

UNIT –I

LESSION- 1

INTRODUCTION TO ACCOUNTING

Contents

1.0 Aims and Objectives

1.1 Book- keeping

1.1.1 Introduction

1.1.2. Definition

1.1.3 Objectives of Book- keeping

1.2 Accounting

1.2.1 Introduction

1.2.2 Definition

1.3 Attributes and steps of accounting

1.3.1 Financial Transactions

1.3.2 Recording

1.3.3 Classification

1.3.4 Summarizing

1.3.5 Analysis and Interpretation

1.4 Objectives of Accounting

1.4.1 To keeping systematic record

1.4.2 To ascertain the results of the operation

1.4.3 To ascertain the financial position of the business

1.4.4 To portray the liquidity position

1.4.5 To protect business properties

1.4.6 To facilitate rational decision – making

1.4.7 To satisfy the requirements of law

1.5 Importance of Accounting

1.5.1. To the Owners

1.5.2. To the Management

1.5.3. To the Creditors

1.5.4. To the Employees

1.5.5. To the Investors

1.5.6. To the Government

1.5.7. To the Consumers

1.5.8. To the Research Scholars

1.6 Functions of Accounting

1.6.1. Record Keeping Function.

1.6.2. Managerial Function

1.6.3. Legal Requirement function

1.6.4. Language of Business

1.7 Advantages of Accounting

1.8 Limitations of Accounting

1.9 Let us Sum Up

- 1.10 Lesson-End Activities
- 1.11 Model answer to check your progress.
- 1.12 References

1.0 AIMS AND OBJECTIVES

In this lesson, we discuss the meaning, functions and advantages of accounting. After going through this lesson you will be able to

- 1) know the meaning of Book keeping and Accounting
 - 2) understand the terms used in Accounting
 - 3) study the definitions and steps of Accounting
 - 4) understand the various functions of Accounting
 - 5) know the limitations of Accounting
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1.1 BOOK- KEEPING

The People, who are earning and spending, must maintain a note or register in which details of the transactions have been recorded. The fundamental idea behind this record is to show a correct position relating to incomes and expenditures. We discuss in this section about meaning, definition and objectives of book- keeping.

1.1.1 Introduction

Book-keeping is that branch of knowledge which tells us how to keep a record of financial transactions. It includes recording of journal, posting in ledgers and balancing of accounts. All the records before the preparation of trial balance are the whole subject matter of book- keeping.

Here it is important to note that only those transactions related to business are recorded which can be expressed in terms of money

1.1.2. Definition

A.H. Rosenkamph observes: “Book- keeping is the art of recording business transactions in a systematic manner”.

R.N.Carter says, “Book- keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money’s worth”.

1.1.3 Objectives of Book- keeping

By keeping a systematic record of transactions, the following objects are fulfilled:

- i) Book- keeping provides a permanent record of each transaction.
- ii) Soundness of a firm can be assessed from the records of assets and liabilities on a particular date.

- iii) Entries related to incomes and expenditures of a concern facilitate to know the profit and loss for a given period.
 - iv) It enables to prepare a list of customers and suppliers to ascertain the amount to be received or paid.
 - v) It is a method gives opportunities to review the business policies in the light of the past records.
 - vi) Amendment of business leaves, provision of licenses, assessment of taxes etc., are based on records.
 - vii) It provides the most vital information to the management for making and preparing budgets.
 - viii) It provides the most effective way to the management for fixing up the objectives of the business.
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1.2 ACCOUNTING

In this section, we attempt to make a brief study about meaning and definition of Accounting

1.2.1 Introduction

The main objectives of every business is making profit, thereby the businessmen invests capital and acquires various properties and assets to generate revenue. He incurs various expenses and receives income from different sources in deals with several persons in the course of buying and selling of goods. In the ancient days business was small and simple and very few transactions used to occur and businessmen used to remember the transactions by memorizing them. After the industrial revolution the business activity has grown and business transactions have multiplied. In practice, it is impossible for any businesses to memories and recollects the large number of his business transactions, at the same time the businessmen will be interested in knowing at the end of the year, what he owns? What he owes? How much profit he has earned? What his financial position is? To relieve businessmen from the burden of memorizing all the business dealings, they are forced to make record of their transactions related to his incomes, expenses, assets and liabilities. The process of collecting, recording, classifying and summarizing financial data is known as Accounting. In other words, wherever money is involved, accounting is required to account for it. Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. Accounting also serves this function.

1.2.2 Definition

American Institute of Certified Public Accountants (AICPA) which defines accounting as “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 results thereof”.

Eric. L. Kohlen defines accounting as “the procedure of analyzing, classifying and recording transactions in accordance with a pre-conceived plan for the benefit of (a) providing a means by which an enterprise can be conducted in orderly fashion and (b) establishing a basis for reporting the financial condition of enterprise and the results of its operations”. According to this definition, Accounting is the science of recording business transactions with the purpose of operations.

1.3 ATTRIBUTES AND STEPS OF ACCOUNTING

Recording, classifying, summarizing and analysis and interpretation of financial data are the attributes or steps of accounting. We present here a brief explanation about different steps involved in accounting

1.3.1 Financial Transactions:

Accounting records only those transactions and events which are of financial character.

1.3.2 Recording

Each and every transaction is recorded as and when it occurs, in chronological order. Systematic recording of business transaction is the first step in the accounting process. Recording of business transaction is usually done by small firms and individuals in “Journal” and bigger firms in “Subsidiary books”. Journal and subsidiary books are books of original entry

1.3.3 Classification

All the business transactions are grouped on a predetermined basis; this process is known as classification. It facilitates segregation of numerous business transactions into identifiable groups. Separate accounts are opened for each person with whom the business has dealings, expense, income, asset and liability in a separate book which is known as “Ledger”. In simple words classifying is the process of grouping transactions or entries of one nature at one place.

1.3.4 Summarizing

Summarizing is the art of presenting the classified data in a manner which is understandable and useful to the owners and other interested parties. Each account in the ledger is balanced and the net balance is shown in the Trial Balance. The Trading account and Profit and loss accounts are reveals gross profit/loss and net profit/loss of the business. The financial position of the business portrays by balance sheet.

1.3.5 Analysis and Interpretation

Analysis of data is useful in evaluating past performance and providing guidance for future plans and operations. Interpretation of the results is needed for the purpose of decision making regarding sales, price structure of products, competition, and credit polices and growth of profit etc., Interpretation is usually done through Ratios and Flow statements.

1.4 OBJECTIVE OF ACCOUNTING

Objective of accounting may differ from business to business depending upon their specific requirements. We discuss in this section the general objectives of accounting.

1.4.1 Keeping systematic record

It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.

1.4.2 To ascertain the results of the operation

Accounting helps in ascertaining result i.e., profit earned or loss suffered in business during a particular period. For this purpose, a business entity prepares either a Trading and Profit and Loss account or an Income and Expenditure account which shows the profit or loss of the business by matching the items of revenue and expenditure of the some period.

1.4.3 To ascertain the financial position of the business

In addition to profit, a businessman must know his financial position i.e., availability of cash, position of assets and liabilities etc. This helps the businessman to know his financial strength. Financial statements are barometers of health of a business entity.

1.4.4 To portray the liquidity position

Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, cash dividends and other distributions of resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.

1.4.5 To protect business properties

Accounting provides upto date information about the various assets that the firm possesses and the liabilities the firm owes, so that nobody can claim a payment which is not due to him.

1.4.6 To facilitate rational decision – making

Accounting records and financial statements provide financial information which help the business in making rational decisions about the steps to be taken in respect of various aspects of business.

1.4.7 To satisfy the requirements of law

Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, Public Trust Act etc. Maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

1.5 IMPORTANCE OF ACCOUNTING

In this section, we attempt to make a brief survey of how the accounting provides information to different groups of persons.

1.5.1 To the Owners

The owners provide funds or capital for the organization. They possess curiosity in knowing whether the business is being conducted on sound lines or not and whether the capital is being employed properly or not. Owners, being businessmen, always keep an eye on the returns from the investment. Comparing the accounts of various years helps in getting good pieces of information. Properly kept accounts are good proof in dispute, they determine the amount of goodwill and facilitate in assessing various taxes.

1.5.2 To the Management

The management of the business is greatly interested in knowing the position of the firm. The accounts are the basis; the management can study the merits and demerits of the business activity. Thus, the management is interested in financial accounting to find whether the business carried on is profitable or not. The financial accounting is the “eyes and ears of management and facilitates in drawing future course of action, further expansion etc.”

1.5.3. To the Creditors

Creditors are the persons who supply goods on credit, or bankers or lenders of money. It is usual that these groups re interested to know the financial soundness before granting credit. The progress and prosperity of the firm, two which credits are extended, are largely watched by creditors from the point of view of security and further credit. Profit and Loss Account and Balance Sheet are nerve centers to know the soundness of the firm.

1.5.4. To the Employees

Payment of bonus depends upon the size of profit earned by the firm. The more important point is that the workers expect regular income for the bread. The demand for wage rise, bonus, better working conditions etc. depend upon the profitability of the firm and in turn depends upon financial position. For these reasons, this group is interested in accounting.

1.5.5. To the Investors

The prospective investors, who want to invest their money in a firm, of course wish to see the progress and prosperity of the firm, before investing their amount, by going through the financial; statements of the firm. This is to safeguard the investment. For this, this group is eager to go through the accounting which enables them to know the safety of investment.

1.5.6. To the Government

Government keeps a close watch on the firms which yield good amount of profits. The state and central Governments are interested in the financial statements to know the earnings for the purpose of taxation. To compile national accounting is essential.

1.5.7. To the Consumers

These groups are interested in getting the goods at reduced price. Therefore, they wish to know the establishment of a proper accounting control, which in turn will reduce to cost of production, in turn less price to be paid by the consumers. Researchers are also interested in accounting for interpretation.

1.5.8. To the Research Scholars

Accounting information, being a mirror of the financial performance of a business organization, is of immense value to the research scholar who wants to make a study into the financial operations of a particular firm. To make a study into the financial operations of a particular firm, the research scholar needs detailed accounting information relating to purchases, sales, expenses, cost of materials used, current assets, current liabilities, fixed assets, long-term liabilities and share-holders funds which is available in the accounting record maintained by the firm.

Check your Progress 1

List four steps in Accounting.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 9-10)

- 1.....
- 2.....
- 3.....
- 4.....

1.6 FUNCTIONS OF ACCOUNTING

In this section, we attempt to make a brief study of different types of accounting functions.

1.6.1. Record Keeping Function.

The primary function of accounting relates to recording, classification and summary of financial transactions-journalisation, posting, and preparation of final statements. These facilitate to know operating results and financial positions. The purpose of this function is to report regularly to the interested parties by means of financial statements. Thus accounting performs historical function i.e., attention on the past performance of a business; and this facilitates decision making programme for future activities.

1.6.2. Managerial Function

Decision making programme is greatly assisted by accounting. The managerial function and decision making programmes, without accounting, may mislead. The day-to-day operations are compared with some pre-determined standard. The variations of actual operations with pre-determined standards and their analysis is possible only with the help of accounting.

1.6.3. Legal Requirement function

Auditing is compulsory in case of registered firms. Auditing is not possible without accounting. Thus accounting becomes compulsory to comply with legal requirements. Accounting is a base and with its help various returns, documents, statements etc., are prepared.

1.6.4. Language of Business

Accounting is the language of business. Various transactions are communicated through accounting. There are many parties-owners, creditors, government, employees etc., who are interested in knowing the results of the firm and this can be communicated only through accounting. The accounting shows a real and true position of the firm or the business.

Check your Progress 2

List four objectives of Accounting.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.9-10)

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1.7 ADVANTAGES OF ACCOUNTING

In this section, we discuss the advantages of accounting.

- i) It helps in having complete record of business transactions.
- ii) Accounting is to supply meaningful information about the financial activities of the business to the owners and the managers.

- iii) It gives information about the profit or loss made by the business at the close of a year and its financial conditions.
- iv) Accounting records can be produced as evidence in court proceedings.
- v) It provides useful information form making economic decisions,
- vi) When a business is likely to be sold to someone else we can ascertain the purchase price with the help of accounting records.
- vii) It facilitates comparative study of current year’s profit, sales, expenses etc., with those of the previous years.
- viii) It supplies information useful in judging the management’s ability to utilise enterprise resources effectively in achieving primary enterprise goals.
- ix) It provides users with factual and interpretive information about transactions and other events which are useful for predicting, comparing and evaluation the enterprise’s earning power.
- x) It helps in complying with certain legal formalities like filing of income-tax and sales-tax returns. If the accounts are properly maintained, the assessment of taxes is greatly facilitated.

Check your Progress 3

Both Book keeping and Accounting are the art of recording, classifying and summarizing of data in a significant manner. But there is some difference between these two.

Distinguish between book keeping and accounting.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.9-10)

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1.8 LIMITATIONS OF ACCOUNTING

Accounting has high importance and it is useful to the business in different ways at the same time it has some demerits. In this section, we discuss the limitations of accounting.

- i) Accounting is historical in nature: It does not reflect the price level changes.
- ii) Accounting is limited to monetary transactions only. It cannot record those transactions which cannot be expressed in terms of money, and also it excludes qualitative elements like management, reputation, employee morale, labour strike etc.
- iii) Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgments of the Accountant of Management. Valuation of inventory, provision for doubtful debts, and assumption about useful life of an asset may, therefore, differ from one business house to another.
- iv) Accounting principles are not static or unchanging-alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable. Therefore, accounting statements do not always present comparable data.
- v) The accounting statements do not reflect those increase in net asset values that are not considered realized.

1.9 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

- i) book- keeping is the art of recording business transactions in a systematic manner.
- ii) recording, classifying, summarizing and analysis and interpretation of financial data are the attributes or steps of accounting
- iii) accounting provides information to owners, creditors, Investors, Government and employees
- iv) the main functions of accounting are record Keeping Function, Managerial Function, Legal Requirement function and Language of Business.
- v) some of the limitation of accounting are it cannot record those transactions which cannot be expressed in terms of money, and also it does not reflect the price level changes. Accounting statements do not always present comparable

1.10 LESSON-END ACTIVITIES

1. Define Accounting. What are the advantages of Accounting?
2. Who are the different parties interested in accounting information?
3. What are the major functions of accounting?

1. 11 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check I

1. Systematic recording of business transactions.
2. Grouping transactions on a predetermined basis
3. Preparation of trial balance and final accounts.
4. Analysis of data is useful in evaluating past performance and providing guidance for the purpose of decision making regarding price structure of products and credit polices etc.

Check II.

1. To identifies business transactions of financial nature and enters into appropriate books of accounts.
2. To gives a true and fair view of the state of affairs of the concern at the end of the accounting period.
3. The result obtained from accounting records makes information available to all those interested parties.
4. Preparing and ascertaining final accounts.

Check III.

S.No.	Basis of difference	Book-keeping	Accounting
1.	Transactions	Recording of transactions in books of original entry.	To examine these recorded transactions in order to find out their accuracy.
2.	Total and Balance	To make total of the amount in journal and accounts of ledger. To ascertain balance in all the accounts.	To prepare trial balance with the help of balances of ledger accounts.
3.	Income Statement and Balance Sheet	Preparation of trading, Profit & loss account and balance sheet is not book keeping	Preparation of trading, profits and loss account and balance sheet is included in it.
4	Rectification of errors	These are not included in book-keeping	These are included in accounting.
5	Special skill and knowledge	It does not require any special skill and knowledge as in advanced countries this work is done by machines.	It requires special skill and knowledge.
6	Liability	A book-keeper is not liable for accountancy work.	An accountant is liable for the work of book-keeper.

1.12 REFERENCES

1. Principles of Accountancy - Jain & Narang
2. .Principles of Accountancy - T.S.Grewal

LESSON 2

SYSTEM OF ACCOUNTING

Contents

- 2.0 Aims and Objectives
- 2.1 Single entry system
 - 2.1.1 Meaning
 - 2.1.2 Definitions
 - 2.1.3 Meaning of debit and credit
- 2.2 Statement of affairs
 - 2.2.1 Meaning
 - 2.2.2 Features of Statement of affairs
- 2.3 Salient features of single entry system
- 2.4 Defects of single entry system.
- 2.5 Methods of ascertainment of profit or loss under single entry system
 - 2.5.1 Comparison method (or) Net worth method
 - 2.5.2 Statement of profit or loss
 - 2.5.3 Limitation of Comparison method
 - 2.5.4 Conversion Method
 - 2.5.5 Procedure for conversion
- 2.6 Double entry system:
 - 2.6.1 Meaning
- 2.7 Advantages of Double entry system:
- 2.8 Stages of double entry system
- 2.9 Differences between single entry system and double entry system
- 2.10 Let us Sum Up
- 2.11 Lesson-End Activities
- 2.12 Model answer to check your progress.
- 2.13 References

2.0 AIMS AND OBJECTIVES

In first lesson, we discussed the meaning, objectives, functions, advantages and limitations of accounting. Here we discuss the different type of entry systems of accounting. After going through this lesson, you will able to

- i) know the meaning of single entry system and double entry system
- ii) study the definition of single entry systems
- iii) understand different methods of ascertainment of profit or loss under single entry system
- iv) learn the features and limitations of single entry system
- v) know the difference between double entry system and single entry system

2.1 SINGLE ENTRY SYSTEM

Business transactions are recorded in two different ways, one is double entry system and another one is single entry system. In this section, we attempt to make a brief study about meaning and definition of single entry system

2.1.1 Meaning:

All business transactions are has two aspects namely Debit and Credit, If these two aspects of a transaction are recorded, which system is known as the Double entry system. The term single entry is vaguely used to refer to any method of maintaining accounts which does not conform to strict principles of double entry system, under single entry method only one aspect of a transaction is recorded, it may be debit without a corresponding credit and vice versa. This system is not based on any scientific system therefore it cannot be termed as a system, It is incomplete and unsatisfactory system and it is clear that accurate information of the operations of the business is entirely lacking.

2.1.2 Definitions:

i) Kohler defines single entry system as “a system of book keeping in which as a rule, only cash and personal accounts are maintained. It is always an incomplete double entry, varying with circumstances”

ii) According to R.N.Carter. “Single entry cannot be termed as a system, as it is not based on any scientific system, like double entry system. For this purpose, single entry is now-a-days known as preparation of account from incomplete records”

2.1.3 Meaning of debit and credit

The word debit is derived from the Latin word Debitum which means Due for that. In short, the benefit receiving aspect of a transaction is known as debit. The word credit is derived from the Latin word Creder which means Due to that. In short, the benefit giving aspect of a transaction is known as credit.

The abbreviations “Dr” for debit and “Cr” for credit are usually used. By convention, the left hand side of an account is termed as debit and right hand side of an account is termed as credit side.

2.2 STATEMENT OF AFFAIRS

The excess of assets over liabilities is called capital. Hence we present here a brief note on a statement which is used to calculate the amount of capital.

2.2.1 Meaning

The capital of a business at any time is ascertained by preparing a statement called “statement of affairs” which consists of the assets side and the liabilities side .The excess of assets over liabilities is called capital. If closing capital is not given, it can be found out by preparing closing statement of affair. If opening capital is not given, it can be found out by preparing opening statement of affair.

2.2.2 Features of Statement of affairs

It is prepare on the basis of those book which are maintained partly on the basis of double entry system and partly on the basis of single entry system.

The purpose of statement of affairs is to find out capital.

Capital account is not maintained, excess of assets over liabilities is treated as capital. Value of assets and liabilities in a statement of affairs are prepared on the basis of estimates, except the figures of debtors, creditors, cash and bank. It is difficult to trace out omission of assets or liabilities in a statement of affairs.

2.3 SALIENT FEATURES OF SINGLE ENTRY SYSTEM

We identified and explained here some features of single entry system.

- i) The system is suitable for sole trader, partnership firms and professionals.
- ii) In this system, usually personal accounts are fully written and cash book is also maintained and ignore all other accounts.
- iii) This system does not follow uniformity .It is highly flexible accounting to the capabilities of individuals maintaining the records.
- iv) This system needs very few numbers of account books and it gives only partial information.
- v) When preparing cash book under this system both personal and business transactions are recorded.
- vi) In this system to know the total purchases and sales, one has to depend on original vouchers.

2.4 DEFECTS OF SINGLE ENTRY SYSTEM

In this section, we pointed out some of the defects of single entry system.

- i) It is not a scientific method of accounting.
- ii) Frauds can be committed easily
- iii) It is difficult to ascertain the value of the business
- iv) It is very difficult to say whether the business is making progress or working at a loss
- v) The Trading and profit and loss account and balance sheet cannot be prepared in a scientific manner
- vi) The trading results of one period cannot be compared with those of the other period.
- vii) Impersonal accounts such as sales account, purchases account as well as assets account are not available.

Check your Progress 1

List four defects of single entry system.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 21-22)

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2.5 METHODS OF ASCERTAINMENT OF PROFIT OR LOSS UNDER SINGLE ENTRY SYSTEM:

Every person keeps the accounts in his own way. In single entry system the nominal accounts are not maintained and hence trading results cannot be known by preparing final accounts. But all businessmen wish to know the amount of profit or loss during any year. In this section, we attempt to make a brief survey the methods of ascertainment of profit or loss by single entry system. There are two methods of ascertaining profit or loss under the single entry system, they are: (a) Comparison method (or) Net worth Method (or) statement of affair method (b) Conversion Method.

2.5.1 Comparison method (or) statement of affair method

Under this method the profit or loss is ascertained by comparing the capital at the beginning with the capital at the end of the period. The closing capital is taken; drawings should be added to this; from this total the additional capital if any introduced should be subtracted; from this total the opening capital should be subtracted. The answer so obtained will be the profit or loss (before adjustment) earned during the year.

Statement of profit is prepared as follows:

2.5.2 Statement of profit or loss

Closing capital	*****
Add: Drawings	*****

Less: Additional capital	*****

Less: Opening capital	*****

Profit/loss for the year	*****

Illustration 1

From the following information, calculate the profit earned by a petty trader during the year 2005:

	Rs
Capital as on 31-12-2005	33,000
Capital as on 1-1-2005	32,500
Drawings during the year	6,000
Further capital introduced by him	3,500

Solution:**Statement of profit or loss**

Closing capital	33,000
Add: Drawings	6,000

	39,000
Less: Additional capital	3,500

	35,500
Less: Opening capital	32,500

Profit for the year	3,000

Illustration 2

Nithilan maintains books on single entry. He gives you the following information.

	Rs
Cash	2,000
Bank	1,000
Stock	16,000
Furniture	3,000
Debtors	21,000
Creditors	5,000

Calculate the amount of his capital.

Solution:

To find out the amount of capital, we want to prepare a statement with the help of given assets and liabilities. First identify which are the items are assets and which are liabilities from the given things.

Assets items:

Cash	2,000
Bank	1,000
Stock	16,000
Furniture	3,000
Debtors	21,000

Liability item:

Creditors	5,000
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Statement of affair as on

Liabilities	Rs	Assets	Rs
Creditors	5,000	Cash	2,000
		Bank	1,000
		Stock	16,000
Capital *	38,000	Furniture	3,000
(balancing figure)		Debtors	21,000
	43,000		
			43,000

Illustration 3

Rukmani maintains books on single entry. She gives you the following information.

	1-1-2005	31-12-2005
Cash	2,000	3,000
Bank	1,000	2,000
Stock	16,000	18,000
Furniture	3,000	5,000
Debtors	21,000	30,000
Creditors	5,000	7,000

Drawings during the year 6,000. Further capital introduced by her 3,500. Calculate the amount of profit or loss for the year 2005.

Solution:

In this problem the amount of opening and closing capitals are not given, therefore we try to calculate these two amount of capitals by preparing two different statement of affairs

Statement of affair as on 1-1-2005

Liabilities	Rs	Assets	Rs
Creditors	5,000	Cash	2,000
		Bank	1,000
		Stock	16,000
Capital *	38,000	Furniture	3,000
(balancing figure)		Debtors	21,000
	43,000		
			43,000

Statement of affair as on 31-12-2005

Liabilities	Rs	Assets	Rs
Creditors	7,000	Cash	3,000
		Bank	2,000
		Stock	18,000
Capital *	51,000	Furniture	5,000
(balancing figure)		Debtors	30,000
	58,000		
			58,000

Statement of profit or loss

Closing capital	51,000
Add: Drawings	6,000

	57,000
Less: Additional capital	3,500

	60,500
Less: Opening capital	38,000

Profit for the year	22,500

Calculation of some missing figures

Illustration 4	Rs
Profit made during the year	2,400
Capital introduced during the year	2,000
Capital at the end	8,000
Drawings	1,200

Calculate the amount of capital at the beginning.

Solution:

Capital at the end	8,000
Add: Drawings	1,200

	9,200
Less: Capital introduced during the year	2,000

	7,200
Less: Profit made during the year	2,400

Capital at the beginning.	4,800

Illustration 5	Rs
Profit made during the year	3,000
Capital introduced during the year	4,000
Capital at the end	13,000
Capital at the beginning.	8,000

Calculate the amount of Drawings

Solution:

Capital at the beginning	8,000
Add: Capital introduced during the year	4,000

	12,000
Add: Profit made during the year	3,000

	15,000
Less: Capital at the end	13,000

Drawings	2,000

2.5.3 Limitation of Comparison method

This method does not provide a clear picture of the operating results of a business. It does not show sales, purchases, gross profit, operating expenses etc. So is not possible to make a meaningful analysis of the financial statements and initiate effective steps to improve the financial position of the business.

Check your Progress 2

Write note on procedure for calculating profit by statement of affairs method.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.21-22)

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2.5.4 Conversion Method

The process of collecting, computing and recording missing information along with the available data in the incomplete books of a business is called “conversion method”. Once the books are “converted”, all future transactions can be recorded as per “double entry system”. Conversion to double entry system enables a business to avoid the harassment of taxation authorities and ensures better management of the business.

2.5.5 Procedure for conversion:

The following are the steps to be followed for conversion of incomplete records to complete record system (Double entry system)

1. A statement of affairs at the beginning of the year should be prepared. The balance in the statement represents opening capital.
2. Single or double column cash book should be prepared to find out missing items like opening cash, closing cash, cash sales, cash purchase, additional capital and drawings etc. Any shortage on the debit side can be cash sales or additional capital introduced or opening cash. Shortage on the credit site can be cash purchase or drawings or sundry expenses or closing cash balance.
3. Impersonal accounts like total debtors account ,total creditors account , Bills receivables account and Bills payable account should be prepared .preparation of these accounts can help in finding any missing items like opening or closing debtors, opening or closing creditors, credit sales and credit purchases
4. Appropriate journal entry should be passed in respect of assets and liabilities included in the opening statement of affairs.
5. Real and nominal accounts must be written from the information recorded in the cash book, total debtors account, total creditors account, etc. The double effect of every entry must be posted to the ledger, opening new accounts wherever necessary.
6. From all the accounts balance in the ledger and any other additional details trading account, profit and loss account and balance sheet must be prepared.

2.6 DOUBLE ENTRY SYSTEM

In this section, we attempt to make a brief study about meaning and Definition of Double entry system.

2.6.1 Meaning:

This system was invented by an Italian named Iuco Pacioli in 1494 A.D. and it has spread all over the world, becoming as popular as Arabic numerals. According to this system, every transaction has two aspects. one is benefit receiving aspect or incoming aspect and the other one is benefit giving aspect or outgoing aspect. For every transaction, one account is to be debited and another account is to be credited in order to have a complete record of the transaction. Therefore every transaction affects two accounts in opposite direction. The basic

principle, under this system is that for every debit, there must be a corresponding and equal credit and for every credit there must be a corresponding and equal debit.

2.7 ADVANTAGES OF DOUBLE ENTRY SYSTEM

We present here a brief account of various advantages of double entry system.

- i) The complete, systematic and accurate record of all transaction of business enables to ascertain the result of business operation for any given period.
- ii) Under double entry system all three types of accounts are prepared .By preparing balance sheet the financial position of the business can be ascertained .This is done with the help of Real and personal accounts.
- iii) In this system full information about all assets and liabilities will be available therefore the businessmen can easily save his business from fraud and misappropriations.
- iv) Double entry system is helpful to businessmen for ascertain the amounts due to his creditors and he can make proper arrangements to pay them promptly.
- v) The systematic record maintained under double entry system, it is enables businessmen to satisfy the tax authorities.
- vi) The businessmen maintains his accounts books properly under the double entry system With the help of this the trader can reveal the amount due from his debtors and reminders can be sent to the customers who do not make payments promptly.
- vii) The trader can compared the business results of one year with those of previous years and also he can ascertain the reasons for the changes if there any.
- viii) In this method the arithmetical accuracy of the books can be tested by preparing Trial balance, and also details of any transactions can be verified at any time.

Check your Progress 3

How does statement of affairs differ from balance sheet-Explain

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 21-22)

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2.8 STAGES OF DOUBLE ENTRY SYSTEM

Different steps involved in converting single entry system into double entry system. These steps can be broadly categorized into five stages. Hence, we present here a brief account of different stages in double entry system.

First stage:

when a transaction takes place, it is recorded in journal book.

Second stage:

All entries in the journal book should be posted to the appropriate ledger account to find out the total effect of all such transactions in a particular account.

Third stage:

All account in the ledger is balanced and it is transferred to a Trial balance.

Fourth stage:

Final accounts that is Trading account, profit and loss account and balance sheet are prepared from trial balance.

Fifth stage:

Analysis and interpretation of final accounts are made in order to have true and fair idea about the concern.

2.9 DIFFERENCES BETWEEN SINGLE ENTRY SYSTEM AND DOUBLE ENTRY SYSTEM

We discuss in this section, the differences between these two accounting systems

Single entry system	Double entry system
1. Personal account and cash account alone are maintained.	Personal account, real account and nominal accounts are maintained properly.
2. It involves less clerical labour.	It involves more clerical labour.
3. Only one aspect of a transaction is recorded.	Two aspect of a transaction are recorded.
4. There may be debit without a corresponding credit and vice versa.	For every debit there is a corresponding equal credit.
5. Trading account, Profit and loss account and Balance sheet cannot be prepared as it has incomplete record.	They can be prepared.
6. It is an imperfect way of book-keeping.	It is a perfect and scientific system.
7. Approximate net profit can be indirectly calculated.	Accurate net profit can be calculated directly.
8.As the ledger does not contain all accounts, trial balance cannot be prepared.	To test the arithmetical accuracy a trial balance can be prepared.
9.Tax authorities do not accept it as such	Tax authorities accept this method.
10.Internal check is not possible	It is possible in this system.
11. Balance sheet cannot prepare. So, financial position is difficult to ascertain.	Reliable financial position can be found through balance sheet.
12. The Accounting records are not acceptable as evidence.	In case of disputes, accounting records can be produced in courts of law
13.It is suitable for small businessmen.	It is suitable for any type of businessmen. s

Check your Progress 4

Explain the method of profit ascertaining by conversion method.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.21-22)

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2.10 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. If the Debit and Credit, aspects of a transaction are recorded, such system is known as the Double entry system. Any method of maintaining accounts which does not conform to strict principles of double entry system, which is known as single entry system.
2. Under single entry methods, we can ascertain the amount of profit or loss of a concern by either comparison method or conversion Method.
3. Single entry system is suitable for sole trader, partnership firms and professionals.
In this system ignore nominal accounts and it is highly flexible accounting to the capabilities of individuals maintaining the records.
4. Single entry system is not a scientific method of accounting. Therefore Trading and profit and loss account and balance sheet cannot be prepared in a scientific manner. Frauds can be committed easily
5. Under the double entry system the business enables to ascertain the result of its operation and financial position for any given period. Double entry system is helpful to businessmen for ascertain the amounts due to his creditors, amounts due from his debtors and also to satisfy the tax authorities.
6. Five steps involved in converting single entry system into double entry system. In many ways single entry system differ from double entry system

2.11 LESSON-END ACTIVITIES

1. What is Double entry system of book keeping? Explain its advantages.
2. Explain single entry system. How does it differ from double entry system?
3. Briefly describe the procedure to be adopted in the conversion of single entry system to double entry system

2. 12 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check 1

1. Comparison of business from tear to year is not possible.
2. Errors happened cannot be traced out easily.
3. Counter check is not at all possible, as in double entry system
4. Full information about the business cannot be obtained because records are incomplete

Check 2

The closing capital thus obtained is taken; drawings should be added to this; from this total the additional capital if any introduced should be subtracted; from this total the opening capital should be subtracted. The answer so obtained will be the profit or loss (before adjustment) earned during the year.

Check 3

1. Balance sheet is prepared on the basis of those books which are maintained in double entry. Statement of affairs is prepared on the basis of those books which are maintained partly on the basis of double entry and partly on the basis of single entry.
2. Omission of assets or liabilities can easily be found out when balance sheet disagrees. It is difficult to trace out omission of assets or liabilities in statement of affairs.
3. The purpose of balance sheet is to find out the financial position of the firm. The purpose of statement of affairs is to find out capital.

Check 4

The following is the procedure to be adopted for ascertained profit or loss under conversion method.

1. A statement of affair at the beginning period should be prepared to find out opening capital.
2. Cash book should be verified and the all items in the debit and credit side of the cash book should be posted to respective accounts.
3. Mainly sales account and purchase account must be prepared to find out credit sales and credit purchase.
4. If any information missing, it should be got by preparing necessary account.
5. Preparing final accounts i.e., trading account, profit and loss account and balance sheet.

2.13 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson-3

ACCOUNTING EQUATION

Contents

- 3.0 Aims and Objectives
- 3.1 Accounting Equation
 - 3.1.1 Meaning of Asset and Equity
 - 3.1.2 Equation
- 3.2 Rules for Accounting Equation
 - 3.2.1 Capital
 - 3.2.2 Assets
 - 3.2.3 Liabilities
 - 3.2.4 Income
 - 3.2.5 Expense
- 3.3 Interaction between assets and liabilities and their effect on accounting Equation
- 3.4 Let us Sum up
- 3.5 Lesson-End Activities
- 3.6 Model answer to check your progress.
- 3.7 References

3.0 Aims and objectives

In second lesson, we discussed the meaning and limitations of single entry system and meaning, advantages and steps of Double entry system of accounting. Here we discuss here, the Accounting Equation. After going through this lesson, you will able to

1. understand the equation as per Dual aspect concept.
 2. know the rules for Accounting Equation
 3. observe interaction between assets and liabilities.
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3.1 INTRIDUCTION

Every business transaction recorded in accounts has two aspects. One aspect is giving benefit (or) debits aspect. Another one is receiving of benefit (or) credit aspect. Both the aspects have to be recorded in accounts appropriately. As per debit and credit rules, we present here an Accounting Equation.

3.1.1 Meaning of Asset and Equity

The properties owned by business are called assets. The rights to properties are called equities. Equities can be divided into two part equity of the owners and equity of creditors.

3.1.2 Equation

Dual aspect concept is the basis for rules of debit and credit used in the Double entry system of book keeping .According to this concept, every business transaction recorded in accounts has two aspects-giving and receiving of benefits. American Accountants have derived the rules of debit and credit through a ‘novel’ medium, i.e., accounting equation .The equation is as follows:

$$\text{Assets} = \text{Equities}$$

The equation is based on the principle of 'Rights.' Accounting deals with property and rights to property and the sum of the properties owned is equal to the sum of the rights to the properties. The properties owned by a business are called assets and the rights to properties are known as liabilities or equities of the business. Equities can be subdivided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business known as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owner's equity in the assets and external represents the outsider's interest in the asset. Based on the bifurcation of equity, the accounting equation can be restated as follows:

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

(Or)

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

(Or)

$$\text{Liabilities} = \text{Assets} - \text{Capital}.$$

The equation is fundamental in the sense that it gives a foundation to the double entry book-keeping system. This equation holds good for all transaction and events and at all periods of time since every transaction and events has two aspects. We can understand the above Equations with the following examples.

When a business is started, entire resources needed may be supplied by the owner. Later on, additional funds may be mobilized through credit purchases and loans.

1. Abishnavi starts a business with a capital of Rs 15,000.

Accounting Equation is

$$\text{Assets} = \text{Equities}$$

Now available cash in the business is Rs 15,000.

Capital contributed by the owner Abishnavi is equity = 15,000

$$\text{Assets} = \text{Equities}$$

$$\text{Rs } 15,000 = 15,000$$

The balance sheet on the date appears as follows:

Capital & Liabilities	Rs	Property & Assets	Rs
Capital	15,000	Cash	15,000

The balance sheet of the business is an expression of the accounting equation. It shows the relationship between assets of the business and capital.

2. Abishnavi purchased machinery from Mr Prasath for Rs 45,000. Cash Rs 15,000 paid immediately and balances on credit.

Accounting Equation is

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

Cash available in the business is Nil.

Capital contributed by the owner Abishnavi is equity = Rs 15,000

Machinery purchased for Rs 45,000 is an asset to the business.

Amount due to Mr Prasath Rs 30,000 (45,000 - 15,000) is a liability to the business.

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

$$\text{Rs } 45,000 = \text{Rs } 15,000 + \text{Rs } 30,000$$

The balance sheet on the date appears as follows:

Balance sheet

Capital & Liabilities	Rs	Property & Assets	Rs
Capital	15,000	Machinery	45,000
Loan from Prasath	30,000		
	45,000		45,000

The balance sheet of the business shows the relationship between assets of the business and capital and liabilities of the same.

2. Abishnavi purchased machinery for Rs 45,000, for this purpose she got loan from Mr Muralidharan Rs 35,000.

Accounting Equation is

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

Capital contributed by the owner Abishnavi is equity = Rs15,000

Machinery purchased for Rs 45,000 is an asset to the business.

Amount due to Mr Muralidharan Rs 30,000 is a liability to the business.

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

$$\text{Rs } 45,000 - \text{Rs } 30,000 = \text{Rs } 15,000$$

The balance sheet on the date appears as follows:

Capital & Liabilities	Rs	Property & Assets	Rs
Capital	15,000	Machinery	45,000
Loan from Muralidharan	30,000		
	45,000		45,000

The balance sheet of the business shows the relationship between assets of the business and capital and liabilities of the same.

Check your Progress 1

What do you understand about internal equity and external equity?

