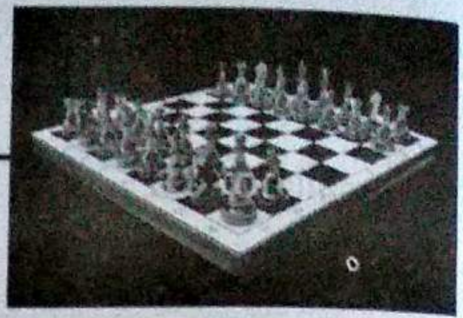
Section – I

Accounting Fundamentals
(*Contd.*)



THREE

BASIC ACCOUNTING TERMS

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- identify the basic terms used in accounting;
- expain the meaning of certain key accounting terms

ACCOUNTING TERMS

It will be appropriate to get familiarised with certain basic terms which are used in accounting before proceeding with the technique of recording of business transactions. It is necessary for the readers to go through these basic terms and understand them clearly, since it will be then convenient for them to understand clearly the contents of the chapters which are to follow:

1. **Assets** The term 'assets' include the resources acquired by a business from the funds made available either by the owners or by others. They are "tangible objects or intangible rights owned by an enterprise and carrying probable future benefits".[1] In other words, property of all kinds owned by a business comes within the category of the term 'assets'.

Assets may be classified into the following categories:

(i) *Fixed assets* These are assets which are acquired for relatively long period for carrying on the business of the enterprise. They are not meant for resale. The examples of such assets are land, buildings, plant, machinery, etc.

(ii) *Current assets* These are assets which are acquired with the intention of converting them into cash during the normal business operations of the company. They include "cash and other assets that are expected to be converted into cash or consumed in the production of goods or rendering of services in the normal course of business".[2] The essential difference between current assets and fixed assets is that the current assets are held essentially for a short period and they are meant for converting into cash. Examples of such assets are cash, inventories (*i.e.*, stocks of raw material, work-in-progress and finished goods), bills receivable, debtors, etc. These assets are also termed as 'Floating' or 'Circulating' Assets.

(iii) *Liquid assets* These are assets which are immediately convertible into cash without much loss. As a matter of fact, all current assets excluding prepaid expenses and inventories are included in the definition of liquid assets.

(iv) *Fictitious assets* These are assets which have no real value but are shown in the books of accounts only for technical reasons. Examples of such assets are preliminary expenses incurred in connection with the establishment of a business or discount allowed on issue of shares by a company, etc.

(v) *Wasting assets* These are the assets which are exhausted with, or which lose themselves in the goods they produce. Mines and quarries are common examples of such assets. The term is also used for describing such assets which get exhausted with the lapse of time, *e.g.*, copyrights, patents, trademark, etc.

2. **Liabilities** The term 'Liabilities' is used to denote amounts which a business owes and has to return or account for. They are present obligations whose amounts can be ascertained with substantial accuracy. They can be divided into two categories:

(i) *Current liabilities* The term 'Current Liabilities' is used to denote liabilities which will be due within a short time (usually one year or less) and that are to be paid out of current assets or by creation of other current liabilities. Creditors for goods, bills payable, outstanding expenses are some of the examples of current liabilities.

(ii) *Fixed liabilities* Liabilities that will not be due for a comparatively long time (usually more than one year) are termed as 'Fixed Liabilities' or 'Long-term Liabilities'. These liabilities would continue to be treated as Fixed Liabilities if they are renewed rather than paid at maturity.

1&2. *Accounting Terminology* issued by Institute of Chartered Accountants of India (ICAI).

3. Capital The term 'Capital' is used to denote the owners' equity in the business. It is a residual claim against the assets of the business after the total liabilities are deducted. Owners' Equity, Proprietorship and Net-Worth are some of the other terms which are also used to denote Capital.

Capital may be classified into the following categories:

(*i*) *Fixed Capital* It is the capital invested in or represented by Fixed Assets.

(*ii*) *Circulating Capital* It is the capital in the form of Current or Floating Assets.

(*iii*) *Working Capital* It is the excess of Current Assets over Current Liabilities.

4. Contingent Asset An asset, the existence, ownership value of which may be known or determined only on the occurrence or non-occurrence of one more future uncertain events. It usually arises from unexpected events that give rise to possibility of inflow of economic benefits to the business enterprise. For example, a claim that the firm is pursuing the outcome of which is uncertain, is a contingent asset.

A contingent asset is not recognised in the books of an enterprise. It also does not require any disclosure in the financial statements. Such an asset is assessed continuously and when it becomes virtually certain that it will result in inflow to economic benefits to the enterprise, the asset and the related income may be recognised in the financial statements of the firm in which such change occurs.

5. Contingent Liability It is an obligation relating to existing condition or situation which may arise in future depending upon the occurrence or non-occurrence of one or more uncertain future events. It is a possible obligation which may or may not arise depending upon the situation.

Following are the examples of contingent liabilities:

1. A claim against the enterprise not acknowledged as debt.
2. Uncalled liability on shares partly paid.
3. Arrears of fixed cumulative dividends.
4. Estimated amount of contracts remaining to be executed on capital account and not provided for.

An enterprise should not recognise a contingent liability. However, it may be disclosed as a note to the financial statements. Such liabilities are assessed on a continuing basis to determine whether an outflow of economic resources has become probable, if so to the extent of the probable amount, the liability will have to be recognised in the books and a provision will have to be created.

6. Provision An amount written off or retained by way of providing for depreciation or diminution in value of assets or for providing any known liability, the amount of which cannot determined with substantial accuracy. Examples of a provision are provision for bad and doubtful debts, a provision for discount on debtors, etc.

Difference between a Contingent Liability, a Provision and a Liability This can be understood with the following example:

A lawsuit has been filed against a firm claiming damages of ₹1,00,000. The firm feels that the case against the firm may or may not be dismissed by the court. Such a liability is a contingent liability and may be disclosed by way of a note to the financial statements. However, if the firm feels that it may be required to pay the damages of around ₹20,000 in the suit in all probabilities, the provision to the extent of ₹20,000 for the lawsuit will be created. Finally if the court fixes the damages payable of ₹25,000 against the firms, a liability of ₹25,000 will be recognised in the books of the firm.

Transaction & event

7. **Transaction and Event** Every economic activity is performed through transactions and events. A transaction may be a business, performance of an act or an agreement. While an event is the happening, consequence or result of a transaction.

For example, A starts business with a capital of ₹1,00,000. He makes cash purchases of ₹80,000 and makes cash sales of ₹90,000 of goods costing ₹60,000. He also pays ₹10,000 as rent of the godown.

The following results can be drawn from the above:

1. *Economic Activity*: Starting of business
2. *Transactions are*:
   (*a*) Investment of ₹1,00,000 in the business.
   (*b*) Purchasing of goods for ₹80,000.
   (*c*) Making cash sales of ₹90,000.
   (*d*) Payment of godown rent ₹10,000.
3. *Events are*:

(*a*) Profit of ₹20,000, computed as under

			₹
	Sales		90,000
	Cost of Purchases	60,000	
Add:	Godown Rent	10,000	70,000
			20,000

(*b*) Cash balance of ₹1,00,000, computed as under:

	Capital introduced		1,00,000
Add:	Cash sales		90,000
			1,90,000
Less:	Cash Purchases	80,000	
	Godown Rent	10,000	90,000
			1,00,000

(*c*) Closing Inventory of ₹20,000 computed as under:

	Goods Purchased	80,000
Less:	Cost of Goods Sold	60,000
		20,000

(*d*) Capital of ₹1,20,000 computed as under:

	Initial capital introduced	1,00,000
Add:	Profit made	20,000
		1,20,000

8. **Revenue** The term 'Revenue' means income of a recurring nature from any source. The source may be sale of goods, performance of services for a customer or a client, the rental of a property, the lending of money and any other business or professional activity carried on for the purpose of earning income.

9. **Expenditure** The term includes incurring a liability disbursement of cases or transfer of property for the purpose of obtaining assets goods or services. It may be of three types:

(*i*) *Capital expenditure* An expenditure incurred for obtaining a long-term advantage for the business.

(*ii*) *Revenue expenditure* An expenditure where benefits expire within a year or which has been incurred merely to maintain the business or keep the assets in good working condition.

(*iii*) *Deferred expenditure* An expenditure or liability for which payment has been made or incurred but which is carried forward on the presumption that it will be of benefit over a ~~subsequent period or periods.~~ This is also referred to as deferred revenue expenditure.

10. **Expense** The term 'Expense' denotes the cost of services and things used for generating revenue.

An 'Expense' is to be distinguished from a Loss. An Expense is supposed to bring some benefit to the firm, whereas a Loss brings no benefit to the firm, *e.g.*, loss by theft, loss by fire, etc.

The terms 8 to 10 discussed above have been explained in detail later in a separate chapter, "Capital and Revenue".

11. **Goods** The term 'Goods' means the property in which the business deals. In other words, 'Goods' are properties for resale. For example, if a furniture dealer purchases furniture for sale, the furniture so purchased will come within the definition of the term 'Goods'. However, if the furniture has been purchased by a furniture dealer for using it in his business, such furniture will come within the definition of the term 'Fixed Assets'.

12. **Debtor** The person who owes money to the business is called a 'Debtor'.

13. **Creditor** A person who has a claim for money against the business is termed as 'Creditor'.

14. **Bill of Exchange** It is a document in ~~writing directing~~ a certain person to pay a certain sum of money to the order of a certain person or to the bearer of the instrument. For example, if *A*, a creditor by a document in writing asks his debtor *B* to pay a sum of ₹10,000 (owed by *B* on account of purchase of certain goods) after 3 months, such a document is termed as 'Bill of Exchange'.

The document will be termed as 'Bill Receivable' for *A* (*i.e.*, the person entitled to get the payment) and a 'Bill Payable' for *B* (*i.e.*, the person who is liable to pay the money under the document).

15. **Accounts Receivable** The term includes both Debtors and Bills Receivable

16. **Accounts Payable** The term included both Creditors and Bills Payable.

17. **Discount** An allowance or a deduction allowed from an amount due is termed as 'Discount'. It may be of three types:

(*i*) *Trade discount* A deduction allowed to the buyers from the gross or catalogue price is termed as 'Trade Discount'.

(*ii*) *Quantity discount* A deduction allowed to the buyers from the gross catalogue price on making bulk purchases is termed as 'Quantity Discount'.

(*iii*) *Cash discount* A discount allowed to a debtor on prompt payment of cash is termed as 'Cash Discount'.

Trade or quantity discount is not taken into account evolute recording accounting transactions. The transactions are recorded at 'net' while cash discount is recorded in the books of account.

18. **Commission** Commission may be termed as remuneration payable to an employee for his services to the firm or to the agent for purchasing or selling goods, collection of debtors on behalf of the firm, etc. The commission is computed as a percentage of the amount involved. The commission earned is considered as an income while commission allowed is considered as an expense for the business.

Following are examples of persons to whom commission may be allowed:

(1) Selling or buying agents.

(2) Brokers and bankers.

(3) Property dealers for helping in renting out or purchase or sale of properties.

(4) Import-export agent in foreign trade.

19. **Merchandise Cost** It is the same as cost of goods sold. It is computed as follows:

	Opening Inventory	....
Add:	Net Purchases (*i.e.*, purchases *less* returns)	....
	Direct Expenses (*i.e.*, expenses incurred for acquiring the goods and making them fit for sale)	....
Less:	Closing Inventory	....
	Cost of goods sold	....

20. **Gross Profit** It is the excess of the selling price over the cost of goods sold (without deducting any expenses incurred in selling the goods).

21. **Net Profit/Income** It is the profit left after deducting all business expenses from the Gross Profit made by the business.

ILLUSTRATION 3.1. Find out merchandise cost, gross profit and net income from the following transactions:

	₹
Purchases (3,000 articles)	25,000
Freight	1,000
Local Taxes	1,000
Salaries	2,500
Shop Rent	500
Godown Rent	500
Electric Charges	600
Municipal Taxes	200
Stationery	250
Furniture (Estimated life 5 years)	12,000
Sales (2,700 articles)	32,000

SOLUTION:

	₹
(*i*) **Merchandise Cost**	
Purchases	25,000
Freight	1,000
Local Taxes	1,000
Cost of 3,000 articles	27,000
Less: Closing Inventory (300 articles)	2,700
	24,300

(*ii*) **Gross Profit**

Sales – Merchandise Cost

= ₹32,000 – 24,300 = ₹7,700

(*iii*) **Net Income**

Gross Profit – All Other Expenses

= ₹7,700 – 6,950* = ₹750

*Includes ₹2,400 as depreciation on Furniture and all other expenses.

22. **Drawings** The withdrawal of goods or cash from the business by the owner for personal use is called 'Drawings'.

23. **Entry** Recording of a transaction in any book of account is called an 'Entry'.

24. **Insolvent** A person who is not in a position to pay his debts in full. It means that the liabilities of such a person are more than his assets.

25. **Solvent** A person who is in a position to pay his debts as they become due.
26. **Bad Debts** The amount lost from a debtor on account of his inability to pay his debts.
27. **Net Assets** The excess of the book value of assets (other than fictitious assets) of an enterprise over its liabilities. This is also referred to as *Net Worth* or *Shareholders' Funds.*
28. **Working Capital** The funds available for day-to-day operations of an enterprise. Also represented by the excess of current assets over current liabilities including short-term loans.

KEY TERMS

1. **Asset:** A tangible object or an intangible right owned by an enterprise and carrying probable future benefits.
2. **Capital:** Owners' equity in the business.
3. **Capital Expenditure:** An expenditure incurred for the purpose of obtaining a long-term advantages for the business.
4. **Goods:** The property in which the business deals.
5. **Liability:** An amount which business owes and has to return or account for.
6. **Revenue:** An income of a recurring nature from any source.
7. **Revenue Expenditure:** An expenditure whose benefit expires within a year or which is incurred merely to maintain the business or keeping the assets in good working condition.

TEST QUESTIONS

Objective Type

1. **State whether each of the following statements is 'True' or 'False':**
   (*i*) The term 'Asset' means a property or possession of the business with the help of which the work of the concern is carried on.
   (*ii*) Wasting Assets are those assets which are meant to be converted into cash in the ordinary course of the firm's business.
   (*iii*) A 'Revenue' denotes the expenditure incurred by the business in earning income.
   (*iv*) A 'Liability' denotes the value in terms of money which the business owes.
   (*v*) Floating Assets are assets those whose value change constantly.
   (*vi*) Circulating Capital is represented by Fixed Assets.
   (*vii*) The terms 'Loss' and 'Expense' have synonymous meaning.
   (*viii*) Goodwill is a current Asset.
   [**Ans.** (*i*) True; (*ii*) False; (*iii*) False; (*iv*) True; (*v*) True; (*vi*) False; (*vii*) False; (*viii*) False]

2. **Fill in the blanks:**
   (*i*) A person who owes money to the firm is a ....
   (*ii*) A person who is entitled to get money from the firm is termed as ....
   (*iii*) All those things which a firm purchases for resale are called ....
   (*iv*) Drawings denote the withdrawal of cash or goods by the owner for ....
   (*v*) The assets used for long-term use in the business are termed as ....
   (*vi*) The excess of Current Assets over Current Liabilities is termed as ....
   [**Ans.** (*i*) debtor; (*ii*) creditor; (*iii*) goods; (*iv*) his personal use; (*v*) fixed assets; (*vi*) working capital]

3. **Choose the correct answer:**
   (*i*) Furniture for a cloth dealer is a
   (*a*) Fixed Asset (*b*) Current Asset
   (*c*) Wasting Assets

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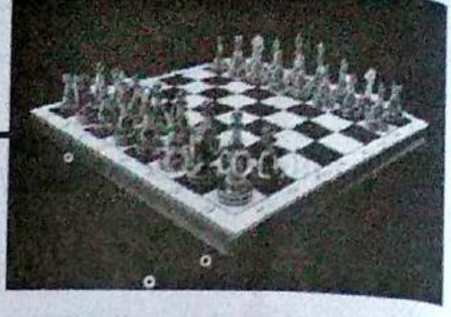
Section – I

Accounting Fundamentals
(*Contd.*)



FOUR

JOURNALIZING TRANSACTIONS

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- identify the stages of the accounting cycle;
- appreciate the role of Journal in recording business transactions;
- understand the rules of debit and credit applicable to different types of business transactions;
- describe the various categories of accounts;
- pass appropriate entries for recording transactions in the Journal;
- explain the meaning of certain key terms

Recording of transaction

It has been explained in Chapter 1, that Accounting is the art of recording, classifying and summarising the financial transactions and interpreting the results therefore. Thus, accounting cycle involves the following stages:

1. **Recording of transactions** This is done in the book termed as 'Journal'.
2. **Classifying the transactions** This is done in the book termed as 'Ledger'.
3. **Summarising the transactions** This includes preparation of the trial balance, profit and loss account and balance sheet of the business.
4. **Interpreting the results** This involves computation of various accounting ratios, etc., to know about the liquidity, solvency and profitability of business. The recording of transactions in the Journal is being explained in this chapter.

JOURNAL

The Journal records all daily transactions of a business into the order in which they occur. A Journal may, therefore, be defined as a book containing a chronological record of transactions. It is the book in which the transactions are recorded first of all under the double entry system. Thus, Journal is the book of original record. A Journal does not replace but precedes the Ledger. The process of recording transaction in a Journal, is termed as Journalising. A proforma of journal is given below:

Journal

Date	*Particulars*	*L.F.*	*Debit* ₹	*Credit* ₹
(1)	(2)	(3)	(4)	(5)

1. **Date** The date on which the transaction was entered is recorded here.
2. **Particulars** The two aspects of transaction are recorded in this column, *i.e.*, the details regarding accounts which have to be debited and credited.
3. **L.F.** It means Ledger Folio. The transactions entered in the Journal are later on posted to the ledger. The relevant ledger folio is entered here. Procedure regarding posting the transactions in the Ledger has been explained in the next chapter.
4. **Debit** In this column, the amount to be debited is entered.
5. **Credit** In this column, the amount to be credited is shown.

ACC | eq

RULES OF DEBIT AND CREDIT

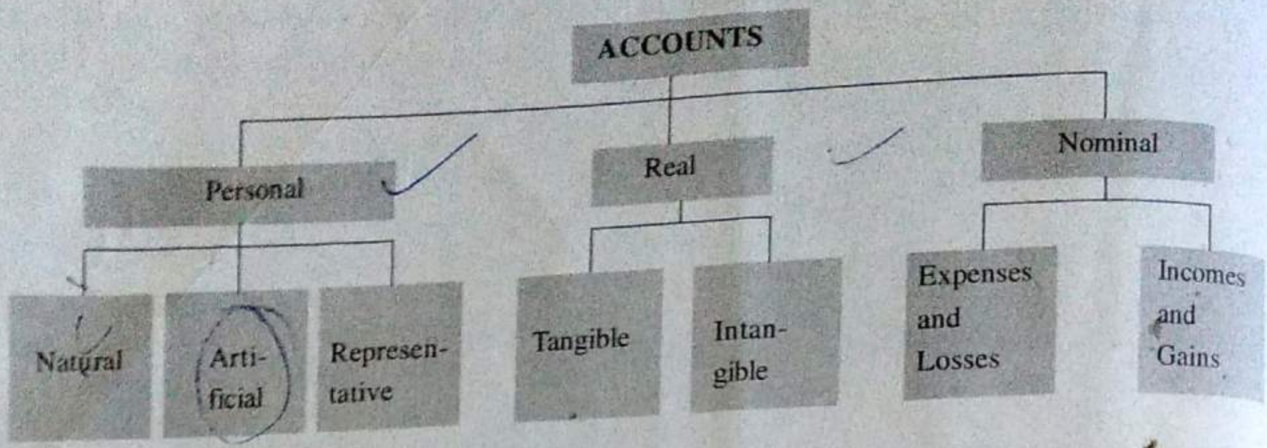
The transactions in the Journal are recorded on the basis of the rules of debit and credit. For this purpose business transactions have been classified into three categories:

(*i*) Transactions relating to persons.
(*ii*) Transactions relating to properties and assets.
(*iii*) Transactions relating to incomes and expenses.

On this basis, it becomes necessary for the business to keep an account of:

(*i*) Each person with whom it deals.
(*ii*) Each property or asset which the business owns.
(*iii*) Each item of income or expense.

The accounts falling under the first heading are called as 'Personal Accounts'. The accounts falling under the second heading are termed as 'Real Accounts'. The accounts falling under the third heading are termed as 'Nominal Accounts'. The classification of the accounts, as explained above, can be put in the form of the following chart:



Each of the above categories of accounts and the relevant rule for 'debit and credit' have been explained in detail in the following pages: Dr. Cr.

Personal accounts Personal accounts include the accounts of persons with whom the business deals. These accounts can be classified into the three categories.

1. *Natural Personal Accounts* The term 'Natural Persons' means persons who are creation of God. For example, Mohan's Account, Sohan's Account, Abha's Account etc.

2. *Artificial Personal Accounts* These accounts include accounts of corporate bodies or institutions which are recognised as persons in business dealings. For example, the account of a Limited Company, the account of a Co-operative Society, the account of a Club, the account of Government, the account of an Insurance Company etc.

3. *Representative Personal Accounts* These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an outstanding rent account will be opened in the books. Similarly, for salaries due to the employees (not paid), an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the accounts of the persons to whom the salaries have to be paid. All such accounts are, therefore, termed as 'Representative Personal Accounts'.

The rule is:

➲ **DEBIT THE RECEIVER**

➲ **CREDIT THE GIVER**

For example, if cash has been paid to Ram, the account of Ram will have to be debited. Similarly, if cash has been received from Keshav, the account of Keshav will have to be credited.

Real accounts Real accounts may be of the following types:

1. *Tangible real accounts* Tangible Real Accounts are those which relate to such things which can be touched, felt, measured etc. Examples of such accounts are cash account, building account, furniture account, stock account, etc. It should be noted that bank account is a personal account; since it represents the account of the banking company—an artificial person.
2. *Intangible real accounts* These accounts represent such things which cannot be touched. Of course, they can be measured in terms of money. For example, patents account, goodwill account, etc.

The rule is: Personal Real T I Nominal

> ➲ **DEBIT WHAT COMES IN**
> ➲ **CREDIT WHAT GOES OUT**

For example, if building has been purchased for cash, building account should be debited (since it is coming into the business) while cash account should be credited (since cash is going out of the business). Similarly when furniture in purchased for cash, furniture account should be debited while the cash account should be credited.

Nominal accounts These accounts are opened in the books to simply explain the nature of the transactions. They do not really exist. For example, in a business, salary is paid to the manager, rent is paid to the landlord, ~~commission is paid to the salesman~~—cash goes out of the business and it is something real; while salary, rent or commission as such do not exist. The accounts of these items are opened simply to explain how the cash has been spent. In the absence of such information, it may be difficult for the person concerned to explain how the cash at his disposal was utilised.

Nominal Accounts include accounts of all expenses, losses, incomes and gains. The examples of such accounts are rent, rates lighting, insurance, dividends, loss by fire, etc.

The rule is:

> ➲ **DEBIT ALL EXPENSES AND LOSSES**
> ➲ **CREDIT ALL GAINS AND INCOMES**

Tutorial Note. Both Real Accounts and Nominal Accounts come in the category of Impersonal Accounts. The student should note that when some prefix or suffix is added to a Nominal Account, it becomes a Personal Account. A table is being given to explain the above rule:

Nominal Account	*Personal Account*
1. Rent account	Rent prepaid account, Outstanding rent account.
2. Interest account	Outstanding interest account, Interest received in advance account, Prepaid interest account.
3. Salary account	Outstanding salaries account, Prepaid salaries account.
4. Insurance account	Outstanding insurance account, Prepaid insurance account.
5. Commission account	Outstanding commission account, Prepaid commission account.

ILLUSTRATION 4.1. From the following transactions find out the nature of account and also state which account should be debited and which account should be credited.

(*a*) Rent paid.
(*b*) Salaries paid.
(*c*) Interest received.
(*d*) Dividends received.
(*e*) Furniture purchased for cash.
(*f*) Machinery sold.
(*g*) Outstanding for salaries.
(*h*) Telephone charges paid.
(*i*) Paid to Suresh.
(*j*) Received from Mohan (the proprietor).
(*k*) Lighting.

Natural Artificial Representative

SOLUTION:

	Transaction	*Accounts Involved*	*Nature of Accounts*	*Debit/Credit*
(*a*)	Rent paid	Rent A/c Cash A/c	Nominal A/c Real A/c	Debit Credit
(*b*)	Salaries paid	Salaries A/c Cash A/c	Nominal A/c Real A/c	Debit Credit
(*c*)	Interest received	Cash A/c Interest A/c	Real A/c Nominal A/c	Debit Credit
(*d*)	Dividends received	Cash A/c Dividends A/c	Real A/c Nominal A/c	Debit Credit
(*e*)	Furniture purchased	Furniture A/c Cash A/c	Real A/c Real A/c	Debit Credit
(*f*)	Machinery sold	Cash A/c Machinery A/c	Real A/c Real A/c	Debit Credit
(*g*)	Outstanding for salaries	Salaries A/c Outstanding Salaries A/c	Nominal A/c Personal A/c	Debit Credit
(*h*)	Telephone charges paid	Telephone Charges A/c Cash A/c	Nominal A/c Real A/c	Debit Credit
(*i*)	Paid to Suresh	Suresh Cash A/c	Personal A/c Real A/c	Debit Credit
(*j*)	Received from Mohan (the proprietor)	Cash A/c Capital A/c	Real A/c Personal A/c	Debit Credit
(*k*)	Lighting	Lighting A/c Cash A/c	Nominal A/c Real A/c	Debit Credit

The journalising of the various transactions is explained now with the help of the following illustration:

ILLUSTRATION 4.2. Ram starts a business with capital of ₹20,000 on January 1, 2011.

In this case there are two accounts involved. They are:

(*i*) The account of Ram.

(*ii*) Cash Account.

SOLUTION:

1. Ram is natural person and, therefore, his account is a Personal Account. Cash Account is a tangible asset and, therefore, it is a Real Account. As per the rules of Debit and Credit, applicable to Personal Accounts, Ram is the giver and, therefore, his account, *i.e.*, Capital Account should be credited. Cash is coming in the business and, therefore, as per the rules applicable to Real Accounts, it should be debited. The transaction will now be entered in the Journal as follows:

Journal

Date	*Particulars*		*L.F.*	*Debit* ₹	*Credit* ₹
2011 Jan. 1	Cash Account To Capital Account (*Being commencement of business*)	Dr.		20,000	20,000

The words put within brackets "Being commencement of business" constitute the narration for the entry passed, since, they narrate the transaction.

2. He purchased furniture for cash for ₹5,000 on January 5, 2011.

The two accounts involved in this transaction are the Furniture Account and the Cash Account. Both are Real Accounts. Furniture is coming in and, therefore, it should be debited while cash is going out and, therefore, it should be credited. The Journal entry will, therefore, be as follows:

Journal

Date	Particulars		L.F.	Debit ₹	Credit ₹
2011 Jan. 5	Furniture Account	Dr.		5,000	
	To Cash Account				5,000
	(Being purchase of furniture)				

3. He paid rent for business premises ₹2,000 on January 10, 2011.

In this transaction, two accounts involved are the Rent Account and the Cash Account. Rent Account is Nominal Account. It is an expense and, therefore, it should be debited. Cash Account is a Real Account. It is going out of the business and, therefore, it should be credited. The journal entry will, therefore, be as follows:

Journal

Date	Particulars		L.F.	Debit ₹	Credit ₹
2011 Jan. 10	Rent Account	Dr.		2,000	
	To Cash Account				2,000
	(Being payment of rent)				

4. He purchased goods on credit of ₹2,000 from Suresh on January 20, 2011.

The two accounts involved in the transaction are those of Suresh and Goods. The account of Suresh is a Personal Account while that of Goods is a Real Account. Suresh is the giver of goods and, therefore, his account should be credited while Goods are coming in the business and, therefore, Goods Account should be debited.

Journal

Date	Particulars		L.F.	Debit ₹	Credit ₹
2011 Jan. 20	Cash Account	Dr.		2,000	
	To Suresh				2,000
	(Being purchase of goods on credit)				

Classification of Goods Account The term goods include articles purchased by the business for resale. Goods purchased by the business may be returned back to the supplier. Similarly, goods sold by the business to its customers can also be returned by the customers back to the business due to certain reasons. In business, it is desired that a separate record be kept of all sale, purchase and return of goods. Hence, Goods Accounts can be classified into the following categories:

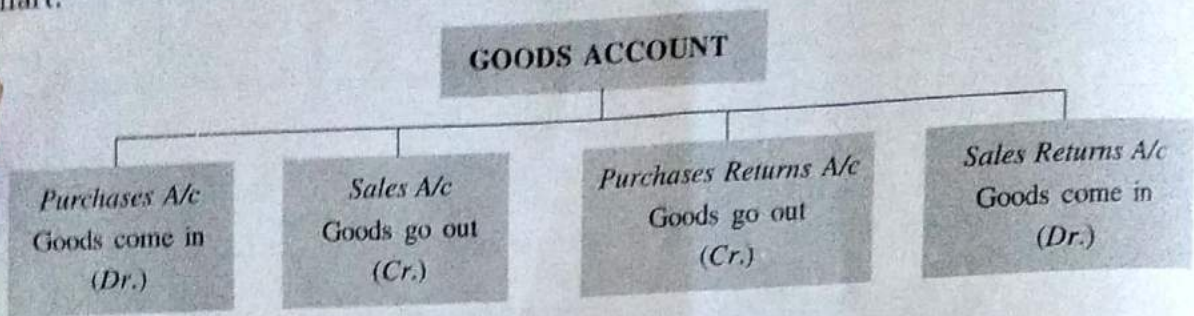
(*i*) *Purchases Account* The account is meant for recording all purchases of goods. Goods "come in" on purchasing of goods and, therefore, the Purchases Account is debited on purchase of goods.

