



Foundation

Fundamentals of Financial and Cost Accounting

Paper

2



The Institute of Cost Accountants of India
Statutory Body under an Act of Parliament

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The Institute of Cost Accountants of India is a Statutory Body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligation, regulates the profession of Cost and Management Accountancy, enrolls students for its courses, provides coaching facilities to the students, organizes professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and structured approach to cost accounting as the key drivers of the profession.

With the current emphasis on management of resources, the specialized knowledge of evaluating operating efficiency and strategic management the professionals are known as "Cost and Management Accountants (CMAs)". The Institute is the 2nd largest Cost & Management Accounting body in the world and the largest in Asia, having more than 5,00,000 students and 90,000 members all over the globe. The Institute operates through four regional councils at Kolkata, Delhi, Mumbai and Chennai and 113 Chapters situated at important cities in the country as well as 11 Overseas Centres, headquartered at Kolkata. It is under the administrative control of the Ministry of Corporate Affairs, Government of India.

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“The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally.”

Mission Statement

“The Cost and Management Accountant professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting.”

Motto

असतोमा सदगमय
तमसोमा ज्योतिर् गमय
मृत्योर्मा मृतं गमय
ॐ शान्तिं शान्तिं शान्तिः

From ignorance, lead me to truth
From darkness, lead me to light
From death, lead me to immortality
Peace, Peace, Peace

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Behind Every Successful Business Decision, there is always a CMA

FOUNDATION

Paper 2

Fundamentals of Financial and Cost Accounting

Study Notes

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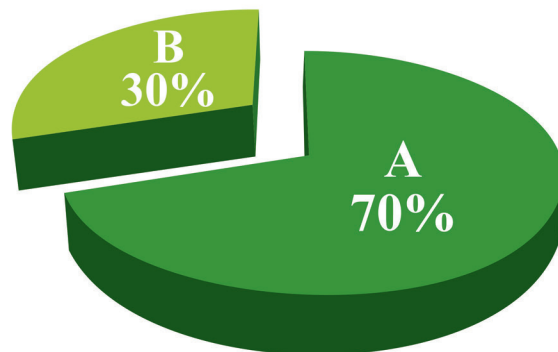
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PAPER 2: FUNDAMENTALS OF FINANCIAL AND COST ACCOUNTING

Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
Section A: Fundamentals of Financial Accounting		70%
1	Accounting Fundamentals	30%
2	Accounting for Special Transactions	15%
3	Preparation of Final Accounts	25%
Section B: Fundamentals of Cost Accounting		30%
4	Fundamentals of Cost Accounting	30%



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SECTION - A

**FUNDAMENTALS OF FINANCIAL
ACCOUNTING**

ACCOUNTING FUNDAMENTALS

1

This Module includes:

- 1.1 Understanding of Four Frameworks of Accounting (Conceptual, Legal, Institutional and Regulatory) and Forms of Organisation**
- 1.2 Accounting Principles, Concepts and Conventions**
- 1.3 Capital and Revenue Transactions - Capital and Revenue Expenditures, Capital and Revenue Receipts**
- 1.4 Accounting Cycle – Charts of Accounts and Codification Structure, Analysis of Transaction – Accounting Equation, Double Entry System, Books of Original Entry, Subsidiary Books and Finalisation of Accounts**
- 1.5 Journal (Day Books; Journal Proper – Opening, Transfer, Closing, Adjustment and Rectification Entries), Ledger**
- 1.6 Cash Book, Bank Book, Petty Cash Book, Bank Reconciliation Statement**
- 1.7 Trial Balance**
- 1.8 Adjustment Entries and Rectification of Errors**
- 1.9 Depreciation (Straight Line and Diminishing Balance Methods Only)**
- 1.10 Accounting Treatment of Bad Debts and Provision for Doubtful Debts**

ACCOUNTING FUNDAMENTALS

Module Learning Objectives:

After studying this Module, the students will be able to –

- ✦ Understand the four frameworks of accounting and various accounting concepts and conventions
- ✦ Understand how to distinguish Capital and Revenue Transitions
- ✦ Develop an idea about the Accounting Cycle and its various stages
- ✦ Learn about the recording of transactions in Journal and posting them to Ledgers
- ✦ Learn the preparation of Cash Book, Bank Book and Bank Reconciliation Statement
- ✦ Understand the use of Trial Balance and its preparation methodology
- ✦ Learn how adjustments and rectification entries are passed before finalization of accounts
- ✦ Learn accounting for Depreciation and Provision for Doubtful Debt

Understanding of Four Frameworks of Accounting and Forms of Organisation

1.1

● Introduction to Financial Accounting

A business is an economic activity undertaken with the objective of earning profits and to maximize the wealth of the owners. A business cannot run in isolation. Largely, the business activities are carried out by people coming together with a purpose to serve a common cause. This team is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, body corporate etc. The rules of business are based on general principles of trade, social values, and statutory framework encompassing national or international boundaries. While these variables could be different for different businesses, different countries etc., the basic purpose is to add value to a product or service in order to satisfy customer demand.

The business activities require resources (which are limited & have multiple uses) primarily in terms of material, labour, machineries, factories and other services. The success of business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure the businessman tracks the use of these resources. The resources are not free and thus one must be careful to keep an eye on cost of acquiring them as well. As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in course of business. Two basic questions would have to be answered:

- (a) What is the result of business operations? This will be answered by finding out whether it has made profit or loss.
- (b) What is the position of the resources acquired and used for business purpose? How are these resources financed? Where the funds come from?

The answers to these questions are to be found continuously and the best way to find them is to record all the business activities. However, recording of business activities has to be done in a scientific manner so that they reveal correct outcome. The science of book-keeping and accounting provides an effective solution in this respect. It is basically a branch of social science.

● Definition of Accounting

According to the American Institute of Certified Public Accountants (Year 1961), accounting is the “art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof”.

According to the American Accounting Association (Year 1966), accounting is “the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting”.

● **Objectives of Accounting**

(i) **Providing Information to the Users for Rational Decision-making**

The primary objective of accounting is to provide useful information for decision-making to stakeholders such as owners, management, creditors, investors, etc. Various outcomes of business activities such as costs, prices, sales volume, value under ownership, return of investment, etc. are measured in the accounting process. All these accounting measurements are used by stakeholders (owners, investors, creditors/bankers, etc.) in course of business operation. Hence, accounting is identified as ‘language of business’.

(ii) **Systematic Recording of Transactions**

To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by bookkeeping. These financial records are classified, summarized and reported in the form of accounting measurements to the users of accounting information i.e., stakeholders.

(iii) **Ascertainment of Results of above Transactions**

‘Profit/loss’ is the core accounting measurement. It is measured by preparing Profit and Loss Account for a particular period. Various other accounting measurements such as different types of revenue expenses and revenue incomes are considered for preparing this Profit and Loss Account. Difference between these revenue incomes and revenue expenses is known as result of business transactions identified as profit/loss. As this measure is used very frequently by stockholders for rational decision making, it has become the objective of accounting to provide such information. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of business and also explain nature and source of every item reported in Income Tax Return.

(iv) **Ascertainment of Financial Position of Business**

‘Financial position’ is another core accounting measurement. Financial position is identified by preparing a statement of ownership i.e., Assets and Owings i.e., liabilities of the business as on a certain date. This statement is popularly known as Balance Sheet. Various other accounting measurements such as different types of assets and different types of liabilities as existed at a particular date are considered for preparing the balance sheet. This statement may be used by various stakeholders for financing and investment decision.

● **Functions of Accounting**

The functions of accounting are as follows:

- (a) Identification of monetary transactions and events;
- (b) Measurement of the identified transactions and events;
- (c) Recording of such transactions;
- (d) Classifying and summarizing of the recorded transactions;
- (e) Obtaining the results of operations and determination of financial state of affairs;
- (f) Analysing and interpreting the results and position to help in decision-making;
- (g) Communicating such information to the users (both internal and external).

- **Book Keeping**

As defined by Carter, ‘Book-keeping is a science and art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth’.

It is an activity concerned with recording and classifying financial data related to business operation in order of its occurrence. Its primary objective is to maintain systematic recording of transactions on a regular basis. It is a concept narrower than accounting.

- **Accountancy**

Accountancy is the discipline that incorporates certain principles or rules of accounting. It refers to the entire body of the theory and practice of accounting. It is a concept wider than accounting.

Thus, while Book-keeping is a subset of accounting, Accounting, in turn, is a part of Accountancy.



Figure 1.1: Relation between Book Keeping, Accounting and Accountancy

1.1.1 Understanding of Four Frameworks of Accounting (Conceptual, Legal, Institutional and Regulatory)

- **Framework of Accounting**

According to Collins Dictionary, the term ‘framework’ refers to ‘a structure that forms a support or frame for something’. In the context of any system, it is ‘a particular set of rules, ideas, or beliefs which you use in order to deal with problems or to decide what to do’.

In accounting, ‘framework’ provides a common set of rules and guidelines that is used to measure, recognize, present, and disclose the information appearing in an entity’s financial statements.

- **Four Frameworks of Accounting**

The framework of accounting has four pillars – Conceptual, Legal, Institutional and Legal. These are discussed below.

(a) **Conceptual Framework**

The Conceptual Framework is a body of interrelated objectives and fundamentals. The objectives identify the goals and purposes of financial reporting and the fundamentals are the underlying concepts that

help achieve those objectives. Those concepts provide guidance in selecting transactions, events and circumstances to be accounted for, how they should be recognized and measured, and how they should be summarized and reported. It states the objectives of General-Purpose Financial Reporting and the information provided by it. Conceptual Framework also guides on the qualitative characteristics that the financial statements must possess.

Conceptual Framework often plays an important role in the development of Institutional Framework and assists preparers to develop consistent accounting policies when no accounting standard applies to a particular transaction or other event, or when a standard allows a choice of accounting policy.

(b) Legal Framework

Businesses are often controlled by various statutes under which they are formed. For example, in India, partnership organisations are governed by Indian Partnership Act, 1932 or Limited Liability Partnership Act, 2008, co-operatives are controlled by the Co-operative Societies Act, 1912, companies are governed by the Companies Act, 2013. In addition, banks are controlled by Banking Regulation Act, 1949, insurance companies are under the Insurance Act, 1938, electricity companies are also governed by the Central Electricity Act, 2003. All these statutes (including various Rules framed under them) not only govern the administrative set up of these organisations, but also provide important guidelines regarding use of resources, financing and also on the maintenance of books of accounts and treatment of specified transactions. For example, the Companies Act, 2013 and Companies (Accounts) Rules, 2014 provide useful provisions on maintenance of accounting records, accounting for issue and redemption of securities, investments to be done, consolidation and even winding up of the company. Companies (Corporate Social Responsibility) Rules, 2014 provides the guidelines regarding accounting of CSR expenses as well as carry forward and set-off of excess amount spent. Thus, legal framework plays an important role in accounting. The Schedules of this Act also provide important guidelines on the form and contents of financial statements.

(c) Institutional Framework

Institutional framework refers to the guidelines issued in form of certain pronouncements by institutions entrusted by the sovereign authorities to oversee the development of the respective field. In India, the Institute of Chartered Accountants of India has been entrusted to develop standards in the field of accounting to ensure comparability and consistency in accounting information. The Indian Accounting Standard Board of ICAI thus develops quality accounting standards on different areas of accounting. Currently, there are two sets of accounting standards in India – Accounting Standards as per Companies (Accounting Standards) Rules, 2021 and Ind ASs under Companies (Indian Accounting Standards) Rules, 2015. In addition, the Cost Accounting Standards Board (CASB) of the Institute of Cost Accountants of India has, so far, developed 24 Cost Accounting Standards to facilitate cost accounting and reporting.

(d) Regulatory Framework

The activities of organisations often come under the regulatory ambit of various regulators. In India, there are different regulatory authorities in different segments of financial market, such as RBI in money market operations, SEBI in capital market operations, IRDAI in insurance sector, PFRDA in pension funds. In addition, there are Telecom Regulatory Authority of India (TRAI), Competition Commission etc. The regulations imposed by these authorities may also have important bearing on accounting of a concerned entity. For example, regulations issued by SEBI largely shape the accounting and, more importantly, reporting by a listed firm in India. Similarly, regulations framed by IRDAI affect the accounting and reporting in insurance companies. In banking, BASEL Norms and other guidelines issued by RBI largely determine the accounting of NPA (Non-Performing Assets). Central Electricity Regulatory Commission

(Terms and Conditions of Tariff) Regulations, 2009 affect the determination of tariff and accounting in an electricity company in India.

The above four frameworks provide the foundation on which accounting and more specifically corporate accounting is based in India. They help to streamline the accounting process and help to improve the quality of the reports generated and thereby contribute in the overall development of accounting.

1.1.2 Forms of Organizations

Among many other factors, the form of organisations contributes a lot in designing the accounting system and policies. Various business forms are often the result of one or more laws and the provisions stated therein governs the accounting as has been explained in the Legal Framework of Accounting. The form of an organisation determines the books to be kept, mode of maintenance of accounts, the components of financial statements and also the extent of disclosure of various information through financial statements. For example –

- The sole proprietorship organisations are least regulated in India. They normally do not have any specific legislation to govern accounting requirements. However, in case their annual turnover exceeds a certain limit they may be subject to some other legislation such as the Income Tax Act, 1961.
- The partnership firms are regulated by the Partnership Act, 1932 and also the Contract Act, 1872. In case, the firm does not have clear provisions in the Partnership Contract, the Partnership Act, 1932 decides on sharing profits and losses, deciding partner's claims such as remuneration and also on interest on loan.
- Operations including some aspects of accounting are strictly governed by Limited Liability Partnership Act, 2008 for LLPs.
- Accounting and reporting are highly regulated by the Companies Act, 2013 for Indian companies.

A common example that may be cited in this respect is the components of financial statements in different forms of business (see the following Table).

Sole Proprietorship	Partnership	LLP	Company
<ul style="list-style-type: none"> ⦿ Manufacturing/ Trading A/c ⦿ Profit and Loss A/c ⦿ Balance Sheet 	<ul style="list-style-type: none"> ⦿ Manufacturing/ Trading A/c ⦿ Profit and Loss A/c ⦿ Profit and Loss Appropriation A/c ⦿ Balance Sheet 	<ul style="list-style-type: none"> ⦿ LLP Profit & Loss A/c ⦿ LLP Balance Sheet 	<ul style="list-style-type: none"> ⦿ Statement of Profit and Loss ⦿ Balance Sheet ⦿ Cash Flow Statement ⦿ Statement Showing Changes in Other Equity

Table 1.1 Components of Financial Statements as per the business forms

Thus, it appears that forms of businesses or more specifically, the legislation forming such organisations plays a vital role in determining the form, contents of accounting reports as well as treatment of certain accounting transactions.

Accounting Principles, Concepts and Conventions

1.2

1.2.1 Introduction

One of the main objectives of accounting is to help users to take appropriate decisions by providing relevant accounting information. For this purpose, accounting maintains records of the each and every transaction in its books of accounts. The practice of this record keeping, however, may be based on diverse policies at various organisations. As a result, there is limited scope for comparing accounting information across entities over the time.

In order to ensure uniformity and consistency in record keeping and produce accounting information which is largely comparable, the accounting profession has developed rules, conventions, standards, and procedures which are generally accepted and universally practiced. This common set of rules, conventions, standards, and procedures is referred to as Generally Accepted Accounting Principles (GAAP).

The GAAPs provide the guidelines for reporting economic events and are thus, used by organisations in drafting their financial statements. These are followed by organisations so that the users of accounting information have an optimum level of consistency in the financial statements they use while comparing such information over time and across entities for decision purpose.

Such accounting principles have been developed from research, accepted accounting practices, and pronouncements of regulators.

In India, financial statements are prepared on the basis of accounting standards issued by the Institute of Chartered Accountants of India (ICAI) and the law laid down in the respective applicable statutes (like, Schedule III to Companies Act, 2013 is required to be followed by all companies). These accounting standards as well as rules prescribed under various statutes have the GGAP at their core.

1.2.2 Accounting Principles – Accounting Concepts and Accounting Conventions

Accounting principles refer to those rules of action that are universally adopted by the accountants for recording accounting transactions. They provide the guidelines for recording and reporting transactions and as such provide explanations to the current accounting practices.

Accounting principles can be further classified into (A) Accounting Concepts and (B) Accounting Conventions.

A. Accounting Concepts: Accounting concepts refer to the assumptions and conditions that define the parameters and constraints within which the accounting operates. They lay down the foundation for accounting principles, and ensure recording of financial facts on sound bases and logical considerations. The common accounting concepts include:

- (a) Entity concept
- (b) Going concern concept

- (c) Periodicity concept
- (d) Money measurement concept
- (e) Accrual concept
- (f) Dual aspect concept
- (g) Matching concept
- (h) Realisation concept
- (i) Cost concept

B. Accounting Conventions: Accounting conventions are customs and traditions associated with the practical application of accounting principles. These are widely accepted, and are the common practices which are used as guidelines when transactions are recorded. These have evolved over time out of different accounting practices. These conventions are also known as doctrine. The different accounting conventions include the following:

- (a) Convention of Conservatism
- (b) Convention of Consistency
- (c) Convention of Materiality
- (d) Convention of Full disclosure.

These accounting concepts and conventions are discussed in the following section.

1.2.2.1 Accounting Concepts

- (a) **Business Entity Concept:** This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense.
- (b) **Going Concern Concept:** Accounting assumes that business will continue to operate for a longer period of time in future. In other words, it is assumed that neither there is any intention nor necessity to curtail the business operations of entity. It is on this basis that financial statements of a business entity are prepared and referring to which investors agree upon their decision to invest in the business.
- (c) **Periodicity or Accounting Period Concept:** Accounting period concepts assumes that the infinite life of an organisation can be split into smaller periods of equal duration (viz. a quarter, half-year or year). Due to this concept, the operating results are ascertained for a specific period, the financial position is reflected (through the balance sheet) at regular intervals.
- (d) **Money Measurement Concept:** A business transaction will always be recorded if it can be expressed in terms of money. The advantage of this concept is that different types of transactions could be recorded as homogenous entries with money as common denominator. A business may own ₹3 Lacs cash, 1500 kg of raw material, 10 vehicles, 3 computers etc. Unless each of these is expressed in terms of money, we cannot find out the assets owned by the business. When expressed in the common measure of money, transactions could be added or subtracted to find out the combined effect. In the above example, we could add values of different assets to find the total assets owned.

- (e) **The Accrual Concept:** The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.
- (f) **Dual Aspect Concept:** Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e., it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example, goods purchased for cash has two aspects which are (i) Giving of cash (ii) Receiving of goods. These two aspects are to be recorded. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

- (g) **Matching Concept:** This concept states that the revenues and expenses must be recorded at the same time at which they are incurred. In general, the revenues earned should be with the expenses incurred during the accounting period. For the application of this concept several adjustments are made for prepaid expenses, accrued incomes, etc. The operating result of an accounting period can be measured only when incomes are compared with the related expenses incurred.
- (h) **Realisation Concept:** This concept states that revenue from any business transaction should be included in the accounting records only when it is realised. The term realisation means creation of legal right to receive money. Selling goods is realisation, receiving order is not. Accordingly, revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both has been created.
- (i) **Cost Concept:** Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them. For example, a machine was purchased by XYZ Limited for ₹5,00,000, for manufacturing shoes. An amount of ₹1,000 were spent on transporting the machine to the factory site. In addition, ₹2,000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e., ₹5,03,000. This cost is also known as historical cost. The effect of cost concept is that if the business entity does not pay anything for acquiring an asset this item would not appear in the books of accounts.

1.2.2.2 Accounting Conventions

- (a) **Convention of Conservatism:** This convention is based on the principle that "Anticipate no profit, but provide for all possible losses". It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit. The main objective of this convention is to show minimum profit. Profit should not be overstated. If profit shows more than actual, it may lead to distribution of dividend out of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise.
- (b) **Convention of Consistency:** The convention of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable.

- (c) **Convention of Materiality:** The convention of materiality states that, to make financial statements meaningful, only material fact i.e., important and relevant information should be supplied to the users of accounting information. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Material fact means the information of which will influence the decision of its user.
- (d) **Convention of Full Disclosure:** Convention of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information.

Accounting principles - concepts and conventions – lie at the core of accounting profession as they bring about the much sought-after uniformity in the process of recording transactions. Such uniformity makes it possible to reliably compare the financial performance, financial position, and cash flows across entities and also across the reporting periods. They contribute a lot in standardising the financial reporting process.

• **Concept of Transactions**

Accounting is all about recording transactions in the books of accounts of an organization in order to determine the financial performance and financial state of affairs at regular periodic interval.

A transaction is an event which can be expressed in monetary terms and brings change in the financial position of a business unit. For example, investing capital in the business, purchasing goods for resale, paying remuneration to employees etc. all are transactions as these events lead to change in the financial position of the organization. On the other hand, using a new material in production, appointment of a new manger etc. are only event as they do not change the financial position of the entity.

• **Capital and Revenue Transactions – Need for Distinction**

Appropriate distinction between capital and revenue transactions lies at the core of accounting and helps in achieving its objectives as stated above. The very act requires application of the accounting concepts of periodicity, accrual and matching.

When transactions are appropriately classified into capital and revenue nature, it serves a number of purposes as follows:

- (a) The distinction ensures proper accounting of transactions by identifying them as income or liability, and expense or asset;
- (b) It helps determining the profitability of the operations of the entity through correct identification of income and expenses.
- (c) It facilitates assessing the financial state of affairs through correct identification of assets and liabilities.

• **Capital and Revenue Transactions**

Capital Transactions are transactions having long-term effect while Revenue Transactions are transactions having short term effect. Each of these transactions can again be either a receipt or an expenditure.

1.3.1 Capital and Revenue Expenditure

Capital Expenditure refers to that expenditure benefit from which can be enjoyed by an entity over a number of accounting periods. This type of expenditure happens to be non-recurring in nature. A capital expenditure takes place when an asset or service is acquired or improvement of a fixed asset is affected. These assets resulting from such expenditure are not intended for resale in the ordinary course of business.

A capital expenditure has the following characteristics:

- (a) The amount involved in such an expenditure is generally large;
- (b) The benefit accruing from such an expenditure is consumed over more than one accounting period;

- (c) The expenditure is non-recurring in nature;
- (d) It results in an increase in value of fixed assets.

Examples of capital expenditure include purchase of machinery, construction of a plant, significant repairs to a fixed or non-current assets that significantly increases its life etc.

Revenue Expenditure refers to that expenditure benefit from which can be enjoyed by an entity in the current accounting period. This type of expenditure happens to be recurring in nature. Revenue expenditures are incurred to carry on the regular course of operations by an organization.

A revenue expenditure has the following characteristics:

- (a) The amount involved in such an expenditure is generally small;
- (b) The benefit accruing from such an expenditure is consumed within one accounting period;
- (c) The expenditure is recurring in nature;
- (d) It is incurred in relation to trading activities (i.e., either for purchase or sale of goods or for providing services).

Examples of revenue expenditure include purchase of goods for resale, payment of salaries, rent, regular maintenance of fixed assets etc.

● Accounting Treatment of Capital and Revenue Expenditure

An expenditure of capital nature is not written off completely (i.e., charged) against income in the accounting period in which it is acquired. Rather, it is capitalized i.e., recorded as an asset. However, over time the amount of capital expenditure is recognized as revenue expenditure i.e., it gets gradually charged against the profit in a systematic manner reflecting the benefits consumed out of it. For example, the acquisition of a machinery is a capital expenditure, but charging regular depreciation on this machinery is a revenue expenditure.

An expenditure of revenue nature charged as an expense against profit of the accounting period in which it is incurred or recognised.

● Distinction between Capital and Revenue Expenditure

Following are the major differences between capital expenditure and revenue expenditure:

Capital Expenditure	Revenue Expenditure
1. The economic benefits of this expenditure are consumed over a number of accounting periods.	1. The economic benefits from revenue expenditure are consumed within one accounting period.
2. It is non-recurring in nature.	2. It is recurring in nature.
3. The amount involved in such an expenditure is generally large.	3. The amount involved in such an expenditure is generally small.
4. It is reflected in the Balance Sheet.	4. It is debited to Income Statement.
5. Capital expenditures are not matched against capital receipts.	5. Revenue expenditures are not matched against revenue receipts
6. It may be incurred before or after the commencement of operations of an entity.	6. It is always incurred after the commencement of operations of an entity.
7. It tends to increase the earning capacity or, reduce the operating expenses of an entity.	7. It helps in carrying on the activities in the current accounting period.
8. It may be incurred before or after the commencement of operations of an entity.	8. It is always incurred after the commencement of operations of an entity.

● Rules for Determining Capital Expenditure

An expenditure can be recognized as capital if it is incurred for the following purposes:

- An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in business to earn profits and not meant for resale, will be treated as a capital expenditure. For example, if a second-hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor cars, for re-sale, then it will be a revenue expenditure because he deals in second hand motor cars.
- When an expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition, it is recognized as a capital expenditure. The expenditure is capitalized and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure.
- For example, if one buys a machine for ₹ 5,00,000 and pays ₹ 20,000 as transportation charges and ₹ 40,000 as installation charges, the total cost of the machine comes up to ₹ 5,60,000. Similarly, if a building is purchased for ₹ 1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹ 1,05,000.
- If an expenditure is incurred to increase earning capacity of a business, it will be considered as capital expenditure. For example, expenditure incurred for shifting the factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.
- Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example, legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.

Note: One useful way of recognizing expenditure as capital is to see that because of the expenditure, the business will own something which qualifies as an asset at the end of the accounting period.

Some examples of capital expenditure:

- (i) Purchase of land, building, machinery or furniture;
- (ii) Cost of leasehold land and building;
- (iii) Cost of purchased goodwill;
- (iv) Preliminary expenditures;
- (v) Cost of additions or extensions to existing assets;
- (vi) Cost of overhauling second-hand machines;
- (vii) Expenditure on putting an asset into working condition; and
- (viii) Cost incurred for increasing the earning capacity of a business.

● Rules for Determining Revenue Expenditure

Any expenditure which cannot be recognized as capital expenditure can be termed as revenue expenditure. A revenue expenditure temporarily influences only the profit earning capacity of the business. An expenditure is recognized as revenue when it is incurred for the following purposes:

Expenditure for day-to-day conduct of the business, the benefits of which last less than one year. Examples are wages of workmen, interest on borrowed capital, rent, selling expenses, and so on.

Expenditure on consumable items, on goods and services for resale either in their original or improved form. Examples are purchases of raw materials, office stationery, and the like. At the end of the year, there may be some revenue items (stock, stationery, etc.) still in hand. These are generally passed over to the next year though they were acquired in the previous year.

Expenditures incurred for maintaining fixed assets in working order. For example, repairs, renewals and depreciation.

Some examples of revenue expenditure:

- (i) Salaries and wages paid to the employees;
- (ii) Rent and rates for the factory or office premises;
- (iii) Depreciation on plant and machinery;
- (iv) Consumable stores;
- (v) Inventory of raw materials, work-in-progress and finished goods;
- (vi) Insurance premium;
- (vii) Taxes and legal expenses; and
- (viii) Miscellaneous expenses.

● **Revenue Expenditure Treated as Capital Expenditure:**

The following are some of the instances where an item of expenditure which is in the nature of revenue expenditure will be treated as capital expenditure.

- (a) **Repairs:** Repairs expenditure is revenue in nature, but huge amount incurred on a second-hand machinery in order to bring it to working condition can be treated as capital expenditure and should be added to the cost of Machinery.
- (b) **Wages:** Normally, wages are revenue in nature. But wages paid to the workers for the construction or installation of fixed assets, will be treated as capital expenditure and added to the cost of that asset.
- (c) **Preliminary Expenses:** All the expenses paid in the process of formation of a company should be treated as capital expenditure and recorded in the balance sheet on asset side.
- (d) **Brokerage, Government Stamp Duty and Legal Expenses:** All the expenses paid on the purchase of a property will be regarded as capital expenditure.
- (e) **Raw Materials and Stores:** These are generally revenue in nature, but if raw materials and stores are consumed in the constructing a fixed asset, the same should be treated as capital expenditure.
- (f) **Development Expenditure:** All the expenditure incurred for the development of mines and plantations should be treated as capital expenditure.

● **Deferred Revenue Expenditures**

Deferred Revenue Expenditure is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that will be of benefit over a subsequent period or periods. [Guidance Note on Terms used in Financial Statements issued by Institute of Chartered Accountants of India]. Deferred revenue expenditures are a combination of capital and revenue expenses whose usefulness does not expire in the year of their occurrence, but generally expires in the near future. These types of expenditures are carried forward and are written-off in future accounting periods. A portion of

such expenditure is capitalised even though it is revenue in nature, and hence is also referred to as Capitalised Revenue Expenditure.

Examples of Deferred Revenue Expenditure include heavy advertisement expenditure incurred prior to launching a new product, development expenses of a product etc.

Out of the total amount of Deferred Revenue Expenditure, a part (the portion representing benefits consumed during the year) is written-off and recorded in the debit-side of the Income Statement, while the unwritten-off portion appears as an asset in the Balance Sheet.

Note: After the issuance of AS-26, the expenditures which were recognised as deferred revenue expenditure has to be treated as simple revenue expense. The accounting standard has specifically mentioned that any expenditure incurred for research, training, advertising and promotional activities should be recognised as an expense of the accounting period in which it has been incurred.

Illustration 1.

State whether the following are capital, revenue or deferred revenue expenditure.

- (i) Carriage of ₹7,500 spent on machinery purchased and installed.
- (ii) Heavy advertising costs of ₹20,000 spent on the launching of a company's new product.
- (iii) ₹200 paid for servicing the company vehicle, including ₹50 paid for changing the oil.
- (iv) Construction of basement costing ₹1,95,000 at the factory premises.

Solution:

- (i) Carriage of ₹7,500 paid for machinery purchased and installed should be treated as a Capital Expenditure.
- (ii) Advertising expenses for launching a new product of the company should be treated as a Revenue = Expenditure. (As per AS-26)
- (iii) ₹200 paid for servicing and oil change should be treated as a Revenue Expenditure.
- (iv) Construction cost of basement should be treated as a Capital Expenditure.

Illustration 2.

State whether the following are capital or revenue expenditure.

- (i) Paid a bill of ₹10,000 of Mr. Kumar, who was engaged as the erection engineer to set up a new automatic machine costing ₹20,000 at the new factory site.
- (ii) Incurred ₹26,000 expenditure on varied advertisement campaigns undertaken yearly, on a regular basis, during the peak festival season.
- (iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent ₹90,000 being the budgeted allocation for the year.

Solution:

- (i) Expenses incurred for erecting a new machine should be treated as a Capital Expenditure.
- (ii) Advertisement expenses during peak festival season should be treated as a Revenue Expenditure.
- (iii) Expenses incurred for Labour Welfare Centre should be treated as a Capital Expenditure.

Illustration 3.

Classify the following items as capital or revenue expenditure:

- (i) An extension of railway tracks in the factory area;
- (ii) Wages paid to machine operators;
- (iii) Installation costs of new production machine;
- (iv) Materials for extension to foremen's offices in the factory;
- (v) Rent paid for the factory;
- (vi) Payment for computer time to operate a new stores control system,
- (vii) Wages paid to own employees for building the foremen's offices.

Give reasons for your classification.

Solution:

- (i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.
- (ii) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only.
- (iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (iv) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit the Company only during the current period.
- (vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.
- (vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Illustration 4.

For each of the cases numbered below, indicate whether the income/expenditure is capital or revenue.

- (i) Payment of wages to one's own employees for building a new office extension.
- (ii) Regular hiring of computer time for the preparation of the firm's accounts.
- (iii) The purchase of a new computer for use in the business.
- (iv) The use of motor vehicle, hired for five years, but paid at every six months.

Solution:

- (i) Payment of wages for building a new office extension should be treated as a Capital Expenditure.
- (ii) Computer hire charges should be treated as a Revenue Expenditure.
- (iii) Purchase of computer for use in the business should be treated as a Capital Expenditure.
- (iv) Hire charges of motor vehicle should be treated as a Revenue Expenditure.

Illustration 5.

State with reasons whether the following are capital or revenue expenditure:

- (i) Freight and cartage on the new machine ₹ 150, and erection charges ₹ 500.
- (ii) Fixtures of the book value of ₹ 2,500 sold off at ₹ 1,600 and new fixtures of the value of ₹ 4,000 were acquired. Cartage on purchase ₹ 100.
- (iii) A sum of ₹ 400 was spent on painting the factory.
- (iv) ₹ 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Solution:

- (i) Freight and cartage totaling ₹ 650 should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.
- (ii) Loss on sale of fixtures $\text{₹}(2,500 - 1,600) = \text{₹}900$ should be treated as a Capital Loss. The cost of new fixtures and carriage thereon should be treated as a Capital Expenditure because the fixture will be used for a long period. So the cost of new fixture will be $\text{₹}(4,000 + 100) = \text{₹}4,100$.
- (iii) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
- (iv) Repairing cost of second hand car should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.

Illustration 6.

State the nature (capital or revenue) of the following expenditure which were incurred by Vedanta & Co. during the year ended 30th June, 2021:

- (i) ₹ 350 was spent on repairing a second hand machine which was purchased on 8th May, 2021 and ₹ 200 was paid on carriage and freight in connection with its acquisition.
- (ii) A sum of ₹ 30,000 was paid as compensation to two employees who were retrenched.
- (iii) ₹ 150 was paid in connection with carriage on goods purchased.
- (iv) ₹ 20,000 customs duty is paid on import of a machinery for modernisation of the factory production during the current year and ₹ 6,000 is paid on import duty for purchase of raw materials.
- (v) ₹ 18,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution:

- (i) Repairing and carriage totaling ₹ 550 for second hand machine should be treated as a Capital Expenditure.
- (ii) Compensation paid to employees shall be treated as a Revenue Expenditure.
- (iii) Carriage paid for goods purchased should be treated as a Revenue Expenditure.
- (iv) Customs duty paid on import of machinery to be treated as a Capital Expenditure. However, import duty paid for raw materials should be treated as a Revenue Expenditure.
- (v) Interest paid during pre-construction period to be treated as a Capital Expenditure.

Illustration 7.

State with reasons whether the following items relating to Parvati Sugar Mill Ltd. are capital or revenue:

- (i) ₹ 50,000 received from issue of shares including ₹ 10,000 by way of premium.
- (ii) Purchased agricultural land for the mill for ₹ 60,000 and ₹ 500 was paid for land revenue for period after purchase.
- (iii) ₹ 5,000 paid as contribution to PWD for improving roads of sugar producing area.
- (iv) ₹ 40,000 paid for excise duty on sugar manufactured.
- (v) ₹ 70,000 spent for constructing railway siding.

Solution:

- (i) ₹ 40,000 (50,000 – ₹ 10,000) received from issue of shares will be treated as a Capital Receipt. The premium of ₹ 10,000 should be treated as a Capital Profit.
- (ii) Cost of land ₹ 60,000 to be treated as Capital Expenditure and land revenue of ₹ 500 to be treated as Revenue Expenditure.
- (iii) Contribution paid to PWD should be treated as a Revenue Expenditure.
- (iv) Excise duty of ₹ 40,000 should be treated as a Revenue Expenditure.
- (v) ₹ 70,000 spent for constructing railway siding to be treated as a Capital Expenditure.

1.3.2 Capital and Revenue Receipts

A receipt of money may be of a capital or revenue nature. A clear distinction, therefore, should be made between capital receipts and revenue receipts in order to determine the correct result of operating performance of the entity.

Capital Receipts refer to the receipts which are obtained by an entity from operations other than the regular operations of the entity. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year. Capital receipts can take one or more of the following forms:

- (a) Additional capital introduced by the owner; and,
- (b) Proceeds from sale of long-term assets.

A receipt of money is considered as Revenue Receipt when it is obtained by an entity from its regular course of operations. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period. For example, collection from customers for goods sold on credit; Fees received for services rendered etc.

⊙ **Accounting Treatment of Capital and Revenue Receipts**

Capital receipts are credited to the respective account of capital nature, and gets reflected in the Balance Sheet. On the other hand, revenue receipts are recognised as income and are reflected in the Income Statement.

◉ Distinction between Capital and Revenue Receipts

Major differences between capital receipts and revenue receipts are as follows:

Sr. No.	Capital Receipt	Revenue Receipt
1.	These receipts are obtained by an entity from operations other than from the regular operations.	These receipts are obtained by an entity from regular day-to-day operations.
2.	It is non-recurring in nature.	It is recurring in nature.
3.	It is not recognised as an income.	It is recognised as an income.
4.	It gets reflected in the Balance Sheet.	It is credited to Income Statement.
5.	It does not affect the operating result of an entity.	It affects the operating result of an entity.
6.	It may result in creation of liability.	It does not create any liability.

◉ Capital and Revenue Profit

While ascertaining the operating performance of an entity for a particular period, a proper distinction is to be made between capital and revenue profits.

If a profit arises out of an ordinary nature, being the outcome of the ordinary functions and object of the business, it is termed as 'revenue profit'. But, when a profit arises out of a non-recurring transaction, it is termed as capital profit. Generally, Capital Profits arise out of the sale of assets other than inventory at a price more than its book value or in connection with the raising of capital or at the time of purchasing an existing business.

Examples of Capital Profit include Profit prior to incorporation; Premium received on issue of shares; Profit made on re-issue of forfeited shares etc. Similarly, examples of Revenue Profit include profit on sale of goods and providing services.

Normally, Capital Profits are transferred to Capital Reserve while Revenue Profits are either distributed to owners or are credited to Reserves for future investments.

◉ Capital and Revenue Losses

While ascertaining profit, revenue losses are differentiated from capital losses, just as revenue profits are distinguished from capital profits.

Revenue losses arise from the normal course of business by selling the merchandise at a price less than its purchase price or cost of goods sold or where there is a decline in the current value of inventories etc. Examples include discount allowed to customers for prompt payment; Bad debt loss.

Capital Loss, on the other hand, refers to a loss which does not arise to an entity in the regular course of its operations. Capital losses may result from the sale of assets, other than inventory for less than written down value or the diminution or elimination of assets other than as the result of use or sale (flood, fire, etc.) or in connection with raising capital of the business (issue of shares at a discount) or on the settlement of liabilities for a consideration more than its book value (debenture issued at par but redeemed at a premium).

Treatment of capital losses are same as that of capital profits. Capital losses arising out of sale of fixed assets generally appear in the Income Statement (being deducted from the net profit). But other capital losses are adjusted against reserves of capital in nature. Revenue losses are transferred to the Income Statement.

Accounting Cycle, Analysis of Transaction Etc.

1.4

1.4.1 Concept of Accounting Cycle

An accountant follows a sequence of activities to record and finally report transactions of an entity during an accounting period. This sequence of activities starts with identifying an event to be a transaction worthy of recording in then books to their presentation in the financial statements after proper process of summarising, classifying and finalising. To keep track of the full accounting cycle from start to finish is one of the main duties of a bookkeeper.

Thus, accounting cycle is defined as the holistic process of recording and processing all financial transactions of a company, from when the transaction occurs, to its representation on the financial statements, to closing the accounts.

Accounting cycle consists of the following sequential steps.

- (a) **Identifying the Transactions:** The first step in the accounting cycle is to analyse the events to determine if they are 'transactions'. Only events that leads to change in the financial position of the accounting unit is called transactions.
- (b) **Recording transaction in the Journal:** The second step in the accounting cycle is to record the transactions in the books of original entry i.e., Journal after identifying the Debit and the Credit element.
- (c) **Posting to Ledger:** In the next step, the transaction is posted in a summarised and classified manner to different accounts of the ledger.
- (d) **Drafting of Unadjusted Trial Balance:** At the next step, the ledger balances are compiled in the trial balance to check whether there is any error during the recording stage. This stage is, however, not mandatory.
- (e) **Passing of adjustment entries:** Identification of necessary adjustments and passing of adjusting entries make up the fifth step in the cycle.
- (f) **Drafting of Adjusted Trial Balance:** Once all adjusting entries are completed, an Adjusted Trail Balance can be prepared. This happens to be the last step before the preparation of the financial statements.
- (g) **Closing of books:** In this stage of the accounting cycle, the ledger accounts are closed and balanced (also referred to as "zeroed out") at the end of every accounting period.
- (h) **Drafting the Financial Statements:** In the last stage of the accounting cycle, the Income Statement is prepared with the closing balances of the nominal accounts, while the balances of real and personal accounts get reflected in the Balance Sheet. Financial statements are prepared in the following order: Income Statement, Statement of Retained Earnings, Balance Sheet and Statement of Cash Flows.

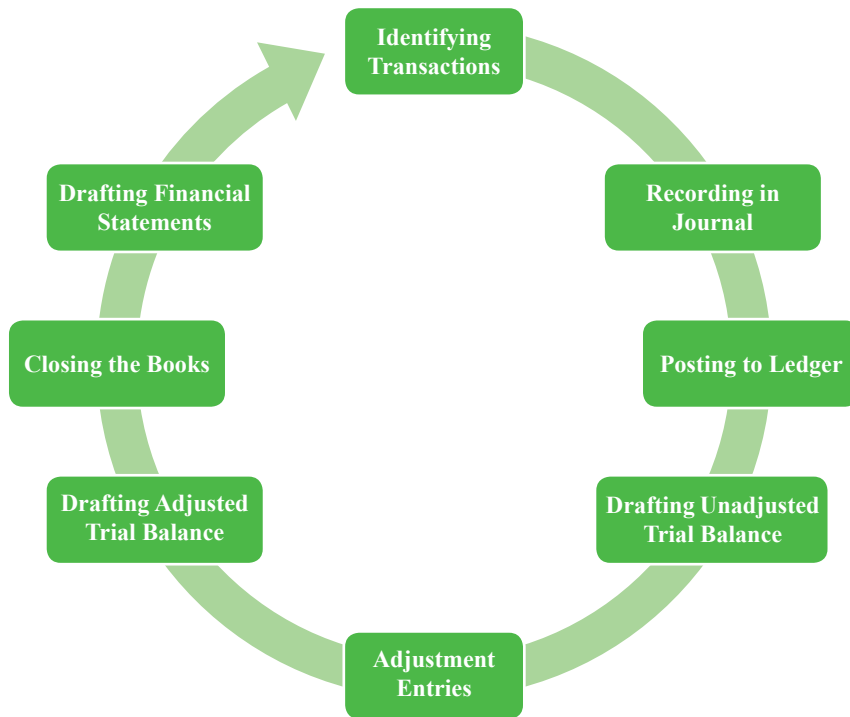


Figure 1.2: Accounting Cycle

These steps and their related components have been explained in greater detail in the following sections of this module.

☉ **Charts of Accounts and Codification Structure**

The primary purpose of financial accounting is to record the transactions entered into by an organisation during an accounting period. To achieve this, various accounts are opened and after the classification exercise the transactions get posted in the ledger (which itself is classified as personal and impersonal). These happen to be the building blocks for developing the financial statements and other management reports of the organisation.

However, with the increase in the complexity of business and flow of data, it has become quite a challenge to retrieve the information stored in the accounting records. It is for the purpose of effective management and retrieval of the already recorded accounting information, Chart of Accounts are developed.

☉ **Concept of Chart of Accounts**

A Chart of Accounts (COA) is the list of all accounts in the general ledger, each account being accompanied by a reference number. It is a financial organizational tool that provides a complete listing of every account in the general ledger of a company, broken down into subcategories. Specifically, it is an index of all the financial accounts in the general ledger of an organisation.

Chart of Accounts is the driving force behind an organisation's book-keeping and accounting systems, and is considered to be the foundation of financial reporting.

The basic purpose of such charting is to organize the accounts and group similar ones together.

This process makes it easier for the accountants and auditors to locate specific accounts. A well-structured chart of accounts is often the single best and most effective way to raise the financial reporting of an organization to the next level.

The organization of accounts within the COA varies from company to company. It usually consists of the accounts that a company has identified and made available for recording transactions in its general ledger. This can be done with accounting software.

🕒 Codification Structure

A Chart of Accounts provides the structure for the general ledger accounts of a concern. It lists specific types of accounts, describes each account, and includes account numbers. A chart of accounts typically lists asset accounts first, followed by liability and capital accounts, and then by revenue and expense accounts.

- (a) **Setting up of a Chart of Accounts:** To set up a chart of accounts, the first is to define the various accounts to be used by the organisation. Each account should have a number to identify it. Each chart of accounts typically contains a name, brief description, and an identification code.
- (b) **Ordering of Accounts:** Balance Sheet Accounts tend to follow a standard that lists the most liquid assets first. Revenue Accounts and Expense Accounts tend to follow the standard of first listing the items most closely related to the operations of the business. For example, Sales would be listed before non-operating income. In some cases, part of all the expense accounts simply may be listed in alphabetical order.
- (c) **Designing of Chart of Accounts:** The designing of a detailed chart of accounts would typically begin with an initial design which would reflect the major headings of the accounts. Thereafter, the detailed descriptions of the transaction are added, which may act as future references.

Note: While codifying the accounts, an organisation may follow a three-layer approach of providing Division Code followed by Department Code followed by Account Code.

Division Code is usually a two-digit code (but may be of three digits as well) that defines the specific company division within an organization. A company with a single division does not require division coding. The department code is usually a two- or three-digit code that defines various departments within a division. A division will usually have various departments such as accounting, production, engineering, and so on. In order to identify the departments in a division, an account manager can use these codes. Account Code is usually a three-digit code that are assigned to the accounts such as assets, supplies, expense, revenue, and so on. For instance, a multi-division company would have the chart accounts numbering in the following manner – zz-aa-123—the zz representing division, aa for the department, and 123 for accounts.

🕒 Illustration of Account Codification for a small business organisation:

For a small business, three digits code may suffice for the account number, although more digits are desirable. However, in order to allow for new accounts to be added as the business grows with more digits, new accounts can be added while maintaining the logical order. Complex businesses may have thousands of accounts, and require longer account reference numbers. As such, it is worthwhile to put thought into assigning the account numbers in a logical way and to follow any specific industry standards.

The following is an example of some of the accounts that may be included in a chart of accounts and reflecting how the digits might be coded:

Account Numbering & Description of Accounts
1000 to 1999: Asset accounts
2000 to 2999: Liability accounts
3000 to 3999: Equity accounts
4000 to 4999: Revenue accounts
5000 to 5999: Cost of goods sold accounts
6000 to 6999: Expense account
7000 to 7999: Other revenue (for example rent received, bad debt recovery etc.)
8000 to 8999: Other expenses (for example depreciation income taxes etc.)

An alternative presentation of a typical Chart of Accounts is as follows:

Balance Sheet Accounts	Income Statement Accounts
Assets (1000 – 1999)	Operating Revenues (4000 – 4999)
Liabilities (2000 – 2999)	Operating Expense (5000 – 5999)
Owner’s Equity (3000 -3999)	Overhead Costs or Expenses (6000 – 6999)
	Non-operating revenue and gains (7000 – 7999)
	Non- operating expenses and Losses (8000 – 8999)

It is to be noted that by separating each account by several numbers many new accounts can be added between any two while maintaining the logical order.

1.4.2 Analysis of Transactions

● Events and Transactions

A transaction is an event between two contracting parties, which can be expressed in terms of money and which leads to change in the financial position of a business unit. A transaction may be an exchange in which each party receives as well as sacrifices value. Examples include sale and purchase of goods, purchase of assets etc.

An event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit. Thus, appointment of a manger, launch of a new product are events but not transactions. Hence, all transactions are events but all events are not transactions.

In accounting, transactions are recorded systematically based on some source documents. Source documents include sales order, invoices and credit notes, petty cash vouchers etc.

1.4.2.1 Accounting Equation

The accounting equation is a representation of the interrelationship among three important components of accounting namely Assets, Liabilities and Equity.

In the most simplistic form, the accounting equation is presented as:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Assets represent the valuable resources owned and controlled by the company with the purpose of using it for generating future profits, such as cash, accounts receivable, fixed assets, inventory etc. Liabilities represent obligations of an organisation to its external stakeholders to be settled at a future date. It represents amount of money that the business owes to the other parties. Equity represents owners net claim on the assets.

The above equation can be further expanded by incorporating the various elements of the Equity component as under:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

or, $\text{Assets} = \text{Liabilities} + [\text{Capital} + (\text{Revenue} - \text{Expenses}) - \text{Drawings}]$

or, $\text{Assets} + \text{Expenses} + \text{Drawings} = \text{Liabilities} + \text{Capital} + \text{Revenue}$

Accounting equation lies at the core of the double-entry accounting system. Whatever be the transaction to be recorded, the accounting equation before and after the entry of the transaction always remains in balance.

Consider the following illustrations.

Transaction	Assets + Expenses + Drawings	Liabilities + Capital + Revenue
Capital introduced by the owner in cash	Cash (Assets) increases	Capital increases
Purchase of goods in credit	Inventory (Asset) increases	Creditors/ Payables (Liabilities) increases
Sale of goods in credit	Debtors/ Receivables (Assets) increases; Inventory (Assets) decreases	N.A.
Wages paid	Wages (Expenses) increases; Cash/ Bank (Assets) decreases	N.A.
Commission received	Cash/ Bank (Assets) increases	Commission received (Revenue) increases
Cash withdrawn by proprietor	Cash (Assets) decreases	Capital decreases

Illustration 8.

Prepare an Accounting Equation from the following transactions in the books of Mr. X for January, 2021:

- 1 Invested Capital in the firm ₹20,000
- 2 Purchased goods on credit from Das & Co. for ₹2,000
- 4 Bought plant for cash ₹8,000
- 8 Purchased goods for cash ₹4,000
- 12 Sold goods for cash (Cost ₹4,000 + Profit ₹2,000) ₹6,000.
- 18 Paid to Das & Co. in cash ₹1,000
- 22 Received from B. Banerjee ₹300
- 25 Paid salary ₹6,000

30 Received interest ₹5,000

31 Paid wages ₹3,000

Solution:

Effect of transaction on Assets, Liabilities and Capital

Date	Transaction	Assets =	Liabilities +	Capital
2021 Jan.1	Invested Capital in the firm ₹20,000	20,000	-	20,000
2	Purchased goods on credit from Das & Co. ₹2000	+2,000	+2,000	-
	Revised Equation	22,000=	2,000+	20,000
4	Bought Plant for cash ₹8,000	+8,000 -8,000	-	-
	Revised Equation	22,000=	2,000+	20,000
8	Purchased goods for cash ₹4,000	+4,000 -4,000	--	--
	Revised Equation	22,000=	2,000+	20,000
12	Sold Goods for cash (Cost ₹4,000 + Profit ₹2,000)	+6,000 -4,000		+2,000
	Revised Equation	24,000	2,000+	22,000
18	Paid to Das & Co. for ₹1,000	-1,000	-1,000	-
	Revised Equation	23,000=	1,000+	22,000
22	Received from B. Banerjee for ₹300	+300 -300		
	Revised Equation	23,000=	1,000+	22,000
25	Paid salary for ₹6,000	-6,000		-6,000
	Revised Equation	17,000=	1,000+	16,000
30	Received Interest for ₹5,000	+5,000		+5,000
	Revised Equation	22,000=	1,000+	21,000
31	Paid Wages for ₹3,000	-3,000		-3,000
	Revised Equation	19,000=	1,000+	18,000

1.4.2.2 Double Entry System

⊙ Concept of Double Entry System

Double entry system of book keeping is an accounting system which recognizes the fact that every transaction has two aspects - 'Debit' and 'Credit' and both aspects of the transaction are recorded in the books of accounts.

The term 'Debit' is derived from the Latin word 'debitum' which means 'what is due'. It is abbreviated by 'Dr.'

The term 'Credit' is derived from the Latin word 'credere' which means 'what is trusted. It is abbreviated by 'Cr.'

Double entry system records the transactions by understanding them as a Debit item or Credit item. A debit entry in one account gives the opposite effect in another account by credit entry. This means that the sum of all Debit accounts must be equal to the sum of Credit accounts.

● Features of Double Entry System

- (i) Every transaction has two-fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (ii) Every transaction is divided into two aspects, Debit and Credit. One account is to be debited and the other account is to be credited.
- (iii) Every debit must have its corresponding and equal credit.

● Concept of Account

An account is defined as a summarized record of transactions related to a person or a thing e.g., when the business deals with customers and suppliers, each of the customers and supplier will be a separate account. The account is also related to inanimate objects – both tangible and intangible. e.g., land, building, equipment, brand value, trademarks etc. are some of the things. When a business transaction occurs, one has to identify the ‘account’ that will be affected by it and then apply the rules to decide the accounting treatment. Only then the transactions can be recorded in accounting.

Typically, an account is expressed as a statement in form of English letter ‘T’. It has two sides. The left-hand side is called as “Debit’ side and the right-hand side is called as “Credit’ side. The debit side is indicated by ‘Dr’ and the credit side by ‘Cr’. Accounts are classified as follows:

- (a) **Personal Account:** As the name suggests, these are accounts related to persons. Personal Accounts can again be of three types as follows.
 - (i) **Natural Personal Account:** These represents natural persons like Suresh’s A/c, Anil’s a/c, Rani’s A/c etc.
 - (ii) **Artificial Personal Account:** The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships etc. For example, M/s ABC Ltd, M/s PQR Industries etc.
 - (iii) **Representative Personal Account:** They represent the person collectively. For example, Outstanding Rent A/c, Prepaid Insurance A/c etc.
- (b) **Real Accounts:** These are accounts related to assets or properties or possessions. Depending on their physical existence or otherwise, they are further classified as -
 - (i) **Tangible Real Account** – They represent assets that have physical existence and can be seen, and touched. e.g., Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
 - (ii) **Intangible Real Account** – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them. e.g. Goodwill A/c, Trade mark A/c, Patents & Copy Rights A/c, Intellectual Property Rights A/c and the like.
- (c) **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g., Salary and Wages A/c, Rent and Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

● Analysing Debit and Credit of a Transaction

The double entry system has specific rules for determining the Debit Account and Credit Account in any transaction. The rules can broadly be discussed as follows:

A. Golden Rule Approach

This method is based on the conventional classification of accounts. Conventionally, accounts are classified into three types – Nominal Account, Real Account and Personal Account. The rules of Debit and Credit under this approach are described below.

Nature of Account	Rule of Debit and Credit	
Nominal Account	Debit	Expenses and Losses
	Credit	Incomes and Gains
Real Account	Debit	What comes in
	Credit	What goes out
Personal Account	Debit	The receiver
	Credit	The giver

B. Accounting Equation Approach

This method is based on the concept of accounting equation. The rules of debit and credit under this method are presented as follows:

Types of Account	To be Debited	To be Credited
Assets Account	Increase	Decrease
Liabilities Account	Decrease	Increase
Capital Account	Decrease	Increase
Revenue Account	Decrease	Increase
Expense Account	Increase	Decrease
Withdrawal Account	Increase	Decrease

Once the transactions are identified into Debit Account and Credit Account, they are recorded in the books of original entry i.e., Journal and therefrom posted to the individual accounts maintained under the Ledger.

Consider the following illustrations on analysis of transactions.

Illustration 9.

Ascertain the debit and credit from the following particulars under Modern Approach.

- Started business with capital.
- Bought goods for cash.
- Sold goods for cash.
- Paid salary.
- Received Interest on Investment.
- Bought goods on credit from Mr. Y
- Paid Rent out of Personal cash.

Solution:

	Effect of Transaction	Account	To be debited/Credited
(a)	Increase in Cash	Cash A/c	Debit
	Increase in Capital	Capital A/c	Credit
(b)	Increase in Stock	Purchase A/c	Debit
	Decrease in Cash	Cash A/c	Credit
(c)	Increase in Cash	Cash A/c	Debit
	Decrease in Stock	Sale A/c	Credit
(d)	Increase in Expense	Salary A/c	Debit
	Decrease in Cash	Cash A/c	Credit
(e)	Increase in Cash	Cash A/c	Debit
	Increase in Income	Interest A/c	Credit
(f)	Increase in Stock	Purchase A/c	Debit
	Increase in Liability	Y A/c	Credit
(g)	Increase in Expense	Rent A/c	Debit
	Increase in Liability	Capital A/c	Credit

Illustration 10.

Ascertain the Debit Credit under British Approach or Double Entry System. Consider previous illustration.

Solution:

	Step-I	Step-II	Step-III	Step-IV
(a)	Cash A/c	Real	Comes in	Debit
	Capital A/c	Personal	Giver	Credit
(b)	Purchase A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(c)	Cash A/c	Real	Comes in	Debit
	Sales A/c	Nominal	Incomes	Credit
(d)	Salary A/c	Nominal	Expenses	Debit
	Cash A/c	Real	Goes out	Credit
(e)	Cash A/c	Real	Comes in	Debit
	Interest A/c	Nominal	Incomes	Credit
(f)	Purchase A/c	Nominal	Expenses	Debit
	Y' A/c	Personal	Giver	Credit
(g)	Rent A/c	Nominal	Expenses	Debit
	Capital A/c	Personal	Giver	Credit

● **Advantages of Double Entry System**

- (i) It ensures arithmetical accuracy of the books of accounts as, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically or at the end of the financial year.
- (ii) It prevents and minimizes frauds. Moreover, frauds can be detected early.
- (iii) Errors can be checked and rectified easily.

● **Limitations of Double Entry System**

- (i) The system does not disclose all the errors committed in the books accounts.
- (ii) The trial balance prepared under this system does not disclose certain types of errors.
- (iii) It is costly as it involves maintenance of a number of books of accounts.

1.4.3 Books of Original Entry

Books of original entry are referred to as the books where a business records all the business transactions initially. It is also known as Journal. These are the primary books of accounts which are used by the accountants for recording the transactions chronologically in the first place. These are also referred to as Books of Primary Entry or Books of First Entry.

● **Types of Books of Original Entry**

The books of original entry are broadly classified into two categories as follows:

- (a) **Special Journal/ Subsidiary Books:** A Special Journal is a book of primary entry in which transactions of a specific type viz. credit purchases, credit sales, return inwards etc. Some examples include Cash Book, Bank Book, Purchase Day Book, Sales Day Book etc. These are also known as Subsidiary Books.
- (b) **General Journal:** It is the book of original entry in which miscellaneous transactions, which do not fit in any other Special Journals (as mentioned above) books, are recorded. Examples are, opening entry, closing entry adjustment entry etc.

For detail discussion, please refer to Module 1.5.

1.4.4 Posting in Ledger and Finalization of Accounts

After recording each transaction in the books of original entry, they are posted to the Ledger. Ledger contains individual accounts to which the transactions are posted. Ledger is also known as the Book of Final entry. At the end of the accounting period (viz. quarter, half-year or year), the ledger accounts are balanced and closed.

The closure of ledger accounts depends on their nature. Specifically, the nominal accounts (viz. accounts representing incomes, expenses, gains and losses) are closed by transfer to the Income Statement (namely, Trading A/c and Profit & Loss A/c for a profit-oriented organisation, and Income & Expenditure A/c for a non-profit organisation). The income statement is prepared to ascertain the operating results (viz. profit/ loss or surplus/ deficit) in relation to a specific accounting period.

The balances of the accounts of real and personal nature are carried forward to the next accounting period. Their balances are reflected in a specific financial statement called the Balance Sheet. It shows the financial position of an organisation at the end of a specific accounting period by reflecting the different assets owned, liabilities and equity of the organisation.

After identification of the transactions, the next step in Accounting Cycle is recording of transactions in the books of primary entry or Journal. This is followed by posting the transactions in respective accounts in the ledger.

1.5.1 Journal

• **Concept of Journal**

The word “journal” has been derived from the French word “jour”. Jour means day. So, journal means daily. Transactions are recorded daily in journal and hence it has been named so. It is a book of original entry to record transactions chronologically (i.e., in order of date) and in detail the various transactions of a trader. The process of recording transaction in a journal is called as ‘journalisation’. The entry made in this book is called a ‘journal entry’.

• **Functions of Journal**

- (a) **Historical Function:** It contains a chronological record of the transactions for future references.
- (b) **Analytical Function:** While recording in journal, each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.
- (c) **Recording Function:** Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explain, the transaction in simple language.

• **Advantages of Journal**

The following are the advantages of journal:

- (a) Each transaction is recorded as soon as it takes place. So, there is no possibility of any transaction being omitted from the books of account.
- (b) Since the transactions are kept recorded in journal, chronologically with narration, it can be easily ascertained when and why a transaction has taken place.
- (c) Journal facilitates ledger posting.
- (d) Journal shows the complete story of a transaction in one entry.
- (e) Any mistake in ledger can be easily detected with the help of journal.

• **Form of Journal**

The specimen of a journal book is shown below.

Journal

Date	Particulars	Voucher number	Ledger folio	Debit (₹)	Credit (₹)
dd-mm-yy	Name of A/c to be debited Name of A/c to be credited (narration describing the transaction)	-----	Reference of page number of the A/c in ledger	-----	-----

- (i) **Date Column:** This column contains the date of the transaction.
- (ii) **Particulars:** This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- (iii) **Voucher Number:** This Column contains the number written on the voucher of the respective transaction.
- (iv) **Ledger Folio (L.F.):** This column contains the folio (i.e., page no.) of the ledger, where the transaction is posted.
- (v) **Dr. Amount and Cr. Amount:** This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

Note: All the columns are filled in at the time of entering the transaction except for the column of ledger folio. This is filled at the time of posting of the transaction to 'ledger'.

Example: As per voucher no. 31 of Roy Brothers, on 10.05.2021 goods of ₹50,000 were purchased. Cash was paid immediately. Ledger Folios of the Purchase A/c and Cash A/c are 5 and 17 respectively. Journal entry of the above transaction is given below:

Date	Particulars	Voucher No.	Ledger Folio	Debit (₹)	Credit (₹)
10.05.2021	Purchase A/c Dr.	31	5	50,000	
	To Cash A/c		17		50,000
	(Being goods purchased for cash)				

Simple vs. Compound Journal Entry

A journal entry can be either a Simple journal entry or a Compound journal entry. When in a journal entry only two accounts are affected – one account is debited and another account is credited, it is called a Simple journal entry. For example, the journal entry for the transaction 'Goods worth ₹22,000 purchased by Ramesh from Rajesh for cash' will be a simple journal entry as in this case Cash A/c will be credited by ₹22,000 and Purchase A/c will get debited with ₹22,000.

In case of a Compound journal entry, at least two debits and at least one credit or at least one debit and two or more credit items are involved. For example, the journal entry for the transaction 'Goods worth ₹22,000 purchased by Ramesh from Rajesh involving cash purchase ₹14,000 and balance on credit' will be a compound journal entry as in this case Cash A/c as-well as Creditors A/c will be credited with ₹14,000 and ₹8,000 respectively, and Purchase A/c will get debited with ₹22,000.

Consider the following illustrations.

Illustration 11.

Let us illustrate the journal entries for the following transactions:

2021 April

- 1 Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of ₹5,00,000 and ₹2,50,000 respectively.
- 10 Bought office furniture of ₹25,000 for cash. Bill No. - 2021/F/3
- 11 Opened a current account with PP National Bank by depositing ₹1,00,000
- 15 Paid office rent of ₹15,000 for the month by cheque to M/s Realtors Properties. Voucher No. 3
- 20 Bought a motor car worth ₹4,50,000 from Millennium Motors by making a down payment of ₹50,000 by cheque and the balance by taking a loan from HH Bank. Voucher No. M/15/7
- 25 Vikas and Vaibhavi carried out a consulting assignment for AA Pharmaceuticals and raised a bill for ₹10,00,000 as consultancy fees. Bill No. B15/4/1 raised. Avon Pharmaceuticals have immediately settled ₹2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into Bank.
- 30 Salary of one receptionist @ ₹5,000 per month and one officer @ ₹10,000 per month. The salary for the current month is payable to them.

Solution:

The entries for these transactions in a journal will look like:

In the Books of Vikash & Vaibhavi Journal Entries Journal Folio-1

Date	Particulars	Voucher number	L.F	Dr.	Cr.
				(₹)	(₹)
01-04-21	Cash A/c	Dr.	1	7,50,000	
	To Vikas's Capital A/c		2		5,00,000
	To Vaibhavi's capital A/c (Being capital brought in by the partners)		3		2,50,000
10-04-21	Furniture A/c	Dr.	4	25,000	
	To Cash A/c (Being furniture purchased in cash)		1		25,000
11-04-21	PP National Bank A/c	Dr.	5	1,00,000	
	To Cash A/c (Being current account opened with PP National Bank by depositing cash)		1		1,00,000
15-04-21	Rent A/c	Dr.	6	15,000	
	To PP National Bank A/c (Being rent paid to Realtors Properties for the month)		5		15,000

20-04-21	Motor Car A/c	Dr.	M/15/7	7	4,50,000	
	To PP National Bank A/c			5		50,000
	To Loan from HH Bank A/c			8		4,00,000
	(Being car purchased from Millennium Motors by paying down payment and loan arrangement)					
25-04-21	PP National Bank A/c	Dr.	B15/4/1	5	2,50,000	
	AA Pharma A/c	Dr.		9	7,50,000	
	To Consultancy Fees A/c			10		10,00,000
	(Being amount received and revenue recognized for fees charged)					
30-04-21	Salary A/c	Dr.		11	15,000	
	To Salary payable A/c			12		15,000
	(Being the entry to record salary obligation for the month)					

Illustration 12.

Journalise the following transactions in the books of Mr. Roy

2021

April

- 1 He started business with a capital of – Plant ₹ 10,000, Bank ₹ 8,000, Stock ₹ 12,000
- 2 Bought furniture for resale ₹ 5,000
Bought furniture for Office decoration ₹ 3,000
- 3 Paid rent out of personal cash for ₹ 2,000
- 8 Sold furniture out of those for resale ₹ 6,000
- 12 Paid Salary to Mr. X for ₹ 1,200
- 15 Purchased goods from Mr. Mukherjee for cash ₹ 3,000
- 18 Sold goods to Mr. Sen on credit for ₹ 8,000
- 20 Mr. Sen returned goods valued ₹ 1,000
- 22 Received cash from Mr. Sen of ₹ 6,500 in full settlement
- 28 Bought goods from Mr. Bose on credit for ₹ 5,000
- 30 Returned goods to Mr. Bose of ₹ 500 and paid to Mr. Bose ₹ 4,000 in full settlement.

Solution:

In the Books of Mr. Roy
Journal Entries

Date	Particulars	L. F.	Dr. (₹)	Cr. (₹)
2021 Aprl.1	Plant A/c Bank A/c Stock A/c To, Capital A/c [Being Plant, Bank, Stock introduced to the business]	Dr. Dr. Dr.	10,000 8,000 12,000	30,000
2	Purchase A/c To, Bank A/c [Being furniture purchased for resale] Furniture A/c To, Bank A/c [Being furniture purchased for office decoration]	Dr. Dr.	5,000 3,000	5,000 3,000
3	Rent A/c To, Capital A/c [Being rent paid out of personal cash]	Dr.	2,000	2,000
8	Cash A/c To, Sales A/c [Being furniture out of those meant for resale are sold]	Dr.	6,000	6,000
12	Salary A/c To, Bank A/c [Being salary paid to Mr. X]	Dr.	1,200	1,200
15	Purchase A/c To, Cash A/c [Being goods purchased]	Dr.	3,000	3,000
18	Mr. Sen A/c To, Sales A/c [Being goods sold on credit to Mr. Sen]	Dr.	8,000	8,000
20	Returns Inward A/c To, Mr. Sen A/c [Being goods returned from Mr. Sen]	Dr.	1,000	1,000
22	Cash A/c Discount Allowed A/c To, Mr. Sen A/c [Being cash received from Mr. Sen in full settlement]	Dr. Dr.	6,500 500	7,000

28	Purchase A/c To, Mr. Bose A/c [Being goods purchased from Mr. Bose on credit]	Dr.		5,000	5,000
30	Mr. Bose A/c To, Cash A/c To, Returns Outward A/c To, Discount Received A/c [Being goods returned to Mr. Bose and paid cash in full settlement]	Dr.		5,000	4,000 500 500

● Rules of Journalising

While journalising a transaction, knowledge of rules to decide the 'Debit' account and 'Credit' account is essential. The rules are prescribed as per the Golden Rule depending on the nature of accounts (Personal or Real or Nominal) or as per the Accounting Equation. These are described below:

Table 1.2 Rules as per Golden Rule of Double Entry Book-keeping

Nature of Account	Rule of Debit and Credit	
Nominal Account	Debit	Expenses and Losses
	Credit	Incomes and Gains
Real Account	Debit	What comes in
	Credit	What goes out
Personal Account	Debit	The receiver
	Credit	The giver

Table 1.3 Rules as per Accounting Equation

Items	Rule of Debit and Credit	
Assets	Debit	Increase
	Credit	Decrease
Liabilities	Debit	Decrease
	Credit	Increase
Capital	Debit	Decrease
	Credit	Increase
Drawings	Debit	Increase
	Credit	Decrease
Expenses	Debit	Increase
	Credit	Decrease
Revenue	Debit	Decrease
	Credit	Increase

● Sub-division of Journal

Journal or the book of original entry is further sub-divided into two categories – Special Journal and General Journal.

