of the amount has been paid. In other cases (where H.P. price is Rs. 5,000 or more), it happens if three-quarters of the hire purchase price has been paid. The Central Government has the power of raising the limit to nine-tenths where the hire purchase price is Rs. 15,000 or more.

3) The hirer has the right of receiving from the owner, on payment of Re. 1 for expenses, a statement showing the amount paid by or on behalf of the hirer, the amount which has become due under the agreement which remains unpaid together with the dates concerned and the amount which has not yet become payable under the agreement and the dates and the modes concerned.

4) If the amount paid by the hirer till the date of the repossession of the goods and the value of the goods on the date of the repossession taken together exceeds the hire purchase price, the excess is payable to the hirer. For ascertaining the value of the goods, the owner or the vendor has the right of deducting reasonable expenses for repossessing the goods for storing the goods or repairing them, for selling them, and for payment of arrears of taxes.

Cheek Your Progress A

1. Fill in the blanks

 i) A contract for sale of goods may be either a sale or an ……….. to sell.

 ii) A hire purchase sale is an agreement to ………..

 iii) The ownership of goods under a hire purchase agreement is to ……….. upon fulfilment of certain…………..

 iv) Under a hire purchase agreement payments are made in ………..

 v) Each instalment payment is treated as ………..

 vi) If the purchaser fails to pay even the last instalment, the seller will be entitled ……….. to the goods.

 vii) From the legal point of view, a hire purchase agreement should be made in ………..

 viii) A hirer has the right to ……….. the agreement before payment of the last instalment by paying the seller the agreed amount.

 ix) A hirer may assign his ……….,………. and interest under a hire purchase agreement.

2. State whether the following statements are **True** or **False**.

 i) A hire purchase agreement is an 'outright' sale transaction.

 ii) If the hirer fails to pay the last instalment, the amounts paid earlier are considered as hire charges.

 iii) A hire purchase agreement is an 'executed contract' and an instalment sale is an 'executory contract'.

 iv) If the hirer opts for full payments before the due dates, a rebate should be available to him.

 v) A seller cannot repossess the goods if the purchaser fails to pay the last instalment only.

 vi) The Hire Purchase Act, 1972 is in operation now.

11.4 ASCERTAINING THE INTEREST AND CASH PRICE

As mentioned earlier, when the goods are sold on hire purchase, the price so charged by the vendor is always higher than the cash price. The excess price i.e., the difference between the hire purchase price and the cash price, includes the interest charges and the compensation for risk. However, for accounting purposes, the difference between the two prices is treated as the payment for interest. Thus, the hire purchase price includes:

i) the cash price, which is a capital expenditure for purchase of an asset, and

ii) the interest, which is an item of revenue nature. Since the cash price is of capital nature and the interest payment is of revenue nature, both will be treated in a different manner in the books of account. It is, therefore, necessary to separate the hire purchase price into cash price and interest. However, it may be noted that the Cash Down Payment made immediately after signing the agreement will not include the element of interest. Another point to be kept in mind is that the interest element in each instalment is not same. It keeps on reducing with every instalment. This is so because the interest is charged on the balance of the principal amount due and not on the full amount. For proper allocation, therefore, we must know the cash price, the hire purchase price and the amount of interest.

11.4.1 Ascertainment of Interest

While calculating interest, we may be faced with any of the following two situations:

a) When rate of interest, total cash price and instalments are given

b) When total cash price and instalments are given but the rate of interest is not given.

In both the above mentioned cases, the interest has to be calculated. Let us now take them one by one.

a) When Rate of Interest, Total Cash Price and Instalments are given

In this situation, before calculating the element of interest included in each instalment, it will be helpful to ascertain the total amount of interest involved. This will be ascertained by subtracting the Total Cash Price from the hire purchase price. Then the following steps should be followed for calculating the amount of interest on each instalment.

i) Calculate the outstanding cash price at the time of first instalment by subtracting down payment from the total cash price.

ii) Calculate interest on the first instalment. This is to be calculated on the outstanding cash price at the time of first instalment by applying the given rate of interest. In this connection, you should keep in view the mode of instalments i.e., whether the instalment is annual, half-yearly or quarterly. Usually, in case of purchases for heavy equipment, the instalment is annual.

iii) Calculate the amount of cash price included in the first instalment by subtracting the amount of interest as calculated in step (ii) from the amount of the first instalment.

iv) Calculate the outstanding cash price at the time of second instalment by subtracting the amount of cash price of the first instalment from the outstanding cash price at the time of first instalment i.e., (i) —

(iii).

v) Calculate, interest on the second instalment by applying the rate of interest to the outstanding cash price at the time of second instalment.

The amount of the subsequent instalments can be worked out in the same manner i.e., by first calculating the outstanding cash price at the time of the instalment due and then applying the rate of interest to this amount. However, the amount of interest on the last instalment is worked out differently. This can be done by simply subtracting the outstanding cash price at the time of last instalment from the amount of the last instalment. Alternatively, you can work it out by subtracting the sum of interests of all previous instalments from the total amount of interest included in the hire purchase price. The amount of interest so calculated can also be verified by applying the rate of interest to the outstanding cash price at the time of last instalment. Of course, there may be a small difference due to the fact that the hire purchase price is not fixed by inclusion of the exact amount of interest. It is usually fixed as a round figure. However, if the difference happens to be a large amount, you should check all calculations of interest and outstanding cash price at the time of each instalment.

illustration 1 will help you to calculate the interest with the help of the above mentioned procedure.

Illustration 1

A Ltd. purchased a Machine on hire purchase from Z Ltd. on January 1, 2016, paying Rs. 8,000 immediately and agreeing to pay three annual instalments of Rs. 8,000 each on December 31, every year. The cash price of the machine is Rs. 29,800 and the vendors charge interest @ 5% per annum. Calculate the amount of interest paid by the buyer to the seller every year.

Solution :

The total interest = Hire Purchase Price – Cash Price

Hire Purchase Pric = Cash Down Payment + Instalments

= 8,000 + 3(8,000)

= 8,000 + 24,000

= Rs. 32,000

Cash Price = Rs. 29,800

So Total Interest = 32,000 — 29,800 = Rs. 2,200

Now, we can calculate the interest on each instalment as follows.

i) **Outstanding Cash Price at the time of first instalment**
Total Cash Price – Down Payment
= 29,800 – 8,000
= Rs. 21,800

ii) **Interest on first instalment**

$$\text{Outstanding Cash Price} \times \frac{\text{Rate of Interest}}{100}$$

$= 21{,}800 \times \frac{5}{100}$

= Rs. 1,090

iii) **Cash Price of first instalment**

Instalment – Interest on first instalment

= 8,000 – 1,090

= Rs. 6,910

iv) **Outstanding Cash Price at the time of second instalment**

Outstanding Cash Price atthe time of 1st instalment – Cash Price of the first Instalment

= 21,800 – 6,910

= **Rs.** 14,890

v) **Interest on second instalment**

$= \frac{14{,}890 \times 5}{100} = \text{Rs. } 745$

vi) **Cash Price of second instalment**

= 8,000 – 745 = Rs. 7,255

vii) **Outstanding Cash Price at the time of last instalment**

= 14,890 – 7,255 = Rs. 7,635

viii) **Interest on the last instalment**

= Instalment – Outstanding Cash Price at the time of last instalment

= Rs. 8,000 – 7,635

= Rs.365

Alternatively, Total Interest – Sum of Interest of all previous years.

= 2,200 – (1,090 + 745)

= 2,200 – 1,835

= Rs. 365

Verification

Outstanding Cash Price at the time of last instalment $\times \frac{\text{Rate of Interest}}{100}$

$= 7{,}635 \times \frac{5}{100}$

= Rs. 382

As indicated earlier, the amount calculated above is not the same as calculated in step (viii). But the difference is small i.e..Rs. 17 (382 – 365).

For Steps from (i) to (viii) following table would he helpful.

	(1) Total Cash Price Rs.	(2) Instalment Paid Rs.	(3) Interest Paid Rs.	(2-3) Cash Price of the Instalment Rs.
Total Cash Price	29,800			
Less Down Payment	8000	8000		8000
Amount outstanding at the time of Ist Instalment	21,800	8000	$(21,800 \times \frac{5}{100})$	(8,000-1,090)
Cash price of the Instalment	6,910		1,090	6,910
Amount outstanding at the time of 2nd Instalment	14890	8000	$(14,890 \times \frac{5}{100})$	(8,000-745)
Cash price of the Instalment	7,255		745	7,255
Amount outstanding at the time of 3rd Instalment Cash	7635	8,000	(8,000-7,635)	7,635
	7635		365	

You should calculate interest and cash price with the help of the above table. It makes your task easier.

b) When Total Cash Price and Instalments are given, but rate of interest is not given:

When the total cash price, down payment and the amount of each instalment is given, but the rate of interest is not given, the interest will be calculated by procedure mentioned below.

i) Calculate the total interest by subtracting the total cash price from the total hire purchase price

ii) Calculate the amounts of hire purchase outstanding at the beginning of each year after subtracting the down payment

iii) Find out the ratio of outstanding amounts calculated in step (ii). If the amount of each instalment is equal, the ascertainment of ratio is simple. For example, if there are four instalments of equal amounts, the ratio will be 4 : 3 : 2 : 1 and if there are three instalments of equal amounts, it will be 3 : 2 :1.

iv) Apply this ratio to the total interest and calculate the interest on each instalment.

Let us now take an example and clarify the calculation of interest included in each instalment.

Illustration 2

Taking the relevant data from illustration 1 excluding the rate of interest element in each instalment.

Hire Purchase Price Rs. 32,000 [8,000 + 3 (8,000)]
Cash Price Rs. 29,800
Down Payment Rs. 8,000

Solution:

Total Interest = Rs. 32,000 – 29,800
= Rs. 2,200

Beginning of the year	Amount (Rs.) Outstanding	Ratio	Interest (Rs.)
1	24,000 (32,000-8,000)	3	1,100 $(2,200 \times \frac{3}{6})$
2	16,000 (24,000-8000)	2	733 $(2,200 \times \frac{2}{6})$
3	8,000 (16,000-8,000)	1	367 $(2,200 \times \frac{1}{6})$
			2,200

You will observe that the amounts of interest for each instalment calculated with the help of ratio in illustration 2 is almost the same as calculated with a given rate of interest in illustration 1.

11.4.2 Ascertainment of Total Cash Price

Sometimes, the total cash price is not given. In such a situation, we cannot proceed with the accounting for hire purchase transaction because in the books of the buyer, the amount to be capitalised cannot be more than the cash price. The different methods of calculation of cash price are as below:

i) Without the help of annuity table

ii) With the help of annuity table

Let us now discuss both the methods

i) Without the Help of Annuity Table

Under this method, interest is calculated starting with the last instalment. Suppose there are three instalments, the interest will be calculated first on the third instalment, then on the second and lastly on the first instalment. No interest is calculated on down payment as it doesnot involve any element of interest.

You know that the interest is to be calculated on the outstanding amount of cash price. But since it is not known, it will have to be calculated with the help of total amount due on hire purchase price. For this purpose, we will have to use the following formula for calculating first the interest involved in each instalment and then subtract this amount of interest from the total amount due, so as to work out the outstanding amount of cash price.

$$\text{Interest} = \text{Total amount due at the time of instalment} \times \frac{\text{rate of interest}}{100 + \text{rate of interest}}$$

Let us now see what steps are followed for the calculation of Cash Price due at the time of each instalment assuming there are three yearly instalments.

a) Calculate the interest on the instalment of the third year, deduct interest from this instalment. The resultant figure is the outstanding cash price at the time of third (last) instalment.

b) Add the cash price calculated under (a) above to the instalment amount of the second year. Calculate the interest on the sum so obtained and subtract it from the total amount due at the end of the second year to get the outstanding cash price at the time of second instalment.

c) Add the cash price calculated under (b) above to the instalment amount of the first year and calculate the interest on the sum so obtained. Deduct this amount of interest from the total amount due at the end of the first year. The resultant figure is the cash price due at the time of the first instalment.

d) Add the cash price calculated under (c) above to the down payment, if any. The sum so obtained will be the total cash price.

Illustration 3 will help you to understand the calculation of cash price.

Illustration 3

Renuka purchased a Machine on January 1, 2015 on hire purchase basis for Rs. 5,000 payable as under :

	Rs.
Down Payment	930
At the end of 1st year (1st instalment)	1,426
At the end of 2nd year (2nd instalment)	1804
At the end of 3rd year (3rd instalment)	840

Rate of interest 5% p.a.

Calculate the Cash Price of the Machine and interest paid with each instalment.

Solution :

	Amount Rs.	Interest Rs.
Total Amount Due on 3rd Instalment (last)	840	
Less Interest	40	40
Outstanding Cash Price of 3rd Instalment	800	$(840 \times \frac{5}{105})$
Add 2nd Instalment	1,804	
Total Amount due on 2nd Instalment	2,604	
Less Interest	124	124
Outstanding Cash Price of 2nd Instalment	2,480	$(2{,}604 \times \frac{5}{105})$
Add 1st Instalment	1,426	
Total Amount dues on Ist Instalment	3,906	
Less Interest	186	186
Outstanding Cash Price of Ist Instalment	3,720	$(3{,}906 \times \frac{5}{105})$
Add Down Payment	930	
Total Cash Price	4650	350

So Total Cash Price is Rs. 4,650 and Total Interest Rs. 350.

Note: This calculation can be verified by following the procedure given for calculation of interest on each instalment when cash price, instalments, down payment and rate of interest are given.

ii) With the Help of an Annuity Table

If the annuity table is available, calculation of interest involved in each instalment is simplified. In the annuity table, the rate of interest is given in the rows and the years in the columns. With reference to the table, the present value of each instalment can be calculated. The sum of these present values as calculated, if added to the cash down payment gives us the cash price. The procedure is as follows:

a) See the given rate of interest in the row and the year in the column and find out the corresponding figure in the table.

b) This figure is the present value of Re. 1

c) Multiply the present value of Re. 1 with the amount of the instalment.

d) The resulting figure is the present value of the instalment. This is nothing but the amount of cash price included in the instalment.

e) Calculate the present values of all the instalments in same manner.

f) Add the present values of all the instalments to the down payment if any. The resultant figure will be the total cash price.

illustration 4 will help us to understand the calculation of total cash price with the help of the annuity table.

Illustration 4

X Ltd. purchased a Machine on hire purchase system. The payment is made as follows:

	Rs.
Down Payment	232.50
1st Instalment	356.50
2nd Instalment	451
3rd Instalment	210

The payments are made at the end of 1st year, 2nd year and 3rd year respectively. The rate of interest is 5% p.a. The annuity table shows that the present value of Re. 1 for one, two and three years is .9524, .9070 and .8639 respectively. Calculate the cash price of the Machine.

Solution:

	(1) Instalement	(2) Present Value of Re. 1	(1×2) Present value of the instalement
Cash Down	232.50	1	232.50
1st Instalment	356.50	.9524	339.53
2nd Instalment	451.00	.9070	409.08
3rd Instalment	210.00	.8619	189.42
Total	1,250.00		1,162.53

So the Total Cash Price is Rs. 1,162.53

Check Your Progress B

1. Calculate total interest and interest on each instalment for the following cases.

   i) Cash Price of a Machinery is Rs. 349. Down payment is Rs. 100 to be followed by three annual instalments of Rs. 100 each. The rate of interest is 10%.

   ....

   ....

   ....

   ii) Cash price of a Machine is Rs. 1900. Payment is to be made in 3 equal instalments of Rs. 800 each.

   ....

   ....

   ....

2. Calculate cash price for each of the following cases.

   i) The price of a Machinery is to be paid in four instalments of Rs. 5,000 each, the first one being made as initial payment. The rate of interest is 5% p.a. and the instalment is paid annually.

   ....

   ....

   ....

   ii) The price of a Machinery is to be paid in five annual instalments of Rs. 10,000 each. The rate of interest is 5% p.a. The first instalment is to be paid at the end of the first year. At 5% interest the present value of Re. 1 payable at the end of each year for 5 years is Rs. 4.3294.

   ....

   ....

   ....

11.5 ACCOUNTING RECORDS IN THE BOOKS OF THE PURCHASER

You know, there are two parties to a hire purchas e agreement i.e., the Vendor and the Purchaser. Both these parties have to maintain books of account and record all the transactions relating to that particular hire purchase.

Before explaining the accounting records, let us first see what information is required for recording the hire purchase transaction in the books of account. The list of items required for accounting records is as follows:

1. Date of Purchase and down payment
2. Date at which the instalments become due
3. Date of closure of accounts
4. Cash Price
5. Hire Purchase Price
6. Number, Amount and Mode of each instalment
7. Rate of Interest
8. Rate of Depreciation
9. Method of Depreciation

Let us now see how accounting records are maintained in the books of the purchaser. There are two methods by which the purchaser can record the hire purchaser transaction in the books of account. These are as follows:

i) When the asset is recorded at the full cash price, and

ii) When the asset is recorded at the cash price actually paid.

Let us now discuss these methods in detail.

11.5.1 When the Asset is Recorded at Full Cash Price

In this method, when the asset is purchased on hire purchase, it is assumed that the purchaser has full intention of paying all the instalments. It is believed that hire purchase is just a method of financing fixed assets. Under this method, on purchase of plant and machinery, the Plant & Machinery Account (Fixed Asset) is debited with the total amount of Cash Price, and the corresponding credit is given to Hire Vendor's Account. Interest is recognised and accounted for at the time of instalments becomes due by debiting the Interest Account and crediting the Hire Vendor's Account. For the purpose of accounting for initial cash down payment and annual instalments, the Hire Vendor's A/c is debited on the relevant date, and the credit is given to Bank Account. The following journal entries are passed in the books of the purchaser.

1 **When the asset is purchased on hire purchase**
Asset A/c Dr.
    To Hire Vendor A/c
(With the total cash price)

2 **For cash down payment**
Hire Vendor A/c Dr.
    To Bank A/c

3 **When the first instalment becomes due**
Interest A/c Dr.
    To Hire Vendor A/c

4 **When the first instalment is paid**
Hire Vendor A/c Dr.
    To Bank A/c

5 **For Depreciation Charge (at the end of accounting period)**
Depreciation A/c Dr.
    To Asset A/c

6 **For transfer of interest and depreciation to Profit & Loss A/c**
Profit& Loss A/c Dr.
    To Interest A/c
    To Depreciation A/c

Entries 3 and 4 will be repeated for all subsequent instalments.

With the help of the journal entries, we can easily prepare the Asset Account and the Hire Vendor's Account. Look at illustration 5 and see how the journal entries are passed and ledger accounts are made in the books of the purchaser.

Illustration 5

ABC Ltd. bought a machine on 1.1.2016 from XYZ Ltd. under a hire purchase system of payment under which three annual instalments of Rs. 2,412 would be paid. There is no down payment and the cash price is Rs, 6,000. The rate of interest would be 10% and depreciation @20% p.a. would be charged on straight line basis.

Solution

Let us first find out all the information required.

1) Date of Purchase – January 1, 2016; No down payment.
2) Date at which the instalments become due – December 31, 2016, 2017 and 2018.
3) Date of closure of accounts – December 31.
4) Cash Price – Rs. 6,000.
5) Hire Purchase Price – Rs. 2,412 x 3 = Rs. 7,236.
6) Number, amount and mode of each instalment – 3 instalments of Rs. 2,412 each payable annually.
7) Rate of Interest – 10% p.a.
8) Rate of Depreciation – 20% p.a.
9) Method of Depreciation – Straight Line.

Journal Entries in the Books of ABC Ltd

Date	Particulars	Amount (Dr.)	Amount (Cr.)
2016		Rs.	Rs.
Jan. 1	Machinery A/c Dr.	6,000	
	To XYZ Ltd.		6,000
	(Being a machine purchased on hire purchase)		
Dec.31	Interest A/c Dr.	600	
	To XYZ Ltd.		600
	(Being the charge of interest @ 10% on Rs. 6,000)		
Dec.31	Depreciation A/c Dr.	1,200	
	To Machinery A/c		
	(Being the charge of depreciation)		1,200
Dec.31	XYZ Ltd. A/c Dr.	2,412	
	To Bank A/c		2,412
	(Being the payment of annual instalment)		
Dec.31	Profit & Loss A/c Dr.	1,800	
	To Interest A/c		600
	To Depreciation A/c		1,200
	(Being the annual charges transferred to Profit & Loss A/c)		
2017			
Dec.31	Interest A/c Dr.	418	
	To XYZ Ltd.		418
	(Being the charge of interest @ 10% on Rs. 4,188)		

Dec.31	Depreciation A/c Dr. To Machinery A/c (Being the annual charge of depreciation)	1,200	 1,200
Dec.31	XYZLtd. A/c Dr. To Bank A/c (Being the payment of annual instalment)	2,412	 2,412
Dec.31	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the transfer of annual charges to Profit & Loss A/c)	1,618	 418 1,200
2018 Dec.31	 Interest A/c Dr. To XYZ Ltd. (Being the charge of interest @ 10% on Rs. 2,194)	 218	 218
Dec.31	Depreciation A/c Dr. To Machinery A/c (Being the annual charge of depreciation)	1,200	 1,200
Dec.31	XYZ Ltd. A/c Dr. To Bank A/c (Being the 3rd and final instalment paid)	2,412	 2,412
Dec.31	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the transfer of annual charges to Profit & Loss A/c)	1,418	 218 1,200

Ledger Accounts in the Books of ABC Ltd
Machinery Account

Dr.					Cr.
2016 Jan. 1	 To XYZ Ltd	Rs. 6,000	2016 Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	Rs. 1,200 4,800
		6,000			6,000
2017 Jan. 1	 To Balance b/d	 4,800	2017 Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	 1,200 3,600
		4,800			4,800
2018 Jan. 1	 To Balance b/d	 3,600	2018 Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	 1,200 2,400
		3,600			3,600

XYZ LTD (Hire Vendor) Account

Dr.					Cr.
2016		Rs.	2016		Rs.
Dec.31	To Bank A/c	2,412	Jan. 1	By Machinery A/c	6,000
Dec.31	To Balance c/d	4,188	Dec. 31	By Interest A/c	600
		6,600			6,600
2017			2017		
Dec.31	To Bank A/c	2,412	Jan. 1	By Balance b/d	4,188
Dec.31	To Balance c/d	2,194	Dec. 31	By Interest A/c	418
		4,606			4,606
2018			2018		
Dec.31	To Bank A/c	2,412	Jan. 1	By Balance b/d	2,194
			Dec. 31	By Interest A/c	218
		2,412			2,412

Working Notes :

	Rs.
Cash Price	6,000
Add : Interest on Ist Instalment $(\frac{10}{100} \times 6,000)$	600
	6,600
Less : Ist Instalment	2,412
Amount outstanding at the time of 2nd Instalment	4,188
Add : Interest on 2nd Instalment $(\frac{10}{100} \times 4,188)$	418
	4,606
Less : 2nd Instalment	2,412
Amount outstanding at the time of 3rd instalment	2,194
Add : Interest on 3rd Instalment	218
	2,412

11.5.2 When the Asset is Recorded at Cash Price Actually Paid

You know that in case of hire purchase, the ownership of the goods passes to the hire purchaser after the last instalment has been paid. Since the goods do not become the property of the purchaser, he does not have any right to debit the asset at its full price. Hence, no entry is passed when the asset is purchased unless it involves down payment. The entries are passed as and when the instalments become due and the amount is paid towards the price of the article. The journal entries are as follows:

1. **When the asset is purchased**
   No entry

2. **When the down payments is made**
   Asset A/c Dr.
   To Bank A/c

3. **When the instalment becomes due**
   Asset A/c Dr. (cash price part of instalment)
   Interest A/c Dr. (interest on instalment)
   To Hire Vendor

4. **When instalment is paid**
   Hire Vendor Dr.
   To Bank A/c

5. **When depreciation is charged**
   Depreciation A/c Dr.
   To Asset A/c

6. **When interest and depreciation accounts are closed by transfer to Profit & Loss A/c**
   Profit & Loss A/c Dr.
   To Interest A/c
   To Depreciation A/c

It should be noted that though the asset account is debited with the amount of the cash price paid (not full cash price), the depreciation is charged on the full cash price. The Balance Sheet will reflect the amount of cash price debited to the asset account minus depreciation charged.

Look at the illustration 6 and see how accounting records are maintained in case the asset is recorded at cash price actually paid.

Illustration 6

Solve illustration 6 by debiting the asset account at cash price actually paid.

Solution:

Journal Entries in the Books of ABC Ltd.

Date	Particulars	Amount (Dr.) Rs.	Amount (Cr.) Rs.
2016			
Dec. 31	Machinery A/c Dr.	1,812	
	Interest A/c Dr.	600	
	To XYZ Ltd.		2,412
	(Being first instalment due)		
Dec. 31	XYZ Ltd Dr.	2,412	
	To Bank A/c		2,412
	(Being first instalment paid)		
Dec. 31	Depreciation A/c Dr.	1,200	
	To Asset A/c		1,200
	(Being annual depreciation charged)		

Dec. 31	Profit & Loss A/c	Dr.	1,800	
	To Depreciation A/c			1,200
	To Interest A/c			600
	(Being annual charges transferred to Profit & Loss A/c)			
2017				
Dec. 31	Machinery A/c	Dr.	1,994	
	Interest A/c	Dr.	418	
	To XYZ Ltd.			
	(Being third instalment due)			2,412
Dec. 31	XYZ Ltd	Dr.	2,412	
	To Bank A/c			2,412
	(Being third instalment paid)			
Dec. 31	Depreciation A/c	Dr.	1,200	
	To Asset A/c			1,200
	(Being annual depreciation charged)			
Dec. 31	Profit & Loss A/c	Dr.	1,618	
	To Depreciation A/c			1,200
	To Interest A/c			418
	(Being annual charges transferred to Profit & Loss A/c)			
2018				
Dec. 31	Machinery A/c	Dr.	2,194	
	Interest A/c	Dr.	218	2,412
	To XYZ Ltd.			
	(Being third instalment due)			
Dec. 31	XYZ Ltd	Dr.	2,412	
	To Bank A/c			2,412
	(Being third instalment paid)			
Dec. 31	Depreciation A/c	Dr.	1,200	
	To Asset A/c			1,200
	(Being annual depreciation charged)			
Dec. 31	Profit & Loss A/c	Dr.	1,418	
	To Depreciation A/c			1,200
	To Interest A/c			218
	(Being annual charges transferred to Profit & Loss A/c)			

Note: Depreciation has been charged on straight line method @20% p.a. at the full cash price of Rs. 6,000.

11.6 ACCOUNTING RECORDS IN THE BOOKS OF VENDOR

So far as the vendor is concerned, a hire purchase sale is just like an ordinary sale with the exception that payment is deferred over a period of time for which the vendor charged interest. He debits the Hire Purchaser's A/c with full cash price and credit is given to Sales A/c. The interest amount is debited to Hire Purchaser's A/c as and when the instalments become due. Instalment amounts received are credited to the Hire Purchaser's A/c and debited to Bank A/c.

The journal entries passed are as follows:

1 **On sale of goods under hire purchase**
Hire Purchaser A/c Dr
To Sales A/c (with full cash price)

2 **On receiving cash price down payment**
Bank A/c Dr
To Hire Purchaser A/c

3 **On instalment becoming due**
Hire purchaser A/c Dr.
To Interest A/c

4 **On getting payment on the due instalment**
Bank A/c Dr.
To Hire Purchaser A/c

With the help of above entries, you can easily prepare the Hire Purchaser's A/c and Interest A/c. Look at illustration 7 and see how accounting records are maintained in the books of the vendor.

Illustration

On January 1, 2017, IFB Ltd. acquired machinery from JK Ltd. for Rs. 1,886 (cash price) under a hire purchase agreement where Rs. 400 was the initial payment and two instalments of Rs. 800 each would be paid. Interest @ 6% p.a. would be charged. Prepare the ledger accounts in the books of J.K. Ltd., assuming rate of depreciation @ 10% (straight line).

Solution:

In the books of JK. Ltd.
IFB LTD.

Dr.					**Cr.**
2017		Rs.	2017		Rs.
Jan.	To Sales A/c 1	1,886	Jan. 1	By Bank A/c	400
Dec. 31	To Interest A/c	89	Dec. 31	By Bank A/c (1st Inst.)	800
			Dec. 31	By Balance c/d	775
		1,975			1,975
2018			2018		
Jan. 1	To Balance b/d	775	Dec. 31	By Bank A/c (2nd Inst.)	800
Dec. 31	To Interest A/c	25			
		800			800

Interest Account

2017		Rs.	2017		Rs.
Dec. 31	To Profit & Loss A/c	89	Dec. 31	By IFB Ltd.	89
		89			89
2018			2018		
Dec. 31	To Profit & Loss A/c	25	Dec. 31	By IFB Ltd	25
		25			25

Working Note

Statement having calculation of hire purchases interest and the amount of principal in each instalment.

	Rs.	Interest Rs.	Cash Price Rs.
Cash Price	1,886	—	400
Less: Down Payment	400		
	1,486		
Add: Interest on 1st instalment to be paid on Dec. 31, 2017 @ 6%	89		
	1,575		
Less : 1st Instalment on Dec. 31, 2017	800	89	711
	775		
Add: Interest on 2nd instalment @ 6%	25		
	800		
Less: 2nd Instalment on Dec. 31, 2018	800	25	775

Check Your Progress C

1. Enlist the information required before solving the hire purchase problem.

   ....

   ....

   ....

   ....

2. State whether following statements are **True** or **False.**

   i) When the asset is recorded at full cash price, the hire purchase becomes a method of financing the fixed asset.

   ii) When the asset is recorded at the price actually paid, the Asset A/c is debited and the Hire Vendor's A/c is credited with full cash price.

   iii) The Hire Vendor debits the hire purchaser's A/c and credits the sales A/c on sale of goods with cash price.

iv) When the asset is recorded at cash price actually paid no entry is passed when the instalment becomes due.

v) The Hire Vendor's A/c is in the nature of a personal account.

11.7 LET US SUM UP

In the hire purchase agreement, the buyer takes the delivery of the goods and promises to pay the price in instalments. Under this agreement, though the buyer takes the possession of the goods, but he does not have the ownership. The ownership of the goods passes only after the last instalment has been paid. In case the buyer fails to pay any of the instalments, the seller can take back the possession of the goods.

The hire purchase price is always more than the cash price, the difference between the two is the interest charged for deferred payment. If any two of the three items of information i.e., hire purchase price, cash price and interest, are given, the third can be found out with the help of the formula HP = CP + Interest (HP is hire purchase price and CP is cash price).

Both the parties to hire purchase agreement i.e., the vendor and the purchaser, record the hire purchase transactions in their books.

The purchaser can prepare accounting records in two ways (i) when the asset is recorded at full cash price, or (ii) when the asset is recorded at the cash price actually paid.

The purchaser mainly maintains two accounts i.e., the Hire Vendor Account and the purchaser, record the hire purchase transactions in their books. The vendor on the other hand maintains the Hire Purchaser's Account and the Interest Account.

11.8 KEY WORDS

Agreement to Sell: In a contract of sale, when the ownership of goods sold is to pass to the buyer subject to fulfilment of certain conditions, such sale is termed as an agreement to sell.

Cash Price: The amount to be paid in outright sale on cash.

Down Payment: Initial payment made at the time of purchase under hire purchase agreement.

Hire Charges: If the hirer in a hire purchase agreement fails to pay even the last instalment, the amounts he has paid so far will be treated as hire charges for using the asset.

Hire Purchase: An agreement to sell under which the buyer takes the delivery of goods promising to pay the price in instalments and until full payment is made, to treat payment as hire charges for using the goods.

Hire Purchaser: The purchaser in a hire purchase contract.

Hire Vendor: The seller in a hire purchase agreement who agrees to receive the price in instalments, and has the right to treat the amounts paid by the hirer as hire charges if the hirer fails to pay the last instalment.

Instalment Payment System: When the price in a contract of sale is paid over a period of time but at fixed intervals, the system of payment is called instalment payment system.

11.9 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) agreement ii) sell iii) pass, conditions iv) instalment v) hire charges vi) repossess vii) writing viii) terminate ix) right, title

2. i) False ii) True iii) False iv) True v) False vi) False

B 1. i) Total interest = Rs. 51(25+17+9)

ii) Total interest = Rs. 500 (264+178+58)

2. i) Cash Price = Rs. 18,616, ii) Cash Price = 43,294

C 1. i) True ii) False iii) True iv) False v) True

11.10 TERMINAL QUESTIONS/EXERCISES

Questions

1) What are the characteristics of a hire purchase agreement?

2) Describe the rights of a hirer under hire purchase agreement.

3) What steps would you take to calculate the interest when the total cash price instalments are given?

Exercises

1. Based on particulars given below, give entries in the books of the purchaser and the seller under the hire purchase system :

   a) Ramesh & Co. – Purchaser, Date of Purchas – Jan. 1, 2018, goods purchased – Trucks, Cash Price – Rs. 1,49,000, Instalments Rs. 40,000 on signing of the agreement. Rest in three instalments of Rs. 40,000 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.

2. Hire Purchases Ltd. purchased Motor Car on hire purchase system. Rs. 12,000 was payable on delivery i.e., on 1.1.18 and the rest in four equal instalments of Rs. 12,000 each payable at the end of each year. The seller, Hire Vendors Ltd. agreed to charge interest @ 5% on the yearly balances. The cash price of the Car was Rs. 54,551. Depreciation @ 25% on written down values was to be written off in each year.

   Give the necessary journal entries and ledger accounts in the books of Hire Purchasers Ltd.

   (Answer: Total Interest Rs. 5,449. The written down value of the Car at the of fourth year is Rs. 17,260)

3 Dinesh Ltd., on April 1, 2015, purchased a machine from Rajesh Ltd., on hire purchase basis. The cash price of the machine was Rs. 25,000. The payment was to be made Rs. 5,000 on the date of the contract and the balance in four annual instalments of Rs. 5,000 each plus interest at 5% per annum payable on December 31 each year, and the first such instalment being payable on 31.12.15. Depreciation is to be charged @10% on original cost.

Show the journal entries and ledger accounts in the books of both the parties.

(Answer: The amount of total interest Rs. 2,500, balance of Machinery A/c on 1.1.19 Rs. 15,000).

4. An engineering company purchased a Machine on Hire Purchase System over a period of three years paying Rs. 846 as initial payment on 1.1.16 and further annual payments of Rs. 2000 due on 31.12.16, 31.12.17 and 31.12.18. The cash price of the Machine was Rs. 6,000 and the vendor company was to charge interest at 8% p.a. on outstanding balances.

Show the appropriate ledger accounts in the books of the hire purchaser assuming depreciation @ 10% p.a. was to be charged on the Machine, Assume that capitalisation was to be done at the time of payment of each instalment.

(**Answer :** Interest (total) Rs. 846).

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 12 HIRE PURCHASE ACCOUNTS-II

Structure

12.0 OBJECTIVES

After studying this unit, you should be able to:

- explain default and repossession in relation to a hire purchase contract;
- pass accounting entries for complete and partial repossession of goods in the books of both hire vendor and hire purchaser;
- describe the instalment payment system and distinguish it from hire purchase system;
- pass accounting entries in case an asset is bought under the instalment payment method;
- explain the basic record maintained for hire purchase transactions of goods of small value;

- explain the terms like cost price, goods sold on hire purchase, hire purchase stock, hire purchase debtors, etc. considered relevant for ascertainment of profit on hire purchase business;
- prepare hire purchase trading account and ascertain the profit/loss on hire purchase business; and
- ascertain the profit or loss on hire purchase business through stock and debtors method.

12.1 INTRODUCTION

In Unit 11, you learnt about the nature, legal position and the accounting treatment of a hire purchase contract. So far as the accounting treatment goes, we discussed a simple situation where the purchaser had paid all the instalments and consequently the ownership was transferred to him. But sometimes the purchaser is unable to pay all instalments. In such a situation, the vendor has the right to take back the possession of goods and treat the instalments paid as hire charges for the use of the asset. But, in practice, he may arrive at some compromise with the hire purchaser. In this unit, you will learn how default in payment of instalments is treated in the books of account of both the parties. We shall also discuss the accounting treatment in case the asset is purchased under instalment payment system as against the hire purchase system.

So far we have discussed the system of maintaining accounting records related to hire purchase transactions for goods of substantial sales value. In practice, however, the goods bearing small value like fridge, TV, scooter, etc. are also sold on hire purchase basis. The retailers often keep separate records for these transactions and compute the profit on hire purchase business separately. This involves a peculiar method of accounting and profit ascertainment. In this unit, we shall also discuss the accounting treatment of hire purchase transactions for goods of small value and study the methods of ascertaining the profit or loss on such transactions during an accounting period.

12.2 DEFAULT AND REPOSSESSION

'Default' is the failure to act, appear or pay i.e., failure to meet obligation. Under a hire purchase agreement, the hirer has obligation to pay up to the last instalment so that the ownership of goods smoothly passes to him. If he fails to meet this obligation, it will be treated as default on his part.

Possession of goods means physical holding of goods. You know that under hire purchase agreement, the vendor simply transfers the possession of goods. He does not transfer the ownership, and if the hirer fails to pay even the last instalment, the vendor has the legal right to recover the possession of the goods. This act of recovery of possession is termed as 'repossession'.

The legal position of the hire vendor and hire purchaser (hirer) in case of default is complicated. The Hire Purchase Act of 1972 did codify this issue first, but as this Act was not put to operation, the legal position is not very clear. However, the relevant provisions of the said Act are discussed below.

12.2.1 Rights of the Hire Vendor

1. **Rights of hire vendor to terminate hire purchase agreement:** Where the hirer makes more than one default in payment of instalment as provided in the agreement, the hire vendor (the owner) shall be entitled to terminate the agreement by giving the notice of termination in writing.

2. **Rights of the hire vendor on termination:** Where a hire purchase agreement is terminated, the hire vendor (the owner) shall-be entitled (i) to enter the premises of the hirer and seize the goods, (ii) to retain the hire charges already paid and to recover the arrears of hire charges due, and (iii) to claim damages for non-delivery of the goods.

12.2.2 Restrictions on the Owner

The above rights of the owner are, however, subject to the following restrictions:

1. **Rights of hirer in case of seizure of goods by the owner:** Where the owner seizes the goods lent under a hire purchase agreement, the hirer may recover from the owner the amount, if any, by which the hire purchase price falls short of the aggregate of two amounts (a) the amounts paid in respect of the hire purchase price up to the date of seizure, and (b) the value of the goods on the date of seizure.
2. **Restrictions on owner's right to repossess:** Where goods have been let under a hire purchase agreement, and the statutory amount of the hire purchase price has been paid, the owner shall not enforce any right to recover possession of the goods from the hirer otherwise than by verdict of any competent court.

12.3 ACCOUNTING FOR DEFAULT AND REPOSSESSION

You know that when the purchaser fails to pay any of the instalments, the hire vendor can take back the possession of the goods. The amount already paid to the vendor as a part of the payment for the asset is treated as the hire charge. So far as the repossession of goods is concerned, the vendor can either take back the whole of the asset or a part of it. Let us now discuss what entries will be passed in case of (i) complete repossession and (ii) the partial repossession.

12.3.1 Complete Repossession

When the hire purchaser does not pay the instalment, the vendor can take back the possession of goods. In case the vendor takes the possession of all the goods, it is called complete repossession. It means the vendor will close Hire Purchaser's Account in his books and vice versa. The journal entries passed are as follows:

i) All the entries (except the entry for payment) are passed as usual up to the date of default.

ii) **For closing the account of the purchaser**
Goods Repossessed A/c Dr.
To Hire Purchaser
(Transfer of balance)

iii) **For repairs and other expenses on the repossessed goods**

Goods Repossessed A/c Dr.

To Cash A/c

(Repairs and other expenses)

iv) **For resale of goods repossessed**

Cash A/c Dr.

To Goods Repossessed A/c

v) **Any balance left in Goods Repossessed Account is either profit or loss, which is ultimately transferred to' Profit & Loss A/c.**

In case of profit the entry will be **:**

Goods Repossessed A/c Dr.

To Profit & Loss A/c

In case of loss, the above entry will be reversed.

In the books of Hire Purchaser

i) All the entries (except the entry for payment) are passed as usual up to the date of default, including the entry for depreciation.

ii) **For closing the account of the vendor**

Hire Vendor A/c Dr.

To Asset A/c

iii) **For closing the Asset Account**

Profit & Loss A/c Dr.

To Asset A/c

Generally there is a loss to the hire purchaser, so the above entry is passed for loss on seizure of goods. In case of profit, the above entry will be reversed.

Look at illustration 1 and see how entries are passed and the books are closed in case of complete repossession.

Illustration 1

On January 1, 2017, ABC Ltd. sold some plant & machinery costing Rs. 28,000 (cash price) to XYZ Ltd. on hire purchase. Payment was to be made as Rs. 7,500 cash down and three instalments of Rs. 7,500 at the end of each year. Rate of interest was @ 5% p.a. The rate of depreciation for the asset was 10% p.a.

XYZ Ltd. made the down payment and paid the first instalment. But they could not pay the second instalment. Consequently, ABC Ltd. repossessed the goods.

ABC Ltd. spent Rs, 300 on repairs and disposed off the asset for Rs. 15,350. Open ledger accounts in the books of both the parties.

Solution:

Books of XYZ Ltd.
Plant & Machinery Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan.1	To ABC Ltd	28,000	Dec.31	By Depreciation (10% on 28,000)	2800
			Dec.31	By Balance c/d	25,200
		28,000			28,000
2018			2018		
Jan. 1	To Balance b/d	25,200	Dec. 31	By Depreciation (10% on 25,200)	2,520
			Dec. 31	By ABC Ltd	14,726
			Dec. 31	By Profit and Loss A/c	7,954
		25,200			25,200

ABC Ltd's Account

2017		Rs.	2017		Rs.
Jan.1	To Cash A/c (down payment)	7,500	Jan. 1	By Plant & Machinery	28,000
			Dec.31	By Interest A/c	1,025
Dec.31	To Cash A/c (first instalment)	7,500			
Dec. 31	To Balance c/d	14,025			
		29,025			29,025
2018			2018		
Dec. 31	To Plant & Machinery A/c (default)	14,726	Jan.1	By Balance b/d	14,025
			Dec.31	By Interest A/c	701
		14726			14,726

Books of ABC Ltd
XYZ Ltd's Account

2017		Rs.	2017		Rs.
Jan.1	To Sales A/c	28,000	Jan.1	By Cash A/c	7,500
Dec.31	To Interest A/c (5% on 20,500)	1,025	Dec.31	By Cash A/c	7,500
			Dec.31	By Balance c/d	14,025
		29,025			29,025
2018			2018		
Jan.1	To Balance b/d	14,025	Dec.31	By Goods Repossessed A/c	14,726
Dec. 31	To Interest A/c (5% on 14,025)	701			
		14,726			14,726

Goods Repossessed Account

2018		Rs.	2018		Rs.
Dec.31	To XYZ Ltd A/c	14,726	Dec.31	By Cash A/c (sales)	15,350
Dec.31	To Cash A/c (repairs)	300			
Dec.31	To Profit & Loss A/c (profit on sale)	324			
		15,350			15,350

12.3.2 Partial Repossession

Sometimes, in case of default, the vendor enters into a compromise with the hirer and does not repossess the complete goods. But, he repossesses a part of the goods called partial repossession. In this case, some part of the asset is still left with the buyer.

So far as the accounting treatment of partial possession is concerned, interest and depreciation entries are passed as usual in the books of both the parties upto te date of default, but not the entry for payment.

As some part of the asset is left with the hire purchaser, the hire vendor does not close the Hire Purchaser's Account in his books, nor does the hire purchaser close the Hire Vendor's Account in his books. They ascertain the current value of the asset repossessed with the help of an agreed rate of depreciation (it is usually an enhanced rate). The hire vendor debits the same to the Goods Repossessed Account and credits it to the Hire Purchaser's Account. Similarly, the hire purchaser debits the Hire Vendor's Account and credits the Asset Account with the agreed value of the asset repossessed. As for the part of asset left with him, the hire purchaser applies the normal rate of depreciation and shows the depreciated value as a balance in the Asset Account. The balancing figure in the asset account will show the profit or loss on default and it will be transferred to the Profit & Loss Account.

Look at the illustration 2 and see how accounts are prepared in case of partial repossession.

Illustration 2

Jalani Distributors sold three light commercial vans to Jain Enterprises on January 1, 2017 on hire purchase system. The price of each van was Rs. 90,000 payment of which was to be made as follows

i) Rs. 30,000 as down payment for each van,

ii) Remaining amount in 3 annual equal instalments along with interest @15%.

Jain Enterprises were charging depreciation @ 20% each year on written down value method. After payment of 1st instalment as on December 31, 2017, they could not pay further instalments. It was agreed between the parties for repossession of two vans adjusting their value against the amount due. For the purposes of repossession, depreciation @ 30% p.a. was charged.

Repossessed goods were repaired at a cost of Rs. 2,000 and were then sold for Rs, 92,000, Calculate the value of repossessed stock and show the necessary accounts in the books of both the parties.

Solution

In the books of Jain Enterprises
Light Commercial Vans Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan, 1	To Jalani Distributors (Rs. 90,000×3)	2,70,000	Dec. 31	By Depreciation A/c (20% on 2,70,000)	54,000
			Dec. 31	By Balance c/d	2,16,000
		2,70,000			2,70,000
2018 Jan. 1	To Balance b/d	2,16,000	2018 Dec. 31	By Depreciation A/c (20% on 2,16,600)	43,200
			Dec. 31	By Jalani Distributors (value of two vans on repossession)	88,200
			Dec. 31	By Profit & Loss A/c (loss on repossession)	27,000
			Dec. 31	By Balance c/d	57,600
		2,16,000			2,16,000
2019 Jan. 1	To Balance b/d	57,600			

Jalani Distributors' Account

Date	Particulars	Amount	Date	Particulars	Amount
2017		Rs.	2017		Rs.
Jan. 1	To Bank A/c (down payment) (Rs. 30,000×3)	90,000	Jan. 1	By Light Commercial Vans A/c	2,70,000
Dec.31	To Bank A/c (first instalment Rs. 60,000+27,000)	87,000	Dec 31	By Interest A/c $(1,80,000 \times \frac{15}{100})$	27,000
Dec.31	To Balance c/d	1,20,000			
		2,97,000			2,97,000
2018 Dec. 31	To Light Commercial Vans A/c	88,200	2018 Jan. 1	By Balance b/d	1,20,000
Dec. 31	To Balance c/d	49,800	Dec. 31	By Interest $(1,20,000 \times \frac{15}{100})$	18,000
		1,38,000			1,38,000
			2019 Jan. 1	By Balance b/d	49,800

Books of Jalani Distributors

Jain Enterprises' Account

2017		Rs.	2017		Rs.
Jan.1	To Sales A/c	2,70,000	Dec. 31	By Bank A/c (down payment)	90,000
Dec. 31	To Interest A/c $(\frac{15}{100}\times 1,80,000)$	27,000	Dec. 31	By Bank A/c (Ist instalment)	87,000
			Dec. 31	By Balance c/d	1,20,000
		2,97,000			2,97,000
2018			2018		
Jan. 1	To Balance b/d	1,20,000	Dec. 31	By Goods Repossessed A/c	88,200
Dec. 31	To Interest A/c $(\frac{15}{100}\times 1,20,000)$	18,000	Dec. 31	By Balance c/d	49,800
		1,38,000			1,38,000
2019					
Jan. 1	To Balance b/d	49,800			

Goods Repossessed Account

2018		Rs.	2018		Rs.
Dec. 31	To Jain enterprises	88,200	Dec. 31	By Cash A/c (sale)	92,000
Dec. 31	To Cash A/c (repairs)	2,000			
Dec. 31	To Profit & Loss A/c (profit on sale)	1,800			
		92,000			92,000

Working Notes

1 Calculation of the value of repossessed asset

		Rs.
Cost Price of two vans (90,000×2)		1,80,000
Depreciation		
First year $(\frac{30}{100}\times 1,80,000)$	54,000	
Second year $(\frac{30}{100}\times 1,80,000-54,000)$	37,800	91,800
Value of repossessed stock		88,200

2 Loss on Repossession

	Rs.
Cost Price of two vans (90,000×2)	1,80,000
Depreciation	

First year $(\frac{20}{100} \times 1,80,000)$	36,000	
Second year $(\frac{20}{100} \times 1,80,000 - 36,000)$	28,800	64,800
Depreciated value of two vans		1,15,200
Less : Value of the two vans at higher rate of depreciation for repossession		88,200
Loss on repossession		27,000

12.4 INSTALMENT PAYMENT SYSTEM

Instalment Payment System also called the Deferred Instalments is a system where the buyer is given the ownership as well as the possession of the goods right at the time of signing the contract. The buyer has the facility to pay the price in instalments. The features of Instalment Payment System are as follows:

i) It is an outright sale.

ii) The possession as well as the ownership is passed to the buyer on signing of the contact.

iii) The buyer can make the payment in instalments.

iv) In case of default in payment, the seller cannot repossess the goods.

v) The amount paid up to the default is not forfeited and the seller can sue the buyer for the amount due.

From the above discussion we can see that the Instalment Payment System has some similarities with the Hire Purchase System, but there are some points of difference as well. They are as follows:

Hire Purchase System	Instalment Payment System
i) It is an agreement of hiring.	i) It is an agreement of sale.
ii) The buyer gets only the possession of goods on signing the contract.	ii) The buyer gets possession on signing of the contract.
iii) In case of default, the goods can be repossessed	iii) The goods cannot be repossessed in case of default.
iv) In case of default, the payment made up to the date of default is forfeited and treated as hire charge.	iv) The payment made up to the date of default is a payment towards the price of the asset and cannot be forfeited. The seller can at the most sue the buyer for the amount due.
v) The buyer cannot sell, destroy, transfer, damage or pledge the . goods.	v) Buyer can sell, destroy, damage, transfer or pledge the goods.

12.5 ACCOUNTING FOR INSTALMENT PAYMENT SYSTEM

You know that the ownership of goods passes to the buyer immediately on the signing of the contract. Hence, while accounting for the purchase under the Instalment payment system, this fact should be taken into account. Accordingly, the buyer credits the vendor with the full amount payable to him (inclusive of total interest) and debits the assets with cash price and the Interest Suspense Account with the total amount of interest being the difference between the full amount payable and the cash price. The Interest Suspense Account is credited with the actual amount of interest at the time of each instalment by transferring the same to Interest Account. Similarly, the vendor debits the buyer with the full amount and credit sale with cash price and Interest Suspense Account with total interest. He transfers the actual amount of interest to Interest Account at the time of each instalment by debiting Interest Suspense Account and crediting the Interest Account.

Thus, from accounting point of view, the main point of difference between Instalment Payment System and the Hire Purchase System relates to the treatment of interest. But in practice, even this may be dispensed with.

The asset account is maintained by the buyer in a manner similar to that of Hire Purchase System i.e., depreciation is charged in the usual manner and the depreciated value of the asset is shown in the Balance Sheet. It should be noted that the balance in Vendor's Account shall be shown on the liability side every year.

Let us now study the journal entries both in the books of the buyer and seller under Instalment Payment System.

12.5.1 Books of the Buyer

The buyer passes the following journal entries in his books.

i) **When the Asset is purchased**

Asset A/c	Dr.	(with cash price)
Interest Suspense A/c	Dr.	(difference between cash price
To Vendor (with Instalment price)		and instalment)

ii) **For cash down payment**

Vendor A/c	Dr
To Bank A/c	

iii) **For interest due at the time of instalment**

Interest A/c	Dr.
To Interest Suspense A/c	

iv) **For the payment of instalment**

Vendor A/c	Dr
To Bank A/c	

v) **For Depreciation at the end of the accounting year**

Deprecation A/c Dr.

To Asset A/c

vi) **For transfer of interest and depreciation to Profit & Loss A/c**

Profit & Loss A/c Dr.
To Interest A/c
To Depreciation A/c

After passing the above mentioned journal entries, the purchaser prepares the following ledger accounts.

i) Asset A/c

ii) Vendor's A/c

iii) Interest Suspense Account

iv) Interest Account

Look at the illustration 3 and see how ledger accounts are maintained in the books of the buyer when goods are purchased under Instalment Payment System.

Illustration 3

Fire industries Ltd. purchased a plant on 1.1.2016 from MMC Ltd. under instalment payment system. The cash price was Rs. 20,000 payable as Rs, 6,384 for down payment and the balance by three equal annual instalment of Rs. 5,000 each including 5% interest. Depreciation @ 10% was to be charged as per W.D.V. method.

Show the necessary ledger accounts in the books of Fire Industries Ltd.

Solution :

In the books of Fire Industries Ltd.
MMC Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To Bank A/c	6,384	Jan. 1	By Plant A/c	20,000
Dec.31	To Bank A/c (1st Inst.)	5,000	Dec.31	By Interest Suspense A/c	1,384
Dec.31	To Balance c/d	10,000			
		21,384			21,384
2017			2017		
Dec.31	To Bank A/c (2nd Inst.)	5,000	Jan. 1	By Balance b/d	10,000
Dec.31	To Balance c/d	5,000			
		10,000			10,000
2018			2018		
Dec.31	To Bank A/c (3rd Inst.)	5,000	Dec.31	By Balance b/d	5,000
		5,000			5,000

Plant Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To MNC Ltd.	20,000	Dec. 31	By Depreciation A/c	2,000
			Dec. 31	By Balance c/d	18,000
		20,000			20,000
2017			2017		
Jan. 1	To Balance b/d	18,000	Dec. 31	By Depreciation A/c	1,800
			Dec. 31	By Balance c/d	16,200
		18,000			18,000
2018			2018		
Jan. 1	To Balance b/d	16,200	Dec. 31	By Depreciation A/c	1,620
			Dec. 31	By Balance c/d	14,580
		16,200			16,200

Interest Suspense Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To MNC Ltd.	1,384	Dec.31	By Interest A/c	681
			Dec.31	By Balance c/d	703
		1,384			1,384
2017			2017		
Jan. 1	To Balance b/d	703	Dec. 31	By Interest A/c	465
			Dec. 31	By Balance c/d	268
		703			703
2018			2018		
Jan. 1	To Balance b/d	238	Dec. 31	By Interest A/c	238
		238			238

Interest Account

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Dec.31	To Interest Suspense A/c	681	Dec. 31	By Profit & Loss A/c	681
		681			681
2017			2017		
Dec.31	To Interest Suspense A/c	465	Dec. 31	By Profit & Loss A/c	465
		465			465
2018			2018		
Dec.31	To Interest Suspense A/c	238	Dec. 31	By Profit & Loss A/c	238
		238			238

Working Note:

Statement showing calculation of Interest for deferment period

Particulars	Amount	Principal	Interest	Total
	Rs.	Rs. (a)	Rs. (b)	Rs. c = (a+b)
Cash Price (6384+13616)	20,000			
1.1.16 Less : Down payment	6,384	6,384		6,384
	13,616			
31.12.16 Add : Interest @ 5% $(\frac{5}{100} \times 13,616)$	681			
	14,297			
Less : Ist Instalment	5,000	4,319	681	5,000
	9,297			
31.12.17 Add : Interest @ 5% $(\frac{5}{100} \times 9,297)$	465			
	9,762			
Less : 2nd Instalment	5,000	4,535	465	5,000
	4,762			
31.12.18 Add : Interest @ 5% $(\frac{5}{100} \times 4,762)$	238			
	5,000			
Less : 3rd Instalment	5,000	4,762	238	5,000
Total	NIL	20,000	1,384	21,384

12.5.2 Books of the Vendor

The vendor passes the following journal entries when the goods are sold on instalment payment system.

i) **When the goods are sold**

Purchaser Dr.		(with total price)
	To Sales A/c	(with cash price)
	To Interest Suspense A/c	(with the difference between the total price and cash price)

ii) **For cash received as down payment**

Bank A/c Dr.	
	To Purchaser A/c

iii) **For interest due on instalment**
Interest Suspense A/c Dr.
To Interest A/c

iv) **For receipt of the amount of instalment**

BankA/c Dr.
To Purchaser A/c

v) **For transfer of interest to Profit & Loss A/c**

Interest A/c Dr.
To Profit & Loss A/c

Like the buyer, the vendor also prepares certain Ledger accounts. They are

i) Buyer's Account

ii) Interest Suspense Account

iii) Interest Account

Look at the illustration 4 and see how the accounts are maintained in the books of the vendor when the goods are sold on instalment payment system.

Illustration 4

We consider the problem given in illustration 3 and prepare ledger accounts in the books of the vendor.

Solution:

In the books of MMC Ltd.
Fire Industries Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2016		Rs.	2016		Rs.
Jan.1	To Sales A/c	20,000	Jan. 1	By Bank A/c (down payment)	6,384
Dec.31	To Interest Suspense A/c	1,384	Dec.31	By Bank A/c (Ist Instalment)	5,000
			Dec.31	By Balance c/d	10,000
		21,384			21,384
2017			2017		
Jan. 1	To Balance b/d	10,000	Dec.31	By Bank A/c (2nd Instalement)	5,000
			Dec.31	To Balance c/d	5,000
		10,000			10,000
2018			2018		
Jan.1	To Balance b/d	5,000	Dec.31	By Bank A/c (3rd Instalment)	5,000
		5,000			5,000

Interest Suspense Account

Dr.					Cr.
2016		Rs.	2016		Rs.
Dec.31	To Interest A/c	681	Jan. 1	By Fire Industries Ltd A/c	1,384
Dec.31	To Balance c/d	703	2016		
		1,384			1,384
2017			2017		
Dec.31	To Interest A/c	465	Jan. 1	By Balance b/d	703
Dec.31	To Balance c/d	238			
		703			703
2018			2018		
Dec.31	To Interest A/c	238	Jan. 1	By Balance b/d	238
		238			238

Interest Account

Dr.					Cr.
2016		Rs.	2016		Rs.
Dec.31	To Profit & Loss A/c	681	Dec.31	By Interest Suspense A/c	681
		681			681
2017			2017		
Dec.31	To Profit & Loss A/c	465	Dec.31	By Interest Suspense A/c	465
		465			465
2018			2018		
Dec.31	To Profit & Loss A/c	238	Dec.31	By Interest Suspense A/c	238
		238			238

Check Your Progress A

1. Fill in the blanks

   i) Default is ……………to act, appear or pay.

   ii) Possession of goods means ……………..of goods.

   iii) The act of………… of …………….is termed as repossession.

   iv) Where a hire purchase agreement is …………..due to default in payment, the hire vendor shall be entitled to enter the premises of the hirer and …………….the goods.

   v) In case of termination due to default in payment the hire vendor is entitled to …………….for non-delivery of goods.

   vi) Under an instalment payment system, the buyer gets the .... of the goods on the date of…………………

2. State whether the following statements are **True** or **False.**

   i) Under a hire purchase agreement, failure in payment of only the last instalment would be considered as a default.

ii) On default, the vendor under the instalment payment system is entitled to retain the amount which has already been paid and recover the arrears of hire due.

iii) After repossession, a hire vendor has no right to resell the goods repossessed.

iv) In case of an instalment payment system, the buyer is entitled to dispose off the goods he has bought.

v) Under an instalment payment system, the buyer can return the goods at any time.

12.6 BASIC RECORD FOR GOODS OF SMALL VALUE SOLD ON HIRE PURCHASE

You are aware of the fact that with advancement of technology and improvement in the standard of living of the people both in India and abroad, the demand, for consumer durables like fridge, T.V., automobiles, etc. has increased manifold over the years. To meet this demand explosion, the dealers have come up with innovative schemes which attract the prospective consumers to purchase such goods. One such scheme is the sale on hire purchase basis. The consumers with limited resource are naturally interested in buying under this scheme in view of the benefits of deferred payment at reasonable rate of interest. Hence, a large volume of transactions in these goods are being conducted everyday.

It should be noted that these transactions take place between a retailer (dealer) and the consumers, and not between two business units. Hence, **the accounting is important only for the vendor and not the buyer.** Let us now study how a hire vendor(retailer) maintain the account when goods of small value are sold on hire purchasebasis.

In case of hire purchase transactions of numerous goods of small value, it becomes practically inconvenient for a particular dealer of these items to maintain separate accounts for each transaction. Hence, the accounting system is designed in such a way that overall control can be exercised on all the transactions during a particular accounting period through control accounts. However, for individual transactions, detailed record may be kept in a subsidiary book called 'Hire Purchase Sale Register showing the necessary information as may be required to control individual accounts of the buyers. A specimen of the register is given in Figure 12.1.

S.No	Date of Agreement	Name of Article	Name of Customer	Cost Price	Hire Purchase Price	Cash Down Payment	No. of Instalments	Instalments Due				Total install-ments received	Instal-ments due but not paid	Instal-ments not yet due
								1	2	3	4			

Fig 12.1: Hire Purchase Sales Register

In Hire Purchase Sales Register as given in Figure 12.1, you will observe that, besides the details of individual hire purchase transactions, there are columns showing cost price, hire purchase price, cash down payment, instalments received, instalments due but not yet paid, and instalments not yet due. The figures are very relevant for the accounting for hire purchase transactions and the ascertainment of profit/loss from hire purchase business and, therefore, the accountant must be careful in recording the amounts and the casting (totalling) of these columns. The totals of these columns are posted to the relative control accounts periodically, say monthly, quarterly, half yearly, or yearly by passing the necessary journal entries.

12.7 RELEVANT TERMS

In connection with the accounting for goods of small value sold on hire purchase basis, we have to define certain terms before we study different methods of ascertaining the profit or loss on such transactions. These relevant terms are

1. Cost price of goods sold on hire purchase
2. Value of goods sold on hire purchase
3. Cash received
4. Hire Purchase Debtors
5. Hire Purchase Stock
6. Stock at shop

1. **Cost price of Goods Sold on Hire Purchase :** You know the hire vendor is only a dealer. He purchases goods from various manufacturers and sells them to the consumers under hire purchase system. Naturally, he sells the goods at a price higher than the price at which he has bought. His mark-up on hire purchase sales is bound to be more than even the cash price because he has also to cover the loss of interest on such transactions. Normally, interest is accounted for separately as you studied in the case of sale of goods of a substantial value. But, **in the case of sale of goods of small value, Interest is ignored and the profit is worked out on the basis of the difference between cost price and hire purchase price.** This is called 'loading'. Loading is generally given in terms of percentage on cost or as percentage of hire purchase price. Usually you are provided with the figure of hire purchase price and you have to work out the cost price with the help of loading. Alternatively, both the hire purchase price and cost price are given and you may have to work out the loading for the purpose of ascertaining profit or loss in hire purchase business.

2. **Goods Sold on Hire Purchase:** For the purpose of finding out the profit or loss on the hire purchase business during an accounting period, we need the figure of the value of goods sold on hire purchase. This reflects the hire purchase price of all the goods sold on hire purchase basis during the accounting period. This is mostly given. If, however, the value of goods sold on hire purchase is not given, it can be worked out by applying the loading rate to the cost of goods sold on hire purchase. Alternatively, it can be worked out with the help of the first part of the Hire Purchase Trading Account.

3. **Cash Received :** This refers to the total amount received during the accounting period in respect of hire purchase sales whether they relate to previous years or the current year. This includes the amount of down payment and the amount of instalments paid during the year.

4. **Hire Purchase Debtors :** It is also known as **instalments due but not yet paid' or 'Instalment due, customers paying'.** Thus, it refers to the total amount of such instalments which have fallen due during the accounting period but have not yet been paid by the hire purchase customers. For purposes of profit on hire purchase business, the total of 'cash received' and 'hire purchase debtors' is taken as the 'realised sales' during an accounting period, and not the goods sold on hire purchase.

5. **Hire Purchase Stock** : You know when goods are sold on hire purchase basis, customer makes some down payment and agrees to pay the balance in instalments. Some of these instalments become due during the accounting year when goods were sold to him while others shall become due during the following year/years. The instalments which have not become due during the current year, are called 'instalments not yet due' or 'hire purchase stock'. It should be noted that hire purchase stock does not mean stock of goods in the shop. **It is a special term used for the total amount of instalments which have not become due during the current year.** It represents the unrealised sales and needs adjustment of loading involved. This amount is required for the purpose of ascertaining profit or loss on hire purchase business.

   The amount of 'instalments not yet due' (hire purchase stock) is usually given. But, if it is not given, the same can be worked out with the help of Hire Purchase Trading A/c.

6. **Stock at Shop:** 'Stock at shop' should not be confused with 'hire purchase stock'. You know that hire purchase stock represents the instalments not yet fallen due. But, the stock at shop is a common term used for unsold goods lying in store. The amount of stock at shop is not relevant to the ascertainment of profit or loss of the hire purchase business. This however, can be helpful in ascertaining the cost of goods sold on hire purchase which, in turn, helps the ascertainment of the value of goods sold on hire purchase (if not given) by adding the loading thereto.

12.8 ASCERTAINMENT OF PROFIT

For the ascertainment of profit or loss on goods of small value sold on hire purchase, we have to prepare a 'Hire Purchase Trading Account'. It is just like the Consignment Account prepared for ascertaining the profit/loss on consignment of goods invoiced at selling price. For preparing the Hire Purchase Trading Account, we require the amounts of goods sold on hire purchase, cash received, goods repossessed, hire purchase debtors (both at the beginning and the end), and hire purchase stock (both at the beginning and at the end).

These figures can be extracted from the Hire Purchase Sales Register or the relevant control accounts and taken to Hire Purchase Trading Account by passing the necessary closing entries in the journal. Further, we shall have to ascertain the percentage of loading and the amount of expenses incurred on hire purchase business.

The proforma of Hire Purchase Trading Account is given in Figure 12.2

Hire Purchase Trading Account

Dr.		Cr.	
To H.P. Stock (opening)	...	By Cash Received	...
To H.P. Debtors (opening)	...	By Goods Repossessed (market value)	...
To Goods Sold on H.P (at H.P. price)	...	By H.P. Stock (closing)	...
To Stock Reserve (loading on closing H.P. stock)	...	By H.P. Debtors (closing)	...
To Expenses	...	By Stock Reserve (loading on opening H.P. stock)	...
To Net Profit (transferred to P&L A/c)	...	By Goods Sold on H.P. (loading)	...
	...		...

Fig. 12.2: Proforma of Hire Purchase Trading Account

The proforma of Hire Purchase Trading Account as given in Figure 12.2 is the usual form in which the Hire Purchase Trading Account is prepared. But, it is better to divide it into two parts as shown in Figure 12.3, the first part to contain only those items which are recorded at H.P. price and the second part showing the adjustment of loading and the expenses, losses, etc. relating to hire purchase business for ascertaining the profit or loss.

Hire Purchase Trading Account

Dr.		Cr.	
To H.P. Stock (opening)	..	By Cash Received	...
To H.P. Debtors (opening)	...	By Goods Repossessed (Instalments unpaids)	...
To Goods Sold on H.P (at H.P. price)	...	By H.P. Stock (closing)	...
		By H.P. Debtors (closing)	...
	...		...
To Loss on Goods Repossessed (dif. between market value or cost and unpaid instalments)	....		
To Stock Reserve (loading on closing H.P. stock)	...	By Stock Reserve (loading on opening H.P. stock)	...
To Expenses (on hire purchase business)	...	By Goods Sold on H.P. (loading)	
To Net Profit (transferred to P&L A/c)	...		
	...		...

Fig. 12.3 : Another Proforma of Hire Purchase Trading Account

It should be noted that **the totals of two sides in the first part of the Hire Purchase Trading Account will be equal.** If they are not equal, it would mean that there is some mistake. Not only that, the first part can also help us in finding out the amount of any item which is missing (being the balancing figure) provided all the other figures are given.

Look at illustration 5 and see how profit is ascertained in respect of goods of small value sold on hire purchase with the help of Hire Purchase Trading Account.

Illustration 5

Capital Electronics & Co. started business on 1.1.18 for selling electronic goods on hire purchase basis. During the year end on 31.12.18, the following transactions were made.

a Krishna purchased a T.V. costing Rs. 3,000 at Rs. 4,500 payable Rs. 1,500 as down payment and the balance in 12 monthly instalments of Rs. 250 each,

b) Vim purchased one Grinder costing Rs. 1,000 at Rs. 1,500 payable Rs. 300 as down payment and the balance in 12 monthly instalments of Rs. 100 each,.

c) Arjun purchased a Refrigerator costing Rs. 2,400 at Rs. 3,000 payable Rs. 600 as down payment and the balance in 12 monthly instalment of Rs. 200.

As on 31.12.18, Krishna could not pay one instalment out of the seven instalments due, Vim could not pay one instalment out of the five instalments due, and Arjun could not pay the two instalments out of eight instalments due.

Calculate the profit or loss on Hire Purchase Transactions.

Solution:

Hire Purchase Trading Account

Dr. **Cr.**

	Rs.		Rs.
To Goods Sold on Hire Purchase	9,000	By Cash Received	5,500
		By Goods Repossessed	.....
		By Hire Purchase Stock (closing)	2,750
		By Hire Purchase Debtors (closing)	750
	9,000		9,000
To Stock Reserve (loading on closing H.P. stock)	810	By Goods Sold on Hire Purchase (closing)	2,600
To Net Profit transferred to P & L A/c	1,790		
	2,600		2,600

Working Notes:

a) Goods sold on hire purchase (H.P. Price)

		Rs.
i)	TV purchased by Krishna	4,500
ii)	Grinder purchased by Vim	1,500
iii)	Refrigerator purchased by Arjun	3,000
	Total	9,000

b) Cash received

i)	From Krishna [Rs. 1,500 + (250 × 6)]	3,000
ii)	From Vim [Rs. 300 + (100 × 4)]	700
iii)	From Arjun[Rs. 600 + (200 × 6)]	1,800
	Total	5,500

c) Amount of instalment due but not paid (H.P. Debtors)

i)	From Krishna Rs. 250 × 1	250
ii)	From Vim Rs. 100 × 1	100
iii)	From ArjunRs. 200 × 2	400
	Total	750

d) Amount of instalment which are not due (H.P. Stock)

i)	From Krishna Amount not due Rs. 250 × 5	1,250
ii)	From Vim Amount not due Rs. 100 × 7	700
iii)	From Arjun Amount not due Rs.200 × 4	800
	Total	2,750

e) Loading

i) On goods sold on hire purchase

Hire Purchase Price – Cost Price

= (4,500 + 1,500 + 3,000) – (3,000 + 1,000 + 2,400)

= 9,000 – 6,400

= Rs. 2,600

ii) On hire purchase stock (Closing)

	HP. Stock Rs.	Loading	Rs.
Krishna	1,250	$(\frac{1,500}{4,500} \times 1,250) =$	417
Vim	700	$(\frac{500}{1,500} \times 700) =$	233
Arjun	800	$(\frac{600}{3,000} \times 800) =$	160
		Total	810

12.8.1 Treatment of Goods Repossessed

You know when the hire purchase customer commits default in payment of instalments,the vendor may repossess the goods. The amount of instalments unpaid (also termed as instalments due) in respect of such goods are shown on the credit side of the first part of the Hire Purchase Trading Account as shown in its proforma given in Figure 12.3.

If the market value of such goods is given or they have been sold out immediately on repossession, the difference between the unpaid amount and the market value (or sale value, if sold out) is treated as loss or profit on goods repossessed. If it is loss, the same is debited in the second part of the Hire Purchase Trading Account, and if it is profit (it is rare), the same can be shown on its credit side. **The difficulty arises when the market value or sales value of repossessed goods is not available. In such asituation, you will have to adjust the loading involved in the unpaid instalment in respect of such goods because its true value is equal to its proportionate cost.** Thus, having credited the first part of Hire Purchase Trading Amount with amount of the unpaid instalments, you must debit the amount of loading included in the unpaid instalments. Alternatively, if you are preparing Hire Purchase Trading Account without dividing it into two parts, credit the Hire Purchasing Trading Account with its true value/market value/sale value itself. In that case, no adjustment will be necessary.

Look at illustration 6 and see how goods repossessed have been treated in the Hire Purchase Trading Account.

Illustration 6

Easy Payment Ltd. sells goods on hire purchase basis at a profit of 50% on cost, The following particulars are given for the year ending December 31, 2018. Prepare the Hire Purchase Trading Account.

	Rs.
Hire Purchase Stock (opening)	18,000
Instalments due, customers paying (opening)	10,000
Goods sold on hire purchase during the year (at hire purchase price)	1,74,000
Cash received from customers	1,20,000
Goods repossessed valued at (instalments due Rs. 6,000)	3,000
Hire Purchase Stock at the end	60,000
Instalments due (at the end), customers paying	16,000
Expenses	19,000

Solutions :

Hire Purchase Trading Account

Dr. **Cr.**

Date	**Particulars**	**Amount**	**Particulars**	**Amount**
		Rs.		Rs.
	To Hire Purchase Stock (opening)	18,000	By Cash Received	1,20,000
	To Hire Purchase Debtors (opening)	10,000	By Goods Repossessed (instalments unpaid)	6,000
	To Goods sold on Hire Purchase	1,74,000	By Hire Purchase Debtors (closing)	16,000
			By Hire Purchase Stock (closing)	60,000
		2,02,000		2,02,000
	To Loss on Goods Repossessed (diff. between instalments unpaid and market value)	3,000	By Stock Reserve (Loading on opening H.P. stock)	6,000
			By Goods sold on Hire Purchase (loading)	58,000
	To Stock Reserve (loading on closing H.P. stock)	20,000		
	To Expenses	19,000		
	To Profit & Loss A/c (Profit)	22,000		
		64,000		64,000

Working Notes:

I **Loading**

a) On Opening H.P. Stock $(18,000 \times \frac{50}{150})$ = Rs. 6,000

b) OnGoodsSoldonH.P. $(1,74,000 \times \frac{50}{150})$ = Rs. 58,000

c) OnClosing H.P. Stock $(60,000 \times \frac{50}{150})$ = Rs. 20,000

2 **Loss on Goods Repossessed:** Amount of unpaid instalments - Market Value

= 6,000- 3,000 = Rs. 3,000

Alternatively

Hire Purchase Trading Account

Dr. **Cr.**

	Rs.		**Rs.**
To Hire Purchase Stock (opening)	18,000	By Cash Received	1,20,000
To Hire Purchase Debtors (opening)	10,000	By Goods Repossessed (market value)	3,000
To Goods sold on Hire Purchase (H.P. Price)	1,74,000	By Hire Purchase Debtors (closing)	16,000

To Stock Reserve (loading on closing H.P. stock)	20,000	By Hire Purchase Stock (closing)	60,000
To Expenses	19,000	By Stock Reserve (loading on opening H.P. stock)	6,000
To Net Profit (transferred to P & L A/c)	22,000	By Goods sold on Hire Purchase (loading)	58,000
	2,63,000		2,63,000

12.8.2 Calculation of Missing Figures

Many times some of the figures needed to calculate the profit or loss on sale of goods of small value on hire purchase are missing. These items may be H.P. Stock (at the beginning or at the end), instalments due (opening or closing), purchases, cash received, etc. Therefore, it becomes necessary to first calculate the figures of these items and then prepare the Hire Purchase Trading Account. **If there is only one figure missing, the same can be worked out with the help of the first part of the Hire Purchase Trading Account.** But, if more than one figure is missing, the following steps should be taken for the calculation of the missing figures.

1. Prepare three memorandum accounts in the order mentioned below:
   i) Memorandum Stock at Shop Account,
   ii) Memorandum Stock out with Customers Account or Hire Purchase Stock Account, and
   iii) Memorandum Instalments Due Account or Hire Purchase Debtors Account.
2. Fill up all the figures given.
3. Start with the account having maximum figures available. This will help you to find out the missing figure of that account.
4. Transfer the figure so calculated to the relevant account.
5. Stock at Shop Account shows all figures at cost, whereas Hire Purchase Stock Account and Hire Purchase Debtors Accounts show all figures at hire purchase price. Therefore, while transferring any figure from Stock at Shop Account to the other accounts, the figure should be raised to hire purchase price. Similarly, while transferring any amount from other accounts to the Stock at Shop Account, the figure has to be brought down to cost.
6. The process of transfer will continue until all the amounts are filled in these accounts. The Proforma of the three accounts is given below.

Memorandum Stock at Shop Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d		By Goods Sold on Hire Purchase (at cost)(1)	
To Purchases		By Balance c/d	

Memorandum Hire Purchase Stock Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d		By Instalment Due (2)	
To Goods Sold on Hire Purchase(at HP. price) (1)		By Goods Repossessed (instalments not yet fallen due)	
		By Balance c/d	

Memorandum Hire Purchase Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d		By Cash Received from Customers	
To Stock with Customer Account (total instalments fallen due) (2)		By Goods Repossessed (instalment due but not paid)	
		By Balance c/d	

illustration 7 will help you to understand the calculation of missing figure for the preparation of Hire Purchase Trading Account.

Illustration 7

Home Appliances Ltd sells goods on hire purchase terms at a profit of 25% on hire purchase price. Following are the transactions for the year ended December 31, 2018.

		Rs.
January, 1	Stock out on hire at cost	6,000
	Stock on hand (at shop)	1,000
	Instalment due	600
	Cash Received	16,000
December, 31	Stock out on hire (at cost)	6,900
	Stock on hand (at shop)	1,400
	Instalment due	1,000

Calculate the profit or loss on hire purchase under Debtors Method.

Hire Purchase Trading Account

Dr.			Cr.
	Rs.		Rs.
To Stock with Customers	8,000	By Cash Received	16,000
To Instalment Due	600	By Stock with Customers	9,200
To Goods Sold on Hire Purchase	17,600		

		By Instalment Due	1,000
	26,200		26,200
To Stock Reserve (loading)	2,300	By Stock Reserve (loading)	2,000
To Profit & Loss A/c (Profit)	4,100	By Goods sold on Hire Purchase (loading)	4,400
	6,400		6,400

Working Note :

Calculation of Missing Figure :

Memorandum Stock at Shop Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d	1,000	By Stock with Customers	13,200
To Purchases (balance figure)	13,600	By Balance c/d	1,400
	14,600		14,600

Memorandum Stock with Customers Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d	8,000	By Instalment Due	16,400
To Stock at Shop (at hire purchase price) (missing figure)	17,600	By Balance c/d	9,200
	25,600		25,600

Memorandum Instalments Due Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d	600	By Cash Received	16,000
To Stock with Customers (missing figure)	16,400	By Balance c/d	1,000
	17,000		17,000

Check Your Progress B

1. Fill in the blanks

   i) The accounting treatment of goods of small value is recorded in the books of …………..only.

   ii) The vendor maintains a ……………….register.

iii) The vendor prepares …………………Account to calculate profit or loss on hire purchase business.

iv) Goods sold on hire purchase are shown on the …………………side of the Hire Purchase Trading Account.

v) Loss on goods repossessed by the vendor is equal to the difference between the market value of the goods repossessed and the…… in respect of such goods.

vi) Three Accounts prepared for the calculation of missing figures are stock at Shop Account, ……………Account and Instalments Due Account.

2. What do you understand by Hire Purchase Debtors?

....

....

....

....

3. What do you mean by Hire Purchase Stock?

....

....

....

12.9 STOCK AND DEBTORS SYSTEM

The profit or loss for an accounting period on goods of small value sold on hire purchase basis can also be ascertained by another method called 'Stock and Debtors System'. This system is similar to the system followed in case of branch accounts. Under this system, we make use of the four control accounts viz (i) Hire Purchase Stock Account, (ii) Hire Purchase Debtors Account, (iii) Goods Sold on Hire Purchase Account, and (iv) Goods Repossessed Account; and prepare Hire Purchase Adjustment Account for working out the profit or loss on the hire purchase business. **The Hire Purchase Adjustment Account is similar to the second part of the Hire Purchase Trading Account** wherein entries are made for the loading involved in the goods sold on hire purchase and the opening and closing balances of hire purchase stock (instalments not yet due), and shows the expenses and losses re1ating to the hire purchase business. The balancing figure in the Hire Purchase Adjustment Account represents the profit or loss on the hire purchase business.

The following journal entries are passed under this system to open the necessary accounts in the ledger.

1. **For goods sold on hire purchase**
   Hire Repossessed A/c Dr.
   To Goods sold on H.P. A/c

2. **For total instalments due during the year**
   Hire Purchase Debtors A/c Dr
   To Hire Purchase Stock A/c

3. **For cash received**
   Cash A/c Dr.
   To Hire Purchase Debtors A/c

4. **For goods repossessed (unpaid instalments)**
   Goods Repossessed A/c Dr.
   To Hire Purchase Stock A/c

5. **For loading on goods sold on H.P.**
   Goods sold on H.P. A/c Dr.
   To Hire Purchase Adjustment A/c

6. **For loading on opening H.P. stock**
   Stock Reserve A/o Dr.
   To Hire Purchase Adjustment A/c

7. **For loading on closing H.P. stock**
   Hire Purchase Adjustment A/c Dr.
   To Stock Reserve A/c

8. **For loss on goods repossessed**

   Hire Purchase Adjustment A/c Dr.
   To Goods Repossessed A/c
   (With difference between instalments unpaid and market value of goods repossessed or for loading only)

9. **For expenses on hire purchase business**
   Hire Purchase Adjustment A/c Dr.
   To Expenses A/c

10. **For transfer of profit on hire purchase business**
    Profit & Loss A/c Dr.
    To Hire Purchase Adjustment A/c

    In case of loss, the entry can be reversed

11. **For closing goods sold on Hire Purchase Account**
    Goods Sold on H.P. A/c Dr.
    To Trading (Stock at shop) A/c

Look at illustrations 8 and 9 and see how profit or loss is ascertained with the help of control accounts under the Stock and Debtors System.