(*ii*) *Sales Account* The account is meant for recording of selling of goods. The goods "go out" on selling of goods, and therefore, on sale of goods, the Sales Account is credited.

(*iii*) *Purchases Returns Account* The account is meant for recording return of goods purchased. The goods "go out" on returning of goods to the suppliers and, therefore, the account should be credited on returning goods purchased.

(*iv*) *Sales Returns Account* The account is meant for recording return of goods sold, by the customers. The goods "come in" and, therefore, the Sales Returns Account should be debited on return of goods.

The above classification of Goods Account can be shown in the form of the following chart:



COMPOUND JOURNAL ENTRY

Sometimes there are a number of transactions on the same date relating to one particular account or of one particular nature. Such transactions may be recorded by means of a single journal entry instead of passing several journal entries. Such entry regarding recording a number of transactions is termed as a "Compound Journal Entry". It may be recorded in any of the following three ways:

(*i*) One particular account may be debited while several other accounts may be credited.

(*ii*) One particular account may be credited while several other accounts may be debited.

(*iii*) Several accounts may be debited and several other accounts may also be credited.

This has been explained in the following illustration:

ILLUSTRATION 4.3. Pass a compound journal entry in each of the following cases:

1. Payment made to Ram ₹1,000. He allowed a cash discount of ₹50.
2. Cash received from Suresh ₹800 and allowed him ₹50 as discount.
3. A running business was purchased by Mohan with the following assets and liabilities: Cash ₹2,000; Land ₹4,000; Furniture ₹1,000; Stock ₹2,000; Creditors ₹1,000; Bank Overdraft ₹2,000.

SOLUTION:

Journal

Sl. No.	*Particulars*	*L.F.*	*Debit* ₹	*Credit* ₹
1.	Ram Dr.		1,050	
	To Cash A/c			1,000
	To Discount A/c			50
	(Being payment made to Ram ₹1,000 and he allowed ₹50 as discount)			

(Contd..)

Sl. No.	Particulars		L.F.	Debit ₹	Credit ₹
2.	Cash A/c	Dr.		800	
	Discount A/c	Dr.		50	
	To Suresh				850
	(Being cash received from Suresh ₹800 and discount allowed ₹50)				
3.	Cash A/c	Dr.		2,000	
	Land A/c	Dr.		4,000	
	Furniture A/c	Dr.		1,000	
	Stock A/c	Dr.		2,000	
	To Creditors				1,000
	To Bank Overdraft				2,000
	To Capital A/c				6,000
	(Being commencement of business by Mohan by taking over a running business)				

Notes:

1. The total of payment due to Ram was ₹1,050. A payment of ₹1,000 has been made to him and he allowed a discount of ₹50. This means by paying ₹1,000, a full credit for ₹1,050 has been obtained. The account of Ram is a Personal Account, and therefore, it has been debited as he is the receiver. The cash has gone out of the business and, therefore, Cash Account being a Real Account, has been credited. Discount Account is a Nominal Account; getting discount is a gain to the business and, therefore, it has been credited.
2. Suresh was to pay sum of ₹850. He paid ₹800 and he was allowed a discount of ₹50. It means by paying ₹800 only, Suresh could get a full credit of ₹850. The Cash Account is a Real Account and, therefore, it has been debited since cash is coming in. Discount Account is a Nominal Account; it has been debited since it is a loss to the business. Suresh is the giver. His account being a Personal Account, it has been credited by ₹850.
3. It is not necessary that a person should start business only with cash. He may bring the assets into the business or he may purchase a running business. Mohan in the present case has purchased the assets of some other business. The net assets (*i.e.* assets–liabilities taken over) will be the capital of Mohan. The business is getting various assets and, therefore, the assets accounts have been debited. The business creates certain liabilities in the form of creditors, bank overdraft, and, therefore, these accounts have been credited. Mohan's Account, *i.e.*, his Capital Account has been credited by the balance since it represents the capital brought in by him.

ILLUSTRATION 4.4. Journalize the following transactions for the month of Dec. 2011. Also state the nature of each account involved in the Journal entry.

1. Dec. 1: Ajit started business with Cash ₹40,000.
2. Dec. 3: He paid into the Bank ₹2,000.
3. Dec. 5: He purchased goods for cash ₹15,000.
4. Dec. 8: He sold goods for cash ₹6,000.
5. Dec. 10: He purchased furniture and paid by cheque ₹5,000.
6. Dec. 12: He sold goods to Arvind ₹4,000.
7. Dec. 14: He purchased goods from Amrit ₹10,000.
8. Dec. 15: He returned goods to Amrit ₹5,000.
9. Dec. 16: He received from Arvind ₹3,960 in full settlement.
10. Dec. 18: He withdrew goods for personal use ₹1,000.
11. Dec. 20: He withdrew cash from business for personal use ₹2,000.
12. Dec. 24: He paid telephone charges ₹1,000.
13. Dec. 26: Cash paid to Amrit in full settlement ₹4,900.
14. Dec. 31: Paid for stationary ₹200, rent ₹500 and salaries to staff ₹2,000.
15. Dec. 31: Goods distributed by way of free samples ₹1,000.

Sales A/C = 6000
Stock
Cheque → bank A/c
personal use → Drawing
full settlement → discount
Discount
Drawing

SOLUTION:

Journal

Sl. No.	Date	Particulars		Nature of Account	L.F.	Debit ₹	Credit ₹
1.	Dec. 1	Cash A/c	Dr.	Real A/c		40,000	
		To Capital A/c		Personal A/c			40,000
		(Being commencement of business)					
2.	Dec. 3	Bank A/c	Dr.	Personal A/c		2,000	
		To Cash A/c		Real A/c			2,000
		(Being cash deposited in the bank)					
3.	Dec. 5	Purchases A/c	Dr.	Real A/c		15,000	
		To Cash A/c		Real A/c			15,000
		(Being purchase of goods for cash)					
4.	Dec. 8	Cash A/c	Dr.	Real A/c		6,000	
		To Sales A/c		Real A/c			6,000
		(Being goods sold for cash)					
5.	Dec. 10	Furniture A/c	Dr.	Real A/c		5,000	
		To Bank A/c		Personal A/c			5,000
		(Being purchase of furniture, paid by cheque)					
6.	Dec. 12	Arvind	Dr.	Personal A/c		4,000	
		To Sales A/c		Real A/c			4,000
		(Being sale of goods)					
7.	Dec. 14	Purchases A/c	Dr.	Real A/c		10,000	
		To Amrit		Personal A/c			10,000
		(Being purchase of goods from Amrit)					
8.	Dec. 15	Amrit	Dr.	Personal A/c		5,000	
		To Purchases Returns A/c		Real A/c			5,000
		(Being goods returned to Amrit)					
9.	Dec. 16	Cash A/c	Dr.	Real A/c		3,960	
		Discount A/c	Dr.	Nominal A/c		40	
		To Arvind		Personal A/c			4,000
		(Being cash received from Arvind in full settlement and allowed him ₹40 as discount)					
10.	Dec. 18	Drawings A/c	Dr.	Personal A/c		1,000	
		To Purchases A/c		Real A/c			1,000
		(Being withdrawal of goods for personal use)					
11.	Dec. 20	Drawings A/c	Dr.	Personal A/c		2,000	
		To Cash A/c		Real A/c			2,000
		(Being cash withdrawal from the business for personal use)					
12.	Dec. 24	Telephone Expenses A/c	Dr.	Nominal A/c		1,000	
		To Cash A/c		Real A/c			1,000
		(Being telephone expenses paid)					

(Contd.)

Purch

Sl. No.	Date	Particulars		Nature of Account	L.F.	Debit ₹	Credit ₹
13.	Dec. 26	Amrit	Dr.	Personal A/c		5,000	
		To Cash A/c		Real A/c			4,900
		To Discount A/c		Nominal A/c			100
		(Being cash paid to Amrit and he allowed ₹100 as discount)					
14.	Dec. 31	Stationery Expenses	Dr.	Nominal A/c		200	
		Rent A/c	Dr.	Nominal A/c		500	
		Salaries A/c	Dr.	Nominal A/c		2,000	
		To Cash A/c		Real A/c			2,700
		(Being expenses paid)					
15.	Dec. 31	Advertisement Expenses A/c	Dr.	Nominal A/c		1,000	
		To Purchases A/c		Real A/c			1,000
		(Being distribution of goods by way of free samples)					
		TOTAL				1,21,700	1,21,700

Notes:

Transaction 9. Ajit was to receive ₹4,000 from Arvind. He accepts only ₹3,960 in full settlement. It means, he allows ₹40 as discount to him. The journal entries will be:

(*i*) Cash A/c	Dr.	3,960	
To Arvind			3,960
(*ii*) Discount A/c	Dr.	40	
To Arvind			40

A single entry may be passed in place of two entries stated above. Cash is a Real Account and, therefore, it should be debited. Discount is a Nominal Account and, therefore, it should also be debited. The account of Arvind is a Personal Account and he is entitled to get a full credit of ₹4,000 by paying only ₹3,960. His account should, therefore, be credited by ₹4,000.

It may be remembered that cash or bank account and discount account go together. It means if cash is debited, the discount account should also be debited. In case the cash is credited, the discount account should also be credited. This is because when cash is received, discount is allowed to debtors. Cash Account is a Real Account and, therefore, it should be debited by the amount of cash actually received. The discount account is a Nominal Account and, therefore, on receipt of cash when discount is allowed, this is a loss which should be debited. Similarly, when cash is paid, discount is earned from the creditors. On payment of cash, therefore, Cash Account should be credited (since cash is a Real Account and it is going out of the business) and Discount Account should be credited (since Discount Account is a Nominal Account and discount received is a gain to the business).

Transaction 10. When goods are withdrawn by the proprietor of the business for his personal use, he is to be charged for them since business and the proprietor are two different persons as per separate entity concept. The problem is at what price should he be charged? He cannot be charged at the selling price for the goods. It will not be fair. He has to be charged with only the cost price of the goods withdrawn by him. It will be, therefore, appropriate to reduce the purchase of the business by the amount of goods withdrawn by the proprietor for his personal use as if the goods were purchased partly for the business and partly for him.

The same rule applies in those cases, where the goods purchased by the business are used for the purpose of business itself. For example, in case of a stationary business, some stationery may be used for the business itself. In such case, the following journal entry will be passed:

Stationery Expenses Account	Dr.		
To Purchases Account			

The same rule has been followed in case of the last entry given in the illustration.

Transaction 13. In case of this transaction two entries could have been passed as under:

(*i*) Amrit	Dr.	4,900	
To Cash A/c			4,900
(*ii*) Amrit	Dr.	100	
To Discount A/c			100

In place of passing the above two entries a single compound entry has been passed.

Transaction 14. Three entries could have been based as follows:

(*i*) Stationery Expenses A/c	Dr.	200	
To Cash A/c			200
(*ii*) Rent A/c	Dr.	500	
To Cash A/c			500
(*iii*) Salaries A/c	Dr.	2,000	
To Cash A/c			2,000

In place of these three entries, a single compound entry has been passed.

Illustration 4.5.

1. Ram started business by introducing the following assets:

Cash	₹10,000
Furniture	₹20,000
Plant	₹30,000
Goods	₹20,000

2. He purchased goods of the invoice value of ₹10,000 at 10% trade discount from Suresh.
3. He supplied goods costing ₹1,000 to Ramesh at a invoice price of 10% above cost at a trade discount of 5%.
4. He installed further machinery of ₹20,000 and paid wages for installation ₹2,000. The machinery was supplied by M/s Surya Brothers. Expenses Debit
5. He purchased stationery for business purposes ₹500.
6. He sold goods to Sidharth for ₹5,000.
7. He withdrew goods for personal use costing ₹5,000 (sale value ₹6,000).
8. He distributed goods costing ₹2,000 (sale value ₹2,500 as free samples).
9. Sidharth became insolvent and the whole money due from him was considered as a bad debt.
10. He sold goods for cash ₹20,000.
11. Salaries paid ₹10,000 after deduction ₹1,000 as income tax, ₹1,500 as employee's share of provident fund but before employer's share of provident fund ₹1,500.
12. Amount due from Sidharth earlier written off bad debts recovered in full.
13. Amount paid to Suresh ₹8,500 in full satisfaction.
14. Income tax liability of Ram ₹1,000 paid in cash.

You are required to pass the necessary journal entries for the above transactions.

SOLUTION:

Journal

Sl. No.	Date	Particulars		L.F.	Debit ₹	Credit ₹
1.		Cash A/c	Dr.		10,000	
		Furniture A/c	Dr.		20,000	
		Plant A/c	Dr.		30,000	
		Purchases (Goods)	Dr.		20,000	
		To Ram's Capital				80,000
		(Being commencement of business with cash and other assets)				
2.		Purchases A/c	Dr.		9,000	
		To Suresh				9,000
		(Being purchase of goods from Suresh) (Invoice price ₹10,000 less Trade Discount 10%)				
3.		Ramesh	Dr.		1,045	
		To Sales A/c				1,045
		(Being goods sold invoice price of ₹1,100 less trade discount of 5%)				
4.		Machinery	Dr.		22,000	
		To Cash				2,000
		To Surya Brothers				20,000
		(Being cost of machinery purchased ₹20,000; installation charges incurred ₹2,000)				
5.		Stationery A/c	Dr.		500	
		To Cash				500
		(Being stationery purchased for business purposes)				
6.		Sidharth	Dr.		5,000	
		To Sales				5,000
		(Being sale of goods to Sidharth)				
7.		Drawings	Dr.		5,000	
		To Purchases A/c				5,000
		(Being goods withdrawn for personal use)				
8.		Advertisement A/c	Dr.		2,000	
		To Purchases A/c				2,000
		(Being goods distributed by way of free samples)				
9.		Bad Debts	Dr.		5,000	
		To Sidharth				5,000
		(Being money due from Sidharth written off as bad debts)				
10.		Cash	Dr.		20,000	
		To Sales				20,000
		(Being sale of goods for cash)				

(Contd...)

$\frac{1100}{100} \times 5$

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Sl. No.	Date	Particulars		L.F.	Debit ₹	Credit ₹
11.		Salaries	Dr.		14,000	
		To Cash				10,000
		To Tax Deducted at Source				1,000
		To Employees Provident Fund				3,000
		(Being payment of salary after deduction of tax at source and employer's and employees contibution to Provident Fund)				
12.		Cash	Dr.		5,000	
		To Bad Debts Recovered A/c				5,000
		(Being amount earlier written off as bad debts and now recovered)				
13.		Suresh	Dr.		9,000	
		To Cash				8,500
		To Discount				500
		(Being amount paid to Suresh and earned ₹500 as cash discount)				
14.		Drawings A/c	Dr.		1,000	
		To Cash				1,000
		(Being Income tax paid)				
		TOTAL			1,78,045	1,78,045

Notes:

8. Trade discount is not recorded in the books. Goods are recorded at the net price.
9. Goods written off for personal use are recorded at cost. The sales value has no significance.
11. Employer's contribution to Provident Fund is taken as a part of Salary and debited to Salaries A/c. Later on both the employee's and employer's contribution to provident fund are deposited with the Provident Fund Authorities by the employer.
12. The money earlier written off as bad debt now recovered is to be credited to a separate account, *i.e.*, bad debts recovered account. It has not to be credited to debtor's account since it has already been closed.
14. Personal tax liability of the proprietor is taken as his drawings.

OPENING ENTRY

In case of a running business, the assets and liabilities appearing in the previous year's balance sheet will have to be brought forward to the current year. This is done by means of a journal entry which is termed as "Opening Entry". All Assets Accounts are debited while all Liabilities Accounts are credited. The excess of assets over liabilities is the proprietor's capital and is credited to his Capital Account. This will be clear with the help of the following illustration:

Illustration 4.6. Pass the Opening Entry on January 1, 2011 on the basis of the following information taken from the business of Mr. Sunil:

		₹
(i)	Cash in Hand	2,000
(ii)	Sundry Debtors	6,000
(iii)	Stock of Goods	4,000
(iv)	Plant	5,000
(v)	Land and Buildings	10,000
(vi)	Sundry Creditors	10,000

SOLUTION:

Journal

Date	Particulars		L.F.	Debit ₹	Credit ₹
2011 Jan.1	Cash A/c	Dr.		2,000	
	Sundry Debtors A/c	Dr.		6,000	
	Stock A/c	Dr.		4,000	
	Plant A/c	Dr.		5,000	
	Land & Buildings A/c	Dr.		10,000	
	To Sundry Creditors				10,000
	To Capital A/c (balancing figure)				17,000
	(Being balances brought forward from the last year)				
	TOTAL			27,000	27,000

ILLUSTRATION 4.7. Journalize the following transactions in the books of a trader.

Debit Balances on Jan. 1, 2011:

1.	Jan. 01	Cash in hand	₹8,000
		Cash at Bank	₹25,000
		Stock of Goods	₹20,000
		Furniture	₹2,000
		Building	₹10,000
		Sundry Debtors:	
		Vijay	₹2,000
		Anil	₹1,000
		Madhu	₹2,000

Credit Balances on Jan. 1, 2011:

Sundry Creditors	
Anand	₹5,000
Loan from Bablu	₹10,000

Vijay A

Following were further transactions in the month of January, 2011:

2. Jan. 01 Purchased goods worth ₹5,000 for cash *less* 20% trade discount and 5% cash discount.
3. Jan. 04 Received ₹1,980 from Vijay and allowed him ₹20 as discount.
4. Jan. 06 Purchased goods from Bharat ₹5,000.
5. Jan. 08 Purchased plant from Mukesh for ₹5,000 and paid ₹100 as cartage for bringing the plant to the factory and another ₹200 as installation charges. — Expense or Asset
6. Jan. 12 Sold goods to Rahim on credit ₹600.
7. Jan. 15 Rahim became an insolvent and could pay only 50 paise in a rupee.
8. Jan. 18 Sold goods to Ram for cash ₹1,000.
9. Jan. 20 Paid salary to Ratan ₹2,000. — why cash & not Ratan
10. Jan. 21 Paid Anand ₹4,800 in full settlement.
11. Jan. 26 Interest received from Madhu ₹200.
12. Jan. 28 Paid to Bablu interest on loan ₹500.
13. Jan. 31 Sold Goods for cash ₹500.
14. Jan. 31 Withdrew goods from business for personal use ₹200.

$5000 \times \frac{20}{100}$

$4000 \times \frac{5}{100}$

200

3800

SOLUTION:

Journal

Sl. No.	Date	Particulars		L.F.	Debit ₹	Credit ₹
1.	2011 Jan. 1	Cash A/c	Dr.		8,000	
		Bank A/c	Dr.		25,000	
		Stock A/c	Dr.		20,000	
		Furniture A/c	Dr.		2,000	
		Building A/c	Dr.		10,000	
		Vijay	Dr.		2,000	
		Anil	Dr.		1,000	
		Madhu	Dr.		2,000	
		To Anand				5,000
		To Bablu's Loan A/c				10,000
		To Capital A/c				55,000
		(Being balances brought forward from last year)				
2.	Jan. 1	Purchases A/c	Dr.		4,000	
		To Cash A/c				3,800
		To Discount A/c				200
		(Being purchase of goods for cash worth ₹5,000 allowed 20% trade discount and 5% cash discount on ₹4,000)				
3.	Jan. 4	Cash A/c	Dr.		1,980	
		Discount A/c	Dr.		20	
		To Vijay				2,000
		(Being cash received from Vijay, allowed ₹20 as cash discount)				
4.	Jan. 4	Purchases A/c	Dr.		5,000	
		To Bharat				5,000
		(Being purchases of goods from Bharat)				
5.	Jan. 8	Plant A/c	Dr.		5,300	
		To Mukesh				5,000
		To Cash				300
		(Being purchase of plant for ₹5,000 and payment of ₹100 as cartage and ₹200 as installation charges)				
6.	Jan. 12	Rahim	Dr.		600	
		To Sales A/c				600
		(Being sale of goods to Rahim)				
7.	Jan. 15	Cash A/c	Dr.		300	
		Bad Debts A/c	Dr.		300	
		To Rahim				600
		(Being cash received from Rahim after his being declared as an insolvent. 50% of the amount due has been received and the rest has been taken as a bad debt)				
8.	Jan. 18	Cash A/c	Dr.		1,000	
		To Sales A/c				1,000
		(Being cash sales)				
9.	Jan. 20	Salary A/c	Dr.		2,000	
		To Cash				2,000
		(Being salary paid)				

(Contd...)

Sl. No.	Date	Particulars		L.F.	Debit ₹	Credit ₹
10.	Jan. 21	Anand	Dr.		5,000	
		To Cash				4,800
		To Discount				200
		(Being cash paid to Anand and he allowed ₹200 as discount)				
11.	Jan. 26	Cash A/c	Dr.		200	
		To Interest				200
		(Being receipt of interest)				
12.	Jan. 28	Interest on Loan	Dr.		500	
		To Cash				500
		(Being payment of interest on loan)				
13.	Jan. 31	Cash A/c	Dr.		500	
		To Sales A/c				500
		(Being goods sold for cash)				
14.	Jan. 31	Drawings A/c	Dr.		200	
		To Purchases A/c				200
		(Being goods withdrawn for personal use)				
		TOTAL			96,900	96,900

ILLUSTRATION 4.8. Journalize the following transactions:

1. Purchased goods from Mukesh & Co. on credit ₹10,000.
2. On obtaining delivery of goods, it was found that the goods have been damaged to the extent of ₹1,000.
3. Mukesh & Co. admitted the claim for breakage to the extent of ₹800. Debit / Credit

SOLUTION:

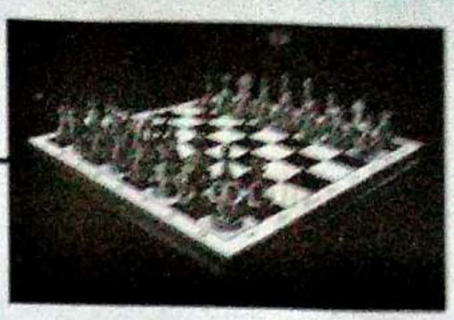
Journal

Sl. No.	Date	Particulars		L.F.	Debit ₹	Credit ₹
1.		Purchases A/c	Dr.		10,000	
		To Mukesh & Co.				10,000
		(Being goods purchased from Mukesh & Co.)				
2.		Loss in Transit A/c	Dr.		1,000	
		To Purchases A/c /Cash A/c				1,000
		(Being damage to the goods purchased in transit)				
3.		Mukesh & Co.	Dr.		800	
		To Loss in Transit A/c				800
		(Being claim admitted for loss in transit by Mukesh & Co.)				

Note: The entries show that against a loss of ₹1,000, Mukesh & Co. has admitted a claim of only ₹800. The loss of ₹200 will have to be suffered by the proprietor of the business. He will transfer this loss to the Profit and Loss Account at the end of the accounting year.

Section – I

Accounting Fundamentals
(*Contd.*)



FIVE

LEDGER POSTING AND TRIAL BALANCE

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- appreciate the role of Ledger in recording business transactions;
- understand the meaning and rules regarding posting;
- describe the meaning and the objects of preparing a trial balance;
- make posting and prepare a trial balance;
- explain the meaning of certain key terms

It has already been explained in an earlier chapter that accounting involves recording, classifying and summarising the financial transactions. Recording is done in the Journal. This has already been explained in the preceding chapter. Classifying of the recorded transactions is done in the Ledger. This is being explained in the present chapter.

LEDGER

Ledger is a book which contains various accounts. In other words, Ledger is a set of accounts. It contains all accounts of the business enterprise whether Real, Nominal or Personal. It may be kept in any of the following two forms:

(*i*) Bound Ledger (*ii*) Loose-leaf Ledger.

It is common to keep the Ledger in the form of loose-leaf cards these days. This helps in posting transactions particularly when mechanised system of accounting is used.

POSTING

The term "Posting" means transferring the debit and credit items from the Journal to their respective accounts in the Ledger. It should be noted that the exact names of accounts used in the Journal should be carried to the Ledger. For example, if in the Journal, Expenses Account has been debited, it would not be correct to debit the Office Expenses Account in the Ledger. Though, in the Journal, it might have been indicated clearly in the narration that it is an item of office expenses the correct course would have been to record the amount to the Office Expenses Account in the Journal as well as in the Ledger.

Posting may be done at any time. However, it should be completed before the financial statements are prepared. It is advisable to keep the more active accounts posted to date. The examples of such accounts are the cash account, personal accounts of various parties etc.

The posting may be done by the book-keeper from the Journal to the Ledger by any of the following methods:

(*i*) He may take a particular side first. For example, he may take the debits first and make the complete postings of all debits from the Journal to the Ledger.

(*ii*) He may take a particular account and post all debits and credits relating to that account appearing on one particular page of the Journal. He may then take some other accounts and follow the same procedure.

(*iii*) He may complete postings of each journal entry before proceeding to the next journal entry.

It is advisable to follow the last method. One should post each debit and credit item as it appears in the Journal.

The Ledger Folio (L.F.) column in the Journal is used at the time when debits and credits are posted to the Ledger. The page number of the Ledger on which the posting has been done is mentioned in the L.F. column of the Journal. Similarly, a folio column in the Ledger can also be kept where the page from which posting has been done from the Journal may be mentioned. Thus, there are cross references in both the Journal and the Ledger.

A proper index should be maintained in the Ledger giving the names of the accounts and the page numbers.

RELATIONSHIP BETWEEN JOURNAL AND LEDGER

Both Journal and Ledger are the most important books used under Double Entry System of book-keeping. Their relationship can be expressed as follows:

(*i*) The transactions are recorded first of all in the Journal and then they are posted to the Ledger. Thus, the Journal is the book of first or original entry, while the Ledger is the book of second entry.

(*ii*) Journal records transactions in a chronological order, while the Ledger records transactions in an analytical order.

(*iii*) Journal is more reliable as compared to the Ledger since it is the book in which the entry is passed first of all.

(*iv*) The process of recording transactions is termed as "Journalising" while the process of recording transactions in the Ledger is called as "Posting".

Recording
Classifying
Summarizing

RULES REGARDING POSTING

The following rules should be observed while posting transactions in the Ledger from the Journal:

(*i*) Separate accounts should be opened in the Ledger for posting transactions relating to different accounts recorded in the Journal. For example, separate accounts may be opened for sales, purchases, sales returns, purchases returns, salaries, rent, cash, etc.

(*ii*) The concerned account which has been debited in the Journal should also be debited in the Ledger. However, a reference should be made of the other account which has been credited in the Journal. For example, for salaries paid, the salaries account should be debited in the Ledger, but reference should be given of the Cash Account which was has been credited in the Journal.

(*iii*) The concerned account, which has been credited in the Journal should also be credited in the Ledger, but reference should be given of the account, which has been debited in the Journal. For example, for salaries paid, Cash Account has been credited in the Journal. It will be credited in the Ledger also, but reference will be given of the Salaries Account in the Ledger.

Thus, it may be concluded that while making posting in the Ledger, the concerned account which has been debited or credited in the Journal should also be debited or credited in the Ledger, but reference has to be given of the other account which has been credited or debited in the Journal, as the case may be. This will be clear with the following example.

Suppose, salaries of ₹10,000 have been paid is cash; the following entry will be passed in the Journal:

Salaries Account	(*i*)	Dr.	10,000	
To Cash Account	(*ii*)			10,000

In the Ledger two accounts will be opened, (*i*) Salaries Account, and (*ii*) Cash Account. Since Salaries Account has been debited in the Journal, it will also be debited in the Ledger. Similarly, Cash Account has been credited in the Journal and, therefore, it will also be credited in the Ledger, but reference will be given of the other account involved. Thus, the accounts will appear as follows in the Ledger:

Dr. **Salaries Account** Cr.

Particulars	₹	*Particulars*	₹
Cash A/c (*ii*)	10,000		

Cash Account Cr.

Particulars	₹	Particulars	₹
		Salaries A/c (i)	10,000

Use of the words "To" and "By"

It is customary to use words "To and 'By' while making posting in the Ledger. The word "To' is used with the accounts which appear on the debit side of a Ledger Account. For example, in the Salaries Account, instead of writing only "Cash" as shown above, the words "To Cash" will appear on the debit side of the account. Similarly, the word "By" is used with accounts which appear on the credit side of a Ledger Account. For example, in the above case, the words "By Salaries A/c" will appear on the credit side of the Cash Account instead of only "Salaries A/c". The words 'To' and 'By' do not have any specific meanings. Modern accountants are, therefore, ignoring the use of these words.

The procedure of posting from the Journal to the Ledger will be clear with the help of the illustrations given in the following pages.

Illustration 5.1. Journalize the following transactions and post them into the Ledger:

1. Ram started business with a capital of ₹10,000.
2. He purchased furniture for cash ₹4,000.
3. He purchased goods from Mohan on credit ₹2,000.
4. He paid cash to Mohan ₹1,000.