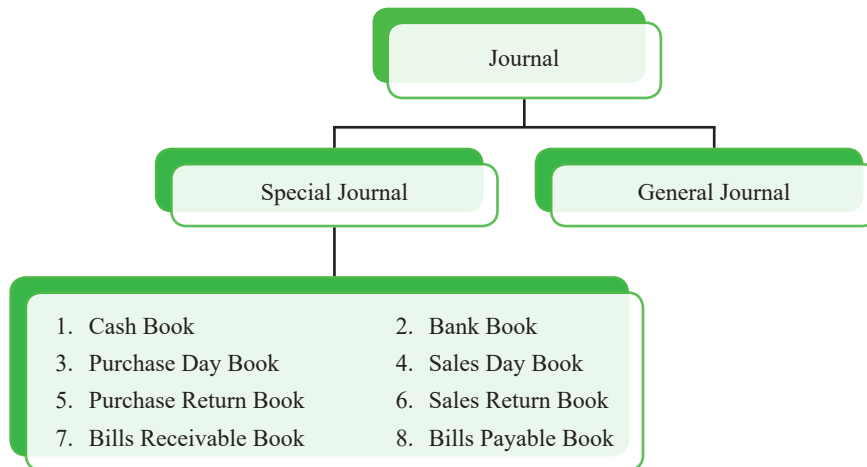


Figure 1.3: Sub-division of Journal

1. **Special Journals:** A Special Journal is a book of primary entry in which transactions of a specific type viz. credit purchases, credit sales, return inwards etc. are first recorded before being posted in the respective ledger accounts. These are also referred to as Subsidiary Books. The different special journals that are usually maintained by an organisation for primary recording of its transactions are:
 - (a) Cash Journal or Cash Book is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows.
 - (b) Bank Book is a special journal, normally maintained in entities with huge number of transactions effected through cheques, drafts or electronic fund transfer. In small business without much bank transactions, a double/triple column Cash Book serves the purpose.
 - (c) Purchases book or purchases day book is a book of original entry maintained to record credit purchases.
 - (d) A sales book, also known as sales day book is a book of original entry in which are recorded the details of credit sales made by an organisation. Total of sales book shows the total credit sales of goods during the period concerned.
 - (e) Purchases returns book is a book in which the goods returned to suppliers are recorded. It is also called returns outward book or purchases returns day book.
 - (f) Sales returns book is also called returns inwards book. It is used for recording goods returned to us by our customers.
 - (g) Bills receivable book is used to record the bills received from debtors. When a bill is received, details of it are recorded in the bills receivable book.
 - (h) Bills payable book is used to record bill accepted by us. When a bill drawn by our creditor is accepted particulars of the same are recorded in this book.

2. General Journal

General Journal, also known as Journal Proper is the book of original entry in which miscellaneous transactions, which do not fit in any other Special Journals (as mentioned above) books, are recorded. It is also called miscellaneous journal. The form and procedure for maintaining this journal is the same that of simple journal. The use of journal proper is confined to record transactions such as (i) Opening entries; (ii) Closing entries; (iii) Transfer entries (iv) Adjustment entries; (v) Rectification entries (vi) Entries for which there is no special journal, say, credit purchase of fixed assets etc.

The above sub-divisions have been discussed in the section that follows.

• Cash Book or Cash Journal

It is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows. In this book of original entry, transactions of every type (whether capital natured transactions or revenue natured transactions) are entered. (Please Refer to Module 1.7 for further discussion)

• Bank Book or Bank Journal

It is a separate subsidiary book similar to cash book to record all receipts and payments made through the bank. Similar to a Single Column Cash Book, a Bank Book consists of two sides, receipts side and payment side. Receipts are debited and payments are credited in the bank book. (Please Refer to Module 1.7 for further discussion)

• Purchase Book or Purchase Day Book or Purchase Journal

The Purchase Journal is a book of original entry which is meant for recording credit purchase of goods. It records credit purchase of goods only. Credit purchase of any other assets is not recorded here. All entries in this book are made from the Purchase invoices.

The format of a Purchase Journal is as given below.

Date	Particulars	Inward Invoice No.	L.F.	(₹)

The total of the purchases made during a period is posted to Purchases Account in the General Ledger, while individual credit purchase transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/Suppliers' Ledger).

Consider the following illustration.

Illustration 13.

1. Bought 20 tables @ ₹500 per table from M.M Appliances on credit @ 12% trade discount as per invoice number 22,334 on 2nd March.
2. Purchased three dozen chairs @ ₹250 each from Metro chairs as per invoice number 1112 on 4th March.
3. Second hand furniture bought from Golden Furnitures on credit as per invoice number 375 for ₹1200 on 7th March.
4. Purchased seven book racks from Mayur Furnitures for ₹4,900 paid for in cash on 6th March.
5. Purchased Machinery for ₹30,000 from Kirloskar Ltd on 9th March as per invoice number 37.

Solution:

In the Books of Furniture Shop
Purchase Day Book

Date	Name of the Suppliers and Details of goods purchased	Invoice reference	L. F.	(₹)
2nd Mar.	M.M Appliances 20 tables @ 500 and 12% trade discount (20 × 500) = 10000 less 12% discount	22334		8,800
4th Mar.	Metro Chairs (3 dozen chairs @ 250 per chair)	1112		9,000
7th Mar.	Golden Furniture	375		1,200
	Total			19,000

Please note that the transaction for purchase of book rack will not be entered in the purchase day book as it is not purchased on credit. (Where will it go then? it will go to the cash book!). Similarly purchase of machinery will not form part of purchase book. It will be entered in Journal Proper.

⊙ **Sales Book or Sales Day Book or Sales Journal**

The Sales Journal is a book of original entry which is meant for recording credit sale of goods. It records credit sale of goods only. Credit sale of any other assets is not recorded here. All entries in this book are made from the Sales invoices.

The format of a Sales Journal is as given below.

Date	Particulars	Outward Invoice No.	L.F.	(₹)

The total of the sales made during a period is posted to Sales Account in the General Ledger, while individual credit sale transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

Consider the following illustration.

Illustration 14.

- 1st July Sold Tip Top clothing 50 suits of ₹2,200 each on two months credit on invoice number -2
- 11th July Sold to New India Woolen 100 sweaters @ ₹250 each on invoice number 55
- 13th July Received an order from Modern clothing for 100 trousers @ ₹500 at trade discount of 10%
- 17th July Sold 50 sarees to Lunkad brothers @ ₹750 each
- 25th July Sold T-shirts at exhibition hall for cash for ₹7,500

Solution:

**In the books of Cloth Marchant
Sales Day Book**

Date	Particulars	Invoice reference	L. F.	(₹)
1st July	Tip Top Clothing (50 suits @ ₹2,200)	2		1,10,000
11th July	New India Woolen (100 sweaters @ ₹250)	55		25,000
17th July	Lunkad brother 50 sarees @ ₹750			37,500
	Total			1,72,500

Here again, cash sales at exhibition hall are not recorded. Also, merely getting an order for goods is not a transaction to be entered in sales book.

⊙ **Purchase Returns Book or Purchase Return Journal**

The Purchase Return Journal is a book of original entry which is meant for recording return of goods purchased earlier on credit. It is also known as Return Outward Book. All entries in this book are made from Debit Note issued to the supplier or Credit Note received from the supplier.

The format of a Purchase Return Journal is as given below.

Date	Particulars	Debit Note No.	L.F.	(₹)

The total of the purchase returns made during a period is posted to Purchase Returns Account in the General Ledger, while individual purchase returns transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/Suppliers' Ledger).

⊙ **Sales Return Book or Sales Return Journal**

The Sales Return Journal is a book of original entry which is meant for recording return of goods sold on credit. It is also known as Return Inward Book. All entries in this book are made from Credit Note issued by the customer.

The format of a Sales Return Journal is as given below.

Date	Particulars	Credit Note No.	L.F.	(₹)

The total of the sales return during a period is posted to Sales Return Account in the General Ledger, while individual sales return transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

⊙ **Bills Receivable Journal or Bills Receivable Book**

The Bill Receivable Journal is a book of original entry which is meant for recording the bills of exchange received from the customers to whom goods have been sold on credit. All entries in this book are made from the bills of exchanges received from the customers.

The format of a Bill Receivable Journal is as given below.

Date	From whom received	Term	Due date	L.F.	(₹)

The total of the bills receivable during a period is posted to Bills Receivable Account in the General Ledger, while individual transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Debtors'/ Customers' Ledger).

● Bills Payable Journal or Bills Payable Book

The Bill Payable Journal is a book of original entry which is meant for recording the bills of exchange issued to the suppliers from whom goods have been purchased on credit. All entries in this book are made from the bills of exchanges accepted against the suppliers.

The format of a Bill Receivable Journal is as given below

Date	To whom given	Term	Due date	L.F.	(₹)

The total of the bills payable during a period is posted to Bills Payable Account in the General Ledger, while individual transactions are posted in the Personal Ledger accounts of the respective suppliers (in the Creditors'/ Suppliers' Ledger).

● General Journal or Journal Proper

As mentioned earlier, General Journal is the book of original entry in which those transactions for which no special journal is maintained, are recorded. Accordingly, it records credit purchases, credit sales, purchase returns, sales return etc. (for which specific subsidiary books are maintained). In addition, it also records certain specified transactions. These are discussed below.

- (a) **Opening Entries:** Opening entry is referred to as the first entry that is recorded or which is brought forward from a previous accounting period to the new accounting period. The balances which are brought forward are assets, liabilities and equity accounts appearing the Balance Sheet of the preceding accounting period.

Example: Suppose a businessman opens a new set of books on January 1, 2021 with cash in hand ₹ 100, debtors ₹ 200, stock in trade ₹ 320, machinery ₹ 700, furniture ₹ 150, bank loan ₹ 300, capital ₹ 1,070 the respective opening entry in the journal will be:

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Cash A/c		Dr.	100	
	Sundry Debtors A/c		Dr.	200	
	Stock in trade A/c		Dr.	320	
	Machinery A/c		Dr.	700	
	Furniture & Fitting A/c		Dr.	200	
	To Sundry creditors A/c				150
	To Bank loan A/c				300
	To Capital A/c				1,070
	(Being opening entry)				

Illustration 15.

Consider the following balances in the Balance Sheet as on 31st March 2021. Pass the opening entry on 1st April 2022.

	(₹)
Subodh's Capital A/c	2,75,000
Loan from HH bank	4,25,000
Plant and machinery	3,30,000
Cash in hand	20,000
Balance at CC bank	1,75,000
Trade Debtors	3,55,000
Closing stock	1,35,000
Trade Payables	2,95,000
Outstanding Expenses	40,000
Prepaid Insurance	20,000

Solution:

The opening entry will be as follows:

Particulars		Dr. (₹)	Cr. (₹)
Plant and machinery A/c	Dr.	3,30,000	
Cash in hand A/c	Dr.	20,000	
Balance at CC bank A/c	Dr.	1,75,000	
Trade Debtors A/c	Dr.	3,55,000	
Closing stock A/c	Dr.	1,35,000	
Prepaid Insurance	Dr.	20,000	
To Subodh's Capital A/c			2,75,000
To Loan from HH bank A/c			4,25,000
To Trade Payables A/c			2,95,000
To Outstanding Expenses A/c			40,000
(Being Opening entry)			

- (b) **Closing Entries:** When the books are balanced at the close of the accounting period with a view to paper final accounts it is necessary that balance of all the income and expenses accounts must be transferred to trading and profit and loss account. The process of transferring balances to the trading and profit and loss account at the end of year is called closing the books and entries passed at that time are called closing entries.

Example: On 31st December, 2021, the balances in expenses accounts are: Salary ₹ 500; rent ₹ 200; Stationary ₹ 50; legal charges ₹ 100; and income accounts are: commission received ₹ 50. These balances will be recorded in profit and loss account though the following closing entry:

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Profit and Loss A/c	Dr.		850	
	To Salary A/c				500
	To Rent A/c				200
	To Stationery A/c				50
	To Legal Charges A/c				100
	(Being closing entry)				

Illustration 16.

Pass closing entries for the following particulars as on 31st March 2021 presented by X Ltd.

Particulars	₹
Opening stock	10,000
Purchases	50,000
Wages	5,000
Returns outward	5,000
Sales	1,00,000
Returns inward	10,000
Salaries	8,000
Insurance	1,000
Bad debts	3,000
Interest received	3,000
Discount allowed	4,000
Discount received	3,000
Closing stock	15,000

Solution:

**In the Books of X Ltd.
Journal**

Date 2021 March 31st	Particulars	L F	Dr. (₹)	Cr. (₹)
	Trading A/c	Dr.	75,000	
	To, Opening Stock A/c			10,000
	To, Purchases A/c			50,000
	To, Wages A/c			5,000
	To, Returns inward A/c			10,000
	(Transfer to balances for closing the latter accounts)			
	Sales A/c	Dr.	1,00,000	

	Returns outward A/c	Dr.		5,000	
	Closing Stock A/c	Dr.		15,000	
	To, Trading A/c				1,20,000
	(Transfer of balances for closing the former accounts)				
	Trading A/c	Dr.		45,000	
	To, Profit and Loss A/c				45,000
	(Gross profit transferred)				
	Profit and Loss A/c	Dr.		16,000	
	To, Salaries A/c				8,000
	To, Insurance A/c				1,000
	To, Bad Debts A/c				3,000
	To, Discount allowed A/c				4,000
	(Transfer of balances for closing the latter accounts)				
	Interest received A/c	Dr.		3,000	
	Discount received A/c	Dr.		3,000	
	To, Profit and Loss A/c				6,000
	(Transfer of balances for closing the former accounts)				
	Profit and Loss A/c	Dr.		35,000	
	To, Capital A/c				35,000
	(Net profit transferred to Capital A/c)				

(c) **Transfer Entry:** In accounting, it is sometimes necessary to transfer an amount or balance of one account to some other account. The journal entries through which the amount of an account are transferred to another account, are referred to as Transfer entries.

Example: Drawings ₹500 is transferred from the drawings account to the capital account to find out the net capital. The transfer entry will be passed as follows:

Journal				Dr.	Cr.
Date	Particulars	V. N	L. F	(₹)	(₹)
	Capital A/c			500	
	Dr.				
	To Drawing A/c				500
	(Being closing entry)				

Illustration: 17

Following Balances appeared in the books of Patnayak on 31st March, 2021. Pass the necessary opening entry for 2021-22:

Credit balances: Capital ₹30,000; Bills Payable ₹5,000; Creditors ₹10,000

Debit balances: Furniture ₹4,000; Machinery ₹18,000; Debtors ₹12,000; B/R ₹9,000; Cash ₹2,000

Solution:

OPENING ENTRY IN THE BOOKS OF PATNAYAK

Date	Particulars	L.F.	Dr.		Cr.	
			(₹)	(₹)		
2022 Apr. 1	Furniture A/c	Dr.	4,000			
	Machinery A/c	Dr.	18,000			
	Debtors A/c	Dr.	12,000			
	Bills Receivable A/c	Dr.	9,000			
	Cash A/c	Dr.	2,000			
	To Capital A/c					30,000
	To Bills Payable A/c					5,000
	To Creditors A/c					10,000
	(Being opening entry)					
			45,000			45,000

- (d) **Adjusting Entries:** These entries are passed at the time of finalization of accounts for honouring the different generally accepted accounting principles i.e., accounting concepts and accounting conventions. Please refer to Module 1.6 for detail discussion.

Example: Wages outstanding ₹ 2,000.

Journal					Dr.		Cr.	
Date	Particulars	V. N	L. F	(₹)	(₹)			
	Wages A/c	Dr.		500				
	To Wages Drawing A/c				500			
	(Being outstanding wages recorded)							

- (e) **Rectification Entries:** These entries are passed for correcting the different errors that get committed while recording, posting, casting, balancing etc. in the books of accounts. Please refer to Module 1.6 for detail discussion.

1.5.2 Ledger

● Concept of Ledger

After recording each transaction in the books of original entry i.e., Journal, the next thing is to classify them according to the accounts affected. All similar transactions must be brought together. For instance, all transactions relating to credit purchase must be put in one place. Similarly, all transactions with a customer or a supplier must be assembled at one place. The book in which this classification is done is called the ledger.

A ledger is a book which contains a condensed and classified record of all the pecuniary transactions of the business posted from the books of original entry i.e., Journal. It is the final destination of all the accounts, and hence, it is also called the Book of Final Entry. The process of recording the entry in the ledger is technically known as Posting.

It should be noted that journal contains a chronological detail record while ledger contains a classified record of all transactions.

● **Ledger Account**

An ‘Account’ is the structural unit of a ledger. A ledger contains numerous accounts depending upon the number of transactions and the parties involved therein.

Following is the format is a ledger account.

Dr.			 Account				Cr.	
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)		

- (i) Date Column: This column contains the date of the transaction.
- (ii) Particulars: This column contains which account is to be credited and which account is to be debited.
- (iii) Journal Folio (J.F.): This column contains the folio (i.e., page no.) of the Journal, where the transaction is recorded.
- (iv) Dr. Amount and Cr. Amount: These columns show the financial value of each transaction.

Note:

1. The posting in the account which is debited, is done on the debit side by writing the name of the account or accounts that are credited with the prefix ‘To’.
2. The posting in the account which is credited, is done on the credit side by writing the name of the account or accounts that are debited with the prefix ‘By’.

● **Features of Ledger Account**

The following are the features of a ledger account.

- (a) It has two identical sides. The left-hand side is called debit side and right-hand side is called credit side.
- (b) Debit aspects of all the concerned transactions is recorded on the debit side, while credit aspect on credit side according to date.
- (c) The difference of the total of the two sides represent balance. The excess of debit side over credit side indicates debit balance and vice-versa.
- (d) Usually, balance is drawn at the end of the accounting period and recorded on the deficit side to make the two sides equal. This balance is known as closing balance.
- (e) The closing balance of the current accounting period will be the opening balance of the next accounting period.

● **Functions of Ledger**

- (a) It acts as a permanent store-house of all the transactions of a concern arranged for ready reference.
- (b) It summarizes the effects of business transactions in terms of the individual accounts, so that a conclusion concerning the status of each account may be drawn periodically.

⦿ **Advantages of Ledger**

The following are the advantages derived from ledger:

- (a) It is the ledger through which successful application of double entry system of bookkeeping is ensured.
- (b) Transactions relating to different persons or concerns are recorded in the account of each person or concern separately. As a result, complete and reliable information is available in respect of each and every account.
- (c) Different types of income and expenses are recorded in different accounts separately. So, it is possible to ascertain the amount of income and expenditure under each head which facilitates assessment of financial performance.
- (d) Separate account is opened for each item of assets and liabilities. It is, therefore, possible to ascertain the value of different assets and liabilities which facilitates assessment of financial position.
- (e) Transactions being recorded primarily in journal and thereafter finally in ledger, the possibility of errors and defalcations is remote.
- (f) Valuable information and statistics are collected from ledger and supplied to the management to enable them to run the concern efficiently.

⦿ **Process of Ledger Posting**

After the transactions are recorded in the journal, it is then posted in the principal book called as 'Ledger'. The process of transferring the entries from journal to respective ledger accounts is called ledger posting. Balancing of ledgers is carried to find out differences at the end of the year.

Ledger posting is entering information in the ledger, in respective accounts from the journal for individual records. The account debited is posted on the debit side and the account credited is posted on the credit side of the same account.

This process is carried throughout the year and at the end of the financial year the ledger accounts are closed and are totalled and balanced. This process is called the balancing of the ledger accounts.

The rules for posting of entries in the ledger are as follows:

- (a) A separate account is opened for each account and entries from the journal are posted in respective ledger account accordingly.
- (b) The words like 'To' and 'By' are used while posting the entries in the ledger accounts. 'To' is used when accounts are posted in the debit side column of a particular account. 'By' is used when accounts are posted in the credit side column of a particular account.
- (c) The account which is debited in the journal should also be debited in the ledger book but the reference should be of respective credit account.

⦿ **Balancing of Ledger Account**

At the end of every accounting year, all the accounts which are operated in the ledger book are closed, totalled and balanced. Balancing of ledgers means finding the difference between the debit and credit amounts of a particular account.

The steps for balancing a Ledger Account are as follows:

- (a) Calculate the totals of debit and credit columns separately and find out their difference. The difference is called a Balance amount.
- (b) If the total of the debit side is higher than that of the credit side, the balance is called as "Debit Balance"

and is written on the credit side (the side with lower amount) of that particular account as “By Balance c/d” or “By Balance c/f”. Here, c/d means carried down and c/f means carried forward.

- (c) Similarly, if the total of the credit side is more than that of debit side total, the balance is called “Credit Balance”. The difference amount is written on the debit side of the account as “To balance c/d” or “To balance c/f”
- (d) Last year’s closing balance is the opening balance of the current year. So, if there is debit it should be shown on the debit side of a particular account as “To Balance b/d” or “To Balance b/f”. Here, b/d means brought down and b/f means brought forward.

Note: Nominal accounts are not balanced; the balances are transferred to profit and loss account.

⊙ **Sub-division of Ledger**

Practically, the Ledger may be divided into two groups –

- (a) Personal Ledger; and
- (b) Impersonal Ledger.

They are again sub-divided as follows:

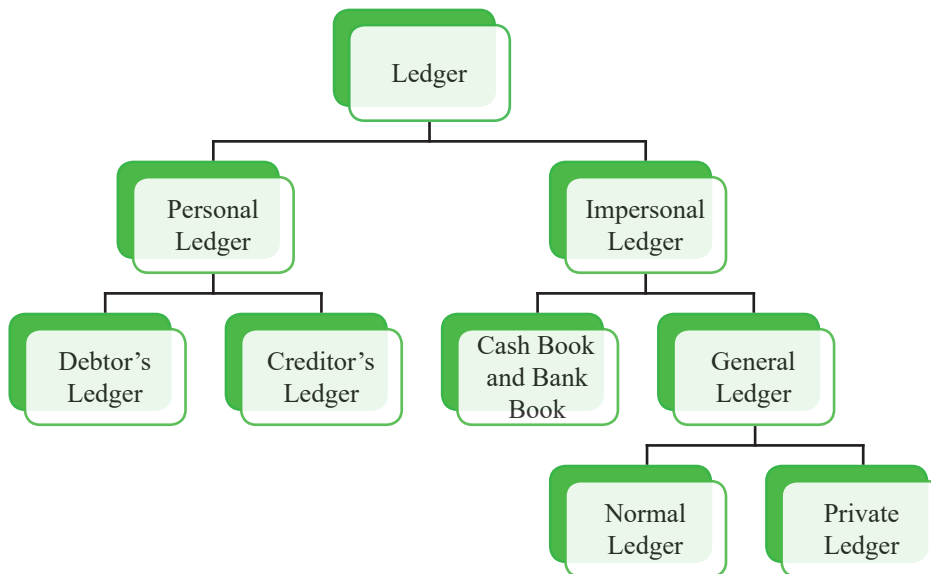


Figure 1.4: Sub-division of Ledger

- (a) **Personal Ledger:** The ledger where the details of all transactions about the persons who are related to the accounting unit, are recorded, is called the Personal Ledger.

Again, Personal Ledger may be divided into two groups:

- (i) **Debtors’ Ledger:** The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc. are recorded, is called Debtors’ Ledger.
- (ii) **Creditors’ Ledger:** The ledger where the details of transactions about the persons from whom goods are purchased on credit, cash is paid etc. are recorded, is called Creditors’ Ledger.

- (b) **Impersonal Ledger:** The Ledger where details of all transactions about assets, incomes & expenses etc. are recorded, is called Impersonal Ledger.

Impersonal Ledger may, again be divided into two group.

- (i) **Cash Book and Bank Book:** The Books where all cash & bank transactions are recorded, is called Cash Book and Bank Book respectively.
- (ii) **General Ledger:** The ledger where all transactions relating to real accounts, nominal accounts, and personal account (other than Trade Debtors and Trade Creditors) are recorded, is called General Ledger.

General Ledger may, again, be divided into two groups. viz, Nominal Ledger; & Private Ledger.

1. **Nominal Ledger:** The ledger where all transactions relating to incomes and expenses are recorded is called Nominal Ledger.
2. **Private Ledger:** The Ledger where all transactions relating to assets and liabilities are recorded is called Private Ledger.

• Advantages of Sub-division of Ledger

The above sub-division of ledger provides important benefits, such as:

- (a) As a result of sub-division, the division of work is possible and records can be maintained
- (b) efficiently by the concerned employee.
- (c) As a result of sub-division, the size and volume of ledger is reduced.
- (d) From the different classes of ledger, a particular type of transactions can easily be found out.
- (e) As a result of sub-division chances of mistakes are minimized.
- (f) As a result of sub-division, the accounting work may be computed quickly which is very helpful to the management.
- (g) Due to sub-division, allotment of different types of work to different employees is done for which concerned employee will be responsible.

Consider the following illustrations.

Illustration 18.

Journalize the following transactions in the books of Gaurav, post them into ledger and prepare trial balance for June 2021:

- June 1: Gaurav started business with ₹10,00,000 of which 25% amount was borrowed from wife.
- June 4: Purchased goods from Aniket worth ₹40,000 at 20% TD and 1/5th amount paid in cash.
- June 7: Cash purchases ₹25,000.
- June 10: Sold goods to Vishakha ₹30,000 at 30% TD and received 30% amount in cash.
- June 12: Deposited cash into bank ₹20,000.
- June 15: Uninsured goods destroyed by fire ₹5,500.
- June 19: Received commission ₹3,500.
- June 22: Paid to Aniket ₹25,500 in full settlement of Account.
- June 25: Cash stolen from cash box ₹1,000.
- June 27: Received from Vishakha ₹14,500 and discount allowed ₹200.
- June 30: Interest received ₹2,400 directly added in our bank account.

Solution:

In the books of Gaurav
Journal

Date 2021	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
1-Jun	Cash A/c To Capital A/c To Loan from Wife A/c (Being capital brought into business)	Dr.	10,00,000	7,50,000 2,50,000
4-Jun	Purchases A/c To Cash A/c To Aniket's A/c (Being goods purchased at 20% TD & 1/5th amount paid in cash)	Dr.	32,000	6,400 25,600
7-Jun	Purchases A/c To Cash A/c (Being cash purchases)	Dr.	25,000	25,000
10-Jun	Cash A/c Vishakha's A/c To Sales A/c (Being goods sold at 30% TD & 30% amount received in cash)	Dr. Dr.	6,300 14,700	21,000
12-Jun	Bank A/c To Cash A/c (Being cash deposited in bank)	Dr.	20,000	20,000
15-Jun	Loss by Fire A/c To Purchases A/c (Being uninsured goods lost by fire)	Dr.	5,500	5,500
19-Jun	Cash A/c To Commission A/c (Being commission received)	Dr.	3,500	3,500
22-Jun	Aniket's A/c To Cash A/c To Discount A/c (Being paid to Aniket in full settlement & discount received)	Dr.	25,600	25,500 100
25-Jun	Loss by Theft A/c To Cash A/c (Being cash stolen)	Dr.	1,000	1,000
27-Jun	Cash A/c Discount A/c To Vishakha's A/c (Being amount received from Vishakha & discount allowed)	Dr. Dr.	14,500 200	14,700
30-Jun	Bank A/c To Interest A/c (Being interest received directly added into bank account)	Dr.	2,400	2,400

Dr.				Cr.			
Cash Account							
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
1/6/21	To Capital A/c		7,50,000	4/6/21	By Purchases A/c		6,400
1/6/21	To Loan from Wife A/c		2,50,000	7/6/21	By Purchases A/c		25,000
10/6/21	To Sales A/c		6,300	12/6/21	By Bank A/c		20,000
19/6/21	To Commission A/c		3,500	22/6/21	By Aniket's A/c		25,500
27/6/21	To Vishakha's A/c		14,500	25/6/21	By Loss by Theft A/c		1,000
				30/6/21	By Balance c/d		9,46,400
			10,24,300				10,24,300
1/7/15	To Balance b/d		9,46,400				

Dr.				Cr.			
Capital Account							
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30/6/21	To Balance c/d		7,50,000	1/6/21	By Cash A/c		7,50,000
			7,50,000				7,50,000
1/7/21	By Balance b/d		7,50,000				

Dr.				Cr.			
Loan from Wife Account							
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30/6/21	To Balance c/d		2,50,000	1/6/21	By Cash A/c		2,50,000
			2,50,000				2,50,000
				1/7/21	By Balance b/d		2,50,000

Dr.				Cr.			
Purchases Account							
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
4/6/21	To Cash A/c		6,400	15/6/21	By loss by fire		5,500
4/6/21	To Aniket's A/c		25,600	30/6/21	By Bal c/d		51,500
7/6/21	To Cash A/c		25,000				
			57,000				57,000
1/7/21	To Balance b/d		51,500				

Dr.				Aniket's Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
22/6/21	To Cash A/c		25,500	4/6/21	By Purchases A/c		25,600				
22/6/21	To Discount A/c		100								
			25,600				25,600				

Dr.				Vishakha's Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
10/6/21	To Sales A/c		14,700	27/6/21	By Cash A/c		14,500				
				27/6/21	By Discount A/c		200				
			14,700				14,700				

Dr.				Sales Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/21	To Balance c/d		21,000	10/6/21	By Cash A/c		6,300				
				10/6/21	By Vishakha's A/c		14,700				
			21,000				21,000				
				1/7/21	By Balance b/d		21,000				

Dr.				Bank Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
12/6/21	To Cash A/c		20,000	30/6/21	By Balance c/d		22,400				
30/6/21	To Interest A/c		2,400								
			22,400				22,400				
1/7/21	To Balance b/d		22,400								

Dr.				Loss by Fire Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
15/6/21	To Purchases A/c		5,500	30/6/21	By Balance c/d		5,500				
			5,500				5,500				
1/7/21	To Balance b/d		5,500								

Dr.				Commission Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/21	To Balance c/d		3,500	19/6/21	By Cash A/c		3,500				
			3,500				3,500				
				1/7/21	By Balance b/d		3,500				

Dr.				Discount Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
27/6/21	To Vishakha's A/c		200	22/6/21	By Aniket's A/c		100				
				30/6/21	By Balance c/d		100				
			200				200				
1/7/21	To Balance b/d		100								

Dr.				Loss by Theft Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
25/6/21	To Cash A/c		1,000	30/6/21	By Balance c/d		1,000				
			1,000				1,000				
1/7/21	To Balance b/d		1,000								

Dr.				Interest Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
30/6/21	To Balance c/d		2,400	30/6/21	By Bank A/c		2,400				
			2,400				2,400				
				1/7/21	By Balance b/d		2,400				

Trial Balance as on 30.6.22

Name of Account	Dr.		Cr.	
	(₹)	(₹)	(₹)	(₹)
Cash A/c	9,46,400	-----		
Capital A/c	-----		7,50,000	
Loan from Wife A/c	-----		2,50,000	
Purchases A/c	51,500	-----		
Aniket's A/c	-----		-----	
Vishakha's A/c	-----		-----	
Sales A/c	-----		21,000	
Bank A/c	22,400	-----		
Loss by Fire A/c	5,500	-----		
Commission A/c	-----		3,500	
Discount A/c	100	-----		
Loss by Theft A/c	1,000	-----		
Interest A/c	-----		2,400	
Total	10,26,900		10,26,900	

Illustration 19.

Journalize the following transactions in the books of M/s Kothari & Sons, post them into ledger and prepare trial balance for April 2021:

- Apr. 1: Commenced business with ₹40,000.
 Apr. 4: Bought goods for cash ₹4,000
 Apr. 7: Sold goods ₹700
 Apr. 10: Bought goods from M/s Bhandari Bros. ₹3,000 at 10% trade discount.
 Apr. 14: Purchased machinery of ₹5,000 from M/s Kirloskar Bros.
 Apr. 16: Paid for transportation of machinery ₹500 & installation charges ₹300 on it.
 Apr. 20: Paid quarterly interest on borrowed amount of ₹5,000 at 12% p.a.
 Apr. 24: Supplied goods to M/s Kunal & Sons ₹3,500.
 Apr. 27: Paid to M/s Bhandari Bros. ₹2,600 in full settlement of account.
 Apr. 28: M/s Kunal & Sons returned goods worth ₹300 & paid for ₹1,200 on account.
 Apr. 29: Received commission ₹250.
 Apr. 30: Paid conveyance to manager ₹450.

Solution:**In the books of M/s Kothari and Sons****Journal**

Date 2021	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
1-Apr	Cash A/c To Capital A/c (Being cash introduced as capital)	Dr.	40,000	40,000
4-Apr	Purchases A/c To Cash A/c (Being bought goods for cash)	Dr.	4,000	4,000
7-Apr	Cash A/c To Sales A/c (Being sold goods for cash)	Dr.	700	700
10-Apr	Purchases A/c To M/s Bhandari Bros. A/c (Being purchased goods at 10% TD)	Dr.	2,700	2,700
14-Apr	Machinery A/c To M/s Kirloskar Bros. A/c (Being purchased machinery on credit)	Dr.	5,000	5,000

16-Apr	Machinery A/c To Cash A/c (Being transportation & installation charges on machinery paid)	Dr.		800	800
20-Apr	Interest A/c To Cash A/c (Being paid quarterly interest on borrowed amt.of ₹5,000 at 12% p.a.)	Dr.		150	150
24-Apr	M/s Kunal & Sons A/c To Sales A/c (Being goods sold on credit)	Dr.		3,500	3,500
27-Apr	M/s Bhandari Bros. A/c To Cash A/c To Discount A/c (Being paid in full settlement & discount received)	Dr.		2,700	2,600 100
28-Apr	Return Inwards A/c Cash A/c To M/s Kunal & Sons A/c (Being goods returned & received on account)	Dr. Dr.		300 1,200	1,500
29-Apr	Cash A/c To Commission A/c (Being commission received)	Dr.		250	250
30-Apr	Conveyance A/c To Cash A/c (Being conveyance paid to manager)	Dr.		450	450
	Total			61,750	61,750

Ledger

Dr.

Cash Account

Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
1.4.21	To Capital A/c		40,000	4.4.21	By Purchases A/c		4,000
7.4.21	To Sales A/c		700	16.4.21	By Machinery A/c		800
28.4.21	To M/s Kunal & Sons A/c		1200	20.4.21	By Interest A/c		150
29.4.21	To Commission A/c		250	27.4.21	By M/s Bhandari Bros. A/c 2,600		
				30.4.21	By Conveyance A/c		450
				30.4.21	By Balance c/d		34,150
			42,150				42,150
1.5.21	To Balance b/d		34,150				

Dr. Capital Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Balance c/d		40,000	1.4.21	By Cash A/c		40,000
			40,000				40,000
				1.5.21	By Balance b/d		40,000

Dr. Purchases Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
4.4.21	To Cash A/c		4,000	30.4.21	By Balance c/d		6700
10.4.21	To M/s Bhandari Bros. A/c		2,700				
			6,700				6,700
1.5.21	To Balance b/d		6,700				

Dr. Sales Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Balance c/d		4,200	7.4.21	By Cash A/c		700
				24.4.21	By M/s Kunal & Sons A/c		3,500
			4,200				4,200
				1.5.21	By Balance b/d		4,200

Dr. M/s Bhandari Bros. Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
27.4.21	To Cash A/c		2,600	10.4.21	By Purchases A/c		2,700
27.4.21	To Discount A/c		100				
			2,700				2,700

Dr. Machinery Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
14.4.21	To M/s Kirloskar Bros. A/c		5,000	30.4.21	By Balance c/d		5,800
16.4.21	To Cash A/c		800				
			5,800				5,800
1.5.21	To Balance b/d		5,800				

Dr. M/s Kirloskar Bros. Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Balance c/d		5,000	14.4.21	By Machinery A/C		5,000
			5,000				5,000
				1.5.21	By Balance b/d		5,000

Dr. Interest Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
20.4.21	To Cash A/c		150	30.4.21	By Balance c/d		150
			150				
1.5.21	To Balance b/d		150				

Dr. M/S Kunal & Sons Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
24.4.21	To Sales A/c		3,500	28.4.21	By Return Inwards A/c		300
				28.4.21	By Cash A/c		1,200
				30.4.21	By Balance c/d		2,000
			3,500				3,500
1.5.21	To Balance b/d		2,000				

Dr. Discount Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Balance c/d		100	27.4.21	By M/s Bhandari Bros. A/c		100
			100				100
				1.5.21	By Balance b/d		100

Dr. Return Inwards Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
28.4.21	To M/s Kunal & Sons A/c		300	30.4.21	By Balance c/d		300
			300				300
1.5.21	To Balance b/d		300				

Dr. Commission Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Balance c/d		250	29.4.21	By Cash A/c		250
			250				250
				1.5.21	By Balance b/d		250

Dr. Conveyance Account Cr.

Date	Particulars	J.F	(₹)	Date	Particulars	J.F	(₹)
30.4.21	To Cash A/c		450	30.4.21	By Balance c/d		450
			450				450
1.5.21	To Balance b/d		450				

Trial Balance as on 30.4.21

Dr. Cr.

Name of Account	(₹)	(₹)
Cash A/c	34,150	-----
Capital A/c	-----	40,000
Purchases A/c	6700	-----
Sales A/c	-----	4,200
M/s Bhandari Bros. A/c	-----	-----
Machinery A/c	5,800	-----
M/s Kirloskar Bros. A/c	-----	5,000
Interest A/c	150	-----
M/s Kunal & Sons A/c	2,000	-----
Discount A/c	-----	100
Return Inwards A/c	300	-----
Commission A/c	-----	250
Conveyance A/c	450	-----
Total	49,550	49,550

Illustration: 20

Enter the following transactions in the proper subsidiary books and post them to ledger accounts. Also prepare Trial Balance:

2021

Jan. 1: Purchased goods worth ₹6,000 from M/s A. Kumar & Sons.

Jan. 5: Sold goods to M/s Vinay Kumar ₹2,000.

- Jan. 7: Purchased goods from M/s Vinod Bros. ₹4,000 at 5% TD.
 Jan. 9: Sold goods to P. Kumar on cash ₹500.
 Jan. 12: Bought goods from Jayant Kumar ₹3,500 at 10% TD.
 Jan. 17: Supplied goods to M/s Ramakanta ₹2,500 at 5% TD.
 Jan. 20: Sold furniture to M/s N. Kumar worth ₹1,200.
 Jan. 22: Returned goods to M/s Vinod Bros. ₹500 gross.
 Jan. 25: M/s Vinay Kumar returned goods worth ₹500.
 Jan. 27: Sent debit note to M/s A. Kumar for ₹200.
 Jan. 30: Sold goods to N. Kumar worth ₹9,000 and received half amount on the spot.

Solution:**Purchases Book**

Date	Name of Supplier	Inward Invoice No.	L.F	(₹)
1.1.21	M/s A. Kumar			6,000
7.1.21	M/s Vinod Bros. (4000 - 5% TD)			3,800
12.1.21	Jayant Kumar (3500 - 10% TD)			3,150
				12,950

Sales Book

Date	Name of Supplier	Outward Invoice No.	L.F	(₹)
5.1.21	M/s Vinay Kumar			2,000
17.1.21	M/s Ramakant (2500 - 5% TD)			2,375
30.1.21	M/s N. Kumar			4,500
				8,875

Return Inwards Book

Date	Name of Supplier	Credit Note No.	L.F	(₹)
25.1.21	M/s Vinay Kumar			500
				500

Return Outwards Book

Date	Name of Supplier	Debit Note No.	L.F	(₹)
22.1.21	M/s Vinod Bros. (500 - 5% TD)			475
27.1.21	M/s A. Kumar			200
				675

Dr. Cash Book Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
9.1.21	To Sales A/c (Being cash sales)		500	31.1..21	By Balance c/d		5,000
30.1..21	To Sales A/c (Being cash sales)		4,500				
			5,000				5,000
1.2..21	To Balance b/d		5,000				

Dr. Purchases Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.21	To Sundries as per purchases book		12,950				
				31.1.21	By Balance c/d		12,950
1.2.21	To Balance b/d		12,950				12,950

Dr. Sales Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.21	To Balance c/d		13,875	9.1.21	By Cash A/c		500
				30.1.21	By Cash A/c		4,500
				31.1.21	By Sundries as per Sales Book		8,875
			13,875				13,875
				1.2.21	By Balance b/d		13,875

Dr. Return Inwards Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.21	To Sundries as per return inwards book		500	31.1.21	By Balance c/d		500
			500				500
1.2.21	To Balance b/d		500				

Dr. Return Outwards Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.21	To Balance c/d		675	31.1.21	By Sundries as per return outwards book		675
			675				675
				1.2.15	By Balance b/d		675

Dr. M/s A. Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
27/1/21	To Return Outwards A/c		200	1/1/21	By Purchases A/c		6000
31/1/21	To Balance c/d		5,800				
			6,000				6,000
				1/2/21	By Balance b/d		5,800

Dr. M/s Vinod Bros Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
22.1.21	To Return Outwards A/c		475	7.1.21	By Purchases A/c		3,800
31.1.21	To Balance c/d		3,325				
			3,800				3,800
				1.2.21	By Balance b/d		3,325

Dr. Jayant Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
31.1.21	To Balance c/d		3,150	12.1.21	By Purchases A/c		3,150
				1.2.21	By Balance b/d		3,150

Dr. M/s Vinay Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
5.1.21	To Sales A/c		2,000	25.1.21	By Return Inwards A/c		500
				31.1.21	By Balance c/d		1,500
			2,000				
1.2.21	To Balance b/d		1,500				

Dr. M/s Ramakant Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
17.1.21	To Sales A/c		2,375	31.1.21	By Balance c/d		2,375
1.2.21	To Balance b/d		2,375				

Dr. M/s N. Kumar Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
20.1.21	To Furniture A/c		1,200	31.1.21	By Balance c/d		5,700
30.1.21	To Sales A/c		4,500				
			5,700				5,700
1.2.21	To Balance b/d		5,700				

Dr.				Furniture Account				Cr.			
Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)				
31.1.21	To Balance c/d		1,200	20.1.21	By M/s N. Kumar A/c		1,200				
				1.2.21	By Balance b/d		1,200				

Trial Balance as on 31.1.2021

Dr.		Cr.	
Name of Account	(₹)	(₹)	
Cash A/c	5,000	-----	
Purchases A/c	12,950	-----	
Sales A/c	-----	13,875	
Return Inwards A/c	500	-----	
Return Outwards A/c	-----	675	
M/s A. Kumar A/c	-----	5,800	
M/s Vinod Bros. A/c	-----	3,325	
Jayant Kumar A/c	-----	3,150	
M/s Vinay Kumar A/c	1,500	-----	
M/s Ramakant A/c	2,375	-----	
M/s N. Kumar A/c	5,700	-----	
Furniture A/c	-----	1,200	
Total	28,025	28,025	

Illustration 21.

The total of debit side of Trial Balance of a larger boot and shoe repairing firm as on 31.12.2021 is ₹ 1,66,590 and that of the credit side is ₹ 42,470. After several checking and re-checking the mistakes are discovered:

Items of Account	Correct Figure (as it would be) ₹	Figures as it appears in the Trial Balance ₹	
Opening Stock	14,900	14,800	
Repairs (outstanding)	61,780	61,780	(appear in the Debit side)
Rent & Taxes	2,160	2,400	
Sundry Creditors	6,070	5,900	
Sundry Debtors	8,060	8,310	

Ascertain the correct total of the Trial Balance.

Solution:

Particulars	Debit (₹)	Credit (₹)
Total as per Trail Balance	1,66,590	42,470
Opening Stock understated (14,900-14,800)	+100	-
Repairs being credit balance, but shown as debit balance	-61,780	+61,780
Rent & Taxes overstated (2,400-2,160)	-240	-
Sundry Creditors understated (6,070-5,900)	-	+170
Sundry Debtors overstated (8,310-8,060)	-250	-
Total	1,04,420	1,04,420

Illustration 22.

Record following transactions in the Personal Account of Raman.

Date	Particulars	₹
2021 Sept. 1	Sold goods to Raman	5,420
4	Received from Raman cash	5,150
	And allowed him discount	270
15	Raman bought goods	6,000
28	Received cash from Raman on account	2,000
Oct.1	Balance from last month b/d	4,000
13	Sold goods to Raman	10,000
20	Received from Raman cash	3,960
	And allowed him discount	40
31	Received cash in full settlement of Raman's account	9,800

Solution:**Raman Account****Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
Sept.1	To Sales A/c	5,420	Sept.4	By Cash A/c	5,150
15	To Sales	6,000	4	By Discount	270
			28	By Cash	2,000
			30	By Balance c/d	4,000
		11,420			11,420
Oct.1	To Balance b/d	4,000	Oct.20	By Cash	3,960
13	To Sales	10,000	20	By Discount	40
			31	Cash	9,800
			31	Discount (Balancing figure)	200
		14,000			14,000

Cash Book, Bank Book, Petty Cash Book, Bank Reconciliation Statement

1.6

1.6.1 Cash Book

☉ Concept of Cash Book

A vast majority of transactions undertaken by an entity actually get settled (either received or paid) through cash, whether liquid cash, cheques or draft or through electronic fund transfer. Due to this high volume of cash transactions, a separate book to record only cash transactions is indispensable.

A Cash Book is a special journal which is used for recording all cash receipts and all cash payments. The receipts are entered on the debit side, while the payments are recorded in the credit side of the cash book.

☉ Cash Book – A Journal or a Ledger Account

Basically, a Cash Book is both a journal as well as a ledger account. It is a journal or book of original entry since transactions are recorded in it for the first time from the source documents. The Cash Book is also a ledger account in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

☉ Features of Cash Book

Following are the features of Cash Book.

- a) Cash Book records only cash transactions.
- b) It records all cash payments and cash receipts.
- c) It records transactions in chronological order.
- d) The proforma of the cash book is similar to that of a ledger account. It has two sides – Debit side and Credit side.
- e) Cash Book simultaneously performs functions as the book of primary entry as well as a ledger account. It is also called journalised ledger.
- f) Cash Book balance reflects the total amount of cash available to the entity.

☉ Types of Cash Book

Depending upon the nature of cash transactions, Cash book is broadly classified into Regular Cash Book and Petty Cash Book. Regular Cash Book is further customized to record bank transactions and discount allowed and received from customers and suppliers respectively. The following diagram demonstrates the classification in detail.

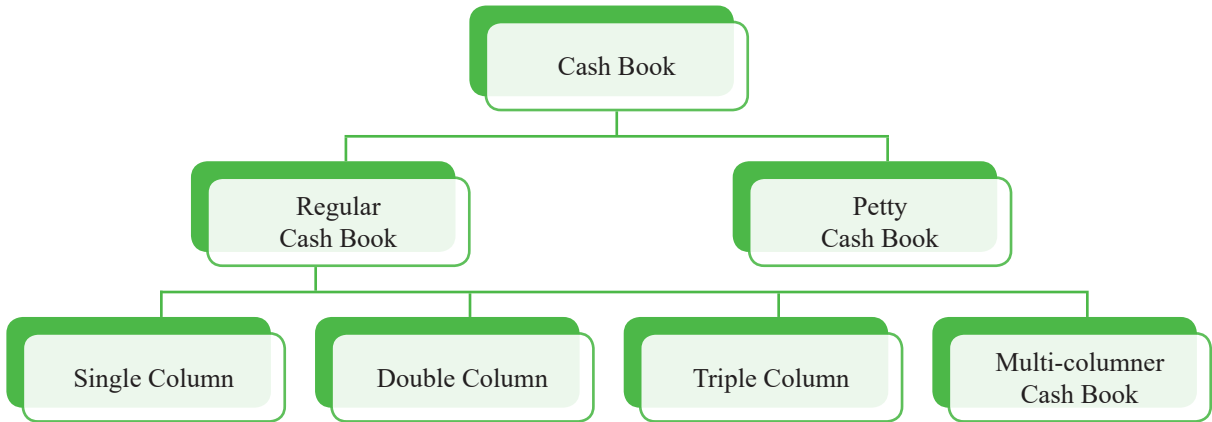


Figure 1.5: Types of Cash Book

These are discussed below.

A. Regular Cash Book: The cash book that records all the usual cash and bank transactions is called a Regular or General Cash Book. These can be further classified based on the number of columns they incorporate on either side to record transactions of specified nature.

- a) **Single Column Cash Book:** In this cash book only one amount column is maintained on each side to record transactions settled in liquid cash only. It is usually maintained by the small organisations without the access to any bank account. In addition, when an organization keeps a separate Bank A/c in its ledger, it also keeps a single column cash book. Single Column Cash Book is equivalent to the cash account of the entity. Its balance represents cash-in-hand at a particular point of time. The proforma of the single column cash book is as under:

Dr.				Cr.			
Cash Book (Single Column)							
Date	Particulars	L.F.	Cash (₹)	Date	Particulars	L.F.	Cash (₹)

- b) **Double Column Cash Book:** A double column cash book, also known as a two-column cash book, consists of two columns on each side to record cash and bank transactions. Rather than separating cash and bank accounts, a double column cash book enables accountants to maintain the two accounts side by side. The balance of this cash book reflects the amounts of Cash-in-hand as-well-as Cash-at-bank at a particular point of time. An entity without any bank transaction may also keep a double column cash book by considering discount column instead of bank column. The proforma of the double column cash book with bank column is as under:

Dr.					Cr.				
Cash Book (Double Column)									
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)

Note: Double column cash book with cash and bank account columns side by side, gives rise to a unique type of entry referred to as the Contra Entry. When any transaction takes place involving Bank A/c and Cash A/c, the posting will happen on both side of the same account (here, the Double Column Cash Book). Examples of such transactions are: Deposit of cash into bank, Withdrawal of cash from bank etc. For recording such a transaction, the letter 'C' is written on both sides in the Ledger Folio (L.F.) column.

- c) **Triple Column Cash Book:** This type of cash book has three columns (namely Cash, Bank and Discount). The discount column on each side, however, indicate two different types of discounts—Discount Allowed on debit side and Discount Received on credit side. This is why Discount columns in a triple column cash book is never balanced but their aggregate figures are directly posted to respective ledger account.

The proforma of the double column cash book is a under:

Dr.						Cr.					
Cash Book (Triple Column)											
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)

- d) **Multi-columnar Cash Book:** This is a customized form of cash book that is maintained by organisations where huge cash transactions take place under certain fixed heads. Generally, organisations like clubs, schools, colleges etc. maintain this type of cash book. The proforma of the multi-columnar cash book is a under

Dr.						Cr.					
Multi-columnar Cash Book											
Date	Particulars	Subscription (₹)	Donation (₹)	Interest Received (₹)	Misc. Income (₹)	Date	Particulars	Salaries & wages (₹)	Rent & Taxes (₹)	Communication charges (₹)	Misc. Expenses (₹)

Note: Bank Book

Deviating from the traditional method of keeping an additional column for bank transactions in a double and triple column cash book, today organisations keep a separate subsidiary book similar to cash book to record all receipts and payments made through the bank. This is known as Bank Book or Bank Journal.

Usually, big companies maintain this book where the volume of bank transactions is very high. Small businesses may still continue to record their bank transactions along with the cash book in an additional column.

Similar to a Single Column Cash Book, a Bank Book consists of two sides, receipts side and payment side. Receipts are debited and payments are credited in the bank book.

Maintaining a Bank Book or Bank Journal helps to ease the process of bank reconciliation. It also helps to decrease the chances of missing entries or any mistake. Separate Bank Books can be maintained for each bank account.

Thus, Bank Book can be distinguished from a Pass Book and a Bank Statement. These are basically the copy of a client's account (as it appears in the book's personal ledger).

B. Petty Cash Book:

In almost all businesses, it is found necessary to keep small sums of liquid cash with the cashier for the purpose of meeting small recurring expenses such as postage, telegrams, stationaries and office sundries etc. The sum of money so kept in hand generally termed as petty cash and book in which the petty cash expenditures are recorded is termed as Petty Cash Book.

In large commercial establishments all receipts and payments are made through bank. Since expenses like postage, telegrams, traveling etc, cannot be made by means of cheques, the maintenance of a small cash balance in form of petty cash to meet these small payments becomes all the more necessary.

A petty cash book is generally maintained on a columnar basis - a separate column being allotted for each type of expenditure. There is only one amount column on the debit side where all sum received from time to time by the petty cashier from the chief cashier are entered. The credit side consists of several columns including a total column. Every payment made by the petty cashier is entered on this side twice - once in the total column and then to the appropriate expense column. The difference between the total of the debit items and that of the "total column" on the credit side at any time will represent the balance of the petty cash in hand and this should tally with the petty cashier's actual holding of cash.

The posting from the petty cash book to the respective accounts in the ledger are made directly in total at the end of every month or any other fixed period.

The amount of petty cash is provided to the petty cashier either on Ordinary System or on Imprest System. Under the Ordinary System, a pre-decided amount of cash is given in lump sum by the chief cashier to the petty cashier. When the entire amount of petty cash gets spent, the petty cashier submits the details of petty expenditures to the chief cashier for review, and reimbursement.

Under the Imprest System, the total amount of petty expenses for a particular period is estimated beforehand. This amount is referred to as Imprest Cash or Imprest Float. The imprest cash is advanced by the principal cashier to the petty cashier out of which the latter meets all the petty expenses incurred during the period. At the end of the fixed period, petty cashier prepares a State of Petty Cash reflecting the petty expenses incurred and submits the same to the chief cashier. The chief cashier after examination of the petty transactions remit an amount equal to the total petty expenses incurred to the petty cashier. Thus, at the beginning of the next accounting period, the petty cashier will have the same amount of imprest cash to meet the petty expenses of the period.

The following is a simple format of a petty cash book:

Petty Cash Book									
Dr.					Cr.				
Amount Received (₹)	Date	Particulars	V.N.	Total (₹)	Postage (₹)	Printing and Stationary (₹)	Cartage (₹)	Traveling Expenses (₹)	Misc. (₹)

Consider the following illustrations.

Illustration 23.

Let us see an illustration for the following cash and bank transactions in the books of Mr. Abhishek

January 1 Opening cash balance was ₹3,800 and bank balance was ₹27,500

- January 4 Wages paid in cash ₹ 1,500
 January 5 received cheque of ₹ 19,800 from KBK enterprises after allowing discount of ₹ 200
 January 7 Paid to consultancy charges by cheque for ₹ 7,500
 January 10 Cash of ₹ 2,500 withdrawn from bank
 January 12 Received a cheque for ₹ 4,500 in full settlement of the account of Mr. X at a discount of 10% and deposited the same into the Bank.
 January 15 X's cheque returned dishonoured by the Bank

Solution:
In the Books of Abhishek

Dr.						Cr.					
Cash Book											
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount Allowed (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount received (₹)
1-Jan	Opening Balance		3,800	27,500		4-Jan	Wages paid		1,500		
5-Jan	Recd from KBK			19,800	200	7-Jan	Consultancy fees			7,500	
10-Jan	Cash withdrawn		2,500			10-Jan	Cash withdrawn			2,500	
12-Jan	Mr. X			4,500	500	15-Jan	Mr. X			4,500	500
							Closing balance		4,800	37,300	
			6,300	51,800	700				6,300	51,800	500

Illustration 24.

Enter the following transactions in the columnar petty cash book of a cashier who was given ₹ 10,000 on 1st March, 2021 on the imprest system:

2021	Particulars	₹
March 2	Paid for postage stamps	800
2	Paid for stationary	1000
3	Paid for cartage	400
3	Paid for postage stamps	600
8	Paid for paper	100
12	Paid for cartage	600
18	Paid tips for trips to office staff	200
23	Paid for ink and nibs	400
25	Paid for Tiffin to office staff	600
26	Paid for train fair	500
28	Paid for bus fair	400
29	Envelops and letter heads	600
30	Printing address on above	400
31	Cab fare to manager	1000

Solution:

Amount Received (₹)	Date	Particulars	V.N.	Total (₹)	Postage (₹)	Printing and Stationary (₹)	Cartage (₹)	Traveling Expenses (₹)	Misc. (₹)
10,000	2021 March 1	To Cash							
	2	By Postage		800	800				
	2	By Stationary		1,000		1,000			
	3	By Cartage		400			400		
	3	By Postage		600	600				
	8	By Paper		100		100			
	12	By Cartage		600			600		
		By Tips to staff		200					200
		By Ink and Nibs		400		400			
		By Tiffin		600					600
		By Train Fare		500				500	
		By Bus Fare		400				400	
		By Envelops etc.		600		600			
		By Printing		400		400			
		By Cab Fare		1,000				1,000	
		By balance c/d		2,400					
10,000				10,000	1,400	2,500	1,000	1,900	800
2,400	April 1	To balance b/d							
7,600	April 1	To Cash							

1.6.2 Bank Reconciliation Statement**⊙ Concept of Bank Reconciliation Statement**

Since transactions effected in cheques, drafts and other electronic fund transfer are recorded in Bank Book (or Double Column Cash Book in case of a small organisation) by the organisation and in Pass Book/ Bank Statement by the bank, at any point of time, the balances as per Bank Book and Pass Book/Bank Statement should be equal in amount. However, this happens rarely in practice due to a number of reasons. A statement which is prepared to reconcile the above two balances is known as Bank Reconciliation Statement.

⊙ Features of Bank Reconciliation Statement

Following are the features of a Bank Reconciliation Statement.

- It is just a statement and not an account.
- It is not a part of double entry book keeping system.
- It is prepared for a particular day, not for a period.
- It is prepared at regular intervals, say every month, three-month, 6-month etc according to the requirement of the company.

- e) It is prepared by an entity who has an account with a bank, a bank does not prepare it.
- f) It explains the causes of disagreement between bank statement and Bank Book.

⊙ **Causes of Disagreement Between Bank Statement and Bank Book (or Bank Column of Cash Book)**

A. Items not appearing in Bank Pass Book

- a) **Cheques issued by business entity not debited by the bank:** This may be due to the reason that the cheques have not been banked by the payee or it may still be under clearance. As a result, Bank Pass Book will show higher balance than cash book balance. This is also termed as unrepresented cheques.
- b) **Cheques deposited but not credited by the bank:** This may be due to the reason that the cheques are deposited for collection but are still in clearance. Here, balance as per Cash Book will be more than the balance as per Bank Passbook. This is also called as outstanding cheques.
- c) **Errors in Bank Pass Book:** The Bank may by mistake miss out entering the debit or credit transactions which results in the difference.
- d) **Standing Instructions:** The entity may give standing instruction to the Bank for certain regular payments like loan repayment instalment, transfer of funds etc. This may get entered in the Pass Book immediately, but Cash Book entry may be delayed leading to the difference.

B. Items not appearing in the Cash Book

- a) **Bank interest, Bank charges etc.:** The Bank will charge interest on overdraft or service fees for issue of demand draft, pay orders etc. Here, being the source of transaction, the Bank will record the transactions in the Pass Book immediately and send the debit advices to the business entity. The entry in the Cash Book may be delayed. Similarly, the Bank could credit interest on fixed deposits, which may get entered in business books at a later date.
- b) **Direct deposits in Bank account:** Sometimes customers or others may directly deposit an amount in the Bank for goods or services rendered. The Bank will enter it immediately, but entry in Cash Book will appear later.
- c) **Bills for collection:** The Business Entity may send bills of exchange for collection. The Bank will collect the payment and credit the same in the Passbook. The entry in Cash Book will be made only after receipt of information from the Bank.
- d) **Errors in Cash Book:** The records may be missed out by the book-keeper of the Business Entity.

⊙ **Steps in Preparation of Bank Reconciliation Statement**

The preparation of Bank Reconciliation Statement can start with any of the available balances viz. balance of Bank Book (alternatively, bank column of Cash Book) or balance of Bank Statement. After this, relevant adjustments must be made of the transactions that has caused the disagreement – either by making addition or subtraction of the relevant items. Once all the items of disagreement get adjusted, the two balances should get tallied.

The sequential steps may be listed as follows:

- a) Identify the balances and the character thereof. Remember, a debit balance in Cash Book means asset where as a credit balance means a Bank overdraft. In Bank passbook, it's reverse. A debit balance in Pass Book means overdraft and a credit balance is a favourable balance. This must be carefully understood.
- b) Based on the above, start with the balance (or overdraft) as per one book and arrive at the balance (or overdraft) as per the other book. The items of differences will be added to or deducted from the balance (or overdraft) with which the reconciliation is started.

- c) The end result should be the balance (or overdraft) as per the other book e. g. if you start with balance as per Cash Book, then after adding or deducting items of differences, you should arrive at the balance (or overdraft) as per the Pass Book.
- d) One has to make sure that all the items of differences from Cash Book as well as Bank book are taken into account in the reconciliation statement.
- e) Whether the items of differences should be added or deducted will depend on the sequence you follow.

This is shown in following table.

When reconciliation is started with	Bal. as per CB	OD as per CB	Bal. as per PB	OD as per PB
Cheques deposited in Bank, but not cleared	Less	Add	Add	Less
Cheques issued, but not presented in Bank	Add	Less	Less	Add
Interest debited in PB only	Less	Add	Less	Add
Payments by Bank debited in PB only	Less	Add	Add	less
Direct payment by customer in PB only	Add	Less	Less	add
Bills discounted & dishonoured in PB only	Less	Add	Add	Less
Cheques deposited, dishonoured in PB only	Less	Add	Add	Less
Interest, Dividend, Commission collected by Bank not recorded in the Cash Book	Add	Less	Less	Add
Overcasting of payment side of Cash Book or Under casting of Receipt side of Cash Book	Add	Less	Less	Add
Undercasting of Payment side of Cash Book or overcasting of Receipts side of Cash Book	Less	Add	Add	Less
Deposits recorded twice in the Cash Book or excess amount recorded in the Cash Book	Less	Add	Add	Less
Undercasting of credit side of the Pass Book or overcasting of the debit side of the Pass Book	Less	Add	Add	Less
Cheques deposited into Bank and credited with out recording in the Cash Book	Add	Less	Less	Add
Wrong debit in the Pass Book for issue of cheque, Bank charges, etc.	Less	Add	Add	Less
Wrong credit in the Pass Book for deposit of cheque, interest, etc.	Add	Less	less	add
Cheques drawn but not actually issued to the suppliers/creditors	Add	Less	Less	Add
Bank charges recorded twice in the Cash Book	Add	LESS	LESS	Add
Amount withdrawn from Bank not recorded in the Cash Book	Less	Add	Add	less

Consider the following illustrations.

Illustration 25.

From the following particulars of M/Ramesh enterprises, prepare a Bank Reconciliation Statement:

- Bank overdraft as per Pass Book as on 31st March 2021 was ₹88,000.
- Cheques deposited in Bank for ₹58,000 but only ₹20,000 were cleared till 31st March 2021.
- Cheques issued were ₹25,000, ₹38,000 and ₹20,000 during the month. The cheque of ₹58,000 is still with the supplier.
- Dividend collected by Bank ₹12,500 was wrongly entered as ₹15,200 in the Bank Column of Cash Book.
- Amount transferred from FD A/c into the Current A/c ₹20,000 appeared only in Pass Book.
- Interest on overdraft ₹9,300 was debited by Bank in Pass Book and the information was received only on 3rd April 2021.
- Direct deposit by M/s Nabin Traders ₹4,000 not entered in Bank Column of Cash Book.
- Corporation tax ₹12,000 paid by Bank as per standing instruction appears in Pass Book only.

Solution:

Bank Reconciliation Statement as on 31st March 2021

Particulars	(₹)	(₹)
Overdraft as per Pass Book		88,000
Add:		
(i) Cheques issued but not presented till 31st March	58,000	
(ii) Transfer from fixed deposit	20,000	
(iii) Direct deposit by M/s Nabin Traders	4,000	82,000
		1,70,000
Less:		
(i) Cheques deposited but not cleared ₹ (58,000 - 20,000)	38,000	
(ii) Dividend collected excess recorded in Bank Column of Cash Book ₹(15,200 - 12,500)	2,700	
(iii) Interest on overdraft debited in Pass Book only	9,300	
(iv) Corporation tax paid appeared in Pass Book only	12,000	62,000
(iv) Corporation tax paid appeared in Pass Book only		1,08,000

Note: Bank Column of Cash Book may be construed as Bank Book.

Illustration 26.

On 31.12.2021, P. Roy's Bank Balance as shown by the Cash Book was ₹75,000. On receipt of Bank Statement it was found that:

- Three cheques of ₹3,000, ₹4,000 and ₹1,500 drawn in favour of suppliers respectively on 28th, 29th and 30th December, 2021 had been debited in the Bank Statement on 2nd January 2022.
- The Bank had credited ₹8,000 on 30th December, 2021, in respect of collection made by Bank directly from a customer, the intimation not having yet been received.

- iii) Two cheques of ₹5,000 and ₹6,000 were deposited into Bank on 30th December, 2021 had been credited in the Bank statement on 4th January, 2022.
- iv) The Bank had debited ₹30 as incidental charges on 30th December, 2021 but not entered in the Cash Book.
- Show the reconciliation of the Bank Balance as per Cash Book with the Bank Balance as per Bank Statement as on 31st December, 2021.

Solution:**Bank Reconciliation Statement of Mr. P. Roy as on 31st December, 2021.**

Particulars	(₹)	(₹)
Bank Balance as per Cash Book (Dr.)		75,000
Add:		
(i) Cheques issued but not presented for payment ₹3,000, ₹4,000 & ₹1500 respectively.	8,500	
(ii) Collection by Bank from a Customer not recorded in the Cash Book	8,000	16,500
		91,500
Less:		
(i) Cheques deposited but not credited in the Pass Book on 31.12.21 ₹5,000 + ₹6,000 respectively.	11,000	
(ii) Bank charges not recorded in the C.B.	30	11,030
Balance as per Pass Book (Cr.)		80,470

Illustration 27.

On 31-12-2021 your pass book showed a credit balance of ₹5,000. Before that date you had issued cheques worth ₹1,000 of which cheques worth ₹300 were not yet cashed. On 26th December, you deposited a cheque for ₹150 in the bank but you did not enter it in cash book. The pass book showed a credit of ₹40 for interest and a debit of ₹10 for bank charges and the cash book had not corresponding entries for them. A cheque for ₹1,200 deposited in your account No. 2 was wrongly credited by the bank to this account. Dishonoured bill was debited in the pass book only ₹500. Cheques for ₹700 paid in to the bank were not yet credited in the pass book.

A wrong debit of ₹100 appears in the pass book. A cheque of ₹150 received from a customer was entered in the cash book in December, 2021 but the same was omitted to be paid in to the bank.

Determine the balance as per cash book as on that date.

Solution:**Bank reconciliation statement as on 31-12-2021**

Particulars	(₹)	(₹)
Credit Balance as per pass book		5,000
Add:	10	
(1) Bank charges not recorded in cash book	500	
(2) Dishonoured bill debited only in pass book	700	
(3) Cheques paid in to bank but not yet credited in pass book	100	

(4) Wrong debit in the pass book	150	1,460
(5) Cheque received but not presented with the bank		
		6,460
Less:		
(1) Cheques issued but not yet encashed (₹ 1,000 - ₹ 700)	300	
(2) Cheque deposited but not recorded in cash book	150	
(3) Interest not recorded in cash book	40	
(4) A wrong credit appears only in pass book	1,200	
		1,690
Balance as per Cash Book (Dr.)		4,770

Illustration 28.

The Bank Pass Book of Mr. Anil showed an overdraft of ₹6,000 on 31.12.2021. Prepare the Bank Reconciliation Statement based on the following details:

- (1) Cheques issued but not presented upto 31.12.2021, ₹5,500
- (2) Cheques deposited but not credited upto 31.12.2021, ₹9,000
- (3) Bank commission ₹30 was entered only in the Pass Book.
- (4) A cheque for ₹6,500 issued in settlement of a debt was encashed on 28.12.2021 but entered in the Cash Book as ₹8,500.

