Accountancy and Financial Management–I

F.Y.B.Com: Semester–I

Discipline Specific Elective (DSE) Course

(As per Revised Syllabus w.e.f. 2016–17)

About the Author

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Preface

Accountancy and Financial Management–I is designed to cater to the needs of students of F.Y.B.Com and teachers for the three-year integrated courses in Bachelor of Commerce at the University of Mumbai. This text book aims to build the foundation of knowledge for future education in the field of Accountancy.

This book exhaustively covers the fundamental theoretical concepts along with the practical problems, provides an insight into examination-based questions, and reinforces the concepts by the way of advance problems/exercise problems provided at the end of the book.

Basis the discussion with students and teachers, this textbook has been written in a jargon-free language and covers all relevant topics meant for undergraduate students and at the same time aims to encourage the students to practice theory and practical problems to appear for various examinations like CA, ICWA, CS, MBA, etc.

Acknowledgements

I express my sincere thanks and gratitude to the team at McGraw Hill Education (India) Pvt. Ltd. for showing confidence in me as an author. I am grateful to Ms. Vibha Mahajan, Mr. Suman Sen and Mr. Sagar Divekar for helping in bringing out this publication. I am also thankful to my fellow teachers for their encouragement.

I would also like to extend my sincere thanks to Professor Harish Jagdish Sharma and Mr. Amit Chatterjee for their invaluable contributions to this title.

I look forward to valuable suggestions from the teachers and students for further improvement on this book.

Sanjay D. Sonawane

Syllabus

Accountancy and Financial Management–I (Semester–I)
(As per Revised Syllabus implemented from 2016–17)
F.Y.B.Com

Under Choice Based Credit, Grading and Semester System
Discipline Specific Elective (DSE) Course

Syllabus [3 credits]	Chapter in the Book
MODULE-1: Accounting Standards Issued by ICAI and Inventory Valuation	
• **Accounting Standards:** Concepts, benefits, procedures for issue of accounting standards, Various AS: ▪ **AS-1: Disclosure of Accounting Policies** (a) Purpose, (b) Areas of Policies, (c) Disclosure of Policies, (d) Disclosure of Change in Policies, (e) Illustrations	**Chapter-1**
▪ **AS-2: Valuation of Inventories (Stock)** (a) Meaning and Definition, (b) Applicability, (c) Measurement of Inventory, (d) Disclosure in Final Account, (e) Explanation with Illustrations	**Chapter-2**
▪ **AS-9: Revenue Recognition** (a) Meaning and Scope, (b) Transactions excluded, (c) Sale of Goods, (d) Rendering of Services, (e) Effects of Uncertainties, (f) Disclosure, (g) Illustrations	**Chapter-3**
• **Inventory Valuation** (a) Meaning of inventories, (b) Cost for inventory valuation, (c) Inventory systems: Periodic and Perpetual Inventory System, (d) Valuation: Meaning and importance, (e) Methods of Stock Valuation as per AS – 2: FIFO and Weighted Average Method (f) Computation of valuation of inventory as on balance sheet date: If inventory is taken on a date after the balance sheet or before the balance sheet	**Chapter-4**
MODULE-2: Final Accounts	
• **Capital and Revenue: Expenditure and Receipts** (a) Expenditure: Capital, Revenue, (b) Receipts: Capital, Revenue	**Chapter-5**
• **Adjustment and Closing Entries, Final accounts of Manufacturing concerns (Proprietary Firm)**	**Chapter-6**
MODULE-3: Departmental Accounts	
(a) Meaning (b) Basis of Allocation of Expenses and Incomes/Receipts (c) Inter Departmental Transfer : at Cost Price and at Invoice Price Stock Reserve (d) Departmental Trading and Profit & Loss Account and Balance Sheet	**Chapter-7**
MODULE-4: Accounting for Hire Purchase	
(a) Meaning (b) Calculation of interest (c) Accounting for hire purchase transactions by asset purchase method based on full cash price (d) Journal entries, ledger accounts and disclosure in balance sheet for hirer and vendor (excluding default, repossession and calculation of cash price)	**Chapter-8**

Question Paper Pattern and Analysis

Accountancy and Financial Management–I (Semester–I)
(As per Revised Syllabus implemented from 2016–17)
F.Y.B.Com

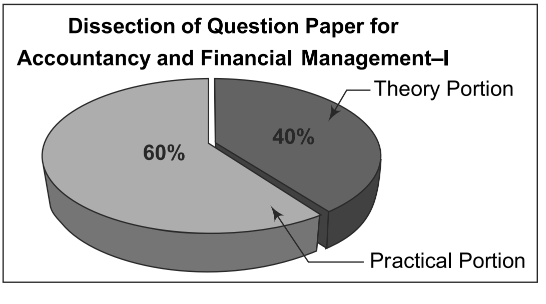
Maximum Marks: **100** **Duration: 3 Hours**

Note: *1. All questions are compulsory.*
2. Question 1 carries 20 marks.
3. Questions 2 to 6 each carries 15 marks.
4. Practical question of 15 marks may be divided into two sub questions of 7 & 8 and 10 & 5 marks.

Question No.	Particulars	Marks	Nature of Question
Q-1	Objective Questions (A) Answer any 10 sub questions out of 12 (B) Answer any 10 sub questions out of 12 (Multiple Choice / True or False / Match the Columns/ Fill in the Blanks)	 10 marks 10 marks	Theory
Q-2 Q-2	Full Length Practical Question ***OR*** Full Length Practical Question	15 marks 15 marks	Practical
Q-3 Q-3	Full Length Practical Question ***OR*** Full Length Practical Question	15 marks 15 marks	Practical
Q-4 Q-4	Full Length Practical Question ***OR*** Full Length Practical Question	15 Marks 15 Marks	Practical
Q-5 Q-5	Full Length Practical Question ***OR*** Full Length Practical Question	15 Marks 15 Marks	Practical
Q-6 Q-6	(A) Theory Questions (B) Theory Questions ***OR*** Short Notes Answer any 4 out of 6 (4 × 5 marks)	10 Marks 10 Marks 20 Marks	Theory
	Gross Total	**100 Marks**	

I. Question Paper – Theory and Numerical Weightage

(Based on November, 2016 and March, 2017 Semester–I Question Papers)

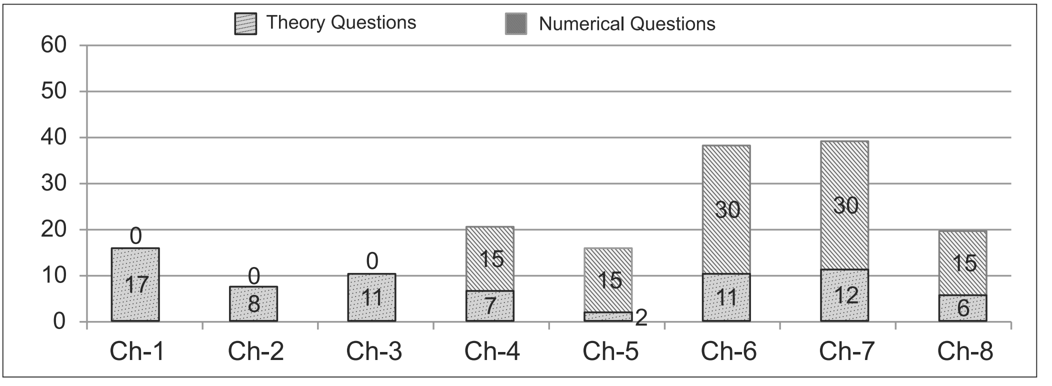


The analysis of question papers of November, 2016 and March, 2017 for Accountancy and Financial Management–I concludes that theoretical portion accounts for 40 marks and numerical portion accounts for 60 marks of the question paper.

II. Chapter-wise Weightage

F.Y.B.Com: Semester–I

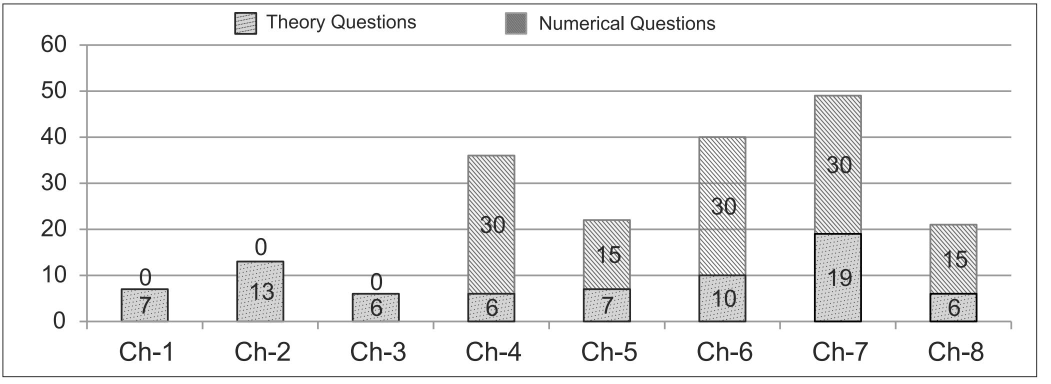
November, 2016



*Total Marks include marks of internal choices
*Chapters are in sequence to chapters order in the book

Analysis of Question Paper of F.Y.B.Com: Semester–I November, 2016							
Ch. No	**Types of Questions**						**Total Marks**
	Chapter Name	**Fill ups**	**True or False**	**Long Answer**	**Short Notes**	**Numerical Questions**	
1	AS-1: Disclosure of Accounting Policies	0	2	1	1	0	17 marks
2	AS-2: Valuation of Inventories	2	1	0	1	0	8 marks
3	AS-9: Revenue Recognition	0	1	1	0	0	11 marks
4	Inventory Valuation	1	1	0	1	2	37 marks
5	Capital and Revenue: Expenditure and Receipts	1	1	0	0	1	17 marks
6	Final Accounts of Manufacturing Concerns	4	2	0	1	2	41 marks
7	Departmental Accounts	1	1	0	2	2	42 marks
8	Accounting for Hire Purchase	3	3	0	0	1	21 marks
	Total No. of Questions	12	12	2	6	8	**194 marks**
							Gross Total (with choices)

March, 2017



*Total Marks include marks of internal choices
*Chapters are in sequence to chapters order in the book

Analysis of Question Paper of F.Y.B.Com: Semester–I March, 2017							
Ch. No	**Types of Questions**						**Total Marks**
	Chapter Name	**Fill ups**	**True or False**	**Long Answer**	**Short Notes**	**Numerical Questions**	
1	AS-1: Disclosure of Accounting Policies	1	1	0	1	0	7 marks
2	AS-2: Valuation of Inventories	1	2	1	0	0	13 marks
3	AS-9: Revenue Recognition	0	1	0	1	0	6 marks
4	Inventory Valuation	0	1	0	1	2	36 marks
5	Capital and Revenue: Expenditure and Receipts	1	1	0	1	1	22 marks
6	Final Accounts of Manufacturing Concerns	4	1	0	1	2	40 marks
7	Departmental Accounts	2	2	1	1	2	49 marks
8	Accounting for Hire Purchase	3	3	0	0	1	21 marks
	Total No. of Questions	12	12	2	6	8	**194 marks**
							Gross Total (with choices)

Contents

CHAPTER 1

Accounting Standards and Disclosure of Accounting Policies (AS-1)

CHAPTER OUTLINE

EXERCISE

1.1 INTRODUCTION

In our journey so far with Accountancy, we have learnt that the books of account must reflect the factual figures. With the help of these financial figures, different accounting users (say, business owners, management, creditors, banks, existing and potential investors, etc.) draw useful information. We know that with the globalisation and technological advancements, flow of investment from one country to another has become easier and faster. These advancements have expanded the scope of investment and investment choices. Nowadays, an investor from the United States can invest in an Indian company and similarly, any Indian investor can invest in any American company. But it is natural that an American company and an Indian company follow different accounting practices and policies. Due to these differences, it becomes difficult for the investors to understand the financial statements of different companies located in different regions. Thus, the need arises for a 'common accounting language' across different companies. This is the role of Accounting Standards that act as a common language for accounting.

1.2 ACCOUNTING STANDARDS

1.2.1 Meaning of Accounting Standards

Accounting Standards are the basic accounting rules and procedures that are issued by an expert accounting body or a regulatory body. These accounting rules and procedures are related to recognition, measurement, treatment and disclosure of transactions in the financial statements. In other words, Accounting Standards provide a basic framework for preparing financial statements.

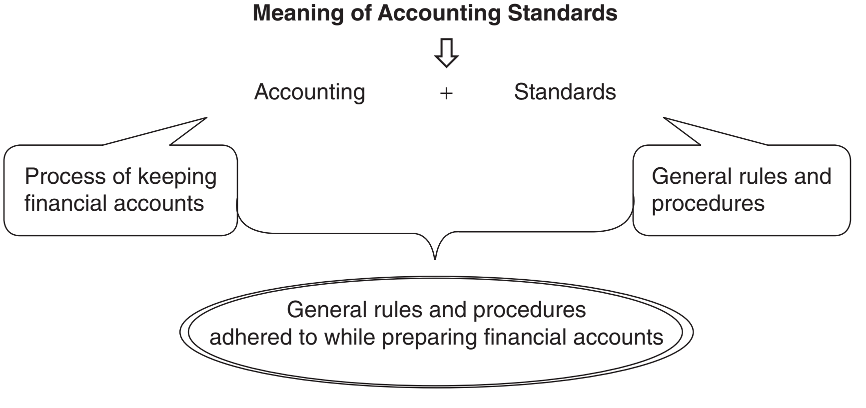


Figure 1.1 *Meaning of Accounting Standards.*

Definition

Accounting Standards are the basic accounting rules and procedures that are related to recognition, measurement, treatment and disclosure of transactions in the financial statements. In other words, Accounting Standards provide a basic framework for preparing financial statements.

In India, Accounting Standards are issued by the Accounting Standards Board (ASB), which has been established by The Institute of Chartered Accountancy of India (ICAI) on April 21, 1977. Since then, ASB has been formulating many Accounting Standards which have to be adhered to and followed by all the Indian organisations.

1.2.2 Objectives and Needs of Accounting Standards

The objectives of Accounting Standards are as follows:

1. To ***eliminate*** the effect of different accounting practices and policies adopted by different enterprises.
2. To enable laying of ***meaningful comparative studies*** of the financial statements of different enterprises to derive useful information.
3. To bring ***uniformity and consistency*** in the recording of transactions and the preparation of financial statements across different enterprises.
4. To prescribe guidelines so as to ***eliminate confusion*** and to ***resolve financial conflicts*** between different accounting users.
5. To reduce the chances of ***frauds and misrepresentation*** of financial performance of the businesses.

1.2.3 Advantages and Disadvantages of Accounting Standards

Advantages

1. ***Uniformity and Consistency***: Accounting Standards bring uniformity and consistency in the financial statements of different enterprises, as they adhere to the common guidelines while preparing their financial statements.
2. ***Enabling Comparisons***: As the financial statements of different enterprises are developed as per the common Accounting Standards, fruitful comparisons (like intra-firm and inter-firm comparisons) can be made.
3. ***Helps in Decision Making***: Different accounting users can fetch meaningful information by analysing the financial statements. This information helps them to take important decisions; for example, a potential investor is interested in knowing the better company for investment.
4. ***Enhances Transparency and Reliability***: Accounting Standards have made it compulsory for the enterprises to disclose important information while preparing financial statements. No enterprise can hide any relevant, significant and material information. Thus, this has made the financial statements to be more transparent and reliable.
5. ***Attracts Investments***: Accounting Standards act as a common accounting language which can be easily understood by potential investors across different regions and different countries. As a result, it helps the businesses to attract investments not only from different regions within a country but also from abroad.

Disadvantages

1. ***Rigidity***: Since Accounting Standards are compulsory in nature, hence, they make presentation of financial statements more rigid.
2. ***Difficulties due to differences in Accounting Standards***: Due to the differences in the Accounting Standards followed in different countries, at times, it becomes difficult to conduct meaningful comparisons between the enterprises located in different countries.
3. ***Subsidised by law***: Accounting Standards cannot override law. There arise a few situations, where, accounts have to be prepared as per law, instead of Accounting Standards, which creates differences.

1.3 ACCOUNTING STANDARDS BOARD (ASB)

In India, The Institute of Chartered Accountants of India (ICAI) established a dedicated body known as 'Accounting Standards Board' (ASB) on April 21, 1977. The primary role of ASB is to prepare Accounting Standards that are to be adhered to by all the Indian enterprises.

1.3.1 Functions and Roles of Accounting Standards Board

The functions and roles performed by ASB are as follows:

1. To suggest areas in which Accounting Standards are needed to be developed.
2. To formulate Accounting Standards.
3. To consider applicable laws, customs, usages and business environment of India.
4. To assist the Council of the ICAI in the establishment and issuance of Accounting Standards in India.
5. To examine and to align Indian Accounting Standards with the International Accounting Standards (IAS) or International Financial Reporting Standard (IFRS).
6. To reviews the already issued Accounting Standards in the light of changing business environment.
7. To evaluate the need or revision of existing Accounting Standards.
8. To promote and persuade the adoption of Accounting Standards.

1.3.2 Steps Involved in Framing Accounting Standards

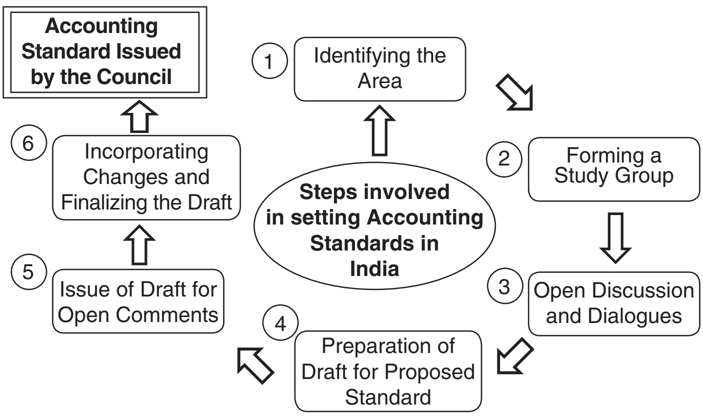


Figure 1.2 *Steps involved in framing Accounting Standards.*

As shown in Figure 1.2, the steps involved in setting an Accounting Standard can be broadly segregated into the following six steps.

1. ***Step 1—Identifying the Area***: At the very first instance, ASB identifies the area in which it is planning to frame an Accounting Standard.
2. ***Step 2—Forming a Study Group***: Once the area in which an Accounting Standard is needed has been identified, as the next step a study group is formed. This group consists of members of the ICAI and other experts. This study group helps ASB to prepare the Accounting Standard so needed.
3. ***Step 3—Open Discussion and Dialogues***: After the formation of study group, ASB organises an open discussion with the representatives from government, public sector undertakings

(PSUs), industries and other organisations. Through these discussions, ASB aims at seeking their views in relation to the need of the proposed Accounting Standard.

4. ***Step 4—Preparation of Draft for Proposed Accounting Standard***: Based on the findings of the study group and discussions with the representatives, ASB prepares a draft of the proposed Accounting Standard. The draft includes the following basic points.
   - A statement of concepts and fundamental accounting principles relating to the standard.
   - Definitions of the terms used in the standard.
   - The manner in which the accounting principles have been applied for formulating the standard.
   - The preparation and disclosure requirements in complying with the standard.
   - Class of enterprises to which the standard will apply.
   - Date from which the standard will be effective.
5. ***Step 5—Issue of Draft for Open Comments***: Now, once the draft has been prepared, it is exposed to the accounting bodies (such as CLB, C&AG, ICWAI, ICSI) and to general public.
6. ***Step 6—Incorporating Changes and Finalising the Draft***: Based on the comments received from the above accounting bodies and from the general bodies, the draft Accounting Standard is modified and the final draft (after incorporating the changes) is submitted to the Council of the ICAI.
7. ***Step 7—Issue of Accounting Standard***: The Council of the ICAI carefully evaluates the draft and if required, necessary modifications in the draft are carried out by the ASB. Once all such modifications have been carried out, the Accounting Standard is issued as a new Accounting Standard.

1.3.3 List of Accounting Standards Issued in India Till Date

Since the establishment of the ASB in 1977, so far 32 Accounting Standards have been issued out of which 28 Accounting Standards are effective and 4 Accounting Standards have been withdrawn. The following is the list of the Accounting Standards as shown in Table 1.1.

Table 1.1 *List of Accounting Standards Issued in India*

Year of Issue/ Revision of Accounting Standards	Number of Accounting Standards	Title of Accounting Standards
1979	AS-1	Disclosure of Accounting Policies ☼
1999 (Revised)	AS-2	Valuation of Inventories ☼
1997 (Revised)	AS-3	Cash Flow Statements
1995 (Revised)	AS-4	Contingencies and Events Occurring after the Balance Sheet Date
1997 (Revised)	AS-5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
1994 (Revised)	AS-6	Depreciation Accounting
2002 (Revised)	AS-7	Accounting for Construction Contracts
1985	AS-9	Revenue Recognition ☼
1985	AS-10	Accounting for Fixed Assets
2003 (Revised)	AS-11	The Effects of Changes in Foreign Exchange Rates

(Continued)

Table 1.1 (Continued)

1991	AS-12	Accounting for Government Grants
1993	AS-13	Accounting for Investments
1994	AS-14	Accounting for Amalgamations
2005 (Revised)	AS-15	Employee Benefits
2000	AS-16	Borrowing Costs
2000	AS-17	Segment Reporting
2000	AS-18	Related Party Disclosures
2001	AS-19	Leases
2001	AS-20	Earnings Per Share
2001	AS-21	Consolidated Financial Statements
2001	AS-22	Accounting for Taxes on Income
2001	AS-23	Accounting for Investments in Associates in Consolidated Financial Statements
2002	AS-24	Discontinuing Operations
2002	AS-25	Interim Financial Reporting
2002	AS-26	Intangible Assets
2002	AS-27	Financial Reporting of Interests in Joint Ventures
2002	AS-28	Impairment of Assets
2003	AS-29	Provisions, Contingent Liabilities and Contingent Assets

Note: The Accounting Standards marked with symbol ☼ are included in the prescribed syllabus for Accountancy and Financial Management-I. The AS-1 will be covered in the remaining part of this chapter, AS-2 is covered in Chapter 2 and AS-9 in Chapter 3.

1.4 ACCOUNTING STANDARD-1: DISCLOSURE OF ACCOUNTING POLICIES

This Accounting Standard was issued in the year 1979. During the initial years, the AS-1 was recommendatory in nature. It became compulsory to be followed by all the Indian enterprises since April 01, 1991. AS-1 deals with the disclosure of Accounting Policies followed by different enterprises with their financial statements.

1.4.1 Meaning of Accounting Policies

Meaning of Accounting Policies

'Accounting policies' is a set of rules, principles and procedures that are followed by an enterprise in preparation and presentation of financial statements of the business, for example, the policies related to depreciation, valuation, method of inventories, etc.

1.4.2 Need for Disclosure of Accounting Policies

Every enterprise follows their own set of Accounting Policies depending upon the circumstances suitable to them. For instance, enterprise A is following Straight Line Method of charging depreciation, whereas, enterprise B is following Written-Down Value Method. Accordingly, their financial position will differ, even if they have performed equally well. Different Accounting Policies also understate and overstate the amount of profits and losses. As a result, one cannot compare the financial statements of two enterprises and therefore, cannot draw out meaningful information. Thus, there arises a need to clearly mention the Accounting Policies followed by the enterprises. The accounting users can analyse the financial statements in consideration with the Accounting Policies so mentioned. This will reflect a true and fair picture of a business.

1.4.3 Fundamental Accounting Assumptions—Exempted from Disclosure (If Followed)

As per AS-1, there are certain basic or fundamental accounting assumptions that all the enterprises follow. The AS-1 exempts such fundamental accounting assumption from disclosure. In other words, an enterprise may or may not disclose these Accounting Policies. The reason for this exemption is that these Accounting Policies are very basic and every enterprise follows them. However, it should be noted that if any enterprise is not following these Accounting Policies, then it is mandatory to disclose that a specific fundamental accounting assumption is not followed.

The three fundamental accounting concepts are explained as follows:

1. ***Going Concern***: Unless it is mentioned explicitly, it is assumed that an enterprise is a going concern. It means 'people will die, but a business will continue its operations for indefinite period of time'. It implies that a business will go on forever. The life of business is not dependent upon the life of its owner/s. Even if the owner/s die/s, the business will continue to exist (as business is a separate legal entity). The financial statements of the business are prepared assuming that the enterprise intends to continue its operations and will not close.
2. ***Consistency***: Unless it is mentioned explicitly, it is assumed that once the Accounting Policies that have been adopted by a business, the same Accounting Policies will be followed consistently in the future as well. This means there would not be any change in the Accounting Policies until there is an absolute necessity. When a business changes its Accounting Policies, it is very much required to reveal such a change by way of disclosure.
3. ***Accrual***: A business records the transaction as and when it occurs and not when the payment is received or made. In other words, it can be stated that all revenues and costs are recorded as the same are earned and incurred. This is related to the time of occurring of transaction and not related to the receipt or making of payment. As a result, all the transactions that happened during a year will be recorded in the financial statements of that year (even if the payments for those transactions are not received/made during that year).

1.4.4 Areas in which Different Accounting Policies can be Adopted

The following are the areas in which different Accounting Policies can be adopted by different enterprises.

1. Methods of depreciation and amortisation
2. Treatment of expenditure during construction
3. Conversion or translation of foreign currency items
4. Valuation of inventories
5. Treatment of goodwill
6. Valuation of investments
7. Treatment of retirement benefits
8. Recognition of profit on long-term contracts
9. Valuation of fixed assets
10. Treatment of contingent liabilities, etc.

Mandatory to disclose the methods or the policies followed by an enterprise

1.4.5 Factors Affecting Selection and Application of Accounting Policies

Selection and application of Accounting Policies is done on the basis that

1. Balance Sheet reflects the true and fair financial position at the end of the accounting period
2. Profit and Loss Account reflects the true financial performance (in terms of profit and loss) during the accounting period

Thus, the following three factors should be carefully analysed while selecting Accounting Policies.

- ***Prudence***: Since the future is always uncertain, it is always wise not to anticipate a profit until and unless it actually happens, but shall always provide for all the prospective losses. On one hand, this concept ensures that the assets and the profits are not overstated, whereas, on the other hand, the liabilities and the losses are not understated. Even if there is a doubt that a probable loss might occur, provision should be made for the same. This is why we make a provision for doubtful debts and record inventories with the lower value (cost or NRV whichever is lower). This concept aims to show the assets and profits at their lowest possibility value, whereas, for the liabilities and losses at their highest possibility value.
- ***Substance over Form***: *Substance* means 'fact or reality' and *form* means 'in legal terms'. In accounts, substance or facts are considered more important than the legality. Accordingly, the financial transactions are recorded and financial statements are presented. For example, say, Mr. Shinde purchased a truck from Mr. Wagle on instalment basis. Mr. Shinde will pay Mr. Wagle the price of truck in say six annual instalments. Here the fact is that now Mr. Shinde is the owner of the truck, he is actually enjoying the benefits of the truck and earning revenue using it. However, in legal terms, until the last instalment is paid, Mr. Wagle remains the actual 'on paper' owner of the truck. Thus, as per the concept of substance over form, here, truck will be recorded as asset in the books of Mr. Shinde. This implies that facts or reality has taken over legality.

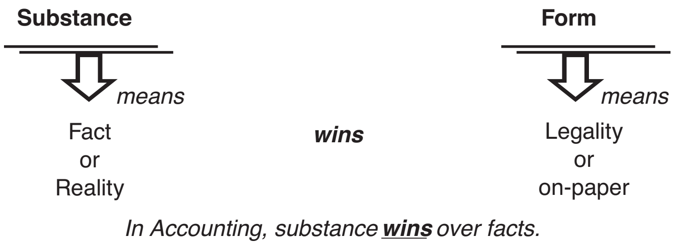


Figure 1.3

- ***Materiality***: Financial statements should disclose all those accounting information that are important for decision making and may influences the decisions of the accounting users. The decision regarding whether a particular piece of information is material (i.e. important and relevant) or immaterial depends on two factors—amount of transaction and the importance of the transaction.

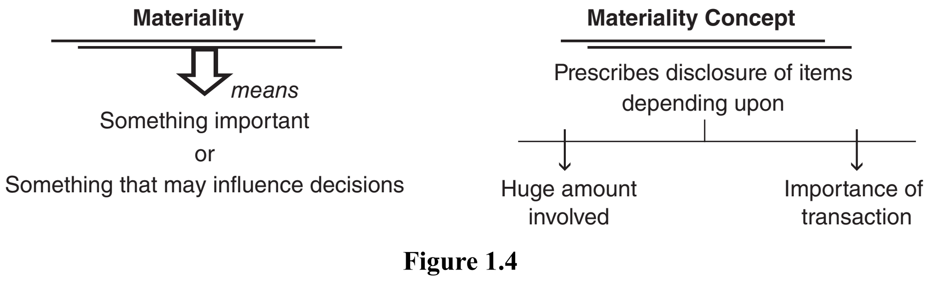


Figure 1.4

1.4.6 Disclosure Requirements as per AS-1

The following are the disclosure requirements as prescribed by AS-1.

1. To *disclose* all significant Accounting Policies that were followed for preparation of financial statements.
2. To *present* those significant Accounting Policies as *a part* of the financial statements and *at one place.*
3. To disclose if the fundamental accounting assumptions are not followed.
4. To disclose any change in the Accounting Policies that are important and can influence decision-making process of accounting users (in simple words—to disclose all changes that have material effects in the present or future years).
5. To quantify the effect of any change on financial items if possible, else, the fact of such change should be explicitly disclosed.

1.4.7 Salient Features of AS-1

The following are the salient features of AS-1.

1. It was issued in 1979.
2. It was recommendatory in nature until April 01, 1991, since when it has been made compulsory.
3. It prescribes presentation and disclosure of all the significant Accounting Policies in the financial statements.
4. It mandates the disclosure of any change in the Accounting Policies, which has a significant effect in the current or the later years.
5. It aims at enhancing transparency, uniformity and consistency of the financial statements, which enables different accounting users to lay meaningful comparisons and to draw important clear-cut conclusions.
6. It enhances the creditability and reliability of the financial statements across different enterprises.

1.5 COMPREHENSIVE ILLUSTRATIONS

Example 1: Fill in the blanks with the appropriate alternatives.

a. The information related to _______ should be disclosed in the financial statements of an enterprise. (Going Concern assumption, Materiality)
b. Provisions for bad and doubtful debts are created in adherence to _______. (Prudence, Consistency)
c. As per AS-1, _______ is not mandatory to be disclosed in the financial statements. (Consistency, Valuation of Inventories)
d. AS-9 states that as per _______ accounting transaction should be recorded on the basis of facts. (Prudence, Substance over form)
e. Accounting Standards are _______ in nature, whereas, Accounting Policies are _______ in nature. (Voluntary, Mandatory)
f. _______ is an example of Accounting Policy, whereas, _______ is an Accounting Standard. (Depreciation, Going Concern, Disclosure, Accrual)
g. _______ should be considered while selecting and applying Accounting Policies. (Materiality, Going Concern, AS-1)
h. ASB was established in the year _______. (1977, 1991)
i. AS-9 deals with the _______. (Valuation of inventories, Revenue recognition)
j. While _______ aim at reducing differences in accounting practices, _______ increases the differences in the financial statements of different enterprises. (Accounting Policies, Accounting Standards)

Solution

a. Materiality
b. Prudence concept
c. Consistency
d. Substance over form
e. Mandatory, Voluntary
f. Depreciation, Disclosure
g. Materiality
h. 1977
i. Revenue Recognition
j. Accounting Standards, Accounting Policies

Example 2: Match the following columns

Column A	Column B
a. Disclosure of Accounting Policies	1. Council of ICAI
b. Revenue Recognition	2. AS-4
c. Accounting Policies	3. ASB
d. Accounting Standards	4. AS-1
e. Issues Accounting Standards	5. Fundamental Accounting Assumptions
f. Valuation of Inventory	6. AS-9
g. Forms Accounting Standards	7. Treatment of Goodwill
	8. AS-2
	9. Mandatory

F.Y.B.Com., IDOL, April 2016 (adapted)

Solution

Column A	Column B
a. Disclosure of Accounting Policies	4. AS-1
b. Revenue Recognition	6. AS-9
c. Accounting Policies	7. Treatment of Goodwill
d. Accounting Standards	9. Mandatory
e. Issues Accounting Standards	1. Council of ICAI
f. Valuation of Inventory	8. AS-2
g. Forms Accounting Standards	3. ASB

Example 3: Match the following columns

Column A	Column B
a. Treatment of Contingent Liabilities	1. Withdrawn
b. AS-8	2. 1977
c. ASB	3. 1997
d. AS-9 (revised)	4. Factor of Accounting Policies
e. Going Concern	5. May not be revealed
f. Substance over Form	6. Fundamental Accounting Assumption
g. Small Amount (immaterial)	7. Alternative Accounting Policy

Solution

Column A	Column B
a. Treatment of Contingent Liabilities	7. Alternative Accounting Policy
b. AS-8	1. Withdrawn
c. ASB	2. 1977
d. AS-9 (revised)	3. 1997
e. Going Concern	6. Fundamental Accounting Assumption
f. Substance over Form	4. Factor of Accounting Policies
g. Small Amount (immaterial)	5. May not be revealed

Example 4: State whether the following statements are True or False after rewriting the same.

a. It is not necessary to disclose the change in Accounting Policy.

Acc&FM-I, November 2016

b. Disclosures under AS-1 need not form a part of final accounts.
c. It is not necessary to disclose the immaterial information.
d. ASB issues Accounting Standards in India.
e. AS-1 is not mandatory for all types of enterprises.
f. AS-1 prescribes the manner in which the enterprises need to prepare their financial statements.
g. Substance over form is a fundamental accounting assumption.
h. Different enterprises can adopt different Accounting Standards.
i. Accounting Standards are voluntary in nature, whereas Accounting Policies are mandatory in nature.
j. An enterprise has the option to choose an Accounting Policy to pay lower tax.

Solution

a. **False:** It is very much necessary for all types of enterprises to disclose all significant information about the changes in its Accounting Policies.
b. **False:** Disclosures under AS-1 form a part of final accounts. Disclosure of all the significant information about the changes in the Accounting Policies should be disclosed at one place and not scattered.
c. **True**
d. **False:** The Council of the ICAI issues Accounting Standards.
e. **False:** AS-1 is mandatory for all types of enterprises in India.
f. **False:** AS-1 does not prescribe the manner in which the enterprises need to prepare their financial statements.
g. **False:** Substance over form is one of the factors that are to be considered while selecting Accounting Policies.
h. **False:** Different enterprises can adopt different Accounting Policies.
i. **False:** Accounting Standards are mandatory in nature, whereas Accounting Policies are voluntary in nature.
j. **True**

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Briefly explain the meaning of Accounting Standards.
(2) Explain the objectives and needs of Accounting Standards.
(3) Explain the steps involved in framing Accounting Standards in India.
(4) Write down the implications of AS-1.
(5) State any three needs for disclosure of Accounting Policies.
(6) State any five salient features of AS-1.
(7) What do you understand by Fundamental Accounting Assumptions?
(8) Enlist all the factors that are to be considered while selecting and applying Accounting Policies. Briefly explain any two of them.
(9) Mention the disclosure requirements as prescribed by AS-1.
(10) "Accounting Standards lead to rigidity and at times are being subsidised by law." Comment.
(11) Highlight any five limitations of Accounting Standards.
(12) State any seven roles and functions performed by Accounting Standards Board in India.
(13) Mention the areas in which different Accounting Policies are adopted. What does AS-1 prescribe for such differential practice?
(14) State any five advantages of Accounting Standards.
(15) Explain the concept of Account Policies and state the needs for disclosure of Accounting Policies.
(16) Briefly explain the concept of 'substance over form' with the help of example.

II. Short Notes (5 marks)

(1) Accounting Standards
(2) Role and functions of ASB
(3) Accounting Assumptions
(4) Going Concern Concept
(5) Prudence
(6) Materiality
(7) Substance over form
(8) Implications of AS-1
(9) Accrual Concept
(10) Needs of Accounting Standards
(11) Consistency
(12) Features of AS-1
(13) Draft contents for proposed Accounting Standard

III. Objective Type Questions

(1) Which of the following organisations issues Accounting Standards in India?
(a) Council of ICAI (b) Government of India
(c) ASB (d) Parliament of India

(2) Who identifies the areas for drafting Accounting Standards in India?
(a) Council of ICAI (b) ICAI
(c) ASB (d) Study Group

(3) Which of the following statements is not an advantage of Accounting Standards?
(a) Uniformity (b) Consistency
(c) Enables comparison (d) Eases complexities

(4) Which of the following statements is not a disadvantage of Accounting Standards?
(a) Rigidity (b) Difficulties due to differences
(c) Reduces innovation (d) Subsidised by law

(5) Which of the following is not mandatory in nature?
(a) Accounting Policies (b) Accounting Standards
(c) Accounting Assumption (d) None of the above

(6) When was the AS-1 issued?
(a) 1977 (b) 1979
(c) 1991 (d) 1999

(7) Since when AS-1 has been made compulsory?
(a) 1977 (b) 1979
(c) 1991 (d) 1999

(8) Which one of the following is not a fundamental accounting assumption?
(a) Going Concern (b) Prudence
(c) Consistency (d) Accrual

(9) Which one of the following is not a selection criterion for Accounting Policies?
(a) Valuation of inventories (b) Prudence
(c) Substance over form (d) Materiality

(10) Which one of the following implications stands true for substance over form?
The financial transactions are recorded on the basis of:
(a) Facts (b) Legality
(c) Materiality (d) Both (b) and (c)

(11) Which of the following is not an objective of Accounting Standards?
(a) To bring uniformity and consistency
(b) To ascertain the financial position of an organisation
(c) To resolve financial conflicts
(d) To eliminate effects due to different accounting practices

(12) Which of the following functions is not performed by ASB?
(a) To identify areas for new Accounting Standards
(b) To formulate Accounting Standards
(c) To consider applicable laws and business environment
(d) To issue new Accounting Standards

(13) Which of the Accounting Standards has been withdrawn?
(a) AS-8 (b) AS-31
(c) AS-29 (d) AS-26

(14) How many Accounting Standards have been issued in India till date?
(a) 29 (b) 30
(c) 31 (d) 32

(15) When was ASB established?
(a) 1977 (b) 1979
(c) 1991 (d) 1999

(16) Which of the following concept underlies 'a business intends to continue its operations and will not close'?
(a) Prudence (b) Accrual
(c) Consistency (d) Going Concern

(17) In which of the following cases different organisations can have differential methods?
(a) Valuation of goodwill (b) Valuation of inventories
(c) Method of charging depreciation (d) Revenue recognition

(18) Which of the following indicates non-adherence to prudence concept?
(a) Provision of doubtful debts
(b) Maintaining provision for depreciation
(c) Recording inventories always at NRV
(d) Recording losses based on anticipation

(19) Which of the following indicates adherence to substance over form concept?
(a) Recording on the basis of facts (b) Recording on the basis of legal facts
(c) Both (a) and (b) (d) None of the above

(20) Which of the following indicates adherence to materiality concept?
(a) Disclosing all the events
(b) Disclosing only the significant facts
(c) Disclosing insignificant things such as pen, pins, etc.
(d) None of the above

(21) Which of the following indicates adherence to accrual concept?
(a) Recognising revenue on the date of sale
(b) Recognising revenue on the date of receiving payment
(c) Recognising revenue on the date of delivering goods
(d) None of the above

(22) Which of the following indicates non-adherence to consistency concept?
  (a) Following the same method of charging depreciation over years
  (b) Following the same method of charging depreciation by different organisation
  (c) Changing method of charging depreciation by an organisation
  (d) Not adopting any change in the method, even if the same is required

(23) Treatment of goodwill is
  (a) Accounting Policy
  (b) Accounting Assumption
  (c) Accounting Standard
  (d) None of the above

(24) Which of the following statements is not a disclosure requirement as prescribed by AS-1?
  (a) Disclosing all significant Accounting Policies
  (b) Disclosing names of accountants
  (c) Quantifying effect of any change on financial items
  (d) Presenting material information along with financial statements

(25) Which of the following is not a salient feature of AS-1?
  (a) Not mandatory during the initial period of issue
  (b) Mandatory since the issue
  (c) Enhances creditability and reliability of the financial statements
  (d) Enhances disclosure of any changes in the Accounting Policies having significant effects

(26) Which of the following are the areas where different Accounting Policies can be adopted?
  (a) Valuation of inventories
  (b) Valuation of fixed assets
  (c) Treatment of Goodwill
  (d) All of the above

(27) Which of the following statement is implied by AS-1?
  (a) Disclosing all significant Accounting Policies
  (b) Quantifying effect of any change on financial items
  (c) Disclosing any change in Accounting Policies
  (d) All of the above

(28) Accounting Policies are
  (a) principles
  (b) methods of applying principles
  (c) rules
  (d) all of the above

(29) Accounting Standards are
  (a) rules and procedures
  (b) related to recognition, measurement and disclosure
  (c) basic framework
  (d) all of the above

(30) Accounting Standards ensure:
  (a) Transparency
  (b) Consistency
  (c) Comparability
  (d) All of the above

IV. Fill in the Blanks

(1) In India, the Accounting Standards are issued by _____________. (ASB/Council of ICAI).
(2) AS-1 was issued in the year _______________. (1979/1991).
(3) AS-1 was mandatory since the year _____________. (1979/1991)
(4) The number of Accounting Standards so far issued in India is ____________. (29/32)
(5) An organisation can change _____________ (Accounting Policies/Accounting Standards) for its betterment and if need be.
(6) It is _______________ (mandatory/optional) for an organisation to disclose if any of the three fundamental accounting assumptions are not followed.
(7) ASB was established in the year ___________ (1979/1977)
(8) As per prudence concept, one should record anticipated _____________ (incomes/losses).
(9) In Accounting, we should record transactions on the basis of _________________ (legal papers/facts).
(10) An ideal practice is to disclose information about all _____________ (material/immaterial) things.
(11) Provision for doubtful debts is maintained as an adherence to _____________ (prudence/going concern concept).

(12) Accounting Policies adopted by different organisations ___________ (are same/vary).
(13) Accounting Standards adhered by different organisations ___________ (are same/vary).
(14) __________ (Valuation of investment/Valuation of goodwill) is an Accounting Policy.
(15) _________________ (Method of Calculating Depreciation/Revenue Recognition) is an example of Accounting Standards.
(16) If goods are sold on credit on 31 December 2016 and the payment is received on 2 January 2017, then it should be recorded in the books of ___________ (2016/2017) as implied by __________ (accrual/ prudence concept).
(17) AS-1 prescribes the disclosure of accounting ____________________ (policies, principles, assumptions).
(18) Balance Sheet reflects the true and fair financial ____________ (position/performance) of a business.
(19) Profit and Loss Account reflects the true and fair financial ___________ (position/performance) of a business.
(20) Materiality can be decided upon by _____________ of transaction (amount/frequency).

V. Match the Following Columns

(A)

Accounting Standards	Year of Issue or Revision	Titles of Accounting Standards
a. AS-1	i. 1997 (revised)	1. Revenue Recognition
b. AS-2	ii. 1994 (revised)	2. Depreciation Accounting
c. AS-3	iii. 1979	3. Disclosure of Accounting Policies
d. AS-9	iv. 1999 (revised)	4. Cash Flow Statements
e. AS-6	v. 1985	5. Valuation of Inventories

(B)

Column A	Column B
a. Accounting Policies	i. Factor affecting selection of Accounting Policies
b. Accounting Standards	ii. Going concern
c. Fundamental Accounting Assumptions	iii. Identify the areas and drafts Accounting Standards
d. Substance over form	iv. Rules adopted by an organisation
e. Uniformity and Consistency	v. Consistency
f. The Council of the ICAI	vi. Advantages of Accounting Standards
g. ASB	vii. Issues of Accounting Standards
	viii. Common rules adopted by all the organisations

VI. State Whether the Following Statements are TRUE or FALSE

(1) An ideal practice is to disclose information about every single thing.
(2) Accounting Standards are issued by Accounting Standards Board in India.
(3) Accounting Standards are prepared by the Council of ICAI in India.
(4) A change in the Accounting Policies should be disclosed and form a part of Final Accounts.
(5) The adoption of AS-1 depends on the discretion and nature of an organisation.
(6) One should record anticipate losses, even if it is unlikely to happen.
(7) Prudence concept implies that the liabilities and the losses should be shown at their highest possibility value.
(8) It is wise to record expected and sure-shot profits based on anticipation and past experience.
(9) The Accounting Standards aim at bringing consistency in Accounting Policies followed by all the organisations across India.
(10) Prudence is one of the fundamental accounting assumptions.

(11) The transactions recorded on the basis of legal facts instead of actual facts.
(12) Only those transactions should be disclosed that are of huge amount and are significant for influencing decisions.
(13) Prudence concept implies that the assets and profits should be shown at their lower possibility value.
(14) It is only in the case when any one of the fundamental accounting assumptions is not followed, disclosure should be made.
(15) Disclosure should be made even if the fundamental accounting assumptions are followed.
(16) ASB formulates Accounting Standards, whereas, the Council of the ICAI issues the Accounting Standards.
(17) Accounting Standards facilitates decision making for the accounting users.
(18) Accounting Policies act as a common accounting language.
(19) Accounting Standards override laws in India.
(20) ASB persuade organisations to adopt Accounting Standards.
(21) The Council of the ICAI aims to align Indian Accounting Standards with the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).
(22) Adoption of and adherence to Accounting Standards are mandatory in nature.
(23) AS-1 is not compulsory for big companies and MNCs; however, it is mandatory of all the other types of organisation.
(24) There is no need to disclose if there have been no changes in the Accounting Policies of an organisation.
(25) There is no need to disclose if the fundamental accounting assumptions are being followed by an organisation.
(26) AS-1 prescribes the presentation of Financial Statements of an organisation.
(27) Closing stock should always be valued at market value irrespective of its cost.
(28) AS-1 prescribes that all the significant Accounting Policies to be a part of financial statements and should be presented at one place.
(29) Accounting Standards aim at reducing the chances of frauds and misrepresentation of financial performances of businesses.
(30) Adoption of and adherence to Accounting Policies are not mandatory in nature.

CHECK YOUR ANSWERS

III. Objective Type Questions

1–a	2–c	3–d	4–c	5–a	6–b	7–c	8–b	9–a	10–b	11–b	12–d	13–a
14–d	15–a	16–d	17–b&c	18–c	19–a	20–b	21–a	22–d	23–a	24–b	25–b	26–d
27–d	28–d	29–d	30–d									

IV. Fill in the Blanks

1-Council of ICAI	2-1979	3-1991	4-32
5-Accounting Policies	6-Mandatory	7-1977	8-Losses
9-Facts	10-Material	11-Prudence	12-vary
13-are same	14-Valuation of Investments	15-Revenue Recognition	16-(a) 31 December 2016 (b) Accrual concept
17-Policies	18- Position	19-Performance	20-amount and frequency

V. Match the Columns

(A)	(B)
(a)–(iii)–(3), (b)–(iv)–(5), (c)–(i)–(4), (d)–(v)–(1), (e)–(ii)–(2)	(a)–(iv), (b)–(viii), (c)–(ii) and (iv), (d)–(i), (e)–(vi), (f)–(vii), (g)–(iii)

VI. True or False

True	False
4, 6, 7, 12, 13, 14, 16, 17, 20, 22, 25, 28, 29	1, 2, 3, 5, 8, 9, 10, 11, 15, 18, 19, 21, 23, 24, 26 27, 30

CHAPTER 2

Accounting Standard-2: Valuation of Inventories

CHAPTER OUTLINE

EXERCISE

I. Descriptive Questions
II. Short Notes
III. Objective Type Questions
IV. Fill in the Blanks
V. Match the Columns
VI. State Whether the Statements are 'True' or 'False'
Check Your Answers

2.1 INTRODUCTION

In the last chapter, we had an in-depth discussion over AS-1 and its implications. Now, we are moving ahead to the second Accounting Standard (AS-2), which deals with valuation of inventories (or stock-in-trade). Inventories are one of the important revenue-earning sources for any business that deals in the production and/or trading of goods. The valuation and accounting of inventories is of prime importance, since incorrect valuation and accounting may either understate or overstate the amount of profit of a business. This would give wrong information about the financial performance of the business.

In the initial part of this chapter, our basic focus will be to understand the concept of inventories and which items are included and excluded from this. After this, we will learn about the scope of AS-2, the mandated techniques of valuation of inventories and finally, the disclosure requirements.

2.2 INVENTORIES

Often, we have been using the term inventories and stock synonymously. However, there is a difference between the two. Stock refers to the finished goods that are ready to be sold. In some cases, stock also includes raw materials and unfinished goods, if the business sells them to the final consumers. For instance, in the case of a textile industry, it sells cotton and threads (which are its raw materials) to its consumers in addition to the finished goods, such as shirts and readymade cloth. Thus, in the case of a textile industry, stock includes finished goods and raw materials. Inventories, on the other hand, include stock of raw materials and finished goods, machines and other materials that are used in the production process. Thus, the term 'inventories' is perhaps a wider term than stock (as it includes stock *plus* assets used in the production process).

2.2.1 Definition of Inventories (as per AS-2)

As per the Accounting Standard for Valuation of Inventories (AS-2), inventories are the assets of the company that are

1. held for sale in the ordinary course of the business;
2. in the production process for such sale or
3. in form of materials or supplies to be consumed in the production process or in rendering of services.

Meaning of Inventory

It is an asset that a business holds either with the motive of selling, reselling or to be used them in the production process of goods and rendering of services.

In simple words, it includes finished goods so produced, work-in-progress, materials, maintenance supplies and loose tools that are used-up in the production process.

2.2.2 Items Included and Excluded from Inventories under AS-2

From the above definition and meaning of inventories, we can enlist the following items that are included in inventories.

Items Included in Inventories

Types of Inventories

1. *Raw materials*: The materials that are used-up as raw materials in the production of final goods.
2. *Work-in-progress*: These are semi-finished or unfinished goods which are still in the production process.
3. *Finished goods*: These are the final finished goods that are ready to be sold to the market.
4. *Other items*: These are the supporting materials such as maintenance supplies, loose tools and consumables that are used in the production process (in addition to the raw materials).

At this moment, it is worth noting that the number of items included in inventories depends and varies from business to business. For instance, the type of inventories held by a manufacturing firm will be different from the type of inventories held by a trading firm. While a manufacturing firm is primarily engaged in the production of goods, whereas a trading firm, on the other hand, deals only in buying and selling of finished goods. Figure 2.1 below depicts the difference between the types of inventories held by both the firms.

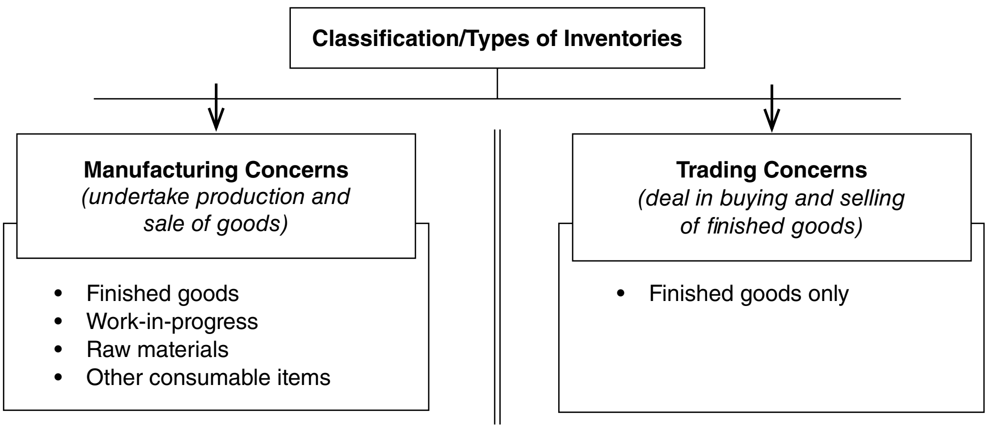


Figure 2.1 *Difference between types of inventories.*

Items Excluded from Inventories as per AS-2

AS-2 is not applied in the accounting of following items.

1. Work-in-progress arising under construction contracts, including directly related service contracts (as a separate Accounting Standard AS-7 is applicable to these cases).
2. Work-in-progress arising in the ordinary course of business of service providers (e.g. an incomplete project by a telecom industry).
3. Stock-in-trade in the form of shares, debentures and other financial instruments.
4. Producer's inventories of livestock, agricultural and forest products and mineral oils, ores and gases which are valued at net realisable value.
5. Finally, inventories do not include machinery spares, since these items can only be used with a part of fixed asset. These spares are used once in a while and there use is quite irregular. These are accounted as per AS-10 (Accounting for Fixed Assets).

2.3 ACCOUNTING STANDARD-2 (REVISED)

In June 1981 the Institute of Chartered Accountancy of India has issued Accounting Standard-2 and on 01 April, 1999 revised it. Since then it has been effective and is compulsory for all types of enterprises to adhere to for determining the cost of inventories, accounting treatment and its disclosure in the financial statements.

2.3.1 Objectives of AS-2 (Revised)

The following are the three major objectives of AS-2.

1. ***Accounting treatment of inventories***: The basic objective of AS-2 was to lay down the accounting treatment of inventories.
2. ***Determination of cost of inventories***: AS-2 provides guidance for determining the cost of inventories on the basis of cost formulas. It prescribes that the inventories should be valued either at cost or at net realisable value—whichever is lesser.
3. ***Bringing consistency in disclosure***: Prior to AS-2, there prevailed varied ways of valuation of inventories. The basic issue was in determining the value which has to be disclosed in the Balance Sheet until the corresponding revenues have been realised. With the implementation of AS-2, such differences have been reduced.

2.3.2 Important Features of AS-2 (Revised)

The important features of AS-2 (revised) have been mentioned below:

1. AS-2 (revised) defines inventories as current assets.
2. It classifies inventories as raw materials, work-in-progress, finished goods and 'maintenance and supplies'.
3. It mandates the use of both fixed as well as variable overheads while determining the cost of inventories.
4. It prescribes the use of FIFO and weighted average method as cost formula, hence, eliminated the use of earlier two methods—base stock method and LIFO (as mentioned in pre-revised version of AS).
5. It emphasises on disclosure of a method (either cost method or net realised value method) that has been opted for valuation. It also makes it compulsory to disclose if there has been any change in policy for valuation of inventories.
6. It prescribes that the inventories should be valued either at cost or at net realisable value—whichever is lesser. This is the fundamental principle of AS-2 (revised).

2.4 MEASUREMENT (OR VALUATION) OF INVENTORIES

Until now, we know that as per AS-2 (revised), inventories are to be valued either at cost or at net realisable value—whichever is lesser. Figure 2.2 below summarises the steps for valuation of inventories.

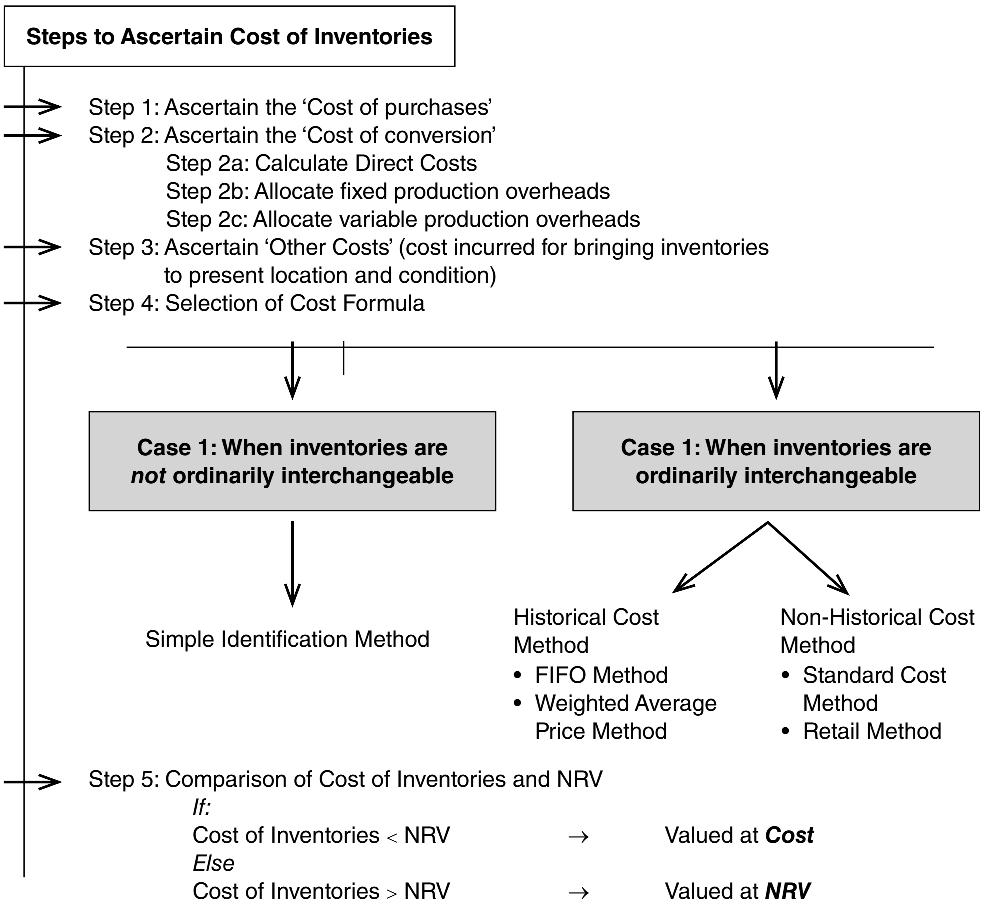


Figure 2.2 *Steps for valuation of inventories.*

2.5 MEASUREMENT (OR VALUATION) OF COST OF INVENTORIES

In order to determine the cost of inventories, we need to consider the following components of costs.

1. Cost of Purchases
2. Cost of Conversion
   - *Fixed production overheads*
   - *Variable production overheads*
3. Other Costs

2.5.1 Cost of Purchases

It includes the cost of goods purchases, duties and taxes paid on goods so purchased, freight, carriage inwards and other direct costs incurred on purchase of goods (such as brokerage, commission paid to middlemen and packing cost for transportation). While calculating the cost of purchase, items such as trade discounts, duty drawbacks, rebates and other similar items are deducted.

$$\text{Cost of Purchase} = \begin{cases} \quad \text{Purchase Price of Goods} \\ + \text{ Duties and Taxes paid (which cannot be reclaimed from government)} \\ + \text{ Freight Inwards} \\ + \text{ Carriage Inwards} \\ + \text{ Brokerage on Purchase} \\ + \text{ Other Direct Costs incurred on Purchase of Goods} \\ - \text{ Trade Discounts} \\ - \text{ Rebates} \\ - \text{ Duty Drawbacks} \end{cases}$$

2.5.2 Cost of Conversion

It includes both direct and indirect costs. Direct costs are directly related to the units of goods produced like direct labour. Indirect costs can be further segmented as fixed and variable production overhead costs.

1. ***Fixed production overhead costs:*** These indirect costs are independent of the number of units of goods produced. These costs remain constant irrespective of the units of goods produced. For example, a firm is incurring ₹1,00,000 as factory rent, factory maintenance and administration (as fixed production overhead cost). If the firm is producing 1,000 units of shoes or only 100 units, the fixed production overhead cost will remain ₹1,00,000, i.e. it irrespective of the units of goods produced.
   - *Allocation of fixed production overhead costs:* The fixed production overhead costs are allocated on the basis of *normal capacity* of the firm. It means an *expected production* level that can be achieved on an *average number of periods* under *normal circumstances* (where periods can be days, weeks, months or quarters). For example, suppose a firm operates for 5 days a week (Monday to Friday) and runs for 8 hr on daily basis. Now, suppose Ganesh Chaturthi (Monday) and Id-ul-Juha (Friday) fall in the same week. This would mean that the firm has been operational only for 3 days in that week. Hence, such a loss of capacity should be planned beforehand to ascertain the normal capacity of the firm.
2. ***Variable production overhead costs:*** These indirect costs (such as indirect materials and indirect labour) are very much dependent on the units of goods produced. Actually, these costs vary with the number of goods produced. Higher the number of goods, higher will be the amount of variable production overheads. For example, suppose that the aforementioned firm has a generator that costs ₹500 for every 100 units of shoes produced. Now, if the firm produces 200 units of shoes, then it needs to incur ₹1,000 as cost of operating generator. However, if it produces only 50 units of shoes, then it needs to incur only ₹250 for operating the generator.

- *Allocation of variable production overhead costs:* AS-2 prescribes that variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities. Figure 2.3 below summarises our discussion upon cost of conversion.

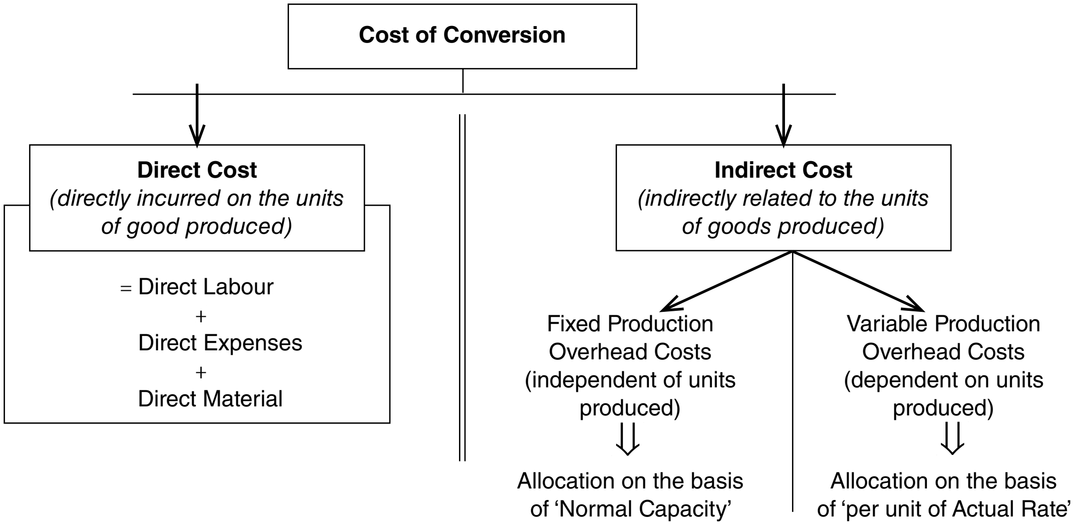


Figure 2.3 *Cost of conversion.*

2.5.3 Joint Products and By-Products

Often a production of a main product (say distillation process of petroleum) results in production of many other products. For instance, in the distillation process of petroleum, we obtain kerosene, diesel, wax, paraffin, LPG, etc. in addition to petrol. Accordingly, we can categorise the products into the following three categories.

1. ***Main product***: The product that the producer intended to produce. This product is of significant value. For instance, in the case of distillation process, petroleum is our main product.
2. ***Joint products***: The products that are produced simultaneously for the same production process have significant values. For instance, petroleum, diesel and LPG are of significant values and are the outcomes of the same production process. In this case, we regard petroleum, diesel and LPG as joint products.
3. ***By-products***: These are the side-products that are also emerged from the same production process. These have insignificant values. For example, wax has relatively insignificant value; hence, wax is regarded as a by-product.

2.5.4 Other Costs

There might be some other costs that have been incurred for bringing the inventories to their present location and conditions. Such costs should be included in the cost of inventories. For instance, warehouse costs for storing the materials before the commencement of production process. Similarly, costs of designing customised products on special demand for some clients are to be included in the cost of inventories.

2.5.5 Costs Excluded from Cost of Inventories

As prescribed by AS-2 (revised), there are a few costs that are to be excluded while calculating the cost of inventories. These costs are to be treated as expenses and are shown on the debit side of

P&L A/c of the accounting period in which these have been incurred. The following are the costs that are to be excluded.

1. Abnormal amounts of wasted materials, labour or other production costs;
2. Storage costs (other than the storage costs included in 'other costs', which are incurred subsequent to the commencement of production process);
3. Administrative overheads;
4. Selling and distribution costs;
5. Interest and borrowing costs.

2.6 COST FORMULAS

Figure 2.4 below presents a summarised picture of methods to be followed in the order to ascertain the cost of inventories.