Solution:

Journal

	Date	Particulars		L.F.	Debit ₹	Credit ₹	
1		Cash Account	Dr.		10,000		
		To Capital Account				10,000	5
2		Furniture Account	Dr.		4,000		
		To Cash Account				4,000	6
3		Purchases Account	Dr.		2,000		
		To Mohan				2,000	7
4		Mohan	Dr.		1,000		
		To Cash Account				1,000	8

Ledger

Cash Account

1	To Capital A/c	10,000	By Furniture A/c	4,000	6
			By Mohan	1,000	8

Capital Account

			By Cash A/c	10,000	5

Furniture Account

2	To Cash A/c	4,000			

Purchases Account

3	To Mohan	2,000			

Mohan

4	To Cash A/c	1,000	By Purchases A/c	2,000	7

Balancing of an Account

In business, there may be several transactions relating to one particular account. In Journal, these transactions appear on different pages in a chronological order while they appear in a classified form under that particular account in the Ledger. At the end of a period (say, a month, a quarter or a year), the businessman will be interested in knowing the position of a particular account. This means, he should total the debits and credits of the account separately and find out the net balance. This technique of finding out the net balance of an account, after considering the totals of both debits and credits appearing in the account is known as 'Balancing the Account'. The balance is put on the side of the account which is smaller and a reference is given that it has been carried forward or carried down (*c/f* or *c/d*) to the next period. On the other hand, in the next period, a reference is given that the opening has been brought forward or brought down (*b/f* or *b/d*) from the previous period. This will be clear with the help of the following illustration.

ILLUSTRATION 5.2. Journalize the following transactions, post them in the Ledger and balance the accounts on 31st January.

1. Ram started business with a capital of ₹10,000.
2. He purchased goods from Mohan on credit ₹2,000.
3. He Paid cash to Mohan ₹1,000.
4. He sold goods to Suresh ₹2,000.
5. He received cash from Suresh ₹3,000.
6. He further purchased goods from Mohan ₹2,000.
7. He paid cash to Mohan ₹1,000.
8. He further sold goods to Suresh ₹2,000.
9. He received cash from Suresh ₹1,000.

SOLUTION:

Journal

Particulars		L.F.	*Debit* ₹	*Credit* ₹
Cash Account To Capital Account *(Being commencement of business)*	Dr.		10,000	10,000
Purchases Account To Mohan *(Being purchase of goods on credit)*	Dr.		2,000	2,000
Mohan To Cash *(Being payment of cash to Mohan)*	Dr.		1,000	1,000
Suresh To Sales *(Being goods sold to Suresh)*	Dr.		2,000	2,000
Cash Account To ~~Mohan~~ Suresh *(Being cash received from Suresh)*	Dr.		3,000	3,000

(*Contd...*)

Particulars		L.F.	Debit ₹	Credit ₹
Purchases Account To Mohan *(Being purchase of goods from Mohan)*	Dr.		2,000	2,000
Mohan To Cash Account *(Being payment of cash to Mohan)*	Dr.		1,000	1,000
Suresh To Sales Account *(Being goods sold to Suresh)*	Dr.		2,000	2,000
Cash Account To Suresh *(Being cash received from Suresh)*	Dr.		1,000	1,000
TOTAL			24,000	24,000

Ledger

Cash Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Capital A/c	10,000		By Mohan	1,000
	To Suresh	3,000		By Mohan	1,000
	To Suresh	1,000	Jan. 31	By Balance c/d	12,000
		14,000			14,000
Feb. 1	To Balance b/d	12,000			

Capital Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	10,000		By Cash A/c	10,000
		10,000			10,000
			Feb. 1	By Balance b/d	10,000

Purchases Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Mohan	2,000	Jan. 31	By Balance c/d	4,000
	To Mohan	2,000			
		4,000			4,000
Feb. 1	To Balance b/d	4,000			

Mohan

Date	Particulars	₹	Date	Particulars	₹
	To Cash	1,000		By Purchases	2,000
	To Cash	1,000		By Purchases	2,000
	To Balance c/d	2,000			
		4,000			4,000
			Feb. 1	By Balance b/d	2,000

Dr. **Suresh** Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Sales	2,000		By Cash A/c	3,000
	To Sales	2,000		By Cash A/c	1,000
		4,000			4,000

Dr. **Sales Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	4,000		By Suresh	2,000
				By Suresh	2,000
		4,000			4,000
			Feb. 1	By Balance b/d	4,000

It is to be noted that the balance of an account is always known by the side which is greater. For example, in the above illustration, the debit side of the Cash Account is greater than the credit side by ₹12,000. It will be, therefore, said that Cash Account is showing a debit balance of ₹12,000. Similarly, the credit side of the Capital Account is greater than debit side by ₹10,000. It will be, therefore, said that the Capital Account is showing a credit balance of ₹10,000.

TRIAL BALANCE

In case the various debit balances and the credit balances of the different accounts are taken down in a statement, the statement so prepared is termed as a Trial Balance. In other words, Trial Balance is a statement containing the various ledger balances on a particular date. For example, with the balances of the ledger accounts prepared in Illustration 5.2, the Trial Balance can be prepared as follows:

Trial Balance
as on 31st January

Particulars	Debit ₹	Credit ₹
Cash Account	12,000	
Capital Account		10,000
Purchases Account	4,000	
Mohan		2,000
Sales Account		4,000
	16,000	16,000

Thus, the two sides of the Trial Balance tally. It means the books of accounts are arithmetically accurate.

Objects of Preparing a Trial Balance

1. *Checking of the arithmetical accuracy of the accounting entries* As indicated above, Trial Balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept for every debit, there must be an equivalent credit. Trial Balance represents a summary of all ledger balances and, therefore, if the two sides of the Trial Balance tally, it is an indication of this fact that the books of account are arithmetically accurate. Of course, there may be certain errors in the books of account in spite of an agreed Trial Balance. For example, if a transaction has been completely omitted from the books of account, the two sides of the Trial Balance will tally, in spite of the books of account being wrong. This has been discussed in detail later in a separate chapter.
2. *Basis for financial statements* Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarised form for a particular period. In case the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements as stated above to know the profit or loss made by the business during a particular period or its financial position on a particular date.
3. *Summarised ledger* It has already been stated that a Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarised in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The Ledger may be seen only when details regarding the accounts are required.

Methods of Preparation of a Trial Balance

A Trial Balance may be prepared according to any of the two methods:

1. **Total Method** In case of this method after totaling each side of the ledger account, the respective debit and credit totals of the ledger accounts are transferred to the respective sides of the trial balance. Thus, in case of this method, the trial balance can be prepared soon after totaling various accounts and the time taken in balancing the account is saved to that extent. This method is not generally followed since it does not help in preparation of financial statements.
2. **Balance Method** According to this method, every ledger account is balanced and only the balance of the ledger account is carried forward to the trial balance. This method is generally used since it helps the preparation of the financial statements where only balances are to be taken.
3. **Total and Balance Method** This method combines the first two methods explained above. In case of this method, the trial balance contains both the totals of both sides of the respective accounts as well as their final balances. This method has the advantage that it helps in immediate location of a mistake incurred, if any in the balancing the account. However, it has disadvantage of increasing the workload of the staff.

ILLUSTRATION 5.3. Prepare (*a*) ledger accounts and (*b*) the trial balance according to (*i*) Total method (*ii*) Balance method and (*iii*) Total and balance method on the basis of transactions given in Illustration 4.7.

SOLUTION:

(*a*) Preparation of Ledger Accounts

Dr. **Cash Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Jan. 1	To Balance b/d	8,000	Jan. 1	By Purchases A/c	3,800
Jan. 4	To Vijay	1,980	Jan. 8	By Plant A/c	300
Jan. 15	To Rahim	300	Jan. 20	By Salary A/c	2,000
Jan. 18	To Sales A/c	1,000	Jan. 21	By Anand	4,800
Jan. 26	To Interest A/c	200	Jan. 28	By Interest on Loan A/c	500
Jan. 31	To Sales A/c	500	Jan. 31	By Balance c/d	580
		11,980			11,980
Feb. 1	To Balance b/d	580			

Dr. **Interest Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	200	Jan. 26	By Cash A/c	200
		200			200
			Feb. 1	By Balance b/d	200

Dr. **Bank Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	25,000	Jan. 31	By Balance c/d	25,000
		25,000			25,000
Feb. 1	To Balance b/d	25,000			

Dr. **Stock Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	20,000	Jan. 31	By Balance c/d	20,000
		20,000			20,000
Feb. 1	To Balance b/d	20,000			

Dr. **Furniture Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	2,000	Jan. 31	By Balance c/d	2,000
		2,000			2,000
Feb. 1	To Balance b/d	2,000			

Building Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	10,000	Jan. 31	By Balance c/d	10,000
		10,000			10,000
Feb. 1	To Balance b/d	10,000			

Vijay

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	2,000	Jan. 4	By Cash A/c	1,980
				By Discount A/c	20
		2,000			2,000

Anil

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	1,000	Jan. 31	By Balance c/d	1,000
		1,000			1,000
Feb. 1	To Balance b/d	1,000			

Madhu

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	2,000	Jan. 31	By Balance c/d	2,000
		2,000			2,000
Feb. 1	To Balance b/d	2,000			

Anand

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 21	To Cash A/c	4,800	Jan. 1	By Balance b/d	5,000
Jan. 21	To Discount A/c	200			
		5,000			5,000

Capital Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	55,000	Jan. 1	By Balance b/d	55,000
		55,000			55,000
			Feb. 1	By Balance b/d	55,000

Babu's Loan Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	10,000	Jan. 1	By Balance b/d	10,000
		10,000			10,000
			Feb. 1	By Balance b/d	10,000

Purchases Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Cash A/c	3,800	Jan. 31	By Drawings A/c	200
Jan. 1	To Discount A/c	200	Jan. 31	By Balance c/d	8,800
Jan. 6	To Bharat	5,000			
		9,000			9,000
Feb. 1	To Balance b/d	8,800			

Discount Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 4	To Vijay	20	Jan. 1	By Purchases A/c	200
Jan. 31	To Balance A/c	380	Jan. 31	By Anand	200
		400			400
			Feb. 1	By Balance b/d	380

Bharat

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	5,000	Jan. 6	By Purchases A/c	5,000
		5,000			5,000
			Feb. 1	By Balance b/d	5,000

Plant Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 8	To Mukesh	5,000	Jan. 31	By Balance c/d	5,300
Jan. 8	To Cash A/c	300			
		5,300			5,300
Feb. 1	To Balance b/d	5,300			

Interest on Loan Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 28	To Cash A/c	500	Jan. 31	By Balance c/d	500
		500			500
Feb. 1	To Balance b/d	500			

Dr. **Mukesh** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	5,000	Jan. 8	By Plant A/c	5,000
		5,000			5,000
			Feb. 1	By Balance b/d	5,000

Dr. **Sales Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Balance c/d	2,100	Jan. 21	By Rahim	600
			Jan. 18	By Cash A/c	1,000
			Jan. 31	By Cash A/c	500
		2,100			2,100
			Feb. 1	By Balance b/d	2,100

Dr. **Rahim** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 12	To Sales A/c	600	Jan. 15	By Cash A/c	300
			Jan. 15	By Bad Debts A/c	300
		600			600

Dr. **Bad Debts Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 15	To Rahim	300	Jan. 31	By Balance c/d	300
		300			300
Feb. 1	To Balance b/d	300			

Dr. **Salary Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 20	To Cash A/c	2,000	Jan. 31	By Balance c/d	2,000
		2,000			2,000
Feb. 1	To Balance b/d	2,000			

Dr. **Drawings Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Purchases A/c	200	Jan. 31	By Balance c/d	200
		200			200
Feb. 1	To Balance b/d	200			

(b) (i) **Total Method**

Trial Balance

(as on 31st January 2011)

Particulars	Debit ₹	Credit ₹
Cash Account	11,980	11,400
Interest Account		200
Bank Account	25,000	
Stock Account	20,000	
Furniture Account	2,000	
Building Account	10,000	
Vijay	2,000	2,000
Anil	1,000	
Madhu	2,000	
Anand	5,000	5,000
Capital Account		55,000
Babu's Loan Account		10,000
Purchases Account	9,000	200
Discount Account	20	400
Bharat		5,000
Plant Account	5,300	
Interest on Loan Account	500	
Mukesh		5,000
Sales Account		2,100
Rahim	600	600
Bad Debts Account	300	
Salary Account	2,000	
Drawings Account	200	
Total	96,900	96,900

(ii) **Balance Method**

Trial Balance

(as on 31st January 2011)

Particulars	Debit ₹	Credit ₹
Cash Account	580	
Interest		200
Bank Account	25,000	
Stock Account	20,000	
Furniture Account	2,000	
Building Account	10,000	
Anil	1,000	
Madhu	2,000	
Capital Account		55,000
Babu's Loan Account		10,000
Purchases Account	8,800	
Discount Account		380
Bharat		5,000

(Contd...)

Particulars	*Debit* ₹	*Credit* ₹
Plant Account	5,300	
Interest on Loan Account	500	
Mukesh		5,000
Sales Account		2,100
Bad Debts Account	300	
Salary Account	2,000	
Drawings Account	200	
	77,680	77,680

(*iii*) Total and Balance Method

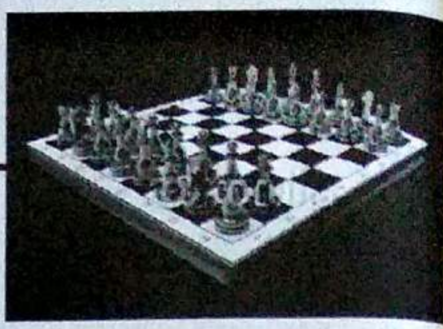
Trial Balance

(as on 31st January 2011)

Particulars	*Total Method*		*Balance Method*	
	Debit ₹	*Credit* ₹	*Debit* ₹	*Credit* ₹
Cash Account	11,980	11,400	580	
Interest Account		200		200
Bank Account	25,000		25,000	
Stock Account	20,000		20,000	
Furniture Account	2,000		2,000	
Building Account	10,000		10,000	
Vijay	2,000	2,000		
Anil	1,000		1,000	
Madhu	2,000		2,000	
Anand	5,000	5,000		
Capital Account		55,000		55,000
Babu's Loan Account		10,000		10,000
Purchases Account	9,000	200	8,800	
Discount Account	20	400		380
Bharat		5,000		5,000
Plant Account	5,300		5,300	
Interest on Loan Account	500		500	
Mukesh		5,000		5,000
Sales Account		2,100		2,100
Rahim	600	600		
Bad Debts Account	300		300	
Salary Account	2,000		2,000	
Drawings Account	200		200	
Total	96,900	96,900	77,680	77,680

Section – I

Accounting Fundamentals
(*Contd.*)



SIX

SUB-DIVISION OF JOURNAL

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- appreciate the importance of sub-division of journal;
- name the different types of journals;
- record transactions in different journals;
- explain the meaning of certain key terms

It has already been explained in an earlier chapter that Journal is the book of prime entry. It means all business transactions are to be first recorded in the Journal. However, in a big business recording of all transactions in one Journal will not only be inconvenient but also cause delay in collecting information required. The Journal is, therefore, sub-divided into many subsidiary books. This sub-division results in the following advantages:

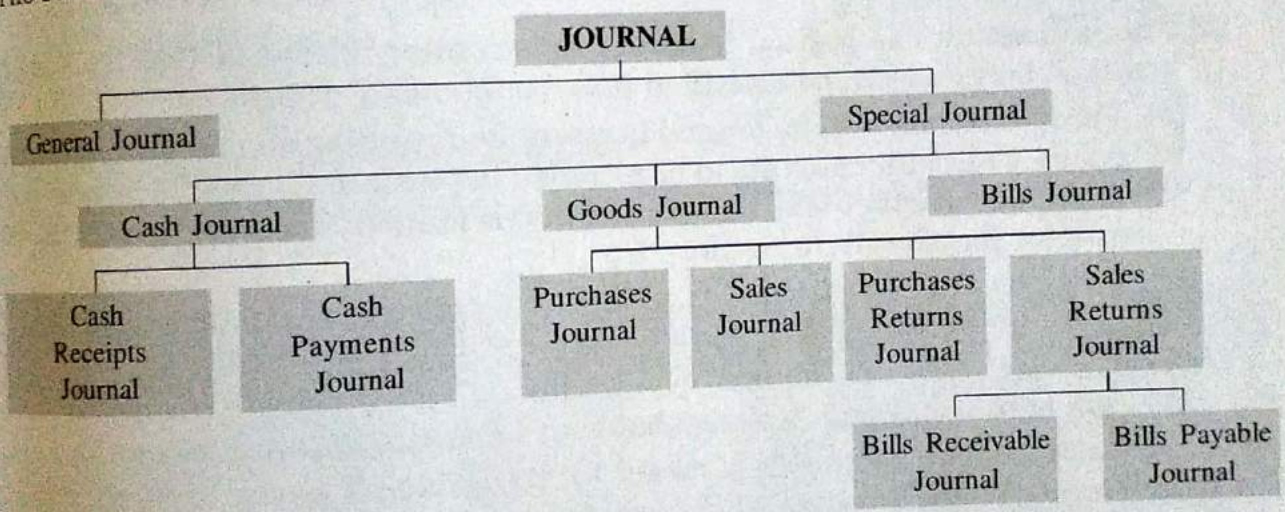
(*i*) **Convenience** As stated above maintenance of one Journal only will make it quite bulky or difficult to handle. Sub-division of Journal only will result in reducing the size of Journal and making it convenient to handle.

(*ii*) **Division of labour** Sub-division of Journal helps in division of labour since different persons can write different Journals.

(*iii*) **Classified information** Each Journal provides information relating to a particular aspect of the business. For example, a Purchases Journal gives information about the total credit purchases made by the business. Similarly, a Sales Journal gives infor mation about the total credit sales made by the business. Thus, the businessman gets the information relating to different aspects of the business in a classified form in the shortest possible time.

SUB-DIVISION OF JOURNAL

The sub-division of Journal can be explained with the help of the following chart:



Each of the above types of Journals have been explained in the following pages:

1. General Journal

It is also known as Journal Proper. It is meant for recording all such transactions for which no special journal has been kept by the business. As a matter of fact, it is meant for recording such transactions which do not occur frequently in the business and, therefore, do not warrant setting up of special journals. Examples of such transactions are as follows:

(*i*) **Opening entries** When a new set of books is started, the old accounts have to be brought forward in the beginning of the year from last year's books. The opening entry is meant for recording these transactions. The entries are made from the balance sheet of the last year.

(*ii*) **Closing entries** At the end of accounting year, the nominal accounts are closed by transferring them to trading account or profit and loss account. The entries passed for this purpose are termed as 'Closing Entries'.

(*iii*) **Adjustment entries** At the end of the accounting year, adjustment entries are to be passed for outstanding/prepaid expenses, accrued/outstanding income etc. Entries for all these adjustment are passed in the General Journal.

(*iv*) **Transfer entries** Transfer entries are required for transferring one account to the other. Entries for such transfer are passed in the General Journal.

(*v*) **Rectification entries** Rectification entries are passed for rectifying the errors which might have been committed in the books of account. For example, the account of Mohan might have been debited in place of the account of Sohan. The necessary rectifying entry will be passed in he General Journal.

(*vi*) **Purchases of fixed assets** The entries for purchases of fixed assets such as plant, machinery, furniture, etc., on credit are also passed in this Journal.

2. Special Journal

The term 'Special Journal' means a Journal which is meant for a special purpose. The following are the various types of Special Journals.

(*i*) **Cash Journal** Cash Journal is meant for recording all cash transactions. It may be further classified into Cash Receipts Journal and Cash Payments Journal. Cash Receipts Journal records all cash receipts while Cash Payments Journal records all cash payments.

(*ii*) **Goods Journal** The Journal is meant for recording all transactions relating to goods. It may, further, be classified into the following categories:

(*a*) *Purchases Journal* The Journal is meant for recording all credit purchases of goods. Cash purchases are to be recorded in the Cash Journal. Moreover, only purchases of goods is to be recorded in this Journal. The term "goods" means articles purchased for resale.

(*b*) *Sales Journal* The Journal is meant for recording all credit sales of goods. Cash sales of the goods are to be recorded in the Cash Journal.

(*c*) *Purchases Returns Journal* It is meant for recording all returns of goods purchased on credit. It is also known as *Returns Outward Journal.*

(*d*) *Sales Returns Journal* It is meant for recording all return of goods sold on credit. It is also known as *Returns Inward Journal.*

(*iii*) **Bills Journal** The Journal is meant for recording all bills of exchange or promissory notes received or issued by the business. It can be classified into two categories:

(*a*) *Bills Receivable Journal* It is meant for recording all bills of exchange or promissory notes received by the business from its debtors.

(*b*) *Bills Payable Journal* It is meant for recording all bills of exchange or promissory notes issued by the business in favour of its creditors.

Transactions relating to bills of exchange and promissory notes have been explained later in a separate chapter.

In the following pages, we are explaining the method of recording business transactions in each Journal and their posting into the ledger.

CASH JOURNAL

Cash Journal or Cash book is meant for recording all cash transactions. It is a very important Journal of business on account of the following reasons:

(i) The number of cash transactions is quite large in every business. The business has to pay for salaries, rent, lighting, insurance, purchase of goods and it has to receive cash for sales of goods and capital assets.

(ii) The chances of fraud being committed regarding cash are higher as compared to other assets. A strict control is, therefore, required. A properly maintained cash book helps in achieving this objective.

(iii) Cash is the nerve centre of the business. Timely payments to its creditors increases the reputation of the business. Similarly timely payments from its debtors improves the financial position of the business.

The cash book can be of any of the following types:

(i) Simple Cash Book
(ii) Two-Columnar Cash Book
(iii) Three-Columnar Cash Book
(iv) Multi-Columnar Cash Book
(v) Cash Receipts Book
(vi) Cash Payments Book

(i) Simple (Single)-Columnar Cash Book

Simple Cash Book is like an ordinary cash account. Its proforma is given below:

Dr. **Simple Cash Book** Cr.

Date	*Particulars*	*L.F.*	*Amount*	*Date*	*Particulars*	*L.F.*	*Amount*

The recording of the transactions in the Simple Cash Book and their posting in the Ledger can be understood with the help of the following illustration:

ILLUSTRATION **6.1.** Record the following transactions in the Cash Book and post them in the ledger:

Jan. 1	Opening Cash balance ₹5,000
Jan. 4	Rent paid ₹2,000
Jan. 6	Interest received ₹3,000
Jan. 15	Cash purchases ₹4,000
Jan. 25	Cash sales ₹8,000
Jan. 31	Salaries paid ₹2,000

SOLUTION:

Cash Book

Dr. Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Jan. 1	To Balance b/d		5,000	Jan. 4	By Rent		2,000
Jan. 2	To Interest	4	3,000	Jan. 15	By Purchases A/c		4,000
Jan. 25	To Sales	5	8,000	Jan. 31	By Salaries A/c		2,000
				Jan. 31	By Balance c/d		8,000
			16,000				16,000
	To Balance b/d		8,000				

Ledger

Interest Account

Dr. Cr.

		4 By Cash A/c	3,000

Sales Account

		5 By Cash A/c	8,000

Rent Account

To Cash A/c	2,000	1	

Purchases Account

To Cash A/c	4,000	2	

Salaries Account

To Cash A/c	2,000	3	

It should be noted that in the ledger no separate cash account will be opened. The Cash Book functions both as a book as well as an account as shown in the illustration above.

(ii) Two (Double)-Columnar Cash Book

Such a Cash Book has two columns: (*i*) Cash Column, and (*ii*) Discount Column. Cash column is meant for recording cash receipts and payments while discount column is meant for recording discount received and the discount allowed. The discount column on the debit side represents the discount allowed while discount column on the credit side represents the discount received.

It should be noted that while the cash column of the cash book serves both the functions of a book as well as an account but discount column does not serve the function of a discount account. A separate discount account has to be opened in the ledger in which total debits and credits from the Cash Book are posted. Sometimes, two separate discount accounts are kept in the ledger—one for discount allowed and the other for discount received.

Trade Discount and Cash Discount The following are the points of distinction between trade discount and cash discount:

(i) Trade discount is a deduction granted by a supplier from the list price of the goods due to large quantity of sales or business tradition. While cash discount is allowed by the creditor to the debtor for either buying in cash or for making payment before the stipulated period.

(ii) Trade discount is allowed on sale of goods while cash discount is allowed on payment of money.

(iii) Trade discount is not recorded in the books of account. The goods are recorded on the net price. While cash discount is shown in the books of account.

(iv) Trade discount may vary with the quantity of goods purchased while cash discount may vary with the time period.

The recording of transactions in a two columnar cash book will be clear with the help of the following illustration:

ILLUSTRATION 6.2. Record the following transactions in the Cash Book and post them in the ledger:

1.	Jan. 01	Cash balance ₹5,000.
2.	Jan. 06	Sold goods to Mahesh ₹4,000.
3.	Jan. 08	Purchased goods from Mukesh ₹3,000.
4.	Jan. 15	Cash received from Mukesh ₹3,900 in full satisfaction.
5.	Jan. 20	Paid to Mukesh ₹2,830 in full satisfaction.
6.	Jan. 25	Sold goods to Suresh ₹3,000.
7.	Jan. 31	Received cash from Suresh ₹2,900 in full satisfaction.

SOLUTION:

Cash Book

Dr. Cr.

Date	Particulars	L.F.	Discount ₹	Cash ₹	Date	Particulars	L.F.	Discount ₹	Cash ₹
Jan. 1	To Balance b/d			5,000	Jan. 20	By Mukesh		150	2,850
Jan. 25	To Mahesh		100	3,900	Jan. 31	By Balance c/d			8,950
Jan. 31	To Suresh		100	2,900					
			200	11,800				150	11,800

Ledger

Mahesh

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 6	To Sales A/c	4,000	Jan. 15	By Cash A/c	3,900
			Jan. 15	By Discount A/c	100

Suresh

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 25	To Sales A/c	3,000	Jan. 31	By Cash	2,900
			Jan. 31	By Discount	100

Mukesh

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 20	To Cash	2,850	Jan. 8	By Purchases A/c	3,000
Jan. 20	To Discount	150			

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Sundries	200			

Dr. Discount Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			Jan. 31	By Sundries	150

Notes:

1. Transactions 2 and 6 relate to credit sales of goods and, therefore, they have not been recorded in the cash book. They will be recorded in the sales book and the posting will be done in the personal accounts of Mahesh and Suresh from there, as shown in the ledger.
2. Transaction 3 relates to credit purchase of goods. It has, therefore, not been recorded in the cash book. It will be recorded in the purchases book from where posting will be done in the personal accounts of Mukesh, as shown in the ledger.
3. The total of the debit side of the discount column has been taken to the 'Discount Allowed Account' in the ledger. The word 'sundries' has been put in the 'Particulars' column. Any person who is interested in knowing the person to whom the discount has been allowed can find it out from the cash book.
4. The total of the discount column appearing on the credit side of the cash book has been taken to 'Discount Received Account' in the ledger. The word 'Sundries' has been put in the 'Particulars' column. Any person who is interested in knowing the names of the persons from whom the discount has been received can find it out from the cash book.

(iii) Three-Columnar Cash Book

This type of cash book contains the following three columns on each side:

(*i*) Cash column for cash received and cash paid.
(*ii*) Discount column for discount received and discount allowed.
(*iii*) Bank column for money deposited and money withdrawn from the bank.

The proforma of such a Cash Book is as follows:

Dr.	Particulars	L.F	Discount	Cash	Bank	Dr.	Particulars	L.F.	Discount	Cash	Bank

The recording of transactions in three-columnar cash book will be clear with the help of the following Illustration.

Illustration 6.3.

Jan. 01	Opening Balance :	Cash ₹3,000
		Bank ₹4,000
Jan. 04	Rent paid by cheque ₹2,000	
Jan. 06	Received on account of cash sales ₹3,000.	
Jan. 08	Paid to Mehta Bros. by cheque ₹2,000 and earned ₹200 as cash discount.	
Jan. 10	Received from Suresh by cheque ₹2,000 and allowed him ₹100 as cash discount.	
Jan. 12	Cash sales ₹20,000.	
Jan. 20	Cash purchases ₹15,000.	
Jan. 31	Salaries paid ₹5,000.	

SOLUTION:

Cash Book

Dr. Cr.

Dt.	Particulars	L.F.	Dis. ₹	Cash ₹	Bank ₹	Dt.	Particulars	L.F.	Dis. ₹	Cash ₹	Bank ₹
Jan.						Jan.					
1	To Balance b/d			3,000	4,000	6	By Rent A/c				2,000
6	To Sales A/c			3,000		8	By Mehta Bros.		200		2,000
10	To Suresh		100		2,000	20	By Purch. A/c			15,000	
12	To Sales A/c			20,000		31	By Salaries A/c			5,000	
						31	By Balance c/d			6,000	2,000
			100	26,000	6,000				200	26,000	6000
	To Balance b/d			6,000	2,000						

Ledger

Sales Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
			Jan. 1	By Cash A/c	3000
			Jan. 10	By Cash A/c	20,000

Suresh

			Jan. 10	By Bank A/c	2000
				By Discount A/c	100

Rent Account

Jan. 4	To Bank A/c	2,000			

Mehta Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 8	To Bank A/c	2,000			
Jan. 8	To Discount A/c	100			

Purchases Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 20	To Cash A/c	15,000			

Salaries Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Cash A/c	5,000			

Discount Allowed Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 31	To Sundries A/c	100			

Discuont Received Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
			Jan. 31	By Sundries	200

Contra entry As explained above, a three columnar cash book contains columns both for cash and bank transactions. An accounting transaction involves two accounts and there may be a transaction where both Cash Account and Bank Account are involved. Since in the ledger, there are no separate Cash Account and Bank Account, therefore, no posting will be done from the Cash Book to the Ledger in case of such a transaction. The transaction will be recorded on both sides of the Cash Book. For example, if cash is withdrawn from the bank, the two accounts involved are the Cash Account and the Bank, Account. In the Cash Book, on the debit side, the amount will be put in cash column against the words "To Bank" while on the credit side of the Cash Book, the amount will be written in the bank column against the words "By Cash". Such an accounting entry which is recorded on both the debit and credit sides of the cash book is known as a Contra Entry. In order to give a hint to the ledger-keeper, that no posting is required for such an entry, the word 'C' is put in the ledger folio column on both the sides of the Cash Book.

