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".

## 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

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

(*Contd...*)

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

**Ledger**

Dr. **Cash Account** 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 | | | |

Dr. **Capital Account** 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 |

Dr. **Purchases Account** 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 | | | |

Dr. **Building Account** 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 | | | |

Dr. **Vijay** 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 |

Dr. **Anil** 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 | | | |

Dr. **Madhu** 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 | | | |

Dr. **Anand** 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 |

Dr. **Capital Account** 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 |



Dr. **Babu's Loan Account** 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 |

Dr. **Purchases Account** 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 | | | |

Dr. **Discount Account** 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 |

Dr. **Bharat** 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 |

Dr. **Plant Account** 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 | | | |

Dr. **Interest on Loan Account** 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 | | | |

**Mukesh**

| Dr. Date | Particulars | ₹ | Date | Particulars | ₹ Cr. |
|---|---|---|---|---|---|
| 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 |

**Sales Account**

| Dr. Date | Particulars | ₹ | Date | Particulars | ₹ Cr. |
|---|---|---|---|---|---|
| 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 |

**Rahim**

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

**Bad Debts Account**

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

**Salary Account**

| Dr. Date | Particulars | ₹ | Date | Particulars | ₹ Cr. |
|---|---|---|---|---|---|
| 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 | | | |

**Drawings Account**

| Dr. Date | Particulars | ₹ | Date | Particulars | ₹ Cr. |
|---|---|---|---|---|---|
| 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 |



## VOUCHER SYSTEM

In a small organisation, it is possible for the proprietor to supervise personally all important matters. However, in case of large organisations, delegation of authority is required and therefore, it is necessary to have a proper internal check system for prevention of errors and frauds in recording the transactions and receiving or making final cash payments. The chances of frauds in case of cash payments are all the more. It is almost impossible for the disbursing official to have all information regarding the goods and services in respect of which he is required to make payments. This is because even in case of organisations of moderate size, the responsibility for issuing purchase orders, inspecting commodities received, verifying contractual and arithmetical details of invoices is divided among the employees of the various departments. The disbursing official should have, therefore, assurance of all concerned officials before making payments that the terms of the contract have been complied with and he is paying the exact amount of obligation. This is possible only when all the activities mentioned above are properly coordinated and linked with ultimate issuance of cheques to the creditors. One of the most effective system employed for this purpose is termed as Voucher System.

Voucher System may, therefore, be defined as "a plan and method of procedure for the verification, recording and payment of all items (other than items to be paid petty cash) which require the disbursement of cash." As a matter of fact, it is mainly a plan of internal check for all cash disbursement items. There are three basic requirements of Voucher System:

(a) A voucher is to be prepared for each item of expenditure.

(b) No payment shall be made without a properly verified and authorised voucher.

(c) Development of a proper and efficient system for determining the amount to be paid on each day. This helps the disbursing official in determining the amount to be paid and the management is conveniently and continuously forecasting the amount of the cash required to meet maturing obligations.

The following documents are used in the Voucher System:

**1. Vouchers** In general terms, a voucher means a documentary evidence in support of a business transaction. It is a documentary evidence by which the accuracy of an entry made in the books of account can be substantiated. It may be a receipt, a counterfoil of a receipt book, an invoice or even correspondence with the concerned parties. The term 'Voucher' has a narrower meaning when applied to the Voucher System. It is a special form on which is recorded pertinent data about a liability and the particulars of its payments.

Vouchers are generally prepared by the accounting department on the basis of invoices or returns that serves as the evidence of expenditure. This is done after the following comparisons and verifications have been completed and noted on the invoices:

(*i*) Comparison with the copy of Purchase Order to verify the quantities, prices and terms.

(*ii*) Comparison with the Goods Received Returns to determine the receipt of items recorded in the invoices.

(*iii*) Verification of the arithmetical accuracy of the Invoices.

After making the above verifications and comparisons, the invoices or other supporting evidence is attached to the voucher and is presented to the concerned official for his final approval.

which uses the voucher system does not have sufficient cash and is not in a position to pay the approved vouchers according to schedule, it may develop an unwieldy file of approved unpaid vouchers.

(iii) *Fails to provide overall position of a creditor's account* The system does not provide for giving an overall position of a creditor's account.

(iv) *Difficulties in case of partial payments, returns, etc.* The system proves as a hindrance rather than as a help in case of concerns which have many returns of goods and other corrections after approving and recording of purchase invoices. Such concerns have to make partial payments of approved vouchers. In some cases, they have to defer payment also.

From the above, it may be concluded that the Voucher System is suitable only for an enterprise which is well equipped both in respect of personnel and finances. It is not suitable for small concerns. Moreover, suitable modifications may have also to be made in the operation of the system as to meet the specific needs of a particular enterprise.