Illustration 8

Prepare necessary accounts in the books of S.S.K. & Co. who sold goods at a profit @ 25% on cost price, with the help of the following information. Follow Stock and Debtors System.

Stock in Shop

On 1.4.18	15,000
On 31.3.19	12,500
Goods with customers on hire purchase on 1.4.18	18000
Purchases for shop stock	32,300
Goods sold on H.P. during the year 18-19	43,500
Instalments received	30,000

Overdue Instalments

On 1.4.18	1,000
On 31.3.19	1,500

Solution:

Hire Purchase Stock Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	18,000	By Hire Purchase Debtors A/c (1)	30,500
To Goods Sold on Hire Purchase A/c	43,500	By Balance c/d	31,000
	61,500		61,500
To Balance b/d	31,000		

Hire Purchase Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	1,000	By Bank A/c	30,000
To Hire Purchase Stock A/c (1) (amount of instalments due-balancing figure)	30,500	By Balance c/d	1,500
	31,500		31,500
To Balance b/d	1,500		

Goods Sold on Hire Purchase Account

Dr.			Cr.
	Rs.		Rs.
To Hire Purchase Adjustment A/c	8,700	By Hire Purchase Stock A/c	43,500
To Shop Stock	34,800		
	43,500		43,500

Hire Purchase Adjustment Account

Dr.			Cr.
	Rs.		Rs.
To Stock Reserve A/c (loading on closing H.P. Stock)	6,200	By Stock Reserve A/c (loading on opening H.P.stock)	3,600
To Profit & Loss A/c (balancing figure)	6,100	By Goods Sold on H.P. A/c (loading)	8,700
	12,300		12,300

Working Notes:

Loading is 25% on cost. The figures of items on which loading is to be calculated are given at H.P. price. Hence, the loading on various items has been calculated as follows:

i) On goods sold on H.P. $= 43,500 \times \frac{25}{125}$ = Rs. 8,700

ii) On opening H.P. stock $= 18,000 \times \frac{25}{125}$ = Rs. 3,600

iii) On closing H.P. stock $= 31,000 \times \frac{25}{125}$ = Rs. 6,200

Illustration 9

Taking the information from illustration 6, ascertain the profit on hire purchase business by following the Stock and Debtors system

Hire Purchase Stock Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d (at hire purchase price)	18,000	By Hire Purchase Debtors A/c (balancing figure)	1,28,000
To Goods Sold on Hire Purchase A/c (at hire purchase price)	1,74,000	By Goods Repossessed A/c	6,000
		By Balance c/d (at hire purchase price)	60,000
	1,92,000		1,92,000
To Balance b/d	60,000		

Hire Purchase Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Balance b/d	10,000	By Cash A/c	1,20,000
To Hire Purchase Stock A/c. (total instalment due— balancing figure)	1,26,000	By Balance c/d	16,000
	1,36,000		1,36,000
To Balance b/d	16,000		

Goods Repossessed Account

Dr.			Cr.
	Rs.		Rs.
To H.P. Stock A/c	6,000	By H.P. Adjustment A/c (loss being the diff. between instalments unpaid and its market value)	3,000
		By Balance c/d	3,000
	6,000		6,000
To Balance b/d	3,000		

Hire Purchase Adjustment Account

Dr. **Cr.**

	Rs.		Rs.
To Stock Reserve A/c (loading on closing H.P. stock)	20,000	By Stock Reserve A/c (loading on opening H.P. Stock)	6,000
To Loss on Goods Repossessed (diff. between instalment due and market price)	3,000	By Goods Sold on Hire Purchase A/c (loading)	58,000
To Expenses A/c	19,000		
To Profit & Loss A/c	22,000		
	64,000		64,000

Check Your Progress C

1. Fill in the blanks:

   i) Hire Purchase Adjustment Account shows the ……….on the opening and closing stocks, and the goods sold on hire purchase.

   ii) Hire Purchase Debtors Account is credited with the closing balance and……….

   iii) The Goods Sold on Hire Purchase are shown at …………in Shop Stock Account.

   iv) The loss on goods repossessed is shown on the debit side of …………………. Account.

   v) The balance of ……………Account represents the value of stock with customers at ………………………. Price.

2. List the accounts opened for ascertaining the profit or loss on hire purchase business under the Stock and Debtors System.

   ....

   ....

   ....

12.10 LET US SUM UP

Under the hire purchase agreement, the hire vendor delivers only the physical possession of the goods to the buyer (the hirer) and not the title of the goods. Title passes when the payment of the last instalment is made. If the buyer makes default, the hire vendor has the right to repossess the goods. But the vendor can also enter into a compromise and repossess a part of the goods. When, on default by the buyer, the vendor repossesses only a part of the goods, he reassesses its value and adjusts the same against the amount due from hirer.

The basic difference between the hire purchase system and the instalment payment system relates to the point of time when the title of the goods passes from the seller to the buyer. In case of hire purchase system, the title of the goods passes at the time of payment of the last instalment while in case of instalment payment system it passes at the time of signing the contract. Accounting treatment in both systems is more or less the same. The only difference relates to the treatment of interest. In case of hire purchase system, the actual amount of interest is debited to the purchaser as and when the instalments fall due. But, in case of instalment payment system, the buyer is debited with the total amount of interest right at the time of sale by crediting it to Interest Suspense Account. This account is debited with the actual amount of interest as and when the instalments fall due. Under this system, the buyer is treated as a debtor for the full amount including total interest. However, in practice, even this may be dispensed with.

When the goods of small value are sold on hire purchase terms, a special accounting treatment is required. The accounting records of sale of such goods are maintained by the vendor only. He keeps a Hire Purchase Sale Register with appropriate columns. The totals of these columns are posted in different control accounts periodically.

There are two methods of ascertaining profit or loss on goods of small value sold on hire purchase. They are (i) Debtors method under which Hire Purchase Trading Account is prepared, and (ii) Stock and Debtors Method.

The Hire Purchase Trading Account is like Consignment Account; the first part of which shows the opening H.P. stock, opening H.P. debtors and the goods sold on hire purchase on the debit side; and cash received, goods repossessed and closing H.P. stock and H.P. debtors on the credit side. The total of these two sides should be equal. Its second part mainly shows the loading on goods sold on hire purchase, loading on opening and closing stocks, the loss on goods repossessed and the expenses on hire purchase business. The difference represents the profit or loss on hire purchase business which is transferred to the Profit & Loss Account.

Sometimes, certain items needed to prepare Hire Purchase Trading Account may be missing. These can be ascertained by preparing three memorandum accounts (i) Stock at Shop Account, (ii) Stock with Customers Account, and (iii) Instalments Due Account. If, however, only one item is missing, it can be ascertained directly from the first part of the Hire Purchase Trading Account.

Under Stock and Debtors Method, the accounts prepared for ascertaining the profit or loss on hire purchase business are : (i) Goods sold on Hire Purchase Account, (ii) Hire Purchase Stock Account, (iii) Hire Purchase Debtors Account, (iv) Goods Repossessed Account, and (v) Hire Purchase Adjustment Account. The Hire Purchase Adjustment Account is nothing but the second part of Hire Purchase Trading Account which shows the profit or loss on Hire Purchase sale. It is similar to Branch Adjustment Account prepared in case of branch accounts.

12.11 KEY WORDS

Default: Failure on the part of the hirer (the buyer of the goods) to pay instalment.

Instalment Sale: An ordinary sale transaction where the payments are made on deferred terms, but the buyer becomes the owner of the goods immediately on completion of the transaction.

Passing of Title: Transfer of ownership.

Seizure: Repossession of goods within the provision of the law. A hire purchase agreement may give the right to the hire vendor to seize the goods he has sold if the hirer (the buyer) makes default in payment of instalments.

Control Accounts: Accounts prepared with aggregate figures to check the accuracy of respective accounts-like H.P. Stock. H.P. Debtors, etc.

Hire Purchase Debtors: Amount of instalment due but not yet paid.

Hire Purchase Stock: Instalments not yet fallen due.

Hire Purchase Trading Account: An account prepared for ascertaining the profit or loss on goods of small value sold on hire purchase basis.

Stock Reserve: Amount of loading involved in hire purchase stock.

Stock at Shop: Stock of unsold goods lying in the store.

12.12 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) failure ii) physical holding iii) recovery, possession iv) terminated, seize, v) damages vi) title, initial payment.

2. i) False ii) True iii) False iv) True v) False

B 1. i) vendor ii) hire purchase sales iii) hire purchase trading iv) debit v) instalment unpaid vi) stock with customers.

C 1. i) loading ii) cash received iii) cost iv) hire purchase adjustment v) hire purchase stock, hire purchase.

12.13 TERMINAL QUESTIONS/EXERCISES

Questions

1. Explain the terms 'Default' and 'Repossession' both in relation to a hire purchase transaction and an instalment sale transaction.
2. What are the rights of a hire vendor in case of default under the Hire Purchase Act, 1972?
3. What are the rights of hirer in case of seizure and repossession of goods under the Hire Purchase Act, 1972?
4. Describe the difference between the accounting treatment under the hire purchase system and the instalment payment system.
5. Discuss in detail the similarities and dissimilarities of Hire Purchase System and Instalment Payment System.
6. Describe how you can keep a detailed record of individual transactions in subsidiary book.
7. State the journal entries passed to open various accounts under Stock and Debtors System as applicable to hire purchase business.
8. Distinguish between 'Stock and Debtor System' and 'Hire Purchase Trading A/c Method' (Debtors System) of ascertaining profit or loss on goods of small value sold on hire purchase basis.

Exercises

I. PQR Ltd. sold a piece of Machinery to RST Ltd. on 1.1.15 under a hire purchase agreement. The payments were to be made in four annual instalments of Rs. 4,230 each at the end of each year. The rate of interest @ 5% was to be charged. RST Ltd. defaulted at the time of the third instalment and POR Ltd. repossessed the machinery. RST Ltd. charged depreciation @ 10% p.a. on W.D.V. method.

Show necessary ledger accounts in the books of RST Ltd.

(**Answer :** Cash Price Rs, 15,000, Total Interest Rs. 1920, Loss on repossession Rs. 2,676).

2. Karim Ltd. purchased some furniture from Solman Ltd. on hire purchase system on 1.1.17 at a cash price of Rs. 60,000, of this Rs. 15,480 was to be paid as down payment and the balance in five annual instalments of Rs. 10,000 each. The rate of interest was charged @ 4% p.a. Karim Ltd., could only pay the first instalment and, on default, Solman Ltd. repossessed the goods which were revalued by charging depreciation @ 15% p.a. on straight line method. On 1.3.19 Solman Ltd. incurred Rs. 1,500 for reconditioning of the goods and sold them at Rs. 45,000.

Show the ledger accounts in the books of Solman Ltd.

(**Answer:** Amount due from Karim Ltd. on 31.12.18 Rs. 37,753; Profit taken to P & L A/c in 2018 Rs. 4,247 : Profit on resale in 2019 Rs. 1,500.)

3. Fair Ltd. purchased on 1.1.16 machinery valued at Rs. 12,000 from Unfair Ltd. under a hire purchase system under which the payments were to be made in three equal annual instalments of Rs. 4,000. The interest @ 6% p.a. was to be charged and paid along with the instalments. Fair Ltd. could not pay the second instalment and it was agreed that Unfair Ltd. would partly repossess Machinery costing Rs. 8,000 at Rs. 4,500 provided Fair Ltd. paid the arrear interest to-date. Show ledger accounts in the books of Fair Ltd. assuming that depreciation @ 10% p.a. was charged on W.D.V. method.

(**Answer:** Loss on partial repossession Rs. 1,980, value of the machinery carried forward Rs. 3,240. Total amount of interest paid Rs. 1,200).

4. Ajay purchased five trucks on hire purchase on July 1, 2016. The cash price of each truck was Rs. 1,00,000. He was to pay 25% of the cash price as down payment with the delivery and the balance in five yearly instalments together with the interest @ 5% per annum. Ajay fails to pay the third instalment due on June 30, 2019. It was agreed that two trucks would be returned to the vendor and the value of these two trucks would be adjusted against the amount due. The trucks to be returned will be valued at depreciation of 25% p.a. on W.D.V. method. The repossessed trucks were overhauled at a cost of Rs 4,000 and sold for Rs. 90,000.

Show the necessary ledger accounts in the books of both the parties. Books are closed on June 30 every year and depreciation @ 20% per annum is charged.

(**Answer:** Goods Repossessed Rs. 84,375. Loss on Goods repossessed Rs. 18,025. Balance due to Hire Vendor Rs. 1,88,297)

5. Harish purchased from Ramesh some motor pumps on 1.1.17 under instalments payment system. The cash price was Rs. 74,466 which was to be paid Rs. 20,000 as down payment and the balance in three equal annual instalments of Rs. 20,000 including interest @ 5% p.a.

   Show the ledger accounts in the books of Harish and Ramesh assuming depreciation @ 10% p.a. on straight line method.

   (**Answer:** Total Interest for Interest Suspense A/c Rs. 5,534 adjusted Rs. 2,723 in 2017, Rs. 1,859 in 2018 and Rs. 952 in 2019).

6. Lokesh purchased on 1.1.17 some machinery from Suresh under instalment payment system under which Rs. 6,000 was to be paid as down payment and the rest in 3 equal annual instalments at interest @ 5%. The cost price was Rs. 22,350. Depreciation was charged @ 10% on W.D.V. method.

   Show the ledger accounts in the books of both the parties.

   (**Answer:** Total interest for Interest Suspense A/c Rs. 1,650 adjusted as Rs. 818 in 2017, Rs. 558 in 2018 and Rs. 274 in 2019)

7. Premier Trader Co., a hire vendor, furnished the following information for the year ended 31.12.2018.

	Rs.
Goods with hire purchase Customers (at hire purchase price) on 1.1.2018	32,000
Goods sold on hire purchase during the year (at hire purchase price) ,	1,60,000
Cash received during the year	1,12,000
Goods received back (instalments unpaid Rs. 4,000) at market value	600
Goods with hire purchase customers (at hire purchase price) on 31.12.2018	72,000

   Prepare Hire Purchase Trading Account in the books of Premier Trader Co. who sold goods on hire purchase at cost plus 60%.

   (Answer: Profit Rs. 41,600; Missing figure : H.P. Debtors at the end of Rs. 4,000)

8. From the following transactions of Lee Ltd., a hire vendor, prepare the necessary accounts under Debtors Method in its books for the year ended 31.12.18. The goods are sold at cost plus $33\frac{1}{3}\%$

		Rs.
January 1, 2018	Stock in the shop	2,000
	Instalments due	1,200
	Stock with customers at H.P. price	16,000
December 31.12.18	Stock in the shop	2,800
	Instalments due and unpaid	2,000
	Stock with customers at H.P. price	18,400
	Cash received during the year	32,000
	Expenses on hire purchase business	3,000
	Purchases	27,200

(Answer: Goods sold on Hire Purchase at H.P. price Rs. 35,200; Profit Rs. 5,200)

9. H.C. Sales, a hire vendor, was engaged in hire purchase business. The following information is provided to you for the year ended December 31, 2018, in respect of his business.

January 1, 2018	Stock with Customers at H.P. price	4,500
	Instalment due	2,500
December 31,2018	Cash received form customers	30,000
	Goods repossessed (instalments due Rs. 1,000) at market value	650
	Instalment due	4,500
	Goods sold on hire purchase	43,500

Prepare necessary accounts under Stock and Debtors System assuming H.P. Price at cost plus50%.

(**Answer:** Net profit Rs. 10,650; missing figure H.P. Stock at end Rs. 15,000)

10. Following information was available for the year ended June 30, 2018, in respect of Auto Dealers Ltd. who was engaged in hire purchase business. Calculate the amount of profit under Stock and Debtors Method.

July 1, 2017	Instalments due	4,000
	Stock, at shop	12,000
	Stock out with customers (at H.P.Price)	25,000
	Cash received during the year	2,00,000

	Purchases	1,67,000
	Goods repossessed (instalments due Rs. 3,000) valued at	500
June 30, 2018	Instalments due	6,000
	Stock at shop	11,000
	Stock out with customers (at H.P. Price)	30,000

The goods were sold on purchase at 20% on hire purchase price.

(**Answer** : Profit Rs. 38,500)

11. Girdhari also sells goods on hire purchase basis. The hire purchase price is fixed by adding 50% to the cost. The following are the figures relating to his hire purchase business for the year 2018.

	Rs.
H.P. Stock as on 1.1.2018	36,000
H.P. Debtors as on 1.1.2018	900
Goods sold on hire purchase at H.P. price	2,71,800
Cash received during the year	2,77,200
Total amount of instalments that fell due during 2018	2,78,100

A customer to whom goods had been sold for Rs. 3,600 paid three instalments of Rs. 300 each. His fourth instalment fell due on December 1, 2018 which he failed to pay. Consequently, the goods were repossessed on December 27, 2018 after due legal notice. Prepare the necessary accounts under the Stock and Debtors System for the year ending December 31, 2018.

(**Answer:** Profit Rs. 92,600; Missing figures; H.P. Stock at the end Rs. 27,300 and H.P. Debtors at the end Rs. 1,500 after crediting Rs. 2,400 and Rs. 300 for goods repossessed.)

12.14 SOME USEFUL BOOKS

Maheshwari. S.N., 2018: ***Introduction to Accounting*** Vikas Publishing House, New Delhi.

MongaJ.R..Ahuja G.C. & Ashok Sehgal, 2018 :***Advanced Accounting*** National Publishing House Sew Delhi.

William Pickes, 2002, *Accountancy,* E.L.B.S. and Pitman, London

Gupta R L. and M. Radbaswamy, 2018.***Advanced Accounting*** Sultan Chand & Sons, New Delhi

Shukla.M.C..Grewal T.S. & S.C. Gupta, 2018 ***Advanced Accounts*** S. Chand & Co. Ltd., New Delhi.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 13 BRANCH ACCOUNTS-I

Structure

13.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the need for branch accounting;
- explain the different types of branches from accounting point of view;
- describe three systems of maintaining branch accounts for a dependent branch;
- prepare branch account under the debtors system both at cost price and at invoice price;
- prepare branch account under the final accounts system; and
- prepare the necessary accounts under the stock and debtors system.

13.1 INTRODUCTION

A business may be split up into a number of divisions. The divisions are known as departments if located under the same roof. On the other hand, if divisions are located at different places of the same town, country or world, they are called branches. For example, Cottage Emporium has various divisions like garments, furniture, gift items, jewellery, etc. They are located in the same building and so are called departments. Snowhite has its showrooms in Connaught Place, Nehru Place, Karol Bagh, South Extension and Kamlanagar. These are all branches of Snowhite. Similarly, Bata has its branches all over the country and Leventies all over the world. Each branch is treated as a separate profit centre and hence the profit or loss is to be worked out separately for each branch. Moreover, the firm has to keep strict control over various activities of each branch and ensure its smooth functioning. The accountants, therefore, have developed some specialised accounting methods for the recording of transactions at branch level and for incorporating the net effect of all branch transactions in the firm's books.

From accounting point of view, the branches are divided into three categories (i) dependent branches, (ii) independent branches, and (iii) foreign branches. In this unit, you will learn how the accounts of dependent branches are maintained and how their profit or loss is worked out.

13.2 NEED FOR BRANCH ACCOUNTING

As stated earlier, each branch is treated as a separate profit centre. Hence, it should record various transactions in such a manner that its profit or loss can be worked out and incorporated in the firm's overall results at the end of the accounting year. Moreover, the branches conduct all activities under the direction and control of the head office which may need a variety of information from time to time about the functioning of each branch. This becomes possible only if the branches keep proper books of account. Thus, the main reasons of keeping branch accounts can be summarised as follows :

i) to find out the profit or loss of each branch for the accounting period;

ii) to ascertain the financial position of each branch at the end of the accounting year;

iii) to incorporate the net effect of branch transactions and their assets and liabilities in a firm's final accounts;

iv) to estimate requirements of cash and stock for each branch;

v) to evaluate the progress and performance of each branch;

vi) to calculate the commission for payment to the managers, if based on profit of branch;

vii) to assess the prospects for expansion of business in each branch; and

viii) to meet audit requirements.

13.3 TYPES OF BRANCHES

From accounting point of view, the branches can be divided into the following categories:

1) Branches not keeping full system of accounting;

2) Branches keeping full system of accounting;

3) Foreign branches.

Let us have an idea about their main characteristics.

Branches not Keeping Full System of Accounting: The branches not keeping full system of accounting are also called dependent branches. The main features of such branches are:

i) They sell only those goods which are received from the head office and are not usually allowed to make purchases in the open market except with the permission of the head office.

ii) Goods are supplied by the head office to such branches either at cost price or at invoice price.

iii) All major expenses of the branch are paid by the head office. The branch manager is allowed to incur only petty expenses like cartage, postage, etc. out of the petty cash provided to him for which he is required to maintain a simple petty cash book.

iv) The amount received from cash sales and debtors is either remitted to the head office daily or deposited in the account of head office in some local bank.

v) The branch manager is normally expected to sell the goods for cash, but he may be authorised to sell goods on credit in certain cases.

vi) Such branches do not keep complete books of account. They simply maintain record of sales and prepare debtors accounts, if necessary. They are also required to maintain a stock register and furnish weekly or monthly statements giving complete information about stock position and movement of goods to the head office. This enables the head office to keep proper control over stock at branches.

Branches Keeping Full System of Accounting: Branches keeping full system of accounting are called independent branches. They are allowed to purchase goods from the market and also supply to the head office, if necessary. They can incur expenses from the cash realised and operate the bank account in their own names. Thus, they operate as independent units for all practical purposes. Their only link with the head office is that they are owned by the head office and whatever profit they earn or loss they incur ultimately belongs to the head office.

Such branches keep a complete set of books on the double entry system and prepare their own Trial Balance, Trading and Profit & Loss Account and Balance Sheet. Such branches open Head Office Account in their books and record all transactions between the branch and the head office in this account.

Foreign Branches: When a branch is located in a foreign country, it is called a foreign branch. Such branches will keep their books of account in foreign currency. The Distinctive feature of foreign branches is that financial information received from them will be in foreign currency which has to be converted into the currency of the country of the head office before it is incorporated in the head office books. For example, if an Indian company has a branch in Nairobi, the branch Trial Balance will be in Kenyan shillings. The Trial Balance must be converted into rupees before it can be incorporated in head office books. For all practical purposes, however, foreign branches are treated as independent branches.

Look at Figure 13.1 for complete classification of branches.

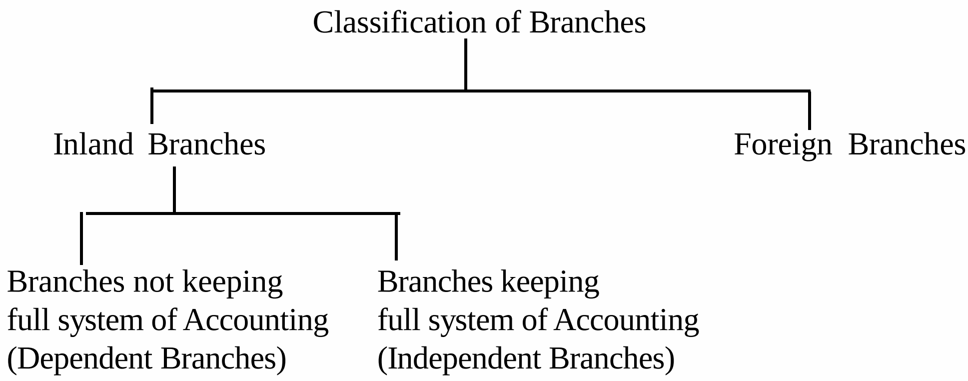


Fig. 13.1

13.4 ACCOUNTING FOR DEPENDENT BRANCHES

You know that the dependent branches do not keep a complete set of books. Most of their transactions are recorded at the head office level. The accounting system adopted by head office for a branch depends up on the size of a branch and the degree of control to be exercised by the head office. The following are the various methods by which the head office usually keeps branch accounts in its books:

i) **Debtors System:** This system is adopted generally for those branches which are fairly small in size. Under this system, the head office simply opens a Branch Account for each branch in which it records all transactions relating to the branch. The Branch Account is prepared in such a manner that it also helps in ascertaining the branch profit or loss.

ii) **Final Accounts System:** Under this system, the head office prepares a Trading and Profit and Loss Account in order to find out profit or loss of each branch and a Branch Account to find out the amount due to, or due from that branch. In this case, the Branch Account simply acts as a personal account.

iii) **Stock and Debtors System:** Under this system, the head office does not open any Branch Account. For each branch, it prepares a Branch Stock Account, a Branch Expenses Account, a Branch Adjustment Account and Goods sent to Branch Account in order to find out the profit or loss of each branch.

13.5 DEBTORS SYSTEM

As stated earlier, under debtors system, the head office simply opens a Branch Account for each branch in which it records all transactions relating to the branch. The Branch Account also helps in ascertaining the profit or loss of the branch.

Goods may be invoiced to a branch at cost or at selling price (also called invoice price). Accordingly, there are two methods of preparing the Branch Account: (1) Cost Price Method, and (ii) Invoice Price Method. Let us now study the preparation of Branch Account under both of these methods.

13.5.1 Cost Price Method

When goods are invoiced at cost, the following journal entries are passed in the books of the head office to record various transactions relating to the branch.

1) **For Goods sent to Branch**
   Branch A/c Dr.
   To Goods Sent to Branch A/c
   (Being goods sent to branch)

2) **For return of goods to head office**
   Goods Sent to Branch A/c Dr
   To Branch A/c
   (Being goods returned by the branch)

3) **For amount sent to branch for expenses**
   Branch A/c Dr.
   To Bank A/c
   (Being cheque sent to branch for expenses)

4) **For amount received from branch**
   Bank A/c Dr.
   To Branch A/c
   (Being cash or cheque received from branch)

5) **For closing goods sent to branch account**
   Goods Sent to Branch A/c Dr.
   To Purchases/Trading A/c
   (Being balance transferred to Trading Account)

6) **For closing balances of assets at the branch**
   Branch Assets A/c (Individually) Dr.
   To Branch A/c
   (Being closing balances of assets brought into account)

7) **For closing balances of liabilities at the branch**
   Branch A/c Dr.
   To Branch Liabilities A/c (Individually)
   (Being closing balances of liabilities brought into account)

8) **For transferring profit or loss to the General Profit and Loss Account**

   i) If profit
   Branch A/c Dr.
   To General Profit and Loss A/c
   (Being branch profit transferred to General P & L A/c)

   ii) If loss
   General Profit and Loss A/c Dr.
   To Branch A/c
   (Being branch loss transferred to General P & L A/c)

The closing balances of branch assets and liabilities are shown in the Balance Sheet of the head office. At the beginning of the next year, the entry numbers 6 and 7 are reversed so as to show opening balances in the Branch Account.

The Branch Account will appear as given in Figure 13.2.

Figure 13.2

Branch Account

Dr.		Cr.	
To Opening Balances		**By Opening Balances**	
Stock		Creditors	
Debtors		Outstanding expenses	
Petty Cash		**By Bank**	
Furniture		Cash Sales	
Prepaid expenses		Collections from Debtors (for remittances)	
To Goods Sent to Branch A/c		By Goods Sent to Branch A/c (goods returned by the branch to head office)	
To Bank A/c (for expenses of any payment made by the H.O. on behalf of the Branch)		**By Closing Balance**	
To Closing Balances		Petty Cash	
Outstanding expenses		Stock	
Creditors		Debtors	
To Profit, if any (transferred to General Profit & Loss A/c)		Furniture (at depreciated value)	
		Prepaid Expenses	
		By Loss, if any (transferred to General Profit & Loss A/c)	

Look at illustrations 1 and 2 and study how Branch Account is prepared with the help of the given information.

Illustration 1

From the following particulars relating to Delhi Branch for the year ending December 31, 2018, prepare Branch Account in the books of head office.

	Rs.			Rs.
Stock at Branch on 1-1-2018	15,000	Cheques sent to Branch:		
Debtors at Branch on 1-1-2018	30,000	Salaries	9,000	
Petty Cash at Branch on 1-1-2018	300	Rent and Taxes	1,500	
Goods sent to Branch	2,52,000	Petty Cash	1,100	11,600
Cash sales	60,000	Goods returned by branch		2,000
Received from Debtors	2,10,000	Stock at Branch on 31-12-2018		25,000
Credit Sales	2,28,000	Petty Cash at Branch on 31-12-2018		200
		Debtors at Branch on 31-12-2018		48,000

Solution:

Head Office Ledger
Delhi Branch Account

Dr.		Rs.	Cr.		Rs.
To Balance b/d			By Cash:		
Branch Stock		15,000	Cash Sales	60,000	
Branch Debtors		30,000	Received from		
Branch Petty Cash		300	Debtors	2,10,000	2,70,000
To Goods sent to Branch A/c		2,52,000			
To Bank A/c			By Goods sent to Branch A/c		2,000
Salaries	9,000				
Rent & Taxes	1,500				
Petty Cash	1,100	11,600	By Balance c/d		
To Profit (transferred to General			Branch Stock		25,000
P & L A/c)		36,300	Branch Debtors		48,000
			Branch Petty Cash		200
		3,45,200			3,45,200

Illustration 2

Sankat Mochan Ltd., Varanasi opened a branch at Madras on January 1, 2018. The following particulars are available in respect of the branch for the year 2018.

	Rs.		Rs.
Goods sent to branch	75,000	Cash remittance to branch towards Petty Cash	6,000
Cash sales at branch	50,000	Petty Cash at branch on 31-12-2018	500
Credit sales at branch	60,000	Debtors at branch on 31-12-2018	5,000
Salaries of branch staff paid by Head Office	15,000	Stock at branch on 31-12-2018	27,000
Office expenses of branch paid by Head Office	12,000		

Prepare Branch Account to show the profit/loss from the branch for the year 2018.

Solution

Books of Sankat Mochan Ltd. Madras Branch Account

Dr.		Rs.	Cr.		Rs.
To Goods sent to Branch A/c		75,000	By Bank A/c		
To Bank A/c			Cash Sales	50,000	
Salaries	15,000		Received from Debtors	55,000	1,05,000
Office expenses	12,000	27,000			
To Bank A/c (for petty expenses)		6,000	By Balance c/d:		
To Profit (transferred to General			Branch Petty Cash		500
P & L A/c)		29,500	Branch Debtors		5,000
			Branch Stock		27,000
		1,37,500			1,37,500

Note: The amount of cash received from debtors is not given. It has been found by preparing the Memorandum Branch Debtors Account as follows:

Memorandum Madras Branch Debtors Account

Dr. **Cr.**

	Rs.		Rs.
To Credit Sales	60,000	By Cash Received (balancing figure)	55,000
		By Balance c/d	5,000
	60,000		60,000

Some Peculiar Items

Petty cash expenses: No entry is made in respect of petty cash expenses incurred by the branch out of its petty cash. As per practice, the Branch Account is debited with the opening balance of petty cash and the amount of petty cash sent by Head Office, and it is credited with the closing balance of petty cash. **This amounts to a net debit to Branch Account which is equal to the amount of petty expenses incurred by branch.** For example, the opening balance of petty cash with a branch was Rs. 200, the cash sent by Head Office for petty expenses was Rs. 300 and the petty expenses incurred by branch were Rs. 400. When we debit the Branch Account with Rs. 200 (opening petty cash balance) and Rs. 300 (amount sent by head office) and credit it with Rs. 100 (closing petty cash balance), the Branch Account stands debited by a net amount of Rs. 400 (Rs. 200 + Rs. 300 — Rs. 100) which is equal to the amount of petty cash expenses (Rs. 400) incurred by the branch.

Credit sales, sales returns, bad debts, discount allowed to debtors etc. : All these items relate to branch debtors and will not be shown in the Branch Account. The reasoning is similar to that of petty cash expenses. When the Branch Account is debited with the opening balance of branch debtors and credited with cash received from debtors and the closing balance of branch debtors, the amount of credit sales automatically stand accounted for.

Shortage or surplus of stock: It is possible that, at the time of checking the stock of a branch, certain amount of shortage or surplus is detected. These are not to be shown in the Branch Account because the closing stock credited to the Branch Account is the actual amount of stock and thus the shortage or surplus is automatically covered.

Depreciation of fixed assets: This is also not shown in the Branch Account because, as per practice, the closing balance of the fixed asset after deducting the amount of depreciation is shown on the credit side of the Branch Account.

Thus you should note that while preparing the Branch Account for dependent branches, the following Items will be ignored:

1) Petty Cash Expenses
2) Credit Sales
3) Sales Returns
4) Bad Debts

5) Discount Allowed to Debtors

6) Shortage or Surplus of Stock

7) Depreciation

Look at illustration 3 and see how Branch Account is prepared without specifically showing the above items, if given.

Illustration 3

Pratap Tractors Ltd., Allahabad, has a branch at Hissar. From the following particulars relating to the branch for the year ending December 31, 2018, prepare the Branch Account in the head office books:

Stock at Branch on 1-1-2018	10,000	Discount allowed to Debtors	100
Branch Debtors on 1-1-2018	4,000	Cash sent to Branch:	
Petty Cash on 1-1-2018	500	Rent	2,000
Furniture on 1-1-2018	2,000	Salaries	2,400
Prepaid Insurance on 1-1-2018	150	Petty Cash	1,000
Salaries Outstanding on1-1-2018	1,00,000	Insurance (upto 31-3-2019)	600
Goods sent to Branch	80,000	Good Returned by Branch	1,000
Cash Sales	30,000	Good Returned by Debtors	2,000
Credit Sales	40,000	Stock at Branch on 31-12-2018	5,000
Cash received from Debtors (direct to HO)	35,000	Petty Expenses paid by Branch	850
Cash paid by Debtors	2,000		

Provide depreciation on furniture @ 10% p.a.

Solution :

Hisar Branch Account

Dr. **Cr.**

		Rs.			Rs.
To Balance b/d			By Balance b/d		
Branch Stock		10,000	Branch Outstanding Salaries		1,00,000
Branch Debtors		4,000			
Branch Petty Cash		500	By Cash:		
Branch Furniture		2,000	Cash Sales	30,000	
Branch Prepaid Insurance		150	Cash Received from Debtors	37,000	67,000
To Goods Sent to Branch	80,000		By Balance c/d		
Less : Return from Branch	1,000	79,000	Branch Stock		5,000
			Branch Petty Cash		650
To Bank			Branch Debtors		4,900
Rent	2,000		Branch Furniture		1,800
Salaries	2,400		Branch Prepaid Insurance		150
Petty Cash	1,000				
Insurance	600				
		6,000			
To Profit (transferred to General P & L A/c)		77,850			
		1,79,500			1,79,500

Notes:

1) Cash received from debtors include Rs. 2,000 which the debtors directly paid to the head office.

2) Branch petty cash balance at the end is not given. It is ascertained as follows:

Petty Cash at the beginning	500
Add: Amount sent by head office	1,000
	1,500
Less: petty cash expenses	850
Petty Cash Balance	650

3) Furniture at the end has been shown after deducting Rs. 200 for depreciation.

4) Prepaid insurance on 31-12-2018 is one-fourth of Rs. 600.

5) The closing balance of branch debtors is not given. It has been worked out by preparing the Memorandum Branch Debtors Account as follows:

Memorandum Branch Debtors Account

	Rs.		Rs.
To Balance c/d	4,000	By Cash Received from Debtors	37,000
To Sales (Credit)	40,000	By Sales Returns	2,000
		By Discount Allowed	100
		By Balance c/d (balancing figure)	4,900
	44,000		44,000

13.5.2 Invoice Price Method

As in the case of consignment, the goods may he invoiced to branches at a price higher than the cost (termed as invoice price). This is done primarily to have an effective control over stock with branches and keep the margin of profit secret from the branch manager. In such a situation, all entries relating to goods are made in the Branch Account at invoice price and necessary adjustments for loading (difference between I.P. and C.P.) are recorded at the end by passing the following **additional** journal entries:

1) **For adjustment of loading in opening stock at branch**
Stock Reserve A/c Dr.
To Branch A/c

2) **For adjustment of loading in goods sent to branch less returns**
Branch A/c Dr.
To Goods Sent to Branch A/c

3) **For adjustment of loading in closing stock at branch**
Branch A/c Dr.
To Stock Reserve A/c

Look at illustration 4 and see how Branch Account is prepared when goods are invoiced at a price higher than cost.

Illustration 4

The Mukund Gas Co., Varanasi have a sales branch at Ghaziabad and invoiced goods to the branch at cost price plus $33\frac{1}{3}$ per cent. It is arranged that all cash received by the branch is to be paid daily to the Head Office Account with the Banaras State Bank Ltd. and the necessary advice sent to the Head Office. From the following particulars, prepare Branch Account and Goods Sent to Branch Account in the Head Office ledger showing the actual profit or loss of the branch for the year ending December 31, 2018.

	Rs.		Rs..
Stock on 1.1.2018 (at invoice price)	12,000	Rent, Rates and Taxes	3,200
Goods Sent to Branch (at invoice price)	96,000	Salaries and Wages	4,800
Debtors on 1-1-2018	1,500	Debtors on 31-12-2018	1,600
Cash Sent to Head Office	77,100	Goods Returned to Head Office (at invoice price)	16,000
Sales	77,000	Shortage of stock (at invoice price)	200

Solution :

Books of Mukumd Gas. Co., Varanasi
Ghaziabad Branch Account

Dr.		Rs.		Cr. Rs.
To Balance b/d			By Cash Received	77,100
Branch Stock		12,000	By Goods Returned by Branch A/c	16,000
Branch Debtors		1,500	By Stock Reserve A/c (loading in op. stock)	3,000
To Goods Sent to Branch		96,000	By Goods Sent to Branch A/c (loading in goods sent less returns)	20,000
To Bank A/c			By Balance c/d	
Rent, Rates & Taxes	3,200		Branch Stock	14,800
Salaries & Wages	4,800	8,000	Branch Debtors	1,600
To Stock Reserve A/c (loading in Cl. Stock)		3,700		
To Profit (Transferred to General P & L A/c)		11,300		
		1,32,500		1,32,500

Goods Sent to Branch Account

	Rs.		Rs.
To Ghaziabad Branch A/c	16,000	By Ghaziabad Branch A/c	96,000
To Ghaziabad Branch A/c (loading on Rs. 80,000)	20,000		
To Trading A/c (transfer)	60,000		
	96,000		96,000

Notes : 1) The branch stock at the end has not been given. It can be worked out by preparing Memorandum Branch Stock Reserve Account as follows :

2) Loading is 25% of invoice price.

Memorandum Branch Stock Account

	Rs.		Rs.
To Balance b/d	12,000	By Goods returned to Head Office	16,000
To Goods received form Head Office	96,000	By Sales	77,000
To Goods returned to Customers	...	By Shortage of stock	200
		By Balance c/d	14,800
	1,08,000		1,08,000

It should be noted that all figures in Memorandum Branch Stock Account have been recorded at the invoice price.

Check Your Progress A

1. What do you mean by dependent branch?

....

....

....

2. Fill in the blank:

i) The branch expenses paid by the Head Office are …..........….. to the Branch Account.

ii) The balance in Goods sent to Branch Account is transferred to…....................… Account.

iii) If the cost price is Rs. 100 and the invoice price is cost plus 20% on invoice price, the invoice price is Rs ……………

iv) Loading is the ……....................….between cost price and invoice price.

v) If opening or closing stock is not given, the same can be worked out by preparing ……….. Account at ………price.

3. List the items which are not to be shown in Branch Account prepared under the Debtors System.

....

....

....

....

13.6 FINAL ACCOUNTS SYSTEM

The profit or loss of a dependent branch can also be worked out by preparing a Memorandum Branch Trading and Profit & Loss Account. This account is prepared on the basis of cost of goods sent to the branch (not the invoice price). Apart from the Branch Trading and- Profit & Loss Account, the Head Office also maintains the Branch Account. But, under this system, the Branch Account is in the nature of a personal account which shows only the mutual transactions between the head office and the branch. The balance of Branch Account, therefore, represents the net assets of the branch.

Look at illustration 5 and study how profit or loss is ascertained and how Branch

Account is maintained under the final accounts system.

Illustration 5

A-one Ltd., Bhopal has a branch at Madras to which the goods are sent at cost plus 25%. The Madras branch keeps its own Sales Ledger and remits all cash received to the Head Office every day. All expenses are paid by the head office. The transactions for Madras Branch during the year ending December 31, 2018 were as follows:

	Rs.		Rs.
Stock (1-1-2018)	11,000	Return Inwards	500
Debtors (1-1-2018)	100	Cheques Sent to Branch	
Petty Cash	100	Rent	600
Cash Sales	2,650	Wages	200
Credit Sales	23,950	Salary and other Expenses	900
Goods Sent to Branch	20,000	Stock (31.12.2018)	13,000
Collection on Ledger A/c	21,000	Debtors (31.12.2018)	2,000
Goods Returned to H.O.	300	Petty Cash (31.12.2018) (Including miscellaneous income Rs. 25 not remitted)	125
Bad Debts	300		
Allowances to Customers	250		

Prepare the Memorandum Branch Trading and Profit & Loss Account and Madras Branch Account for the year ending December 31, 2018.

Solution:

Memorandum Branch Trading and Profit & Lass Account for the year ending 31.12.2018

Dr. **Cr.**

	Rs.			Rs.
To Opening Stock (11,000 – 2,200) (1/5 loading)	8,800	By Sales		
To Goods sent to Branch (20,000 – 4,000) (1/5 loading)	16,000	Cash	2,650	
		Credit	23,950	
			26,600	
To Wages	200	Less Returns	500	26100
To Gross Profit c/d	11,740	By Goods sent to HO. (300-60) 1/5 loading		240
		By Closing Stock (13,000 – 2,600) (1/5 loading)		10,400
	36,740			36,740
To Bad Debts	300	By Gross Profit b/d		11,740
To Allowances	250	By Misc. Income		25
To Rent	600			
To Salaries and other expenses	900			
To Profit transferred to General Profit & Loss A/c	9,715			
	11,765			11,765

Madras Branch Account

	Rs.		Rs.
To Balance b/d		By Bank A/c	
Stock	8,800	Cash Received from	
Debtors	100	Debtors	21,000
Petty Cash	100	Cash Sales	2,650
To Goods sent to Branch A/c	16,000	By Goods Sent to Branch (returns to H.O.)	240
To Bank A/c		By Balance c/d	
Rent	600	Stock	10,400
Wages	200	Debtors	2,000
Salaries and other expenses	900	Petty Cash	125
To Profit as per Branch Trading and P & L A/c	9,715		
	36,415		36,415

13.7 STOCK AND DEBTORS SYSTEM

Under Stock and Debtors System, the Head Office does not open a Branch Account in its books. It maintains a few control accounts for recording the various branch transactions. These accounts usually are : (1) Branch Stock Account, (ii) Branch Debtors Account, (iii) Branch Expenses Account, (iv) Branch Cash Account, (v) Goods Sent to Branch Account, and (vi) Branch Fixed Assets Account. At the end of the accounting year, it prepares the Branch Adjustment Account and the Branch Profit & Loss Account. This system is used only when goods are invoiced at selling price which the branch is not allowed to vary.

Let us now study the working of each account opened by the Head Office when such a system is followed.

Branch Stock Account: This is the most important account which helps the Head Office in controlling the branch stock. It shows all branch transactions relating to goods. The goods sent to branches and the sales returns are shown on its debit side, and the sales (both cash and credit) and the goods returned to head office on the credit side. **All these items are recorded at the invoice price.** Hence, if the figure of any of these items is given at cost, the same should be converted into invoice price before recording it in the Branch Stock Account. The balance of this account would show the unsold goods (stock) lying with the branch. If it is found that the actual stock with the branch is less than the balance shown by the Branch Stock Account, it means that there is a 'shortage' in the stock with the branch. Similarly, if the actual stock with the branch is more than the balance shown by the Branch Stock Account, it would reflect 'surplus'. Both situations warrant investigation. But, so far as their recording goes, the shortage will be shown on the credit side of the Branch Stock Account and if there is surplus, the same will be recorded on its debit side. Then, the balance of the Branch Stock Account will be the exact amount of actual stock with the branch. In other words, while preparing the Branch Stock Account, you will show the actual stock with branch as the balance in this account, and then if the totals of both sides do not tally, you will show the difference as shortage or surplus as the case may be.

Branch Debtors Account: This account shows all transactions relating to branch debtors. The credit sales are shown on its debit side, and cash received from debtors, sales returns, bad debts, discount allowed, etc. on the credit side. The balance of this account represents the closing debtors of the branch.

Branch Expenses Account: This account shows all expenses incurred by the branch. In addition, the items like bad debts, discount allowed, depreciation on branch fixed assets, etc. are also debited to this account. This account is closed by transfer to the Branch Adjustment Account.

Branch Cash Account: This account shows all cash transactions of the branch where the branch is not required to remit all collection of cash immediately to the Head Office, but use it for branch expenses and remit the balance to the Head Office from time to time. This account helps the Head Office to keep control over branch cash. Normally, the dependent branch is not allowed the freedom to retain cash collections. Hence, this account need not be maintained.

Branch Fixed Assets Account: The Head Office maintains separate account for each type of branch asset such as furniture, equipment, building, etc. These accounts are prepared in the usual manner. The depreciation on branch fixed assets is, however, debited to Branch Expenses Account and credited to the respective account.

Goods Sent to Branch Account: This account is prepared in the same manner as in case of branches to which the goods are sent at the invoice price.

Branch Adjustment Account: This account is like a Trading Account of the branch. It is prepared to ascertain the gross profit or gross loss made at the branch by recording the loading (difference between invoice price and cost price) on various items. The loading on branch closing stock and shortage is shown on its debit side while the loading on branch opening stock, goods sent to branch (less returns) and surplus on the credit side. The balance of this account reflects the gross profit or gross loss which is transferred to Branch Profit & Loss Account.

Branch Profit & Loss Account: This account is prepared to ascertain the net profit or net loss made at the branch. As stated earlier, the gross profit or gross loss ascertained by the Branch Adjustment Account is transferred to this account. It is debited with branch expenses as per the Branch Expenses Account and the loss on account of shortage being the cost of such shortage. In case the Branch Stock Account reveals some surplus, the amount equal to the cost of such surplus will be shown on the credit side of the Branch Profit & Loss Account. The balance of the Branch Profit & Loss Account represents the net profit or net loss made at the branch which is transferred to the General Profit & Loss account.

The following journal entries are passed in the Head Office books for opening the above accounts relating to the various branch transactions:

1) **When goods are sent to the branch (at invoice price)**
   Branch Stock Ale — Dr.
   To Goods Sent to Branch A/c

2) **When goods are returned by the branch to the H.O. (at invoice price)**
   Goods Sent to Branch A/c — Dr.
   To Branch Stock A/c

3) **When sales are made by the branch**
   i) **For Cash Sales**
   Cash A/c — Dr.
   To Branch Stock A/c

   ii) **For Credit Sales**
   Branch Debtors A/c — Dr.
   To Branch Stock A/c

4) **When cash is received from debtors**
   Cash A/c — Dr.
   To Branch Debtors A/c

5) **For sales returns**
Branch Stock A/c Dr.
To Branch Debtors A/c

6) **For discount allowed, bad debts, etc.**
Branch Expenses A/c Dr.
To Branch Debtors A/c

7) **For shortage of stock**
Branch Adjustment A/c Dr.
(with amount of loading)

Branch P & L A/c Dr.
(with cost of shortage)
To Branch Stock A/c
For surplus at branch, the reverse entry will be passed.

8) **For Branch expenses paid in Cash**
Branch Expenses A/c Dr.
To Cash A/c

9) **For closing branch expenses account**
Branch P & L A/c Dr.
To Branch Expenses A/c

10) **For adjustment of loading on the opening stock**
Stock Reserve A/c Dr.
To Branch Adjustment A/c

11) **For adjustment of loading on the closing stock**
Branch Adjustment A/c Dr.
To Stock Reserve A/c

12) **For adjustment of loading on net goods sent to branch**
Goods Sent to Branch A/c Dr.
To Branch Adjustment A/c

13) **For transfer of gross profit**
Branch Adjustment A/c Dr.
To Branch P & L A/c

14) **For transfer of net profit to General Profit & Loss Account**
Branch Adjustment A/c Dr
To General P & L A/c

The entry will be reversed if there is net loss.

15) **For closing the Goods Sent to Branch Account**
Goods Sent to Branch A/c Dr.
To Trading A/c

Look at illustration 6 and see how the accounts for various branch transactions are prepared under Stock and Debtors System.

Illustration 6

Indiana Traders, Jaipur opened a branch at Jodhpur on 1-7-2017. The goods were sent by the Head Office to the branch invoiced at selling price of the branch which was 125% of the cost price of the head office.

The following are the particulars relating to the transactions of Jodhpur Branch

	Rs.		Rs.	
Goods sent to branch (at cost to head office)	2,80,000	Cash sent to branch for:		
		Wages	3,000	
Sales—Cash	1,24,000	Freight	11,000	
Sales—Credit	1,75,000	Other expenses including godown rent	6,000	20,000
Cash collected from debtors	1,56,000			
Discount allowed	4,000	Stock on June 30, 2018 (at invoice price)		55,500
Spoiled cloth in bales written off at invoice price	500			

Ascertain the profit or loss for the Jodhpur Branch for the year ended June 30, 2018 by preparing accounts under the Stock and Debtors System.

Solution

Branch Stock Account

Dr.	Rs.		Cr. Rs.
To Goods Sent to Branch A/c	3,50,000	By Cash A/c (cash sales)	1,24,000
To Branch Debtors A/c (sales returns being balancing figure)	5,000	By Branch Debtors A/c (credit sales)	1,75,000
		By Branch Adjustment A/c (spoilage-loading)	100
		By Branch P & L A/ (spoilage-cost)	400
		By Balance c/d	55,500
	3,55,000		3,55,000

Note: Total of the credit side of Branch Stock A/c exceeds the debit side by Rs. 5,000. It is assumed to be on account of returns by customers.

Goods Sent to Branch Account

Dr.	Rs.		Cr. Rs.
To Branch Adjustment A/c (loading)	70,000	By Branch Stock A/c	3,50,000
To Trading A/c	2,80,000		
	3,50,000		3,50,000

Branch Debtors Account

Dr.			Cr.
	Rs.		Rs.
To Branch Stock A/c	1,75,000	By Cash A/c	1,56,000
		By Branch Stock A/c (returns)	5,000
		By Branch Expenses A/c (discount allowed)	4,000
		By Balance c/d	10,000
	1,75,000		1,75,000

Branch Expenses Account

Dr.			Cr.
	Rs.		Rs.
To Cash A/c			
Wages	3,000	By Branch Profit & Loss A/c	24,000
Freight	11,000		
Other Expenses	6,000		
To Branch Debtors A/c (discount)	4,000		
	24,000		24,000

Branch Adjustment Account

Dr.			Cr.
	Rs.		Rs.
To Branch Stock A/c (loading on spoilage)	100	By Goods Sent to Branch A/c (loading)	70,000
To Stock Reserve A/c (loading on closing stock)	11,100		
To Branch Profit & Loss A/c	58,800		
	70,000		70,000

Branch Profit & Loss Account

Dr.			Cr.
	Rs.		Rs.
To Branch Expenses A/c	24,000	By Branch Adjustment A/c	58,800
To Branch Stock A/c (spoilage-cost)	400		
To Net Profit transferred to General P & L A/c	34,400		
	58,800		58,800

It should be noted that if there is any theft or spoilage of goods at the branch, or some goods are lost in transit, these are to be treated in accounts in the same way as the shortage of goods. If, however, some amount is received from the insurance company for such abnormal losses of stock, the same will be credited to the Branch Profit and Loss Account.

Check Your Progress B

1. How is the Branch Account prepared under the Debtors System different from the Branch Account prepared under the Final Accounts System.

   ....

   ....

   ....

2. Fill in the blanks :

   i) The closing balance of Branch Account under the Final Accounts System represents ……….at the branch.

   ii) Branch Expenses Account under the Stock and Debtors System is closed by transfer to ……….Account.

   iii) Under Stock and Debtors System, all figures in Branch Stock Account are recorded at ……….price.

   iv) Under Stock and Debtors System,…………….. Account is credited when the branch returns goods to the Head Office.

   v) Under the Stock and Debtors System, Bad Debts are credited to Branch Debtors Account and debited to …………..................…….. Account.

   vi) If the balance shown by Branch Stock Account is different from actual stock with the branch, the difference reflects……………………

13.8 LET US SUM UP

From accounting point of view, each branch is treated as a separate profit-centre.

Hence, accounting for branch transaction is designed in such a way that profit or loss made at each branch can be correctly worked out and proper control can be exercised over their financial activities. For this purpose, the branches are divided into three categories: (i) branches not keeping full system of accounting (dependent branches), (ii) branches keeping full system of accounting (independent branches), and (iii) foreign branches.

Where branches do not keep full system of accounting, the Head Office has to maintain proper record of branch transactions. There are three methods that can be followed for this purpose: (i) Debtors System, (ii) Final Accounts System, and (iii) Stock and Debtors System.

Debtors System is usually adopted for small branches which merely act as sales depots. Under this system, the head office simply opens a Branch Account for each branch in which it records all related transactions. The Branch Account is maintained like a Consignment Account which also helps in ascertaining the profit or loss made by the branch.

Under the Final Accounts System of maintaining branch accounts, the Head Office prepares a Memorandum Trading and Profit & Loss Account for each branch from the data 'provided by the branch and ascertains its profit or loss for the accounting period.

Then it also maintains a Branch Account for recording mutual transactions between the Head Office and the branch which finally reveals the amount due to, or due from, the branch. Its balance will be equal to the net assets with the branch.

Stock and Debtors System is followed where the goods are invoiced to the branch at selling price. Under this system, no Branch Account is opened. The Head Office maintains (i) Branch Stock Account, (ii) Branch Expenses Account, (iii) Goods Sent to Branch Account, and (iv) Branch Fixed Assets Account. At the end of the accounting period, it prepares Branch Adjustment Account and Branch Profit and Loss Account for ascertaining the branch gross profit/ gross loss and the net profit/net loss respectively. This system also enables the Head Office to exercise effective control on branch stock.

13.9 KEY WORDS

Branch Adjustment Account: An Account prepared under Stock and Debtors System for ascertaining the gross profit or gross loss made by a branch.

Debtors System: A system of accounting for transactions of a branch by opening Branch Account which also helps to ascertain branch profit or loss.

Dependent Branch: A small branch which does not keep full system of accounting.

Final Accounts System: A system of accounting for transactions of a branch under which branch profit or loss is ascertained by preparing Memorandum Branch Trading and Profit & Loss A/c.

General Profit & Loss Account: Profit and Loss Account of the Head Office which shows the profit or loss of the business unit as a whole.

Independent Branch: Branch keeping full system of accounting.

Loading: Difference between the cost price and the price at which goods are invoiced to the branch.

Stock and Debtors System: A System of accounting for transactions of a branch without opening a Branch Account. Under the system, branch profit or loss is ascertained through Branch Adjustment Account.

13.10 ANSWERS TO CHECK YOUR PROGRESS

A 2) i) debited ii) Trading iii) 125 iv) difference

v) Memorandum Branch Stock, invoice price

B 2) i) net assets ii) Branch Adjustment iii) invoice iv) Branch Stock v) Branch Expenses vi) Shortage or surplus

13.11 TERMINAL QUESTIONS/EXERCISES

Questions

1) What are the objectives of keeping, branch accounts?

2) Name the three systems of maintaining the accounts of a dependent branch, and describe how profit is ascertained under each system.

3) Explain how Branch Stock Account helps in keeping effective control over the branch stock.

Exercises

1) Kabir & Co. of Moradabad have their branch at Kanpur. The following are the transactions relating to the branch for the year ending December 31, 2018:

		Rs.
Opening Stock on January 1, 2018		20,000
Goods supplied to Branch		50,000
Cash sent to Branch for		
Rent	200	
Other Expenses	100	300
Cash received from Branch during the year		60,000
Closing Stock on December 31, 2018		15,000
Closing balance of Petty Cash on December 31, 2018		10

From the above information, pass the necessary journal entries and prepare Kanpur Branch Account and other necessary accounts in the books of the Head Office.

(**Answer:** Branch Net Profit Rs. 4,710)

2) A Meerut Company has a retail branch in Kota which is supplied with all goods from Meerut. The branch keeps its own Sales Ledger, receives cash against the ledger accounts and remits the whole of the cash received daily to the Head Office. All wages and branch expenses are drawn by cheque weekly from the Head Office upon the imprest system. From the under mentioned particulars supplied by the Branch Manager, show how the Branch Account would appear in the Head Office books as on December 31, 2018.

	Rs.		Rs.
Six months credit sales	2,387	Stock on December 31, 2018	1,121
Return inwards	20	Debtors July 1, 2018	1,227
Cash received on Ledger accounts	2,384	Goods received from Head Office	2,178
Cash Sales	1,214	Rent, Taxes etc. paid	375
Stock on July 1,2018	720	Sundry Expenses	396
Bad Debts	100		

(**Answer :** Net Profit Rs 933; Missing Figure; Closing Debtors Rs. 1,110)

3) Royal Store of Kanpur opened a selling branch at Madras on July 1, 2018. Goods are sent to branch from the head office at cost plus 25%. The branch is advised to deposit cash every day in the bank in head office account. From the following particulars, prepare Branch Account in the books of head office for the period ending December 31, 2018. Petty Cash at branch is maintained on imprest system.

		Rs.		Rs.
Cash sent to branch for meeting petty expenses		1,500	Cash sales by the branch	80,000
Furniture purchased for the branch		12,000	Credit sales during 6 months	30,000
Goods sent to branch at invoice price		1,60,000	Cash received from debtors Discount allowed to the debtors	22,000 400
Expenses paid by Head Office:			Goods returned by debtors (at invoice price)	800
Rent	2,200		Bad debts written off	100
Advertisement	800		Petty expenses paid by the branch	1,000
Salaries	4,600			
Insurance (up to June 30, 2019)	400		Stock at invoice price on December 31 (excluding stock received from debtors)	40,000

Provide depreciation on furniture at 10% p.a.

(**Answer:** Profit Rs. 3,940; Debtors at the end Rs. 6,700)

4) X Ltd. of Bombay has a branch in Delhi. The head office sends goods to the branch at cost plus 50%. From the following data, prepare the necessary accounts in the books of head office under Stock and Debtors System.

	Rs.		Rs.
Goods sent from Head Office (at invoice price)	50,000	Credit Sales	8,000
Returned to Head Office	1,000	Opening Stock	10,000
Cash Sales	35,500	Closing Stock	11,000

(**Answer:** Profit Rs. 11,500; Shortage of Goods Rs. 4,500)

5) Shyam Brothers of Delhi has a branch at Hyderabad. In order to maintain strict control over stocks, it invoices goods to the branch at selling price including profit of 25% on selling price. From the following particulars, prepare Branch Stock Account, Branch Debtors Account, Goods Sent to Branch Account, Branch Adjustment Account, and Branch Profit and Loss Account.

	Rs.
Stock January 1, 2018	30,000
Debtors on January 1, 2018	22,800
Goods invoiced to Branch at invoice price	1,34,000
Sales at the branch	
Cash	62,000
Credit	74,800
Cash received from Debtors	80,000
Bad Debts written off	500
Discount allowed to customers	600
Expenses at the branch	13,400
Stock on December 31, 2018	26,800

(Answer: Gross Profit Rs. 34,200; Net Profit Rs. 19,400)

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 14 BRANCH ACCOUNTS-II

Structure

14.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the features of the accounting system of an independent branch;
- make adjustment entries in the books of both Head Office and branch for certain peculiar items relating to independent branches;
- pass necessary journal entries for the incorporation of branch balances in the books of the Head Office;
- make closing entries in the books of the branch; and
- prepare consolidated balance sheet of the business.

14.1 INTRODUCTION

In Unit 13, you learnt about the systems of accounting for a dependent branch. Dependent branch is usually a small branch which merely functions as a sales depot. It does not keep full system of accounting. The main accounting records for such branches are maintained at the Head Office level. But, when a branch functions as an independent unit and enjoys certain amount of operational autonomy, it keeps full system of accounts. Such branches are termed as independent branches and maintain complete set of books on double entry system. They prepare their own Trial Balance, Profit & Loss Account and Balance Sheet. At the end of the accounting year, their summarised results and the assets and liabilities are incorporated in the books of the Head Office. In this unit, you will learn how does the Head Office incorporate all branch balances in its books and what sort of records are maintained for mutual transactions between the branch and the Head Office.

14.2 ACCOUNTING SYSTEM OF AN INDEPENDENT BRANCH

You know an independent branch enjoys certain amount of operational autonomy. Besides receiving goods from the Head Office, it may also purchase goods from the outside parties. It maintains its own bank account and remits money from time to time to Head Office as per the instructions of the Head Office. It is treated as a separate accounting entity. The main features of the accounting system of independent branches are as follows:

1) The branch maintains complete set of books on double entry system.

2) The branch opens a Head Office Account in its books. It is a personal account wherein, all transactions between the branch and the Head Office are recorded at the branch level. This account is debited with cash sent to the Head Office and the goods returned or supplied to the Head Office, and is credited by goods received from the Head Office and the Head Office expenses charged to the branch for centralised services.

3) The Head Office also maintains a Branch Account in its books for all transactions, it makes with a particular branch. It is also a personal account which shows the same entries as the Head Office Account in branch books, but on the reverse sides.

4) At the end of the accounting period, the branch prepares its trial balance and the final accounts, and send their copies to the Head Office.

5) As soon as the Head Office receives the trial balance from a branch, it compares the balance in Head Office Account as shown in the branch Trial Balance with the balance in the Branch Account as it appears in the Head Office books. The difference, if any, is investigated and, after ascertaining the causes thereof, the necessary adjustment entries are passed.

6) After reconciling the Head Office Account balance with the Branch Account balance, the Head Office passes the necessary entries for incorporating various branch balances in its books.

14.3 SOME PECULIAR ITEMS

In respect of independent branches, there are certain items which require special accounting treatment. These items are:

i) Goods in transit

ii) Cash in transit

iii) Head Office expenses chargeable to branch

iv) Depreciation on branch fixed assets, the accounts of which are maintained at the head office level

v) Inter-branch transactions

Let us discuss these items one by one.

14.3.1 Goods in Transit

The Head Office and the branch send goods to each other quite frequently. When goods are sent by the Head Office to the branch, the Head Office debits the Branch Account in its books immediately. But the branch credits the Head Office Account only when it receives the goods. Similarly, when the branch sends or returns some goods to the Head Office, it (the branch) debits the Head Office Account in its books immediately, but the Head Office credits the Branch Account only when it receives the same. It is quite possible that goods sent in the later part of the accounting year may not have been received by the closing date of the accounting year by the Head Office or the branch, as the case may be. Such goods are called 'goods in transit' for which no entry will appear in the books at the receiving end at the time of the closing the accounts. Hence, the balance in the Head Office Account in branch books will not tally with the balance in the Branch Account in the Head Office books. This will require an adjustment entry which may be passed either in the Head Office book or in the branch books, but not in both sets of books.

If the Head Office decides to pass the adjustment entry, it will be as follows:

Goods in Transit A/c Dr.
To Branch A/c

If, however, the adjustment is made in branch books, the entry will be:

Goods in Transit A/c Dr.
To Head Office A/c

It should be noted that the adjustment entry for goods in transit shall be passed only in one set of books, either at the Head Office level or the branch level. **Usually, such entry is made in the books of the Head Office.**

14.3.2 Cash in Transit

Like goods, cash is also regularly remitted by the Head Office and the branch to each other. For this, the entries are made in both sets of books in the same manner, as they are made for the goods. In this case also, it is possible that some remittances are in transit at the time of closing the books for the accounting year. This would again lead to difference in Branch Account balance in the Head Office books and Head Office Account balance in branch books. Hence, an adjustment entry will have to be passed to reconcile the same. This may be done either by the Head Office or by the branch, but not by both.

In case the Head Office decides to pass the adjustment entry, it will be as follows:

Cash in Transit A/c Dr.
To Branch A/c

If, however, the adjustment is made in the branch books, the entry will he:

Cash in Transit A/c Dr.
 To Head Office A/c

It should be noted that for cash in transit also, the entry shall be passed in one set of books, either at the Head Office level or at the branch level. This entry is also made usually at the Head Office level. The reason for passing such adjustment entries in Head Office books lies in the fact that all in-transit items are noticed by the Head Office at the time of receiving the branch Trial Balance and, at this stage, it is not considered desirable to alter the balances in the branch books.

Look at illustration 1 and see how are the amounts of goods in transit and cash in transit ascertained and the adjustment entries passed to reconcile the difference between the Branch Account balance and the Head Office Account balance.

Illustration 1

Following are the extracts from the Trial Balances of a Head Office and a branch. You are required to pass the necessary journal entries for reconciling the balances of the Head Office Account and the Branch Account.

Trial Balance

Particulars	**Head Office**		**Branch Office**	
	Dr.	**Cr.**	**Dr.**	**Cr**
	Rs.	Rs.	Rs.	Rs.
Current Accounts	1,00,000			90,000
Goods sent/received by Branch		1,50,000	1,45 ,000	

Solution

The current accounts represent the Branch Account in the Head Office books and the Head Office Account in the branch books. As per the above Trial Balance, there is a difference of Rs. 10,000 between the two current account balances. It is observed that there is a difference of Rs. 5,000 in the goods sent received by branch. This can be attributed to goods in transit. The remaining difference of Rs. 5,000 may be taken to be on account of the cash in transit. The required adjustment entry may be passed in the books of Head Office as follows:

Cash in Transit A/c	Dr.	5,000
Goods in Transit A/c	Dr.	5,000
To Branch A/c		10,000

(Being cash in transit and goods in transit adjusted)

If, however, this entry is passed in the books of the branch. it will be as follows:

Cash in Transit A/c	Dr.	5,000	
Goods in Transit A/c	Dr.	5,000	
To Head Office A/c			10,000

(Being cash in transit and goods in transit adjusted)

14.3.3 Head Office Expenses Chargeable to Branch

The Head Office may like to allocate a part of its expenses to branches for the centralised services at the Head Office level. As a matter of fact, quite a good amount of time of the Head Office staff may be spent in doing the work of the branches. Hence, it may decide to charge a part of its expenditure on salaries to the branches. The same thing may be true for certain other items of expenses. If the Head Office so decides to charge some expenses to the branch, the journal entry passed in the books of the Head Office is as follows:

Branch A/c Dr.
To Expenses (Salaries A/c)
(Being Head Office expenses chargeable to branch)

The branch will also pass a corresponding entry in its books as follows:

Head Office Expenses A/c Dr.
To Head Office
(Being Head Office expenses chargeable to branch)

Like all other expenses accounts, the Head Office Expenses Account will be closed by transferring its balance to the Profit & Loss Account at the end of the accounting year.

14.3.4 Depreciation on Branch Fixed Assets, Accounts Maintained by Head Office

Sometimes, the accounts for the fixed assets of independent branches are maintained at the Head Office level. In such a situation, all entries in respect of branch fixed assets are made in the Head Office books. For example, when a fixed asset is purchased for the branch, the Head Office debits the Branch Fixed Assets Account and credits the Cash Account. No entry for this transaction is passed by the branch unless the payment is made by the branch for this purchase. Even if the payment for the purchase of such fixed assets is made by the branch, it will not debit the Fixed Assets Account. In fact such payment is treated like a remittance to the Head Office, Therefore, is debited to the Head Office Account. But when it comes to depreciation on such fixed assets, the branch has to pass the necessary entry in its books because the assets were used by the branch and not by the Head Office. Normally an entry for the depreciation on fixed assets is passed by debiting the Depreciation Account and crediting the Fixed Asset Account. But in this situation, the branch cannot credit the Fixed Asset Account because the accounts for its fixed assets are maintained at the Head Office level. Hence, the entry passed for depreciation on such fixed assets is different from the normal entry for depreciation. It is as follows:

Depreciation A/c Dr.
To Head Office A/c
(Being depreciation on fixed assets)

Since the account for the branch fixed assets is maintained in head office books, the Head Office must reduce the balance in Branch Fixed Assets Account by the amount of depreciation thereon. But, it cannot debit the Depreciation Account because the loss relates to the branch. Hence, it makes the following journal entry for depreciation on branch fixed assets when their accounts are maintained by the Head Office:

Branch A/c Dr.
    To Branch Fixed Assets A/c
(Being depreciation on branch fixed assets)

It should be noted that the above entries are passed only for such branch fixed assets accounts of which are maintained by the Head Office. **Any branch fixed assets for which the branch itself maintains the accounts, the branch will pass the normal entry for depreciation.** The Head Office need not pass an entery in its books for the amount of depreciation on such fixed assets.

14.3.5 Inter-branch Transactions

When an organisation has more than one branch, it is possible that some transactions take place between one branch and the other. This usually happens under instructions from the Head Office. For example, a branch may be asked to transfer its surplus stock to some other branch which may need the same (it may be facing shortage). In such a situation, the usual practice for the sending branch is to regard it as a transaction of returning the goods to the Head Office. Similarly, the receiving branch shall regard it as a transaction of receiving the goods from the Head Office. Hence, entries are passed on the same basis in the books of the branches and the Head Office. These are as follows:

In the books of the Head Office

Receiving Branch A/c Dr.
    To Sending Branch A/c
(Being goods transferred from .... branch to .... branch)

In the books of the sending branch

Head Office A/c Dr.
    To Goods Sent to H.O. A/c
(Being goods sent to .... branch under instructions from H. O.)

In the books of the receiving branch

Goods from H.O. A/c Dr.
    To Head Office A/c
(Being goods received from .... branch under instruction from H.O.)

Look at illustration 2 and see how the above-mentioned peculiar items are recorded in the books of the Head Office and the branches.

Illustration 2

Give the journal entries that would be passed in the books of the Head Office to record the following transactions:

i) Goods amounting to Rs. 1,000 transferred from Madras branch to Bombay branch under instructions from the Head Office.

ii) Depreciation on branch fixed assets accounts maintained by the Head Office: (Bombay Rs. 4,000 and Madras Rs. 6,000).

iii) A remittance of Rs. 6,000 made by Bombay branch to Head Office on December 27, 2018 and received by Head Office on January 7, 2019.

iv) Goods worth Rs. 10,000 sent by the Head Office on December 25, 2018 and received by Madras branch latter on January 15, 2019.

v) A sum of Rs. 10,000 is to be charged to the Madras branch for administrative services rendered by the Head Office.

Solution

Head Office Books
Journal

		Rs.	Rs
i)	Bombay Branch A/c Dr. To Madras Branch A/c (Being goods transferred from Madras branch to Bombay branch)	1,000	1,000
ii)	Bombay Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation)	4,000	4,000
iii)	Madras Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation)	6,000	6,000
iv)	Goods in Transit A/c Dr To Bombay Branch A/c (Being Goods in transit adjusted)	6,000	6,000
v)	Goods in Transit A/c Dr To Madras Branch A/c (Being Goods in transit adjusted)	10,000	10,000
vi)	Madras Branch A/c Dr. To Gen. P & LA/c (Being Administrative expenses charged to Madras branch)	10,000	10,000

Check Your Progress A

1. What do you mean by Cash in Transit?

....

....

....

....

....

2. Why does Head Office charge a part of its expenses to branches?

....

....

....

3. Put tick (√) mark against the correct answer:

i) An independent branch

a) receives the goods from the Head Office.

b) purchases the goods from outside parties.

c) receives the goods from both (a) and (b) sources.

ii) The Head Office Account in the books of branch is debited with

a) cash sent to the Head Office and goods returned to the Head Office.

b) cash and goods received from Head Office, and Head Office expenses allocated to branch by Head Office.

c) none of the above.

iii) The adjustment entry for goods in transit is passed in the books of

a) either the branch or the Head Office.

b) branch as well as the Head Office.

c) none of them.

iv) For depreciation on fixed assets. whose accounts are maintained by the Head Office, the Head Office

a) debits Fixed Assets A/c and credits Branch A/c.

b) debits Branch A/c and credits its Fixed Assets A/c

c) none of the above.

v) In case of inter-branch transactions, each branch

a) opens separate accounts for other branches.

b) passes no entry.

c) may treat such transactions as the transactions with the Head Office.

vi) The Head Office Account maintained by the branch is of the nature of

a) Real Account.

b) Personal Account.

c) Nominal Account.

14.4 INCORPORATION OF BRANCH TRIAL BALANCE IN THE HEAD OFFICE BOOKS

Just because an independent branch keeps full system of accounting and prepares its own final accounts does not mean that its year-end results will not form part of the final accounts of the Head Office. In fact, as in case of dependent branches, the profit or loss made by an independent branch shall also be included in the General Profit and Loss Account which shows the profit or loss of the company as a whole. Similarly, its assets and liabilities shall also be shown as part of the assets and liabilities of the company. This is done by preparing the combined (consolidated) Balance Sheet of the Head Office and its branches. Thus, it becomes necessary for the Head Office to incorporate the branch balances in the Head Office books by means of suitable journal entries at the end of the accounting period.

The incorporation of branch balances involves the following two steps:

i) incorporation of branch profit or loss, and

ii) incorporation of branch assets and liabilities.

For incorporation of the branch profit or loss, the Head Office may either pass various entries to include all revenue items and prepare a proper Branch Trading and Profit & Loss Account or simply pass one entry for profit or loss made by the branch after working it out with the help of a Memorandum Branch Trading and Profit & Loss Account. The first method is called 'detailed incorporation' and the second method is called 'abridged incorporation' (or simply short cut method). Whatever the method for incorporating branch profit or loss, the entries for incorporating branch assets and liabilities remain the same.

14.4.1 Detailed Incorporation

As stated earlier, under this method, the Head Office prepares a proper Branch Trading and Profit & Loss Account and makes entries for all revenue items before incorporating the branch assets and liabilities in its books. The entries passed under this method are as follows:

1) **For items on the debit side of the Trading Account**
Branch Trading A/c Dr.
To Branch A/c
(This entry is passed for the total amount of items like opening stock, net purchases, wages, goods received from HO., carriage inwards, etc.)

2) **For items on the credit side of the Trading Account**
Branch A/c Dr.
To Branch Trading A/c
(This entry is passed for the total amount of items like net sales, closing stock, etc.)

3) **For branch gross profit**
Branch Trading A/c Dr
To Branch Profit & Loss A/c
(In case of gross loss, the above entry will be reserved)

4) **For items on the debit side of the Profit and Loss Account**
Branch Profit & Loss A/c Dr.
To Branch A/c
(This entry is passed for the total amount of items like salaries, rent, bad debts, repairs, depreciation, etc.).

5) **For items on the credit side of the Profit & Loss Account**
Branch A/c Dr
To Branch Profit & Loss A/c
(This entry is passed for total amount of items like interest received, discount received, commission received, etc.)

6) **For branch net profit**
Branch Profit & Loss A/c Dr.
To General Profit & Loss A/c
(If there is net loss, the above entry will be reversed)

7) **For branch assets**
Branch Assets A/c Dr.
To Branch A/c
(Each asset should be debited individually)

8) **For Branch liabilities**
Branch A/c Dr.
To Branch Liabilities A/c
(Each liability credited individually. This should not include H.O. A/c balance)

As a result of the last two entries (7 and 8), the Branch Account in the Head Office books will stand closed because the net assets (assets minus liabilities) of the branch are equal to the balance in the Branch Account after branch net profit or net loss has been incorporated in Head Office books. In order to open the Branch Account in the next year's books of the Head Office and show the amount due from the branch, the entries for branch assets and branch liabilities (7 and 8 above) shall be reversed at the beginning of the next year.

Look at illustration 3 and see how branch balances are incorporated in the Head Office books when detailed incorporation method is followed.

Illustration 3

On December 31, 2018, the Trial Balance of the Kanpur branch stood as follows:

	Dr.	Cr.
	Rs.	Rs.
Stock on January 1, 2018	12,000	
Furniture	4,800	
Debtors	11,200	
Goods received from H.O.	32,000	
Salaries, rent and expenses	4,400	
Cash in hand	3,600	
Head Office Account		22,000
Sales		45,600
Sundry creditors		400
	68,000	68,000

Stock on December 31, 2018 was Rs. 9,200.

Pass the necessary journal entries to incorporate Kanpur branch balances in the Head Office books, and prepare the Kanpur Branch Account in the books of the Head Office.

Solution

Head Office Books

JOURNAL

		Rs.	Rs
2018			
Dec.31	Kanpur Branch Trading A/c Dr To Kanpur Branch A/c (Being incorporation of opening stock and goods received from HO.)	44,000	44,000
" 31	Kanpur Branch A/c Dr. To Kanpur Branch Trading A/c (Being incorporation of branch sales and closing stock)	54,800	54,800
" 31	Kanpur Branch Trading A/c Dr. To Kanpur Branch P&L A/c (Being gross profit transferred to Branch P & L A/c)	10,800	10,800
" 31	Kanpur Branch P & LA/c Dr. To Kanpur Branch A/c (Being incorporation of branch expenses)	4,400	4,400
" 31	Kanpur Branch P & LA/c Dr. To General Profit & Loss A/c (Being incorporation of branch expenses)	6,400	6,400
" 31	Branch Closing Stock A/c Dr. Branch Furniture A/c Dr. Branch Debtors A/c Dr Branch Cash **A/c** Dr. To Kanpur Branch A/c (Being incorporation of branch assets)	9,200 4,800 11,200 3,600	 28,800
" 31	Kanpur Branch A/c Dr. To Branch Creditors A/c (Being incorporation of branch liabilities)	400	400

Kanpur Branch Account

Dr. **Cr.**

	Rs.		Rs.
To Balance b/d	22,000	By Branch Trading A/c	44,000
To Branch Trading A/c	54,800	By Branch P & L A/c	4.400

To Creditors	400	By Closing Stock	9,200
		By Furniture	4,800
		By Debtors	11,200
		By Cash	3,600
	77,200		77,200

14.4.2 Abridged Incorporation

Incorporation of branch balances in the Head Office books can also be effected with the help of a short cut method known as the 'abridged incorporation'. Under this method, we prepare a Memorandum Branch Trading and Profit & Loss Account and pass a journal entry only for the net profit or net loss. Thus, the six entries passed under the detailed incorporation method are replaced by just one entry which is as follows:

Branch Account Dr.
To General Profit & Loss A/c
Being branch net profit incorporated)

In case of net loss, the above entry shall be reversed.

Look at illustration 4 and see how branch balances are incorporated in the Head Office books with the help of the short cut method.

Illustration 4

From the particulars given in illustration 3, prepare Memorandum Branch Trading and Profit & Loss Account, pass the necessary journal entries to incorporate the Kanpur branch balances, and prepare Kanpur Branch Account in the books of the head office.

Solution :

Books of Head Office

Memorandum Kanpur Branch Trading and Profit & Loss Account for the year ended December 31, 2018

Dr.			Cr.
	Rs.		Rs.
To Opening Stock	12,000	By Sales	45,600
To Goods Received from H.O.	32,000	By Closing Stock	9,200
To Gross Profit c/d	10,800		
	54,800		54,800
To Salaries, Rent and Expenses	4,400	By Gross Profit b/d	10,800
To Net Profit	6,400		
	10,800		10,800

Solution

Journal

		Rs.	Rs.
2018 Dec. 31	Kanpur Branch A/c Dr.	6,400	
	To General Profit & Loss A/c		6,400
	(Being branch net profit incorporated)		
" 31	Kanpur Branch Closing Stock A/c Dr.	9,200	
	Kanpur Branch Furniture A/c Dr.	4,800	
	Kanpur Branch Debtors A/c Dr.	11,200	
	Kanpur Branch Cash A/c Dr.	3,600	
	To Kanpur Branch A/c		28,800
	(Being branch assets incorporated)		
" 31	Kanpur Branch A/c Dr.	400	
	To Kanpur Branch Creditors A/c		400
	(Being branch liabilities incorporated)		

Kanpur Branch Account

Dr. Cr.

	Rs.		Rs.
To Balance b/d	22,000	By Closing Stock	9,200
To General Profit & Loss A/c	6,400	By Furniture	4,800
		By Debtors	11,200
To Creditors	400	By Cash	3,600
	28,800		28,800

14.5 CLOSING ENTRIES IN BRANCH BOOKS

At the end of the accounting period, the branch books have also to be closed. For this purpose, the branch can pass the usual closing entries for transferring all revenue items to its Trading and Profit & Loss Account and ascertaining its net profit or net loss. The amount of net profit or net loss should be transferred to the Head Office Account by passing the following journal entry.

