

Accountancy

Financial Accounting Part - II
Textbook for Class XI



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Financial Accounting

Part II

Textbook for Class XI



11112



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FOREWORD

The National Curriculum Framework (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee

responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences Professor Hari Vasudevan and the Chief Advisor for this book, Professor R.K. Grover, (Retd.) Director, School of Management Studies (IGNOU), New Delhi for guiding the work of this committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to the systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement.

New Delhi
20 December 2005

Director
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Financial Statements - I

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- state the nature of the financial statements;
- identify the various stakeholders and their information requirements;
- distinguish between the capital and revenue expenditure and receipts;
- explain the concept of trading and profit and loss account and its preparation;
- State the nature of gross profit, net profit and operating profit;
- describe the concept of balance sheet and its preparation;
- explain grouping and marshalling of assets and liabilities;
- prepare profit and loss account and balance sheet of a sole proprietary firm; and
- make an opening entry.

You have learnt that financial accounting is a well-defined sequential activity which begins with Journal (Journalising), Ledger (Posting), and preparation of Trial Balance (Balancing and Summarisation at the first stage). In the present chapter, we will take up the next step, namely, preparation of financial statements, and discuss the types of information requirements of various stakeholders, the distinction between capital and revenue items and its importance and the nature of financial statements and the preparation thereof.

9.1 Stakeholders and their Information Requirements

Recall from chapter I (Financial Accounting Part I) that the objective of business is to communicate the meaningful information to various stakeholders in the business so that they can make informed decisions. A stakeholder is any person associated with the business. The stakes of various stakeholders can be monetary or non-monetary. The stakes can be active or passive; or can be direct or indirect. The owner and persons advancing loan to the business would have monetary stake. The government, consumer or a researcher will have non-monetary stake in the business. The stakeholders are also called users who are normally classified as *internal* and *external* depending upon whether they are inside the business or outside the business. All users have different objectives for

joining business and consequently different types of information requirements from it. In nutshell, the various users have diverse financial information requirements from the business.

For example we have classified the following into the category of internal and external users specifying their objectives and consequent information requirements.

<i>Name</i>	<i>Internal/ External users</i>	<i>Objective for participating in business</i>	<i>Accounting Information requirements</i>
Current owners	Internal	To make investment in the business and wealth grow.	Likes to know extent of profit in the last accounting period, current position of the assets/liabilities of the business.
Manager	Internal	For a career. They essentially act as the agent of owners (their employers).	Accounting information in the form of financial statements is like their report card and they are interested in information about both profits and financial position.
Government	External	Its role is regulatory and tries to lay down the rules in the best public interest.	Its concerns are that the rights of all stakeholders are protected. Since the government levies taxes on the business, they are interested in information about profitability in particular besides lot of other information.
Prospective owner	External	He is expecting to make investments in the business with a view to make his investment and wealth grow.	He is interested in information about past profits and financial position as indicative of likely future performance.
Bank	External	Bank is interested in safety of the principal as well as the periodic return (interest).	Bank is interested in adequacy of profits only as an assurance of the return of principal and interest back in time. Bank is equally concerned about the form in which the assets are held by the business. When more assets are held in cash or near cash form, the aspect is known as liquidity.

Fig. 9.1 : Analysis of various users of accounting information

Box 1

Accounting Process (up to Trial balance) :

1. Identify the transactions, which that are recorded.
2. Record transactions in journal. Only those transactions are recorded which are measured in money terms. The system followed for recording is called double entry system whereby two aspects (debit and credit) of every transaction are recorded. Repeated transactions of same nature are recorded in subsidiary books, also called special journals. Instead of recording all transactions in journal, they are recorded in subsidiary books and the journal proper. For example, the business would record all credit sales in sales book and all credit purchases in purchases book. The other examples of subsidiary books are return inwards book, return outwards book. An other important special book is cash book, in which all cash and bank transactions are recorded. The entries, which are not recorded in any of these books, are recorded in a residual journal called *journal proper*.
3. The entries appearing in the above books are posted in the respective accounts in the ledger.
4. The accounts are balanced and listed in a statement called *trial balance*. If the total amounts of debit and credit balances agree, accounts are taken as free from arithmetical errors.
5. The trial balance forms the basis for making the financial statements, i.e. trading and profit and loss account and balance sheet.

9.2 Distinction between Capital and Revenue

A very important distinction in accounting is between capital and revenue items. The distinction has important implications for making of the trading and profit and loss account and balance sheet. The revenue items form part of the trading and profit and loss account, the capital items help in the preparation of a balance sheet.

9.2.1 Expenditure

Whenever payment and/or incurrance of an outlay are made for a purpose other than the settlement of an existing liability, it is called expenditure. The expenditures are incurred with a viewpoint they would give benefits to the business. The benefit of an expenditure may extend up to one accounting year or more than one year. If the benefit of expenditure extends up to one accounting period, it is termed as *revenue expenditure*. Normally, they are incurred for the day-to-day conduct of the business. An example can be payment of salaries, rent, etc. The salaries paid in the current period will not benefit the business in the next accounting period, as the workers have put in their efforts in the current accounting period. They will have to be paid the salaries in the next accounting period as well if they are made to work. If the benefit of expenditure extends more than one accounting period, it is termed

as *capital expenditure*. An example can be payment to acquire furniture for use in the business. Furniture acquired in the current accounting period will give benefits for many accounting periods to come. The usual examples of capital expenditure can be payment to acquire fixed assets and/or to make additions/extensions in the fixed assets.

Following points of distinction between capital expenditure and revenue expenditure are worth noting :

- (a) Capital expenditure increases earning capacity of business whereas revenue expenditure is incurred to maintain the earning capacity.
- (b) Capital expenditure is incurred to acquire fixed assets for operation of business whereas revenue expenditure is incurred on day-to-day conduct of business.
- (c) Revenue expenditure is generally recurring expenditure and capital expenditure is non-recurring by nature.
- (d) Capital expenditure benefits more than one accounting year whereas revenue expenditure normally benefits one accounting year.
- (e) Capital expenditure (subject to depreciation) is recorded in balance sheet whereas revenue expenditure (subject to adjustment for outstanding and prepaid amount) is transferred to trading and profit and loss account.

Sometimes, it becomes difficult to classify the expenditure into revenue or capital category. In normal usage, the advertising expenditure is termed as revenue expenditure. The heavy expenditure incurred on advertising is likely to benefit the business firm for more than one accounting period. Such revenue expenditures, which are likely to give benefit for more than one accounting period, are termed as *deferred revenue expenditure*.

It must be understood that expenditure is a wider term and includes expenses. Expenditure is any outlay made/incurred by the business firm. The part of the expenditure, which is perceived to have been used or consumed in the current year, is termed as expense of the current year.

Revenue expenditure is treated as an expense for the current year and is shown in trading and profit and loss account. For example, salary paid by the business firm is treated as an expense of the current year. Capital expenditures are charged to income statement and are spread over to more than one accounting period. Hence, furniture of ₹ 50,000 if expected to be used for 5 years will be treated as expense @ ₹ 10,000 per year. The name given for the expense is depreciation. The treatment of deferred revenue expenditure is same as of capital expenditure. They are also written-off over their expected period of benefit.

9.2.2 Receipts

The similar treatment is given to the receipts of the business. If the receipts imply an obligation to return the money, these are capital receipts. The example can be an additional capital brought in by the owner or a loan taken from the bank. Both receipts are leading to obligations, the first to the owner (called equity) and the other to the outsiders (called liabilities). Another example on a capital receipt can be the sale of a fixed asset like old machinery or furniture. However, if a receipt does not incur an obligation to return the money or is not in the form of a sale of fixed asset, it is termed as revenue receipt. The examples of revenue receipts sales made by the firm and interest on investment received by the firm.

9.2.3 Importance of Distinction between Capital and Revenue

As stated earlier, the distinction between capital and revenue items has important implications for the preparation of trading and profit and loss account and the balance sheet as all items of revenue value are to be shown in the trading and profit and loss account and the items of capital nature in the balance sheet. If any item is wrongly classified, i.e. if any item of revenue nature is treated as capital item or vice-versa, the ascertainment of profit or loss will be incorrect. For example, the revenues earned during an accounting period are ₹ 10,00,000 and the expenses shown are ₹ 8,00,000, the profit shall work out as ₹ 2,00,000. On scrutiny of the details, you find that a revenue item of ₹ 20,000 (an expenditure on repairs of machinery) has been treated as capital expenditure (added to the cost of machinery and debited to machinery account, not to repairs account), and hence, does not form part of the expenses for the period. It means the actual expenses for the period are ₹ 8,20,000 and not ₹ 8,00,000. So, the correct profit is ₹ 1,80,000, not ₹ 2,00,000. In other words, the profit has been over stated. Similarly, if any capital expenditure is wrongly shown as revenue expenditure (for example, purchase of furniture shown as purchases), it will result in under statement of profits, and also an under statement of assets. Thus, the financial statements will not reflect the true and fair view of the affairs of the business. Hence, it is necessary to identify the correct nature of each item and treat it accordingly in the book of accounts. It is also important from taxation point of view because capital profits are taxed differently from revenue profits.

9.3 Financial Statements

It has been emphasised that various users have diverse informational requirements. Instead of generating particular information useful for specific users, the business prepares a set of financial statements, which in general satisfies the informational needs of the users.

The basic objectives of preparing financial statements are :

- (a) To present a true and fair view of the financial performance of the business;
- (b) To present a true and fair view of the financial position of the business; and

For this purpose, the firm usually prepares the following financial statements:

1. Trading and Profit and Loss Account
2. Balance Sheet¹

Trading and Profit and Loss account, also known as Income statement, shows the financial performance in the form of profit earned or loss sustained by the business. Balance Sheet shows financial position in the form of assets, liabilities and capital. These are prepared on the basis of trial balance and additional information, if any.

Example 1

Observe the following trial balance of Ankit and signify correctly the various elements of accounts and you will notice that the debit balances represent either assets or expenses/ losses and the credit balance represent either equity/liabilities or revenue/gains.

[This trial balance of Ankit will be used throughout the chapter to understand the process of preparation of financial statements]

Trial Balance of Ankit as on March 31, 2017

Account Title	L.F.	Debit Amount ₹	Credit Amount ₹
Cash		1,000	
Capital			12,000
Bank		5,000	
Sales			1,25,000
Wages		8,000	
Creditors			15,000
Salaries		25,000	
10% Long term loan (raised on April 01, 2016)			5,000
Furniture		15,000	
Commission received			5,000
Rent of building		13,000	
Debtors		15,500	
Bad debts		4,500	
Purchases		75,000	
		1,62,000	1,62,000

¹ The balance sheet and profit and loss account are now called position statement and statement of profit and loss in the company's financial statements. Since Chapters 9 and 10 deal with the preparation of financial statements of sole proprietorship firm, the terms balance sheet and profit and loss account are retained.

Analysis of Trial Balance of Ankit as on March 31, 2017

<i>Account Title</i>	<i>Elements</i>	<i>L.F.</i>	<i>Debit Amount</i> ₹	<i>Credit Amount</i> ₹
Cash	Asset		1,000	
Capital	Equity			12,000
Bank	Asset		5,000	
Sales	Revenue			1,25,000
Wages	Expense		8,000	
Creditors	Liability			15,000
Salaries	Expense		25,000	
10% Long-term loan (raised on April 01, 2016)	Liability			5,000
Furniture	Asset		15,000	
Commission received	Revenue			5,000
Rent of building	Expense		13,000	
Debtors	Asset		15,500	
Bad debts	Expense		4,500	
Purchases	Expense		75,000	
			1,62,000	1,62,000

9.4 Trading and Profit and Loss Account

Trading and Profit and Loss account is prepared to determine the profit earned or loss sustained by the business enterprise during the accounting period. It is basically a summary of revenues and expenses of the business and calculates the net figure termed as profit or loss. Profit is revenue *less* expenses. If expenses are more than revenues, the figure is termed as *loss*. Trading and Profit and Loss account summarises the performance for an accounting period. It is achieved by transferring the balances of revenues and expenses to the trading and profit and loss account from the trial balance. Trading and Profit and Loss account is also an account with *Debit and Credit* sides. It can be observed that debit balances (representing expenses) and losses are transferred to the debit side of the Trading and a Profit and Loss account and credit balance (representing revenues/gains) are transferred to its credit side.

9.4.1 Relevant Items in Trading and Profit and Loss Account

The different items appearing in the trading and profit and loss account are explained hereunder:

Items on the debit side

- (i) *Opening stock* : It is the stock of goods in hand at the beginning of the accounting year. This is the stock of goods which has been carried forward

from the previous year and remains unchanged during the year and appears in the trial balance. In the trading account it appears on the debit side because it forms the part of cost of goods sold for the current accounting year.

- (ii) *Purchases less returns* : Goods, which have been bought for resale appears as purchases on the debit side of the trading account. They include both cash as well as credit purchases. Goods which are returned to suppliers are termed as purchases return. It is shown by way of deduction from purchases and the computed amount is known as *Net purchases*.
- (iii) *Wages* : Wages refer to remuneration paid to workers who are directly engaged in factory for loading, unloading and production of goods and are debited to trading account.
- (iv) *Carriage inwards/Freight inwards*: These expenses are the items of transport expenses, which are incurred on bringing materials/goods purchased to the place of business. These items are paid in respect of purchases made during the year and are debited to the trading account.
- (v) *Fuel/Water/Power/Gas* : These items are used in the production process and hence are part of expenses.
- (vi) *Packaging material and Packing charges* : Cost of packaging material used in the product are direct expenses as it refers to small containers which form part of goods sold. However, the packing refers to the big containers that are used for transporting the goods and is regarded as an indirect expense debited to profit and loss account.
- (vii) *Salaries* : These include salaries paid to the administration, godown and warehouse staff for the services rendered by them for running the business. If salaries are paid in kind by providing certain facilities (called perks) to the employees such as rent free accommodation, meals, uniform, medical facilities should also be regarded as salaries and debited to the profit and loss account.
- (viii) *Rent paid* : These include office and godown rent, municipal rates and taxes, factory rent, rates and taxes. The amount of rent paid is shown on the debit side of the profit and loss account.
- (ix) *Interest paid* : Interest paid on loans, bank overdraft, renewal of bills of exchange, etc. is an expense and is debited to profit and loss account.
- (x) *Commission paid*: Commission paid or payable on business transactions undertaken through the agents is an item of expense and is debited to profit and loss account.

- (xi) *Repairs* : Repairs and small renewals/ replacements relating to plant and machinery, furniture, fixtures, fittings, etc. for keeping them in working condition are included under this head. Such expenditure is debited to profit and loss account.
- (xii) *Miscellaneous expenses* : Though expenses are classified and booked under different heads, but certain expenses being of small amount clubbed together and are called miscellaneous expenses. In normal usage these expenses are called *Sundry expenses* or *Trade expenses*.

Items on the credit side

- (i) *Sales less returns* : Sales account in trial balance shows gross total sales(cash as well as credit) made during the year. It is shown on the credit side of the trading account. Goods returned by customers are called return inwards and are shown as deduction from total sales and the computed amount is known as net sales.
- (ii) *Other incomes* : Besides salaries and other gains and incomes are also recorded in the profit and loss account. Examples of such incomes are rent received, dividend received, interest received, discount received, commission received, etc.

9.4.2 Closing Entries

The preparation of trading and profit and loss account requires that the balances of accounts of all concerned items are transferred to it for its compilation.

- Opening stock account, Purchases account, Wages account, Carriage inwards account and direct expenses account are closed by transferring to the debit side of the trading and profit and loss account.

This is done by recording the following entry :

Trading A/c	Dr.
To Opening stock A/c	
To Purchases A/c	
To Wages A/c	
To Carriage inwards A/c	
To All other direct expenses A/c	

- The purchases returns or return outwards are closed by transferring its balance to the purchases account. The following entry is recorded for this purpose :

Purchases return A/c	Dr.
To Purchases A/c	

- Sales A/c Dr.
To Sales return A/c

- Sales A/c Dr.
To Trading A/c

Profit and Loss A/c Dr.
 To Expenses (individually) A/c
 To Losses (individually) A/c

Incomes (individually) A/c	Dr.
Gains (individually) A/c	Dr.
To Profit and Loss A/c	

(i) *For closing the accounts of expenses*

Trading A/c	Dr.	83,000	
To Purchases A/c			75,000
To Wages A/c			8,000

(ii) Profit and Loss A/c	Dr.	43,500	
To Salaries			25,000
To Rent of building			13,000
To Bad debts			4,500

(i) *For closing the accounts of revenues*

Sales A/c	Dr.	1,25,000	
To Trading A/c			1,25,000

(ii) Commission received A/c	Dr.	5,000	
To Profit and Loss A/c			5,000

The posting done in ledger will appear as follows :

Purchases Account

Cr.

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount</i> ₹	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount</i> ₹
	Balance b/d		75,000		Trading		75,000
			75,000				75,000

Wages Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		8,000		Trading		8,000
			8,000				8,000

Salaries Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		25,000		Profit and Loss		25,000
			25,000				25,000

Rent of Building Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		13,000		Profit and Loss		13,000
			13,000				13,000

Bad Debts Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		4,500		Profit and Loss		4,500
			4,500				4,500

Sales Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Trading		1,25,000		Balance b/d		1,25,000
			1,25,000				1,25,000

Commission Received Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Profit and Loss		5,000		Balance b/d		5,000
			5,000				5,000

As result of the foregoing discussion, we will now learn how the trading and profit and loss account can be prepared from the trial balance, the format of which is shown in figure 9.2. However, this list is not exhaustive. In real sense, there can be many more of other items, which we will be dealing at the later stage and there you will notice how this format undergoes a change with respect to each one of them.

**Trading and Profit and Loss Account of ABC
for the year ended March 31, 2017**

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	.....	Sales	.....
Purchases	.....	
Wages	.....	
Carriage inwards/ Freight inwards/cartage	.....	
Gross profit c/d ¹			
Gross loss b/d ²			
	xxx		xxx
		Gross loss c/d ¹	.....
Rent/rates and taxes	.....	Gross profit b/d	.....
Salaries	.....	Interest received	.....
Repairs and renewals	.....		.....
Bad debts	.....	Net loss ²	
Net profit ² (transferred to capital account)	.....	
	xxx		xxx

^{1,2}either of the items computed

Fig. 9.2 : A format trading and profit and loss account

9.4.3 Concept of Gross Profit and Net Profit

The trading and profit and loss can be seen as combination of two accounts, viz. Trading account and Profit and Loss account. The trading account or the first part ascertains the *gross profit* and profit and loss account or the second part ascertains *net profit*.

Trading Account

The trading account ascertains the result from basic operational activities of the business. The basic operational activity involves the manufacturing, purchasing and selling of goods. It is prepared to ascertain whether the selling

of goods and/or rendering of services to customers have proved profitable for the business or not. Purchases is one of the main constituents of expenses in business organisation. Besides purchases, the remaining expenses are divided into two categories, viz. *direct expenses and indirect expenses*.

Direct expenses means all expenses directly connected with the manufacture, purchase of goods and bringing them to the point of sale. Direct expenses include carriage inwards, freight inwards, wages, factory lighting, coal, water and fuel, royalty on production, etc. In our example-1, besides purchases, four more items of expenses are listed. These are wages, salaries, rent of building and bad debts. Out of these items, wages is treated as *direct expense* while the other three are treated as *indirect expenses*.

Similarly, *sales* constitute the main item of revenue for the business. The excess of sales over purchases and direct expenses is called *gross profit*. If the amount of purchases including direct expenses is more than the sales revenue, the resultant figure is *gross loss*. The computation of gross profit can be shown in the form of equation as :

$$\text{Gross Profit} = \text{Sales} - (\text{Purchases} + \text{Direct Expenses})$$

The gross profit or the gross loss is transferred to profit and loss account.

The *indirect expenses* are transferred to the debit side of the second part, viz. profit and loss account. All revenue/gains other than *sales* are transferred to the credit side of the profit and loss account. If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the *net profit* for the period of which it is being prepared. On the other hand, if the total of the debit side is more than the total of the credit side, the difference is the *net loss* incurred by the business firm. In an equation form, it is shown as follows :

$$\text{Net Profit} = \text{Gross Profit} + \text{Other Incomes} - \text{Indirect Expenses}$$

Net profit or net loss so computed is transferred to the capital account in the balance sheet by way of the following entry :

(i) *For transfer of net profit*

Profit and Loss A/c	Dr.
To Capital A/c	

(ii) *For transfer of net loss*

Capital A/c	Dr.
To Profit and Loss A/c	

We are now redrafting the trading and profit and loss account to show gross profit and net profit of Ankit for the year ended March 31, 2017. The redrafted trading and profit and loss account will look like as shown in figure 9.3.

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases	75,000	Sales	1,25,000
Wages	8,000		
Gross profit c/d	42,000		
	1,25,000		1,25,000
Salaries	25,000	Gross profit b/d	42,000
Rent of building	13,000	Commission received	5,000
Bad debts	4,500		
Net Profit (transferred to capital account)	4,500		
	47,000		47,000

Fig. 9.3 : Showing the computation of gross profit and net profit of Ankit

Gross profit, which represents the basic operational activity of the business is computed as ₹ 42,000. The gross profit is transferred from trading account to profit and loss account. Besides gross profit, business has earned an income of ₹ 5,000 as commission received and has spent ₹ 42,500 (₹ 25,000 + ₹ 13,000 + ₹ 4,500) on expenses/losses including salaries, rent and bad debts. Therefore, the net profit is calculated as ₹ 4,500.

Illustration 1

Prepare a trading account from the following particulars for the year ended March 31, 2017:

	₹
Opening stock	37,500
Purchases	1, 05,000
Sales	2,70,000
Wages	30,000

Solution

**Trading Account
for the year ended March 31, 2017**

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	37,500	Sales	2,70,000
Purchases	1,05,000		
Wages	30,000		
Gross profit	97,500		
	2,70,000		2,70,000

Illustration 2

Prepare a trading account of M/s Prime Products from the following particulars pertaining to the year 2016-17.

	₹
Opening stock	50,000
Purchases	1,10,000
Return inwards	5,000
Sales	3,00,000
Return outwards	7,000
Factory rent	30,000
Wages	40,000

Solution

Books of Prime Products
Trading Account
for the year ended March 31, 2017

Dr.		Cr.	
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	50,000	Sales	3,00,000
Purchases	1,10,000	Less : Return	(5,000)
Less : Return	(7,000)	inwards	
outwards	1,03,000		2,95,000
Factory rent	30,000		
Wages	40,000		
Gross profit	72,000		
	2,95,000		2,95,000

Illustration 3.

Prepare a trading account of M/s Anjali from the following information related to March 31, 2017.

	₹
Opening stock	60,000
Purchases	3,00,000
Sales	7,50,000
Purchases return	18,000
Sales return	30,000
Carriage on purchases	12,000
Carriage on sales	15,000
Factory rent	18,000
Office rent	18,000
Dock and Clearing charges	48,000
Freight and Octroi	6,500
Coal, Gas and Water	10,000

Solution

Books of Anjali
Trading Account
for the year ended March 2017

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	60,000	Sales	7,50,000
Purchases 3,00,000		Less : Sales return (30,000)	7,20,000
Less : Purchases return (18,000)	2,82,000		
Carriage on purchases	12,000		
Factory rent	18,000		
Dock and Clearing charges	48,000		
Freight and Octroi	6,500		
Coal, Gas and Water	10,000		
Gross profit	2,83,500		
	7,20,000		7,20,000

Illustration 4

From the following information, prepare a profit and loss account for the year ending March 31, 2017.

	₹
Gross profit	60,000
Rent	5,000
Salary	15,000
Commission paid	7,000
Interest paid on loan	5,000
Advertising	4,000
Discount received	3,000
Printing and stationery	2,000
Legal charges	5,000
Bad debts	1,000
Depreciation	2,000
Interest received	4,000
Loss by fire	3,000

Profit and Loss Account
for the year ended March 31, 2017

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Rent	5,000	Gross profit	60,000
Salary	15,000	Discount received	3,000
Commission	7,000	Interest received	4,000
Interest paid on loan	5,000		
Advertising	4,000		
Printing and Stationery	2,000		
Legal charges	5,000		

Bad debts	1,000		
Depreciation	2,000		
Loss by fire	3,000		
Net profit (transferred to the capital account)	18,000		
	67,000		67,000

Test Your Understanding - I

I State True or False :

- Gross profit is total revenue.
- In trading and profit and loss account, opening stock appears on the debit side because it forms the part of the cost of sales for the current accounting year.
- Rent, rates and taxes is an example of direct expenses.
- If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the net profit.

II Match the items given under 'A' with the correct items under 'B'

- | | |
|--|---------------------|
| (i) Closing stock is credited to | (a) Trial balance |
| (ii) Accuracy of book of account is tested by | (b) Trading account |
| (iii) On returning the goods to seller, the buyer sends | (c) Credit note |
| (iv) The financial position is determined by | (d) Balance sheet |
| (v) On receiving the returned goods from the buyer, the seller sends | (e) Debit note |

9.4.4 Cost of Goods Sold and Closing Stock–Trading Account Revisited

The trading and profit and loss account prepared in figure 9.3 presents useful information as to the profitability from the basic operations of the business enterprise. It is reproduced for further perusal.

Trading Account of Ankit for the year ended March 31, 2017

Dr.		Cr.	
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages	8,000		
Gross profit	42,000		
	1,25,000		1,25,000

Fig. 9.4 : An illustrative trading account of Ankit

If there is no opening or closing stock, the total of purchases and direct expenses is taken as *Cost of goods sold*. In our example, notice that purchases amount to ₹ 75,000 and wages amounts to ₹ 8,000. Hence, the cost of goods sold will be computed using the following formula :

$$\begin{aligned}\text{Cost of Goods Sold} &= \text{Purchases} + \text{Direct Expenses} \\ &= ₹75,000 + ₹ 8,000 \\ &= ₹ 83,000\end{aligned}$$

As there is no unsold stock, the presumption here is that all the goods purchased have been sold. But in practice, there is some unsold goods at the end of the accounting period.

In our example, let us assume that out of the goods purchased amounting to ₹ 75,000 in the current year, Ankit is able to sell goods costing ₹ 60,000 only. In such a situation, the business will have an unsold stock of goods costing ₹ 15,000 in hand, also called closing stock. The amount of cost of goods sold will be computed as per the following equation :

$$\begin{aligned}\text{Cost of Goods Sold} &= \text{Purchases} + \text{Direct Expenses} - \text{Closing Stock} \\ &= ₹ 75,000 + ₹ 8,000 - ₹ 15,000\end{aligned}$$

As a result, the amount of gross profit will also change with the existence of closing stock in business from ₹ 42,000 (as computed in figure 9.4) to ₹ 57,000 (refer figure 9.5).

**Trading Account of Ankit
for the year ended March 31, 2017**

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases	75,000	Sales	1,25,000
Wages	8,000	Closing stock	15,000
Gross profit c/d	57,000		
	1,40,000		1,40,000
Salaries	25,000	Gross profit b/d	57,000
Rent of building	13,000	Commission received	5,000
Bad debts	4,500		
Net Profit (transferred to capital account)	19,500		
	62,000		62,000

Fig. 9.5 : The trading account of Ankit

It may be noted that closing stock does not normally form part of trial balance, and is brought into books with the help of the following journal entry :

Closing stock A/c	Dr.
To Trading A/c	

This entry opens a new account of asset, i.e. closing stock ₹ 15,000 which is transferred to the balance sheet. The closing stock shall be an opening stock for the next year and shall be sold during the year. In most cases, therefore, the business shall have opening stock as well as closing stock every year, and the cost of goods sold should be worked as per the following equation:

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

Look at Illustration 5 and see how it has been computed.

Illustration 5

Compute cost of goods sold for the year 2017 with the help of the following information and prepare trading account

	₹
Sales	20, 00,000
Purchases	15, 00,000
Wages	1, 00,000
Stock (Apr. 01, 2016)	3, 00,000
Stock (March 31, 2017)	4,00,000
Freight inwards	1,00,000

Solution

Computation of Cost of Goods Sold

<i>Particulars</i>	<i>Amount</i> ₹
Opening stock	3,00,000
Add Purchases	15,00,000
Direct expenses :	
Freight inwards	1,00,000
Wages	<u>1,00,000</u>
	20,00,000
Less Closing stock	<u>(4,00,000)</u>
Cost of goods sold	<u><u>16,00,000</u></u>

Trading Account
for the year ended March 31, 2017

Dr.

Cr.

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	3,00,000	Sales	20,00,000
Purchases	15,00,000	Closing stock	4,00,000
Freight inwards	1,00,000		
Wages	1,00,000		
Gross profit	4,00,000		
	24,00,000		24,00,000

Illustration 6

From the following balances obtained from the few accounts of Mr. H. Balaram. Prepare the Trading and Profit and Loss Account.

	₹		₹
Stock on Apr. 01, 2016	8,000	Bad debts	1,200
Purchases for the year	22,000	Rent	1,200
Sales for the year	42,000	Discount allowed	600
Purchase expenses	2,500	Commission paid	1,100
Salaries and wages	3,500	Sales expenses	600
Advertisement	1,000	Repairs	600

Closing stock on March 31, 2017 is ₹ 4,500

Books of H. Balaram
Trading Account
for the year ended March 31, 2017

Dr.

Cr.

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	8,000	Sales	42,000
Purchases	22,000	Closing stock	4,500
Purchase expenses	2,500		
Gross profit c/d	14,000		
	46,500		46,500
Salaries and Wages	3,500	Gross profit b/d	14,000
Rent	1,200		
Advertisement	1,000		
Commission	1,100		
Discount allowed	600		
Bad debts	1,200		
Sales expenses	600		
Repairs	600		
Net profit	4,200		
(transferred to capital account)			
	14,000		14,000

9.5 Operating Profit (EBIT)

It is the profit earned through the normal operations and activities of the business. Operating profit is the excess of operating revenue over operating expenses. While calculating operating profit, the incomes and expenses of a purely financial nature are not taken into account. Thus, operating profit is profit before interest and tax (EBIT). Similarly, abnormal items such as loss by fire, etc. are also not taken into account. It is calculated as follows:

Operating profit = Net Profit + Non Operating Expenses – Non Operating Incomes

Refer to the trial balance of Ankit in example 1 (Page no. 336), you will notice that it depicts an item relating to 10% interest on long-term loan raised on April 01, 2017. The amount of interest works out to ₹ 500 ($₹ 5,000 \times 10/100$), which has been shown on the debit side of the trading and profit and loss account (figure 9.6).

Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017

Dr.		Cr.	
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages	8,000	Closing stock	15,000
Gross profit c/d	57,000		
	1,40,000		1,40,000
Salaries	25,000	Gross profit b/d	57,000
Rent of building	13,000	Commission received	5,000
Bad debts	4,500		
Interest	500		
Net Profit (transferred to capital account)	19,000		
	62,000		62,000

Fig. 9.6 : Showing the treatment of interest on profit

The operating profit will be :

Operating profit = Net profit + Non-operating expenses – Non-operating incomes

Operating profit = ₹ 19,000 + 500 – nil

= ₹ 19,500

Test Your Understanding - II

Choose the correct option in the following questions :

- The financial statements consist of:
 - Trial balance
 - Profit and loss account
 - Balance sheet
 - (i) & (iii)
 - (ii) & (iii)
- Choose the correct chronological order of ascertainment of the following profits from the profit and loss account :
 - Operating Profit, Net Profit, Gross Profit
 - Operating Profit, Gross Profit, Net Profit
 - Gross Profit, Operating Profit, Net Profit
 - Gross Profit, Net Profit, Operating Profit
- While calculating operating profit, the following are not taken into account.
 - Normal transactions
 - Abnormal items
 - Expenses of a purely financial nature
 - (ii) & (iii)
 - (i) & (iii)
- Which of the following is correct :
 - Operating Profit = Operating profit – Non-operating expenses – Non-operating incomes
 - Operating profit = Net profit + Non-operating Expenses + Non-operating incomes
 - Operating profit = Net profit + Non-operating Expenses – Non-operating incomes
 - Operating profit = Net profit – Non-operating Expenses + Non-operating incomes

Illustration 7

Following balance is extracted from the books of a trader ascertain gross profit, operating profit and net profit for the year ended March 31, 2017.

Particulars	Amount ₹
Sales	75,250
Purchases	32,250
Opening stock	7,600
Sales return	1,250
Purchases return	250
Rent	300
Stationery and printing	250
Salaries	3,000
Misc. expenses	200
Travelling expenses	500
Advertisement	1,800

Commission paid	150
Office expenses	1,600
Wages	2,600
Profit on sale of investment	500
Depreciation	800
Dividend on investment	2,500
Loss on sale of old furniture	300
Closing stock (March 31, 2017) valued at ₹ 8,000	

**Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.

Cr.