## KEY TERMS

1. **Ledger:** A book containing different accounts of an entity.
2. **Posting:** Transferring the debit and credit items from the Journal to the respective accounts in the Ledger.
3. **Trial Balance:** A statement containing the various ledger balances on a particular date.
4. **Voucher System:** A plan and method of procedure for the verifications, recording and payment of all items (other than items to be paid from petty cash) which require disbursement of cash.

## TEST QUESTIONS

### Objective Type

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

(i) The "Posting" is done in the Journal.
(ii) Ledger is a set of accounts.
(iii) Transactions are recorded first of all in the Ledger.
(iv) Journal records transactions in a chronological order.
(v) Ledger records transactions in an analytical order.
(vi) While posting transactions in the ledger, if the account is debited in the Journal, it will be credited in the Ledger.
(vii) The word "To" is used with the accounts which appear on the Debit side of a ledger account.
(viii) Trial Balance helps in knowing the arithmetical accuracy of the accounting entries.

[Ans. (i) False; (ii) True; (iii) False; (iv) True; (v) True; (vi) False; (vii) True; (viii) True]

2. **Fill in the blanks:**

(i) The process of transferring the debit and credit items from a Journal to their respective accounts in the Ledger is termed as ..........
(ii) Journal is the book of ........ entry, while Ledger is the book of ......... entry.
(iii) The word "By" is used with an account while making posting on the ...... side of an account.
(iv) The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as .........
(v) The statement containing various ledger balances on a particular date is known as ..........
(vi) If the two sides of the trial balance tally, it is an indication of the fact that the books of accounts are ...... accurate.

[Ans. (i) posting; (ii) first, second; (iii) credit; (iv) balancing of an account; (v) trial balance; (vi) arithmetically]



### Essay Type

1. Explain the rules regarding posting of transactions into the Ledger.
2. What is a trial balance? Explain its objectives.

## PRACTICAL PROBLEMS

1. Journalize the following transactions and post them into the Ledger.

| 2011 | | | ₹ |
|---|---|---|---|
| Jan. | 01 | Surendra started business with cash | 5,000 |
| Jan. | 02 | Goods purchased from Prasad on credit | 200 |
| Jan | 03 | Goods sold to Prem | 500 |
| Jan. | 04 | Good purchased from Sohan for cash | 400 |
| Jan. | 05 | Paid for wages | 50 |
| Jan. | 15 | Goods purchased from Prem | 100 |
| Jan. | 17 | Goods sold to Om | 50 |
| Jan. | 21 | Good purchased from Charanjit | 300 |
| Jan. | 23 | Paid for interest | 15 |
| Jan. | 24 | Goods purchased from Om | 200 |
| Jan. | 28 | Cash received from Prem | 100 |
| Jan. | 31 | Cash paid to Charanjit | 300 |
| Jan. | 31 | Paid for Rent | 10 |

2. Give journal entries of the following postings in the ledger accounts:

(a) **Dividens**

| | | | |
|---|---|---|---|
| | | By Cash | 1,500 |

(b) INSURANCE

| | | | |
|---|---|---|---|
| To A | 2,000 | | |

(c) **Discount**

| | | | |
|---|---|---|---|
| To Bank | 20 | | |

(d) **Rent**

| | | | |
|---|---|---|---|
| To Cash | 1,200 | | |

(e) **Plant**

| | | | |
|---|---|---|---|
| To Cash | 20,000 | | |
| To Manohar | 40,000 | | |

(f) **Sales**

| | | | |
|---|---|---|---|
| | | By Cash | 54,000 |
| | | By Naresh | 37,000 |

3. Journalize the following transactions and post them into Ledger.

| 2011 | | |
|---|---|---|
| Sept. | 01 | Started business with ₹50,000, out of which paid into Bank ₹20,000. |
| Sept. | 02 | Bought furniture for ₹5,000 and machinery for ₹10,000. |
| Sept. | 03 | Purchased goods for ₹14,000. |
| Sept. | 06 | Sold goods for ₹8,000. |
| Sept. | 08 | Purchased goods from Malhotra & Co. ₹11,000. |
| Sept. | 10 | Paid telephone rent for the year by cheque ₹500. |
| Sept. | 11 | Bought one typewriter for ₹2,100 from Universal Typewriter Co. on credit. |

| | | |
|---|---|---|
| Sept. 15 | Sold goods to Keshav Ram for ₹12,000. | |
| Sept. 17 | Sold goods to Rajesh Kumar for ₹2,000 for cash. | |
| Sept. 19 | Amount withdrawn from bank for personal use ₹1,500. | |
| Sept. 21 | Received cash from Keshav Ram ₹11,900, discount allowed ₹100. | |
| Sept. 22 | Paid into bank ₹5,800. | |
| Sept. 23 | Bought 50 shares in XY & Co. Ltd. at ₹60 per share, brokerage paid ₹20. | |
| Sept. 25 | Goods worth ₹1,000 found defective were returned to Malhotra & Co. and the balance of the amount due to them settled by issuing a cheque in their favour. | |
| Sept. 28 | Sold 20 shares of XY & Co. Ltd at ₹65 per share, brokerage paid ₹20. | |
| Sept. 28 | Bought goods worth ₹2,100 from Ramesh and supplied them to Suresh at ₹3,000. | |
| Sept. 30 | Suresh returned goods worth ₹100, which in turn were sent to Ramesh. | |
| Sept. 30 | Issued a cheque for ₹1,000 in favour of the landlord for rent for September. | |
| Sept. 30 | Paid salaries to staff ₹1,500 and received from travelling salesman ₹2,000 for goods sold by him, after deducting the travelling expenses ₹100. | |
| Sept. 30 | Paid for: Charity | ₹101 |
| | Stationery | ₹450 |
| | Postage | ₹249 |

