



**केन्द्रीय विद्यालय संगठन**  
**KENDRIYA VIDYALAYA SANGATHAN**



**शिक्षा एवं प्रशिक्षण का आंचलिक संस्थान, चंडीगढ़**

**ZONAL INSTITUTE OF EDUCATION AND TRAINING, CHANDIGARH**

**अध्ययन सामग्री / STUDY MATERIAL**

**शैक्षिक सत्र / SESSION – 2023-24**

**कक्षा / CLASS – ग्यारहवीं/ XI**

**विषय / SUBJECT – लेखांकन / ACCOUNTANCY**

**विषय कोड / SUBJECT CODE - 055**

**तैयारकर्ता - रवि कुमार, सह-प्रशिक्षक (वाणिज्य)**

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## **ACCOUNTANCY (Code No. 055)**

### **RATIONALE**

The course in accountancy is introduced at plus two stage of senior second of school education, as the formal commerce education is provided after ten years of schooling. With the fast changing economic scenario, accounting as a source of financial information has carved out a place for itself at the senior secondary stage. Its syllabus content provides students a firm foundation in basic accounting concepts and methodology and also acquaints them with the changes taking place in the preparation and presentation of financial statements in accordance to the applicable accounting standards and the Companies Act 2013.

The course in accounting puts emphasis on developing basic understanding about accounting as an information system. The emphasis in Class XI is placed on basic concepts and process of accounting leading to the preparation of accounts for a sole proprietorship firm. The students are also familiarized with basic calculations of Goods and Services Tax (GST) in recording the business transactions. The accounting treatment of GST is confined to the syllabus of class XI.

The increased role of ICT in all walks of life cannot be overemphasized and is becoming an integral part of business operations. The learners of accounting are introduced to Computerized Accounting System at class XI and XII. Computerized Accounting System is a compulsory component which is to be studied by all students of commerce in class XI; whereas in class XII it is offered as an optional subject to Company Accounts and Analysis of Financial Statements. This course is developed to impart skills for designing need based accounting database for maintaining book of accounts.

The complete course of Accountancy at the senior secondary stage introduces the learners to the world of business and emphasizes on strengthening the fundamentals of the subject.

### **OBJECTIVES:**

1. To familiarize students with new and emerging areas in the preparation & presentation of financial statements.
2. To acquaint students with basic accounting concepts and accounting standards.
3. To develop the skills of designing need based accounting database.
4. To appreciate the role of ICT in business operations.
5. To develop an understanding about recording of business transactions and preparation of financial statements.
6. To enable students with accounting for Not-for-Profit organizations, accounting for Partnership firms and Company accounts.

## ACCOUNTANCY (Code No.055)

### Course Structure Class - XI (2023 - 24)

**Theory: 80 Marks**

**3 Hours**

**Project: 20 Marks**

Units		Periods	Marks
<b>Part A: Financial Accounting - I</b>			
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### PART A: FINANCIAL ACCOUNTING - I

#### Unit-1: Theoretical Frame Work

Units/Topics	Learning Outcomes
<p><b>Introduction to Accounting</b></p> <ul style="list-style-type: none"><li>Accounting- concept, meaning, as a source of information, objectives, advantages &amp; limitations, types of accounting information; users of accounting information and their needs. Qualitative Characteristics of Accounting Information. Role of Accounting in Business.</li><li>Basic Accounting Terms- Entity, Business Transaction, Capital, Drawings. Liabilities (Non Current &amp; Current). Assets (Non Current, Current); Expenditure (Capital &amp; Revenue), Expense, Revenue, Income, Profit, Gain, Loss, Purchase, Sales, Goods, Stock, Debtor, Creditor, Voucher, Discount (Trade discount &amp; Cash Discount)</li></ul> <p><b>Theory Base of Accounting</b></p> <ul style="list-style-type: none"><li>Fundamental accounting assumptions: GAAP: Concept</li></ul>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"><li>describe the meaning, significance, objectives, advantages and limitations of accounting in the modern economic environment with varied types of business &amp; non-business economic entities.</li><li>identify / recognise the individual(s) &amp; entities that use accounting information for serving their needs of decision making.</li><li>explain the various terms used in accounting &amp; differentiate between different related terms like current &amp; non-current, capital and revenue.</li><li>give examples of terms like business transaction, liabilities, assets, expenditure &amp; purchases.</li><li>explain that sales/ purchases include both cash &amp; credit sales/purchases relating to the accounting year.</li><li>differentiate among income, profits and gains.</li><li>state the meaning of fundamental accounting assumptions and their relevance in accounting.</li></ul>

<ul style="list-style-type: none"> <li>• Basic Accounting Concept : Business Entity, Money Measurement, Going Concern, Accounting Period, Cost Concept, Dual Aspect, Revenue Recognition, Matching, Full Disclosure, Consistency, Conservatism,</li> <li>• Materiality and Objectivity</li> <li>• System of Accounting. Basis of Accounting: cash basis and accrual basis</li> <li>• Accounting Standards: Applicability of Accounting Standards (AS) and Indian Accounting Standards (Ind AS)</li> <li>• Goods and Services Tax (GST): Characteristics and Advantages.</li> </ul>	<ul style="list-style-type: none"> <li>• describe the meaning of accounting assumptions and the situation in which an assumption is applied during the accounting process.</li> <li>• explain the meaning, applicability, objectives, advantages and limitations of accounting standards.</li> <li>• appreciate that various accounting standards developed nationally and globally are in practice for bringing parity in the accounting treatment of different items.</li> <li>• acknowledge the fact that recording of accounting transactions follows double entry system.</li> <li>• explain the bases of recording accounting transaction &amp; to appreciate that accrual basis is a better basis for depicting the correct financial position of an enterprise.</li> <li>• Explain the meaning, advantages &amp; characteristic of GST.</li> </ul>
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## Unit-2: Accounting Process

Units/Topics	Learning Outcomes
<p><b>Recording of Business Transactions</b></p> <ul style="list-style-type: none"> <li>• Voucher and Transactions: Source documents &amp; Vouchers, Preparation of Vouchers, Accounting Equation Approach: Meaning and Analysis, Rules of Debit &amp; Credit.</li> <li>• Recording of Transactions: Books of Original Entry- Journal</li> <li>• Special Purpose books: <ul style="list-style-type: none"> <li>➤ Cash Book: Simple, cash book with bank column and petty cashbook</li> <li>➤ Purchases book</li> <li>➤ Sales book</li> <li>➤ Purchases return book</li> <li>➤ Sales return book</li> <li>➤ Journal proper</li> </ul> </li> </ul> <p><b>Note: Including trade discount, freight and cartage expenses for simple GST calculation.</b></p> <ul style="list-style-type: none"> <li>• Ledger: Format, Posting from journal and subsidiary books, Balancing of accounts</li> </ul> <p><b>Bank Reconciliation Statement:</b></p> <ul style="list-style-type: none"> <li>• Need and preparation, Bank Reconciliation Statement</li> </ul>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"> <li>• explain the concept of accounting equation &amp; appreciate that every transaction affects either both the sides of the equation or a positive effect on one item and a negative effect on another item on the same side of accounting equation.</li> <li>• explain the effect of a transaction (increase or decrease) on the assets, liabilities, capital, revenue &amp; expenses.</li> <li>• appreciate that on the basis of source documents, accounting vouchers are prepared for recording transaction in the books of accounts.</li> <li>• develop the understanding of recording of transactions in journal and the skill of calculating GST.</li> <li>• explain the purpose of maintaining a Cash Book &amp; develop the skill of preparing the format of different types of cash books and the method of recording cash transactions in Cash book.</li> <li>• describe the method of recording transactions other than cash transactions as per their nature in different subsidiary books .</li> <li>• appreciate that at times bank balance as indicated by cash book is different from the bank balance as shown by the pass book /bank statement and to reconcile both</li> </ul>

<p><b>Depreciation, Provisions and Reserves</b></p> <ul style="list-style-type: none"> <li>• Depreciation: Meaning, Features, Need, Causes, factors</li> <li>• Other similar terms: Depletion &amp; Amortisation</li> <li>• Methods of Depreciation: <ul style="list-style-type: none"> <li>i. Straight Line Method (SLM)</li> <li>ii. Written Down Value Method (WDV) <i>Note: Excluding change of method</i></li> </ul> </li> <li>• Difference between SLM and WDV; Advantages of SLM and WDV</li> <li>• Method of recoding depreciation <ul style="list-style-type: none"> <li>i. Charging to asset account</li> <li>ii. Creating provision for depreciation/ accumulated depreciation account</li> </ul> </li> <li>• Treatment of disposal of asset</li> <li>• Provisions, Reserves, Difference Between Provisions and Reserves.</li> <li>• Types of Reserves: <ul style="list-style-type: none"> <li>i. Revenue reserve</li> <li>ii. Capital reserve</li> <li>iii. General reserve</li> <li>iv. Specific reserve</li> <li>v. Secret Reserve</li> </ul> </li> </ul> <p>Difference between capital and revenue reserve</p> <p><b>Trial balance and Rectification of Errors</b></p> <ul style="list-style-type: none"> <li>• Trial balance: objectives, meaning and preparation (<b>Scope: Trial balance with balance method only</b>)</li> <li>• Errors: classification-errors of omission, commission, principles, and compensating; their effect on Trial Balance.</li> <li>• Detection and rectification of errors; <ul style="list-style-type: none"> <li>(i) Errors which do not affect trial balance</li> <li>(ii) Errors which affect trial balance</li> </ul> </li> <li>• preparation of suspense account.</li> </ul>	<p>the balances, bank reconciliation statement is prepared.</p> <ul style="list-style-type: none"> <li>• develop understanding of preparing bank reconciliation statement.</li> <li>• appreciate that for ascertaining the position of individual accounts, transactions are posted from subsidiary books and journal proper into the concerned accounts in the ledger and develop the skill of ledger posting.</li> <li>• explain the necessity of providing depreciation and develop the skill of using different methods for computing depreciation.</li> <li>• understand the accounting treatment of providing depreciation directly to the concerned asset account or by creating provision for depreciation account.</li> <li>• appreciate the method of asset disposal through the concerned asset account or by preparing asset disposal account.</li> <li>• appreciate the need for creating reserves and also making provisions for events which may belong to the current year but may happen in next year.</li> <li>• appreciate the difference between reserve and reserve fund.</li> <li>• state the need and objectives of preparing trial balance and develop the skill of preparing trial balance.</li> <li>• appreciate that errors may be committed during the process of accounting.</li> <li>• understand the meaning of different types of errors and their effect on trial balance.</li> <li>• develop the skill of identification and location of errors and their rectification and preparation of suspense account.</li> </ul>
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## Part B: Financial Accounting – II

### Unit 3: Financial Statements of Sole Proprietorship

Units/Topics	Learning Outcomes
<p><b>Financial Statements</b></p> <p>Meaning, objectives and importance; Revenue and Capital Receipts; Revenue and Capital Expenditure; Deferred Revenue expenditure. Opening journal entry.</p>	<p><b>After going through this Unit, the students will be able to:</b></p> <ul style="list-style-type: none"> <li>• state the meaning of financial statements the purpose of preparing financial statements.</li> </ul>

<p>Trading and Profit and Loss Account: Gross Profit, Operating profit and Net profit. Preparation.</p> <p>Balance Sheet: need, grouping and marshalling of assets &amp; liabilities. Preparation. Adjustments in preparation of financial statements with respect to closing stock, outstanding expenses, prepaid expenses, accrued income, income received in advance, depreciation, bad debts, provision for doubtful debts, provision for discount on debtors, Abnormal loss, Goods taken for personal use/staff welfare, interest on capital and managers commission. Preparation of Trading and Profit and Loss account and Balance Sheet of a sole proprietorship with adjustments.</p> <p><b>Incomplete Records</b></p> <p>Features, reasons and limitations.</p> <p>Ascertainment of Profit/Loss by Statement of Affairs method. (excluding conversion method)</p>	<ul style="list-style-type: none"> <li>state the meaning of gross profit, operating profit and net profit and develop the skill of preparing trading and profit and loss account.</li> <li>explain the need for preparing balance sheet.</li> <li>understand the technique of grouping and marshalling of assets and liabilities.</li> <li>appreciate that there may be certain items other than those shown in trial balance which may need adjustments while preparing financial statements.</li> <li>develop the understanding and skill to do adjustments for items and their presentation in financial statements like depreciation, closing stock, provisions, abnormal loss etc.</li> <li>develop the skill of preparation of trading and profit and loss account and balance sheet.</li> </ul>
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### Part C: Project Work (Any One)

1. Collection of source documents, preparation of vouchers, recording of transactions with the help of vouchers.
2. Preparation of Bank Reconciliation Statement with the given cash book and the pass book with twenty to twenty-five transactions.
3. Comprehensive project of any sole proprietorship business. This may state with journal entries and their ledgering, preparation of Trial balance. Trading Account, Profit and Loss Account; and Balance Sheet. Expenses, incomes and profit (loss), assets and liabilities are to be depicted using pie chart / bar diagram. This may include simple GST related transactions.

### PROJECT WORK

It is suggested to undertake this project after completing the unit on preparation of financial statements. The student(s) will be allowed to select any business of their choice or develop the transaction of imaginary business. The project is to run through the chapters and make the project an interesting process. The amounts should emerge as more realistic and closer to reality.

#### Specific Guidelines for Teachers

Give a list of options to the students to select a business form. You can add to the given list:

- |                         |                               |                          |
|-------------------------|-------------------------------|--------------------------|
| 1. A beauty parlour     | 10. Men's wear                | 19. A coffee shop        |
| 2. Men's saloon         | 11. Ladies wear               | 20. A music shop         |
| 3. A tailoring shop     | 12. Kiddies wear              | 21. A juice shop         |
| 4. A canteen            | 13. A Saree shop              | 22. A school canteen     |
| 5. A cake shop          | 14. Artificial jewellery shop | 23. An ice cream parlour |
| 6. A confectionery shop | 15. A small restaurant        | 24. A sandwich shop      |
| 7. A chocolate shop     | 16. A sweet shop              | 25. A flower shop        |
| 8. A dry cleaner        | 17. A grocery shop            |                          |
| 9. A stationery shop    | 18. A shoe shop               |                          |

After selection, advise the student(s) to visit a shop in the locality (this will help them to settle on a realistic amounts different items. The student(s) would be able to see the things as they need to invest in furniture, decor, lights, machines, computers etc.

A suggested list of different item is given below.

- |  |   |
|--|---|
| 1. Rent                                      | 19. Wages and Salary                      |
| 2. Advance rent [approximately three months] | 20. Newspaper and magazines               |
| 3. Electricity deposit                       | 21. Petty expenses                        |
| 4. Electricity bill                          | 22. Tea expenses                          |
| 5. Electricity fitting                       | 23. Packaging expenses                    |
| 6. Water bill                                | 24. Transport                             |
| 7. Water connection security deposit         | 25. Delivery cycle or a vehicle purchased |
| 8. Water fittings                            | 26. Registration                          |
| 9. Telephone bill                            | 27. Insurance                             |
| 10. Telephone security deposit               | 28. Auditors fee                          |
| 11. Telephone instrument                     | 29. Repairs & Maintenance                 |
| 12. Furniture                                | 30. Depreciations                         |
| 13. Computers                                | 31. Air conditioners                      |
| 14. Internet connection                      | 32. Fans and lights                       |
| 15. Stationery                               | 33. Interior decorations                  |
| 16. Advertisements                           | 34. Refrigerators                         |
| 17. Glow sign                                | 35. Purchase and sales                    |
| 18. Rates and Taxes                          |   |

At this stage, performas of bulk of originality and ledger may be provided to the students and they may be asked to complete the same.

In the next step the students are expected to prepare the trial balance and the financial statements.

**Suggested Question Paper Design**  
**Accountancy (Code No. 055) Class XI**  
**(2023-24)**

**Theory: 80 Marks**

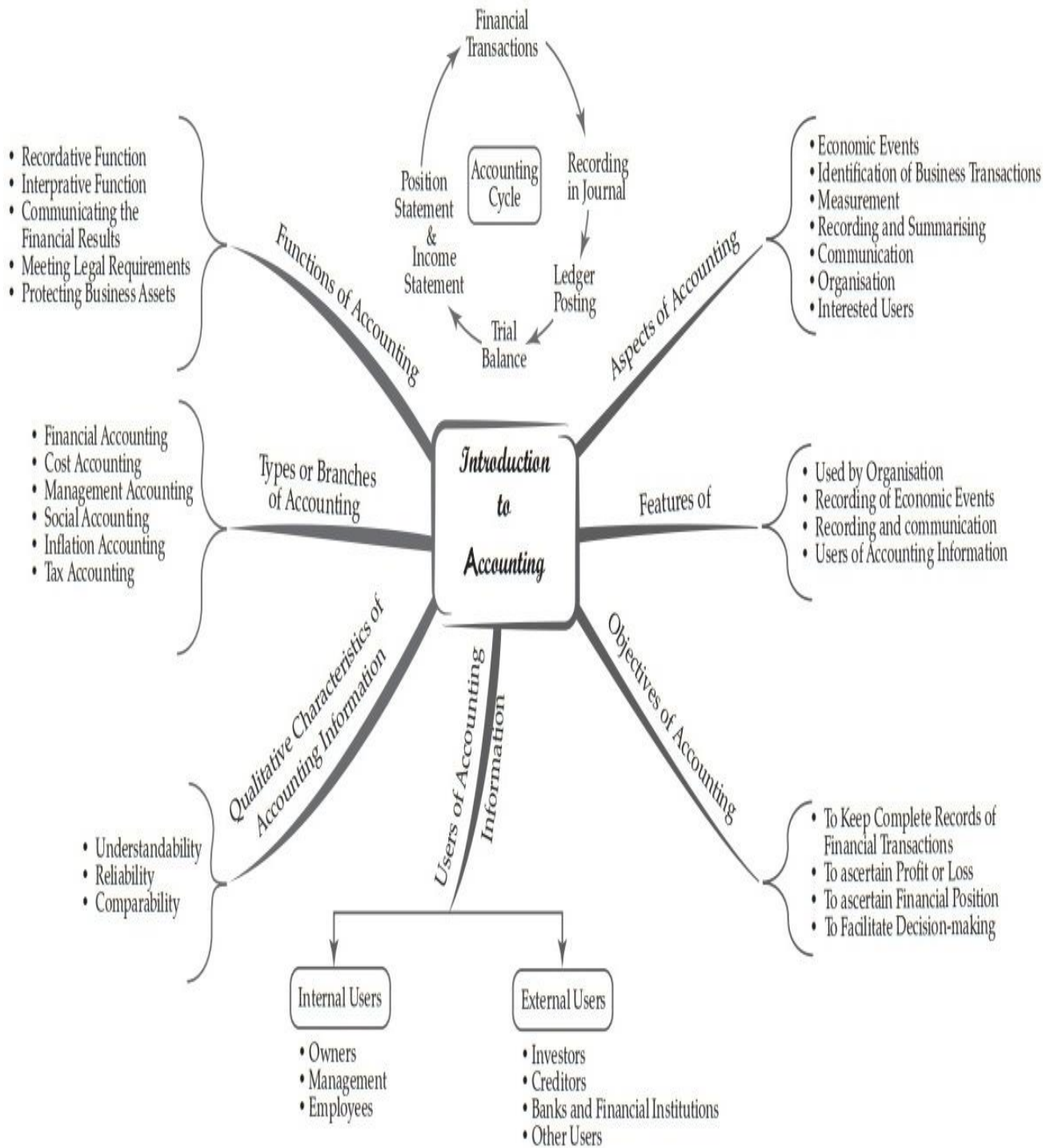
**3 hrs.**

**Project: 20 Marks**

S.No.	Typology of Questions	Marks	Percentage
1.	<b>Remembering and Understanding:</b> Exhibit memory of previously learned material by recalling facts, terms, basic concepts, and answers. Demonstrate understanding of facts and ideas by organizing, comparing, translating, interpreting, giving descriptions, and stating main ideas.	44	55%
2.	<b>Applying:</b> Solve problems to new situations by applying acquired knowledge, facts, techniques and rules in a different way.	19	23.75%
3.	<b>Analysing, Evaluating and Creating:</b> Examine and break information into parts by identifying motives or causes. Make inferences and find evidence to support generalizations. Present and defend opinions by making judgments about information, validity of ideas, or quality of work based on a set of criteria. Compile information together in a different way by combining elements in a new pattern or proposing alternative solutions.	17	21.25%
<b>TOTAL</b>		<b>80</b>	<b>100%</b>

# CH - 01. INTRODUCTION TO ACCOUNTING

## (MIND MAP)



## **LEARNING OBJECTIVES:**

The students will be able to:

- Describe the meaning, significance, objectives, advantages and limitations of accounting in the modern economic environment with varied types of business and non-business economic entities.
- Identify / recognise the individual(s) and entities that use accounting information for serving their needs of decision making.
- Explain the various terms used in accounting.
- Differentiate between different related terms like current and non-current, capital and revenue.
- Give examples of terms like business transaction, liabilities, assets, expenditure and purchases.
- Explain that sales/ purchases include both cash and credit sales/ purchases relating to the accounting year.
- Differentiate among income, profits and gains.
- State the meaning of fundamental accounting assumptions and their relevance in accounting.
- Describe the meaning of accounting assumptions and the situation in which an assumption is applied during the accounting process.
- Explain the meaning, applicability, objectives, advantages and limitations of accounting standards.
- Double entry system
- Explain the meaning, advantages and characteristic of GST.

## **Meaning Of Accounting:**

The American Institute of Certified Public Accountants (AICPA) had defined accounting as the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof.

In order to appreciate the exact nature of accounting, we must understand the following relevant aspects of the definition:

- Economic Events.
- Identification, Measurement, Recording and Communication.
- Organisation.

### **➤ Economic Events:**

Business organisations involves economic events. An economic event is known as a happening of consequence to a business organisation which consists of transactions and which are measurable in monetary terms. For example, purchase of machinery.

If an event involves transactions between an outsider and an organisation, these are known as **external events**. The following are the examples of such transactions:

- Sale of merchandise to the customers.
- Rendering services to the customers by ABC Limited.
- Purchase of materials from suppliers.
- Payment of monthly rent to the landlord.

An **internal event** is an economic event that occurs entirely between the internal wings of an enterprise, e.g., supply of raw material or components by the stores department to the manufacturing department, payment of wages to the employees, etc.

➤ **Identification, Measurement, Recording and Communication**

(a) **Identification:** It means determining what transactions to record, i.e., to identify events which are to be recorded. It involves observing activities and selecting those events that are of considered financial character and relate to the organisation.

(b) **Measurement:** It means quantification (including estimates) of business transactions into financial terms by using monetary unit, viz. rupees and paise as a measuring unit.

(c) **Recording:** Once the economic events are identified and measured in financial terms, these are recorded in books of account in monetary terms and in a chronological order.

(d) **Communication:** The economic events are identified, measured and recorded in order that the pertinent information is generated and communicated in a certain form to management and other internal and external users.

➤ **Organisation**

Organisation refers to a business enterprise, whether for profit or not-for-profit motive. Depending upon the size of activities and level of business operation, it can be a Sole-proprietary concern, Partnership firm, Cooperative society, Company, Local authority, Municipal Corporation or any other association of persons.

➤ **Interested Users of Information**

Accounting is a means by which necessary financial information about business enterprise is communicated and is also called the language of business. Many users need financial information in order to make important decisions. These users can be divided into two broad categories: *internal users and external users*. Internal users include: Chief Executive, Financial Officer, Vice President, Business Unit Managers, Plant Managers, Store Managers, Line Supervisors, etc. External users include: present and potential Investors (shareholders), Creditors (Banks and other Financial Institutions, Debenture-holders and other Lenders), Tax Authorities, Regulatory Agencies (Department of Company Affairs, Registrar of Companies, Securities Exchange Board of India, Labour Unions, Trade Associations, Stock Exchange and Customers, etc.

**Why do the Users Want Accounting Information?**

- The owners/shareholders use them to see if they are getting a satisfactory return on their investment, and to assess the financial health of their company/business.
- The directors/managers use them for making both internal and external comparisons in their attempts to evaluate the performance. They may compare the financial analysis of their company with the industry figures in order to ascertain the company's strengths and weaknesses. Management is also concerned with ensuring that the money invested in the company/organisation is generating an adequate return and that the company/organisation is able to pay its debts and remain solvent.
- The creditors (lenders) want to know if they are likely to get paid and look particularly at liquidity, which is the ability of the company/organisation to pay its debts as they become due.

- The prospective investors use them to assess whether or not to invest their money in the company/organisation.
- The government and regulatory agencies such as Registrar of companies, Custom departments IRDA, RBI, etc. require information for the payment of various taxes such as Value Added Tax (VAT), Income Tax (IT), Customs and Excise duties for protecting the interests of investors, creditors (lenders), and also to satisfy the legal obligations imposed by The Companies Act 2013 and SEBI from time-to-time.

### **Accounting as a Source of Information:**

Accounting is a definite process of interlinked activities that begins with the identification of transactions and ends with the preparation of financial statements. Every step in the process of accounting generates information. To be useful, the accounting information should ensure to:

- Provide information for making economic decisions;
- Serve the users who rely on financial statements as their principal source of information;
- Provide information useful for predicting and evaluating the amount, timing & uncertainty of potential cash-flows;
- Provide information for judging management's ability to utilise resources effectively in meeting goals
- Provide factual and interpretative information by disclosing underlying assumptions on matters subject to interpretation, evaluation, prediction, or estimation; and
- Provide information on activities affecting the society.

### **Branches of Accounting:**

The economic development and technological advancements have resulted in an increase in the scale of operations and the advent of the company form of business organisation. This has made the management function more and more complex and increased the importance of accounting information. This gave rise to special branches of accounting.

These are:

#### ➤ **Financial accounting:**

The purpose of this branch of accounting is to keep a record of all financial transactions so that:

- (a) The profit earned or loss sustained by the business during an accounting period can be worked out,
- (b) The financial position of the business as at the end of the accounting period can be ascertained, &
- (c) The financial information required by the management and other interested parties can be provided.

#### ➤ **Cost Accounting:**

The purpose of cost accounting is to analyse the expenditure so as to ascertain the cost of various products manufactured by the firm and fix the prices. It also helps in controlling the costs and providing necessary costing information to management for decision-making.

#### ➤ **Management Accounting:**

The purpose of management accounting is to assist the management in taking rational policy decisions and to evaluate the impact of its decisions and actions.

#### ➤ **Tax accounting:**

(GST and income tax). The purpose of this accounting is to calculate the tax liabilities of business.

**Book-Keeping Base of Accounting:-**

Book keeping is an art of recording the transactions in the books of accounts. Only those transactions which bear a monetary value are recorded. It is the first step of accounting.

**Difference between Book-Keeping and Accounting**

Basis of distinction	Book-keeping	Accounting
<b>1. Scope</b>	It is concerned only with recording of monetary transactions.	It also includes classifying, summarizing, analysing and also communicating the results to users.
<b>2. Stage</b>	It's a primary stage.	It's a secondary stage.
<b>3. Objective</b>	To maintain systematic records of business.	To calculate the net profit or net loss in the business.
<b>4. Nature</b>	Routine and clerical.	Analytical.
<b>5. Staff involved</b>	It is done by junior level staff.	It is done by senior level staff.

**Qualitative Characteristics of Accounting Information:**

Qualitative characteristics are the attributes of accounting information which tend to enhance its understandability and usefulness. In order to assess whether accounting information is decision useful, it must possess the characteristics of reliability, relevance, understandability and comparability.

**Qualitative Characteristics of Accounting:**

- (i) Reliability: Accounting information should be reliable, verifiable and based on facts.
- (ii) Relevance: Only Relevant information should be disclosed. Information which is irrelevant and useless should not be the part of financial statements.
- (iii) Understandability: Accounting information should be presented in a very simple way so that it is easy to understand by its users.
- (iv) Comparability: Financial Statements should contain the figures of current year as well as figures of previous year so that the current performance of the business can be compared with the performance of previous year.

**Objectives of Accounting:**

- (i) The main objective of the accounting is to keep systematic record of business transactions. That is why, all financial transactions are first recorded in journal & then posted into ledger.
- (ii) Accounting is helpful in preventing and detecting the errors and frauds.
- (iii) Accounting plays important role in calculating the profit or loss during a particular period by preparing Trading account and Profit and Loss Account.
- (iv) Accounting is helpful in ascertaining the financial position of the business.
- (v) Accounting provides useful information to its users.

**Advantages of Accounting**

- 1. Financial Information about Business
- 2. Assistance to Management
- 3. Replaces Memory
- 4. Facilitates Comparative Study
- 5. Facilitates Settlement of Tax Liabilities
- 6. Facilitates Loans
- 7. Evidence in Court

## Limitations of Accounting

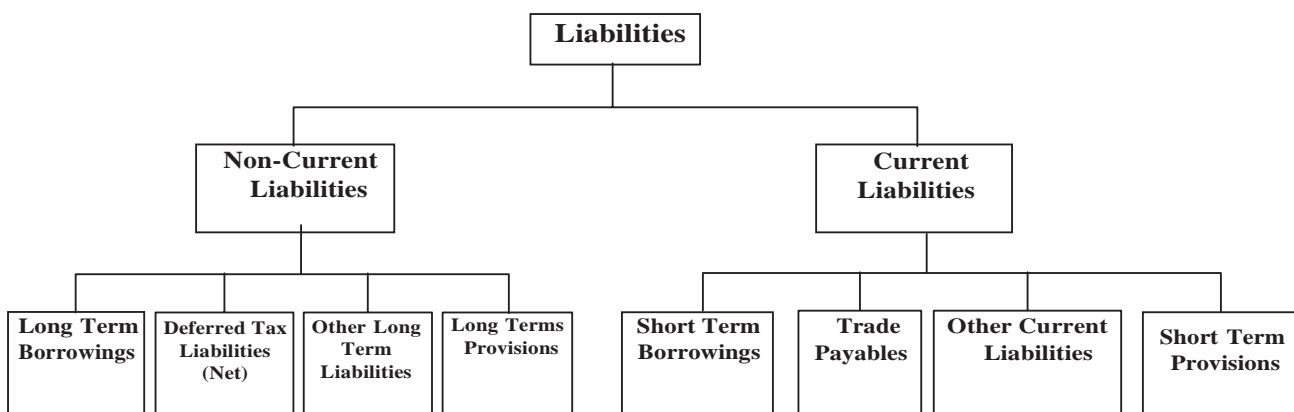
1. Accounting is not Fully Exact
2. Accounting does not Indicate the Realizable Value
3. Accounting Ignores the Qualitative Elements
4. Accounting Ignores the Effect of Price Level Change
5. Accounting may Lead to Window Dressing

### ➤ Role of Accounting:

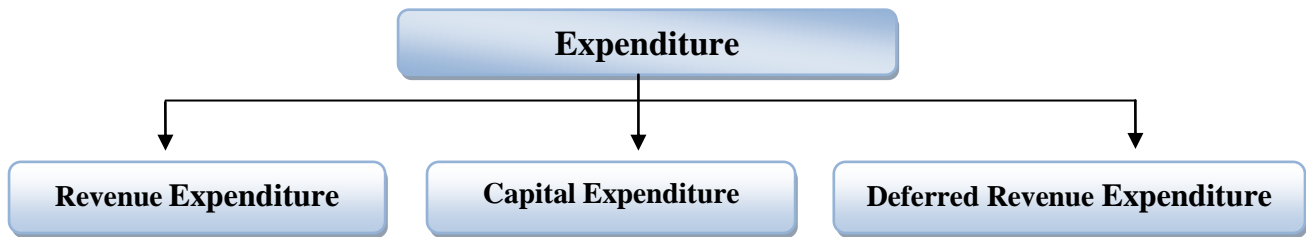
For centuries, the role of accounting has been changing with the changes in economic development and increasing societal demands. It describes and analyses a mass of data of an enterprise through measurement, classification and summarisation, and reduces those data into reports and statements, which show the financial condition and results of operations of that enterprise. Hence, it is regarded as a language of business.

## Basic Accounting Terms:

1. **Entity:** An economic unit, which may be business entity (enterprise) or non-business entity.
2. **Business Transaction:** A Business transaction is an economic activity of business that changes its financial position.
3. **Account:** It is a record of all business transactions relating to a particular person or item. It is a T-Shaped Performa.
4. **Capital:** It refers to the amount invested by the owner in a business. The amount invested could be in the form of cash, goods, etc.
5. **Drawing:** Any cash or goods withdrawn by the owner for personal use made out of business funds are known as drawings.
6. **Liabilities:** Liabilities refer to financial obligations of business. It denotes the amount which a business owes to others. eg.- Creditors, loan, etc. It is of 2 types;
  - (a) **Non-current liabilities:** It refers to those which fall due for payment in a relatively longer period. For eg- long term loans.
  - (b) **Current liabilities:** It refers to those which are to be paid in the near future. For eg- Creditors, Outstanding expenses.



7. **Receipts:** Amount received from sale of goods and/ or services or both.
8. **Expenditure:** It involves spending cash or incurring a liability for the purpose of acquiring assets, goods or services. It is of 3 types.

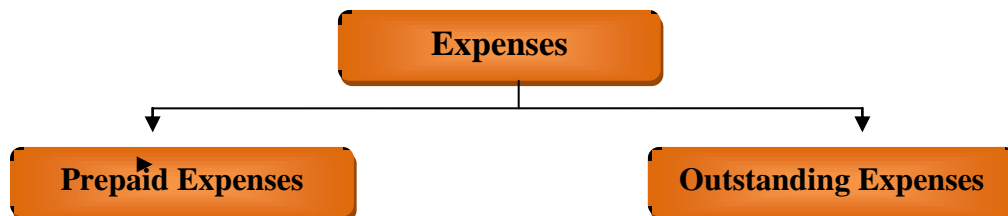


(a) **Revenue Expenditure:** It refers to any expenditure, the full benefit of which is received during one accounting period. eg- salaries, rent etc.

(b) **Capital Expenditure:** It refers to expenditure, the benefit of which is received during more than one year. Example - Machinery.

(c) **Deferred Revenue Expenditure:** It refers to expenditure which are revenue in nature but benefit of which is likely to be derived over no of years. Example - Advertisement.

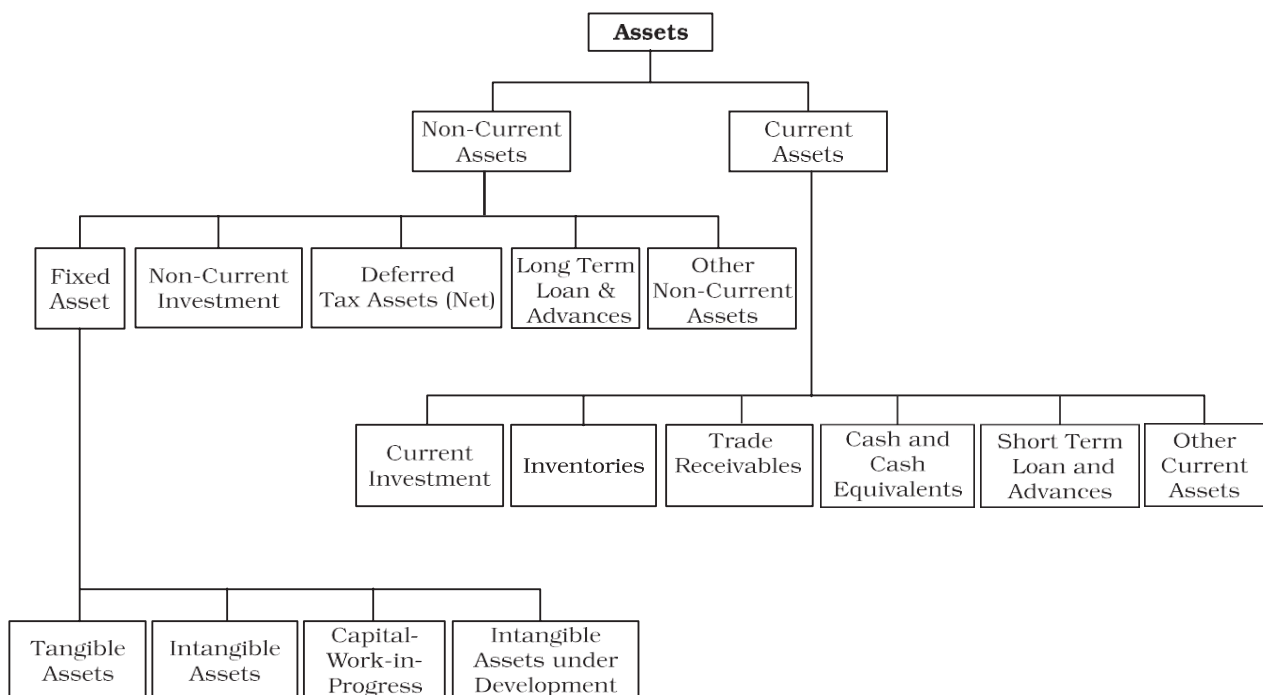
**9. Expenses:** It is the amount used in order to produce and sell goods and services.



(a) **Prepaid Expenses:** Expenses paid in the current year but relating to next financial year or years.

(b) **Outstanding Expenses:** Expenses incurred but not paid.

**10. Assets:** - These are properties or economic resources of enterprises which can be expressed in monetary terms it can be divided in two parts.