In case of net profit

Profit and Loss A/c Dr.
  To Head Office A/c

In case of net loss

Head Office A/c Dr.
  To Profit and Loss A/c

After the above entry for transferring net profit or net loss to the Head Office Account has been passed, the balance in the Head Office Account will be equal to the branch net assets (assets minus liabilities). The branch can then prepare its Balance Sheet by showing the Head Office Account balance on the liabilities side as this account would normally show a credit balance. If, the Head Office Account shows a debit balance, the same will appear on the assets side of the Balance Sheet.

The accounts pertaining to assets and liabilities can also be closed, if required, by transferring their balances to the Head Office Account. For this purpose, the following two journal entries will be passed in the branch books.

1) **For transfers of assets**
   Head Office A/c Dr.
   To Assets A/c
   The assets should be credited individually

2) **For transfer of liabilities**
   Liabilities A/c Dr.
   To Head Office A/c
   (The liabilities should be debited individually)

As a result of the above entries, the Head Office Account shall also be closed as it will not show any balance.

Look at illustration 5 and see how does a branch close its books.

Illustration 5

A Delhi trader has independent branch at Patna. Its Trial Balance for the year ending December 31, 2018 is given below. Pass journal entries to close the books of Patna branch and prepare its Head Office Account.

Trial Balance

Dr.	Rs.		Cr. Rs.
Purchases	25,600	Creditors	5,400
Stock on 1.1.18	16,400	Sales	69,900
Wages	13,100	Head Office	28,000
Factory Expenses	6,800	Discount	300
Salaries	8,000	Purchase Returns	600
Rent	3,400		
Sundry Expenses	4,000		
Goods Received from HO.	14,400		
Debtors	11,000		
Cash	1,500		
	1,04,200		1,04,200

Additional information

1) The accounts of the branch fixed assets were maintained in the Head Office which show machinery of Rs. 50,000 and furniture of Rs. 2,000

2) Depreciation is to be charged @ 10% on Machinery and 15% on Furniture.

3) Rs. 300 are due for salaries.

4) A remittance of Rs. 8,000 made by branch on December 29, 2018, was received by head office on January, 3, 2019

5. Clossing stock at branch was Rs. 28,700

Solution

Books of Patna Branch
Journal

2017		Rs.	Rs.
Dec.31	Depreciation A/c Dr.	5,300	
	To Head Office A/c		5,300
	(Being depreciation on fixed assets accounts maintained by Head Office)		
" 31	Cash in Transit A/c Dr.	8,000	
	To Head Office A/c		8,000
	(Being outstanding salaries)		
" 31	Salaries A/c Dr.	300	
	To Salaries Outstanding A/c		300
	(Being outstanding salaries)		
" 31	Profit & Loss A/c Dr.	2,200	
	To Head Office A/c		2,200
	(Being net profit transferred)		
" 31	Head Office A/c Dr.	49,200	
	To Debtors		
	To Cash A/c		11,000
	To Cash in Transit A/c		1,500
	To Closing Stock A/c		8,000
	(Being assets account balance transferred)		28,700
" 31	Creditors A/c Dr.	5,400	
	Salaries Outstanding A/c Dr.	300	
	To Head Office A/c		5,700
	(Being liabilities account balances transferred)		

Head Office Account

Dr. **Cr.**

	Rs.		Rs.
To Balance c/d	43,500	By Balance b/d	28,000
		By Depreciation A/c	5,300
		By Cash in Transit A/c	8,000
		By Profit & Loss A/c	2,200
	43,500		43,500
To Debtors	11,000	By Balance b/d	43,500
To Cash A/c	1,500	By Creditors	5,400
To Cash in Transit A/c	8,000	By Salaries outstanding A/c	300
To Closing Stock A/c	28,700	A/c	
	49,200		49,200

Working Notes

Trading and Profit & Loss Account

Dr.		Rs.		Cr. Rs.
To Opening Stock A/c		16,400	By Sales	69,900
To Purchases	25,600		By Closing Stock	28,700
Less Return	600	25,000		
To Goods from H.O.		14,400		
To Wages		13,100		
To Factory Expense		6,800		
sTo Gross Profit c/d		22,900		
		98,600		98,600
To Salaries	8,000		By Gross Profit b/d	22,900
Add O/s	300	8,300	By Discount	300
To Rent		3,400		
To Depreciation		5,300		
To Sundry Expenses		4,000		
To Net Profit		2,200		
		23,200		23,200

Notes: 1) The closing entries for transfer of revenue items have been omitted.

2) The balance in Head Office Account after adjustment entries and transfer of net profit is Rs. 43,500. This is equal to the net assets at Patna as given below:

	Rs.	Rs.
Assets		
Debtors	11,000	
Cash	1,500	
Cash in Transit	8,000	
Closing Stock	28,700	
Liabilities:		49,200
Creditors	5,400	
Salaries O/s	300	5,700
Net Assets		43,500

3) After the assets and liabilities are transferred to Head Office Account, it stands closed.

Check Your Progress B

1. Why is the incorporation of branch balances necessary in the books of the Head Office?

....

....

2/ Name the two methods of incorporating branch balances in the books of the Head Office?

....

....

....

3. Fill in the blanks:

i) The short cut method of incorporating the branch balances is called ………….

ii) The branch net profit can be incorporated in the Head Office books by debiting the …………..Account and crediting the …………… Account.

iii) The net assets of the branch are equal to the …………… of the Branch Account after the entry of branch net profit or net loss has been passed in Head Office books.

iv) The balance in the Head Office Account in branch books represents the branch………………. after the net profit or not loss has been transferred to this account.

14.6 A COMPREHENSIVE ILLUSTRATION

As stated earlier, any organisation having branches has to present the final accounts of the organisation as a whole and not separately for the Head Office and for the branches. Hence, it prepares General Profit and Loss Account which includes the profit or loss made by the branches and draws a consolidated Balance Sheet to show the assets and liabilities of both the Head Office and the branch office. Illustration 6 below will help you to understand the preparation of a consolidated Balance Sheet.

Illustration 6

Following are the Trial Balances of the Head Office and its branch as on December 31, 2018.

Particulars	**Head Office**		**Branch Office**	
	Dr.	**Cr.**	**Dr.**	**Cr**
	Rs.	Rs.	Rs.	Rs.
Capital		1,50,000		
Fixed Assets	86,000		26,000	
Stock	34,700		20,700	
Debtors and Creditors	17,820	13,900	14,800	23,000
Cash	10,740		1,500	
Profit & Loss		14,720		13,100
Branch Office	29,360			
Head Office A/c				26,900
	1,78,620	1,78,620	63,000	63,000

Prepare the Balance Sheet of the business as on December 31, 2018 and pass the necessary journal entries in both sets of books to record the adjustments dealing with the following.

a) On December 28, the branch had sent a cheque for Rs. 1,600 to the Head Office but not yet received by them.

b) Goods valued at Rs. 560 had been forwarded by the Head Office to the branch and invoiced on December 30, but were not yet received by the branch.

c) It was agreed that the branch should be charged with Rs. 400 for administration services rendered by the Head Office during the year.

d) Rs. 1,250 for depreciation on branch assets, the accounts of which are maintained by the Head Office, is to be provided for.

e) The balance of profit shown by the branch is to be transferred to the Head Office books.

Solution

Head Office Journal

2018		Rs.	Rs.
1	Cash in Transit A/c Dr. To Branch A/c (Being cash sent by branch but not received by H.O. till December31)	1,600	1,600
2	Goods in Transit A/c Dr. To Branch A/c (Being goods invoiced on December 31 not yet received by the branch)	460	460
3	Branch A/c Dr. To Gen. Profit & Loss A/c (Being administrative expenses charged by H.O. to the Branch)	400	400
4	Branch A/c Dr. To Branch Fixed Assets A/c (Being depreciation on branch fixed assets accounts provided by H.O.)	1,250	1,250
5	Branch A/c Dr. To General P & L A/c (Being profit of branch transferred to General P & L A/c)	11,450	11,450

Branch Journal

2018		Rs.	Rs.
1	Profit & Loss A/c Dr To Head Office A/c (Being administrative expenses charged by H.O.)	400	400

2	Depreciation A/c Dr. To Head Office A/c (Being depreciation on Branch fixed assets accounts which are maintained by H.O.)	1,250	1,250
3	Profit & Loss A/c Dr. To Head Office A/c (Being transfer of profit credited to Head Office A/c)	11,450	11,450

Balance Sheet as on December 31, 2018

Liabilities			Rs.	Assets			Rs.
Capital			1,50,000	**Fixed Assets**			
Creditors				H.O.		86,000	
H.O.	13,900			Branch	26,000		
Branch	23,000		36,900	Less Dep.	1,250	24,750	1,10,750
Profit & Loss A/c				**Stock**			
H.O.	15,120			H.O.		34,700	
Branch	11,450		26,570	Branch		20,700	
				Goods in Transit		460	55,860
				Debtors			
				H.O.		17,820	
				Branch		14,800	32,620
				Cash			
				H.O.		10,740	
				Branch		1,500	
				Cash in Transit		1,600	
				Cash for Exp.		400	14,240
			2,13,470				2,13,470

Working Notes

1) The profits at branch and Head Office have been ascertained by preparing Profit and Loss A/c of the Head Office as well as that of branch.

Branch Profit and Loss Account

Dr. **Cr.**

	Rs.		Rs.
To Head Office Exp.	400	By Profit (as given)	13,100
To Depreciation	1,250		
To Profit taken to General P & L A/c	11,450		
	13,100		13,100

General (H.O.) Profit and Loss Account

Dr.	Rs.		Cr. Rs.
To Profit c/d	15,120	By Profit (as given)	14,720
		By Branch A/c	400
	15,120		15,120
To Net Profit (taken to Balance Sheet)	26,570	By Profit b/d	15,120
		By Branch A/c (profit made by branch)	11,450
	26,570		26,570

2) The Head Office A/c in the books of branch and Branch A/c in the books of Head Office will appear as follows:

Branch Books
Head Office Account

Dr.	Rs.		Cr. Rs.
To Balance c/d	40,000	By Balance b/d	29,900
		By H.O. Exp. A/c	400
		By Depreciation	1,250
		By P & L A/c	11,450
	40,000		40,000

Head Office Books
Branch Account

Dr.	Rs.		Cr. Rs.
To Balance b/d	29,360	By Goods in Transit	460
To Branch Assets A/c	1,250	By Cash in Transit	1,600
To General P & L A/c	11,450	By Balance c/d	40,000
	42,060		42,060

3) The balance in the Branch Account in Head Office books and the balance in Head Office Account in branch books show the same amount. i.e.. Rs. 40,000. But, the Branch Account balance is a debit balance while the Head Office Account balance is a credit balance. Having merged branch accounts with the Head Office accounts, these two balance cancel each other and so they do not appear in the consolidated Balance Sheet.

14.7 LET US SUM UP

Independent Branches are those branches which keep full system of accounting and enjoy certain amount of autonomy in functioning. They maintain complete records on double entry system and prepare their own trial balances. The Head Office simply maintains a personal account for each branch which shows all transactions that take place between the branch and the Head Office. Similarly, each branch maintains a Head Office Account to show the corresponding entries.

There are certain transactions which require special treatment both in Head Office and branch books. These are: (i) goods in transit, (ii) cash on transit, (iii) Head Office expenses chargeable to branch, (iv) depreciation on branch fixed assets the accounts of which are maintained at the Head Office level, and (v) inter-branch transactions.

At the end of the accounting year, the branch sends its Trial Balance to the Head Office. This enables the Head Office to incorporate all branch balances in its books so as to include them in the final accounts of the organisation. The incorporation entries can be passed for all items given in branch Trial Balance (called detailed incorporation), or simply for branch profit/loss (based on Memorandum Branch Profit and Loss Account) and for branch assets and liabilities (called abridged incorporation or short cut method). After the incorporation entries have been passed, the Branch Account stands closed. At the beginning of the next year, the opening entries are passed for branch assets and liabilities which restores the balance in the Branch Account. The branch closes its books by transferring its profit or loss to Head Office Account which then shows a credit balance equal to the net assets with the branch.

14.8 KEY WORDS

Abridged Incorporation: A short cut method of incorporating the branch balances in Head Office books.

Cash-in-transit: Cash remitted by branch to Head Office, but not received by Head Office by the end of the accounting year,or vice versa.

Consolidated Balance Sheet: Combined Balance Sheet showing both Head Office and branch assets and liabilities.

Goods-in-transit: Goods sent by Head Office to branch but not received by branch by the end of the accounting year, or vice versa.

Inter-branch transactions: The transactions between two or more branches under the same Head Office.

14.9 ANSWERS TO CHECK YOUR PROGRESS

A 3. i) c

ii) a

iii) a

iv) b

v) c

vi) b

B 3. i) Abridged Incorporation

ii) Branch Account, General Profit & Loss Account

iii) balance

iv) net assets

14.10 TERMINAL QUESTIONS/EXERCISES

Questions

1) How are branch balances incorporated in Head Office books at the end of the accounting year?

2) Write short notes including accounting treatment on the following:

   a) Cash in Transit

   b) Goods in Transit

   c) Head Office Expenses Chargeable to Branch

   d) Inter-branch Transactions

3) How do you deal with purchase and depreciation of branch fixed assets whose accounts are maintained at the Head Office level?

Exercises

1) Show what entries would be passed by the Head Office to record the following transactions in their books.

   a) Goods amounting to Rs. 1,000 transferred from Varanasi branch to Allahabad branch under intimation from H.O.

   b) Depreciation amounting to Rs. 2,000 on branch fixed assets when such assets' accounts are opened in the Head Office books.

   c) A remittance of Rs. 3,000 made by the Calcutta branch to Head Office on December 25, 2018 and received by Head Office on January 4, 2019.

   d) Goods of Rs. 10,000 sent by the Head Office on December 27, 2018 and received by Calcutta branch on January 10, 2019.

   e) The Allahabad branch collected Rs. 4,000 from Allahabad customers of Head Office.

   f) The Varanasi branch paid Rs. 25,000 for machinery purchased by the Head Office at Varanasi.

2) Show the journal entries that will be passed by Surat branch to record the following transactions in its books.

   a) Goods amounting to Rs. 6,000 transferred from Surat branch to Lucknow branch under instructions from Calcutta Head Office assuming that Head Office keeps a control on inter-branch transactions.

   b) Depreciation on Lucknow Branch Machinery Rs. 4,000 and Surat Branch Machinery Rs. 3,000, when the Branch Machinery Account is maintained in Head Office books.

   c) A remittance of Rs.10,000 made by Surat branch to Head Office on December 28, 2018 but received by the Head Office on January 4, 2019.

d) Goods worth Rs. 15,000 sent by Head Office to Surat branch on December 26, 2018 but received by the latter on January 2, 2019.

3) On December 31, 2018, the Trial Balance of Varanasi branch stood as follows:

Particulars	Debit Rs.	Credit Rs.
Stock on January 1, 2018	12,000	
Furniture	4,800	
Debtors	11,200	
Goods Received from Delhi HO.	32,000	
Salaries, Rent and Expenses	4,400	
Cash in Hand	3,600	
Delhi Office Account		22,000
Sales		45,600
Sundry Creditors		400
Total Rs.	68,000	68,000

Stock on December 31, 2018 was Rs. 9,200. Prepare (1) Trading and Profit & Loss Account, Balance Sheet and Head Office Account in Varanasi branch books (2) Prepare journal entries necessary to incorporate the Varanasi Branch Trial Balance and show the Varanasi Branch Account in the Head Office books.

Answer: Branch Profit Rs. 6,400; Balance Sheet Total Rs. 28,800; Head Office A/c Balance Rs. 28,400 and Total of Varanasi Branch A/c Rs, 77,200)

4) The Kanpur branch of Wahi Bros. sent the following Trial Balance to Head Office, as on December 31, 2018:

	Rs.		Rs.
Sundry Debtors	12,000	Sundry Creditor	8,600
Cash in hand	6,250	Goods returned to H.O.	2,250
Furniture	1,900	Sales	1,12,500
Stock on 1-1-88	2,250	Head Office A/c	10,250
Goods from H.O.	34,000		
Purchases	66,450		
Wages & Salaries	5,500		
Trade Expenses	5,250		
	1,33,600		1,33,600

The stock on December 31, 2018 was Rs. 5,200. Pass the necessary journal entries to incorporate the above figures and show Branch A/c in Head Office books, and Trading and Profit & Loss A/c and Balance Sheet in the branch books.

(**Answer:** Branch profit Rs. 6,500; Balance Sheet Total Rs. 25,350; Total of Branch A/c Rs. 1,38,800.)

5) Following is the Trial Balance of Kanpur Branch of Varanasi Head Office. Prepare Trading and Profit & Loss A/c and Balance Sheet in the books of branch. Also show Head Office A/c in the books of branch:

	Rs.		Rs.
Furniture & Fixtures	1,500	Cash in Bank	3,000
Purchases	20,000	Carriage etc.	150
Goods from H.O.	40,000	Bad Debts	100
Sales	80,000	Allowances to Customers	200
Sundry Debtor	10,000	Bills Receivable	4,000
Sundry Creditors	12,000	Stock on 1-1-2018	10,000
Head Office A/c Salaries	6,400	Returns Inwards	1,000
General Exp.	600	Returns to H.O.	400
Rent & Taxes	600		

Closing Stock on December 31, 2018 Rs. 9,000

(**Answer:** Branch Net Profit Rs. 10,350; Balance Sheet Total Rs. 27,500; H.O. A/c Balance including net profit Rs. 15,500.)

6) From the following balances, prepare the Branch Current Account in the books of head office and Head Office Current A/c in the books of branch.

Particulars	**Head Office**		**Branch**	
	Dr. Rs.	**Cr. Rs.**	**Dr. Rs.**	**Cr. Rs.**
Branch Current A/c	5,000	-	-	-
Goods sent to Branch	-	7,800	-	-
Goods received from H,O.	-	-	7,000	-
Head Office Current A/c	-	-	-	1,400

(**Answer:** Goods in Transit Rs. 800: Cash in Transit Rs. 2,800.)

7) A limited company with its Head Office in Delhi has a branch at Kota which obtains goods from the Head Office as well as from outside suppliers. The branch keeps a separate set of books on June 30, 2019. The trial balances of the Head Office and its branch were as follows:

Particulars	**Head Office**		**Branch**	
	Dr. Rs.	**Cr. Rs.**	**Dr. Rs.**	**Cr. Rs.**
Share Capital	–	30,000	–	–
P & L Account balance on 1-7-18	–	4,000	–	–
Fixed Assets	16,000	–	8,000	–
Opening Stock	14,000	–	1,900	–
Debtors and Creditors	17,000	10,000	1,500	2,050
Cash	3,000	–	1,000	–
Purchases and Sales	1,20,000	1,40,000	6,750	20,500
Sundry Expenses	15,000	–	2,250	–
Goods from HO. to Branch	–	12,000	11,500	–
Current Accounts on 30-6-19	11,000	–	–	10,350
	1,96,000	1,96,000	32,900	32,900

The difference between the balances of Head Office and the Branch Current Accounts is due to goods and cash being in transit at the close of the year. Fixed assets are to be depreciated at 10 per cent. Stocks on June 30, 2019 were: Head Office Rs. 10,000 and Branch Rs. 2,100.

Prepare consolidated Balance Sheet of the company. Also show journal entries for the adjustments and the incorporation of Branch Trial Balance.

(**Answer:** Balance Sheet Total Rs. 56,850.)

Hints: Goods in Transit Rs. 500; Cash in Transit Rs. 150; Branch Net Loss Rs. 600; H.O. Net Profit (excluding branch net loss) Rs. 11,400.

14.11 SOME USEFUL BOOKS

Maheshwari. S.N., 1998: ***Introduction to Accounting*** Vikas Publishing House, New Delhi. (Chapters 4 & 5, Section II).

Gupta R L. and M. Radbaswamy, 1998.***Advanced Accounting*** Sultan Chand & Sons, New Delhi (Chapters 19 & 20).

Shukla.M.C..Grewal T.S. & S.C. Gupta, 1998 ***Advanced Accounts*** S. Chand & Co. Ltd., New Delhi, Chapter 11.

MongaJ.R..Ahuja G.C. & Ashok Sehgal, 1998 :***Advanced Accounting*** National Publishing House Sew Delhi.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

Indira Gandhi
National Open University
School of Management Studies

BCOC-131
Financial Accounting

Block

5

CONSIGNMENTS AND JOINT VENTURES

PROGRAMME DESIGN COMMITTEE B.COM (CBCS)

Prof. Madhu Tyagi
Director, SOMS, IGNOU

Prof. R.P. Hooda
Former Vice-Chancellor
MD University, Rohtak

Prof. B. R. Ananthan
Former Vice-Chancellor
Rani Chennamma University
Belgaon, Karnataka

Prof. I. V. Trivedi
Former Vice-Chancellor
M. L. Sukhadia University
Udaipur

Prof. Purushotham Rao (Retd.)
Department of Commerce
Osmania University, Hyderabad

Prof. R. K. Grover (Retd.)
School of Management Studies
IGNOU

Prof. D.P.S. Verma (Retd.)
Department of Commerce
University of Delhi, Delhi

Prof. K.V. Bhanumurthy (Retd.)
Department of Commerce
University of Delhi, Delhi

Prof. Kavita Sharma
Department of Commerce
University of Delhi, Delhi

Prof. Khurshid Ahmad Batt
Dean, Faculty of Commerce & Management
University of Kashmir, Srinagar

Prof. Debabrata Mitra
Department of Commerce
University of North Bengal
Darjeeling

Faculty Members
SOMS, IGNOU
Prof. N V Narasimham
Prof. Nawal Kishor
Prof. M.S.S. Raju
Dr. Sunil Kumar
Dr. Subodh Kesharwani
Dr. Rashmi Bansal
Dr. Madhulika P Sarkar
Dr. Anupriya Pandey

COURSE DESIGN COMMITTEE

Prof. Madhu Tyagi
Director, SOMS, IGNOU

Prof. A.A. Ansari
Jamia Millia Islamia, New Delhi

Ms. Surbhi Gupta
Vivekananda College
University of Delhi, Delhi

Faculty Members
SOMS, IGNOU
Prof. N. V. Narasimham
Prof. Nawal Kishor
Prof. M.S.S. Raju
Dr. Sunil Kumar
Dr. Subodh Kesharwani
Dr. Rashmi Bansal
Dr. Madhulika P. Sarkar
Dr. Anupriya Pandey

COURSE PREPARATION TEAM

Accountancy-I: ECO-02

(Unit-10, 11, 12 and 13 Revised by Dr. Sunil Kumar)

Shri Vinod Prakash, Moti Lal Nehru College
University of Delhi, Delhi

Prof. N V Narasimham, Editor

Prof. M.S.S. Raju
(Course Coordinator & Editor)

Dr. Sunil Kumar
(Course Coordinator & Editor)

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 5 CONSIGNMENTS AND JOINT VENTURES

It is a common practice in business to send goods on consignment basis to some firms who undertake to sell it on behalf of the consignor. The consignor would like to ascertain the profit or loss of each consignment separately. This involves certain peculiarities in accounting. Sometimes two or more persons agree to carry out a specific project or a job jointly. This is termed as a joint venture. In that case, the parties to the joint venture called co-venturers want to ascertain their share of profit or loss from the joint venture business separately. For this purpose, they may prepare a separate set of books for the joint venture business or record the joint venture transactions in their own books only. This block consisting of three units covers the accounting procedure usually followed for recording various transactions related to the consignments and the joint ventures.

Unit 15 discusses various concepts related to consignment and describes the basic framework of accounting for recording the consignment transactions. It also deals with accounting treatment of normal and abnormal losses which may take place in transit or in the godown of the consignee.

Unit 16 explains how Consignment Account is prepared when goods are invoiced to the consignee at a price which is higher than its cost. It also describes the adjustments to be made at the time of working out the profit on consignment when goods are consigned at invoice price.

Unit 17 discusses various methods of accounting for the joint venture transactions.

UNIT 15 CONSIGNMENT ACCOUNTS-I

Structure

15.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of consignment;
- distinguish it from sale;
- identify the parties involved in consignment and describe their relationship;
- explain the basic framework of accounting for consignment transactions in the books of the consignor and the consignee;
- record consignment transactions directly in the ledger accounts of the consignor and the consignee;
- compute the value of unsold stock;

- explain the nature of normal and abnormal losses;
- compute the value of unsold goods in case of normal loss; and
- explain the treatment of normal and abnormal losses of goods and their impact on profit.

15.1 INTRODUCTION

The producers often make use of the services of selling agents and distributors in their channel of distribution. This is particularly true of the agricultural goods. The selling agents/distributors act in various ways. One of the methods used is to receive the goods on consignment basis. Under this system, the agent receives the goods and undertakes to sell it on behalf of the consignor. He often settles the account of the consignor after all the goods received from him have been sold. This involves certain peculiarities in accounting. In this unit, you will learn about various concepts relating to consignment and the basic framework of accounting for consignment transactions in the books of the consignor and the consignee.

You know the method of working out the profit on each consignment when all goods are sold out. In practice, you will find that at the time of submitting the Account Sales, some goods may remain unsold. Then, there is also a possibility of loss while the goods are in tranit or while they are lying in the godown of the consignee. Such loss may occur due to normal or abnormal causes. In this unit, you will learn how the value of unsold goods is worked out and recorded in books of account. You will also learn about the treatment of normal and abnormal losses which may take place in transit or in the godown of the consignee and their impact on valuation of stock and the profit on consignment.

15.2 CONCEPTS OF CONSIGNMENT

You know that goods are often sent by the producer on consignment basis to the selling agents or distributors. Let us now understand what exactly we mean by consignment, how does it differ from sale and what kind of relationship exists between the consignor and the consignee.

15.2.1 What is Consignment?

When goods are sent by a manufacturer or a trader to an agent to be sold by him on commission basis and at the risk and account of the former, they are said to be sent on consignment. In other words a producer/trader forwards his products to his selling agents, appointed at different places, to sell them on his behalf for an agreed commission. The process of sending goods on this basis by one firm to another for sale is known as 'Consignment' and this transaction is called a 'Consignment Transaction'. The consignment is 'Outward Consignment' for the person who sends the goods and an 'Inward Consignment' for the person who receives the goods for sale.

15.2.2 Parties to Consignment

You know that in consignment, the goods are sent by one person to another for sale by the latter on behalf of the former. Therefore, there are two parties involved: (i) the person who sends the goods and, (ii) the person to whom the goods are sent. The person who sends the goods to the agent is called the 'consignor' and the person to whom the goods are sent for sale is called the 'consignee'.

If 'X' sends goods to 'Y' for sale, 'X' is known as consignor and 'Y' consignee. The Consignor is the 'principal' and the consignee is the 'agent'. Their mutual relations are governed by the Law of Agency and, of course, by the terms of the contract between themselves. The consignee is a special kind of agent who is in possession of the goods. He passes the title of the goods to those who buy from him even if he sells the goods in contravention to the principal's instructions. Suppose, the consignor instructs the consignee not to sell the goods below a certain price. If the consignee sells the goods below the stipulated price, the buyer will have good title to goods. The consignor may, of course, ask the consignee to pay damages for breaking the terms of the contract with him. Like all agents, the consignee must render true accounts to the consignor, be faithful to him, and act according to his instructions. He is entitled to remuneration and reimbursement of expenses incurred by him on behalf of the consignor.

15.2.3 Features of Consignment

- Goods are forwarded by the consignor to the consignee with an objective of sale at a profit.
- Under the consignment, goods are to be treated as the property of the consignor and to be sold at his risk entirely. The consignee does not buy the goods, he merely undertakes to sell them on behalf of the consignor. He is not responsible for any loss or even for any destructions or damages to the goods. But the consignee should not show any negligence.
- The consignor does not sell the goods to the consignee. Therefore, he can not ask the consignee to pay the price of the goods unless they are sold and the sale proceeds are actually realised.
- The consignee agrees to sell the goods for an agreed rate of commission and is allowed to deduct his commission due from the sale proceeds.
- The agent enters into the picture only when he sells the goods and realises the amount. He becomes indebted for amounts realised on behalf of the principal. The relationship between the consignor and the consignee is that of a principal and an agent.
- As it is not a sale, whatever the consignee does is on behalf of the consignor and, therefore, all legitimate expenses incurred by the consignee for receiving and selling the goods should be reimbursed.
- Any stock remaining unsold with the consignee belongs to the consignor.
- As the consignee acts on behalf of the consignor, the profit or loss on sale of goods sent on consignment belongs to the consignor.

15.2.4 Distinction between Sale and Consignment

Although the possession of goods is transferred from one person to the other, both in case of sale and in case of consignment, they differ from each other in various ways. The difference between an outright sale and the goods sent on consignment has been explained as follows:

No. and Item	Sale	Consignment
1. Parties	Seller and Buyer	Consignor and Consignee
2. Ownership and title of goods	Ownership and title of goods is transferred from seller to the buyer of the goods.	The legal ownership and title of goods is not transferred to the consignee. It remains with the consignor till they are sold.
3. Relationship	The relationship between the seller and the buyer of the goods is that of a creditor and debtor.	The relationship between the consignor and the consignee is that of a principal and an agent. The consignee is to sell goods on behalf of the consignor.
4. Expenses	Expenses incurred after sale of goods are borne by the buyer.	Expenses incurred by the consignee in connection with the goods consigned to him are borne by the consignor.
5. Risk	Risk attached to the goods sold is transferred to the buyer of goods as soon as goods are sold. In case, the goods are destroyed after sale, the loss is suffered by the buyer.	Risk attached to the goods consigned lies with the consignor till the goods consigned are sold. In case, the goods are destroyed, the loss is borne by the consignor.
6. Return of Goods	Return of goods is not possible as goods once sold are not returnable.	Goods can be returned if they are not sold by the consignee.
7. Account Sales	No Account sale is required to be submitted by the buyer to the seller.	Account sale has to be submitted by the consignee to the consignor from time to time.
8. Unsold Goods	The seller has nothing to do with the goods which could not be resold.	Unsold goods with the consignee will be treated as stock of the consignor.

The distinction between sale and consignment given above also amply clarifies the difference between the rights and duties of the buyer and the consignee.

Check Your Progress A

1. Read the following carefully and tick mark the correct answer.

   a) The relationship between the consignor and the consignee is that of

      i) Buyer and Seller

ii) Principal and Agent

iii) Debtor and Creditor

b) The term used for consignee's remuneration is

i) Commission

ii) Brokerage

iii) Discount

c) The party responsible for the risk attached to the goods in consignment is

i) Consignee

ii) Consignor

iii) Both

d) The legal ownership of the goods is not transferred till the goods are sold in case of

i) Sale

ii) Consignment

iii) Both

2. State whether the following statements are **True** or **False.**

i) Despatch of goods on consignment amounts to sale of goods by the consignor. (T/F)

ii) All the legitimate expenses incurred by the consignee relating to consignment are borne by the consignor. (T/F)

iii) For the consignor the consignment is an outward consignment and the same becomes an inward consignment for the consignee. (T/F)

iv) Goods are treated as sales under consignment when they are consigned. (T/F)

v) The consignee does not become the debtor of the consignor on receipt of goods. (T/F)

15.2.5 Important Terms in Consignment

There are a few terms relating to consignment which are commonly used. These are proforma invoice, account sales, non-recurring and recurring expenses, commission, advance, etc. These are explained as follows:

ProformaInvoice : Since the goods sent on consignment cannot be treated as sales, the consignor does not prepare proper Invoice. He simply prepares a Proforma Invoice and sends it to the consignee along with the goods despatched. This is prepared with a view to inform the consignee about price of goods, expenses incurred, mode of transportation and the minimum sale price at which the goods are to be sold. A specimen of proforma invoice is given in figure 15.1

Fig. 15.1

Specimen of Proforma Invoice.

BABAR TRADERS

Proforma Invoice — 222, Mount Road, Chennai

For Goods Sent on consignment basis to: — Oct. 10, 2018
M/s Hari Kishan Enterprises, Hauz Khas, New Delhi.

Serial No.	Particulars		Amount
		Rs.	Rs.
	Rs. 500 Bush Radio sets at Rs. 600 each		3,00,000
	Charges		
	Packing and Cartage	4,000	
	Freight	3,000	
	Insurance	6,000	13,000
	Total		3,13,000
	Goods despatched vide R.R.NO. Smt. G.834866, Dated 10/10/18 Freight to pay.		

E. & O. E. — For Babbar Traders
(D. BABBAR)
Partner

Note: E.&.O.E. stands for Errors and Omissions Excepted. Which mean that invoice is subject to the errors of omission and commission.

In the above invoice, Babbar Traders is the consignor and Hari Kishan Enterprises is the consignee. Goods worth Rs. 3,00,000 have been consigned on which a sum of Rs. 13,000 has been incurred on various expenses.

Account Sales : As the consignee is an agent and is selling the goods on behalf of the consignor, he has to furnish the details of sale proceeds, expenses, commission, etc. to the consignor. He furnishes all these details by means of a statement called 'Account Sales'. This shows the quantity and description of goods sold, sale proceeds realised, the expenses incurred by the consignee, commission due to him, and the balance amount payable by him to the consignor. While preparing an Account Sales, the consignee will deduct all expenses incurred by him in relation to the consignment and the commission due to him. The remittances made in advance, if any, are also to be deducted from the balance so obtained. The consignee will send a bank draft or his acceptance for the balance due to the consignor. Illustration I will give you a clear understanding as to how an Account Sales is prepared.

Illustration 1

On January 1, 2018 Babbar Traders of Mumbai consigned 500 Bush Radio sets to Hari Kishan Enterprises, Chennai. The cost of each set was Rs. 750. On receiving the consignment, Hari Kishan Enterprises sent a bank draft for Rs.

25,000 as an advance to Babbar Traders. Hari Kishan Enterprises paid Rs. 1,500 for freight, Rs. 2,000 for octroi, Rs. 2,500 for godown rent and other selling expenses. Hari Kishan enterprises submitted an Account Sale on March, 1, 2018 showing that all the sets had been sold at Rs. 850 each. They were entitled to 10% commission on sales. Prepare the Account Sales.

Solution

ACCOUNT SALES
of 500 Bush Radio Sets Received from Babbar Traders, Mumbai

S.No.	Particulars		Amount
	Sale Proceeds: 500 Bush Radio Sets sold at Rs. 850 each		4,25,000
	Less:		
	Freight	1,500	
	Octroi	2,000	
	Godown rent & selling expenses	2,500	6,000
			4,19,000
	Less: Commission Rs. 4,25,000 × 10%		42,500
			3,76,500
	Less: Advance (Bank Draft)		25,000
	Balance due to Babbar Traders remitted as per draft enclosed		3,51,500
E. & O. B. Dated 01/03/18		For Hari Kishan Enterprises HARIKISHAN Managing Partner	

Commission : It is the remuneration paid to the consignee by the consignor in consideration of the services rendered by the former in selling the goods consigned. This commission can be divided into two types (a) Ordinary Commission, and (b) Special Commission.

a) **Ordinary Commission**: It is a commission usually paid as a fixed percentage on gross sale proceeds. The terms commission normally denotes ordinary commission, unless specified otherwise. The consignee is not responsible for any bad debts and he does not guarantee the payment from all those who buy on credit so long as he is getting ordinary commission only.

b) **Special Commission:** This is the commission which the consignee gets over and above the ordinary commission. It can be sub-divided into two categories viz., (i) Over-riding Commission and (ii) Del Credre Commission.

   i) **Over-riding Commission:**This is an extra commission allowed over and above the normal commission and is generally offered when the agent is required to put in hard work either in introducing a new product in the market or where he is entrusted with the work of supervising the performance of other agents in a particular area. This commission is also given for sales at prices higher than the price fixed by the consignor.

   ii) **Del Credre Commission:** Usually, all the losses are borne by the consignor. Sometimes the consignor expects that the consignee should also be responsible for recovering the debts and bear the loss on account of bad debts, if any. In order to compensate him for this additional responsibility, he is given some extra commission called 'Del Credre Commission'. Such commission is calculated on the total sales unless there is a special agreement to the effect that it is to be paid only on the amount of credit sales. Payment of this commission imposes extra liability on the consignee and induces him to deal in a prudent and cautious manner.

In illustration 2, we have given you the details regarding the computation of commission. It would certainly give you an idea about the calculation of normal commission and special commission.

Illustration 2

Rajadhani Cycles Ltd, sent 2,000 dynamos costing Rs. 50 each for sale on consignment basis to Banerjee & Co. Calcutta. Normal selling price per dynamos is Rs. 60. Consignee is entitled to commission at i) 5% on normal selling price; ii) 10% additional commission on excess sales and iii) 1 ½ % Del credre commission on total sales for guaranteeing collection of credit sales. Banerjee & Co. reported sales of 500 dynamos at Rs. 60 each and 200 dynamos at Rs. 75 each on cash basis, 400 dynamos at Rs. 75 each and another 400 at Rs. 80 each on credit basis. Compute consignee's commission.

Solution:

Total Sales:

500 units Rs 60 each	30,000
200 Units @ Rs 75 each	15,000
400 units @ Rs 75 each	30,000
400 Units @ Rs 80 each	32,000
	1,07,000

i) **Normal Commission**

5% on normal price of goods sold.
Number of Units sold are: 1,500 (500 + 200 + 400 + 400)
Normal selling price per unit Rs. 60

Normal Sale: 1500 × 60 = Rs. 90,000

Normal Commission: $\frac{5}{100} \times 90{,}000 = \text{Rs. } 4{,}500$

ii) **Additional Commission :** 10% on amount realized in excess of the normal price

	Rs.
Total Sales Value:	1,07,000
Normal Sales Value:	90,000
Excess Sales Value:	17,000

Additional Commission: $\frac{10}{100} \times 17{,}000 = \text{Rs. } 1{,}700$

iii) **Del Credre Commission**

$1\frac{1}{2}\%$ on Total Sales

$\frac{3}{100} \times 1{,}07{,}000 = \text{Rs. } 1{,}605$

Total Commission (i) + (ii) + (iii) Rs.4,500+ Rs. 1,700 + Rs. 1,605 =Rs.7,805

Expenses: Expenses relating to consignment of goods are divided into two categories viz., (i) Non-recurring Expenses, and (ii) Recurring Expenses.

i) **Non-recurring Expenses:** All the expenses which are incurred for bringing goods to the godown of the consignee are non-recurring in nature. Such expenses are generally incurred on the consignment as a whole. The non-recurring expenses will be incurred partly by the consignor and partly by the consignee.

The consignor usually incurs expenses on sending the goods to the consignee such as packing, cartage, loading charges, insurance, freight. etc. The consignee usually incurs expenses on receiving the goods from the consignor such as dock dues, customs duty, clearing charges, octroi, etc.

ii) **Recurring Expenses:** These expenses are incurred after the goods have reached the consignee's place or godown. They are recurring in nature because they may be incurred repeatedly by the consignor and the consignee. The examples of recuing expenses incurred by the consignor are: advertising, discount on bills, commission on collection of cheques, travelling, expenses of salesmen, bad debts etc. The examples of recurring expenses incurred by the consignee are godown rent, godown insurance, sales promotion, etc.

Advance: It is a common trade practice for the consignor to demand some advance from the consignee as a security for the goods despatched to him. It may be in the form of cash or bank draft or in the form of a bill of exchange. The consignee will send some amount as an advance before or after he receives the goods from the consignor. The advance received from the consignee should not be credited to consignment account as it is not a part of the sale proceeds. The advance will be adjusted against the amount due from the consignee when the accounts are finally settled. In some cases, a bill may be drawn on the consignee if he is not in a position to pay advance money. The consignor can discount the bill with his bankers. In such a case, the value of the bill (as advance) so accepted will be deducted from the sale proceeds. The discount paid to the bank can be straight away charged to the Profit &Loss Account as it represent cost of raising finance.

Check Your Progress B

1. Distinguish between Account Sales and Sales Account?

....

....

....

....

2. Under what circumstances can the consignee get a special commission?

....

....

....

3 Fill in the blanks:

   i) E. & O.E. stands for ………..

   ii) Consignor allows ……….Commission to the consignee to bear the bad debts.

   iii) ……….expenses are those expenses which are incurred after the goods reach the consignee's godown.

   iv) The consignee gives advance to the consignor as a……… for goods despatched.

   v) Unloading charges paid by the consignee are ………….expenses.

15.3 ACCOUNTING TREATMENT

The transactions relating to each consignment are recorded in such a way that the profit or loss of each consignment can be worked out separately. For this purpose, the consignor prepares a Consignment Account relating to each consignment to which all concerned expenses including the cost of goods consigned are debited and the sales proceeds and the closing stock are credited. In addition, he also maintain a consignee's account in order to compute the amount due from him. The consignee, on the other hand, simply maintains consignor's account in his books to which he debits the amounts remitted to the consignor the expenses incurred by him in relation to the consignment and the commission due to him. Consignor's Account is credited mainly by the amount of sale proceeds. Now let us study how various transactions related to consignment are recorded in the books of the consignor and the consignee.

15.3.1 Books of the Consignor

You know each transaction is recorded first in a subsidiary book and then posted to the respective accounts in the ledger. All transactions related to consignment therefore, are first recorded in the Journal. The entries passed in respect of various transaction are as follows:

1. **Goods despatched to the consignee:** As you know the consignment of goods cannot be treated as a sale of goods. Therefore, Sales Account will not be credited. In its place, an account called 'Goods Sent on Consignment Account will be credited and the Consignment Account is debited with the cost of the goods consigned'. Thus the journa1entry will be as follows:

   Consignment A/c Dr.
   To Goods Sent on Consignment A/c
   (Being the value of the consignment)

   If consignments have been sent to more than one consignee, the consignment accounts may be distinguished by adding the names of the places to the

Consignment Account. (For example Consignment to Calcutta Account, Consignment to Gonda Account, etc.

2. **Expenses incurred by the consignor:** All expenses incurred by the consignor on consignment of goods are debited to the Consignment Account and are thus added to cost of goods consigned. The entry would be:

Consignment A/c Dr.
To Cash/Bank A/c
(Being the expenses incurred on the consignment)

3. **Advance made by the consignee:** The amount of advance received from the consignee cannot be treated as sale proceeds, and so should not be credited to the Consignment Account. It is treated as follows.

Cash/Bank/Bills Receivable A/c Dr.
To Consignee's A/c
(Being an advance from the consignee)

4. **Bill received from the consignee discounted with the bank:** If the consignor gets the bills receivable discounted from his bankers, the entry will be

Bank A/c Dr.
Discount A/c Dr.
To Bills Receivable A/c
(Being bill discounted with the bank)

5. **Receipt of account sales from the consignee:** When the goods are sold out, the consignee will send an Account Sales to the consignor intimating him the total sales and the amount of his expenses and commission. The following three entries will be recorded in this connection.

   a) **For sales made by the consignee:**
   Consignee's A/c Dr.
   To Consignment A/c
   (Being gross proceeds of sales)

   b) **For consignee's expenses:**
   Consignment A/c Dr.
   To Consignee's A/c
   (Being expenses incurred by the consignee in dealing with consignment)

   c) **For consignee's commission:**
   Consignment A/c Dr.
   To Consignee's A/c
   (Being commission payable on sale proceeds)

6. **Goods returned by the consignee:** Sometimes defective or obsolete goods are returned by the consignee to the consignor. When such goods are received, the journal entry will be :

Goods Sent on Consignment A/c Dr.
To Consignment A/c
(Being goods returned by the consignee)

7 **Bad debts incurred:** When the consignee is entitled to delcredre commission, no entry for bad debts is to be passed as such loss is to be borne by the consignee himself. But when delcredre commission is not paid, the loss on account of bad debts is to be borne by the consignor, the entry will be:

Consignment A/c Dr.
To Consignee's A/c
(Being value of bad debts)

8. **Remittance by the consignee in full settlement:** The balance amount will have to be remitted by the consignee to the consignor on settlement of the account. The following entry will be recorded, when the consignee remits to the consignor:

Cash/Bank/Bills Receivable A/c Dr.
To Consignee's A/c
(Being balance due from the consignee received).

9. **Profit or loss on consignment:** When you balance the Consignment Account, it reveals profit or loss. If the total of credit side is more than the total of debit side, it is a profit and if the total of debit side is more than that of the credit side, it is a loss. The profit or loss is transferred to the Profit & Loss Account and thus the Consignment Account is closed.

The following entries will be recorded:

a) **If there is a profit:**
Consignment A/c Dr.
To Profit & Loss A/c
(Being profit on consignment)

b) **If there is loss:**
Profit & Loss A/c Dr.
To Consignment A/c
(Being loss on consignment)

10. **Closing entry for goods sent on consignment :** Goods Sent on Consignment Account is closed by transfer to the Trading Account. The entry passed is as follows:

Goods Sent on Consignment A/c Dr.
To Trading A/c
(Being goods sent on consignment account closed)

11. **Unsold stock with the consignee:** It is quite possible that all the goods sent on consignment are not sold by the consignee up to the date on which final accounts are prepared. Some goods may remain unsold known as the 'Consignment Stock'. This should be properly valued and credited to the Consignment Account. You will learn about the valuation of unsold stock in section 15.5 in this unit. However, the entry for consignment stock will be:

Consignment Stock A/c Dr.
To Consignment A/c
(Being unsold goods with the consignee)

You have learnt how to record consignment transactions in the Journal of the consignor.

Now let us see how these accounts are shown in the ledger and how profit or loss on consignment is worked out. The consignor usually maintains the following three accounts:

1. **Consignment Account:** It is prepared by the consignor showing all transactions relating to a particular consignment. The objective of this account is to ascertain net profit/loss aising from each consignment. Once goods are consigned by the consignor, its cost is debited to the Consignment Account alongwith various expenses incurred by the consignor and the consignee in dealing with that particular consignment. The commission due to the consignee is also debited to the Consignment Account. When Del Credre Commission is not paid, the bad debts, if any, are also to be debited to this account. Once the goods reach the consignee, some of these will be unsold and the rest sold either on cash or on credit. irrespective of the type of sale, the entire sale proceeds will he shown on the credit side of the Consignment Account. The unsold goods are treated as consignment stock and credited to this Account. If some goods are found unsuitable for sale, the consignee will send them back to the consignor and the same will appear on its credit side. After all these items are recorded, the Consignment Account is balanced. The difference between the debit and credit totals of Consignment Account is regarded as profit or loss which is transferred to the Profit and Loss Account and the Consignment Account stands closed. It is infact a nominal account and is just like a Trading and Profit and Loss Account about which you have studied earlier in final accounts. Therefore, the principles applied to Trading and Profit & Loss Account hold good for this account also. Like Trading and Profit & Loss Account, all expenses and purchases are debited to this account and all sales and incomes are credited. The proforma of the consignment account is given in Figure 15.2.

Fig. 15.2

Consignment to Patna Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
	To Goods Sent on Consignment A/c	xxx		By Consignee's A/c (Cash and Credit sales)	xxx
	To Cash A/c (Consignor's Expenses)	xxx		By Goods Sent on Consignment A/c (Goods returned by the Consignee)	xxx
	To Consignee's A/c (Consignee's Expenses)	xxx		By Consignment Stock A/c (Unsold Stock)	xxx
	To Consignee's A/c (Commission)	xxx		By Profit and Loss A/c (Loss transferred)	xxx
	To Consignee's A/c (Bad Debts if any)	xxx			
	To Profit and Loss A/c (Profit transferred)	xxx			
		xxx			xxx

2. **Goods Sent on Consignment Account:** This is a real account. It deals with the goods transferred from the consignor to the consignee and goods returned by the consignee to the consignor. All the goods consigned by the consignor will be credited to this account and the goods returned by the consignee are debited to this account. The balance represents the cost of goods with consignee for sale, and is transferred to the Trading Account. The proforma of the Goods Sent on Consignment Account is depicted in Figure 15.3

Fig. 15.3

Goods Sent to Consignment Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Consignment A/c (Goods returted)	xxx		By Consignment A/c (Goods consigned)	xxx
	To Trading A/c (Balance transferred)	xxx			
		xxx			xxx

3. **Consignee's Account:** It is a personal account of the consignee. It is prepared for ascertaining the amount due from the consignee. The consignee's account is debited with all cash and credit sales effected by the consignee. The various expenses incurred by the consignee, the commission charged by him as well as the advance remitted by him are credited to this account. This account usually shows a debit balance indicating the amount due from the consignee. At time it may show credit balance, if the advance given by the consignee is more than the sale affected by him. The balance revealed by this account is shown in the balance sheet of the consignor, debit balance on the assets side, and credit balance on the liabilities side, unless the account is settled by the required remittance. Figure 15.4 shows the proforma of Consignee's Account.

Fig. 15.4

Consignee's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Consignment A/c (Cash and Credit Sales)	xxx		By Cash/Bank/Bills Receivable A/c (Advance)	xxx
				By Consignment A/c (Consignee's Expenses)	xxx
				By Consignment A/c (Consignee's Commission)	xxx
				By Banks A/c or Balance c/d	xxx
		xxx			xxx

Look at illustration 3 and see how various transactions relating to consignment are recorded in the books of the consignor.

Illustration 3

Bush Radio & Co., Delhi sent on consignment to Chadda& Co., Calcutta 100 radio sets, invoiced at Rs. 100 each on January 6, 2018. Bush Radio & Co. paid Rs. 1,000 on the same day for despatching goods to the consignee. Consignee remitted Rs. 5,000 as an advance by bank draft on January 14. The Consignee is entitled to a commission of 10% on the sale proceeds. On receipt of goods, the consignee paid Rs. 1,000 for freight and Rs. 500 for godown charges.

On January 28, Chadda & Co. sent an Account Sales showing that the radio sets have realisedRs. 200 each. He remits the amount due to Bush Radio & Co. Pass Journal entries and prepare ledger accounts in the books of the consignor.

Books of Bush Radio & Co., Delhi
JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2018			Rs	Rs.
Jan. 6	Consignment to Calcutta A/c Dr.		10,000	
	To Goods Sent on Consignment A/c			10,000
	(Being cost of consignment sent to Chadda & Co.)			
" 6	Consignment to Calcutta A/c Dr.		1,000	
	To Bank A/c			1,000
	(Being expenditure incurred on despatching of goods)			
" 14	Bank A/c Dr.		5,000	
	To Chadda & Co.			5,000
	(Being receipt of an advance payment from the consignee)			
" 28	Consignment to Calcutta A/c Dr.		1500	
	To Chadda & Co.			1500
	(Being expenses paid by the consignee)			
" 28	Chadda & Co. Dr.		20,000	
	To Consignment to Calcutta A/c			20,000
	(Being the gross proceeds of sales made by the consignee)			
" 28	Consignment to Calcutta A/c Dr.		2,000	
	To Chadda & Co.			2,000
	(Being commission payable on sale proceeds)			
Jan. 31	Bank A/c Dr.		11,500	
	To Chadda & Co.			11,500
	(Being balance payment received from the consignee)			
" 31	Consignment to Calcutta A/c Dr.		5,500	
	To Profit & Loss A/c			5,500
	(Being Profit on consignment transferred to Profit & Loss Account)			
" 31	Goods Sent on Consignment A/c Dr.		10,000	
	To Trading A/c			10,000
	(Being goods sent on consignment transferred to Trading Account)			

LEDGER

Consignment to Calcutta Account

Dr. | | | | | Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		Rs.	Jan		Rs.
	To Goods sent on Consignment A/c	10,000		To Chadha & Co	20,000
	To Bank A/c (Consignor's Expenses)	1,000			
	To Chadha & Co. (Consignee's Expenses)	1,500			
	To Chadha & Co. (Consignee's Commission)	2,000			
	To Profit & Loss A/c (Profit transferred)	5,500			
		20,000			20,000

Goods Sent on Consignment Account

Dr. | | | | | Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018			**2018**		
Jan 30	To Trading A/c	10,000	Jan 6	By Consignment to Calcutta A/c	10,000

Chadha& Co. Account

Dr. | | | | | Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	**2018**		**Rs.**
Jan 28	To Consignment to Calcutta A/c (Sale Proceeds)	20,000	Jan 14	By Bank A/c (Advance)	5,000
				By Consignment to Calcutta A/c (Expenses)	1,500
				By Consignment to Calcutta A/c (Commission)	2,000
				By Bank A/c (Balance received)	11,500
		20,000			20,000

15.3.2 Books of the Consignee

The Consignee mainly prepares a consignor's account in his books to find out what is finally due to the consignor. He records all transactions relating to the consignment first in the Journal and then posts them to the relevant accounts (including Consignor's Account) in the ledger. The journal entries passed by the consignee are:

1. **Receipt of goods from the consignor:** No entry is passed by the consignee when he receives goods from the consignor because receipt of goods on consignment does not amount to purchases of goods by him. He keeps them in his godown on behalf of the consignor for which he usually maintains an Inwards Consignment Book.

2. **Expenses incurred by the consignor:** No entry is passed by the consignee.

3. **Advance made by the consignee**

   Consignor's A/c Dr.

   To Bank/Bills Payable A/c

   (Being advance made by the consignee)

4. **Bill discounted by the consignor with the bank:** No entry is passed by consignee.

5. **Sale of goods by the consignee**

   Cash A/c (cash sales) Dr.

   Consignment Debtors A/c (Credit sales) Dr.

   To Consignor's A/c

   (Being goods sold)

6. **Expenses incurred by the Consignee:** Being an agent of the consignor, all legitimate expenses incurred by the consignee related to the consignment are to be reimbursed by the consignor, the entry will be:

   Consignor's A/c Dr.

   To Cash/Bank A/c

   (Being expenses incurred on consignment)

7. **Commission due to the consignee**: This should include all types of commissions due to the consignee: The entry will be

   Consignor's A/c Dr.

   To Commission A/c

   (Being commission due on sales)

8. **Return of goods to the consignor:** No entry will be passed in the books of the consignee as no entry was passed at the time of receipt of the goods.

9. **Payment received from debtors**

   Cash/Bank A/c Dr.

   To Consignment Debtors A/c

   (Being amount collected from debtors)

10. **Bad debts incurred**

    a) If consignee does not get delcredre commission, all bad debts have to be borne by the consignor himself. The entry will be.

Consignor's A/c Dr.

To Consignment Debtors A/c

(Being bad debts on consignment)

b) If delcredre commission is paid to the consignee, the bad debts are to be borne by him. The entry will be:

Bad Debts A/c Dr.

To Consignment Debtors A/c

(Being bad debts incurred on consignment)

11. When the bills payable accepted in favour of consignor is met on the due date:

Bills Payable A/c Dr.

To Bank A/c

(Being bills payable honoured)

12. **Remittance in final settlement**

Consignor's A/c Dr.

To Cash/Bank Account

To Bills Receivable Account

(Being payment of the balance due to the consignor)

13. **Unsold stock in possession of the consignee :** No entry will be passed for unsold goods in the books of consignee as no entry was passed when he received goods from the consignor.

14. Profit or Loss on consignment: No entry is passed for profit or loss on consignment as the consignee is not concerned with it.

The Consignee also prepares ledger accounts after passing all the journal entries. The Consignor's Account and Commission Account are the two important accounts prepared by the Consignee in his books. Of course, he will also do the postings to the other accounts such as Consignment Debtor's Account, Consignment Expenses Account and Bills Payable Account. etc. But these are of less importance, hence not discussed here.

1. **Consignor's Personal Account:** This is the main account in Consignee's ledger which is prepared for working out the amount due to the consignor. Whatever amount he receives from sales of goods is credited to this account. All expenses incurred by the consignee in relation to consignment, the commission due to him, and the advance given by him to the consignor will be debited to this account. Further, if the consignee does not get delcredre commission, the bad debts on account of credit sales are also debited to the Consignor's Account. The balance of this account indicates the amount payable to the consignor. This account is just the opposite of the Consignee's Account in the books of the consignor. The proforma of the Consignor's Account is given in Figure 15.5

Fig. 15.5
Consignor's Personal Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Bank/Cash A/c (Consignee's Expenses)	xxx		By Bank A/c (Cash Sales)	xxx
	To Bank/Bills Payable A/c (Advance)	xxx		By Consignment A/c (Credit Sales)	xxx
	To Commission A/c (Consignee's Commission)	xxx		By Bank A/c (Balance remitted)	xxx
		xxx			xxx

2 **Commission Account:** This is nominal account. It shows the income earned by the consignee for the services rendered by him, All types of commission whether, ordinary or special, due to the consignee is credited to this account. The Commission Account will be debited with bad debts if the consignee is to bear such loss because of delcredre commission. The proforma of the Commission Account is given in Figure 15.6

Fig. 15.6
Commission Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Bad debts A/c	xxx		By Consignor's A/c (Consignee's Commission)	xxx
	To Profit & Loss A/c (balance)	xxx			
		xxx			xxx

Taking the data of illustration 3 let us see how transactions related to consignment will be recorded in the books of the consignee.

Books of Chadha & Co.
JOURNAL

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
2018				Rs	Rs.
Jan. 14	Bush & Co.	Dr.		5,000	
	To Bank A/c				5,000
	(Being advance paid by the consignee)				
" 15	Bush & Co.	Dr.		1,500	
	To Cash/Bank A/c				1,500
	(Being expenses incurred on consignment)				

"	28	Bank A/c Dr. To Bush & Co. (Being cash sales on consignment)		20,000	20,000
"	28	Bush & Co. Dr. To Commission A/c (Being commission due on goods sold)		2,000	2,000
"	31	Bush & Co. Dr. To Bank A/c (Being balance payment made)		11,500	11,500

LEDGERS

Bush & Co's Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	2018		**Rs.**
Jan. 14	To Bank A/c	1,500	Jan. 31	By Bank A/c (Sales)	20,000
Jan. 14	To Bank A/c (Advance)	5,000			
Jan. 14	To Commission A/c	2,000			
Jan. 14	To Bank A/c (Balance)	11,500			
		20,000			20,000

Commission Account

2018		**Rs.**	2018		**Rs.**
Jan. 31	To Profit & Loss A/c	2,000	Jan. 28	By Bush & Co.	2,000

Check Your Progress C

1. Fill in the blanks.

   i) All expenses incurred by the consignee are………… to Consignment Account.

   ii) When the defective goods are returned by the consignee, the consignor debits it to ………….Account.

   iii) When there is no del-credre commission, bad debts are borne by the …...............…….

   iv) Consignment Account is similar to……………Account.

   v) Consignee passes …………..entry for closing stock.

   vi) Commission Account is a …………Account.

2. Explain why the consignee does not pass any entry for

   a) Goods sent on consignment

b) Profit or loss on consignment, and

c) Closing stock.

....

....

....

....

15.4 DIRECT RECORDING IN THE LEDGER

You know for each consignment, the Consignor prepares the Consignment Account, the Goods Sent on Consignment Account and the Consignee's Account in his books, whereas the consignee prepares the Consignor's Account and the Commission Account in his books. Sometimes, you may be asked to prepare the ledger accounts directly i.e., without passing any journal entries, You should therefore learn how to prepare these accounts directly.

You should debit the Consignment Account with the cost of goods consigned, expenses incurred by the consignor, expenses incurred by the consignee and the Consignee's commission; and credit it with sales (both cash and credit) and the goods returned by the Consignee. The Consignee's Account will be debited with the sales made by him and credited with his expenses, commission and the remittances made to the Consignor.

The Consignor's Account in the books of Consignee is just the reverse of Consignee's Account in Consignor's books. It is debited with the expenses incurred by the Consignee, the commission due to him and the remittances made to the Consignor on account; and credited with the total amount of sales.

Look at illustration 4 and see how the consignment transactions are recorded directly in the ledger accounts.

Illustration 4

On January 1, 2018, Gursharan & Co. of Delhi consigned 50 cases of glassware costing Rs. 40,000 to Singh & Co. of Calcutta for sale on commission @ 5% on gross sale proceeds. Gursharan & Co. paid Rs. 500 for freight and carriage and Rs. 600 for packing. Singh & Co. took the delivery of goods on January 5, 2018 and paid Rs. 300 for clearing charges, Rs. 200 for carriage, Rs. 50 for miscellaneous expenses, and Rs. 100 for godown rent.

They sold 15 cases @ Rs. 1,000 each, 25 cases @ Rs. 1,200 each and 10 cases @ Rs. 1,100 each.

On April 5, 2018 Singh & Co. sent a bank draft for Rs. 15,000 to Gursharan & Co. on account. On April 10, 2018 Singh & Co. forwarded an Account Sales together with a bill of exchange for the balance due.

Prepare the necessary ledger accounts in the books of both the parties.

Solution :

Books of Gursharan & Co.
Consignment to Singh &Co's Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amoun
2018		**Rs.**	2018		**Rs.**
Jan. 1	To Goods Sent on Consignment A/c	40,000	Apr. 10	By Singh & Co. (Sales)	56,000
" 1	To Bank A/c Freight and Carriage 500 Packing 600	1,100			
Apr.10	To Singh & Co. (Expenses) Clearing charges 300 Carriage 200 Misc. Expenses 50 Godown Rent 100	650			
" 10	To Singh & Co. (Commission)	2,800			
" 10	To Profit & Loss A/c (Profit transferred)	11,450			
		56,000			56,000

Goods Sent on Consignment Account

2018		**Rs.**	2018		**Rs.**
Apr.10	To Trading A/c	40,000	Jan. 1	By Consignment to Singh & Co. A/c	40,000

Singh & Co's Account

2018		**Rs.**	2018		**Rs.**
Apr. 10	To Consignment to	56,000	Apr. 5"	By Bank A/c	15,000
			Apr. 10"	By Consignment to Singh & Co. A/c (Expenses)	650
			Apr. 10"	By Consignment to Singh & Co. A/c to (Commission)	2,800
			Apr. 10	By Bills Receivable A/c (Balance)	37,550
		56,000			56,000

Books of Singh & Co.
Gursharan& Co. Account

2018		Rs.	2018		Rs.
Apr. 5"	To Bank A/c	15,000	Apr. 10	By Bank A/c (Sales)	56,000
10"	To Cash A/c (Expenses)	650			
10"	To Commission A/c	2,800			
10	To Bills Payable A/c	37,550			
		56,000			56,000

Commission Account

2018		Rs.	2018		Rs.
Apr. 10	To Profit & Loss A/c	2,800	Apr. 10	By Gursharan & Co. A/c	2,800
		2,800			2,800

15.5 UNSOLD STOCK

In illustration 4, you saw that Singh & Co. sold all the goods consigned to them. But, in practice, you will find that at the time of submitting the Account Sale, a part of goods consigned will still be unsold and will be lying with the consignee. In order to calculate the true profit or loss on consignment, the unsold stock should be valued and accounted for. Let us therefore, learn first how the unsold stock is valued.

15.5.1 Valuation of Unsold Stock

You know that valuation of unsold stock is usually done at cost. In case of consignment, cost of stock would include the cost at which the goods are consigned plus the proportionate non-recurring expenses i.e., all those expenses incurred till the goods reach the godown of the consignee. You should note that all non-recurring expenses, whether incurred by the consignor or by the consignees, are to be taken into account. In the absence of details of expenditure incurred by the consignee, all expenses incurred by him are to be taken as recurring expenses and thus are not to be considered in the calculation of closing stock. In other words, while valuing the closing stock we add such proportionate expenses to the cost price that have been incurred upto the time the goods are brought to the place of the consignee. Any other expenses paid by the consignor or the consignee after this point will not be considered, as these expenses do not add to the value of the goods. Such expenses are godown rent, selling expenses, carriage outwards, godown insurance, discount etc.

Following expenses are usually added for calculation of closing stock:

Carriage and Freight

Loading Charges

Customs Duty

Clearing Charges

Dock Dues

Carriage paid upto the Godown

Unloading Charges

Following are the expenses which are not considered for calculation of closing stock:

Godown Rent
Discount
Bad Debts
Insurance of the Goods in the Godown
Selling and Distribution Expenses.

You will notice that all expenses incurred by the Consignor are considered for valuation of the closing stock. The problem arises only in case of Consignee's expenses. The Consignee's expenses which are to be included in the value of closing stock are those expenses which are incurred till the goods reach the godown of the Consignee. Any other expenses incurred thereafter are ignored for purposes of closing stock valuation.

Look at illustration 5 and see how the unsold stock is valued.

Illustration 5

A sent goods worth Rs. 10,000 to B and paid Rs. 1,200 for packing and Rs. 800 for insurance. B took the delivery of the goods and paid Rs. 2,000 for freight, Rs. 400 for cartage and unloading, Rs. 600 for godown rent, Rs. 400 as selling expenses and Rs. 800 for insurance. B sold three fourth of the goods for Rs. 1,800. Calculate the value of closing stock.

Solution

1	Cost of Unsold Stock:	Rs. 2,500 (1/4 of 10,000)
2	Non-recurring Expenses:	
	Incurred by Consignor	Rs. 2,000 (1,200 + 800)
	Incurred by Consignee	Rs. 2,400 (2,000 + 400)
		Rs. 4,400
3	Value of Closing Stock	

$$\text{Cost of Unsold Stock} + (\text{Non} - \text{recurnng Expenses} \times \frac{\text{Cost of Unsold Stock}}{\text{Cost of Goods Consigned}})$$

$= \text{Rs. } 2,500 + (4,400 \times 2,500/10,000)$

$= \text{Rs.}2,500 + 1,100$

$= \text{Rs. } 3,600$

Note : The godown rent, selling expenses and insurance being recurring expenses have not been included in the value of closing stock

15.5.2 Accounting Treatment of Unsold Stock

Since the value of unsold stock affects the profit or loss on any consignment, its valuation and recording in the books of Consignor is very important. It is shown on the credit side of Consignment Account for which the following journal entry will be passed.

Consignment Stock A/c Dr.
To Consignment A/c
(Being the value of closing stock)

The Consignee, however, will not pass any entry for the closing stock. It is because he is not the owner of the goods and does not pass any entry even when he receives or returns the goods.

Look at ilustration 6 and see how the closing stock is valued and treated in the books of account.

Illustration 6

On January 1, 2018 Universal Sports, Delhi consigned 180 cases of sports goods costing Rs. 360 each to Gemini Sports, Mumbai. They paid Rs 360 for insurance and Rs. 1,800 for freight. Gemini Sports are entitled to a commission of 10% on gross sales. Gemini Sports received the consignment on January 15 and sent a 60 days bill for Rs 10,000 to Universal Sport. The Bill was discounted for Rs. 9,000 .

On opening the cases, the Consignee found 10 cases of wrong description and returned them, paying return freight of Rs. 400. Gemini Sports sold 120 cases @ Rs 600 each for cash and 20 cases @ Rs. 700 each on credit. Gemini Sports spent Rs. 720 on clearing charges and Rs. 600 on carriage outwards. They incurred bad debts amounting to Rs 400. The accounts were settled on June 30, and the balance remitted by cheque. Show necessary ledger accounts in the books of both the parties.

Solution :

Books of Universal Sports
Consignment Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	2018		**Rs.**
Jan. 1	To Goods Sent on Consignment A/c	64,800	Jan. 15	By Goods Sent on Consignment A/c (Returns)	3,600
" 1	To Bank A/c (Expenses) Insurance 360 Freight 1,800	2,160	Jan. 30	By Gemini Sports Cash Sales 72,000 Credit Sale 14,000	86,000
" 15	To Gemini Sports (Freight on goods returned)	400	" 30	By Consignment Stock A/c	11,280
Jun 30	To Gemini Sports (Expenses) Clearing Charge 720 Carriage Outward 600	1,320			
" 30	To Gemini Sports (Bad Debts)	400			
" 30	To Gemini Sports (Commission)	8,600			
" 30	To Profit & Loss A/c (Profit transferred)	23,200			
		1,00,880			1,00,880

Gemini Sport Account

2018		Rs.	2018		Rs.
June 30	To Consignment A/c (Sales)	86,000	Jan.15	By Bills Receivable A/c (Advance)	10,000
			15	By Consignment A/c (Freight on returns)	400
			30 June	By Consignment A/c (Expenses)	1,320
			30"	By Consignment A/c (Bad Debts)	400
			30"	By Consignment A/c (Commission)	8,600
			30"	By Bank A/c	65,280
		86,000			86,000

Goods Sent on Consignment Account

2018		Rs.	2018		Rs.
Jan. 15	To Consignment A/c	3,600	Jan. 1	By Consignment A/c	.64,800
June 30	To Trading A/c	61,200			
		64,800			64,800

Books of Gemini Sports
Universal Sports Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2018		Rs.	2018		Rs.
Jan. 15	To Bills Payable A/c	10,000	June 30	By Cash A/c (Cash Sales)	72,000
" 15	To Cash A/c (Freight on returns)	400	June 30	By Debtors A/c (Credit Sales)	14,000
June 30	To Cash A/c (expenses)	1,320			
" 30	To Debtors A/c (Bad Debts)	400			
" 30	To Commission A/c	8,600			
" 30	To Bank A/c	65,280			
		86,000			86,000

Commission Account

2018		Rs.	2018		Rs.
June 30	To Profit & Loss A/c	8,600	June 30	By Universal Sports	8,600

Working Notes:

1. Closing Stock Valuation:

$$\text{No. of Closing Units} \times \text{Cost price per Unit} + (\text{Non-recurring Expenses} \times \frac{\text{Closing Stock Units}}{\text{No. of Units Consigned}}$$

= 30 x 360 + (2,880 x 30/180)

= 10,800 + 480

= Rs. 11,280.

(Non-recurring Expenses include all the expenses of Consignor and clearing charges paid by the Consignee)

2. **Goods Returned to the Consignor :** The goods returned are to be valued at Cost Price only. They should not include any other expenses. However, all the expenses incurred by the Consignee to return the goods should be considered as the expenses on that consignment. So the Consignment Account is debited and the Consignee's Account is credited with the amount of expenses incurred on returns.

Check Your Progress D

1. Tick the correct alternative

   a) The cost of consignment stock is the cost at which the goods are consigned plus

      i) the non-recurring expenses

      ii) proportionate non-recurring expenses

      iii) all the recurring expenses

   b) Non-recurring expenses are the expenses incurred

      i) after the goods reach the godown of the consignee

      ii) in transportation

      iii) till the goods reach the godown of the consignee

   c) Consignment stock is shown on'

      i) credit side of Consignee's Account

      ii) credit side of Consignment Account

      iii) debit side of Consignor's Account

   d) Goods returned by the Consignee should be charged to the Consignment Account at

      i) cost price

      ii) market price

      iii) cost or market price whichever is lower

   e) Expenses incurred in forwarding the defective goods should be debited to

      i) Profit and Loss Account

      ii) Consignment Account

      iii) Goods Sent on Consignment Account

15.6 LOSS OF GOODS

Under Consignment arrangement, when goods are transferred from one place to another, there is a possibility of loss in transit. The loss can also take place in the godown of the Consignee. The loss may occur due to factors like evaporation, leakage, mishandling etc., or due to some accident or theft. Such losses can be broadly divided into two types :

a) Normal Loss

b) Abnormal Loss.

Let us discuss the exact nature of these losses and their accounting treatment.

15.6.1 Normal Loss

It is a loss which is due to the inherent nature of the goods consigned. It may arise in the process of loading and unloading of goods, breaking of bulk pieces into smaller ones, weighing, due to evaporation, processing, etc. For example, while loading or unloading or weighing coal, some part is bound to fall down in powdered form. Similarly, the petroleum products are bound to loose weight due to evaporation or leakage. This type of loss is unavoidable. It can be reduced to some extent but cannot be eliminated altogether. Since this loss occurs in the ordinary course of business and is on account of inherent characteristics of the goods, it is called a normal loss. Normal loss is not shown separately in the books of accounts. The cost of normal loss is spread over the remaining units, thereby increasing the cost per unit of the goods. For example 10,000 tons of coal is sent on consignment costing Rs. 100 each. The normal wastage is i.e., 200 tons. Let us see how normal loss leads to an inflated cost price per unit.

Total Cost of 10,000 = Rs. 10,00,000 (10,000 $\times$ 100)

Total units = 10,000 tons

Normal Loss = 200 tons

Remaining units = 9,800 tons

Rs. 10,00,000 will now be the cost of 9,800 tons as the cost of normal loss is borne by the remaining units. The cost per unit will therefore be 10,00,000/9,800 = Rs. 102.04 approximately.

As stated earlier, no separate entry is passed for the normal loss. The effect of this is reflected in the valuation of closing stock only.

If the consignee is able to sell all the goods so that there is no stock left unsold, the question of normal loss becomes irrelevant. The problem arises only when some goods are left unsold with the consignee. In that case, we shall first calculate the inflated cost per unit as explained above, and then the closing stock shall be valued by multiplying the number of units in stock with the inflated cost per unit. The value of closing stock can also be computed directly (without calculating the inflated cost per unit) with the help of the following formula.

$$\text{Total Cost of Goods Consigned} \times \frac{\text{Unsold Units}}{\text{Remaining Units}}$$

Look at illustration 7 and see how the closing stock is valued when there is normal loss.

Illustration 7

Ram consigned 2,000 tons of coal at Rs. 50 per ton to Shyam of Delhi. He paid Rs. 20,000 as freight. Due to normal wastage 1,950 tons only were received by Shyam. He paid Rs. 5,000 as unloading charges. Goods sold were 1,300 tons. You are required to calculate the value of closing stock.

Solution :

	Rs.
Cost of 2,000 tons of coal at Rs. 50 per ton	1,00,000
Add:	
Freight paid by the Consignor	20,000
Unloading charges paid by the consignee	5,000
Total Cost of Goods	1,25,000

Unsold units:	**Tons.**
Total Units	2,000
Units Lost	50
Remaining Units	1,950
Units Sold	1,300
Units Unsold	**650**

Value of Closing Stock: Rs.

Cost of 2,000 tons = = 1,25,000

Cost of 1,950 (2,000 —50) tons = 1,25,000

Inflated Cost per ton $= \dfrac{1{,}25{,}000}{1950 \text{ tons}}$ Rs.64.10

Value of Closing Stock = Number of unsold units×Inflated cost per unit

= 650 tons × 64.10

Rs. 41,665

Alternatively

Value of clossing Stock =

$$\text{Total Cost of Goods Consigned} \times \frac{\text{Unsold Units}}{\text{Remaining Units}}$$

$$= \text{Rs.}1{,}25{,}000 \times \frac{650}{1{,}950}$$

= Rs. 41,667

15.6.2 Abnormal Loss

The loss which occurs due to negligence, inefficiency or some accident is treated as abnormal loss. For example, loss of goods due to fire, floods, earth quakes, riots, war, theft etc. Such a loss does not occur on account of inherent nature of the product, but on account of the operation of certain external forces.

Abnormal loss is calculated in the same manner as the value of closing stock. Inother words, in order to calculate the 33 abnormal loss, all the proportionate non-recurring expenses incurred upto the point of loss are also added to the cost of abnormal loss units. The formula for calculation of abnormal loss is as follows:

Cost of Abnormal Loss Units =

No. of Abnormal Loss Units × Cost Per Unit +

$$\text{Non-recurring Expenses upto the Point of Loss} \times \frac{\text{No. of Abnormal Loss Units}}{\text{No. of Units Consigned}}$$

Since the abnormal loss is not incidental to the consignment, it should be shown separately in the books of accounts. The total abnormal loss is credited to the Consignment Account. The following entry is passed in the books of the Consignor:

Abnormal Loss A/c Dr.
To Consignment A/c
(Being loss on account of ...)

Such an abnormal loss may be

i) Uninsured

ii) Partially Insured

iii) Fully Insured

i) **When the abnormal loss is Uninsured:** In case the abnormal loss is not insured with an insurance company, the total amount of the loss is transferred to Profit & Loss Account by passing the following entry.
Profit & Loss A/c Dr.
To Abnormal Loss A/c
(Being Abnormal Loss transferred to P & LA/c)

ii) When the abnormal loss is partially insurred : In case the abnormal loss is insured and the claim is admitted for a part of the loss, then the following entry is passed
Insurance Company's A/c Dr.
Profit & Loss A/c Dr.
To Abnormal Loss A/c
(Being partial claim admitted)

Insurance Company will be debited with the amount of claim admitted and only the balance amount (total loss minus the claim) is transferred to Profit & Loss Account.

iii) When the abnormal loss is fully insured: In case the loss is fully insured and the total 'claim' is admitted by the insurance company, the following entry will be passed.
Insurance Company's A/c Dr.
To Abnormal Loss A/c
(Being claim fully admitted)

Nothing is transferred to the Profit & Loss Account as the claim for the whole amount of loss had been admitted by the insurance company. No loss is to be borne by the Consignor. Look at illustration 8 and see how abnormal loss is calculated and treated in the books of accounts.

Illustration 8

Philips Radio Company consigned 100 transistors to their agent Paul Radios, Delhi. The cost price of each transistor is Rs. 75. The Consignor paid Rs. 200 for freight, Rs. 50 for cartage and Rs. 400 for insurance. Five transistors were totally destroyed in transit. The insurance claim of Rs. 300 was admitted by the insurance company. The Consignee took the delivery of 95 radios and spent Rs. 190 for clearing charges, Rs. 95 for cartage, Rs. 250 on godown rent and Rs. 150 as selling expenses. They sold all the units at Rs 100 each. Paul Radios are entitled to 5% commission on total sales. The balance due was remitted by way of a bank draft. Calculate the abnormal loss and prepare necessary ledger accounts in the books of both the parties.

Solution

Abnormal Loss = Number of Abnormal Loss Units × Cost Price Per Unit +

$$\left(\text{Non-recurring expenses before loss} \times \frac{\text{Abnormal Loss Units}}{\text{Total Units}}\right)$$

$= 5 \times 75 + (650 \times 5/100)$

$= 375 + 32.50$

$=$ Rs. 407.50 say Rs. 408

Books of Philips Radio Company
Consignment Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs**
	To Goods Sent on Consignment A/c	7,500		By Abnormal Loss A/c	408
	To Bank A/c (Expenses)	650		By Paul Radios (Sales)	9,500
	To Paul Radios (Expenses)	685			
	To Paul Radios (Commission)	475			
	To Profit & Loss A/c (Profit transferred)	598			
		9,908			9,908

Paul Radio's Account

		Rs.		**Rs**
	To Commission A/c (Sales)	9,500	By Consignment A/c (Expenses)	685
			By Consignment A/c (Commission)	475
			By Bank A/c	8,340
		9,500		9,500

Goods Sent on Consignment A/c

	Rs.		Rs.
To Trading A/c	7,500	By Consignment A/c	7,500
	7,500		7,500

Abnormal Loss Account

	Rs.		Rs.
To Consignment A/c	408	By Insurance Company A/c	300
		By Profit & Loss A/c	108
	408		408

Books of Paul Radio

Philips Radio's Account

Dr. Cr.

	Rs.		Rs
To Bank A/c (Expenses)	685	By Bank A/c (Sales)	9,500
To Commission A/c	475		
To Bank A/c	8,340		
	9,500		9,500

Commission Account

	Rs.		Rs.
To Profit & Loss A/c	475	By Philips Radio A/c	475
	475		475

Effect of abnormal loss on valuation of closing stock: The value of closing stock is also effected in case of abnormal loss. Abnormal loss may occur either in the godown of the Consignee or in transit. Let us see the effect of abnormal loss on the closing stock under both situations. When the abnormal loss occurs in the godown of the Consignee, the valuation of closing stock is not effected because the expenses incurred after reaching the godown of the Consignee are not to be taken into account for the purpose. Hence, the normal formula will be followed for the valuation of closing stock. Look at illustration 9 and see how the abnormal loss and the value of closing stock is calculated when the abnormal loss occurs in the godown of the Consignee.

Illustration 9

Vanaspati Ltd. consigned 5,000 kg. of vanaspati ghee to Ashoka Dealers, Chandigarh. Each kg.of ghee costs Rs. 8. Vanaspati Ltd. paid Rs 50 for carriage, Rs. 250 for packing and Rs. 200 for insurance in transit.

After three months from the date of the consignment of goods, Ashoka Dealers reported that 3,500 kg. of ghee was sold @ Rs. 9.50 per kg. and expenses were Rs. 500 on godown rent and Rs. 750 on salesmen salary. Ashoka Dealers are entitled to a commission of 5% on sales. 500 kg. of ghee was accidentally destroyed in the godown. Insurance claim of Rs. 3,500 was admitted. Prepare the necessary ledger accounts in the books of both the parties.