4. On 1st January, 2011, the following were the ledger balances of Rajan & Co. : Cash in hand ₹900; Cash at Bank ₹21,000; Soni (Cr.) ₹3,000; Zahir (Dr.) ₹2,400; Stock ₹12,000; Prasad (Cr.) ₹6,000; Sharma (Dr.) ₹4,500; Lall (Cr.) ₹2,700; Ascertain Capital.
Transactions during the month were:

| 2011 | | ₹ |
|---|---|---|
| Jan. 02 | Bought goods of Prasad | 2,700 |
| Jan. 03 | Sold to Sharma | 3,000 |
| Jan. 05 | Bought goods of Lall for cash, paid by cheque | 3,600 |
| Jan. 07 | Took goods for personal use | 200 |
| Jan. 13 | Received from Zahir in full settlement | 2,350 |
| Jan. 17 | Paid to Soni in full settlement | 2,920 |
| Jan. 22 | Paid cash for stationery | 50 |
| Jan. 29 | Paid to Prasad by cheque | 2,650 |
| | Discount allowed by him | 50 |
| Jan. 30 | Provided interest on capital | 100 |
| | Rent due to landlord | 200 |

Journalize the above transactions and post to the ledger and prepare a Trial Balance.

5. Journalize the following transactions, post them in the ledger and prepare a Trial Balance:
January 1, 2011
*Assets:* Furniture ₹5,000; Machinery ₹10,000; Stock ₹4,000; Cash in hand ₹550; Cash at bank ₹7,450; Amount due from Ramesh & Co. ₹1,000; and amount due from Suresh ₹2,000.
*Liabilities:* Amount due to Rama ₹4,500; Amount due to Ranjeet ₹2,000; and amount due to Shyam ₹1,500.

| 2011 | | ₹ |
|---|---|---|
| Jan. 01 | Purchased goods from Ajay | 4,500 |
| Jan. 03 | Sold goods for cash | 1,500 |
| Jan. 05 | Paid to Himanshu by cheque | 5,500 |
| Jan. 10 | Deposited in bank | 2,800 |
| Jan. 13 | Sold goods on credit to Mukesh | 1,700 |
| Jan. 15 | Paid for postage | 100 |
| Jan. 16 | Received cash from Rakesh | 2,200 |
| Jan. 17 | Paid telephone charges | 250 |
| Jan. 18 | Cash sales | 1,500 |



| | | |
|---|---|---|
| Jan. 20 | Purchased Govt. Securities | 500 |
| Jan. 22 | Purchased goods worth ₹1,600 *less* 20% trade discount and 5% cash discount from Mahesh & Co. for cash and supplied them to Ramesh and Co. at list price *less* 10% trade discount[1] | |
| Jan. 25 | Cash purchases | 16,500 |
| Jan. 27 | Goods worth ₹500 were damaged in transit; a claim was made on the railway authorities for the same.[2] | |
| Jan. 28 | Suresh is declared insolvent and a dividend of 50 paise in the rupee is received from him in full settlement | |
| Jan. 29 | Bought a horse for ₹2,600 and a carriage for ₹1,200 for delivering goods to customers. Paid by cheque | |
| Jan. 30 | The horse bought on Jan. 29 dies, and the carriage was sold for ₹1,000 | |
| Jan. 31 | Allowed interest on capital @ 10% p.a. for one month | |
| Jan. 31 | Paid for: Salaries ₹150; Rent ₹60 | |

1. Sales price: ₹1,600 *less* 10% trade discount.
2. *Debit* Loss-in-Transit Account and *Credit* Purchases Account. On receipt of money from the Railways *Debit* Bank Account, *Credit* Loss-in-Transit Account. Transfer any difference to P & L Account.

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 |





## 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 | 3,000 |
| 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 | | ...... | | | |
| To Gross Profit* | | ...... | By Gross Loss* | | ...... |
| | | ...... | | | ...... |

* 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 |

**Solution:**

**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 | | | |
| To Gross Profit | | 3,000 | | | |
| | | 21,000 | | | 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

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

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:

| | | |
|---|---|---|
| (*i*) | Trading Account | Dr. |
| | To Stock Account (Opening) | |
| | To Purchases Account | |
| | To Sales Returns Account | |
| | To Carriage Account | |
| | To Customs Duty Account | |
| (*ii*) | 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.