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	7,600	Sales	75,250
Purchases 32,250		Less : Sales return (1,250)	74,000
Less: Purchases return (250)	32,000	Closing stock	8,000
Wages	2,600		
Gross profit c/d	39,800		
	82,000		82,000
Rent	300	Gross profit b/d	39,800
Stationery and printing	250		
Salaries	3,000		
Misc. expenses	200		
Travelling expenses	500		
Advertisement expenses	1,800		
Commission paid	150		
Office expenses	1,600		
Depreciation	800		
Operating profit c/d	31,200		
	39,800		39,800
Loss on sale of old furniture	300	Operating profit b/d	31,200
Net Profit (transferred to capital account)	33,900	Profit on sale of investment	500
		Dividend on investment	2,500
	34,200		34,200

9.6 Balance Sheet

The balance sheet is a statement prepared for showing the financial position of the business summarising its assets and liabilities at a given date. The assets reflect debit balances and liabilities (including capital) reflect credit balances. It is prepared at the end of the accounting period after the trading and profit and

loss account have been prepared. It is called balance sheet because it is a statement of balances of ledger accounts that have not been transferred to trading and profit and loss account and are to be carried forward to the next year with the help of an opening entry made in the journal at the beginning of the next year.

9.6.1 Preparing Balance Sheet

All the account of assets, liabilities and capital are shown in the balance sheet. Accounts of capital and liabilities are shown on the left hand side, known as *Liabilities*. Assets and other debit balances are shown on the right hand side, known as *Assets*. There is no prescribed form of Balance sheet, for a proprietary and partnership firms. (However, *Schedule III Part I of the Companies Act 2013* prescribes the format and the order in which the assets and liabilities of a company should be shown). The horizontal format in which the balance sheet is prepared is shown in the figure 9.7.

Balance Sheet ofas at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital		Furniture	.....
Add Profit .....	.....	Cash	.....
Long-term loan	.....	Bank	.....
Short-term loan		Goodwill	.....
Sundry creditors	.....	Sundry debtors	.....
Bills payable		Land and Buildings	
Bank overdraft		Closing stock	
	XXXX		XXXX

Fig. 9.7 : Format of a balance sheet

Refer to our example -1 you will observe that the trial balance of Ankit depicts 14 accounts, out of which 7 accounts have been transferred to the trading and profit and loss account (refer figure 9.3). These are the accounts of revenues and expenses. The analysis of figure 9.3 shows that the business has incurred total expenses of ₹ 1,25,500 and revenues generated are ₹ 1,30,000 making a profit of ₹ 4,500. The remaining *seven items* in the trial balance reflects the capital, assets and liabilities. We are reproducing the trial balance (example - 1) to show how the accounts of assets and liabilities of Ankit would be presented in the balance sheet.

Trial Balance of Ankit as on March 31, 2017

<i>Account Title</i>	<i>L.F.</i>	<i>Debit Amount ₹</i>	<i>Credit Amount ₹</i>
Cash		1,000	
Capital			12,000
Bank		5,000	
Sales			1,25,000
Wages		8,000	
Creditors			15,000
Salaries		25,000	
10% Long-term loan (raised on April 01, 2016)			5,000
Furniture		15,000	
Commission received			5,000
Rent of building		13,000	
Debtors		15,500	
Bad debts		4,500	
Purchases		75,000	
		1,62,000	1,62,000

Fig. 9.8 : Showing the accounts of assets and liabilities in the trial balance of Ankit**Balance Sheet of Ankit as at March 31, 2017**

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital	12,000	Furniture	15,000
Add Profit	<u>4,500</u>	Cash	1,000
10 % Long-term loan	5,000	Bank	5,000
Creditors	15,000	Debtors	15,500
	<u>36,500</u>		<u>36,500</u>

Fig. 9.9 : Showing the balance sheet of Ankit**9.6.2 Relevant Items in the Balance Sheet**

Items which are generally included in a balance sheet are explained below :

- (1) **Current Assets:** Current assets are those which are either in the form of cash or a can be converted into cash within a year. The examples of such assets are cash in hand/bank, bills receivable, stock of raw materials, semi-finished goods and finished goods, sundry debtors, short term investments, prepaid expenses, etc.

- (2) *Current Liabilities*: Current liabilities are those liabilities which are expected to be paid within a year and which are usually to be paid out of current assets. The examples of such liabilities are bank overdraft, bills payable, sundry creditors, short-term loans, outstanding expenses, etc.
- (3) *Fixed Assets*: Fixed assets are those assets, which are held on a long-term basis in the business. Such assets are not acquired for the purpose of resale, e.g. land, building, plant and machinery, furniture and fixtures, etc. Some times the term 'Fixed Block' or 'Block Capital' is also used for them.
- (4) *Intangible Assets* : These are such assets which cannot be seen or touched. Goodwill, Patents, Trademarks are some of the examples of intangible assets.
- (5) *Investments*: Investments represent the funds invested in government securities, shares of a company, etc. They are shown at cost price. If, on the date of preparation the balance sheet, the market price of investments is lower than the cost price, a footnote to that effect may be appended to the balance sheet.
- (6) *Long-term Liabilities* : All liabilities other than the current liabilities are known as long-term liabilities. Such liabilities are usually payable after one year of the date of the balance sheet. The important items of long term liabilities are long-term loans from bank and other financial institutions.
- (7) *Capital*: It is the excess of assets over liabilities due to outsiders. It represents the amount originally contributed by the proprietor/ partners as increased by profits and interest on capital and decreased by losses drawings and interest on drawings.
- (8) *Drawings* : Amount withdrawn by the proprietor is termed as drawings and has the effect of reducing the balance on his capital account. Therefore, the drawings account is closed by transferring its balance to his capital account. However it is shown by way of deduction from capital in the balance sheet.

9.6.3 Marshalling and Grouping of Assets and Liabilities

A major concern of accounting is about preparing and presenting the financial statement. The information so provided should be decision useful for the users. Therefore, it becomes necessary that the items appearing in the balance sheet should be properly *grouped* and presented in a particular order.

Marshalling of Assets and Liabilities

In a balance sheet, the assets and liabilities are arranged either in the order of *liquidity* or *permanence*. Arrangement of assets and liabilities in a particular order is known as Marshalling.

In case of *permanence*, the most permanent asset or liability is put on the top in the balance sheet and thereafter the assets are arranged in their reducing level of permanence.

In the balance sheet of Ankit you will find that furniture is the most permanent of all the assets. Out of debtors, bank and cash, debtors will take maximum time to convert back into cash. Bank is less liquid than cash. Cash is the most liquid of all the assets. Similarly, on the liabilities side, the capital, being the most important source of finance will tend to remain in the business for a longer period than the long-term loan. Creditors being a liquid liability will be discharged in the near future. The balance sheet of Ankit in the order of permanence is shown in figure 9.10(a).

Balance Sheet of Ankit as on March 31, 2017 (in order of permanence)

Liabilities	Amount ₹	Assets	Amount ₹
Capital 12,000		Furniture	15,000
Add Profit 4,500	16,500	Debtors	15,500
10 % Long-term loan	5,000	Bank	5,000
Creditors	15,000	Cash	1,000
	36,500		36,500

Fig. 9.10 (a) : Items of balance sheet shown in the order of permanence

In case of *liquidity*, the order is reversed. The information presented in this manner would enable the user to have a good idea about the life of the various accounts. The assets account of the relatively permanent nature would continue in the business for a longer time whereas the less permanent or more liquid accounts will change their forms in the near future and are likely to become cash or cash equivalent.

The balance sheet of Ankit in the order of liquidity is shown in figure 9.10(b)

**Balance Sheet of Ankit as at March 31, 2017
(in order of liquidity)**

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	15,000	Cash	1,000
10 % Long-term loan	5,000	Bank	5,000
Capital 12,000		Debtors	15,500
Add Profit 4,500	16,500	Furniture	15,000
	36,500		36,500

Fig. 9.10 (b) : Items of balance sheet shown in the order of liquidity

Grouping of Assets and Liabilities

The items appearing in the balance sheet can also be properly grouped. The term grouping means putting together items of similar nature under a common heading. For example, the balance of accounts of cash, bank, debtors, etc. can be grouped and shown under the heading of 'current assets' and the balances of all fixed assets and long-term investment under the heading of 'non-current assets'.

Balance Sheet of Ankit as at March 31, 2017
(in order of permanence)

Liabilities	Amount ₹	Assets	Amount ₹
<i>Owners Funds</i>		<i>Non Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Profit <u>4,500</u>	16,500	<i>Current Assets</i>	
<i>Non-Current Liabilities</i>		Debtors 15,500	
Long-term loan 5,000	5,000	Bank 5,000	
<i>Current Liabilities</i>		Cash 1,000	
Creditors 15,000	15,000		
	<u>36,500</u>		<u>36,500</u>

Fig. 9.10 (c): Showing assets and liabilities arranged in logical groups

Do it Yourself

Arrange the following items in the order of both permanence and liquidity. Also group them under logical heads :

Liabilities

Long-term loans
Bank overdraft
Bills payable
Owner's equity
Short-term loans
Sundry creditors

Assets

Building
Cash in hand
Cash at bank
Bills receivable
Sundry debtors
Land
Finished goods
Work in progress
Raw material

Illustration 8

From the following balances prepare a trading and profit and loss account and balance sheet for the year ended March 31, 2017

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Carriage on goods purchased	8,000	Cash in hand	2,500
Carriage on goods sold	3,500	Bank overdraft	30,000
Manufacturing expenses	42,000	Motor car	60,000
Advertisement	7,000	Drawings	8,000
Excise duty	6,000	Audit fees	2,700
Factory lighting	4,400	Plant	1,53,900
Debtors	80,000	Repairs to plant	2,200
Creditors	61,000	Stock at the end	76,000
Dock and Clearing charges	5,200	Purchases <i>less</i> return	1,60,000
Postage and Telegram	800	Commission on purchases	2,000
Fire Insurance Premium	3,600	Incidental trade expenses	3,200
Patents	12,000	Investment	30,000
Income tax	24,000	Interest on investment	4,500
Office expenses	7,200	Capital	1,00,000
		Sales <i>less</i> return	5,20,000
		Salest tax paid	12,000
		Discount allowed	2,700
		Discount on purchases	3,400

**Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.

Cr.

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases less return	1,60,000	Sales less return	5,20,000
Commission on purchases	2,000		
Carriage on goods purchases	8,000		
Manufacturing expenses	42,000		
Factory lighting	4,400		
Dock and Clearing charges	5,200		
Gross profit c/d	2,98,400		
	5,20,000		5,20,000
Carriage on sales	3,500	Gross profit b/d	2,98,400
Advertisement	7,000	Interest on investment	4,500
Excise duty	6,000	Discount on purchases	3,400
Postage and telegram	800		
Fire Insurance premium	3,600		
Office expenses	7,200		
Audit fees	2,700		
Repairs to plant	2,200		
Incidental trading expenses	3,200		
Sales tax paid	12,000		
Discount allowed	2,700		
Net profit (transferred to capital account)	2,55,400		
	3,06,300		3,06,300

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Bank overdraft	30,000	Cash in hand	2,500
Creditors	61,000	Debtors	80,000
Capital	1,00,000	Closing stock	76,000
Add Net profit	2,55,400	Investment	30,000
	3,55,400	Motor car	60,000
Less Drawings	(8,000)	Plant	1,53,900
	3,47,400	Patents	12,000
Less Income tax	(24,000)		
	3,23,400		
	4,14,400		4,14,400

Illustration 9

From the following balances prepare trading and profit and loss account and balance sheet for the year ended March 31, 2017

Account Title	Amount ₹	Account Title	Amount ₹
Opening stock	15,310	Capital	2,50,000
Purchases	82,400	Drawings	48,000
Sales	256,000	Sundry debtors	57,000
Returns (Dr.)	4,000	Sundry creditors	12,000
Returns (Cr.)	2,400	Depreciation	4,200
Factory rent	18,000	Charity	500
Custom duty	11,500	Cash balance	4,460
Coal, gas & power	6,000	Bank balance	4,000
Wages and salary	36,600	Bank charges	180
Discount (Dr.)	7,500	Establishment expenses	3,600
Commission (Cr.)	1,200	Plant	42,000
Bad debts	5,850	Leasehold building	1,50,000
Bad debts recovered	2,000	Sales tax collected	2,000
Apprenticeship premium	4,800	Goodwill	20,000
Production expenses	2,600	Patents	10,000
Administrative expenses	5,000	Trademark	5,000
Carriage	8,700	Loan (Cr.)	25,000
		Interest on loan	3,000

The value of closing stock on March 31, 2017 was ₹ 25,400

Solution

**Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.**Cr.**

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	15,310	Sales: 2,56,000	
Purchases: 82,400		Less Returns <u>(4,000)</u>	2,52,000
Less Returns : <u>(2,400)</u>	80,000		
Factory rent	18,000	Closing stock	25,400
Custom duty	11,500		
Coal, gas, power	6,000		
Wages and salary	36,600		
Production expenses	2,600		
Carriage	8,700		
Gross profit c/d	98,690		
	<u>2,77,400</u>		<u>2,77,400</u>

Discount (Dr.)	7,500	Gross profit b/d	98,690
Bad debts	5,850	Commission	1,200
Administrative expenses	5,000	Bad debts recovered	2,000
Depreciation	4,200	Apprenticeship premium	4,800
Charity	500		
Bank charges	180		
Establishment expenses	3,600		
Interest on loan	3,000		
Net profit	76,860		
(transferred to capital account)			
	1,06,690		1,06,690

Balance Sheet as at March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
Sales tax collected	2,000	Cash balance	4,460
Sundry creditors	12,000	Bank balance	4,000
Loan	25,000	Sundry debtors	57,000
Capital	2,50,000	Closing stock	25,400
Add Net profit	<u>76,860</u>	Leasehold building	1,50,000
	3,26,860	Plant	42,000
		Patents	10,000
Less Drawings	<u>(48,000)</u>	Goodwill	5,000
	2,78,860	Trade mark	20,000
	3,17,860		3,17,860

9.7 Opening Entry

The balances of various accounts in balance sheet are carried forward from one accounting period to another accounting period. In fact, the balance sheet of an accounting period becomes the opening trial balance of the next accounting period. Next year an opening entry is made which opens these accounts contained in the balance sheet.

Refer the balance sheet shown in figure 9.10(c). The opening entry with regard to it will be recorded as follows :

Furniture A/c	Dr.	15,000	
Debtors A/c	Dr.	15,500	
Bank's A/c	Dr.	5,000	
Cash A/c	Dr.	1,000	
To Capital A/c			16,500
To 10 % Long-term loan A/c			5,000
To Creditors A/c			15,000

Key Terms Introduced in the Chapter

- Balance Sheet
- Bills Payable
- Capital
- Capital Receipts
- Carriage Outwards
- Closing Entries
- Current Assets
- Purchases Return
- Return Inwards
- Revenue Expenditure
- Discount Allowed
- Cash
- Factory Expenses
- Fixed Assets
- Gross Profit
- Income Tax
- Interest on Drawings
- Net Profit
- Order of Performance and Liquidity
- Revenue Receipts
- Sales
- Grouping and Marshalling
- Bank Overdraft
- Bills Receivable
- Capital Expenditure
- Carriage Inwards
- Cash at Bank
- Closing Stock
- Currents Liabilities
- Rent
- Return Outwards
- Depreciation
- Discount Received
- Trade Expenses
- Financial Statements
- Freight
- Gross Loss
- Interest on Capital
- Net Loss
- Revenue Expenditure
- Salaries
- Sales Return
- Opening Entries

Summary with Reference to Learning Objectives

- 1 *Meaning, usefulness and types of financial statements* : After the agreement of the trial balance, a business enterprise proceeds to prepare financial statements. Financial statements are the statements, which present periodic reports on the process of business enterprises and the results achieved during a given period. Financial statements includes trading and profit and loss account, balance sheet and other statements and explanatory notes, which form part thereof. Information provided by financial statements is useful to management to plan and control the business operations. Financial statement are also useful to creditors, shareholders and employees of the enterprise.
- 2 *Meaning need and preparation of trading and profit and loss account* : The profit and loss account highlights the profit earned or loss sustained by the business entity in the course of business operation during a given period.
The need for preparing the trading and profit and loss account is to ascertain the net result of business operations during a given period. The profit and loss account shows the items of revenue expenses and losses on the debit side, while items of gain and gross profit are shown on the credit side. For the preparation of the trading and profit and loss account, closing entries are recorded to transfer balances of account of items of expenses and revenues. Net profit or net loss shown by the profit and loss account is transferred to the capital account.

- 3 *Meaning, characteristic, need and structure of the balance sheet* : The balance sheet is a statement of assets and liabilities of a business enterprise and shows the financial position at a given date. Informations contained in a balance sheet is true only on that date. The balance sheet is a part of the final account. But it is not an account, it is only a statement. In a balance sheet the totals of assets and liabilities are always equal. It portrays the accounting equation.

A balance sheet has to be prepared to know the financial position of the business, and the nature and values of its assets and liabilities. All the accounts which have not been closed till the preparation of the profit and loss account are shown in the balance sheet. Assets and liabilities shown in the balance sheet are marshalled in order of liquidity or in order of permanence.

Questions for Practice

Short Answers

1. What are the objectives of preparing financial statements ?
2. What is the purpose of preparing trading and profit and loss account?
3. Explain the concept of cost of goods sold?
4. What is a balance sheet. What are its characteristics?
5. Distinguish between capital and revenue expenditure and state whether the following statements are items of capital or revenue expenditure :
 - (a) Expenditure incurred on repairs and whitewashing at the time of purchase of an old building in order to make it usable.
 - (b) Expenditure incurred to provide one more exit in a cinema hall in compliance with a government order.
 - (a) Registration fees paid at the time of purchase of a building
 - (b) Expenditure incurred in the maintenance of a tea garden which will produce tea after four years.
 - (c) Depreciation charged on a plant.
 - (d) The expenditure incurred in erecting a platform on which a machine will be fixed.
 - (e) Advertising expenditure, the benefits of which will last for four years.
6. What is an operating profit?

Long Answers

1. What are financial statements? What information do they provide.
2. What are closing entries? Give four examples of closing entries.
3. Discuss the need of preparing a balance sheet.
4. What is meant by Grouping and Marshalling of assets and liabilities. Explain the ways in which a balance sheet may be marshalled.

Numerical Questions

1. From the following balances taken from the books of Simmi and Vimmi Ltd. for the year ending March 31, 2017, calculate the gross profit.

	(₹)
Closing stock	2,50,000
Net sales during the year	40,00,000
Net purchases during the year	15,00,000

Opening stock	15,00,000
Direct expenses	80,000

(Ans. Gross profit ₹11,70,000)

2. From the following balances extracted from the books of M/s Ahuja and Nanda. Calculate the amount of :
- Cost of goods available for sale
 - Cost of goods sold during the year
 - Gross Profit

	₹
Opening stock	25,000
Credit purchases	7,50,000
Cash purchases	3,00,000
Credit sales	12,00,000
Cash sales	4,00,000
Wages	1,00,000
Salaries	1,40,000
Closing stock	30,000
Sales return	50,000
Purchases return	10,000

(Ans. (a) ₹ 11,65,000 ; (b) ₹11,35,000 ; (c) ₹4,15,000)

3. Calculate the amount of gross profit and operating profit on the basis of the following balances extracted from the books of M/s Rajiv & Sons for the year ended March 31, 2017.

	₹
Opening stock	50,000
Net sales	11,00,000
Net purchases	6,00,000
Direct expenses	60,000
Administration expenses	45,000
Selling and distribution expenses	65,000
Loss due to fire	20,000
Closing stock	70,000

(Ans. Gross profit ₹4,60,000, Operating profit ₹3,50,000)

4. Operating profit earned by M/s Arora & Sachdeva in 2016-17 was ₹17,00,000. Its non-operating incomes were ₹1,50,000 and non-operating expenses were ₹3,75,000. Calculate the amount of net profit earned by the firm.
(Ans. Net profit ₹14,75,000)

5. The following are the extracts from the trial balance of M/s Bhola & Sons as on March 31, 2017

Account title	Debit ₹	Credit ₹
Opening stock	2,00,000	
Purchases	8,10,000	
Sales		10,10,000
	10,10,000	10,10,000

(only relevant items)

Closing Stock as on date was valued at ₹3,00,000.

You are required to record the necessary journal entries and show how the above items will appear in the trading and profit and loss account and balance sheet of M/s Bhola & Sons.

6. Prepare trading and profit and loss account and balance sheet as on March 31, 2017 :

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Machinery	27,000	Capital	60,000
Sundry debtors	21,600	Bills payable	2,800
Drawings	2,700	Sundry creditors	1,400
Purchases	58,500	Sales	73,500
Wages	15,000		
Sundry expenses	600		
Rent & taxes	1,350		
Carriage inwards	450		
Bank	4,500		
Openings stock	6,000		

Closing stock as on March 31, 2017 ₹22,400

[Ans. Gross profit ₹15,950, Net profit ₹14,000, Total balance sheet ₹75,500]

7. The following trial balance is extracted from the books of M/s Ram on March 31, 2017. You are required to prepare trading and profit and loss account and the balance sheet as on date :

<i>Account title</i>	<i>Amount ₹</i>	<i>Account title</i>	<i>Amount ₹</i>
Debtors	12,000	Apprenticeship premium	5,000
Purchases	50,000	Loan	10,000
Coal, gas and water	6,000	Bank overdraft	1,000
Factory wages	11,000	Sales	80,000
Salaries	9,000	Creditors	13,000
Rent	4,000	Capital	20,000
Discount	3,000		
Advertisement	500		
Drawings	1,000		
Loan	6,000		
Petty cash	500		
Sales return	1,000		
Machinery	5,000		
Land and building	10,000		
Income tax	100		
Furniture	9,900		

(Ans. Gross profit: ₹ 12,000, Net profit: ₹ 500, Total balance sheet: ₹ 43,400)

8. The following is the trial balance of Manju Chawla on March 31, 2017. You are required to prepare trading and profit and loss account and a balance sheet as on date :

<i>Account title</i>	<i>Debit Amount ₹</i>	<i>Credit Amount ₹</i>
Opening stock	10,000	
Purchases and sales	40,000	80,000
Returns	200	600
Productive wages	6,000	
Dock and Clearing charges	4,000	
Donation and charity	600	
Delivery van expenses	6,000	
Lighting	500	
Sales tax collected		1,000
Bad debts	600	
Misc. incomes		6,000
Rent from tenants		2,000
Royalty	4,000	
Capital		40,000
Drawings	2,000	
Debtors and Creditors	6,000	7,000
Cash	3,000	
Investment	6,000	
Patents	4,000	
Land and Machinery	43,000	

Closing stock ₹ 2,000.

(Ans. Gross Profit: ₹ 18,400, Net profit: ₹ 18,700, Total balance sheet: ₹ 64,700)

9. The following is the trial balance of Mr. Deepak as on March 31, 2017. You are required to prepare trading account, profit and loss account and a balance sheet as on date :

<i>Account title</i>	<i>Debit Amount ₹</i>	<i>Account title</i>	<i>Credit Amount ₹</i>
Drawings	36,000	Capital	2,50,000
Insurance	3,000	Bills payable	3,600
General expenses	29,000	Creditors	50,000
Rent and taxes	14,400	Discount recived	10,400
Lighting (factory)	2,800	Purchases return	8,000
Travelling expenses	7,400	Sales	4,40,000
Cash in hand	12,600		
Bills receivable	5,000		

Sundry debtors	1,04,000		
Furniture	16,000		
Plant and Machinery	1,80,000		
Opening stock	40,000		
Purchases	1,60,000		
Sales return	6,000		
Carriage inwards	7,200		
Carriage outwards	1,600		
Wages	84,000		
Salaries	53,000		

Closing stock ₹ 35,000.

(Ans. Gross profit: ₹1,83,000, Net profit : ₹ 85,000, Total balance sheet: ₹ 3,52,600)

10. Prepare trading and profit and loss account and balance sheet from the following particulars as on March 31, 2017.

Account Title	Debit Amount ₹	Credit Amount ₹
Purchases and Sales	3,52,000	5,60,000
Return inwards and Return outwards	9,600	12,000
Carriage inwards	7,000	
Carriage outwards	3,360	
Fuel and power	24,800	
Opening stock	57,600	
Bad debts	9,950	
Debtors and Creditors	1,31,200	48,000
Capital		3,48,000
Investment	32,000	
Interest on investment		3,200
Loan		16,000
Repairs	2,400	
General expenses	17,000	
Wages and salaries	28,800	
Land and buildings	2,88,000	
Cash in hand	32,000	
Miscellaneous receipts		160
Sales tax collected		8,350

Closing stock ₹ 30,000.

(Ans. Gross profit: ₹ 1,22,200, Net profit : ₹92,850, Total balance sheet: ₹5,13,200)

11. From the following trial balance of Mr. A. Lal, prepare trading, profit and loss account and balance sheet as on March 31, 2017.

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Credit Amount ₹</i>
Stock as on April 01, 2016	16,000	
Purchases and Sales	67,600	1,12,000
Returns inwards and outwards	4,600	3,200
Carriage inwards	1,400	
General expenses	2,400	
Bad debts	600	
Discount received		1,400
Bank over draft		10,000
Interest on bank overdraft	600	
Commission received		1,800
Insurance and taxes	4,000	
Scooter expenses	200	
Salaries	8,800	
Cash in hand	4,000	
Scooter	8,000	
Furniture	5,200	
Building	65,000	
Debtors and Creditors	6,000	16,000
Capital		50,000

Closing stock ₹ 15,000.

(Ans. Gross profit : ₹ 40,600, Net profit: ₹ 27,200, Total balance sheet: ₹ 1,03,200)

12. Prepare trading and profit and loss account and balance sheet of M/s Royal Traders from the following balances as on March 31, 2017.

<i>Debit balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Stock	20,000	Sales	2,45,000
Cash	5,000	Creditors	10,000
Bank	10,000	Bills payable	4,000
Carriage on purchases	1,500	Capital	2,00,000
Purchases	1,90,000		
Drawings	9,000		
Wages	55,000		
Machinery	1,00,000		
Debtors	27,000		
Postage	300		
Sundry expenses	1,700		
Rent	4,500		
Furniture	35,000		

Closing stock ₹8,000

(Ans. Gross loss ₹ 13,500, Net loss ₹ 20,000, Total balance sheet ₹ 1,85,000)

13. Prepare trading and profit and loss account from the following particulars of M/s Neema Traders as on March 31, 2017.

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Account Title</i>	<i>Credit Amount ₹</i>
Buildings	23,000	Sales	1,80,000
Plant	16,930	Loan	8,000
Carriage inwards	1,000	Bills payable	2,520
Wages	3,300	Bank overdraft	4,720
Purchases	1,64,000	Creditors	8,000
Sales return	1,820	Capital	2,36,000
Opening stock	9,000	Purchases return	1,910
Machinery	2,10,940		
Insurance	1,610		
Interest	1,100		
Bad debts	250		
Postage	300		
Discount	1,000		
Salaries	3,000		
Debtors	3,900		

Stock on March 31, 2017 ₹16,000.

(Ans. Gross profit ₹17,850, Net profit ₹ 10,590, Total of balance sheet ₹2,69,830)

14. From the following balances of M/s Nilu Sarees as on March 31, 2017. Prepare trading and profit and loss account and balance sheet as on date.

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Account Title</i>	<i>Credit Amount ₹</i>
Opening stock	10,000	Sales	2,28,000
Purchases	78,000	Capital	70,000
Carriage inwards	2,500	Interest	7,000
Salaries	30,000	Commission	8,000
Commission	10,000	Creditors	28,000
Wages	11,000	Bills payable	2,370
Rent & taxes	2,800		
Repairs	5,000		
Telephone expenses	1,400		
Legal charges	1,500		
Sundry expenses	2,500		
cash in hand	12,000		
Debtors	30,000		
Machinery	60,000		
Investments	90,000		
Drawings	18,000		

Closing stock as on March 31, 2017 ₹22,000.

(Ans. Gross profit ₹ 1,56,500, Net profit ₹ 1,10,300, Total balance sheet ₹2,14,000)

15. Prepare trading and profit and loss account of M/s Sports Equipments for the year ended March 31, 2017 and balance sheet as on that date :

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Credit Amount ₹</i>
Opening stock	50,000	
Purchases and sales	3,50,000	4,21,000
Sales returns	5,000	
Capital		3,00,000
Commission		4,000
Creditors		1,00,000
Bank overdraft		28,000
Cash in hand	32,000	
Furniture	1,28,000	
Debtors	1,40,000	
Plants	60,000	
Carriage on purchases	12,000	
Wages	8,000	
Rent	15,000	
Bad debts	7,000	
Drawings	24,000	
Stationery	6,000	
Travelling expenses	2,000	
Insurance	7,000	
Discount	5,000	
Office expenses	2,000	

Closing stock as on March 31, 2017 ₹2,500

(Ans. Gross loss ₹ 1,500, Net loss ₹ 41,500 , Total balance sheet ₹3,62,500)

Checklist to Test Your Understanding

1. *Test Your Understanding - I*

I (i) T (ii) T (iii) F (iv) T
II (i) b (ii) a (iii) e (iv) c (v) d

2. *Test Your Understanding - II*

1. (v) 2. (iii) 3. (iii) 4. (iii)



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Financial Statements - II

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- describe the need for adjustments while preparing the financial statements;
- explain the accounting treatment of adjustments for outstanding and prepaid expenses, accrued and advance receipts of incomes;
- discuss the adjustments to be made regarding depreciation, bad debts, provision for doubtful debts, provision for discount on debtors;
- explain the concepts and adjustment of manager's commission and interest on capital;
- prepare profit and loss account and balance sheet with adjustments.

In chapter 9, you learnt about the preparation of simple final accounts in the format of trading and profit and loss account and balance sheet. The preparation of simple final accounts pre-supposes the absence of any accounting complexities which are normal to business operations. These complexities arise due to the fact that the process of determining income and financial position is based on the accrual basis of accounting. This emphasises that while ascertaining the profitability, the revenues be considered on earned basis and not on receipt basis, and the expenses be considered on incurred basis and not on paid basis. Hence, many items need some adjustment while preparing the financial statements. In this chapter we shall discuss all items which require adjustments and the way these are brought into the books of account and incorporated in the final accounts.

10.1 Need for Adjustments

According to accrual concept of accounting, the profit or loss for an accounting year is not based on the revenues realised in cash and the expenses paid in cash during that year. There may exist some receipts and expenses in the current year which partially relate to the previous year or to the next year. Also, there may exist incomes and expenses relating to the current year that still need to be brought into books of account. Such items duly adjusted, the final accounts will not reflect the true and fair view of the state of affairs of the business.

For example, an amount of ₹ 1,200 paid on July 01, 2016 towards insurance premium. Any general insurance premium paid usually covers a period of 12 months. Suppose the accounting year ends on March 31, 2017, it would mean that one fourth of the insurance premium is paid on July 01, 2016 relate to the next accounting year 2017-18. Therefore, while preparing the financial statements for 2016-17, the expense on insurance premium that should be debited to the profit and loss account is ₹ 900 (₹ 1,200 – ₹ 300).

Let us take another example. The salaries for the month of March, 2017 were paid on April 07, 2017. This means that the salaries account of 2016-17 does not include the salaries for the month of March 2017. Such unpaid salaries is termed as *salaries outstanding* which have to be brought into books of account and is debited to profit and loss account along with the salaries already paid for the month of April, 2016 up to February, 2017.

Similarly, adjustments may also become necessary in respect of certain incomes received in advance or those which have accrued but are still to be received. Apart from these, there are certain items which are not recorded on day-to-day basis such as depreciation on fixed assets, interest on capital, etc. These are adjusted at the time of preparing financial statements. The purpose of making various adjustments is to ensure that the final accounts reveal the true profit or loss and the true financial position of the business. The items which usually need adjustments are:

1. Closing stock
2. Outstanding/expenses
3. Prepaid/Unexpired expenses
4. Accrued income
5. Income received in advance
6. Depreciation
7. Bad debts
8. Provision for doubtful debts
9. Provision for discount on debtors
10. Manager's commission
11. Interest on capital

It may be noted that when we prepare the financial statements, we are provided with the trial balance and some other additional information in respect of the adjustments to be made. All adjustments are reflected in the final accounts at two places to complete the double entry. Our earlier example in chapter 9 (Page no. 336) which represents the trial balance of Ankit is reproduced in figure 10.1:

Trial Balance of Ankit as on March 31, 2017

<i>Account Title</i>	<i>Elements</i>	<i>L.F.</i>	<i>Debit Amount ₹</i>	<i>Credit Amount ₹</i>
Cash	Assets		1,000	
Bank	Assets		5,000	
Wages	Expense		8,000	
Salaries	Expense		25,000	
Furniture	Assets		15,000	
Rent of building	Expense		13,000	
Debtors	Assets		15,500	
Bad debts	Expense		4,500	
Purchases	Expense		75,000	
Capital				12,000
Equity				
Sales	Revenue			1,25,000
Creditors	Liabilities			15,000
Long-term loan (raised on 1.4.2013)	Liabilities			5,000
Commission received	Revenue			5,000
Total			1,62,000	1,62,000

Additional Information : The stock on March 31, 2017 was ₹ 15,000.

Figure 10.1 : Showing the trial balance of Ankit

We will now study about the items of adjustments and you will observe how these adjustments are helpful in the preparation of financial statements in order to reflect the true profit and loss and financial position of the firm.