Solution:**Mr. Anil Bank Reconciliation Statement as on 31st December, 2021**

Particulars	(₹)	(₹)
Overdraft as per Pass Book		6,000
Add:		
(i) Cheques issued but not presented for payment	5,500	
(ii) Cheque for ₹6,500 issued and encashed but entered in the Cash Book at ₹8,500 (8,500 - 6,500)	2,000	7,500
		13,500
Less:		
(i) Cheques deposited but not credited	9,000	
(ii) Bank commission entered in the Pass Book only Overdraft as per Cash Book	30	9,030
Over Draft as per Cash Book (Cr.)		4,470

Illustration 29.

From the following particulars of M/s Suresh enterprises, prepare a Bank reconciliation statement:

- (1) Bank overdraft as per Pass Book as on 31st March 2021 was ₹8,800

- (2) Cheques deposited in Bank for ₹5,800 but only ₹2,000 were cleared till 31st March
- (3) Cheques issued were ₹2,500, ₹3,800 and ₹2,000 during the month. The cheque of ₹5,800 is still with supplier.
- (4) Dividend collected by Bank ₹1,250 was wrongly entered as ₹1,520 in Cash Book.
- (5) Amount transferred from fixed deposit A/c into the current A/c ₹2,000 appeared only in Pass Book
- (6) Interest on overdraft ₹930 was debited by Bank in Pass Book and the information was received only on 3rd April 2021.
- (7) Direct deposit by M/s Rajesh Traders ₹400 not entered in Cash Book.
- (8) Corporation tax ₹1,200 paid by Bank as per standing instruction appears in PB only

Solution:**Bank Reconciliation Statement as on 31st March, 2021**

Particulars	(₹)	(₹)
Overdraft as per Pass Book		8,800
Add:		
(i) Cheques issued but not presented till 31st March	5,800	
(ii) Transfer from fixed deposit	2,000	
(iii) Direct deposit by M/s Rajesh Traders	400	8,200
		17,000
Less:		
(i) Cheques deposited but not cleared ₹(5,800 - 2,000)	3,800	
(ii) Dividend collected excess recorded in CB ₹(1,520 - 1,250)	270	
(iii) Interest on overdraft debited in PB only	930	
(iv) Corporation tax paid appeared in PB only	1,200	6,200
Overdraft as per Cash Book		10,800

⊙ **Amendment in Cash Book Before Preparing BRS**

Sometimes, in order to find out the correct balance at bank, one needs to amend the Cash Book (i.e., bank column of Cash Book or Bank Book) before the preparation of Bank Reconciliation statement. In short, Bank Reconciliation Statement should be prepared by taking the balance shown by the amended Cash Book. The students should remember that usually two types of transactions are recorded in amended Cash Book -

- i) Items which were not at all recorded in Cash Book.
- ii) Any error made by Cash Book.

The transactions which are already recorded in Cash Book i.e., the rest of the transactions will go to Bank reconciliation statement.

Note: It must be remembered that preparation of amended Cash Book is possible only when the balance as per Cash Book is given in the problem.

Steps to be followed for preparation:

- a) Open the Cash Book with the Balance as per Cash Book, whether favourable or unfavourable,
- b) Against the items (i.e., which are not recorded in Cash Book as any other error made by Cash Book.)

- c) Close the Cash Book and find out the balance,
 d) Prepare Bank Reconciliation Statement by taking the Cash Book balance and rest of the transaction which are not adjusted against amended Cash Book.

Consider the following illustrations.

Illustration 30.

The Bank Column of the Cash Book showed an Overdraft of ₹5,000 on 31.3.2021, whereas per Bank Statement the overdraft is ₹4,200. The following differences were noticed between the two records:

- a) Cheques of ₹2,400 issued but not encashed by customers
 b) Cheques deposited but not cleared ₹1,200
 c) Collection charges debited by Bank not recorded in CB ₹100
 d) Bank interest charged by the Bank not recorded in CB ₹300
 e) Cheques dishonoured debited by Bank not in CB ₹400
 f) Interest directly received by Bank not entered in CB ₹400

Prepare Bank Reconciliation Statement after amending the CB.

Solution:

Here, please note that amended CB is asked. What it actually means is to record all revenue (expense or income) items of differences and those items that are recorded in PB only must first be recorded in the CB and then the reconciliation statement should be prepared by taking the revised balance as per CB. Here is the amended CB.

Dr.	Cash Book (Bank column only)		Cr.
Particulars	(₹)	Particulars	(₹)
To, Interest received	400	By, Balance b/d (OD)	5,000
		By, Colloection charges	100
		By, Bank interest	300
To, Balance c/d (OD)	5,400	By, Customer (chq dishonoured)	400
	5,800		5,800

Bank Reconciliation Statement as on 31-03-2021

Particulars	(₹)
Bank OD as per CB	5,400
Add: Cheques deposited, but not cleared	1,200
Less: cheques issued but not encashed	(2,400)
Bank OD as per PB	4,200

Illustration 31.

The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2021.

	(₹)		(₹)
Balance b/d	1,407	Payments	15,520
Receipts	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that

- Bank charges of ₹35 were not entered in the Cash Book
- A cheque of ₹47 issued to supplier was entered by mistake as a receipt in the Cash Book.
- A cheque of ₹18 was returned by the Bank marked as 'refer to drawer' but it's not entered in Cash Book.
- The balance brought forward in Sept 2021 should have been ₹1,470.
- Cheques paid to suppliers ₹214, ₹370 and ₹30 have not been presented for payment.
- Deposits of ₹1542 on 30th Sept were cleared by the Bank on 2nd October.
- The Bank charged a cheque wrongly to Adarsh trading ₹72.
- Bank statement shows overdraft of ₹124 as on 30th Sept 2021.

Show what adjustments will you make in the Cash Book and prepare a Bank reconciliation statement as on 30-09-2021.

Solution:

As we know, the errors in the Cash Book must first be corrected and entries that have been missed out in the CB should be recorded.

Dr.		Cash Book for Sept 2021		Cr.	
Particulars	(₹)	Particulars	(₹)		
To, Original balance b/d	960	By, Bank charges not recorded earlier	35		
To, Error in balance carried (1,470 - 1,407)	63	By, Cheques issued recorded as receipt Now corrected (2×47)	94		
		By, Cheque returned	18		
		By, Revised balance c/d	876		
	1,023		1,0230		

Now we can prepare the Bank reconciliation statement.

Bank Reconciliation from member as on 30.9.2021

Particulars	(₹)	(₹)
Balance as per Cash Book		876
Add: Cheques issued but not presented (214 + 370 + 30)		614
		1,490
Less: i) Deposits not cleared	1542	
ii) Cheques charged by mistake	72	
Overdraft as per Pass Book		124

In the process of accounting, transactions are initially recorded in the primary books wherefrom they are posted to respective accounts in the ledgers. On the reporting date, the ledger accounts are balanced for the purpose of drafting the financial statements. At this juncture, a statement is generally prepared by summarizing the account balances with a view to check the arithmetical accuracy of accounting. This statement is known as Trial Balance.

⦿ Definition of Trial Balance

Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledgers on a particular date to check the arithmetical accuracy.

According to the Dictionary for Accountants by Eric. L. Kohler, Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”.

According to Rolland, Trial Balance is defined as “The final list of balances, totalled and combined, is called Trial Balance”.

Trial is merely a listing of balances on a particular date. Further it must be understood that Trial Balance does not form part of books of account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts. Although it is supposed to be prepared at the end of accounting period, computerized accounting packages are capable of providing instant Trial Balance reports even on daily basis.

⦿ Features of a Trial Balance

Following are the features of Trial Balance:

- a) It is a list of debit and credit balances which are extracted from various ledger accounts.
- b) It is not an account. It is only a statement of debit and credit balances of account.
- c) The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- d) It does not prove accounting accuracy which can be determined by audit.
- e) It is not a part of the final statements.
- f) It is usually prepared at the end of the accounting year, but it can also be prepared anytime as and when required.
- g) It is a link between books of accounts and the Profit and Loss Account and Balance Sheet.

⦿ Purpose of a Trial Balance

Trial Balance serves the following purposes:

- a) **Bird Eye View:** The trial balance gives the summary of all the ledgers. Since the net amount gets displayed, one can save time by not viewing the concerned ledger again.

- b) **Pointing out Error:** The trial balance aids in pointing out errors. It is also used to check the arithmetical accuracy of books of accounts. If the trial balance does not tally, the errors can be found out, rectified and then financial statements can be prepared.
- c) **Basis for Preparation of Financial Statements:** It forms the basis for preparation of financial statements i.e., Profit and Loss Account and Balance Sheet.
- d) **Quick Reference:** It acts as a quick reference. One can easily find out the balance in any ledger account without actually referring to the ledger.
- e) **Helps in Analyses:** If the listing of ledger accounts is systematically done in the trial balance, one can do a quick trend analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or losses accounts in that order. One can draw some quick inferences from trial balance by interpreting the same. If one plots monthly trial balances side by side, one can analyse the movement of balances in various accounts e.g., one can see how expenses are increasing or decreasing or showing a trend of movements. By comparing the owner's equity balances as on two dates, one can interpret the business result e.g., if the equity has gone up, one can interpret that business has earned net profit and vice versa.

Preparation of Trial Balance is not indispensable as it is not a part of financial statements. It is a mere statement prepared by the accountants for his own convenience and if it agrees, it is assumed that at least arithmetical accuracy has been confirmed although there may be a lot of errors undetected.

☉ **Method of Preparation of Trial Balance**

Trial Balance can be prepared under any of the following two methods:

- a) Total Method or Gross Trial Balance:
- b) Balance Method or Net Trial Balance.

These are explained as under:

- a) **Total Method or Gross Trial Balance:** Under this method, two sides of the accounts are totalled. The total of the debit side is called the "debit total" and the total of the credit side is called the "credit total". Debit totals are entered on the debit side of the Trial Balance while the credit total is entered on the credit side of the Trial Balance.

If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages:

- a) It checks arithmetical accuracy of the accounts.
- b) Extraction of ledger balances is not required at the time of preparation of Trial Balance.

Disadvantages: Preparation of final accounts is not facilitated.

- ☉ **Balance Method or Net Trial Balance:** Under this method, all the ledger accounts are balanced. The balances may be either "debit-balance" or "credit balance".

Advantages:

- a) It helps in the easy preparation of final accounts.
- b) It saves time and effort in constructing a Trial Balance.

Disadvantages:

Errors may remain undisclosed irrespective of the agreement of Trial Balance.

Note: In the trial balance, all assets, drawings, debtors, expenses and losses are included in the debit balances column and all liabilities, capital, creditors, gains and incomes are included in credit balances column.

⊙ **Pro-forma of Trial Balance**

Generally, the following pro-forma is used in preparation of a Trial Balance.

Trial Balance of as on

Dr.

Cr.

Sl. No.	Ledger Accounts	L.F.	₹	₹

Note: However, in some cases, in order to minimize the space utilised, Debit. and Credit balances are shown on the left and right sides of the trial balance respectively.

⊙ **Treatment of Various Items in the Trial Balance**

The following table gives the treatment of various items in the trial balance.

Heads of Accounts	Side of Trial Balance	Reasons
Cash in hand	Debit	Assets
Cash at Bank	Debit	Assets
Cash at Bank (overdrawn)	Credit	Liability
Bank Overdraft	Credit	Liability
Capital	Credit	Liability
Opening stock	Debit	Assets
Wages	Debit	Expenses
Purchase	Debit	Expense/Increase in stock
Carriage Inwards	Debit	Expenses
Freight	Debit	Expenses
Royalty on production	Debit	Expenses
Gas, Water, Fuel	Debit	Expenses
Motive Power	Debit	Expenses
Import Duty	Debit	Expenses
Sales	Credit	Income/Decrease in stock
Discount Allowed	Debit	Losses
Discount Received	Credit	Gains
Bad Debts	Debit	Losses

Reserve /Provision for Bad & Doubtful Debt (Opening)	Credit	Gains
Commission Received	Credit	Incomes
Salaries	Debit	Expenses
Commission paid	Debit	Expenses
Rent, rates, and taxes	Debit	Expenses
Repairs and maintenance	Debit	Expenses
Insurance	Debit	Expenses
Carriage outward	Debit	Expenses
Trade charges	Debit	Expenses
Royalty on sales	Debit	Expenses
Interest paid	Debit	Expenses
Interest received	Credit	Income
Advertisement	Debit	Expenses
Sundry expenses	Debit	Expenses
Miscellaneous expenses	Debit	Expenses
Miscellaneous receipts	Credit	Incomes
Income tax	Debit	Drawings
L.I.C. Premium	Debit	Drawings
Office expenses	Debit	Expenses
Export duty	Debit	Expenses
Allowances	Debit	Losses
Rebates	Debit	Losses
Sales tax	Debit	Expenses
Horses and Carts	Debit	Assets
Watch Dog Squad	Debit	Assets
Loan Secured	Credit	Liability
Loans Advanced	Debit	Assets
Reserve Funds	Credit	Liability
Sinking Fund	Credit	Liability
Sinking Fund Investments	Debit	Assets
Ecology Fund	Credit	Liability
Ecology Fund Investments	Debit	Assets
Building Fund	Credit	Liability
Building	Debit	Assets
Land	Debit	Assets
Plant	Debit	Assets
Machinery	Debit	Assets

Furniture & fittings	Debit	Assets
Motor vehicles	Debit	Assets
Computer	Debit	Assets
Office equipment	Debit	Assets
Goodwill	Debit	Assets
Patent rights	Debit	Assets
Copyrights	Debit	Assets
Trade marks	Debit	Assets
Investments	Debit	Assets
Shares & Securities	Debit	Assets
G. P. Notes	Debit	Assets
Sundry debtors	Debit	Assets
Sundry creditors	Credit	Liability
General Reserve	Credit	Liability
Bill Receivable	Debit	Assets
Bills Payable	Credit	Liability
Provision for Discount on Debtors	Credit	Liability
Provision for Discount on Creditors	Debit	Assets
Lighting and Heating	Debit	Expense
Drawings	Debit	Assets
Contribution to Provident Fund	Debit	Assets
Prize Fund	Credit	Liability
Depreciation	Debit	Losses
Provision for Depreciation	Credit	Liability
Returns Inwards	Debit	Losses
Returns Outwards	Credit	Gains
Freehold Property	Debit	Assets
Premises	Debit	Assets
Leasehold Property	Debit	Assets
Loose Tools	Debit	Assets
Petty Cash	Debit	Assets
Provident Fund	Credit	Liability
Debentures Purchased	Debit	Assets
Debentures (from Public)	Credit	Liability
Loan on Mortgage	Credit	Liability
Prepaid Expenses	Debit	Assets
Outstanding Expenses	Credit	Liability
Bad Debts Recovered	Credit	Gains

Accrued Incomes	Debit	Assets
Apprenticeship Premium received	Credit	Income
Books	Debit	Assets
Newspaper and Magazine	Debit	Expenses
Profit and Loss A/c (Dr.)	Debit	Losses
Profit and Loss A/c (Cr.)	Credit	Gains
Accumulated Depreciation	Credit	Liability
Postage and Telegram	Debit	Expense
Travelling & Conveyance	Debit	Expenses

Consider the following illustration.

Illustration 32.

From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March, 2022. Capital ₹80,000; Sales ₹10,00,000; Adjusted Purchase ₹8,00,000; Current A/c (cr) ₹10,000; Petty Cash ₹10,000; Sales Ledger Balance ₹1,20,000; Purchase Ledger Balance ₹60,000; Salaries ₹24,000; Carriage Inwards ₹4,000; Carriage Outward ₹6,000; Discount Allowed ₹10,000; Building ₹80,000; Outstanding Expenses ₹10,000; Prepaid Insurance ₹2,000; Depreciation ₹4,000; Cash at Bank ₹80,000; Loan A/c (cr) ₹66,000; Profit & Loss A/c(cr) ₹20,000; Bad Debts Recovered ₹2,000; Stock at 31.03.2015 ₹1,20,000; Interest Received ₹10,000; Accrued Interest ₹4,000; Investment ₹20,000; Provision for Bad Debts (01.04.2021) ₹6,000; General Reserve ₹20,000.

Solution.

Trial Balance of Mr. Sen as on 31st March, 2022

Dr.

Cr.

Heads of Accounts	₹	Heads of Accounts	₹
Adjusted Purchase	8,00,000	Capital	80,000
Petty Cash	10,000	Sales	10,00,000
Sales Ledger Balance	1,20,000	Current A/c	10,000
Salaries	24,000	Purchase Ledger Balance	60,000
Carriage Inward	4,000	Outstanding Expenses	10,000
Discount Allowed	10,000	Loan A/c	66,000
Building	80,000	Profit & Loss A/c(cr)	20,000
Prepaid Insurance	2,000	Bad Debts Recovered	2,000
Depreciation	4,000	Interest Received	10,000
Cash at Bank	80,000	Provision for Bad debts	6,000
Stock (31.03.2015)	1,20,000	General Reserve	20,000
Accrued Interest	4,000		
Investment	20,000		
Carriage outward	6,000		
Total	12,84,000	Total	12,84,000

Adjustment Entries and Rectification of Errors

1.8

1.8.1 Adjustment Entries

⦿ Concept of Adjustment Entries

At the end of the reporting period, entities prepare the financial statements on the basis of the ledger balances appearing as on that date. However, in many cases the balances reflected by the ledger accounts are not final and certain adjustments may be required to convert into the true figures. The entries which are required to adjust the ledger balances to reflect the true figure are known as adjustment entries.

The passing of adjusting entry(s) is a fundamental bookkeeping and accounting process. The primary purpose for the adjusting process is to reflect true essence of the transactions and the proper situation of the entity as on the date of passing of such entries. It happens to be a necessary part of the accounting cycle and has to be built into the accounting system.

The adjustment entries are passed at the end of an accounting period, and these entries usually have reflections in the income statement as-well-as the balance sheet. These entries are not passed on the basis of source documents like invoice, bill etc. However, the documents may indicate the amount to be adjusted.

After the ledger balances are adjusted by the adjusting entries, accountant has to prepare an adjusted trial balance based on all account balances, now adjusted. These adjusted balances are finally used to prepare the financial statements.

⦿ Features of Adjustment Entries

The features of adjustment entries are:

- (a) These are a special type of journal entries.
- (b) They are no source documents like vouchers for the transactions.
- (c) These entries are recorded on the Journal Proper.
- (d) These are passed to reflect the final balance of an account that would appear in the financial statements.
- (e) These entries are passed to comply with the accounting principles.
- (f) Adjustment entries are passed at the end of an accounting period.

⦿ Different Categories of Adjustment Entries

Adjustment entries are broadly classified into the following three types:

A. Prepaid and Pre-received: The transactions under this category involve – Prepaid expenses and Unearned revenues. The former refers to money paid in advance for expenses not yet incurred, while the later are money received in advance but yet to be earned.

For example, suppose, M/S X & Co. paid insurance premium of ₹12,000 on car insurance for one year effective from 01.07.2021. Out of the total amount paid, ₹9,000 (01.07.21 to 31.03.22) will be considered for the financial year 2021-22 and the remaining 3 months' premium will be considered as Prepaid Insurance.

Similarly, suppose, Youngsters' Club received subscription of ₹18,000 from a member for 18 months effective from 01.07.2021. Out of the total amount, ₹9,000 (01.07.21 to 31.03.22) will be considered for the financial year 2021-22 and the remaining 9 months' subscription will be considered as Subscription Received in Advanced.

The above two adjustments are required to be done by performing an adjustment entry in each case.

B. Accruals: The accrual transactions can be either accrued expenses or accrued incomes. Accrued expenses, also referred to as outstanding expenses, are expenses which have actually taken place, but for which no payment has yet been made up to the end of the accounting period. As such, they are not accounted for in the books. On the other hand, accrued incomes are incomes earned, but not yet recorded nor money received.

For example, suppose, M/S Y & Co. has not yet paid the electricity bill for March 2021 ₹20,000 till 31.03.2021. This represents outstanding electricity expenses to be adjusted.

Again, rent for the month of March is not yet recovered from the tenant till 31.03.21. This will be treated as Accrued Rent.

C. Estimates and Non-cash Expenses:

Expenses such as depreciation and provisions are transactions which are of non-cash in nature (i.e., no cash goes out for the same). They are required to be estimated. Similarly closing stock also requires valuation

The items which require the passing of adjustment entries are practically called 'Adjustments'. Some of the usual adjustment items that emerge at the time of finalization of accounts are as follows:

Adjustments	Type of Adjustment Entry to be passed
a) Closing stock	Adjustments regarding Estimated Items
b) Outstanding expenses	Adjustments regarding Accrual
c) Prepaid expenses	Adjustments regarding Prepaid
d) Accrued incomes	Adjustments regarding Accrual
e) Pre-received incomes	Adjustments regarding Pre-received
f) Depreciation on Fixed Assets	Adjustments regarding Estimated Items
g) Provision for doubtful debts and discount on debtors	Adjustments regarding Estimated Items

Adjustment	Journal Entry
A. Income Statement Related Items	
a) Relating to Income	
Pre-received Incomes	Income A/c Dr. To Pre-received Income A/c
Accrued Incomes	Accrued Income A/c Dr. To Income A/c
b) Relating to Expenses	
Outstanding expenses	Expenses A/c Dr. To Outstanding Expenses A/c

Prepaid expenses	Prepaid Expenses A/c To Expenses A/c	Dr.
B. Balance Sheet Related Items		
a) Stock		
Closing stock	Stock-in-trade A/c To Purchases/ Trading A/c	Dr.
Goods withdrawn by owner for personal use	Drawing A/c To Purchases A/c	Dr.
Goods distributed as free samples to public	Advertisement A/c To Purchases A/c	Dr.
Goods distributed as free samples to employees	Wages/ Salaries A/c To Purchases A/c	Dr.
Goods-in-Transit	Goods-in-transit A/c To Purchases/ Trading A/c	Dr.
Abnormal loss of stock	Abnormal Loss A/c To Purchase/ Trading A/c	Dr.
Stock used as stationary	Stationery A/c To Purchases/ Stock A/c	Dr.
Materials used for constructing Fixed Assets	Fixed Assets A/c To Purchases/ Stock A/c	Dr.
Goods sent on approval basis, pending approval on Balance Sheet date	Sales A/c To Debtors A/c	Dr.
	Stock on Sale or Return A/c To Trading A/c	Dr.
Goods sent on Consignment	Goods sent on Consignment A/c To Purchases A/c	Dr.
Goods sent to Branch	Goods sent on Branch A/c To Purchases A/c	Dr.
Goods sent on Hire Purchase basis	Goods sent on Hire Purchase A/c To Purchases A/c	Dr.
b) Receivables		
Provision for Bad Debts	P/L A/c To Provision for Bad Debts A/c	Dr.
Provision for Discount on Debtors	P/L A/c To Provision for Discount on Debtors A/c	Dr.
Mutual Set-off between debtors and creditors	Creditors A/c Dr. To Debtors A/c	
c) Fixed Assets		
Depreciation on tangible fixed assets	Depreciation A/c To Fixed Assets A/c	Dr.
Amortisation on intangible fixed assets	Amortisation A/c To Fixed Assets A/c	Dr.

Illustration 33.

Pass the necessary entries to make the following adjustment as on 31st Dec. 2021

1. Stock on 31st Dec. 2021 was ₹12,000.
2. Depreciation at 10% on furniture valued at ₹4,500 and machinery valued at ₹50,000.
3. Interest accrued on securities ₹650.
4. Bad debts during the year amounted to ₹450.
5. Unexpired insurance as on 31st Dec. 2021 was ₹290.
6. Salaries outstanding on 31st Dec., 2021 were ₹600.
7. Make provision for discount on debtors and creditors @ 2.5%. The debtors and creditors at the end of the year were ₹35,000 and ₹24,000.

Solution:

Sl. No.	Particular	₹	₹
1	Stock Account Dr. To Trading Account (being the value of closing stock)	12,000	12,000
2	Depreciation Account Dr. To Furniture Account To Machinery Account (Being depreciation at 10% on furniture and machinery for the year)	5,450	450 5,000
3	Interest Accrued Account Dr. To Interest Account (being interest accrued on securities brought in to account)	650	650
4	Bad debts Account Dr. To Debtors Account (being loss on account of non-recovery of debts debited to bad debts account)	450	450
5	Unexpired or prepaid Insurance Account Dr. To Insurance Account (Being the amount of the unexpired insurance as on the date of the balance sheet)	290	290
6	Salaries Account Dr. To Salaries outstanding Account (Being the amount of outstanding salaries brought into account)	600	600
7(a)	Profit and Loss Account Dr. To Provision for discount on debtors Account (Being provision made for discount on debtors @ 2.5%)	875	875
7(b)	Provision for discount of creditors Account Dr. To Profit and Loss Account (Being provision made for discount on creditors @ 2.5)	600	600

Note: The above list is not exhaustive but indicative only.

1.8.2 Rectification of Errors

⊙ Concept

Every concern is interested in ascertaining its true profit and financial position at the close of the financial year. But in spite of the best efforts of the book-keeper and the accountant, certain errors are committed in the recording of the transactions which affect the financial statements of the concern. It, therefore, becomes utmost important for the book-keeper and the accountant to locate such errors and rectify them so that correct profit and financial position of the concern may be ascertained. So, whenever errors in accounting records come to notice, they should be rectified without waiting till the end of the accounting year when Trial Balance is to be prepared. Such rectification essentially requires passing a journal entry in the Journal Proper.

⊙ Adjustment Entry vs. Rectification Entry

The purpose of adjustment entries is to determine the correct profit and for finalization of accounts keeping in mind certain accounting concepts and conventions including matching concept.

On the contrary, the purpose of rectification entries is to rectify any error occurred during the recording, casting, posting of transactions.

⊙ Stages of Errors

Errors may occur at any of the following stages of the accounting process:

A) At the Stage of Recording the Transactions in Journal

Following types of errors may happen at this stage:

- i) Errors of principle,
- ii) Errors of omission,
- ii) Errors of commission.

B) At The Stage of Posting the Entries in Ledger

- i) Errors of omission:
 - a) Partial omission,
 - b) Complete omission.
- ii) Errors of commission:
 - a) Posting to wrong account,
 - b) Posting on the wrong side,
 - c) Posting of wrong amount.

C) At the Stage of Balancing the Ledger Accounts

- a) Wrong totaling of accounts,
- b) Wrong balancing of accounts.

D) At the Stage of Preparing the Trial Balance

- a) Errors of omission,
- b) Errors of commission:
 1. Taking wrong account,
 2. Taking wrong amount,
 3. Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,
4. Compensating Errors

⊙ Types of Errors

Basically, errors are of two types:

- a) Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.
- b) Clerical errors: These errors arise because of mistake committed in the ordinary course of the accounting work. Clerical errors are again of three types:
 - i) Errors of Omission: If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.
 - ii) Errors of Commission: If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of “errors of commission”.
 - iii) Compensating Errors: if the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of ₹ 10 received from A is not credited to his account and the total of the sales book is ₹ 10 in excess. The omission of credit to A’s account will be made up by the increased credit to the Sales Account.

⊙ Effect of Errors on Trial Balance

Errors	Effect on Trial Balance
Errors of Principle	Trial balance will tally
Errors of partial omission	Trial balance will not tally
Errors of full omission	Trial balance will tally
Errors of commission	Normally Trial Balance does not tally
Compensating Errors	Trial balance will tally

The following chart clarifies the issue further.

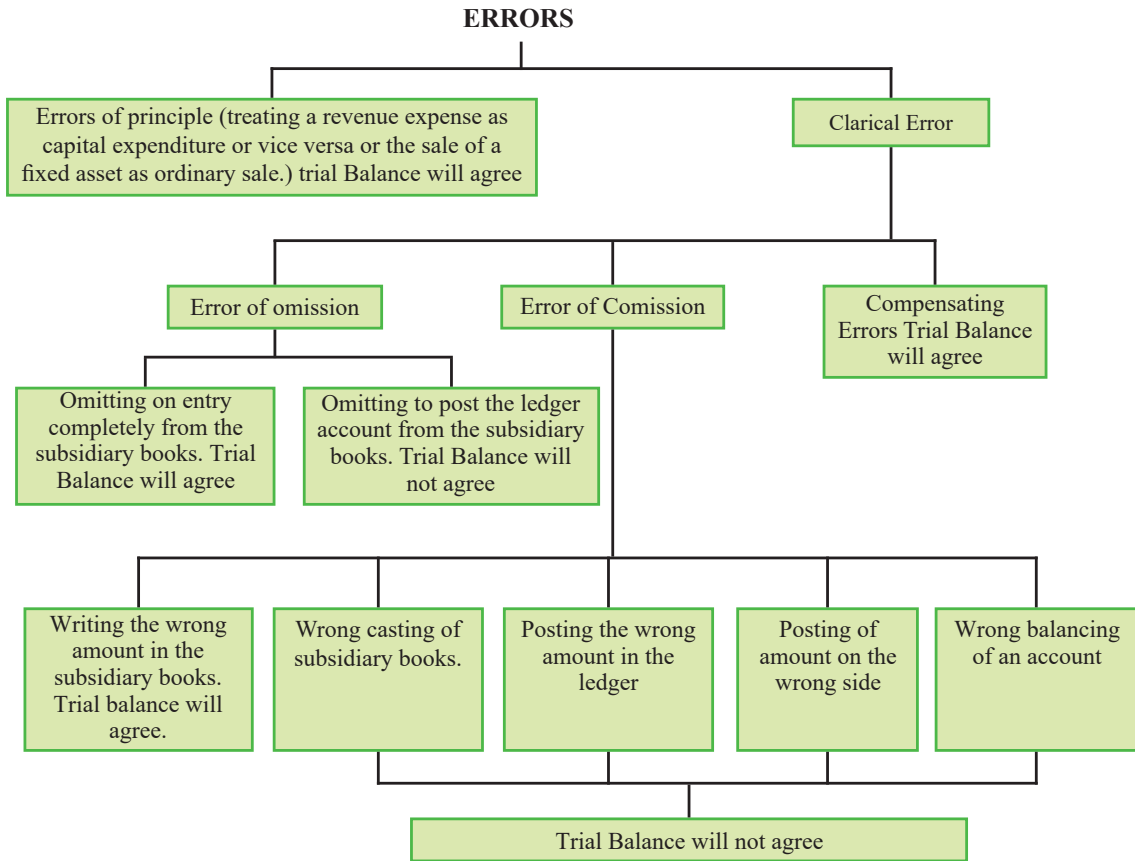


Figure 1.6: Types of Errors and Their Effect on Trial Balance

⊙ **Process of Rectification of Errors**

Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If, however, the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry. In fact, the rectification of an error depends on at which stage it is detected and whether the error is single sided or double sided. An error can be detected at any one of the following stages:

- a) Before preparation of Trial Balance
- b) After Trial Balance but before the final accounts are drawn.
- c) After final accounts, i.e., in the next accounting period

Accordingly, the following are the possibilities:

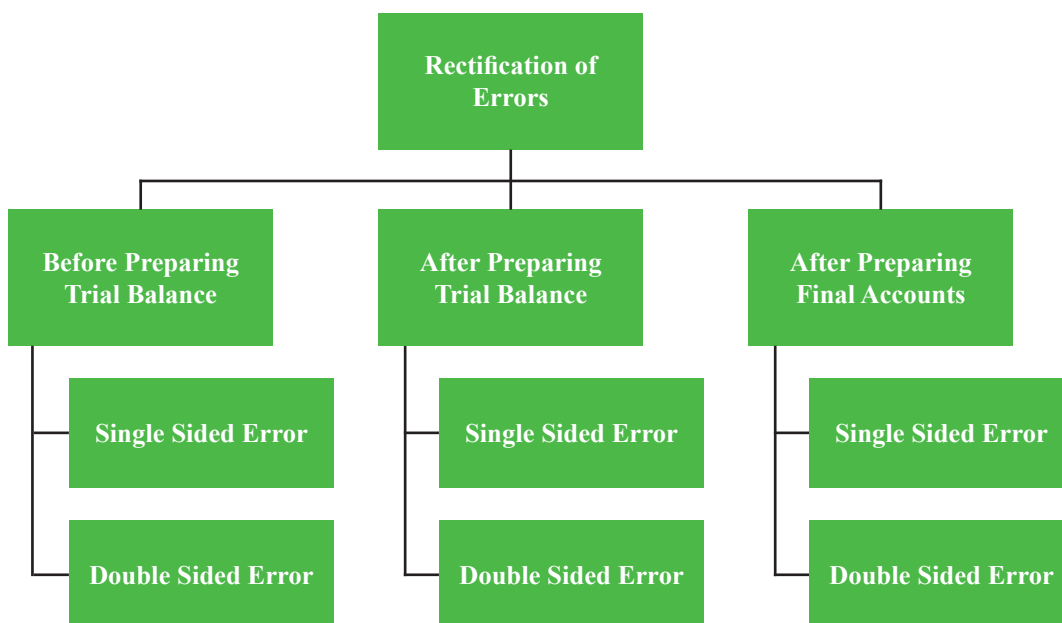


Figure 1.7: Rectification of Errors at Different Stages

Here single sided errors mean the errors that affect only one aspect of account i.e., either debit or credit and double-sided errors mean the errors that affect both aspects i.e., debit as well as credit.

Certain examples of single sided errors are:

1. Wrong casting (e.g., under casting of purchase day book)
2. Wrong carry forward (Total of a page of sales day book of ₹2,000 carried to the next page as ₹200)
3. Wrong posting (sales posted to the credit side of the customer account)
4. Balancing (Plant account debit balance shows short debit by ₹150)

Stage 1: Before Preparation of Trial Balance

- a) **Single Sided Errors:** Only a rectification statement is required to be passed. No double entry is required.

For example: For under-casting of purchase day book ₹2,000, Purchase A/c is to be debited by ₹2,000 only.

- b) **Double Sided Errors:** For rectifying a double-sided error at this stage, a rectification entry is required to be passed. The approach has been clarified as follows.

For example: Purchase of a Building for ₹3,00,000 was wrongly passed through Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

Stage 2: After Preparation of Trial Balance

At this stage, Trial Balance is already drafted with the ledger balances. Hence, any difference in the aggregate Debit and Credit balances of Trial Balance is transferred to Suspense A/c. It is also kept for unsure accounting treatment.

At this stage, any error is rectified by passing a rectification entry.

- a) **Single Sided Errors:** Rectification entry to be passed involving Suspense Account.

For example, for Purchased Day Book under-casted by ₹2,000, the rectification entry will be as follows:

Purchase A/c	Dr.	₹2,000
	To Suspense A/c	₹2,000

- b) **Double Sided Errors:** These errors are rectified by passing rectification entries without involving the Suspense Account. The approach has been clarified as follows.

For example: Purchase of a Building for ₹3,00,000 was wrongly passed through the Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

Stage 3: After Preparation of Final Accounts

At this stage, the final accounts are also prepared. Thus, apart from Suspense Account, preparation of a Profit and Loss Adjustment Account is mandatory here to reflect the rectifications in any nominal account.

- a) **Single Sided Errors:** Rectification entry to be passed involving Suspense Account. In addition, nominal accounts are to be replaced by Profit and Loss Adjustment Account.

For example, for Purchased Day Book under-casted by ₹2000, the rectification entry will be as follows:

Profit and Loss Adjustment A/c.....	Dr.	₹2,000
	To Suspense A/c	₹2,000

- b) **Double Sided Errors:** These errors are rectified by passing rectification entries without involving the Suspense Account. In addition, nominal accounts are to be replaced by Profit and Loss Adjustment Account. The approach is explained below.

For example: Purchase of a Building for ₹3,00,000 wrongly passed through Purchase A/c.

Correct Entry		Wrong Entry		Rectification Entry	
Building A/c	Dr. ₹3,00,000	Purchase A/c	Dr. ₹3,00,000	Building A/c	Dr. ₹3,00,000
To Cash A/c	₹3,00,000	To Cash A/c	₹3,00,000	To Purchase A/c	₹3,00,000

The net balance of Profit and Loss Adjustment Account represents the net impact of all rectifications on the profit and loss for the year. This balance is transferred to Capital Account.

Note: In the rectification entry, if the nominal account is debited, the profit will decline while, if the nominal account is credited, the profit will increase.

Now, consider the following illustrations.

Illustration 34.

Correct the following errors located before preparation of Trial Balance.

- a) The Sales Book has been totaled ₹100 short.
- b) Goods worth ₹150 returned by Green & Co. have not been recorded anywhere.

- c) Furniture purchased from Gulab & Bros., ₹1,000 has been entered in Purchases Day Book.
- d) Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Solution:

In the books of

Journal

		Dr.	Cr.
Date	Particulars	L.F.	(₹)
2022			
(a)	Since sales book has been cast ₹100 short, the Sales Account has been similarly credited ₹100 short. The correcting entry is to credit the Sales Account by ₹100 as "By wrong totaling of the Sales Book ₹100".		
(b)	Returns Inward Account To Green & Co. Account (Being Goods returned by the firm, previously omitted from the Returns Inward Book)	Dr.	150
			150
(c)	Furniture A/c To Purchase A/c (Being correction of the mistake, by which purchases Account was debited instead of the Furniture Account)	Dr.	1,000
			1,000
(d)	In this case the account of the customer has been correctly posted; the discount account has been debited ₹18 short since it has been omitted from the discount column on the debit side of the cash book. The discount account should now be debited by the entry. "To Omission of entry in the Cash Book ₹18".	Dr.	

Illustration 35.

Mr. A closed his books of account on September 30, 2021 in spite of a difference in the trial balance. The difference was ₹830 the credits being short; it was carried forward in a suspense account. In 2021 following errors were located:

- i) A sale of ₹2,300 to Mr. Lala was posted to the credit of Mr. Mala.
- ii) The total of the Returns Inward Book for July, 2014 ₹1,240 was not posted in the ledger.
- iii) Freight paid on a machine ₹5,600 was posted to the Freight account as ₹6,500.
- iv) White carrying forward the total in the Purchase Account to the next page, ₹65,590 was written instead of ₹56,950.
- v) A sale of machine on credit to Mr. Mehta for ₹9,000 was not entered in the books at all. The book value of machine was ₹7,500. The firm has the practice of writing off depreciation @10% on the balance at the end of the year.

Pass journal entries to rectify the errors. Have you any comments to make?

Solution:**Journal of Mr. A**

		Dr.	Cr.	
Date	Particulars	L.F.	(₹)	(₹)
2022	Mr. Mala A/c	Dr.	2,300	
(i)	Mr. Lala A/c	Dr.	2,300	
	To Suspense A/c			4,600
	(Correction of error by which a sale of ₹2,300 to Mr. Lala was posted to the Credit of Mrs. Mala)			
(ii)	Profit and Loss Adjustment A/c	Dr.	1,240	
	To Suspense A/c			1,240
	(Rectification of omission to post the total of Returns Inward Book for July, 2014)			
iii)	a) Machinery A/c	Dr.	5,600	
	Suspense A/c	Dr.	900	
	To Profit & Loss Adjustment A/c			6,500
	(Correction of error by which freight paid for a machine ₹5,600 was posted to Freight Account at ₹6,500 instead of capitalizing it)			
	b) Profit & Loss Adjustment A/c	Dr.	560	
	To Plant and Machinery A/c			560
	(Depreciation @ 10% charged on freight paid on a machine capitalized)			
iv)	Suspense A/c	Dr.	8,640	
	To Profit & Loss Adjustment A/c			8,640
	(Correction of wrong carry forward of total in the purchase Account to the next page ₹65,590 instead of ₹56,950)			
v)	Mr. Mehta	Dr.	9,000	
	To Plant & Machinery A/c			6,750
	To Profit & Loss Adjustment A/c			2,250
	(Correction of omission of sale of machine on credit to Mr. Mehta for ₹9,000 with a book value of ₹7,500 on which depreciation @10% has been charged in 2010)			

Comments:

The Suspense Account will not appear as shown below:

Suspense Account**Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2022	To Profit and Loss Adjustment A/c	900	2022	By Balance b/d	830
	To Profit and Loss Adjustment A/c	8,640		By Sundries:	2,300
				Mr. Mala	
				Mr. Lala	2,300
				By Profit and Loss Adjustment A/c	1,240
				By balance c/d	2,870
		9,540			9,540

Since the suspense Account still shows a balance, it is obvious that there are still some errors left in the books.

Profit & Loss Adjustment Account**(For Prior Period Items)****Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2022	To Suspense A/c	1,240	2022	By Machinery A/c	5,600
	To Plant & Machinery A/c	560		By Suspense A/c	900
	To Balance c/d	15,590		By Suspense A/c	8,640
				By Mr. Mehta	2,250
		17,390			17,390

Illustration 36.

Rectify the following errors assuming that the errors were detected

- Before the Preparation of Trial Balance;
- After the preparation of Trial Balance and
- After the preparation of Final Accounts.
 - Purchase Plant for ₹10,000 wrongly passed through Purchase Account.
 - Sales Day Book was cast short by ₹1,000.
 - Cash paid to Mr. X for ₹1,000 was posted to his account as ₹100.
 - Purchase goods from Mr. T for ₹3,500 was entered in the Purchase Day Book as ₹500.
 - Paid salary for ₹3,000 wrongly passed through wages account.

Solution:

In the Books of

Journal (without narration)

Date	Before preparation of Trial Balance		After preparation of Trial Balance		After preparation of Final Accounts	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
i)	Plant A/c	₹ 10,000	Plant A/c	₹ 10,000	Plant A/c	₹ 10,000
	To Purchase A/c.	₹ 10,000	To Purchase A/c.	₹ 10,000	To P&L Adjustment A/c	₹ 10,000
ii)	Sales account will be credited with ₹ 1,000		Suspense A/c Dr.	₹ 1,000	Suspense A/c Dr.	₹ 1,000
			To Sales A/c.	₹ 1,000	To P&L Adjustment A/c	₹ 1,000
iii)	X Account will be debited when ₹ 900		X A/c Dr.	₹ 900	X A/c Dr.	₹ 900
			To Suspense A/c.	₹ 900	To Suspense A/c	₹ 900
iv)	Purchase A/c Dr.	₹ 3,000	Purchase A/c Dr.	₹ 3,000	P&L Adjustment A/c Dr.	₹ 3,000
	To T A/c	3,000	To T A/c	₹ 3,000	To T's A/c.	₹ 3,000
v)	Salary A/c Dr.	₹ 3,000	Salary A/c Dr.	₹ 3,000	P&L Adjustment A/c. Dr.	3,000
	To Wages A/c	₹ 3,000	To wages A/c.	₹ 3,000	To P&L Adjustment A/c	₹ 3,000

Illustration 37.

A merchant, while balancing his books of accounts notices that the T.B. did not tally. It showed excess credit of ₹ 1,700. He placed the difference to Suspense A/c. Subsequently he noticed the following errors:

- Goods brought from Narayan for ₹ 5,000 were posted to the credit of Narayan's A/c as ₹ 5,500
- An item of ₹ 750 entered in Purchase returns book was posted to the credit of Pandey to whom the goods had been returned.
- Sundry items of furniture sold for ₹ 26,000 were entered in the sales book.
- Discount of ₹ 300 from creditors had been duly entered in creditor's A/c but was not posted to discount A/c. Pass necessary journal entries to rectify these errors. Also show the Suspense A/c

Solution:

- Goods bought from Narayan are posted to credit of his A/c as ₹ 5,500 instead of ₹ 5,000. Here, it is correct to credit Narayan's A/c. But the mistake is extra credit of ₹ 500. This is one sided error, as posting to purchases A/c is correctly made. So the rectification entry will affect the suspense A/c. This needs to be reversed by the rectification entry:

Narayan's A/c	Dr.	₹ 500	
To Suspense A/c			₹ 500

- b) Goods bought from Pandey were returned back to him. It should have appeared on the debit side of his A/c. For rectifying we will need to debit his A/c with double the amount i.e. ₹ 1500 (₹ 750 to cancel the wrong credit and another ₹ 750 to give effect for correct debit) and the effect will go to Suspense A/c. The correction entry is:

Pandey A/c	Dr.	₹ 1,500	
	To Suspense A/c		₹ 1,500

- c) Sale of furniture was recorded in sales book. What's wrong here? Remember that sales book records sale of goods only and nothing else. Sale of furniture will appear in either cash book (if sold for cash) or journal proper (if sold on credit). Hence, wrong credit to Sales A/c must be removed and credit should be given to Furniture A/c. It's important to note that this rectification entry will not affect the Suspense A/c. The correction entry is:

Sales A/c	Dr.	₹ 26,000	
	To Furniture A/c		₹ 26,000

- d) The discount received from creditor is not entered in discount A/c but was correctly recorded in creditors' A/c. This is one sided error and will therefore be routed through suspense for correction. A discount is received; it must be credited being an income.

Suspense A/c	Dr.	₹ 300	
	To Discount received A/c		₹ 300

Let us now see how suspense A/c will look like. Excess credit of ₹ 1,700 in Trial Balance will be shown on the debit side of suspense A/c. This will bring in total debit equal to total credit.

Dr.				Suspense Account				Cr.			
Date	Particulars	J. F.	(₹)	Date	Particulars	J. F.	(₹)				
	To Balance b/d		1,700		By Narayan		500				
	To Discount received		300		By Pandey		1,500				
			2,000				2,000				

Please observe that after correcting passing all rectification entries, the Suspense A/c tallies automatically.

Illustration 38.

Pass necessary journal entries to rectify the following errors:

- An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.
- Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.
- A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.
- ₹ 150 received from Malhotra was credited to Mehrotra.
- ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.
- A bill of ₹ 2,750 for extension of building was debited to building repairs A/c
- Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not posted.
- Old furniture sold for ₹ 200 to Sethi was recorded in sales book
- The period end total of sales book was under cast by ₹ 100
- Amount of ₹ 80 received as interest was credited to commission.

Solution:

Sl. No.		Particulars		Dr.	Cr.
				(₹)	(₹)
(a)	Wrong Entry	Trade Expenses A/c	Dr.	200	
		To Cash A/c			200
	Correct entry	Drawings A/c	Dr.	200	
		To Cash A/c			200
	Rectification entry	Drawings A/c	Dr.	200	
		To Trade Expenses A/c			200
(b)	Wrong Entry	Nathan A/c	Dr.	300	
		To Sales A/c			300
	Correct entry	Purchases A/c	Dr.	300	
		To Nathan A/c			300
	Rectification entry	Purchases A/c	Dr.	300	
		Sales A/c	Dr.	300	
		To Nathan A/c			600
(c)	Wrong Entry	Purchases A/c	Dr.	100	
		To Santhanam A/c			100
	Correct entry	Santhanam A/c	Dr.	100	
		To Sales A/c			100
	Rectification entry	Santhanam A/c	Dr.	200	
		To Sales A/c			100
		To Purchases A/c			100
(d)	Wrong Entry	Cash A/c	Dr.	150	
		To Mehrotra A/c			150
	Correct entry	Cash A/c	Dr.	150	
		To Malhotra A/c			150
	Rectification entry	Mehrotra A/c	Dr.	150	
		To Malhotra A/c			150
(e)	Wrong Entry	Dhawan A/c	Dr.	375	
		To Cash A/c			375
	Correct entry	Salary A/c	Dr.	375	
		To Cash A/c			375
	Rectification entry	Salary A/c	Dr.	375	
		To Dhawan A/c			375

(f)	Wrong Entry	Building Repairs A/c	Dr.	2,750		
		To Cash A/c			2,750	
	Correct entry	Buildings A/c	Dr.	2,750		
		To Cash A/c			2,750	
	Rectification entry	Buildings A/c	Dr.	2,750		
		To Building Repairs A/c			2,750	
(g)	Wrong Entry	No entry passed A/c				
		Correct entry	Sales Returns A/c	Dr.	500	
		To Akashdeep A/c			500	
		Rectification entry	Sales Returns A/c	Dr.	500	
		To Asashdeep A/c			500	
		(h)	Wrong Entry	Sethi A/c	Dr.	200
		To Sales A/c			200	
		Correct entry	Sethi A/c	Dr.	200	
		To Furniture A/c			200	
		Rectification entry	Sales A/c	Dr.	200	
		To Furniture A/c			200	
		(i)	Wrong Entry	No entry passed A/c		
		Correct entry	Suspense A/c	Dr.	100	
				To Sales A/c		
Rectification entry	Suspense A/c			Dr.	100	
		To Sales A/c			100	
		(j)	Wrong Entry	Cash A/c	Dr.	80
		To Commission A/c			80	
		Correct entry	Cash A/c	Dr.	80	
		To Interest A/c			80	
		Rectification entry	Commission A/c	Dr.	80	
		To Interest A/c			80	

Illustration 39.

Rectify the following error and find out the effect of the errors on Net Profit.

- i) Purchases of ₹300 from Raman passed through Sales Book
- ii) Bill received from Ramu for ₹500 passed through Bills Payable Book.
- iii) An item of ₹150 relating to Prepaid Rent was omitted to be brought forward from last year.
- iv) ₹400 paid to Mehta B, against our acceptance was debited to Mehta N.
- v) Received ₹300 from Ajit whose account for ₹300 was written off earlier and posted to the credit of Amit.
- vi) Transistor sold to Karun for ₹750 passed through Sales Book twice.

Solution:**Rectification Entries**

	Particulars		Dr. (₹)	Cr. (₹)
(i)	Purchase A/c Dr. Sales A/c Dr. To Raman A/c (Being the amount passed through sales book cancelled and debited to purchases account)		300 300	600
(ii)	Bills Receivable A/c Dr. Bills Payable A/c Dr. To Ramu's A/c (Being prepaid Insurance omitted to bring into books of accounts earlier, now brought into books of accounts)		500 500	1,000
iii)	Prepaid Rent A/c Dr. To Suspence A/c (Being prepaid Insurance omitted to bring into books of accounts earlier, now brought into books of accounts))		150	150
iv)	Bills Payable A/c Dr. To N. Mehta A/c (Being the amount wrongly debited to N. Mehta cancelled)		400	400
v)	Amrit A/c Dr. To Bad Debts Recovered A/c (Being the amount credited to Ajit account cancelled and credited to bad debts recovered)		300	300
vi)	Sales A/c Dr. To Karun A/c (Being wrong credit given to sales account cancelled)		750	750

Note: As a result of rectifications, profit will decrease by ₹ (300 + 300 - 300 +750) = ₹1050.

Illustration 40.

Following errors were detected in the Accounts of AA Ram and Sons for the year ended 30th June, 2021:

- A builder's bill for ₹2,700 for the erection of a small shed was debited to repairs account.
- A cheque for ₹300 received from Rahim Bux and Co. was dishonoured and debited to allowances account.
- Goods to the value of ₹150 returned by Chandmal Bros. were included in stock, but no entry was made in the books.
- Repairs to plant amounting to ₹567 had been charged to plant and machinery account

- v) Wages paid to the firm's own workmen for making certain additions to machinery amounting to ₹550 were posted to wages account.
- vi) A cheque for ₹75 received from Lala Ram was credited to the account of Tika Ram and debited incorrectly to cash account.
- vii) A sum of ₹100 drawn by the proprietor for personal use was debited to travelling expenses account.
- Give journal entries to correct these errors. Which of these errors, if any, will cause disagreement of the trial balance? Give reasons for your answer.

Solution:**Journal Entries**

	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Building A/c To Repairs A/c (Being a builder's bill for the erection of a small shed wrongly debited to Repairs Account, now corrected)	Dr.	2,700	2,700
(ii)	Rahim Bux & Co.A/c To Allowances A/c (Being a cheque received from Rahim Bux & Co. dishonoured was wrongly debited to Allowances Account, now rectified)	Dr.	300	300
iii)	Returns Inwards A/c To Chandmanl Bros.A/c (Being goods returned by Chandmal Bros. omitted to be recorded, now recorded)	Dr.	150	150
iv)	Repairs A/c To Plant and Machinery A/c (Being repairs to plant and machinery wrongly debited to Plant and Machinery Account, now corrected)	Dr.	567	567
v)	Plant & Machinery A/c To Wages A/c (Being wages paid for making certain additions to machinery wrongly debited to Wags Account, now rectified)	Dr.	550	550
vi)	a) Tika Ram A/c To Lala RamA/c (Being cheque received from Lala Ram wrongly credited to Tika Ram instead of to Lala Ram, now corrected)	Dr.	75	75
	b) Bank A/c To Cash A/c (Being cheque received from Lala Ram wrongly debited to Cash Account instead of to Bank A/c, now rectified)	Dr.	75	75

vii)	Drawings A/c To Travelling Expenses A/c (Being amount drawn by the proprietor wrongly debited to Travelling Expenses account, now corrected)	Dr.		100	100
------	--	-----	--	-----	-----

Illustration 41.

On going through the Trial balance of Ball Bearings Co. Ltd. You find that the debit is in excess by ₹ 150. This was credited to “Suspense Account”. On a close scrutiny of the books the following mistakes were noticed:

1. The totals of debit side of “Expenses Account” have been cast in excess by ₹ 50.
2. The “Sales Account” has been totaled in short by ₹ 100.
3. One item of purchase of ₹ 25 has been posted from the day book to ledger as ₹ 250.
4. The sale return of ₹ 100 from a party has not been posted to that account through the Party’s account has been credited.
5. A cheque of ₹ 500 issued to the Suppliers’ account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.
6. A credit sale of ₹ 50 has been credited to the Sales and also to the Trade receivables Account.
 - i) Pass necessary journal entries for correcting the above;
 - ii) Show how they affect the Profits; and
 - iii) Prepare the “Suspense Account” as it would appear in the ledger.

Solution:**Journal Entries**

Particulars		L.F.	Dr.	Cr.
			(₹)	(₹)
Suspense A/c	Dr.		50	
To Expenses A/c				50
(Being the mistake in totaling of Expenses A/c, rectified)				
Suspense A/c	Dr.		100	
To Sales A/c				100
(Being the mistake in totaling of Sales A/c, rectified)				
Suspense A/c	Dr.		225	
To Purchase A/c				225
(Being the mistake in posting from Day Book to Ledger rectified)				
Sales Returns A/c	Dr.		100	
To Suspense A/c				100
(Being the sales return from a party not posted to “Sales Returns” now rectified)				
Trade Payable A/c	Dr.		500	
To Purchases A/c				500
(Being the payments made to supplier wrongly posted to purchases now rectified)				
Trade Receivables A/c	Dr.		100	
To Suspense A/c				100
(Being the sales wrongly credited to Customer’s Account now rectified)				

Dr.	Suspense Account		Cr.
Particulars	(₹)	Particulars	(₹)
To Expenses A/c	50	By Difference in Trial balance	150
To Sales A/c	100	By Trade payables	225
To Balance c/d	425	By Sales Returns A/c	100
		By Trade Receivables	100
	575		575
		By Balance b/d	425

Since the Suspense Account does not balance, it is clear that all the errors have not been traced. As a result of the above corrections the Net Profit will be:

Particulars	₹	₹
Mistake in totaling in "Expenses"	50	
Mistake in totaling in "Sales"	100	
Mistake in posting from day book to Ledger under "Purchases"	225	
Mistake in wrongly debiting the Purchase A/c	500	
Omission in positing under "Sales Returns"		100
	875	100
Net Increase	775	

As a result of these adjustments, the Profits will be increased by ₹775 in The books of accounts of A Co. Ltd. for the year.

Illustration 42.

The books of accounts of A Co. Ltd. for the year ending 31.3.2022 were closed with a difference in books carried forward. The following errors were detected subsequently:

- Return outward book was under cast by ₹100.
- ₹1,500 being the total of discount column on the credit side of the cash book was not posted.
- ₹6,000 being the cost of purchase of office furniture was debited to Purchase A/c.
- A credit sale of ₹760 was wrongly posted as ₹670 to the customers A/c. in the sales ledger.
- The Sales A/c. was under casted by ₹10,000 being the carry over mistakes in the sales day book.
- Closing stock was over casted by ₹10,000 being casting error in the schedule or inventory. Pass rectification entries in the next year.

Prepare suspense account and state effect of the errors in determination of net profit of last year.

Solution:

In the Books of A Co. Ltd.

Journal

Date 2022	Particulars	L.F.	(₹)	(₹)
(a) Apr 1	Suspense A/c Dr.		100	
	To Profit & Loss Adjustment A/c			100
	(Returns outward book was under cast now rectified).			

(b)	Suspense A/c	Dr.	1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Discount received was not recorded, now rectified.)			
(c)	Office Furniture A/c	Dr.	6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Office furniture purchased wrongly debited to Purchase A/c. not rectified.)			
(d)	Debtors' A/c	Dr.	90	
	To Suspense A/c.			90
	(Debtors account was posted ₹ 670 in place of ₹ 760, now rectified.)			
(e)	Suspense A/c.	Dr.	10,000	
	To Profit & Loss Adjustment A/c.			10,000
	(Sales account was under casted, now rectified)			
(f)	Profit & Loss Adjustment A/c.	Dr.	10,000	
	To Suspense A/c.			10,000
	Closing Stock was overcastted, now rectified.)			

Dr.		Suspense Account			Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)	
2022	To Profit & Loss Adj. A/c	100	2022	By Difference in Trial Balance	21,510	
Apr.1	To Profit & Loss Adj. A/c	1,500	Apr.1	By Debtors A/c.	90	
	To Profit & Loss Adj. A/c	10,000				
	To Profit & Loss Adj. A/c	10,000				
		21,600			21,600	

Particulars	Decrease (-) (₹)	Increase (+) (₹)
Item (a).....	-	100
(b).....	-	1,500
(c).....	-	6,000
(d) No effect	-	-
(e).....	-	10,000
(f).....	10,000	-
	10,000	17,600
Profit will increase by	7,600	-
	17,600	17,600

Depreciation (Straight Line and Diminishing Balance Methods Only)

1.9

1.9.1 Concept of Depreciation

An entity requires various types of assets for conducting its operations. These assets can broadly be classified into Fixed Assets and Current Assets.

Fixed Assets are those assets which provide benefit to an entity over multiple accounting periods, instead of one accounting period. So, the cost of the Fixed Asset should not be charged to the accounting period in which it is acquired but should be allocated over the periods during which benefits will be derived from such assets. This allocation of the total cost of a fixed asset over several accounting periods leads to the concept of Depreciation.

Depreciation is derived from the Latin word 'Depretium', where 'De' – decline 'Pretium' – Price. This decline in price is due to constant use, wear and tear. Thus, the term 'Depreciation' means a gradual and permanent decline in the value of a tangible fixed asset due to its use, wear and tear, obsolescence, effluxion of time, expiration of legal rights or similar other causes.

According to Accounting Standard 10, Property, Plant and Equipment, depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

1.9.2 Depreciation and Other Losses of Value of a Fixed Asset

a) **Amortization**

Amortization refers to the deterioration in the value of an intangible Fixed Assets due to effluxion of time or expiration of legal right. In other words, it is the process of allocating an amount against the profits over the period of beneficial life of the intangible asset. Assets such as Copyright, Patent Right etc. are subject to amortization.

b) **Obsolescence**

Obsolescence refers to the fall in the value of a fixed asset due to new technology, introduction of better processes/ techniques or change in taste, fashion, etc. It is a sudden loss in the value of an asset difficult to predict.

c) **Depletion**

Depletion refers to fall in value of a tangible fixed assets (being a non-renewable natural resource) arising due to its exhaustion. It occurs only for wasting assets (viz. Mines, quarries, oil wells, timber stands, etc.)

1.9.3 Causes of Depreciation

The factors which cause depreciation of fixed assets can be broadly divided into two categories as follows:

A. Internal Factors

- a) Wear and Tear: Regular usage of the asset results in its wear and tear. Accordingly, its value falls.
- b) Physical deterioration: Deterioration of the physical capacities of an asset due to non-use or improper use of the asset results in fall in the value of the asset.
- c) Exhaustion: Wasting assets lose value when they get exhausted due to resources being extracted out of such assets.

B. External Factors

- a. Effluxion/Passage of time: If it is not put to regular use, value of an asset may fall with the passage of time.
- b. Expiry of the legal life of an asset: Certain intangible assets are acquired for a pre-determined specified time period. On expiry of such period, they will not be usable for the purpose of regular operations.
- c. Obsolescence: Invention of new technologies, processes/techniques or change in taste, fashion, etc. may cause a sudden loss in the value of an asset which may be in good physical and operating condition.
- d. Abnormal reasons: Certain abnormal occurrences, viz. destruction of an asset on any natural calamity, fire, and other accidents may result in fall in the value of an asset.

1.9.4 Methods of Providing Depreciation

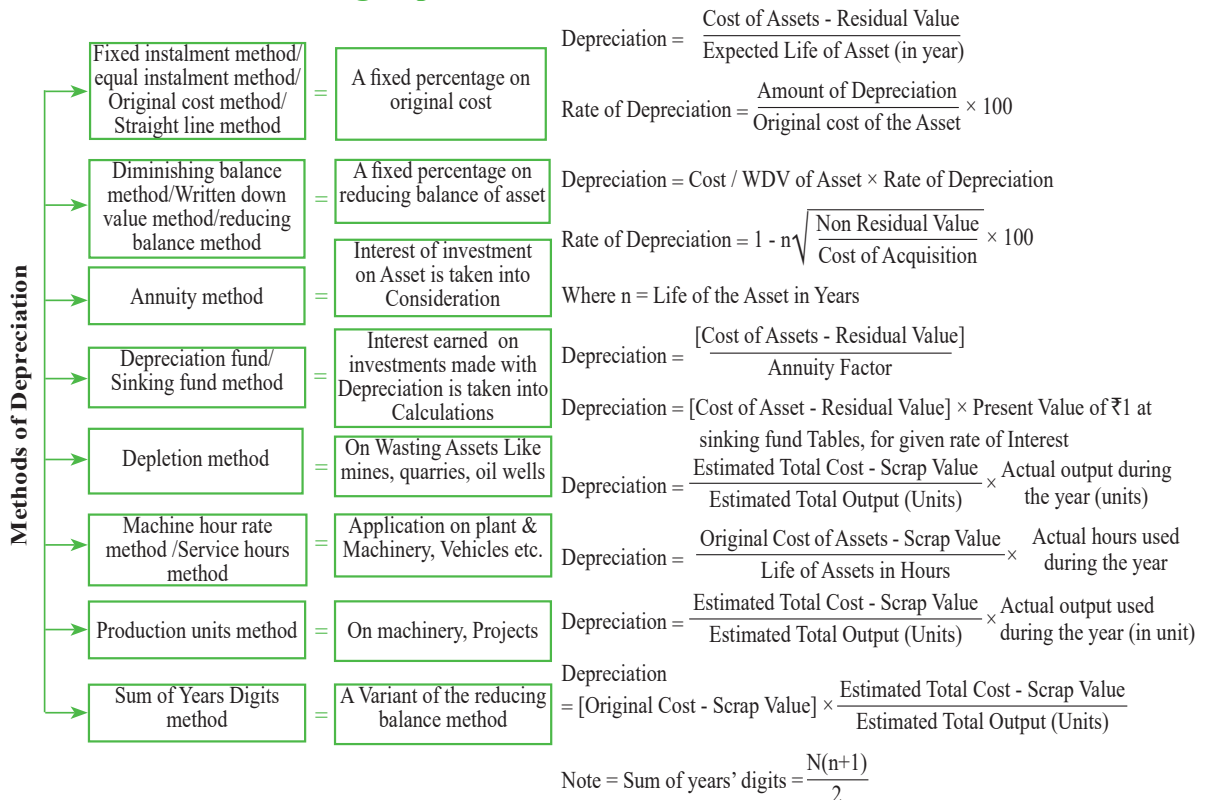


Figure 1.8: Methods of Depreciation

⊙ Fixed/Equal Instalment or Straight-Line Method

Following are the features of this method:

- Under this method, depreciation is always calculated on the 'Original Cost' of the fixed asset.
- An equal amount of depreciation is written-off in every accounting period of the economic life of the fixed asset.
- The written down value (i.e., depreciated value) of a fixed asset gets reduced to either the Scrap value or Nil value (when there is no scrap value).

The formula for calculating the amount of depreciation p.a. is as follows:

$$\text{Depreciation p.a.} = \frac{\text{Original Cost of Fixed asset} + \text{Other Capital costs} - \text{Estimated Scrap Value}}{\text{Life of the fixed asset (in years)}}$$

Consider the following illustration.

Illustration 43.

A Ltd. purchased a machine costing ₹4,25,000. Installation expenses incurred ₹25,000. The estimated useful life of the asset is 10 years having a scrap value of ₹30,000. Determine the amount of depreciation p.a. under SLM.

Solution:

Given, Original Cost = ₹4,25,000; Other Capital Costs = ₹25,000; Scrap value = ₹30,000.

Life of the asset = 10 years.

$$\begin{aligned} \text{Here, Depreciation p.a.} &= \frac{\text{Original Cost of Fixed asset} + \text{Other Capital costs} - \text{Estimated Scrap Value}}{\text{Life of the fixed asset (in years)}} \\ &= \frac{\text{₹4,25,000} + \text{₹25,000} - \text{₹30,000}}{10} = \text{₹42,000} \end{aligned}$$

⊙ Reducing / Diminishing Balance Method or Written Down Value Method

Under this method, the depreciation is calculated on the Book Value of the fixed asset. To be more specific, in the year of acquisition, depreciation is calculated on the Original Cost of the asset, and in the subsequent years it is calculated on the Written Down Value of the asset.

- The rate of depreciation remains constant every year.
- The amount of depreciation goes on decreasing over the years.
- Under this method w.d.v. of the asset never gets reduced to zero.

The formula for calculating the amount of depreciation p.a. is as follows:

Depreciation p.a. = Opening W.D.V (or original cost for new asset) × Rate of depreciation.

$$\text{Rate of depreciation} = \left(1 - \sqrt[n]{\frac{\text{Scrap Value}}{\text{Original cost}}} \right) \times 100$$

Consider the following illustration.

Illustration 44.

A Ltd. purchased a machine costing ₹4,80,000. Installation expenses incurred ₹20,000. It provides depreciation @10% p.a. on the WDV of the machine. Determine the amount of depreciation p.a. under WDV method for year 1 and 2.

Solution:

Total cost of the machinery = 4,80,000 + 20,000 = ₹5,00,000

Depreciation p.a. (1st Year) = 5,00,000 × 10% = ₹50,000

Depreciation p.a. (2nd Year) = (5,00,000 – 50,000) × 10% = ₹45,000.

1.9.5 Methods of Recording Depreciation:

Depreciation can be recorded in the books of account by two different methods. They are discussed below:

1. When a provision for Depreciation Account is maintained:

In case of this method, the amount of depreciation to be charged in a particular year is debited to Depreciation A/c and credited to Provision for Depreciation Account. The Asset Account appears in the books at original cost. In case the asset is sold, the provision for Depreciation Account is transferred to the Asset Account. Any amount released on account of sale of asset is also credited to Asset Account. The balance, if any, in the Asset Account is transferred to the Profit and Loss Account.

2. When a provision for Depreciation Account is not maintained:

In case a Provision for Depreciation Account is not maintained, the amount of depreciation is debited to the Depreciation Account and credited to the Asset Account. The Asset Account thus appears in the books at written down value. The Depreciation Account is transferred to the Profit and Loss account like any other item of expense.

Accounting Treatment under Different Method

Sl. No.	Transaction	If Provision for Depreciation A/c is maintained					
		If Provision for Depreciation A/c is NOT maintained (ordinary method)		If Asset Disposal A/c is NOT opened		If Asset Disposal A/c is opened	
1.	For the purchase of an asset (including exp. Incurred till it is brought into use)	Depreciation A/c To Cash/Bank A/c	Dr.	Asset A/c To Cash/Bank A/c	Dr.	Asset A/c To Cash/Bank A/c	Dr.
2.	For the depreciation on the asset.	Depreciation A/c To Cash/Bank A/c	Dr.	Depreciation A/c To Prov. for Dep. A/c	Dr.	Depreciation A/c To Prov. for Dep. A/c	Dr.
3.	For the transfer of depreciation to P & L a/c	Profit & Loss A/c To Depreciation A/c	Dr.	Profit & Loss A/c To Depreciation A/c	Dr.	Profit & Loss A/c To Depreciation A/c	Dr.
4.	When the asset is to be sold a. For the transfer of original cost of the asset to Asset Disposal A/c	No Entry		No Entry		Asset Disposal A/c To Asset A/c	Dr.

b. For the transfer of provision for Depreciation A/c	No Entry		Prov. for Dep A/c To Asset A/c	Dr.	Prov. for Dep A/c To Asset Disposal A/c	Dr.
c. For the sale of asset	Cash / Bank A/c To Asset A/c	Dr.	Cash / Bank A/c To Asset A/c	Dr.	Cash / Bank A/c To Asset Disposal A/c	Dr.
d. For the profit on the sale of asset.	Asset A/c To Profit & Loss A/c	Dr.	Asset A/c To Profit & Loss A/c	Dr.	Asset Disposal A/c To Profit & Loss A/c	Dr.
e. For the loss on the sale of asset	Profit & Loss A/c To Asset A/c	Dr.	Profit & Loss A/c To Asset A/c	Dr.	Profit & Loss A/c To Asset Disposal A/c	Dr.