## 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.

## 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.

| | |
|---|---|
| *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 | |

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.

## 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 Finished Goods during the | |
| *Add:* Purchases of Raw | | | | |

(Contd...)

| 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 | ......... |
| | | By Closing Stock of Finished Goods | ......... |
| To Cost of Production of Finished Goods Transferred from Manufacturing Account | ......... | By Gross Loss c/d* | ......... |
| To Purchases of Finished Goods *less* Returns | ......... | | |
| 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. **Liabiities** 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.

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

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

**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 | |
| *Less:* Returns Outward | 1,380 | 7,299 | | | 10,141 |
| To Wages | | 1,589 | Closing Stock | | 3,700 |
| 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 |





**Balance Sheet**
*as on 31st December, 2011*

| Liabilities | | ₹ | Assets | ₹ |
|---|---|---|---|---|
| Bills Payable | | 541 | Cash | 895 |
| Creditors | | 1,780 | Petty Cash | 47 |
| Bank Overdraft | | 4,000 | Bills Receivable | 2,730 |
| Capital | 9,228 | | Debtors | 1,905 |
| *Add:* Net Profit | 628 | 9,856 | Closing Stock | 3,700 |
| | | | Plant and Machinery | 6,230 |
| | | | Furniture | 670 |
| | | 16,177 | | 16,177 |

**ILLUSTRATION 8.10.** From the following Trial Balance prepare the Manufacturing Account, Trading and Profit and 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 | | 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 | 20,000 | |
| Land and Buildings | 26,000 | |
| Purchases of Raw Materials | 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 2011was 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:





Dr. **Trading Account** 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 | Dr. | 2,000 | |
| | To Outstanding Salaries A/c | | | 2,000 |
| | *(Being salaries due but not paid)* | | | |
| | Rent A/c | Dr. | 1,000 | |
| | To Outstanding Rent A/c | | | 1,000 |
| | *(Being rent due but not paid)* | | | |

The items will appear in the final accounts as follows:

**Profit and Loss Account**

Dr. Cr.

| Particulars | | ₹ | Particulars | ₹ |
|---|---|---|---|---|
| To Salaries | 10,000 | | | |
| (as given in the Trial Balance) | | | | |
| *Add:* Outstanding Salaries | 2,000 | 12,000 | | |
| To Rent | 5,000 | | | |
| (as given in the Trial Balance) | | | | |
| *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 Accounts 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 Dr.<br>To Interest A/c<br>*(Being interest on loan due but not received)* | 200 | 200 |
| | Accrued Interest A/c<br>To Interest on Investments A/c<br>*(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.<br>To Rent received in Advance A/c<br>*(Being rent received in advance for three months)* | 300 | 300 |
| | Interest A/c Dr.<br>To Interest received in Advance A/c<br>*(Being interest received in advance)* | 500 | 500 |

**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)* | | | |

Dr. **Profit and Loss Account** Cr.
*for the year ending 31 December 2009*

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

**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.

**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**

| | Particulars | L.F. | Trial Balance Dr. | Trial Balance Cr. | Adjustments Dr. | Adjustments Cr. | Adjusted Trial Balance Dr. | Adjusted Trial Balance Cr. | Income Statement Dr. | Income Statement Cr. | Balance Sheet Dr. | Balance Sheet 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 19000 | 17,800 | By Gross Loss c/d | 2,700 |
| To Wages | 9,600 | By cl St. | 1200 |
| 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% | | Provision for B/D | 880 |
| p.a.-balance on 1.4.2009 | 44,000 | Interest on loan to Shri Krishna | 1,100 |
| Cash at Bank | 29,260 | Cash in Hand | 2,640 |
| Bills Payable | 5,500 | 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 $33^1/_3$ %.
   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 | | | |

*(Contd...)*



| 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 | | |
| | 2,69,600 | | (15,400 + 1,100) | 16,500 | |
| | | | | 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 requested to prepare the Trading and Profit and Loss Account for the year ended 31st March, 2009 and Balance Sheet as 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 | | | Furniture & Fittings | 1,10,000 | |
| 1.4.2008 | 14,43,000 | | Additions during the year | 50,000 | |
| *Add:* Net Profit | 10,375 | | | 1,60,000 | |
| | 14,53,375 | | | | |
| *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 Depreciation: | | | | |
| 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: | | | By Sales | 1,26,225 |
| Finished Goods | | 3,500 | By Closing Stock: Finished Goods | 5,000 |
| To Cost of Goods transferred from Manufacturing A/c | | 75,710 | | |
| 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 | |
| To Carriage Outwards | | 450 | (on fixed deposit for ₹2,000 | |
| To Rebates and Discounts | | 105 | for 8 months @ 6% p.a.) | 80 |
| 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.

