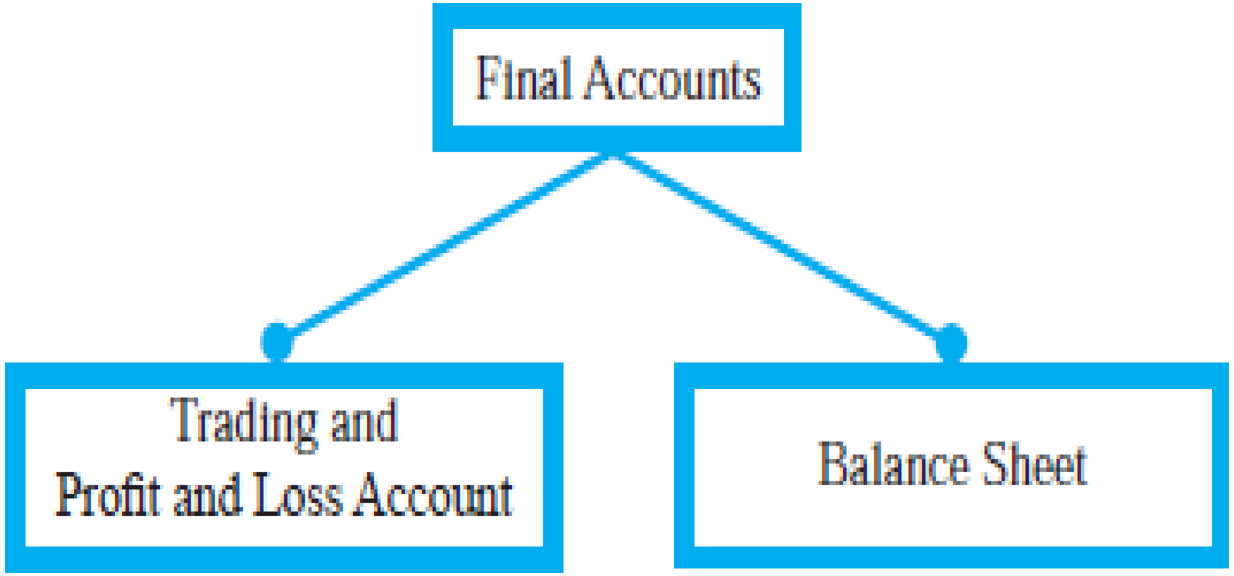
FINAL ACCOUNTS AND DEPRECIATION



The final accounts or financial statements include the following:

a. Income Statement or Trading and Profit and Loss Account and

b. Position Statement or Balance Sheet.

THE PURPOSES OF PREPARING THE FINANCIAL STATEMENTS ARE:

i. To ascertain the financial performance of an enterprise and
ii. To ascertain the financial position of an enterprise.
The income statement and balance sheet are prepared for these purposes respectively. Income statement gives the manner in which the profit or loss for an accounting period is arrived at.
The revenues earned and expenses incurred to earn the revenues during the period are shown in the income statement under appropriate heads as per matching principle. All the nominal accounts and accounts relating to goods during an accounting period are to be considered only in the relevant accounting period and are not to be carried forward. Moreover, only these items are to be compared for determining the financial performance. Hence, at the close of the accounting period, all nominal accounts (i.e. expenses, losses, revenues, gains, purchases, purchases returns, sales and sales returns) are to be closed by transferring to the income statement or trading and profit and loss account.

12.3.3 Closing of trading account

The difference between the totals of two sides of the trading account indicates either gross profit or gross loss. If the total of the credit side is more, the difference represents gross profit. On the other hand, if the total of the debit side is higher, the difference represents gross loss. The gross profit or gross loss is transferred to profit and loss account.

12.3.4 Format of trading account

Dr. **Trading account for the year ended . . .** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales returns	xxx	xxx
Less: Purchases returns	xxx	xxx	By Closing stock		xxx
To Direct expenses:			By Gross loss c/d*		xxx
Carriage/Freight inwards		xxx			
Wages		xxx			
Dock charges		xxx			
Octroi		xxx			
Royalty		xxx			
Import duty		xxx			
To Cost of goods manufactured		xxx			
To Gross profit c/d*		xxx			
		xxx			xxx

* The difference in trading account will be either gross profit or gross loss.

From the following information, prepare trading account for the year ending 31st December, 2017.

Particulars	₹	Particulars	₹
Opening stock	50,000	Dock charges on purchases	4,000
Cost of goods manufactured	12,000	Import duty on purchases	3,500
Cash purchases	60,000	Wages	11,000
Cash sales	85,000	Sales returns	3,000
Purchases returns	2,000	Credit purchases	35,000
Carriage inwards	4,000	Credit sales	60,000
Freight outwards	3,000	Other direct expenses	7,000
Coal and fuel	2,500		

Solution

Dr. **Trading account for the year ended 31st December, 2017** Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		50,000	By Sales:		
To Cost of goods			Cash	85,000	
manufactured		12,000	Credit	60,000	
To Purchases:				1,45,000	
Cash	60,000		Less: Sales returns	3,000	1,42,000
Credit	35,000		By Gross loss c/d		45,000
	95,000				
Less: Purchases returns	2,000	93,000			
To Carriage inwards		4,000			
To Coal and fuel		2,500			
To Dock charges on Purchases		4,000			
To Import duty on					
Purchases		3,500			
To Wages		11,000			
To Other direct expenses		7,000			
		1,87,000			1,87,000

Note: Freight outwards will not appear in trading account as it is not a direct expense.

Compute cost of goods sold from the following information:

Particulars	₹
Opening stock	8,000
Purchases	60,000
Direct expenses	5,000
Indirect expenses	6,000
Closing stock	9,000

Solution

Cost of goods sold = Opening stock + Net purchases + Direct expenses – Closing stock

= 8,000 + 60,000 + 5,000 – 9,000

= ₹ 64,000

Note: Indirect expenses do not form part of cost of goods sold.

Find out the amount of sales from the following information.

Particulars	₹
Opening stock	20,000
Purchases less returns	70,000
Direct expenses	10,000
Closing stock	30,000
Gross profit margin (on sales)	20%

Solution

Cost of goods sold = Opening stock + Net purchases + Direct expenses – Closing stock
= 20,000 + 70,000 + 10,000 – 30,000
= ₹ 70,000

Let the sales be	100
Less: Gross profit (20% on sales, i.e., 100)	20
Cost of goods sold	80

Therefore, percentage of Gross profit on Cost of goods sold is $\frac{20}{80} \times 100 = 25\,\%$

Gross profit = 25 % on ₹ 70,000 i.e: $\frac{25}{100} \times 70{,}000 =$ ₹ 17,500

Sales = Cost of goods sold + Gross profit
= 70,000 + 17,500 = ₹ 87,500

the difference is termed as net loss. Net profit or net loss is transferred to the capital account.