**11. Revenue:** Gross inflow of cash (Received or Receivable), receivables or other consideration in the normal course of business.

**12. Income:** It is the difference between revenue and expense.

**13. Profit:** It is the excess of total revenue over total expense of a business.

$$\text{Profit} = \text{Revenue} - \text{Expenses.}$$

**14. Gain:** It is a monetary benefit resulting from events or transactions which are incidental to business like profit on sale of fixed assets.

**15. Loss:** The excess of expenses over related revenue is known as loss.

$$\text{Loss} = \text{Expenses} - \text{Revenue.}$$

**16. Purchases:** It refers to the amount of goods bought by business for resale or use in production. It can be of cash or credit.

**17. Purchase return:** When purchased goods are returned to suppliers, it is referred to as purchase return.

**18. Sales:** It means transfer of goods or services for money in the normal course of business.

**19. Sales return:** When customers return the goods sold to them it is known as sales returns.

**20. Revenue from Operation:** Amount received or receivable from the sale of goods and/ or services or both.

**21. Goods:** Goods purchased for resale or for manufacturing product.

**22. Stock/ Inventory:** It includes goods unsold on a particular date.

**23. Trade Receivables:** Amount receivable against sale of goods and/or services or both.

(a) **Debtors:** A person or entity to whom goods are sold and / or services are rendered on credit.

(b) **Bills Receivable:** Acceptance (Bills of Exchange) received from a debtor.

**24. Trade Payables:** Amount payable against purchase of goods and /or services or both.

(a) **Creditors:** It refers to those persons whose business buys goods on credit & payment has not been done yet.

(b) **Bills Payable:** Acceptance (Bill of Exchange) given to a creditor.

**25. Cost:** Expenses on purchasing and/or manufacturing goods.

**26. Voucher:** A voucher is a written document which is created in support of a particular transaction. It may be in the form of a cash memo, invoice or receipt. Voucher is a necessary component of auditing.

**27. Discount:** It is the rebate given by the seller to the buyer.



- (a) **Trade Discount:** This is a type of discount allowed by the sellers to their customers at a fixed percentage on the list price of goods and also it is not entered in the books of accounts.
- (b) **Cash Discount:** When discount is allowed to customers for making prompt payment. It is always recorded in books of accounts.
- (c) **Rebate:** Reduction allowed in the sale value due to (saying) poor quality, excess supply, etc.
- 28. Bad Debts:** It refers to the amount that debtor has not paid even after repeated reminders & has no intention of paying in the future.
- 29. Balance Sheet:** A statement of balances of assets and liabilities.
- 30. Book Value:** Value of assets as existing in the books of accounts.
- 31. Books of Accounts:** Books in which transactions are recorded or transferred (posted).
- 32. Credit:** Traditionally, right side of an account is credit side.
- 33. Debit:** Traditionally, left side of an account is debit side.
- 34. Depreciation:** Decrease in book value of an asset due to its use or efflux of time or obsolescence.
- 35. Entry:** Recording business transaction in the books of account.
- 36. Insolvent:** A person or entity unable to pay his/its debts.
- 37. Solvent:** A person or entity who is in a position to pay his/its debts.
- 38. Proprietor:** A person who owns the business.
- 39. Financial Statements or Final Accounts:** Statements prepared at the end of the accounting period to determine financial performance and financial position.

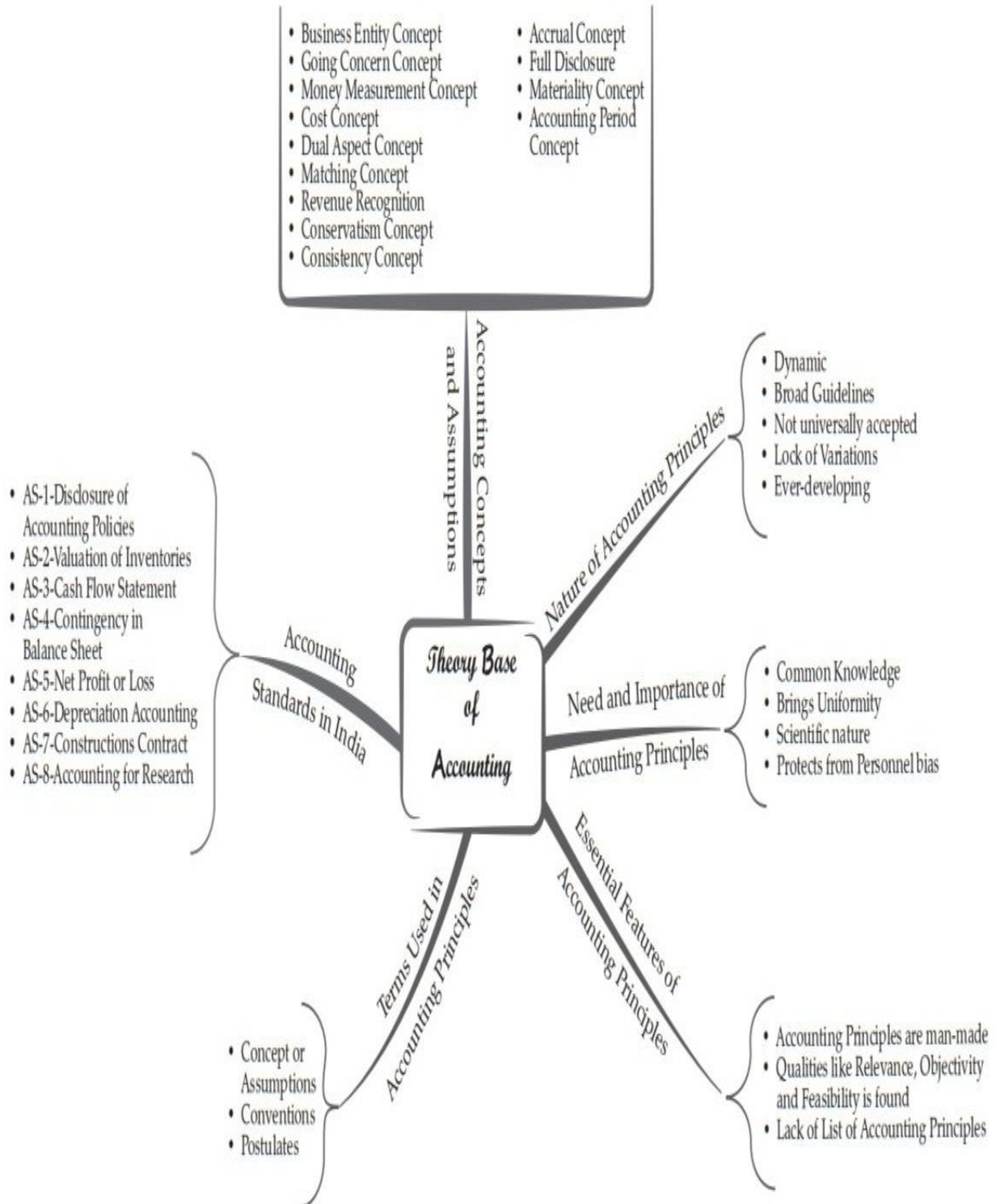
### **PRACTICE QUESTIONS:**

1. Define accounting.
2. State the end product of financial accounting.
3. Enumerate main objectives of accounting.
4. Who are internal users of accounting information?
5. State the nature of accounting information required by long-term lenders.
6. Who are the external users of information?
7. Enumerate information needs of management.
8. Give any three examples of revenues.
9. Distinguish between debtors and creditors; profit and gain
10. 'Accounting information should be comparable'. Do you agree with this statement?  
Give two reasons.

-----**END OF CHAPTER**-----

## CH - 02. THEORY BASE OF ACCOUNTING

### (MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

- identify the need for theory base of accounting;
- explain the nature of Generally Accepted Accounting Principles (GAAP);
- state the meaning and purpose of the basic accounting concepts;
- list the accounting standards issued by Institute of Chartered Accountants of India;
- describe the systems of accounting; and
- describe the basis of accounting.

### **Generally Accepted Accounting Principles:**

Generally Accepted Accounting principles refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements. These principles are also referred to as concepts and conventions. From the practicality view point, the various terms such as principles, postulates, conventions modifying principles, assumptions, etc. have been used interchangeably and are referred to as basic accounting concepts, in the present book.

### **Basic Accounting Concepts:**

The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities and developed by the accounting profession. The important concepts have been listed as below:

- |   |                                    |
|---|------------------------------------|
| • <b>Business entity;</b>                   | • <b>Money measurement;</b>        |
| • <b>Going concern;</b>                     | • <b>Accounting period;</b>        |
| • <b>Cost</b>                               | • <b>Dual aspect (or Duality);</b> |
| • <b>Revenue recognition (Realisation);</b> | • <b>Matching;</b>                 |
| • <b>Full disclosure;</b>                   | • <b>Consistency;</b>              |
| • <b>Conservatism (Prudence);</b>           | • <b>Materiality;</b>              |
| • <b>Objectivity.</b>                       |                                    |

**1. Business Entity Concept:** This concept assumes that business has distinct and separate entity from its owners. Thus, for the purpose of accounting, business and its owners are to be treated as two separate entities.

**2. Money Measurement Concept:** The concept of money measurement states that only those transactions and happenings in an organisation, which can be expressed in terms of money are to be recorded in the book of accounts. Also, the records of the transactions are to be kept not in the physical units but in the monetary units.

**3. Going Concern Concept:** The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely (for a fairly long period of time) and would not be liquidated in the near future.

**4. Accounting Period Concept:** Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities, at the end of that period.

**5. Cost Concept:** The cost concept requires that all assets are recorded in the book of accounts at their cost price, which includes cost of acquisition, transportation, installation and making the asset ready for the use.

**6. Dual Aspect Concept:** This concept states that every transaction has a dual or two-fold effect on various accounts and should therefore be recorded at two places. The duality principle is commonly expressed in terms of fundamental accounting equation, which is:

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

**7. Revenue Recognition (Realisation) Concept:** Revenue is the gross in-flow of cash arising from the sale of goods and services by an enterprise and use by others of the enterprise resources yielding interest royalties and dividends. The concept of revenue recognition requires that the revenue for a business transaction should be considered realised when a legal right to receive it arises.

**8. Matching Concept:** The concept of matching emphasises that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenue must belong to the same accounting period.

**9. Full Disclosure Concept:** This concept requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes.

**10. Consistency Concept:** This concept states that accounting policies and practices followed by enterprises should be uniform and consistent one the period of time so that results are comparable. Comparability results when the same accounting principles are consistently being applied by different enterprises for the period under comparison, or the same firm for a number of periods.

**11. Conservatism Concept:** This concept requires that business transactions should be recorded in such a manner that profits are not overstated. All anticipated losses should be accounted for but all unrealised gains should be ignored.

**12. Materiality Concept:** This concept states that accounting should focus on material facts. If the item is likely to influence the decision of a reasonably prudent investor or creditor, it should be regarded as material, and shown in the financial statements.

**13. Objectivity Concept:** The concept of objectivity requires that accounting transaction should be recorded in an objective manner, free from the bias of accountants and others. This can be possible when each of the transaction is supported by verifiable documents or vouchers.

## Systems of Accounting:

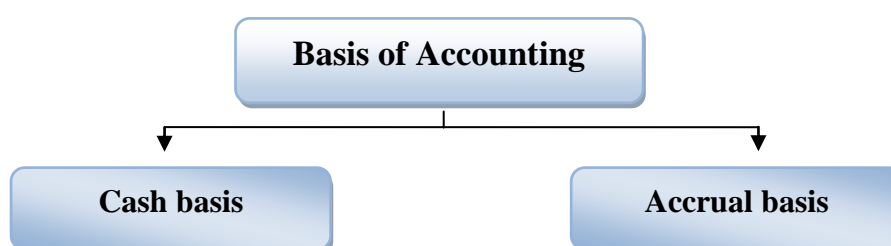
The systems of recording transactions in the book of accounts are generally classified into two types, viz. Double entry system and Single entry system. Double entry system is based on the principle of “Dual Aspect” which states that every transaction has two effects, viz. receiving of a benefit and giving of a benefit. Each transaction, therefore, involves two or more accounts and is recorded at different places in the ledger.

Double entry system is a complete system as both the aspects of a transaction are recorded in the book of accounts. The system is accurate and more reliable as the possibilities of frauds and misappropriations are minimised.

Single entry system is not a complete system of maintaining records of financial transactions. It does not record two-fold effect of each and every transaction.

## Basis of Accounting:

From the point of view the timing of recognition of revenue and costs, there can be two broad approaches to accounting. These are:



### (i) Cash basis; and (ii) Accrual basis.

**1. Cash basis:** Under this entry in the books of accounts are made when cash received or paid and not when the receipt or payment becomes due. For example, if salary ₹ 10,000 of February 2023 paid in March 2023 it would be recorded in the books of accounts only in March, 2023.

**2. Accrual basis:** Under this however, revenues and costs are recognized in the period in which they occur rather when they are paid. It means it record the effect of transaction is taken into book when they are earned rather than in the period in which cash is actually received or paid by the enterprise. It is more appropriate basis for calculation of profits as expenses are matched against revenue earned in the relation thereto.

For example, raw materials consumed are matched against the cost of goods sold for the accounting period.

### Difference between Accrual Basis of Accounting and Cash Basis of Accounting

Basis	Accrual Basis of Accounting	Cash Basis of Accounting
<b>1. Nature of Transactions</b>	Both cash and credit transactions are recorded.	Cash transactions are recorded.
<b>2. Prepaid/ Outstanding Expenses; Accrued Income / Income received in</b>	Prepaid & Outstanding expenses are accounted in the Profit & loss A/c. Accrued income & income received in advance are also accounted and shown in	Prepaid & outstanding expenses are not adjusted. Similarly, accrued income & income received in advance

<b>Advance</b>	the Balance Sheet.	are not adjusted.
<b>3. Profit or Loss</b>	Correct profit or loss is ascertained because it records both cash & credit transactions.	Correct profit or loss is not ascertained because it records only cash transactions.
<b>4. Technical Knowledge</b>	The Accrual Basis of Accounting require technical knowledge as many adjustment like prepaid, outstanding, capital & revenue are required to be made.	It does not require much of technical knowledge as is required for Accrual Basis of Accounting.
<b>5. Legal Position</b>	Accrual basis of Accounting is recognised by the Companies Act, 2013.	Cash basis of Accounting is not recognised by the companies Act, 2013.
<b>6. Acceptability</b>	Accrual basis of Accounting is more acceptable in business as it reveals correct income and expenses besides assets and liabilities.	Cash basis of accounting is not acceptable in business as it does not reveal the required information.

### **ACCOUNTING STANDARDS:**

Accounting standards may be defined as written statements issued from time to time by institutions of accounting professionals e.g. ICAI, specifying uniform rules or practices for preparing & presenting financial statements. Some of accounting standards are as follows:

- (i) AS-1: Disclosure of Accounting Policies
- (ii) AS-2: Valuation of Inventories
- (iii) AS-3: Cash Flow Statement.

### **Need or Utility or Advantages of Accounting Standards:**

- (i) Accounting standards bring uniformity in preparation and presentation of financial statements.
- (ii) They ensure the consistency and comparability of different financial statements.
- (iii) They significantly reduce the chances of manipulations and frauds.
- (iv) To improve the reliability and credibility of financial statements.

### **Benefits of Accounting Standards:**

1. Accounting standard helps in eliminating variations in accounting treatment to prepare financial statements.
2. Accounting standard may call for disclosures of certain information which may not be required by law, but such information might be useful for general public, investors and creditors.
3. Accounting standard facilitate comparability between financial statements of inter and intra companies.

### **Limitations of Accounting Standards:**

1. Accounting standard makes choice between different alternate accounting treatments difficult to apply.
2. It is rigidly followed and fails to extend flexibility in applying accounting standards.
3. Accounting standard cannot override the statue. The standards are required to be farmed within the ambit of prevailing status.

### Goods and Services Tax (One Country One Tax):

GST is a destination-based tax on consumption of goods and services. It is proposed to be levied at all stages right from manufacture up to final consumption with credit of taxes paid at previous stages available as set off.

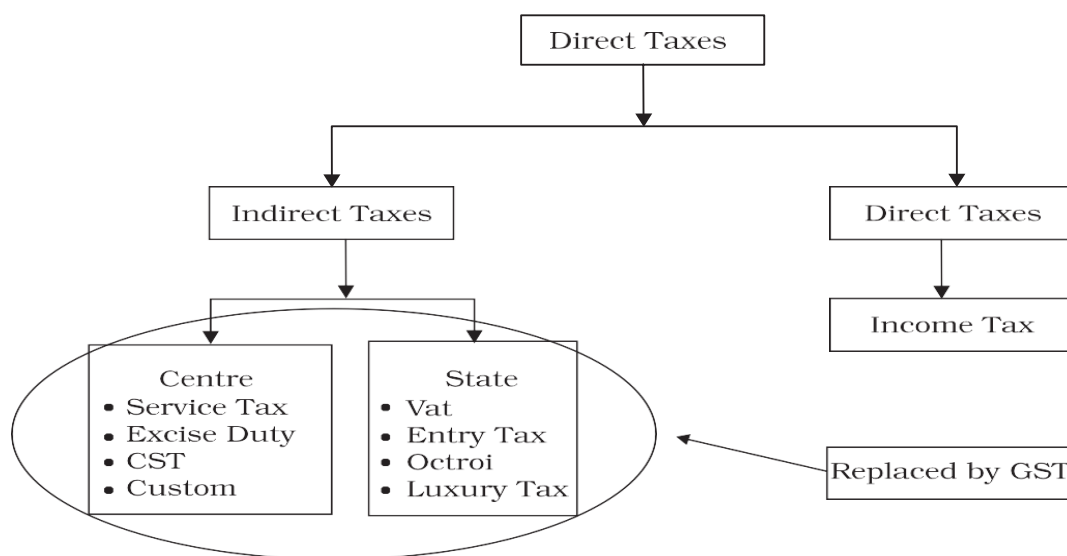
GST has a dual aspect with the Centre and States simultaneously levying on a common tax base. There are three main components of GST which are CGST, SGST and IGST.

CGST means Central Goods and Services Tax. Taxes collected under CGST will constitute the revenues of the Central Government.

SGST means State Goods and Services Tax. A collection of SGST is the revenue of the State Government.

For example, Ramesh a dealer in Punjab sell goods to Seema in Punjab worth ₹ 10,000. If the GST rate is 18%, i.e., 9% CGST and 9% SGST, ₹ 900 will go to Central Government and ₹ 900 will go to Punjab Government.

IGST means Integrated Goods and Services Tax. Revenue collected under IGST is divided between Central and State Government as per the rates specified by the Government. IGST is charged on transfer of goods and services from one state to another. Import of goods and services are also covered under IGST.



### Characteristics of Goods and Services Tax:

1. GST is a common law and procedure throughout the country under single administration.
2. GST is a destination-based tax and levied at a single point at the time of consumption of goods & services by the end consumer.
3. GST is a comprehensive levy and collection on both goods & services at the same rate with benefit of input tax credit or subtraction of value.
4. Minimum number of rates of tax does not exceed two.
5. There is no scope for levy of cess, resale tax, additional tax, turnover tax etc.
6. There is no multiple levy of tax on goods and services, such as sales tax, entry tax, Octroi, entertainment tax or luxury tax etc.

**Advantages:**

1. Introduction of GST has resulted in the abolition of multiple types of taxes in goods and services.
2. GST widens the tax base & increased revenue to Centre and State thereby reducing administrative cost for the Government.
3. GST has reduced compliance cost and increases voluntary compliance.
4. GST has affected rates of tax to the maximum of two floor rates.
5. GST has removed the cascading effect on taxation.
6. GST will result in enhancing manufacturing & distribution system affecting the cost of production of goods and services and consequently the demand & production of goods and services will increase.
7. It will eventually promote economic efficiency & sustainable long-term economic growth as GST is neutral to business processes, business models, organisational structure & geographical location.
8. GST would help to extend competitive edge in international market for goods & services produced in the country leading to increased exports.

**PRACTICE QUESTIONS:**

1. Why is it necessary for accountants to assume that business entity will remain a going concern?
2. When should revenue be recognised? Are there exceptions to the general rule?
3. What is the basic accounting equation?
4. The realisation concept determines when goods sent on credit to customers are to be included in the sales figure for the purpose of computing the profit or loss for the accounting period. Which of the following tends to be used in practice to determine when to include a transaction in the sales figure for the period. When the goods have been:  
(a) Dispatched    (b) Invoiced    (c) Delivered    (d) Paid for.

**5. Give reasons for your answer. Complete the following worksheet:**

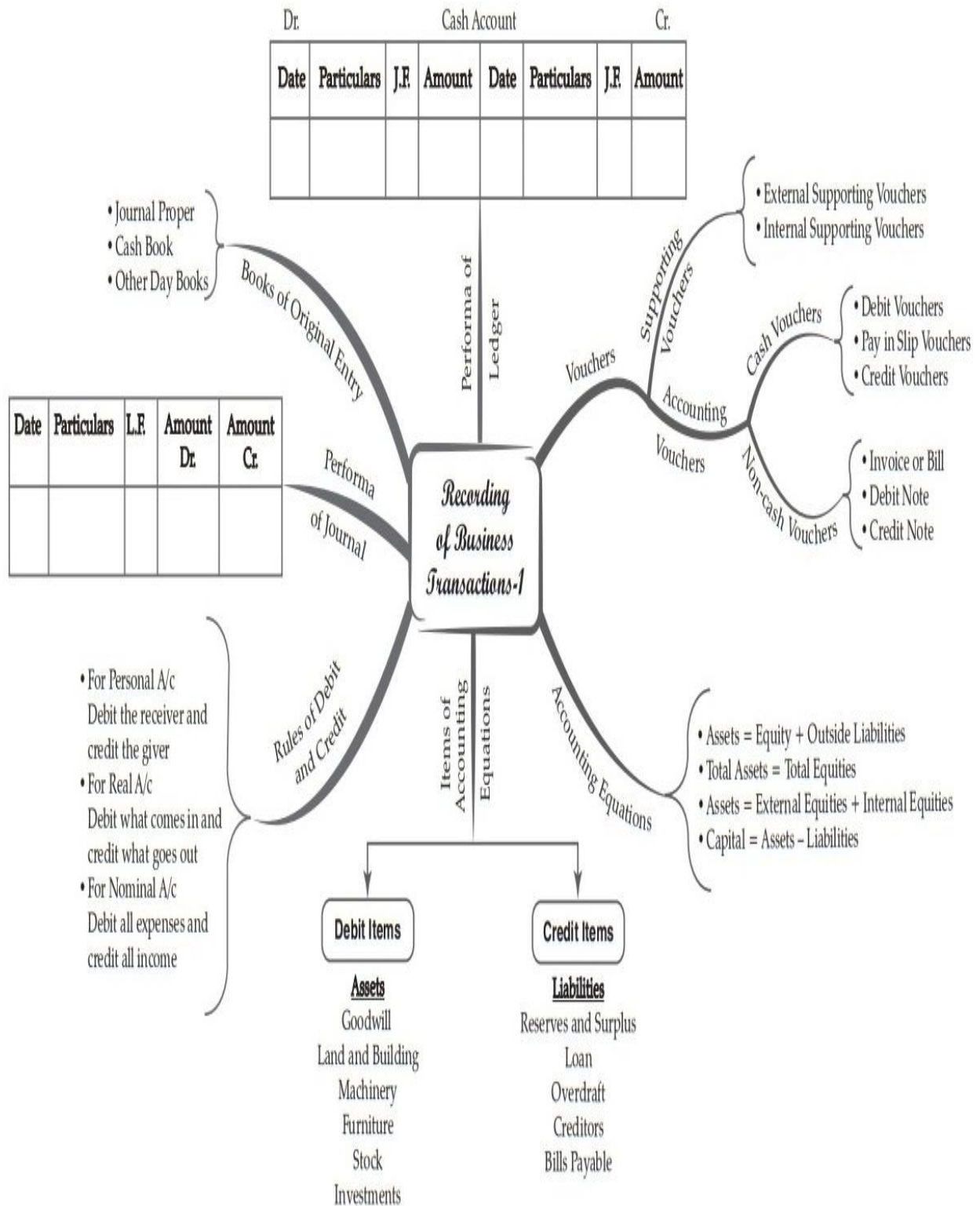
- (i) If a firm believes that some of its debtors may 'default', it should act on this by making sure that all possible losses are recorded in the books. This is an example of the \_\_\_\_\_ concept.
- (ii) The fact that a business is separate and distinguishable from its owner is best exemplified by the \_\_\_\_\_ concept.
- (iii) Everything a firm owns, it also owns out to somebody. This co-incidence is explained by the \_\_\_\_\_ concept.
- (iv) The \_\_\_\_\_ concept states that if straight line method of depreciation is used in one year, then it should also be used in the next year.
- (v) A firm may hold stock which is heavily in demand. Consequently, the market value of this stock may be increased. Normal accounting procedure is to ignore this because of the \_\_\_\_\_.
- (vi) If a firm receives an order for goods, it would not be included in the sales figure owing to the \_\_\_\_\_.
- (vii) The management of a firm is remarkably incompetent, but the firms accountants cannot take this into account while preparing book of accounts because of \_\_\_\_\_ concept.

6. Explain Cost concept.
7. What is mean by accounting standard? What is the main objective of accounting standard?
8. Explain the following concepts.  
(a) Business entity concept      (b) Going concern concept      (c) Revenue recognition concept
9. Explain the utility of Accounting Standards.
10. Which principle assumes that a business enterprise will not be liquidated in near future?  
Ans. Going concern concept.
11. "Closing stock is valued lower than the market price" which concept of accounting is applied here?  
Ans. Conservatism (Prudence) concept.
12. "An asset may define as a bundle of services" – explain with an example.
13. Under which accounting principle, quality of manpower is not recommended in the books of accounts?  
Ans. Money measurement concept.

-----**END OF CHAPTER**-----

## CH - 03. RECORDING OF TRANSACTIONS - I

### (MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

- describe the nature of transaction and source documents;
- explain the preparation of accounting vouchers;
- apply accounting equation to explain the effect of transactions;
- record transactions using rules of debit and credit;
- explain the concept of book of original entry and recording of transactions in journal;
- explain the concept of ledger and posting of journal entries to the ledger accounts.

### **Business Transactions and Source Document:**

Business transactions are exchanges of economic consideration between parties and have two-fold effects that are recorded in at least two accounts.

Business transactions are usually evidenced by an appropriate document such as Cash memo, Invoice, Sales bill, Pay-in-slip, Cheque, Salary slip, etc. A document which provides evidence of the transactions is called the *Source Document or a Voucher*.

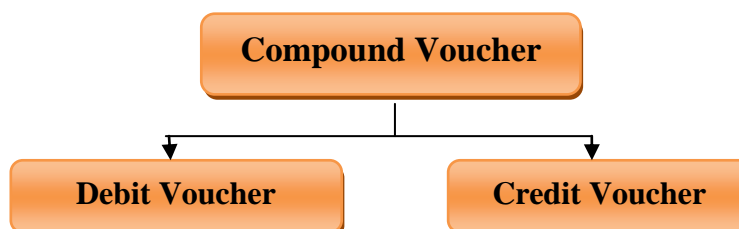
### **Preparation of Accounting Vouchers:**

Accounting vouchers may be classified as cash vouchers, debit vouchers, credit vouchers, journal vouchers, etc. There is no set format of accounting vouchers.

A transaction with one debit and one credit is a simple transaction and the accounting vouchers prepared for such transaction is known as *Transaction Voucher*.

Voucher which records a transaction that entails multiple debits/credits and one credit/debit is called **compound voucher**.

Compound voucher may be: (a) *Debit Voucher* or (b) *Credit Voucher*;



Transactions with multiple *debts* and multiple *credits* are called complex transactions and the accounting voucher prepared for such transaction is known as *Complex Voucher/ Journal Voucher*.

The design of the accounting vouchers depends upon the nature, requirement and convenience of the business. There is no set format of an accounting voucher. To distinguish various vouchers, different colour papers and different fonts of printing are used. Some of the specimens of the accounting vouchers are given in the earlier pages.

An accounting voucher must contain the following essential elements:

- It is written on a good quality paper;
- Name of the firm must be printed on the top;
- Date of transaction is filled up against the date and not the date of recording of transaction is to be mentioned;
- The number of the voucher is to be in a serial order;
- Name of the account to be debited or credited is mentioned;

- Debit and credit amount is to be written in figures against the amount;
- Description of the transaction is to be given account wise;
- The person who prepares the voucher must mention his name along with signature; and
- The name and signature of the authorised person are mentioned on the voucher.

### Meaning of Accounting Equation

Accounting equation signifies that the assets of a business are always equal to the total of its liabilities and capital. The equation reads as follows:

$$A = C + L$$

Where,

A= Assets

L= Liabilities

C= Capital

The above equation can also be presented in the following forms as its derivatives to enable the determination of missing figures of Capital(C) or Liabilities (L).

$$A - L = C$$

$$A - C = L$$

Since, the accounting equation depicts the fundamental relationship among the components of the balance sheet, it is also called the Balance Sheet Equation. As the name suggests, the balance sheet is a statement of assets, liabilities and capital

**Illustration 1.** Find the capital of the business if total assets are ₹ 1, 50,000 & liabilities are ₹ 70,000.

**Solution:** Assets = Liabilities + Capital

So, Capital = Assets – Liabilities

$$\text{Capital} = ₹ 1, 50,000 - ₹ 70,000 = ₹ 80,000$$

**Illustration 2.** Aryan Ltd. commenced business on 1<sup>st</sup> April, 2016 with a capital of ₹ 50,000. On 31<sup>st</sup> March 2017, its assets were worth ₹ 95,000 and liabilities of ₹ 30,000. Find the capital at the end of the year and profit earned during the year.

**Solution:** Assets = Liabilities + Capital

$$\text{So, Capital} = \text{Assets} - \text{Liabilities} = ₹ 95,000 - ₹ 30,000 = ₹ 65,000$$

$$\text{Profit} = \text{Closing Capital} - \text{Opening Capital} = ₹ 65,000 - ₹ 50,000 = ₹ 15,000$$

### **Illustration 3.**

Prepare the Accounting Equation on the basis of the following:

	(₹)
1. Ramesh commenced business with cash.	1,50,000
2. Furniture purchased for cash.	20,000
3. Purchased goods from Manish on credit.	25,000
4. Sold goods (costing ₹ 10,000) to Mohini for cash.	14,000
5. Additional capital introduced.	20,000
6. Commission received in advance.	2,000
7. Paid to creditor (Manish) in full settlement.	22,500
8. Sold goods (costing ₹ 15,000) for ₹ 18,000 out of which ₹ 5,000 received in cash.	
9. Depreciation on furniture provided @ 10%.	

## Solution:

	Transactions	Assets = Liabilities + Capital											
		Cash	+ Furniture	+ Stock	+ Debtors	=	Creditors	+ Comm. Rec. in Advance	+ Capital				
		₹	₹	₹	₹		₹	₹	₹	₹	₹	₹	₹
1	Ramesh Commenced business with cash	1,50,000	+	0	+	0	=	0	+	0	+	1,50,000	
2.	Furniture purchased for cash	-20,000	+	20,000	+	0	=	0	+	0	+	0	
	<b>New Equation</b>	1,30,000	+	20,000	+	0	=	0	+	0	+	1,50,000	
3.	Purchased goods from Manish	0	+	0	+	25,000	=	25,000	+	0	+	0	
	<b>New Equation</b>	1,30,000	+	20,000	+	25,000	=	25,000	+	0	+	1,50,000	
4.	Cash Sales (Profit ₹ 14,000 – ₹ 10,000)	14,000	+	0	+	-10,000	=	0	+	0	+	4,000	
	<b>New Equation</b>	1,44,000	+	20,000	+	15,000	=	25,000	+	0	+	1,54,000	
5.	Additional capital introduced	20,000	+	0	+	0	=	0	+	0	+	20,000	
	<b>New Equation</b>	1,64,000	+	20,000	+	15,000	=	25,000	+	0	+	1,74,000	
6	Commission received in advance	2,000	+	0	+	0	=	0	+	2,000	+	0	
	<b>New Equation</b>	1,66,000	+	20,000	+	15,000	=	25,000	+	2,000	+	1,74,000	
7	Paid to creditor Manish ₹22,500 in full settlement	-22,500	+	0	+	0	=	-25,000	+	0	+	2,500	
	<b>New Equation</b>	1,43,500	+	20,000	+	15,000	=	0	+	2,000	+	1,76,500	
8	Sold goods (costing ₹15,000) for ₹18,000 out of which ₹ 5,000 received in cash	5,000	+	0	+	-15,000	=	13,000	+	0	+	3,000	
	<b>New Equation</b>	1,48,500	+	20,000	+	0	=	13,000	+	2,000	+	1,79,500	
9	Dep. on furniture @ 10% on ₹ 20,000	0	-	2,000	+	0	=	0	+	0	-	2,000	
	<b>New Equation</b>	1,48,500	+	18,000	+	0	=	13,000	+	2,000	+	1,77,500	

### Illustration 4. Show effect of following transaction on the accounting equation:

- Manoj started business with Cash ₹ 2, 30,000; Goods ₹ 1, 00,000 and Building ₹ 2, 00,000.
- He purchased goods for cash ₹ 50,000.
- He sold goods (costing ₹ 20,000) ₹ 35,000.
- He purchased goods from Rahul ₹ 55,000.
- He sold goods to Varun (Costing ₹ 52,000) ₹ 60,000.
- He paid cash to Rahul in full settlement ₹ 53,000.
- Salary paid by him ₹ 20,000.
- Received cash from Varun in full settlement ₹ 59,000.
- Rent outstanding ₹ 3,000.
- Prepaid Insurance ₹ 2,000.
- Commission received by him ₹ 13, 000.
- Amount withdrawn by him for personal use ₹ 20,000.
- Depreciation charge on building ₹ 10,000.
- Fresh capital invested ₹ 50,000.
- Purchased goods from Rakhi ₹ 10,000.

**Solution:**

S.N	TRANSACTION	ASSETS = LIABILITIES + CAPITAL							
		CASH	STOCK	BUILDING	DEBTORS	PREPAID INSUR.	CREDITORS	O/S RENT	CAPITAL
a	Started business	2,30,000	1,00,000	2,00,000					5,30,000
		2,30,000	1,00,000	2,00,000					5,30,000
b	Purchased goods for cash	(50,000)	50,000						
		1,80,000	1,50,000	2,00,000					5,30,000
c	Sold goods for cash	35,000	(20,000)						15,000
		2,15,000	1,30,000	2,00,000					5,45,000
d	Purchased goods from Rahul		55,000				55,000		
e	Sold goods to Varun	2,15,000	1,85,000 (52,000)	2,00,000	60,000				5,45,000 8,000
		2,15,000	1,33,000	2,00,000	60,000		55,000 (55,000)		5,53,000
f	Paid cash to Rahul	(53,000)							2,000
		1,62,000	1,33,000	2,00,000	60,000				5,55,000
g	Paid salary	(20,000)							(20,000)
		1,42,000	1,33,000	2,00,000	60,000				5,35,000
h	Received cash from Varun	59,000			(60,000)				(1,000)
		2,01,000	1,33,000	2,00,000					5,34,000
i	O/S Rent							3,000	(3,000)
		2,01,000	1,33,000	2,00,000		2,000		3,000	5,31,000
j	Prepaid Insurance	(2,000)							
		1,99,000	1,33,000	2,00,000		2,000		3,000	5,31,000
k	Commission received	13,000							13,000
		2,12,000	1,33,000	2,00,000		2,000		3,000	5,44,000
l	Drawings	(20,000)							(20,000)
		1,92,000	1,33,000	2,00,000		2,000		3,000	5,24,000
m	Depreciation on building			(10,000)					(10,000)
		1,92,000	1,33,000	1,90,000		2,000		3,000	5,14,000
n	Fresh capital	50,000							50,000
		2,42,000	1,33,000	1,90,000		2,000		3,000	5,64,000
o	Purchased goods from Rakhi		10,000				10,000		
		2,42,000	1,43,000	1,90,000	---	2,000	10,000	3,000	5,64,000
				5,77,000			5,77,000		

**Illustration 5.** How are the following items dealt in Accounting Equation?

- Interest due but not received ₹ 5,000.
- Rent received in advance ₹ 10,000.
- Insurance premium paid in advance ₹ 15,000.
- Salaries due but not paid ₹ 20,000.

**Solution:**

- Interest due but not received shall be added to assets on one side & to the capital on other side.
- It will increase cash on the assets side and increase the liabilities.
- It will decrease one asset (cash) and increase another asset (Prepaid insurance).
- Salary being an expense will be deducted from the capital & being unpaid will be added to liabilities.

**Illustration 6.** Give an example for each of the following types of transactions:

1. Increase in one asset, decrease in another asset.
2. Increase in asset, increase in liability.
3. Increase in asset, increase in owner's capital.
4. Decrease in asset, decrease in liability.
5. Decrease in asset, decrease in owner's capital.
6. Decrease in liabilities, increase in owner's capital.
7. Increase in one liability, decrease in another liability.
8. Increase in liabilities, decrease in owner's capital.