Illustration 45.

Calculate the Rate of Depreciation under Straight Line Method (SLM) in each of the following cases:-

Machine No.	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Estimated Residual Value (₹)	Expected Useful Life in years
1	90,000	10,000	20,000	8
2	24,000	7,000	3,100	6
3	1,05,000	20,000	12,500	5
4	2,50,000	30,000	56,000	10

Solution:

Machine No	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Total Cost of Asset = (b+c) (₹)	Estimated Residual Value (₹)	Expected Useful Life in years	Depreciation = (d-e)/f (₹)	Rate of Depreciation under SLM = (g/d)×100
a	b	c	d	e	f	g	h
1	90,000	10,000	1,00,000	20,000	8	10,000	10%
2	24,000	7,000	31,000	3,100	6	4,650	15%
3	1,05,000	20,000	1,25,000	12,500	5	22,500	18%
4	2,50,000	30,000	2,80,000	56,000	10	22,400	8%

Illustration 46.

A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2021, if this machine is purchased on:

(a) 1st April, 2020 (b) 1st July, 2020 (c) 1st October, 2020 (d) 1st January, 2021

Solution:

Here, Total Cost of Asset = Purchased Price + Cost of Cartage and Installation

$$= ₹ 7,00,000 + ₹ 3,00,000 = ₹ 10,00,000$$

So, Depreciation

$$= \text{Total Cost of Asset} \times \text{Rate of Depreciation} \times \frac{\text{Period from the date of purchase of date of closing accounts}}{12}$$

a) The machine was purchased on 1st April, 2020:

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{12}{12} = ₹ 2,00,000$$

b) 1st July, 2020

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{9}{12} = ₹ 1,50,000$$

c) 1st October, 2020

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{6}{12} = ₹ 1,00,000$$

d) 1st January, 2021

$$\text{Amount of Depreciation} = ₹ 10,00,000 \times 20\% \times \frac{3}{12} = ₹ 50,000$$

Illustration 47.

A company whose accounting year is the calendar year, purchased on 1st April, 2019 Machinery costing ₹ 30,000. It purchased further machinery on 1st October, 2019 costing ₹ 20,000 and on 1st July, 2020 costing ₹ 10,000. On 1st January, 2021 one third of the Machinery installed on 1st April, 2019 became obsolete and was sold for ₹ 3,000. Show how machinery account would appear in the books of the company, it being given that machinery was depreciated by fixed installment method at 10% per annum.

Solution:

Dr.		Machinery Account				Cr.
2019	Particulars	₹	2019	Particulars	₹	
Apr.1	To Bank A/c	30,000	Dec.31	By Depreciation A/c (on ₹ 30,000 for nine months and on ₹ 20,000 for 3 months)	2,750	
Oct. 1	To Bank A/c	20,000	Dec.31	By Balance c/d	47,250	
		50,000			50,000	
2020			2020			
Jan.1	To Balance b/d	47,250				
July1	To Bank A/c	10,000	Dec.31	By Depreciation A/c (on ₹ 50,000 for one year and on ₹ 10,000 for 6 months)	5,500	
			2021			
			Dec.31	By Balance c/d	51,750	
		57,250			57,250	
2021			2021			
Jan.1	To Balance b/d	51,750	Jan. 1	By Bank a/c	3,000	
			Jan.1	By Profit and Loss A/c (loss on sale) (1)	5,250	
			Dec.31	By Depreciation (on ₹ 50,000 for one year) A/c	5,000	
			Dec.31	By Balance c/d	38,500	
		51,750			51,750	
2022						
Jan.1	To Balance b/d	38,500				

Working Note:

(1) Calculation of Loss on sale of 1/3 of the Machinery

	₹	₹
Cost of Machinery (30000 × 1/3)		10,000
Less: Depreciation for 2019 for 9 months	750	
Depreciation for 2020	1,000	
		1,750
Written down value of Machinery 1-1-2021		8,250
Less: Amount realized		3,000
Loss transferred to profit and loss A/c		5,250

Illustration 48.

On July 1, 2018 Granites Ltd. purchased second hand machine for ₹40,000 and reconditioned the same by spending ₹6,000. On January 1, 2019 a new machine was purchased for ₹24,000. On June 30, 2020 the machine purchased on January 1, 2019 was sold for ₹16,000 and another machine was installed at a cost of ₹30,000.

The company writes off 10% on original cost every year on March 31. Show the Machinery account update.

Solution:

Dr.		Machinery Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
1-7-18	To Bank (₹40,000 + ₹6,000)	46,000	31-3-19	By Depreciation A/c $\text{₹}46,000 \times \frac{9}{20} \times \frac{10}{100} = 3,450$	
1-1-19	To Bank	24,000		$\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100} = 600$	4,050
			31-3-19	By Balance c/d	65,950
		70,000			70,000
1-4-19	To Balance b/d	65,950	31-3-20	By Depreciation A/c (on ₹70,000 at 10%)	7,000
			31-3-20	By Balance c/d	58,950
		65,950			65,950
1-4-20	To Balance b/d	58,950	30-6-20	By Bank (Sale of Machinery)	16,000
30-6-20	To Bank	30,000	30-3-21	By P & L A/c (1)	4,400
			31-3-21	By Depreciation (2)	7,450
			31-3-21	By Balance c/d	61,100
		88,950			88,950
1-4-21	To Balance b/d	61,100			

Working Notes:**1. Calculation of Loss on sale of machinery:**

Particulars	₹	₹
Cost of Machinery on 1-1-2019		24,000
Less: Depreciation upto 31-3-2019 ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)		
Less: Depreciation upto 31-3-2020 (on ₹24,000 at 10%)		
Less: Depreciation till the date of sale of machinery i.e. (30-6-2020) ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)		
Less: Amount realized on sale of machinery		
Loss on sale of machinery		4,400

2. Calculation of depreciation on the balance of machinery form 1-4-2014 to 31-3-2015:

Particulars	₹
Depreciation on the machinery sold for 3 months form 1-4-2020 to 30-6-2020 (date of sale) ($\text{₹}24,000 \times \frac{3}{12} \times \frac{10}{100}$)	600
On ₹46,000 at 10%	4,600
On ₹30,000 at 10% for 9 months ($\text{₹}30,000 \times \frac{9}{12} \times \frac{10}{100}$)	2,250
	7,450

Illustration 49.

A company purchased some machineries for ₹1,00,000 on 1st April, 2017. It charges depreciation @ 10% p.a. on reducing balance method every year. On 30th September, 2021 a part of machinery was sold for ₹14,000, the original cost of the machine was ₹20,000. Calculate the profit or loss on sale of machinery.

Solution:

Particulars	₹	₹
Original cost of the machines as on 1.4.2017		20,000
(-) Depreciation for the year 2017-18	2,000	
2018-19	1,800	
2019-20	1,620	
2020-21	1,458	
2021-22	656	(7,534)
Written down value as on 30-9-2021		12,466
Sale price		14,000
Profit on sale of machinery		1,534

Illustration 50.

On 1.1.2019 a machine was purchased for ₹ 1,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2021.

Solution:

Year	Opening Book Value (₹)	Rate	Depreciation (₹)	Closing Book Value (₹)
2019	1,50,000	10%	15,000	1,35,000
2020	1,35,000	10%	13,500	1,21,500
2021	1,21,500	10%	12,150	1,09,350

Note: Cost of the machine (i.e. Opening Book Value for the year 2019)

= Cost of Purchase + Cost of Installation

= ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

Illustration 51.

A Manufacturing concern whose books are closed on 31st March, Purchased Machinery for ₹ 1,50,000 on 1st April 2017. Additional machinery was acquired for ₹ 40,000 on 30th September, 2018 and for ₹ 25,000 on 1st April, 2020. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2018, was sold for ₹ 34,000 on 30th September, 2020.

Give the Machinery Account for the year ending 31st March, 2021 taking into account depreciation at 10% per annum on the written-down value.

Solution:

Dr.			Machinery Account			Cr.		
Date	Particulars	₹	Date	Particulars	₹			
2017 April	To Bank	1,50,000	Mar. 31	By Depreciation	15,000			
				By Bal. c/d	1,35,000			
		1,50,000			1,50,000			
2018 April 1	To Bal. b/d	1,35,000	2019 Mar. 31	By depreciatio (13,500+2,000)	15,500			
Sept. 30	To Bank	40,000		By Bal. c/d	1,59,500			
		1,75,000			1,75,000			
2019 Apr.1	To Bal B/d	1,59,500	Mar. 31	By Depreciatio (12,150+3,800)	15,950			
				By Bal. c/d	1,43,550			
		1,59,500			1,59,500			
2020 April 1	To balance b/d	1,43,550	2020 Sept. 30	By Depreciation A/c	1,710			
	To Bank (additions)	25,000		By Bank A/c	34,000			
2020 Sept. 30	To P & L A/c (profit on sale of machinery) (₹ 34,000 - ₹ 32,490)	1,510	2021 Mar. 31	By depreciation (10,935+ 2,500)	13,435			
				By Balance c/d	1,20,915			
		1,70,060			1,70,060			
2021 April	To Bal. b/d	1,20,915						

Calculation of profit on sale of machinery:

Particulars	₹	₹
Cost of machinery on 30-9-2018		40,000
Less: Depreciation for 2018-2019 (i/1 year)	2,000	
2019-20	3,800	
2020-21 (1/2 year)	1,710	
		7,510
		32,490
Less: Amount realized on sale of machinery		34,000
Profit on sale of Machinery		1,510

Illustration 52.

One lathe machine whose original value was ₹1,20,000 on 1.4.2019, being the date of installation was sold on 30.9.2021 for ₹1,00,000. Depreciation is charged at the rate of 10% on reducing balance. Show machinery account and assets disposable account.

Solution:

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particular	₹
2019 Apr. 1	To Balance b/d	1,20,000	2020 Mar 31	By Depreciation A/c (1,20,000*10%)	12,000
			Mar 31	By Balance c/d	1,08,000
		1,20,000			1,20,000
2020 Apr. 1	To Balance b/d	1,08,000	2021 Mar 31	By Depreciation A/c (1,08,000*10%)	10,800
			Mar 31	By Balance c/d	97,200
		1,08,000			1,08,000
2021 Apr. 1	To Balance b/d	97,200	Sep 30	By Machinery disposal A/c	97,200
		97,200			97,200

Dr. Machinery Disposal Account Cr.

Particular	₹	Particular	₹
To Machinery A/c	97,200	By Bank A/c	1,00,000
To Profit and Loss A/c (profit on sale of Machinery)	7,660	By Depreciation A/c (1.4.08-30.9.15)	4,860
	1,04,860		1,04,860

Accounting Treatment of Bad Debts and Provision for Doubtful Debts

1.10

⦿ Concept of Provisions

A provision is defined as a charge against profit for the purpose of providing for any liability or loss. The anticipated liability or loss is expected but may or may not be ascertained with reasonable accuracy. It is an internal non-cash expense. If the amount of a known liability or loss can be ascertained with substantial accuracy, it should be treated as a liability and not a provision. A provision is created for any of the following purposes:

- a) For liabilities and charges (e.g., provision for taxation, provision for sales tax etc.);
- b) Valuation adjustment for fixed assets (e.g., provision for depreciation);
- c) Valuation adjustment for current assets (e.g., provision for doubtful debts).

⦿ Credit Sales, Bad Debt, Doubtful Debt

Organisations are often found to sell goods on credit. This is because credit sales attract more buyers as they need not to pay for the goods immediately; rather, they get an additional period for the paying their dues. This period is known as credit period which may range from a few days to a few months depending upon the contractual terms. Thus, on any reporting date, there remains amount receivable from customers or debtors. This is known as debt.

On the basis of the chances of collection from the debtors, debts may be classified into the following three categories: Good Debts, Bad Debts and Doubtful Debts.

Good Debts: This represents the debts which are likely to be realised in full.

Bad Debt: This represents the debt which are confirmed to be uncollectible or irrecoverable. This is a confirmed loss.

Doubtful Debt: This represents the debt the collectability of which is not certain due to factors such as the customer's becoming insolvent.

⦿ Provision for Doubtful Debt

Since, bad debt is a confirmed loss, the same is charged to Profit and Loss A/c along with a reduction of the receivables (i.e., Debtors). However, as doubtful debts are not confirmed loss, they cannot be debited to Profit and Loss A/c until they are confirmed to be so. Therefore, this is an anticipated liability or loss which is expected but not ascertainable with reasonable accuracy on the date of reporting. Hence, it requires a provision. Such a provision also justifies the conservatism principle which advocates providing for all possible losses.

Hence, Provision for Doubtful Debt is the amount charged against the profit by an entity to provide for the possible collection loss from customers.

⊙ Accounting for Bad Debt and Doubtful Debt

There are two alternative methods for accounting of bad debt and doubtful debt.

I. First Method

Under this method, a Provision for Doubtful Debt is opened and all bad debts are adjusted against the Provision for Doubtful debt A/c. The accounting entries are:

- a) For bad debt after Trial Balance

Bad Debt A/c Dr.
 To Sundry Debtors A/c

- b) For writing off the bad debt to Provision for Doubtful Debt A/c

Provision for Doubtful Debt A/c Dr.
 To Bad Debt A/c

- c) For creating necessary provision at the end of the year

Profit and Loss A/c Dr.
 To Provision for Doubtful Debt A/c

Note: The amount to be provided is created as follows:

Particulars	₹
Closing provision required #	***
Add: Bad Debt written off (total)	***

Less: Provision at the beginning	***
Amount to be charged to P/L A/c	***

Provision is calculated on the balance of sundry debtors after adjusting bad debts (after Trial Balance)

II Second Method

Under this method, all bad debts are written off to Profit and Loss A/c at the end of the year. The difference between Opening and closing provision is adjusted through Profit and Loss A/c. In other words, if the closing provision required is more than the opening provision, additional provision is created and charged to P/L A/c and vice-versa. The accounting entries are:

- a) For bad debt after Trial Balance

Bad Debt A/c Dr.
 To Sundry Debtors A/c

- b) For writing off the bad debt to Profit and Loss A/c

Profit and Loss A/c Dr.
 To Bad Debt A/c

c) For creating necessary provision at the end of the year

i) When Closing Provision > Opening Provision

Profit and Loss A/c Dr.

 To Provision for Doubtful Debt A/c

ii) When Closing Provision < Opening Provision

Provision for Doubtful Debt A/c Dr.

 To Profit and Loss A/c

Consider the following illustrations.

Note: Recovery of Bad Debt

Bad debt written off in any earlier year(s), if recovered during the current year) is directly credited to Profit and Loss A/c.

Note: Presentation of Provision for Doubtful Debt

The Provision for Doubtful Debt is shown as a deduction from the Sundry Debtors in the Balance Sheet of the entity.

Illustration 53.

The Balance Sheet of X as on 31.12.2019 included the following items:

Particulars	₹
Sundry Debtors	98,000
Less: Provision for bad debts	2,450
	95,550

At the end of the following financial years, the gross amount of Debtors (before deducting a provision) were as under:

As on 31.12.2020—₹94,000; As on 31.12.2021—₹1,02,000.

On each of these years there was a provision for bad debts calculated on the same percentage basis as on 31.12.2019.

The actual amount of bad debts written off from Debtors Accounts over those periods were:

For the year ended 31.12.2020—₹2,600; For the year ended 31.12.2021—₹2,300.

You are required to prepare Bad Debts Account and Provision for Doubtful Debts Account for the years 2020 and 2021 (as per Method 1 and Method 2).

Solution:**Under Method 1****In the books of X**

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2019 Dec. 31	To Sundry Debtors A/c	2,600	2019 Dec. 31	By Provision for Doubtful Debts A/c	2,600
2020 Dec. 31	To Sundry Debtors A/c	2,300	2020 Dec. 31	By Provision for Doubtful Debts A/c	2,300

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2019 Dec. 31	To Bad Debts A/c	2,600	2019 Jan. 1	By Balance b/d	2,450
	To Balance c/d (2.5% on ₹94,000)	2,350	Dec. 31	By Profit and Loss A/c	2,500
		4,950			4,950
2020 Dec. 31	To Bad Debts A/c	2,300	2020 Jan. 1	By Balance b/d	2,350
	To Balance c/d (2.5% on ₹1,02,000)	2,550	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,500
		4,850			4,850
			2021 Jan. 1	By Balance b/d	2,550

Note: Percentage of provision to be created = $(2,450/98000 \times 100) \% = 2.5\%$

Under Method 2**In the books of A**

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 Dec. 31	To Sundry Debtors A/c	2,600	2020 Dec. 31	By Profit and Loss A/c	2,600
2021 Dec. 31	To Sundry Debtors A/c	2,300	2021 Dec. 31	By Profit and Loss A/c	2,300

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 Dec. 31	To Profit and Loss A/c	100	2020 Jan. 1	By Balance b/d	2,450
	To Balance c/d (2.5% on ₹94,000)	2,350	Dec. 31		
		2,450			2,450
2021 Dec. 31	To Balance c/d (2.5% on ₹1,02,000)	2,550	2021 Jan. 1	By Balance b/d	2,350
			Dec. 31	By Profit and Loss A/c (Balancing figure)	200
		2,550			2,550
			2022 3 Jan. 1	By Balance b/d	2,550

Note: Percentage of provision to be created = $(2,450/98000 \times 100) \% = 2.5\%$

⊙ Discount Allowed and Provision for Discount on Debtors

It is a common practice of the entities to allow cash discount to its customers for prompt settlement of receivables. Discount allowed during the year is deducted from Debtors and the same is debited to Profit and Loss A/c as an expense. However, for any discount expected to be allowed on the balance amount of receivable, it would be prudent to create a provision so that the profit is not inflated. This provision is known as Provision for Discount on Debtors.

⊙ Accounting for Discount Allowed and Provision for Discount on Debtors

The accounting for Discount Allowed and Provision for Discount on Debtors is similar to what has been discussed in case of Bad Debt and Provision for Doubtful Debt.

Note: Provision for discount on debtors is calculated on the balance of sundry debtors after adjusting bad debts (after Trial Balance), provision for doubtful debts and discount allowed.

Illustration 54.

Following are the balances taken from the Trial Balance of a trader as on 31.12.2021.

Particulars	Dr	Cr.
	₹	₹
Sundry Debtors	1,00,000	
Bad debts	7,000	
Discount allowed	3,000	
Provision for Doubtful debts		12,000
Provision for discount on Debtors		6,000

You are required to prepare Bad Debts Account, Discount Allowed Account, Provision for Doubtful Debts Account and Provision for Discount on Debtors Account. Also, show how they appear in the Profit and Loss Account and in the Balance Sheet, after considering the following:

- Further bad debts and discount allowed are ₹3,000 and ₹2,000 respectively;
- Provision for bad debts and provision for discount on Debtors to be created @ 10% and @ 5% respectively. (Under Method 1 and 2)

Solution:

Under Method 1

In the books of the Trader

Dr.			Cr.		
Bad Debts Account					
Date	Particulars	₹	Date	Particulars	₹
2021 Dec. 31	To Sundry Debtors A/c	7,000	2020 Dec. 31	By Provision for Bad Debts A/c	10,000
	To Sundry Debtors A/c	3,000			
		10,000			10,000

Dr.		Discount Allowed Account			Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2021 Dec. 31	To Sundry Debtors A/c	3,000	2021 Dec. 31	By Provision for Discount on Debtors A/c	5,000	
	To Sundry Debtors A/c	2,000				
		5,000			5,000	

Dr.		Provision for Doubtful Debts Account			Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2021 Dec. 31	To Bad Debts A/c	10,000	2021 Jan. 1	By Balance b/d	6,000	
	To Balance c/d	9,500	Dec. 31	By Profit and Loss A/c (Balancing figure)		
	(10% on ₹95,000)	19,500			19,500	

Dr.		Provision for Discount on Debtors Account			Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2021 Dec. 31	Flo Discount Allowed A/c	5,000	2021 Jan. 1	By Balance b/d	6,000	
	₹(3,000 + 2,000) To Balance c/d	4,275	Dec. 31	By Profit and Loss A/c	3,275	
	(5% on ₹85,500)	9,275		(Balancing figure)	9,275	

Dr.		Profit and Loss Account for the year ended 31st December, 2021 (includes)			Cr.	
Particulars		₹	Particulars		₹	
To Provision for Doubtful Debts A/c		7,500				
To Provision for Discount on Debtors A/c		3,275				

Balance Sheet as at 31st December, 2021 (includes)

Liabilities	₹	Assets	₹	₹
		Sundry Debtors (Note 3)	95,000	
		Less: Provision for Doubtful Debts	9,500	
			85,500	
		Less: Provision for Discount on Debtors	4,275	
				81,225

Solution:

Under Method 2

In the books of the Trader

Dr.		Bad Debts Account			Cr.	
Date	Particulars	₹	Date	Particulars	₹	
2021 Dec. 31	To Sundry Debtors A/c	7,000	2021 Dec. 31	By Profit and Loss A/c	10,000	
	To Sundry Debtors A/c	3,000				
		10,000			10,000	

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2021 Dec. 31	To Sundry Debtors A/c	3,000	2021 Dec. 31	By Profit and Loss A/c	5,000
	To Sundry Debtors A/c	2,000			
		5,000			5,000

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2021 Dec. 31	To Profit and Loss A/c (b. f)	2,500	2021 Jan. 1	By Balance b/d	12,000
	To Balance c/d (10% on ₹95,000)	9,500			
		12,000			12,000

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2021 Dec. 31	To Profit and Loss A/c (b. f)	1,725	2021 Jan. 1	By Balance b/d	6,000
	To Balance c/d (5% on ₹85,500)	4,275			
		6,000			6,000

Dr. Profit and Loss Account for the year ended 31st December, 2021 (includes) Cr.

Particulars	₹	Particulars	₹
To Bad Debt	10,000	By Provision for Doubtful Debt	2,500
To Discount Allowed	5,000	By Provision for Discount on Debtors	1,725

Balance Sheet as at 31st December, 2021 (includes)

Liabilities	₹	Assets	₹	₹
		Sundry Debtors (Note 3)	95,000	
		Less: Provision for Bad Debts	9,500	
			85,500	
		Less: Provision for Discount on Debtors	4,275	
				81,225

Working Notes:

- Provision for bad debts and provision for discount on debtors appearing in the Trial Balance represent opening provisions.
- Bad debts are increased to ₹10,000 (₹7,000 + ₹3,000) and discount allowed to ₹5,000 (₹3,000 + ₹2,000).

3. Following are the required Journal Entries.

Bad Debts Account	Dr.	₹3,000	
			₹3,000
To Sundry Debtors Account			
Discount Allowed Account	Dr.	₹2,000	
			₹2,000
To Sundry Debtors Account			

4. The closing balance of sundry debtors becomes ₹95,000 [₹(1,00,000 -3,000 -2,000)].

5. Provision for discount on debtors is to be created @ 5% on (₹95,000 - ₹9,500) = ₹85,500.

Exercise

A. Theoretical Questions

⊙ Multiple Choice Questions (MCQ)

1. The revenues and expenses of a company are displayed in which statement?
 - (a) Balance Sheet
 - (b) Cash Flow Statement
 - (c) Income Statement
 - (d) Periodicity
2. The main Purpose of Financial Accounting is?
 - (a) To Provide financial information to shareholders
 - (b) To maintain Balance Sheet
 - (c) To minimize taxes
 - (d) To keep track of liabilities
3. Accounting provides information on
 - (a) Cost and income for managers
 - (b) Company's tax liability for a particular year
 - (c) Financial conditions of an institutions
 - (d) All of the above
4. The determination of expenses for an accounting period is based on the concept of
 - (a) Objectivity
 - (b) Materiality
 - (c) Matching
 - (d) Periodicity
5. Accounting does not record non-financial transactions because of
 - (a) Entity Concept
 - (b) Accrual Concept
 - (c) Cost Concept
 - (d) Money Measurement Concept
6. Provision for bad debt is made as per the
 - (a) Entity Concept
 - (b) Conservatism Convention
 - (c) Cost Concept
 - (d) Going Concern Concept

7. Fixed Assets and Current Assets are categorized as per concept of
 - (a) Separate Entity
 - (b) Going Concern
 - (c) Consistency
 - (d) Time period
8. Omission of paise and showing the round figures in Financial Statements is based on
 - (a) Conservatism Concept
 - (b) Consistency Concept
 - (c) Materiality Concept
 - (d) Realization Concept
9. P & L Account is prepared for period of one year by following
 - (a) Consistency Concept
 - (b) Conservatism Concept
 - (c) Accounting Period Concept
 - (d) Cost Concept
10. An expenditure is capital in Nature when
 - (a) The receiver of the amount is going to treat it
 - (b) It increase the quantity of fixed assets for the purchase of fixed assets
 - (c) It is paid as interests on loans for the business
 - (d) It is maintains a fixed assets
11. Capital expenditures are recorded in the
 - (a) Balance Sheet
 - (b) Profit and Loss A/c
 - (c) Trading A/c
 - (d) Manufacturing A/c
12. Which of the following transaction is of capital nature
 - (a) Purchases of a truck
 - (b) Replacement of old trucks
 - (c) Cost of repairing of truck
 - (d) All of the above
13. ₹5,000 incurred for up gradation of computer by installation of 128 MB Ram is
 - (a) Capital Expenditure
 - (b) Deferred Revenue Expenditure

- (c) Revenue Expenditure
 - (d) None of the above
14. Entrance fee of ₹ 20,000 received by a club is a
- (a) Capital Receipts
 - (b) Revenue Receipt
 - (c) Capital Expenditure
 - (d) Revenue Expenditure
15. Life membership fees received by a club is a
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) Capital Receipt
16. Cost of goods purchased for resale is an example of
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
17. Import duty of raw material purchased
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
18. Received from Soloman & co., an invoice for ₹ 1,500 for repairs to factory walls
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These
19. Compensation received from government for compulsory acquisition of land
- (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) None of These

20. All revenue receipts and expenditures are shown in
- (a) Balance Sheet
 - (b) Trading and Profit and Loss A/c
 - (c) Cash Flow Statement
 - (d) Statement of Affairs
21. A bad debt recovered during the year will be
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Capital Receipt
 - (d) Revenue Receipt
22. Insurance claim received on account of machinery damaged completely by fire is
- (a) Capital Receipt
 - (b) Revenue Receipt
 - (c) Capital Expenditure
 - (d) Revenue Expenditure
23. Amount of ₹ 5,000 spent as lawyers' fees to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditures
 - (d) None
24. Money spent ₹ 10,000 as travelling expenses of the directors on trips abroad for purchase of capital assets is
- (a) Capital Expenditure
 - (b) Revenue Expenditure
 - (c) Deferred Revenue Expenditures
 - (d) None
25. Nominal Account represents
- (a) Profit & gain
 - (b) Loss/Expenses
 - (c) None
 - (d) Both (a) and (b)

26. S.B.I Account is a ...
- (a) Nominal
 - (b) Artificial Personal Account
 - (c) Representative Personal Account
 - (d) None
27. The process of recording business transactions in a book of original entry is known as
- (a) Journal
 - (b) Balance
 - (c) posting
 - (d) none
28. Prepaid rent is a
- (a) Nominal A/c
 - (b) Representative Personal A/c
 - (c) Tangible Assets A/c
 - (d) None
29. In an Account if debit > credit side, the balance is known as the
- (a) Negative balance
 - (b) Debit balance
 - (c) Positive balance
 - (d) Credit balance
30. A sale of goods to Ram for cash should be debited to:
- (a) Ram
 - (b) Cash
 - (c) Sales
 - (d) Capital
31. A withdrawal of cash from business by the proprietor should be credited to
- (a) Drawing A/c
 - (b) Capital A/c
 - (c) Cash A/c
 - (d) Purchase A/c
32. Rent Account is
- (a) Personal
 - (b) Real

- (c) Nominal
 - (d) None
33. Ledger contains various _____ in it
- (a) Transactions
 - (b) Entries
 - (c) Accounts
 - (d) None
34. The process of transfer of entries from day book to ledgers is called _____
- (a) Simple posting
 - (b) Journal posting
 - (c) Transaction
 - (d) Ledger posting
35. The rent paid to landlord is credited to
- (a) Landlord's A/c
 - (b) Rent A/c
 - (c) Cash A/c
 - (d) None
36. Which financial statement represents the accounting equation-
Assets = Liabilities + Owner's equity:
- (a) Income Statement
 - (b) Statement of Cash flows
 - (c) Balance Sheet
 - (d) None
37. The debts written off as bad, if recovered subsequently are
- (a) Credited to Bad Debts Recovered A/c
 - (b) Credited to Trade Receivables Account
 - (c) Debited to Profit and Loss Account
 - (d) None
38. A trial balance will not balance if _____
- (a) correct entry is posted twice
 - (b) The purchase on credit basis is debited to purchases and credited to cash
 - (c) ₹ 500 cash payment to creditors is debited to creditors for ₹ 50 and credited to cash as ₹ 500
 - (d) None of the above

39. A Trial Balance shows
- (a) Honesty of accountants
 - (b) Accuracy of account
 - (c) Only arithmetical accuracy of accounts
 - (d) None of these
40. The process of recording business transactions in a book of original entry is known as
- (a) Journal
 - (b) Balance
 - (c) Posting
 - (d) none
41. In an Account if debit > credit side, the balance is known as the
- (a) Negative balance
 - (b) Debit balance
 - (c) Positive balance
 - (d) Credit balance
42. Ledger contains various _____ in it
- (a) Transactions
 - (b) Entries
 - (c) Accounts
 - (d) None
43. The process of transfer of entries from day book to ledgers is called _____
- (a) Simple posting
 - (b) Journal posting
 - (c) Transaction
 - (d) Ledger posting
44. A Ledger is also called
- (a) Book of Original entry
 - (b) Book of Primary entry
 - (c) Book of Final entry
 - (d) None of the above
45. Whenever errors are noticed in the accounting records, they should be rectified _____
- (a) At the time of preparation of Trial Balance
 - (b) without waiting the accounting year to end

- (c) After the preparation of Final Accounts
 - (d) in the next accounting year
46. A Trial Balance will not tally if ___
- (a) correct journal entry is posted twice
 - (b) credit purchase debited to purchases and credited to cash
 - (c) ₹5,000 cash paid to creditors is debited
 - (d) none of the above to creditors for ₹500 and credited to cash as ₹5,000
47. Sales of Shyam of ₹ 500 not recorded in the books would affect ___
- (a) Shyam's Account
 - (b) Sales Account
 - (c) Sales Account and Shyam's Account
 - (d) Cash Account
48. Errors of carry forward from one year to another affects ___
- (a) Personal Account
 - (b) Real Account
 - (c) Nominal Account
 - (d) both (a) and (b)
49. Goods worth ₹272 returned by Lala passed through the books as ₹722. The rectification entry is
- (a) Lala will be debited by ₹450
 - (b) Lala will be debited by ₹272
 - (c) Lala will be credited by ₹722
 - (d) Lala will be credited by ₹272
50. If a receipt of ₹200 from rajesh (debtor) has not been recorded in the books the profits would show
- (a) An increase of ₹2,000
 - (b) A decrease of ₹200
 - (c) Neither an increase nor a decrease
 - (d) None of the above
51. A credit purchase of ₹950 from sudhir was recorded in purchases book as ₹590. The rectification entry is ___
- (a) purchases account will be debited by ₹360
 - (b) sudhir will be credited by ₹590
 - (c) purchases account will be debited by ₹950
 - (d) sudhir will be credited by ₹950

52. Which of these errors affect only one account
- (a) errors of casting
 - (b) errors of carry forward
 - (c) errors of posting
 - (d) All the three
53. If goods worth ₹ 1,750 returned to supplier is wrongly entered in sales returns book as ₹ 1,570, then ___
- (a) Net Profit will decrease by ₹ 3,140
 - (b) Gross Profit will increase by ₹ 3,320
 - (c) Gross Profit will decrease by ₹ 3,500
 - (d) Gross Profit will decrease by ₹ 3,320
54. Which of the following is one sided error
- (a) ₹ 500 purchase of old equipment not recorded
 - (b) ₹ 500 being expense on travelling expense in the books of account at all credited to travelling expenses
 - (c) Both
 - (d) None
55. Which of the following errors affects the agreement of a Trial Balance?
- (a) Mistake in balancing an account
 - (b) Omitting to record a transaction entirely in the subsidiary books
 - (c) Recording of a wrong entry in the subsidiary books
 - (d) Posting an entry on the correct side but in the wrong account
56. Which of these errors affect only one account
- (a) Errors of casting
 - (b) Errors of carry forward
 - (c) Errors of posting
 - (d) All the three
57. Which of these errors affect two or more accounts
- (a) Errors of complete omission
 - (b) Errors of principle
 - (c) Errors of posting to wrong account
 - (d) All the three
58. Which of the following error is an error of principle
- (a) ₹5,000 received from sham credited to Ram A/c.
 - (b) ₹5,000 incurred on installation of new plant debited to travelling expenses A/c

- (c) ₹500 paid for wages debited to Salary A/c
 - (d) ₹500 being purchase of raw material debited to Purchase A/c ₹50
59. ₹200 paid as wages for erecting a machine should be debited to
- (a) Repair A/c
 - (b) Machine A/c
 - (c) Capital A/c
 - (d) Furniture A/c
60. Bank Reconciliation Statement compares a Bank Statement with _____.
- (a) Cash Payment Journal
 - (b) Cash Receipt Journal
 - (c) Financial Statements
 - (d) BankBook
61. On the Bank Statement, cash deposited by the company is known as
- (a) Credit
 - (b) Debit
 - (c) Liability
 - (d) Expenses
62. In Bank Book, the favourable balance indicates
- (a) Credit Balance
 - (b) Debit Balance
 - (c) Bank Overdraft
 - (d) Adjusted Balance
63. In Bank Book, bank charges of ₹5,000 was not recorded. Name the correct Bank Book adjustment
- (a) It will be credited in Bank Book
 - (b) It will be debited in Bank Book
 - (c) No adjustment needed in the Bank Book
 - (d) Charges will be added to the Bank Book Balance
64. A Bank Reconciliation Statement is prepared by?
- (a) Banker
 - (b) Accountant of the business
 - (c) Auditors
 - (d) Registrar

65. When preparing a Bank Reconciliation Statement, if you start with debit balance as per Cash Book cheques sent to bank but not collected should be
- (a) Added
 - (b) Deducted
 - (c) Not required to be adjusted
 - (d) None
66. Balance as per adjusted Cash Book ₹274. Cheques not yet presented ₹730. Cheques deposited not yet recorded by bank ₹477 balance as per Pass Book will be
- (a) ₹528
 - (b) ₹527
 - (c) ₹500
 - (d) none
67. A debit balance in the depositor's Cash Book will be shown as
- (a) A debit balance on the Bank Statement
 - (b) A credit balance on the Bank Statement
 - (c) An overdrawn balance on Bank Statement
 - (d) None of the above
68. Which of these types of errors are not detected during Bank Reconciliation?
- (a) Cash embezzlement by the cashier
 - (b) cheque deposited but not credited by bank
 - (c) Casting mistakes in bank column of cash book
 - (d) Interest or commission charged by the bank but not accounted for in cash book.
69. Which of these documents is not required for Bank Reconciliation
- (a) Bank column of Cash Book
 - (b) Bank Pass Book
 - (c) Bank Statement
 - (d) Trial Balance
70. From the following details ascertain the adjusted bank balance as per Cash Book – overdraft as per cash book ₹80,000; cheque received entered twice in the Cash Book ₹5,000; credit side of bank column cast short by ₹500; bank charges amounting to ₹200 entered twice; cheque issued but dishonoured ₹2,000.
- (a) ₹80,500
 - (b) ₹85,500
 - (c) ₹85,000
 - (d) ₹83,300

71. Which of these items are taken in to consideration for preparation of adjusted Cash Book
- (a) Mistake in Cash Book
 - (b) Mistake in Pass Book
 - (c) Cheque issued but not presented for payment
 - (d) Cheques deposited but not cleared
72. When overdraft as per Cash Book is the starting point, a cheque of ₹500 deposited in to bank but not recorded in Cash Book will be:
- (a) Added by ₹500
 - (b) Deducted by ₹500
 - (c) Added by ₹1,000
 - (d) Deducted by ₹1,000
73. Bank has directly paid ₹1,250 for rent as per standing instructions. In BRS starting with Pass Book overdraft
- (a) ₹1,250 will be added to Pass Book overdraft
 - (b) ₹2,500 will be added to Pass Book overdraft
 - (c) This amount will be ignored
 - (d) ₹1,250 will be deducted from Pass Book overdraft.
74. When credit balance as per Pass Book is the starting point bank charges are –
- (a) Subtracted
 - (b) Added
 - (c) Neither of the two
 - (d) None
75. The Bank Reconciliation Statement is prepared
- (a) to rectify the mistakes in the Cash Book
 - (b) to arrive at the bank balance
 - (c) to arrive at the cash balance
 - (d) to bring out the reasons for the difference between the balance as per Cash Book and the balance as per Bank Statement
76. Benefits of preparing Bank Reconciliation Statement includes –
- (a) it brings out any errors committed in preparation
 - (b) highlights under delay in clearance of cheques of Cash Book/ Bank Pass Book deposited but not credited
 - (c) Help known actual bank balance

- (d) all the three
77. Debit balance as per Bank Pass Book mean –
- (a) surplus cash
 - (b) bank overdraft
 - (c) Terms deposits with bank
 - (d) none of these
78. Debit side of Bank Pass Book corresponds to –
- (a) credit side of Cash Book
 - (b) debit side of Cash Book
 - (c) debit side of Trial Balance
 - (d) credit side of Balance Sheet
79. Difference in bank balance as per Pass Book and Cash Book may arise on account of
- (a) Cheque issued but not presented
 - (b) cheque issued but dishonored
 - (c) cheque deposited and credited by bank
 - (d) All of (a) and (b) above
80. Trial Balance is used to check the accuracy of
- (a) Balance Sheet balances
 - (b) Ledger Accounts balances
 - (c) Cash Flow Statement balances
 - (d) Income Statement balances
81. When is Trial Balance normally prepared?
- (a) At the end of an accounting period
 - (b) At the end of a year
 - (c) Frequently during the year
 - (d) At the end of a month
82. Which of the following account with normal balance is shown at the debit side of a Trial Balance?
- (a) Creditors Account
 - (b) Unearned Income Account
 - (c) Rent Income Account
 - (d) Cash Account
83. In Trial Balance, which accounts with normal balance is recorded at the credit side?
- (a) Bank Account

- (b) Equipment Account
 - (c) Cash Account
 - (d) Accrued Expenses Account
84. A Trial Balance shows up on both the equal sides of the credit and debit column:
- (a) This means that though the arithmetic is correct,
 - (b) This means that there would be only a single there are still chances of some errors in the sheet error in the sheet
 - (c) This means that there would be more than one error in the sheet
 - (d) This means that there is no error in the sheet
85. Depreciation refers to the process of ____.
- (a) Asset valuation
 - (b) Allocation of cost of the assets over the period of its life
 - (c) verification of assets
 - (d) increasing or decreasing the value of asset
86. In case the depreciable assets are revalued, the provision for depreciation is based on
- (a) market value of the assets
 - (b) historical cost of assets
 - (c) depreciated value of the assets
 - (d) The revalued amount over the estimate of the remaining useful life of such asset
87. Which of the following is the internal causes for depreciation?
- (a) wear and tear
 - (b) depletion or exhaustion
 - (c) both (a) & (b)
 - (d) none of the above
88. Which are the methods of depreciation prescribed by the income tax act ____
- (a) Straight Line and Annuity Method
 - (b) Sinking Fund and Double Declining Method
 - (c) Equal Installment and Written Down Value Method
 - (d) Production Hour and Sum of Year's Digit Method
89. Depreciation is not provided for which of the following asset?
- (a) goodwill
 - (b) land
 - (c) inventory of goods

- (d) both (b) & (c)
90. Obsolescence means decline in the value due to
- (a) physical wear and tear
 - (b) efflux of time
 - (c) fall in market price
 - (d) innovations and inventions
91. The Depreciation Account is closed at the end of the year by transfer to the
- (a) General Reserve A/c
 - (b) Profit and Loss A/c
 - (c) Provision for Depreciation A/c
 - (d) Fixed Asset A/c
92. Which of the following is an external cause for depreciation
- (a) Obsolescence
 - (b) time element
 - (c) abnormal occurrences
 - (d) all of the above
93. Accumulated depreciation is an example of
- (a) A liability
 - (b) An expense
 - (c) An income
 - (d) An unrecorded revenue
94. Purchase price of machine ₹ 8,90,000, freight and cartage ₹ 7,000, installation charges ₹ 30,000, Insurance charges ₹ 20,000, residual value is ₹ 40,000, estimated useful life 5 years. Calculate the amount of annual depreciation under straight line method?
- (a) ₹ 1,77,400
 - (b) ₹ 1,81,400
 - (c) ₹ 1,97,400
 - (d) ₹ 1,77,900
95. Depreciation of a ten-year lease is best done on the method
- (a) WDV
 - (b) SLM
 - (c) Annuity method

- (d) both (a) & (b)
96. Original cost is ₹1,50,000 residual value is 10,000, depreciation for 3rd year @ 10% p.a. under WDV method____
- (a) ₹14,000
(b) ₹12,150
(c) ₹11,340
(d) ₹12,240
97. For charging depreciation, on which of the following assets, the depletion method is adopted?
- (a) Plant & Machinery
(b) Land & Building
(c) Goodwill
(d) Wasting assets like mines and quarries
98. The value of an asset after deducting depreciation from the historical cost is known as
- (a) Fair Value
(b) Market Value
(c) Net Realizable Value
(d) Book Value
99. If the original cost of the machine = ₹1,00,000, life = 5 years residual value = ₹2,000. If the depreciation for 4th year as per SLM is ₹19,600, then the rate of depreciation p.a. is
- (a) 10%
(b) 15%
(c) 20%
(d) 5%
100. To write off bad debt, following entry is passed:
- (a) Provision for bad debts debit: Debtors credit
(b) Provision for bad debts debit: Bad debts credit
(c) Bad debts debit: Debtors credit
(d) none of the above
101. A recovery of bad debt
- (a) increases net income
(b) decreases net income
(c) increases gross profit and net income

- (d) None of the above
102. Provision for discount allowed on outstanding debtors balances should be calculated, at an appropriate rate, on _____
- total debtors
 - total debtors net of any bad debts written off
 - total debtors less. total creditors
 - total debtors net of any bad debts written off and after deducting the cumulative amount of any provision for doubtful debts
103. Bad Debts are recorded on which accounting principle:
- Going Concern
 - Substance Over Form
 - Prudence
 - None of the above
104. Provisions are
- External Transactions
 - Internal Transactions
 - Either (a) or (b)
 - None of the above

⊙ **State True or False**

- Accounting is the 'language of business'.
- 'Profit/loss' is the core accounting measurement.
- Accounting Standards are Institutional Framework.
- The Schedules of the Companies Act also provide important guidelines on the form and contents of Financial Statements.
- Consistency is one of the accounting concepts.
- Accounting is concerned with both monetary and non-monetary transactions.
- Joint venture follows the Going Concern Concepts.
- An expenditure is revenue in nature, when it benefits the current period.
- Paper purchased for use as stationery is Capital Expenditure.
- Purchase of machinery for sale is Revenue Expenditure.
- Gratuity and pension paid to employees after retirement is Deferred Revenue Expenditure.
- A bad debt recovered during the year is Revenue Receipt.
- Freight paid on purchase of machinery is to be treated as Revenue Expenditure.
- Repainting of building done every 3 years is "Revenue Expenditure".

15. Premium received on issue of share is Capital Profit.
16. A motor truck costing ₹15,000 and standing in the books at ₹7,250 was sold for ₹1200. “Capital Loss ₹4,750 & Capital Expenditure ₹1200”.
17. A motor car which was purchased for ₹20,000 and had its book value ₹12,000 was sold for ₹17,000. The capital profit will be “₹5000”.
18. Ram has assets of ₹20,000 and liabilities of ₹4,000 his capital therefore would be ₹16,000.
19. Depreciation is loss.
20. Double accounting system owes its origin to Luca Pacioli.
21. Profit or loss have no effect on Net Worth.
22. Capital Account is a Real Account.
23. Trial Balance is a Final Accounts
24. Trial Balance contains the balances of only Personal and Real Accounts.
25. After preparation of ledgers, the next step is the preparation of Trial Balance.
26. Journal is the book of Final Entry.
27. Trade Discount will be entered in the book of accounts.
28. Ledger is the book of Primary Entry.
29. An entry which has more than one debit and or credit is called Simple Entry.
30. At the time of journalising, it is necessary to analyse a transaction in terms of debit and credit.
31. Narration is not necessary for each and every journal entry.
32. Posting is done in Ledger.
33. Error of commission permit the trial balance to agree
34. The discount column of the cash book is not posted is an example of error of omission
35. Full omission do not affect trial balance
36. An error in wrong casting of the sales day book will not affect the personal account of debtors
37. Mistake in balancing an account will affect the agreement of a trial balance
38. Total of purchase journal is short by `1,000 will not affect trial balance
39. Recording a transaction in a wrong book of original entry with wrong amount will affect the trial balance
40. Under casting or overcasting of a subsidiary book is an example of error of commission
41. The mistake of treating a liability as an income or vice versa will affect the trial balance
42. ₹500 purchase of old equipment not recorded in the books of account at all is an one sided error
43. Bank Reconciliation Statement is prepared by the Bank.
44. Bank Reconciliation Statement is prepared to detect the errors that take place to accounting.
45. Bank reconciliation statement is generally prepared at the end of the year.
46. Unfavourable balance as per Bank Book means overdraft balance.

47. An unpresented cheque is a cheque given to company's creditor but the creditor has not presented it for payment to your company's bank account.
48. A credit balance in the pass book indicates excess of deposits over withdrawals.
49. A bank reconciliation statement is a part of pass book.
50. Bank charges increase debit balance as per bank pass book.
51. Bank pass book is also known as bank statement.
52. Reserve bank of India prepares bank reconciliation statement.
53. Bank overdraft as per cash book means debit balance.
54. The balance of cash book shows cash in hand.
55. Cheque deposited and cleared on the same date will not affect bank and cash balance.
56. Trial balance document is required for bank reconciliation.
57. In arriving at adjusted cash balance errors in the pass book is not taken into account.
58. A Trial Balance is a list of ledger balances.
59. A Trial Balance is a statement and not an account.
60. A Trial Balance does not ensure accounting accuracy.
61. A Trial Balance is prepared only once in a year.
62. A Trial Balance is prepared before the preparation of financial statements.
63. In case of mineral resources depreciation is not provided, but depletion is charged.
64. Under straight line method the cost of the asset written off in equal proportion, during its economic life.
65. Depreciation is charged on tangible fixed assets and it is not charged on any current asset.
66. Depreciation is a process of allocation and not of valuation.
67. An asset is purchased for ₹25,000, depreciation is to be provided annually according to straight line method useful life if the asset is 10 years and scrap value is ₹5,000. The rate of depreciation is 10%.
68. If the written down value of the machine on 1-1-2021 is ₹9,72,000 what will be the value of machine on 1-1-2019. If the method is RBM and rate of depreciation is 10%. The value on 1-1-2019 is ₹12,00,000.
69. Under the RBM of depreciation, the value of machinery never comes to zero and, under SLM of depreciation the value of machinery comes to zero at the end of its useful life.
70. Original cost of a machine was ₹2,52,000. Salvage value was ₹12,000, Depreciation for 2nd year @ 10% under WDV method is ₹21,600.
71. The portion of the acquisition of cost of the asset, yet to be allocated is known as written down value.
72. Under diminishing balance method, depreciation decreases every year.
73. Discount allowed is called bad debt.
74. The amount that is not recoverable from the debtors is termed as bad debts.
75. Provision for doubtful debt is debited to Sundry debtors.
76. Provision is a charge against profit.

77. Increase in provision for doubtful debts is a gain for the firm.

● **Fill in the Blanks**

1. _____ is the discipline that incorporates certain principles or rules of accounting.
2. The _____ is a body of interrelated objectives and fundamentals.
3. It is generally assumed that the business will not liquidate in the near forcible future because of _____.
4. The capital contributed by the proprietor is treated as a liability according to _____.
5. GAAP's means _____.
6. Revenue receipts are shown in _____.
7. Any donation received for a specific purpose is a _____.
8. Capital expenditure provide _____ benefit.
9. Amount received from a bank as a midterm loan for working capital _____.
10. ₹3,500 spent on painting new factory is _____.
11. Extension to building occupied on lease for 5 years _____.
12. ₹20,000 received from an issue of further shares the expenses of issue being ₹2500 _____.
13. Taxes paid _____.
14. Revenue is generally recognized as being earned at that point of time when _____.
15. Capital receipts are shown in _____ side of Balance Sheet.
16. White washing expenses are _____.
17. ₹2,500 spent on the overhaul of Machinery purchased second hand is _____.
18. ₹1,200 spent on repairs on machinery _____.
19. Inauguration expenses incurred on the opening of new manufacturing unit in an existing business. _____.
20. Subsidy of ₹40,000 received from the government per working capital _____.
21. Cash Account is _____ account.
22. Liability Account has _____ balance.
23. Interest Account has _____ balance.
24. Opening entries are generally passed through _____.
25. Goodwill Account is a/an _____.
26. The debit balance in a Nominal Account shows _____.
27. The allowance made for prompt payment is called _____.
28. The left hand side of an account is called _____ side.
29. If the debit side of goods account exceeds the credit side the difference will be _____.
30. The balance of _____ account will be shown in the debit column of trail balance.
31. The equality of debit and credit of the _____ does not mean that the individual accounts are also accurate.

32. Trail Balance is statement which shows the _____ or the totals of all the accounts.
33. _____ lists the balance and the title of account in the ledger.
34. Closing stock appearing in the Trial Balance is shown on the _____ Balance Sheet.
35. The balance of liabilities account will be shown in the _____ of the Trial Balance.
36. Opening entries are generally passed through _____.
37. The left-hand side of an account is called _____.
38. If the debit side of goods account exceeds the credit side the difference will be _____.
39. The balance of _____ account will be shown in the debit column of Trail Balance.
40. _____ is the abbreviation used for debit.
41. The _____ is often called “the king of all books.”
42. Unintentional omission or commission of amounts and accounts in the process of recording transactions are known as _____.
43. In case trial balance does not agree difference is put to _____.
44. If an effect of an error is cancelled by the effect of some other error, it is commonly known as _____.
45. The equality of debits and credits can be tested periodically by preparing a _____.
46. It is easy to detect _____ than _____.
47. On purchase of old furniture, the amount spent on its repair should be debited to _____.
48. A credit sale wrongly passed through purchases book will _____ the Trial Balance.
49. Goods sold to Sethi for ₹ 640 was recorded in his account as ₹ 460. In the rectifying entry, Sethi's Account will be debited with _____.
50. Casting errors is an error in _____.
51. Goods sold to Busy & co on credit, worth ₹ 4,000 were not recorded in books. The rectification entry is _____.
52. Treating revenue expenses as a capital expenditure is an example of _____ errors.
53. The difference in the Trial Balance is transferred to _____ account.
54. ₹ 200 received from Smith whose account was written off as a bad debt should be credited to _____.
55. _____ amount will be credited in Gopal Account when goods purchased from Gopal for ₹ 3,600 but way recorded as ₹ 6,300.
56. Rectified entries to be passed in _____.
57. Pass Book is a copy of _____ as it appears in the ledger of the bank.
58. When money is withdrawn from the bank, the bank _____ the account of the customer.
59. Normally, the bank book shows a debit balance, Pass Book shows _____ balance.
60. When the cheques are not presented for payment, favourable balance as per the Bank Book is _____ than that of the Pass Book.
61. When a banker collects the bills and credits the account, Pass Book overdraft shows _____ balance.

62. Bank Reconciliation Statement is not a part of ____.
63. The debit side of the Pass Book was under-cast by ₹ 7,000. In the BRS, starting with Cash Book balance ____.
64. Unfavorable balance as per Bank Pass Book means which of ____.
65. Overdraft as per Cash Book means ____.
66. ____ prepares Bank Reconciliation Statement.
67. Bank balance shown in Trial Balance ____.
68. A debit balance in the depositor's Cash Book will be shown as ____.
69. The total of payment side of cash book is ₹ 700 short. If Bank Reconciliation Statement is started with Pass Book over drafts balance then : ____.
70. While preparing Bank Reconciliation Statement from debit balance of Cash Book cheques paid into bank but not yet cleared are ____.
71. Cheque of ₹ 6,250 deposited on 8.4.2021, realized on 14.4.2021. In the BRS as on 30.4.2021, starting with Cash Book balance, this item will be ____.
72. Credit balance in the Cash Book means ____.
73. When balance as per Pass Book is the starting point interest allowed by bank ____.
74. A Bank Reconciliation Statement is prepared by ____.
75. Debit balance as per Bank Pass Book means ____.
76. When debit balance as per Cash Book is the starting point unpresented cheques are ____.
77. Carriage inwards is entered into the _____ column of the Trial Balance.
78. The debit and credit columns of the Trial Balance should always be _____.
79. Ledger accounts with credit balances are placed in the _____ column of the Trial Balance.
80. Returns outwards are placed in the credit column of the Trial Balance because it has a _____ balance.
81. A Trial Balance is prepared using the information from a company's _____.
82. Depreciation means ____.
83. Amortization means ____.
84. Depreciation Accounts is _____ type of account.
85. _____ is a charge against the profits.
86. The amount of depreciation charged on a machinery will be debited to _____ account.
87. Profit on sale of machinery is _____ to P&L.
88. The amount charged to depreciation declines in ____.
89. Formula to calculate rate of depreciation under diminishing balance method ____.
90. Depreciation is a _____ item.
91. Obsolescence of a depreciable asset is caused by _____ changes.
92. In case of down ward revaluation of an asset which is for the first time revalued, the account debited is _____.

93. ____ is an expenses accruing from use of fixed assets.
94. For providing depreciation on hand tools, the appropriate method of depreciation is ____.
95. In ____ method physical wear and tear are more important than economic obsolescence.
96. Formula to calculate depreciation under straight line method ____.
97. A provision is created for valuation adjustment for _____.
98. _____ represents the debts which are likely to be realised in full.
99. Bad debt is a confirmed _____.
100. _____ represents the debt the collectability of which is not certain.
101. Provision for doubtful debt is calculated on the balance of _____ after adjusting bad debts.

⊙ Short Essay Type Questions

1. What do you mean by Accounting Cycle? Discuss its stages.
2. Write a short note on Accounting Equation.
3. Discuss the various types of accounts.
4. What do you mean by Double Entry System? State its features.

⊙ Essay Type Questions

1. State the functions of accounting.
2. Discuss the objectives of accounting.
3. Write short note on
 - (i) Conceptual Framework of Accounting
 - (ii) Legal Framework of Accounting
 - (iii) Institutional Framework of Accounting
 - (iv) Regulatory Framework of Accounting
4. Distinguish between Accounting Concepts and Accounting Conventions.
5. Write a short note on:
 - (a) Entity Concept
 - (b) Going Concern Concept
 - (c) Periodicity Concept
 - (d) Money Measurement Concept
 - (e) Accrual Concept
 - (f) Dual Aspect Concept
 - (g) Matching Concept
 - (h) Realisation Concept

- (i) Cost Concept
 - (j) Convention of Conservatism
 - (k) Convention of Consistency
 - (l) Convention of Materiality
 - (m) Convention of Full disclosure
6. State with reasons whether the following are Capital Expenditure or Revenue Expenditure:
- (i) Expenses incurred in connection with obtaining a licensee for starting the factory were ₹10,000.
 - (ii) ₹1,000 paid for removal of stock to a new site.
 - (iii) Rings and Pistons of an engine were changed at a cost of ₹5,000 to get full efficiency.
 - (iv) ₹2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
 - (v) ₹10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
 - (vi) A factory shed was constructed at a cost of ₹1,00,000. A sum of ₹5,000 had been incurred for the construction of the temporary huts for storing building materials.

B. Numerical Questions

⊙ Comprehensive Numerical Problems

1. Journalise the following transactions:

2021	Particulars	₹	2021	Particulars	₹
Jan 3	Received cash from Ram	15,000	Jan. 17	Receive from Hari	1,100
4	Purchased goods for cash	2,500	20	Bought Furniture from Ram	2,200
11	Sold goods to Hari	3,200	27	Paid rent	480
13	Paid Ramesh	1,400	30	Paid salary	1,100

[Answer: Total of Journal: ₹26,980]

2. Journalise the following transactions:

2021	Particulars	₹	2021	Particulars	₹
Jan 1	Started business with cash	50,000	Jan. 15	Paid to M/s Singh & Co.	21,000
2	Paid into bank	36,000		Discount allowed by them	1,000
3	Bought goods from M/s Singh & Co. on credit	22,000	25	Sold goods to M/s Ray & Co.	5,000
4	Purchased furniture	4,200	26	Received Cheque from M/s Sharda & co. in full settlement of amount due by them	4,560
	Purchased adding machine & typewriter (Payment in all cases made by cheque)	8,400	31	Paid for: Electric Charges	100

6	Paid for postage	215		Paid salary	1,500
8	Sold goods for cash	5,400		Paid rent by cheque	2,000
9	Sold goods on credit to M/s Sharda & co.	4,600		Drew for private use	3,500

[Answer: Total of Journal: ₹ 1,69,515]

3. Journalise the following transactions in the Books of Rama & Co.

2021	Particulars	₹	2021	Particulars	₹
Jan 1	Business started with	50,000	Jan 15	Cash paid to Z in full settlement of his account	8,800
	Cash deposited in Bank	20,000	16	Cash received from Y in full settlement of his account	24,500
	Goods purchased	10,000	20	Goods sold to B	6,000
2	Furniture purchased for cash	3,000		Goods purchased	9,000
	Office Stationary purchased for cash	2,000	25	Cash withdrawn from bank	5,000
3	Goods purchased from X	20,000		Cash paid to X	4,000
5	Goods sold to Y	25,000	28	Allowed us a discount	100
	Paid rent	1,000		Cash received from B	3,000
8	Paid for repairs	800	30	Allowed a discount	200
9	Paid for advertisement	1,500	31	Cash deposited in bank	4,000
	Cash paid to X	10,000		Cash paid for electricity	400
	discount received	50		Cash paid for Salaries	1,000
10	Good purchased from Z	9,000		Wages paid	500
	Goods purchased in cash from A	6,000		Rent paid	400

[Answer: Total of Journal: ₹ 2,25,950]

4. Prepare the Ledger account of Mr. Solkar from the following:

2021 March 1	Debit balance to his account ₹ 2,000.
3	Sold goods on credit to him worth ₹ 10,800
8	Received cash from him ₹ 12,600 and allowed discount of ₹ 200.
10	Solkar bought goods on credit ₹ 3,000.
15	Received cash from him ₹ 2,900 and allowed him discount ₹ 100
20	Purchased goods on credit from Solkar worth ₹ 2,000
25	Paid cash to Solkar ₹ 1,000
28	Returned goods to him ₹ 200.
31	Paid cash to him in full settlement of his account ₹ 780.

5. Prepare Ledger Accounts for the following transactions

Debit Balance on January 1, 2021:

Cash in Hand ₹ 8,000, Cash at Bank ₹ 25,000, Inventory of goods ₹ 20,000, Building ₹ 10,000. Trade receivables: Vijay ₹ 2,000 and Madhu ₹ 2,000

Credit Balance on January 1, 2021:

Trade Payables: Anand ₹ 5,000, Capital ₹ 55,000

Following were further transactions in the month of January, 2021:

Jan. 1 Purchased goods worth ₹ 5,000 for cash less 20% trade discount and 5% cash discount.

Jan. 4 Received ₹ 1,980 from Vijay and allowed him ₹ 20 as discount

Jan. 8 Purchased plant from Mukesh for ₹ 5,000 and paid ₹ 100 as cartage for bringing the plant to the factory and another ₹ 200 as installation charges.

Jan. 12 Sold goods to Rahim on credit ₹ 600

Jan. 15 Rahim became insolvent and could pay only 50 paise in a rupee

Jan. 18 Sold goods to Ram for cash ₹ 1,000.

6. Enter the following transactions in the subsidiary books of Soundarya Saree Shop.

2021 Aug 1	Purchased from Pathi Silk Kendra, 100 Silk sarees at ₹ 250 each.
5	Purchased from NSR and company, 200 Kanchi Silk sarees at ₹ 1,000 each
7	Sold to Kumar on account, 50 printed sarees at ₹ 300 and 100 Kanchi sarees at ₹ 1,000 each
8	Claimed for damages from Pathi Silk Kendra ₹ 500
9	Returned damaged goods to NSR and Co. 5 Kanchi sarees
12	Purchased from Sudharshan Silks 150 Mysore Silk at ₹ 250 each, 100 Handloom sarees at ₹ 750 each, less trade discount at 10%
16	Sold to Kala on account 20 printed sarees at ₹ 300 each, 25 Kanchi sarees at ₹ 1,300 each, 20 Mysore Silk sarees at ₹ 300 each, less trade discount at 5%.
20	Sold to Kusum sarees, 40 Handloom sarees at ₹ 1,000 each
21	Kumar returned, 10 printed sarees and 20 Kanchi sarees
25	Returned to Sudharshan's Silk, 25 Mysore Silk
27	Returned from Kusum sarees, 10 handloom sarees
30	Purchased from Nandi Silk, 400 Nandi brand sarees at ₹ 500 each

7. Enter the following transactions in Simple Cash Book and post them into ledger:

2021 July 1	Balance of cash in hand ₹ 15,000
8	Purchased goods for cash from X for ₹ 3,200
15	Sold goods for cash ₹ 4,800
20	Received commission ₹ 650
	Paid commission ₹ 550

31	Paid salary to the office clerk ₹1,000 and office rent ₹600
----	---

[Answer: Cash Book Balance = ₹15,100]

8. Enter the following transactions in a two (Cash & discount) Column and post them into Ledger Accounts:

2021	Particulars	₹	2021	Particulars	₹
Dec.1	Commenced business with cash	50,000	Dec.16	Paid into bank	10,000
2	Brought goods for cash	28,000	18	Cash sales	2,500
5	Received cash from Arun	2,000	20	Purchased stationery for cash	250
7	Paid cash to Sanjay	2900	23	Paid suresh cash	3900
	Discount allowed by him	100		Discount allowed	100
10	Paid wages	3000	26	Received from Rajesh	1,900
14	Received from Rajesh cash	950		Allowed him discount	100
	Allowed him discount	50	30	Paid salaries	2,000

[Answer: Cash Balance = ₹7,300, Discount = Dr. ₹150, Cr. ₹200]

9. Prepare a Three Column Cash Book from following transactions and bring down the balance for the start of next month.

2022	Particulars	₹	2022	Particulars	₹
Apr.1	Cash in hand	2,500	Apr.19	Paid into Bank	400
1	Cash at bank	10,000	23	Withdrew from Bank for private exp.	600
2	Paid into Bank	1,000	24	Received cheque from Patel	1,430
5	Bought furniture and issued cheque	2,000		Allowed him discount	20
8	Purchased goods for cash	500	26	Deposited Patel's cheque into bank	
12	Received from mohinder	980	28	Withdrew cash from Bank for the office use	2,000
14	Cash sales	4,000	30	Paid rent by cheque	800
16	Paid to Amarnath by cheque	1,450			
	Discount allowed	50			

[Answer: Cash = (Dr.) ₹7,580, Bank = (Dr.) ₹5,980, Discount = (Dr.) ₹40, Cr. ₹50]

10. Prepare a Three Column Cash Book from following transactions having cash, bank and discount columns:

2022 Apr.1	Balance of cash in hand ₹400, overdraft at Bank ₹5,000
4	Invested further capital ₹10,000 out of which ₹6,000 deposited bank
5	Sold goods for cash ₹8,000

6	Collected from Sridhar a debtor of last year ₹8,000 discount allowed ₹200
7	Paid Ramvilas, out creditor, ₹2,500, discount allowed by him ₹65
13	Commission paid to Robert our agent ₹530
14	Office furniture purchased from Keshar ₹200
17	Draw cheque for personal use ₹700
18	Collection from Atal ₹4,000; deposited in the bank on 19 th
20	Draw from bank for office use ₹500
21	Draw cheque for petty cash ₹150
29	Drew from the bank and paid salary of office staff ₹1,500
30	Deposited cash in the bank ₹10,000

[Answer: Cash in hand ₹7,870, Bank = (Dr.) ₹12,150, Discount = (Dr.) ₹200, (Cr.) ₹65]

11. Prepare Columnar Petty Cash Book on imprest system from the following particulars:

2022	Particulars	₹	2022	Particulars	₹
June 1	Received for petty cash payments	1,000	June 20	Paid for conveyance	44
2	Paid for postage	80	25	Paid for travelling expenses	160
5	Paid for stationery	50	27	Paid for postage	100
8	Paid for advertisement	100	28	Wages to office cleaner	20
12	Paid for wages	40	30	Paid for telegrams	40
16	Paid for carriage	30	30	Sent registered notice to landlord	6

[Answer: Petty Cash balance = ₹330]

12. The Bank statement of Mr. J. White dated 31.12.2021 showed a balance with his Bank of ₹924, when checked with his Cash Book the following were noted:
- During December, the Bank had paid ₹200 for a yearly contribution of Mr. White, made to a local charity, as per his standing order. This amount appeared in the Bank statement but not in the Cash Book.
 - The Bank had credited his account with ₹28 interest and had collected on his behalf ₹230 as dividends. No corresponding entries were made in the Cash Book.
 - A cheque of ₹65 deposited into the Bank on 28.12.2021 was not cleared by the Bank till after 31.12.2021.
 - A cheque of ₹150 deposited into and cleared by the Bank before 31.12.2021 was not entered in the Cash Book, through an oversight.
 - Cheques drawn by and posted to parties by Mr. White on 31.12.2021 for ₹73, ₹119 and ₹46 were presented for payment to the Bank only on 3.1.2022.

[Answer: Bank Balance as per Cash Book (Dr.) ₹ 543]

13. Mr. Suresh request you to ascertain the Bank balance as per the Pass Book for January 2021, as his cash clerk reported a figure of ₹ 11,515 (credit) as on 31.1.2021. Scrutiny revealed the following discrepancies:
- Cheques issued and deposited by the cash clerk in January 2021, were ₹ 15,000 and ₹ 7,000 respectively. However, against the above, the Bank had paid out and debited cheques worth ₹ 9,000 only and cleared and credited cheques worth ₹ 4,000 only, by 31.1.2021.
 - A customer had paid in ₹ 6,400 directly into Suresh's Bank account, the effect of which was missing in the Cash Book
 - Bank commission of ₹ 45 charged and interest earned ₹ 1,400 on investments of Mr. Suresh, where only recorded in the Pass Book.
 - Total cash withdrawals of ₹ 3,000 by self and bearer cheques for office use, were recorded erroneously as ₹ 5,000 in the Cash Book.

[Answer: Bank Balance as per Pass Book (Dr.) ₹ 1,240]

14. Based on the following information prepare a Bank Reconciliation statement as on 31st December 2021 and find the balance as per pass book:
- Bank overdraft as per cash book on 31-12-2021 ₹ 6,340.
 - Interest on overdraft for 6 months ending 31.12.2021 ₹ 160 is entered in pass book.
 - Bank charges amounted to ₹ 30 for the above periods were entered in the pass book.
 - Cheques issued but not presented upto 31.12.2021 amounted to ₹ 1168
 - Cheques sent for collection to the bank but not collected up to 31.12.2021 amounted ₹ 2,170.
 - Interest on investments collected by the bank and entered in the pass book ₹ 1200.