12.4.4 Format of profit and loss account

Dr. Profit and loss account for the year ended …….. Cr.

Particulars	₹	Particulars	₹
To Gross loss b/d	xxx	By Gross profit b/d	xxx
To Office and administrative expenses:		By Indirect incomes:	
Salaries	xxx	Rent earned	xxx
Rent, rates and taxes	xxx	Discount received	xxx
Printing and stationery	xxx	Commission earned	xxx
Postage	xxx	Interest on drawings	xxx
Legal charges	xxx	Interest on investments	xxx
Audit fees	xxx	Dividend on shares	xxx
Establishment expenses	xxx	Bad debts recovered	xxx
Trade expenses	xxx	Profit on sale of fixed assets	xxx
General travelling expenses	xxx	Apprenticeship premium	xxx
Lighting	xxx	Miscellaneous receipts	xxx
Insurance premium	xxx	By **Net loss***	xxx
		(transferred to capital account)	
To Selling and distribution expenses:			
Carriage outwards	xxx		
Advertisement	xxx		
Commission	xxx		
Brokerage	xxx		
Bad debts or provision for bad debts	xxx		
Export duty	xxx		
Packing charges	xxx		
To Other expenses and losses:			
Repairs	xxx		
Depreciation	xxx		
Interest charges	xxx		
Discount allowed	xxx		
Provision for discount on debtors	xxx		
Bank charges	xxx		
Interest on capital	xxx		
Donation and charity	xxx		
Loss on sale of fixed assets	xxx		
Abnormal loss due to fire, theft etc. not covered by insurance	xxx		
Miscellaneous expenses	xxx		
To **Net profit***	xxx		
(transferred to capital account)			
	xxx		xxx

* The balance will be either net profit or net loss.

From the following information, prepare profit and loss account for the year ended 31st March, 2018.

Particulars	₹	Particulars	₹
Gross profit b/d	1,50,000	Advertisement expenses	3,800
Carriage outward	25,500	Bad debts	8,500
Office rent	7,000	Dividend received	9,000
Office stationery	3,500	Discount received	4,600
Distribution expenses	2,000	Rent received	7,000

Solution

Dr. Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Carriage outward	25,500	By Gross profit b/d	1,50,000
To Office rent	7,000	By Dividend received	9,000
To Office stationery	3,500	By Discount received	4,600
To Distribution expenses	2,000	By Rent received	7,000
To Advertisement expenses	3,800		
To Bad debts	8,500		
To Net profit transferred to capital account	1,20,300		
	1,70,600		1,70,600

From the following information, prepare profit and loss account for the year ended 31st December, 2017.

Particulars	₹	Particulars	₹
Gross profit b/d	60,000	Interest received	2,100
Freight outward	15,000	Financial charges	4,000
Packing charges (on sales)	12,000	Repairs on vehicles used in office	8,000
Salesmen commission paid	1,300	Depreciation on vehicles used in office	3,000
Promotional expenses	10,200	Interest paid	9,000
Office telephone expenses	22,400	Rent received	7,000
Bad debts recovered	4,000	Carriage inwards	4,000

Solution

Dr. **Profit and Loss Account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Freight outward	15,000	By Gross profit b/d	60,000
To Packing charges	12,000	By Bad debts recovered	4,000
To Salesmen commission	1,300	By Interest received	2,100
To Promotional expenses	10,200	By Rent received	7,000
To Office telephone expenses	22,400	By Net loss transferred to	
To Financial charges	4,000	capital account	**11,800**
To Repairs on vehicles	8,000		
To Depreciation on vehicles	3,000		
To Interest paid	9,000		
	84,900		84,900

Note: Carriage inwards will not appear in profit and loss account as it is a direct expense.

Balance sheet

Balance sheet is a statement which gives the position of assets and liabilities on a particular date. Assets are the resources owned by the business. Liabilities are the claims against the business. After ascertaining the net profit or net loss of the business enterprise, a business person would like to know the financial position of the business.

For this purpose, balance sheet is prepared which contains amounts of all the assets and liabilities of the business enterprise as on a particular date. The statement so prepared is called 'balance sheet' because it gives the balances of ledger accounts which are still there, after the closure of all nominal accounts by transferring to the trading and profit and loss account. Balances of all the personal and real accounts are grouped into assets and liabilities. In the balance sheet, liabilities are shown on the left hand side and assets on the right hand side.

According to J.R. Batliboi, "A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date."

Need for preparing a balance sheet

The purposes of preparing a balance sheet are as follows:

(a) The main purpose of preparing a balance sheet is to ascertain the true financial position of the business at a particular point of time.

(b) It helps in comparing the cost of various assets of the business such as the amount of closing stock, amount due from debtors, amount of fictitious assets, etc. Moreover as assets and liabilities of similar nature are grouped and presented in balance sheet, a comparative study of these assets and liabilities is facilitated. It helps in comparing the various liabilities of the business.

(c) It helps in finding out the solvency position of the firm. The firm's solvency position is favourable if the assets exceed the external liabilities. The firm's solvency position is not favourable it the external liabilities exceed the assets.

liabilities are shown on the left hand side of the balance sheet.

Balance sheet of ... as on...

Liabilities	₹	₹	Assets	₹	₹
Capital	xxx		**Fixed assets:**		
Add: Net profit/ Less: Net loss	xxx		**i) Intangible assets**		
	xxx		Goodwill		xxx
Less: Drawings	xxx	xxx	Patent rights		xxx
Reserves		xxx	Copy rights		xxx
Long term loans		xxx	Trade marks		xxx
Current liabilities:			Computer software		xxx
Bank overdraft, Cash credit	xxx		**ii) Tangible assets**		
Outstanding expenses	xxx		Land		xxx
Unearned income	xxx		Buildings	xxx	
Short term loans from banks	xxx		Less: Depreciation	xxx	xxx
Sundry creditors	xxx		Plant and machinery	xxx	
Bills payable	xxx	xxx	Less: Depreciation	xxx	xxx
Provisions			Vehicles	xxx	
Provision for employee benefits		xxx	Less: Depreciation	xxx	xxx
Provision for tax		xxx	Furniture and Fittings	xxx	
			Less: Depreciation	xxx	xxx
			Investments		xxx
			Current assets		
			Stock		xxx
			Advances given		xxx
			Sundry debtors		xxx
			Bills receivable		xxx
			Prepaid expenses		xxx
			Accrued income		xxx
			Cash at bank		xxx
			Cash in hand		xxx
			Fictitious assets		
			Preliminary expenses		xxx
		xxx			xxx

Preparation of Balance Sheet

There is no prescribed format for preparing the balance sheet of sole proprietor and partnership.

For Joint Stock Company, the format of preparing balance sheet is given under Schedule III of Indian Companies Act, 2013. After transferring all nominal accounts, the items left out in trial balance are real account and personal accounts. These are grouped under assets (debit balance) and liabilities (credit balance) and presented in a balance sheet.