**Solution:**

1. Purchase of furniture for cash—Increase in furniture and decrease in cash.
2. Purchase of furniture on credit—Increase in furniture and increase in liability.
3. Capital introduced by proprietor—Increase in cash and increase in capital.
4. Payment to creditors—Decrease in cash and decrease in creditors.
5. Cash withdrawn by proprietor—Decrease in cash and decrease in capital.
6. Conversion of partner's loan into capital—Increase in capital and decrease in loan.
7. Bills Payable accepted—Increase in bills payable and decrease in creditors.
8. Outstanding expenses provided—Increase in creditors for outstanding expenses and decrease in capital.

**Using Debit and Credit:**

As already stated every transaction involves give and take aspect. In double entry accounting, every transaction affects and is recorded in at least two accounts. When recording each transaction, the *total amount debited must equal to the total amount credited*. In accounting, the terms — *debit* and *credit* indicate whether the transactions are to be recorded on the left hand side or right hand side of the account. In its simplest form, an account looks like the letter T. Because of its shape, this simple form called a T-account. Notice that the T format has a left side and a right side for recording increases and decreases in the item. This helps in ascertaining the ultimate position of each item at the end of an accounting period.

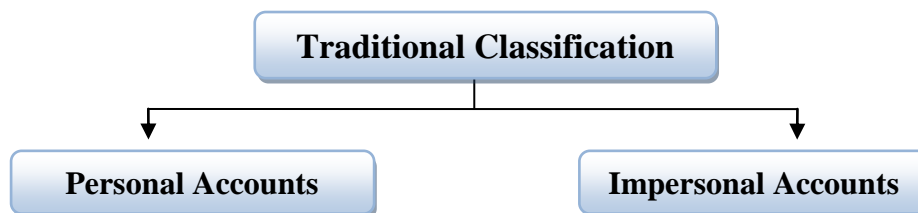
➤ **Rules of Debit and Credit:**

**Classification of Accounts:**

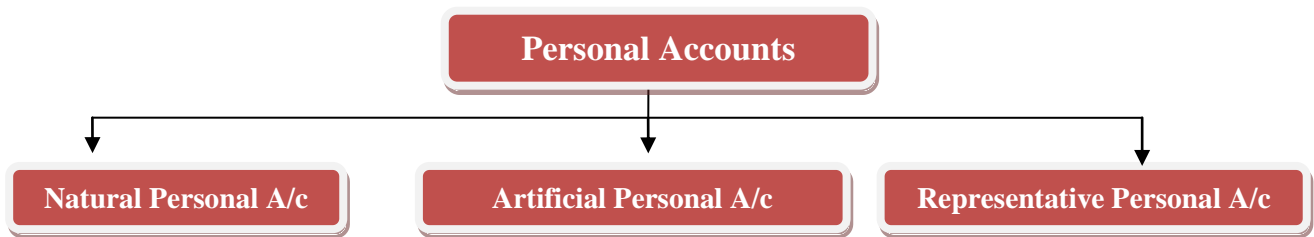
Accounts can be classified in two ways:

(a) **Traditional Classification:** and (b) **Modern Classification.**

(a) Traditional Classification:



**1. Personal Accounts:** Accounts which relate to persons, i.e., individuals, firms, companies, debtors or creditors, etc. are Personal Accounts. Ex. of Personal A/c are the account of Mohan & Co., a customer (Debtor).



Personal Accounts can be classified into three categories:

**(i) Natural Personal A/c's:-** The term 'Natural Person' means persons who are creations of God. Therefore, these will include accounts in individual name. Like Sita's A/c, Mohan's A/c, etc.

**(ii) Artificial Personal A/c's:-** These accounts include accounts of corporate bodies or institutions which are recognised as person in business dealings. Like then account of a limited company, the account of a club etc.

**(iii) Representative Personal A/c's:-** These are accounts which represent a certain person or a group of persons. Like if rent is due to the landlord, an Outstanding Rent Account will be opened in the books.

▪ ***Rule of Debit and Credit - Debit the receiver, Credit the giver.***

**2. Impersonal Accounts:** Account which are not personal such as Machinery A/c, Furniture A/c, Cash A/c etc. are termed as Impersonal Account. These can be further subdivided into two accounts;

**(a) Real A/c's:** Real accounts are the accounts which relate to tangible or intangible assets of the firm (excluding debtors).

**Tangible assets like** – Building, Land, Plant and Machinery and Investment, Cash in hand or stock.

**Intangible assets like-** Patents, Trademark and Goodwill.

▪ ***Rule of Debit and Credit - Debit what comes in, Credit what goes out.***

**(ii) Nominal (Revenue or Expense) Accounts:-** Accounts which relate to expenses, losses, gains, revenue, etc. are termed as Nominal Accounts. These are Rent A/c, Salary A/c, Sales A/c, Commission Received A/c etc.

▪ ***Rule of Debit and Credit - Debit all expenses and losses, Credit all incomes & gains.***

## B. Modern Classification:-

Under this classification, all the accounts are classified into the following five categories.

- |                      |                        |                      |
|----------------------|------------------------|----------------------|
| 1. Asset Accounts.   | 2. Liability Accounts. | 3. Capital Accounts. |
| 4. Revenue Accounts. | 5. Expense Accounts.   |                      |

**1. Asset Accounts:** Asset accounts are those accounts which relate to the economic resources of an enterprise such as Plant & Machinery, Land & Building etc.

• ***Rule of Debit and Credit - Debit the increases, Credit the decreases.***

**2. Liability Accounts:** - Liability accounts are accounts of lenders, creditors for goods, outstanding expenses, etc.

- **Rule of Debit and Credit - Debit the decreases, Credit the increases.**

**3. Capital Accounts:** - These are the accounts of proprietors/partners who have invested amount in the business. It includes both Capital and Drawings Account.

- **Rule of Debit and Credit - Debit the decreases, Credit the increases.**

**4. Revenue Accounts:** - These are accounts of incomes and gains. Examples are - Sales, Discount received, Interest received, bad debts recovered etc.

- **Rule of Debit and Credit - Debit the decreases, Credit the increases.**

**5. Expense Accounts:** - These are the accounts of expenses or losses incurred in carrying the business. Examples are: Purchases, Wages, Salaries Discount allowed etc.

- **Rule of Debit and Credit - Debit the increases, Credit the decreases.**

➤ The rules applicable to the different kinds of accounts have been summarised in the following chart:

Rules of Debit and Credit			
Asset		Liabilities	
(Increase) + Debit	(Decrease) - Credit	(Decrease) - Debit	(Increase) + Credit
Capital		Expenses/Losses	
(Decrease) - Debit	(Increase) + Credit	(Increase) + Debit	(Decrease) - Credit
Revenues/Gains			
(Decrease) - Debit	(Increase) + Credit		

**Illustration 7:** On which side will increase in following accounts be recorded? Also, mention the nature of accounts are debited and credited?

- |                        |                   |                       |
|------------------------|-------------------|-----------------------|
| 1. Cash                | 2. Creditors      | 3. Bank loan          |
| 4. Stock               | 5. Rent received  | 6. Salary paid        |
| 8. Rajan(owner)        | 9. Suman (debtor) | 7. Salary payable     |
| 11. Purchase           | 12. Sales         | 10. Sharan (Customer) |
| 14. Accrued Commission | 15. Drawings      | 13. Interest Payable  |
| 17. Depreciation       |                   | 16. Discount received |

**Solution:**

S/No.	Name of the Account	Nature of the A/c	Side in which Increase will be recorded
1.	Cash	Asset	<b>Debit</b>
2.	Creditors	Liability	<b>Credit</b>
3.	Bank loan	Liability	<b>Credit</b>
4.	Stock	Asset	<b>Debit</b>
5.	Rent Received	Income/ Revenue	<b>Credit</b>
6.	Salary Paid	Expenses/ losses	<b>Debit</b>
7.	Salary Payable	Liability	<b>Credit</b>
8.	Rajan (Owner)	Capital	<b>Credit</b>
9.	Suman (Debtor)	Asset	<b>Debit</b>
10.	Sharan (Customer)	Asset	<b>Debit</b>
11.	Purchase	Expenses/ losses	<b>Debit</b>
12.	Sales	Income/ Revenue	<b>Credit</b>
13.	Interest Payable	Liability	<b>Credit</b>
14.	Accrued Commission	Asset	<b>Debit</b>
15.	Drawings	Capital	<b>Credit</b>
16.	Discount received	Income/ Revenue	<b>Credit</b>
17.	Depreciation	Expenses/ losses	<b>Debit</b>

**Books of Original Entry:**

The book in which the transaction is recorded for the first time is called journal or book of original entry. The source document, as discussed earlier, is required to record the transaction in the journal. This practice provides a complete record of each transaction in one place and links the debits and credits for each transaction. After the debits and credits for each transaction are entered in the journal, they are transferred to the individual accounts. The process of recording transactions in journal is called journalising. Once the **Journalising** process is completed, the journal entry provides a complete and useful description of the event's effect on the organisation. The process of transferring journal entry to individual accounts is called **Posting**.

This sequence causes the journal to be called the **Book of Original Entry** and the ledger account as the **Principal Book** of entry. In this context, it should be noted that on account of the number and commonality of most transactions, the journal is subdivided into a number of books of original entry as follows:

**(a) Journal Proper****(b) Cash book****(c) Other day books:****(i) Purchases (journal) book****(ii) Sales (journal) book****(iii) Purchase Returns (journal) book****(iv) Sale Returns (journal) book****(v) Bills Receivable (journal) book****(vi) Bills Payable (journal) book**

**Journal:-**

The first book in which the transactions of a business unit are recorded is called Journal. Here, business transactions are recorded in chronological order i.e. in the order in which they occur. Each record in a journal is called an entry. As the journal is the first book in which entries are recorded, it is also known as a book of original entry.

**Format of Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)

Ledger Folio (L.F.): Ledger Folio is the page No. of Ledger on which the Debit A/c & Credit A/c are to be posted.

**Types of Entries:**

- 1. Simple Entry:** It is that entry in which only two accounts are affected i.e. one account is debited and another account is credited with an equal amount.
- 2. Compound Entry:** It is that entry in which more than two accounts are involved. Compound Entries can further be classified into single compound entry and double compound entry.
- 3. In Single Compound Entry** several accounts are to be debited and only one account is to be credited or only one account is to be debited and several accounts are to be credited.
- 4. Opening Entry:** The entry passed to record the closing balances of the previous year is called opening entry. While passing an opening entry, all assets accounts are debited and all liabilities accounts are credited.

**Transaction related to Goods:**

<b>1. Goods purchased for cash:</b> Purchase A/c Dr. To Cash A/c (Being goods purchased for cash)	<b>2. Goods purchased from Ram on Credit:</b> Purchase A/c Dr. To Ram (Being goods purchased from Ram on credit)
<b>3. Goods sold for cash:</b> Cash A/c Dr. To Sales A/c (Being goods sold for cash)	<b>4. Goods sold on credit to Mohan:</b> Mohan Dr. To Sales A/c (Being goods sold to Mohan on credit)
<b>5. Withdrawal of goods by owner for personal use:</b> Drawings A/c Dr. To Purchase A/c (Being goods withdrew by owner for personal use)	<b>6. Goods distributed as free samples:</b> Advertisement A/c Dr. To Purchase A/c (Being goods distributed as free samples)
<b>7. Goods given as charity:</b> Charity A/c Dr. To Purchases A/c (Being goods given as charity)	<b>8. Goods lost by fire/ flood/ theft etc.:</b> Loss by fire/ theft A/c Dr. To Purchase A/c (Being goods lost by fire/flood/theft)

**Note:** Purchases A/c is credited in the above mentioned entries at S. No. 5 to 8 because the goods are going out of our business on cost and it is not a sale hence, deducted from the purchases A/c.

**Transaction related to Bank:-**

**1. Cash deposited into the bank:**

Bank A/c Dr.  
    To Cash A/c  
(Being cash deposited to bank)

**2. Cash withdrawn for office use:**

Cash A/c Dr.  
    To Bank A/c  
(Being cash withdrew from bank for office use)

**3. When cheque is received from customer and deposited into bank same day:**

Bank A/c Dr.  
    To Customer's personal A/c  
(Being cheques deposited into bank)

**4. Cash withdrawn for personal use by owner:**

Cash A/c Dr.  
    To Bank A/c  
(Being cash withdrew for personal use)

**5. When cheque is received from customer and not deposited into bank same day:**

Cheque-in-hand A/c Dr.  
    To Customer's personal A/c  
(Being cheque received from customer)

**6. When above cheque (Point 5) is deposited later into bank:**

Bank A/c Dr.  
    To Cheque-in-hand A/c  
(Being cheques deposited into bank received from ..... On .....)

**7. When payment is made through cheque:**

Personal A/c Dr.  
    To Bank A/c  
(being payment made to ..... by cheque)

**8. When expense is paid through cheque:**

Expense A/c Dr.  
    To Bank A/c  
(Being expense paid by cheque)

**9. When interest is allowed by the bank:**

Bank A/c Dr.  
    To Interest A/c  
(Being interest allowed by bank)

**10. When Bank charges for the services provided:**

Bank Charges A/c Dr.  
    To Bank A/c  
(Being Bank charges deducted)

**Note:** - Bank A/c will be debited if the amount is deposited/ credited by bank & Bank A/c will be credited if the amount is withdrawn/ debited by bank.

**Note:** - Cash will also be debited if business receives it & Credited if business paid it.

### Transaction related to Expense or Income:-

1. <b>Expense paid by bank/ Cash by the Business:</b> Expense A/c      Dr. To Cash / Bank A/c (Being expense paid by cash/Bank)	2. <b>Expense is outstanding during a Current F.Y</b> Expense A/c      Dr. To Outstanding Exp. A/c (Being expense is due but not paid)
3. <b>Expense paid in advance:</b> Prepaid Expense A/c      Dr. To Cash/Bank A/c (Being expense paid in advance by cash/ Bank)	4. <b>Income received in Cash/Bank:</b> Cash/Bank A/c      Dr. To Income A/c (Being Income received in cash / bank)
5. <b>Income due but not received:</b> Accrued / Outstanding Income A/c Dr. To Income A/c (Being Income due but not received)	6. <b>Income received in cash/Bank in advance:</b> Cash/Bank A/c      Dr. To Prepaid Income A/c (Being income received in advance)

### Transactions related to Assets/ Liabilities:-

1. <b>When Assets is purchased in Cash/Bank:</b> Assets A/c              Dr. To Cash / Bank A/c (Being Assets purchased in cash/Bank)	2. <b>Depreciation charged on assets:</b> Depreciation A/c Dr. To Assets A/c (Being Depreciation charged on assets @.... %)
3. <b>Assets Sold by the business:</b> Cash/ Bank A/c      Dr. To Assets A/c (Being Assets sold in cash/Bank)	4. <b>Liability arise when business raise funds:</b> Cash/Bank A/c Dr. To Liability A/c (Being fund raised)
5. <b>Payment of Liability:</b> Liability A/c      Dr. To Cash/Bank A/c (Being Liability paid in Cash/Bank)	

### Some other Journal Entries:-

1. <b>Bad Debts (when Debtors fail to pay due):</b> Bad Debts      Dr. To Debtors A/c (Being amount Bad Debts )	2. <b>Bad Debts Recovered:</b> Cash / Bank A/c      Dr. To Bad Debts Recovered A/c (Being bad debts recovered )
3. <b>Debtors Become insolvent:</b> Cash/ Bank A/c Dr.      (Amt. Received) Bad Debts              Dr.      (Amt. not rec.) To Debtors A/c      (The due amt.) (Being Debtors become insolvent could pay only ..... paise in a Rupees)	4. <b>Interest on Capital:</b> Interest on Capital A/c Dr. To Capital A/c (Being Interest on capital credited by business in capital A/c)
5. <b>Interest on drawing:</b> Capital A/c      Dr. To Interest on Drawing A/c (Being interest on Drawing charged by business from capital A/c)	

**Important:** Besides opening Journal entries, any transaction which is not covered under any of the Subsidiary Book is recorded in Journal proper.

**Discount:** There are two types of discount that are explained below:

(a) **Trade discount:** - Trade discount is allowed by wholesalers and manufacturers to the retailers at a fixed percentage. Trade discount is not to be shown in the books.

(b) **Cash discount:** - Cash discount is allowed to the customers for making an early payment.

Ex: If a retailer sells goods of list price ₹ 10,000 at 10% trade discount & 2% cash discount

<b>Ans:</b> List price	₹ 10,000
Less: Trade discount @ 10%	(1,000)
	₹ 9,000
Less: Cash discount @ 2%. (₹ 9000 × 2 ÷ 100)	(180)
	<b>₹ 8,820</b>

**Illustration 8.** Soraj Mart furnishes the following information:

Transactions during the month of April, 2023 are as under:

Date	Details
01.4.2023	Business started with cash ₹ 1, 50,000.
01.4.2023	Goods purchased form Manisha ₹ 36,000.
01.4.2023	Stationery purchased for cash ₹ 2,200.
02.4.2023	Open a bank account with SBI for ₹ 35,000.
02.4.2023	Goods sold to Priya for ₹ 16,000.
03.4.2023	Received a cheque of ₹ 16,000 from Priya.
05.4.2023	Sold goods to Nidhi ₹ 14,000.
08.4.2023	Nidhi pays ₹ 14,000 cash.
10.4.2023	Purchased goods for ₹ 20,000 on credit from Ritu.
14.4.2023	Insurance paid by cheque ₹ 6,000.
18.4.2023	Paid rent ₹ 2,000.
20.4.2023	Goods costing ₹ 1,500 given as charity.
24.4.2023	Purchased office furniture for ₹ 11,200.
29.4.2023	Cash withdrawn for household purposes ₹ 5,000.
30.4.2023	Interest received cash ₹ 1,200.
30.4.2023	Cash sales ₹ 2,300.
30.4.2023	Commission paid ₹ 3,000 by cheque.
30.4.2023	Telephone bill paid by cheque ₹ 2,000.
30.4.2023	Payment of salaries in cash ₹ 12,000.

Journalise the transactions.

**Solution:**

**Books of Saroj Mart (Journal)**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2023 Apr.01	Cash A/c To Capital A/c (Being Business started with cash)		1,50,000	1,50,000
Apr.01	Purchases A/c To Manisha A/c (Being Goods purchase on credit)		36,000	36,000

Apr.01	Stationery A/c To Cash A/c (Being Purchase of stationery for cash)	Dr.	2,200	2,200
Apr. 02	Bank A/c To Cash A/c (Being Opened a bank account with SBI)	Dr.	35,000	35,000
Apr. 02	Priya A/c To Sales A/c (Being Goods sold to Priya On Credit)	Dr.	16,000	16,000
Apr. 03	Bank A/c To Priya A/c (Being Cheque Received from Priya)	Dr.	16,000	16,000
Apr. 05	Nidhi A/c To Sales A/c (Being Sale of goods to Nidhi on credit)	Dr.	14,000	14,000
Apr. 08	Cash A/c To Nidhi A/c (Being Cash received from Nidhi)	Dr.	14,000	14,000
Apr. 10	Purchases A/c To Ritu A/c (Being Purchase of goods on credit)	Dr.	20,000	20,000
Apr. 14	Insurance Premium A/c To Bank A/c (Being Payment of Insurance premium bycheque)	Dr.	6,000	6,000
Apr. 18	Rent A/c To Cash A/c (Being Rent paid)	Dr.	2,000	2,000
Apr. 20	Charity A/c To Purchases A/c (Being Goods given as charity)	Dr.	1,500	1,500
Apr. 24	Furniture A/c To Cash A/c (Being Purchase of office furniture)	Dr.	11,200	11,200
Apr. 29	Drawings A/c To Cash A/c (Being With drawl of cash from the business for personal use of the proprietor)	Dr.	5,000	5,000
Apr. 30	Cash A/c To Interest received A/c (Being Interest received)	Dr.	1,200	1,200
Apr. 30	Cash A/c To Sales A/c (Being Sale of goods for cash)	Dr.	2,300	2,300
Apr. 30	Commission A/c To Bank A/c (Being Commission paid by cheque)	Dr.	3,000	3,000
Apr. 30	Telephone expenses A/c To Cash A/c (Being Payment of telephone bill)	Dr.	2,000	2,000
Apr. 30	Salaries A/c	Dr.	12,000	

To Cash A/c (Being Payment of salary to the office persons)		12,000
--	--	--------

**Illustration 9:** Prove that the accounting equation is satisfied in all the following transactions of Chhaya house by preparing the analysis table. Also record the transactions in Journal.

- (i) Business commenced with a capital of ₹ 6, 00,000.
- (ii) Deposited ₹ 4, 50,000 in a bank account.
- (iii) Purchased Plant & Machinery for ₹ 2, 30,000 by paying ₹ 30,000 cash immediately.
- (iv) Purchased goods worth ₹ 40,000 for cash and ₹ 45,000 on account.
- (v) Paid a cheque of ₹ 2, 00,000 to the supplier for Plant and Machinery.
- (vi) ₹ 70,000 cash sales (of goods costing ₹ 50,000).
- (vii) Withdrawn by the proprietor ₹ 35,000 cash for personal use.
- (viii) Insurance paid by cheque of ₹ 2,500.
- (ix) Salary of ₹ 5,500 outstanding.
- (x) Furniture of ₹ 30,000 purchased in cash.

**Solution:**

**Journal**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Cash A/c Dr. To Capital A/c (Business started with cash)		6,00,000	6,00,000
(ii)	Bank A/c Dr. To Cash A/c (Cash deposited into the bank)		4,50,000	4,50,000
(iii)	Plant and Machinery A/c Dr. To Cash A/c To Creditors A/c (Purchase of plant and machinery by paying ₹ 30,000 cash and balance on a later date)		2,30,000	30,000 2,00,000
(iv)	Purchases A/c Dr. To Cash A/c To Creditors A/c (Bought goods for cash as well as on credit)		85,000	40,000 45,000
(v)	Creditor's A/c Dr. To Bank A/c (Payment made to the supplier of plant and machinery)		2,00,000	2,00,000
(vi)	Cash A/c To Sales A/c (Sold goods on profit)		70,000	70,000
(vii)	Drawings A/c To Cash A/c (Withdrew cash for personal use)		35,000	35,000
(viii)	Insurance A/c To Bank A/c		2,500	2,500

	(Paid insurance by cheque)			
(ix)	Salary A/c To Outstanding salary A/c (Salary outstanding)		5,500	5,500
(x)	Furniture A/c To Cash A/c (Furniture purchased for cash)		30,000	30,000

**Statement showing the effect of various transaction on accounting equation**  
(Figures in rupees)

No .	Cash	Bank	Stock	Furniture	Plant and Machinery	Total	=	Non-trade Creditors	Trade Creditors	Capital	Total
1	6,00,000					6,00,000	=			6,00,000	6,00,000
	6,00,000	-	-	-	-	6,00,000	=	-	-	6,00,000	6,00,000
2	(4,50,000)	4,50,000									
	1,50,000	4,50,000	-	-	-	6,00,000	=	-	-	6,00,000	6,00,000
3	(30,000)	-	-	-	2,30,000	2,00,000	=	2,00,000	-	-	2,00,000
	1,20,000	4,50,000	-	-	2,30,000	8,00,000	=	2,00,000	-	600,000	8,00,000
4	(40,000)	-	85,000	-	-	45,000	=	-	45,000	-	45,000
	80,000	4,50,000	85,000	-	2,30,000	8,45,000	=	2,00,000	45,000	600,000	8,45,000
5	-	(2,00,000)	-	-	-	(2,00,000)	=	(2,00,000)	-	-	(2,00,000)
	80,000	2,50,000	85,000	-	2,30,000	6,45,000	=	-	45,000	6,00,000	20,000
6	70,000	-	(50,000)	-	-	20,000	=	-	-	20,000	20,000
	1,50,000	2,50,000	35,000	-	2,30,000	6,65,000	=	-	45,000	6,20,000	6,65,000
7	(35,000)	-	-	-	-	(35,000)	=	-	-	(35,000)	(35,000)
	1,15,000	2,50,000	35,000	-	2,30,000	6,30,000	=	-	45,000	5,85,000	6,30,000
8		(2,500)				(2,500)	=			(2,500)	(2,500)
	1,15,000	2,47,500	35,000	-	2,30,000	6,27,500	=	-	45,000	5,82,500	6,27,500
9							=	5,500	-	(5,500)	
	1,15,000	2,47,500	35,000	-	2,30,000	6,27,500	=	5,500	45,000	5,77,000	6,27,500
10	(30,000)	-	-	30,000	-	-	=	-	-	-	
	<b>85,000</b>	<b>2,47,500</b>	<b>35,000</b>	<b>30,000</b>	<b>2,30,000</b>	<b>6,27,500</b>	=	<b>5,500</b>	<b>45,000</b>	<b>5,77,000</b>	<b>6,27,500</b>

### Accounting Entries under Goods and Services Tax

#### Illustration 10:

Record necessary Journal entries assuming CGST @ 5% and SGST @ 5% and all transactions are occurred within Delhi.

- Shobit bought goods ₹ 1, 00,000 on credit
- He sold them for ₹ 1, 35,000 in the same state on credit
- He paid for Railway transport ₹ 8,000
- He bought computer printer for ₹ 10,000
- Paid postal charges ₹ 2,000

#### Solution:

#### Journal

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	Purchases A/c Dr. Input CGST A/c Dr. Input SGST A/c Dr. To Creditors A/c (Being Goods bought on credit)		1,00,000 5,000 5,000	1,10,000
(ii)	Debtors A/c Dr.		1,48,500	

	To Sales A/c			1,35,000
	To Output CGST A/c			6,750
	To Output SGST A/c			6,750
	(Being Goods sold on credit)			
(iii)	Transport Charges A/c	Dr.	8,000	
	Input CGST A/c	Dr.	400	
	Input SGST A/c	Dr.	400	
	To Bank A/c			8,800
	(Being transport charges paid)			
(iv)	Computer printer A/c	Dr.	10,000	
	Input CGST A/c	Dr.	500	
	Input SGST A/c	Dr.	500	
	To Bank A/c			11,000
	(Being Computer-Printer bought)			
(v)	Postal charges A/c	Dr.	2,000	
	Input CGST A/c	Dr.	100	
	Input SGST A/c	Dr.	100	
	To Bank A/c			2,200
	(Being Paid for Portage)			
(vi)	Output CGST A/c	Dr.	6,750 <sup>3</sup>	
	Output SGST A/c	Dr.	6,750 <sup>4</sup>	
	To Input CGST A/c			6,000 <sup>1</sup>
	To Input SGST A/c			6,000 <sup>2</sup>
	To Electronic Cash Ledger A/c			1,500
	(Being GST set off and balance paid)			

### **Working Notes:-**

Total Input CGST = ₹ 5,000 + ₹ 400 + ₹ 500 + ₹ 100 = ₹ 6,000 <sup>1</sup>

Total Input SGST = ₹ 5,000 + ₹ 400 + ₹ 500 + ₹ 100 = ₹ 6,000 <sup>2</sup>

Total Output CGST = ₹ 6,750 <sup>3</sup>

Total Output SGST = ₹ 6,750 <sup>4</sup>

Net CGST Payable = ₹ 6,750 - ₹ 6,000 = ₹ 750

Net SGST Payable = ₹ 6,750 - ₹ 6,000 = ₹ 750

### **The Ledger:**

The ledger is the principal book of accounting system. It contains different accounts where transactions relating to that account are recorded. A ledger is the collection of all the accounts, debited or credited, in the journal proper and various special. A ledger may be in the form of bound register, or cards, or separate sheets may be maintained in a loose leaf binder. In the ledger, each account is opened preferably on separate page or card.

### **Utility**

A ledger is very useful & is of utmost importance in the organisation. The net result of all transactions in respect of a particular account on a given date can be ascertained only from the ledger. For ex., the management on a particular date wants to know the amount due from a certain customer or the amount the firm has to pay to a particular supplier, such information can be found only in the ledger. Such information is very difficult to ascertain from the journal because the transactions are recorded in the chronological order and defies classification.

**Format of the account is shown in figure**

Dr.				Cr.			
Name of the Account							
Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)

***Distinction between Journal and Ledger:***

The Journal & the Ledger are the most important books of the double entry mechanism of accounting and are indispensable for an accounting system.

Following points of comparison are worth noting:

1. The Journal is the book of *first* entry (original entry); the ledger is the book of *second* entry.
2. The Journal is the book for *chronological* record; the ledger is the book for *analytical* record.
3. The Journal, as a book of source entry, gets greater importance as *legal evidence* than the ledger.
4. *Transaction* is the basis of classification of data within the Journal; *Account* is the basis of classification of data within the ledger.
5. Process of recording in the Journal is called Journalising; the process of recording in the ledger is known as *Posting*

**Illustration 11:**

Date	Details	Amt. (₹)
2022		
Dec. 01	Business started with cash	1,20,000
Dec. 02	Opened a bank account with ICICI	4,00,00
Dec. 04	Goods purchased for cash	12,000
Dec. 10	Paid cartage	500
Dec. 12	Goods sold on credit to M/s Lara India	25,000
Dec. 14	Cash received from M/s Lara India	10,000
Dec. 16	Goods returned from Lara India	3,000
Dec. 18	Paid trade expenses	700
Dec. 19	Goods purchased on credit from Taranum	32,000
Dec. 20	Cheque received from M/s Lara India for final settlement and deposited same day into bank	11,500
Dec. 22	Goods returned to Taranum	1,500
Dec. 24	Paid for stationery	1,200
Dec. 26	Cheque given to Taranum on account	20,000
Dec. 28	Paid rent by cheque	4,000
Dec. 29	Drew cash for personal use	10,000
Dec. 30	Cash sales	12,000
Dec. 31	Goods sold to M/s Rupak Traders	11,000

**Solution:**

**Books of Time Zone**

**Journal**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2022				
Dec. 01	Cash A/c To Capital A/c ( Business started with cash)	Dr.	1,20,000	1,20,000

02	Bank A/c To Cash A/c (Opened a current account with ICICI bank)	Dr.	40,000	40,000
04	Purchases A/c To Cash A/c (Goods purchased for cash)	Dr.	12,000	12,000
10	Cartage A/c To Cash A/c (Cartage paid)	Dr.	500	500
12	Lara India A/c To Sales A/c (Goods sold on credit)	Dr.	25,000	25,000
14	Cash A/c To Lara India A/c (Cash received from Lara India)	Dr.	10,000	10,000
16	Sales Return A/c To Lara India A/c (Goods returned from Lara India)	Dr.	3,000	3,000
18	Trade Expenses A/c To Cash A/c (Trade expenses paid)	Dr.	700	700
19	Purchases A/c To Taranum's A/c (Goods purchased on credit)	Dr.	32,000	32,000
20	Bank A/c Discount A/c To Lara India A/c (Cheque received for final settlement)	Dr. Dr.	11,500 500	12,000
22	Taranum's A/c To Purchase Return's A/c (Goods returned to Taranum)	Dr.	1,500	1,500
24	Stationery A/c To Cash A/c (Cash paid for stationery)	Dr.	1,200	1,200
26	Taranum's A/c To Bank A/c (Cheque given to Taranum)	Dr.	20,000	20,000
28	Rent A/c To Bank A/c (Rent paid by cheque)	Dr.	4,000	4,000
29	Drawings A/c To Cash A/c (Cash withdrawn for personal use)	Dr.	10,000	10,000
30	Cash A/c To Sales A/c (Goods sold for cash)	Dr.	12,000	12,000
31	Rupak Trader A/c To Sales A/c (Goods sold on credit)	Dr.	11,000	11,000
	Total		3,14,900	3,14, 900

## Posting in the Ledger books:

### Cash Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023				2023			
Dec. 01	Capital		1,20,000	Dec. 02	Bank		40,000
Dec. 14	Lara India		10,000	Dec. 04	Purchase		12,000
Dec. 30	Sales		12,000	Dec. 10	Cartage		500
				Dec. 18	Trade		700
					Expenses		
				Dec. 24.	Stationery		1,200
				Dec. 29	Drawings		1,000

### Capital Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				2023			
				Dec.01	Cash		1,20,000

### Bank Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023				2023			
Dec.02	Cash		40,000	Dec.26	Taranum's		20,000
Dec.20	Lara India		11,500	Dec.28	Rent		4,000

### Purchases Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023							
Dec.04	Cash		12,000				
Dec.19	Taranum		32,000				

### Cartage Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023							
Dec.10	Cash		500				

### Lara India Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.12	Sales		25,000	2023 Dec. 14	Cash		10,000
				Dec. 16	Sales return		3,000
				Dec. 20	Bank		11,500
					Discount		500

### Sales Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				2023 Dec.12	Lara India		25,000
				Dec.30	Cash		12,000
				Dec.31	Rupak Traders		11,000

### Sales Return Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.16	Lara India		3,000				

### Trade Expenses Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.18	Cash		700				

### Taranum Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.22	Purchase Return		1,500	2023 Dec.19	Purchase		32,000
Dec.26	Bank		20,000				

### Discount Paid Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.20	Lara India		500				

### Purchases Return Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				2023 Dec.22	Taranum		1,500

### Stationery Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec.	Cash		1,200				

### Rent Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec. 28	Bank		4,000				

### Drawings Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec. 29	Cash		10,000				

### Rupak Traders Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2023 Dec. 31	Sales		11,000				

## **USEFUL LINK**

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## **PRACTICE QUESTIONS:**

**1.** Prepare accounting equation for the following transactions:

- (i) Introduced ₹ 8, 00,000 as cash and ₹ 50,000 by stock.
- (ii) Purchased plant for ₹ 3, 00,000 by paying ₹ 15,000 in cash and balance at a later date.
- (iii) Deposited ₹ 6, 00,000 into the bank.
- (iv) Purchased office furniture for ₹ 1, 00,000 & paid by cheque.
- (v) Purchased goods worth ₹ 80,000 for cash and for ₹ 35,000 in credit.
- (vi) Goods amounting to ₹ 45,000 was sold for ₹ 60,000 on cash basis.
- (vii) Goods costing ₹ 80,000 were sold for ₹ 1, 25,000 on credit.
- (viii) Cheque issued to the supplier of goods worth ₹ 35,000.
- (xi) Cheque received from customer amounting to ₹ 75,000.
- (x) Withdrawn by owner for personal use ₹ 25,000.

**2.** Prepare accounting equation for the following transactions:

- (i) Started business with cash ₹ 2, 00,000 & stock ₹ 1, 50,000.
- (ii) Purchased goods for cash ₹ 15,000 & on credit ₹ 20,000.
- (iii) Sold goods for cash ₹ 20,000 & on credit ₹ 10,000.
- (iv) Purchased goods of the value of ₹ 12,000 for ₹ 15,000.
- (v) Sold goods for ₹ 20,000 (Cost price ₹ 17,500).

**3.** Find the total assets of the firm if the capital is ₹ 60,000 & liabilities ₹ 39,000.

**4.** A started business on 1<sup>st</sup> April, 2017 with a capital of ₹ 1, 10,000 & took loan from bank ₹ 40,000. At the end of the year on 31<sup>st</sup> March, 2018, his assets were for ₹ 2, 50,000; creditors for ₹ 70,000. Bank loan has not been paid so far; however interest on loan has been paid. Find the closing capital and profit earned during the year.

**5.** Find the opening capital of the firm from the following information given at the end of the year:

Total assets ₹ 1, 30,000; External liabilities ₹ 40,000; Additional capital ₹ 20,000; Drawings ₹ 15,000 & Profit ₹ 25,000.

**6.** Pass Journal Entries for the following:

- (a) Goods worth ₹ 35,000 and cash ₹ 17,000 were stolen by an employee.
- (b) Charge Depreciation @ 10% p.a. for two months on machine costing ₹ 1, 40,000.
- (c) Paid to landlord by cheque ₹ 90,000 for Rent. One-third of the building is occupied by the proprietor for residential use.
- (d) Sold goods to Raj costing ₹ 80,000 at a profit of 25% & allowed him 10% trade discount and paid for cartage ₹ 1,000 to be charged from him.

7. Enter the following transactions in the Journal of Manohar Lal & Sons.:-

2023		(₹)
Feb 1	Manohar Lal & Sons started business with cash	60,000
2	Purchased furniture for cash	10,000
4	Purchased goods for cash	25,000
5	Bought goods from Kamlesh	15,000
10	Paid cash to Kamlesh	15,000
16	Purchased goods from Sohan	6,000
18	Purchased goods from Sohan for cash	8,000
22	Paid rent for the office	1,000

8. Enter the following transactions in the Journal of M/s Tripathi Bros.:-

2023		(₹)
Jan. 1	Sold goods for cash	36,000
8	Sold goods to Hari	30,000
14	Received cash from Hari	18,000
26	Received Commission	750
27	Paid Salary to Gopal	1,200
28	Received cash from Hari	12,000
29	Withdrew cash from office for personal use	4,000
30	Wages paid	7,200
31	Bought Machinery for Cash	8,000

9. Pass Journal entries in the books of Gauri Shankar & Co. and also prepare Ledger Account from the following:

2022		(₹)
April 01	Commenced business with cash	50,000
02	Purchased goods from Shubh	20,000
04	Sold goods to Shyamnath.....	15,000
06	Shyamnath returned defective goods	1,000
10	Received cash from Shyamnath and Discount allowed	13,800 200
12	Mani sold goods to us.....	10,000
14	Paid to Mani in full settlement of his account after deducting 5% discount.	
15	Paid Rent	10,000
16	Paid Rent of Gauri Shankar's residence.....	5,000
18	Purchased goods for cash from Govinda for ₹ 6,000 at 20% trade discount.	
20	Purchased goods from Govinda for ₹ 10,000 at 20% trade discount.	
24	Paid to Govinda ₹ 7,850 in full settlement of his account.	
25	Paid to Shubh ₹ 4,750; discount received ₹ 250.	
30	Paid Wages ₹ 400; Salaries ₹ 4,000; Advertisement expenses ₹ 800 and Trade expenses ₹ 1,000.	