[Answer: Over Draft Balance as per Pass Book (Dr.) ₹ 6,332]

15. The following is a summary from Cash Book of M/s Adarsh Trading for the month of Sept 2021:

Particulars	(₹)	Particulars	(₹)
Balance b/d Receipts	1,407	Payments	15,520
	15,073	Balance c/d	960
	16,480		16,480

On investigation it was found that:

- Bank charges of ₹ 35 were not entered in the Cash Book.
- A cheques of ₹ 47 issued to supplier was entered by mistake as a receipt in the Cash Book.
- A cheques of ₹ 18 was returned by the bank marked as 'refer to drawer' but it's not entered in Cash Book.
- The balance brought forward in Sept 2020 should have been ₹ 1,470.
- Cheques paid to suppliers ₹ 214, ₹ 370 and ₹ 30 have not been presented for payment.
- Deposits of ₹ 1,542 on 30th Sept were cleared by the bank on 2nd October.
- The bank charged a cheque wrongly to Adarsh trading ₹ 72.

h) Bank statement shows overdraft of ₹ 124 as on 30th Sept 2021.

Show what adjustments will you make in the cash book and prepare a Bank Reconciliation Statement as on 30.09.2021. [Answer: Revised Cash Book Balance (Dr.) ₹ 876]

16. From the following particulars prepare a Bank Reconciliation Statement to find out the causes of difference in two balances as on August 31st, 2021 for Five Star (Pvt.) Ltd.

Particulars	(₹)
i) Bank Overdraft as per Bank Statement	17,000
ii) Check issued but not encashed during the August	2,200
iii) Dividends on shares collected by banker	2,300
iv) Interest charged by the bank recorded twice in the Bank Book	500
v) Check deposited as per Bank Statement not entered in Bank Book	3,400
vi) Credit side of the Bank column in Bank Book cast short	1,000
vii) Club dues paid by bank as per standing instruction not recorded in Bank Book	1,200
viii) Uncredited check due to outstation	3,900

[Answer: Balance as per Bank Book (Cr.) ₹ 19,300]

17. From the following particulars, you are required to find out the errors in cash book and bank statement by using missing method and prepare Bank Reconciliation Statement as on 31.12.2021, for Chand Bibi Ltd:

Particulars	(₹)
i) Bank balance overdraft as per Bank Book	80,000
ii) Cheque recorded for collection but not sent to the bank	10,000
iii) Credit side of the Bank Book cast short	1,000
iv) Premium on proprietor's Life Insurance Policy (LIP) paid on standing order	5,000
v) Bank Charges recorded twice in the Bank Book	100
vi) Customer's cheque returned by the bank as dishonored	4,000
vii) Bill Receivable collected by the bank directly on the behalf of company	20,000
viii) Cheque received entered twice in the Bank Book	6,000
ix) Cheque issued but dishonored on technical grounds	3,000
x) A cheque deposited into the bank of worth ₹ 45,000 but ₹ 8,000 cheque was not collected by bank	

[Answer: Balance as per Bank Statement (Dr.) ₹ 90,900]

18. Prepare a Trial Balance from the following information:

Particulars	(₹)
Cash A/c	9,46,400
Capital A/c	7,50,000
Loan A/c	2,50,000
Purchases A/c	51,500

Sales A/c	21,000
Bank A/c	22,400
Loss by Fire A/c	5,500
Commission Received A/c	3,500
Discount Allowed A/c	100
Loss by Theft A/c	1,000
Interest Received A/c	2,400

[Answer: Total ₹ 10,26,900]

19. Prepare a Trial Balance from the following information:

Particulars	₹
Cash A/c	34,150
Capital A/c	40,000
Purchases A/c	6700
Sales A/c	4,200
Machinery A/c	5,800
Creditors A/c	5,000
Interest Allowed A/c	150
Debtors A/c	2,000
Discount Received A/c	100
Return Inwards A/c	300
Commission Received A/c	250
Conveyance A/c	450

[Answer: Total ₹ 49,550]

20. M/s Suba Pharmaceuticals has imported a machinery on 1st July, 2018 for ₹ 1,60,000 paid custom duty and freight ₹ 80,000 and incurred erection charges ₹ 60,000. Another local machinery costing ₹ 1,00,000 was purchased on January 1, 2019. On 1st July, 2020 a portion of the imported machinery (value one third) got out of order and was sold for ₹ 34,800. Another machinery was purchased to replace the same for ₹ 50,000. Depreciation is to be calculated at 20% p.a. on straight line method. Show the machinery account for 2018, 2019 and 2020. (Accounting period January to December)

[Answer: Balance in Machinery Account ₹ 2,05,000; Loss on sale ₹ 25,200]

21. A manufacturing concern, whose books are closed on 31st March, purchased machinery for ₹ 1,50,000 on 1st April 2017. Additional machinery was acquired for ₹ 40,000 on 30th September 2018 and for ₹ 25,000 on 1st April, 2020. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2018 was sold for ₹ 34,000 on 30th September, 2020. Give the machinery account for the year ending 31st March, 2021 taking into account depreciation at 10% per annum on the written – down value.

[Answer: Balance in Machinery Account ₹ 1,20,915; Profit on sale of Machinery = ₹ 1,510]

22. A Transport company purchased 5 trucks at ₹ 2,00,000 each on April 1. 2019. The company observes calendar year as its accounting year.

On October 1, 2021 one of the trucks is involved in an accident and is completely destroyed. Insurance company pays ₹90,000 in full settlement of the claim. On the same day the company purchases an used truck for ₹1,00,000 and spends ₹20,000 on its overhauling.

Prepare truck account (in clummnar form) for the three years ending on December, 2021 if the company writes off depreciation @ 20% per annum on

Original cost method and diminishing balance method.

[Answer: Balance i) ₹4,74,000; Loss on sale of machinery ₹10,000
ii) ₹5,49,200; Loss on sale of machinery ₹25,600]

23. From the following information determine amounts to be transferred to the Profit & Loss Account (₹):

- | | |
|--|---------|
| a. Sundry Debtors as on Mar. 31, 2021 | ₹50,000 |
| b. Provisions for bad debt as on Apr. 1, 2020 | ₹4,000 |
| c. Bad debts written off during the year 2020-21 | ₹1,000 |
| d. Recovery of bad debts earlier written off | ₹1,000 |

Provision for bad debts is maintained @ 5%.

[Answer: Provision to be transferred to the Credit side of P/L A/c ₹500; Bad Debt Recovery ₹1,000]

24. The Provision for Doubtful Debts A/c shows a balance of ₹5,000 on Jan. 1, 2021. The Bad Debts during the year 2021 amounted to ₹3,000. The Sundry Debtors on Dec. 31, 2021 are ₹50,000. On Dec. 31, 2021, there is an additional Bad Debts of ₹3,000. Create a new Provision for Bad Debts @ 10% on Debtors. You are required to show how the different items will appear in the firm's Profit and Loss A/c and Balance Sheet.

[Answer: New Provision ₹4,700]

25. The Trial Balance of Mr. Y as on May 31, 2021 included the following figures (Figures in ₹):

01.06.2021	Provision for Doubtful Debts	4,000
	Provision for Discount Allowed Bad Debts written-off during the year	2,000
31.05.2022	Sundry Debtors	45,480
	Discount Allowed during the year	2,400
	Bad Debts recovered during the year	950

Write off further ₹480 (judged completely irrecoverable). Maintain the provision for doubtful debts @10% and the provision for discount allowed @ 2%.

[Answer: Provision for doubtful debt ₹4,500 and Provision for Discount on debtors ₹810]

26. How will you rectify the following errors discovered before preparation of the trial Balance?

- ₹1,000 spent for repairs of buildings has been posted to building account
- A sale of ₹730 to mohinder Singh has been entered in the Sales Book as ₹370.
- Goods worth ₹500 purchased from Bankey Lal have been omitted to be recorded in the books.
- ₹400 paid as salary to a clerk has been debited to his personal account

- e) ₹75 discount allowed by a creditor has been debited to Discount Account.
- f) The Total of Sales Book has been added ₹100 too much.
- g) Office furniture purchased for ₹1,800 has been passed through the Purchases Book.
27. Write out the journal entries to rectify the following errors using a suspense account:
- The total of discount allowed from the Cash Book for the month of December 2021 amounting to ₹350 was not posted.
 - An amount of ₹175 entered in the Sales Return Book has been posted to the debit of Ram, who had returned the goods.
 - Bad Debts aggregating to ₹250 were written off during the year in the sales ledger, but were not adjusted in the general ledger
 - Goods of the value of ₹500 returned to Shyam were entered in the Sales Day Book and posted there from to the credit of his account.
 - A sale of ₹800 made to Mohan was correctly entered in the Sales Day Book but wrongly posted to the debit of Mahesh as ₹80.
28. The debit side of the Trial Balance Showed ₹1,000 less than the credit side. The Suspense Account was debited with ₹1,000. Later on following errors were detected. Prepare Suspense Account passing the necessary rectification entries without giving narrations:
- Goods return by a customer ₹300 entered in the customer's account but not entered in the Sales Returns Account.
 - Goods sold to Mahesh on credit for ₹700 was entered in the Sales Book but not posted to his account.
 - 580 paid by Varsha traders was credited to their account ₹508.
 - ₹260 due from Dinesh was not entered in the schedule of S. Drs.
 - Purchases book was overcast by ₹188.

[Answer: Total of suspense Account = ₹1,260]

29. Following mistakes were located in the books of a concern after its books were closed and a Suspense Account was opened in order to get the Trial Balance agreed:
- Sales Day Book was overcast by ₹100.
 - A sale of ₹50 to x was wrongly debited to the account of Y.
 - General expenses of ₹18 were posted in the General Ledger as ₹80.
 - A bill receivable for ₹155 was passed through Bills Payable Book. The bill was given by P.
 - Legal expenses of ₹119 paid to Mr. Duftry were debited to his Personal Account.
 - Cash received from C. Dass has been debited to G. Dass ₹150.
 - While carrying forward the total of one page of the Purchases Book to the next, the amount of ₹1,235 was written as ₹1,325.

Find out the nature and amount of the Suspense Account and pass entries for the rectification of the above errors in the subsequent year's book.

Answer:

Multiple Choice Questions (MCQ)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
c	a	d	c	d	d	b	c	c	b	a	a	a	a	d	b	a	a	d
20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38
b	d	a	b	a	d	b	a	b	d	b	c	c	c	d	c	c	a	c
39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57
c	a	b	c	d	c	b	c	c	d	a	c	a	d	d	b	a	d	d
58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76
b	b	d	a	b	a	b	b	b	b	a	d	d	a	b	d	b	d	d
77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
b	a	d	b	a	d	d	a	b	d	c	c	d	d	b	a	a	a	b
96	97	98	99	100	101	102	103	104										
b	d	d	c	c	a	d	c	b										

State True or False

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
T	T	T	T	F	F	F	T	F	T	F	T	F	F	T	F	T	T
19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36
T	T	F	F	F	F	T	F	F	F	F	T	F	T	F	T	T	T
37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54
T	F	F	T	F	F	F	F	F	T	T	T	F	T	T	F	F	T
55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72
T	F	T	T	T	T	F	T	T	T	T	T	F	T	T	T	T	T
73	74	75	76	77													
F	T	F	T	F													

● **Fill in the Blanks**

1	Accountancy	2	Conceptual Framework
3	Going Concern Concept	4	Business Entity Concept
5	Generally Accepted Accounting Principles	6	Trading and P & L Account
7	Liability or capital receipt	8	Long period
9	Capital Receipt	10	Capital Expenditure
11	Deferred Revenue Expenditure	12	Capital receipt ₹ 20,000 and deferred revenue expenditure ₹ 2500
13	Revenue Expenditure	14	Sale is effected
15	liabilities	16	Revenue Expenditure
17	Capital Expenditure	18	Revenue Expenditure
19	Revenue Expenditure	20	Revenue Receipt
21	Real	22	credit
23	'debit or credit'	24	'General journal'
25	'intangible asset'	26	Expenditure
27	Cash Discount	28	Debit
29	Closing stock	30	Assets/Expenses
31	"Trial Balance"	32	"balances"
33	Trial Balance	34	asset side of
35	credit column	36	General Journal
37	Debit	38	Closing Stock
39	Assets/Expenses	40	Dr.
41	Ledger	42	errors.
43	Suspense Account	44	Compensating errors
45	Trial Balance	46	errors, frauds.
47	Furniture Account	48	Affect
49	₹ 180	50	totaling
51	sales account will be credited	52	principle
53	suspense	54	Bad Debts Recovered Account
55	₹ 3,600	56	Journal Proper
57	Customer Account	58	debit

59	credit	60	less
61	less	62	Cash Book
63	₹ 7,000 will be added to Cash Book balance.	64	bank overdraft and debit balance in Pass Book
65	credit balance in bank column of the Cash Book	66	Business Enterprises
67	as per Cash Book	68	A credit balance on the bank statement
69	₹ 700 will be less	70	deducted
71	ignored	72	bank overdraft
73	subtracted	74	the bank account holder
75	bank overdraft	76	added
77	debit	78	equal
79	credit	80	credit
81	ledger accounts	82	decrease in the value of an asset
83	charging a period with the proportionate cost of an intangible asset	84	Nominal
85	Provision	86	Depreciation
87	credited	88	reducing balance method
89	$\left(1 - \sqrt{\frac{R}{C}}\right)$	90	(non- cash)
91	Technological	92	Profit and Loss Account
93	Depreciation	94	Revaluation Method
95	Straight Line	96	Cost of the Asset – Estimated Scrap Value / Estimated Life Time
97	Fixed Assets	98	Good Debts
99	loss	100	Doubtful Debt
101	sundry debtors		

ACCOUNTING FOR SPECIAL TRANSACTIONS

2

This Module includes:

- 2.1 Consignment**
- 2.2 Joint Venture**
- 2.3 Bills of Exchange (excluding Accommodation Bill, Insolvency)**

ACCOUNTING FOR SPECIAL TRANSACTIONS

Module Learning Objectives:

After studying this Module, the students will be able to –

- ✦ Learn the accounting for Consignment business
- ✦ Learn the accounting for Joint Venture business
- ✦ Learn the accounting for Bills of Exchange

• Concept of Consignment

Wholesalers and Manufacturers find it quite convenient and profitable to sell goods, through an agent at home and abroad. The mode is extremely helpful when an entity wants to expand its market but does not want to incur substantial cost to build up own retail facilities. An agent sells the goods on behalf of sender of goods and charges commission. The knowledge of the agent regarding local conditions proves quite useful for increasing the sales. The person who sells the goods is called 'consignor' or 'principal', the person to whom the goods are sent is termed as 'consignee' or 'agent' and the shipment of the goods is known as consignment. Thus, a consignment may be defined as shipment of goods by a manufacturer or wholesale dealer to an agent for sale on commission basis. An agent sells the goods on account of consignor and risk is borne by the consignor. It is not transfer of ownership of goods, but only sending of goods by one person to another at a different place to be sold by the latter on behalf of the former. When the goods are sent by the consignor, it is known as outward consignment. To the consignee, it is an inward consignment. Consignee does not become the debtor for the goods received on consignment. The relationship between both the parties is that of an agent and a principal only. The goods consigned to the agent are treated as sales only when these are sold by the consignee and he becomes entitled to be reimbursed for the expenses incurred on behalf of consignor and is also entitled to receive commission for the goods sold by him.

• Parties to a Consignment

As discussed above, the parties involved in consignment business are Consignor and Consignee.

- a) **Consignor:** It is the party who sends the goods to its agent for sale of goods. The consignor is the 'principal' in the consignment business. Consignor remains the owner of the goods sent on consignment basis, till they are actually sold by the consignee.
- b) **Consignee:** It is the party to whom goods are sent on consignment basis by the consignor. It sells the goods received on consignment basis and acts as the 'agent' in a consignment relation. It is entitled to receive commission from the consignor as consideration.

• Distinction between Consignment and Sale

The following are the main points of difference between consignment and sale of goods:

- a) In case of consignment, legal ownership of goods rests with the consignor. It is only the possession of goods which is transferred to the consignee. In case of sale, the legal ownership of goods is transferred immediately from the seller to the buyer of goods.
- b) In case of consignment the relationship between the consignor and consignee is that of principal and an agent and continue till terminated, while in case of sale, the relationship between the two parties is that of buyer and seller and terminate as soon as payment is made and goods are transferred.

- c) In case of consignment, the risk of loss or damage to the goods remains with the consignor till the goods consigned are sold by the consignee. In case of sale, risk attached to the goods passes along with ownership to the buyer of goods.
- d) In consignment, the consignor usually bears the expenses incurred by the consignee in connection with the goods consigned to him. In case of sale, expenses incurred by the buyer, after its completion, will be borne by him.
- e) In consignment, 'Account Sales' is required to be submitted periodically by the consignee to the consignor. But in case sale, no 'Account sales' is required to be submitted by the buyer to the seller.
- f) In consignment, goods are sold by the consignee against commission, while in case of sale, goods are sold against price.
- g) In consignment, unsold goods with the consignee can be returned at any time if he feels that goods cannot be sold except at a loss, while in case of sale, the goods cannot be returned by the buyer after the sale is complete.

• **Operating Cycle of Consignment Arrangement**

- a) Goods are sent by consignor to the consignee.
- b) Consignor incurs expenses to send the goods.
- c) Consignee may pay some advance or accept a bill of exchange.
- d) Consignee incurs expenses for receiving, carrying/holding and finally selling the goods.
- e) Consignee maintains records of all cash and credit sale.
- f) Consignee prepares a summary of results called as Account sales.
- g) Consignor pays commission to the consignee.
- h) Consignee remits the amount to the consignor after deducting expenses incurred and commission receivable.

Note: Sometimes, the consignor may send the goods at a price higher than cost so that the consignee gets no knowledge of the real cost of goods which is confidential for the consignor. Such a price is known as Invoice Price.

• **Important Documents in a Consignment Business**

In a consignment arrangement, the following two documents are considered to be of prime importance. These are (a) Proforma Invoice and (b) Account Sales. These are discussed below.

(a) Proforma Invoice

When the goods are sent by consignor to the consignee, consignor sends a 'Proforma Invoice' in the form of an invoice to the consignee, 'Proforma Invoice' contains information related to the nature of goods, number and/ or quantity, weights, other measurements related to the goods and marked price, etc. It is to be noted that proforma invoice is only in the nature of memorandum invoice and is not a regular invoice. So, it does not make the consignee accountable to pay the amount mentioned therein. Generally, the price shown in such invoice is not the cost price but it is sometimes the selling price and sometimes the cost price plus an arbitrary percentage of profit, better known as invoice price. Following is the general format of a Proforma Invoice.

ABC Toy Merchant Proforma Invoice		
Goods sent on Consignment to: Bimal Stores 80A, Nehru Road, Guwahati – 781005. Date: March 17, 2022		
Particulars		(₹)
1,400 Toy Guns @ ₹ 200 each		2,80,000
500 Dolls @ ₹ 100 each		50,000
Charges:	₹	3,30,000
Packing	2,500	
Carriage	4,200	
Insurance	1,300	8,000
Goods despatched vide A.W.B. No. 96415 dated 18.6.2021	Total	3,38,000
E. & O.E. Ahmedabad	ABC Toy Merchant Anurag Verma <i>Partner</i>	

(b) Account Sales

This is a periodical statement prepared by consignee to be sent to the consignor giving details of all sales (cash and credit), expenses incurred and commission due for sales, goods destroyed-in-transit, or ingodown and deducting the amount of advance remitted by him. Following is the general format of an Account Sales.

Account Sales for Toys sold by Bimal Stores on behalf of ABC Toy Merchant		
Particulars	(₹)	(₹)
Gross Sale Proceeds:		
1,050 wrist watches @ ₹ 240 each	2,52,000	2,79,000
180 wall clocks @ ₹ 150 each	27,000	19,500
Less: Charges:		
Unloading & Carriage to godown	450	
Godown rent & insurance	2,600	
Selling expenses	2,500	
Commission @ 5% on ₹ 2,79,000	13,950	
Net Sale Proceeds:		2,59,500
Less: Advance (by Bank Draft No. dated)		1,00,000
		1,59,500
Less: Amount remitted (by Bank Draft No. dated)		1,00,000
Balance Due		59,500
E. & O.E. Guwahati	For Bimal Stores (Signature)	

● Type of Commission

It is the consideration for which the Consignee acts as the agent of the Consignor. Commission can be of the following types.

- a) **Ordinary Commission:** This is a fee payable by consignor to consignee for sale of goods when the consignee does not guarantee the collection of money from ultimate customer. The % of such commission is generally lower.
- b) **Del Credre Commission:** This is additional commission payable to the consignee for taking over additional responsibility of collecting money from customers. In case, the customers do not pay of the consignee takes over the loss of bad debts in his books. Although it's paid for taking over risk of bad debts that arise out of credit sales only, this commission is calculated on total sales and not on credit sales.
- c) **Over-riding Commission/Special Commission:** This is an extra commission which is paid over and above the ordinary commission. It is also referred to as Special Commission. This commission is paid when the consignee manages to sell the goods above a pre-determined selling price, or exceeds the sales target.

● Accounting for Consignment

The consignor and consignee keep their own books of accounts. The consignor generally maintains the following accounts:

- i) Consignment Account (to know the profit or loss on consignment)
- ii) Consignee Account (to know the amount due from consignee)
- iii) Goods Sent on Consignment Account (to adjust the goods sold on consignment from the main business)
- iv) Consignment Debtors Account (when goods are sold on credit and consignee is not paid any Del-credere Commission)
- v) Consignment Stock Reserve Account (to cancel the load on cost price)

On the other hand, the Consignee keeps the following accounts:

- i) Consignor Account (to know the amount due from or to consignor)
- ii) Commission Received Account (To know the commission received)
- iii) Consignment Debtors Account (To know the amount due from consignment debtors when goods are sold on credit and consignee is paid Del-credere Commission)

The journal entries under various situations are discussed below.

I. Goods sent at cost, ordinary commission, sale in cash only

Situations	Consignor's books	Consignee's books
Opening stock	Consignment A/c To Consignment Stock A/c	Dr. No Entry
On sending goods	Consignment A/c To Goods Sent on Consignment A/c	Dr. No Entry
On return of goods by consignee	Goods Sent on Consignment A/c To Consignment A/c	Dr. No Entry

On expenses for sending goods	Consignment A/c To Cash/Bank A/c	Dr.	No Entry
On consignee paying cash or accepting Bill of Exchange as advance	Cash/Bank/Bills Receivables A/c To Consignee's Personal A/c	Dr.	Consignor's Personal A/c To Cash/Bank/Bills Payable A/c
On consignor discounting the bill	Bank A/c Discount on Bill A/c To Bills Receivable A/c	Dr. Dr.	No Entry
	P/L A/c or Consignment A/c To Discount on Bill A/c	Dr.	No Entry
On expenses incurred by consignee	Consignment A/c To Consignee's Personal A/c	Dr.	Consignor's Personal A/c To Cash/Bank A/c
On consignee reporting sales	Consignee's Personal A/c To Consignment A/c	Dr.	Cash/Bank A/c To Consignor's Personal A/c
For commission	Consignment A/c To Consignee's Personal A/c	Dr.	Consignor's Personal A/c To Commission A/c
On closing stock	Stock on Consignment A/c To Consignment A/c	Dr.	No Entry
For Goods-in-transit	Goods-in-Transit A/c To Consignment A/c	Dr.	No Entry

II. Goods sent at Invoice Price

Sometimes, the consignor does not want to reveal actual price of the goods to the consignee so that he may not know the actual profit or loss being made by him on these goods. Therefore, the consignor sends the goods at a price higher than cost price, known as proforma invoice price. The consignor adds some profit margin to the cost price of the goods and prepare an invoice showing the invoice price of the goods. Thus, consignment account stands debited with the invoice price of the goods. Therefore, some adjustments are required at the end of each balancing period to ascertain the correct profit or loss on consignment. Hence, the following journal entries are required to be passed in the books of consignor.

Situations	Consignor's books	Consignee's books
Opening stock	Consignment A/c To Consignment Stock A/c	Dr. No Entry
Cancellation of load on opening stock	Consignment Stock Reserve A/c To Consignment A/c	Dr. No Entry
On sending goods at I.P	Consignment A/c To Goods Sent on Consignment A/c	Dr. No Entry
On return of goods by consignee	Goods Sent on Consignment A/c To Consignment A/c	Dr. No Entry
Cancellation of load on goods sent less return	Goods Sent on Consignment A/c To Consignment A/c	Dr. No Entry

On closing stock	Stock on Consignment A/c To Consignment A/c	Dr.	No Entry
Cancellation of load on closing stock	Consignment A/c To Consignment Stock Reserve A/c	Dr.	
For Goods-in-transit	Goods-in-Transit A/c To Consignment A/c	Dr.	No Entry
Cancellation of load on goods-in-transit	Consignment A/c To Goods-in-Transit A/c	Dr.	

Note: Valuation of Unsold Stock with Consignee

If the consignee fails to sell all the goods sent to him during the accounting period, the remaining unsold goods are treated as 'Stock Lying with Consignee' or simply, 'Consignment Stock'. Its ownership lies with the consignor, even though they lie physically with the consignee. Valuation of such consignment stock is necessary for determination of correct operating results of the consignment business. The valuation of unsold stock depends on the fact whether the goods sent have been recorded by the consignor 'at Cost' or 'at IP'.

- When goods sent at Cost:** Consignment stock is valued considering the cost of the goods sent on consignment. In addition, proportionate adjustments are required to be made for the expenses incurred by the consignor and non-recurring expenses incurred by the consignee.
- When goods sent at Invoice Price:** Consignment stock is valued considering the Invoice Price of the goods sent on consignment. Proportionate adjustments are required to be made for the expenses incurred by the consignor and non-recurring expenses incurred by the consignee on these goods. Moreover, for determination of correct operating result, the load margin on such goods needs to be adjusted.

As per AS-2, unsold stock is to be valued at 'Cost' or 'Net Realisable Value (NRV)', whichever is lower. When the NRV (i.e., Expected Selling Price Less Incidental expenses for making such sale) of the unsold stock fall below its cost, in that case the consignment statement is to be valued at the lower NRV.

- Valuation of Goods-in-Transit:** The goods which have been dispatched by the consignor, but are yet to reach the premises of the consignee are referred to as Goods-in-Transit. The ownership of such goods lies with the consignor, and at the end of an accounting period, such goods are required to be valued for the purpose of reflecting such goods in the financial statements. Such goods-in-transit are required to be valued after considering the expenses incurred by the consignor for sending such goods. It is to be noted that no expenses incurred by the consignee are to be included in valuing the same.

Illustration 1.

Ram & Co. of Calcutta consigned 50 cases of goods at ₹200 each to Nathan of Bombay. The consignor pays ₹200 for insurance and for freight ₹300. Nathan sent an account sales showing the gross proceeds at ₹24,000. The expenses paid by Nathan were dock dues ₹ 20, carriage ₹ 50 warehousing expenses ₹ 130. He sent the amount due to the consignor after deducting 4% commission. Give journal entries in the books of both the parties.

Solution:**In the Books of Ram & Co.****Journal Entries**

		Dr.	Cr.
Consignor's books		₹	₹
Consignment A/c	Dr.	10,000	
To Goods Sent on Consignment A/c			10,000
(Being the cost of 50 cases of goods @ ₹200 each consigned to consignee)			
Consignment A/c	Dr.	500	
To Cash A/c			500
(Being ₹200 for Insurance and ₹300 for freight paid)			
Nathan's A/c	Dr.	24,000	
To Consignment A/c			24,000
(Being the sales proceeds at ₹24,000)			
Consignment A/c	Dr.	200	
To Nathan's A/c			200
(Being expenses paid by Nathan i.e. dock dues ₹20, carriage ₹50 and warehousing expenses ₹130)			
Consignment A/c	Dr.	960	
To Nathan's A/c			960
(Being the commission payable to Nathan @4% on ₹24,000)			
Consignment A/c	Dr.	12,340	
To Profit and Loss A/c			12,340
(Being the profit on consignment transferred to Profit and loss A/c)			
Cash A/c	Dr.	22,840	
To Nathan's A/c			22,840
(Being the amount due from Nathan received)			
Goods Sent on Consignment A/c	Dr.	10,000	
To Trading A/c			10,000
(Being the transfer of goods sent on consignment account to Trading A/c)			

In the Books of Nathan
Journal Entries

Particulars	Dr.	Cr.
(₹)	(₹)	(₹)
Ram & Co. A/c To Cash A/c (Being various expenses paid on goods on consignment)	Dr. 200	200
Bank A/c To Ram & Co. A/c (Being goods sold on behalf of Ram & Co.)	Dr. 24,000	24,000
Ram & Co. A/c To Commission A/c (Being the commission due on sale proceeds paid to Ram & Co.)	Dr. 960	960
Ram & Co. A/c To Bank A/c (Being amount due on consignment remitted to Ram & Co.)	Dr. 22,840	22,840

Illustration 2.

The Bombay Mills Ltd. of Bombay consign to their Calcutta agent ₹10,000 worth of piece goods, drawing on Calcutta for the amount. They pay charges freight and insurance on the consignment amounting to ₹650 and discount the bill which costs ₹200. The goods were received in Calcutta and in due course the account Sales was received as follows:

Account sales of 200 bales of piece goods from Bombay Mills Ltd. of Bombay.

Particulars	(₹)	(₹)
200 Bales of piece goods at		14,000
Less:		
Delivery charges etc.,	500	
Godown rent	70	
Insurance	80	
Sundry charges	18	
Commission	700	1,368
		12,632
Draft paid		10,000
Balance herewith		2,632

Enter these particulars in the ledger of the consignor and complete the transaction showing final profit or the loss on the consignment.

Solution:**In the Books of Bombay Mills Ltd.****Consignment Account**

Dr.		Cr.		
Particulars	(₹)	(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c		10,000	By Agent (Sales)A/c	14,000
To Cash (Freight & Insurance)A/c		650		
To Agent A/c				
Delivery charges etc.	500			
Godown rent	70			
Insurance	80			
Sundry charges	18			
Commission	700	1,368		
To Profit & Loss A/c		1,982		
		14,000		14,000

Agent Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Consignment A/c	14,000	By Bills Receivable A/c	10,000
		By Consignment A/c	1,368
		By Bank A/c	2,632
	14,000		14,000

Goods sent on Consignment Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Trading A/c	10,000	By Consignment A/c	10,000
	10,000		10,000

Bills Receivable Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Agent A/c	10,000	By Bank	9,800
		By Discount	200
	10,000		10,000

Illustration 3.

'A' sends goods worth ₹50,000 to 'B' for sales for 5% commission. He incurs ₹1,500 for Freights and ₹500 for Insurance. The goods are sold for ₹60,000, consignee incurs ₹500 unloading expenses and ₹500 rent. B sends a draft after deducting his expenses and commission.

Prepare necessary accounts in the books of A.

Solution:

In the books of A
Consignment Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c	50,000	By B's A/c Sale	60,000
To Cash A/c (Freight)	1,500		
To Cash A/c (Insurance)	500		
To B's A/c			
- Unloading Expenses	500		
- Rent	500		
To B's A/c - Commission (₹60,000 x 5%)	3,000		
To Profits and Loss A/c (Profit on Consignment)	4,000		
	60,000		60,000

B's (Consignee's) Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Consignment A/c- Sale	60,000	By Consignment A/c – (Unloading Expenses)	500
		By Consignment A/c (Rent)	500
		By Consignment A/c (Commission)	3,000
		By Bank A/c	56,000
	60,000		60,000

Goods Sent on Consignment Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Trading A/c (Balancing Figure)	50,000	By Consignment A/c	50,000
	50,000		50,000

Illustration 4.

Usha sent goods costing ₹75,50,000 on consignment basis to Gayathri on 1.2.2021 @ 8.5% commission, ₹8,25,000 was spent on transportation by Usha. Gayathri spent ₹5,25,000 on unloading. 80% of the goods received were sold

for ₹90,00,000, 10% of the goods for ₹10,00,000 and the balance was taken over by Gayathri @10% below the cost price. She has sent a demand draft to Usha for the amount due show in Usha's Books.

- (i) Consignment Account
(ii) Gayathri's Account.

Solution:

In the Books of Usha

Consignment Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c	75,50,000	By Gayathri A/c (W.N.- 1)	1,01,35,900
To Bank A/c – Transportation	8,25,000		
To Gayathri A/c – Unloading Expenses	5,25,000		
To Gayathri A/c – Commission (W. N.- 2)	8,61,551		
To Profit and Loss on Consignment A/c	3,74,349		
	1,01,35,900		1,01,35,900

Gayathri's Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment A/c	1,01,35,900	By Consignment A/c – Expenses	5,25,000
		By Consignment A/c – Commission	8,61,551
		By Bank A/c (Balancing Figure)	87,40,349
	1,01,35,900		1,01,35,900

Working Note:

1. Computation of Amount of Sales by Gayathri

Particulars	(₹)
Goods Sent on Consignment Basis	75,50,000
88% of the goods received, sold for	90,00,000
10% of the goods received, sold for	10,00,000
2% of the goods received taken over (₹75,50,000 × 2%) × 90%	1,35,900
Total Amount of Sales	1,01,35,900

2. Computation of Commission

Commission = Total Sales Proceeds × Rate of Commission = ₹1,01,35,900 × 8.5% = ₹8,61,551

Illustration 5.

Sree Traders of Gujrat purchased 10,000 sarees @ ₹100 per saree. Out of these 6,000 sarees were sent on consignment to Nirmala Traders of Kolkata at the selling price of ₹120 per saree. The consignor paid ₹3,000 for packing and freight. Nirmala Traders sold 5,000 sarees @ ₹125 per saree and incurred ₹1,000 for selling expenses and remitted ₹5,00,000 to Gujrat on account. They are entitled to a commission of 5% on total sales plus a further of 25% commission on any surplus price realized over ₹120 per saree. 3,000 sarees were sold at Gujrat @ ₹110 per saree. Owing to fall in market price, the value of stock of saree in hand is to be reduced by 5%. You are required to prepare (i) Consignment Account, and (ii) Nirmala Traders Account.

Solution:

i) **In the books of Sree Traders**
Consignment Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To, Goods Sent on Consignment A/c (6,000 × ₹ 100)	6,00,000	By, Nirmala Traders A/c : Sale proceeds (5,000 × ₹ 125)	6,25,000
To, Bank A/c (Packing and Freight)	3,000	By, Stock on Consignment A/c (W.N.2)	90,250
To, Nirmala Traders A/c			
- Selling Expenses	1,000		
- Commissions (W.N.1)	37,500		
To, Profit & Loss A/c (Profit on Consignment)	73,750		
	7,15,250		7,15,250

Note:

3,000 sarees which were sold at Gujrat @ ₹110 per saree are not to be taken into consideration since it is not a consignment transaction and hence the same is excluded from Consignment Account.

Although the consignor purchased 10,000 sarees, only 6,000 sarees are related to consignment transaction, balance is not to be taken into Consignment Account at all.

(ii)**Nirmala Traders Account**

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Consignment A/c:		By, Bank A/c (Advance)	5,00,000
Sales Proceeds	6,25,000	By, Consignment A/c (Exp. + Com.)	38,500
		By, Balance c/d	86,500
	6,25,000		6,25,000

Workings:**1. Calculation of Commission payable to Nirmala Traders:**

Particulars	(₹)
Total Sales @ ₹ 125 per saree	6,25,000
Less: Amount ₹ 120 per saree	6,00,000
Surplus Price Realised	25,000
Commission: @ 5% on total Sales (₹ 6,25,000 × 5%)	31,250
Add: 25% on ₹ 25,000	6,250
	37,500

2. Valuation of Unsold Stock:

Since market price has fallen by 5%, valuation of unsold stock on consignment will be calculated as under:

Particulars	(₹)
Total Cost (1,000 × ₹ 100) (without Considering expenses)	1,00,000
Less: 5% in reduction	5,000
	95,000
Less: Consignee's Com. @ 5%	4,750
Estimated Selling Price	90,250

Illustration 6.

T of Jamshedpur consigned goods costing ₹2,00,000 to his agent P of Patna. The invoice was made pro-forma so as to show a profit of 25% on cost. T paid freight and insurance ₹4,000. P sold part of the consignment for ₹1,76,000 at a uniform price of 10% over invoice price and spent ₹6,000 as warehousing charges and ₹2,000 as selling expenses. P is entitled to a commission of 5% on sales and 20% of the net profit after charging commission on sales. Draw up the Consignment Account in the books of T.

**In the books of Tilak
Consignment to Patna Account**

Dr.

Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	2,50,000		By Goods Sent on Consignment A/c	50,000
	To Bank A/c (freight and insurance)	4,000		By Pulak A/c (sale proceeds)	1,76,000
	To P A/c:			By Stock on Consignment A/c (Note 2)	91,440
	Warehousing Charges	6,000		By Profit b/d	
	Selling Expenses	2,000			
	Commission (5% on ₹1,76,000)	8,800			
	To Stock Reserve A/c (Note 3)	18,000			
	To Pulak A/c (share of profit) (Note 4)	5,728			
	To Profit and Loss on Consignment A/c	22,912			
		3,17,440			3,17,440

Working Notes:

- Invoice price - Cost price + 25% profit on cost (loading) – ₹2,00,000 + ₹50,000 = ₹2,50,000.
- Valuation of Stock on Consignment

Invoice price of the goods sent	₹2,50,000
Less: Invoice price of the goods sold (₹1,76,000 / 110 × 100)	₹1,60,000
Invoice price of the Stock on Consignment	₹90,000
Add: Proportionate non-recurring expenses (₹4,000 × 90,000 / 2,50,000)	₹1,440
	₹91,440
- Loading on stock = $90,000 \times 25/125 = ₹18,000$
- Profit after charging commission on sales but before charging commission on profit = ₹28,640
Pulak's share = 20% of 28,640 = ₹5,728

Illustration 7.

K of Kolkata sends 1,000 boxes of clothing to P of Patna on consignment basis. The goods in each box cost ₹200. K pays railway freight and insurance ₹500 and draws upon P a bill for ₹10,000, which is duly accepted. P forwards an Account Sales to K showing that 500 boxes have been sold at ₹250 per box while 300 boxes were sold at ₹260 per box. 200 boxes remained unsold. The expenses incurred by P consisted of carriage ₹100 and other charges ₹2,000. P is entitled to a commission @ 7% on the gross sales. P encloses a cheque for the balance due to K.

Show the Consignment Account in the books of K.

Solution:

In the books of K
Consignment to Patna A/c

Dr.

Cr.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c [Goods sent: 1,000 × ₹200]	2,00,000	By P A/c [Sale]	2,03,000
To Bank A/c [Expenses incurred] - Railway freight & Insurance	500	500 boxes: (500 × 7250) 1,25,000 300 boxes: (300 × 7260) 78,000	
To P A/c [Expenses paid by consignee] - Carriage 100 - Other Charges 2,000	2,100	By Consignment Stock A/c [WN: 1]	40,120
To P A/c [Commission due] - Ordinary Com. [₹2,03,000 × 7%]	14,210		
To P/L A/c [Profit on consignment transferred]	26,310		
	2,43,120		2,43,120

Workings:**1. Valuation of Unsold Stock**

Particulars	Units	₹
Cost of Goods Sent	1,000	2,00,000
Add: Consignor's expenses (being, railway freight & insurance)	—	500
	1,000	2,00,500
Add: Non-recurring expenses incurred by consignee (being, carriage)		100
		2,00,600
Unsold Stock = $[1,000 - (500 + 300)] = 200$ units Value of 200 units		$₹2,00,600 \times 200/1000 = ₹40,120$

III. Credit Sales and Del-Credre Commission

It is not necessary that all the goods are to be sold by the consignee in cash. He may require to sell some part of the goods on credit. When goods are sold on credit, the problem of bad debt arises. Since consignee has better knowledge about the local market conditions, he may be offered an additional commission to take the responsibility of realizing the proceeds from the customers and also to bear the consequent bad debt loss. This additional commission is known as del-credre commission. Accordingly, accounting in the books of the consignor and the consignee differs based on whether the bad debts loss is borne by the consignee or the consignor. i.e., whether del credere commission is given to the consignee or not.

(a) When del-credre commission is given to the consignee

Situations	Consignor's books	Consignee's books
For credit sales	Consignee's Personal A/c Dr. To, Consignment A/c	Consignment Debtors A/c Dr. To, Consignor A/c
For bad debt	No entry	Bad Debts A/c Dr. To, Consignment Debtors A/c
For del-credre commission	Consignment A/c Dr. To, Consignee's Personal A/c	Consignor A/c Dr. To Commission Received A/c
For realization of proceeds	No entry	Cash/ Bank A/c Dr. To, Consignment Debtors A/c
For transfer of bad debt	No entry	Commission Received A/c Dr. To Bad Debt A/c

(b) When del-credre commission is not given to the consignee

Situations	Consignor's books	Consignee's books
For credit sales	Consignment Debtor A/c Dr. To, Consignment A/c	No entry
For bad debt	Consignment Debtors A/c Dr. To Consignment Debtors A/c	No entry
For realization of proceeds	Cash/Bank A/c Dr. To, Consignment Debtors A/c (if collected by consignor)	No entry
	Consignee's Personal A/c Dr. To, Consignment Debtors A/c (if collected by consignee)	Cash/ Bank A/c Dr. To, Consignor A/c

Consider the following illustrations.

Illustration 8.

S of Mumbai consigned 100 units of a commodity to M of Kolkata. The goods were invoiced at ₹300 so as to yield a profit of 50% on cost. S incurred ₹2,000 on freight and insurance. M incurred ₹1,000 on Salesmen's salary and ₹1,600 on godown rent. M sold 50 units for cash at ₹320 per unit and 20 units on credit at ₹350 per unit. She retained her commission @ 6 per cent (including 1 per cent for the del credere arrangements) and remitted the balance due. A debtor for ₹2,000 to whom the goods were sold by M became insolvent and only 50 paise in a rupee was recovered.

Show necessary ledger accounts in the books of M.

Solution:

In the Books of M

S Account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
	To Commission Received A/c:	1,150		By Bank A/c (cash sales)	16,000
	Ordinary commission	230		By Consignment Debtors A/c	7,000
	Del credere commission				
	To Bank A/c (Expenses)	2,600			
	To Bank (Final remittance)	19,020			
		23,000			23,000

Dr.			Cr.		
Consignment Debtors Account					
Date	Particulars	₹	Date	Particulars	₹
	To S A/c	7,000		By Bank A/c	6,000
				By Bad Debts A/c	1,000
		7,000			7,000

Dr.			Cr.		
Commission Received Account					
Date	Particulars	₹	Date	Particulars	₹
	To Consignment Debtors A/c	1,000		By S A/c	1,380
	(Bad Debts)				
	To Profit and Loss A/c	380			
		1,380			1,380

Illustration 9.

On 1st November, 2021, K of Calcutta sends goods costing ₹1,00,000 to D of Delhi on consignment basis. K paid ₹5,000 as railway freight and ₹2,000 as insurance. On 31st December, 2021, an Account Sales was received from D disclosing that the entire quantity of goods were sold for ₹1,50,000 — out of which, ₹30,000 was sold on credit. A customer who purchased goods for ₹5,000 failed to pay and the debt proved bad. All other debts were collected

by D in full. As per agreement, D is allowed a commission @ 10% on sales. D sends the amount due to K by a cheque. Prepare necessary ledger accounts in the books of K.

Solution:

In the books of K
Consignment to D Account

Dr.					Cr.
Date	Particulars	₹	Date	Particulars	₹
2019 Nov 1	To Goods Sent on Consignment A/c	1,00,000	2019 Dec 31	By D A/c (Cash Sales)	1,20,000
	To Cash A/c			By Consignment Debtors A/c (Credit Sales)	30,000
	Railway Freight	5,000			
	Insurance	2,000			
Dec 31	To D A/c (Commission @ 10%)	15,000			
		5,000			
	To Consignment Debtors A/c (Bad Debts)	23,000			
	To Profit & Loss on Consignment A/c				
		1,50,000			1,50,000

D Account

Dr.					Cr.
Date	Particulars	₹	Date	Particulars	₹
	To Consignment to D A/c	1,20,000		By Consignment to D A/c	6,000
	To Consignment Debtors A/c	25,000		By Bank A/c	1,30,000
		1,45,000			1,45,000

Consignment Debtors Account

Dr.					Cr.
Date	Particulars	₹	Date	Particulars	₹
2019 Dec 31	To Consignment to D A/c	30,000	2019 Dec 31	By D A/c	25,000
	To Consignment Debtors A/c			By Consignment to D A/c	5,000
		30,000			30,000

Goods Sent on Consignment Account

Dr.					Cr.
Date	Particulars	₹	Date	Particulars	₹
2019 Dec 31	To Purchase A/c	1,00,000	2019 Dec 31	By Consignment to D A/c	1,00,000
		1,00,000			1,00,000

IV. Loss of Goods Sent on Consignment

In consignment business losses may be divided into two broad categories – Normal Loss and Abnormal Loss. The loss of goods which occurs due to the inherent nature of the goods involved is referred to as Normal Loss. It is by nature an unavoidable loss and forms part of the cost of goods sold. For example, evaporation of materials, spillage of liquid materials etc. On the other hand, Abnormal Loss of goods refers to those losses which are avoidable in nature. Such loss is not considered to be a part of the cost of goods sold. For example, goods pilfered, goods stolen, goods lost by fire and other natural calamities etc. Depending on the stage of occurrence of abnormal loss in a consignment business, such loss arising can be broadly discussed under two heads:

- Goods lost in Transit: These losses occur on the movement of the goods from the consignor's premise to the consignee's warehouse. Such goods lost are required to be valued after considering the expenses incurred by the Consignor for sending such goods. Any expense incurred by the consignee which are of non-recurring nature are not to be included in valuing the goods lost in transit.
- Abnormal loss of goods in Consignee's premises: Such loss includes goods damaged by fire in consignee's godown, goods stolen from godown, loss due to bad handling etc. For the purpose of valuation of such loss, all expenses incurred by the consignor and the non-recurring expenses incurred by the consignee are considered.

Consider the following illustration.

Illustration 10.

- A consigned to B 5,000 kg. of tea costing ₹40 per kg. A incurred ₹3,000 on freight and ₹2,000 on insurance. 500 kg of tea were lost in transit. The insurance company admitted the claim for ₹15,000. After receiving the goods, B spent ₹1,000 on carriage, ₹500 on selling and ₹500 on godown rent, B was allowed a commission of 5% on sales. 3,000 kg of tea were sold at ₹64 per kg. 25 kg of tea were lost due to breakage of a chest which was considered to be normal. Prepare necessary Ledger Accounts in the books of A and B.
- Will your answer be different, if in the above example, abnormal loss of 500 kg took place in the consignee's godown by theft—other things remaining the same?

Solution:

(a)

In the Books of A Consignment to B Account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	2,00,000		By Abnormal Loss A/c (Note 1)	20,500
	To Bank A/c (Expenses)			By B A/c (sale proceeds)	1,92,000
	Freight ₹3,000			(3000 × ₹ 64)	
	Insurance ₹2,000	5,000		By Stock on Consignment A/c	61,142
				(Note 2)	
	To B A/c (Expenses)				
	Carriage ₹1,000				
	Selling ₹500	2,000			
	Godown rent ₹500	9,600			
	To B A/c - commission				
	(5% on ₹1,92,000)				
	To Profit and Loss on Consignment	57,042			
	A/c				
		2,73,642			2,73,642

Working Notes:**1. Calculation of Abnormal Loss**

	₹
Cost of 5,000 kgs @ ₹ 40 per kg.	= 2,00,000
Add: Expenses prior to the loss (3,000 + 2,000)	= 5,000
Value of 5,000 kgs	= 2,05,000

Therefore, value of 500 kg. = $2,05,000 \times 500/5,000 = ₹20,500$

2. Calculation of Stock on Consignment

	₹
Value of 5,000 kgs (Note 1)	2,05,000
Less: Abnormal loss of 500 kgs (Note 1)	20,500
Value of the goods received by the consignee	1,84,500
Add: Non-recurring expenses of the consignee (Cartage)	1,000
Total value of the goods sent to the consignee	1,85,500

The consignee received 4,475 kgs (5,000 kgs – 500 kgs abnormal loss – 25 kgs normal loss). Out of that 3,000 kgs sold by him. Therefore, stock in hand is 1,475 kgs (4,475 – 3,000).

Thus, Value of stock = $(1,85,500 \times 1,475) \div 4,475 = ₹61,142$.

Solution:**(b)**

When the abnormal loss of 500 kgs takes place in the consignee's godown (other things remaining the same) the value of abnormal loss and stock on consignment will be as follows:

Ascertainment of Abnormal Loss and Unsold Stock	₹
Value of the goods received by the consignee	2,05,000
Add: Proportionate expenses of the consignee (cartage)	1,000
	2,06,000

The consignee received 4,975 units (5,000 kgs – 25 kgs normal loss)

Therefore, Value of Abnormal Loss = $2,06,000 \times 500/4,975 = ₹20,704$

Value of Unsold Stock = $2,06,000 \times 1,475/4,975 = ₹61,075$

Profit on consignment will be ₹57,179.

Illustration 11.

Ashok sends goods on consignment basis to Srinivas. The terms are that Srinivas will receive the 10% commission on Invoice price and 20% on price realized over and above the Invoice price. Srinivas will meet his expenses himself.

Ashok sent goods whose cost was ₹16,000 at a proforma Invoice price cost plus 25% and spent ₹1,500 on freight charges. Srinivas accepted a bill for 16,000 immediately on receiving the consignment. His expenses were ₹200 as rent and ₹100 as insurance. Srinivas sold $\frac{3}{4}$ of goods for ₹19,500. Part of sales were on credit and one customer failed to pay ₹400. Pass journal entries in the books of Ashok.

Solution:

**Journal Entries
In the books of Ashok**

	Particulars	Dr. (₹)	Cr. (₹)
1	Consignment A/c Dr. To Goods Sent on Consignment A/c (Being the invoice value of the goods sent on consignment)	20,000	20,000
2	Consignment A/c Dr. To Bank A/c (Being the expenses incurred on consignment)	1,500	1,500
3	Consignment A/c Dr. To Srinivas A/c (Being the expenses incurred by Srinivas)	300	300
4	Bill Receivable A/c Dr. To Srinivas A/c (being the bill drawn as an advance)	16,000	16,000
5	Srinivas A/c Dr. To Consignment A/c (being the sales made by srinivas)	19,500	19,500
6	Consignment A/c Dr. To Srinivas A/c (being the commision due to srinivas)	2,400	2,400
7	Consignment Stock A/c Dr. To Consignment A/c (Being the value of ¼ of the goods left unsold)	5,375	5,375 ²
8	Goods Sent on Consignment A/c Dr. To Consignment A/c (Being the excess of invoice price over cost price in stock adjusted)	4,000	4,000
9	Consignment A/c Dr. To Consignment Stock Reserve A/c (Being the excess of invoice price over cost price in stock adjusted)	1,000	1,000
10	Consignment A/c Dr. To Srinivas A/c (Being the bad debts on the credit sale made by srinivas)	400	400
11.	Consignment A/c Dr. To Profit and Loss A/c (Being the profit on consignment transferred to P & L A/c)	3,575	3,575
12.	Goods Sent on Consignment A/c Dr. To Trading A/c (Being the transfer of goods sent on consignment account)	16,000	16,000

Working Notes:

1. Calculation of commission	₹
10% on invoice price	
(i.e., 10% on $15,000 \times 3/5$)	1,500
20% on excess of invoice price	
(i.e., 20% on $19,500 - 15,000$)	<u>900</u>
Total commission	<u>2,400</u>
2. Closing stock:	
Invoice price of $\frac{1}{4}$ of the goods	
Left unsold, i.e., $\frac{1}{4} \times 20,000$	5,000
Add: $\frac{1}{4}$ of freight $\frac{1}{4} \times 1,500$	<u>375</u>
	<u>5,375</u>

• **Concept of Joint Venture**

Joint venture is a short-term business undertaking jointly by two or more persons who share the profits and losses in an agreed ratio. Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multiple skills. In such cases, an individual person may not be able to master all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity.

• **Examples of Joint Venture**

The business activities for which Joint Ventures (JV) are formed could be:

- i) Construction of dams, bridges, roads.
- ii) Buying & selling of goods for a particular season
- iii) Producing a film
- iv) Purchasing land selling plots etc.

• **Features of Joint Venture**

The basic features of a Joint Venture business are:

- i) It is done for a specific purpose and hence has a limited duration.
- ii) The partners are called co-venturers
- iii) The profit or loss on joint venture is shared between the co-venturers in the agreed ratio.
- iv) The co-venturers may or may not contribute initial capital.
- v) The joint venture is dissolved once the purpose of the business is over.
- vi) The accounts of the co-venturers are settled immediately on dissolution.
- vii) A joint venture has no name.

• **Difference between Joint Venture and Consignment**

The following are differences between Joint Venture and Partnership.

Sl. No.	Point of Distinction	Joint Venture	Consignment
1	Relation between parties.	Relation is that of owners.	Relation is that of the principal and the agent.
2	Methods of keeping accounts.	There are multiple methods of keeping accounts.	There is only one method of keeping accounts.
3	Ownership of goods.	Ownership is that of co-venturers.	Ownership remains with the consignor though possession of goods passes from the consignor to the consignee.
4	Profit earned	Profit belongs to the co-venturers.	Profit belongs to the consignor and not to the consignee.
5	Management	The co-venturers enjoy full powers to manage the business & contribute funds for the business.	The consignee being an agent has no powers except that he has simply to obey instructions of his principal
6	Finance	Money is contributed by all co-venturers in ascertain proportion	All money is invested by the consignor
7	Risk	Risk is shared between venturers.	Sales are made at consignor's risk.

⊙ Difference between Joint Venture and Partnership

The following are differences between Joint Venture and Partnership.

Sl. No.	Point of Distinction	Joint Venture	Partnership
1	Name of the firm.	It is carried on with out a firm's name.	It is carried on with firm's name.
2	Co-venturers/ Partners	Parties are called co-venturers.	Parties are called partners.
3	Continuity	It is a temporary partnership and comes to an end after the completion of a particular venture.	Continuous and does not end after the completion of a particular venture.
4	Liability	Liability is limited to the adventure concerned for which they agree to contribute capital and share profits or losses.	Liability is unlimited to the extent of their business and private estate.
5	Location of Business	It is generally local.	It may be located at different places.
6	Position of a Minor	In it, minor is generally not admitted.	A minor, can be admitted only for benefits.
7	Application of the Act	No enactment is applicable.	Indian Partnership Act, 1932 is applicable.
8	No. of Partners / Members	There is no limit in it	It is limited to 20 in ordinary trade and 10 in banking business.

Accounting of Joint Venture

There are different methods of recording joint venture transactions. They can be broadly classified into two following methods:

- I. When separate set of books are maintained
- II. When separate set of books are not maintained.

Method I: When separate set of books are maintained

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to know profit or loss on account of the joint venture. Therefore, under this approach, only three accounts are maintained:

- a) **Joint Venture Account:** It is similar to a Profit & Loss A/c. a “Joint Venture A/c” is opened which records all transactions related to the activities carried out. In this account, in the debit side all expenses (paid personally by the co-venturers or out of joint bank) irrespective of its nature (i.e., capital or revenue) are recorded. In the credit side, all sales (to outsiders as well as to the co-venturers) are recorded. The net result of this account will be either profit or loss.
- b) **Joint Bank Account:** A “Joint Bank A/c” is maintained to record all cash/bank transactions. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution of the venture. All cash inflows are recorded in the debit side and the outflows are recorded in the credit side. Final settlement of the co-venturers is lastly put into this account so that it tallies.
- c) **Co-venturers Account:** Co-Venturers’ personal A/cs are maintained to record transactions related to co-venturers. At the end of the joint venture, the balance of these accounts represents the claim of a co-venture to / from the business which is ultimately settled through Joint Bank A/c.

The accounting entries are normally as follows:

No.	Transaction	Entry
1	Contribution of co-venturers	Joint Bank A/c Dr. To, Co-Venturers A/c
2	Goods sent by co-venturer out of his own stock	Joint Venture A/c Dr. To, Co -Venturers A/c
3	Expenses paid by co-venturers	Joint Venture A/c Dr. To, Co -Venturers A/c
4	Materials purchase out of joint venture funds	Joint Venture A/c Dr. To Joint Bank A/c
5	For expenses out of joint bank A/c	Joint Venture A/c Dr. To Joint Bank A/c
6	For goods sold for cash	Joint Bank A/c Dr. To Joint Venture A/c
7	Contract / sale price received in form of shares / cash	Joint Bank A/c Dr. Shares A/c Dr. To Joint Venture A/c

8	Commission / salary to co-venturers	Joint Venture A/c To Co-Venturers A/c	Dr.
9	Unsold goods taken over by co-venturers	Co-Venturers A/c To Joint Venture A/c	Dr.
10	Shares taken over by co-venturers	Co -Venturers A/c To Shares A/c	Dr.
11	If shares are sold in open market	Joint Bank A/c To Shares A/c	Dr.
12	For profit on joint venture	Joint Venture A/c To Co -Venturers A/c	Dr.
13	For loss on joint venture	Co -Venturers A/c To Joint Venture A/c	Dr.
14	For final distribution of funds	Co -Venturers A/c To Joint Bank A/c	Dr.

Consider the following illustration.

Illustration 12.

Aditya and Amit entered into a joint venture to buy and sale Ganesh idols for the Ganesh festival. They opened a Joint Bank Account. Aditya deposited ₹2,00,000 and Amit ₹1,50,000. Aditya supplied Ganesh idols worth ₹25,000 and Amit supplied decoration material worth ₹15,000. The following payments were made by the venture:

- Cost of Ganesh idols purchased ₹2,50,000
- Transportation charges ₹12,000
- Advertising ₹7,500 and Sundry Expenses ₹2,500. They sold idols for ₹4,00,000 for cash. Aditya took over some idols for ₹30,000 and Amit took over remaining for ₹10,000. The profit or losses were to be shared equally between co-venturers. Prepare Joint Venture Account, Joint Bank Account and each Co-Venturer's Account.

Solution:

Joint Venture Account

Dr.		Cr.	
Particulars	(₹)	Particulars	(₹)
To Aditya A/c (Materials)	25,000	By Joint Bank A/c – Sales	4,00,000
To Amit A/c (Materials)	15,000	By Aditya A/c	30,000
To Joint Bank A/c (Materials Purchased)	2,50,000	By Amit A/c	10,000
To Joint Bank A/c (Transport)	12,000		
To Joint Bank A/c (Advertising)	7,500		
To Joint Bank A/c (Sundry Exp.)	2,500		
To Profit on Venture A/c :			
Aditya	64,000		
Amit	64,000		
	4,40,000		4,40,000

Joint Bank Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To Aditya A/c (Contribution)	2,00,000	By Joint Venture A/c : (Material purchase)	2,50,000
To Amit A/c (Contribution)	1,50,000	By Joint Venture A/c : (Transport)	12,000
To Joint venture A/c (Sales)	4,00,000	By Joint Venture A/c : (Advertising)	7,500
		By Joint Venture A/c : (Sundry)	2,500
		By Aditya A/c : (Closing)	2,59,000
		By Amit A/c : (Closing)	2,19,000
	7,50,000		7,50,000

Aditya's Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To Joint Venture A/c – (materials)	30,000	By, Joint Bank	2,00,000
To Joint Bank A/c – (closing)	2,59,000	By, Joint Venture – (materials)	25,000
		By, Joint Venture – (profit)	64,000
	2,89,000		2,89,000

Amit's Account

Dr.

Cr

Particulars	(₹)	Particulars	(₹)
To Joint Venture A/c – (materials)	10,000	By, Joint Bank	1,50,000
To Joint Bank A/c – (closing)	2,19,000	By, Joint Venture A/c – (materials)	15,000
		By, Joint Venture A/c – (profit)	64,000
	2,29,000		2,29,000

Illustration 13.

Prabir and Mihir doing business separately as building contractors undertake jointly to build a skyscraper for a newly started public limited company for a contract price of ₹1,00,00,000 payable as ₹80,00,000 in cash and the balance by way of fully paid equity shares of the new company. A Bank Account was opened for this purpose in which Prabir paid ₹25,00,000 and Mihir ₹15,00,000. The profit sharing ratio was agreed as 2:1 between Prabir and Mihir.

The transactions were:

- Advance received from the company ₹50,00,000
- Wages to contractors ₹10,00,000
- Bought materials ₹60,00,000
- Material supplied by Prabir ₹10,00,000

- (e) Material supplied by Mihir ₹15,00,000
 (f) Architect's fees paid from Joint Bank Account ₹21,00,000

The contract was completed and the price was duly paid. The joint venture was duly closed by Prabir taking all the shares at ₹18,00,000 and Mihir taking over the balance material for ₹3,00,000. Prepare the Joint Venture Account, Joint Bank Account. Co-venturer's Accounts and Shares Account.

Solution:**Joint Venture Account****Dr.****Cr.**

Particulars	(₹)	Particulars	(₹)
To, Joint Bank A/c – (wages)	10,00,000	By, Joint Bank A/c – (advance)	50,00,000
To, Joint Bank A/c – (materials)	60,00,000	By, Joint Bank A/c – (balance) price	30,00,000
To, Joint Banks A/c – (Architect)	21,00,000	By, Shares A/c – (received)	20,00,000
To, Prabir A/c – (materials)	10,00,000	By, Mihir A/c – (stock taken)	3,00,000
To, Mihir A/c – (materials)	15,00,000	By, Prabir A/c – (2/3rd loss)	10,00,000
To, Shares A/c – (loss)	2,00,000	By, Mihir A/c – (1/3rd loss)	5,00,000
	1,18,00,000		1,18,00,000

Joint Bank Account**Dr.****Cr.**

Particulars	(₹)	Particulars	(₹)
To, Prabir A/c	25,00,000	By, Joint Venture A/c – (wages)	10,00,000
To, Mihir A/c	15,00,000	By, Joint Venture A/c – (materials)	60,00,000
To, Joint Venture A/c – (advance)	50,00,000	By, Joint Venture A/c – (Architect)	21,00,000
To, Joint Venture A/c – (balance)	30,00,000	By, Prabir A/c – (balance paid)	7,00,000
		By, Mihir A/c – (balance paid)	22,00,000
	1,20,00,000		1,20,00,000

Prabir's Account**Dr.****Cr.**

Particulars	(₹)	Particulars	(₹)
To, Shares A/c – (taken)	18,00,000	By, Joint Bank A/c	25,00,000
To, Joint Venture A/c – (loss)	10,00,000	By, Joint Venture A/c – (material)	10,00,000
To, Joint Bank A/c – (balance paid)	7,00,000		
	35,00,000		35,00,000

Mihir's Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To, Joint Venture A/c—(stock taken)	3,00,000	By, Joint Bank A/c	15,00,000
To, Joint Venture A/c – (loss)	5,00,000	By, Joint Venture A/c – (material)	15,00,000
To, Joint Bank A/c –(balance paid)	22,00,000		
	30,00,000		30,00,000

Shares Account

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To, Joint Venture A/c	20,00,000	By, Prabir A/c	18,00,000
		By, Joint Venture A/c – (loss)	2,00,000
	20,00,000		20,00,000

Method II: When no Separate Books of Accounts are Maintained

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank Account is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also met by them. Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e., done by himself and by his co-venturer as well.

This method, again, has two versions as follows.

a) When each co-venturer keeps record of all transactions

Under this approach, each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Here, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e., done by himself as well as by his co-venturer.

The accounting entries are as follows:

In books of Co-venturer A	In books of Co-venturer B
When good sare supplied and expenses paid by A	
Joint Venture A/c Dr.	Joint Venture A/c Dr.
To, Goods A/c	To, A's A/c
To, Cash / Bank A/c	
When goods are supplied by B and expenses paid by B	
Joint Venture A/c Dr.	Joint Venture A/c Dr.
To, B's A/c	To, Goods A/c
To, Cash / Bank A/c	

When advance is given by A to B or bill accepted by A	
B's A/c Dr.	Cash / Bank A/cDr.
To, Cash / Bank A/c	B / R A/cDr.
To,B / P A/c	To, A's A/c
When sale proceeds are received by A	
Cash / Bank A/c Dr.	A's A/c Dr.
To, Joint Venture A/c	To, Joint Venture A/c
When sale proceeds are received by B	
B's A/c Dr.	Cash / Bank A/c Dr.
To, Joint Venture A/c	To, Joint Venture A/c
For unsold goods taken over by A	
Goods A/c Dr.	A'sA/c Dr.
To Joint Venture A/c	To Joint Venture A/c
For unsold goods taken over by B	
B's A/c Dr.	Goods A/c Dr.
To, Joint Venture A/c	To, Joint Venture A/c
For profit on joint venture business	
Joint Venture A/c Dr.	Joint Venture A/c Dr.
To, B'sA/c	To, A's A/c
To, P&L A/c	To, P&L A/c
For loss on joint venture business	
B's A/c Dr.	A's A/c Dr.
P & L A/c Dr.	P & L A/c Dr.
To, Joint Venture A/c	To, Joint Venture A/c

Consider the following illustrations.

Illustration 14.

Ram, Mohan and Rahim were partners in a joint venture, each contributing ₹5,000. Ram purchased goods for ₹13,000 and also supplied goods worth ₹1,000 from his stock, Rahim also supplied goods to the value of ₹1,500 from stock and his expenses in connection with the supplying of goods on account of joint venture amounted to ₹50. Ram paid ₹250 for expenses in connection with the joint venture. There was a sale of ₹20,800 by Ram. Ram was entitled to a commission of 5 per cent on sales. Unsold goods amounting to ₹500 were taken over by Mohan. Ram settled accounts of Mohan and Rahim by Bank draft.

Records these transactions in Ram's journal and also prepare Joint venture account and Rohan and Rahim accounts in Ram's books.

Solution:**Ram's Journal**

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c Dr. To Mohan A/c To Rahim A/c (Being amount received from Mohan and Rahim for joint venture)	10,000	5,000 5,000
Joint Venture A/c Dr. To Bank A/c (Being goods purchased on account of joint venture)	13,000	13,000
Joint Venture A/c Dr. To Goods A/c (Being goods supplied out of stock for joint venture)	1,000	1,000
Joint Venture A/c Dr. To Rahim A/c (Being goods for ₹ 1,500 supplied for joint venture and expenses ₹ 50 incurred by Rahim)	1,550	1,550
Joint Venture A/c Dr. To Bank A/c (Being expenses incurred in connection with joint venture)	250	250
Bank A/c Dr. To Joint Venture A/c (Being goods sold on account of joint venture)	20,800	20,800
Joint Venture A/c Dr. To Commission A/c (Being 5% commission on sale of ₹ 20,800 on account of joint venture)	1,040	1,040
Mohan A/c Dr. To Joint Venture A/c (Being unsold goods taken by Mohan)	500	500
Joint Venture A/c Dr. To Profit and Loss A/c To Mohan A/c To Rahim A/c (Being profit on joint venture transferred)	4,460	1,486 1,487 1,487
Mohan A/c Dr Rahim A/c Dr To Bank A/c (Being amount remitted to mohan and rahim in settlement of their accounts)	5,987 8,037	14,024

Joint Venture Account

Dr.

Cr.

Particulars		(₹)	Particulars		(₹)
To Bank Account (purchase)		13,000	By Bank Account (Sale)		20,800
To Goods Account (Goods Supplied)		1,000	By Mohan (unsold goods taken)		500
To Rahim (goods and expenses)		1,550			
To Bank Account (expenses)		250			
To Commission Account (5%)		1,040			
To Profit on joint venture transferred to:					
Profit & Loss Account	₹1,486				
Mohan	₹1,487				
Rahim	₹1,487	4,460			
		21,300			21,300

Mohan Account

Dr.

Cr.

Particulars		(₹)	Particulars		(₹)
To Joint Venture Account		500	By Bank Account		5,000
To Bank Account		5,987	By Joint Venture Account (profit)		1,487
		6,487			6,487

Rahim Account

Dr.

Cr.

Particulars		(₹)	Particulars		(₹)
To Bank Account		8,037	By Bank Account		5,000
			By Joint Venture Account		1,550
			By Joint Venture Account (profit)		1,487
		8,037			8,037

Illustration 15.

John and Smith entered into a joint venture business to buy and sale garments to share profits or losses in the ratio of 5:3. John supplied 400 bales of shirting at ₹500 each and also paid ₹18,000 as carriage & insurance. Smith supplied 500 bales of suiting at ₹480 each and paid ₹22,000 as advertisement & carriage. John paid ₹50,000 as advance to Smith. John sold 500 bales of suiting at ₹600 each for cash and also all 400 bales of shirting at ₹650 each for cash. John is entitles for commission of 2.5% on total sales plus an allowance of ₹2,000 for looking after business. The joint venture was closed and the claims were settled. Prepare Joint Venture Account and Smith's Account in the books of John and John's Account in the books of Smith.