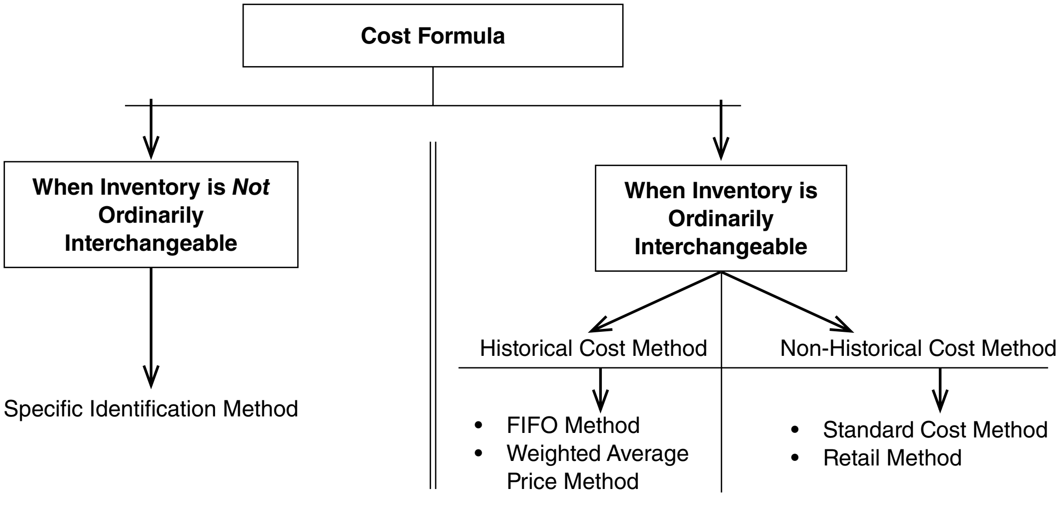


Figure 2.4 *Cost of inventories.*

Case 1: When inventories are *not* ordinarily interchangeable
It is the situation, where each item of inventories is different and cannot be replaced by another item in the production process or sale. This is to say that each item is peculiar and distinct from the other. For instance, where there are two finished products such as notebooks and pencil, the inventories used for production of notebooks are different and cannot be used in the production of pencils. In such a case, a 'specific identification method' is used to ascertain the cost of inventories.

2.6.1 Specific Identification Method

According to this method, the cost of inventories is ascertained on the basis of the items that have been exclusively used up in the production of specific product/s. This cost is then allocated to the cost of specific goods so produced. In this method, a detailed record of inventories purchased in different lots and at different points of time is maintained. For instance, suppose a notebook manufacturing firm receives a special demand from Mumbai University to produce customised notebooks with the university logo and faculties' names engraved. In this case, the inventories used for the production of these notebooks cannot be used up for producing regular notebooks. Hence, the costs of material, labour, cover pages, etc. will be allocated to the cost of notebooks (finished goods).

Suitability of specific identification method

1. When inventories cannot be ordinarily interchangeable and
2. When specific inventories are used for individual finished products only

Case 2: **When inventories are ordinarily interchangeable**

This case is opposite to case 1, as here, the inventories can be interchanged and the same inventories can be used up in the production of different goods. In such a situation, valuation of inventories can be performed by the following methods.

1. ***Historical cost method***: Historical cost is the amount that has been incurred on the acquisition of the goods. The two methods of Valuation of Inventories under historical cost method are FIFO (First-in-First-out) Method and Weighted Average Price Method.
2. ***Non-historical cost method***: Unlike the historical cost method, the Standard Cost Method or Retail Method can be applied.

2.6.2 First-In-First-Out (FIFO) Method (under Historical Cost Method)

As the name suggests, the first item of inventory purchased will be the first item to be sold. This is to say that all the inventories are sold in the order of their purchase. Likewise, at the end of an accounting period will depict those inventories as unsold which were recently purchased or produced. For example, on the basis of Table 2.1 below, if out of 1,700 units purchases, 800 units are in stock, then these 800 units will be valued as per the latest purchase price.

Table 2.1

Lot No.	Date	Quantity (units)	Per unit Price (₹)	Price Paid (₹)
1	01 January 2017	200	4	800
2	07 February 2017	400	4.5	1,800
3	12 March 2017	500	3.5	1,750
4	19 March 2017	600	4.20	3,600
	Total	1,700		7,950

Stock Valuation

200 units @ ₹3.50 = 700
600 units @ ₹4.20 = 2,520

800 units = ₹3,220

We will continue our discussion about this method more in Chapter 4.

2.6.3 Weighted Average Price Method (under Historical Cost Method)

This method has been designed to off-set or to average out the changes in the prices of inventories over a period of time. For this purpose, the unsold stock is multiplied by weighted average price, which gives us the cost of closing inventories at an average price of opening inventories, cost of inventories purchased during the year. (*We will continue our discussion about this method more in Chapter 4*).

$$\text{Closing Inventories} = (\text{Opening Stock} + \text{Purchases} - \text{Sales}) \times \text{Weighted Average Price}$$

where,

$$\text{Weighted Average Price} = \frac{\text{Opening Stock} + \text{Purchases (in } \textit{amount}\text{)}}{\text{Opening Stock} + \text{Purchases (in } \textit{units}\text{)}}$$

2.6.4 Standard Cost Method (under Non-Historical Cost Method)

It is a pre-determined cost based on estimates according to current cost.

2.6.5 Retail Method or Adjusting Selling Price (under Non-Historical Cost Method)

AS-2 prescribes this method as an appropriate method for inventory valuation by retail businesses. The inventories of a retailer are large in number, of smaller values and have more or less the similar margins. In this method, the cost of closing inventories is ascertained by deducting the gross margin percentage from the sale value of closing inventories.

Cost of Closing Inventories = Sale Price of Closing Inventories − Gross Profit Margin

2.7 NET REALISABLE VALUE (NRV)

As mentioned in the initial part of this chapter that AS-2 prescribes inventories to be valued either at cost or at Net Realisable Value (NRV)—whichever is lesser. This is in adherence to the prudence concept, which states that assets (inventories) should not be overstated and all losses and expenses should be anticipated beforehand. The fundamental principle is that inventories should not be valued at an amount, which is higher than the expected sale value. Consequently, we need to consider NRV of inventories instead of the cost of inventories in certain cases (mentioned below).

- Damage of inventories;
- Obsolescence of inventories;
- Decline in the market price;
- Rise in expected costs of completion or costs necessary to make sales.

Hence, because of the aforementioned facts, NRV is used for inventory valuation instead of the cost of inventories method. NRV is estimated every year on item-to-item basis for distinct items and on group basis for similar items. NRV is calculated using the formula mentioned below.

$$\text{Net Realisable Value} = \text{Estimated Selling Price} - \text{Estimated Cost of Completion or Costs necessary to make Sales}$$

Table 2.2 *Valuation of Inventories*

Valuation of Inventories	
Price Conditions of Finished Goods	**Value of Finished Goods**
NRV ≥ Cost Price	At Cost
NRV < Cost Price	At NRV

2.8 COMPARISON OF COST AND REALISED VALUE

This is the last step wherein the both the amounts—cost of inventories and NRV are compared. This comparison is carried out for each individual item on item-to-item basis. If for a particular item cost is more than NRV, then the item will be valued at NRV (as it is lower). In contrast, if the cost is lower than NRV of an item, then it will be valued at cost (as it is lower).

Table 2.3

Step 3: Comparison of Cost and Realised Value	
Item-to-Item Comparison	**Valuation of Inventory**
Cost of Inventory < NRV	At Cost
Cost of Inventory > NRV	At NRV

2.9 DISCLOSURE REQUIREMENTS AS PER AS-2

AS-2 provides the following guidance regarding disclosure of inventories in the financial statements of the firm.

- Information should be explicitly provided about the accounting policies adopted in measuring inventories, including the cost formulas used;
- The total amount of inventory held by the firm along with its classification into raw materials and components, finished goods, work-in-progress, stores and spares and loose tools

2.10 COMPREHENSIVE ILLUSTRATIONS

Example 1: A mobile phone shopkeeper has the following stock of mobiles of different companies at the end of March 2017. Calculate the value of stock that is to be shown on the firm's Balance Sheet.

Mobiles	Xiomi	Panasonic	LeEco	Swipe	LG	Moto
Cost of inventories	2,50,000	1,90,000	95,000	50,000	36,000	1,10,000
NRV	2,65,000	2,20,000	1,05,000	45,000	46,000	1,05,000

Solution

As per AS-2 (revised), the inventories should be valued at the cost of inventories or at NRV—whichever is lesser, so we need to start comparing cost with NRV item-by-item and pick the lower amount for each of the item.

Value of stock = 2,50,000 + 1,90,000 + 95,000 + 45,000 + 36,000 + 1,05,000 = ₹7,21,000

Example 2: Using the following items calculate the cost of purchases of inventories.

Purchase price	3,00,000	Trade discounts	15,000
Freight inwards	50,000	Duty drawbacks	35,000
Carriage outwards	65,000	Duty and Taxes	70,000

Solution

Cost of Purchase = Purchase Price of Goods + Freight Inwards + Duties and Taxes − Trade Discounts − Duty Drawbacks

= 3,00,000 + 50,000 + 70,000 − 15,000 − 35,000 = ₹4,20,000

Note: Carriage outwards is an expense on sale; hence, excluded.

Example 3: Consider the following information to ascertain the cost of purchases.

Purchase price	2,00,000	Rebates	5,000
Taxes and duties (irrecoverable)	40,000	Packaging cost	20,000
Transportation costs	15,000		

Solution

Cost of Purchase = Purchase Price + Taxes and Duties + Transportation Costs + Packaging Costs − Rebates

= 2,00,000 + 40,000 + 15,000 − 5,000 = ₹2,50,000

Packaging cost is excluded while calculating cost of purchases; whereas, *packing cost* is included to ascertain cost of purchases.

Example 4: Consider the following information to calculate per unit cost of shoes for recording of closing stock of 300 unsold shoes.

Purchase price of goods	₹3,00,000	Factory rent	₹10,000
Direct labour	₹50,000	Factory maintenance (incl. interest of ₹10,000)	₹50,000
Direct overheads	₹65,000	Variable production overheads	₹35,000
Units of shoe produced	1,000 units	Closing stock (unsold)	300 units

Solution

Cost of Inventory

$$= \text{Cost of Purchase} + \text{Cost of Conversion}$$

$$= \text{Purchase Price of Goods} + \text{Direct Cost} + \text{Indirect Cost}$$

$$= \text{Purchase Price of Goods} + \begin{pmatrix} \text{Direct labour} \\ + \\ \text{Direct overheads} \end{pmatrix} + \begin{pmatrix} \text{Factory rent} + \text{Factory} \\ \text{maintenance} - \text{Interest} + \\ \text{Variable production overheads} \end{pmatrix}$$

$$= 3{,}00{,}000 + (50{,}000 + 65{,}000) + (10{,}000 + 50{,}000 - 10{,}000 + 35{,}000)$$

$$= ₹5{,}00{,}000$$

The total cost of inventory of 1,000 shoes = ₹5,00,000

The cost of unsold inventory of 300 shoes $= \dfrac{5{,}00{,}000}{1{,}000} \times 300 = ₹1{,}50{,}000$

Example 5: Consider the following information to ascertain the cost of closing inventory using the Retail Method.

Sales price	₹200 per unit	Unsold units	100 units
Gross profit margin	25% on sales	Actual production	900 units

Solution

Cost of Closing Inventories = (Sale Price – Gross Profit Margin) × Units in stock
= (200 – 25% of 200) × 100 units
= (200 – 50) × 100 units
= ₹15,000

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Briefly explain the term ‘inventories’ as defined by AS-2.
(2) Enlist the items included in and excluded from ‘inventories’ as prescribed by AS-2.
(3) What are the objectives of AS-2 (revised)?
(4) State any five features of AS-2 (revised).
(5) Briefly explain the steps involved in ascertainment of cost of inventories.
(6) Explain measurement of cost of inventories.

(7) Highlight any four differences between 'Fixed Production Overhead Costs' and 'Variable Production Overhead Costs'.
(8) What do you mean by cost of conversion? Explain its components.
(9) How Fixed and Variable Production Overheads are allocated?
(10) State the costs that are excluded from cost of inventories as prescribed by AS-2 (revised).
(11) State the definition of main product, joint products and by-products.
(12) Describe cost formulas along with different methods followed when inventories are not interchangeable.
(13) Briefly explain Specific Identification Method and its suitability.
(14) What is Historical Cost Method? Explain the different methods followed under Historical Cost Method with the help of numerical examples.
(15) With the help of an example explain the working of Weighted Average Price Method.
(16) What is Non-Historical Cost Method? Explain the different methods followed under Non-Historical Cost Method.
(17) How should we compare cost of inventories and NRV?
(18) State the disclosure requirements as prescribed by AS-2.

II. Short Notes (5 marks)

(1) Inventories as per AS-2
(2) Steps involved in valuation of inventories
(3) Salient features of AS-2
(4) Cost of conversion
(5) Disclosure requirements of AS-2
(6) Cost excluded from cost of inventories
(7) Cost formula for non-interchangeable items
(8) Cost formula for interchangeable items
(9) Retail Method
(10) Weighted Average Price Method
(11) Net Realisable Value
(12) Types of inventories
(13) Objectives of AS-2
(14) Cost of purchases
(15) Cost of conversion
(16) Direct costs
(17) Indirect costs
(18) Joint products and by-products
(19) Steps involved in ascertaining cost of inventories Going Concern Concept

III. Objective Type Questions

(1) AS-2 prescribes valuation of inventories at
(a) Cost Price (b) NRV
(c) Lower of (a) and (b) (d) Retail Price

(2) Which of the following methods is not followed when items of inventories are interchangeable?
(a) Standard Cost Method (b) FIFO
(c) Specific Identification Method (d) Retail Method

(3) When items of inventories are non-interchangeable, then cost formula used belongs to
(a) Standard Cost Method (b) FIFO
(c) Specific Identification Method (d) Retail Method

(4) Which of the following items is excluded from cost of inventories?
(a) Advertisement costs (b) Labour cost
(c) Factory rent (d) Direct Costs

(5) Which of the following methods belong to Non-Historical Cost Method?
(a) Retail Method (b) FIFO
(c) Specific Identification (d) Weighted Average Price

(6) Fixed Production Overheads Costs are allocated on
(a) Actual use (b) Normal capacity
(c) Head-count of employees (d) Gross profit rate

(7) When cost of inventories is less than NRV, then inventories are recorded at
(a) Market price (b) Historical cost
(c) NRV (d) Cost of inventories

(8) When cost of inventories is more than NRV, then inventories are recorded at
(a) Market price (b) Historical cost
(c) NRV (d) Cost of inventories

(9) While calculating cost of purchases, which of the following items are included?
   (a) Duty drawbacks   (b) Trade Discounts
   (c) Packing Costs   (d) Packaging Costs

(10) While calculating cost of purchases, which of the following items are excluded?
   (a) Packing Costs   (b) Packaging Costs
   (c) Brokerage on purchases   (d) Freight paid on purchases

(11) Direct Labour + Direct Expenses + Direct Material =
   (a) Direct Material Cost   (b) Direct Cost
   (c) Cost of Purchases   (d) Cost of Inventories

(12) The costs that are incurred for bringing inventories to their present condition and location are termed as
   (a) Direct costs   (b) Indirect costs
   (c) Other costs   (d) Cost of purchases

(13) Cost of inventories excludes:
   (a) Selling costs
   (b) Pre-commencement storage cost
   (c) Post-commencement production cost
   (d) Interest costs

(14) Which of the following methods offsets the price effects?
   (a) Retail Method   (b) FIFO
   (c) Specific Identification   (d) Weighted Average Price

(15) Which of the following methods ensures that the unsold stock is valued at current purchase price?
   (a) Retail Method   (b) FIFO
   (c) Specific Identification   (d) Weighted Average Price

(16) The pre-determined cost based on estimates according to current cost is termed as
   (a) Standard cost   (b) Direct Cost
   (c) Cost of Purchases   (d) Cost of Inventories

(17) Which of the following methods is used when inventory items are large quantity and have similar margins?
   (a) Retail Method   (b) FIFO
   (c) Specific Identification   (d) Weighted Average Price

(18) Cost of Closing Inventories = Sale Price of Closing Inventories – Gross Profit Margin relates to
   (a) Retail Method   (b) FIFO
   (c) Specific Identification   (d) Weighted Average Price

(19) Under which of the following cases, it is recommended to use NRV instead of cost price?
   (a) Inventories damage   (b) Obsolescence
   (c) Declining market price   (d) All of the above

(20) 'Estimated Selling Price – Costs necessary to make sales' gives us:
   (a) Profit   (b) Indirect cost
   (c) NRV   (d) Cost of inventories

(21) Disclosure requirements as prescribed by AS-2 includes explicit information about
   (a) Accounting Policies   (b) Cost formulas
   (c) Total amount of inventories   (d) All of the above

(22) Disclosure requirements as prescribed by AS-2 excludes:
   (a) Disclosing all significant accounting policies that were followed for preparation of financial statements
   (b) Disclosing all the cost formulas used to ascertain cost of inventories
   (c) Clear-cut segmentation of all the types of inventories
   (d) None of the above

(23) Which of the following methods have been scrapped by AS-2?
   (a) Standard cost   (b) LIFO
   (c) Base Stock Method   (d) Retail Method

(24) Inventories as defined by AS-2 is
(a) Fixed Assets (b) Tangible Assets
(c) Current Assets (d) Current Liabilities

(25) Which of the following items are included in the definition of inventories?
(a) Raw materials (b) Work-in-progress
(c) Loose tools (d) All of the above

(26) Which of the following items are excluded from the definition of inventories?
(a) Work-in-progress under construction contracts
(b) Machinery spares
(c) Livestock inventories
(d) All of the above

(27) As per AS-2, inventories are the Assets that are
(a) held for sale
(b) to be used in production
(c) materials or supplies to be consumed
(d) All of the above

(28) Inventories of a manufacturing firm includes:
(a) Finished goods (b) Work-in-progress
(c) Other consumable items (d) All of the above

(29) Inventories of a trading firm includes:
(a) Finished goods (b) Work-in-progress
(c) Other consumable items (d) All of the above

(30) AS-2 was revised in the year:
(a) 1979 (b) 1991
(c) 1999 (d) 2001

(31) The fundamental principle of AS-2 (revised) is
(a) inventories to be valued at lower of the two cost or net realisable value
(b) inventories to be classified as raw materials, work-in-progress, finished goods and maintenance and supplies
(c) use of FIFO Method and Weighted Average Price Methods as designated cost formulas
(d) to disclose the method employed to ascertain cost of inventories

(32) Variable Production Overheads Costs are allocated on
(a) Actual use (b) Normal capacity
(c) Head-count of employees (d) Gross profit rate

(33) Consider the following information to find the cost of purchases

Purchases	₹20,000	Packaging cost	₹300
Carriage inwards	₹1,000	Packing cost	₹450
Freight outwards	₹500	Duty paid to Municipal Corporation of Greater Mumbai	₹200
Trade discounts	₹1,500		
Duty drawbacks	₹700	Brokerage on purchases	₹1,200
Material used	₹1,100		

Cost of purchases is:
(a) 21,650 (b) 20,650
(c) 20,150 (d) 22,150

Consider the following information to answer Q 34 to Q 39

Labour cost	₹2,000	Electricity bill	₹4,100
Material used	₹3,000	Unsold stock	30 units
Total direct cost	₹9,500	Factory rent	₹6,000
Goods produced	400 units	Purchase price of goods	₹20,000

(34) Direct expenses amount to
   (a) 6,500 (b) 7,500
   (c) 4,500 (d) 14,500

(35) Cost of conversion amounts to
   (a) 15,600 (b) 18,600
   (c) 19,600 (d) 20,600

(36) Total cost of inventory amounts to
   (a) 20,600 (b) 39,600
   (c) 40,550 (d) 40,600

(37) Cost of unsold inventory:
   (a) 1,970 (b) 2,970
   (c) 3,970 (d) 4,970

(38) If Sale price is ₹300 per unit, Gross Profit margin is 25% on sales, actual production is 1,000 units and unsold closing stock is 50 units, find cost of closing inventories.
   (a) 15,000 (b) 11,250
   (c) 15,550 (d) 20,550

(39) Calculate the amount of purchases, if cost of goods sold is ₹75,000, opening inventory is ₹5,000 and closing inventory is ₹5,500.
   (a) 75,000 (b) 74,500
   (c) 75,500 (d) 80,000

(40) If Closing inventory is 1.5 times more than the opening inventory and average inventory is ₹10,000, then the value of closing inventory is
   (a) 8,000 (b) 10,000
   (c) 12,000 (d) 15,000

(41) If sales is ₹1,20,000 and purchases is ₹1,30,000, then find estimate closing inventory if sales were made at a margin of 20% on cost.
   (a) 24,000 (b) 30,000
   (c) 94,000 (d) 1,06,000

IV. Fill in the Blanks

(1) The effect of inflation is nullified in __________ (Weighted Average/FIFO) Method of stock valuation.
(2) Producer's inventories of livestock are __________ (excluded/included) from inventories as per AS-2.
(3) Items such as _________ are deducted while calculating cost of purchases. (duty drawbacks/brokerage)
(4) Stock-in-trade such as debentures are ___________ (excluded/included) from inventories.
(5) An incomplete project by a telecom industry is ___________ (excluded/included) from inventories.
(6) The Fixed Production Overheads are allocated on the basis of _________ (normal capacity/actual use).
(7) Valuation of machinery spares has been prescribed by ____________ (AS-10/AS-2).
(8) AS-2 eliminated __________________ methods, whereas prescribed ______________. (FIFO/Weighted Average/LIFO/Base Stock)
(9) In a production-house producing shoes and cloth, ___________ method is used to ascertain the cost of inventories. (specific identification/FIFO/retail)
(10) While calculating cost of purchases _____________ is ignored, while _____________ is added. (packing cost/packaging cost).
(11) The indirect costs that are independent of the units of goods produced are termed as _______ (Variable Production Overheads/Fixed Production Overheads).
(12) In a production-house producing textiles, ______________ method/s is/are used to ascertain cost of inventories. (FIFO/weighted average/specific identification)
(13) The fixed variable overheads are allocated on the basis of _________ (normal capacity/actual use).
(14) The products of insignificant values that got produced from the production process of main products are termed as ____________ (joint products/by-products).

(15) Under ________method, the unsold units of stock are valued at the current purchase price. (FIFO/ Retail)
(16) The cost of closing inventories is ascertained by deducting gross profit margin from sale price of closing inventories under ___________ method (standard cost/retail)
(17) Costs of designing customized products on special demand are __________ (included/excluded) in the cost of inventories.
(18) _____________ are excluded from cost of inventories, while _________ are included in cost of inventories. (pre-production warehouse costs/post-production warehouse costs)
(19) AS-2 defines inventories as ___________ (Fixed/Current) Assets.
(20) _______________ method is used when inventory items are separate from each other. (Specific Identification/Standard Cost)

V. Match the Following Columns

(A)

Formulas	Output
a. Estimated Selling Price – Estimated Cost of Completion	i. Weighted Average Price
b. (Opening Stock + Purchases – Sales) × Weighted Average Price	ii. Direct Costs
c. $\dfrac{\text{Opening Stock} + \text{Purchases (in } amount\text{)}}{\text{Opening Stock} + \text{Purchases (in } units\text{)}}$	iii. Cost of Purchases
d. Direct Labour + Direct Expenses + Direct Material	iv. Closing Inventories
e. Purchase Price of Goods + Freight and Carriage Inwards + Brokerage and Packing Costs – Trade Discounts and Rebates	v. Net Realisable Value

(B)

Column A	Column B
a. Different inventories are used for different production process	i. Weighted average price method
b. Normal capacity	ii. Actual use
c. Inventory items of smaller values and similar margins	iii. Non-historical cost method
d. Standard cost method and Retail method	iv. FIFO
e. Unsold inventories are valued at latest purchase price	v. Fixed production overheads costs
f. Offsets inflationary effect	vi. Retail method
g. Variable production overheads	vii. Cost of purchases
	viii. Specific identification method

VI. State Whether the Following Statements are TRUE or FALSE

(1) When each item of inventories is distinct and can only be used for production of exclusive products, Standard Cost Method is used to evaluate the cost of inventories.
(2) AS-2 prescribes the recording of inventories at lower of the two cost price or NRV.
(3) Variable Production Overhead costs are allocated on the basis of normal capacity.
(4) AS-2 defines inventories as Current Assets.
(5) Administrative overheads, selling and distribution costs along with interest costs are included in cost of inventories.
(6) Variable Production Overheads Costs vary directly with the units produced.

(7) Fixed Production Overheads Costs vary indirectly with the units produced.
(8) Abnormal amounts of wasted material and labour cost are excluded in cost of inventories.
(9) AS-2 prescribes the use of FIFO and Weighted Average Price Method as the only methods for evaluating cost of inventories under Historical Cost Method.
(10) Packing costs are excluded, while packaging costs are included in the cost of purchases.
(11) Fixed Production Overhead Costs are allocated on the basis of normal capacity.
(12) Costs incurred for bringing inventories to present location and condition are added in order to find cost of inventories.
(13) Duty drawbacks and Rebates are deducted while calculating cost of purchases.
(14) Variable Production Overheads are dependent on the quantity of unit produced.
(15) LIFO and Base Stock Methods have been scrapped by AS-2.
(16) In case of declining market price and obsolescence of inventories, one should consider NRV instead of cost of inventories.
(17) NRV is estimated every year on item-to-item basis for distinct items.
(18) NRV is estimated on group basis for similar items.
(19) It is necessary to explicitly state the accounting policies adopted for measuring inventories including the cost formula.
(20) The term ‘inventories’ include raw materials and components, finished goods, work-in-progress, stores and spares and loose tools.

CHECK YOUR ANSWERS

III. Objective Type Questions

1–c	2–c	3–c	4–a	5–a	6–b	7–d	8–c	9–c	10–b	11–b	12–c	13–b
14–d	15–b	16–a	17–a	18–a	19–d	20–c	21–d	22–a	23–b&c	24–c	25–d	26–d
27–d	28–d	29–a	30–c	31–a	32–a	33–b	34–c	35–c	36–b	37–b	38–b	39–c
40–c	41–b											

IV. Fill in the Blanks

1–Weighted Average	2–Excluded	3–Duty Drawbacks	4–Excluded
5–Excluded	6–Normal capacity	7–AS-10	8–(a) LIFO and Base Stock (b) FIFO and Weighted Average
9–Specific Identification	10–(a) Packaging Cost (b) Packing Cost	11–Variable Production Overheads	12–FIFO and Weighted Average
13–Actual use	14–By–products	15–FIFO	16–Retail
17–Included	18–(a) Post-production warehouse (b) Pre-production warehouse cost	19–current	20–Specific Identification

V. Match the Columns

(A)	(B)
(a)–(v), (b)–(iv), (c)–(i), (d)–(ii), (e)–(iii)	(a)–(viii), (b)–(v), (c)–(vi), (d)–(iii), (e)–(iv), (f)–(i), (g)–(ii)

VI. True or False

True	False
2, 4, 6, 8, 9, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20	1, 3, 5, 7, 10

CHAPTER 3

Accounting Standard-9: Revenue Recognition

CHAPTER OUTLINE

EXERCISE

3.1 INTRODUCTION

This chapter focuses on revenue and the time when to consider it as realised or materialised. The need of learning this chapter arises from the fact that revenue is the life-line of a business. No business can survive in the absence of revenue. As we know that revenue is income of a business that it earns by selling off the goods and rendering of services. The moment cash sale happens, we say that the business has earned the revenue and hence, revenue should be recognised. This is the simplest form, wherein, the revenue is earned right at the moment of sale. But in real world of business, majority of sales happens on credit and with many conditions attached to it. In this chapter, we will deal with such instances and learn what guidelines are being followed by the accountants while recording revenues. We will learn about Accounting Standard-9, which is actually a guide book for all underlying practices of recognising revenues.

3.2 REVENUE AND ITS RECOGNITION

3.2.1 Meaning of Revenue

The term 'revenue' implies income or earnings of a business from its normal operation such as sale of goods produced or further value added by it, sale of services and use of business resources. In other words, revenues are cash inflows to a business that are either received or yet to be received.

Meaning of Revenue as per AS-9

The incomes generated by a business from sale of goods, rendering of services and from use of its assets. In other words, it comprises sales proceeds (from goods), fees charged (for services rendered) and factor incomes from use of its assets (in the form of interest, dividend and royalty). Revenues are gross inflow of cash, receivables and other consideration from the normal operation of the business.

3.2.2 Concept of Revenue Recognition

The term revenue recognition consists of two terms—'revenue' and 'recognition'. We know the meaning of revenue, which is income to a business. Recognition implies when we identify *revenue as income*. In other words, it indicates the *time of recording* the transaction as income earned.

3.3 SCOPE OF ACCOUNTING STANDARD-9 (AS-9)

3.3.1 Salient Features of AS-9

The following are the salient features of AS-9.

1. AS-9 was issued in 1985 and was mandatory since April 01, 1991.
2. It prescribes the recognition of revenues earned during the normal course of a business through
   - sale of goods
   - rendering of services, and
   - other cases where assets of one business are used by another

   Sources of Revenue

3. The aim of AS-9 is to prescribe the right time to recognise revenue and to record it in the books of account (on the credit side of Profit and Loss Account).
4. It requires the disclosure of the situations under which revenues have not been disclosed.

3.3.2 Exclusions from Revenue Recognition Criteria

The following are the cases, where AS-9 Revenue Recognition criteria are not applied. The cases, where revenue arises from are as follows:

1. Construction contracts
3. Government grants and subsidies
2. Hire-purchase and lease agreements
4. Insurance contracts

3.3.3 Implications of AS-9

AS-9 provides the guidance for recognising revenues and the time to record the revenues in the books of account.

S. No.	Items	When to Recognise Revenue?
1	Proceeds from Sale of Goods	Sale Proceeds are recorded in the books of account when • ownership of goods has been transferred to the buyer • seller has no effective control over the ownership of goods • all significant risks and rewards of ownership are with the buyer
2	Fees charged for rendering of services	Fees charged for rendering of services are recorded in the books when • service has been performed completely (by *Completed Service Contract Method*) • service has been performed proportionately (by *Proportionate Completion Method*)
3	Fees charged for use of business assets by other business	The following forms of revenues are recorded: • On time basis—For Interest • As per the terms of agreement—For Royalties • When right to receive payment is established—For Dividend

3.4 REVENUE FROM SALE OF GOODS

Sale of goods is a major source of revenue for a production-based business. A business produces goods with the motive of selling them and, thereby, earns income. The income from sale of goods, i.e. the sale proceeds account for the major portion of a manufacturing and a trading firm.

As prescribed by AS-9, the revenues from sale of goods should be recognised, when all the following conditions are satisfied.

- When the ownership of goods has been transferred to the buyer from the seller
- When the seller has no effective control over the ownership of the goods so sold
- When all the significant risks and rewards of ownership are lying with the buyer

These conditions hold true for majority of the cases; however, there are a few additional cases that are specific in nature. The list of those specific examples is presented in Table 3.1:

Table 3.1 *Specific Examples to Revenue from Sale of Goods*

S. No.	Examples	When to Recognise or Record Revenue?
1	Delivery of goods is *delayed at buyer's request* and buyer takes title and accepts billing	Revenue should be recognised, even though the delivery of goods has been delayed as per buyer's request. Further, the following conditions should be met. • Seller must have the goods on hand • The goods must be ready to be delivered
2	Sale of goods require *installation and buyer's inspection*	When: • Buyer accepts the delivery of the goods, and • The installation and inspection of goods are complete
3	Sale of goods on *approval* basis	When: • Buyer accepts the delivery of the goods, or • The time period for rejection has elapsed (and where no time period is specified and a reasonable time period has elapsed)
4	*Guaranteed* sales	According to the matter of the agreement between the seller and the buyer
5	*Consignment* sales	When goods are sold to a third party
6	*Cash on delivery* sales	When cash has been received by seller or his agent
7	Sale of goods on *instalment basis* and goods are delivered *on the date of sale*	Revenue (Sale Price – Interest) should be recognised on the date of sale. *and* Interest amount to be recognised proportionately to unpaid balance with the buyer.
8	*Special order and Shipments* (orders for which payments have been received but goods are yet to be manufactured or to be delivered by third party)	When the goods are manufactured and are ready for delivery to the buyer.
9	Sales to intermediate parties (such as sale to wholesalers, distributors, etc.)	When significant risks of ownership have been passed
10	Subscriptions for publications	When prices of goods *change* from one period to another period, then revenue is recognised on the basis of sales value of the item delivered, *else*, When prices of goods *do not change* from one period to another, then revenue is recognised on straight line basis over time.
11	Trade discounts and volume rebates	These are not a part of revenue, hence, should be deducted for calculating revenues

3.5 REVENUE FROM RENDERING OF SERVICES

Sale of services or rendering of services is a major source of revenue for a service-based business. Such a business renders services to its customers and in exchange charges fees. For example, telecom companies render telecom services and in exchange we pay them for the services rendered to us.

As prescribed by AS-9, the fees charged against the rendering of services should be recognised on the completion of service, i.e. when the service has been performed. The completion of service is measured by either of the following two methods.

1. ***Method-1: Completed Service Contract Method***—This method is applicable for the services that are performed in one shot; for example, installation of TV requires one time service.
   As per this method, revenue is recognised on the date of completion/performance of the service.
2. ***Method-2: Proportionate Completion Method***—This method is applicable for the services that are performed in more than one act. For example, the Root Canal Treatment is rendered by a dentist in three stages. The first visit needs cleaning of bad tooth, then on the next visit the cavity is filled and finally in the third visit, cap is fitted. In this case, fees charged by the dentist are to be recognised in proportion to the degree of completion of services in each phase.

A few specific examples to recognition of revenues from rendering services have been presented in Table 3.2.

Table 3.2 *Specific Examples to Revenue from Rendering of Services*

S. No.	Examples	When to Recognise or Record Revenue?
1	Installation fees	When: • Installation is completed and • Accepted by the client or buyer
2	Advertising and insurance agency commissions	• In general—When the service is completed • For Advertising agencies— When advertisement appears before public • For Insurance agencies— When policy period starts or policy is renewed
3	Admission fees (for entry in grounds for matches, performances, other events)	On the date of event
4	Tuition fees	Over the period of instruction
5	Entrance fees	These fees are capitalised and shown on the liabilities side of the Balance Sheet
6	Membership fees	• If membership fees are only for membership (and nothing free), then revenue is recognised on the date of receipt of such fees. • If membership fees include membership in addition to some additional services, then revenue is recognised on systematic manner in respect to the time and nature of services provided.

3.6 REVENUE FROM USE OF BUSINESS' ASSETS OR CAPITAL

This source of earning revenue is secondary in nature unlike sale of goods or rendering of services that are primary in nature. Often, business rents out or uses its capital to be used by other businesses; for instance, investment by M/s Bandra Ltd. in the form of debentures of M/s Wagle Ltd. or leasing out patents and copyrights to our businesses, etc. In this manner, business earns money in the form of interest, dividends (e.g. interest earned on debentures of M/s Wagle Ltd.) and royaltiese.g. amount received by the use of patents and copyrights).

AS-9 prescribes the recognition of revenues in the form of interest, dividends and royalties in the following manner.

1. ***Interest***—Revenue in the form of interest is recognised on a time proportion basis considering the outstanding amount and the rate of interest.
2. ***Royalties***—Revenue in the form of royalties is recognised on an accrual basis as per the terms and conditions mentioned in the agreement.
3. ***Dividends***—Revenue in the form of dividend earned on shares is recognised when the owner's right to receive payment is established.

3.7 EFFECTS OF UNCERTAINTIES IN REVENUE RECOGNITION

AS-9 states that revenues should be recognised only when it is measurable and there is absolute surety of getting the amount (i.e. collectability). If there is any chance that the amount of revenue might not be collected, then it is advised to postpone recognition of revenue. However, if the uncertainty arises after the date of sale or rendering of services, then it advised to make a separate provision for such uncertainty.

Table 3.3

Timing	Certainty or Uncertainty	Action
At the time of sale or rendering of service	Certainty/surety of collecting funds	Recognise revenue
At the time of sale or rendering of service	Uncertainty/not sure of collecting funds	Recognise revenue later, when it is certain
After sale or service has been rendered	Uncertainty/not sure of collecting funds	Make a separate provision for uncertainty

3.8 DISCLOSURE

AS-9 prescribes that a business should disclose the circumstances in which revenue recognition has been postponed due to uncertainties so involved.

3.9 COMPREHENSIVE ILLUSTRATIONS

Example 1: Kilkari Orphanage issues monthly journal to its members. On April 01, 2017, one of its members pays ₹1,800 for 3 years subscription to journal (i.e. from 2017–2018 to 2019–2020). How and when the revenue will be recognised?

Solution

This is the case of subscription for publications. As per AS-9, advance subscription amount received for publications should be treated as advance income. In this case, since the price of publication would not change for the member, as he has made advance payment, so the revenue is to be recognised on straight line basis over time. Accordingly, every year ₹600 $\left(\frac{1,800}{3}\right)$ will be recognised as revenue for every year.

Example 2: M/s Lalbagh Ltd. made the following sales. You need to advise the accountant of M/s Lalbagh Ltd. to recognise the revenue in each of these cases.

1. Goods sold for ₹50,000 on approval basis to M/s Ram Mandir Ltd. on July 01, 2017, where approval to be provided by December 31, 2017.
2. Out of a consignment of ₹10,000, the agent sold worth ₹3,000 till March 31, 2018.
3. On April 01, 2017, goods sold for ₹25,000 (inclusive of interest amount of ₹4,000) were sold on three equated monthly instalments schemes.

Solution

1. ***Case of goods sold on approval basis***: In this case, revenue is recognised when either the buyer has provided his acceptance to the seller or the time period for rejection has elapsed. Since M/s Ram Mandir Ltd. has not rejected the goods till December 31, 2017, so the revenue can be recognised on January 01, 2018.
2. ***Case of consignment sales***: In this case, revenue is recognised when goods are sold to a third party.
3. ***Case of instalment sales***: In this case, revenue is recognised on the date of the sale. Second, the amount of revenue to be recognised should be net of interest amount, which is ₹21,000. Thus, on April 01, 2017, the revenue should be recognised with ₹21,000.

Example 3: M/s Vidyamandir Tuition Classes has received advance fees of ₹20,000 on January 01, 2017 for the crash course classes scheduled from March 01, 2017 to April 30, 2017. When and with what amount should the revenue be recognised for the financial years 2016–2017 and 2017–2018?

Solution

This is case of receipt of tuition fees in advance. In this case, the payment of ₹10,000 pertains to the financial year 2016–2017 and the remaining ₹10,000 to the financial year 2017–2018. Accordingly, ₹10,000 will be recognised on March 31, 2017 (for the performance of service in the month of March 2017) and remaining ₹10,000 will be recognised on April 30, 2017 in the financial year 2017–2018 for the performance of service in the month of April 2017.

Example 4: Your e-commerce company named Eee-kart Ltd. sold two items worth ₹2,999 each on September 30, 2016 with cash payable on delivery. One of the items was delivered on October 01, 2016 and the other was delivered on October 03, 2016 due to national holiday on October 02, 2016. When should be revenue recognised and by how much?

Solution

This is the case of sale of goods on condition with cash on delivery. In this case, the revenue is recognised when the cash has been collected from the customer or client. As mentioned, the two items have been delivered on two different dates. Thus, accordingly, for the first good the revenue should be recognised on October 01, 2017 with ₹2,999 and for the next item, revenue will be recognised on October 03, 2017 with ₹2,999.

Example 5: You run a not-for-profit organisation named 'Be-Human' centred at Powai. The following are the membership options available.

Particulars	Amount	Validity	Freebies
Annual Membership Fees	10,000	1 year	All services available at the club
Half-Yearly Membership Fees	6,000	6 months	NA
Entrance Fees	1,000	Lifetime	NA

Suppose during the month of July 2017, your organisation has received one annual membership, two half-yearly membership and 10 entrance fees. Comment upon the recognition of revenues in each of the cases.

Solution

As the annual membership fees comes with the free services available at the club, the revenue of ₹10,000 will be recognised in respect of the time and nature of services provided.

For the half-yearly membership fees, it has no additional services, so the amount of ₹12,000 (for two subscriptions) will be recognised on the date of receipt of fees.

Lastly, the entrance fees will be capitalised.

Example 6: M/s Bhide and Sons received an order of ₹1,00,000 from M/s Mangal Enterprise on June 01, 2017. Comment upon the recognition of revenue.

Solution

In this case, M/s Bhide has just received an order and sales are yet to be made, hence, no revenue will be recognised. The revenue will be recognised on the date of sales.

Example 7: On May 01, 2017, M/s Deep & Co. accepted the title and billing from M/s Joshi and Sons for goods worth ₹1,00,000. However, the goods are yet to be delivered. Comment upon the recognition of revenue.

Solution

In this case, since M/s Deep & Co. has already accepted the title and the billing, so the revenue will be recognised by M/s Joshi and Sons on May 01, 2017, even though the delivery is pending.

Example 8: Maharashtra Iron Ore Ltd. is entitled for revenue in the following forms during the financial year 2017–2018. You need to comment upon the revenue recognition as per AS-9.

Particulars	Amount
Receipt of Interest (for January 01, 2017 to June 30, 2017)	6,000
Receipt of Royalties (for April 01, 2017 to June 30, 2017)	9,000
Dividend declared for 2016–2017 on April 25, 2017	12,000

Solution

Particulars	Amount	Reasons
Interest (for April 01, 2017 to June 30, 2017)	3,000	Interest amount of ₹3,000 pertains to the current financial year (April to June 2017), hence, would be recognised during this year. The interest amount for (January to March 2017) should be recognised in the last financial year (2016–2017).

(Continued)

Particulars	**Amount**	**Reasons**
Royalties (for April 01, 2017 to June 30, 2017)	9,000	AS-9 prescribes the recognition of royalties on accrual basis. Also, the royalty amount belongs to this financial year only; hence, ₹9,000 will be recognised during the financial year 2017–2018.
Dividend declared for 2016–2017 on April 25, 2017	12,000	Even though dividend has been merely declared and no amount has been received, yet revenue will be recognised on the date, when the right to receive the payment has been established. The date of revenue recognition is April 25, 2017.

Example 9: Consider the following information related to sales of M/s Poppatlal and Sons. You being the financial manager of this firm need to guide your accounts team based on the remarks provided by the sales manager.

Sales	**Remarks by Sales Managers**	**Remarks by Finance Manager**
Goods sold worth ₹1,00,000 to M/s Shinde on credit	We are quite sure about getting the payment based on long relationship with M/s Shinde.	?
Goods sold for ₹50,000 to a new client	Not so sure about collection.	?
Goods sold to M/s Tavre worth ₹45,000	We were quite sure about getting the payment at the time of sales, but after 3 months, the financial position of M/s Tavre is not so good.	?

Solution

Sales	**Remarks by Sales Managers**	**Remarks by Finance Manager**
Goods sold worth ₹1,00,000 to M/s Shinde on credit	We are quite sure about getting the payment based on long relationship with M/s Shinde.	As it is certain to collect the funds, so it is prescribed by AS-9 to recognise this as revenue on the date of sale.
Goods sold for ₹50,000 to a new client	Not so sure about collection.	As it is not certain to collect the funds, so we should postpone recognising it as revenue until we are certain about getting the funds.
Goods sold to M/s Tavre worth ₹45,000	We were quite sure about getting the payment at the time of sales, but after 3 months, the financial position of M/s Tavre is not so good.	As this is case, where uncertainty about collection of funds is arising after the sales have been made, make a separate provision for this uncertainty.

Example 10: State whether the following statements as True or False after rewriting the same.

1. AS-9 does not cover revenue arising from government grants and subsidies.

   (November 2016)
2. AS-9 prescribes that revenue should be recognised when the seller receives the payment.
3. Dividend for the year 2016–2017 was declared on March 13, 2017 and received on May 10, 2017. It is to be recognised as revenue.
4. AS-9 does not deal with revenue arising from lease agreements.
5. AS-9 states that even though the goods have not been delivered to the buyer, the seller can recognise the revenue if buyer accepts the ownership.

Solution

1. **True**
2. **False**: AS-9 prescribes recognition of revenue on the date when the buyer has accepted the ownership.
3. **False**: AS-9 prescribes that revenue in form of dividend needs to be recognised; the moment the right to receive such dividend is established. The date of revenue is March 13, 2017.
4. **True**
5. **True**

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Define revenue and explain the different sources of revenue to a business.
(2) What are the provisions of Revenue Recognition as per AS-9?

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(3) What are the conditions for recognising revenues from sale of goods?
(4) Highlight the salient features of AS-9.
(5) What are the implications of AS-9?
(6) What are the conditions for recognising revenues from rendering of services?
(7) What are the conditions for recognising revenues from use of business's assets or capital?
(8) How do the uncertainties affect revenue recognition?

II. Short Notes (5 marks)

(1) Sources of revenue
(2) Implications of AS-9
(3) Salient features of AS-9
(4) Methods to measure completion of services
(5) Disclosure requirements of AS-9
(6) Recognition of revenue from interest, royalties and dividend

III. Objective Type Questions

(1) When to recognise a sale of good?
  (a) On the receipt of payment
  (b) On the date of delivery
  (c) On the date of sale
(2) Revenue includes:
  (a) Sale proceeds (b) Government grants and aids
  (c) Loan receipt (d) Recovery of bad debts

(3) Which of the following bases is used for recognised revenue in form of interest?
  (a) Accrual basis (b) Time basis
  (c) Contractual basis (d) Depends on the agreement

(4) Revenues from sale of goods are recognised when
  (a) ownership of goods has been transferred to the buyer
  (b) seller has no effective control over the ownership of goods
  (c) goods have been delivered
  (d) all the significant risks and rewards are with the buyer
  (e) all of the above

(5) Revenues from rendering of services are recognised when
  (a) service has been performed completely
  (b) service has been performed proportionately
  (c) on the date of rendering services
  (d) Only (a) and (b)
  (e) All (a), (b), (c)

(6) Which of the following cases is/are excluded from the scope of AS-9?
  (a) Construction contracts (b) Hire Purchase Sale
  (c) Lease Agreements (d) Insurance contracts
  (e) All of the above

(7) Revenue in case of sale on approval basis is recognised when
  (a) buyer accepts the delivery of goods (b) time period of rejection has elapsed
  (c) receipt of payment (d) order has been placed

(8) Revenue in case of consignment sale is recognised when
  (a) consignee gets the delivery of goods
  (b) consignor dispatches the consignment
  (c) goods have been sold off to third parties
  (d) payments have been received by consignor

(9) Revenue in case of sale of goods that require installation is recognised when
  (a) goods have been delivered (b) order for goods have been placed
  (c) installation has been done by the seller (d) payment has been received

(10) Revenue can be recognised even if the goods are not yet delivered when
  (a) buyer accepts the billing (b) goods are ready to be delivered to buyer
  (c) seller has the goods on hand (d) none of the above

(11) Revenue in case of instalment sales is recognised:
  (a) On the date of sale (b) On the date of receiving payment
  (c) When the goods are delivered (d) When the buyer agrees to pay in instalments

(12) Revenue in case of sale with cash on delivery facility is said to recognise when
  (a) order has been placed
  (b) seller confirms the availability of goods
  (c) goods are ready to be delivered to buyer
  (d) payment has been received

(13) On 15 September 2016, M/s Vijay and Sons placed an order of a small machinery part that is to be delivered by M/s Lightpace services on 1 October 2016. However, on 1st October, M/s Vijay and Sons accepted the billing and requested to delay the delivery of the machinery to 10th October due to festive season. In this case, when should the revenue be recognised as per AS-9?
  (a) 15th September (b) 1st October
  (c) 10th October

(14) On 15 September 2016, M/s Vijay and Sons placed an order of a small machinery part that is to be delivered and to be installed by M/s Lightpace services on 1 October 2016. M/s Vijay and Sons also made it explicit that until and unless the installed machinery is being inspected by its engineering, there would not be release of payment. M/s Lightspace failed to meet the deadline due to festive season and on 10 October 2016 it installed the machinery at M/s Vijay and Sons premise. The engineer inspected the machinery and suggested some changes in

the installation, which were then finally through on 15 October 2016. On which of the following dates should the revenue be recognised?

(a) 15th September (b) 1st October
(c) 10th October (d) 15th October

(15) On 1 March 2017, M/s Aaple Dukaan consigned 5,000 units of goods to M/s Akkumbakkum in Chennai. The goods were delivered in Chennai on 15 March 2016. M/s Akkumbakkum was to sell those goods to its retailers and customers by 25 March 2016. All the stock so received got sold on 28 March 2016. On which of the following dates should the revenue be recognised?

(a) 1st March (b) 15th March
(c) 25th March (d) 28th March

(16) On 1 March 2017, M/s Aaple Dukaan consigned 5,000 units of goods to M/s Akkumbakkum in Chennai. The goods were delivered in Chennai on 15 March 2016. M/s Akkumbakkum was to sell those goods to its retailers and customers by 25 March 2016. However, till 31st March as extended deadline from M/s Aaple Dukaan, none of the goods were sold. On which of the following dates should the revenue be recognised?

(a) 1st March (b) 15th March
(c) 25th March (d) Can't say

Consider the below instance to answer Q 17 to Q 20

On 1 February 2015, M/s Tuition-on-web has received advance fees of ₹45,000 for a professional course, for which the classes will be broadcasted from 1 March 2015 to 31 May 2015.

(17) When should the revenue for the financial year 2014–15 be recognised?

(a) 1 February 2015 (b) 31 March 2015
(c) 31 May 2015

(18) What is the amount of revenue recognised for the financial year 2014–15?

(a) ₹45,000 (b) ₹15,000
(c) ₹30,000

(19) When should the revenue for the financial year 2015–16 be recognised?

(a) 1 February 2015 (b) 31 March 2015
(c) 30 April 2015 (d) 31 May 2015

(20) What is the amount of revenue recognised for the financial year 2015–16?

(a) ₹45,000 (b) ₹15,000
(c) ₹30,000

Consider the below instance to answer Q 21 to Q 26

M/s Bluewater is entitled for revenue in the following forms during the financial year 2015–16 and 2016–17.

Revenue	Amount
Receipt of Interest (for 1 January 2016 to 31 May 2016)	12,000
Receipt of Royalties (for 1 March 2016 to 30 June 2016)	18,000
Dividend declared for 2016–17 on 12 April 2016	24,000

(21) Revenue in the form of interest to be recognised during the financial year 2015–16 is

(a) ₹12,000 (b) ₹7,200
(c) ₹4,800

(22) Revenue in the form of interest to be recognised during the financial year 2016–17 is

(a) ₹12,000 (b) ₹7,200
(c) ₹4,800

(23) Revenue in the form of royalty to be recognised during the financial year 2015–16 is

(a) ₹18,000 (b) ₹4,500
(c) ₹13,500

(24) Revenue in the form of royalty to be recognised during the financial year 2016–17 is

(a) ₹18,000 (b) ₹4,500
(c) ₹13,500

(25) Revenue in the form of dividend to be recognised during the financial year 2015–16 is
(a) ₹24,000 (b) ₹2,000
(c) Nil

(26) Revenue in the form of dividend to be recognised during the financial year 2016–17 is
(a) ₹24,000 (b) ₹2,000
(c) Nil

IV. Fill in the Blanks

(1) _______________ method is used to measure completion of services which are performed in one action. (Completed Service Contract Method/Proportionate Completion Method)

(2) Revenue received from advance booking of IPL match will be recognised on ____________________ (the date of match / the receipt of payment)

(3) Revenue in form of membership fees (including some additional services to the members) are recognised on ____________________ (the date of receipt of such fees/systematic manner as per time and nature of services)

(4) Revenue are recognised by an advertising agency, when ___________ (payment is received from client/advertisement is broadcasted)

(5) Revenue in the form of interest is recognised _________________ (time proportion basis/accrual basis)

(6) Revenue in the form of dividend is recognised __________________ (right to receive payment is established/accrual basis)

(7) On the date of sale of goods, if it is certain to collect the funds from the clients, then _____________ (recognise revenue/postpone recognition till payment is received)

(8) If there is any uncertainty of collecting funds after rendering of services, then ____________ (postpone recognition till payment is received/make a separate provision)

(9) Revenue from sale of machinery with free installation by the seller will be recognised, when _______________ (installation and inspection by buyer is complete/machinery is ready to be delivered to buyer)

(10) Trade discounts and volume rebates are _________________ while ascertaining revenues (ignored/ deducted/added)

(11) Revenue from subscription to newspapers on weekdays is recognised on ____________ (the basis of sale value of newspaper/the straight line basis over time)

(12) An e-commerce company recognises the revenue from sale of goods with cash on delivery facility, when _____________ (it receives the order/it deliver the goods to the customer)

(13) Revenue from sale of goods on approval basis is recognised when _______________ (goods are delivered/buyers accepts the delivery)

(14) Revenue from sale of goods to wholesalers are recognised when ________________ (payment is received/wholesalers place the order/significant ownership risks have been passed)

(15) The instances where revenue from ______________ and ______________ are excluded from revenue recognition criteria (construction contracts/hire-purchase agreements/consignment sales/approval sales)

V. Match the Following Columns

(A)

Formulas	Output
a. After the sale of goods, uncertainty lies in collecting funds	i. Time period for rejection has elapsed
b. When goods are manufactured and ready for delivery	ii. Recognise revenue in the form of dividend
c. When right to receive is established	iii. Recognise revenue from consignment sales
d. When goods are sold to third party	iv. Recognise revenue from special order and shipments
e. Goods sold on approval basis	v. Postpone the revenue recognition

(B)

Column A	Column B
a. Advance booking of a Baahubali-2	i. Recognise revenue on accrual basis
b. Recognise revenue on the basis of straight line	ii. Recognise revenue on the date of event
c. Revenue in form of leasing out of patents	iii. Recognise revenue when goods are ready for delivery
d. Delivery delayed at buyer's end	iv. Subscription of periodicals
e. Tuition fees	v. As per the agreement between seller and buyer
f. Recognise revenue for guaranteed sales	vi. Recognised over the period involved
	vii. Recognise revenue on time proportion basis
	viii. Not to be recognised as revenue

VI. State Whether the Following Statements are TRUE or FALSE

(1) For a manufacturing firm, the term 'revenue' includes income from sale of goods and interest earned on its investments.
(2) For a trading firm, the term 'revenue' only includes income from the sale of goods.
(3) In case of cash on delivery sales, revenue is recognised as soon as the customer places the order.
(4) Insurance and construction contracts are excluded by AS-9.
(5) For a consignment sale, the moment goods are delivered to the consignee and s/he acknowledges the consignor.
(6) Trade discounts and volume rebates are added to ascertain the actual value of revenue from sale.
(7) Entrance fees are not considered for recognising revenue.
(8) Recognition of revenue indicates the time of recording revenue in the books of accounts.
(9) AS-9 requires disclosure of the situations under which revenues have not been disclosed.
(10) Government grants and subsidies are excluded from revenue recognition criteria.
(11) Complete service contract method is used to measure services that are performed in more than one action.
(12) Revenue of insurance agencies is recognised when a policy is being renewed.
(13) When a seller has no effective control over the ownership of the goods so sold, then it is the time to recognise it as revenue.
(14) Installation fees of a water-purifier are recognised on the date of installation and the same has been accepted by the buyer.
(15) AS-9 does not deal with lease agreements and construction contracts.

CHECK YOUR ANSWERS

III. Objective Type Questions

1–c	2–a	3–b	4–e	5–d	6–e	7–b	8–c	9–c	10–a, b, c	11–a	12–d	13–b
14–d	15–d	16–d	17–b	18–b	19–c, d	20–c	21–b	22–c	23–b	24–c	25–c	26–a

IV. Fill in the Blanks

1-Completed Service Contract Method	2-The date of match	3-Systematic manner as per time and nature of services	4-Advertisement is broadcasted
5-Time proportion basis	6-Right to receive payment is established	7-recognise revenue	8-make a separate provision
9-installation and inspection by buyer is complete	10-Deducted	11-the straight line basis over time	12-it deliver the goods to the customer
13-buyers accepts the delivery	14-significant ownership risks have been passed	15-(a) construction contracts (b) hire-purchase agreements	

V. Match the Columns

(A)	(B)
(a)–(v), (b)–(iv), (c)–(ii), (d)–(iii), (e)–(i)	(a)–(ii), (b)–(iv), (c)–(i), (d)–(iii), (e)–(vi), (f)–(v)

VI. True or False

True	False
1, 4, 7, 8, 9, 10, 12, 13, 14, 15	2, 3, 5, 6, 11

CHAPTER 4

Inventory Valuation

CHAPTER OUTLINE

EXERCISE

4.1 INTRODUCTION AND RECALLING

In Chapter 2, we learnt about AS-2 (revised) and ascertainment of cost of inventories. Now, in this chapter, we will learn how to determine the physical quantities of unsold inventories by periodic system and perpetual system. After this, we take up the recording of transaction in stock ledger by FIFO and Weighted Average Method.

To begin with, let us quickly refer to the crux of Chapter 2.

Crux of AS-2 (revised) Valuation of Inventory

AS-2 (revised)

As per the Accounting Standard for Valuation of Inventories – AS-2, inventories are the assets that are held by a business with the following purposes.

1. *To sell them in the ordinary course of the business; (e.g. mobile phones ready to be sold at factory outlets or to the wholesalers or to the final consumers)*,
2. *To use them in the production process for sale; (e.g. mobile phones at the display window of shops) or,*
3. *To use them in form of materials or supplies to be consumed in the production process or in rendering of services. (e.g. screens, chipsets, batteries and plastic bodies that are used up to produce a mobile phone)*.

Types of Inventories

1. *Raw materials: The materials that are used up as raw materials in the production of final goods.*
2. *Work-in-progress: These are semi-finished or unfinished goods which are still in the production process.*
3. *Finished goods: These are the final finished goods that are ready to be sold to the market.*
4. *Other items: These are the supporting materials such as maintenance supplies, loose tools and consumables that are used in the production process (in addition to the raw materials).*

Valuation of Inventories

AS-2 (revised) prescribes that inventories should be valued either at cost or at NRV—whichever is lesser.

4.1.1 Meaning of Inventory Valuation

We know that every business organisation is interested in knowing the amount of profit earned or loss incurred by it at the end of an accounting period. For this purpose, financial statements are prepared with the known value of closing stock (or inventory). In Trial Balance, the value of closing stock is not given to us as it is mentioned in the adjustment to the question of final accounts. Instead, the value of closing stock is to be determined. This act of determining the value of inventory is termed as inventory valuation.

4.1.2 Effects of Inventory Valuation

We know that closing stock is shown on the credit side of Trading Account and on the Assets side of Balance Sheet. In case of any improper valuation of inventory, the Trading Account will reflect incorrect (either understated or overstated) amount of gross profit or gross loss. This will subsequently, lead to wrong net profit or net loss and finally, misleading financial position will be reflected by the Balance Sheet.

Further, it should be noted that the effects of incorrect inventory valuation are not only limited to the current year. In fact, the closing inventories of the current year become the opening inventories of the next year. This leads to automatic wrong calculation of the gross and net profit or loss in the next year. This continues year after year. Hence, valuation of inventories is to be carried out with utmost care otherwise the books of account will reflect more/less profit than the actual profit or more/less loss than the actual loss.

Table 4.1 *Effects of Incorrect Inventory Valuation*

Conditions	Effects on Trading Account	Effects on Profit and Loss Account
Overstated closing inventories	Higher Gross Profit	Higher of Net Profit
Understated closing inventories	Lower Gross Profit	Lower of Net Profit
Overstated opening inventories	Lower Gross Profit	Lower of Net Profit
Understated opening inventories	Higher Gross Profit	Higher of Net Profit

4.1.3 Need and Significance of Inventory Valuation

From our above discussion, it is quite evident that the valuation of inventory is of great importance; else, the final accounts would not depict truthful financial performance and position of a business. The mentioned below reasons highlight the importance of inventory valuation.

1. ***To determine actual profits and losses:*** Incorrect inventory valuation leads to incorrect computation of gross and net profit or loss. This provides misleading and false information about the financial performance of the business during an accounting period. In addition to this, it might hamper the future growth prospectus of the business. The understated profits might not attract new investors to invest or bank to forward loan to the business.
2. ***To reveal true and fair financial position:*** The incorrect values of inventories affect the Balance Sheet of the business. It may either overstate or understate the assets of a business. Consequently, numerous analyses of financial statements such as ratio analysis, preparation of cash flow statements, comparative and common-size Balance Sheets will reveal incorrect results. This will also badly influence the decision-making process and policies formed by the management and other parties such as creditors, potential investors, auditors, etc.
3. ***To compliant with legal requirements:*** As prescribed by AS-2 (revised) regarding the disclosure of inventories in the Balance Sheet, calculation of each type of inventories (in form of finished goods, work-in-progress, raw materials, stores and spares, and loose tools) becomes important. In addition to this, information regarding any change in policies and cost formulas for inventory valuation should be explicitly mentioned. Thus, in order to adhere to these requirements, it is very important to ascertain the value of inventories.

4.2 SYSTEMS OF DETERMINING PHYSICAL QUANTITIES OF INVENTORIES OR RECORDING SYSTEMS

In order to ascertain the true value of inventories, we need to know two figures—units of inventories and cost of per unit. 'Units of inventories' is multiplied with cost per unit and the resultant is total value of inventories. *Algebraically*,

$$\text{Value of Inventories} = \underbrace{\begin{matrix}\text{Units (or Physical Quantities)}\\ \text{of Inventories}\end{matrix}}_{\substack{\Downarrow \\ \textit{Determined by 2 methods}}} \times \underbrace{\begin{matrix}\text{Cost per}\\ \text{Unit}\end{matrix}}_{\substack{\Downarrow \\ \textit{Normally known}}}$$

- Periodic Inventory System
- Perpetual Inventory System

There are two methods or recording systems of inventories for determining physical quantities of inventories. These are as follows:

1. Periodic Inventory System
2. Perpetual Inventory System

4.2.1 Periodic Inventory System (also known as Physical Inventory System)

As per this system, inventory on a given date is ascertained by actually counting the units of inventories in hand. In other words, calculation of inventories is based on the physical counts. As the calculation is based on physical counting, this method is also termed as *physical inventory system*. Now, once the units of inventories are counted, then it is multiplied by per unit cost/rate to get value of stock (closing stock, if calculated at year-end) on that particular date. Finally, with the help of this value of closing stock, cost of goods sold can be determined by using the following formula.

$$\text{Cost of Goods Sold} = \begin{cases} \text{Opening Inventory} \\ +\text{Purchases during the year} \\ -\text{Closing Inventory} \end{cases}$$

Steps involved in Periodic Inventory System

Step 1: On a given date (say 31 March 2017), count the items left unsold at the godown.

$$\underset{1}{\otimes}\ \underset{2}{\otimes}\ \underset{3}{\otimes}\ \underset{4}{\otimes}\ \underset{5}{\otimes}\ \underset{6}{\otimes} \qquad \text{Total units} = 6$$

Step 2: Ascertain the value of inventories (closing) as follows:

$$\begin{aligned} \text{Value of Inventories} &= \text{Total units} \times \text{Per unit Cost} \qquad (\text{Assume per unit cost} = ₹10) \\ &= 6 \times ₹10 \\ &= ₹60 \end{aligned}$$

Step 3: Now, using the following formula, we can calculate the amount of cost of goods sold.

Assume,
Opening inventories = ₹100
Purchases = ₹500
Cost of Goods sold = Opening Inventories + Purchases − Closing Stock
= 100 + 500 − 60
= ₹540

Advantages and Disadvantages of Periodic Inventory System

Table 4.2 *Advantages and Disadvantages of Periodic Inventory System*

Advantages	S. No.	Disadvantages
More accurate results	**1**	Considers goods lost, damaged by fire or wasted as sales (as goods counted represent closing stock)
Suitable for smaller organisations	**2**	Continuous stock checking is not possible
Lesser expensive	**3**	Can be costlier, if financial statements are prepared very frequently, i.e. monthly, quarterly or half-yearly basis
Simple to use	**4**	Affects normal business operation during physical counting process
	5	Inventory control is not possible

4.2.2 Perpetual Inventory System

The term perpetual means continuous. This method keeps a continuous record of inventory, which is getting automatically updated on bin card and stores ledgers with each movement of inventory. Unlike Periodic Inventory System, in Perpetual Inventory System, inventory is not counted physically. It is the stock ledger that provides up-to-date information about the amount of inventories on any given date. This system comprises the following:

- ***Bin Card***: This is maintained and updated by a storekeeper. For every type of item in inventory, a storekeeper maintains the records on a printed card which is termed as bin card. It consists of important information such as name of item, date of receipt and issue, rate of item, balance quantity remaining, etc. On any given date, this card provides the information regarding the count/number of items left in the firm's warehouse or inventory.
- ***Stores Ledger***: This is maintained and updated by cost department. It records the count of the items (in the similar manner such as bin cards) along with the values of the items. In this manner, we can spot the difference between a bin card and store ledgers. While a bin card only records the quantitative aspects (count) of items, store ledgers record quantitative as well as monetary value of the items.
- ***Continuous Stock Taking***: This is a process of cross-checking of the records of bin cards and store ledgers with the physical verification of items in the inventory. There may be cases, where, the number of items left in the inventory (as per bin card and store ledgers) might be different from the actual items in the inventory. Continuous stock taking helps in locating such errors and in reconciling the differences.