10.2 Closing Stock

As per the example in chapter 9 (Page no. 336), the closing stock represents the cost of unsold goods lying in the stores at the end of the accounting period. The adjustment with regard to the closing stock is done by (i) by crediting it to the trading and profit and loss account, and (ii) by showing it on the asset side of the balance sheet. The adjustment entry to be recorded in this regard is :

Closing stock A/c
To Trading A/c

Dr.

The closing stock of the year becomes the opening stock of the next year and is reflected in the trial balance of the next year. The trading and profit and

loss account of Ankit for the year ended March 31, 2017 and his balance sheet as on that date shall appear as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases	75,000	Sales	1,25,000
Wages	8,000	Closing stock	15,000
Gross profit c/d	57,000		
	1,40,000		1,40,000
Salaries	25,000	Gross profit b/d	57,000
Rent of building	13,000	Commission received	5,000
Bad debts	4,500		
Net profit (transferred to Ankit's capital account)	19,500		
	62,000		62,000

Sometimes the opening and closing stock are adjusted through purchases account. In that case, the entry recorded is as follows :

Closing stock A/c Dr.
To Purchases A/c

This entry reduces the amount in the purchases account and is also known as *adjusted purchases* which is shown on the debit side of the trading and profit and loss account. In this context, it may be noted, that the closing stock will not be shown on the credit side of the trading and profit and loss as it has been already been adjusted through the purchases account. Not only, in such a situation, even the opening stock will not be separately reflected in the trading and profit and loss account, as it is also adjusted in purchases by recording the following entry:

Purchases A/c Dr.
To Opening stock A/c

Another important point to be noted in this context is that when the opening and closing stocks are adjusted through purchases, the trial balance does not show any opening stock. Instead, the closing stock shall appear in the trial balance (not as additional information or as an adjustment item) and so also the adjusted purchases. In such a situation, the adjusted purchases shall be debited to the trading and profit and loss account.

The closing stock shall be shown on the assets side of the balance sheet as shown below:

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Net profit 19,500	31,500	<i>Current Assets</i>	
<i>Non-Current Liabilities</i>		Debtors 15,500	
Long-term loan 5,000	5,000	Bank 5,000	
<i>Current Liabilities</i>		Cash 1,000	
Creditors 15,000	15,000	Closing stock 15,000	
	51,500		51,500

10.3 Outstanding Expenses

It is quite common for a business enterprise to have some unpaid expenses in the normal course of business operations at the end of an accounting year. Such items usually are wages, salaries, interest on loan, etc.

When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as *outstanding expenses*. As they relate to the earning of revenue during the current accounting year, it is logical that they should be duly charged against revenue for computation of the correct amount of profit or loss. The entry to bring such expenses into account is :

Concerned expense A/c

Dr.

To Outstanding expense A/c

The above entry opens a new account called *Outstanding Expenses* which is shown on the liabilities side of the balance sheet. The amount of outstanding expenses is added to the total of expenses under a particular head for the purpose of preparing trading and profit and loss account.

For example, refer to Ankit's trial balance (refer figure 10.1). You will notice that wages are shown at ₹ 8,000. Let us assume that Ankit owes ₹500 as wages relating to the year 2016-17 to one of his employees. In that case, the correct expense on wages amounts to ₹ 8,500 instead of ₹ 8,000. Ankit must show ₹ 8,500 as expense on account of wages in the trading and profit and loss account and recognise a current liability of ₹ 500 towards the sum owed to his staff. It will be referred to as *wages outstanding* and it will be adjusted to wages account by recording the following journal entry:

Wages A/c

Dr.

500

To Wages outstanding A/c

500

The amount of outstanding wages will be added to wages account for the preparation of the trading and profit and loss account as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.		Cr.	
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages 8,000			
Add Outstanding wages 500	8,500	Closing stock	15,000
Gross profit c/d	56,500		
	1,40,000		1,40,000
Salaries	25,000	Gross profit b/d	56,500
Rent of building	13,000	Commission received	5,000
Bad debts	4,500		
Net profit (transferred to Ankit's capital account)	19,000		
	61,500		61,500

Observe carefully the trading and profit and loss account of Ankit. Did you notice the amount of net profit is reduced to ₹ 19,000 on account of outstanding wages. The item relating to outstanding wages will be shown in balance sheet as follows :

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture	15,000
Add Profit 19,000	31,000	<i>Current Assets</i>	
<i>Non-Current Liabilities</i>		Debtors	15,500
Long-term loan	5,000	Bank	5,000
<i>Current Liabilities</i>		Cash	1,000
Creditors	15,000	Closing stock	15,000
Outstanding wages	500		
	51,500		51,500

10.4 Prepaid Expenses

There are several items of expense which are paid in advance in the normal course of business operations. At the end of the accounting year, it is found that the benefits of such expenses have not yet been fully received; a portion

of its benefit would be received in the next accounting year. This portion of expense, is carried forward to the next year and is termed as *prepaid expenses*. The necessary adjustment in respect of prepaid expenses is made by recording the following entry:

Prepaid expense A/c	Dr.
To concerned expense A/c	

The effect of the above adjustment entry is that the amount of prepaid part is deducted from the total of the particular expense, and the new account of prepaid expense is shown on the assets side of the balance sheet. For example, in Ankit's trial balance, let us assume that the amount of salary paid by him to the employees includes an amount of ₹ 5,000 which was paid in advance to one of his employees upon his joining the office. This implies that Ankit has overpaid his staff by ₹ 5,000 on account of his salary. Hence, correct expense on account of salary during the current period will be ₹ 20,000 instead of ₹ 25,000. Ankit must show ₹ 20,000 expense on account of salary in the profit and loss account and recognise a current asset of ₹ 5,000 as an advance salary to the employee. It will be termed as prepaid salary account and will be recorded by the following journal entry :

Prepaid salary A/c	Dr.	5,000	
To salary A/c			5,000

The account of prepaid salary will be shown in the trading and profit and loss account as follows:

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.			Cr.
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages 8,000		Closing stock	15,000
Add Outstanding wages 500	8,500		
Gross profit c/d	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit b/d	56,500
Less Prepaid salary (5,000)	20,000	Commission received	5,000
Rent of building	13,000		
Bad debts	4,500		
Net profit (transferred to Ankit capital account)	24,000		
	61,500		61,500

The account of accrued income will be recorded in trading and profit and loss account as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.		Cr.	
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages 8,000		Closing stock	15,000
Add Outstanding 500	8,500		
Gross profit c/d	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit b/d	56,500
Less Prepaid salary (5,000)	20,000	Commission received 5,000	
Rent of building	13,000	Add Accrued 1,500	6,500
Bad debts	4,500	commission	
Net profit (transferred to Ankit's capital account)	25,500		
	63,000		63,000

Observe that the accrued income has resulted in an increase in the net profit by ₹ 1,500 making it as ₹ 25,500. Further, it will be shown in the balance sheet of Ankit on the assets side under the head current asset.

Balance Sheet of Ankit as at March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
Owners Funds		Non-Current Assets	
Capital 12,000		Furniture	15,000
Add Profit 25,500	37,500	Current Assets	
Non-Current Liabilities		Debtors	15,500
Long-term loan	5,000	Prepaid salary	5,000
Current Liabilities		Accrued commission	1,500
Creditors	15,000	Bank	5,000
Outstanding wages	500	Cash	1,000
	58,000	Closing stock	15,000
			58,000

10.6 Income Received in Advance

Sometimes, a certain income is received but the whole amount of it does not belong to the current period. The portion of the income which belongs to the next accounting period is termed as income received in advance or an *Unearned Income*. Income received in advance is adjusted by recording the following entry:

Concerned income A/c	Dr.
To Income received in advance A/c	

The effect of this entry will be that the balance in the income account will be equal to the amount of income earned for the current accounting period, and the new account of income received in advance will be shown as a liability in the balance sheet.

For example, let us assume Ankit has agreed in March 31, 2017 to sublet a part of the building to a fellow shopkeeper @ ₹ 1,000 per month. The person gives him rent in advance for the next three months of April, May and June. The amount received had been credited to the profit and loss account. However, this income does not pertain to current year and hence will not be credited to profit and loss account. It is *income received in advance* and will be recognised as a liability amounting to ₹ 3,000. Ankit needs to record an adjustment entry to give effect to income received in advance by way of following journal entry:

Rent received A/c	Dr.	3,000	
To Rent received in advance A/c			3,000

This will lead a new account of rent received in advance of ₹ 3,000 which will appear as follows :

Balance Sheet of Ankit as at March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
<i>Owners Funds</i>		<i>Non Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Net profit <u>25,500</u>	37,500	<i>Current Assets</i>	
<i>Non Current Liabilities</i>		Debtors 15,500	
Long-term loan 5,000		Prepaid salary 5,000	
<i>Current Liabilities</i>		Accrued commission 1,500	
Creditors 15,000		Bank 5,000	
Outstanding wages 500		Cash 4,000	
Rent received in advance 3,000		Closing stock 15,000	
	<u>61,000</u>		<u>61,000</u>

Recall from chapter 7 (Part-I), that depreciation is the decline in the value of assets on account of wear and tear and passage of time. It is treated as a business expense and is debited to profit and loss account. This, in effect, amounts to writing-off a portion of the cost of an asset which has been used in the business for the purpose of earning profits. The entry for providing depreciation is :

Depreciation A/c Dr.
To Concerned asset A/c

In the balance sheet, the asset will be shown at cost *minus* the amount of depreciation. For example, the trial balance in our example shows that Ankit has a furniture account with a balance of ₹ 15,000. Let us assume that furniture is subject to a depreciation of 10% per annum. This implies that Ankit must recognise that at the end of the year the value attached to furniture is to be reduced by ₹ 1,500 ($₹ 15,000 \times 10\%$). Ankit needs to record an adjustment entry to give effect to depreciation on furniture as follows :

Depreciation A/c	Dr.	1,500	
To Furniture A/c			1,500

Depreciation will be shown in the profit and loss account and balance sheet as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.		Cr.	
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Purchases	75,000	Sales	1,25,000
Wages 8,000		Closing stock	15,000
Add Outstanding wages (500)	8,500		
Gross Profit c/d	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit b/d	56,500
Less Prepaid salary (5,000)	20,000		
Rent of building	13,000	Commission received 5,000	6,500
		Add Accrued Commission 1,500	
Depreciation-Furniture	1,500		
Bad debts	4,500		
Net profit (transferred to Ankit's capital account)	24,000		
	63,000		63,000

Notice that the amount of net profit declines with the adjustment of depreciation. Let us now see how depreciation as an expense will be shown in balance sheet.

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Profit <u>24,000</u>	36,000	Less Depreciation (1,500)	13,500
<i>Non-Current Liabilities</i>		<i>Current Assets</i>	
Long-term loan 5,000	5,000	Debtors 15,500	15,500
<i>Current Liabilities</i>		Prepaid salary 5,000	5,000
Creditors 15,000	15,000	Accrued commission 1,500	1,500
Outstanding wages 500	500	Bank 5,000	5,000
Rent received in advance 3,000	3,000	Cash 4,000	4,000
		Closing stock 15,000	15,000
	<u>59,500</u>		<u>59,500</u>

10.8 Bad Debts

Bad debts refer to the amount that the firm has not been able to realise from its debtors. It is regarded as a loss and is termed as *bad debt*. The entry for recording bad debt is:

Bad debts A/c
To Debtors A/c

Dr.

You will notice in Ankit's trial balance, that it contains bad debts amounting to ₹ 4,500. Whereas, the sundry debtors of Ankit are reported as ₹ 15,500. The existence of bad debts in the trial balance signifies that Ankit has incurred a loss arising out of bad debts during the year and which has been already recorded in the books of account.

However, assuming one of his debtors who owed him ₹ 2,500 had become insolvent, and nothing is receivable from him. But the amount of bad debts related to the current year is still to be account for. This fact appears as additional information and is termed as *further bad debts*. The adjustment entry to be recorded for the amount will be as follows. For this purpose, Ankit needs to record an adjustment entry as under :

Bad debts A/c
To Debtors A/c

Dr.	2,500	
		2,500

This entry will reduce the value of debtors to ₹ 13,000(₹ 15,500 – ₹ 2,500) and increases the amount of bad debts to ₹ 7,000 (₹ 4,500 + ₹ 2,500).

The treatment of further bad debts in profit and loss account and balance sheet is shown below :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases	75,000	Sales	1,25,000
Wages 8,000		Closing stock	15,000
Add Outstanding wages 500	8,500		
Gross profit c/d	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit b/d	56,500
Less Prepaid salary (5,000)	20,000		
Rent of building	13,000	Commission received 5,000	
	1,500	Add Accrued commission 1,500	6,500
Depreciation – Furniture			
Bad Debts 4,500			
Add Further bad debts 2,500	7,000		
Net profit (transferred to Ankit's capital account)	21,500		
	63,000		63,000

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Profit 21,500	33,500	Less Depreciation (1,500)	13,500
<i>Non-Current Liabilities</i>		<i>Current Assets</i>	
Long-term loan	5,000	Debtors 15,500	
		Less Further bad debts (2,500)	13,000
<i>Current Liabilities and Provisions</i>		Prepaid salary	5,000
Creditors	15,000	Accrued commission	1,500
		Bank	5,000
Outstanding Wages	500	Cash	4,000
Rent received in advance	3,000	Closing stock	15,000
	57,000		57,000

10.9 Provision for Bad and Doubtful Debts

In the above balance sheet, debtors now appears at ₹ 13,000, which is their estimated realisable value during next year. It is quite possible that the whole

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Net profit <u>20,850</u>	32,850	Less Depreciation <u>(1,500)</u>	13,500
<i>Non-Current Liabilities</i>		<i>Current Assets</i>	
Long-term loan 5,000	5,000	Debtors 15,500	
		Less Furtherbad debts <u>2,500</u>	
		13,000	
		Less Provision for doubtful debts <u>650</u>	12,350
<i>Current Liabilities & Provisions</i>		Prepaid salary 5,000	
Creditors 15,000	15,000	Accrued commission 1,500	
Outstanding wages 500	500	Bank 5,000	
Rent received in advance 3,000	3,000	Cash 4,000	
		Closing stock 15,000	
	<u>56,350</u>		<u>56,350</u>

It may be noted that the provision created for doubtful debts at the end of a particular year will be carried forward to the next year and it will be used for meeting the loss due to bad debts incurred during the next year. The provision for doubtful debts brought forward from the previous year is called the *opening provision or old provision*. When such a provision already exists, the loss due to bad debts during the current year are adjusted against the same and while making provision for doubtful debts required at the end of the current year is called *new provision*. The balance of old provision as given in trial balance should also be taken into account.

Let us take an example to understand how bad debts and provision for doubtful debts are recorded. An extract from a trial balance on March 31, 2017 is given below :

	₹
Sundry debtors	32,000
Bad debts	2,000
Provision for doubtful debts	3,500

Additional Information :

Write-off further bad debts ₹ 1,000 and create a provision for doubtful debts @ 5% on debtors.

In this case, the following journal entries will be recorded :

Date	Particulars	L.F.	Debit Amount ₹	Credit Amount ₹
March 31, 2017	(a) Bad debts A/c Dr. To Sundry debtors (Further bad debts)		1,000	1,000
	(b) Provision for doubtful debts A/c Dr. To Bad debts A/c (Bad debts adjusted against the provision)		3,000	3,000
	Profit and Loss A/c Dr. To Provision for doubtful debts A/c (Amount charges from profit and loss account)		1,050	1,050

**Profit and Loss Account
for the year ended March 31, 2017**

Provision for doubtful debts:		₹		₹
Bad debts	2,000			
Further bad debts	1,000			
New provision	<u>1,550</u>			
	4,550			
Less Old provision	<u>3,500</u>	1,050		

*Only relevant items.

Balance Sheet as at March 31, 2017

			₹
	Sundry debtors	32,000	
	Less Further	<u>(1,000)</u>	
	bad debts	31,000	
	Less Provision	<u>(1,550)</u>	
	for doubtful debts		29,450

*Only relevant items.

Note : The amount of new provision for doubtful debts has been calculated as follows:
 $\text{₹ } 31,000 \times 5/100 = \text{₹ } 1,550.$

10.10 Provision for Discount on Debtors

A business enterprise allows discount to its debtors to encourage prompt payments. Discount likely to be allowed to customers in an accounting year

Balance Sheet of Ankit as on March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Net profit <u>20,623</u>	32,623	Less Depreciation <u>(1,500)</u>	13,500
<i>Non-Current Liabilities</i>		<i>Current Assets</i>	
Long-term loan	5,000	Debtors 15,500	
		Less Further 2,500	
		bad debts 13,000	
		Less Provision	
		for doubtful 650	
		debts	
		12,350	
		Less Provision	
		for discount	
		on debtors (227)	12,123
<i>Current Liabilities & Provisions</i>		Prepaid salary	5,000
Creditors	15,000	Accrued commission	1,500
Outstanding wages	500	Bank	5,000
Rent received in advance	3,000	Cash	4,000
		Closing stock	15,000
	<u>56,123</u>		<u>56,123</u>

In the subsequent year, the discount will be transferred to the provision for discount on debtors account. The account will be treated in the same manner as the provision for doubtful debts.

10.11 Manager's Commission

The manager of the business is sometimes given the commission on the net profit of the company. The percentage of the commission is applied on the profit either *before charging such commission* or *after charging such commission*. In the absence of any such information, it is assumed that commission is allowed as a percentage of the net profit before charging such commission.

Suppose the net profit of a business is ₹ 110 before charging commission. If the manager is entitled to 10% of the profit before charging such commission, the commission will be calculated as :

$$= ₹ 110 \times \frac{10}{100} = ₹ 11$$

In case the commission is 10% of the profit after charging such commission, it will be calculated as :

$$= \text{Profit before commission} \times \text{Rate of commission} / (100 + \text{commission})$$

$$= ₹ 110 \times \frac{10}{110} = ₹ 10$$

The managers commission will be adjusted in the books of account by recording the following entry :

Profit and loss A/c	Dr.
To Manager's commission A/c	

Let us recall our example and assume that Ankit's manager is entitled to a commission @ 10%. Observe the following profit and loss account if it is based on :

- (i) amount of net profit before charging such commission
- (ii) amount of profit after charging such commission.

**(i) Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

Dr.		Cr.	
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases	75,000	Sales	1,25,000
Wages 8,000		Closing stock	15,000
Add Outstanding wages 500	8,500		
Gross profit c/d	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit	56,500
Less Prepaid salary (5,000)	20,000		
Rent of building	13,000	Commission received 5,000	
	1,500	Add Accrued commission 1,500	6,500
Depreciation – Furniture			
Bad debts 4,500			
Add Further bad debts 2,500	7,000		
Provision for doubtful debts	650		
Provision for discount on debtors	227		
Manager's commission	2,062		
Net profit (transferred to Ankit's capital account)	18,561		
	63,000		63,000

Balance Sheet of Ankit as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
<i>Owners Funds</i>		<i>Non-Current Assets</i>	
Capital 12,000		Furniture 15,000	
Add Net profit 18,561	30,561	Less Depreciation (1,500)	13,500
<i>Non-Current Liabilities</i>		<i>Current Assets</i>	
Long-term loan 5,000	5,000	Debtors 15,500	
		Less Further bad debts (2,500)	13,000
<i>Current Liabilities and Provisions</i>		Less Provision for doubtful debts (650)	
Creditors 15,000	15,000		12,350
		Less Provision for discount on debtors (227)	12,123
Outstanding wages 500	500	Prepaid salary 5,000	5,000
Rent received in advance 3,000	3,000	Accrued commission 1,500	1,500
		Bank 5,000	5,000
Manager's commission outstanding 2,062	2,062	Cash 4,000	4,000
		Closing stock 15,000	15,000
	56,123		56,123

**(ii) Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

<i>Dr.</i>		<i>Cr.</i>	
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Purchases 75,000	75,000	Sales 1,25,000	1,25,000
Wages 8,000		Closing stock 15,000	15,000
Add Outstanding wages 500	8,500		
Gross profit c/d 56,500	56,500		
	1,40,000		1,40,000
Salaries 25,000		Gross profit b/d 56,500	56,500
Less Prepaid salary (5,000)	20,000		
Rent of building 13,000	13,000	Commission received 5,000	
		Add Accrued commission 1,500	6,500
	1,500		
Depreciation-Furniture 4,500			
Bad debts 2,500	7,000		
Add Further bad debts 2,500			
Provision for doubtful debts 650			
Provision for discount on debtors 227			
Manager's commission 1,875	1,875		
Net profit (transferred to Ankit's capital account) 18,748	18,748		
	63,000		63,000

interest on capital shall be added to the capital, this effect shall be neutralised. As shown below :

	₹
Capital	12,000
Add Profit	<u>17,961</u>
	29,961
Add Interest on capital	<u>600</u>
	30,561

Test Your Understanding

Tick the correct answer :

- Rahul's trial balance provide you the following information :

Debtors	₹ 80,000
Bad debts	₹ 2,000
Provision for doubtful debts	₹ 4,000

It is desired to maintain a provision for bad debts of ₹ 1,000
State the amount to be debited/credited in profit and loss account :

(a) ₹ 5,000 (Debit) (b) ₹ 3,000 (Debit)
(c) ₹ 1,000 (Credit) (d) none of these.
- If the rent of one month is still to be paid the adjustment entry will be :

(a) Debit outstanding rent account and Credit rent account
(b) Debit profit and loss account and Credit rent account
(c) Debit rent account and Credit profit and loss account
(d) Debit rent account and Credit outstanding rent account.
- If the rent received in advance ₹ 2,000. The adjustment entry will be :

(a) Debit profit and loss account and Credit rent account
(b) Debit rent account Credit rent received in advance account
(c) Debit rent received in advance account and Credit rent account
(d) None of these.
- If the opening capital is ₹ 50,000 as on April 01, 2016 and additional capital introduced ₹ 10,000 on January 01, 2017. Interest charge on capital 10% p.a. The amount of interest on capital shown in profit and loss account as on March 31, 2017 will be :

(a) ₹ 5,250 (b) ₹ 6,000
(c) ₹ 4,000 (d) Rs, 3,000.
- If the insurance premium paid ₹ 1,000 and pre-paid insurance ₹ 300. The amount of insurance premium shown in profit and loss account will be :

(a) ₹ 1,300 (b) ₹ 1,000
(c) ₹ 300 (d) ₹ 700.

<i>Adjustment</i>	<i>Adjustment Entry</i>	<i>Treatment in Trading and Profit and Loss Account</i>	<i>Treatment in Balance Sheet</i>
1. Closing stock	Closing stock A/c Dr. To Trading A/c	Shown on the credit assets side and profit and loss account	Shown on the assets side
2. Outstanding expenses	Expense A/c Dr. To outstanding expense A/c	Added to the respective expense on the debit side	Shown on the liabilities side
3. Prepaid/ Unexpired expenses	Prepaid expense A/c Dr. To Expenses A/c	Deducted from the respective expense on the debit side	Shown on the assets side
4. Income earned but not received	Accrued income A/c Dr. To Income A/c	Added to the respective income on the credit side	Shown on the assets side
5. Income received in advance	Income A/c Dr. To Income received in advance A/c	Deducted from the respective income on the credit side	Shown on the liabilities sides
6. Depreciation	Depreciation A/c Dr. To Assets A/c	Shown on the debit side	Deducted from the value of asset
7. Provision for bad and doubtful debts	Profit and Loss A/c Dr. To Provision for doubtful debts	Shown on the debit side	Shown as deduction from debtors
8. Provision for discount on debtors	Profit and Loss A/c Dr. To Provision for discount debtors	Shown on the debit side	Shown as deduction from debtors
9. Manager's commission	Manager's commission A/c Dr. To outstanding commission A/c	Shown on the debit side	Shown on the liabilities side
10. Interest on capital	Interest on capital A/c Dr. To capital A/c	Shown on the debit side	Shown as addition to capital
11. Further bad debts	Bad debts A/c Dr. To Sundry Debtors A/c	Shown on the debit side	Deducted from debtors

Fig. 10.2 : Showing treatment of various types of adjustments

Illustration 1

From the following balances, prepare the trading and profit and loss account and balance sheet as on March 31, 2017.

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit Balances</i>	<i>Amount ₹</i>
Drawings	6,300	Capital	1,50,000
Cash at bank	13,870	Discount received	2,980
Bills receivable	1,860	Loans	15,000
Loan and Building	42,580	Purchases return	1,450
Furniture	5,130	Sales	2,81,500
Discount allowed	3,960	Reserve for bad debts	4,650
Bank charges	100	Creditors	18,670
Salaries	6,420		
Purchases	1,99,080		
Stock (opening)	60,220		
Sales return	1,870		
Carriage	5,170		
Rent and Taxes	7,680		
General expenses	3,630		
Plant and Machinery	31,640		
Book debts	82,740		
Bad debts	1,250		
Insurance	750		
	<u>4,74,250</u>		<u>4,74,250</u>

Adjustments

1. Closing stock ₹ 70,000
2. Create a reserve for bad and doubtful debts @ 10% on book debts
3. Insurance prepaid ₹ 50
4. Rent outstanding ₹ 150
5. Interest on loan is due @ 6% p.a.

Solution

**Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.		Cr.	
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	60,220	Sales	2,81,500
Purchase	1,99,080	Less : Sales return	(1,870)
Less Purchases return	(1,450)	Closing stock	70,000
Carriage	5,170		
Gross profit c/d	86,610		
	<u>3,49,630</u>		<u>3,49,630</u>

Discount allowed	3,960	Gross profit b/d	86,610
Bank charges	100	Discount received	2,980
Salaries	6,420		
Rent and Taxes	7,680		
Add Rent outstanding	<u>150</u>		
General expenses	3,630		
Insurance	750		
Less Insurance prepaid	<u>(50)</u>		
Bad debts	1,250		
Add New provision	<u>8,274</u>		
for bad debts	9,524		
Less Old provision	<u>(4,650)</u>		
for bad debts	4,874		
Interest on loan outstanding	900		
Net profit (transferred to capital account)	61,176		
	<u>89,590</u>		<u>89,590</u>

Balance Sheet as at March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	18,670	Cash at bank	13,870
Loan	15,000	Book debts	82,740
Add Interest on loan outstanding	<u>900</u>	Less Reserve for bad debts	<u>(8,274)</u>
Rent outstanding	150	Bills receivable	1,860
Capital	1,50,000	Land and Building	42,580
Add Net profit	<u>61,176</u>	Furniture	5,130
	2,11,176	Plant and Machinery	31,640
Less Drawings	<u>(6,300)</u>	Insurance (prepaid)	50
	2,04,876	Closing stock	70,000
	<u>2,39,596</u>		<u>2,39,596</u>

Illustration 2

The following were the balances extracted from the books of Yogita as on March 31, 2017:

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit Balances</i>	<i>Amount ₹</i>
Cash in hand	540	Sales	98,780
Cash at bank	2,630	Return outwards	500
Purchases	40,675	Capital	62,000
Return inwards	680	Sundry creditors	6,300
Wages	8,480	Rent	9,000
Fuel and Power	4,730		
Carriage on sales	3200		
Carriage on purchases	2040		
Opening stock	5,760		
Building	32,000		
Freehold land	10,000		
Machinery	20,000		
Salaries	15,000		
Patents	7,500		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
Sundry debtors	14,500		

Taking into account the following adjustments prepare trading and profit and loss account and balance sheet as on March 31, 2017 :

- Stock in hand on March 31, 2017, was ₹ 6,800.
- Machinery is to be depreciated at the rate of 10% and patents @ 20%.
- Salaries for the month of March, 2017 amounting to ₹ 1,500 were outstanding.
- Insurance includes a premium of ₹ 170 on a policy expiring on September 30, 2017.
- Further bad debts are ₹ 725. Create a provision @ 5% on debtors.
- Rent receivable ₹ 1,000.

Solution

Books of Yogita
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.			Cr.
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	5,760		
Purchases 40,675		Sales 98,780	
Less Return outwards (500)	40,175	Less Return inwards (680)	98,100
Wages	8,480	Closing stock	6,800
Fuel and Power	4,730		
Carriage on purchases	2,040		
Gross profit c/d	43,715		
	1,04,900		1,04,900
Salaries 15,000		Gross profit b/d	43,715
Add Outstanding salaries 1,500	16,500	Rent 9,000	
Carriage	3,200	Add Accrued rent 1,000	10,000
General expenses	3,000		
Insurance 600			
Less Prepaid insurance (85)	515		
Further bad debts 725			
Add Provision for doubtful debts 689	1,414		
Depreciation : machinery 2,000			
Patent 1,500	3,500		
Net profit	25,586		
(transferred to capital account)			
	53,715		53,715

Balance Sheet as at March 31, 2017

Dr.			Cr.
<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Sundry creditors	6,300	Cash in hand	540
Salaries outstanding	1,500	Cash in bank	2,630
Capital 62,000		Sundry debtors 14,500	
		Less Further (725)	
		bad debts 13,775	
		Less Provision (689)	13,086
		for bad debts	
Add Net profit 25,586		Insurance prepaid	85
87,586		Stock	6,800
		Rent accrued	1,000
Less Drawings (5,245)	82,341	Freehold land	10,000
		Building	32,000
		Machinery 20,000	
		Less Depreciation (2,000)	18,000
		Patents 7,500	
		Less Depreciation (1,500)	6,000
	90,141		90,141

Illustration 3

The following balances were extracted from the books of Shri R. Lal on March 31, 2017:

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Capital	1,00,000	Rent (Cr.)	2,100
Drawings	17,600	Railway freight on sales	16,940
Purchases	80,000	Carriage inwards	2,310
Sales	1,40,370	Office expenses	1,340
Purchases return	2,820	Printing and Stationery	660
Stock on April 01, 2016	11,460	Postage and Telegram	820
Bad debts	1,400	Sundry debtors	62,070
doubtful debts reserve April 01, 2016	3,240	Sundry creditors	18,920
Rates and Insurance	1,300	Cash in bank	12,400
Discount (Cr.)	190	Cash in hand	2,210
Bills receivable	1,240	Office furniture	3,500
Sales returns	4,240	Salaries and Commission	9,870
Wages	6,280	Addition to buildings	7,000
Buildings	25,000		

Prepare the trading and profit and loss account and a balance sheet as on March 31, 2017 after keeping in view the following adjustments :

- (i) Depreciate old building by ₹ 625 and addition to building at 2% and office furniture at 5%.
- (ii) Write-off further bad debts ₹ 570.
- (iii) Increase the bad debts reserve to 6% of debtors.
- (iv) On March 31, 2017 ₹ 570 are outstanding for salary.
- (v) Rent receivable ₹ 200 on March 31, 2017.
- (vi) Interest on capital at 5% to be charged.
- (vii) Unexpired insurance ₹ 240.
- (viii) Stock was valued at ₹ 14,290 on March 31, 2017.

Solution

Books of Shri R. Lal
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.

Cr.