9. **Liabilities:** The claims of outsiders (other than owners) against the firm's assets.
10. **Liquid Assets:** Assets which are immediately convertible into cash without much loss.
11. **Manufacturing Account:** An account giving the cost of goods manufactured by the manufacturer during a particular period.
12. **Profit & Loss Account:** An account presenting the revenues and expenses of an enterprise for an accounting period and shows the excess of revenues over expenses and *vice-versa*. It is also known as Income Statement.
13. **Trading Account:** An account giving the overall result of trading, *i.e.*, purchasing and selling of goods.

## TEST QUESTIONS

### Objective type

1. **State whether each of the following statements is 'True' or 'False':**
   (*i*) The 'Current Liabilities' is used to denote those liabilities which are payable after a year.
   (*ii*) The terms 'Current Assets' and 'Liquid Assets' have synonymous meanings.
   (*iii*) All Intangible Assets are fictitious assets.
   (*iv*) Creating reserve for discount on creditors is not strictly according to the principle of conservatism.
   (*v*) Stock at the end, if appears in the Trial Balance, is taken only to the Balance Sheet.
   (*vi*) Goods taken out by the proprietor from the business for his personal use are credited to Sales Account.
   (*vii*) 'Salary paid in advance' is not an expense because it neither reduces assets nor increases liabilities.
   (*viii*) The terms "Accrued Income" and "Outstanding Income" have synonymous meanings.
   (*ix*) Premium paid on the life policy of the proprietor is debited to the Profit and Loss Account.

   [**Ans.** (*i*) False; (*ii*) False; (*iii*) False; (*iv*) True; (*v*) True; (*vi*) False; (*vii*) True; (*viii*) False; (*ix*) False]

2. **Select the most appropriate answer:**
   (*i*) Sales are equal to
   (*a*) Cost of goods sold + Gross Profit. (*b*) Cost of goods sold – Gross Profit.
   (*c*) Gross Profit – Cost of goods sold.
   (*ii*) Interest on Drawings is
   (*a*) Expenditure for the business. (*b*) Expense for the business.
   (*c*) Gain for the business.
   (*iii*) Goods given as samples should be credited to
   (*a*) Advertisement Account. (*b*) Sales Account.
   (*c*) Purchases Account.
   (*iv*) Outstanding Salaries are shown as
   (*a*) an expense. (*b*) a liability.
   (*c*) an asset.
   (*v*) Income Tax paid by a sole proprietor on his business income should be
   (*a*) Debited to the Trading Account. (*b*) Debited to the Profit and Loss Account.
   (*c*) Deducted from the Capital Account in the Balance Sheet.

   [**Ans.** (*i*) (*a*); (*ii*) (*c*); (*iii*) (*c*); (*iv*) (*b*); (*v*) (*c*)]



### Essay type

1. What are Final Accounts? What purpose do they serve?
2. What is meant by Marshalling of Assets and Liabilities?
3. Differentiate between:
   (*i*) Outstanding Expense and Prepaid Expense.
   (*ii*) Outstanding Income and Accrued Income.
   (*iii*) Interest on Capital and Interest on Drawings.
4. Why adjustment entries are required to be made at the time of preparing Final Accounts? Given illustrative examples of any four such adjustment entries.
5. Write short notes on:
   (*i*) Closing Entries
   (*ii*) Trading Account
   (*iii*) Work Sheet.
6. What do you understand by the terms 'Grouping' and 'Marshalling', used in connection with the Balance Sheet? Illustrate the different forms of Marshalling.
7. Distinguish between Trial Balance and Balance Sheet.

## PRACTICAL PROBLEMS

### Final Accounts without Adjustments

1. Prepare Manufacturing, Trading and Profit and Loss Account from the following figures relating for the year 2011:

| | *1.1.2011* ₹ | *31.12.2011* ₹ |
|---|---|---|
| Stock: | | |
| Finished Goods | 33,000 | 27,500 |
| Raw Materials | 16,000 | 18,300 |
| Work-in-progress | 11,100 | 9,400 |
| Purchase of Materials | | 1,50,900 |
| Carriage on Purchases | | 4,100 |
| Wages | | 65,000 |
| Factory Salaries | | 26,000 |
| Office Salaries | | 18,000 |
| Repair and Maintenance: | | |
| Machinery | | 8,300 |
| Office Equipment | | 1,700 |
| Depreciation : | | |
| Machinery | | 25,000 |
| Office Equipment | | 8,100 |
| Sundry Expenses : | | |
| Factory | | 5,300 |
| Office | | 17,800 |
| Sales | | 3,60,000 |

It is the firm's practice to transfer goods from the Factory to Sales godown at cost plus 10%.