The overall process of perpetual inventory method to ascertain the amount of closing inventory left on hand can be algebraically presented as follows:

$$\text{Closing Inventory} = \begin{cases} \text{Opening Inventory} \\ + \text{ Purchases during the year} \\ - \text{ Cost of Goods sold} \end{cases}$$

Advantages and Disadvantages of Perpetual Inventory System

Table 4.3 *Advantages and Disadvantages of Perpetual Inventory System*

Advantages	S. No.	Disadvantages
Helps in continuous check on record of stock	**1**	Costlier method
Helps in inventory control	**2**	Not suitable for small firms
Does not require suspension of the normal business working	**3**	Extra workload on cost department
Enables double cross-checking at cost department as well as at storekeeper	**4**	Might lead to delays due to more paperwork and dependence on storekeeper and cost department
Ensures timely and readily available figures for preparing financial statements as the value of closing stock can easily be obtained from stock ledgers	**5**	Time consuming in order to reconcile in case of differences between the records indicated by bin card and by store ledgers
Ensures maintaining of stock levels within the prescribed limits—with no overstocking and understocking of inventories	**6**	
Minimises the chances of inventory deterioration and obsolescence—as inventories are maintained within the prescribed limits	**7**	

4.2.3 Difference between Periodic Inventory System and Perpetual Inventory System

Table 4.4 *Difference between Periodic Inventory System and Perpetual Inventory System*

S. No.	Basis of Difference	Periodic Inventory System	Perpetual Inventory System
1	Ascertainment	On the basis of *physical count*	On the basis of *book records* (indicated by bin card/store ledgers)
2	Date of information	Provides information on *a given* date (ascertainment date)	Provides *continuous* information on *any* given date (ascertainment date)

(Continued)

Table 4.4 (Continued)

3	Result	It gives us cost of goods sold.	It gives us value of closing inventory.
4	Suspension of business operations	Required	Not required
5	Stock checking	Does not facilitate continuous stock checking	Facilitates continuous stock checking
6	Inclusion of goods lost, stolen and damaged	Included in cost of goods sold (as all goods that are not in inventory are assumed to be sold)	Included in closing inventory (all unsold goods are assumed to be in inventory)
7	Cost	Inexpensive	Expensive
8	Complexity level	Simple and easy	Complex
9	Inventory control	Not possible	Possible
10	Suitability	Effective for small-sized firms	Effective for large-sized firms

4.3 RECORDING OF TRANSACTIONS IN STOCK LEDGER/STOCK CARDS

In Chapter 2, we have learnt about the two methods of ascertaining cost of inventories—FIFO and Weighted Average Methods. These methods are used by the cost department while recording transactions in store ledger.

4.3.1 First-in-First-out Method (FIFO Method)

As the name suggests, first item of inventory purchased will be the first item to be sold. This means that all the inventories are sold in the order of their purchase. Likewise, the end of an accounting period will depict those inventories as unsold which were recently purchased or produced. For example, as shown in below table, 1,200 items (300 from lot 3 and 900 from lot 4) remain unsold. Thus, the valuation of closing inventory of 1,200 items reflects the current market price.

Lot No.	Date	Quantity (units)	Per unit Price (₹)	Price Paid (₹)
1	January 01, 2017	200	4	800
2	January 07, 2017	400	4.5	1,800
3	March 12, 2017	500	3.5	1,750
4	March 19, 2017	600	4.20	2,520
	Total	1,700		6,870

Stock Valuation

200 units @ ₹3.50 = 700

600 units @ ₹4.20 = 2,520

800 units = ₹3,220

It should be noted that irrespective of the methods of accounting of inventories, whether periodic inventory system or perpetual inventory system is followed, we get the same cost of inventories using FIFO method.

4.3.2 Format of Stock Ledger Account under FIFO Method

The following is the format of Stock Ledger Account under FIFO method.

Table 4.5 *Stock Ledger Account or Stock Cards (under FIFO Method)*

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Quantity	Prices	Amount	Quantity	Prices	Amount	Quantity	Prices	Amount
	(1)	(2)	(3) = (2 × 1)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (7 × 8)
Opening date							Balance b/d		
Date of Purchase and Sales	Units purchased	Per unit price	Units × Per unit price	Units sold	Per unit sale price	Units × Per unit price	Units left (Opening + Purchases – Sales)	Per unit price	Units left × Per unit price
Total									

Total Purchases

Cost of Goods Sold

Cost of Closing Stock

Example 1: Consider the following information to find value of stock (FIFO method) on 31 December 2016 and cost of goods sold; if the opening stock as on 01 January 2016 is 20 units @ ₹26 per unit.

Date	Nature of Transactions	Quantities	Per unit Rate
January 02, 2016	Purchases	100	₹25
February 03, 2016	Sales	30	₹35
April 10, 2016	Issues	70	₹40
June 15, 2016	Purchases	90	₹20
July 20, 2016	Sales	25	₹25
August 31, 2016	Purchases	35	₹26
November 30, 2016	Issues	40	₹32

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2016							20	26	520

(Continued)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 02, 2016	100	25	2,500				20 100	26 25	520 2,500
February 03, 2016				20 10	26 25	520 250	90	25	2,250
April 10, 2016				70	25	1,750	20	25	500
June 15, 2016	90	20	1,800				20 90	25 20	500 1,800
July 20, 2016				20 5	25 20	500 100	85	20	1,700
August 31, 2016	35	26	910				85 35	20 26	1,700 910
November 30, 2016				40	20	800	45 35	20 26	900 910
December 31, 2016 **(Total)**	225		5,210	165		3,920	80		1,810

Value of closing stock as on December 31, 2016 is ₹900 + ₹910 = ₹1,810 and
Cost of Goods Sold = Opening Inventory + Purchases − Closing Stock
= 520 + 5,210 − 1,810 = ₹3,920

Example 2: Consider the following information to find the value of inventory (June 30, 2017) using FIFO method.

Date	Units Purchased	Rate	Sales/Issue
January 01, 2017	100	35	
January 02, 2017	150	40	
March 03, 2017			220
April 04, 2017	95	50	
May 5, 2017			120

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2017	100	35	3,500				100	35	3,500
February 02, 2017	150	40	6,000				100 150	35 40	3,500 6,000

(Continued)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
March 03, 2017				100 120	35 40	3,500 4,800	30	40	1,200
April 04, 2017	95	50	4,750				30 95	40 50	1,200 4,750
May 05, 2017				30 90	40 50	1,200 4,500	5	50	250
Total	345		14,250	340		14,000	5		250

Value of closing stock as on June 30, 2017 is ₹250.

Example 3: Find out the value of closing stock (FIFO method) as on December 31, 2016 and cost of goods sold for the year 2016; if the balance brought down amount of stock is 40 units @ ₹11 per unit on January 01, 2016.

Purchases			Sales/Issues		
Date	Units	Rate	Date	Units	Rate
Marh 02, 2016	100	₹10	March 01, 2016	35	₹13
June 10, 2016	50	₹11	May 10, 2016	102	₹14
October 06, 2016	75	₹12	December 31, 2016	48	₹16

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2016							40	11	440
March 01, 2016				35	11	385	5	11	55
March 02, 2016	100	10	1,000				5 100	11 10	55 1,000
May 10, 2016				5 97	11 10	55 970	3	10	30
June 10, 2016	50	11	550				3 50	10 11	30 550
October 06, 2016	75	12	900				3 50 75	10 11 12	30 550 900

(Continued)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
December 31, 2016				3 45	10 11	30 495	5 75	11 12	55 900
Total	225		2,450	185		1,935	80		955

Value of closing stock as on December 31, 2016 is ₹955

Cost of Goods Sold = Opening Inventory + Purchases – Closing Stock

= 440 + 2,450 – 955 = ₹1,935

Example 4: M/s Lalbagh has made the following purchases and sales in the month of June 2017. Prepare Stock Ledger using FIFO method; if the stock on June 01, 2017 is 50 units @ ₹5 per unit.

Purchases			Sales/Issues		
Date	Units	Rate	Date	Units	Rate
June 01, 2017	100	₹5.5	June 04, 2017	140	₹10
June 02, 2017	50	₹6	June 07, 2017	5	₹12
June 18, 2017	30	₹7	June 24, 2017	125	₹14

It was lately found out that

a. On June 15, 2017, 46 units were received back from completed job, which were earlier issued at ₹5 per unit.
b. On June 30, 2017, a carton containing 25 units ordered on June 22, 2017 received costing ₹7.80 per unit.

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases/Returned to Stores			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
June 01, 2017							50	5	250
June 01, 2017	100	5.5	550				50 100	5 5.5	250 550
June 04, 2017				50 90	5 5.5	250 495	10	5.5	55
June 07, 2017				5	5.5	27.5	5	5.5	27.5
June 12, 2017	50	6	300				5 50	5.5 6	27.5 300
June 15, 2017	46	5	230				5 50 46	5.5 6 5	27.5 300 230

(Continued)

Date of Transactions	Purchases/Returned to Stores			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
June 18, 2017	30	7	210				5 50 46 30	5.5 6 5 7	27.5 300 230 210
June 24, 2017				5 50 46 24	5.5 6 5 7	27.5 300 230 168	6	7	42
June 30, 2017	25	7.80	195				6 25	7 7.80	42 195
Total	251		1,485	270		1,498	31		237

4.3.3 Merits and Demerits of FIFO Method

Merits

1. This method considers the *physical flow of goods*.
2. This method values closing stock at current market price, hence, this method gives us a more *realistic picture*.
3. It is aligned with the *prudence concept*, as this is based on cost price of the goods, thus, no unrealised profit is accounted for on closing stock.
4. It is more useful to account for perishable goods and for the materials which are slow-moving.
5. This method also minimises the *chances of deterioration and loss of goods* due to fire, theft and obsolescence, as the items purchased at first is sold off first.

Demerits

1. This method is less impactful in cases of *higher price fluctuations* (either inflation or deflation).
2. This method indicates higher profits in case of higher prices, which increases the tax liabilities of the business.
3. It would be difficult and would involve complex calculations, if price changes too frequently.
4. This method by-passes the *matching principle*, as the current cost cannot be matched with the current revenue.
5. It would be impossible to use this method in cases where non-identifiable items are issued.
6. This method becomes less effective if sales returns are received after a longer period of time.

4.3.4 Weighted Average Method under Periodic Inventory System

This method has been designed to off-set or to average out the changes in the prices of inventories over a period of time. This method can be used for both the systems of recording of inventories—periodic as well as perpetual inventory system.

In case of Periodic Inventory System, the unsold (closing) stock is multiplied by weighted average price, which gives us the cost of closing inventories at an average price of opening inventories, cost of inventories purchased during the year. The weighted average price is calculated considering all purchases made during the period (or the accounting year or month).

> **Let's Take a Pause!**
>
> *It should be noted that in order to calculate Weighted Average Price (per unit), we add value of opening stock with the values of* ***all*** *purchases made. This sum amount is then divided by the* ***total*** *units of stock (purchased units + opening units).*

$$\text{Value of Closing Inventories} = \left(\underbrace{\text{Opening Stock} + \text{Purchases} - \text{Sales}}_{(\textit{in units})}\right) \times \text{Weighted Average Price (per unit)}$$

where

$$\text{Weighted Average Price (per unit)} = \frac{\text{Opening Stock } (\textit{in amount}) + \text{Purchases } (\textit{in amount})}{\text{Opening Stock } (\textit{in units}) + \text{Purchases } (\textit{in units})}$$

Example 5: Find out value of closing stock (Weighted Average method) and cost of goods sold if the balance brought down amount of stock is 35 units @ ₹12 per unit.

Purchases			Sales/Issues		
Date	**Units**	**Rate**	**Date**	**Units**	**Rate**
April 02, 2017	100	₹10	April 03, 2017	30	₹20
May 20, 2017	40	₹15	May 03, 2017	50	₹25
October 26, 2017	65	₹16	December 31, 2017	100	₹26

Solution

Calculation of Weighted Average Price

Date of Transactions	Details of Purchases and Opening Balance		
	Units	**Prices**	**Amount**
Opening Date	35	12	420
April 02, 2017	100	10	1,000
May 20, 2017	40	15	600
October 26, 2017	65	16	1,040
Total	240		3,010

$$\text{Weighted Average Price (per unit)} = \frac{\text{Opening Stock} + \text{Purchases } (\textit{in amount})}{\text{Opening Stock} + \text{Purchases } (\textit{in units})}$$

$$= \frac{3{,}060}{240} = 12.75$$

$$\text{Value of Closing Inventories} = (\text{Opening Stock} + \text{Purchases} - \text{Sales}) \times \text{Weighted Average Price (per unit)}$$

$$= [35 + (100 + 40 + 65) - (35 + 50 + 100)] \times 12.75$$

$$= [240 - 185] \times 12.75 = ₹701.25$$

4.3.5 Weighted Average Method under Perpetual Inventory System

Under Perpetual Inventory System, the weighted average price is calculated by *dividing total cost of inventory after each purchase by total number of units in inventory after that purchase*. On the other hand, under Periodic Inventory System, the weighted average price is calculated by *considering all the purchases made during the accounting period.*

Value of Closing Inventories = Opening Stock + Purchases – Cost of Goods Sold till date

where,

Weighted Average Price (per unit)

$$= \frac{\text{Total } \textbf{Cost of Inventory} \text{ on hand after each Purchases } (\textit{in amount})}{\text{Total } \textbf{Number of Units} \text{ in Inventory after each Purchases } (\textit{in units})}$$

In order to understand this method under Perpetual Inventory System let us revisit the Example 5 and solve it as follows:

Example 6: Find out value of closing stock (Weighted Average method) and cost of goods sold; if the balance brought down amount of stock is 35 units @ ₹25 per unit.

Purchases			Sales/Issues		
Date	**Units**	**Rate**	**Date**	**Units**	**Rate**
April 02, 2017	100	₹10	April 03, 2017	30	₹35
May 20, 2017	40	₹15	May 03, 2017	50	₹30
October 26, 2017	65	₹20	December 31, 2017	100	₹35

Solution

Stock Ledger Account or Stock Cards (under Weighted Average Method)

	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
Date	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
Opening Date							35	25	875
April 02, 2017	100	10	1,000				$135\begin{cases}35\\100\end{cases}$	$13.88 = \frac{1000+875}{100+35}$	$1,875 = \begin{cases}135 \times\\13.88\end{cases}$
April 03, 2017				30	13.88	$416.4 = \begin{cases}30 \times\\13.88\end{cases}$	$105\begin{cases}135\\-30\end{cases}$	13.88	$1,457 = \begin{cases}105 \times\\13.88\end{cases}$
May 03, 2017				50	13.88	$694 = \begin{cases}50 \times\\13.88\end{cases}$	$55\begin{cases}105\\-50\end{cases}$	13.88	$763 = \begin{cases}55 \times\\13.88\end{cases}$
May 20, 2017	40	15	600				$95\begin{cases}55\\+40\end{cases}$	$14.34 = \frac{763+600}{55+40}$	$1,363 = \begin{cases}95 \times\\14.34\end{cases}$

(Continued)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
October 26, 2017	65	20	1,300				$140\begin{cases}95\\+65\end{cases}$	$19.02 = \frac{1363+1,300}{95+65}$	$2,663 = \begin{cases}140\times\\19.02\end{cases}$
December 31, 2017				100	19.02	1902	$40\begin{cases}140\\-100\end{cases}$	19.02	$761 = \begin{cases}40\times\\19.02\end{cases}$
Total			2,900			3012.4			761

Total Purchases

Cost of Goods Sold

Value of Closing Inventories = Opening Stock + Purchases − Cost of Goods Sold till date

= 875 + 2,900 − 3,012.4 = ₹761 (approx.)

Example 7: Using the below information, find out the following:

a. Cost of Goods Sold (using FIFO method)
b. Value of Closing Stock (using Weighted Average Method)

Opening Stock as on April 01, 2017 Consists of 100 Units @ ₹2 per Unit

Purchases		Sales/Issues	
Date	**Units @ ₹**	**Date**	**Units**
April 03, 2017	200 units @ ₹3 per unit	April 06, 2017	250 units
April 07, 2017	150 units @ ₹4 per unit	April 08, 2017	100 units
April 09, 2017	70 units @ ₹5 per unit	April 10, 2017	130 units
April 11, 2017	40 units @ ₹6 per unit	April 11, 2017	30 units
		April 30, 2017	10 units

Solution

a. Using FIFO Method

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
Opening April 01, 2017							100	2	200
April 03, 2017	200	3	600				100 200	2 3	200 600
April 06, 2017				100 150	2 3	200 450	50	3	150
April 07, 2017	150	4	600				50 150	3 4	150 600
April 08, 2017				50 50	3 4	150 200	100	4	400
April 09, 2017	70	5	350				100 70	4 5	400 350

(Continued)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
April 10, 2017				100 30	4 5	400 150	40	5	200
April 11, 2017				30	5	150	10	5	50
April 12, 2017	40	6	240				10 40	5 6	50 240
April 30, 2017				10	5	50	40	6	240
Total			1,790			1,750			240

Value of closing stock as on April 30, 2017 is ₹240 and

Cost of Goods Sold = Opening Inventory + Purchases − Closing Stock

= 200 + 1,790 − 240 = ₹1,750

b. Using Weighted Average Method

Stock Ledger Account or Stock Cards (under Weighted Average Method)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
Opening Date							100	2	200
April 03, 2017	200	3	600				$300\left\{\begin{matrix}100\\200\end{matrix}\right\}$	2.67 = $\frac{600+200}{200+100}$	$801 = \left\{\begin{matrix}300\times\\2.67\end{matrix}\right.$
April 06, 2017				250	2.67	$667.5 = \left\{\begin{matrix}250\times\\2.67\end{matrix}\right.$	$50\left\{\begin{matrix}300\\-250\end{matrix}\right.$	2.67	$133.5 = \left\{\begin{matrix}50\times\\2.67\end{matrix}\right.$
April 07, 2017	150	4	600				$200\left\{\begin{matrix}50\\+150\end{matrix}\right.$	3.67 = $\frac{600+133.5}{150+50}$	$734 = \left\{\begin{matrix}200\times\\3.67\end{matrix}\right.$
April 08, 2017				100	3.67	367	$100\left\{\begin{matrix}200\\-100\end{matrix}\right.$	3.67	$367 = \left\{\begin{matrix}100\times\\3.67\end{matrix}\right.$
April 09, 2017	70	5	350				$170\left\{\begin{matrix}100\\+70\end{matrix}\right.$	4.22 = $\frac{350+367}{70+100}$	$717.4 = \left\{\begin{matrix}170\times\\4.22\end{matrix}\right.$
April 10, 2017				130	4.22	548.6	$40\left\{\begin{matrix}170\\-130\end{matrix}\right.$	4.22	$168.8 = \left\{\begin{matrix}40\times\\4.22\end{matrix}\right.$
April 11, 2017				30	4.22	126.6	$10\left\{\begin{matrix}40\\-30\end{matrix}\right.$	4.22	$42.2 = \left\{\begin{matrix}10\times\\4.22\end{matrix}\right.$
April 12, 2017	40	6	240				$50\left\{\begin{matrix}10\\+40\end{matrix}\right.$	5.64 = $\frac{240+42.2}{40+10}$	$282 = \left\{\begin{matrix}50\times\\5.64\end{matrix}\right.$
April 30, 2017				10	5.64	56.4	$40\left\{\begin{matrix}50\\-10\end{matrix}\right.$	5.64	$225.6 = \left\{\begin{matrix}40\times\\5.64\end{matrix}\right.$
Total			1,790			1,766.1			225.6

Value of Closing Inventories = Opening Stock + Purchases − Cost of Goods Sold till date

= 200 + 1,790 − 1,766 = ₹224 (approx.)

4.3.6 Merits and Demerits of Weighted Average Method

Merits

1. As this method is based on the average price, it mitigates the effects of price fluctuations.
2. It also reduces the scope of window-dressing and manipulation of profits.

3. It scores over FIFO method, as it considers both quantity as well as price of inventories.
4. It also reduces the use of long calculations as would have been required by FIFO method in case of high price fluctuations.
5. This method is very useful for inventory valuation especially in case of process-based industries.

Demerits

1. Since this method is based on average price which is an approximation, so difference arises between total cost, cost of goods sold and the unsold stock in hand.
2. It involves more calculation compared to FIFO method.
3. If price fluctuates acutely, then this method loses its effectivity and gives misleading results.
4. The value of closing inventories is not the actual cost or their current market price.
5. Conservatism principle is ignored by this method because closing inventories reflect average price (which is neither the market price nor the cost price).

4.4 STOCK TAKING AND RELATED ADJUSTMENTS

Stock taking is the process where the stock in hand is verified and valued at the end of the accounting year. It is simply counting of inventories physically such as 1, 2, 3 … and so on. This is not required under Perpetual Inventory Method as the accounting of inventory is done by bin card and ready quantity figures are provided by stock ledgers. However, in Periodic Inventory System, stock taking becomes important, wherein, on the last day of the accounting year, i.e. on 31 March, counting of inventories is required. This is quite impossible to complete the process on a single day. Accordingly, there exists two ways of stock taking.

1. Initiating and work-out the stock taking process few days ***before*** year-end say by 24 March
2. Initiating and work-out the stock taking process dew days ***after*** year-end say by 7 April

But it should be noted that during these days, i.e. (a) 24 March to 31 March and (b) 1 April to 7 April; the normal sale and purchase of inventories also occurs simultaneously. In order to account for these transactions (that happened during these days), we need to make certain adjustments to the value of closing stock on 31 March.

Table 4.6 *List of Items Included/Excluded from Stock Taking*

Before Year-end: Stock Taking Process (for instance — 24 March)		**After Year-end: Stock Taking Process (for instance — 7 April)**	
Value of Closing Stock (on 24 March)	xxx	Value of Closing Stock (on 7 April)	xxx
Included items **(During 24th March to 31st March)**		***Included items*** **(During 1st April to 7th April)**	
Add: Purchases Sales Return (at cost price)	xxx xxx	*Add*: Sales at cost Purchases Return	xxx xxx
Excluded items **(During 24th March to 31st March)**		***Excluded items*** **(During 1st April to 7th April)**	
Less: Sales Purchases Return (at cost)	(xxx) (xxx)	*Less*: Purchases Sales Return (at cost)	(xxx) (xxx)

Transaction taken place during 24 March to 31 March (in case of stock taking process is initiated before year-end) or during 1 April to 7 April (in case of stock taking process initiated after year-end) relating to Consignment Stock, Goods-in-Transit, Goods on Sale on Return Basis—to be accounted to work-out stock on 31 March. In brief, transactions taken place during this gap period need to be adjusted.

Example 8: M/s Bandra Ltd. follows the accounting period of April 1 to March 31. On March 25, 2017, the value of closing stock was ₹3,00,000. Consider the following information to ascertain the amount of closing stock as on March 31, 2017.

a. Purchases made on March 26 amounted to ₹40,000
b. Goods costing ₹4,500 sold on March 10, 2017 were returned by M/s Poppatlal
c. Goods costing ₹5,400 were held by Mr. Rane on consignment basis.
d. Goods sold to Mr. Tavre at 125% of cost at ₹1,50,000 on March 31, 2017

Solution

Ascertainment of Closing Stock as on March 31, 2017	
Value of Closing Stock (on March 25)	3,00,000
Add: Purchases made on March 26	40,000
Sales Return (at cost price)	4,500
Goods held by consignee (at cost price)	5,400
Less: Sales made on March 31, 2017	(1,20,000)
Closing Stock as on March 31, 2017	2,29,900

Working Note

$$\text{SP} = 1{,}50{,}000 = 125\% \text{ of CP}$$

$$\Rightarrow 1{,}50{,}000 = \frac{125}{100} \times \text{CP}$$

$$\Rightarrow \text{CP} = \frac{100}{125} \times 1{,}50{,}000 = ₹1{,}20{,}000$$

Example 9: M/s Shivpati Ltd. has taken physical verification of closing stock of ₹4,00,000 as on April 7, 2017. During this week (1 April to 7 April), the following events took place. You are required to ascertain the value of closing stock as on March 31, 2017.

a. Gross profit rate is 25% on cost.
b. Purchases and Sales made during this week were ₹35,000 and ₹40,000.
c. Goods worth ₹3,500 were purchased on 15 March, but yet the goods are not delivered.
d. Goods worth ₹15,000 purchased on 3 April were returned back on April 04, 2017.

Solution

Ascertainment of Closing Stock as on March 31, 2017	
Value of Closing Stock (on 7 April)	4,00,000
Add: Sales at cost (during the week)	32,000
Purchases Return	15,000

(Continued)

Ascertainment of Closing Stock as on March 31, 2017	
Purchase on March 15, 2017 but not received (through ownership transferred)	3,500
Less: Purchases (during the week)	(35,000)
Closing Stock as on March 31, 2017	4,15,500

Working Note

GP = 25% of CP

If Cost is $100x$, then GP is $25x$ and Sales will be $125x$.

$$\therefore \quad \text{Cost} = \frac{\text{Sales}}{125\%} = \frac{40{,}000}{125\%} = ₹32{,}000$$

Example 10: M/s Wankhede took stock on April 10, 2017 when the closing stock was computed as ₹5,50,000. The following facts pertain to the period April 01, 2017 to April 10, 2017.

a. Goods worth ₹65,000 were sold at a profit of 25% on sales
b. Purchases of ₹37,000 include ₹7,000 for which ownership has not been transferred yet.
c. Goods sold costing ₹11,000 were received from consignee Mr. Ram Manhor.
d. Goods sent to Mr. Keke (at ₹25,000) on approval basis at a profit of 25% on sales.
e. Sales of ₹9,000 were found to be undercasted.
f. Goods purchased at ₹6,000 (which was purchased at 20% more than its market-price) were not received; however, the invoice was recorded in the Purchase Day Book.

You are required to calculate closing stock as on March 31, 2017.

Solution

Ascertainment of Closing Stock as on March 31, 2017	
Value of Closing Stock (on April 10)	5,50,000
Add: Sales at cost (during the week)	65,000
Purchases return	15,000
Goods sent on approval basis	18,750
Undercasting of sales	9,000
Less: Purchases (during the week)	(30,000)
Purchases (ownership transferred)	(6,000)
Goods held on consignment basis	(11,000)
Closing Stock as on March 31, 2017	5,95,750

Working Notes

Profit = 25% of Sales

$\therefore$ Cost is 75% of Sales

$\therefore$ Cost = Sales $\times$ 75%

$\Rightarrow$ Cost = 25,000 $\times$ 75% = ₹18,750

4.5 COMPREHENSIVE ILLUSTRATIONS

Example 11: The following particulars have been extracted in respect of Raw materials of Ultra Chemicals. Find the value of closing stock as on June 30, 2016 on the basis of (I) First-In-First-Out Method and (II) Weighted Average Method.

Receipts:

Jaunary 01, 2016	Opening Stock	100 units at ₹35 per unit
February 03, 2016	Purchased	400 units at ₹40 per unit
April 13, 2016	Purchased	900 units at ₹45 per unit
June 23, 2016	Purchased	600 units at ₹50 per unit

Issues:

March 05, 2016	Issued	400 units
May 15, 2016	Issued	600 units
June 30, 2016	Issued	600 units

Acc&FM-I, November 2016

Solution

(I) Using FIFO Method

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2016							100	35	3,500
February 03, 2016	400	40	16,000				100 400	35 40	3,500 16,000
March 05, 2016				100 300	35 40	3,500 12,000	100	40	4,000
April 13, 2016	900	45	40,500				100 900	40 45	4,000 40,500
May 15, 2016				100 500	40 45	4,000 22,500	400	45	18,000
June 23, 2016	600	50	30,000				400 600	45 50	18,000 30,000
June 30, 2016				400 200	45 50	18,000 10,000	400	50	20,000
June 30, 2016 **(Total)**			86,500			70,000	400		20,000

Value of closing stock as on June 30, 2016 is ₹20,000.

(II) Using Weighted Average Method

Stock Ledger Account or Stock Cards (under Weighted Average Method)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
January 01, 2016							100	35	3,500
February 03, 016	400	40	16,000				$500\left\{\begin{matrix}100\\400\end{matrix}\right\}$	$39=\frac{16,000+3,500}{400+100}$	$19,500=\begin{cases}500\times\\39\end{cases}$
March 05, 2016				400	39	$15,600=\begin{cases}400\times\\39\end{cases}$	$100\begin{cases}500\\-400\end{cases}$	39	$3,900=\begin{cases}100\times\\39\end{cases}$
April 13, 2016	900	45	40,500				$1,000\begin{cases}100\\+900\end{cases}$	$44.4=\frac{40,500+3,900}{900+100}$	$44,400=\begin{cases}1000\times\\44.4\end{cases}$
May 15, 2016				600	44.4	$26,640=\begin{cases}600\times\\44.4\end{cases}$	$400\begin{cases}1000\\-600\end{cases}$	44.4	$17,760=\begin{cases}400\times\\44.4\end{cases}$
June 23, 2016	600	50	30,000				$1,000\begin{cases}400\\+600\end{cases}$	$47.76=\frac{30,000+17,760}{600+400}$	$47,760=\begin{cases}1000\times\\47.76\end{cases}$
June 30, 2016				600	47.76	$28,656=\begin{cases}600\times\\47.76\end{cases}$	$400\begin{cases}1000\\-600\end{cases}$	47.76	$19,104=\begin{cases}400\times\\47.76\end{cases}$
June 30, 2016 **(Total)**			86,500			70,896	400		19,104

Value of Closing Inventories = Opening Stock + Purchases − Cost of Goods Sold till date
= 3,500 + 86,500 − 70,896 = ₹19,104.

Example 12: Find out the value of Closing Stock of M/s Mayur Ltd. using (A) FIFO Method (B) Weighted Average Method from the following details of Material 'X' as on January 31, 2016.

Date	Particulars	Unit	@ ₹
2016			
January 05	Opening Stock	700	25
January 06	Issues	400	–
January 09	Purchases	900	35
January 11	Issues	600	–
January 16	Purchases	200	40
January 21	Purchases	900	45
January 31	Issues	500	–

Acc&FM-I, November 2016

Solution

(A) Using FIFO Method

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 05, 2016							700	25	17,500
January 06				400	25	10,000	300	25	7,500
January 09	900	35	31,500				300 900	25 35	7,500 31,500
January 11				300 300	25 35	7,500 10,500	600	35	21,000
January 16	200	40	8,000				600 200	35 40	21,000 8,000
January 21	900	45	40,500				600 200 900	35 40 45	21,000 8,000 40,500
January 31				500	35	17,500	100 200 900	35 40 45	3,500 8,000 40,500
Total	2,000		80,000	1,500		45,000	1,200		52,000

Value of closing stock as on January 31, 2016 is ₹52,000.

(B) Using Weighted Average Method

Stock Ledger Account or Stock Cards (under Weighted Average Method)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
January 05, 2016							700	25	17,500
January 06				400	25	10,000	$300\left\{\begin{matrix}700\\-400\end{matrix}\right.$	25	$7{,}500=\left\{\begin{matrix}300\times\\25\end{matrix}\right.$
January 09	900	35	31,500				$1{,}200\left\{\begin{matrix}300\\+900\end{matrix}\right.$	$32.5=\dfrac{7{,}500+31{,}500}{300+900}$	$39{,}000=\left\{\begin{matrix}1{,}200\times\\32.5\end{matrix}\right.$
January 11				600	32.5	19,500	$600\left\{\begin{matrix}1{,}200\\-600\end{matrix}\right.$	32.5	$19{,}500=\left\{\begin{matrix}600\times\\32.5\end{matrix}\right.$
January 16	200	40	8,000				$800\left\{\begin{matrix}600\\+200\end{matrix}\right.$	$34.375=\dfrac{19{,}500+8{,}000}{600+200}$	$27{,}500=\left\{\begin{matrix}800\times\\34.375\end{matrix}\right.$
January 21	900	45	40,500				$1{,}700\left\{\begin{matrix}800\\+900\end{matrix}\right.$	$40=\dfrac{40{,}500+27{,}500}{800+900}$	$68{,}000=\left\{\begin{matrix}1{,}700\times\\40\end{matrix}\right.$

(Continued)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
January 31				500	40	20,000 = $\begin{cases}500 \times \\ 40\end{cases}$	1,200 $\begin{cases}1,700 \\ -500\end{cases}$	40	48,000 = $\begin{cases}1,200 \times \\ 40\end{cases}$
January 31 2016 **(Total)**	2,000		80,000	1,500		49,500			48,000

Value of Closing Inventories = Opening Stock + Purchases − Cost of Goods Sold till date
= 17,500 + 80,000 − 49,500 = ₹48,000.

Example 13: From the following particulars, prepare stock register by FIFO as well as weighted average method and also find out cost of goods sold by both methods.

Date	Transaction	Units	Rate per Unit (₹)
January 01, 2015	Opening Stock	14,000	3.50
January 03, 2015	Purchases	24,000	3.80
January 07, 2015	Sales	26,000	4.20
January 11, 2015	Purchases	30,000	3.90
January 15, 2015	Sales	34,000	4.30
January 19, 2015	Purchases	32,000	4.05
January 23, 2015	Sales	27,000	4.40
January 27, 2015	Purchases	37,000	4.10
January 31, 2015	Sales	31,200	4.55

F.Y.B.Com., IDOL, April 2014 (adapted)

Solution

(I) Using FIFO Method

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2015							14,000	3.5	49,000
January 03, 2015	24,000	3.80	91,200				14,000 24,000	3.5 3.8	49,000 91,200
January 07, 2015				14,000 12,000	3.5 3.8	49,000 45,600	12,000	3.8	45,600
January 11, 2015	30,000	3.90	1,17,000				12,000 30,000	3.8 3.9	45,600 1,17,000
January 15, 2015				12,000 22,000	3.8 3.9	45,600 85,800	8,000	3.9	31,200
January 19, 2015	32,000	4.05	1,29,600				8,000 32,000	3.9 4.05	31,200 1,29,600

(Continued)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 23, 2015				8,000 19,000	3.9 4.05	31,200 76,950	13,000	4.05	52,650
January 27, 2015	37,000	4.10	1,51,700				13,000 37,000	4.05 4.10	52,650 1,51,700
January 31, 2015				13,000 18,200	4.05 4.10	52,650 74,620	18,800	4.10	77,080
Total	1,23,000		4,89,500	1,18,200		4,61,420	18,800		77,080

Value of closing stock as on January 31, 2015 is ₹77,080.

(II) Using Weighted Average Method

Stock Ledger Account or Stock Cards (under Weighted Average Method)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
January 01, 2015							14,000	3.5	49,000
January 03, 2015	24,000	3.80	91,200				$38{,}000\left\{\begin{matrix}14{,}000\\24{,}000\end{matrix}\right.$	$3.7=\frac{91{,}200+49{,}000}{24{,}000+14{,}000}$	$1{,}40{,}600=\left\{\begin{matrix}38{,}000\times\\3.7\end{matrix}\right.$
January 07, 2015				26,000	3.7	96,200	$12{,}000\left\{\begin{matrix}38{,}000\\-26{,}000\end{matrix}\right.$	3.7	44,400
January 11, 2015	30,000	3.90	1,17,000				$42{,}000\left\{\begin{matrix}12{,}000\\+30{,}000\end{matrix}\right.$	$3.84=\frac{1{,}17{,}000+44{,}400}{30{,}000+12{,}000}$	1,61,280
January 15, 2015				34,000	3.84	1,30,560	$8{,}000\left\{\begin{matrix}42{,}000\\-34{,}000\end{matrix}\right.$	3.84	30,720
January 19, 2015	32,000	4.05	1,29,600				$40{,}000\left\{\begin{matrix}8{,}000\\+32{,}000\end{matrix}\right.$	$4=\frac{1{,}29{,}600+30{,}720}{8{,}000+32{,}000}$	1,60,000
January 23, 2015				27,000	4	1,08,000	$13{,}000\left\{\begin{matrix}40{,}000\\-27{,}000\end{matrix}\right.$	4	52,000
January 27, 2015	37,000	4.10	1,51,700				$50{,}000\left\{\begin{matrix}13{,}000\\+37{,}000\end{matrix}\right.$	$4.07=\frac{1{,}51{,}700+52{,}000}{13{,}000+37{,}000}$	2,03,500
January 31, 2015				31,200	4.07	1,26,984	$18{,}800\left\{\begin{matrix}50{,}000\\-31{,}200\end{matrix}\right.$	4.07	76,516
Total	1,23,000		4,89,500	1,18,200		4,61,744	18,800		76,516

Cost of goods sold is ₹76,516.

Example 14: From the following details of Woodland Stores, Dadar prepare stores ledger account pricing the material issued under FIFO method also find out cost of goods sold.

Date	Particulars	Quantity (Units)	Rate (₹) per Unit
January 01, 2015	Balance	900 Units	20
January 02, 2015	Received	400 Units	21
January 05, 2015	Issued	600 Units	–
January 08, 2015	Received	800 Units	22
January 09, 2015	Issued	700 Units	–
January 10, 2015	Received	900 Units	23
January 11, 2015	Issued	400 Units	–
January 14, 2015	Issued	300 Units	–

F.Y.B.Com., IDOL, October 2012 (adapted)

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
January 01, 2015							900	20	18,000
January 02, 2015	400	21	8,400				900 400	20 21	18,000 8,400
January 05, 2015				600	20	12,000	300 400	20 21	6,000 8,400
January 08, 2015	800	22	17,600				300 400 800	20 21 22	6,000 8,400 17,600
January 09, 2015				300 400	20 21	6,000 8,400	800	22	17,600
January 10, 2015	900	23	20,700				800 900	22 23	17,600 20,700
January 11, 2015				400	22	8,800	400 900	22 23	8,800 20,700
January 14, 2015				300	22	6,600	100 900	22 23	2,200 20,700
Total	2,100		46,700	2,000		41,800	1,000		22,900

The value of cost of goods sold is ₹41,800.

Example 15: From the following data of March 2015; calculate the cost of goods sold and value of closing stock using the following methods—FIFO and Weighted Average Price:

Purchases			Sale	
Date	**Quantity**	**Rate per Unit (₹)**	**Date**	**Quantity**
01	2,000	10	06	1,200
02	300	12	11	1,000
10	200	14	30	200
22	300	11		

F.Y.B.Com., IDOL, March 2006 (adapted)

Solution

Stock Ledger Account or Stock Cards (under FIFO Method)

Date of Transactions	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	**Prices**	**Amount**	**Units**	**Prices**	**Amount**	**Units**	**Prices**	**Amount**
March 01, 2015	2,000	10	20,000				2,000	10	20,000
March 02, 2015	300	12	3,600				2,000 300	10 12	20,000 3,600
March 06, 2015				1,200	10	12,000	800 300	10 12	8,000 3,600
March 10, 2015	200	14	2,800				800 300 200	10 12 14	8,000 3,600 2,800
March 11, 2015				800 200	10 12	8,000 2,400	100 200	12 14	1,200 2,800
March 22, 2015	300	11	3,300				100 200 300	12 14 11	1,200 2,800 3,300
March 30, 2015				100 100	12 14	1,200 1,400	100 300	14 11	1,400 3,300
Total	2,800		29,700	2,400		25,000	400		4,700

Cost of goods sold is ₹25,000 and value of closing stock is ₹4,700.

Stock Ledger Account or Stock Cards (under Weighted Average Method)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	**Prices**	**Amount**	**Units**	**Prices**	**Amount**	**Units**	**Prices**	**Amount**
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6) = (4 × 5)**	**(7)**	**(8)**	**(9) = (8 × 7)**
March 01, 2015	2,000	10	20,000				2,000	10	20,000

(Continued)

Date	Purchases			Sales or Issues of Inventories			Balance or Closing Inventories		
	Units	Prices	Amount	Units	Prices	Amount	Units	Prices	Amount
	(1)	(2)	(3)	(4)	(5)	(6) = (4 × 5)	(7)	(8)	(9) = (8 × 7)
March 02, 2015	300	12	3,600				$2{,}300\left\{\begin{matrix}2{,}000\\300\end{matrix}\right.$	$10.26 = \frac{20{,}000+3{,}600}{2{,}000+300}$	23,598
March 06, 2015				1,200	10.26	12,312	$1{,}100\left\{\begin{matrix}2{,}300\\-1{,}200\end{matrix}\right.$	10.26	11,286
March 10, 2015	200	14	2,800				$1{,}300\left\{\begin{matrix}1{,}100\\+200\end{matrix}\right.$	$10.84 = \frac{2{,}800+11{,}286}{1{,}100+200}$	14,092
March 11, 2015				1,000	10.84	10,840	$300\left\{\begin{matrix}1{,}300\\-1{,}000\end{matrix}\right.$	10.84	3,252
March 22, 2015	300	11	3,300				$600\left\{\begin{matrix}300\\+300\end{matrix}\right.$	$10.92 = \frac{3{,}252+3{,}300}{300+300}$	6,552
March 30, 2015				200	10.92	2,184	$400\left\{\begin{matrix}600\\-200\end{matrix}\right.$	10.92	4,368
Total	2,800		29,700	2,400		25,336			4,368

Cost of goods sold is ₹25,336 and value of closing stock is ₹4,368.

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Define inventories as per AS-2 (revised). Explain the types of inventories and valuation of inventories as per AS-2 (revised).

(2) Explain the effects of incorrect inventory valuation on gross and net profit of a firm.

(3) Highlight three importance of inventory valuation.

(4) What do you mean by Periodic Inventory System? Explain the steps to ascertain cost of goods sold under this system.

(5) What do you mean by Perpetual Inventory System? Explain the components involved in this system.

(6) Put your comments for advocating the use of Periodic Inventory System over Perpetual Inventory System.

(7) Differentiate between Periodic Inventory System and Perpetual Inventory System on the following grounds

- (a) Cost involved
- (b) Suitability
- (c) Complexity involved
- (d) Stock checking
- (e) Ascertainment basis

(8) Explain FIFO method with the help of hypothetical figures and format of Stock Ledger Account.

(9) Explain Weighted Average Method under Perpetual Inventory System with the help of hypothetical figures and format of Stock Ledger Account.

(10) '*Weighted Average Method enjoys an edge over FIFO Method*'. Provide your comments in favour or against the statement.

(11) What is stock taking process? List down the items excluded and included from stock taking in case of:

- (a) Before year-end stock taking process
- (b) After year-end stock taking process

II. Short Notes (5 marks)

(1) Importance of Inventory Valuation

(2) Periodic Inventory System

(3) Perpetual Inventory System
(4) Advantages and Disadvantages—Periodic Inventory System
(5) Bin Card and Stores Ledger
(6) Advantages and Disadvantages—Perpetual Inventory System
(7) FIFO Method
(8) Merits and Demerits of FIFO Method
(9) Weighted Average Price Method
(10) Merits and Demerits of Weighted Average Price Method
(11) Stock taking

III. Objective Type Questions

(1) Which of the following does not serve as a need of inventory valuation?
  (a) To reveal true and fair financial position
  (b) To determine actual profits and losses
  (c) To facilitate meaningful comparisons
  (d) To compliant with legal requirements

(2) Which of the following will hold valid in case of overstated closing inventories?
  (a) Higher Gross Profit and Lower Net Profit
  (b) Lower Gross Profit and Lower Net Profit
  (c) Lower Gross Profit and Higher Net Profit
  (d) Higher Gross Profit and Higher Net Profit

(3) Which of the following methods is featured by suitable by large-sized firms, ensures double cross-checking and minimises deterioration of inventories?
  (a) Perpetual Inventory System (b) Periodic Inventory System
  (c) FIFO Method (d) Weighted Average Price Method

(4) Under which method the closing inventories reflect the current market price?
  (a) Perpetual Inventory System (b) Periodic Inventory System
  (c) FIFO Method (d) Weighted Average Price Method

(5) Which of the following will hold valid in case of understated closing inventories?
  (a) Higher Gross Profit and Lower Net Profit
  (b) Lower Gross Profit and Lower Net Profit
  (c) Lower Gross Profit and Higher Net Profit
  (d) Higher Gross Profit and Higher Net Profit

(6) Which of the following is not an advantage of Periodic Inventory System?
  (a) More accurate results (b) Suitable for small firms
  (c) Lesser expensive (d) Continuous stock checking

(7) Which of the following methods/systems is featured by inexpensive and is based on physical count?
  (a) Perpetual Inventory System (b) Periodic Inventory System
  (c) FIFO Method (d) Weighted Average Price Method

(8) Which of the following is an advantage of Perpetual Inventory System?
  (a) More accurate results (b) Suitable for small firms
  (c) Lesser expensive (d) Continuous stock checking

(9) Which of the following methods mitigates price effect?
  (a) Perpetual Inventory System (b) Periodic Inventory System
  (c) FIFO Method (d) Weighted Average Price Method

(10) Which of the following principles/concepts is ignored by Weighted Average Price Method?
  (a) Matching Principle (b) Prudence Concept
  (c) Conservatism Principle

(11) Which of the following principles is being adhered by FIFO Method?
  (a) Matching Principle (b) Prudence Concept
  (c) Conservatism Principle

(12) Bin card, Stores ledger and Continuous stock taking relate to
   (a) Perpetual Inventory System (b) FIFO Method
   (c) Weighted Average Price Method

(13) Which of the following is an advantage of Perpetual Inventory System?
   (a) Suitable for small firms
   (b) Ensures no overstocking and no understocking
   (c) Simple to use

(14) Under which method does cost of goods sold includes goods lost, stolen and damaged?
   (a) Periodic Inventory System (b) Perpetual Inventory System
   (c) FIFO Method

(15) Under which method does cost of closing inventories includes goods lost, stolen and damaged?
   (a) Periodic Inventory System (b) Perpetual Inventory System
   (c) FIFO Method

(16) Which of the following is not a disadvantage of Periodic Inventory System?
   (a) Continuous stock checking is not possible
   (b) Can be costlier if records are prepared frequently
   (c) Suspends business operations
   (d) Inventory control is possible

(17) Which of the following will hold valid in case of overstated opening inventories?
   (a) Higher Gross Profit and Lower Net Profit
   (b) Lower Gross Profit and Lower Net Profit
   (c) Lower Gross Profit and Higher Net Profit
   (d) Higher Gross Profit and Higher Net Profit

(18) Which of the following will hold valid in case of understated opening inventories?
   (a) Higher Gross Profit and Lower Net Profit
   (b) Lower Gross Profit and Lower Net Profit
   (c) Lower Gross Profit and Higher Net Profit
   (d) Higher Gross Profit and Higher Net Profit

(19) Stock in hand is verified and valued at the end of the accounting period is related to
   (a) Stock taking process
   (b) Weighted Average Price Method
   (c) FIFO Method

(20) Which of the following items is deducted from the value of closing stock as on 7 April in case of after year-end stock taking process?
   (a) Sales at cost (b) Purchase Return
   (c) Overcasting of Purchases (d) Opening Stock

(21) Calculate closing inventories, if cost of goods sold is ₹45,000, opening inventories is ₹4,000 and purchases is ₹50,000.
   (a) ₹7,000 (b) ₹8,000
   (c) ₹8,500 (d) ₹9,000

(22) If goods purchased is ₹1,00,000, Sales amounted to ₹84,000 and profit is 20% on cost, then closing inventories is
   (a) ₹16,000 (b) ₹20,000
   (c) ₹30,000 (d) ₹1,84,000

(23) If average stock is ₹20,000 and closing stock is 1.5 times of the opening stock. Calculate closing stock.
   (a) ₹10,000 (b) ₹14,000
   (c) ₹16,000 (d) ₹20,000

(24) Average stock is ₹20,000 and closing stock is 1.5 times of the opening stock. Calculate closing stock and sales, if purchases is ₹40,000.
   (a) ₹24,000 (b) ₹48,000
   (c) ₹72,000 (d) ₹96,000

Consider the following information during the month of January, 2017 to answer Q 25 to Q 30.

Date	Purchases	Date	Issues
1 January	Stock in hand 50 units (cost ₹3,000)	10 January	Items issued 25 units
3 January	Items purchased 100 units @ ₹65	15 January	Items issued 85 units
28 January	Items purchased 50 units @ ₹60	29 January	Items issued 30 units

(25) Calculate weighted average price on 28 January.
(a) 60 (b) 61
(c) 61.48 (d) 63.33

(26) Calculate value of closing stock by weighted average method.
(a) 3,689 (approx.) (b) 3,709 (approx.)
(c) 3,869 (approx.) (d) 3,969 (approx.)

(27) Calculate amount of issues on 10 January, 2017.
(a) 25 units @ ₹60 (b) 25 units @ ₹65
(c) 25 units @ ₹62.5 (d) 25 units @ ₹63.33

(28) Calculate cost of goods sold during the month of January 2017.
(a) 8,010 (approx.) (b) 8,801 (approx.)
(c) 8,108 (approx.) (d) 8,810 (approx.)

(29) Calculate the amount of issues on 15 January 2017.
(a) 5,838 (approx.) (b) 5,338 (approx.)
(c) 5,833 (approx.) (d) 5,383 (approx.)

(30) Calculate the opening inventory for the month of February, 2017.
(a) 3,689 (approx.) (b) 3,709 (approx.)
(c) 3,869 (approx.) (d) 3,969 (approx.)

Consider the following information during the financial year, 2016–2017 to answer Q 31 and Q 32.

Month	Nature of Transactions	Quantity (units)	Per Unit Cost (₹)
1 January 2017	Opening	100	20
21 January 2017	Purchases	500	22
1 February 2017	Sales	450	23
21 February 2017	Purchases	400	20
21 March 2017	Purchases	300	24

(31) Calculate value of inventory as on 31 March 2017
(a) 18,000 (b) 18,438
(c) 19,438 (d) 19,843

(32) Calculate weighted average price.
(a) 21.69 (b) 22.69
(c) 20.69 (d) 23.69

Consider the following information during April to December 2015 to answer Q 33 to Q 39.

Opening stock as on 1 April 2016 consists of 100 units @ ₹2 per unit.			
Purchases		**Sales/Issues**	
Date	**Units @ ₹**	**Date**	**Units**
3 April 2016	100 units @ ₹3 per unit	6 April 2016	195 units
7 May 2016	250 units @ ₹4 per unit	8 June 2016	130 units

(Continued)

Opening stock as on 1 April 2016 consists of 100 units @ ₹2 per unit.			
Purchases		**Sales/Issues**	
Date	**Units @ ₹**	**Date**	**Units**
9 July 2016	170 units @ ₹5 per unit	10 August 2016	130 units
11 September 2016	40 units @ ₹6 per unit	11 November 2016	150 units
		30 December 2016	50 units

(33) Using FIFO method, calculate the value of sales for the month of May 2016.
(a) ₹2,590 (b) ₹2,560
(c) ₹3,000 (d) ₹3,510

(34) Calculate the value of sales for the month of November 2016.
(a) 750 (b) 600
(c) 500 (d) 900

(35) Ascertain the rate used for valuating issues during the month of August 2016.
(a) 130 units @ ₹5 (b) 5 units @ ₹4 and 125 units @ ₹5
(c) 125 units @ ₹4 and 5 units @ ₹5 (d) 5 units @ ₹3 and 125 units @ ₹4

(36) Calculate the value of sales for the month of August 2016.
(a) 650 (b) 525
(c) 545 (d) 515

(37) Ascertain the rate used for valuating issues during the month of November 2016.
(a) 150 units @ ₹4
(b) 5 units @ ₹4 and 145 units @ ₹5
(c) 125 units @ ₹4 and 25 units @ ₹5
(d) 150 units @ ₹5

(38) Calculate the cost of closing stock as on 31 December 2016.
(a) ₹25 (b) ₹30
(c) ₹35 (d) ₹40

(39) Calculate the cost of goods sold as per FIFO method.
(a) 2,590 (b) 2,560
(c) 3,000 (d) 3,510

(40) Calculate the total profit earned by the concern during the first three quarters.
(a) 0 (b) 25
(c) 30 (d) Need more information

(41) M/s Shinde has closing stock costing ₹40,000 which included a deteriorated item costing ₹3,000. Repairing costs of ₹500 were spent and finally it can be sold off for ₹1,200. The amount of closing stock is
(a) ₹37,700 (b) ₹36,300
(c) ₹38,800 (d) ₹41,200

(42) Consider the following information for the month of March 2017.

Opening stock as on 1 April 2016 consists of 100 units @ ₹2 per unit.		
Date	**Particulars**	**Amount**
1 March 2017	Opening Stock	12,000
15 March 2017	Credit Purchases from M/s X	1,20,000
29 March 2017	Payment to M/s X	1,25,000
31 March 2017	Sales	?
31 March 2017	Closing Stock	10,000

Calculate the value of sales made on 31 March 2017, if profit margin is 25% above cost.

(a) ₹1,52,500 (b) ₹1,58,750

(c) ₹1,22,000 (d) ₹1,27,000

(43) M/s Kohinoor- a trading concern closes its accounts every year on 31 December every year. The stock taking process was initiated from on 26 December and the transactions during this week (25–31 December) were recorded separately. On 26 December, closing stock was valued to be ₹80,000. Consider the following transactions that took place during the week of stock taking process.

Particulars	Amount	Expenses/Losses	Amount
Purchases	5,000	Manufacturing Expenses	4,500
Sales Return	2,500	Financial Charges	2,100
Sales	40,000	Cartage Outwards	750
Gross Profit Rate	25% on cost	Proceeds from sale of scrap (damaged goods due to fire)	600
		Goods damaged due to fire	3,000

Ascertain the value of stock as on 31 December.

(a) ₹29,520 (b) ₹77,080

(c) ₹86,520 (d) ₹56,980

(44) M/s Siddiqui has taken physical verification of closing stock of ₹6,00,000 as on 7 April 2017. Consider the following events that happened during stock taking process to calculate closing stock as on 31 March 2017.

- Purchases amounted to ₹44,500
- Sales amounted to ₹40,000
- Gross profit rate is 25% on cost
- Goods worth ₹2,500 were purchased on 25 March, but were not delivered till 7 April.
- Goods worth ₹10,000 purchased on 3 April were returned back on 4 April 2017.

(a) ₹6,00,000 (b) ₹6,40,000

(c) ₹6,44,500 (d) ₹6,50,000

(45) M/s Anupam Ltd. follows the accounting period of 1 April to 31 March. On 25 March 2017, the value of closing stock was ₹4,00,000. Consider the following information to ascertain the amount of closing stock as on 31 March 2017.

- Purchases made on March 26 amounted to ₹50,000
- Goods costing ₹10,500 sold on 10 March 2017 were returned by M/s Kamble
- Goods costing ₹14,400 were held by Mr. Ajinkya on consignment basis.
- Goods sold to Mr. Tendulkar at 125% of cost at ₹2,50,000 on 31 March 2017

(a) ₹2,50,000 (b) ₹2,53,900

(c) ₹2,66,900 (d) ₹2,80,000

(46) The books of M/s AXE Ltd. shows the following information.

- Opening Inventory amounts to ₹4,00,000
- Purchases amount to ₹50,00,000
- Sales of ₹40,00,000

At the end of the year, the closing stock stood at ₹18,00,000 as concluded after stock-taking process. The company's gross profit is 20% on sales throughout. The company's management was skeptic about stock going missing from the warehouse. Calculate the missing amount of the inventory.

(a) ₹2,00,000 (b) ₹4,00,000

(c) ₹6,00,000 (d) No stock is missing

(47) On 6 April 2017, M/s Sampat & Sons undertook stock-verification process. The value of closing stock as per the physical verification stood at ₹60,000. The following transactions took place during the period, i.e. from 1 April 2017 to 6 April 2017.

- Sales ₹6,000.
- Goods as per stock sheet was recorded as ₹4,000 instead of ₹5,500

- Goods worth ₹500 sold on 28 February was returned by Mr. Sharma on 5 April.
- Goods are in transit to M/s Lalbagh amounted to ₹3,000.

(a) ₹66,500 (b) ₹70,000
(c) ₹70,500 (d) ₹75,500

(48) Consider the following information to calculate the final cost of inventories.

Particulars	Amount
Cost of inventory ₹55,000 *excluding*:	
• Administrative expenses	2,000
• Storage cost of work-in-progress	1,500
• Interest paid on bank loan	500
• Goods lost due to flood	4,000

(a) ₹47,000 (b) ₹51,000
(c) ₹56,500 (d) ₹63,000

IV. Fill in the Blanks

(1) If closing inventories are overstated due to incorrect inventory valuation, then Trading Account will reflect ___________ gross profit and P&L Account will depict ____________ net profit. (higher/ lower)

(2) Physical quantities of inventories are ascertained by _________________. (Periodic Inventory System/ FIFO Method)

(3) Cost of Goods Sold = Opening Inventory + __________________ − Closing Inventory (Purchases/ Sales)

(4) Stock checking process requires suspension of business operations in ___________.(Perpetual Inventory System/Periodic Inventory System)

(5) Valuation of Closing Inventories = (Opening Stock + _________________) × Weighted Average Price (Sales/Purchases/Total cost of inventory/Total number of units in inventory)

(6) If closing inventories are understated due to incorrect inventory valuation, then Trading Account will reflect ___________ gross profit and P&L Account will depict ____________ net profit. (higher/ lower)

(7) ___________________ is considered by FIFO method. (Physical flow of goods/Matching concept)

(8) _______________ Method is less impactful in cases of higher price fluctuation. (FIFO/Weighted Average Price)

(9) The value of closing stock so ascertained is not the actual cost or their current market price under ______ method. (FIFO/Weighted Average Price)

(10) Stock taking process is not based on physical counting of inventories under _______ method. (Perpetual/Periodic)

(11) In case of frequent price fluctuations, the results given by __________ method are less reliable. (Perpetual/Periodic)

(12) There is low probability of inventories getting deteriorating under ________ method. (FIFO/Weighted Average Price)

(13) In case of non-identifiable items in inventories, we cannot apply _______ method. (FIFO/Weighted Average Price)

(14) ______________ Method off-sets the impact of deflation and inflation over a period of time. (FIFO/ Weighted Average Price)

(15) _____________________ Method ignores the matching principle. (FIFO/Weighted Average Price)

(16) If opening inventories are overstated due to incorrect inventory valuation, then Trading Account will reflect ___________ gross profit and P&L Account will depict ____________ net profit. (higher/ lower)

(17) Under _________ Inventory System, the weighted average price is calculated by dividing total cost of inventory after each purchases by total number of units in inventory after that purchase. (Perpetual/ Periodic)

(18) Weighted Average Price Method ignores ____________ principle. (matching/conservatism)

(19) Under ____________ Inventory System, the weighted average price is calculated by considering all the purchases made during the accounting period. (Perpetual/ Periodic)

(20) ___________ Method reduces the scope of window-dressing. (FIFO/Weighted Average)

(21) Process-based industries prefer to opt for ________ Method to ascertain cost of inventories. (FIFO/ Weighted Average)

(22) If opening inventories are understated due to incorrect inventory valuation, then Trading Account will reflect ___________ gross profit and P&L Account will depict ____________ net profit. (higher/lower)

V. Match the following Columns

(A)

Column A	Column B
a. Expensive and involves complex calculation	i. Mitigates effects of price fluctuations
b. Weighted average price method	ii. Considers goods lost as sales
c. Ensures timely and readily available figures for preparing financial statements	iii. Perpetual Inventory System
d. Periodic inventory system	iv. By-passes matching principle
e. FIFO method	v. Adheres to conservatism principle

(B)

Column A	Column B
a. FIFO Method	i. Mitigates the effect of price fluctuations
b. Weighted Average Price Method	ii. Inventory control is not possible
c. Perpetual Inventory System	iii. Useful for perishable goods
d. Periodic Inventory System	iv. Time consuming in order to reconcile differences between records of bin card and store ledgers

VI. State whether the following statements are TRUE or FALSE

(1) Bin card belongs to Periodic Inventory System.

(2) Inventory valuation is required as compliance to legal requirements.

(3) Sales during the last week (say 24 March to 31 March) are deducted in order to ascertain value of closing stock under before year-end stock taking process.

(4) Periodic Inventory System keeps a continuous record of inventory.

(5) Weighted Average Price method becomes less effective if sale returns are received after a longer period of time.

(6) Conservatism principle is ignored by Weighted Average Price Method.

(7) Closing inventories is ascertained by deducting cost of goods sold from the sum of opening stock and purchases.

(8) Perpetual Inventory System is more suitable for large-sized firms.

(9) FIFO method mitigates the changes due to price fluctuations.
(10) We get different values of cost of unsold inventories are fetched under FIFO method, if prepared under Periodic Inventory System and Perpetual Inventory System.
(11) Understated opening inventories lead to lower gross profit which subsequently leads to lower net profit.
(12) If closing inventories are understated due to incorrect inventory valuation, then it will undercast net profit.
(13) FIFO method is aligned with prudence concept; however, it ignores matching principle.
(14) Under Perpetual Inventory System, the weighted average price is calculated by considering all the purchases made during the accounting period.
(15) Under Periodic Inventory System, the weighted average price is calculated by dividing total cost of inventory after each purchase by total number of units in inventory after that purchase. (Perpetual/ Periodic)
(16) Stock taking is a process to verify and value stock in hand at the end of an accounting period.
(17) Sales return is deducted while calculating value of closing stock under after year-end stock taking process.
(18) Physical counting of unsold inventory at the year-end is not required under Perpetual Inventory System.
(19) FIFO method is suitable for perishable goods.
(20) Net profit is overcasted, if opening inventories is understated.
(21) Perpetual Inventory System makes available stock at the end of the year only.
(22) FIFO method of stock valuation is a logical method.
(23) Cost of goods sold can be ascertained by preparing stores ledger.
(24) In Periodic Inventory System of stock valuation inventory control is not possible.
(25) Selling price is always taken into consideration while preparing stores ledger.

VII. Practical Questions

Q1. The following details are available in respect of material MX

Date	Particulars
1 March 2017	Opening Stock 2,000 kg @ 10 per kg
2 March 2017	Purchases 1,000 kg @ 13 per kg
9 March 2017	Issued 700 kg
17 March 2017	Purchases 300 kg @ 12 per kg
20 March 2017	Issued 800 kg
25 March 2017	Issued 1,500 kg @ 10 per kg

Calculate the value of stocks as on 31 March 2017 under FIFO Method.

Q2. From the following transactions extracted from the books of Madhur Ltd. as on 30 June 2016, work out the value of closing stock under the Weighted Method.

Date	Particulars
1 June	Opening Stock 200 units @ ₹20
3 June	Purchases 350 units @ ₹25
11 June	Issue 300 units
15 June	Purchases 250 units @ ₹22
20 June	Issue 210 units
25 June	Purchases 150 units @ ₹24

Q3. Calculate the cost of goods sold and closing stock under Weighted Average Cost of Inventory using: (1) Periodic System (2) Perpetual System.

Date	Units Purchased	Per Unit Rate (₹)	Date	Units Issued
1 March	Stock in hand 1,000 units	9	2 March	800
3 March	1,000	11	9 March	1,000
10 March	2,000	12	16 March	1,800
18 March	1,200	10	23 March	1,000
24 March	1,000	12	31 March	600
30 March	800	13		

Q4. From the following particulars prepare stock record by FIFO and Weighted Average Method. Opening stock as on 1 September 2016 was ₹300 units at ₹20 per unit.

Purchases	Units @ ₹	Sales	Units
5 September 2016	700 at ₹10	6 September 2016	600
8 September 2016	900 at ₹12	10 September 2016	800
12 September 2016	1,000 at ₹14	14 September 2016	900

Q5. From the following particulars, prepare stock record by FIFO Method:

Stock Register			
Date	**Transactions**	**Units**	**Rates (₹)**
1 January 2017	Opening Stock	100	50
4 April 2017	Purchase	80	60
17 April 2017	Purchase	120	55
20 April 2017	Sale	100	-
22 April 2017	Purchase	160	65
25 April 2017	Sale	160	-
28 April 2017	Sale	40	-
30 April 2017	Purchase	200	70

Q6. From the following particulars, prepare stock ledgers by FIFO as well as Weighted Average method and also find out Cost of Goods sold by both the methods.