-----END OF CHAPTER-----

## CH - 04. RECORDING OF TRANSACTIONS - II

### LEARNING OBJECTIVES:

After studying this chapter, you will be able to:

- state the need for special purpose books;
- record the transactions in cash book and post them in the ledger;
- prepare the petty cashbook;
- record the transactions in the special purpose books;
- post the entries in the special purpose book and to the ledger;
- balance the ledger accounts.

A small business may be able to record all its transactions in one book only, i.e., the journal. But as the business expands and the number of transactions becomes large, it may become cumbersome to journalise each transaction. For quick, efficient and accurate recording of business transactions, Journal is sub-divided into special journals.

These special journals are also called daybooks or subsidiary books. Transactions that cannot be recorded in any special journal are recorded in journal called the **Journal Proper**. Special journals prove economical and make division of labour possible in accounting work. In this chapter we will discuss the following special purpose books:

- *Cash Book*
- *Purchases Return (Return Outwards) Book*
- *Sales Return (Return Inwards) Book*
- *Purchases Book*
- *Sales Book*
- *Journal Proper*

### **Cash Book:**

Cash book is a book in which all transactions relating to cash receipts and cash payments are recorded. It starts with the cash or bank balances at the beginning of the period. Generally, it is made on monthly basis. This is a very popular book and is maintained by all organisations, big or small, profit or not-for profit.

### **Single Column Cash Book:**

The single column cash book records all cash transactions of the business in a chronological order, i.e., it is a complete record of cash receipts and cash payments. When all receipts and payments are made in cash by a business organisation only, the cash book contains only one amount column on each (debit and credit) side.

#### **Format of Simple Cash book**

Dr.				Simple Cash book				Cr.	
Date	Receipts	L.F	(₹)	Date	Payments	L.F	(₹)		
	To.....				By...				

### **Illustration 1: Enter the following transaction in a single column cash book:-**

- 2023 March 01. Commenced business with cash ₹ 10,000.  
02. Bought goods for cash ₹ 2,500.  
05. Sold goods for cash ₹ 2,000.

10. Goods purchased from Ravi on credit ₹ 5,000.
13. Paid to Ravi ₹ 3,500.
15. Cash sale ₹ 4,000.
18. Purchased furniture for cash ₹ 3,000.
20. Paid wages ₹ 190.
24. Paid rent ₹ 200.
26. Received commission ₹ 300.
28. Withdrew for personal use ₹ 500.
31. Paid salary ₹ 450.

**Ans: Dr.**

**Simple Cash Book**

**Cr.**

Date	Particulars	L.F	(₹)	Date	Particulars	L.F	(₹)
2023, Mar 1	To Capital A/c			2023, Mar 2	By Purchases		2,500
5	To Sales A/c		10,000	13	By Ravi A/c		3,500
15	To Sales A/c		2,000	18	By Furniture A/c		3,000
26	To Commission A/c		4,000	18	By Wages A/c		190
			300	20	By Rent A/c		200
				24	By Drawings A/c		500
				28	By Salary A/c		450
				31	By Balance c/d		5,960
			<b>16,300</b>				<b>16,300</b>
2017, April 1	By Balance b/d		5,960				

**Cash Book with Cash and Bank Column:**

In this case the Cash Book is ruled with two amount columns on either side of the cash book namely, "Cash and Bank". Cash columns in such a case will record actual cash received in the debit side and payments in the credit side. Cheques received should be entered on the debit side of the bank column when it deposited in the bank. The payments by cheques should be entered on the credit side in bank column and also when cash is withdrawn from the bank.

**Performa of Double Column Cash Book**

**Dr.**

**Double Column Cash Book**

**Cr.**

Date	Particulars	L.F	Cash(₹)	Bank(₹)	Date	Particulars	L.F	Cash(₹)	Bank(₹)
	To.....					By...			

**Important Entries:-**

**1. Contra Entries:** These entries affect cash and bank columns both at the same time. To indicate contra entry "C" is mentioned in the L.F. column of the cash Book. Following two cases result in Contra entries.

- (a) Depositing cash into Bank ₹ 1,000. It will increase bank balance, so bank column is debited and cash balance will decrease, so cash column is credited.

**Dr.**

**Cash Book (with Cash & Bank Column)**

**Cr.**

Date	Particulars	L.F.	Cash (₹)	Bank(₹)	Date	Particulars	L.F.	Cash (₹)	Bank(₹)
2023, Apr 01	To Cash A/c	C		1,000	2023	By Bank A/c	C	1,000	

- (b) Withdrawn from Bank for office use ₹ 1,000. It will increase cash balance, so cash column is debited and bank balance will decrease, so bank column is credited.

Dr.		Cash Book (with Cash & Bank Column)						Cr.	
Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)
2023, Apr 01	To Bank A/c	C	1,000		2023	By Cash A/c	C		1,000

**(2) Entries relating to cheques:**

- When any payment is made by cheque: It will reduce the bank balance and thus bank column will be credited.
- When any payment is received in the form of cheque and no information about its deposit into bank is given. In this case it is assumed that the cheque is deposited into bank on the same day, when it is received & so bank A/c will be debited.
- When any payment is received in the form of cheque and it is deposited into bank on same day than bank A/c will be debited. When payment is received in the form of cheque on one day & it is deposited into Bank on other day i.e. when two dates, one for the receipt of cheque and the other for deposit. In this case no entry is to be recorded at the time of receiving the cheque. Entry is to be made when cheque is deposited in the bank, as bank column is debited

**Illustration 2:**

Date	Details	Amt. (₹)
Sep 1, 2022	Bank balance.	21,000
Sep 01	Cash balance.	7,500
Sep 04	Purchased goods by cheque.	6,000
Sep 08	Sale of goods for cash.	3,000
Sep 13	Purchase of machinery by cheque.	2,750
Sep 16	Sold goods and received cheques (deposited same day.)	2,250
Sep 17	Purchase goods from Mira in cash.	8,700
Sep 20	Purchase stationery by cheque.	550
Sep 24	Cheque given to Rohit.	750
Sep 27	Cash withdrawn from the bank.	5,000
Sep 31	Rent paid by cheque.	1,250
Sep 31	Paid salary.	1,750

**Ans: Dr.**

**Double column cash book**

**Cr.**

Date	Particulars	LF	Cash (₹)	Bank (₹)	Date	Particulars	L.F	Cash (₹)	Bank (₹)
2022, 01 Sep	To balance b/d		7,500	21,000	04 Sept	By Purchases		-----	6,000
08 Sept	To Sales A/c		3,000	-----	13 Sept	By Machinery A/c		-----	2,750
16 Sept	To Sales A/c		-----	2,250	17 Sept	By Purchases A/c		8,700	-----
27 Sept	To Bank A/c		5,000	-----	20 Sept	By Stationery A/c		-----	550
					24 Sept	By Rohit		-----	750
					27 Sept	By Cash A/c		-----	5,000
					31 Sept	By Rent A/c		-----	1,250
					31 Sept	By Salary A/c		1,750	-----
					31 Sept	By Balance c/d		5,050	6,950
			<b>15,500</b>	<b>23,250</b>				<b>15,500</b>	<b>23,250</b>
Oct 1	To balance b/d		5,050	6,950					

**Illustration 3:** Prepare double column cash book of M/s Adreno Technology Pvt. Ltd. for the month of December 2022 from the following transactions:

<i>Date</i>	<i>Details</i>	<i>Amt. (₹)</i>
2022, Dec. 01	Cash in hand	3,065
	Cash at bank	6,780
Dec. 02	Cash paid to petty cashier	1,000
Dec. 03	Received cheque from Priya	3,000
Dec. 04	Cash sales	2,000
Dec. 05	Deposited into bank	1,200
Dec. 06	Priya's cheque deposited into bank	3,000
Dec. 08	Purchased furniture by cheque	6,500
Dec. 10	Paid trade expenses	400
Dec. 12	Cash Sales	9,000
Dec. 13	Bank charges	300
Dec. 15	Dividend collected by bank	1,200
Dec. 16	Paid electric bill by cheque	600
Dec. 17	Cash purchases	2,000
Dec. 19	Paid for advertising	1,000
Dec. 21	Goods sold and received a cheque (deposited same day)	6,000
Dec. 22	Paid legal charges	500
Dec. 23	Drew from bank for personal use	2,000
Dec. 24	Paid establishment expenses	340
Dec. 25	Paid for printing of bill book	850
Dec. 26	Paid insurance premium by cheque	2,150
Dec. 27	Cash sales	7,200
Dec. 28	Paid salary by cheque	4,000
Dec. 29	Rent paid	3,000
Dec. 30	Commission received by cheque (deposited same day)	2,500
Dec. 31	Paid for charity by cheque	800

**Solution:**

**Dr.**

**Cash Book with Cash & Bank Column**

**Cr.**

<i>Date</i>	<i>Receipts</i>	<i>L.F.</i>	<i>Cash(₹)</i>	<i>Bank(₹)</i>	<i>Date</i>	<i>Payments</i>	<i>L.F.</i>	<i>Cash(₹)</i>	<i>Bank(₹)</i>
2022,1.Dec	To Balance b/d		3,065	6,780	2022,Dec2	By Petty Cashier		1,000	
03	To Priya		3,000		05	By Bank A/c	C	1,200	
04	To Sales A/c		2,000		06	By Bank A/c	C	3,000	
05	To Cash A/c	C		1,200	08	By Furniture A/c			6,500
06	To Cash A/c	C		3,000	10	By Trade exp. A/c		400	
12	To Sales A/c		9,000		13	By Bank char. A/c			300
15	To Dividend A/c			1,200	16	By Electric charges			600
21	To Sales A/c			6,000	17	By Purchases A/c		2,000	
27	To Sales A/c		7,200		19	By Advertisement		1,000	
30	To Commission			2,500	22	By Legal charges		500	
					23	By Drawings A/c			2,000
					24	By Establi. exp. A/c		340	
					25	By Printing A/c		850	

					26	By Insurance Prem.			2,150
					28	By Salary A/c			4,000
					29	By Rent A/c	3,000		
					31	By Charity A/c			800
					31	By Balance c/d	10,975		4,330
			<u>24,265</u>	<u>20,680</u>				<u>24,265</u>	<u>20,680</u>
1 Jan, 2023	To Balance b/d		10,975	4,330					

### Petty Cash Book:

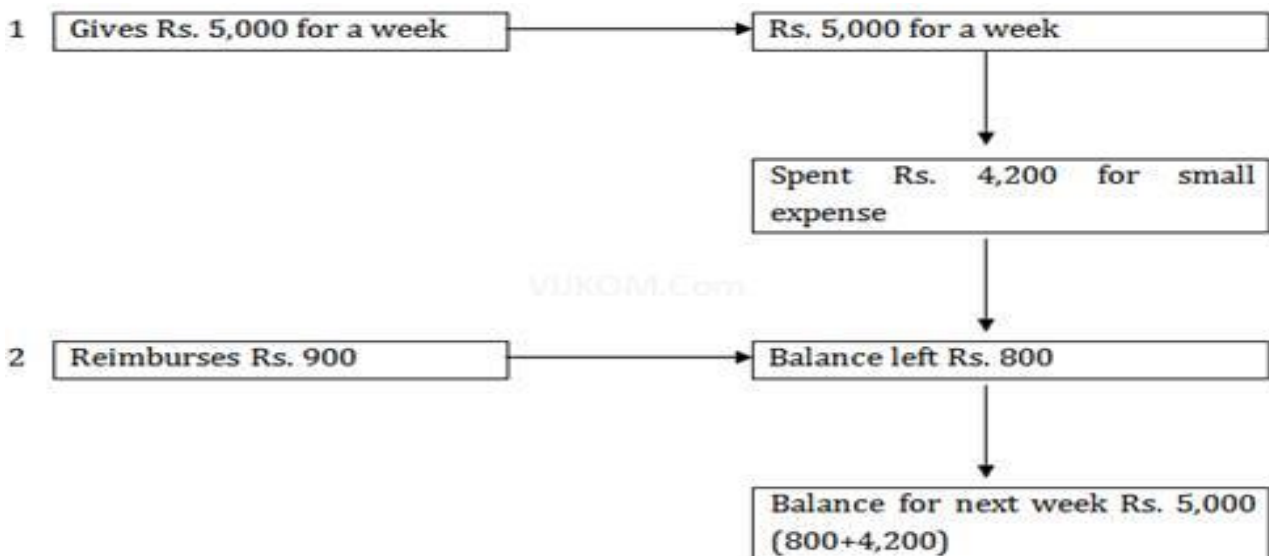
Business has to incur small expenses which are repetitive in nature. To save the time and efforts of head cashier, business appoints a petty cashier. He is entrusted with the duty of paying these expenses.

### Imprest System of Petty Cash Book:-

Under this system, Head cashier gives a fixed amount to petty cashier for a definite period. At the end of given period, Head cashier reimburses the amount actually spent by the petty cashier resulting the same amount with petty cashier which he had in the beginning of the period.

This can be illustrated as under.

Head Cashier →→ Petty Cashier



### Advantage of Petty Cash Book:

- (a) Saving of time and efforts of Head cashier
- (b) Control on Petty expenses
- (c) Less chances of fraud.

### Illustration 4:

Mr. Mohit, the petty cashier of M/s Samaira Traders received ₹ 2,000 on May 01, 2023 from the Head Cashier. For the month, details of petty expenses are listed here under.

Date	Details	Amt. (₹)
2023, May 02	Auto fare	55
03	Courier services	40
04	Postal stamps	105
05	Erasers/Sharpeners/Pencils/Pads	225
06	Speed post charges	98
08	Taxi fare (₹ 105 + ₹ 90)	195
08	Refreshments	85
10	Auto fare	60
12	Registered postal charges	42
13	Telegram	34
14	Cartage	25
16	Computer stationery	165
19	Bus fare	24
19	STD call charges	87
20	Office sanitation including disinfectant (₹ 36 + ₹ 24)	60
22	Refreshment	45
23	Photo stating charges	47
28	Courier services	40
29	Unloading charges	40
30	Bus fare	15

**Solution:** The Petty Cash Book for the month will be prepared as follows:

Amt. Received	Date	Particulars	Voucher No.	Amt. paid	Analysis of Payments				
	2023 May				Postage	Telephone & Telegram	Conveyance	Stationery	Misc.
2,000	01	To Cash received							
	02	By Auto fare		55			55		
	03	By Courier services		40	40				
	04	By Postal stamps		105	105				
	05	By Erasers/Sharpeners/Pencils		225				225	
	06	By Speed post charges		98	98				
	08	By Taxi fare (105 + 90)		195			195		
	08	By Refreshments		85					85
	10	By Auto fare		60			60		
	12	By Registered postal charges		42	42				
	13	By Telegram		34		34			
	14	By Cartage		25					25
	16	By Computer stationery		165				165	
	19	By Bus fare		24			24		
	19	By STD call charges		87		87			
	20	By Office sanitation including disinfectant (36+24)		60					60
	22	By Refreshment		45					45
	23	By Photo stating charges		47					47
	28	By Courier services		40	40				
	29	By Unloading charges		40					40
	30	By Bus fare		15			15		
				1,487	325	121	349	390	302
	31	By Balance c/d		513					
2,000				2,000					
513	Jun. 01	To Balance b/d							
1,487	01	To Cash received							

### **Books of Original Entry/ Special Purpose Books**

As the business grows and number of transactions increase, it becomes necessary for the necessary for the business to divide the recording work.

#### **Advantages of Maintaining Subsidiary Books:-**

- (a) Division of work
- (b) Leads to Specialization
- (c) Easy to maintain Ledger
- (d) Check on frauds
- (e) Easy to fix responsibility
- (f) Quick availability of required information.

#### **Special Purpose Subsidiary Books:-**

##### **Purchases Book:-**

In this book, only those transactions are recorded which are related to credit purchases of goods in which the business deals in. Recording is made on the basis of Bills/ Invoices issued by the Suppliers.

##### **Transactions not recorded in purchases Book:**

- Purchases of goods for cash.
- Purchases of Assets meant for long term, not for resale.

#### **Format of Purchases (journal) Book**

##### **Purchase (Journal) Book**

Date	Invoice No.	Name of Supplier (Account to be Credited)	L.F	Amt (₹)

##### **Sales Books/ Sales Journal:**

In this book, transactions for credit sales of goods are recorded. The source documents for this book is duplicate copy of invoice/bills issued to the customers.

##### **Transactions not recorded in Sales Book**

- Sales of goods for cash
- Sales of Assets.

#### **Format of Sales (journal) Book**

##### **Sales (Journal) Book**

Date	Invoice No.	Name of Customer (Account to be Debited)	L.F	Amt (₹)

##### **Purchases Returns/ Returns Outward Book:**

This book includes only those transactions which are related to returns of goods bought on credit. The goods may be returned due to various reasons such as goods bought being defective, supply of inferior quality goods etc. Entries in this book are made on the basis of Debit Note. A Debit note contains the name of the supplier to whom good are returned, details of goods returned.

#### **Format of Purchases Return (journal) Book**

##### **Purchase Return (Journal) Book**

Date	Debit No.	Name of Supplier (Account to be Debited)	L.F	Amt (₹)

**Sales Returns Book:**

This book includes all the returns by customers of credit sales of goods. The Credit Note is used for recording entries in this book. The credit note contains the details of customers and goods returned.

**Format of Sales Return (journal) Book****Sales Return (Journal) Book**

Date	Credit No.	Name of Customer (Account to be credited)	L.F	Amt (₹)

**Journal Proper:**

A book maintained to record transactions, which do not find place in special journals, is known as Journal Proper or Journal Residual.

Following transactions are recorded in this journal:

**1. Opening Entry:** In order to open new set of books in the beginning of new accounting year and record there in opening balances of assets, liabilities & capital, the opening entry is made in the journal.

**2. Adjustment Entries:** In order to update ledger account on accrual basis, such entries are made at the end of the accounting period. Such as Rent outstanding, Prepaid insurance, Depreciation and Commission received in advance.

**3. Rectification entries:** To rectify errors in recording transactions in the books of original entry and their posting to ledger accounts this journal is used.

**4. Transfer entries:** Drawing account is transferred to capital account at the end of the accounting year. Expenses accounts and revenue accounts which are not balanced at the time of balancing are opened to record specific transactions. Accounts relating to operation of business such as Sales, Purchases, Opening Stock, Income, Gains and Expenses, etc., and drawing are closed at the end of the year and their Total/balances are transferred to Trading and Profit and Loss account by recording the journal entries. These are also called *closing entries*.

**5. Other entries:** In addition to the above mentioned entries in the point's number 1 to 4, recording of the following transaction is done in the journal proper:

- (i) At the time of a dishonour of a cheque the entry for cancellation for discount received or discount allowed earlier.
- (ii) Purchase/sale of items on credit other than goods.
- (iii) Goods withdrawn by the owner for personal use.
- (iv) Goods distributed as samples for sales promotion.
- (v) Endorsement and dishonour of bills of exchange.
- (vi) Transaction in respect of consignment and joint venture, etc.
- (vii) Loss of goods by fire/ theft/ spoilage.

**Illustration 5:** Enter the following transactions in the Purchase Book, Sales Book, Purchase Returns Book and Sales Returns Book of Abhishek and Co. for the month of January, 2022.

- 01. Jan. Purchased goods from Raj Traders ₹ 16,400 at 10% trade discount.
- 03. Jan. Preeti enterprises invoiced goods to us ₹ 17,250.
- 06. Jan. Sold goods to Vinita Stores Rs 19,000 at 5% trade discount.
- 09. Jan. Mitesh Associates invoiced goods to us ₹ 17,000 at 2½% trade discount.
- 12. Jan. Returned goods to Raj traders ₹ 1,650 (Net).
- 15. Jan. Vinita Traders returned goods to us as they were damaged in transit ₹ 4,000(Gross).

18. Jan. Returned goods to Preeti ₹ 2,550  
 23. Jan. Placed an order with Novel Stores for goods worth ₹ 29,000.  
 25. Jan. Novel Stores supplied goods worth ₹ 19,000 only  
 26. Jan. Returned goods to Novel Stores as they were not as per specification ₹ 2,550.  
 28. Jan. Sold goods to Deepika ₹ 24,000 at 8% trade discount.  
 30. Jan. Deepika returned goods of ₹ 4,000 (Gross).

**Answer:**

**In the Books of Abhishek and Co.  
Purchases Book**

Date	Particulars	L.F.	Details (₹)	Amount(₹)
2022				
1 Jan	Raj Traders		16,400	
	Less: Trade Discount @ 10%		(1,640)	14,760
3 Jan	Preeti Enterprises			17,250
9 Jan	Mitesh Associates		17,000	
	Less: Trade Discount @ 2.5%		(425)	16,575
25 Jan	Novel Stores			19,000
31 Jan	<b>Purchases A/c</b>	<b>Dr.</b>		<b>67,585</b>

**Sales Book**

Date	Particulars	L.F.	Details (₹)	Amount (₹)
2022				
6 Jan	Vinita Stores		19,000	
	Less: Trade Discount @ 5%		(950)	18,050
28 Jan	Deepika		24,000	
	Less: Trade Discount @ 8%		(1,920)	22,080
31 Jan	<b>Sales A/c</b>	<b>Cr.</b>		<b>40,130</b>

**Purchase Return Book**

Date	Particulars	L.F.	Details (₹)	Amt. (₹)
2022				
12 Jan	Raj Traders		1650	
18 Jan	Preeti Enterprises		2550	
26 Jan	Novel Stores		2550	
31 Jan	<b>Purchases Returns A/c</b>	<b>Cr.</b>		<b>6750</b>

**Sales Return Book**

Date	Particulars	Credit Note No.	L.F.	Details (₹)	Amt. (₹)
Jan 2022					
15 Jan	Vinita Traders			4,000	
	Less: Trade Discount @ 5%			(200)	3,800
30 Jan	Deepika			4,000	
	Less: Trade Discount @ 8%			(320)	3,680
31 Jan	<b>Sales Returns A/c</b>	<b>Dr.</b>			<b>7,480</b>

**PRACTICE QUESTIONS:**

1. Record the following transaction in simple cash book for November 2023:

2023,	Amt. (₹)
Jan. 01. Cash in hand	12,500
Jan. 04. Cash paid to Hari	600
Jan. 07. Purchased goods	800
Jan. 12. Cash received from Amit	1,960
Jan. 16. Sold goods for cash	800
Jan. 20. Paid to Manish	590
Jan. 25. Paid cartage	100
Jan. 31. Paid salary	1,000

2. Prepare Double column Cash Book with Cash and Bank Columns from following information.

2023		Amt. (₹)
Feb 04	Cash in Hand	30,000
	Bank Overdraft	1,40,000
Feb 06	Paid wages	8,000
Feb 07	Cash Sales	2,80,000
Feb 10	Cash deposited in Bank	1,60,000
Feb 15	Goods purchased against Cheque	80,000
Feb 20	Paid Rent	20,000
Feb 25	Drew from bank for personal use	16,000
Feb 27	Salary paid	40,000

3. Prepare double column cash book from the following transactions for the year August 2022:

2022,	Amt. (₹)
Aug. 01. Cash in hand	17,500
Cash at bank	5,000
Aug. 03. Purchased goods for cash	3,000
Aug. 05. Received cheque from Jasmeet	10,000
Aug. 08. Sold goods for cash	7,000
Aug. 10. Jasmeet's cheque deposited into bank	
Aug. 12. Purchased goods and paid by cheque	20,000
Aug. 15. Paid establishment expenses through bank	1,000
Aug. 18. Cash sales	7,000
Aug. 20. Deposited into bank	10,000
Aug. 24. Paid trade expenses	500
Aug. 27. Received commission by cheque	6,000
Aug. 29. Paid Rent	2,000
Aug. 30. Withdrew cash for personal use	1,200
Aug. 31. Salary paid	6,000

4. M/s Ruchi trader started their cash book with the following balances on June 2023:

Cash in hand ₹1,354 and balance in bank current account ₹ 7,560. He had the following transaction in the month of June 2023:

	Amt. (₹)
03 June, Cash sales	2,300
05 June, Purchased goods, paid by cheque	6,000
08 June, Cash sales	10,000
12 June, Paid trade expenses	700
15 June, Sales goods, received cheque (deposited same day)	20,000

18 June, Purchased motor car paid by cheque	15,000
20 June, Cheque received from Manisha (deposited same day)	10,000
22 June, Cash Sales	7,000
25 June, Manisha's cheque returned dishonoured	
28 June, Paid Rent	2,000
29 June, Paid telephone expenses by cheque	500
30 June, Cash withdrawn for personal use	2,000
Prepare bank column cash book.	

5. Prepare Petty cash book from the following transactions. The Imprest amount is ₹ 2,000.

2023	Amt. (₹)
Jan. 01. Paid cartage	50
Jan. 02. STD charges	40
Jan. 02. Bus fare	20
Jan. 03. Postage	30
Refreshment for employees	80
Jan. 06. Courier charges	30
Jan. 08. Refreshment of customer	50
Jan. 10. Cartage	35
Jan. 15. Taxi fare to manager	70
Jan. 18. Stationery	65
Jan. 20. Bus fare	10
Jan. 22. Fax charges	30
Jan. 25. Telegrams charges	35
Jan. 27. Postage stamps	200
Jan. 29. Repair on furniture	105
Jan. 30. Laundry expenses	115
Jan. 31. Miscellaneous expenses	100

6. Enter the following transactions in the Purchase Journal (Book) of M/s Rai Traders of July 2022:

- 01 July 2022. Bought from Rahul Traders as per invoice no.20041  
40 Registers @ ₹ 60 each  
80 Gel Pens @ ₹ 15 each  
50 Note books @ ₹ 20 each  
Trade discount 10%.
- 15 July 2022. Bought from Global Stationers as per invoice no.1132  
40 Ink Pads @ ₹ 8 each  
50 Files @ ₹ 10 each  
20 Colour Books @ ₹ 20 each  
Trade Discount 5%
- 23 July 2022. Purchased from Lamba Furniture as per invoice no. 3201  
2 Chairs @ ₹ 600 per chair  
1 Table @ ₹ 1,000 per table
- 25 July 2022. Bought from Mumbai Traders as per invoice no.1111  
10 Paper Rim @ ₹ 100 per rim  
400 Drawing Sheets @ ₹ 3 each  
20 Packets waters colour @ ₹ 40 per packet

7. Enter the following transactions in Sales (journal) book of M/s. Bansal Electronics of Sep. 2022:

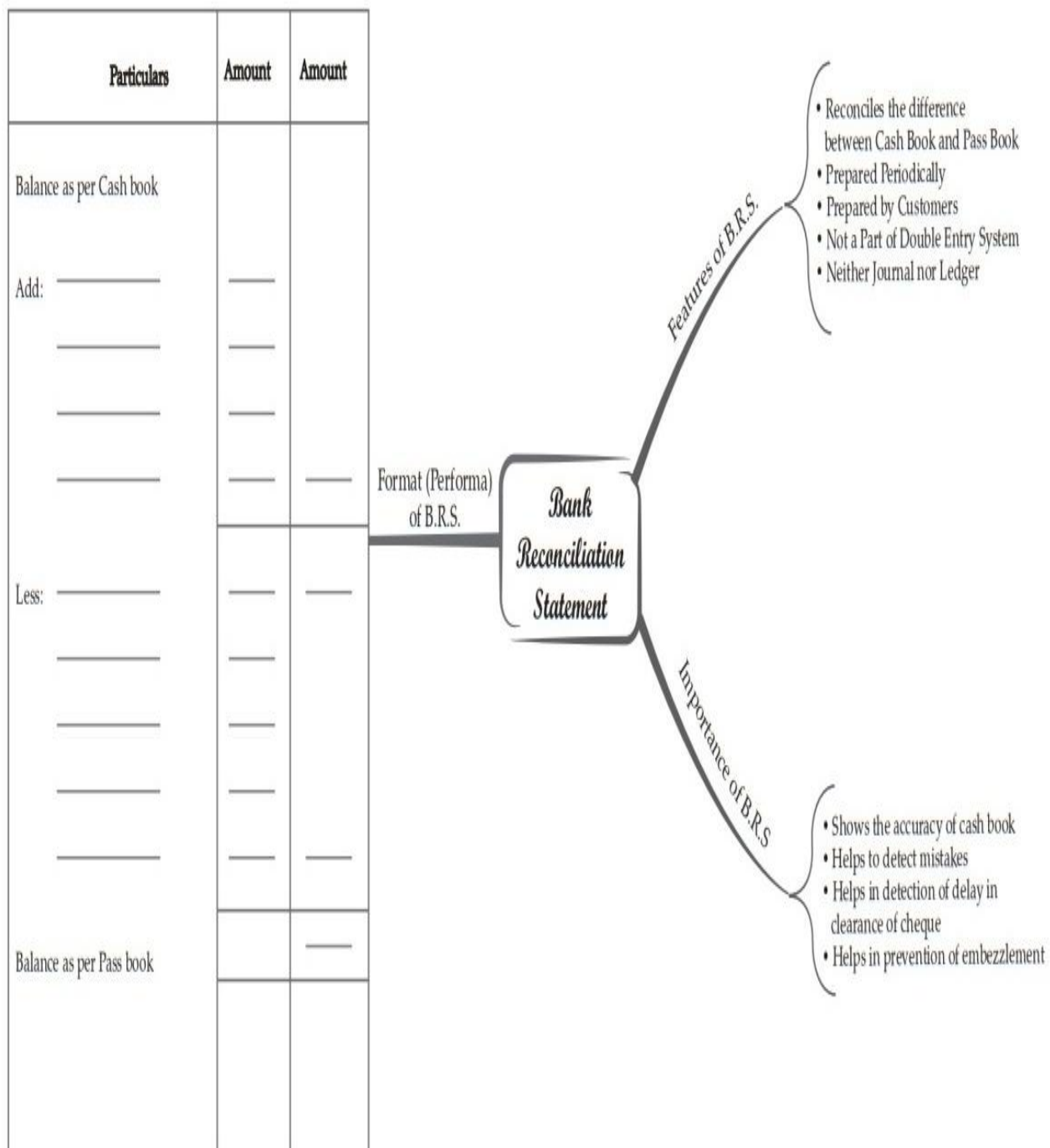
01. Sep. Sold to Amit Traders as per bill no. 4321  
20 Pocket Radio @ ₹ 70 per Radio

- 2 T.V. set, B&W.(6'') @ ₹ 800 per T.V.
10. Sep. Sold to Arun Electronics as per bill no. 4351  
5 T.V. sets (20'') B&W @ ₹ 3,000 per T.V.  
2 T.V. sets (21'') Colour @ ₹ 4,800 per T.V.
22. Sep. Sold to Handa Electronics as per bill no. 4399  
10 Tape recorders @ ₹ 600 each  
5 Walkman @ ₹ 300 each.
28. Sep. Sold to Harish Trader as per bill no. 4430  
10 Mixer Juicer Grinder @ ₹ 800 each.
8. Prepare a Purchases Return (journal) book from the following transactions for April 2023.
- |  | Amt. (₹) |
|--|----------|
| 2023   |          |
| April 05. Returned goods to M/s Kartik Traders   | 1,200    |
| April 10. Goods returned to Sahil Pvt. Ltd.  | 2,500    |
| April 17. Goods returned to M/s Kohinoor Traders. for list price ₹ 2,000<br><i>Less: 10% trade discount.</i> |          |
| April 28. Return outwards to M/s Handa Traders   | 550      |
9. Prepare Return Inward Journal (Book) from the following transactions of M/s Bansal Electronics for July 2022:
- |   | Amt. (₹) |
|---|----------|
| 2022  |          |
| July 04. M/s Gupta Traders returned the goods                           | 1,500    |
| July 10. Goods returned from M/s Harish Traders                         | 800      |
| July 18. M/s Rahul Traders returned the goods not as per specifications | 1,200    |
| July 28. Goods returned from Sushil Traders                             | 1,000    |
10. Record the following transactions in Purchase Book, Sales Book, Purchase Returns Book & Sales Returns Book of Tushar General Stores for the month of May 2022.
- May 01 - Jaya invoiced goods of ₹ 15,000 at 9% trade discount as per their Invoice no. 231.
- May 13 - Purchased computer from IBM Computers worth ₹ 55,000 as per their Invoice no. 863.
- May 23 - Invoiced goods to Priya for ₹ 20,000 at 4½ % trade discount as per Invoice no. 341.
- May 25 - Sold goods to Sneha for ₹ 14,500 at 10% trade discount as per Invoice no. 342.
- May 27 - Sold goods to Anita for ₹ 26,650 as per Invoice no. 343 and purchased goods from her for ₹ 12,250 as per their Invoice no. 545.
- May 29 - Satya supplied goods to us of ₹ 2,450 Invoice no. 630.
- May 30 - Returned goods worth ₹ 460 to Satya and issued Debit Note No. 95
11. Enter the following transactions in the books of Ajay in Purchase Book, Sales Book, Purchase Returns Book and Sales Returns Book for the month of July 2022.
- July 01 - Purchased goods from Neelkamal Stores ₹ 33,000 at 5% trade discount. Half the amount was paid immediately
- July 05 - Sonali invoiced goods of ₹ 14,000 to us at 4% trade discount as per our order dated 27<sup>th</sup> June 2022.
- July 14 - Sold goods of ₹ 30,000 on credit to Ramlal and Sons at 7% trade discount
- July 19 - Purchased goods from Surabhi Stores ₹ 15,000 & sold the same to Prachi at a profit of 25% on cost
- July 24 - Purchased goods of ₹ 6,600 from Seema Stores and paid for carriage ₹ 340.
- July 26 - Purchased furniture for office use ₹ 23,000 from Bharat Furniture on credit.

-----END OF CHAPTER-----

## CH - 05. BANK RECONCILIATION STATEMENT

(MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

- state the meaning and need for the preparation of bank reconciliation statement;
- identify causes of difference between bank balance as per cash book and pass book;
- prepare the bank reconciliation statement;
- ascertain the correct bank balance as.

Bank Reconciliation Statement is a record book of the transactions of a bank account. This statement helps the account holders to check and keep track of their funds and update the transaction record that they have made. Bank Reconciliation statement is also known as bank passbook. The balance mentioned in the bank Passbook of the statement must tally with the balance mentioned in the Cash book. In the statement, all the deposit will be shown in the credit column and withdrawals will be shown in the debit column. However, if the withdrawal exceeds deposit it will show a debit balance (overdraft).

### **Importance:**

While making a comparison between the company's cash book and bank balance, the balance does not tally. Therefore, it is important to determine the cause for the difference and display them in the bank reconciliation statement and then tally the two balances. The bank reconciliation statement helps in explaining the differences in the amount between the company's cash book and bank balance. The cash book and the bank pass book differences are caused by:

The difference in timing can be caused by many factors which are:

1. Bank-issued cheque but not yet deposited for payment
2. Paid cheque in the bank but yet not cleared
3. Bank made direct debit from the customer's side
4. Cheque/ amount deposited directly to the bank account
5. Dividends and Interest collected by the bank
6. Bank made direct payment from the customer's side
7. Cheques deposited/bills discounted dishonoured

In a few occasions, the error in two balances can be made from the bank side or in the company's cash book. Few errors are as follows:

1. Errors made while registering the transaction by the company
2. Errors made while registering the transaction by the bank

### **Types of Bank Reconciliation Statement:**

The Bank Reconciliation Statement can be prepared in 2 ways:

1. Documenting of bank reconciliation statement without adjusting the cash book balance.
2. Filing of bank reconciliation statement after adjusting the cash book balance.

### **Steps to Prepare Bank Reconciliation Statement:**

- First, the date on which the statement is recorded is mentioned.
- After which the balance displayed in the cash book is mentioned in the statement. Sometimes, the balance mentioned in the passbook can also be mentioned.
- The deposited cheques which are not collected are deducted.

- Then the cheques issued but the deposited for payment, but amount directly deposited in the bank account are recorded.
- All the transactions like overdraft interest, amount debited by the bank but not recorded in the cashbook, cheques and bills dishonoured are deducted.
- All the credits and profit collected by the company and directly deposited in the bank is added.
- Adjustments of errors are made
- Now the balance between the cash book and statement should be equal or the same.

### Illustration 1.

Prepare Bank Reconciliation Statement from the following particulars on 31<sup>st</sup> July 2022

- Balance as per Pass Book ₹ 500.
- Three cheque for ₹ 60, ₹ 39.37, and ₹ 15.25 issued in July 2022 were presented her payment to the bank in August 2022.
- Two cheques of ₹ 50 and ₹ 65 sent to the bank for collection where not entered in the pass book by July 31<sup>st</sup>, 2022.
- The Bank charged ₹ 46 for its commission and allowed interest ₹ 10 which were not entered in the bank account.