Special Points Regarding Cheques

A business may receive cheques from its customers or it can issue cheques in favour of its customers or other creditors. Following are some special points which should be kept in view while making accounting entries in the Cash Book regarding such cheques received or issued.

1. *Receipt of cheques* There can be two situations:

(*A*) A cheque may be received by the business and sent to the Bank the same day for collection. In such a case, it will be better to put the cheque received in the debit side of the bank column as soon as it is received. For example, if on January 10, a cheque is received from *A* for ₹10,000 and is sent to the Bank for collection on the same day, the entry for receipt of the cheque will appear in the Cash Book as follows:

Dr. **Cash Book (Receipts Side)** **Cr.**

Date	*Particulars*	*Discount*	*Cash* ₹	*Bank* ₹
Jan. 10	To *A*			10,000

(*B*) In case a cheque received from a party is sent to the Bank at a later date, it will be better to take the cheque as receipt of cash when it is received and deposit of cash in the bank when the cheque is sent for collection to the Bank. For example, if on January 10, a cheque is received from *A* for ₹10,000 and is sent to the Bank for collection on January 14, the entries in the Cash Book will appear as follows:

Dr. **Cash Book (Cash and Bank Columns)** **Cr.**

Date	*Particulars*	*L.F.*	*Cash* ₹	*Bank* ₹	*Date*	*Particulars*	*L.F.*	*Cash* ₹	*Bank* ₹
Jan. 10	To *A*		10,000		Jan.14	By Bank	C	10,000	
Jan. 14	To Cash	C		10,000					

Tutorial Note. In the absence of any specific instructions in the question, the students should presume that the cheque received from a party was sent to the Bank the same day for collection.

2. *Endorsement of cheques received* A cheque received by the business may not be sent by it to the Bank for collection, but may be endorsed by the business in favour of a creditor of the business. In such a case, the cheque received will be taken as a receipt of cash. Similarly, the cheque endorsed, will be taken as payment of cash. For example, if on January 10, cheque was received from *A* for ₹10,000 and it was endorsed on January 14 in favour of *B*, a creditor of the business, the entries in the Cash Book will appear as follows:

Cash Book (Cash Column Only)

Dr. Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Jan. 10	To *A*		10,000	Jan. 14	By *B*		10,000

3. *Dishonour of cheques* The term 'dishonour of cheque' means non-payment of the cheque by the drawee Bank on its being presented for payment. There can be two different situations.

(*I*) A cheque received by a business and sent to the Bank for collection may be dishonoured on presentation for payment. In such a case, the party from whom the cheque was received should be debited while the account of the Bank should be credited. For example, if a cheque received from, '*A*' for ₹10,000 on January 10, is dishonoured by his bankers on presentation for payment on January 14, entries in the Cash Book will appear as follows:

Cash Book (Bank Column)

Dr. Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
Jan. 10	To *A*		10,000	Jan.14	By *A*		10,000

Similarly when a cheque received from customer and endorsed in favour of a creditor is dishonoured, the entries to be passed in the Cash Book can be well understood on the basis of the following journal entries:

(*a*) On receipt of cheque
Cash A/c Dr
To Customer

(*b*) On endorsement of cheque
Creditor Dr.
To Cash

(*c*) On dishonour of the cheque
Customer Dr.
To Creditor

Thus, it is clear that no entries will be passed in the Cash Book in the event of dishonour of a cheque received from a customer and endorsed in favour of a creditor. Entries (*a*) and (*b*) will be passed through the Cash Book while entry (*c*) will be passed through the Journal Proper.

(*II*) Cheques issued by the business in favour of third parties may be dishonoured by the Bank. In such a case, the entry to be passed on the Cash Book can be understood by passing the following journal entries:

(*a*) On issue of the cheque in favour of a creditor

Creditor ... Dr.

To Bank

(*b*) On dishonour of the cheque issued by the Bank

Bank ... Dr.

To Creditor

Thus, when the cheque is issued in favour of a creditor, the creditor is debited and the Bank Account is credited. The entry will appear in the Cash Book on the credit side in the Bank column. On return of the cheque by the creditor on account of its non-payment, the Creditor's Account, which was previously debited, would now be credited while the Bank Account, which was previously credited, would now be debited. The entry for dishonour will, therefore, appear in the debit side of the Cash Book in the Bank column.

The recording of transactions in a three-columnar cash book and from there posting into the ledger will be clear with the help of the following illustration.

ILLUSTRATION 6.4. Enter the following transactions in the appropriate type of the cash books, and post the same to the relevant ledger accounts:

2011	
July 01	Started business with an investment of ₹9,000.
July 02	Deposited in Bank of India, ₹7,000.
July 04	Acquired a building by issuing a cheque of ₹5,000.
July 10	Paid the bill of the furniture by cheque ₹1,000.
July 15	Purchased ₹800 of merchandise by cheque.
July 18	Withdrew ₹100 from the bank.
July 20	Sold merchandise for ₹1,200.
July 22	Deposited ₹2,000 into the bank.
July 25	Bought ₹1,000 merchandise.
July 26	Sold ₹1,500 merchandise by crossed cheque.
July 27	Paid ₹100 by cheque as the premium for insuring building against fire.
July 28	Paid freight ₹50.
July 30	Withdrew from bank for personal use ₹500.
July 31	Cleared electricity bill ₹90.
July 31	Paid to Mahesh ₹1,080 in full satisfaction by cheque. We owed to Mahesh ₹1,100 for goods purchased.
July 31	Received from Suresh a cheque for ₹1,480, in full satisfaction of the debt of ₹1,510.

SOLUTION:

Cash Book

Dr. **Cr.**

Date	Particulars	L.F.	Dis. ₹	Bank ₹	Cash ₹	Date	Particulars	L.F.	Dis. ₹	Bank ₹	Cash ₹
2011						2011					
Jul. 1	To Capital				9,000	Jul. 2	By Bank	C			7,000
Jul. 2	To Cash	C		7,000		Jul. 4	By Building			5,000	
Jul. 18	To Bank	C			100	Jul. 10	By Furniture			1,000	
Jul. 20	To Sales				1,200	Jul. 15	By Purchases			800	
Jul. 22	To Cash	C		2,000		Jul. 18	By Cash	C		100	
Jul. 26	To Sales			1,500		Jul. 22	By Bank	C			2,000
Jul. 31	To Suresh		30	1,480		Jul. 25	By Purchases				1,000
						Jul. 27	By Insurance Premium			100	
						Jul. 28	By Freight				50
						Jul. 30	By Drawings			500	
						Jul. 31	By Electricity				90

(Contd...)

Date	Particulars	L.F.	Dis. ₹	Bank ₹	Cash ₹	Date	Particulars	L.F.	Dis. ₹	Bank ₹	Cash ₹
2011						2011					
						Jul. 31	By Mahesh	20	1,080		
						Jul. 31	By Bal. c/d		3,400		160
			30	11,980	10,300			20	11,980		10,300
Aug. 1	To Bal. b/d			3,400	160						

Ledger

Capital Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
			July 1	By Cash	9,000

Building Account

July 4	To Bank	5,000			

Purchases Account

July 15	To Bank	800			
July 25	To Cash	1,000			

Freight Account

July 28	To Cash	50			

Electricity Account

July 31	To Cash	90			

Sales Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
			July 20	By Cash	1,200
			July 26	By Bank	1,500

Furniture Account

July 10	To Bank	1,000			

Insurance Premium Account

July 27	To Bank	100			

Drawings Account

July 30	To Bank	500			

Discount Account

July 31	To Sundries	35	July 31	By Sundries	20

Notes:

(*i*) Cash and Bank columns in the cash book serve the purpose of prime as well as final entries. Hence, in the ledger no Cash and Bank Accounts have been opened.

(*ii*) Cash Account never shows a credit balance, since a person cannot spend more than what he has. While, the Bank Account may show a credit balance, since a bank may permit a customer to overdraw his account (*i.e.*, withdraw more money than what he has in his account). In such a case, it will be said that the customer has an overdraft with the Bank.

(*iii*) Postings to the Discount Account is done at the end of the period with Total Discount Received and Total Discount Allowed.

Cash Receipts and Payments Journal

It is common practice these days to keep separate Cash books for receipts and payments. Thus, the business maintains two Cash Journals: (*i*) Cash Receipts Journal, and (*ii*) Cash Payments Journal.

(*i*) **Cash Receipts Journal** The Journal is meant for recording all cash receipts. The posting is done daily from the Cash Receipts Book to the Ledger. The concerned accounts are all credited with amount mentioned in the Cash Receipts Journal. The total cash received as shown by the Cash Receipts Journal is debited to the Cash Account at the end of a period usually at the end of a week.

(*ii*) **Cash Payments Journal** The book is meant for recording all cash payments. The posting is done daily from this book to the ledger and the concerned accounts are debited. At the end of a period (usually at the end of the week), cash account is credited with the total cash paid during the period.

PETTY CASH BOOK

Petty Cash Book is maintained by the business to record petty cash expenses of the business, such as postage, cartage, stationery, cleaning charges etc. In every business, there are many payments like the above which are of small amounts. In case all these transactions are recorded in the Main Cash Book, their recording will not only be inconvenient but also consume a lot of valuable time of the cashier and the Posting Clerk. A Petty Cashier is appointed by the business to make payments of all such petty expenses. He works under the supervision of the Chief Cashier, who advances money in the beginning of every month/quarter to meet petty expenses. At the end of the month/quarter, the Petty Cashier submits a statement of account of the expenses incurred by him during the month/quarter and gets a fresh advance.

The Petty Cash Book is usually maintained on the basis of Imprest System. According to this system, a fixed amount is advanced to the Petty Cashier at the beginning of the period by the Chief Cashier. He submits his accounts at the end of the period and the Chief Cashier after examining his accounts gives him a fresh advance equivalent to the amount spent by him during the period. Thus, in the beginning of the each period (month or quarter as the case may be), the Petty Cashier has a fixed balance. The amount so advanced to him is termed as "Imprest" or "Float".

The recording of transactions in a Petty Cash Book will be clear with the help of the following Illustration.

Illustration 6.5. Enter the following transactions in the Petty Cash Book (maintained on Imprest system) for the month of January, 2010.

Jan. 01	Cash received from the Chief Cashier ₹200
Jan. 03	Typing paper ₹8, Postage ₹4
Jan. 06	Office cleaning ₹4
Jan. 08	Postage ₹2
Jan. 10	Cartage ₹2
Jan. 15	Postage ₹6
Jan. 18	Ink ₹3, Typing paper ₹10
Jan. 20	Typewriter ribbon ₹10
Jan. 22	Telephone charges ₹7
Jan. 24	Office cleaning ₹2
Jan. 25	Nailpolish ₹27
Jan. 27	Telegrams ₹25
Jan. 29	Typing paper ₹30

(For Solution please see next page)

SOLUTION: (Illustration 6.5):

Petty Cash Book

Receipts				Payments								
Date	*Particulars*	*Cash Book Folio*	*Total ₹*	*Date*	*Particulars*	*Voucher Nos.*	*Stationery ₹*	*Postal charges etc. ₹*	*Cartage*	*Cleaning ₹*	*Miscellaneous ₹*	*Total ₹*
2010				3	Typing paper, postage	1, 2	8	4				12
Jan. 1	To Cash from Chief Cashier		200	6	Office cleaning	3				4		4
				8	Postage, office cleaning	4, 5		2		2		4
				10	Cartage	6			2			2
				15	Postage	7		6				6
				18	Ink, typing paper	8, 9	13					13
				20	Typewriter ribbon	10	10					10
				22	Telephone charges	11		7				7
				24	Cleaning	12				2		2
				25	Nailpolish	13					27	27
				27	Telegrams	14		25				25
				29	Typing paper	15	30					30
							61	44	2	8	27	142
					Ledger Folio		2	3	4	5	6	
					Balance c/d							58
			200									200
Feb. 1	To Balance b/d		58									
Feb. 1	To Cash from Chief Cashier		142									

Note: Voucher numbers, Ledger Folio numbers are imaginary.

Postings from the Petty Cash Book Postings in the Ledger from the Petty Cash Book is done at the end of the period, *i.e.*, month or quarter as the case may be. There are two alternative ways of making postings from the Petty Cash Book.

1. *Petty Cash Book maintained as a Memorandum Book only* In such a case, the total of the various expenses from the Petty Cash Book is debited, to the concerned accounts at the end of the period and credit is given to the Cash Account with the actual expenditure incurred. The amount advanced by the Chief Cashier to the Petty Cashier is recorded by him as a memorandum by way of a note in the Cash Book itself. This method is usually not followed.
2. *Where Petty Cash Book is taken as a part of the Double Entry System* This method is quite popular. The recording is done regarding the petty cash transactions on the basis of the following entries:
   (*i*) When money is advanced to the Petty Cashier:
   Petty Cash Account Dr.
   To Cash Account
   (The Petty Cash Account is debited with the actual amount of money advanced)
   (*ii*) On submission of accounts by the Petty Cashier:
   Expenses Accounts Dr.
   To Petty Cash Account
   (Each expense is to be debited separately with the expenditure incurred during the period as shown by the Petty Cash Book.)

Thus, in the Ledger, there is a Petty Cash Account as well as separate Expenses Accounts for each of the expenses.

Taking the figures as given in the preceding illustration, the various ledger accounts, according to the second method, will appear as follows:

Dr. **Petty Cash Account** *Cr.*

Date	*Particulars*	*Amount* ₹	*Date*	*Particulars*	*Amount* ₹
Jan. 1	To Cash	200	Jan. 3	By Stationery	61
				By Postal Charges	44
				By Cartage	2
				By Cleaning	8
				By Miscellaneous	27
				By Balance c/d	58
		200			200
Feb. 1	To Balance b/d	58			

Stationery Account

Jan. 31	To Petty Cash A/c	61			

Postal Charges Account

Jan. 31	To Petty Cash A/c	71			

Cartage Account

Jan. 31	To Petty Cash A/c	2			

Cleaning Account

Jan. 31	To Petty Cash A/c	8			

Miscellaneous Expenses Account

Jan. 31	To Petty Cash A/c		27			

PURCHASES JOURNAL

The Purchases Journal is meant for recording credit purchases of goods. It is also known as the Purchases or Bought Day Book. It has columns for date of purchase, invoice number, name of the party, ledger folio and the amount of purchases. It should be noted that the book records only purchase of goods on credit. Purchases of items other than goods on credit is recorded in the General Journal. Similarly, cash purchases are recorded in the Cash Book.

Posting The posting is done in the Personal Accounts daily from the Purchases Book. At the end of a week/month, the total of the Purchases Book is debited to the Purchases Account in the ledger.

The following illustration will make clear the recording of transactions in the Purchases Journal and their subsequent posting in the ledger.

ILLUSTRATION 6.6. Record the following transactions in the purchases journal and post them in the ledger.

2011

Jan. 1. Purchased from Ram & Co. on credit:

30 Heater Rods @ ₹10
20 Philips Bulbs @ ₹20

Jan. 4 Purchased from Shyam & Co. on credit:

40 Heater Rods @ ₹10
20 E.C.E. Bulbs @ ₹15

Jan. 8 Purchased from Bajaj & Co. on credit:

20 Electric Elements @ ₹40
3 Electric Boxes @ ₹100

Jan. 24 Purchased from K C & Co. on credit:

30 Electric Sockets @ ₹20
40 Electric Switches @ ₹200

SOLUTION:

Purchases Journal

Date	*Invoice No.*	*Particulars*	*L.F.*	₹	₹
2011					
Jan. 1	50	Ram & Co.:	4		
		30 Heater Rods @ ₹10		300	
		20 Philips Bulbs @ ₹20		400	700
Jan. 4	55	Shyam & Co.:	8		
		40 Heater Rods @ ₹10		400	
		20 E.C.E. Bulbs @ ₹15		300	700
Jan. 8	62	Bajaj & Co.:	12		
		20 Electric Elements @ ₹40		800	
		3 Electric Boxes @ ₹100		300	1,100

(Contd...)

Date	Invoice No.	Particulars		L.F.	₹	₹
Jan. 24	65	KC & Co.:		13		
		30 Electric Sockets @ ₹20			600	
		40 Electric Switches @ ₹200			8,000	8,600
Jan. 31		Purchases Account	Dr.	14		11,100

Ledger

Ram & Co.

(Folio 4)

Date	Particulars	₹	Date	Particulars	₹
			Jan. 1	By Purchases	700

Shyam & Co. *(Folio 8)*

			Jan. 4	By Purchases	700

Bajaj & Co. *(Folio 12)*

			Jan. 8	By Purchases	1,100

KC & Co. *(Folio 13)*

			Jan. 24	By Purchases	8,600

Purchases Account *(Folio 14)*

Jan. 31	To Sundries	11,100			

Notes:

(i) Folio Nos. are all imaginary.

(ii) Purchases account has been debited with the total purchases made during the month. This has been done at the end of the month. A firm may make the posting in the purchases account weekly also.

(iii) Posting is done in the personal accounts daily.

SALES JOURNAL

The Journal is meant for recording all sales of goods on credit. This is also known as Sales or Sold Day Book. It should be noted that Cash Sales are recorded in the Cash Book while sales of articles other than goods on credit is to be recorded in the General Journal.

Posting is done in the Personal Accounts daily from the Sales Book. They are debited with individual amounts. The Sales Account is credited with the total sales made during the period (*i.e.*, a week or month) at the end of the period.

The recording of the transactions in the Sales Book and their posting in the Ledger will be clear with the help of the following illustration.

Illustration 6.7. Record the following transactions in the Sales Day Book and post them into the ledger.

2010			
Jan. 01	Sold to Mukesh & Co.:		
	10 Heater Rods	@ ₹	20
	10 Lamp Shades	@ ₹	30

Jan. 10	Sold to Suresh & Brothers:		
	10 Table Fans	@ ₹	250
	20 Philips Tubelights	@ ₹	30
Jan. 25	Sold to Ramesh & Co.:		
	10 Electric Switches	@ ₹	50
	20 E.C.E. Tubelights	@ ₹	30

SOLUTION:

Sales Journal

Dr. Cr.

Date	Invoice No.	Particulars	L.F.	₹	₹
Jan. 1	101	Mukesh & Co.:	4		
		10 Electric Pins @ ₹20		200	
		10 Bulbs @ ₹30		300	500
Jan. 10	102	Suresh & Brothers:	6		
		10 Table Fans @ ₹250		2,500	
		20 Philips Tubelights @ ₹30		600	3,100
Jan. 25	103	Ramesh & Co.:	8		
		10 Electric Plugs @ ₹50		500	
		20 E.C.E. Tubelights @ ₹30		600	1,100
		Sales A/c Cr.	10		4,700

Ledger

Mukesh & Co.

Dr. Cr.

(Folio 4)

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Sales	500			

Suresh & Brothers *(Folio 6)*

Jan. 10	To Sales	3,100			

Ramesh & Co. *(Folio 8)*

Jan. 25	To Sales	1,100			

Sales Account *(Folio 10)*

			Jan. 31	By Sundries	4,700

Notes:

(i) Folio Nos., Invoice Nos. are all imaginary.

(ii) Posting is done in the Personal Accounts daily. The total sales are posted at the end of the month (or week) on the credit side of the Sales Account, against the word 'Sundries'. Any person interested in finding out the names of the parties to whom the sales have been made can do so by looking to the Sales Book.

SALES RETURNS JOURNAL

The Journal is meant for recording return of goods sold on credit. The goods which are sold for cash, if returned, are either exchanged for new goods or the parties are paid in respect of them depending upon the circumstances. In case the goods returned are not immediately exchanged for the other goods or not paid for in cash, they are recorded in a memorandum book only. Thus, goods sold for cash and returned do not find a place in the Sales Returns Journal. They are recorded in the Cash Book in case cash is paid for them or no entry will be passed in case they have been recorded in a memorandum book only. A proforma of Sales Returns Journal is as under:

Sales Returns Journal

Date	*Credit Note No*	*Particulars*			*L.F.*	*Amount ₹*	*Amount ₹*
Jan. 10	202	Ram & Co.:					
		5 Electric Plugs	@ ₹20			100	
		3 Philips Tubelights	@ ₹30			90	190
		Sales Returns A/c		Dr.			190

The posting from the Sales Returns Journal will be done daily in the personal accounts. For example, in the above case, the account of Ram & Co. will be credited with a sum of ₹190 on Jan. 10. The total of the Sales Returns Journal will be posted to the debit of Sales Returns Account at the end of the period, say, a week or a month.

Credit Note The customer who returns the goods, gets credit for the value of the goods returned. A Credit Note is sent to him intimating that his account has been credited with the value of the goods returned. The Note is prepared in duplicate. Its Proforma is as under:

MAHESHWARI BROTHERS
3, Strand Road, Kolkata

No. 202 Date Jan. 10, 2011

To

Ram & Co.,
21, Shri Ram Road, Delhi.

Dear Sir,

We have credited your account in respect of the following goods returned by you:

		₹	₹
(*i*) 5 Electric Plugs	@ ₹20	100	
(*ii*) 3 Philips Tubelights	@ ₹30	90	190

For Maheshwari Brothers
Sunil
Manager

PURCHASES RETURNS JOURNAL

The book is meant for recording return of goods purchased on credit. The goods purchased for cash and returned are not recorded in this book. They are recorded in a memorandum book only. On receipt of cash in respect of the goods returned, the entry will be passed through cash book. In case, the goods are exchanged for other goods of the same value, no entry will be required. The entry in the memorandum book will be cancelled on getting cash or goods for goods returned. A proforma of the Purchases Returns Journal is given below:

Purchases Returns Journal

Date	Credit Note No.	Particulars	L.F.	Amount ₹	Amount ₹
Jan. 12	301	Shyam & Co.			
		3 Electric Elements @ ₹40		120	
Jan. 21	302	Bajaj & Co.			
		3 Electric Mixers @ ₹300			900
		Purchases Returns A/c Cr.			1,020

Note: The entries in the Personal Accounts are done daily from the Purchases Returns Book. They are debited with the respective amounts. The total of the Purchases Returns Book is posted to the credit of Purchases Returns Account at the end of the period, say, a week or a month, as the case may be.

Debit Note When the goods are returned to the supplier, a debit note is sent to him indicating that this account has been debited with the amount mentioned in the Debit Note. Its proforma is given as under:

MAHESHWARI BROTHERS

3, Strand Road Kolkata

No. 301 Date Jan. 12, 2009

To

Shyam & Co.

3, Clive Road, Kolkata.

Dear Sir,

We have debited your account for the goods returned by us as under:

4 Electric Rods @ ₹30 ₹120

For Maheshwari Brothers

Sunil

Manager

Thus, in case of purchases returns or sales returns of goods, the flow of *Debit Note* or *Credit Note* can be put as follows:

(*i*) The **Debit Note** is sent by the Purchaser of goods to the Seller of goods on return of goods by the Purchaser to the Seller.

(*ii*) The **Credit Note** is sent by the Seller of goods to the Purchaser of goods on return of goods to the Seller by the Purchaser.

A comprehensive illustration is given below for explaining the recording of transactions in the various Journals, their posting into the Ledger and finally preparation of the Trial Balance.

Illustration 6.8. Record the following transactions in various subsidiary books and post them into Ledger and prepare a Trial Balance:

2009

June 01 Cash in hand ₹15,700; Cash at bank ₹25,400 and Capital Account ₹41,100.

June 03 Bought goods for cash ₹4,100.

June 04	Purchased goods from Mahesh & Co. for ₹5,800 *less* 10% trade discount.
June 07	Sold goods to Bindia & Co. for ₹8,900 less 20% trade discount.
June 09	Withdrew ₹500 from bank for private use.
June 12	Sold goods to Amjad for ₹6,400.
June 15	₹5,000 paid to Mahesh & Co. in full settlement of their account.
June 18	Goods worth ₹400 returned by Amjad.
June 20	Received ₹4,000 from Amjad.
June 21	Purchased goods from Shiv & Co. for ₹8,700.
June 23	₹6,000 paid to Shiv & Co. by cheque; discount allowed ₹300.
June 24	Purchased furniture for ₹800 from Surjeet Furniture House on credit.
June 26	Paid into bank ₹2,200.
June 28	Amjad declared insolvent; a first and final dividend of 50 paise in a rupee is received from him.
June 29	Goods worth ₹600 returned to Shiv & Co.
June 30	Interest on capital provided ₹411.
June 30	Goods worth ₹400 taken by the proprietor for his personal use.
June 30	Paid ₹500 for advertisement by cheque.
June 30	Paid salaries to staff, ₹1,800.
June 30	Cash Sales ₹21,800.
June 30	Paid into bank ₹20,000
June 30	Bought 100 shares in Hind Mills Ltd. at ₹11 per share brokerage paid ₹25.
June 30	Received ₹5,900 from Bindia & Co.; discount allowed ₹100.

Journal Proper

Date	*Particulars*	*L.F.*	*Debit Amount ₹*	*Credit Amount ₹*
2009 June 24	Furniture Account Dr.		800	
	To Surjeet Furniture House			800
	(Being furniture purchased on credit)			
June 28	Bad Debts Account Dr.		1,000	
	To Amjad			1,000
	(Being 50% amount due written-off as bad debt on Amjad becoming insolvent)			
June 30	Interest on Capital Account Dr.		411	
	To Capital Account			411
	(Being interest on capital provided)			
June 30	Drawings Account Dr.		400	
	To Purchases Account			400
	(Being goods taken for personal use of the proprietor)			
June 30	Capital Account Dr.		900	
	To Drawings Account			900
	(Being transfer of balance of Drawings Account)			
			3,511	3,511

Sales Book

Date	*Particulars*	L.F.	₹	₹
2009				
June 7	Bindia and Co.: Goods sold		8,900	
	Less: 20% Trade Discount		1,780	7,120
June 12	Amjad			6,400
June 30	Sales Account Cr.			13,520

Purchases Book

Date	*Particulars*	L.F.	₹	₹
2009				
June 4	Mahesh & Co.: Goods Purchased		5,800	
	Less: 10% Trade Discount		580	5,220
June 21	Shiv and Co.			8,700
June 30	Purchases Account Dr.			13,920

Sales Returns Book

Date	*Particulars*	L.F.	₹	₹
2009				
June 28	Amjad			400
June 30	Sales Returns Account Dr.			400

Purhases Returns Book

Date	*Particulars*	L.F.	₹	₹
2009				
June 29	Shiv and Co.			600
June 30	Purchases Returns Account Cr.			600

Ledger

Dr. **Capital Account** Cr.

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2009					
June 30	To Drawings Account	900	June 1	By Balance b/d	41,100
June 30	To Balance c/d	40,611	June 30	By Interest on Capital	411
		41,511			41,511
			[illegible]	b/d	40,611

Furniture Account

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 24	To Surjeet Furniture House	800	June 30	By Balance c/d	800
		800			800
July 1	To Balance b/d	800			

Surjeet Furniture House

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 30	To Balance c/d	800	June 24	By Furniture Account	800
		800			800
			July 1	By Balance b/d	800

Bad Debts Account

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 28	To Amjad Account	1,000	June 30	By Balance Account	1,000
		1,000			1,000
July 1	To Balance b/d	1,000			

Amjad

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 12	To Sales Account	6,400	June 18	By Sales Returns Account	400
			June 20	By Cash Account	4,000
			June 28	By Cash Account	1,000
			June 28	By Bad Debts	1,000
		6,400			6,400

Interest on Capital Account

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 3	To Capital Account	411	June 30	By Balance c/d	411
		411			411
July 1	To Balance b/d	411			

Drawings Account

Dr. | Cr.

Date	Particulars	₹	Date	Particulars	₹
June 9	To Bank Account	500	June 30	By Capital Account	900
June 30	To Purchases Account	400			
		900			900

Dr. **Purchases Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
June 4	To Cash Account	4,100	June 30	By Drawings Account	400
June 30	To Sundries (as per Purchases Book)	13,920	June 30	By Balanced c/d	17,620
		18,020			18,020
July 1	To Balance b/d	17,620			

Dr. **Bindia & Co.** Cr.

Date	Particulars	₹	Date	Particulars	₹
2009 June 7	To Sales Account	7,120	June 30	By Cash Account	5,900
			June 30	By Discount Account	100
			June 30	By Balance c/d	1,120
		7,120			7,120
July 1	To Balance b/d	1,120			

Dr. **Sales Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
June 30	To Balance c/d	35,320	June 30	By Sundries	13,520
				(amount as per Sales Book)	13,520
			June 30	By Cash Account	21,800
		35,320			35,320
			July 1	By Balance b/d	35,320

Dr. **Mahesh & Co.** Cr.

Date	Particulars	₹	Date	Particulars	₹
June 15	To Cash Account	5,000	June 1	By Purchases Account	5,220
June 15	To Discount Account	220			
		5,220			5,220

Dr. **Shiv & Co.** Cr.