Date	Transactions	Units	Rate per unit
1 May 2017	Opening Stock	300	8.00
3 May 2017	Purchases	350	10.00
7 May 2017	Sales	450	-
11 May 2017	Purchases	550	7.00
15 May 2017	Sales	600	-
20 May 2017	Purchases	700	9.00
31 May 2017	Sales	600	-

Q7. From the following details find out closing stock of Akshay Industrial Ltd as per Weighted Method:

Date	Purchases Units	Sales Units	Purchase Price per unit in ₹
1 October 2016	Balance 100	-	30
2 October 2016	70	-	36

(Continued)

Date	Purchases Units	Sales Units	Purchase Price per unit in ₹
4 October 2016	50	-	30
5 October 2016	-	60	
10 October 2016	-	40	
17 October 2016	40	-	40
20 October 2016	-	50	
28 October 2016	120		42
31 October 2016		80	

On 29 October 2016, 10 units were found damaged and had to be discarded.

Q8. Following are the purchases and sales of wheat in the month of November 2016. Prepare a statement showing valuation of closing stock on the basis of FIFO method.

Date	Purchases (kg)	Rate (₹)	Sales (kg)
1 November 2016	1,400	10.00	-
4 November 2016	-	-	800
5 November 2016	700	8.00	-
10 November 2016	-	-	400
18 November 2016	600	9.00	-
23 November 2016			1,000
29 November 2016	1,200	8.80	
30 November 2016			800

Out of sales on 23 November 2016, a customer returned 200 kg on 26 November 2016.

Q9. Calculate by FIFO and Weighted Average cost of inventory valuation, the Cost of Goods sold and Value of Closing inventory from the following data:

Purchases			Sales	
Date	Units	Rate per unit	Date	Units
1 August 2016	800	30	2 August 2016	600
4 August 2016	1000	40	7 August 2016	800
9 August 2016	1800	34	11 August 2016	600
16 August 2016	400	44	18 August 2016	400
25 August 2016	600	50	27 August 2016	1,000
31 August 2016	800	42		

Q10. You are required to ascertain: Cost of Stock on hand as on 31 March 2017 under each of the following methods:

1. FIFO
2. Weighted Average Method.

Value of opening stock on 1 January 2017 was 26,000 units at ₹10 per unit, other information are as under:

Date	Particulars
On 22 January	Sales of 12,000 units
On 28 January	Purchases (Carriage Inward ₹3,000) 24,000 units @ ₹34 each unit
On 5 February	Sales of 14,000 units
On 25 February	Purchased (carriage Inwards ₹2,000) 22,000 units @ ₹44 each unit
On 31 March	Sales 28,000 units

Q11. M/s XYZ Ltd. financial ends on 31 March 2017. Their actual stock was taken on 10 April 2017 in which date it is valued at ₹55,000. The following additional information is available.

1. Sales are entered in the sales book on the same day as dispatched and Returns Inward in the returns book the day goods are received back.
2. Purchases are entered in the purchase book as the invoices are received.
3. Sales between 1 April 2017 and 10 April 2017 was ₹30,000.
4. Mr. A, one of the debtors returns the goods on 8 April 2017 worth ₹6,000 out of sales made before 31 March 2017.
5. Purchase between 1 April 2017 and 10 April 2017 was ₹20,000.

Goods are sold by the trader at a profit of $33^{1/3rd}$ % on sales. You are required to ascertain the value of inventory as on 31-3-2017.

Q12. BOM Ltd, financial ends on 31 August 2016. Their actual stock was taken on 5 September 2016 in which date it is valued at ₹85,000. The following additional information is available.

1. Sales are entered in the sales book on the same day as dispatched and returns inward in the returns book the day goods are received back.
2. Purchases are entered in the purchase book as the invoices are received.
3. Sales between 1 September 2016 to 5 September 2016 were ₹60,000.
4. On 17 August goods of the sale value 12,000 were sent on sale or return basis to a customer. The customer was billed on 6 September 2016.
5. Purchase between 1 September 2016 to 5 September 2016 was ₹30,000 Goods are sold by the trader at a profit of 25% on sales.

You are required to ascertain the value of inventory as on 31 August 2016.

Q13. Pratap Ltd, financial ends on 31 August 2016. Their actual stock was taken on 25 August 2016 in which date it is valued at ₹65,000. The following additional information is available.

1. Sales are entered in the sales book on the same day as dispatched and returns inward in the returns book the day goods are received back.
2. Purchases are entered in the purchase book as the invoices are received.
3. Sales between 26 August 2016 to 31 August was ₹45,000.
4. On 17 August goods of the sale value 12,000 were sent on sale or return basis to a customer. The customer was billed on 27 August 2016.
5. Purchase between 26 August 2017 ₹30,000 and purchase return during the same period was ₹6,000 over and above sales.Goods are sold by the trader at a profit of 25% on sales.

You are required to ascertain the value of inventory as on 31 August 2016.

Q14. PQ Ltd conducts physical stock taking every year at the end of 30 September 2016. However, stock taking was done on 9 October 2016.

1. Stock was valued on 9 October 2016 was ₹80,000.
2. Goods Purchased on 21 September 2016 amounted to ₹15,000 out of which goods worth ₹3,000 received on 8 October 2016.
3. Unsold Stock in the hands of consignee was ₹5,000 at cost. It was supplied to him on 15 September 2016.
4. During the month credit notes at invoiced value of ₹2,000 had been issued to customer in respect of goods returned by him on 7 October.
5. Sales during the period of 1 October 2016 to 9 October 2016 were ₹40,000.
6. The gross margin earned by the company is 25% of cost on these goods.

Q15. Mr K who was closing his books on 31 March 2017, failed to take actual Stock which he did only on 9 April 2017, when it was ascertained by him to be worth ₹50,000.

Following transaction took place during 1 April 2017 and 9 April 2017.

1. Net Sales during the Period were ₹18,000. These goods were sold at the usual gross profit of 25% on cost except goods, which realised ₹1,600 on the basis of 20% profit on cost.
2. Purchases during the period were ₹10,000.

3. Sales returns during the period were ₹3,000 of which 50% were out of sales at 20% profit on cost.
4. On 5 April goods worth ₹10,000 were received, which were to be sold on consignment basis. You are required to prepare a statement showing the value of the stock to be taken in to account for preparing Final Account.

CHECK YOUR ANSWERS

III. Objective Type Questions

1–c	2–d	3–a	4–c	5–b	6–d	7–b	8–d	9–d	10–c	11–a	12–a	13–b
14–a	15–b	16–d	17–b	18–d	19–a	20–c	21–d	22–c	23–c	24–b	25–c	26–a
27–d	28–d	29–d	30–a	31–b	32–a	33–b	34–a	35–c	36–b	37–d	38–b	39–b
40–a	41–a	42–a	43–d	44–a	45–b	46–a	47–b	48–c				

IV. Fill in the Blanks

1-(a) higher (b) higher	2-Periodic Inventory	3-Purchases	4-Periodic Inventory
5-(a) + Purchases (b) − Sales	6-(a) lower (b) lower	7-physical flow of goods	8-FIFO
9-Weighted Average Price	10-Perpetual Inventory	11-Perpetual Inventory System	12-FIFO
13-FIFO	14-Weighted Average	15- FIFO	16-(a) Lower, (b) Lower
17-Perpetual Inventory	18-Weighted Average	19-Periodic Inventory	20-Weighted Average
21-Weighted Average	22-(a) higher, (b) higher		

V. Match the Columns

(A)	**(B)**
(a)–(iii), (b)–(i), (c)–(iii), (d)–(ii), (e)–(iv)	(a)–(iii), (b)–(i), (c)–(iv), (d)–(ii)

VI. True or False

True	**False**
2, 3, 6, 7, 8, 12, 13, 16, 17, 18, 19, 20, 21, 22, 23, 24	1, 4, 5, 9, 10, 11, 14, 15, 25

VII. Practical Questions

Q-1. ₹10,100	**Q-5.** ₹24,400	**Q-9.** COGS-₹1,18,400, Valuation-₹88,000 (FIFO), COGS-₹1,24,470, Valuation-₹81,936 (WAV)	**Q-13.** ₹41,000
Q-2. ₹10,150	**Q-6.** COGS-₹15,900, Valuation ₹2,250 (FIFO) COGS-₹13,866, Valuation ₹2,184 (WAV)	**Q-10.** ₹7,93,620 (FIFO) and ₹6,16,680 (WAV)	**Q-14.** ₹1,12,400
Q-3. ₹20,160 (Periodic) and ₹21,506 (Perpetual)	**Q-7.** ₹5,340	**Q-11.** ₹53,000	**Q-15.** ₹41,995
Q-4. ₹8,400 (FIFO) ₹7,878- WAV	**Q-8.** ₹9,680	**Q-12.** ₹1,03,000	

CHAPTER 5

Capital and Revenue: Expenditure and Receipts

CHAPTER OUTLINE

EXERCISE

5.1 INTRODUCTION

From our journey with accountancy so far, we know that all the financial nature transactions are recorded in the books of accounts. By transactions we mean all those instances and events which lead to flow of cash into the business and out of the business. Those transactions that lead to inflow of cash are termed as receipts and those transactions that lead to outflow of cash are termed as payments.

Let us now have a brief recall of the structure of Final Accounts. Remember, we use Trial Balance to prepare Final Accounts! All the items given in Trial Balance are either posted in Manufacturing

Account, Trading or Profit and Loss Account (altogether termed as P&L A/c) or shown in the Balance Sheet. But have we ever observed the difference between the items posted in Manufacturing Account Trading and P&L A/c and the items shown in Balance Sheet? Let us revisit the difference in Figure 5.1.

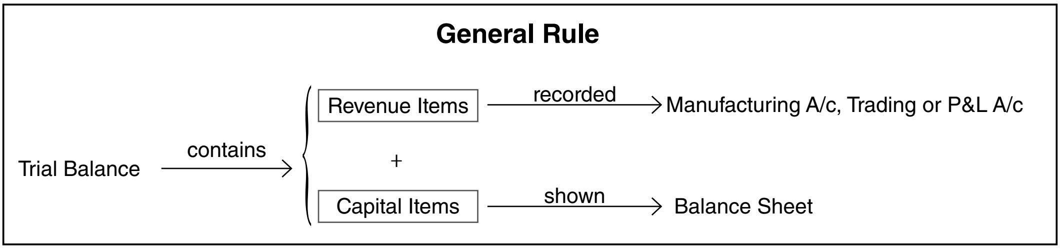


Figure 5.1

But did we notice this earlier? Do you know the underlying principle of separating the items as revenue nature and capital nature items? What is the need of such a classification? Our main motto throughout this chapter will be to figure out an answer to these questions.

In the chapter, we will start with the basic meaning of expenditure and revenues. Further, we extend our discussion on the types of expenditure and revenue and determining the rules to categorise a transaction into capital and revenue nature items. After this, we will learn more about profits and losses.

5.2 EXPENDITURE

5.2.1 Meaning of Expenditure

Meaning of Expenditure

The financial transactions that lead to outflow of cash from the business in order to acquire new assets, to add value to the existing assets and to buy goods and services.

Let us consider two examples of expenditure—salary paid to the officers and purchase of a new machine. Although both the events lead to outflow of cash from the business but there is a difference between them. Can we find the difference between the two?

The difference lies in the benefits derived from the two events. While paying salaries will have benefit of only 1 month, the benefits of purchasing the machine can be derived for a longer period of time.

5.2.2 Types of Expenditure

Let us continue our discussion with the above examples. Based on the nature of the expenditure, we can distinguish expenditure into two types.

1. ***Capital Expenditure*** (for instance, purchase of machine): This is incurred for acquiring fixed assets. The benefits of such expenditure can be availed in the future as well (and is not limited to just current period). Such expenditure enhances the production capacity. In addition to this, any amount spent on increasing the existing efficiency of the assets is

also considered as capital expenditure (say expenditure incurred on the upgrading of an existing machine for achieving higher efficiency and production levels).

2. ***Revenue Expenditure*** (for instance, salaries paid to officers): This is incurred for running day-to-day business operations. This expenditure is normally incurred on regular basis. The benefits of such expenditure are availed during the current period.

5.3 CAPITAL EXPENDITURE

Definition of Capital Expenditure

The expenditure that is incurred to avail future benefits in terms of enhanced production capacity, efficiency and greater useful lifespan of the assets in a business. The benefits of such expenditure are not only limited to the current year but spread over a longer period of time.

5.3.1 Characteristics of Capital Expenditure

The following are the characteristics of capital expenditure.

1. ***Amount size***: The amount of capital expenditure is generally huge (think of amount required for purchasing building or machine).
2. ***Benefitted period***: The benefit against the capital expenditure can be availed in the future besides the current accounting period.
3. ***Frequency***: The frequency of incurring capital expenditure is less and is non-recurring in nature. (think of how frequently new machines or new building is purchased)
4. ***Recovery***: The amount of capital expenditure can be recovered either generating income by the fixed assets so purchased or by selling of an asset.
5. ***Purpose***: It is an investing activity. The basic purpose for incurring capital expenditure is to enjoy benefits for longer period through raising production capacity and to enhance efficiency. It should be noted that the assets so purchased by incurring capital expenditure should be for the purpose of earning more profit and not for the motive of resale at higher value.
6. ***Disclosure***: The capital expenditure is shown on the assets side of the Balance Sheet.

5.3.2 Purposes for Capital Expenditure

The purposes for which a firm incurs capital expenditure are mentioned as follows:

1. ***Acquisition of Fixed Assets***: Capital expenditure is majorly incurred for purchasing of fixed assets such as building, plant and machinery, furniture, etc. These fixed assets are purchased to be used up in the production process and not with the motive of reselling them at higher prices. For instance, if a shoe manufacturer purchases a new or second-hand truck for faster movement of finished goods to market then cost price of truck is regarded as capital expenditure. However, if the same truck would have been bought by a truck-selling

firm, then it would be incorrect to consider this as capital expenditure (instead it would be considered as revenue expenditure). This is because for the truck-selling firm, the truck is bought with the motive of reselling and to earn profit.

2. ***Improvement of Fixed Assets***: Any amount spent on improving the existing capacity of the fixed assets is considered as capital expenditure. For instance, cost incurred for overhauling of machine, technological up-gradation of plants, etc. are a part of capital expenditure. This is because such costs enhance the useful life of an asset in the business and also raises their production efficiency, and thereby, give rise to higher income-earning capacity of the firm.
3. ***Bringing Fixed Assets (new or old) to use***: Any amount that is spent for bringing a fixed asset (new or old) into working condition would be considered as capital expenditure. For instance, if a machine costing ₹10,00,000 has been purchased, on which ₹1,50,000 was incurred as carriage to bring it to the factory premise and further, ₹1,00,000 was spent as wages paid for installation, then the total capital expenditure on the machine is considered as ₹12,50,000 (i.e. 10,00,000 + 1,50,000 + 1,00,000). Similarly, if a piece of land is purchased for say ₹20,00,000 on which ₹3,00,000 was paid as registration and ₹1,00,000 was paid as stamp duty, the capital expenditure on the piece of land is considered to be ₹24,00,000.
4. ***Acquisition of Long-term* Rights**: Costs incurred in acquiring long-term rights such as patents, copyrights, license, trademarks, sole selling rights, etc. are considered as capital expenditure. These rights allow the business to enjoy monopoly rights over the production of some exclusive products with some techniques that cannot be opted by any other business. Acquiring of such rights enhances the income-earning capacity of the business, hence, the cost involved is considered as capital expenditure.
5. ***Raising Capital and Preliminary Expenses***: Amount spent on raising capital such as underwriting commission paid to the underwriters, brokerage paid to the brokers, etc. are considered as capital expenditure. Similarly, preliminary expenses incurred by the promoters during the commencement of a business are also considered as capital expenditure.

5.3.3 Criteria to Determine Capital Expenditure

The following criteria should be tested to categorise a given item to be capital expenditure.

1. Generally, the amount of capital expenditure is huge.
2. The amount is used to purchase a fixed asset (new or second-hand).
3. The amount is used to improve the efficiency of the fixed asset.
4. The purpose of capital expenditure is to bring a fixed asset to its use or to its working condition.
5. The capital expenditure are non-recurring, i.e. such expenditure are incurred once in a while.
6. The benefits against capital expenditure can be availed over a longer period of time (more than a year).

5.3.4 Treatment of Capital Expenditure in Final Accounts

Capital expenditure is shown on the assets side of a firm's Balance Sheet.

5.4 REVENUE EXPENDITURE

Definition of Revenue Expenditure

It is the expenditure that is incurred to avail benefits in the current accounting period. These expenditure are recurring and are incurred for carrying out day-to-day operations of a business. Wages and salaries, repairs and maintenance costs, fuel charges, etc. are a few examples of revenue expenditure.

5.4.1 Characteristics of Revenue Expenditure

The following are the characteristics of revenue expenditure.

1. ***Amount size***: The amount of revenue expenditure is generally ***small*** (think of amount required for repairs of machine and building as compared to cost of such machine and building).
2. ***Benefitted period***: The benefits against the revenue expenditure can be availed only in the current accounting period.
3. ***Frequency***: The frequency of incurring revenue expenditure is quite high. The revenue expenditure is recurring in nature. (think of salaries and wages that are paid 12 times in a year for each corresponding month).
4. ***Purpose***: The basic purpose for incurring revenue expenditure is to maintain the current efficiency and existing production capacity, unlike capital expenditure which aims at increasing production capacity and efficiency.
5. ***Recording***: The revenue expenditure pertaining to the current year is shown on the debit side of the so-called P&L Account. However, if the revenue expenditure for the next accounting period has been paid in advance, we show the amount of revenue expenditure paid in advance on the assets side of the Balance Sheet as pre-paid expenses. On the other hand, if the revenue expenditure for the current year remains outstanding at the end of year, then we show such amount outstanding on the liabilities side of the Balance Sheet as outstanding expenses.

5.4.2 Purposes for Revenue Expenditure

The purposes for which a firm incurs revenue expenditure are explained as follows:

1. ***Financing Day-to-Day Operational Expenses***: The basic purpose of incurring revenue expenditure is to carry out day-to-day business operations. The daily operational expenses of a business can be further divided into the following.
   - *Production expenses*: Factory-related expenses incurred on purchase of materials, payment of wages, electricity, fuel charges, etc.
   - *Administrative expenses*: Office-related expenses incurred for salary payments, printing and stationery, telephone expenses, rent paid for office premises, office lighting, etc.
   - *Selling and Distribution expenses*: Expenses incurred for selling-related activities such as, advertisement, travelling expenses and commissions paid to the salesmen, delivery, van expenses, carriage on sales, etc.
   - *Finance and Interest expenses*: Expenses incurred for arranging finance from external parties, for example, interest payment on bank loans, interest on unsecured loans, etc.
2. ***Expenses for Repairs and Maintenance***: Expenses incurred for repairing and maintaining the assets in proper working condition or order are considered a part of revenue expenditure. These expenses are incurred again and again on regular basis for keeping assets in working condition.

3. ***Normal Losses***: These losses happen to a firm during its normal course of business, for example, bad-debts, goods destroyed by fire, goods lost in transit, goods lost due to theft, etc. Since such losses are ordinary and are recurring in nature, such losses are regarded as revenue expenditure.
4. ***Expired Cost or Depreciation Costs***: It is the cost incurred in terms of loss of value of fixed assets due to normal wear and tear. Since the fixed assets are used in the business activity, every year, a part of their value gets lost. The part of value so lost is termed as depreciation or expired cost. Let us understand this concept with the help of an example. Suppose a firm purchased a machinery worth ₹1,00,000 with a useful estimated life of 5 yr. This implies that every year the machinery is being depreciated by ₹20,000 and at the end of fifth year, the value of machinery becomes zero. Depreciation amount is recurring in nature and it is regarded as revenue expenditure.

5.4.3 Criteria to Determine Revenue Expenditure

The following criteria should be tested to categorise a given item to be revenue expenditure.

1. Generally, the amount of revenue expenditure is small.
2. The amount is used to carry out day-to-day business operations.
3. The amount is used to maintain the existing efficiency and current production capacity intact.
4. The revenue expenditure are recurring in nature, i.e. such expenditure are incurred again and again.
5. The benefits against revenue expenditure can be availed only during the current accounting period.

5.4.4 Treatment of Revenue Expenditure in Final Accounts

Case 1: Revenue Expenditure related to *Current Year*		**Case 2**: Revenue Expenditure is *Paid in Advance* for Next Year		**Case 3**: Revenue Expenditure remains *Outstanding* at Year-end	
Dr. P&L A/c		**Balance Sheet**		**Balance Sheet**	
Particulars	**Amount**	**Assets**	**Amount**	**Liabilities**	**Amount**
To Concerned Expenditure A/c	XXX	Prepaid Expenditure	XXX	Outstanding Expenditure	XXX

5.4.5 Difference between Capital Expenditure and Revenue Expenditure

Basis of Difference	Capital Expenditure	Revenue Expenditure
Meaning	***Increases*** the earning capacity of the business	***Maintains*** the earning capacity of the business
Purpose	To ***acquire*** fixed assets	To carry ***day-to-day operations*** of business
Benefit	Can be availed for ***more than 1 accounting yr***	Can be availed for ***1 accounting yr only***

(Continued)

Basis of Difference	Capital Expenditure	Revenue Expenditure
Nature	***Non-recurring*** (Not very frequent)	***Recurring*** (Very frequent)
Appearance	***Assets side*** (Balance Sheet)	***Debit side*** (Manufacturing, Trading and Profit & Loss Account)
Examples	***Purchase of machinery, building, goodwill, etc.***	***Payment of salaries and wages, rent, interest, etc.***

Comparative Chart of Expenditure

S. No.	Examples of Capital Expenditure	Examples of Revenue Expenditure
1	Expenditure incurred in preparing report, cost of conducting feasibility study and market surveys for an implemented project	Expenditure incurred in preparing report, cost of conducting feasibility study and market surveys for a rejected project (treated as expired cost)
2	Expenditure incurred for technological up-gradation of machinery	Expenditure incurred for maintaining normal working condition of a machinery
3	Expenditure incurred in constructing an extension to the existing building	Expenditure incurred in repairing/white-washing the existing building
4	Amount spent for purchase of new or second-hand asset	Cost of replacing a defective or worn-out part of an asset
5	Repairing cost (installation work) of a second-hand asset at the time of purchase	Repairing cost of an existing asset during the normal course of a business
6	Wages paid to the workers for construction of cycle shed or some extension to the existing building	Wages paid to the workers for production of goods and services
7	Import duties and taxes paid on transportation of assets to factory	Import duties and taxes paid on transportation of raw materials to factory
8	Cost of construction of railway siding	Cost of maintaining railway siding
9	Repayment of loan amount borrowed earlier	Payment of interest amount on loan amount borrowed
10	Purchase of printing machine	Expenses on printing and stationery
11	Initial deposit for fresh electricity and telephone connection	Expenses on electricity bill and telephone bill
12	Legal expenses paid for the purchase of building	Legal expenses paid for consultation
13	Acquisition cost of a piece of land	Payment of land revenue (property tax)
Some Specific Examples		
14	Expenditure incurred for obtaining factory license and copyrights	Compensation paid to employees

(Continued)

S. No.	Examples of Capital Expenditure	Examples of Revenue Expenditure
15	Expenditure incurred for constructing temporary huts for the construction workers and to store building materials	Excise duties paid for goods produced
16	Investment in government bonds, securities and bills	Expenditure incurred for advertisement
17	Cost of goodwill purchased	Commission paid on sales
18	Purchase of marketing rights, broadcasting rights, patents and other exclusive rights (mining rights)	Interest paid on bank overdraft, audit fees
19	Construction of railway sidings, sheds, godown, etc.	Payment of insurance premium
20	Brokerage paid on purchase of land	Payment of taxes and fines to the government authorities
21	Subscription paid to trade association for 3 yr	Payment of preliminary expenses
22	Replacement cost of petrol-engine by a diesel engine	Replacement cost of defective engine parts
23	Amount spent for registration of company, design, patents, etc.	Office rent paid in advance for 3 yr

5.5 DEFERRED REVENUE EXPENDITURE

5.5.1 Concept of Deferred Revenue Expenditure

So far, we have learnt that the benefits of revenue expenditure can be availed during the year in which the expenditure has been incurred. But there exists a special case of revenue expenditure, where, the benefits of the expenditure last over the following years (in addition to the year in which the expenditure has been incurred). Precisely, such a special case pertains to the item of deferred revenue expenditure.

The term deferred comes from 'defer', which means to delay or to postpone. Since the benefits against such expenditure can be availed over the forthcoming years (normally 3 yr), so these are termed as 'deferred revenue expenditure'. It is the revenue expenditure whose benefits can be enjoyed over many years, i.e. capital nature. Similarly, it is a capital expenditure but not a real asset, which requires to be written-off over many years (e.g. heavy advertisement expenditure in a new product)

Definition of Deferred Revenue Expenditure

The expenditure which has benefits spread over many years is regarded as deferred revenue expenditure.

As defined in the Guidance Note of ICAI, "The expenditure for which payment has been made or a liability has been incurred but is carried forward on the presumption that it will be benefit over a subsequent period/s."

Often, a firm incurs heavy expenditure at the time of commencement of business, for instance, expenses given to the promoters, registration of the firm, arranging for initial capital requirements, etc. The benefits of incurring such expenditure are spread over the years to come. Similarly, advertisement expenses are another example, where a firm incurs heavy expenditure. Think of an advertisement campaign, video and TV commercial shooting, promotion on different channels, renting of the highway-boards, putting up sign boards, etc. All these are one-time investment and the benefits can be availed till the firm thinks of putting up a new advertisement campaign. Let us take an example to understand this better. Suppose in 2017, a firm incurred a total expenditure of ₹20,00,000 for advertisement expenses. It is also presumed that this expenditure will help the firm to market its new product for the next 4 yr. It would be inappropriate to charge the expenditure of ₹20,00,000 with the revenue earned this year. Accordingly, we estimate the proportionate portion of expenditure that belongs to 2017 on the basis of total numbers of years.

$$\text{Proportionate amount} = \frac{\text{Total Expenditure}}{\text{No. of years}} = \frac{20,00,000}{4} = ₹5,00,000$$

Thus, in the year 2017, only ₹5,00,000 will be regarded as the expenditure incurred in the current year and will be written-off. The remaining portion of ₹15,00,000 (i.e. 20,00,000 – 5,00,000) will be carried forward to the next year. Table 5.1 indicates the amount written-off and remaining balance at the end of each year starting from 2017.

Table 5.1

Years	*Amount Written-off*	*Remaining Balance*
2017	5,00,000	15,00,000
2018	5,00,000	10,00,000
2019	5,00,000	5,00,000
2020	5,00,000	Nil

5.5.2 Accounting Treatment of Deferred Revenue Expenditure

The accounting treatment of deferred revenue expenditure is segmented into two parts.

a. ***Written-off part***: The amount pertaining to the current year will be shown on the debit side of the current year's P&L Account.
b. ***Remaining part***: The amount (remaining) related to the subsequent years will be shown on the assets side of current year's Balance Sheet, as fictitious assets.

5.5.3 Characteristics of Deferred Revenue Expenditure

The following are the characteristics of deferred revenue expenditure.

1. ***Benefitting years***: Deferred revenue expenditure provides medium-term benefits, which can be availed not only in the current year but also in the forthcoming years to come (normally, 3 yr).

2. ***Amount size***: Generally, the amount of deferred revenue expenditure is huge. For instance, heavy advertisement expenditure, high preliminary expenses, etc.
3. ***Writing-off of expenditure amount***: The total expenditure is written-off equally every year till the benefits are availed. For instance, in the above example, the advertisement expenditure of ₹20,00,000 has benefits spread over 4 subsequent yr; hence, every year starting from 2017, ₹5,00,000 will be written-off till the year 2021. The reason for this treatment is in adherence to the matching concept of accounting, which states that revenues earned should be matched with the amount of expenses incurred during a particular accounting period.
4. ***Accounting treatment***:
   - *Written-off part*—Shown on the debit side of the current year's P&L Account
   - *Remaining part*— Shown as 'fictitious assets' on the assets side of current year's Balance Sheet.

5.5.4 Criteria to Determine Deferred Revenue Expenditure

The following criteria should be tested to categorise a given item to be deferred revenue expenditure.

1. The amount of expenditure should be heavy.
2. The expenditure should be of non-recurring nature.
3. The benefits against the expenditure should not be limited to the current year, instead, it should be spread over the years to follow.

5.5.5 Some Examples of Deferred Revenue Expenditure

1. Preliminary expenses
2. Underwriting commission
3. Heavy advertisement expenditure
4. Expenditure incurred prior to launch of a new product (includes consumer awareness about the product, spreading market awareness and product insights).

5.6 RECEIPTS

5.6.1 Meaning of Receipts

Meaning of Receipts

The financial transactions that lead to inflow of cash to a business either due to financing activity or due to normal business activity. Receipts of cash can be either once in a while (not so frequent) or quite frequent.

Let us consider two examples of receipts—proceeds from sale of machine and proceeds from sale of goods (say shoes produced by a shoes producing firm). Although both the events lead to inflow of cash to the business but there exists a difference between them. Let us spot the difference between the two.

The difference lies in the nature of activities. While the selling of machine is a financing activity, the sale of shoes is a normal business activity.

- ***Financing activities*** either leads to fall in assets or rise in liabilities. For instance, sale of assets reduces the amount of assets with the business; hence, it is a financing activity. Similarly, borrowing from bank is a financing activity, as it raises the amount of liabilities to a business.
- ***Business activities*** neither lead to change in assets nor liabilities. Business activities leave the assets and liabilities unaffected. For instance, sale of goods, commission received, interest received on deposit given, etc. are business activities. These activities happen in the normal routine of a business.

5.6.2 Types of Receipts

Based on the nature of activities, receipts can be classified under following two types.

1. ***Capital Receipts*** (for instance, sale proceeds of machine): The receipts to a business due to financing activities are termed as capital receipts. These receipts are non-recurring in nature. For instance, think of how frequently, a business will sell its assets or how frequent a business will borrow fresh loan. Such instances occur once in a while.
2. ***Revenue Receipts*** (for instance, sale of goods): The receipts to a firm from its normal business activities are termed as revenue receipts. These receipts are recurring in nature. For instance, sale of goods produced is a normal routine of a firm, hence, the sale proceeds are regarded as revenue receipts. Similarly, commission received and interest amounts received on deposits given by the firm are revenue receipts.

5.7 CAPITAL RECEIPTS

5.7.1 Meaning of Capital Receipts

Definition of Capital Receipts

These are the receipts to a business from its financing activities such as sale of assets, proceeds from new borrowings from bank and introduction of fresh capital into the business. These receipts are non-recurring in nature. These receipts either reduce assets or create liabilities to a business.

5.7.2 Characteristics of Capital Receipts

The following are the characteristics of capital receipts.

1. ***Reasons of Occurrence***: Capital receipts arise due to financing activities of a business.
2. ***Nature***: These receipts are not recurring in nature, i.e. they do not happen frequently.
3. ***Effect on Liabilities***: Such receipts create liabilities to a business. For example, introduction of fresh capital into a business creates liability to the business (as the business needs to pay

back to the proprietor at the winding up). Similarly, receipt of loan amount from bank is a capital receipt as it creates liability to the business.

4. ***Effect on Profits***: Such receipts reduce the earning capacity (amount of profit) in future. For instance, on borrowing from bank a business needs to pay the amount of interest to the bank (for the loan taken), which reduces the amount of profit to the business. In the same manner, when an existing asset is sold-off, the future production-installed capacity is reduced; hence, the profit earning capacity of the business also reduces.

5.7.3 Criteria to Determine Capital Receipts

The following criteria should be tested to categorise a given item to be capital receipts.

1. The receipts should lead to creation of liabilities and/or reduction in assets.
2. The receipts are non-recurring in nature.
3. The receipts reduce the future profits of a business.
4. Generally, the receipts are refundable in nature. For instance, introduction of fresh capital and receipt of loan amount from the bank are to be repaid back by the business.

5.7.4 Treatment of Capital Receipts in Final Accounts

The treatment of capital receipts depends on its impact on liabilities and assets of a business. Accordingly, we can separate the treatment in the following manner.

- *Case 1—When capital receipts create liabilities*: In such a case, the capital receipts are shown on the liabilities side of the firm's Balance Sheet. For example, bank loan is shown on the liabilities side.
- *Case-2—When capital receipts reduce assets*: In this case, the capital receipts are shown as deduction from the concerned asset on the assets side of the firm's Balance Sheet. For example, machinery sold is deducted from the machinery balance on the assets side.

Case 1: When Capital Receipts *create Liabilities*				**Case 2**: When Capital Receipts *reduce Assets*			
Balance Sheet				**Balance Sheet**			
Liabilities	**Amt.**	**Assets**	**Amt.**	**Liabilities**	**Amt.**	**Assets**	**Amt.**
Capital						Machinery	
Add: Fresh Capital	XXX					*Less*: Machinery Sold	XXX
Secure Loan	XXX					Investment	
Bank Loan	XXX					*Less*: Investment Sold	XXX

5.8 REVENUE RECEIPTS

5.8.1 Meaning of Revenue Receipts

Definition of Revenue Receipts

The receipts to a business from its conduct of ordinary and day-to-day business activities are called as Revenue Receipts. In other words, these receipts arise from the routine business activities such as sale of goods produced and services provided, interest amounts received for use of its funds and amount received from external parties on account of use of firm's assets (such as patents and copyrights). These receipts are recurring in nature. These receipts neither create liabilities nor reduce assets.

5.8.2 Characteristics of Revenue Receipts

The following are the characteristics of revenue receipts.

1. ***Reasons of Occurrence***: Revenue receipts arise due to normal business activities, such as sale of goods and services.
2. ***Nature***: These receipts are recurring in nature, i.e. they occur frequently.
3. ***No Effect on Liabilities***: These receipts neither create liabilities nor reduce assets of a business. For example, interest received on loan granted to external parties neither creates liabilities nor reduce assets. Similarly, rent received and commission received are revenue receipts.
4. ***Positive Effect on Profits***: Revenue receipts raise the amount of profit in the current year. With revenue receipts to a business, the amount of funds available to the business is higher. With higher amount of funds, more production can be undertaken; hence, more profit can be earned in the future.

5.8.3 Criteria to Determine Revenue Receipts

The following criteria should be tested to categorise a given item to be revenue receipts.

1. The receipts should arise out of normal business activities.
2. The receipts are of recurring nature.
3. The receipt does not lead to creation of liabilities or reduction in assets.
4. The funds received are non-refundable in nature.
5. The receipts have positive effect on amount of current year's profit.

5.8.4 Accounting Treatment of Revenue Receipts in Final Accounts

Case 1: Revenue Receipts pertaining to *Current Year*		**Case 2**: Revenue Receipts are received in advance pertaining to *Next Year*		**Case 3**: Revenue Receipts are yet to be received pertaining to *Last Year*	
P&L A/c	**Cr.**	**Balance Sheet**		**Balance Sheet**	
Particulars	**Amount**	**Liabilities**	**Amount**	**Assets**	**Amount**
By Revenue Receipts	XXX	Revenue Receipts received in advance	XXX	Revenue Receipts Receivable	XXX

5.8.5 Difference between Capital Receipts and Revenue Receipts

Basis of Difference	Capital Receipts	Revenue Receipts
Meaning	Receipts from the ***sale of fixed assets***, loan taken or additional capital introduced	Receipts from the ***sale of goods and services***, receipts on account of use of firm's funds and assets by external parties
Purpose	Received from the ***financing*** and ***investing activities***	Received from the ordinary ***business activities***
Nature	***Non-recurring*** (Not very frequent)	***Recurring*** (Very frequent)
Disclosure in Final Accounts	***Liabilities*** side of the firm's Balance Sheet	Credit side of firm's ***Trading and Profit & Loss Account***
Examples	Sale of furniture, loan taken from bank, etc.	Sale of goods and services, rent income, etc.

Comparative Chart of Receipts

S. No.	Examples of Capital Receipts	Examples of Revenue Receipts
1	Proceeds from sale of fixed assets	Proceeds from sale of goods and services
2	Proceeds from sale of investments and government securities and bonds	Receipt of dividend and interest on investments
3	Repayment of loan given to the third parties	Interest received on loan given to the third parties
4	Compensation received for loss of goodwill	Royalty income received
5	Gift received from external parties	Commission/Service charges received
6	Amount received from an insurance company for loss of assets due to natural calamities	Amount received from an insurance company for loss of production during election days
7	Subsidy and grant received from government on installation of plant and machinery	Subsidy and grant received from government on sale of product in rural areas

5.9 CONCEPT OF CAPITAL PROFITS AND REVENUE PROFITS

5.9.1 Capital Profits

The profits that arise from financing and investing activities of a business are termed as capital profits. Normally, these profits are earned when an asset is sold at a higher price than its book-value and when shares are issued at a higher price than its face value. For example, if a furniture of book-value ₹10,000 on the date of sale was sold at ₹12,000, then the difference amount of ₹2,000 (i.e. 12,000 – 10,000) is regarded as capital profit. Likewise, (in case of a company) if shares of face value ₹10 are issued at ₹13 (i.e. at a premium of ₹3), the difference between the issue price and the face value is regarded as capital profit. The capital profits are not so frequent and happen once in a while (not on everyday basis).

5.9.2 Revenue Profits

The profits that arise from the normal business activities are termed as revenue profits. Generally, these profits are earned when goods produced (goods in which a business deals in) are sold at a higher price than its cost of production. For example, if cost of producing a shirt is ₹500 and it is being sold at ₹700, then the difference of ₹200 (i.e. Sale Price – Cost Price) is revenue profit. Revenue profits are quite frequent in nature and happen to a business on everyday basis.

5.9.3 Difference between Capital Profits and Revenue Profits

Basis of Difference	Capital Profits	Revenue Profits
Source	Profits from ***financing*** and ***investing*** activities	Profits from ***ordinary business*** activities
Nature	***Non-recurring*** (Not very frequent)	***Recurring*** (Very frequent)
Relation	Related to the ***sale of assets***	Related to ***sale of goods produced*** by the firm
Accounting Treatment	If not arising out of regular business activity, then transferred to ***Capital Reserve Account***, e.g. premium issued on issued shares. *or* If arising out of regular business activity, then shown on the credit side of P&L Account as extraordinary income, e.g. profit on sale of asset.	It is recorded on the credit side of P&L Account.
Examples	Profit on sale of assets, issue of shares and debentures at premium, etc.	Profit on sale of goods and rendering of services

5.10 CONCEPT OF CAPITAL LOSSES AND REVENUE LOSSES

5.10.1 Capital Losses

The losses that arise from financing and investing activities of a business are termed as capital losses. Normally, these losses are incurred when an asset is sold at a lower price than its book-value, asset destroyed by fire and natural calamities (such as earthquake, flood) and when shares are issued at a lower price than its face value. For example, if a furniture of book-value ₹10,000 on the date of sale was sold at ₹7,000, then the difference amount of ₹3,000 (i.e. 10,000 – 7,000) is regarded as capital loss. Similarly, if a machine of book-value ₹1,00,000 is destroyed due to fire, the amount of 1,00,000 is considered s capital loss. The capital losses are not so frequent and happen once in a while (not on everyday basis).

5.10.2 Revenue Losses

The losses that happen in the normal routine of a business are termed as revenue losses. These losses result when the goods produced are sold off at a lower price than its cost of production and when the stock of goods gets damaged due to fire or there is loss due to theft.

5.10.3 Difference between Capital Losses and Revenue Losses

Basis of Difference	Capital Losses	Revenue Losses
Source	Losses from ***financing*** and ***investing*** activities	Losses from ***ordinary business*** activities
Nature	***Non-recurring*** (Not very frequent)	***Recurring*** (Very frequent)
Relation	Related to the ***sale of assets***	Related to ***sale of goods produced*** by the firm
Accounting Treatment	Capital losses from sale of fixed assets are shown on the debit side of P&L Account, whereas other capital losses adjusted against capital profits are shown on the assets side of Balance Sheet as 'fictitious assets'.	Revenue losses are shown on the debit side of Manufacturing, Trading and P&L Account
Examples	Loss on sale of assets, discount on issue of shares, assets lost due to fire and natural calamities	Loss on sale of goods, depreciation of fixed assets, loss of goods due to fire, theft and natural calamities

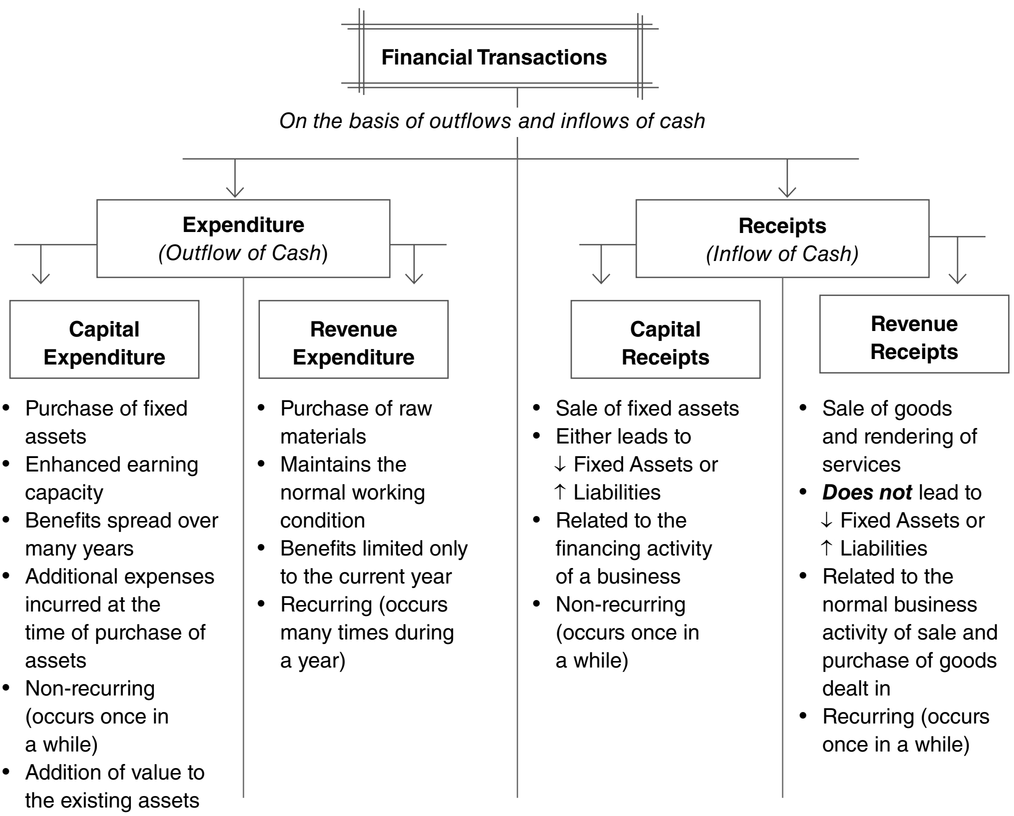


Figure 5.2 *Financial transactions on the basis of outflows and inflows of cash.*

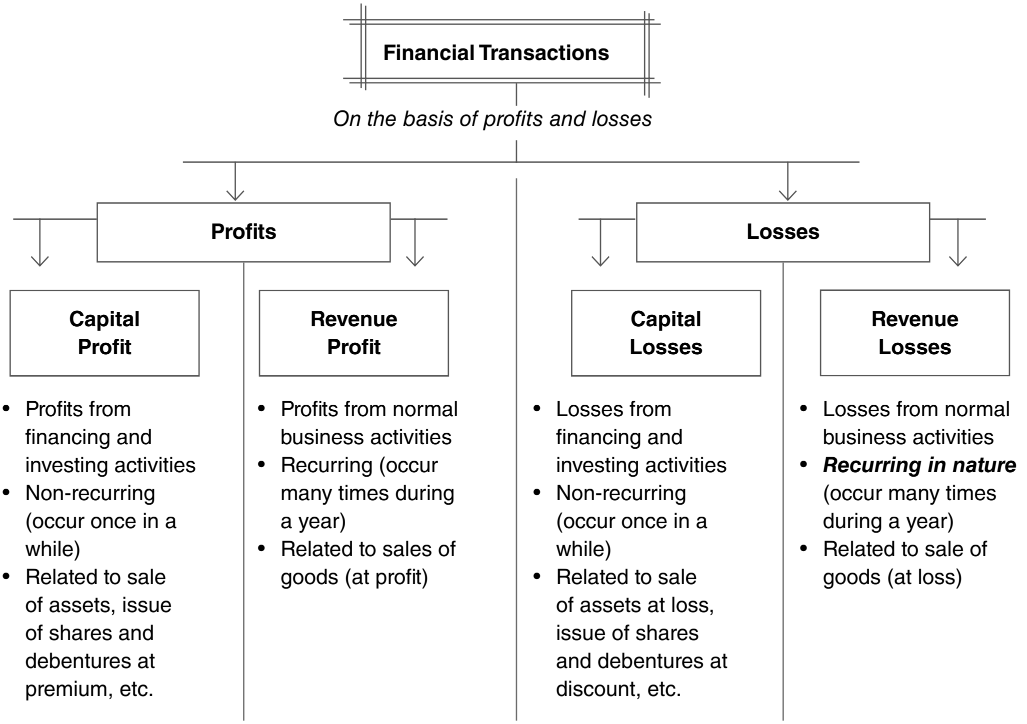


Figure 5.3 *Financial transactions on the basis of profits and losses.*

5.11 COMPREHENSIVE ILLUSTRATIONS

Example 1: State with reasons to classify the following transactions into capital expenditure and revenue expenditure.

a. Erecting expenses incurred on a newly purchased machine
b. Fees paid to lawyer to defend a suit for claiming ownership right on building
c. White-washing done on an old building
d. Issue of bonus shares to employees as rewards for their hard work and performance
e. Free samples distributed for promoting sales of a new product
f. Purchase of printing and stationery items

Solution

Transactions	Nature of Transactions	Reasons
a. Erecting expenses incurred on a newly purchased machine	Capital Expenditure	It is incurred on the installation of machinery at the time of purchase to bring the machine to usable condition.
b. Fees paid to the lawyer to defend a suit for claiming ownership right on a building	Revenue Expenditure	It does not contribute to the production capacity of the building; hence, is considered as revenue expenditure.

(Continued)

Transactions	Nature of Transactions	Reasons
c. White-washing done on an old building	Revenue Expenditure	It is spent to maintain working condition of the asset; hence is revenue expenditure.
d. Issue of bonus shares to employees as rewards for their hard work and performance	Revenue Expenditure	It does not result in the inflow of funds or an increase in the capital employed. It is one sort of incentive to employees.
e. Free samples distributed for promoting sales of a new product	Revenue Expenditure	It is considered as an advertisement expense. The expenditure is of regular activity, hence, is considered as revenue expenditure.
f. Purchase of printing and stationery items	Revenue Expenditure	It is a recurring expense incurred in a normal course of business.

Example 2: State with reasons whether the given statements are true or false.

a. Amount spent for building temporary huts for the workers and for storing materials for constructing a building for the enterprise is revenue expenditure.
b. Deposit of security money by a tenant is a capital receipt.
c. Annual Day expenses is revenue expenditure.
d. Interest paid on loan taken is a capital expenditure.

Solution

Transactions	True/False	Reasons
a. Amount spent for building temporary huts for the workers and for storing materials for constructing a building for the enterprise is revenue expenditure.	False	The amount is spent as an incidental expense in relation to the construction of building, the benefits of which can be availed beyond the current year. Also, new building will add to the production capacity of the business; hence, it is capital expenditure.
b. Deposit of security money by a tenant is a capital receipt.	True	Security deposit money is refundable money. This arises due to the use of business premise, but does not stay permanently with us.
c. Annual Day expenses is revenue expenditure.	True	The benefits of such expenses cannot be availed beyond the current year, hence, is considered as revenue expenditure.
d. Interest paid on loan taken is a capital expenditure.	False	It is recurring in nature and is payable at the end of each interval, hence, is revenue expenditure.

Example 3: State with reasons to classify the following receipts into capital and revenue.

a. Rent paid in advance to a landlord
b. Compensation received from the insurance company for loss of machine due to fire
c. Receipt of life time subscription
d. Recovery of bad debts

Solution

Transactions	Nature of Transactions	Reasons
a. Rent paid in advance to a landlord	Revenue Expenditure (prepaid)	It is a revenue expenditure paid in advance. Current year rent is treated as revenue expenditure and advance rent is treated as prepaid.
b. Compensation received from the insurance company for loss of machine due to fire	Capital Receipt	As the loss is related to machine, it is regarded as capital receipt. Also, such compensations are non-recurring in nature.
c. Receipt of life time subscription	Capital Receipt	This is a one-time receipt and is non-recurring in nature, hence, regarded as capital receipt.
d. Recovery of bad debts	Revenue Receipt	Recovery of bad debts is nothing but recovery of revenue receipts.

Example 4: Categorise the following transactions into capital receipts, revenue receipts, capital expenditure, revenue expenditure and deferred revenue expenditure.

a. Monthly rental receipts
b. Replacement of a worn-out part of machinery
c. Interest on loan
d. Heavy advertisement expenditure
e. Sale of furniture
f. Bank loan (taken)
g. Wages paid to workers

Solution

Transactions	Nature of Transactions	Reasons
a. Monthly rental receipts	Revenue Receipt	It is recurring in nature.
b. Replacement of a worn-out part of machinery	Revenue Expenditure	These expenses are incurred to maintain the machinery into its normal working condition.
c. Interest on loan	Revenue Expenditure	It is recurring in nature, hence, is revenue expenditure.
d. Heavy advertisement expenditure	Deferred Revenue Expenditure	Since the amount of expenditure is huge and its benefits spread beyond the current year, it is considered as deferred revenue expenditure.
e. Sale of furniture	Capital Receipts	It is the sale proceeds of capital asset, hence, regarded as capital receipts.
f. Bank loan (taken)	Capital Receipts	Loan amount received from a bank is a financing activity.
g. Wages paid to workers	Revenue Expenditure	Payment of wages is recurring in nature and the benefits against wages can be availed by the business only during the month for which the wages are paid for.

Example 5: Categorise the following transactions into capital receipts, revenue receipts, capital expenditure, revenue expenditure and deferred revenue expenditure.

a. Payment of income tax
b. Legal charges for acquiring a property
c. Rent received on factory premise
d. Purchase of furniture on monthly instalments
e. Fresh capital introduced by the proprietor
f. Carriage paid on purchases of materials
g. Import duties paid for importing machine
h. License fees paid for use of patents
i. Preliminary expenses

Solution

Transactions	Nature of Transactions	Reasons
a. Payment of income tax	Revenue Expenditure	It is quite usual to the normal routine of the business, hence, is revenue expenditure.
b. Legal charges for acquiring a property	Capital Expenditure	Acquiring of property raises the assets of a business, hence, the earning capacity, so it is regarded as capital expenditure.
c. Rent received on factory premise	Revenue Receipts	It happens in the normal course of a business. Rent amount will be received at regular intervals, hence, recurring in nature.
d. Purchase of furniture on monthly instalments	Capital Expenditure	It is spent for purchase of furniture, which increases the production capacity of the business, hence, is a capital expenditure.
e. Fresh capital introduced by the proprietor	Capital Receipts	The introduction of fresh capital creates liability to the business, since the firm needs to pay back this amount at the time of winding up of business.
f. Carriage paid on purchases of materials	Revenue Expenditure	Purchases imply purchases of raw materials. Carriage paid on purchases is a cost incidental to purchase of materials; hence, it is revenue expenditure.
g. Import duty paid for importing machine	Capital Expenditure	The import duty is added to the acquisition cost of the machinery; hence, it is a capital expenditure.
h. License fees paid for use of patents	Capital Expenditure	Since the use of license enhances the production capacity of a business. It is spent for acquiring intangible assets, i.e. patents; hence, the fees paid are capital expenditure.
i. Preliminary expenses	Deferred Revenue Expenditure	Such expenses are incurred at the time of commencement of business. The benefits against these expenses are spread over the subsequent years; hence, these expenses are considered as deferred revenue expenditure.

Example 6: Classify the following transactions into capital receipts, revenue receipts, capital expenditure and revenue expenditure.

a. Travelling expenses to Bangkok paid to the engineers for negotiating machine price
b. Subsidy received for acquiring assets from the Government of India
c. Expenses incurred for fresh issue of debentures
d. Membership fees paid to the Trade Association in advance
e. Expenditure incurred for undertaking market research and to gain customer insights

Solution

Transactions	Nature of Transactions	Reasons
a. Travelling expenses to Bangkok paid to the engineers for negotiating machine price	Capital Expenditure	Such expenses are required for purchase of machine, hence, are regarded as capital expenditure.
b. Subsidy received for acquiring assets from the Government of India	Capital Receipts	Such receipts are towards capital assets and are non-recurring in nature, hence, are regarded as capital receipts.
c. Expenses incurred for fresh issue of debentures	Deferred Revenue Expenditure	Such expenses are incurred for raising fresh capital. The benefits of such expenses can be availed for a longer period of time; hence these expenses are regarded as deferred revenue expenditure.
d. Membership fees paid to the Trade Association in advance	Revenue Expenditure	These fees are quite usual in the normal course of business; hence, these are considered as revenue expenditure.
e. Expenditure incurred for undertaking market research and to gain customer insights	Capital Expenditure	This expenditure is of capital nature, as the benefits against them can be availed over a longer period of time.

Example 7: Classify the following transactions into capital receipts, revenue receipts, capital expenditure, revenue expenditure, capital profits and revenue losses.

a. Issue of shares at discount
b. Interest receivable
c. Dismantling charges of a machinery
d. Sale of machinery at ₹20,000
e. Machinery costing ₹20,000 on April 01, 2016 (depreciating at 10% p.a) was sold on October 01, 2016 for ₹19,500
f. Import duties paid by a publishing company for importing special paper from Canada.

Solution

Transactions	Nature of Transactions	Reasons
a. Issue of shares at discount	Deferred Revenue Expenditure*	The discount so allowed on the issue of shares has benefits that can be spread over a longer period of time; hence such a discount is considered as deferred revenue expenditure.
b. Interest receivable	Revenue Receipts	These are quite usual to the normal routine of a business; hence, it is a revenue receipt.

(Continued)

Transactions	Nature of Transactions	Reasons
c. Dismantling charges of a machinery	Capital Expenditure	Since such charges are related to assets of a business; hence, it is a capital expenditure.
d. Sale of machinery at ₹20,000	Capital Receipts	Since machine is a capital asset and sale of machinery is non-recurring in nature, hence, this transaction is a capital receipt.
e. Machinery costing ₹20,000 on April 01, 2016 (depreciating at 10% p.a WDV) was sold on October 01, 2016 for ₹19,500	Capital Receipts Revenue Loss Capital Profit	Sale proceeds of machinery ₹19,500—Not recurring Depreciation—Recurring (20,000 @ 10% depreciation for 6 months) Profit on sale of machinery—Related to capital asset.
f. Import duties paid by a publishing company for importing special paper from Canada.	Revenue Expenditure	For a publishing company, import of paper is a material cost incurred as normal business activity; hence, import duties paid for import is considered as revenue expenditure.

****Note*: As per The Companies Act, 2013 such discounts are to be categorised as capital expenditure.

Working Note: *Ascertaining Profit on Sale of Machinery*
Cost of machinery on the date of sale = Cost as on April 01 − Depreciation for 6 months

$$= 20,000 - \left(\frac{10}{100} \times 20,000 \times \frac{6}{12}\right) = 19,000$$

Sale price of machinery = ₹19,500
Cost of machinery on the date of sale = ₹19,000
Profit on sale of machinery = 19,500 − 19,000 = ₹500

Example 8: Classify the following transactions into capital receipts, revenue receipts, capital expenditure, revenue expenditure, capital profits and revenue losses.

a. Lawyer's fees to defend a land case in court (the verdict was against the firm)
b. Lawyer's fees to defend a land case in court (the verdict was in favour of the firm)
c. Excise duties paid for production of cigarettes
d. Goods worth ₹5,000 sold at a throw-away price of ₹500
e. Loss of stock of raw materials due to flood

Solution

Transactions	Nature of Transactions	Reasons
a. Lawyer's fees to defend a land case in court (the verdict was against the firm)	Revenue Expenditure	Since the verdict is against the firm, the benefit against the fees has been availed during the current year; hence, it is a revenue expenditure.
b. Lawyer's fees to defend a land case in court (the verdict was in favour of the firm)	Capital Expenditure	Since the verdict is in favour of the firm, the benefits against the fees will be availed in the future as well; hence, it is a capital expenditure.

(Continued)

Transactions	Nature of Transactions	Reasons
c. Excise duties paid for production of cigarettes	Revenue Expenditure	Since such duties have been paid for production of goods, the duties paid are considered as revenue expenditure.
d. Goods worth ₹5,000 sold at a throw-away price of ₹500	Revenue Loss	This is a case of sale of goods at discount for promotional purpose, hence, is a revenue loss.
e. Loss of stock of raw materials due to flood	Revenue Loss	As the stock of raw materials is destroyed, which is related to production, hence is a revenue loss.

Example 9: Classify the following transactions into capital receipts, revenue receipts, capital expenditure, revenue expenditure, capital profits and revenue losses.

a. Replacement of petrol engine by CNG kit for a vehicle used for office purpose
b. Repairing cost of a second-hand asset at the time of purchase
c. Interest on drawings charged by the firm
d. 10 acres of land taken on lease for 99 yr
e. Interest of ₹2,000 accrued on the loan amount, which was taken for construction of cycle shed; however, the construction work has not started yet.

Solution

Transactions	Nature of Transactions	Reasons
a. Replacement of petrol engine by CNG kit for a vehicle used for office purpose	Capital Expenditure	Such a replacement would enhance efficiency and working capacity of the vehicle; hence, it is considered as capital expenditure.
b. Repairing cost of a second-hand asset at the time of purchase	Capital Expenditure	As the expense has been incurred at the time of purchase to bring the capital asset to be put to use, it is of capital nature.
c. Interest on drawings charged by the firm	Revenue Receipts	It is quite usual to the normal business activity, hence, is a revenue receipt.
d. Ten acres of land taken on lease for 99 yr	Capital Expenditure	The benefits of such a lease are spread over the lifetime of the lease period; hence, it is a capital expenditure.
e. Interest of ₹2,000 accrued on the loan amount, which was taken for construction of cycle shed; however, the construction work has not started yet.	Capital Expenditure	As the loan amount has been taken for the construction of cycle shed (asset), the interest accrued on the loan amount is a capital expenditure.

Example 10: State with reasons the nature of the following payments/receipts:

a. Sold 6% Government Bonds (Investment) for ₹3,00,000.
b. Preliminary Expenses paid ₹76,000.

c. Carriage outward paid ₹11,000.
d. Import duty paid on purchase of machinery of ₹98,000 to be used in the factory.
e. Received ₹7,00,000 on the issue of 6% debentures.
f. Paid ₹30,000 underwriting commission on issue of debentures.
g. Legal expenses of ₹22,000 paid in connection with purchase of land.
h. Repairing charges of ₹31,000 paid for keeping the machinery in working condition.

F.Y.B.Com., IDOL, March 2006 (adapted)

Solution

Transactions	Nature of Transactions	Reasons
a. Sold 6% Government Bonds (Investment) for ₹3,00,000.	Capital Receipt	The transaction is related to financing activity of business, hence, regarded as capital receipt.
b. Preliminary Expenses paid of ₹76,000.	Deferred Revenue Expenditure	The benefits of preliminary expenses are spread over a subsequent years, hence, are regarded as deferred revenue expenditure.
c. Carriage outward paid ₹11,000.	Revenue Expenditure	It is an expense on sales, which is a normal business activity and recurring in nature.
d. Import duty paid on purchase of machinery of ₹98,000 to be used in the factory.	Capital Expenditure	Computer equipment is an asset; hence, import duties paid to bring the asset to its usable form are treated as capital expenditure.
e. Received ₹7,00,000 on the Issue of 6% Debentures.	Capital Receipt	Issue of debentures is related to financing activities of a business; hence, the transaction is regarded as capital receipt.
f. Paid ₹30,000 underwriting commission on issue of debentures.	Deferred Revenue Expenditure	The benefits of underwriting commission are spread over subsequent years, hence, are regarded as deferred revenue expenditure.
g. Legal expenses of ₹22,000 paid in connection with purchase of land.	Capital Expenditure	With the help of legal expenses, the business is acquiring a piece of land, which raises the amount of assets with the firm; hence, it is capital expenditure.
h. Repairing charges of ₹31,000 paid for keeping the machinery in working condition.	Revenue Expenditure	The repairing charges maintain the machine in its normal working condition; hence, it is a revenue expenditure. Also, such repairs are recurring in nature.

Example 11: State whether the following items are Capital or Revenue or Deferred Revenue together with brief reasons for your answer:

a. Compensation of ₹1,07,000 received from an insurance company for suspension of business activities due to fire.
b. A plant worth ₹4,50,000 is introduced as capital by proprietor for business activities.
c. A dealer in timber acquired wood worth ₹2,00,000 and made furniture out of it at a total cost of ₹4,20,000 and sold it to a customer for ₹4,50,000.
d. Incurred ₹1,00,000 on research of a new product, which did not materialise.
e. Heavy repairs to the roof of the building for ₹2,00,000 for protection against rains.
f. Carriage and freight paid ₹22,000 for bringing machinery to be used in factory for manufacturing purpose.
g. Payment of legal fees to advocate for preparation of agreement of building for ₹26,000.
h. Wages paid to worker of ₹16,400 for installation of new machinery in own factory.

F.Y.B.Com., IDOL, October 2007 (adapted)

Solution

Transactions	Nature of Transactions	Reasons
a. Compensation of ₹1,07,000 received from an insurance company for suspension of business activities due to fire.	Revenue Receipt	Since the claim is associated with the production, hence, it is regarded as revenue receipt.
b. A plant worth ₹4,50,000 is introduced as capital by proprietor for business activities.	Capital Receipt	The business is now having an additional plant; hence, it is a capital receipt.
c. A dealer in timber acquired wood worth ₹2,00,000 and made furniture out of it at a total cost of ₹4,20,000 and sold it to a customer for ₹4,50,000.	Revenue Expenditure and Revenue Profit	Purchasing of raw material is a regular activity; hence, the timber purchased is revenue expenditure. The profit of ₹30,000 (i.e. 4,50,000 – 4,20,000) is arising due to normal sale of finished goods, which is a normal business activity; hence, it is regarded as revenue profit.
d. Incurred ₹1,00,000 on research of a new product, which did not materialise.	Revenue Expenditure	The amount spent has benefit limited to the year of incurring and cannot be extended to the subsequent years; hence, it is revenue expenditure (as the new product didn't materialise). If the new product has been materialised, then it would be considered as capital expenditure.
e. Heavy repairs to the roof of the building for ₹2,00,000 for protection against rains.	Capital Expenditure	Heavy repairs extend the life and efficiency of the building and the benefits can be extended to many years to come.

(Continued)

Transactions	Nature of Transactions	Reasons
f. Carriage and freight paid ₹22,000 for bringing machinery to be used in factory for manufacturing purpose.	Capital Expenditure	The carriage and freight charges have been incurred to bring the machinery to usable form; hence, these charges are regarded as capital expenditure.
g. Payment of legal fees to advocate for preparation of agreement of building for ₹26,000.	Capital Expenditure	Since the legal fees have been incurred in connection with the purchase of land/building, hence, such charges are regarded as capital expenditure.
h. Wages paid to worker of ₹16,400 for erection of new machinery in own factory.	Capital Expenditure	The amount paid to the workers has been incurred in connection with bringing the machinery to usable form; hence, wages in this case are regarded as capital expenditure.

Example 12: State whether the following expenses are Capital or Revenue or Deferred Revenue.

a. Legal expenses in issuing shares of ₹41,000
b. Legal expenses incurred in an action for infringement of patent rights for ₹14,300
c. ₹1,00,000 spent on air conditioning the office of the Manager
d. ₹12,400 spent on registration of design
e. Legal expenses incurred in a central excise appeal for ₹11,000
f. Legal expenses of ₹16,000 incurred in connection with the purchase of business premises
g. ₹3,50,000 paid for application and allotment of a plot of land in MIDC
h. Legal expenses of ₹9,200 incurred in defending a suit for breach of contract to supply of goods

F.Y.B.Com., IDOL, April 2008 (adapted)

Solution

Transactions	Nature of Transactions	Reasons
a. Legal expenses in issuing shares of ₹41,000.	Deferred Revenue Expenditure	The legal expenses have been spent for issuing shares and debentures. The benefits of these expenses can be availed in the subsequent years as well; hence, such expenses are considered as deferred revenue expenditure.
b. Legal expenses incurred in an action for infringement of patent rights for ₹14,300.	Revenue Expenditure	The benefits of these expenses will only be limited to the current year; hence, it is revenue expenditure.
c. ₹1,00,000 spent on air conditioning the office of the Manager.	Capital Expenditure	Since air conditioning is an asset, thus, this transaction is similar to purchase of assets; hence, it is regarded as capital expenditure.
d. ₹12,400 spent on registration of design.	Capital Expenditure	Registration of design gives the firm a monopoly power and creates legal right. Also, such expenses are incurred once in a while, hence, regarded as capital expenditure.