**Solution:**

### Bank Reconciliation Statement

Particulars	Plus (₹)	Minus (₹)
Balance as per Pass Book	500.00	
Less: Cheque issued but not yet presented (₹ 60 + ₹ 39.37 + ₹ 15.25)		114.62
Add: Cheque sent to the bank but not yet collected (₹ 50 + ₹ 65)	115.00	
Add: Bank charges	46.00	
Less: Interest allowed by Bank		10.00
<b>Balance as per cash Book</b>		536.38
	<b><u>661.00</u></b>	<b><u>661.00</u></b>

### Illustration 2.

Prepare Bank Reconciliation Statement from the following particulars on 31<sup>st</sup> December 2021. Cash book showed a balance of ₹ 15,000 on 31<sup>st</sup> December 2021. On comparing the same with the balance of Pass Book it was revealed that:

- A cheque of ₹ 2,000 issued in the month of Dec. 2021 has not been presented for payment to the bank.
- The customer deposited cheque worth ₹ 3,000 but they have not been collected by the bank.
- The bank had allowed ₹ 200 as interest.
- Bank had charged ₹ 20 as commission for his service.

**Solution:**

### Bank Reconciliation Statement

Particulars	Plus (₹)	Minus (₹)
Balance as per Cash Book	15,000	
Add: Cheque issued but not yet issued for payment	2,000	
Interest allowed by the bank	200	
Less: Cheque deposited but not yet collected by the bank		3,000
Bank Charges		20
<b>Balance as per pass Book</b>		14,180
	<b><u>17200</u></b>	<b><u>17200</u></b>

**Illustration 3.**

On 31<sup>st</sup> Dec. 2022 the Cash Book on Jain works showed an overdraft of ₹ 5,600 from the following particulars make out a bank reconciliation statement.

- Cheque drawn but not cashed before 31<sup>st</sup> Dec. 2022 amounted to ₹ 3,946.
- Cheque paid into bank but not collected and credited before 31<sup>st</sup> December amount to ₹ 4,891.
- A bill received for ₹ 520 previously discounted with the bank had been dishonoured & debited in the pass book.
- Bank charges debited in the pass book amounted to ₹ 55.
- Debit is made in the pass book for ₹ 120 on account of interest on overdraft.
- The bank has collected interest on investment and credited ₹ 760 in the pass book.

**Solution:****Bank Reconciliation Statement**

Particulars	Plus (₹)	Minus (₹)
Overdraft as per Cash Book		5,600
Add: Cheque issued but not yet presented for payment	3,946	
Less: Cheque paid into bank but not yet credited		4,891
Less: Dishonoured bills debited by the bank		520
Less: Interest on overdraft debited in the pass book		120
Less: Bank Charges		55
Add: Interest on investment collected and credited by bank	760	
<b>Overdraft as per pass book</b>	<b>6,480</b>	
	<b><u>11,186</u></b>	<b><u>11,186</u></b>

**Illustration 4.**

The Bank pass book of Mr. X showed an overdraft of ₹ 33,575 on 31<sup>st</sup> March, 2022. On going through the pass book the accountant found the following.

- A cheque of ₹ 1,080 credited in the pass book on March 28 is dishonoured and debited in the pass book on April 1, 2022. There was no entry in the cash book about the dishonour of the cheque until 15<sup>th</sup> April.
- Bank had credited his account with ₹ 2,800 for interest collected by them on his behalf but the same had not been entered in his pass book.
- Out of ₹ 20,500 paid in by Mr. X in cash and by the cheque on 31<sup>st</sup> March, cheque amount to ₹ 7,500 were collected on 7<sup>th</sup> April.
- Out of the cheque amount to ₹ 7,800 drawn by him on 27<sup>th</sup> March, a cheque for ₹ 2,500 was encashed on 3<sup>rd</sup> April.

Prepare a Bank Reconciliation Statement on 31<sup>st</sup> March, 2022.

**Solution:****Bank Reconciliation Statement**

Particulars	Plus (₹)	Minus (₹)
Overdraft as per pass book		33,575
Less: Interest collected and credited by the bank		2,800
Add: Cheque paid into the bank but not yet collected	7,500	
Less: cheque issued but not yet encashed		2,500
<b>Overdraft as per cash book</b>	<b>31,375</b>	
	<b><u>38,875</u></b>	<b><u>38,875</u></b>

### OBJECTIVE QUESTIONS:

1. Why is the bank reconciliation statement important?

**Answer :** The bank reconciliation statement is important to determine the cause for the difference made on the part of the bank or customers side.

2. Which balance is caused an overdraft of cash book and passbook?

**Answer:** Cash book Cr. and Pass book Dr. balances.

3. Mention two items drafted in a plus column while starting with a debit balance of cash book.

**Answer:** The two items drafted in a plus column while starting with a debit balance of cash book are.

- Bank issued cheque but not yet presented for payment
- Interest allowed by the bank but not recorded in the cash book

4. Mention two items drafted in a minus column while starting with a debit balance of cash book.

**Answer:** The two items drafted in a minus column while starting with a debit balance of cash book are.

- Cheque deposited but not cleared
- Bank made direct payment from the customer's side

5. Mention two items drafted in a minus column while starting with an overdraft balance of cash book.

**Answer:** The two items drafted in a minus column while starting with an overdraft balance of cashbook are.

- Cheque deposited but not cleared.
- Bank made direct payment from the customer's side.

6. Mention two items drafted in a plus column while starting with an overdraft balance of cash book.

**Answer:** The two items drafted in a plus column while starting with an overdraft balance of cash book are.

- Bank-issued cheque but not yet presented for payment.
- Interest allowed by the bank but not recorded in the cash book.

7. A bank reconciliation statement is prepared to.

- (a) Reconcile Bank balance as per cash book and bank balance as per pass book.
- (b) Reconcile Cash balance as per cash book and bank balance as per pass book.
- (c) Both (a) & (b).
- (d) None of the above.

**Answer: (a)**

8. A Pass Book is a copy of

- (a) A customer's account in the bank's book
- (b) Cash book relating to bank column
- (c) Cash book relating to cash column
- (d) Firm's receipts and payments

**Answer: (a)**

9. A bank reconciliation statement is prepared with the balance of

- (a) Cash Book
- (b) Pass Book

- (c) Either Cash Book or Pass Book
- (d) Neither Cash Book nor Pass Book

**Answer: ( c )**

10. A bank reconciliation statement is prepared by

- (a) Bank
- (b) Customers of the Bank
- (c) Creditors
- (d) Auditors

**Answer: (b)**

### **PRACTICE QUESTIONS:**

1. From the following particulars prepare Bank reconciliation statement of Arun Ltd. as on 31<sup>st</sup> March, 2023:

- (a) Balance as per Pass Book was ₹ 14,000.
- (b) Bank collected a cheque of ₹ 500 on behalf of Arun Ltd. but forgot to record it in the Pass Book.
- (c) Bank deposits a cash deposit of ₹ 2,589 as ₹ 2,598.
- (d) The payment of a cheque of ₹ 700 was recorded twice in the Pass Book.
- (e) Dividend collected by bank ₹ 450.
- (f) Bank charges ₹ 250 debited by the bank.

2. On examining the Bank Statement of Green Ltd., it is found that the balance shown on 31<sup>st</sup> March, 2023, differs from the bank balance of ₹ 23,650 shown by the Cash Book on that date. From a detailed comparison of the entries it is found that:

- (i) ₹ 2,860 is entered in the Cash Book as paid into the bank on 31<sup>st</sup> March, 2023 but not credited by the bank until the following day.
- (ii) Bank charges of ₹ 70 on 31<sup>st</sup> March, 2023 are not entered in the Cash Book.
- (iii) A bill for ₹ 5,500 discounted with the bank is entered in the Cash Book without recording the discount charges of ₹ 270.
- (iv) Cheques totaling ₹ 16,720 were issued by the company and duly recorded in the Cash Book before 31<sup>st</sup> March, 2023 but had not been presented at the Bank for payment until after that date.
- (v) On 25<sup>th</sup> March, 2019, a debtor paid ₹ 1,000 into the Company's Bank in settlement of his account but no entry was made in the Cash Book of the company in respect of this.
- (vi) No entry has been made in the Cash Book to record the dishonors on 15<sup>th</sup> March, 2023, of a cheque for ₹ 550 received from Ram Babu.

Prepare a Bank Reconciliation Statement as on 31<sup>st</sup> March, 2023

3. Prepare a Bank Reconciliation Statement as on 31<sup>st</sup> March, 2023 from the following:

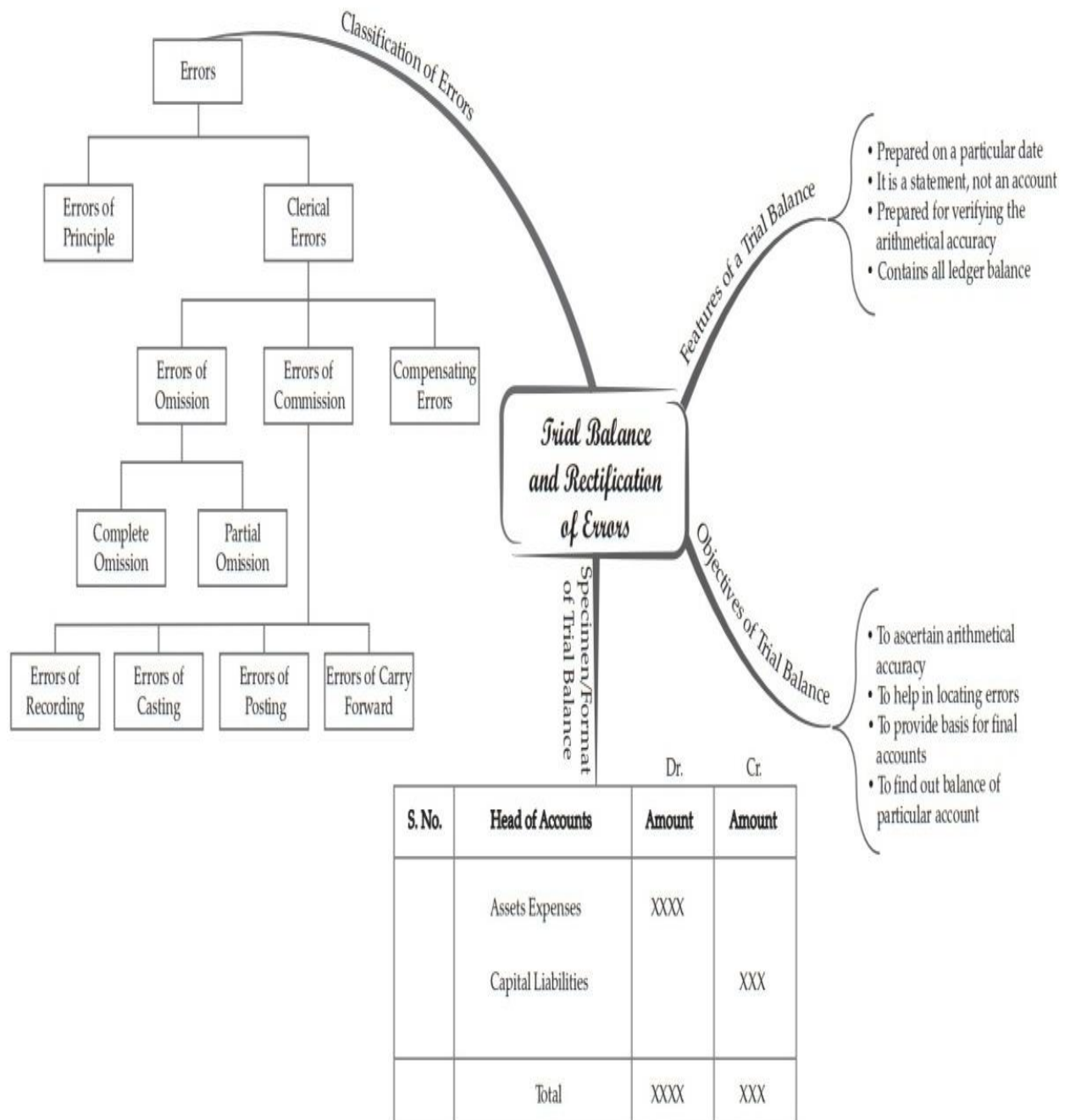
- (i) On 31<sup>st</sup> March, 2023, Cash Book of a firm showed bank balance of ₹ 36,000 (Cr.).
- (ii) Cheques had been issued for ₹ 30,000, out of which cheques of ₹ 24,000 were presented for payment.
- (iii) Cheques of ₹ 8,400 were deposited in the bank on 28<sup>th</sup> March, 2023 but had not been credited by the bank. Also, a cheque of ₹ 3,000 entered in the Cash Book on 30<sup>th</sup> March, 2023 was banked on 3<sup>rd</sup> April.

- (iv) A cheque from Suresh for ₹ 2,400 was deposited in the bank on 26<sup>th</sup> March, 2023 was dishonoured, advice was received on 2<sup>nd</sup> April.
- (v) Pass Book showed bank charges of ₹ 120 debited by the bank.
- (vi) One of the Debtors deposited ₹ 3,000 in the bank account of the firm on 26<sup>th</sup> March, 2023, but the intimation in this respect was received from the bank on 2<sup>nd</sup> April.
4. Prepare Bank Reconciliation Statement from the following particulars on 31<sup>st</sup> July, 2022:
- (i) Balance as per the Pass Book ₹ 50,000.
- (ii) Three cheques for ₹ 6,000, ₹ 3,937 and ₹ 1,525 issued in last week of July, 2022 were presented for payment to the bank in August, 2022.
- (iii) Two cheques of ₹ 500 and ₹ 650 sent to the bank for collection were not entered in the Pass Book by 31<sup>st</sup> July, 2022.
- (iv) The bank charged ₹ 460 for its commission and allowed interest of ₹ 100 which were not mentioned in the Bank Column of the Cash Book.
5. On 31<sup>st</sup> Dec, 2022 the Cash book of Mittal Bros. Showed an overdraft of ₹ 6,920. From the following particulars prepare a Bank Reconciliation Statement and ascertain the balance as per passbook.
- (i) Debited by bank for ₹ 200 on account of Interest on overdraft and ₹ 50 on account of charges for collecting bills.
- (ii) Cheques drawn but not encashed before 31<sup>st</sup> Dec, 2022 for ₹ 4,000.
- (iii) The bank has collected interest and has credited ₹ 600 in Pass book.
- (iv) A bill receivable for ₹ 700 previously discounted with the bank had been dishonoured & debited in the passbook.
- (v) Cheques paid into bank but not collected and credited before 31<sup>st</sup> Dec, 2022 amounted ₹ 6,000.
6. The passbook of Mr. Randhir Singh showed an overdraft of ₹ 40,950 on 31<sup>st</sup> March, 2023. Prepare bank reconciliation statement on 31<sup>st</sup> March, 2017.
- (i) Out of cheques amounting to ₹ 8,000 drawn by Mr. Randhir Singh on 27<sup>th</sup> March a cheque for ₹ 3,000 was encashed on April 2023.
- (ii) Credited by bank with ₹ 3,800 for interest collected by them, but the amount is not entered in the Cash book.
- (iii) ₹ 10,900 paid in by Mr. Randhir Singh in cash and by cheques on 31<sup>st</sup> March, cheques amounting to ₹ 3,800 were collected on 7<sup>th</sup> April.
- (iv) A Cheque of ₹ 780 credited in the passbook on 28<sup>th</sup> March being dishonoured is debited again in the passbook on 1<sup>st</sup> April, 2023. There was no entry in the cash book about the dishonour of the cheque until 15<sup>th</sup> April.

----- **END OF CHAPTER** -----

## CH - 06. TRIAL BALANCE AND RECTIFICATION OF ERRORS

### (MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

- state the meaning of trial balance;
- enumerate the objectives of preparing trial balance;
- prepare trial balance;
- explain the types of errors;
- state various process of locating errors;
- identify the errors which affect the agreement of trial balance and those which do not affect the agreement of trial balance;
- rectify the errors without preparing suspense account; and
- rectify the errors with suspense account.

### **Meaning of Trial Balance:**

A trial balance is a statement showing the balances, or total of debits and credits, of all the accounts in the ledger with a view to verify the arithmetical accuracy of posting into the ledger accounts. Trial balance is an important statement in the accounting process as it shows the final position of all accounts and helps in preparing the final statements.

### ***Format of a trial balance***

#### **Trial Balance of .....as on March 31, 2023**

<i>Account Title.</i>	<i>L.F</i>	<i>Debit Bal. (₹)</i>	<i>Credit Bal. (₹)</i>
<b>Total</b>			

It is normally prepared at the end of an accounting year. However, an organisation may prepare a trial balance at the end of any chosen period, which may be monthly, quarterly, half yearly or annually depending upon its requirements.

In order to prepare a trial balance following steps are taken:

- Ascertain the balances of each account in the ledger.
- List each account and place its balance in the debit or credit column, as the case may be.  
(If an account has a zero balance, it may be included in the trial balance with zero in the column for its normal balance).
- Compute the total of debit balances column.
- Compute the total of the credit balances column.
- Verify that the sum of the debit balances equal the sum of credit balances. If they do not tally, it indicate that there are some errors. So one must check the correctness of the balances of all accounts. It may be noted that all assets expenses and receivables account shall have debit balances whereas all liabilities, revenues and payables accounts shall have credit balances.

### **Objectives of Preparing the Trial Balance:**

The trial balance is prepared to fulfil the following objectives:

1. To ascertain the arithmetical accuracy of the ledger accounts.
2. To help in locating errors.
3. To help in the preparation of the financial statements. (Profit & Loss account and Balance Sheet).

### Illustrative Trial Balance:

<i>Account Title</i>	<i>L.F.</i>	<i>Debit Bal. (₹)</i>	<i>Credit Bal. (₹)</i>
• Capital			✓
• Land and Buildings		✓	
• Plant and Machinery		✓	
• Equipment		✓	
• Furniture and Fixtures		✓	
• Cash in Hand		✓	
• Cash at Bank		✓	
• Debtors		✓	
• Bills Receivable		✓	
• Stock of Raw Materials		✓	
• Stock of Finished Goods		✓	
• Purchases		✓	
• Carriage Inwards		✓	
• Carriage Outwards		✓	
• Sales			✓
• Sales Return		✓	
• Purchases Return		✓	✓
• Interest Paid			
• Commission/Discount Received		✓	✓
• Salaries			
• Long Term Loan		✓	✓
• Bills Payable			✓
• Creditors			✓
• Advances from Customers			✓
• Drawings			
<b>Total</b>		<b>xxxx</b>	<b>xxxx</b>

### Preparation of Trial Balance

Theoretically spreading, a trial balance can be prepared in the following three ways:

- (i) Totals Method
- (ii) Balances Method
- (iii) Totals-cum-balances Method

### 1. Totals method:

Under this method, total of each side in the ledger (debit and credit) is ascertained separately & shown in the trial balance in the respective columns. However, this method is not widely used in practice, as it does not help in assuming accuracy of balances of various accounts and preparation of the financial statements.

## 2. Balances Method:

This is the most widely used method in practice. Under this method trial balance is prepared by showing the balances of all ledger accounts and then totalling up the debit and credit columns of the trial balance to assure their correctness.

### **3. Totals-cum-balances Method:**

This method is a combination of totals method and balances method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts. However, this method is also not used in practice because it is time consuming and hardly serves any additional or special purpose.

### **Significance of Agreement of Trial Balance:**

It is important for an accountant that the trial balance should tally. Normally a tallied trial balance means that both the debit and the credit entries have been made correctly for each transaction. However, as stated earlier, the agreement of trial balance is not an absolute proof of accuracy of accounting records. A tallied trial balance only proves, to a certain extent, that the posting to the ledger is arithmetically correct. But it does not guarantee that the entry itself is correct. There can be errors, which affect the equality of debits and credits, and there can be errors, which do not affect the equality of debits & credits.

*Some common errors include the following:*

- Error in totalling of the debit and credit balances in the trial balance.
- Error in totalling of subsidiary books.
- Error in posting of the total of subsidiary books.
- Error in showing account balances in wrong column of the trial balance, or in the wrong amount.
- Omission in showing an account balance in the trial balance.
- Error in the calculation of a ledger account balance.
- Error while posting a journal entry: a journal entry may not have been posted properly to the ledger, i.e., posting made either with wrong amount or on the wrong side of the account or in the wrong A/c.
- Error in recording a transaction in the journal: making a reverse entry, i.e., account to be debited is credited and amount to be credited is debited, or an entry with wrong amount.
- Error in recording a transaction in subsidiary book with wrong name or wrong amount.

### **Classification of Errors:**

Keeping in view the nature of errors, all the errors can be classified into the following four categories:

- Errors of Commission
- Errors of Omission
- Errors of Principle
- Compensating Errors

### **Errors of Commission:**

These are the errors which are committed due to wrong posting of transactions, wrong totalling or wrong balancing of the accounts, wrong casting of the subsidiary books, or wrong recording of amount in the books of original entry, etc.

For example:

Raj Traders paid ₹ 25,000 to Preetpal Traders (a supplier of goods). This transaction was correctly recorded in the cashbook. But while posting to the ledger, Preetpal's account was debited with ₹ 2,500 only. This constitutes an error of commission. Such an error by definition is of clerical nature and most of the errors of commission affect in the trial balance.

### **Errors of Omission:**

The errors of omission may be committed at the time of recording the transaction in the books of original entry or while posting to the ledger. These can be of two types:

- (i) Error of complete omission.
- (ii) Error of partial omission.

When a transaction is completely omitted from recording in the books of original record, it is an error of complete omission. For example, credit sales to Mohan ₹ 10,000, not entered in the sales book. When the recording of transaction is partly omitted from the books, **it is an error of partial omission.**

If in the above example, credit sales had been duly recorded in the sales book but the posting from sales book to Mohan's account has not been made, **it would be an error of partial omission.**

### **Errors of Principle:**

Accounting entries are recorded as per the generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle. An error of principle may occur due to incorrect classification of expenditure or receipt between capital and revenue. This is very important because it will have an impact on financial statements. It may lead to under/over stating of income or assets or liabilities, etc.

For example, amount spent on additions to the buildings should be treated as capital expenditure & must be debited to the asset account. Instead, if this amount is debited to maintenance and repairs account, it has been treated as a revenue expense. This is an error of principle. Similarly, if a credit purchase of machinery is recorded in purchases book instead of journal proper or rent paid to the landlord is recorded in the cash book as payment to landlord, these errors of principle. *These errors do not affect the trial balance.*

### **Compensating Errors:**

When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called **Compensating errors**. *Such errors do not affect the tallying of the trial balance.*

For example, if purchases book has been overcast by ₹ 10,000 resulting in excess debit of ₹ 10,000 in purchases account and sales returns book is undercast by ₹ 10,000 resulting in short debit to sales returns account is a case of two errors compensating each other's effect. One plus is set off by the other minus, the net effect of these two errors is nil and so they do not affect the agreement of trial balance.

### **Rectification of Errors:**

Errors are of two types:

- a. Errors that do not affect the Trial Balance
- b. Errors that affect the Trial Balance.

#### **Errors that do not affect the Trial Balance:**

These are those errors that are being committed in two or more accounts so that it doesn't affect the balances in Trial Balance. To rectify this rectifying journal entry is passed.

There are following types of errors that do not affect the Trial Balance:

- (i) **Error of Omission:** When the transaction is omitted to be recorded in the books of account. For Example, Goods sold to Mohan were omitted to be recorded in the Sales Book.

**(ii) Compensating errors:** When the net effects of two or more errors result in nil it is referred to as compensating errors. For example, if the purchase account has an excess debit of ₹ 5,000 and the Sales Return Account is undercast by the same amount.

**(iii) Errors of Principle:** If any accounting principle is violated while recording the transaction such errors do not affect the Trial balance. For example, an addition to machinery was wrongly debited to Repairs and Maintenance Account considering as revenue expenditure instead of capital expenditure.

**i. Incorrect account in the original book:** Instead of Babu's account, Shyam's account is maintained.

**ii. Posting to the wrong account:** Instead of posting in the purchase account, the transaction is posted in the sales account.

### Errors that affects the Trial Balance:

These are those errors that are being committed in one account and they can be rectified by opening The Suspense Account.

There are following errors that affect the Trial Balance:

(i) *Error of Omission* (ii) *Error of Commission* (iii) *Wrong Posting*

### Suspense Account:

When Trial Balance Does not agree, then first of all we try to locate the errors. Sometimes, in spite of the best efforts, all the errors are not located and the Trial Balance does not tally. Then in order to avoid delay in the preparation of final accounts, a new account is opened which is known as "Suspense Account" Difference in Trial Balance is posted to this Account.

<b>1. If there is Excess Debit in the Trial Baal</b>	→	<b>Difference is posted to the Credit side of Suspense A/c</b>
<b>2. If there is Excess Credit in the Trial Balance</b>	→	<b>Difference is posted to the Debit side of Suspense A/c</b>

Example:

### Trial Balance

S.No	Trial Dr. Total (₹)	Balance (Cr. Total) (₹)	Difference (₹)	Posted to Suspense A/c
1.	2,25,000	2,16,500	8,500 (Excess Debit)	Credit Side of Suspense A/c
2.	2,16,500	2,25,000	8,500 (Excess Debit)	Debit Side of Suspense A/c

### Closing of Suspense A/c

- The errors which led to the difference still remains to have to be located.
- These errors will be rectified through Suspense A/c (One sided errors) which will be explained in the topic Rectification of Errors.
- When all the errors are rectified, this Account closes down automatically. If the difference in Trial Balance persist, it is shown in the Balance Sheet.
  - Debit Balance of Suspense Account is shown in the Asset Side of the Balance Sheet.
  - Credit Balance of Suspense Account is shown in the Liability Side of the Balance Sheet.

(a) Total of Return Inward Book ₹ 3,300 posted to Purchase A/c.

(b) Old furniture Sold for ₹ 5,000 was posted to Sales A/c as ₹ 2,000

(c) An item of ₹ 1,605 entered in the Sales Return Book had been posted to debit of the customer who returned the goods.

(d) Credit Purchases from Manorama & Co. ₹ 8,000 were recorded in Sales Book as ₹ 4,000 and posted there from to the credit of Manorama & Co. as ₹ 3,000

(e) Goods bought from a merchant for ₹ 660 had been posted to the credit of account as ₹ 6,600

**Illustration 2:** Trial Balance of ABC Ltd. doesn't meet; it showed an excess credit ₹ 20,000. They put the difference to a suspense account. The errors that they located were:

(i) Sales return book overcast by ₹ 2,000.

(ii) Purchases book was undercast by ₹ 1200.

(iii) In the sales book total of page no. 4 was carried forward to page 5 as ₹ 2,000 instead of ₹ 2,400 and total of page 8 was carried forward to page 9 as ₹ 11,200 instead of ₹ 10,000.

(iv) Goods returned to Ram ₹ 2,000 were recorded through sales book.

(v) Credit purchases from M & Co. ₹ 16,000 were recorded through sales books.

(vi) Credit purchases from S & Co. ₹ 10,000 were recorded through sales books. However, S & Co. were correctly credited.

(vii) Salary paid ₹ 4,000 was debited to employee's personal account.

(i) Sales return book overcast by ₹ 2,000.

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(ii) Purchases book was undercast by ₹ 1,200.

Purchase A/c ..... Dr.	1,200	
To Suspense A/c		1,200
(Being Purchase book undercast by ₹ 1,200 now corrected)		

(iii) In the sales book total of page no. 4 was carried forward to page 5 as ₹ 2,000 instead of ₹ 2,400 & total of page 8 was carried forward to page 9 as ₹ 11,200 instead of ₹ 10,000.

Sales A/c ..... Dr.	800	
To Suspense A/c		800
(Being Error in carry forward of sales book now corrected)		

(iv) Goods returned to Ram ₹ 2,000 were recorded through sales book.

Sales A/c ..... Dr.	2,000	
To Returns Outwards A/c		2,000
(Being Return Outwards wrongly recorded through sales book now rectified)		

(v) Credit purchases from M & Co. ₹ 16,000 were recorded through salesbooks.

Purchase A/c ..... Dr.	16,000	
Sales A/c ..... Dr.	16,000	
To M & Co.'s A/c		32,000
(Being Credit purchases wrongly recorded through sales book, now rectified)		

(vi) Credit purchases from S & Co. ₹ 10,000 were recorded through sales books. However S & Co. were correctly credited.

Purchase A/c ..... Dr.	10,000	
Sales A/c ..... Dr.	10,000	
To Suspense A/c		20,000
(Being Credit purchases wrongly recorded through sales book, however suppliers account correctly credited now rectified)		

(vii) Salary paid ₹ 4,000 was debited to employee's personal account.

Salary A/c..... Dr.	4,000	
To Employees Personal A/c		4,000
(Being Salary paid wrongly debited to employee's personal account, now corrected)		

Dr.				Suspense A/c				Cr.			
Date	Particulars	J.F	Amt (₹)	Date	Particulars	J.F	Amt. (₹)				
	To Difference as per Trial balance		20,000		By Purchases A/c		1,200				
	To Sales Returns A/c		2,000		By Sales A/c		800				
					By Purchases A/c		10,000				
					By Sales A/c		10,000				
			<b>22,000</b>				<b>22,000</b>				

### **PRACTICE QUESTIONS:**

1. Prepare a Trial Balance from the following balances as at 31<sup>st</sup> March 2023:

	(₹)		(₹)
Purchases	82,000	Interest on Investment	2,400
Sales	1,60,000	Return Inwards	7,500
Stock on 01-04-2022	28,800	Return Outwards	5,600
Wages	16,160	Carriage Inwards	1,640
Salaries	6,400	Carriage Outwards	3,200
Repair Charges	1,500	Furniture	12,000
Commission Received	1,800	Motor Car	80,000
Sundry Debtors	24,200	Cash in Hand	4,700
Sundry Creditors	7,300	Bank Overdraft	35,400
Capital	90,000	Investment	30,000
Drawings	4,400		

2. A newly appointed clerk prepared the following Trial Balance from the balances of ledger. It seems to be correct, but it is not correct. Prepare a corrected Trial Balance:

Particular	L.F	Dr. (₹)	Cr. (₹)
Purchases		60,000	
Sales			45,000
Reserve Fund		5,000	
Opening Stock		5,000	
Closing Stock		10,000	
Outstanding expenses			5,000
Machinery		40,000	
Capital			50,000
Suspense A/c			20,000
<b>Total</b>		<b><u>1,20,000</u></b>	<b><u>1,20,000</u></b>

3. Rectify the following errors:

Credit purchases from Raghu ₹ 20,000

- (a) Were not recorded.
- (b) Were recorded as ₹ 10,000.
- (c) Were recorded as ₹ 25,000.
- (d) Were not posted to his account.
- (e) Were posted to Raghav's account.
- (f) Were posted to the debit of Raghu's account.
- (g) Were posted to the debit of Raghav.
- (h) Were recorded through sales book.

4. Trial balance of Anurag did not agree. It showed an excess credit ₹ 10,000. Anurag put the difference to suspense account. He located the following errors:

- (a) Sales return book over cast by ₹ 1, 000.

- (b) Purchases book was undercast by ₹ 6,000.
- (c) Goods returned to Ram ₹ 1,000 were recorded through sales book.
- (d) Credit purchases from M & Co. ₹ 8,000 were recorded through sales book.
- (e) Salary paid ₹ 2,000 was debited to employee's personal account.

5. Tick the correct

I) Agreement of trial balance is affected by:

- (a) One sided errors only.
- (b) Two sided errors only.
- (c) Both (a) and (b).
- (d) None of the above.

II) Which of the following is not an error of principle:

- (a) Purchase of furniture debited to Purchases account.
- (b) Repairs on the overhauling of second hand machinery purchased debited to Repair account.
- (c) Cash received from Manoj posted to Saroj.
- (d) Sale of old car credited to Sales account.

III) Which of the following is not an error of commission:

- (a) Over casting of Sales book.
- (b) Credit sales to Ramesh ₹ 5,000 credited to his account.
- (c) Wrong balancing of machinery account.
- (d) Cash sales not recorded in cash book.

IV) If suspense account does not balance off even after rectification of errors it implies that:

- (a) There are some one sided errors only in the books yet to be located.
- (b) There are no more errors yet to be located.
- (c) There are some two sided errors only yet to be located.
- (d) There may be both one sided errors and two sided errors yet to be located.

6. Give two examples of errors of principle?

7. Give two examples of errors of commission?

8. What is a suspense account? Is it necessary that a suspense account will balance off after rectification of the errors detected by the accountant? If Not, then what happens to the balance still remaining in suspense account?

9. Rectify the following errors:

- (i) Credit sales to Mohan ₹ 7,000 were not recorded.
- (ii) Credit purchases from Rohan ₹ 9,000 were not recorded.
- (iii) Goods returned from Mahesh ₹ 1,000 were not recorded.
- (iv) Goods returned to Rakesh ₹ 4,000 were not recorded.

10. Rectify the following errors:

- (i) Salary paid ₹ 5,000 was debited to employee's personal account.
- (ii) Rent Paid ₹ 4,000 was posted to landlord's personal account.

- (iii) Cash received from Kohli ₹ 2,000 was posted to Kapur's account.
- (iv) Cash paid to Babu ₹ 1,500 was posted to Sabu's account.
11. Rectify the following errors & ascertain the amount of difference in trial balance by preparing Suspense A/c:
- Credit sales to Mohan ₹ 7,000 were posted as ₹ 9,000.
  - Credit purchases from Rohan ₹ 9,000 were posted as ₹ 6,000.
  - Goods returned to Rakesh ₹ 4,000 were posted as ₹ 5,000.
  - Goods returned from Mahesh ₹ 1,000 were posted as ₹ 3,000.
  - Cash sales ₹ 2,000 were posted as ₹ 200.
12. Rectify the following errors assuming that suspension account was opened. Ascertain the difference in trial balance.
- Furniture purchased for ₹ 10,000 wrongly debited to purchase account as ₹ 4,000
  - Repairs on machinery ₹ 1,400 debited to Machinery account as ₹ 2,400
  - Repairs on overhauling of second hand machinery purchased ₹ 2,000 was debited to Repairs account as ₹ 200.
  - Sale of old machinery at book value ₹ 3,000 was credited to sales account as ₹ 5,000
13. Trial balance of Anuj did not agree. It showed an excess credit of ₹ 6,000. He put the difference to suspense account. He discovered the following error:
- Cash received from Ravish ₹ 8,000 posted to his account as ₹ 6,000.
  - Returns inwards book overcast by ₹ 1,000.
  - Total of sales book ₹ 10,000 was not posted to Sales account.
  - Credit purchases from Nanak ₹ 7,000 were recorded in sales Book. However Nanak's account was correctly credited
  - Machinery purchased for ₹ 10,000 was posted to purchases account as ₹ 5,000. Rectify the errors and prepare Suspense account
14. Pass Journal Entries to rectify the following errors:-
- An amount of ₹ 1,000 is withdrawn by the proprietor for his personal use has been debited to the Trade Expenses Account.
  - A purchase of goods from Ram amounting to ₹ 1,500 has been wrongly passed through Sales Book.
  - Bill for ₹ 820 received from Raju for repairs to Machinery was entered in the Purchase book as ₹ 720.
15. Rectify the following errors by passing the rectifying entries using Suspense A/c.
- Credit Sale of ₹ 2,000 to Rohan was posted to Raman's A/c.
  - Sales Return book is under cast by ₹ 1,000
  - Paid ₹ 20,000 as wages for construction of building debited to wages A/c ₹ 20,000
  - ₹ 1,000 paid in cash for a typewriter was charged to office expense account.
16. Pass necessary Journal Entries in the book of X to rectify the following errors:
- Bought Machinery for ₹ 2,500 for the proprietor was debited to General Expenses A/c's ₹ 500.
  - Goods returned by Mohan ₹ 960 have been debited to his account ₹ 1,680.

(c) Bought goods from Krishan ₹ 2,000 was passed through the sales book, however, the account of Ramesh was credited correctly.

17. Which types of error has been made in these sentences? Identify the errors & explain about them.

(a) Purchased goods from Raj on credit but were recorded in the purchases book.