Solution:

Books of Vanaspati Ltd.
Consignment Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Goods Sent on Consignment A/c	40,000		By Abnormal Loss A/c	4,050
				By Ashoka Dealers (Sales)	33,250
	To Bank A/c (Expenses)	500		By Consignment Stock A/c	8,100
	To Ashoka Dealers (Expenses)	1,250			
	To Ashoka Dealers (Commission)	1,662			
	To Profit & Loss A/c	1,988			
		45,400			45,400

Ashoka Dealer's Account

		Rs.			Rs.
	To Consignment A/c	33,250		By Consignment Stock A/c (Expense)	1,250
				By Consignment Stock A/c (Commission)	1,662
				By Balance c/d	30,338
		33,250			33,250

Good Sent on Consignment Account

		Rs.			Rs.
	To Trading A/c	40,000		By Consignment A/c	40,000

Abnormal Loss Account

		Rs.			Rs.
	To Consignment A/c	4,050		By Insurance Company's A/c	3,500
				By Profit & Loss A/c	550
		4,050			4,050

Note: Abnormal loss has been worked out as follows:

Cost of 500 units = Rs. 4,000 (500 × 8)

Add : proportionate non-recurring expenses Rs. 50 (500/5,000 × 500)

Abnormal Loss = Rs. 4050

Books of Ashoka Dealers
Vanaspati Ltd'/s Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs**
	To Bank A/c (expenses)	1,250		By Bank A/c (Sales)	33,250
	To Commission A/c	1,662			
	To Balance c/d	30,338			
		33,250			33,250

Commission Account

		Rs.			**Rs**
	To Profit & Loss A/c	Rs.1,662		By Vanaspati Ltd	Rs.1,662

You have learnt that when abnormal loss occurs in the godown of the Consignee, the closing stock valuation is not affected. But it is not so when the abnormal loss occurs in transit. The closing stock valuation is also affected due to abnormal loss in transit because some non recurring expenses may be incurred after the loss has taken place. Hence, when such loss occurs in transit, you will have to distinguish between the non-recurring expenses incurred before the loss and the non-recurring expenses incurred after the loss. The non-recurring expenses incurred before the loss relate to the total units consigned whereas the non-recurring expenses incurred after the loss relate to the remaining units (total units minus abnormal loss units) only. So the expenses before the loss will be proportionately divided amongst the total units, whereas the expenses incurred after the loss will be proportionately divided amongst the remaining units. Look at illustration 10 and see how closing stock and abnormal loss are calculated and treated when such a loss occurs in transit.

Illustration 10

On June 10, 2018, Modi & Co., Patiala consigned 500 cases of goods costing Rs. 150 each to Sethi & Co., Calcutta. On the same date, the Consignor paid Rs. 2,500 for freight and carriage, Rs. 1,000 as loading charges, and Rs. 1,200 for insurance. On July 1, 2018 the Consignee paid Rs. 1,800 for clearing charges, Rs. 1,750 for warehousing and storage charges, and Rs. 900 for packing and selling expenses. He also remitted a bank draft for Rs. 15,000 as an advance against the consignment. On July 5, 2018 they sold 275 cases at Rs. 200 each. Sethi & Co. are entitled to 5% commission on the gross proceeds of sales. It is found that 50 cases have been lost in transit. Sethi & Co submitted an Account Sale on July 10, 2018. Prepare the necessary ledger accounts in the books of the Consignor.

Solution

Books of Modi & Co.
Consignment Account

Dr. **Cr.**

Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2018		**Rs.**	2018		**Rs**
June10	To Goods Sent on Consignment A/c (500 cases)	75,000	July,10	By Sethi & **Co.** (Sales of 275 cases)	55,000
" 10	To Bank A/c (Consignor's Expenses)	4,700	" 10	By Abnormal loss A/c (Loss in transit 50 cases)	7,970
July,10	To Sethi & Co. (Consignee's Expenses)	4,450	" 10	By Consignment Stock A/c	28,595
" 10	To Sethi & Co. (Commission)	2,750			
" 10	To Profit & Loss A/c (transfer of profit)	4,665			
		91,565			91,565

Sethi & Co. Account (Consignee)

2018		**Rs.**	2018		**Rs**
July,10	To Consignment A/c (Sale proceeds)	55,000	July, 1"	By Bank A/c (Advance)	15,000
			10"	By Consignment A/c (Consignment expenses)	4,450
			10"	By Consignment A/c (Commission)	2,750
			10	By Balance c/d	32,800
		55,000			55,000

Good Sent on Consignment Account

2018		**Rs.**	2018		**Rs**
July 10	To Trading A/c	75,000	July 10	By Consignment A/c	75,000

Notes:

1. All expenses incurred by the Consignor and the clearing charges incurred by the Consignee are non-recurring expenses.

2. **Abnormal Loss:**

Number of Abnormal Loss Units × Cost Price Per Unit

$$+\left(\text{Non-recurnng Expenses up to the point of loss} \times \frac{\text{Abnormal Loss Units}}{\text{Total Units Consigned}}\right)$$

$$= (50 \times 150) + (4{,}700 \times \frac{50}{500})$$

$$= 7{,}500 + 470 = \text{Rs. } 7{,}970$$

3 **Valuation of Closing Stock:**

Number of Closing Units = 175

Cost Price Per Unit = Rs. 150

Cost of Unsold stock = 175 × 150 = Rs. 26,250

Non-recurring expenses before loss = Rs. 4,700 (2,500 + 1,000 + 1,200)

Since these expenses are incurred on total consignment i.e., 500 units, the proportionate amount of expenses for consignment stock will be

$$4{,}700 \times \frac{175}{500} = \text{Rs. } 1{,}645$$

Non-recurring expenses after loss of Rs. 1,800 i.e., clearing charges of the consignee, as they are incurred after the consignment reaches the consignee. They would relate to 450 units (500—50). Hence, the proportionate amount of these expenses for consignment stock will be 1,800 × 175/450 = Rs. 700

Now the value of closing stock will be as follows:

Cost of unsold stock (175×1150)	=	Rs. 26,250
Add proportionate Expenses		
i) Before loss	=	Rs. 1,645
ii) After loss	=	Rs. 700
Value of Unsold stock	=	Rs. 28,595

The above method of valuation of closing stock can be put in the form of a formula which is as follows:

Number of Unsold Units × Cost price per unit

$$+ \text{Non-recurring expenses before loss} \times \frac{\text{Unsold Units}}{\text{Total Units}}$$

$$+ \text{Non-recurring expenses before loss} \times \frac{\text{Unsold Units}}{\text{Total Units} - \text{Abnormal Loss Units}}$$

15.6.3 Where Normal and Abnormal Losses Occur Simultaneously

In the illustration done earlier you had either the normal loss or the abnormal loss on the consignment. But it is quite possible that both normal and abnormal losses occur simultaneously in connection with the same consignment. In such a situation, the abnormal loss will be calculated in the same manner as discussed in sub-section 15.6.2. But, the valuation of closing stock needs special attention as the normal loss is also involved. In order to calculate the value of closing stock, the following procedure will be followed:

i) Take the total cost of goods consigned and add all the non-recurring expenses incurred by the Consignor as well as the Consignee.

ii) Deduct the quantity and cost of abnormal loss from the total number of goods consigned and the cost as obtained in (i) above respectively.

iii) Deduct the quantity of normal loss from the quantity worked out in (ii) above without making any adjustment in cost.

iv) How you will be left with the cost of goods of the good units with the Consignee. Calculate cost per unit of these units by dividing the cost (remaining after deducting the cost of abnormal loss) by the number of good units.

v) Multiply the number of unsold units with the cost per unit obtained in (iv) above to arrive at the value of unsold stock.

Look at iIllustration 11 and see how cost of abnormal loss and the value of unsold stock are calculated when the normal and abnormal losses occur simultaneously.

Illustration 11

Deepak Oil Mills, Cochin consigned 2,500 kg. of castor oil to Madhu & Co. Varanasi on April 1, 2018. The cost of oil was Rs. 18 per kg. The consignor paid Rs. 900 towards carriage, freight and insurance in transit. During transit 250 kg. oil was accidentally destroyed for which the insurance company paid Rs. 2,200 in full settlement of the claim directly to the Consignor.

Madhu & Co. took delivery of the consignment on April 10 and accepted a bill drawn on them by Deepak oil Mills of Rs. 5,000 for 2 months, On June 30, 2018, Madhu & Co. reported that 1,750 kg. were sold at Rs. 25 per kg. The expenses of the consignee were Rs. 1,850 towards godown rent, advertisement and salaries of salesmen. Madhu & Co. charged a commission of 3% plus 2% delcredre commission. Madhu & Co. further reported a loss of 20 kg. due to leakage. Prepare the necessary ledger accounts in the books of the Consignor.

Books of Deepak Oil Mills
Consignment Account

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		**Rs.**
To Goods Sent on Consignment A/c (2,500 kg)	45,000	By Madhu & Co. (Sale proceeds of 1,750 kg)	43,750
To Bank A/c (Consignor's expenses)	900	By Abnormal Loss A/c (250 kg)	4,590
To Madhu & Co. (Consignee's expenses)	1,850	By Consignment Stock A/c	8,892
To Madhu & Co. Commission 3% = 1,313; Del credre 2% = 875	2,188		
To Profit & Loss A/c (Balance)	7,294		
	57,232		57,232

Abnormal Loss Account

	Rs.		Rs.
To Consignment A/c (Sales)	4,590	By Bank A/c (amount from Insurance Co.)	2,200
		By Profit and Loss A/c (Balance)	2,390
	4,590		4,590

Madhu& Co. Account

	Rs.		Rs.
To Consignment A/c	43,750	By Consignment A/c (Expenses)	1,850
		By Consignment A/c (Commission)	2,188
		By Bank A/c (Advance)	5,000
		By Balance	34,712
	43,750		43,750

Goods Sent on Consignment Account

	Rs.		Rs.
To Trading A/c	45,000	By Consignee A/c	45,000

Working Notes:

i) **Abnormal Loss**

Number of Abnormal Loss Units × Cost Price Per Unit

$$+(\text{Non recurring expenses before loss} \times \frac{\text{Abnormal Loss Units}}{\text{Total Units}})$$

$$= (250 \times 18) + (900 \times \frac{250}{2,500}) = 4,500 + 90 = \text{Rs.}4,590$$

ii) **Value of Closing Stock**

	Number of units	Cost
Total Quantity and Cost of Oil	2,500	45,000
Add : Non-recurring Expenses	—	900
Total	2,500	45,900
Less : Abnormal Loss	250	4,590
	2,250	41,310
Less Normal Loss	20	—
Good Units	2,230	41,310
No. of Units sold	1,750	

Number of unsold units (2,230-1750) = 480 units

Now value of closing stock (480 units) will be

= 41,310 × 480/2,230

= Rs. 8,892

Check Your Progress E

1 Fill in the blanks

i) Losses occur either due to inherent nature of the product or due to operation of ………….

ii) Loss of weight due to evaporation is a …………….loss.

iii) Normal loss affects the valuation of …………………..

iv) Abnormal loss is ………………to Consignment Account.

v) Insurance claim is ………………to Abnormal Loss Account.

vi) The amount of loss not accepted by the insurance company is transferred to ………………Account

2. How will you treat abnormal loss if

a) loss is fully insured: ……………………..

b) loss is uninsured: ……………………..

c) loss is partly insured:……………………..

15.7 LET US SUM UP

Consignment is a kind of arrangement where the manufacturer or a trader sends goods to his agents for sale. The agents sell goods on behalf of the manufacturer or the trader. The person who sends the goods is called the Consignor and the person to whom the goods are sent is called the Consignee. The relationship between the Consignor and the Consignee is that of a Principal and an Agent.

While sending goods to the Consignee, the Consignor sends a proforma invoice which gives full details about the goods Consigned. After the goods have been sold, the Consignee prepares an Account Sales, giving full details about the number of units sold, the price at which they have been sold, and the expenses and commission due to him. The Consignee is entitled to commission for the services rendered to the Consignor. The commission can be ordinary or special commission.

In order to work out the profit or loss on each consignment and the amount due from each Consignee, the Consignor prepares Consignment Account, Goods Sent on Consignment Account and Consignee's Personal Account in his ledger for each consignment. The Consignee on the other hand, mainly prepares two accounts in his books viz., Commission Account and Consignor's Personal Account. This helps him to know the amount due to the Consignor and his income from commissions.

Sometimes the Consignee is not able to sell all goods consigned to him. He is left with some unsold stock, the cost of which must be shown on the credit side of the Consignment Account before calculating the profit on consignment. The cost of the unsold stock shall include the proportionate amount of non-recurring expenses.

When goods are consigned, it is possible that some goods are lost in transit or destroyed while it is lying in the Consignee's godown. Such losses may occur either due to the inherent nature of goods or due to some accident. The first is called normal loss and the second is called abnormal loss.

The normal loss is not shown anywhere in the books of account. It simply inflates the cost per unit of the goods consigned and, therefore, affects the revaluation of closing stock and the profit. But the abnormal loss requires special treatment in the books of account of the Consignor. The cost of such loss is worked out in the same manner as the cost of unsold stock and credited to the Consignment Account. Any amount received from the insurance company must be subtracted from the abnormal loss before it is transferred to the Profit and Loss Account.

15.8 KEY WORDS

Account Sales: A statement submitted by the Consignee to the Consignor giving account of the sale proceeds, details of various expenses incurred, and the commission due to him.

Consignee: A person to whom the goods are sent on consignment basis.

Consignment: Goods sent by a producer or a trader to his agents for sale on their behalf and at their risk.

Consignor: A person who sends the goods to his agents on consignment basis.

Del Credre Commission: Commission paid by the Consignor to the Consignee for bearing the risk of bad debts arising out of credit sales made by him on behalf of the Consignor.

Over-riding Commission: The commission over and above the normal commission paid to the Consignee for extra services provided by him or excess price realized by him.

Proforma Invoice: A statement prepared by the Consignor and sent to the Consignee giving details of goods consigned.

Normal Loss: Loss caused in the ordinary course of things due to evaporation, leakage, brakeing the bulk into pieces etc.

Abnormal Loss: Loss caused on account of storm, fire, accident theft etc.

15.9 SOME USEFUL BOOKS

Maheshwari, S.N. 2018. Introduction to Accounting.Vikas Publishing House: New Delhi.

Patil, V.A. and J.S. Korlahalli. 2012. Principles and Practice of Accounting, R. Chand & Co. : New Delhi.

William Pickles. 1992. Accountancy, R.L.B.S. and Pitman: London.

Gupta, R.L. and M. Radhaswamy. 2018. Advanced Accountancy, Sultan Chand & Sons; New Delhi

15.10 ANSWERS TO CHECK YOUR PROGRESS

A 1. a) ii b) i c) ii d) ii

2. i) False ii) True iii) True iv) False v) True

B 3. i) Errors and Omissions Excepted.

ii) Del Credre Commission iii) Recurring iv) security v) Non-recurring

C 1. i) debited ii) Goods Sent on Consignment iii) Consignor

iv) Trading and Profit & Loss Account. v) no vi) nominal

D 1. a) ii b) iii c) ii d) i e) ii

E 1. i) external forces ii) normal iii) closing stock
iv) credited v) credited vi) Profit & Loss

15.11 TERMINAL QUESTIONS/EXERCISES

Questions

1. "Consignment is the same thing as sale". Discuss.

2 What is an 'Account Sales'? How do you prepare it? State how it is useful to the Consignor?

3 Distinguish between

a) Non-recurring and Recurring Expenses

b) Ordinary Commission and Del Credre Commission

c) Account Sales and Invoice

4. List the expenses taken into account while valuing the unsold stock.

5. What is the difference between normal loss and abnormal loss? Give examples.

6. What procedure is followed for valuation of closing stock when the abnormal and normal losses occur simultaneously.

Exercises:

1. 'X' & Co. Bombay consigned 250 Weston T.V. sets to 'Y' & Co. Banglore. Each T.V. set costs Rs. 7,500. Y & Co. received the consignment and sold the sets as follows:

160 T.V. sets at Rs. 9,000 each on cash basis and 90 T.V. sets at Rs. 10,500 each on credit basis.

The Consignor is allowed 5% normal commission and 2.5% del credre commission to the Consignee on the sales effected by him.

Compute total commission due to Y & Co.

(**Answer:** Normal Commission Rs. 1,19,250; Del Credre Commission Rs. 59,625)

2. Harish & Co. Lucknow, consigned goods valued at Rs. 1,25,000 to Dinesh Enterprises, Ahmedabad. Harish paid Rs. 1,800 towards freight, insurance and crriage. Dinesh received the consignment and accepted a bill for Rs. 50,000. He paid Rs. 1,500 for freight, Rs. 2,200 for carriage and godown rent, and Rs. 2,500 as salesmans salaries. The Consignee is allowed to take 7% commission on the total sales. Consignee sold all goods for Rs. 1,68,000. Balance owed by Dinesh was remitted by a bank draft. Prepare an Account Sales.

   (Answer: Balance due from the consignee: Rs. 1,00,040)

3. On January 1, 2018Gopal Enterprises, Hyderabad sent 50 radio sets to Rakesh & Co., Bombay invoiced at Rs. 1,200 per set and incurred the following expenses in relation to the consignment: dock dues Rs.2,000; customs duty Rs. 1,000 and frieght Rs. 2,300. Rakesh & Co. remitted Rs. 20,000 by bank draft on January 5, 2018. It sold all the sets at Rs 1,500 each by January 31, 2018 and incurred Rs. 2,500 as godown rent. Commission is allowed at 5% on sales. The Consignee sent the Account Sale and enclosed a bank draft for the balance.

   Journalise the above transactions in the books of the Consignor and the Consignee. Also prepare necessary ledger accounts and calculate the profit on consignment.

   (**Answer:** Profit on consignment Rs. 3,450; Balance due from the Consignee Rs 48,750)

4. Krishna of Bombay consigned goods costing Rs. 2,50,000 to Kajriwal of Jodhpur.

   Krishna paid Rs. 1,500 for carriage and Rs. 5,250 for freight and insurance. Kajriwalis entitled to a commission of 5% on all sales in addition to 2% del credre commission. Krishna draws on Kajriwal a bill for Rs. 80,000, payable two months after date, which later accepts. The bill is discounted with the bank for Rs. 79,000. An Account sale received from Kajriwal stating that the goods had been sold for Rs. 3,10,000 (Rs.1,60,000 on credit and Rs. 1,50,000 for cash), while expenses incurred by him were: unloading Rs. 1,250; godown rent Rs. 2,500 and insurance Rs. 500. A bank draft was enclosed for the balance due. Kajriwal could not recover Rs. 2,500 from a customer to whom goods were sold on credit.

   Pass Journal entries in the books of the Consignor and the Consignee and prepare ledger accounts.

Hints : i) Discount will not be debited to Consignment Account

ii) Bad Debts will be borne by the Consignee and debited to his commission account.

iii) Del Credre commission is computed on total sales.

(**Answer:** Profit on consignment Rs. 27,300; Amount due from Consignee Rs. 2,04,050.)

5 Kabir of Jhansi consigned to Moses of Cochin 400 chairs on April 10, 2018. The Cost of each chair was Rs. 250. The Consignor paid Rs. 2,000 for cartage, freight etc., on April 12, 2018, and drew a bill on the Consignee as an advance against the consignment at 3 months for Rs. 60,000. Later, it was discounted at their bank at 5%. The Consignee sold all the goods on July 1, 2018 and submitted an Account Sales showing that the goods realisedRs. 1,20,000. He incurred Rs. 1,000 on carriage inwards and Rs. 550 on selling and other expenses. He was allowed to take 5% commission on the total sales. You are required to show ledger accounts for the above transactions in the books of the Consignor and the Consignee.

(**Answer :** Profit Rs. 10,450)

6. 'X' of Bangalore consigned 100 bags of cement for sale to his agent 'Y'. Cost price of each bag is Rs. 120. 'X' immediately drew a 4 months bill for Rs. 5,000 on the latter and discounted it with bank at 6% per annum. 'X' paid Rs. 800 on packing and Rs. 250 for carriage. 'Y' spent Rs. 300 as selling expenses. The Consignee returned 5 bags. He realised 20 bags at Rs. 130 per bag and 50 bags on credit at Rs. 140 per bag and took the balance in his own stock at Rs. 135 per bag.

Consignee is entitled to get commission of 3% and 2% delcredre commission on credit sales. 'Y' recovered all money from debtors except Rs. 500. Prepare the necessary ledger accounts in the books of both parties.

(**Answer :** Loss Rs. 204)

7. Grover Enterprises, Delhi sent 100 bicycles to Khan Enterprises, Patna. Cost of each cycle was Rs. 640. Grover incurred Rs. 1,500 for freight and Rs. 1,100 for insurance in transit. Khan paid Rs. 650 for cartage and 2,000 towards godown rent and selling expenses. 20 bicycles remained unsold at the end. The remaining bicycles realisedRs. 800 per cycle. Calculate the value of unsold stock.

(**Answer:** Cost of unsold stock Rs. 13,450)

8. Kiran Bros. on January 1, 2018 consigned sports materials costing Rs. 10,000 to their agent Kabir Agency. Kiran Bros. paid Rs. 200 for freight and Rs. 100 for insurance and other charges. Consignee received the delivery by paying Rs. 150 for non-recurring expenses on January 15, 2018. He sent an account sale on February 20, 2018 showing that 20% of the stock realised Rs. 3,200 and 30% of the stock was sold on credit for Rs. 3,600.

One customer from whom Rs. 500 was due became insolvent and only 25% of the debt could be recovered. Consignee is entitled to a commission of 5% on sales. Pass journal entries and prepare the necessary ledger accounts.

(**Answer:** Profit Rs. 860: Stock Rs. 5,225)

9. Srikanth consigned 2.500 kg. of coconut oil costing Rs. 50,000. Expenses incurred were Rs. 1,400. Consignee spent Rs. 2,000 on unloading and cartage. 100 kg. of oil was lost due to natural deterioration and 1,500 kg. were sold. Calculate the cost of stock at the end?

   (**Answer :** Cost of Stock Rs. 20,025)

10. Kapur of Lucknow consigned 200 bags of rice, each costing Rs. 300 to Jam Traders of Bombay on April 1, 2018. The Consignor paid Rs. 2,000 towards freight and insurance. 30 bags were damaged in transit. The Consignee received on May 31, 2018 Rs. 2,000 on account of the damaged bags from the Insurance Company. On May 31, 2018 the Consignee reported that 140 bags were sold at Rs. 375 per bag. The Consignee incurred Rs. 2,000 for godown rent and selling expenses. The Consignee is allowed 10% commission on the sale proceeds. You are required to prepare the ledger accounts in the books of Mr. Kapur assuming that Jam Traders remit the balance by bank draft on May 31, 2018.

    (**Answer :** Profit Rs. 1,850 : Accidental Loss Rs. 9,300)

11. Dinesh of Delhi consigned 200 sewing machines costing Rs. 150 each to Chander of Calcutta. He paid Rs. 2,800 on insurance and received an advance of Rs 20,000 from Chander. 30 machines were damaged in transit. Chander took the delivery of the remaining goods and paid Rs. 1,700 for unloading the consignment. He sold 50 machines @ Rs. 270 each for cash and 100 machines @ Rs, 300 each on credit. Chander could not realise Rs. 2,000 from his debtors. Chander recovered Rs. 1, 500 from the insurance company. He sold damaged machines for Rs. 2,300. Chander is entitled to an ordinary commission @ 5% and 3% delcredre commission. The accounts were settled and balance remitted by bank draft. Show the necessary ledger accounts in the books of Dinesh.

    Hint: i) Sale of damaged stock as well as the amount recovered from insurance company will he credited to Abnormal Loss Account and debited to Chander's Account.

    ii) Commission on sale proceeds of damaged goods @ 5% will be debited to Abnormal Loss Account and credited to Chander's Account.

    (Answer :Abnormal Loss Rs. 4,920; Value of Unsold Stock Rs, 3,480; Profit Rs. 13,920; Balance due from ChanderRs. 22,005)

12. SohnaVanaspati, Faridabad consigned 10,000 kg. of ghee to Krishna Dealers of Delhi at Rs. 16 per kg. The Consignor paid Rs. 950 as carriage, Rs. 250 as freight and Rs. 400 as insurance. In transit, 1,000 kg. of ghee was accidentally destroyed for which an amount of Rs. 8,000 was recovered from the insurance company in full settlement.

Krishna Dealers reported that 8,000 kg. of ghee was sold @ Rs. 20 pe kg. They spent Rs. 500 on salesmen salary and Rs. 200 on godown rent, The Consignee is entitled to a commission of 5% on sales. Krishna dealers reported a shortage of 40 kg. due to leakage. Prepare necessary ledger accounts in the books of both the parties.

(**Answer:** Profit Rs. 22,443; Abnormal Loss Rs. 16,160; Closing stock Rs. 15,583)

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 16 CONSIGNMENT ACCOUNTS-II

Structure

16.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of invoice price and the reasons for consigning goods at invoice price,;
- compute cost price and invoice price in different situations,
- explain the meaning of loading and pass necessary entries for its adjustment in consignment account; and
- prepare books of the consignor and the consignee based on invoice price.

16.1 INTRODUCTION

In Unit 15, you have learnt about the recording of tranactions relating to consignments in books of both the Consignor and the Consignee. You know that the goods sent on consignment are recorded in Consignment Account at cost price. Sometimes, the Consignor does not want to reveal the cost of goods to the Consignee and, therefore, invoices the goods at a price which is higher than the cost price. Such price is known as 'invoice price' and the difference between the invoice price and the cost price is called 'loading'. In such a situation, the entry for goods sent on consignment is also recorded at the invoice price which would need an adjustment for loading at the time of computing the profit on consignment. In this unit, you will learn how Consignment Account is prepared when the goods are consigned at invoice price and how the necessary adjustments are made at the time of working out the profit on consignment.

You will also learn how the invoice price is calculated when the loading is given in the form of a percentage at the cost price or the invoice price.

16.2 CONCEPTS OF INVOICE PRICE

In Unit 15, you learnt that when the Consignor sends goods on consignment to the Consignee, he records it in his books at cost and the same is reflected in the proforma invoice.

Sometimes, the consignor does not want the Consignee to know the actual cost of goods sent to him. Therefore, consigne the goods at a price other than the cost price. Such price would generally be higher than the cost. It is called the invoice price. In other words, the invoice price is equal to the cost price plus a certain amount of profit.

Apart from the intention of not revealing the cost of goods to the Consignee there are a number of other reasons why the Consignor Consignees the goods at invoice price. These are:

i) The Consignee will not able to assess the profit earned on consignment and therefore may not demand a higher commission.

ii) If the Consignee know about the actual cost of goods, he may resort to some dishonest practices such as buying goods for himself at a lower price and then selling them at a higher price in the market.

iii) It would give a fair idea to the Consignee of the minimum price at which he is to sell the goods.

You should note that invoice price is not the same thing as selling price. The invoice price is the price at which the Consignor sends the goods to the Consignee, whereas the selling price is the price at which the Consignee sells the goods to the customers. Let us take an example in order to clearly understand the difference between the three prices i.e., the cost price, the invoice price and the selling price. Suppose, Gopal consigns goods worth Rs. 15,000 to his agent Ashok at an invoice price of Rs. 18,000. Ashok sells the goods at Rs. 20,000. In this example, the cost price (CP) of the goods is Rs. 15,000, the invoice price (IP) of the goods is Rs. 18,000, and the selling price (SP) of the goods Rs, 20,000.

You will observe that the IP is higher than CP whereas SP is higher than the CP as well as the IP, and that the SP and the IP are not the same. If, however, the Consignor directs the Consignee to sell the goods at invoice price itself, then the SP and the IP will be the same.

16.3 CALCULATION OF COST PRICE AND INVOICE PRICE

You know the relationship between the invoice price (IP), the cost price (CP) and the profit. This can be expressed in the form of an equation as follows.

$$IP = CP + Profit$$

With the help of the above equation, you can find out the missing figure i.e., if any two figures are given, the third one can be worked out. For example, if the CP is given as Rs. 150 and the profit as Rs. 50, the invoice price will be

IP = CP + Profit

= 150 + 50

= Rs. 200

Similarly, if invoice price and profit are given as Rs. 200 and Rs. 50 respectively, the cost price will be

IP	=	CP	+	Profit
200	=	CP	+	50
CP	=	200	-	50
	=	Rs. 150		

In the above examples, the profit is given as an absolute Figure. But, in many cases the profit may be given in the form of a percentage either on cost price or on invoice price. In that case, the calculation of missing price may become difficult. Of course, if the percentage of profit is based on the price, the figure of which is given, you may not face much problem. But if the percentage of profit is based on the price, the figure of which is not given, you may find it difficult to work out the profit and so also the missing price. Let us take different situations where the profit is given in the form of a percentage and we have to work out the missing price. These situations are:

1. CP is given and Profit is given as a percentage of CP, you have to work out IP
2. CP is given and Profit is given as a percentage of IP, you have to work out IP
3. IP is given and Profit is given as a percentage of IP, you have to work out CP
4. IP is given and Profit is given as a percentage of CP, you have to work out CP

Let us take them one by one and find out the missing figure with the help of examples.

1. **CP is given and the profit is given as a percentage on CP**

   Suppose the CP of a product is Rs. 200 which is invoiced at 20% profit on cost. The IP will be calculated as follows:

   IP = CP + Profit

   $$IP = 200 + (\frac{20}{100} \times 200)$$

   IP = 200 + 40

   IP = Rs. 240

2. **CP** is **given and the profit** is **given as percentage on IP**

Suppose CP of a product is Rs. 200 which is invoiced at 20% profit on IP. Now IP will be calculated as follows:

Let us assume that the IP is X

IP = CP + Profit

$$X = 200 + (\frac{20}{100} \times X)$$

$$X = 200 + \frac{20}{100}X$$

$$X - \frac{20}{100}X = 200$$

$$\frac{100X - 20X}{100} = 200$$

$$\frac{80}{100}X = 200$$

$$X = \frac{200 - 100}{80} = Rs.250$$

So the IP is Rs. 250 and the Profit is Rs. 50. Now you can verify that the profit is 20% on invoice Price.

$$\text{Profit} = \frac{20}{100} \times IP$$

$$\text{Profit} = \frac{20}{100} \times 250$$

Profit = Rs. 50

3. **IP is given and the profit is given as percentage of IP:** Suppose the IP of a product is Rs. 500 and Profit is 25% on IP. The missing figure i.e., the CP is worked out as follows :

IP = CP + Profit

$$500 = CP + \frac{25}{100} \times 500$$

500 = CP + 125

CP = 500—125

CP = Rs. 375

4. **IP is given and the profit is given as a percentage of CP:** Suppose the IP is Rs. 600 and Profit is 20% on CP then CP will be calculated as follows:

Let us assume CP to be X

IP = CP + Profit

$$600 = X + \frac{20}{100}X$$

$$600 = \frac{100X + 20X}{100}$$

$$600 = \frac{120}{100}X$$

$$X = \frac{600 \times 100}{120}$$

X = Rs.500

So the CP is Rs. 500 and Profit is Rs. 100. Now you can verify that the profit is 20% on cost.

$$\text{Profit} = \frac{20}{100} \times CP$$

$$= \frac{20}{100} \times 500$$

= Rs. 100

16.4 LOADING

16.4.1 What is Loading?

You know that the invoice price is obtained by adding a certain amount of profit to the cost price. The amount of profit which is added to the cost in order to arrive at the invoice price is called loading. In other words, loading is the difference between the invoice price and the cosi price.

Loading = IP – CP

For example, if the invoice price is Rs. 10,000 and the cost price is Rs. 7,500, the amount of loading will be :

Loading = IP - CP or Number of units × (IP per unit – CP per unit)

= 10,000 – 7,500

= Rs. 2,500.

If the invoice price or the cost price is given and the proft (loading) is given in the form of a percentage, either on IP or CP, the loading can be worked out directly in the same manner as we worked out the IP or CP in the examples under Ssection 16.3 earlier.

16.4.2 Items which Involve Loading

Loading is usually involved in all such items which are recorded at the invoice price in the Consignment Account. These items are:

1 Opening Stock

2 Goods Sent on Consignment

3 Goods Returned by the Consignee

4 Closing Stock.

You have to compute the loading in respect of all the above items and make necessary adjustments in books of the Consignor.

16.4.3 Adjustment of Loading

You know the profit is the difference between selling price and cost price. In Consignment Account prepared earlier, the goods sent on consignment and the other related items, were shown at cost. Hence you had no problem in computing the profit. But, when the goods sent on consignment and other related items are shown in the Consignment Account at invoice price, it becomes necessary to adjust the loading in the Consignment Account so as to bring down the invoice price to the level of cost. If such adjustment is not done, the profit figure will be incorrect. There is also a possibility that the Consignment Account shows loss because the difference between the selling price and the invoice price is generally small which cannot cover all expenses. Look at figure 16.1 and see the difference between the actual profit and the profit without adjustment. The profit thus calculated will be the difference between sales and invoice price.

Fig. 16.1

	Rs.		
Cost price	15,000		
Invoice Price	18,000	Rs. 3,000 Loading	
Sale Price	20,000	Rs. 2,000 Profit without adjustment	Rs. 5,000 Actual Profit

From Figure 16.1 it is clear that if no adjustment is made, the profit will be Rs. 2,000 whereas the actual profit is Rs. 5,000. Therefore, in order to calculate the actual profit earned on any consignment, all the items shown at invoice price are to be brought down to the level of cost by adjusting the amount of loading on each of them. Let us now take the items involving loading one by one and see how the necessary adjustments are made.

1. **Opening Stock :** Opening stock is always shown on the debit side of Consignment Account. In case the stock is shown at invoice price, the difference between the invoice price and the cost price of the stock will be shown on the credit side of the Consignnt Account by passing the following journal entry.

   Stock Reserve A/c Dr.

   To Consignment A/c

   (Being unloading on opening stock)

2. **Goods Sent on Consignment :** Goods sent on Consignment are shown on the debit side of Consignment Account. In order to nullify the effect of invoice price, the difference between the invoice price and the cost price

in respect of goods sent on consignment will be shown on the credit side of the Consignment Account by passing the following journal entry.

Goods Sent on Consignment A/c Dr.
To Consignment A/c
(Being unloading on goods sent on consignment)

3. **Goods Returned by the Consignee :** As the return of goods is shown on the credit side of Consignment Account, the adjustment for the loading will be made on the debit side of Consignment Account with the help of the following journal entry:

Consignment A/c Dr.
To Goods Sent on Consignment A/c
(Being loading on goods returned)

4. **Closing Stock:** Since closing stock is shown on the credit side of Consignment Account, the adjustment for the loading will be made on the debit side with the help of the following journal entry.

Consignment A/c Dr.
To Stock Reserve A/c
(Being unloading on closing stock)

Thus you will observe that the adjustment entry for loading in the Consignment Account is made on the opposite side of the original entry. For example, the closing stock is shown on the credit side of the Consignment Account, whereas its adjustment is shown on the debit side of the Consignment Account. This is how the effect of loading in Consignment Account is neutralised and the invoice price is brought down to the cost level. You should remember that the adjustment for loading is to be made in the books of the Consignor only. The Consignee does not record any entries for the items involving loading. Therefore no adjustment is needed in consignee's books.

Check Your Progress A

1. State whether the following statements are **True** or **False.**

   i) Consignor always consigns goods at invoice price.

   ii) Sending goods at invoice price shall result in less profit in the Consignment Account, if no adjustment is made for the loading.

   iii) Invoice price is always equal to selling price.

   iv) Consignor consigns the goods at invoice price to conceal the actual profit earned on consignment.

   v) Loading on closing stock will be nullified by debiting Stock Reserve Account and crediting Closing Stock Account

   vi) All the entries of adjustment for loading are recorded in the books of Consignee.

2. What is Loading?

....

....

....

3. Name the items that involve loading.

....

....

....

4. Work out the following problems:

   i) Cost price of a fan is Rs. 500 and loading is Rs. 100. What is the invoice price.

   ii) Cost price of a watch is Rs. 150. It is consigned at 33.33% above cost. Find out the invoice price.

   iii) Cost price of a bicycle is Rs. 500. It is invoiced at a profit of 20% on invoice price. What is the invoice price?

   iv) A ceiling fan is consigned at an invoice price of Rs. 250. Invoice price is cost plus a profit of 10% on the invoice price. What is the cost price.

   v) Invoice price of a chair is Rs. 300, which is 20% above cost. Find out its cost price.

5. Find out the loading in the following cases:

   i) Goods costing Rs. 1,800 are invoiced at Rs. 2,200.

   ii) Cost price Rs. 600 invoiced at a profit of 20% above cost.

   iii) Cost price is Rs. 600 invoiced at a profit of 20% on invoice price.

   iv) Invoice price is Rs. 600 involving profit of 20% on invoice price.

   v) Invoice price is Rs. 600 involving profit of 20% above cost.

16.5 ACCOUNTING FOR GOODS SENT AT INVOICE PRICE

You have learnt about the concept of invoice price, the calculation of loading involved and the adjustment entries to be passed in respect of all items involving loading. As for the recording of transactions for goods consigned at invoice price, the treatment in books of the Consignee is not affected at all. Even in the books of the Consignor all entries remain the same. But, the amounts with which the four items involving loading (opening stock, goods sent on consignment, goods returned by the Consignee, and closing stock) will reflect the invoice price. Then, at the time of working out the profit on consignment, you will have to pass the necessary adjustment entries for the loading involved in respect of all the four item as stated earlier. Look at Illustrations 1 to 4 and see how various consignment transactions have been recorded when goods are invoiced at the invoice price.

Illustration 1

Ages Cycle Co., Delhi sent 100 bicycles on January 1, 2018 to Murugan Enterprises, Madras. The cost of each bicycle was Rs. 500 and it was invoiced at Rs. 600. Ages Cycle Co. incurred Rs. 2,000 on freight and insurance and received Rs. 30,000 as advance from Murugan Enterprises. Murugan Enterprises paid Rs. 1,000 as octroi and carriage, Rs. 800 as rent and Rs. 600 as insurance. By June 30, 2018 they had sold 100 bicycles for Rs. 62,500. Murugan Enterprises are entitled to a commission @ 10% on the proforma invoice price and 20% of any surplus realised over and above the invoice price. Murugan Enterprises remitted the amount due from them by a bank draft.

You are required to prepare ledger accounts in the books of both parties

Solution:

Books of Ages Cycle Co.
Consignment to Madras Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			**Rs.**
2018			2018		
Jan. 1	To Goods Sent on Consignment A/c (IP)	60,000	Jan.30	By Murugan Enterprises (Sales)	62,500
“ 1	To Bank A/c (Expenses)	2,000	“ 30	By Goods Send on Consignment A/c (Loading)	10,000
“ 30	To Murugan Enterprises (Consignee’s expenses)	2,400			
“ 30	To Murugan Enterprises (Commission)	6,500			
“ 30	To Profit & Loss A/c (Profit transferred)	1,600			
		72,500			72,500

Murugan Enterprise's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	**2018**		**Rs.**
Jan 30	To Consignment to Madras A/c (sales)	62,500	Jan. 1	By Bank A/c (advance)	30,000
			Jan. 30	By Consignment to Madras (expenses)	2,400
			Jan. 30	By Consignment to Madras (expenses)	6,500
			Jan. 30	By Bank A/c (Balance)	23,600
		62,500			62,500

Goods Sent on Consignment Account

2018		Rs.	2018		Rs.
Jun 30	To Consignment to Madras A/c (loading)	10,000	Jan. 1	By Consignment to Madras A/c (IP)	60,000
Jun 30	To Trading A/c	50,000			
		60,000			60,000

Books of Murugan Enterprise
Ages Cycle Co. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	**2018**		**Rs.**
Jan 1	To Bank A/c (advance)	30,000	Jan. 30	By Bank A/c (sales)	62,500
" 1	To Bank A/c (expenses)	2,400			
Jun 30	To Commission A/c	6,500			
Jun 30	To Bank A/c (Balance)	23,600			
		62,500			62,500

Commission Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2018		**Rs.**	**2018**		**Rs.**
Jun 30	To Profit and Loss A/c	6,500	Jun 30	By Ages Cycle Co.	6,500

Working Notes

1. **Loading on Goods Sent on Consignment**

	Rs.
Total cost of 100 bicycles (500 × 100)	50,000
Total Invoice price of 100 bicycles (600 × 100)	60,000
Loading involved (IP-CP)	10,000

2. **Commission**

	Rs.
10% on Proforma Invoice Price of Rs. 60,000	6,000
20% on Surplus realised (Rs. 62,500-60,000=2,500)	500
	6,500

3. Since there are no opening and closing stocks and the goods returned by the Consignee, the adjustment for loading has been made only in respect of the goods sent on consignment.

Illustration 2

Raj Traders of Ludhiana consigned 100 computers costing Rs. 20,000 each to Bahadur of Gauhati at 10% above cost. Raj Traders incurred Rs. 500 for packing and other charges on each computer. The Consignee received the consignment by paying Rs. 1,500 for railway charges, Rs. 1,300 for insurance and Rs. 200 for carriage. He submitted an Account Sales as follows:

20 Computers sold at Rs. 25,000 each for cash
50 Computers sold on credit at Rs. 30,000 each
10 taken for his own stock at Rs. 25,000 each

Consignee remitted the balance after deducting his commission at 10% on sales. Assuming that original entries are made at invoice price and consignment stock is valued at invoice price, write necessary accounts in the books of RajTraders.

Solution:

Books of Raj Traders
Consignment to Gauhati Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Goods Sent on Consignment A/c (IP)	22,00,000	By Bahadur (Sales)	22,50,000
To Bank A/c (Consignor's expenses)	50,000	By Consignment Stock A/c	4,50,600
To Bahadur (Consignee's expenses)	3,000	By Goods Sent on Consignment A/c (Loading on goods sent)	2,00,000
To Bahadur (Commission)	2,25,000		
To Stock Reserve A/c (Loading on closing stock)	40,000		
To Profit & Loss A/c (Profit transferred)	3,82,600		
	29,00,600		29,00,600

Goods Sent on Consignment Account

	Rs.		Rs.
To Consignment A/c (loading)	2,00,000	By Consignment A/c (IP)	22,00,000
To Trading A/c	20,00,000		
	22,00,000		22,00,000

Bahadur of Gauhati Account

	Rs.		Rs.
To Consignment A/c (Sale proceeds)	22,50,000	By Consignment A/c (Expenses)	3,000
		By Consignment A/c(Commission)	2,25,000
		By Balance c/d	20,22,000
	22,50,000		22,50,000

Stock Reserve Account

	Rs.		Rs.
To Balance c/d	40,000	By Consignment A/c (Loading)	40,000

Working Notes

1. **Calculation of Invoice Price per computer**

   Cost price of each computer Rs. 20,000

   Invoice price 10% above the cost price

   Invoice price = Cost price + 10% of cost price

   $$= 20,000 + \frac{10}{100} \times 20,000$$

   = 20,000 + 2000

   = Rs. 22,000

2. **Calculation of closing stock:** While calculating closing stock, proportionate non-recurring expenses are added, as you learnt in the previous unit.

		Rs.
Total invoice price of 20 computers (Rs. 22,000 × 20)		4,40,000
Add: proportionate non-recurring expenses by the		
Consignor	50,000	
Consignee	3,000	
Total	53,000	
Proportionate Expenses (Rs. 53,000 × 20/100)		10,600
Closing Stock		4,50,600

3. **Calculation of loading:**

Invoice price per computer	22,000
Cost price per computer	20,000
Loading (IP- CP) per computer	2,000
Total loading on goods sent on consignment	2,00,000
Total loading on closing stock of 20 computers (200 $\times$ 20)	40,000

Illustration 3

Ram Das of Hyderabad consigned goods costing Rs. 72,000 to Prakash of Cochin at a pro-. forma invoice price which is cost plus a profit of 1/6th on invoice price. The Consignor paid Rs. 1,800 as insurance and other charges. Prakash received the goods and paid Rs. 3,000 for freight and other charges. He was allowed 3% commission on gross sales. Three fourths of the goods were sold at $33\frac{1}{3}\%$ profit on cost, half of which were credit sales. Half of the balance was stolen, but the stock being insured, a claim was lodged for Rs. 8,000 and was settled for Rs. 7,000. Balance of stock was valued at proforma invoice price. Write up the Consignment and the Abnormal Loss Accounts.

Solution:

Consignment to Cochin Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Goods Sent on Consignment A/c	86,400	Prakash (Sales)	72,000
To Bank A/c (Consignor's expenses)	1,800	By Abnormal Loss A/c	9,600
To Prakash (Freight and other charges)	3,000	By Consignment Stock A/c (Unsold stock)	11,400
To Prakash (Commission on Sales)	2,160	Goods Sent on Consignment A/c (Loading)	14,100
To Stock Reserve A/c (Loading on closing stock)	1,800		
To Profit & Loss A/c (Profit transferred)	12,240		
	1,07,400		1,07,400

Abnormal Loss Account

	Rs.		Rs.
To Consignment to Cochin A/c	9,600	By Bank A/c (Insurance)	7,000
		By Profit & Loss A/c (Balance transferred)	2,600
	9,600		9,600

Working Note:

1. **Invoice Price of the Goods Sent:**

Cost price (CP) of the Goods = Rs 72,000

Let IP be X

IP = CP + Profit

$$X = 72,000 + \frac{1}{6}X$$

$$X - \frac{1}{6}X = 72,000$$

$$\frac{6X - X}{6} = 72,000$$

$$\frac{5X}{6} = 72,000$$

$$X = 72,000 \times \frac{6}{5} = \text{Rs. } 86,4000$$

Therefore IP = Rs. 86,400

2. **Sale of price of 3/4 of the goods:** (3/4th of the goods sold at a profit of 33.3% on cost) CP of 3/4th goods (72,000 × 3/4) = Rs. 54,000

Add $33\frac{1}{3}\%$ of cost as profit = $(54,000 \times \frac{100}{300})$ = Rs. 18000

Sales = Cost Price + Price + Profit

= Rs. 54,000 + 18,000 = Rs. 72,000

3. **Value of closing stock:**

Invoice Prince of Goods Consigned	Rs. 86,400
IP of stock left unsold (86,400 × 1/4)	Rs.21,600
Less: 1/2 of the unsold stock lost in transit (21,600 × 1/2)	Rs, 10,800
IP of stock with the consignee after the loss (21,600-10,800)	Rs. 10,800

Add proportionate expenses (1/8 × 4,800)	600
Value of closing stock	11,400

4. **Cost of Goods Lost (Abnormal Loss)**

Goods lost is half of the goods unsold i.e.,

1/2 × 1/4 = 1/8th of goods consigned

CP of abnormal loss (1/8 × 72,000)	9,000
Add proportionate non-recurring expenses (1/8 × 4,800)	600
Cost of Abnormal Loss	9,600

5. **Loading on Closing Stock:**

	Rs.
IP (1/8 of 86,400)	10,800
CP (1/8 of 72,000)	9,000
Loading	1,800

Illustration 4

Verma Bros. of Bombay consigned goods at the invoice price of Rs. 1,00,000 which is 25% above cost price, to their agent Kabir Agency, Ahmedabad. The consignor incurred Rs. 5,000 for carriage and freight and Rs. 3,500 for insurance. Verma Bros. received Rs. 25,000 as advance against the consignment.

The Consignee is allowed 3% commission on all sales. Any goods taken by the Consignee himself or lost through Consignee's negligence shall be valued at cost plus 25% and no commission would be allowed on them. The Consignee sold 4/5th of the goods consigned for Rs. 1,40,000. Goods of the invoice price of Rs. 10,000 were taken by the Consignee and the remaining goods were lost through his negligence. The Consignee paid Rs. 2,500 for advertisement and selling expenses. Prepare necessary accounts in the books of the Consignor.

Solution:

Consignment to Ahmedabad Account
Consignment to Cochin Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Goods Sent on Consignment A/c	1,00,000	By Kabir Agency (Sales)	1,40,000
To Bank A/c (expenses)	8,500	By Kabir Agency (CP of goods taken)	9,000
To Kabir Agency (Consignee's expenses)	2,500	By Kabir Agency (Stock lost)	9,000
To Kabir Agency (Commission)	4,200	By Goods Sent on Consignment A/c(Loading)	20,000
To Profit & Loss A/c (Profit transferred)	62,800		
	1,78,000		1,78,000

Kabir's Account

	Rs.		Rs.
To Consignment to Ahmedabad A/c (sales)	1,40,000	By Bank A/c (Advance)	2,5000
To Consignment to Ahmedabad A/c	9,000	By Consignment to Ahmedabad A/c (Expenses)	2,500
To Consignment to Ahmadabad A/c (Balance)	9,000	By Consignment to Ahmedabad A/c (Commission)	4,200
		By Balance c/d	1,26,300
	1,58,000		1,58,000

Working Notes

1. **Calculation of CP of Goods Consigned**

IP of the Goods Sent is Rs. 1,00,000 which is 25% above cost.

The CP shall be calculated as follows.

IP = CP + P (25% on CP)

Let CP be X

$$1,00,000 = X + \frac{25}{100}X$$

$$1,00,000 = X + \frac{1}{4}X$$

$$1,00,000 = \frac{4X + X}{4}$$

$$1,00,000 = \frac{5X}{4}$$

$$X = \frac{1,00,000 \times 4}{5}$$

X = 80,000

CP= Rs. 80,000

2. **Value of goods taken by the Consignee**

IP of goods taken = Rs. 10,000

CP of goods taken

$(10000 \times \frac{4}{5})$ = Rs. 8,000

$$= 8.000 + \frac{12.5}{8000}$$

These are to be valued at the cost plus 12.5% on cost. Hence, its value will be = 8,000 + 1000 = Rs. 9,000

3. **Value of goods lost due to Consignee's negligence** It will be worked in the same manner as the value of goods taken by the consignee.

16.6 LET US SUM UP

In order to conceal the actual profit earned on consignment, sometimes the Consignor invoices the goods to the Consignee at a price which is higher than the cost, This is called invoice price (IP). The difference between the invoice price (IP) and the cost price (CP) is called loading. This affects four items shown in the Consignment Account viz (i) goods sent on Consignment; (ii) goods returned by the Consignee; (iii) opening consignment stock, and (iv) closing consignment stock. In order to work out the actual profit, the effect of loading on all these has to be nullified, otherwise the Consignment Account will show profit which is less than the profit actually earned.

Loading can be found out by subtracting CP from IP. The calculation of loading is simple when both CP and IP are given. But it needs special attention when the loading is given as a percentage of CP or IP and only the figure of IP or CP is given. In such a situation, the formula will be IP = CP+P is used for the calculation of loading or the cost price, or the invoice price, whichever is not given. For the adjustment of loading involved in different items, we have to pass the necessary journal entries in the books of the Consignor. However, the books of the Consignee are not affected by this because his books do not include an entry in respect of the four items involved.

16.7 KEY WORDS

Invoice Price : The price at which the Consignor invoices the goods to the Consignee. It is usually higher than cost price.

Loading : Difference between the Invoice Price and the Cost Price.

16.8 SOME USEFUL BOOKS

Maheswari, S .N. 2018. Introduction to Accounting, Vikas publishing House, New Delhi.

Patil, V.A. and J.S. Korlahalli, 2018, Principles and Practice of Accouiiring, R. Chand & Co. New Delhi.

William Pickles. 2018 Accountancy, E.L. B.S. and Pitman: London.

Gupta R.L. and M. Radhaswamy. 2018. Advanced Accountancy. Sultan Chand & Sons: New Delhi.

16.9 ANSWERS TO CHECK YOUR PROGRESS

1. i) False ii) True iii) False iv) True v) False vi) False

2. Difference between IP and CP

3. i) goods sent on consignment ii) goods returned by the Consignee
   iii) opening consignment stock iv) closing consignment stock

4. i) Rs. 600 ii) Rs. 200 iii) Rs. 625
   iv) Rs. 225 v) Rs. 250

5. i) Rs.400 ii) Rs. 120 iii) Rs. 150
   iv) Rs. 120 v) Rs. 100

16.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. What do you understand by invoice price? Give reasons for consigning the goods at the invoice price.

2. What is loading? How do you compute it? Give examples.

3. Name items which are recorded at the invoice price in the Consignment Account. Give journal entries passed for the adjustment of loading in respect of each item.

Exercises

1. Vijay & Co. of Kolhapur consigned 2,000 bicycles on July 18, 2018 to Chaudhari of Madras for sale on the following conditions.

   a) Cycles may be sold at invoice price or above

   b) Chaudhari is entitled to a commission of $7\frac{1}{2}\%$ on invoice price of goods sold and 20% on an excess over the invoice price.

   The cost of each cycle was Rs. 300 and it was invoiced at cost plus $33\frac{1}{3}$ % at cost. Vijay & Co. incurred Rs. 20,000 on freight and insurance. Chaudhari received the consignment on July 14, and accepted a 3 months bill drawn on him by Vijay & Co. for Rs. 2,00,000. Chaudhari paid Rs. 8,000 as custom duty and Rs. 5,000 as insurance and rent for the godown. They sold 1,600 cycles at Rs. 500 each. Give ledger accounts as they would appear in the books of Vijay & Co. and Chaudhari.

   (**Answer:** Profit Rs. 2,12,600; Stock at invoice price Rs. 1,65,600; Amount due from Shri Chaudhary Rs. 5,07,000)

2. On June 10, 2018, Raj & Co. of Bombay consigned 100 cases of Red Wine to Singham Bros. of Ceylon. The cost of the consignment amounted to Rs. 7,500 but the goods were charged at invoice price so as to show a profit of 25% on invoice price. On the same date, the Consignor paid Rs. 600 for freight and insuranèe. On July 1, the Consignee paid Rs. 1,000 for import duty, Rs. 200 for dock dues, and remitted a bank draft for Rs. 4,000 as an advance against the consignment. On July 15, they sold

80 cases for Rs. 10,500. Singham Bros. are entitled to a commission of 5% on gross proceeds of sales as their remuneration. Show the entries in the books of the Consignor and the Consignee, assuming that the Consignee has remitted the balance due from them by draft.

(**Answer** : Profit Rs. 2,535; Value of stock Rs. 2,360)

3. Modi Textiles, Delhi consigned to Vinod Enterprises, Calcutta 100 cotton bales. The invoice price of each bale was Rs. 1,500 which includes 20% profit on invoice price. The Consignor paid Rs. 2,500 for insurance and Rs. 4,000 for carriage and freight. The Consignee received cotton bales and sold 75 bales for cash and realised Rs. 1,12,500. He incurred Rs. 1,800 on godown rent and was allowed 10% conmission on sales. 5 cotton bales were spoiled in godôwn and they are to be valued at 50% depreciation. Show Consignment Account in the books of Modi Textiles.

   Hint: The damaged goods are also to be included in stock and they will be valued at 50% of the invoice price and the proportionate expenses.

   (**Answers:** Profit Rs. 1,412; Value of stock Rs. 35,212 (including Rs. 3,912 for damaged goods); Amount due from the Consignee Rs. 99,450)

4. On January 1, 2018 the Consignment to Ceylon A/c in the books of Unique Clock Makers showed a debit balance of Rs. 3,750. This is represented by the invoice value of 50 clocks which is 25% above cost.

   On January 7, they sent another consignment of 2,500 clocks at the invoice price of Rs. 75 each which was 25% above cost. They paid Rs. 1,000 for packing, Rs. 500 for insurance and Rs. 3,000 for carriage and freight. Rama watch Co. the Consignee, received the clocks on January 21 and paid Rs. 3,000 for custom duty, clearing, etc. They also sent a bank draft for 50% of the invoice price of the goods received. On June 15, they returned 50 clocks which were found defective.

   By December 31, 2018 they sold the opening stock of 50 clocks at Rs. 85 each on credit and 2,400 clocks of the new Consignment at Rs. 90 each. Their expenses were: advertising Rs. 2,000, salaries Rs. 2,000, and service charges Rs. 250.

   The Consignee is entitled to a commission of 8% on sales. The Consignee could not recover Rs. 250 on account of credit sales. Show the necessary ledger accounts in the books of both the parties.

   (**Answer:** Profit Rs. 43,780; Value of closing stock Rs. 3,900; Amount due from Consignees Rs. 1,01,630)

5. 'A' of Agra consigned 100 units of a commodity to 'D' of Delhi. The goods were invoiced at Rs. 150 per unit so as to yield a profit of 50% on cost. A incurred Rs. 1.000 on freight and insurance, while D incurred Rs. 500 on freight and Rs. 800 on rent. Before December 31. 2018 he sold 50 units for cash at Rs. 160 per unit and 20 units on credit for Rs. 175 per unit. He retained his commissions at 5% and 1% del credre on all sales and remitted the balance on December 31, 2018. D noticed that 10 units were damaged on account of bad packing and could sell them

only for Rs. 80 per unit. A debtor for Rs. 1,000 to whom goods were sold on credit became insolvent and only 50 paise in a rupee could be recovered. Prepare necessary ledger accounts in the books of 'A' and 'D'.

(**Answer:** Profit Rs. 1,960; Abnormal Loss Rs. 398; Value of stock Rs. 3,300)

> **Note** : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 17 JOINT VENTURE ACCOUNTS

Structure

17.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning and importance of a joint venture;
- distinguish joint venture from partnership and consignment;
- record joint venture transactions in the books of one venture;
- record joint venture transactions in the books of all venturers;
- prepare Memorandum Joint Venture Account; and
- prepare separate set of books for the joint venture business.

17.1 INTRODUCTION

In Units 15 and 16 you have studied how various transactions related to the consignments are recorded in the books of the concerned parties. The basic objective of preparing the Consignment Account is to ascertain the profit or loss on each consignment. Similarly, when some persons join hands to carry out a specific job or a project (called joint venture), each person (called co-venturer) would like to ascertain his share of profit or loss from the joint venture business. For this purpose, they record the transactions related to the joint venture business in their own books or prepare a separate set of books altogether. In this unit, you will learn how various transactions related to the joint venture business are recorded whenseparate set of books are prepared and when the co-venturers decide to record them in their own books without preparing a separate set.

17.2 WHAT ISA JOINT VENTURE ?

When two or more persons join together to carry out a specific business venture and share the profits on an agreed basis, it is called a 'joint venture'. Each one of them who join as a party to the joint venture is called 'Co-venturer'. No firm name is normally used for the joint venture business because its duration is limited to a short period. During this period, the - co-venturers are free to carry on their own business as usual, unless agreed otherwise. The

Business relationship amongst the co-venturers comes to an end as soon as the venture is completed. Thus a joint venture is some kind of a temporary partnership between two or more persons who have agreed to jointly carry out a specific venture. The joint ventures are quite common in construction business, consignment, sale and purchase of property, underwriting of shares and debentures, etc. For example, A and B agreed to construct a college building for which they pooled their resources and skill. A provided Rs. 6 lakh and B Rs. 4 lakh as capital. They completed the building and shared the profits in the ratio of their contributions to capital. In this example, joining hands by A and B to construct a building is a joint venture. A and B are co-venturers. They will share the profits in the ratio of 6 and 4 (same as the ratio of their capitals). This venture will be closed once the construction of the college bulding is completed.

From the above discussion, the essential features of a joint venture can be listed as follows:

1. It is formed by two or more persons.
2. The purpose is to execute a particular venture or project.
3. No specific firm name is used for the joint venture business.
4. It is of a temporary nature. Hence, the agreement regarding the venture automatically stands terminated as soon as the venture is completed.
5. The co-venturers share profit and loss in the agreed ratio. However, in the absence of any other agreement between the co-venturers, the profits and losses are to be shared equally.
6. During the tenure of joint venture, the co-venturers are free to continue with their own business unless agreed otherwise.

The main advantages of a joint venture are:

1. **Sufficient Resources:** Since two or more persons pool their resources, there is sufficient capital available.
2. **Ability and Experience:**In joint venture the different venturers may be having different skills and experience. The benefit of their common wisdom will be available to the venture.
3. **Spreading of Risk:** The co-venturers agree to share the profits and losses in a particular ratio. This implies that the risk is also borne by them in that ratio.

17.3 JOINT VENTURE AND CONSIGNMENT

Even though both consignment and joint venture are in the nature of an agreement between different parties, there are many points of difference between the two. The main points of difference are as follows:

	Consignment	Joint Venture
1	Normally two persons are involved, the Consignor and the Consignee.	Number of co-venturers is usually two, but it may also be more than two.
2	The relationship between the Consignor and the Consignee is of Principal and Agent.	The relationship between co-venturers is that that of partnership.
3	The arrangement may continue for a long time,	The relationship comes to an end as soon as the venture is completed.
4	The funds are provided by the Consignor.	All the co-venturers contribute to a common pool.
5	The consignee acts merely as an agent and he has to follow instructions of the Consignor.	The co-venturers have equal authority to take decisions.
6	Consignment is generally concerned with the sale of movable goods.	Joint Venture may be for sale of goods or for carrying on any other activity like construction of building, investment in shares, etc.
7	The profit belongs to the Consignor only. The Consignee is entitled only to his commission.	The profit is shares by all the co ventures.
8	The Consignor owns the goods.	There is joint ownership.
9	There is only one method of maintaining the accounts for consignment transactions.	There are four methods of maintaining accounts for the joint venture.

17.4 JOINT VENTURE AND PARTNERSHIP

Though joint venture is in the nature of a temporary partnership but in the strict legal sense it is not a partnership. Both in joint venture and partnership some business is carried on by two or more persons and the profits are shared by all of them. But, there are some basic differences between the two. They are as follows:

	Partnership	Joint Venture
1	A partnership firm always has a name.	There is no need for firm name.
2	It is of a continuous nature.	It comes to an end as soon as the work is completed.

3	Separate set of books have to be maintained.	There is no need for a separate set of books, the accounts can be maintained even in one of the co-venturer's books only.
4	No partner can carry on a similar business.	The co-venturers are free to carry on the business of a similar nature.
5	Though the registration of partnership is not compulsory but it is considered desirable.	There is no need for registration at all.
6	A minor can also be admitted to thebenefits of the firm.	A minor cannot be a co-venturer as he is incompetent to enter into a contract.

Check Your Progress A

1. A & B enter into a joint venture for the construction of a building. They contributed Rs. 2,00,000 and Rs. 3,00,000 respectively. They agreed to share the profits or losses in the ratio of their contribution to capital. The profit for the joint venture is Rs. 45,000. State (i) the names of the co-venturers, and (ii) each co-venturer's share of profit.

   i) ....

   ii) ....

2. State whether each of the following statements is **True** or **False.**

   i) A joint venture is a partnership formed under the Indian Partnership Act

   ii) A joint venture has a definite life.

   iii) Joint venture is the same thing as consignment.

   iv) Joint venture agreement must be registered .

   v) Co-venturers share the profits in the agreed ratio.

17.5 ACCOUNTING TREATMENT

Broadly speaking, accounts of a joint venture business can be kept in any one of the following four ways:

1. **In the Books of One Co-venturer:** In case the business is not very large, only one of the venturers may be entrusted with the task of recording the transactions in his books. In that case, all other co-ventures will send their contribution to such venturer and he will open a Joint Venture Account and the personal accounts ofother co-venturers in his books.

2. **In the Books of All the Co-venturers:** When all Co-venturers are working actively, each one of them shall open a Joint Venture Account and the personal accounts of other Co-venturers in his books. In such a situation, each Co-venturer informs others about the transactions undertaken by him so that they can incorporate them in their books.

3. **Memorandum Joint Venture Account:** Sometimes each Co-venturer records only such transactions as are directly concerned with him. In that case, he cannot work out the profit or loss because his books do not include all transactions of the joint venture. Hence, for calculating the profit or loss of the joint venture, a Memorandum Joint Venture Account has to be prepared by incorporating all transactions related to the joint venture. Thereafter the Joint Venture Account is completed and closed.

4. **Separate Set of Books:** Sometimes, for the sake of convenience, a separate set of books are maintained for the joint venture. Under this system, a Joint Bank Account, a Joint Venture Account and the personal accounts of all the co-venturers are to be opened in the independent set of books of account.

Let us now study these methods one by one in detail.

17.5.1 Recording in the Books of One Co-venturer

If the joint venture business is not very large, the task of recording transactions can very well be entrusted to one of the Co-venturers. He will prepare a Joint Venture Account and the personal accounts of other Co-venturers. The Joint Venture Account is prepared for ascertaining the profit or loss of the joint venture. The personal account of other co— venturers are prepared to find out the amount due from them. As stated earliest, each co-venturer is also entitled to carry on his own business and these transactions will be in addition to what he records in respect of his own business. The following journal entries are passed in his books before preparing the necessary accounts of the joint venture.

1. **When the co-venturers send their contribution:**
   Cash/Bank A/c Dr.
   To Co-venturer's Personal A/c

2. **When the goods are purchased for the joint venture:**
   Joint Venture A/c Dr.
   To Cash/Bank A/c

3. **When the goods are supplied from his own stock by the Co-venturer who is recording the transactions:**
   Joint Venture A/c Dr.
   To Purchases A/c

   Here we are crediting Purchases Account because he is supplying the goods from his own stock at cost. But if the goods are supplied by him at a price other than the cost price, we shall credit the Sales Account instead of the Purchases Account.

4. **When the goods are supplied by other Co-venturers:**
   Joint Venture A/c Dr.
   To Co-venturer's Personal A/c

5. **When some expenditure is incurred on account of the joint venture:**
   Joint Venture A/c Dr.
   To Cash/Bank A/c

   But, if expenses are paid by a Co-venturer other than the one who is recording the transactions, then the entry will be:

Joint Venture A/c Dr.
To Co-venturer's Personal A/c

Here we have debited the Joint Venture Account because it is an expenditure on account of the joint venture business.

6. **When the Co-venturer recording the transactions sells the goods:**

a) **For cash sales:**
Cash/Bank A/c Dr.
To Joint Venture A/c

b) **For credit sales:**
Debtor's Personal A/c Dr.
To Joint Venture A/c

7. **When cash is received from debtors:**

Cash/Bank A/c Dr.
To Debtor's Personal A/c

8. **When some cash discount is allowed to the debtor making payment, or some bad debts are incurred:**
Joint Venture A/c Dr.
To Debtor's Personal A/c

9. **When sales are made by other Co-venturers:**
Co-venturer's Personal A/c Dr.
To Joint Venture A/c

10. **When some cash or bills receivable are received from other co-venturers on account of sales made by them:**
Cash/Bank/Bills Receivable A/c Dr.
To Co-venturer's Personal A/c

11. **When the Co-venturers recording the transactions is entitled to some commission or salary:**
Joint Venture A/c Dr.
To Commission/Salary A/c

Joint Venture Account is debited as it is an expenditure related to the joint venture business.

12. **When the unsold stock ofjoint venture is taken over by the co-venturer recording the transactions:**
Purchases A/c Dr.
To Joint Venture A/c

If the unsold stock is taken over by some other Co-venturer, the journal entry will be:
Co-venturer's Personal A/c Dr.
To Joint Venture A/c

After passing the above entries, the Joint Venture Account is prepared. The balance of this account will show either profit or loss which is to be shared by all the Co-venturers in their profit sharing ratio. This will require the following further entries:

a) **If it shows profit:**
Joint Venture A/c Dr.
To Profit & Loss A/c
(his own share)
To Co-venturers' Personal A/cs
(individually for their shares)

b) **If it results in loss:**
Profit & Loss A/c Dr.
(his own share of loss)
Co-venturers' Personal A/c Dr.
(individually for their shares)
To Joint Venture A/c

After closing the Joint Venture Account, we have to find out the amount due to other Co-venturers. When this amount is sent to them, we record the following entry.

Co-venturers' Personal A/c Dr.
To Cash/Bank A/c

Look at illustration 1, it shows the journal entries as well as the different accounts in the ledger of the Co-venturer who is recording the transactions relating to the joint venture business in his books.

Illustration 1

Rajesh and Suresh entered into a contract to construct a building for Rs. 4,00,000. Rajesh and Suresh contributed Rs. 2,00,000 and Rs. 1,50.000 respectively. They agreed to share profits and losses in the ratio of 4:3. It was decided that the work will be looked after by Rajesh who will be paid 5% commission on contract price in addition to his share of profits. Rajesh purchases the necessary materials for Rs. 3,20,000 and paid Rs. 9,000 for expenses. Rajesh also contributed building materials worth Rs. 20,000 from his own stock. Rs. 5,000 remained to be paid for wages.

Suresh took over the stock of materials for an agreed valuation of Rs. 16,000. The building was completed and the contract money was duly received.

Record the above transactions in the books of Rajesh and show the Joint Venture Account and Suresh's Account assuming that the outstanding wages were paid by Rajesh.

In the Books of Rajesh
Journal Entries

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
	Cash A/c Dr. To Suresh (Being cash received from Suresh)		1,50,000	1,50,000
	Joint Venture A/c Dr. To Cash A/c (Being materials purchased)		3,20,000	3,20,000

Joint Venture A/c Dr. To Cash A/c (Being expenses paid)		9,000	9,000
Joint Venture A/c Dr. To Purchases A/c Being material supplied from personal stock)		20,000	20,000
Joint Venture A/c Dr. To Outstanding Wages A/c (Being outstanding wages)		5,000	5,000
Joint Venture A/c Dr. To Commission A/c (Being Commission @ 5%)		20,000	20,000
Cash Account Dr. To Joint Venture (Being the contract price received)		4,00,000	4,00,000
Suresh Dr. To Joint Venture A/c (Being goods taken over by Suresh)		16,000	16,000
Joint Venture A/c Dr. To Profit & Loss A/c To Suresh (Being the profit shared)		42,000	24,000 18,000
Outstanding Wages A/c Dr. To Cash A/c (Being wages paid by Rajesh)		5,000	5,000
Suresh Dr. To Cash A/c (Being the amount due paid)		1,52,000	1,52,000

Joint Venture Account

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Cash A/c (Purchases)	3,20,000	By Cash A/c	4,00,000
To Cash A/c (Expenses)	9,000	By Suresh	16,000
To Purchase A/c (Material supplied)	20,000		
To Outstanding Wages A/c	5,000		
To Commission A/c	20,000		
To Profit transferred to :			
Profit & Loss A/c 24,000			
Suresh 18,000	42,000		
	4,16,000		4,16,000

Suresh's Account

	Rs.		Rs.
To Joint Venture A/c	16,000	By Cash A/c	1,50,000
To Cash A/c	1,52,000	By Joint Venture A/c	18,000
	1,68,000		1,68,000

Illustration 2

Anand and Prakash entered into a joint venture agreement to share the profits and losses in the ratio of 2:1. Anand supplied goods worth Rs. 60,000 to Prakash and incurred expenses amounting to Rs. 2,000 for freight and insurance. During transit, the goods costing Rs. 5,000 were damaged and a sum of Rs. 3,000 was received from the insurance company. Prakash reported that 90% of the remaining goods were sold at a profit of 30% of their original cost. Towards the end of the venture, a fire damaged the balance stock lying unsold with Prakash. The goods were not insured and Prakash agreed to compensate Anand by paying in cash 80% of the aggregate of the original cost of such goods, plus proportionate expenses incurred by Anand. Apart from the joint venture share of profit, Prakash was also entitled to a commission @ 5% on net profits of the joint venture after charging such commission. Selling expenses incurred by Prakash amounting Rs. 1,000. Prakash had earlier remitted an advance of Rs. 10,000. Prakash paid the balance due to Anand by a bank draft. You are required to prepare the Joint Venture Account, and Prakash's Account in Anand's books.

Solution:

In the Ledger of Anand
Joint Venture Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Purchase A/c (Goods Supplied)	60,000	By Bank A/c (Insurance)	3,000
To Bank A/c (expenses)	2,000	By Prakash (Sales)	64,350
To Prakash (expenses)	1,000	By Prakash (agreed value of damaged goods)	4,546
To Prakash (Commission- 5/105 of Rs. 8,896)	424		
To Profit transferred to Profit & Loss A/c 5,648			
Prakash 2,824	8,472		
	71,896		71,896

Prakash'/s Account

	Rs.		Rs.
To Joint Venture A/c (Sales)	64,350	By Bank A/c (Advance)	10,000
To Joint Venture A/c (Claim for damaged goods)	4,546	By Joint Venture A/c (Expenses)	1,000
		By Joint Venture A/c (Commission)	424
		By Joint Venture A/c (Profit)	2,824
		By Bank A/c (Balance received by draft)	54,648
	68,896		68,896

Working Notes:

1. **Calculation of Sales:**

	Rs.
Cost of goods sent	60,000
Less Damage in transit	5,000
Cost of remaining goods	55,000
Cost of goods sold (90% of Rs. 55,000)	49,500
Add Profit 30% of Rs. 49,500	14,850
Sales	64,350

2. **Loss by fire borne by Prakash:**

	Rs.
Cost of goods in stock (10% of 55,000)	5,500
Add Proportionate Expenses $= \frac{2,000 \times 5,500}{60,000}$	183
Total Loss	5,683
80% of this loss (5683 × 80/100)	4,546

3. Abnormal loss on account of damage in transit relates to the joint venture. Hence no calculation is needed.

17.5.2 Recording in the Books of all Co-venturers

Under the second method, all transactions relating to the joint venture are recorded in the books of all the Co-venturers. In order to complete the Joint Venture Account in the books of all Co-venturers, each Co-venturer sends the necessary information about his dealings to the other Co-venturers. There is not much of a difference in the recording of transactions between the first and the second method. We will be having similar entries in the joint venture accounts in each Co-venturer's books, who shall all open the personal accounts of other Co-venturers. Look at illustration 3 to clearly understand the recording of transactions under the second method.

Illustration 3

Arvind and Babloo entered into a joint venture agreeing to share profits and losses equally.

The following transactions took place during the course of venture:

	Rs.
Arvind bought goods for cash	2,550
Babloo bought goods for cash	7,000
Arvind paid storage charges	500
Babloo paid freight and insurance	800
Babloo sold goods for cash	7,000
Babloo received 3% commission on sales	210
Sales made by Arvind	5,000
Commission payable to Arvind	150
Babloo took over the unsold stock	560

Prepare the necessary ledger accounts in the books of Arvind and Babloo assuming that the accounts are finally settled between them.

Solution:

Ledger of Arivind
Joint Venture Account

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Cash A/c (goods purchased)	2,500	By Babloo (sales)	7000
To Babloo (goods purchased)	7,000	By Cash (sales)	5,000
To Cash A/c (expenses)	500	By Babloo (stock taken over)	560
To Babloo (expenses)	800		
To Babloo (commission)	210		
To Commission A/c	150		
To Profit transferred to:			
Babloo 700			
Profit & Loss A/c 700	1,400		
	12,560		12,560

Babloo's Account

	Rs.		Rs.
To Joint Venture A/c (sales)	7,000	By Joint Venture A/c (goods purchased)	7,000
To Joint Venture A/c (stock taken over)	560	By Joint Venture A/c (expenses)	800
To Cash A/c (balance due paid)	1,150	By Joint Venture A/c (commission)	210
		By Joint Venture A/c (share of profit)	700
	8,710		8,710

Ledger of Babloo
Joint Venture Account

Dr. Cr.

	Rs.		Rs.
To Arvind (Goods purchased)	2,500	By Cash A/c (Sales)	7,000
To Cash A/c (Good)	7,000	By Arvind (Sales)	5,000
To Arvind (Expenses)	500	By Purchases A/c (Stock taken over)	560
To Cash A/c (Expenses)	800		
To Commission A/c	210		
To Arvind (Commission)	150		
To Profit transferred to:			
Arvind 700			
Profit & Loss A/c 700	1,400		
	12,560		12,560

Arvind's Account

	Rs.		Rs.
To Joint Venture A/c (sales)	5,000	By Joint Venture A/c (goods purchased)	2,500
		By Joint Venture A/c (expenses)	500
		By Joint Venture A/c (commission)	150
		By Joint Venture A/c (share of profit)	700
		By Cash A/c (Balance due received)	1,150
	5,000		5,000

17.5.3 Memorandum Joint Venture Account Method

In the method discussed above, each Co-venturer records all transactions relating to the joint venture in the Joint Venture Account opened in his books. But, under the Memorandum Joint Venture Account Method, each Co-venturer will record only those transactions relating to the joint venture which are directly concerned with him, and not those of others. Under this method, each Co-venturer opens a Joint Venture Account including the name of the other Co-venturer. For example, if 'A' and 'B' are partners in a joint venture, then in the books of 'A' it will be termed as 'Joint Venture with 'B' Account' and in the books of 'B' it will be termed as 'Joint Venture with 'A', Account'. Each Co-venturer will record only such transactions which are actually effected by him. For example, if goods are purchased by 'A' for the joint venture, it will be recorded only by A and not by other Co-venturers. Similarly, if goods are sold by 'B', it will be recorded in the books of 'B' only. This account is in the nature of a personal account and, therefore, will not disclose the profit or loss of the venture. For that purpose we prepare an additional account called, 'Memorandum Joint Venture Account'. This is like Profit and Loss A/c.

Let us say 'A' and 'B' enter into a joint venture and certain transactions have taken place for which the following entries will be passed in each Co-venturer's books.

1. **A purchases goods for cash:**

   This transaction shall be recorded in the books of A only. The entry will be:

   Joint Venture with B A/c Dr.
   To Cash A/c

2. **A incurs some expenditure on account of the joint venture:**
   It shall be recorded in A's books only. The entry will be:

   Joint Venture with B A/c Dr.
   To Cash A/c

3. **B sells goods for cash:**

   No entry will be made in A's books. But the following entry will be made in B's books:

   Cash Account Dr.
   To Joint Venture with A A/c

4. **B sends money to A:**

   a) **It shall be recorded in B's books as follows:**

      Joint Venture with A A/c Dr.
      To Cash/Bank A/c

   b) **It shall be recorded in A's books as follows:**

      Cash/Bank A/c Dr.
      To Joint Venture with B A/c

As stated earlier, for ascertaining the profit or loss on the joint venture, we prepare a Memorandum Joint Venture Account. This account is prepared exactly on the pattern of Profit & Loss Account. Since this account does not form part ofthe double entry system, the word 'Memorandum' is prefixed.

The method of preparing this account is very simple. It is prepared on the basis of information supplied by all the Co-venturers. The debit entries appearing in the personal accounts of all Co-venturers are written on the debit side of the Memorandum Account and the entries appearing on the credit side of those accounts are shown on the credit side of the Memorandum Joint Venture Account. However, you should remember that the transactions which do not relate to an item of expense or income are to be excluded from this Memorandum Account. The difference in the totals of the debit side and the credit side represents profit or loss. The profit or loss thus calculated is then shared by the Co-venturers in the agreed profit sharing ratio.

Each Co-venturer will record only his share of profit or loss. In the event of **profit, the** entries shall be:

In the books of A

Joint Venture with B A/c	Dr.
To Profit & Loss A/c	

In the books of B

Joint Venture with A A/c	Dr.
To Profit & Loss A/c	

In the event of Loss the entries shall be reversed as follows :

In the books of A

Profit and Loss A/c	Dr.
To Joint Venture with B A/c	

In the books of B

Profit and Loss A/c	Dr.
To Joint Venture with A A/c	

In the end, each venturer balances the 'Joint Venture with .....Account' in his books and settles the account by paying or receiving cash. Look at illustration 4 carefully to understand the preparation of Memorandum Joint Venture Account.

Illustration 4

Prem of Delhi and Satish of Calcutta entered into a joint venture for the purchase and sale of goods. The profits and losses are to be shared in the ratio of 2:1.

Prem purchased goods for Rs. 40,000 and sent them to Satish paying Rs. 3,000 for freight and insurance. Prem also incurred sundry expenses amounting to Rs. 400. Satish sold goods for Rs. 55,000 and incurred Rs. 6,000 as expenses. Unsold stock valued at Rs. 7,000 was taken over by Satish. Satish remitted the balance due to Prem by a bank draft.

Each party's ledger contains a record of his own transactions in the Joint Venture Account. Prepare (a) Memorandum Joint Venture Account, (b) Joint Venture with Satish's Account in Prem's ledger, and (c) Joint Venture with Prem's Account in Satish's ledger.

Solution:

Ledger of Prem
Joint Venture with Satish Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Bank A/c (purchases)	40,000	By Bank A/c (In final settlement)	51,800
To Bank A/c (freight & ins.)	3,000		
To Bank A/c (Sundry Exp.)	400		
To Profit & Loss A/c (share of profit)	8,400		
	51,800		51,800

Ledger of Satish
Joint Venture with Prem Account

Dr.			Cr.
	Rs.		Rs.
To Bank A/c (expenses)	6,000	By Bank A/c (sales)	55,000
To Profit & Loss A/c	4,200	By Purchases A/c (stock taken over)	7,000
To Bank A/c (final settlement)	51,800		
	62,000		62,000

Memorandum Joint Venture Account

		Rs.			Rs.
To Prem:			By Satish		
Goods	40,000		Sale Proceeds	55,000	
Freight insurance	3,000		Stock taken over	7,000	62,000
Sundry Expenses	400	43,400			
To Satish (expenses)		6,000			
To Profit transferred to					
Prem	8,400				
Satish	4,200	12,600			
		62,000			62,000

Interest in Joint Venture Transactions : When the Co-ventures invest money in joint venture business and received back the amounts on different dates, it is quite usual for them to agree to calculate interest at a certain rate. Each Co-venturer is entitled to received interest on the amounts invested by him and pay interest on the amounts received by him. You should remember that only the net interest receivable from or payable to the Co-venturer is recorded in the Joint Venture Account. Thus, the net amount of interest is also taken into account before ascertaining the profit or loss on joint venture. For clarification look at illustration 5.

Illustration 5

Anand and Bimal enter into a joint venture sharing profits and losses equally. Anand purchased goods for Rs. 5,000 for cash and Bimal spent Rs. 1,000 on freight, etc., on January 1, 2018. On the same day, Bimal bought goods for Rs. 10,000 on credit. Further expenses were incurred as follows:

On 1-2-2018	
On 1-3-2018	Rs 500 by Anand

Sales were made by each one of them as follows:

15-1-2018	Rs. 3,000 by Anand
31-1-2018	Rs. 6,000 by Bimal
15-2-2018	Rs. 3,000 by Anand
1-3- 2018	Rs. 4,000 by Bimal

Creditors for goods were paid as follows:

1-2-2018	Rs. 5,000 by Anand
1-3-2018	Rs. 5,000 by Bimal

On March 31, 2018 the balance of stock was taken over by Bimal at Rs. 9,000. The accounts between the Co-venturers were settled by cash payment on this date. The Co-venturers are entitled to interest at 12% per annum. Prepare necessary ledger accounts in the books of venturers as per Memorandum Joint Venture Account Method.