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	11,460	Sales	1,40,370
Purchases 80,000		Less Sales Return	(4,240)
Less Purchase return (2,820)	77,180		1,36,130
Carriage inwards	2,310		
Wages	6,280	Closing stock	14,290
Gross profit c/d	53,190		
	1,50,420		1,50,420
Railway freight on sales	16,940	Gross profit c/d	53,190
Office expenses	1,340	Rent	2,100
Postage and Telegram	820	Add Accrued rent	200
Printing and Stationery	660	Discount	190
Salary and Commission 9,870			
Add Outstanding salary	570		
Rates and Insurance	1,300		
Less unexpired insurance	(240)		
Bad debts	1,400		
Add Further bad debts	570		
Add New doubtful debts	3,690		
provision	5660		
Less Old provision	(3,240)		
for bad debts	2,420		
Interest on capital	5,000		
Depreciation on building	625		
Depreciation on addition	140		
to building			
Depreciation on furniture	175		
Net profit (transferred to capital account)	16,060		
	55,680		55,680

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Sundry creditors	18,920	Cash at bank	12,400
Outstanding salaries	570	Cash in hand	2,210
Capital	1,00,000	Bills receivable	1,240
Add Net profit	16,060		
Add Interest on capital	<u>5,000</u>		
	1,21,060	Debtors	62,070
		Less Further bad debts	<u>(570)</u>
			61,500
Less Drawings	<u>(17,600)</u>	Less New provision	<u>(3,690)</u>
	1,03,460	for doubtful debts	57,810
		Accrued rent	200
		Unexpired insurance	240
		Building	25,000
		Less Depreciation	<u>(625)</u>
			24,375
		Addition to building	7,000
		Less Depreciation	<u>(140)</u>
			6,860
		Office furniture	3,500
		Less Depreciation	<u>(175)</u>
			3,325
		Closing stock	14,290
	<u>1,22,950</u>		<u>1,22,950</u>

Illustration 4

Prepare the trading profit and loss account of M/s Mohit Traders as on 31 March 2017 and draw necessary Journal entries and balance sheet as on that date :

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit Balances</i>	<i>Amount ₹</i>
Opening stock	24,000	Sales	4,00,000
Purchases	1,60,000	Return outwards	2,000
Cash in hand	16,000	Capital	1,50,000
Cash at bank	32,000	Creditors	64,000
Return inwards	4,000	Bills payable	20,000
Wages	22,000	Commission received	4,000
Fuel and Power	18,000		
Carriage inwards	6,000		
Insurance	8,000		
Buildings	1,00,000		
Plant	80,000		
Patents	30,000		
Salaries	28,000		
Furniture	12,000		
Drawings	18,000		
Rent	2,000		
Debtors	80,000		
	<u>6,40,000</u>		<u>6,40,000</u>

Adjustments

	₹
(a) Salaries outstanding	12,000
(b) Wages outstanding	6,000
(c) Commission is accrued	2,400
(d) Depreciation on building 5% and plant 3%	
(e) Insurance paid in advance	700
(f) Closing stock	12,000

Solution

Books of Mohit Traders
Journal

Date	Particulars	L.F.	Debit Amount ₹	Credit Amount ₹
2017 March 31	Salary A/c Dr. Wages A/c Dr. To Salary outstanding A/c To Wages outstanding A/c (Amount of salary and wages outstanding as on March 31, 2017)		12,000 6,000	12,000 6,000
March 31	Prepaid Insurance A/c Dr. To Insurance A/c (Insurance paid in advance]		1,400	1,400
March 31	Commission accrued A/c Dr. To Commission A/c (Commission accrued but not received)		2,400	2,400
March 31	Depreciation A/c Dr. To Building A/c To Plant A/c (Depreciation charged on plant and building)		7,400	5,000 2,400
March 31	Profit and Loss A/c Dr. To Capital A/c (Profit transferred to capital account)		1,23,700	1,23,700

Books of Mohit Traders
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.**Cr.**

<i>Expenses / Losses</i>	<i>Amount ₹</i>	<i>Revenue / Gains</i>	<i>Amount ₹</i>
Opening stock	24,000	Sales 4,00,000	
Purchases 1,60,000		Less Returns (4,000)	3,96,000
Less returns (2,000)	1,58,000	Closing stock	12,000
Wages 22,000			
Add Outstanding wages 6,000	28,000		
Fuel and Power	18,000		
Carriage inwards	6,000		
Gross profit c/d	1,74,000		
	4,08,000		4,08,000
Salary 28,000		Gross Profit b/d	1,74,000
Add Outstanding salary 12,000	40,000	Commission received (4,000)	
Insurances 8,000		Add Accrued 2,400	6,400
Less Prepaid (700)	7,300	commission	
Rent	2,000		
Depreciation on building	5,000		
Plants	2,400		
Net Profit (transferred to capital account)	1,23,700		
	1,80,400		1,80,400

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Creditors	64,000	Cash in hand	16,000
Bills payable	20,000	Cash at bank	32,000
Capital 1,50,000		Building	95,000
Add Net profit 1,23,700		Plant	77,600
2,73,700		Patents	30,000
Less Drawings (18,000)	2,55,700	Debtors	80,000
Outstanding salaries	12,000	Insurance prepaid	700
Outstanding wages	6,000	Commission accrued	2,400
		Furniture	12,000
		Closing stock	12,000
	3,57,700		3,57,700

Illustration 5

The following information has been extracted from the trial balance of M/s Randhir Transport Corporation.

<i>Debit balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Opening stock	40,000	Capital	2,70,000
Rent	2,000	Creditors	50,000
Plant and Machinery	1,20,000	Bills payable	50,000
Land and Buildings	2,55,000	Loan	1,10,000
Power	3,500	Discount	1,500
Purchases	75,000	Sales	1,50,000
Sales return	2,500	Provision for bad debts	1,000
Telegram and Postage	400	General reserves	50,000
Wages	4,500		
Salary	2,500		
Insurance	3,200		
Discount	1,000		
Repair and Renewals	2,000		
Legal charges	700		
Trade taxes	1,200		
Debtors	75,000		
Investment	65,000		
Bad debts	2,000		
Trade expenses	4,500		
Commission	1,250		
Travelling expenses	1,230		
Drawings	20,020		
	6,82,500		6,82,500

Adjustments

1. Closing stock for the year was ₹ 35,500.
2. Depreciation charged on plant and machinery 5% and land and building 6%.
3. Interest on drawing @ 6% and Interest on loan @ 5%.
4. Interest on investments @ 4%.
5. Further bad debts 2,500 and make provision for doubtful debts on debtors 5%.
6. Discount on debtors @ 2%.
7. Salary outstanding ₹ 200.
8. Wages outstanding ₹ 100.
9. Insurance prepaid ₹ 500.

You are required to make trading and profit and loss account and a balance sheet on March 31, 2017.

Solution

Books of Randhir Transport Corporation
Trading and Profit and Loss Account
for the year ended March 31, 2017

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenue/Gains</i>	<i>Amount ₹</i>
Opening stock	40,000	Sales 1,50,000	
Purchases	75,000	Less Sales return (2,500)	1,47,500
Wages 4,500		Closing stock	35,500
Add Outstanding wages 100	4,600		
Power	3,500		
Gross profit c/d	59,900		
	1,83,000		1,83,000
Rent	2,000	Gross profit b/d	59,900
Telegram and Postage	400	Outstanding interest on investment	2,600
Salary 2,500		Discount	1,500
Add Outstanding salary 200	2,700	Interest on drawings	1,200
Insurance 3,200			
Less Prepaid (500)	2,700		
Discount	1,000		
Repair and Renewals	2,000		
Legal charges	700		
Trade taxes	1,200		
Trade expenses	4,500		
Outstanding interest on loan	5,500		
Commission	1,250		
Travelling expenses	1,230		
Discount on debtors	1,450		
Depreciation on Plant and Machinery	6,000		
Depreciation on Land and Building	15,300		
Bad debts 2,000			
Add Further bad debts 2,500			
Add New provision 3,553			
	8,053		
Less Old provision (1,000)	7,053		
Net Profit (transferred to capital account)	10,217		
	65,200		65,200

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Creditors	50,000	Debtors	75,000
Bills payable	50,000	Less Further	(2,500)
Loan	1,10,000	bad debts	72,500
Add Outstanding interest	5,500	Less Discount	(1,450)
General reserve	50,000		71,050
Capital	2,70,000	Less New Provision	(3,553)
Add Net Profit	10,217	Investment	65,000
	2,80,217	Outstanding interest on investment	2,600
Less Drawings	(20,020)	Insurance pre-paid	500
	2,60,197		
Less Interest on drawings	1,200	Plant and Machinery	1,14,000
Outstanding salary	200	Land and Building	2,39,700
Outstanding wages	100	Closing stock	35,500
	5,24,797		5,24,797

Illustration 6

From the following balances of M/s Keshav Bros. You are required to prepare trading and profit and loss account and a balance sheet of March 31, 2017.

<i>Debit balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Plant and Machinery	1,30,000	Sales	3,00,000
Debtors	50,000	Return outwards	2,500
Interest	2,000	Creditors	2,50,000
Wages	1,200	Bills payable	70,000
Salary	2,500	Provision for bad debts	1,550
Carriage inwards	500	Capital	2,20,000
Carriage outwards	700	Rent received	10,380
Return inwards	2,000	Commission received	16,000
Factory rent	1,450		
Office rent	2,300		
Insurance	780		
Furniture	22,500		
Buildings	2,80,000		
Bills receivable	3,000		
Cash in hand	22,500		
Cash at bank	35,000		
Commission	500		
Opening stock	60,000		
Purchases	2,50,000		
Bad debts	3,500		
	8,70,430		8,70,430

Adjustment

- (i) Provision for bad debts @ 5% and further bad debts ₹ 2,000.
- (ii) Rent received in advance ₹ 6,000.
- (iii) Prepaid insurance ₹ 200.
- (iv) Depreciation on furniture @ 5%, plant and machinery @ 6%, building @ 7%.

Solution

Books of Keshav Bros.
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.**Cr.**

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenue/Gains</i>	<i>Amount ₹</i>
Opening stock	60,000	Sales	3,00,000
Purchases	2,50,000	Less Return	(2,000)
Less Returns	(2,500)	Closing stock	70,000
Wages	1,200		
Carriage inwards	500		
Factory rent	1,450		
Gross profit c/d	57,350		
	3,68,000		3,68,000
Interest	2,000	Gross profit b/d	57,350
Salary	2,500	Rent received	10,380
Carriage outwards	700	Less Advance rent	(6,000)
Office Rent	2,300	Commission received	16,000
Insurance	780		
Less Prepaid insurance	(200)		
Depreciation on furniture	1,125		
Depreciation on Plant and Machinery	7,800		
Depreciation on building	19,600		
Commission	500		
Bad debts	3,500		
Add Further bad debts	2,000		
Add New provision	2,400		
	7,900		
Less Old provision	(1,550)		
Net Profit (transferred to capital account)	34,275		
	77,730		77,730

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Liabilities</i>	<i>Amount ₹</i>
Creditors	2,50,000	Cash In hand	22,500
Bills payable	70,000	Cash at bank	35,000
Advance rent	6,000	Bills receivable	3,000
Capital	2,20,000	Prepaid insurance	200
Add Net profit	<u>34,275</u>	Debtors	50,000
	2,54,275	Less Further	<u>(2,000)</u>
		bad debts	48,000
		Less New provision	(2,400)
			45,600
		Plant and Machinery	1,22,200
		Furniture	21,375
		Buildings	2,60,400
		Closing stock	70,000
	<u>5,80,275</u>		<u>5,80,275</u>

Illustration 7

The following information have been taken from the trial balance of M/s Fair Brothers Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as at March 31, 2017.

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Cash	20,000	Sales	3,61,000
Wages	45,050	Loan 12% (1.7.2016)	40,000
Return outwards	4,800	Discount received	1,060
Bad debts	4,620	Return (Purchase)	390
Salaries	16,000	Creditors	60,610
Octroi	1,000	Capital	75,000
Charity	250		
Machinery	32,000		
Debtors (Including a dishonoured bill of ₹1,600)	60,000		
Stock	81,600		
Purchases	2,60,590		
Repairs	3,350		
Interest on loan	1,200		
Sales tax	1,600		
Insurance	2,000		
Rent	4,000		
	<u>5,38,060</u>		<u>5,38,060</u>

Adjustments

1. Wages include ₹ 4,000 for erection of new machinery on April 01, 2016.
2. Provide 5% depreciation on furniture.
3. Salaries unpaid ₹1,600.
4. Closing stock ₹ 81,850.
5. Create a provision at 5% on debtors.
6. Half the amount of bill is recoverable.
7. Rent is paid up to July 30, 2017.
8. Insurance unexpired ₹ 600.

**Books of Fair Brothers Ltd.
Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.**Cr.**

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenue/Gains</i>	<i>Amount ₹</i>
Opening stock	81,600	Sales 3,61,000	
Purchases 2,60,590		Less Sales return (4,800)	3,56,200
Less Purchases return (390)	2,60,200	Closing stock	81,850
Wages 45,050			
Less Prepaid wages (4,000)	41,050		
including erection of machines			
Octroi 1,000			
Gross profit c/d	54,200		
	4,38,050		4,38,050
Salaries 16,000		Gross profit b/d	54,200
Add Outstanding salary 1,600	17,600	Discount received	1,060
Repairs 3,350			
Bad debts 4,620			
Add Further bad debts 800			
Add New provision 2,960	8,380		
Interest on loan 1,200			
Add Outstanding interest 2,400	3,600		
Sales tax 1,600			
Insurance 2,000			
Less Prepaid insurance (600)	1,400		
Charity 250			
Rent 4,000			
Less Prepaid rent 1,000	3,000		
Depreciation on machinery 1,800			
Net profit (transferred to capital account)	14,280		
	55,260		55,260

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Creditors	60,610	Cash	20,000
Outstanding salaries	1,600	Debtors	60,000
Loan	40,000	Less Bad debts	(800)
Outstanding interest	2,400	Less Provision	<u>2,960</u>
Capital	75,000	Prepaid rent	1,000
Add Net profit	<u>14,280</u>	Unexpired insurance	600
	89,280	Machinery	32,000
		Add Erection	<u>4,000</u>
		Wages	36,000
		Less Depreciation	<u>(1,800)</u>
		Closing stock	81,850
	<u>1,93,890</u>		<u>1,93,890</u>

Illustration 8

From the following balance extracted from the books of M/s Hariharan Brother, you are required to prepare the trading and profit and loss account and a balance sheet as on December 31, 2017.

<i>Debit balance</i>	<i>Amount ₹</i>	<i>Credit balance</i>	<i>Amount ₹</i>
Opening stock	16,000	Capital	1,00,000
Purchases	40,000	Sales	1,60,000
Return inwards	3,000	Return outwards	800
Carriage inwards	2,400	Apprenticeship premium	3,000
Carriage outwards	5,000	Bills payable	5,000
Wages	6,600	Creditors	31,600
Salaries	11,000		
Rent	2,200		
Freight and Dock	4,800		
Fire Insurance premium	1,800		
Bad debts	4,200		
Discount	1,000		
Printing and Stationery	500		
Rates and Taxes	700		
Travelling expenses	300		
Trade expenses	400		
Business premises	1,10,000		
Furniture	5,000		
Bills receivable	7,000		
Debtors	40,000		
Machine	9,000		
Loan	10,000		
Investment	6,000		
Cash in hand	500		
Cash at bank	7,000		
Proprietor's withdrawal	6,000		
	<u>3,00,400</u>		<u>3,00,400</u>

Adjustments

1. Closing stock ₹ 14,000.
2. Wages outstanding ₹ 600, Salaries Outstanding ₹ 1,000, Rent outstanding ₹ 200.
3. Fire Insurance premium includes ₹ 1,200 paid in July 01, 2016 to run for one year from July 01, 2016 to June 30, 2017.
4. Apprenticeship Premium is for three years paid in advance on January 01, 2016.
5. Stationery bill for ₹ 60 remain unpaid.
6. Depreciation on Premises @ 5%, furniture @ 10%, Machinery @ 10%.
7. Interest on loan given accrued for one year @ 7%.
8. Interest on investment @ 5% for half year to December 31, 2016 has accrued.
9. Interest on capital to be allowed at 5% for one year.
10. Interest on drawings to be charged to him ascertained for the year ₹ 160.

Solution**Books of Hariharan Bros.****Trading and Profit and Loss Account for the year ended December 31, 2017****Dr.****Cr.**

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenue/Gains</i>	<i>Amount ₹</i>
Opening stock	16,000	Sales	1,60,000
Purchases 40,000		Less Sales return	(3,000)
Less purchases return (800)	39,200	Closing stock	14,000
Wages 6,600			
Add Outstanding Wages 600	7,200		
Carriage inwards	2,400		
Freight and Dock	4,800		
Gross profit c/d	1,01,400		
	<u>1,71,000</u>		<u>1,71,000</u>
Salaries 11,000		Gross profit b/d	1,01,400
Add Outstanding salary 1,000	12,000	Apprenticeship premium	3,000
Carriage outwards	5,000	Less Advance premium	(2,000)
Rates and Taxes	700	Accrued interest on loan	700
Printing and Stationery 500		Interest on drawings	160
Add Outstanding bill 60	560	Accrued interest on investment	150
Trade expenses	400		
Travelling expenses	300		
Fire insurance 1,800			
Less Prepaid insurance (600)	1,200		
Bad debts	4,200		
Rent 2,200			
Add Outstanding rent 200	2,400		
Interest on capital	5,000		
Depreciation on premises	5,500		
Depreciation on furniture	500		
Depreciation on machinery	900		
Discount	1,000		
Net profit (transferred to capital account)	63,750		
	<u>1,03,410</u>		<u>1,03,410</u>

Balance Sheet as at December 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital 1,00,000		Premises 1,10,000	
Add Interest on capital 5,000		Less Depreciation (5,500)	1,04,500
Add Net profit 63,750			
1,68,750		Furniture	4,500
Less drawings (6,000)		Machinery	8,100
1,62,750			
Less Interest on drawings (160)	1,62,590	Debtors	40,000
Creditors 31,600		Bills receivable	7,000
Bills payable 5,000		Cash in hand	500
Outstanding wages 600		Cash at bank	7,000
Outstanding salaries 1,000		Loan 10,000	
Outstanding rent 200		Add accrued interest 700	10,700
Outstanding stationery 60		Investments 6,000	
Apprenticeship premium (advance) 2,000		Add accrued interest 150	6,150
		Pre-paid insurance	600
		Closing stock	14,000
	<u>2,03,050</u>		<u>2,03,050</u>

Illustration 9

The following balances have been extracted from the trial balance of M/s Kolkata Ltd. You are required to prepare the trading and profit and loss account on dated March 31, 2017. Also prepare balance sheet on that date.

<i>Debit balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Opening stock	6,000	Capital	20,000
Furniture	1,200	Sales	41,300
Drawings	2,800	Purchases return	4,000
Cash in hand	3,000	Bank overdraft	4,000
Purchases	24,000	Bad debts provision	400
Sales return	2,000	Creditors	5,000
Establishment expenses	4,400	Commission	100
Bad debts	1,000	Bills payable	5,000
Debtors	10,000	Apprenticeship premium	500
Carriage	1,000		
Bills receivable	6,000		
Bank deposits	8,000		
Wages	1,000		
Trade expenses	500		
Bank charges	400		
General expenses	1,000		
Salaries	2,000		
Insurance	1,500		
Postage and Telegram	500		
Rent, Rates and Taxes	2,000		
Coal, Gas, Water	2,000		
	<u>80,300</u>		<u>80,300</u>

Adjustments

1. Outstanding salaries ₹ 100. Rent and taxes ₹ 200, Wages ₹ 100.
2. Unexpired insurance ₹ 500.
3. Commission is received in advances ₹ 50.
4. Interest ₹ 500 is to be received on bank deposits.
5. Interest on bank overdraft ₹ 750.
6. Depreciation on furniture @ 10%.
7. Closing stock ₹ 9,000.
8. Further bad debts ₹ 200 New provision @ 5% on debtors.
9. Apprenticeship premium received in advance ₹ 100.
10. Interest on drawings @ 6%.

Solution**Books of Kolkata Ltd.****Trading and Profit and Loss Account for the year ended as at March 31, 2017****Dr.****Cr.**

<i>Expenses / Losses</i>	<i>Amount ₹</i>	<i>Revenue / Gains</i>	<i>Amount ₹</i>
Opening stock	6,000	Sales 41300	
Purchases 24,000		Less sales return (2,000)	39,300
Less purchases return (4,000)	20,000	Closing stock	9,000
Wages 1,000			
Add Outstanding wages 100	1,100		
Coal, Gas, Water	2,000		
Gross profit c/d	19,200		
	48,300		48,300
Establishment expenses	4,400	Gross profit b/d	19,200
Carriage	1,000	Commission 100	
Trade expenses	500	Less Advance commission (50)	50
Bank charges	400	Accrued interest on deposits	500
General expenses	1,000	Apprenticeship premium 500	
Salaries 2,000		Less Advance received 100	400
Add Outstanding salary 100	2,100	Interest on drawings	168
Insurance 1,500			
Less Prepaid insurance (500)	1,000		
Postage and Telegram	500		
Rent, rates and Taxes	2,200		
Interest on bank overdraft	750		
Bad debts 1,000			
Add Further bad debts 200			
Add New provision 490			
	1,690		
Less Old provision (400)	1,290		
Depreciation on furniture	120		
Net profit (transferred to capital account)	5,058		
	20,318		20,318

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital 2,00,00		Insurance prepaid 500	500
Net profit 5,058		Bank deposits 8,000	
25,058			
Less Drawings (2,800)		Add outstanding interest 500	8,500
22,258			
Less Interest on drawings (168)	22,090	Furniture	1,080
Creditors 5,000	5,000	Cash in hand	3,000
Commission received in advance 50	50	Debtors 10,000	
Apprenticeship premium 100	100	Less Further (200)	
		bad debts 9,800	
Outstanding wages 100	100	Less Provision for (490)	9,310
		doubtful debts	
Outstanding salaries 100	100	Bills receivable	6,000
Outstanding rent, rates, taxes 200	200		
Bank overdraft 4,000		Closing stock	9,000
Add Outstanding interest 750	4,750		
Bills payable	5,000		
	37,390		37,390

Illustration 10

Prepare the trading and profit and loss account of M/s Roni Plastic Ltd. from the following trial balance and a balance sheet as at March 31, 2017.

<i>Debit balances</i>	<i>Amount ₹</i>	<i>Credit balances</i>	<i>Amount ₹</i>
Drawings 6,000	6,000	Creditors 16,802	16,802
Sundry debtors 38,200	38,200	Capital 60,000	60,000
Carriage outwards 2,808	2,808	Loan on mortgage 17,000	17,000
Establishment expenses 16,194	16,194	Bad debts provision 1,420	1,420
Interest on loan 400	400	Sales 2,22,486	2,22,486
Cash in hand 6,100	6,100	Purchases return 2,692	2,692
Stock 11,678	11,678	Discount 880	880
Motor car 18,000	18,000	Bills payable 5,428	5,428
Cash at bank 9,110	9,110	Rent received 500	500
Land and Buildings 24,000	24,000		
Bad debts 1,250	1,250		
Purchases 1,34,916	1,34,916		
Sales return 15,642	15,642		
Advertisement 4,528	4,528		
Carriage inward 7,858	7,858		
Rates, taxes, insurance 7,782	7,782		
General expenses 8,978	8,978		
Bills receivable 13,764	13,764		
	3,27,208		3,27,208

Adjustments

1. Depreciation on land and building at @ 5% and Motor vehicle at @ 15%.
2. Interest on loan is @ 5% taken on April 01, 2016.
3. Goods costing Rs1,200 were sent to a customer on sale on return basis for ₹ 1,400 on March 30, 2017 and has been recorded in the books as actual sales.
4. Salaries amounting to ₹ 1,400 and Rates amounting to ₹ 800 are due.
5. The bad debts provision is to be brought up to @ 5% on sundry debtors.
6. Closing stock was ₹ 13,700.
7. Goods costing ₹ 1,000 were taken away by the proprietor for his personal use but not entry has been made in the books of account.
8. Insurance pre-paid ₹ 350.
9. Provide the manager's commission at @ 5% on Net profit after charging such commission.

Solution**Books of Roni's Plastic Ltd.****Trading and Profit and Loss Account for the year ended March 31, 2017****Dr.****Cr.**

Expenses/Losses	Amount ₹	Revenue/Gains	Amount ₹
Opening stock	11,678	Sales	2,22,486
Purchases	1,34,916	Less Sales	15,642
		return	2,06,844
Less Purchases return	2,692	Less Return basis	(1,400)
	1,32,224		2,05,444
Less Goods withdrawn	(1,000)	Closing stock	13,700
Carriage inwards	7,858		
Gross profit c/d	68,384		
	2,19,144		2,19,144
Outstanding salaries	1,400	Gross profit b/d	68,384
Carriage outwards	2,808	Discount	880
Establishment expenses	16,194	Rent	500
Bad debts	1,250		
Add New provision	1,840		
	3,090		
Less Old provision	(1,420)		
Rates and Taxes	7,782		
Less Prepaid	(350)		
	7,432		
Add Outstanding	800		
Advertisement	4,528		
Interest on loan	400		
Add Outstanding Interest	450		
General expenses	8,978		
Depreciation on :			
Land and Building	1,200		
Motor car	2,700		
Manager commission	1,010		
Net profit (transferred to capital account)	20,194		
	69,764		69,764

Balance Sheet as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital 60,000		Cash in hand 6,100	
Add Net profit 20,194			
80,194		Cash at bank 9,110	
Less Drawings (6,000)			
(74,194)		Bills receivable 13,764	
Less Goods withdrawn 1,000	73,194	Debtors 38,200	
loan 17,000		Less sales (1,400)	
		return basis 36,800	
Add interest 450	17,450	Less New provisions (1,840)	34,960
Bills payable 5,428		Land and Building 24,000	
		Less Depreciation (1,200)	22,800
Creditors 16,802		Motor car 18,000	
		Less Depreciation (2,700)	15,300
Outstanding Salaries 1,400		Prepaid insurance 350	
Outstanding Rates Taxes 800		Closing stock 13,700	
Manager commission 1,010			
	1,16,084		1,16,084

Do it yourself

1. From the following Trial Balance of M/s Karan on March 31, 2017, prepare a Trading and Profit and Loss Account and a Balance Sheet:

<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
Creditors/Debtors	2,05,000	96,000
Bills Payable/Bills Receivables	10,000	9,600
15% Loan	—	50,000
Sales/Purchases	2,80,000	12,00,000
Discount	4,000	3,000
Bad Debt Recovered/Bad Debt	5,000	14,000
Interest on Investments	—	6,000
Interest on Loan	8,000	4,000
Vehicles	6,50,000	—
Stock	3,00,000	—
10% Investments (Purchased on 30 th September, 2016)	1,80,000	—
Cash in hand	20,000	—
Cash at bank	37,000	—

Capital /Drawings	9,000	4,50,000
Carriage on Purchases	1,600	—
Carriage on sales	4,400	—
Primary Packing Expenses	2,000	—
Rent	3,000	7,000
Insurance	3,600	—
Office & Administrative Expenses	4,000	—
Discount	2,000	3,000
10% Loan	60,000	—
Delivery Expenses	4,000	—
Selling and Distribution Expenses	10,000	—
Income Tax	2,000	—
Outstanding Salary	—	1,000
Sales Tax Collected	—	3,000
Apprenticeship Premium	—	6,000
Returns	1,000	4,000
Live Stock	53,000	—
Commission	10,000	12,000
	18,68,600	18,68,600

(I) Additional Information

- The cost of closing stock was ₹ 50,000 but the market value was ₹ 40,000.
- Rent is due but not yet paid for March 2017 ₹ 500.
- Insurance carried forward ₹ 900.
- 1/3 of the commission received is in respect of work to be done in next year and commission paid represents only 1/4 of the actual commission to be paid during the year.
- Vehicles were valued at 90% of the book value.
- The Horse worth ₹ 30,000 was donated to a charitable organization.

(II) Name the accounting concept followed while treating the adjustment (a), (b) and (d) above?

2. The following balances were extracted from the books of Avika Enterprises on 31st March 2017.

Particulars	Dr. (₹)	Cr. (₹)
Capital	—	24,500
Drawings	2,000	—
General Expenses	2,500	—
Buildings	21,000	—
Machinery	9,340	—
Stock (1.4.2016)	16,200	—
Power	2,240	—
Taxes and Insurance	1,315	—
Wages	7,200	—
Debtors and Creditors	6,280	2,500
Charity	105	—
Bad debts	550	—
Bank Overdraft	—	11,180
Sales and Purchases	13,500	65,360
Stock (31.03.2017)	23,500	—
Motor Vehicles	2,000	—
Motor Vehicle expenses	500	—
Provision for doubtful debts	—	900
Commission	—	1,320
Trade expenses	1,280	—
Bills payable	—	3,850
Cash	100	—
Total	1,09,610	1,09,610

You are required to :

- (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
 - (a) $1/5^{\text{th}}$ of General expenses and Taxes & Insurance to be charged to factory and the balance to the office.
 - (b) Write off a further Bad debts of ₹ 160 and maintain the provision for doubtful debts at 5% and create a provision for discount on Debtors at 10%.
 - (c) Depreciate Machinery at 10% and Motor Vehicles by ₹ 240
 - (d) Provide ₹ 700 for interest on Bank Overdraft to be paid.
 - (e) ₹ 50 is to be carried forward to next year out of Insurance.
 - (f) Provide for Manager's Commission at 10% on the Net Profit after charging such commission.
- (ii) Name the accounting concepts which are followed while treating the adjustment (a), (b) and (d) above?

3. The following balances were extracted from the books of Anushka Enterprises on March 31, 2017.

Particulars	Amount (₹)
Creditors	2,00,000
Loan from SBI	2,00,000
Sales	12,30,000
Debtors	2,00,000
Dividend Received on Shares	20,000
Bad Debt	2,000
Bad Debt Recovered	12,000
Bills Receivables	1,50,000
Interest on Loan	50,000
Goodwill	4,00,000
Purchases	2,10,000
Stock (1.4.2016)	1,00,000
Cash at Bank	3,00,000
Factory Repairs	40,000
Capital	7,24,000
Audit Fees	6,000
Petty Expenses	4,000
Salary	70,000
Life Insurance Premium	15,000
Premises	4,00,000
Insurance	25,000
Sales Returns	12,000
Employees Provident Fund	60,000
Provision for Doubtful Debts	75,000
Delivery Expenses	8,000
Dock Charges (Outward)	6,000
Packing Charges	17,000
Advance Salary	30,000
Warehouse Insurance	13,000
Loss in Exchange	9,000
Bank Charges	5,000
Bonus from Suppliers	3,45,000
Purchases Returns	10,000
Machinery	8,00,000
Discounting of Bills of Exchange	1,000

You are required to :

- (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
 - (a) Insurance is due but not yet paid for 31 March 2017 ₹ 500.
 - (b) Salary Unexpired ₹ 900.
 - (c) Write off a further Bad debts ₹ 2,000 and maintain the provision for bad debts at 5% on Debtors.
 - (d) Machinery is to be valued at 90% less than the book value.
 - (e) Goods kept in warehouse worth ₹ 10,0000 were used for staff welfare.
 - (f) Half of the Bills Receivable were irrecoverable.
 - (h) Closing Stock is ₹ 40,000
- (ii) Name the accounting concepts which will be followed while treating the adjustment (a), (b), (c) and (d) above?

4. The following balances were extracted from the books of Ankita Enterprises on March 31, 2017.

Particulars	Dr. (₹)	Cr. (₹)
Capital	—	1,92,680
Cash	—	60
Purchases	17,980	—
Sales	—	22,120
Bank	1,770	—
Plant	450	—
Freehold Land	3,000	—
Heating and Lighting	130	—
Bills Receivables	—	1,650
Return Inwards	—	60
Salaries	2,150	—
Creditors	—	63,780
Debtors	11,400	—
Stock (as on 01.04.2016)	6,000	—
Printing	450	—
Bills Payable	3,750	—
Taxes	380	—
Discount Received	890	—
Commission (Dr.)	—	800
Trucks	25,000	—
Furniture	—	12,000
Wages	2,00,000	—
Drawings	—	340
Returns Outward	400	—
	2,73,750	2,93,490

You are required to :

- (i) Redraft the Trial Balance.
- (ii) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
 - (a) Taxes are paid for 10 months only.
 - (b) Creditors worth ₹ 780 have accepted bills payables.
 - (c) Depreciate furniture by 10%.
 - (d) Trucks were depreciated to the extent of ₹ 21,000.
 - (e) Wages includes ₹ 2,000 for the making of Furniture.
 - (f) Closing Stock is of ₹ 20,000.
 - (g) Provide for Manager's Commission at 10% on the Net Profit before charging such commission.
 - (h) Land was acquired on 1st April, 2016 by paying a claim at 50% less than market value to the owner.
- (iii) Name the accounting principles which will be followed while treating the adjustment (a), (c) and (e) above?
(Correct total of Trial Balance ₹ 2,83,620)

Key Terms Introduced in the Chapter

- | | |
|---------------------------------|-------------------------------------|
| • Outstanding /Accrued expenses | • Prepaid/Unexpired expenses |
| • Accrued Incomes | • Income received in advance |
| • Depreciation | • Bad Debts |
| • Provision for doubtful debts | • Provision for discount on debtors |
| • Managers Commission | • Interest on Capital |

Summary with Reference to Learning Objectives

1. *Need for adjustments* : For the preparation of financial statements, it is necessary that all the adjustments arising out of the accrual basis of accounting are made at the end of the accounting period. Another important consideration in the preparation of final accounts with adjustments, is the distinction between capital and revenue items. Entries which are recorded to give effect to these adjustments are known as adjusting entries.
2. *Outstanding expenses* : At the end of the accounting period sometimes a business enterprises is left with some unpaid expenses due to one reason or another. Such expenses are termed as outstanding expenses.

3. *Prepaid expenses* : At the end of the accounting year, it is found that the benefits of some expenses have not been fully received; a portion of total benefits would be received in the next accounting year. That portion of the expense, the benefit of which will be received during the next accounting period is known as 'prepaid expenses'.
4. *Accrued Income* : These are certain items is received by a business enterprise but the whole amount of it does not belong to the next period. Such portion of income which belongs to the next accounting period is income received in advance and is known as "unearned income".
5. *Depreciation* : Depreciation is the decline in the value of an asset an account of wear and tear or passage of time or with. It actually amounts to writing off a portion of the cost of an asset which has been used in the business for the purpose of earning profits. In the balance sheet, the asset is shown at loss minus the amount of depreciation.
6. *Provisions for bad and doubtful debts* : It is a normal feature of business operations that some debts prove irrecoverable which means that the amount to the realised from them becomes had to view of this. An attempt is made to bring in a certain element of certainty in the amount in respect of bad debts charged every year against incomes.