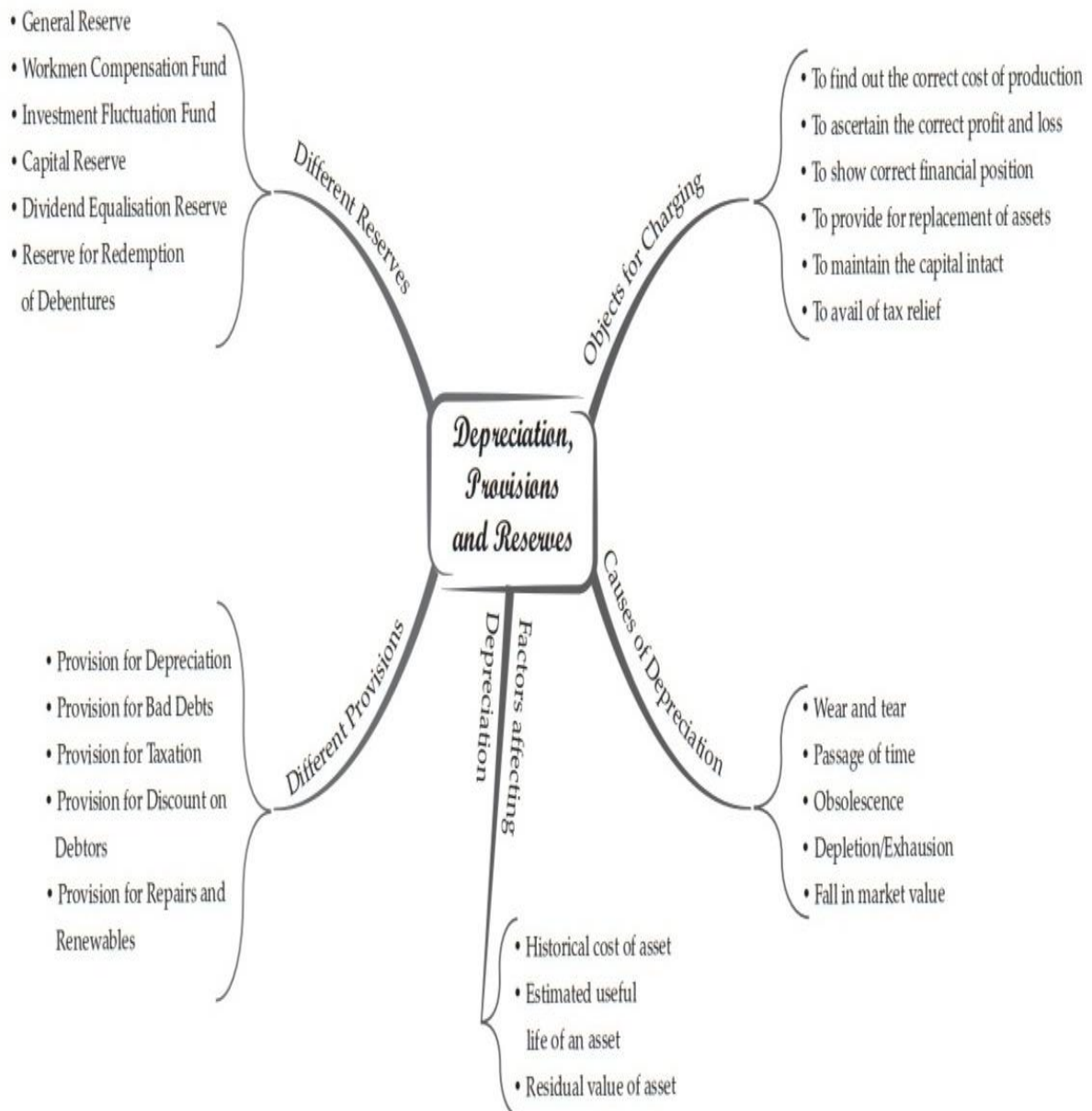
(b) Sale of ₹ 10,000 recorded as ₹ 1,000 and Purchase of ₹ 10,000 recorded as ₹ 1,000.

(c) Sales of some parts of old car was credited to Sales A/c.

----- **END OF CHAPTER** -----

## CH - 07. DEPRECIATION, PROVISIONS AND RESERVES

### (MIND MAP)



## **LEARNING OUTCOME:**

After studying this chapter, you will be able to:

- Students will understand the need for providing depreciation.
- Learn about the various methods that will help in calculating depreciation.
- Learn the accounting treatment of providing depreciation directly to asset Account or by preparing provision for depreciation Account.
- Appreciate the methods of asset disposal.
- The need for creating reserves and provisions.

### **Meaning of depreciation:**

Fixed assets are subject to decline in value and this decline is technically referred to as depreciation. In other words, depreciation may be described as a permanent, continuing and gradual shrinkage in the book value of fixed assets.

### **Features of Depreciation:**

1. It is decline in the book value of fixed assets.
2. It includes loss of value due to effluxion of time, usage or obsolescence.
3. It is a continuing process.
4. It is an expired cost and hence must be deducted before calculating taxable profits.
5. It is a non-cash expense. It does not involve any cash outflow.

**Depletion:** The term depletion is used in the context of extraction of natural resources like mines, quarries, etc. that reduces the availability of the quantity of the material or asset.

**Amortisation:** Amortisation refers to writing-off the cost of intangible assets like patents, copyright, trademarks, franchises, goodwill which have utility for a specified period of time.

### **Causes of Depreciation:**

1. Wear and Tear due to Use or Passage of Time
2. Expiration of Legal Rights
3. Obsolescence
4. Abnormal factors such as accidents due to fire, earthquake, floods, etc.

### **Need for Depreciation:**

1. Matching of Costs and Revenue.
2. Consideration of Tax.
3. True and Fair Financial Position.
4. Compliance with Law.

### **Factors Affecting the Amount of Depreciation:**

The determination of depreciation depends on three parameters, viz. cost, estimated useful life & Probable salvage value.

- (a) Cost of Asset.
- (b) Estimated Net Residual Value.
- (c) Depreciable Cost.
- (d) Estimated Useful Life.

### Methods of Calculating Depreciation Amount:

1. **Straight Line Method-** It is also called fixed instalment method because the amount of depreciation remains constant from year to year over the useful life of the asset. According to this method, a fixed and an equal amount is charged as depreciation in every accounting period during the life time of an asset.

$$\text{Depreciation} = \frac{\text{Cost of asset} - \text{Estimated net residential value}}{\text{Estimated useful life of the asset}}$$

$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation Amount}}{\text{Acquisition cost}} \times 100$$

### Advantages of Straight-Line Method:

Straight Line method has certain advantages which are stated below:

1. It is very simple, easy to understand and apply. Simplicity makes it a popular method in practice;
2. Asset can be depreciated up to the net scrap value or zero value.
3. Every year, same amount is charged as depreciation in profit and loss account. This makes comparison of profits for different years easy.
4. This method is suitable for those assets whose useful life can be estimated accurately and where the use of the asset is consistent from year to year.

### Limitations of Straight Line Method:

Although straight line method is simple and easy to apply it suffers from certain limitations which are given below:

- (a) This method is based on the faulty assumption of same amount of the utility of an asset in different accounting years;
- (b) With the passage of time, work efficiency of the asset decreases & repair and maintenance expense increases. Hence, under this method, the total amount charged against profit on account of depreciation and repair taken together, will not be uniform throughout the life of the asset, rather it will keep on increasing from year to year.

### 2. Written Down Value Method:

Under this method, depreciation is charged on the book value of the asset. Since book value keeps on reducing by the annual charge of depreciation, it is also known as 'Reducing Balance Method'.

For example, the original cost of the asset is ₹ 2,00,000 and depreciation is charged @ 10% p.a. at written down value, then the amount of depreciation will be computed as follows:

(i) **Depreciation (I year)** = ₹ 2,00,000 × 10/100 = ₹ 20,000

(ii) **Written down value** = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000 (at the end of the I year)

(iii) **Depreciation (II year)** = ₹ 1,80,000 × 10/100 = ₹ 18,000

(iv) **Written down value** = ₹ 1,80,000 – ₹ 18,000 = ₹ 1,62,000 (at the end of the II year)

(v) **Depreciation (III year)** = ₹ 1,62,000 × 10/100 = ₹ 16,200

(vi) **Written down value** = ₹ 1,62,000 – ₹ 16,200 = ₹ 1,45,800.

### Advantages of Written Down Value Method:

Written down value method has the following advantages:

- (a) This method is based on a more realistic assumption that the benefits from asset go on diminishing (reducing) with the passage of time.
- (b) It results into almost equal burden of depreciation and repair expenses taken together every year on profit and loss account.
- (c) Income Tax Act accepts this method for tax purposes.
- (d) As a large portion of cost is written-off in earlier years, loss due to obsolescence gets reduced.
- (e) This method is suitable for fixed assets which last for long and which require increased repair & maintenance expenses with passage of time.

### Limitations of Written Down Value Method:

Although this method is based upon a more realistic assumption it suffers from the following limitations:

- (a) As depreciation is calculated at fixed percentage of written down value, depreciable cost of the asset cannot be fully written-off. The value of the asset can never be zero;
- (b) It is difficult to ascertain a suitable rate of depreciation.

### Difference between the Straight line method and Written down value method.

Basis	Straight line method	Written down value method
1. Amount of Depreciation	Equal depreciation charged every year.	Depreciation goes on decreasing year after year.
2. Basis of calculation of depreciation.	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the reducing balance of the asset.
3. Zero levels.	The book value of the asset can be reduced to zero.	The book value of the asset can never be reduced to zero.
4. Approval of Income tax authorities.	This method is not approved by income tax authorities.	This method is approved by income tax authorities.

### Methods of Recording Depreciation:

In the books of account, there are two types of arrangements for recording depreciation on fixed assets:

- Charging depreciation to asset account or
- Creating Provision for depreciation/Accumulated depreciation account.

#### Charging Depreciation to Asset account:

#### ➤ Straight Line Method:-

Depreciation is charged at a fixed percentage on the original cost of the asset. The amount of depreciation remains equal from year to year and as such the method is also known as the 'Equal instalment method'.

#### (Accounting treatment)

Following entries are passed in this method:-

#### 1. Entry for Purchase of Asset:-

Asset A/c  
To Bank A/c

**2. Entry for providing Depreciation at the end of each year:-**

Depreciation A/c  
To Asset A/c

**3. Entry for the amount realized on the Sale of Asset:-**

Bank A/c  
To Asset A/c

**4. Entry in case of Loss on Sale of Asset:-**

Profit /loss A/c  
To Asset A/c

**5. Entry in case of Profit on the Sale of Asset:-**

Asset A/c  
To Profit and Loss A/c

**Let's practice with a question:-****Illustration 1.**

On 1<sup>st</sup> April 2019, Rama Glass Ltd. purchased a machine for ₹ 90,000 and spent ₹ 6,000 on its carriage and ₹ 4,000 on its erection. On the date of purchase, it was estimated that the effective life of the machine will be 10 years and after 10 years its scrap value will be ₹ 20,000.

Prepare Machine A/c and depreciation A/c for 4 years after providing depreciation on the fixed installment method. Accounts are closed on 31<sup>st</sup> March every year.

**Ans: Dr.****Machine A/c****Cr.**

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2019 Apr. 1	To Bank A/c	90,000	2020 Mar. 31	By Depreciation A/c (8% on ₹ 1,00,000)	8,000
Apr. 1	To Bank A/c (Expenses)	6,000	Mar. 31	By balance c/d	92,000
Apr. 1	To Bank A/c (Expenses)	4,000			<u>1,00,000</u>
		<u>1,00,000</u>			
2020 Apr. 1	To balance b/d	92,000	2021 Mar. 31	By Depreciation A/c (8% on ₹ 1,00,000)	8,000
			Mar. 31	By balance c/d	84,000
		<u>92,000</u>			<u>92,000</u>
2021 Apr. 1	To balance b/d	84,000	2022 Mar. 31	By Depreciation A/c (8% on ₹ 1,00,000)	8,000
			Mar. 31	By balance c/d	76,000
		<u>84,000</u>			<u>84,000</u>
2022 Apr. 1	To balance b/d	76,000	2023 Mar. 31	By Depreciation A/c (8% on ₹ 1,00,000)	8,000
			Mar. 31	By balance c/d	68,000
		<u>76,000</u>			<u>76,000</u>
2023, Apr. 1	To balance b/d	68,000			

**Dr.****Depreciation A/c****Cr.**

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
2019 Apr. 1	To Bank A/c	8,000	2020, Mar. 31	By depreciation A/c (10% on ₹ 10,000)	1,000
Apr. 1	To Bank A/c (Expenses)	2,000	Mar. 31	By balance c/d	9,000
		<u>10,000</u>			<u>10,000</u>

2020, Apr. 1	To balance b/d	9,000	2021, Mar. 31	By Depreciation A/c (10% on ₹ 9,000)	900
			Mar. 31	By balance c/d	8,100
		<b>9,000</b>			<b>9,000</b>
2021, Apr. 1	To balance b/d	8,100	2022, Mar. 31	By Depreciation A/c (10% on ₹ 8,100)	810
			Mar. 31	By balance c/d	7,290
		<b>8,100</b>			<b>8,100</b>
2022, Apr. 1	To balance b/d	7,290	2023, Mar. 31	By Depreciation A/c (10% on ₹ 7,290)	729
			Mar. 31	By balance c/d	6,561
		<b>7,290</b>			<b>7,290</b>
2023, Apr. 1	To balance b/d	<b>6,561</b>			

### Working note:-

As the rate of depreciation is not given in the question, the amount of the annual depreciation will be arrived at as under:

$$\text{Annual Depreciation} = \frac{\text{Cost of the asset} \times \text{Estimated net residual value}}{\text{No. of years of expected life}} = \frac{1,00,000 - 20,000}{10} = ₹ 8,000$$

$$\text{Rate of depreciation} = \frac{\text{Amount of Depreciation}}{\text{Total Cost of Asset}} \times 100 = \frac{8,000}{1,00,000} \times 100 = 8\% \text{ p.a.}$$

### ➤ Written Down Value Method:

Under this method, the value of assets goes on diminishing year after year; the amount of depreciation charged every year also goes on declining.

For example, if a machine is purchased for ₹ 20,000 and depreciation is to be charged at 10% p.a. according to written down value method the depreciation will be charged as:

- **1st year**  
10% of ₹ 20,000 = ₹ 2,000
- **2nd year**  
₹ 20,000 - ₹ 2,000 = ₹ 18,000  
10% of ₹ 18,000 = ₹ 1,800
- **3rd year**  
₹ 18,000 - ₹ 1,800 = ₹ 16,200  
10% of ₹ 16,200 = ₹ 1,620  
And so on...

### Let's practice with a question:-

#### Illustration 2.

Tesla traders purchased a machine on April 1, 2019, at a cost of ₹ 8,000 and spent ₹ 2,000 on its installation. The firm writes off depreciation @10% p.a. by a written down value method. The scrap value of the plant at the end of its economic life of 4 years is expected to be ₹ 6,561.

Show the machine account for 4 years in the books of Tesla traders. The books are closed on 31<sup>st</sup> March, every year.

Ans: Dr.

**Machine A/c**

Cr.

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
1/4/19	To Bank A/c	8,000	31/3/20	By Depreciation A/c (10% on ₹ 10,000)	1,000
	To Bank A/c (Expenses)	2,000	31/3/20	By Balance c/d	9,000
		<b>10,000</b>			<b>10,000</b>
1/4/20	To Balance b/d	9,000	31/3/21	By Depreciation A/c (10% on ₹ 9,000)	900
			31/3/21	By Balance c/d	8,100
		<b>9,000</b>			<b>9,000</b>
1/4/21	To Balance b/d	8,100	31/3/22	By Depreciation A/c (10% on ₹ 8,100)	810
			31/3/22	By Balance c/d	7,290
		<b>8,100</b>			<b>8,100</b>
1/4/22	To Balance b/d	7,290	31/3/23	By Depreciation A/c (10% on ₹ 7,290)	729
			31/3/23	By Balance c/d	6,561
		<b>7,290</b>			<b>7,290</b>
1/4/23	To Balance b/d	<b>6,561</b>			

**Illustration 3.**

M/s Samarth Enterprises acquired a printing machine for ₹ 40,000 on July 01, 2019 and spent ₹ 5,000 on its transport and installation. Another machine for ₹ 35,000 was purchased on January 01, 2021. Depreciation is charged at the rate of 20% on written down value. Prepare Printing Machine account.

**Solution:**

**Books of Samarth Enterprises**

Dr.

**Printing Machine Account**

Cr.

Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Amt. (₹)
2019, Jul. 01	To Bank A/c		40,000	Mar. 31	By Depreciation A/c		6,750 <sup>1</sup>
	To Bank A/c		5,000	2020	By Balance c/d		38,250
			<b>45,000</b>				<b>45,000</b>
2020, Apr.01	To Balance b/d		38,250	Mar. 31	By Depreciation A/c		9,400 <sup>2</sup>
2021, Jan.01	To Bank A/c		35,000	2021	Balance c/d		63,850
			<b>73,250</b>				<b>73,250</b>
2021, Apr. 01	To Balance b/d		63,850	Mar.31	By Depreciation A/c		12,770 <sup>3</sup>
				2022	By Balance c/d		51,080
			<b>63,850</b>				<b>63,850</b>
2022, Apr. 01	To Balance b/d		51,080				

**Working Notes:**

	(₹)
Original cost Machine purchased on July 01, 2019	45,000
(-) Depreciation till Mar. 31, 2020 (for 9 months @ 20%)	(6,750) <sup>1</sup>
	38,250
+ Cost of new machine purchased on Jan. 01, 2021	35,000
	73,250
(-) Depreciation for the year 2020-2021	
(20% of ₹ 38,250 + 20% of ₹ 35,000 for 3 month)	(9,400) <sup>2</sup>
<b>WDV on Mar. 31, 2021</b>	<b>63,850</b>

(–) Depreciation for the year 2021-22 (20% of ₹ 63,850)

(12,770)<sup>3</sup>

**WDV on Mar. 31, 2022**

**51,080**

### Methods of recording depreciation:-

- **First Method: - By charging to an asset account.**
- **Second Method: - By creating provision for depreciation accounts.**

**Let's practice with a question:-**

### Illustration 4.

Bhulal Ltd. Purchased on April 1, 2019, a Second-hand Plant for ₹ 4, 00,000 and immediately spent ₹ 80,000 for its overhauling and ₹ 20,000 for its instalment. On 1<sup>st</sup> Oct, 2022 the Plant became obsolete and was sold for ₹ 2, 00,000. Depreciation is provided at 10% p.a. on the original cost method. Accounts are closed each year on 31<sup>st</sup> March.

**Show necessary ledger accounts assuming that:-**

**1. Provision for depreciation account is not maintained, and**

**2. Provision for depreciation account is maintained.**

**Ans: 1. When provision for depreciation account is not maintained:-**

Dr.			Plant A/c			Cr.	
Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)		
2019 April 1	To Bank A/c	4,00,000	2020 Mar. 31	By Depreciation A/c	50,000		
	To Bank A/c (expense)	1,00,000	Mar. 31	By Balance c/d	4,50,000		
		<b><u>5,00,000</u></b>			<b><u>5,00,000</u></b>		
2020 April 1	To Balance b/d	4,50,000	2021 Mar. 31	By Depreciation A/c	50,000		
			Mar. 31	By Balance c/d	4,00,000		
		<b><u>4,50,000</u></b>			<b><u>4,50,000</u></b>		
2021 April 1	To Balance b/d	4,00,000	2022 Mar. 31	By Depreciation A/c	50,000		
			Mar. 31	By Balance c/d	3,50,000		
		<b><u>4,00,000</u></b>			<b><u>4,00,000</u></b>		
2022 April 1	To Balance b/d	3,50,000	2022 Oct. 1	By Bank A/c	2,00,000		
			Oct. 1	By Depreciation A/c (6 m)	25,000		
			Oct. 1	By Statement of P/L (B.F.)	1,25,000		
		<b><u>3,50,000</u></b>			<b><u>3,50,000</u></b>		

**2. Provision for depreciation account is maintained.**

Dr.			Plant A/c		Cr.	
Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)	
1/04/19	To Bank A/c	4,00,000	31/3/20	By Balance c/d	5,00,000	
1/04/19	To Bank A/c (Expenses)	1,00,000				
		<b><u>5,00,000</u></b>			<b><u>5,00,000</u></b>	
1/04/20	To Balance b/d	5,00,000	31/3/21	By Balance c/d	5,00,000	
1/04/21	To Balance b/d	5,00,000	31/3/22	By Balance c/d	5,00,000	
		<b><u>5,00,000</u></b>			<b><u>5,00,000</u></b>	

1/04/22	To Balance b/d	5,00,000	1/10/22	By Bank A/c	2,00,000
				By Provision for dep.	1,75,000
				By Statement of P/L	1,25,000
		<u>5,00,000</u>			<u>5,00,000</u>

Dr.			Cr.		
Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
31/3/2020	To Balance c/d	<u>50,000</u>	31/3/2020	By Depreciation A/c	<u>50,000</u>
31/3/2021	To Balance c/d	1,00,000	01/4/2020	By Balance b/d	50,000
		<u>1,00,000</u>	31/3/2021	By Depreciation A/c	50,000
31/3/2022	To Balance c/d	1,50,000			<u>1,00,000</u>
		<u>1,50,000</u>	01/4/2021	By Balance b/d	1,00,000
1/10/2022	To Plant A/c	1,75,000	31/3/2022	By Depreciation A/c	50,000
	(Transfer to Plant A/c)				<u>1,50,000</u>
		<u>1,75,000</u>	01/4/2022	By Balance b/d	1,50,000
			1/10/2022	By Depreciation A/c	25,000
					<u>1,75,000</u>

### Disposal of Asset

Disposal of asset can take place either (a) at the end of its useful life or (b) during its useful life (due to obsolescence or any other abnormal factor). If it is sold at the end of its useful life, the amount realised on account of the sale of asset as scrap should be credited to the asset account and the balance is transferred to profit and loss account. In this regard the following journal entries are recorded.

#### 1. For sale of asset as scrap:

Bank A/c Dr.  
To Asset A/c

#### 2. For transfer of balance in asset account:

##### (a) In case of profit

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

##### (b) In case of loss:

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

In case, however, the provision for depreciation account has been in use for recording the depreciation, then before passing the above entries transfer the balance of the provision for depreciation account to the asset account by recording the following journal entry:

Provision for depreciation A/c Dr.  
To Asset A/c

**Illustration 5:** Surya Ltd. purchased a vehicle for ₹ 4, 00,000. After 4 years its salvage value is estimated at ₹ 40,000. To find out the amount of depreciation to be charged every year based on straight line basis, and show as to how the vehicle account would appear for four years assuming it is sold for ₹ 50,000 at the end when

(a) depreciation is charged to asset account; and

(b) provision for depreciation account is maintained.

Consider the following entries in the book of account of Surya Ltd.

(a) When depreciation is charged to assets account

**Solution:**

**Books of Surya Ltd.**

Dr.				Cr.			
Vehicle A/c							
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
I year	To Bank A/c		4,00,000	End of the year	By Depreciation A/c		90,000
			<b>4,00,000</b>		By Balance c/d		3,10,000
II year	To Balance b/d		3,10,000	End of the year	By Depreciation A/c		90,000
			<b>3,10,000</b>		By Balance c/d		2,20,000
III year	To Balance b/d		2,20,000	End of the year	By Depreciation A/c		90,000
			<b>2,20,000</b>		By Balance c/d		1,30,000
IV year	To Balance b/d To P&L (Profit on sale of vehicle)		1,30,000	End of the year	By Depreciation A/c By Bank A/c		90,000
			10,000				50,000
			<b>1,40,000</b>				<b>1,40,000</b>

(b) When Provision of Depreciation A/c is maintained

**Books of Surya Ltd.**

Dr.				Cr.			
Vehicle A/c							
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
I year	To Bank A/c		4,00,000	End of the year	By Balance c/d		4,00,000
			<b>4,00,000</b>				<b>4,00,000</b>
II year	To Balance b/d		4,00,000	End of the year	By Balance c/d		4,00,000
			<b>4,00,000</b>				<b>4,00,000</b>
III year	To Balance b/d		4,00,000	End of the year	By Balance c/d		4,00,000
			<b>4,00,000</b>				<b>4,00,000</b>
IV year	To Balance b/d To P&L (Profit on Sale of Vehicle)		4,00,000	End of the year	By Provision for Dep. By Bank		3,60,000
			10,000				50,000
			<b>4,10,000</b>				<b>4,10,000</b>

**Dr.**

**Provision for Depreciation A/c**

**Cr.**

Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
I year	To Balance b/d		90,000	End of the year	By Depreciation A/c		90,000
			<b>90,000</b>				<b>90,000</b>
II year	To Balance b/d		1,80,000	End of the year	By Balance b/d		90,000

				By Depreciation A/c	90,000
		<b><u>1,80,000</u></b>			<b><u>1,80,000</u></b>
III year	To Balance b/d	2,70,000	End of the year	By Balance c/d	1,80,000
				By Depreciation A/c	90,000
		<b><u>2,70,000</u></b>			<b><u>2,70,000</u></b>
IV year	To Machinery	3,60,000	End of the year	By Balance c/d	2,70,000
				By Provision for Dep. A/c	90,000
		<b><u>3,60,000</u></b>			<b><u>3,60,000</u></b>

### Use of Asset Disposal Account:

Asset disposal account is designed to provide a complete and clear view of all the transactions involved in the sale of an asset under one account head. The concerned variables are the original cost of the asset, depreciation accumulated on the asset upto date, sale price of the asset, value of the parts of the asset retained for use, if any and the resultant profit or loss on disposal. The balance of this amount is transferred to the profit and loss account. This method is generally used when a part of the asset is sold and provision for depreciation account exists.

Under this method, a new account titled *Asset Disposal Account* is opened. The original cost of the asset being sold is debited to the asset disposal account and accumulated depreciation amount appearing in provision for depreciation account relating to that asset till the date of disposal is credited to the asset disposal account. The net amount realised from the sale of the asset is also credited to this account. The balance of asset disposal account shows profit or loss which is transferred to profit and loss account.

The advantage of this method is that it gives a full picture of all the transactions related to asset disposal at one place.

The journal entries required for the preparation of asset disposal account is as follows:

1. Asset Disposal A/c Dr. (with the original cost of asset, being sold)  
To Asset A/c
2. Provision for Depreciation A/c Dr. (with the accumulated balance in provision for depreciation A/c)  
To Asset Disposal A/c
3. Bank A/c Dr. (with the net sales proceeds)  
To Asset Disposal A/c

Asset Disposal Account may ultimately show a debit or credit balance. The debit balance on the account indicate loss on disposal and would be dealt with as follows:

Profit and Loss A/c Dr. (with the amount of loss on sale)  
To Asset Disposal A/c

The credit balance of the account, profit on disposal & would be closed by the following journal entry:

Asset Disposal A/c Dr. (with the amount of profit on sale)  
To Profit and Loss A/c

**Illustration 6:** Kartik Enterprises has the following balances in its books as on 31<sup>st</sup> March, 2022

Machinery (*gross value*): ₹ 6, 00,000

Provision for depreciation: ₹ 2, 50,000

A machine purchased for ₹ 1, 00,000 on 01<sup>st</sup> Nov, 2018, having accumulated depreciation amounting to ₹ 60,000 was sold on 01<sup>st</sup> April, 2022 for ₹ 35,000. The Asset Disposal account will be prepared in the following manner:

**Books of Kartik Enterprises**

Dr.				Machinery Disposal A/c		Cr.	
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
2022 Apr. 01	To MachineryA/c		1,00,000	2022,Apr1	By Provision for Dep. A/c By Bank A/c By P&L (Loss on sale)		60,000
							35,000
							5,000 <sup>1</sup>
			1,00,000				1,00,000

Dr.				Machinery A/c		Cr.	
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
2022 April 01	To Balance b/d		6,00,000	2022 Apr. 01	By Machine Disposal		1,00,000
				2023 Mar. 31	By Balance c/d		5,00,000
			6,00,000				6,00,000

**Working Notes:**

(1) Computation of loss on sale of machinery	<b>Amt. (₹)</b>
Original cost of the asset being sold	1,00,000
Less: accumulated depreciation	<u>(60,000)</u>
	40,000
(2) Sales value realised	<u>(35,000)</u>
<b>Loss on sale (i.e. ₹ 40,000 – ₹ 35,000)</b>	<b><u>5,000<sup>1</sup></u></b>

**Illustration 7:**

On 01<sup>st</sup> Jan, 2020 Kohli Transport Co. purchased five trucks for ₹ 20,000 each. Depreciation has been provided at the rate of 10% p.a. using straight line method and accumulated in provision for depreciation account. On 01<sup>st</sup> Jan, 2021, one truck was sold for ₹ 15,000. On 1<sup>st</sup> July, 2022, another truck (purchased for ₹ 20,000 on Jan, 01, 2019) was sold for ₹ 18,000. A new truck costing ₹ 30,000 was purchased on 01<sup>st</sup> Oct., 2021.

You are required to prepare Trucks A/c, Provision for depreciation A/c & Truck disposal A/c for the years ended on Dec. 2020, 2021 and 2022 assuming that the firm closes its accounts in Dec. every year.

**Solution:**

**Book of Kohli Transport Co.**

Dr.				Trucks A/c				Cr.			
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)				
1/1/20	To Bank A/c (Truck Purc.)		1,00,000	31/12/20	By Balance c/d		1,00,000				
			<u>1,00,000</u>				<u>1,00,000</u>				
1/1/21	To Balance b/d		1,00,000	1/1/21	By Truck disposal A/c		20,000				
				31/12/21	By Balance c/d		80,000				
			<u>1,00,000</u>				<u>1,00,000</u>				

1/1/22	To Balance b/d		80,000	1/7/22	By Truck disposal A/c		20,000
1/1/22	To Bank A/c( <i>Purchase of new truck</i> )		30,000	31/12/22	By Balance c/d		90,000
			<b>1,10,000</b>				<b>1,10,000</b>

Dr. Truck Disposal A/c				Cr.			
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
1/1/21	To Machinery A/c		20,000	1/1/21	By Provision for Dep. A/c		2,000
					By Bank A/c ( <i>Sale</i> )		15,000
					By P&LA/c ( <i>Loss on sale</i> )		3,000 <sup>4</sup>
			<b>20,000</b>				<b>20,000</b>
1/7/22	To Machinery A/c		20,000	1/7/22	By Provision for Dep. A/c		5,000
	To P&L A/c ( <i>Profit on sale</i> ) <sup>5</sup>		3,000		(₹ 2,000+ ₹ 2,000+ ₹ 1,000)		
					By Bank A/c ( <i>Sale</i> )		18,000
			<b>23,000</b>				<b>23,000</b>

Dr. Provision for Depreciation A/c				Cr.			
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
31/12/20	To Balance c/d		10,000	31/3/20	By Depreciation A/c		10,000 <sup>1</sup>
			<b>10,000</b>				<b>10,000</b>
01/1/21	To Truck Disposal A/c		2,000	1/1/21	By Balance b/d		10,000
31/12/21	To Balance c/d		16,000	31/12/21	By Depreciation A/c		8,000 <sup>2</sup>
			<b>18,000</b>				<b>18,000</b>
1/1/22	To Truck Disposal A/c		5,000	1/1/22	By Balance b/d		16,000
31/12/22	To Balance c/d		18,750	31/12/22	By Depreciation A/c		7,750 <sup>3</sup>
			<b>23,750</b>		(₹ 6000+ ₹ 1000+ ₹ 750)		
							<b>23,750</b>

#### Working Notes:

- Calculation of amount of depreciation**

Year - 2020	Amt. (₹)
10% on ₹ 1,00,000 for one year	10,000 <sup>1</sup>
Year - 2021	
10% on ₹ 80,000 for one year	8000 <sup>2</sup>
Year - 2022	
10% on ₹ 60,000 for 1 year	6,000
10% on ₹ 20,000 for six months	1,000
10% on ₹ 30,000 for three months	750
	<b>7,750<sup>3</sup></b>
- Loss on sale of first truck**

Original cost on January 01, 2020	20,000
Less: Depreciation at 10%	(2,000)
Book value on January 1, 2021	18,000
Sales price realised on 01.01.2021	(15,000)
Loss on sale of first machine	<b>3,000*</b>
- Profit on sale of second truck**

Original Cost of second truck	Amt. (₹)
(Less) depreciation charged	20,000
2020	2,000
2021	2,000

2022 (upto June, 2021)	<u>1,000</u>	<u>5,000</u>
Book value of second truck		15,000
Sale price of second truck		<u>18,000</u>
<b>Profit on sale</b>		<b><u>3,000</u></b>

#### Illustration 8:

On 01<sup>st</sup> Jan, 2019 Chawla & Sons purchased a second hand plant costing ₹ 2, 00,000 & spent ₹ 10,000 on its overhauling. It also spent ₹ 5,000 on transportation & installation of the plant. It was decided to provide for depreciation @ 20% on written down value. The plant was destroyed by fire on 31<sup>st</sup> July, 2022 & an insurance claim of ₹ 50,000 was admitted by the insurance company.

Prepare plant account, accumulated depreciation A/c & Plant disposal A/c assuming that the company closes its books on 31<sup>st</sup> Dec, every year.

#### Solution:

#### Books of Chawla & Sons.

Dr.				Cr.			
Plant A/c							
Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
1/1/19	To Bank A/c		2,15,000	31/12/19	By Balance c/d		2,15,000
			<b>2,15,000</b>				<b>2,15,000</b>
1/1/20	To Balance b/d		2,15,000	31/12/20	By Balance c/d		2,15,000
			<b>2,15,000</b>				<b>2,15,000</b>
1/1/21	To Balance b/d		2,15,000	31/12/21	By Balance c/d		2,15,000
			<b>2,15,000</b>				<b>2,15,000</b>
1/1/22	To Balance b/d		2,15,000	31/12/22	By Plant Disposal A/c		2,15,000
			<b>2,15,000</b>				<b>2,15,000</b>

#### Dr.

#### Accumulated Depreciation A/c

#### Cr.

Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
31/12/19	To Balance c/d		43,000	31/12/19	By Depreciation A/c		43,000 <sup>1</sup>
			<b>43,000</b>				<b>43,000</b>
31/12/20	To Balance c/d		77,400	1/1/20	By Balance b/d		43,000
			<b>77,400</b>	31/12/20	By Depreciation A/c		34,400 <sup>2</sup>
31/12/21	To Balance c/d		1,04,920				<b>77,400</b>
			<b>1,04,920</b>	1/1/21	By Balance b/d		77,400
31/7/22	To Plant Disposal A/c		1,17,763	31/12/21	By Depreciation A/c		27,520 <sup>3</sup>
			<b>1,17,763</b>				<b>1,04,920</b>
				1/1/22	By Balance b/d		1,04,920
				31/7/22	By Depreciation A/c		12,843 <sup>4</sup>
							<b>1,17,763</b>

#### Dr.

#### Plant Disposal A/c

#### Cr.

Date	Particulars	L.F	Amt. (₹)	Date	Particulars	L.F	Amt. (₹)
31/7/22	To Plant A/c		2,15,000	31/7/22	By Accumulated Dep. A/c		1,17,763
					By Insurance Co.		50,000
					By P&L A/c (Loss on sale)		47,237 <sup>5</sup>
			<b>2,15,000</b>				<b>2,15,000</b>

**Working Notes:**

1. <i>Calculation of Depreciation</i>	Amt. (₹)
Original cost on 01/01/2019	2, 15,000
(₹ 2, 00,000 + ₹ 10,000 + ₹ 5,000)	
Depreciation for the year 2019 (@ 20% of ₹ 2, 15,000)	(43,000)
	<b>1, 72,000</b>
Depreciation for the year 2020(@ 20% of ₹ 1,72,000)	(34,400 <sup>2</sup> )
	1,37,600
Depreciation for the year 2021 (@ 20% of ₹ 1,37,600)	27,520 <sup>3</sup>
	1,10,080
Depreciation till 31.07.22 (@ 20% of ₹ 1,10,080)	(12,843 <sup>4</sup> )
	97,237
Insurance claim	(50,000)
<b>Loss on disposal</b>	<b><u>47,237<sup>5</sup></u></b>

## SECTION – II

### Provisions and Reserve

**Provision:** - Provision can be described as an amount kept aside to cover a known expense/liability in the future. This is the fund that is to be put aside by a company/organisation to cover the anticipated losses in the future.

Examples of provisions are:

- Provision for depreciation;
- Provision for bad and doubtful debts;
- Provision for taxation;
- Provision for discount on debtors; and
- Provision for repairs and renewals.

It must be noted that the amount of provision for expense and loss is a charge against the revenue of the current period. Creation of provision ensures proper matching of revenue and expenses and hence the calculation of true profits. Provisions are created by debiting the profit and loss account.

In the balance sheet, the amount of provision may be shown either:

- By way of deduction from the concerned asset on the assets side.

For example, provision for doubtful debts is shown as deduction from the amount of sundry debtors and provision for depreciation as a deduction from the concerned fixed assets;

- On the liabilities side of the balance sheet along with current liabilities. For example provision for taxes and provision for repairs and renewals.

#### ***Accounting Treatment for Provisions***

The accounting treatment of all types of provisions is almost similar. Therefore, the accounting treatment is explained here taking up the case of provision for doubtful debts. As already stated that when business transaction takes place on credit basis, debtors account is created and its balance is shown on the asset-side of the balance sheet.

These debtors may be of three types:

- *Good Debtors* are those from where collection of debt is certain.

- *Bad Debts* are those debtors from where collection of money is not possible and the amount of credit given is a certain loss.
- *Doubtful Debts* are those debtors who may pay but business firm is not sure about the collection of full amount from them.

For creating a provision for doubtful debts the following journal entry is recorded:

Profit and Loss A/c Dr. (with the amount of provision)

To Provision for doubtful debts A/c

This is explained with the help of the following example

Observe an extract of the trial balance from the books of Somnath Traders on March 31, 2023 is given below:

Date	Account title	L.F.	Dr. (₹)	Cr. (₹)
	Sundry Debtors		68,000	

#### Additional Information:

- Bad debts proved bad but not recorded amounted to ₹ 8,000
- Provision is to be maintained at 10% of debtors.