Classification of assets and liabilities

The resources acquired by the business entity out of funds provided by owners or creditors are called assets. These are the resources owned by the business. Assets of a business include cash, stock, plant and machinery, etc.

A) Classification of assets

According to the nature of assets, they may be classified into the following:

a) Fixed assets

Fixed assets are those assets which are acquired or constructed for continued use in the business and last for many years such as land and building, plant and machinery, motor vehicles, furniture, etc. According to Finney and Miller, "Fixed assets are assets of a relatively permanent nature used in the operations of business and not intended for sale." As the purpose of keeping such assets is not to sell but to use them, changes in their realisable values are ignored and these are always shown in the balance sheet at cost less depreciation. Fixed assets can be classifed into i) Tangible fixed assets ii) Intangible fixed assets.

i) Tangible fixed assets Tangible fixed assets are those which have physical existence or which can be seen and felt. Examples: plant and machinery, building and furniture. **ii) Intangible fixed assets** Intangible fixed assets are those which do not have any physical existence or which cannot be seen or touched. Examples: goodwill, trade-marks, copy rights and patents. Intangible assets are as much valuable as tangible assets because they also help the firm in earning profits. For example, goodwill helps in attracting customers and patents represent the know-how which helps in producing the goods.

b) Current assets

Current assets are those assets which are either in the form of cash or can be easily converted into cash in the normal course of business or within one year. In the words of Hovard and Upton, "The current assets are usually defined as those assets which are convertible into cash through the normal course of business within a short time, ordinarily in a year." Current assets include cash in hand, cash at bank, short-term investments, bills receivable, debtors, prepaid expenses, accrued income, closing stock, etc. Among these, closing stock is valued at cost or realisable value whichever is lower and debtors are shown after deducting a reasonable provision for bad and doubtful debts.

Prepaid expenses are treated as current assets. Though cash cannot be realised from prepaid expenses, the service will be available against these without further payment.

c) Liquid assets

Liquid assets are the assets which are either in the form of cash or which can be immediately converted into cash within a very short period of time, such as cash at bank, bills receivable, short-term investments, debtors and accrued incomes. In other words, if prepaid expenses and closing stock are excluded from current assets, the balance is known as liquid assets.

d) Investments

Amount invested outside the business in shares, debentures, bonds and other securities is called investments. If it is invested for a period more than a year they are called long-term investments. If they are invested for a period less than a year they are short term investments and shown under current assets.

e) Wasting assets

These are the assets which get exhausted gradually in the process of excavation. Examples: mines and quarries.

f) Fictitious or Nominal assets

These are assets only in name but not in reality. These assets are not really assets but are shown on the assets side only for the purpose of writing off by transferring them to the profit and loss account gradually over a period of time in future. Such assets include the expenditures, the benefit of which lasts for more than a year, not yet written off, such as advertisement expenses, preliminary expenses, etc.

B) Classification of liabilities

Liabilities or equities are claims against the business entity. These are the amounts owed by a business entity to the outsiders (outsiders equity) and owners (owners equity).

Liabilities may be classified according to their nature as follows:

(a) Fixed or long-term liabilities

The liabilities which are to be repaid after one year or more are termed as long-term liabilities.

Example: Long-term loans.

(b) Current or short-term liabilities

The liabilities which are expected to be paid within the normal operating cycle or one year are termed as current or short-term liabilities. These include bank overdraft, creditors, bills payable, outstanding expenses, etc.

(c) Contingent liabilities

These are the liabilities which are not certain at the time of preparation of balance sheet. These liabilities may or may not occur. These are the liabilities which will become payable only on the happening of some specific event which itself is not certain, otherwise these need not be paid. Such liabilities are as follows:

- Liabilities for bills discounted

In case a bill discounted with the bank is dishonoured by the acceptor on the due date, the firm will become liable to the bank.

From the following balances of Niruban, prepare balance sheet as on 31st December, 2017.

Particulars	Dr. ₹	Cr. ₹
Plant and machinery	8,00,000	
Land and building	6,00,000	
Furniture	1,50,000	
Cash in hand	20,000	
Bank overdraft		1,80,000
Debtors and Creditors	3,20,000	2,40,000
Bills receivable and Bills payable	1,00,000	60,000
Closing stock	4,00,000	
Investments (short-term)	80,000	
Capital		15,00,000
Drawings	1,30,000	
Net Profit		6,20,000
	26,00,000	26,00,000

Solution

In the books of Niruban
Balance sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	15,00,000		Land and building		6,00,000
Add: Net profit	6,20,000		Plant and machinery		8,00,000
	21,20,000		Furniture		1,50,000
Less: Drawings	1,30,000	19,90,000	Investments (short-term)		80,000
Creditors		2,40,000	Stock in trade		4,00,000
Bills payable		60,000	Debtors		3,20,000
Bank overdraft		1,80,000	Bills receivable		1,00,000
			Cash in hand		20,000
		24,70,000			24,70,000

Question.1 What is meant by Adjusting Entries?

Answer 1.

Adjusting Entries are the entries passed to record expenses and incomes that relate to the accounting period but yet to be paid or recovered.

Question.2 Why is it necessary to pass adjusting entries when final accounts are prepared?

Answer 2.

It necessary to pass adjusting entries when final accounts are prepared, because Accrual Concept is the fundamental accounting concept and requires that all expenses, whether paid or not, should be accounted to ascertain correct profit or loss, assets and liabilities. They are recorded through the adjustment entries.

Question.3 What are Outstanding Expenses? What is its adjusting entry?

Answer 3.

Outstanding Expenses mean the expenses incurred but not yet paid. At the end of the accounting year such expenses is accounted in the books, otherwise profit will be overstated and liabilities will be understated. Its adjusting entry is:

Expenses A/c Dr.

To Outstanding Expenses A/c

(Being particular expenses provided)

Question.4 What is meant by Prepaid Expenses? How are they adjusted in the Final Accounts?

Answer 4.

Prepaid Expenses are those expenses which we pay in this year, the benefit of which expenses relates to next accounting year. Such part of the expenses is known as prepaid expenses or unexpired expenses. The unexpired part such expenses is deducted from the total expenses in the Profit and Loss Account and prepaid expenses are shown as an asset in the Balance Sheet under the head current assets.

Question.5 Define Accrued Income. What is its adjusting entry?

Answer 5.

Accrued Incomes or Outstanding Incomes are those incomes which have been earned during the accounting period but have not been received till the end of accounting period. As per the Accrual Concept of Accounting, total income of the period, both received and yet to be received, are shown in the Final Accounts otherwise the profit and assets will remain under stated.

The adjusting entry for this purpose is:

Accrued Income A/c

To Income A/c (Amount of Particular Income)

To Output CGST A/c (Amount of CGST)

To Output SGST A/c (Amount of SGST)

(Being the particular accrued income accounted in the books)

Question.6 What is Unearned Income? How is it adjusted in the Final Accounts?