(Continued)

Transactions	Nature of Transactions	Reasons
e. Legal expenses incurred in a central excise appeal for ₹11,000.	Revenue Expenditure	Income tax appeal is a regular business activity, hence, it is regarded as revenue expenditure.
f. Legal expenses of ₹16,000 incurred in connection with the purchase of business premises.	Capital Expenditure	Expenses are incurred in connection with the purchase of asset; hence, it is regarded as capital expenditure.
g. ₹3,50,000 paid for application and allotment of a plot of land in MIDC.	Capital Expenditure	With the expense so incurred, the firm is acquiring a new plot of land, which implies higher level of assets; hence, it is a capital expenditure.
h. Legal expenses of ₹9,200 incurred in defending a suit for breach of contract to supply of goods.	Revenue Expenditure	The benefits of these expenses are limited to the current year only. These expenses are incurred in the normal course of business; hence, the transaction is of revenue nature.

Example 13: State with reasons whether the following expenses or income are Capital or Revenue or Deferred Revenue.

a. Repairs of computer for ₹3,900
b. Amount of ₹4,000 realised from sale of old furniture
c. Replacement of defective spare parts of a machinery costing ₹22,000
d. Heavy advertisement expenses of ₹35,000 incurred for introduction of a new product in a market
e. Cost of improving the seating capacity of a theatre is ₹4,00,000
f. Legal charges paid for defending a legal suit is ₹19,500
g. A second hand car purchased for 60,000 and ₹26,000 spent to bring it in working condition
h. Paid membership fees of ₹16,000 to the Club for 3 yr

F.Y.B.Com., IDOL, October 2008 (adapted)

Solution

Transactions	Nature of Transactions	Reasons
a. Repairs of computer for ₹3,900.	Revenue Expenditure	Since repairs maintain the normal working condition of the machine; hence, it is revenue expenditure.
b. Amount of ₹4,000 realised from sale of old furniture.	Capital Receipt	Sale of old typewriter (similar to sale of assets) results in reduction of assets; hence, it is a capital receipt.
c. Replacement of defective spare parts of a machinery costing ₹22,000.	Revenue Expenditure	Since replacement of defective parts maintain the normal working condition of the machine; hence, it is a revenue expenditure.

(Continued)

Transactions	Nature of Transactions	Reasons
d. Heavy advertisement expenses of ₹35,000 incurred for introduction of a new product in a market.	Deferred Revenue Expenditure	The benefits of heavy advertisement expenses can be extended to the subsequent years; hence, it is considered as deferred revenue expenditure.
e. Cost of improving the seating capacity of a theatre is ₹4,00,000.	Capital Expenditure	As the expenses so incurred will enhance the working capacity and efficiency of the cinema hall, so it is regarded as capital expenditure.
f. Legal charges paid for defending a legal suit is ₹19,500.	Revenue Expenditure	The benefits of these expenses are limited to the current year only; hence, the transaction is of revenue nature.
g. A second hand car purchased for ₹60,000 and ₹26,000 spent to bring it in working condition.	Capital Expenditure	This transaction is similar to purchase of an asset. Since the amount of ₹5,000 was spent at the time of purchase, the transaction is considered to be a capital expenditure.
h. Paid membership fees of ₹16,000 to the club for 3 yr.	Deferred Revenue Expenditure	The benefits of the fees paid will be availed for the next 3 yr; hence, it is considered as a deferred revenue expenditure.

Example 14: State whether the following are capital, revenue or deferred revenue expenditure, receipt, profit or loss.

a. Wages paid to the worker for construction of railway platform.
b. Received ₹1,35,000 on the issue of 8% cumulative preference shares.
c. Direct wages of ₹3,25,000 paid for the month of March 2016.
d. Paid ₹2,16,000 underwriting commission on issue of equity shares.
e. Paid to the Government of Maharashtra on account of MVAT (sales tax).
f. Premium of ₹4,40,000 received on issue of new 7.5% preference shares.
g. Paid legal fees of ₹12,600.

F.Y.B.Com., IDOL, April 2012 (adapted)

Solution

Transactions	Nature of Transactions	Reasons
a. Wages paid to the worker for construction of railway platform.	Capital Expenditure	Since the wages have been paid in connection with the creation of new assets, these are considered as capital expenditure.
b. Received ₹1,35,000 on the issue of 8% cumulative preference shares.	Capital Receipt	Issue of preference shares is a financing activity of a business; hence, the proceeds from such issues are regarded as capital receipt.

(Continued)

Transactions	Nature of Transactions	Reasons
c. Direct wages of ₹3,25,000 paid for the month of March, 2016.	Revenue Expenditure	These wages are incurred in connection to carry out the normal business activity. These expenses are of recurring nature, thus, these are considered to be of revenue nature.
d. Paid ₹2,16,000 underwriting commission on the issue of equity shares.	Deferred Revenue Expenditure	As the benefits of the underwriting commission extend to the subsequent years, the amount spent is considered as deferred revenue expenditure.
e. Paid to the government of Maharashtra on account of MVAT (sales tax).	Revenue Expenditure	Maharashtra Value Added Tax (or MVAT) is a tax related to the production of goods, which is a regular activity of business, thus, it is of revenue nature.
f. Premium of ₹4,40,000 received on issue of new 7.5% preference shares.	Capital Receipt	As the premium has been received on the preference shares, which is related to financing activity of a business, the receipt of premium is considered as capital receipt.
g. Paid legal fees of ₹12,600.	Revenue Expenditure	The legal fees so paid have benefits limited to the current year; hence, these fees are considered as revenue expenditure.

Example 15: State whether the following expenditure or receipts are capital or revenue. Give reasons for your answers.

a. Purchased a plot of land for ₹19,00,000 and paid ₹7,00,000 towards stamp duty.
b. Received ₹8,00,000 on Issue of 10% Debentures.
c. Interest of ₹11,000 paid on Bank Overdraft.
d. Paid ₹7,600 as Excise duty on goods produced.
e. A petrol engine of a vehicle was replaced by a diesel engine for ₹48,000.
f. Received ₹4,000 as dividend on shares.

Acc&FM-I, November 2016

Solution

Transactions	Nature of Transactions	Reasons
a. Purchased a plot of land for ₹19,00,000 and paid ₹7,00,000 towards stamp duty.	Capital Expenditure	Cost of plot along with registration and allotment fees together has been incurred for the purchase of plot (asset); hence, it is a capital expenditure.
b. Received ₹8,00,000 on issue of 10% debentures.	Capital Receipt	Issue of debentures is related to the financing activity of a business; hence, issue proceeds are considered as capital receipts.
c. Interest of ₹11,000 paid on Bank Overdraft.	Revenue Expenditure	Interest payments on Bank Overdraft are quite usual to a business, which are recurring in nature. Thus, such interest payments are considered as revenue expenditure.

(Continued)

Transactions	Nature of Transactions	Reasons
d. Paid ₹7,600 as Excise duty on goods produced.	Revenue Expenditure	Excise duty is a tax related to the production of goods, which is a regular activity of business, so it is of revenue nature.
e. A petrol engine of a vehicle was replaced by a diesel engine for ₹48,000.	Capital Expenditure	Such a replacement would enhance efficiency and production capacity of the vehicle; hence, it is considered as capital expenditure.
f. Received ₹4,000 as dividend on shares.	Revenue Receipt	This revenue is arising out of asset of a recurring nature; hence, receipts of dividend on such investments are considered as revenue receipts.

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Briefly explain expenditure and its types.
(2) Briefly explain receipts and its types.
(3) State any *five* characteristics of capital expenditure.
(4) Explain the purposes of incurring capital expenditure.
(5) State any *five* characteristics of revenue expenditure.
(6) Explain the purposes of incurring revenue expenditure.
(7) How to determine whether a given expenditure is of capital or revenue nature?
(8) Differentiate between capital expenditure and revenue expenditure (any *six* points).
(9) State any *five* characteristics of capital receipts.
(10) How to determine whether a given receipt is of capital or revenue nature?
(11) State any *five* characteristics of revenue receipts.
(12) Differentiate between capital receipts and revenue receipts (any *six* points).
(13) What do you understand by deferred revenue expenditure? Explain with the help of an example.
(14) Highlight the characteristics of deferred revenue expenditure.
(15) Differentiate between capital profits and revenue profits.
(16) Differentiate between capital losses and revenue losses.
(17) How to determine whether a given expenditure is of deferred revenue nature or of capital nature?
(18) State the accounting treatment of capital and revenue expenditure in Final Accounts.
(19) State the accounting treatment of capital and revenue receipts in Final Accounts.

II. Short Notes (5 marks)

(1) Concept of Capital Expenditure
(2) Features and purposes of Capital Expenditure
(3) Concept of Revenue Expenditure
(4) Features and purposes of Revenue Expenditure
(5) Concept of Capital Receipt
(6) Features and purposes of Capital Receipt
(7) Concept of Revenue Receipt
(8) Features and purposes of Revenue Receipt
(9) Revenue Losses
(10) Capital Losses
(11) Criteria to categorise an expenditure as—Capital, Revenue and Deferred Revenue

III. Distinguish Between

(1) Capital Expenditure *versus* Revenue Expenditure
(2) Capital Receipt *versus* Revenue Receipt
(3) Capital Losses *versus* Revenue Losses
(4) Capital Incomes *versus* Revenue Incomes
(5) Capital Expenditure *versus* Deferred Revenue Expenditure
(6) Deferred Revenue Expenditure and its accounting treatment in Final Accounts

IV. Objective Type Questions

(1) Which of the following items is recorded on the debit side of Trading and Profit and Loss Account?
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(2) Which of the following items is recorded on the credit side of Trading and Profit and Loss Account?
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(3) Which of the following is related to purchase of fixed assets?
(a) Capital Expenditure (b) Capital Receipts
(c) Revenue Expenditure (d) Revenue Profits

(4) Which of the following is related to loss on sale of fixed assets?
(a) Revenue Expenditure (b) Capital Loss
(c) Revenue Loss (d) Deferred Revenue Expenditure

(5) Which of the following items is shown on the assets side of Balance Sheet?
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(6) Overhauling expenses on the purchase of machinery is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(7) Amount spent on whitewash and repair on the purchase of an old building is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(8) Free gifts to customers for promoting the sales of a new product is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Profits

(9) The amount spent on the construction of temporary sheds for the construction workers who are constructing a building is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Receipts

(10) The payment of interest on loan is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Receipts

(11) Advance received from the tenants is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Receipts

(12) Bad debts recovered during the accounting year is
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Receipts

(13) Heavy Advertisement expenditure is a
(a) Revenue Expenditure (b) Deferred Revenue Expenditure
(c) Capital Expenditure (d) Revenue Loss

(14) Sale of furniture is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Loss

(15) Purchase of furniture on hire–purchase basis is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Loss

(16) Interest on loan taken is a
(a) Revenue Expenditure (a) Capital Receipts
(c) Capital Expenditure (d) Revenue Loss

(17) Repayment of 20% of loan at the end of every year is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Loss

(18) Distribution of free samples to customers is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Loss

(19) Interest received on investment having a maturity period of 5 years is a
(a) Revenue Expenditure (b) Capital Receipts
(c) Capital Expenditure (d) Revenue Receipt

(20) A machine costing ₹40,000 was purchased on 1 April 2016. It was mistakenly treated as revenue expenditure. The depreciation charged on the machine was at the rate 10% p.a. on original cost. The incorrect net profit for year 2016–2017 is ₹60,000. Which of the following amounts indicate the correct net profit?
(a) ₹20,000 (b) ₹36,000
(c) ₹36,000 (d) ₹96,000

(21) PRV Ltd. purchased a piece of land to construct a new multiplex for ₹10,00,000. It spent ₹50,000 for obtaining license for screening movies for next 30 years. However, it was fined ₹26,000 for non-adherence to the safety rules to be incorporated in the theatre. Identify the types of expenditure involved and its respective amounts.
(a) Revenue Expenditure, ₹76,000 and Capital Expenditure, ₹10,00,000
(b) Revenue Expenditure, ₹50,000 and Capital Expenditure, ₹10,26,000
(c) Revenue Expenditure, ₹26,000 and Capital Expenditure, ₹10,50,000
(d) Revenue Expenditure, ₹26,000, Capital Expenditure, ₹10,00,000 and Deferred Revenue Expenditure, ₹50,000

(22) Receipt of ₹2,000 as dividend on shares is a
(a) Revenue Receipt (b) Capital Receipt
(c) Revenue Profit (d) Capital Expenditure

(23) Issue proceeds from fresh issue of shares are
(a) Revenue Receipts (b) Capital Receipts
(c) Revenue Profit (d) Capital Expenditure

(24) Interest of ₹8,000 paid on bank overdraft is a
(a) Revenue Receipt (b) Capital Receipt
(c) Revenue Expenditure (d) Capital Expenditure

(25) Legal expenses of ₹41,000 incurred in connection with issue of shares is
(a) Revenue Loss (b) Deferred Revenue Expenditure
(c) Revenue Expenditure (d) Capital Expenditure

(26) Legal expenses of ₹16,000 incurred in connection with the purchase of business premise is a
(a) Revenue Loss (b) Deferred Revenue Expenditure
(c) Revenue Expenditure (d) Capital Expenditure

(27) Payment of ₹16,000 was made in order to register the product design is a
(a) Revenue Loss (b) Deferred Revenue Expenditure
(c) Revenue Expenditure (d) Capital Expenditure

(28) Interest on drawings charged by the firm is a
(a) Revenue Receipt (b) Deferred Revenue Expenditure
(c) Revenue Profit (d) Capital Profit

(29) Repairing of a second-hand asset at the time of purchase is a
(a) Revenue Receipt (b) Capital Expenditure
(c) Revenue Expenditure (d) Capital Loss

(30) Loan taken from a friend and the amount was introduced in the business as fresh capital is to be treated as

(a) Capital Receipt (b) Capital Expenditure
(c) Revenue Expenditure (d) Capital Loss

V. Fill in the Blanks

(1) The transactions that lead to an outflow of cash from business are termed as ___________. (Expenditure/Loss)
(2) ___________ items are recorded in Trading and Profit and Loss Account. (Capital/Revenue)
(3) Expenses incurred to finance day-to-day business operations are ___________ expenditure. (Capital/Revenue)
(4) Repairing cost of second-hand asset at the time of purchase is of ___________ nature. (Capital/Revenue)
(5) The transactions that lead to an inflow of cash to business are termed as ___________. (Income/Receipts)
(6) Wages paid to the workers for creating new partitions in office are of ___________ nature. (Capital/Revenue)
(7) Cost of replacing a defective or worn-out part of an existing asset is ___________ expenditure. (Capital/Revenue)
(8) Capital expenditure is shown/recorded in ___________. (Profit and Loss Account/Balance Sheet)
(9) Cost of constructing railway siding is treated as ___________ expenditure. (Capital/Revenue)
(10) Cost of maintaining the constructed railway siding is treated as ___________ expenditure. (Capital/Revenue)
(11) ___________ expenditure are incurred to acquire new machines and other fixed assets. (Capital/Revenue)
(12) ___________ items are recorded in firm's Balance Sheet. (Capital/Revenue)
(13) Repayment of the principal amount of ₹10,000 is of ___________. (Capital/Revenue)
(14) Payment of interest amount of ₹10,000 on outstanding amount is of ___________. (Capital/Revenue)
(15) Audit fees paid of ₹3,000 is to be treated as ___________ expenditure. (Capital/Revenue)
(16) The benefits of ___________ expenditure are limited only to the current year. (revenue/deferred revenue)
(17) ___________ expenditure is incurred to buy raw materials and semi-finished goods. (Capital/Revenue)
(18) The amount of ___________ expenditure can be recovered either by generating income by fixed assets or by selling the fixed assets. (Capital/Revenue)
(19) Revenue losses are shown on the ___________ side (debit/assets) of ___________. (P&L Account/Balance Sheet)
(20) Any expenditure that has been incurred with the motive of improving the efficiency and enhancing the existing capacity of fixed assets is termed as ___________ expenditure. (Deferred Revenue/Capital)
(21) Expenses incurred to acquire patents and copyrights are treated as ___________. (Capital/Revenue)
(22) The expenditure for which payment has been made or liability has been incurred but is carried forward is ___________ expenditure. (Capital/Revenue/Deferred Revenue)
(23) Expenses incurred for repairing and/or replacing any existing fixed assets are treated as ___________ expenses. (Capital/Revenue)
(24) Receipts to a business from its financing activities are termed as ___________ receipts. (Capital/Revenue)
(25) Expenses incurred for arranging finance from external parties are of ___________ nature. (Capital/Revenue)
(26) Administrative expenses are of ___________ nature (Deferred Revenue/Revenue).
(27) ___________ receipts reduce the earning capacity and future profits of a business. (Capital/Revenue)
(28) Expenses incurred to maintain the existing capacity of fixed assets are of ___________ nature. (Capital/Revenue)

(29) Expenses incurred to enhance the existing efficiency of fixed assets are of ___________ nature. (Capital/Revenue)
(30) Salaries paid to officers are treated as ___________. (Revenue Expenditure/Revenue Losses)
(31) ___________ receipts raises the current year's profit of a business. (Capital/Revenue)
(32) Receipts from business activities are termed as ___________ receipts. (Capital/Revenue)
(33) ___________ receipts are non-refundable in nature. (Capital/Revenue)
(34) The amount of capital expenditure is generally ___________ (higher/lower) as compared to revenue expenses.
(35) ___________ expenditure is shown as fictitious assets on the Balance Sheet. (Capital/Deferred Revenue)
(36) Sale proceeds of fixed assets are ___________ receipts. (Capital/Revenue)
(37) Sale proceeds of goods are ___________ receipts. (Capital/Revenue)
(38) Compensation received on account of loss of goodwill is a ___________. (Revenue receipt/Revenue income)
(39) ___________ receipts do not create liabilities. (Capital/Revenue)
(40) ___________ receipts reduce firm's assets. (Capital/Revenue)
(41) ___________ receipts create liabilities. (Capital/Revenue)
(42) Expenditure that has medium-term benefits is classified as ___________. (Capital/Revenue/Deferred Revenue)
(43) Expenditure that has short-term benefits is classified as ___________. (Capital/Revenue/Deferred Revenue)
(44) Expenditure that has long-term benefits is classified as ___________. (Capital/Revenue/Deferred Revenue)
(45) The amount of revenue expenditure is usually ___________ (higher/lower) as compared to deferred revenue expenditure.
(46) The benefits of ___________ expenditure can be availed over a longer period of time. (deferred revenue/capital)
(47) ___________ receipts are recorded on the debit side of Trading and Profit and Loss Account. (Capital/Revenue)
(48) ___________ receipts are shown on the Liabilities side of firm's Balance Sheet. (Capital/Revenue)
(49) The profits that arise from financing and investing activities of a business are termed as ___________. (Capital/Revenue)
(50) ___________ profits are related to sale of fixed assets. (Capital/Revenue)
(51) If the cost of producing a mobile phone is ₹1,000 and it is sold at ₹1,350, then the difference amount is ___________ profit. (Capital/Revenue)
(52) If an equity share of face value ₹10 is issued at ₹15, then the difference amount is ___________ profit. (Capital/Revenue)
(53) The losses from ordinary course of business are categorised as ___________ losses. (Capital/Revenue)
(54) Fixed asset of book-value ₹12,000 was sold off for ₹9,000, and then ₹3,000 is treated as ___________ loss. (Capital/Revenue)
(55) Depreciation of fixed assets is an example of ___________ loss/expenditure. (Capital/Revenue)

VI. Match the Following Columns

(A)

Column A	Column B
a. Proceeds from the sale of fixed assets	i. Capital Expenditure
b. Freight outwards	ii. Revenue Expenditure
c. Royalty income received	iii. Capital Receipt
d. Subsidy received government	iv. Revenue Receipt

(Continued)

Column A	Column B
e. Loss of assets due to natural calamities	v. Deferred Revenue Expenditure
f. Receipt of dividend and interest on investments	vi. Capital Loss
g. Amount spent for registration of company	
h. Expenditure incurred prior to the launch of new product	
i. Interest paid on bank overdraft	
j. Amount spent to register design and patent rights	
k. Construction of sheds	
l. Repayment of loan	
m. Payment of interest	
n. Excise duties	
o. Preliminary expenses	
p. Wages paid to daily workers	

(B)

Column A	Column B
a. Discount received	i. Capital Profit
b. Discount allowed	ii. Revenue Profit
c. Loss on sale of furniture	iii. Capital Loss
d. Import Duty	iv. Revenue Loss
e. Shares issued at premium	v. Revenue Expenditure
f. Fictitious assets	
g. Loss on sale of raw materials	
h. Goods sold at heavy discount of 50% + 50%	
i. Timber worth ₹10,000 by furniture company sold at ₹11,000	

VII. State Whether the Following Statements are TRUE or FALSE

(1) Erection expenses incurred for a new machine is to be treated as revenue expenditure.
(2) Issue of bonus shares to employees is a capital expenditure.
(3) Capital expenditure enhances the production capacity of a business.
(4) Capital expenditure being expenditure is recorded on the debit side of Profit and Loss Account.
(5) The benefits of revenue expenditure are only limited to the current year.
(6) Revenue nature items are highly frequent and occur many times during an accounting period.
(7) Generally, the amounts of capital nature items are more than revenue nature items.
(8) Expired costs are treated as capital losses.
(9) Deferred revenue expenditure is written off over a period of years.
(10) Revenue expenditure being expenditure is recorded on the debit side of Profit and Loss Account.
(11) Capital expenditure is incurred to maintain the existing efficiency of an asset.
(12) Goods lost in transit are to be classified as revenue loss.
(13) The benefits of capital expenditure can be availed for many years to come.
(14) Revenue expenditure paid in advance is shown on the assets side of Balance Sheet.
(15) Revenue expenditure is incurred to raise the existing efficiency of an asset.
(16) Capital expenditure is shown on the assets side of firm's Balance Sheet.

(17) Repairs and replacement costs are classified as revenue expenditure.
(18) Receipts from financing and investing activities are capital receipts.
(19) Capital receipts create liabilities to a business.
(20) Interest payment on unsecured loan is revenue expenditure.
(21) The amount paid for acquiring long-term rights is treated as deferred revenue expenditure.
(22) Capital receipts reduce the profit earning capacity of a business.
(23) Revenue receipts enhance the profit earning capacity of a business during the current year.
(24) Capital expenditure is incurred to bring an asset to use and to the working condition.
(25) Revenue receipts are non-refundable in nature.
(26) Revenue items are non-recurring in nature.
(27) Outstanding revenue expenditure at the end of current year is shown on the liabilities side of Balance Sheet.
(28) Payment of insurance premium is treated as revenue expenditure.
(29) If benefits against expenditure can be availed for medium-term period, then it is deferred revenue expenditure.
(30) Interest receivable on investments is revenue receipt.
(31) Receipt of life-time subscription is a capital receipt.
(32) Revenue receipts neither affects liabilities nor firm's assets.
(33) Fresh capital introduced by proprietor in business is capital receipt to the business.
(34) Depreciation of fixed assets is revenue loss.
(35) Usually, capital items are less frequent in nature.
(36) Lawyer's fees to defend a case in court is revenue expenditure, if the verdict is against firm's favour.
(37) Lawyer's fees to defend a case in court is capital expenditure, if the verdict is in firm's favour.
(38) Lease payment for 25 years is a capital expenditure.
(39) Insurance claim received from insurance company against assets lost due to fire is a revenue receipt.
(40) Insurance claim received from insurance company against goods lost due to fire is a revenue receipt.
(41) Capital receipts reduce firm's assets.
(42) Carriage paid on purchase of raw material is revenue expenditure.
(43) License fees paid for use of patents is capital expenditure.
(44) Wages paid for construction of extension to existing building is revenue expenditure.
(45) Wages paid for construction of new building is capital expenditure.
(46) Profit on sale of goods is revenue profit.
(47) Profit on sale of fixed asset is capital profit.
(48) Heavy advertisement expense is deferred revenue expenditure.
(49) Capital nature items are less frequent and happen once in a while.
(50) Receipts from business activities are revenue receipts.

VIII. Practical Questions

Q1. Classify the following items as Capital Expenditure or Revenue Expenditure

Particulars	Amount (₹)	Classification
1. Machine dismantling expenses	5,000	?
2. Goodwill purchase for acquiring new business	1,00,000	?
3. Salary paid to new staff	10,000	?
4. Audit fees paid	1,000	?
5. Transport and Insurance paid for a new car	5,000	?

Q2. Classify the following items as Capital Receipt or Revenue Receipt

Particulars	Amount (₹)	Classification
1. Subsidy received on Machinery	10,000	?
2. Premium received on issue of shares	1,00,000	?

(Continued)

Particulars	Amount (₹)	Classification
3. Rent received	20,000	?
4. Brokerage received	10,000	?
5. Sale proceeds received from sale of inventory	1,00,000	?

Q3. State with reasons whether the following is an example of Capital or Revenue Expenditure.

(1) Purchase of computer for office use; paid ₹50,000.
(2) Purchase of raw materials ₹25,000 for production.
(3) Spend ₹1,00,000 for cost of development of new product.
(4) Custom duty paid for import of machine ₹60,000.
(5) Bonus of ₹10,000 paid to the employees.
(6) Legal expenses paid ₹10,000 to acquire machinery.
(7) Discount of ₹100 given to the debtors for prompt payment.

Q4. State with reasons whether the following is an example of Capital or Revenue Receipt.

(1) ₹10,000 received on sale of furniture.
(2) ₹500 received as discount from creditors.
(3) ₹10,000 received as gift from the family.
(4) ₹7,000 received on sale of patents.
(5) Brokerage of ₹5,000 received on sale of property.
(6) Cash withdrawal of ₹10,000 from personal bank and introduced as capital into business.
(7) ₹1,00,000 received on issue of shares.

Q5. State in each of the following cases, whether the expenditure or receipt are capital or revenue.

(1) Travelling expenses of director for purchase of imported raw materials.
(2) Wages paid to technical staff for erection of machinery.
(3) Cost of repainting factory shed.
(4) Security premium received.
(5) Interest received on fixed deposits.
(6) Tax refund received from Income Tax Department.
(7) Receipt of proceeds of goodwill.

Q6. On scrutiny of the accounts of Z and Co., the following transactions were come across.

Transactions	Amount (₹)	Debited to Account
1. Purchase of furniture	50,000	Purchases Account
2. Carriage outwards are paid for goods sold	1,000	Carriage Outwards Account
3. Legal expenses paid for acquisition of land	20,000	Legal Expenses Account
4. Wages paid for erection of machinery	1,000	Wages Account
5. Freight charges paid for raw materials	500	Freight Account
6. Replacement of defective parts of machinery	65,000	Machinery Account
7. Amount spent on buying copyrights	10,000	Copyright Account

You are required to state whether the aforementioned expenditure:

(a) is of capital or revenue nature
(b) is debited to correct account; if not, then mention the correct account

Q7. State with reasons, whether the following expenditure is capital, revenue or deferred revenue.

(1) Freight paid ₹800 for purchase of second-hand furniture.
(2) Advertisement of ₹40,000 on a new product introduced in the market.
(3) Painting of old and new factory buildings of ₹4,000 and ₹6,000 respectively.
(4) Expenses of ₹10,000 incurred in connection with issue of fresh shares.

Q8. How would you treat the following items while preparing Final Accounts?

(1) A firm of estate brokers and dealers purchase premises at a cost of ₹10,00,000 and spent ₹50,000 for repairing and repainting it.

(2) Expenses incurred to prepare separate cabins:
   (a) Architect fees- ₹15,000
   (b) Wood purchased to create partition walls- ₹60,000
   (c) Labour cost incurred- ₹40,000

(3) Due to excessive rain leakage, the building has to be repaired and repainted at a very heavy cost of ₹2,00,000

(4) Furniture was sold for ₹10,000; original cost of furniture was ₹25,000. Provision for depreciation till the date of sale was ₹10,000.

(5) Municipal and water tax of ₹10,000 were paid during the year.

(6) Amount of ₹1,500 were spent on account of uniform of liftman and watchman.

Q9. Mody Ltd. relocated their factory to a more suitable location and during this relocation the following transactions occurred.

(1) A sum of ₹15,000 was spent on dismantling, removing and re-erecting the plant.

(2) Stock removal cost ₹2,000.

(3) The furniture valued at ₹15,000. A part of it worth ₹4,000 was disposed for ₹2,400 and new furniture was acquired for ₹5,000.

(4) ₹5,000 was spent on account of uniform to the workers.

(5) The Plant and Machinery Account stood at ₹3,00,000 which include a machine having a book-value of ₹6,800. This was sold off for ₹1,800 and was replaced by a new machine costing ₹9,600.

Q10. The following amounts have been spent by Star Ltd. during the year in respect of Plant and Machinery. State and classify the items given below into Capital or Revenue.

(1) ₹40,000 for repairs necessitated by negligence of a worker.

(2) ₹10,000 for replacement of defective part of machine.

(3) Technical consultant fees of ₹5,000 were paid to run the machine at its normal capacity.

(4) Director's airfare of ₹50,000 was reimbursed for travelling to Germany for acquiring machine.

(5) Chairs and tables of the office were repaired and labour charges of ₹1,500 were incurred.

Q11. Classify the below items as Capital or Revenue or Deferred Revenue and state your reasons.

Particulars	Nature of Expenditure/Revenue	Reasons
1. Cost of designing a new product which did not materialised to production	?	?
2. Cost of alteration of cinema theatre in accordance with new municipal guidelines.	?	?
3. Amount received from insurance company for loss of stock	?	?
4. Renewal of factory license	?	?
5. Profit on sale of investment	?	?
6. Receipt of amount previously written-off as bad debts	?	?
7. Compensation from local authority for land acquisition	?	?

Q12. State whether the following items are of capital/revenue/receipt/expenditure/loss/profit.

(1) Cash robbed on the way to bank.

(2) Excise duty paid on manufacturing.

(3) Premium given for lease.

(4) Goods destroyed by fire.

Q13. State whether the following items are of capital/revenue/receipt/expenditure/loss/profit.

(1) Spent for alteration of existing plant which would reduce the cost of production.
(2) Bad debts recovered.
(3) Cost of training new employees.
(4) Interest paid on loan taken from bank.

Q14. State whether the following items are of capital/revenue/receipt/expenditure/loss/profit.

(1) Wages paid to workers for construction of railway platform.
(2) Received ₹8,00,000 on the issue of 9% cumulative preference shares.
(3) Direct wages of ₹3,25,000 paid for the month of January 2012.
(4) Paid ₹12,800 underwriting commission on issue of Preference Shares.
(5) Legal Expenses ₹54,875 paid in connection with purchase of Machinery.
(6) Paid to the Government of Maharashtra on account of M-VAT.
(7) Premium ₹1,60,000 received on issue of new 9% cumulative preference Shares.
(8) Paid Legal fees of ₹64,500.

F.Y.B.Com., IDOL, April 2012

Q15. M/s. Sirona Industries manufactures and sells special chairs required by the dentists. They have incurred following expenses during the year ended 31 March 2013 you are requested to state whether these expenses are capital expenses, revenue expenses or deferred revenue expenses.

(1) Rent paid ₹25,000.00 to the landlord for the month of May 2012 during the month of June 2012.
(2) Import duty paid ₹35,000.00 on purchase of New Machinery.
(3) Professional Fees paid ₹25,000.00 to the advocate for preparing documents for purchase of new office premises.
(4) Annual Membership fees paid ₹5,000.00 to the Machinery Manufactures Association of India
(5) Bank interest paid ₹35,000 on loan taken for purchase of Land and Buildings.
(6) VAT paid ₹15,000.00
(7) Printing charges paid ₹28,000.00
(8) Transfer fees paid ₹25,000.00 to the society where he has purchased new office premises.

F.Y.B.Com., IDOL, April 2013

Q16. State whether the following items are of capital or revenue nature.

(1) Interest paid on bank overdraft ₹50,00,000 to State Bank of India for quarter ended 31 December 2014.
(2) Custom duty paid ₹35,00,000 on import of Raw Materials.
(3) Purchased old plant for ₹20,000.
(4) ₹300 was paid for the up-keep of a water pump.
(5) Paid audit fees ₹5,000 to Mr. Jayesh, our Chartered Accountant.
(6) Paid ₹1,000 for annual renewal of factory license.
(7) Reimbursed ₹12,500. Travelling expenses to Mr. Abhishek our salesman.
(8) Purchased 20 Box Files for office use at ₹20 per file.

F.Y.B.Com., IDOL, April 2015

Q17. State whether the following items are of capital or revenue nature.

(1) A new machinery was purchased for ₹80,000. A sum of ₹l,000 was spent on its installation and erection.
(2) Premium paid on the redemption of debentures.
(3) Commission paid on issue of debentures.
(4) Cost of air-conditioning the office of the director of a company.
(5) Damages paid on account of the breach of contract to supply certain goods.
(6) Cost of replacement of an old and worn out part of machinery.
(7) Repairs to a motor car met with an accident.
(8) Cost of redecorating a cinema hall.

F.Y.B.Com., IDOL, October 2016

Q18. Given below is the Trading and Profit and Loss Account of M/s Kapoor and Sons Ltd. for the year ended 31 March 2017.

Trading and Profit and Loss Account
for the year ending 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	1,20,000	By Sales	12,00,000
To Purchases	6,00,000	By Closing Stock	2,40,000
To Wages	2,40,000		
To Gross Profit	4,80,000		
	14,40,000		14,40,000
To Salaries	1,20,000	By Gross Profit	4,80,000
To Carriage on Sale	40,000		
To Travelling Expenses	20,000		
To Legal Charges	20,000		
To Interest on Capital	10,000		
To Net Profit	2,70,000		
	4,80,000		4,80,000

***Additional Information*:**
1. Purchases include furniture purchased of ₹10,000.
2. Wages include ₹10,000 related to erection of machine.
3. Legal charges of ₹6,000 are incurred for purchase of land.
4. Travelling expenses included ₹10,000 incurred by manager for purchase of fixed assets.
5. Sales included sale of old furniture of ₹20,000.

You are required to recast the above Trading and Profit and Loss Account considering the concept of Capital and Revenue expenditure. Also, ascertain the new gross profit and net profit.

CHECK YOUR ANSWERS

IV. Objective Type Questions

1–a	2–d	3–a	4–b	5–c	6–c	7–c	8–a	9–c	10–a	11–d	12–d	13–b
14–b	15–c	16–a	17–c	18–a	19–d	20–d	21–c	22–a	23–b	24–c	25–b	26–d
27–d	28–a	29–b	30–a									

V. Fill in the Blanks

1-Expenditure	2-Revenue	3-Revenue	4-Capital
5-Receipts	6-Capital	7-Revenue	8-Balance Sheet
9-Capital	10-Revenue	11-Capital	12-Capital
13-Capital	14-Revenue	15-Revenue	16-Revenue
17-Revenue	18-Capital	19-Debit	20-Capital
21-Capital	22-Deferred Revenue	23-Revenue	24-Capital
25-Capital	26-Revenue	27-Capital	28-Revenue
29-Capital	30-Revenue Expenditure	31-Revenue	32-Revenue
33-Revenue	34-Higher	35-Deferred Revenue	36-Capital
37-Revenue	38-Revenue Receipt	39-Revenue	40-Capital
41-Capital	42-Deferred Revenue	43-Revenue	44-Capital
45-Lower	46-Capital	47-Revenue	48-Capital
49-Capital	50-Capital	51-Revenue	52-Capital
53-Revenue	54-Capital	55-Revenue Loss	

(Continued)

VI. Match the Columns

(A)	(B)
(i)–g, j, k, l; (ii)–b, i, m, n, p; (iii)–a; (iv)–c, d, f, (v)–h, o; (vi)–e	(i)–e; (ii)–a, i; (iii)–c, f; (iv)–b, g, h; (v)–d

VII. True or False

True	False
3, 5, 6, 7, 9, 10, 13, 14, 16, 17, 18, 19, 20, 22, 23, 24, 25, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 40, 41, 42, 43, 45, 46, 47, 48, 49, 50	1, 2, 4, 8, 11, 12, 15, 21, 26, 39, 44

VIII. Practical Questions

Q1. Revenue Expenditure–1, 3, 4 and Capital Expenditure–2, 5	**Q6.** Revenue Expenditure–2, 5, 6 and Capital Expenditure–1, 3, 4, 7; *Correct Accounts:* 1–Furniture Account, 3–Land Account (as addition to cost), 4–Machinery Account, 6–Repairs Account	**Q11.** Deferred Revenue Expenditure–1, Revenue Expenditure–2, 4, Capital Receipt–7, Revenue Receipt–3, 5, 6	**Q16.** Capital Expenditure–3; Revenue Expenses–1,2, 4, 5, 6, 7, 8
Q2. Revenue Receipts–3, 4, 5 and Capital Receipts–1, 2	**Q7.** Revenue Expenditure–3 (old building), Capital Expenditure–1 and 3 (new building), Deferred Revenue Expenditure–2, 4	**Q12.** Revenue Loss–1, Revenue Expenditure–2 and 4, Capital Expenditure–3	**Q17.** Capital Expenditure–1, 2, 3, 4, 5, 8; Revenue Expenses–6, 7
Q3. Revenue Expenditure–2, 3, 5, 7 and Capital Expenditure–1, 4, 6	**Q8.** Capital Expenditure–1, 2 and Revenue Expenditure–3, 5, 6; 4- Capital Receipt (₹10,000 sale of furniture) and Capital Loss (₹5,000)	**Q13.** Capital Expenditure–1 and Revenue Expenditure–3, 4 and Revenue Receipt–2	**Q18.** Gross Profit–₹4,80,000, Net Profit–₹2,86,000
Q4. Revenue Receipts–2, 5 and Capital Receipts–1, 3, 4, 6, 7	**Q9.** Revenue Expenditure–1, 2, 4 and Capital Expenditure–3, 5; 5- Capital Loss of ₹5,000 and ₹9,600 is Capital Expenditure	**Q14.** Capital Expenditure–1, 3, 5; Capital Receipts–2, 7; Revenue Expenditure–6, 8; Deferred Revenue Expenditure–4	
Q5. Revenue Receipts–5, 6 and Capital Receipts–4, 7; Revenue Expenditure-1, 3 and Capital Expenditure–2	**Q10.** Revenue Expenditure–1, 2, 3, 5 and Capital Expenditure–4	**Q15.** Capital Expenses–2, 3, 5, 8; Revenue Expenses–1, 4, 6, 7	

CHAPTER 6

Final Accounts of Manufacturing Concerns

CHAPTER OUTLINE

EXERCISE

6.1 FINAL ACCOUNTS

Final Accounts is the last step, wherein, we get a summarised picture of all the transactions incurred by an enterprise during an accounting period. We know that all transactions are first recorded in subsidiary books and then posted in ledgers. From these ledgers, Trial Balance is drawn. It is thereafter, on the basis of the Trial Balance so drawn, we prepare Final Accounts. Hence, the word 'final' itself implies that it is the final outcome of all the previous steps of accounting (i.e. from subsidiary books to Trial Balance).

6.1.1 Meaning of Final Accounts

We know that every enterprise maintains a proper record of all its transactions during an accounting year to keep a complete track of all of its expenses and incomes. The books of accounts like subsidiary books, Journal, ledgers are maintained and updated on daily basis in order to record every day transactions. Now at the end of the accounting period (normally yearly), enterprises are interested in knowing the amount of profit earned or loss incurred. They are also interested in assessing the financial position of their business at the end of the accounting period. Hence, this is why Final Accounts are prepared.

Definition of Final Accounts

The accounting records those are prepared to ascertain the financial performance of an enterprise (in terms of profit or loss) and to assess the financial position of the business at the end of an accounting period.

6.1.2 Purpose/Needs/Objectives/Importance of Final Accounts

The following are the purposes for which Final Accounts are being prepared.

1. ***Ascertainment of Profits or Losses***—The very first motive of preparing Final Accounts is to ascertain profits earned or losses incurred by a manufacturer during an accounting period. A business can ascertain gross profit or gross loss by preparing Trading Account which in turn helps in determining net profit or net loss.
2. ***Assessing Financial Position and Financial Health***—Final Accounts depict the true and fair financial position of a business for an accounting period. With the help of Balance Sheet, one can look at the book values of Asset and Liabilities of a business. This helps in assessing the financial health and vitality of the business.
3. ***Enable Comparative Studies***—With the help of Final Accounts, one can underlay comparative studies. The financial items, say, gross or net profit of 2016 can be compared with the gross or net profit of 2017. Such a comparison is termed as intra-firm comparison, which forms the base for framing various managerial decisions. Likewise, we can compare the financial items of two or more firms (known as inter-firm comparisons).
4. ***Evaluating Solvency and Credit Worthiness***—Solvency and credit worthiness of business refers to what extent the business can be relied upon in terms of repaying its debts. This is very crucial especially for the creditors, financial institutions (banks) and investors, as they need to ensure the safety of their funds before lending it to the business. Final Accounts provide vital information about the financial items of the business based on which the credit worthiness of a business can be evaluated.
5. ***Enable Providing and Maintaining Provisions and Reserves***—Based on the information fetched from the Final Accounts of previous years and from its past experiences, business learns.

These learnings help them to maintain different provisions and reserves so as to mitigate and minimise the impact of unforeseen future conditions. This further ensures a smooth functioning of the business and a steady growth.

6.1.3 Components of Final Accounts

The components of Final Accounts depend on the nature of the enterprise—a trading firm or a manufacturing firm. We know that a manufacturer produces goods to sell them at a higher price, whereas, a trader, on the other hand, purchases the already produced goods with the motive of selling them at a higher price. Accordingly, the components of their Final Accounts differ from each other. Let us refer to Figure 6.1.

Components of Final Accounts

- Manufacturer
  - → Manufacturing Account
  - → Trading Account
  - → Profit and Loss Account
  - → Balance Sheet
- Trader
  - → Trading Account
  - → Profit and Loss Account
  - → Balance Sheet

Observation: For a trader, there is no manufacturing account, since he is not manufacturing or producing any goods

Figure 6.1 *Components of Final Accounts.*

Manufacturing Account, Trading Account and Profit & Loss Account are collectively termed as Income Statements. With the help of these statements, we can assess the financial performance of a manufacturing firm in terms of the amount of profit earned or loss incurred. On the other hand, Balance Sheet (also termed as positional statement) helps us to ascertain the financial position of the firm at the end of the accounting period. It lists down the value of Assets vis-à-vis the value of Liabilities of the firm.

6.1.4 Layout of Final Accounts of a Manufacturer

From the above paragraph, we know that the Final Accounts of a manufacturer consists of four parts—Manufacturing A/c, Trading A/c, Profit and Loss A/c and finally Balance Sheet. Now, let us have a glance how these parts are connected to each other as shown in Table 6.1. This will also help us to know why the sequence of these parts matters.

Table 6.1 *Layout of Final Accounts of a Manufacturer*

Dr.		**Manufacturing Account**	**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
To Opening Stock of Work-in-progress	xxx	By Closing Stock of Work-in-progress	xxx
To Raw Materials consumed	xxx		
To $\left\{\begin{matrix}\text{Direct Expenses} \\ \text{or} \\ \text{Factory Expenses}\end{matrix}\right\}$	xxx	By Cost of Goods Produced $\left(\begin{matrix}\text{Total of} \\ \text{Dr. side}\end{matrix}\right) - \left(\begin{matrix}\text{Total of} \\ \text{Cr. side}\end{matrix}\right)$	xxx
	xxx		xxx

Dr. side of Trading Account

(Continued)

Dr. **Trading Account** **Cr.**

Particulars	Amount	Particulars	Amount
To Opening Stock of Finished Goods	xxx	By Sales	xxx
To Cost of Goods Produced b/d	xxx	By Closing Stock of Finished Goods	xxx
To Gross Profit (Total of Cr. side) – (Total of Dr. side)	xxx	By Gross Loss (Total of Dr. side) – (Total of Cr. side)	xxx
	xxx		xxx

From Cr. side of Manufacturing Account

Dr. **Profit and Loss Account** **Cr.**

Particulars	Amount	Particulars	Amount
To Gross Loss b/d	xxx	To Gross Profit b/d	xxx
To {Indirect Expenses or Office Expenses}	xxx	By {Indirect Incomes and Gains}	xxx
To Net Profit (Total of Cr. side) – (Total of Dr. side)	xxx	By Net Loss (Total of Dr. side) – (Total of Cr. side)	xxx
	xxx		xxx

Balance Sheet

Liabilities	Amount	Assets	Amount
Capital xxx *Add*: Net Profit xxx or *Less*: Net Loss (xxx)	xxx	{Assets of the Manufacturing Firms}	xxx
{All Other Liabilities}	xxx		
	xxx		xxx

6.1.5 Introduction to Manufacturing Concerns

We all might have seen factories with smoky chimneys or a small-scale industry carrying out production of goods. These factories or firms undertake the production process by acquiring raw materials, hiring labourers, purchasing machines and Fixed Assets. These firms produce their own goods to sell them at higher price and, thereby, earn profits. Thus, such firms are termed as manufacturing firms, since they undertake the production of goods.

Now, let us focus on the term 'trader'. How a trader is different from a manufacturer? Trader is the one who primarily buy and sell finished products. In other words, a trader purchases finished or produced goods (from the manufacturers) with the motive of selling them at a higher price and thereby earn profits. Since a trader operates in already finished goods, so s/he needs not to undertake production process.

6.2 MANUFACTURING ACCOUNT OF A MANUFACTURER

6.2.1 Meaning and Proforma of Manufacturing Account

From the name itself, we can infer that this account is primarily prepared to record items related to production of goods. It records all the expenses that are incurred by a manufacturer while producing goods. With the help of this account, we can ascertain the total cost of production.

Definition of Manufacturing Account

Account that record all the expenses incurred by a firm in course of production of goods. In simple words, Manufacturing Account records transactions relating to expenses incurred for converting raw materials into finished goods. It records the production related expenses (direct expenses) on the debit side and Closing Stock and Sale of Scrap on the credit side. The balancing figure indicates the cost of finished goods which is transferred to the debit side of Trading Account.

Format of Manufacturing Account

The format for Manufacturing Account is shown in Table 6.2 as follows:

Table 6.2 *Format of Manufacturing Account*

Manufacturing Account

for the year ended...

Dr. **Cr.**

Particulars		Amount ₹	Particulars	Amount ₹
To Opening Stock of WIP		xxx	By Closing Stock of WIP	xxx
To Consumption of Raw Material			By Sale of Scrap	xxx
Opening Stock of Raw Materials	xxx		By Drawings of Raw Materials	xxx
Add: Purchases of Raw Materials *Less*: Returns of Raw Materials *Less*: Closing Stock of Raw Materials	xxx (xxx) (xxx)		By Trading A/c—(Cost of Production transferred to Trading Account)—*Balancing figure*	xxx
Add: Freight on Materials Carriage Inwards on Materials Import Duty on Materials Excise Duty on Materials Cartage on Materials Octroi Duty on Materials Dock Charges on Materials	xxx xxx xxx xxx xxx xxx xxx	xxx		
To Wages Foreman Timekeeper Supervisor Factory Manager Security Men	 xxx xxx xxx xxx xxx	xxx		

(Continued)

Particulars		Amount ₹	Particulars	Amount ₹
To Manufacturing Expenses				
Royalty for technical know-how	xxx			
Hire (or Rent payments) for Machines	xxx			
Design Expenses	xxx	xxx		
To Factory Expenses				
Stores	xxx			
Grease	xxx			
Lubricating Oil	xxx			
Repair and Maintenance of Factory Building	xxx			
Factory Rent, Rates, Taxes	xxx			
Insurance	xxx			
Factory Electricity	xxx			
Factory Lighting and Heating	xxx			
Depreciation of Factory Assets	xxx	xxx		
		XXX		XXX

6.2.2 Explanation of Items Related to Manufacturing Account

Items recorded on the Debit Side of Manufacturing Account

1. **Opening Stock of Work-in-Progress (WIP)**—It is the very first item that is shown on the debit side of the Manufacturing Account. This indicates the stock of work-in-progress goods in the beginning of the accounting year. It consists of all those goods that are either in raw form or semi-finished form.
2. **Consumption of Raw Materials**—It indicates the amount of raw materials that has been consumed during the production process. In order to calculate the total consumption of raw material, we ***add*** opening stock of raw material, purchases of fresh stock of raw materials, expenses (also termed as direct expenses) incurred on its transportation into factory (including freight and duties) and ***deduct*** closing stock of raw materials and purchase returns (return of raw material, if any).
3. **Direct Expenses**—These expenses are incurred on the movement or transportation of raw materials into the factory premises. Carriage, freight charges, import duties, octroi, custom duties, dock charges, etc. are a few examples of direct expenses. These expenses are one of the important factors that determine the cost of production of finished goods. Higher the direct expenses, higher will be the price of the finished goods. Let us now discuss each component of direct expenses one by one.
   - *Carriage Inwards or Cartage or Freight*—Here 'inwards' is in reference to movement into the factory premises. Often, the place where the raw materials are located and purchased is different from the factory place. Thus, the need to incur transportation cost arises in order to bring the raw materials into the factory.
   - *Import Duty (or Custom Duty)*—Many times, raw materials are not available locally but can be found in foreign countries. Thus, the raw materials are bought from foreign countries. Now, when the raw materials so purchased enter the domestic territory, the

importer needs to pay import duty at airport. Since this expense is incurred in relation to the transportation of raw materials, so it is clubbed into direct expenses.

- *Excise Duty*—This is a kind of duty that a producer needs to pay in order to carry out production and sale of certain items within the domestic territory of a country.
- *Octroi*—It is a kind of duty which is paid at the time of bringing purchased goods within the municipal limits. In simple words, octroi is to be levied when goods enter the territory of another state. For example, if goods produced in Andhra Pradesh enter in Maharashtra for sale or further production, then Maharashtra State Government levies octroi charges on the goods.
- *Dock Charges*—These charges are payable at the dockyard. These are incurred for unloading of raw materials from ships on dock.

4. **Wages**—The money paid to the workers and factory labourers in order to carry out production process is termed as wages. Wages are often known as direct labour costs.
5. **Manufacturing Expenses**—These expenses are incurred due to manufacturing or production of goods. Expenses such as royalty payments in exchange of technical know-how, rent paid for special machines, etc.
6. **Factory Expenses**—These expenses are incurred for the upkeep of factory working and production. Expenses such as factory rent, rates, taxes, electricity, lightning, heating, repairs, etc. are a few examples of factory expenses.

6.2.3 Transfer of Value of Finished Goods

The balancing figure of Manufacturing Account indicates the stock of finished goods with the business. This stock of finished goods is then transferred from the factory or the manufacturing unit to the warehouse. In the books of account, the balancing figure is transferred to the debit side of Trading Account. Now, there are three manners in which the value of finished goods can be transferred from Manufacturing to Trading Account.

- **Transfer at Cost Price**—This is a normal practice. The Manufacturing Account is prepared as normally and then the closing balancing figure is transferred to the debit side of Trading Account with the same amount.
- **Transfer at Sale Price**—In this method, the finished goods are transferred to the Trading Account at sale price. The sale price can be higher or lower than the cost price. Thus, accordingly, the Manufacturing Account might reflect profit (SP > CP) or loss (SP < CP).
- **Transfer at Transfer Price**—Transfer price implies cost price *plus* some mark-up price. As per this method, the finished goods are transferred at transfer price (which is cost price of goods + some mark-up). For example, suppose the cost price is ₹100 and mark-up is ₹25, the price at which the value is transferred is ₹125 (which is the sale price). The excess of sale price over cost price (i.e. ₹125 – ₹100 = ₹25) denotes the gross profit earned by the manufacturing unit. This profit is transferred to the General Profit and Loss Account. The remaining procedure of preparing Manufacturing Account will remain as it is.

In this case, it might happen that at the end of the accounting period, the business may be left with some unsold stock of finished goods. Now, since the finished goods are at transfer price, thus the value of closing stock shows a higher figure than the actual value of goods remaining unsold (since the value of closing stock is cost price + profit amount). Now, in order to enable the closing stock to reveal the actual value of unsold stock, we need to adjust the unrealised profit. This is done by passing the following journal entry.

Profit and Loss A/c Dr.
To Stock Reserve A/c

Effects:

1. Stock Reserve Account will be shown on the debit side of P&L A/c.
2. Stock Reserve Account will be deducted from the Closing Stock on the Assets side of the Balance Sheet.

6.3 TRADING ACCOUNT OF A MANUFACTURER

6.3.1 Meaning and Proforma of Trading Account

This account is prepared to ascertain the trading results of a manufacturer in terms of gross profit earned or gross loss incurred during an accounting period. In case of a manufacturing concern, Trading Account is prepared to show cost of finished goods towards opening stock, cost of manufactured finished goods and cost of closing stock of finished goods. It is a nominal account, thus, all expenses or losses are debited and all incomes or gains are credited. On the ***debit side*** of this account purchases, opening stock and cost of manufactured goods are shown, whereas, on the ***credit side*** sales and closing stock are shown. The excess of ***credit side over its debit side*** is regarded as ***Gross Profit***. The excess of ***debit side over its credit side*** is regarded as ***Gross Loss***.

Table 6.3

Trading Account

for the year ended...

Dr. **Cr.**

Particulars	Amount ₹	Particulars		Amount ₹
To Opening Stock of Finished Goods A/c	xx	By Sales of Finished Goods	xxx	
To Cost of Manufactured Goods A/c	xx	*Less*: Sales Returns or Returns Inwards of Finished Goods	xxx	xx
		By Loss of Finished Goods by theft/fire		xx
		By Finished Goods withdrawn by proprietor		xx
		By Finished Goods distributed as Sample		xx
		By Closing Stock of Finished Goods		xx
**Gross Profit transferred to Profit and Loss A/c (*Balancing Figure*)	xx	**Gross Loss transferred to Profit & Loss A/c (*Balancing Figure*)		xx
	xxx			xxx

*Note: **Either Gross Profit or Gross Loss will appear at one time.*

6.3.2 Steps for Preparing Trading Account

The following steps are adhered to while preparing Trading Account of a manufacturing organisation.

***Step* 1**: First, record opening stock of finished goods to the debit side of the Trading Account.

***Step* 2**: After this, transfer the Cost of Goods manufactured (balancing figure on the credit side of Manufacturing Account) to the debit side of Trading Account.

***Step* 3**: Now, on the credit side record gross sale of the finished goods and deduct sales returns or return inwards from gross sales.

***Step* 4**: After this, on the same side record the closing stock.

***Step* 5**: Finally, tally both the sides.

If,	*Else*,
$\underbrace{\text{Debit side} < \text{Credit side}}$	$\underbrace{\text{Debit side} > \text{Credit side}}$
$\Downarrow$	$\Downarrow$
Gross Profit	Gross Loss

6.3.3 Explanation of Items Recorded in Trading Account

Items Recorded on the Debit Side of Trading Account

1. **Opening Stock**—It is the stock of ***finished*** goods in hand in the beginning of the year. It is shown on the debit side of Trading Account, whereas, the opening stock of raw materials, work-in-progress, semi-finished goods are recorded in the Manufacturing Account.
2. **Cost of Manufactured Goods**—This is the cost transferred from Manufacturing Account and is shown on the debit side of Trading Account.

Items on the Credit Side of Trading Account

1. **Sales**—It represents the sale revenue of the goods sold during an accounting period. It includes both cash sales as well as credit sales. It should be noted that like sale, Fixed Assets are regarded as capital nature item; hence, are not included in this sales. Further, we need to compute net sales, which is to be shown on the credit side of the Trading Account.

How to Calculate Net Sales?
Net Sales = Gross Sales – Sale Returns or Return Inwards

2. **Closing Stock**—It indicates the stock of ***finished*** goods that remained unsold at the end of the accounting period. It is recorded on the credit side of manufacturer's Trading Account. As per the '***Principle of Conservatism***', closing stock should be recorded at a lesser value of the two—either 'cost price' or 'market value'. This means, if cost price is ₹10,000 and market value is ₹9,500, then we should record closing stock at ₹9,500, since market value is lesser.

6.3.4 Closing Entries Related to Trading Account

The format for Closing Entries related to Trading Account is shown in Table 6.4.

Table 6.4 *Journal Entries or Closing Entries for Recording Items in the Trading Account*

Date	Particulars	L.F.	Debit	Credit
	Recording of Opening Stock and Net Purchases			
	Trading A/c Dr.			
	To Opening Stock A/c (only finished goods)			
	To Net Purchases A/c			
	(Debit balances transferred to Trading Account)			
	Recording of Sales and Closing Stock			
	Net Sales A/c Dr.			
	Closing Stock A/c Dr.			
	To Trading A/c			
	(Credit balances transferred to Trading Account)			
	In case of Gross Profit			
	Trading A/c Dr.			
	To Profit and Loss A/c			
	(Gross Profit transferred to Profit and Loss A/c)			
	In case of Gross Loss			
	Profit and Loss A/c Dr.			
	To Trading A/c			
	(Gross Loss transferred to Profit and Loss A/c)			

6.3.5 Difference between Manufacturing Account and Trading Account

The major differences between Manufacturing Account and Trading Account are explained in Table 6.5.

Table 6.5 *Difference between Manufacturing Account and Trading Account*

Basis of Difference	Manufacturing Account	Trading Account
Purpose	Prepared for ascertaining ***cost of production***	Prepared for ascertaining ***gross profit*** or ***gross loss***
Sequence	Prepared ***before*** Trading Account	Prepared ***after*** Manufacturing Account
Nature of firms	Prepared ***only*** by the manufacturing firm/manufacturers	Prepared by ***all*** manufacturers and traders
Balancing figure	Always has a closing ***debit*** balance	May have a ***debit or credit*** closing balance
Transfer of closing balance	Closing balance transferred to ***Trading Account*** as ***Cost of Manufacturing Goods***	Closing balance transferred to ***Profit and Loss Account*** as ***Gross Profit/Loss***

Example 1: Net Purchases + Opening Stock − Closing Stock = ?

(a) Gross Profit (b) Purchase Return
(c) Adjusted Purchases (d) Cost of Goods Sold

Solution

Net Purchases + Opening Stock − Closing Stock = *Adjusted Purchases*

Example 2: Which accounting convention is adhered to while recording closing stock of finished goods?

(a) Cost Principle (b) Matching Principle
(c) Prudence Principle (d) Materiality Principle

Solution

It is the convention of prudence or conservatism which is adhered to while recording closing stock. As per this, closing stock is valued at cost or net realisable value, whichever is lower.

Example 3: Goods worth ₹5,000 were donated to an orphanage. Which of the following impacts will this transaction have?

(a) Decreases opening stock (b) Decreases closing stock
(c) Decreases purchases made (d) All of the above

Solution

The transaction will reduce the amount of purchases made, as the goods worth ₹5,000 will be deducted from the Purchase Account.

6.4 PROFIT AND LOSS ACCOUNT OF A MANUFACTURER

6.4.1 Meaning and Proforma of Profit and Loss Account

Definition of Profit and Loss Account

A nominal account that summarises all the incomes, gains, expenses and losses incurred by a firm during an accounting period. It records all the expenses and losses on its debit side, whereas, all the incomes and gains on the credit side. The final balance in terms of 'Net Profit' or 'Net Loss' indicate the financial performance of the firm during a period.

It can be well inferred from the name of the account that this is prepared for determining the amount of profit or loss incurred by a manufacturer. It is a nominal account; hence, the golden rule of 'debit all losses and expenses and credit all incomes and gain' is applied. The basic crux of Profit & Loss Account (P&L A/c henceforth) is explained in Table 6.6. It should be noted that Profit and Loss Account records all the indirect expenses and indirect incomes.

- *Indirect expenses*—The expenses that are incurred for selling, administrative and other related purposes. Basically, these expenses are incurred for facilitating selling of produced goods. For instance, salary and commission paid to the sales executives for selling the goods, telephone expenses incurred for connecting to clients, packing charges of the goods, etc. In a nutshell, all these expenses are incurred during the ***post-production phase***.
- *Indirect incomes*—These are incomes of a firm which are other than sale receipts. For instance, interest received on investments, rent received from tenant, commission received, etc. are not related to goods in which the firm deals. Hence, these are regarded as indirect incomes to a firm.

Table 6.6

Profit and Loss Account
for the year ending…

Records all indirect expenses and losses

Records all indirect incomes and gains

Dr. **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Gross Loss	xx	By Gross Profit	xx
(transferred from Trading A/c)		(transferred from Trading A/c)	
To Administrative Expenses		**By (Indirect) Incomes and Gains**	
To General Expenses	xx	By Rent (Cr.)	xx
To Lighting	xx	By Rent from Tenant	xx
To Salaries	xx	By Discount Received or Discount (Cr.)	xx
To Printing and Stationary	xx	By Dividend on Shares	xx
To Salaries and Wages	xx	By Interest on Investments	xx
To Rent, Rates and Taxes	xx	By Commission Received	xx
To Insurance	xx	By Income from other Sources	xx
To Establishment Expenses	xx	By Bad Debts Recovered	xx
To Legal Charges	xx	By Miscellaneous Receipts	xx
To Audit Fees	xx	By Profit on Sale of Assets	xx
To Telephone/Internet Charges	xx	By Provision for Discount on Creditors	xx
To Postage and Courier	xx		
To Trade Expenses	xx		
To Conveyance Expenses	xx		
To Selling and Distribution Expenses			
To Carriage Outwards	xx		
To Carriage on Sales	xx		
To Brokerage on Sales	xx		
To Advertisement	xx		
To Bad Debts	xx		
To Provision for Doubtful Debts	xx		
To Packing Charges	xx		
To Delivery Van Expenses	xx		
To Commission on Sales/Commission	xx		
To Other Expenses			
To Depreciation	xx		
To Bank Charges	xx		
To Discount	xx		
To Donation and Charity	xx		
To Repairs and Maintenance	xx		

(Continued)

Particulars	Amount ₹	Particulars	Amount ₹
To Interest paid	xx		
To Conveyance Expenses	xx		
To Loss on Sale of Assets	xx		
*To Net ***Profit*** transferred to Capital A/c	xx	**By Net ***Loss*** transferred to Capital A/c	xx
	xx		xx

*Note: **Either Net Profit or Net Loss will appear at one point of time.*

6.4.2 Steps for Preparing Profit and Loss Account

The following steps are adhered to while preparing Profit and Loss Account of a manufacturer.

***Step* 1**: First, transfer Gross Profit to the credit side of P&L A/c and in case of Gross Loss transfer the loss amount to the debit side of P&L A/c.

***Step* 2**: Thereafter, record all the indirect expenses and losses on the debit side of P&L A/c.

***Step* 3**: Now, record all the indirect incomes and gains on the credit side of the P&L A/c.

***Step* 4**: Finally, tally both the sides and workout the difference to ascertain net profit or net loss.

If,	*Else*,
$\underbrace{\text{Debit side} < \text{Credit side}}_{\Downarrow}$	$\underbrace{\text{Debit side} > \text{Credit side}}_{\Downarrow}$
Net Profit	Net Loss

6.4.3 Explanation of Items Related to Profit and Loss Account

Debit Side Items of Profit and Loss Account

1. **Gross Loss**—If the Trading Account shows Gross Loss, then it is shown on the debit side of Profit and Loss Account as the very first item.
2. **Administration and Office Expenses**—These expenses are incurred at the place of administration (office) for drafting and implementing plans, which are required for efficient functioning of a business and maintenance of the office. For example, office salaries, office rent, postage, printing and stationery, etc.
3. **Selling Expenses**—These expenses are incurred for marketing finished goods and distribution thereof and undertaking various promotional activities for boosting-up the sales. For instance:
    - *Marketing expenses* incurred on advertisement, salaries to salesman, commission to salesman/agents, etc.
    - *Distribution expenses* incurred on warehousing or storage, packing costs, Carriage or Freight Outwards, transportation costs, etc.
4. **Other Losses and Provisions for Losses**—It includes all the losses that are accidental to a business enterprise and does not happen frequently in a normal course of business. For instance, losses by fire and by theft are basically accidental in nature. Such losses are shown

on the debit side of Profit and Loss Account. The given below are some factors that result in the abnormal losses to a business.

- Loss of Goods/Stock or Assets by Fire or Theft
- Loss on Sale of Fixed Assets
- Cash Embezzlement
- Loss of Goods due to Accidents
- Certain losses are to be estimated and accounted on the basis of judgment such as provision for doubtful debts, contingent expenses, etc.