Date	Particulars	₹	Date	Particulars	₹
June 23	To Bank Account	6,000	June 21	By Purchases Account	8,700
June 23	To Discount Account	300			
June 29	To Purchases Returns A/c	600			
June 30	To Balance c/d	1,800			
		8,700			8,700
			July 1	By Balanced b/d	1,800

Dr. **Sales Returns Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
June 30	To Sundries	400	June 30	By Balance c/d *(amount as per Sales Returns Book)*	400
		400			400
July 1	To Balance b/d	400			

Sl. No.	Name of the Account	L.F.	Debit Balance	Credit Balance
4.	Bad Debts Account		1,000	
5.	Interest on Capital Account		411	
6.	Purchases Account		17,620	
7.	Bindia & Co.		1120	
8.	Sales Account			35,320
9.	Shiv & Co.			1,800
10.	Sales Returns Account		400	
11.	Purchases Returns Account			600
12.	Advertisement Account		500	
13.	Salaries Account		1,800	
14.	Investment in Shares Account		1,125	
15.	Discount Account			420
16.	Cash in hand (as per Cash Book)		14,175	
17.	Cash at Bank (as per Cash Book)		40,600	
			79,551	79,551

KEY TERMS

1. **Bills Journal**: A journal meant for recording all transactions relating to Bills of Exchange or Promissory Notes received or issued by the business.
2. **Cash Journal**: A journal meant for recording all cash transactions.
3. **Contra Entry**: An accounting entry which is recorded on both the debit and credit sides of the Cash Book.
4. **General Journal**: A journal meant for recording all such transactions for which no special journal has been kept by the business.
5. **Goods Journal**: A journal meant for recording all credit transactions relating to goods.
6. **Imprest**: The amount advanced to the petty cashier in the beginning of a period. It is also term as float.
7. **Petty Cash Book**: A book meant for recording all petty cash expenses of the business.
8. **Special Journal**: A journal meant for recording transactions of a specific type.

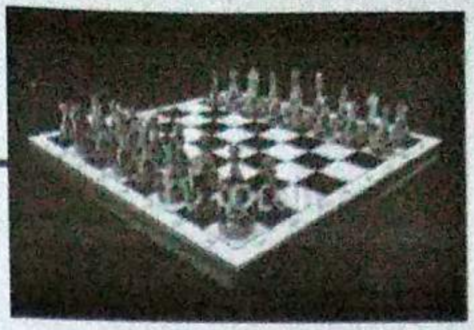
TEST QUESTIONS

Objective Type

1. **State whether each of the following statements is 'True' or 'False':**
   - (*i*) Purchase Journal is meant for recording all purchases of goods.
   - (*ii*) Posting is done in the personal accounts from the Purchases Book daily.
   - (*iii*) Sales Journal is meant for recording all cash sales of goods.
   - (*iv*) Sales Returns Journal is also known as Returns Inward Journal.
   - (*v*) Purchases Returns Journal is meant for recording all returns of goods purchased.
   - (*vi*) Credit Note is sent to a customer when goods sold are returned by him.
   - (*vii*) Debit Note is sent to the supplier of the goods when the goods are returned.
   - (*viii*) Office equipment purchased on credit will be recorded in the Purchases Book.
   - (*ix*) The balance in petty cash book represents amount spent.

Section – I

Accounting Fundamentals
(*Contd.*)



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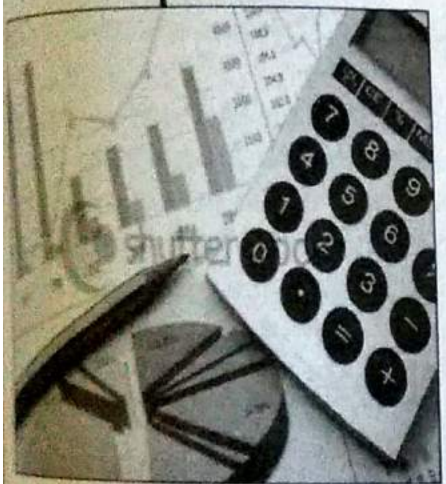

FINAL ACCOUNTS

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- **identify the objectives of preparing final accounts;**
- **list the various statements/accounts which comprise the final accounts of a business entity;**
- **understand the treatment of different items in preparation of the final accounts;**
- **appreciate the meaning and importance of different adjustment entries;**
- **pass appropriate adjustment entries;**
- **appreciate the role of work sheet in preparing final accounts;**
- **prepare Trading and Profit & Loss Accounts and Balance Sheet;**
- **explain the meaning of certain key terms**

It has been explained in a preceding chapter that the accuracy of the books of accounts is determined by means of preparing a Trial Balance. Having determined the accuracy of the books of accounts every businessman is interested in knowing about two more facts. They are: (*i*) Whether he has earned a profit or suffered a loss during the period covered by the Trial Balance, (*ii*) Where does he stand now? In other words, what is his financial position?

The determination of the Profit or Loss is done by preparing a Trading and Profit and Loss Account (or an Income Statement). While the financial position is judged by means of preparing a Balance Sheet of the business. The two statements together, *i.e.*, Income Statement and the Balance Sheet, are termed as Final Accounts. As the term indicates, Final Accounts means accounts which are prepared at the final stage to give the financial position of the business.

Trading and Profit and Loss Account

The Trading and Profit and Loss Account is a final summary of such accounts which affect the profit or loss position of the business. In other words, the account contains the items of Incomes and Expenses relating to a particular period. The account is prepared in two parts: (*i*) Trading Account, and (*ii*) Profit and Loss Account.

TRADING ACCOUNT

Trading Account gives the overall result of trading, *i.e.*, purchasing and selling of goods. In other words, it explains whether purchasing of goods and selling them has proved to be profitable for the business or not. It takes into account on the one hand the cost of goods sold and on the other the value for which they have been sold away. In case the sales value is higher than the cost of goods sold, there will be a profit, while in a reverse case, there will be a loss. The profit disclosed by the Trading Account is termed as Gross Profit, similarly the loss disclosed by the Trading Account is termed as Gross Loss.

This will be clear with the help of the following illustration:

Illustration 8.1. The following figures have been taken from the Trial Balance of a trader:

	₹
Purchases	30,000
Purchases Returns	5,000
Sales	40,000
Sales Returns	5,000

Calculate the amount of profit or loss made by the trader.

Solution:

The profit or loss made by the trader can be found out by comparing the cost of goods sold with sales value. This has been done as follows:

Particulars	*Amount* ₹	*Amount* ₹
Sales	40,000	
Less: Sales Returns	5,000	35,000
Purchases	30,000	
Less: Purchases Returns	5,000	25,000
Gross Profit		10,000

Unsold goods → closing stock

Opening and Closing Stocks

In Illustration 8.1, we have presumed that all goods purchased have been sold away by the trader. However, it does not normally happen. At the end of the accounting year, a trader may be left with certain unsold goods. Such stock of goods with a trader unsold at the end of the accounting period is termed as Closing Stock. Such a stock will become the opening stock for the next period. For example, if a trader has with himself goods amounting to ₹5,000 unsold at the end of the year 2010, this stock of ₹5,000 will be termed as his Closing Stock. For the year 2011, this stock of ₹5,000 will be termed as his Opening Stock. While calculating the amount of profit or loss on account of trading, a trader will have to take such Opening and Closing Stocks into consideration. This will be clear with the help of the following illustration.

ILLUSTRATION 8.2. Taking the figures given in Illustration 8.1, calculate the amount of Gross Profit if stock of ₹5,000 is left at the end of the accounting period.

SOLUTION:

In case all goods purchased have not been sold away, goods of ₹5,000 are still left with the trader. Stock of such goods is termed as Closing Stock. Thus, cost of goods sold will be calculated as follows:

COST OF GOODS SOLD = NET PURCHASES – CLOSING STOCK
= ₹25,000 – 5,000 = ₹20,000

The Gross Profit now can be computed as follows:

GROSS PROFIT = NET SALES – COST OF GOODS SOLD
= ₹35,000 – 20,000 = ₹15, 000

ILLUSTRATION 8.3. From the following data calculate the profit made by a trader in 2009.

	₹
Stock of goods on 1.1.2009	10,000
Purchases during the year	40,000
Purchases Returns during the year	5,000
Sales during the year	60,000
Sales returns during the year	10,000
Stock of goods on 31.12.2009	15,000

SOLUTION:

Particulars	*Amount ₹*	*Amount ₹*
Sales	60,000	
Less: Sales Returns	10,000	50,000
Cost of goods sold:		
Opening Stock	10,000	
Add: Net Purchases (₹40,000 – 5,000)	35,000	
	45,000	
Less: Closing Stock	15,000	30,000
Gross Profit		20,000

Expenses on Purchases etc.

In the Illustrations given above, we have presumed that the trader has not incurred any expenses for purchase of goods and bringing them to his shop for sale. However, a trader has to incur various types of expenses for purchasing of goods as well as for bringing them to his shop for sale. Such expenses may include brokerage or commission paid to agents for purchase of goods, cartage or carriage charges for bringing the goods to the trader's shop, wages paid to coolies for transportation of goods etc. All such expenses increase the cost of the goods sold and hence they have also to be included in the cost of purchasing the goods. In other words, cost of goods sold will be calculated as follows:

Cost of Goods Sold = Opening Stock + Net Purchases + Expenses on Purchasing of Goods – Closing Stock

Cost of goods sold calculated as above will then be compared with the net sales to find out the amount of profit or loss made by the business. This will be clear with the following Illustrations.

Illustration 8.4. Calculate the amount of the profit made by the trader with the help of data given in Illustration 8.3, if the wages, carriage charges etc. incurred for bringing the goods to the trader's shop amount to ₹5,000.

Solution:

Particulars	*Amount ₹*
Net Sales	50,000
Less: Cost of goods sold (30,000 + 5,000)	35,000
Gross Profit	15,000

The term 'merchandise' is also used for the term 'goods'.

Thus:

Cost of Goods	=	**Cost of Merchandise**
Cost of Goods Purchased	=	**Cost of Merchandise Purchased**
Cost of Goods Sold	=	**Cost of Merchandise Sold**

Illustration 8.5. Find out the cost of merchandise purchased, cost of merchandise sold, cost of merchandise unsold and Gross Profit from the following transactions:

	₹
Purchases (3,000 articles)	25,000
Freight	1,000
Local Taxes	1,000
Salaries	2,500
Shop Rent	500
Godown Rent	500
Electrical Charges	600
Municipal Taxes	200
Stationery	250
Furniture (estimated life 5 years)	12,000
Sales (2,700 articles)	32,000

Solution:

Particulars	Amount ₹
Cost of Merchandise purchased	
This consists of:	
Purchases	25,000
Freight	1,000
Local Taxes	1,000
	27,000
Cost of Merchandise sold	
Cost of 3,000 units of merchandise purchased	27,000
Cost of one unit of merchandise	9
Cost of 2,700 units of merchandise sold	24,300
Gross Profit	
Sales of 2,700 units of merchandise	32,000
Less: Cost of merchandise sold	24,300
	7,700
Cost of Merchandise unsold	
300 units @ ₹9 per unit	2,700

All other expenses including annual depreciation of furniture (amounting in all to ₹6,950) will be considered for computing the Net Profit of the business. The concept of Net Profit has been explained later in the chapter.

Equation for Preparing Trading Account

On the basis of the Illustrations given in the preceding pages, the following equation can be derived for preparing Trading Account:

	Gross Profit	=	**Sales – Cost of Goods Sold**
	Cost of Goods Sold	=	**Opening Stock + Purchases + Direct Expenses – Closing Stock**
Therefore,	**Gross Profit**	=	**Sales – (Opening Stock + Purchases + Direct Expenses – Closing Stock)**
Or	**Gross Profit**	=	**(Sales + Closing Stock) – (Opening Stock + Purchases + Direct Expenses)**

The term "Direct Expenses" include those expenses which have been incurred in purchasing the goods, bringing them to the business premises and making them fit for sale. Examples of such expenses are carriage charges, octroi, import duty, expenses for seasoning the goods, etc.

The Trading Account can be prepared in the following form on the basis of equation given above.

Trading Account
for the period ending ...

Dr. Cr.

Particulars		*Amount ₹*	*Particulars*		*Amount ₹*
To Opening Stock		......	By Sales	......	
To Purchases	......		*Less:* Returns	......	......
Less: Returns	......	......	By Closing Stock		......
To Direct Expenses		......	By Gross Loss*		......
To Gross Profit*		......			......
		......			

* Only one figure will be there.

Illustration 8.6. Prepare the Trading Account of Mr. Ramesh for the year ending 31st December, 2009 from the data as follows:

	₹		₹
Purchases	10,000	Wages	4,000
Purchases Returns	2,000	Carriage Charges	2,000
Sales	20,000	Stock on 1.1.2009	4,000
Sales Returns	5,000	Stock on 31.12.2009	6,000

D D Cr.

Solution:

15,000

Trading Account
for the year ending 31-12-2009

Dr. Cr.

Particulars		*Amount ₹*	*Particulars*		*Amount ₹*
To Opening Stock		4,000	By Sales	20,000	
To Purchases	10,000		*Less:* Sales	5,000	
Less: Returns	2,000	8,000	Returns		15,000
To Wages		4,000	By Closing Stock		6,000
To Carriage Charges		2,000	18,000		21,000
To Gross Profit		3,000			
		21,000			21,000

18,000, 21,000

Important Points Regarding Trading Account

1. **Stock** The term 'Stock' includes goods lying unsold on a particular date. The Stock may be of two types:
   (*i*) Opening Stock
   (*ii*) Closing Stock

21-18 300 D, closing stock

The term 'Opening Stock' means goods lying unsold with the businessman in the beginning of the accounting year. This is shown on the debit side of the Trading Account.

The term 'Closing Stock' includes goods lying unsold with the businessman at the end of the accounting year. It should be noted that stock at the end of the accounting year is taken after the books of accounts have been closed. The following journal entry is passed in the Journal Proper to record the amount of closing stock:

Closing Stock Account Dr.
To Trading Account

The amount of closing stock is shown on the credit side of the Trading Account and as an asset in the Balance Sheet. This has been explained later. The Closing Stock at the end of the accounting period will become the Opening Stock for the next year. The Opening Stock is, therefore, shown on the debit side of the Trial Balance.

The following equations can be derived for computation of stocks:

Opening Stock = Cost of Goods Sold + Closing Stock – Cost of Purchases

Closing Stock = Opening Stock + Cost of Purchases – Cost of Goods Sold

Taking the figures from Illustration 8.6 the two stocks can be computed as under:

Opening Stock = Cost of Goods Sold + Closing Stock – Cost of Purchases
= 12,000 + 6,000 – 14,000 = ₹4,000

Closing Stock = Opening Stock + Cost of Purchases – Cost of Goods Sold
= 4,000 + 14,000 – 12,000 = ₹6,000

Valuation of Closing Stock The closing stock is valued on the basis of "cost or market price whichever is less" principle. It is, therefore, very necessary that the cost of the goods lying unsold should be carefully determined. The market value of such goods will also be found out on the Balance Sheet date. The closing stock will be valued at the lower of the two values. For example, if the goods lying unsold at the end of the accounting period amount to ₹11,000, while their market price on the Balance Sheet date amounts to ₹10,000, the closing stock will be valued at ₹10,000. This valuation is done because of the accounting convention of conservatism, according to which expected losses are to be taken into account but not expected profits.

2. **Purchases** The term "Purchases" includes both cash and credit purchases of goods. The term "goods", as already explained in an earlier chapter, means items purchased for resale. Assets purchased for permanent use in the business such as purchase of plant, furniture, etc., are not included in the purchase of goods. Similarly, purchase of articles such as stationery meant for using in the business will also not be included in the item of purchases. In case a proprietor has himself used certain goods for his personal purposes, the value of such goods at cost will be deducted from the purchases and included in the drawings of the proprietor. The journal entry in such a case would be as follows:

Drawings Account Dr.
To Purchases Account

Similarly, in case certain goods are given by way of free samples, etc., the value of such goods should be charged to advertisement account and deducted from purchases. The journal entry in such a case would be as follows:

Advertisement Account Dr.
To Purchases Account

Opening stock
Purchases
Direct exps
To gross profit

By sales
Less: sale
Retur
To gross loss

The amount of purchases will be the net purchases made by the proprietor. The term 'net purchases' means total purchases of goods made by the businessman less the goods that he has returned back to the suppliers. In other words, purchases will be taken to the Trading Account after deducting purchases returns from the gross purchases made during the accounting period.

3. Sales The term 'Sales' includes both cash and credit sales. Gross sales will be shown in the inner column of the Trading Account out of which "sales returns" will be deducted. The net sales will then be shown in the outer column of the Trading Account. Proper care should be taken in recording sale of those goods which have been sold at the end of the financial year but have not yet been delivered. The sales value of such goods should be included in the sales, but care should be taken that they are not included in the closing stock at the end of the accounting period.

Sales have to be recorded at net realisable value excluding sales tax, *i.e.*, Sales excluding Sales Tax – Cost incurred necessarily to make the sale. For example, an item can be sold for ₹50 plus sales tax at 10% after getting it repaired at a cost of ₹5. The sales should be recorded at net relisable value, *i.e.*, ₹45.

Sales of assets like plant and machinery, land and building or such other assets which were purchased for using in the business, and not for sale, should not be included in the figure of 'sales' to be taken to the Trading Account.

4. Wages The amount of wages is taken as a direct expense and, therefore, is debited to the Trading Account. Difficulty arises in those cases when the Trial Balance includes a single amount for "wages and salaries". In such a case, the amount is taken to the Trading Account. However, if the Trial Balance shows "salaries and wages" the amount is taken to the Profit and Loss Account. In actual practice such difficulties do not arise because the businessman knows for which purpose he has incurred the expenditure by way of wages or salaries. However, in an examination problem, it will be useful for the students to follow the principle given above, *i.e.*, "wages and salaries" to be charged to Trading Account while "wages and salaries" to be charged to the Profit and Loss Account. Wages paid for purchase of an asset for long-term use in the business, *i.e.*, wages paid for plant and machinery or wages paid for construction of a building should not be charged to the Wages Account. They should be charged to the concerned Asset Account.

5. Customs and Import Duty In case the goods have been imported from outside the country, customs and import duty may have to be paid. The amount of such duty should be charged to the Trading Account.

6. Freight, Carriage and Cartage Freight, Carriage and Cartage are taken as direct expenses incurred on purchasing of the goods. They are, therefore, taken to the debit side of the Trading Account. The terms "Freight In", "Cartage In" and "Carriage In" have also the same meaning. However, "Cartage Out", "Freight Out" and "Carriage Out" are taken to be the expenses incurred on selling the goods. They are, therefore, charged to the Profit and Loss Account. The term "Inward" is also used for the term "IN". Similarly, the term "Outward" is also used for the term "Out". In other words, "Carriage" or "Carriage Inward" or "Cariage In" are used as synonymous terms. Similarly, "Carriage Out" or "Carriage Outward" are also synonymous terms. The same is true for other expenses like Freight or Cartage.

7. **Royalty** Royalty is the amount paid to the owner for using his rights. For example, the royalty is paid by a "Lessee" of a coalmine to its owner for taking out the coal from the coalmine. Similarly, royalty is paid to the owner of a patent for using his right. It is generally taken as a direct expense and, therefore, is charged to the Trading Account. However, where royalty is based on sales, for example, in case of the book publishing trade, it may be charged to the Profit and Loss Account.

8. **Gas, Electricity, Water, Fuel, etc.** All these expenses are direct expenses and, therefore, they are charged to the Trading Account.

9. **Packing Materials** Packing Materials used for packing the goods purchased for bringing them to the shop or convert them into a saleable state are direct expenses and, therefore, they are charged to the Trading Account. However, packing expenses incurred for making the product look attractive or packing expenses incurred after the product has been sold away are charged to the Profit and Loss Account.

Closing Entries

Closing Entries are entries passed at the end of the accounting year to close different accounts. These entries are passed to close the accounts relating to incomes, expenses, gains and losses. In other words, these entries are passed to close the different accounts which pertain to Trading and Profit and Loss Account. The accounts relating to assets and liabilities are not closed but they are carried forward to the next year. Hence, no closing entries are to be passed regarding those accounts which relate to the Balance Sheet.

The principle of passing closing entry is very simple. In case an account shows a debit balance, it has to be credited in order to close it. For example, if the Purchases Account is to be closed, the Purchases Account will have to be credited so that it may be closed because it has a debit balance. The Trading Account will have to be debited.

The closing entries are passed in the Journal Proper. The different closing entries to be passed by the accountant for preparing a Trading Account are being explained below:

(a) Trading Account	10.	Dr.
To Stock Account (Opening)		
To Purchases Account		
To Sales Returns Account		
To Carriage Account		
To Customs Duty Account		
(b) Sales Account		Dr.
Purchases Returns Account		Dr.
Stock Account (Closing)		Dr.
To Trading Account		

In case the total of the credit side of the Trading Account is greater than the total of the debit side of the Trading Account, the difference is known as Gross Profit. In a reverse case it will be a Gross Loss. Gross Profit or Gross Loss disclosed by the Trading Account is transferred to the Profit and Loss Account.

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Importance of the Trading Account

Trading Account provides the following information to a businessman regarding his business:

1. Gross Profit disclosed by the Trading Account tells him the upper limit within which he should keep the operating expenses of the business besides saving something for himself. The cost of purchasing and the price at which he can sell the goods are governed largely by market factors over which he has no control. He can control only his operating expenses. For example, if the cost of purchasing an article is ₹10 and it can be sold in the market at ₹15 per unit, the gross margin available on each article is ₹5. In case a businessman proposes to sell 1,000 units of that article in a year, his gross profit or gross margin will be ₹5,000. His other expenses should therefore be less than ₹5,000 so that he can also save something for himself.
2. He can calculate his Gross Profit Ratio[1] and compare his performance year after year. A fall in the Gross Profit Ratio means increase in the cost of purchasing the goods or decrease in the selling price of the goods or both. In order to maintain at least same figure of gross profit in absolute terms, he will have to push up the sales or make all out efforts to obtain goods at cheaper prices. Thus, he can prevent at least fall in the figure of his gross profit if he cannot bring any increase in it.
3. Comparison of stock figures of one period from another will help him in preventing unnecessary lock-up of funds in inventories.
4. In case of new products, the businessman can easily fix up the selling price of the products by adding to the cost of purchases, the percentage gross profit that he would like to maintain. For example, if the trader has been so far maintaining a rate of gross profit of 20% on sales and he introduces a new product in the market having a cost of ₹100, he should fix the selling price at ₹125 in order to maintain the same rate of gross profit (*i.e.*, 20% on sales).

PROFIT AND LOSS ACCOUNT

The Trading Account simply tells about the gross profit or loss made by a businessman on purchasing and selling of goods. It does not take into account the other operating expenses incurred by him during the course of running the business. For example, he has to maintain an office for getting orders and executing them, taking policy decisions and implementing them. All such expenses are charged to the Profit and Loss Account. Besides this, a businessman may have other sources of income. For example, he may receive rent from some of his business properties. He may have invested surplus funds of the business in some securities. He might be getting interest or dividends from such investments. In order to ascertain the true profit or loss which the business has made during a particular period, it is necessary that all such expenses and incomes should be considered. Profit and Loss Account considers all such expenses and incomes and gives the net profit made or loss suffered by a business during a particular period. It is generally prepared in the following form:

---

1. $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$

Profit and Loss Account
for the year ending.....

Dr. Cr.

Particulars	₹	Particulars	₹
To Gross Loss b/d*	....	By Gross Profit b/d*	....
To Salaries	....	By Discount received	....
To Rent	....	By Net Loss transferred to Capital A/c*	
To Commission	....		
To Advertisements	....		
To Bad Debts	....		
To Discount	....		
To Net Profit Transferred to Capital Account*	....		
	....		....

* Only one figure of profit or loss will appear.

SRCA BD SR CA BD

Important Points Regarding Profit and Loss Account

1. Gross Profit or Gross Loss The figure of gross profit or gross loss is brought down from the Trading Account. Of course, there will be only one figure, *i.e.*, either of gross profit or gross loss.

2. Salaries Salaries payable to the employees for the services rendered by them in running the business being of indirect nature are charged to the Profit and Loss Account. In case of a partnership firm, salaries may be allowed to the partners. Such salaries will also be charged to the Profit and Loss Account.

3. Salaries Less Tax In case of employees earning salaries beyond a certain limit, the employer has to deduct at source income tax from the salaries of such employees. In such a case, the amount of gross salaries should be charged to the Profit and Loss Account, while the tax deducted by the employer will be shown as a liability in the Balance Sheet of the business till it is deposited with the Tax Authorities. For example, if salaries paid are ₹2,400 after deducting income tax of ₹600, the amount of salaries to be charged to the Profit and Loss Account will be a sum of ₹3,000. The amount of tax-deducted at source by the employer, *i.e.*, ₹600 will be shown as a liability in the Balance Sheet.

4. Salaries after deducting Provident Fund Contribution etc. In order to provide for old age of the employees, employers contribute a certain percentage of salaries of the employees to the Provident Fund. The employee is also required generally to contribute an equivalent amount. The share of the employee's contribution to Provident Fund is deducted from the salary due to him and the net amount is paid to him. The amount of salaries to be charged to the Profit and Loss Account will be the gross salary payable to the employee, *i.e.*, including the employee's contribution to the Provident Fund. The contribution by the employer will also be charged as an expense to the Profit and Loss Account. Both employer's and employee's contributions to the Provident Fund will also be shown as liability in the Balance Sheet under the heading "Employees Provident Fund".

5. Interest Interest on loans whether short-term or long-term is an expense of an indirect nature and, therefore, is charged to the Profit and Loss Account. However, interest on loans advanced by a firm to third-parties is an item of income and, therefore, will be credited to the Profit and Loss Account.

6. **Commission** Commission may be both an item of income as well as an item of expense. Commission on business brought by agents is an item of expense while commission earned by the business for giving business to others is an item of income. Commission to agents is, therefore, debited to the Profit and Loss Account while commission received is credited to the Profit and Loss Account.

7. **Trade Expenses** Trade expenses are expenses of a miscellaneous nature. They are of small amount and varied in nature and, therefore, it is not considered worthwhile to open separate accounts for each of such types of expenses. The terms "Sundry Expenses", "Miscellaneous Expenses" or "Petty Expenses" have also the same meaning. They are charged to the Profit and Loss Account.

8. **Printing and Stationery** This item of expense includes expenses on printing of bills, invoices, registers, files, letter heads, ink, pencil, paper and other items of stationery, etc. It is of an indirect nature and, therefore, charged to the Profit and Loss Account.

9. **Advertisements** Advertisement expenses are incurred for attracting the customers to the shop and, therefore, they are taken as selling expenses. They are debited to the Profit and Loss Account. However, advertisement expenses incurred for purchasing of goods should be charged to the Trading Account, while an advertisement expense incurred for purchase of a capital asset (*e.g.*, cost of insertion in a newspaper for purchase of car) should be taken as a capital expenditure and debited to the concerned asset account. Similarly, advertisement expenditure incurred for sale of a capital asset should be deducted out of the sale proceeds of the asset concerned.

10. **Bad Debts** Bad Debts denotes, the amount lost from debtors to whom the goods were sold on credit. It is a loss and, therefore, should be debited to the Profit and Loss Account.

11. **Depreciation** Depreciation denotes decrease in the value of an asset due to wear and tear, lapse of time, obsolescence, exhaustion and accident. For example, a motor car purchased gets depreciated on account of its constant use. A property purchased on lease for ₹12,000 for a period of 12 years will depreciate at the rate of ₹1,000 per year. On account of new inventions, old assets become obsolete and they have to be replaced. Mines etc. get exhausted after the minerals are competely taken out of them. An asset may meet an accident and may lose its value. It is necessary that depreciation on account of all these factors is charged to the Profit and Loss Account to ascertain the true profit or loss made by the business.

12. **Discount** It is a reduction from a list price, quoted price or invoice price. Discount may be of three types:

(*a*) *Trade Discount* It is a reduction from the list price. It is a reduction granted by a supplier from the list price of goods or services.

(*b*) *Quantity Discount* It is similar to trade discount with the difference that it is given in case of purchasing of goods in bulk quantity.

(*c*) *Cash Discount* It is reduction granted by a supplier from the invoice price in consideration of immediate payment or payment within a stipulated period.

Thus, quantity discount is similar to trade discount. However, cash discount is different from trade discount.

Distinction between trade discount and cash discount can be put as follows:

(*a*) *Meaning* A trade discount is a reduction granted by the supplier from the list price on total amount of sales, while a cash discount is a reduction for prompt payment or payment within a stipulated time period.

(*b*) *Objective* The objective of trade discount is to promote sales, while the objective of cash discount is quick collection of payment.

(c) *Time* Trade discount is allowed at the time of purchasing of goods, while cash discount is allowed at the time of making payment.

(d) *Disclosure* Trade discount is shown as reduction in the invoice itself, while cash discount is not shown in the invoice. Moreover, trade discount account is not opened in the ledger, while cash discount account is opened in the ledger.

(e) *Variation* Trade discount may vary with the quantity of goods purchased, while cash discount may vary with time period within which payment is received.

13. **Manager's Commissions** The manager of a firm may be given a certain percentage of net profit. This percentage of commission may be before or after charging of such commission. The computation of commission can be understood with the following example.

Example:

Net Profit before charging commision: ₹10,000.

Manager's Commission 10% of Net Profit before charging his commission.

The Manager's Commission can be computed as under:

$$= ₹10,000 \times \frac{10}{100} = ₹1,000$$

However, if the manager's commission is 10% of Net profit after charging his commission, the amount of commission will be computed as follows:

$$= ₹10,000 \times \frac{10}{110} = ₹909$$

This can be verified as under:

Net Profit before charging commission	=	₹10,000
Less: Manager's Commission	=	₹909
Net Profit after charging commission	=	9,091

Thus, manager' commission of ₹909 is 10% of firm's net profits after charging commisson.

Accounting (Closing) Entries for Preparing Profit and Loss Account

The following journal entries will be passed in the Journal Proper for preparing the Profit and Loss Account.