Answer 6.

Unearned Income or Income Received in Advance means an income that has not been earned but is received in advance. At times an amount is received during a year in respect of an income that relates partially or fully to the next year.

It is adjusted in the Final Accounts as given below:

1. In the credit side of Profit and Loss Account by deducting from the amount under that head of income.

2. In the liabilities side of the Balance Sheet under the head current liabilities.

3. If income received in advance is shown in the trial Balance, it means that the adjusting entry is already passed. It such a case, Income Received in Advance is shown in the Balance Sheet under the head current liabilities.

Question.9 Ravi's Trail Balance as on 31st March,2019 has the following information:

Heads of Accounts	Debit	Credit
Loan (Taken on 1st October,2018 interest @ 10% p.a.)	-	1,00,000
Interest	4,000	-

What is the amount of outstanding interest to be provided?

Answer 9.

The amount of outstanding interest to be provided

=Total Interest – Interest paid during the year

= Rs. 1,00,000 × 10/100 × 6/12 – Rs. 4,000

= Rs. 5,000 – Rs. 4,000

= Rs. 1,000

Question.10 Manish has paid salaries of Rs. 1,50,000 for the year ended 31st March, 2019. Salaries include Rs. 20,000 paid in advance for the year ending 31st March. 2020. Show how it will be shown in the Profit and Loss Account and the Balance Sheet.

Answer 10.

In the Books of Kapil
Profit and Loss Account for the Year ended 31st March

Particular		Amount	Particular	Amount
To Salaries	Rs. 1,50,000			
Less: Salaries paid in Advance	Rs. 20,000	1,30,000		

Balance Sheet of Rahul as at 31st March

Liabilities	Amount	Assets	Amount
		Current Assets:	
		Salaries paid in Advance	20,000

Question.11 Rahul's Trial Balance as on 31st March,2019 has the following information:

Heads of Accounts	Debit	Credit
Salaries and Wages	3,30,000	-
Electricity Expenses	55,000	-

Additional information: (i) Salary for the month of March, 2019 is yet to be paid. (ii) Electricity Bill for March,2019 amounted to Rs.5,200 was received on 2nd April,2019.

Question.11 **Rahul's Trial Balance as on 31st March,2019 has the following information:**

Heads of Accounts	Debit	Credit
Salaries and Wages	3,30,000	-
Electricity Expenses	55,000	-

Additional information: (i) Salary for the month of March, 2019 is yet to be paid. (ii) Electricity Bill for March,2019 amounted to Rs.5,200 was received on 2nd April,2019.

Answer 11.

In the Books of Rahul

Profit and Loss Account for the Year ended 31st March

Particular		Amount	Particular	Amount
To Salaries and Wages A/c	Rs. 3,30,000			
Add: Outstanding Salaries	Rs. 30,000	3,60,000		
To Electricity Expenses A/c	Rs. 55,000			
Add: Outstanding Electricity Expenses	Rs. 5,200	60,200		

Balance Sheet of Rahul as at 31st March

Particular	Amount	Particular	Amount
Current Liabilities:			
Outstanding Salaries	30,000		
Outstanding Electricity Expenses	5,200		

Point of Knowledge:

1.) Rs. 3,30,000 $\times \frac{1}{11}$ = 30,000

Question.12 Ramesh's Trail Balance as on 31st March, 2019 given the following information:

Heads of Accounts	Debit	Credit
Investment (rate of interest 10% p.a.)	5,00,000	-
Interest Received	-	45,000

Show how the above items would appear in the Profit and Loss Account and Balance Sheet.

Answer 12.

In the Books of Kapil

Profit and Loss Account for the Year ended 31st March

Particular	Amount	Particular		Amount
		Interest Received	45,000	
		Add: Accrued Interest	5,000	50,000

Balance Sheet of Kapil as at 31st March

Liabilities	Amount	Assets		Amount
		Investment A/c	Rs. 5,00,000	
		Add: Accrued Interest	Rs. 5,000	5,05,000

Question.13 Ramesh's Trail Balance given the following information:

Heads of Accounts	Debit	Credit
Furniture	10,00,000	-
Building	20,00,000	-

Depreciation is provided @ 10% p.a. on the fixed assets. Show how this will be shown in the Profit and Loss Account.

Answer 13.

In the Books of Ramesh

Profit and Loss Account for the Year ended 31st March

Particular	Amount	Particular	Amount
To Depreciation on ~~Plant and Machinery~~ Fur A/c Rs. 10,00,000 x $\frac{10}{100}$	1,00,000		
To Depreciation on ~~Plant and Machinery~~ A/c Rs. 20,00,000 x $\frac{10}{100}$	2,00,000		

Question.14 **Sanjiv's Trial Balance as on 31st March, 2019 shows the following information:**

Heads of Accounts	Debit	Credit
Purchases	2,80,000	-
Sales	-	3,50,000
Carriage on Purchases	10,000	-

Sanjiv took goods costing Rs.20,000 for his personal use but entry was not passed in the books of account. Show the treatment in the Final Accounts.

Answer 14.

In the Books of Sanjeev

Trading Account for the Year ended 31st March

Particular		Amount	Particular	Amount
To Purchases A/c	Rs. 2,80,000		By Sales A/c	3,50,000
Less: Stock Drawings	Rs. 20,000	2,60,000		
To Carriage on Purchases A/c		10,000		

Balance Sheet of Sanjeev as at 31st March

Liabilities		Amount	Assets	Amount
Long Term Liabilities and Capital:				
Capital	-			
Less: Goods Drawings	Rs. 20,000			
Add: Net Profit	-			

Question 24. Ramesh valued stock at the end of the year at Rs. 1,00,000. Goods costing Rs. 5,000 were destroyed by fire during the accounting period. Show the treatment if the goods are not insured.

Answer 24:

In the books of Ramesh

Trading A/c

Particulars		Amount	Particulars	Amount
To Purchases	-		By Closing Stock	1,00,000
Less: Loss by fire	5,000	-		

Profit and Loss A/c

Particulars	Amount	Particulars	Amount
To Loss by fire	5,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets:	
		Insurance Claim	Nil

Question 3: Following Trial Balance has been extracted from the books of Pawan as on 31st March, 2024:

Particulars	Dr. (Rs.)	Particulars	Cr. (Rs.)
Machinery	4,00,000	Capital	9,00,000
Cash at Bank	1,00,000	Sales	16,00,000
Cash in Hand	50,000	Sundry Creditors	4,50,000
Wages	1,00,000	Interest Received	30,000
Purchases	8,00,000		
Stock on 1st April, 2023	6,00,000		
Sundry Debtors	7,30,000		
Rent	45,000		
Commission	25,000		
General Expenses	80,000		
Salaries	50,000		
	29,80,000		29,80,000

Additional Information:

(i) Outstanding salaries were Rs. 45,000.