[**Ans.** Manufacturing Profit ₹28,400; Gross Profit ₹42,100; Net Loss ₹3,500]

2. From the following particulars, prepare Manufacturing Account, Trading Account, and Profit and Loss Account:

| Particulars | ₹ |
|---|---|
| Purchases of Raw Materials | 13,195 |
| Return Inward | 70 |
| Stock on 31-12-2010 | |
| Raw Materials | 1210 |
| Work-in-progress | 1,000 |
| Finished Goods | 1,370 |
| Productive Wages | 2,000 |
| Factory Expenses | 1,840 |
| General Office Expenses | 300 |
| Salaries | 600 |
| Distribution Expenses | 100 |
| Selling Expenses | 700 |
| Purchasing Expenses | 600 |
| Export Duty | 300 |
| Import Duty | 200 |
| Interest on Bank Loan | 600 |
| Stock on 1-1-2010 | |
| Raw Material | 400 |
| Work-in-progress | 300 |
| Finished Goods | 410 |
| Sales | 19,500 |
| Returns Outward | 85 |
| Carriage Outward | 105 |
| Carriage Inward | 100 |
| Cash Discount (allowed) | 10 |
| Sale of scrap | 20 |
| Depreciation of Machinery | 500 |
| Repairs of Machinery | 100 |
| Depreciation of Office Furniture | 40 |

[Ans. Gross Profit ₹3,470; Net Profit ₹7,150]

3. From the following Trial Balance, prepare a Trading, Manufacturing and Profit and Loss Account and Balance Sheet as on 31st December, 2011:

**Trial Balance**
*as on 31 December 2011*

| Particulars | Dr. ₹ | Cr. ₹ |
|---|---|---|
| Stock on 1-1-2011 | | |
| Raw Materials | 2,000 | |
| Work-in-progress | 5,000 | |
| Finished Goods | 10,000 | |
| Manufacturing Wages | 10,000 | |
| Purchasing of Raw Materials | 30,000 | |
| Factory Rent | 5,000 | |
| Carriage of Raw Materials | 3,000 | |

*(Contd...)*




| Particulars | Dr. ₹ | Cr. ₹ |
|---|---|---|
| Salary of the Works Manager | 2,000 | |
| Office Rent | 2,000 | |
| Printing and Stationery | 1,000 | |
| Bad Debts | 1,000 | |
| Sales | | 60,000 |
| Land and Buildings | 30,000 | |
| Plant and Machinery | 20,000 | |
| Depreciation on Plant | 2,000 | |
| Sundry Debtors | 5,000 | |
| Sundry Creditors | | 30,000 |
| Cash in Hand | 5,000 | |
| Capital | | 43,000 |
| | 1,33,000 | 1,33,000 |

Closing stocks on 31 December 2011 were as follows:

| | ₹ |
|---|---|
| Raw Material | 5,000 |
| Work-in-process | 4,000 |
| Finished Goods | 10,000 |

[Ans. Cost of Production ₹50,000, Gross Profit ₹10,000; Net Profit ₹6,000; Total of Balance Sheet ₹79,000]

4. Prepare manufacturing, trading and profit and loss account for the year ended 31 March 2011 and balance sheet as at the end of the year from the following trial balance:

| Particulars | Dr. ₹ | Cr. ₹ |
|---|---|---|
| Opening Stock of Raw Materials | 30,000 | |
| Opening Stock of Finished Goods | 16,000 | |
| Opening Stock of Work-in-progress | 5,000 | |
| Capital | | 72,000 |
| Purchases of Raw Materials | 2,50,000 | |
| Sales | | 4,00,000 |
| Purchases of Finished Goods | 8,000 | |
| Carriage Inwards | 4,000 | |
| Wages | | 50,000 |
| Salaries (75% Factory) | 26,000 | |
| Commission | 3,000 | |
| Bad Debt | 2,000 | |
| Insurance | 4,000 | |
| Rent, Rates and Taxes (50% Factory) | 12,000 | |
| Postage and Telegram | 2,800 | |
| Tea and Tiffin | 1,600 | |
| Travelling and Conveyance (25% Factory) | 3,500 | |
| Carriage Outwards | 2,600 | |
| Machinery | 40,000 | |
| Furniture | 5,000 | |
| Debtors | 60,000 | |
| Creditors | | 53,500 |
| | 5,25,500 | 5,25,500 |

The closing stocks are as follows:

| | |
|---|---|
| Raw Materials | 40,000 |
| Work-in-progress | 12,000 |
| Finished Goods | 8,000 |

[**Ans.** Cost of Production ₹3,13,375; Gross Profit ₹70,625;
Net Profit ₹39,500; Balance Sheet Total ₹1,65,000]

**5.** From the following balances draw up a trading and profit and loss account and balance sheet:

| *Particulars* | ₹ |
|---|---|
| P Parikh Capital | 20,000 |
| Bank Overdraft | 5,000 |
| Machinery | 13,400 |
| Cash in Hand | 1,000 |
| Fixtures & Fittings | 5,500 |
| Opening Stock | 45,000 |
| Bills Payable | 7,000 |
| Creditors | 40,000 |
| Debtors | 63,000 |
| Bills Receivable | 5,000 |
| Purchases | 50,000 |
| Sales | 1,29,000 |
| Returns from Customers | 1,000 |
| Returns to Creditors | 1,100 |
| Salaries | 9,000 |
| Manufacturing Wages | 4,000 |
| Commission and T.A. | 5,500 |
| Trade Expenses | 1,500 |
| Discount (Cr.) | 4,000 |
| Rent | 2,200 |

The closing stock amounted to ₹52,000.