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 29)

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3.1 RULES FOR ACCOUNTING EQUATION

In accounting, there are some rules followed to record the transactions in appropriate books. To understanding the accounting equation clearly, we presenting here some ‘rules’ which help in making the accounting equation.

3.2.1 Capital:

When capital is increased, it is credited and when capital is withdrawn, it is debited.

Example:

Capital on the beginning of the year 2007 is Rs 10,000

Capital introduced during the year is Rs 2,000

Drawings during the year is Rs 1,500

Profit made during the year is Rs 3,000

Dr	Capital Account		Cr
To Drawings	1,500	By Balance b/d	10,000
To Balance c/d *	10,500	By Additional capital	2,000
(balancing figure)	-----		-----
	12,000		12,000
		By Balance b/d	10,500

3.2.2 Assets:

If there is increase in assets, this increase is debited in assets account. If there is decrease in assets, the assets' account is credited.

Example:

Building on the beginning of the year 2007 is Rs 50,000

New building purchased during the year is Rs 12,000

Old building sold during the year is cost Rs 11,000

Depreciation on building for the year is Rs 2,000

Dr	Building Account		Cr
To Balance b/d	50,000	By Bank(sale)	11,000
To Bank a/c	12,000	By Depreciation a/c	2,000
(purchase)		By Balance c/d *	49,000
		(balancing figure)	
	-----		-----
	62,000		62,000
		By Balance b/d	49,000

3.2.3 Liabilities:

When liabilities are increase, outsider's equities are credited and when liabilities are decreased, outsider's equities are debited.

Example:

Bank loan a/c on the beginning of the year 2007 is Rs 30,000

Additional loan borrowed during the year is Rs 5,000

Loan repaid during the year is Rs 7,000

Dr	Bank loan Account		Cr
To cash (repaid)	7,000	By Balance b/d	30,000
To Balance c/d *	28,000	By Additional loan	5,000
(balancing figure)	-----		-----
	35,000		35,000
		By Balance b/d	28,000

3.2.4 Income or profits:

Owner’s equity is increased by the amount of revenue income.

Example:

Capital on the beginning of the year 2007 is Rs 20,000

Profit made during the year is Rs 5,000

Dr	Capital Account		Cr
		By Balance b/d	20,000
		By Profit made during the year	5,000
To Balance c/d *	25,000		
(balancing figure)	-----		-----
	25,000		25,000
		By Balance b/d	25,000

3.2.5 Expenses or loss:

Owner’s equity is decreased by the amount of revenue expenses.

Example:

Capital on the beginning of the year 2007 is Rs 20,000

Loss made during the year is Rs 6,000

Dr	Capital Account		Cr
To loss made during the year	6,000	By Balance b/d	20,000

To Balance c/d *	14,000		20,000
(balancing figure)	-----		
	20,000		
		By Balance b/d	14,000

Check your Progress 2

What do you understand about rules of accounting equation?

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.29)

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3.2 INTERACTION BETWEEN ASSETS AND LIABILITIES AND THEIR EFFECT ON ACCOUNTING EQUATION

Among the business transactions some of them alter the total amount of accounting equation and some other does not affect the total amount of equation. Hence, we present here a small classification of the transactions

3.3.1 Transactions does not alter the total amount of accounting equation

(a) Sometimes, one asset decreases and another asset increases due to a transaction. For example, when debtors are collected, debtors decrease and cash increases. This does not change the accounting equation.

(b) One liability decreases and another liability increases due to a transaction. For example, creditors are paid through bank overdraft. Creditor’s decrease and bank overdraft increases. This transaction also does not alter the total figures in the accounting equation.

3.3.2 Transactions alter the total amount of accounting equation

(c) Assets may increase and correspondingly liabilities may increase due to some transactions. For example, loan taken from bank increases cash on the assets side and bank loan on the liabilities side. This transaction alters the total figures in the accounting equation.

(d) Assets decrease and liabilities also decrease correspondingly due to some transactions, For example, creditors paid in cash decreases creditors on liabilities side and cash on the assets side.

Check your Progress 3

Some of the business transactions alter the total amount of accounting equation and some other does not. List out some example for the above statement

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 29)

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3.3 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Assets are the properties owned by business. Equities are the rights to properties. Equities may be owner’s equities and creditor’s equity.
2. In both capital and liabilities accounts the credit is made for increase in it and debit is made for decrease in it. The asset account is debited for increase in the value of an asset and it is credited for any decrease in it.
3. If both assets and liabilities are decrease or increase correspondingly with same amount these transactions does alter the total amount of accounting equation. If there is one asset decreases and another asset increases or one liability decreases and another one liability increases due to a transaction it does not alter the total amount of accounting equation

3.5 LESSON-END ACTIVITIES

- 1.What is ‘Accounting equations’?
- 2.What are the difference between the rules of accounting and accounting equations?

MODEL ANSWERS TO “CHECK YOUR PROGRESS REFERENCES

Check 1

Owner’s fund is equity; creditor’s fund is external equity.

Check2

1. Increase in assets account is effected by debiting and decrease in assets account is effected by crediting them.

2. Increase in liabilities is recorded by crediting and decrease in liabilities account is recorded by debiting them.

3. Increase in capital is recorded by crediting in capital account and decrease in capital account is recorded by debiting them.

Check 3

The following transactions not alter the total figures in the accounting equation.

1. when cash collected from debtors, debtors decrease and cash increases. This does not change the accounting equation.

2. creditors are paid through bank overdraft. Creditor’s decrease and bank overdraft increases.

The following transactions alter the total figures in the accounting equation.

3. loan taken from bank increases cash on the assets side and bank loan on the liabilities side.

4. creditors paid in cash decreases creditors on liabilities side and cash on the assets side

3.7 Reference

1. Jain and Narang -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. R.L.Gupta -- Advanced accountancy

Lesson -4

TYPES OF ACCOUNTS AND RULES OF ACCOUNTING

Contents

- 4.0 Aims and Objectives
- 4.1 Introduction
- 4.2 Types of account
 - 4.2.1 Account
 - 4.2.2 Chart shows the various types of accounts
 - 4.2.3 Personal account
 - 4.2.4 Real account
 - 4.2.5 Nominal account
- 4.3 Rules of accounting
 - 4.3.1 Rule for Personal account
 - 4.3.2 Rule for Real account
 - 4.3.3 Rule for Nominal account
- 4.4 Let us Sum Up
- 4.5 Lesson-End Activities
- 4.6 Model answer to check your progress.
- 4.7 References

4.0 AIMS AND OBJECTIVES

In third lesson, we discussed the accounting equation and its rules, interaction between assets and liabilities and their effect on accounting equation. Here we discuss the different types of account and rules of accounting. After going through this lesson, you will be able to

1. know the different kinds of account
2. understand various types of personal account and Real account
3. study rules for different type of accounts

4.1 INTRODUCTION

The object of book-keeping is to keep a complete record of all the transactions that place in the business. Practically every business deals with other persons, firms and companies and possesses assets like cash, stock, building, furniture etc., and also spend for various expenses and receives incomes. It is necessary to maintain record for all the dealings. In this lesson we have a brief study about various type of account and its rules.

4.2 TYPES OF ACCOUNT

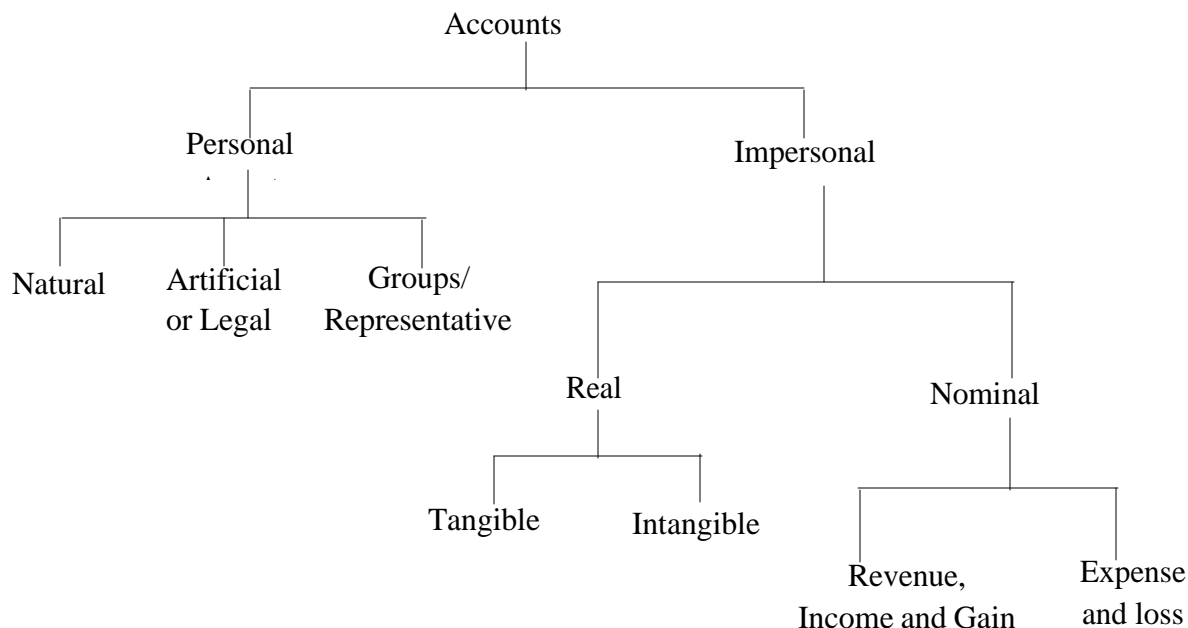
All the business transactions are classified under different groups on the basis of its nature. Hence we discuss here the different types account.

4.2.1 Account

An account is a statement in the ledger which records the transactions relevant to the person, asset, expense or income named in the heading. Accounts can be divided into two namely 1) personal accounts 2) Impersonal Accounts. Impersonal accounts can be further

divided into two groups' namely 1) Real accounts 2) Nominal accounts The accounts for the transactions relating to persons are known as 'personal Accounts'. The accounts for the transactions relating to properties and assets are known as 'Real Account' and the accounts for the transactions relating to incomes and expenses are called 'Nominal Accounts'. The following chart will show the various types of accounts:

4.2.2 Chart shows the various types of accounts



4.2.3 Personal Accounts

Accounts recording transactions with a person or group of persons with whom the business has dealings are known as personal accounts. To record credit transactions, these accounts are necessary. Personal accounts are of the following types:

(a) Natural persons

An account recording transactions with an individual human being is termed as a natural persons' personal account. Both males and females are included in it. e.g., Selvaganapathi's account, Jayabharathi's account, Shanthi's accounts.

(b) Artificial or legal persons

An account recording financial transactions with an artificial person created by law or otherwise is termed as an artificial person, personal account, e.g. Firms' accounts, limited companies' accounts, educational institutions' accounts, Co-operative society account.

(c) Groups/Representative personal Accounts

An account indirectly representing a person or persons is known as representative personal account. When accounts are of a similar nature and their number is large, it is better to group them under one head and open representative personal accounts. e.g., prepaid insurance, outstanding salaries, rent, and wages etc.

When a person starts a business, he is known as proprietor. This proprietor is represented by capital account for that entire he invests in business and by drawings accounts for all that which he withdraws from business. So, capital accounts and drawings account are also personal accounts.

4.2.4 Real Accounts: Accounts relating to properties or assets are known as ‘Real Accounts’, A separate account is maintained for each asset e.g., Cash Machinery, Building, etc., Real accounts can be further classified into tangible and intangible.

(a) Tangible Real Accounts: These accounts represent assets and properties which can be seen, touched, felt, measured, purchased and sold and they have a physical shape e.g. Machinery, Cash, Furniture and Stock etc.

(b) Intangible Real Accounts: These accounts represent assets and properties which cannot be seen, touched or felt because they have no physical shape, but they can be measured in terms of money. e.g. Goodwill, Patents, Trademarks and Copyrights etc.

4.2.5 Nominal Accounts: It relates to the items which exist in name only. Expenses, incomes etc., are there in business activities .Accounts relating to income, revenue, gain ,expenses and losses are termed as nominal accounts. These accounts are also known as fictitious accounts as they do not represent any tangible asset. A separate account is maintained for each head or expense or loss and gain or income. e.g., Wages account, Rent account Commission account, Interest received account are some examples of nominal account

Check your Progress 1

Give two examples each for artificial persons, tangible assets and intangible assets

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 35)

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4.3 RULES OF ACCOUNTING

The double entry system of book keeping is a scientific and complete system hence; the transactions should be recorded according to the following rules. Each transaction must have two aspects, namely debit aspect and credit aspect. In each transaction, two accounts are involved. One account gives benefit and the other account receiving benefit. The account that gets benefit is debited and the account that gives benefit is credited. Therefore, a general rule can be framed. Debit the account that receives the benefit and credit the account that gives the benefit. But for convenience, three different sets of rules have been laid down for the three classes of accounts. Hence we discuss here the accounting rules for different types account.

The rules for making entries under double entry system can be summarized as follows:-

- 1. Personal accounts : Debit the receiver
Credit the giver**
- 2. Real accounts : Debit what comes in
Credit what goes out**
- 3. Nominal accounts : Debit all expenses and losses
Credit all incomes and gains**

N.B: It is important to note that the above rules should be interpreted from the business point of view and not from the proprietor's point of view.

4.3.1 Personal Accounts:

The personal account which receives the benefit is debited while the personal account which gives the benefit is credited.

Examples

1) Debit the receiver

a. Goods sold to Abishnavi.

Here benefit (goods) is given to Abishnavi. She is a receiver and hence her account should be debited.

b. Building sold to Jayabharathi.

Here benefit (Building) is given to Jayabharathi. She is a receiver and hence her account should be debited.

2. Credit the giver

c. Goods purchased from Nithilan:

Here benefit (goods) is given by Nithilan. He is a giver and hence his account should be credited.

d. Motor car purchased from Shanthi:

Here benefit (Motor car) is given by Shanthi. She is a giver and hence her account should be credited

4.3.2 Real Accounts:

When an asset is purchased, that asset comes in .Hence the account is debited. When an asset is sold out, that asset goes out and therefore, that asset account is credited.

Examples

1. Debit what comes in

a. Furniture purchased for Rs 10,000

Furniture has come into the business. Furniture account should be debited.

b. T.N.Samy started business with cash Rs 20,000:

Cash to the extent of Rs 20,000 has come into the business and hence Cash account should be debited.

2. Credit what goes out

c. Land sold for Rs 25,000

Here land has gone out from business; therefore land account should be credited.

d. Paid cash to Muthuvelayutham Rs 5,000

Cash goes out from business; therefore cash account should be credited.

4.3.3. Nominal accounts

When an expense is incurred or loss suffered, the account representing the expense or loss is debited .When any income is earned or gain made, the account representing the income or the gain is credited.

Examples

1. Debit all expenses and losses

a. Paid salaries Rs 5,000

Salary is an expenses account. Hence salaries account should be debited

b.Paid rent Rs 4,000

Rent is an expenses account. Hence rent account should be debited

2.Credit all incomes and Gains

c.Received commission Rs 3,000

Here commission is an income to the business and hence commission account should be credited.

d.Received interest on loan Rs 2,000

Here is an interest income to the business and hence interest account should be credited.

Check your Progress 2

Give two transactions for each type of accounts

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 35)

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4.4 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

- 1) An account is a statement for the transactions relevant to the person, asset, expense or income named in the heading.
- 2) If the transactions relating to persons are known as ‘personal Accounts’, and if it is relating to properties and assets are known as ‘Real Account’ and the accounts for the transactions relating to incomes and expenses are called ‘Nominal Accounts’.
- 3) The double entry system of book keeping is a scientific and complete system hence; the transactions should be recorded according to Debit and Credit rules.

4.5 LESSON-END ACTIVITIES

1. Mention which account should be debited for the following transactions
 - i) Cash paid to Mani
 - ii) Purchase of Land
 - iii) Sale of Building
 - iv) Payment of rent
 - v) Commission received
2. Mention which account should be credited for the following transactions
 - i) Cash received from kolanchi
 - ii) Purchase of car for cash
 - iii) Building sold to Narayanasamy
 - iv) Payment of salaries
 - v) Rent received
3. How are accounts classified? What is the basis for such classifications?
4. Explain the Rules for Debit and Credit with examples.

4.6 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check 1

Artificial persons

1. Bank
2. Government

Tangible assets

1. Building
2. Machinery

Intangible assets

1. Goodwill
2. Trade mark

Check 2

1. Personal accounts

- i) Capital contributed by Samysivam Rs 10,000
- ii) Sivan paid cash into the bank Rs 5000

2. Real accounts

- i) Machinery purchased for Rs 2,000
- ii) Sale of Furniture Rs 3,000

3. Nominal accounts

- i) paid rent Rs 500
- ii) received commission Rs 5,200

4.7 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

LESSON – 5

ACCOUNTING STANDARDS

5.0 Aims and Objectives

5.1 Introduction

5.2 Preface to the statements of accounting standards

5.2.1. Formation of the accounting standards board

5.2.2. Scope and functions of accounting standards board

5.2.3. Audited financial statements

5.2.4. Scope of accounting standards

5.2.5 Procedure for issuing accounting standards

5.3. Compliance with the accounting standards

5.4 Summary of the accounting process

5.5 Different levels

5.5.1 International accounting standards (IAS)

5.5.2 Accounting standards and the institute of chartered accountants of india

5.6 Let us Sum Up

5.7 Lesson-End Activities

5.8 Model answer to check your progress.

5.9 References

5.0 AIMS AND OBJECTIVES

In fourth lesson, we discussed the different kinds of accounts and its rules. Here we discuss various accounting standards. After going through this lesson, you will be able to

1. know the meaning of accounting standards
2. understand International Accounting Standards (IAS)
3. know the Accounting standards and the Institute of Chartered Accountants of India

5.1 INTRODUCTION

Comparability of accounts prepared by different firms in a particular period or by the same firm over several accounting periods is possible only when some uniform principles and practices are adopted. To achieve such uniformity in preparation of financial statements, concerted efforts started in the 1970s to develop standardized accounting practices, called 'Accounting standards.'

5.2. PREFACES TO THE STATEMENTS OF ACCOUNTING STANDARDS

Accounting is the language of business. To make the language convey the same meaning to all people, accountants all over the world have developed certain rules. In this section, we discuss the prefaces to the statements of accounting standards.

5.2.1 . Formation of the Accounting Standards Board

The Institute of Chartered Accountants of India, recognizing the need to harmonise the diverse accounting policies and practices at present in use in India, constituted and Accounting Standards Board (ASB) on 21st April, 1977.

5.2.2. Scope and Functions of Accounting Standards Board

i) The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India. While formulating the accounting standards, ASB will take into consideration the applicable laws, customs, usages and business environment.

ii) The Institute is one of the Members of International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC. While formulating the Accounting Standards, ASB will give due consideration to International Accounting Standards, issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

iii) The Accounting Standards will be issued under the authority of the council. ASB has also been entrusted with the responsibility of propagating the Accounting Standards and persuading the concerned parties to adopt them in the preparation and presentation of financial statements. ASB will issue guidance notes on the Accounting Standards and give clarifications on issue arising there from. ASB will also review the Accounting Standards at periodical intervals.

5.2.3. Audited Financial Statements

i) For discharging the above functions, ASB will keep in view the purpose and limitations of published financial statements and the attest function of the auditors. ASB will enumerate and describe the basic concept to which accounting principles should be oriented and state the accounting principles to which the practices and the procedures should conform.

ii) ASB will clarify the phrases commonly used in such financial statements and suggests improvements in the terminology wherever necessary. ASB will examine the various current alternative practices in vogue and identify such alternatives which should be preferred.

iii) The Institute will issue the Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term “General Purpose Financial Statements” includes balance sheet, statement of profit and loss and other elements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large. Reference to financial statements in the Preface and in the standard titled from time to time will be construed to refer to General Purpose Financial Statements.

iv) Responsibility for the preparation of financial statements and for adequate disclosure is that of the management of the enterprise. The Auditor’s responsibility is to form his opinion and report on such financial Statements.

5.2.4. Scope of Accounting Standards

i) Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, usage and business environment of our country. However, if due to subsequent amendments in law, a particular Accounting Standard is found to be not in conformity with such law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with inch law.

ii) The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in our country. However, the Institute will determine the extent of disclosure to be made in financial statements and the related Auditor's reports. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of classification and, therefore, need not be treated as adverse comments on the related financial statements.

iii) The Accounting Standards are intended to apply to items which are material. Any limitations with regard to the applicability of a specific Standard will be made clear by the Institute from time to time. The date from which a particular Standard will come into effect, as well as the class of enterprise to which it will apply, will also be specified by the Institute. However, no standard will have retrospective application, unless otherwise stated.

iv) The Institute will use its best endeavours to persuade the Government, appropriate authorities, industrial and business community to adopt these standards in order to achieve uniformity in the presentation of financial statements.

v) In carrying out the task of formulation of Accounting Standards, the intention is to concentrate on basic matters. The endeavour would be to confine Accounting Standards to essentials and not to make them so complex that they cannot be applied effectively on a nation-wide basis. In the years to come, it is to be expected that Accounting Standards will undergo revision and a greater degree of sophistication may then be appropriate.

5.2.5 Procedure for Issuing Accounting Standards

Broadly, the following procedure will be adopted for formulating Accounting Standards :

i) ASB shall determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

ii) In the preparation of Accounting Standards, ASB will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.

iii) ASB will also hold a dialogue with the representatives of the Government, Public Sector Undertakings, Industry and other Organisations for ascertaining their views.

iv) On the basis of the work of the Study Groups and the dialogue with the organisation referred to in

v) Above, an exposure draft of the proposed standard will be prepared and issued for comments by members of the Institute and the public at large.

vi) The draft of the proposed standards will include the following basic points:

1. A Statement of concepts and fundamental accounting principles relating to the Standard.
2. Definitions of the terms used in the Standard.
3. The manner in which the accounting principles have been applied for formulating the Standard.
4. The presentation and disclosure requirements in complying with the Standard.
5. Class of enterprises to which the Standard will apply.
6. Date from which the standard will be effective.
7. After taking into consideration the comments received, the draft of the proposed Standards will be finalised by ASB and submitted to the Council of the Institute.

8 The council of the Institute will consider the final draft of the proposed standard, and if found necessary, modify the same in consultation with ASB. The Accounting Standard on the relevant subject will then be issued under the authority of the Council.

5.3. COMPLIANCE WITH THE ACCOUNTING STANDARDS

In this section, we discuss the compliance with the accounting standards.

5.3.1 While discharging their attest functions, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audited reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations

5.3.2 In the initial years, the standards will be recommendatory in character and the Institute will give wide publicity among the users and educate members about the utility of Accounting Standards and the need for compliance with the above disclosure requirements. Once an awareness about these requirements is ensured steps will be taken, in course of time, to enforce compliance with the accounting standards in the manner out-lined in para 6.1 above.

5.3.3 The adoption of Accounting Standards in our country and disclosure of the extent to which they have not been observed will, over the years, have an important effect, with consequential improvement in the quality of presentation of financial statements. Texts of Some Indian Accounting Standards are given below. These should be read in the context of the preface to the Statements of Accounting Standards given above.

5.4 SUMMARY OF THE ACCOUNTING PROCESS

In this section, we discuss the Summary of the Accounting Process

The first and most important part of the accounting process is the analysis of transactions. This is the process of deciding which account or accounts should be debited, which should be credited, and in what amounts, in order to reflect events in the accounting records. This requires knowledge of accounting concepts as well as judgment.

1. Next comes the purely mechanical step of journalizing original entries-recording the results of the transaction analysis in the journal.
2. Posting is the process of recording changes in the ledger accounts exactly as specified by the journal entries. This is another purely mechanical step.
3. At the end of the accounting period, judgment is involved in deciding on the adjusting entries. These are journalized and posted in the same way as original entries.

Check your Progress 1

Give any five areas in which differing accounting policies are encountered.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 43)

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5.5 DIFFERENT LEVELS

In this section, we discuss the Accounting standards at International level and at national level

At International level, international accounting standards have been developed. At national level the Institute of Chartered Accountants has taken initiative and several accounting standards have been developed.

5.5.1 International Accounting Standards (IAS)

International Accounting Standards Committee (IASC) was established on 29th June 1973 when 16 accounting bodies from nine nations (called founder members) signed the agreement and constitution for its formation. The committee operates from its head office situated at London.

The aim of the committee is “to formulate and publish, in public interest standards to be observed in the presentation of audited financial statements and to promote their world wide acceptance and observance.” The formulation of such standards will bring uniformity in terminology, approach and presentation of results. This helps in meaningful understanding and exchange of economic and financial information. Smooth flow of international investment is also facilitated.

The following are the accounting standards laid down by the committee till now:

- | | | |
|-----|----|---|
| IAS | 1 | Disclosure of Accounting policies; |
| IAS | 2 | Valuation and presentation of inventories in the context of historical cost system; |
| IAS | 3 | Consolidated financial statements |
| IAS | 4 | Depreciation Accounting; |
| IAS | 5 | Information to be disclosed in financial statements; |
| IAS | 6 | Accounting responses to changing prices |
| IAS | 7 | Statement of changes in Financial position |
| IAS | 8 | Unusual and prior period items and changes in accounting policies, |
| IAS | 9 | Accounting for Research and Development Activities |
| IAS | 10 | Contingencies and events occurring after balance sheet date |
| IAS | 11 | Accounting for construction contracts |
| IAS | 12 | Accounting for Taxes on income |
| IAS | 13 | Presentation of current assets and current liabilities |
| IAS | 14 | Reporting financial information by segments |
| IAS | 15 | Information reflecting the effects of changing prices |
| IAS | 16 | Accounting for property, plant and equipment |
| IAS | 17 | Accounting for Leases |
| IAS | 18 | Revenue recognition |
| IAS | 19 | Accounting for retirement benefits in the financial statements of employers. |
| IAS | 20 | Accounting for Government grants and disclosure of government assistance. |
| IAS | 21 | Accounting for effects of changes in foreign exchange rates. |
| IAS | 22 | Accounting for business combination |
| IAS | 23 | Capitalisation of borrowing costs |

- IAS 24 Related party disclosures
- IAS 25 Accounting for Investments
- IAS 26 Accounting and reporting of retirement benefit plans
- IAS 27 Consolidated financial statements accounting for investment in subsidiaries.
- IAS 28 Accounting for investment in associates
- IAS 29 Financial Reporting in Hyper inflationary economies
- IAS 30 Disclosure in the Financial statements of banks and similar financial institutions
- IAS 31 Financial reporting of interests in joint ventures
- IAS 32 Financial Instruments: Disclosure and presentation
- IAS 33 Earning per share
- IAS 34 Interim Financial Reporting
- IAS 35 Discontinuing operations
- IAS 36 Impairment of assets
- IAS 37 Provisions, contingent liabilities and contingent assets
- IAS 38 Intangible assets.

Check your Progress 2

Give the objectives of setting up of International Accounting Standards Committee

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.43)

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5.5.2 Accounting standards and the Institute of Chartered Accountants of India

Accounting Standards Board (ASB) was established on 22nd April 1977 by the Institute of Chartered Accountants of India.

The objective of ASB is to formulate uniformity in terminology, approach, and presentation of accounting results. The main function of ASB is to formulate accounting ‘standards’ so that standards will be established by the council of the Institute of Chartered Accountants of India. The ASB gives due consideration to the International Accounting standards, applicable laws, customs, usages and business environment prevailing in India while formulating accounting standards.

The accounting standards issued by the ASB so far are as follows:

S. No.	Title of standard	Date for effective implementation	Date of Issue
AS 1	Disclosure of accounting policies	1-4-1991	Nov. 79
AS 2	Valuation of Inventories	1-4-1991	June. 81
AS 3 (Revised)	Changes in Financial position	1-4-1991	June. 81

AS 4 (Revised)	Contingencies and events occurring after the balance sheet date.	1-4-1995	Nov. 82
AS 5 (Revised)	Prior period and extraordinary items and changes in accounting policies	1-4-1996	Nov. 82
AS 6 (Revised)	Depreciation Accounting	1-4-1995	Nov. 82
AS 7	Accounting for construction contracts	1-4-1991	Dec. 83
AS 8	Accounting for research and development	1-4-1991	Jan. 85
AS 9	Revenue recognition	1-4-1991	Jan. 85
AS 10	Accounting for fixed assets	1-4-1991	Nov. 85
AS 11 (Revised)	Accounting for the effects of changes in foreign exchange rates	1-4-1995	June. 89
AS 12	Accounting for government grants	1-4-1994	Aug. 91
AS 13	Accounting for Investment	1-4-1995	Sep. 93
AS 14	Accounting for Amalgamations	1-4-1995	Oct. 94
AS 15	Accounting for retirement benefits in the financial statements of employers	1-4-1995	Jan. 95

5.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Standardized accounting practices, called 'Accounting standards.'
2. While formulating the accounting standards, ASB will take into consideration the applicable laws, customs, usages and business environment.
3. Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, usage and business environment of our country.
4. ASB will clarify the phrases commonly used in such financial statements and suggests improvements in the terminology wherever necessary.
5. The objective of Accounting Standards Board is to formulate uniformity in terminology, approach, and presentation of accounting results.

5.7 LESSON-END ACTIVITIES

1. Briefly enumerate the provision of Indian Accounting Standard 3.
2. Enumerate the latest provisions of AS 5
3. Describe briefly accounting policies and fundamental accounting assumptions as given in Accounting Standard 1

5.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Check 1

1. Methods of depreciation, depletion and amortisation.
2. Treatment of expenditure during construction.
3. Valuation or translation of foreign currency item.
4. Treatment of Goodwill
5. Treatment of retirement benefits.

Check 2

The main objective of the committee is to formulate and publish in the public interest, standards to be observed in presentation of audited financial statement and to promote their world –wide acceptance and observance.

5.9 REFERENCES

1. Jain and Narang -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. R.L.Gupta -- Advanced accountancy

UNIT-II

LESSON – 6

ACCOUNTING CONCEPTS-CONVENTIONS

Contents

- 6.0 Aims and Objectives
- 6.1 Introduction
- 6.2 Principles of Accounting
- 6.3 Accounting concepts
 - 6.3.1. Business Entity Concept
 - 6.3. 2. Money Measurement Concept
 - 6.3.3. Going Concern Concept
 - 6.3. 4. Dual Aspect Concept
 - 6.3.5. Periodicity Concept
 - 6.3. 6. Historical Cost Concept
 - 6.3.7. Matching Concept
 - 6.3. 8. Realisation Concept
 - 6.3.9. Accrual Concept
 - 6.3.10. Objective Evidence Concept
- 6.4 Accounting Conventions
 - 6.4.1. Consistency
 - 6.4.2. Disclosure
 - 6.4.3. Conservatism
- 6.5 Accounting Terminology
- 6.6 Let us Sum Up
- 6.7 Lesson-End Activities
- 6.8 Model answer to check your progress.
- 6.9 References

6.0 AIMS AND OBJECTIVES

In fifth lesson we discussed the accounting standards. Here we discuss the different types of accounting concepts-conventions. After going through this lesson, you will able to

1. know the different kinds of accounting concepts
 2. understand various types of accounting conventions
 3. know the meaning for various accounting Terminology
-

6.1. INTRODUCTION

In this section, we discuss the principles of accounting .The word ‘Principle’ has been differently viewed by different schools of thought. The American Institute of Certified Public Accountants (AICPA) has viewed the word ‘principle’ as a general law of rule adopted or professed as a guide to action a settled ground or basis of conduct of practice”

6.2 PRINCIPLES OF ACCOUNTING

Accounting principles refer, to certain rules, procedures and conventions which represent a consensus view by those indulging in good accounting practices and procedures. Canadian Institute of Chartered Accountants defined accounting principle as “the body of doctrines commonly associated with the theory and procedure of accounting, serving as an explanation of current practices as a guide for the selection of conventions or procedures where alternatives exist. Rules governing the formation of accounting axioms and the principles derived from them have arisen from common experiences, historical precedent, statements by individuals and professional bodies and regulations of Governmental agencies”. To be more reliable, accounting statements are prepared in conformity with these principles. If not, chaotic conditions would result. But in reality as all the businesses are not alike, each one has its own method of accounting. However, to be more acceptable, the accounting principles should satisfy the following three basic qualities, viz., relevance, objectivity and feasibility. The accounting principle is considered to be relevant and useful to the extent that it increases the utility of the records to its readers. It is said to be objective to the extent that it is supported by the facts and free from personal bias. It is considered to be feasible to the extent that it is practicable with the least complication or cost. Though accounting principles are denoted by various terms such as concepts, conventions, doctrines, tenets, assumptions, axioms, postulates, etc., it can be classified into two groups, viz., accounting concepts and accounting conventions.

6.3 ACCOUNTING CONCEPTS

In this section, we discuss the concepts of accounting and its kinds. The term ‘concept’ is used to denote accounting postulates, i.e., basic assumptions or conditions upon the edifice of which the accounting super-structure is based. The following are the common accounting concepts adopted by many business concerns.

- | | |
|----------------------------|--------------------------------|
| 1. Business Entity Concept | 2. Money Measurement Concept |
| 3. Going Concern Concept | 4. Dual Aspect Concept |
| 5. Periodicity Concept | 6. Historical Cost Concept |
| 7. Matching Concept | 8. Realisation Concept |
| 9. Accrual Concept | 10. Objective Evidence Concept |

6.3.1. Business Entity Concept

A business unit is an organization of persons established to accomplish an economic goal. Business entity concept implies that the business unit is separate and distinct from the persons who provide the required capital to it. This concept can be expressed through an accounting equation, viz., $Assets = Liabilities + Capital$. The equation clearly shows that the business itself owns the assets and in turn owes to various claimants. It is worth mentioning here that the business entity concept as applied in accounting for sole trading units is different from the legal concept. The expenses, income, assets and liabilities not related to the sole proprietorship business are excluded from accounting. However, a sole proprietor is personally liable and required to utilize non-business assets or private assets also to settle the business creditors as per law. Thus, in the case of sole proprietorship, business and non-

business assets and liabilities are treated alike in the eyes of law. In the case of a partnership, firm, for paying the business liabilities the business assets are used first and if any surplus remains thereafter, it can be used for paying off the private liabilities of each partner. Similarly, the private assets are first used to pay off the private liabilities of partners and if any surplus remains, it is treated as part of the firm's property and is used for paying the firm's liabilities. In the case of a company, its existence does not depend on the life span of any shareholder.

6.3.2. Money Measurement Concept

In accounting all events and transactions are recorded in terms of money. Money is considered as a common denominator, by means of which various facts, events and transactions about a business can be expressed in terms of numbers. In other words, facts, events and transactions which cannot be expressed in monetary terms are not recorded in accounting. Hence, the accounting does not give a complete picture of all the transactions of a business unit. This concept does not also take care of the effects of inflation because it assumes a stable value for measuring.

6.3.3. Going Concern Concept

Under this concept, the transactions are recorded assuming that the business will exist for a longer period of time, i.e., a business unit is considered to be a going concern and not a liquidated one. Keeping this in view, the suppliers and other companies enter into business transactions with the business unit. This assumption supports the concept of valuing the assets at historical cost or replacement cost. This concept also supports the treatment of prepaid expenses as assets, although they may be practically unsaleable.

6.3.4. Dual Aspect Concept

According to this basic concept of accounting, every transaction has a two-fold aspect, viz., 1. giving certain benefits and 2. receiving certain benefits. The basic principle of double entry system is that every debit has a corresponding and equal amount of credit. This is the underlying assumption of this concept. The accounting equation viz., $\text{Assets} = \text{Capital} + \text{Liabilities}$ or $\text{Capital} = \text{Assets} - \text{Liabilities}$, will further clarify this concept, i.e., at any point of time the total assets of the business unit are equal to its total liabilities. Liabilities here relate both to the outsiders and the owners. Liabilities to the owners are considered as capital.

6.3.5. Periodicity Concept

Under this concept, the life of the business is segmented into different periods and accordingly the result of each period is ascertained. Though the business is assumed to be continuing in future (as per going concern concept), the measurement of income and studying the financial position of the business for a shorter and definite period will help in taking corrective steps at the appropriate time. Each segmented period is called "accounting period" and the same is normally a year. The businessman has to analyse and evaluate the results ascertained periodically. At the end of an accounting period, an Income Statement is prepared to ascertain the profit or loss made during that accounting period and Balance Sheet is prepared which depicts the financial position of the business as on the last day of that period. During the course of preparation of these statements capital revenue items are to be necessarily distinguished.

6.3.6. Historical Cost Concept

According to this concept, the transactions are recorded in the books of account with the respective amounts involved. For example, if an asset is purchased, it is entered in the accounting record at the price paid to acquire the same and that cost is considered to be the base for all future accounting. It means that the asset is recorded at cost at the time of purchase but it may be methodically reduced in its value by way of charging depreciation. However, in the light of inflationary conditions, the application of this concept is considered highly irrelevant for judging the financial position of the business.

6.3.7. Matching Concept

The essence of the matching concept lies in the view that all costs which are associated to a particular period should be compared with the revenues associated to the same period to obtain the net income of the business. Under this concept, the accounting period concept is relevant and it is this concept (matching concept) which necessitated the provisions of different adjustments for recording outstanding expenses, prepaid expenses, outstanding incomes, incomes received in advance, etc., during the course of preparing the financial statements at the end of the accounting period.

6.3.8. Realisation Concept

This concept assumes or recognizes revenue when a sale is made. Sale is considered to be complete when the ownership and property are transferred from the seller to the buyer and the consideration is paid in full. However, there are two exceptions to this concept, viz., 1. hire purchase system where the ownership is transferred to the buyer when the last instalment is paid and 2. contract accounts, in which the contractor is liable to pay only when the whole contract is completed, the profit is calculated on the basis of work certified each year.

6.3.9. Accrual Concept

According to this concept the revenue is recognized on its realization and not on its actual receipt. Similarly the costs are recognized when they are incurred and not when payment is made. This assumption makes it necessary to give certain adjustments in the preparation of income statement regarding revenues and costs. But under cash accounting system, the revenues and costs are recognized only when they are actually received or paid. Hence, the combination of both cash and accrual system is preferable to get rid of the limitations of each system.