Questions for Practice

Short Answers

1. Why is it necessary to record the adjusting entries in the preparation of final accounts?
2. What is meant by closing stock? Show its treatment in final accounts?
3. State the meaning of:
 - (a) Outstanding expenses
 - (b) Prepaid expenses
 - (c) Income received in advance
 - (d) Accrued income
4. Give the Performa of income statement and balance in vertical form.
5. Why is it necessary to create a provision for doubtful debts at the time of preparation of final accounts?
6. What adjusting entries would you record for the following :
 - (a) Depreciation
 - (b) Discount on debtors
 - (c) Interest on capital
 - (d) Manager's commission
7. What is meant by provision for discount on debtors?
8. Give the journal entries for the following adjustments :
 - (a) Outstanding salary ₹ 3,500.
 - (b) Rent unpaid for one month at ₹ 6,000 per annum.
 - (c) Insurance prepaid for a quarter at ₹ 16,000 per annum.
 - (d) Purchase of furniture costing ₹ 7,000 entered in the purchases book.

Long Answers

1. What are adjusting entries? Why are they necessary for preparing final accounts?
2. What is meant by provision for doubtful debts? How are the relevant accounts prepared and what journal entries are recorded in final accounts? How is the amount for provision for doubtful debts calculated?
3. Show the treatment of prepaid expenses depreciation, closing stock at the time of preparation of final accounts when:
 - (a) When given inside the trial balance?
 - (b) When given outside the trial balance?

Numerical Questions

1. Prepare a trading and profit and loss account for the year ending March 31, 2017. from the balances extracted of M/s Rahul Sons. Also prepare a balance sheet at the end of the year.

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Stock	50,000	Sales	1,80,000
Wages	3,000	Purchases return	2,000
Salary	8,000	Discount received	500
Purchases	1,75,000	Provision for doubtful debts	2,500
Sales return	3,000	Capital	3,00,000
Sundry Debtors	82,000	Bills payable	22,000
Discount allowed	1,000	Commission received	4,000
Insurance	3,200	Rent	6,000
Rent Rates and Taxes	4,300	Loan	34,800
Fixtures and fittings	20,000		
Trade expenses	1,500		
Bad debts	2,000		
Drawings	32,000		
Repair and renewals	1,600		
Travelling expenses	4,200		
Postage	300		
Telegram expenses	200		
Legal fees	500		
Bills receivable	50,000		
Building	1,10,000		
	5,51,800		5,51,800

Adjustments

1. Commission received in advance ₹1,000.
2. Rent receivable ₹ 2,000.
3. Salary outstanding ₹ 1,000 and insurance prepaid ₹ 800.

4. Further bad debts ₹ 1,000 and provision for doubtful debts @ 5% on debtors and discount on debtors @ 2%.
5. Closing stock ₹ 32,000.
6. Depreciation on building @ 6% p.a.

(Ans : Gross loss ₹17,000 ; Net loss ₹43,189 ; Total balance sheet ₹2,83,611)

2. Prepare a trading and profit and loss account of M/s Green Club Ltd. for the year ending March 31, 2017. from the following figures taken from his trial balance :

Account Title	Amount ₹	Account Title	Amount ₹
Opening stock	35,000	Sales	2,50,000
Purchases	1,25,000	Purchase return	6,000
Return inwards	25,000	Creditors	10,000
Postage and Telegram	600	Bills payable	20,000
Salary	12,300	Discount	1,000
Wages	3,000	Provision for bad debts	4,500
Rent and Rates	1,000	Interest received	5,400
Packing and Transport	500	Capital	75,000
General expense	400		
Insurance	4,000		
Debtors	50,000		
Cash in hand	20,000		
Cash at bank	40,000		
Machinery	20,000		
Lighting and Heating	5,000		
Discount	3,500		
Bad debts	3,500		
Investment	23,100		
	3,71,900		3,71,900

Adjustments

1. Depreciation charged on machinery @ 5% p.a.
2. Further bad debts ₹1,500, discount on debtors @ 5% and make a provision on debtors @ 6%.
3. Wages prepaid ₹1,000.
4. Interest on investment @ 5% p.a.
5. Closing stock 10,000.

(Ans. : Gross Profit ₹79,000 ; Net Profit ₹52,565 ; Total Balance Sheet ₹1,57,565).

3. The following balances has been extracted from the trial of M/s Runway Shine Ltd. Prepare a trading and profit and loss account and a balance sheet as on March 31, 2017.

Account Title	Amount ₹	Account Title	Amount ₹
Purchases	1,50,000	Sales	2,50,000
Opening stock	50,000	Return outwards	4,500
Return inwards	2,000	Interest received	3,500
Carriage inwards	4,500	Discount received	400
Cash in hand	77,800	Creditors	1,25,000
Cash at bank	60,800	Bill payable	6,040
Wages	2,400	Capital	1,00,000
Printing and Stationery	4,500		
Discount	400		
Bad debts	1,500		
Insurance	2,500		
Investment	32,000		
Debtors	53,000		
Bills receivable	20,000		
Postage and Telegraph	400		
Commission	200		
Interest	1,000		
Repair	440		
Lighting Charges	500		
Telephone charges	100		
Carriage outward	400		
Motor car	25,000		
	4,89,440		4,89,440

Adjustments

1. Further bad debts ₹ 1,000. Discount on debtors ₹ 500 and make a provision on debtors @ 5%.
 2. Interest received on investment @ 5%.
 3. Wages and interest outstanding ₹ 100 and ₹ 200 respectively.
 4. Depreciation charged on motor car @ 5% p.a.
 5. Closing Stock ₹ 32,500.
- (Ans. : Gross profit ₹ 78,000 ; Net profit ₹ 66,010, Total balance sheet ₹ 2,97,350).

4. From the following Trial Balance you are required to prepare trading and profit and loss account for the year ending March 31, 2017 and Balance Sheet on that date.

Particulars	Amount ₹	Particulars	Amount ₹
Opening stock	25,000	Sales	7,00,000
Furniture	16,000	Creditors	72,500
Purchases	5,55,300	Bank Overdraft	50,000
Carriage Inwards	4,700	Provision for bad and doubtful debts	2,100
Bad debts	1,800	Discount	500
Wages	52,000	Capital	2,00,000
Debtors	80,000	Purchases Return	20,000
Sales Return	15,000		
Rent	24,000		
Miscellaneous Expenses	3,400		
Salaries	68,000		
Cash	8,900		
Drawings	14,000		
Buildings	1,60,000		
Advertising	10,000		
Interest on Bank Overdraft	7,000		
	10,45,100		10,45,100

Adjustments

1. Closing stock valued at ₹ 36,000.
 2. Private purchases amounting to ₹ 5000 debited to purchases account.
 3. Provision for doubtful debts @ 5% on debtors.
 4. Sign board costing ₹ 4,000 includes in advertising.
 5. Depreciate furniture by 10%.
- (Ans : Gross Profit ₹1,09,000; Net loss ₹ 4,600; Total balance sheet ₹2,98,900).

5. From the following information prepare trading and profit and loss account of M/s Indian sports house for the year ending March 31, 2017.

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Drawings	20,000	Capital	2,00,000
Sundry debtors	80,000	Return outwards	2,000
Bad debts	1,000	Bank overdraft	12,000
Trade Expenses	2,400	Provision for bad debts	4,000
Printing and Stationery	2,000	Sundry creditors	60,000
Rent Rates and Taxes	5,000	Bills payable	15,400
Feright	4,000	Sales	2,76,000
Return inwards	7,000		
Opening stock	25,000		
Purchases	1,80,000		
Furniture and Fixture	20,000		
Plant and Machinery	1,00,000		
Bills receivable	14,000		
Wages	10,000		
Cash in hand	6,000		
Discount allowed	2,000		
Investments	40,000		
Motor car	51,000		
	5,69,400		5,69,400

Adjustments

1. Closing stock was ₹45,000.
 2. Provision for doubtful debts is to be maintained @ 2% on debtors.
 3. Depreciation charged on : furniture and fixture @ 5%, plant and Machinery @ 6% and motor car @ 10%.
 4. A Machine of ₹30,000 was purchased on October 01, 2016.
 5. The manager is entitle to a commission of @ 10% of the net profit after charging such commission.
- (Ans. : Gross profit ₹1,01,000 ; Net profit ₹68,909 ; Total balance sheet ₹ 3,43,200 ; Manager's commission ₹6,891).

6. Prepare the trading and profit and loss account and a balance sheet of M/s Shine Ltd. from the following particulars.

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Sundry debtors	1,00,000	Bills payable	85,550
Bad debts	3,000	Sundry creditors	25,000
Trade expenses	2,500	Provision for bad debts	1,500
Printing and Stationary	5,000	Return outwards	4,500
Rent, Rates and Taxes	3,450	Capital	2,50,000
Freight	2,250	Discount received	3,500
Sales return	6,000	Interest received	11,260
Motor car	25,000	Sales	1,00,000
Opening stock	75,550		
Furniture and Fixture	15,500		
Purchases	75,000		
Drawings	13,560		
Investments	65,500		
Cash in hand	36,000		
Cash in bank	53,000		
	4,81,310		4,81,310

Adjustments

1. Closing stock was valued ₹ 35,000.
 2. Depreciation charged on furniture and fixture @ 5%.
 3. Further bad debts ₹ 1,000. Make a provision for bad debts @ 5% on sundry debtors.
 4. Depreciation charged on motor car @ 10%.
 5. Interest on drawing @ 6%.
 6. Rent, rates and taxes was outstanding ₹200.
 7. Discount on debtors 2%.
- (Ans. : Gross loss Rs,17,050 ; Net loss ₹27,482 ; Total balance sheet ₹ 3,18,894).

7. Following balances have been extracted from the trial balance of M/s Keshav Electronics Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as on March 31, 2017.

Account Title	Amount ₹	Account Title	Amount ₹
Opening stock	2,26,000	Sales	6,80,000
Purchases	4,40,000	Return outwards	15,000
Drawings	75,000	Creditors	50,000
Buildings	1,00,000	Bills payable	63,700
Motor van	30,000	Interest received	20,000
Freight inwards	3,400	Capital	3,50,000
Sales return	10,000		
Trade expense	3,300		
Heat and Power	8,000		
Salary and Wages	5,000		
Legal expense	3,000		
Postage and Telegram	1,000		
Bad debts	6,500		
Cash in hand	79,000		
Cash at bank	98,000		
Sundry debtors	25,000		
Investments	40,000		
Insurance	3,500		
Machinery	22,000		
	11,78,700		11,78,700

The following additional information is available :

1. Stock on March 31, 2017 was ₹ 30,000.
 2. Depreciation is to be charged on building at 5% and motor van at 10%.
 3. Provision for doubtful debts is to be maintained at 5% on Sundry Debtors.
 4. Unexpired insurance was ₹ 600.
 5. The Manager is entitled to a commission @ 5% on net profit after charging such commission.
- (Ans. : Gross profit ₹,37,600 ; Net profit ₹ 25,381 ; Total balance sheet ₹4,15,350 ; Manager's commission ₹1,269).

8. From the following balances extracted from the books of Raga Ltd. prepare a trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date.

Account Title	Amount ₹	Account Title	Amount ₹
Drawings	20,000	Sales	2,20,000
Land and Buildings	12,000	Capital	1,01,110
Plant and Machinery	40,000	Discount	1,260
Carriage inwards	100	Apprentice premium	5,230
Wages	500	Bills payable	1,28,870
Salary	2,000	Purchases return	10,000
Sales return	200		
Bank charges	200		
Coal, Gas and Water	1,200		
purchases	1,50,000		
Trade Expenses	3,800		
Stock (Opening)	76,800		
Cash at bank	50,000		
Rates and Taxes	870		
Bills receivable	24,500		
Sundry debtors	54,300		
Cash in hand	30,000		
	4,66,470		4,66,470

The additional information is as under :

1. Closing stock was valued at the end of the year ₹, 20,000.
2. Depreciation on plant and machinery charged at 5% and land and building at 10%.
3. Discount on debtors at 3%.
4. Make a provision at 5% on debtors for doubtful debts.
5. Salary outstanding was ₹100 and Wages prepaid was ₹ 40.
6. The manager is entitled a commission of 5% on net profit after charging such commission.

(Ans. : Gross profit ₹,21,240 ; Net profit ₹12,664 ; Total balance sheet ₹ 2,23,377 ; Manager's commission ₹633).

9. From the following balances of M/s Jyoti Exports, prepare trading and profit and loss account for the year ended March 31, 2017 and balance sheet as on this date.

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Account Title</i>	<i>Credit Amount ₹</i>
Sundry debtors	9,600	Sundry creditors	2,500
Opening stock	22,800	Sales	72,670
Purchases	34,800	Purchases returns	2,430
Carriage inwards	450	Bills payable	15,600
Wages	1,770	Capital	42,000
Office rent	820		
Insurance	1,440		
Factory rent	390		
Cleaning charges	940		
Salary	1,590		
Building	24,000		
Plant and Machinery	3,600		
Cash in hand	2,160		
Gas and Water	240		
Octroi	60		
Furniture	20,540		
Patents	10,000		
	1,35,200		1,35,200

Closing stock ₹10,000.

1. To provision for doubtful debts is to be maintained at 5 per cent on sundry debtors.
2. Wages amounting to ₹ 500 and salary amounting to ₹ 350 are outstanding.
3. Factory rent prepaid ₹ 100.
4. Depreciation charged on Plant and Machinery @ 5% and Building @ 10%.
5. Outstanding insurance ₹100.

(Ans : Gross profit ₹23,250 ; Net profit ₹15,895 ; Total balance Sheet ₹ 76,945).

10. The following balances have been extracted from the books of M/s Green House for the year ended March 31, 2017, prepare trading and profit and loss account and balance sheet as on this date.

<i>Account Title</i>	<i>Amount ₹</i>	<i>Account Title</i>	<i>Amount ₹</i>
Purchases	80,000	Capital	2,10,000
Bank balance	11,000	Bills payable	6,500
Wages	34,000	Sales	2,00,000
Debtors	70,300	Creditors	50,000
Cash in hand	1,200	Return outwards	4,000
Legal expenses	4,000		
Building	60,000		
Machinery	120,000		
Bills receivable	7,000		
Office expenses	3,000		
Opening stock	45,000		
Gas and fuel	2,700		
Freight and Carriage	3,500		
Factory lighting	5,000		
Office furniture	5,000		
Patent right	18,800		
	4,70,500		4,70,500

Adjustments :

- Machinery is depreciated at 10% and buildings depreciated at 6%.
- Interest on capital @ 4%.
- Outstanding wages ₹ 50.
- Closing stock ₹ 50,000.

(Ans : Gross profit ₹ 83,750 ; Net Profit ₹ 52,750 ; Total balance sheet ₹ 3,27,700).

11. From the following balances extracted from the book of M/s Manju Chawla on March 31, 2017. You are requested to prepare the trading and profit and loss account and a balance sheet as on this date.

Account Title	Amount ₹	Amount ₹
Opening stock	10,000	
Purchases and Sales	40,000	80,000
Returns	200	600
Wages	6,000	
Dock and cleaning charges	4,000	
Lighting	500	
Misc. Income		6,000
Rent		2,000
Capital		40,000
Drawings	2,000	
Debtors and Creditors	6,000	7,000
Cash	3,000	
Investment	6,000	
Patent	4,000	
Land and Machinery	43,000	
Donations and Charity	600	
Sales tax collected		1,000
Furniture	11,300	
	1,36,600	1,36,600

Closing stock was ₹ 2,000.

- Interest on drawings @ 7% and interest on capital @ 5%.
- Land and Machinery is depreciated at 5%.
- Interest on investment @ 6%.
- Unexpired rent ₹100.
- Charge 5% depreciation on furniture.

(Ans. : Gross profit ₹ 21,900 ; Net profit ₹ 25,185 ; Total balance sheet ₹ 71,185).

12. The following balances were extracted from the books of M/s Panchsheel Garments on March 31, 2017.

<i>Account Title</i>	<i>Debit Amount ₹</i>	<i>Account Title</i>	<i>Credit Amount ₹</i>
Opening stock	16,000	Sales	1,12,000
Purchases	67,600	Return outwards	3,200
Return Inwards	4,600	Discount	1,400
Carriage inwards	1,400	Bank overdraft	10,000
General expenses	2,400	Commission	1,800
Insurance	4,000	Creditors	16,000
Scooter expenses	200	Capital	50,000
Salary	8,800		
Cash in hand	4,000		
Scooter	8,000		
Furniture	5,200		
Buildings	65,000		
Debtors	6,000		
Wages	1,200		
	<u>1,94,400</u>		<u>1,94,400</u>

Prepare the trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date.

- Unexpired insurance ₹ 1,000.
- Salary due but not paid ₹ 1800.
- Wages outstanding ₹ 200.
- Interest on capital 5%.
- Scooter is depreciated @ 5%.
- Furniture is depreciated @ 10%.
- Closing stock was ₹ 15,000.

(Ans.: Gross profit ₹ 39,200 ; Net profit ₹ 22,780 ; Total balance sheet ₹ 1,03,280).

13. Prepare the trading and profit and loss account and balance sheet of M/s Control Device India on March 31, 2017 from the following balance as on that date.

Account Title	Debit Amount ₹	Credit Amount ₹
Drawings and Capital	19,530	67,500
Purchase and Sales	45,000	1,12,500
Salary and Commission	25,470	1,575
Carriage	2,700	
Plant and Machinery	27,000	
Furniture	6,750	
Opening stock	42,300	
Insurance premium	2,700	
Interest		7,425
Bank overdraft		24,660
Rent and Taxes	2,160	
Wages	11,215	
Returns	2,385	1,440
Carriage outwards	1,485	
Debtors and Creditors	36,000	58,500
General expenses	6,975	
Octroi	530	
Investment	41,400	
	2,73,600	2,73,600

Closing stock was valued ₹ 20,000.

- Interest on capital @ 10%.
- Interest on drawings @ 5%.
- Wages outstanding ₹ 50.
- Outstanding salary ₹ 20.
- Provide a depreciation @ 5% on plant and machinery.
- Make a 5% provision on debtors.

(Ans.: Gross profit ₹ 29,760 ; Net loss ₹ 8,973 ; Total balance sheet ₹1,28,000)

14. The following balances appeared in the trial balance of M/s Kapil Traders as on March 31, 2017

	₹
Sundry debtors	30,500
Bad debts	500
Provision for doubtful debts	2,000

The partners of the firm agreed to records the following adjustments in the books of the Firm: Further bad debts ₹300. Maintain provision for bad debts 10%. Show the following adjustments in the bad debts account, provision account, debtors account, profit and loss account and balance sheet.

(Ans : Dr. Profit and Loss account ₹1,820)

15. Prepare the bad debts account, provision for account, profit and loss account and balance sheet from the following information as on March 31, 2017

	₹
Debtors	80,000
Bad debts	2,000
Provision for doubtful debts	5,000

Adjustments :

Bad debts ₹500 Provision on debtors @ 3%.

(Ans : Credit Profit and Loss account ₹115)

Checklist to Test Your Understanding

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



11112CH11

Accounts from Incomplete Records

We have so far studied accounting records of firms, which follow the double entry system of book keeping. This gives us an impression that all business units follow this system. However, in practice, all firms do not maintain accounting records strictly as per the double entry system. Many small size enterprises keep incomplete records of their transactions. But, they also have to ascertain the profit or loss for the year and the financial position of the firm as at the end of the year. This chapter deals with the ascertainment of profit or loss and financial position of the firm that have not been maintaining records as per double entry book-keeping or whose records are otherwise incomplete.

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- *state the meaning and features of incomplete records;*
- *calculate profit or loss using the statement of affairs method;*
- *distinguish between balance sheet and statement of affairs;*
- *prepare trading and profit and loss account and balance sheet from incomplete records; and*
- *detect the missing figures/information by preparing relevant accounts.*

11.1 Meaning of Incomplete Records

Accounting records, which are not strictly kept according to double entry system are known as incomplete records. Many authors describe it as single entry system. However, single entry system is a misnomer because there is no such system of maintaining accounting records. It is also not a 'short cut' method as an alternative to double entry system. It is rather a mechanism of maintaining records whereby some transactions are recorded with proper debits and credits while in case of others, either one sided or no entry is made. Normally, under this system records of cash and personal accounts of debtors and creditors are properly maintained, while the information relating to assets, liabilities, expenses and revenues is partially recorded. Hence, these are usually referred as incomplete records.

11.1.1 Features of Incomplete Records

Incomplete records may be due to partial recording of transactions as is the case with small shopkeepers such as grocers and vendors. In case of large sized organisations, the accounting records may be rendered to the state of incompleteness due to natural calamity, theft or fire. The features of incomplete records are as under :

- (a) It is an unsystematic method of recording transactions.
- (b) Generally, records for cash transactions and personal accounts are properly maintained and there is no information regarding revenue and/or gains, expenses and/or losses, assets and liabilities.
- (c) Personal transactions of owners may also be recorded in the cash book.
- (d) Different organisations maintain records according to their convenience and needs, and their accounts are not comparable due to lack of uniformity.
- (e) To ascertain profit or loss or for obtaining any other information, necessary figures can be collected only from the original vouchers such as sales invoice or purchase invoice, etc. Thus, dependence on original vouchers is inevitable.
- (f) The profit or loss for the year cannot be ascertained under this system with high degree of accuracy as only an estimate of the profit earned or loss incurred can be made. The balance sheet also may not reflect the complete and true position of assets and liabilities.

11.2 Reasons of Incompleteness and Its Limitations

It is observed, that many businessmen keep incomplete records because of the following reasons :

- (a) This system can be adopted by people who do not have the proper knowledge of accounting principles;
- (b) It is an inexpensive mode of maintaining records. Cost involved is low as specialised accountants are not appointed by the organisations;
- (c) Time consumed in maintaining records is less as only a few books are maintained; and
- (d) It is a convenient mode of maintaining records as the owner may record only important transactions according to the need of the business.

However, the mechanism of incomplete records suffers from a number of limitations. This is due to the basic nature of this mechanism. Broadly speaking, unless a systematic approach to maintenance of records is followed, reliable financial statements cannot be prepared.

The limitations of incomplete records are as follows :

- (a) As double entry system is not followed, a trial balance cannot be prepared and accuracy of accounts cannot be ensured.
- (b) Correct ascertainment and evaluation of financial result of business operations can not be made.
- (c) Analysis of profitability, liquidity and solvency of the business cannot be done. This may cause a problem in raising funds from outsiders and planning future business activities.
- (d) The owners face great difficulty in filing an insurance claim with an insurance company in case of loss of inventory by fire or theft.
- (e) It becomes difficult to convince the income tax authorities about the reliability of the computed income.

11.3 Ascertainment of Profit or Loss

Every business firm wishes to ascertain the results of its operations to assess its efficiency and success and failures. This gives rise to the need for preparing the financial statements to disclose:

- (a) the profit made or loss sustained by the firm during a given period; and
- (b) the amount of assets and liabilities as at the closing date of the accounting period.

Therefore, the problem faced in this situation is how to use the available information in the incomplete records to ascertain the profit or loss for the particular accounting year and to determine the financial position of a entity as at the end of the year. This can be done in two ways :

1. Preparing the Statement of Affairs as at the beginning and as at the end of the accounting period, called statement of affairs or net worth method.
2. Preparing Trading and Profit and Loss Account and the Balance Sheet by putting the accounting records in proper order, called conversion method.

11.3.1 Preparing Statement of Affairs

Under this method, statement of asset and liabilities as at the beginning and at the end of the relevant accounting period are prepared to ascertain the amount of change in the capital during the period. Such a statement is known as statement of affairs, shows assets on one side and the liabilities on the other just as in case of a balance sheet. The difference between the totals of the two sides (balancing figure) is the capital (refer figure 11.1). Though statement of affairs resembles balance sheet, it is not called a balance sheet because the data is not wholly based on ledger balances. The amount of items like fixed assets, outstanding expenses, bank balances, etc. are ascertained from the relevant documents and physical count.

Statement of Affairs as at —

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Bills payable	----	Land and Building	----
Creditors	----	Machinery	----
Outstanding expenses	----	Furniture	----
Capital (balancing figure)*	----	Stock	----
		Debtors	----
		Cash and Bank	----
		Prepaid expenses	----
		Capital (balancing figure)*	----
	XXX X		XXXX

*Note: * where the total of liabilities side is more than total of assets side, capital would be shown in assets side and it represents debit balance of capital.*

Fig. 11.1 : Format of statement of affairs

Once the amount of capital, both at the beginning and at the end is computed with the help of statement of affairs, a *statement of profit and loss* is prepared to ascertain the exact amount of profit or loss made during the year. The difference between the opening and closing capital represents its increase or decrease which is to be adjusted for withdrawals made by the owner or any fresh capital introduced by him during the accounting period in order to arrive at the amount of profit or loss made during the period. The statement of profit and loss is prepared as shown in figure 11.2.

Statement of Profit or Loss for the year ended

	<i>Particulars</i>	<i>Amount ₹</i>
	Capital as at the end of year (computed from statement of affairs as at the end of year)	....
<i>Add</i>	Drawings during the year	....
<i>Less</i>	Additional capital introduced during the year	(....)
	Adjusted capital at the end of year	....
<i>Less</i>	Capital as at the beginning of year (computed from statement of affairs as at the beginning of year)	(....)
	Profit or Loss made during the year	....

Fig. 11.2 : Format of statement of profit or loss

If the net result of above computation is a positive amount, it represents the profit earned during the year. In case the net result is a negative amount, it would represent the loss sustained during the year. The same computation can be done in the form of an equation as follows :

$$\text{Profit or Loss} = \text{Capital at end} - \text{Capital at beginning} + \text{Drawings during the year} - \text{Capital introduced during the year.}$$

For example, consider the following information extracted from the records of Ms. Sheetu :

	₹
Capital at the beginning of year, i.e. April 01, 2016	1,20,000
Capital at the end of year, i.e. on March 31, 2017	2,00,000
Capital brought in by the proprietor during the year	50,000
Withdrawals by the proprietor during the year	30,000

The profit for the year will be calculated as follows :

The profit earned or loss incurred during a given period will be computed as follows :

	Particulars	Amount ₹
	Capital as on March 31, 2017	2,00,000
Add	Drawings during the year	30,000
		2,30,000
Less	Additional capital introduced during the year	(50,000)
	Adjusted capital at the end, i.e. March 31, 2017	1,80,000
Less	Capital in the beginning, i.e. April 01, 2016	(1,20,000)
	Profit made during the year	60,000

Illustration 1

Mr. Mehta started his readymade garments business on April 1, 2016 with a capital of ₹ 50,000. He did not maintain his books according to double entry system. During the year he introduced fresh capital of ₹ 15,000. He withdrew ₹ 10,000 for personal use. On March 31, 2017, his assets and liabilities were as follows :

Total creditors ₹ 90,000 ; Total debtors ₹ 1,25,600 ; Stock ₹ 24,750 ; Cash at bank ₹ 24,980.

Calculate profit or loss made by Mr. Mehta during the first year of his business using the statement of affairs method.

Solution

Books of Mr. Mehta Statement of Affairs as on March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	90,000	Cash at bank	24,980
Capital	85,330	Debtors	1,25,600
(balancing figure)		Stock	24,750
	1,75,330		1,75,330

Statement of Profit or Loss for the year ended March 31, 2017

<i>Particulars</i>		<i>Amount ₹</i>
<i>Add</i>	Capital as on March 31, 2017	85,330
	Drawings during the year	<u>10,000</u>
		95,330
<i>Less</i>	Additional capital introduced during the year	<u>(15,000)</u>
	Adjusted capital at end of the year, i.e. March 31, 2017	80,330
<i>Less</i>	Actual capital at the beginning of year, i.e. April 01, 2016	<u>(50,000)</u>
	Profit made during the year	<u>30,330</u>

Illustration 2

Mrs. Vandana runs a small printing firm. She was maintaining only some records, which she thought, were sufficient to run the business. On April 01, 2016, available information from her records indicated that she had the following assets and liabilities: Printing Press ₹ 5,00,000, Buildings ₹ 2,00,000, Stock ₹ 50,000, Cash at bank ₹ 65,600, Cash in hand ₹ 7,980, Dues from customers ₹ 20,350, Dues to creditors ₹ 75,340 and Outstanding wages ₹ 5,000. She withdrew ₹ 8,000 every month for meeting her personal expenses. She had also introduced ₹ 15,000 during the year as additional capital. On March 31, 2017 her position was as follows :

Press ₹ 5,25,000, Buildings ₹ 2,00,000, Stock ₹ 55,000, Cash at bank ₹ 40,380, Cash in hand ₹ 15,340, Dues from customers ₹ 17,210, Dues to creditors ₹ 65,680.

Calculate the profit made by Mrs. Vandana during the year using statement of affairs method.

Solution

Books of Mrs. Vandana
Statement of Affairs as on April 1, 2016
and as on March 31, 2017

<i>Liabilities</i>	<i>Apr. 01, 16 ₹</i>	<i>Mar. 31, 17 ₹</i>	<i>Assets</i>	<i>Apr. 01, 16 ₹</i>	<i>Mar. 31, 17 ₹</i>
Creditors	75,340	65,680	Printing press	5,00,000	5,25,000
Wages outstanding	5,000	–	Buildings	2,00,000	2,00,000
Capital	7,63,590	7,87,250	Debtors	20,350	17,210
(balancing figure)			Stock	50,000	55,000
			Cash at bank	65,600	40,380
			Cash in hand	7,980	15,340
	8,43,930	8,52,930		8,43,930	8,52,930

Statement of Profit or Loss for the year ended on March 31, 2017

<i>Particulars</i>		<i>Amount</i> ₹
<i>Add</i>	Capital as on March 31, 2017	7,87,250
	Drawings during the year	<u>96,000</u>
		8,83,250
<i>Less</i>	Additional capital introduced during the year	<u>(15,000)</u>
	Adjusted capital at the end of the year (31. 3. 2017)	8,68,250
<i>Less</i>	Capital as on April 01, 2016	<u>(7,63,590)</u>
	Profit made during the year	<u>1,04,660</u>

11.3.2 Difference between Statement of Affairs and Balance Sheet

Both statement of affairs and balance sheet show the assets and liabilities of a business entity on a particular date. However, there are some fundamental differences between the two. A statement of affairs is prepared from incomplete records where most of the assets are recorded on the basis of estimates as compared to a balance sheet which is prepared from records maintained on the basis of double entry book-keeping and all assets and liabilities can be verified from the ledger accounts. Hence, a balance sheet is more reliable than a statement of affairs. The objective of preparing a statement of affairs is to ascertain the amount of capital account as on that date whereas a balance sheet is prepared to know the financial position of the business at a particular date. In statement of affairs, an item of assets or liabilities may get omitted and this omission may remain unknown because the effect of this omission gets adjusted in the capital account balance and the total of both sides of statement match. However, in case of a balance sheet the possibility of omission of any item is remote because in case of an omission, the balance sheet will not agree and the accountant will trace the missing item from accounting records. These differences have been shown in a tabular form as under :

<i>Basis of difference</i>	<i>Statement of affairs</i>	<i>Balance sheet</i>
Reliability	It is less reliable as it is prepared from incomplete records.	It is more reliable as it is prepared from double entry records.
Objective	The objective of preparing statement of affairs is to estimate the balance in capital account on a particular date.	The objective of preparing balance sheet is to show the true financial position of an entity on a particular date.
Omission	Omission of assets or liabilities cannot be discovered easily.	Omissions of assets or liabilities can be discovered easily and can be traced from accounting records.

Fig. 11.3 : Showing comparison between statement of affairs and balance sheet

Do It Yourself

Identify a small shopkeeper in your locality, ask him about the accounting records maintained by him. If he is not maintaining the records as per double entry system, list the reasons thereof and ask him how does he compute profit or loss.

11.4 Preparing Trading and Profit and Loss Account and the Balance Sheet

To prepare proper trading and profit and loss account and the balance sheet one needs complete information regarding expenses, incomes, assets and liabilities. In case of incomplete records, details of some items like creditors, cash purchases, debtors, cash sales, other cash payments and such receipts are easily available, but there are a number of items the details of which will have to be ascertained in an indirect manner by using the logic of double entry. The most common items that are missing and have to be worked out as such are :

- Opening capital
- Credit purchases
- Credit sales
- Bills payable accepted
- Bills receivable received
- Payments to creditors
- Payments to debtors
- Any other cash/bank related items.

You know that opening capital can be worked out by preparing the statement of affairs at the beginning of the year. For other items we have explained as to how available information can be used to ascertain their missing figures with the help of total debtors and total creditors, total bills receivable and total bills payable accounts and summary of cash.

11.4.1 Ascertaining Credit Purchases

The credit purchases figure is not usually available from the incomplete records. It is quite possible that some other information related to creditors may also be missing. Therefore, by preparing the total creditors account, a proforma of which is given in figure 11.4, credit purchases or any other missing figure related to creditors, as the case may be, can be ascertained as the balancing figure.