In order to create the provision for doubtful debts, the following journal entries will be recorded:

#### Journal

Date	Account title	L.F.	Dr. (₹)	Cr. (₹)
31/3/2023	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		8,000	8,000
31/3/2023	Profit & Loss A/c Dr. To Bad debts A/c (Bad debts debited to Profit and loss account)		8,000	8,000
31/3/2023	Profit and Loss A/c Dr. To Provision for doubtful debts A/c (For creating provision for doubtful debts)		6,000	6,000

#### Working Notes:

Provision for doubtful debts @10% of Sundry debtor's i.e.

$$₹ 68,000 - ₹ 8,000 = ₹ 60,000$$

$$₹ 60,000 \times \frac{10}{100} = ₹ 6,000$$

#### Reserves:

A part of the profit may be set aside and retained in the business to provide for certain future needs like growth and expansion or to meet future contingencies such as workmen compensation. Unlike provisions, reserves are the appropriations of profit to strengthen the financial position of the business. Reserve is not a charge against profit as it is not meant to cover any known liability or expected loss in future. However, retention of profits in the form of reserves reduces the amount of profits available for distribution among the owners of the business. It is shown under the head Reserves and Surpluses on the liabilities side of the balance sheet after capital.

Examples of reserves are:

- General reserve;
- Investment fluctuation fund;
- Dividend equalisation reserve;
- Workmen compensation fund;
- Capital reserve;
- Reserve for redemption of debenture.

#### Difference between Provision and Reserve

Basis	Provision	Reserve
<b>1. Meaning</b>	Provisions are created to meet a known liability.	Reserves are created to meet an unknown liability in future.
<b>2. Object</b>	The objective of creating provisions is to provide for depreciation and other specific liabilities.	The objective of creating reserves is to strengthen the financial position of the business.
<b>3. Mode of creation</b>	They are created even if there is insufficient profit.	They are created out of adequate profit only.
<b>4. Investment outside</b>	Provision cannot be invested outside the business.	Reserves can be invested outside the business.

#### Types of Reserves:

A reserve is created by retention of profit of the business can be for either a general or a specific purpose.

**1. General reserve:** When the purpose for which reserve is created is not specified, it is called *General Reserve*. It is also termed as free reserve because the management can freely utilise it for any purpose. General reserve strengthens the financial position of the business.

**2. Specific reserve:** Specific reserve is the reserve, which is created for some specific purpose and can be utilised only for that purpose. Examples of specific reserves are given below:

**(i) Dividend equalisation reserve:** This reserve is created to stabilise or maintain dividend rate. In the year of high profit, amount is transferred to Dividend Equalisation reserve. In the year of low profit, this reserve amount is used to maintain the rate of dividend.

**(ii) Workmen compensation fund:** It is created to provide for claims of the workers due to accident, etc.

**(iii) Investment fluctuation fund:** It is created to make for decline in the value of investment due to market fluctuations.

**(iv) Debenture redemption reserve:** It is created to provide funds for redemption of debentures. Reserves are also classified as revenue and capital reserves according to the nature of the profit out of which they are created.

**(a) Revenue reserves:** Revenue reserves are created from revenue profits which arise out of the normal operating activities of the business and are otherwise freely available for distribution as dividend. Examples of revenue reserves are:

- General reserve;
- Investment fluctuation fund;
- Debenture redemption reserve;
- Workmen compensation fund;
- Dividend equalisation reserve;

**(b) Capital reserves:** Capital reserves are created out of capital profits which do not arise from the normal operating activities. Such reserves are not available for distribution as dividend. These reserves can be used for writing off capital losses or issue of bonus shares in case of a company. Examples of capital profits, which are treated as capital reserves, whether transferred as such or not, are:

- Premium on issue of shares or debenture.
- Profit on redemption of debentures.
- Profits prior to incorporation.
- Profit on sale of fixed assets.
- Profit on revaluation of fixed asset & liabilities.
- Profit on reissue of forfeited shares

#### **Difference between Revenue Reserve & Capital Reserve**

<b>Basis</b>	<b>Revenue Reserve</b>	<b>Capital Reserve</b>
<b>1. Source of creation</b>	It is created out of revenue profits which arise out of normal operating activities of the business and are otherwise available for dividend distribution.	It is created primarily out of capital profit which do not arise out of the normal operating activities of the business and not available for dividend distribution. But revenue profits may also be used for this purpose.
<b>2. Purpose</b>	It is created to strengthen the financial position, to meet unforeseen contingencies or for some specific purposes.	It is created for compliance of legal requirements or accounting practices.
<b>3. Usage</b>	A specific revenue reserve can be utilised only for the earmarked purpose while a general reserve can be utilised for any purpose including distribution of dividend.	It can be utilised for specific purposes as provided in the law in force e.g., to write off capital losses or issue of bonus shares.

#### **Importance of Reserves:**

A business firm may consider it proper to set up some mechanism to protect itself from the consequences of unknown expenses and losses, it may be required to bear in future. It may also regard it as more appropriate in certain cases to reduce the amount that can be drawn by the proprietors as profit in order to conserve business resource to meet certain significant demands in future. An example of such a demand is the much needed expansion in the scale of business operations. This is presented as the justification for reserves in business activities and in accounting. The amount so set aside may be meant for the purpose of:

- Meeting a future contingency
- Strengthening the general financial position of the business;
- Redeeming a long-term liability like debentures, etc.

#### **Secret Reserve:**

Secret reserve is a reserve which does not appear in the balance sheet. It may also help to reduce the disclosed profits and also the tax liability. The secret reserve can be merged with the profits during the lean periods to show improved profits. Management may resort to creation of secret reserve by charging higher depreciation than required. It is termed as 'Secret Reserve', as it is not known to outside stakeholders. Secret reserve can also be created by way of:

- Undervaluation of inventories/stock
- Charging capital expenditure to profit and loss account

- Making excessive provision for doubtful debts
- Showing contingent liabilities as actual liabilities

Creation of secret reserves within reasonable limits is justifiable on grounds of expediency, prudence and preventing competition from other firms.

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Link of practice questions:

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### **PRACTICE QUESTIONS:**

1. What is 'Depreciation'?
2. State briefly the need for providing depreciation.
3. What are the causes of depreciation?
4. Explain basic factors affecting the amount of depreciation.
5. Distinguish between Straight line & Written down value method of calculating depreciation.
6. On 1<sup>st</sup> July, 2010, Asha Ltd. Purchased a Machine for ₹ 1, 08,000 and spent ₹ 12,000 on its installation. At the time of purchase it was estimated that the effective commercial life of the machine will be 12 years & after 12 years its salvage value will be ₹ 12,000.  
Prepare Machine A/c & Depreciation A/c in the books of Asha Ltd. For first three years, if depreciation is written off according to straight line method. The accounts are closed on 31<sup>st</sup> Dec, every year.

**(Ans: Balance of Machine account as on 1.01.2013 ₹ 97,500).**

7. Barela Ltd. Purchased a second hand machine for ₹ 56,000 on 1<sup>st</sup> July, 2019 & spent ₹ 24,000 on its repair and installation and ₹ 5,000 for its carriage. On 1<sup>st</sup> Sept, 2020, it purchased another machine for ₹ 2, 50,000 and spent ₹ 10,000 on its installation.

- (a) Depreciation is provided on machinery @10% p.a on original cost method annually on 31<sup>st</sup> Dec. Prepare Machinery A/c and Depreciation A/c from the year 2019 to 2022.
- (b) Prepare Machinery A/c and Depreciation A/c from the year 2019 to 2022, if depreciation is provided on machinery @10% p.a. on written down value method annually on 31<sup>st</sup> Dec.

(Ans: [a] **Balance of Machine account as on 1.01.23 ₹ 2, 54,583.**

[b] **Balance of Machine account as on 1.01.23 ₹ 2, 62,448.**

**8.** M/s Aroma Fabrics purchased a Textile Machine on 1<sup>st</sup> April, 2018 for ₹ 1, 00,000. On 1<sup>st</sup> July, 2019 another machine costing ₹ 2, 50,000 was purchased. The machine purchased on 1<sup>st</sup> April, 2018 was sold for ₹ 25,000 on 1<sup>st</sup> Oct, 2022. The company charges depreciation @15% p.a. on straight line method.

Prepare Machinery A/c and Machinery Disposal A/c for the year ended 31<sup>st</sup> March, 2023.

(Ans. **Loss on sale of Machine A/c ₹ 7,500.**)

**9.** The following balances appear in the books of Shiney Ltd, on 1<sup>st</sup> Jan, 2022

Machinery A/c on ₹ 15, 00,000

Provision for Depreciation A/c ₹ 5, 50,000

On 1<sup>st</sup> April, 2022 a machinery which was purchased on 1<sup>st</sup> Jan, 2019 for ₹ 2, 00,000 was sold for ₹ 75,000. A new machine was purchased on 1<sup>st</sup> July, 2022 for ₹ 6, 00,000. Depreciation is provided on machinery at 20% p.a. on Straight line method and books are closed on 31<sup>st</sup> Dec every year.

Prepare the Machinery A/c & Provision for depreciation A/c for the year ending 31<sup>st</sup> Dec, 2022.

(Ans. **Profit on sale of Machine ₹ 5,000.**

**Balance of Machine A/c t as on 31.12.19 ₹ 19, 00,000.**

**Balance of Provision for depreciation A/c as on 31.12.19 ₹ 4, 90,000).**

**10.** Agra Transport Company purchased 5 trucks at the cost of ₹ 2, 00,000 each on 1<sup>st</sup> April, 2020. The company writes off depreciation @ 20% p.a. on original cost and closes its books on 31<sup>st</sup> Dec, every year. On 1<sup>st</sup> Oct, 2022, one of the trucks is involved in an accident and is completely destroyed. Insurance company has agreed to pay ₹ 70,000 in full settlement of the claim.

On the same date the company purchased a second hand truck for ₹ 1, 00,000 and spent ₹ 20,000 on its overhauling.

Prepare Truck A/c and Provision for depreciation A/c for the three years ended on 31<sup>st</sup> Dec, 2022. Also give Truck A/c if Truck Disposal A/c is prepared.

(Ans: **Loss of settlement of Truck Insurance ₹ 30,000.**

**Balance of Provision for depreciation A/c as on 31.12.22 ₹ 4, 46,000.**

**Balance of Trucks A/c as on 31.12.22 ₹ 9, 20,000).**

**11.** On 1<sup>st</sup> Oct, 2020 Janmeja Transport Company purchased 2 Trucks for ₹ 10, 00,000 each. On 1<sup>st</sup> July, 2022, One Truck was involved in an accident and was completely destroyed & ₹ 6, 00,000 were received from the insurance company in full settlement.

On 31<sup>st</sup> Dec, 2022 another truck was involved in an accident & destroyed partially, which was not insured. It was sold off for ₹ 1, 50,000. On Jan 31, 2023 Company purchased a fresh truck for ₹ 12, 00,000. Depreciation is to be provided at 10% p.a. on the written down value every year.

The books are closed every year on 31<sup>st</sup> March.

Give the Truck A/c from 2020 to 2023.

(Ans: Loss on Ist Truck Insurance claim ₹ 3, 26,250.  
Loss on IInd Truck ₹ 7, 05,000.  
Balance of Truck A/c as on 31.03.23 ₹ 11, 80,000).

12. Shri Brij Manufacturing Company purchased 10 machines for ₹ 75,000 each on 1<sup>st</sup> July, 2019. On 1<sup>st</sup> Oct, 2021, one of the machines got destroyed by fire & an insurance claim of ₹ 45,000 was admitted by the company. On the same date another machine is purchased by the company for ₹ 1, 25,000. The company writes off 15% p.a. depreciation on written down value basis. The company maintains the calendar year as its financial year.

Prepare the Machinery A/c from 2019 to 2022.

(Ans: Loss on settle of Insurance claim ₹ 7,735.  
Balance of Machine A/c as on 31.12.22 ₹ 4, 85,709).

13. An extract of Trial balance from the books of Tayal and Sons Enterprises on 31<sup>st</sup> March, 2023 is given below:

Name of the Account	Debit Amt. (₹)	Credit Amt. (₹)
Sundry debtors.	50,000	
Bad debts	6,000	
Provision for doubtful debts		4,000

**Additional Information:**

- Bad Debts proved bad but not recorded amounted to ₹ 2,000.
- Provision is to be maintained at 8% of Debtors.

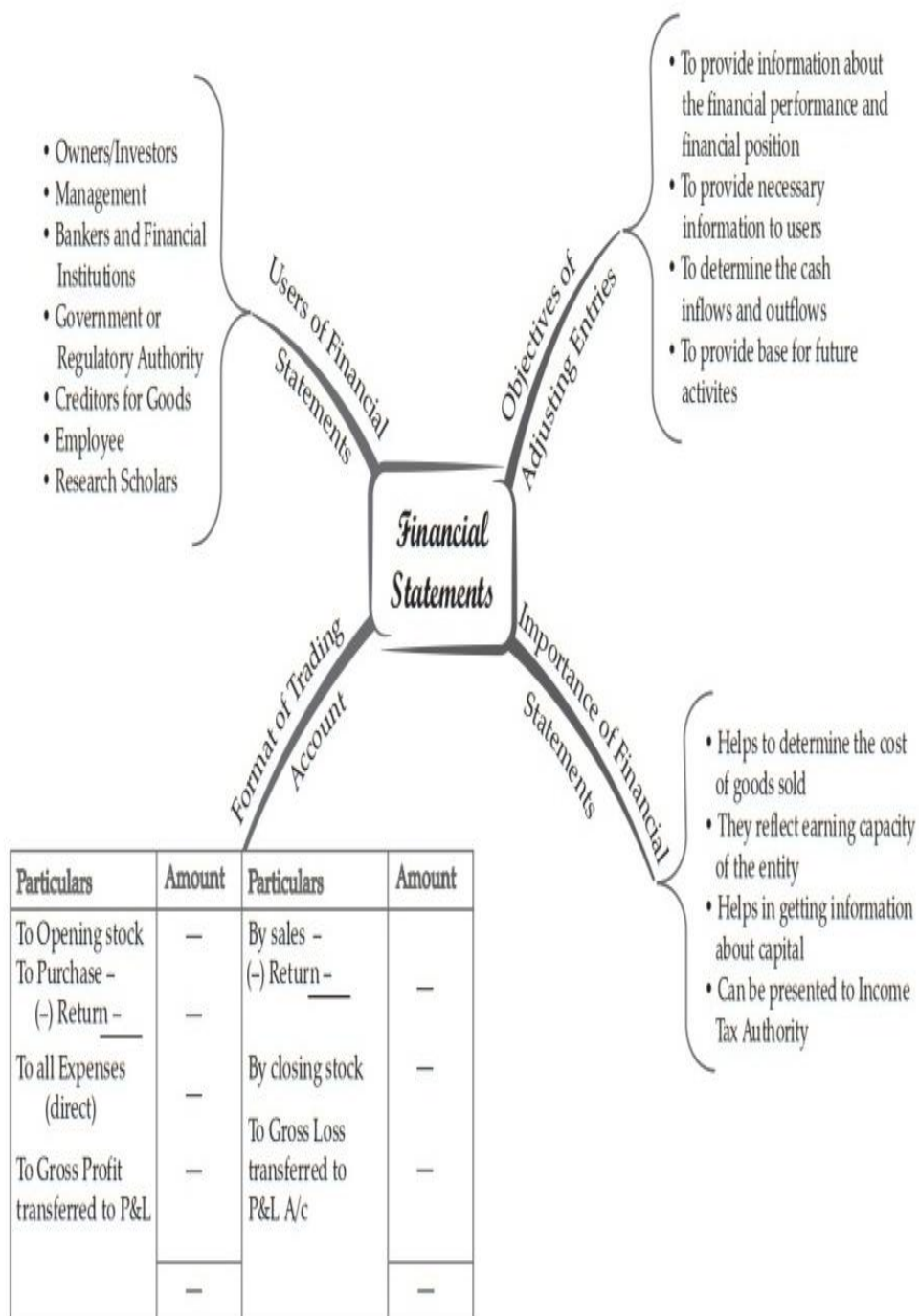
Give necessary accounting entries for writing off the bad debts & creating the provision for doubtful debts account. Also show the necessary accounts.

(Ans: New provision for Bad debts ₹3,840, profit and loss account [Dr.] ₹ 7,840.)

----- END OF CHAPTER -----

## CH - 08. FINANCIAL STATEMENTS - I

(MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

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

## **Financial Statements:**

Financial statement are those statement that show the profitability (Income statement) and the financial position (Balance Sheet) of the business at the end of accounting period.

**In the word of John N. Myer** “*The financial statement provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the result of operation during a certain period*”.

## **Financial statements include the following statements:**

1. **Income statement (Trading and Profit and Loss Account)** – Prepared to ascertain gross profit/loss and net profit/loss during an accounting period.
2. **Statement of Financial Position (Balance Sheet)** – Prepared to ascertain position (assets, liabilities and capital) of an enterprise at a particular point of time.
3. **Schedules and notes forming part of Balance sheet and Income statement** – To give details of various items shown in both the statements.

These two Financial Statements (Income Statement and Statement of Financial Position) are termed as ‘Final Accounts’.

## **Objective of Preparing Financial Statements:**

1. To present a true and fair view of the financial performance (Profit/Loss) of the business.
2. To present a true and fair view of the financial position (Assets/Liabilities) of the business.

## **Distinction between Capital and Revenue:**

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

## **(a) Expenditure:**

Whenever there is a payment made for other than settling the existing liabilities it is called expenditure. On the basis of the nature of this payment expenditure are classified as:

**1. Capital Expenditure:** These are those non-recurring expenditure benefits of which are extended to more than one accounting year. For example, Expenditure incurred to purchase machinery, the benefits of machinery would definitely extend to more than one accounting year hence this is a capital expenditure. Capital expenditures are shown on the assets side of the Balance Sheet.

**2. Revenue Expenditure:** These are those recurring expenditures that are incurred for smooth conduct of the business benefits of which are extended to only one accounting year. Example, Salary paid to the employees, advertising expenditures, etc. These are shown on the debit side of Trading and Profit and Loss Account.

**(b) Receipts:**

Receipts are the cash inflows that may or may not result in obligation to pay in future. On the basis of this nature, receipts can be classified as:

**1. Capital receipts:** These are that receipt that implies a future obligation to return the money in future. These are those receipts that are irregular and not received in the normal course of business. Example: Sale of machinery, Long- term loan taken, Capital brought in by the owner, etc. These are shown in the balance sheet, either increase in liabilities (Loan taken) or decrease in assets (Sale of Machinery).

**2. Revenue Receipts:** These are receipts that do not imply a future obligation to return the money in future. These are regular receipts that are necessary for operational activities of the business. Example, Rent received, Interest or commission received, etc. These are shown in the credit side of the Trading and Profit and Loss Account.

**(c) Deferred Revenue Expenditure:**

The expenditure which is revenue in nature, but the heavy amount spent and benefit likely to be derived over a number of years called deferred revenue expenditure e.g. heavy expenses on advertising on launching of a new product and hence it is capitalized like any fixed asset.

**Capital Nature Items:**

Capital Expenditure: Those expenditures which are incurred in acquiring and increasing the value of fixed assets. Example:

1. Purchase of fixed assets or bringing into existence of fixed assets
2. Expenditure incurred on erection of a fixed asset
3. Payment of goodwill
4. Decrease in long term debts.
5. Capital Receipts: Any receipt from the sale of fixed assets is known as capital receipt.

**Revenue Nature items:**

**Revenue Receipts:** Receipts in the business of recurring nature are called as Revenue receipts ex: rent received, discount received, commission received.

**Revenue Expenditures:** Recurring nature of expenditure done in the business which are done in order to earn profit are known as revenue expenditure ex.:

1. Purchase of goods during the year
2. Money spent in acquiring or manufacturing goods like freight, carriage, wages etc. Any expenses for meeting day to day business like wages, salaries, postage etc.

### Distinction between Capital Expenditure and Revenue Expenditure

Basis	Capital Expenditure	Revenue Expenditure
<b>1. Purpose</b>	Money spent for purchasing a fixed asset for business.	Money spent for the conduct of the business.
<b>2. Benefit duration</b>	For several years	For one accounting period only.
<b>3. Presentation</b>	Shown in the Balance sheet.	Shown either in Trading A/c or in Profit and Loss A/c.
<b>4. Nature of Account</b>	Real account	Nominal account

#### Types of Expenses:

**Direct Expenses:** Those expenses which are incurred on purchasing of goods and for converting the raw materials into the finished goods e.g. Manufacturing wages, Expenses on purchases (including all duties and taxes paid on purchases), Carriage/Freight/Cartage inwards, Production expenses (such as power and fuel, water etc.), factory expenses (e.g. lighting, rent and rates), Royalty based on Production etc.

**Note:** All direct expenses are debited to Trading account.

**Indirect Expenses:** Those expenses which are not directly related to production or purchase of the goods are called indirect expenses. It includes those expenses which are related to office and administration, selling and distribution of goods and financial expenses etc.

**These expenses are shown on the debit side of the Profit and Loss A/c.**

#### Calculation of Gross Profit

**Gross Profit** = Net Sales – Cost of Goods Sold

**Net Sales** = Total Sales – Sales Return.

**Cost of goods sold** = Opening Stock + Net Purchases + Direct Expenses (Wages, Expenses on Purchases, Carriage inward etc.) – Closing Stock.

**Net Purchases** = Total Purchases – Purchases Return

#### Calculation of Operating Profit:

**Operating profit** = Net sales – Operating cost.

**OR** = Gross Profit – (Office and Administrative Expenses + Selling and distribution exp.)

**Operating Cost** = Cost of Goods Sold + Office and Administrative Expenses + Selling and distribution exp.

**Net Profit** = Operating Profit + Non-operating Income – Non-operating expenses.

**Operating expenses:** The expenses which are related to the main or normal activities of the business e.g. office and Administrative expenses, selling and distribution expenses. Operating profit is also called EBIT (Earnings before interest and taxes).

**Income Statement:**

It is divided into two parts:

1. **Trading Account which shows the gross profit or gross loss.**
2. **Profit and Loss Account which shows the net profit or net loss.**

**1. Trading and Profit and Loss Account:**

It is the income statement that depicts the profit earned or the loss incurred at the end of the current accounting year. The net of revenue and expenditure is profit or loss.

**Items come under Trading Account:****Items on the debit side:**

1. **Opening Stock:** It is the stock of goods that are in hand at the beginning of the year and is being carried forward from the previous year.
2. **Net Purchases:** Goods which are purchased during the year both cash and credit purchases less goods returned to the suppliers known as Purchase Returns gives Net Purchases.
3. **Wages:** These are direct wages paid to the factory workers as remuneration.
4. **Carriage Inwards/ Freight inwards:** These are the transportation costs that are incurred for bringing items to the place of purchase.
5. **Fuel/Water/Power/Gas:** These are those expenses that are incurred while production of goods.
6. **Packaging Materials and packing charges:** These form part of direct expenses for packing and packaging expenses of goods to be sold.

**Items on the Credit Side:**

1. **Net Sales:** It refers to the total sales made during the year both cash and credit sales less the Sales returns i.e., the goods returned by the customers.
2. **Other Incomes:** Incomes in the form of Interest received, Commission received, rent received comes under the credit side of the Profit and Loss Account.
3. **Closing Stock:** It is the stock of goods that are in hand at the end of the year and is being carried forward to the upcoming year

**Format of Trading Account**

**Name of Business Firm**

**Trading Account**

Particulars	Amt.(₹)	Particulars	Amt.(₹)
To Opening Stock		By Sales	
To Purchases		Less: Returns Inward/ Sales Returns	
Less: Purchase Return/Return outwards		By Scrap sales	
To All Direct Expenses		By Closing Stock	
To Wages		By Gross Loss transferred to Profit	
To Wages & Salaries		& Loss A/c) (Bal. figure)	
To Carriage of Carriage Inwards or			
Carriage on purchases			
To Direct Expenses			

To Gas, Fuel and power To Freight, Octroi and cartage To Manufacturing Expenses or Productive expenses To Custom or import duty To Dock and clearing charge To Excise duty To Factory rent and lighting To Other direct charges To Royalty To Gross Profit transferred to Profit & Loss A/c)(Bal. figure)			

#### Items come under Profit and Loss Account:-

- 1. Salaries:** These are the remuneration paid to administrative, office or godown staff for their services in the business.
- 2. Rent Paid:** It is the expense of Rent for office, administration building, municipal taxes paid for running the business.
- 3. Interest Paid:** It is the interest component paid on liabilities, i.e., Interest on loans/debentures, etc.
- 4. Commission Paid:** It is the commission paid to sales agents that are an expense and are debited to Profit and Loss Account.
- 5. Repairs:** These include the revenue expenditure made on maintenance and repairs of fixed assets.
- 6. Miscellaneous Expenses:** Some petty or sundry expenses that are so small that cannot come under one head are clubbed together and are written as miscellaneous expenses.
- 7. Depreciation:** It refers to decrease in the value of asset on account of wear and tear and passage of time. It is treated as expense and debited to profit and loss account and in the balance sheet deducted from asset value.
- 8. Provision for bad debts:** It's not possible for the business to know the actual amount of bad debts; hence we make a reasonable estimate for the loss and provide the loss. It is known as provision for bad debts.

#### Formal of Profit & Loss Account Profit & Loss A/c for the Year Ended.....

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Gross Loss (Transferred from Trading A/c)		By Gross Profit (Transferred from Trading A/c)	
<b>To Office &amp; Admin. Expenses</b>		By Rent Received	
To Salaries		By Rent (Cr.)	
To Rent Rates Taxes		By Discount Received	
To Printing and Stationery		By Discount (Cr.)	
To Salaries & Wages		By Rebates	
To Postages and Telephones		By Commission Received	

To Office Lighting To Insurance Premium To Legal Expenses To Establishment Expenses To Audit Fees To Trade Expenses To Travelling Expenses To General Expenses <b>To Selling &amp; Distribution Exp.</b> To Carriage and Freight Outwards To Commission To Brokerage To Advertisement To Publicity To Bad Debts To Export Duty To Packing Expenses To Salaries of Salesman To Delivery Van Expenses <b>To Financial Exp.</b> To Interest paid on loans To Interest (Dr.) To Discounts (Dr.) To Rebate Allowed To Bank Charges <b>To Miscellaneous Exp.</b> To Repairs To Depreciation on Fixed Assets To Conveyance Expenses To Entertainment Expenses To Donations & Charity To Loss on Sale of Fixed Assets To Stable Expenses To Loss by Fire To Loss by theft To Unproductive Expenses  To Net Profit Transferred to Capital Account (If Cr. side > Dr, side)		By Interest Received By Dividend Received By Bad Debts Recovered By Apprentice fees or premium By Gain on Sale of Fixed Asset By Miscellaneous Receipts By Net Loss (If Dr. side > Cr. side) (Transferred to capital Account) By Gross Profit (Transferred from Trading A/c) By Rent Received By Rent (Cr.) By Discount Received By Discount (Cr.) By Rebates By Commission Received By Interest Received By Dividend Received By Bad Debts Recovered By Apprentice fees or premium By Gain on Sale of Fixed Asset By Miscellaneous Receipts By Net Loss (If Dr. side > Cr. side) (Transferred to capital Account)	

- The words 'To' and 'By' are generally not used these days.
- The name of Business Firm is stated on the top of trading & P & L A/c.

## **Balance Sheet:**

### **Meaning of Balance Sheet**

Balance sheet is a summarised statement of assets and liabilities, prepared generally at the end of financial year to show the financial position of the business. All liabilities are put on the left hand side of balance sheet where all assets are shown on its right hand side.

### **Items come under Balance Sheet:**

- 1. Current Assets:** These are those assets that can be liquefied in cash easily i.e., they can be converted to cash within one year. For ex- Debtor, Bills receivables, Cash, Bank etc.
- 2. Current Liabilities:** These are those liabilities that are paid within a period of one year. Such as Creditors, Bills payable, outstanding expenses etc.
- 3. Fixed Assets:** These are those long-term assets that are not easily liquefied into cash and are kept in business for a longer period of time like, plant and Machinery.
- 4. Intangible Assets:** These are those assets that are not tangible in nature i.e., they cannot be seen or touched like goodwill, trademark, etc.
- 5. Investments:** These are the investments made in the securities of government or other businesses. They are generally represented at Cost price.
- 6. Long-term liabilities:** These are those liabilities that are payable after one year such as long-term bank loan, long-term debentures.
- 7. Capitals:** It is the amount brought in by the owner. It is the difference of liabilities due to outsiders from assets.
- 8. Drawings:** These are the amounts withdrawn by the proprietor or the owner for personal use that reduce the amount of capital.
- 9. Closing Stock:** It is the stock of goods that are in hand at the end of the year and is being carried forward to the upcoming year.

### **Grouping and Marshalling of Assets and Liabilities:**

**Grouping:** The term 'Grouping' means putting together items of a similar nature under a common heading.

For example, under the heading 'trade Creditors' the balances of the ledger accounts of all the suppliers from whom goods have been purchased on credit, will be shown.

**Marshalling:** It refers to the order in which the various assets and liabilities are shown in the Balance Sheet. The assets and liabilities can be shown either in the order of liquidity or in the order of permanence.

#### **Order of Liquidity:**

1. The assets are arranged in the order of their liquidity i.e., the most liquid asset (e.g., cash-in-hand), is shown first. The least liquid asset (e.g., goodwill) is shown last.
2. The liabilities are arranged in the order of timing i.e., the liabilities which are to be paid immediately (e.g., Creditors) are shown first and which are to be paid later are shown at last (long-term loans).

**A general format of a Balance Sheet in order of liquidity is shown below:**

**Balance Sheet of .....As at.....**

<b>Liabilities</b>	<b>Amt. (₹)</b>	<b>Assets</b>	<b>Amt. (₹)</b>
<b>Current Liabilities:</b>		<b>Current Assets:</b>	
Bank Overdraft		Cash-in hand	
Bills Payable		Cash at Bank	
Sundry Creditors		Bills Receivable	
Outstanding Expenses		Short Term Investment	
Income received-in-advance		Sundry Debtors	
<b>Long-term Liabilities:</b>		Prepaid Expenses	
Long term loan		Accrued Income	
<b>Reserve and Surplus</b>		Closing Stock	
<b>Capital:</b>		<b>Investment: (Long term)</b>	
Add : Interest on Capital		<b>Fixed Assets:</b>	
Add : Net Profit		Furniture and Fixtures	
Less : Drawings		Plant & Machinery	
Less : Interest on Drawings		Building	
Less : Income Tax		Land	
Less : Life Insurance Premium		Goodwill	
Less : Net Loss			

**Order of Permanence:** This order is exactly reverse of the liquidity order

1. The assets are arranged in the order of their permanence i.e., the least liquid asset (e.g., goodwill) is shown first and the most liquid asset (e.g., Cash-in-hand) is shown last.
2. The least urgent payment to be made (e.g., short-term creditors) is shown last.
3. A company is required to prepare the balance sheet in the order of permanence.

**A general format of a Balance Sheet in the order of performance is shown below:**

**Balance Sheet of .....As at.....**

<b>Liabilities</b>	<b>Amt. (₹)</b>	<b>Assets</b>	<b>Amt. (₹)</b>
<b>Capital:</b>		<b>Fixed Assets:</b>	
Opening Balance      XXX		Good will	
Add: Net Profit      XXX		Land	
(Less: Net Loss)		Building	
Less: Drawings <u>XXX</u>		Plant & Machinery	
<b>Long-term Liabilities:</b>		Furniture & Fixtures	
Long term loan		Investment: (long term)	
<b>Current liabilities:</b>		<b>Current Assets:</b>	
Income received-in-advance		Closing stock	
Outstanding Expenses		Accrued income	
Sundry Creditors		Prepaid expenses	
Bills Payable		Sundry Debtors	
Bank Overdraft		Bills Receivable	
		Cash at Bank	
		Cash in Hand	

**Cost of Goods Sold:**

Cost of goods sold is computed in two ways:

- (i) Cost of goods sold or cost of sales = Sales – Gross profit  
(ii) Cost of goods sold = Opening stock + Purchases + Direct expenses – Closing stock

**Illustration 1:**

Find the cost of goods sold and closing stock from the following information:

Sales ₹ 4,30,000; Return inward ₹ 5,000; Gross profit ₹ 1,00,000; Opening stock ₹ 35,000; Purchases ₹ 2,85,000; Wages ₹ 27,000; Other direct expenses ₹ 16,000.

**Solution:**

(a) Net Sales = Sales – Sales return

$$= ₹ 4, 30,000 - ₹ 5,000 = ₹ 4, 25,000$$

(b) Cost of goods sold = Sales – Gross profit

$$= ₹ 4, 25,000 - ₹ 1, 00,000 = ₹ 3, 25,000$$

(c) Cost of goods sold = Opening stock + Purchase + Direct expenses – Closing stock

$$₹ 3, 25,000 = ₹ 35,000 + ₹ 2, 85,000 + (₹ 27,000 + ₹ 16,000) - \text{Closing stock}$$

$$\text{Closing stock} = ₹ 3, 63,000 - ₹ 3, 25,000 = ₹ 38,000$$

**Illustration 2:**

Prepare a Trading A/c of M/s Prime Products from the following particulars pertaining to the year 2022-23.

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

**Solution:****Books of Prime Products****Dr.****Trading Account for the year ended March 31, 2023****Cr.**

Expenses/ Losses	Amt. (₹)	Revenues/ Gains	Amt. (₹)
To Opening stock	50,000	By Sales 3,00,000	2,95,000
To Purchases 1,10,000		Less: Return Inwards (5,000)	
Less: Return outwards (7,000)	1,03,000		
To Factory rent	30,000		
To Wages	40,000		
To Gross profit	72,000		
	2,95,000		2,95,000

**Illustration 3:**

Prepare a trading account of M/s Anjali from the following information related to March 31, 2023.

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

**Solution:****Books of Anjali****Dr.****Trading Account for the year ended March 2023****Cr.**

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

**Illustration 4:**

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

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

Closing stock on March 31, 2023 is ₹ 4,500

**Solution:****Books of Mr. Bhagat****Dr.****Trading Account for the year ended March 2023****Cr.**

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

**Illustration 5:**

Following balance is extracted from the books of a trader ascertain Gross Profit, Operating Profit & Net Profit for the year ended March 31, 2023.

<b>Particulars</b>	<b>Amount (₹)</b>
Sales	75,250
Purchases	32,250
Opening stock	7,600
Sales return	1,250
Purchases return	250
Rent	300
Stationery and printing	250
Salaries	3,000
Misc. Expenses	200
Travelling expenses	500
Advertisement	1,800
Commission paid	150
Office expenses	1,600
Wages	2,600
Profit on sale of investment	500
Depreciation	800
Dividend on investment	2,500
Loss on sale of old furniture	300

Closing stock (March 31, 2023) valued at ₹ 8,000

**Sol: Dr. Trading and Profit & Loss Account for the year ended 31<sup>st</sup> March, 2023 Cr.**

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

**Illustration 6:** From the following information prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31<sup>st</sup> March, 2023.

Account	Amt. (₹)	Account	Amt. (₹)
Capital	7,20,000	Salaries	1,20,000
Machinery	1,40,000	General Expenses	40,000
Sales	16,40,000	Rent	1,00,000
Purchases	8,00,000	Purchases Return	10,000
Sales Return	20,000	Debtors	6,00,000
Opening Stock	2,00,000	Cash	80,000
Drawings	80,000	Carriage Outwards	40,000
Wages	2,00,000	Advertising	40,000
Carriage Inwards	10,000	Creditors	1,00,000

Closing Stock was valued at ₹ 4, 00,000.

**Ans: Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2023**

**Dr.**

**Cr.**

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Opening Stock	2,00,000	By Closing Stock	4,00,000
To Purchases 8,00,000		By Sales 16,40,000	
Less: Purchase Returns (10,000)	7,90,000	Less: Sales Return 20,000	16,20,000
To Wages	2,00,000		
To Carriage Inwards	10,000		
To Gross Profit c/d	8,20,000		
	<b><u>20,20,000</u></b>		<b><u>20,20,000</u></b>
To Salaries	1,20,000	By Gross Profit b/d	8,20,000
To General Expenses	40,000		
To Rent	1,00,000		
To Carriage outwards	40,000		
To Advertising	40,000		
To Net Profit (trf. to capital A/c)	4,80,000		
	<b><u>8,20,000</u></b>		<b><u>8,20,000</u></b>

**Balance Sheet as at 31<sup>st</sup> March, 2023**

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capital 7,20,000		<b>Fixed Assets:</b>	
Less: Drawings (80,000)		Machinery	1,40,000
Add: Net Profit 4,80,000	11,20,000	<b>Current Assets:</b>	
<b>Current Liabilities:</b>		Debtors	6,00,000
Creditors	1,00,000	Cash	80,000
		Closing Stock	4,00,000
	<b><u>12,20,000</u></b>		<b><u>12,20,000</u></b>

**PRACTICE QUESTIONS:**

- The Manager is entitled to commission of 5% on profits before deducting the Commission. The profit is ₹ 2,100, therefore, the commission will be:  
 (a) ₹ 100                      (b) ₹ 105                      (c) ₹ 110.53                      (d) ₹ 210
- Find Cost of Goods Sold and Closing Stock from the following information:  
 Sales ₹ 4, 30,000; Return Inward ₹ 5,000; Gross Profit ₹ 1, 00,000; Opening Stock ₹ 35,000;  
 Purchases ₹ 2, 85,000; Wages ₹ 27,000; Other Direct Expenses ₹ 16,000;  
 Sundry Creditors ₹ 30,000.
- (a) Calculate Gross profit on the basis of the following information:  
 Wages ₹ 50,000; Purchases ₹ 6, 80,000; Return Outwards ₹ 30,000;  
 Carriage Outwards ₹ 15,000; Carriage Inwards ₹ 20,000; 3/4<sup>th</sup> of the goods are sold for ₹ 60,000.