5. **Other Expenses**—There are other set of expenses a few illustrated below are shown on the debit side of the Profit and Loss Account.
   - Depreciation
   - Charity
   - Donations
   - Repairs and Maintenance of Assets or Equipment
   - Income Tax Paid

Credit Side Items of Profit and Loss Account

1. **Gross Profit**—This is the very first item that is transferred from the debit side of Trading Account to the credit side of the Profit and Loss Account. This amount indicates the amount of profit that a manufacturer has earned from selling of final goods.
2. **Financial and Other Incomes/Gains**—These are the indirect incomes and gains to a manufacturer that happen due to events other than producing and trading of goods. In simple words, such gains and incomes are due to other business operations. For instance, rent received from tenant for a premise owned by a manufacturer or commission received on sales of goods. Hence, such incomes and gains are regarded as indirect and are shown on the credit side of Profit and Loss Account. The following are a few of the indirect incomes and gains.
   - Rent Received
   - Commission Received
   - Interest Received
   - Dividend Received
   - Discount Received
   - Income from Investments
   - Profit on Sale of Assets
   - Bad Debts Recovered
   - Insurance Claim Received
   - Interest on Drawings
   - Other Miscellaneous Incomes

6.4.4 Journal Entries or Closing Entries for Recording Items in the Profit and Loss Account

The format for Journal Entries or Closing Entries for recording of items in the Profit and Loss Account is shown in Table 6.7.

Table 6.7

Date	Particulars	L.F.	Debit	Credit
	Recording of Indirect Expenses and Losses			
	Profit & Loss A/c Dr.			
	To Administration and Office Expenses			
	To Selling and Distribution Expenses			

(Continued)

Date	Particulars	L.F.	Debit	Credit
	To Financial Expenses To Other Expenses To Other Losses and Provisions (Indirect expenses and losses transferred to P&L A/c)			
	Recording of Indirect Incomes and Gains Indirect Incomes and Gains A/c Dr. To Profit and Loss A/c (Indirect incomes and gains transferred to P&L A/c)			
	In case of Net Profit Profit and Loss A/c Dr. To Capital A/c (Net Profit transferred to Capital A/c)			
	In case of Net Loss Capital A/c Dr. To Profit and Loss A/c (Net Loss transferred to Capital A/c)			

6.4.5 Difference between Direct and Indirect Expenses

The major differences between Direct and Indirect Expenses are shown in Table 6.8.

Table 6.8 *Difference between Direct and Indirect Expenses*

Basis of Difference	Direct Expenses	Indirect Expenses
Definition	The expenses that are incurred on the purchases and movement of goods such as carriage, freight charges, etc.	The expenses that are incurred for selling, administrative and other related purposes.
Treatment	Recorded on the debit side of Manufacturing Account	Recorded on the debit side of Profit and Loss Account
Purpose	Incurred during the production process and for bringing the raw material or semi-finished goods to finished stage	Incurred during the post-production stage, i.e. for selling and distribution of the finished goods
Nature	Primary nature (as a business incurs these expenses for production of goods)	Secondary nature (as a business incurs these expenses basically for administration purposes or for selling of the finished goods)
Examples	Wages, Carriage Inwards, Freight, etc.	Salaries, Advertisements, Transportation costs, etc.

Judging Criteria

Q. How to decide whether an item should be posted in Manufacturing Account, Trading Account or in Profit and Loss Account?

Criteria	Manufacturing Account	Trading Account	Profit and Loss Account
1. In relation to	Relates to or Raw materials or Production	Relates to finished goods	Relates to post-production activities like selling, administrative, etc.
2. Place	Item related to factory (where production in carried)	Item related to shop, warehouse (where finished goods are stocked for trading)	Item related to office (where post-production activities are carried out)

Example 4: Ascertain the amount of Net Profit/Net Loss, if the Gross Profit is ₹6,00,000.

Particulars	Amount
Wages and Salaries	20,000
Carriage on Sales	10,000
Discount allowed by clients	8,000
Bad debts recovered	25,000
Trade Expenses	6,500
Rent for Godown	16,500

(a) ₹3,90,000 (b) ₹3,99,000 (c) ₹4,05,000 (d) ₹4,06,500

Solution

Net Profit = Gross Profit + Bad Debts Recovered + Discount Allowed by Clients − Carriage on Sales − Trade Expenses − Rent for Godown

= 6,00,000 + 25,000 + 8,000 − 10,000 − 6,500 − 16,500

= ₹6,00,000

Example 5: Which of the following items is shown on the debit side of P&L Account?

(a) Direct expenses (b) Direct incomes

(c) Indirect expenses (d) Indirect incomes

Solution

Out of all the options, it is only indirect expenses that are shown on the debit side of the P&L Account. These expenses are regarded as indirect, as these expenses are not directly incurred for production of goods. On the other hand, direct expenses are recorded on the debit side of Manufacturing Account.

Example 6: Which of the following items will not be recorded in the P&L Account?

(a) Salaries and Wages (b) Freight

(c) Rent paid (d) Carriage Outwards

Solution

Out of all the options, 'freight' would not be recorded in the P&L Account. Indeed, it is recorded on the debit side of Manufacturing Account, as it is incurred for transporting the raw materials and semi-finished goods into the factory premises, hence are related to production of goods. Thus, freight will not be recorded in the P&L Account. All the remaining options will be shown on the debit side of P&L Account.

6.5 BALANCE SHEET OF A MANUFACTURER

6.5.1 Meaning and Proforma of Balance Sheet

Definition of Balance Sheet

It is regarded as a report card of an organisation indicating its financial status. It supplies information about the values of Assets and Liabilities of an organisation at the end of an accounting period. It facilitates in ascertaining true and fair financial position of a business, which further enables different accounting users to fetch-out information about solvency, liquidity position and financial health of a business.

Quoted by Freeman, 'A Balance Sheet is an item-wise list of Assets, Liabilities and proprietorship of a business at a certain date'.

Characteristics/Features of a Balance Sheet

The following are the important characteristics of a Balance Sheet.

1. It ***is only a statement*** depicting book values of different Assets and Liabilities of a business.
2. It is ***not an account***, hence there is no Dr. and Cr. mentioned on the either sides of a Balance Sheet.
3. It has two parts—Liabilities on the left-hand side and Assets on the right-hand side.
4. The total of the left side (Liabilities) must be equal to the total of the right side (Assets).
5. It is prepared on a ***particular date*** (normally at the end of an accounting period) say 31st December and 31st March.
6. It helps in ascertaining the ***true financial position*** of the business.
7. It is prepared on the basis of Accounting Period Principle (which states that the lifespan of a business is divided into equal intervals say, annually, half-yearly, etc.)

Proforma of a Balance Sheet

The proforma of a Balance Sheet is shown in Table 6.9.

Table 6.9 *Proforma of a Balance Sheet*

Balance Sheet

as on year ended...

Liabilities		Amount ₹	Assets		Amount ₹
Capital Account			**Fixed Assets**	xx	
Opening Balance	xx		*Less*: Depreciation	(xx)	xxx
**Add*: Net Profit	xx		Goodwill		xxx
Add: Additional Capital introduced	xx		Land		xxx
			Patents and Trademarks	xx	
**Less*: Net Loss	(xx)		Building or Premises	xx	
Less: Drawings	(xx)	xxx	Plant and Machinery	xx	
Reserves and Surplus			Equipment	xx	
Reserve Funds	xx		Furniture and Fixtures	xx	
General Reserve	xx	xx	Motor Vehicles	xx	
			Less: Depreciation	(xx)	xxx

(Continued)

Liabilities		Amount ₹	Assets		Amount ₹
Loan Liabilities			**Investments**		xxx
Bank Overdraft	xxx		**Current Assets**		
Loan from Bank	xxx	xxx	Stock or Inventory (Closing)		xxx
Current Liabilities and Provisions			Sundry Debtors or Book Debts	xx	
Sundry or Trade Creditors	xx		*Less*: Provision for DD	(xx)	xxx
Bills Payable	xx		Bills Receivables		xxx
Outstanding Expenses	xx		Prepaid Expenses		xxx
Income Received in Advance	xx		Accrued Income		xxx
Provision for Tax	xx	xxx	Cash in Hand		xxx
			Cash at Bank		xxx
			Loans Granted		xxx
			Fictitious Assets		
			Deferred Revenue Expenditure		xxx
			Advertisement Suspense		xxx
			Profit and Loss (Dr. Balance)		xxx
		xxx			xxx

*Note: *Either Net Profit or Net Loss will happen at a time.*

6.5.2 Explanation of Items Related to Balance Sheet and Classification of Assets and Liabilities

Assets Side Items

On the right-hand side of a Balance Sheet, we show all the Assets of the manufacturing firm. Based on the nature of these Assets, we can classify them into the following heads.

1. **Fixed Assets**—These Assets are possessed by a firm for a longer period of time, which is more than 1 yr. Further, a firm acquires such Assets not for the purpose of resale, instead, for the purpose of using them for business activity. For instance, machinery purchased by a firm is used for production; similarly, building premise is used to set up factory or office. Fixed Assets can be further classified on the following basis.

On the basis of Mobility

- ***Immovable Fixed Assets***—Those Assets that cannot be shifted from one place to another. For example, land and building.
- ***Movable Fixed Assets***—Movable means Assets can be moved from one place to another. For instance, plant and machinery, furniture, etc. can be moved from one place to another.

On the basis of Physical Existence

- ***Tangible Assets***—These are the Assets that can be touched and seen. In other words, such Assets have physical existence. For example, plant, building, machinery, furniture, etc. can be seen as tangible Assets.

- ***Intangible Assets***—Such Assets cannot be seen, as they do not have any physical existence. For example, goodwill (or brand name, reputation), trademarks, and patents are intangible Assets.

2. **Investments**—These include investments in the form of shares, debentures and bonds.
3. **Current Assets**—These Assets are held by a firm for a shorter period of time. These are working Assets which keeps on changing as per business activity such as stock-in-trade, debtors, advances to suppliers, bank balance, cash balance, prepaid expenses, etc.
4. **Fictitious Assets**—Unlike current Assets, fictitious Assets cannot be converted into cash. For example, deferred revenue nature expenditure (say, advertisement expenditure) once spent cannot be recovered back in form of cash. But then why are such expenditures regarded as Assets? The simple reason is that the benefits from such expenditure are spread over a longer period of time. For example, say a firm spent ₹2 crores today for shooting of a TV advertisement clip. This amount is regarded as deferred revenue nature expenditure, since the benefit of this expenditure will be availed by the firm till the time (suppose 5 yr) the advertisement is broadcasted. Thus, we can say that the benefit of one time expenditure of ₹2 crores can be spread across next 5 yr. Accordingly, we write-off (or show) only this year's balance on the Assets side of the Balance Sheet. This implies that for next 5 yr, each year ₹40,00,000 $\left(\text{i.e.} \frac{20,000,000}{5}\right)$ will be shown as Miscellaneous Expenditure. Thus from the above discussion, we can say that Fictitious Assets are not the actual Assets but are recorded on the Assets side for writing-off them over benefited period of time.

Liabilities Side Items

The following are the items that appeared on the Liabilities side of the Balance Sheet.

1. **Capital**—It represents the amount of money invested by the manufacturer in the business. To be precise, it is the amount that the manufacturer has lent to the business and the business uses this amount to carry out its activities. The items that increase the capital balance are added to the capital, whereas, the items that reduce the capital balance are deducted from the capital. For example, introducing fresh capital into the business and net profit are added to the capital, whereas, items such as net loss and drawings are deducted from capital amount.
2. **Loan Liabilities**—These are the long-term Liabilities that a business needs to repay For example, long-term loans, loan from bank and mortgage loan.
3. **Reserves and Surpluses**—Reserves and surpluses are the accumulated profits or the amount that are kept aside to meet the future uncertainties and losses, for example, general reserve, reserve fund.
4. **Current Liabilities and Provisions**—Current Liabilities are the short-term Liabilities that are to be repaid within a span of 1 yr, for example, creditors, bills payable, outstanding expenses, provision for tax.
5. **Contingent Liabilities**—These Liabilities depend on the happening of future events. These are not the actual Liabilities, but might become a liability if the future event happens or occurs. In simple words, these are potential Liabilities. For example, liability in respect of a court case verdict. Suppose, if some customers have sued the manufacturer on account of defective products. Now, if the verdict falls in favour of manufacturer, then he need not pay any compensation; however, if the verdicts favours the customers, the manufacturer need to pay the compensation amount, hence, liability arises. Since these Liabilities are potential Liabilities, hence these are not shown in the Balance Sheet instead are disclosed as a footnote below the Balance Sheet.

6.5.3 Arrangement of Assets and Liabilities (Grouping and Marshalling of Assets and Liabilities)

Grouping and marshalling of Assets and Liabilities refer to arranging Assets and Liabilities under different heads and present them in a definite order in a firm's Balance Sheet.

Grouping of Assets and Liabilities—By grouping, we aim to identify the nature of different Assets and based on their similarities in nature we present the Assets under one head. In simple words, all those Assets which have the same nature are presented under one head. For example, cash in hand, cash at bank, bills receivables and stock can be easily converted into cash, hence are clubbed under one head of 'Current Assets'. Similarly, building, plant and machinery, furniture are acquired for long-term use, hence are clubbed under the head of 'Fixed Assets'. Similarly, we arrange the Liabilities on the basis of their nature and show the Liabilities of same nature under one head. The following are the main heads of Assets and Liabilities as shown in Table 6.10.

Table 6.10

Major Heads/Groups under	
Assets	**Liabilities**
a. Current Assets b. Fixed Assets c. Investments	a. Current Liabilities b. Fixed Liabilities c. Capital

Marshalling of Assets and Liabilities—By marshalling, we basically mean the order in which different Assets and Liabilities are arranged. The two orders based on which Assets and Liabilities can be arranged are as follows:

- *Order of Liquidity*—Liquidity means how quickly Assets can be converted into cash and how quickly Liabilities can be repaid. The most liquid Assets and Liabilities are presented at the top, which are then followed by the least liquid Assets and Liabilities at the bottom. For instance, cash in hand and cash at bank are the two most liquid Assets (i.e. they can be converted into cash in no time), hence, are shown at the top on the Assets side of balance sheet. On the contrary, we have goodwill at the bottommost of the Assets side, as it is very hard to convert into cash.
- *Order of Permanence*—Permanence refers to the degree of permanency. The items which are most permanent will top the list and will be shown first. The most permanent items will be followed by the least permanent items. For instance, goodwill and capital are the two most permanent items and remain in the business till the wind-up of business; hence, both these items are shown at the top on respective sides.

Table 6.11 explains the order of liquidity and permanence more explicitly.

Table 6.11 *Marshalling of Assets and Liabilities*

Order of *Liquidity*				Order of *Permanency*			
Balance Sheet *as on year ended…*				**Balance Sheet** *as on year ended…*			
Liabilities	**₹**	**Assets**	**₹**	**Liabilities**	**₹**	**Assets**	**₹**
B/P—***Highest Priority***		Cash in Hand—***Most Liquid***		Capital—***Most Permanent***		Goodwill—***Most Permanent***	
Sundry Creditors		Cash at Bank		*Add*: Net Profit		Patents & Trade Marks	

(Continued)

Liabilities	₹	Assets	₹	Liabilities	₹	Assets	₹
Bank Overdraft		Bills Receivable		*Add:* Additional Capital		Land and Building	
Outstanding Expenses		Short-term Investments		*Less:* Net Loss		Plant and Machinery	
Income Received in Advance		Sundry Debtors		*Less:* Drawings		Motor Vehicles	
Loans		Closing Stock		Reserves and Provisions		Furniture	
Reserves and Provisions		Prepaid Expenses		Loans		Investment	
Capital—***Least Priority***		Accrued Income		Income Received in Advance		Closing Stock	
Add: Net Profit		Long-term Investment		Outstanding Expenses		Sundry Debtors	
Add: Additional Capital		Furniture		Bank Overdraft		Bills Receivable	
Less: Net Loss		Motor Vehicles		Sundry Creditors		Accrued Income	
Less: Drawings		Plant and Machinery		Bills Payable—***Least Permanent***		Prepaid Expenses	
		Land and Building				Cash at Bank	
		Patents and Trade Marks				Cash in Hand—***Least***	
		Goodwill—***Least Liquid***				***Permanent***	

Example 7: Classify the above into Current Liability, Non-Current Liability, Contingent Liability or Owner's Funds and Current Assets.

1.Shares 2. Mortgage Loan 3. Bank Overdraft 4. Accrued Income 5. Bills discounted with Bank 6. Capital 7. Guarantee to bank for loan taken by proprietor's brother 8. Short-term investments 9. Stock

Solution

Current Liability	Non-Current Liability	Contingent Liability	Current Assets
Bank Overdraft	Shares	Guarantee for Loan	Stock
	Mortgage Loan	Bills discounted with Bank	Accrued Income
	Capital		Short-term investments

6.6 ADJUSTING ENTRIES

6.6.1 Meaning and Concept of Adjusting Entries

It is quite normal that while preparing Final Accounts, a few of the items are not recorded till drawing of Trial Balance. It requires adjustment entries to reflect these in Final Accounts. In such cases, the Final Accounts so prepared will not be able to reveal true and fair financial position of the business. Thus, there arises a need to incorporate or adjust such corrections in order to make the Final Accounts reflect the clear picture. Normally, adjustments are given outside the Trial Balance. Since these adjustments provide extra information about the items in the Trial Balance, so these are also termed as additional information.

Adjusting entries are the journal entries that are made in order to incorporate the adjustments of the omitted or wrongly recorded entries.

6.6.2 Need of Adjusting Entries

The following are the needs for passing adjusting entries.

1. To assess the true and fair financial position of a business
2. To record the omitted or wrongly recorded items
3. To ascertain actual amount of profit or loss
4. To provide for the depreciation on Fixed Assets
5. To maintain year-wise Final Accounts by recording transactions belonging to current year only (and ignoring those transactions that belong to the previous year and/or following years)
6. To provide and maintain provisions for next year on the basis of current year experience

6.6.3 Treatment of Adjustments

Before we move ahead to learn the treatment of various adjustments, let us take a pause and refer carefully to the following points.

LET'S TAKE A PAUSE!

1. If the adjustments are given ***outside the Trial Balance***, then the multiple treatments will be shown so that total debit effects equal total credit effects. This is in accordance to the double-entry system as per which every transaction will have multiple effects.
2. If the adjustments are given inside the Trial Balance, then the treatment will be shown only in to the extent of balance shown in Trial Balance.
3. When adjustments are given in Trial Balance, its expenses/income effects are already given and only Assets/Liabilities effects are required to be given.

1. Closing Stock

It is the amount of ***finished goods*** that left unsold with a manufacturer at the end of an accounting period. As the actual value of the closing stock can be ascertained only at the end of the accounting period, hence, generally it is given outside the Trial Balance.

Treatment of Closing Stock—When given outside the Trial Balance

Journal entry for recording the closing stock

Closing Stock A/c	Dr.
To Trading A/c	
(Closing Stock transferred to Trading Account)	

Effects:

1. Recorded on the credit side of the Trading Account and
2. Shown on the Assets Side of the Balance Sheet under the head Current Assets

When both—'Cost Price' and 'Market Price' of Closing Stock is given

There might be instances, when the question specifies two different values for closing stock—i.e. 'cost price' and 'market price'. While cost price implies the cost of producing the stock, the market price implies prevailing selling price in a market of finished goods.

If we have two values of closing stock then as per the 'conservatism' principle, we record the closing stock with the cost or market value whichever is lower. For instance, suppose the cost price of closing stock is ₹20,000 and market price of closing stock is ₹25,000 then we will record closing stock with the cost price (i.e. ₹20,000), as cost is lower. This is strictly in adherence to the principle of conservatism, as per which we should not anticipate profit but should always provide for all prospective losses.

Example 8: Record the treatment of closing stock in the following cases, if the closing stock is given outside Trial Balance

a. Closing stock valued at ₹10,000.
b. Closing stock ₹15,000 (market price ₹25,000).
c. Closing stock ₹30,000 (market price ₹24,000).

Solution

Trading A/c Dr.			Cr.	Balance Sheet			
Particulars	**Amount**	**Particulars**	**Amount**	**Liabilities**	**Amount**	**Assets**	**Amount**
		a. Closing Stock	10,000			a. Closing Stock	10,000
		b. Closing Stock	15,000			b. Closing Stock	15,000
		c. Closing Stock	24,000			c. Closing Stock	24,000

Treatment of Closing Stock—When given Inside the Trial Balance

There might be instances, where Closing Stock is given inside the Trial Balance. In such cases, it implies that the value of Closing Stock has already been adjusted in the value of cost of production. This implies that Trading Account appearing in the Trial Balance is adjusted for both Opening and Closing Stock. While treating Closing Stock when it appears inside the Trial Balance, it should be noted that there will be only one effect, since the other effect has already taken into account (in form of net purchases or cost of production). In such cases, we just show the Closing Stock only on the Assets side of the Balance Sheet (and not on the credit side of Trading Account).

Treatment of Closing Stock

Given Outside the Trial Balance
Effect is at '*Two Places*'

Trading A/c **Cr.**

	Particulars	Amt.
	By Closing Stock Finished Goods	XXXX

Balance Sheet

	Assets	Amt.
	Closing Stock Finished Goods	XXXX

Given Inside the Trial Balance
Effect is at '*One Place*'

Balance Sheet

	Assets	Amt.
	Closing Stock Finished Goods	XXXX

Figure 6.2 *Treatment of Closing Stock when given outside and inside the Trial Balance.*

2. Outstanding Expenses

These are expenses against which the benefits or the services have been availed; however, the payments are yet to be made. For instance, in case of post-paid mobile bills, we first avail the benefits of the mobile services, make calls, use data services, etc. and at the end of the month, the bill is generated and we pay the bill. Thus, till the moment, we actually pay the bill amount, it remained an outstanding expense.

Treatment of Outstanding Expenses—When given outside the Trial Balance
Journal entry for recording the outstanding expenses

Concerned Expenses A/c (such as salary, rent, professional fees, etc.)	Dr.
To Outstanding Expenses A/c	

Effects:

1. It is shown as addition to the related expenses on the debit side of Manufacturing or Trading or P&L A/c
2. It is shown on the Liabilities side of the Balance Sheet under the head Current Liabilities

Treatment of Outstanding Expenses—When given inside the Trial Balance
As we know, when the items appear inside the Trial Balance then it has just one effect. In the similar manner, if outstanding expenses are given inside the Trial Balance then we only show it on the Liabilities side of the Balance Sheet under the head of Current Liabilities.

Treatment of Outstanding Expenses

Given Outside the Trial Balance
Effect is at '*Two Places*'

Given Inside the Trial Balance
Effect is at '*One Place*'

Dr. **Manufacturing or Trading or P&L A/c**

	Particulars	Amt.
	To Expenses + Outstanding Expenses	XXXX

Balance Sheet

	Liabilities	Amt.
	Outstanding Expenses	XXXX

Balance Sheet

	Liabilities	Amt.
	Outstanding Expenses	XXXX

Figure 6.3 *Treatment of Outstanding Expenses when given outside and inside the Trial Balance.*

Example 9: Consider the below extract of a Trial Balance. Show the treatment of the items in the Final Accounts.

Extract of Trial Balance

Particulars	Amount
Octroi	15,500
Salary	6,000

Additional Information:

(a) Octroi yet to be paid ₹500.
(b) Salary for the last month of the year is yet to be paid amounting to ₹600.

Solution

Manufacturing A/c

Dr. **Cr.**

Particulars		Amt.	Particulars	Amt.
To Octroi	15,500			
+ Outstanding Octroi	500	16,000		

Balance Sheet

Liabilities	Amt.	Assets	Amt.
Current Liabilities			
Outstanding Octroi	500		
Outstanding Salary	600		

P&L A/c

Dr. **Cr.**

Particulars		Amt.	Particulars	Amt.
To Salary	6,000			
+ Outstanding Salary	600	6,600		

Working Notes:

Salary for 10 months = ₹6,000

Salary for 1 month = ₹$\frac{6,000}{10}$ = ₹600

Salary for 2 months = ₹600 × 2 = ₹1,200

Example 10: Consider the following extract of a Trial Balance. Show the treatment of the items in the Final Accounts.

Extract of Trial Balance

Particulars	Amount
Factory Expenses	8,050
Rent	6,950
Outstanding Rent	1,550
Outstanding Factory Expenses	125

Solution

Manufacturing or Trading A/c

Dr. **Cr.**

Particulars		Amt.	Particulars	Amt.
To Factory Expenses	8,050			

Balance Sheet

Liabilities	Amt.	Assets	Amt.
Current Liabilities			
Outstanding Factory Expenses	125		
Outstanding Rent	1,550		

P&L A/c

Dr. **Cr.**

Particulars		Amt.	Particulars	Amt.
To Rent	6,950			

3. Prepaid Expenses

Sometime, certain expenses are paid in advance for instance, train ticket booked in advance, advance payment for insurance premium. Such expenses are termed as prepaid expenses. From the name itself ('pre' – 'paid'), it can be inferred that these are advance payments. We first make the payment and after that we enjoy the services or avail the benefits of it. We can consider the example of prepaid mobile recharges. We first pay for recharge amount and thereafter can avail call and data services. Thus, we can define prepaid expenses as the expenses made in advance and the benefits against the expenses are yet to be availed.

For example, premium of ₹14,000 paid for 14 months. In this case, advance premium is paid for 2 months, since in a year there are 12 months. Hence, the 2 months premium is our prepaid expense and which is related to the next accounting year. Thus, in the current year, we will only record the premium paid for 12 months (i.e. ₹12,000) and the amount for 2 months (₹2,000) will be shown by subtracting as premium paid in advance. Let us go through treatment part and thereafter, we will get back to this example.

Treatment of Prepaid Expenses—When given outside the Trial Balance

Journal entry for recording prepaid expenses

Prepaid Expenses A/c	Dr.
To Concerned Expenses A/c	
(Expenses paid in advance)	

Effects:

1. It is shown on the debit side of the Manufacturing or Trading or P&L Account as deduction from the concerned expenses.
2. It is shown on the Assets side of the Balance Sheet under the head Current Assets as Prepaid Expenses.

Treatment of Prepaid Expenses—When given inside the Trial Balance

When prepaid expenses are given inside the Trial Balance, then there will be just one effect. In such a case, we show the prepaid expenses on the Assets side of the Balance Sheet under the head of Current Assets as Prepaid Expenses. The Expense Account is already adjusted (as it is prepaid expense and is given inside the Trial Balance), hence, we need not further adjust the concerned account.

Treatment of Prepaid Expenses

Given Outside the Trial Balance
Effect is at '*Two Places*'

Given Inside the Trial Balance
Effect is at '*One Place*'

Dr. **Manufacturing or Trading or P&L A/c**

	Particulars	Amt.
	To Concerned Expense	XXXX
	Less: Prepaid Expense	(XXXX)

Balance Sheet

	Assets	Amt.
	Prepaid Expenses	XXXX

Balance Sheet

	Assets	Amt.
	Prepaid Expenses	XXXX

Figure 6.4 *Treatment of Prepaid Expenses when given outside and inside the Trial Balance.*

<u>**Example 11:**</u> Consider the below extract of a Trial Balance. Show the treatment of the items in the Final Accounts.

Extract of Trial Balance

Particulars	Amount
Insurance Premium	14,000
Rent	12,000
Rent paid in advance	1,000
Prepaid Wages	1,250

Additional Information: Insurance premium is paid for 14 months

Solution

Profit and Loss A/c

Dr.			Cr.
Particulars	**Amt.**	**Particulars**	**Amt.**
To Insurance Premium 14,000 *Less*: Prepaid Insurance (2,000)	12,000		
To Rent	12,000		

Balance Sheet

Liabilities	Amt.	Assets	Amt.
		Current Assets	
		Prepaid Wages	1,250
		Prepaid Rent	1,000
		Prepaid Insurance	2,000

Working Notes:

Insurance Premium for 14 months = ₹14,000

Insurance Premium for 1 month = $₹\frac{14,000}{14} = ₹1,000$

Insurance Premium for 2 months = ₹1,000 × 2 = ₹2,000

4. Accrued Income (or Income Accrued or Income Earned but not Received)

From the name itself, it can be inferred that such incomes have been earned but the payments have been not yet received by the business. To be precise, income is due as receivable and has been earned during the current year, however, will be receivable in the next or following accounting year.

For example, rent from tenant amounts to ₹3,000 per month. During the year, the firm has received amount of ₹30,000 as rent. This implies that the rent for 2 months is yet to be received. Hence, the amount of ₹6,000 (3,000 × 2) is regarded as accrued income or income earned but not received.

Treatment of Accrued Income—When Given Outside the Trial Balance

Journal entry for recording prepaid expenses

Accrued Income A/c	Dr.
To Concerned Income A/c	
(Income earned but not received)	

Effects:

1. Shown on the credit side of the Manufacturing or Trading or Profit and Loss Account as addition to the related income.
2. Shown on the Assets side of the Balance Sheet under the head Current Assets.

Treatment of Accrued Income—When Given Inside the Trial Balance

When accrued incomes are given inside the Trial Balance, then there will be just one effect. In such a case, we show the income on the Assets side of the Balance Sheet under the head of Current Assets.

Treatment of Accrued Incomes

Given Outside the Trial Balance
Effect is at '*Two Places*'

Given Inside the Trial Balance
Effect is at '*One Place*'

Manufacturing or Trading or P&L A/c

	Particulars	Amt.
	By Concerned Income	XXXX
	Add: Accrued Income	XXXX

Balance Sheet

	Assets	Amt.
	Accrued Income	XXXX

Balance Sheet

	Assets	Amt.
	Accrued Income	XXXX

Figure 6.5 *Treatment of Accrued Income when given outside and inside the Trial Balance.*

Example 12: Given below is the extract of a Trial Balance. Show how the following items will appear in the financial statements.

Extract of Trial Balance

Particulars	Amount ₹
Interest on Investments (Cr.)	2,900
Commission received	6,350
Commission Receivables	1,500

Additional Information: Interest outstanding on investments is ₹300.

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars		Amount
By Interest on Investments	2,900	
Add: Accrued Interest	300	3,200
By Commission received		6,350

Balance Sheet

Assets	Amount
Accrued Interest on Investments	300
Commission Receivables	1,500

5. Income Received in Advance (Unearned Income)

The income that has been received during the current year but are not related to the current year are regarded as income received in advance. In simple words, these are the income the benefits of which are yet to be availed in the next accounting period, but the amount has been received in advance.

For example, rent received during the current year is ₹39,000 (@₹3,000 per month) which includes 1 month's rent in advance. Thus the rent of ₹3,000 that has been received in advance but does not belong to this year, thus is considered as unearned income.

Treatment of Unearned Income—When Given Outside the Trial Balance

Journal entry for recording prepaid expenses

Concerned Income A/c	Dr.
To Income Received in Advance A/c	
(Income received in advance)	

Effects:

1. Shown on the credit side of the Manufacturing or Trading or P&L Account as deduction from the related income.
2. Shown on the Liabilities side of the Balance Sheet under the head Current Liabilities

Treatment of Unearned Income—When given inside the Trial Balance

When unearned incomes are given inside the Trial Balance, then there will be just one effect. In such a case, we show the income on the Liabilities side of the Balance Sheet under the head of Current Liabilities.

Treatment of Unearned Incomes

Given Outside the Trial Balance	Given Inside the Trial Balance
Effect is at '*Two Places*'	Effect is at '*One Place*'

Manufacturing or Trading or P&L A/c Cr.

	Particulars	Amt.
	By Concerned Income	XXXX
	Less: Received in Advance	XXXX

Balance Sheet

	Liabilities	Amt.
	Income Received in Advance	XXXX

Balance Sheet

	Liabilities	Amt.
	Income Received in Advance	XXXX

Figure 6.6 *Treatment of Unearned Income when given outside and inside the Trial Balance.*

Example 13: Given below is the extract of a Trial Balance. Show how the following items will appear in the financial statements.

Extract of Trial Balance

Particulars	Amount ₹
Rent Received	21,900
Interest Received	11,000
Interest received in advance	1,000

Additional Information:

1. Rent received in advance ₹2,900.
2. Accrued interest ₹3,800.

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars		Amount
		By Rent	21,900	
		Less: Received in advance	(2,900)	19,000
		By Interest	11,000	

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities		**Current Assets**	
Insurance Outstanding	5,400		
Interest Received in Advance	2,900		

Snapshot

Manufacturing Account/Trading Account/Profit and Loss Account

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Concerned Expenses *Add:* Outstanding Expenses *Less:* Prepaid Expenses		By Concerned Income *Add:* Accrued Income *Less:* Unearned Income	

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Outstanding Expenses Unearned Income		Prepaid Expenses Accrued Income	

6. Depreciation on Fixed Assets

We know that depreciation refers to reduction in the value of the fixed Assets over a period of time. It can be due to many factors—regular use, normal wear and tear, climatic conditions, technological obsolesces, etc. Since depreciation reduces the value of the fixed Assets, hence, it is regarded as loss to a firm. Further, we know that all losses are accounted on the debit side of P&L A/c, similarly, depreciation is also shown on the debit side of P&L A/c. Let us understand the treatment of depreciation in more depth. The treatment of depreciation in Final Accounts depends on the condition whether the 'Provision for Depreciation Account' in Final Accounts is maintained or not. Accordingly, the treatment differs in each of the two cases.

(i) When a firm *does not* maintain 'Provision for Depreciation Account'
(ii) When a firm maintains 'Provision for Depreciation Account'

Table 6.12 *Treatment of Depreciation*

When Provision for Depreciation A/c is *not* Maintained	When Provision for Depreciation A/c is Maintained
Journal Entry	**Journal Entry**
Depreciation A/c Dr. To Assets A/c Profit & Loss A/c Dr. To Depreciation A/c **Effects:** 1. Depreciation amount is shown on the debit side of Profit & Loss A/c 2. Depreciation amount is deducted from the concerned Assets on the Assets side of Balance Sheet	Depreciation A/c Dr. To Provision for Depreciation A/c Profit & Loss Dr. To Depreciation A/c **Effects:** 1. Depreciation amount is shown on the debit side of Profit & Loss A/c 2. Depreciation amount is accumulated to Provision for Depreciation. The total accumulated depreciation is then subtracted from the concerned Asset on the Assets side of Balance Sheet

Treatment of Depreciation—When given inside the Trial Balance

If the amount of depreciation appears inside the Trial Balance, then it implies that related Asset in the Trial Balance is already being net of the depreciation amount. Thus, there is no need to deduct depreciation amount from the concerned Asset in the Balance Sheet. Instead, we simply show the amount of depreciation on the debit side of the Profit & Loss A/c (similar to the first part of treatment when depreciation appears outside the Trial Balance)

Conclusion—-Treatment of Depreciation when given outside and inside the Trial Balance

LET'S TAKE A PAUSE!

Important Points in Regards to Depreciation

1. If in the question, rate of depreciation is mentioned without per annum, then depreciation is charged for the whole year. For example, book-value of plant is ₹20,000 and rate of depreciation is 10%, then depreciation amount would be calculated as ₹2,000 $\left(\text{i.e. } 20{,}000 \times \frac{10}{100}\right)$
2. If the question is silent about the date of purchase of Asset, we need to assume that the Asset has been purchased in the beginning of the year. Hence, we need to charge depreciation on the whole year. For example, plant costing ₹25,000 was purchased during the year and rate of depreciation is 10% p.a. In this case, depreciation amounts to ₹2,500 $\left(\text{i.e. } 25{,}000 \times \frac{10}{100}\right)$
3. Now, if the question is silent about the date of the sale of the Assets, then as done in case of purchase, we will again assume the sale of Assets has taken place in the beginning of the year and accordingly, we would not provide for depreciation. This is because the Asset has been sold off in the beginning of the year.

Example 14: Given below is the extract of a Trial Balance. Show the treatment of depreciation in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Building	32,000	–
Provision for Depreciation on Building	–	4,800
Plant	50,000	–
Provision for Depreciation on Plant	–	13,550

***Additional Information*:** Building is to be depreciated @ 5% p.a. as per straight line method and plant is to be depreciated @ 10% p.a. as per diminishing balance method.

Solution

Depreciation A/c (***WN***)	Dr.	1,600	
To Provision for Depreciation on Building A/c			1,600
(Provision for depreciation on building made)			
Depreciation A/c (***WN***)	Dr.	3,645	
To Provision for Depreciation on Plant A/c			3,645
(Provision for depreciation on plant made)			

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Depreciation on Building	1,600		
To Depreciation on Plant	3,645		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Building	32,000	
		Less: Provision for Depreciation (4,800 + 1,600)	(6,400)	25,600
		Plant	50,000	
		Less: Provision for Depreciation (13,550 + 3,645)	(17,195)	32,805

Note 1: Depreciation on building is charged on the cost as per the straight line method.
Note 2: Depreciation on plant is charged on the diminished value as per the diminishing balance method.

***Working Note**: Calculation of Depreciation*

$$\text{On Building} = 32{,}000 \times \frac{5}{100} = 1{,}600 \qquad \text{On Plant} = (50{,}000 - 13{,}500) \times \frac{10}{100} = 3{,}645$$

Example 15: Given below is the extract of a Trial Balance. Show the treatment of depreciation in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount ₹	Credit Amount ₹
Furniture	70,000	
Building	90,000	
Depreciation on Furniture	12,500	
Depreciation on Building	10,800	
Provision for Depreciation on Building		32,400

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Depreciation on Furniture	12,500		
To Depreciation on Building	10,800		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Furniture		70,000
		Building	90,000	
		Less: Provision for Depreciation	(32,400)	57,600

Note 1: Here, depreciation on furniture is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.

Note 2: Depreciation on building is also given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not added to the amount of provision for depreciation in the Balance Sheet.

7. Amortisation of Intangible Assets

Similar to depreciation, amortisation also implies reduction in the value of the Assets. The only difference between depreciation and amortisation is that while depreciation reduces the value of *Fixed Assets* (Tangible Assets), amortisation reduces the value of *Intangible Assets* (such as goodwill, patents, trademarks, etc.). The treatment of amortisation is exactly the same to that of depreciation, i.e. shown on the debit side of P&L A/c and on other hand, shown as deduction from the value of concerned Asset/s on the Assets side of the Balance Sheet.

Treatment of* Amortisation of Intangible Assets—*When given outside the Trial Balance

Journal entry for recording amortisation

Profit and Loss A/c	Dr.
To Intangible Assets	
(Writing-off value of Intangible Asset)	

Effects:

1. Shown on the debit side of P&L Account with the amount written-off or amortised
2. Deducted from the value of the concerned Asset/s on the Assets side of Balance Sheet

Treatment of* Amortisation of Intangible Assets—*When given inside the Trial Balance

If the amount of amortisation appears inside the Trial Balance, then it implies that related Asset in the Trial Balance is already being net of the amortisation amount. Thus, there is no need to deduct amortisation amount separately from the concerned Asset in the Balance Sheet. Instead, we simply show the amount of amortisation on the debit side of the P&L A/c (similar to the first part of treatment when amortisation appears outside the Trial Balance)

Treatment of Amortisation of Intangible Assets

Given Outside the Trial Balance
Effect is at '*Two Places*'

Dr. **P&L A/c**

	Particulars	**Amt.**
	To Amortised Value	XXXX

Balance Sheet

	Assets	**Amt.**
	Intangible Asset	XXXX
	Less: Amortised Value	(XXX)
		XXX

Given Inside the Trial Balance
Effect is at '*One Place*'

Dr. **P&L A/c**

	Particulars	**Amt.**
	To Amortised Value	XXXX

Figure 6.7 *Treatment of Amortisation of Intangible Assets when given outside and inside the Trial Balance.*

Example 16: Given below is the extract of a Trial Balance. Show the treatment of following item in the Final Accounts.

Extract of Trial Balance

Particulars	**Debit Amount**
Goodwill	35,000

***Additional Information*:** Goodwill written-off during the year ₹4,500.

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Goodwill written-off	4,500		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Goodwill	35,000	
		Less: Written-off	4,500	30,500

Example 17: Given below is the extract of a Trial Balance. Show the treatment of following item in the Final Accounts.

Solution

Extract of Trial Balance

Particulars	Debit Amount ₹
Goodwill	80,000
Goodwill written-off	12,000

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Goodwill written-off	12,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Fixed Assets	
		Goodwill	80,000

Note: Here, the amount of goodwill written-off is given inside the Trial Balance. This implies that Goodwill appearing in the Trial Balance is already at its net value (i.e. after deducting the amount written-off). Therefore, goodwill written-off is shown only in the Profit and Loss A/c and not deducted from the value of goodwill in the Balance Sheet.

Example 18: Given below is the extract of a Trial Balance.

Extract of Trial Balance
as on 31 March 2017

Particulars	Debit Amount ₹
Patents	60,000

***Additional Information*:** Patents rights were purchased on 01 April 2012 for ₹1,00,000 whose expected life at that time was 10 yr. Calculate the amount of patents written-off each year and show it in the relevant accounts.

Solution

$$\text{Amount of Patents written-off} = \frac{\text{Book Value}}{\text{Remaining Life}} = \frac{60,000}{6} = 10,000$$

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Patents written-off	10,000		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Patent	60,000	
		Less: Written-off	10,000	50,000

Example 19: Given below is the extract of a Trial Balance. Show the treatment of following items in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount ₹	Credit Amount ₹
Machinery	1,80,000	
Building	2,20,000	
Goodwill	75,000	
Provision for depreciation on machinery		54,000
Salary	35,000	
Interest on Investments		14,800
Insurance	36,000	
Commission received		25,000

***Additional Information*:**

i. Salary @ ₹3,500 outstanding for 2 months.
ii. Interest accrued on investments ₹3,200.
iii. Insurance paid in advance for 3 months.
iv. Commission received in advance ₹3,000.
v. Goodwill written-off ₹15,000.
vi. Depreciate machinery @ 10% p.a. and building 8% p.a.

Solution

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars		Amt.	Particulars		Amt.
To Salary	35,000		By Interest on Investments	14,800	
Add: Outstanding Salary (3,500 × 2)	7,000	42,000	*Add*: Accrued Interest	3,200	18,000
To Insurance	36,000		By Commission	25,000	
Less: Prepaid Insurance (***WN1***)	(7,200)	28,800	*Less*: Received in advance	(3,000)	22,000
To Goodwill written-off		15,000			

(Continued)

Particulars		Amt.	Particulars	Amt.
To Depreciation on:				
Machinery	18,000			
Building	17,600	35,600		

Balance Sheet
as on…

Liabilities	Amt.	Assets		Amt.
Current Liabilities		**Fixed Assets**		
Salary Outstanding	7,000	Goodwill (75,000 – 15,000)	75,000	
Commission received in Advance	3,000	*Less*: Written-off	(15,000)	60,000
		Machinery	1,80,000	
		Less: Provision for Depreciation (54,000 + 18,000)	(72,000)	1,08,000
		Building	2,20,000	
		Less: Depreciation	(17,600)	2,02,400
		Current Assets		
		Prepaid Insurance		7,200
		Accrued Interest on Investments		3,200

Working Note*: *WN1—Calculation of Insurance Paid in Advance

Insurance paid for 15 months = ₹36,000

So, Monthly insurance = $\frac{36,000}{15}$ = ₹2,400

Advance Insurance paid for 3 months = 2,400 × 3 = ₹7,200

8. Bad Debts and Related Adjustments

Meaning and Categories of Debtors

When a business sells goods on credit to a person/party, then the latter is regarded as debtors. Debtors can be categorised as follows:

1. ***Good Debtors***—Those persons/parties from whom the receipt of amount is highly certain.
2. ***Bad Debtors***—Those persons/parties from whom amount are not recoverable or highly difficult to recover.
3. ***Doubtful Debtors***—Those persons/parties from whom receipt of amount is tentative or doubtful (i.e. they may either pay or may not pay).

Let us consider a real-life example of a fruit seller. Suppose he has in total 20 kg of apples. He found a few of the apples to be in good condition, a few about to rot and remaining are almost rotten. Accordingly, he categorises the apples and put them in three different baskets.

- *Basket-1:* This basket contains all the apples that are in good condition. Let us name this basket as Good Apples.
- *Basket-2:* This contains the apples that are in not so good condition and are slightly rotten. Let us name this basket as Doubtful Apples.
- *Basket-3:* This contains all those apples that are rotten and are to be thrown away. Accordingly, let us name this as Bad Apples.

Now, the fruit seller is highly sure about the Good Apples that the same will get sold at good price. Thus, the seller is quite certain about receiving money for these apples. On the other hand, the Doubtful Apples are quite tentative. These apples may get sold or remain unsold and are to be thrown away. Hence, the seller is doubtful about receiving money. Finally, it is very difficult to sell the Bad Apples and there is less chance of receiving money for these apples.

After understanding the meaning of debtors, let us now move to learn its adjustment in the financial statements.

8(i) Bad Debts

Bad Debts' imply amounts that are irrecoverable. Since these are hard to be recovered, so these are considered as losses to a business; hence, these debts are shown on the debit side of Profit and Loss Account.

Treatment of* Bad Debts—*When given outside the Trial Balance

Journal entry for recording bad debts

Bad Debts A/c	Dr.
To Sundry Debtors A/c	
(Charging bad debts from debtors)	
Profit and Loss A/c	Dr.
To Bad Debts A/c	
(Bad debts transferred to Profit and Loss Account)	

Effects:

1. Bad Debts amount shown on the debit side of P&L Account
2. Bad Debts amount deducted from the Debtors on the Assets side of Balance Sheet

Treatment of Bad Debts—When given inside the Trial Balance

If Bad Debts are given inside the Trail Balance, then the amount of debtors given in the question is already net of the Bad Debts. Hence, we just need to show the amount of Bad Debts only on the debit side of P&L A/c.

Treatment of Bad Debts

Given Outside the Trial Balance
Effect is at '*Two Places*'

Dr. **P&L A/c**

	Particulars	Amt.
	To Bad Debts	XXXX

Balance Sheet

	Assets	Amt.
	Debtors	XXXX
	Less: Bad Debts	XXXX
		XXXX

Given Inside the Trial Balance
Effect is at '*One Place*'

Dr. **P&L A/c**

	Particulars	Amt.
	To Bad Debts	XXXX

Figure 6.8 *Treatment of Bad Debts when given outside and inside the Trial Balance.*

Example 20: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit Amount (₹)
Debtors	32,500

***Additional Information*:**
Bad debts amounted to ₹1,250.

Solution

Bad Debts A/c	Dr. 1,250	
To Sundry Debtors A/c		1,250
Profit and Loss A/c	Dr. 1,250	
To Bad Debts A/c		1,250

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Bad Debts	1,250		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	32,500	
		Less: Bad Debts	(1,250)	31,250

Example 21: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)
Debtors	18,000
Bad debts	700

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Bad Debts	700		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Debtors	18,000

Note: *Here, Bad debts are given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.*

When Bad Debts appear *inside* and *outside* the Trial Balance

There might be instances, when Bad Debts appear at both the places—inside as well as outside the Trial Balance. In such cases, the treatment of bad debts remains the same as we have learnt in the individual cases.

- ***Old Bad Debts***—The amount of bad debt that is given inside the Trial Balance. This amount is shown only on the debit side of Profit and Loss Account.
- ***New Bad Debts or Further Bad Debts***—It is the amount of bad debt given outside the Trial Balance or in adjustments. This amount is shown on the debit side of Profit and Loss Account and on the other hand, it is deducted from the debtors on the Assets side of Balance Sheet.

Example 22: Given below is the extract of a Trial Balance. Show the treatment of bad debts in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)
Debtors	25,000
Bad Debts	1,400

***Additional Information*:** Further bad debts amounted to ₹2,000.

Solution

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Bad Debts	1,400			
Add: Further Bad Debts	2,000	3,400		

Balance Sheet

as on...

Liabilities	Amount	Assets		Amount
		Debtors	25,000	
		Less: Further Bad Debts	(2,000)	23,000

Note: Here, both old as well as new Bad debts are given in the question. New Bad debts are shown in both the accounts, whereas old Bad debts are shown only in the Profit and Loss Account and not shown in the Balance Sheet.

8(ii) Recovery of Bad Debts or Bad Debts Recovered

Sometimes, the amount that has been considered as bad debts during the earlier year/s may get recovered during the current year. As we know that bad debts are losses to a business, but when the amount gets recovered, then it becomes a gain to the business; hence, bad debts recovered are shown on the credit side of the Profit and Loss Account.

Treatment of Recovery of Bad Debts

Journal entries for recording recovery of bad debts

Cash/Bank A/c	Dr.
To Bad Debts Recovered A/c	
(Cash or Cheque received from bad debtors)	
Bad Debts Recovered A/c	Dr.
To Profit and Loss A/c	
(Bad debts so recovered transferred to P&L Account)	

Example 23: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Debtors	47,000	
Bad Debts	5,100	
Bad Debts Recovered		2,200

Additional Information: Further Bad debts amounted to ₹4,300.

Solution

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Bad Debts	5,100		By Bad Debts Recovered	2,200
Add: Further Bad Debts	4,300	9,400		

Balance Sheet

as on...

Liabilities	Amount	Assets		Amount
		Debtors	47,000	
		Less: Further Bad Debts	(4,300)	42,700

Note: Bad debts recovered is a gain for the business, therefore, it is shown on the credit side of the P&L A/c.

9. Provision or Reserve for Doubtful Debts

We know that in the case of credit sales, there is always a possibility of default in the payment (wholly or partly) by the customers. The actual irrecoverable amount from the debtors, i.e. the amount of Bad debts for the current year will be known in the next year when the debtors are actually realised. In order to cover this risk of default, it is always advisable to make provision to meet this uncertainty. In this regard, the business maintains the provision for doubtful-debts with the motive of minimising the effect of actual loss caused by the bad-debts. It is maintained at a specific rate on the amount of debtors on the basis of accounting convention of Conservatism which states that provide for all anticipated expenses or losses, but do not provide for anticipated profits or gains.

Table 6.13 *Treatment of Provision or Reserve for Doubtful Debts*

<table>
<tr><th>*When only New Provision is given*</th><th colspan="2">*When Old Provision and New Provision are given*</th></tr>
<tr><th>Case-1: (Old Provision is not given)</th><th>Case-2: Old Provision < New Provision</th><th>Case-3: Old Provision > New Provision</th></tr>
<tr><td>*Journal Entry*
P&L A/c Dr.
To Provision or Reserve for Bad and Doubtful Debts A/c
(Provision or reserve created)</td><td>*Journal Entry*
P&L A/c Dr.
To Provision or Reserve for Bad and Doubtful Debts A/c
(New Provision – Old Provision)</td><td>*Journal Entry*
Provision or Reserve for Bad and Doubtful Debts A/c Dr.
To P&L A/c
(Old Provision – New Provision)</td></tr>
<tr><td>*Steps*
1. The amount of new provision as calculated is deducted from the Good Debtors on the Asset side of Balance Sheet and the final amount is mentioned on the outer column.
2. The New Provision is shown on the *outer* column of the *debit* side of P&L A/c.</td><td>*Steps*
1. The amount of new provision as calculated is deducted from the Good Debtors on the Asset side of Balance Sheet and the final amount is mentioned on the outer column.
2. The New Provision is shown on the *inner* column of the *debit* side of P&L A/c.
Now, the amount of *Old Provision* is shown as deduction from the New Provision amount on the *debit* side and the final amount is shown on the outer column of P&L A/c.</td><td>*Steps*
1. The amount of new provision as calculated is deducted from the Good Debtors on the Asset side of Balance Sheet and the final amount is mentioned on the outer column.
2. The Old Provision is shown on the *inner* column of the *credit* side of P&L A/c.
Now, the amount of *New Provision* is shown as deduction from the *Old Provision* amount on the *credit* and the final amount in shown on the outer column of P&L A/c.</td></tr>
</table>

LET'S TAKE A PAUSE!

Always adhere to the following sequence for Bad Debts and Related Adjustments

1. **Old Bad Debts—**Always to be recorded on the debit side of P&L A/c
2. **New/Further Bad Debts—**Always to be recorded on the debit side of P&L A/c and deducted from Debtors on the Assets side of Balance Sheet
3. **New Provision for Bad and Doubtful Debts—**Always calculated on the Good Debtors (final amount of debtors after deduction of Further Bad Debts from Debtors) and is shown on the debit side of P&L A/c and as deduction from Good Debtors (i.e. Debtors – Further Bad Debts – New Provision)
4. **Old Provision for Bad and Doubtful Debts—**Shown as deduction from the New Provision on the debit side of P&L A/c (if Old Provision < New Provision) else, shown on the credit side of P&L A/c (if Old Provision > New Provision)

Example 24: From the extract of a Trial Balance given below show the treatment of provision for doubtful debts in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (₹)
Debtors	30,000

Additional Information: Create a provision for doubtful debts @ 5% on Debtors.

Solution

Profit and Loss A/c (***WN***)	Dr.	1,500	
To Provision for Bad and Doubtful Debts A/c			1,500
(Provision created for doubtful debts)			

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Provision for Doubtful Debts	1,500		

Balance Sheet

as on…

Liabilities	Amount	Assets		Amount
		Debtors	30,000	
		Less: Provision for Doubtful Debts	(1,500)	28,500

***Working Note**: Calculation of Provision for Doubtful Debts*

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 30,000 \times \frac{5}{100} = ₹1,500$$

Case 1—When Old Provision is less than the New Provision

Example 25: From the information given below show the treatment of provision for doubtful debts in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Debtors	12,500	
Provision for Doubtful Debts		900

Additional Information: Create a provision for doubtful debts @ 8% on debtors.

Solution

Profit and Loss A/c (***WN2***)	Dr.	100	
To Provision for Bad and Doubtful Debts A/c			100

Profit and Loss Account

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To New Provision for Doubtful Debts	1,000			
Less: Old Provision for Doubtful Debts	(900)	100		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	12,500	
		Less: New Provision for DD	(1,000)	11,500

Note: *In this case, old provision (i.e. ₹900) is less than the new provision (i.e. ₹1,000). Therefore, the difference of ₹100 (1,000 – 900) is recorded on the debit side of Profit and Loss A/c. Also, the new provision is deducted from the amount of debtors in the Balance Sheet.*

Working Notes: *Calculation of New Provision for Doubtful Debts*

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 12,500 \times \frac{8}{100} = ₹1,000$$

Case 2—When Old Provision is more than the New Provision

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Debtors	45,000	
Provision for Doubtful Debts		5,000

Additional Information: Create a provision for doubtful debts @ 10% on debtors.

Solution

Provision for Bad and Doubtful Debts A/c	Dr.	500	
To Profit and Loss A/c (***WN*2**)			500
(Old Provision – New Provision, i.e. 5,000 – 4,500)			

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars		Amount
		By Old Provision for DD	5,000	
		Less: New Provision for DD	(4,500)	500

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	45,000	
		Less: New Provision for DD	(4,500)	40,500

Note: *In this case, old provision (i.e. ₹5,000) is more than the new provision (i.e. ₹4,500). Therefore, the difference of ₹500 (5,000 – 4,500) is recorded on the credit side of Profit and Loss A/c. Also, the new provision of ₹4,500 is deducted from the amount of debtors in the Balance Sheet.*

Working Notes: *Calculation of New Provision for Doubtful Debts*

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 45,000 \times \frac{10}{100} = ₹4,500$$

Example 26: From the given below extract of Trial Balance show the treatment of provision for doubtful debts in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Debtors	17,500	
Bad debts	2,000	
Provision for Doubtful Debts		600

***Additional Information*:**

i. Further Bad debts amounted to ₹1,500.
ii. Create a provision for doubtful debts @ 5% on Debtors.

Solution

Profit and Loss Account
for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Bad debts	2,000			
Add: Further Bad debts	1,500			
Add: New Provision for Doubtful Debts	800			
Less: Old Provision for Doubtful Debts	(600)	3,700		

Balance Sheet
as on...

Liabilities	Amount	Assets		Amount
		Debtors	17,500	
		Less: Further Bad debts	(1,500)	
		Less: New Provision for DD	(800)	15,200

Working Note: *Calculation of Provision for Doubtful Debts*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= (17,500 - 1,500) \times \frac{5}{100} = ₹800$$

Example 27: From the extract of the Trial Balance given below show the treatment of provision for doubtful debts in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Debtors	8,000	
Bad debts Recovered		1,100
Provision for Doubtful Debts		550

Additional Information:

i. Further Bad debts amounted to ₹1,350.

ii. Create a provision for doubtful debts @ 12% on debtors.

Solution

Profit and Loss Account
for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Further Bad Debts	1,350		By Bad Debts Recovered	1,100
Add: New Provision for DD	798			
Less: Old Provision for DD	(550)	1,598		

Balance Sheet
as on...

Liabilities	Amount	Assets		Amount
		Debtors	8,000	
		Less: Further Bad Debts	(1,350)	
		Less: New Provision for DD	(798)	5,852

Working Note: *Calculation of Provision for Doubtful Debts*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= (8,000 - 1,350) \times \frac{12}{100} = ₹798$$

From the above examples the following can be concluded:
Old Bad debts and Old Provision are never shown in the New Balance Sheet. Only Further Bad debts and New Provision are shown in the New Balance Sheet.

10. Provision for Discount on (Good) Debtors

Normally, a business allows discount to its good debtors for encouraging them to make early payments or payments on time. For instance, 10% discount is allowed to all those debtors who pay their dues on time. This would encourage the debtors to make payment on time in order to avail the 10% discount (as they need to pay only ₹9,000 instead of ₹10,000). This is an expense to the business, therefore, is shown on the debit side of the Profit and Loss Account. It should be noted that provision for discount on debtors is always calculated on the Net Good Debtors (i.e. Gross Debtors − Further Bad Debts − New Provision for Bad and Doubtful Debts).

Treatment of Provision for Discount on (Good) Debtors

The following journal entry is passed for provision for discount of debtors

Profit and Loss A/c	Dr.
To Provision for Discount on Debtors A/c	
(Provision for discount created on good debtors)	

Effects:

1. It is shown on the debit side of the Profit and Loss Account.
2. It is deducted from the amount of Net Good Debtors in the Balance Sheet.

Steps to Calculate Amount of Provision for Discount on Debtors

1. Show Further Bad Debts on the debit side of P&L A/c and deduct it from the Gross Debtors on the Assets side of Balance Sheet to compute Good Debtors.
2. Calculate New Provision on Bad and Doubtful Debts at the given rate on the Good Debtors.
3. The New Provision is then shown as deduction from the Good Debtors amount (i.e. Gross Debtors − Further Bad Debts − New Provision for Bad and Doubtful Debts). This final amount after deduction is our Net Good Debtors.
4. Now, Provision for Discount is calculated on this Net Good Debtors amount at the rate given in the question.

Extract of Balance Sheet

Liabilities	Amt. (₹)	Assets		Amt. ₹
		Gross Debtors (from Trial Balance)	20,000	
		Less: Further Bad debts	3,000	
			17,000	Good Debtors
		Less: New Provision for Doubtful Debts @ 10%	1,700	
			15,300	Net Good Debtors
		Less: Provision for Discount on Debtors @ 5%	765	14,535

Example 28: From the information given below, calculate the amount of provision for discount on debtors. Also show the relevant items in the Final Accounts.

Extract of Trial Balance

Particulars	Debit (₹)	Credit (₹)
Debtors	72,000	
Bad debts	5,400	
Provision for Doubtful Debts		3,500

Additional Information:

i. Further Bad debts amounted to ₹6,200.
ii. Provision for doubtful debts is to be maintained @10% on Debtors.
iii. Create a provision for discount on debtors @ 5%.

Solution

Calculation of Provision for Discount on Debtors

$$\text{Provision for Discount on Debtors} = \text{Amount of Net Good Debtors} \times \frac{\text{Rate}}{100} = 59,220 \times \frac{5}{100} = ₹2,961$$

Calculation of Amount of Net Good Debtors

Debtors	72,000
Less: Further Bad debts	(6,200)
Good Debtors	65,800
Less: New Provision for Doubtful Debts*	(6,580)
Amount of Net Good Debtors	**59,220**

Profit and Loss Account

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Bad Debts	5,400			
Add: Further Bad debts	6,200			
Add: New Provision for Doubtful Debts	6,580			
Less: Old Provision for Doubtful Debts	(3,500)	14,680		
To Provision for Discount on Debtors		2,961		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	72,000	
		Less: Further Bad debts	(6,200)	
		Less: New Provision for DD	(6,580)	
		Less: Provision for Discount on Debtors	(2,961)	56,259

Note 1: *Provision for doubtful debts* is created on the debtors after deducting the amount of further bad debts.

Note 2: *Provision for discount on debtors* is created on the amount of good debtors, i.e. after deducting the amount of further bad debts and also the new provision for doubtful debts.

Example 29: From the information given below, calculate the amount of provision for discount on debtors. Also show the relevant items in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount	Credit Amount
Debtors	24,000	
Less: Provision for Doubtful Debts		1,500

Additional Information:

i. Create Provision for doubtful debts @ 8%.

ii. Create Provision for discount on debtors @ 3%.

Solution

$$\text{New Provision for Doubtful Debts} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100} = 24,000 \times \frac{8}{100} = ₹1,920$$

Calculation of Provision for Discount on Debtors

$$\text{Provision for Discount on Debtors} = \text{Amount of Net Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= 22{,}080 \times \frac{3}{100} = ₹662 \text{ (approx.)}$$

Calculation of Amount of Good Debtors

Debtors	24,000
Less: New Provision for Doubtful Debts	(1,920)
Amount of Good Debtors	**22,080**

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Provision for Doubtful Debts (1,920 − 1,500) (New Provision − Old Provision)	420		
To Provision for Discount on Debtors	662		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	24,000	
		Less: New Provision for DD	(1,920)	
		Less: Provision for Discount on Debtors	(662)	21,418

Note: Here, further Bad debts are not given. Therefore, provision for discount on debtors is created after deducting only new provision for doubtful debts.

11. Provision for Discount on Creditors

As a business allows discount to its debtors, similarly, the business may receive discount from its creditors in order to make or clear its dues on time. Such discounts are normally availed on the credit purchases made during the present year and the payment to be made in the near future. Hence, by nature such discounts are expected gains to the business. Accordingly, the provision for discount on creditors is shown on the credit side of the Profit & Loss A/c.

Treatment

The following Journal entry is passed for creation of provision for discount on creditors.

Provision for Discount on Creditors A/c	Dr.
To Profit and Loss A/c	
(Provision created for discount on creditors)	

Effects:

1. It is shown on the credit side of the Profit and Loss Account
2. It is deducted from the amount of creditors on the Liabilities side of the Balance Sheet

Example 30: Show the treatment of the following items in the Final Accounts.

Extract of Trial Balance

Particulars	Debit (₹)	Credit (₹)
Debtors	62,000	
Creditors		47,000
Bad Debts	2,000	
Provision for Doubtful Debts		1,500
Bad Debts Recovered		2,500

***Additional Information*:**

i. Further bad debts amounted to ₹4,000.
ii. Provision for doubtful debts is to be maintained @ 5% on Debtors.
iii. Create a provision for discount on debtors @ 10%.
iv. Discount on creditors @ 2%

Solution

Profit and Loss Account
for the year ended...

Dr. **Cr.**

Particulars		Amt.	Particulars	Amt.
To Bad Debts	2,000		By Bad Debts Recovered	2,500
Add: Further Bad Debts	4,000		By Provision for Discount of Creditors	940
Add: New Provision for DD	2,900			
Less: Old Provision for DD	(1,500)	7,400		
To Provision for Discount on Debtors		5,510		

Balance Sheet
as on...

Liabilities		Amount	Assets		Amount
Creditors	47,000		Debtors	62,000	
Less: Provision for Discount on Creditors	(940)	46,060	*Less*: Further Bad Debts	(4,000)	58,000
			Less: New Provision for DD	(2,900)	
			Less: Provision for Discount on Debtors	(5,510)	49,590

Working Notes: WN1—*Calculation of New Provision for Doubtful Debts*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= (62,000 - 4,000) \times \frac{5}{100} = ₹2,900$$

***WN2**: Calculation of Provision for Discount on Debtors*

$$\text{Provision for Discount on Debtors} = \text{Amount of Net Good Debtors} \times \frac{\text{Rate}}{100} = 55{,}100 \times \frac{10}{100} = ₹5{,}510$$

Calculation of Amount of Good Debtors

Debtors	62,000
Less: Further Bad Debts	(4,000)
Less: New Provision for Doubtful Debts	(2,900)
Amount of Good Debtors	**55,100**

12. Abnormal Losses—Loss of Fixed Assets and Loss of Goods

As we know that future is uncertain and it is beyond human capabilities to foresee future conditions with certainty. There can be situations such as fire, theft, accidents, natural calamities (earthquake, floods, etc.) which lead a business to face losses in terms of damage of Assets and goods. Since such losses cannot be predicted or foreseen, such losses are termed as accidental losses or abnormal losses. At this point, let us separate abnormal losses into following two categories.