(i) For transfer of items of expenses, losses, etc., appearing on the debit side of the Trial Balance

Profit and Loss Account Dr.
  To Salaries
  To Rent
  To Commission
  To Advertisements
  To Bad Debts
  To Discount
  To Printing and Stationery

(ii) For transfer of items of incomes, gains, etc., appearing on the credit side of the Trial Balance

Interest Account	Dr.
Dividends Account	Dr.
Discount Account	Dr.
To Profit and Loss Account	

(*iii*) For transfer of net profit or net loss:

In case the total of the credit side of the Profit and Loss Account is greater than the debit side of the Profit and Loss Account, the difference is termed as Net Profit. In a reverse case, it will be termed as Net Loss. The amount of Net Profit or Net Loss shown by the Profit and Loss Account will be transferred to Capital Account in case of sole proprietary firm. In case of a partnership firm, the amount of net profit or net loss will be transferred to the Partners' Capital Accounts in the agreed ratio. In the absence of any agreement, the partners will share profits and losses equally.

2000 + 22000 -

For transfer of Profit

Profit and Loss Account	Dr.
To Capital Account(s)	

For transfer of Net Loss

Capital Account(s)	Dr.
To Profit and Loss Account	

ILLUSTRATION 8.7. From the following balances, taken from the Trial Balance of Shri Suresh, prepare a Trading and Profit and Loss Account for the year ending 31st Dec., 2009:

Particulars	*Dr.* ₹	*Cr.* ₹
Stock on 1.1.2009	2,000	
Purchases and Sales	20,000	30,000
Returns	2,000	1,000
Carriage	1,000	
Cartage	1,000	
Rent	1,000	
Interest Received		2,000
Salaries	2,000	
General Expenses	1,000	
Discount		500
Insurance	500	

P/L.

The Closing Stock on 31st December, 2009 is ₹5,000.

SOLUTION:

Trading and Profit and Loss Account
for the year ending 31st December, 2009

Dr. *Cr.*

Particulars		₹	*Particulars*		₹
To Opening Stock		2,000	By Sales	30,000	
To Purchases	20,000		*Less:* Returns	2,000	28,000
Less: Returns	1,000	19,000	By Closing Stock		5,000
To Carriage		1,000			
To Cartage		1,000			
To Gross Profit c/d		10,000			
		33,000			33,000
To Rent		1,000	By Gross Profit b/d		10,000
To Salaries		2,000	By Interest		2,000
To General Expenses		1,000	By Discount		500
To Insurance		500			
To Net Profit taken to Capital Account		8,000			
		12,500			12,500

Importance of Profit and Loss Account

The Profit and Loss Account provides information regarding the following matters:

(i) It provides information about the net profit or net loss earned or suffered by the business during a particular period. Thus, it is an index of the profitability or otherwise of the business.

(ii) The Profit figure disclosed by the Profit and Loss Account for a particular period can be compared with that of the other period. Thus, it helps in ascertaining whether the business is being run efficiently or not.

(iii) An analysis of the various expenses included in the Profit and Loss Account and their comparison with the expenses of the previous period or periods helps in taking steps for effective control of the various expenses.

(iv) Allocation of profit among the different periods or setting aside a part of the profit for future contingencies can be done. Moreover, on the basis for profit figures of the current and the previous period estimates about the profit in the year to come can be made. These projections will help the business in planning the future course of action.

20,000 - 30,000

MANUFACTURING ACCOUNT

In the preceding pages, we have explained the preparation of the Trading and Profit and Loss Account from the point of view of a trader, *i.e.*, a person who purchases and sells goods. However, a person may manufacture goods by himself for selling them at a profit. In case of such a person, *i.e.*, a manufacturer, it will be necessary to ascertain the cost of manufacturing the goods. In his case, therefore, the profit or loss made by him will be ascertained by preparing the following three accounts:

(i) **Manufacturing account** This account gives the cost of the goods manufactured by a manufacturer ~~during a particular period.~~

(ii) **Trading account** This account gives information about the gross profit or loss made by a manufacturer in selling the manufactured goods. In case a manufacturer also functions as a trader, *i.e.*, besides manufacturing and selling goods of his own, he also purchases and sells goods of others, he will be a manufacturer-cum-trader. In such a case, his Trading Account will disclose not only the profit made by him on selling his manufactured goods, but also the profit made by him in selling the goods purchased by him from others.

(iii) **Profit and Loss account** This account gives the overall profit or loss made or suffered by the manufacturer or manufacturer-cum-trader during a particular period.

The proforma of a Manufacturing Account is given below:

Manufacturing Account
for the year ending.........

Dr. Cr.

Particulars		₹	*Particulars*	₹
To Work-in-process (Opening)		....	By Work-in-process (Closing)	....
To Raw Materials consumed:			By Sale of Scrap	....
Opening Stock	....		By Cost of Production of	
Add: Purchases of Raw			Finished Goods during the	

(*Contd...*)

M O H A M M A D

4

Particulars		₹	Particulars	₹
Materials	....		Period transferred to the Trading Account	....
Less: Closing Stock of Raw Materials	....	....		
To Direct or Productive wages		....		
To Factory Overheads:				
Power and Fuel		....		
Repairs of Plant		....		
Depreciation on Plant		....		
Factory Rent		....		
		......		......

The Trading Account in case of a manufacturer will appear as follows:

Trading Account

for the year ending.........

Dr. Cr.

Particulars	₹	Particulars	₹
To Opening Stock of Finished Goods	....	By Sales *less* Returns	....
To Cost of Production of Finished Goods Transferred from Manufacturing Account	....	By Closing Stock of Finished Goods	....
To Purchases of Finished Goods *less* Returns	....	By Gross Loss c/d*	....
To Carriage Charges on Goods Purchased	....		
To Gross Profit c/d*	....		
	....		....

* Only one figure of profit or loss will appear.

The Gross Profit or Loss shown by the Trading Account will be taken to the Profit and Loss Account which will be prepared in the usual way as explained in the preceding pages.

Important Points Regarding Manufacturing Account

1. Stock In case of a manufacturer, there can be stocks of three types:
   (*i*) **Stock of Raw Materials** It includes stock of raw materials or finished components which might have been purchased by the manufacturer for using them in the products manufactured by him but still lying unsold.
   (*ii*) **Stock of Work-in-process** This is also termed as stock of work-in-progress. It includes goods in semi-finished form.
   (*iii*) **Stock of Finished Goods** It includes stock of those goods which have been completely processed and are lying unsold at the end of a period with the manufacturer. It also includes stock of those finished goods which might have been purchased by a manufacturer-cum-trader from outside parties, but still lying unsold with him at the end of the accounting period.

2. Raw Materials Consumed It is customary to show in the Manufacturing Account, the value of raw materials consumed for manufacturing goods during a particular period. This is computed as follows:

Opening Stock of Raw Materials	......
***Add:* Purchase of Raw Materials**	......
	......
***Less:* Closing Stock of Raw Materials**	......
Raw Materials Consumed	......

For example, if the opening stock of raw materials is ₹5,000, purchases of raw materials is ₹20,000 and closing stock of raw materials is ₹8,000, the value of raw materials consumed will be calculated as follows:

	₹	₹
Opening Stock of Raw Materials	5,000	
Add: Purchase of Raw Materials	20,000	25,000
Less: Closing Stock of Raw Materials		8,000
Raw Materials Consumed		17,000

3. Carriage Inwards, etc. The expenses incurred for bringing the raw materials to the factory or the octroi or customs duty paid by the manufacturer on the raw materials purchased or imported by him will also be charged to Manufacturing Account.

4. Factory Overheads The term "Overheads" includes indirect material, indirect labour and indirect expenses. The term "Factory Overheads", therefore, stands for all factory indirect material, indirect labour, and indirect expenses. For example, in case of a manufacturer of chairs, the cost of timber purchased will be taken as raw materials. However, the polishing material used by him will be taken as indirect material and will be taken as an item of factory overheads. Similarly, the wages paid to the carpenters who have been employed for making chairs will come as cost of direct labour since they are actively engaged in manufacturing the chairs. However, the salaries of the supervisor or the wages of the gatekeeper will be taken as indirect labour cost and come in the definition of factory overheads. Similarly, the carriage charges paid for bringing the raw materials to the factory are considered to be direct charges since they can directly be charged to the raw materials purchased. However, the rent for the factory, depreciation of the factory machines, insurance of the factory are all taken as indirect factory expenses and, therefore, covered under the category of factory overheads.

5. Cost of Production The Manufacturing Account gives the cost of manufacturing the goods during a particular period. This is computed by deducting from the total of the debit side of the Manufacturing Account, the total of the various items appearing on the credit side of the Manufacturing Account as shown in the proforma of the Manufacturing Account given earlier in the chapter.

6. Sale of Scrap In manufacturing operations, certain scrap is unavoidable. It may or may not have any sales value. In order to calculate the true cost of manufacturing the goods, it is necessary that the money realised on account of sale of scrap (or realisable value of the scrap in case it had not been sold) should be considered. The amount of scrap is, therefore, credited to the Manufacturing Account.

ILLUSTRATION 8.8. From the following details, prepare a Manufacturing and a Trading Account for the year ending 31st December, 2010.

	₹
Stock on 1.1.2010:	
Raw Materials	10,000
Work-in-Process	5,000
Finished Goods	20,000
Stock on 31.12.2010:	
Raw Materials	5,000
Work-in-Process	15,000
Finished Goods	30,000
Purchase of Raw Materials	50,000
Direct Wages	10,000
Carriage Charges on purchase of raw materials	5,000
Factory Power	5,000
Depreciation on Factory Machines	5,000
Purchase of Finished Goods	30,000
Cartage paid on Finished Goods purchased	2,000

SOLUTION:

Manufacturing Account
for the year ending 31.12.2010

Particulars		₹	*Particulars*	₹
To Work-in-process on 1.1.2010		5,000	By Work-in-process on 31.12.2010	15,000
To Raw Materials consumed			By Cost of Production transferred to Trading Account	70,000
Stock on 1.1.2010	10,000			
Add : Purchases	50,000			
	60,000			
Less: Closing Stock	5,000	55,000		
To Direct Wages		10,000		
To Carriage Charges		5,000		
To Factory Power		5,000		
To Depreciation on Factory Machines		5,000		
		85,000		85,000

Trading Account
for the year ending 31.12.2010

Particulars	₹	*Particulars*	₹
To Stock of Finished Goods on 1.1.2010	20,000	By Stock of Finished Goods on 31.12.2010	30,000
To Cost of Production of Finished Goods Transferred from Manufacturing Account	70,000	By Sale of Finished Goods	1,00,000
To Purchases of Finished Goods	30,000		
To Cartage on Finished Goods Purchased	2,000		
To Gross Profit Transferred to Profit and Loss A/c	8,000		
	1,30,000		1,30,000

Tutorial Note. The following points may further be noted by students:

(i) It is customary to give a separate heading to the Manufacturing Account as shown above. However, the Trading Account and Profit and Loss Account are not given separate headings. There will be a common heading for both these accounts as shown below:

TRADING AND PROFIT & LOSS ACCOUNT

for the year ending........

(ii) In case in an examination question, a Manufacturing Account is not separately asked, the examinees may show all items relating to the Manufacturing Account in the Trading Account itself. However, it will be advisable in such a case to prepare a Manufacturing Account, if possible.

(iii) In case of joint stock companies, the heading given is only, "Profit and Loss Account for the year ending....." and not Trading and Profit and Loss Account. However, the amount of Gross Profit and Net Profit may be calculated separately.

BALANCE SHEET

Having prepared the Manufacturing, Trading and Profit and Loss Account, a businessman will like to know the financial position of his business. For this purpose, he prepares a statement of his assets and liabilities as on a particular date. Such a statement is termed as "Balance Sheet". Thus, Balance Sheet is not an account but only a statement containing the assets and liabilities of a business on a particular date. It is, as a matter of fact, a classified summary of the various remaining accounts after accounts relating to Incomes and Expenses have been closed by transfer to Manufacturing, Trading and Profit and Loss Account.

Balance Sheet has two sides. On the left hand side, the "liabilities" of the business are shown while on the right hand side the assets of the business appear. These two terms have been explained later in the chapter.

It will be useful here to quote definitions of the Balance Sheet given by some prominent writers. According to Palmer, "The Balance Sheet is a statement at a given date showing on one side the trader's property and possessions and on the other side his liabilities." According to Freeman, "A Balance Sheet is an itemised list of the assets, liabilities and proprietorship of the business of an individual at a certain date." The definition given by the American Institute of Certified Public Accountants makes the meaning of Balance Sheet more clear. According to it, Balance Sheet is "a list of balances of the asset and liability accounts. This list depicts the position of assets and liabilities of a specific business at a specific point of time."

Proforma of Balance Sheet and Principle of Marshalling

There is no prescribed form of Balance Sheet for a sole proprietary and partnership firm.[2] However, the principle of marshalling is applied while arranging the assets and liabilities in the balance sheet of a firm. Marshalling refers to arrangement of assets and liabilities in the balance sheet in any of the following order:

1. Liquidity Order 2. Permanency Order

1. **Liquidity Order** In case a concern adopts liquidity order, the assets which are more readily convertible into cash come first and those which cannot be so readily converted come next and so on. Similarly, those liabilities which are payable first come first, and those payable later, come next and so on. A proforma of Balance Sheet according to liquidity order is given below:

2. Paul Grady, 'Inventory of Generally Accepted Accounting Principles for Business Enterprises', 234–35.

Balance Sheet

as on ....

Liabilities	₹	*Assets*		₹
Bank Overdraft	....	Cash in Hand		....
Outstanding Expenses	....	Cash at Bank		....
Bills Payable	....	Prepaid Expenses		....
Sundry Creditors	....	Bills Receivable		....
Long-term Loans	....	Sundry Debtors		....
Capital	....	*Closing Stock:*		
		Raw Materials	....	
		Work-in-Progress	....	
		Finished Goods	....	....
		Plant and Machinery		....
		Furniture		....
		Building		....
		Land		....
		Goodwill	....	....
	....			....

2. **Permanency Order** In case of permanency order, assets which are more permanent come first, less permanent come next and so on. Similarly, liabilities which are more permanent come first, less permanent come next and so on. In other words, an asset which will be sold in the last or a liability which will be paid in the last come first and that order is followed both for all assets and liabilities. In case a balance sheet is to be prepared according to permanency order, arrangement of assets and liabilities will be reversed than what has been shown above in case of liquidity order.

Distinction between Profit & Loss Account and Balance Sheet

The points of distinction between Profit & Loss Account and Balance Sheet are as under:

(*i*) A profit and loss account shows the profit or loss made by the business during a particular period. While a balance sheet shows the financial position of the business on a particular date.

(*ii*) A profit and loss account incorporates those items which are of a revenue nature while a balance sheet incorporates those items which are of a capital nature.

(*iii*) Of course, both profit and loss account and the balance sheet are prepared from the Trial Balance. However, the accounts transferred to the profit and loss account are finally closed while the accounts transferred to the balance sheet represent those accounts whose balances are to be carried forward to the next year.

Difference between Trial Balance and Balance Sheet

The difference between trial balance and balance sheet can be put as under:

(*a*) **Meaning** A trial balance is a statement containing various ledger balances on a particular date while a balance sheet is a statement of various assets and liabilities of the business on a particular date.

(*b*) **Objective** The objective of preparation of a trial balance is to check the arithmetical accuracy of the books of account of the business, while the objective of preparation of a balance sheet is to ascertain the financial position of the business.

(*c*) **Items covered** A trial balance contains all items relating to incomes, expenses, assets and liabilities while a balance sheet incorporates only assets and liabilities.

(d) **Preparation** A trial balance is prepared before preparation of a balance sheet. In other words, the preparation of a trial balance is independent of the preparation of a balance sheet. While a balance sheet is prepared not only on the basis of trial balance but also of any additional information which may not have been incorporated in the trial balance.

(e) **Use** A trial balance is meant only for internal use while a balance is prepared both for internal as well as external use.

Important Points Regarding Balance Sheet

1. **Liabiiities** The term "Liabilities" denotes claims against the assets of a firm, whether those of owners of the business or of the creditors. As a matter of fact, the term "Equity" is more appropriate than the term "Liabilities". This is supported by the definition given by American Accounting Association. According to this Association, Liabilities are "claims of the creditors against the enterprise arising out of past activities that are to be satisfied by the disbursement or utilisation of corporate resources". While the term "Equity" stands both for owners equity (owners claims) as well as the outsiders equity (outsiders claims). However, for the sake of convenience, we are using the term "Liabilities" for the purposes of this book.

Liabilities can be classified into two categories:

(i) Current Liabilities

(ii) Long-Term or Fixed Liabilities.

Current liabilities The term "Current Liabilities" is used for such liabilities which are payable within a year from the date of the Balance Sheet either out of existing current assets or by creation of new current liabilities. The broad categories of current liabilities are as follows:

(a) Accounts Payable, *i.e.*, bills payable and trade creditors.

(b) Outstanding Expenses, *i.e.*, expenses for which services have been received by the business but for which payments have not been made.

(c) Bank Overdraft.

(d) Short-term Loans, *i.e.*, loans from Bank which are payable within one year from the date of the Balance Sheet.

(e) Advance payments received by the business for the services to be rendered or goods to be supplied in future.

Fixed liabilities All liabilities other than Current Liabilities come within this category. In other words, these are the liabilities which do not become due for payment in one year and which do not require current assets for their payment.

2. **Assets** The term "Assets" denotes the resources acquired by the business from the funds made available either by the owners of the business or others. It thus includes all rights or properties which a business owns. Cash, investments, bills receivable, debtors, stock of raw materials, work-in-progress and finished goods, land, buildings, machinery, trademarks, patent rights, etc., are some examples of assets.

Assets may be classified into the following categories:

(a) **Current assets** Current Assets are those assets which are acquired with the intention of converting them into cash during the normal business operations of the enterprise. According to Grady, "the term Current Assets is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realised in cash or sold during the normal operating cycle of the business."[3] Thus, the term "Current Assets" includes cash and bank balances, stocks of raw materials, work-in-progress and finished goods, debtors, bills receivable, short-term investments, prepaid expenses, etc.

(*b*) **Liquid assets** Liquid Assets are those assets which are immediately convertible into cash without much loss. Liquid Assets are a part of current asset. In computing liquid assets, stock of raw materials, work-in-progress and finished goods and prepaid expenses are excluded while all other current assets are taken.

(*c*) **Fixed assets** Fixed assets are those assets which are acquired for relatively long periods for carrying on the business of the enterprise. They are not meant for resale. Land and building, machinery, furniture are some of the examples of Fixed Assets. Sometimes, the term "Block Capital" is also used for them.

(*d*) **Intangible assets** Intangible Assets are those assets which do not have any physical identity. Goodwill, patents, trademarks, etc., are some examples of Intangible Assets.

(*e*) **Fictitious assets** There are assets not having any real value. Examples of such assets are formation expenses incurred for establishing a business such as registration charge paid to the Registrar of joint stock companies for getting a company incorporated, discount on issue of shares, debit balance in the Profit and Loss Account when shown on the assets side in case of a joint stock company etc.

Valuation of Assets The following requirements of various accounting standards (ASs) should be kept in mind while valuing assets.

(*i*) The cost of a fixed asset should comprise its purchase price and any attributable costs of bringing the asset to its working condition for its intended use. (AS 10)

(*ii*) Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. (AS 10)

(*iii*) The direct costs incurred in developing the patents should be capitalised, and written off over their legal term of validity or over their working life, whichever is shorter. (AS 10)

(*iv*) Amount paid for knowhow for the plants, lay-out and designs of building and/or design of the machiery should be capitalised under the relevant asset heads, such as buildings, plants and machinery, etc., (AS 10)

(*v*) If the recoverable amount of an asset is less than its carrying amount, *i.e.*, it has become an impaired asset, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss. Impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard (see Accounting Standard (AS) 10, Accounting for Fixed

3. Paul Grady, "Inventory of Generally Accepted Accounting Principles for Business Enterprises", pages 234-35.

Assets), in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard. (AS 28)

(vi) The current assets are meant for converting into cash during the normal operating cycle of business, hence, they are valued on the principle of "cost or market price whichever is less".

(vii) Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicates that the fundamental accounting assumption of going concern (*i.e.*, the continuance of existence or substratum of the enterprise) is not appropriate. (AS 4)

ILLUSTRATION 8.9. From the following balances extracted from the books of M/s Rajendra Kumar Gupta & Co., pass the necessary closing entries, prepare a Trading and Profit & Loss Account and a Balance Sheet.

Debit Credit

Particulars	₹	*Particulars*	₹
Opening Stock — T	1,250	Plant and Machinery — A	6,230
Sales — T	11,800	Returns Outwards — T	1,380
Depreciation — E	667	Cash in hand — A	895
Commission (Cr.) — E	211	Salaries — E	750
Insurance — E	380	Debtors — A	1,905
Carriage Inwards — T	300	Discount (Dr.) — E	328
Furniture — A	670	Bills Receivable — A	2,730
Printing Charges — E	481	Wages — E	1,589
Carriage Outwards P/L — E	200	Returns Inwards — T	1,659
Capital — L	9,228	Bank Overdraft — L	4,000
Creditors — L	1,780	Purchases — T	8,679
Bills Payable — L	541	Petty Cash in hand — A	47
		Bad Debts — E	180

The value of stock on 31st December, 2011 was ₹3,700. closing stock

SOLUTION:

Journal

Date	*Particulars*		*Dr.* ₹	*Cr.* ₹
	Trading A/c	Dr.	13,477	
	To Opening Stock A/c			1,250
	To Purchases A/c			8,679
	To Wages A/c			1,589
	To Returns Inward A/c			1,659
	To Carriage Inward A/c			300
	(For closing all accounts to be debited to Trading A/c)			
	Sales A/c	Dr.	11,800	
	Returns Outward A/c	Dr.	1,380	
	To Trading A/c			13,180
	(For closing all accounts to be credited to the Trading A/c)			
	Trading A/c	Dr.	3,403	
	To Profit and Loss A/c			3,403
	(For transfer of gross profit)			

(Contd...)

Date	Particulars		Dr. ₹	Cr. ₹
	Profit and Loss A/c	Dr.	2,986	
	To Depreciation A/c			667
	To Insurance A/c			380
	To Printing Charges A/c			481
	To Carriage Outward A/c			200
	To Salaries A/c			750
	To Discount A/c			328
	To Bad Debts A/c			180
	(For closing all indirect and selling expenses accounts)			
	Commission A/c	Dr.	211	
	To Profit and Loss A/c			211
	(For closing commission account)			
	Profit and Loss A/c	Dr.	628	
	To Capital A/c			628
	(For transferring Net Profit to Capital Account)			

Trading and Profit & Loss Account
for the year ending 31st December, 2011

Particulars		₹	Particulars		₹
To Opening Stock		1,250	By Sales	11,800	
To Purchases	8,679		*Less:* Returns Inwards	1,659	10,141
Less: Returns Outward	1,380	7,299	Closing Stock		3,700
To Wages		1,589			
To Carriage Inward		300			
To Gross Profit c/d		3,403			
		13,841			13,841
To Depreciation		667	By Gross Profit b/d		3,403
To Insurance		380	By Commission		211
To Printing Charges		481			
To Carriage Outwards		200			
To Salaries		750			
To Discount		328			
To Bad Debts		180			
To Net Profit		628			
		3,614			3,614

2986 3614

Per - Debit the Receiver Credit the giver
Nominal - Debit all expenses
Real - Debit what comes in Credit what goes out

Balance Sheet

as on 31st December, 2011

Liabilities		₹	*Assets*	₹
...s Payable		541	Cash	895
...ditors		1,780	Petty Cash	47
...nk Overdraft		4,000	Bills Receivable	2,730
...pital	9,228		Debtors	1,905
...: Net Profit	628	9,856	Closing Stock	3,700
			Plant and Machinery	6,230
			Furniture	670
		16,177		16,177

...USTRATION **8.10.** From the following Trial Balance prepare the Manufacturing Account, Trading and Profit ...d Loss Account for the year ending 31st March, 2011 and the Balance Sheet as on that date:

Particulars	*Dr.* ₹	*Cr.* ₹
Shri Banker's Capital Account — Liability		41,000
Shri Banker's Drawing Account	6,100	
Mrs Banker's Loan Account		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 — Real	20,000	
Land and Buildings — Real	26,000	
Purchases of Raw Materials — Real	35,000	
Raw Material as on : 1.4.2010	3,500	
Work-in-process as on : 1.4.2010	2,000	
Finished Stock as on : 1.4.2010	18,000	
Carriage Inwards	1,100	
Wages	27,000	
Salary of Works Manager	5,600	
Factory Expenses	3,400	
Factory Rent and Taxes	2,500	
Royalties (paid on sales)	1,200	
Sales (*less* Returns)		1,23,400
Advertising	3,000	
Office Rent and Insurance	4,800	
Printing and Stationery	1,000	
Office Expenses	5,800	
Carriage Outwards	600	
Discounts	1,400	2,100
Bad Debts	750	
	2,15,500	2,15,500

The Stock on 31 March 2011 was as follows:
₹4,000 Raw Materials, ₹4,500 Work-in-progress and ₹28,000 finished goods.

SOLUTION:

Manufacturing Account
for the year ending March 31, 2011

Particulars		₹	Particulars	₹
To Opening Work-in-process		2,000	By Transfer to Trading Account (cost of finished goods produced)	71,600
To Raw Materials used:			By Closing Work-in-process	4,500
Opening Stock	3,500			
Add: Purchases	35,000			
	38,500			
Less: Closing Stock	4,000	34,500		
To Carriage Inwards		1,100		
To Wages		27,000		
To Salary of Works Manager		5,600		
To Factory Expenses		3,400		
To Factory Rent and Taxes		2,500		
		76,100		76,100

Trading and Profit & Loss Account
for the year ending March 31, 2011

Particulars	₹	Particulars	₹
To Opening Stock of Finished Goods	18,000	By Sales	1,23,400
To Manufacturing A/c (Cost of goods produced)	71,600	By Closing Stock of Finished Goods	28,000
To Gross Profit c/d	61,800		
	1,51,400		1,51,400
To Royalties	1,200	By Gross Profit b/d	61,800
To Advertising	3,000	By Discount received	2,100
To Office Rent and Insurance	4,800		
To Printing and Stationery	1,000		
To Office Expenses	5,800		
To Carriage Outwards	600		
To Bad Debts	750		
To Discount Allowed	1,400		
To Net Profit carried to Capital Account	45,350		
	63,900		63,900

Balance Sheet
as on 31st March, 2011

Liabilities		₹	Assets		₹
Sundry Creditors		45,000	Current Assets:		
Mrs Banker's Loan		4,000	Cash in hand		250
Capital Account			Cash at Bank		4,000
Balance on 1.4.2010		41,000	Sundry Debtors		40,500
Profit		45,350	Closing Stock:		
	86,350		Raw Materials	4,000	
Less: Drawings	6,100	80,250	Work-in-process	4,500	
			Finished goods	28,000	36,500
			Fixed Assets:		
			Patents		2,000
			Plant and Machinery		20,000
			Land and Buildings		26,000
		1,29,250			1,29,250

ADJUSTMENT ENTRIES

In the preceding pages, we have explained the preparation of the Final Accounts, without any adjustments. We have presumed that the accountant has taken into consideration all important facts before closing the books of accounts and preparing the Final Accounts. However, it may not always happen. The accountant may come to know of certain adjustments to be made in the books of accounts to give a true picture of the state of affairs of the business after closing the books of accounts and preparing the Trial Balance. These adjustments usually relate to the following:

1. Closing stock
2. Outstanding expenses
3. Prepaid expenses
4. Outstanding or accrued income
5. Income received in advance or unearned income
6. Depreciation
7. Bad debts
8. Provision for bad debts
9. Provision for discount on debtors
10. Reserve for discount on creditors
11. Interest on capital
12. Interest on drawings

Each of these adjustments are being explained in detail in the following pages:

Closing Stock

We have already explained about the treatment of the stock at the end of the accounting year while explaining Final Accounts in the preceding pages. The following journal entry is passed for the unsold stock at the end of the accounting period:

Closing Stock A/c ... Dr.
To Trading Account

The stock at the end appears in the Balance Sheet and its balance at the end of the accounting year is carried forward to the next year. It comes as Opening Stock in the Trial Balance of the next year from where it is transferred to the Trading Account on the debit side. The Trading Account is debited and the stock in the beginning of the accounting year (which was Closing Stock last year) is credited. Stock Account is thus closed.

Sometimes, the value of the stock at the end of the accounting year is given in the Trial Balance. In such a case, the Closing Stock will be shown only in the Balance Sheet. This is because it means that the Closing Stock has already been taken into account while computing the cost of goods sold. This will be clear with the help of the following example:

Trial Balance

Particulars	Dr. ₹	Cr. ₹
Opening Stock	10,000	
Purchases	30,000	
Sales		40,000

Stock at the end of the accounting year is ₹15,000.

In this case, the Closing Stock has been given outside the Trial Balance and, therefore, the different items will appear in the Final Accounts as follows:

Dr. **Trading Account** Cr.

Particulars	₹	Particulars	₹
To Opening Stock	10,000	By Sales	40,000
To Purchases	30,000	By Closing Stock	15,000
To Gross Profit taken to Profit and Loss Account	15,000		
	55,000		55,000

Balance Sheet

Liabilities	₹	Assets	₹
		Closing Stock	15,000

The Opening and Closing Stocks may both be adjusted with purchases and the cost of sales may be found out separately. In such a case, the items in the Trial Balance will appear as follows:

Trial Balance

Particulars	Dr. ₹	Cr. ₹
Adjusted Purchases or Cost of Sales	25,000	
Sales		40,000
Closing Stock	15,000	

The different items will now appear in the Final Accounts as follows:

Trading Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Adjusted Purchases	25,000	By Sales	40,000
To Gross Profit taken to Profit and Loss Account	15,000		
	40,000		40,000

Balance Sheet

Liabilities	₹	Assets	₹
		Closing Stock	4,000

Outstanding Expenses

Outstanding Expenses refer to those expenses which have become due during the accounting period for which the Final Accounts have been prepared but have not yet been paid. This happens particularly regarding those expenses which accrue from day-to-day business activities but which are recorded only when they are paid. Examples of such expenses are rent, salaries, interest, etc. Some of these expenses may have remained unpaid at the end of the accounting period and, therefore, no entry might have been passed in the books of accounts. For example, if the salary for the month of December has not been paid, no entry might have been passed in the books for the salary remaining outstanding on 31st December. However, in order to ascertain the true profit or loss made during the accounting year ending 31st December, it is necessary that such outstanding salaries are taken into account. The following journal entry will be passed in case of such outstanding expenses:

Salaries A/c Dr.