(ii) Depreciate Machinery at 10%.

(iii) Wages outstanding were Rs. 5,000.

(iv) Rent prepaid Rs. 10,000.

(v) Provide for interest on capital @ 5% per annum.

(vi) Stock on 31st March, 2024 Rs. 8,00,000.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2024 and Balance Sheet as at that date.

In the Books of M/s. Ram Prasad & Sons

Trading Account Profit & Loss for the year ended March 31, 2024

Dr. Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Opening Stock		6,00,000	By Sales	16,00,000
To Purchases		8,00,000	By Closing Stock	8,00,000
To Wages	1,00,000			
Add: Outstanding Wages	5,000	1,05,000		
To Gross Profit (B/F)		8,95,000		
		24,00,000		**24,00,000**
To Rent	45,000		By Gross Profit	8,95,000
Less: Prepaid Rent	(10,000)	35,000	By Interest Received	30,000
To Commission		25,000		
To General Expenses		80,000		
To Salaries	50,000			
Add: Outstanding Salaries	45,000	95,000		
To Depreciation on Machinery		40,000		
To Interest on Capital A/c		45,000		
To Net Profit (Balancing Figure)		6,05,000		
		9,25,000		**9,25,000**

Balance Sheet as on March 31, 2024

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Capital	9,00,000		**Fixed Assets**		
Add: Net Profit	6,05,000		Machinery	4,00,000	
Add: Interest on Capital	45,000	15,50,000	Less: 10% Depreciation	(40,000)	3,60,000
Current Liabilities			**Current Assets**		
Sundry Creditors		4,50,000	Closing Stock		8,00,000
Outstanding Salary		45,000	Sundry Debtors		7,30,000
Outstanding Wages		5,000	Prepaid Rent		10,000
			Cash at Bank		1,00,000
			Cash in Hand		50,000
		20,50,000			**20,50,000**

From the following balances as on 31st December, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	50,000	Rent received	2,000
Salaries	18,000	Discount received	3,000
Office rent paid	12,000	Carriage outwards	2,500
Advertisement	8,000	Fire insurance premium	6,500

Adjustments:

(a) Rent accrued but not yet received ₹500

(b) Fire insurance premium prepaid to the extent of ₹1,500

(c) Provide manager's commission at 10% on profits before charging such commission.

Dr. Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Salaries		18,000	By Gross profit b/d		50,000
To Office rent		12,000	By Rent received	2,000	
To Advertisement		8,000	Add: Rent accrued	500	2,500
To Carriage outwards		2,500	By Discount received		3,000
To Fire insurance premium	6,500				
Less: Prepaid	1,500	5,000			
To Manager's commission		1,000			
To Net profit (transferred to capital account)	-	9,000			
		55,500			55,500

Working note:

$$\text{Manager's Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{100}$$

Net profit = 55,500 – (18,000 + 12,000 + 8,000 + 2,500 + 5,000) = ₹ 10,000

$$\text{Manager's commission} = 10{,}000 \times \frac{10}{100} = 1{,}000$$

From the following balances obtained from the books of Siva, prepare trading and profit and loss account.

Particulars	₹	Particulars	₹
Stock on 01.01.2016	9,000	Bad debts	1,200
Purchases	22,000	Sundry expenses	1,800
Sales	42,000	Discount allowed	1,700
Expenses on purchases	1,500	Expenses on sale	1,000
Bank charges paid	3,500	Repairs on office furniture	600

Adjustments:

a) Closing stock on, 31st December, 2016 was ₹ 4,500

b) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening stock	9,000	By Sales	42,000
To Purchases	22,000	By Closing stock	4,500
To Expenses on purchases	1,500		
To Gross profit c/d	14,000		
	46,500		
To Bank charges	3,500	By Gross profit b/d	46,500
To Bad debts	1,200		14,000
To Sundry expenses	1,800		
To Discount allowed	1,700		
To Expenses on sale	1,000		
To Repairs on office furniture	600		
To Manager's commission	200		
To Net profit (transferred to capital A/c)	4,000		
	14,000		14,000

Working note:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{(100+\text{Rate of commission})} \times 100$$

$$\text{Net profit} = 14{,}000 - (3{,}500 + 1{,}000 + 1{,}200 + 1{,}800 + 1{,}700 + 600) = ₹\ 4{,}200$$

$$\text{Manager's commission} = 4{,}200 \times \frac{5}{105} = ₹\ 200$$

Given below are the balances extracted from the books of Nagarajan as on 31st March, 2016.

Particulars	₹	Particulars	₹
Purchases	10,000	Sales	15,100
Wages	600	Commission received	1,900
Freight inwards	750	Rent received	600
Advertisement	500	Creditors	2,400
Carriage outwards	400	Capital	5,000
Cash	1,200		
Machinery	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2016	1,000		
	25,000		25,000

Prepare the trading and profit and loss account for the year ended 31st March, 2016 and the balance sheet as on that date after adjusting the following:

(a) Commission received in advance ₹ 400
(b) Advertisement paid in advance ₹ 150
(c) Wages outstanding ₹ 200
(d) Closing stock on 31^{st} March 2016, ₹ 2,100

Solution

In the books of Nagarajan

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		1,000	By Sales		15,100
To Purchases		10,000	By Closing stock		2,100
To Wages	600				
Add: Outstanding	200	800			
To Freight inwards		750			
To Gross profit c/d		**4,650**			
		17,200			17,200
To Advertisement	500		By Gross profit b/d		4,650
Less: Prepaid advertisement	150	350	By Commission received	1,900	
To Carriage outwards		400	Less: Received in advance	400	1,500
To Net profit (transferred to capital a/c)		**6,000**	By Rent received		600
		6,750			6,750

Balance Sheet as on 31st March, 2016

Particulars	₹	₹	Particulars	₹	₹
Capital	5,000		Machinery		8,000
Add: Net profit	6,000	11,000	Stock in trade		2,100
Creditors		2,400	Debtors		300
Commission received in			Bills receivable		2,250
advance		400	Advertisement prepaid		150
Outstanding wages		200	Cash		1,200
		14,000			14,000

Consider the following balances extracted from the books of Jain as on 31st December, 2016. Prepare the final accounts.

Particulars	₹	Particulars	₹
Capital	20,000	Office Salaries	6,600
Debtors	8,000	Establishment expenses	4,500
Creditors	10,500	Selling expenses	2,300
Purchases	60,000	Furniture	10,000
Sales	80,000	Cash at bank	2,400
Income tax of Jain paid	500	Miscellaneous receipts	600
Opening stock	12,000	Drawings	4,800

Adjustments

(a) Salaries outstanding for December, 2016 amounted to ₹ 600

(b) Provide depreciation on furniture @ 10% p.a.