(i) Loss of Fixed Assets
(ii) Loss of Goods

12(i) Loss of Fixed Assets

The damage caused to the business Assets due to fire, earthquake and accidents leads to loss of value of fixed Assets.

Treatment of Loss of Fixed Assets

1. The amount of loss of fixed Assets is shown on the debit side of the Profit and Loss Account
2. The amount lost is deducted from the value of concerned fixed Assets on the Assets side of the Balance Sheet.

Example 31: A business had furniture worth ₹52,000. During the year, furniture of ₹17,500 burnt due to fire. Show the loss in the value of furniture in the books of the firm.

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Loss of Furniture	17,500		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Furniture	52,000	
		Less: Loss of Furniture	(17,500)	34,500

12(ii) Loss of Goods

'Goods' refers to the product which a business deals in. It can be raw material, semi-finished product and finished products. For instance, a furniture manufacturing firm produces furniture using machines. In this case, furniture is the good and the machines are the Assets to the firm. The loss of goods is recorded on the credit side (as it reduces the amount of stock of goods with the business) of Manufacturing Account or Trading Account, whereas, on the other hand, it is recorded on the debit side of Profit & Loss Account (as it is a loss to the business).

Treatment of Loss of Goods

The following Journal entry is passed to record the loss of goods.

Loss of Goods A/c	Dr.
To Manufacturing A/c or Trading A/c	
(Loss of goods recorded in Manufacturing or Trading A/c)	
Profit & Loss A/c	Dr.
To Loss of Goods A/c	
(Loss of Goods transferred to Profit & Loss A/c)	

From the previous experiences, a business always takes up an insurance policy to mitigate or to reduce the amount of losses due to such unforeseen conditions. Accordingly, in an event of loss of goods, a business may face the following two conditions.

a. No Insurance Policy
b. Existence of Insurance Policy
   - Insurance Company admits 100% of loss claimed by business
   - Insurance Company admits *part* of loss claimed by business

a. **Loss of Goods and No Insurance Policy Exists**

In this case, since there is no insurance policy, hence the whole loss is to be borne by the firm. The same (as above) journal entries are passed with the whole amount of goods so lost.

<table>
<tr><th>Journal Entries</th><th colspan="4">Effects</th></tr>
<tr><td rowspan="2">Loss of Goods A/c Dr.
To Manufacturing A/c or Trading A/c</td><td colspan="4">Dr. Manufacturing or Trading A/c Cr.</td></tr>
<tr><td></td><td></td><td>By Loss of Goods A/c</td><td>XX</td></tr>
<tr><td rowspan="2">P&L A/c Dr.
To Loss of Goods A/c
(Loss of Goods transferred to P&L A/c)</td><td colspan="4">Dr. Profit and Loss A/c Cr.</td></tr>
<tr><td>To Loss of Goods A/c</td><td>XX</td><td></td><td></td></tr>
</table>

b. **Existence of Insurance Policy**

- ***Loss of Goods and Insurance Company admits the 100% claim***

If in case, the claim made by the business for loss gets admitted by the insurance company to the whole amount, then it is no more a loss to the firm. This is because the business is being compensated for the loss. Thus, we would not be showing the loss on the debit side of P&L A/c as did earlier. However, there has been reduction in the value of goods because of this loss; thus, on the credit side of Manufacturing or Trading Account we will be showing the Loss of Goods Account.

Further, on the Assets side of the Balance Sheet, we will be showing the insurance claim so receivable from the insurance company (as it is income that is yet to be received).

Journal Entries		**Effects**			
Loss of Goods A/c	Dr.	**Dr.**	**Manufacturing or Trading A/c**		**Cr.**
To Manufacturing A/c or Trading A/c				By Loss of Goods A/c	XX
Insurance Claim Due A/c	Dr.				
To Loss of Goods A/c		**Balance Sheet**			
				Current Assets	
				Insurance Claim Due	XX

- ***Loss of Goods and Insurance Company admits the claim partly***

Depending on the situation and terms and conditions of insurance company, it might happen that the insurance company only admits a part of the loss claimed by the business. For instance, suppose due to fire, a business lost goods worth ₹10,000. The insurance company admits the claim only to the extent of 70% (i.e. ₹7,000). Let's follow the three points below for this case.

i. Overall Loss (or Goods Lost)—₹10,000
ii. Net Loss (Difference between the goods lost and insurance claim admitted)—₹3,000 (10,000 – 7,000)
iii. Amount compensated by insurance company—₹7,000

Journal Entries		**Effects**			
Loss of Goods A/c	Dr.	**Dr.**	**Manufacturing or Trading A/c**		**Cr.**
To Manufacturing A/c or Trading A/c				By Loss of Goods A/c	10,000
Insurance Claim Due A/c	Dr	**Dr.**	**Profit and Loss A/c**		**Cr.**
P&L A/c	Dr.	To Net Loss of Good (10,000 – 7,000)	3,000		
To Loss of Goods A/c					
(Net loss of Goods transferred to P&L A/c)		**Balance Sheet**			
				Current Assets Insurance Claim due	7,000

Example 32: The stock of goods worth ₹1,40,000 was destroyed due to fire which were insured by an insurance company. Record the amount of goods lost in the Final Accounts under different situations given below. Also pass the necessary Journal entries.

i. If insurance company does not accept the claim of goods lost
ii. If insurance company accepts claim of only 65% of goods lost
iii. If insurance company accepts the full claim of goods lost

Solution

Case i *—If insurance company does not accept the claim of goods lost*

Goods lost by Fire A/c	Dr.	1,40,000	
To Trading A/c			1,40,000
(Goods lost due to fire)			
Profit and Loss Account	Dr.	1,40,000	
To Goods Lost by Fire A/c			1,40,000
(Goods lost due to fire transferred to Profit and Loss Account)			

Trading Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		By Goods lost by fire	1,40,000

Profit and Loss Account

Dr. **Cr.**

Solution	Amount	Particulars	Amount
To Goods lost by fire	1,40,000		

Case ii*—If insurance company accepts claim of only 65% of goods lost*

Goods lost by Fire A/c	Dr.	1,40,000	
To Trading A/c			1,40,000
(Goods lost due to fire)			
Insurance Company A/c	Dr.	91,000	
Profit and Loss Account	Dr.	49,000	
To Goods Lost by Fire A/c			1,40,000
(65% of claim accepted by Insurance Co. and remaining loss transferred to Profit and Loss Account)			

Trading Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		By Goods lost by Fire	1,40,000

Profit and Loss Account

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Goods lost by Fire	1,40,000			
Less: Claim Received	(91,000)	49,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets	
		Claim due from Insurance Co.	91,000

***Case iii**—If insurance company accepts the full claim of goods lost*

Goods lost by Fire A/c	Dr.	1,40,000	
To Trading A/c			1,40,000
(Goods lost due to fire)			
Insurance Claim Due A/c	Dr.	1,40,000	
To Goods Lost by Fire A/c			1,40,000
(100% claim accepted by Insurance co.)			

Trading Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		By Goods lost by Fire	1,40,000

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets	
		Claim due from Insurance Co.	1,40,000

13. Goods Withdrawn by the Proprietor for Personal Use

Often, the proprietor may withdraw goods from the business for his/her personal use. Such withdrawals of goods from the business are termed as drawings. Since drawings reduce the amount of stock of goods with the business, so drawings are deducted from the Purchases on the debit side of the Trading Account. On the other hand, drawings are deducted from the Capital balance on the Liabilities side of the Balance Sheet.

Treatment of Drawings (in Goods)

The following Journal entry is passed to record drawings made in goods.

Drawings A/c	Dr.
To Purchases A/c	
(Goods withdrawn by the proprietor for his/her personal use)	

Effects:

1. Deducted from the purchases on the debit side of the Trading Account.
2. Deducted from the Capital on the Liabilities side of the Balance Sheet.

Example 33: Given below is the extract of Trial Balance. Show the treatment of goods withdrawn for personal use in the Final Accounts. Also pass the necessary Journal entry.

Trial Balance

Particulars	Debit ₹	Credit ₹
Purchases	74,000	
Capital		1,55,000

Additional Information: Goods worth ₹22,000 withdrawn by proprietor for personal use.

Solution

Drawings A/c Dr.	22,000	
To Purchases A/c		22,000
(Goods withdrawn for personal use)		

Trading Account

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Purchases	74,000			
Less: Drawings of Goods	(22,000)	52,000		

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	1,55,000			
Less: Drawings of Goods	(22,000)	1,33,000		

14. Goods Distributed as Free Samples

Often, we have seen bundled offers and free samples with the products we purchase. For example, a mini pack face cream being distributed as free sample on the purchase of soap bar. The free samples are distributed basically for promoting and advertising the product. Since distribution of such samples reduces the amount of stock with the business, hence, free samples are deducted from the Purchases on the debit side of the Trading Account. On the other hand, we show the free samples on the debit side of P&L A/c as 'Advertisement Expense'.

Treatment of Free Samples (in Goods)

The following Journal entry is passed to record distribution of free samples.

Advertisement Expense A/c Dr.
To Purchases A/c
(Goods distributed as free samples)

Effects:

1. It is deducted from the Purchases on the debit side of the Trading Account.
2. It is shown on the debit side of the Profit and Loss Account as 'Advertisement Expense'.

Example 34: Show the treatment of the following items in the Final Accounts.

Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Purchases	90,000	
Capital		1,65,000

Additional Information:

i. Goods worth ₹3,100 withdrawn by the proprietor for his personal use.
ii. Goods distributed as free samples worth ₹7,800
iii. Goods lost by fire ₹15,000. The Insurance Company accepts the claim of only ₹7,000.

Solution

Trading Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Purchases	90,000		By Goods lost by Fire	15,000
Less: Drawings of goods	(3,100)			
Less: Free Samples	(7,800)	79,100		

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Advertisement (Free Samples)		7,800		
To Goods lost by fire	15,000			
Less: Insurance claim accepted	7,000	8,000		

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	1,65,000		Claim due from Insurance Co.	7,000
Less: Drawings of Goods	(3,100)	1,61,900		

15. Goods Given as Charity/Donation

As a part of Social Responsibility, firms donate some amount of goods as charity or donation to underprivileged and weaker sections of society. Since such charities or donations reduce the amount of goods available with the firms, so we deduct donated goods from Purchases A/c on the debit side of Trading Account. On the other hand, such charities are treated as an expense to the firm, so accordingly, we show them on the debit side of the P&L Account.

Treatment of Charity/Donation (in Goods)

The following Journal entry is passed to record distribution of goods as charity or donation.

Charity A/c	Dr.
To Purchases A/c	
(Goods distributed as charity)	

Effects:

1. It is deducted from the Purchases on the debit side of the Trading Account.
2. It is shown on the debit side of the Profit and Loss Account as 'Charity/Donation'.

Example 35: Given below is the extract of a Trial Balance. Show the treatment of following items in the Final Accounts.

Trial Balance

Particulars	Debit (₹)	Credit (₹)
Purchases	1,35,500	
Capital		2,20,000

Additional Information:

i. Goods worth ₹15,500 withdrawn for personal use.
ii. Goods worth ₹11,200 given as charity.
iii. Goods worth ₹21,000 distributed as free samples.
iv. Goods destroyed by fire worth ₹34,000. Insurance Claim received ₹19,000.

Solution

Trading Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Purchases	1,35,500		By Goods Lost by Fire	34,000
Less: Drawings of Goods	(15,500)			
Less: Goods given as Charity	(11,200)			
Less: Free Samples	(21,000)	87,800		

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
To Charity		11,200		
To Advertisement		21,000		
To Goods Lost by Fire	34,000			
Less: Insurance Claim	(19,000)	15,000		

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	2,20,000		Claim due from Insurance Co.	19,000
Less: Drawings of Goods	(15,500)	2,04,500		

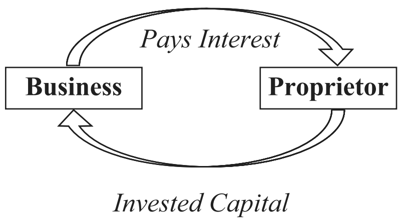
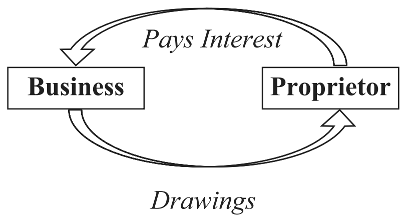
16. Interest on Capital

We know that as per Business Entity concept, a proprietor is different or separate from the business. As per this concept, a proprietor lends amount in form of capital to the business to initiate the business operations. This implies that a proprietor actually foregoes the interest earnings on the amount of capital so invested in the business (that he would have earned if he would have invested the capital amount in some other investment opportunity). Thus, a proprietor is compensated for investing the amount of capital in the business by way of providing interest on capital by the business. This interest amount is an income for the proprietor whereas it is an expense for the business.

17. Interest on Drawings

By the term 'drawings', we mean the amount of cash or goods that has been withdrawn by the proprietor from the business for his/her personal use. It represents the amount of cash or goods that remained out of the business till the moment the proprietor returns it back to the business. For this period of time, the business charges interest on the amount of drawings, which is payable by the proprietor to the business. Hence, interest on drawings is an expense for the proprietor, whereas, it is an income for the business. Let us now understand the treatment of interest on capital and interest on drawings simultaneously from the Table 6.14.

Table 6.14

Basis	Interest on Capital	Interest on Drawings
Meaning	Interest payable by the business to the proprietor on the amount of capital invested in the business  	Interest payable by the proprietor to the business on the amount of drawings 
From Business's point of view	Expense	Income
Journal Entry	Interest on Capital A/c Dr. To Capital A/c	Drawings A/c Dr. To Interest on Drawings A/c
Treatment when given ***outside*** the Trial Balance	**Effects:** It is shown on the debit side of P&L A/c It is added to Capital amount on Liabilities side in the Balance Sheet	**Effects:** It is shown on the credit side of P&L A/c It is deducted from Capital amount on Liabilities side in the Balance Sheet
Treatment when given ***inside*** the Trial Balance	**Effects:** It is shown on the debit side of P&L A/c	**Effects:** It is shown on the credit side of P&L A/c

Example 36: Given below is extract of a Trial Balance. Show the treatment of interest on capital in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit (₹)	Credit (₹)
Capital		1,80,000

Additional Information: Interest on capital to be allowed at 10% p.a.

Solution

Interest on Capital A/c Dr.	18,000	
To Cap]ital A/c		18,000
(Interest provided on capital)		

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Interest on Capital	18,000		

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	1,80,000			
Add: Interest on Capital	18,000	1,98,000		

Working Note: *Calculation of Interest on Capital*

$$\text{Interest on Capital} = 1{,}80{,}000 \times \frac{10}{100} = ₹18{,}000$$

Example 37: Given below is the extract of a Trial Balance. Show the treatment of interest on capital in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital		2,46,000
Interest on Capital	22,500	

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Interest on Capital	22,500		

Balance Sheet

Liabilities	Amount	Assets	Amount
Capital	2,46,000		

Note: Here, interest on capital is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not added again to the capital in the Balance Sheet.

Example 38: Given below is the extract of a Trial Balance. Show the treatment of interest on drawings in the Final Accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital		1,25,000
Drawings	42,000	

***Additional Information*:** Interest on drawings is charged ₹5,000.

Solution

Drawings A/c	Dr.	5,000	
To Interest on Drawings A/c			5,000
(Interest charged on drawings)			

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		By Interest on Drawings	5,000

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	1,25,000			
Less: Drawings	(42,000)			
Less: Interest on Drawings	(5,000)	78,000		

Example 39: Following is the extract of a Trial Balance. Show the treatment of interest on drawings in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital		2,12,000
Drawings	19,000	
Interest on Drawings		2,200

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		By Interest on Drawings	2,200

Balance Sheet

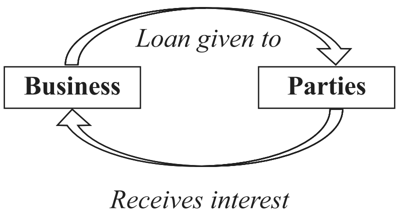
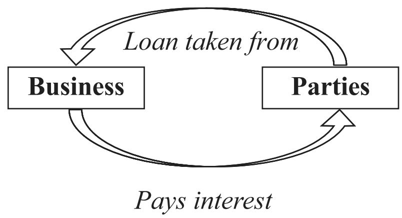
Liabilities		Amount	Assets	Amount
Capital	2,12,000			
Less: Drawings	(19,000)	1,93,000		

Note: Here, interest on drawings is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not deducted from capital in the Balance Sheet.

18. Interest on Loan

It can be observed that in a Trial Balance, loan appears on either side of the balances—debit as well as credit balance. Accordingly, it denotes two different meaning. If loan appears as debit balance, then it denotes loan granted by the business to the outside parties. In such a case, the business is entitled to receive interest on the loan amount so granted. On the contrary, there might be cases, where loan appears as credit balance. This implies loan taken by the business from the outside parties. This would imply that the business needs to pay interest amount on the loan so taken. Let us understand the two cases in detail from Table 6.15.

Table 6.15

<table>
<tr><th>Basis</th><th>Interest on Loan (granted)</th><th>Interest on Loan (taken)</th></tr>
<tr><td>Meaning</td><td>Interest is receivable by the business from the outside parties for the loan given to them

</td><td>Interest payable by the proprietor to the outside business on the amount of loan taken from them

</td></tr>
<tr><td>From Business's point of view</td><td>Loan given is an Asset for the business
and
Interest received on loan given is income</td><td>Loan taken is a liability for the business
and
Interest paid on loan taken is expense</td></tr>
<tr><td>Journal Entry</td><td>Interest Receivables A/c Dr.
To Interest on Loan A/c</td><td>Interest on Loan A/c Dr.
To Outstanding Interest A/c</td></tr>
<tr><td>Treatment when given outside the Trial Balance</td><td>Effects:
1. It is shown on the credit side of P&L A/c
2. It is added to Loan given on the Assets side of the Balance Sheet</td><td>Effects:
1. It is shown on the debit side of P&L A/c
2. It is added to Loan taken on the Liabilities side of the Balance Sheet</td></tr>
<tr><td>Treatment when given inside the Trial Balance</td><td>Effect:
1. Interest is shown on the credit side of P&L A/c</td><td>Effect:
1. Interest is shown on the debit side of P&L A/c</td></tr>
</table>

Example 40: Given below is an extract of a Trial Balance. Show the treatment of interest on loan in the Final Accounts. Also pass the adjusting Journal entries.

Extract of Trial Balance

Particulars	Debit (₹)	Credit (₹)
Loan from Bank @ 8% p.a.		1,20,000
Loan to Mr. A @ 10% p.a.	80,000	

Solution

Interest on Loan Taken A/c	Dr.	9,600	
To Outstanding Interest A/c			9,600
(Interest on loan provided)			
Interest Receivable A/c	Dr.	8,000	
To Interest on Loan Given A/c			8,000
(Interest on loan charged)			

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Interest on loan taken	9,600	By Interest on loan given	8,000

Balance Sheet

Liabilities		Amount	Assets		Amount
Loan from Bank	1,20,000		Loan to Mr. A	80,000	
Add: Interest on loan	9,600	1,29,600	*Add*: Interest on loan	8,000	88,000

Example 41: Given below is the extract of a Trial Balance. Show the treatment of interest on loan in the Final Accounts.

Extract of Trial Balance

Particulars	Debit (₹)	Credit (₹)
Bank Loan		2,35,000
Loan Given	1,68,000	
Interest on Loan (Dr.)	13,500	
Interest on Loan (Cr.)		9,200

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Interest on Loan	13,500	By Interest on Loan	9,200

Balance Sheet

Liabilities	Amount	Assets	Amount
Bank Loan	2,35,000	Loan Given	1,68,000

Note: Here, both—interest on loan taken and interest on loan granted— are given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.

Example 42: Given below is the extract of a Trial Balance. Show the treatment of the following items in the Final Accounts.

Extract of Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital		2,50,000
Drawings	95,000	
Loan to Wife	50,000	
Loan from Bank		1,60,000

***Additional Information*:**

i. Interest on capital provided @ 8% p.a.
ii. Interest on drawings charged ₹7,800.
iii. Interest on Bank Loan ₹12,500.
iv. Interest receivable on loan given to wife ₹3,500.

Solution

Profit and Loss Account

for the year ended...

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Interest on Capital @ 8%	20,000	By Interest on Drawings	7,800
To Interest on Bank Loan	12,500	By Interest on Loan to Wife	3,500

Balance Sheet

as on...

Liabilities		Amount	Assets		Amount
Capital	2,50,000		Loan to Wife	50,000	
Add: Interest on Capital	20,000		*Add*: Interest	3,500	53,500
Less: Drawings	(95,000)				
Less: Interest on Drawings	(7,800)	1,67,200			
Bank Loan	1,60,000				
Add: Interest	12,500	1,72,500			

19. Adjustments Related to Rectification of Errors

i. ***Unrecorded Purchases***—Purchases imply purchases of goods in which a trader deals in. For instance, purchase of ply, nails, logs of woods, etc. by a carpenter. In case of unrecorded purchases, the accountant forgot to record the transaction in the books of account. Hence, the given Trial Balance depicts an incomplete picture. Thus, in order to rectify this error of omission, we need to record this transaction in the books of account. For this purpose, we will add the amount of purchases in the Purchases Account on the debit side of Trading Account. On the other hand, we add the same amount to the Creditors on the Liabilities side of Balance Sheet. The following rectifying entry is passed.

Purchases A/c Dr.
    To Creditors A/c

ii. ***Unrecorded Sales***—Sales imply sales of goods in which a trader deals in. For instance, sale of furniture by a carpenter. In order to rectify unrecorded sales, we need to record the entry in the books of account by passing the following entry.

Debtors A/c Dr.
  To Sales A/c

In the Final Account, we first add the amount of unrecorded sales to the sales amount on the credit side of Trading Account and on the other hand, we add the same amount to the Debtors Account on the Assets side of the Balance Sheet.

It should be noted that in case, we have to calculate provision (new) for doubtful debts, then it should be calculated on the new balance of good debtors, i.e. after addition of unrecorded sales amount to the debtors.

iii. ***Capital Expenditure wrongly treated as Revenue Expense***—We know that capital expenditure denotes the expenditure incurred on acquiring Fixed Assets or building up new Assets. On the other hand, revenue expenses denote the amount spent on recurring needs (for example, maintenance of Fixed Assets). The mentioned below are a few cases, where capital expenditure has been mistakenly considered as revenue expense.

a. *Machinery installation charges wrongly included in wages*: The amount spent on the installation of machinery is a capital expenditure and therefore should be added to the original cost of machinery. However, instead of doing this treatment, the installation charges have been wrongly added in the Wages Account. Thus, in order to rectify this error, we will deduct the installation charges from the wages on the debit side of Manufacturing or Trading Account and the same amount will be added to the Machinery Account on the Assets side of the Balance Sheet.

Example 43: The given below is an extract of a Trial Balance.

Extract of Trial Balance

Particulars	Debit Amount (₹)
Plant	2,00,000
Wages	20,000

Additional information: Plant costing ₹50,000 was purchased on 30 September 2016. Wages of ₹2,000 spent on its installation were mistakenly debited to the Wages Account. Depreciation on plant is charged @ 10% p.a. and the books of accounts are closed on December 31 every year. Show how the above error will be rectified and treated in the Final Accounts.

Solution

Trading Account

Dr.

Particulars		Amt.
To Wages	20,000	
Less: Installation of Plant	(2,000)	18,000

Profit & Loss Account

Dr.

Particulars		Amt.
To Depreciation		
On ₹1,50,000	15,000	
On ₹52,000 (for *3 months*)	1,300	18,300

a.

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Plant		
		Opening Balance	2,00,000	
		Add: Wages	2,000	
		Total	2,02,000	
		Less: Depreciation	(18,300)	1,83,700

b. *Expenditure incurred on construction of building wrongly debited to Purchases Account*: The amount spent on construction of building is a capital expenditure; hence, it should be included in the Building Account. However, this amount has been wrongly treated as purchases of goods and accordingly has been considered in the purchases. In order to rectify this error, we will add the construction expenditure to the Building Account on the Assets side of the Balance Sheet and deduct the same amount from Purchases Account on the debit side of Trading Account.

Example 44: On 31 March 2017, the value of Building and Purchases of Natraj Ltd. was as follows.

Building	₹4,00,000
Purchases	₹1,50,000

***Additional information*:** ₹20,000 spent on the purchase of goods for the construction of the Building had been wrongly debited to the Purchases Account. Show how the error is rectified and recorded in the Final Accounts.

Solution

Trading Account

Dr.

Particulars		Amount
To Purchases	1,50,000	
Less: Purchased for construction of Building	(20,000)	1,30,000

Balance Sheet

Assets		Amount
Fixed Assets		
Building	4,00,000	
Add: Goods purchased for construction	20,000	4,20,000

iv. ***Revenue Expenses wrongly treated as Capital Expenditure***—This is in contrary to the above case. Let us revisit the above examples.

a. *Wages wrongly included machinery installation charges*: In order to rectify this error, we will add the amount to the Wages Account on the debit side of Manufacturing or Trading Account and the same amount will be deducted from the Machinery Account on the Assets side of the Balance Sheet.

b. *Purchases wrongly included in purchase of construction material for building*: In order to rectify this error, we will add amount to the Purchases Account on the debit side of Manufacturing or Trading Account and will deduct the same amount from Building Account on the Assets side of the Balance Sheet.

v. ***Sales of Assets wrongly treated as Sales***—Sales of Assets are capital receipts to a business, whereas, sales are revenue receipts. Hence, if sale of Asset is wrongly treated as sales, then in this case, capital receipts have been mistakenly considered as revenue receipts. In order to rectify this mistake, we will deduct the amount from the Sales Account on the credit side of the Trading Account and on the other hand, the same amount will be deducted from the Asset Account (say Machinery Account) in the Balance Sheet.

20. Bill Receivable Dishonoured but no Entry was made in the Books of Accounts

Dishonour of bill receivable means that failure of payment or encashment of bill receivables. In case of dishonour of bill receivables, the obligation of debtor to make payment arises. Thus, in order to record this event in the books of account, we need to add the bill receivables amount to the debtors amount on the Assets side and we will be deduct the same amount from bill receivables on the Assets side of the Balance Sheet. The following adjusting entry is passed in case of dishonour of a bill receivable.

Debtors A/c Dr.
To Bill Receivables A/c

Example 45: The following is an extract of the Balance Sheet of M/s Rajesh as on 31 March 2017.

Assets	Amount (₹)
Debtors	80,000
Bills Receivable	40,000

Additional information: On the last day of the year, it was discovered that a bill of ₹5,000 was dishonoured and no entry was passed in the books. Show the accounting treatment in case of such omission.

Solution

Balance Sheet

Liabilities	Amount	Assets		Amount
		Current Assets		
		Debtors	80,000	
		Add: Bill Dishonoured	5,000	85,000
		Bills Receivable	40,000	
		Less: Bill Dishonoured	(5,000)	35,000

21. Bill Payable Dishonoured but no Entry was made in the Books of Accounts

When a bill payable gets dishonoured, it means that the business fails to meet its obligation to pay to its creditors. Thus, to record this event, we pass the following adjusting entry.

Bill Payables A/c Dr.
To Creditors A/c

In the Final Accounts, we will deduct the dishonoured Bill Payables amount from Bills Payable and the same amount will be added to the Creditors Account on the Liabilities side of the Balance Sheet.

Example 46: Fatafat Namkeen—a leading manufacturing firm producing snacks. Consider the following information to prepare Manufacturing Account for the firm, if total packets produced are 15,000 packets.

Particulars	Amount (₹)
Opening Stock of Work-in-Process	₹30,000
Purchases during the year	₹2,00,000
Opening Stock of Raw Materials	₹33,000
Closing Stock of Raw Materials	₹28,000
Factory Rent	₹40,000
Direct Wages	₹30 per packet
Repairs and Maintenance	₹43,000
Closing Stock of Work-in-Process	₹15,000
Sale of scrap	₹53,000

Solution

Manufacturing Account

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		30,000	Closing Work-in-Process	15,000
To Raw Material Consumed:			By Sale of Scrap	53,000
Opening Stock	33,000		By Cost of goods manufactured	7,00,000
Add: Purchases	2,00,000		(*balancing figure*)	
Less: Closing Stock	(28,000)	2,05,000		
To Direct Wages (30×15,000)		4,50,000		
To Factory Rent		40,000		
To Repairs and Maintenance		43,000		
		7,68,000		**7,68,000**

Example 47: M/s Tellu Ram Mills, an oil refinery firm, has the following information for the financial year 2016–2017. You are required to prepare Manufacturing Account based on the given information for the year ended 31 March 2017, if the total units produced during the year is 10,000 units.

Particulars		Amount (₹)	Particulars	Amount (₹)
Opening Stock			Purchases made during the year	1,10,000
Raw Material	12,000		Labour Charges @ ₹40/unit	
Work-in-Process	5,000		Carriage Inwards	4,000
Finished Goods	4,500	21,500	Royalty Paid @ ₹0.25/unit	
Closing Stock			Salary to Works Manager	15,000
Raw Material	5,000		Sale of Scrap	20,000
Work-in-Process	500		General Factory Expenses	20,000
Finished Goods	10,000	15,500	Sales	2,40,000
			Salaries	40,000

Solution

Manufacturing Account

for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		5,000	By Closing Work-in-Process	500
To *Raw Material Consumed*			By By-Products	20,000
Opening Stock	12,000		By Trading A/c (*balancing figure*)	1,83,000
Plus: Purchases	1,10,000		(*transfer of manufacturing cost*)	
Less: Closing Stock	(5,000)			
Plus: Carriage Inwards	4,000	1,21,000		
To Direct Wages (40 × 10,000)		40,000		
To Royalty (0.25 × 10,000)		2,500		
To Salary to Works Manager		15,000		
To General Factory Expenses		20,000		
		2,03,500		**2,03,500**

Example 48: The following information, prepare the Manufacturing Account, Trading and Profit and Loss Account of M/s Baji Rao for the year ended 31 March 2017.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening stock of raw materials	2,000	General expenses	4,000
Advertisement expenses	15,000	Purchase returns	1,500
Carriage inwards	4,500	Coal	3,500
Carriage outwards	5,000	Interest paid on loan taken from Jai	500
Direct Wages	9,000	Salaries (paid for 10 months)	20,000
Sales	2,00,000	Interest received from bank	200
Purchase of raw material	1,00,000	Consumption of diesel	2,500
Provision for Doubtful Debts	5,500	Sale of scrap	4,500
Opening Stock of finished goods	15,000	Depreciation on machine	2,000
Sales returns	2,500	Depreciation on office furniture	1,500
Debtors	40,000	Opening stock of work-in-progress	2,300

Additional Information:

1. On 1 April 2016, loan of ₹1,00,000 was taken from Jai @ 10% p.a. interest.
2. During the year, bad debts amounted to ₹1,000 and new provision for doubtful debts is ₹1,500
3. Due to fire, goods worth ₹2,000 were destroyed. Insurance company accepted the claim of only 90% of the damaged goods.
4. Goods worth ₹4,000 were distributed as free samples.

5. Wages outstanding amount to ₹3,000
6. Invoices of value ₹6,000 were recorded in the sales book on 29 March 2017 but the goods were not dispatched till 7 April 2017.
7. Closing stock—Raw Materials-₹3,500; Work-in-progress-₹3,700 Finished Goods-₹18,000.

Solution

Manufacturing Account

for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		2,300	By Closing Work-in-Process	3,700
To *Raw Material Consumed*:			By Sale of Scrap	4,500
Opening Stock	2,000		By Trading A/c (*balancing figure*)	1,15,600
Plus: Purchases	1,00,000		(*transfer of manufacturing cost*)	
Less: Closing Stock	(3,500)			
Less: Returns	(1,500)			
Plus: Carriage Inwards	4,500	1,01,500		
To Wages	9,000			
Add: Outstanding	3,000	12,000		
To Coal		3,500		
To Depreciation on Machine		2,000		
To Consumption of Diesel		2,500		
		1,23,800		1,23,800

Trading Account

for the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars		Amount (₹)
To Opening Finished Goods	15,000	By Sales	2,00,000	
To Cost of Goods Manufactured	1,15,600	*Less*: Returns	2,500	1,97,500
To Gross Profit	84,900	By Loss of Goods due to fire		2,000
		By Goods distributed as Samples		4,000
		By Closing Stock	18,000	
		Less: Goods sold but not dispatched	(6,000)	12,000
	2,15,500			2,15,500

Profit and Loss Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars		Amount (₹)
To Net Loss due to fire		200	By Gross Profit		84,900
(2,000 –1,800)			By Interest received from Bank		200
To Salaries	20,000		By Provision for Doubtful Debts		
Add: Outstanding	4,000	24,000	New Provision	5,500	
To Advertisement Expenses		15,000	Old Provision	(3,900)	1,600
To Carriage Outwards		5,000			
To General Expenses		4,000			
To Interest Paid on loan	500				
Add: Outstanding	9,500	10,000			
To Bad Debts		1,000			
To Depreciation-Office Furniture		1,500			
To Net Profit		26,000			
		86,700			86,700

Example 49: Following is the Trial Balance of Mr. Ramesh C. as on 31 March 2011.

Trial Balance
as on 31 March 2011

Debit Balances	₹	Credit Balances	₹
Sundry Debtors	2,65,500	Sundry Creditors	1,98,750
Factory Rent	84,500	Interest on Investments	18,750
General Trade Expenses	28,950	Discount Received	12,600
Manufacturing Wages	1,74,850	Returns Outward	15,750
Purchases of Raw Materials	6,65,750	Sales	24,46,700
Furniture	54,000	Bank Loan @ 12%	12,00,000
Carriage Inward	82,750	Provision Bad Debts	12,650
Carriage Outward	92,450	Bills Payables	82,550
Return Inward	36,700	Sale of Scrap	14,350
Plant and Machinery	7,50,000	Outstanding Office Rates	27,900
Freehold Office	3,50,000		
Motor Vehicles	6,40,000		
Drawing	32,500		
Cash in Hand	8,500		
Cash at Bank	76,550		
Travelling Expenses	29,350		

(Continued)

Debit Balances		₹	Credit Balances	₹
Stock on 1 April 2012				
Raw Material	1,87,550			
Work-in-Progress	54,650			
Finished Goods	1,65,600	4,07,800		
Discount Allowed		14,500		
Office Salaries		2,78,950		
Office Rates and Taxes		84,000		
Bad Debts		18,750		
Bills Receivables		53.650		
10% Investments		2,50,000		
		44,80,000		**44,80,000**

***Additional Information*:**

(a) Stock as on 31 March 2011: Raw Materials ₹1,65,550, Work in Progress ₹44,850 and Finished Goods ₹1,35,450.
(b) Provide Depreciation; on Furniture @ 20%; Plant and Machinery @ 12% Motor Vehicles @ 20%.
(c) Loan from bank was taken as on 1 January 2011.
(d) Investments were made on 1 April 2010.
(e) Office Salaries ₹21,050. Factory Rent ₹15,500 are in arrears.
(f) Purchase invoice amounting to ₹24.000 has been omitted from the books.
(g) Provision for Bad Debts to be created @ 2% on Sundry Debtors.
(h) ₹5,500 due from debtor included in Sundry Debtors has been bad.

Prepare manufacturing account, Trading Account and Profit & Loss Account for the year ended 31 March 2011 and Balance Sheet as on that date. **F.Y.B.Com., IDOL, April 2012**

Solution

In the books of Mr. Ramesh C.
Manufacturing A/c
for the year ended 31 March 2011

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening Stock of Raw Material		1,87,550	By Sale of Scrap		14,350
To Purchase of Raw Material	6,65,750		**By Closing Stock**		
Less: Return Outward	15,750	6,50,000	Raw Material	1,65,550	
To Carriage Inward		82,750	Work in Progress	44,850	2,10,400
To Manufacturing Wages		1,74,850	By Cost of Production		**10,49,050**
To Factory Rent	84,500				
Add: Outstanding	15,500	1,00,000			
To Work in Progress		54,650			
To Purchase Omitted		24,000			
		12,73,800			**12,73,800**

Trading A/c
for the year ended 31 March 2011

Dr. **Cr.**

Particulars	₹	Particulars		₹
To Opening Stock of finished goods	1,65,600	By Sales	24,46,700	
		Less: Return Outward	36,700	24,10,000
To Cost of Production	10,49,050	By Closing Stock of finished goods		1,35,450
To Gross Profit c/d	13,30,800			
	25,45,450			**25,45,450**

Profit and Loss A/c
for the year ended 31March 2011

Dr. **Cr.**

Particulars		₹	Particulars	₹
To General Trade Expenses		28,950	By Gross Profit b/d	13,30,800
To Carriage Outward		92,450	By Interest on Investments	18,750
To Travelling Expenses		29,350		
To Discount Allowed		14,500	By Discount received	12,600
To Office Salaries	2,78,950		By Provision Bad debts	12,650
Add: Outstanding	21,050	3,00,000		
To Office rates and taxes		84,000	By Interest on Investments	25,000
To Bad debts	18,750			
Add: Further bad debts	5,500			
Add: New R.D.D.	5,200	29,450		
To Depreciation on Furniture		10,800		
To Depreciation on Machinery		90,000		
To Depreciation on Motor		1,28,000		
To Interest on Loan		36,000		
To Net Profit c/d		5,56,300		
		13,99,800		**13,99,800**

Balance Sheet
as on 31 March 2011

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	4,50,000		Furniture	54,000	
Less: Drawing	32,500		*Less*: Depreciation	10,800	43,200
Add: Net Profit	5,56,300	9,73,800	Plant and Machinery	7,50,000	
Bank Loan at the 12%	12,00,000		*Less*: Depreciation	90,000	6,60,000
Add: Interest on loan	36,000	12,36,000	Freehold Office	3,50,000	3,50,000

(Continued)

Liabilities	Amount (₹)	Assets		Amount (₹)
Sundry Creditors	1,98,750	Motor Vehicles	6,40,000	
Bills Payable	82,550	*Less*: Depreciation	1,28,000	5,12,000
Outstanding		Cash in Hand		8,500
Office Rates	27,900	Cash at Bank		76,550
Outstanding factory		Sundry Debtors	2,65,500	
Rent	15,500	*Less*: Further Bad debts	5,500	
Outstanding			2,60,000	
Office Salaries	21,050	*Less*: New R.D.D.	5,200	2,54,800
Purchase Omitted	24,000	Bills Receivables		53,650
		10% Investments	2,50,000	
		Add: Interest on Investment	25,000	2,75,000
		Stock		
		Raw Material	1,65,550	
		Work in Progress	44,850	
		Finished Goods	1,35,450	3,45,850
	25,79,500			**25,79,500**

Example 50: From the following Trial Balance and the additional information, prepare Manufacturing, Trading and Profit and Loss Account along with the Balance Sheet relating to 2016–2017.

Trial Balance

Particulars	Debit Amount (₹)	Particulars	Credit Amount (₹)
Stock as on 1 April 2016		Sundry Creditors	1,63,000
Raw Materials	2,10,000	Bills Payable	75,000
Work-in-progress	95,000	Sale of Scrap	25,000
Finished Goods	1,15,000	Commission	4,500
Sundry Debtors	2,44,000	Provision for Doubtful Debts	16,500
Carriage Inwards	15,000	Capital Account	9,00,000
Bills Receivable	1,50,000	Sales	17,70,000
Wages	1,30,000	Bank Overdraft	10,200
Salaries	1,00,000		
Telephone Charges	10,000		
Repairs to plant	11,000		
Repairs to furniture	3,500		
Purchases	8,00,000		
Cash at Bank	1,20,000		

(Continued)

Particulars	Debit Amount (₹)	Particulars	Credit Amount (₹)
Plant and Machinery	7,00,000		
Rent	50,000		
Lightning of Factory	72,000		
Office General Expenses	15,700		
Insurance	13,000		
Office Furniture	1,10,000		
	29,64,200		29,64,200

Additional Information:

1. Stock on 31 March 2017 were: Raw Materials ₹1,62,000, Finished Goods ₹1,70,000 and Work-in-Progress ₹70,000
2. Salaries and wages outstanding for March, 2017 were ₹8,000 and ₹12,000 respectively.
3. Machinery is to be depreciated by 10% p.a. and office furniture by 10% p.a.
4. Provision for Doubtful Debts should be maintained @ 5% on debtors.
5. Insurance amounting to ₹1,000 is prepaid

F.Y.B.Com., IDOL, April 2009 (adapted for Acc&FM-I)

Solution

Manufacturing Account

for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		95,000	By Closing Work-in-Process	70,000
To *Raw Material Consumed*:			By Sale of Scrap	25,000
Opening Stock	2,10,000		By Trading A/c (*balancing figure*)	11,58,000
Plus: Purchases	8,00,000		(*transfer of manufacturing cost*)	
Less: Closing Stock	(1,62,000)			
Plus: Carriage Inward	15,000	8,63,000		
To Wages		1,42,000		
To Repairs to Plant		11,000		
To Depreciation on Machine		70,000		
To Factory Lighting		72,000		
		12,53,000		12,53,000

Trading Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Finished Goods	1,15,000	By Sales	17,70,000
To Cost of Goods Manufactured	11,58,000	By Closing Stock-Finished Good	1,70,000
To Gross Profit	66,700		
	19,40,000		19,40,000

Profit and Loss Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars		Amount (₹)
To Telephone Charges		10,000	By Gross Profit		66,700
To Repairs to Furniture		3,500	By Commission received		4,500
To Salaries	1,00,000		By Provision for Doubtful Debts		
Add: Outstanding	8,000	1,08,000	New Provision	16,500	
To Rent		50,000	*Less*: Old Provision	(12,200)	4,300
To Office General Expenses		15,700			
To Insurance	13,000				
Less: Prepaid	(1,000)	12,000			
To Depreciation-Office Furniture		11,000			
To Net Profit		4,65,600			
		6,75,800			6,75,800

Balance Sheet
for the year ended 31 March 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	9,00,000		Bills Receivables		1,50,000
Add: Net Profit	4,65,600	13,65,600	Debtors	2,44,000	
Bank Overdraft		10,200	*Less*: New Provision	(12,200)	2,31,800
Bills Payable		75,000	Plant and Machinery	7,00,000	
Creditors		1,63,000	*Less*: Depreciation	(70,000)	6,30,000
Outstanding Wages		12,000	Cash at Bank		1,20,000
Outstanding Salaries		8,000	Office Furniture	1,10,000	
			Less: Depreciation	(11,000)	99,000

(Continued)

Liabilities	Amount (₹)	Assets		Amount (₹)
		Closing Stock		
		Raw Materials	1,62,000	
		Finished Goods	1,70,000	
		WIP	70,000	4,02,000
		Prepaid Insurance		1,000
	16,33,800			16,33,800

Example 51: From the given Trial Balance of Mohan, prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31 March 2017 and Balance Sheet on that date.

Trial Balance

Particulars	Debit Amount (₹)	Credit Amount (₹)
Stock as on 1April, 2016		
Raw Materials	12,000	-
Work-in-progress	7,000	-
Finished Goods	20,000	-
Purchase of Raw Materials	97,000	-
Octroi on Raw Materials	11,000	-
Direct Wages	57,000	-
Factory Rent	7,000	-
Other Direct Expenses	12,000	-
Indirect Wages	8,000	-
Machinery	60,000	-
Cash at Bank	12,000	-
Sales	-	3,10,000
Administrative Expenses	31,000	-
Selling Expenses	13,000	-
Creditors	-	25,000
Interest	7,000	-
Discount Allowed	4,000	-
Bad Debts	1,000	-
Provision for Bad Debts	-	3,000
Sundry Debtors	50,000	-
Drawings	21,000	-
Capital	-	85,000
Bills Payable	-	7,000
	4,30,000	4,30,000

Additional Information:

1. Closing stock was: Raw Material-₹8,000, Finished Goods-₹10,000 and WIP-₹4,000
2. Outstanding direct wages at the end were ₹3,000.
3. Other direct expenses were prepaid to the extent of ₹1,000.
4. Depreciate machinery @ 10% p.a.
5. Maintain provision for bad debts @ 5% of sundry debtors.

F.Y.B.Com., IDOL, April 2008 (adapted for Acc&FM-I)

Solution

Manufacturing Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		7,000	By Closing Work-in-Process	4,000
To *Raw Material Consumed*:			By Trading A/c (*balancing figure*) (*transfer of manufacturing cost*)	2,07,000
Opening Stock	12,000			
Plus: Purchases	97,000			
Plus: Octroi	11,000			
Less: Closing Stock	(8,000)	1,12,000		
To Wages	57,000			
Add: Outstanding	3,000	60,000		
To Direct Expenses	12,000			
Less: Prepaid	1,000	11,000		
To Factory Rent		7,000		
To Indirect Wages		8,000		
To Depreciation on Machinery		6,000		
		2,11,000		2,11,000

Trading Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Finished Goods	20,000	By Sales	3,10,000
To Cost of Goods Manufactured	2,07,000	By Closing Stock-Finished Good	10,000
To Gross Profit	93,000		
	3,20,000		3,20,000

Profit and Loss Account
for the year ended 31 March 2017

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Administrative Expenses		31,000	By Gross Profit	93,000
To Bad Debts	1,000			
Add: New Provision	2,500			
Add: Old Provision	3,000	500		
To Selling Expenses		13,000		
To Interest		7,000		
To Discount		4,000		
To Net Profit		37,500		
		93,000		93,000

Balance Sheet
for the year ended 31 March 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	85,000		Prepaid Expenses		1,000
Add: Net Profit	37,500		Cash at Bank		12,000
Less: Drawings	21,000	1,01,500	Debtors	50,000	
Creditors		25,000	*Less:* New Provision	(2,500)	47,500
Outstanding Wages		3,000	Machinery	60,000	
Bills Payable		7,000	*Less*: Depreciation	(6,000)	54,000
			Closing Stock		
			Raw Materials	8,000	
			Finished Goods	10,000	
			WIP	4,000	22,000
		1,36,500			1,36,500

Example 52: From the following Trial Balance of Mr. Aditya, prepare Manufacturing Account, Trading Account, Profit and Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date.

Trial Balance of Mr. Aditya
as on 31 March 2016

Particulars	Debit (₹)	Credit (₹)
Opening Stock-Raw Materials	12,000	
Opening Stock-Work in Progress	7,000	
Opening Stock-Finished Goods	20,000	
Purchase of Raw Materials	1,05,000	

(Continued)

Particulars	Debit (₹)	Credit (₹)
Carriage Inward on Raw Materials	4,000	
Direct Wages	56,000	
Factory Rent	8,000	
Factory Power and Fuel	11,000	
Machinery	80,000	
Sales		3,25,000
Office Expenses	50,000	
Cash at Bank	11,000	
Creditors		21,000
Bad Debts	1,000	
Provisions for Bad Debts		2,000
Sundry Debtors	53,000	
Capital		82,000
Drawings	12,000	
	4,30,000	4,30,000

Additional Information:

1. Closing stock as on 31 March 2016 is:
   Raw Material ₹15000, Work-in-progress ₹8,000, Finished goods ₹25,000.
2. Depreciate Machinery @10% p.a.
3. During the year, finished goods worth ₹5,000 were distributed as free samples but were not recorded.
4. Provide Reserve for Doubtful Debts @ 5% on debtors.

Acc&FM-I, November 2016

Solution

Manufacturing Account

for the year ended 31 March 2016

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		7,000	By Closing Work-in-Process	8,000
To *Raw Material Consumed*:			By Trading A/c (*balancing figure*) (*transfer of manufacturing cost*)	1,88,000
Opening Stock	12,000			
Plus: Purchases	1,05,000			
Less: Closing Stock	(15,000)			
Plus: Carriage Inward	4,000	1,06,000		

(Continued)

Particulars	Amount (₹)	Particulars	Amount (₹)
To Direct Wages	5,600		
To Factory Rent	8,000		
To Depreciation on Machine	8,000		
To Factory Power and Fuel	11,000		
	1,96,000		1,96,000

Trading Account

for the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Finished Goods	20,000	By Sales	3,25,000
To Cost of Goods Manufactured	1,88,000	By Goods distributed as Samples	5,000
To Gross Profit	1,47,000	By Closing Stock-Finished Good	25,000
	3,55,000		3,55,000

Profit and Loss Account

for the year ended 31 March 2016

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Office Expenses		50,000	By Gross Profit	1,47,000
To Goods distributed as Samples		5,000		
To Bad Debts	1,000			
Add: New Provision	2,650			
Less: Old Provision	(2,000)	1,650		
To Net Profit		90,350		
		1,47,000		1,47,000

Balance Sheet

for the year ended 31 March 2016

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	82,000		Cash at Bank		11,000
Add: Net Profit	90,350		Debtors	53,000	
Less: Drawings	(12,000)	1,60,350	*Less*: New Provision	(2,650)	50,350

Liabilities	Amount (₹)	Assets		Amount (₹)
Creditors	21,000	Machinery	80,000	
		Less: Depreciation	(8,000)	72,000
		Closing Stock		
		Raw Materials	1,50,000	
		Finished Goods	25,000	
		WIP	8,000	48,000
	16,33,800			16,33,800

Example 53: From the following Trial Balance of Mr. Gangadhar, prepare Manufacturing Account, Trading Account, Profit and Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date.

Trial Balance of Mr. Gangadhar

as on 31 March 2016

Particulars	Dr. (₹)	Cr. (₹)
Capital Account	-	1,00,000
Opening Stock-Raw Materials	24,000	-
Opening Stock-Work in Progress	4,000	-
Opening Stock-Finished Goods	31,000	-
Purchase of Raw Materials	2,50,000	-
Direct Wages	36,000	-
Factory Rent	8,000	-
Machinery	1,00,000	-
Sales	-	4,35,000
Cash at Bank	6,000	-
Travelling and conveyance	20,000	-
Salaries	24,000	-
Discount Allowed	7,000	-
Sundry Creditors	-	90,000
Sundry Debtors	40,000	-
Vehicles	75,000	-
Total	**6,25,000**	**6,25,000**

Additional Information: Following further information is provided to you.

1. Closing Stock as on 31 March 2016: Raw Material ₹25,000, Work-in-Progress ₹8,000, and Finished Goods ₹35,000.
2. Depreciate Machinery @10% p.a. and Vehicles @10% p.a.
3. Provide Reserve for Doubtful Debts @5% on Debtors.
4. During the year, Raw Materials worth ₹5,000 purchased on credit basis were not recorded in the books.

Acc&FM-I, November 2016

Solution

Manufacturing Account
for the year ended 31 March 2016

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		4,000	By Closing Work-in-Process	8,000
To *Raw Material Consumed*:			By Trading A/c (*balancing figure*) (*transfer of manufacturing cost*)	3,04,000
Opening Stock	24,000			
Plus: Purchases	2,50,000			
Less: Closing Stock	(25,000)			
Plus: Additional purchases	5,000	2,54,000		
To Direct Wages		36,000		
To Factory Rent		8,000		
To Depreciation on Machine		10,000		
		3,12,000		3,12,000

Trading Account
for the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Finished Goods	31,000	By Sales	4,35,000
To Cost of Goods Manufactured	3,04,000	By Closing Stock-Finished Good	35,000
To Gross Profit	1,35,000		
	4,70,000		4,70,000

Profit and Loss Account
for the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Travelling and Conveyance	20,000	By Gross Profit	1,35,000
To Salaries	24,000		
To Discount Allowed	7,000		
To Depreciation on Vehicle	7,500		
To Provision for Doubtful Debts	2,000		
To Net Profit	74,500		
	1,35,000		1,35,000

Balance Sheet
for the year ended 31 March 2016

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	1,00,000		Cash at Bank		6,000
Add: Net Profit	74,500	1,74,500	Debtors	40,000	
			Less: New Provision	(2,000)	38,000
			Machinery	1,00,000	
Creditors	90,000		*Less*: Depreciation	(10,000)	90,000
Add: Credit Purchases	5,000	95,000	Vehicle	75,000	
			Less: Depreciation	(7,500)	67,500
			Closing Stock		
			Raw Materials	35,000	
			Finished Goods	25,000	
			WIP	8,000	68,000
		2,69,500			2,69,500

Example 54: Following is the Trial Balance of M/s. Technocraft as on 31 March 2016.

Particulars	Debit (₹)	Credit (₹)
Mr. Omkar Capital	-	3,15,600
Stock on 1st April, 2015	-	-
Finished Goods	85,700	-
Raw Materials	9,000	-
WIP	17,000	-
Land and Building	1,50,000	-
Bills Receivable	37,600	-
Bills Payable	-	27,600
Purchases	4,17,600	-
Sales	-	6,78,700
Patents	25,000	-
Returns Inward	3,700	-
Sale of Scrap	-	10,000
Carriage Inwards	4,000	-
Returns Outwards	-	10,600
Drawings	36,000	-
Sundry Debtors	1,23,400	-
Sundry Creditors	-	56,800
Salaries	25,300	-

(Continued)

Particulars	Debit (₹)	Credit (₹)
Wages	17,200	-
Insurance	6,000	-
Audit Fees	4,500	-
General expenses	31,200	3,600
Discount received	-	-
Investment in Govt. securities	25,000	2,500
Interest on above	-	-
Bad debts	4,200	-
Advertisement	7,200	4,200
Reserve for doubtful debts	-	-
Goodwill	1,00,000	20,000
Commission received	-	
	11,59,600	**11,59,600**

Adjustments:

(1) Stock as on 31 March 2016 was valued at ₹13,000 (Raw Materials), ₹15,000 (WIP) and ₹1,40,000 (Finished Goods)

(2) Depreciate Patents at 10% per annum. Land and Building at 5% p.a.

(3) Of the Debtors ₹3,400 are bad. Provide reserve for doubtful debts at 5%.

(4) Wages outstanding ₹5,000

(5) Goods costing ₹8,000 were destroyed by fire, insurance company admitted claim for ₹5,000

From the above you are required to prepare Manufacturing Account, Trading Profit and Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date.

F.Y.B.Com., IDOL, April 2016 (adapted for Acc&FM-I)

Solution

Manufacturing Account

for the year ended 31 March 2016

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		17,000	By Closing Work-in-Process	15,000
To *Raw Material Consumed*:			By Sale of Scrap	10,000
Opening Stock	9,000		By Trading A/c (*balancing figure*)	4,21,200
Plus: Purchases	4,17,600		(*transfer of manufacturing cost*)	
Plus: Carriage Inwards	4,000			
Less: Closing Stock	(25,000)			
Less: Return Outwards	(10,600)	4,07,000		
To Wages	17,200			
Add: Outstanding Wages	5,000	22,200		
		4,46,200		4,46,200

Trading Account
for the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars		Amount (₹)
To Opening Finished Goods	85,700	By Sales	6,78,700	
To Cost of Goods Manufactured	4,21,200	*Less*: Sales Return	(3,700)	6,75,000
To Gross Profit	3,16,100	By Goods destroyed by fire		8,000
		By Closing Stock-Finished Good		1,40,000
	8,23,000			8,23,000

Profit and Loss Account
for the year ended 31 March 2016

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Insurance		6,000	By Gross Profit	3,16,100
To Salaries		25,300	By Discount Received	3,600
To Loss due to fire (8,000 – 5,000)		3,000	By Interest on Govt. Securities	2,500
To Audit Fees		4,500	By Commission received	20,000
To General Expenses		31,200		
To Depreciation of Patents		2,500		
To Advertisement		7,200		
To Depreciation on Building		7,500		
To Bad Debts	4,200	2,000		
Add: Further Bad Debt	3,400			
Less: Old Provision	(4,200)			
Add: New Provision	6,000	9,400		
To Net Profit		2,45,600		
		3,42,200		3,42,200

Balance Sheet
for the year ended 31 March 2016

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	3,15,600		Goodwill		1,00,000
Add: Net Profit	2,45,600		Bills Receivable		37,600
Less: Drawings	36,000	5,25,200	Debtors	1,23,400	
Bills Payable		27,600	*Less*: Further Bad Debt	(3,400)	
Creditors		56,800	*Less:* New Provision	(6,000)	1,14,000
Outstanding Wages		5,000			

(Continued)

Liabilities	Amount (₹)	Assets		Amount (₹)
		Land and Building	1,50,000	
		Less: Depreciation	(7,500)	1,42,500
		Patents	25,000	
		Less: Depreciation	(2,500)	22,500
		Claim due to Insurance		5,000
		Investment in Govt. Securities		25,000
		Closing Stock		
		Raw Materials	13,000	
		Finished Goods	1,40,000	
		WIP	15,000	1,68,000
	6,14,600			6,14,600

Example 55: The following is the Trial Balance of Mr. Gyan on 30 June 2015:

Particulars	(₹)	(₹)
Cash in Hand	540	
Cash at bank	2,630	
Purchases Account	40,675	
Sales Account		98,780
Returns Inward Account	680	
Returns Outward Account		500
Wages Account	10,480	
Fuel and Power Account	4,730	
Carriage on Sales Account	3,200	
Carriage on Purchase Account	2,040	
Stock Account (1st July, 2014)		
Finished Goods	2,000	
Raw Materials	760	
WIP	3,000	
Building Account	30,000	
Freehold Land Account	10,000	
Machinery Account	20,000	
Patent Account	7,500	
Salaries Account	15,000	

(Continued)

Particulars	(₹)	(₹)
General Expenses Account	3,000	
Insurance Account	600	
Drawings Account	5,245	
Sale of scrap		300
Capital Account		71,000
Sundry Debtors Account	14,500	
Sundry Creditors Account		6,000
Total	1,76,580	1,76,580

Taking into account the following adjustments, prepare Manufacturing Account, Trading Account and Profit and Loss Account and the Balance sheet:

(a) Stock on hand on 30 June 2015: Raw Materials ₹1,800, WIP ₹2,200 and Finished Goods- ₹2,800.
(b) Machinery is to be depreciated at rate of 10% and the patents @ 20%.
(c) Salaries for the month of June, 2015 amounting to ₹1,500 were unpaid.
(d) Insurance includes a premium of ₹170 on a policy expiring on 31 December 2015.
(e) Wages include a sum of ₹2,000 spent on the erection of a cycle shed for employees and customers.
(f) A provision of Bad and Doubtful Debts is to be created to the extent of 5 per cent on Sundry Debtors.

F.Y.B.Com., IDOL, October 2016 (adapted for Acc&FM-I)

Solution

Manufacturing Account

for the year ended 30 June 2015

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		3,000	By Closing Work-in-Process	2,200
To *Raw Material Consumed*:			By Sale of Scrap	300
Opening Stock	760		By Trading A/c (*balancing figure*)	56,885
Plus: Purchases	40,675		(*transfer of manufacturing cost*)	
Plus: Carriage Inwards	2,040			
Less: Closing Stock	(1,800)			
Less: Return Outwards	(500)	41,175		
To Wages	10,480			
Less: Wages for Cycle Shed	(2,000)	8,480		
		59,385		59,385

Trading Account
for the year ended 30 June 2015

Dr. **Cr.**

Particulars	Amount (₹)	Particulars		Amount (₹)
To Opening Finished Goods	2,000	By Sales	98,780	
To Cost of Goods Manufactured	56,885	*Less*: Sales Return	(680)	98,100
To Gross Profit	42,015	By Closing Stock-Finished Good		2,800
	1,00,900			1,00,900

Profit and Loss Account
for the year ended 30 June 2015

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Carriage on Sales		3,200	By Gross Profit	42,015
To Salaries	15,000			
Add: Outstanding	1,500	16,500		
To Insurance	600			
Less: Prepaid	(170)	430		
To General Expenses		3,000		
To Depreciation on Patent		1,500		
To Provision for Doubtful Debts		725		
To Net Profit		16,660		
		42,015		42,015

Balance Sheet
for the year ended 30 June 2015

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	71,000		Cash in Hand		540
Add: Net Profit	16,660		Cash at Bank		2,630
Less: Drawings	5,245	82,415	Debtors	14,500	
Creditors		6,000	*Less:* New Provision	(725)	13,775
Outstanding Salary		1,500	Building	30,000	
			Plus: Cycle Shed	2,000	32,000
			Patents	7,500	
			Less: Depreciation	(1,500)	6,000
			Machinery	20,000	
			Less: Depreciation	(2,000)	18,000
			Freehold Land		10,000
			Prepaid Insurance		170

(Continued)

Liabilities	Amount (₹)	Assets		Amount (₹)
		Closing Stock		
		Raw Materials	1,820	
		Finished Goods	2,200	
		WIP	2,800	68,000
	89,915			89,915

Example 56: Following is the Trial Balance of Pratibha Electronics as on 31 March 2015.

Particulars	Debit (₹)	Credit (₹)
Bank Overdraft	-	2,94,000
Opening Stock:		
Finished Goods	1,20,000	-
Raw Materials	20,000	-
WIP	1,00,000	-
Advertisement	1,10,400	-
Audit fees	63,000	-
Bad debts	9,600	-
Bills payable	-	1,20,000
Bills receivable	1,22,100	-
Goodwill	3,00,000	-
Commission received	-	6,000
Discount received	-	12,000
Drawings	15,900	-
Land and Buildings	2,40,000	-
General Expenses	74,100	-
Insurance	18,900	-
Interest on bank overdraft	12,000	-
Investments in shares of ABC Ltd.	3,36,000	-
Plant and Machinery	6,00,000	-
M/s Pratibha's Capital	-	16,20,000
Purchases	12,61,920	
Reserve for doubtful debts	-	6,000
Returns Inward	7,680	
Return Outward	-	19,920
Salaries	3,12,000	
Sales	-	19,27,680
Sundry Creditors	-	3,90,000
Sundry Debtors	4,90,500	-
Wages	1,81,500	-
Carriage Inwards	7,500	-
Sale of scrap		7,500
	44,03,100	44,03,100

Adjustments:

1. Stock as on 31 March 2015 was: Raw Materials-₹25,000, WIP-₹1,10,00 and Finished Goods 3,87,000
2. Depreciate Land and Buildings at 5% p.a. and Plant and Machinery at 10% p.a.
3. Of the debtors ₹10.500 are bad. Provide reserve for doubtful debts at 5%.
4. Wages outstanding ₹15.000.
5. Insurance is prepaid to the extent of ₹3,900.

From the above Trial Balance and the adjustments prepare Manufacturing, Trading Profit and Loss account for the year ended 31 March 2015 and Balance Sheet as on that date.

F.Y.B.Com., IDOL, October 2015 (adapted for Acc&FM-I)

Solution

Manufacturing Account

for the year ended 31 March 2015

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Opening Work-in-Process		1,00,000	By Closing Work-in-Process	1,10,000
To *Raw Material Consumed*:			By Sale of Scrap	7,500
Opening Stock	20,000		By Trading A/c (*balancing figure*)	14,83,500
Plus: Purchases	12,61,920		(*transfer of manufacturing cost*)	
Plus: Carriage Inwards	7,500			
Less: Closing Stock	(25,000)			
Less: Return Outwards	(19,920)	12,44,500		
To Wages	1,81,500			
Add: Outstanding	15,000	1,96,500		
To Depreciation on Machinery		60,000		
		16,01,000		16,01,000

Trading Account

for the year ended 31 March 2015

Dr. **Cr.**

Particulars	Amount (₹)	Particulars		Amount (₹)
To Opening Finished Goods	1,20,000	By Sales	19,27,680	
To Cost of Goods Manufactured	14,83,500	*Less*: Sales Return	(7,680)	19,20,000
To Gross Profit	7,03,500	By Closing Stock-Finished Good		3,87,000
	23,07,000			23,07,000

Profit and Loss Account

for the year ended 31 March 2015

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Advertisement Expenses		1,10,400	By Gross Profit	7,03,500
To Bad Debts	9,600		By Commission received	6,000
Add: Further Bad Debts	10,500			
Add: New Provision	24,000			
Add: Old Provision	6,000	38,100	By Discount received	12,000
To Insurance	18,900			
Less: Prepaid	(3,900)	15,000		
To General Expenses		74,100		
To Interest on Bank Overdraft		12,000		
To Depreciation on Building		12,000		
To Salaries		3,12,000		
To Audit Fees		63,000		
To Net Profit		84,900		
		7,21,500		7,21,500

Balance Sheet

for the year ended 31 March 2015

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	16,20,000		Bills Receivables		1,22,100
Add: Net Profit	84,900		Goodwill		3,00,000
Less: Drawings	15,900	16,89,000	Debtors	4,90,500	
			Less: Further Bad Debt	(10,500)	
Creditors		3,90,000	*Less:* New Provision	(24,000)	4,56,000
Outstanding Wages		15,000	Land and Building	2,40,000	
			Less: Depreciation	12,000	2,22,800
			Plant and Machinery	6,00,000	
			Less: Depreciation	(60,000)	5,40,000
			Prepaid Insurance		3,900
			Investment in Shares of ABC Ltd.		3,36,000
			Closing Stock		
			Raw Materials	25,000	
			Finished Goods	3,87,000	
			WIP	1,10,000	5,22,000
		25,08,000			25,08,000

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) What is cost of production? How is it ascertained?
(2) What is Manufacturing Account? Explain the proforma of Manufacturing Account.
(3) State the steps involved in preparing Trading Account and briefly explain the items recorded in it.
(4) Draw the proforma of Profit and Loss Account and briefly explain the items recorded in it.
(5) State the closing entries of Manufacturing Account.
(6) Briefly state any *five* objectives of final accounts.
(7) Explain the debit items in Manufacturing Account.
(8) Differentiate between Manufacturing Account and Trading Account.
(9) Explain the debit items in Profit and Loss Account.
(10) Differentiate between direct and indirect expenses of a manufacturer.
(11) State any *five* characteristics of Balance Sheet of a manufacturer.
(12) What do you understand by Grouping? Draw a Balance Sheet as per different groups of assets and liabilities.
(13) What is marshalling of assets and liabilities? Draw a Balance Sheet in the order of Liquidity and Permanency with fictitious amounts.
(14) Discuss the manner in which assets and liabilities can be arranged in a Balance Sheet.
(15) What do you mean by adjusting entries? State the need of adjusting entries.
(16) State the treatment of bad debts and its related adjustments.
(17) Explain the classification of assets in Balance Sheet.
(18) Discuss the classification of liabilities in Balance Sheet.