Solution:

Memorandum Joint Venture Account

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Anand (Cost of goods)	5,000	By Anand (Sales)	6,000
To Bimal (Cost of goods)	10,000	By Bimal (Sales)	10,000
To Bimal (Freight etc.)	1,000	By Bimal (Interest)	50
To Anand (expenses)	500	By Bimal (Stock taken)	9,000
To Bimal (expenses)	1,500		
To Anand (interest)	135		
Anand 3,457			
Bimal 3,458	6,915		
	25,050		25,050

Anand's Ledger

Jont Venture with Bimal Account

Dr.					Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2018		Rs.	2018		Rs.
Jan. 1	To Bank A/c (Purchases)	5,000	Jan. 15	By Bank A/c (sales)	3,000
Feb. 1	To Bank A/c (creditors)	5,000	Feb. 15	By Bank A/c (sales)	3,000
Mar. 1	To Bank A/c (expenses)	5,00	Mar. 15	By Bank (Final settlement)	8,092
Mar. 31	To Interest A/c	135			
Mar. 31	To Profit & Loss A/c	3,457			
		14,092			14,092

Bimal's Ledger

Jont Venture with Anand Account

Dr.					Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2018		Rs.	2018		Rs.
Jan. 1	To Bank A/c (freight)	1,000	Jan. 31	By Bank (sales)	6,000
Feb. 1	To Bank A/c (expenses)	1,500	Mar. 31	By Bank (sales)	4,000
Mar. 1	To Bank A/c (creditors)	5,000	Mar. 31	By Goods (stock taken over)	9,000
Mar. 31	To Profit & Loss A/c	3,458	Mar. 31	By Interest	50
Mar. 31	To Bank A/c (Amount in final settlement)	8,092			
		19,050			19,050

Calculation of Interest

Payments by Anand

Date	**Amount**	**Months**	**Product**	
1-1-18	Rs.5,000	3	15,000	(5,000 × 3)
1-3-18	Rs. 500	1	500	(500 × 1)
1-2-18	Rs. 5,000	2	10,000	(5,000 × 2)
			25,500	

$$\text{Interest} = 25{,}500 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs. } 255$$

Receipts by Anand

15-1-18	Rs. 3,000	$2\frac{1}{2}$	7,500 $(3,000 \times 2\frac{1}{2})$
15-2-18	Rs. 3,000	$1\frac{1}{2}$	4,500 $(3,000 \times 1\frac{1}{2})$
			12,000

$$\text{Interest} = 12,000 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs.}120$$

Net Interest due to Anand = 255 — 120 = Rs. 135

Payments by Bimal

1-1-18	Rs. 1,000	3	3,000 (1000×3)
1-2-18	Rs. 1,500	2	3,000 $(1,500 \times 2)$
1-3-18	Rs. 5,000	1	5,000 $(5,000 \times 1)$
			11,000

$$\text{Interest} = 11,000 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs.}110$$

Receipts by Bimal

31-1-18	Rs. 6,000	2	12,000 $(6,000 \times 2)$
1-3-18	Rs. 4,000	1	4,000 $(4,000 \times 1)$
			16,000

$$\text{Interest} = 16,000 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs.}160$$

Net Interest Due from Bimal

= 160—110 = Rs.50

Check Your Progress-B

1. Put a tick ✓) against the right answer.

   a) The goods supplied from his stock at cost by the Co-venturer maintaining the accounts, are debited to

      i) Sales Account

      ii) Purchases Account

      iii) Stock Account

   b) In Memorandum Joint Venture Account Method, the co-venturer records

i) His transactions only

ii) Other Co-venturers' transactions only

iii) All the transactions of the Joint Venture

c) Memorandum Joint Venture Account is prepared to find out

i) Amount due from the Co-venturers

ii) Profit or 1oss on the joint venture

iii) None of the above

d) The share of profit of the Co-venturer maintaining the records is credited to

i) Profit and Loss Account

ii) His personal account

iii) None of the above

e) Any bad debts incurred on account of joint venture are debited to

i) Bad Debts Account

ii) Debtor's Personal Account

iii) Joint Venture Account

17.5.4 Separate Set of Books

So far, you have studied the methods of recording joint venture transactions where no separate set of books were maintained. Now we shall study another method where Co-venturers agree to keep separate set of books for recording the joint venture transactions. When separate set of books are maintained, the joint venture transactions are recorded as a separate accounting entity on the basis of double entry principles. Under this method, the following accounts are opened:

1. Joint Bank Account
2. Joint Venture Account
3. Personal accounts of each Co-venturer

Joint Bank Account is a real account like the ordinary Bank Account. All the Co-venturers pay or deposit their contribution in this account. **The Joint Venture Account is like a profit and loss account which shows all the expenses and incomes of the joint venture.** The personal accounts of the Co-venturers simply show their contributions in the form of goods, cash or expenses and the amounts received by them.

Let us now see the various journal entries which are normally recorded under this method.

1. **When co-venturers contribute their share of capital:**
   Joint Bank A/c Dr.
   To Co-venturers Personal A/c

2. **When a Co-venturer contributed in the form of goods:**
   Joint Venture A/c Dr.
   To Co-venturers Personal A/c

3. **When purchases are made for joint venture:** .
   a) **If on cash:**
   Joint Venture A/c Dr.
   To Joint Bank A/c

   b) **If on credit:**
   Joint Venture A/c Dr.
   To Creditor's Personal A/c

   Note that when goods are purchased for the joint venture business, you will debit the joint venture account not the Purchases Account.

4. **When expenses are incurred on account of joint venture:**

   a) **If paid out of Joint Bank Account**
   Joint Venture A/c Dr.
   To Joint Bank A/c

   b) **If paid by a co-venturer**
   Joint Venture A/c Dr.
   To Co-venturer's Personal A/c

5. **When goods are sold:**

   a) **For cash sales:**
   Joint Bank A/c Dr.
   To Joint Venture A/c

   b) **For or credit sales:**
   Debtor's Personal A/c Dr.
   To Joint Venture A/c

6. **When creditors are paid:**
   Creditors' Personal A/c Dr.
   To Joint Bank Account

7. **When amounts are received from debtors:**
   Joint Bank A/c Dr.
   To Debtor's Personal A/c

8. **Any commission, interest, etc. payable to a Co-venturer:**
   Joint Venture A/c Dr.
   To Co-venturer's Personal A/c

9. **Unsold stock taken over by a Co-venturer:**
   Co-venturer's Personal A/c Dr.
   To Joint Venture A/c

10. Now if we balance the Joint Venture Account, it will disclose the amount of profit or loss made on the joint venture which is to be shared by the Co-venturers in their profit sharing ratio. The entries for the distribution of profit and loss will be as follows:

a) **In case of profit:**
Joint Venture A/c Dr.
To Co-venturers' Personal A/cs

b) **In case of loss:**
Co-venturers' Personal A/c Dr.
To Joint Venture A/c

11. This closes the Joint Venture Account. After transferring the amount of profit or loss to the Co-venturer's personal accounts, you can find out the amount payable to each one of them. When the payment is made, the journal entry will be as follows:

    Co-venturers' Personal A/cs Dr.
    To Joint Bank A/c

    You will notice that the balance in the Joint Bank Account will be sufficient to pay-off all the Co-venturers, and when the above entries are passed all the accounts will be closed.

12. **Treatment of cash discount :** When some cash discount is llowed by the creditors, it will be an item of gain for the joint venture. Hence it is credited to the Joint Venture Account. The journal entry will be:

    Creditor's Personal A/c Dr.
    To Joint Venture A/c

    Similarly, when some cash discount is allowed to the debtors, it will be an item of loss for the joint venture and, therefore, is debited to the Joint Venture Account. The journal entry will be:

    Joint Venture A/c Dr.
    To Debtor's Personal A/c

The same entry is passed in case of bad debts. Look at illustration 6 and see how the concerned accounts are prepared when separate set of books are maintained for the joint venture business.

Illustration 6

Vikas and Salil entered into a joint venture to construct a building for a joint stock company. The contract price was settled at Rs. 25 lakh, payable Rs. 20 lakh in cash and the balance in the form of fully paid equity shares of the company. They opened a Joint Bank Account wherein Vikas deposited Rs. 6 lakh and Salil paid in Rs. 3 lakh. They agreed to share the profits and losses in the ratio of 2:1

They purchased materials for Rs. 3 lakh for cash and Rs. 10 lakh worth on credit from Anil. They paid Rs. 4,50,000 for wages. etc., and Rs. 70,000 for other expenses.Vikas and Salil supplied materials worth Rs. 2,00,000 and Rs. 80,000 respectively. Architect's fees of Rs. 10,000 was paid by Vikas. The contract was duly completed and the price received as stipulated. Anil was paid Rs. 9,80,000 in full settlement. Vikas agreed to take up the shares of the company at a valuation of Rs. 4,40,000. Salil took over the remaining material at an agreed value of Rs. 70,000.

Separate books are maintained for joint venture business. Prepare the necessary ledger accounts.

Solution :

Joint Venture Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Joint Bank A/c (Material)	3,00,000	By Joint Bank A/c	20,00,000
To Anil (Credit purchases)	10,00,000	By Equity Shares A/c	5,00,000
To Joint Bank A/c (Wages)	4,50,000	By Anil (Discount)	20,000
To Joint Bank A/c (Expenses)	70,000	By Salil (Material taken over)	70,000
To Vikas (Material)	2,00,000		
To Salil (Material)	80,000		
To Vikas (Architects fee)	10,000		
To Equity Shares A/c (Loss)	60,000		
To Profit transferred to: Vikas 2,80,000 Salil 1,40,000	4,20,000		
	25,90,000		25,90,000

Joint Bank Account

	Rs.		Rs.
To Vikas	6,00,000	By Joint Venture A/c (Material)	3,00,000
To Salil	3,00,000	By Joint Venture A/c (Wages)	4,50,000
To Joint Venture A/c	20,00,000	By Joint Venture A/c (Expenses)	70,000
		By Anil (creditor paid)	9,80,000
		By Vikas	6,50,000
		By Salil	4,50,000
	29,00,000		29,00,000

Vikas's Account

	Rs.		Rs.
To Equity Shares A/c	4,40,000	By Joint Bank A/c	6,00,000
To Joint Bank A/c	6,50,000	By Joint Venture (Material)	2,00,000
		By Joint Venture(Architect fees)	10,000
		By Joint Venture (Profit)	2,80,000
	10,90,000		10,90,000

Salil's Account

	Rs.		Rs.
To Joint Venture (Material)	70,000	By Joint Bank A/c	3,00,000
To Joint Bank A/c	4,50,000	By Joint Venture A/c (Material)	80,000
		By Joint Venture A/c (Profit)	1,40,000
	5,20,000		5,20,000

Equity Shares Account

	Rs.		Rs.
To Joint Venture	5,00,000	By Vikas	4,40,000
		By Joint Venture A/c (Loss transferred)	60,000
	5,00,000		5,00,000

Anil's Account

	Rs.		Rs.
To Joint Bank A/c	9,80,000	By Joint Venture A/c (Materials)	10,00,000
To Joint Venture A/c (Discount)	20,000		
	10,00,000		10,00,000

Underwriting of Shares: Let us now take an illustration where the Co-venturers agreed to underwrite the shares or debentures of a limited company.Underwriting means agreeing to buy shares that are not subscribed by the public. For this service, they receive some commission which may be paid partly in the form of shares of the company and partly in cash. The shares thus received are sold to the public or taken over by the Co-venturers at an agreed price. Look at illustration 7 and see how accounts are prepared for the jointventure of underwriting the shares when separate set of books are maintained.

Illustration 7

A and B enter into a joint venture to guarantee the subscription at par of 1,00,000 shares of Rs. 10 each of a limited company, and sharing profits and losses in the ratio of 4.5. The terms with the company are : 4.5% commission payable in cash and 6,000 fully paid shares of the company. They agreed to pay expenses in connection with the issue of shares. The expenses incurred are advertisement Rs. 5,000; printing and stationery Rs. 2,000 and postage Rs. 600. All expenses are paid by A. The public subscribed to 88,000 shares only. The remaining shares under the agreement were duly taken up by A and B who provided the necessary cash equally. The commission is received in cash and is shared by the Co-venturers in the ratio 4:5. The entire holding of the joint venture is then sold in the market through brokers as follows: 25% at a price of Rs. 9 per share; 50% ata price of Rs. 8.75 per share, 15% at a price of Rs. 8.50 per share, and the remaining 10% is taken over by A and B equally at an agreed price of Rs. 8 per share. Prepare the Joint Venture Account, Joint Bank Account, Shares Account, and the accounts of A and B showing the final settlement.

Solution

Joint Venture Account

Dr. Cr.

Particulars		Amount	Particulars	Amount
		Rs.		**Rs.**
To A			By Joint Bank A/c (commission)	45,000
Advertisement	5,000		By Shares A/c (commission)	
Printing	2,000			
Postage	600	7,600		
To Shares A/c (loss on sale)		23,400		
To Profit transferred to :				
A	29,600			
B	44,400	74,000		
		1,05,000		1,05,000

Joint Bank Account

Particulars		Amount	Particulars	Amount
		Rs.		**Rs.**
To A (contribution)		60,000	By Shares A/c	1,20,000
To B (contribution)		60,000	By A (commission)	20,000
To Joint Venture A/c (commission)		45,000	By B (commission)	25,000
To Shares A/c (sale for cash)			By A (final settlement)	70,000
25%	40,500		By B (final settlement)	72,200
50%	78,750			
10%	22,950	1,42,200		
		3,07,200		3,07,200

Shares Account

Particulars	Amount	Particulars	Amount
	Rs.		**Rs.**
To Joint Bank A/c	1,20,000	By Joint Bank A/c (Sale of shares)	40,500
To Joint Venture (Commission)	60,000	By Joint Bank A/c (Sale of shares)	78,750
		By Joint Bank A/c (Sale of shares)	22,950
		By A (shares taken over)	7,200
		By A (shares taken over)	7,200
		By Joint venture A/c (Loss)	23,400
	1,80,000		1,80,000

A's Account

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		**Rs.**
To Joint Bank A/c (Commission)	20,000	By Joint Venture A/c (Expenses)	7,600
To Shares A/c	7,200	By Joint Venture A/c (Contribution)	60,000
To Joint Bank A/c (Final settlement)	70,000	By Joint Venture A/c (Profit)	29,600
	97.200		97.200

B's Account

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		**Rs.**
To Joint Bank A/c (Commission)	25,000	By Joint Bank A/c (Contribution)	60,000
To Shares A/c	7,200		
To Joint Bank A/c (Final settlement)	72,200	By Joint Venture A/c (Profit)	44,400
	1,04,400		1,04,400

Working Notes

1.. **Distribution of commission received in cash**

4 ½ % of 10,00,000	=	Rs. 45,000
A's share 4/9 × 45,000	=	Rs. 20,000
B's share 5/9 × 45,000	=	Rs. 25,000

2. **Treatment of shares received:**

Shares received by way of commission	6,000
Shares not subscribed by public	12,000
Total no. of shares received	18,000

a) Sold for Cash Rs.

25% of 18,000 i.e... 4,500 shares sold @ Rs. 9 per share	40,500
50% of 18,0o0 i.e.. 9,000 shares sold @ Rs. 8.75 per share	78,750
15% of 18,000 i.e.. 2,700 shares sold @ Rs. 8.50 per share	22,950

b) Divided amongst A and B

10% of the remaining shares i.e. 1,800 shares are taken over equally by A & B at an agreed price of Rs. 8 per share.

A: 900 shares @ Rs. 8 per share Rs. 7,200

B: 900 shares @ Rs. 8 per share Rs. 7,200

Check Your Progress C

1. What is the need for maintaining separate set of books for the joint venture?

   ....

   ....

   ....

2. Fill in the blanks

   i) Joint Bank Account is like a …………………… Account.

   ii) When Co-venturers'contribution is in the form of goods ………….. Account is debited.

   iii) All the amounts paid out of joint bank are credited to ……………..Account.

   iv) Co-Venturers' contribution in cash is debited to Joint Bank Account and credited to …………………………Account.

   v) In underwriting of shares, the ....shares are taken over by the underwriters.

17.6 LET US SUM UP

Joint Venture is a temporary partnership between two or more persons who have agreed to undertake jointly a specific project or a job. On the completion of the project or the job, the joint venture will automatically come to an end. The joint venture differs from consignment and partnership in many ways.

The accounts for the joint venture business can be kept in four ways: (i) all recording be done in the books of one co-venturer only, (ii) the accounting records be maintained by each one of them in their own books, (iii) each Co-venturer records his own transactions relating to the joint yenture and on the completion of the project a Memorandum Joint Venture Account is prepared to find out the profit or loss, and (iv) separate set of books of accounts may be maintained for the joint business and a joint account be opened in the bank.

Under the first method, only one Co-venturer records the joint venture transactions who opens a Joint Venture Account and the personal accounts of other co-venturers. Under the second method, each Co-venturer opens a Joint Venture Account and the personal accounts of other Co-venturers. The Joint Venture Account serves the purpose of Profit and Loss Account. Under the third method, no Joint Venture Account is maintained. Each Co-venturer simply opens the personal accounts of other Co-venturers and for ascertaining the profit or loss of the venture, a Memorandum Joint Venture Account is prepared.

When any of the above three methods is followed, no separate books are maintained for the Joint Venture business. All transactions are recorded in the books of the Co-venturers themselves. Under the fourth method, a separate set of books are prepared for the joint venture business treating it as a separate accounting entity, and all transactions are recorded strictly according to the double entry system. The main accounts prepared under this method are (i) Joint Venture Account, (ii) Joint Bank Account, and (iii) the personal accounts of the Co-venturers. In this case also, the Joint Venture Account serves the purpose of a Profit and Loss Account.

17.7 KEY WORDS

Co-venturer: Persons who are parties to the agreement for carrying out the joint venture business.

Joint Venture: A temporary partnership between two or more persons who agree to carry out a specific job or a project.

Memorandum Joint Venture Account: An account prepared for ascertaining the profit or loss of a joint venture where no Joint Venture Account is prepared by Co-venturers.

Underwriting: An undertaking to take up the shares which are not subscribed by the public.

17.8 SOME USEFUL BOOKS

Maheshwari.S.N. 2018. Introduction to Accounting,Vikas Publishing House: New Delhi. 72.

Patil V. A. and J. S.Korlahalli, 2018 Principles and Practice of Accounting R. Chand & Co., New Delhi.

William Pickles. 1992. Accountancy, E.L.B.S. and Pitman, London.

Gupta, R.L. and M. Radhaswamy. 2018. Advanced Accountancy Sultan Chand & Sons. New Delhi

17.9 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) A and B ii) A's share Rs. 18,000 and B's share Rs. 27,000

2. i) False ii) True iii) False v) False v) True

B 1. a) ii b) i c) ii d) i e) iii

C 2. i) Bank ii) Joint Venture iii) Joint Bank iv) Co-venturers' Personal Accounts v) unsubscribed

17.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. State the salient features of joint venture. Distinguish it from consignment.
2. "Joint Venture is a temporary partnership". Comment and explain how does it differs from the partnership?
3. Explain briefly various methods of recording the joint venture transactions without maintaining separate set of books.
4. Explain the separate set of books method for maintaining joint venture accounts.

Exercises

1. Mohan and Sohan were partners in a joint venture sharing profits and losses in the ratio of 3:2. Mohan supplied goods of the value of Rs. 6,000 and incurred an expenditure of Rs. 200. Sohan supplied goods of the value of Rs. 5,000 and his expenses were Rs. 300. Sohan sold all the goods for a sum of Rs. 18,000. Sohan is entitled to a commission of 4% on sales and he settled his account by sending a bank draft to Mohan. Pass necessary journal entries in the books of both the parties.

   (**Answer :**Profit on Joint VentureRs. 5,780 Commission Rs. 720)

2. 'A' of Banglore enters into a joint venture with 'B' of Bombay to ship cotton bales to 'C' in Japan. A sends cotton of the value Rs. 30,000, pays railway freight etc. Rs. 1,500 and sundry expenses R. 1,575. B sends goods valued at Rs. 20,750 and pays freight and insurance Rs. 1200, dock dues Rs. 200, customer charges Rs. 500, and other sundry expenses Rs. 500. A advances to B Rs. 6,000 on account of the venture. B receives Account sale and remittance of net proceeds from C for the whole of the goods amounting to Rs. 80,000.

   Show the Joint Venture Account and the personal accounts of the Co-ventures in the books of A and B

   (**Answer**: Profit on joint venture Rs. 23,775; Balance due to A Rs. 50,962. 50)

3. Sundar, Bindia and Gora entered into a contract with Mohindra Ltd. for the construction of a building at a cost of Rs. 5,00,000 payable Rs. 4,00,000 in cash and Rs. 1,00,000 in debentures. They share profits and losses equally.

   Sunder, Bindia and Gora contributed Rs. 60,000. Rs. 75,000 and Rs. 40,000 respectively. All these amounts were deposited in a Joint Bank Account. Sundar paid Rs. 7,000 to the architect. Bindia purchased concrete mixture for Rs. 25,000 and Gora brought a motor truck for Rs. 20,000 for joint venture work. They purchased plant for Rs. 24,000, materials for Rs. 2,40,000 in cash and paid Rs. 1,95,000 as wages. After construction of the building, Sundar took over the remaining material for Rs. 14,000 and Bindia took over mixture for Rs. 12,000. Gora took over the motor truck for Rs. 8,000. The plant was sold for Rs. 6,000. When full price was received form the contractee, Sundar took over the debentures for Rs. 80,000. Prepare Joint Venture Account, Joint Bank Account and the Co-venturer's personal accounts.

   (**Answer:** Profit Rs. 9,000. Sundar will bring in Rs. 24,000 and Bindia will get Rs. 91,000 and Gora Rs. 55,000. Joint bank total Rs. 605,000)

4. Ajay and Banwari doing business separately as building contractors undertake jointly to construct a building for a newly setup company with Rs. 1,00,000 payable, Rs,80,000 in cash and Rs. 20,000 in fully paid shares of the company. A Joint Bank Account is opened in their names, Ajay paying in Rs. 25,000 and Banwari Rs. 15,000. They are to share profits and losses in the proportion of 2:1. Their transactions were as follows :

	Rs.
Paid wages	30,000
Bought material	70,000
Materials supplied by Ajay	5,000
Materials supplied by Banwari	4,000
Architect's fee paid by Ajay	2,000

The contract was completed and the price (cash and shares) duly received. The joint venture was closed by Ajay taking up all the shares of the company at an agreed value of Rs. 16,000 and Banwari taking up the stock of materials at an agreed value of Rs. 3,000. Show the necessary ledger accounts.

(**Answer:** Loss Rs. 12,000; Payments to Ajay Rs. 8,000 and Banwari Rs. 12,000)

5. A, B and C enter into a Joint Venture for the construction of a building for a joint stock company. The contract price is Rs. 2,00,000. Incidental expenses paid by the co-venturers will be reimbursed to the extent of actual expenditure or Rs. 10,000 whichever is less. A spends Rs. 8,000, B Rs. 10,000 and C Rs. 12,000. The profits and losses are to be shared equally, but C, being a technical person, is entitled to a commission of 10% on the profit of the venture after charging such commission. Joint Bank Account is opened wherein A deposits Rs. 40,000, B Rs. 30,000 and C Rs. 30,000. B gives his own plant to the venture for Rs. 16,000. Materials worth Rs. 40,000 and wages of Rs. 60,000 are paid out of the Joint Bank Account.

   On completion of the contract, the company paid the agreed contract price (keeping Rs. 20,000 as retention money). The contract price was paid Rs. 60,000 in cash and the balance in equity shares of the company of Rs. 10 each at an agreed value of Rs. 12 per share. The shares were subsequently sold in the market @ Rs. 13 per share. A took over the unused materials at Rs. 2,000. B took over the plant at an agreed value of Rs. 4,000 and the retention money was taken over by C at Rs. 14,000. Show necessary ledger accounts in the books of the joint venture.

   Hint: Contract price received is Rs. 1,80,000, out of which Rs. 60,000 in Cash and Rs. 1,20,000 worth of shares @ Rs. 12 per share. So, the number of shares received is Rs. 1,20,0000 12 = 10,000 shares.

   (**Answer:** Profit Rs. 60,000; Final settlement A Rs. 66,000, B Rs. 72,000; and C Rs. 52,000)

6. Devendra and Ravindra entered into a joint venture involving the buying and selling of old railway materials, the profit or loss to be shared equally. The cost of the goods purchased was Rs. 42,500 which was paid by Devendra who drew a bill on Ravindra at two months for Rs. 30,000. The bill was discounted by Devendra at a cost of Rs. 240.

   The transactions relating to the joint venture were (a) Devendra paid Rs. 300 for carriage, Rs. 500 for commission on sales and Rs. 200 travelling expenses, (b) Ravindra paid Rs. 100 for travelling expenses and Rs. 150 for sundry expenses, (c) sales made by Devendra amounted to Rs. 20,000, and (d) sales made by Ravindra were Rs. 30,000.

Goods costing Rs 1,000 and Rs. 1,500 (being unsold stock) were retained by Devendra and Ravindra respectively, and these were charged to them at prices so as to show the same gross profits as made on the total sales. Devendra was credited with a sum of Rs. 400 to cover the cost of warehousing and insurance. The expenses in connection with the bills were to be treated as a charge against the joint venture.

Show the necessary accounts in the books of each party and prepare the Memorandum Joint Venture Account

(**Answer:** Profit on Joint Venture Rs. 8,735; Payment by Devendra to RavindraRs. 2,742.50; Rate of Gross profit 25%; Stock taken over by Devendra valued at Rs. 1,250 and Ravindra at Rs. 1,875)

7. Akash and Vijay enter into a joint venture on January 1, 2018. Akash bought goods costing Rs. 4,000 and on the same day he received a cheque from Vijay for Rs. 1,500. Akash and Vijay incurred expenses as follows:

	Akash	**Vijay**
February 1	300	
April 1	300	
March 1		400
May 31		1400

Vijay sold the goods, in two months, namely, on April 1 Rs. 4,800 and on June 30 Rs. 2400. They share profits and losses equally and interest was to beallowed at5% per annum. On June 1, Vijay gives Akash a three months bill for Rs. 2,500 and on June 30, the venture was completed and the accounts settled by cheque between the parties. Calculate interest in months and show the necessary accounts.

(**Answer:** Profit: Akash Rs. 368.70 and Vijay Rs. 368.70; Akash will charge Rs. 100 as interest and Vijay will pay Rs. 47.50 as interest)

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

Indira Gandhi
National Open University
School of Management Studies

BCOC-131
Financial Accounting

Block

6

COMPUTERISED ACCOUNTING

COURSE PREPARATION TEAM

Ms. Surbhi Gupta (Unit-18, 19, 20 and 21)

Prof. N V Narasimham, Editor

Prof. M.S.S. Raju
(Course Coordinator & Editor)

Dr. Sunil Kumar
(Course Coordinator & Editor)

Print Production

Sh. Y. N. Sharma
Assistant Registrar (Pub.)
MPDD, IGNOU

Sh. Sudhir Kumar
Section Officer (Pub.)
MPDD, IGNOU

June, 2019

ISBN-978-93-89200-

Further information on the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-l10068 or website of INGOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :

BLOCK 6 COMPUTERISED ACCOUNTING

Computerised Accounting is the need of present business environment. In this era of technological advancement where humans are moving towards automation, preparing financial statements through use of computers is essential as it provides accuracy, reliability, security from disasters as well as speed required in maintaining data for growing business operations. Many accounting softwares have been developed like Tally ERP 9, Marg, Profit wave and others to provide support to accounting professionals in maintaining and preparing records digitally. This block on computerised accounting has been divided into four units which cover introduction to computerised accouinting, creation of company, creating masters, vouching entries & invoicing and preparation of reports.

Unit 18 explains what computerised accounting system is and how does it differs from the manual accounting procedure. It also highlights the advantages and disadvantages of computerised accounting system. It describes the procedure of creation of company in Tally ERP.9. It also explains how can a company be altered, deleted or shut down in Tally software. It also discusses the configuration and features of the software.

Unit 19 describes how ledgers and groups account are created in computerised form and how data related to stock/inventory can be maintained in Tally software. It also highlights the way to delete or alter or display any ledger or group or inventory masters.

Unit 20 explains the procedure of creation of different vouchers and recording journal entries therein. It also discusses the method of creating invoices, deletion and alteration of vouchers and invoices.

Unit 21 discusses the preparation of various reports like Balance Sheet, Profit and Loss Account, Trading Account, Stock Summary, Day Book and other reports which Tally software creates automatically.

UNIT 18 INTRODUCTION TO COMPUTERISED ACCOUNTING AND CREATION OF COMPANY

Structure

18.0 OBJECTIVES

After studying this unit, you will be able to:

- define computerised accounting system
- distinguish between manual and computerised accounting system;
- highlight advantages and disadvantages of computerised accounting system;

- describe Tally ERP.9 system;
- identify various components of Tally ERP.9;
- set, alter, delete and shut a company under Tally ERP.9; and
- understand the features and configuration option in Tally ERP.9

18.1 INTRODUCTION

An accounting system is a collection of processes, procedures and controls designed to collect, record, classify and summarize financial data for interpretation and management decision-making. Whether the accounting system is simple or complex, it must meet certain objectives to keep the business running smoothly. It is difficult to make informed business decisions without accurate accounting information that helps the managers to see where the business is, where it has been and (based upon trends) foresee where it is headed. Thus, an accounting system should be devised as an effective tool that provides information which is easy to understand.

While some firms still do their book-keeping by hand, most firms generally have too many transactions to sustain a manual accounting system. The more complicated the financial activities of a business are, the more likely it will need a computerized accounting system to ensure effective financial reporting. Computerized accounting systems involve making use of computers and accounting software to record, store and analyze financial data. These are software programs that are stored on a company's computer, a network server, or remotely accessible via Internet.

Computerized Accounting represents a technological advancement in the field of business accounting which allows the user(s) to set up income and expense accounts, such as rental or sales income, salaries, advertising expenses, and material costs. They also can be used to manage bank accounts, to pay bills, and prepare budgets. Also, depending upon the program, some accounting systems also allow users to prepare tax documents, handle payroll, and manage project costing.

18.2 DIFFERENCE BETWEEN MANUAL AND COMPUTERISED ACCOUNTING SYSTEM

Owners and other stakeholders of any business, whether large or small, want to know whether the business is making a profit or not. Many small businesses do their accounting manually and they are happy with this setup. Others may be considering using a computerized system, since accounting software is also affordable these days. Manual and computerized accounting systems perform basically the same processes; the accounting principles and concepts are the same with differences lying in the mechanics of the process. Let us now see the difference between these two:

Speed

The main difference between manual and computerized systems is speed. Accounting software processes data and creates reports much faster than manual systems. Calculations are done automatically in software programs, minimizing errors and increasing efficiency. Once data is fed into the system, one can create reports literally by pressing a button in a computerized system.

Cost

Another difference between manual and computerized systems is cost. Manual accounting with paper and pencil is much cheaper than a computerized system, which requires a machine and software. Other expenses associated with accounting software include training and program maintenance. Expenses can add up fast with costs for printers, paper, ink and other supplies. However, manual accounting requires more staff. Threfore, more expenditure on salaries/ wages in case of manual accounting.

Backup

A third difference between manual and computerized systems is the ease of backup of a computerized system. All transactions can be saved and backed up, in case of fire or other mishap. You cannot do this with paper records, unless you make copies of all pages – a long and inefficient process.

The following table makes a further attempt to explain the difference between the manual and computerized accounting systems:

BASIS	MANUAL ACCOUNTING	COMPUTERIZED ACCOUNTING
1. Definition `	Manual accounting is the system in which we keep physical register of journal and ledger for keeping the records of each transaction.	In this system of accounting, we make use of a computer and different accounting software for maintaining a digital record of every transaction.
2. Ledger Accounts	We check the journal and then we transfer figures to related accounts debit or credit side by manually posting it.	Computerized Accounting System will automatically process the system and will make all the accounts' ledgers since the voucher entries under its respective ledger account have already been passed.
3. Trial Balance	We collect the information of all the balances of all accounts in our ledger, and on this basis we manually prepare the trial balance.	The computerized accounting system will automatically produce the Trial Balance.
4. Adjustment Entries Record	Both, the adjustment journal entries and its posting in the ledger accounts will be done manually, one after another.	Only adjustment entries will be passed in the computerized accounting software, these will then be automatically posted to respective ledger accounts.

18.3 ADVANTAGES AND DISADVANTAGES OF COMPUTERISED ACCOUNTING SYSTEM

Advantages of Computerized Accounting

There are many advantages of computerized Accounting System. Let us discuss few of them in detail.

1. **Automation**: As all the calculations are handled by the software, computerized accounting eliminates many of the mundane and time-consuming processes associated with manual accounting. For example, once issued, invoices are processed automatically thus saving time.

2. **Accuracy**: This accounting system is designed to be accurate to the minutest detail. Once the data is entered into the system, all the calculations, including additions and subtractions, are done automatically by software.

3. **Data Access**: Using accounting software, it becomes much easier for different individuals to access accounting data outside the office, securely. This is particularly true if an online accounting solution is being used.

4. **Easy representation of data in various formats**: Viewing the accounts using a computer allows the users to take advantage of the option to view the data in different formats i.e. one can view data in tables and using different types of charts.

5. **Reliability**: Since the calculations are very accurate, the financial statements prepared by computers are highly reliable.

6. **Scalable**: When a company grows, the number of transactions entered into the system increases, as a result of which the need for accounting not only increases but also becomes more complex. With computerized accounting, everything is kept straight forward because shifting data using software is easier than sifting through a bunch of papers.

7. **Speed**: Using accounting software, the entire process of preparing accounts becomes faster. Furthermore, statements and reports can be generated instantly at the click of a button. Managers do not have to wait for hours, even days, to lay their hands on an important report.

8. **Security**: The latest data can be saved and stored in offsite locations so it is safe from natural and man-made disasters like earthquakes, fires, floods and terrorist attacks. In case of disasters, the system can be quickly restored on other computers. This level of precaution is taken by Computerized Accounting.

9. **Cost-effective:** Since using computerized accounting is more efficient than paper-based accounting, than naturally, work will be done faster and time will be saved.

Disadvantages of Computerized Accounting

Computerized Accounting suffers from many limitations. Let us discuss those limitations one by one.

Cost of Software: In case of computerized accounting, you must buy the software. Some software requires you to purchase upgrades or updates for additional features. You must also ensure your computer is capable of running the software. If not, you'll need to upgrade your computer as well.

Most accounting software requires you to have additional software in order to view reports. For instance, some programs allow you to export data as a PDF file or an Excel spreadsheet. This allows users without the accounting program to view the data. However, the viewing software may pose an additional expense to the user.

2. **Reliance on Computers:** If your computer crashes or data is corrupted by a virus, you won't be able to use your accounting software until the problem is fixed. This also means you won't have access to any entered data until the computer is running again. Your data can also be corrupted. It means you will have to re-enter information unless you've backed up your files. In addition, if there's a power failure, your software will be unusable unless you're on a battery-powered laptop.

3. **Fraud:** Accounting software data requires extra levels of security to prevent fraud and embezzlement. Software makes it easier for users to alter data, making fraud easier to accomplish. As a result, there is an increased need for internal auditors to check for any data inaccuracies. Security measures must also be taken to limit the amount of control users have over any accounting software's features.

4. **Human Error:** While it is easy to write down numbers incorrectly, it is even easier to mistype a number. Entering data into accounting software too quickly may result in serious errors. With the program performing calculations, it can be more difficult to trace the cause of the problem. Spreadsheets, digital ledgers or written ledgers make tracking simpler and faster.

5. **Training:** Accounting software requires you to take the time to learn how to use it. While you may be an experienced accountant, you'll still need to learn what each button and menu command does in order to use accounting software effectively. This learning curve can result in costly affairs. In some cases, paid training may be necessary to learn how to perform certain tasks. If you're not tech savvy, the process could be even more difficult.

6. **Time:** Many accountants find that it takes more time to enter data into accounting software than it does to write it or type it into a spreadsheet. Due to step-by-step screens, the process often takes longer, especially for those who don't use the software often or are still new to using the program. If the software requires numerous steps to enter basic data, the time requirements may outweigh the benefits of automatic calculations.

18.4 CONSIDERATION WHILE CHOOSING ACCOUNTING SOFTWARE

When it comes to selecting accounting software, there are a number of options available in the market and it can be overwhelming to choose the best one. The following is a list of factors to be considered while choosing accounting software:

1. **The Size of the Business Organization**: The size of the organization and the volume of the business transactions entered into influence the choice of software. While a large organization will require software that meets the multi-user requirements because it is geographically scattered and connected through complex networks, a smaller organization may opt for simple, single user operated software.

2. **Ease of Use**: The interface and navigation should be simple and self-explanatory. There should also be an option for data back-up. Preference can be given to vendors that offer help at no additional cost, have reasonable service plans or offer tutorial training that walks the clients through the most popular business tasks and transactions.

3. **Features**: What particular software offers is an important consideration. A list of the primary things that the business needs to track and account for should be carefully prepared. The business must know how much each service or product costs and be able to track the cost of goods sold (COGS). Features like invoicing, online payments, payroll, auto payments, reporting, bank balances will help to stay up to date on sources of business income, expenses and where it may need to make adjustments.

4. **Protects Classified Data**: When financial data is stored in the cloud, there is no longer the possibility of vital information being lost in the event of a hard drive crash, power surge, or coffee spill. The data is backed up on external servers. However, with cloud-based software comes, the threat of classified data falling victim to malicious activity. Online banking has set a standard for security, so it becomes necessary to ensure that the chosen software either meets or exceeds this standard. This means Secure Socket Layer (SSL) encryption, multi-layered firewall server protection, and routine external audits and inspection.

5. **Compatibility**: If there are other financial tools that are used in the business – for example, an e-commerce system, then business would want to look into the compatibility of the financial software with any other essential software to run the online or storefront portion of the business. In an ideal world, it may want a solution that provides most of what it requires in a single program. However, if it must have multiple software packages, it will have to ensure that the data can automatically be linked for real-time updates or transferred daily with the upload of an Excel or CSV file.

6. **Price**: While price is a necessary factor to be considered, it shouldn't necessarily be the deciding one. The ability to manage money is far more important if it's the difference of saving just a few rupees. What one should be aware of is the different pricing models that are used by software product providers.

Having suitable software in place, will allow a business to stay on top of cash flow and focus on what it does best (i.e. allow the business to focus on its core competence). It also helps keep the records clean.

18.5 ACCOUNTING SOFTWARE IN INDIA

Only a few years ago, accounting applications lived on the desktop of the small business owner or an accountant's computer. The books were not accessible from another location and only one person could view them at a time. Then cloud computing took off and business **accounting** software providers caught on.

In a computerized accounting system, the framework of storage and processing of data is called operating environment that consists of hardware as well as software in which the accounting system works. The type of accounting system used determines the operating environment.

Some of the most prevalent business accounting software systems are:

1. **Tally ERP.9:** Tally ERP.9 is a business accounting software for the purposes of accounting, inventory and payroll. Tally has been one of the dominating accounting software for almost two decades. The software has been developed by Tally Solutions Pvt Ltd. It is the most user-friendly for accounting software and thus, employers prefer Tally for easy availability of trained professionals for this specific software. Almost all accounting activities like inventory, purchase, sales, cost, payroll and statutory year end processes can be easily handled by Tally.

2. **Profitbooks:** This is an Online accounting software developed for small enterprises. It can only be operated on the internet as it is cloud based. The data can be securely placed in a cloud and can be accessed anywhere.

3. **Marg:** Accounting Software is developed by Marg Compusoft Pvt Ltd and is well accepted in small and medium enterprises of India. The software is marketed for the last two decades in the Indian market.

4. **Wave:** Wave's accounting tools are 100% free, secure, and very popular in accounting community. It is one of the best web based accounting software solution available at present.

5. **Xero: D**eveloped by Xero, it is an award winning web based accounting software for small business owners and accountants. The user interface is nicely designed and is easy to use for online bookkeeping.

6. **Reach:** Reach Accounting Software is developed by Reach Accountant. It is an online Accounting Software aimed at Small & Medium Businesses. The significant part of Reach is that all the business operations are bundled in single software and it ensures that the business owner is able to track every aspect of the business.

18.6 INTRODUCTION TO TALLY ERP.9

18.6.1 About Tally Software

Tally ERP.9, developed by Tally Solutions Ltd., is one of the most popular and widely used business management software available in India and other countries. It can be used by small to large business organization. It is available with two types of licensing system:

1. **Silver Edition Mode (Single user):** It is for single use PC. It can be activated online or offline. It can be accessed from the system on which it is installed by only a single user.

2. **Gold Edition Mode (Unlimited Multi user):** It is for unlimited number of user PCs. It is installed on LAN (local area network) and supports a maximum of ten users.

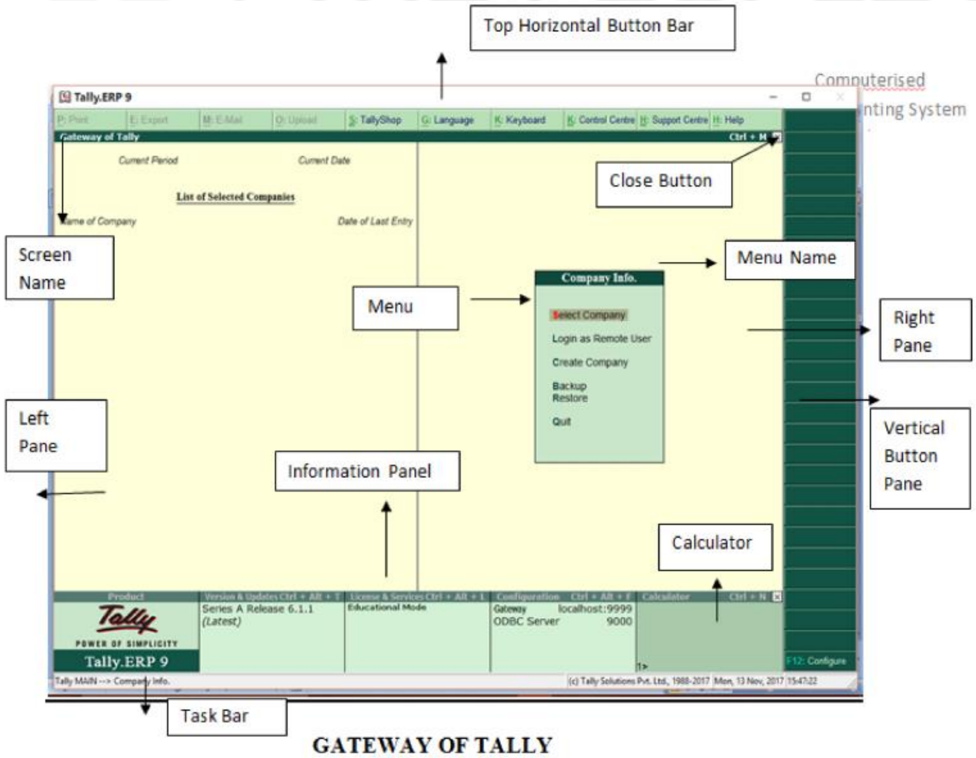
18.6.2 How to Start Tally ERP.9

Go to start button, click 'all programs'. With in 'All Program', go to Tally ERP.9 or installation of Tally icon on the desktop. If you double click on Tally icon, Tally will open and you can start working on it.

18.6.3 Components of Tally

The gateway of Tally displays menus, screens, reports and options that you select. The components of Tally ERP.9 are:

- **Top Horizontal Button Bar:** This is a collection of buttons that are fixed and provide quick interaction
- **Close Button:** This helps in moving out of Tally application.
- **Screen Name:** It shows the name of the current screen.
- **Right Pane:** In right pane menus are displayed. The red letter in each menu represents short cut and by pressing that alphabet from keyboard one can open the menu.
- **Left Pane:** It shows current period, current date and name of companies with last date of voucher entry done in each company.
- **Vertical Panel Bar:** It is used for quick interaction.
- **Calculator:** It can be used for calculation work and figures can be computed. (Ctrl + N)
- **Information Panel:** This displays details of product, version, license and configurations.
- **Task Bar:** It shows the complete navigation path of the current menu or screen selected.



GATEWAY OF TALLY

Fig. 18.1

Check Your Progress A

1. Choose the correct answer:

i) The disadvantages of Computerised Accounting System is/are:

(a) Speed (b) Efficiency (c) Breach of Security (d) All of the above

ii) Tally Software is developed by

(a) Apple (b) Adobe (c) Microsoft (d) Tally Solutions

iii) The screen of Gateway of Tally consists of following components:

(a) Task Bar (b) Information Panel (c) Vertical Button Pane (d) All of the above

iv) Which of the following is not an accounting software?

(a) Tally.ERP.9 (b) Wave (c) SPSS (d) Marg

18.7 CREATION OF A COMPANY

Creating company is the first step towards starting working with Tally ERP.9. A company is an organization for which financial records are to be maintained and therefore, it can be called as a central repository from where any financial statement or report can be extracted at any time. A company can be Partnership Firm or a Sole Proprietor or a Limited Liability Partnership or Non-Governmental Organization or a Company registered under Companies Act, 2013.

18.7.1 Procedure of Creating a Company

To create a company, click on the 'create company' in 'Company Info'. Alternatively, one can press ALT+ F3 and the company info screen will appear as appeared in Fig. 18.2.

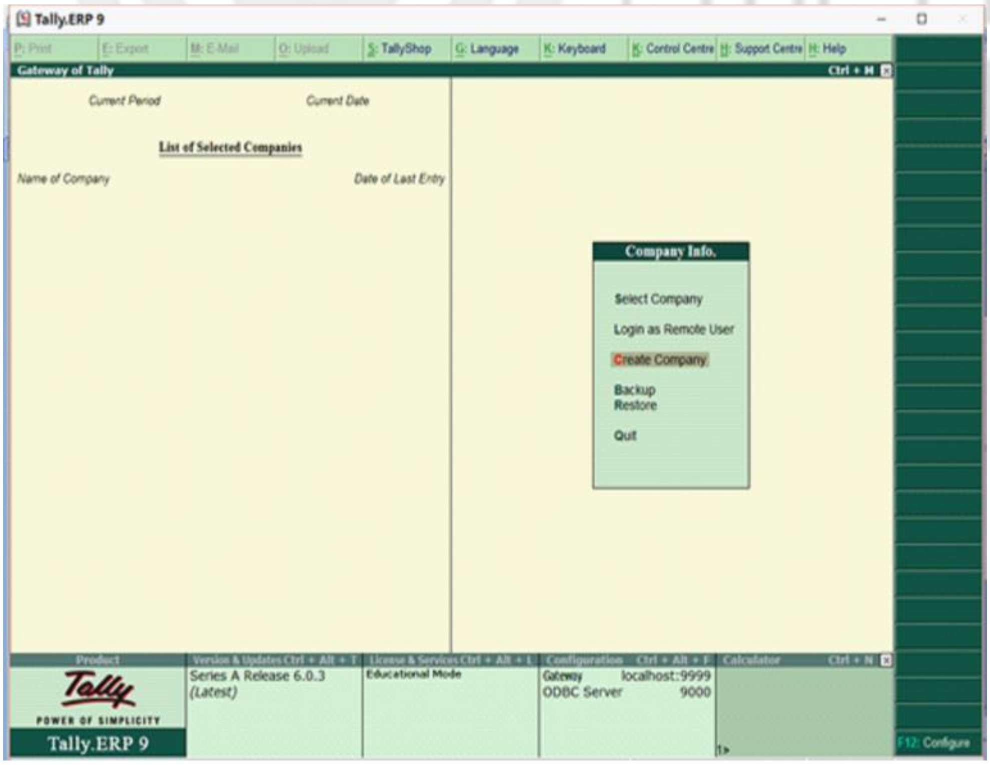


Fig. 18.2

Once, you click 'create company', the following screen will appear as appeared in Fig. 18.3 in front of you.

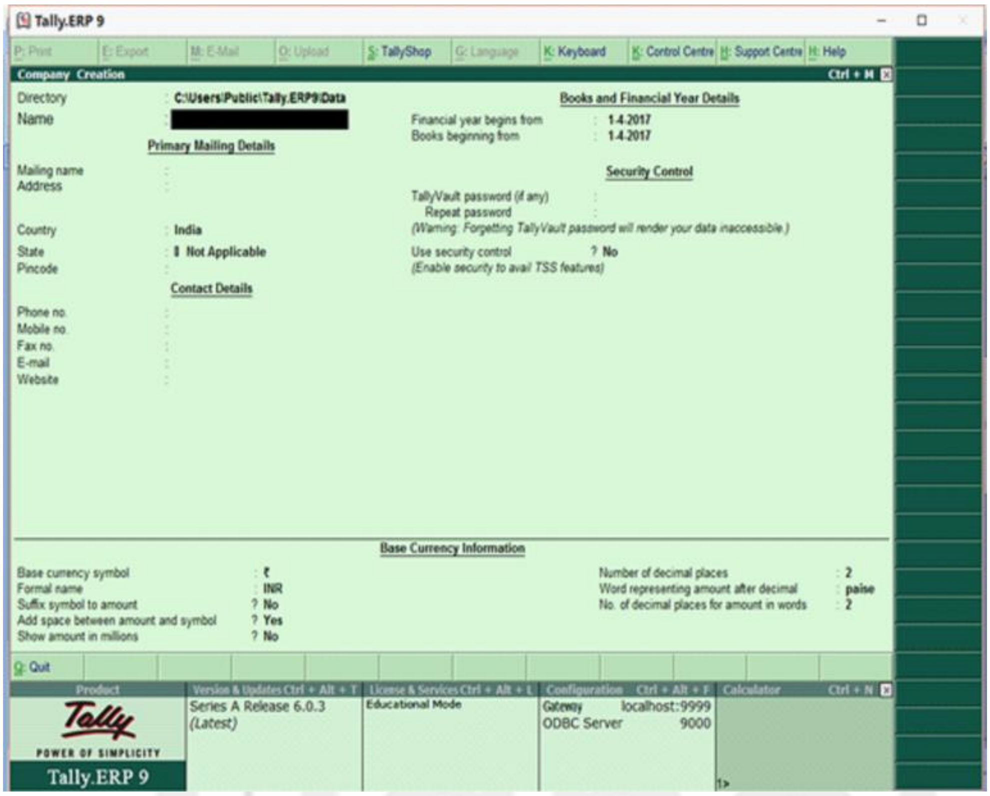


Fig. 18.3

The various fields appearing in company creation in Fig. 18.3 are explained below:

- **Directory:** It will display the path where your company data is stored. By default, it would automatically be stored in Tally ERP.9 data folder, but you can change its path and can specify any location where you want to store the data relating to the company by pressing backspace key
- **Name:** It means providing a name to the company. Example: Surbhi Ltd.
- **Primary Mailing Details:**

  Mailing Name: You can specify any other name if you want for mailing purpose. By default, it will always show the name which you have entered in the Name field earlier

  Address: Provide the address of the company in this field

  Statutory Compliance: Choose the country in which the company is located. For example, we have selected India.

  State: Choose the state in which the company is located. For example, we have selected Delhi.

  Pin-code: Provide the Pin code for the company where it is located.
- **Contact Details**
- Provide telephone number, mobile number and Fax number (if any) of the company. Also, provide the official email address of the company which would be further used for emailing of reports and statements.

- **Auto-Back up:** Putting 'Yes' to enable auto backup will result in automatically creating backup of the data of the company in the company data folder.

- **Company Details:**

  Currency Symbol: Once country is selected, Tally will automatically choose the currency of the country. In this example, we have selected India, so currency symbol would be of 'Rupee'.

  Maintain: If company maintains inventory with them, select accounts with inventory otherwise accounts only. Selecting accounts with inventory would combine both financial accounts and inventory books.

  Financial Year: Financial year is a period of 12 months starting from 1st April. The accounting period in this example, will begin from 1st April, 2017.

  Books beginning from: Provide a date at which you started maintaining your books. It can be a date later than 1st April, 2017. By default, it would automatically take date mentioned in previous field.

- **Security Control:**

  Tally Vault Password: Entering this password will require, opening the company with password each time. The name of the company having tally vault password will be shown with asterisk '*' mark.

  Repeat Password: Password entered in various field has to re-enter for confirmation.

  Use Security Control: Enabling this field as 'Yes' will allow to define access administrator user name and password. Every time you open a company, it would ask for name of administrator and password.

- **Base Currency Information:**

  Base Currency Symbol: The selection of country will define base currency symbol. In this example, we have selected India, so currency symbol would be of 'Rupee'

  Formal Name: The formal name of the currency like INR (Indian Rupee) will be displayed.

  Suffix Symbol to amount: This will allow putting symbol of currency after the amount.

Add space between amount and symbol: This will allow space between amount and symbol.

Show amounts in millions: This will allow the values of amount to be expressed in millions i.e. international system of numeration.

Number of Decimal Places: By default, it will be set to 2 places only and Indian currency has 2 decimal places whereas some currency has 3 decimal places. It can go upto 4 decimal places.

Words representing amount after decimal: By default, it will be automatically set according to currency.

Number of Decimal places for amounts in words: Provide the number of decimal places for which printing is required. It can be equal to or less than number of decimal places field but can't be more than that.

After filling all the requisite details, the company creation screen will appear as follows shown in Fig. 18.4

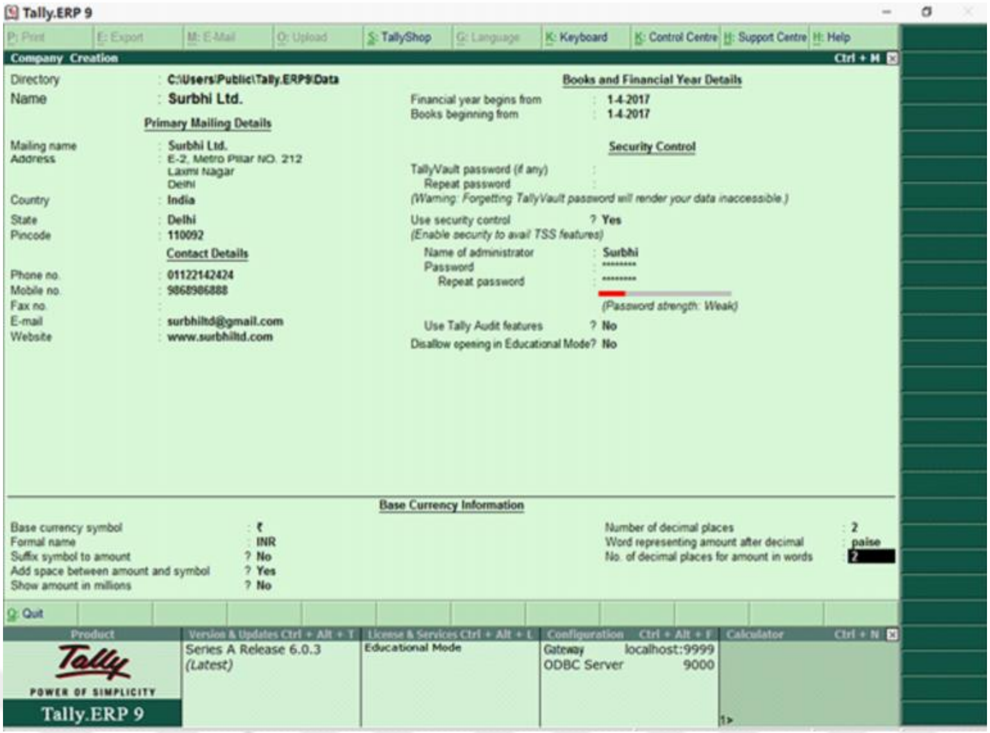


Fig. 18.4

Once the details are filled and you press enter again, screen will displays a box saying accept Yes or No? If all the details are correctly filled, then proceed to select 'yes' otherwise select 'No' as shown in Fig. 18.5.

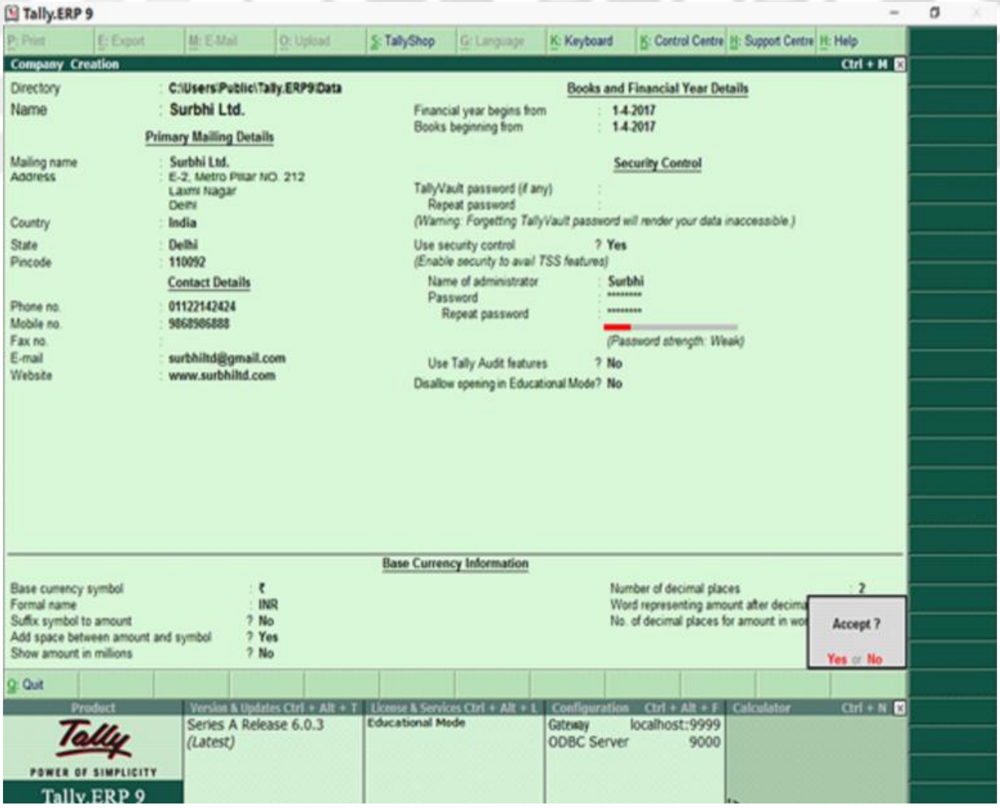


Fig. 18.5

Once you select ‘Yes’, the company creation is complete and the following screen will appear as sown in Fig. 18.6.

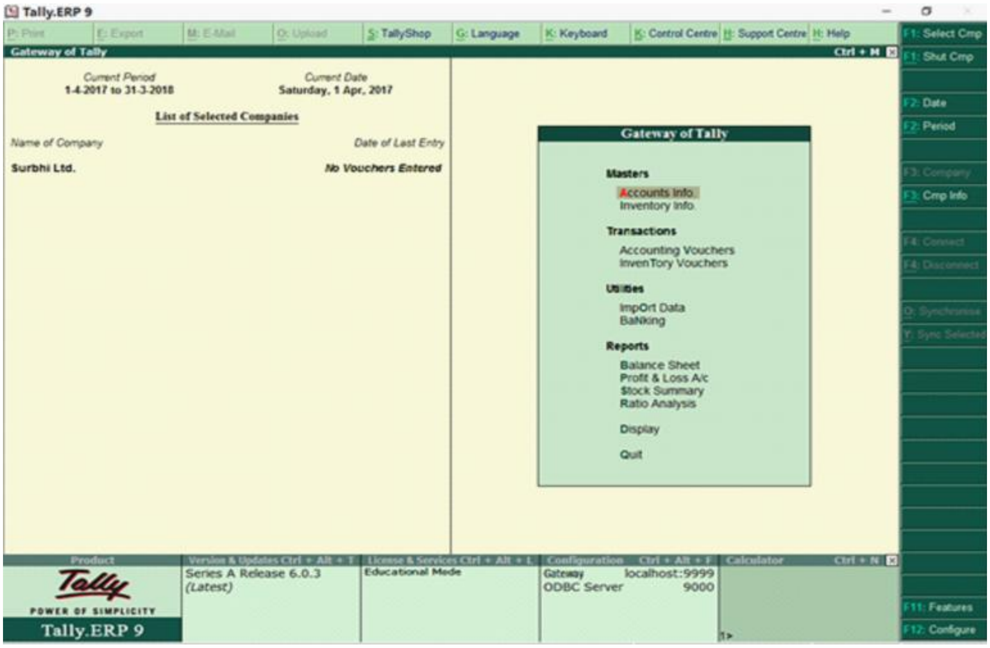


Fig. 18.6

The Gateway of Tally will appear as above with current period and current date on left side pane of tally screen. Below that it will display the name of the company which is open. Since it is a new company created, therefore in date of last entry it is written no vouchers entered. In the right pane, you can see masters where ledger and group creation along with inventory are created. In transactions, vouchers are created related to accounting and inventory. Utilities consist of importing of data from outside and other banking related operations like cheque printing, deposit slip etc. Finally reports include all financial statements like balance sheet and profit and loss, stock summary and ratio analysis. Display includes trial balance, day book, cash/fund flow etc. and in the end finally quit where you will be able to close the tally programme if selected ‘Yes’.

18.7.2 Selecting a Company

By using ‘select company’ field you can open another company from list of companies already existing in tally. Click Alt+F3 and company info will open as shown in Fig. 18.7. Click select company field or press S.

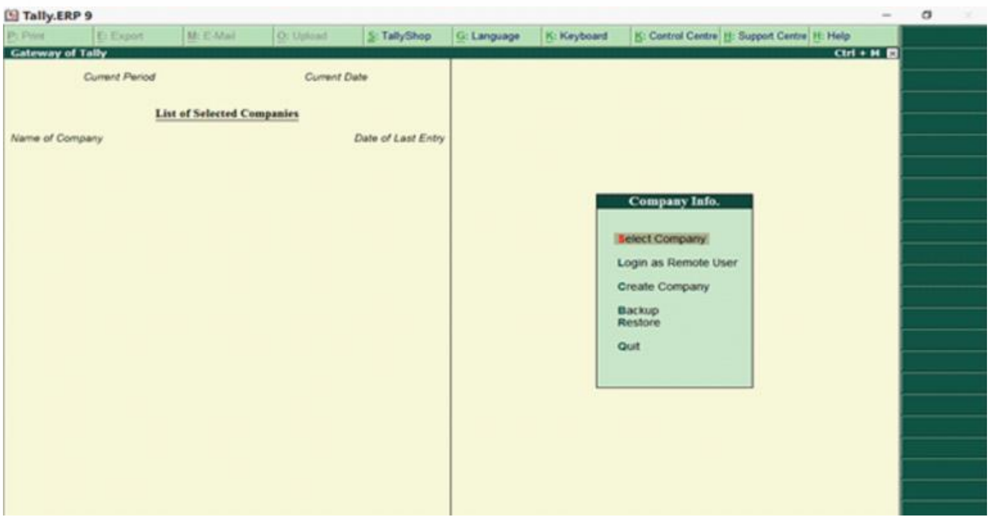


Fig. 18.7

Once you click select company, the following screen will appear as shown in Fig. 18.8:

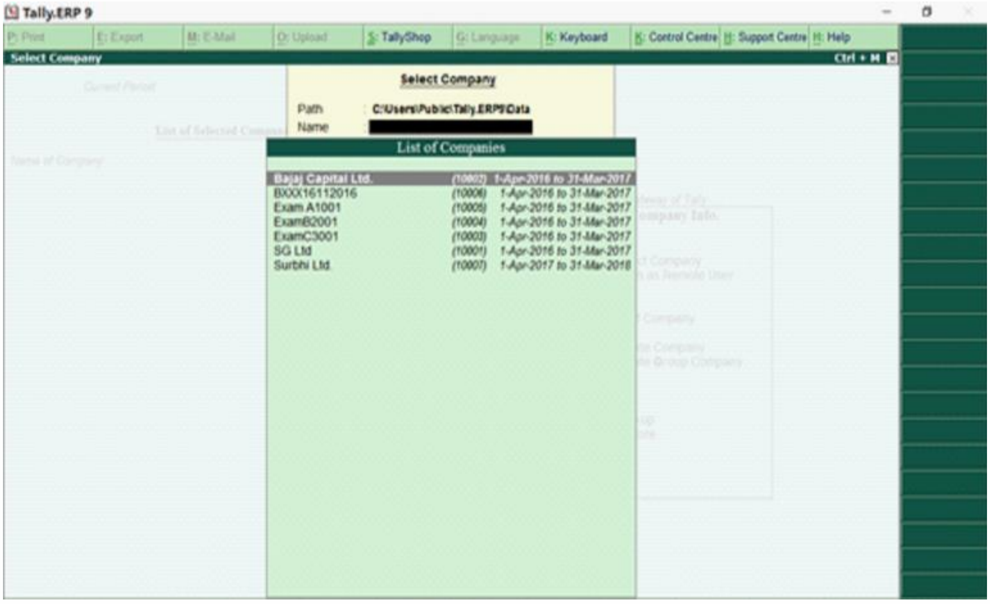


Fig. 18.8

You can select the company which you want by using arrow key and then pressing enter or by clicking the company through mouse.

18.7.3 Alteration of Details of a Company

Once company is created, you might need to update details related to company already created before. Again go to gateway of tally, click company info or Press F3, the following screen will appear as shown in Fig. 18.9.

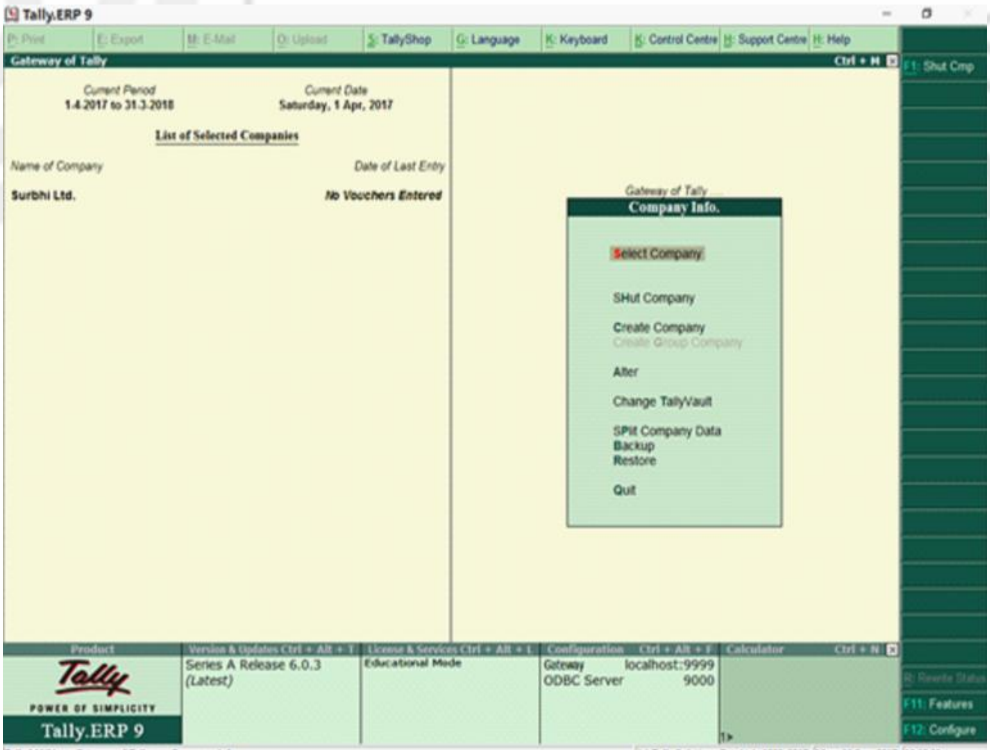


Fig. 18.9

Once you click 'alter', the following screen shall appear as shown in Fig. 18.10.

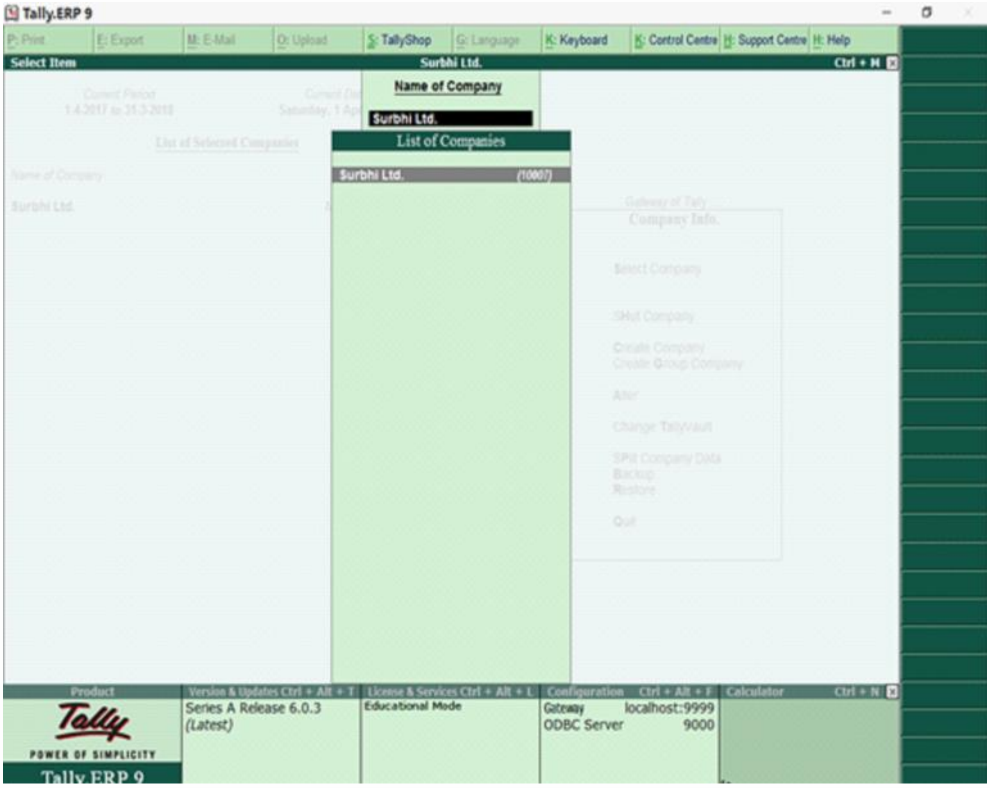


Fig. 18.10

Select the company for which you wish to alter details and after selecting, the following screen will appear and you can alter any details you want as shown in Fig. 18.11.

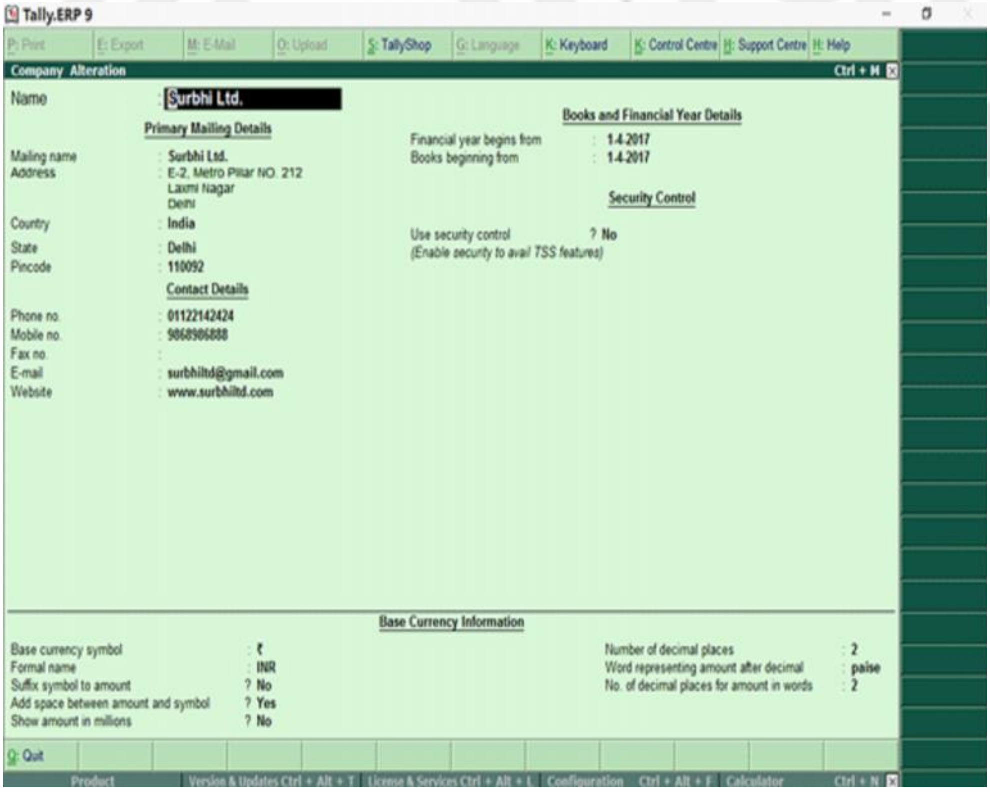


Fig. 18.11

After altering the same, once again a box will appear saying Accept 'Yes' or 'No'? Click 'yes' if alteration is done and click 'no' if you further wish to alter the details of the company.

18.7.4 Deletion of a Company

For deletion of a company, you have to go to gateway of tally and then company info and then alter (same like alteration of details of a company). Once you click alter and select the company, the company details screen will appear as follows as shown in Fig. 18.12:

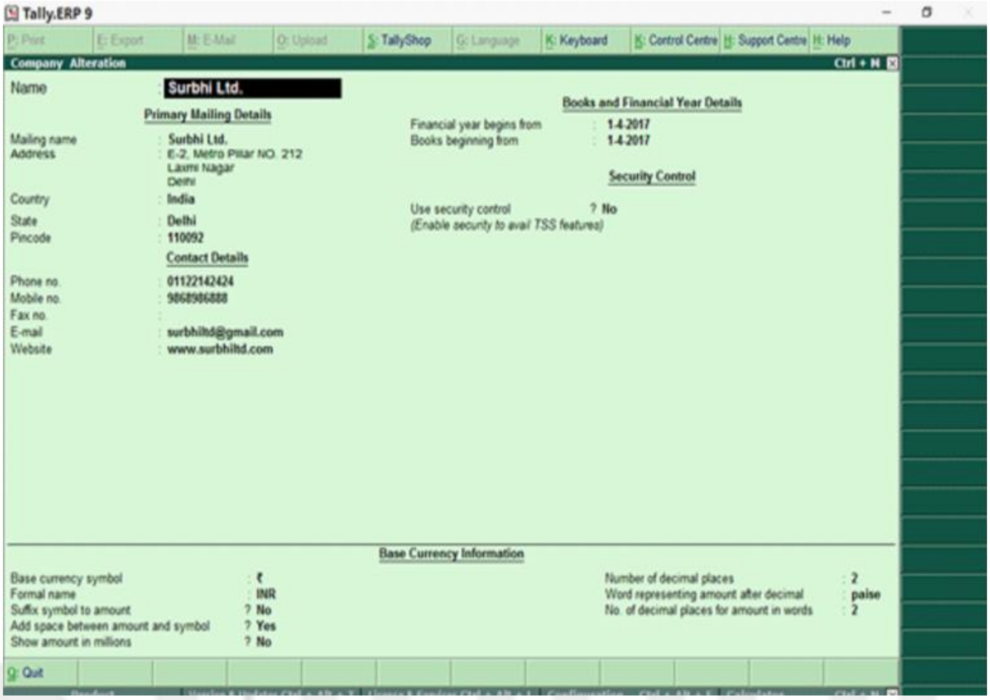


Fig. 18.12

Now, Press Alt+ D and it will ask you to delete the company i.e. yes or No. If you wish to delete the company press 'Yes' or otherwise 'No'. Once you press Y or select 'Yes' through mouse click, company will be deleted and the data will not be available as shown in Fig. 18.13:

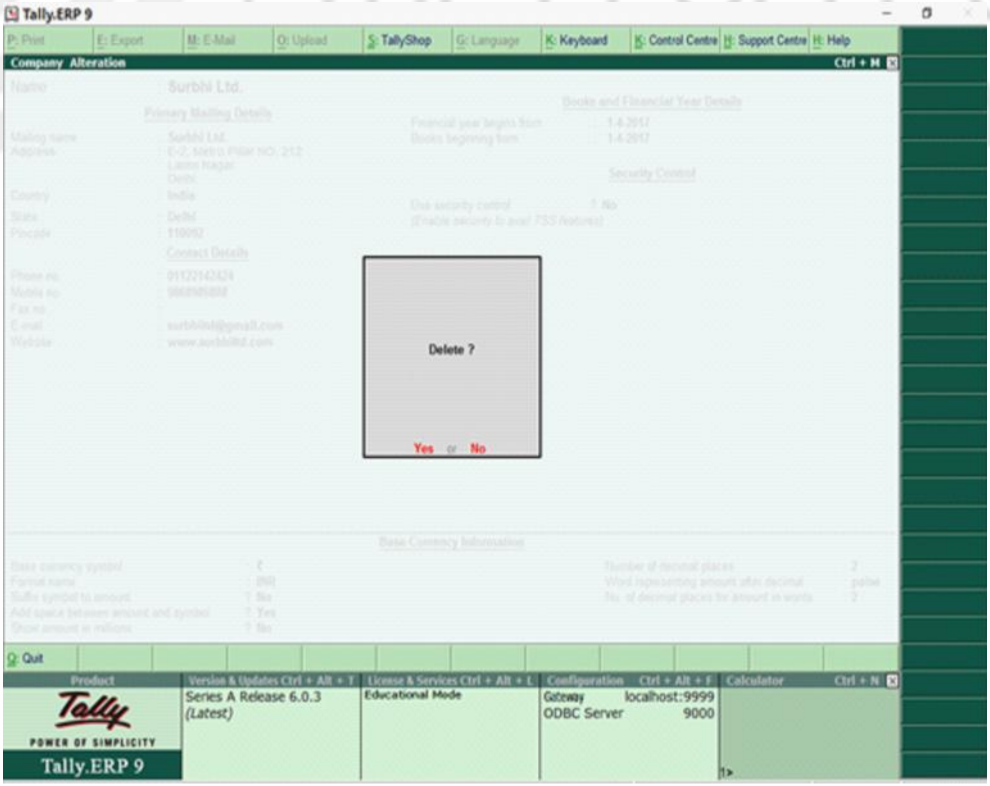


Fig. 18.13

18.7.5 Shutting of a Company

Once company is created, if you want to shut the company which is already open, again go to gateway of tally, click company info or Press F3, the following screen will appear as shown in Fig. 18.14:

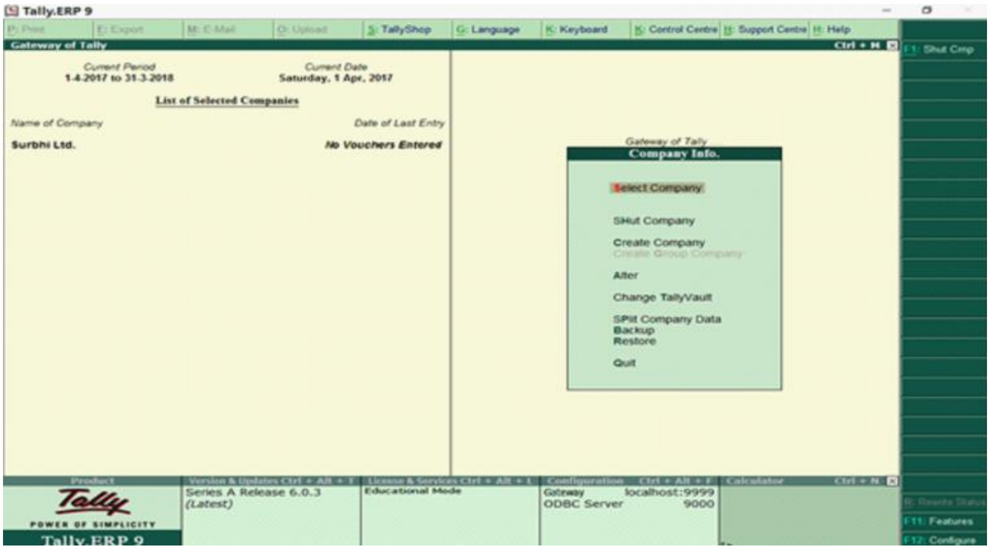


Fig. 18.14

Press shut company field or Press H or Alt+ F1 or click F1: Shut Company on the right pane.