Total Creditors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash paid		....		Balance b/d		....
	Bank		....		Bank (cheques dishonoured)		....
	(cheques issued)				Bills payable		....
	Bills payable		....		(bills dishonoured)		....
	(bills accepted)				Credit purchases		....
	Discount received		....			
	Purchases return		....			
	Balance c/d		....			
			XXXXXXX				XXXXXXX

Fig. 11.4 : Showing format of creditors account

For example, consider the following transactions relating to M/s Kisan Food Suppliers:

	₹
Opening balance of creditors	40,000
Closing balance of creditors	50,000
Payment made in cash	85,000
Discount received	2,000

The total creditors account will be prepared as follows :

**Books of Kisan
Food Suppliers
Total Creditors Account**

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash		85,000		Balance b/d		40,000
	Discount		2,000		Credit purchases		97,000
					(balancing figure)		
	Balance c/d		50,000				
			1,37,000				1,37,000

11.4.2 Ascertainment of Credit Sales

The figure of credit sales is also not usually available from incomplete records. Some other information on related to debtors may also be missing. Therefore, if the total debtors account is prepared as shown in figure 11.5, credit sales or any other missing figure, as the case may be, can be traced out as the balancing figure.

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

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		....		Cash (cash received)		....
	Bills receivable (bills dishonoured)		....		Bank (cheque received)		....
	Bank (cheque dishonoured)		....		Discount allowed		....
	Credit sales (balancing figure)		....		Bad debts		....
					Sales return		....
					Bills receivable (bills received)		....
					Balance c/d		....
			XXX				XXX

Fig. 11.5 : Showing format of debtors account

From the credit sales as ascertained from total debtors account, the sales returns should be deducted from gross credit sales to get net credit sales. For example, the following information is obtained from the books of Mohanlal Traders :

	₹
Debtors on April 01, 2016	50,000
Debtors on March 31, 2017	70,000
Cash received from debtors	60,000
Discount allowed	1,000
Bills receivable	30,000
Bad debts	3,000

The total debtors account will be prepared as follows :

Mohan Lal Traders
Total Debtors Account

Dr.**Cr.**

Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
2016 Apr. 01	Balance b/d		50,000		Cash		60,000
	Credit sales		1,14,000		Discount		1,000
	(balancing figure)				Bills receivable		30,000
				2017 Mar. 31	Bad debts		3,000
					Balance c/d		70,000
			1,64,000				1,64,000

11.4.3 Ascertainment of Bills Receivable and Bills payable

Quite often, while all details relating to bills receivable and bills payable are available but the figures of the bills received and bills accepted during the year are not given. In such a situation, total bills receivable account and total bills payable account can be prepared and the missing figures ascertained as the balancing figures. The proforma of total bills receivable account and total bills payable account is shown in figure 11.6 and figure 11.7.

Total Bills Receivable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		....		Bank (bills honoured)		....
	Sundry debtors (bills received)		....		Sundry debtors (bills dishonoured)		....
			xxx		Balance c/d		....
							xxx

Fig. 11.6 : Showing format of bills receivable account

Total Bills Payable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Bank (bills matured)		....		Balance b/d		....
	Sundry creditors (bills dishonoured)		....		Sundry creditors (bills accepted)		....
	Balance c/d		....				xxx
			xxx				

Fig. 11.7 : Showing format of bills payable account

For example consider the following data available from the records of M/s S.S. Senapati

	₹
Opening bills receivable	5,000
Opening bills payable	37,500
Bills receivable dishonoured	2,000
Bills payable dishonoured	66,750
Closing bills payable	52,500
Bills collected during the year	12,000
Closing bills receivable	4,000

The bills receivable and bills payable will be prepared as follows :

Total Bills Receivable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		5,000		Sundry debtors (bills dishonoured)		2,000
	Sundry debtors (bills received) (balancing figure)		13,000		Bank (bills collected)		12,000
					Balance c/d		4,000
			18,000				18,000

Total Bills Payable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Bill dishonoured		66,750		Balance b/d		37,500
	Balance c/d		52,500		Sundry Creditors (bills accepted) (balancing figure)		81,750
			1,19,250				1,19,250

Test Your Understanding - I

Tick the correct answer :

- Incomplete record mechanism of book keeping is :
 (a) Scientific (b) Unscientific
 (c) Unsystematic (d) both (b) and (c)
- Opening capital is ascertained by preparing :
 (a) Total debtors account (b) Total creditors account
 (c) Cash account (d) Opening statement of affairs
- Credit purchase, during the year is ascertained by preparing :
 (a) Total creditors account (b) Total debtors account
 (c) Cash account (d) Opening statement of affairs
- If opening capital is ₹ 60,000, drawings ₹ 5,000, capital introduced during the period ₹ 10,000, closing capital ₹ 90,000. The value of profit earned during the period will be :
 (a) ₹ 20,000 (b) ₹ 25,000
 (c) ₹ 30,000 (d) ₹ 40,000

11.4.4 Ascertainment of Missing Information through Summary of Cash

Sometimes, the amount paid to creditors or the amount received from debtors or the opening or closing cash or bank balance may be missing. To ascertain any missing item of receipt or payment, we may prepare a cash book summary showing all receipts and payments during the year and the balancing figure is taken as the amount of missing item.

If however, both amount paid to creditors and that received from debtors are missing, then any one of these may be obtained first through the total creditors or total debtors account, as the case may be, and the other missing information ascertained from the cash book summary in the same way as stated earlier.

After the missing figures have been traced out, the final accounts may be prepared straight away or after the preparation of the trial balance. The components of the trial balance and their sources of information are summarised below :

1.	Closing assets (except stock) and liabilities	Closing list
2.	Opening assets (including opening stock) and liabilities	Opening list
3.	Purchases	Credit purchases from total creditors account and cash purchases from summary of cash
4.	Sales	Credit sales from total debtors account and cash sales from summary of cash
5.	Opening capital	Opening statement of affairs
6.	Expenses and Revenues	As per cash summary of cash plus subsidiary information
7.	Losses and Gains	From all the accounts and scattered information
8.	Bills receivable received	Total bills receivable account
9.	Bills payable accepted	Total bills payable account
10.	Cash/Bank balance	Summary of cash

Fig. 11.7 : Detecting the missing information

Illustration 3

Compute the amount of total purchases and total sales of Mr. Amit from the following information for the year ending on March 31, 2017.

	Amount ₹
Total debtors as on April 01, 2016	40,000
Total creditors as on April 01, 2016	50,000
Bills receivable as on April 01, 2016	30,000
Bills payable as on April 01, 2016	45,000
Discount received	5,000
Bad debts	2,000
Return inwards	4,000
Discount allowed	3,000

Cash sales	10,000
Cash purchases	8,000
Total debtors as on March 31, 2017	80,000
Cash received from debtors	1,00,000
Cash paid to creditors	80,000
Cash received against bills receivable	25,000
Payment made against bills receivable	40,000
Total creditors as on March 31, 2017	40,000
Bills payable as on March 31, 2017	50,000
Bills receivable as on March 31, 2017	35,000

Solution

Total Bills Receivable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		30,000		Cash		25,000
	Total debtors (balancing figure)		30,000		Balance c/d		35,000
			60,000				60,000

Total Bills Payable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash		40,000		Balance b/d		45,000
	Balance c/d		50,000		Total creditors (balancing figure)		45,000
			90,000				90,000

Total Debtors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		40,000		Bad debts		2,000
	Sales		1,79,000		Return inwards		4,000
	(balancing figure)				Discount allowed		3,000
					Cash		1,00,000
					Bills receivable		30,000
					(Transfer from bills receivable account)		
					Balance c/d		80,000
			2,19,000				2,19,000

Total Creditors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Discount received		5,000		Balance b/d		50,000
	Cash		80,000		Purchases (credit)		1,20,000 ²
	Bills payable (transfer from bills payable account)		45,000		(balancing figure)		
	Balance c/d		40,000				
			1,70,000				1,70,000

Working Notes

- (i) Credit purchases have been computed from total creditors account as ₹ 1,20,000². Cash purchases given are ₹ 8,000. Total purchases will be ₹ 1,20,000 + ₹ 8,000 = ₹ 1,28,000.
- (ii) Credit sales have been computed from total debtors account as ₹ 1,79,000 and cash sales are given as ₹ 10,000. Total sales will be ₹ 1,79,000 + ₹ 10,000 = ₹ 1,89,000.

Illustration 4

From the following information supplied by Ms. Sudha, calculate the amount of 'Net Sales'

	₹
Debtors on April 01, 2016	65,000
Debtors on March 31, 2017	50,000
Opening balance of bills receivable as on April 01, 2016	23,000
Closing balance of bills receivable as on March 31, 2017	29,000
Cash received from debtors	3,02,000
Discount allowed	8,000
Cash received against bills receivable	21,000
Bad debts	14,000
Bill receivables (dishonoured)	20,000
Cash sales	2,25,000
Sales return	17,000

Total Bills Receivable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Opening balance		23,000		Cash (bills honoured)		21,000
	Debtors (Bills receivable) (balancing figure)		47,000		Bills receivable dishonoured		20,000
			70,000		Closing balance		29,000
							70,000

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

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
2016 Apr. 01	Opening balance		65,000		Cash received		3,02,000
	Bills receivable		20,000		Discount allowed		8,000
	(dishonoured)				Sales return		17,000
	Sales (balancing figure)		3,53,000		Bad debts		14,000
					Bills receivable		47,000
					(transferred from bills receivable account)		
				2017 Mar.31	Closing balance		50,000
			4,38,000				4,38,000

(Working Notes)

With the preparation of total debtors account and total bills receivable account, the net sales will be computed as follows :

$$\begin{aligned}
 \text{Net Sales} &= \text{Cash Sales} + \text{Credit Sales} - \text{Sales return} \\
 &= ₹ 2,25,000 + ₹ 3,53,000 - ₹ 1,7000 \\
 &= ₹ 5,61,000
 \end{aligned}$$

Illustration 5

Mr. Om Prakash did not keep his books of accounts under double entry system. From the following information available from his records, prepare profit and loss account for the year ending on March 31, 2017 and a balance sheet as at that date, depreciating the washing equipment @ 10%.

Summary of Cash Book**Dr.****Cr.**

<i>Receipts</i>	<i>Amount ₹</i>	<i>Payments</i>	<i>Amount ₹</i>
Balance b/d	8,000	Cash purchases	14,000
Cash sales	40,000	Paid to creditors	20,000
Received from debtors	30,000	Sundry expenses	6,000
		Cartage	2,000
		Drawings	8,000
		Balance c/d	28,000
	78,000		78,000

Other information :

March 31, 2017

	March 31, 2016 ₹	March 31, 2017 ₹
Debtors	9,000	12,000
Creditors	14,400	6,800
Stock of materials	10,000	16,000
Washing equipment	40,000	40,000
Furniture	3,000	3,000
Discount allowed during the year		1,400
Discount received during the year		1,700

Solution

Books of Om Prakash
Trading and Profit and Loss Account
for the year ended on March 31, 2017

Expenses/losses	Amount ₹	Revenues/gains	Amount ₹
Opening stock	10,000	Sales	74,400
Purchases	28,100	Closing stock	16,000
Cartage	2,000		
Gross profit c/d	50,300		
	90,400		90,400
Sundry expenses	6,000	Gross profit b/d	50,300
Discount allowed	1,400	Discount received	1,700
Depreciation	4,000		
Net profit (transferred to capital account)	40,600		
	52,000		52,000

Balance Sheet as at March 31, 2017

Liabilities	Amount ₹	Assets	Amount ₹
Capital	55,600	Washing equipment	40,000
Add Profit	40,600	Less Depreciation	(4,000)
	96,200		36,000
Less Drawings	(8,000)	Furniture	3,000
Creditors	6,800	Stock of materials	16,000
		Debtors	12,000
		Cash	28,000
	95,000		95,000

Working Notes :

Total Debtors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		9,000		Cash		30,000
	Sales (credit)		34,400		Discount allowed		1,400
	(balancing figure)				Balance c/d		12,000
			43,400				43,400

Total Creditors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash		20,000		Balance b/d		14,400
	Discount received		1,700		Purchases (credit)		14,100
	Balance c/d		6,800		(balancing figure)		
			28,500				28,500

Statement of Affairs as at March 31, 2016

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	14,400	Washing equipment	40,000
Capital	55,600	Furniture	3,000
(balancing figure)		Stock of material	10,000
		Debtors	9,000
		Cash	8,000
	70,000		70,000

Illustration 6

Mrs. Surabhi started business on April 01, 2016 with cash of ₹ 50,000, furniture of ₹ 10,000, goods of 2,000 and machinery worth 20,000. During the year she further introduced ₹ 20,000 in her business by opening a bank account. From the following information extracted from her books, you are required to prepare final accounts for the ended March 31, 2017.

	₹
Receipt from debtors	57,500
Cash sales	45,000
Cash purchases	25,000
Wages paid	5,000
Salaries to staff	17,500
Trade expenses	6,500
Electricity bill of factory	7,500
Drawings of Surabhi	3,000
Cash paid to creditors	42,000
Discount allowed	1,200
Discount received	3,000
Bad debts written-off	1,300
Cash balance at end of year	20,000

Mrs. Surabhi used goods worth 2,500 for private purposes, which is not recorded in the books. Charge depreciation on furniture 10% and machinery 20% p.a. on March 31, 2017 her debtors were worth 70,000 and creditors ₹ 35,000, stock in trade was valued on that date at ₹ 25,000.

Solution

Books of Mrs. Surabhi
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.

Cr.

Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	20,000	Sales	45,000
Purchases :		Credit	1,30,000
Cash	25,000	Closing stock	25,000
Credit	<u>80,000²</u>		
	1,05,000		
Less Goods used for private use	<u>(2,500)</u>		
Wages	5,000		
Electricity bill of factory	7,500		
Gross profit c/d	65,000		
	<u>2,00,000</u>		<u>2,00,000</u>
Salaries	17,500	Gross profit b/d	65,000
Trade expenses	6,500	Discount received	3,000
Discount allowed	1,200		
Bad debts	1,300		
Depreciation:			
Furniture	1,000		
Machinery	<u>4,000</u>		
Net profit (transferred to capital account)	36,500		
	<u>68,000</u>		<u>68,000</u>

Balance Sheet of Mrs. Surabhi as at March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Creditors	35,000	Cash	20,000
Capital	1,00,000	Bank	13,000
Add Net profit	<u>36,500</u>	Stock	25,000
	1,36,000	Debtors	70,000
Add Additional capital	<u>20,000</u>	Furniture	10,000
	1,56,500	Less Depreciation	(1,000)
			9,000
		Machinery	20,000
		Less Depreciation	(4,000)
			16,000
Less Drawings			
Cash 36,000			
Goods <u>2,500</u>	<u>(38,500)</u>		
	1,18,000		
	<u>1,53,000</u>		<u>1,53,000</u>

Working Notes :

(i) Total Debtors Account**Dr.****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
	Balance b/d		NIL		Cash		57,500
	Sales (credit)		1,30,000		Discount allowed		1,200
	(balancing figure)				Bad debts		1,300
					Balance c/d		70,000
			<u>1,30,000</u>				<u>1,30,000</u>

(ii) Total Creditors Account**Dr.****Cr.**

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
	Cash		42,000		Balance b/d		NIL
	Discount received		3,000		Purchase credit		80,000
	Balance c/d		35,000		(balancing figure)		
			<u>80,000</u>				<u>80,000</u>

(iii) Statement of Affair as on March 31, 2016

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amounts ₹</i>
Capital (balancing figure)	1,00,000	Cash	50,000
		Stock	20,000
		Furniture	10,000
		Machinery	20,000
	1,00,000		1,00,000

(iv) Summary of Cash

Dr.		Cr.	
<i>Receipts</i>	<i>Amount ₹</i>	<i>Payments</i>	<i>Amount ₹</i>
Balance b/d	50,000	Purchases	25,000
Capital(bank)	20,000	Wages	5,000
Debtors	57,500	Salaries	17,500
Sales	45,000	Trade expenses	6,500
		Electric bill	7,500
		Drawings	36,000
		Creditors	42,000
		Balance c/d—cash	20,000
		Closing bank(balancing figure)	13,000
	1,72,500		1,72,500

Test Your Understanding - II**Write the correct word(s) :**

- Credit sales can be ascertained as the balancing figure in the.....account.
- Excess ofover.....represents loss sustained during the period.
- To ascertain the profit, closing capital is to be adjusted by deductingand adding
- Incomplete records are generally used by

Illustration 7

Mr. Bahadur does not know how to keep books of account. From his various records, the following particulars have been made available prepare the final Accounts, after providing for doubtful debts 5 per cent of debtors outstanding and depreciating the motor car @ 20 per cent.

(i) Balance Sheet as on April 1, 2016

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital	92,500	Motor Car	71,700
Bills payable	32,800	Stock	51,500
Creditors	84,200	Debtors	49,500
		Bills receivable	24,400
		Cash in hand	12,400
	2,09,500		2,09,500

(ii) Cash Transactions during the year

Dr.

Cr.

<i>Receipts</i>	<i>Amount ₹</i>	<i>Payments</i>	<i>Amount ₹</i>
Balance b/d	12,400	Furniture	30,000
Receipt from debtors	1,15,000	Wages	9,400
Bills receivable	14,200	Purchases	40,500
Sales	1,03,000	Drawings	24,000
		Bills payable	30,700
		General expenses	20,700
		Payment to creditors	80,800
		Balance c/d	8,500
	2,44,600		2,44,600

(iii) Other Information

<i>Particulars</i>	<i>Amount ₹</i>
Bills receivable drawn (received)	6,300
Discount to customers	2,300
Discount from suppliers	700
Credit purchases	29,600
Closing stock	41,700
Closing balance of debtor	55,000
Closing balance of bills payable	10,200

Solution

Cash sales and cash purchases are available from cash transactions. Credit purchase is also given. But credit sale is to be ascertained by the opening debtors account. Though the credit purchase is available, the closing balance of creditors is not known. That is why the creditors account also has to be opened. As there are bills payable and bills receivable, those accounts also have to be opened, otherwise the creditors and debtors accounts will not be complete.

Books of Mr. Bahadur
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.

Cr.

<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	51,500	Sales	
purchases		Cash	1,03,000
Cash	40,500	Credit	<u>1,29,100</u>
Credit	<u>29,600</u>	Closing stock	41,700
Wages	9,400		
Gross profit c/d	1,42,800		
	<u>2,73,800</u>		<u>2,73,800</u>
General expenses	20,700	Gross profit b/d	1,42,800
Discount allowed	2,300	Discount received	700
Depreciation on motor car	14,340		
Reserve for bad debts	2,750		
Net profit	1,03,410		
	<u>1,43,500</u>		<u>1,43,500</u>

Balance Sheet as March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Capital	92,500	Motor car	71,700
Add Net profit	<u>1,03,410</u>	Less depreciation	<u>(14,340)</u>
	1,95,910	Furniture	30,000
Less Drawings	<u>(24,000)</u>	Stock	41,700
Creditors	24,200	Debtors	55,000
Bills payable	10,200	Less Provision	<u>(2,750)</u>
		Bills receivable	16,500
		Cash	8,500
	<u>2,06,310</u>		<u>2,06,310</u>

Working Notes:

(i) Total Bills Receivable Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
	Balance b/d		24,400		Cash (receipt)		14,200
	Debtors		6,300		Balance c/d		16,500
	(bills drawn)				(balancing figure)		
			<u>30,700</u>				<u>30,700</u>

(ii) Total Debtors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Balance b/d		49,500		Cash (receipt)		1,15,000
	Credit sales		1,29,100		Bills (drawn)		6,300
	(balancing figure)				Discount allowed		2,300
					Balance c/d		55,000
			1,78,600				1,78,600

(iii) Total Bills payable Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash (paid)		30,700		Balance b/d		32,800
	Balance c/d		10,200		Creditors		
					(bills accepted)		8,100
			40,900		(balancing figure)		40,900

(iv) Total Creditors Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹
	Cash		80,800		Balance b/d		84,200
	Bills payable		8,100		Credit purchases		29,600
	Discount received		700				
	Balance c/d		24,200				
	(balancing figure)		1,13,800				1,13,800

Illustration 8

Dinesh does not keep systematic books of account due to lack of Knowledge about the double entry system of accounting. He supplies you the following information :

**(i) Assets and Liabilities
March 31, 2017**

	April, 2016 ₹	March 31, 2017 ₹
Sundry debtors	45,000	48,600
Sundry creditors	24,000	?

Cash	4,500	?
Furniture and Fixtures	15,000	?
Stock	25,000	?
Motor Van	16,000	?

(ii) Transaction during the year

	₹
Cash received from debtors	80,000
Discount allowed to debtors	1,400
Bad debts written off	1,800
Cash paid to creditors	63,000
Discount allowed by creditors	1,000
Sales return	3,000
Purchases return	2,000
Expenses paid	6,000
Drawings	5,000
Rent paid	2,500

(iii) Other Information

Outstanding expenses ₹ 1,200. Charge 10 per cent depreciation on furniture and 5 per cent on motor van. Dinesh informs that he sells goods at cost plus 40 per cent. A provision of 5 per cent on debtors is to be created. Prepare his trading and profit and loss account and balance sheet as on March 31, 2017

Books of Dinesh
Trading and Profit and Loss Account
for the year ending March 31, 2017

Dr.			Cr.
Expenses/Losses	Amount ₹	Revenues/Gains	Amount ₹
Opening stock	25,000	Sales	89,800
Purchases 69,000		Less Returns (3,000)	86,800
Less Returns (2,000)	67,000	Closing stock	30,000
Gross profit c/d	24,800		
	1,16,800		1,16,800
Discount allowed	1,400	Gross profit b/d	24,800
Bad debts	1,800	Discount received	1,000
Expenses paid 6,000			
Add Outstanding expenses 1,200	7,200		
Rent paid	2,500		
Depreciation on Furniture 1,500			
Motor van 800	2,300		
Provision for doubtful debts	2,430		
Net profit (transferred to capital account)	8,170		
	25,800		25,800

Balance Sheet as on March 31, 2017

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Outstanding expenses	1,200	Cash	8,000
Creditors	27,000	Debtors	48,600
Capital	81,500	Less Provision	(2,430)
Less Drawings	(5,000)	Closing stock	30,000
	76,500	Furniture & Fixtures	15,000
Add Net profit	8,170	Less Depreciation	(1,500)
	84,670	Motor van	16,000
		Less Depreciation	(800)
			15,200
	1,12,870		1,12,870

Working Notes :

(i) Total Debtors Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
	Balance b/d		45,000		Cash received		80,000
	Sales		89,800		Discount allowed		1,400
					Bad debts		1,800
					Sales return		3,000
					Balance c/d		48,600
			1,34,800				1,34,800

(ii) Total Creditors Account

Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount ₹</i>
	Cash paid		63,000		Balance b/d		24,000
	Discount received		1,000		Purchases		69,000
	Purchases return		2,000				
	Balance c/d		27,000				
			93,000				93,000

(iii) Summary of Cash

Dr.		Cr.	
<i>Receipts</i>	<i>Amount ₹</i>	<i>Payments</i>	<i>Amount ₹</i>
Balance b/d	4,500	Creditors	63,000
Debtors	80,000	Expenses paid	6,000
		Drawings	5,000
		Rent paid	2,500
		Balance c/d	8,000
	84,500		84,500

(iv) Statement of Affairs as on March 31, 2016

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>	<i>Amount ₹</i>
Creditors	24,000	Debtors	45,000
		Cash	4,500
		Stock	25,000
Capital in the beginning (Balancing figure)	81,500	Furniture and Fixtures	15,000
		Motor Van	16,000
	<u>1,05,500</u>		<u>1,05,500</u>

(v) Calculation of Closing Stock

	₹
Total sales	89,800
Less Sales return	<u>(3,000)</u>
Net sales	<u>86,800</u>
Total purchases	69,000
Less Purchases returns	<u>(2,000)</u>
	<u>(67,000)</u>
Rate of gross profit on cost	40%
Suppose cost of goods sold is	100
Then, Gross profit equals to	40
Sales equals to	140
Hence, Cost of goods sold will be	

$$\text{Sales} = \text{Rs. } 86,800 = \frac{100}{140} \times 86,800 = 62,000$$

The amount of closing stock will be calculated as :

Net Purchases	67,000
Add Closing stock	<u>25,000</u>
Cost of goods available for sale	92,000
Less Cost of goods sold	<u>(62,000)</u>
Closing stock	30,000

Key Terms Introduced in the Chapter

- Incomplete records
- Statement of Affairs

Summary with Reference to Learning Objectives

1. *Incomplete records* : Incomplete records refer to, lack of accounting records according to the double entry system. Degree of incompleteness may vary from highly disorganised records to organised, but still not complete.
2. *Difference between statement of affairs and balance sheet* : A statement of affairs is a statement showing various assets and liabilities of a firm on date, with

difference between the two sides denoting capital. Since, the records are incomplete, the values of assets and liabilities are normally estimates based on information available. They are not the balances taken from properly maintained ledger like in case of balance sheet. The balance sheet is derived from a set of books maintained on the basis of double entry system.

3. *Computation of profit and loss from incomplete records* : The statement of affairs is used to compute capital when a firm has a highly disorganised set of incomplete records. To the difference between the closing and opening capital, any sum withdrawn from business are added back and any additional capital introduced during the year are deducted to find out profit and loss made for the period.
4. *Preparation of profit and loss account and balance sheet* : When cash summary of a firm is available along with information about personal accounts of creditors and customers, an attempt can be made to prepare the profit and loss account and balance sheet. Missing figures about purchases, sales, debtors and creditors can be obtained by preparing proforma accounts of debtors, creditors, bills receivable and bills payable using the logic of double entry system. Once a profit and loss account and balance sheet are prepared, it will be possible for the firm to start a complete accounting system for future.

Questions for Practice

Short Answers

1. State the meaning of incomplete records?
2. What are the possible reasons for keeping incomplete records?
3. Distinguish between statement of affairs and balance sheet.
4. What practical difficulties are encountered by a trader due to incompleteness of accounting records?

Long Answers

1. What is meant by a 'statement of affairs'? How can the profit or loss of a trader be ascertained with the help of a statement of affairs?
2. 'Is it possible to prepare the profit and loss account and the balance sheet from the incomplete book of accounts kept by a trader'? Do you agree? Explain.
3. Explain how the following may be ascertained from incomplete records:
 - (a) Opening capital and closing capital
 - (b) Credit sales and credit purchases
 - (c) Payments to creditors and collection from debtors
 - (d) Closing balance of cash.

Numerical Questions

Ascertainment of profit or loss by statement of affairs method

1. Following information is given below prepare the statement of profit or loss:
- | | |
|--------------------------------------|----------|
| | ₹ |
| Capital at the end of the year | 5,00,000 |
| Capital in the beginning of the year | 7,50,000 |

Drawings made during the period	3,75,000
Additional Capital introduced	50,000

[Ans : Profit : ₹ 75,000].

2. Manveer started his business on April 01, 2016 with a capital of ₹ 4,50,000. On March 31, 2017 his position was as under:

	₹
Cash	99,000
Bills receivable	75,000
Plant	48,000
Land and Building	1,80,000
Furniture	50,000

He owned ₹ 45,000 from his friend Susheel on that date. He withdrew ₹ 8,000 per month for his household purposes. Ascertain his profit or loss for this year ended March 31, 2017

[Ans : Profit : ₹53,000].

3. From the information given below ascertain the profit for the year :

	₹
Capital at the beginning of the year	70,000
Additional capital introduced during the year	17,500
Stock	59,500
Sundry debtors	25,900
Business premises	8,600
Machinery	2,100
Sundry creditors	33,400
Drawings made during the year	26,400

[Ans : Profit : ₹1,600].

4. From the following information, Calculate Capital at the beginning :

	₹
Capital at the end of the year	4,00,000
Drawings made during the year	60,000
Fresh Capital introduced during the year	1,00,000
Profit of the current year	80,000

[Ans : Capital at the beginning of the year : ₹2,60,000].

5. Following information is given below : calculate the closing capital

	April 01, 2016	March 31, 2017
	₹	₹
Creditors	5,000	30,000
Bills payable	10,000	—
Loan	—	50,000
Bills receivable	30,000	50,000
Stock	5,000	30,000
Cash	2,000	20,000

[Ans : Closing capital : ₹20,000].

Calculation of profit or loss and ascertainment of statement of affairs at the end of the year (Opening Balance is given)

6. Mrs. Anu started firm with a capital of ₹ 4,00,000 on 1st October, 2016. She borrowed from her friends a sum of ₹ 1,00,000 @ 10% per annum (interest

paid) for business and brought a further amount to capital ₹ 75,000 on March 31, 2017, her position was :

	₹
Cash	30,000
Stock	4,70,000
Debtors	3,50,000
Creditors	3,00,000

He withdrew ₹ 8,000 per month for the year. Calculate profit or loss for the year and show your working clearly.

[Ans : Profit : ₹23,000].

7. Mr. Arnav does not keep proper records of his business he provided following information, you are required to prepare a statement showing the profit or loss for the year.

	₹
Capital at the beginning of the year	15,00,000
Bills receivable	60,000
Cash in hand	80,000
Furniture	9,00,000
Building	10,00,000
Creditors	6,00,000
Stock in trade	2,00,000
Further capital introduced	3,20,000
Drawings made during the period	80,000

[Ans : Loss : ₹ 1,00,000].

Ascertainment of statement of affairs at the beginning and at the end of the year and calculation of profit or loss.

8. Mr. Akshat keeps his books on incomplete records following information is given below :

	April 01, 2016	March 31, 2017
	₹	₹
Cash in hand	1,000	1,500
Cash at bank	15,000	10,000
Stock	1,00,000	95,000
Debtors	42,500	70,000
Business premises	75,000	1,35,000
Furniture	9,000	7,500
Creditors	66,000	87,000
Bills payable	44,000	58,000

During the year he withdrew ₹ 45,000 and introduced ₹ 25,000 as further capital in the business compute the profit or loss of the business.

[Ans : Profit : ₹ 61,500].

9. Gopal does not keep proper books of account. Following information is given below:

	April 01, 2016	March 31, 2017
	₹	₹
Cash in hand	18,000	12,000
Cash at bank	1,500	2,000

Stock in trade	80,000	90,000
Sundry debtors	36,000	60,000
Sundry creditors	60,000	40,000
Loan	10,000	8,000
Office equipments	25,000	30,000
Land and Buildings	30,000	20,000
Furniture	10,000	10,000

During the year he introduced ₹ 20,000 and withdrew ₹ 12,000 from the business. Prepare the statement of profit or loss on the basis of given information

[Ans : Profit : ₹ 53,500].

10. Mr. Muneesh maintains his books of accounts from incomplete records. His books provide the information :

	April 01, 2016 ₹	March 31, 2017 ₹
Cash	1,200	1,600
Bills receivable	—	2,400
Debtors	16,800	27,200
Stock	22,400	24,400
Investment	—	8,000
Furniture	7,500	8,000
Creditors	14,000	15,200

He withdrew ₹ 300 per month for personal expenses. He sold his investment of ₹ 16,000 at 2% premium and introduced that amount into business.

[Ans : Profit : ₹ 9,780].

11. Mr. Girdhari Lal does not keep full double entry records. His balance as on April 01, 2016 is as.

Liabilities	Amount ₹	Assets	Amount ₹
Sundry creditors	35,000	Cash in hand	5,000
Bills payable	15,000	Cash at bank	20,000
Capital	40,000	Sundry debtors	18,000
		Stock	22,000
		Furniture	8,000
		Plant	17,000
	90,000		90,000

His position at the end of the year is :

	₹
Cash in hand	7,000
Stock	8,600
Debtors	23,800
Furniture	15,000

Plant	20,350
Bills payable	20,200
Creditors	15,000

He withdrew ₹ 500 per month out of which to spent ₹ 1,500 for business purpose. Prepare the statement of profit or loss.

[Ans : Profit : ₹ 4,050].

12. Mr. Ashok does not keep his books properly. Following information is available from his books.

	April 01, 2016 ₹	March 31, 2017 ₹
Sundry creditors	45,000	93,000
Loan from wife	66,000	57,000
Sundry debtors	22,500	—
Land and Building	89,600	90,000
Cash in hand	7,500	8,700
Bank overdraft	25,000	—
Furniture	1,300	1,300
Stock	34,000	25,000

During the year Mr. Ashok sold his private car for ₹ 50,000 and invested this amount into the business. He withdrew from the business ₹ 1,500 per month upto October 31, 2016 and thereafter ₹ 4,500 per month as drawings. You are required to prepare the statement of profit or loss and statement of affair as on March 31, 2017.

[Ans : Loss : ₹ 57,900].

13. Krishna Kulkarni has not kept proper books of accounts prepare the statement of profit or loss for the year ending March 31, 2016 from the following information:

	April 01, 2016 (₹)	March 31, 2017 (₹)
Cash in hand	10,000	36,000
Debtors	20,000	80,000
Creditors	10,000	46,000
Bills receivable	20,000	24,000
Bills payable	4,000	42,000
Car	—	80,000
Stock	40,000	30,000
Furniture	8,000	48,000
Investment	40,000	50,000
Bank balance	1,00,000	90,000

The following adjustments were made :

- Krishna withdrew cash ₹ 5,000 per month for private use.
- Depreciation @ 5% on car and furniture @10% .
- Outstanding Rent ₹ 6,000.
- Fresh Capital introduced during the year ₹30,000.

[Ans : Profit : ₹ 1,41,200 ; Statement of affairs with adjusted : ₹ 4,29,200].