6.3.10. Objective Evidence Concept

This concept ensures that all accounting must be based on objective evidence, i.e., every transaction recorded in the books of account must have a verifiable document in support of its existence. Only then, the transactions can be verified by the auditors and declared as true or otherwise. The verifiable evidence for the transactions should be free from the personal bias, i.e., it should be objective in nature and not subjective. However, in reality the subjectivity cannot be avoided in the aspects like provision for bad and doubtful debts, provision for depreciation, valuation of inventory, etc., and the accountants are required to disclose the regulations followed.

Check your Progress 1

What you understand about Money Measurement Concept, Dual Aspect Concept and Accrual Concept

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 52)

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ACCOUNTING CONVENTIONS

In this section, we discuss the conventions are to be followed to have a clear and meaningful information and data in accounting:

6.4.1. Consistency

The convention of consistency refers to the stale of accounting rules, concepts, principle, practices and conventions being observed and applied constantly, i.e., from one year to another there should not be any change. If consistency is there, the results and performance of one period can he compared easily and meaningfully with the other. It also prevents personal bias as the persons involved have to follow the consistent rules, principles, concepts and conventions. This convention, however, does not completely ignore changes. It admits changes wherever indispensable and adds to the improved and modern techniques of accounting.

6.4.2. Disclosure

The convention of disclosure stresses the importance of providing accurate, full and reliable information and data in the financial statements which is of material interest to the users and readers of such statement. This convention is given due legal emphasis by the Companies Act, 1956 by prescribing formats for the preparation of financial statements. However, the term disclosure does not mean all information chat one desires to get should be included in accounting statements. It is enough if sufficient information, which is of material interest to die users, is included.

6.4.3. Conservatism

In the prevailing present day uncertainties, the convention of conservatism has its own importance. This convention follows the policy of caution or playing safe. It takes into account all possible losses but not the possible profits or gains. A view opposed to this convention is that there is the possibility of creation of secret reserves when conservatism is excessively applied, which is directly opposed to the convention of full disclosure. Thus, the convention of conservatism should be applied very cautiously.

6.5 ACCOUNTING TERMINOLOGY

It is necessary to understand some basic accounting terms which are daily in business world. In this section, we discuss some important terminology used in accounting

1. Transaction

Transaction means the exchange of money or moneys worth from one account to another account .in other words any dealing of a business that involves buying and selling in value is called business transaction. It is an event which results in change in value of assets and equity. Events like purchase and sale of goods, receipt and payment of cash for services or on personal accounts, profit or loss in dealings etc., are the transactions.

There are three types of transactions

1. Cash transaction 2. Credit transaction 3. Non-cash transaction

Cash transaction: Cash transaction is one where cash receipt or payment is involved in the exchange.

Credit transaction: In credit transaction there is on immediate payment or receipt of cash. The payment or receipt is postponed to a future date, but gives rise to debtor and creditor relationship.

Non-cash transaction: Non-cash transaction is one where the question of receipt or payment of cash does not all arise, e.g. Depreciation, return of goods etc.

Proprietor: The person who makes the investment and bears all the risks connected with the business is known as proprietor.

2.Capital

The investment made by the proprietor in business or the owner can claim from the firm is called as capital. It may be terms of money or assets having money value) It is also known as owner's equity or net worth. It will always represented by the difference between assets and liabilities. $Capital = Assets - Liabilities$

3.Drawings

It is the amount of money or the value of goods withdrawal by the owner of the business for his domestic or personal use is called "drawings". It is usually subtracted from capital.

4.Asset

Any physical thing or right owned that has a money value is an asset. In other words In other words anything of use to future operation of the enterprise and belonging to the enterprise. Assets can be two type namely current assets and fixed assets

Current assets: These are assets which are expected to be converted into cash in the normal course of business .Example cash, stock, debtors and bills receivable etc.

Fixed assets: Assets held for the purpose of producing goods or providing services and not for resale in the normal course of business.

5.Liability

It means the amount repayable to outsiders by the business either now or in future. In the words of Finny and Miller, "Liabilities are debts; they are amounts owed to creditors; thus the claims of those who ate not owners are not owners are called liabilities". In simple terms, liabilities are a financial obligation of a firm other than proprietor funds. There are two types namely current liabilities and fixed or long term liabilities.

Current liabilities: These are liabilities which become due and payable within a period of one year from paid out of current assets. Example: creditors, bills payable, outstanding expenses etc.

Fixed or long term liabilities: There are liabilities remain in the business as such for a longer period. It need not be discharged within a period of one year. Example: Debentures, Long term loans etc.

6. Goods

It is a general term used for the all merchandise articles which are purchased by the business for resale for profit.

7. Stock

The goods purchased are for selling, if the goods are not sold out fully, a part of the total goods purchased is available with the business for sale on a particular date is termed as stock. The value of remaining unsold at the end of the accounting year, it is said to be a closing stock. This closing stock at the year end will be the opening stock for the subsequent year.

8. Purchases

Buying of goods by the trader for cash or credit for the purpose of selling them to his customers or processing into finished goods are known as purchases. It is the main function of a business. Purchases can be of two types. Viz, cash purchases and credit purchases. If cash is paid immediately for the purchase, it is cash purchases, if the payment is postponed, it is credit purchases.

9. Sales

When the goods purchased are sold out, It is known as sales. in simple words the income earned from transferred the possession and the ownership right over the goods to the buyer It can be of two types, viz., cash sales and credit sales. If the sale is for immediate cash payment, it is cash sales. If payment for sales is postponed, it is credit sales. The amount received from the sale of fixed assets is not treated as sales

10. Debtor

A person who owes money to the firm mostly on account of credit sale of goods is called debtor. For example, when goods are sold to a person on credit that person pays the price in future, he is called a debtor because he owes the amount to the firm.

11. Creditor

A person to whom money owes by the firm is called creditor. In simple words a person who have claim for money against the goods supplied and services rendered by them on credit.

12. Revenue

It means the amount which as a result of operations, is added to the capital. It is the monetary value of the products or services sold to the customers during the period. Revenue includes all incomes like sales receipts, interest, commission, brokerage etc., However, receipts of capital nature like additional capital, sale of assets etc., are not a part of revenue.

13. Expense

The terms 'expense' refers to the amount incurred by the enterprise in the process of earning revenue. If the benefit of expenditure is limited to one year, it is treated as an expense such as payment of salaries and rent. Expense is differing from expenditure. Expenditure takes place when an asset or service is acquired. The purchase of goods is expenditure, where as cost of goods sold is an expense. Similarly, if an asset is acquired during the year, it is expenditure, if it is consumed during the same year; it is also an expense of the year.

14. Losses

It means the result of the business for a period when expenses exceed the revenue. It represents money given up without any return. For example: loss due to fire, theft and damages payable to others.

15. Account

It is a statement of the various dealings which occur between a customer and the firm. It can also be expressed as a clear and concise record of the transaction relating to a person or a property (or assets) or a liability or an expense or an income.

16. Discount

Customers are allowed any type of deduction in the prices of goods by the businessman that is called discount.

i) Trade Discount

When a customer buys goods regularly or buys large quantity or buys for a large amount, the seller is usually inclined to allow a concession in price. He will calculate the total price according to the list of catalogue. But after the total is arrived at, he will make a deduction 5% or 10% depending upon his business policy. This deduction is known as Trade discount. Generally, this discount is recorded in the purchases book and sales book but it does not enter in the ledger accounts. In the ledger, only net amount of purchase and sale are entered.

ii) Cash Discount

An amount which is allowed for the prompt settlement of debt arising out of a sale within a specified time and calculated on a percentage basis is known as cash discount,

17. Insolvent

A person whose liabilities are more than the realizable values of his assets is called an insolvent.

18. Solvent

A person whose liabilities are not more than the realizable values of his assets is called a solvent.

Check your Progress 2

List five differences between trade discount and cash discount

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.52)

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.....
.....

6.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

- 1) Accounting is the language of business; it should be based on certain uniform and scientifically laid down standards. These standards are known as accounting principles.
- 2)The accounting principles are generally divided into two categories, accounting principles.viz., Accounting concepts and Accounting conventions. The term ‘concepts’ include those basic assumptions or conditions upon which the science of accounting is based.
- 3) A person who owes money to the firm mostly on account of credit sale of goods is called debtor. A person to whom money owes by the firm is called creditor.
- 4) The value of remaining unsold at the end of the accounting year is known as stock. Liabilities means the amount repayable to outsiders by the business

6.7 LESSON-END ACTIVITIES

1. What are the basic accounting concepts and conventions?
 2. What is dual aspect concept?
 3. What do you stand by convention of materiality?
 4. What is an accounting equation?
 5. Explain the following terms
 - a) Assets b) Liabilities c) Capital d) Revenue e) Expenses
-

6.8 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check 1 i) Money Measurement Concept: As per this concept, transactions that can be measured in the terms of money only are recorded in the books of account. An event which cannot be expressed in terms of money cannot be recorded in the books of account.

ii) Dual Aspect Concept: This concept is also known as Equivalence concept. According to this concept each and every business transaction has two aspects—a giving aspect and a receiving aspect.

Check 2 Difference between Trade Discount and Cash Discount

S.No.	Trade discount	Cash discount
1.	It is given by the manufacturer or the wholesaler to a retailer and not to others.	It may be allowed by seller to any debtor.
2.	It is allowed on a certain quantity being purchased.	It is allowed on payment being made before a certain date.
3.	It is a reduction in the catalogue price of an article.	It is a reduction in the amount due by a debtor.
4.	It is not usually accounted for in the books since the net amount (i.e. after deducting discount) is shown.	This discount must have to be accounted for in the books since it is deducted from the gross selling price.
5.	It is allowed only when there is a sale either cash or credit.	It is allowed only when there is cash receipt or cash payment including cheques.

6.9 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

LESSON – 7

PHASES OF ACCOUNTING – “JOURNAL”

7.0 Aims and Objectives

7.1 Introductions

7.1.1 Journal

7.1.2 Journalising

7.1.3 Rules of journalising

7.2 Specimen of journal

7.2.1 Narration

7.3. Advantages of journal

7.4. Sub- division of journal

7.5 Analysis of transaction for journal entries

7.6 Important points to note at the item of recording a transaction

7.7 Let us sum up

7.8 Lesson-End Activities

7.9 Model answer to check your progress.

7.10 References

7.0 AIMS AND OBJECTIVES

In sixth lesson, we discussed the accounting concepts-conventions. Here we discuss the different phase of accounting; first of all we discuss the ways to make journal entries for different type of business transactions. After going through this lesson, you will able to

1. know the meaning of journal
2. understand advantages and important point of journal
3. know the meaning rules and sub-division of ledger
4. have knowledge about Journalising

7.1 INTRODUCTIONS

As per the definition of Accounting, recording classifying, summarizing and finalizing all business transactions are the important stages in the Accounting cycle.

1. Recording is the first step which is usually comprised through Journal or subsidiary books.
2. Classifying is achieved through ledger.
3. Summarising is accomplished by preparation of Trial Balance.
4. Finalising is through preparation of Trading Account, Profit and Loss Account and Balance sheet.

It is essential to understand the objective of each stage and the books and records maintained to achieve the objective.

Recording of business transactions in a systematic manner is the first step in the accounting process. Each transaction has to be recorded as and when it occurs, in chronological order. Every thing recorded must be supported by reliable documentary evidence like cash receipts and other vouchers.

Recording of business transactions is usually done in journal or subsidiary books. Small firms or sole traders may use the single journal system and the bigger firms and companies may use subsidiary books system

In this section, we have briefly touched upon the meaning of journal, Journalising, and rules of journalizing In accounting procedure is to record the transactions first in the books in the order of their happening. The book of original entry for the transaction is called Journal book. Journal is the prime book of transaction showing the names of account to be debited and credited.

7.1.1 Journal

When the business transactions take place, the first step is to record the same in the books of original entry or subsidiary books or books of prime or journal. The French word 'jour' means 'day'. Journal, therefore means a daily record of business transactions. Thus journal is simple book of accounts in which all the business transactions are originally recorded in chronological order and from which they are posted to the ledger accounts at any convenient time. A thorough understanding of the principles of debit and credit which are the basis for journal is essential for every student of accountancy to get a thorough grasp of the subject.

7.1.2 Journalising

It refers to the act of recording the debit and credit aspect of a business transaction each transaction in the journal and the form, in way which it is recorded, is known as a journal entry.

7.1.3 Rules of Journalising

The act of recording is made according to certain rules and these rules , are called rules of journalizing.

7.2 THE SPECIMEN OF JOURNAL

In this section we presented a specimen of journal book

Journal Book of Mr/Mrs

Date	Particulars	L.F.	Debit (Dr) Rs	Credit (Cr) Rs

The journal has five columns, viz.

1. Date; 2. Particulars, 3.Ledger Folio, 4.Amount (Debit) ,5. Amount (Credit)

i) Date: In each page of the journal at the top of the date column, the year is written and in the next line, month and date of the first entry are written. The year and month need not be repeated until a new page is begun or the month or the year changes. Thus, in this column, the date on which the transaction takes place is alone written.

ii) Particulars: In this column, the details regarding account titles and description are recorded. The name of the account to be debited is entered first at the extreme left of the particulars column next to the date and the abbreviation 'Dr.' is written at the right extreme of the same column in the same line. The name of the account to be credited is entered in the next line preceded by the word "To" leaving a few spaces away from the extreme left of the particulars column. In the next line immediately to the account credited, under this a short

explain about the transaction is given called as narration. To indicate the completion of the entry for a transaction, a line is usually drawn all through the particulars column.

iii) **Ledger Folio:** This column is meant to record the reference of the main book, i.e., ledger and is not filled in when the transactions are recorded in the journal. The page number of the ledger in which the accounts are appearing is indicated in this column, while the debits and credits are posted o the ledger accounts.

iv) **Amount (Debit):** The amount to be debited along with its unit of measurement at the top of this column on each page is written against the account debited.

v) **Amount (Credit):** The amount to be credited along with its unit of measurement at the top of this column on each page is written against the account credited.

7.2.1 Narration

A brief explanation of the transaction is given after passing the journal entrys know as “Narration”. It may include particulars required to identify and understand the transaction and should be adequate enough to explain the transaction. It usually starts with the word “Being” which means what it is and is written within parentheses. The use of the word “Being” is completely dispensed with, in modern parlance.

Check your Progress 1

What is the use of narration

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 64)

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.....
.....

7.3. ADVANTAGES OF JOURNAL

In this section, we presented some of the inherent advantages of using journal, though the transactions can also be directly recorded in the respective ledger accounts. As all the transactions are entered in the journal chronologically, a date wise record can easily be maintained;

1. All the necessary information and the required explanations regarding all transactions can be obtained from the journal; and
2. Errors can be easily located and prevented by the use of journal or book of prime entry.
3. The history of each transaction can be known.

7.4. SUB DIVISION OF JOURNAL

When innumerable number of transactions takes place, the journal, as the sole book of the original entry becomes inadequate. Thus, the number and type of journals required are determined by the nature of operations and the volume of transactions in a particular business. There are many types of journals. In this section, we presented some of the important types of journals.

1. Sales Day Book- to record all credit sales.
2. Purchases Day Book- to record all credit purchases.
3. Cash Book- to record all cash transactions of receipts as well as payments.
4. Sales Returns Day Book- to record the return of goods sold to customers on credit.
5. Purchases Returns Day Book- to record the return of goods purchased from suppliers on credit.
6. Bills Receivable Book- to record the details of all the bills received.
7. Bills Payable Book- to record the details of all the bills accepted.
8. Journal Proper- to record all residual transactions which do not find place in any of the aforementioned books of original entry.

7.5 TRANSACTION ANALYSIS FOR JOURNAL ENTRIES

In every transaction, two accounts are affected. Before journalizing a transaction, we ask ourselves the following questions i) what aspects are affected? ii) What class of accounts are they?iii) Which account is to be debited and which one to be credited? In this section we have given the steps to be followed to write correct journal entry.

- a) The accounts affected by the transaction have to be identified.
- b) The identified accounts should be classified as to personal or real or nominal.
- c) The accounts to be debited and credited should be decided on the basis of ‘Rules’ governing debiting and crediting.

Example 1

1. Transactions

Started business with Rs.10,000

2.Accounts involved

Cash a/c and Capital a/c

3.Classification of Accounts

Real account and Personal account

4.Rules for debit and credit

Debit what comes in

Credit the giver

5. Explanation

Cash comes in the business

Proprietor is giver of cash

6. Account to be debited

Cash a/c– Rs.10,000

7.Account to be credited

Capital a/c Rs 10,000

Example 2

1. Transactions

Received interest Rs.1,000

2. Accounts involved

Cash a/c and Interest a/c

3. Classification of Accounts

Real account and Nominal account

4. Rules for debit and credit

Debit what come in

Credit the all incomes and gains

5. Explanation

Cash comes in the business

Interest received is the income

6. Account to be debited

Cash a/c – Rs.1,000

7.Account to be credited

Interest a/c Rs 1,000

7.6 COMPOUND JOURNAL

When many transactions of the same nature occur on a particular day, such transaction can be entered in the journal by means of combined (composite) journal entries, known as Compound Journal Entry. Make sure that the amount in the debit column equals to the amount in the credit column, based on the double entry system of book-keeping. One amount in the debit column must be equal to two or more amounts in the credit column or one amount in the credit column equals to two or more amounts in the debit column or under compound entry, a few debits will be equal to a few credits. The rule for journalizing is the same as that of simple journal.

7.7 IMPORTANT POINT TO NOTE AT THE ITEM OF RECORDING A TRANSACTION

In this lesson, we attempt to make a brief survey the main points to be remembered.

1. When money is paid for expenses like rent, salary etc., the concerned expenses accounts should be debited. The persons who received the money should not be debited.
2. Purchases, sales etc., if names of supplier or customer are given, should be assumed to be on credit basis even if not specifically mentioned so.
3. Any expenses incurred while acquiring fixed assets like machinery, buildings etc., should be added to the asset cost.

4. Compound entry: A Particular transaction may affect more than tow accounts Debits or credits of both may be more than one account. However, the total debit should be equal to the total credit.
5. Trade discount is to be reduced from the 'list price of sales or purchases and entry should b e written for net amount only.
6. Goods accounts: *The* articles or products in which a firm deals are termed as 'goods' for that firm. Purchases A/c, purchase returns A/c and sales returns A/c are all different types of goods accounts and thus 'Real accounts' by nature.
7. Purchases A/c is meant for purchase of goods only. It should not be used for purchase of assets like machinery or for purchase of stationery, etc.,
8. Sales A/c is concerned with sales of goods only. It should not be used in case of sale of assets.
9. Owner's transactions: When owner provides money to the business, it is capital. Capital account is credited. If owner withdraws money or anything else like goods, it is drawings. Drawings account is debited.
10. Payments for owner: Payments made on owner's behalf for Income tax, Insurance premium, purchase of assets for his personal use etc., should be treated as drawings.
11. Abnormal losses of goods: Loss by fire, loss by theft or pilferage etc., of goods should be treated as abnormal losses and credited to Trading a/c, after debiting the respective loss accounts.
12. Goods utilised: Goods purchased for the purpose of sales may be used for other purposes. If the owner takes goods, drawings A/c is debited and purchases A/c is credited; if goods are distributed as 'samples', advertising account is debited and purchases a/c is credited. If goods are given as charity, charity A/c (loss) is debited and purchases A/c is credited.
13. Cancellation of discount allowed: Cheque may e received from a customer and he is allowed discount. If the cheque is dishonoured, the discount allowed also should be cancelled by crediting discount allowed A/c.

Check your Progress 2

List the important stages in the accounting cycle.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 64)

.....

7.8 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to pass journal entries for business transaction.

Illustration1.

Journalise the following transactions in the books of Shankar & Co.

1998			Rs.
June	1	Started business with a capital of	60,000
June	2	Paid into bank	30,000
June	4	Purchased goods from Kamal on credit	10,000
June	6	Paid to Shiram	4,920

June 6	Discount allowed by him	80
June 8	Cash Sales	20,000
June 12	Sold to Hameed	5,000
June 15	Purchased goods from Bharat on credit	7,500
June 18	Paid Salaries	4,000
June 20	Received from Prem	2,480
June 20	Allowed him discount	20
June 25	Withdrew from bank for office use	5,000
June 28	Withdraw for personal use	1,000
June 30	Paid Hanif by cheque	3,000

Solution:**In the books of Shankar & Co.**

Date		Particulars	L.F.	Dr. Rs.	Cr. Rs.
1998	June 1	Cash A/c To Capital A/c (being capital brought into the business)	Dr.	60,000	60,000
	June 2	Bank A/c To Capital A/c (being Cash paid into bank)		30,000	30,000
	June 4	Purchases A/c To Kamal's A/c (being Purchased goods worth from Kamal on credit)		10,000	10,000
	June 6	Shriram's A/c To Discount A/c To Cash A/c (being Cash paid to Shriram)	Dr.	5,000	80 4,920
	June 8	Cash A/c To Sales A/c (being Cash sales effected)	Dr.	20,000	20,000
	June 12	Hameed's A/c To Sales A/c (being Goods sold to Hameed)	Dr.	5,000	5,000
	June 15	Purchases A/c To Bharat's A/c (being Purchased goods from Bharat)	Dr.	7,500	7,500
	June 18	Salaries A/c To Cash A/c (being Payment salaries)	Dr.	4,000	4,000
	June 20	Cash A/c Discount A/c	Dr. Dr	2,480 20	

		To Prem's A/c ((being Cash received from Prem))			3,000
June	25	Cash A/c To Bank A/c (being Withdrawn from bank)	Dr.	5,000	5,000
June	28	Drawings A/c To Cash A/c (being Withdrawn for personal use)	Dr.	1,000	1,000
June	30	Hanif's A/c To Bank A/c (being Paid to Hanif by cheques)	Dr.	3,000	3,000

Illustration-2

Journalise the following transactions:

1998

- June 1 Purchased goods worth Rs.300 from Vimal and Rs.500 from Kamal on credit.
- June 3 Sale of goods worth Rs.1,000 to Balram and Rs.700 to Dhanram.
- June 5 Cash of Rs.900 received from Ramasamy and Rs.800 from Krishnasmy.
- June 7 Paid Rs.800 to Pradeep and Rs.500 to kuldeep.
- June 9 Withdrawn from bank Rs.600 for office use and Rs.300 for personal use.

Solution:**Journal**

Date		Particulars	L.F.	Dr. Rs.	Cr. Rs.
1998 June	1	Purchases A/c To Vimal's A/ c To Kamal's A/c ((being Purchased goods worth Rs.300 from Vimal and Rs.500 from Kamal on credit	Dr.	800	300 500
June	3	Balram's A/c Dhanram A/c To Sales A/c ((being Sales of goods worth Rs.1,000 to Balram and Rs.700 to Dhanram)	Dr. Dr.	1,000 700	1,700
June	5	Cash A/c To Ramasamy's A/c To Krishnasamy's A/c ((being Cash of Rs.900 received from Ramasamy and Rs.800 from Krishnasamy)	Dr.	1,700	900 800

June	7	Pradeep's A/c Kuldeep's A/c To Cash A/c ((being Paid Rs.800 to Pradeep and Rs.500 to Kuldeep	Dr. Dr.		800 500	1,300
June	9	Cash A/c Drawings A/c To Bank A/c ((being Withdrawn from bank Rs.600 for office use and Rs.300 for personal use)	Dr. Dr.		600 300	900

Illustration - 3

Journalise the following transactions,
1998

- June 1 Karthik commenced business with Rs.20,000.
 June 2 Paid into bank Rs.5,000 from Anwar.
 June 3 Purchased Plant worth Rs.10,000 from Modi & Co.
 June 4 Purchased goods worth Rs. 5,000 form Anwar.
 June 6 Goods worth Rs.4,000 sold to Anbu
 June 8 Sold goods worth Rs.2,000 for cash.
 June 10 Goods returned by Anbu Rs.50.
 June 15 Paid rent Rs.250.
 June 18 Withdrawn from bank for office use Rs. 2,500.
 June 20 Paid Salaries Rs.1,800.
 June 25 Withdrawn for persona use Rs.250.
 June 26 Goods returned to Anwar Rs.100.
 June 27 Paid for office furniture Rs.1,500 by cheque.
 June 28 Received Rs.3,900 cash from Anbu and discount allowed Rs.50.
 June 29 Paid Answer on account Rs.4,800 and discount allowed by him
Rs.100.

Solution**Journal entries in the Books of**

Date	Particular	L.F.	Dr. Rs.	Cr. Rs.
1998 June 1	Cash A/c To Karthik's Capital A/c ((being Capital brought into the business)	Dr	20,000	20,000
June 2	Bank A/c To Cash A/c ((being Cash Paid in to bank)	Dr	5,000	5,000
June 3	Plant A/c To Modi & Co's. A/c (being Plant purchased from Modi & Co.)	Dr	10,000	10,000
June 4	Purchase A/c To Answer's A/c ((being Goods purchased from Anwar)	Dr	5,000	5,000

June 6	Anbu's A/c To Sales A/c ((being Goods sold to Anbu)	Dr	4,000	4,000
June 8	Cash A/c To Sales A/c (Goods sold for cash)	Dr	2,000	2,000
June 10	Sales Returns A/c To Anbu's A/c ((being Goods returned by Anbu)	Dr	50	50
June 15	Rent A/c To Cash A/c ((being Payment of rent)	Dr	250	250
June 18	Cash A/c To Bank A/c ((being Withdrawn from bank for office use)	Dr	2,500	2500
June 20	Salaries A/c To Cash A/c ((being Payment of Rs.1,800 as salaries)	Dr	1,800	1800
June 25	Drawing A/c To Cash A/c ((being Withdrawn for personal use)	Dr	250	250
June 26	Anwar's A/c To Purchases Returns A/c (Goods returned to Anwar)	Dr	100	100
June 27	Furniture A/c To Bank A/c ((being Payment by cheque for office furniture)	Dr	1,500	1,500
June 28	Cash A/c Discount A/c To Anbu's A/c ((being Cash of Rs.3,900 received from Anbu and discount allowed Rs.50)	Dr Dr	3,900 50	3,950
June 29	Answar's A/c To Cash A/c To Discount A/c ((being Cash of Rs.4,800 paid to Answar and discount allowed by him Rs.100)	Dr	4,900	4,800 100

7.9 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Recording of business transactions is usually done in journal or subsidiary books.
2. Along with the entry in the journal, a complete explanation is written, so that, later it would be possible to understand the entry properly.
3. Ledger folio column is not used at the time of recording of transaction.

4. To write correct journal entry we must check up the following things what aspects are affected?, what class of accounts are they? And which account is to be debited and which one to be credited?

7.10 LESSON-END ACTIVITIES

1. What is journal?

2. What are the advantages of journal?

3. Journalize the following transactions:

2005

- | | | |
|------|----|--|
| Jan. | 1. | Sivalingam started business with Rs.25,000 |
| | 2. | Bought goods from B Rs.20,000 |
| | 3. | Paid into bank Rs.10,000 |
| | 4. | Returned goods to B Rs.1000 |
| | 5. | Sold goods to R Rs.2500 |
| | 6. | Paid cartage Rs.20 |
| | 7. | Received dividend on investment Rs.100 |
| | 8. | Paid salary Rs.250 |

4. Journalize the following transactions in the books of Mr.Subramanian

2001

- | | | |
|------|----|--|
| Apr. | 1 | Started business with cash Rs.40,000 and furniture Rs.10,000. |
| | 5 | Paid tuition fee of the son Rs.1,000 |
| | 8 | Paid household expenses Rs.1,400. |
| | 10 | Sold personal car for Rs.18,000 and the amount is brought into the business. |
| | 15 | Withdrew goods for personal use Rs.2,000. |
| | 16 | Sold goods to Navin on credit Rs.8,000. |
| | 18 | Sold old typewriter Rs.1,000. |
| | 19 | Purchase goods on credit from Ramesh Rs.20,000 |
| | 20 | Received interest on investment Rs.6,000. |
| | 22 | Received commission from Manohar Rs.2,000. |
| | 23 | Receive a cheque from Navin Rs.5,000. |
| | 25 | Issued a cheque to Ramesh Rs.12,000 |
| | 26 | Received cash from Anand on account Rs.4,000 |
| | 27 | Paid cash to Bhagwan on account Rs.1,000. |
| | 28 | Returned goods to Ramesh Rs.1,000. |
| | 29 | Navin returned goods Rs.500. |
| | 30 | Paid rent Rs.1,000. |
| | | Paid salaries Rs.12,000. |

5. Journalise the following transactions in the books of Sabitha .

2000

- | | | | | |
|------|---|------------------------------------|-----|--------|
| Apr. | 1 | Bought goods for cash | Rs. | 15,000 |
| | 3 | Sold goods for cash | Rs. | 19,000 |
| | 5 | Bought goods on credit from Perara | Rs. | 12,000 |
| | 6 | Sold goods on credit to Ravindar | Rs. | 16,000 |

8	Received from Ravindar	Rs.	12,000
10	Paid to Perara	Rs.	7,500
25	Bought furniture for cash	Rs.	4,500

7.11 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

check 1

A short explanation of the transaction is known as narration. It should be adequate to the transaction and may include any data needed to identify the transaction.

check 2

Recording classifying, summarizing and finalizing all business transactions are the important stages in the Accounting cycle.

7.12 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

LESSON – 8

PHASES OF ACCOUNTING – “LEDGER”

Contents

- 8.0 Aims and objectives
- 8.1 Introduction
 - 8.1.1. Ledger
- 8.2 Ruling of ledger account
- 8.3 Sub-division of ledger
 - 8.3.1 Debtors’ Ledger
 - 8.3.2 Creditors’ Ledger
 - 8.3.3 General Ledger
- 8.4 Posting
- 8.5 Procedures of Posting
 - 8.5.1 First part of the Account:
 - 8.5.2 Second part of the other Account
- 8.6 Balancing of an account
- 8.7 Distinction between journal and ledger
- 8.8 Illustrations
- 8.9 Let us sum up
- 8.10 Lesson-End Activities
- 8.11 Model answer to check your progress
- 8.12 References

8.0 AIMS AND OBJECTIVES

In seventh lesson we discussed the Journal and Entry of Journalizing. Here we discuss the meaning of Ledger and how to posting the journals in the ledger accounts. After going through this lesson, you will able to

1. know the meaning of ledger and posting
 2. understand various Sub-division of ledger
 3. know the Distinction between journal and ledger
-

8.1INTRODUCTION

In journal, as all the business transactions are recorded chronologically, it is very difficult to obtain all the transactions pertaining to one head of account together at one place .In this section we attempt to make a brief survey of the Ledger, sub –division of ledger, Posting and Procedures of Posting.

8.1.1. Ledger

Ledger is a main book of account in which various accounts of personal, real and nominal nature, are opened and maintained. The preparation of different ledger accounts helps to get a consolidated picture of the transactions pertaining to one ledger account at a time. Thus, a ledger account may be defined as a summary statement of all the transactions relating to a person, asset, expense, or income or gain or loss which have taken place during a specified period and shows their net effect ultimately. From the above definition, it is clear

that when transactions take place, they are first entered in the journal and subsequently posted to the concerned accounts in the ledger. Posting refers to the process of entering in the ledger the information given in the journal. In the past, the ledgers were kept in bound books. But with the passage of time, they became loose-leaf ones and the advantages of the same lie in the removal of completed accounts, insertion of new accounts and arrangement of accounts in any required manner.

8.2 RULING OF LEDGER ACCOUNT

In this section we presented here a specimen of a ledger account.

Ledger Account

Dr.				Cr.			
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
	To				By		

8.3 SUB-DIVISION OF LEDGER

In a big business, the number of accounts is numerous and it is found necessary to maintain a separate ledger for customers, suppliers and for others. In this section we presented here the three types of ledgers are maintained in such big business concerns.

8.3.1 Debtors' Ledger

It contains accounts of all customers to whom goods have been sold on credit. From the Sales Day Book, Sales Returns Book and Cash Book, the entries are made in this ledger. This ledger is also known as sales ledger.

8.3.2 Creditors' Ledger

It contains accounts of all suppliers from whom goods have been bought on credit. From the Purchases Day Book, Purchases Returns Book and Cash Book, the entries are made in this ledger. This ledger is also known as Purchase Ledger.

8.3.3 General Ledger

It contains all the residual accounts of real and nominal nature. It is also known as Nominal Ledger.

Check your Progress 1

Give the utility of ledger

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.74-75)

.....

.....

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.....

8.4 POSTING

The method of writing from journal to the ledger is called posting or ledger posting.

8.5 PROCEDURES OF POSTING

In this section we presented here the procedures are followed for posting

8.5.1 First part of the Account:

1. Locate in the ledger, the first account named in the journal.
2. Write the date of the transaction, in the date column, in debit-side of that account.
3. Enter in the debit side of the ledger, in particulars column, the name of the account credited with prefix "To"
4. Write in folio column on the debit side of the account, the page number of journal from which the entry is being posted.
5. Entry the amount, on the debit column of the ledger as per journal
6. Similarly, write the ledger page number in the folio column of the journal.

8.5.2 Second part of the other Account:

1. Locate in the ledger, the second account named in the journal.
 2. Write the date of the transaction, in the date column, in credit-side of that account.
 3. Enter in the credit side of the ledger, in particulars column, the name of the account credited with prefix "By"
 4. Write in folio column on the credit side of the account, the page number of journal from which the entry is being posted.
 5. Entry the amount, on the credit column of the ledger as per journal
 6. Similarly, write the ledger page number in the folio column of the journal.
-

8.4 BALANCING OF LEDGER ACCOUNTS

It is customary to balance all ledger accounts at the end of an accounting year. However, any account can be balanced any time, if necessary. In this section we attempt to make a brief explanation about how to balancing of ledger accounts

- (a) Both sides of an account are totaled separately;
- (b) Difference between the totals of both sides is ascertained; and
- (c) The difference is entered on the side on which the total is short. In the particulars column, 'Balance c/d' is written.
- (d) If the left hand side of an account is more, it is called 'Debit balance'. It is written on the right hand side as 'By balance c/d'. If the right hand side is more, it is termed as 'Credit balance'. It is written on the left hand side as 'To Balance c/d'.
- (e) Balances of accounts for expenses, incomes, sales purchases etc., are transferred to Trading & P&L A/c. Balance in personal and real accounts are carried forward to the next year by carrying the balances down. Balance 'c/d' from debit side appears on the credit side as Balance 'b/d and vice versa.

Ledger balances obtained at the end of an accounting year from the basis for finalization of accounts.

Check your Progress 2

Write a note on ‘Account’

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.74-75)

.....

8.5 DISTINCTION BETWEEN JOURNAL AND LEDGER

In this section we pointed out some of the difference between journal and ledger

- (i) Journal is a book of prime entry, whereas ledger is a book of final entry.
- (ii) Transactions are recorded daily in the journal, whereas posting in the ledger is made periodically.
- (iii) In the journal, information about a particular account is not found at one place, whereas in the ledger information about a particular account is found at one place only.
- (iv) Recording of transactions in the journal is called journalising and recording of transactions in the ledger is called posting.
- (v) A journal entry shows both the aspects debit as well as credit but each entry in the ledger shows only one aspect.
- (vi) Narration is written after each entry in the journal but no narration is given in the ledger.
- (vii) Vouchers, receipts, debit notes, credit notes etc., from the basic documents form journal entry, whereas journal constitutes basic record for ledger entries.

8.6 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to posting the journal entries to the ledger accounts.

Illustration1.

Journalise the following transactions, post the same in relevant ledger account and balance the same.

1998

- June 1 Karthik commenced business with Rs.20,000.
- 2 Paid into bank Rs.5,000 from Anwar.
- 3 Purchased Plant worth Rs.10,000 from Modi & Co.
- 4 Purchased goods worth Rs. 5,000 form Anwar.
- 6 Goods worth Rs.4,000 sold to Anbu
- 8 Sold goods worth Rs.2,000 for cash.
- 10 Goods returned by Anbu Rs.50.
- 15 Paid rent Rs.250.
- 18 Withdrawn from bank for office use Rs. 2,500.
- 20 Paid Salaries Rs.1,800.
- 25 Withdrawn for persona use Rs.250.
- 26 Goods returned to Anwar Rs.100.

- 27 Paid for office furniture Rs.1,500 by cheque.
 28 Received Rs.3,900 cash from Anbu and discount allowed Rs.50.
 29 Paid Answer on account Rs.4,800 and discount allowed by him Rs.100.