[**Ans.** Gross Profit ₹82,100 : Net Profit ₹67,900 and Balance Sheet Total ₹1,39,900]

**6.** From the following trial balance of M/s Suneel Brothers prepare (*a*) manufacturing account; (*b*) trading and profit and loss account; and (*c*) balance sheet:

**Trial Balance**
*as on 31 December 2011*

| *Debit Balances* | ₹ | *Credit Balances* | ₹ |
|---|---|---|---|
| Wages | 20,000 | Sales | 1,74,000 |
| Stock (Raw Materials) 1.1.2011 | 5,710 | Profit and Loss Balance 1.1.2011 | 12,000 |
| Purchases | 88,274 | Capital | 1,30,000 |
| Carriage Inward | 3686 | | |
| Repairs | 6,000 | | |
| Salaries (Factory) | 2,100 | | |
| Salaries General | 1,000 | | |
| Rates and Taxes | 2,240 | | |
| Travelling Expenses | 3,550 | | |
| Insurance (Factory) | 700 | | |
| Insurance General | 80 | | |
| Bad Debts | 410 | | |
| General Expenses | 2,942 | | |
| Carriage Outward | 9,424 | | |
| Various Assets | 1,13,884 | | |
| Stock 1.1.2011 (Finished Goods) | 56,000 | | |
| | 3,16,000 | | 3,16,000 |



**Closing stock:** Raw materials ₹5,272; Finished Goods. ₹34,324.

[**Ans.** Cost of Production, ₹1,21,198; Gross Profit ₹31,126;
Net Profit ₹11,480; Balance Sheet Total ₹1,53,480]

**7.** The following are the trading, profit and loss account and balance sheet of *B* as on 31 December 2011. Redraw them in proper form, giving reasons for your correction.

**Trading and Profit and Loss Account**
*for the year ended 31 December 2011*

| *Particulars* | ₹ | *Particulars* | ₹ |
|---|---|---|---|
| Pruchases | 4,66,800 | Sales | 5,59,900 |
| Stock | 55,110 | Profit on Consignment to A & Co., | 19,080 |
| Salaries | 11,010 | Interest on Capital | 7,500 |
| *B*'s Drawings | 19,170 | Stock (1st Jan.) | 50,310 |
| Wages | 65,590 | Commission received | 27,990 |
| Rent | 2,250 | Discount received | 11,250 |
| General Expenses | 17,470 | | |
| Interest on Loan | 3,000 | | |
| Bad Debts | 11,890 | | |
| Net Profit to *B/S* | 23,740 | | |
| | 6,76,030 | | 6,76,030 |

**Balance Sheet**
*as on 31 December 2011*

| *Liabilities* | ₹ | *Assets* | ₹ |
|---|---|---|---|
| Creditors | 1,95,070 | Debtors | 2,61,580 |
| Bills Receivable | 1,30,140 | Cash | 960 |
| Capital (1.1.2011) | 1,50,000 | Bank | 52,210 |
| Net Profit from P&L A/c | 23,740 | Loan from Bank | 75,000 |
| | | Stock (31-12-2011) | 55,110 |
| | | Bills Payable | 54,090 |
| | 4,98,950 | | 4,98,950 |

[**Ans.** Gross Profit ₹32,310; Net Profit ₹37,510; Balance Sheet Total ₹5,00,000]

## Final Accounts with Adjustments

**8.** State how the following must be dealt with in the final accounts of a firm for the year ended 31.12.2011 giving reasons in brief:

(*i*) Adverstisement expenditure of ₹10,000 paid on 30.12.2010, the adverstisement in respect of which has appeared in the magazines only in January, 2011.

(*ii*) Cost of temporary pandal erected for an exhibition on 1.7.2010, the exhibition being expected to be over by June 2011: ₹17,000.

(*iii*) Cost of a second-hand scooter purchased on 1.10.2010 for ₹2,500, which was totally destroyed in an accident on 31.11.2010, the insurance company paying ₹1,000 in full settlement in January, 2011.

(*iv*) Petrol expenses of ₹420 paid for the car of one of the partners for an official visit, the car not being an asset of the firm.

(v) Hire charges of ₹1,000 for a compressor, when the firm's own compressor was under breakdown.