18.8 FEATURES AND CONFIGURATIONS

Once you have created a company, it is now time to set features and configurations as per requirement. Features will affect only the company in which they are enabled as 'Yes' or 'No' where as configurations will have an effect on all companies in the directory data.

18.8.1 Features

Features are set of capabilities which are provided as options, which will enable you to set and maintain your records of financial statements as per your need. It can be found by Clicking FEATURES on vertical button bar on right pane. Alternatively you can press F11 and features screen will appear as follows as shown in Fig. 18.15:

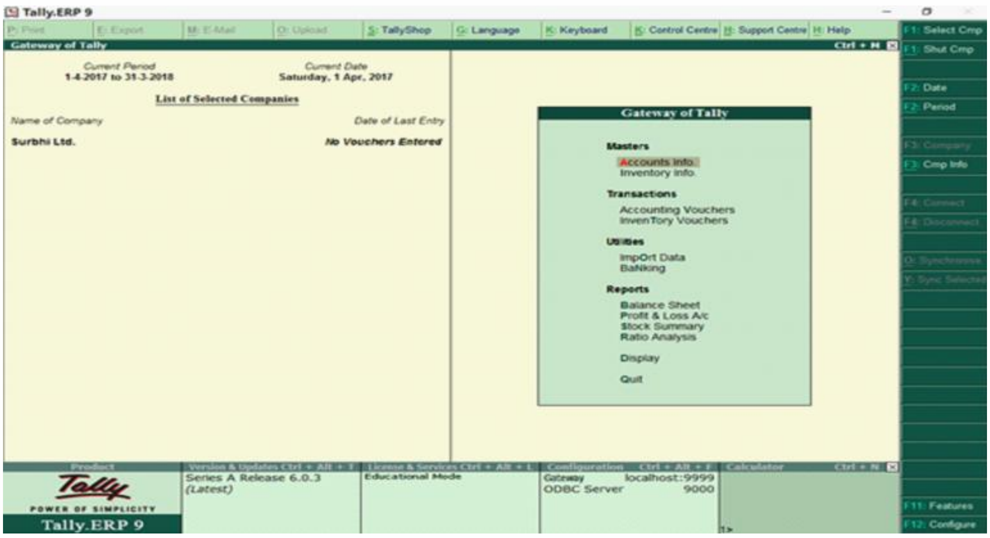


Fig. 18.15

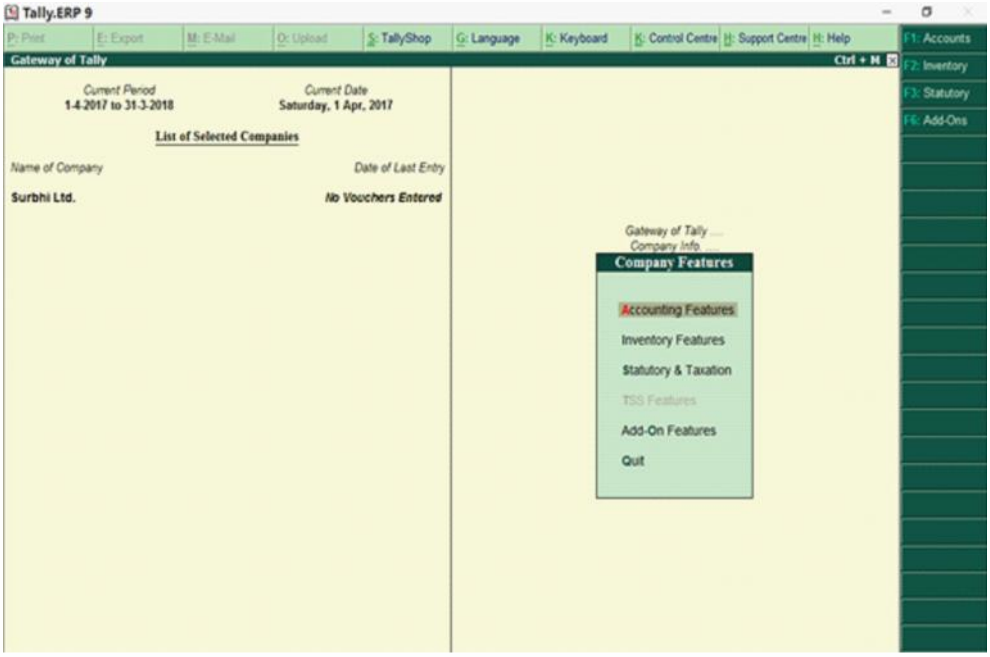


Fig. 18.16

You can now see various features like accounting, inventory, statutory and taxation and add on features as shown in Fig. 18.16. You can open say accounting feature by clicking it or pressing 'A' or pressing F1 or by clicking F1: Accounts on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 18.17:

Fig. 18.17

There are three categories of features viz; (i) Accounting Features; (2) Inventory features, and (3) Taxation and statutory features.

18.8.1.1 Accounting Features

The **accounting features** consists of general, outstanding management, cost/profit centres management, invoicing, budgeting and scenario management, banking features and other features as shown in Fig. 18.17:

- General: If you have chosen accounts with inventory while creating company, maintain accounts only option will be set as 'No' and integrate accounts with inventory option as 'Yes'. If you have chosen accounts only while creating company, maintain accounts only option will be set as 'Yes' and integrate accounts with inventory option will not be highlighted and will be grey in color. If you wish to have income and expenditure account in place of Profit and loss account (Like for NPO) you can enable this as 'Yes'.

- Outstanding Management: This will help maintain bill wise details and also, calculate interest on outstanding.

- Cost/Profit Centres Management: It helps in maintaining payroll and cost centres.

- Invoicing: To enable recording purchase in invoice mode, type 'Yes'. To record sales and purchase return, debit and credit note is used. Set Debit and credit note as 'Yes'

- Budgeting and scenario management: To maintain budget, enable the option as "Yes'.

- Banking Features: To enable cheque printing, enable cheque option as 'Yes'.

- Other Features: To enable zero valued transactions while recording transactions, enable this option as 'Yes'.

After carrying out all requisite changes in accounting features, Accept 'yes' or 'No'. The tally screen will appear as follows as shown in Fig. 18.18:

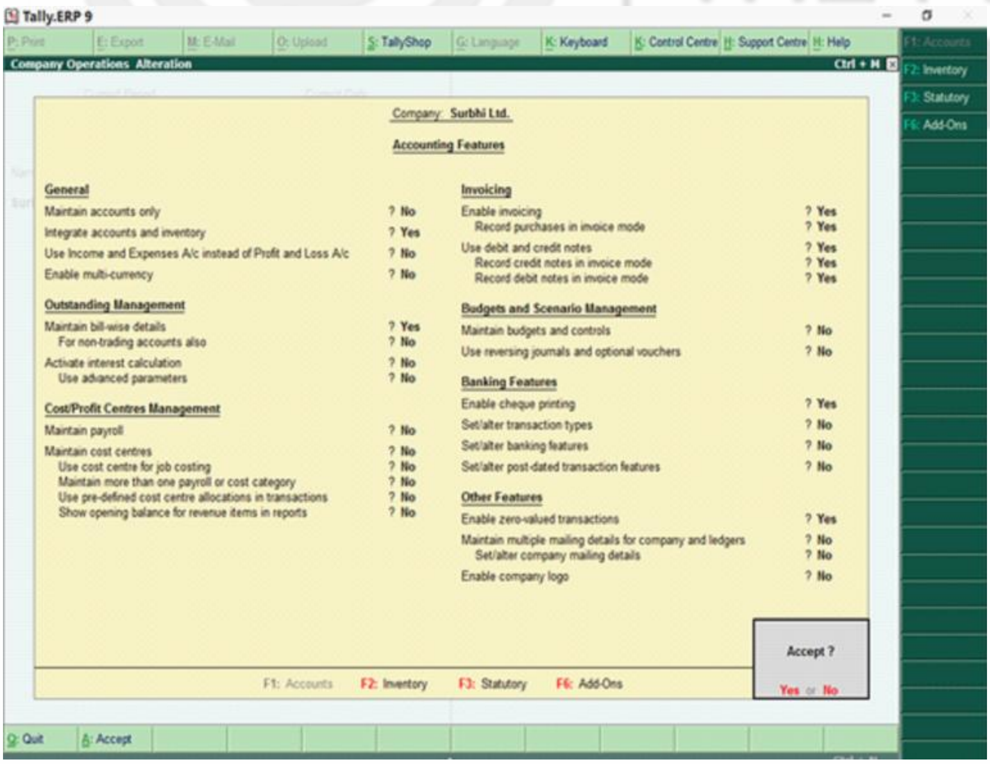


Fig. 18.18

18.8.1.2 Inventory Features

The **inventory features** consists of general, storage and classification, order processing, invoicing, purchase and sales management and other features. You can open inventory feature by clicking it or pressing ‘I’ or pressing F2 or by clicking F2: inventory on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 18.19:

Fig. 18.19

In general, integrate accounts and inventory will be set as ‘Yes’ if you have selected accounts with inventory while creating company. If you want to enable zero valued transactions, set this option as ‘Yes’.

In storage and classification, if you want to maintain stock according to location or warehouse, enable maintain multiple godowns/locations as ‘Yes’. To maintain stock category wise, enable maintain stock categories as ‘Yes’.

Set invoicing as ‘Yes’ and use debit and credit notes in invoice mode as ‘Yes’. To record discount in invoice in separate column, enable this option as ‘Yes’.

After all settings, the screen will appear as follows as shown in Fig. 18.20: and accept ‘Yes’ to proceed further:

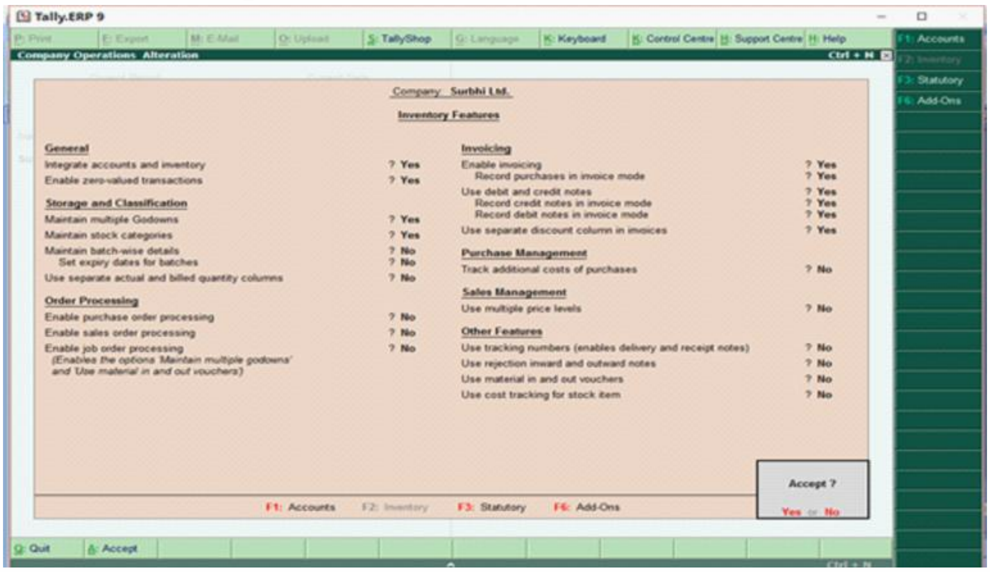


Fig. 18.20

18.8.1.3 Statutory and Taxation Features

Next feature is **Statutory and taxation**. You can open inventory feature by clicking it or pressing 'S' or pressing 'F3' or by clicking 'F3': statutory on the vertical button bar on right pane. Once you do so, the following screen will appear as shown in Fig. 18.21:

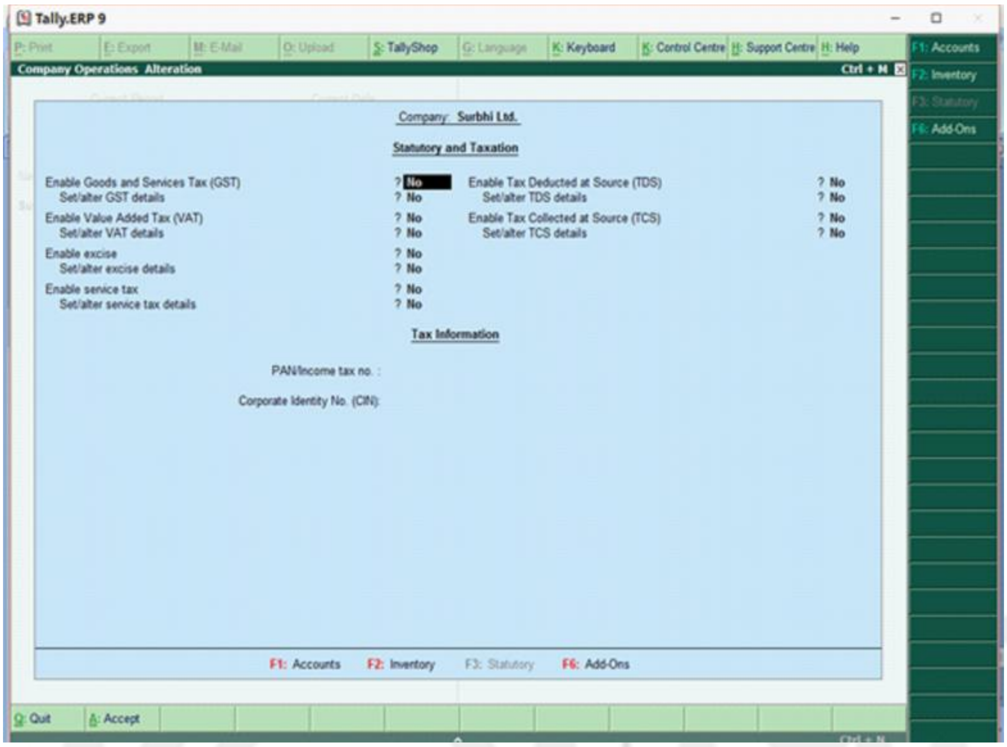


Fig. 18.21

Please note statutory compliance is country specific. Since we have selected India as option in statutory compliance for, therefore the displayed statutory and taxation features are those that are relevant to India. One can set these according to business specific requirement. To enable GST, VAT, Service Tax, TDS & TCS enable option as 'Yes' along with set/alter details option. Suppose, GST is relevant to our business, then setting GST as 'Yes' will appear like above as shown in Fig. 18.22:

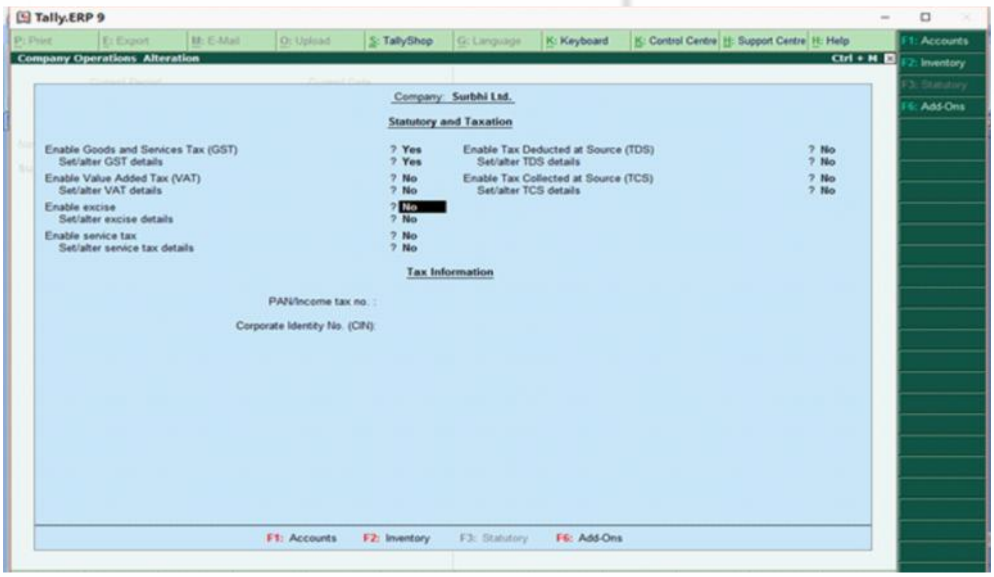


Fig. 18.22

In tax information, put PAN number and Corporate Identity Number if available. After all settings, the screen will show accept ‘Yes’ or ‘No’. If all the settings have been done, accept as ‘Yes’ otherwise ‘No’ and do the required settings.

Sometimes, there are specific problems which relates to specific organization or company or business. The solution provider i.e. Tally partners provide a new feature as solution which is specific to that organization or company or business only. It is known as customized solution and it gets placed as add on feature. One can see add on feature by clicking it or pressing ‘O’ or pressing ‘F6’ or by clicking ‘F6’: Add-Ons on the vertical button bar on right pane as shown in Fig. 18.23:.

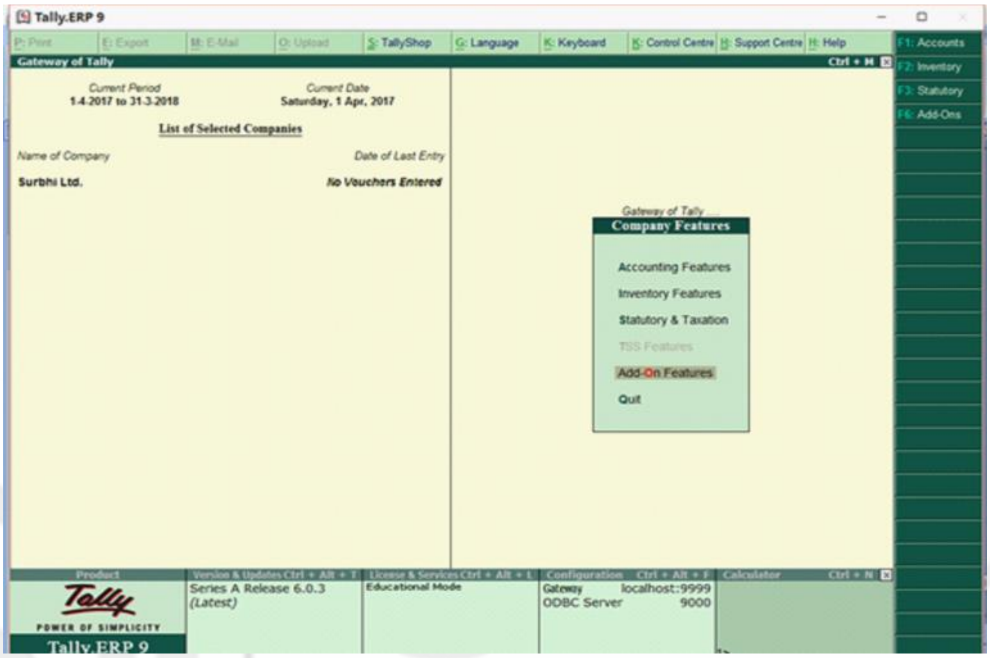


Fig. 18.23

To return to the main screen, either click quit or Ctrl +M.

18.8.2 Configurations

Configurations are options that help you modify the way a feature works. Configuration can be located on vertical button bar in the last. You can also press F12 or click F12: Configure.

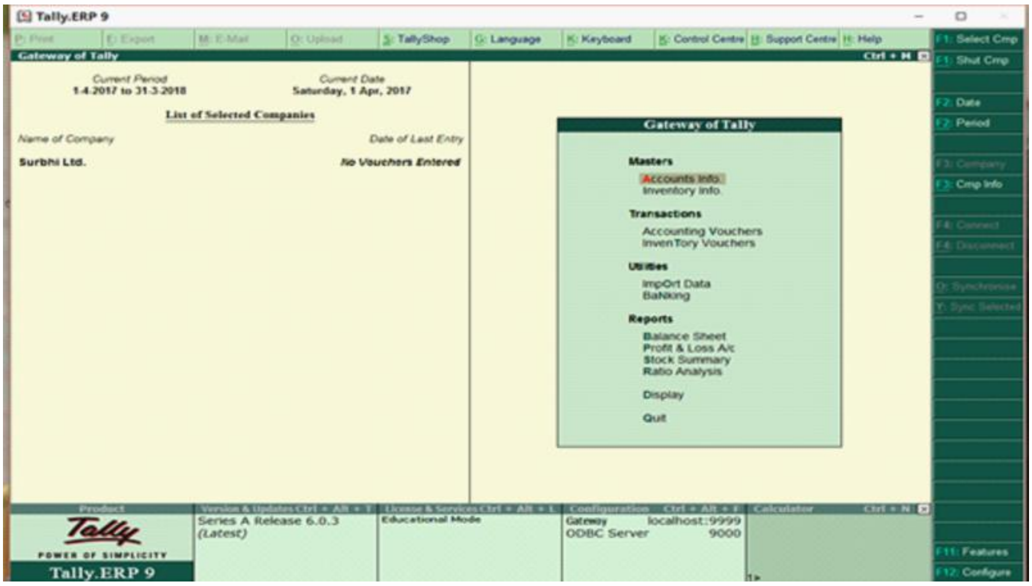


Fig. 18.24

Once you press F12 or open F12: Configure, the following screen will appear as shown in Fig. 18.24:

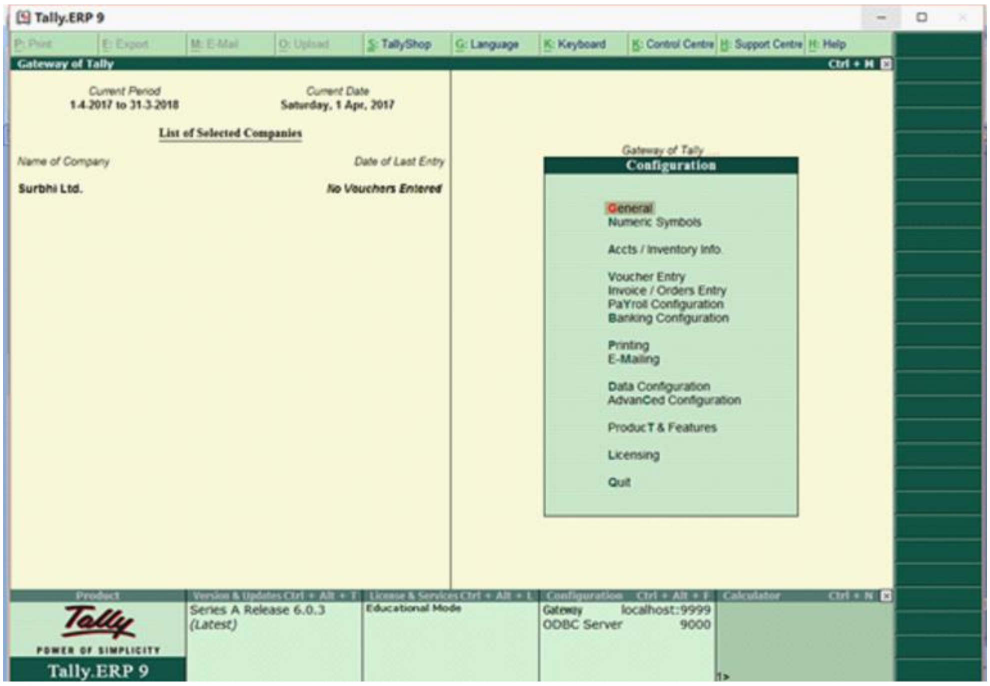


Fig. 18.25

This gateway of tally screen of configuration will allow different configuration like general configuration, numeric symbols, accounts/inventory info, voucher entry, order entry, payroll and banking configuration etc. as shown in Fig. 18.25:

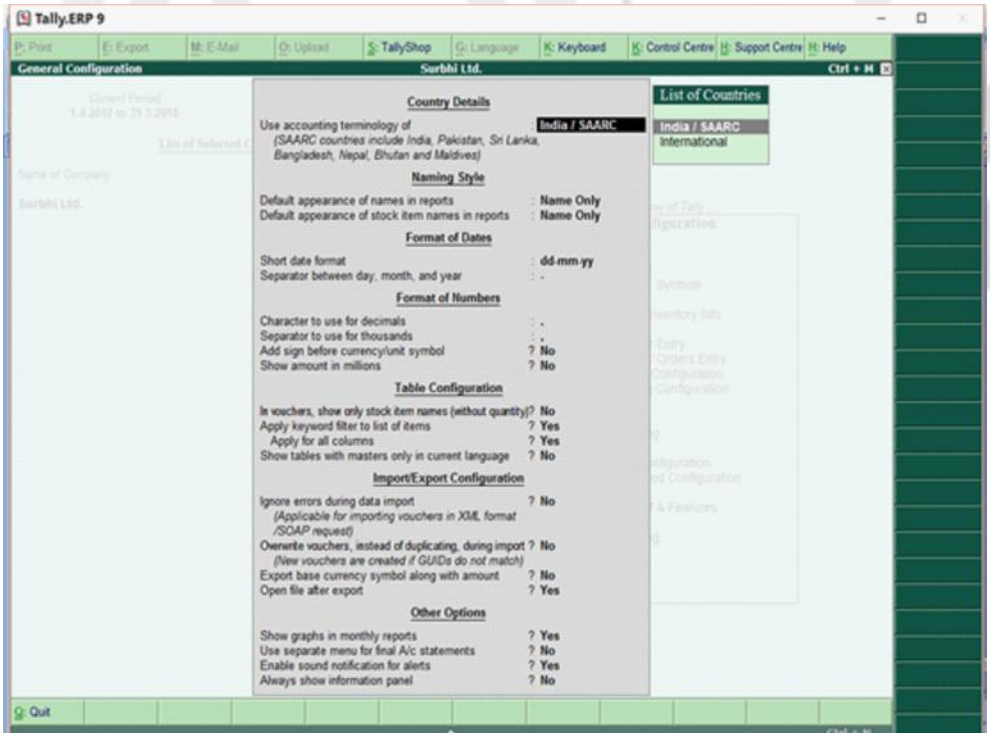


Fig. 18.26

In the above screen as shown in Fig. 18.26, you can see general configurations where you can select country from India/SAARC or international, different styles of displaying names of reports and stock items, different styles of writing dates, formatting of numbers (character to use for decimal, separator to use for thousands etc) and other options like monthly reports in form or graph. If you enable use separate menu for final account statement as 'Yes', then on main screen of gateway of tally, balance sheet and profit and loss will come under Final Accounts field as below as shown in Fig. 18.27:

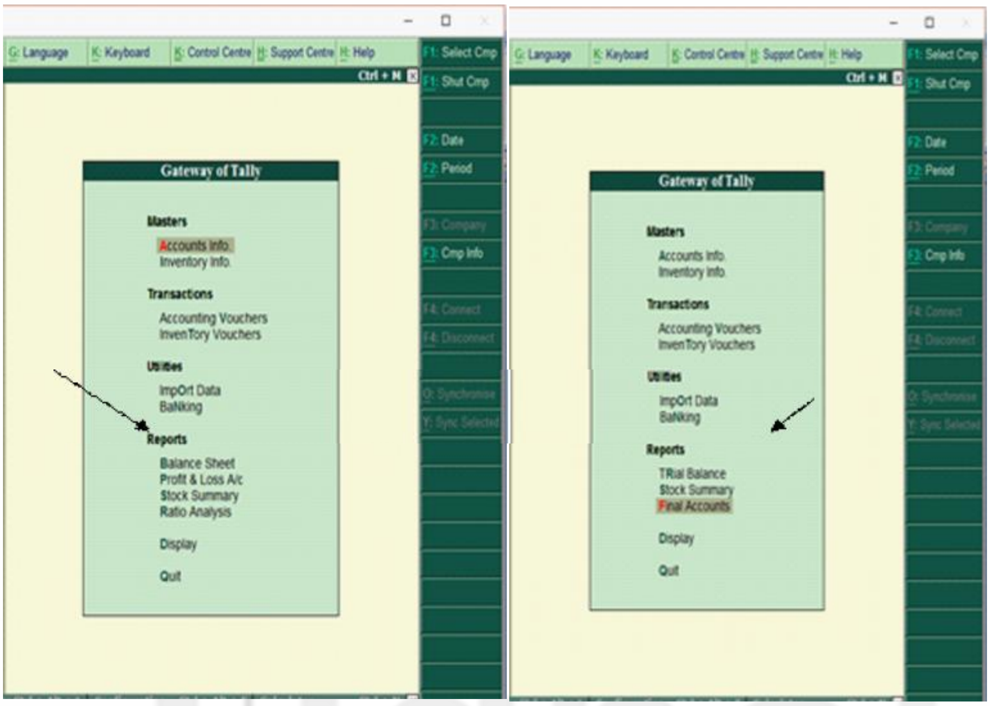


Fig. 18.27

To configure the numeric symbols, select the option 'Numeric Symbols' and the following screen will appear as shown in Fig. 18.28:

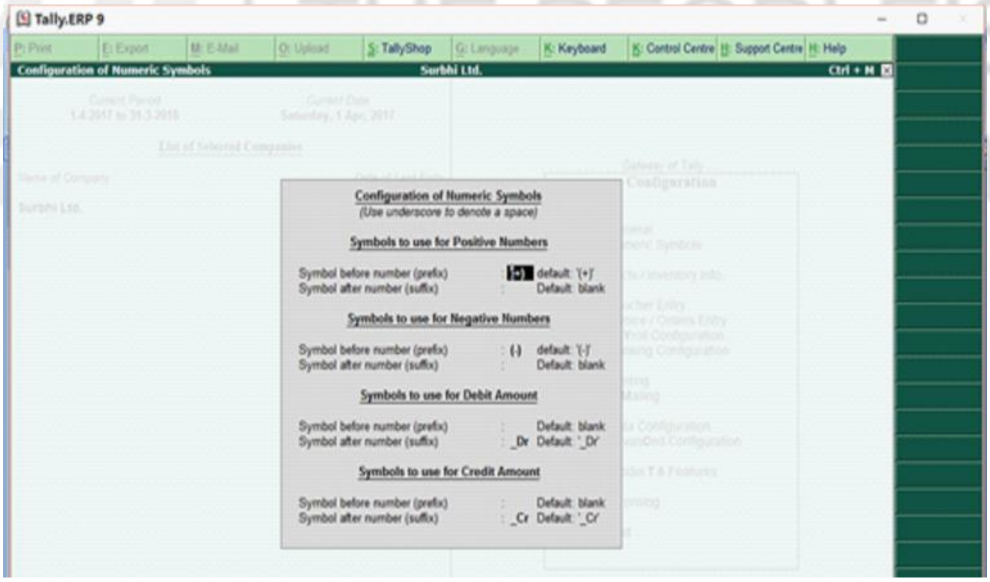


Fig. 18.28

It includes symbols to be used for negative and positive numbers and debit and credit amounts.

The screen below as shown in Fig. 18.29 shows master configurations related to accounts and inventory.

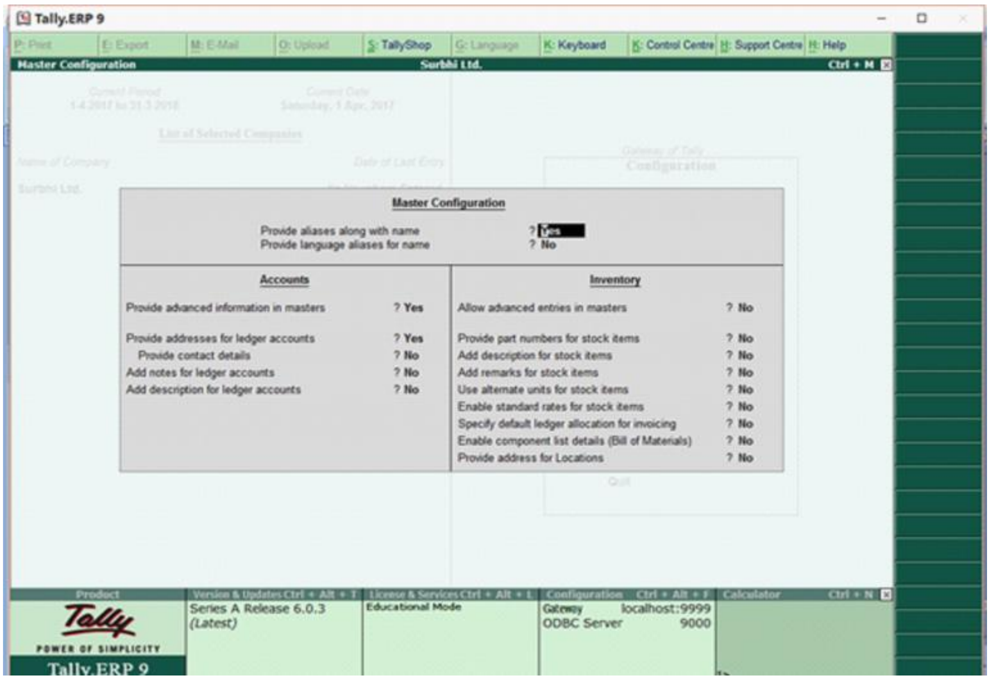


Fig. 18.29

Next is voucher entry related configurations pertaining to both accounting and inventory info. On opening voucher entry, the following screen will appear as shown in Fig. 18.30.

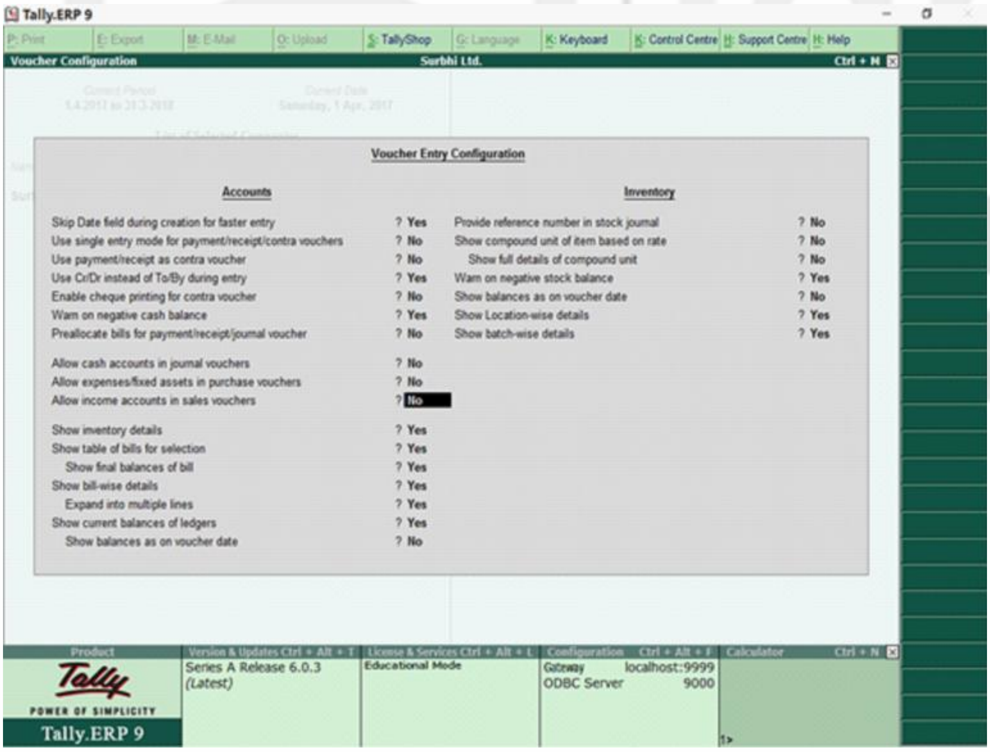


Fig. 18.30

If you wish to skip date for faster entry, enable this option as 'Yes'. It will jump to next field automatically.

Set use single entry mode for Pymt/Rcpt/Contra and Use payment/Receipt as contra as 'NO' and use Cr/Dr instead of To/By during entry as 'Yes'.

Set warn on negative cash balance as 'Yes' so that whenever cash balance goes negative, it will show warning as shown in Fig. 18.31.

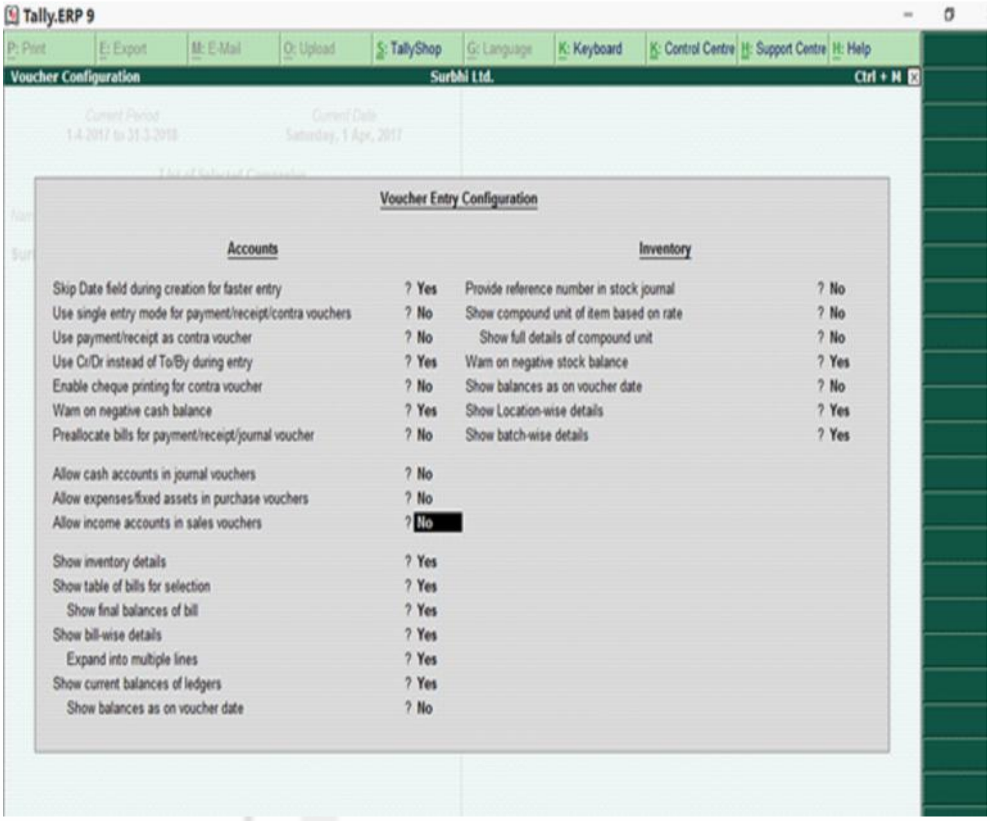


Fig. 18.31

Invoice /Order Entry will let you configure additional things like export details, shipping details etc.

Payroll configuration is used to configure additional details for the employees.

Banking configuration will let you configure banking details.

Printing configuration helps to configure the printing screens for the reports and transactions.

E-mailing will help you configure email related details.

Data configuration will enable configuration of data i.e. location of tally files, export files etc.

Product and features will tell you about the details of current product installed in your system.

Licensing will help you update, surrender, reset license and also configure existing license.

Quit will enable you to return to the main screen of gateway of tally.

18.9 SHUTTING TALLY ERP.9

To exit out of Tally application, close all the screens. Once all the screens are closed, you can see gateway of tally, now press ‘EscÆ key from keyboard and when promoted to quit, press yes. Otherwise you can also click Ctrl +M on the extreme right corner and when promoted to quit, press yes.

You can also click Ctrl+Q to exit without confirmation.

18.10 KEYBOARD CONVENTIONS

ACTIONS	PARTICULARS
Fn (F11: FEATURES)	**Press the Key**
Fn (K: KEYBOARD)	**Press Alt+ Key**
Fn (K: CONTROL CENTRE)	**Press Ctrl+ Key**

Check Your Progress B

1. The option used in Tally to close an open company is:

   (a) Alter Company (b) Close Company (c) Shut Company (d) Exit Company

2. In features option, F2 option contains:

   (a) Accounting Features (b) Inventory Features (c) Statutory Features (d) Tally NET Features

3. For creating a company we use the following shortcut:

   (a) Alt+ F1 (b) Alt +F2 (c) Alt +F3 (d) Esc Key

4. One can modify an existing Company:

   (a) Company Info > Alter (b) Company Info > Alter Company (c) Gateway of Tally > Modify Company (d) None of the above

5. To change date from gateway of Tally, Press

   (a) F1 (b) F2 (c) F3 (d) F4

6. The shortcut to use calculator

   (a) Ctrl +N (b) Ctrl + M (c) Ctrl +P (d) Ctrl + L

18.11 LET US SUM UP

With the advancement of technology, maintaining records of financial transactions has also changed from manual to electronic form. Computerised Accounting system has been adopted by most business organizations because of its comparative advantages like speed, ease, security, reliability to name a few. But these advantages come at a cost. There are chances of data being corrupt, electricity issues, theft of data and too much reliance on computer. Still its advantages outperform in relation to disadvantages.

Business organization should keep in mind various factors while choosing accounting softwares as varied softwares are available in market. The main difference between computerized accounting and manual accounting is that ledgers are created first and then journal entries are done through vouchers instead of journal entries being followed by ledger posting as done in manual accounting system.

First step in computerized accounting system is creation of company where all the basic details like name, address, email, mobile number, maintaining accounts with or without inventory, financial year are filled in the software. The company details can be altered at any stage if needed. The company can also be deleted if required. The features and configurations help the business organization to maintain financial record as per requirement of business. Features are applicable to only company where as configurations are for overall Tally Software. The next step after company creation is creating masters.

18.12 KEY WORDS

Accounting Features: The accounting features consists of general, outstanding management, cost/profit centres, management, invoicing, budgeting and scenario management, banking features and other features.

Alteration of Details of a Company: A process of making changes in the details of company or any data which is misspelt or wrongly taken while putting information during company creation process.

Computerised Accounting System: A process of digitally collecting, recording, classifying and summarising financial data using accounting software for managerial decision making.

Configuration: Configurations are options that help you modify the way a feature works. Configuration can be located on vertical button bar in the last. You can also press F12 or click F12: Configure.

Features: Features are set of capabilities which are provided as options, which will enable you to set and maintain your records of financial statements as per your need.

Gateway of Tally: The gateway of Tally displays menus, screens, reports and options that you select.

Inventory Features: The inventory features consists of general, storage and classification, order processing, invoicing, purchase and sales management and other features.

Manual Accounting System: A process of physically maintaining books of accounts.

Statutory and Taxation Features: You can open statutory and taxation feature by clicking it or pressing 'S' or pressing F3 or by clicking F3: statutory on the vertical button bar on right pane.

Shutting a Company: Once company is created, if you want to shut the company which is already open, go to gateway of tally, click company info or Press F3, a screen will appear, press shut company field or Press H or Alt+ F1 or click F1: Shut Cmp on the right pane.

Tally ERP.9: A business accounting software for purposes of accounting, inventory and payroll.

18.13 ANSWERS TO CHECK YOUR PROGRESS

A 1. i) (c) 2. ii) (d) 3. iv) (d) 4. v) (c)

B 1. (c) 2. (b) 3. (c) 4. (a) 5. (b) 6. (a)

18.14 TERMINAL QUESTIONS/EXERCISES

Questions

1. Define a computerised accounting system. Distinguish between manual and computerised accounting system.
2. Explain the considerations which are required to be kept in mind while choosing accounting software.
3. Explain the components of Tally.
4. Distinguish between features and configurations.

Exercises

Create a company with following details in Tally ERP.9:

Name of Company	S Bose Beverages Ltd.	Bhartiya Book Trading Company
Address	147/A, Jheel Industrial Area, Delhi – 110051	4044/A/F, Rajpura Road, Mumbai – 400007
Country	India	India
State	Delhi	Maharashtra
Contact No.	011-22590475	022-22224477
Email-id	sbose@gmail.com	contactinfo@btrading.com
Mobile No.	9911000012	9899477701
Books Beginning From	01-04-2017	01-04-2017
Financial Year Beginning From	01-04-2017	01-04-2017
Maintain	Accounting with inventory	Accounting with inventory
Maintain	Accounting with inventory	Accounting with inventory

UNIT 19 CREATING MASTERS

Structure

19.0 OBJECTIVES

After studying this unit, you will be able to:

- create ledger accounts and groups in tally;
- create inventory masters for stock;
- kearn the process of deleting and altering Legder and Groups; and
- display various ledgers and inventory items.

19.1 INTRODUCTION

A chart of accounts is a list that depicts the accounts that a business use to store and record transactions in its books of accounts. Tally ERP.9 divides chart of accounts into two: Ledgers and Groups. In manual accounting process, Ledger creating is next step after recording journal entries. But in computerized accounting, ledger creation is done before journal entries because you need ledgers to debit and credit while doing journal entries. In this unit, you will learn how ledgers and groups account are created, how data related to stock/ inventors can be maintained, and the way to delete or alter an display any ledger, group and inventory masters.

19.2 LEDGERS AND GROUPS

LEDGER

Ledger is a T- shape account head. For example, Purchase account head will be called as 'Purchase Ledger'. To record specific transactions, you can create ledgers as per transaction.

By default, Tally has two pre defined ledgers viz. (1) cash, and (2) Profit & loss Account as shown in Fig. 19.1.

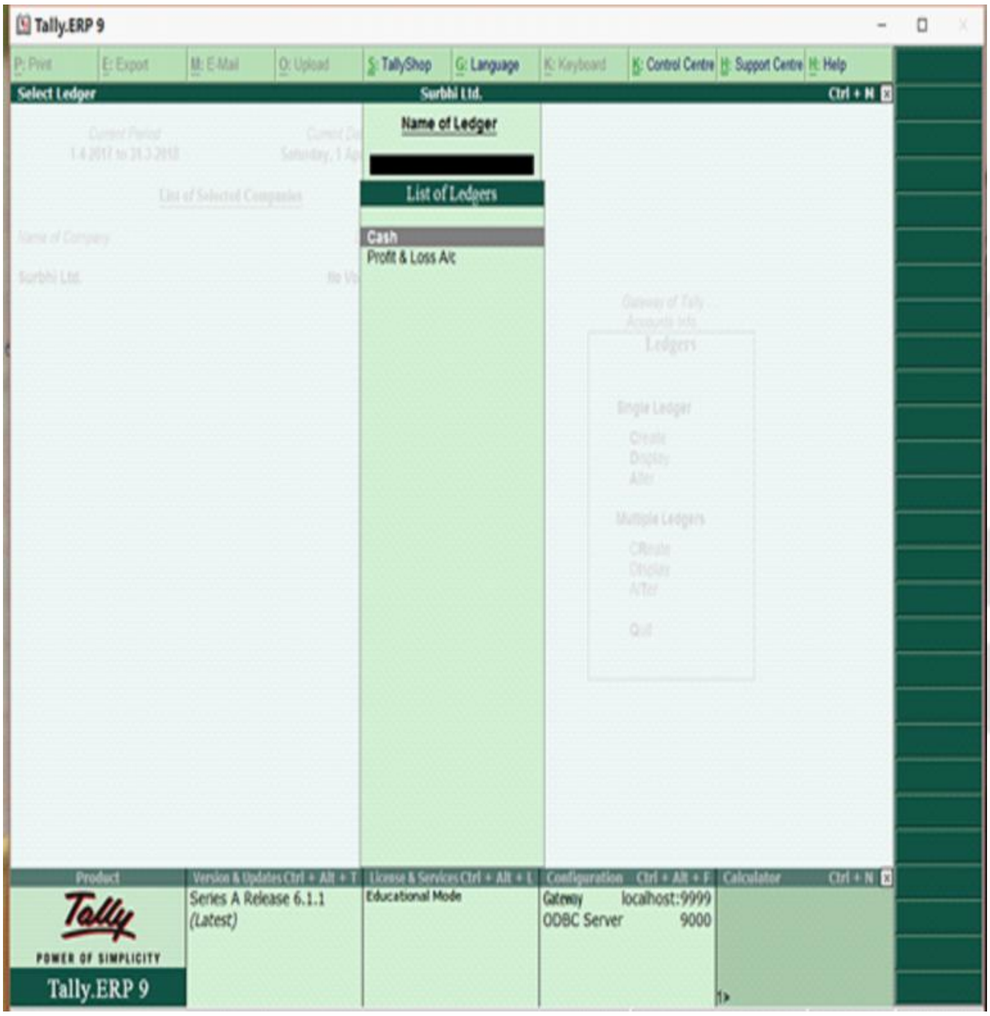


Fig. 19.1

To view already predefined ledgers: Go to Gateway of Tally → Accounts Info.

Ledgers → Multiple Ledgers → Display and the screen will appear as follows as shows in Fig. 19.2.

Fig. 19.2

GROUP

A group is the accounting group which consists of ledger accounts of similar nature. For example, Bank account group will have all bank accounts classified under it.

Tally has 198 predefined groups out of which 15 are main or primary groups and remaining 13 are sub-groups.

Out of 15 primary groups, 9 are related to balance sheet items and remaining 6 are Profit and loss related items.

You can see in Fig. 19.3, all 28 predefined groups by going to Gateway of Tally → Accounts Info. → Groups → Multiple Groups → Display

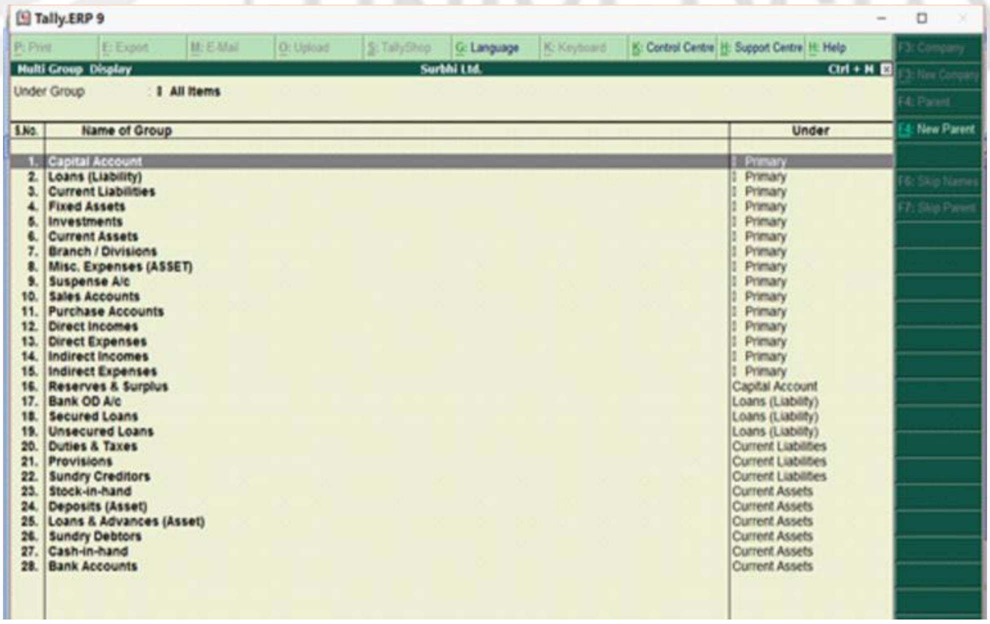


Fig. 19.3

19.3 LEDGER CREATION

19.3.1 Single Ledger Creation

Let us create ledgers for company created in Unit 18: Surbhi Ltd.

Ledger: Surbhi Capital Account

Group: Capital Account

Amount: Rs. 5,00,000

Ledger: Building

Group: Fixed Assets

Amount: Rs. 19,00,000

Creating Surbhi Capital A/c (Fig. 19.4)

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click single ledger - create
- Type Surbhi Capital Account in Name
- Select Under - Capital Account
- Enter 5,00,000 in opening balance on 1-Apr-19017

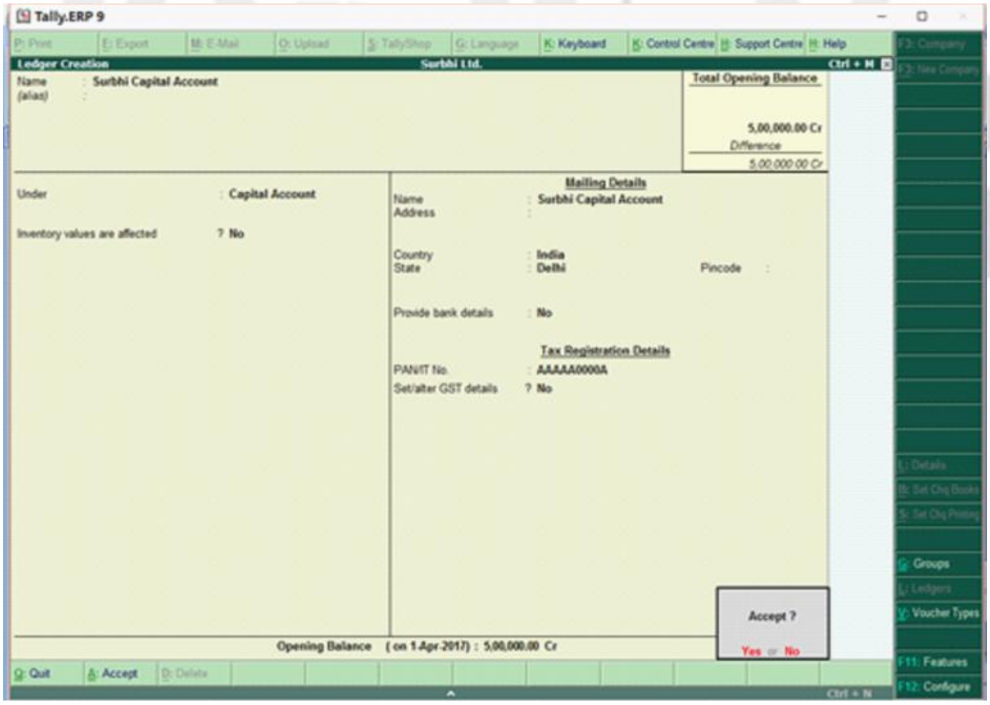


Fig. 19.4

Once you put opening balance, press enter and a box will appear asking you to accept. Click 'Yes' and your ledger will be created. The screen in Fig. 19.5 shows that the ledger has been created:

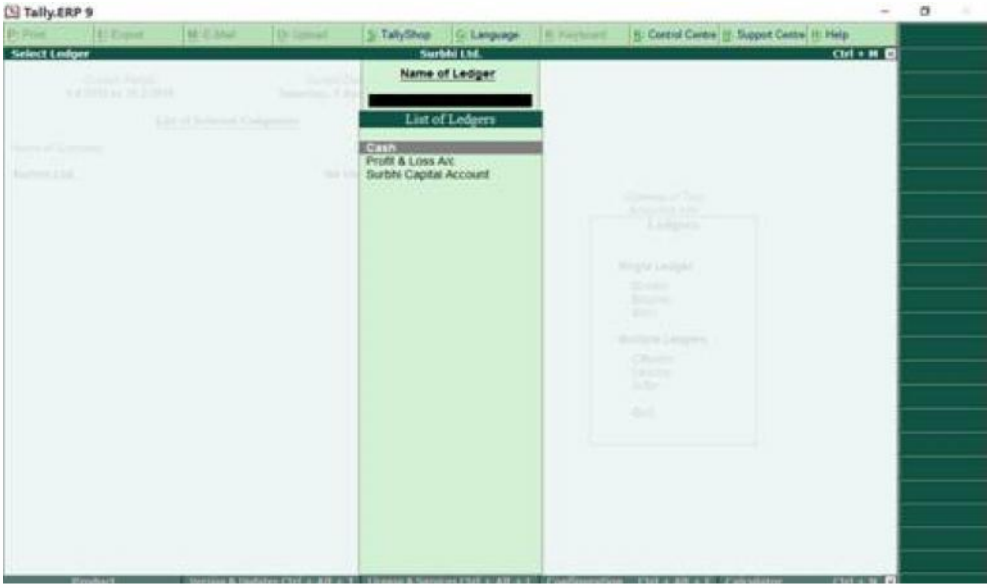


Fig. 19.5

Creating Building A/c (Fig. 19.6)

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click single ledger - create
- Type Building Account in Name
- Select Under- Fixed Asset Account
- Enter 2,00,000 in opening balance on 1-Apr-2017

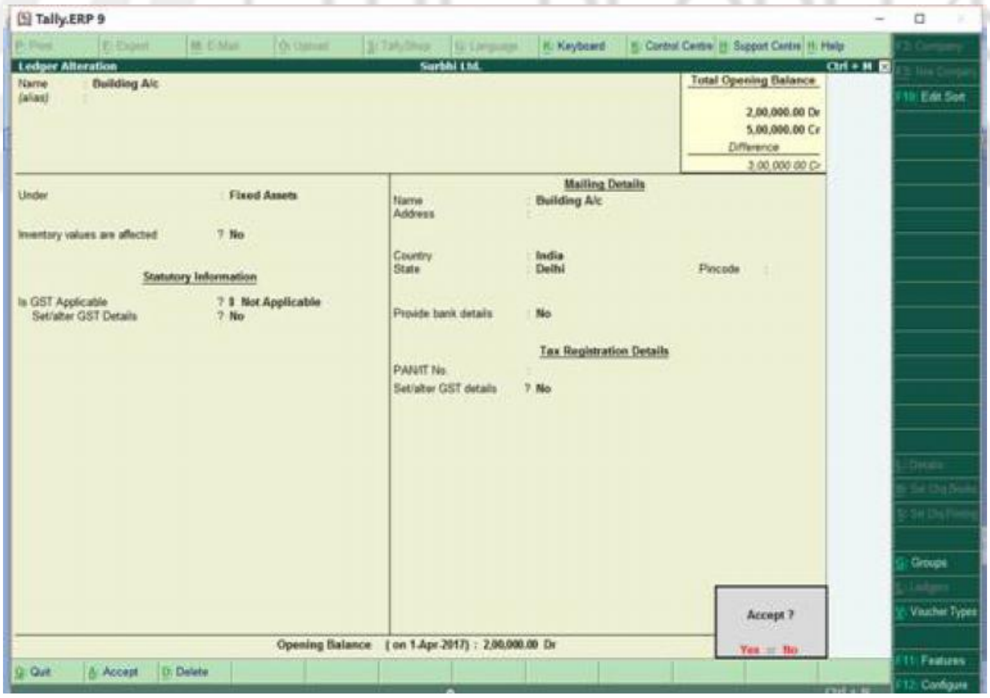


Fig. 19.6

Once you put opening balance, press enter and a box will appear asking you to accept as shown in Fig. 19.6. Click 'Yes' and your ledger will be created. The screen shows the ledger has been created as shown in Fig. 19.7.

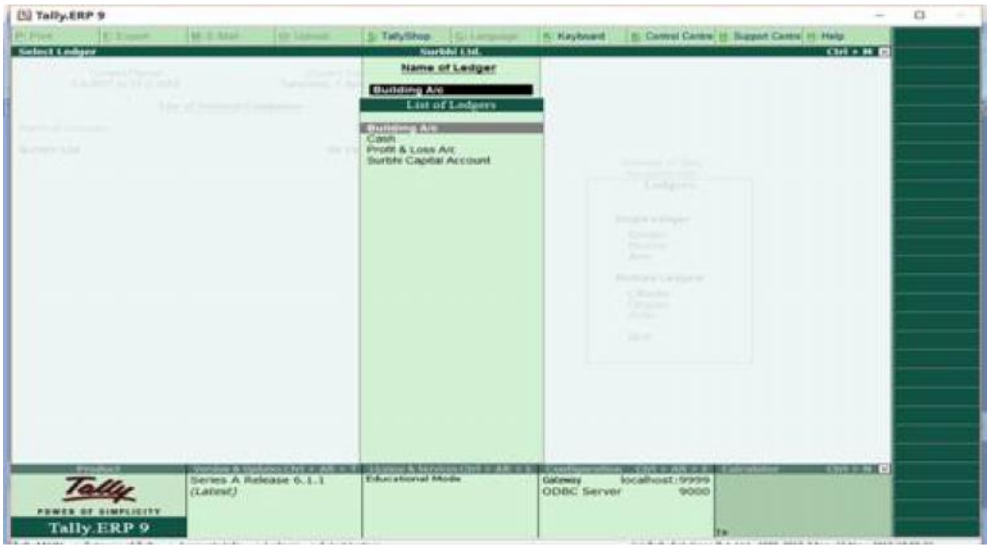


Fig. 19.7

19.3.2 Multiple Ledger Creation

Multiple Ledger creation will enable to create same class of ledgers quickly as creating single ledger takes time.

Let us create ledger account of Furniture and Plant & Machinery.

Ledger: Furniture A/c
Group: Fixed Assets
Amount: Rs. 50,000

Ledger: Plant & Machinery A/c
Group: Fixed Assets
Amount: Rs. 1,00,000

Creating Both Ledgers (See Fig. 19.8)

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click multiple ledger – create
- Select Under- Fixed Asset Account
- Type Furniture Account in Name of Ledger, Press Enter (Fixed Asset group will come automatically) as shown in Fig. 19.8.
- Enter 50,000 in opening balance on 1-Apr-19017 and press enter
- Type Plant & Machinery in Name of Ledger, Press Enter (Fixed Asset group will come automatically).
- Enter 1,00,000 in opening balance on 1-Apr-19017
- Press Enter and again press enter
- Now, a box will appear asking you to Accept 'Yes' as show in Fig. 19.8

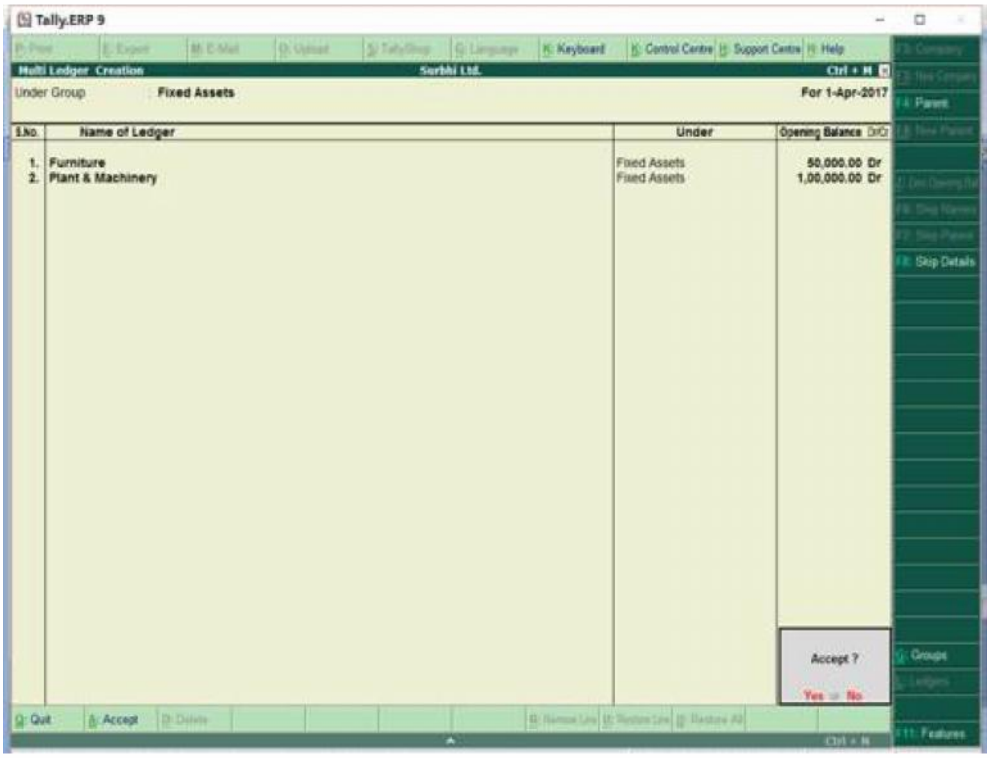


Fig. 19.8

Once you accept, both the ledgers will be created, as shown in Fig. 19.9.

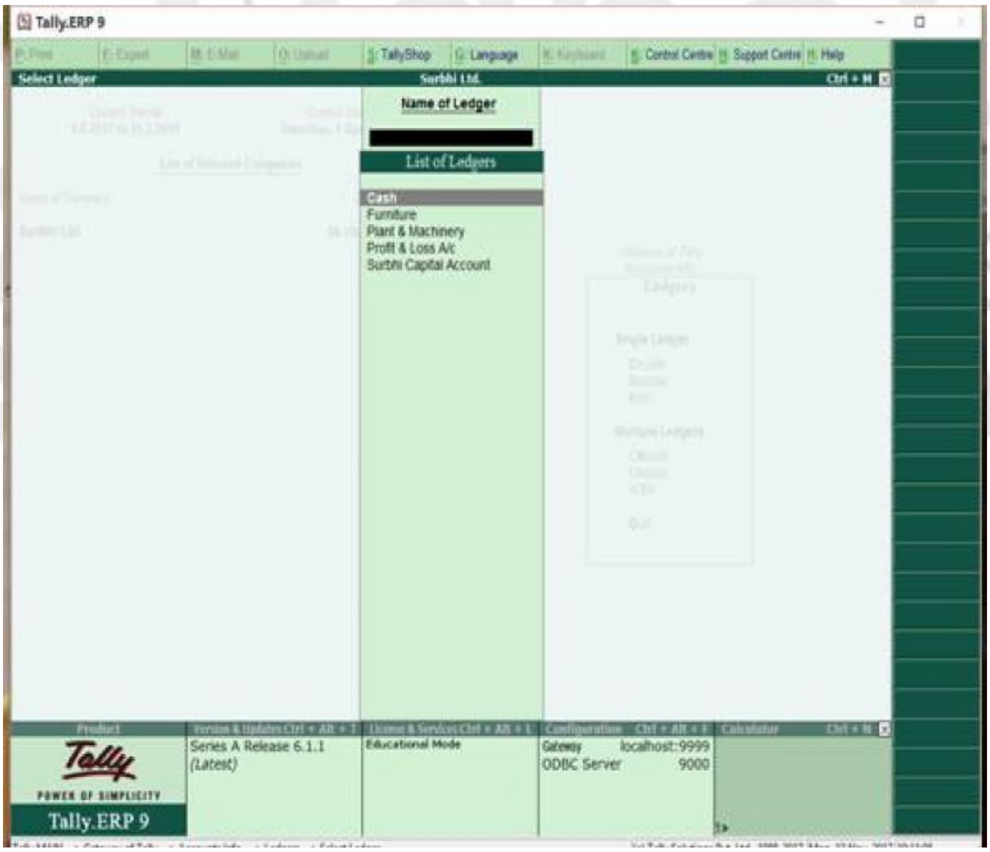


Fig. 19.9

19.3.3 Altering and Displaying Ledger

Alteration of ledger is the process by which you can alter any ledger say for spelling mistake, wrong selection of group, altering balance of ledger etc.

Example: To change Building A/c ledger name as 'Land & Building'

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click single ledger - alter
- Select Building A/c from List of Ledgers
- Change Building A/c to Land & Building A/c
- Press Y or Accept Yes

Please note: Even if ledgers are created in multiple, but alteration will always be done in single mode only.

Display will enable to view the ledger accounts.

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click single ledger - Display

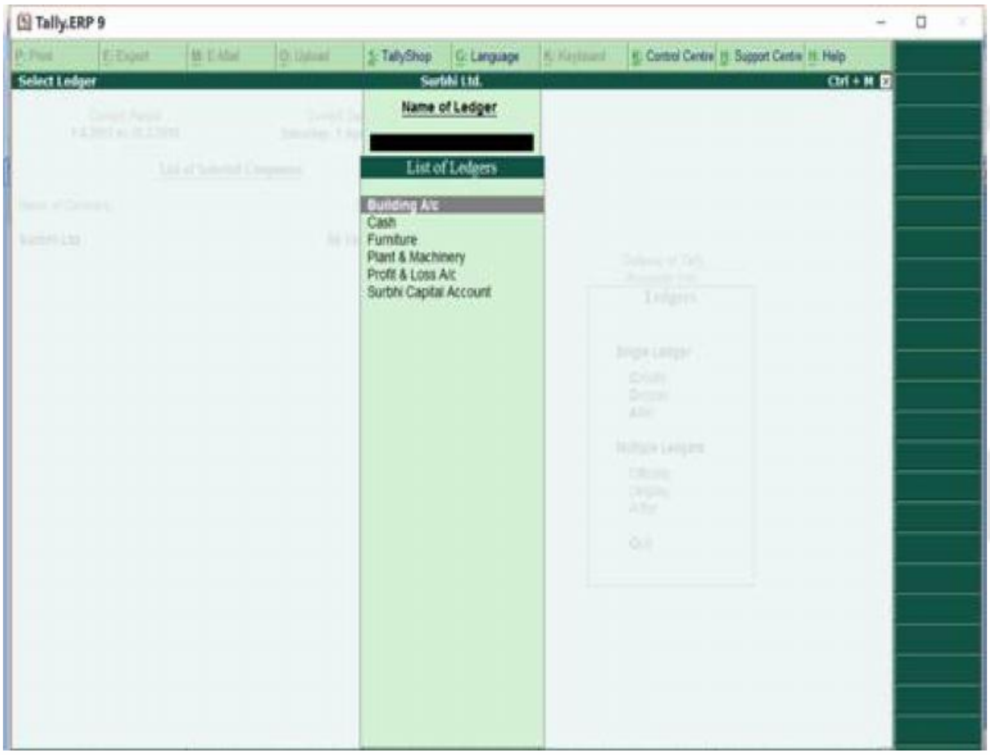


Fig. 19.10

Once you click single ledger display, the screen in Fig. 19.10 will appear and after selecting the ledger account, the ledger display will open. You can only view the ledger as appeared in Fig. 19.11 but no change can be done in the ledger account.

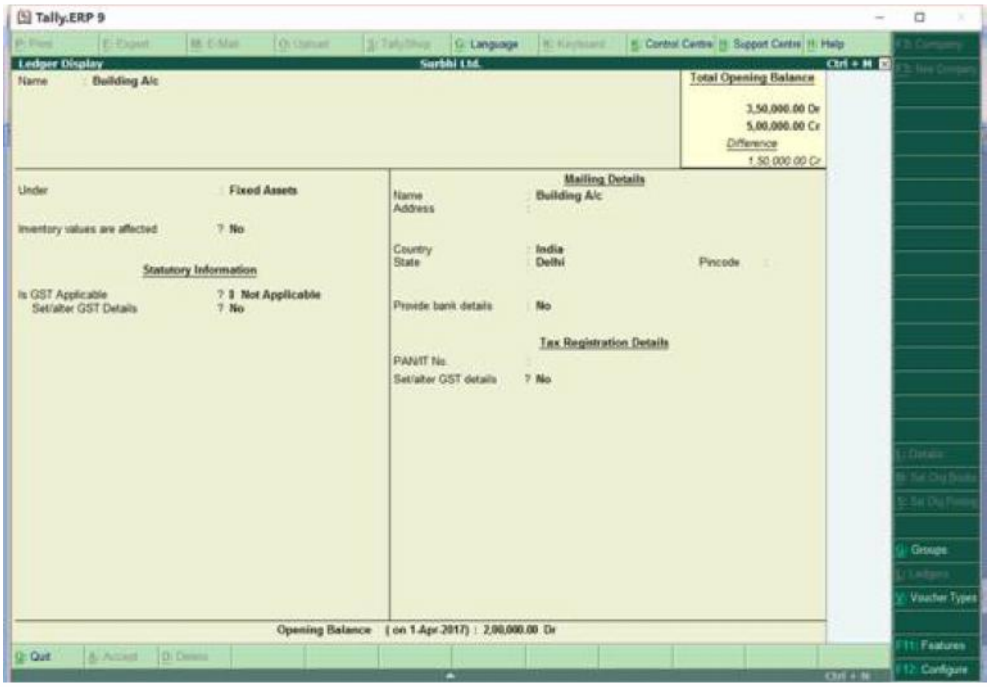


Fig. 19.11

19.3.4 Deleting Ledger

To delete a ledger:

- Go to Accounts Info in masters in Gateway of Tally
- Click Ledgers
- Now click single ledger - alter
- Select Building A/c from List of Ledgers
- Press Alt + D
- Press Y or Accept Yes

Ledger will be deleted as appeared in Fig. 19.12

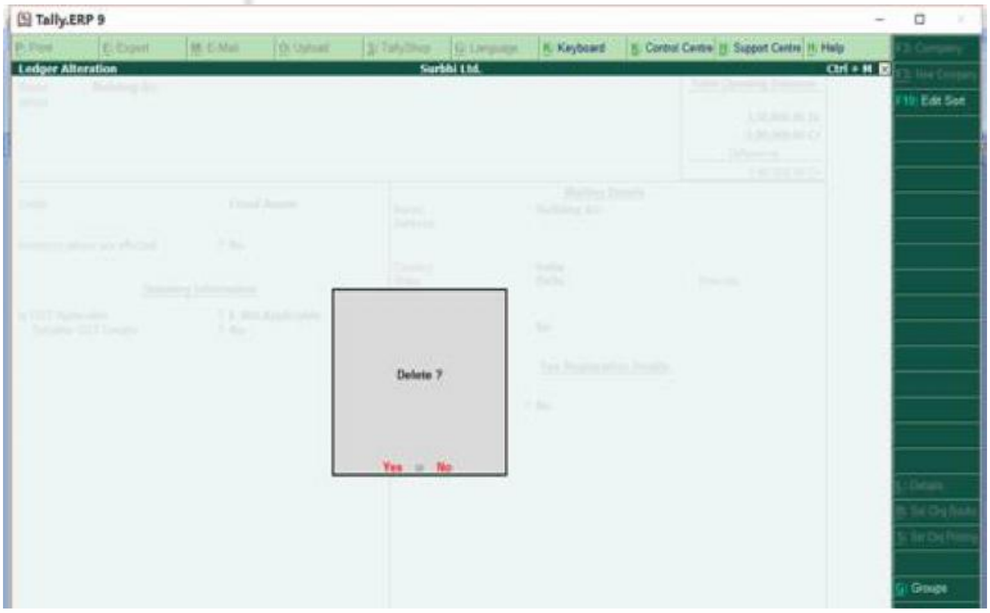


Fig. 19.12

To delete a ledger once accounting entry has already been entered in journal, you will need to delete journal entry first and then only you will be able to delete the ledger.

19.4 GROUP CREATION

Although Tally has pre defined groups but if you wish to create new group to meet your specific business requirement, then you can create new group as well.

Example: Suppose you have raw material requirement which are met by suppliers in different parts of country and therefore, you need to categorize your creditors say as Creditors – West or East.

Group - Creditors - East

Under - Sundry Creditors

To create group (Fig. 19.13):

- Go to Accounts Info in masters in Gateway of Tally
- Click Group
- Now click single group - create
- Type Creditors- East in Name
- Select Under- Sundry Creditors
- Enter No to all other fields
- Press Enter and Accept or Press Y

Group has been created as shown in Fig. 19.14

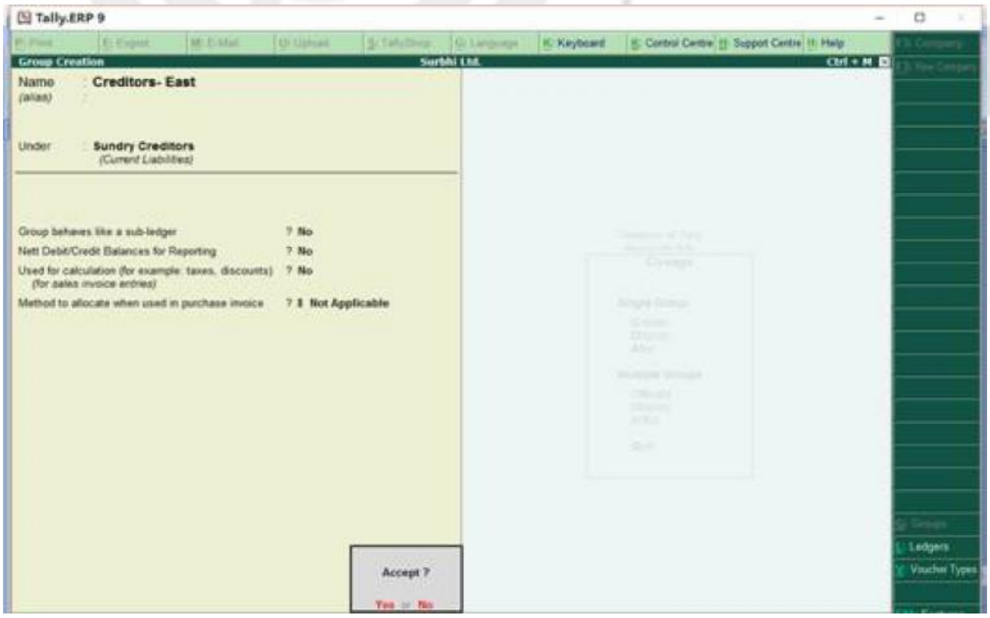


Fig. 19.13

Once created, this will appear among list of groups as shown in Fig. 19.14:

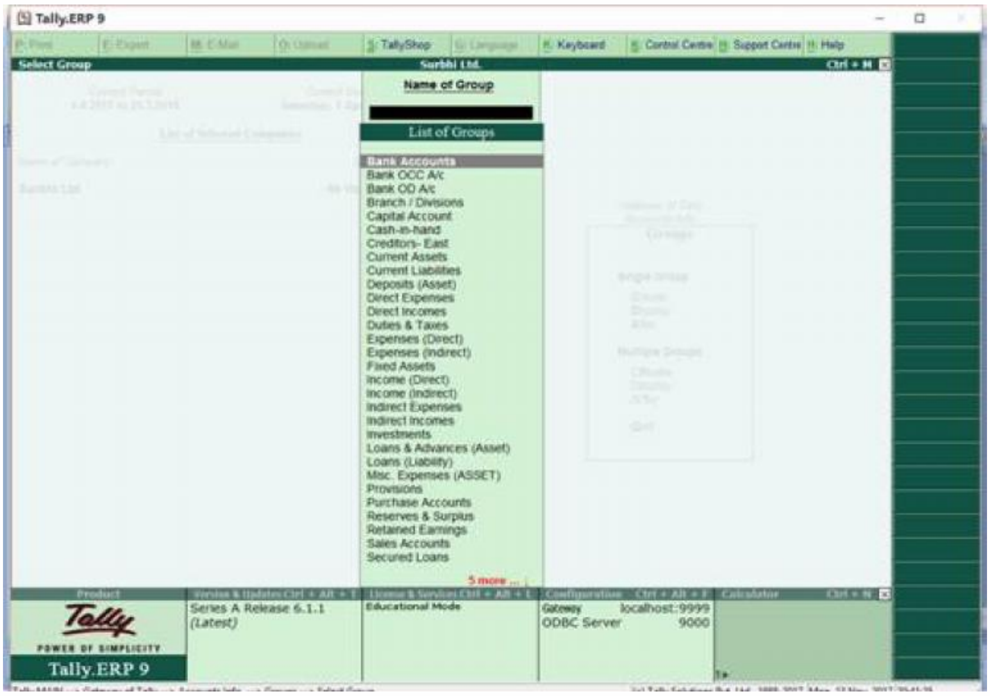


Fig. 19.14

Once group is created, you can alter, display and delete a group in the same way as used for ledger alteration, display and deletion.

Check Your Progress A

1. Create the following ledgers for Surbhi Ltd. –

   a) Profit & Loss A/c with opening balance ₹ 75,000

   b) Sundry Creditors:

      i) Vardhaman Furniture Ltd ₹ 10,000

      ii) Jatin Electricals Ltd. ₹ 15,000

   c) Cash ₹ 1,00,000

   d) Punjab National Bank ₹ 1,00,000

   e) [illegible]

      [illegible] ₹ 7,000

      ii) Vedant Hardware Store ₹ 11,000

2. Fill in the blanks:

   a) There are _________ predefined ledgers in Tally ERP.

   b) The predefined ledgers in Tally are ___________.

   c) The predefined groups in Tally ERP 9 are ___________.

   d) Out of 15 primary groups, ________ groups are related to Profit & Loss A/c.

   e) Discount Received Account is defined under _________ group.

19.5 INVENTORY MASTERS CREATION

The inventory system is same as accounting system. In accounting system, we have ledgers, in inventory we have Stock items. Similarly, Stock group and category replaces accounting group in inventory masters.

Stock Item: It is that goods in which a business trades in. For example, Surbhi Ltd. trades in Bulbs - LED, CFL and Tube lights: Coloured and white

Stock Group: Stock items of similar nature or brand can be classified under stock group. For example, CFL bulb and LED Bulb can be classified under Bulbs.

Stock Category: It is parallel classification of a stock item. They can be classified based on behaviour. For example, CFL Bulbs can be categorized as 6 watts or 8 watts Bulb.

Unit of Measure: Quantity is measured in terms of units. For example, Bulbs and tube lights can be measured in numbers (Nos.)

Godowns/Location: Stock items are stored in warehouses or godowns. For example, CFL bulb of 6 watts is stored in Delhi West Godown.

To begin with inventory creation, let us start with the following information shown in Table 19.1

Table 19.1

S. No.	Stock Group	Stock Item	Price (Rs.)	Quantity (Nos.)	Godown
1.	Bulbs	CFL (6 watts)	90	30	Delhi West
		CFL (8 watts)	1190	195	Delhi East
		LED (6 watts)	1190	50	Delhi East
		LED (8 watts)	150	40	Delhi West
2.	Tube Lights	White	100	50	Delhi East
		Coloured	150	60	Delhi West

19.5.1 Creating Stock Group

In the above information (Table 19.1), we can see two main stock groups: Bulbs and Tube lights.