Solution

Journal entries in the book of Mr Karthik

Date	Particular	L.F.	Dr. Rs.	Cr. Rs.
1998 June 1	Cash A/c To Karthik's Capital A/c ((being Capital brought into the business)	Dr	20,000	20,000
June 2	Bank A/c To Cash A/c ((being Cash Paid into Bank)	Dr	5,000	5,000
June 3	Plant A/c To Modi & Co's. A/c ((being Plant purchased from Modi & Co.)	Dr	10,000	10,000
June 4	Purchase A/c To Anwar's A/c ((being Goods purchased from Anwar)	Dr	5,000	5,000
June 6	Anbu's A/c To Sales A/c ((being Goods sold to Anbu)	Dr	4,000	4,000
June 8	Cash A/c To Sales A/c ((being Goods sold for cash)	Dr	2,000	2,000
June 10	Sales Returns A/c To Anbu's A/c ((being Goods returned by Anbu)	Dr	50	50
June 15	Rent A/c To Cash A/c ((being Payment of as rent)	Dr	250	250
June 18	Cash A/c To Bank A/c ((being Withdrawn from bank for office use)	Dr	2,500	1,800
June 20	Salaries A/c To Cash A/c ((being Payment of salaries)	Dr	1,800	1,800
June 25	Drawing A/c To Cash A/c ((being Withdrawn for personal use)	Dr	250	250
June 26	Anwar's A/c To Purchases Returns A/c ((being Goods returned to Anwar)	Dr	100	100
June 27	Furniture A/c	Dr	1,500	

	To Bank A/c ((being Payment of Rs.1,500 by cheque for office furniture)			1500
June 28	Cash A/c Discount A/c To Anbu's A/c ((being Cash of Rs.3,900 received from Anbu and discount allowed Rs.50)	Dr Dr	3,900 50	3,950
June 29	Answar's A/c To Cash A/c To Discount A/c ((being Cash of Rs.4,900 paid to Answar and discount allowed by him Rs.100)	Dr	4,9000	100 4,800

Ledger Accounts in the book of Mr Karthik's

Dr				Cr			
Cash A/c							
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
1998 June 1	To Karthik's Capital A/c		20,000	1998 June 2	By Bank A/c		5,000
8	To Sales A/c		2,000.	15	By Rent A/c		250
18	To Bank A/ c		2,500	20	By Salaries A/c		1,800
28	To Anbu's A/c		3,900	25	By Drawings A/c		250
				29	By Anwar's A/c		4,800
				30	By Balance c/d		16,300
			28,400				28,400
July1	To Balance B/d		16,300				

Bank A/c

Dr.				Cr.			
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
1998 June 2	To Cash A/c		5,000	1998 June 18	By Cash A/c		2,500
				June 27	By Furniture A/c		1,500
				June 30	By Balance C/d		1,000
			5,000				5,000
July 1	To Balance b/d		1,000				

Karthik's Capital A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		20,000	June	1	By Cash A/c		20,000
				<u>20,000</u>					<u>20,000</u>
					July	1	By Balance b/d		20,000

Plant A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	3	To Modi & Co's. A/c		10,000	June	30	By Balance c/d		10,000
				<u>10,000</u>					<u>10,000</u>
July	1	To Balance c/d		10,000					

Modi & Co's. A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance c/d		10,000	June	3	By Plant A/c		10,000
				<u>10,000</u>					<u>10,000</u>
					July	1	By Balance b/d		10,000

Purchase A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	4	To Anwar's A/c		5,000	June	30	By Balance C/d		5,000
				<u>5,000</u>					<u>5,000</u>
July	1	To Balance b/d		5,000					

Anwar's A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	26	To Purchases		100	June	4	By Purchases		5,000
		Returns A/c					A/c		
June	29	To Cash A/c		4,800					
June	29	To Discount		100					
		A/c							
				<u>5,000</u>					<u>5,000</u>

Sales A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance		6,000	June	6	By Anbu's		4,000
		c/d					A/c		
					June	8	By Cash A/c		2,000
				6,000					
				<u>6,000</u>					<u>6,000</u>
					July	1	To Balance		6,000
							b/d		

Anbu's A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	6	To Sales A/c		4,000	June	10	By Sales		50
							Returns A/c		
					June	28	By Cash A/c		3,900
					June	28	By Discount		50
							A/c		
				<u>4,000</u>					<u>4,000</u>

Purchases Returns A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	30	To Balance		100	June	26	By Anwar's		100
		c/d					A/c		
				100					
				<u>100</u>					<u>100</u>
					July	1	By Balance		100
							b/d		

Sales Returns A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	10	To Anbu's A/c		50	June	30	By Balance		50
				50					50
July	1	To Balance b/d		50					

Furniture A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	27	To Bank A/c		1,500	June	30	By Balance c/d		1,500
				1,500					1,500
July	1	To Balance b/d		1,500					

Discount A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	28	To Anbu's A/c		50	June	29	By Anwar's A/c		100
June	30	To Balance c/d		50					10,000
				100	July	1	By Balance b/d		100
									50

Drawings A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	25	To Cash A/c		250	June	30	By Balance c/d		250
				250					250
July	1	To Balance b/d		250					

Rent A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	15	To Cash A/c		250	June	30	By Balance c/d		250
				250					250
July	1	To Balance b/d		250					

Salaries A/c

Dr.				Cr.					
Date		Particulars	J.F.	Rs.	Date		Particulars	J.F.	Rs.
1998					1998				
June	20	To Cash A/c		1,800	June	30	By Balance c/d		1,800
				1,800					1,800
July	1	To Balance b/d		1,800					1,800

8.7 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. The ledger is the principle book of accounts where similar transactions relating to a particular person or thing are recorded.
2. Each journal entry involves two accounts, one is debited and the other is credited.
3. The balance is an accounting term which means the difference between the two sides of an account.
4. Journal is a book of prime entry, whereas ledger is a book of final entry.
5. Transaction are recorded daily in the journal, whereas posting in the ledger is made periodically.

8.10 LESSON-END ACTIVITIES

1. Explain the significance of Ledger
2. Explain the meaning of journalizing, posting, Balancing, debiting and crediting.
3. Distinguish between 'Journal' and 'Ledger'

8.11 MODEL ANSWERS TO "CHECK YOUR PROGRESS"**Check 1**

A ledger is the most important book of any organization. As the various transactions pertaining to an account are recorded on one page of the ledger, a clear idea about the net result of a group of transactions can be obtained from the ledger at a glance. The amount due from a customer or the amount due to a supplier can be ascertained at any time from the ledger.

Check 2

It is a statement of the various dealing which occurs between a customer and the firm. It can be also being expressed as a clear and concise record of the transaction relating to a person or a firm or a property or a liability or an expense or an income. An account is usually in the 'T' format and contains two sides-the left hand side called 'debit side' and the right hand side called 'credit side'. The heading mentions the name of the account. On both sides of the account, date column is maintained.

When an entry is written on the left hand side of an account, it is called 'Debiting'. When an entry is made on the right hand side of an account, it is known as 'Crediting'. All the accounts must be 'debited and credited for relevant transactions as per the rules for debiting and crediting.

8.12 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

LESSON – 9

PHASES OF ACCOUNTING – “TRIAL BALANCE”

Contents

- 9.0. Aims and objectives
 - 9.1. Introduction
 - 9.1.1. Meaning
 - 9.1.2. Definition
 - 9.2. Objectives of preparing a Trail Balance
 - 9.3. Features of Trail Balances
 - 9.4. Limitations of Trail Balance
 - 9.5. Methods of preparing Trail Balance
 - 9.5.1. Total method
 - 9.5.2. Balance Method
 - 9.6 Ruling of a trail balance
 - 9.7 Errors disclosed by the Trial Balance
 - 9.8. Errors not disclosed by the Trail Balance
 - 9.9 Let us sum up
 - 9.10 Lesson-End Activities
 - 9.11 Model answer to check your progress
 - 9.12 References
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9.0. AIMS AND OBJECTIVES

In eighth lesson we discussed the meaning and method of posting in details. Here we discuss the meaning and method of preparing Trial balance. After going through this lesson, you will able to

1. know the meaning and definition of Trial Balance
 2. understand the objectives, features and limitations of trail balance
 3. learn the methods of preparing trial balance.
-

9.1. INTRODUCTION

According to the dual aspect concept, the total of debit balance must be equal to the credit balance. It is a must that the correctness of posting to the ledger accounts and their balances be verified. This is done by preparing a trail balance. In this section, we present here brief explanations about meaning and definition of Trial balance.

9.1.1 Meaning

Trial balance is a statement prepared with the balances or total of debits and credits of all the accounts in the ledger to test the arithmetical accuracy of the ledger accounts. As the name indicates it is prepared to check the ledger balances. If the total of the debit and credit amount columns of the trail balance are equal, it is assumed that the posting to the ledger in terms of debit and credit amounts is accurate. The agreement of a trail balance ensure arithmetical accuracy only, A concern can prepare trail balance at any time, but its preparation as on the closing date of an accounting year is compulsory.

9.1.2 Definition

According to M.S. Gosav (The Substance of Accountancy) “Trail balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings”.

9.2 OBJECTIVES OF PREPARING A TRAIL BALANCE

Trial balance is prepared to check arithmetic accuracy. In this section we present the main objectives of Trial balance.

- (i) It gives the balances of all the accounts of the ledger. The balance of any account can be found from a glance from the trail balance without going through the pages of the ledger.
- (ii) It is a check on the accuracy of posting. If the trail balance agrees, it proves that both the aspects of each transaction are recorded and that the books are arithmetically accurate.
- (iii) It facilitates the preparation of profit and loss account and the balance sheet.
- (iv) Important conclusions can be derived by comparing the balances of two or more than two years with the help of trail balances of those years.

9.3 FEATURES OF TRIAL BALANCES

In this section we present the main features of Trial balance.

- (i) A trial balance is prepared as on a specified date.
- (ii) It contains a list of all ledger accounts including cash account.
- (iii) It may be prepared with the balances or totals of Ledger accounts.
- (iv) Total of the debit and credit amount columns of the trial balance must tally.
- (v) If the debit and credit amounts are equal, we assume that ledger accounts are arithmetically accurate.
- (vi) Difference in the debit and credit columns points out that some mistakes have been committed.
- (vii) Tallying of trail balance is not a conclusive proof of accuracy of accounts.

Check your Progress 1

List out the objectives of Trial balance

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 89)

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9.4 LIMITATIONS OF TRAIL BALANCE

In this section we present the important limitations Trial balance.

- (i) The trail balance can be prepared only in those concerns where double entry system of book- keeping is adopted. This system is too costly.
- (ii) A trail balance is not a conclusive proof of the arithmetical accuracy of the books of account. If the trail balance agrees, it does not mean that now there are absolutely no errors in books. On the other hand, some errors are not disclosed by the trail balance.
- (iii) If the trail balance is wrong, the subsequent preparation of Trading, P&L Account and Balance Sheet will not reflect the true picture of the concern.

9.5 METHODS OF PREPARING TRAIL BALANCE

A trail balance refers to a list of the ledger balances as on a particular date. It can be prepared in the two manners. In this section we present the important methods of preparing Trial balance

9.5.1 Total method

According to this method, debit total and credit total of each account of ledger are recorded in the trail balance.

9.5.2 Balance Method

According to this method, only balance of each account of ledger is recorded in trail balance. Some accounts may have debit balance and the other may have credit balance. All these debit and credit balances are recorded in it. This method is widely used.

9.6 RULING OF A TRAIL BALANCE

In this section we present the form of a trail balance.

9.6.1 Total Method

Trail Balance as on.....

S.No.	Name of Account	L.F	Debit Total Amount Rs.	Credit Total Account Rs.

9.6.2 Balance Method

Trail Balance as on.....

S.No.	Name of Account	L.F	Debit balance Rs.	Credit balance Rs.

Note: Accounts of all assets, expenses, losses and drawings are debit balances. Accounts of incomes, gains, liabilities and capital are credit balances

Check your Progress 2

Indicate whether the following statements are True or False:

1. Wages paid for erection of machinery should be debited to trial balance.
2. The trial balance is prepared to ascertain the financial position of a business concern.
3. When the total amount of trial balance agree, we can assume that there is no error in the accounts.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 89)

.....

9.7 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to prepare trial balance

Illustration 1 Prepare a trial balance of Mr Pramasivam as on March 31, 2006.

	Rs.		Rs.
Capital	9,20,000	Cash at bank	1,45,340
Creditors	1,88,520	Bills receivable	58,440
Bills payable	69,300	Purchases	8,55,220
Sales	12,18,500	Carriage inwards	12,910
Prov. for doubtful debts	13,200	Carriage outwards	8,000
Interest (Cr.)	3,400	General expenses	60,850
Buildings	7,00,000	Insurance	7,830
Machinery	1,20,000	Bad debts	6,130
Furniture	16,400	Audit fees	4,000
Debtors	1,56,000	Travelling expenses	3,250
Opening stock	1,50,400	Discounts (Dr.)	6,200
Cash in hand	9,880	Sales returns Investments	89,220

Solution

Trial Balance as on March 31, 2006

	Dr.	Cr.
	Rs.	Rs.
Capital		9,20,000
Creditors		1,88,520
Bills payable		69,300
Sales		12,18,500
Provision for doubtful debts		13,200
Interest		3,400
Building	7,00,000	
Machinery	1,20,000	
Furniture	16,400	
Debtors	1,56,000	

Opening stock	1,50,400	
Cash in hand	9,880	
Cash at bank	1,45,340	
Bills receivable	58,440	
Purchases	8,55,220	
Carriage inwards	12,910	
Carriage outwards	8,000	
General expenses	60,850	
Insurance	7,830	
Bad debts	6,130	
Audit fees	4,000	
Travelling expenses	3,250	
Discount	6,200	
Sales returns	2,850	
Investments	89,220	
Total	24,12,920	24,12,920

Illustration 2

The following Trail balance has been prepared wrongly. You are asked to prepare the Trail balance correctly.

	Dr.	Cr.
	Rs.	Rs.
Capital	22,000	
Stock		10,000
Debtors	8,000	
Creditors		12,000
Machinery		20,000
Cash in hand		2,000
Bank overdraft	14,000	
Sales returns		8,000
Purchases returns	4,000	
Misc. expenses	12,000	
Sales		44,000
Purchases	26,000	
Wages	10,000	
Salaries		12,000
Prepaid insurances		200
Bills payable	10,800	
Outstanding salaries	1,400	
Total	1,08,200	1,08,200

Solution**Corrected Trial Balance as at....**

	Dr.	Cr.
	Rs.	Rs.
Capital		22,000
Stock	10,000	
Debtors	8,000	
Creditors		12,000
Machinery	20,000	
Cash in hand	2,000	
Bank overdraft		14,000
Sales returns	8,000	
Purchases returns		4,000
Misc. expenses	12,000	
Sales		44,000
Purchases	26,000	
Wages	10,000	
Salaries	12,000	
Prepaid insurances	200	
Bills payable		10,800
Outstanding salaries		1,400
Total	1,08,200	1,08,200

Illustration 3

A book-keeper submitted to you the following Trail Balance, which he has not been able to agree. Rewrite the Trial Balance, correcting the mistakes committed by him.

	Dr.	Cr.
	Rs.	Rs.
Capital		15,000
Drawings	3,250	
Stock (1-1-2006)	17,445	
Return inwards		554
Carriage inwards	1,240	
Deposit with Anand Gupta		1,375
Return outwards	840	
Carriage outwards		725
Loan to Ashok @ 5% given on		1,000
Interest on the above		25
Rent	820	
Rent outstanding	130	
Stock (31-12-2006)		18,792
Purchases	12,970	
Debtors	4,000	
Goodwill	1,730	
Creditors		3,000

Advertisement expenses	954	
Provision for doubtful debts		1,200
Bad debts	400	
Patents and patterns	500	
Cash	62	
Sales		27,914
Discount allowed		330
Wages	754	
Total	45,095	69,915

Solution**Corrected Trail Balance as at 31st December 2006**

	Dr.	Cr.
	Rs.	Rs.
Capital		15,000
Drawings	3,250	
Stock (1-1-2006)	17,445	
Return inwards	554	
Carriage inwards	1,240	
Deposit with Anand Gupta	1,375	
Return outwards		840
Carriage outwards	725	
Loan to Ashok @ 5% given on	1,000	
Interest on the above		25
Rent	820	
Rent outstanding		130
Stock (31-12-2006)	12,970	
Purchases	4,000	
Debtors	1,730	
Goodwill		3,000
Creditors	954	
Advertisement expenses		1,200
Provision for doubtful debts	400	
Bad debts	500	
Patents and patterns	62	
Cash		27,914
Sales		
Discount allowed	330	
Wages	754	
Total	18,109	48,109

Note: Closing stock is an adjustment, so it has not been taken in the Trial balance.

Illustration 4

From the following transactions, pass journal entries, prepare ledger accounts and also prepare Trial Balance under (i) Balance method (ii) Total method.

		Rs.
1.	Anil started business with	8,000
2.	Purchased furniture	1,000
3.	Purchased goods	6,000
4.	Sold goods	7,000
5.	Purchased from Raja	4,000
6.	Sold to Somu	5,000
7.	Paid to Raja	2,500
8.	Received from Somu	3,000
9.	Paid rent	200
10.	Received commission	100

Solution**Journal Entries**

Particulars		L.F	Dr Rs.	Cr Rs.
Cash A/c	Dr.		8,000	8,000
To Capital A/c				
[being Started business]				
Furniture A/c	Dr.		1,000	
To Cash A/c				1,000
[being Purchased furniture]				
Purchases A/c	Dr.		6,000	
To Cash A/c				6,000
[being Purchased goods]				
Cash A/c	Dr.		7,000	
To Sales A/c				7,000
[being Sold goods for cash]				
Purchases A/c	Dr.		4,000	
To Raja A/c				4,000
[being Purchased goods]				
Somu A/c	Dr.		5,000	
To Sales A/c				5,000
[being Sold goods on credit]				
Raja A/c	Dr.		2,500	
To Cash A/c				2,500
[being Paid cash]				
Cash A/c	Dr.		3,000	
To Somu A/c				3,000
[being Received from Somu]				
Rent A/c	Dr.		200	
To Cash A/c				200
[being Paid rent]				
Cash A/c	Dr.		100	
To Commission received A/c (being				
[Received commission]				100

Cash Account

Dr		Cr	
	Rs.		Rs.
To Capital	8,000	By Furniture	1,000
To Sales	7,000	By Purchases	6,000
To Somu	3,000	By Raja	2,500
To Commission	100	By Rent	200
		By Balance c/d	8,400
	18,100		18,100
To Balance b/d	8,400		

Capital Account

Dr		Cr	
	Rs.		Rs.
To Balance	8,000	By Cash	8,000
	8,000		8,000
		By Balance b/d	8,000

Furniture Account

Dr		Cr	
	Rs.		Rs.
To Cash	1,000	By Balance c/d	1,000
	1,000		1,000
By Balance b/d	1,000		

Purchase Account

Dr		Cr	
	Rs.		Rs.
To Cash	6,000	By Balance c/d	10,000
To Raja	4,000		10,000
	10,000		
To Balance b/d	10,000		

Sales Account

Dr		Cr	
	Rs.		Rs.
To Balance	12,000	To Cash	7,000
		To Somu	5,000
	12,000		12,000
		By Balance b/d	12,000

Raja's Account

Dr		Cr	
To Cash	Rs. 2,500	By Purchase	Rs. 4,000
To Balance c/d	1,500		
	4,000		4,000
		By Balance b/d	1,500

Somu's Account

Dr		Cr	
To Sales	Rs. 5,000	By Cash	Rs. 3,000
		By Balance c/d	2,000
	5,000		5,000
By Balance b/d	2,000		

Rent Account

Dr		Cr	
To Cash	Rs. 200	By Balance c/d	Rs. 200
	200		200
To Balance b/d	200		

Commission received Account

Dr		Cr	
To Balance c/d	Rs. 100	By Cash	Rs. 100
	100		100
		By Balance c/d	100

I. Balance Method**Trail balance as on.....**

	Dr. (Rs.)	Cr. (Rs.)
Cash	8,400	
Capital	-	8,000
Furniture	1,000	-
Purchases	10,000	-
Sales	-	12,000
Raja	-	1,500
Somu	2,000	-
Rent	200	-
Commission received		100
	21,600	21,600

II. Total Method**Trial balance as on.....**

	Dr. (Rs.)	Cr. (Rs.)
Cash	18,100	9,700
Capital	-	8,000
Furniture	1,000	-
Purchases	10,000	-
Sales	-	12,000
Raja	2,500	4,000
Somu	5,000	3,000
Rent	200	-
Commission received	-	100
	36,800	36,800

9.10 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Trial balance is a statement containing the balances of all ledger accounts as at any given date.
2. It is prepared to ascertain arithmetical accuracy of ledger accounts.
3. Trial balance can be prepared by two different methods i) Balance method and ii) Total method.
4. Total of the debit and credit amount columns of the trial balance must tally. Disagreement of trial balance is mainly due to errors.

9.11 LESSON-END ACTIVITIES

1. Explain the meaning and objectives of Trial Balance
2. What are the different methods of preparing Trial Balance?
3. Name the errors which do not affect the Trial Balance.
4. From the following ledger accounts of Podder, draw Trial Balance as on 31st Dec 2004.

	Rs.		Rs.
House Property	45,000	Repairs	1,200
Furniture	5,000	Rent Received	4,800
Utensils	6,000	Medical Expenses	1,200
Ornaments	25,000	School Fee	1,800
Cash	630	Conveyance	1,350
Bank Balance:		Cosmetics	1,150
Fixed Deposits	20,000	Interest Received	3,000

Savings Bank	3,500	House Loan from Govt.	20,000
Shares & Govt. Securities	12,000	Interest paid	1,870
Claims against persons	1,500	Municipal Taxes	3,000
Salary (Income)	24,000	Income-tax	2,500
Servants wages	1,200	Accumulated Fund	88,300
Food and Drink	3,750		
Dress and Clothings	2,40		

[Ans. total of Trail Balance: Rs. 1,40,100]

5. The following Trail Balance was extracted from the books of a Merchant, although the columns are agreed, yet they are incorrect. You are required to correct and redraft it.

	Dr.		Cr.
Premises	30,000	Capital	36,800
Machinery	8,500	Fixtrues	2,800
Bad Debts	1,400	Sales	52,000
Returns Outwards	1,300	Debtors	30,000
Cash	200	Interest Received	1,300
Discount Received	1,500		
Bank Overdraft	5,000		
Creditors	25,000		
Purchases	50,000		
	1,22,900		1,22,900

[Ans. T.B. Rs. 1,22,900]

6. Correct the following Trail balance:

	(Dr.) Rs.		(Cr.) Rs.
Return Outwards	16,000	Debtors	15,000
Opening Stock	34,200	Carriage Outwards	5,000
Salaries	12,000	Capital	55,200
Creditors	28,000	Machinery	18,000
Bank	45,000	Returns Inward	3,000
Carriage Inwards	6,000	Discount Received	4,000
Rent Received	3,000	Trade Expenses	6000
Discount allowed	2,000	Building	20,000
Purchases	1,00,000	Sales	1,40,000
Bills Payable	20,000		
	2,66,200		2,66,200

[Ans. Correct Total of Trail Balance Rs.,2,66,200]

7. Mr. Blank, a client of your with whom book-keeping is not a strong point, ask you to audit his accounts for the year ended 31st December 2004, upon which data his Closing Stock was values at Rs.574.

As a basis for your audit Blank furnishes you with the following statements:

	Dr.	Cr.
	Rs.	Rs.
Blank Capital	-	1,556
Blank Drawings	564	-
Leasehold Premises	741	-
Sales	-	2,756
Due from Customers	-	530
Purchases	1,268	-
Purchases Return	264	-
Loan form Bank	-	250
Creditors	528	-
Trade Expenses	784	-
Cash at Bank	142	-
Bills Payable	100	-
Salaries & Wages	598	-
Stock (1 st January)	-	264
Rent, Rates, etc.	465	-
Sales Return	-	98
	5,454	5,454

[Ans. Correct total of the Trail Balance Rs.5,454]

- 9 The under mentioned balances were extracted from the books of Sri Kumar as on 31st March 2005. You are asked to prepare a Trail Balance as on that date.

	Rs.
Capital	78,000
Stock 1.4.2004	5,000
Leasehold Premises	46,00
Furniture & Fittings	13,500
Plant & Machinery	35,000
Purchases	78,900
Sales	1,30,620
Discount Received	470
Discount Allowed	540
Carriage Inwards	120
Carriage Outwards	230
Returns Inward	1,500
Returns Outward	380
Wages and Salaries	17,680
Rates and Taxes	1,370

Rent Received	530
Sundry Expenses	1,660
Trade Creditors	22,760
Book Debts	34,000
Drawings	3,000
Bills Payable	1,140
Cash in hand	1,200
Bank Loan	5,800
Closing Stock	3,900

[Ans. Total of Trial Balance Rs.2,39,700]

9.11 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check 1

- 1.to help in locating errors
- 2.to help in preparation of final accounts
- 3.summary of each account.
- 4.to ascertain arithmetical accuracy of ledger accounts.

Check 2

- 1.true 2.fales 3.fales
-

9.13 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

UNIT - III
Lesson 10
PREPARATION OF CASH BOOK

Contents

- 10.0 Aims and Objectives
 - 10.1 Introduction
 - 10.2 Kinds of Cash Book
 - 10.3 Preparation of cash book
 - 10.3.1 Single or Simple Column Cash Book
 - 10.3.2 Two Column Cash Book
 - 10.3.3 Three Columnar Cash Book
 - 10.3.3(a) Contra Entries
 - 10.3.4 Cash Book with Bank and Discount Columns
 - 10.3.5 Petty Cash Book
 - 10.2.5 (a) Columnar Petty Cash Book or analytical Petty Cash Book
 - 10.4 Illustrations
 - 10.4 Let us Sum Up
 - 10.5 Lesson-End Activities
 - 10.6 Model answer to check your progress.
 - 10.7 References
-

10 AIMS AND OBJECTIVES

In ninth lesson we discussed the meaning of trial balance and method of preparing trial balance in details. Here we discuss the meaning cash book its various kinds. After going through this lesson, you will be able to

1. know the meaning of cash book
 2. understand the various types of cash book.
 3. learn the methods of preparing cash book.
-

10.1 INTRODUCTION

Cash Book is a sub-division of Journal recording transactions pertaining to cash receipts and payments. Firstly, all cash transactions are recorded in the Cash Book wherefrom they are posted subsequently to the respective ledger accounts. The Cash Book is maintained in the form of a ledger with the required explanation called as narration and hence, it plays a dual role of a journal as well as ledger. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side. All cash transactions are recorded chronologically in the Cash Book. The Cash Book will always show a debit balance since payments cannot exceed the receipts at any time.

10.2 KINDS OF CASH BOOK

We present here a brief account of different kinds of cash book

1. Single Column Cash Book
 2. Two Column Cash Book or Cash Book with cash and discount columns.
 3. Three Columnar Cash Book or Cash Book with cash, bank and discount columns.
 4. 'Bank' Cash Book or Cash Book with bank and discount columns.
 5. Petty Cash Book.
-

10.3 PREPARATION OF CASH BOOK

In this section, we attempt to make a brief explain of the different types of cash books.

10.3.1 Single or Simple Column Cash Book

Single Column Cash Book: This is the simplest form of Cash Book. This type of cash book makes a record of all the receipts and payment of cash- coin, notes, cheques, bank drafts, etc. Usually no cash discount is allowed or received. But, when transactions involving discounts are effected, it is recorded in a separate ledger account. The ruling of Single Column Cash Book is as follows:

Single Column Cash Book									
Dr.					Cr.				
Date	Particulars	R.No.	L.F.	Rs.	Date	Particulars	R.No.	L.F.	Rs.

From the above it can be observed that the Single Column Cash Book is just like a ledger account. When cash is received, it is recorded on the debit side, i.e., 'Receipts Side' of the Cash Book, with the date on which the transaction is effected, in the 'Date Column', the name of the party or the head of a nominal account, from whom or for which the cash has been received, in the 'Particulars Column', the receipt number, with which the cash has been received by the cashier, in the 'R. No. Column and the money value of the transaction in the 'Amount Column' respectively. The L.F. (Ledger Folio) column is for entering the reference ledger folio number when posting to the ledger is made.

Similarly when payment of cash is made, it is recorded on the credit side, i.e., "Payments Side" of the Cash Book, with the date in the 'Date Column', the name of the party or head of a nominal account in the 'Particulars Column', the voucher number in the 'V. No. Column', and the money value of the transaction in the 'Amount Column' respectively. The voucher represents the supporting document for all cash payments effected.

10.3.2 Two Column Cash Book or Cash Book with Cash and Discount Columns

This type of Cash Book is used when cash transactions involving discount allowed or received are effected. Usually, discount is allowed when payments are promptly made by the customers and discount is enjoyed when payments are promptly made by the business. In this two column Cash Book, instead of only one column for cash as in a Single Column Cash Book, one additional column is introduced, viz., 'Discount Column'. The discounts allowed

by the business are entered on the debit side and discounts received are entered on the credit side of the Cash Book. The discount columns as such cannot be balanced since they are purely memorandum columns and will not serve the purpose of a ledger account as cash columns do. To know the balance of discount columns, separate ledger accounts, viz., Discount Allowed Account and Discount Received Account can be opened. The ruling of a two column Cash Book is as follows.

Two Column Cash Book (with Cash and Discount Columns)

Dr.						Cr.					
Date	Particulars	R. No.	L. F	Discount allowed	Rs	Date	Particulars	R .No	L. F	Discount received	Rs

10.3.3 Three Columnar Cash Book or Cash Book with Cash, Bank and Discount Columns:

Nowadays, every businessman invariably has a bank account to reap the advantages of safety, convenience, credit facilities and less clerical work. Thus, when a business is maintaining a bank account, the transactions can be made through cheques. Instead of maintaining the bank account in the ledger, it is found more convenient if it is included in the Cash Book as Cash Column. Thus, the three columnar Cash Book is the resultant effect where in addition to cash and discount columns, bank column is also included. The ruling of a three columnar cash book is as follows:

Three Columnar Cash Book (with Cash, Bank and Discount Columns)

Dr.							Cr.						
Date	Particulars	R No.	L.F.	Discount allowed Rs.	Cash Rs.	Bank Rs.	Date	Particulars	V.No.	L.F.	Discount received Rs.	Cash Rs.	Bank Rs.

All cash receipts are entered on the debit side in the cash column and all cash payments on the credit side in the cash column of the Cash Book. Amounts paid into the bank or deposited are recorded on the debit side in the bank column and all payments made by cheques are recorded on the credit side in the bank column.

10.3.3 (a) Contra Entries

For any single transaction the same account cannot be debited and credited. But since cash and bank accounts are maintained in the cash book, the debit and credit may be found in the two different accounts in the Cash Book. They are transactions which affect both the sides of the Cash Book. For instance, when cash is deposited into the bank, bank account should be debited and cash account should be credited. Hence, on the debit side of the Cash Book, 'To Cash' is written in the particulars column and the amount is entered in the bank column. Similarly, on the credit side of the Cash Book, 'By Bank' is written in the particulars column and the amount is entered in the cash column.

When cash is withdrawn from the bank, on the debit side of the Cash Book, 'To Bank' is written in the particulars column and the amount is written in the cash column. Likewise, on the credit side of the Cash Book, 'By Cash' is written in the particulars column and amount is entered in the bank column. Therefore, those entries which appear on both the

sides of the Cash Book are called Contra Entries and they are identified and denoted in the Cash Book itself by writing the letter 'C' in the Ledger Folio Columns on either side. For these transactions, as double entry procedure is completed in the cash book itself, no further positing is made in the ledger.

In a three columnar Cash Book, cash and bank columns are balanced as any other ledger account and discount columns are imply totaled. To know the balance of the discount columns, a separate account, viz., discount account is opened in the ledger. While the cash column will always show a debit balance, the bank column may show a credit balance at times. The credit balance in the bank column represents nothing but bank overdraft.

10.3.4 'Bank' Cash Book or Cash Book with Bank and Discount Columns:

In case of a business where all transactions are effected through bank, i.e., all receipts are banked (deposited into the bank) on the same day and all payments are made by cheques only, the cash column in the cash book is of no use. Hence, the Cash Book with bank and discount columns alone is maintained. The ruling of a Cash Book with bank and discount column is as follows:

Two Column Cash Book (with Bank and Discount Columns)

Dr.						Cr.					
Date	Particulars	R.No.	L.F.	Discount allowed	Bank Rs.	Date	Particulars	V.No.	L.F.	Discount received	Bank Rs.

10.3.5 Petty Cash Book

The word 'petty' has its origin from the French word 'petit' which means small. The petty cash book is used to record items like carriage, cartage, entertainment expenses, office expenses, postage and telegrams, stationery, etc. The person who maintains this book is called the 'petty cahsier'. The petty cash book is used by many business concerns to save the much valuable time of the senior official, who usually writes up the main cash book, to prevent over burdening of the main cash book with so many petty items and to find out readily and easily information about the more important transactions.

The amount required to meet out various petty items is estimated and given to the petty cashier at the beginning of the stipulated period say a fortnight or a month. When the petty cashier finds shortage of money, he has to submit the petty cash book, after making all the entries, to the chief cashier for necessary verifications. The chief cashier in turn, verifies all the entries with supporting vouchers and disburses cash or issues cheque for the exact amount spent.

10.3.5.(a) Columnar Petty Cash Book or analytical Petty Cash Book

In this cash book various items of petty cash payments are analysed and separate analytical columns are provided for recording each and every item. The amount of cash received from the chief cashier for meeting out the petty expenses is recorded on the debit side and the actual cash payments towards various petty items are recorded on the credit side in the total as well as analytical columns.

The analytical column is provided for each usual head of expense like postage & telegrams, printing & stationery, carriage & cartage, traveling expenses, entertainment expenses, office expenses, sundry expenses, etc. Subsequently, the totals of these analytical

columns are posted to the respective ledger accounts which save labour used in posting each item of payment separately in the ledger. The balancing of petty cash book is done in the total payments column.

Where the debit side (Receipts) exceeds that of the credit side (in the totals column- Payments), it represents the unspent balance of cash remaining with the petty cashier.

Check your Progress 2

When you prepare triple column cash book Give journal entries for the following transactions.

1. When a cheque is received on a particular day and the same is deposited into bank on a later day.
2. When a bearer cheque is received but not encashed or deposited into bank on the same day.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.100)

- 1.....
 2.....

10.4 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to prepare different types of cash book.

Illustration1

Enter the following transactions in a Single Column Cash Book and post the same in the relevant ledger accounts.

1998		Rs.
July	1 Cash on hand	2,000
	2 Goods purchased for cash	700
	3 Paid Carriage Inwards	70
	4 Cash Sales	600
	5 Paid Salaries	1,100
	6 Cash received from Shankar	1,100
	10 Sale of old machinery	800
	12 Cash Sales	700
	14 Goods purchased from Kamal & Co. on credit	600
	16 Goods sold to Sathyan on credit	500
	18 Stationery purchased	400
	19 Lent to Vignesh	120
	20 Received from Dinesh	150
	22 Withdrawn from business for private use	140
	23 Cash Sales	150
	24 Paid fro repairs	60
	25 Paid Rent	150
	31 Vignesh repaid his loan	120

Solution**Single Column Cash Book**

Dr.					Cr.				
Date	Particulars	R. No	L.F	Rs.	Date	Particulars	V. No	L. F.	Rs.
1998					1998				
July					July				
1	To Balance b/d			2,000	2	By Purchases A/c			700
4	To Sales A/c			600	3	By Carriage Inwards A/c			70
6	To Shankar's A/c			1,100	5	By Salaries A/c			1,100
10	To Machinery A/c			800	18	By Stationery A/c			400
12	To Sales A/c				19	By Vignesh's A/c			120
20	To Dinesh's A/c			150	22	By Drawings A/c			140
23	To Sales A/C			150	24	By Repairs A/c			60
31	To Vignesh;s A/c			120	25	By Rent A/c			150
					31	By Balance c/d			2,880
				5,602					0
									5,620
Aug 1	To Balance b/d			2,880					

Note: The transactions effected on July 14 & 16 represent credit transactions and hence not entered in the Cash Book.

Illustration 2

Enter the following transactions in a two column Cash Book and prepare discount account in the ledger

1998		Rs.
July	1 Cash on Hand	1,200
	2 Received from Naushad	3,900
	Allowed him discount	100
	5 Purchased goods for cash	4,100
	7 Paid to Metha	850
	Discount allowed by him	50
	9 Cash Sales	4,900
	11 Withdrew from bank	5,500
	15 Credit purchase from Yusuf	3,000
	21 Paid to Yusuf in full settlement	2,800

22	Received from Kurien	1,250
	Allowed him discount	50
23	Drew Cheque for office use	200
25	Paid office rent	800
28	Received interest on investments	3,000
31	Paid into bank	3,150

Solution

Two Column Cash Book (with Cash and Discount Columns)

Dr.						Cr.					
Date	Particulars	R. No.	L. F.	Discount allowed	Rs.	Date	Particulars	V.No.	L.F.	Discount Received	Rs.
1998 July						1998 July					
1	To Balance b/d				1,200	5	By Purchases A/c				4,100
2	To Naushad's A/c			100	3,900	7	By Metha's A/c			50	850
9	To Sales A/c				4,900	21	By Yusuf's A/c			200	2,800
11	To Bank A/c				5,500	25	By Office Rent A/c				800
22	To Kurien's A/c			50	1,250	31	By Bank A/c				3,150
23	To Bank A/c				200	31	By Balance c/d				8,250
28	To Interest on investment A/c				3,000						
				150	19,950					250	19,950
1 Aug	To Balance b/d				8,250						

Note: The transactions effected on July 14 & 16 represent credit transactions and hence not entered in the Cash Book

Illustration 3. Enter the following transactions in a three columnar Cash Book.

1998			Rs.
July	1	Cash on hand	600
		Cash at bank	9,670
	2	Received cash from A.Arul	1,900
		Allowed him discount	100
	4	Paid A.Azar by cheque	800
		Discount received	30

6	Purchased Goods and paid by cheque	2,100
8	Deposited with bank	2,100
10	Sold goods to A.Anil on credit	1,100
12	Sold goods & received payment by cheque	900
15	Received a cheque from A.Anil in full settlement of his account	1,050
17	Withdrawn from bank for office use	900
19	Purchased goods from Kanishka & Co.	3,000
19	Paid Kanishka & Co. by cheque	2,900
	Discount received	100
20	Paid telephone charges	100
23	Paid A.Ahmad by cheque	684
	Discount received	16
24	Cash Sales	1,900
26	Received cheque from A.Antony and sent to the bank	480
	Discount allowed	20
27	Purchased a new machinery for office use by cheque	4,000
28	Bank intimated that A.Antony's cheque has been dishonored	
31	Deposited with bank	600
31	Bank charges as shown in the pass book	26

Solution:**Three Columnar Cash Book**

Dr.						Cr.					
Date	Particulars	L F	Discount allowed	Cash	Bank	Date	Particulars	L F	Discount received	Cash	Bank
			Rs.	Rs.	Rs.				Rs.	Rs.	Rs.
1998 July						1998 July					
1	To Balance b/d			600	9,670	4	By A.Azar's A/c		30		800
2	To A.Arul's A/c		100	1,900		6	By Purchases A/c				2,100
8	To Cash A/c	C			2,100	8	By Bank A/c	C		2,100	
12	To Sales A/c				900	17	By Cash A/c	C			900
15	To A.Anil's A/c		50		1,050	19	By Purchase A/c		100		2,900
17	To Bank A/c	C		900		20	By Telephone Charges A/c			100	
24	To Sales A/c			1,900		23	By A.Ahmad's A/c		16		684
26	To A.Antony's A/c		20		480	27	By New Machinery A/c				4,000
31	To Cash A/c	C			600	28	By A.Antony's A/c		200		480
						31	By Bank A/c	C		600	
						31	By Bank Charges A/c				26
						31	By Balance c/d			2,500	2,510
			170	5,300	14,800				166	5,300	14,800
Au 1	To Balance b/d			2,500	2,510						

Illustration 4

Enter the following transactions in Cash Book with bank and discount columns only, assuming all receipts are banked on the same day and that all payments are made by means of cheques only.