To Outstanding Salaries A/c

Salaries Account is a nominal account and, therefore, it should be charged to the Profit and Loss Account, while the Outstanding Salaries Account is a personal account representing the persons to whom the salary has to be paid. It is, therefore shown in the Balance Sheet on the liabilities side.

ILLUSTRATION **8.11.** Following are the extracts from the Trial Balance of a firm as on 31st December, 2009:

Trial Balance

as on 31st December, 2009

Particulars	Dr. ₹	Cr. ₹
Salaries A/c	10,000	
Rent A/c	5,000	

Additional Information:

(i) Salary for the month of December ₹2,000 has not yet been paid.

(ii) Rent amounting to ₹1,000 is still outstanding.

You are required to pass the necessary adjusting entries and show how the above items will appear in the Firm's Accounts:

Journal Proper

Date	Particulars		Dr. ₹	Cr. ₹
	Salaries A/c To Outstanding Salaries A/c *(Being salaries due but not paid)*	Dr.	2,000	2,000
	Rent A/c To Outstanding Rent A/c *(Being rent due but not paid)*	Dr.	1,000	1,000

The items will appear in the final accounts as follows:

Profit and Loss Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Salaries (as given in the Trial Balance)	10,000			
Add: Outstanding Salaries	2,000	12,000		
To Rent (as given in the Trial Balance)	5,000			
Add: Outstanding Rent	1,000	6,000		

Balance Sheet

Liabilities		₹	Assets	₹
Outstanding Expenses:				
Outstanding Salaries	2,000			
Outstanding Rent	1,000	3,000		

It should be noted that any item given outside the Trial Balance will be recorded at two places on account of Dual Aspect Concept. For example, in the above illustration, the amount of outstanding salaries has been shown in the Profit and Loss Account and also in the Balance Sheet.

However, if the accountant had come to know about these outstanding expenses before closing the books of accounts, the Salaries Account and Outstanding Salaries Account, Rent Account and Outstanding Rent Account would have appeared in the ledger as follows:

Salaries Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Bank	10,000	By Balance c/d	12,000
To Outstanding Salaries	2,000		
	12,000		12,000

Outstanding Salaries Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance c/d	2,000	By Salaries	2,000
	2,000		2,000

Rent Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Bank	5,000	By Balance c/d	6,000
To Outstanding Rent	1,000		
	6,000		6,000

Outstanding Rent Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance c/d	1,000	By Rent A/c	1,000
	1,000		1,000

The above balances would have appeared in the Trial Balance as follows:

Trial Balance
as on 31st December, 2009

Particulars	Dr. ₹	Cr. ₹
Salaries A/c	12,000	
Rent A/c	6,000	
Outstanding Salaries A/c		2,000
Outstanding Rent A/c		1,000

The above accounts would have appeared in the Final Accounts as follows:

Profit & Loss Account
for the year ending 31.12.2009

Particulars	₹	Particulars	₹
To Salaries	12,000		
To Rent	6,000		

Balance Sheet
as on 31.12.2009

Liabilities	₹	Assets	₹
Outstanding Salaries	2,000		
Outstanding Rent	1,000		

Thus, the position in both the cases is the same. The point to be noted is that any item appearing in the Trial Balance is recorded at only one place in the Final Account while any item outside the Trial Balance is recorded at two places in the Final Accounts

Prepaid Expenses

Prepaid Expenses are those expenses which have been paid in advance. In other words, these are the expenses which have been paid during the accounting period for which the Final Accounts are bring prepared but they relate to the next period. For example, during the accounting year ending on 31st December, 2009, insurance premium for the year ending 31st March, 2010 might have been paid. It means insurance for three months has been paid in advance. In order to ascertain true profit or loss only expenses relating to the accounting period should be charged to the Profit and Loss Account. Any expenses paid in advance should be carried forward to the next year. The following journal entry is passed for an expense paid in advance:

Prepaid Expense A/c Dr.
To Expense A/c

Expense Account is a nominal account and, therefore, the amount should be credited to the Profit and Loss Account, preferably the amounts should be deducted from the relevant Expense Account in respect of which the payment has been made in advance. Prepaid Expense Account is a Personal Account; it represents the account of the person to whom payment has been made in advance. It is, therefore, shown on the Balance Sheet on the assets side.

Illustration 8.12. The following are the extracts from the Trial Balance of a firm as on 31st Dec. 2009.

Trial Balance
as on 31st December, 2009

Particulars	*Dr. ₹*	*Cr. ₹*
Insurance	8,000	
Rent	4,000	

Additional Information:

(*i*) Insurance premium has been paid in advance amounting to ₹1,000 for the next year.
(*ii*) Rent ₹500 has been paid for the next year.

You are required to pass the necessary adjusting entries and show how the items will appear in the firm's final accounts.

Solution:

Journal Proper

Date	*Particulars*		*Dr. ₹*	*Cr. ₹*
2009	Prepaid Insurance A/c	Dr.	1,000	
	To Insurance A/c			1,000
	(*Being Insurance premium paid in advance*)			
	Prepaid Rent A/c	Dr.	500	
	To Rent A/c			500
	(*Being rent paid in advance*)			

Profit and Loss Account
as on 31 Decmeber 2009

Dr. Cr.

Particulars		*₹*	*Particulars*	*₹*
To Insurance	8,000			
Less: Prepaid	1,000	7,000		
To Rent	4,000			
Less: Prepaid	500	3,500		

Balance Sheet
as on 31st December, 2009

Liabilities	₹	Assets	₹
		Prepaid Insurance	1,000
		Prepaid Rent	500

Outstanding Income

Outstanding Income means income which has become due during the accounting year but which has not so far been received by the firm. In order to ascertain the true profit or loss, adjustments for such income must be made in the Final Accounts of the business. The following journal entry will be passed:

Outstanding Income A/c Dr.
To Income A/c

Accrued Income

Accrued income means income which has been earned by the business during the accounting year but which has not yet become due and, therefore, has not been received. Adjusting entry of such income is also on the pattern of outstanding income as shown below:

Accrued Income A/c Dr.
To Income A/c

A distinction has to be made between accrued income and outstanding income. Though, both the incomes have been earned by the business and not yet received but in case of accrued income, the income has not become due to the business while outstanding income is an income which has become due to the business. For example, if a loan of ₹10,000 has been given @ 12% p.a. and interest is payable monthly, if interest for one month, *i.e.*, ₹100 has not been received by the business, the income will be termed as an Outstanding Income since interest has become due but it has not yet been received by the business. However, in case of these securities where interest is payable on definite dates, interest may have been earned by the business, but it will become due not earlier than the definite date. For example, if a business has purchased 6% Government Securities of ₹10,000 on which interest is payable on 31st March and 30th September, for the accounting year ending on 31st December interest for 3 months (*i.e.*, ₹150 for October, November and December) will be taken as accrued interest and not an outstanding interest. This is because interest will become due after 30th September, only on 31st March and not earlier.

Illustration 8.13. The following are the extracts from the Trial Balance of a firm on 31st Dec. 2010.

Particulars	*Dr.* ₹	*Cr.* ₹
6% Loan	20,000	
Investments in 6 per cent Debentures of '*B*' Ltd	30,000	
(Interest payable on 31 March and 30 Sept.)		
Interest on loan received up to 31 October 2010		1,000
Interest on Investments		900

SOLUTION:

In the above case, interest on loan for a period of two months is still outstanding. The amount of such interest is ₹200. In case of debentures, interest for three months has been earned by the business but it has not become due. The amount of accrued interest, therefore, comes to ₹450. The following adjusting entries will, therefore, be passed in the journal proper.

Date	*Particulars*		*Dr.* ₹	*Cr.* ₹
	Outstanding Interest A/c To Interest A/c *(Being interest on loan due but not received)*	Dr.	200	200
	Accrued Interest A/c To Interest on Investments A/c *(Being interest earned, not due and not received)*		450	450

Outstanding Interest Account and Interest Accrued Account are personal accounts. They represent the accounts of the persons from whom the interest has to be received. They will, therefore, be shown on the 'assets side' in the Balance Sheet. Interest Account is a nominal account, and it has been credited. The amount of interest will, therefore, be added to the amount of interest already appearing in the Trial Balance.

The items will appear in the Final Accounts as follows:

Profit and Loss Account

for the year ending 31st December, 2010

Particulars	₹	*Particulars*		₹
		By Interest on Loan	1,000	
		Add: Outstanding Interest	200	1,200
		By Interest on Investments	900	
		Add: Accrued Interest	450	1,350

Balance Sheet

as on 31st December, 2010

Liabilities	₹	*Assets*	₹
		Outstanding Interest A/c	200
		Accrued Interest A/c	450

Income Received in Advance

Income received in advance means income which has been received by the business before it is earned by the business. This includes certain prepayments which the business may receive during the course of the accounting year. In order to ascertain the true profit or loss, it is necessary that such income is not taken into account while preparing the Profit and Loss Account for the year. The following adjustment entry is passed for such income:

Income A/c Dr.
To Income Received in Advance A/c

ILLUSTRATION 8.14. The following are the extracts from the Trial Balance of a firm on 31st December, 2009. You are required to pass the necessary adjustment entries and show how the various will appear in the firm's Final Accounts.

Trial Balance
as on 31st December, 2009

Date	Particulars	Dr. ₹	Cr. ₹
	Rent received for 12 months ending 31 March 2010		1,200
	Interest on Loan		2,000

Additional Information: Interest on loan has been received in advance to the extent of ₹500.

SOLUTION:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Rent A/c	Dr.	300	
	To Rent received in Advance A/c			300
	(Being rent received in advance for three months)			
	Interest A/c	Dr.	500	
	To Interest received in Advance A/c			500
	(Being interest received in advance)			

Profit and Loss Account
for the year ending 31st December, 2009

Particulars	₹	Particulars		₹
		By Interest	2,000	
		Less: Received in advance	500	1,500
		By Rent	1,200	
		Less: Received in advance	300	900

Balance Sheet
as on 31st December, 2009

Liabilities	₹	Assets	₹
Rent received in advance	300		
Interest received in advance	500		

Depreciation

Depreciation denotes decrease in the value of an asset due to wear and tear, lapse of time, obsolescence, exhaustion and accident. In order to ascertain the true profit for the business, it is necessary that depreciation is charged on the fixed assets of the business.

The following entry will be passed for depreciation.

Depreciation A/c Dr.
To Fixed Asset A/c

ILLUSTRATION 8.15. The following are the extracts from the Trial Balance of a firm.

Trial Balance
as on 31st December, 2009

Particulars	Dr. ₹	Cr. ₹
Plant		30,000
Buildings		50,000

Additional Information:

(*i*) Charge depreciation on plant @ 10% per annum.

(*ii*) Charge depreciation on buildings @ 5% per annum.

SOLUTION:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Depreciation A/c	Dr.	5,500	
	To Plant A/c			3,000
	To Buildings A/c			2,500
	(Being depreciation charged on Plant and Buildings)			

Profit and Loss Account

for the year ending 31 December 2009

Dr. Cr.

Particulars		₹	Particulars	₹
To Depreciation:				
Plant	3,000			
Buildings	2,500	5,500		

Balance Sheet

as on 31 December 2009

Liabilities	₹	Assets		₹
		Plant	30,000	
		Less: Depreciation	3,000	27,000
		Buildings	50,000	
		Less: Depreciation	2,500	47,500

Depreciation on Assets Acquired during the Course of the Year

Sometimes, fixed assets are acquired during the course of the year. In such a case, the problem arises whether depreciation should be charged for the full accounting year or it should be charged only for a part of the accounting year. In such a situation in the absence of any specific instructions in the question, it will be appropriate to charge depreciation for the full year even in respect of those assets which have been acquired during the course of the year. However, where depreciation rate has been given as per annum and the date of acquisition of the fixed assets has been given, it will be appropriate to charge depreciation only for the remaining part of the accounting year.

ILLUSTRATION 8.16. The following are the extracts from the Trial Balance of a firm.

Trial Balance

as on 31st December, 2009

Date	Particulars	Dr. ₹	Cr. ₹
	Furniture and Fixtures		10,000
	Plant and Machinery		40,000

Additional Information:

(*i*) Furniture of ₹5,000 was purchased on 1st July, 2009. Charge depreciation @ 10% p.a.

(*ii*) Plant of ₹10,000 was acquired on 1st July, 2009. Charge depreciation @ 20%.

Pass the necessary journal entries and show how the items will appear in the firm Final Accounts:

SOLUTION:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Depreciation A/c	Dr.	8,750	
	To Furniture & Fixtures A/c			750
	To Plant and Machinery A/c			8,000
	(Being depreciation charged on furniture and fixtures and Plant and Machinery including additions)			

Profit and Loss Account
for the year ending 31st December, 2009

Particulars		₹	*Particulars*	₹
To Depreciation:				
Furniture and Fixtures	750			
Plant and Machinery	8,000	8,750		

Balance Sheet
as an 31st December, 2009

Particulars	₹	*Particulars*		₹
		Furniture & Fixtures	10,000	
		Less: Depreciation	750	9,250
		Plant & Machinery	40,000	
		Less: Depreciation	8,000	32,000

Notes:

(*i*) Since depreciation has been given on furniture at 10% p.a., depreciation for only 6 months has been charged for furniture acquired on 1st July, 2009.

(*ii*) In case of plant, the rate of depreciation has been given as 20%, hence, depreciation for the full year has been charged even on plant which has been acquired on 1st July, 2009.

Tutorial Note. The students should give note regarding their workings. In case the question regarding charging of depreciation on additions to fixed assets made during the year is silent, the students can also presume that no depreciation is to be charged on additions. However, a specific note should be given to that effect.

Bad Debts

Credit sales have become a must these days and bad debts occur when there are credit sales. Bad Debt is a loss to the business and a gain to the debtor. The following journal entry should, therefore, be passed in the event of a debt becoming bad.

Bad Debts A/c　　　　　　　　　　　　　　　　Dr.

　　To Debtor's Personal A/c

ILLUSTRATION 8.17. The following are the extracts from Trial Balance of a business.

Trial Balance
as on 31 December 2009

Date	*Particulars*	*Dr. ₹*	*Cr. ₹*
	Sundry Debtors	50,000	
	Bad Debts	5,000	

Additional Information: Mahesh, one of the debtors, became insolvent and it was learnt on 31 December, that out of the total debt of ₹5,000 only ₹2,500 will be recovered from him. No adjustment has so far been made.

You are required to pass necessary adjusting entries and show how the items will appear in the final accounts of the business.

SOLUTION:

Journal

Date	*Particulars*		*Dr. ₹*	*Cr. ₹*
	Bad Debts A/c	Dr.	2,500	
	To Mahesh			2,500
	(Being ₹2,500 became irrecoverable)			

Profit and Loss Account
for the year ending 31 December 2009

Dr. Cr.

Particulars		*₹*	*Particulars*	*₹*
To Bad Debts		5,000		
(as given in the Trial Balance)				
Add: Additional bad debts	2,500	7,500		

Balance Sheet
as on 31 December 2009

Liabilities	*₹*	*Assets*		*₹*
		Sundry Debtors	50,000	
		Less: Bad Debts	2,500	47,500

Provision for Bad Debts

In an earlier chapter, we have already explained that in accounting we observe the "convention of conservatism" while recording business transactions. This means that we make provision for expected losses but we do not take credit for expected profits. A firm, therefore, makes provision at the end of the accounting year for likely bad debts which may happen during the course of the next year. This is for the simple reason that if out of credit sales made during a particular year some sales are likely to become bad in the course of the next year, the proper course would be to charge the same accounting year with such likely bad debts in which the sales have been made, since, the profit on such sales has been considered in the year in which the sales have been made.

The following journal entry is passed for creating a provision for bad debts.

Profit & Loss A/c Dr.

To Provision for Bad Debts

The provision for bad debts is charged to the Profit & Loss Account and is deducted from debtors in the Balance Sheet.

ILLUSTRATION 8.18. The following are the extracts from the Trial Balance of a firm.

Trial Balance

as on 31 December 2009

Date	*Particulars*	*Dr. ₹*	*Cr. ₹*
	Sundry Debtors	30,000	
	Bad Debts	5,000	

Additional Information:

(*i*) After preparing the trial balance, it is learnt that a debtor Ramesh has become insolvent and, therefore, the entire amount of ₹3,000 due from him was irrecoverable.

(*ii*) Create 10% provision for bad and doubtful debts.

You are required to pass necessary adjusting entries and show how the items will appear in the firm's balance sheet.

SOLUTION:

Adjusting Journal Entries

Date	*Particulars*		*Dr. ₹*	*Cr. ₹*
	Bad Debts A/c	Dr.	3,000	
	To Ramesh			3,000
	(Being amount due from Ramesh proved to be bad)			
	Profit and Loss A/c	Dr.	2,700	
	To Provision for Bad and Doubtful Debts			2,700
	(Being bad debts provision created)			

Profit and Loss Account

for the year ending 31 December 2009

Dr. Cr.

Particulars		*₹*	*Particulars*	*₹*
To Bad Debts	5,000			
(as given in the Trial Balance)				
Add : Additional bad debts	3,000			
Add : Provision for bad debts	2,700	10,700		

Balance Sheet

as on 31 December 2009

Liabilities	*₹*	*Assets*		*₹*
		Sundry Debtors	30,000	
		Less: Additional bad debts	3,000	
			27,000	
		Less: Provision for bad debts	2,700	24,300

The provision for bad debts created at the end of the accounting year is carried forward to the next year and the bad debts occurring during the course of the next year are met out of this provision. At the end of the next year, suitable adjusting entry is passed for keeping the provision for doubtful debts at an appropriate amount to be carried forward.

Illustration 8.19. The following are the extracts from the Trial Balance of a firm:

Trial Balance

as on 31 December 2009

Date	Particulars	Dr. ₹	Cr. ₹
	Sundry Debtors	50,000	
	Provision for Doubtful Debts		5,000
	Bad Debts	3,000	

Additional Information:

(i) Additional bad debts ₹3,000.

(ii) Keep the provision for bad debts @ 10% on debtors.

You are required to pass the necessary journal entries and prepare Provision for Doubtful Debts Account and show how the different items will appear in the firm's Final Accounts.

Solution:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Bad Debts A/c To Sundry Debtors (Being additional bad debts of ₹3,000)	Dr.	3,000	3,000
	Provision for Bad Debts A/c To Bad Debts A/c (Being bad debts, ₹3,000 appearing in the Trial Balance + ₹3,000 additional bad debts, transferred to Provision for Bad Debts A/c)	Dr.	6,000	6,000
	Profit and Loss A/c To Provision for Bad Debts A/c (Being amount charged from *P & L* A/c to keep provision for bad debts @10% on debtors)	Dr.	5,700	5,700

Provision for Bad Debts Account

Particulars	₹	Particulars	₹
To Bad Debts A/c	6,000	By Balance b/d	5,000
To Balance c/d	4,700	By Profit & Loss A/c	5,700
	10,700		10,700

Profit and Loss Account
as on 31st December, 2009

Particulars		₹	Particulars	₹
To Bad Debts (as given in the Trial Balance)	3,000			
Add: Additional bad debts	3,000			
	6,000			
Add: New provision for bad debts	4,700			
	10,700			
Less: Old provision for bad debts	5,000	5,700		

Balance Sheet
as on 31st December, 2009

Liabilities	₹	Assets		₹
		Sundry Debtors	50,000	
		Less : Additional bad debts	3,000	
			47,000	
		Less : New provision for bad debts	4,700	42,300

Provision for Discount on Debtors

Discount may have to be allowed to the debtors on account of their making prompt payments. When discount is allowed, the following journal entry is passed:

Discount A/c Dr.
To Debtor's Personal A/c

At the end of the accounting year, the firm also estimates the amount of discount which it may have to give to the debtors outstanding at the end of the accounting year in the course of the next year. This is done by creating a provision for discount on debtors. The following journal entry is passed:

Profit and Loss A/c Dr.
To Provision for Discount A/c

It should be noted that 'provision for discount' will be created only on good debtors. In other words, provision for discount should be made after deducting bad debts and provision for bad debts from the debtors' balances.

ILLUSTRATION 8.20. The following are the extracts from the Trial Balance of a firm:

Trial Balance
as on 31 December 2009

Date	*Particulars*	*Dr.* ₹	*Cr.* ₹
	Sundry Debtors	50,000	
	Bad Debts	3,000	
	Discount	2,000	

Additional Information:

(*i*) Create a provision for doubtful debts @ 10% on debtors.
(*ii*) Create a provision for discount on debtors @ 5% on debtors.
(*iii*) Additional discount given to the debtors ₹1,000.

You are required to pass the necessary journal entries and show how the different items will appear in the Final Accounts.

SOLUTION:

Journal Entries

Date	*Particulars*		*Dr.* ₹	*Cr.* ₹
	Discount A/c	Dr.	1,000	
	To Sundry Debtors A/c			1,000
	(*Being discount allowed to debtors*)			
	Profit & Loss A/c	Dr.	4,900	
	To Provision for Bad Debts A/c			4,900
	(*Being provision for bad debts created @ 10% on debtors of ₹49,000*)			
	Profit & Loss A/c	Dr.	2,205	
	To Provision for Discount			2,205
	(*Being provision for discount created @ 5% on debtors of ₹44,100 (i.e., ₹49,000 – ₹4,900)*)			

Profit and Loss Account
for the year ending 31 December 2009

Particulars		₹	*Particulars*	₹
To Bad Debts	3,000			
(as given in the Trial Balance)				
Add: Provision for bad debts	4,900	7,900		
To Discount	2,000			
(as given in the Trial Balance)				
Add: Additional discount	1,000			
Add: Provision for discount	2,205	5,205		

Balance Sheet
as on 31 December 2009

Liabilities	₹	Assets		₹
		Debtors	50,000	
		Less: Additional discount	1,000	
			49,000	
		Less: Provision for bad debts	4,900	
				44,100
		Less: Provision for discount	2,205	41,895

ILLUSTRATION 8.21. The following are the extracts from the Trial Balance of a firm:

Trial Balance
as on 31 December 2010

Date	Particulars	Dr. ₹	Cr. ₹
	Sundry Debtors	50,000	
	Provision for Bad Debts		5,000
	Provision for Discount		2,000
	Bad Debts	3,000	
	Discount	1,000	

Additional Information:

(i) Additional Bad Debts ₹1,000.
(ii) Additional Discount ₹500.
(iii) Create a provision for bad debts @10% on debtors.
(iv) Create a provision for discount @5% on debtors.

Pass the necessary journal entries, prepare Provision for Bad Debts Account and Provision for Discount on Debtors Account and show how the different items will appear in the Firm's Final Accounts.

SOLUTION:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Bad Debts A/c	Dr.	1,000	
	Discount A/c	Dr.	500	
	To Sundry Debtors			1,500
	(Being additional bad debts and additional discount on debtors)			
	Provision for Bad Debts A/c	Dr.	4,000	
	To Bad Debts A/c			4,000
	(Being bad debts written-off from Provision for Bad Debts A/c)			

(Contd...)

Date	Particulars		Dr. ₹	Cr. ₹
	Provision for Discount on Debtors A/c	Dr.	1,500	
	To Discount A/c			1,500
	(Being discount allowed written-off from Provision for Discount on Debtors A/c)			
	Profit and Loss A/c	Dr.	3,850	
	To Provision for Bad Debts A/c			3,850
	(Being amount charged from P&L A/c to maintain a provision of 10 per cent for bad debts on debtors amounting to ₹48,500)			
	Profit and Loss A/c	Dr.	1,682.50	
	To Provision for Discount A/c			1,682.50
	(Being amount charged from P&L A/c for keeping the provision for discount @ 5 per cent on good debtors amounting to ₹43,650)			

Provision for Bad Debts Account

Dr. Cr.

Particulars	₹	*Particulars*	₹
To Bad Debts A/c	4,000	By Balance b/d	5,000
To Balance c/d	4,850	By Profit & Loss A/c	3,850
	8,850		8,850

Provision for Discount Account

Dr. Cr.

Particulars	₹	*Particulars*	₹
To Discount A/c	1,500.00	By Balance b/d	2,000.00
To Balance c/d	2,182.50	By *P&L* A/c	1,682.50
	3,682.50		3,682.50

Profit and Loss Account

for the year ending 31 December 2010

Dr. Cr.

Particulars		₹	*Particulars*	₹
To Bad Debts *(as given in the Trial Balance)*		3,000.00		
Add: Additional bad debts	1,000.00			
Add: New provision for bad debts	4,850.00			
	8,850.00			
Less: Old provision for bad debts	5,000.00	3,850.00		
To Discount *(as given in the Trial Balance)*	1,000.00			
Add: Additional discount	500.00			
Add: New provision for discount	2,182.50			
	3,682.50			
Less: Old provision	2,000.00	1,682.50		

Balance Sheet
as on 31 December 2010

Liabilities	₹	*Assets*		₹
		Sundry Debtors	50,000	
		Less: Additional bad debts and additional discount	1,500	
			48,500	
		Less: New provision for bad debts	4,850	
			43,650	
		Less: New provision for discount	2,182.50	41,467.50

Reserve for Discount on Creditors

A firm may like to create a reserve for discount on its creditors on a similar pattern on which a provision for discount on debtors is made. However, creating of such a reserve is against the fundamental convention of conservatism. Such a reserve, therefore, is usually not created. However, if this is done the accounting entries are passed on the same pattern on which the accounting entries are passed for provision for discount on debtors.

On receipt of additional discount from creditors:

Sundry Creditors A/c	Dr.
To Discount A/c	

For creating a reserve for discount on creditors:

Reserve for Discount on Creditors	Dr.
To Profit and Loss A/c	

ILLUSTRATION **8.22.** The following are the extracts from the Trial Balance of a firm.

Trial Balance
as on 31 December 2010

Date	*Particulars*	*Dr.* ₹	*Cr.* ₹
	Sundry Creditors		30,000
	Discount		1,000
	Reserve for Discount on Creditors	2,000	

Additional Information:

(i) Additional discount received from creditors after closing the accounts ₹1,500.

(ii) Create a reserve for discount on creditors @10%.

You are required to pass the necessary journal entries, prepare Reserve for Discount Account and show how the various items will appear in the Firm's Final Accounts.

SOLUTION:

Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
	Sundry Creditors A/c	Dr.	1,500	
	To Discount A/c			1,500
	(Being additional discount received from Creditors)			
	Discount A/c	Dr.	2,500	
	To Reserve for Discount on Creditors			2,500
	(Being discount received transferred to Reserve for Discount A/c)			
	Reserve for Discount A/c	Dr.	3,350	
	To Profit and Loss A/c			3,350
	(Being amount credited to Profit and Loss Account for maintaining Reserve for Discount Account @ 10 per cent on creditors)			

Dr. Reserve for Discount for Creditors Account Cr.

Particulars	₹	*Particulars*	₹
To Balance b/d	2,000	By Discount A/c	2,500
To Profit and Loss Account	3,350	By Balance c/d	2,850
	5,350		5,350

Profit and Loss Account
for the year ending 31 December 2010

Dr. Cr.

Particulars	₹	*Particulars*		₹
		By Discount	1,000	
		(as given in the Trial Balance)		
		Add: Additional discount received	1,500	
		Add: New Reserve for discount	2,850	
			5,350	
		Less: Old Reserve for discount	2,000	3,350

Interest on Capital

Funds provided by the proprietor to run the business is termed as Capital. In order to determine the real profit made by the business, it is necessary that the profit should be determined after deducting interest on such funds, which the proprietor could have earned otherwise. The entry for interest on proprietor's funds (or capital) is passed as follows:

Interest on Capital A/c Dr.
To Capital A/c

In case of a partnership firm, interest will be allowed on the capital of each partner. The following journal entry will be passed:

Interest on Capital A/c Dr.
To Partner's Capital Account

Interest on capital is allowed on the balance in the Capital Account in the beginning of the accounting year. However, in case the proprietor has introduced further capital during the course of the accounting year, interest on such capital will also be allowed from the date on which such further capital was introduced till the end of the accounting period.

ILLUSTRATION 8.23. The following are the extracts from the Trial Balance of a firm:

Trial Balance
as on 31 December 2010

Particulars	*Dr.* ₹	*Cr.* ₹
Capital Accounts:		
Ramesh		30,000
Suresh		20,000

Additional Information:

(*i*) Interest on capital is to be allowed @ 10% p.a.
(*ii*) Suresh introduced additional capital amounting to ₹5,000 on 1st July, 2010.

You are required to pass the necessary journal entries and show how the different items will appear in the Firm's Final Accounts.