(b) Calculate Closing Stock from the following details:

Opening Stock ₹ 4, 80,000; Purchase ₹ 13, 60,000; Sales ₹ 19, 50,000; GP is 30% on Cost.

4. On 31<sup>st</sup> March, 2023 the following trial Balances was extracted from the books of Mohan:

Particulars	Dr. Amt. (₹)	Cr. Amt. (₹)
Capital. ....	-----	30,000
Drawings	5,000	-----
Debtors & Creditors	20,000	10,000
Loan	-----	9,500
Interest on Loan . . . . .	300	-----
Cash	2,000	-----
Provision for Bad Debts	-----	700
Stock (1 <sup>st</sup> April, 2022)	6,800	-----
Motor Vehicles. ....	10,000	-----
Bank	3,500	-----
Land & Building	12,000	-----
Bad Debts	500	-----
Purchases & Sales. ....	66,000	1,10,000
Returns	8,000	1,500
Carriage Outwards	2,500	-----
Carriage Inwards	3,000	-----
Salaries. ....	9,000	-----
Rent and Insurance	3,000	-----
Advertising	3,500	-----
Discount	-----	500
General Expenses. ....	3,400	-----
Bills Receivable & Bills Payable	6,000	2,000
Rent Received	-----	300

Stock on 31<sup>st</sup> March, 2023 was valued at ₹ 7, 000.

Prepare the Trading Account and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2023 & the Balance Sheet as on that date.

5. Prepare Trading, Profit and Loss Account and Balance Sheet from the following particulars as at 31<sup>st</sup> March, 2023:-

	Debit (₹)	Credit (₹)
Scooty	12,000	-----
Stock on 1 <sup>st</sup> April, 2022	24,000	-----
Bad-Debts	900	-----
General Expenses	3,600	-----
Bank Loan	-----	15,000
Commission	-----	2,700
Scooty Expenses	7,800	-----
Cash in Hand	6,000	-----
Capital	-----	75,000
Furniture	7,920	-----

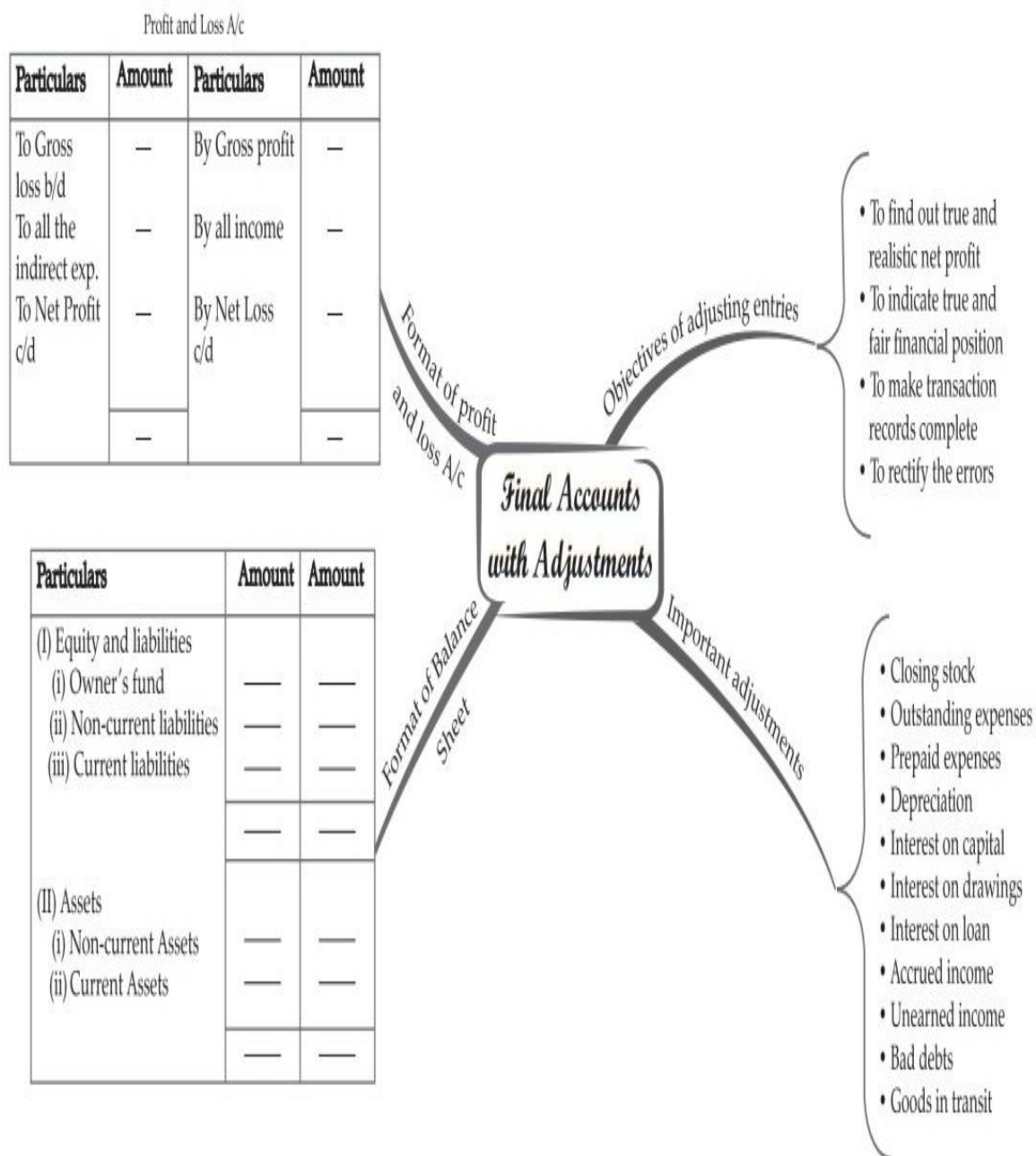
Purchases and Sales	1,01,400	1,68,120
Carriage inward	2,100	-----
Bad-Debts Provision	-----	2,100
Interest on Bank Loan	900	-----
Insurance and taxes	6,000	-----
Debtors and Creditors	9,000	24,000
Salaries	13,200	-----
Building	90,000	-----
Return inward and Outward	<u>6,900</u>	<u>4,800</u>
	<b><u>2,91,720</u></b>	<b><u>2,91,720</u></b>

Closing Stock on 31<sup>st</sup> March, 2023 was valued at ₹ 13,020.

----- **END OF CHAPTER** -----

## CH - 09: ADJUSTMENTS IN PREPARATION OF FINANCIAL STATEMENTS

### (MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

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

### **Adjustment in preparation of financial statements of Sole-proprietor:**

**Meaning of Adjustment entries:** Those entries which need to be passed at the end of the accounting year to show the accurate profit or loss and fair financial position of the business.

#### **Need of Adjustment:**

There are number of transactions that may not find the place in the Trial Balance due to any reason such as Closing Stock (because it is valued at the end of the year), Manager's Commission based on Net profits (because its calculation requires preparation of Income Statement first). These transactions can only be taken into account by passing Adjustment entries so that their impact on the profitability and financial position can be shown.

**1. Closing Stock:** the closing stock represents the cost of unsold goods lying in the stores at the end of the accounting period.

**2. Outstanding Expenses:** When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as outstanding expenses.

As they relate to the earning of revenue during the current accounting year, it is logical that they should be duly charged against the revenue for computation of the correct amount of profit or loss.

**3. Prepaid Expenses:** At the end of the accounting year, it is found that the benefits of some expenses have not yet been fully received; a portion of its benefit would be received in the next accounting year. This portion of expenses is carried forward to the next year and is termed as prepaid expenses.

**4. Accrued Income:** It may sometime happen that certain items of income such as a interest on loan, commission, rent, 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 accrued income.

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

**6. Depreciation:** It is the decline in the value of assets on account of wear and tear and passage of time. It is treated as a business expense and is debited to profit and loss account. This, in effect,

amounts to writing-off a portion of the cost of an asset which has been used in the business for the purpose of earning profits.

<b>Closing Stock</b>	Closing Stock A/c To Trading A/c	Dr.	(i) Credit side of Trading A/c. (ii) Show on the assets side of Balance sheet.
<b>Outstanding/Unpaid Expenses</b>	Expenses A/c Dr. To Outstanding Expenses A/c	Dr.	(i) Add to the concerned item on the Debit side of Trading/Profit & Loss A/c. (ii) Shown on the liabilities side of Balance sheet.
<b>Prepaid expenses/Unexpired expenses</b>	Prepaid Expenses A/c To Expenses A/c	Dr.	(i) Deduct from the concerned expenses on the debit side of Profit & Loss A/c (ii) Show on the assets side of Balance sheet.
<b>Accrued income/Income due but not received</b>	Accrued Income A/c To Income A/c	Dr.	(i) Add to the concerned income on Credit side of Profit and Loss A/c (ii) Show on the assets side of Balance sheet.
<b>Unearned income/Income received in Advance</b>	Income A/c To Unearned Income A/c	Dr.	(i) Deduct from the concerned income on the credit side of Profit & Loss A/c (ii) Show on the liabilities side of Balance Sheet.
<b>Depreciation</b>	Depreciation A/c To Asset A/c	Dr.	(i) Show on the debit side of Profit Loss A/c (ii) Deduct from the concerned asset in the Balance Sheet.

**7. Bad Debts:** The debtors from whom amounts cannot be recovered are treated in the books of accounts as bad and are termed as bad debts.

**8. Further Bad Debts:** These Bad debts is a loss that occurred after reparation of Trial Balance. Further bad debts be added in the bad debts already appearing in the Profit and Loss A/c and Debtors would be reduced with the same amount.

**9. Provision for Bad Debts:** In the balance sheet, debtors appear on the assets side of the Balance Sheet, which is their estimated realisable value during next year. It is quite possible that the whole of the amount may not be realized in future. However it is not possible to accurately know the amount of such bad debts.

Hence, a reasonable estimate of such loss is provided in the book. Such provision is called provision for bad debts. Provision for doubtful debts is shown as a deduction from the debtors on the asset side of the balance sheet.

**Note:** The provision for doubtful debts brought forward from the previous year is called the opening

provision or old provision. When such a provision already exists, the loss due to bad debts during the current year are adjusted against the same and while making provision for doubtful debts required at the end of the current year is called new provision. The balance of old provision as given in trial balance should also be taken into account.

**10. Provision for discount on Debtors:** Discount is allowed to customers to encourage them to make prompt payment. The discount likely to be allowed to customers in an accounting year can be estimated & provided for by creating a provision for Discount on debtors. Provision for discount on debtors is made on good debtors which are arrived at by deducting further bad debts and provision for bad debts out of Debtors shown in the Balance sheet.

<b>To write off bad debts</b>	Bad Debts A/c To Debtors	Dr.	(i) Debit side of P&L A/c. (ii) Deduct from debtors on the assets side of Balance Sheet.
<b>Provision for bad and doubtful debts</b>	Prov. for Doubtful Debts A/c To Debtors A/c	Dr.	(i) Debit side of P & L A/c. (ii) Deduct from debtors on the assets side of Balance Sheet.
<b>Provision for discount on debtors</b>	P & L A/c To Prov. for Discount on Debtors A/c	Dr.	(i) Debit side of P & L A/c. (ii) Deduct from debtors on the assets side of Balance Sheet.

### 11. Manager's Commission:

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

#### 1. Commission on Net profits before charging such commission

$$\text{Commission} = \text{Net profit before Commission} \times \frac{\text{Percentage of Commission}}{100}$$

#### 2. Commission on Net profits after charging such commission

$$\text{Commission} = \text{Net profit before Commission} \times \frac{\text{Percentage of Commission}}{100 + \text{Percentage of Commission}}$$

<b>Interest on Capital</b>	Interest on Capital A/c To Capital A/c	Dr.	(i) Debit side of P & L A/c. (ii) Add to capital on the liabilities side of Balance Sheet.
<b>Interest on drawings</b>	Capital/Drawings A/c To Interest on Drawings A/c	Dr.	(i) Credit side of P & L A/c. (ii) Deduct from capital on the liabilities side of Balance Sheet.
<b>Interest payable on loan (borrowed)</b>	Interest on Loan A/c To Loan A/c	Dr.	(i) Debit side of P & L A/c. (ii) Add to loan on the liabilities side of Balance Sheet.
<b>Commission payable to manager</b>	P& L A/c To Comm. Payable to Manage A/c	Dr.	(i) Debit side of P & L A/c. (ii) Show on the liabilities side of Balance Sheet.

## 12. Adjustment in Respect of Goods:

**Abnormal Loss:** Sometimes losses occur due to some abnormal circumstances such as accident, fire, flood, earthquakes etc. Such losses are called Abnormal losses. These may be divided into two categories:-

(A) Loss of Goods (B) Loss of fixed assets.

**Good taken for personal use (Drawings in goods):** When the goods are withdrawn by proprietor for personal use the cost of such goods deduct from purchases and the amount should be deduct from capital in Balance Sheet.

**Goods distributed as free samples:** Sometime goods are distributed as free sample by the businessman for the purpose of advertisement. The cost of free sample deduct from purchase and shown in Debit side of profit and loss account.

### Abnormal loss of goods by fire, theft, accident, etc.

Adjustment	Treatment in Trading & P & L A/c		Treatment in Balance Sheet
<b>1) Loss of Goods (By accident, Fire, Theft)</b>	1) Loss of ... A/c To Trading A/c (or) To Purchases A/c	Dr.	(i) Gross Loss: Deduct from Purchases or show on the credit side of Trading A/c.
<b>If goods were not insured</b>	2) P & L A/c To Loss by ..... A/c	Dr.	(ii) Net Loss: Debit side of P & L A/c.
<b>If goods were insured and full claim accepted by insurance company</b>	2) Insurance company A/c To Loss by ... A/c	Dr.	(iii) Insurance claim: Assets side of Balance Sheet.
<b>If full claim not accepted by Insurance Company</b>	2) Insurance Company A/c Profit & Loss A/c To Loss By .... A/c	Dr. Dr.	
<b>2) Goods taken by the proprietor for his personal use</b>	Drawings A/c To Purchases A/c	Dr.	(i) Deduct the amount of goods from the purchases in Trading A/c. (ii) Deduct the amount from the capital on the liabilities side of Balance Sheet.
<b>3) Goods distributed as free samples</b>	Advertising A/c To Purchases A/c	Dr.	(i) Deduct the amount of goods from the purchases in Trading A/c. (ii) Show on the debit side of P & L A/c.
<b>4) Goods given as charity</b>	Charity A/c To Purchases A/c	Dr.	(i) Deduct the amount from the purchases on the debit side of Trading A/c. (ii) Show on the debit side of P & LA/c.

### Key Points:

1. **If closing stock** is shown in Trial Balance then it will be shown in balance sheet only. It is assumed that purchases amount already gets adjusted in trial balance.

2. **Salary and wages** will be shown in profit and loss A/c debit side (assuming that salary is prominent) while wages and salary will be shown in trading A/c debit side, (wages are prominent).
3. **Freight, carriage, cartage** will be shown in Dr. side of trading A/c. if inward word attached with these then it also debited to trading A/c, if outward word attached with these item then it will be debited to profit and loss account.
4. Any expenses related to factory are debited to trading account like factory lighting, factory rent if factory word is not given then lighting and rent will be debited to profit and loss account.
5. **Trade expenses** always debited to profit and loss A/c not as name indicate trading A/c.
6. **Packaging material:** Cost of packaging material used in product are direct expenses as it refers to small containers which form part sold, it will debited to trading A/c.
7. **Packing:** The packing refers to the big containers that are used for transporting the goods & regarded as indirect expenses and debited to profit and loss account.
8. **Adjusted purchases** mean the amount of purchases is adjusted by way of adding opening stock & reduced by the amount of closing stock, e.g., purchases ₹ 1,00,000; opening stock ₹ 12,000, closing stock ₹ 8,000. Calculate adjusted purchases.

Adjusted Purchases = Purchases + Opening stock – Closing stock

$$= ₹ 1, 00,000 + ₹ 12,000 – ₹ 8,000 = ₹ 1, 04,000.$$

When adjusted purchases is given in trail balance, then there is no need of debiting opening stock & crediting closing stock in trading A/c.

In this case closing stock will be shown in balance sheet only.

9. **Wasting Assets:** - Assets which are exhausted during the working are called wasting assets. For exp. Mines, oil wells etc.
10. **Contingent liabilities:** - Liabilities the happening of which is uncertain are called contingent liabilities. For exp. – case of bonus pending in the court, bill discounted not yet matured. It is stated as footnote below the balance sheet.

**Remember:-** While preparing Final Accounts the items which are given inside the Trial Balance are written only once either in Income Statement or in the Balance Sheet. (Assuming that they have been already adjusted in the respective account). On the other hand, the items which are given outside the Trial Balance (known as adjustment) are to be written twice because the double entry in respect of all adjustments is to be completed in the final accounts itself.

#### **Illustration 1:**

From the following information prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31<sup>st</sup> March, 2023.

Account	Amt. (₹)	Account	Amt. (₹)
Capital	7,20,000	Salaries	1,20,000
Machinery	1,40,000	General Expenses	40,000
Sales	16,40,000	Rent	1,00,000
Purchases	8,00,000	Purchases Return	10,000

Sales Return	20,000	Debtors	6,00,000
Opening Stock	2,00,000	Cash	80,000
Drawings	80,000	Carriage Outwards	40,000
Wages	2,00,000	Advertising	40,000
Carriage Inwards	10,000	Creditors	1,00,000

**Adjustments:**

- (a) Closing Stock was valued at ₹ 4, 00,000.  
(b) Outstanding salaries amounting to be ₹ 20,000  
(c) Rent includes prepaid rent of ₹ 30,000.  
(d) Bad debts amount to ₹ 50,000.

**Ans: Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2023**

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Opening Stock	2,00,000	By Sales 16,40,000	
To Purchases 8,00,000		Less: Sales Return (20,000)	16,20,000
Less: Purchase Returns (10,000)	7,90,000	By Closing Stock	4,00,000
To Wages	2,00,000		
To Carriage Inwards	10,000		
To Gross Profit c/d	8,20,000		
	<b>20,20,000</b>		<b>20,20,000</b>
To Salaries 1,20,000		By Gross Profit b/d	8,20,000
Add: Outstanding Salary (20,000)	1,40,000		
To General Expenses	40,000		
To Rent 1,00,000			
Less: Prepaid Rent (30,000)	70,000		
To Carriage outwards	40,000		
To Advertising	40,000		
To Bad Debts	50,000		
To Net Profit (trf to Capital A/c)	4,40,000		
	<b>8,20,000</b>		<b>8,20,000</b>

**Balance Sheet as at 31<sup>st</sup> March, 2023**

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capital 7,20,000		<b>Fixed Assets:</b>	
Less: Drawings (80,000)		Machinery	1,40,000
Add: Net Profit 4,40,000	10,80,000	<b>Current Assets:</b>	
<b>Current Liabilities:</b>		Debtors (6,00,000-50,000)	5,50,000
Creditor	1,00,000	Cash	80,000
Outstanding Salary	20,000	Closing Stock	4,00,000
	<b>12,00,000</b>	Prepaid rent	30,000
			<b>12,00,000</b>

**PRACTICE QUESTIONS:**

1. Extract of Trial Balance as on 31<sup>st</sup> March, 2023:

	Amt. (₹)	Amt. (₹)
Debtors (including Mohan for dishonoured bill of ₹ 1,000)	60,000	-----
Bad Debts	3,000	-----

**Adjustments:**

- (i) Half of Mohan's bill is irrecoverable.
- (ii) Create a provision of 5% on Debtors.

2. Show the effect on Profit & Loss Account and Balance sheet for the following:

(a) Extract of Trail Balance as on 31<sup>st</sup> March, 2023:

	Amt. (₹)	Amt. (₹)
Debtors	80,000	-----
Bad Debts	2,000	-----
Provision for Doubtful debts	-----	5,000
Discount received	-----	2,500

**Adjustments:**

- (i) Write off further Bad Debts ₹ 500.
- (ii) Provision for Doubtful debts is to be maintained at 3% on Debtors.
- (iii) Discount on Debtors is 2%.

3. From the following figures prepare Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2023 and a Balance Sheet as on that date:

	Amt. (₹)
Opening Stock	36,600
Purchases	1,86,000
Sales	3,05,000
Sales return	5,000
Wages	22,000
Carriage	4,200
Bad debts	700
Bad debts provision	2,100
Sundry debtors	40,400
Sundry creditors	25,700
Furniture	8,000
Plant and machinery	50,000
Salaries	11,000
Advertisement	4,400
Goodwill	6,000
Freight	6,300
Commission (Cr.)	1,000
Capital	86,800
Drawing	15,000
Investments	14,000
Cash	8,000
Rent and Insurance	3,000

**Adjustments:**

- (a) Stock on 31<sup>st</sup> march 2020 was ₹ 31,500
- (b) Salary and wages for March 2023 were unpaid.
- (c) Rent outstanding amounted to ₹ 600 and insurance unexpired amounted to ₹ 400.
- (d) Commission amounting to ₹ 200 has been received in advance.
- (e) Write off ₹ 400 as bad debts, create provision for doubtful debts at 5% on Sundry debtors & provide 2% provision for discount on debtors and creditors.
- (f) Depreciate furniture and plant and machinery by 10%.

**(GP ₹ 3, 31,500; NP ₹ 48,554; B/S ₹ 1, 49,340)**

4. Following is the Trial Balance of Rama & Co. for the year ending 31<sup>st</sup> December 2022.  
Prepare Trading and Profit and Loss Account and Balance Sheet:

Name of Account	Dr. Balance (₹)	Cr. Balance (₹)
Drawing and Capital	4,000	23,000
Furniture	8,000	----
Apprentice Premium	----	1,000
Machinery	20,000	----
Bad debts	350	----
Provision for bad debts	----	500
Sundry debtors and Creditors	8,200	5,000
Stock on January 1, 2022	7,400	----
Purchases and sales	75,000	1,05,000
Bank overdraft	----	2,600
Sales return and purchase returns	500	400
Advertisement	2,400	----
Interest	200	----
Commission	----	400
Cash in hand	1,650	----
Taxes and Insurance	3,200	----
Carriage and Freight	1,500	----
Salaries	5,500	----

**Adjustments:**

The following adjustments are to be made:

- (i) Stock in hand on 31<sup>st</sup> December 2022 was value ₹ 8,250.
- (ii) Salary is paid at ₹ 500 for month.
- (iii) Tax outstanding ₹ 300 and insurance is prepaid ₹ 400.
- (iv) Write off furniture bad debts ₹ 200 and create provision for bad debts on debtors at 5%.
- (v) Apprentice Premium ₹ 300 is related to 2023.
- (vi) Commission Accrued ₹ 100.

**(G.P. ₹ 29,250; NP ₹ 18,300 and B/S ₹ 46,000)**

5. The following is the Trial Balance of Sh. Anil Kumar on 31<sup>st</sup> March 2023. You are required to prepare the final Accounts after giving effects to the adjustments.

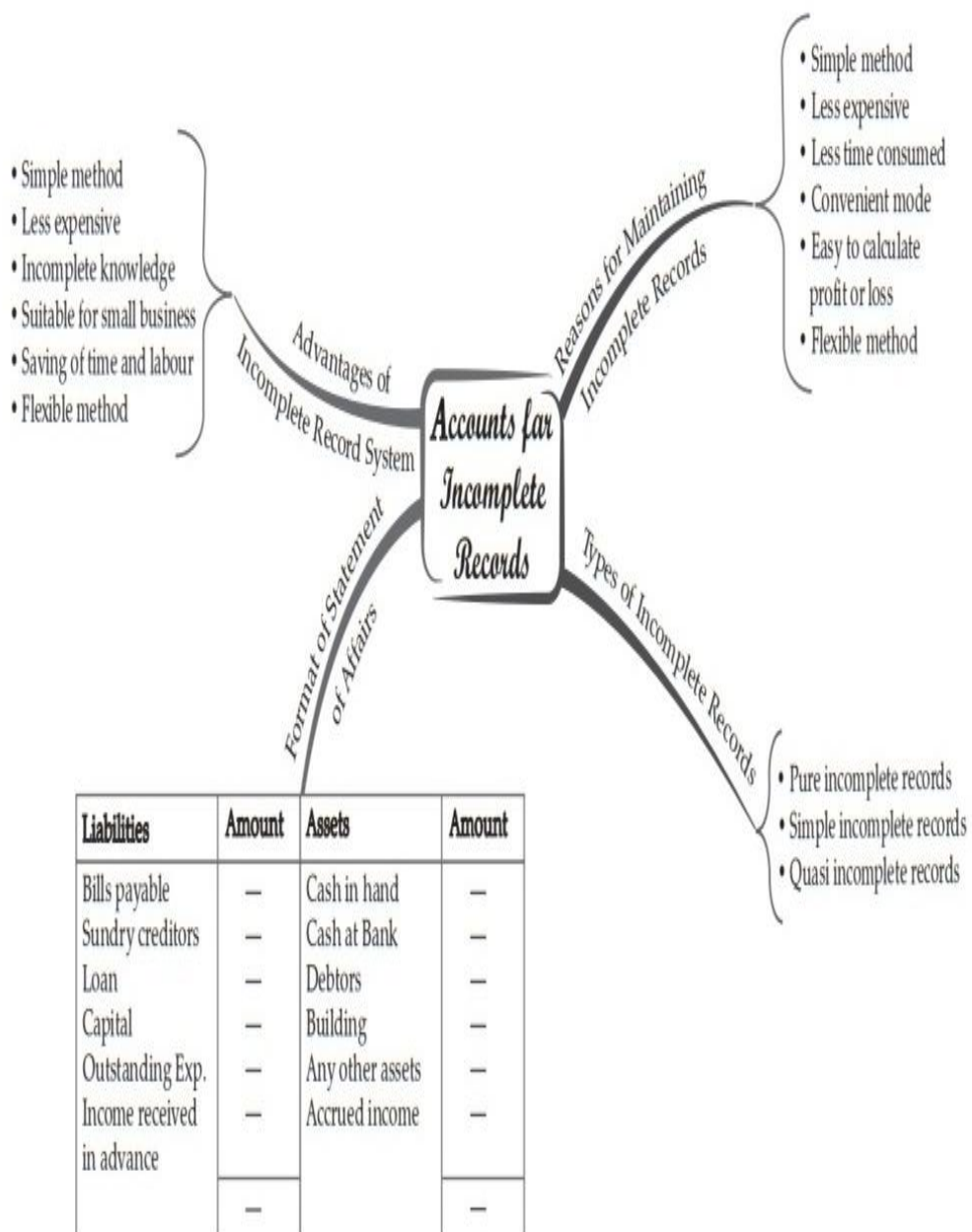
Debit Balance	Amt. (₹)	Credit Balance	Amt. (₹)
Sundry Debtors	1,45,000	Sundry Creditors	63,000
Drawings	52,450	Capital A/c	7,10,000
Insurance	6,000	Return Outward	5,000
General Expenses	30,000	Sales	9,87,800
Salaries	1,50,000		
Patents	75,000		
Machinery	2,00,000		
Freehold Land	1,00,000		
Building	3,00,000		
Stock (1 <sup>st</sup> April, 2022)	57,600		
Cash at Bank	26,300		
Carriage on Purchases	20,400		
Carriage on Sales	32,000		
Fuel & Power	47,300		
Wages	1,04,800		
Return Inwards	6,800		
Purchases	4,06,750		
Cash in Hand	5,400		
	<b><u>17,65,800</u></b>		<b><u>17,65,800</u></b>

**Adjustments:**

- Stock on 31<sup>st</sup> March 2023 was valued at ₹ 68,000.
- A Provision for Bad & Doubtful Debts is to be made to the extent of 5% on Sundry Debtors.
- Depreciate Machinery by 10%; Patents by 20% & Building by 5%.
- Wages include a sum of ₹ 20,000 spent on construction of a cycle shed.
- Salaries for the month of February and March 2023 were not paid.
- Insurance includes a premium of ₹ 1,700 on a policy expiring on 30<sup>th</sup> Sep. 2023.

## ACCOUNTS FROM INCOMPLETE RECORDS

(MIND MAP)



## **LEARNING OBJECTIVES:**

After studying this chapter, you will be able to:

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

Accounting records, which are not strictly kept according to double entry system, are known as **incomplete records**. Many authors describe it as single entry system.

However, single entry system is a misnomer because there is no such system of maintaining accounting records. Normally, under this system records of cash and personal accounts of debtors & creditors are properly maintained, while the information relating to assets, liabilities, expenses and revenues is partially recorded. Hence, these are usually referred as incomplete records.

### **Features of Incomplete Records:**

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

The features of incomplete records are as under:

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

### **Reasons of Incompleteness and its Limitations:**

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

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

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

**The limitations of incomplete records are as follows:**

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

**Ascertainment of Profit or Loss:**

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

- (a) the profit made or loss sustained by the firm during a given period; and
- (b) the amount of assets and liabilities as at the closing date of the accounting period. Therefore, the problem faced in this situation is how to use the available information in the incomplete records to ascertain the profit or loss for the particular accounting year and to determine the financial position of a entity as at the end of the year.

This can be done in two ways:

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

**Preparing Statement of Affairs** Under this method, statements of assets and liabilities as at the beginning and at the end of the relevant accounting period are prepared to ascertain the amount of change in the capital during the period. Such a statement is known as **statement of affairs**, shows assets on one side and the liabilities on the other just as in case of a balance sheet. The difference between the totals of the two sides (balancing figure) is the capital.

Though statement of affairs resembles balance sheet, it is not called a balance sheet because the data is not wholly based on ledger balances. The amount of items like fixed assets, outstanding expenses, bank balances, etc. are ascertained from the relevant documents and physical count.

**Format of statement of affairs****Statement of Affairs as at –**

<b>Liabilities</b>	<b>Amt. (₹)</b>	<b>Assets</b>	<b>Amt. (₹)</b>
Bills payable	.....	Land and Building	.....
Creditors	.....	Machinery	.....
Outstanding expenses	.....	Stock	.....
Capital (balancing figure)*	.....	Furniture	.....
		Debtors	.....
		Cash and Bank	.....
		Prepaid expenses	.....
		Capital (balancing figure)*	.....
	<b>XXXX</b>		<b>XXXX</b>

**Note:** \* where the total of liabilities side is more than total of assets side, capital would be shown in assets

side and it represents debit balance of capital

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

#### Statement of Profit or Loss for the year ended.....

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

The same computation can be done in the form of an equation as follows:

**Profit or Loss** = Capital at end – Capital at beginning + Drawings during the year – Capital introduced during the year.

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

Capital at the beginning of year, i.e. April 01, 2022	₹ 60,000
Capital at the end of year, i.e. on March 31, 2023	₹ 1, 00,000
Capital brought in by the proprietor during the year	₹ 25,000

Withdrawals made by the proprietor during the year ₹ 15,000. The profit for the year will be calculated as follows: The profit earned or loss incurred during a given period will be computed as follows:

#### Statement of Profit or Loss for the year ended.....

Particulars	Amt. (₹)
Capital as on March 31, 2023	1,00,000
<b>Add:</b> Drawings during the year	<u>15,000</u>
	<b>1,15,000</b>
<b>Less:</b> Additional capital introduced during the year	<u>(25,000)</u>
<b>Adjusted capital at the end, i.e. March 31, 2023</b>	<b>90,000</b>
<b>Less:</b> Capital in the beginning, i.e. April 01, 2022	<u>(60,000)</u>
<b>Profit made during the year</b>	<b><u>30,000</u></b>

Mrs. Sugandha runs a small printing firm. She was maintaining only some records, which she thought, were sufficient to run the business.

On April 01, 2022, available information from her records indicated that she had the following assets & liabilities: Printing Press ₹ 5,00,000; Buildings ₹ 2,00,000; Stock ₹ 50,000; Cash at bank ₹ 65,600; Cash in hand ₹ 7,980; Dues from Customers ₹ 20,350; Dues to creditors ₹ 75,340 and Outstanding

wages ₹ 5,000. She withdrew ₹ 8,000 every month for meeting her personal expenses. She had also introduced ₹ 15,000 during the year as additional capital.

On 31<sup>st</sup> March, 2023 her position was as follows: Press ₹ 5, 25,000; Buildings ₹ 2, 00,000; Stock ₹ 55,000; Cash at bank ₹ 40,380; Cash in hand ₹ 15,340; Dues from Customer's ₹ 17,210; Dues to Creditors ₹ 65,680.

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

**Solution:**

**Books of Mrs. Sugandha**

**Statement of Affairs as on April 1, 2013 and as on March 31, 2023**

Liabilities	01 Apr. 2022 (₹)	31Mar. 2023 (₹)	Assets	01 Apr. 2022 (₹)	31Mar. 2023 (₹)
Creditors	75,340	65,680	Printing press	5,00,000	5,25,000
Wages outstanding	5,000	-----	Building	2,00,000	2,00,000
Capital (bal. figure)	7,63,590	7,87,250	Debtors	20,350	17,210
			Stock	50,000	55,000
			Cash in hand	65,600	40,380
			Cash at bank	7,980	15,340
	<b>8,43,930</b>	<b>8,52,930</b>		<b>8,43,930</b>	<b>8,52,930</b>

**Statement of Profit or Loss for the year ended as on March 31, 2023**

Particulars	Amt. (₹)
Capital as on March 31, 2023	7,87,250
<b>Add:</b> Drawings during the year	<u>96,000</u>
	8,83,250
<b>Less:</b> Additional capital introduced during the year	<u>(15,000)</u>
<b>Adjusted capital at the end of the year (31.3.2023)</b>	8,68,250
<b>Less:</b> Capital as on April 01, 2022	<u>(7,63,590)</u>
<b>Profit made during the year</b>	<b><u>1,04,660</u></b>

**Difference between Statement of Affairs and Balance Sheet:**

Both statement of affairs and balance sheet show the assets and liabilities of a business entity on a particular date. However, there are some fundamental differences between the two.

These differences have been shown in a tabular form as under:

Basis of difference	Statement of affairs	Balance sheet
<b>1. Reliability</b>	It is less reliable as it is prepared from incomplete records.	It is more reliable as it is prepared from double entry records.
<b>2. Objective</b>	The objective of preparing statement of affairs is to estimate the balance in capital account on a particular date.	The objective of preparing balance sheet is to show the true financial position of an entity on a particular date.
<b>3. Omission</b>	Omission of assets or liabilities cannot be discovered easily.	Omissions of assets or liabilities can be discovered easily and can be traced from accounting records.

### **PRACTICE QUESTIONS:**

1. Manu started his business on 1<sup>st</sup> Jan, 2013 with a capital of ₹ 4, 50,000. On 31<sup>st</sup> Dec, 2022 his position was as under:

Cash ₹ 99,000; Bills receivable ₹ 75,000; Plant ₹ 48,000; Land and Building ₹ 1, 80,000; Furniture ₹ 50,000. He owed ₹ 45,000 from his friend Sunil on that date. He withdrew ₹ 8,000 per month for his household purposes.

Ascertain his profit or loss for this year ended 31<sup>st</sup> Dec, 2022.

**[Ans: Profit: ₹ 53,000]**

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

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

**[Ans: Profit: ₹ 1,600]**

3. Mr. Manoj maintains his books of accounts from incomplete records. His books provide the information:

	<b>Jan. 01, 2022</b>	<b>Dec. 31, 2022</b>
	<b>Amt. (₹)</b>	<b>Amt. (₹)</b>
Cash	1,200	1,600
Bills receivable	—	2,400
Debtors	16,800	27,200
Stock	22,400	24,400
Investment	—	8,000
Furniture	7,500	8,000
Creditors	14,000	15,200

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

**[Ans: Profit: ₹ 9,780]**

4. Mr. White does not keep his books properly. Following information is available from his books.

	<b>01/04/2022 Amt. (₹)</b>	<b>31/03/2023 Amt. (₹)</b>
Sundry Creditors	45,000	93,000
Loan from wife	66,000	57,000
Sundry Debtors	22,500	-----
Land & Building	89,600	90,000
Cash in Hand	7,500	8,700
Bank Overdraft	25,000	-----
Furniture	1,300	3,000
Stock	24,000	15,500
Computer	10,000	9,500

During the year Mr. White sold his private car for ₹ 50,000 at 5% Premium and invested this amount into the business. He withdrew from the business ₹ 1,500 per month upto 30<sup>th</sup> June 2022 & thereafter ₹ 4,500 per month drawings. Depreciation on Furniture is 25% and 10 % annually.

5. Mr. Ashwani does not keep his books properly. Following information is available from his books.

	<b>Jan. 01, 2022</b>	<b>Dec. 31, 2022</b>
	<b>Amt. (₹)</b>	<b>Amt. (₹)</b>
Sundry creditors	45,000	93,000
Loan from wife	66,000	57,000
Sundry debtors	22,500	-----
Land and Building	89,600	90,000
Cash in hand	7,500	8,700
Bank overdraft	25,000	-----
Furniture	1,300	1,300
Stock	34,000	25,000

During the year Mr. Ashwani sold his private car for ₹ 50,000 and invested this amount into the business. He withdrew from the business ₹ 1,500 per month upto July 31, 2022 and thereafter ₹ 4,500 per month as drawings.

You are required to prepare the statement of profit or loss and statement of affair as on 31<sup>st</sup> Dec, 2022.

**[Ans: Loss: ₹ 57,900]**

----- END OF CHAPTER -----