Solution:

Books of John
Joint Venture Account

Dr.		Cr.	
Particular	(₹)	Particular	(₹)
To, Goods A/c - shirting (400×500)	2,00,000	By, Cash A/c – sales	
To, Bank A/c - carriage & insurance	18,000	shirting (500 × 600)	3,00,000
To, Smith A/c - suiting (500×480)	2,40,000	suiting (400 × 650)	2,60,000
To, Smith A/c - Advt & Carriage	22,000		
To, Commission A/c - 2.5%	14,000		
To, Allowance A/c	2,000		
To, P & L A/c (5/8th share)	40,000		
To, Smith A/c (3/8th share)	24,000		
	5,60,000		5,60,000

Smith's Account

Dr.		Cr.	
Particular	(₹)	Particular	(₹)
To, Cash A/c – advance	50,000	By, Joint Venture A/c – suiting	2,40,000
To, Cash A/c - balance paid	2,36,000	By, Joint Venture A/c – Expenses	22,000
		By, Joint Venture A/c - profit	24,000
	2,86,000		2,86,000

Books of Smith
John's Account

Dr.		Cr.	
Particular	(₹)	Particular	(₹)
To, Joint Venture A/c – sales	5,60,000	By, Cash A/c – advance	50,000
		By, Joint Venture A/c – shirting	2,00,000
		By, Joint Venture A/c – expenses	18,000
		By, Joint Venture A/c – commission	14,000
		By, Joint Venture A/c – allowance	2,000
		By, Joint Venture A/c – profit	40,000
		By, Cash A/c - balance paid	2,36,000
	5,60,000		5,60,000

b) Memorandum Joint Venture Account

Here each Co-Venturer records only those joint venture transactions which are affected by him with the help of a personal account designed as 'Joint Venture with.....(Name of the other Co-Venturer).....Account'. It is debited with the amount of purchases/supplies made and expenses incurred by the Co-Venturer. Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturer and on receipt of the aforesaid statement, each Co-Venturer prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions. Since this account is in fact, not a part and parcel of double entry system the word 'memorandum' is prefixed.

The accounting entries are as follows:

1. (a) On receipt of any amount / Bills Receivable from other Co-Venturer:		
Cash / Bank / Bills Receivable A/c	Dr.	
To, Joint Venture with A/c		
1. (b) On discounting Bills Receivable:		
Bank A/c	Dr.	(with net proceeds)
Joint Venture with A/c	Dr.	(with discount)
To, Bills Receivable A/c		(with total)
2. On purchase of goods:		
Joint Venture with A/c	Dr.	(with total)
To, Cash / Bank A/c		(with cash purchase)
To, Supplier's A/c		(with credit purchase)
3. On making payment to supplier		
Supplier's A/c	Dr.	(with total)
To, Cash / Bank / Bills Payable A/c		(with payment made)
To, Joint Venture with A/c		(with discount received)
4. On supply of goods out of own stock:		
Joint Venture with A/c	Dr.	(if supplies at cost)
To, Purchases / Goods sent on Joint Venture A/c		(if supplies at profit)
5. On payment of expenses:		
Joint Venture with A/c	Dr.	(with total)
To, Cash / Bank A/c		(with cash expenses)
To, Creditor's A/c		(with outstanding expenses)
6. On sale of goods:		
Cash / Bank A/c	Dr.	(with cash sales)
Customer's A/c	Dr.	(with credit sales)
To, Joint Venture with A/c		(with total)
7. On receiving payment from a customer:		
Cash / Bank A/c	Dr.	(with the payment received)
Joint Venture with A/c	Dr.	(discount allowed / bad debt)
To, Customer's A/c		(with the payment received)

8. On taking away of unsold goods:	
Goods Sent on Joint Venture A/c	Dr.
To, Joint Venture with A/c	
9. On considering some commission /salary to the Co-Venturer:	
Joint Venture with A/c	Dr.
To, Commission / Salary A/c	
10. On recording the share of Profit / Loss:	
(a) When profit-	
Joint Venture with A/c	Dr.
To, Profit & Loss A/c	
(b) When loss-	
Profit & Loss A/c	Dr.
To, Joint Venture with A/c	
11. On settlement of balance of Joint Venture with A/c:	
(a) When there is a debit balance:	
Cash / Bank A/c	Dr.
To, Joint Venture with A/c	
(b) When there is a credit balance:	
Joint Venture with A/c	Dr.
To, Cash / Bank A/c	

Illustration 16.

Bharat and Sujit joined together as co-ventures for equal share in profits through sale of television cabinets. On March 31, 2021. Bharat purchased 2,000 cabinets at ₹1,250 each for cash and sent 1,500 of these to Sujit for sale, the selling price of each being ₹1,300. All the cabinets were sold by April 30, 2021 by both and the proceeds collected.

Each venturer recorded in his books only those transactions concluded by him, final profit and loss being ascertained through a Memorandum joint venture Account.

The expenses met by the venturer were:

Particulars	(₹)
Bharat: Freight and insurance	12,000
Selling expenses	5,000
Sujit: Clearing charges	1,000
Selling expenses	12,000

Final settlement between the venturers took place on May 31, 2021. You are required to show:

- Joint Venture with Sujit A/c in the books of Bharat
- Joint Venture with Bharat A/c in the books of Sujit; and
- Memorandum Joint Venture Account.

Solution:**Bharat's books****Joint Venture with Sujit Account****Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2021 Mar. 31	To Purchases – 2,000 television cabinets @ ₹ 1,250	25,00,000	2021 April. 30	By Cash- sale proceeds of 500 @ cabinets ₹ 1,300 each	6,50,000
April, 30	To Cash – expenses: Freight & Insurance	12,000	May 31	By Cash (settlement of accounts)	19,02,000
	Selling Expenses	5,000			
May 31	To Profit & Loss Account ½ share of profit	35,000			
		25,52,000			25,52,000

Sujit's books**Joint Venture with Bharat Account****Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2021 Mar.31	To Cash – expenses: Clearing charges	1,000	2021 April 30	By Cash- sale proceeds of 1,500 cabinets at ₹1,300 each	19,50,000
	Selling expenses	12,000			
May 31	To Profit & Loss A/c ½ share of profit	35,000			
May 31	To Cash (settlement)	19,02,000			
		19,50,000			19,50,000

Memorandum Joint Venture Account**Dr.****Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2021 Mar.31	To Purchases: Bharat 2,000 Television cabinets at ₹1,250 each	25,00,000	2021 April 30	By Sales : Bharat	6,50,000

April,30	To Expenses:			Sujit	19,50,000
	Bharat (12,000 + 5,000)	17,000			
	Sujit (1,000 + 12,000)	13,000			
May 31	To Net profit:				
	Bharat (1/2) 35,000				
	Sujit (1/2) 35,000	70,000			
		26,00,000			26,00,000

Illustration 17.

M and N decided to work in partnership with the following scheme, agreeing to share profits as under :

M — $\frac{3}{4}$ th share.

N — $\frac{1}{4}$ th share.

They guaranteed the subscription at par of 10,00,000 shares of ₹1 each in U Ltd. And to pay all expenses up to allotment in consideration of U Ltd. issuing to them 50,000 other shares of ₹1 each fully paid together with a commission @ 5% in cash which will be taken by M and N in 3 : 2. M and N introduced cash as follows:

Particulars	(₹)
M – Stamp Charges, etc.,	4,000
Advertising Charges	3,000
Printing Charges	3,000
N – Rent	2,000
Solicitor's Charges	3,000

Application fell short of the 10,00,000 shares by 30,000 shares and N introduced ₹30,000 for the purchase of those shares. The guarantee having been fulfilled, U Ltd. handed over to the venturers 50,000 shares and also paid the commission in cash. All their holdings were subsequently sold by the venturer N receiving ₹18,000 and M ₹50,000. Write-up necessary accounts in the books of both the parties on the presumption that Memorandum Joint Venture Account is opened for the purpose.

Solution:

Memorandum Joint Venture Account

Dr.

Cr.

Particulars	(₹)	(₹)	Particulars	(₹)
To, N : Cost or Shares		30,000	By M : Commission (3/5)	30,000
To, M : Stamp Charges etc,	4,000		N : Commission (2/5)	20,000
Advertising Charges	3,000		By M : Sale Proceeds	50,000
Printing Charges	3,000	10,000	N : Sale Proceeds	18,000
To, N : Rent	2,000			
Solicitor's Charges	3,000	5,000		

To, Profit on Venture :				
To M — $\frac{3}{4}$	54,750			
To N — $\frac{1}{4}$	18,250	73,000		
		1,18,000		1,18,000

**In the books of M
Joint Venture with N**

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To, Bank : Stamp, Adv. & Printing Charges	10,000	By, Bank : Commission	30,000
To, Share of Profit	54,750	By, Bank : Sale Proceeds	50,000
To, Bank (Remittance)	15,250		
	80,000		80,000

**In the books of N
Joint Venture with M**

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To, Bank : Cost of Shares	30,000	By, Bank : Commission	20,000
To, Bank : Rent and Solicitor's Charges	5,000	By, Bank : Sale Proceeds	18,000
To, Share of Profit	18,250	By, Bank (Remittance)	15,250
	53,250		53,250

Bills of Exchange (excluding Accommodation Bill, Insolvency)

2.3

● Concept of Bill of Exchange

A bill of exchange is a negotiable instrument. As per Section 13(1) of the Negotiable Instruments Act, 1881, “A negotiable instrument means a promissory note or bill of exchange or cheque, payable either to order or to the bearer”.

According to Section 5 of the Negotiable Instrument Act, 1881, ‘A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.’

● Elements of a Bill of Exchange

Following are the essential elements of a bill of exchange:

- a. It must be an instrument in writing;
- b. It must contain an unconditional order;
- c. It must be signed by the maker;
- d. It must be drawn on a specific person;
- e. There must be an order to pay a specific sum of money;
- f. It must be dated and stamp;
- g. It must bear revenue stamp;

● Parties to a Bill of Exchange

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

- a. Drawer: He is a person who draws the bill. Typically, he is the seller or a creditor.
- b. Drawee: He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the payee on the due date.
- c. Payee: He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.

In addition, there may be -

- a. Endorser: He is the person who transfers rights of payment.
- b. Endorsee: He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.
- c. Bearer: He is the person in possession of bearer bill.

• Types of Bills of Exchange

Following are the different Types of bills of exchange.

- a. **Documentary Bill:** In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- b. **Clean Bill:** This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- c. **Demand Bill:** This bill is payable when it demanded. The bill does not have a fixed date of payment; therefore, the bill has to be cleared whenever presented.
- d. **Usance Bill:** It is a time-bound bill which means the payment has to be made within the given time period and time.
- e. **Inland Bill:** An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to the foreign bill.
- f. **Foreign Bill:** A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- g. **Trade Bill:** Where the bill of exchange is drawn and accepted to settle a trade transaction, it is called Trade bill. This bill of exchange is drawn by the seller of the goods and is accepted by the buyer.
- h. **Accommodation Bill:** A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.

• Trade Bill vs. Accommodation Bill

Following are the differences between a trade bill and an accommodation bill.

Points	Trade Bill	Accommodation Bill
Objectives	These bills are drawn to facilitate the trade transactions of sale and purchases of goods.	These bills are drawn to help someone in need of financial assistance.
Consideration	There is a definite consideration for which the bill is accepted.	These bills are drawn without consideration.
Extension of Credit	Trade bills are a form of credit extension.	These bills are not a form of credit extension.
Proceeds	When trade bills are discounted, the proceeds remain with the holder.	When these bills are discounted, the proceeds may be shared by two parties in an agreed ratio.
Recovery	If trade bills are dishonoured, the amount may be recovered easily through the court.	In case of dishonour of these bills, the drawer cannot file a suit against the drawee.

• **Date of Maturity / Due Date of a Bill of Exchange and Days of Grace**

Due Date	
Maturity date in case of On Demand Bill / At Sight Bill / On Presentation Bill	<ul style="list-style-type: none"> ➤ The bill at sight becomes due for payment, as soon as it is presented for payment. ➤ In case of 'Instrument payable on demand', No time for payment is mentioned. ➤ Such Bills are not entitled to the Days of Grace.
Maturity date in case of After Date Bill	<ul style="list-style-type: none"> ➤ In the case of 'Bill after date,' the time for payment is mentioned. ➤ Three Days of Grace is allowed on such a bill.
Maturity date in case of After Sight Bill	<ul style="list-style-type: none"> ➤ In case of 'Bill after Sight, payable at a fixed period 'after sight'. ➤ The period begins from the date of accepting the bill. ➤ Three Days of Grace is allowed on such a bill.

Grace Period	
When the Period of Bill is Given in Months	<ul style="list-style-type: none"> ➤ In this case, the maturity date is calculated according to calendar months. ➤ Ignoring the number of days in a month. ➤ 3 days of the Grace period are added. ➤ For example: If a bill dated 4th May, 2021 is payable 3 months after date: = Then the maturity date will be 4th August 2021 + 3 Days of Grace = 7th August 2021.
When the Period of Bill is Given in Days	<ul style="list-style-type: none"> ➤ The maturity date will be calculated in days, ➤ This excludes the date of transaction but includes the date of payment. ➤ 3 days of the Grace period are added in this case also. ➤ For example: If a bill dated 5th June 2021 is payable after 65 days, then the maturity date will be: =25 Days of June + 31 Days of July + 9 Days of August + 3 Days of Grace =12th August 2021
When Maturity Date Falls on a National Holiday	<ul style="list-style-type: none"> ➤ If the due date of the bill is on the national holiday ➤ Then the maturity day of the bill shall be the preceding business day. ➤ Example: If due date of the bill falls on 26th January (Republic Day), then its due date will be 25th January. ➤ If the due date is 15th August (Independence Day), then the due date will be 14th August.
When the Maturity Date Has Been Declared as Emergency Holiday	<ul style="list-style-type: none"> ➤ If the due date of the bill is declared as an emergency holiday, ➤ Then the due date of the bill shall be after 1 day from the date of maturity. ➤ Example: If the due date of a bill is 25th July and it is declared as an emergency holiday, then the due date will be 26th July.

• **Bills Receivable vs. Bills Payable**

Bills Receivable (B/R)	<ul style="list-style-type: none"> ➤ For the person who draws the bill of exchange and is entitled to receive its payment is known as Bill Receivable. ➤ The drawer of the bill will show B/R on the assets side of the Balance Sheet.
Bills Payable (B/P)	<ul style="list-style-type: none"> ➤ For the person who accepts the bill, and is liable to make its payment, is known as Bills Payable. ➤ The Drawee of the bill will show B/P on the liabilities side of the Balance Sheet.

• **Dishonour of Bills**

Dishonour of a Bill refers to a situation when the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place. To provide legal evidence of dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'. The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'. These charges are to be paid by the holder of the bill on the date of default. Actually, the acceptor of the bill is liable for the dishonour, the noting charges paid by the holder are to be reimbursed by the acceptor.

• **Accounting for Trade Bills**

The accounting entries under various circumstances are as follows:

Situation 1: When the drawer retains the bill till maturity

Situations	Drawer's books	Drawee's books
Drawing of a bill	B/R A/c Dr. To Drawee A/c	Drawer A/c Dr. To B/P A/c
Payment on due date	Bank A/c Dr. To B/R A/c	B/P A/c Dr. To Bank A/c/
Dishonour on due date	Drawee A/c Dr. To B/R A/c To Bank A/c/ (for noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To Drawer A/c

Situation 2: When the drawer discounts the bill with bank before maturity

If the holder of a bill receivable cannot wait till the date of maturity of the bill and needs cash before the date due, then he can get the bill discounted from the bank. At the time of discounting it, the bank pays cash after deducting the discount from the value of the bill. The discount which is to be deducted depends upon the rate of interest and the remaining period of the bill and is calculated as follows.

$$\text{Discount} = \text{Amount of the bill} \times \text{Remaining period to maturity} \times \text{Rate of interest}$$

Discount is an expense for the holder receiving the payment and gain to the bank. Journal Entries in the books of drawer and drawee at the time of discounting and payment on due date are as under:

Situations	Drawer's books	Drawee's books
Drawing of a bill	B/R A/c Dr. To, Drawee A/c	Drawer A/c Dr. To, B/P A/c
Discounting with bank	Bank A/c Dr. Discount A/c Dr. To, B/R A/c	No Entry
Payment due date	No Entry	B/P A/c Dr. To, Bank A/c
Dishonoured on due date	Drawee A/c Dr. To Bank A/c (bill + noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To Drawer A/c
Transfer of discount to Profit and Loss A/c	Profit & Loss A/c Dr. To Discount A/c	No Entry

Note: Treatment of Discount in the Books of the Bank

The following entries are recorded in the books of the bank:

(a) When the bill is discounted:

Bill Discounted A/c Dr.
To Customer's Current A/c
To Discounting on Bill A/c

(b) When amount is received from the drawee:

Cash A/c Dr.
To, Bills Discounted A/c

Situation 3: When the drawer endorses the bill to a person before maturity

Situations	Drawer's books	Drawee's books	Endorsee's books
Drawing of a bill	B/R A/c Dr. To Drawee A/c	Drawer A/c Dr. To B/P A/c	Not applicable
Endorsement	Endorsee A/c Dr. To B/R A/c	No Entry	B/R A/c Dr. To Drawer A/c
Payment on due date	No Entry	B/P A/c Dr. To, Bank A/c/cash	Bank A/c Dr. To B/R A/c
Dishonoured on due date	Drawee A/c Dr. To Endorsee A/c (bill + noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To, Drawer A/c	Drawer A/c Dr. To B/R A/c To Bank A/c (noting charges)

Situation 4: When the drawer sends the bill to bank for collection before maturity

Situations	Drawer's books	Drawee's books
Drawing of a bill	B/R A/c Dr. To Drawee A/c	Drawer A/c Dr. To, B/P A/c
Sending for collection	Bill for Collection Dr. To B/R A/c	No Entry
Payment on due date	Bank A/c Dr. Collection Charges A/c Dr. To Bill for Collection	B/P A/c Dr. To Bank A/c
Dishonoured on due date	Drawee A/c Dr. To Bill for Collection A/c To Bank A/c (bill & noting charges)	B/P A/c Dr. Noting Charges A/c Dr. To Drawer A/c

Situation 5: Retiring a Bill under Rebate

Sometimes the acceptor of the bill desires to make its payment before its due date, he will do so if he is given some rebate or discount by the holder of the bill on earlier payment. This rebate is like discount and is calculated at agreed rate for the period between the date of earlier payment and the due date of the bill. Thus, if a bill is paid before its due date and some rebate or discount is allowed by the holder to the acceptor, it is said to be retired under rebate. The following are the accounting entries in connection with retiring a bill under rebate:

(a) Entries in Holder's Books:

Cash A/c Dr.
Rebate or Discount A/c Dr.
To Bills Receivable A/c

(Being bill retired under rebate, rebate given for the unexpired period of bill debited being loss to the holder)

(b) Entries in Acceptor's Books:

Bills Payable Account Dr.
To Cash A/c
To Rebate or Discount A/c

(Being bill retired under rebate, rebate granted for the unexpired period credited being gain to the acceptor)

Situation 6: Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a fresh bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

Entries in the books of Drawer and Drawee are shown below:

Transactions	Entries in the books of Drawer	Entries in the books of Drawee
(a) For dishonor of Bills	Usual entry	Bills Payable A/c Dr. To Drawer A/c
(b) For interest on renewed period	Drawee A/c Dr. To, Interest A/c	Interest A/c Dr. To Drawer A/c
(c) If interest is paid in Cash	Cash A/c Dr. To Interest A/c	Interest A/c Dr. To Cash A/c
(d) For fresh Bill	Bills Receivable A/c Dr. To Drawee A/c	Drawer A/c Dr. To Bills Payable A/c

Consider the following illustrations

Illustration 18.

Mohan sold goods to Sohan for ₹50,000. On 1st Jan 2021, Mohan drew a bill for three months on Sohan who accepted the same. Pass necessary journal entries in the books of Mohan and Sohan in following situations:

- The bill is retained by Mohan till 31st March and Sohan paid it on that day upon presentation.
- Bill is discounted with the bank and the bank pays ₹ 49,000 to Mohan. Sohan paid the bill on due date.
- Mohan endorsed the bill to Rohan (his creditor) in settlement of his claim for ₹ 51,000. The bill is settled on the due date.
- Mohan sent the bill to the bank for collection on due date. The bank collected bill amount and after deducting collection charges of ₹100 paid the balance to Mohan.

Solution:

Entries in the books of Mohan

- Bill is retained by Mohan:**

		Dr.	Cr.
On getting Sohan's acceptance	B/R A/c Dr. To, Sohan's A/c (Being the bill accepted by Sohan)	50,000	50,000
On payment on 31.03.2021	Bank A/c / Cash A/c Dr. To, B/R A/c (Being the payment received against the B/R)	50,000	50,000

b. Bill is discounted by Mohan:

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
On getting Sohan's acceptance	B/R A/c Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)			50,000
On discounting 31.03.2021	Bank A/c Dr.		49,000	
	Discount A/c To B/R A/c (Being bill discounted with bank)		1,000	50,000

On the date of maturity, as the bill is settled by Sohan to bank, there will be no entry in Mohan's books.

c. Bill is endorsed to Rohan by Mohan:

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
On getting Sohan's acceptance	B/R A/c Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)			50,000
On endorsement 31.03.2021	Rohan A/c Dr.		51,000	
	To, B/R A/c To discount (Being bill endorsed and discount received from Rohan in full settlement)			50,000 1,000

d. Bill is sent for collection to bank by Mohan:

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
On getting Sohan's acceptance	B/R A/c Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)			50,000
On sending bill of collection	Bill for Collection A/c Dr.		50,000	
	To, B/R A/c (being bill sent to bank for collection)			50,000
On payment on due date	Bank A/c Dr.		49,900	
	Collection Charges A/c Dr. To, Bills for Collection A/c (being payment received on bill collected).		100	50,000

Entries in the books of Sohan

In all four situations, since the bill was honoured, the entries will be same as below.

			Dr.	Cr.
	Particulars	L.F.	(₹)	(₹)
On acceptance of bill drawn by Mohan	Mohan's A/c Dr. To, B/P A/c (Being the bill of Mohan accepted)		50,000	50,000
On payment on due date	B/P A/c Dr. To, Bank A/c / cash A/c (Being payment of bill)		50,000	50,000

Illustration 19.

Sunil owed Anil ₹ 80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April 2021. Sunil accepts it and returns it to Anil. On 15th April 2021, Anil discounts it with CD Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of ₹100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of ₹ 3,000 on 1st July 2021. Before the new bill became due, Sunil retires the bill with a rebate of ₹ 500. Show journal entries in books of Anil.

Solution:**In the books of Anil****Journal**

			Dr.	Cr.
Date	Particulars	L.F.	(₹)	(₹)
2021 April 1	Bills Receivables A/c Dr. To Sunil's A/c (Being acceptance by Sunil)		80,000	80,000
2021 April 15	Bank A/c Dr. Discount A/c Dr. To, Bills Receivables A/c (Being discounting of the bill @ 12% p.a. & discounting charges for 2.5 months)		78,000 2,000	80,000
2021 June 30	Sunil's A/c Dr. To, Bank A/c (Being dishonour of the bill & noting charges paid by bank)		80,100	80,100

Date	Particulars	L.F.	(₹)	(₹)
2021 June 30	Bank A/c Dr. To, Cash A/c (Being cash paid to bank)		80,100	80,100
2021 July 1	Sunil's A/c Dr. To, Interest A/c (Being interest due from Sunil)		3,000	3,000
2021 July 1	Bills Receivables A/c Dr. To, Sunil's A/c (Being new acceptance by Sunil for ₹80,100 & interest of ₹3,000)		83,100	83,100
	Bank A/c Dr. Rebate A/c Dr. To, Bills Receivables A/c (Being the amount received on retirement of the bill)		82,600 500	83,100

Illustration 20.

On 1st April 2021 Mr. Bala draws a bill of ₹1,20,000 on Mr. Lala for the amount due for 4 months. On getting acceptance, on 5th April 2021, Bala endorses it to Mr. Kala in full settlement of his claim of ₹1,40,000 by paying the difference in cash. Lala approached Bala on 26th July saying that he needed to renew the bill for a further period of 4 months at an interest of 12% p.a. which Bala accepted. A fresh bill including interest was accepted by Lala on 1st August 2021. Bala settled his liability to Kala by cheque. This was duly settled on the due date. Pass journal entries in the books of Bala and Lala. Also show Bills Receivables Account and Bills Payable Account.

Solution:**In the books of Bala****Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2021 April 1	Bills Receivables A/c Dr. To Mr. Lala's A/c (Being acceptance by Lal)		1,20,000	1,20,000
2021 April 15	Kala's A/c To Cash A/c To, Bills Receivables A/c (Being bill endorsed to Kala & cash payment made to him)		1,40,000	20,000 1,20,000

Date	Particulars	L.F.	(₹)	(₹)
2021 July 25	Lala's A/c Dr. To, Kala's A/c (Being cancellation of bill for renewal)		1,20,000	1,20,000
2021 July 25	Lala's A/c Dr. To, Interest A/c (Being interest due from Lala)		4,800	4,800
2021 July 25	Kala's A/c Dr. To, Bank A/c (Being claim of Mr. Kala settled)		1,20,000	1,20,000
2021 August 1	Bills Receivables A/c Dr. To Lala's A/c (Being acceptance by Lala with interest of ₹ 3,000)		1,24,800	1,24,800
2021 November 30	Bank A/c Dr. To Bills Receivables A/c (Being payment received on due date)		1,24,800	1,24,800

Bills Receivable Account

Dr.

Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.2021	To Lala A/c	1,20,000	05.04.2021	By Kala A/c	1,20,000
01.08.2021	To Lala A/c	1,24,800	30.11.2021	By Bank A/c	1,24,800
		2,44,800			2,44,800

Journal entries in the Books of Lala

Dr.

Cr.

Date	Particulars	L.F.	(₹)	(₹)
2021 April 1	Bala's A/c Dr. To Bills Payable A/c (Being acceptance of Bala's bill)		1,20,000	1,20,000
2021 July, 26	Bills Payable A/c Dr. To Bala's A/c (Being cancellation of the bill for renewal)		1,20,000	1,20,000

2021 August 1	Interest A/c To Bala's A/c (being interest due to Bala)	Dr.		4,800	4,800
2021 August, 1	Bala's A/c To Bills Payable A/c (Being Bala's bill accepted with interest)	Dr.		1,24,800	1,24,800
2021 November, 30	Bills Payable A/c To Bank A/c (Being settlement of the bill due)	Dr.		1,24,800	1,24,800

Bills Payable Account

Dr.

Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2021 July, 26	To Bala A/c	1,20,000	2021 April, 1	By Bala A/c	1,20,000
2021 Nov. 30	To Bank A/c	1,24,800	2021 August, 1	By Bala A/c	1,24,800
		2,44,800			2,44,800

Illustration 21.

On 1st January, 2021, P draws three months bill of exchange for ₹30,000 on his debtor, Q who accepts it on the same date. P discounts the bill on 4th January, 2021 with his bankers, the discount rate being 6% p.a. On the due date, the bill is dishonored, the noting charges being ₹200. Q immediately makes an offer to P to pay him ₹10,000 cash on account and to settle the balance by agreeing to accept one bill of exchange for ₹ 12,000 at one month and the other for the balance at three months, the latter including at 12% p.a. for both the bills. P accepts the arrangement. The bill for ₹ 12,000 is met on the due date, but the other bill is dishonored. Show Q's Account and Bills Receivable Account in the books of P.

Solution:

In the books of P

Q's Account

Dr.

Cr.

Date	Particular	(₹)	Date	Particulars	(₹)
2021 Jan 1	To, Balance b/d	30,000	2021 Jan 1	By, Bills Receivable A/c	30,000
Apr 5	To, Bank A/c (dishonor +noting charge)	30,200	Apr 5	By, Bank A/c	10,000

Apr 5	To, Interest A/c	366	Apr 5	By, Bills Receivable A/c	12,000
July 8	To, Bills Receivable A/c	8,566		By, Bills Receivable A/c (8,200+366)	8,566
			July 8	By, Balance c/d	8,566
		69,132			69,132
July 9	To, Balance b/d	8,566			

Bills Receivable Account

Dr.

Cr.

Date	Particular	(₹)	Date	Particulars	(₹)
2021			2021		
Jan 1	To Q' A/c	30,000	Jan 4	By, Bank A/c	29,550
Apr 5	To Q' A/c	12,000		By, Discount A/c (₹30,000 × 6/100 × 3/12)	450
	To Q' A/c	8,566	May 8	By, Bank A/c	12,000
			July 8	By, Q' A/c	8,566
		50,666			50,666

Calculation of Interest

$$\begin{aligned}
 \text{On ₹ 12,000 for 1 month @ 12\%: } & (12,000 \times 12\% \times 1/12) = ₹120 \\
 \text{On ₹ 8,200 for 3 month @ 12\%: } & (8,200 \times 12\% \times 3/12) = ₹246 \\
 & \underline{\hspace{1.5cm}} \\
 & ₹366
 \end{aligned}$$

Illustration 22.

X bought goods from Y for ₹4,000. Y draws a bill on 1.1.2021 for 3 months which was accepted by X for this purpose. On 1.3.2021, X arranged to retire the bill at a rebate of 12% p.a. Show the entries in the books of X and Y.

Solution:

In the books of Y

Journal

Date	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
2021 Jan 1	X A/c To, Sales A/c (Goods sold to X)	Dr.	4,000	4,000
Jan 1	Bills Receivable A/c To, X A/c (Bills drawn for 3 months)	Dr.	4,000	4,000

March 1	Cash A/c	Dr.		3,954	
	Rebate Allowed A/c	Dr.		46	
	To, Bills Receivable A/c				4,000
	(Bills retired under a rebate of 12% p.a.)				

Rebate = ₹ 4,000 × 12/100 × 35/365 (1st March to 5th April) = ₹46.

**In the books of X
Journal**

Date	Particulars	L.F.	Dr.	Cr.
			(₹)	(₹)
2021 Jan 1	Purchase A/c	Dr.	4,000	
	To, Y A/c			4,000
	(Goods purchased from Y)			
Jan 1	Y A/c	Dr.	4,000	
	To, Bills Payable A/c			4,000
	(Bills accepted for 3 months)			
March 1	Bills Payable A/c	Dr.	4,000	
	To, Cash A/c			3,954
	To, Rebate Received A/c			46
	(Bills retired under a rebate of 12% p.a.)			

Illustration 23.

Mohan sold goods to Gupta on 1st September, 2021 for ₹1,600. Gupta immediately accepted a three months bill. On due date Gupta requested that the bill be renewed for a fresh period of two months. Mohan agrees provided interest at 9% was paid immediately in cash. To this Gupta was agreeable. The second bill was met on due date. Give journal entries in the books of Mohan.

Solution:

**In the books of Mohan
Journal**

2021	Particulars		Dr.	Cr.
			(₹)	(₹)
Sept. 1	Gupta A/c	Dr.	1,600	
	To Sales A/c			1,600
	(sales of goods to Gupta as per Invoice No....)			

	Bills Receivable A/c To Gupta A/c (3 months acceptance received from gupta for the amount due from him)	Dr.	1,600	1,600
Dec. 4	Gupta A/c To Bill Receivable A/c (Gupa's acceptance cancelled because of renewal)	Dr.	1,600	1,600
	Gupta A/c To Interest A/c (interest @ 9 % on ₹1,600 due form Gupta for 2 months because of renewal)	Dr.	24	24
	Bills receivable A/c Cash A/c To Gupta A/c (New acceptance for 2 months for ₹1,600 and cash (for interest) received from Gupta}	Dr. Dr.	1,600 24	1,624
2022 Feb. 7	Cash A/c To Bills Receivable A/c (Cash received against Gupta's second acceptance)	Dr.	1,600	1,600

Exercise

Theoretical Questions

Multiple Choice Questions (MCQ)

- Which of these is/are recurring (indirect expenses)?
 - transit insurance and freight
 - octroi
 - loading and unloading
 - godown rent and insurance
- On receipt of goods the consignee debits which of these accounts
 - Purchase Account
 - Goods Account
 - Consignors Account
 - None of these
- X sends out goods to Y, costing ₹1,50,000. Goods are to be sold at cost +33 $\frac{1}{3}$ %. The consignor asked consignee to pay an advance for an amount equivalent to 60% of sales value. The amount of advance will be
 - ₹1,20,000
 - ₹1,00,000
 - ₹1,50,000
 - None
- Goods of the invoice value of ₹ 2,40,000 sent out to consignee at 20% profit on cost the loading amount will be
 - ₹40,000
 - ₹48,000
 - ₹50,000
 - none
- Goods sent on consignment account is of the nature of
 - Personal Account
 - Nominal Account
 - Real Account
 - Sales Account
- Out of the given option which cannot be treated as part of cost of purchase for valuing stock on hand
 - packing

- (b) octroi
 - (c) delivery charges
 - (d) freight
7. X sends out 100 bags to Y costing ₹1,000 each. 60 bags were sold at 10% above cost price. Sale value will be
- (a) ₹66,000
 - (b) ₹65,000
 - (c) ₹60,000
 - (d) ₹65,500
8. The consignment accounting is made on the following basis
- (a) accrual basis
 - (b) realization basis
 - (c) cash basis
 - (d) all of above
9. Which of the following term is true about consignment?
- (a) sale of goods
 - (b) hypothecation of
 - (c) shipment of goods
 - (d) mortgage of goods
10. Which of these accounts are not opened in the books of consignor?
- (a) Consignment Account
 - (b) Commission Account
 - (c) Goods Send on Consignment Account
 - (d) Consignees Personal Account
11. For closing stock held by consignee which account must be debited
- (a) Consignment Stock
 - (b) Sales Account
 - (c) Consignee Account
 - (d) Consignment Account
12. X of Kanpur sends out 1000 boxes to Y Delhi costing ₹ 200 each at an invoice price of ₹ 220 each goods sent out on consignment to be credited in general trading will be
- (a) ₹ 2,00,000
 - (b) ₹ 2,40,000

- (c) ₹ 40,000
(d) None
13. A proforma invoice is sent by
(a) consignee to consignor
(b) consignor to consignee
(c) debtor to consignee
(d) debtor to consignor
14. Commission will be shared by
(a) consignor and consignee
(b) only consignee
(c) only consignor
(d) third party
15. X of Mumbai sends out certain goods at cost +25%. Invoice value of the goods is ₹2,00,000. 4/5th of the goods were sold by consignee at ₹1,76,000. Commission 2% upto invoice value and 10% of any surplus above invoice. The amount of commission will be.
(a) ₹4,800
(b) ₹5,200
(c) ₹3,200
(d) ₹1,600
16. Joint venture account is of the nature of
(a) Personal A/c
(b) Nominal A/c
(c) Real A/c
(d) Suspense A/c
17. A and B purchased a piece of land for ₹40,000 and sold it for ₹ 60,000 in 2021. Originally A had contributed ₹24,000 and B ₹16,000. What will be the profit on venture?
(a) ₹20,000
(b) ₹16,000
(c) ₹30,000
(d) Nil
18. A, for joint venture with B, Purchased goods costing ₹2,00,000. B sold 80% of the goods for ₹2,50,000. Balance of goods were taken over by B at cost less 25%. Find out profit on venture?
(a) ₹80,000
(b) ₹90,000

- (c) ₹50,000
(d) None of these
19. If unsold goods costing ₹ 20,000 is taken over by venture at ₹15,000 the Joint venture A/c will be credited by
- (a) ₹20,000
(b) ₹15,000
(c) ₹5,000
(d) Nil
20. Memorandum Joint Venture Account is
- (a) Personal Account
(b) Real Account
(c) Nominal Account
(d) None of the above
21. A purchased goods costing ₹42,500. B sold goods of ₹40,000 at ₹50,000. Balance goods were taken over by A at same gross profit percentage as in case of sale. The amount of goods taken over will be.
- (a) ₹3,125
(b) ₹2,500
(c) ₹3,000
(d) None
22. What is the nature of joint venture with co-venture account
- (a) Nominal Account
(b) Real Account
(c) Personal Account
(d) None of these
23. 'M' and 'N' enter into joint venture where 'M' supplies goods worth ₹6,000 and spend ₹100 on various expenses. 'N' sells the entire lot for ₹7,500 meeting selling expenses amounted to ₹200 profit sharing ratio equal. N remits M the amount due. The amount of remittance will be
- (a) ₹6,700
(b) ₹7,300
(c) ₹6,400
(d) ₹6,100
24. A and B purchased a piece of land for ₹ 20,000 and sold it for ₹60,000 in 2021. Originally A had contributed ₹12,000 and B ₹8,000. The profit on venture will be :
- (a) ₹40,000

- (b) ₹20,000
 - (c) ₹60,000
 - (d) Nil
25. A and B enter in to joint venture sharing profit and loss in the ratio 1:1 A purchased goods costing ₹20,000. B sold the goods for ₹25,000. A is entitled to get 1% commission on purchase and B is entitled to get 5% commission on sales the profit will be
- (a) ₹3,550
 - (b) ₹3,600
 - (c) ₹3,400
 - (d) ₹3,800
26. Goods costing ₹10,000 destroyed by an accident, insurance claim nil
- (a) ₹10,000 will be credited to joint venture account
 - (b) No entry will be made in the books of joint venture
 - (c) ₹10,000 will be debited in Joint venture account as loss
 - (d) ₹ 8,000 will be credited in joint venture account
27. Which of the following statement is true?
- (a) There is no difference between joint venture and partners
 - (b) Consignment and joint venture is same
 - (c) There is not separate act for joint venture
 - (d) In case of joint venture, the number of third party is none only
28. Which of the following accounts are maintained in the joint venture when separate set of books are maintained
- (a) Joint Bank A/c
 - (b) Joint Venture A/c
 - (c) Co-ventruer A/c
 - (d) All of these
29. If A co-venturer takes away goods under memorandum joint venture method then he will debit these goods in his books to
- (a) Joint Venture Account
 - (b) Personal Account
 - (c) Purchases Account
 - (d) Sales Account
30. For opening Joint Bank Account, in case of separate sets of books:
- (a) Ventruer a/c will be debited and Co-ventures A/c will be credited

- (b) Joint Bank A/c is debited and Ventures Capital A/c is credited
 - (c) Joint Venture A/c is debited and Joint Bank A/c will be credited
 - (d) Joint Bank A/c will be debited and Joint Venture A/c will be credited
31. The person other than the original creditor to whom the amount in the bill is made payable to is known as the ____ of the bill.
- (a) holder
 - (b) payee
 - (c) drawer
 - (d) endorser
32. Payment of Bills of exchange is received
- (a) by drawer
 - (b) by holder in due course of due date
 - (c) by endorsee
 - (d) by bank
33. Retirement of bill means:
- (a) making payment before the due date
 - (b) cancellation of the bill
 - (c) sending the bill for collection
 - (d) endorsing the bill in favour of third party
34. At the time of retirement of a bill, the acceptor debits:
- (a) Bills Receivable Account
 - (b) bill Payable Account
 - (c) Discount
 - (d) None of the above
35. The party who is ordered to pay the amount is known as
- (a) payee
 - (b) Drawer
 - (c) drawee
 - (d) endorsee
36. In which of these ways a bill of exchange cannot be disposed of
- (a) discounting with bank
 - (b) retain till maturity
 - (c) endorsement to creditors

- (d) destroyed
37. Bills Receivable Book is a part of the
- (a) Ledger
 - (b) Balance Sheet
 - (c) Journal
 - (d) Profit and Loss Account
38. X Sold goods to Y for ₹30,00,00. $\frac{1}{2}$ of the amount will be received in cash and the balance through a B/R for what amount X should draw a bill Y
- (a) ₹1,50,000
 - (b) ₹3,00,000
 - (c) ₹1,00,000
 - (d) ₹1,20,000
39. A person who endorses a bill is called
- (a) drawer
 - (b) drawee
 - (c) Bank
 - (d) endorser
40. At the time of dishonor of an endorsed bill which one or these accounts would be credited by the drawee
- (a) Bill Payable Account
 - (b) Drawer
 - (c) Bank
 - (d) Bill Dishonored Account
41. Date on which the payment of the bill is to be made
- (a) public holiday
 - (b) date of grace
 - (c) due date
 - (d) date of bill + 3 days
42. Kuntal draws a bill on shyam for ₹ 3,000. Kuntal endorsed it to Ram. Ram endorsed it to Rahim. The payee of the bill will be:
- (a) Kuntal
 - (b) Ram
 - (c) Shyam

- (d) Rahim
43. If the due date is a public holiday what will be the due date of the bill
- (a) following day
 - (b) preceding day
 - (c) the same day only
 - (d) one month later
44. On 1-8-21, X draws a bill on Y for 30 days after sight The date of acceptance is 8-8-21. The due date of the bill will be
- (a) 8.9.2021
 - (b) 10.9.2021
 - (c) 11.9.2021
 - (d) 9.9.2021
45. If bill drawn on 3rd July 2021 for 40 days, payment must be made on
- (a) 16th August, 2021
 - (b) 15th August, 2021
 - (c) 12th August, 2021
 - (d) 14th August, 2021

• **State True or False**

1. Goods Sent on Consignment Account is of the nature of Real Account.
2. Goods valued at invoice price refers to valued at lower price than its original cost.
3. Balance in Consignment Account shows profit and loss on consignment.
4. Profit and loss on consignment is retained / borne by consignor.
5. Commission will be shared between only consignee.
6. The details contained in Account Sales are unsold stock left with the consignee.
7. All proportionate consignee's expenses will be added up for valuation of consignment stock.
8. In consignment, the goods are dispatched on the basis that the goods will be sold on behalf of and at the expenses of and at the risk of the consignee.
9. Cost of the goods include all non-recurring expenses incurred till the goods reach the premises of the consignee's godown.
10. Accounts Sales is a statement furnished by consignor to consignee.
11. Expenses incurred by co-venture are debited in Joint Venture Account.

12. The profit to be shared between the venture in agreed ratio.
13. In joint venture, provisions of partnership act applies.
14. The transactions regarding transfer of goods from one venturer to another venturer will affect book-keeping entries.
15. If goods costing ₹10,000 destroyed by an accident, insurance claim nil then no entry will be made in the books of joint venture.
16. Joint Venture has a definite life.
17. Joint Venture agreement must be registered.
18. Memorandum Joint Venture Account is a Real Account.
19. Contract money received is credited to Joint Venture Account.
20. Joint Bank Account is a Nominal Account.
21. Oral bill of exchange is also valid.
22. Creditors can draw a bill on debtors.
23. Bank will draw a bill on customer at the time of overdraft.
24. Retirement of bill means sending the bill for collection.
25. A person by whom the bill is endorsed is called endorser.
26. Foreign trade is facilitated with the help of foreign bills of exchange.
27. If the bill is assigned by the drawer it is invalid.
28. In case of endorsement of bill endorser debits endorsee and credits B/R account.
29. Endorser or drawer credits endorsee when the payment is received.
30. When a bill is retired under rebate the holder of a bill debits B/R account.

● **Fill in the Blanks**

1. The person who sends the goods for sale on fixed commission basis is _____.
2. When the consignor sends goods to consignee he prepares a _____.
3. A periodic statement furnished by the consignee to consignor is _____.
4. Del credere commission is allowed to cover the risk of _____.
5. Where goods are sent on consignment, credit is given to _____ in the books of consignor.
6. Goods costing ₹2,00,000 sent out to consignee at cost +25%. Invoice value of the goods will be _____.
7. Stock reserve is created to adjust _____.

8. Goods of the invoice value of ₹1,20,000 sent out to consignee at 20% profit on cost. The loading amount will be ____.
9. Extra commission given to the consignee, for making him responsible for bad debts this extra commission is known as ____.
10. Balance in consignment account shows ____.
11. 'X' of Kolkata sends out certain goods to Y of Mumbai at cost + 25%. 1/2 of the goods received by Y is sold at ₹1,76,000 at 10% above Ip. Invoice value of goods send out is ____.
12. X of Kolkata sends out 400 bags to Y on Delhi costing ₹200 each consignor expenses ₹2,000. Y expenses non selling ₹2,000 selling 1000. 300 bags were sold by y. Value of consignment stock will be ____.
13. The balance of consignment stock is shown on the ___side of the balance shet.
14. Consignment account is ____Account.
15. Goods costing ₹1,80,000 sent out to consignee to show a profit of 20% on the invoice price. Invoice price of the good will be ____.
16. The account opened in the bank in joint name of the co-ventures is ____.
17. Partners of Joint venture business are called ____.
18. Under Memorandum Joint venture, each co-venturer opens only one account which is in the nature of a ____.
19. When goods are sold for the joint venture the account to be credited in separate set of books ____.
20. The accounts to be credited for transferring profit on Joint venture in the books of the co-venturer maintaining accounts regarding joint venture are ____.
21. Generally, when the size of the venture is ___ the co-venture keep separate set of books of account for the joint venture.
22. ___ is the concept which the joint venture accounting does not follow.
23. ___ is credit balance of joint venture account.
24. ___ is not a part of double entry system.
25. When co-venture initially contribute for a joint venture ___ account should be debit in the case when separate set of books are maintained.
26. Maximum number of members in joint venture business ____.
27. Memorandum Joint-venture account is prepared to find out ___in venture.
28. Joint venture does not follow ____basis of accounting.
29. When separate set of books is maintained expenses paid by venture will be ___to joint venture account.
30. Co-ventruer account is ___ account.
31. When a B/R is endorsed by the drawer what entry is passed by the drawee ____.

32. Negotiable instrument act was enacted in the year ____ .
33. The debtor on whom a bill of exchange is drawn is called ____ .
34. ____ ____ is the date on which a bill falls due for payment.
35. X-draws a trade bill of ₹25,000 for 6 months on Y. After holding the bill for 1.5 months, X-discounts the bill with bank @ 10% p.a. the amount of discount on bill is ____ .
36. A promissory note contains an ____ ____ to pay.
37. A bill of exchange is a ____ of indebtedness of the purchaser of goods or services on credit.
38. Amount ordered to be paid by the drawer in a bill must be ____ ____.
39. Renewal of a bill includes interest for the ____ ____ period.
40. When the drawer discounts the bill with bank before maturity the drawee passes ____ entry in his books.
41. Rebate is given in case of ____ of a bill.
42. Bills receivable account is a ____ account.
43. Bill of exchange is a ____ instrument
44. The cash allowance provided by the drawer to the drawee for the pre-payment of the bill is known as ____.
45. M sold goods worth ₹50,000 to N on 1.1.21. N immediately accepted a three months bill on due date N requested that the bill be renewed for a fresh period of 3 months. N agrees to pay interest @ 18% p.a. in cash. How much interest to be paid in cash by N? _____.

B. Numerical Questions

⊙ Comprehensive Numerical Problems

1. On 1st July, 2021 Radio House of Delhi consigned 200 Radios to Banerjee Bros. of Calcutta. The cost of each radio was ₹400. Radio House paid ₹5,000 for freight and insurance. On 7 July, 2021 Banerjee Bros. accepted a 3 month bill drawn upon them by Radio House for ₹50,000. Banerjee Bros. Paid ₹2,200 as rent and ₹1,300 for advertisement and upto 31st December, 2021 (on which date Radio House close their books) they sold 180 radios at ₹500 each. Banerjee Bros. were entitled to a commission of 5% on sales.

Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties.

[Answer: Profit = ₹5,500, Value of Stock = ₹8,500, Balance due from Banerjee = ₹32,000]

2. A of Sonepat consigned 500 bicycles to B of Cochin to be sold on his account and at his risk. The cost

of one bicycle was ₹200. A paid ₹5,500 as freight and insurance and received ₹40,000 as advance from B. B paid ₹1,000 as octroi and carriage, ₹1,500 as rent and ₹1,200 as insurance. 410 bicycles were sold by B for ₹1,10,000. B was entitled to a commission of 5% on sale @ ₹250 per bicycle and 25% of any surplus price realized. Give journal entries in the books of A and B.

[Answer: Profit = ₹12,970, Value of Stock = ₹19,170,
Commission = ₹7,000, Balance due from B = ₹59,300]

3. H Ltd. Forwarded on 1.7.2021, 100 bicycles to Vasu of Hyderabad to be sold on behalf of H Ltd. The cost of each bicycle was ₹150 but the invoice price was ₹200. H Ltd. incurred ₹1,000 on freight and insurance. Vasu received the consignment on 14.7.2021 and accepted a three months draft drawn upon him by H Ltd. For ₹10,000. Vasu paid ₹400 as rent and ₹250 as insurance and by 31.12.2021 had disposed of 80 bicycles at ₹205 each. Vasu is entitled to a commission of 5% on sales including del credere commission of 1%. Vasu sold 20 bicycle on credit and was not able to recover sales proceeds of 5 bicycles because of insolvency of the debtor.

Give journal entries to record the above transactions in the books of H Ltd. and Vasu.

[Answer: Profit = ₹2,130, Value of Stock at invoice price = ₹4,200]

4. A and B were participants in a joint venture, sharing profits and losses in the proportion of 10:9 respectively. Each party maintains a complete record in his own books. A supplies goods to the value of ₹25,000 and incurs an expenditure of ₹500 on them; and B supplies goods to the extent of ₹21,000 and his expenses thereon amounted to ₹1,000. A sells all the goods for ₹70,000 for which he is entitled to receive a commission at 5 percent. Accounts are settled by bank draft. Give journal entries and prepare necessary accounts in the books of both parties.

[Answer: Profit = ₹19,000, Amount Paid to B = ₹31,000]

5. Dilip and raj are doing business separately as engineering contractors. They undertake jointly to build and install new machinery for a company for a contract price of ₹1,34,000. ₹84,000 payable in installments in cash and the balance as fully paid share in the new company. A bank account is opened in joint names. Dilip paying ₹45,000 and Raj ₹20,000. They agree to share profits and losses in the proportion of 3/5 and 2/5 respectively. The transactions were as follows:

Particulars	(₹)
Amount advance to suppliers for supply of materials	52,000
Value of materials supplied by suppliers	89,000
Balance amount paid to suppliers in full and final settlement	35,500
Paid wages	36,000
Materials purchased in cash	2,500
Engineering consultant's fee paid	3,250

Materials supplied by Dilip from stock	9,250
Value of stocks lost by fire and not covered by insurance	3,500

The contract was completed and price duly received.

Dilip took all the shares at an agreed value of ₹47,000 and Raj took the balance stock of materials worth ₹3,500 at an agreed value of ₹2,750.

Show the necessary ledger accounts assuming a separate set of books is opened.

[Answer: Loss of Joint Venture = ₹4,750, Final settlement Dilip- ₹4,400, Raj - ₹15,350 Discount allowed by the supplier - ₹1,500]

6. Das, Bose and Gupta undertake to erect a five storied mansion for National Housing Trust Ltd. The contract price is agreed at ₹25,00,000 to be paid in cash ₹22,00,000 by four equal installments and the balance amount in 8% Debentures of the company. They agree to share equally the profit or loss.

They opened a Joint Banking Account with cash contributed as stated below; Das ₹3,00,000; Bose: ₹3,75,000; Gupta ₹2,00,000 Das arranges the preparation of building plans, etc., and pays ₹32,000 as architect's fees. Bose brings a concrete mixer and other implements valued at ₹80,000 and Gupta brings a motor lorry valued at ₹75,000.

They paid in cash for the following;

Particulars	(₹)
Materials	12,26,800
Wages	7,33,200
Sundry Expenses	20,000
Plant	60,000

On completion of the venture concrete mixer is sold ₹50,000 and plant and other implements are sold as scrap for ₹10,000. Gupta takes back the motor lorry at ₹40,000.

Subsequently Das took over the Debentures issued by the company at a valuation of ₹2,80,000.

Show the necessary ledger accounts for the joint venture.

[Answer: ₹3,54,000, Amount paid to Das ₹1,70,000, Bose ₹5,73,000 Gupta = ₹3,53,000]

7. A and B decided to work on a joint venture to sell electric motors. On 21st May 2020, A purchased 200 electric motors at ₹1,750 each and dispatched 150 motors to B incurring ₹10,000 as freight and insurance. 10 motors got damaged in transit. On 1st Feb 2021, insurance company paid ₹5,000 to A in full settlement of the claim. On 15th March, 2021, A sold 50 motors at ₹2,250 each. He received ₹1,50,000 from B on 1st April 2021.

On 25th May 2021, B took delivery of motors and paid ₹1,700 for clearing, repairs ₹3,000 and rent of ₹6,000. B sold motors as on 1st Feb 2021 – 10 damaged motors at ₹170 each, on 15th March 2021 – 40 motors at ₹2,000 each, on 1st April 2021 – 20 motors at ₹3150 each and on 1st April 2021, 80 motors at ₹2,500 each. It was agreed that they would be entitled for a commission of 10% on the respective sales made by them and that the profit or losses will be shared by A & B in the ratio of 2:1.

On 30th April 2021, B remits the cash to A to close the venture Prepare “Joint venture with B A/c” in the books of A and the memorandum joint venture A/c.

[Answer: Profit A - ₹39,700, B - ₹19,850, Balance received from B - ₹1,43,450]

8. Pass journal entries in the books of Hema for the following transactions:
 - a. Hema’s acceptance to Nanda for ₹5,000 renewed for 3 month with interest at 10% p.a.
 - b. Nalini’s acceptance to Hema was for ₹10,000 was retired one month before due date at a discount of 12% p.a.
 - c. Discounted Natasha’s acceptance to Hema for ₹4,000 with the bank for ₹3,920.
 - d. Neela requests Hema to renew her acceptance for ₹3,500 for 3 months. Hema accepted on the condition that interest of ₹100 was paid in cash which Neela did.

9. Mohan sold goods on 1st September, 2020 for ₹2,00,000 to Sohan. Sohan immediately accepted a 3 months bill. On the due date Sohan requested for the renewal of the bill for a further period of two months. Mohan agrees to pay interest @ 9% per annum to be included in the new bill. Determine the amount of the new bill.

[Answer: ₹2,03,000]

10. On 1.4.21, Mr. A draws a bill for ₹ 6,000 for 7 months on Mr. B who returned the bill to Mr. A after acceptance. On 10.4.21, Mr. A endorsed the bill in favour of Mr. C who endorsed the bill on 15.4.21 in favour of Mr. D. On 1.5.2021, Mr. D discounted the bill at 10%. On maturity, the bill was dishonoured and banker paid ₹ 50 towards noting charges. Pass necessary journal entries in the books of Mr. D.

11. Mr. A draws on Mr. B a bill of exchange for ₹5,000 on 1st Jan, 2021. Mr. A endorses the bill in favour of Mr. C Before maturity, Mr. B approaches Mr. A with the request that the bills be renewed for a further period of 3 months at fifteen percent interest per annum. Mr. A pays the sum to Mr. C on due date and agrees to the proposal of Mr. B pass the journal entries in the books of Mr. A assuming that the second bill is duly met.

Answer:

⊙ **Multiple Choice Questions (MCQ)**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
d	d	a	a	c	c	a	a	c	b	a	a	b	b	a	b	a	a	b
20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38
c	a	c	a	a	a	b	c	d	c	b	b	b	a	b	c	d	c	a
39	40	41	42	43	44	45												
d	b	c	d	b	b	d												

⊙ **State True or False**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
T	F	T	T	T	F	F	F	T	F	T	T	F	F	T	T	F	F
19	20	21	22	23	24	25	26	27	28	29	30						
T	F	F	T	F	F	T	T	F	T	F	F						

⊙ **Fill in the Blanks**

1	consignor	2	proforma invoice
3	account sales	4	bad debts
5	Goods sent on consignment account	6	₹ 2,50,000
7	valuation of closing stock to cost	8	₹ 20,000
9	del credere commission	10	profit or loss on consignment
11	₹ 3,20,000	12	₹ 21,000
13	asset	14	nominal
15	₹ 2,25,000	16	Joint bank account
17	Co-venturers	18	personal account
19	Joint venture account	20	profit and loss account and other party account
21	Big	22	Going concern
23	Profit	24	Memorandum
25	Joint bank	26	Unlimited.
27	profit or loss	28	Accrual
29	debited	30	personal

31	No entry at all	32	1881
33	Drawee	34	maturity date
35	₹ 938	36	undertaking or promise
37	conclusive proof	38	certain and unconditional
39	extended period	40	no entry
41	retirement	42	personal account
43	negotiable	44	rebate
45	₹ 2,250		

PREPARATION OF FINAL ACCOUNTS

3

This Module includes:

- 3.1 Preparation of Financial Statements of Sole Proprietorship**
- 3.2 Preparation of Financial Statements of a Not-for-Profit Organisation**

PREPARATION OF FINAL ACCOUNTS

Module Learning Objectives:

After studying this Module, the students will be able to –

- ↗ Learn preparation of Financial Statements of profit seeking entities.
- ↗ Learn preparation of Financial Statements of not-for-profit organisations.

● **Finalisation of Accounts and Preparation of Financial Statements**

The ultimate objective of accounting is to determine the financial performance and financial state of affairs of an organisation. Thus, after recording the transactions systematically in a summarised form, accounts are to be finalised for the above two purposes. Accordingly, an organisation needs to prepare financial statements. Financial statements are formally defined as certain written reports created by an entity to summarize the business's financial performance and financial condition over a certain period.

● **Components of Financial Statements**

Organisations differ according to nature, objectives and ownership structure. Accordingly, the components of financial statements also vary.

I. Components of Financial Statements based on the type of organizations classified according to nature:

Manufacturing Organizations	Trading Organization
a. Manufacturing Account	a. Trading Account
b. Trading Account	b. Profit and Loss Account
c. Profit and Loss Account	c. Balance Sheet
d. Balance Sheet	

II. Components of Financial Statements based on the type of Organizations classified according to objective

Profit oriented organizations	Not for profit organizations
a. Manufacturing Account or Trading Account (as the case may be)	a. Receipts and Payments Account
b. Profit and Loss Account	b. Income and Expenditure Account
c. Balance Sheet	c. Balance Sheet

II. Components of Financial Statements based on the type of Organizations classified according to ownership structure

Sole Proprietorship	Partnership	Company
a. Manufacturing Account or Trading Account (as the case may be)	a. Manufacturing or Trading Account (as the case may be)	a. Statement of Profit and Loss
b. Profit and Loss Account	b. Profit and Loss Account	b. Balance Sheet
c. Balance Sheet	c. Profit and Loss Appropriation Account	
	d. Balance Sheet	

Preparation of Financial Statements of Sole Proprietorship

3.1

◉ Concept of Sole Proprietorship Form of Business

A Sole proprietorship can be explained as a form of business or an organization that is owned, controlled and operated by a single individual who is the sole beneficiary of all profits or loss, and responsible for all risks. It is a popular form of business, especially suitable for small business at least for its initial years of operation.

Sole proprietorship form of business shares the following features:

- a. This type of business organization is formed by the owner himself.
- b. Legal formalities relating to formation and closure are the minimum here.
- c. In the sole proprietorship business, the sole owner has unlimited liability.
- d. A sole proprietor is only the one who bears all risks which are related to its business.
- e. The sole proprietor controls all the business activities as all the rights and responsibilities lie with him only.
- f. The law does not make any distinction between the sole proprietor and its business. However, while accounting the owner and the business are considered as two separate entities.

3.1.1 Income Statement, Balance Sheet (of a Sole Proprietorship Firm)

While finalising the accounts, a sole proprietorship entity prepares financial statements to determine its financial results (by Income Statement) and financial state of affairs (by Balance Sheet). Accordingly, the components of financial statements of a sole proprietorship organisation include –

- a. Manufacturing Account (only in case of manufacturing entities)
- b. Trading Account
- c. Profit and Loss Account
- d. Balance Sheet

Sole proprietorship firms do not require any Profit and Loss Appropriation Account as the entire profit is attributable to the sole owner.

These are discussed in detail as follows.

- a. **Manufacturing Account:** This is prepared only by a manufacturing organisation. It is prepared to determine the cost of goods manufactured. The items that appear in the Debit side of this account are – Opening Work-in-progress (i.e., balance of goods yet to be finished), Raw materials consumed, Direct labour, Direct expenses and factory overhead costs. The credit side includes closing work-in-progress only. The difference, being cost of goods manufactured, is transferred to Trading A/c. Following is the structure of a Manufacturing Account.

Dr.		Manufacturing Account		Cr.	
For the period ended on					
Particulars	Amount	Particulars	Amount		
To Opening WIP		By Trading Account			
To Raw materials consumed		(cost of finished goods transferred) (bal. fig.)			
To Direct Labour		By Closing WIP			
To Direct Expenses					
To Factory Overhead					

Consider the following illustration.

Illustration 1.

From the following information, prepare Manufacturing Account for the year ended on 31.03.2021.

Particulars	₹	Particulars	₹
Stock on 01.04.2020		Stock on 31.03.2021	
Raw materials	12,000	Raw materials	14,000
WIP	6,000	WIP	7,000
Purchase of raw materials	2,50,000	Salary of Factory Manager	80,000
Factory wages	1,75,000	Depreciation on Machinery	10,000
Factory Rent	10,000		

Solution:

Dr.		Manufacturing Account		Cr.	
For the period ended on 31.03.2021					
Particulars	Amount	Particulars	Amount		
To Opening WIP	6,000	By Trading Account	5,22,000		
To Raw materials consumed (12,000+2,50,000 – 14,000)	2,48,000	(cost of finished goods transferred) (bal. fig.)			
To Direct Labour	1,75,000	By Closing WIP			
To Factory Overhead					7,000
Factory rent	10,000				
Salary of factory manager	80,000				
Depreciation on machinery	10,000				
	5,29,000				5,29,000

- b. Trading Account:** This is prepared by a non-corporate trading business entity (manufacturer-cum-trader or only trader). It is prepared to determine the gross operating results (i.e., Gross Profit or Gross Loss). Its principle involves matching of the Cost of Goods Sold (COGS) of an accounting period against the corresponding Sales. It considers only the direct costs and direct income (i.e., Sales) for determination of Gross Profit/ Gross Loss. It is a nominal account, and is closed by transfer of the Gross Profit/ Gross Loss to the P/L A/c. The following items will appear in the debit side of the Trading Account:

The following items will appear in the debit side of the Trading Account:

- (i) **Opening Stock:** In case of trading concern, the opening stock means the finished goods only. The amount of opening stock should be taken from Trial Balance.
- (ii) **Purchases:** The amount of purchases made during the year. Purchases include cash as well as credit purchase. The deductions can be made from purchases, such as, purchase return, goods withdrawn by the proprietor, goods distributed as free sample etc.
- (iii) **Direct expenses:** It means all those expenses which are incurred from the time of purchases to making the goods in suitable condition. These expenses include freight inward, octroi, wages etc.
- (iv) **Gross profit:** If the credit side of Trading A/c is greater than debit side of Trading A/c gross profit will arise.

The following items will appear in the credit side of Trading Account:

- (i) **Sales Revenue:** The sales revenue denotes income earned from the main business activity or activities. The income is earned when goods or services are sold to customers. If there is any return, it should be deducted from the sales value. As per the accrual concept, income should be recognized as soon as it is accrued and not necessarily only when the cash is paid for.
- (ii) **Closing Stock:** In case of trading business, there will be closing stocks of finished goods only. According to convention of conservatism, stock is valued at cost or net realizable value whichever is lower.
- (iii) **Gross Loss:** When debit side of Trading A/c is greater than credit side of Trading A/c, gross loss will appear.

The proforma of Trading Account is as follows:

Dr.	Trading Account for the year ended		Cr.
Particulars	₹	Particulars	₹
Opening Stock:		Sales	
Finished goods		Less: Sales return	
Purchases		Closing stock	
Less: Purchase returns		Finished goods	
Gross Profit (transferred to P&L A/c)		Gross Loss (transferred to P&L A/c)	
Total		Total	

Consider the following illustration.

Illustration 2.

Following are the ledger balances presented by M/s. P. Sen as on 31st March 2021.

Particulars	₹	Particulars	₹
Stock (1.4.2020)	10,000	Sales	3,00,000
Purchase	1,60,000	Return Inward	16,000
Carriage Inwards	10,000	Return Outward	10,000
Wages	30,000	Royalty on Production	6,000
Freight	8,000	Gas and Fuel	2,000

Additional Information:

- (1) Stock on 31.3.2021: (i) Market Price ₹ 24,000; (ii) Cost Price ₹ 20,000;
- (2) Stock valued ₹ 10,000 were destroyed by fire and insurance company admitted the claim to the extent of ₹6,000.

- (3) Goods purchased for ₹ 6,000 on 29th March, 2021, but still lying in-transit, not at all recorded in the books.
 (4) Goods taken for the proprietor for his own use for ₹ 3,000.
 (5) Outstanding wages amounted to ₹ 4,000.
 (6) Freight was paid in advance for ₹ 1,000.

Solution:**In the books of M/s. P. Sen****Trading Account****For the year ended 31st March, 2021**

Dr.					Cr.
Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		10,000	By Sales	3,00,000	
To Purchase	1,60,000		Less: Return Inward	16,000	2,84,000
Less: Return Outward	10,000		By Closing Stock	20,000	
	1,50,000		Add: Stock Destroyed	10,000	
Less: Goods taken by Proprietor	3,000			30,000	
	1,47,000		Add: Goods-in-Transit	6,000	36,000
Add: Goods-in-transit	6,000	1,53,000			
To Wages	30,000				
Add: Outstanding	4,000	34,000			
To Carriage Inwards		10,000			
To Freight	8,000				
Less: Prepaid	1,000	7,000			
To Royalty on Production		6,000			
To Gas & Fuel		2,000			
To Profit & Loss A/c (Gross Profit transferred)		98,000			
		3,20,000			3,20,000

Note:

- (a) Stock should be valued as per cost price or market price whichever is lower.
 (b) The claim which was admitted by insurance company and the loss of stock, will not appear in Trading Account.

c. Profit and Loss Account

The next component of financial statements is the Profit & Loss Account. It is drafted after the determination of Gross operating result i.e., Gross Profit or Gross Loss. This account determines the Net Profit or Net Loss of an organisation for a particular accounting period. It is prepared by charging the indirect expenses and losses against the Gross Profit and other indirect incomes. It is closed by transfer of the Net Profit or Net Loss to the Capital Account of the proprietor.

The following items will appear in the debit side of the Profit & Loss A/c:

- (i) **Cost of Sales:** This term refers to the cost of goods sold. The goods can be manufactured and sold or can be directly purchased and sold.

(ii) Other Expenses: All expenses which are not directly related to main business activity will be reflected in the P&L component. These are mainly the Administrative, Selling and distribution expenses. Examples are salary to office staff, salesmen commission, insurance, legal charges, audit fees, advertising, free samples, bad debts etc. It will also include items like loss on sale of fixed assets, interest and provisions. Students should be careful to include accrued expenses as well.

(iii) Abnormal Losses: All abnormal losses are charged against Profit & Loss Account. It includes stock destroyed by fire, goods lost in transit etc.

The following items will appear in the credit side of Profit & Loss A/c:

(i) Revenue Incomes: These incomes arise in the ordinary course of business, which includes commission received, discount received etc.

(ii) Other Incomes: The business will generate incomes other than from its main activity. These are purely incidental. It will include items like interest received, dividend received, etc. The end result of one component of the P&L A/c is transferred over to the next component and the net result will be transferred to the balance sheet as addition in owners' equity. The profits actually belong to owners of business. In case of company organizations, where ownership is widely distributed, the profit figure is separately shown in balance sheet.

The proforma of Profit & Loss Account is as follows:

Profit & Loss Account for the year ended			
Dr.			Cr.
Particulars	(₹)	Particulars	(₹)
To Trading A/c (Gross Loss transferred)		By Trading A/c (Gross Profit transferred)	
To Administrative expenses		By Other Income	
To Office salaries		By Interest received	
To Communication		By Commission received	
To Travel & Conveyance		By Profit on sale of assets	
To Office rent		By Rent received	
To Advertising		By Capital A/c	
To Audit fees		(Net loss transferred)	
To Insurance			
To Repairs & maintenance			
To Selling & Distribution expenses			
To Bad debts			
To Salesmen commission			
To Interest on loans			
To Depreciation and Amortisation			
To Financial expenses			
To Bank charges			
To Loss on sale of assets			
To Capital A/c			
(Net profit transferred)			

Consider the following illustration.