[Ans. (i) Prepaid expense; (ii) Charge ₹8,500 to P & L in 2010 and carry forward the balance to 2011; (iii) Write off ₹1,500 from P & L; (iv) Charge P & L A/c as a travelling expense] (v) Charge Manufacturing A/c (if prepared) or P & L A/c]

9. (i) On 1st January, 2011 the Provision for Doubtful Debts Account in the books of a firm which maintains it at 5% had a credit balance of ₹1,100. During the year the Bad Debts amounted to ₹800 and the debtors at the end of the year were ₹20,000. Show Provision for Doubtful Debts Account and Bad Debts Account for the year 2011.

(ii) At the end of an accounting year, a trader finds that no entry has been passed in the books of accounts in respect of the following transactions:

(a) Outstanding salary at the end of the year ₹200.

(b) Goods given as charity during the year ₹300.

(c) Stock-in-hand at the end of the year ₹20,000. Journalise these transactions.

10. The following balances were taken from the records of a firm. For each account give the adjusting journal entry which may have resulted in the change in that account balance.

| Particulars | Trial Balance | Adjusted Trial Balance |
|---|---|---|
| Advance from Customers | 20,000 | 16,000 |
| Prepaid Insurance | 8,000 | 6,000 |
| Wages Payable | 3,000 | 5,000 |
| Interest (Credit Balance) | 1,000 | 1,200 |
| Accumulated Depreciation | 15,000 | 20,000 |

Assume that the final accounts were prepared from the unadjusted balances. How would the Profit and Loss account and Balance Sheet be affected in each of the above cases?

11. The following items are found in the Trial Balance of John on 31st December, 2009:

| | ₹ |
|---|---|
| Debtors | 16,000 |
| Bad Debts | 300 |
| Bad and Doubtful Debts Provision 1.1.2009 | 700 |

You are to provide for the bad and doubtful debts @ 5%. Give the necessary journal entries and prepare the Bad Debts Account, Bad and Doubtful Debts Provision Account, Profit and Loss Account, Sundry Debtors Account in the ledger and a Balance Sheet appearing after the final adjustments.

12. A firm had the following Balances on Ist January, 2009:

| | ₹ |
|---|---|
| (a) Provision for Bad and Doubtful Debts | 2,500 |
| (b) Provision for Discount on Debtors | 1,200 |
| (c) Provision for Discount on Creditors | 1,000 |

During the year Bad Debts amounted to ₹2,000, Discounts allowed were ₹100 and Discounts received were ₹200. During 2010 Bad Debts amounting to ₹1,000 were written off while Discounts allowed and received were ₹2,000 and ₹500 respectively.

Total Debtors on December, 31, 2009 were ₹48,000 before writing off Bad Debts, but after allowing Discounts. On December 31, 2009 the amount was ₹19,000 after writing off the Bad Debts but before allowing Discounts. Total Creditors on these two dates were ₹20,000 and ₹25,000 respectively.



It is the firm's policy to maintain a provision of 5% against Bad and Doubtful Debts and 2% for Discount on Debtors and a provision of 3% for Discount on Creditors.

Show the accounts relating to Provision on Debtors and Provision on Creditors for the year 2009 and 2010.

[Ans. Balances on 31.12.2010 Bad Debts Provision ₹850; Provision for Discount on Debtors ₹323; and Provision for Discount on Creditors ₹750]

13. Apear Ltd. makes provision for doubtful debts at the end of each year against specific debtors. On 30th June, 2011 the following debtors' balances were considered doubtful and provided for

| | ₹ |
|---|---|
| Raman | 1,500 |
| Jalil | 400 |
| Nagpal | 250 |
| Sharma | 500 |

The following are the particulars for the year ended 30th June, 2011.

(a) Bad Debts written off:

| | ₹ |
|---|---|
| Raman | 1,200 |
| Sharma | 350 |
| Gupta | 300 |
| Ramesh | 200 |
| Atmaram | 150 |

(b) Amounts realised against debts written off in earlier year:

| | | |
|---|---|---|
| Hossain | ₹ | 350 |
| Kriparam | ₹ | 175 |
| Dayaram | ₹ | 225 |

(c) Debts considered doubtful (after taking into account all realisations during the year) at the end of the year.

| | | |
|---|---|---|
| Abraham | ₹ | 180 |
| Ganesh | ₹ | 230 |
| Gangasarn | ₹ | 375 |
| Ramchandra | ₹ | 470 |

You are required to draw up:

(i) Bad Debts Account.

(ii) Provision for Doubtful Debts Account and to show the relevant amount in the Profit and Loss Account for the year ended 30th June, 2011.

[Ans. Amount charged from P & L A/c for Bad Debts Provision ₹805; Bad Debts recovered ₹750 Credited to P & L A/c]

14. The accountant of M/s Kasturi Agencies extracted the following Trial Balance as on March 31, 2011:

| Particulars | Trial Balance | Adjusted Trial Balance |
|---|---|---|
| Capital | | 1,00,000 |
| Drawings | | 18,000 |
| Buildings | 15,000 | |
| Furniture & Fittings | 7,500 | |
| Motor Van | 25,000 | |
| Loan from Hari @ 12% interest | 15,000 | |

(Contd...)