14. M/s Saniya Sports Equipment does not keep proper records. From the following information find out profit or loss and also prepare balance sheet for the year ended March 31, 2017

	March 31, 2016	March 31, 2017
	₹	₹
Cash in hand	6,000	24,000
Bank overdraft	30,000	—
Stock	50,000	80,000
Sundry creditors	26,000	40,000
Sundry debtors	60,000	1,40,000
Bills payable	6,000	12,000
Furniture	40,000	60,000
Bills receivable	8,000	28,000
Machinery	50,000	1,00,000
Investment	30,000	80,000

Drawing ₹10,000 p.m. for personal use, fresh capital introduced during the year ₹2,00,000. A bad debts of ₹2,000 and a provision of 5% is to be made on debtors outstanding salary ₹2,400, prepaid insurance ₹700, depreciation charged on furniture and machine @ 10% p.a.

[Ans : Profit : ₹ 1,71,300 ; Statement of affairs with adjustment : ₹ 4,87,700].

Ascertainment of Missing Figures

15. From the following information calculate the amount to be paid to creditors:

	₹
Sundry creditors as on March 31, 2017	1,80,425
Discount received	26,000
Discount allowed	24,000
Return outwards	37,200
Return inward	32,200
Bills accepted	1,99,000
Bills endorsed to creditors	26,000
Creditors as on April 01, 2016	2,09,050
Total purchases	8,97,000
Cash purchases	1,40,000

[Ans : Cash paid to creditors : ₹ 4,40,175].

16. Find out the credit purchases from the following:

	₹
Balance of creditors April 01, 2016	45,000
Balance of creditors March 31, 2017	36,000
Cash paid to creditors	1,80,000
Cheque issued to creditors	60,000
Cash purchases	75,000
Discount received from creditors	5,400
Discount allowed	5,000
Bills payable given to creditors	12,750
Return outwards	7,500
Bills payable dishonoured	3,000

Bills receivable endorsed to creditors	4,500
Bills receivable endorsed to creditors dishonoured	1,800
Return inwards	3,700

[Ans : Credit purchases : ₹ 2, 56,350].

17. From the following information calculate total purchases.

	₹
Creditors April 01, 2016	30,000
Creditors March 31, 2017	20,000
Opening balance of Bills payable	25,000
Closing balance of Bills payable	35,000
Cash paid to creditors	1,51,000
Bills discharged	44,500
Cash purchases	1,29,000
Return outwards	6,000

[Ans : Total purchases : ₹ 3,30,500].

18. The following information is given

	₹
Opening creditors	60,000
Cash paid to creditors	30,000
Closing creditors	36,000
Returns Inward	13,000
Bill matured	27,000
Bill dishonoured	8,000
Purchases return	12,000
Discount allowed	5,000

Calculate credit purchases during the year

[Ans : Credit purchases : ₹ 37,000].

19. From the following, calculate the amount of bills accepted during the year.

	₹
Bills payable as on April 01, 2016	1,80,000
Bills payable as on March 31, 2017	2,20,000
Bills payable dishonoured during the year	28,000
Bills payable honoured during the year	50,000

[Ans : Bills accepted : ₹ 1,18,000].

20. Find out the amount of bills matured during the year on the basis of information given below ;

	₹
Bills payable dishonoured	37,000
Closing balance of Bills payable	85,000
Opening balance of Bills payable	70,000
Bills payable accepted	90,000
Cheque dishonoured	23,000

[Ans : Bills matured : ₹ 38,000].

21. Prepare the bills payable account from the following and find out missing figure if any :

	₹
Bills accepted	1,05,000
Discount received	17,000
Purchases returns	9,000
Return inwards	12,000
Cash paid to accounts payable	50,000
Bills receivable endorsed to creditor	45,000
Bills dishonoured	17,000
Bad debts	14,000
Balance of accounts payable (closing)	85,000
Credit purchases	2,15,000

[Ans : Opening balance of creditors : ₹ 79,000].

22. Calculate the amount of bills receivable during the year.

	₹
Opening balance of bills receivable	75,000
Bill dishonoured	25,000
Bills collected (honoured)	1,30,000
Bills receivable endorsed to creditors	15,000
Closing balance of bills receivable	65,000

[Ans : ₹ 1,60,000].

23. Calculate the amount of bills receivable dishonoured from the following information.

	₹
Opening balance of bills receivable	1,20,000
Bills collected (honoured)	1,85,000
Bills receivable endorsed	22,800
Closing balance of bills receivable	50,700
Bills receivable received	1,50,000

[Ans : ₹ 11,500].

24. From the details given below, find out the credit sales and total sales.

	₹
Opening debtors	45,000
Closing debtors	56,000
Discount allowed	2,500
Sales returns	8,500
Irrecoverable amount	4,000
Bills receivables received	12,000
Bills receivable dishonoured	3,000
Cheque dishonoured	7,700
Cash sales	80,000
Cash received from debtors	2,30,000
Cheque received from debtors	25,000

[Ans : Total sales : ₹ 3,62,300].

25. From the following information, prepare the bills receivable account and total debtors account for the year ended March 31, 2017.

	₹
Opening balance of debtors	1,80,000
Opening balance of bills receivable	55,000
Cash sales made during the year	95,000
Credit sales made during the year	14,50,000
Return inwards	78,000
Cash received from debtors	10,25,000
Discount allowed to debtors	55,000
Bills receivable endorsed to creditors	60,000
Cash received (bills matured)	80,500
Irrecoverable amount	10,000
Closing balance of bills receivable on March 31, 2017	75,500
[Ans : Bills received : ₹ 1,61,000 ; Closing balance of debtors : ₹ 3,01,000].	

26. Prepare the suitable accounts and find out the missing figure if any.

	₹
Opening balance of debtors	14,00,000
Opening balance of bills receivable	7,00,000
Closing balance of bills receivable	3,50,000
Cheque dishonoured	27,000
Cash received from debtors	10,75,000
Cheque received and deposited in the bank	8,25,000
Discount allowed	37,500
Irrecoverable amount	17,500
Returns inwards	28,000
Bills receivable received from customers	1,05,000
Bills receivable matured	2,80,000
Bills discounted	65,000
Bills endorsed to creditors	70,000
[Ans : Credit sales : ₹ 5,16,000].	

27. From the following information ascertain the opening balance of sundry debtors and closing balance of sundry creditors

	₹
Opening stock	30,000
Closing stock	25,000
Opening creditors	50,000
Closing debtors	75,000
Discount allowed by creditors	1,500
Discount allowed to customers	2,500
Cash paid to creditors	1,35,000
Bills payable accepted during the period	30,000
Bills receivable received during the period	75,000
Cash received from customers	2,20,000
Bills receivable dishonoured	3,500
Purchases	2,95,000

The rate of gross profit is 25% on selling price and out of the total sales ₹ 85,000 was for cash sales.

$$\text{Hint : Total sales} = 4,00,000 = 3,00,000 \times \frac{100}{75}$$

[Ans : Opening balance of debtors : ₹ 54,000 ; Closing balance of creditors: ₹ 1,78,500].

28. Mrs. Bhavana keeps his books by Single Entry System. You're required to prepare final accounts of her business for the year ended March 31, 2017. Her records relating to cash receipts and cash payments for the above period showed the following particulars :

Summary of Cash

Dr.

Cr.

Receipts	Amount ₹	Payments	Amount ₹
Opening balance of cash	12,000	Paid to creditors	53,000
Further capital	20,000	Business expenses	12,000
Received from debtors	1,20,000	Wage paid	30,000
		Bhavana's drawings	15,000
		Balance at bank on March 31, 2017	35,000
		Cash in hand	7,000
	1,52,000		1,52,000

The following information is also available :

	April 01, 2016 ₹	March 31, 2017 ₹
Debtors	55,000	85,000
Creditors	22,000	29,000
Stock	35,000	70,000
Plant	10,00,000	1,00,000
Machinery	50,000	50,000
Land & Building	2,50,000	2,50,000
Investment	20,000	20,000

All her sales and purchases were on credit. Provide depreciation on plant and building by 10% and machinery by 5%, make a provision for bad debts by 5%.

[Ans : Gross profit ; ₹ 95,000 ; Net profit : ₹ 41,250 ; Total of balance sheet : ₹ 5, 75,250].

Checklist to Test Your Understanding1. *Test Your Understanding - I*

1. (b) 2. (d) 3. (a) 4. (b)

2. *Test Your Understanding - II*

- | | |
|---------------------------------------|-------------------------------------|
| 1. Total debtors | 2. Opening capital, closing capital |
| 3. Fresh capital introduced, drawings | 4. Small traders |

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Applications of Computers in Accounting

12

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- *state the meaning, elements and capabilities of computer system;*
- *explain the need for computers in accounting;*
- *describe the automation of accounting process;*
- *explain design of accounting reports from the accounting data;*
- *list the various Management Information System (MIS) reports and their uses;*
- *explain the data interface between information systems.*

Computer technology and its usage have registered a significant development during the last three decades. Historically, computers have been used effectively in science and technology to solve the complex computational and logical problems. They have also been used for carrying out economic planning and forecasting processes. Recently, modern day computers have made their presence felt in business and industry. The most important impact of computers has been on the manner in which data is stored and processed within an organisation. Although manual data processing for Management Information System (MIS) has been quite common in the past, modern MIS would be nearly impossible without the use of computer systems. In this chapter we shall discuss the need for the use of computers in accounting, the nature of accounting information system and the types of accounting related MIS reports.

12.1 Meaning and Elements of Computer System

A computer is an electronic device, which is capable of performing a variety of operations as directed by a set of instructions. This set of instructions is called a computer programme. A computer system is a combination of six elements:

12.1.1 Hardware

Hardware of computer consists of physical components such as keyboard, mouse, monitor and processor. These are electronic and electromechanical components.

12.1.2 Software

A set(s) of programmes, which is used to work with such hardware is called its software. A coded set of instructions stored in the form of circuits is called firmware. There are six types of software as follows:

- (a) *Operating System* : An integrated set of specialised programmes that are meant to manage the resources of a computer and also facilitate its operation is called operating system. It creates a necessary interface that is an interactive link, between the user and the computer hardware.
- (b) *Utility Programmes* : These are a set of computer programmes, which are designed to perform certain supporting operations: such as programme to format a disk, duplicate a disk, physically reorganise stored data and programmes.
- (c) *Application Software* : These are user oriented programmes designed and developed for performing certain specified tasks: such as payroll accounting, inventory accounting, financial accounting, etc.
- (d) *Language Processors* : These are the software, which check for language syntax and eventually translate (or interpret) the source programme (that is a programme written in a computer language) into machine language (that is the language which the computer understands).
- (e) *System Software* : These are a set of programmes which control such internal functions as reading data from input devices, transmitting processed data to output devices and also checking the system to ensure that its components are functioning properly.
- (f) *Connectivity Software* : These are a set of programmes which create and control a connection between a computer and a server so that the computer is able to communicate and share the resources of server and other connected computers.

12.1.3 People

People interacting with the computers are also called *live-ware* of the computer system. They constitute the most important part of the computer system :

- *System Analysts* are the people who design data processing systems.
- *Programmers* are the people who write programmes to implement the data processing system design.
- *Operators* are the people who participate in operating the computers. People who respond to the procedures instituted for executing the computer programmes are also a part of live-ware.

12.1.4 Procedures

The procedure means a series of operations in a certain order or manner to achieve desired results. There are three types of procedures which constitute

part of computer system: hardware-oriented, software-oriented and internal procedure. Hardware-oriented procedure provide details about components and their method of operation. The software-oriented procedure provides a set of instructions required for using the software of computer system. Internal procedure is instituted to ensure smooth flow of data to computers by sequencing the operation of each sub-system of overall computer system.

12.1.5 Data

These are facts and may consist of numbers, text, etc. These are gathered and entered into a computer system. The computer system in turn stores, retrieves, classifies, organises and synthesises the data to produce information according to a pre-determined set of instructions. The data is, therefore, processed and organised to create information that is relevant and can be used for decision-making.

12.1.6 Connectivity

It is being acknowledged as a sixth element of the computer system. The manner in which a particular computer system is connected to others say through telephone lines, microwave transmission, satellite link, etc. is the element of connectivity.

12.2 Capabilities of Computer System

A computer system possesses some characteristics, which, in comparison to human beings, turn out to be its capabilities. These are as follows ;

Speed : It refers to the amount of time computers takes in accomplishing a task or completes an operation. Computers require far less time than human beings in performing a task. Normally, human beings take into account a second or minute as unit of time. But computers have such a fast operating capability that the relevant unit of time is fraction of a second. Most of the modern computers are capable of performing a 100 million calculations per second and that is why the industry has developed Million Instructions per Second (MIPS) as the criterion to classify different computers according to speed.

Accuracy : It refers to the degree of exactness with which computations are made and operations are performed. One might spend years in detecting errors in computer calculations or updating a wrong record. Most of the errors in Computer Based Information System (CBIS) occur because of bad programming, erroneous data and deviation from procedures. These errors are caused by human beings. Errors attributable to hardware are normally detected and corrected by the computer system itself. The computers rarely commit errors and perform all types of complex operations accurately.

Reliability : It refers to the ability with which the computers remain functional to serve the user. Computers systems are well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. Therefore, they are more reliable than human beings. Yet there can be failures of computer system due to internal and external reasons. Any failure of the computer in a highly automated industry is unacceptable. Therefore, the companies in such situations provide for back-up facility to swiftly take over operations without loss of time.

Versatility : It refers to the ability of computers to perform a variety of tasks: simple as well as complex. Computers are usually versatile unless designed for a specific application. A general purpose computer is capable of being used in any area of application: business, industry, scientific, statistical, technological, communications and so on. A general purpose computer, when installed in an organisation, can take over the jobs of several specialists because of its versatility. computer system when installed can take over the jobs of all these specialists because of being highly versatile. This further ensures fuller utilisation of its capability.

Storage : It refers to the amount of data a computer system can store and access. The computer systems, besides having instant access to data, have huge capacity to store such data in a very small physical space. A CD-ROM with 4.7" of diameter is capable of storing a large number of books, each containing thousands of pages and yet leave enough space for storing more such material. A typical mainframe computer system is capable of storing and providing online billion of characters and thousands of graphic images. It is clear from the above discussion that computer capabilities outperform the human capabilities. As a result, a computer, when used properly, will improve the efficiency of an organisation.

12.3 Limitations of a Computer System

In spite of possessing all the above capabilities, computers suffer from the following limitations :

Lack of Commonsense : Computer systems as on date do not possess any common sense because no full-proof algorithm has been designed to programme common sense. Since computers work according to a stored programme(s), they simply lack of commonsense.

Zero IQ : Computers are dumb devices with zero Intelligence Quotient (IQ). They cannot visualise and think what exactly to do under a particular situation, unless they have been programmed to tackle that situation. Computers must be directed to perform each and every action, however, minute it may be.

Lack of Decision-making : Decision-making is a complex process involving information, knowledge, intelligence, wisdom and ability to judge. Computers cannot take decisions on their own because they do not possess all the essentials of decision-making. They can be programmed to take such decisions,

which are purely procedure-oriented. If a computer has not been programmed for a particular decision situation, it will not take decision due to lack of wisdom and evaluating faculties. Human beings, on the other hand, possess this great power of decision-making.

12.4 Components of Computer

The functional components of computer system consist of Input Unit, Central Processing System and Output Unit. The way these components are embedded in a computer may differ from one architectural design to another, yet all of them constitute the essential building blocks of a computer system. Diagrammatically, these components may be presented as follows:

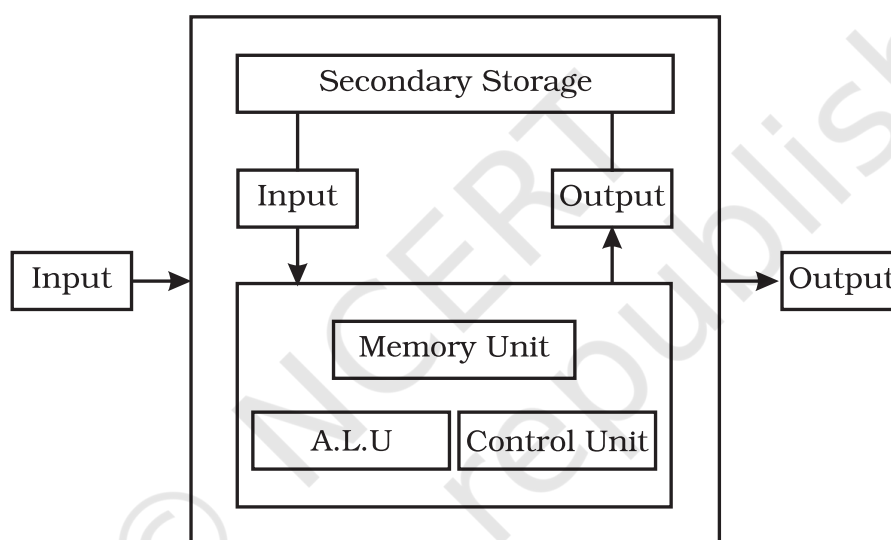


Fig. 12.1 : Block diagram of main components of computer

12.4.1 Input Unit

It controls various input devices which are used for entering data into the computer system. Keyboard and Mouse, for instance, are the most commonly used input device. Other such devices are magnetic tape, magnetic disk, light pen, optical scanner, Magnetic Ink Character (MICR) Recognition, Optical Character Recognition (OCR), bar code reader, smart card reader, etc. Besides, there are other devices which respond to voice and physical touch. A menu layout is displayed on a touch sensitive screen. Whenever user touches a menu item on touch-screen, the computer senses which particular menu item has been touched and accordingly performs the operation associated with that menu item. Such touch screens have been installed at major railway stations for obtaining the online information about arrival and departure of trains.

12.4.2 Central Processing Unit (CPU)

This is the main part of computer hardware that actually processes data, according to the instructions it receives. It controls the flow of data by directing the data to enter the system, places the data into its memory, retrieves the same as and when needed and directs the output of data according to a set of stored instructions. It has three main units as described below :

- (a) *Arithmetic and Logic Unit (ALU)* : It is responsible for performing all the arithmetic computations such as addition, subtraction, division, multiplication and exponentiation. In addition to this, it also performs logical operations involving comparisons among variables and data items.
- (b) *Memory Unit* : In this unit, data is stored before being actually processed. The data so stored is accessed and processed according to a set of instructions which are also stored in the memory of the computer well before such data is transmitted to the memory from input devices.
- (c) *Control Unit* : This unit is entrusted with the responsibility of controlling and coordinating the activities of all other units of the computer system. Specifically, it performs the following functions :
 - Read instructions out of memory unit;
 - Decode such instructions;
 - Set up the routing of data, through internal circuitry/wiring, to the desired place at right time; and
 - Determine the input device from where to get next instruction after the instruction in hand has been executed.

12.4.3 Output Unit

After processing the data, the information produced according to a set of instruction need to be made available to user in a human readable and understandable form. A computer system, therefore, needs an output device to communicate such information to the user. Essentially, the output device is assigned the task of translating the processed data from machine coded form to a human readable form. The commonly used output devices include: external devices like monitor also called Visual Display Unit (VDU), printer, graphic plotter for producing graphs, technical drawings and charts and internal devices like magnetic storage devices. Recently, a new device being perfected is the speech synthesiser, which is capable of producing verbal output that sounds like human speech. Information:

12.5 Evolution of Computerised Accounting

Manual system of accounting has been traditionally the most popular method of keeping the records of financial transactions of an organisation.

Conventionally, the bookkeeper (or accountant) used to maintain books of accounts such as cash book, journal and ledger so as to prepare a summary of transactions and final accounts manually. The technological innovations led to the development of various machines capable of performing a variety of accounting functions. For example, the popular billing machine was designed to typewrite description of the transaction along with names, addresses of customers. This machine was capable of computing discounts; adding the net total and posting the requisite data to the relevant accounts. The customer's bill was generated automatically once the operator has entered the necessary information. These machines combined the features of a typewriter and various kinds of calculators.

With substantial increase in the number of transactions, the technology advanced further. With exponential increase in speed, storage and processing capacity, newer versions of these machines evolved. A computer to which they were connected operated these machines. The success of a growing organisation with complexity of transactions tended to depend on resource optimisation, quick decision-making and control. As a result, the maintenance of accounting data on a real-time (or spontaneous) basis became almost essential. Such a system of maintaining accounting records became convenient with the computerised accounting system.

12.5.1 Information and Decisions

An organisation is a collection of interdependent decision-making units that exist to pursue organisational objectives. As a system, every organisation accepts inputs and transforms them into outputs. All organisational systems pursue certain objectives through a process of resource allocation, which is accomplished through the process of managerial decision-making. Information facilitates decisions regarding allocation of resources and thereby assists an organisation in pursuit of its objectives. Therefore, the information is the most important organisational resource. Every medium sized to large organisation has a well-established information system that is meant to generate the information required for decision-making.

With the increasing use of information systems in organisations, Transaction Processing Systems (TPS) have started playing a vital role in supporting business operations. Every transaction processing system has three components: Input, Processing and Output. Since Information Technology (IT) follows the GIGO principle (Garbage in-Garbage out), it is necessary that input to the IT-based information system is accurate, complete and authorised. This is achieved by automating the input. A large number of devices are now available to automate the input process for a TPS.

12.5.2 Transaction Processing System

Transaction Processing Systems (TPS) are among the earliest computerised systems catering to the requirements of large business enterprises. The purpose of a typical TPS is to record, process, validate and store transactions that occur in the various functional areas of a business for subsequent retrieval and usage. A transaction could be internal or external. When a department requisitions material supplies from stores, an internal transaction is said to have occurred. However, when the purchase department purchases materials from a supplier, an external transaction takes place. The scope of financial accounting is confined to external transactions only. TPS involves following steps in processing a transaction. In order to understand these steps, let us consider a case wherein a customer withdraws money using the Automated Teller Machine (ATM) facility, as described below :

- *Data Entry* : The action data must be entered into the system before it is processed. There are a number of input devices to enter data: Keyboard, mouse, etc. For example, a bank customer operates an ATM facility to make a withdrawal. The actions taken by the customer constitute data, which is processed after validation by the computerised personal banking system.
- *Data Validation* : It ensures the accuracy and reliability of input data by comparing the same with some predetermined standards or known data. This validation is performed by error detection and error correction procedures. The control mechanism, wherein actual input is compared with the standard, is meant to detect errors while error correction procedures make suggestions for entering correct data input. The Personal Identification Number (PIN) of the customer is validated with the known data. If it is incorrect, a suggestion is made to indicate that the PIN is invalid. After validating the PIN (which is also a part of processing by TPS), the amount of withdrawal being made by the customer is also checked to ensure that it does not exceed a certain limit.
- *Processing and Revalidation* : The processing of data, representing actions of the ATM user, occurs almost instantaneously in case of the Online Transaction Processing (OLTP) system provided a valid data representing actions of the user has been encountered. This is called check input validity. Revalidation occurs to ensure that the transaction in terms of delivery of money by ATM has been completed. This is called check output validity.
- *Storage* : Processed actions, as described above, culminate into financial transaction data, which describe the withdrawal of money by a particular customer, are stored in transaction database of Computerised personal banking system. This implies that only valid transactions are stored in the database.
- *Information* : The stored data is processed using the query facility to produce desired information. A database supported by DBMS is bound to have standard Structured Query Language (SQL) support.

- *Reporting* : Finally, reports can be prepared on the basis of the required information content according to decision usefulness of report.

A simple computerised accounting system accepts the complete transaction data as input; stores such data in computer storage media (say hard disk) and retrieves the accounting data for processing as and when required for generating an accounting report, as output. The input-process-output diagram shown below indicates as to how accounting software translates data into information. This processing of data is accomplished either through Batch Processing or Real-time Processing.

Batch Processing applies to large and voluminous data that is accumulated offline from various units: branches or departments. The entire accumulated data is processed in one shot to generate the desired reports according to decision requirement.

Real-Time Processing provides online outcome in the form of information and reports without time lag between the transaction and its processing. The accounting reports are generated by query language popularly called *Structured Query Language* (SQL). It allows the user to retrieve report relevant information that is capable of being laid out in pre-designed accounting report.

Accounting software may be structured with such components as provide for storage and processing of data pertaining to purchase, sales, inventory, payroll and other financial transactions (refer figure 12.2).

12.6 Features of Computerised Accounting System

Accounting software is used to implement a computerised accounting system. The computer accounting system is based on the concept of databases. It does away with the concept of creating and maintaining journals, ledger, etc. which are essential while working with manual accounting system. Typically computerised accounting system offers the following features :

- Online input and storage of accounting data.
- Printout of purchase and sales invoices.
- Logical scheme for codification of accounts and transactions. Every account and transaction is assigned a unique code.
- Grouping of accounts is done from the very beginning.
- Instant reports for management, for example – Aging Statement, Stock Statement, Trial Balance, Trading and Profit and Loss Account, Balance Sheet, Stock Valuation, GST, Returns, Payroll Report, etc.

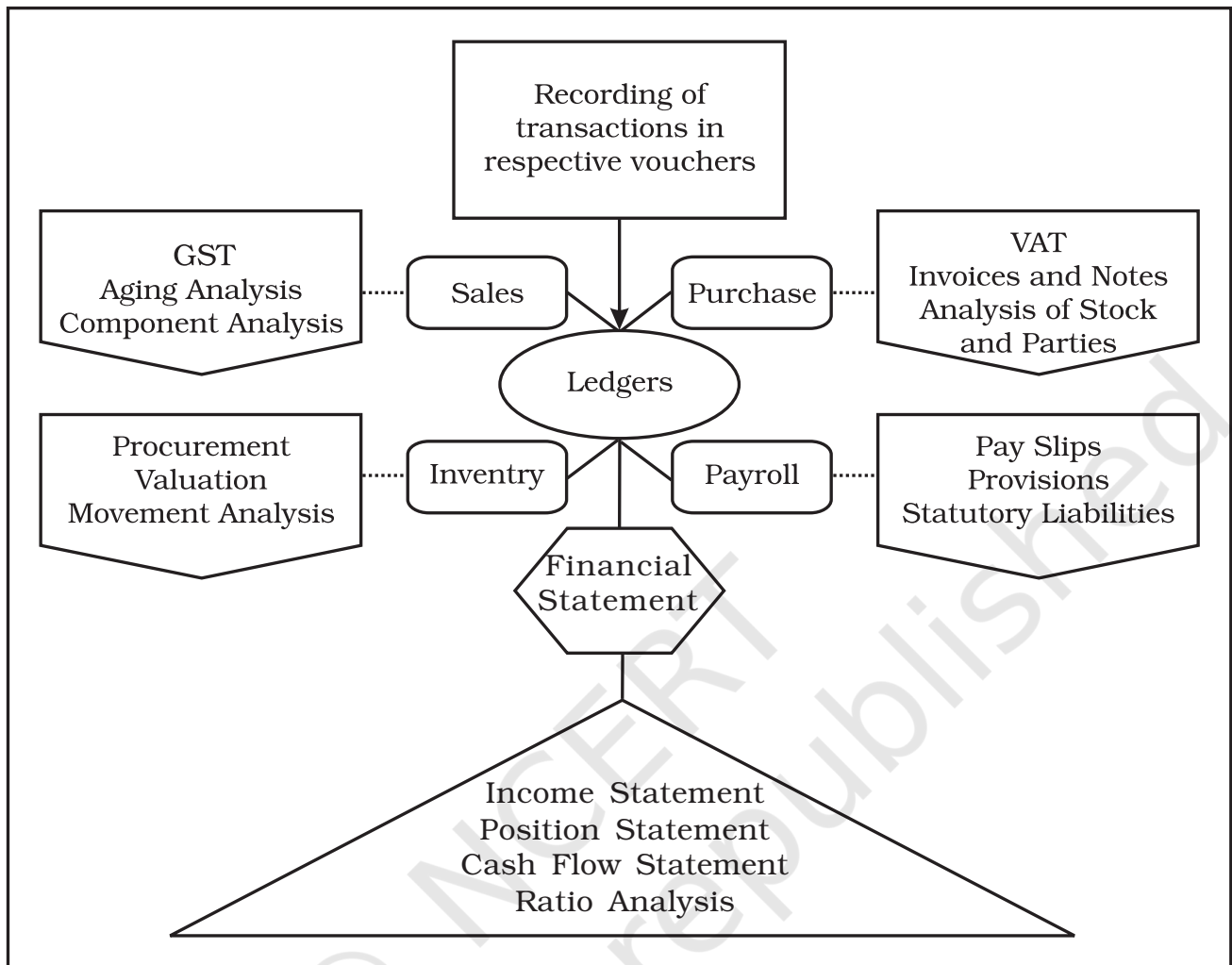


Fig. 12.2 : Components of computerised accounting software system

Test Your Understanding - I

Fill in the correct words :

1. The user oriented programmes designed and developed for performing certain specific tasks are called as
2. Language syntax is checked by software called as
3. The people who write programmes to implement the data processing system design are called as
4.is the brain of the computer.
5.andare two of the important requirements of an accounting report.
6. An example of responsibility report is

12.7 Management Information System and Accounting Information System

In order to remain competitive, organisations depend heavily on Information Systems. Management Information System (MIS) is used the most common form of information system. A management information system (MIS) is a system that provides the information necessary to take decisions and manage an organisation effectively. MIS is supportive of the institution's long-term strategic goals and objectives. MIS is viewed and used at many levels by management: Operational, Tactical and Strategic. Accounting Information System (AIS) identifies, collects, processes, and communicates economic information about an entity to a wide variety of users. Such information is organised in a manner that correct decisions can be based on it.

Every accounting system is essentially a part of the Accounting Information System (AIS) which, in turn is a part of the broader system, viz. the organisation's Management Information System.

The following diagram shows the relationship of the Accounting System with the other functional management information systems.

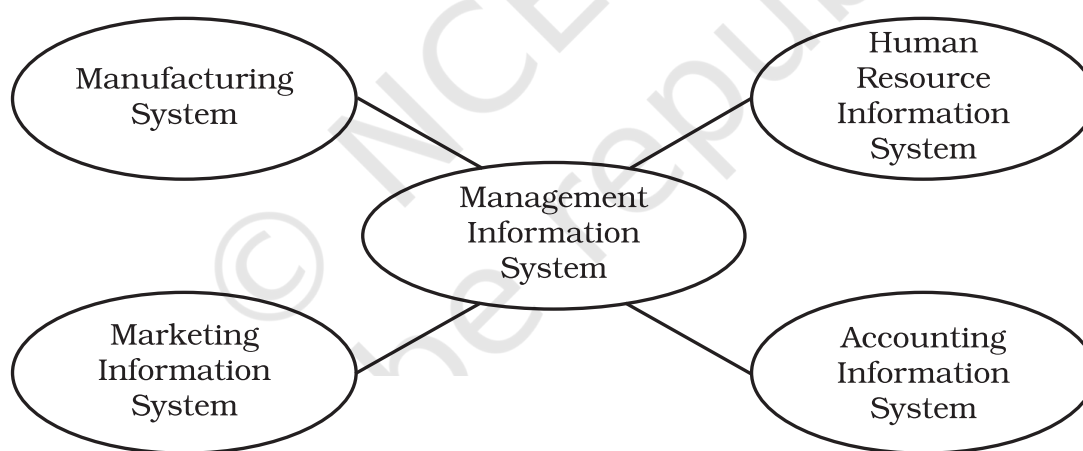


Fig. 12.3 : Relationship of the accounting system with other functional management information system

The diagram shown above entails the four widely recognised functional areas of management. An organisation operates in a given environment surrounded by the suppliers and customers. The informational needs emerge from the business processes stratified into functional areas where accounting is one of them. The accounting information system (AIS) receives and provides information to the various sub-systems of the institutional/integrated MIS.

Accounting Information System (AIS) is a collection of resources (people and equipment), designed to transform financial and other data into information. This information is communicated to a wide variety of decision-makers. Accounting information systems perform this transformation whether they are essentially manual systems or thoroughly computerised.

Conventionally, MIS was also perceived as day-to-day financial accounting systems that are used to ensure basic control is maintained over financial record keeping activities, but now it is widely recognised as a broader concept and accounting system is a sub component.

The reports generated by the accounting system are disseminated to the various users – internal and external to the organisation. The external parties include the proprietors, investors, creditors, financiers, government suppliers and vendors and the society at large. The reports used by these parties are more of routine nature. However, the internal parties – the employees, managers, etc. use the accounting information for decision-making and control.

12.7.1 Designing of Accounting Reports

Data when processed becomes information. When the related information is summarised to meet a particular need, it is called as a report. The content and design of the report is expected to vary depending upon *the level to which it is submitted* and *decision to be made on the basis of the report*. A report must be effective and efficient to the user and should substantiate the decision-making process. Akin to any report, every accounting report must be able to fulfil the following criterion :

- (a) Relevance
- (b) Timeliness
- (c) Accuracy
- (d) Completeness
- (e) Summarisation

The accounting reports generated by the accounting software may be either routine reports or on the specific requirements of the user. For example, the ledger is a routine report while a report on supplies of a particular item by a given party is an on-demand report. However, from a broader perspective, the accounting related MIS reports may be of following reports :

- (a) *Summary Reports* : Summarises all activities of the organisation and present in the form of summary report. Profit and Loss account and Balance Sheet.