SOLUTION:

Journal Entries

Date	*Particulars*		*Dr.* ₹	*Cr.* ₹
	Interest on Capital A/c	Dr.	4,750	
	To Ramesh's Capital A/c			3,000
	To Suresh's Capital A/c			1,750
	(Being interest on capital allowed to Ramesh on ₹30,000 for full year and to Suresh on ₹15,000 for full year and on ₹5,000 for 6 months)			

Balance Sheet
as on 31 December 2010

Liabilities		₹	*Assets*	₹
Capital Accounts:				
Ramesh	30,000			
Add: Interest on capital	3,000	33,000		
Suresh	20,000			
Add: Interest on capital	1,750	21,750		

Profit and Loss Account

for the year ending 31st December, 2010

Particulars		₹	Particulars	₹
To Interest on Capital:				
Ramesh	3,000			
Suresh	1,750	4,750		

Interest on Drawings

Drawings denote the money withdrawn by the proprietor from the business for his personal use. It is usual practice to charge interest on drawings in case interest is allowed to the proprietor on his capital. The following journal entry is passed for interest on drawings.

Capital A/c Dr.

To Interest on Drawings A/c

In case of a partnership firm, interest on drawings will be charged on the drawings made by each partner. The journal entry will be as follows:

Partners Capital/Current Accounts* Dr.

To Interest on Drawings A/c

Computation of Interest on Drawings There is a difference between the method of computation of interest on capital and computation of interest on drawings. In most cases, interest on capital is charged on the opening balance in the Capital Account. However, in case of additional capital introduced during the year by the proprietor, interest may be charged from the date of introducing additional capital till the end of the accounting period. This does not create much problem. However, in case of drawings, the things are different. The proprietor does not usually make the entire amount of drawings on a particular date for the whole accounting year.

For example, if the proprietor has withdrawn ₹12,000 from the business, it cannot reasonably be pressumed that he must have withdrawn the entire amount in the beginning of the accounting year.

Since, the interest is to be charged on the amount withdrawn by the proprietor from the date on which he withdrew the amount from the business till the end of the accounting period, it requires computation of interest on each withdrawal made by the proprietor separately. In the absence of any specific information, it can reasonably be presumed that the drawings were made evenly throughout the year. Moreover, for computation of interest, any of the following three presumptions can reasonably be made:

* Partners Capital Accounts can be maintained either on a Fixed or a Fluctuating Capital System. In case of a Fixed Capital System, two accounts are maintained for each partner. (*i*) Capital Account, and (*ii*) Current Account. Capital Account is credited with the amount of capital introduced by the partner or debited with the amount of capital withdrawn by the partner, while all adjustments regarding interest on capital, share of profit, drawings, etc., are made in the Current Accounts. Thus, balance in the Capital Account remains more or less fixed. This is the reason for calling it as a Fixed Capital System. In case of Fluctuating Capital System all adjustments regarding capital, drawings, interest, share or profit etc. are made only in the Capital Account. Thus, the balance of the Capital Account goes on fluctuating. This is the reason for calling this system as Fluctuating Capital System.

(i) The proprietor withdrew the money on the 1st of each month. In such a case, interest should be charged for $6^1/_2$ months on the total amount at the given rate of interest.

(ii) The proprietor withdrew the money on the 15th of each month. In such a case, interest should be charged on the total amount of drawings for six months.

(iii) The proprietor withdrew the money at the end of each month. In such a case, interest should be charged on the total amount for $5^1/_2$ months.

Tutorial Note. The students may adopt the second presumption in the absence of any specific instructions in the question.

ILLUSTRATION 8.24. The following are the extracts from the Trial Balance of a Firm.

Trial Balance
as on 31 December 2010

Particulars	*Dr ₹*	*Cr ₹*
Capital Accounts:		
A's Capital		30,000
B's Capital		20,000
Drawings:		
A	6,000	
B	3,000	

Additional Information:

(i) Interest on capital is to be allowed to the partners @ 10% p.a. on the opening balances standing to the credit of their Capital Accounts.

(ii) Interest on drawings is to be charged @ 12% p.a.

You are required to pass the necessary journal entries and show how the different items will appear in the Firm's Final Accounts. You may presume that the drawings were made evenly throughout the year on 15th of each month.

SOLUTION:

Journal Entries

Date	*Particulars*		*Dr. ₹*	*Cr. ₹*
	Interest on Capital A/c	Dr.	5,000	
	To *A*'s Capital A/c			3,000
	To *B*'s Capital A/c			2,000
	(Being interest on capital @ 10 per cent p.a.)			
	A's Capital A/c	Dr.	360	
	B's Capital A/c	Dr.	180	
	To Interest on Drawings A/c			540
	(Being interest on drawings charged for 6 months @ 12 per cent p.a. on the total amount)			

Profit and Loss Account

for the year ending 31st December 2010

Particulars		₹	Particulars		₹
To Interest on Capital:			By Interest on Drawings:		
A	3,000		A	360	
B	2,000	5000	B	180	540

Balance Sheet

as on 31 December 2010

Liabilities		₹	Assets	₹
Capital Accounts:				
A's Capital	30,000			
Add: Interest on Capital	3,000			
	33,000			
Less: Drawings	6,000			
	27,000			
Less: Interest on Drawings	360	26,640		
B's Capital	20,000			
Add: Interest on Capital	2,000			
	22,000			
Less: Drawings	3,000			
	19,000			
Less: Interest on Drawings	180	18,820		

WORK SHEET

In the preceding pages, we have explained about the passing of the necessary adjusting entries in the books of accounts so that final accounts represent the true position of the business. As a result of these adjusting entries and their posting into the ledger, some new accounts are opened in the books while the balances of some of the existing accounts appearing in the Trial Balance also get changed. In order to prevent errors and facilitate the preparation of the final accounts, it is sometimes considered necessary to prepare a preliminary draft incorporating all balances of the Trial Balance, the necessary adjustments to be made therein and showing separately the items relating to Income Statement and the Balance Sheet. Such a preliminary draft is termed as a Work Sheet.

The Work Sheet contains the following information:

(*i*) The Trial Balance as originally prepared.

(*ii*) The necessary adjustments to be carried out on account of adjustment entries.

(*iii*) The new Trial Balance after making the necessary adjustments as required under point (*ii*) above. The new Trial Balance is termed as the 'Adjusted Trial Balance'.

(*iv*) Classification of the items appearing in the Trial Balance between those relating to Income Statement and those relating to Balance Sheet.

A Work Sheet may, therefore, be defined as a large columnar statement specially designed to organise and arrange all accounting data required at the end of the accounting period.

The necessary closing entries are passed on the basis of Adjusted Trial Balance. The Final Accounts are then prepared on the basis of the classification of the items made in the Work Sheet as explained under point (*iv*) above.

It should be noted that Work Sheet is not a part of the accounting records. It is, therefore, not supplied to the bankers, creditors and shareholders. It is simply a working tool of the accountant prepared by him for his own convenience as an aid to preparing the financial statements at the end of the year. A Proforma of Work Sheet is given below:

Proforma of Work Sheet

Sl. No.	*Name of Account*	*L.F.*	*Trial Balance*		*Adjustments*		*Adjusted Trial Balance*		*Income Statement*		*Balance Sheet*	
			Dr.	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*

Advantages of Work Sheet

The Work Sheet offers the following advantages:

(*i*) It brings together the Trial Balance and the adjusting data. Thus, it reduces the chances of errors and at the same time assists in the location of errors which may be made in adjusting, closing and balancing account.

(*ii*) It classifies and summarises the information shown by the Trial Balance and the adjusting data. It thus, facilitates preparation of Final Accounts and passing of closing entries.

(*iii*) The net results of the business operations are known even before preparing formal Final Financial Statements. It makes possible the preparation of the statements during the financial period without the necessity of formal adjusting and closing entries.

Thus, Work Sheet is extremely useful for the management since it furnishes a quick means of determining the business results.

ILLUSTRATION **8.25.** From the following Trial Balance and additional information, you are required to prepare a Work Sheet and Final Accounts.

Trial Balance
as on 31 December 2010

Particulars	*Dr.* ₹	*Cr.* ₹
Capital		20,000
Sundry Debtors	5,400	
Drawings	1,800	
Machinery	7,000	
Sundry Creditors		2,800
Wages	10,000	
Purchases	19,000	
Opening Stock	4,000	
Bank Balance	3,000	
Carriage Charges	300	
Salaries	400	
Rent and Taxes	900	
Sales		29,000
	51,800	51,800

Solution (Illustration 8.25):

Work Sheet

		L.F.	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
			Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
1.	Capital			20,000				20,000				20,000
2.	Sundry Debtors		5400				5,400				5,400	
3.	Drawings		1,800				1,800				1,800	
4.	Machinery		7,000			700	6,300				6,300	
5.	Sundry Creditors			2,800				2,800				2,800
6.	Wages		10,000			400	9,600		9,600			
7.	Purchase/Adjusted Purchases		19,000			1,200	17,800		17,800			
8.	Opening Stock		4,000				4,000		4,000			
9.	Cash at Bank		3,000				3,000				3,000	
10.	Carriage		300				300		300			
11.	Salaries		400				400		400			
12.	Rent and Taxes		900		100		1,000		1,000			
13.	Sales			29,000				29,000		29,000		
14.	Closing Stock				1,200		1,200				1,200	
15.	Outstanding Rent					100		100				100
16.	Prepaid Wages				400		400				400	
17.	Depreciation on Machinery				700		700		700			
			51,800	51,800	2,400	2,400	51,900	51,900				
18.	Net Loss									4,800	4,800	
									33,800	33,800	22,900	22,900

Additional Information:

(*i*) Closing Stock ₹1,200
(*ii*) Outstanding Rent and Taxes ₹100
(*iii*) Charge depreciation on machinery at 10%
(*iv*) Wages prepaid ₹400.

Trading and Profit and Loss Account
for the year ending 31 December 2010

Particulars	₹	*Particulars*	₹
To Opening Stock	4,000	By Sales	29,000
To Adjusted Purchases	17,800	By Gross Loss c/d	2,700
To Wages	9,600		
To Carriage	300		
	31,700		31,700
To Gross Loss b/d	2,700	By Net Loss taken to Capital A/c	4,800
To Salaries	400		
To Rent and Taxes	1,000		
To Depreciation on Machinery	700		
	4,800		4,800

Balance Sheet
as on 31 December 2010

Liabilities		₹	*Assets*	₹
Outstanding Rent		100	Cash at Bank	3,000
Creditors		2,800	Debtors	5,400
Capital	20,000		Closing Stock	1,200
Less: Net Loss	4,800		Prepaid Wages	400
	15,200		Machinery	6,300
Less: Drawings	1,800	13,400		
		16,300		16,300

ILLUSTRATION 8.26. From the following figures extracted from the books of Shri Govind, you are required to prepare a trading and profit and loss account for the year ended 31 March 2010 and a balance sheet as on that date after making the necessary adjustments:

Particulars	₹	*Particulars*	₹
Shri Govind's Capital	2,28,800	Stock 1.4.2009	38,500
Shri Govind's Drawings	13,200	Wages	35,200
Plant and Machinery	99,000	Sundry Creditors	44,000
Freehold Property	66,000	Postage and Telegrams	1,540
Purchases	1,10,000	Insurance	1,760
Returns Outwards	1,100	Gas and Fuel	2,970
Salaries	13,200	Bad Debts	660

(*Contd...*)

Particulars	₹	Particulars	₹
Office Expenses	2,750	Office Rent	2,860
Office Furniture	5,500	Freight	9,900
Discounts A/c (Dr.)	1,320	Loose Tools	2,200
Sundry Debtors	29,260	Factory Lighting	1,100
Loan to Shri Krishan @10% p.a.-balance on 1.4.2009	44,000	Provision for B/D	880
Cash at Bank	29,260	Interest on loan to Shri Krishna	1,100
Bills Payable	5,500	Cash in Hand	2,640
		Sales	2,31,440

Adjustments

1. Stock on 31st March, 2010 was valued at ₹72,600.
2. A new machine was installed during the year costing ₹15,400, but it was not recorded in the books as no payment was made for it. Wages ₹1,100 paid for its erection have been debited to wages account.
3. Depreciate:
   Plant and Machinery by $33\frac{1}{3}$ %.
   Furniture by 10%
   Freehold Property by 5%.
4. Loose tools were valued at ₹1,760 on 31.3.2010.
5. Of the Sundry Debtors ₹600 are bad and should be written off.
6. Maintain a provision of 5% on Sundry Debtors for doubtful debts.
7. The manager is entitled to a commission of 10% of the net profits after charging such commission.

SOLUTION:

Shri Govind
Trading and Profit and Loss Account
for the year ending 31 March 2010

Dr. Cr.

Particulars		₹	Particulars		₹
To Stock (1.4.2009)		38,500	By Sales		2,31,440
To Purchases	1,10,000		By Closing Stock		72,600
Less: Returns	1,100	1,08,900			
To Wages	35,200				
Less: Erection of machinery	1,100	34,100			
To Gas and Fuel		2,970			
To Freight		9,900			
To Factory Lighting		1,100			
To Gross Profit c/d		1,08,570			
		3,04,040			3,04,040
To Salaries		13,200	By Gross Profit b/d		1,08,570
To Office Expenses		2,750	By Interest	1,100	
To Postage and Telegram		1,540	*Add:* Outstanding	3,300	4,400
To Insurance		1,760			
To Office Rent		2,860			

Particulars		₹	*Particulars*	₹
To Discounts		1,320		
To Bad Debts	660			
Add: Addl. Bad Debts	600			
Add: New Provision	1,430			
	2,690			
Less: Old Provision	880	1,870		
To Depreciation:				
Machinery	38,500			
Furniture	550			
Freehold Property	3,300			
Loose Tools	440	42,790		
To Commission to Manager		4,080		
To Net Profit taken to Balance Sheet		40,800		
		1,12,970		1,12,970

Shri Govind
Balance Sheet
as at 31.3.2010

Liabilities		₹	*Assets*		₹
Capital	2,28,800		Plant & Machinery	99,000	
Add: Net Profit	40,800		*Add* : New Machinery (15,400 + 1,100)	16,500	
	2,69,600			1,15,500	
Less: Drawings	13,200	2,56,400	*Less:* Depreciation	38,500	77,000
Bills Payable		5,500	Freehold Property	66,000	
Sundry Creditors		59,400	*Less:* Depreciation	3,300	62,700
Manager's Commission Outstanding		4,080	Office Furniture	5,500	
			Less: Depreciation	550	4,950
			Loose Tools	2,200	
			Less: Depreciation	440	1,760
			Closing Stock		72,600
			Sundry Debtors:	29,260	
			Less: Addl. bad debts	600	
				28,600	
			Less: Provision for doubtful debts	1,430	27,170
			Loan to Sh. Krishna	44,000	
			Add: Interest accrued and outstanding	3,300	47,300
			Cash at Bank		29,260
			Cash in Hand		2,640
		3,25,380			3,25,380

ILLUSTRATION 8.27. The following is the Trial Balance of Shri Om, as on 31st March, 2009. You are reques to prepare the Trading and Profit and Loss Account for the year ended 31st March, 2009 and Balance Sheet on that date after making the necessary adjustments:

Particulars	*Dr.* ₹	*Cr.* ₹
Sundry Debtors	5,00,000	......
Sundry Creditors	......	2,00,000
Outstanding Liability for Expenses	55,000	......
Wages	1,00,000	......
Carriage Outwards	1,10,000	......
Carriage Inwards	50,000	......
General Expenses	70,000	......
Cash Discounts	20,000	......
Bad Debts	10,000	......
Motor Car	2,40,000	......
Printing and Stationery	15,000	......
Furniture and Fittings	1,10,000	......
Advertisement	85,000	......
Insurance	45,000	......
Salesmen's Commission	87,500	......
Postage and Telephone	57,500	......
Salaries	1,60,000	......
Rates and Taxes	25,000	......
Drawings	20,000	......
Capital Account	....	14,43,000
Purchases	15,50,000	......
Sales	......	19,87,500
Stock on 1-4-2008	2,50,000	
Cash at Bank	60,000	......
Cash in Hand	10,500	......
	36,30,500	36,30,500

The following adjustments are to be made:

(1) Stock on 31st March, 2009 was valued at ₹7,25,000.

(2) A Provision for Bad and Doubtful Debts is to be created to the extent of 5 per cent on Sundry Debtors.

(3) Depreciate:
Furniture and Fittings by 10%
Motor Car by 20%

(4) Shri Om had withdrawn goods worth ₹25,000 during the year.

(5) Sales include goods worth ₹75,000 sent out to Shanti & Company on approval and remaining unsold on 31st March, 2009. The cost of the goods was ₹50,000.

(6) The Salesmen are entitled to a Commission of 5% on total sales.

(7) Debtors include ₹25,000 bad debts.

(8) Printing and Stationery expenses of ₹55,000 relating to 2007-08 had not been provided in that year but was paid in this year by debiting outstanding liabilities.

(9) Purchases include purchase of Furniture worth ₹50,000.

SOLUTION:

Shri Om
Trading and Profit and Loss Account
for the year ended 31 March 2009

Particulars		₹	*Particulars*		₹
To Opening Stock		2,50,000	By Sales	19,87,500	
To Purchases	15,50,000		*Less:* Goods sent on		
Less: Drawings	25,000		Approval	75,000	19,12,500
	15,25,000		By Closing stock	7,25,000	
Less: Furniture	50,000	14,75,000	*Add:* Stock on		
To Wages		1,00,000	approval (at cost)	50,000	7,75,000
To Carriage Inwards		50,000			
To Gross Profit c/d		8,12,500			
		26,87,500			26,87,500
To Salaries		1,60,000	By Gross Profit b/d		8,12,500
To Rates and Taxes		25,000			
To Postage and Telephone		57,500			
To Insurance		45,000			
To Printing and Stationery		15,000			
To General Expenses		70,000			
To Depreciation:					
Furniture (11,000 + 5,000)		16,000			
Motor Car	48,000				
To Salesmen's Commission		95,625			
(5% on ₹19,12,500)					
To Advertisement		85,000			
To Carriage Outwards		1,10,000			
To Bad Debts	10,000				
Add: Addl. Bad Debts	25,000				
Add: Prov. for Bad Debts					
(5% on ₹4,00,000					
See *WN* 3)	20,000	55,000			
To Cash Discount		20,000			
To Net Profit		10,375			
		8,12,500			8,12,500

Shri Om
Balance Sheet
as at 31.3.2009

Liabilities		₹	*Assets*		₹
Capital as on 1.4.2008	14,43,000		Furniture & Fittings	1,10,000	
Add: Net Profit	10,375		Additions during the year	50,000	
	14,53,375			1,60,000	
Less: Drawings (20,000 + 25,000)	45,000		*Less:* Depn.	16,000	1,44,000
	14,08,375		Motor Car	2,40,000	
Less: Printing & Stationery of last year	55,000	13,53,375	*Less:* Depn.	48,000	1,92,000
Sundry Creditors		2,00,000	Closing Stock (7,25,000 + 50,000)		7,75,000
Salesmen's Commission Outstanding (₹95,625 – ₹87,530)		8,125	Sundry Debtors	5,00,000	
			Less: Goods sent on approval	75,000	
				4,25,000	
			Less: Addl. Bad debts	25,000	
				4,00,000	
			Less: Provision for doubtful debts 5% on 4,00,000	20,000	3,80,000
			Cash at Bank		60,000
			Cash in Hand		10,500
		15,61,500			15,61,500

Working Notes:

1. Both Sales and Sundry Debtors have been reduced by ₹75,000 representing invoice value of goods sent on approval. ₹50,000 have been added to the closing stock being the cost of goods sent on approval.
2. Last year's short provision for Printing and Stationery has not been charged to the current year's Profit & Loss Account. It is preferable to charge it directly to in Capital Account.
3. Sundry Debtors = ₹5,00,000 – (₹75,000 Goods on Approval + ₹25,000 Bad Debt) = ₹4,00,000.

Illustration 8.28. From the undermentioned particulars of Mr. Philip, prepare the Manufacturing, Trading and Profit and Loss Account for the year ended 31.3.2011 and Balance Sheet as at that date after making the necessary adjustments:

	₹
Capital as at 1.4.2010	25,000
Drawings Account	7,000
Sundry Creditors	8,000
Discount Received	702
Allahabad Bank (Cr.)	4,000
Reserve for Bad and Doubtful Debts	600
Purchase Returns	530
Sales	67,500
Sales Returns	86
Stock as at 1.4.2010	9,000
Plant and Machinery (including Machinery for ₹5,000 purchased on 1.1.2011)	17,000
Furniture	1,500
Buildings	15,000

	₹
Purchases	30,230
Sundry Debtors	11,000
Manufacturing Wages	6,000
Manufacturing Expenses	5,000
Carriage Inwards	400
Carriage Outwards	420
Bad Debts	150
Salaries	2,800
Interest and Bank Charges (Dr.)	126
Discount allowed	150
Insurance (Dr.)	300
Bank of Bikaner (Dr.)	140
Cash in Hand	30
Stock as at 31.3.2011	7,550

Adjustments

1. Provide for:
   (*a*) Interest on capital at 10% p.a. (no interest is to be provided on drawings).
   (*b*) Outstanding Expenses:

	₹
(*i*) Salaries	100
(*ii*) Manufacturing Wages	50
(*iii*) Interest on Bank Loan	100

   (*c*) Depreciation on:
   (*i*) Machinery at 10% p.a.
   (*ii*) Furniture at 10% p.a.
   (*iii*) Building at 2½% p.a.
   (*d*) Prepaid expenses:

(*i*) Insurance	100
(*ii*) Salary	50

   (*e*) Provision for Bad and Doubtful Debts at 10% of Debtors.

Furniture costing ₹500 was sold for ₹350 on 1.4.2010 and this amount was later credited to Furniture Account.

SOLUTION:

Mr. Philip
Manufacturing, Trading and Profit and Loss Account
for the year ended 31st March, 2011

Particulars	₹	*Particulars*	₹
To Purchases *less* Returns	29,700	By Trading A/c (transfer of Cost of Goods produced)	42,475
To Carriage Inward	400		
To Manufacturing Wages	6,050		
To Manufacturing Expenses	5,000		
To Depreciation on Machinery	1,325		
	42,475		42,475
To Opening Stock	9,000	By Sales *less* Returns	67,414
To Manufacturing A/c (Cost of goods produced)	42,475	By Closing Stock	7,550
To Gross Profit c/d	23,489		
	74,964		74,964

Particulars		₹	Particulars	₹
To Salaries		2,850	By Gross Profit b/d	23,489
To Interest and Bank Charges		226	By Discount	702
To Discount		150		
To Insurance		200		
To Carriage Outward		420		
To Provision for bad and doubtful debts (*See Note*)		650		
To Loss on Sale of Furniture		150		
To Depreciataion:				
Building		375		
Furniture	135	510		
To Interest on Capital		2,500		
To Net Profit to Capital A/c		16,535		
		24,191		24,191

Mr. Philip
Balance Sheet
as on 31st March, 2011

Liabilities		₹	Assets		₹
Capital Account:			Fixed Assets:		
Opening Balance	25,000		Buildings		
Add: Interest		2,500	Balance as on 1.4.2010	15,000	
Add: Profit		16,535	*Less*: Depreciation		
	44,035		written off	375	14,625
Less: Drawings	7,000	37,035	Plant & Machinery		
Liabilities:			Balance as on 1.4.2010	12,000	
Bank Overdraft		4,000	Additions during the yr.	5,000	
Sundry Creditors		8,000		17,000	
Outstanding Expenses		250	*Less*: Dep. written off	1,325	15,675
			Furniture:		
			Balance as on 1.4.2010	1,850	
			Less: Cost of furniture disposed of during the year	500	
				1,350	
			Less: Depreciation written off	135	1,215
			Current Assets:		
			Stock-in-trade (assumed at cost)		7,550
			Debtors	11,000	
			Less: Provision for bad and doubtful debts	1,100	9,900
			Cash in Hand		30
			Cash in Bank		140
			Prepaid Expenses		150
		49,285			49,285

Notes:

1. Loss on sale of furniture has been deducted from the book value of furniture before calculating depreciation.
2. Provision of Bad and Doubtful Debts:

	₹
Provision required	1,100
Add: Bad Debts	150
	1,250
Less: Opening balance	600
	650

ILLUSTRATION 8.29. The Trial Balance of Jagfay Corporation, New Delhi, as on 30.9.2011 is as below:

Particulars		*Amount* ₹
Capital Account (including ₹5,000) (Introduced on 1.4.2011)		22,500
Stock as on 1.10.2010		
Finished Goods	3,500	
Work-in-progress	7,000	
Raw Materials	3,000	13,500
Purchase of Raw Material		70,500
Machinery		22,500
Sales		1,26,225
Carriage Inwards		750
Carriage Outwards		450
Rent (including ₹450 for the factory premises)		1,350
Rebates and Discounts allowed		105
Fire Insurance (for machinery)		210
Sundry Debtors		18,900
Sundry Creditors		5,100
Reserve for Bad and Doubtful Debts		60
Printing and Stationery		180
Miscellaneous Expenses		840
Advertisement		4,500
Drawings of Proprietor		1,800
Office Salaries		5,400
Manufacturing Wages		6,000
Furniture and Fixtures		2,250
Factory Power and Fuel		300
Cash in Hand		600
Balance with Bank of Bikaner Ltd., Delhi (Dr.)		3,750

Adjustments

(*i*) Provide for interest @ 10% per annum on Capital. (No interest on drawings need be provided).
(*ii*) A motor car purchased on 1.4.2011 for ₹6,000 has been included in "Purchases"
(*iii*) Provide depreciation:
Machinery @ 10% p.a., Motor Car @ 20% p.a., Furniture and Fixtures @ 10% p.a.
(*iv*) Provision for unrealised rent in respect of a portion of the office sublet at ₹50 per month from 1.4.2011 has to be made.
(*v*) Sundry Debtors include bad debts of ₹400 which must be written off.
(*vi*) Provision for Bad and Doubtful Debts as on 30.9.2011 should be maintained at 10% of the Debtors.
(*vii*) A sum of ₹2,000 transferred from the Current Account with Bank of Bikaner Ltd., to Fixed Deposit Account on 1.2.2011 has been passed through books. Make suitable adjustments and provide for accrued interest @ 6% p.a.

(*viii*) Stock as on 30.9.2011.

Finished goods ₹5,000, Raw Materials ₹1,000, Work-in-progress ₹5,500.

Prepare the Manufacturing, Trading and Profit and Loss Account for the year ended 30.9.2011 and Balance Sheet as on that date after making the necessary adjustments (Journal entries are not required).

SOLUTION:

Jagfay Corporation, New Delhi

Manufacturing Account

for the year ended 30.9.2011

Particulars		₹	*Particulars*	₹
To Work-in-progress		7,000	By Cost of Manufactured goods transferred to Trading Account	75,710
To Materials used:			By Work-in-progress at end	5,500
Opening Stock	3,000			
Purchases	64,500			
	67,500			
Less: Closing Stock	1,000	66,500		
To Carriage Inwards		750		
To Factory Power and Fuel		300		
To Manufacturing Wages		6,000		
To Factory Rent		450		
To Fire Insurance for Machinery		210		
		81,210		81,210

Trading and Profit and Loss Account

for the year ended 30.9.2011

Particulars		₹	*Particulars*	₹
To Opening Stock: Finished Goods		3,500	By Sales	1,26,225
To Cost of Goods transferred from Manufacturing A/c		75,710	By Closing Stock: Finished Goods	5,000
To Gross Profit c/d		52,015		
		1,31,225		1,31,225
To Office Salaries		5,400	By Gross Profit b/d	52,015
To Rent		900	By Rent Receivable	300
To Advertisement		4,500	By Interest Receivable (on fixed deposit for ₹2,000 for 8 months @ 6% p.a.)	80
To Carriage Outwards		450		
To Rebates and Discounts		105		
To Bad Debts written off	400			
Add: New provision for bad debts	1,850			
		2,250		
Less: Old provision for bad debts	60	2,190		
To Printing and Stationery		180		
To Miscellaneous Expenses		840		
To Depreciation written off		3,075		
To Interest on Capital		2,000		
To Net Profit transferred to Capital A/c		32,755		
		52,395		52,395

Balance Sheet

as on 30.9.2011

Liabilities		₹	*Assets*		₹
Capital Account:			Machinery:		
Balance	22,500		As per last Balance Sheet	22,500	
Add: Profit for the year	32,755		*Less:* Depreciation	2,250	20,250
Interest	2,000		Motor Car:		
	57,255		Cost	6,000	
Less: Drawings	1,800	55,455	*Less:* Depreciation	600	5,400
Sundry Creditors		5,100	Furniture & Fixtures:		
			As per last Balance Sheet	2,250	
			Less: Depreciation	225	2,025
			Closing Stock:		
			Finished Goods	5,000	
			Work-in-progress	5,500	
			Raw Materials	1,000	11,500
			Sundry Debtors	18,900	
			Less: Bad debts written off	400	
				18,500	
			Less: Provision for bad and doubtful debts	1,850	16,650
			Interest Accrued		80
			Rent Receivable		300
			Bank Balance:		
			Fixed Deposit with Bank of Bikaner Ltd.		2,000
			Balance with Bank of Bikaner Ltd.		1,750
			Cash in Hand		600
		60,555			60,555

KEY TERMS

1. **Adjustment Entry:** A journal entry passed at the end of an accounting period to record the completed portion of an incomplete continuous event.
2. **Assets:** Tangible objects or intangible rights owned by an enterprise and carrying probable future benefits.
3. **Balance Sheet:** A statement of financial position of an enterprise as at a given date.
4. **Current Assets:** Cash and other assets that are expected to be converted into cash or consumed in the production of goods or rendering of services in the normal course of business.
5. **Current Liabilities:** Liabilities payable within a year from the date of Balance Sheet either out of the existing current assets or by creation of new current liabilities.
6. **Fictitious Assets:** Assets not represented by tangible possession or property.
7. **Fixed Assets:** Assets held for the purpose of providing or producing goods and services and not held for resale in the normal course of business.
8. **Fixed Liabilities:** All liabilities other than current liabilities.