(c) Provide interest on capital for the year @ 5% p.a.

(d) Stock on 31st December, 2016 ₹ 14,000

Solution

In the books of Jain

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		12,000	By Sales		80,000
To Purchases		60,000	By Closing Stock		14,000
To Gross Profit c/d		22,000			
		94,000			94,000
To Office salaries	6,600		By Gross Profit b/d		22,000
Add: Outstanding	600	7,200	By Miscellaneous receipts		600
To Establishment expenses		4,500			
To Selling expenses		2,300			
To Depreciation on furniture (10,000 x 10%)		1,000			
To Interest on capital (20,000 x 5%)		1,000			
To Net profit (transferred to capital A/c)		6,600			
		22,600			22,600

Balance Sheet as on 31st December, 2016

Liabilities		₹	₹	Assets	₹	₹
Capital		20,000		Furniture	10,000	
Add: Net profit		6,600		Less: Depreciation	1,000	9,000
Add: Interest on capital		1,000		Stock in trade		14,000
		27,600		Debtors		8,000
Less: Drawings	4,800			Cash at bank		2,400
Income tax	500	5,300	22,300			
Creditors			10,500			
Office salaries outstanding			600			
			33,400			33,400

Practice problems

2. From the following balances taken from the books of Saravanan, calculate gross profit for the year ended December 31, 2017

Particulars	₹	Particulars	₹
Opening stock	1,50,000	Net sales during the year	4,00,000
Direct expenses	8,000	Net purchases during the year	1,50,000
Closing Stock	25,000		

(**Answer:** Gross profit: ₹ 1,17,000)

3. From the following details for the year ended 31st March, 2018, prepare trading account.

Particulars	₹	Particulars	₹
Opening stock	2,500	Returns inwards	7,000
Purchases	27,000	Coal and gas	3,300
Sales	40,000	Carriage inwards	2,600
Wages	2,500	Closing stock	5,200
Returns outwards	5,200		

(**Answer:** Gross profit: ₹ 5,500)

7. From the following details, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	50,000	Interest received	2,000
Office rent	10,000	Discount received	3,000
Depreciation on office assets	8,000	Carriage outwards	2,500
Discount allowed	12,000	Insurance on office building	3,500
Advertisement	4,000	General expenses	3,000
Audit fees	1,000	Freight inwards	1,000

(**Answer:** Net profit ₹ 11,000)

(**Hint:** Freight inwards will not appear in profit and loss account as it is a direct expense)

8. From the following information, prepare profit and loss account for the year ending 31st December, 2016.

Particulars	₹	Particulars	₹
Gross loss	60,000	Printing and stationery (office)	2,000
Promotional expenses	5,000	Legal charges	5,000
Distribution expenses	15,000	Bad debts	1,000
Commission paid	7,000	Depreciation	2,000
Interest on loan paid	5,000	Rent received	4,000
Packing charges (on sales)	4,000	Loss by fire not covered by insurance	3,000
Dividend received	3,000		

(**Answer:** Net loss: ₹ 1,02,000)

9. Prepare trading account of Archana for the year ending 31st December, 2016 from the following information.

Debit balance	₹	Credit balance	₹
Opening stock	80,000	Purchases returns	10,000
Purchases	8,60,000	Sales returns	3,16,000
Freight inwards	52,000	Import duty on purchases	30,000
Wages	24,000	Sales	14,40,000

Adjustments:

(a) Closing stock ₹ 1,00,000 (b) Wages outstanding ₹ 12,000

(c) Freight inwards paid in advance ₹ 5,000

(**Answer**: Gross Profit: ₹ 1,81,000)

10. Prepare profit and loss account of Manoj for the year ending on 31st March, 2016

Particulars	₹	Particulars	₹
Gross profit	25,000	Travelling expenses	500
Salaries	5,600	Stationery	75
Insurance	200	Rent	650
Discount allowed	400	Interest on loan	225
Discount received	300	Repairs	125
Commission received	100	Office expenses	55
Advertisement	450	General expenses	875
Printing charges	375	Postage	175

Adjustments:

(i) Salary outstanding ₹ 400 (ii) Rent paid in advance ₹ 50

(iii) Commission receivable ₹ 100

(**Answer**: Net profit: ₹ 15,445)

11. Prepare trading and profit and loss account in the books of Ramasundari for the year ended 31st December, 2017 and balance sheet as on that date from the following information:

Particulars	₹	Particulars	₹
Opening stock	2,500	Sales	7,000
Wages	2,700	Purchases	3,300
Closing Stock	4,000	Salary	2,600
Discount received	2,500	Capital	52,000
Machinery	52,000	Cash at Bank	6,400
Creditors	8,000		

(**Answer**: Gross profit: ₹ 2,500; Net profit: ₹ 2,400; Balance sheet total: ₹ 62,400)

12. Prepare trading and profit and loss account and balance sheet in the books of Deri, a trader, from the following balances as on March 31, 2018.

Debit Balances	₹	Credit Balances	₹
Stock	10,000	Sales	1,22,500
Cash	2,500	Creditors	5,000
Bank	5,000	Bills payable	2,000
Freight inwards	750	Capital	1,00,000
Purchases	95,000		
Drawings	4,500		
Wages	27,500		
Machinery	50,000		
Debtors	13,500		
Postage (office)	150		
Sundry expenses	850		
Rent paid	2,500		
Furniture	17,250		
	2,29,500		2,29,500

Closing stock (31st March, 2018) ₹ 8,000

(**Answer**: Gross loss: ₹ 2,750; Net loss: ₹ 6,250; Balance sheet total: ₹ 96,250)

11. From the trial balance of Sumathi and the adjustments prepare the trading and profit and loss account for the year ended 31st March, 2016, and a balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock on April 1, 2015	900	
Purchases	2,000	
Sales		4,000
10% Loan		2,000
Carriage on purchases	200	
Rent from tenant		250
Interest on loan	100	
Machinery	400	
Postage	100	
Salary	650	
Commission received		200
Cash in hand	75	
Furniture	4,000	
Capital		1,975
	8,425	8,425

Adjustments

(a) Six months interest on loan is outstanding.

(b) Two months rent is due from tenant, the monthly rent being ₹ 25.

(c) Salary for the month of March 2016, ₹ 75 is unpaid.

(d) Stock in hand on March 31, 2016 was valued at ₹ 1,030.

(**Answer**: Gross profit: ₹ 1,930; Net profit ₹ 1,405, Balance sheet total ₹ 5,555)

16. From the following information prepare trading and profit and loss account and balance sheet of Kumar for the year ending 31st December, 2017.