1998			Rs.
July	1	Bank Balance	5,000
	4	Purchased goods for each	1,600
	5	Sold goods to Alen for cash	1,300
	10	Received cheque from Wilson (in full settlement of Rs.400)	378

12	Paid Halda	375
	Discount allowed by him	25
13	Received Commission from Gafoor	231
15	Paid Travelling Expenses to John	45
18	Received for Cash Sales	245
19	Paid to Samuel for office furniture	185
20	Paid Electricity Charges	35
21	Paid Office Rent	100
24	Drew self cheque for personal use	300
25	Received from Nelson	245
	Discount allowed	25
29	Drew cheque for petty cash	190
30	Drew cheque for salaries	360
31	Paid to Manian (in full settlement of Rs.485)	450

Solution:

Cash Book with Bank and Discount Columns

Dr.						Cr.					
Date	Particulars	R. No.	L F	Disco't Aallowed Rs.	Bank Rs.	Date	Particulars	V. No.	L F	Disco't received Rs.	Bank Rs.
1998 July						1998 July					
1	To Balance b/d				5,000	4	By Purchases A/c				1,600
5	To Sales A/c				1,300	12	By Halda's A/c			25	375
10	To Wilson's A/c			22	378	15	By Travelling Expenses A.c				
13	To Commission A/c				231	19	By Office Furniture A/c				45
18	To Sales A/c				245		By Electricity Charges A/c				185
25	To Nelson's A/c			25	245	20	By Office rent A/c				35
						21	By Drawings A/c				100
						24	By Petty Cash A/c				190
						29	By Salaries A/c				360
						30	By Manian's A/c			35	450
						31	By Balance c/d				3,759
				47	7,399					35	7,399
Au 1	To Balance b/d				3,759						

10.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points

1. Cash book records transactions connected with cash.
2. Cash book can be classified into five types.
3. If a transaction which affect both the sides of the Cash Book is known as contra entry.
4. There is little bit difference among the preparation of different types of cash book.

10.6 LESSON-END ACTIVITIES

1. Define a cash book. Is it a subsidiary book or principal book of accounts? Give reasons.
 2. What do you mean by contra Entry?
 3. Explain the advantages of cash book.
-

10.7 MODEL ANSWER TO CHECK YOUR PROGRESS.

Check I

1. On receipt of a cheque

Cash A/c Dr
 To Customer A/c

2. On deposit of the cheque into the bank

Bank A/c Dr
 To Cash A/c

Check II

1. Cash A/c Dr
 To Customer A/c
-

10.8 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson 11

PREPARATION OF PASS BOOK

Contents

- 11.0 Aims and Objectives
 - 11.1 Introduction
 - 11.2 Preparation of pass book
 - 11.3 Specimen of pass book
 - 11.4 Items appearing in the customer's account
 - 11.4.1 on the debit side
 - 11.4.2 on the credit side
 - 11.5 Balancing of pass book
 - 11.6 Illustrations
 - 11.7 Let us Sum Up
 - 11.8 Lesson-End Activities
 - 11.9 Model answer to check your progress.
 - 11.10 References
-

11.0 AIMS AND OBJECTIVES

In tenth lesson, we discussed the meaning cash book and method of preparation of different types of cash book. In this lesson, we discuss the meaning of pass book and method of preparation of pass book. After going through this lesson you will able to

- 1) know the meaning of pass book.
 - 2) understand the items debited in customer's account
 - 3) understand the various items credited in customer's account
 - 4) study the preparation of pass book
-

11.1 INTRODUCTION

Generally at present in a business firm many transaction involving receipts and payments of money take place every day during the normal course of business. Cash dealing is a tedious work, so every businessman opens a current account with banks and all payments are made through cheques and all receipts are banked. This all transactions relating to bank deposits and withdrawals by the individual customer are recorded by the banker in their personal ledger. Banker periodically give a statement to their customers in the form a book such book is called "Pass book". It is showing how the customer account stands.

11.2 PREPARATION OF PASS BOOK

All receipts for the customer are credited in the pass book and all payments for him are debited in it. This pass book is ruled in such a manner that the balance of an account can be immediately referred to by the customer after each transaction.

11.3 SPECIMEN OF PASS BOOK

In this section, we presented a model pass book for your easy understand
Name..... Account No.....
Address.....

Current Account.....Bank (Pass Book)					
Date	particulars	Withdrawals Dr	Deposits Cr	Balance Dr/Cr	Accountant initials

11.4 ITEMS APPEARING IN THE CUSTOMER’S ACCOUNT

In this section, we pointed out the items to be debited and credited in the pass book.

11.4.1 on the debit side

The following items are generally will appear in the debit side of the pass book

1. Cash withdraw by customer
2. Cheque issued by customer to third parties and they received cash by presented it.
3. Banker make some deduction for some charges.
4. Payments made by banker on behalf of customer as per their standing orders.
5. Banker charge interest on overdraft

11.4.2 on the credit side

The following items are generally will appear in the credit side of the pass book

1. Deposits received from customer
2. Payments made by third parties directly in the customer’s account
3. Banker directly received some incomes on behalf of customers such as interest on investment and dividend etc.
4. Interest on bank balance

In the Banker’s personal ledger	
Dr	Cr
Customer’s Account	
1 Withdrawal by customer 2. Cheque issued by customer to third parties and they received cash by presented it. 3.charges made by banker 4. Payments made by banker on behalf of customer as per their standing orders. 5. Interest on overdraft	1. Deposits received from customer 2. When payments made by third parties directly in the customer’s account 3. When banker directly received some incomes on behalf of customers 4. Interest on bank balance

Check your Progress 1

Give any four items to increase the overdraft balance in a customer account.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 104)

- 1.....
- 2.....
- 3.....
- 4.....

11.5 BALANCING OF PASS BOOK

In this section, we have briefly explained about favourable and unfavourable balance of pass book. Pass book is maintained and entered by the bank. When credit balance is more than debit balance it is called credit balance or favourable balances as per pass book. In case debit balance is more than credit balances it is debit balance or unfavourable balance of overdraft as per pass book.

- i) when deposits is more than withdraws there is cash balance in the bank
- ii) when withdraw is more than deposits there is overdraft from the bank

11.6 ILLUSTRATIONS

In this section, we worked out one modal problem for you, to learn how to prepare pass book

1. Entry the following transactions in the Mathan’s current account.

2007

- Jan 1 Opening credit balance Rs 5,000
4. Cash deposited by Mathan Rs 3,000
- 6 He withdraw Rs 1,000
9. Insurance premium paid by banker as per standing order Rs 450
11. Deposited by kumar in mathan’s account Rs 800
18. Bank charges Rs 25
22. Banker directly collected interest on investment Rs 5,000
25. Cheque presented and get payment by babu Rs 2,000

In the Banker’s personal ledger

Dr	Mathan’s Account		Cr
To Cash	1,000	By Balance b/d	5,000
To Insurance premium	450	By Cash	3,000
To Charges	25	By Kumar	800
To Babu	2,000	By Interest on	5,000
To Balance c/d	10,325	Investment	
	13,800		13,800
		By Balance b/d	10,325

PASS BOOK**Mathan's Account**

Date	particulars	Withdrawals Dr	Deposits Cr	Balance Dr/Cr	Accountant initials
2007 Jan 1	Opening credit balance			5,000 Cr	
4	Cash deposited		3,000	8,000 Cr	
6	withdraw	1,000		7,000 Cr	
9	Insurance premium paid	450		6,550 Cr	
11	kumar account		800	7,350 Cr	
18	Bank charges	25		7,375 Cr	
22	Interest on investment		5,000	12,375 Cr	
25	Babu account	2,000		10,375 Cr	

11.7 LET US SUM UP

In this lesson, we have briefly touched upon the following points

1. All entries in the pass book are made by the bank.
2. When the bank receives the deposit, the customer's account is credited.
3. When cash withdraw by customer his account is debited.
4. If pass book shows credit balance = Favourable balance.

11.8 LESSON-END ACTIVITIES

1. What you mean by Bank overdraft?
2. As a banker how do you prepare customer's account?

11.9 MODEL ANSWER TO CHECK YOUR PROGRESS**Check 1**

- 1 Cash withdrawal by customer
2. Sundry charges made by banker
3. Payments made by banker on behalf of customer as per their standing orders.
4. Interest on overdraft

11.10 REFERENCES

1. Jain and Narang -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. R.L.Gupta -- Advanced accountancy

Lesson 12

BANK RECONCILIATION STATEMENT

Contents

- 12.0 Aims and objectives
- 12.1 Introduction
- 12.2 Purpose of preparing a bank reconciliation statement
- 12.3 Causes of difference between cash book and pass book balance
 - 12.3.1 Cheques issued but not presented for payment
 - 12.3.2 Cheques deposited but not credited
 - 12.3.3 Direct payment by a customer to the bank
 - 12.3.4 Interest on deposit credited by the banker
 - 12.3.5 Interest, dividend, rent etc. collected by bank
 - 12.3.6 Payments made for standing instructions
 - 12.3.7 Bank charges debited in the pass book
 - 12.3.8 Bills discounted but dishonoured
 - 12.3.9 Interest on over draft debited in pass book
 - 12.3.10 Credit instruments recorded in the pass book
 - 12.3.11 Cheques failed to deposit
 - 12.3.12 Errors in cash book and pass book
- 12.4 Preparation of the Bank Reconciliation statement
 - 12.4.1 Specimen
- 12.5 Overdraft
 - 12.5.1 Specimen:
- 12.6 Method of preparation of bank reconciliation statement
 - 12.6.1 Performa of a bank reconciliation statement
 - a) If we take cash book balance or overdraft as per pass book as the starting point:
 - b) If we take pass book balance or overdraft as per cash book as starting point
- 12.7 Bank balance to be shown in balance sheet
 - 12.7.1 Adjustments in the cash book
- 12.8 Illustration
- 12.9 Let us Sum Up
- 12.10 Lesson-End Activities
- 12.11 Model answer to check your progress.
- 12.12 References

12.0 AIMS AND OBJECTIVES

In eleventh lesson, we discussed the meaning of pass book and method of preparation of pass book. In this lesson, we discuss the meaning of bank reconciliation statement and reasons for discrepancies. After going through this lesson you will be able to

- 1) know the meaning of Bank reconciliation statement
- 2) understand the causes for differences
- 3) understand the technique of preparing bank reconciliation statement.

12.1 INTRODUCTION

All receipts for the customer are credited in the pass book and all payments for him are debited in it. If transactions recorded by the trader in the bank column of his cash book and those appearing in his pass book are the same, it is quite obvious that the balance shown by the pass book should agree with bank balance shown by cash book. However in practice, these two balances do not agree. It is due to certain items which lead to difference in the cash book and pass book balances. A statement is prepared to bring the cash book balance in agreement with the balance as per pass book which is known as Bank reconciliation statement.

12.2 PURPOSE OF PREPARING A BANK RECONCILIATION STATEMENT

When a trader maintains a Bank account he incorporates deposits made and withdrawals in this cash book in the bank column. The banker supplies the customer with a pass book and makes entries at periodical intervals from his ledger. Most of the banks now a days supply their current account customers with a statement of account which is more or less like a pass book. When such statement is received from the bank, it is necessary for the cashier to compare the entries made in the pass book with that made in the cash book. On any one day there will be always be a difference between the pass book balance and the cash book balance. To find out the accuracy of entries made in the cash book and pass book the entries which are not recorded either in the pass book or cash book are taken out and a statement is prepared. After making adjustments if the balance arrived at tallies with the pass book balance then the entries made in the cash book/pass book are correct. But if they do not tally it means there should be some entries left out or some wrong entries might have been made by the accountant in preparing the cash book. The statement prepared for ascertaining the correctness of balances as shown by the cash book and pass book is called Bank Reconciliation statement.

12.3 CAUSES OF DIFFERENCE BETWEEN CASH BOOK AND PASS BOOK BALANCE

Preparation of Bank Reconciliation Statement is of very important to a trader. If the bank balance shown by the cash book does not agree with the balance as per pass book, the trader has to identify the reasons for the difference. In this section, we attempt to make a brief survey about the different causes of difference between cash book and pass book balance.

12.3.1 Cheques issued but not presented for payment

When the trader issues a cheque, he credits its amount immediately in his cash book. The same will be entered in the pass book only on presenting the cheque and making payment by the bank. If the cheque is not presented for payment before the date of preparation of bank reconciliation statement, the balance as per pass book will be more than the balance as per cash book.

12.3.2 Cheques deposited but not credited

On depositing cheques into bank for collection, the trader debits the same amount in the bank account. The bank credits the amount in the pass book only on getting the amount collected. Such uncleared cheques make the cash book balance to be more than the pass book balance.

12.3.3 Direct payment by a customer to the bank

Customers of the trader occasionally make some payments directly in to the trader's bank account. The trader may come to know of it only later. But the banker gives immediate credit to the trader on receipt of the amount. If it remains unrecorded in the cash book, the balance as per pass book will be more than the balance as per cash book.

12.3.4 Interest on deposit credited by the banker

At regular intervals, banks allow interest on the deposit balance of a trader and credit the amount in the pass book. The same usually remains unrecorded in the cash book. In such a case, the pass book balance will be more than the cash book balance.

12.3.5 Interest, dividend, rent etc. collected by bank

Bank collects interest, dividend, rent etc. on behalf of the customer and credits the same amount to his account. The trader comes to know of it only on a later date. If such collections remain unrecorded in the cash book, the pass book balance will be more than the cash book balance.

12.3.6 Payments made for standing instructions

The banker makes payment for rent, insurance etc. for the customer as per standing instructions. The banker debits the trader's account with such payments. The trader comes to know of it only later. Due to such payments that remain unrecorded in cash book, the balance as per pass book will be less than the balance as per cash book.

12.3.7 Bank charges debited in the pass book

Bank charges and commission for collection of cheques, bills etc. are debited in the pass book. The corresponding credits are often not given in the cash book. As these items are not entered in the cash book, its balance will be more than that of the pass book.

12.3.8 Bills discounted but dishonoured

When a trader discounts bills of exchange, the banker credits the trader's account with the amount due. The same amount is debited by the trader in cash book. If such a bill is later dishonoured, the banker immediately debits it in the pass book. But the same remains unrecorded in the cash book. This causes the balance as per cash book. This causes the balance as per cash book to be more than the pass book balance.

12.3.9 Interest on over draft debited in pass book

Periodically the bank calculates interest due by the trader on his overdraft and debits the amount in the pass book. Corresponding credit is often not made by the trader in his cash book. It leads to difference in the balance as per cash book and pass book.

12.3.10 Credit instruments recorded in the pass book

Bills of exchange, promissory notes and other credit instruments collected by bank are credited in the pass book. But if they remain unrecorded in the cash book it may lead to disagreement between the balance as per the two books.

12.3.11 Cheques failed to deposit

There may also be instances of cheques recorded as paid in for collection but failed to be deposited into the bank, by which the cash book balance will be more than the balance as per pass book.

12.3.12 Errors in cash book and pass book

Errors in any of these two books may also lead to disagreement in the balances. Such errors may be

- (a) By recording cheques issued in the cash column instead of bank column of cash book.
- (b) By recording the amount of cheque drawn against one account, in another account with the same bank.
- (c) By recording wrong amounts in cash book or pass book.
- (d) By mistakes in totaling, balancing etc.

12.4 PREPARATION OF THE BANK RECONCILIATION STATEMENT

In this section, we identify the steps to be followed for the preparation of reconciliation statement when cash book shows a debit balance. After ascertaining the causes of disagreement between the balance as per cash book and the pass book, the trader prepares a reconciliation statement to establish the genuineness of the balances of the two sets of books. The bank reconciliation statement is prepared in such a way that on adjusting the amount of the items of difference in the balance of one set of books, the balance of the other set is arrived at. The statement is started either with the balance as per cash book or with that of the pass book. If we start with the balance as per cash book, our aim is to arrive at the balance as per pass books on adjusting the items of difference. For the purpose, certain items are added and certain items are deducted.

12.4.1 Specimen**Bank Reconciliation statement as on 31st Dec...**

Balance as per cash book		
Add: Cheques issued but not presented Interest credited in pass book Deposits made directly by outsiders Wrong credit made in the pass book by the bank		
Less: Cheques deposited but not credited Bank charges debited in pass book Interest on overdraft debited in pass book Insurance premium paid by bank Cheque entered in the cash book but not deposited Cheques dishonoured and entered in pass book		
Balance as per pass book		

12.5 OVERDRAFT

In this section, we identify the steps to be followed for the preparation of reconciliation statement when cash book shows an overdraft. The amount drawn by the customer of a bank in excess of his deposit balance is called an overdraft. In case of an overdraft, the bank column of the cash book will have a credit balance & the pass book will have a debit balance. On preparing the reconciliation statement starting with an overdraft, the adjustments should be made in the opposite direction of starting with the debit balance. For example, on

direct payment by a customer to the bank, when there is an overdraft as per pass book, the overdraft will be reduced by the amount. Conversely, when the bank makes any payment for the customer, the overdraft as per pass book increases.

12.5.1 Specimen:

Bank Reconciliation statement as on 31st Dec....

		Rs.
Overdraft as per cash book		
Add: Cheques deposited but not credited		
Interest on overdraft debited in pass book		
Amount remitted by banker on behalf of customer		
Cheque dishonoured and entered in pass book		
Cheques debited in cash book but not paid in to Bank		
Bank charges debited in pass book only		
Less: Cheques issued but not presented		
Interest credited in pass book		
Dividend, interest collected and credited in pass book		
Overdraft as per pass book		

Bank reconciliation statement may be divided into the following for different cases, on the basis of the balance with which it is started.

Cash	I	Starting with debit balance as per cash book
Cash	II	Starting with credit balance as per cash book
Cash	III	Starting with overdraft as per cash book
Cash	IV	Starting with overdraft as per pass book

12.6 METHOD OF PREPARATION OF BANK RECONCILIATION STATEMENT

In this section, we identify the various methods to prepare bank reconciliation statement

- Balance shown by the cash book and the pass book on a specified date is to be noted. Debit balance in the cash book and credit balance in the pass book indicate that the business has favourable balance in the bank. Similarly, credit balance in the cash book and debit balance in the pass book indicate that the business has unfavorable balance in the bank. It means bank has given 'overdraft' to the business.
- All the debits and credits shown in the cash book must be compared with the entries in the pass book to identify any items omitted. Similarly all the debits and credits in the pass book should be compared with the entries in the cash book to ascertain the items which were not recorded. Any items recorded in both the books but amounts being different should be carefully noted to adjust the difference in the amounts. It is preferable to make a list of all the differences.
 - The balance shown by the cash book or pass book can be taken as the 'Starting balance', each difference should be either added to or subtracted from the starting balance depending on the nature of the difference (see proforma B.R.S. I and II below).

2. When all the differences are adjusted, the balance must be the balance as per the other book. If cash book balance was the starting balance, the final balance must be the balance as per the pass book and vice versa.

12.6.1 Performa of a bank reconciliation statement

In this section, we have presented a Performa which indicate the effect of each 'difference' on cash book balance or pass book balance.

a) If we take cash book balance or overdraft as per pass book as the starting point:

Bank Reconciliation Statement as on.....

	Rs.	Rs.
Balance as per cash book		xxx
Or overdraft as per pass book		
Add: (i) Cheques issued / drawn but not presented	xxx	
(ii) Direct deposit made by customers into bank not recorded in cash book	xxx	
(iii) Dividend or other incomes collected by the bank not recorded in cash book	xxx	
(iv) Interest credited by the bank but not debited in cash book	xxx	xxx
		xxx
Less: (i) Cheques paid / deposited into bank but not credited	xxx	
(ii) Payments by the bank as per standing instruction, not entered in cash book	xxx	
(iii) Bank charges debited in pass book but not recorded in cash book	xxx	
(iv) Cheques issued and recorded in cash book as deposited into bank but the same was not deposited into bank	xxx	
(v) Cheques issued but not recorded in cash book	xxx	
(vi) interest on bank deposits recorded in cash book but not credited by the bank	xxx	xxx
Balance as per pass book or overdraft as per cash book		xxx

b) If we take pass book balance or overdraft as per cash book as starting point:

Bank Reconciliation Statement as on.....

	Rs.	Rs.
Balance as per cash book		xxx
Or overdraft as per pass book		
Add: (i) Cheques paid / deposited into bank but not credited	xxx	
(ii) Payments made by the bank as per standing instruction, not entered in cash book	xxx	

(iii) Bank charges debited in pass book but out recorded in cash book	xxx	
(iv) Cheques deposited but dishonoured not recorded in cash book	xxx	xxx
(v) Cheques issued and recorded in cash book as deposited into the bank but the same was not deposited into the bank		xxx
(vi) Cheques issued but not recorded in cash book	xxx	
(vii) Interest on bank deposits recorded in cash book but not credited, by the bank	xxx	
Less: (i) Cheques issued / drawn but not presented	xxx	
(ii) Direct deposit made by customers into bank, not recorded in cash book	xxx	
(iii) Dividends or their income collected by the bank but not recorded in cash book	xxx	
(iv) Interest credited by the bank but not debited in cash book	xxx	xxx
Balance as per cash book or overdraft as per pass book		xxx

Check your Progress 1

List out any two importance of bank reconciliation statement

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 117)

- 1.....
- 2.....

12.7 BANK BALANCE TO BE SHOWN IN BALANCE SHEET

When accounts are finalized at the end of an accounting year, cash at bank must be shown in the balance sheet. For this purpose, neither cash book balance nor pass book balance can be taken as it is. The cash book should be adjusted appropriately and the adjusted cash book balance has to be shown in the balance sheet. The cash book has to be adjusted in the light of differences observed in the context of preparation of bank reconciliation statement.

12.7.1 Adjustments in the cash book

- (a) Incomes recorded in the pass book but not yet entered in the cash book like interest and dividend from investments directly collected by the bank, cheques and cash directly deposited by customers in the bank and not recorded in the cash book have to be entered in the cash book on the debit side. Corresponding credits to the respective accounts in the ledger must also be completed.
- (b) Payments and expenses shown in the pass book but not yet recorded in the cash book should be entered on the credit side of the cash book. Corresponding debits to the accounts concerned must also be posted in the ledger. Examples of such items are

bank charges, interest on overdraft, interest on loans, payments as per standing order etc.

- (c) Any cheques or bills sent to bank for collection but not entered in the cash book, have to be debited in cash book. Similarly, bills and cheques dishonoured but not yet recorded must be credited in the cash book.
- (d) All mistakes in the cash book relating to entering casting, balancing etc. must be rectified.

All this stage, all items causing difference between cash book and pass book are recorded in the cash book except three specific items.

- 1. Cheques and bills deposited in the bank, but not yet credited in pass book;
- 2. Cheques issued, but not yet presented for payment;
- 3. Mistakes made in the pass book by the bankers.

These items are automatically adjusted in due course of time. So, they are ignored in the preparation of the adjusted cash book.

Check your Progress 2

List out any three advantages of keeping bank account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 117)

- 1.....
- 2.....
- 3.....

12.8 ILLUSTRATION

In this section, we worked out some modal problems for you, to learn how to prepare this account.

Illustration 1

From the following particulars, prepare a bank reconciliation statement as at 31st December 1992 to find out the balance as per cash book of Ms.Akila.

- (i) The following cheques were paid into bank in December 1992 but were credited by the in January 1993.
Maninder – Rs.1,400; Kalyani – Rs.1,600; Rajesh – Rs.1,200
- (ii) The following cheques were issued in December 1992 but were presented for payment in January 1993.
Shalini – Rs.1,000; Bhagat Rs.9000
- (iii) The following charges were made by the bank which were not recorded in the cash book.
Incidental charges for the half year ended 31-12-1992 Rs.40 Collection charges for outstanding cheques Rs.30.
- (iv) The following payments made by the bank direct as per standing instructions were not entered in the cash book.
Insurance premium – Rs.700; Subscription for commerce – Rs.150
- (v) A cheque for Rs.1,000 which was received form a customer was entered in the bank column of cash book in December 1992 but was omitted to be banked in December 1992.

- (vi) A bill for Rs.2,000 was retired by the bank under rebate of Rs.40 but the full amount of the bill was credited in bank column of the cash book.

The bank balance as per pass book was Rs.31,600 on 31st December 1992.

Solution

Books of Ms. Akila

Bank Reconciliation Statement as on 31.12.1992			
		Rs.	Rs.
Balance as per pass book			31,600
Add: (i) Cheques paid into bank not yet cleared and credited:			
Maninder	1,400		
Kalyani	1,600		
Rajesh	1,200	4,200	
(ii) Charges recorded in the pass book but not in the cash book:			
Incidental charges	40		
Collection charges	30	70	
(iii) Payment made by the bank directly as per standing instructions, not recorded in the cash book:			
Insurance Premium	700		
Subscription for commerce	150	850	
(iv) Cheques entered in the cash book but omitted to be banked		1,000	6,120
			37,720
Less: Cheques issued but not yet presented for payment			
Shalini	1,000		
Bhagat	900	1,900	
Rebate allowed for the bill retired but not entered in the cash book		40	1,940
Balance as per cash book			35,780

Illustration -2

The bank overdraft of Rajini on 31.12.93 as per cash book is Rs.9,000.

From the following particulars, prepare bank reconciliation statement.

	RS.
(i) Unpresented cheque	3,000
(ii) Uncleared cheque	1,700
(iii) Bank interest debited in the pass book only	500
(iv) Bill collected and credited in the pass book only	800
(v) Cheque of Renu dishonoured	500
(vi) Cheques issued to Sekar entered in the Cash column of cash book	300

Solution

Bank Reconciliation Statement as on 31-12-93			
		Rs.	Rs.
	Bank Overdraft as per cash book		9,000
Add:	(i) Uncleared cheques	1,700	
	(ii) Interest debited	500	
	(iii) Dishonoured cheques	500	
	(iv) Cheques omitted from the Bank column	300	3,000
Less:	(i) Un presented cheques	3,000	12,000
	(ii) Bill Collected	800	3,800
	Bank Overdraft as per pass book		8,200

Illustration -3

From the following particulars prepare a Bank Reconciliation Statement showing the balance as per Bank pass book on 31.3.1989.

- Cheques for Rs.7,900 was paid into bank in March 1989 but were credited only in April 1989.
- Cheque for Rs.11,000 were issued in March 1989 but were cashed in April 1989 only.
- A cheque for Rs.1,000 which was received from a customer was entered in the bank column of the cash book in March 1989 but the same was paid in to bank in April 1989 only.
- The pass book shows a credit of Rs.2,500 for interest and a debit of Rs.500 for bank charges.
- The bank balance as per cash book was Rs.1,80,000 on 31.3.1989.

Solution:

Bank Reconciliation Statement as on 31.3.1989		
	Rs.	Rs.
Balance as per Cash book		1,80,000
Add: Interest credited in the pass book	25,000	
Cheques issued but not presented	11,000	13,500
		1,93,500
Less: Cheques deposited but not collected	7,900	
Cheques received but not deposited	1,000	
Bank charges debited in the pass book	500	9,400
Balance as per pass book		1,84,100

Illustration -4

From the following particulars, ascertain the bank balance as per the pass book of Shri Bimaraj as at 31st March 1991.

- (a) Credit balance as per cash book up to 31st March 1991 was Rs.1,500.
- (b) Interest charged by the bank up to 31st March 1991 Rs.50 is recorded only in the pass book.
- (c) Bank charges made by the bank Rs.12.50 were also recorded only in the pass book.
- (d) Cheques paid in to bank Rs.2,500 but cheques of Rs.1,875 only were charged and credited by the banker.
- (e) Two cheques of Rs.750 and Rs.1,500 were issued but out of them only one cheque of Rs.750 was presented for payment up to 31st March 1991.
- (f) Dividends on shares Rs.450 were collected by the banker directly but Bimaraj did not have any information.

Solution:**Bank Reconciliation Statement as on 31.3.1991**

	Rs.	Rs.
Bank overdraft as per cash book		1,500.00
Add: Interest charged by bank	50.00	
Bank charges made by bank	12.50	
Cheques paid in but not collected	625.00	687.50
		2,187.50
Less: Cheques issued but not presented	1,500.00	
Dividends collected by the banker	450.00	1,950.00
Bank overdraft as per pass book		237.50

12.9 LET US SUM UP

In this lesson, we have briefly touched upon the following points

1. A bank reconciliation statement is a statement reconciling the balance as shown by the Bank pass book and the balance as shown by the cash book.
2. The objective of preparing such a statement is to know the cases of difference between the two balances.
3. There may be errors in the account maintained by the customer as well as the bank.
4. Importance of bank reconciliation statement is a moral check on the staff of the organization to keep the cash records always up to date.

12.10 LESSON-END ACTIVITIES

1. What is a Bank Reconciliation Statement?
2. What is the purpose of preparing a Bank Reconciliation statement? Give a proforma of such a statement.
3. How will you prepare a Bank Reconciliation Statement?
4. What are the various reasons for the difference between balance as per cash book and pass book?

5. From the following particulars ascertain the bank balance as per the pass book of Mani as on 31st March 1980.

- a) Balance as per cash book as on 31.12.80 was Rs.2,200.
- b) Out of cheques worth Rs.2,000 paid into bank only Rs.1,650 had been collected and credited.
- c) Cheques for Rs.950 issued by Mani had not been presented for encashment till 31st March 1980.
- d) Interest credited by the bank on 31.3.80 Rs.160 was entered by the customer only on 4.4.80.
- e) Dividends amounting to Rs.400 were collected by the banker's directly but Mani did not have information of this.
- f) Bank charges Rs.25 recorded only in the pass book.

6. On 30th September 1995 the pass book of John showed a credit balance of Rs.7,400. On comparison with the cash book, the following omissions were found out.

- a) Cheques received from customers for Rs.450 and Rs.220 were not yet collected.
 - b) As cheque for Rs.100 received from 'A' though debited by him in the bank column of the cash book was not paid into bank.
 - c) The pass book showed a credit of Rs.75 being interest on investment collected.
 - d) There was a debit of Rs.120 in the pass book in respect of cheque dishonoured.
- Prepare a Bank Reconciliation Statement as on 30th September 1995.

7

7. Prepare a Bank Reconciliation statement of the following.

- a) Bank overdraft as per cash book as on 30th June 1995 Rs.4,800.
 - b) Cheques issued but not presented for payment Rs.1,300.
 - c) Cheques paid in for collection, but not cleared Rs.950.
 - d) Interest and dividend credited in the pass book Rs.2,100.
 - e) Bank charges as per pass book Rs.120.
 - f) Interest on overdraft debited in the pass book Rs.600.
 - g) Cheques issued and presented but not recorded in the cash book Rs.800.
8. The pass book of Mr. Perumal showed an overdraft of Rs.9,300 on 31st March 1996. Ascertain the bank balance shown by the cash book on that date by means of a bank reconciliation statement taking into account the following.
- a) Cheques worth Rs.850 paid into bank were collected and credited only in April.
 - b) Cheques worth Rs.580 issued were encashed only in April.
 - c) No entries in the cash book have been made for bank charges of Rs.10 and interest on overdraft Rs.120.
 - d) A Cheque for Rs.600 paid into bank had been dishonoured and entered only in the bank pass book.
 - e) Interest on investments amounting to Rs.250 has been entered only in the pass book.

12.11 MODEL ANSWER TO CHECK YOUR PROGRESS.

Check 1

i) It highlights the causes of difference between the bank balance as per cash book and bank balance as per pass book.

ii) It reduces the chances of fraud by the cash staff.

Check 2

1. Keeping large cash balance in the office is a risk it can be avoided.
 2. Prevention of fraud and misappropriation.
 3. Reduction in accounting work.
-

12.12 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

UNIT IV
Lesson-13
FINAL STATEMENTS OF ACCOUNTS

Contents

- 13.0 Aims and Objectives
- 13.1 Introduction
- 13.2 Objectives of financial statements
- 13.3 Functions of the financial statements
- 13.4 Consists of financial statements
 - 13.4.1 Manufacturing account
 - 13.4.2 Trading account
 - 13.4.3 Profit and loss account
 - 13.4.4 Balance sheet
- 13.5 Let us Sum Up
- 13.6 Lesson-End Activities
- 13.7 Model answer to check your progress.
- 13.8 References

13.0 AIMS AND OBJECTIVES

In lesson No12, we discussed the meaning and method of preparation of cash book, pass book and BRS. Here we discuss the objectives and functions of financial statements. After going through this lesson, you will able to

- i) know the meaning and objectives of financial statements.
 - ii) understand the functions of financial statements.
-

13.1 INTRODUCTION

When a person starts a business he wishes to know periodically how his business is faring. One convenient and universally accepted method of knowing this is to ascertain the profit made or loss incurred and also the financial position at yearly intervals. Trial balance indicates that all the transactions for a particular period have been duly entered, posted and balanced. But this it is not the end of book-keeping work. It is a means to an end, on the basis of trial balance a businessmen can ascertain the profit or loss made by the business firm and the financial position in a given period by preparation of final statements.

13.2 OBJECTIVES OF FINANCIAL STATEMENTS

Financial statements are very useful to management are intended primary to provide relevant information on parties external to the business. In this section, we few objectives of financial statement are highlighted.

1. Financial statements should provide information useful to present and potential investors and creditors in making rational investment and credit decisions.

2. It should supply information about the economic resources of an enterprise the claims to those resources, and the effects of transactions and events that change resources.
3. Providing information to help users assess the amounts, timing and uncertainty of prospective receipts.
4. Providing information about an enterprise's financial performance during a period.
5. If should provide information comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
6. Financial statements provide information about the post to aid users in making predictions and decisions related to the future financial status and flows of the business.

13.3 FUNCTIONS OF THE FINANCIAL STATEMENTS

The preparation of financial statements (or) final accounts is the last step in the accounting circle. In this section, we discuss the functions of financial statements

1. The aim of the trading account is to ascertain the gross profit or gross loss, for a certain period.
2. The aim of profit and loss account is to ascertain the net profit or net loss for the same period.
3. The aim of the profit and loss appropriation account is to show all dispositions, divisions and appropriations of the net-profit.
4. The aim of the Balance sheet is show is summary form the financial state of the concern as disclosed by the books and to that end will be scheduled to assets, liabilities reserves and capital as they exist upon a given date.

13.4 CONSISTS OF FINANCIAL STATEMENTS

Financial statements are prepared to throw light on the financial results of operation of business during the period under consideration and the financial position at the end of the period. In this section, we pointed out the various accounts and statement includes in financial statements.

- 13.4.1 Manufacturing account
- 13.4.2 Trading account
- 13.4.3 Profit and loss account
- 13.4.4 Balance sheet

Check your Progress 1

List out two benefits and two drawbacks of financial statements

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 120)

- 1.....
- 2.....
- 3.....
- 4.....

13.5 LET US SUM UP

1. A businessmen can ascertain the profit or loss made by the business firm and the financial position in a given period by preparation of final statements. The preparation of financial statements (or) final accounts is the last step in the accounting circle .
 2. Financial statements are very useful to management are intended primary to provide relevant information on parties external to the business
-

13.6 LESSON-END ACTIVITIES

1. Describe to steps involved in to preparation of financial statement of accounts of a firm
-

13.7 MODEL ANSWER TO CHECK YOUR PROGRESS

Check 1

Benefits

1. With the help of manufacturing account we can find out the value cost of goods manufactured .
2. we can know the major item of costs .

Drawbacks

1. We can not found the trading results such as profits or loss.
 2. It does not show the financial position of the concern.
-

13.8 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson-14

MANUFACTURING ACCOUNT

Contents

- 14.0 Aims and Objectives
- 14.1 Introduction
 - 14.1.1 Meaning
 - 14.1.2 Purpose of manufacturing account
- 14.2 Features of manufacturing account
 - (A) Debit side
 - 14.2.1. Raw material consumed
 - 14.2.2 Partly finished stock (work-in-progress)
 - 14.2.3 Direct wages and direct expenses
 - 14.2.4 Factory expenses
 - 14.2.5 Scrap
 - (B) Credit side
 - 14.2.6 Closing work in progress
 - 14.2.7 Cost of production
- 14.3 The specimen of manufacturing account
- 14.4 Illustration
- 14.5 Let us Sum Up
- 14.6 Lesson-End Activities
- 14.7 Model answer to check your progress.
- 14.8 References

14.0 AIMS AND OBJECTIVES

In lesson No13, we discussed the meaning and method of preparation of cash book, pass book and BRS. Here we discuss the objectives and functions of financial statements, and preparation of manufacturing account. After going through this lesson, you will able to

- i) know the purpose of preparing Manufacturing account.
- ii) identify the items debited and credited in Manufacturing account.
- iii) understand the method of preparing Manufacturing account.

14.0 INTRODUCTION

In this section, we attempt to make a brief explanation about manufacturing account.

14.1.1 Meaning

The Concern which is converting raw materials into finished products are called manufacturing concern. Manufacturing concerns are required to prepare manufacturing account besides preparing trading and profit and loss account. It is a statement prepared to ascertain the amount of cost of the finished goods manufactured during the year. All the items of expenses pertaining to the manufacturing activity are debited to this account.

14.1.2 Purpose if manufacturing Account:

1. This account is prepared to calculate to cost of goods manufactured.
2. Manufacturing account is to show constituent items there of such as cost of material consumed, productive wages, direct and indirect expenses.

14.2 FEATURES OF MANUFACTURING ACCOUNT

In this section, let us now discuss the items of manufacturing account in details. One thing to be observed is that all the items relating to manufacturing activities only appear in the manufacturing account.

Items appearing in the debit side of manufacturing account:

14.2.1. Raw material consumed:

Raw materials consumed means, opening stock of raw materials plus purchases and incidental expenses of purchase less closing stock of raw materials. In the debit side, raw materials consumed is the first item of manufacturing account

14.2.2 Partly finished stock (work-in-Progress):

The value of partly finished goods at end of the last year was credited in this account. This is debited to the manufacturing account of the current year as an opening balance.

14.2.3 Direct wages and direct expenses:

Wages and expenses which are directly identifiable with the output produced are known as direct wages and direct expenses. These are debited to manufacturing account.