Illustration 3.

Indicate where the following items will be shown in various components of Trading Account and P & L Account:

(1) Wages	(2) Salaries to office staff
(3) Depreciation on office car	(4) Power & fuel
(5) Repairs to machinery	(6) Maintenance of office building
(7) Purchase returns or return outwards	(8) Closing stock of WIP
(9) Opening stock of finished goods	(10) Interest received
(11) Commission paid	(12) Telephone
(13) Travel & conveyance	(14) Insurance
(15) Audit fees	(16) Carriage inward
(17) Freight outward	(18) Bad debts
(19) Provision for outstanding rent	(20) Return inwards or sales returns
(21) Discount earned	(22) Depreciation on delivery van
(23) Printing and stationery	(24) Sales

Solution:

Item	Treatment	Where
Wages	Trading A/c	Dr
Salaries to office staff	P & L A/c	Dr.
Depreciation on office car	P & L A/c	Dr.
Power & fuel	Trading A/c	Dr.
Repairs to machinery	P & L A/c	Dr
Maintenance of office building	P & L A/c	Dr
Purchase returns or return outward	Trading A/c	Dr less from purchases
Closing stock of WIP	Trading A/c	Cr
Opening stock of finished goods	Trading A/c	Dr
Interest received	P & L A/c	Cr
Commission paid	P & L A/c	Dr
Telephone	P & L A/c	Dr
Travel & conveyance	P & L A/c	Dr
Insurance	P & L A/c	Dr
Audit fees	P & L A/c	Dr
Carriage inward	Trading A/c	Dr
Freight outward	P & L A/c	Dr

Bad debts	P & L A/c	Dr
Provision for outstanding rent	P & L A/c	Dr
Return inwards or sales returns	Trading A/c	Cr less from sales
Discount earned	P & L A/c	Cr
Depreciation on delivery van	P & L A/c	Dr
Printing and stationery	P & L A/c	Dr.
Sales	Trading A/c	Cr.

Preparations of Profit & Loss Account

Illustration 4.

From the following particulars presented by Sri Tirthankar for the year ended 31st March 2021, Prepare Profit and Loss Account.

Gross Profit ₹ 1,00,000, Rent ₹ 22,000; Salaries, ₹ 10,000; Commission (Cr.) ₹ 12,000; Insurance ₹ 8,000; Interest (Cr.) ₹ 6,000; Bad Debts ₹ 2,000; Provision for Bad Debts (1.4.2018) ₹ 4,000; Sundry Debtors ₹ 40,000; Discount Received ₹ 2,000; Plant & Machinery ₹ 80,000.

Adjustments:

- Outstanding salaries amounted to ₹ 4,000;
- Rent paid for 11 months;
- Interest due but not received amounted to ₹ 2,000
- Prepaid Insurance amounted to ₹ 2,000;
- Depreciate Plant and Machinery by 10% p.a.
- Further Bad Debts amounted to ₹ 2,000 and make a provision for Bad Debts @5% on Sundry Debtors.
- Commissions received in advance amounted to ₹ 2,000.

Solution:

**In the Books of Sri Tirthankar
Profit and Loss Account
for the year ended 31st March 2021**

Dr.

Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To, Rent	22,000		By Trading A/c (Gross Profit)		1,00,000
Add: Outstanding	2,000	24,000	By Commission	12,000	
To, Salaries	10,000		Less: Received in advance	2,000	10,000
Add: Outstanding	4,000	14,000	By Interest	6,000	
To, Insurance	8,000		Add: Accrued Interest	2,000	8,000
Less: Prepaid	2,000	6,000	By Discount received		2,000

To, Bad Debts	2,000		By Provisions for Bad Debts	4,000	
Add: further Bad Debts	2,000	4,000	Less: New Provision @ 5% on (₹ 40,000 – ₹ 2,000)	1,900	2,100
To, Depreciation on Plant & Machinery @10% on ₹ 80,000		8,000			
To, Capital A/c (Net Profit Transferred)		66,100			
		1,22,100			1,22,100

d. Balance Sheet

Balance Sheet is the financial statement that is prepared to show the financial position of the organisation on a specific date. It is prepared after drafting Income Statements i.e., Trading Account and P/L Account. It reflects the assets and liabilities of a concern at a particular point of time. The Balance Sheet may be drafted either in Horizontal format or in Vertical format. In the horizontal format, the Liabilities appear on the left-hand side, while the Assets appear on the right-hand side of the Balance Sheet. This is the traditional format followed by non-corporate commercial organisations. In the vertical format, the liabilities and assets appear in a top-down order.

The various items should appear in the Balance Sheet in a specific order which is known as Marshalling. There are three approaches in this respect.

- a. **Rigidity/ Permanence Order:** Here, non-current or fixed assets come before the current assets and non-current or long-term liabilities come before the current liabilities.
- b. **Liquidity Order:** Here, non-current or fixed assets come after the current assets and non-current or long-term liabilities come after the current liabilities.
- c. **Mixed Order:** Here, asset side items are arranged in order of liquidity while liability side items are arranged in order of rigidity.

The components of assets and liabilities are discussed below.

A. Liabilities

- (a) **Capital:** This indicates the cumulative claim of the owner of the business.
- (b) **Long Term or Non-Current Liabilities:** These are obligations which are to be settled over more than one accounting period. These funds are raised by way of loans from banks and financial institutions. Such loans are normally obtained on the basis of some security e.g., against a charge on the fixed assets. They are called “Secured Loan”.
- (c) **Short Term or Current Liabilities:** These are liabilities expected to be settled within the same accounting period or same operating cycle period. These include -
 - (i) **Sundry Creditors:** It represents amounts payable to suppliers against purchase of goods.
 - (ii) **Advances from customers:** It represents amounts taken from the customers as advance against the orders already placed by them.

- (iii) **Outstanding Expenses:** These represent services procured but not paid for.
- (iv) **Bills Payable:** These are bills accepted by the firm to the creditors.
- (v) **Bank Overdrafts:** This represents amount utilised over and above the balance in account as approved by the bank in form of a short-term loan.

B. Assets

- (a) **Fixed Assets/ Non-current Assets:** These represent the facilities or resources owned by the business for a longer period of time. The basic purpose of these resources is not to buy and sell them, but to use for future earnings. The benefit from use of these assets is spread over a very long period. The fixed assets could be in tangible form such as buildings, machinery, vehicles, computers etc, whereas some could be in intangible form viz. patents, trademarks, goodwill etc. The fixed assets are subject to wear and tear which is called as depreciation. In the balance sheet, fixed assets are always shown as “original cost less depreciation”.
- (b) **Investments:** These are funds invested outside the business on a temporary basis. At times, when the business has surplus funds, and they are not immediately required for business purpose, it is prudent to invest it outside business e.g., in mutual funds or fixed deposit. The purpose is to earn a reasonable return on this money instead of keeping them idle. Investments can be classified into Current Investments and Non-current Investments. Non-current Investments are investments which are restricted beyond the current period as to sale or disposal. Whereas, current investments are investments that are by their nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.
- (c) **Current Assets:** An asset shall be classified as Current when it is expected to be realised in, or is intended for sale or consumption in the organisation’s normal Operating Cycle. It is held primarily for the purpose of being traded. Current assets comprise of:
 - (i) **Stocks/Inventories:** This includes stock of raw material, semi-finished goods or WIP, and finished goods.
 - (ii) **Debtors:** They represent customer balances which are not paid. The bad debts or a provision for bad debt is reduced from debtors and net figure is shown in balance sheet.
 - (iii) **Bills receivables:** Credit to customers may be given based on a bill to be signed by them and payable to the business at an agreed date in future.
 - (iv) **Cash in Hand:** This represents cash actually held by the business on the balance sheet date.
 - (v) **Cash at Bank:** this represents funds held as balances with bank.
 - (vi) **Prepaid Expenses:** They represent payments made against which services are expected to be received in a very short period.
 - (vii) **Advances to suppliers:** They represent amounts paid to suppliers in advance for which goods or services are not received till the balance sheet date.

Balance Sheet as on.....

Liabilities	₹	Assets	₹
Capital		Fixed Assets:	
Long term Liabilities:		Land	
Loans from banks or financial Institutions		Building less depreciation	
Current Liabilities:		Plant and Machinery	
Sundry creditors		less depreciation	
Bills payable		Vehicles less depreciation	
Advances from customers		Computer systems less depreciation	
Outstanding expenses		Office equipment less depreciation	
		Current Assets:	
		Stocks	
		Sundry debtors less provisions	
		Bills receivables	
		Advances to suppliers	
		Prepaid expenses	
		Cash at bank	
		Cash in hand	

Consider the following illustrations.

Illustration 5.

From the following particulars prepare a Balance Sheet of Mr. X, for the year ended 31st March, 2021. Capital: ₹2,00,000; Drawings : ₹ 40,000 ; Cash In Hand : ₹ 15,000 ; Loan from Bank : ₹ 40,000; Sundry Creditors : ₹40,000; Bills Payable : ₹ 20,000; Bank Overdraft : ₹ 20,000; Goodwill : ₹ 60,000; Sundry Debtors : ₹ 80,000; Land and Building : ₹50,000; Plant and Machinery : ₹ 80,000; Investment : ₹ 20,000; Bills Receivable : ₹ 10,000. Cash at Bank : ₹ 25,000.

The following adjustments are made at the time of preparing final accounts:

- (i) Outstanding Liabilities for : Salaries ₹ 10,000; wages ₹ 20,000; Interest on Bank Overdraft ₹ 3,000; and Interest on Bank Loan ₹ 6,000.
- (ii) Provide Interest on Capital @ 10% p.a.
- (iii) Depreciation on Plant and Machinery by 10% p.a.
- (iv) Bad Debts amounted to ₹ 10,000 and make a provision for Bad Debts @ 10% on Sundry Debtors.
- (v) Closing stock amounted to ₹ 1,20,000.

Net profit for the year amounted to ₹ 96,000 after considering all the above adjustments.

Solution:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital	2,00,000		Goodwill		60,000
Add: Interest on Capital @ 10%	20,000		Land & Building		50,000
Add: Net Profit	96,000		Plant & Machinery	80,000	
	3,16,000		Less: Depreciation @ 10%	8,000	72,000
Less: Drawings	40,000	2,76,000	Investment		20,000
Bank Overdraft	20,000		Closing Stock		1,20,000
Add: Out. Interest	3,000	23,000	Sundry Debtors	80,000	
Bank Loan	40,000		Less: Bad Debts	10,000	
Add: Out. Interest	6,000	46,000		70,000	
Sundry Creditors		40,000	Less: Prov. for bad debts @ 10%	7,000	63,000
Bills Payable		20,000	Bills Receivable		10,000
Outstanding Liabilities:			Cash at Bank		25,000
Salaries	10,000		Cash in Hand		15,000
Wages	20,000	30,000			
		4,35,000			4,35,000

Illustration 6.

Prepare a Trading Account of trader for the year ending 31st March, 2021 from following data:

Particulars	(₹)
Stock on 1.4.2020	2,40,000
Cash purchases for the year	2,08,000
Credit purchases for the year	4,00,000
Cash sales for the year	3,50,000
Credit sales for the year	6,00,000
Purchases returns during the year	8,000
Sales returns during the year	10,000
Direct expenses incurred:	
Freight	10,000
Carriage	2,000
Import duty	8,000
Clearing charges	12,000
Cost of goods distributed as free samples during the year	5,000
Goods withdrawn by the trader for personal use	2,000
Stock damaged by fire during the year	13,000

The cost of unsold stock on 31st March, 2021 was ₹1,20,000 but its market value was ₹1,50,000.

Solution:

Trading Account of a trader
For the year ending 31st March, 2021

Dr.

Cr.

Particulars	(₹)	Particulars	(₹)
To Opening stock	2,40,000	By Sales:	
To Purchases		Cash	₹3,50,000
Cash	₹ 2,08,000	Credit	₹ 6,00,000
Credit	₹4,00,000		₹9,50,000
	₹6,08,000	Less: Sales returns	₹ 10,000
Less: Purchases Returns	₹ 8,000	By Stock damaged by fire	13,000
	₹6,00,000	By Closing stock	1,20,000
Less: Goods Distributed as free sample	₹ 5,000		
	₹5,95,000		
Less: Goods withdrawn for personal use	₹2,000		
To Freight	10,000		
To Carriage	2,000		
To Import duty	8,000		
To Clearing charges	12,000		
To Gross profit c/d	2,08,000		
	10,73,000		10,73,000

Illustration 7.

Prepare Trading and Profit and Loss Account of M/s Suraj Prakash & Sons for the year ending 31st December, 2020 from following information:

Particulars	(₹)	Particulars	(₹)
Stock (1.1.2020)	2,00,000	Salaries	30,000
Purchases	2,55,000	Rent, rates & taxes	12,000
Wages	1,00,000	Depreciation	3,020
Carriage	5,000	Repairs	6,000
Purchases returns	13,250	Discount allowed	12,505
Export duty	9,000	Bad debts	9,000
Sales	5,75,000	Advertisement	2,500
Coal & coke	25,000	Gas & water	1,500
Sales returns	10,000	Factory lighting	2,500
Printing & stationery	2,250	General expenses	4,000
Stock (31-12-2021)	3,00,000		

Solution:

**Trading and Profit and Loss Accounts of
M/s Suraj Prakash and Sons
For the year ending 31st December, 2020**

Dr.**Cr.**

Particulars	₹	Particulars	₹
To Stock (1.1.2020)	2,00,000	By Sales	₹5,75,000
To Purchases	₹ 2,55,000	Less: Sales returns	₹ 10,000
Less: Purchases Return	₹ 13,250	By Stock (31.12.2021)	3,00,000
To Wages	1,00,000		
To Carriage	5,000		
To Coal and coke	25,000		
To Gas and water	1,500		
To Factory lighting	2,500		
To Gross profit c/d	2,89,250		
	8,65,000		8,65,000
To Salaries	30,000	By Gross profit b/d	2,89,250
To Rent, rates & taxes	12,000		
To Printing & stationery	2,250		
To Depreciation	3,020		
To Repairs	6,000		
To Export duty	9,000		
To Discount allowed	12,505		
To Bad Debts	9,000		
To Advertisement	2,500		
To General expenses	4,000		
To Net profit transferred to capital account	1,98,975		
	2,89,250		2,89,250

Illustration 8.

Prepare Manufacturing and trading account for the year ending 30th June, 2021 with following figures extracted from the books of a manufacturing concern:

Particulars	Opening Stock (₹)	Closing Stock (₹)
Raw material	1,20,000	80,000
Work-in-progress	24,000	16,000
Finished goods	86,400	64,000
Transactions during the year:		
Purchase of Materials		4,00,000
Wages		2,50,000
Stores consumed		30,000
Indirect wages		72,000

Factory rent		24,000
Depreciation on plant & machinery		40,000
Sales		11,20,000
Purchases of finished goods		10,000

Solution:

Manufacturing and Trading Account
For the year ending 30th June, 2021

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Opening Stock:		By Closing Stock:	
Raw materials ₹1,20,000		Raw materials ₹ 80,000	
Work-in-progress ₹24,000	1,44,000	Work-in-progress ₹16,000	96,000
To Purchase of materials	4,00,000	By Cost of goods manufactured trans. to trading A/c	8,64,000
To Wages	2,50,000		
To Stores consumed	30,000		
To factory rent	24,000		
To Depreciation on plant and Machinery	40,000		
To Indirect wages	72,000		
	9,60,000		9,60,000
To Opening stock of finished goods	86,400	By Sales	11,20,000
To Cost of goods manufactured transferred from manufacturing A/c	8,64,000	By Closing stock of Finished goods	64,000
To Purchase of finished goods	10,000		
To Gross profit transferred to profit and loss account	2,23,600		
	11,84,000		11,84,000

Illustration 9.

Following is the Trial Balance of M/s Kasturi Agencies as on 31st March, 2021. Prepare Trading, Profit and Loss Account for the year ended 31st March, 2021 and a Balance Sheet on that date

Particulars	₹	₹
Capital		1,00,000
Buildings	15,000	
Drawings	18,000	
Furniture & Fittings	7,500	
Motor van	25,000	
Loan from Hari @ 12% interest		15,000
Interest paid on above	900	
Sales		1,00,000

Purchases	75,000	
Opening stock	25,000	
Establishment expenses	15,000	
Wages	2,000	
Insurance	1,000	
Commission received		4,500
Sundry debtors	28,100	
Bank balance	20,000	
Sundry creditors		10,000
Interest		3,000
	2,32,500	2,32,500

Adjustments: (a) The value of stock on 31-3-2021 was ₹ 32,000. (b) outstanding wages ₹ 500 (c) Prepaid Insurance ₹ 300. (d) Commission received in advance ₹ 1,300 (e) Allow interest on capital @ 10%. (f) Depreciate building 2 ½%. Furniture & Fitting 10%, Motor van 10%. (g) charge interest on drawings ₹ 500. (h) Accrued Interest ₹ 500.

Solution:

Trading and Profit and Loss Account of Kasturi Agency for the year ending 31.3.2021

Dr.

Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		25,000	By Sales		1,00,000
To Purchases		75,000	By Closing Stock		32,000
To Wages	2,000				
Add: Outstanding	500	2,500			
To Gross Profit c/d		29,500			
		1,32,000			1,32,000
To Insurance	1,000		By Gross profit		29,500
Less: Prepaid	300	700	By Commission	4,500	
To Interest on loan	900		Less: Received in Advance	1,300	3,200
Add: Outstanding	900	1,800	By Interest	3,000	
To Establishment expenses		15,000	Add: Accrued interest	500	3,500
To Depreciation			By Interest on drawings		500
Buildings	375				
Furniture & Fittings	750				
Motor van	2,500	3,625			
To Interest on capital		10,000			
To Net profit transferred to capital A/c		5,575			
		36,700			36,700

Balance sheet
as on 31st March, 2021

Liabilities	₹	₹	Assets	₹	₹
Outstanding wages		500	Cash at bank		20,000
Commission received in advance		1,300	Sundry debtors		28,100
Sundry creditors		10,000	Closing stock		32,000
Loan from Hari	15,000		Prepaid insurance		300
Add: Outstanding Interest	900	15,900	Buildings	15,000	
Capital	1,00,000		Less: Depreciation	375	14,625
Add: Net profit	5,575		Furniture & Fittings	7,500	
Add: Interest on Capital	10,000		Less: Depreciation	750	6,750
	1,15,575		Motor Van	25,000	
Less: Drawings	18,000		Less: Depreciation	2,500	22,500
Interest on drawings	500	18,500	Accrued Interest		500
		1,24,775			1,24,775

Illustrations 10.

Following is the Trial Balance of M/s Brijesh and Sons. Prepare final accounts for the year ended on 31st March 2021.

Particulars	Debit (₹)	Credit (₹)
Stock as on 01-04-2020	2,00,000	
Purchases and Sales	22,00,000	35,00,000
Bills receivables	50,000	
Returns	100,000	50,000
Carriage Inwards	50,000	
Debtors and Creditors	200,000	4,00,000
Carriage Outwards	40,000	
Discounts	5,000	5,000
Salaries and wages	2,20,000	
Insurance	60,000	
Rent	60,000	
Wages and salaries	80,000	
Bad debts	10,000	
Furniture	4,00,000	
Brijesh's capital		5,00,000
Brijesh's drawing	70,000	
Loose tools	1,00,000	
Printing & stationery	30,000	
Advertising	50,000	
Cash in hand	45,000	

Cash at bank	2,00,000	
Petty Cash	5,000	
Machinery	3,00,000	
Commission	10,000	30,000
Total	44,85,000	44,85,000

Adjustments:

- (i) Stock on 31st March was valued at Cost price ₹ 4,20,000 and market price ₹ 400,000.
- (ii) Depreciate furniture @ 10% p.a. and machinery @ 20% p.a. on reducing balance method.
- (iii) Rent of ₹ 5,000 was paid in advance. (iv) Salaries & wages due but not paid ₹ 30,000.
- (iv) Make a provision for doubtful debts @ 5% on debtors.
- (v) Commission receivable ₹ 5,000.

Solution:
Dr. Trading Account for the year ended 31st March 2021 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock of Finished Goods			By Sales	35,00,000	
To purchases	22,00,000		Less: Sales Returns	1,00,000	34,00,000
Less: Purchases returns	50,000	21,50,000	By Closing Stock of Finished goods		4,00,000
To Carriage inwards		50,000			
To Wages & Salaries		80,000			
To Gross profit c/d		13,20,000			
		38,00,000			38,00,000

Dr. Profit & Loss Account for the Year Ended 31st March 2021 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Salaries & Wages	2,20,000		By Gross Profit b/d		13,20,000
Add: Not paid	30,000	2,50,000	By Discount received		5,000
To Depreciation on furniture		40,000	By Commission Received	30,000	
To Depreciation of machinery		60,000	Add: Receivable	5,000	35,000
To Insurance		60,000			
To Rent	60,000				
Less: Paid in advance	5,000	55,000			
To Printing & Stationery		30,000			
To Advertising		50,000			
To Carriage outwards		40,000			
To Discounts		5,000			
To Bad debts		10,000			

To Commission		10,000		
To Provision for doubtful debts		10,000		
Net Profit		7,40,000		
		13,60,000		13,60,000

Balance Sheet as on 31st March 2021

Liabilities	₹	₹	Assets	₹	₹
Brijesh's Capital	5,00,000		Fixed Assets:		
Less: Drawings	(70,000)		Furniture	4,00,000	
Add: Net Profit for the year	7,40,000	11,70,000	Less: Depreciation	40,000	3,60,000
Current Liabilities			Machinery	3,00,000	
Sundry Creditors		4,00,000	Less: Depreciation	60,000	2,40,000
Outstanding salaries & wages		30,000	Loose tools		1,00,000
			Current Assets:		
			Stocks		4,00,000
			Sundry debtors	2,00,000	
			Less: Provision for doubtful debts	10,000	1,90,000
			Bills receivables		50,000
			Cash in hand		45,000
			Cash at bank		2,00,000
			Petty cash		5,000
			Prepaid Rent		5,000
			Commission receivable		5,000
		16,00,000			16,00,000

Notes:

- (1) Closing stock is valued at market price here as it is less than cost price (conservatism concept)
- (2) Returns in debit column mean sales return, while that in credit column means purchase returns
- (3) Discounts in debit column mean allowed (expense) and that in credit means received (income)
- (4) Commission in debit column mean allowed (expense) and that in credit means received (income)
- (5) There are two peculiar items given in the TB. One is Salaries & wages and the other is Wages and salaries. The interpretation is – where first reference is made to wages, it's assumed to be directly for goods and taken to Trading A/c. If the first reference is to salaries, it's assumed to be related to office and taken to P&L.

Preparation of Financial Statements of a Not-for-Profit Organisation

3.2

• **Concept of Not-for-Profit Organisation**

There are certain organisations that are not established for making profit but to provide some service. These services are generally given to members who make subscriptions to avail them. These are also called non-trading entities. The examples of such organisations are:

- a. Gymkhana / sports clubs
- b. Educational institutions
- c. Public hospitals
- d. Libraries
- e. Cultural clubs like Rotary or Lions club
- f. Religious institutions
- g. Charitable trusts etc.

These organisations get their funds in form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc.

These institutions are formed not for carrying on a business and making a profit but for some charitable, religious or similar purposes. Their income is spent on the objects for which they are started.

• **Features of Not-for-Profit Organisation**

The salient features of not-for-profit organisations are:

- a. Such establishments are established for furnishing service to a particular group or public at large.
- b. These are established and organised as charitable societies/trusts and subscribers to such establishments are known as members.
- c. Their activities are normally regulated by a managing/executive committee selected/elected by its members.
- d. The principal source of income of these organisations are entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc.
- e. The surplus generated in the form of excess of income over expenditure is not allocated amongst the members.

• **Accounting in a Not-for-Profit Organisation**

The accounting of such organisations is based on similar principles followed by the other organisations. However, given the nature of these institutions, there are certain items of revenue and expenses that need special understanding so that accounting treatment could be correctly decided. The constitution/by-laws of these organisations play an important role in deciding the accounting for a particular item of income or expenditure.

Financial Statements of a Not-for-Profit Organisation

The periodic financial statements of a not-for-profit organisation comprises of the following.

- Receipts and Payments Account to determine the inflow and outflow of cash of the organisation for a given period.
- Income and Expenditure Account to determine the surplus and deficit of the organisation for the period concerned.
- Balance Sheet to assess the financial state of affairs as at the end of the accounting period.

These are discussed in detail in the following sections.

3.2.1 Preparation of Receipts and Payments Account

Concept of Receipt and Payment Account

This is similar to cash book. Entries are made on cash basis and items pertaining to previous year or current year or subsequent years are also recorded. It begins with the cash in hand/at bank at the commencement and ends with that at the close of the year. Receipts are shown on debit side and payments are shown on credit side. Capital as well as revenue items are entered in the Receipt & Payment Account. This account is real account in nature. No provisions are recorded in this account. The opening and a closing balance of the account are reflected as assets in the balance sheet.

Features of Receipts and Payments Account

Following are the features of Receipts and Payments Account.

- It is an Account which contains all cash and bank transactions made by a not-for-profit organization during a particular financial period.
- It starts with the opening balances of cash and bank. All cash receipts, both capital & revenue during the period, are debited to it.
- All cash payments, both capital & revenue during the period, are credited to this Account. It ends with the closing cash and bank balances.
- While recording the cash and bank transactions all entries are made on cash basis.
- It is a summary of Cash Book.
- It is basically a real account by nature.

Format of Receipts and Payments Account

Following is the format of a Receipts and Payments Account.

Receipt and Payment Account

Receipts	₹	Payments	₹
To Balance b/f Cash in hand Cash at bank		By All payments (capital or revenue and may be related to any period previous, current or subsequent.)	
To All receipts (capital or revenue and may be related to any period previous, current or subsequent.)		By Balance c/f Cash in hand Cash at bank	
Total		Total	

Consider the following illustration.

Illustration 11.

From the following particulars, prepare Receipts and Payments Account

Particulars	₹
Cash in hand	2,000
Cash at Bank	6,000
Subscriptions	3,000
Donations received	2,400
Furniture purchased	1,600
General Expenses	1,000
Postage	400
Stationery	600
Lockers Rent Received	1,800
Office Expenses	800
Closing balance of Cash	7,000

Solution:

Receipts and Payments Account

Receipts	(₹)	Payments	(₹)
To Balance b/d(cash)	2,000	By Furniture	1,600
To Balance b/d (Bank)	6,000	By General Exp.	1,000
To Subscriptions	3,000	By Postage	400
To Donations	2,400	By Stationery	600
To Locker Rent	1,800	By Office Expenses	800
		By Balance c/d (Cash)	7,000
		By Balance c/d (Bank) (Bal. fig)	3,800
	15,200		15,200

3.2.2 Preparation of Income and Expenditure Account

⊙ **Concept of Income and expenditure Account**

This is similar to the Profit and loss Account and is prepared exactly based on same principles. As the name suggests, only revenue items are recorded herein. Incomes are recorded on the credit side while the expenses on the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are pertaining to current period. Previous and subsequent year items are to be excluded. This account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called as deficit.

⊙ **Features of income and expenditure Account**

Following are the features of Income and Expenditure Account.

- a. It is a nominal account by nature.

- b. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
- c. Similarly, all revenue incomes related to the particular period are credited to this account on accrual basis.
- d. All capital incomes and expenditures are excluded.
- e. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
- f. Profit on sale of asset is credited while loss on sale of asset is debited. Annual depreciation on assets is also debited.
- g. If income is more than expenditure, it is called a surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
- h. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

◉ **Format of Income and Expenditure Account**

Following is the format of An Income and Expenditure Account.

Dr.		Income and Expenditure Account	Cr.
		For the year ended on	
Expenses	₹	Income	₹
To All Revenue expenses relating to current period		By All Revenue receipts relating to current period	
To Capital Fund Surplus		By Capital Fund Deficit	
Total		Total	

Consider the following illustrations.

Illustration 12.

From the following particulars, prepare Income and Expenditure Account.

	₹
Fees Collected (including ₹3,000 on account of last year)	28,000
Meeting Expenses	2,000
Travelling & Conveyance	800
Fees for the year outstanding	5,000
Salary paid (including ₹300 on account of last year)	2,400
Salary outstanding	400
Entertainment Expenses	500
Tournament Expenses	1,000
Purchase of Books and Periodicals (includes ₹2,000 for purchase of books)	3,000
Rent	1,200
Postage, Telephone and Telegram charges	1,700

Printing & Stationery	500
Donations received	800

Solution:
Dr. Income and Expenditure Account Cr.

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
To Salaries	2,400		By Fees Add: O/s Current Year	28,000 5,000	
Less: O/s last year	(300)		Less Last Year	(3,000)	
Add: O/s Current Year	400				30,000
		2,500	By Donation Received		800
To Entertainment Exp		500			
To Tournament Exp		1,000			
To Meeting Exp.		2,000			
To Travelling Exp.		800			
To Cost of Periodicals (₹3,000 - ₹2,000)		1,000			
To Rent		1,200			
To Postage, Telephone and Telegram charges		1,700			
To Printing & Stationery		500			
To Surplus		19,600			
		30,800			30,800

Difference between Receipts and Payments Account and Income and Expenditure Account

The differences between Receipts and Payments Account and Income and Expenditure Account are as follows.

Receipts & Payments Account	Income & Expenditure Account
It is a summarised Cash Book	It closely resembles the Profit & Loss Account of a Trading concern.
Receipts are debited and Payments are credited.	Incomes are credited and Expenditures are debited.
Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
It records both Capital and Revenue transactions.	It records Revenue transactions only.

It serves the purpose of a Real Account.	It serves the purpose of a Nominal Account.
It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
It does not record notional loss or noncash expenses like bad debts, depreciations etc.	It considers all such expenses for matching against revenues
Its closing balance is carried forward to the same account of the next accounting Period.	Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
It helps to prepare an Income & Expenditure A/c.	It helps to prepare a Balance Sheet.

⊙ **Difference between Profit and Loss Account and Income and Expenditure Account**

Profit and Loss Account	Income & Expenditure Account
It is prepared by profit-oriented business undertakings.	It is prepared by not-for-profit organizations.
The debit balance of this Profit and Loss Account is known as “net loss” and deducted from opening capital.	Credit balance of Income and Expenditure Account is known as excess of income over expenditure or surplus and added to opening capital fund.
To check correctness of accounts trial balance is prepared before preparing this account.	Debit balance of this Income and Expenditure Account is known as “excess of expenditure over income” or deficit and deducted from opening capital fund.

3.2.3 Preparation of Balance Sheet

It is prepared as on the last day of the accounting period. It also has assets and liabilities and is prepared based on accounting equation. But, there's no capital account, instead, there is a capital fund. The surplus or deficit from Income & Expenditure Account is adjusted against this capital fund at the end of the year.

⊙ **Fund Asset Accounting – Important Considerations**

Following are the concepts of some funds which are generally maintained by non-profit organizations:

- (a) **Capital Fund:** It is also called “General Fund” or “Accumulated Fund.” It is actually the Capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually “Surplus” or “Deficit” during a period is added with or deducted from it. A portion of capitalised incomes like donations may be added with it.
- (b) **Special Fund:** It may be created out of special donation or subscription or out of a portion of the “Surplus”. For example, a club may have a “Building Fund”. It may be used for meeting some specific expenses or for acquiring an asset. If any income is derived out of investments made against this fund or if any profit or loss occurs due to sale of such investments, such income or profit or loss is transferred to this fund.
 - (i) If the Special Fund is used to meet an expense, the following entry is passed:

Special Fund A/c	Dr.
To Bank A/c (amt. of expense)	

NB: The balance of the Fund is shown as a liability in the Balance Sheet.
 - (ii) Finally, when the balance is transferred to Capital Fund, the entry will be:

Special Fund A/c Dr.

To Capital Fund A/c

(iii) If the Special Fund is used to purchase an asset, the entry will be

Asset A/c Dr.

To Bank A/c (Cost of the asset)

Special Fund A/c Dr.

To Capital Fund A/c (Special Fund closed)

Consider the following illustration.

Illustration 13.

Ujjwal Vavishwa Club was holding a building valuing ₹10 lakhs as on 31.03.2020. Building Fund stands ₹8 lakhs and Cash at Bank is ₹15 lakhs as on 01.04.2020. During the year 2020-21 donation received for the building fund is ₹20 lakhs. Give the journal entries and the effect in the Balance Sheet as on 31.03.2021. If

(i) It purchases building of ₹ 15 lakhs during 2020-21

(ii) It purchases building of ₹30 lakhs during 2020-21

Solution:

(i)

Journal entries

(₹ in Lakhs)

Date	Particulars	L.F	Debit	Credit
	Bank A/c Dr. To, Donation for Building Fund A/c (Donation received for Building Fund)		20	20
	Building A/c Dr. To, Bank A/c (Building purchased utilizing the Building Fund)		15	15
	Building Fund A/c Dr. To, Capital Fund A/c (Being the capital expenditure transferred to the Capital Fund)		15	15

Balance Sheet as on 31.03.2021

(₹ in Lakhs)

Liabilities	₹	₹	Assets	₹	₹
Capital Fund			Building	10.00	
Add: Building Fund (Amount Transferred)	15.00		Add: Purchase of building	15.00	25.00
Building Fund	8.00		Bank	15.00	
Add: Donation	20.00		Add: Donation Received	20.00	

				35.00	
	28.00				
Less: Amount trans. to Capital Fund	15.00	13.00	Less: Purchase of Building	15.00	20.00

(ii)

Journal entries

(₹ in Lakhs)

Date	Particulars	L.F	Dr.	Cr.
	Bank A/c Dr. To, Donation for Building Fund A/c (Donation received for Building Fund)		20	20
	Building A/c Dr. To, Bank A/c (Building purchased utilizing the Building Fund)		30	30
	Building Fund A/c Dr. To, Capital Fund A/c (Being the capital expenditure transferred to the Capital Fund)		28	28

Balance Sheet as on 31.03.2021

₹ in Lakhs

Liabilities	₹	₹	Assets	₹	₹
Capital Fund			Building	10.00	
Add: Building Fund (Amount Transferred)	28.00		Add: Purchase of building	30.00	40.00
Building Fund	8.00		Bank	15.00	
Add: Donation	20.00		Add: Donation Received	20.00	
				35.00	
	28.00		Less: Purchase of Building	30.00	5.00
Less: Amount trans. to Capital Fund	28.00	NIL			

⊙ **Treatment of Some Important Items**

- a. **Subscriptions:** The members of the associations, as per rules, are generally required to make annual subscription to enable it to serve the purpose for which it was created. It appears on the receipts side of the receipt and payment account. Subscription is credited to Income and Expenditure Account on accrual basis i.e., Only subscriptions related to current accounting period is credited to Income and Expenditure Account.

Illustration 14.

On 31st December 2019, a club had subscription in arrears of ₹16,000 and in advance ₹4,000. During the year ended 31-12-2020, the club received subscription of ₹2,08,000 of which ₹10,400 was related to 2021. On 31st

December 2020, there were 4 members who had not paid subscription for 2020 @ ₹1,600 per person. Write up subscription Account for the year 2020.

Solution:

A single subscription account should be prepared to reflect both advance and arrears figures. The balancing figure will reflect the subscription amount that will be recognised as Income and transferred to I&E A/c as shown below:

Dr.		Subscription Account		Cr.	
Particulars	(₹)	Particulars	(₹)		
To, Balance c/d (arrears)	16,000	By, Balance c/d (advance)	4,000		
To, I & E A/c (income for 2014) (Balance in figure)	1,92,000	By, R & P A/c (received)	2,08,000		
		By, Balance c/d (arrears)	6,400		
To, Balance c/d (advance)	10,400				
	2,18,400				2,18,400

Illustration 15.

The sports club of Orissa had received in 2020-2021 ₹ 2,000 towards subscription. Subscription for 2019 -20 unpaid on 1.4.2020 were ₹ 200.

Subscriptions paid in advance on 31.3.2020 were ₹ 50 and the same on 31.3.2021 was ₹ 40. Subscriptions for 2020-2021 unpaid on 31.3.2021 were ₹ 90.

Show how the subscriptions item will appear in the Income and Expenditure Account.

Solution:

Particulars	₹
Subscriptions received during the year 2020-2021	2,000
Add : Subscription outstanding on 31.3.2021	90
	2,090
Less : Subscription outstanding on 1.4.2020	200
	1,890
Add : Subscription paid in advance on 31.3.2020	50
	1,940
Less : Subscription received in advance on 31.3.2021	40
Subscription Income for 2020-2021	1,900

Illustration 16.

The amount of Subscription appears in the Income and Expenditure Account of South Indian Club is ₹ 3,000. Adjustments were made in respect of the following:

Subscription for 2020 unpaid at 1st Jan., 2021, ₹400; ₹200 of which was received in 2021.

Subscription paid in advance at 1.1.2021 ₹100.

Subscription paid in advance at 31.12.2021 ₹80.

Subscription for 2020 unpaid at 31.12.2021 ₹140.

Prepare Subscription Account.

Solution:

Dr.		Subscription Account		Cr.	
Particulars	₹	Particulars	₹		
To, Balance b/d	400	By, Balance b/d	100		
To, Income & Expenditure A/c	3,000	By, Cash Received (bal. fig.)	3,040		
To, Balance c/d (paid in advance to 2014)	80	By, Balance (200+140) c/d	340		
	3,480		3,480		
To, Balance b/d:		By, Balance b/d (2021)	80		
For 2020	200				
For 2021	140				

Note: Opening outstanding subscription = ₹ 400 of which ₹ 200 received in 2021.

Illustration 17.

From the following information, prepare the Subscription Account for the year ending on March, 31, 2020

(i) Subscription in arrears on 31.03.2019 ₹ 1,500

(ii) Subscription received in advance on 31.03.2019 ₹ 1,000

(iii) Amount of Subscription received during 2019-20 ₹ 40,000, which includes ₹1,000 for the year 2018-19, ₹1,500 for the year 2020-21.

(iv) Subscription outstanding ₹ 1,000.

Solution:

Dr.		Subscription Account		Cr.	
Particulars	(₹)	Particulars	(₹)		
To, Balance b/d	1,500	By, Balance b/d	1,000		
To, Income & Expenditure A/c	39,500	By, Bank A/c	40,000		
		By, Balance c/d			
		For 2018-19	500		
		For 2019-20	1,000		
To, Balance c/d					
For 2020-21	1,500				
	42,500		42,500		

b. Donations

(i) Donation received for a particular purpose should be credited to Special Fund. For example, Donation received for Building should be credited to Building Fund Account.

(ii) For other donations received the by-laws or rules of the concern should be followed.

(iii) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund.

Recurring donations received should be credited to Income & Expenditure Account.

(iv) Donation paid by the concern should be debited to Income & Expenditure Account.

• **Entrance Fees or Admission Fees**

(i) The rules or by-laws of the concern should be followed.

(ii) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.

(iii) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

• **Life Membership Fees**

Life-membership fees are lump-sum subscriptions or fees that are collected from new members at the time of their joining a non-profit organization. It is a receipt that is non-recurring in nature. It can be treated either 'as a capital receipt' or 'as deferred revenue receipt'.

When it is treated as 'capital receipts', no separate Life Membership Fund is maintained. The receipts are recorded in the Receipts side of Receipts & Payments A/c and the same is added to Capital Fund in the 'liabilities' side of the Balance Sheet.

When it is treated as 'deferred revenue receipts', a separate Life Membership Fund is maintained and the fees received are credited to this fund only. Every year, a fair portion of life membership fee is transferred to Income & Expenditure A/c till the total amount of fee gets amortised. However, in the event of expiry of the member, the unamortised amount is to be transferred to the 'Capital Fund'.

• **Legacy received**

It is the amount or other item of value received from a deceased person under the terms of a will. It is to be directly added with Capital Fund after deduction of tax, (if any).

• **Sale of News Papers, Periodicals etc.**

As the old newspapers, magazines, and periodicals etc. are to be disposed of every year, the receipts on account of such sales should be treated as income, and therefore to be credited to income and expenditure account.

• **Sales of Sports Material**

Sale of support materials (used) is also a regular feature of the clubs. Sales proceeds should be treated as income, and therefore to be credited to income and expenditure account.

• **Honorarium**

Persons may be invited to deliver lectures or artists may be invited for their performance by a club (for its members). Any money so paid is termed as honorarium and not salary. Such honorarium represents expenditure and will be debited to income and expenditure account.

• **Restaurant or Bar Trading**

In order to calculate the profit, a separate Restaurant or Bar Trading Account is prepared in the same way as a normal Trading A/c is prepared. The resultant profit or loss is transferred to Income and Expenditure Account.

Receipts and Payments Account

Receipts	(₹)	Payments	(₹)
To Balance b/d	40,000	By Salaries	15,000
To Donations	60,000	By Conveyance	6,000
To Legacies	16,000	By Rent	12,000
To subscriptions	14,000	By Subscriptions to Journals	5,400
To Furniture Sold (on 31.12.2020)	6,000	By Stationery	1,000
		By Books	4,000
		By Buildings (Purchased on 1.1.2020)	68,000
		By Balance	24,600
	1,36,000		1,36,000

Additional information:

- Provide for depreciation on Furniture @10% and on Buildings @10% and on Books ₹1,000
- Outstanding subscriptions at the end of the year 2020 ₹15,000 and subscriptions received in advance for 2015 were ₹5,000
- Outstanding expenses: Rent ₹1,000; Salary ₹2,000

Solution:

Pattabhi Memorial Trust
Income and Expenditure Account for the year ended 31.12.2020

Dr.

Cr.

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
To Salaries	15,000		By Donations		60,000
Add: Outstanding	2,000	17,000	By Subscriptions	14,000	
To Conveyance		6,000	Add: Outstanding Subscription	15,000	
				29,000	
To Rent	12,000		Less: Received in Adv.	5,000	24,000
Add: Outstanding rent	1,000	13,000			
To Subscriptions to Journals		5,400			
To Stationery		1,000			
To Depreciation on:					
-Furniture @10%	2,000				
-Building @10%	6,800				
-Books	1,000	9,800			

To Loss on sale of Furniture(20000-2000-6000)		12000		
To Surplus –Excess of Income over Expenditure		19,800		
		84,000		84,000

Illustration 20.

From the following Receipts and Payments Account of Shyam Club for the year ended 31st December, 2021:

Receipts and Payments Account

Receipts	(₹)	Payments	(₹)
Cash in hand	150	Mowing Machine	1,100
Cash at Bank	2,100	Ground men's fee	1,500
Subscription	5,800	Rent	500
Rent of the Hall	3,000	Salaries to coaches	4,500
Life Membership fee	2,000	Office Exp	2,400
Entrance fee (income)	200	Sports equipment purchased	1,200
Donations (Gen)	1,500	Cash in hand	350
Sale of Grass	100	Cash at Bank	3,300
	14,850		14,850

Subscriptions due on 31st December, 2020 and December, 2021 were ₹900 and ₹800 respectively. Subscriptions received also included subscriptions for the year 2021 ₹200. Sports equipment in hand on 31st December 2020 was ₹1,100. The value placed on his equipment in hand on 31st December 2021 was ₹1,300. The mowing machine was purchased on 1st January, 2021 and is to be depreciated @ 20% per annum. Office expenses include ₹300 for 2020 and ₹400 are still due for payment.

Prepare Income and Expenditure account and Balance Sheet relating to the year 2021.

Solution:**Shyam Club****Income and Expenditure Account for the year ended 31.12.2021****Dr.****Cr.**

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
To Ground Men's Fees		1,500	By Subscriptions	5,800	
To Rent		500	Less: Outstanding Last Year	900	
To Salaries to Coaches		4,500		4,900	
To Office Expenses	2,400		Add: Outstanding this year	800	
Add: Outstanding this year	400			5,700	
	2,800		Less: for 2021	200	

Less: Outstanding Last Year	300			5,500
		2,500	By Rent of Hall	3,000
To Depreciation:			By Entrance fees	200
-Mowing Machine	220		By Donations	1,500
-Sports Equipments	1,000		By Sales of Grass	100
₹(1,100+1,200-1,300)		1,220		
To Surplus- Excess of Income over Expenditure		80		
		10,300		10,300

Balance Sheet As on 31st December, 2021

Liabilities		(₹)	Assets		(₹)
Outstanding Office Exp		400	Cash in hand		350
Subscription received in adv.		200	Cash at Bank		3,300
Life membership Fee.		2,000	Subscription Outstanding		800
Capital Fund (1)	₹3,950		Mowing Machine	₹1,100	
Add: Surplus	₹80	4,030	Less: Depreciation	₹220	880
			Sports equipment	₹ 1,100	
			Add:-Purchase	₹ 1,200	
				₹2,300	
			Less:- Depreciation	₹1,000	1,300
		6,630			6,630

Working Note:

1) Calculation of Beginning Capital Fund:

Balance Sheet as on 31st December, 2020

Liabilities		(₹)	Assets		(₹)
Outstanding Office Exp		300	Cash in hand		150
Capital fund (Bal. Fig)		3,950	Cash at Bank		2,100
			Subscription Outstanding		900
			Sports equipment		1,100
		4,250			4,250

Exercise

A. Theoretical Questions

⊙ Multiple Choice Questions (MCQ)

- The purpose of preparing final accounts is to ascertain ____
 - profit or loss
 - Capital
 - The value of assets
 - Profit or loss and financial position
- If the manager is entitled to a commission of 5% on profits before deduction this commission, he will get a commission of ₹ ____ on a profit of ₹ 8,400
 - ₹400
 - ₹ 442.11
 - ₹ 420
 - None of these
- The balance of the petty cash is
 - An expense
 - An income
 - An asset
 - A liability
- Fixed assets are
 - Kept in the business for use over a long time for earning income
 - Meant for resale
 - Meant for conversion into cash as quickly as possible
 - All of the above
- The manufacturing account is prepared
 - To ascertain the profit or loss on the goods produced
 - To ascertain the cost of the manufactured goods
 - To show the sale proceeds from the goods produced during the year
 - both (b) and (c)
- A company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark upon cost, which will achieve the required profit margin?
 - 33%

- (b) 25%
 - (c) 20%
 - (d) None of the above
7. At the time of preparation of financial accounts, bad debts recovered account will be transferred to
- (a) Debtors A/c
 - (b) Profit & Loss A/c
 - (c) Profit & loss Adjustment A/c
 - (d) Profit & loss Appropriation A/c
8. Depreciation appearing in the Trial Balance should be
- (a) Debited to P & L A/c
 - (b) Shown as liability in balance sheet
 - (c) reduced from related asset in balance sheet
 - (d) both (a) and (c) above
9. Gross profit is equal to
- (a) sales – cost of goods sold
 - (b) sales – closing stock + purchase
 - (c) opening stock + purchases – closing stock
 - (d) none of the above
10. The profit and loss Account shows the
- (a) financial results of the concern for a period
 - (b) Financial position of the concern on particular date
 - (c) financial results of the concern on a particular date
 - (d) cost of goods sold during the period
11. Which of the following is not a financial statement?
- (a) Profit and loss account
 - (b) Balance sheet
 - (c) funds flow statement
 - (d) Trial balance
12. Based on which of the following concepts, is share capital account shown on the liabilities side of a balance sheet?
- (a) business entity concept
 - (b) money measurement concept

- (c) going concern concept
 (d) matching concept
13. Closing stock appearing in the trial balance is shown in –
- (a) Trading A/c and Balance Sheet
 (b) Profit and Loss A/c
 (c) Balance Sheet only
 (d) Trading A/c only
14. Consider the following data and identify the amount which will be deducted from sundry debtors in Balance sheet.

Particulars	₹
Bad debts (from trial balance)	1,600
Provision for doubtful debts (old)	2,000
Current year's provision (new)	800

- (a) ₹ 400
 (b) ₹800
 (c) ₹2,000
 (d) ₹2,400
15. Inventory is
- (a) Included in the category of fixed assets
 (b) An investment
 (c) A part of current assets
 (d) An intangible fixed asset
16. Endowment fund receipt is treated as -
- (a) Capital Receipt
 (b) Revenue Receipt
 (c) Loss
 (d) Expenses
17. Which one of the following is not prepared by non-profit organizations
- (a) Profit and Loss Account
 (b) Income & Expenditure Account
 (c) Receipts and Payments Account
 (d) Balance Sheet

18. Legacy are generally -
- (a) Capitalized
 - (b) Treated Loss
 - (c) Revenue Expenses
 - (d) Deferred Revenue expenses
19. Any donation received for a specific purpose is a
- (a) Assets
 - (b) Revenue receipts
 - (c) Capital receipts
 - (d) None of the above
20. The receipts and payments account of a non-profit organization is a
- (a) Nominal Account
 - (b) Real Account
 - (c) Income Statement Account
 - (d) Financial Account
21. The capital of a non-profit organization is generally known as
- (a) Equity
 - (b) Accumulated Fund
 - (c) Finance Reserve
 - (d) Cash Fund
22. If ₹1,500 was outstanding at the beginning of the year towards subscription and ₹10,000 is received during the year, with ₹2,500 still outstanding at the end of the year the amount to be taken to receipts and payments account is
- (a) ₹11,000
 - (b) ₹8,500
 - (c) ₹10,000
 - (d) None of the above
23. Any revenue expenses for which a separate fund is available will be
- a) Debited to the separate fund
 - b) Debited to Income and Expenditure Account
 - c) Capitalized and shown in the Balance Sheet
 - d) None of the above

24. Sale of old materials must be shown on the credit side of
- Cash Book
 - Income and Expenditure Account
 - Balance Sheet
 - None of the above
25. The information for the preparation of receipts and payments account is taken from
- Cash Book
 - Income and Expenditure Account
 - Cash Book and Balance Sheet
 - None
26. Any donation received for a specific purpose is a
- Capital receipt
 - Revenue receipt
 - Liability
 - None of the above
27. The Receipts and Payments Account shows the following details:
- Subscription Arrears ₹500
- Current ₹10,500
- Advance ₹800
- There are 1,200 members each paying an annual subscription of ₹10. The amount to be credited to Income and Expenditure Account will be
- ₹11,800
 - ₹ 11,300
 - ₹12,000
 - None of the above
28. Any income arising from special fund will be credited to
- Special Fund in the Balance Sheet
 - Income and Expenditure Account
 - General Fund in the Balance Sheet
 - None of the above
29. Income and Expenditure Account shows subscriptions at ₹10,000. Subscriptions accrued in the beginning of the year and at the end of the year were ₹1,000 and ₹1,500 respectively. The figure of subscriptions

received appearing in Receipts and Payments Account will be

- a) ₹9,500
 - b) ₹11,000
 - c) ₹10,000
 - d) None of the above
30. Which of the following item(s) is (are) shown in the Income and Expenditure Account
- a) Only items of capital nature
 - b) Only items of revenue nature which are received during the period of accounts
 - c) Only items of revenue nature pertaining to the period of accounts
 - d) Both the items of capital and revenue nature

• **State True or False**

1. Income earned but not received are called accrued incomes.
2. For a shirt factory, cotton is a Finished Goods.
3. State the following equation is true/false
$$\text{Gross Profit} - \text{Direct Expenses} + \text{Purchases} + \text{Opening Stock} - \text{Closing Stock} = \text{Sales}.$$
4. Carriage on goods purchased is shown on Trading Account.
5. The Balance Sheet will not give the information regarding the financial position as on particular date.
6. Preliminary expenses would be included in Balance Sheet as Current Asset
7. Fixed assets are kept in the business for use over a long period.
8. Furniture and fittings is a Current Asset.
9. In sole trade, income tax is recorded as drawings.
10. All revenue receipts and expenditure are shown in Trading and Profit & Loss Account
11. Receipts and Payments Account is nothing but a consolidated summary of the Cash Book.
12. Receipts and Payments Account is a Real Account.
13. Income and Expenditure Account is a Real Account.
14. Entrance fees unless otherwise stated is to be taken as a capital receipt.
15. Donations unless otherwise stated is to be taken as a capital receipt.
16. Sale of old materials must be credited to capital fund in the Balance Sheet.
17. Income and expenditure relating to special funds should not be dealt with in the Income and Expenditure Account.

18. Receipts and Payments Account is a summary of all capital receipts and payments.
19. Any subscriptions received in advance are treated as capital receipts and are therefore taken to the liabilities side of the balance sheet.
20. Payment of honorarium is treated as a capital expenditure.

● **Fill in the Blanks**

1. Insurance prepaid is shown on the ___ of the Balance Sheet
2. If sales are ₹2,000 and the rate of G.P on cost of goods sold is 25%, then the cost of goods sold will be ___
3. Goodwill is an _____ asset
4. ___ is the difference between Assets and Liabilities
5. Opening stock ₹50,000 closing stocks ₹40,000, purchases ₹1,90,000, profit margin is 16.67% on the sales, then sales are _____
6. Average stock = ₹12,000, closing stock is ₹3,000 more than Opening Stock the value of Closing Stock will be ___
7. ___ contains closing balances of Real and Personal Account
8. Expenses due but not yet paid are known as ___
9. Given old provision for bad & doubtful debt is ₹ 4,000 sundry debtors ₹50,000, new PBD required = 10% on sundry debtors then the amount of additional provision to be credited is ₹ _____
10. Bills receivable discounted but not due till the date of Final Accounts is shown in ___
11. ___ are passed at the end of the year.
12. Assets appearing in the books having no real value are known as _____
13. Various Expenses Accounts are closed by ___ the Profit and Loss Account and crediting the Expenses Account.
14. Provisions for Bad & Doubtful Debts Account will show ___ balance.
15. Loss on sale of old car is shown on debit side of ___
16. In a Receipts and Payments Account the payments are recorded on the ___ side
17. The closing debit balance in the Receipts and Payments Account indicates the ___ balance at the end of the year
18. The Income and Expenditure Account is prepared on the basis of ___ system of accounting
19. A debit balance in the Income and Expenditure Account denotes excess of ___
20. Income and expenditure matches all ___ receipts against Revenue payments pertaining the relevant accounting year.
21. Any amount received towards Endowment fund is a ___ Receipt

22. Interest received on special fund investments will be added to ___ fund in the Balance Sheet
23. Subscriptions received in advance will figure in the ___
24. Any revenue expenditure relating to special fund must be deducted from ___
25. Out of ₹5,00,000 collection for the building ₹3,00,000 is invested and the balance spent on building. Income from investments ₹20,000. The balance to be shown in the building fund ___

• **Comprehensive Numerical Problems**

1. Prepare a Trading Account of Ramesh Kumar for the year ending 31st March, 2021 from the following particulars:

Particulars	₹	Particulars	₹
Stock of goods on 1-4-20	2,50,000	Returns to suppliers	25,000
Stock of goods on 31-3-21	4,75,000	Returns by customers	20,000
Purchases – cash	3,70,000	Goods withdrawn by Rajesh Kumar for personal use	21,000
Credit	8,25,000	Goods distributed as free samples during the year	4,000
Sales – cash	5,10,000		
Credit	11,50,000		

Ans: Gross Profit-₹7,20,000

2. From the following balances extracted at the close of the year ended 31st March 2021, prepare profit and loss Account of M/s. Amal and Sons:

Particulars	₹	Particulars	₹
Gross profit	1,01,000	Discount (Dr.)	500
Carriage outward	2,500	Apprentice premium (Cr.)	1,500
Salaries	5,500	Printing & stationery	250
Rent	4,100	Rates & taxes	350
Fire insurance premium	900	Travelling expenses	200
Bad debts	2,100	Sundry trade expenses	300
Income tax paid	3,500	Rent received on sub-letting	1,000
Life insurance premium	3,000		

Ans: Net Profit - ₹86,800

3. The following are the balances of Shri Gupta as on 30th June, 2021:

Debit Balance:	₹		₹
Cash in Hand	540	Patents	7,500
Cash at Bank	2,630	Salaries	15,000
Purchases	40,675	General expenses	3,000

Returns Inward	680	Insurance	600
Wages	8,480	Drawings	5,245
Fuel and power	4,730	Sundry debtors	14,500
Carriage on sales	3,200	Credit balances:	
Carriage on purchases	2,040	Sales	98,780
Stock (1 st July, 2020)	5,760	Returns outwards	500
Buildings	22,000	Capital	62,000
Freehold land	10,000	Sundry creditors	6,300
Machinery	20,000	Rent	9,000
Investments	10,000		

Taking into account the following adjustments prepare the Trading and Profit and Loss Account and Balance Sheet as on 30th June, 2021:

(a) Stock on hand on 30th June, 2021 is ₹6,800. (b) Machinery is to be depreciated at the rate of 10% and patents at the rate of 20%. (c) Salaries for the month of June, 2015 amounting to ₹1500 were unpaid (d) Insurance includes a premium of ₹ 170 on a policy expiring on 31st December 2021. (e) Bad Debts are ₹725 (f) rent received in Advances ₹ 1,000. (g) Interest on investment of ₹ 2,000 is accrued.

Ans: Gross Profit = ₹43,715, Net Profit = ₹26,360, Balance Sheet Total = ₹91,915

4. Mr. Vivek had a small business enterprise. He has given the trial balance as at 31st March 2021. You are required to prepare final accounts in the books of Mr. Vivek.

Particulars	Debit (₹)	Credit (₹)
Mr. Vivek's Capital		1,00,000
Machinery	36,000	
Depreciation on machinery	4,000	
Repairs to machinery	5,200	
Wages	54,000	
Salaries	21,000	
Income tax of Mr. Vivek	1,000	
Cash in hand	4,000	
Land & Building	1,49,000	
Depreciation on building	5,000	
Purchases	2,50,000	
Purchase returns		3,000
Sales		4,98,000
Citi Bank		7,600
Accrued Income	3,000	
Salaries outstanding		4,000
Bills receivables	30,000	

Provision for doubtful debts		10,000
Bills payable		16,000
Bad debts	2,000	
Discount on purchases		7,080
Debtors	70,000	
Creditors		62,520
Opening stock	74,000	
	7,08,200	7,08,200

Additional information:

- (1) Stock as on 31st March 2021 was valued at ₹ 60,000;
- (2) Write off further ₹6,000 as bad debt and maintain a provision of 5% on doubtful debt;
- (3) Goods costing ₹10,000 were sent on approval basis to a customer for ₹12,000 on 30th March, 2015. This was recorded as actual sales.
- (4) ₹2,400 paid as rent for office was debited to Landlord's Account and was included in debtors.
- (5) General Manager is to be given commission at 10% of net profits after charging his commission.
- (6) Works manager is to be given a commission at 12% of net profit before charging General Manager's commission and his own.

Ans: Gross Profit = ₹1,81,000, Net Profit = ₹1,20,000, Balance Sheet Total = ₹3,39,120

5. From the following details prepare Receipts and Payments Account

Particulars	₹
Opening Cash in hand	3,400
Opening Cash at Bank	23,400
Subscriptions received	25,000
Donations collected	5,000
Salaries paid	6,000
Rent Paid	1,000
Tournament Expenses	3,000
Purchase of Investments	10,000
Interest Received	600
Sundry expenses	1,500
Electricity charges	500
Cash in hand at the end	700

Ans: Receipts and Payments A/c Total = ₹57,400

6. From the following Receipts and Payments Account of the Venkateswara Society for the year ended 31.12.2020. Prepare income and expenditure account for the year ended 31.12.2020

Dr.

Cr.

Receipts	(₹)	Payments	(₹)
To Balance 1-1-2020	3,485	By Books	6,150
To Entrance Fees	650	By Printing & Stationery	465
To Donations	6,000	By News Papers	1,110
To Subscriptions	6,865	By Sports Materials	5,000
To Interest on Bank Deposits	1,900	By Repairs	650
To Sale of furniture	685	By Investments	2,000
To Sale of old news papers	465	By furniture	1,000
To Proceeds from entertainments	865	By Salaries	1,500
To Sundry Receipts	125	By Balance (31-12-2020)	3,165
	21,040		21,040

The Entrance fees and donations are to be capitalized. Sports materials value ₹4,000 as on 31.12.2014.

Ans: Surplus = ₹5,495

7. From the following Receipts and Payments Account of the Guntur Sports Club for the year ended 31.3.2020. Prepare Income and Expenditure Account

Dr.

Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	14,000	By Salaries	1,400
To Subscriptions		By Repairs	600
(including ₹1,000 for the previous year)	18,000	By Purchase of Sports Equipment	2,000
To Legacies	2,000	By Furniture	8,000
To Life Membership Fees	5,000	By Honorarium paid	5,000
To Sale of tickets	500	By Books	2,000
To Lockers Rent	1,500	By Investments	10,000
To Entrance Fees	1,000	By Office Expenses	1,200
To interest on Investments	200	By balance c/d	12,000
	42,200		42,200

Additional Information:

- Outstanding Salaries ₹600
- Opening value of sports equipments ₹1,000 closing value ₹500
- Interest accrued on investments ₹200
- Subscription receivable for the year 2014 ₹3,000

Ans: Surplus = ₹12,100

8. From the following Receipts and Payments Account prepare Final Accounts of Sports Club Account.

Dr.

Cr.

Receipts	(₹)	Payments	(₹)
To Subscriptions	15,000	By Land	10,000
To Donations	50,000	By Buildings	40,000
To Legacies	10,000	By Furniture	10,000
To Entrance Fee	5,000	By Sports Material	5,000
To Life Membership Fees	3,000	By Sports Expenditure	6,000
To Sports Income	17,000	By General Exp.	1,000
To Sundries	5,000	By Magazines	1,500
To Sale of old papers	500	By Ground expenses	4,000
		By balance c/d	28,000
	1,05,500		1,05,500

Capitalize half of donations, legacies, entrance and life membership fee. Subscriptions still outstanding ₹5,000. Depreciate fixed assets other than land by 5% and sports material by 10%.

Ans: Surplus = ₹61,000, Balance Sheet Total = ₹95,000

9. From the following Receipts and Payments Account additional information prepare the income and expenditure account for the year ended 31st Dec. 2020 and a Balance Sheet as on that date of Cosmopolitan club.

Dr.

Cr.

Receipts	(₹)	Payments	(₹)
To Donations	50,000	By Furniture (1-1-2020)	10,000
To Life Membership Fees	10,000	By Buildings (1-1-2020)	40,000
To Legacies	40,000	By Salaries	5,000
To subscriptions	41,000	By Wages	1,000
To Lecturers	9,000	By Entertainments	4,000
To Entertainments	13,000	By News paper subscription	1,800
To Sale of old papers	500	By Printing & Stationery	1,200
To Sundries	500	By Telephone charges	300
		By Grass Seeds	700
		By Bats and Balls	5,000
		By Balance c/d	95,000
	1,64,000		1,64,000

Additional Information:

- a) Salaries Outstanding ₹1,000
- b) Printing and Stationery outstanding ₹200
- c) Bats and Balls on 31.12.2020 ₹3,000
- d) Depreciate Buildings at 5%
- e) Depreciate Furniture at 10%
- f) Subscriptions include ₹1,000 relating to 2021
- g) Subscriptions payable by members for the year 2020 is ₹500

Ans: Surplus = ₹43,300, Balance Sheet Total = ₹1,45,500

10. Laxman Cricket association gives you the following Receipts and Payments Account for the year ended 31st March, 2021.

Dr.

Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Salaries	22,000
Cash	1,500	By sports Equipment	50,000
Bank	14,200	By Stationery	2,000
To subscriptions	75,000	By Maintenance of Ground	8,000
To Admission fee	13,500	By Prizes	1,000
To Interest on investments @10% p.a. for full year	10,000	By Balance c/d	
To Donations	2,000	Cash	23,200
		Bank	10,000
	1,16,200		1,16,200

	On 1.4.2020 (₹)	On 31.3.2021 (₹)
i) Subscriptions due	4,000	5,500
ii) Subscriptions received in advance	800	500
iii) Land and buildings (Cost les depreciate)	2,00,0000	1,90,000
iv) Salaries due	1,000	2,000

Prepare Income and Expenditure A/c for the year ended 31st March, 2021 and Balance Sheet as on that date.

Ans: Surplus = ₹58,300, Capital Fund = ₹3,17,900, Balance Sheet Total = ₹3,78,700

Answer:

• **Multiple Choice Questions (MCQ)**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
d	c	c	a	b	b	b	a	a	a	b	a	c	b	c
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
a	a	a	c	b	b	a	a	b	a	c	c	a	a	c

• **State True or False**

1	2	3	4	5	6	7	8	9	10
T	F	F	T	F	F	T	F	T	T
11	12	13	14	15	16	17	18	19	20
T	T	F	F	T	F	T	F	F	F

• **Fill in the Blanks**

1	Asset side	2	₹1,600
3	Intangible	4	Capital
5	2,40,000	6	₹13,500
7	Balance Sheet	8	Outstanding Expenses
9	₹1,000	10	Foot-notes
11	Closing Entries	12	Fictitious Assets
13	Debiting	14	Credit
15	Profit and Loss Account	16	Credit
17	Cash	18	Mercantile
19	Expenditure over Income	20	Revenue
21	Capital	22	Special
23	Balance Sheet	24	Special Fund
25	₹5,20,000		

SECTION - B

FUNDAMENTALS OF COST ACCOUNTING

FUNDAMENTALS OF COST ACCOUNTING 4

This Module includes:

- 4.1 Meaning, Definition, Significance of Cost Accounting, its relationship with Financial Accounting**
- 4.2 Application of Cost Accounting for Business Decisions**
- 4.3 Definition of Cost, Cost Centre, Cost Unit and Cost Drivers**
- 4.4 Classification of Costs (with Reference to Cost Accounting Standard 1)**
- 4.5 Ascertainment of Cost and Preparation of Statement of Cost and Profit (Cost Sheet)**

FUNDAMENTALS OF COST ACCOUNTING

Module Learning Objectives:

After studying this Module, the students will be able to –

- ↗ Understand fundamental concepts of Cost Accounting
- ↗ Understand the role of Cost Accounting in decision making.
- ↗ Learn the criteria for classifying the costs.
- ↗ Learn preparation of the Statement of Cost and Profit.

Meaning, Definition, Significance of Cost Accounting, its Relationship with Financial Accounting

4.1

● Evolution of Cost Accounting:

Every modern business has to make its way through keen competition, uncertainty and risks. Quick changes in social and economic environment also create impact upon the businesses. Changes in political outlook of the government of the country also require adjustment in the business policies. Thus, a modern business becomes more and more complex in nature.

In old times the business concerns were small in size; there was no keen competition; necessity of adjustment in business outlook due to changes in social, economic and political outlook was rare and the owner/ owners of the business could maintain personal contact with the business and gather all information relating to the business whenever necessary. The present-day business is, however, large in size, complex in character and is under keen competition. So, information relating to the business in detail, appropriate management policy on the basis of detailed information and proper execution of such policies can only bring about success.

The traditional Financial Accounting fails to furnish all information necessary for managing a modern business successfully. Thus, as a branch of Financial Accounting, Cost Accounting has evolved and made rapid progress during the last few decades. This branch of accounting, with its developing techniques and procedures, has been rapidly expanding in the fields of its application. In recent years, another aspect of accounting, called Management Accounting, has been developed and is being employed in many concerns.

Where Financial accounting limits its activities in determining the financial result of trading during a given period of time and stating the financial position as on the closing date of the period, Cost Accounting takes the responsibility of generating information for controlling operations with a view to maximizing efficiency and hence profit, and Management accounting takes the duty of assisting the management with information for planning and decision making.

It is well known that the double entry system of accounting was initiated in 1494. Since then, till the after period of Industrial Revolution cost accounting remained as a small branch of financial accounting. The need for information on internal operation and the competitive business environment ushered by the Industrial revolution acted as catalyst in the development cost accounting. Firms, such as textile mills and railroads, were compelled to devise internal administrative procedures to coordinate the various operations involved in the performance of the basic activity of conversion of raw materials into finished goods by textile mills and the transportation of passengers and freight by the railroads. During 1880s, the newly formed mass distribution and mass production enterprises adapted the internal accounting reporting systems of the railroads to their own organizations. But all these along with the adaptations were exclusively focussed on direct labour and direct material (prime costs). The scientific management movement⁶ provided a major impetus to the further development of cost accounting practices. The period 1880 - 1925 saw the development of complex product designs and the emergence of multi activity diversified corporations like Du Pont, General Motors etc. It was during this period that scientific management was developed which led the accountants to convert physical

standards into Cost Standards, the latter being used for variance analysis and control. During the World War I and II the social importance of Cost Accounting grew with the growth of each country's defence expenditure. In the absence of competitive markets for most of the material required for war, the governments in several countries placed cost-plus contracts under which the price to be paid was cost of production plus an agreed rate of profit. The reliance on cost estimation by parties to defence contracts continued after World War II.