Debit balance	₹	Credit balance	₹
Purchases	14,500	Sales	20,100
Coal and fuel	600	Bills payable	400
Carriage inwards	750	Rent received	2,500
Advertisement	500	Creditors	2,000
Carriage outwards	400	Capital	5,000
Bank	1,200		
Furniture	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2017	1,500		
	30,000		30,000

Adjustments:

a) The closing stock on 31st December, 2017 was valued at ₹ 3,900.

b) Carriage inwards prepaid ₹ 250

c) Rent received in advance ₹ 100

d) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

(**Answer:** Gross profit ₹ 6,900; Manager's commission ₹ 400;
Net profit ₹ 8,000; Balance sheet total ₹ 15,900)

Depreciation - Meaning and definition

The process of allocation of the relevant cost of a fixed asset over its useful life is known as depreciation. It is an allocation of cost against the benefit derived from a fixed asset during an accounting period.

According to **Spicer and Pegler**, “Depreciation is the measure of exhaustion of the effective life of an asset from any cause during a given period”.

According to **R.N. Carter**, “Depreciation is the gradual and permanent decrease in the value of an asset from any cause”.

Objectives of providing depreciation

Following are the objectives of providing depreciation:

(i) To find out the true profit or loss

According to matching principle, the expenses incurred during a period must be matched with revenue earned during that period. Hence, when an asset is used for generating income for a business, the cost of the asset attributable to the use, i.e., the reduction in the book value of the asset proportionate to the benefit derived from it, should be charged against the revenue. This is to be done to find out the true cost of production and profit or loss of the business for every accounting period.

(ii) To present the true and fair view of financial position

When the depreciation is charged on fixed assets, the book value of fixed assets are reduced to that extent and the remaining value is shown in the balance sheet. The balance represents the value of benefit that is yet to be derived from them. The written down value is the true value of fixed assets which represent cost not yet written off. The balance sheet must represent a true and fair view of financial status. Hence, fixed assets must be shown their at written down value.

(iii) To facilitate replacement of fixed assets

When the depreciation is debited to profit and loss account, an equal amount is either retained in the business or invested outside the business. When the useful life of an asset comes to an end, a new asset can be purchased by using the resources available in the business.

(iv) To avail tax benefits

As per the Indian Income Tax Act, while computing tax on business income, depreciation is deductible from income. Hence, depreciation is computed and charged to profit and loss account to reduce tax liability.

(v) To comply with legal requirements

Depreciation is provided on fixed assets to comply with the provisions of law apart from Income Tax Act. For example, Section 123(1) of the Indian Companies Act, 2013, requires every company to provide depreciation on fixed assets before declaring dividend to its shareholders.

Causes of depreciation

There are different reasons causing the reduction in the book value of the fixed assets. Such causes are as follows:

(i) Wear and tear: The normal use of a tangible asset results in physical deterioration which is called wear and tear. When there is wear and tear, the value of the asset decreases proportionately.

(ii) Efflux of time : Certain assets whether used or not become potentially less useful with the passage of time.

(iii) Obsolescence: It is a reduction in the value of assets as a result of the availability of updated alternative assets. This happens due to new inventions and innovations. Though the original asset is in a usable condition, it is not preferred by the users and it loses its value. For example, preference of latest computers by the users.

(iv) Inadequacy for the purpose: Sometimes, the use of assets may be stopped due to their inadequacy for the purpose. These may become inadequate due to expansion in the capacity of a firm.

(v) Lack of maintenance: A good maintenance will naturally increase the life of the asset. When there is no proper maintenance, there is a possibility of more depreciation.

(vi) Abnormal factors: Decline in the usefulness of fixed asset may be caused by abnormal factors like damage due to fire accidents, natural calamities, etc. These may even lead to the state of an asset being discarded.

Characteristics of depreciation

Following are the characteristics of depreciation:

i. Depreciation is the process of allocation of cost of depreciable asset (capital expenditure) to revenue expenditure or to profit and loss account over the useful life of the asset.

ii. It is the process of allocation of cost and not the process of valuation.

iii. It is a decrease in the book value of the asset and not the market value of the asset.

iv. It is a gradual and continuous decrease in the book value of asset over its useful life.

v. It is calculated only for tangible depreciable fixed assets. Depreciation is not provided on intangible and wasting assets.

Methods of providing depreciation

There are various methods used for providing depreciation on fixed assets. The management of a business enterprise has to select the most appropriate method based on the consideration of various factors such as nature of the asset, use of the asset and circumstances that prevail in the business. The following are the different methods of providing depreciation:

i) Straight line method or Fixed instalment method or Original cost method
ii) Written down value method or Diminishing balance method
iii) Sum of years of digits method
iv) Machine hour rate method
v) Depletion method
vi) Annuity method
vii) Revaluation method
viii) Sinking fund method
ix) Insurance policy method

Straight line method/ Fixed instalment method / Original cost method

Under this method, a fixed percentage on the original cost of the asset is charged every year by way of depreciation. Hence it is called original cost method. As the amount of depreciation remains equal in all years over the useful life of an asset it is also called as fixed instalment Method or straight line method.

This method is suitable for those assets the useful life of which can be estimated accurately and which do not require much expense on repairs and renewals.

Under this method, the following formulae are used for calculating the amount of depreciation and the rate of depreciation respectively:

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

On 1.1.2012, a firm purchased a machine at a cost of ₹ 1,10,000. Its life was estimated to be 10 years with a scrap value of ₹ 10,000. The amount of depreciation to be charged at the end of each year is:

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1,10,000 - 10,000}{10} = \frac{1,00,000}{10} = ₹\ 10,000 \text{ per year}$$

When it is plotted on a graph for 5 years, it appears as follows:

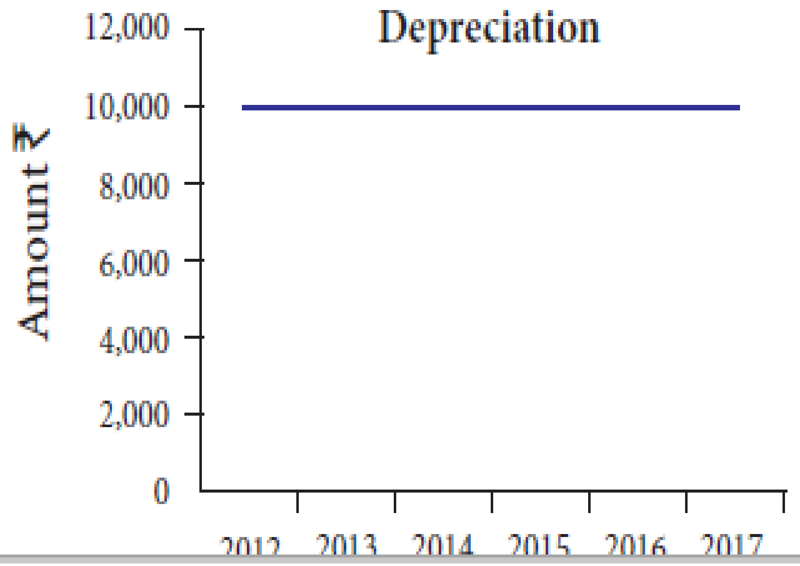


Illustration 1

On 1.1.2017 a firm purchased a machine at a cost of ₹ 1,00,000. Its life was estimated to be 10 years with a scrap value of ₹ 10,000. Compute the amount of depreciation to be charged at the end of each year.