14.2.4 Factory expenses:

All factory expenses are debited to this account. eg. Rent, rates salaries of supervising staff, power, light, heat, fuel, repairs and renewals, depreciation, relating to factory to factory property, etc.

14.2.5 Scrap

Scrap is the incidental residue from certain types of manufacture. The value realized from the sale of scrap may be reduced from material cost on the debit side to manufacturing account. Alternatively it can be shown on credit side of the manufacturing account, like an income.

Items appearing in the debit side of manufacturing account:

14.2.6 Closing work in progress

Partly finished output at the end of the accounting period is known as closing working-Progress (Semi-finished output). It is credited to manufacturing account. Alternatively it may be reduced from material cost on debit side to this account.

14.2.7 Cost of production

The difference between the two sides of the manufacturing account shows the cost of goods produced. It is transferred to trading account.

14.3 THE SPECIMEN OF MANUFACTURING ACCOUNT

In this section, here we have presents a proforma of manufacturing account

Dr	Manufacturing A/c for the year ended.....		Cr
		Rs.	Rs.
To work-in-progress (opening)		xxx	By Sale of scrap
To Material used			By Work-in-progress (closing)
Opening stock	xxx		By Cost of goods produced
			transferred to trading A/c (bal. fig)
Add: Purchases	xxx		
	xxx		
Less: Closing stock	xxx	xxx	
To Wages		xxx	
To Factory expenses		xxx	
To Purchase expenses		xxx	
To Import duty		xxx	
To Carriage inward		xxx	
To Depreciation on machinery		xxx	
To Repairs to Machinery		xxx	
		xxx	xxx

Check your Progress 1

Explain the method of preparing manufacturing account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 126)

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14.4 ILLUSTRATION

In this section, we worked out some modal problems for you, to learn how to prepare this account.

Illustration -1

- From the following balances in the ledger of Mr. Muraliprasath for the year ended 31-3-2006, prepare manufacturing account.

	Rs.
Opening work-in-progress	1,00,000
Opening stock of raw materials	55,000
Purchases of raw materials	10,00,000
Closing stock of raw materials	40,000

Carriage on purchases	10,000
Factory wages	50,000
Fuel and coal	45,000
Factory power	20,000
Depreciation on plant and machinery	15,000
Factory supervisor's salary	75,000
Closing work-in-progress	20,000

Solution**Manufacturing Account of Mr. Muraliprasath for the year ended 31-3-2006**

Dr			Cr	
Particulars	.	Rs.	Particulars	Rs.
To opening work-in-progress		1,00,000	By Closing work-in-progress	20,000
To Raw materials used:			By Cost of goods	
Opening stock	55,000		Manufactured,	13,10,000
			transferred to trading	
			a/c (balancing figure)	
Add: Purchases	10,00,000			
	10,55,000			
Less: Closing stock	40,000	10,15,000		
To Carriage on purchase		10,000		
To Factory wages		50,000		
To Fuel and coal		45,000		
To Factory power		20,000		
To Depreciation on plant and machinery		15,000		
To Supervisor's salary		75,000		
		13,30,000		13,30,000

Illustration -2

From the following ledger balance of Sri Shanthi Ltd. prepare manufacturing and trading account for the year ended 31-3-2007.

	Rs.
Opening stock:	
Raw Materials	20,000
Work-in-progress	15,000
Purchase of raw materials	4,00,000
Factory expenses :	
Cleaning	500
Power	500
Fuel & coal	1,000
Wages	2,000
Closing stock:	
Raw materials	5,000
Work-in-progress	8,000

Solution :**Manufacturing Account of Sri Shanthi Ltd for the year ended 31-3-2007**

Dr			Cr
Particulars	Rs.	Rs.	Particulars Rs.
To opening work-in-progress		15,000	By Closing work-in-progress
To Raw materials used:			By Cost of goods
Opening stock	20,000		Manufactured,
			transferred to trading
			a/c (balancing figure)
Add: Purchases	4,00,000		
	4,20,000		
Less: Closing stock	5,000	4,15,000	
To Wages		2,000	
To Factory cleaning		500	
To Factory power		500	
To Fuel & coal		1,000	
		4,34,000	
			4,34,000

14.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Manufacturing concerns are required to prepare manufacturing account besides preparing trading and profit and loss account
2. Manufacturing account is prepared to calculate the value of cost of goods manufactured. The difference between the two sides of the manufacturing account shows the cost of goods produced

14.6 LESSON-END ACTIVITIES.

1. Describe the contents of manufacturing account.
2. Explain to various financial statements.
3. What is material consumed?
4. Following are the ledger balances of Suguna on 31-12-1999. Prepare her manufacturing account for the year 1999.

	Rs.
Opening stock of raw materials	10,000
Closing stock of raw materials	15,000
Purchase of raw materials	1,50,000
Freight on purchases	500
Wages (Productive)	75,000
Factory cleaning	2,000

Factory rent	4,000
Factory lighting	5,000
Power	20,000
Depreciation: On plant and machinery	15,000
On Factory vehicles	5,000
Factory managers salary	2,000

5. Following are the ledger balances of M/s karthik & Brose as on 31-3-2000. Prepare manufacturing account for the year ending on that date.

	Rs.
Stock of Materials on 1-4-1999	20,000
Purchase of raw materials	3,00,000
Stock of raw materials on 31-3-2000	10,000
Carriage inwards	1,500
Factory wages	20,000
Fuel and coal	5,000
Factory cleaning	4,000
Factory lighting	2,000
Depreciation: Factory machinery	4,000
Factory building	2,000
Factory watchman's salary	2,000
Stores consumed	200
Opening work-in-progress	5,000
Closing work-in-progress	2,000

14.7 MODEL ANSWER TO CHECK YOUR PROGRESS.

Check 1

Opening raw material, opening work in progress, direct expenses are to be debited. Closing work in progress is to be credited. The balance in the credit side is known as cost of goods manufactured.

14.8 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson 15

TRADING ACCOUNT

Contents

- 15.0 Aims and objectives
- 15.1 Introduction
- 15.2 Method of preparation of trading account
 - 15.2.1 items shown on the debit side of trading account:
 - i) opening stock
 - ii) purchase
 - iii) direct expenses
 - 15.2.3 items appearing on the credit side of trading account:
 - i) sales
 - ii) closing stock
- 15.3 Specimen of trading account
- 15.4 Illustration
- 15.5 Let us Sum Up
- 15.6 Lesson-End Activities
- 15.7 Model answer to check your progress.
- 15.8 key words
- 15.9 References

15. 0 AIMS AND OBJECTIVES

In lesson 14, we discussed the meaning financial statements and preparation of manufacturing account. Here we discuss the meaning and preparation of trading account.

After going through this lesson, you will able to

- i) know the meaning and objectives of Trading account.
- ii) understand the method of preparation of Trading account.
- iii) know the purpose of preparing Trading account.
- iv) identify the items debited and credited in Trading account .

15.1 INTRODUCTION

A concern which purchase goods and sell the same is known as merchandising concern. To know to trading results of the business an account is prepared at end of the accounting period which is called as trading account. Trading account is a ledger account. Therefore, its form and construction conform to the rules of double entry principles of debit and credit.

15.2 METHOD OF PREPARATION OF TRADING ACCOUNT

Trading account is a nominal account, therefore expenses will appear on debit side and incomes will appear on credit side .In this section, we discuss the items shown on the debit side and credit side of trading account.

15.2.1 Items shown on the debit side of Trading Account:

i) Opening stock:

The stock at the beginning of the year is called opening stock. It may include raw materials, work-in-progress and finished goods. Opening stock is the closing stock as per the last

balance sheet, and it is available from the current year trial balance. This item is usually shown as to first item on the debit side of the Trading account.

ii) Purchase:

Any materials and goods made buy during the year which is meant for resale is known as purchase. There are two types of purchase namely Gross purchase and net purchase

a) Gross Purchase:It includes both cash and credit purchase of goods before subtracting the purchase returns.

b) Net Purchase:Purchase return is subtracted from the Gross purchase the balance is known as net purchase. Net Purchase is shown in the trading account.

c) Purchase returns, Returns outwards:If Purchased goods return to the suppliers due to any reason is know as purchase return.

iii). Direct expenses

Expenses which are incurred to make the goods saleable, is known as direct expenses. Factory rent, wages, freight on purchase, octroi, import duty, customs duty, clearing and forwarding charges, dock dues, motive power, oil, grease, waste, wages and salaries, Carriage inward and royalty on production. All direct expenses are extracted from the trial balance. These all direct expenses are shown on the debit side of trading account.

15.2.3 Items appearing on the credit side of trading account:

i) Sales:

Sales made during to year is called Gross sales, it includes both cash and credit sales of goods. If sales return subtracted from the gross sales the balance is know as net sales. This is alone shown on the credit side of trading account.

a)Sales return or return in wards

Due to any reason, it our customer return a part of sold out goods is known as return inwards or sales return.

ii) Closing stock:

The unsold goods which are lying in the godown at the end of the accounting year is known as closing stock. It may include raw materials, work-in-progress and finished goods at end of the year. Generally, the closing stock does not appear in the trial balance. It appears outside the trial balance. But when purchases are adjusted with opening and closing stock, closing stock appears as debit balance in the trial balance.

It closing stock in given outside trial balance, it is shown on credit side of trading account and also shown as current asset in the balance sheet. If it is given in trial balance, it is shown only as current asset in the balance sheet will not appear on credit side of trading account.

N.B: The balance of this account shows gross profit or gross loss. If credit side total is more, the difference is gross profit and if debit side total is more, the difference is gross loss.

Check your Progress 1

Explain the features of trading account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.134.135)

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15.3 SPECIMEN OF TRADING ACCOUNT

In this section, here we have presents a proforma of Trading Account

Trading account for the year ended

Dr			Cr		
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		xxx	By Sales	Xxx	
To purchases	xxx		Less: Returns inwards (or) Sales Returns	xxx	
Less: purchase returns	xxx	xxx		-----	xxx
To direct expenses:					
Wages		xxx	By closing stock		
Fuel & Power		xxx	By Gross loss c/d *		xxx
Carriage inwards		xxx	(transferred to profit and loss A/c)		xxx
Royalty on production		xxx			
Power		xxx			
Coal water, Gas		xxx			
Import duty		xxx			
Consumable stores		xxx			
Factory expenses		xxx			
To Gross profit *c/d (transferred to profit and loss A/c)		xxx			-----

*Balancing figure will be either gross profit or loss in Trading A/c

Check your Progress 2

Explain the method of preparing trading account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.134-135)

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15.4 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to prepare Trading account

Illustration 1

Prepare trading account of Muthumani for the year ending 31-3-2007.

	Rs.
Opening stock	4,00,000
Purchases	43,00,000
Carriage inward	2,60,000
Wages	1,20,000
Credit sales	72,00,000
Cash sales	18,00,000
Sales returns	15,80,000
Purchase returns	50,000
Closing stock	5,00,000

Solution :

Trading account of Muthumani for the year ending 31-3-2007

Dr			Cr		
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		4,00,000	By Sales ;		
To purchase	43,00,000		Cash sales	18,00,000	
Less: Purchase returns	50,000		Credit sales	72,00,000	
		42,50,000		90,00,000	
To wages		1,20,000	Less: Sales returns	15,80,000	74,20,000
To carriage inward		2,60,000	By Closing stock		5,00,000
To gross profit		28,90,000			
		79,20,000			79,20,000

Illustration 2

Prepare Trading Account of Abisamy for the year ending 31-12-2006 from the following information:

	RS.
Opening Stock	80,000
Purchases	8,60,000
Freight Inward	52,000
Wages	24,000
Sales	14,40,000
Purchase Returns	10,000
Sales Returns	3,16,000
Closing Stock	1,00,000
Import duty	30,000

Solution :**Trading Account of Abisamy for the year ending 31-12-2006**

Dr			Cr		
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		80,000	By Sales ;	14,40,000	
To purchase	8,60,000		Less: Sales returns	3,16,000	11,24,000
Less: Purchase returns	10,000	8,50,000	By Closing Stock		1,00,000
To Freight Inward		52,000			
To Wages		24,000			
To Import duty		30,000			
To Gross Profit c/d		1,88,000			
		12,24,000			12,24,000

Illustration- 3

The following are the balances in the Ledger of Mr.Marasamy for the year ended 31st March 2007.

	RS.
Opening Stock:	
Raw materials	20,000
Work-in-progress	3,000
Finished goods	10,800
Purchase of raw materials	50,000
Sales	2,40,000
Fuel and coal	1,000
Wages	32,000
Factory	40,000
Office expenses	30,000
Depreciation on Plant & Machinery	3,00
Closing stock:	
Raw materials	20,000
Work-in-progress	4,000
Finished goods	8,000

Prepare manufacturing and Trading Account for the year ended 31st March 2007.

Solution:**Manufacturing Account of Mr. Marasamy for the year ending 31.3.2007**

Dr		Cr		
Particulars	Rs.	Rs.	Particulars	Rs.
To Opening work-in-progress		3,000	By Closing work-in-progress	4,000
The Cost of Materials consumed:			By cost of goods	
Opening	20,000		Manufactured	
Add: Purchases	50,000		transferred to	
	70,000		Trading A/c	1,25,000
Less: Closing Stock	20,000	50,000		
To Wages		32,000		
To Fuel & Coal		1,000		
To Factory expenses		40,000		
To Depreciation on plant & Machinery		3,000		
		1,29,000		1,29,000

Trading Account of Mr. Marasamy for the year ending 31.3.2007

Dr		Cr		
To Opening Stock of finished goods		10,800	BY Sales	2,40,000
To Cost of goods manufacture		1,25,000	By Closing Stock of finished goods	8,000
To Gross Profit c/d		1,12,200		
		2,48,000		2,48,000

Illustration - 4

From the following ledger balance of M/s M T N & Co. Prepare manufacturing and Trading account for the year ended 31-3-2007.

	RS.
Opening Stock:	
Raw materials	20,000
Work-in-progress	15,000
Finished goods	40,000
Purchase of raw materials	4,00,000
Factory expenses :	
Cleaning	500
Power	500
Fuel & Coal	1,000
Wages	2,000
Closing stock:	
Raw materials	5,000
Work-in-progress	8,000
Finished stock	12,000
Sales	10,00,000

Solution :

Manufacturing Account of M/s M T N & Co. for the year ended 31 st March,2007.

Dr		Cr		
Particulars	Rs.	Rs.	Particulars	Rs.
To Opening work-in-progress		15,000	By Closing work-in-progress	8,000
To Raw materials used:			By cost of goods	
Opening Stock	20,000		Manufactured	
			transferred to trading	4,26,000
			A/c (Bal. Fig)	
Add: Purchases	4,00,000			
	4,20,000			
Less: Closing Stock	5,000	4,15,000		
To Wages		2,000		
To Factory cleaning		500		
To Factory power		500		
To Fuel & Coal		1,000		
		4,34,000		4,34,000

Trading Account of M/s M T N & Co. for the year ended 31st March,2007.

Dr		Cr		
To Opening Stock of finished goods		40,000	By Sales	10,00,000
To Cost of goods manufacture b/d		4,26,000	By Closing Stock of finished goods	12,000
To Gross Profit c/d		5,46,000		
		10,12,000		10,12,000

Check your Progress 3

Explain the following terms

- i) **return inwards** ii) **return outwards** iii) **closing stock**

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 134-135)

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15.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. Trading refers to buying and selling of goods. Trading account shows the results of buying and selling of goods.
2. The balance of trading account represents gross profit or loss and is transferred to profit & loss account.
3. Direct expenses alone are shown on the debit side. Indirect expenses should not be shown in this account.

4. The balance of this account shows gross profit or gross loss. If credit side total is more, the difference is gross profit and if debit side total is more, the difference is gross loss.

15.6 QUESTIONS FOR DISCUSSION

1. What is trading account? Why it is prepared?
2. Distinguish between trading and manufacturing account?
3. From the under mentioned balances obtained at the end of 31-March 2007, prepare Trading account.

	RS.
Stock of goods on 1-4-2006	12,50,000
Stock of goods on 31-3-2007	23,75,000
Purchases – Cash	18,50,000
- Credit	41,25,000
Sales – Cash	25,50,000
-Credit	57,50,000
Returns to suppliers	25,000
Returns by customers	30,000
Duty and clearing charges	50,000

4. Prepare trading and manufacturing A/c of M/s Samibharathi & Bros from their ledger balances as on 31-3-2006.

	RS.
Stock as on 1-4-2005.	
Raw materials	10,000
Work-in-progress	5,000
Finished goods	30,000
Purchase of Raw materials	2,00,000
Purchase returns	10,000
Sales of finished goods	5,00,000
Factory lighting	5,000
Power	6,000
Coal & Fuel	4,000
Wages	50,000
Depreciation of plant & Machinery	1,000
Stock as on 31-3-2006	
Raw materials	5,000
Work-in-progress	10,000
Finished goods	50,000

15.7 MODEL ANSWER TO CHECK YOUR PROGRESS.

Check 1

- 1.This account is prepared mainly to know the profitability of goods bought and goods sold during the year.
- 2.This account is not relating to the study of the financial position of the concern.
- 3.By preparing this account we an found out the value of closing stock.

Check 2

Opening finished goods, net purchase, direct expenses are to be debited. Sales and Closing finished goods are to be credited. The balance in the credit side is known as gross loss. If the balance in the debit side is known as gross profit

Check 3

Returns outwards: If Purchased goods return to the suppliers due to any reason is know as purchase return. Return inwards: Due to any reason, it our customer return a part of sold out goods is known as return inwards or sales return.

15.8 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson -16

PROFIT AND LOSS ACCOUNT

Contents

- 16.0 Aims and objectives
- 16.1 Introduction
 - 16.1.1 Meaning
 - 16.1.2 Definition
- 16.2 Method of preparation of profit or loss account
 - 16.2.1 Items shown on the debit side of profit or loss account:
 - i) Gross loss ii) operating expenses, iii) non operating expenses
 - 16.2.3 Items appearing on the credit side of profit or loss account:
 - i) Gross gain ii) operating incomes, iii) non -operating incomes
- 16.3 Specimen of profit or loss account
- 16.4 Purpose of preparing profit and loss account
- 16.5 Principles of preparing profit or loss Account
- 16.6 Journal entries for the preparation of profit or loss Account
- 16.7 Illustration
- 16.8 Let us Sum Up
- 16.9 Lesson-End Activities
- 16.10 Model answer to check your progress.
 - 16.11 key words
 - 16.12 References

16.0 AIMS AND OBJECTIVES

In lesson 15, we discussed the meaning and preparation of Trading account. Here we discuss the meaning and preparation of Profit and loss account. After going through this lesson, you will able to

- i) know the meaning and objectives of profit and loss account.
- ii) understand the method of preparation of profit and loss account.
- iii) know the purpose of preparing profit and loss account.
- iv) identify the items debited and credited in profit and loss account .

16.1 INTRODUCTION

In this section, we attempt to make a brief study of meaning and definition of profit and loss account

16.1.1 Meaning

Profit and loss Account is an account prepared to ascertain to net profit earned or net loss incurred by the business concern for an accounting period. From the trial balance, some items of nominal accounts affecting manufacturing activities and some other affecting trading activities these items are transfer to manufacturing account and trading account respectively. Such items represent the expenses on administration of the office or for the selling and distribution of goods are transferred to profit and loss account. Similarly those non trading incomes are transferred to profit and loss account.

16.1.2 Definition

Prof carter “Profit and loss account is an account into which all gains and losses are collected in order to ascertain the excess of gains over the losses or vice versa”.

16.2 PREPARATION OF PROFIT AND LOSS ACCOUNT

In this section, we attempt to make a brief survey of how to preparation of profit and loss account. This account starts with gross loss brought down form trading account on the debit side. (It gross profit, on the credit side) It is debited with the all indirect expenses both operating and non- operating expenses and losses and credited with all revenue incomes and profits. The balance of this account is net profit or net loss. If incomes or credit side of this account is more than the expenses of debit side, the difference is net profit. On the other hand if the expenses or debit side is more, the difference is net loss. The amount of net profit or net loss is transferred to capital account.

16.2.1 Items shown in the debit side of Profit and Loss Account

i)Gross loss (if any) is the first item appearing on the debit side of profit and loss account. Other revenue expenses also appear on the debit side of profit and loss account. Expenses shown on the debit side of profit and low account are classified into two categories

- 1. Operating expenses and
- 2. Non operating expenses

ii) Operating expenses:

These expenses are incurred to operate the business efficiently. They are incurred in running the organization. Operating expenses include administration, selling, distribution, finance, depreciation and maintenance expenses.

iii) Non operating expenses:

These expenses are not directly associated with day today operations of the business concern. They include loss on sale of assets, extraordinary losses, etc.

16.2.2 Items shown in the debit side of Profit and Loss Account

i) Gross profit:

It is the first item appearing on the credit side of profit and loss account. Other revenue incomes also appear on the credit side of profit and loss account. The other incomes are classified as operating incomes and non operating incomes.

ii) Operating incomes:

These incomes are incidental to business and earned from usual business carried on by the concern. Examples: discount received, commission received.

iii) Non operating incomes :

These incomes are not related to the business carried on by the firm. Examples are profit on sale of fixed assets, refund of taxes etc.

.Check your Progress 1

Explain the features of profit and loss account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 144)

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16.3 THE SPECIMEN OF PROFIT AND LOSS ACCOUNT:

In this section, here we have presents a proforma of profit and loss account.

Profit and Loss Account for the year ended 31st

Dr				Cr
	Particulars	Rs.	Particulars	Rs.
	To Gross loss b/d	xxx	By Gross profit b/d	xxx
	To Salaries	xxx	By Interest received	xxx
	To Rent rates & taxes	xxx	By Discount received	xxx
	To Printing & Stationery	xxx	By commission received	xxx
	To Postage and Telegrams	xxx	By Rent received	xxx
	To Telephone expenses	xxx	By Profit on sale of assets	xxx
	To Legal charges	xxx	By Sundry revenue receipts	xxx
	To Insurance	xxx	By Net loss transferred to capital A/c (Bal. Fig)*	xxx
	To Audit fees	xxx		
	To Directors fees	xxx		
	To General expenses	xxx		
	To Selling & Distribution Expenses :			
	To Advertising	xxx		
	To Commission paid too salesmen	xxx		
	To Bad debts	xxx		
	To Provision for doubtful debts	xxx		
	To Godown rent	xxx		
	To Carriage outward	xxx		
	To Upkeep of delivery vans	xxx		
	To Depreciation	xxx		
	To Repairs	xxx		
	To Interest ob borrowings	xxx		
	To Discount allowed	xxx		
	To Loss on sale of assets	xxx		
	To Net profit transferred * to capital A/c (bal.fig)	xxx		
		xxx		xxx

Note: *Either net profit or net loss is the balancing figure in P & L A/c

16.4 THE PURPOSE OF PREPARING PROFIT AND LOSS ACCOUNT.

In this section, we attempt to make a brief explain about the purpose of preparing profit and loss account.

- To determine the future line of action
- To know the net profit or loss of business
- To calculate different ratios
- To compare the actual performance of the business with the desired one

Check your Progress 2

Explain the difference between operating and non operating expenses.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.144)

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16.5 PRINCIPLES OF PREPARING PROFIT OF LOSS ACCOUNT

In this section, we attempt to make a brief survey about the principles to be followed while preparing profit and loss account.

1. Only revenue receipts should be entered
2. Only revenue expenses together with losses should be taken into account.
3. Expenses and incomes relating only to the period for which the accounts are being prepared should be considered.
4. All expenses and income relating to the period concerned should be considered even if the expense has not yet been paid in cash or the income has not yet been received in cash.
5. All personal expenses of the proprietor and partners must be debited to the capital or drawings accounts and must not be debited to the profit and loss account. Similarly any income has been earned from the private assets of the proprietor which is received by firm, it must be credited to the capital or drawings account.

16.6 JOURNAL ENTRIES FOR THE PREPARATION OF P&L A/C ARE GIVEN BELOW

In this section, we listed out some journal entries to be passed to prepare profit and loss account.

. For transferring the items of expenses and losses the entry is:

Profit & Loss Account	Dr
To Each item of expenses or Loss a/c	

2. For transferring the items of income and gains the entry is
 Each item of income & gain account Dr
 To profit and loss account

3. For transferring the net profit to capital the entry is:
 Profit & Loss Account Dr
 To capital Account

4. For transferring the net loss to capital account the entry is:
 Capital Account Dr
 To profit and loss Account

Check your Progress 3

List out three difference between trading account and profit and loss account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 144)

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16.7 ILLUSTRATION

In this section, we worked out some modal problems for you, to learn how to prepare profit and loss account

Illustration-1

From the following Trial balance of Kanmani prepare profit and loss account for the year ended 31-3-2007.

	Debit Rs.	Credit Rs.
Gross Profit		9,50,000
Commission received		5,000
Interest received		4,000
Sundry income		7,000
Depreciation	10,000	
Salaries	15,000	
Discount (Dr)	8,000	
Discount (Cr)		12,000
Bank charges	4,000	
Audit fees	2,000	
Stationery	400	

Solution**Profit and Loss Account of Kanmani for the year ended 31-3-2007**

Dr		Cr	
Particulars	Rs.	Particulars	Rs.
To Depreciation	10,000	By Gross profit b/d	9,50,000
To Salaries	15,000	By Commission received	5,000
To Discount	8,000	By Interest received	4,000
To Bank charges	4,000	By Sundry income	7,000
To Audit fees	2,000	By Discount	12,000
To Stationery	400		
To Net profit c/d	9,38,600		
	9,78,000		

Illustration-2

From the following balance given below, prepare Profit and loss A/c of Lingam Ltd. for the year ending 31.12.2006.

	Rs.		Rs.
Salary & wages	8,000	Discount allowed	7,000
Interest paid	5,000	Interest received	4,000
Commission received	11,000	Traveling	5,000
Commission paid	6,000	Bad debts	1,500
Advertisement	5,000	Depreciation	10,000
Printing & Stationery	11,500	Other office expenses	1,200
Postage & telegram	7,500	Sundry income	15,000
Rent & rates	1,500	Provision for doubtful debts	2,000
Medical fees	3,000	Gross Profit for the year	1,25,000

Solution**Profit & Loss of Lingam Ltd. for the year ending 31.12.2006**

Dr		Cr	
	Rs.		Rs.
To Salary & wages	8,000	By Gross profit b/d	1,25,000
To Interest paid	5,000	By Commission	11,000
To Commission	6,000	By Interest	4,000
To Advertisement	5,000	By Sundry income	15,000
To Discount	7,000	By Provision for doubtful debts	2,000
To Traveling expenses	5,000		
To Bad debts	1,500		
To Depreciation	10,000		
To Printing & Stationery	11,500		
To Postage & rates	7,500		
To Rent & rates	1,500		
To Medical fees	3,000		
To Other office expenses	1,200		
To Net profit	84,800		
	1,57,000		1,57,000

Illustration- 3

From the following balance extracted at the close of the year ended 31st Dec. 2005. Prepare Profit and Loss account of Mr.Veerappan as at that date:

	Rs.		Rs.
Gross profit	55,000	Repairs	500
Carriage on sales	500	Telephone expenses	520
Office Rent	500	Interest (Dr.)	480
General expenses	900	Fire insurance premium	900
Discount to customers	360	Bad debts	2,100
Interest from Bank	200	Apprentice Premium (Cr.)	1,500
Traveling expenses	700	Printing & Stationary	2,500
Salaries	900	Trade expenses	300
Commission	300		

Solution**Profit & Loss Account Mr. Veerappan for the year ending 31-12-2005**

Dr		Cr	
	Rs.		Rs.
To Carriage on Sales	500	By Gross profit b/d	55,000
To Office Rent	500	By Bank Interest	200
To General	900	By Apprentice Premium	1,500
To Discount to customers	360		
To Traveling expenses	700		
To Salaries	900		
To Commission	300		
To Repairs	500		
To Telephone expenses	520		
To Interest paid	480		
To Fire Insurance Premium	900		
To Bad debts	2,100		
To Printing & Stationery	2,500		
To Trade expenses	300		
To Net Profit transferred to Capital A/c	45,240		
	56,700		56,700

16.8 LET US SUM UP

In this lesson, we have briefly touched upon the following points

1. The resulting balance of profit and loss account is either Net profit or Net loss for the given period.
2. Personal expenses of proprietor should not be debited to the profit and loss account
Examples: Life insurance premium, Medical expenses of the owner, income tax
3. If any expenses are paid after deduction of income tax should be added back to the net expenses in order to arrive at the gross expenses.

4. The amount charged from a person to whom training is given by the business is an income and shown on the credit side of the profit and loss account

5. The incomes earned from usual business carried on by the concern is known as operating incomes. If the incomes are not related to the business carried on by the firm is known as non- operating incomes.

6. The main purpose of preparing profit and loss account is to know the net profit or loss of business

16.9 LESSON-END ACTIVITIES

1. What is profit and loss account? What purpose does it serve?
2. Describe the steps involved in the preparation of profit and loss account.
3. From the following Trial balance of sun and moon Ltd. prepare profit and loss account for the year ended 31-12-2007.

	Debit Rs.	Credit Rs.
Gross Profit		10,50,000
Commission received		10,000
Interest received		14,000
Sundry income		5,000
Depreciation	40,000	
Salaries	25,000	
Discount (Dr)	10,000	
Discount (Cr)		22,000
Bank charges	9,000	
Audit fees	3,000	
Stationery	1,400	

4. From the following balance given below, prepare Profit and loss a/c of Kannan Ltd. for the year ending 31.12.2007.

	Rs.		Rs.
Salary & wages	9,000	Discount allowed	17,000
Interest paid	12,000	Interest received	24,000
Commission received	18,000	Traveling	9,000
Commission paid	7,000	Bad debts	5,500
Advertisement	15,000	Depreciation	10,500
Printing & Stationery	4,500	Other office expenses	4,200
Postage & telegram	6,500	Sundry income	10,000
Rent & rates	4,500	Provision for doubtful debts	4,000
Medical fees	4,000	Gross Profit for the year	2,40,000

5. From the following balance extracted at the close of the year ended 31st Dec. 2005. Prepare Profit and Loss account of MrMeena as at that date:

	Rs.		Rs.
Gross loss	25,000	Repairs	1,500
Carriage on sales	1,500	Telephone expenses	520
Office Rent	2,200	Interest (Dr.)	2,880
General expenses	1,000	Fire insurance premium	2,900
Discount to customers	2,360	Bad debts	2,100
Interest from Bank	1,200	Apprentice Premium (Cr.)	1,000
Traveling expenses	2,000	Printing & Stationary	3,400
Salaries	800	Trade expenses	2,200
Commission	400		

16.10 MODEL ANSWER TO CHECK YOUR PROGRESS

Check1

- 1.This account is prepared mainly to know the net profit or net loss during the year.
- 2.This account is not relating to the study of the financial position of the concern.
- 3.Both operating and non operating incomes and expenses will appear in this account.

check 2

Operating expenses: These expenses are incurred to operate the business efficiently. They are incurred in running the organization. Non operating expenses are not directly associated with day today operations of the business concern.

Check 3

1. Opening and closing stock will appear in trading account. These items will not appear in profit and loss account.
2. The trading shows Gross profits or loss. Profit and loss account shows Net profit or loss.
3. All direct expenses are debited in trading account. All indirect expenses are debited profit and loss account
4. We can prepare trading account with out result of profit and loss account. Incase of profit and loss account can not prepare with out knowing the results of trading account

16.11 REFERENCES

1. A.Mukherjee -- Modern accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson 17

BALANCE SHEET

Contents

- 17.0 Aims and objectives
 - 17.1 Introduction
 - 17.1.1 Meaning
 - 17.1.2 Definitions
 - 17.2 Classification of assets and liabilities
 - 17.2.1 Assets
 - 17.2.2 Liabilities
 - 17.3 Examples for assets
 - 17.4 Examples for liabilities
 - 17.5 The specimen of balance sheet
 - 17.6 The purpose of preparing balance sheet
 - 17.7 Illustration
 - 17.8 Let us sum up
 - 17.9 Lesson-End Activities
 - 17.10 Model answer to check your progress.
 - 17.11 References
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17.0 AIMS AND OBJECTIVES

In lesson No 16, we discussed the meaning and preparation of Profit and loss account. Here we discuss the meaning and preparation of a statement is called as 'Balance sheet'. After going through this lesson, you will able to

- i) know the meaning and objectives of Balance sheet
 - ii) understand the method of preparation of Balance sheet
 - iii) identify the items that are shown on the asset side and liabilities side of Balance sheet.
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17.1 INTRODUCTION

In addition to finding out profit earned by him during the year, the businessman is also anxious to know his financial position as at the end of the year. For this purpose he prepares a statement known as Balance Sheet. In this section, we attempt to make a brief study of meaning and definition of Balance sheet.

17.1.1 Meaning

Balance sheet is a statement that shows readily the financial position of the business as on a given date by disclosing the amount of capital contributed and how the same has been invested and the values of assets and liabilities and their nature. It is rightly called as "mirror" of the business wherein the business can see its face i.e., its true position. It is prepared at the end of the accounting period, after preparation of Trading and profit and loss Accounts. From the balance sheet at one glance, the situation of the enterprise at certain date can be understood.

17.1.2 Definitions

i) **Francis R. Stead**:“Balance Sheet is a Screen picture of the financial position of a going business at a certain moment”

ii) **R.N. Antony** :“Balance sheet is a statement which reports the property values owned by the enterprise and the claims of the creditors and owners against the properties. It shows the status of the business as at a given moment of time, in so far as a counting of figures can show its status.”

iii)**Cropper**:“Balance sheet is a classified summer” of the ledger balances remaining after closing all revenue items into the trading and profit and loss accounts.”

The assets and liabilities can be put down in this statement, assets on one side and liabilities on the other, traditionally, assets are shown on the right hand side and liabilities and capital are shown on the left hand side. The total of assets must be equal to a total of liabilities and capital. Really speaking, capital is nothing but the difference between assets and liabilities, because what remains after paying off the third parties belongs to the proprietor. The two sides’ totals of the balance sheet must agree. If the total of assets does not agree with the total of liabilities and capital there is definitely something wrong.

Check your Progress 1

What do you understand about balance sheet?

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 155)

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17.2 CLASSIFICATION OF ASSETS AND LIABILITIES

A Clear and correct understanding of the basic divisions of the assets and liabilities and the meanings which they signify and the amounts which they represent is very essential for a proper perspective of financial position of a business concern. In this section, we classified the assets and liabilities under the following major headings.

17.2.1 Assets:

Assets are properties of business. It represents everything which a business owns and has money value. Assets are always shown as debit balances; therefore it is shown in the right hand side of the balance sheet. Assets are classified on the basis of their nature. The various types of types are as under

(i) Fixed assets:

Fixed Assets are the assets which are acquired and held permanently and used in the business with the objective of making profits. Land and building, Plant and machinery Furniture and Fixtures are examples of fixed assets.

(ii) Current assets:

The assets of the business in the form of cash, debtors, bank balances, bill receivable and stock are called current sets as they can be realized within an operating cycle of one year to discharge liabilities.

(iii) Tangible assets:

Tangible assets have definite physical shape or identity and existence; they can be seen, felt and have volume such as land, cash, stock etc. Thus tangible assets can be both fixed assets and current assets.

(iv) Intangible assets:

The assets which have no physical shape which cannot be seen or felt but have value are called intangible assets. Goodwill, patents, trade marks and licenses are examples of intangible assets. They are usually classified under fixed assets.

(v) Fictitious assets:

Fictitious assets are not real assets. Past accumulated losses or expenses which are capitalized for the time being, expenses for promotion of organizations (Preliminary expenses), discount on issue of shares, debit balance of profit and loss account etc, are the examples of fictitious assets.

(vi) Wasting assets :

These assets are also called depleting assets. Assets such as mines, Timber forests, quarries etc, which become exhausted in value by way of excavation of the minerals, cutting of wood etc, are known as wasting assets. Such assets are usually natural resources with physical limitations.

(vii) Contingent assets:

Contingent assets are assets, the existence, value and possession of which is based on happening or otherwise of specific events. For example, if a business firm has filed a suit for a particular property now is possession of other persons, the firm will get the property if the suit is decided in it favour. Till the suit is decided, it is a contingent asset.

17.2.2 Liabilities:

A liability is an amount which a business firm is 'liable to pay' legally. All the amounts which are claims by outsiders on the assets of the business are known as liabilities. They are credit balances in the ledger. The capital and liabilities of the business are shown on the left hand side in the balance sheet. Liabilities are classified into four categories as given below.

i) Owner's capital:

Capital is the amount contributed by the owners of the business. In addition to initial capital introduced, proprietors may introduce additions capital and withdraws some amounts from business over a period of time. Owner's capital is also called 'net worth'. Net worth is the total fund of proprietors on a particulars date. It consists of capital, profits and interest on capital subject to reduction of drawings and interest on drawings. In case of limited companies, capital refers to capital subscribed by shareholders. Net worth refers to paid up equity capital plus reserves and profits, minus losses.

i) Long term Liabilities:

Liabilities repayable after specific duration of long period of time are called long term liabilities. They do not become due for payment in the ordinary 'operating cycle' of business

or within a short period of time. Examples are long term loans and debentures. Long term liabilities may be secured or unsecured, though usually they are secured.

ii) Current liabilities:

Liabilities which are repayable during the operating cycle of business, usually within a year, are called short term liabilities of current liabilities. They are paid out of current assets or by the creation of other current liabilities. Examples of current liabilities are trade creditors, bills payable, outstanding expenses, bank overdraft, taxes payable and dividends payable.

iii) Contingent liabilities:

Contingent liabilities will result into liabilities only if certain events happen. Examples are bills discounted and endorsed which may be dishonored, unpaid calls on investments.

17.3 SOME EXAMPLES FOR ASSETS

In this section, we listed out some items as examples for assets.

Land & Buildings, Furniture & fixtures, Plant and machinery, Investments, Vehicles, Loose tools, Trade marks, Patents rights, copy rights, Closing stock, Sundry debtors, Bills receivable, Cash in hand ,Cash at bank, Accrued incomes, Prepaid expenses Goodwill and Preliminary expenses.