Create Group: Bulb

- Go to Inventory Info in masters in Gateway of Tally
- Click Stock Group
- Now click single stock group - create
- Type Bulbs in Name
- Select Under- Primary(Already Displayed)

- Enter Yes to 'Should quantities of items be added'
- Press Enter and Press Y or Accept 'Yes'

The screen shown in Fig. 19.15 will appear for stock group bulbs.

Fig. 19.15

Create Group: Tubelights

- Go to Inventory Info in masters in Gateway of Tally
- Click Stock Group
- Now click single stock group - create
- Type Tubelights in Name
- Select Under- Primary(Already Displayed)
- Enter Yes to 'Should quantities of items be added'
- Press Enter and Press Y or Accept 'Yes'

The screen shown in Fig. 19.16 will appear for stock group Tubelights.

Fig. 19.16

19.5.2 Creating Stock Category

Before creating stock category, we have to enable stock category. Go to F11: Features then go to Inventory Features and set Maintain Stock Category as 'Yes' (see Fig. 19.17).

Fig. 19.17

Press Enter till you are asked to Accept 'Yes' or 'No'. Now accept Yes or Press Y.

Now creating stock category will include creation of two stock categories: 6 watts and 8 watts

Create 6 watts Stock Category:

- Go to Inventory Info in masters in Gateway of Tally
- Click Stock Category
- Now click single stock category - create
- Type 6 watts in Name
- Select Under- Primary(It will display list of categories, select primary)
- Press Enter and Press Y or Accept 'Yes'

The screen shows in Fig. 19.18 will appear:

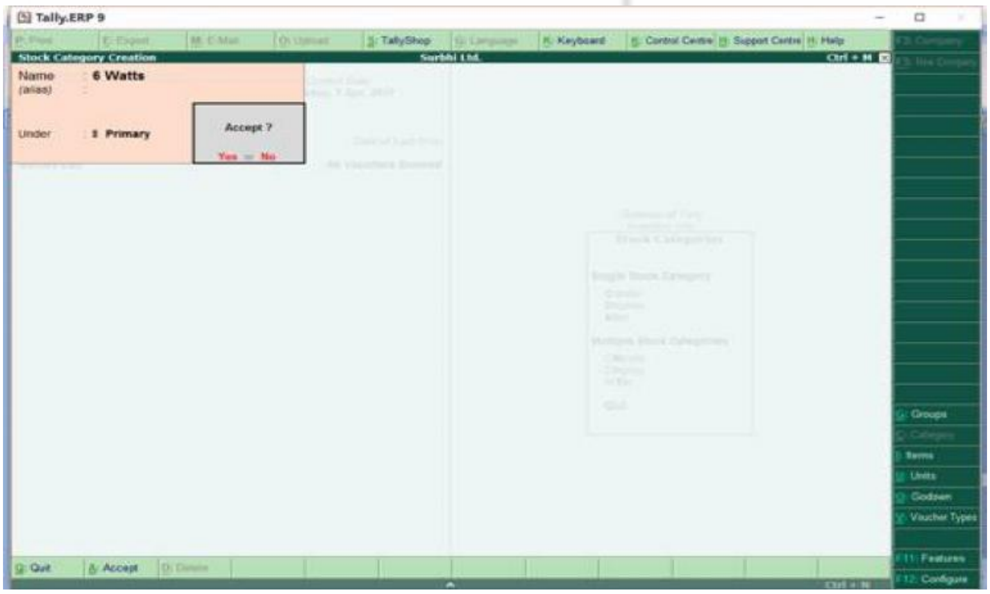


Fig. 19.18

Create 8 watts Stock Category:

- Go to Inventory Info in masters in Gateway of Tally
- Click Stock Category
- Now click single stock category - create
- Type 8 watts in Name
- Select Under- Primary (It will display list of categories. Select Primary)
- Press Enter and Press Y or Accept 'Yes'

The screen shown in Fig. 19.19

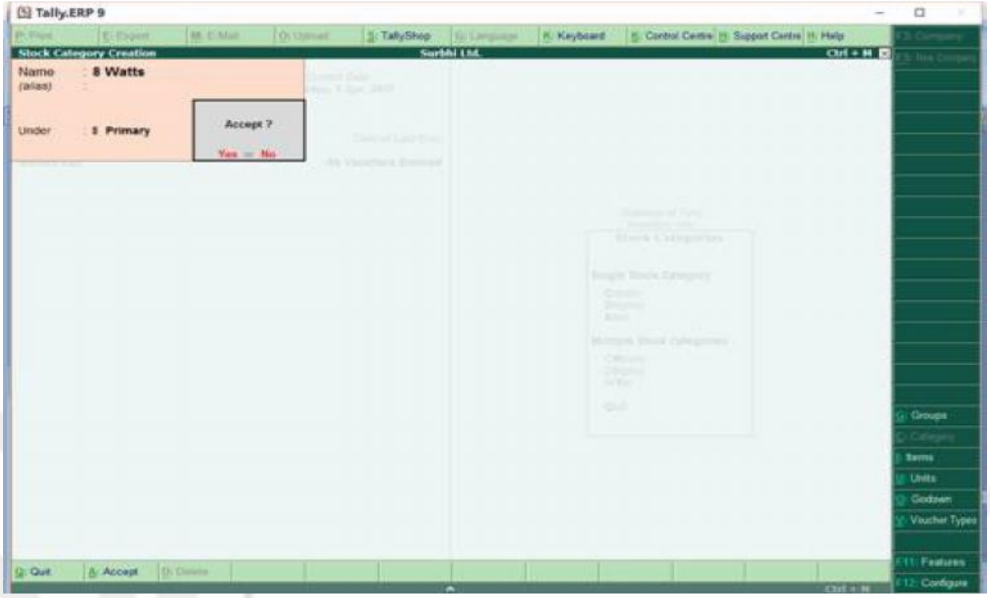


Fig. 19.19

19.5.3 Creating Unit of Measure

- Go to Inventory Info in masters in Gateway of Tally
- Click Units of Measure
- Type will be simple, Symbol : Nos., Formal Name: Numbers and No. of Decimal Places: 0 (If unit is Kg, then Decimal places can be put as 1 or 2)
- Press Enter and Press Y or Accept 'Yes' (Fig. 19.20)

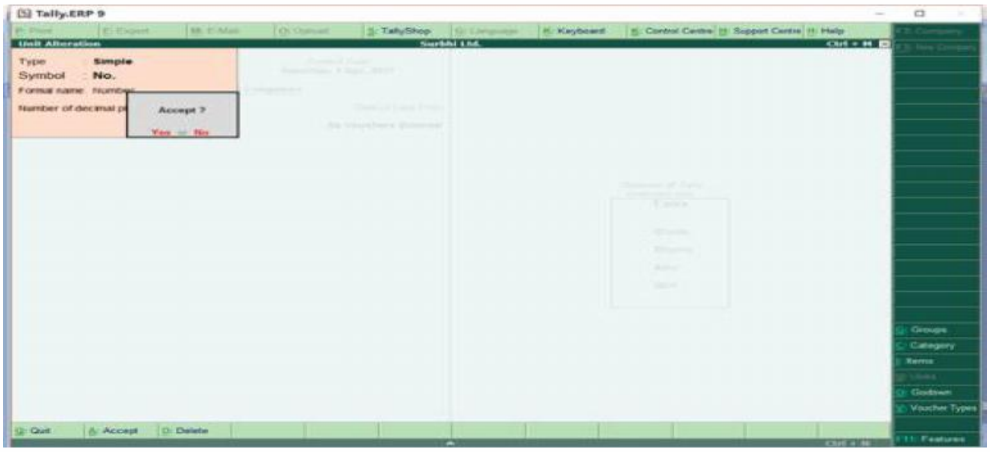


Fig. 19.20

Once accepted as 'Yes', the unit of measure will be created.

Units can be complex as well like a carton of 25 units. Here, If one has 2 cartons, then it would signify 50 units (195 x 19).

19.5.4 Creating Godowns

Before creating godowns, we have to enable Godowns. Go to F11: Features, then go to Inventory Features and set Maintain Multiple Godowns as 'Yes' as showns in Fig. 19.21. Press Enter till you are asked to Accept 'Yes' or 'No'. Now accept Yes or Press Y.

Fig. 19.21

Creating Delhi East Godown:

- Go to Inventory Info in masters in Gateway of Tally
- Click Godowns
- Now click single godown - create
- Type Delhi -East in Name
- Select Under- Primary or You can select Main Location if that Godown is business main godown.
- Press Enter and Press Y or Accept 'Yes' (Fig. 19.22)

Please note one Godown with name: Main Location already exists in Godown.

Fig. 19.22

Similarly Delhi- West can be created and screen will appear like Fig. 19.23

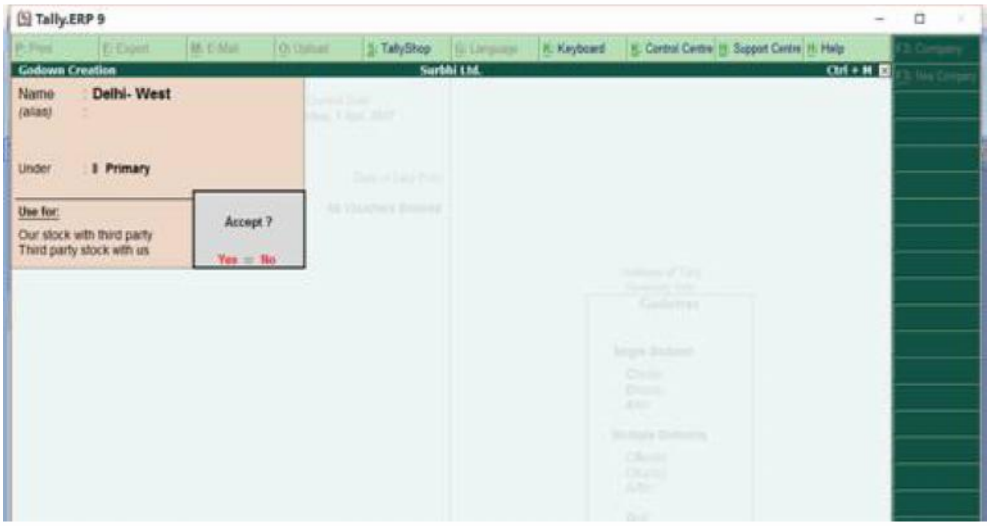


Fig. 19.23

19.5.5 Creating Stock Items

To create stock item: CFL (6 watts) stored in Delhi-West; No. of Units: 30 with Price of Rs. 90 each:

- Go to Inventory Info in masters in Gateway of Tally
- Click Stock Items
- Now click single stock items - create
- Type CFL (6 Watts) in Name
- Select Under- Bulb (Stock Group)
- Select Category- 6 Watts and Units – Nos.
- Now Enter Quantity as 30

The screen will appear as showns in Fig. 19.24

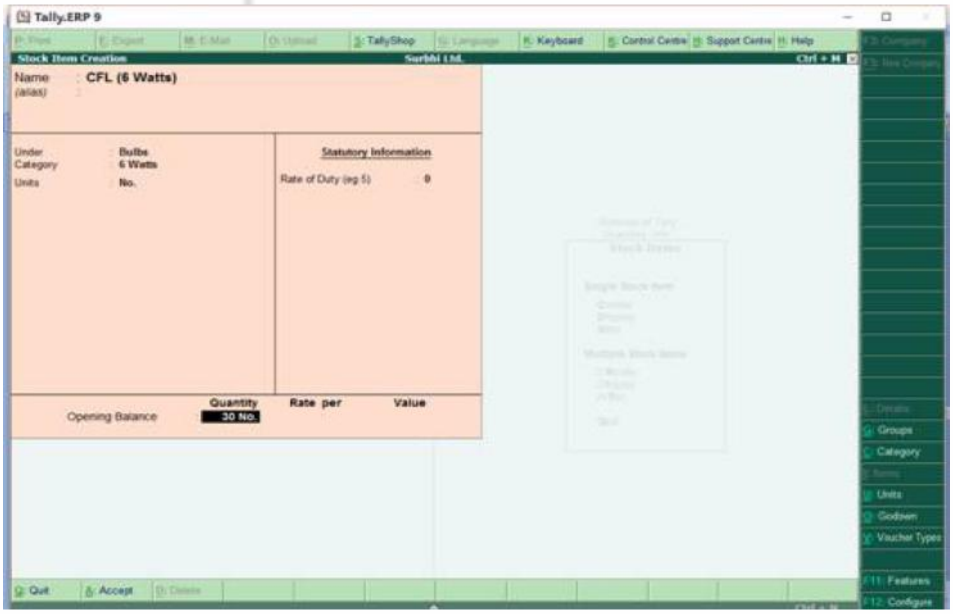


Fig. 19.24

Once you click enter, the screen shown in Fig. 19.25 will appear:

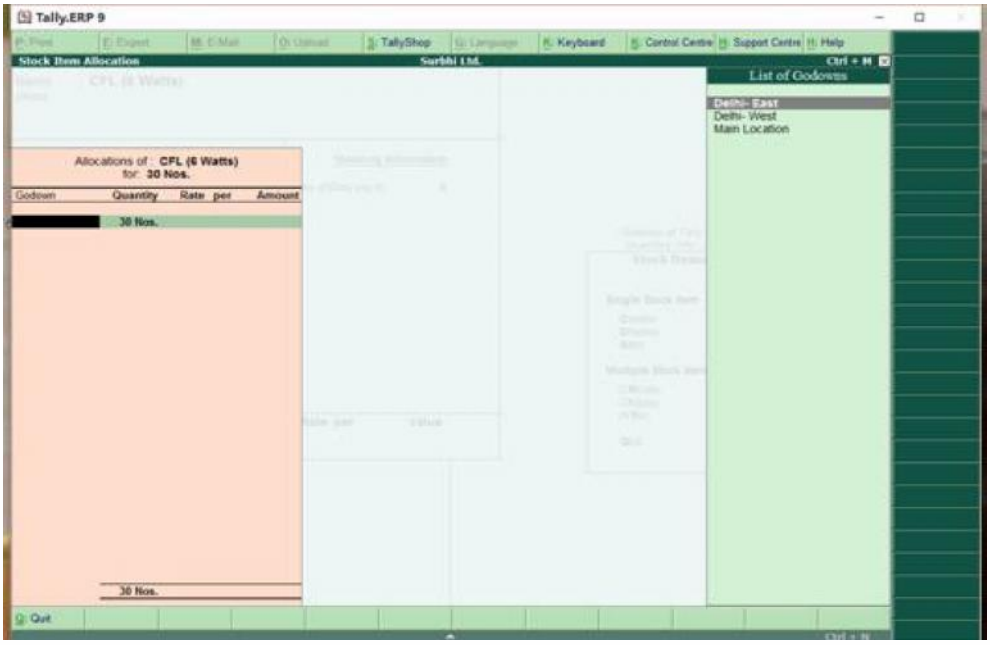


Fig. 19.25

- Select Godown as Delhi west
- Type Rate as Rs. 90 and Press enter. Amount will automatically appear on screen as shown in Fig. 19.26.

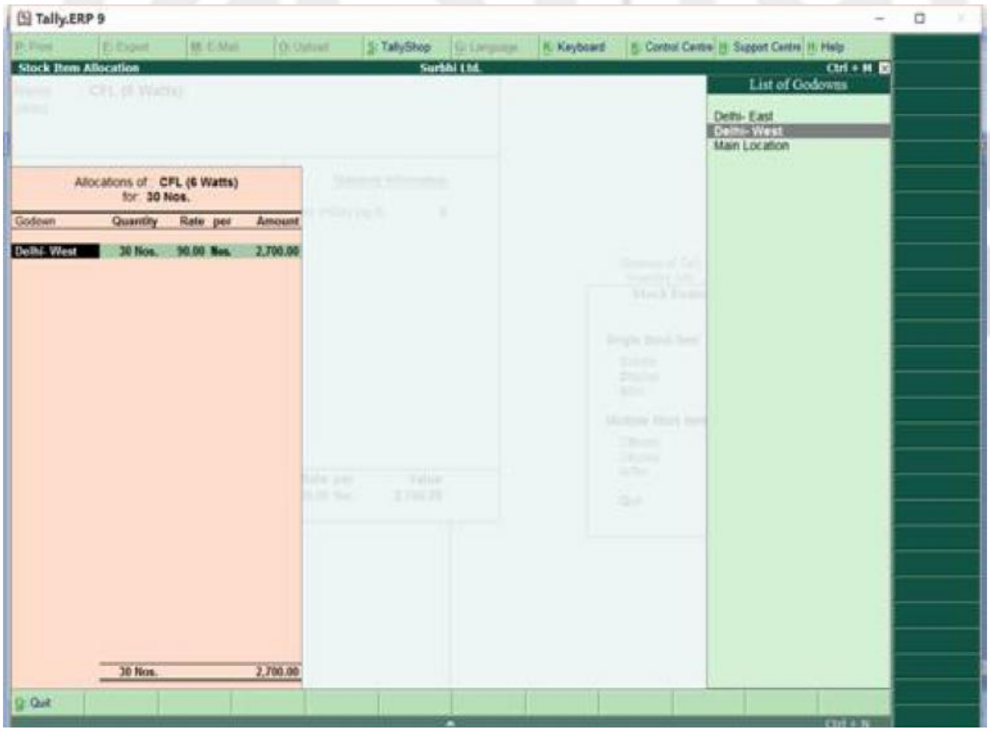


Fig. 19.26

- Press Enter and the screen will return to original stock item screen and Accept Yes or Press Y (see Fig. 19.27)

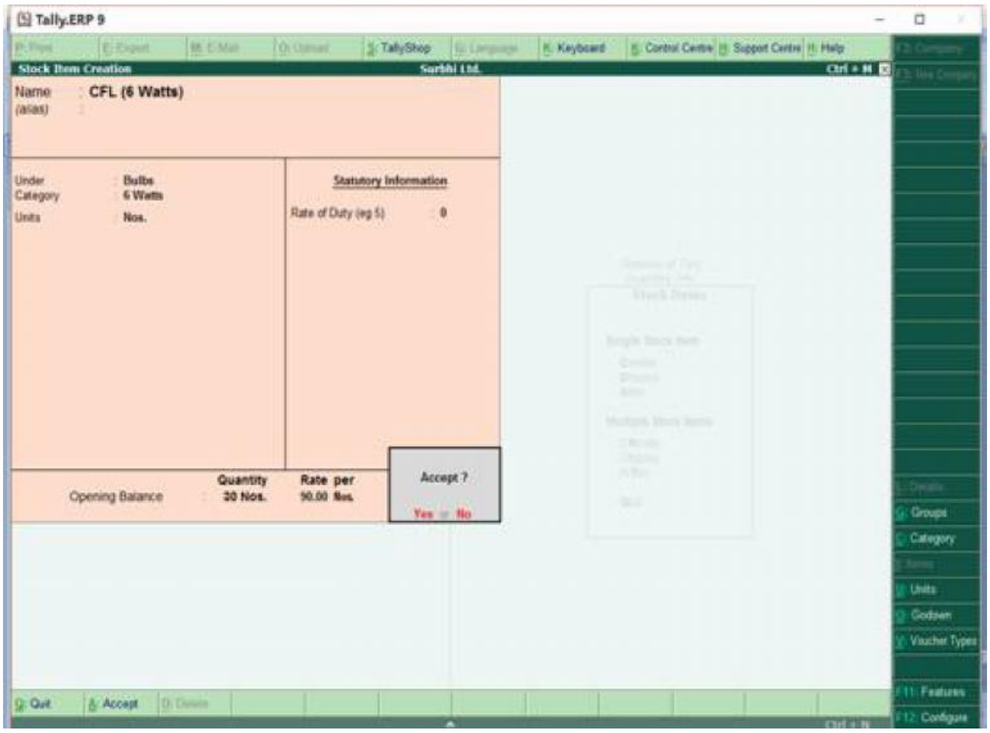


Fig. 19.27

19.6 ALTERING, DISPLAYING AND DELETING INVENTORY MASTERS

To display any Inventory master like stock group, go to Inventory Info in Masters in Gateway of Tally → Stock Group → Single Stock Group → Display → Select stock Group from list of Stock group → Stock Group will be displayed. You can only view stock group. To alter a stock group, go to single stock group → Alter → Select stock Group from list of Stock group → Stock group will be displayed and you can alter it as per need. If you wish to delete it, Press Alt +D, when promoted to delete Yes or No, Press Y or Select Yes with cursor.

Similarly Stock category, stock item, godown and Unit of measure can be displayed and altered. But please note to delete stock group, stock category, unit of measure or Godown, you need to delete stock item first as transaction (Stock Item) has already been recorded by using stock group, category, unit and godown.

To be precise, to delete the first step, the following steps need to be deleted first and then only the first step could be deleted.

Check Your Progress B

1. Create the rest stock items which are mentioned earlier in Table 19.1 inventory master.

2. State True or False:

   i) Godown is a place where stock items are stored.

   ii) Accuracy is measured in units.

iii) Sakshi Ltd. deals in trousers. Pieces can be created as unit of measure for trousers.

iv) Main location is the pre-defined godown in Tally.

v) For deleting stock item, stock group should be deleted first and thereafter stock item can be deleted.

19.7 LET US SUM UP

The second step after company creation is creating masters. It includes accounting and inventory system. Accounting system consists of creating ledger and groups. While maintaining inventory, records forms part of inventory system. In accounting system, we have ledgers, whereas in inventory, we have Stock items. Similarly, Stock group and category replaces accounting group in inventory masters.

There are already two ledger accounts pre defined in tally namely, Cash Account and Profit & Loss Account. It also consists of 28 pre-defined groups out of which 15 are main or primary groups and 13 is sub-groups. Out of 15 primary groups, 9 are related to balance sheet items and rest are Profit and Loss related items. Inventory records are maintained by creating stock group, category, unit and Godown. After this, stock items are created in inventory info.

19.8 KEY WORDS

Ledger: A permanent summary of all accounts which list individual transactions by date.

Group: A combination of ledgers for the purpose of applying the functions. There are 198 pre-defined groups in Tally ERP 9, out of which 15 are primary groups and 13 are sub-groups.

Alteration of Ledger: The details of any Ledger or the group of a ledger account may be changed at any stage in Tally.

Display of Ledger: Ledger accounts can be displayed by selecting 'Display' option under gateway of Tally.

Stock Item: Stock items are the goods we manufactured, purchased and sold. To raise item invoice, we must create stock item in Tally.

Stock Group: It is the classification or grouping of similar nature of products which helps in managing products.

Stock Category: It offers a parallel classification of stock items. Like stock groups, classification is done based on similarity in behavior.

Unit of Measure: Goods are measured using units.

Godown: A place where stock items are stored.

19.9 ANSWERS TO CHECK YOUR PROGRESS

A **2** a) two b) Cash & Profit and Loss Account c) 198
d) 6 e) indirect Income

B **2** a) True b) False c) True d) True e) False

19.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. Define Ledger & Group. How Ledger is different from Group?
2. Differentiate between stock item, stock group and stock category.

Exercises

3. Create following ledgers and stock entries for S Bose Beverages Ltd. as on 1st April, 19017:

LEDGER		**BALANCE (Rs.)**
Capital		20,00,000
Profit & Loss		8,00,000
Secured Loan		10,00,000
Provision for tax		3,50,000
Sundry Creditors:		
1) Rajat	40,000	
2) Shriram	50,000	2,00,000
3) Renu Coffee Ltd.	70,000	
4) S K Beverages Ltd.	40,000	
Salaries outstanding		35,000
Rent outstanding		60,000
Land & Building		15,00,000
Plant & Machinery		8,00,000
Furniture		19,00,000
Investment		3,00,000
Stock		8,00,000
Sundry Debtors:		
1) Sujeet Thandai Ltd.	8,000	
2) Vedanta cold drinks	75,000	3,00,000
3) Rekha & Sanjay Ltd.	1,45,000	
Cash in Hand		65,000
Standard Chartered Bank		4,80,000

Stock details of the company are:

Group	**Item**	**Category**	**(Nos.) Qty**	**Rate Rs.**	**Total Rs.**
Cold Drinks	Orange	300 ml	350	40	14,000
		600 ml	350	75	26,250
	Cola	300 ml	4,257	25	10,625
		600 ml	250	48	12,000
Coffee	100ml Instant		350	1190	42,000
	100ml Brewed		325	135	43,875
Tea	Darjeeling		200	600	1,20,000
	Assam		250	850	2,12,500
	Nilgiri		150	675	1,01,250
Thandai	Badam		290	300	87,000
	Kesar		230	350	80,500
	Rose		250	200	50,000

4. Create following ledgers and stock entries for Bhartiya Book Trading Company as on 1st April, 19017:

LEDGER NAME	**OPENING BALANCE (Rs)**
Capital	15,00,000
Loan from SBI Bank	5,00,000
Provision for Depreciation	2,50,000
O/S Rent	6,000
O/S Salaries	8,000
Sundry Creditors	2,36,000
Building	6,50,000
Investment in Shares	1,60,000
Furniture	48,000
Computers	80,000
Cash in Bank	2,30,000
Cash in Hand	75,000
Stock	4,87,000
Sahakari Bank	1,25,000
Machinery	4,00,000
Debtors	2,45,000

Debtors	(Rs.)
Kamal Book Store	45,000
Janta Stationery Store	82,000
Jetha Student Corner	1,18,000
Sundry Creditors	
R V Group Ltd	47,500
Helima Book Center	85,000
Pascal Reader Store	47,500
Sabnis Book Corner	56,000

Group	**Category**	**Stock item price**	**Purchase**	**Qty**	**Godown**
Pre-School	English	Nursery Rhyme	80	750	Linking Road
		Creative Writing	75	900	
	Maths	Introduction to Numbers	65	1100	
		Elementary Maths Operations	55	1210	
High School	Science	Physics	85	1000	P D Mello Road
		Botany	88	1000	
	Maths	Calculus	45	460	Andheri (East)
		Algebra	37	750	

UNIT 20 VOUCHER ENTRIES AND INVOICING

Structure

20.0 OBJECTIVES

After studying this unit, you will be able to:

- create voucher and record journal entries;
- create invoices;
- deleting and alter voucher; and
- display after creation of voucher.

20.1 INTRODUCTION

Voucher is a document which is proof of transaction. Example: sales receipt, purchase cash memo, bank interest statement etc. Voucher is used to enter the transactions of the business so that financial statements can be prepared to determine financial position of the business.

SCREEN OF VOUCHER ENTRY

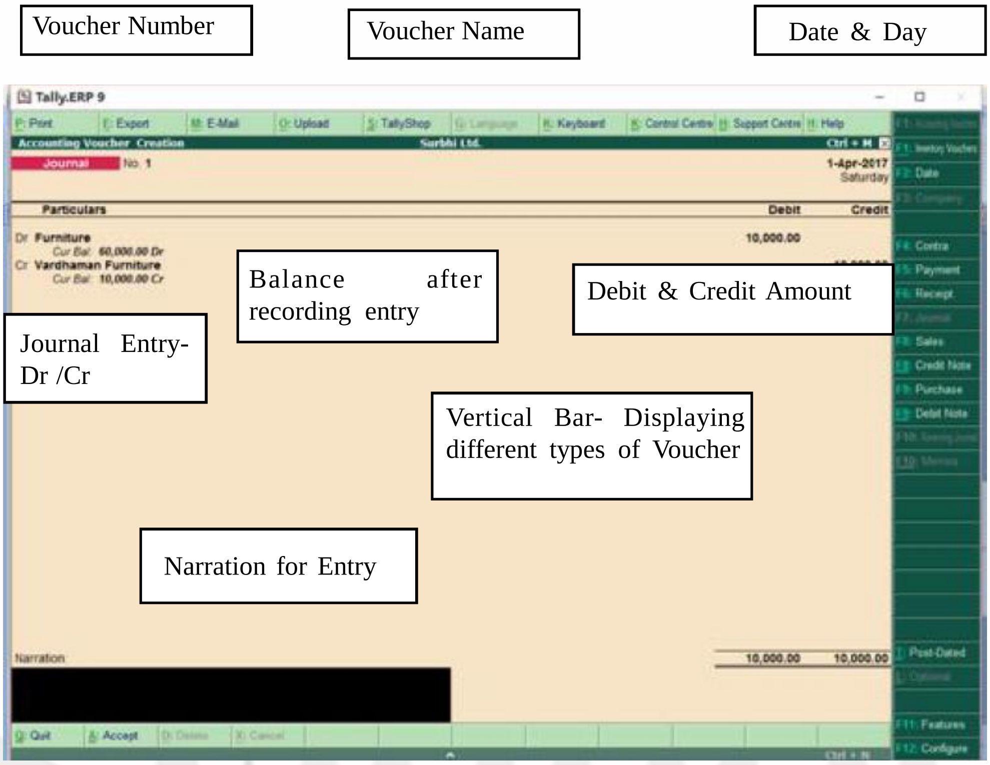


Fig. 20.1

By default you will get 'By' and 'To' instead of 'Dr' and 'Cr'. If you wish to use 'Dr' and 'Cr' for entering journal entries, Go to configuration: F12, then Voucher Entry and then set Use Cr/Dr instead of To/By during entry as 'Yes'.

Also, Set Warn on negative cash balance and show ledger current balances and show balances as on Voucher date as Yes.

If you wish to skip date for faster entry, enable it as Yes as shown in Fig. 20.2.

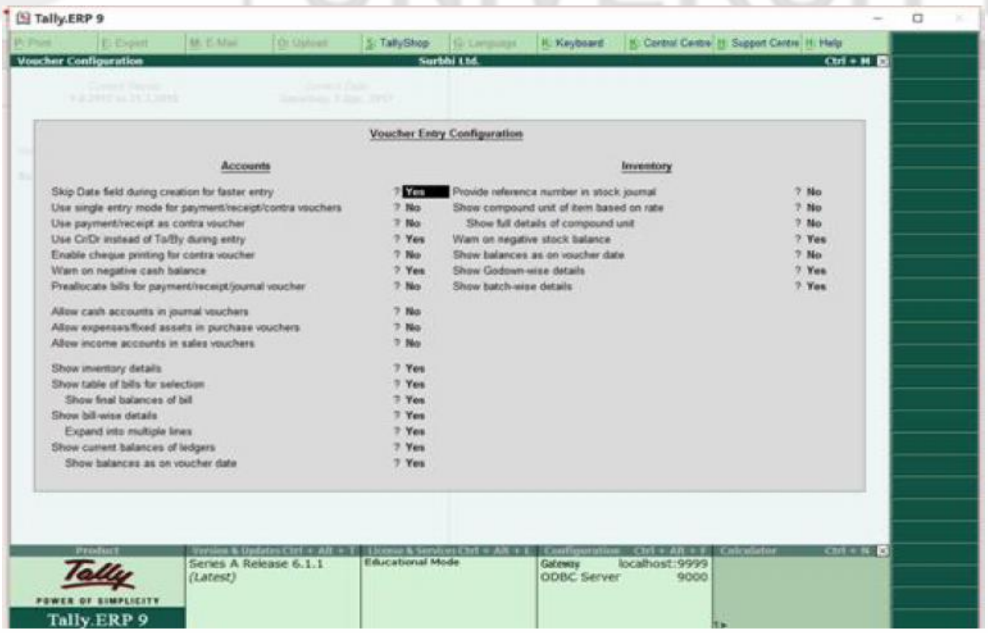


Fig. 20.2

Also, Tally automatically selects the Dr or Cr for first which you cannot change, and you can change thereafter Dr or Cr as per transaction. It also displays a list of Accounts which can be debited or credited automatically in the specific voucher. Example: Cash or Bank will be displayed in Payment or Receipt voucher or Purchase or Sales voucher, but it cannot be shown in Journal Voucher. Similarly, in payment voucher, Cash or Bank will only be shown while crediting. Balance of both debit and credit should be same, otherwise transactions will not be recorded as Tally voucher will prompt to debit or credit another account.

TYPES OF VOUCHERS

Tally has pre-defined 10 vouchers to record various types of transactions. They are:

- Contra Voucher (F4)
- Payment Voucher (F5)
- Receipt Voucher (F6)
- Journal Voucher (F7)
- Sales Voucher / Invoice (F8)
- Purchase Voucher / Invoice (F9)
- Credit Note Voucher (Ctrl + F8)
- Debit Note Voucher (Ctrl +F9)
- Reversing Journals (F10)
- Memorandum Voucher (Ctrl + F 10)

20.2 CREATION OF VOUCHER AND RECORDING ENTRIES

Let us record transactions for Surbhi Ltd. and understand how to create different vouchers.

20.2.1 Contra Voucher (F4)

Contra Voucher is used to record transactions of funds transfer from bank to cash account, cash to bank account and bank account to bank account.

Example: Surbhi Ltd. deposited cash Rs 10,000 into PNB bank.

Journal Entry:	PNB Bank A/c	Dr.	10000	
	(Bank Account)			
	To Cash A/c			10000
	(Cash in Hand)			

Create Contra Voucher as shown in Fig, 20.3:

- Go to Accounting Voucher in transactions in Gateway of Tally
- On the Vertical bar click F4: Contra or Press F4
- Contra Voucher will open with serial Number 1
- Put the Date of Transaction
- Now Cr will be on display already. Select Cash A/c from the list of ledger account.

- Enter 10,000 in amount and enter
- Similarly, Dr will be on display. Select PNB A/C and enter amount 10,000 and Press enter.
- Enter Narration, if needed and again press enter
- You can now see Contra Voucher No 2. It shows that entry has been recorded.

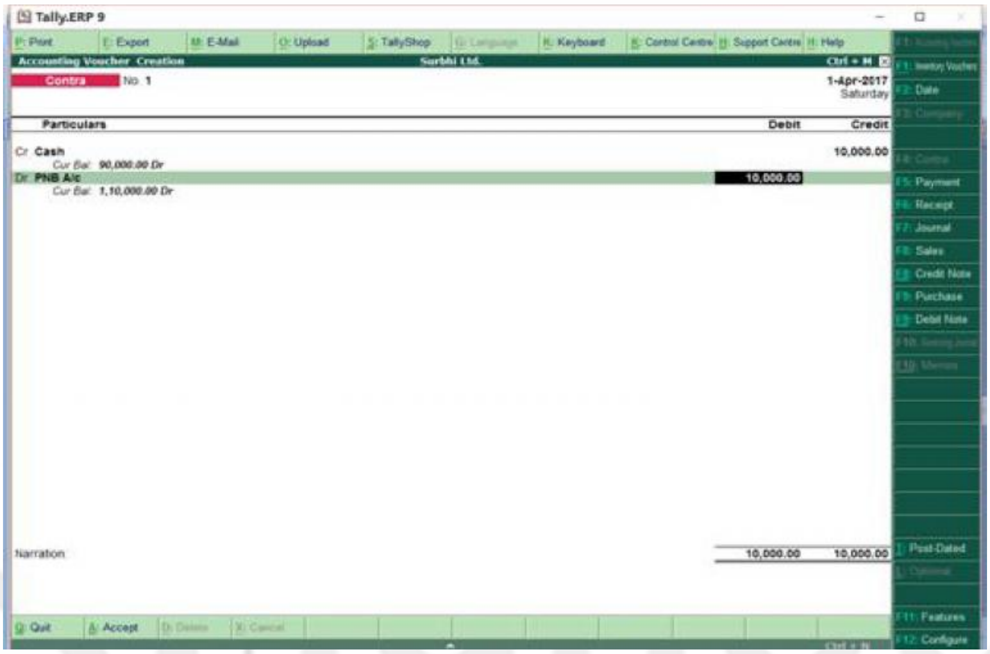


Fig. 20.3

Once you enter the account to be debited as PNB A/c along with amount Rs. 10,000, the screen shown in Fig. 20.4 will appear.

This screen will display the transaction type as cash since cash has been the deposited amount and Bank name can also be specified as PNB and press enter. Next you are required to put details of cash deposited i.e. Denominations of money. In our case, we have deposited 5 notes of Rs. 2000 amounting to Rs. 10,000. Once these details have been put, you will be taken to original screen of Contra Voucher and prompted to Accept 'Yes' or 'No'. It is not mandatory to put denominations of currency deposited, one can skip the same.

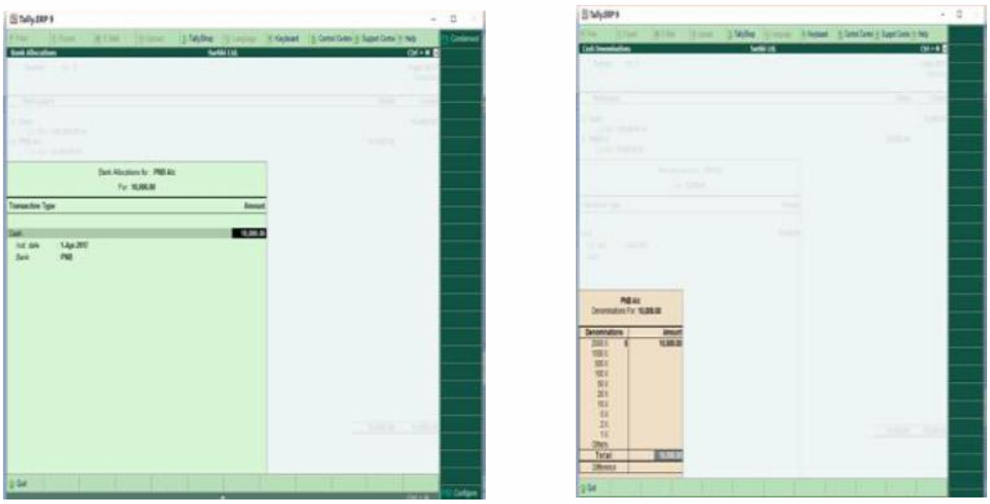


Fig. 20.4

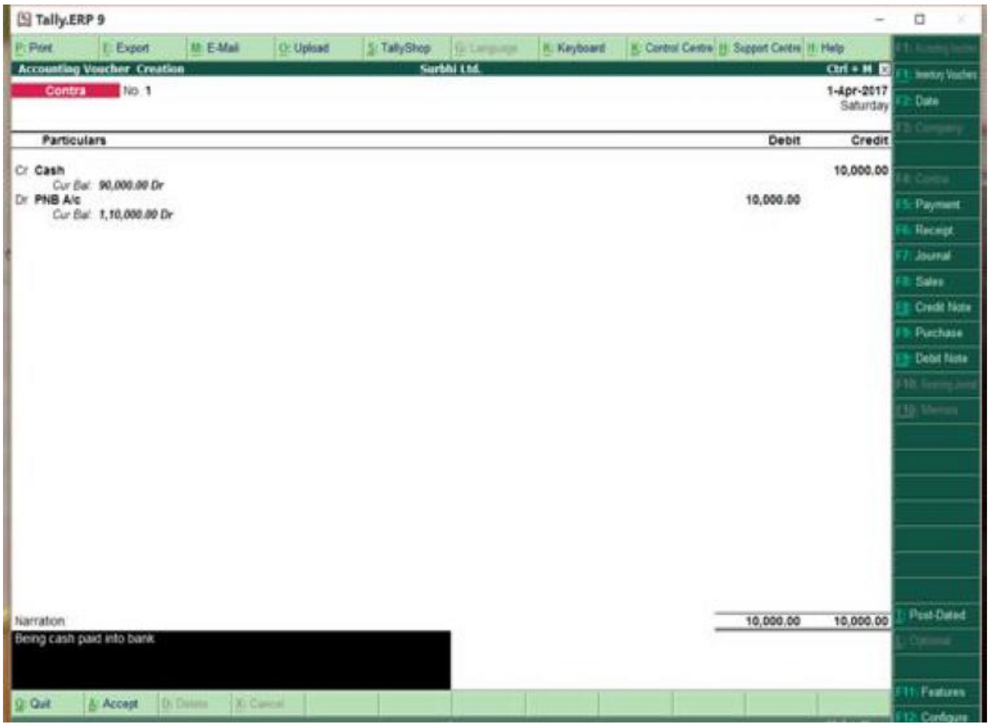


Fig. 20.5

20.2.2 Payment Voucher (F5)

Payment Voucher is used to record transactions of all payments made through bank or by cash.

For example, Surbhi Ltd. paid Rs 2,000 by cheque to Vardhaman Furniture Ltd.

Journal Entry:	Vardhaman Furniture Ltd. (Sundry Creditors)	Dr	2000	
	To PNB A/C (Bank A/c)			2000

Create Payment Voucher as shown in Fig. 20.6:

- Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F5: Payment or Press F5
- Payment Voucher will open with serial Number 1
- Put the Date of Transaction
- Now Dr will be on display already. Select Vardhaman Furniture Ltd. from the list of ledger account.
- Enter Rs. 2,000 in amount and enter
- Similarly, Cr will be on display. Select PNB A/C and enter amount Rs 2000 and Press enter. You may be promoted to enter transaction type (cheque) and cheque range
- Enter Narration, if needed and again press enter
- You can now see Payment Voucher No 2. It shows that entry has been recorded.

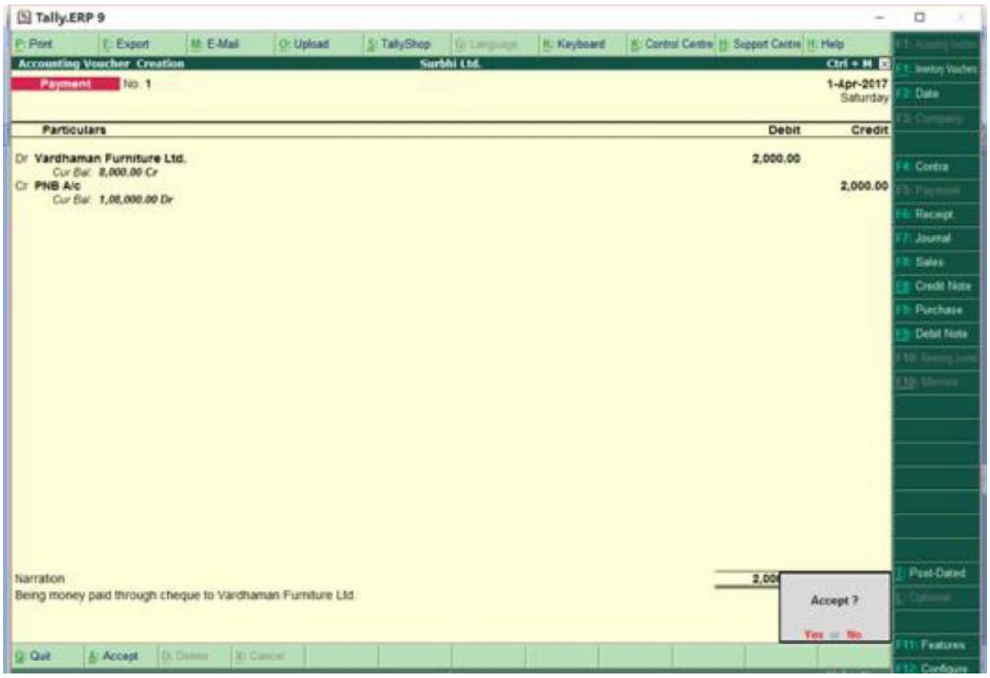


Fig. 20.6

Tally also shows warning on negative cash balances, as shown in Fig. 20.7. If balance goes negative i.e. you are making more payment than cash held by you, then screen will appear as follows:

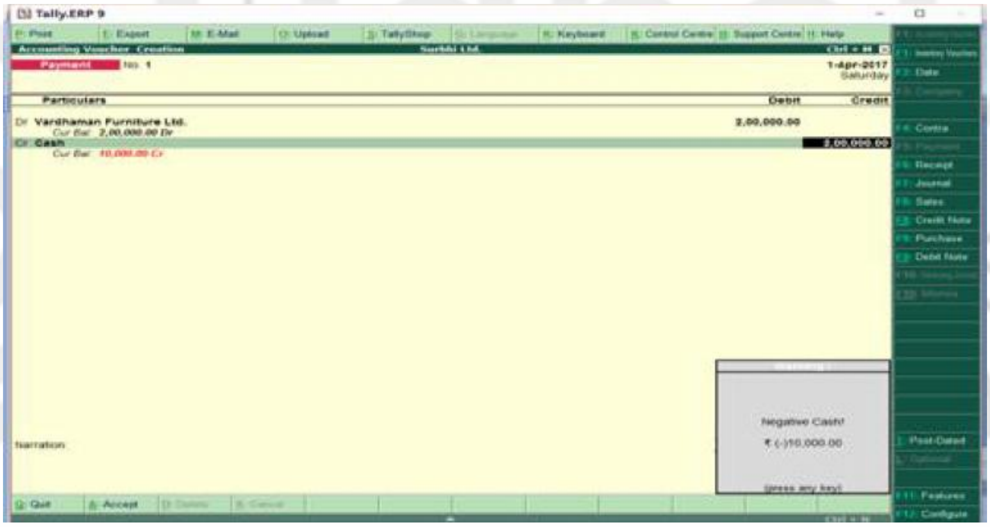


Fig. 20.7

20.2.3 Receipt Voucher (F6)

Receipt Voucher is used to record transactions of all receipts of cash or receipt through bank.

For example, Surbhi Ltd. received Rs 5,000 by cheque from Suresh Electrical Fittings Ltd.

Journal Entry:	PNB A/C (Bank A/c)	Dr	5,000	
	To Suresh Electrical Fittings Ltd. (Sundry Debtors)			5,000

Create Receipt Voucher (see Fig. 20.8):

- Go to Accounting Voucher in transactions in Gateway of Tally

- On the Vertical bar click F6: Receipt or Press F6
- Receipt Voucher will open with serial Number 1
- Put the Date of Transaction
- Now Cr will be on display already. Select Suresh Electrical Fittings Ltd. from the list of ledger account.
- Enter Rs. 5000 in amount and enter
- Similarly, Dr will be on display. Select PNB A/C and enter amount Rs 5000 and Press enter. You may be promoted to enter transaction type (cheque) and cheque range, which you may skip.
- Enter Narration, if needed and again press enter
- You can now see Receipt Voucher No 2. It shows that entry has been recorded.

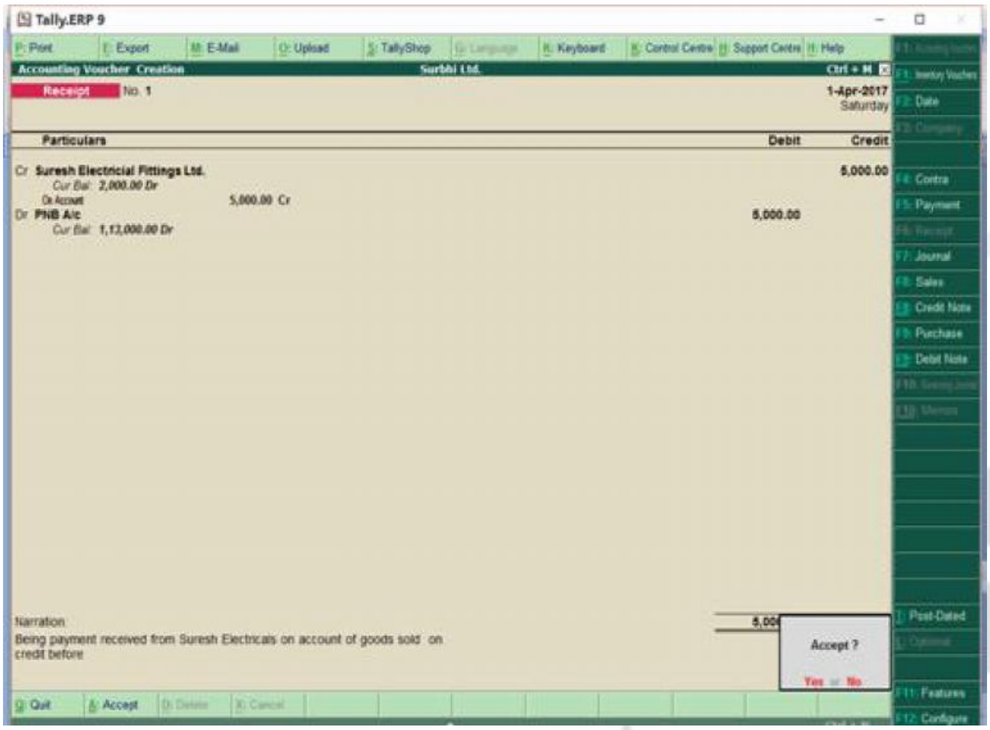


Fig. 20.8

20.2.4 Journal Voucher (F7)

Journal Voucher is used to record transactions which does not fit in any other voucher i.e. receipt or payment or purchase or sales or it can be used to pass adjustment entries which do not involve cash or bank.

For example, Surbhi Ltd. incurred an expenditure on printing and stationery amounting to Rs 1,000, as office cost and not recording it as separate ledger transaction.

It is a two step procedure: (1) creating purchase voucher for printing and stationery and (2) recording it as office cost in journal voucher.

(Before starting, prepare Printing & Stationery A/c & Office Costs A/c in account info (ledgers). Both comes under indirect expenses

Step 1: Creating Purchase Voucher

Journal Entry:	Printing and Stationery A/c (Indirect Expense A/c)	Dr	1000	
	To Cash (Cash in Hand)			1000

Create Purchase Voucher (see Fig. 20.9):

- Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F9: Purchase or Press F9
- Purchase Voucher will open with serial Number 1
- Click F12: Configure and a box with Purchase Standard Configuration will open.
- Again press F12 and it will display more options
- Set Allow expenses/fixed assets in purchase voucher as Yes
- Press enter till you return to voucher screen
- Put the Date of Transaction
- Now Cr will be on display already. Select Cash A/c from the list of ledger account.
- Enter Rs. 1,000 in amount and enter
- Similarly, Dr will be on display. Select Printing and Stationery and enter amount Rs. 1,000 and Press enter.
- Enter Narration, if needed and again press enter
- You can now see Purchase Voucher No 2. It shows that entry has been recorded.

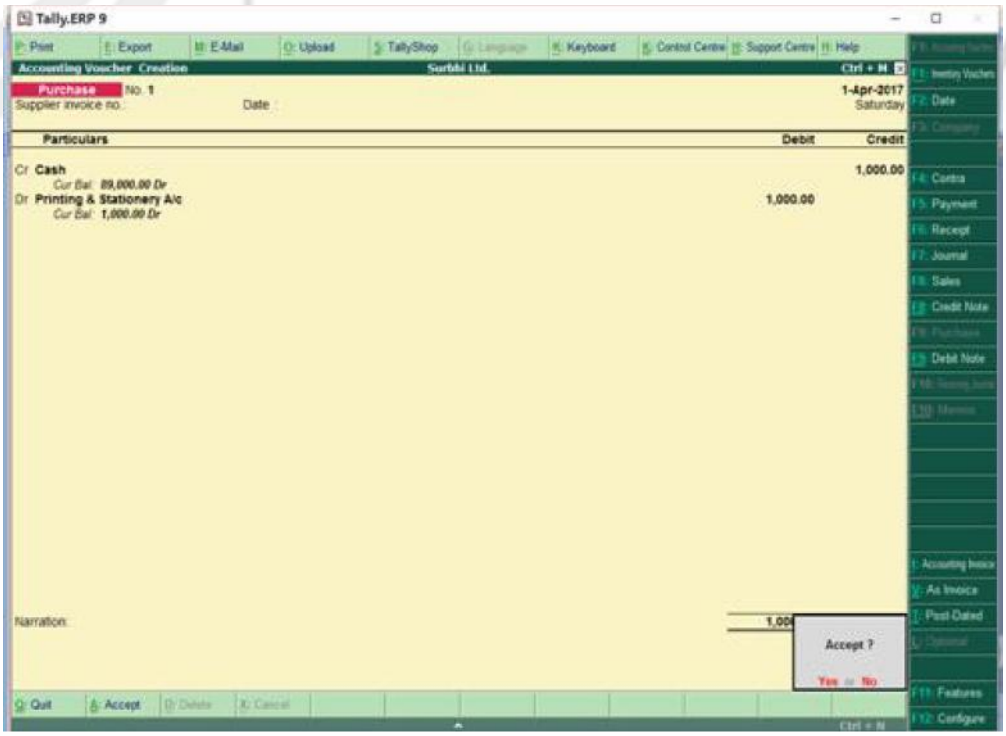


Fig. 20.9

Step 2: Creating Journal Voucher

Journal Entry: Office Cost A/c (Indirect Expense A/c)	Dr	1000	
To Printing and Stationery A/c (Indirect Expense A/c)			1000

Create Journal Voucher (see Fig. 20.10):

- Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F7: Journal or Press F7
- Purchase Voucher will open with serial Number 1
- Put the Date of Transaction
- Now Dr will be on display already. Select Office Cost A/c from the list of ledger account.
- Enter Rs. 1000 in amount and enter
- Similarly, Cr will be on display. Select Printing and Stationery and enter amount Rs. 1000 and Press enter.
- Enter Narration, if needed and again press enter
- You can now see Journal Voucher No 2. It shows that entry has been recorded.

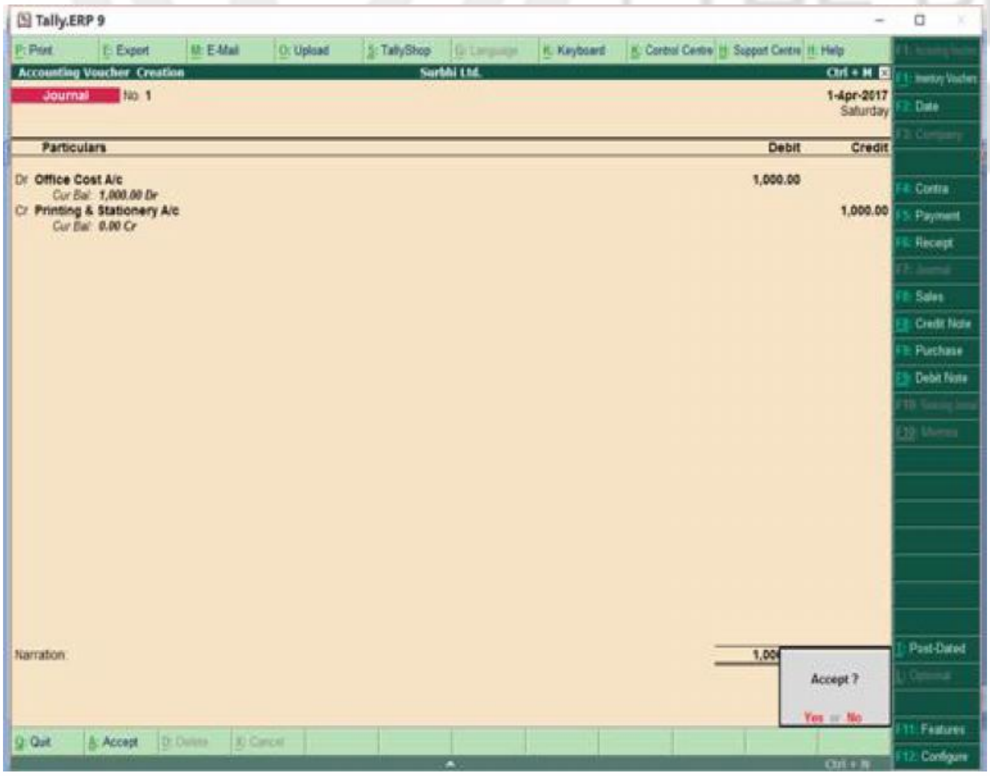


Fig. 20.10

Check Your Progress A

1. Where do we record all types of adjustment entries in Tally?

   a) Payment b) Receipt c) Journal d) Contra

2. Which voucher is used to transfer amount from one bank to another?

   a) Contra b) Receipt c) Journal d) Payment

3. Which submenu is used to create voucher in Tally?

   a) Account Info b) Accounting Voucher c) Inventory Info d) Inventory Voucher

4. To create a receipt voucher in Tally, we have to press?

   a) F5 b) F6 c) F8 d) F9

5. Which voucher is created by use of F4 Key?

   a) Contra b) Receipt c) Journal d) Payment

20.2.5 Sales Voucher/Invoice

Sales voucher is used to record transactions of goods sold on cash (cheque) or credit basis.

For example, Surbhi Ltd. sold 10 white Tubelights @ 110/- and 8 LED 6 watts @150/- to Suresh Electrical Fittings Ltd.

Journal Entry:	Suresh Electrical Fittings Ltd. (Sundry Debtors)	Dr	2300	
	To Sales A/c (Sales A/c)			2300

Create Sales Voucher (see Fig. 20.11):

- Prepare Sales A/c under account info (ledgers) under Sales a/c group and put inventory values to be effected as 'Yes'.
- Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F8: Sales or Press F8. Please ensure that sales voucher is opened in 'As Voucher' mode. On vertical button panel on right side, you can find as voucher or as invoice above post dated voucher option. The written mode on right panel is the one not in use. Set that as voucher mode. Or you can press V.
- Sales Voucher will open with serial Number 1
- Put the Date of Transaction and Reference No, if available
- Now Dr will be on display already. Select Suresh Electrical Fittings Ltd. A/c from the list of ledger account. It will ask buyers details, enter details if available otherwise press enter and method of adjustment as new reference.
- Enter Rs. 2,300 in amount and enter
- Similarly, Cr will be on display. Select Sales A/c and Press enter

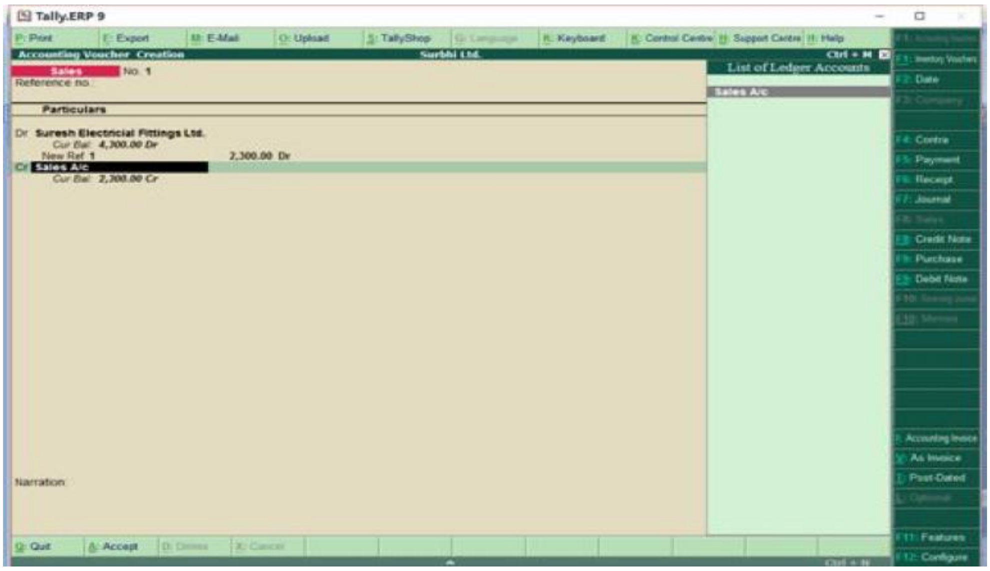


Fig. 20.11

- Now, Inventory allocation box will open.
- Type name of item as White and list of stock item will display towards your right. Select white (see Fig. 20.12).

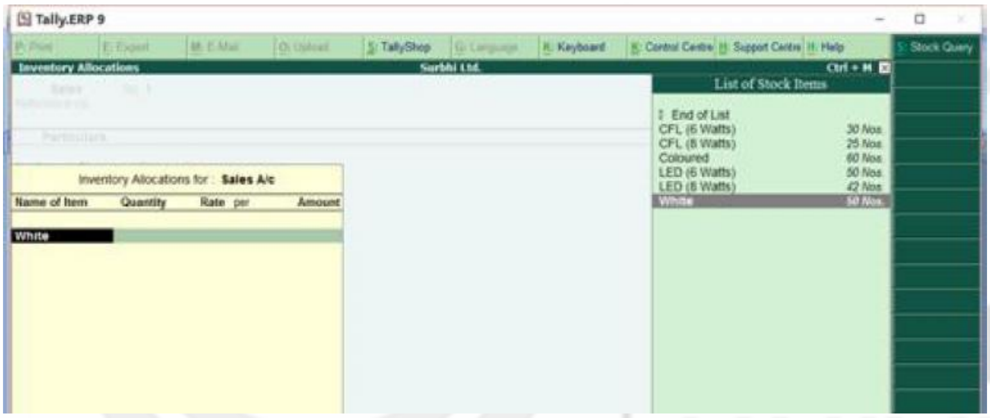


Fig. 20.12

- Now inventory allocation for white tube light will open.
- Enter godown name where it is stored and quantity and rate. Amount will be displayed automatically as shown in Fig. 20.13.

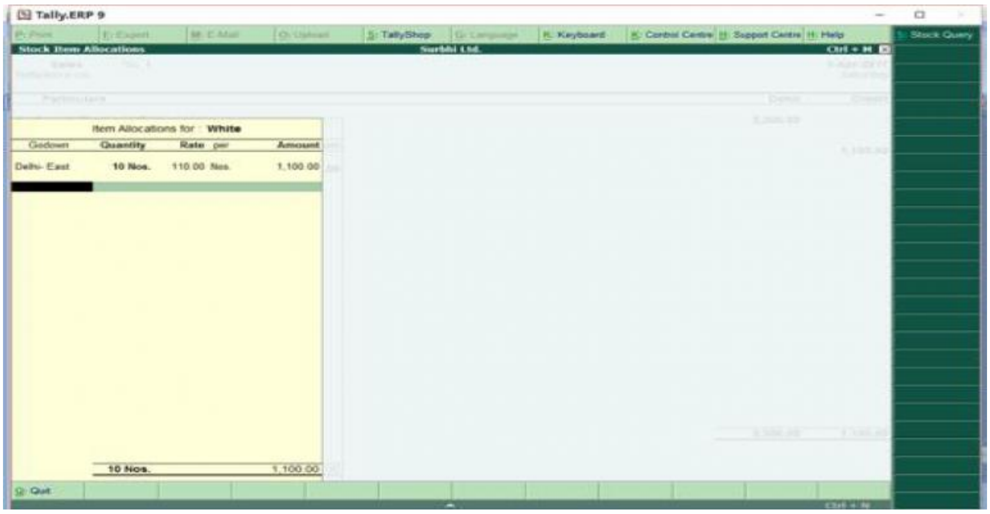


Fig. 20.13

- Similarly enter details for LED 6 watts bulb (see Fig. 20.14).

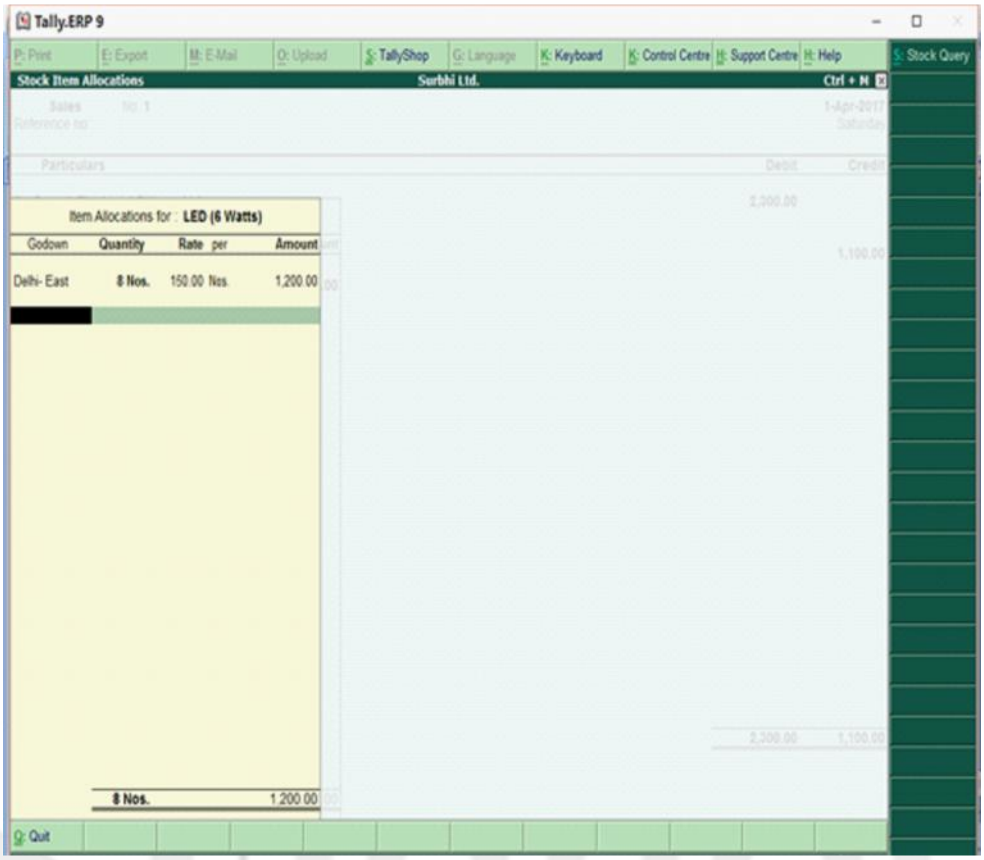


Fig. 20.14

Next, the screen shown in Fig. 20.15 will appear:

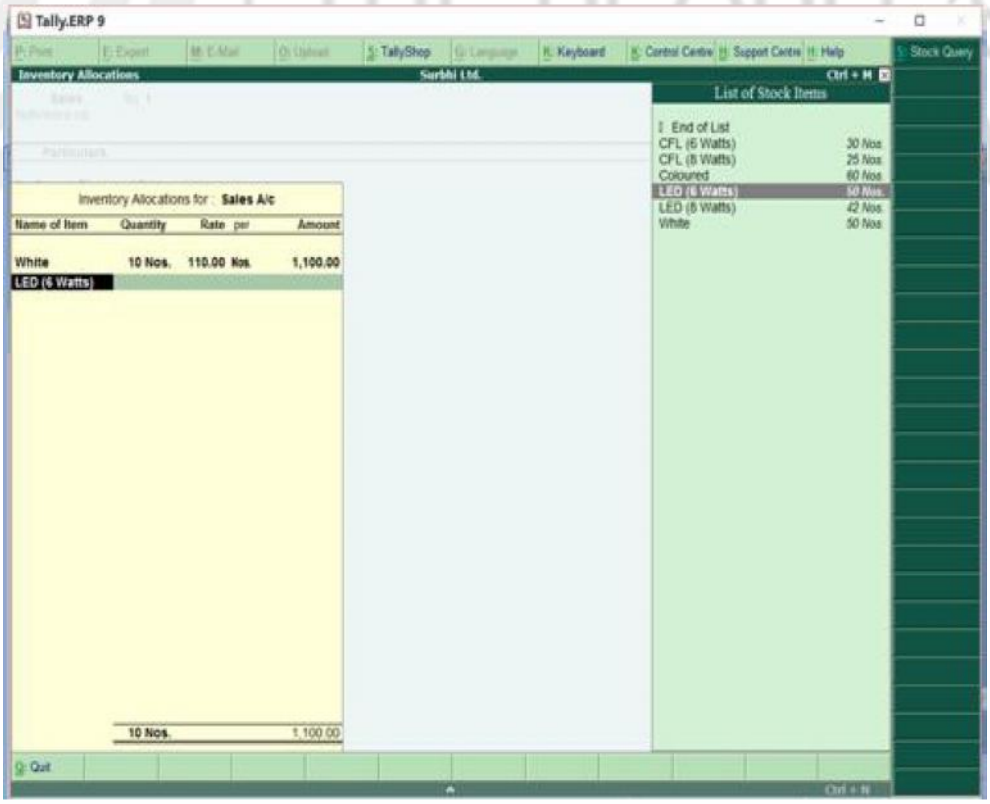


Fig. 20.15

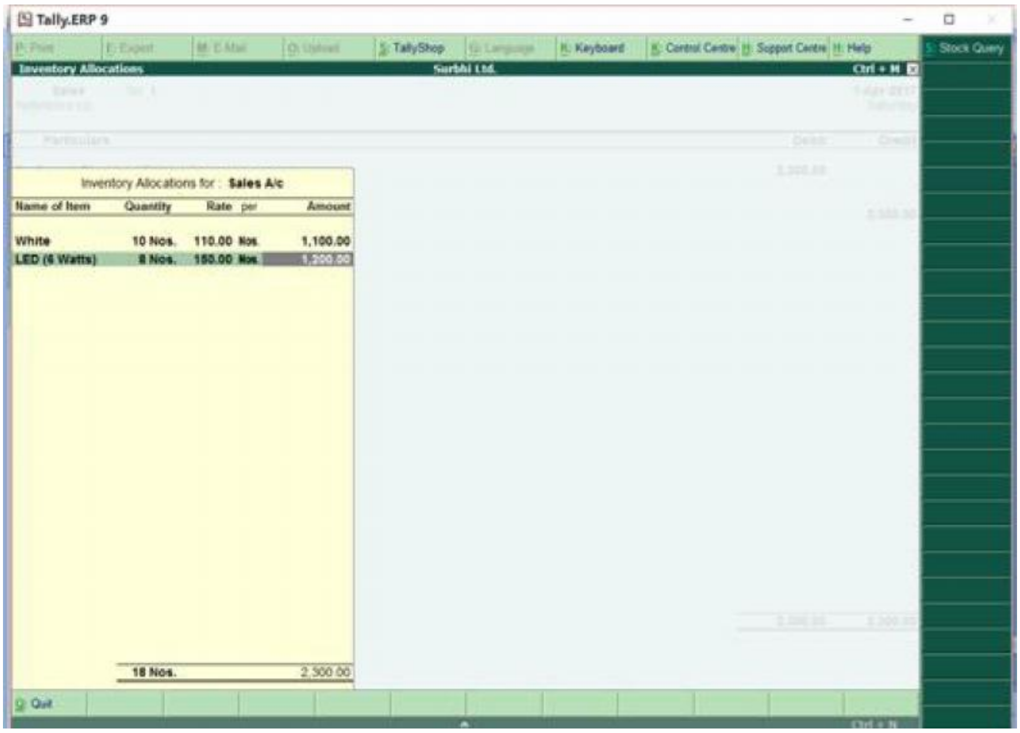


Fig. 20.16

- Press enter till you return to original screen of sales voucher
- Enter Narration, if needed and again press enter
- You can now see sales Voucher No 2. It shows that entry has been recorded (Fig. 20.17).

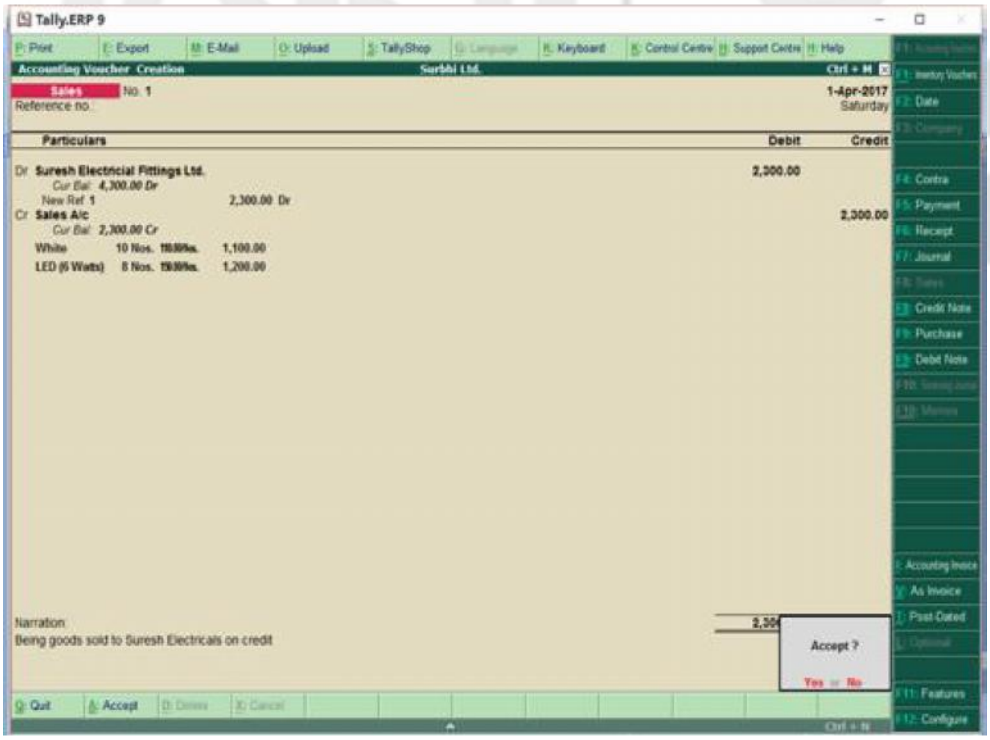


Fig. 20.17

20.2.6 Credit Note Voucher (Ctrl + F8)

Credit Note voucher is used to record transaction of sold goods returned back by buyer.

Example: Suresh Electrical Fittings Ltd. returned 2 white Tubelights being defective goods.

Journal Entry:	Sales A/c	Dr	160	
	To Suresh Electrical Fittings Ltd. (Sundry Debtors)			160

Create Credit Note Voucher:

- Before, recording transactions go to F11: inventory Features and Set Use debit note and credit note as Yes.
- Now, Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F8: Credit Note Voucher or Press Ctrl + F8
- Credit Note Voucher will open with serial Number 1
- Put the Date of Transaction and original invoice No, if available
- Now Cr will be on display already. Select Suresh Electrical Fittings Ltd. A/c from the list of ledger account. It will ask buyers details, enter details if available otherwise press enter. Also, it will ask method of adjustmen : select against reference no 1 and amount Rs. 220
- Similarly, Dr will be on display. Select Sales A/c and Press enter and enter details of goods returned
- Once it is filled, the screen shown in Fig. 20.18 will appear:

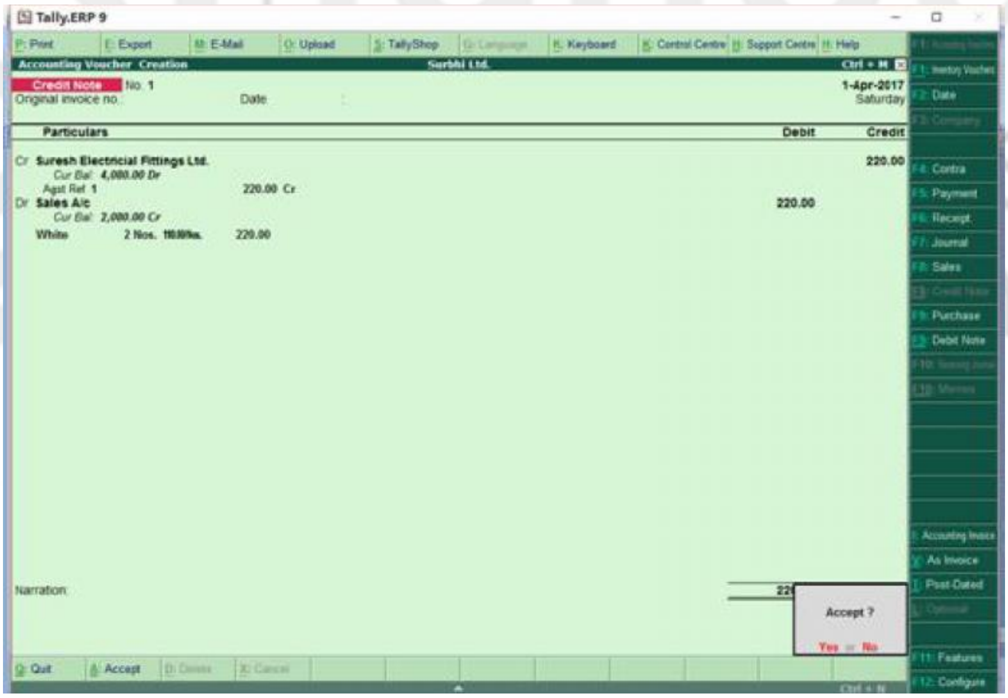


Fig. 20.18

- Enter Narration, if needed and again press enter
- You can now see credit note Voucher No 2. It shows that entry has been recorded

20.2.7 Purchase Voucher/Invoice (F9)

Purchase voucher is used to record transaction of goods bought on cash (cheque) or credit basis.

For example, Surbhi Ltd. bought 15 white Tubelights @ 100/- and
5 CFL 8 watts @120/- from Jatin Electrical Ltd.

Journal Entry:	Purchase Account (Purchase Account)	Dr	2100	
	To Jatin Electrical Ltd. (Sundry Creditors)			2100

Create Purchase Voucher:

- Purchase A/c under account info (ledgers) under purchase A/c group has been already made while recording entry for Printing and Stationery and please note to put inventory values to be effected as 'Yes'.
- Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F9: Purchase or Press F9. Please ensure that purchase voucher is opened in 'As Voucher' mode. On vertical button panel on right side, you can find as voucher or as invoice above post dated voucher option. The written mode on right panel is the one not in use. Set that as voucher mode. Or you can press V.
- Purchase Voucher will open with serial Number 2
- Put the Date of Transaction and Reference No, if available
- Now Cr will be on display already. Select Jatin Electrical Ltd. A/c from the list of ledger account. It will ask buyers details, enter details if available otherwise press enter and method of adjustment as new reference
- Enter Rs. 2100 in amount and enter
- Similarly, Dr will be on display. Select Purchase A/c and Press enter and enter details of goods purchased
- Once it is filled, the screen shown in Fig. 20.19 will appear as below:
- Enter Narration, if needed and again press enter

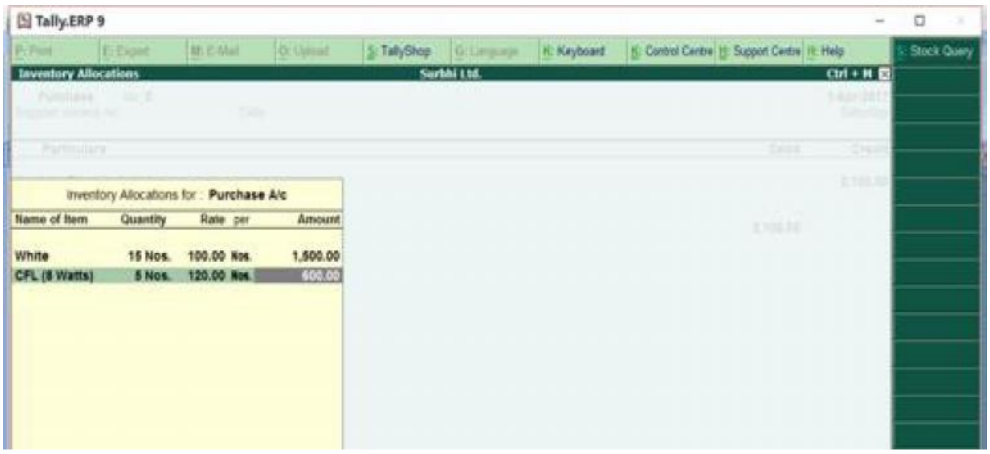


Fig. 20.19

- You can now see Fig. 20.20 Purchase Voucher No 2. It shows that entry has been recorded.

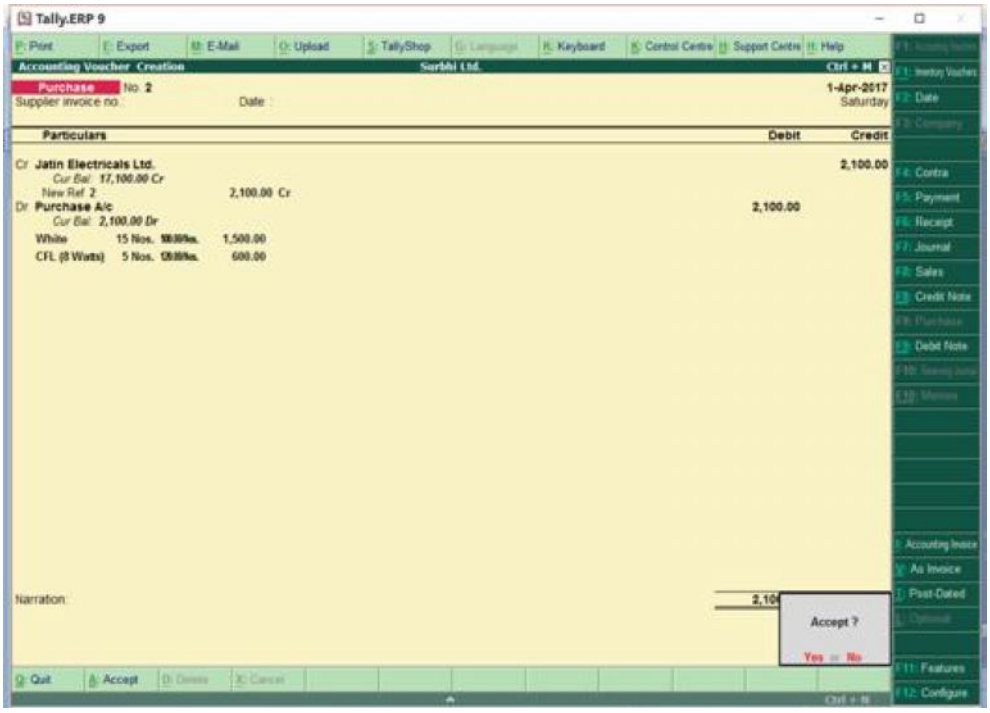


Fig. 20.20

20.2.8 Debit Note Voucher (Ctrl +F9)

Debit Note voucher is used to record transactions of purchased goods returned back to seller or to record price consideration changes.