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1{,}00{,}000 - 10{,}000}{10} = \frac{90{,}000}{10} = ₹\ 9{,}000 \text{ per year}$$

Illustration 2

From the following information, calculate the amount of depreciation and rate of depreciation under straight line method.

Purchase price of machine	₹	80,000
Expenses to be capitalised	₹	20,000
Estimated residual value	₹	35,000
Expected useful life		5 years

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1{,}00{,}000 - 35{,}000}{5} = \frac{65{,}000}{5} = ₹\ 13{,}000 \text{ per year}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \quad \text{x } 100$$

$$= \frac{13{,}000}{1{,}00{,}000} \text{ x } 100 = 13\%$$

Note:

Original cost = Purchase price + Expenses to be capitalised

= 80,000 + 20,000 = ` 1,00,000

Illustration 3

Find out the rate of depreciation under straight line method from the following details:

Original cost of the asset	= ₹ 10,000
Estimated life of the asset	= 10 years
Estimated scrap value at the end	= ₹ 2,000

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{10{,}000 - 2{,}000}{10} = \frac{8{,}000}{10} = ₹\ 800 \text{ per year}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

$$= \frac{800}{10{,}000} \times 100 = 8\%$$

Ramu Brothers purchased a machine on 1st July 2016 at a cost of ` 14,000 and spent ` 1,000 on its installation. The firm writes off depreciation at 10% of original cost every year. The books are closed on 31st December every year. Give journal entries and prepare machinery account and depreciation account for 2 years.

Solution

Note: Cost of the asset = Purchase price + Installation cost

= 14,000 + 1,000 = ₹ 15,000

Journal entries

Date	Particulars	Debit ₹	Credit ₹
2016 July 1	Machinery A/c Dr. To Bank A/c (Machinery bought)	14,000	14,000
July 1	Machinery A/c Dr. To Bank A/c (Installation expenses on machinery incurred)	1,000	1,000
December 31	Depreciation A/c Dr. To Machinery A/c (15,000 × 10/100 × 6/12) (Depreciation provided)	750	750
December 31	Profit and Loss A/c Dr. Dr. To Depreciation A/c (Depreciation transferred to profit and loss account)	750	750
2017 December 31	Depreciation A/c (15,000 × 10/100) Dr. To Machinery A/c (Depreciation provided)	1,500	1,500
December 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation transferred to profit and loss account)	1,500	1,500

Ledgers

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
July 1	To Cash A/c	15,000	Dec 31	By Depreciation A/c	750
				By Balance c/d	14,250
		15,000			15,000
2017	To Balance b/d	14,250	2017		
Jan 1			Dec 31	By Depreciation A/c	1,500
				By Balance c/d	12,750
		14,250			14,250
2018 Jan1	To Balance b/d	12, 750			

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec 31	To Machinery A/c	750	Dec 31	By Profit and Loss A/c	750
		750			750
2017			2017		
Dec 31	To Machinery A/c	1,500	Dec 31	By Profit and Loss A/c	1,500
		1,500			1,500

A firm acquired a machinery on 1st July 2010 at a cost of ` 45,000 and spent ` 5,000 for its installation. The firm writes off depreciation at 10% per annum on the original cost every year. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

Solution:

Dr. **Machinery Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2013			2014		
Jul 1	To Bank	45,000	Mar.31	By Depreciation	
Jul 1	To Bank (Installation			(10% on ₹50,000 for 9	
	Expenses)	5,000		months)	3,750
			Mar.31	By Balance c/d	46,250
		50,000			50,000
2014			2015		
April 1	To Balance b/d	46,250	Mar. 31	By Depreciation	
				(10% on ₹50,000)	5,000
			Mar. 31	By Balance c/d	41,250
		46,250			46,250
2015			2016		
April 1	To Balance b/d	41,250	Mar. 31	By Depreciation	
				(10% on ₹50,000)	5,000
			Mar. 31	By Balance c/d	36,250
		41,250			41,250
2016					
April 1	To Balance b/d	36,250			

Dr. **Depreciation Account** *Cr.*

Dr. **Depreciation Account** Cr.

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2013			2014		
Mar.31	To Machinery A/c	3,750	Mar.31	By Profit & Loss A/c	3,750
2014			2015		
Mar.31	To Machinery A/c	5,000	Mar.31	By Profit & Loss A/c	5,000
2015			2016		
Mar.31	To Machinery A/c	5,000	Mar.31	By Profit & Loss A/c	5,000

Practice Problems

Straight line method

1. A firm purchased a plant for ` 40,000. Erection charges amounted to ` 2,000. Effective life of the plant is 5 years. Calculate the amount of depreciation per year under straight line method.
(**Answer**: ` 8,400)
2. A company purchased a building for ` 50,000. The useful life of the building is 10 years and the residual value is ` 5,000. Find out the amount and rate of depreciation under straight line method.
(**Answer**: Amount of depreciation: ` 4,500; Rate of depreciation 9%)
3. Furniture was purchased for ` 1,00,000 on 1.7.2016. It is expected to last for 5 years. Estimated scrap at the end of five years is ` 10,000. Find out the rate of depreciation under straight line method.
(**Answer**: Amount of depreciation ` 18,000; Rate of depreciation 18%)
5. Machinery was purchased on 1st January 2015 for ` 4,00,000. ` 15,000 was spent on its erection and ` 10,000 on its freight charges. Depreciation is charged at 10% per annum on straight line method. The books are closed on 31st March each year. Calculate the amount of depreciation on machinery for the first two years.
(**Answer**: Amount of depreciation on 31.03.2015: ` 10,625; on 31.03.2016: ` 42,500)

Theory Questions – Final Accounts

1. What are the key components of an income statement?
2. Define the terms "assets" and "liabilities."
3. What is the basic accounting equation?
4. List three examples of current assets.
5. What is the primary purpose of a balance sheet?
6. Explain the difference between operating and non-operating expenses.
7. How does the income statement show a company’s financial performance?
8. Why is depreciation recorded in financial statements?
9. Differentiate between gross profit and net profit.
10. What role does equity play in the balance sheet?
11. What are adjusting entries?
12. What is outstanding expense?
13. What is prepaid expense?
14. What are accrued incomes?
15. What is the need for preparing final accounts?

Theory Questions – Depreciation

1. Explain the characteristics of depreciation.
2. What is depreciation?
3. Name two common methods of calculating depreciation.
4. Explain the objectives of depreciation
5. What factors determine the depreciation expense of an asset?
6. What is the difference between depreciation, amortization, and depletion?