17.4 SOME EXAMPLES FOR LIABILITIES

In this section, we listed out some items as examples for liabilities
Capital, Loan on mortgage ,Bank loan, Sundry creditors, Bills payable, Bank overdraft, Income received in advance ,outstanding expenses. Reserves, all type of funds.

Check your Progress 2

Difference between balance sheet and profit and loss account

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 155)

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17.5 THE SPECIMEN OF BALANCE SHEET

In this section, here we have presents a proforma of Balance sheet.

Balance Sheet as on

Liabilities		Rs.	Assets	Rs.
Capital	xxx		Fixed assets	
Add: Net profit	xxx		Goodwill	xxx
Add: Interest on capital	xxx		Land & Buildings	xxx
	----		Loose tools	xxx
Less: Drawing	xxx		Furniture & fixtures	xxx
Less: Int. on drawings	xxx		Vehicles	xxx
Less: Loss if any	xxx		Patents	xxx
	----	xxx	Trade marks	xxx
Long term liabilities			Long term loans (advances)	xxx
Loan on mortgage		xxx	Investments	xxx
			Current assets	
Bank loan		xxx	Closing stock	xxx
Current liabilities			Sundry debtors	xxx
Sundry creditors		xxx	Bills receivable	xxx
Bills payable		xxx	Prepaid expenses	xxx
Bank overdraft		xxx	Accrued incomes	xxx
Creditors for outstanding exp.		xxx	Cash at bank	xxx
Income received in advance		xxx	Cash in hand	xxx
			Fictitious assets	
			Preliminary expenses	xxx
			Advertisement expenses	xxx
			Underwriting commission	xxx
			Discount on issue of shares	xxx
			Discount on issue of debentures	xxx
	xxx			xxx

17.6 THE PURPOSE OF PREPARING BALANCE SHEET

In this section, we attempt to make a brief purpose of preparing Balance sheet.

To measure the correct financial position of a business

To know the total value of the assets of the firm

To calculate the claims of the owners and creditors against the business's properties

Check your Progress 3

Explain the terms with two examples each.

1. Contingent liabilities 2. Fictitious assets:

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 155)

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17.7 ILLUSTRATION

In this section, we worked out some modal problems for you, to learn how to prepare balance sheet.

Illustration-1

The following adjusted Trial Balance was prepared after Trading and Profit & Loss Accounts are drafted; prepare Balance Sheet of Sutha as at 31st December 2005. Under.

(a) Permanency order and (b) Liquidity order.

	Dr. Rs.	Cr. Rs.
Capital	-	1,00,000
Closing Stock	40,000	-
Fixed Assets less depreciation Rs.16,000	72,000	-
Sundry Debtors	1,00,000	-
Provision for Bad debts	-	5,000
Profit & Loss Account	-	42,000
Sundry Creditors	-	80,000
Liabilities for expenses	-	11,000
Drawings	6,000	
Cash & Bank	20,000	
	2,38,000	2,38,000

Solution**(a) Permanency Order:- Balance Sheet of Sutha as on 31-12-2005**

Liabilities		Rs.	Assets		Rs.
Capital opening bal.	1,00,000		Fixed Assets	88,000	
Add: Net Profit	42,000		Less: Depreciation	16,000	72,000
	1,42,000		Stock		40,000
Less: Drawing	6,000	1,36,000	Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for Bad debts	5,000	95,000
Liabilities for expenses		11,000	Cash & Bank		20,000
		2,27,000			2,27,000

(b) Liquidity Order:**Balance Sheet of Sutha as on 31-12-2005**

Liabilities		Rs.	Assets		Rs.
Liabilities for expenses		11,000	Cash & Bank		20,000
Sundry Creditors		80,000	Debtors	1,00,000	
Capital A/c			Less: Provision for Bad debts	5,000	95,000
Opening Balance:	1,00,000		Stock		40,000
Add: Net Profit	42,000		Fixed Assets	88,000	
	1,42,000		Less: Depreciation	16,000	72,000
Less: Drawings	6,000	1,36,000			
		2,27,000			2,27,000

Illustration -2

From the following adjustment Trial Balance, prepared after Trading and Profit and Loss Accounts are drafted, Prepare Balance Sheet of Sivakumari Traders as at 31st December 2004.

Trial balance

	Dr. (Rs.)	Cr. (Rs.)
Capital	-	2,50,000
Cash in hand	40,000	-
Cash at bank	30,000	-
Closing stock	20,000	-
Fixed assets less depreciation (Rs.20,000)	1,80,000	-
Bills receivable	21,000	-
Bills payable	-	2,000
Sundry debtors	52,000	-
Sundry creditors	-	25,000
Liabilities for expenses	-	10,000
Drawings	12,000	-
Investments	15,000	-
P&L A/c	-	70,000

Bank overdraft	-	13,000
	3,70,000	3,70,000

Solution**Balance Sheet of Sivakumari Traders as on 31st December 2004**

Liabilities		Rs.	Assets	Rs.
Capital	2,50,000		Fixed assets	2,00,000
Add : Net profit	70,000		Less: Depn.	20,000
	-----			-----
				1,80,000
Less: Drawings	3,20,000		Investments	15,000
	12,000		Closing stock	20,000
	-----	3,08,000	Sundry debtors	52,000
Bills payable		2,000	Bills receivable	21,000
Sundry creditors		25,000	Cash at bank	30,000
Liabilities for expenses		10,000	Cash in hand	40,000
Bank overdraft		13,000		
		3,58,000		3,58,000

Illustration -3

From the following balances prepare Balance Sheet of Raja Traders as at 31st December 2006.

Trial balance

	Dr. (Rs.)	Cr. (Rs.)
Capital	-	5,00,000
Sundry debtors	1,04,000	-
Sundry creditors	-	50,000
Closing stock	40,000	-
Liabilities for expenses		20,000-
Bills receivable	42,000	-
Bills payable	-	4,000
Investments	30,000	
Fixed assets less depreciation (Rs.40,000)	3,60,000	
Drawings	24,000	
Cash at bank	60,000	-
Cash in hand	80,000	-
P&L A/c	-	1,40,000
Bank overdraft	-	26,000
	7,40,000	7,40,000

Solution**Balance Sheet of Raja Traders as on 31st December 2006**

Liabilities		Rs.	Assets	Rs.
Capital	5,00,000		Fixed assets 4,00,000	
Add : Net profit	1,40,000		Less: Depreciation. 40,000	
	-----			3,60,000
	6,40,000		Investments	30,000
Less: Drawings	24,000		Closing stock	40,000
	-----	6,16,000	Sundry debtors	1,04,000
Bills payable		4,000	Bills receivable	42,000
Sundry creditors		50,000	Cash at bank	60,000
Liabilities for expenses		20,000	Cash in hand	80,000
Bank overdraft		26,000		
		7,16,000		7,16,000

17.8 LET US SUM UP

In this lesson, we have briefly touched upon the following points

1. Balance sheet shows readily the financial position of the business at a given date by disclosing the amount of capital and how the same has been invested and the value of assets and liabilities and their nature.
2. Assets are shown in the right hand side and liabilities are shown in the left hand side
3. The total value of the assets is always equal to the total value of the liabilities in other words $\text{Assets} = \text{Capital} + \text{liabilities}$
4. Assets can be classified in to six categories and liabilities may be four categories.

17.9 LESSON-END ACTIVITIES

1. Define "Balance sheet"
 2. What do you understand about preparation of balance sheet by 'Liquidity order'?
 3. What are the major classification of assets and liabilities?
 4. The following adjusted Trial Balance was prepared after Trading and Profit & Loss Accounts are drafted; prepare Balance Sheet of Samynarayan as at 31st December 2005.
Under.
- (a) Permanency order and (b) Liquidity order.

	Dr. Rs.	Cr. Rs.
Capital	-	1,00,000
Sundry Debtors	1,00,000	-
Provision for Bad debts	-	5,000
Good will	60,000	
Loan from Kumari		35,000

Land	40,000	
Building less depreciation Rs.16,000	72,000	
Closing Stock	40,000	-
Liabilities for expenses	-	11,000
Drawings	6,000	
Reserve fund		65,000
Profit & Loss Account	-	42,000
Sundry Creditors	-	80,000
Cash & Bank	30,000	
Prepaid rent	5,000	
Commission received in advance		15,000
	3,53,000	3,53,000

5. From the following adjustment Trial Balance, prepared after Trading and Profit and Loss Accounts are drafted, Prepare Balance Sheet of Sivakumari Traders as at 31st December 2004.

Trial balance

	Dr. (Rs.)	Cr. (Rs.)
Capital	-	2,50,000
Cash in hand	40,000	-
Land & building	50,000	
Cash at bank	30,000	-
Closing stock	20,000	-
Plant & machinery	30,000	
Motor car	1,80,000	-
Loan from kavitha		80,000
Reserves		35,000
Prepaid rent	15,000	
Bills receivable	21,000	-
Bills payable	-	2,000
Sundry debtors	52,000	-
Sundry creditors	-	25,000
Good will	20,000	
Liabilities for expenses	-	10,000
Drawings	12,000	-
Investments	15,000	-
P&L A/c	-	70,000
Bank overdraft	-	13,000
	4,85,000	4,85,000

6. From the following balances prepare Balance Sheet of Rojamalar Traders as at 31st December 2006.

Trial balance

	Dr. (Rs.)	Cr. (Rs.)
Capital	-	10,00,000
Sundry debtors	2,08,000	-

Sundry creditors	-	1,00,000
Closing stock	80,000	-
Liabilities for expenses		40,000-
Bills receivable	84,000	-
Bills payable	-	8,000
Investments	60,000	
Fixed assets less depreciation (Rs.40,000)	7,20,000	
Drawings	48,000	
Cash at bank	1,20,000	-
Cash in hand	1,60,000	-
P&L A/c	-	2,80,000
Bank overdraft	-	52,000
	14,80,000	14,80,000

17. 10 MODEL ANSWERS TO “CHECK YOUR PROGRESS”

Check 1

Balance sheet is a statement prepared to ascertain the true position of assets and liabilities as on a particular date. It is prepared at the end of the accounting period, after the preparation of trading and profit and loss accounts. It shows the financial position of a business on a particular date.

Check 2

1. Balance sheet is a statement but profit and loss account is an account
2. Balance sheet discloses financial position of the business. Profit and loss account discloses the net profit or loss of the business
3. Balance sheet is prepared on a particular day. Profit and loss account is prepared for a particular period.
4. Balance sheet includes only real and personal accounts .Profit and loss account includes only nominal account.

Check 3

1. Contingent liabilities

These are not actual liabilities but their becoming actual liability is contingent on the happening of certain even. If it does not occur, no liability is incurred.

2. Fictitious assets

The assets which are not represented by any thing concrete or tangible is known as ictitious assets. Preliminary expenses, debit balance of profit and loss account are the examples of such assets.

17.11 REFERENCES

1. A.Mukherjee-- Modern accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

Lesson -18

ADJUSTMENTS AND PREPARATION OF FINAL ACCOUNTS

Contents

- 18.0 Aims and objectives
 - 18.1 Introduction
 - 18.2 List of adjustments
 - 18.3 Accounting treatments for each adjustments
 - 18.4 Illustration
 - 18.5 Let us Sum Up
 - 18.6 Lesson-End Activities
 - 18.7 Model answer to check your progress.
 - 18.8 References
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18.0 AIMS AND OBJECTIVES

In lessons Nos 12, 13, 14 and 15, we discussed the method of preparation of manufacturing account, trading account, Profit and loss account and Balance sheet separately. Here we discuss the various types of adjustments involved in the preparation of final accounts and the method of preparation of final accounts in details. After going through this lesson, you will be able to

1. know the accounting treatment for different type of adjustments
 2. understand method of preparation of final accounts
-

18.1 INTRODUCTION

Final accounts are prepared for a completed period. If expenses have been incurred but not paid during that period. On the other hand if an income has been earned but it may not be received during that period while preparing Trading and profit and Loss Account on mercantile system of accountancy, all expenses and incomes should be properly adjusted through accounting entries.

18.2 LIST OF ADJUSTMENTS

Adjustment entries are made before the accounts are closed and final account is prepared. In this section, we identify and listed the common items of adjustment to be made at the end of the accounting period.

1. Closing Stock
2. Outstanding Expenses
3. Prepaid Expenses
4. Income Earned but not received (Outstanding or accrued income)
5. Income received in advance

6. Depreciation
7. Bad Debts
8. Provision for doubtful debts
9. Provision for discount on debtors
10. Reserve for discount on creditors
11. Interest on capital
12. Interest on Drawings
13. Transfer to Reserve
14. Commission on Profit
15. Loss of goods by fire or accidents
16. Goods drawn for personal use
17. Goods used in office from purchases
18. Goods sent on sale or return basis
19. Goods distributed as free samples

18.3 ACCOUNTING TREATMENTS FOR EACH ADJUSTMENTS

A concern is required to pass certain entries at the end of the year to adjust the various items of incomes and expenses. In this section, we attempt to make a brief explanation of the accounting treatment for various adjustments.

1. Closing Stock

This is the stock which remained unsold in the preceding accounting period.

Closing stock A/c Dr			
To Trading A/c			
Dr	Trading A/c	Cr	
	By Closing stock		

Balance Sheet			
	Liabilities		Assets
			Closing stock

2. Outstanding Expenses

Outstanding expenses refer to those expenses which have become due during the accounting period for which the final accounts have been prepared, but have not yet been paid.

Expenses A/c Dr			
To Outstanding expenses A/c			
Dr	Trading A/c	Cr	
To Wages (+) O/s wages			

Balance Sheet			
	O/S wages		

P & L A/c Dr			
To Salary			
Dr	P & L A/c	Cr	
To Salary (+) O/s wages			

Balance Sheet			
	O/S wages		

3. Prepaid Expenses

Prepaid expenses are the expenses the benefit of which has not been fully enjoyed before the end of the accounting year. They are expenses paid in advance or unexpired expenses.

Prepaid expense A/c		Dr		
To Expenses A/c				
Dr	P & L A/c	Cr	Balance Sheet	
To Insurance				Prepaid insurance
(-) Prepaid Ins.				

4. Income Earned but not received (Outstanding or accrued income)

It may often happen that certain items of income such as interest on investments, commission etc. are earned during the current accounting year, but have not been actually received by the end of the same year. Such incomes are known as outstanding or accrued incomes.

Accrued Income A/c		Dr		
To Income A/c				
Dr	P&L A/c	Cr	Balance Sheet	
	By interest			Accrued interest
	(+) Accrued int.			

5. Income received in advance

Sometimes a portion of income received during the current year relate to the future period. Such portion of the income which belongs to the next accounting period is income received in advance and is known as unexpired income.

Income A/c		Dr		
To Income received in advance A/c				
Dr	P & L A/c	Cr	Balance Sheet	
	By Rent received		Rent received	
	(-) Received in advance		in advance	

6. Depreciation

Depreciation is the decreased in the value of an asset due to wear and tear, passage of time, obsolescence etc. It is a business expenses, though it is not paid in cash every year. It is to be debited to profit and loss account and the amount be deducted from the relevant asset in the Balance Sheet.

If depreciation is given in the Trial Balance, it is taken only on the debit side of Profit and Loss Account as its adjustment is over.

Depreciation A/c		Dr.		
To Concerned Assets A/c				
Dr	P&L A/c	Cr	Balance Sheet	
To Dep. On machinery				Machinery (-) Depreciation

7. Bad Debts

Any irrecoverable portion of sundry debtors is termed as bad debt. Bad debt is a loss to the business. If is given in the Trial Balance, it should be shown on the debit side of Profit and Loss Account. Bad debts given in the adjustment is to be deducted from sundry debtors in the Balance Sheet and the same is debited to the Profit and Loss Account.

Bad debts A/c		Dr.		
To Sundry Debtors A/c				
Dr	P&L A/c	Cr	Balance Sheet	
To Bad debts				Debtors (-) Bad debts

8. Provision for doubtful debts

It is a provision created to meet any loss, if the debtors fail to pay the whole or part of the debt owed by them. The amount required for doubtful debt is kept by changing the amount to the profit and loss account.

Profit and Loss A/c		Dr		
To Provision for doubtful debts A/c				
Dr	P&L A/c	Cr	Balance Sheet	
To Provision for doubtful debts				Debtors (-) Bad debts (-) Provision for double debts

9. Provision for discount on debtors

Sometimes the goods are sold on credit to customers in one accounting period whereas the payment of the same is received in the next accounting period and discount is to be allowed.

Profit and Loss A/c		Dr.		
To Provision for discount on debtors A/c				
Dr	P&L A/c	Cr	Balance Sheet	
To Provision for discount on debtors				Debtors (-) Bad debts (-) Provision for double debts (-) Discount on debtors

10. Reserve for discount on creditors

Prompt payment, if made, enables a business man to receive discount. So on last day of accounting period if some amount is still payable to creditors, a provision should be created for such probable income and the amount should be credited to the profit and loss account of that year in which purchases are made.

Reserve for discount on creditors A/c Dr.

To Profit and Loss A/c			Balance Sheet	
Dr	P & L A/c	Cr		
	By Provision for discount creditors		Creditors (-) Provision for discount on creditors	

11. Interest on capital

Sometimes interest is paid on the proprietor's capital. Such interest is an expense to the business and is debited to profit and Loss Account.

Interest on capital A/c Dr

To Capital A/c			Balance Sheet	
Dr	P&L A/c	Cr		
To Interest on capital			Capital (+) Interest on Capital	

12. Interest on Drawings

Often, interest is charged on drawings made by the proprietor. It is a gain to the business.

Drawings A/c Dr

To Interest on drawings A/c

To Interest on drawings A/c			Balance sheet	
Dr	P&L A/c	Cr		
	To Interest on drawings		Capital (+) Interest on Capital (-) Interest on drawings	

13. Transfer to Reserve

Reserves save a business from future losses and meet the losses without reduction in capital. The reserves are appropriation of profits and are created only in the year when there are profits.

Profit and loss A/c

Dr.

To Reserve A/c

To Reserve A/c			Balance Sheet	
Dr	P&L A/c	Cr		
To New reserve			Reserve (+) New reserve	

14. Commission on Profit

The Commission as a percentage of the net profit may be ‘before’ or ‘after’ charging such commission. In the absence of any special instruction, it is assumed that commission is allowed as a percentage of the net profit before charging such commission.

a) If the commission is on the net profit before charging such commission, the formula is.

$$\text{Profit before} \times \frac{\text{Rate of commission}}{100}$$

For example, if profit is Rs.22,000 and rate of commission is 10% on the profit before charging such commission, the calculation is as follow:

$$\text{Commission} = 22,000 \times \frac{10}{100} = 2,200$$

b) If the commission is on the net profit after charging such commission, the amount is calculated as follows:

$$\text{Commission} = \text{Profit} \times \frac{\text{Rate}}{(100+\text{rate})}$$

$$\begin{aligned} \text{Commission as per above example} &= 22,000 \times \frac{10}{110} \\ &= \text{Rs.}2,000 \end{aligned}$$

Manager’s Commission A/c Dr. To Outstanding commission A/c			Balance Sheet	
Dr	P & L A/c	Cr		
To Outstanding commission			Outstanding Commission	

15. Loss of goods by fire or accidents

a) Such losses are abnormal losses. Stock destroyed by fire or accidents is credited to the Trading Account.

Loss of stock A/c Dr. To Trading A/c			Balance Sheet	
Dr	Trading A/c	Cr		
	By Loss by fire		Insurance claims	

18. Goods sent on sale or return basis

The sales value of such goods if included in the total sales should be deducted from sales and debtors. The entry for the same is:

Sale Return A/c **Dr.**
or
Sale A/c **Dr.**
To Debtors

19. Goods distributed as free samples

It may be debited in the goods sent as free samples or Advertisement account and credited to Purchases Account.

Goods sent as free sample A/c **Dr.**
or
Advertisement A/c **Dr.**
To Purchases A/c

Check your Progress 1

Give adjustment entries for the following items

1. Provision for doubtful debts.
2. Interest on capital
3. Commission on profit
4. Prepaid expenses.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 179-180)

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18.4 ILLUSTRATIONS

In this section, we worked out some modal problems for you, to learn how to prepare Final accounts

Illustration-1

The following balances are drawn from the books of M/s Arvind Mills as on 31-12-1997.

Account	Amount	Account	Amount
	Rs		Rs.
Land	1,00,000	Sales	3,00,000
Building	2,00,000	Purchases	1,75,000
Sales returns	10,000	Stock (1-1-97)	25,000

Purchase returns	5,000	Debtors	50,000
Bank overdraft	15,000	Cash in hand	5,000
Creditors	20,000	Salaries	10,000
Wages	12,000	Goodwill	15,000
General expenses	5,000	Selling expenses	12,000
Bad debts	1,000	Insurance	1,000
Capital	2,81,000		

Adjustments:

- Closing stock is Rs.30,000
- Provide for depreciation @ 10 % on buildings.
- Write off further bad debts – Rs. 1,000
- Salaries yet to be paid- Rs. 3,000

You are required to prepare a trading and profit & loss a/c and balance sheet of M/s Arvind Mills.

Solution:

Trading and Profit and Loss account of M/s. Arvind Mills for the year ended 31-012-97.

Dr.

Cr.

Particulars		Rs.	Particulars		Rs
To Opening stock		25,000	By Sales	3,00,000	
To Purchases	1,75,000		Less: Returns	10,000	2,90,000
Less: Returns	5,000	1,70,000	By Closing stock		30,000
To Wages		12,000			
To Gross profit c/d		1,13,000			
		3,20,000			3,20,000
To General expenses		5,000	By Gross Profit b/d		1,13,000
To Bad debts: Old	1,000				
New	1,000	2,000			
To Salaries	10,000				
Add: Outstanding	3,000	13,000			
To Insurance		1,000			

To Depreciation on Building (2,00,000 x 10 %)		20,000		
To Selling expenses		12,000		
To Net profit, transferred to capital A/c		60,000		
		1,13,000		1,13,000

Balance sheet of M/s. Arvind Mills as on 31-12-1997.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs
Bank overdraft		15,000	Cash on hand		5,000
Creditors		20,000	Debtors	50,000	
Outstanding salaries		3,000	Less: Bad debts written off.	1,000	49,000
Capital	2,81,000		Closing stock		30,000
Add: Net profit	60,000	3,41,000	Building	2,00,000	
			Less: Depreciation at 10%	20,000	1,80,000
			Land		1,00,000
			Goodwill		15,000
		3,79,000			3,79,000

Illustration -2

The following is the Trial balance as on 31st December 1992 extracted from the books of Mr. Shanthi

Particulars	Debit Rs.	Credit Rs.
Freehold Land	35,000	
Mortgage Loan		20,000
Plant and Machinery	45,500	
Loose tools 1.1.92	5,600	
Bills payable		3,400
Book debts	18,200	
Sales		1,21,500
Cash at bank	11,000	
Stock 1.1.1992	10,500	
Insurance	300	
Bad debts	560	
Sundry creditors		15,600
Bills Receivable	5,400	
Purchases	50,000	
Cash on hand	640	
Rent, Rates, etc.	1,300	
Interest	250	
Wages	10,700	
Trade expenses	150	
Salary	1,560	
Repairs to plant	875	
Carriage Inwards	350	
Discount	290	175
Satish's capital		40,000
Drawings	2,500	
	2,00,675	2,00,675

Prepare trading and profit and loss account and balance sheet after making the following adjustment: Provision for doubtful debts at 5% on book debts; Interest on capital at 5% unexpired insurance premium Rs.90; Rent outstanding on 31-12-92 Rs. 300; Loose tools revalued at Rs.4,500, Closing stock Rs.30,000.

Solution

**Trading and Profit and Loss A/c of Mr.Satish
For the year ended 31st December 1992**

Dr.			Cr.	
Particulars		Rs.	Particulars	Rs.
To Opening stock		10,500	By Sales	1,21,500
To Purchases		50,000	By Closing stock	30,000
To Wages		10,700		
To Carriage inwards		350		
To Gross profit c/d		79,950		
		1,51,500		1,51,500
To Insurance	300		By Gross profit b/d	79,950
Less: Unexpired	90	210	By Discount	175
To Bad debts	560			
Add: Provision for doubtful debts	910	1470		
To Rent & Rates	1,300			
Add: Outstanding	300	1,600		
To Interest		250		
To Trade expenses		150		
To Salary		1,560		
To Repairs to plant		875		
To Discount		290		
To Interest on capital (40,00 x 5%)		2,000		
To Depreciation on Loose tools		1,100		
To Net profit, transferred to capital A/c		70,620		
		80,125		80,125

Note : Loose tools are generally revalued at the end of accounting year. They are the low value tools and implements like spanners, screw drivers etc. The difference between closing value of loose tools and their opening value is to be treated as depreciation. (Revaluation method of depreciation)

Balance sheet of Mr. Satish as on 31-12-1992

Liabilities		Rs.	Assets		
Bills payable		3,400	Cash at Bank		11,000
Sundry creditors		15,600	Cash on hand		640
Outstanding rent		300	Book debts	18,200	
Mortgage loan		20,000	Less: Provision for doubtful debts	910	17,290
Capital	40,000		Bills receivable		5,400
Add: Net profit	70,620		Closing stock		30,000
Add: Interest on capital	2,000		Prepaid insurance		90
	1,12,620		Loose tools	5,600	
Less: Drawings	2,500	1,10,120	Less: Depreciation	1,100	4,500
			Plant and machinery		45,500
			Freehold land		35,000
		1,49,420			1,49,420

Note : Prepaid Insurance and unexpired insurance are both one and the same.

Illustration 3

The following Trial Balance is extracted from the books of a merchant on 31st December 1989.

Particulars	Debit Rs.	Credit Rs.
Furniture and fittings	640	
Motor vehicles	6,250	
Buildings	7,500	
Capital		12,500
Bad debts	125	
Provision for bad debts		200
Sundry debtors and creditors	3,800	2,500
Stock on January 1, 1989	3,460	
Purchases and sales	5,475	15,450
Bank overdraft		2,850
Sales and purchase returns	200	125
Advertising	450	

Interest	118	
Commission		375
Cash	650	
Taxes and insurance	1,250	
General expenses	782	
Salaries	3,300	
	34,000	34,000

The following adjustment are to be made:

- Stock in hand on 31st December 1989 was Rs.3,250.
- Depreciate buildings @ 5%, furniture and fittings @ 10% and motor vehicles @ 20%.
- Rs.85 is due for interest on bank overdraft.
- Salaries Rs.300 and taxes Rs.120 are outstanding.
- Insurance amounting to Rs.100 is prepaid.
- One-third of the commission received is in respect of work to be done next year.
- Write off a further Rs.100 as bad debts and provision for bad debts is to be made at 5% on sundry debtors.
- Purchases included purchase of furniture Rs.200, on January 1, 1989.

Prepare a trading and profit and loss A/c for the year ending 31st December 1989 and a balance sheet as on that date.

Solution:

Trading and profit and Loss A/c for the year ended 31st December 1989.

Particulars		Rs.	Particulars		Rs.
To Opening stock		3,460	By Sales	15,450	
To Purchases	5,475		Less: Sales returns	200	15,250
Less: Purchase returns	125		By Closing stock		3,250
	5,350				
Less: Purchase of furniture	200	5,150			
To Gross profit c/d		9,890			
		18,500			18,500
To Advertising		450	By Gross profit b/d		9,890
To Interest	118		By Commission	375	
Add: Outstanding	85	203	Less: Received in advance	125	250
To Bad debts	125				
Add: New Bad debts	100				
Add: Provision required	185				

(3,800 – 100) x 5%				
	410			
Less: Existing provision	200	210		
To Taxes and insurance	1,250			
Less: Insurance prepaid	100			
	1,150			
Add: Taxes outstanding	120	1,270		
To Depreciation:				
Buildings (7,500 x 5%)	375			
Furniture x (640+200)10%	84			
Motor vehicles (6,250x20%)	1,250	1,709		
To General expenses		782		
To Salaries	3,300			
Add: Outstanding	300	3,600		
To Net profit, transferred to Capital account		1,916		
		10,140		10,140

Balance sheet as on 31st December 1989

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		2,500	Cash		650
Bank overdraft		2,850	Sundry debtors	3,800	
Outstanding expenses :			Less: Bad debts	100	
Interest due	85			3,700	
Salaries	300		Less: Provision for bad debts	185	3,515
Taxes	120	505	Closing stock		3,250
Commission received in advance		125	Insurance prepaid		100
Capital	12,500		Furniture	640	
Add: Net profit	1,916	14,416	Add: Purchases	200	
				840	
			Less: Depreciation	84	756
			Motor vehicles	6,250	
			Less: Depreciation	1,250	5,000
			Building	7,500	
			Less: Depreciation	375	7,125
		20,396			20,396

Illustration -4

From the following data, prepare a profit and loss a/c and a balance sheet as on 31-3-1996.

Particulars	Rs.	Particulars	Rs.
Drawings	10,000	Capital	30,000
Purchases	30,000	Purchase returns	1,000
Sales Returns	5,000	Sales	60,000
Carriage in	2,000	Wages outstanding	2,000
Carriage out	3,000	Rent received	1,000
Depreciation on Plant	4,000	Reserve for doubtful debts	1,000
Plant account	20,000	Interest (Cr)	5,000
Salaries & wages	3,000	Sundry creditors	6,000
Bad debts	2,000	Loans	38,000
Premises	20,000		
Interest	5,000		
Stock 1.4.95	25,000		
Sundry debtors	15,000		
	1,44,000		1,44,000

Adjustment:

- Stock on 31-3-96 was Rs.40,000. A fire broke-out in the godown and destroyed stock worth Rs.5,000. Insurance company had accepted the claim in full.
- Provide for bad debts @ 10% and provide for discount on debtors @ 5% and on creditors @ 10%
- Depreciate buildings at the rate of 15% p.a.
- Rent outstanding amounted to Rs.1,000
- Closing stock includes samples worth of Rs.2,000.
- Provide interest on drawings @ 10% and on capital @ 10%.

Solution:**Trading and profit and loss account for the year ending 31st March 1996**

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening stock		25,000	By Sales	60,000	
To purchases	30,000		Less: Returns	5,000	55,000
Less: purchase returns	1,000		By Closing stock		38,000
	29,000		By Stock destroyed by fire		5,000
Less: Sample	2,000	27,000			
To Carriage inwards		2,000			
To Gross Profit C/d		44,000			
		98,000			98,000
To Salaries & Wages		3,000	By Gross profit b/d		44,000
To Rent outstanding		1,000	By Rent received		1,000
To Carriage outwards		3,000	By Interest		5,000
To Bad debts	2,000		By Provision of discount creditors 6,000 x 10%		600
Add: New provision for bad debts (15,000 x 10%)	1,500		By Interest on drawings (10,000 x 10%)		1,000
	3,500				
Less: Existing provision for bad bets	1,000	2,500			
To Provision for discount on debtors (15,000-1,500) x 5%		675			
Interest		5,000			
To Depreciation:					
Plant	4,000				
Building (20,000x15%)	3,000	7,000			
To Interest on capital		3,000			
To Net profit, transferred to capital account.		26,425			
		51,600			51,600

Note:

- (1) Premises include Land and Buildings, So, depreciation on Buildings applies to premises.

- (2) Stock destroyed by fire is credited to trading a/c and claim is shown as an asset.
- (3) Depreciation on plant given in Trial balance is assumed to be current year's depreciation.
- (4) Samples included in closing stock should be separated from stock by reducing from stock. So, effective closing stock is only Rs.38,000.

The samples should be reduced from purchases because they are not meant for sale. Since they are not yet distributed, they appear on assets side of balance sheet.

Adjustment entry is:

Samples A/c	Dr	2,200	
To purchases A/c			2000

Balance sheet as on 31.3.1996

Liabilities		Rs.	Assets		Rs.
Sundry creditors	6,000		Debtors	15,000	
Less: Provision for discount	600		Less: Provision for bad debts	1,500	
		5,400		13,500	
Loans		38,000			
Wages outstanding		2,000	Less: Provision for discount on debtors	675	12,825
Rent outstanding		1,000			
Capital	30,000		Closing stock		38,000
Add: Net profit	26,425		Samples in stock		2,000
Add: Interest on capital	3,000		Insurance claim Receivable		5,000
	59,425		Plant		20,000
Less: Interest on drawings	1,000		Premises	20,000	
	58,425		Less: Depreciation	3,000	17,000
Less: Drawings	10,000				
		48,425			
		94,825			94,825

Illustration - 5

The following is the Trial balance of B.Gopal on 30th June 1981:

	Debit Rs.	Credit Rs.
Cash in hand	540	
Cash at bank	2,630	
Purchases account	40,675	
Sales account		98,780
Returns inward account	680	
Returns outward account		500

Wages account	10,480	
Fuel and Power A/c	4,730	
Carriage on Sales A/c	3,200	
Carriage on Purchases A/c	2,040	
Stock Account (1 st July, 1980)	5,760	
Buildings Account	30,000	
Freehold Land A/c	10,000	
Machinery A/c	20,000	
Patents A/c	7,500	

Salaries Account	15,000	
General expenses A/c	3,000	
Insurance Account	600	
Drawings Account	5,245	
Capital account		71,000
Sundry debtors A/c	14,500	
Sundry creditors A/c		6,300
	1,76,580	1,76,580

Taking into account the following adjustments prepare Trading and Profit & Loss account and the balance sheet:

- (a) Stock on hand 30th June, 1981 is Rs.6,800. Machinery is to be depreciated at the rate of 10% and patents at the rate of 20%.
- (b) Salaries for the month of June 1981 amount to Rs.1,500 were unpaid.
- (c) Insurance includes a premium of Rs. 170 on a policy expiring on 31st December, 1981.
- (d) Wages include a sum of Rs.2,000 spent on the creation of a cycle shed for employees and customers.
- (e) A provision for bad and doubtful debts is to be created to the extent of 5% on sundry debtors.

Solution:

**Trading and profit and Loss Account of Gopal
for the year ended 30th June 1981.**

Dr.			Cr.		
Particulars		Rs.	Particulars		Rs.
To Opening stock		5,760	By Sales	98,780	
To Purchase	40,675		Less: Sales returns	680	
Less: Purchase returns	500	40,175	By Closing stock		98,100
To Carriage on purchases		2,040			6,800
To Wage	10,480				
Less: Wages for erection of cycle shed	2,000	8,480			
To Fuel and power		4,730			
To Gross profit b/d		43,715			
		1,04,900			1,04,900
To Carriage on sales		3,200	By Gross profit b/d		43,715
To Salaries	15,000				
Add: Outstanding	1,500	16,500			
To General expenses		3,000			
To Insurance	600				
Less: Prepaid 170 x 6/12	85	515			
To Depreciation:					
Machinery					
20,000 x 10%	2,000				
Patents 7.500 x 20%	1,500	3,500			
To Provision for doubtful debts (14,500 x 5%)		725			
To Net profit transferred to capital A/c		16,275			
		43,715			43,715

Note:

1. Carriage on Purchased is carriage inward;
Carriage on Sales is carriage outward.
2. Wages for erecting cycleshed is a capital expenditure. It should be reduced from wages and added to the asset i.e., cycleshed (or) Buildings.

3. Out of insurance Rs.600. Rs.170 is paid on a policy which is upto Dec. 81. So,
 $170 \times \frac{6}{12} = \text{Rs.85}$ it's the insurance prepaid.

Balance sheet of B. Gopal as on 30th June 1981

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry creditors		6,300	Cash in hand		540
Salaries unpaid		1,500	Cash at bank		2,630
Capital	71,000		Sundry debtors	14,500	
Add: Net profit	16,275		Less: Provision for doubtful debts	725	
	87,275				13,775
Less: Drawings	5,245		Closing stock		6,800
		82,030	Prepaid insurance		85
			Machinery	20,000	
			Less: Depreciation	2,000	18,000
			Patents	7,500	
			Less: Written off	1,500	6,000
			Freehold land		10,000
			Building	30,000	
			Add: Wages incurred for cycleshed erection	2,000	
					32,000
		89,830			89,830

Check your Progress 2

Indicate whether the following statements are true or false:

- Salary paid in advance is not an expense.
- All intangible assets are fictitious assets
- Adjustment entries are made at the end of each business day.
- Provision for bad debts account normally has a debit balance.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp. 179-180)

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18.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points

- While preparing trading and profit and loss accounts all expenses and incomes should be properly be adjusted through accounting entries.
- Fixed assets are acquired for use in the business. These assets decrease in value year after year due to wear and tear .This decrease in the value of fixed assets is known as depreciation.

3. The adjustments which are given along with trial balance are known as self evident adjustments and adjustments hidden in the trial balance are termed as implied adjustments.

18.6 LESSON-END ACTIVITIES

1. What is meant by closing stock? Show its treatment in final accounts.
2. State the usual adjustments that have to be made while preparing the final accounts
3. From the following Trial Balance of Mr. Annadurai, prepare Trading and Profit & Loss account for the year ended 30-6-2001 and a Balance Sheet as on that date:

	Debit Rs.	Credit Rs.
Drawings	5,000	-
Insurance	600	-
General expenses	3,000	-
Debtors and Creditors	14,500	6,300
Furniture	7,500	-
Plant & machinery	20,000	-
Building	40,000	-
Stock (1-7-2000)	5,800	-
Carriage inwards	2,000	-
Carriage outwards	3,200	-
Salary & wages	15,000	-
Power & fuel	4,000	-
Productive wages	10,500	-
Returns	600	500
Purchases and Sales	41,000	98,800
Cash in hand & at bank	3,900	-
Ganesh's capital	-	71,000
	1,76,600	1,76,600

Adjustment:

- (i) Stock on 30-6-2001 was valued at Rs.7,000.
- (ii) Charge 5% interest on drawings.
- (iii) Goods purchased worth Rs.5,000 were received and included in closing stock but were not entered in purchases book.
- (iv) Prepaid insurance amounted to Rs.170.

- (v) Salaries and advertisement bill are outstanding to the extent of Rs.500 and Rs.1,000 respectively.
- (vi) Building, Machinery and Furniture are to be depreciated by Rs.2,000, Rs.3,000 and Rs.1,500 respectively.
4. The following is the trial balance of Mr.Palani as on 31-3-95, prepare final accounts as on that date.