- (b) *Demand Reports* : This report will be prepared only when the management requests them, e.g. Bad Debts Report for a given product, Stock Valuation Report.
- (c) *Customer/Supplier Reports* : According to the specifications of the management it will be prepared. For example, Top 10 Customers report, Interest on Customer Account/Invoices, Statement of Account, Customer Reminder Letters Outstanding/Open Delivery Order, Purchase Analysis, Vendor Analysis report.
- (d) *Exception Reports* : According to the conditions or exceptions the report is prepared. For example, Inventory Report in short supplies, Stock Status Query, Over stocked Status, etc.
- (e) *Responsibility Reports* : The MIS structure specifies the premises of management responsibilities. For example, the report on Cash Position, to be submitted by the head of Finance and Accounts department.

The various steps involved in designing accounting reports from accounting data are as follows :

- (1) Definition of objectives : the objectives of the report must be clearly defined, who are the users of the report and the decision to be taken on the basis of report.
- (2) Structure of the report : the information to be contained therein and the style of presentation.
- (3) Querying with the database : the accounting information queries must be clearly defined and the methodology to be adopted while interacting with the database.
- (4) Finalising the report.

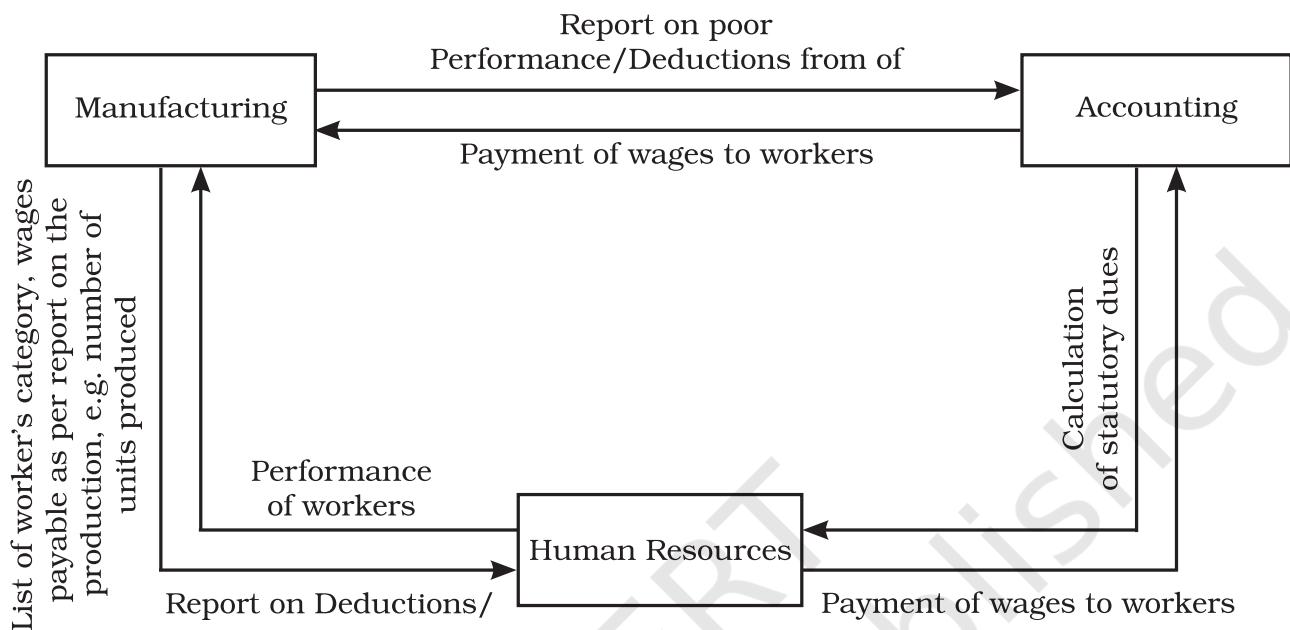
12.7.2 Data Interface between the Information System

Accounting information system is important component of the organisational MIS in an organisation. It receives information and provides information to the other functional MIS. The following examples illustrate the relationship and data interface between the various sub-components of MIS.

I Accounting Information System, Manufacturing Information System and Human Resource Information System

Look at figure 12.4. It depicts the relationship between the three information systems, viz. manufacturing information system, accounting information system and the human resource information system.

The manufacturing department receives the list of workers from the Human Resource (HR) department. It sends the details of production achieved by the workers on the basis of which the HR department to the finance and accounts



(F&A) department to pay the wages. The details of the wages paid and statutory dues are also send by the F & A department to the production department also to the HR department to monitor the performance of workers. The HR department communicates to the other departments about the good/bad performance on the basis decision on various operational matters may be taken.

Fig. 12.4 : Relationship between AIS, manufacturing information system and human resource information system

II AIS and Marketing Information System

Consider the business process in the Marketing and Sales department involving the following activities :

- inquiry
- contact creation
- entry of orders
- dispatch of goods
- billing to customers

The accounting sub-system's transaction cycle include the processing of sales orders, credit authorisation, custody of the goods, inventory position, shipping information, receivables, etc. It also keeps a track of the customer accounts, e.g. Aging Report, which should be generated by the system.

III AIS and Manufacturing Information System

Similarly, business process in the production department may involve the following activities :

- preparation of plans and schedules
- issue of material requisition forms and job cards
- issue of inventory
- issue of orders for procurement of raw materials
- handling of vendors invoices
- payments to vendors

The accounting sub-system transaction cycle would therefore include the processing of purchase orders, advance to suppliers/vendors, inventory status updation, account payable, etc. All of this information has to share with the other MIS in the organisation.

Hence, the computerised accounting system as a sub component of the accounting information system transforms the financial data into meaningful information and communicates the information to the decision-makers. The report demanded may be routine or specific ones.

Key Terms Introduced in the Chapter

- | | |
|------------------------|----------------------------------|
| • Operating system | • Management information system |
| • Analysts | • Transactions processing system |
| • Utility programme | • Accounting information system |
| • Data | • Data interface |
| • Application software | • Report |

Summary with Reference to Learning Objectives

- 1 *Meaning of a Computer* : Computer is an electronic device capable of performing variety of operations as desired by a set of instructions.
- 2 *Elements of a Computer System* :
 - Hardware
 - Software
 - People
 - Procedure
 - Data
 - Connectivity
- 3 *Capabilities of a Computer* :
 - Speed
 - Accuracy
 - Reliability
 - Versatility
 - Storage

- 4 *Need of Computers in Accounting* : The advent of globalisation has resulted in the rise in business operations. Consequently, every medium and large sized organisations require well-established information system in order to generate information required for decision-making and achieving the organisational objectives. This made information technology to play vital role in supporting business operations.
- 5 *MIS and Accounting Information System* : A management information system provides information necessary to take decisions and manage an organisation effectively. Accounting information system on the other hand identifies, collects, processes and communicates economic information about an entity to a wide variety of users.
- 6 *Accounting Reports* : Information supplied to meet a particular need is called report. An accounting report must fulfil the following conditions :
 - Relevance
 - Timeliness
 - Accuracy
 - Completeness
 - Summarisation

Questions for Practice

Short Answers

1. State the different elements of a computer system.
2. List the distinctive advantages of a computer system over a manual system.
3. Draw block diagram showing the main components of a computer.
4. Give three examples of a transaction processing system.
5. State the relationship between information and decision.
6. What is Accounting Information System?
7. State the various essential features of an accounting report.
8. Name three components of a Transaction Processing System.
9. Give example of the relationship between a Human Resource Information System and MIS.

Long Answers

1. 'An organisation is a collection of interdependent decision-making units that exists to pursue organisational objectives'. In the light of this statement, explain the relationship between information and decisions. Also explain the role of Transaction Processing System in facilitating the decision-making process in business organisations.
2. Explain, using examples, the relationship between the organisational MIS and the other functional information system in an organisation. Describe how AIS receives and provides information to other functional MIS.
3. 'An accounting report is essential a report which must be able to fulfil certain basic criteria ' Explain? List the various types of accounting reports.
4. Describe the various elements of a computer system and explain the distinctive features of a computer system and manual system.

Checklist to Test Your Understanding

1. Application software
2. Language processor
3. Programmer
4. CPU
5. Timeliness, Relevance
6. Cash position, Management responsibility

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Computerised Accounting System

In chapter 12, you have learnt about the need for use of computers in accounting the nature and use of accounting information system. In this chapter, we shall discuss the nature of computerised accounting system, its advantages, limitations and sourcing.

13.1 Concept of Computerised Accounting System

A computerised accounting system is an accounting information system that processes the financial transactions and events as per Generally Accepted Accounting Principles (GAAP) to produce reports as per user requirements. Every accounting system, manual or computerised, has two aspects. First, it has to work under a set of well-defined concepts called *accounting principles*. Another, that there is a user-defined framework for maintenance of records and generation of reports.

In a computerised accounting system, the framework of storage and processing of data is called *operating environment* that consists of hardware as well as software in which the accounting system, works. The type of the accounting system used determines the operating environment. Both hardware and software are interdependent. The type of software determines the structure of the hardware. Further, the selection of hardware is dependent upon various factors such as the number of users, level of secrecy and the nature of various activities of functional departments in an organisation.

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- define a computerised accounting system;
- distinguish between a manual and computerised accounting system;
- highlight the advantages and limitations of computerised accounting system; and
- state the sourcing of a computerised accounting system.

Take the case of a club, for example, where the number of transactions and their variety is relatively small, a Personal Computer with standardised software may be sufficient. However, for a large business organisation with a number of geographically scattered factories and offices, more powerful computer systems supported by sophisticated networks are required to handle the voluminous data and the complex reporting requirements. In order to handle such requirements, multi-user operating systems such as UNIX, Linux, etc. are used.

Modern computerised accounting systems are based on the concept of *database*. A database is implemented using a database management system, which is defined by a set of computer programmes (or software) that manage and organise data effectively and provide access to the stored data by the application programmes. The accounting database is well-organised with active interface that uses accounting application programs and reporting system. Every computerised accounting system has two basic requirements;

- *Accounting Framework* : It consists a set of principles, coding and grouping structure of accounting.
- *Operating Procedure* : It is a well-defined operating procedure blended suitably with the operating environment of the organisation.

The use of computers in any database oriented application has four basic requirements as mentioned below ;

- *Front-end Interface* : It is an interactive link or a dialog between the user and database-oriented software through which the user communicates to the back-end database. For example, a transaction relating to purchase of goods may be dealt with the accounting system through a purchase voucher, which appears on the computer's monitor of data entry operator and when entered into the system is stored in the database. The same data may be queried through reporting system say purchase analysis software programme.
- *Back-end Database* : It is the data storage system that is hidden from the user and responds to the requirement of the user to the extent the user is authorised to access.
- *Data Processing* : It is a sequence of actions that are taken to transform the data into decision useful information.
- *Reporting System*: It is an integrated set of objects that constitute the report.

The computerised accounting is also one of the database-oriented applications wherein the transaction data is stored in well-organised database. The user operates on such database using the required and desired interface and also takes the desired reports by suitable transformations of stored data into information. Therefore, the fundamentals of computerised accounting embrace all the basic requirements of any database-oriented application in

computers. Accordingly, the computerised accounting system has the above four additional requirements.

13.2 Comparison between Manual and Computerised Accounting

Accounting, by definition, is the process of identifying, recording, classifying and summarising financial transactions to produce the financial reports for their ultimate analysis. Let us understand these activities in the context of manual and computerised accounting system.

- *Identifying* : The identification of transactions, based on application of accounting principles is, common to both manual and computerised accounting system.
- *Recording* : The recording of financial transactions, in manual accounting system is through books of original entries while the data content of such transactions is stored in a well-designed accounting database in computerised accounting system.
- *Classification* : In a manual accounting system, transactions recorded in the books of original entry are further classified by posting into ledger accounts. This results in transaction data duplicity. In computerised accounting, no such data duplication is made to cause classification of transactions. In order to produce ledger accounts, the stored transaction data is processed to appear as classified so that the same is presented in the form of a report. Different forms of the same transaction data are made available for being presented in various reports.
- *Summarising* : The transactions are summarised to produce trial balance in manual accounting system by ascertaining the balances of various accounts. As a result, preparation of ledger accounts becomes a pre-requisite for preparing the trial balance. However, in computerised accounting, the originally stored transactions data are processed to churn out the list of balances of various accounts to be finally shown in the trial balance report. The generation of ledger accounts is not a necessary condition for producing trial balance in a computerised accounting system.
- *Adjusting Entries* : In a manual accounting system, these entries are made to adhere to the principle of cost matching revenue. These entries are recorded to match the expenses of the accounting period with the revenues generated by them. Some other adjusting entries may be made as part of errors and rectification. However, in computerised accounting, Journal vouchers are prepared and stored to follow the principle of cost matching revenue, but there is nothing like passing adjusting entries for errors and rectification, except for rectifying an error of principle by having recorded a wrong voucher such as using payment voucher for a receipt transaction.
- *Financial Statements* : In a manual system of accounting, the preparation

of financial statements pre-supposes the availability of trial balance. However, in computerised accounting, there is no such requirement. The generation of financial statements is independent of producing the trial balance because such statements can be prepared by direct processing of originally stored transaction data.

- *Closing the Books* : After the preparation of financial reports, the accountants make preparations for the next accounting period. This is achieved by posting of closing and reversing journal entries. In computerised accounting, there is year-end processing to create and store opening balances of accounts in database.

It may be observed that conceptually, the accounting process is identical regardless of the technology used.

13.3 Advantages of Computerised Accounting System

Computerised accounting offers several advantages vis-a-vis manual accounting, these are summarised as follows ;

- *Speed* : Accounting data is processed faster by using a computerised accounting system than it is achieved through manual efforts. This is because computers require far less time than human beings in performing a task.
- *Accuracy* : The possibility of error is eliminated in a computerised accounting system because the primary accounting data is entered once for all the subsequent usage and processes in preparing the accounting reports. Normally, accounting errors in a manual accounting system occur because of repeated posting of same set of original data by several times while preparing different types of accounting reports.
- *Reliability* : The computer system is well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. As a result, computers are highly reliable compared to human beings. Since computerised accounting system relies heavily on computers, they are relatively more reliable than manual accounting systems.
- *Up-to-Date Information* : The accounting records, in a computerised accounting system are updated automatically as and when accounting data is entered and stored. Therefore, latest information pertaining to accounts get reflected when accounting reports are produced and printed.

For example, when accounting data pertaining to a transaction regarding cash purchase of goods is entered and stored, the cash account, purchase account and also the financial statements (trading and profit and loss account) reflect the impact immediately.

- *Real Time User Interface* : Most of the automated accounting systems are

inter-linked through a network of computers. This facilitates the availability of information to various users at the same time on a real time basis (that is spontaneously).

- *Automated Document Production* : Most of the computerised accounting systems have standardised, user defined format of accounting reports that are generated automatically. The accounting reports such as Cash book, Trial balance, Statement of accounts are obtained just by click of a mouse in a computerised accounting environment.
- *Scalability* : In a computerised accounting system, the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The additional cost of processing additional transactions is almost negligible. As a result the computerised accounting systems are highly scalable.
- *Legibility* : The data displayed on computer monitor is legible. This is because the characters (alphabets, numerals, etc.) are type written using standard fonts. This helps in avoiding errors caused by untidy written figures in a manual accounting system.
- *Efficiency* : The computer based accounting systems ensure better use of resources and time. This brings about efficiency in generating decisions, useful informations and reports.
- *Quality Reports* : The inbuilt checks and untouchable features of data handling facilitate hygienic and true accounting reports that are highly objective and can be relied upon.
- *MIS Reports* : The computerised accounting system facilitates the real time production of management information reports, which will help management to monitor and control the business effectively. Debtors' analysis would indicate the possibilities of defaults (or bad debts) and also concentration of debt and its impact on the balance sheet. For example, if the company has a policy of restricting the credit sales by a fixed amount to a given party, the information is available on the computer system immediately when every voucher is entered through the data entry form. However, it takes time when it comes to a manual accounting system. Besides, the results may not be accurate.
- *Storage and Retrieval* : The computerised accounting system allows the users to store data in a manner that does not require a large amount of physical space. This is because the accounting data is stored in hard-disks, CD-ROMs, floppies that occupy a fraction of physical space compared to books of accounts in the form of ledger, journal and other accounting registers. Besides, the system permits fast and accurate retrieval of data and information.
- *Motivation and Employees Interest* : The computer system requires a

specialised training of staff, which makes them feel more valued. This motivates them to develop interest in the job. However, it may also cause resistance when we switch over from a manual system to a computer system.

Test Your Understanding - I

1. The framework of storage and processing of data is called as
2. Database is implemented using
3. A sequence of actions taken to transform the data into decision useful information is called.....
4. An appropriate accounting software for a small business organisation having only one user and single office location would be

13.4 Limitations of Computerised Accounting System

The main limitations emerge out of the environment in which the computerised accounting system is made to operate. These limitations are as given below ;

- *Cost of Training* : The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training costs are incurred to understand the use of hardware and software on a continuous basis because newer types of hardware and software are acquired to ensure efficient and effective use of computerised accounting systems.
- *Staff Opposition* : Whenever the accounting system is computerised, there is a significant degree of resistance from the existing accounting staff, partly because of the fear that they shall be made redundant and largely because of the perception that they shall be less important to the organisation.
- *Disruption* : The accounting processes suffer a significant loss of work time when an organisation switches over to the computerised accounting system. This is due to changes in the working environment that requires accounting staff to adapt to new systems and procedures.
- *System Failure* : The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerised accounting system. However, providing for back-up arrangements can obviate this limitation. Software damage and failure may occur due to attacks by viruses. This is of particular relevance to accounting systems that extensively use Internet facility for their online operations. No full-proof solutions are available as of now to tackle the menace of attacks on software by viruses.
- *Inability to Check Unanticipated Errors* : Since the computers lack capability

to judge, they cannot detect unanticipated errors as human beings commit. This is because the software to detect and check errors is a set of programmes for known and anticipated errors.

- *Breaches of Security* : Computer related crimes are difficult to detect as any alteration of data may go unnoticed. The alteration of records in a manual accounting system is easily detected by first sight. Fraud and embezzlement are usually committed on a computerised accounting system by alteration of data or programmes. Hacking of passwords or user rights may change the accounting records. This is achieved by tapping telecommunications lines, wire-tapping or decoding of programmes. Also, the people responsible for tampering of data cannot be located which in a manual system is relatively easier to detect.
- *Ill-effects on Health* : The extensive use of computers systems may lead to development of various health problems: bad backs, eyestrain, muscular pains, etc. This affects adversely the working efficiency of accounting staff on one hand and increased medical expenditure on such staff on the other.

Do It Yourself

Visit a commercial organisation where the accounting is performed manually. Observe the various accounting activities. Now list the advantages, which would have accrued, had the accounting being performed through computers.

13.5 Sourcing of Accounting Software

Accounting software is an integral part of the computerised accounting system. An important factor to be considered before acquiring accounting software is the accounting expertise of people responsible in organisation for accounting work. People, not computers, are responsible for accounting. The need for accounting software arises in two situations : (a) when the computerised accounting system is implemented to replace the manual system or (b) when the current computerised system needs to be replaced with a new one in view of changing needs.

Box 1
Accounting Software

Variety of accounting software is available in the market. The most popular software used in India are Tally and Ex. The basic features of all accounting software are same on a global basis. The legal reporting requirements in a given country and the business needs affect the software contents. The other popular softwares are Sage, Wings 2000, Best Books, Cash Manager, and Ace Pays, etc.

13.5.1 Accounting Packages

Every Computerised Accounting System is implemented to perform the accounting activity (recording and storing of accounting data) and generate reports as per the requirements of the user. From this perspective,

The accounting packages are classified into the following categories :

- (a) Ready to use
- (b) Customised
- (c) Tailored

Each of these categories offers distinctive features. However, the choice of the accounting software would depend upon the suitability to the organisation especially in terms of accounting needs.

13.5.2 Ready-to-Use

Ready-to-Use accounting software is suited to organisations running small/conventional business where the frequency or volume of accounting transactions is very low. This is because the cost of installation is generally low and number of users is limited. Ready-to-use software is relatively easier to learn and people (accountant) adaptability is very high. This also implies that level of secrecy is relatively low and the software is prone to data frauds. The training needs are simple and sometimes the vendor (supplier of software) offers the training on the software free. However, these software offer little scope of linking to other information systems.

13.5.3 Customised

Accounting software may be customised to meet the special requirement of the user. Standardised accounting software available in the market may not suit or fulfil the user requirements. For example, standardised accounting software may contain the sales voucher and inventory status as separate options. However, when the user requires that inventory status to be updated immediately upon entry of sales voucher and report be printed, the software needs to be customised.

Customised software is suited for large and medium businesses and can be linked to the other information systems. The cost of installation and maintenance is relatively high because the high cost is to be paid to the vendor for customisation. The customisation includes modification and addition to the software contents, provision for the specified number of users and their authentication, etc. Secrecy of data and software can be better maintained in customised software. Since the need to train the software users is important, the training costs are therefore high.

13.5.4 Tailored

The accounting software is generally tailored in large business organisations with multi users and geographically scattered locations. These software requires specialised training to the users. The tailored software is designed to meet the specific requirements of the users and form an important part of the organisational MIS. The secrecy and authenticity checks are robust in such softwares and they offer high flexibility in terms of number of users.

To summarise, the following table represents the comparison between the various categories of accounting software :

<i>Basis</i>	<i>Ready to use</i>	<i>Customised</i>	<i>Tailored</i>
Nature of business	Small, conventional business	Large, medium business	Large, typical business
Cost of installation and maintenance	Low	Relatively high	High
Expected Level of secrecy (Software and Data)	Low	Relatively high	Relatively high
Number of users and their interface	Limited	As per specifications	Unlimited
Linkage to other information system	Restricted	yes	Yes
Adaptability	High	Relatively high	Specific
Training requirements	Low	Medium	High

13.6 Generic Considerations before Sourcing an Accounting Software

The following factors are usually taken in considerations before sourcing an accounting software.

13.6.1 Flexibility

An important consideration before sourcing an accounting software is flexibility, viz. data entry and the availability and design of various reports expected from it. Also, it should offer some flexibility between the users of the software, the switch over between the accountants (users), operating systems and the hardware. The user should be able to run the software on variety of platforms and machines, e.g. Windows 98/2000, Linux, etc.

13.6.2 Cost of Installation and Maintenance

The choice of the software obviously requires consideration of organisation ability to afford the hardware and software. A simple guideline to take such a decision is the cost benefit analysis of the available options and the financing opportunities available to the firm. Some times, certain software which appears cheap to buy, involve heavy maintenance and alteration costs, e.g. cost of addition of modules, training of staff, updating of versions, data failure/restoring costs. Conversely, the accounting software which appear initially expensive to buyers, may require least maintenance and free upgrading and negligible alteration costs.

13.6.3 Size of Organisation

The size of organisation and the volume of business transactions do affect the software choices. Small organisations, e.g. in non-profit organisations, where the number of accounting transactions is not so large, may opt for a simple, single user operated software. While, a large organisation may require sophisticated software to meet the multi-user requirements, geographically scattered and connected through complex networks.

13.6.4 Ease of Adaptation and Training needs

Some accounting software is user friendly requiring a simple training to the users. However, some other complex software packages linked to other information systems require intensive training on a continuous basis. The software must be capable of attracting users and, if it requires simple training, should be able to motivate its potential users.

13.6.5 Utilities/MIS Reports

The MIS reports and the degree to which they are used in the organisation also determine the acquisition of software. For example, software that requires simply producing the final accounts or cash flow/ratio analysis may be ready-to-use software. However, the software, which is expected to produce cost records needs to be customised as per user requirements.

13.6.6 Expected Level of Secrecy (Software and Data)

Another consideration before buying accounting software is the security features, which prevent unauthorised personnel from accessing and/or manipulating data in the accounting system. In tailored software for large businesses, the user rights may be restricted to purchase vouchers for the purchase department, sales vouchers to the billing accountants and petty cash module access with the cashier. The operating system also matters. Unix environment allows multi-users compared to Windows. In Unix, the user cannot make the computer system functional unless the user clicks with a password, which is not a restriction in Windows.

13.6.7 Exporting/Importing Data Facility

The transfer of database to other systems or software is sometimes expected from the accounting software. Organisations may need to transfer information directly from the ledger into spreadsheet software such as Lotus or Excel for more flexible reporting. The software should allow the hygienic, untouched data transfer.

Accounting software may be required to be linked to MIS software in the organisation. In some ready to use accounting softwares, the exporting, importing facility is available but is limited to MS Office modules only, e.g. MS Word, MS Excel, etc. However, tailored softwares are designed in manner that they can interact and share information with the various sub components of the organisational MIS.

13.6.8 Vendors Reputation and Capability

Another important consideration is the reputation and capability of about the vendor. This depends upon how long has he been the vendor is in business of software development, whether there are other users of the software and extent of the availability of support mechanisms outside the premises of the vendor.

Key Terms Introduced in the Chapter

- Computerised Accounting System
- Generally Accepted Accounting Principles
- Accounting Software
- Manual Accounting System
- Operating Environment
- Accounting Packages

Summary with Reference to Learning Objectives

- 1 *Computerised Accounting System* : A computerised accounting system is an accounting information system that processes the financial transactions and events to produce reports as per user requirements. It is based on the concept of database and has two basic requirements: (a) Accounting framework and (b) Operating Procedure.
- 2 *Advantages of Computerised Accounting System* :

<ul style="list-style-type: none"> • Speed • Reliability • Scalability • Efficiency • MIS Reports • Storage and Retrieval • Automated document production 	<ul style="list-style-type: none"> • Accuracy • Up-to-date • Legibility • Quality Report • Real time user interface • Motivation and Employees interest
--	---
- 3 *Limitations of Computerised Accounting System* :

<ul style="list-style-type: none"> • Cost of training • Disruption • Breache of security • Inability to check unanticipated errors 	<ul style="list-style-type: none"> • Staff Opposition • System failure • Ill-effects on health
--	---
- 4 *Categories of Accounting Packages* :

<ul style="list-style-type: none"> • Ready-to-Use • Tailored 	<ul style="list-style-type: none"> • Customised
--	--

Questions for Practice

Short Answers

1. State the four basic requirements of a database applications.
2. Name the various categories of accounting package.
3. Give examples of two types of operating systems.
4. List the various advantages of computerised accounting systems.
5. Give two examples each of the organisations where 'ready-to-use', 'customised', and 'tailored' accounting packages respectively suitable to perform the accounting activity.
6. Distinguish between a 'ready-to-use' and 'tailored' accounting software.

Long Answers

1. Define a computerised accounting system. Distinguish between a manual and computerised accounting system.
2. Discuss the advantages of computerised accounting system over the manual accounting system.
3. Describe the various types of accounting software along with their advantages and limitations.
4. 'Accounting software is an integral part of the computerised accounting system' Explain. Briefly list the generic considerations before sourcing an accounting software.
5. 'Computerised Accounting Systems are best form of accounting system'. Do you agree? Comment.

Checklist to Test Your Understanding

1. Operating environment 2. DBMS 3. Data Processing 4. Ready to use

APPENDIX

Description of Commonly Used Functions in Access

There are three types of functions that are used to set the Control Source property of calculated controls and/or to form part of calculated field expression in SQL statement. A brief description of the commonly used functions is below :

A-1. Domain Aggregate Functions

These functions are used to perform calculations based on values in a field of a table or query. Criteria to select the set of records in the table or query that is desired to be used for calculations may also be specified. The criteria, if not specified, imply that all the records of the table or query specific to the field are used for computation. All the domain aggregate functions use the same syntax as is given hereunder :

DFunction ("FldName", "TblName" or "QryName", "SrchCond")

Wherein DFunction refers to a named domain aggregate function. A brief description of its input arguments is given below:

FldName : It refers to the name of field that is to be searched in a table or query, which is specified as an argument.

TblName (or QueryName) : It refers to the name of a table or query that contains the field specified as second input argument.

SrchCond : It refers to the search condition on the basis of which the relevant record is searched.

Some of the important domain aggregate functions have been described as below :

- (a) DLookup : This function is meant to look up information that is stored in a table or query, which is not the underlying source of Access Form or Report. It is used to set the Control Source property of a calculated control to display data from other table or query. Consider the following example:

DLookup ("Name", "Accounts", "Code = '110001'")

In the above example, this function has been applied to search the name of account (in Accounts table) whose code is '110001'.

- (b) DMax and DMin : These functions are used to retrieve respectively the maximum and minimum values in the specified field. Consider the following example :

DMin ("Amount", "Vouchers", "Debit = '711001'")

Dmax ("Amount", "Vouchers", "Debit = '711001'")

In the above examples, the amount of minimum purchase transaction and maximum purchase transaction is retrieved and reported. It may also be noted that '711001' is the code of Purchase account in Accounts table

- (c) DSum : This function computes and returns the sum of the values in the specified field or expression. For Example, in a table : **Sales** that contains

ItemCode, Price and Quantity as fields, the total amount of *sales* may be computed by using the DSum () function as follows :

DSum ("Price*Quantity", "Sales")

However, if the total sales is to be computed for a particular item coded as 1678, the DSum () function shall be applied as follows :

DSum ("Price*Quantity", "Sales", "ItemCode = 1678")

- (d) DFirst and DLast : These functions are used to retrieve respectively the values in the specified field from first and last physical records.

Consider the following application examples :

DFirst ("Name", "Accounts")

DLast ("Name", "Accounts")

In the above examples, the name first and last account that physically exists in Accounts table is retrieved and reported.

- (e) DCount : This function is meant to compute the number of records with non-null values in the specified field. Consider the following application example :

DCount ("*", "Accounts")

In the above example, The number of records in accounts table are counted and reported by DCount () function.

A-2. SQL Aggregate Functions

The SQL aggregate functions have the functionality similar to that of domain aggregate function. However, unlike domain aggregate functions, these functions cannot be called directly into controls used in Forms and Reports of Access. These functions are used in SQL statements that provide the underlying record source of Forms and Reports. All these functions, when used require the GROUP BY clause in SQL statement :

- (a) Sum : This function is used to compute and return the sum of a set of values. For Example, consider the following SQL statement that has been used in Chapter-V to prepare the underlying information source of Trial Balance (Model-I.).

```
SELECT Debit As Code, SUM (Amount) AS Total
FROM VOUCHERS
GROUP BY Debit ;
```

In the above SQL statement, Sum () has been used to compute the total amount by which the transacted accounts have been debited.

- (b) Min and Max : These functions are used to retrieve respectively the minimum and maximum of value set with respect to field or query expression. For Example, the following SQL statement is capable of returning the amount of minimum and maximum sales transaction in Model-I :

```
SELECT Min (Amount) As MinSales, Max (Amount) As MaxSales
FROM Vouchers
WHERE Credit = '811001' ;
```

It may be noted that the sales account that is coded as '811001' is credited as and when a sales transaction is recorded.

- (c) **Count** : This function counts the number of records returned by a query. The number of times a sales transaction has occurred and recorded in books of accounts can be known by executing the following SQL statement.

SQL statement.

SELECT count (*)

FROM Vouchers

WHERE Credit = '811001'

In the above SQL statement, the Credit field stores the account code of sales when a sales transaction occurs. The WHERE clause restricts the number of records returned by the above SQL to those in which credit field has the account code of sales. Accordingly, the count () function returns the count value of records returned by the above SQL statement.

- (d) **First and Last** : These functions are meant to retrieve the first and last record of a value set pertaining to a field or query expression.

A-3. Other Functions

- (a) **IIF** : The purpose of this function is to provide a value to the field from a mutually exclusive set of values. Its syntax is as given below :

IIF (<Condition>, Value-1, Value-2)

Wherein <Condition> refers to any logical expression in which a comparison is made by using following comparison operators :

= equal to

<less than

>greater than

<= less than or equal to

>= greater than or equal to

The condition formed by the above comparison operators is evaluated to result into TRUE or FALSE.

<Value-1> This value is returned by IIF() function to the field, if the condition turns out to be TRUE

<Value-2> This value is returned by IIF() function to the field, if the condition turns out to be FALSE

Example : Suppose a field Type is to return the string of characters "Debit" when its value is 0 and "Credit" when its value is 1, IIF() function is used as shown below :

IIF (Type = 0, "Debit", "Credit")

- (b) **Abs** : The purpose of this function is to return absolute value, This function receives a numeric value as its input argument and returns an absolute value. Consider the following examples on use of Abs () function :

When - 84 is given as input argument to Abs(- 84), it returns 84

When 84 is given as input argument to Abs(84), it returns 84

- (c) **Val** : The purpose of this function is to return the numbers contained in a string as a numeric value of appropriate type. Its Syntax is **Val**(string)
The string argument of the above Val() function is any valid string expression. The Val() function stops reading the string at the first character that cannot be recognised as number. For example, Val("12431") returns the value 12431 by converting the enclosed string of numerals into value. However, Val("12,431") returns the numeric value 12 because comma after 12 in the enclosed string of characters in Val () function is not recognised as number.

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