For example: Jatin Electrical Ltd. sent 2 CFL 8 watts @ Rs 120/- and 1 white Tubelight defective which was returned by Surbhi Ltd.

Journal Entry:	Jatin Electrical Ltd. Dr (Sundry Creditors)	340	
	To Purchase Account		340

Create Debit Note Voucher:

- Before, recording transactions go to F11: inventory Features and Set Use debit note and credit note as Yes.
- Now, Go to Accounting Voucher in transactions in Gateway of tally
- On the Vertical bar click F9: Debit Note Voucher or Press Ctrl + F9
- Debit Note Voucher will open with serial Number 1
- Put the Date of Transaction and original invoice No, if available
- Now Cr will be on display already. Select Suresh Electrical Fittings Ltd. A/c from the list of ledger account. It will ask buyers details, enter details if available otherwise press enter. Also, it will ask method of adjustment : select against reference no. 1 and amount 220
- Similarly, Dr will be on display. Select Sales A/c and Press enter and enter details of goods returned

- Once it is filled, the screen in Fig. 20.21 will appear:

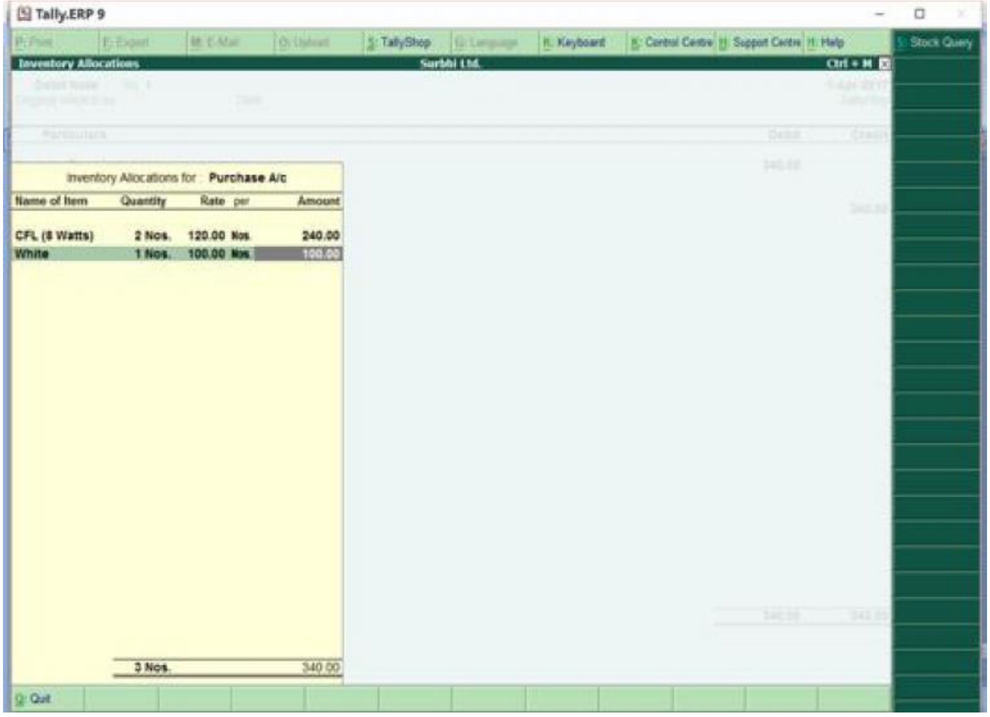


Fig. 20.21

- Enter Narration, if needed and again press enter
- You can now see the screen in Fig. 20.22 Purchase Voucher No 2. It shows that entry has been recorded

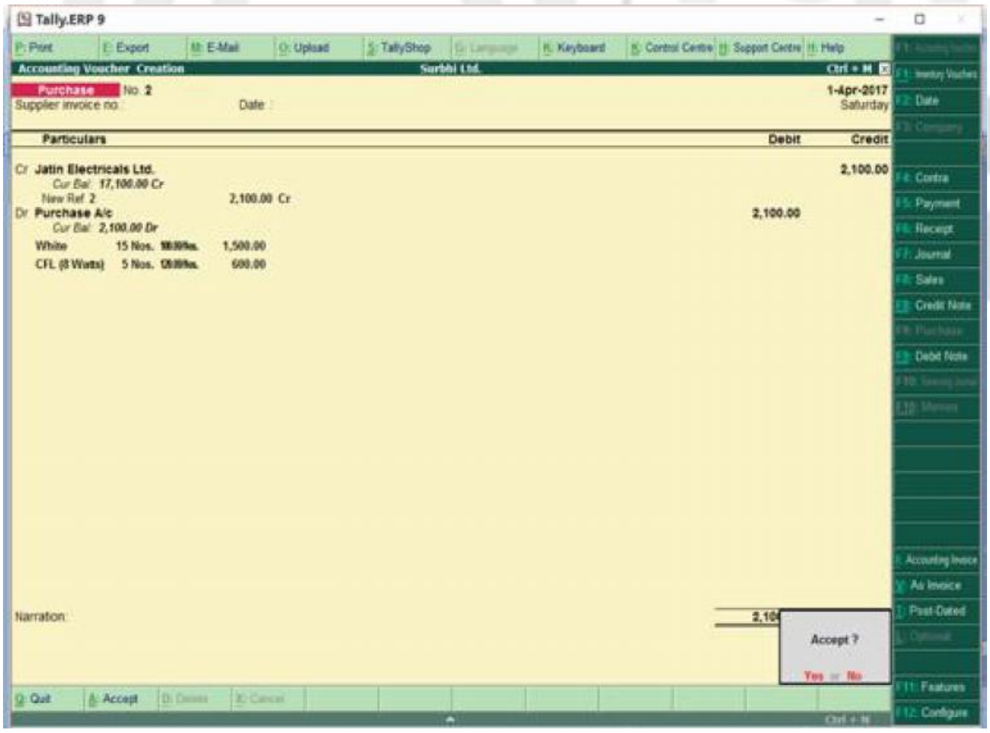


Fig. 20.22

20.2.9 Reversing Journal Voucher (F10)

They are special journals that are reversed after the specified date by the user. They are effective only till that date and are effective only when they are included in reports.

To enable this voucher, go to accounting features: F11 and Set Use reversing Journals and optional vouchers as Yes.

For example: For Pay Projections of employees

20.2.10 Memo Voucher (Ctrl + F10)

It is a non accounting voucher which does not affect books of account. These entries are stored in a separate Memo Register. Later on, you can convert this into regular voucher.

To enable this voucher go to accounting features: F11 and Set Use reversing Journals and optional vouchers as Yes.

For example, Making suspense payments

20.2.11 Post–Dated Voucher

It is used for entering such transactions which occur frequently on a regular basis.

Example: Instalments payment for vehicle on hire-purchase

20.3 ALTERING, DELETING AND DISPLAYING VOUCHER ENTRY

To view voucher entry done for transactions, Go to gateway of Tally and then 'Display' and then click 'Day Book' (see Fig. 20.23).

Fig. 20.23

On the vertical bar on top, Press F1: Detailed or Alt +F1 to get more details of journal entry.

To Alter any journal entry recorded in voucher, Press the specific entry and the voucher screen will appear as shown in Fig. 20.24. Now, you can alter the amount, voucher type by clicking the voucher which you wish to convert to or change any account ledger wrongly credited or debited.

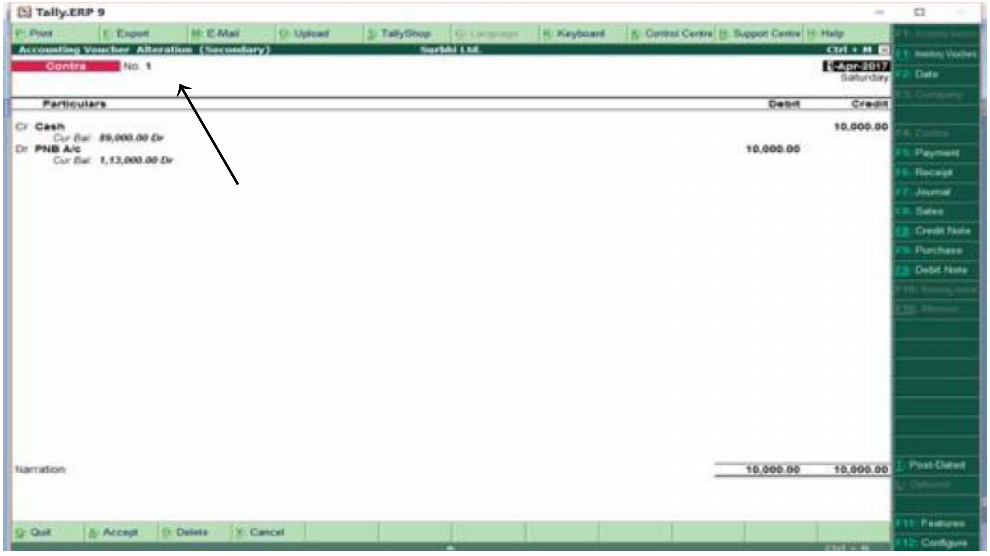


Fig. 20.24

To delete any journal entry recorded in voucher, Press the specific entry and now again, the voucher screen will appear and you can delete by pressing Alt+D. When prompted accept Yes or Press Y as seen in Fig. 20.25.

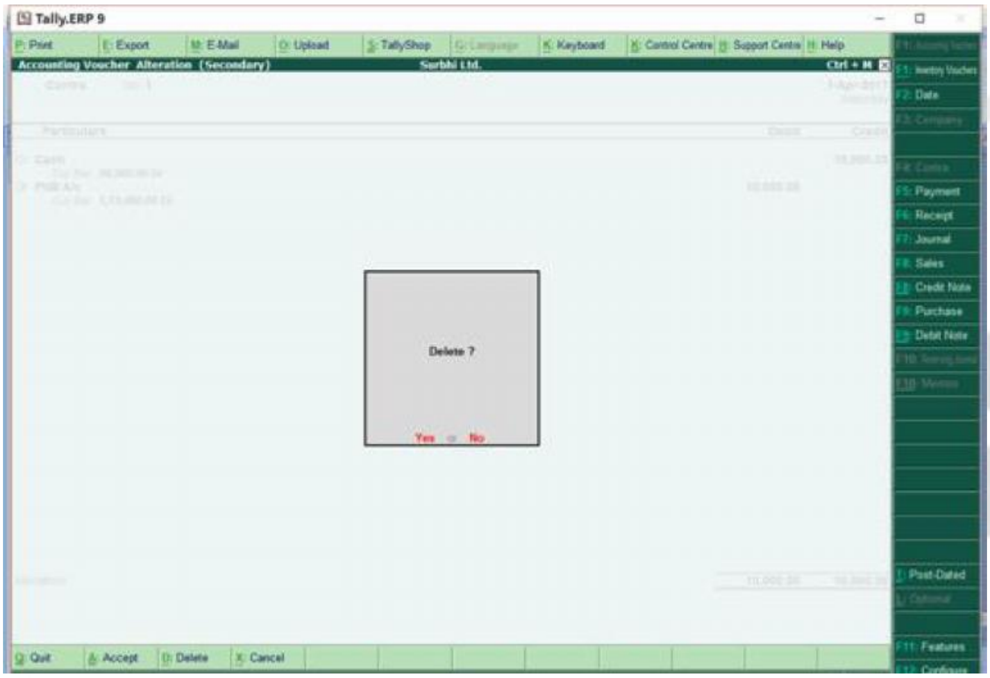


Fig. 20.25

20.4 CREATING VOUCHER TYPE

Surbhi Ltd. wishes to record petty cash transactions in petty cash voucher instead of pre- defined Payment voucher.

Create New Voucher Type (see Fig. 20.26):

- Go to Accounts Info in masters in Gateway of Tally
- Click Voucher Types
- Now click Create
- Type Name- Petty Voucher class

- Select type of voucher- Payment and under abbreviation – Pymt will come automatically
- Select method of vouching numbering as automatic
- Set allow narration in voucher as Yes and set rest as No
- Skip Print voucher after saving a No
- Skip Name of class
- Press Y or Accept Yes

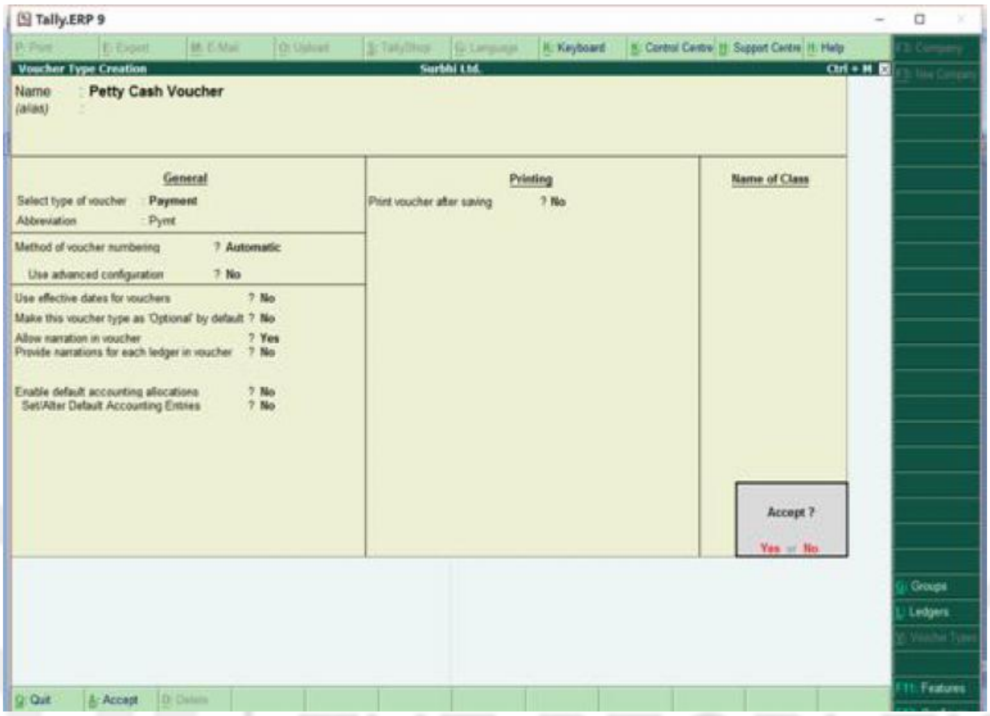


Fig. 20.26

- New Voucher class under payment is created
- Now go to accounting voucher in Gateway of Tally and click payment voucher or F5 (see Fig. 20.27).

Fig. 20.27

- Select Voucher Type: Petty Cash Voucher
- Now you can record the entry as required

- To display, alter and delete, go to Accounts Info in masters in Gateway of Tally
- Click Voucher Types
- Now click display and List of all vouchers type will be displayed and select type of voucher as required
- To alter, click alter and select voucher type then changes can be done as required
- To delete, click alter and select voucher type then press Alt +D and when promoted select Yes or Press Y

20.5 CREATING INVOICES

Tally allows creating and recording transactions as invoices as well. Example: You can record sales and purchase transactions in form of invoice. It allows recording transactions as invoice in two forms: (1) Account Invoice (to raise invoices for service rendered) and (2) Item Invoice (to raise invoice with item details).

To enable invoicing, go to F11: features and Set Allow Invoicing and record purchases in invoice mode as Yes in both accounting and inventory Feature.

Also, make sure in both sales and purchase ledger, 'Inventory values are affected' are set as 'Yes'.

20.5.1 Creating Account Invoice

For example, Surbhi Ltd. provided advisory to Ramesh Infotech Ltd. for electrical fittings for Rs 2000.

- Go to Accounting Voucher in Gateway of Tally
- Go to F8: Sales
- Click Accounting Invoice and the screen will appear as shown in Fig. 20.28.

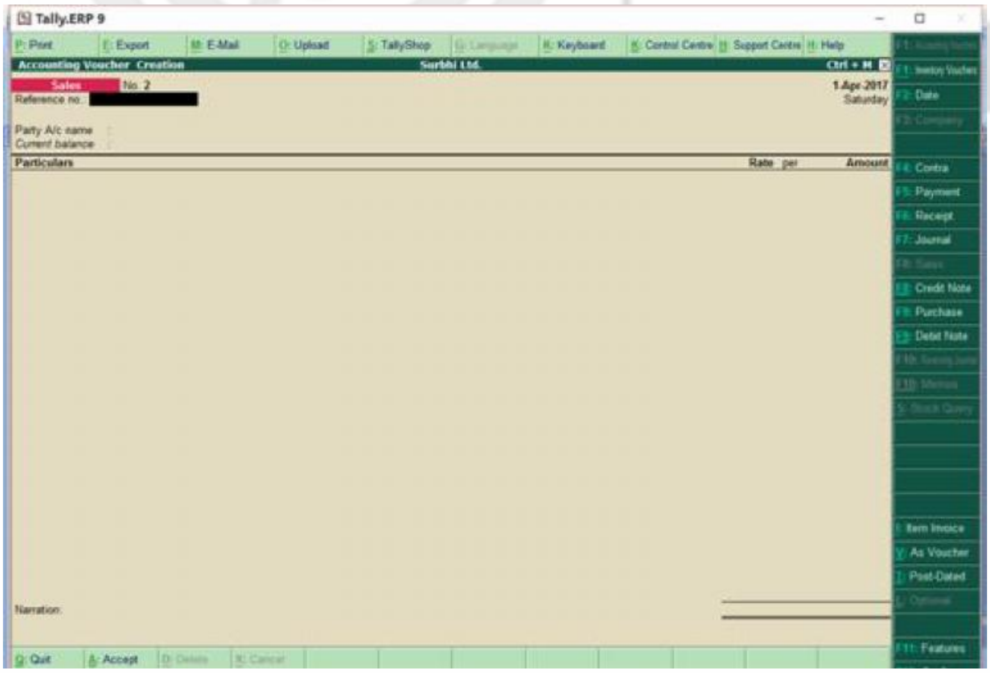


Fig. 20.28

- Select the date and enter Party name: Ramesh Infotech Ltd. (Create ledger by pressing Alt + C)

- Create Advisory Fees ledger (Alt+ C)
- Select Advisory Fees in Particulars
- Enter Rs. 2,000 as Amount

The screen shown in Fig. 20.29 will appear

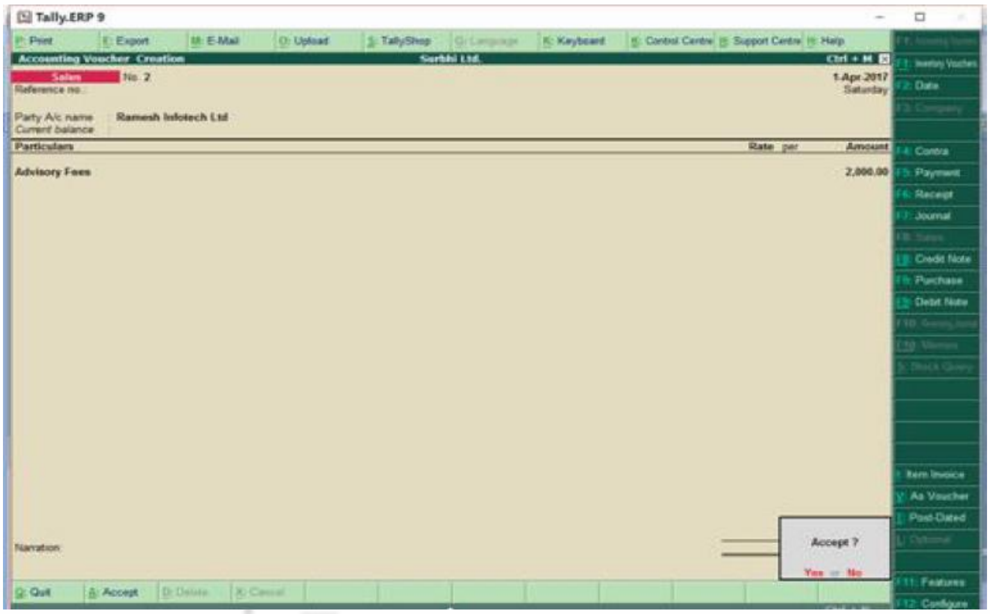


Fig. 20.29

- Enter Narration, if needed and again press enter and entry will be recorded

20.5.2 Creating Item Invoice

For example: Surbhi Ltd. sold 5 White Tubelights to Garg Electricals and Fittings Ltd. on 1st May, 2017

- Go to Accounting Voucher in Gateway of Tally
- Go to F8: Sales
- Press F12: configure and Set Use common ledger A/c for item allocation as 'Yes'
- Click Item Invoice and the screen will appear as shown in Fig. 20.30.

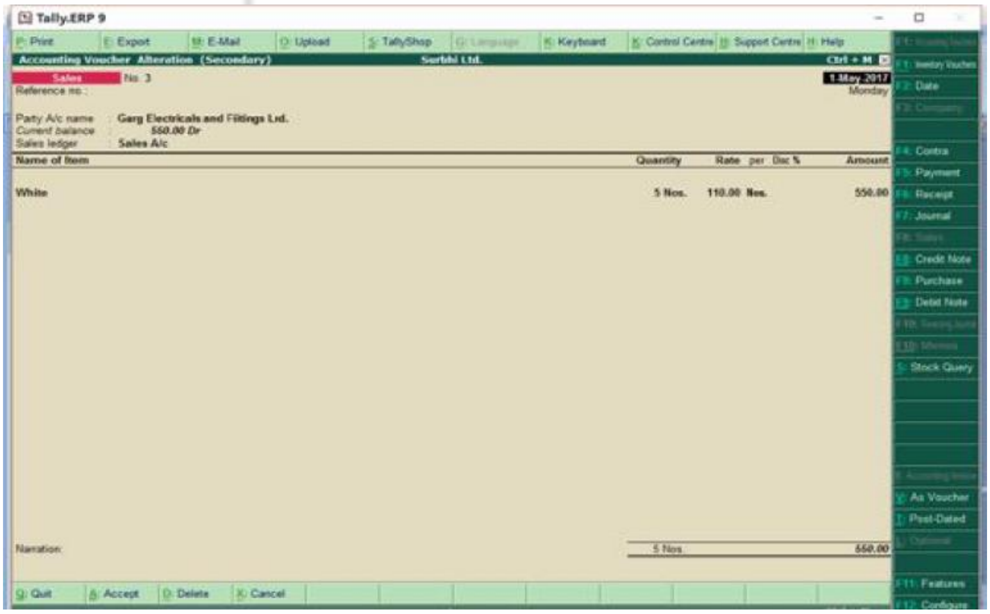


Fig. 20.30

- Enter Party name as Garg Electricals and Fittings Ltd. (Create ledger using Alt + C)
- Enter Sales A/c as Sales Ledger
- Enter item name, godown and quantity
- Rate and amount will be automatically displayed.
- Enter Narration, if needed and again press enter and entry will be recorded

The screen will appear as shown in Fig. 20.31

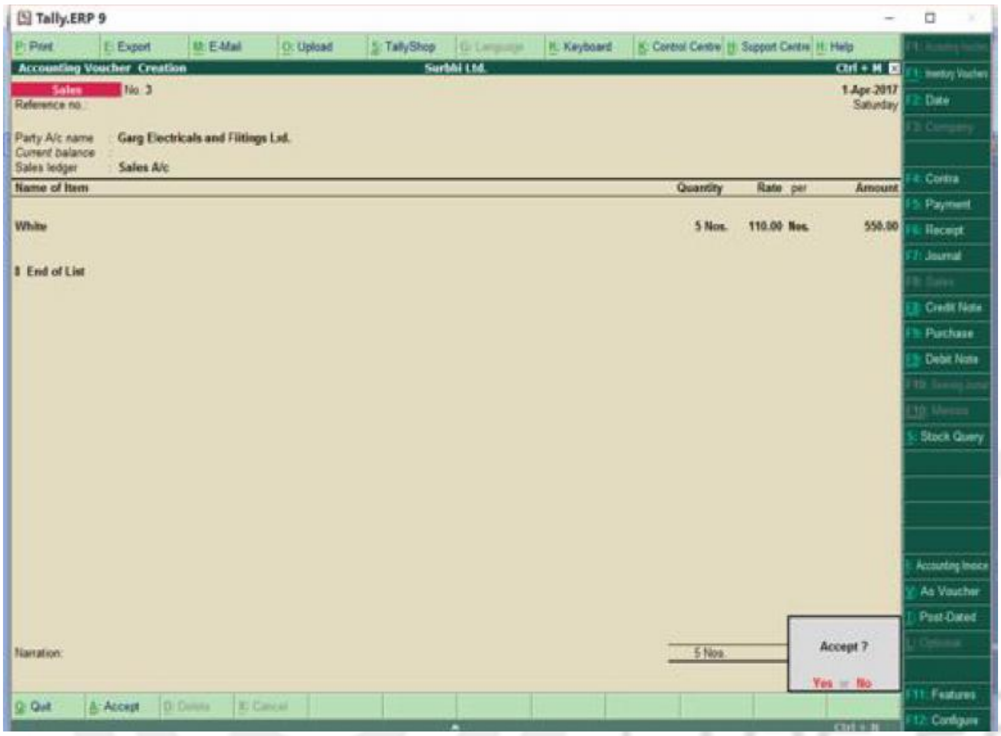


Fig. 20.31

Please Note:

Recording Discounts Transactions

Discount may be classified into two types: (1) Trade Discount which is offered at the time of purchase, for example, when goods are purchased in bulk or to retain loyal customers. (2) Cash Discount which are offered to customers as an incentive for timely payment of their liabilities in respect of credit purchases.

In books of account, trade discount is not separately shown but transactions are recorded at net value i.e. List price – Trade discount.

In tally, to record trade discount in invoices, go to inventory features and set 'Use separate discount column in invoices as 'Yes'.

And then while preparing invoice, trade discount can be recorded and final entry will be reflected at net amount only.

Suppose Surbhi Ltd. purchased 24 CFL (8 watts) bulbs @ Rs. 120/- each from Jatin Electricals Ltd. at 5% trade discount. The screen will appear like Fig. 20.32:

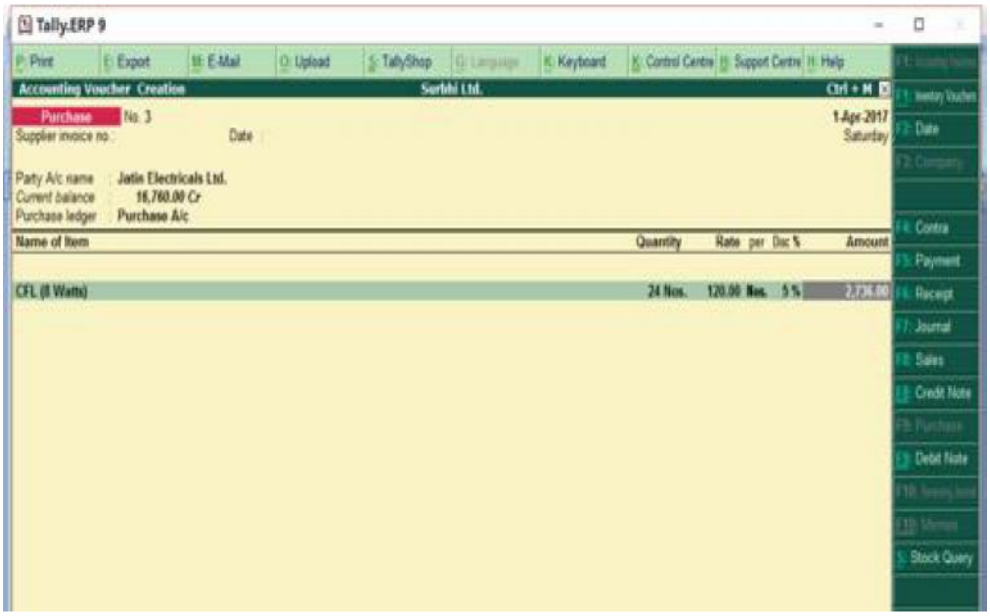


Fig. 20.32

To record cash discount, normal journal entry will be recorded in voucher. Two ledgers i.e. Discount received (Indirect Income) and Discount Allowed (Indirect Expense) will be created and then transaction will be recorded accordingly.

Check Your Progress B

1. Record the following journal entries in the books of Surbhi Ltd.

   a) Purchased Plant & Machinery for Rs. 15,000 from Rita & Sons Pvt. Ltd.

   b) Received Rs. 10,500 in final settlement from Vedant Hardware Store.

   c) Salaries paid to staff by cheque Rs. 11,000.

   d) Paid electricity bill Rs. 1,000; Municipal tax Rs. 200 in cash; Entertainment expenses Rs. 450.

   e) Withdrew Rs. 5,000 for personal use.

   f) Paid Jatin Electricals Rs. 1,500 for goods purchased.

2. Multiple Choice Questions:

   i) Which key is used to post entry in Debit note in Tally?

   a) F7 b) F8 c) Ctrl+F9 d) Ctrl+F8

   ii) Where do we record Credit purchase of furniture in Tally?

   a) Purchaseb) Payment c) Journal d) Receipt

   iii) Sales can be entered in which format?

   a) Invoice b) Voucher c) Both of them d) None of them

   iv) Which one of the invoice is/are used for service rendered?

   a) Accounting Invoice b) Item Invoice c) Both of them

   d) None of them

20.6 LET US SUM UP

The third step after creation of company and ledgers is recording entries through vouchers. Voucher is a document that records financial transaction and serves as the proof that the transaction has been carried out. Tally helps in recording financial transactions with the help of 8 main vouchers and others like reversing journal, memorandum and post dated vouchers. The recorded transaction can be viewed in day book. In day book, one can alter or delete any voucher entry. Tally allows creating and recording transactions as invoices as well. It allows recording transactions as invoice in two forms: Account Invoice (to raise invoices for service rendered) and Item Invoice (to raise invoice with item details).

20.7 KEY WORDS

Voucher: A voucher is the primary online document for recording transactions

Contra Voucher: A voucher used to record transactions of funds transfer from bank to cash account, cash to bank account and bank account to bank account

Payment Voucher: A voucher which is used to record transactions of all payments made through bank or by cash

Receipt Voucher: A voucher which is used to record transactions of all receipt of cash or receipt through bank

Journal Voucher: A voucher which is used to record transactions which does not fit in any other voucher i.e. receipt or payment or purchase or sales or it can be used to pass adjustment entries which do not involve cash or bank

Sales Voucher: A voucher which is used to record transaction of goods sold on cash (cheque) or credit basis

Credit Note Voucher: A voucher which is used to record transactions of sold goods returned back by buyer

Purchase Voucher: A voucher which is used to record transactions of goods bought on cash (cheque) or credit basis

Debit Note Voucher: A voucher which is used to record transaction of purchase goods returned back to seller.

Accounting Invoice: An invoice created to record transactions for services rendered

Item Invoice: An invoice created to record item details

20.8 ANSWERS TO CHECK YOUR PROGRESS

A 1. (c) 2. (a) 3. (b) 4. (b) 5. (a)

B **2** (i) (c) (ii) (c) (iii) (c) (iv) (a)

20.9 TERMINAL QUESTIONS/EXERCISES

Exercises

Transaction	Item	Qty	Amount
Purchase from Renu Coffee Ltd.	Coffee Brewed	100	13,500
Sale to Sujeet Thandai Ltd. in cash	Thandai Rose	125	25,000
Sujeet Thandai returned goods not being upto mark		20	
Paid money to Renu in full settlement for the transaction at Sr. No. 1 above			12,800
Received from Vedanta Cold drinks in full settlement			74,500
Purchase from Sangeeta Beverages & sons	Tea Assam	50	42,500
Sale to Suruchi Cold drinks (Trade discount 10% on list price)	Cold Drink 300 ml Orange	150 units List Price Rs. 30/- each	
Purchased machinery			25,000
Paid insurance premium			4,000
Depreciation on furniture @ 20% and Machinery @ 10%			
Sold all the investment			5,00,000
Paid 1. Outstanding Salaries			20,000
2. Electricity			10,000
3. Telephone			5,000
4. Current Salaries			50,000
5. Rent (including outstanding)			70,000
6. Tax of last year			2,30,000
Outstanding			
1. Total Salaries			50,000
2. Total Provision for Tax			2,40,000
3. Total Rent outstanding			90,000

Questions

1. Define voucher and Discuss different types of vouchers.
2. Explain how a new voucher type is created and its use?
3. What are post-dated vouchers? Explain its use.

Exercises

2. Record the following transactions in the books of Bhartiya Book Trading Company that took place during the period:

a) Goods are purchased from these parties

Party name	Stock item	Godown	Qty
Sabnis Corner	Nursery Rhyme	Linking Road	100
Helima Book Center	Maths- Calculus	Andheri (East)	200
Saraswati Store	Botany	P D Mello Road	150

b) Goods are sold to these parties

Party name	Stock item	Godown	Qty	Selling price
Janta Stationery Store	Elementary Maths Operations	Linking Road	550	75
Omtex Store	Botany	P D Mello Road	250	105
Kamal Book Store	Calculus	Andheri (East)	475	55
Janta Stationery Store	Physics	P D Mello Road	670	100

c) Withdrew Rs. 50000 from Sahakari bank for business purpose.

d) Incurred the following expenses and earned the following incomes during the period:

EXPENSES	AMOUNT (RS.)	MODE
Printing & Stationery	200	Cheque
Electricity charges	6000	Cheque
Miscellaneous expenses	820	Cash
Advertisement	1960	Cheque
Office expenses	2000	Cheque
Interest on loan	35000	Cheque
Refreshment expenses	340	Cheque
Administrative expenses	3400	Cheque
Commission received A/c	5000	Cheque

e) Charge Depreciation @ 10% on furniture, 20% on computer, and 12.5% on Machinery and 7.5% on Building

f) Received from Janta Stationery Store Rs. 1,45,000 in total for full settlement.

3. Create a Company as "Tech Comp & Sons" in Tally with Inventory Management. (Assume rest details hypothetically). Pass the following entries:

   a) Sujeet started "Tech Comp & Sons" by bringing Capital Rs.10,50,000/- Cash on 1st April, 2017.

   b) He deposited Rs. 5,90,000/- cash at HDFC bank and purchased building for Rs. 2,50,000 and Furniture for Rs. 50,000.

   c) He purchased the following items from Computer Lab Ltd. on credit:

      Computer – 5 Nos. @ 25000/- each

      Mouse – 20 Nos.@ 245/- each

      Sound Card – 10 Nos.@ 2000/- each

      64 GB RAM – 12 Nos.@ 2700/- each

      Speakers – 5 Set@ 8000/- each

      LCD Monitors – 10 Nos.@ 8000/- each

      Keyboard – 18 Nos.@ 450/- each

   d) He made the following payments to Computer Lab Ltd. in full settlement:

      Bank for Rs. 4,50,000

      Cash for Rs. 1,50,000

   e) He sold the following items to Somnath Traders in Cash:

      Computer – 3 Nos. @ 32,500/- each

      64 GB RAM – 5 Nos. @ 3,200/- each

      Mouse –2 Nos. @ 300/- each

   f) He sold the 2 set of speakers & 10 Nos. of LCD Monitors worth Rs. 24,200/- & Rs. 85,000/- to Crack My PC.

   g) He received Rs. 36,000/- as commission from Seva Kendra Hub by cash for consultancy services.

   h) He paid House Rent for Rs. 5,000/- by cash.

i) He withdrew Rs. 25,000/- cash from Bank for personal use.

j) He purchased furniture for Rs. 25,000/- by cash for office use.

k) He paid electricity bill, salaries and miscellaneous expenses for Rs. 1,200/-, Rs. 10,000/- and Rs 860/- respectively by cash.

UNIT 21 PREPARATION OF REPORTS

Structure

21.0 OBJECTIVES

After studying this unit, you will be able to:

- display financial statements and inventory reports in Tally; and
- customize and analyse reports.

21.1 INTRODUCTION

After recording transactions, Tally helps user to view different reports to assess the financial health and performance of the firm. As soon as the transactions are entered into the tally, the preparation of reports is done by Tally automatically The tally software creates automatically all crucial and important financial statements like balance sheet, profit and loss account, stock summary, trial balance, day book etc. The user can reach to the transaction level from report by pressing enter key on the required item. The reports can be customized as well as per user needs.

21.2 FINANCIAL STATEMENTS

Financial Statements shows the financial health of the business. It summarizes the business transactions for use by the various stakeholders. Financial statements include:

a) Balance Sheet b) Profit and Loss Account c) Cash Flow Statement

21.2.1 Balance Sheet

It is a financial statement that reports the financial position of the business as on a specific data. It shows a balance between assets and liabilities signifying Assets = Liabilities + Capital

You can view balance sheet on Gateway of Tally under Reports. Alternatively, if you have set 'Use separate menu for Final Accounts Statements as 'yes' in General Configurations, then you can find balance sheet under 'Final Accounts'.

The balance Sheet of Surbhi Ltd. will appear as seen in Fig. 21.1.

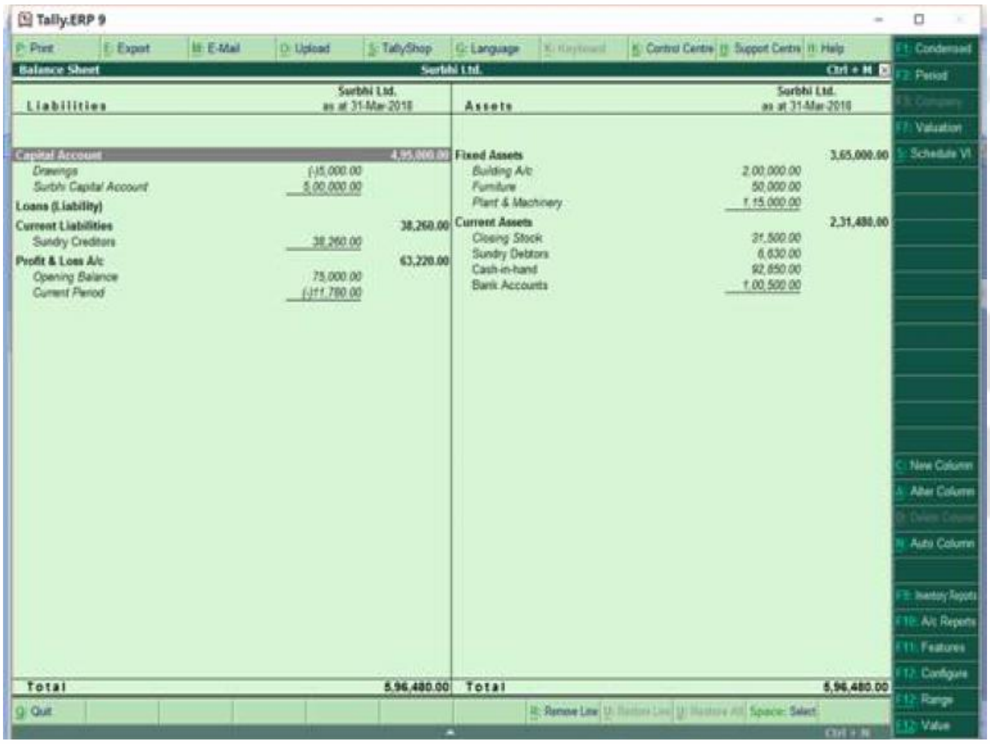


Fig. 21.1

You can view detailed balance Sheet by using F1: Detailed or in condensed form.

Also you can see the balance sheet on different dates like on 1st April, 2017 and 1st May, 2017 and the same will show effect on stock valuation on different dates.

The balance sheet gets updated automatically after each transaction once recorded.

21.2.2 Profit and Loss Account

Profit and Loss Account or Income and Expenditure Statement is a financial statement which shows the revenues, cost and expenses for a specified period. It gets updated automatically after each transaction and displays information based on primary groups.

You can view Profit and Loss Account on Gateway of Tally under Reports. Alternatively, if you have set 'Use separate menu for Final Accounts Statements as 'yes' in General Configurations, then you can find Profit and Loss Account under 'Final Accounts'. You can view detailed Profit and Loss Account by using F1: Detailed or in condensed form.

The Profit and Loss Account of Surbhi Ltd. will appear as shown in Fig. 21.2.

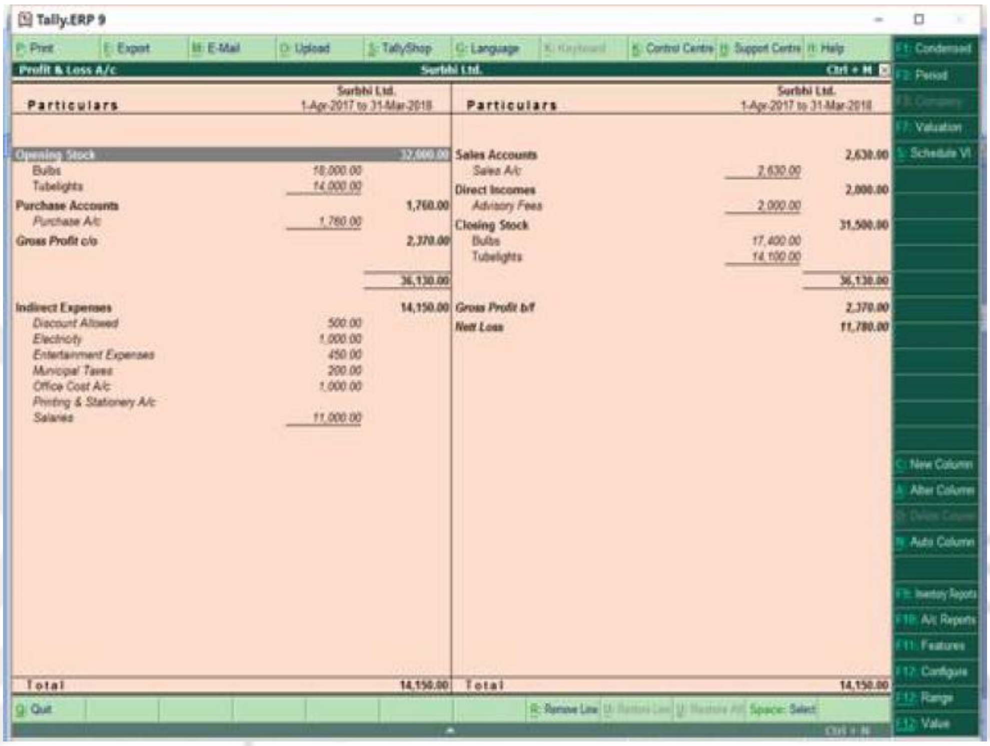


Fig. 21.2

Also you can see the Profit and Loss Account on different dates like on 1st April, 2017 and 1st May, 2017 and the same will show effect of stock and expenses and income on different dates.

21.2.3 Trial Balance

A trial balance is a book-keeping worksheet in which the balances of all ledgers are compiled into debit and credit columns. The objective is to ensure arithmetical accuracy. The total of debit and credit should be equal. A trial balance is usually prepared at the end of reporting period.

You can view Trial Balance on Gateway of Tally under Reports and by using F1: Detailed or in condensed form.

The Trial Balance of Surbhi Ltd. will appear as in Fig. 21.3.

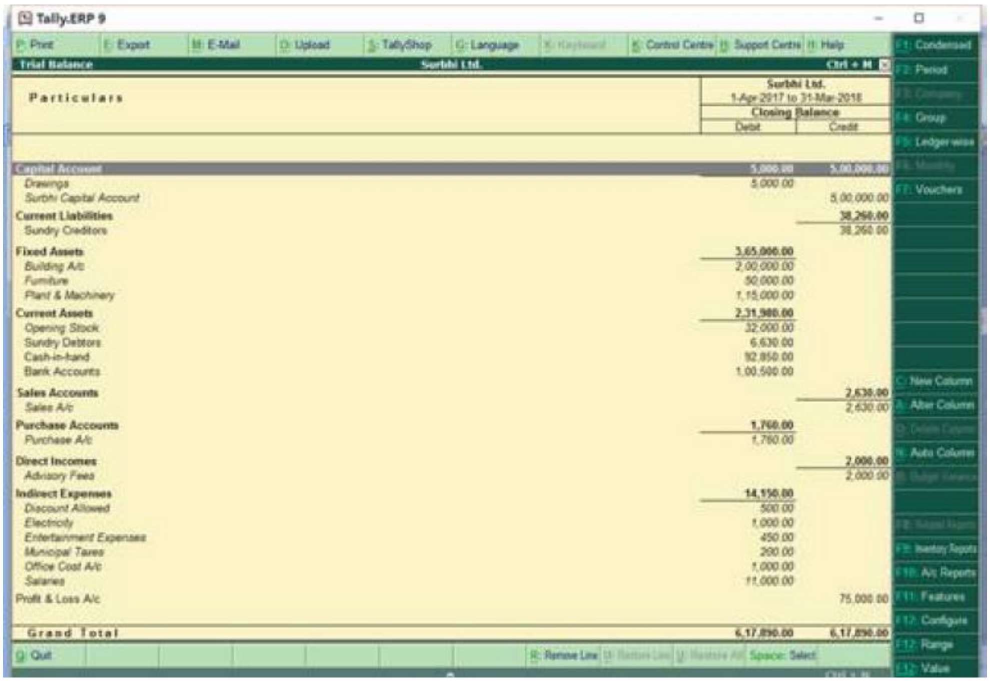


Fig. 21.3

21.2.4 Ratio Analysis

Ratio Analysis is a form of financial statement analysis that is used to obtain a quick indication of a firm's financial performance in several key areas. It evaluates the firms or business on various aspects like liquidity, efficiency, profitability and solvency. The ratios are categorized as Short-term Solvency Ratios, Debt Management Ratios, Asset Management Ratios, Profitability Ratios, and Market Value Ratios.

You can view Ratio Analysis on Gateway of Tally under Reports. Alternatively, if you have set 'Use separate menu for Final Accounts Statements as 'yes' in General Configurations, then you can find Ratio Analysis under 'Final Accounts'.

The Ratio Analysis of Surbhi Ltd. will appear as shown in Fig. 21.4.

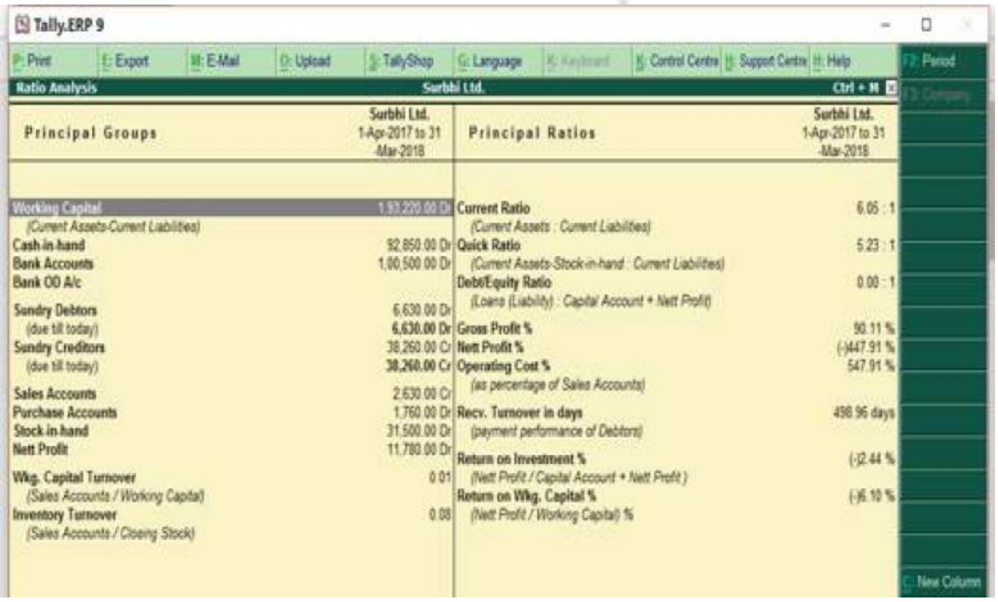


Fig. 21.4

21.3 BOOKS AND REGISTERS

Tally updates all books, ledgers and registers as soon as the transactions are entered.

21.3.1 Day Book

It displays all the transactions recorded through vouchers i.e. journal entries. It displays the last date transactions that are recorded for the business. So you can view entries of specific date by changing the date. You can see F2: Date on vertical button panel or press F2 from Keyboard.

You can view Day Book under Display on Gateway of Tally. The Day book of Surbhi Ltd. will appear as in Fig. 21.5 and 21.6 for two periods (April & May). Please note that the entries are shown on 1st April, 2017 as author is working on educational mode.

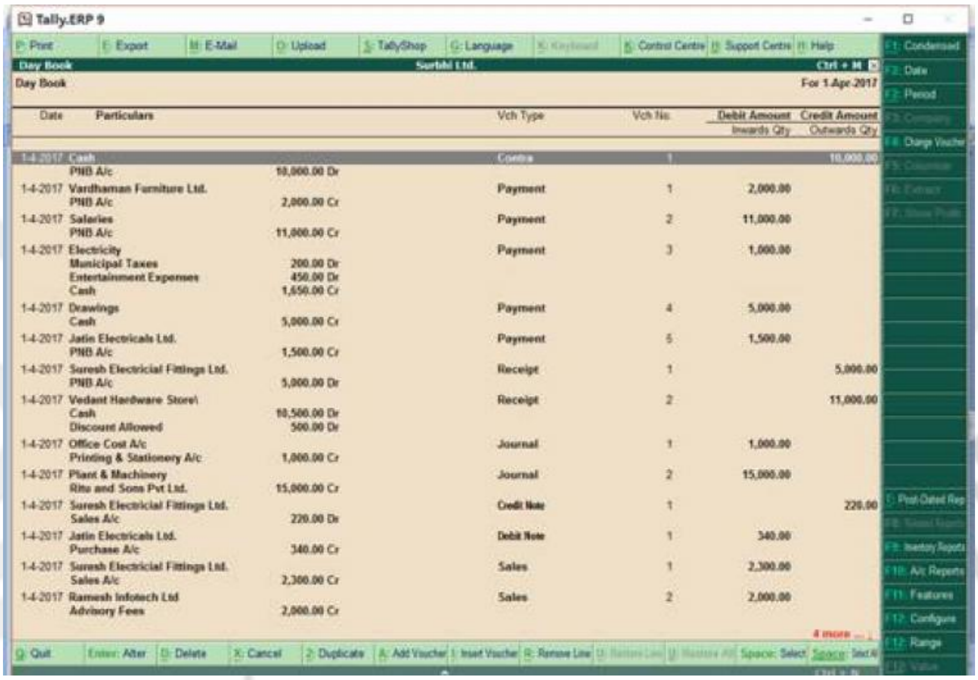


Fig. 21.5

Fig. 21.6

21.3.2 Purchase and Sales Register

Purchase and sales register shows the details about the purchases made and goods sold by the firm or business and also help in tracking movement of goods to godowns. It can also display the purchases made in graphical form if you set the 'Show graphs in monthly reports' under General Configurations as 'Yes'.

You can view Purchase and sales register under Accounts Book under Display on Gateway of Tally. The Purchase and Sales Register of Surbhi Ltd. will appear as in Fig. 21.7 and 21.8.

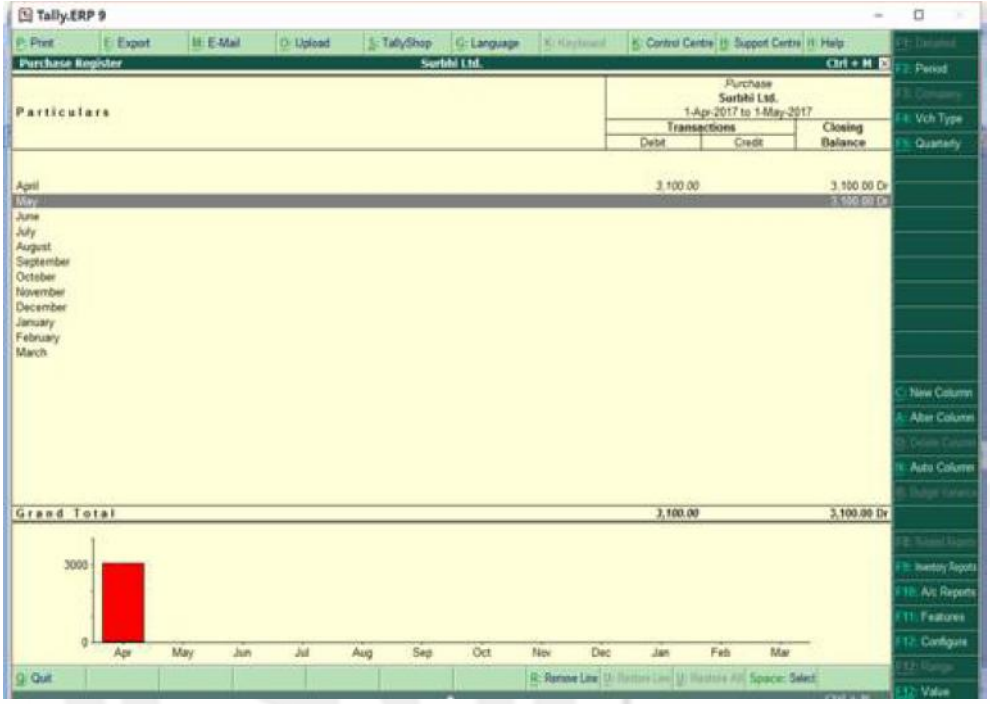


Fig. 21.7

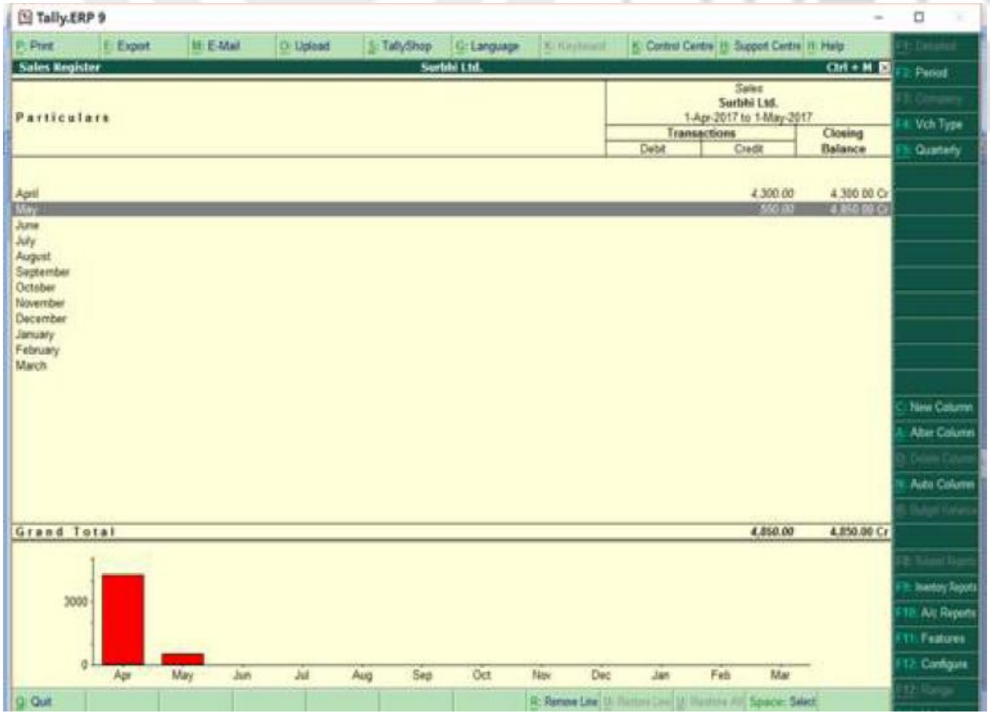


Fig. 21.8

21.3.3 Cash / Bank Books

It displays balances as and when transactions that affect cash and bank balances are recorded. You can view Cash/ Bank Books under Accounts Book under Display on Gateway of Tally. If you press enter on cash, you can view monthly ledger summary as well. The Cash/ Bank Books of Surbhi Ltd. will appear as shown in Fig. 21.9 and 21.10.

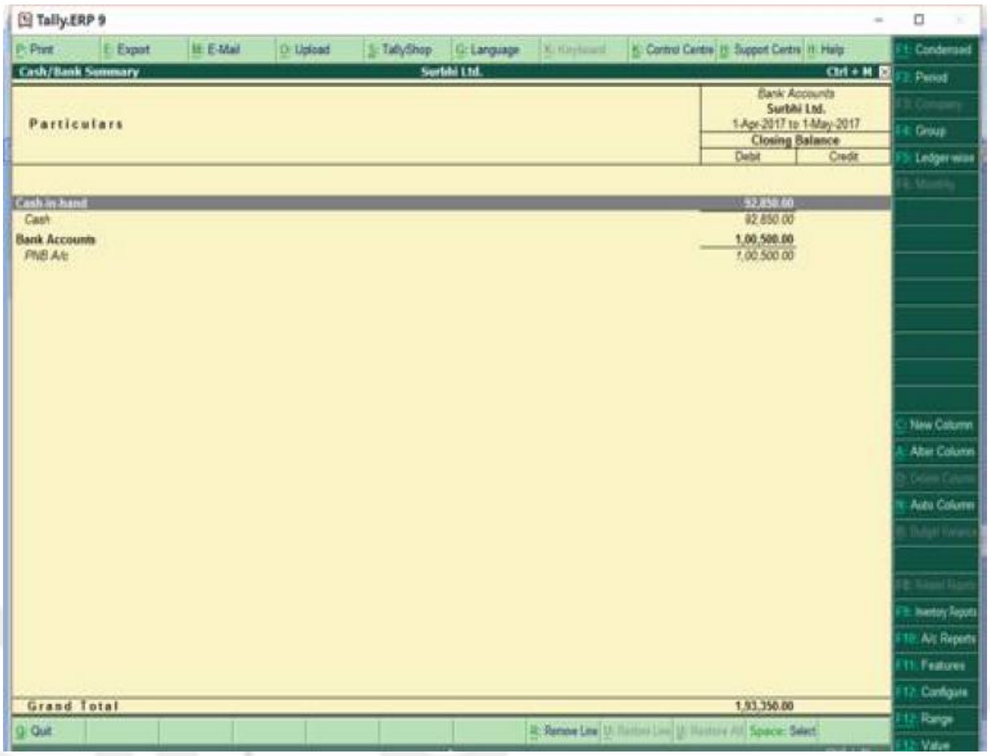


Fig. 21.9

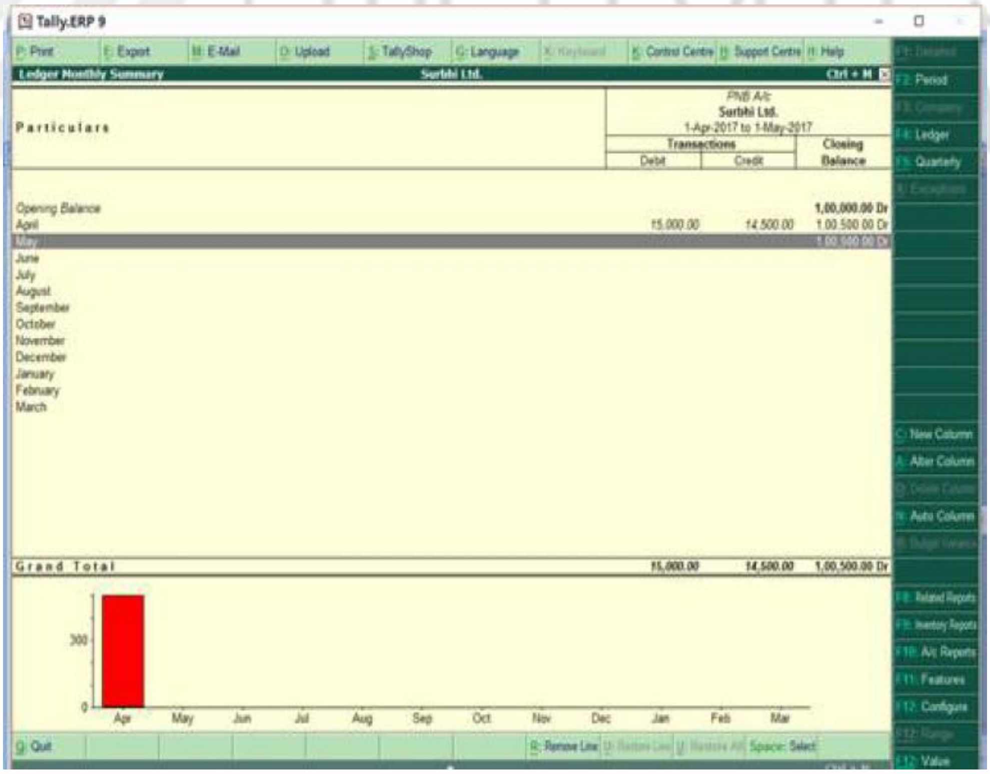


Fig. 21.10

21.4 STATEMENT OF ACCOUNTS

It displays receivables and payables of the business or firm. They form important part of working capital. They help in knowing about the financial health as well as short term liquidity position of the firm or business. To view Outstandings, go to gateway of tally, then display and then statement of accounts. Within Outstandings, you can find receivables and payables and Ledger and group as shown in Fig 21.11.

Fig. 21.11

Bills Receivables (see Fig. 21.12) and Payables (see Fig. 21.13) display the sundry debtors' and creditors' bill wise till date. To view bill wise details, set this option as 'yes' under accounting features.

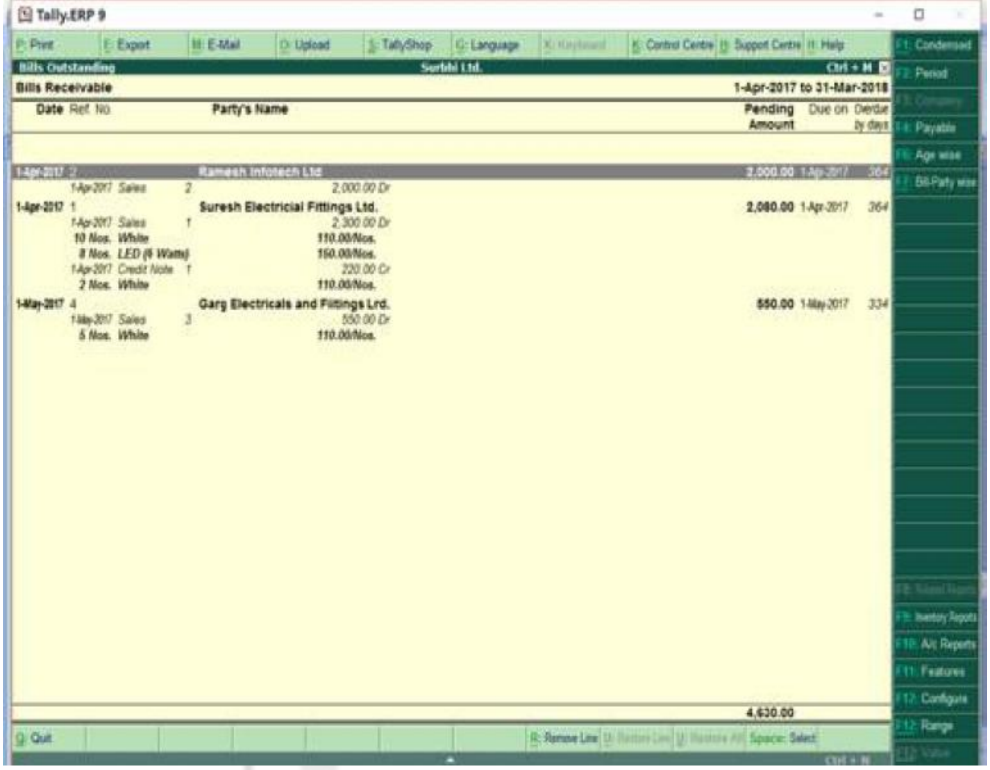


Fig. 21.12

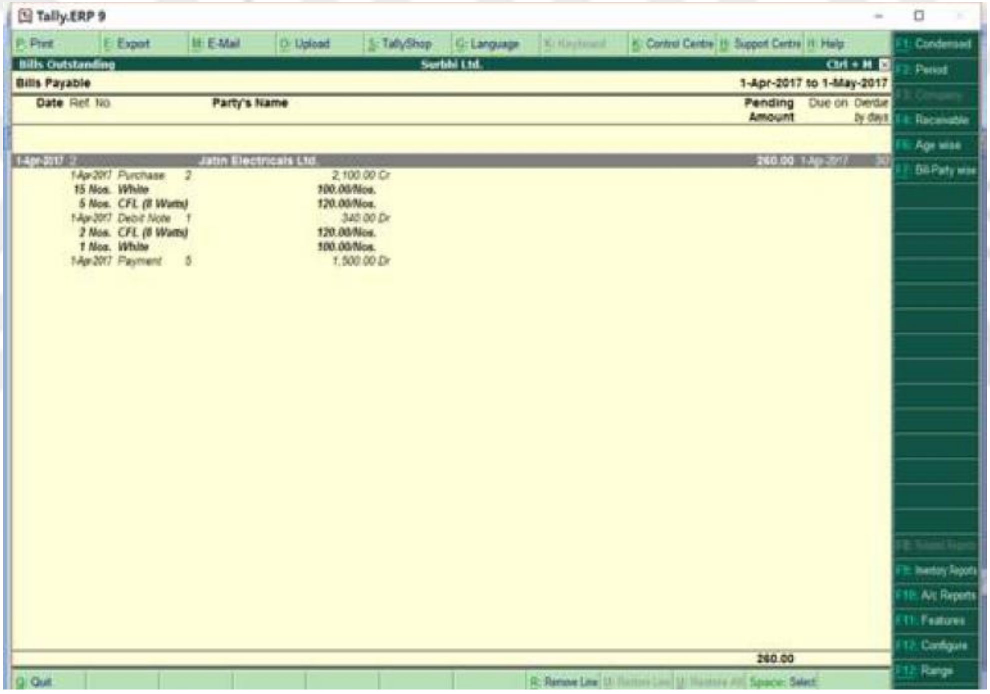


Fig. 21.13

Similarly, you can view ledgers and group wise Outstandings as well.

21.5 STATISTICS

Statistics help in knowing the total masters and vouchers created for business transactions. To view Statistics, go to gateway of tally, then display and then statement of accounts (Fig. 21.14).

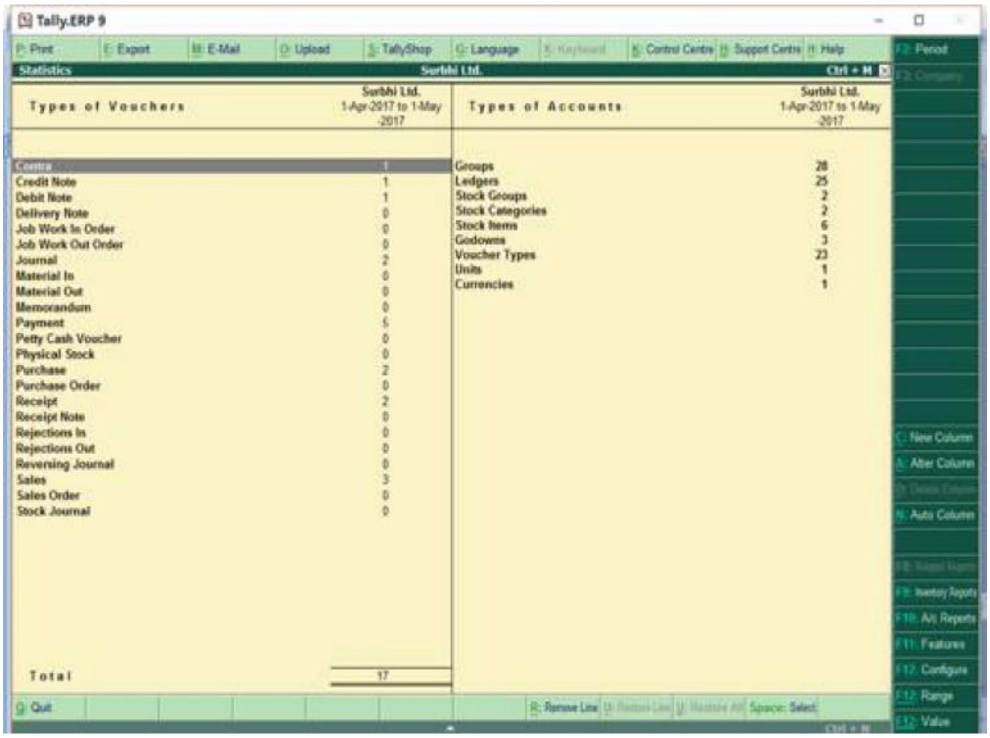


Fig. 21.14

You can also view stock summary by clicking 'Stock Summary' on gateway of tally under reports (Fig. 21.15).

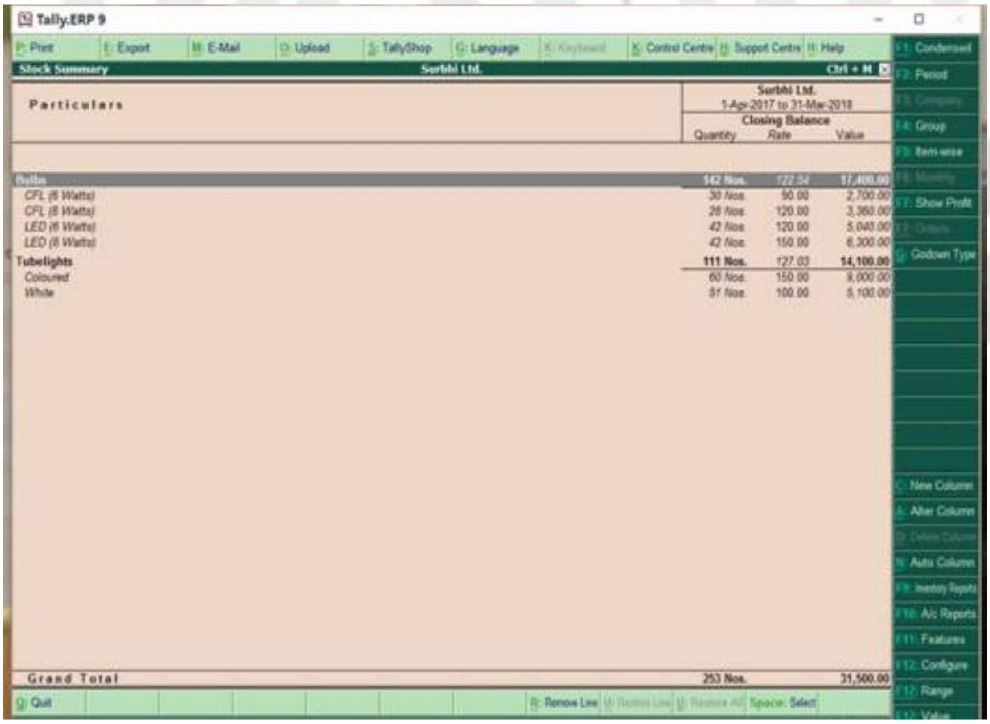


Fig. 21.15

Receipts and Payment account can be viewed under display menu (Fig. 21.16).

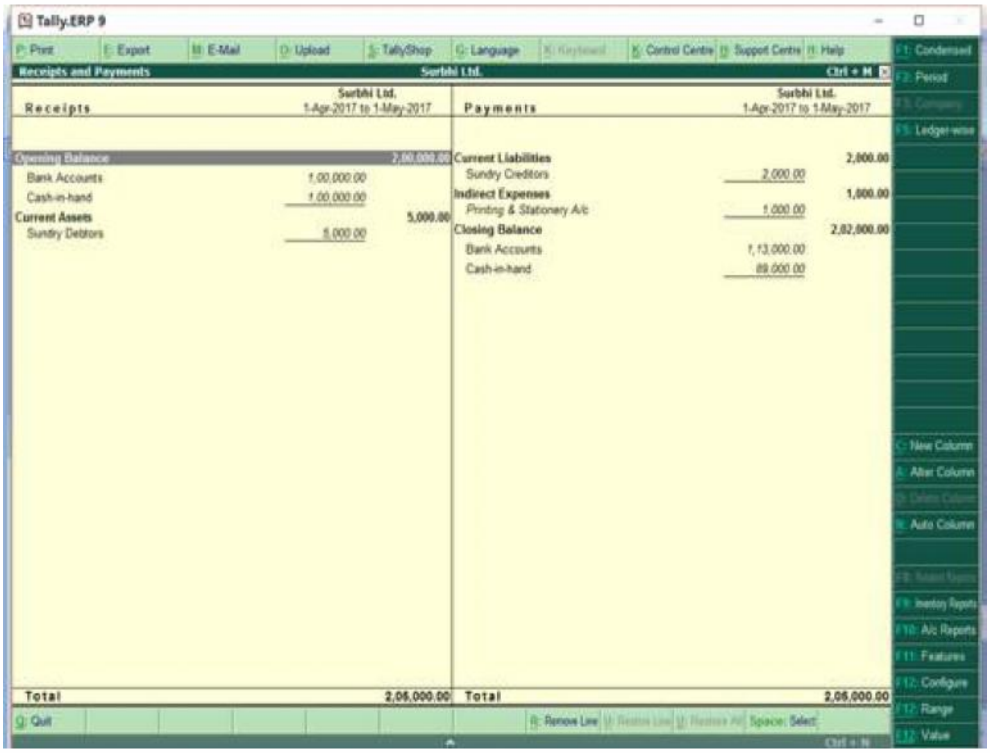


Fig. 21.16

21.6 RESTORE AND BACKUP OF DATA

Backup

Backup is a process of creating a copy to protect data at different location from threat of data loss and data corruption. It can be taken daily or weekly or monthly depending upon business need. Tally allows you to do backup of data manually and automatically. To automatically back up data set 'Enable auto back' as 'Yes' in Company Info under alter.

The data can be manually backup by going to Gateway of Tally, then Company Info and then, backup.

The 'backup companies on Disk' appears and by default, the source folder is set to current location where data files are stored. In destination, enter where data backup need to be store and press enter. Then select the company or companies from list of Companies you want to create backup for and then, End of List.

Restoring Data from Backup File

It allows you to restore the data backup taken earlier. It can be done manually or auto back also. To restore it, go to company info and then restore.

The restore companies on Disk appear into two sections: Backup and Auto Back. In destination field, specify where data has to be restored and in source field, where data backup is stored. Then select the company or companies you wish to restore.

Check Your Progress A

1. Fill in the blanks –

   a) Daybook displays the transaction belonging to .... date.

   b) Ledger outstanding statement displays .... bills and settled invoices.

   c) For detailed view of any report .... key is used.

   d) Bills receivables details can be viewed under .... under statements of accounts.

   e) The status report displays .... for company.

21.7 LET US SUM UP

The preparation of reports is the last step in Tally ERP.9. The user need not to prepare reports, but it automatically gets prepared as each transaction is entered in Tally ERP.9. The reports which are critical for determining financial health & performance of business are reflected on main pane on gateway of Tally under 'Reports'. These include Balance Sheet, P&L A/c, Stock Summary and Trial Balance. Others like Day Book, Receivables, Payables, Cash/Bank Book can be found under Display under Reports.

21.8 KEY WORDS

Balance Sheet: It is a financial statement that reports a business financial position as on a specific data. It shows a balance between assets and liabilities.

Day Book: It displays all the transactions recorded through vouchers i.e. journal entries. It displays the last date transactions that are recorded for the business.

Financial Statement: Financial Statements shows the financial health of the business. It summarizes the business transactions for use by the various stakeholders.

Outstandings: It displays receivables and payables of the business or firm. They help in knowing about the financial health as well as short term liquidity position of the firm or business.

Payables: Bills Payables display the sundry creditors' bill wise till date.

Profit & Loss Account: A financial statement which shows the revenues, cost and expenses for a specified period.

Purchase Register: Purchase register shows the details about the purchases made by the firm or business and also help in tracking movement of goods to godowns.

Receivables: Bills Receivables display the sundry debtors' bill wise till date.

Sales Register: Sales register shows the details about the goods sold by the firm or business and also help in tracking movement of goods from godowns.

21.9 ANSWERS TO CHECK YOUR PROGRESS

1. a) Last voucher entry
   b) History or pending
   c) Alt+F1
   d) Outstandings
   e) Both the masters & vouchers created

21.10 TERMINAL QUESTIONS/EXERCISES

Questions

1. Write short note on 'Preparation of Reports'?
2. What books and registers or financial statements can be viewed in Tally ERP.9? Name them.
3. Display the following reports in the books of :
   i) S Bose Beverages Ltd.
   ii) Bhartiya Book Trading Company
   iii) Tech Comp & Sons

Balance Sheet	Trial Balance
P&L A/c	Purchase & Sales Register
Day Book	Outstandings

21.11 APPENDIX-J-SHORT-OUT KEYS IN TALLY

Window Key	**Functionality**	**Availability**
Fl	To select a company To select the Accounts Button and Inventory Buttons	At all Master Menu screen At Accounting/Inventory Voucher Creation and alteration screen.
F2	To change the menu period	At almost all screens in Tally
F3	To select the company	At almost all screens in Tally
F4	To select the Contra Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F5	To select the Payment Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F6	To select the Receipt Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F7	To select the Journal Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F8	To select the Sales Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F8 (Ctrl +F8)	To select the Credit Note Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F9	To select the Purchase	At Accounting/Inventory Voucher
	Voucher	Creation and alteration screen
F9 (Ctrl +F9)	To select the Debit Note Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F10	To select the Memorandum Voucher	At Accounting/Inventory Voucher Creation and alteration screen
F11	To select the Functions and Features screen	At almost all screens in Tally
FI2	To select the Configure	At almost all screens in Tally
Alt + 2	To Duplicate a voucher	At list of Vouchers - creates a voucher similar to the one where you positioned the cursor and used this key combination
Alt + A	To Add a voucher	At list of Voucher - adds a voucher after the one where you positioned the cursor and used this key combination

Alt + C	To create a master at a voucher screen (if it has not been already assigned a different function, as in reports like Balance Sheet, where it adds a new column to the report)	At voucher entry and alteration screens, at a field where you have to select a master from a list. If the necessary account has not been created already, use this key combination to create the master without quitting from the master screen
Alt + D	To Delete a voucher To delete a master (if it has not been already assigned a different function)	At Voucher and Master (Single) alterations screens. Master can be deleted subject to conditions, as explained in the content before
Alt + E	To export the report in ASCII, SDF, HTML or SML format	At all reports screen in Tally
Alt + I	To inselt a voucher	At list of Vouchers - inserts a voucher before the one where you positioned the cursor and used this key combination
Alt + P	To print the report	At all reports screen in Tally
Alt + X	To cancel a voucher in Day Book/List of Vouchers	At all reports screen in Tally
Alt + R	To Register Tally	At Licensing Menu in Tally
Ctrl + G	To select the Group	At Groups/Ledgers/Cost Centres/B ud gets/Scenarios/ Voucher Types/Currencies (Accounts Info) creation and alteration screen
Ctrl + 1	To select the Units	At Stock Group/Stock Categories/Stock Items/Reorder Levels/Godowns/Voucher Types/ Units of Measure (Inventory Info) creation and alteration screen
Ctrl + O	To select the Godown	At Stock Group/Stock Categories/Stock Items/Reorder Levels/Godowns/Voucher Types/ Units of Measure (Inventory Info) creation and alteration screen
Ctrl+Alt+R	Rewrite data for a company	From Gateway of Tally screen
Ctrl+S	Allow you to alter Stock from master	At Stock Voucher and Godown Voucher Report

Ctrl+U	To select the Units	At Stock Group/Stock Categories/Stock Items/Reorder Levels/GodownsN oucher Types/ Units of Measure (Inventory Info) creation and alteration screen
Ctrl+V		At Groups/Ledgers/Cost Centres/B udgets/Scenarios/ Voucher Types/Currencies (Accounts Info) creation and alteration screen

Window Combination Used for Navigation

Windows Key	**Functionality**	**Availability**
PgUp	Display previous voucher during voucher entry/alter	At voucher entry and alteration screen
PgDn	Display next voucher during voucher entry/alter	At voucher entry and alteration screens
Enter	To accept anything you type into a field	You have to use this key at most area in Tally
Esc	To remove what you typed in a field To come *out* of a screen To indicate you do not want to accept a voucher or master	At almost all screens in Tally

ACKNOWLEDGEMENT

All the pictures have been taken as screenshot from Tally ERP.9 software. Special thanks to Tally ERP.9 software developers and the company.