Trial Balance as on 31-12-2000

	Dr Rs.	Cr Rs.
Capital	-	1,00,000
Building	15,000	-
Drawing	18,000	-
Furniture	7,500	-
Motor car	25,000	-
Loan from Y @ 12% interest	-	15,000
Interest paid on above	900	-
Sales	-	1,00,000
Purchase	75,000	
Opening stock	25,000	
Sundry expenses	15,000	
Wages	2,000	
Insurance	1,000	
Commission received	-	7,500
Debtors	28,100	-
Bank balance	20,000	-
Creditors	-	10,000
	2,32,500	2,32,500

Adjustment:

- (i) Closing stock Rs.32,000;
- (ii) Outstanding wages Rs.500;
- (iii) Prepaid insurance Rs.300;
- (iv) Commission received in advance Rs.800;
- (v) Interest on capital 10%;
- (vi) Depreciate; buildings 21/2; furniture and fittings 10%; motor van 10%;
- (vii) Interest on drawings Rs.500.

5. The following balance were taken from the books of Shri. Ram Prasad on 31-3-1996.

	Rs.		Rs.
Capital	1,00,000	Rent (Cr)	2,100
Drawings	17,600	Railway freight and other expenses on goods sold	16,940
Purchases	80,000	Carriage inwards	2,310
Sales	1,40,370	Office expenses	1,340
Purchase returns	2,820	Printing & stationery	660
Opening stock	11,460	Postage & telegrams	820
Bad debts	1,400	Sundry debtors	62,070
Bad debts provision (1-4-95)	3,240	Sundry creditors	18,920
Rates & insurance	1,300	Cash at bank	12,400
Discount (Cr)	190	Cash in hand	2,210
Bills receivable	1,240	Office furniture	3,500
Sales returns	4,240	Salaries & commission	9,870
Wages	6,280	Additions to buildings	7,000
Buildings	25,000		

Prepare Trading and Profit and Loss Account and Balance Sheet as on 31st March 1996, after keeping in view the following adjustment:

- (i) Depreciate old buildings at 2.5% and new additions to buildings at 2% and office furniture at 5%.
- (ii) Write off further bad debts at Rs.570.
- (iii) Increase the bad debts provision at 6% of debtors.
- (iv) Rs.570 are outstanding salary.
- (v) Rent receivable Rs.200.
- (vi) Interest on capital at 5%.
- (vii) Stock on 31-3-96 is valued at Rs.14,290.
- (viii) Unexpired insurance Rs.240.

18.6 MODEL ANSWER TO CHECK YOUR PROGRESS.

Check 1

1..Profit and loss A/c Dr
 To Provision for doubtful debts A/c

2. Interest on capital A/c Dr
 To Capital A/c
3. Commission A/c Dr
 To outstanding commission A/c
4. Prepaid expenses A/c Dr
 To Expenses A/c

Check 2

1. True 2. False 3. False 4.False

18.8 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

UNIT –V
LESSION- 19
MANUAL ACCOUNTING SYSTEM

Contents

- 19.0 Aims and Objectives
19.1 Introduction
19.2 Accountant
19.3 Categories of accountant
19.4 Advantages of manual accounting system
19.5 Limitations of manual accounting
19.6 Let us Sum Up
19.7 Lesson-End Activities
19.8 Model answer to check your progress.
19.9 References

19.0 AIMS AND OBJECTIVES

In this lesson, we discuss the meaning, advantages and limitations of manual accounting. After going through this lesson you will able to

- 1) know the meaning of Manual Accounting System
- 2) understand the advantages of Manual Accounting
- 3) know the limitations of Manual Accounting

19.1 INTRODUCTION

Accounting is an important part of every firm. Businesses are required to keep book on their credit and debits. Every company applies accounting because it is generally accepted that companies have to reveal certain financial and management information to the government and public users and of course because accounting is indispensable tool in business decision making process. Accounting can be divided into basic categories: Manual accounting and computerized accounting systems. From the accounting theory it is known that accounting cycle includes the following steps: journalizing the transactions, posting them to ledger accounts, preparing trail balance, making adjustment entries, preparing final accounts and appropriate disclosures. If the all above steps are carried out by a person means such system of accounting is called as Manual Accounting.

19.2 ACCOUNTANT

In this section, we attempt to make a brief explanation about Accountant. Accountant is a person who practices the art of accounting. The Accounting System and the Accountants, who maintain it, provide useful services to the society.

19.3 CATEGORIES OF ACCOUNTANT

We identify here some categories of Accountant. Accountants can broadly be classified into two categories.

1. Accountants in Public Practice
2. Accountants in Employment.

19.3.1 Accountants in public Practice

Accountants in public practice offer their service for conducting financial audit, cost audit, designing of accounting system and rendering other professional services for a fee. Such accountants are usually members of professional bodies. In our country there are two recognised professional bodies for this purpose. They are (i) the Institute of Chartered Accountants of India and (ii) the Institute of Cost and Works Accountants of India.

The accountants in public practice are also known as professional accountants. Such accountants are the members of the professional accounting bodies. These accounting bodies usually require from their members the following:

- (i) Getting themselves trained in the prescribed manner over a prescribed period.
- (ii) Pass the examination conducted by the professional bodies.
- (iii) Undertake to observe the generally accepted accounting principles enunciate by the professional bodies concerned.
- (iv) Observe the Code of Ethics lay down by the concerned accounting body.
- (v) Subject themselves to disciplinary proceedings whenever it is alleged that the member has violated the Code of Ethics laid down by the concerned body.

19.3.2 Accountants in Employment

These are accountants who are employed in non-business entities or business entities. Non-business entities are a diverse set of organisations including Educational Institutions, Government, Churches, Museums, Hospitals, etc. Their object is not to earn profit. The accountants employed by business entities are frequently called Management Accountants since they report to, and are the part of, the entity's Management. These accountants provide information for the tax returns of the business, budgeting, routine operating. Most of these accountants are also members of a professional Accounting Body. Of course it is not necessary.

Check your Progress 1

Compare manual accounting with computerized accounting system.

Note: a) Write your answer in the space given below.

- b) Check your answer with the ones given at end of this lesson (pp. 185)

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19.4 ADVANTAGES OF MANUAL ACCOUNTING SYSTEM

In this section, we attempt to make a brief explanation the advantages of manual accounting system. As many professional accountants and auditors state accounting is a language of business which is accepted in all developed and developing countries. Manual accounting has many advantages as compare with other machineries accounting. We can summarise the advantages of manual accounting as follows:

19.4.1. Maintenance of Books of Accounts.

Manual accounting system keeps a systematic record of the transactions entered by a business firm or an institution in the normal course of its operations. This helps the organization in ascertaining the profit or loss made for a particular period and also the financial position of the organisation as on a particular date. Accounting is an important managerial tool since it provides the management adequate information for its effective functioning. The basic functions of the management are planning, controlling, co-ordinating, motivating and decision making.

Accounting helps the management in planning by making available the relevant data after pruning and analysing suitably for effective planning and decision making.

Controlling involves evaluation of performance keeping in view that the actual performance coincides with the planned one and remedial measures are taken in the event of variation between the two. The techniques of budgeting control, standard of costing and departmental operating statements greatly help in performing these functions.

Co-ordinating involves inter-linking different divisions of the business enterprises in a way so as to achieve the objective of the organisation as a whole, Thus perfect co-ordination is required among production, purchase, finance, personnel and sales departments. Effective co-ordination is achieved through departmental budgets and reports which form the nucleus of Management Accounting.

Motivating involves maintenance of high degree of morale in the organisation. Conditions should be such that each person gives his best to realise the goals of the enterprise. The superior should be in a position to find out whom to promote or demote or demote or to reward or penalize. Periodical departmental profit and loss accounts, budgets and reports go a long way in achieving these objectives.

Communicating involves transmission of data results etc., both to the insiders as well as the outsiders. Accounting provides information both to the insiders i.e. management and the outsiders that is the creditors, prospective investors, shareholders, etc.

19.4.2 Cheaper

As capital and recurring costs are high, introduction of mechanical system becomes economic only when the volume of work is very huge. There should be properly trained staff to operated and maintain these equipment. Manual accounting is very cheap compare with computerized accounting. No machinery is requires and the businessmen need not invest large amount in purchase of machinery and maintained of it.

19.4.3 Independence from machine

Manual accounting system is useful for small concern. it is not required skilled workers and workforce and accounting machineries.

19.4.4 Replacement of memory.

A person cannot remember everything about his business transactions since human memory has its own limitations. It is, therefore, necessary that the transactions are recorded in the books of accounts at the earliest, it considerably easy in manual accounting system.

19.4.5. Data lost

It is possible that data can be lost because of hardware or software damage in computerized accounting system but it is not possible in manual accounting system.

19.4.6 Fraud and embezzlement

There are numerous techniques, varying from additions and deletions to input data in computerized accounting. Fraud and embezzlement are usually achieved by altering data or programs. It is not passable in manual accounting system.

19.4.7 Financial Services.

An accountant being well familiar with legal, accounting and taxation matters, can properly advise individual firms with regard to managing their financial affairs. For instance, he can assist his clients in selecting the most appropriate investment or insurance policy. Professional accountants have also these day started management consultancy services. Such services include designing of Management Information System, Corporate planning, conducting of Feasibility Studies, Executive Selection Services, etc.

18.5 LIMITATIONS OF MANUAL ACCOUNTING

In this section, we can summarise the limitations of manual accounting system as follows.

19.5.1 Manual accounting implies that employees perform the whole accounting cycle manually on a periodic basic, so it requires well qualified accountants to keep a record of business transactions and he must acquired knowledge in different field of accounting.

19.5.2 The accounts are always up-to-date and accounts can be finalized within a short time after the close of the year. Day to day accuracy of accounting records may be checked by making daily Trial Balance, which is totally impossible under manual system.

19.5.3 Manual accounting system is not suitable for large size organizations.

19.5.4 Mechanized accounting system any number of copies of original accounting records may be made at a time. Subsidiary records for sending statements to parties, for statistical, costing and budgetary purpose flow out as a by-product of recording accounting transactions it is totally impossible under manual system.

19.5.5 High speed and mobility of reporting are not possible in this system of accounting.

19.5.6 With a computer, one can receive a balance sheet, income statement or other accounting reports at a moment's notice. It is not possible in manual accounting system.

19.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. In manual accounting system the accountant's role has been traditional regarded as one of gathering, recording and reporting financial information of a business for users such as managers, government, bank, creditors and others.
2. In this manual accounting system, the accountants nowadays are also information managers. They must be able to manage, coordinate, communicate, persuade, interpret and analyse information that they come across.
3. Among the advantages of manual accounting there are comparatively cheap workforce and resources, reliability, independence from machines, skilled workers availability.
4. Dis advantages of manual accounting include reduced speed, increased effort of accountants, relatively slower internal control reporting, routine work.

19.7 LESSON-END ACTIVITIES

1. Briefly explain the role of accountant in manual accounting system.
2. How we can overcome the limitations of manual accounting system.

19.8 MODEL ANSWER TO CHECK YOUR PROGRESS

The main difference between them are the costs health fitness Articles, speed and mobility. The small and medium businesses usually prefer manual accounting without detriment to quality while large corporations apply complex accounting systems which cost millions dollars but the effect from their application exceeds all the expectations.

19.9 REFERENCES

1. R.L.Gupta -- Advanced accountancy
2. T.S Grewal -- Double Entry Book Keeping
3. Jain and Narang -- Advanced accountancy

LESSION-20

COMPUTERISED ACCOUNTING SYSTEM

Contents

- 20.0 Aims and Objectives
- 20.1 Introduction- computer
- 20.2 Memory unit
 - 20.2.1 Main memory
 - (a) ram (b) rom
 - 20.2.2 Secondary memory
 - (a) Hard disk (b) floppy disk(c) optical disks (cd-roms)
 - 20.2.3 Advantages of computer
- 20.3 Computer-based accounting systems
- 20.4 Use of computers in accounting
 - 20.4.1 Spreadsheets,
 - 20.4.2 General ledger
 - 20.4.3 Accounts receivable
 - 20.4.4. Accounts payable
 - 20.4.5. Inventory control
 - 20.4.6. Point of sale
 - 20.4.7. Purchasing and receiving
 - 20.4.8. Time and billing module
- 20.5 Software packages for accounting
- 20.6 Advantages of using the computer in accounting
- 20.7 Disadvantages of using the computer in accounting
- 20.8. Old methods and machines used in accounting
 - 20.8.1 Relationship to manual accounting
 - 20.8.2 Differences between manual and computerized accounting systems
- 20.9 Accounting as a system
- 20.10 Let us sum up
- 20.11 Lesson-End Activities
- 20.12 Model answer to check your progress
- 20.12 References

20.1 INTRODUCTION- COMPUTER

In lesson No19, we discussed the meaning, advantages and disadvantages of manual accounting system. In this section, we attempt to make a brie survey of the computer. Computer is the most utilitarian, versatile and complex creation of modern civilization. Historically, its importance can be compared with the invention of wheel, fire or the concept of zero. The idea of computers was first conceived by Charles P. Babbage in 1833. He designed his 'Analytical Engine', the world's first general purpose digital computer-more than 150 years ago. In its simplest form, a modern computer is a fast electronic calculating machine which can add, subtract, multiply and divide. Sometimes it is also termed as 'electronic brain', it can suggest solutions to problems placed before it. The machine accepts information as 'inputs' in the form of digits, process this information in accordance with predefined set of instructions, called a 'program' stored in its 'memory', to produce the desired result, called the 'output'.

The term 'computer' encompasses a large variety of electronic automatic calculating machines, widely differing in size, speed, cost and reliability. Computers are used in scientific calculations, commercial and business data processing, air traffic control, space research, weather forecasting, diagnosis of diseases like in CT scan and even in wars, as in the last Afghan War.

20.2 MEMORY UNIT

In this section, we attempt to make a brief survey of the memory unit of computer. Located very close to the Central Processing Unit (CPU) is the brain of the computer. The CPU takes the data from the memory and makes its decision. Memory is divided into two parts- (i) **main memory** or the primary memory; and (ii) the secondary memory.

20.2.1 Main memory:

The main memory of the computer is fast and reliable. It has an input area, an output area, an area for application programs, working area and operating system's area. The main memory consists of : (a) Ram; and (b) Rom

(a) RAM:

The Random Access Memory-This is the memory space where computer stores data and programs temporarily. Data can be placed into and extracted from, and accessed from it easily. We can "read from" and "write into" it, so such a memory is called a Read/Write memory. But RAM is volatile, i.e., when the computer is switched off everything in it gets lost. RAMs can be static or dynamic depending upon the need for supply of electric pulses in it. Static RAMs receive pulses only when its contents are changed but dynamic RAMs need a constant supply of pulses.

(b) ROM:

This is the memory space where computer stores data and programs permanently. Operating system, language translator, software responsible for controlling computer peripherals (devices surrounding the computer), stay within the ROM. This is a Read only memory, i.e., we can just access information from it, but can not write anything into it. Besides, **ROM** is not volatile, i.e., nothing is lost, when the computer is switched off, thus the information in it. Besides, ROM is not volatile, i.e., nothing is lost, when the computer is switched off, thus the information in it is permanently protected from damage.

CD-ROMS contain permanent copies of programs. Video games, music and movies, etc., come in CD-ROMS. Programmable ROMs (PROMs) allow the users to permanently program the chip. Erasable ROMs (EPROMs) are also programmable ROMs, but these programs are not permanent, i.e., could be erased using ultra-violet rays when necessary. Electrically Erasable ROMs (EEPROMs) can be erased more conveniently.

20.2.2 Secondary Memory:

As the main memory is too small to hold all the data need to be stored into a computer, a secondary storage device must be used to back-up the main memory. These secondary storage devices are magnetic in nature. These devices are two types:

- (i) those which can be accessed serially (like magnetic tapes, etc.)
- (ii) those which can be accessed directly (hard disk, floppy, CDs, etc.).

Here, we will briefly discuss the Floppy Disks, Hard Disks and Optical Disks or CD-ROMs, which are widely used for storing data.

(a) Hard Disk:

This is the storage area attached to the system unit. A hard disk is similar to a floppy disk in which it stores information, but much larger and much faster. Their storage capacity is also very large. Nowadays, common PCs comes with 20 GB capacity or more. They are made of metallic material with an aluminium surface and encased in a sealed dust proof case. One attached to the system unit they are not taken out so, called fixed disks.

(b) Floppy Disk:

Floppy disks are used to store and move data easily from one PC to another. They come in two sizes-5 1/4 inch and 3 1/2 inch. Nowadays, 3 1/2 inches floppies are mostly used. They have three common features: lable area read/write openings and protect notches. Floppies come in different sizes and varying storage capacity. The storage capacity of commonly used floppies are:

(c) Optical Disks (CD-ROMs):

Another storage medium, offering a capacity far in excess of the traditional magnetic disk is the video or optical dis. The optical disks have very high storage capacities measured in giga bytes but unlike the magnetic media cannot be over-written when data changes. Application like the whole Encyclopaedia Britannica and other archiving visual material comes in this kind of WORM (Write-Once-Read-Many) disks. Moreover, the optical disk drives capable of being overwritten are also becoming available.

20.2.3 Advantages of Computer

The important characteristics of computer that make it a trusted of the humans are its speed, enormous storage capacity, accuracy, ability to work automatically, diligence, scientific and analytical approach as also versatility.

(a) Speed

This is the first noticeable advantage computer has over humans and it can function at speeds unthinkable by them. The computer's speed of performing operations is measured in terms of:

Millisecond = 1/1,000 of a second

microsecond = 1/1,000,000 of a second

nanosecond = 1/1,000,000,000 of a second

picosecond = 1/1,000,000,000,000 of a second

(b) Storage

The computer, like humans, can store large volumes of information. But the retrieval system of humans is not able to diagnose the needed information at the right time and within a short time span. Whereas, a computer can bring back whatever is stored in its memory, depending on its capacity as described in the magnetic disk section, repeatedly at an unbelievable speed and with certitude.

(c) Accuracy

To err is human. However simple a problem may be one can make a mistake. But the amount of research and hard work that has gone into developing the computer has made it 100% accurate. Any error in the results derived by a computer is due to the error of humans in giving the needed logical set of instructions to it.

(d)Automaticity

The computer is capable of functioning automatically; only the process must be initiated. This characteristic is best used in robots or special- purpose computers.

(e)Diligence

Human beings are susceptible to boredom by physical and mental tiredness and by lack of concentration. This does not hold true for computer which is capable of operating at exactly the same level of speed and accuracy in carrying out the most complex and voluminous operations for a long period of time.

(f) Versatility

The wide use of computers in every field of human life is a proof of their versatility. They can carry out widest range of calculations from those of a school student to the complex calculations and logical evaluation needed in launching a rocket. They are used in widely different field-from medical world to criminal world to trace a criminal; and from art and music to combat in war.

(g)Scientific Approach

The whole approach of a computer in solving problems or carrying out instructions is highly scientific methodical, and objective sequentially, and is carried out uninfluenced by the unpredictable mind of humans, which has been the cause of so many errors and unjustified results.

20.3 COMPUTER-BASED ACCOUNTING SYSTEMS

In this section, we have briefly touched upon the computer- based accounting system. Computerization has become part of our everyday life over the past few years. Concept of computers has been made popular not only by referrals in the press, radio and TV, films etc. but also due to the versatility and dynamic uses of computers. Most of the organizations now do their accounting work with an electronic computer rather than with the manual methods described above but some others may be despondent. We initially explained the process in terms of manual methods because the forms and records used in manual systems are visible whereas the operations that go on inside a computer are invisible. The aim this section is explains the role of Computer in Accounting, while drawing attention to so concepts, working and potentials of this wonder machine.

20.4 USE OF COMPUTERS

In this section, we summarized the uses of computers .Because of the minute by minute change in finances, accurate record keeping is critical. Computerizing a business's general ledger, payroll and other accounting tasks increase office efficiency. With a computer, you

can request and receive an in house balance sheet, an income statement, or other accounting reports at a moment's notice.

20.4.1 Spreadsheets

Electronic spreadsheets allow you to do anything that you would normally do with a calculator, pencil and columnar scratch pad. Spreadsheets were primarily designed for managers who in the process of planning must do “what if” calculations. Due to their flexibility, electronic spreadsheets have found their way into small businesses and, to a lesser extent to homes. A typical integrated double entry accounting system will contain some or all of the following components: accounts receivable, accounts payable, general ledger, inventory, order entry, payroll, time, and billing.

It takes its name from the accountant's spreadsheet—a sheet of paper with rules for rows and columns—on which such work was usually done. Spreadsheet programs are much faster, more accurate, and easier to use than traditional accounting techniques. The programs are widely used on personal computers for keeping sales, expense and inventory records, and for budgeting and forecasting future sales and expenses. As a result of these and many other applications, computer spreadsheets have become the most important of all software tools for modern businesses.

A new generation of computer software for business began with integrated spreadsheet programs, which can be used to prepare spreadsheets, create graphs, and manage data. In such programs, for example, it is easy to display spreadsheet data in the form of a graph or to transfer data from a data base to a spreadsheet. One of the first such programs was Lotus 1-2-3, an immediate success following its introduction in 1983. In the third generation of integrated business software, spreadsheet, graphics, and data management capabilities were supplemented by word processing and communications capabilities. With such comprehensive programs, it became possible to create multiple windows on the computer display. Each window could contain a different application—a graph in one, a spreadsheet in another, and word processing in a third. The window capabilities of integrated programs such as Symphony and Framework make it easy.

20.4.2 General Ledger

General Ledger is a labor saving device for the preparation of financial statements and for establishing multiple income and cost entries.

20.4.3 Accounts Receivable

Accounts receivable, when computerized, can get your bills out the same day you've performed a service. An accounts receivable module prepares invoices and customer accounts, adds credit charges where appropriate, handles incoming payments, flags your attention to customers that are delinquent, and produces dunning notices. It allows you to have daily cash control. You get out the bills on time, yet you avoid errors such as billing a customer twice for the same item. The further advantage is that debits and credits are posted automatically to the general ledger, order entry, and in some instances inventory, once they are entered in accounts receivable.

20.4.4. Accounts Payable

Accounts payable, when computerized, will provide for purchase order control, invoice processing, payment selection and handling, check writing and control, cash-requirements, forecasting, and Form 1099 preparation. It will also double-check the accuracy of the vendor's invoice, and some software systems will cross-check it against the purchase order and the inventory module.

20.4.5. Inventory Control

Inventory Control module has multiple functions, including tracking inventory for both costing and tax purposes, controlling purchasing (and the overall level of expenditure) and minimizing the investment in inventory (and subsequent loss of cash flow). The payroll module prepares and prints payroll checks, including all itemized deductions. It is integrated with the general ledger so you automatically set aside the correct amount for FICA and withholding.

20.4.6. Point of Sale

Point of sale module captures all sales information at (or in place of) the cash register, including salesperson, date, customer, credit information, items, and quantity sold. It can produce sales slips or sales invoices, plus it reports on items, customer, and salesperson activity.

20.4.7. Purchasing and Receiving

Purchasing and receiving module can represent an invaluable addition. It can generate purchase orders and track their fulfillment. You can find out which vendors are delivering on time and saving you the expense of having to follow up on partial and incomplete orders.

20.4.8. Time and Billing Module

Time and billing module reduces manual and clerical work, simplifies the billing process, prompts you and your partners to bill on time, reduces unbilled work-in progress, minimizes unreported time, reduces unbilled time, measures and analyzes nonchargeable time and provides criteria to analyze staff performance. Because a computerized accounting system is basically a computerized data management system, the disposition of labor is almost the same. One staff member must serve as a data-base manager and be in charge of setting up the chart of accounts, establishing the interrelationships among the files and establishing and maintaining an audit trail.

20.5 SOFTWARE PACKAGES FOR ACCOUNTING

In this section, we attempt to make brief survey of the software packages for accounting. Today there are number of ready-made software's package that are available in the market Since the applications in area of accounting are standard, difference is in the number of

features provided by an individual package. Listed below are some standard applications in the area of Accounting, which will be covered by one or other package. The accounting areas according to application may be broadly divided into:

- (i) General Ledger
- (ii) Accounts Payable
- (iii) Accounts Receivable.

General Ledger

The General Ledger System (G/L) helps in managing financial accounting. It generally serves the operational needs of an accounting system and also the statutory and management information requirements of an organisation. The reports generated by the system include:

- Daybooks
- Journal
- General ledger
- Subsidiary ledger

Accounts Payable

The Accounts Payable System (A/P) helps in monitoring Suppliers Bills, Payments and Outstanding. A/P also assists in managing payments and planning for cash requirements. Facilities are available to enquire on supplier's details, balances, outstanding and transactions.

A/P generally generates about the following reports:

- Bills Register
- Payments Register
- Credit Notes/Debit Notes Register
- Suppliers Journal
- Supplier Ledger
- Supplier-wise List of Outstandings
- Payment Schedule by Due Dates
- Payment Schedule by Discount Dates
- Interest Payable on Overdue Bills
- Suppliers Directory

The packages can be used as they are or modified by the originating agency as per user's requirements. Standard packages are now offered by big as well as small organisations. These packages have immensely facilitated computerisation of commercial applications, viz.

- Trial Balance
- Balance Sheet
- Profit and Loss Statement
- Budget Variance '
- Funds Flow Statement
- Ratio Analysis

Accounts Receivable

The Accounts Receivable System (A/R) helps in reducing money collection periods and minimizing bad debts. A/R details with customer invoices, receipts and outstandings. with the use A/R one can enquire regarding customers details, balances, outstanding and transactions.

A/R may generate about the following reports:

- Invoices Register
- Receipts Register
- Credit/Debit Notes Register
- Customers Journal
- Customers Ledger
- Customers Statement of Accounts
- Receipts Due Statements
- Discount Due Statements
- Interest Receivable on Overdue Invoices
- A User-defined Aging Report of Receivables
- Customers Directory

Check your Progress 1

Give various utility of accounting software.

Note: a) Write your answer in the space given below.

b) Check your answer with the ones given at end of this lesson (pp.199)

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20.6 ADVANTAGES OF USING THE COMPUTER IN ACCOUNTING

In this section, we attempt to make a brief survey of the advantages of using computer in accounting. The most important advantage of using the computer is the speed with which we can get accounting done. In addition, we find that it is very easy to do accounting functions. Posting to the ledger, a tedious task of double entry, when done directly from the general ledger module, can be largely automated when done through special purpose modules like accounts payable or accounts receivable. With an accounts receivable module, you just need to enter the actual cash totals of items purchased and the software distributes these amounts to the general ledger so they become credits to corresponding revenue accounts. At the same time, an offsetting entry is made automatically to the accounts receivable account.

With a computer, one can receive a balance sheet, income statement or other accounting reports at a moment's notice. We also find that some day to day data entry can be turned over to relatively unskilled workers.

20.7 DISADVANTAGES OF USING THE COMPUTER IN ACCOUNTING

In this section, we attempt to make a brief survey of the disadvantages of using computer in accounting. When you use a computer, it is possible that data can be lost because of hardware or software damage. Since the computer has no judgment of its own, it does not pick up on errors as a human being does. There can be loss of data due to accidents like fire etc.. There can be loss of data or change of data due to fraud or embezzlement. There can be loss or unavailability of data due to loss of staff. Inaccurate data may be due to clerical error

or mistakes in programming. Total security is economically unachievable and some failures must be expected. The right level of expenditure on security measures will minimize the sum of the cost of the measures and the expected loss. There will always be some risks that are best shared through insurance, rather than prevented or avoided.

Much computer-related crime is opportunist: people who were not seeking any advantage had temptation thrust under their noses. Copies of computer printouts get misdirected, or thrown in a waste paper basket in a public place. Magnetic tapes from bankrupt companies have been sold with data still on them. Often a programming error reveals a system flaw: someone who by chance reads a magnetic tape file that he should have been writing discovers interesting data on it. Sabotage, vandalism, malicious damage, and arson tend to be even more destructive than the Acts of God they emulate. Political and industrial action, riots and civil commotions, may not be aimed specifically at the computer but they can be very effective in preventing its operation.

Fraud and embezzlement are usually achieved on a computer system by altering data or programs. There are numerous techniques, varying from additions and deletions to input data, through changing the standing information files, modifying the behavior of programs, to duplicating or suppressing output. Although most frauds that have been reported had gone on for some time, it could be that 'one shot' frauds have been more frequent but more often escape detection.

Eavesdropping and stealing information by tapping telecommunications lines requires the sort of technical skill which is very widely available (to the surprise of those without technical education). It is possible to emulate a legitimate user of a system, or discover his password through trickery or as the result of carelessness, and thus have access to the information he would have, such access can be very important for setting up more profitable operations, such as taking money out of little used bank accounts, or concealing changes made in files. There are other ways of trespassing, without using wire tapping. For example, the magnetically encoded cards often used as keys to systems can be copied and altered, giving the villain access to credit, cash or other valuable assets.

Wherever a computer is used to handle an organization's accounts, it can be used as a means of attacking the funds it controls. In most computerized bookkeeping systems, it is the computer which effectively causes credit transfer; so by establishing false accounts, or diverting some of the contents of the real ones, credit can reach a false beneficiary. The system can also be used to conceal a change in the cost, or the illegitimate acquisition or the destruction of tangible goods and services.

20.8. OLD METHODS AND MACHINES USED IN ACCOUNTING

The most common method of keeping the financial records of a company was manually. A bookkeeper kept the journals, the accounts receivable, the accounts payable and the ledgers in his best possible penmanship. In later years, an accounting machine, which was capable of performing normal bookkeeping functions, such as tabulating in vertical columns, performing arithmetic functions, and typing horizontal rows was used. The billing machine,

which was designed to typewrite names, addresses, and descriptions, to multiply and extend, to compute discounts, and to add net total, posting the requisite data to the proper accounts, and so to prepare a customer's bill automatically once the operator has entered the necessary information, was used. Early accounting machines were marvels of mechanical complexity, often combining a typewriter and various kinds of calculator elements. The refinements in speed and capacity made possible by advances in electronics and operating complexity of these machines. Many of the newer "generations" of accounting machines are operated by a computer to which they are permanently connected. In this section, we describe the similarities and the differences between a computers based system and a manual system.

20.8.1 Relationship to Manual Accounting

Any accounting system does the following:

1. It records and stores data.
2. It performs arithmetic operations on data.
3. It sorts and summarizes data.
4. It prepares reports.

20.8.2 Differences between manual and computerized accounting systems

The principal differences between manual and computerized accounting systems lie in the means of performance of arithmetic operations and in the storage of data. Regardless of the degree of computerization in the recordkeeping process, professional accounting judgment is required in analyzing transactions and in creating source documents or machine methods to capture the important information about routine transactions. In a computerized system, however, the computer does tasks that humans do in a manual system: journalizing entries, posting in general and subsidiary ledgers, taking a trial balance, and preparing reports. Of course, accountants still must analyze the trial balance and initiate the proper adjusting entries.

Two differences between manual and computerized systems should be noted. The first difference relates to the audit trail. In a manual system, the ability to trace every entry in the ledger to its components in journals and eventually to the source document establishes the integrity of the audit trail. In computerized systems, creating an acceptable audit trail becomes more difficult because the data storage and arithmetic manipulation are hidden from view. The integrity of accounting data within computerized databases is an important concern of internal accounting control. Spectacular computer frauds in recent years, while few in number, have made management more aware of the internal control complexities that accompany the computerizing of recordkeeping systems.

The second major difference involves the number of reports generated by computerized systems as compared to manual systems. Since, with a manual system, the cost of preparing reports other than the basic financial statements is high, most reports are of a broad, general-purpose nature, and identical reports are distributed to many different managers in the organization. On the other hand, the cost of preparing specialized management reports in computerized systems is usually quite low. This often leads to a larger number of different reports oriented toward specific managers and their responsibilities. Such customized reports are advantageous if they are carefully designed to meet their recipients' informational needs. However, managers in some organizations suffer from "information overload" as a result of having too many detailed, only partially relevant reports sent to them every week. In such instances, the managers may cease to use any of the reports, making the reports of no value despite the low cost of preparing them.

20.9 ACCOUNTING AS A SYSTEM

The accounting system is a tool for accumulating the financial activity. The business concern receives funding from various sources, most of which is specified for certain types of expenditures. To enable the administrators of these funds to monitor and report on the activity of the funds, the accounting system must maintain separate records of each source of funds, and the expenditures from each source. This is accomplished by establishing separate accounts in the system, much as a bank establishes separate accounts for each depositor. An account is defined as a functional unit established for a specific purpose, with one individual having primary responsibility for its activity.

There are three types of accounts namely general ledger accounts, subsidiary ledger accounts and roll-up accounts. The general ledger (GL) accounts accumulate asset, liability, fund balance, fund addition and fund deduction records, also known as balance sheet records. The subsidiary ledger (SL) accounts accumulate budget, encumbrance, revenue and expenditure records. The roll-up accounts do not accumulate actual dollar records, but are used to provide summary reporting for a series of SL accounts. The Financial Services Office is responsible for establishing accounts. This responsibility may be delegated. The each account is to be assigned numbers The numbers have been assigned in blocks, so similar types of accounts will all be in the same range of numbers

i) Attributes

As each account is established, a series of attributes for the account is recorded. Attributes are non dollar, descriptive data about the account. They include a short account name (twenty characters) and a long description (eighty characters); the name of the person responsible for the account; the department, executive level, division and school to which the account belongs organizationally; the persons that may be authorized to sign certain source documents for the account; and several other pieces of information. These attributes are used to identify account information for reporting purposes.

ii) Subcodes

To maintain detailed records of the dollar activity within an account, a series of sub-codes are used. Sub-codes are four-digit numbers that represent detail activity within an account. The sub-codes used with GL accounts are referred to as account controls. The sub-codes used with SL accounts are referred to as object codes.

iii) Posting Transactions

Once an account has been established in the system, transactions originated on various source documents may be posted to the account. A three-digit transaction code is assigned to each transaction. The transaction code identifies the type of transaction and tells the computer system how to process that transaction. Following is a brief summary of the different types of transactions that may be posted to an account.

Budgets : Posted to SL accounts only, these transactions are used to enter original budgets to accounts and to process budget revisions or transfers.

Receipts :Used to post cash receipts to GL or SL accounts.

Disbursements: Used to post cash disbursements from GL or SL accounts.

Encumbrances Posted to SL accounts only, these transactions are used to temporarily reserve funds for anticipated future expenditures. These transactions are canceled, in part or completely, when the actual expenditures takes place.

Journal Entries : GL or SL accounts. These entries transfer dollars from one account to another account.

Bank Transfers : Used to transfer funds from one bank account to another.

Beginning Balances : Used to post the beginning balance of GL or SL account. This transaction is primarily used when account balances from the previous accounting system are established in the new system. In addition to the transaction code, the originator of a transaction must also provide the date of the transaction and the account number and the detail subcode to which the transaction is to be posted.

v) Components of the Accounting System

Think of the accounting system as a wheel whose hub is the general ledger (G/L). Feeding the hub information are the spokes of the wheel. These include

- Accounts receivable

- Accounts payable

- Order entry

- Inventory control

- Cost accounting

- Payroll

- Fixed assets accounting

These modules are ledgers themselves. We call them subledgers. Each contains the detailed entries of its specific field, such as accounts receivable. The subledgers summarize the entries, and then send the summary up to the general ledger. For example, each day the receivables subledger records all credit sales and payments received. The transactions net together then go up to the G/L to increase or decrease A/R, increase cash and decrease inventory. We'll always check to be sure that the balance of the subledger exactly equals the account balance for that subledger account in the G/L. If it doesn't, then there's a problem

vi) Organization of the accounting Department

Organize your small-business accounting system by function. Often there's just one person there to do all the transaction entries. From an internal control standpoint, this isn't desirable. Having too few people doing all the accounting opens the door for fraud and embezzlement. Companies with more people assign functions in such a way that those done by the same person don't pose a control threat. Having the same person draft the checks and reconcile the checking account is a good example of how not to assign accounting duties. We'll talk extensively about internal control later. However, for now, small businesses often can't afford the number of people needed for an adequate separation of duties. The internal control structure that we'll install in your new accounting system helps mitigate that risk through mechanics and procedures rather than expensive people.

vii) Assignment of Duties

Here's your first assignment: Figure out who is going to do what in your new accounting system. The duties and areas of responsibility we need to assign include

- Overall responsibility for the accounting system

- Management of the computer system (if you're using one)

Accounts receivable

Accounts payable

Order entry

Cost accounting

Monthly reporting

Inventory control

Payroll (even if you use an outside payroll service, someone must be in control and responsible)

Internal accounting control

Fixed assets

In many cases the same person will do many of these things. However, these are the areas we'll be dealing with in setting up the accounting system. The person you assign to be in overall charge of the system should be the one who is most familiar with accounting. If you are just starting your company, you might want to think about the background of some of your new employees. At least one should have the capacity to run the accounting system.

If you find it difficult to determine someone's expertise in a field with which you are unfamiliar, here are some solutions:

1. Have them interviewed by an expert. Your own CPA will probably be glad to interview a few for you.
2. Carefully check references from past jobs. Ask detailed questions on exactly what they did in the accounting function. Compare the answers with what they say they did.
3. Ask them some accounting questions. It may sound odd that you (of all people) should be asking such questions. However, even if you can't judge the technical merit of the answers, you can get a feel for how comfortable they are with the subject and the authority with which they answer.

20.10 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

1. In manual accounting systems, special journals, subsidiary ledgers, and other devices facilitate the process of recording accounting data. A computer-based system performs the same functions more rapidly, more accurately, and (if the volume of repetitive transactions is large) at lower cost.

2. Any accounting system does records and stores data, it performs arithmetic operations on data and prepares reports.

3. Two differences between manual and computerized systems should be noted. The first difference relates to the audit trail and second major difference involves the number of reports generated by computerized systems as compared to manual systems

20.11 LESSON-END ACTIVITIES

1. List some application of computers with special reference to the area of accounting.
2. Explain software packages for accounting.

20.12 MODEL ANSWER TO CHECK YOUR PROGRESS

1. An accounting software reduces the job of accountant substantially.
 2. After the journal entered in the computer, the software itself posts in the ledger, prepare the trial balance, the income statements and the balance sheet.
 3. The newer versions of softwares like Tally can also keep the inventory records and can also do the financial analysis at the click of a mouse.
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20.12 REFERENCES

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