● **Development of Cost Accounting Profession in India**

In India, prior to independence, there were a few Cost Accountants, and they were qualified mainly from I.C.M.A. (now CIMA) London. During the World War II, the need for developing the profession in the country was felt, and the leadership of forming an Indian Institute was taken by some members of Defence Services employed at Kolkata. However, with the enactment of the Cost and Works Accountants of India Act, 1959, the Institute of Cost and Works Accountants of India (presently, The Institute of Cost Accountants of India) was established at Kolkata. The profession assumed further importance in 1968 when the Government of India introduced Cost Audit under section 233(B) of the Companies Act, 1956. At present it is under Section 148 of the Companies Act, 2013.

● **Meaning of a Few Important Terms**

a) Meaning of 'Cost'

Cost is defined as the expenditure (actual or notional) incurred on or attributable to a given product or service. It can also be described as the resources that have been sacrificed or must be sacrificed to attain a particular objective. In other words, cost is the amount of resources used for something which must be measured in terms of money.

For example, cost of preparing a wooden chair is the amount incurred on the elements like material, labour and other expenses. Similarly cost of offering any services like banking is the amount of expenditure for offering that service. Thus, cost of production or cost of service can be calculated by ascertaining the resources used for the production or services.

CIMA Official Terminology defines cost either as a noun or as a verb.

The term 'cost' as a noun refers to the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction.

The term 'cost' as a verb refers to the process to ascertain the cost of a specified thing or activity.

b) Meaning of 'Costing'

CIMA Official Terminology specifically states that the use of the term costing is not recommended except with a qualifying adjective, for example standard costing. The term is used in the following connotations; batch costing, continuous operation costing, contract costing, job costing, service costing, specific order costing, absorption costing and marginal costing.

Thus, it is important to note that the term 'costing' is only to be used as a qualifying adjective.

In general, Costing is a technique and process of ascertaining costs. This technique consists of principles and rules which govern the procedure of ascertaining the cost of products/services. The process of costing includes routines of ascertaining costs by historical or conventional costing, standard costing or marginal costing..

c) Meaning of 'Cost Accounting'

CIMA Official Terminology defines cost accounting as the process of gathering of cost information and its attachment to cost objects, the establishment of budgets, standard costs and actual costs of operations,

processes, activities or products; and the analysis of variances, profitability or the social use of funds. Thus, cost accounting encompasses the following;

- (i) One of the main purposes of cost accounting is gathering of cost information related to cost objects. This cost information is then suitably presented to the management which aids them in their decision-making process.
- (ii) Nuances of cost accounting includes the process of cost accumulation through which the cost of operations, processes or activities or products is calculated. Establishment of standard cost and variance analysis are important aspects.
- (iii) Computation profitability which pivots around fixation of selling price is an important aspect of cost accounting.

d) Meaning of ‘Cost Accountancy’

Cost Accountancy is the academic discipline of cost accounting and is defined as ‘the application of costing and cost accounting principles, methods and techniques to the science and art and practice of cost control and the ascertainment of profitability as well as presentation of information for the purpose of managerial decision making.’

Four particular points summarizes the above-mentioned definition.

- (i) The application of the costing and cost accounting principles is encompassed in cost accountancy.
- (ii) This application is with specific purpose and that is for the purpose of cost control, ascertainment of profitability.
- (iii) Cost accounting is a combination of art and science; it is a science as it has well defined rules and regulations, it is an art as application of any science requires art and it is a practice as it has to be applied on continuous basis and is not a onetime exercise.
- (iv) Cost accountancy merely caters to the need of the cost information need of the management which facilitate decision making.

• **Scope of Cost Accounting**

The scope of cost accountancy is very wide and includes the following:

(i) Cost Ascertainment

It deals with the collection and analysis of expenses, the measurement of production of the different product at the different stages of manufacture and the linking up of production with the expenses. In fact, the varying procedures for the collection of expenses give rise to the different systems of costing as historical or actual costs, estimated costs, standard costs etc. Again, the varying procedures for the measurement of production have resulted in different methods of costing such as specific order costing, operation costing etc. For linking up of production with the expenses the different techniques of costing such as marginal cost technique, the total cost technique, direct cost technique etc., have been evolved.

(ii) Cost Book Keeping

It involves maintenance of records of all costs incurred from their incurrence to their charge to departments, products and services. Such recording is done on the basis of double entry system. If the cost and financial accounts are kept separately then their reconciliation is also to be done in order to verify the accuracy of both sets of accounts.

(iii) Cost Control

Cost accounting also includes the utilization of cost information for exercising control. It involves a detailed examination of each cost in the light of benefit derived from the incurrence of the cost. Thus, cost is analyzed to recognize whether the current level of costs is satisfactory in the light of standards set in advance.

(iv) Cost Reports

Presentation of cost is the ultimate function of cost accounting. These reports are primarily for use by the management at different levels. Cost Reports forms the basis for planning and control, performance appraisal and managerial decision making.

• Objectives of Cost Accounting

The objectives of cost accounting include the following:

- a) To ascertain the cost per unit of the different products manufactured by a business concern.
- b) To provide a correct analysis of cost of processes or operations and by different elements of cost.
- c) To disclose sources for wastage and to prepare such reports which may be necessary to control such wastage.
- d) To provide requisite data and serve as a guide to price fixation of products manufactured or services rendered.
- e) To ascertain the profitability of each of the products and advise management as to how these profits can be maximized.
- f) To exercise effective control of stocks of raw material, work-in-progress, consumable stores and finished goods in order to minimize the capital locked up in these stocks.
- g) To reveal sources of economy by installing and implementing a system of cost control for materials, labour and overheads.
- h) To present and interpret data for management planning, decision-making and control.
- i) To help in the preparation of budgets and implementation of budgetary control.
- j) To organize an effective information system so that different levels of management may get the required information at the right time in right form for carrying out their individual responsibilities in an efficient manner.
- k) To guide management in the formulation and implementation of incentive bonus plans based on productivity and cost savings.
- l) To organize cost reduction programmes with the help of different departmental managers.
- m) To find out profit or loss by identifying with revenues the costs of those products or services by selling which the revenues have been earned.

• Significance of Cost Accounting

- a) Cost accounting helps in identifying profitable and unprofitable activities so that steps can be taken to eliminate or reduce those activities from which little or no benefit is obtained or to change the method of production in order to make such activities more profitable.
- b) It enables a concern to measure the efficiency and then to maintain and improve it.

- c) It provides information upon which estimates and tenders are based.
- d) It guides future production policies. It explains the cost incurred and profit made in various lines of business and processes and thereby provides data on the basis of which production can be appropriately planned.
- e) It helps in increasing profits by disclosing the sources of loss or waste and by suggesting such controls so that wastages, leakages and inefficiencies of all departments may be detected and prevented.
- f) It enables a periodical determination of profits or losses without resort to stock taking.
- g) It furnishes reliable data for comparing costs in different periods, for different volumes of output, in different departments and processes and in different establishments. This helps in maintaining costs at the lowest point consistent with the most efficient operating conditions.
- h) Cost accounting may help in identifying the exact cause of a decrease or an increase in profit or loss.
- i) Cost Accounting discloses the relative efficiencies of different workers and thereby facilitates the introduction of suitable plans of wage payment to reward efficiency and to provide adequate incentive to the less efficient worker.
- j) It facilitates the assessment of excise duty and income tax and the formulation of policies regarding industry, export, import, taxation etc. It also facilitates the preparation of national plans for economic development. It provides ready figures for use by the Government for application to problems like price fixation, price control, tariff protection, wage level fixation, payment of dividends or settlement of disputes.

• **Methods of Costing**

The following are the methods of costing.

a. Job Costing

Job costing method is used in firms which work on the basis of job work. There are some manufacturing units which undertake job work and are called as job order units. The main feature of these organizations is that they produce according to the requirements and specifications of the consumers. Each job may be different from the other one. Production is done only on specific order and there is no predetermined production. Because of this situation, it is necessary to compute the cost of each job and hence job costing system is used. In this system, each job is treated separately and a job cost sheet is prepared to find out the cost of the job. The job cost sheet helps to compute the cost of the job in a phased manner and finally arrives at the total cost of production.

b. Batch Costing

This method of costing is used in those firms where productions are made on continuous basis. Each unit coming out is uniform in all respects and production is made prior to the demand i.e., in anticipation of demand. One batch of production consists of the units produced from the time machinery is set to the time when it will be shut down for maintenance. The total cost incurred during this period will be divided by the number of units produced and unit cost will be worked out. Firms producing consumer goods like television, air-conditioners, washing machines etc. use batch costing.

c. Process Costing

Some of the products like sugar, chemical etc involve continuous production process and hence process costing method is used to work out the cost of production, The meaning of continuous process is that the input introduced in the process I travels through continuous process before finished product is produced. The output of process I becomes input of process II and the output of process II becomes input of the

process III. If there is no additional process, the output of process III will be the finished product. In process costing, cost per process is worked out and per unit cost is worked out by dividing the total cost by the number of units. Industries like sugar, edible oil, Chemical are examples of continuous production process and use process costing.

d. Operating Costing

This type of costing method is used in service sector to work out the cost of services offered to the consumers. For example, operating costing method is used in hospitals, power generating units, transportation sector etc. A cost sheet is prepared to compute the total cost and is divided by cost units for working out the per unit cost.

e. Contract Costing

This method of costing is used in construction industry to work out the cost of contract undertaken. For example, cost of constructing a bridge, commercial complex, residential complex, highways etc is worked out by use of this method of costing. Contract costing is actually similar to job costing, the only difference being that in contract costing, one construction job may take several months or even years before they are complete while in job costing, each job may be of a short duration. In contract costing, as each contract may take a long period of completion, the question of computing of profit, it to be solved with the help of a well-defined and accepted method.

Following table illustrates appropriate method of costing in different industries.

Sr. No.	Name of industry	Method of costing
1.	Sugar industry	Process costing
2.	Toy making	Batch costing
3.	Steel or cement	Process costing
4.	Bicycle manufacturing	Multiple costing
5.	Steel or cement	Process costing
6.	Aircraft manufacturing	Multiple costing
7.	Printing	Job costing
8.	Hospital	Service/operating
9.	Pharmaceuticals	Process costing
10.	Breweries	Single unit (or) output
11.	Canteen	Operating/service costing
12.	House building	Contract costing
13.	Road transport	Operating/service
14.	Readymade garments	Batch costing
15.	Soft drinks	Process costing
16.	Coal	Single unit or output
17.	Oil refining	Process costing
18.	Brick kiln	Single unit or output
19.	Interior decoration	Job costing
20.	College	Operating/service

21.	Advertising	Job costing
22.	Soap industry	Process costing
23.	Electricity supply	Operating/service
24.	Foundries	Job costing
25.	video/audio manufacturing	Multiple costing
26.	Sub-assembling	Operation costing

● Cost Accounting Systems

Systems and procedures are devised for proper accounting for costs. Such a system is referred as a cost accounting system. The design of such a system varies significantly and depends on the type of the product/ service of the organisation. As such six types of cost accounting system may be identified. These are listed as under.

a. Historical Costing

In this type of costing system, the costs are ascertained only after they have been incurred. The main objective of it is to ascertain costs that have been incurred in past. It is the process of accumulation of costs after they are incurred in a systematic manner. The historical costs are used only for post-mortem examination of actual costs incurred and it would be too late to control. The actual figures can be compared only when the standards of performance exist.

b. Absorption Costing

Under the 'absorption costing system' all fixed and variable costs are allotted to cost units and total overheads are absorbed according to activity level. In absorption costing system, fixed manufacturing overheads are allocated to products, and these are included in stock valuation. Therefore, valuation of inventories of finished goods and work in progress includes manufacturing fixed cost and transferred to next period. Unlike manufacturing fixed overhead, the administrative overhead, selling and distribution overheads are treated as fixed cost and recorded only when they are incurred. It is a traditional form of cost ascertainment. It is based on the principle that costs should be charged or absorbed to whatever is being costed – be it cost unit, cost centre – on the basis of the benefit received from these costs.

c. Direct Costing

It is a method of costing in which the product is charged with only those costs which vary with volume. Variable or direct costs such as direct material, direct labour and variable manufacturing expenses are examples of costs charged to the product. All indirect costs are charged to profit and loss account of the period in which they arise. Indirect costs are disregarded in inventory valuation. This is similar to marginal cost accounting system where costs are classified into fixed and variable costs. Variable costs are charged to unit cost and the fixed costs attributable to the relevant period are written-off in full against the contribution for that period. Contribution margin indicates the recovery of fixed cost before contributing towards the operational profit. This technique is widely used for internal management purpose for decision making rather than for external reporting.

d. Standard Costing

Under standard costing system, the ascertainment and use of standard costs and the measurement and analysis of variances is done for control purpose. Standard cost is a predetermined cost which is computed in advance of production on the basis of a specification of all the factors affecting costs and used in Standard Costing. Its main purpose is to provide a base for control through Variance Accounting, for

valuation of stock and work-in-progress and, in some cases, for fixing selling prices.

e. Uniform Costing

It is not a distinct method of costing. It is the adoption of identical costing principles and procedures by several units of the same industry or several undertakings by mutual agreement. It facilitates valid comparisons between organizations and helps in elimination of inefficiencies.

f. Marginal Costing

It is the ascertainment of marginal cost by differentiation between fixed and variable cost. It is used to ascertain the effect of changes in volume or type of output on profit.

● **Cost Accounting and Financial Accounting**

Cost Accounting is a branch of accounting, which has been developed because of the limitations of Financial Accounting from the point of view of management control and internal reporting. Cost accounts and financial accounts are usually kept independently in organizations. In some respects, these accounts are similar, but they differ in others. The similarities can be summarized as follows:

- (i) Both cost accounts and financial accounts are maintained using the double entry system of accounting.
- (ii) Recording of transactions, both under the cost accounting system and financial accounting system, is made on the basis of common vouchers, invoices, and documents.
- (iii) Both cost accounts and financial accounts disclose the profit or loss of the business.
- (iv) Both cost accounts and financial accounts involve the process of matching the costs and revenues of the related activity for the current period.
- (v) Both accounting systems keep records of direct costs and indirect costs.
- (vi) Both accounting systems enable the business to compare and reconcile trading results.
- (vii) Both accounting systems assist managers in deciding on business policy and making managerial decisions.

In spite of the above similarities, they certainly differ from each other. Main difference between financial accounting and cost accounting are given as under:

Point of distinction	Financial Accounting	Cost Accounting
1. Purpose	It is prepared for providing information about the results of the business activities as a whole for a particular period to the users.	The main purpose of Cost Accounting is to provide information to the management for the proper planning, control and decision making.
2. Form of accounts	These accounts are kept in such a way as to meet the requirements of companies Act and Income Tax Act.	These accounts are generally kept voluntarily to meet the requirements of the management. But now companies Act has made it obligatory to keep cost records in some manufacturing industries.
3. Recording	It classifies, records and analyses the transactions in a subjective manner i.e., according to the nature of expenses.	It records the expenditure in an objective manner i.e., according to the purposes for which the costs are incurred.

4. Control	It lays emphasis on the recording aspect without attaching any importance on control	It provides a detailed system of control for materials, labour and overhead costs with the help of standard costing and budgetary control.
5. Periodicity of reporting	It reports operating results and financial position usually at the end of the year.	It gives information through cost reports to management as and when desired.
6. Analysis of profit	Financial accounts are the accounts of the whole business. They are independent in nature and disclose the net profit or loss of the business as a whole.	Cost Accounting is only a part of the financial accounts and discloses profit or loss of each product, job or service.
7. Reporting of costs	The costs are reported in aggregate in financial accounts	The costs are broken down on a unit basis in cost accounts.
8. Nature of transactions	Financial accounts relate to commercial transactions of the business and include all expenses viz., manufacturing office, selling and distribution etc.	Cost accounts relate to transactions connected with the manufacture of goods and services and include only those expenses which enter into production.
9. Information	Monetary information is only used (i.e. only monetary transactions are recorded).	Non-monetary information like units is also used (i.e., it deals with monetary as well as non-monetary information).
10. Figures	Financial accounts deal mainly with actual facts and figures.	Cost accounts deal partly with facts and figures and partly with estimates.
11. Reference	In devising or operating a system of financial accounting reference can be made in case of difficulty to the company law, case decisions and to the canons of sound professional practice.	No such reference is possible. Guidance can be had only from a body of convention followed by cost accountants.
12. Relative efficiency	Financial accounts do not provide information on the relative efficiencies of various workers, plants and machinery.	Cost accounts provide valuable information on the relative efficiencies of various plants and machinery.
13. Stock valuation	Stock is valued at cost or market price whichever is less	Stock is valued at cost
14. Type of science	Financial accounting is a positive science because it is subject to legal rigidity with regard to the preparation of the financial statements	Cost accounting is not only a positive science but also a normative science because it includes techniques of budgetary control and standard costing.

Application of Cost Accounting for Business Decisions

4.2

Accounting is often considered as an information processing system that facilitates management decision making. This is true not only for financial accounting but for every branch of accounting. Similar to its other counterparts, cost accounting also discharges its role as an information processing system effectively. The techniques of cost accounting and costing helps the management in every sphere of business decisions. The major applications of cost accounting and costing in facilitating business decisions are discussed below:

a. Classification and sub-division of costs

Costs are collected and classified by various ways in order to provide information to the management for control purposes and to ascertain the profitability of each area of activity. It enables the concern to measure the efficiency and then to maintain and improve it.

b. Control of material, labour and overhead costs

Various inventory control techniques or methods of costing are used to control the material cost. For example, fixation of maximum level helps the management to reduce the over-stocking; use of EOQ helps the Purchase Department to order right quantity. An efficient check on labour and machines is provided by giving detailed information about availability of machine and labour capacity. The work is so planned that no section is over-worked and no section remains idle. By classifying the overheads into controllable and uncontrollable or fixed and variable, it helps to control the overhead costs.

Thus, cost accounting provides a detailed control of material, labour and overhead costs.

c. Business Policy

Business policy may require consideration of alternative methods and procedures and this is facilitated by cost information correctly presented. Cost accounting helps the management to take vital decisions such as introduction of new product, selection of optimum product mix, utilization of spare capacity, replacement of existing assets, etc.

d. Budgeting.

Two important cost accounting tools for helping managers are budgets and performance reports. Budgets are financial and/or quantitative statements prepared and approved prior to a defined period of time, of the policies to be pursued during that period for the purpose of attaining objectives of the management. Thus, budgets are the formal quantifications of the plans of management. Performance reports measure actual performance and give accounts of comparisons of budgets with actual results which facilitate action against those persons whose performance is less than the performance specified in the budgets. The technique of control through performance reports is technically known as management by exception, which is the practice of concentrating on areas whose performance is not up to the mark as it was planned and ignoring areas that are running smoothly as these were planned.

e. Standards for measuring efficiency

It provides the use of standards to assist management in making estimates and plans for future and to provide the basis for measuring efficiency. Actuals are compared with standards to determine the operating efficiency.

f. Best Use of Limited Resources.

Cost Accounting provides the reliable data of costs with regard to materials, wages and other expenses. These help management to get maximum output at the minimum cost by indicating where economies may be affected, waste eliminated and efficiency increased; some of the loss occasioned by reduced turnover and falling prices may be avoided.

g. Price determination

Cost Accounting helps the management to fix the remunerative selling prices of various items of goods under different circumstances. During the period of recession, a businessman has to become very watchful and vigilant in tracking down the concealed inefficiencies and sources of wastage, so that he may reduce the cost of production to the minimum. During depression the businessman has to cut the price to such an extent so as to recover the variable costs. Cost accounting makes the distinction between fixed and variable costs and helps the management in determination of prices. If prices are fixed without cost information, it is possible that prices quoted may be too high or too low.

In line with the above broad principles, cost accounting actively helps the management in making individual business decisions in various areas. Decisions may relate to various problems like -

- (i) Whether or not price should be reduced for increased level of sales;
- (ii) Whether a change in production should be followed;
- (iii) Whether or not factory should operate at full capacity;
- (iv) Determination of the most profitable levels of production;
- (v) Whether to make or buy a spare part;
- (vi) Whether a new product should be introduced in the market;
- (vii) Whether the product should be exported or not;
- (viii) Whether a particular market should be tapped or not;
- (ix) Whether a product should be discontinued to avoid the present loss; and
- (x) Whether or not an investment in a particular asset will be worthwhile.

Thus, cost accounting provides the foundation based on which the management accountants perform further processing of data to help the manager to arrive at effective decisions.

Definition of Cost, Cost Centre, Cost Unit and Cost Drivers

4.3

In costing and cost accounting, we often come across a number of important terms which are required to be defined authentically. Following are the definitions of some of these terms used in costing, cost accounting and also in cost management.

4.3.1 Definition of Cost

CIMA official terminology states that the term can be used either as a noun (referring to the cost of an item) or as a verb (cost of an activity). The documents furnish the two definitions as follows:

As a noun, cost means ‘the amount of expenditure (actual or notional) incurred on, or attributable to, a specified thing or activity’

As a verb, cost means ‘to ascertain the cost of a specified thing or activity’.

As such, cost accounting transactions are recorded at historic cost for measurement basis. But for decision making purpose costs are referred as economic cost.

Economic costs are only a type of cost used in the managerial decision-making process.

Some of the important concepts of costs are discussed below.

- a. **Out-of-Pocket Cost** – This is the portion of the cost associated with an activity that involve cash payment to other parties, as opposed to costs which do not require any cash outlay, such as depreciation and certain allocated costs. Out-of-Pocket Costs are very much relevant in the consideration of price fixation during trade recession or when a make-or-buy decision is to be made.
- b. **Opportunity Cost** - It is the value of the best alternative course of action that was not chosen. In other words, it is what could have been accomplished with the resources used in the course of action if they were employed in the next best alternative. It represents opportunities forgone. For example, if the idle capacity of a production facility can be rented for ₹4,000 p.m., and the entity decides to continue production, then the production cost must include the same as cost of opportunity lost.
- c. **Sunk Cost** – Cost that has been irreversibly incurred or committed and cannot therefore be considered relevant to a decision. Sunk costs may also be termed irrecoverable costs.
- d. **Imputed Costs** – Imputed costs are hypothetical or notional costs, not involving cash outlay computed only for the purpose of decision making. In this respect, imputed costs are similar to opportunity costs. Interest on funds generated internally, payment for which is not actually made is an example of imputed cost.
- e. **Relevant Costs** - Relevant costs are costs which are relevant for a specific purpose or situation. In the context of decision making, only those costs are relevant which are pertinent to the decision at hand. Since we are concerned with future costs only while making a decision, historical costs, unless they remain unchanged in the future period are irrelevant to the decision-making process.

- f. Avoidable Costs & Unavoidable Costs** – Avoidable Costs are those which under given conditions of performance efficiency should not have been incurred. Unavoidable Costs which are inescapable costs, which are essentially to be incurred, within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction. It is fixed in nature and inescapable
- g. Controllable and Non-Controllable Costs** – Controllable Cost is that cost which is subject to direct control at some level of managerial supervision. Non-controllable Cost is the cost which is not subject to control at any level of managerial supervision.

4.3.2 Definition of Cost Centre

Cost centres are the collecting places for costs before they are further analysed. For cost accounting purposes, departments are termed cost centres.

CIMA Official Terminology defines a cost centre as a production or service location, function, activity or item of equipment for which costs are accumulated.

GACAP21 defines a cost unit as any unit of an entity selected with a view to accumulating all cost under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units. This definition has also been corroborated in paragraph 4.6 of CAS 1.

Cost Centre is the logical unit for accumulation of cost. Cost Centre may be of two types – personal and impersonal cost centres. Personal cost centre consists of a person or a group of persons. Cost centres which are not personal cost centres are impersonal cost centres.

Cost centres may also be classified into broad types i.e., Operating Cost Centres and Support- Service Cost Centres. Operating Cost Centres are those which are in the chain of operations like machine shop, welding shop, assembly shop, operation theatre, call centre and so on. Support-service Cost centres are for rendering services to operating cost centre like power house, maintenance, stores, help desk, transport for call centre staff and so on.

Cost centre is often referred as a responsibility centre whose managers are normally accountable for only those costs that are under their control, also known as expense centres.

4.3.3 Definition of Cost Object

Costs are often measured in terms of a product, a service to a hotel guest or a sales territory. These are known as Cost Object.

CIMA Official Terminology states that cost object is (for example) a product, service, centre, activity, customer or distribution channel in relation to which costs are ascertained.

Generally Accepted Cost Accounting Principles (GACAP¹) 21 defines a cost object as an activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained. This definition is also corroborated in paragraph 4.7 of CAS 1.

4.3.4 Definition of Cost Unit

Cost Unit is a device for the purpose of breaking up costs into smaller sub divisions attributable to products or services.

CIMA official Terminology defines a cost unit as a unit of product or service in relation to which costs are ascertained. Cost unit should be appropriate to the type of business. It is important to note that once costs are traced to cost centres, they are further analysed in order to establish the cost per cost unit. Alternatively, some items of

¹ The GACAP is the abbreviated form of Generally Accepted Cost Accounting Principles. It is issued by the Institute of Cost Accountants of India. This document is like a preface to the Cost Accounting Standards. (<https://icmai.in/upload/CASB/2015/GACAP-Final.pdf>)

costs may be charged directly to a cost unit, for example direct materials and direct labour costs.

GACAP21 defines a cost unit as a form of measurement of volume of production of a product or a service. Cost unit is generally adopted on the basis of convenience and practice in the industry concerned. This definition is also corroborated in paragraph 4.5 of CAS 1.

Example of cost unit

Business	Appropriate Cost Unit
Power	Megawatt, Kilo Watt Hour (KWH)
Cement	Metric Tonne (MT)
Automobile	Number of vehicles
Audit Firm	Audit File / Chargeable hour

Note: The cost units for services are intangible and often comprise of two parts. Thus, they are referred as composite cost units. For example, if costs of a delivery service depend not only on the quantity of goods carried but also on the distance travelled. Hence, they should be measured using tonne-kilometre which is a composite unit. Some more examples are –

Business	Appropriate Cost Unit
Hotel	Room - Day
Hospital	Patient - Day
Goods Transport	Tonne – kilometre
Passenger Transport	Passenger - Km

4.3.5 Definition of Cost Driver

A cost driver triggers a change in the cost of an activity. The concept is most commonly used to assign overhead costs to the number of produced units. It can also be used in activity-based costing analysis to determine the causes of overhead, which can be used to minimize overhead costs.

Activity Based Costing is ‘an approach to the costing and monitoring of activities which involves tracing resource consumption and costing final outputs. Resources are assigned to activities, and activities to cost objects based on consumption estimates. The latter utilise cost drivers to attach activity costs to outputs.’

A large number of cost drivers may be used within an activity-based costing system. If a business is only concerned with following the minimum accounting requirements to allocate overhead to produced goods, then just a single cost driver should be used.

A few examples of Cost Drivers are –

Activity	Cost Drivers
Machine Set-up	No. of Set-Ups or Set-up Hours
Inspection	Inspection Hours
Ordering Costs	No. of orders
Delivery Costs	No. of deliveries

A few other important terms are defined below:

• Cost Allocation

When items of cost are identifiable directly with some products or departments such costs are charged to such cost centres. This process is known as cost allocation. Wages paid to workers of service department can be allocated to the particular department. Indirect materials used by a particular department can also be allocated to the department. Cost allocation calls for two basic factors –

- a. Concerned department/product should have caused the cost to be incurred, and
- b. Exact amount of cost should be computable.

• Cost Apportionment

When items of cost cannot be directly charged to or accurately identifiable with any cost centres, they are prorated or distributed amongst the cost centres on some predetermined basis. This method is known as cost apportionment. Thus, items of indirect costs residual to the process of cost allocation are covered by cost apportionment. The predetermination of suitable basis of apportionment is very important and usually following principles are adopted (in order to find suitable relation between the cost object and the cost to be apportioned).

- a. Service or use
- b. Survey method
- c. Ability to bear.

The basis ultimately adopted should ensure an equitable share of common expenses for the cost centres and the basis once adopted should be reviewed at periodic intervals to improve upon the accuracy of apportionment.

The term allocate is defined by the CIMA official terminology to assign a whole item of cost, or of revenue, to a single cost unit, centre, account or time period. In the US, “allocate” does not have this precise meaning, it is used more generally to refer to the whole process of overhead apportionment, allocation and absorption

• Cost Accounting Standards

The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement of cost in manufacture or service sector and to provide guidance to the user organizations, government bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards. Till date, the Board has issued 24 Cost Accounting Standards, Generally Accepted Cost Accounting Principles, 11 Guidance Notes²⁹.

Following is the list of all Cost Accounting Standards.

CAS	Title
1	Classification of Cost
2	Capacity Determination
3	Overheads
4	Captive Consumption
5	Average (equalized) Cost of Transportation
6	Material Cost
7	Employee Cost

8	Cost of Utilities
9	Packing Material Cost
10	Direct Expenses
11	Administrative Overheads
12	Repairs & Maintenance Cost
13	Cost of Service Cost Centre
14	Pollution Control Cost
15	Selling and Distribution Overheads
16	Cost Accountings Standard on Depreciation and Amortisation
17	Cost Accountings Standard on Interest and Financing Charges
18	Cost Accountings Standard on Research and Development Costs
19	Cost Accountings Standard on Joint Costs
20	Cost Accountings Standard on Royalty and Technical Know-How Fee
21	Cost Accountings Standard on Quality Control
22	Cost Accountings Standard on Manufacturing Cost
23	Cost Accounting Standard on Overburden Removal Cost
24	Cost Accounting Standard on Treatment of Revenue in Cost Statement

Classification of Costs (with Reference to Cost Accounting Standard 1)

4.4

• **Concept of Classification of Cost**

Classification of Costs is the logical process of categorising the different costs involved in a business process according to their type, nature, frequency and other features to fulfil accounting objectives and to facilitate economic analysis necessary for decision making. Classification of Costs lies at the core of costing, cost accounting and cost management.

• **Principle of Classification of Cost**

As per Para 5 of CAS 1, Costs shall be classified by the process of grouping the components of cost under a common designation on the basis of similarities of nature, attributes or relations. Items grouped together under common heads shall be further classified according to their fundamental differences.

Moreover, scheme of classification shall be such that every item of cost is classified.

The process will ensure identification of each item and the systematic placement of like items together according to their common features. The same costs may appear in several different classifications depending on the purpose of classification.

Cost is classified normally in terms of managerial objective. Its presentation normally requires sub-classification. Such sub-classification may be according to nature of the cost elements, functional lines, areas of responsibility, or some other useful break-up. The appropriate sub-classification depends upon the uses to be made of the cost report.

Cost may be classified with reference to the nature of expense, its traceability to a cost object (direct/ indirect), its relation to functions /activities, its behaviour (fixed, semi-variable or variable) and its relationship to production process.

• **Classification of Cost as per CAS 1**

As per Para 4.3 of CAS 1, Classification of cost is the arrangement of items of costs in logical groups having regard to their nature (subjective classification) and purpose (objective classification).

Thus, in CAS 1, two types of classification (logical groups) are recommended.

- a. Subjective classification (classification on the basis of nature) and
- b. Objective classification (on the basis of purpose)

Accordingly, Para 6 of CAS 1 suggest five classifications along with some sub classifications. These are as follows.

1. **Classification by nature of expense (Para 6.1)** – on the basis of nature of the expense the elements of cost can be classified in the following three categories:

- a. **Material** – Material Costs are cost of materials used for the purpose of production of a product or rendering of a service, net of trade discounts, rebates, taxes and duties refundable that can be quantified with reasonable accuracy.
 - b. **Employee** - Employee Costs are consideration, including benefits paid or payable to employees, permanent or temporary, for the purpose of production of a product or rendering of a service.
 - c. **Expenses** - Expenses are costs other than material cost and employee cost for the purpose of production of a product or rendering of a service. For example - cost of utilities, payment for bought out services, job processing charge.
2. **Classification by traceability of the cost to a cost object (Para 6.2)** – on the basis of traceability costs are either direct cost or indirect cost.
- a. **Direct cost** - If a cost can be assigned to a cost object in an economically feasible way, it shall be termed as direct to that cost object. These are of three types
 - i. **Direct material cost** - Direct Material Costs are the cost of materials which can be assigned to a cost object in an economically feasible way.
 - ii. **Direct employee cost** - Direct Employee Cost are employee costs, which can be assigned to a cost object in an economically feasible way.
 - iii. **Direct expenses** - Direct Expenses are expenses except direct material and direct employee cost which can be assigned to a cost object.
 - b. **Indirect cost** – if a cost is not identifiable as a direct cost, then it is referred as indirect cost.
It comprises of the following.
 - i. **Indirect material** - Indirect Material Costs are cost of materials, which cannot be directly assigned to a particular cost object in an economically feasible way
 - ii. **Indirect employee cost** - Indirect Employee costs are employee costs, which cannot be directly assigned to a particular cost object in an economically feasible way.
 - iii. **Indirect expenses** - Indirect Expenses are expenses, which cannot be directly assigned to a particular cost object in an economically feasible way.
3. **Classification by function (Para 6.3)** – costs can be classified according the functions which are -
- (i) **Manufacturing/Production cost:** The cost of operating the manufacturing division of a company is production cost. It includes costs beginning with supplying materials, labour and services and ends with the primary packing of the product. Thus, it includes the cost of direct material, direct labour, direct expenses and factory overheads.
 - (ii) **Administration cost:** The cost of formulating the policy, directing the organisation and controlling the operations, which is not related directly to a production, selling, distribution, research or development activity or function are administration costs.
 - (iii) **Selling cost:** The cost of seeking to create and stimulate demand (sometimes termed as marketing) and of securing orders.
 - (iv) **Distribution cost:** The expenditure incurred from making the packed product available for dispatch to making the reconditioned returned empty packages, if any, available for-use. Expenditure incurred in moving articles to and from prospective customers as in the case of goods on sale or return basis is also included in distribution cost.

- (v) **Research cost:** The cost of searching for new or improved products, new application of materials, or new or improved methods.
- (vi) **Development cost:** The cost of implementation of the decision to produce a new or improved product or to employ a new or improved method till the commencement of formal production of that product or by the method is development cost.
4. **Classification by nature of behaviour of the cost (para 6.4)** - Costs shall be classified based on behaviour in response to the changes in the activity levels such as, fixed cost, variable cost and semi-variable cost. Accordingly, costs are -
- Fixed cost** - Fixed costs are costs which do not vary with the change in the volume of activity.
 - Variable cost** - Variable costs are the cost which tends to directly vary with the volume of activity.
 - Semi variable cost** - Semi Variable Costs are the costs that contain both fixed and variable elements. They partly change with the change in the level of activity
5. **Classification by nature of production or operation process (para 6.5)** - Costs shall also be classified on the basis of nature of production or operation process. Operation Cost shall be the cost a specific operation involved in production of goods or rendering of services. Accordingly, costs are -
- Job cost
 - Batch cost shall be the aggregate cost related to a cost unit which consist of a group of similar articles or services which maintain its identity throughout one or more stages of production or operation.
 - Contract cost shall be the cost of a contract agreed upon between the contractee and the contractor.
 - Process cost shall be the cost of production or operation process where goods are produced or services rendered from a sequence of continuous or repetitive operations or processes during a period.
 - Joint costs are the costs of common resources used for producing two or more products or rendering two or more services simultaneously

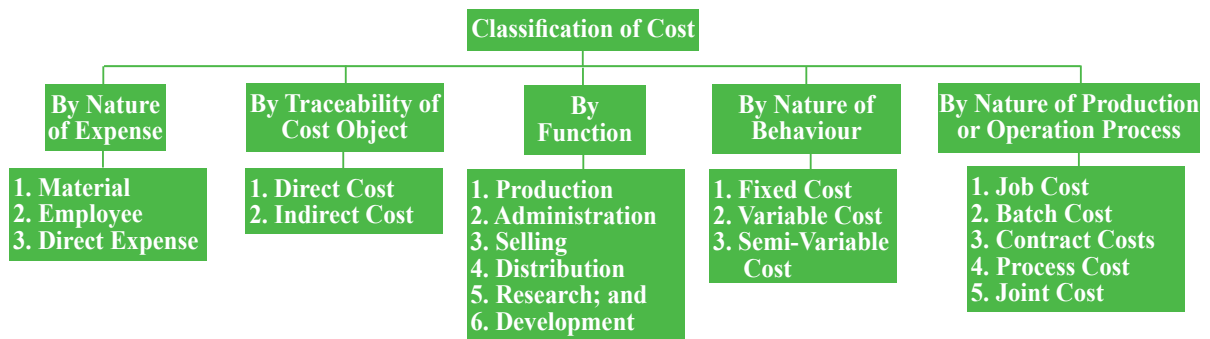


Figure 4.1: Classification of Cost (as per CAS 1)

Ascertainment of Cost and Preparation of Statement of Cost and Profit (Cost Sheet)

4.5

4.5.1 Elements of Cost

Mere knowledge of total cost cannot satisfy the needs of management. For proper control and managerial decisions, management is to be provided with necessary data to analyse and classify costs. For this purpose, the total cost is analysed by elements of cost i.e., by the nature of expenses. Strictly speaking, there are three elements of cost - materials, labour and other expenses. These elements of cost are further analysed into different elements as illustrated in the following chart.

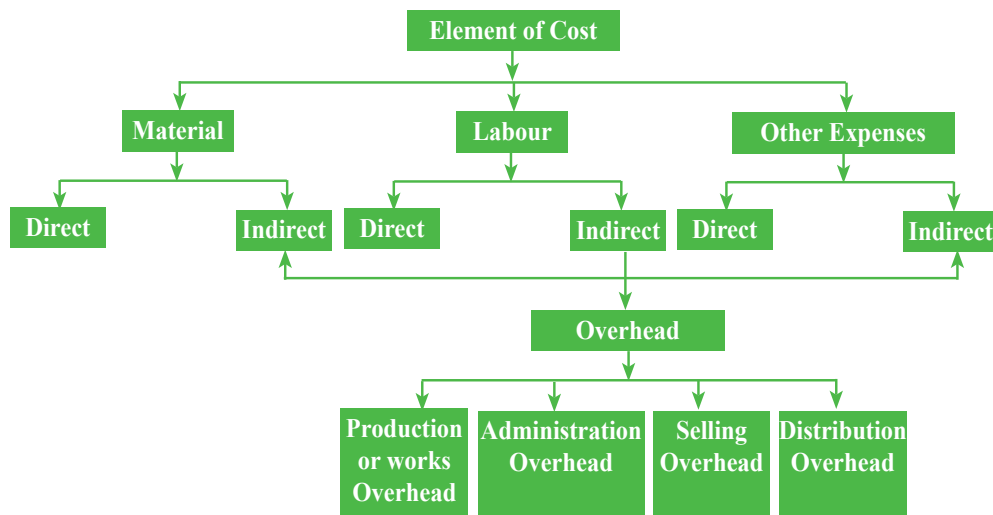


Figure 4.2: Elements of Cost

The above elements are discussed below.

1. Direct Material

Direct materials are those materials which can be identified in the product and can be conveniently measured and directly charged to the product. These materials directly enter the production and form a part of the finished product. For example, timber in furniture making, cloth in dress making and bricks in building a house.

Following are normally classified as direct materials:

- (i) All raw materials like jute in the manufacture of gunny bags, pig iron in foundry, and fruits in canning industry.
- (ii) Materials specifically purchased for a specific job, process or order like glue for book binding, starch

powder for dressing yarn.

- (iii) Parts or components purchased or produced like batteries for transistor- radios and tyres for cycles.
- (iv) Primary packing materials like cartons, wrappings, cardboard boxes, etc. used to protect finished product from climatic conditions or for easy handling inside the factory.

From the above discussion it becomes clear that indirect materials are those materials which cannot be classified as direct materials. These are not traceable to the product. Examples of indirect materials are: consumables, like cotton waste, lubricants, brooms, rags, cleaning materials, materials for repairs and maintenance of fixed assets, high speed diesel used in power generators etc.

In some cases, though the material is a part of the finished product yet it is not treated as direct material; for example, sewing thread in dress making and nails in furniture making. This is because they are used in comparatively small quantities and it would be futile elaboration to make an analysis of them for the purpose of direct charge. Such materials are treated as indirect materials. Thus, it can be concluded that the ease and the feasibility with which a material can be traced into the composition of a finished product will determine what is to be treated as direct material.

2. Direct Labour

Direct labour is all labour costs expended in altering the construction, composition or condition of the product. In simple words, it is that labour which can be conveniently identified or attributed wholly to a particular job, product or process or expended in converting raw materials into finished goods. Wages of such labour are known as direct wages. Thus, it includes payment made to the following groups of labour.

- (i) Labour engaged on the actual production of the product or carrying out of an operation or process.
- (ii) Labour engaged in aiding the manufacture by way of supervision, maintenance, tools setting transportation of material etc.
- (iii) Inspectors, analysts etc, specially required for such production.

Wages paid to supervisors, inspectors, etc., though not direct labour, can be treated as direct labour if they are directly engaged on specific product or process and the hours they spend on it can be directly measured without much of an effort. Similarly, where the cost is not significant like the wages of trainees or apprentices, their labour, though directly spent on a product, is not treated as direct labour.

3. Direct Expenses (or chargeable expenses)

All expenses which can be identified to a particular cost centre and hence directly charged to the centre are known as direct expenses. In other words, all expenses (other than direct materials and direct labour) incurred specifically for a particular product, job, department etc. are called direct expenses. These are directly charged to the product. Examples of such expenses are royalty, excise duty, hire charges of a specific plant and equipment cost of any experimental work carried out specially for a particular job, travelling expenses incurred in connection with a particular contract or job etc.

4. Overheads

Overheads may be defined as the aggregate of the cost of indirect materials, indirect labour and such other expenses including services which cannot conveniently be charged to specific cost units. Thus, overheads are all expenses other than direct expenses. In general terms, overheads comprise all expenses incurred for or in connection with the general organization of the whole or part of the undertaking i.e., the cost of operating supplies and services used by the undertaking and including the maintenance of capital assets. The main groups into which overheads may be sub-divided are -

- a. **Production overheads:** These are indirect costs involved in the production of a product or in rendering service. It is also called Factory Overheads, Works Overheads and Manufacturing Overheads. Production overheads include administration costs relating to production, factory, works or manufacturing.
- b. **Administration overheads:** These are cost of all activities relating to general management and administration of an entity. Administrative overheads shall exclude production overheads, marketing overheads and interest and finance charges. Administrative overheads do not include administration cost relating to production, factory, works or manufacturing.
- c. **Selling overheads:** Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.
- d. **Distribution overheads:** Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer. The cost of any non-manufacturing operations such as packing, repacking and labelling at an intermediate storage location will be part of distribution cost. Examples are secondary packing, outward transportation cost, warehousing cost, cost of delivering the products to customers, clearing and forwarding charges, cost of mending or replacing packing materials at distribution point.

4.5.2 Preparation of Cost Sheet and Ascertainment of Profit

• Concept of Cost Sheet

A cost sheet, also referred as statement of cost, is a statement that shows the various components of total cost for a product. The selling price (after adding certain percentage of profit to the cost) can be deduced for a product based on the cost sheet. It is the depiction of the cost accumulation process of a single output based on a single cost unit. An estimated cost sheet is prepared based on estimated cost just before the production begins. Under absorption costing system, direct material, direct labour, direct expenses, fixed and variable production overhead are considered as composing the factory (works) cost. Administrative overhead added to works cost gives the cost of production. Selling and distribution overhead adds to cost of production to give the cost of sales.

The term conversion cost is used to represent the cost of converting raw material into finished goods. Thus conversion cost is the sum of direct labour cost, direct expenses and production overhead. Cost sheet shows the operating results.

• Advantages of Cost Sheet

Main advantages of a cost sheet are as under:

- a. It discloses the total cost and the cost per unit of the units produced during the given period.
- b. It enables a manufacturer to keep a close watch and control over the cost of production.
- c. By providing a comparative study of the various elements of current cost with the past results and standard costs, it is possible to find out the causes of variations in cost and to eliminate the adverse factors and conditions which go to increase the total cost.
- d. It acts as a guide to the manufacturer and help him in formulating a definite useful production policy.
- e. It helps in fixing up the selling price more accurately.
- f. It helps the business to submit quotations with reasonable degree of accuracy against tenders for the supply of goods.

⊙ **Format of Cost Sheet**

Cost Sheet or Statement of Cost and Profit

Particulars	Amount (₹)	Amount (₹)
A. Direct Material		
Opening stock		
+ Purchases		
+ Carriage inwards		
- Closing stock		
B. Direct wages		
C. Direct Expenses		
I. Prime cost (A+B+C)		
D. Factory overheads-		
Indirect materials		
Loose tools		
Indirect wages		
Rent and rates (Factory)		
Lighting and heating (F)		
Power and fuel		
Repairs and Maintenance		
Drawing office expenses		
Research and experiment		
Depreciation – plant (F)		
Insurance – (F)		
Work manger's salary		
Add: Opening Work-in-progress		
Less: Closing Work-in-progress		
II. Factory cost/works cost (I+D)		
E. Office and Administrative Overheads		
Rent and rates – office		
Salaries – Office		
Insurance of office building and equipment		
Telephone and postage		
Printing and stationery		
Depreciation of furniture and office equipment		
Legal expenses		
Audit fees		
Bank charges		

III. Cost of production (II + E)		
Add: Opening Stock of Finished Goods		
Less: Closing Stock of Finished Goods		
IV. Cost of Goods Sold		
F. selling and distribution overheads		
Showroom rent and rates		
Sales men's salaries and commission		
Traveling expenses		
Printing and stationery – sales department		
Advertising		
Postage		
Collection expenses		
Carriage outward		
Depreciation of delivery van		
Samples and free gifts		
V. Cost of sales (IV+F)		
VI. Profits / loss		
VII. Sales (V + VI)		

Note: The following items are, however, not included in Cost Sheet.

a)	Income Tax
b)	Dividends to shareholders
c)	Premium on redemption of shares and debentures
d)	Capital losses i.e., loss out of sales
e)	Interest on loan or debentures or bank interest
f)	Donations
g)	Capital expenditure
h)	Discounts on shares and debentures
i)	Commission to managing directors
j)	Underwriting commission
k)	Writing off goodwill and preliminary expenses
l)	Reserve for bad debts
m)	Transfer to all reserves or appropriation of profits
n)	Share premium
o)	Interest on capital
p)	Drawing of proprietors
q)	All personal expenses of owner

Consider the following illustrations.

Illustration 1.

From the following information, find out purchases.

Raw material consumed = ₹26,500.

Closing Stock = ₹4,500

Opening Stock = ₹3,000

Solution:

We Know, Raw Material Consumed = Opening Stock + Purchases – Closing Stock.

Purchases = Raw Material Consumed + Closing Stock – Opening Stock

= ₹ (26,500 + 4,500 – 3,000)

= ₹ 28,000.

Illustration 2.

Prime Cost = ₹33,500, Depreciation = ₹1,500. Factory rent is 200% of Depreciation.

Find out the Factory Cost.

Solution:

Particulars	₹
Prime Cost	33,500
Add: Factory Overheads:	
Depreciation	1,500
Factory Rent (₹1,500 x 200%)	3,000
Factory Cost	38,000

Illustration 3.

Cost of Sales = ₹37,416. Advertisement Expenses = ₹600. Discount on sales = 50% of advertisement Expenses. Find Cost of Goods Sold.

Solution:

We Know, Cost of Goods Sold + Selling and Distribution Overheads = Cost of Sales.

Both Advertisement Expenses and Discount on sales together constitutes Selling and Distribution Overhead

Particulars	₹
Cost of Sales	37,416
Less: Selling and Distribution Overheads	
Advertisement Expenses	600
Discount on sales(50% of ₹600)	300
Cost of Goods Sold	36,516

Illustration 4.

Factory Cost is ₹3,95,000. Find Office and Administration overheads cost which is 7.315% of factory cost.

Solution:

Office and Administration Overheads = 7.315% of Factory Cost = 7.315% of ₹3,95,000 = ₹28,894.25.

Illustration 5.

Gross Factory Cost = ₹58,000. Net Factory Cost = ₹54,000. Opening stock of work-in-progress is ₹8,000. Find closing stock of work-in-progress.

Solution:

Net Factory Cost = Gross Factory Cost + Opening Stock in WIP – Closing Stock in WIP

₹54,000 = ₹58,000 + ₹8,000 – Closing Stock in WIP

Closing Stock in WIP = ₹66,000 - ₹54,000 = ₹12,000

Illustration 6.

Prime Cost is ₹41,000. Direct labour cost consists of skilled labour ₹6,000 and unskilled labour ₹2,000. Variable works overhead is 100% of direct wages and fixed works overhead is 60% of direct wages. Sale of scrap is ₹1,800. Find works cost.

Solution:

Particulars	₹
Prime Cost	41,000
Works Overhead:	
Add: Variable 100% direct wages	8,000
Add: Fixed 60% direct wages	4,800
Less: Sale of scrap	(1,800)
Works Cost	52,000

Illustration 7.

From the information, prepare a statement showing expenses which you would disregard in estimating costs. Rent, rates and insurance of office ₹2500, Bad Debt ₹200, Discount Allowed ₹300, Bank charges ₹100 and Donations ₹150.

Solution:

Expenses excluded from estimating cost	₹
Donations	150
Discount Allowed	300
Bad debt	200
Total	650

Illustration 8.

Calculate the amount of direct material if:

Prime cost = ₹50,000. Direct labour = 70% of prime cost.

Solution:

Prime Cost = ₹50,000.

Direct Labour = 70% of prime cost = 70% of ₹50,000 = ₹35,000.

Direct Material = ₹ (50,000 – 35,000) = ₹15,000.

Illustration 9.

Direct materials cost is ₹80,000. Direct labour cost is ₹ 60,000. Factory overhead is ₹ 90,000. Beginning goods in process were ₹ 15,000. The cost of goods manufactured is ₹ 2,45,000. What is the cost assigned to the ending goods in process?

Solution:

Particulars	₹
Direct Material	80,000
Direct Labour	60,000
Prime Cost	1,40,000
Add: Factory Overhead	90,000
Add: Opening WIP	15,000
Less: Closing WIP	-
Cost of goods manufactured (given)	2,45,000

As cost of goods manufactured is given as ₹2,45,000 so there will be no closing goods in process.

Illustration 10.

Given data that:

Finished goods Opening Inventory ₹ 30,000

Finished goods Closing Inventory ₹ 50,000

Cost of goods sold ₹ 1,90,000

What will be the value of Cost of Production?

Solution:

We Know, Cost of Goods Sold = Cost of Production + Opening stock of finished goods – Closing stock of finished goods.

Particulars	₹
Cost of Goods Sold	1,90,000
Add: Closing Stock of finished goods	50,000
Less: Opening stock of finished goods	(30,000)
Cost of Production	2,10,000

Illustration 11

Prepare a statement of cost from the following data to show material consumed, Prime cost, factory cost, Cost of goods sold and profit.

	1-1-2021 (₹)	31-12-2021 (₹)
Raw material	60,000	50,000
Work-in-progress	24,000	30,000
Finished goods	1,20,000	1,10,000
Purchase of materials during the year		9,00,000
Wages paid		5,00,000
Factory overheads		2,00,000
Administration overheads		50,000
Selling and distribution overheads		30,000
Sales		20,00,000

Solution:

Statement of Cost and Profit

Particulars	(₹)	(₹)
Opening stock of raw materials	60,000	
Add: purchase of raw materials	9,00,000	
	9,60,000	
Less: Closing stock of raw materials	50,000	
Materials consumed		9,10,000
Wages paid		5,00,000
Prime cost		14,10,000
Factory overheads		2,00,000
Add: opening stock or WIP		24,000
		16,34,000
Less: closing stock of WIP		30,000
Factory cost		16,04,000
Administrative overheads		50,000
Add: opening stock of finished goods		1,20,000
		17,74,000
Less: closing stock of finished goods		1,10,000
Cost of goods sold		16,64,000
Selling and distribution overheads		30,000
Cost of sales		16,94,000
Profit		3,06,000
Sales		20,00,000

Illustration 12.

From the following particulars, prepare cost statement showing the component of total cost and the profit for the year ended 31st December, 2021.

Particulars	1-1-2021 (₹)	Particulars	31-12-2021 (₹)
Stock of finished goods	6,000	Stock of finished goods	15,000
Stock of raw materials	40,000	Stock of raw material	50,000
Work-in-progress	15,000	Work-in-progress	10,000
Purchase of raw materials	4,75,000	General expenses	32,500
Carriage inward	12,500	sales for the year	8,60,000
Wages	1,75,000	Income tax	500
Works manager's salary	30,000	Dividend	1,000
Factory employees salaries	60,000	Debenture interest	5,000
Factory rent, taxes and Insurance	7,250	transfer to sinking fund for	
replacement of machinery	10,000		
Power expenses	9,500	goodwill written off	10,000
Other production expenses	43,000	payment of sales tax	
		Selling expenses	9,250

Solution:

Statement of Cost and Profit

Particulars	₹	₹
Opening stock of raw materials	40,000	
Add: purchase of raw materials	4,75,000	
	5,15,000	
Less: closing stock of raw materials	50,000	
	4,65,000	
Add: Carriage inward	12,500	
Materials consumed		4,77,500
Wages		1,75,000
Prime cost		6,52,500
Factory expenses:		
Works manager's salary	30,000	
Factory employees salaries	60,000	
Factory rent, taxes and insurance	7,250	
Power expenses	9,500	
Other production expenses	43,000	
Opening work-in-progress	15,000	1,64,750
		8,17,250

Less: closing work-in-progress		10,000
Works cost		8,07,250
General expenses		32,500
Cost of production		8,39,750
Add: opening stock of finished goods		6,000
		8,45,750
Less: opening stock of finished goods		15,000
Cost of goods sold		8,30,750
Selling expenses		9,250
Cost of sales		8,40,000
Profit		20,000
Sales		8,60,000

Illustration 13.

Mr. Gopal furnishes the following data relating to the manufacture of a standard product during the month of April, 2021:

Raw materials consumed	₹ 15,000
Direct labour charges	₹ 9,000
Machine hours worked	900
Machine hour rate	5
Administrative overheads	20% on works cost
Selling overheads	₹ 0.50 per unit
Units produced	17,100
Units sold	16,000 at ₹ 4 per unit.

You are required to prepare a cost sheet from the above, showing: (a) the cost per unit (b) profit per unit sold and profit for the period.

Solution:

Statement of Cost

	Total (₹)	Per unit
Raw materials consumed	15,000	
Direct labour charges	9,000	
Prime cost	24,000	
Factory expenses (900 hrs, @ ₹ 5 per hr)	4,500	
Works cost	28,500	
Administrative overheads (20% on works cost)	5,700	
Cost of production	34,200	₹ 2.00 (₹34,200 ÷ 17,100)

Statement of Profit

	(₹)
Cost of production of 16,000 units @ ₹ 2 per unit	32,000
Selling overheads @ 50 paise per unit for 16,000 units	8,000
Cost of sales	40,000
Profit for the period	24,000
Sales (16,000 units @ ₹ 4 unit)	64,000
Profit per unit sold = $\frac{24,000}{16,000} = ₹1.50$	

Exercise

A. Theoretical Questions

⊙ Multiple Choice Questions (MCQ)

1. The total cost incurred in the operation of a business undertaking other than the cost of manufacturing and production is known as:
 - (a) direct cost
 - (b) Variable cost
 - (c) commercial cost
 - (d) conversion cost
2. Which of the following is not a relevant cost?
 - (a) Replacement cost
 - (b) Sunk cost
 - (c) Marginal cost
 - (d) standard cost
3. Process cost is very much applicable in:
 - (a) construction industry
 - (b) pharmaceutical industry
 - (c) Air line company
 - (d) none of these
4. The main purpose of cost accounting is to:
 - (a) maximize profits,
 - (b) help in inventory valuation
 - (c) provide information to management for decision making
 - (d) Aid in the fixation of selling price
5. Opportunity cost is the best example of:
 - (a) sunk cost
 - (b) Standard cost
 - (c) relevant cost
 - (d) irrelevant cost
6. Costs are classified into fixed costs, variable costs and semi-variable costs, it is known as
 - (a) functional classification
 - (b) behavioral classification
 - (c) element wise classification
 - (d) classification according to controllability
7. Which method of costing is used for determination of costs for printing industry?
 - (a) process costing
 - (b) operating costing

- (c) batch costing
 - (d) job costing
8. Over which of the following costs, management is likely to have least control
- (a) wages cost
 - (b) building insurance cost
 - (c) machinery breakdown cost
 - (d) advertisement cost
9. Variable costs are fixed
- (a) for a period
 - (b) per unit
 - (c) depends upon the entity
 - (d) for a particular process of production
10. In behavioral analysis', costs are divided into
- (a) production and non-production costs
 - (b) controllable and non-controllable costs
 - (c) direct and indirect costs
 - (d) fixed and variable costs
11. Prime cost plus factory overheads is known as
- (a) factory on cost
 - (b) conversion cost
 - (c) factory cost
 - (d) marginal cost
12. Which of the following items is excluded from cost Accounts?
- (a) Income tax
 - (b) interest on debentures
 - (c) cash discount
 - (d) All of these
13. The following is included in financial accounts, but not in cost accounts.
- (a) carriage and freight
 - (b) Excise duty
 - (c) Royalty
 - (d) Dividend paid
14. Advertisements are treated as
- (a) direct expenses
 - (b) cost of production
 - (c) selling overheads
 - (d) distribution overheads

15. Which cost system description applies to the manufacture of 20 engraved doors for the new club house at a golf course?
 - (a) contract
 - (b) process
 - (c) Batch
 - (d) service
16. Prime cost may be correctly termed as
 - (a) the sum of direct material and labour cost with all other costs excluded.
 - (b) the total of all cost items which can be directly charged to product units.
 - (c) The total costs incurred in producing a finished unit.
 - (d) the sum of the large cost there in a product cost.
17. The guidance and regulation by executive action of the cost of operating an undertaking is said to be
 - (a) Budgetary control
 - (b) cost control
 - (c) cost analysis
 - (d) None
18. Direct expenses are also known as
 - (a) Overhead expenses
 - (b) process expenses
 - (c) chargeable expenses
 - (d) None
19. Indirect material cost is a part of
 - (a) Prime cost
 - (b) Factory overhead
 - (c) chargeable expenses
 - (d) None of these
20. Which of the following is a part of both Prime cost and conversion cost
 - (a) Direct Material
 - (b) Indirect Labour
 - (c) Indirect Material
 - (d) Direct Labour
21. Statement showing break-up of costs is known as
 - (a) cost-sheet
 - (b) statement of profit
 - (c) production account
 - (d) Tender
22. The works cost plus administration expenses

- (a) Total Cost
 - (b) Cost of production
 - (c) cost of sales
 - (d) Factory cost
23. Directors remuneration and expenses form a part of
- (a) Production overhead
 - (b) Administration overhead
 - (c) Selling overhead
 - (d) Distribution overhead
24. Cost reduction is
- (a) Long term phenomena
 - (b) It challenges the standards
 - (c) It is carried out without compromising the quality
 - (d) All of the above
25. Interest on own capital is
- (a) Cash cost
 - (b) Notional cost
 - (c) Sunk cost
 - (d) Part of Prime Cost

⊙ **State True or False**

1. Process costing method is suitable for coal industry
2. Fixed cost per unit remains fixed but variable cost per unit vary with variation in output
3. Financial accounts provide information for determination of profit or loss
4. Cost accounts provide information for ascertainment of the financial position as on a particular date
5. Cost accounting is an instrument of management control
6. Service costing is used in industries producing goods
7. In construction industry, contract costing is used
8. The process of finding cost is costing
9. Depreciation is an out of pocket cost
10. Variable cost per unit varies with increase or decrease in volume of output
11. All costs are controllable
12. Cash discount is excluded from cost sheet
13. Finance expenses are included in cost sheet
14. Discount to customer comes under “distribution cost”
15. Variable overhead cost is a period cost
16. In the cement industries the unit of cost is per tonne

17. Scrap is a residue which comes out of a manufacturing process but has no recoverable value
18. Contract costing as a basic method is specific order costing
19. All the indirect cost related to indirect material, Indirect labour and indirect expenses are termed as overheads
20. Direct wages is a variable cost
21. Historical costs are relevant costs for decision making
22. Contract costing is based on job costing principles
23. Cost accounting is an instrument of management control.
24. Abnormal cost is controllable
25. Fixed cost per unit decreases with rise in output and increases with fall in output

● **Fill in the Blanks**

1. Costing is a technique of ___
2. Cost accountancy is the science, art and ___ if a cost accountant.
3. Cost accounting serves the information needs of _____
4. Cost accounting provides data for ___ decision making.
5. Cost accounting has been developed because of ___ of financial accounting.
6. The method of costing used in a refinery is ___
7. For the goods Transport Company ___ is the suitable cost unit.
8. The cost which does not change due to change in volume of production is called ___
9. The semi- finished goods is also known as ___ in cost accounting.
10. An item of cost that is direct for the business may be ___ for another business.
11. The total of all direct expenses is known as _____
12. All costs are ___ controllable
13. The aggregate of indirect material indirect labour and indirect expenses together is called ___
14. Factory overheads are also known as ___ overheads.
15. Chargeable expenses are an example ___ cost.
16. ___ cost are cost which are ascertained after they have been incurred.
17. Any expenditure over and above prime cost is known as ___
18. In ___ the cost of a group of products is ascertained.
19. Cost accounting is a separate ___ of accounting.
20. In automobile industry cost unit is ___
21. ___ costs are partly fixed and partly variable in relation to output.
22. Fixed cost per unit ___ with increasing output.
23. Wages of delivery van driver is a ___
24. Cost accounting deal partly with facts and figures and partly with _____
25. Cost accountant provides the detailed information about ___ of various products, processes services and operations.

B. Numerical Questions

⊙ Comprehensive Numerical Problems

1. The following data relate to the manufacture of a standard product during the month of March, 2021.

Raw materials	80,000
Direct wages	48,000
Machine hours worked	8,000
Office overhead	10% on works cost
Machine hour rate	₹ 4
Selling overhead	₹ 1.50 p unit
Units produced	4,000
and sold @ ₹ 50 each	3,600

Prepare cost sheet

You are required to find out from the above showing a) Cost of Production per unit b) Profit per unit sold and profit for the period.

Ans: (a) ₹44 per unit (b) ₹4.5 per unit, Profit ₹16,200

2. From the following particulars prepare a cost sheet showing the total cost per tone for the period ended 31st Dec. 2021.

Particulars	₹	Particulars	₹
Raw Materials	33,000	Rent and taxes (office)	500
Productive wages	38,000	Water supply (works)	1,200
Unproductive wages	10,500	Factory insurance	1,100
Factory rent and taxes	7,500	Office insurance	500
Factory lighting	2,200	Legal expenses	400
Factory heating	1,500	Rent of warehouse	300
Motive power	4,400	Depreciation of	
Haulage (works)	3,000	-Plant and machinery	2,000
Directors fees (works)	1,000	-Office building	1,000
Directors fees (office)	2,000	- Delivery vans	200
Factory cleaning	500	Bad debts	100
Sundry office expenses	200	Advertising	300
Estimating expenses(works)	800	Sales department's salaries	1,500
Factory stationery	750	Upkeep of delivery vans	700
Office stationery	900	Bank charges	50
Loose tools written off	600	Commission on sales	1,500

The total output for the period has been 14,775 tonnes

Ans: Prime Cost ₹71,000, Factory Cost ₹1,08,050, Cost of Production ₹1,13,600, Total Cost ₹1,18,100, Cost per ton ₹8/-

Answer:

• **Multiple Choice Questions (MCQ)**

1.	2	3	4	5	6	7	8	9	10	11	12	13	14	15
c	b	b	c	c	b	d	d	b	d	c	d	d	c	c
16	17	18	19	20	21	22	23	24	25					
b	b	c	b	d	a	b	b	d	b					

• **State True or False**

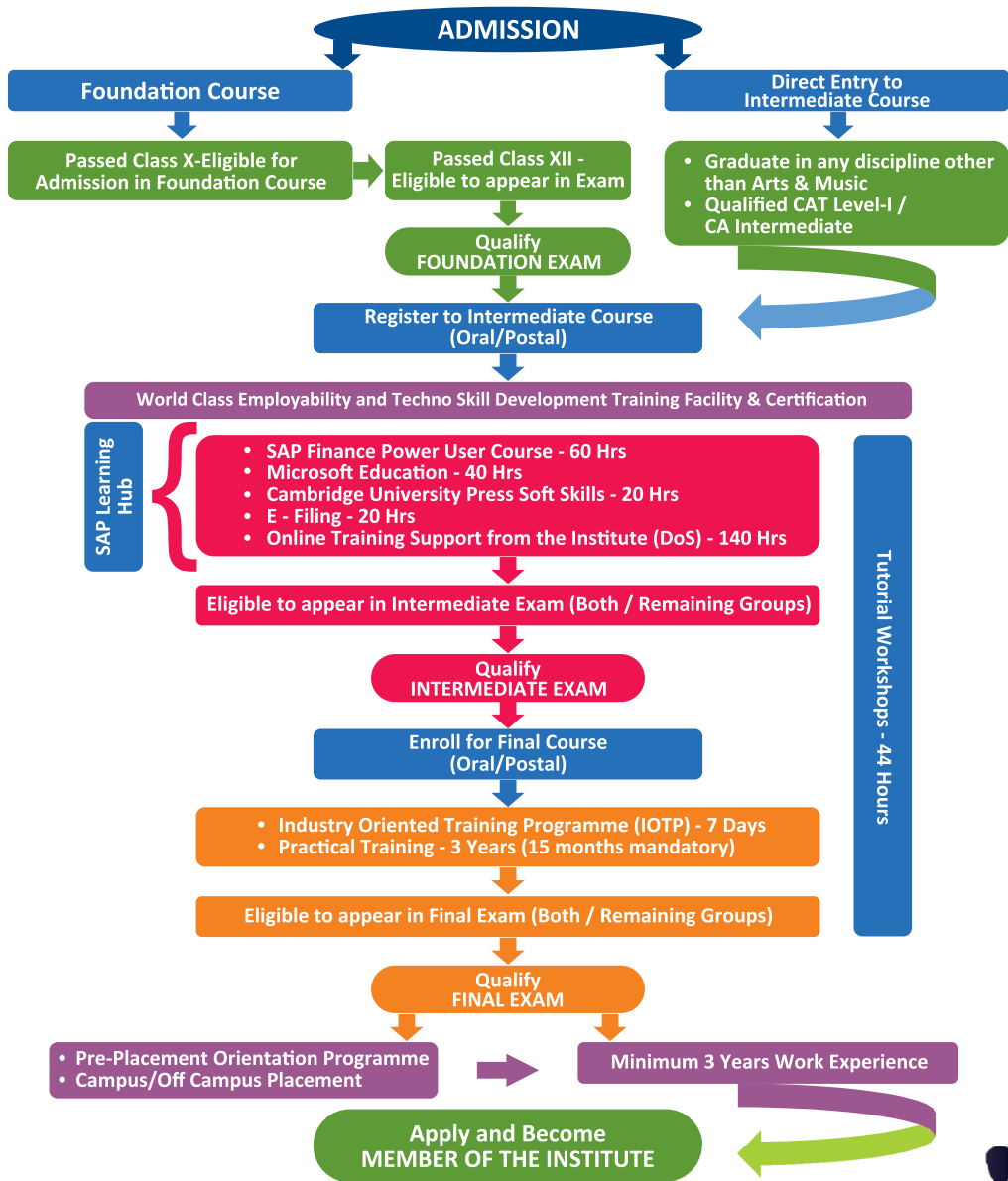
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
F	F	T	F	T	F	T	T	F	F	F	T	F	F	F
16	17	18	19	20	21	22	23	24	25					
T	F	T	T	T	F	T	T	T	T					

• **Fill in the Blanks**

1	ascertaining cost	2	practice
3	Management	4	managerial
5	Limitations	6	process
7	per ton km	8	fixed cost
9	work-in-progress	10	indirect
11	prime cost	12	not
13	overheads	14	works
15	direct	16	Historical
17	overheads	18	Batch Costing
19	branch	20	number
21	Semi variable	22	decreases
23	Distribution Overhead	24	estimates
25	costs		

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