II. Short Notes (5 marks)

(1) Treatment of Closing Stock in Final Accounts
(2) Treatment of Outstanding Expenses
(3) Treatment of Prepaid Expenses
(4) Treatment of Unearned Income
(5) Treatment of Accrued Income
(6) Treatment of Depreciation
(7) Treatment of Bad Debts
(8) Treatment of Provision for Doubtful Debts
(9) Treatment of Provision for Discount on Debtors
(10) Treatment of Provision for Discount on Creditors
(11) Treatment of Loss of Fixed Assets
(12) Treatment of Loss of Goods and Insurance Claims
(13) Treatment of Unrecorded Purchases
(14) Treatment of Unrecorded Sales
(15) Treatment of Capital Expenditure treated as Revenue Expenditure
(16) Treatment of Revenue Expenditure treated as Capital Expenditure
(17) Treatment of Dishonour of Bills Receivables
(18) Treatment of Bills Payables
(19) Objectives of Final Accounts
(20) Treatment of Goods Distributed as Free Samples
(21) Treatment of Goods Donated as Charity
(22) Treatment of Interest on Loan (given)
(23) Treatment of Interest on Loan (taken)
(24) Treatment of Interest on Capital
(25) Treatment of Interest on Drawings
(26) Treatment of Drawings in form of goods
(27) Manufacturing Account
(28) Cost of Production
(29) Closing Entries of Manufacturing Account
(30) Closing Entries of Trading Account
(31) Closing Entries of Profit and Loss Account
(32) Marshalling of Assets and Liabilities
(33) Grouping of Assets and Liabilities
(34) Classification of Assets
(35) Classification of Liabilities
(36) Proforma of Manufacturing Account
(37) Proforma of Trading Account
(38) Proforma of Profit and Loss Account
(39) Differentiate between Gross Profit and Net Profit
(40) Contingent Liabilities
(41) Components of Final Accounts of a Manufacturer
(42) Components of Final Accounts of a Trader
(43) Transfer of Value of Finished Goods
(44) Manufacturing Account *versus* Trading Account

III. Objective Type Questions

(1) Which of the following accounts does not form a part of Final Accounts of a trader?
(a) Manufacturing Account (b) Trading Account
(c) P&L Account (d) Balance Sheet

(2) Which of the following purposes is served by Manufacturing Account?
(a) ascertaining gross profit (b) ascertaining cost of production
(c) ascertaining net profit

(3) Which of the following statements holds true in reference to Manufacturing Account?
(a) always have a credit balance (b) always have a debit balance
(c) credit balance equals debit balance

(4) Consumption of Raw Materials equals to
(a) Opening Stock of WIP + Opening Stock of Raw Materials + Purchases of Raw Materials – Closing Stock of Raw Materials
(b) Opening Stock of WIP + Opening Stock of Raw Materials + Purchases of Raw Materials – Closing Stock of Raw Materials – Closing Stock of WIP
(c) Opening Stock of Raw Materials – Purchases of Raw Materials – Closing Stock of Raw Materials
(d) Opening Stock of Raw Materials + Purchases of Raw Materials – Closing Stock of Raw Materials

(5) We close the Manufacturing Account by transferring the cost of production to the
(a) debit side of Trading Account (b) credit side of Trading Account
(c) debit side of P&L Account (d) credit side of P&L Account

(6) Which of the following items is related to Manufacturing Account?
(a) Depreciation on Factory Plant and Machinery
(b) Depreciation on Office Furniture
(c) Depreciation on Office Building
(d) Amortisation of Goodwill

(7) If wages paid for installation of new machinery have been wrongly debited to Wages Account, then we have
(a) understated gross profit (b) understated net profit
(c) overstated cost of production (d) understated cost of production

(8) If purchases of building material have been wrongly considered as Purchases Account, then we have
(a) understated gross profit (b) understated net profit
(c) overstated cost of production (d) understated cost of production

(9) If sales returns have been mistakenly considered as sales, then we have
(a) understated gross profit (b) understated net profit
(c) overstated cost of production (d) understated cost of production

(10) Carriage inwards incurred by a manufacturer is
(a) shown on the credit side of Manufacturing Account
(b) shown on the debit side of Trading Account
(c) shown on the debit side of Manufacturing Account
(d) shown on the debit side of P&L Account

(11) Freight outwards is
(a) shown on the credit side of Manufacturing Account
(b) shown on the debit side of Trading Account
(c) shown on the debit side of Manufacturing Account
(d) shown on the debit side of P&L Account

(12) Wages and salary is debited to
(a) Manufacturing Account (b) Trading Account
(c) Profit and Loss Account (d) Assets

(13) Salary and wages is debited to
(a) Manufacturing Account (b) Trading Account
(c) Profit and Loss Account (d) Shown as Liabilities

(14) Closing stock of WIP is shown on the
- (a) Debit side of Manufacturing Account
- (b) Debit side of Trading Account
- (c) Credit side of Manufacturing Account
- (d) Credit side of Trading Account

(15) Opening stock of finished goods is shown on the
- (a) Debit side of Manufacturing Account
- (b) Debit side of Trading Account
- (c) Credit side of Manufacturing Account
- (d) Credit side of Trading Account

(16) Closing stock of raw materials is
- (a) shown on the debit side of Manufacturing Account
- (b) shown on the debit side of Trading Account
- (c) deducted from Opening stock of raw materials
- (d) deducted from raw materials consumed

(17) Proceeds from sale of scrap is
- (a) shown on the credit side of Manufacturing Account
- (b) shown on the credit side of Trading Account
- (c) shown on the credit side of P&L Account
- (d) deducted from closing stock in Balance Sheet

(18) Goods distributed as free samples are
- (a) debited to Manufacturing Account
- (b) credited to Manufacturing Account
- (c) debited to Trading Account
- (b) credited to Trading Account

(19) Good destroyed by fire are
- (a) debited to Manufacturing Account
- (b) credited to Manufacturing Account
- (c) debited to Trading Account
- (d) credited to Trading Account

(20) Drawings of finished goods by the proprietor are
- (a) shown on the credit side of Trading Account
- (b) shown on the debit side of Trading Account
- (c) shown on the credit side of P&L Account
- (d) shown on the credit side of Manufacturing Account

(21) Drawings in form of other than goods by the proprietor are
- (a) shown on the credit side of Trading Account
- (b) shown on the debit side of Trading Account
- (c) shown on the debit side of P&L Account
- (d) shown on the credit side of Manufacturing Account

(22) Purchases Returns of finished goods are
- (a) debited to Manufacturing Account
- (b) credited to Manufacturing Account
- (c) debited to Trading Account
- (d) debited to P&L Account

(23) Returns outwards of raw materials are
- (a) deducted from purchases of raw materials in Manufacturing Account
- (b) deducted from sales of raw materials in Manufacturing Account
- (c) shown on the debit side of Trading Account
- (d) deducted from sales on the credit side of Trading Account

(24) Profit on sale of fixed asset is
- (a) income
- (b) gain
- (c) revenue profit

(25) Loss on sale of fixed asset is
- (a) expense
- (b) revenue loss
- (c) capital loss

(26) Which of the following items is shown on the debit side of P&L Account?
- (a) Direct expenses
- (b) Indirect expense
- (c) Direct income
- (d) Indirect income

(27) Which of the following items is not recorded in the P&L Account?
- (a) Salary and wages
- (b) Freight
- (c) Rent paid
- (d) Carriage Outwards

(28) Which of the following assets cannot be converted into cash?
(a) Tangible Assets (b) Immovable Fixed Assets
(c) Fictitious Assets (d) Current Assets

(29) Which of the following assets cannot be seen?
(a) Tangible Assets (b) Immovable Fixed Assets
(c) Fictitious Assets (d) Intangible Assets

(30) Which of the following assets is the most permanent?
(a) Land and Building (b) Goodwill
(c) Patents and Trade Marksd. Motor Vehicles

(31) Which of the following assets is the most liquid?
(a) Cash at Bank (b) Prepaid Expenses
(c) Closing Stock (d) Cash in Hand

(32) Which of the following liabilities has the highest priority?
(a) Capital (b) Bills Payables
(c) Creditors (d) Loan from Bank

(33) Which of the following liabilities has the least priority?
(a) Capital (b) Bills Payables
(c) Creditors (d) Loan from Bank

(34) Which of the following assets is the least permanent?
(a) Cash at Bank (b) Prepaid Expenses
(c) Closing Stock (d) Cash in Hand

(35) Mortgage loan is classified as
(a) Current Liability (b) Non-current Liability
(c) Contingent Liability

(36) Which of the following assets is the least liquid?
(a) Goodwill (b) Cash in Hand
(c) Closing Stock (d) Prepaid Expenses

(37) Which of the following liabilities is the least permanent?
(a) Capital (b) Bills Payables
(c) Creditors (d) Loan from Bank

(38) Interest paid on loan taken from a friend is an
(a) debited to P&L Account
(b) debited to Trading Account
(c) debited to Manufacturing Account

(39) Interest on manufacturer's drawings is
(a) an expense from the firm
(b) an income for the firm
(c) charge against firm's profit

(40) Interest on manufacturer's capital is
(a) an expense from the firm (b) an income for the firm
(c) charge against firm's profit

(41) Which of the following items is/are shown on the Assets side of the Balance Sheet?
(a) Prepaid expense (b) Outstanding expense
(c) Unearned income (d) Accrued Income

(42) Which of the following items is/are shown on the Liabilities side of the Balance Sheet?
(a) Prepaid expense (b) Outstanding expense
(c) Unearned income (d) Accrued Income

(43) Which of the following items is/are shown as deduction from their related item?
(a) Prepaid expense (b) Outstanding expense
(c) Unearned income (d) Accrued Income

(44) Which of the following items is/are shown as addition to their related item?
(a) Prepaid expense (b) Outstanding expense
(c) Unearned income (d) Accrued Income

(45) Discount allowed is shown on the
 (a) debit side of Manufacturing Account (b) debit side of Trading Account
 (c) debit side of P&L Account
(46) Discount received is shown on the
 (a) credit side of Manufacturing Account (b) credit side of Trading Account
 (c) credit side of P&L Account
(47) For a shoe manufacturing, leather is
 (a) Raw Material (b) Work-in-progress (c) Finished Good
(48) Income tax paid by a manufacturer on his business income is
 (a) debited to Trading Account (b) debited to Manufacturing Account
 (c) debited to P&L Account (d) deducted from Capital Account
(49) Balance sheet reveals financial position of a business
 (a) during an accounting period (b) at the end of an accounting period
 (c) at the beginning of an accounting period
(50) Profit and Loss Account reveals financial performance of a business
 (a) during an accounting period (b) at the end of an accounting period
 (c) at the beginning of an accounting period
(51) For a shirt producing firm, cotton is
 (a) Raw Material (b) Work-in-progress (c) Finished Good
(52) Discount implies
 (a) discount allowed (b) discount received
 (c) profit (d) income
(53) Patents and copyrights are
 (a) Tangible Assets (b) Movable Assets
 (c) Current Assets (d) Intangible Assets
(54) Amortisation of Goodwill when given inside the Trial Balance is
 (a) debited to P&L Account (b) deducted from Goodwill on Asset side
 (c) Both (a) and (b)
(55) Bad Debts when given inside the Trial Balance is
 (a) debited to P&L Account (b) deducted from Debtors on Asset side
 (c) Both (a) and (b)
(56) Further Bad Debts are
 (a) debited to P&L Account (b) deducted from Debtors on Asset side
 (c) Both (a) and (b)
(57) New Provision for Doubtful Debts are
 (a) calculated on debtors after deducting further bad debt
 (b) calculated on debtors after deducting bad debts and further bad debts
 (c) calculated on debtors after deducting old provision, bad debts and further bad debts
(58) Old Provision for Doubtful Debts are
 (a) shown on the credit side of P&L Account if New Provision amount is lesser
 (b) deducted from the debtors amount before deducting further bad debts
 (c) ignored if new provision is given
 (d) shown on the debit side of P&L Account if New Provision amount is greater
(59) Provision for Discount on creditors are
 (a) shown on the credit side of P&L Account
 (b) shown on the debit side of P&L Account
 (c) deducted from creditors in the Balance Sheet
 (d) added to creditors in the Balance Sheet
(60) Provision for Discount on debtors are
 (a) shown on the debit side of P&L Account
 (b) shown on the credit side of P&L Account
 (c) deducted from good debtors in the Balance Sheet
 (d) added to good debtors in the Balance Sheet

IV. Fill in the Blanks

(1) In a Manufacturing organisation, Manufacturing Account is prepared to ascertain __________. (Gross Profit/Net Profit/Cost of Production)

(2) Income received in advance is shown in the ___________. (Balance Sheet/Profit and Loss Account/ Manufacturing Account)

(3) For a book-manufacturing organisation, paper is a __________. (Raw Material/WIP/Finished Goods)

(4) In a Manufacturing organisation, purchase of machinery spares will appear in the _________. (Balance Sheet/Profit and Loss Account/Manufacturing Account)

(5) ___________ shows the financial position of the company at the end of the year. (Trading Account/ Profit and Loss Account/Balance Sheet)

(6) In case of a manufacturer, Sale of Scrap appears on the credit side of ___________ Account. (Trading/ Profit and Loss/Manufacturing)

(7) Goodwill and Copyright are the examples of ____________ assets. (Tangible Assets/Intangible Assets)

(8) Interest on drawings is shown on the credit side of ___________ Account. (Manufacturing/Trading/ Profit and Loss)

(9) Interest on drawings is shown on the debit side of ___________ Account. (Manufacturing/Trading/ Profit and Loss)

(10) For a manufacturer, carriage inwards is __________. (added to opening stock of raw materials/shown on the debit side of Trading Account)

(11) While making the adjusting entry in respect of depreciation ______ account is credited. (Depreciation Account, Asset Account)

(12) Stock of WIP___________ of an accounting period is called Opening Stock. (at the end of/in the beginning)

(13) Fixed assets are not intended for___________. (resale/further processing/profit motive)

(14) For a trader, carriage inwards is __________. (added to opening stock of raw materials/shown on the debit side of Trading Account)

(15) Liquid assets are readily convertible into ___________. (cash/liquid liabilities)

(16) Closing Stock of WIP is ___________. (deducted from Opening Stock of Finished Goods/shown on the credit side of Manufacturing Account)

(17) Outstanding salary is shown on the ___________ side of Manufacturer's Balance Sheet. (assets/ liabilities)

(18) Prepaid expense is shown on the ___________ side of Manufacturer's Balance Sheet. (assets/liabilities)

(19) Unearned income is shown on the ________ side of Manufacturer's Balance Sheet. (assets/liabilities)

(20) Accrued income is shown on the ___________ side of Manufacturer's Balance Sheet. (assets/ liabilities)

(21) Goods distributed as free samples are ___________ (credited/debited) to ___________ Account. (Manufacturing/Trading/Profit and Loss)

(22) If new provision for bad debts exceeds the old provision for bad debts, then it is shown on the ___________ side of Profit and Loss Account. (credit/debit)

(23) If new provision for bad debts is less than the old provision for bad debts, then it is shown on the ___________ side of Profit and Loss Account. (credit/debit)

(24) Balance Sheet is a ____________. (statement/account)

(25) We deduct ____________ of doubtful debts from Sundry Debtors in the Balance Sheet. (New Provision/Old Provision)

(26) On the debit side of Profit and Loss Account, we debit all ___________ expenses. (direct/indirect)

(27) Deferred Revenue Expenditure is classified as ___________. (current assets/fictitious assets).

(28) When Balance Sheet is arranged in the order of liquidity, then ___________ appears on the top most and __________ appears on the bottom most of the Liabilities side. (Bills Payable/Capital/Sundry Creditors/Loans)

(29) When Balance Sheet is arranged in the order of liquidity, then ___________ appears on the top most and __________ appears on the bottom most of the Assets side. (Cash in Hand/Cash at Bank/Goodwill/ Land and Building)

(30) When Balance Sheet is arranged in the order of permanency, then ___________ appears on the top most and __________ appears on the bottom most of the Liabilities side. (Bills Payable/Capital/Sundry Creditors/Loans)

(31) When Balance Sheet is arranged in the order of permanency, then ___________ appears on the top most and __________ appears on the bottom most of the Assets side. (Cash in Hand/Cash at Bank/Goodwill/Land and Building)

(32) Mortgage loan is classified as ____________. (Current Liability/Non-Current Liability)

(33) Bills discounted with bank is a ____________. (Current Liability/Contingent Liability)

(34) Outstanding expense is _________ concerned expense on the debit side of Profit and Loss Account. (added to/deducted from)

(35) Prepaid insurance is _________ insurance on the debit side of Profit and Loss Account. (added to/deducted from)

(36) Income earned but not received is _________ concerned income on the credit side of Profit and Loss Account. (added to/deducted from)

(37) Unearned income is _________ concerned income on the credit side of Profit and Loss Account. (added to/deducted from)

(38) Provision for Discount on Debtors is calculated on the amount of _____________. (Sundry Debtors/Good Debtors)

(39) New provision for doubtful debt is calculated on the amount of debtors after deducting ___________. (bad debts/further bad debts/old provision)

(40) _____________ of doubtful debts is not shown in the Balance Sheet. (Old Provision/New Provision)

(41) If a machine is used in the production process by a manufacturer, then depreciation on the machine is shown on the debit side of ___________ Account. (Trading/Manufacturing/Profit and Loss)

(42) If a machine is *not* used in the production process by a manufacturer, then depreciation on the machine is shown on the debit side of __________ Account. (Trading/Manufacturing/Profit and Loss)

(43) Depreciation on office furniture is shown on the debit side of __________. (Trading/Manufacturing/Profit and Loss)

(44) Depreciation on factory furniture is shown on the debit side of _________. (Trading/Manufacturing/Profit and Loss)

(45) Freight outwards is shown on the debit side of ___________. (Trading/Manufacturing/Profit and Loss)

(46) Freight inwards is shown on the debit side of ____________. (Trading/Manufacturing/Profit and Loss)

(47) Carriage outwards is shown on the debit side of ___________. (Trading/Manufacturing/Profit and Loss)

(48) Salary or salary and wages is shown on the debit side of ____________. (Trading/Manufacturing/Profit and Loss)

(49) Wages or wages and salary is shown on the debit side of _____________. (Trading/Manufacturing/Profit and Loss)

(50) Commission paid is shown on the ___________ side of Profit and Loss Account. (debit/credit)

V. Match the following Columns

(A)

Column A	Column B
a. Carriage Inwards	i. Shown on the debit side of P&L Account
b. Freight Outwards	ii. Shown as deduction on the credit side of Trading Account
c. Outstanding Expense	iii. Added to find raw material consumed
d. Sales Return	iv. Shown on the Liabilities side of Balance Sheet
e. Purchase returns of finished goods	v. Credited to the Manufacturing Account
f. Sale of scrap	vi. Shown on the debit side of Trading Account as deduction

(B)

Column A	Column B
a. Manufacturing Account	i. Shown on the debit side of P&L Account
b. If New Provision > Old Provision of Doubtful Debts	ii. Credited to Manufacturing Account
c. Closing Stock of WIP	iii. Shown on the Assets side of Balance Sheet
d. Goods withdrawn by proprietor for personal use	iv. Credited to Trading Account
e. Non-accepted claim amount (of goods lost due to fire) by Insurance Company	v. Shown the debit side of P&L Account
f. Mortgage Loan	vi. Non-Current Liability
g. Claim accepted by insurance company	vii. Always have a debit balance

VI. State whether the following statements are TRUE or FALSE

(1) Profit and Loss Account reveals the financial performance of a business during an accounting period.
(2) Balance Sheet reveals the financial position of a business during an accounting period.
(3) Balance Sheet Account reveals the financial position of a business at the end of an accounting period.
(4) Profit and Loss Account reveals the financial performance of a business at the end of an accounting period.
(5) The Manufacturing Account always shows a debit balance.
(6) Income received in advance is shown on the Assets side of the Balance Sheet.
(7) Accrued income is shown on the Liabilities side of the Balance Sheet.
(8) Long term liabilities become due for payment within one year.
(9) Prepaid expense is shown on the asset side of the Balance Sheet.
(10) Income received in advance is shown on the Liabilities side of the Balance Sheet.
(11) Balance Sheet is a statement prepared on a specified date.
(12) Accrued income is shown on the Assets side of the Balance Sheet.
(13) Carriage inwards are debited to Profit and Loss Account of a manufacturer.
(14) Interest on drawings is added to manufacturer’s capital in the Balance Sheet.
(15) Outstanding expense is shown on the Asset side of the Balance Sheet.
(16) Interest paid on loan taken from bank is shown on the credit side of Profit and Loss Account.
(17) Outstanding expense is shown on the Liabilities side of the Balance Sheet.
(18) Depreciation on office building is shown on the debit side of the Profit and Loss Account.
(19) Depreciation on plant and machinery used in factory is shown on the debit side of Trading Account.
(20) Wages paid for installation of a machine is shown on the debit side of the Profit and Loss Account.
(21) Wages paid for construction of cycle shed is added to the wages on the debit side of Trading Account.
(22) Depreciation on machine used in factory is shown on the debit side of Manufacturing Account.
(23) Wages paid for construction of cycle shed is added to the Building Account on Asset side of Balance Sheet.
(24) New provision for bad and doubtful debts is calculated on the amount of debtors after deducting old provision of doubtful debts.
(25) New provision for bad and doubtful debts is calculated on the amount of debtors after deducting further bad debts.
(26) Closing stock of WIP is shown on the credit side of Manufacturing Account.
(27) Provision for discount on debtors is calculated after deducting new provision of doubtful debts from net debtors.
(28) Interest on capital is deducted from the manufacturer’s capital on the Liabilities side of Balance Sheet.
(29) Provision for discount on debtors is calculated after deducting old provision of doubtful debts from net debtors.

(30) Amount received from sale of old machinery is shown on the credit side of Manufacturing Account.
(31) Amount of depreciation on old machinery is shown on the debit side of Manufacturing Account.
(32) Closing stock of WIP is shown on the credit side of Trading Account.
(33) Commission received in advance is a liability.
(34) Carriage inwards on furniture purchased is shown on the debit side of Manufacturing Account.
(35) Carriage inwards on raw materials purchased is shown on the debit side of Manufacturing Account.
(36) Manufacturer's Capital will always have a credit balance.
(37) Interest on manufacturer's drawing is an income to the organisation.
(38) Interest on manufacturer's drawing is an expense to the organisation.
(39) Outstanding salary is a nominal account.
(40) Interest on manufacturer's capital is an expense to the organisation.
(41) Interest on manufacturer's capital is an income to the organisation.
(42) We record only those expenses and losses that are related to the current year on the debit side of Profit and Loss Account.
(43) When new provision for doubtful debts is less than the old provision, then we show the net provision on the credit side of Profit and Loss Account.
(44) Goods distributed as free samples are shown on the credit side of the Manufacturing Account.
(45) Goods distributed as free samples are shown on the credit side of the Trading Account.
(46) Drawings in form of goods by the manufacturer are shown on the credit side of Manufacturing Account.
(47) Drawings in form of goods by the manufacturer are shown on the credit side of Trading Account.
(48) In case of goods lost due to fire, we shown the amount of goods lost on the credit side of Trading Account.
(49) When insurance company accepts 60% of the claimed amount, then only 40% of the amount of goods so lost is shown on the credit side of Trading Account.
(50) The insurance claim accepted by the insurance company is shown on the Liabilities side of the Balance Sheet.
(51) Goods distributed as free samples are shown on the debit side of Trading Account and also on the credit side of Manufacturing Account.
(52) Goods distributed as free samples are shown on the debit side of Profit and Loss Account and also on the credit side of Trading Account.
(53) Profit on sale of fixed assets is shown on the credit side of Trading Account.
(54) Loss on sale of fixed assets is shown on the debit side of Profit and Loss Account.
(55) Provision for discount from creditors of raw materials is shown on the credit side of Manufacturing Account.
(56) Provision for discount from creditors of raw materials is shown on the credit side of Profit and Loss Account.
(57) Profit on sale of fixed assets is shown on the credit side of Profit and Loss Account.
(58) Unrecorded purchases are added to the Purchases Account and are added to the creditors on the Liabilities side of the Balance Sheet.
(59) If wages paid for installation of machinery has been wrongly considered as revenue expenditure, then the amount of gross profit is overstated.
(60) If wages paid for installation of machinery has been wrongly considered as revenue expenditure, then the amount of gross profit is understated.
(61) Unrecorded sales are added to the sales account and are also added to the debtors on the Assets side of the Balance Sheet.
(62) If expenditure incurred on construction of building has been wrongly debited to Purchases Account, then the amount of gross profit is understated.
(63) If expenditure incurred on construction of building has been wrongly debited to Purchases Account, then the amount of gross profit is overstated.

(64) In order to rectify the error due to wrong consideration of expenditure incurred on construction of building as purchases, we need to reduce Purchases Account and raise Building Account by the same amount.

(65) All the items that are given inside a Trial Balance have only one effect.

(66) All the items that are given outside a Trial Balance have two effects.

VII. Practical Questions

Q1. Consider the following information extracted from the books of Ram & Co. to prepare Manufacturing Account for the year ended 31 March 2017.

Particulars	Amount (₹)
Opening Stock	
Raw Materials	10,000
Work-in-progress	8,000
Finished Goods	14,000
Closing Stock	
Raw Materials	12,000
Work-in-progress	16,000
Finished Goods	20,000
Purchase of Raw Materials	60,000
Wages of Workers	44,000
Light, Gas etc. (Factory)	5000
Carriage Inwards	3000
Factory Rent	12,000
Repairs to Factory	10,000
Depreciation on Plant	10,000
Royalty on Production	6,000
Fuel & Power	4,000
Sale of Scrap	1,000

Q2. You are required to prepare Manufacturing & Trading Account for the year ended 31 March 2017 using the below given financial figures.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening Stock		Power & Fuel	6,000
Raw Materials	14,000	Repairs of Office Furniture	8,000
Work-in-progress	14,000	**Closing Stock**: Work-in-progress	6,000
Finished Goods	20,000	Finished Goods	12,000
Purchase of Raw Materials	1,80,000	Raw Materials	5,000
Direct Wages	22,000	Salaries & Wages	16,000
Factory Overhead	16,000	Repair for Plant	15,000
Sales	3,50,000	Sale of Scrap	2,500
Depreciation on Factory Building	8,000	Discount Received	1,000
Carriage Inwards	2,000	Discount Allowed	500
Return Inwards	5,000	Interest paid on Capital	12,000

Q3. The following information was extracted from the books of M/s Ram Chautrani. You are required to prepare Manufacturing & Trading Account using these figures.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening Stock		**Closing Stock**	
Raw Materials	10,000	Raw Materials	8,000
Work-in-progress	15,000	Work-in-progress	10,000
Finished Goods	20,000	Finished Goods	15,000
Purchase of Raw Materials	1,00,000	Purchase of Finished Goods	18,000
Octroi	2,000	Carriage Inward	5,000
Dock Dues	1,500	Sale of Scrap	1,200
Direct Wages	15,000	Sales of Finished Goods	3,00,000
Custom Duty	2,500		
Hiring Charges	15,000		
Finished Goods taken by Proprietor	2,000		
Return Inwards	5,000		
Return Outward	10,000		
Lighting of Factory Building	2,000		

Q4. From the following detail for the year ended 31 March 2017, prepare Manufacturing Account, Trading Account and Profit & Loss Account of Mr. Priyesh.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening Stock		Salesman Salary	1,50,000
Raw Materials	2,10,000	Electric & Water Charges	15,000
Work-in-progress	1,65,000	Wages	4,50,000
Finished Goods	1,00,000	Machine Supervisor Salary	21,000
Purchase of Raw Materials	10,50,000	Office Salary	24,000
Sales	19,50,000	Salesman Salary	15,000
Purchase Return	18,000	**Depreciation**: On Plant	12,000
Sales Return	12,000	On Machinery	6,000
Carriage Inward	6,000	On Office Furniture	1,800
Advertisement Expenses	6,000	**Closing Stock**	
Octroi Charges	4,500	Raw Materials	1,50,000
Factory Rent	12,000	Work-in-progress	1,65,000
Office Rent	7,500	Finished Goods	1,80,000

Q5. The given below is the Balance Sheet of M/s Salim as on 31 March 2016.

Balance Sheet

for the year ended 31 March 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	6,00,900	Land and Building	2,28,000
Bills Payable	75,600	Plant and Machinery	1,65,000
Sundry Creditors	1,03,500	Sundry Debtors	84,000
		Investments @ 10% p.a. interest	45,000
		Cash at Bank	52,500
		Closing Stock	2,05,500
	7,80,000		7,80,000

Profit and Loss for the year ending 31 March 2017 disclosed a net profit of ₹1,18,620. The net profit has been ascertained without considering the following adjustments.

(a) Prepaid insurance of ₹1,380
(b) Interest on investment was due for 6 months,
(c) ₹9,000 were unpaid as salary
(d) Depreciation of ₹4,560 on Land and Building and on Plant and Machinery is ₹18,150
(e) Closing Stock amounted to ₹1,78,000

Additional Information as on 31 March 2017:

(a) Sundry Debtors were valued at ₹84,000.
(b) Closing Stock was valued at ₹1,33,000.
(c) Bank balance on the above date was ₹1,34,620.

On the basis of the above information, you are required to prepare Balance Sheet of M/s Salim as on 31 March 2017.

Q6. Considering the below given Trial Balance and the additional information, you are required to prepare the Manufacturing Account, Trading Account, Profit and Loss Account along with Balance Sheet.

Trial Balance

as on 31 March 2017

Particulars	Debit Amount (₹)	Credit Amount (₹)	Particulars	Debit Amount (₹)	Credit Amount (₹)
Stock as on 1 April 2016			Cash at Bank	24,000	–
Raw Materials	24,000	–	Other Direct Wages	24,000	–
Work-in-progress	14,000	–	Machinery	1,20,000	–
Finished Goods	40,000	–	Indirect Wages	16,000	–
Purchase of Materials	1,94,000	–	Factory Rent	14,000	–
Bills Payable	–	14,000	Direct Wages	1,14,000	–
Capital	–	1,70,000	Octroi on Raw Material	22,000	–
Drawings	42,000	–	Creditors	–	50,000
Sundry Debtors	1,00,000	–	Selling Expenses	26,000	–
Provision for Bad Debts	–	6,000	Administrative Expenses	62,000	–

(Continued)

Particulars	Debit Amount (₹)	Credit Amount (₹)	Particulars	Debit Amount (₹)	Credit Amount (₹)
Discount allowed	8,000	–	Sales	–	6,20,000
Interest	14,000	–	Bad Debts	2,000	–
				8,60,000	8,60,000

Additional Information:

(a) Closing Stock-Raw Materials-₹44,000, WIP-₹25,000 and Finished Goods-₹2,00,000
(b) Depreciation to be provided @ 5% on Machinery
(c) 25% of admin expenses pertain to factory
(d) Provision for doubtful debt is to be maintained @ 10%.

Q7. From the following Trail Balance of Ram & Co. Enterprise, prepare Manufacturing, Trading Profit & Loss Account for the year ended 31 March 2017.

Particulars	Debit	Credit
Opening Stock		
Raw Materials	3,600	–
Factory Goods	7,000	–
Work-in-progress	10,000	–
Machinery	90,800	–
Furniture	60,000	–
Debtors	1,08,000	–
10% Interest (01 Jan. 2017)	30,000	–
Creditors	–	1,76,000
Electricity for Factory	2,500	–
Stationery	67,500	–
Professional Fees	12,000	–
Conveyances	19,000	–
Return Outward	–	5,000
Sales	–	4,07,000
Sale of Scrap	–	2,000
Repairs to Machinery	2,600	–
Insurance Machinery	1,400	–
Power Lighting	9,000	–
Salaries	28,000	–
Wages	36,000	–
Carriage (50% of Sales)	24,000	–
Premises	46,200	–
	5,90,000	5,90,000

Adjustment

The following additional information are overhead:

1. On 31 March 2017, Closing Stock was valued as Raw materials 14,000, WIP-₹15,000 and Finished Goods at ₹18,000
2. Bad debts of ₹5,000 was to be accounted
3. Opening Stock expenses on Salaries Wages was ₹2,000 & ₹4000

Q8. From the following Ledger Balance as on 31 March 2017 appears in the books of Kedar. Prepare Manufacturing. Trading, Profit and Loss Account for the year ended 31 March 2017 and Balance Sheet as on 31 March 2017.

Particulars		Debit	Credit
General Expenses		38,000	–
Insurance		8,000	–
Rent & Traces		40,000	–
Salaries & Wages			
Office Expenses		1,46,000	–
Factory		3,60,000	–
Freight on Materials		80,000	–
Purchase of Materials		14,00,000	–
Provision for Bad Debts		–	12,000
Miscellaneous Income		–	10,000
Net Sales		–	20,00,000
Opening Stock		–	–
Materials	2,40,000	–	–
Work-in-progress	16,000	–	–
Finished Goods	1,70,000	4,26,000	–
Sundry Debtors & Creditors		5,14,000	4,60,000
10% Bank Loan (01 Jan. 2017)			1,30,000
Capital			5,60,000
Machinery		1,00,000	–
Factory Stock		60,000	–
		31,72,000	31,72,000

Adjustment

1. Closing Stock: ₹1,00,000 (Raw materials), ₹10,000 (Work in progress), ₹1,50,000 (Finished goods)
2. 1/4th of Insurance & General Expenses to be allocated to office
3. Bad debts to created @ 10% on existing debtors
4. Deprecation @ 10% p.a was to be calculated on Machinery & Factory Shed

Q9. Prepare the Manufacturing, Trading & Profit & Loss Account for the year ended on 31 December 2016 as on that date from the following balances extended from the books of Mr. Rakesh.

I.C.W.A. 1985 (adapted)

Particulars	Amount (₹)	Particulars	Amount (₹)
Drawings	32,000	Discount Returned	1,648
Capital Account	1,40,000	Sales	3,16,696
Bank Charges	480	Stock (01 Jan. 2016)	
Provision for Bad Debt	4,000	(a) Raw Materials	20,920
Bad Debt	2,420	(b) Finished Goods	29520
Advertising	3,320	(c) Work-in-progress	6,680
Machinery Purchased on 1 July 2016	8,000	Factory Wages	82,800
Purchases	1,34,672	Creditors	24,600
Packing & Transport	4,340	Cash at Bank	16,404
Rent & Rates	5,944	Office	1,384
Repairs to Machinery	3,140	Insurance	3,608

(Continued)

Particulars	Amount (₹)	Particulars	Amount (₹)
Salaries-Office	14,760	Machinery on 01 Jan. 2016	60,000
Factory Power	14,456	Debtors	42,240
General Expenses	820	Furniture	3,600
Bills Payable	6,492	Light & Heat	1,928

Additional Information:

(1) Stock at 31 December 2016: Raw materials - ₹14,240, Work-in-progress - ₹6,960, Finished goods - ₹38,600 and Packing materials - ₹500

(2) The following items are to be provided.
Factory Power ₹2,248, Rent Rates ₹1,544, Light and Heat ₹640, General Expenses (Factory) ₹100, General Expenses (Office) ₹160 and Insurance prepaid ₹680

(3) Provided depreciation @ 10% p.a. on plant and 5% p.a. on furniture.

(4) Raise the provision for bad debts by ₹2,000

(5) 5/6th of rent & rates, light & heat and insurance are to be allocated to the factory and 1/6th to the office.

Q10. The following information is given to years from the books of a manufacture in respect of the year ending 31 March 2017. **I.C.W.A. 1985 (adapted)**

Particulars	Amount (₹)	Particulars	Amount (₹)
Electricity & Telephones	12,000	**Opening Stock**	
Selling & Expenses	12,000	Raw Materials	54,000
Miscellaneous Expenses	28,000	Freight Inward	17,000
Stock of finished goods (31 March 2016)	60,000	Fright Outward	12,000
Provision for doubtful debts	17,000	Wages Direct	36,000
Depreciation on Plant & Machinery	8,000	Wages Indirect	28,000
Stationery	3,000	Sales	8,36,000
Travelling Expenses	10,000	Depreciation on Office Furniture	6,000
Salaries (Head Office)	52,000	Repair to Plant & Machinery	9,300
Factory Expenses	52,000	Scrap Sales	7400
Interest on Loan paid	3,600	Purchase of Raw Materials	5,00,000
Return Inward	10,000	Coal conformed	18,000
Return Outward	7,000	Work in progress (01 April 2016)	14,000
Power & Fuel	16,000	Bank Interest Received	5,200

Additional Information:

(1) Finished goods worth ₹10,000 were distributed as free samples.

(2) A loan was obtained on 1st October, 2016 for ₹1,00,000 carrying interest @ 10% p.a.

(3) Bad debts to be written-off ₹1,500 & provision for doubtful debts to be maintained at ₹14,000.

(4) Electricity & Telephone expenses are to be apportioned as factory 3/5th and office 2/5th.

(5) A fire occurred destroying finished goods worth ₹30,000. Insurance company admitted a closing of ₹24,000 not yet received.

(6) Stock on 31 March 2017 stationery in hand ₹300, Raw materials ₹44,000, Work in progress ₹8000 & finished goods ₹80,000.

You are required to prepare Manufacturing, Trading and Profit & Loss Account for the year ended 31 March 2017

Q11. Considering the following Trial Balance of Mr. Ashwin, prepare Final Accounts.

Trial Balance of Mr. Ashwin
for the year ended 31 December 2016

Debit Balance	Amount	Credit Balance	Amount
Cash at Bank	19,060	Capital A/c	83,720
Machinery	60,000	Sales	2,77,560
Drawings	5,000	Sundry Creditors	17,600
Miscellaneous Expenses	1,260	Reserve for Doubtful Debts	7,120
Discount Allowed	1,220		
Purchase of Raw Materials	1,65,900		
Factory Insurance	2,560		
Printing & Stationery	2,400		
Advertisement	2,550		
Sundry Debtors	43,200		
Rent (Factory portion - 1/4th)	8,000		
Carriage Inwards	2,000		
Opening Stock			
Finished Goods	8,000		
Work-in-progress	14,500		
Raw Materials	5,6000		
Furniture & Fixture	6,800		
Manufacturing Expenses	19,500		
Other Expenses	12,450		
	3,80,000		3,80,000

Adjustment

(1) Closing Stock: Finished goods ₹13,000, Raw materials ₹1,500 and Work in progress ₹9500
(2) Provision for unrealised rent in respect of portion of office sublet @ ₹240 from 01 October 2016.
(3) Depreciate Machinery at 15% p.a. & Furniture & Fixtures at 10% p.a.
(4) On 28 December 2016 goods costing ₹3,600 were purchased and included in the closing stock. However, no entry was passed in the books.
(5) Doubtful debts provision is to be maintained @ 5% on debtors.

Q12. The following balances are extracted from the ledger accounts of Mr. Jay as on 31 December 2016. You are required to prepare Manufactures, Trading, Profit & Loss & Balance Sheet.

Particulars	Debit	Credit
Mr. Jay's Capital	–	2,80,000
Plants Machinery	90,000	–
Opening Stock	–	–
Raw materials	40,000	–
Finished goods	10,000	–
Purchase & Sales	7,48,000	9,20,000
Debtors and Creditors	2,70,000	1,80,000
Wages	60,000	–

(Continued)

Particulars	Debit	Credit
Salaries	44,000	–
Trade Expenses	18,000	–
Rent	24,000	–
Consignment (Mr. Jeet Account)	66,000	–
Cash	10,000	–
	13,80,000	13,80,000

Adjustment

(1) Opening Stock of Finished goods included stock of stationery of ₹400

(2) Closing Stock of raw materials ₹20,000. Closing Stock of finished goods ₹40,000 (including Stock of Stationery ₹200)

(3) Trade expenses include payment of stationery of ₹4,000

(4) Closing Creditors include Creditors for Stationery of ₹1,000 for credit purchases

(5) Mr. Jay sent goods costing ₹66,000 to Mr. Jeet (consignee) who sold two-third of the quantity for ₹70,000 The consignee has incurred expenses of ₹4,000 and is entitled for commission of 5% on sales.

(6) Provide depreciation on Plant & Machinery @ 10% p.a.

(7) Sales include of ₹64,000 received on sale of all goods received on behalf of Mr. Prashant (consignor). Mr. Jay entitled for 10% of commission no entry passed yet. Trade expenses include ₹1,000 spend for this sale.

Q13. Following the trail balance of Mrs. Dimple as on 31 March 2017, you are required to prepare Manufacturing, Trading & Profit & Loss A/c 31 March 2017 & Balance Sheet as on that date.

Particulars	Debit	Credit
Capital/Drawings	80,000	16,00,000
Opening Stock:		
RM	1,01,600	
WIP	51,600	
Finished Goods	4,36,000	
Purchase of Raw Materials	44,48,000	
Wages	1,58,400	
Power & Fuel	97,000	
Factory Rent	50,000	
Carriage o/w	69,400	
Sales		97,48,000
Insurance Premium	1,02,000	
Discount	10,000	38,000
Printing & Stationery	82,800	
Office Rent	1,29,200	
Bills Receivable	6,02,000	
Bills Payable		2,00,000
Sundry Debtors	12,00,000	8,00,000
Plant & Machinery	32,00,000	
Motor Car	12,00,000	
Returns	48,000	60,000
Interest @ 14% on Investment		44,000
Investments (01 April 2016)	4,00,000	

(Continued)

Particulars	Debit	Credit
Bad Debts	20,000	
Provision for Doubtful Debts		12,000
Life Insurance Premium	16,000	
	1,25,02,000	1,25,02,000

Adjustment

(1) **Closing Stock** — **Price Cost** — **Market Cost**

Closing Stock	Price Cost	Market Cost
(a) Raw Materials	1,80,000	2,00,000
(b) Work-in-progress	1,80,000	1,00,000
(c) Finished Goods	8,00,000	7,20,000

(2) Depreciation Plant & Machinery @ 15% p.a. & Motor Car @ 20% p.a.
(3) General Insurance pre-paid was ₹1,8000
(4) Provides for outstanding factory rent ₹26,000
(5) Finished goods costing ₹40,000 & Raw materials costing ₹60,000 were destroyed by fire. Insurance company admitted claim of ₹30,000 for finished goods & ₹40,000 for Raw material by the date of balance sheet.
(6) Write off Bad debts of ₹40,000 & create a Provision for doubtful debts and provision for discount on debtors @ 5% & 2% respectively.
(7) Purchase included ₹1,60,000 in respect of plant & Machinery which was purchased on 01 October 2016.
(8) On 30 March 2017 goods costing ₹80,000 here purchased credit (included in closing stock) which remained unrecorded.
(9) Proprietor had withdrawn goods at sale price of ₹60,000, which included profit elements of 20% on cost. This amount was recorded through sales register & was wrongly debited to Mr. Rajesh (Debtors Account).

Q14. Consider the following Trial Balance as on 31 March 2017 to prepare Manufacturing Account, Trading Account, Profit and Loss Account along with Balance Sheet.

Trial Balance
as on 31 March 2017

Particulars	Debit Amount (₹)	Credit Amount (₹)	Particulars	Debit Amount (₹)	Credit Amount (₹)
Opening Stock			Capital	–	17,00,000
Raw Materials	5,00,000	–	Sundry Creditors	–	1,04,000
Work-in-progress	1,60,000	–	Wages	1,66,000	–
Finished Goods	4,40,000	–	Factory Taxes	8,000	–
Purchase of Materials	4,30,000	–	Power	18,000	–
Building	3,00,000	–	Factory Insurance	10,000	–
Plant and Machinery	7,20,000	–	Salary to Staff	22,000	–
Furniture	80,000	–	Office Rent	21,000	–
Trade Marks	60,000	–	Carriage Inwards	5,000	–
Printing and Stationery	10,400	–	Sundry Debtors	1,65,000	–
Bank Charges	5,000	–	Discount	–	5,000
Travelling Expenses	20,000	–	Misc. Expenses	11,000	–
Discount	6,600	–	Bills Payable	–	68,000
Sales Return	22,000	–	Bills Receivables	32,000	–

(Continued)

Particulars	Debit Amount (₹)	Credit Amount (₹)	Particulars	Debit Amount (₹)	Credit Amount (₹)
Advertisement	11,000	–	Bank balance at	2,14,000	–
Sales	–	15,60,000	Bank of Baroda		
				34,37,000	34,37,000

Additional Information:

(1) Closing Stock-Raw Materials-₹1,70,000, WIP-₹60,000 and Finished Goods-₹4,10,000
(2) Factory tax prepaid-₹4,000
(3) Depreciation on furniture @ 10%, on Plant and Machinery @ 15%, on Trade Marks @ 20% and on Building @ 5% p.a

Q15. The following balances were extracted from the books of M/S Pawan as on 31 March 2017. Prepare Final Accounts.

Particulars	Amount	Particulars	Amount
Drawings	60,000	Extension to Building	40,000
Manager's Salary	12,000	Land & Building	4,00,000
Cash in hand	4,000	Plant & Machinery	2,00,000
Bad debts	8,000	Patents	8,00,000
Advertisement	10,000	Sundry Debtors	1,90,000
Discount	12,000	Cash at bank	82,000
Printing & Stationery	20,000	Capital	10,00,000
Office Expenses	10,000	Sundry Creditors	2,00,000
Stock		Loan	1,60,000
Finished Goods (01 April 2016)	1,90,000	Reserve for Bad debts	12,000
Work in progress	3,50,000	Purchase Return	14,000
Raw Materials	80,000	Sales	5,28,000
Purchase of Raw materials	2,00,000	Carriage Inwards	16,000
Legal changes for assuring assets	10,000		

Adjustment

(1) On 31 March 2017 stocks were valued as Raw materials ₹1,00,000; Work in progress ₹1,60,000 & Finished goods ₹2,00,000
(2) Outstanding expenses: Advertisement ₹1,000 & Printing ₹600
(3) Stock of stationery on hand 2000on 31 March 17
(4) Depreciate Plant & Machinery at 10% p.a. & patents at 20% p.a.
(5) Manager is entitled for commission of 5% on Net Profit before changing his commission.
(6) Raise reserve for bad debts by ₹6,000
(7) Interest on loan of ₹2,000 still unpaid.

Q16. Wasim Chemicals has the following ledger Balance as on 31 March 2017. Prepare Manufacturing and Profit and Loss Account for the year ended 31 March 2017.

Particulars	Amount	Particulars	Amount
Land	1,00,000	Net Sales	22,00,000
Factory Shed	40,000	Miscellaneous Income	8,000
Machinery	2,60,000	Bad debts	10,000
Furniture	16,000	Purchase of Materials	17,20,000
Investment	20,000	Freight on Materials	1,00,000

(Continued)

Particulars	Amount	Particulars	Amount
Capital	3,90,000	Factory repair	30,000
Bank Loan	6,00,000	Salaries & wages	
Creditors	3,00,000	Factory	3,00,000
Debtors	2,70,000	Office	1,30,000
Opening Stock		Repairs & Rents	5,000
Material	2,60,000	Rent & Taxes	33,000
Work in progress	15,000	Insurance	7,800
Finished Goods	1,65,000	General Expenses	36,200

Adjustment

The following additional information is available

(1) Closing Stock: Materials ₹4,20,000, Work-in-progress ₹25,000, Finished Goods ₹4,15,000

(2) Depreciation to be recommended at 2.5% p.a. and factory shed 10% p.a. on machinery & 15% p.a. on furniture

(3) Repairs and rent and taxes are to be apportioned between factory & office in the rates of 3:2.

(4) Create Bad & doubtful debts @ 4% on debtors.

(5) Insurance premium covers a period of one month in advance.

Q17. From the following Trial Balance of Mr. Shiva, Prepare Manufacturing Account, Trading Profit & Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date.

Trial Balance of Mr. Shiva

as on 31 March 2016

Particulars	Debit	Credit
Creditors	–	71,000
Machinery	80,000	–
Opening Stock - Raw Materials	26,000	–
Opening Stock - Work In Progress	2,000	–
Opening Stock - Finished Goods	30,000	–
Purchase of Raw Materials	2,80,000	–
Carriage Inward on Raw Materials	5,000	–
Direct Wages	56,000	–
Factory Rent	27,000	–
Drawings	30,000	–
Sales	–	5,00,000
Cash at Bank	19,000	4,07,000
Salaries	9,000	2,000
Discount Allowed	7,000	–
Capital Account		1,00,000
Sundry Debtors	1,00,000	–
	6,71,000	6,71,000

Adjustment

The following additional information are overhead:

1. Closing Stock as on 31 March 2016: Raw Material ₹32,000, Work in Progress ₹4,000, Finished Goods ₹35,000.
2. Depreciate Machinery @ 10% p.a.
3. On January 2016, there was a fire in the godown of Mr. Shiva, destroying finished goods worth ₹12,000; insurance company admitted the claim for ₹8,000. This transaction was not recorded in the books.
4. Provide Reserve for Doubtful Debts @ 5% on Sundry Debtors

Acc&FM-I, March 2017

Q18. From the following Trial Balance of Mr. Neelkanth, Prepare Manufacturing Account, Trading Profit & Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date.

Trial Balance of Mr. Neelkanth
as on 31 March 2016

Particulars	Debit	Credit
Carriage Inwards	10,000	–
Purchase of Raw Material	1,95,000	–
Sales	–	3,70,000
Furniture	32,000	–
Bills Payable	–	10,000
Opening Stock - Raw Materials	22,000	–
Opening Stock - Work in Progress	25,000	–
Opening Stock - Finished Goods	30,000	–
Capital	–	1,29,000
Direct Wages	60,000	–
Factory Power and Fuel	18,000	–
Machinery	1,00,000	–
Office Salaries	20,000	–
Cash at Bank	10,000	–
Selling and Distribution Expenses	29,000	–
Creditors	–	90,000
Provisions for Bad Debts	–	2,000
Sundry Debtors	50,000	–
	6,01,000	6,01,000

Adjustment

The following additional information are overhead:

1. Closing Stock as on 31 March 2016: Raw Material ₹20,000, Work in Progress ₹6,000, Finished Goods ₹39,000.
2. Depreciate Machinery @ 5% p.a.
3. Outstanding Factory Power and Fuel is ₹2,000.
4. Provide Reserve for Doubtful Debts @ 5% on Sundry Debtors

Acc&FM-I, March 2017

CHECK YOUR ANSWERS

III. Objective Type Questions

1–a	2–b	3–b	4–d	5–a	6–a	7–c	8–c	9–a	10–c	11–d	12–a	13–c
14–c	15–d	16–c	17–a	18–d	19–d	20–a	21–c	22–c	23–a	24–b	25–c	26–b
27–b	28–c	29–d	30–b	31–d	32–b	33–a	34–d	35–b	36–b	37–b	38–a	39–b
40–a	41–d	42–b	43–a	44–b	45–c	46–c	47–a	48–d	49–b	50–a	51–a	52–a
53–d	54–a	55–a	56–c	57–a	58–d	59–a,c	60–a,c					

IV. Fill in the Blanks

1-Cost of Production	2-Balance Sheet	3-Raw Material	4-Balance Sheet
5-Balance Sheet	6-Manufacturing	7-Intangible Assets	8-Profit and Loss
9-Profit and Loss	10-added to opening stock of raw materials	11-Asset Account	12-in the beginning

(Continued)

13-resale	14-shown on the debit side of Trading Account	15-cash	16-shown on the credit side of Manufacturing Account
17-Liabilities	18-Assets	19-Liabilities	20-Assets
21-(a) credited, (b) Trading	22-debit	23-credit	24-statement
25-New Provision	26-indirect expenses	27-fictitious assets	28-(a) Bills Payables, (b) Capital
29-(a) Cash in Hand, (b) Goodwill	30-(a) Capital, (b) Bills Payables	31-(a) Goodwill, (b) Cash in Hand	32-Non-Current Liability
33-Contingent Liability	34-added to	35-deducted from	36-added to
37-deducted from	38-Good Debtors	39-Further Bad Debts	40-Old Provision
41-Manufacturing	42-Profit and Loss	43-Profit and Loss	44-Manufacturing
45-Profit and Loss	46-Manufacturing	47-Profit and Loss	48-Profit and Loss Account
49-Manufacturing	50-Debit		

V. Match the Columns

(A)	(B)
(a)–(iii), (b)–(i), (c)–(iv), (d)–(ii), (e)–(vi), (f)–(v)	(a)–(vii), (b)–(v), (c)–(ii), (d)–(iv), (e)–(i), (f)–(vi), (g)–(iii)

VI. True or False

True	False
1, 3, 5, 9, 10, 11, 12, 17, 18, 22, 23, 25, 26, 27, 31, 33, 35, 36, 37, 40, 42, 43, 45, 47, 48, 52, 54, 57, 58, 59, 61, 64, 65, 66	2, 4, 6, 7, 8, 13, 14, 15, 16, 19, 20, 21, 24, 28, 29, 30, 32, 34, 38, 39, 41, 44, 46, 49, 50, 51, 53, 55, 56, 60, 62, 63

VII. Practical Questions

Q1. Cost of Goods Produced–₹1,56,000
Q2. Cost of Manufacturing–₹2,63,500; Gross Profit–₹73,500
Q3. Cost of Manufacturing–₹1,38,800
Q4. Cost of Manufacturing–₹16,18,500; Gross Profit–₹3,43,500; Net Profit–₹2,89,200
Q5. Total of Balance Sheet–₹8,69,160
Q6. Cost of Manufacturing–₹3,74,500; Gross Profit–₹4,05,500; Net Profit–₹3,05,000 and Total of Balance Sheet–₹4,97,000
Q7. Cost of Manufacturing–₹78,500; Gross Profit–₹3,16,500
Q8. Cost of Manufacturing–₹20,20,500; Gross Profit–₹40,500; Net Loss–₹2,86,650, and Total of Balance Sheet–₹8,66,600
Q9. Cost of Manufacturing–₹2,61,856
Q10. Cost of Manufacturing–₹6,89,100; Gross Profit–₹1,96,900
Q11. Cost of manufacturing–₹2,13,660, Net Profit–₹42,020 and Total of Balance Sheet–₹1,41,940
Q12. Cost of Manufacturing–₹8,36,000; Gross Profit–₹76,200; Net Loss–₹10,100 and Total od Balance Sheet–₹5,05,500
Q13. Cost of Manufacturing–₹49,44,600; Gross Profit–₹50,69,400; Balance Sheet Total–₹69,54,100
Q14. Cost of Manufacturing–₹11,71,000; Gross Profit–₹3,37,000; Net Profit–₹2,00,000 and Total of Balance Sheet–₹20,72,000
Q15. Cost of Manufacturing–₹4,09,600, Gross Profit–₹1,28,400; Net Profit–₹46,360 and Total of Balance Sheet–₹13,52,400
Q16. Cost of Manufacturing–₹20,29,800; Net Profit–₹2,36,450
Q17. Cost of Goods Produced–₹3,68,000, GP–₹1,49,000, NP–₹1,24,000 and Total of Balance Sheet–₹2,65,000
Q18. Cost of Goods Produced–₹3,11,000, GP–₹68,000, NP–₹16,900 and Total of Balance Sheet–₹2,47,900

CHAPTER 7

Departmental Accounts

CHAPTER OUTLINE

EXERCISE

7.1 INTRODUCTION TO DEPARTMENT

In the last chapter, we have learnt how a manufacturing firm prepares its final accounts—Manufacturing Account, which is followed by Trading and Profit and Loss Account and finally the Balance Sheet. The manufacturer in the last chapter was producing only one good; however, in reality, a manufacturer can actually produce many products simultaneously. For instance, think of TATA, Birla, Britannia, P&G and many more big production units. They simultaneously produce many products that are of different nature. All these different product segments are regarded to be different departments and each department is operating individually and independently of each other. In other words, we can say that each department is in totality a separate production unit, which deals in a specific product, earns profit and thereby contribute to the overall organisational profits. Thus, the organisation–department relationship can be regarded as parent–child relationship. Figure 7.1 below further extends our explanations.

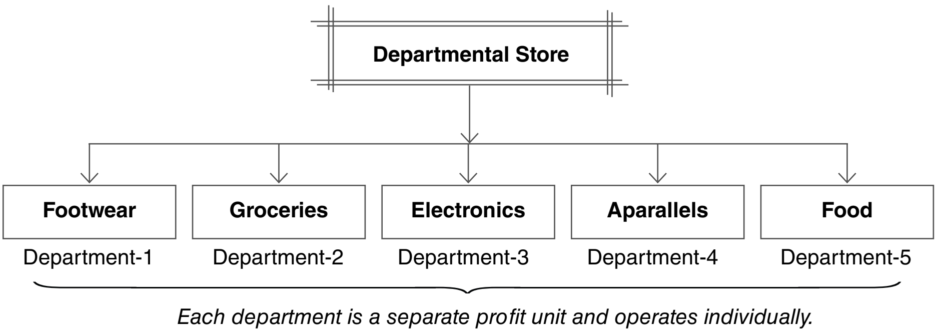


Figure 7.1 *Departments in departmental store.*

Meaning of Department

A department is although a part of an organisation but operates individually and independently. It is a separate unit that undertakes production and trading activities of a specific product in order to earn profit and thereby contribute to the overall financial performance of the (parent) organisation.

7.2 DEPARTMENTAL ACCOUNTS

These accounts maintain and record the transactions related to different departments separately in order to ascertain their individual financial performance (in terms of profit and loss). These accounts not only reveal department-wise profits or losses but also sum-up the overall profit or loss of the whole organisation.

7.2.1 Objectives (Purposes) of Departmental Accounts

The important objectives of departmental accounts are to:

1. ascertain and evaluate the financial performance of each department separately
2. compare the financial performance of one department with other departments
3. identify the under-performing and inefficiently performing departments

4. guide and manage the under-performing departments
5. frame policies and to take important decisions

7.2.2 Advantages of Departmental Accounts

The following are the major advantages of departmental accounts.

1. It provides a summarised view of operational affairs of different departments.
2. It helps the organisation to ascertain and evaluate financial performance separately for each of the different departments.
3. It further enables to compare performances of different departments and to reward them accordingly.
4. It facilitates in better planning and framing effective controlling measures.
5. It enables the management to supervise each departmental performance and to channelise them to achieve the common organisational goals.
6. It enables in establishing responsibility and accountability to each department.
7. It helps the management to frame department-wise policies, which is in alignment to the overall organisational goals.

7.2.3 Recording of Department-wise Transactions

In order to evaluate the department-wise financial performance, we need to prepare departmental final accounts, which consists of Departmental Trading and Profit and Loss Account. For this purpose, the transactions related to each department are recorded and maintained separately in form of columnar subsidiary books such as Sales Book, Sales Return Book, Purchases Book, Purchases Return Book and Department-wise stock-sheet and journal.

It can be easily observed that the below formats are almost similar to normal subsidiary books that we have learnt earlier. The only difference is in terms of *some extra columns*. Each column records the information related to each department.

Table 7.1 *Department-wise Transactions*

Sales Book

Date	Particulars	L.F.	Total (₹)	Dept. 1 (₹)	Dept. 2 (₹)	Dept. 3 (₹)

Purchases Book

Date	Particulars	L.F.	Total (₹)	Dept. 1 (₹)	Dept. 2 (₹)	Dept. 3 (₹)

Department 1: Stock Ledger/Stock Sheet

Date	Purchases			Sales or Issues			Balance		
	Units	Rate	Amt.	Units	Rate	Amt.	Units	Rate	Amt.

Similarly, we can maintain the other subsidiary books such as Sales Return, Purchase Returns and Stock Ledger Books for Departments 2 and 3.

7.2.4 Allocation or Appropriation of Expenses: Distribution of Expenses among Departments

In order to prepare Departmental Final Accounts (namely, Departmental Trading and Profit and Loss Account) for the purpose of finding departmental profit and loss, we need to know the amount of expenses incurred by each department. For this, we need to have department-wise expenses report. Accordingly, expenses can be separated on the following basis.

1. ***Department Specific Expenses*****:** These expenses are incurred by a particular department. Hence, these should be charged to that particular department only. These are shown either on the debit side of Departmental Trading Account (for direct expenses or production related expenses) or on the debit side of Departmental Profit and Loss Account (for indirect expenses).
2. ***Common Expenses*****:** These expenses are jointly carried out by all the departments of an organisation. This is to say that these expenses are not exclusive or specific to one particular department; in fact, these are common to all the departments. Accordingly, the expense is shared among the departments on suitable basis (normally given in the question).

   It should be noted that the treatment of common expenses is exactly the same to that of department specific expenses. The only *difference* is:
   - *Department Specific Expenses:* Concerned department bears 100% of the amount
   - *Common Expenses*: Concerned department bears only a share of the expense amount

Table 7.2 *Comprehensive Chart of Expenses to be Apportioned on Suitable Basis*

Nature of Expenses	Basis of Allocation	Accounting Treatment
Expenses on Purchases • Freight Inwards (Carriage Inwards) • Octroi • Import Duty	Net purchases of each department (excluding inter-departmental purchases)	Debit side of Departmental Trading Account
Expenses on Sales • Freight Outwards (Carriage Outwards) • Commission paid on sale • Bad Debts • Reserve for Bad Debts • Discount Allowed • Reserve for Discount on Debtors • Sales Tax • Advertisement Expenses • Delivery Van Expenses • Travelling Expenses • Sales Manager's Salary • After-Sale Services • Packaging and Delivery Charges	Net sales of each department (excluding inter-departmental sales)	Debit side of Departmental Profit and Loss Account

(Continued)

Table 7.2 (Continued)

Nature of Expenses	Basis of Allocation	Accounting Treatment
• Administrative and Office Expenses	Net sales of each department (excluding inter-departmental sales)	Debit side of Departmental Profit and Loss Account
• Selling and Distribution Expenses	Net sales of each department (excluding inter-departmental sales)	
Building Expenses • Rent and Rates • Air-Conditioning • Insurance on building • Repairs of building	Area covered or Floor space occupied by each department	
Lighting and Heating • Lighting • Heating • Power	On the basis of: • Electric Meter Readings *If not available, then* • Number of Electric Points *If not available, then* • Area covered/Floor space covered	Debit side of Departmental Trading Account
Power	Horse Power of machinery installed in each department	
Remuneration Related		
• Recreation Expenses • Canteen Expenses/Subsidy • Labour Welfare Expenses • Medical Benefits to Workers	Number of workers/ employees employed in each department	Debit side of Departmental Trading Account
• Workmen's Compensation • PF Contribution • ESI Contribution	Amount of wages paid by each department	
• Work Manager's Salary	Time spent in each department	
Insurance Related Expenses		
• Insurance Premium for Stock	Value of Stock in each department	Debit side of Departmental Profit and Loss Account
• Insurance Premium for Assets (except Building)	Value of Asset in each department	
Depreciation and Repairs	Value of Asset in each department	

3. ***Organisational Expenses*:** These expenses are carried out at an organisational level and are difficult to be distributed among the departments, since there does not exist any suitable basis of distribution. These expenses are incurred at an organisational level; hence, are shown on the debit side of General Profit and Loss Account. Usually, organisational expenses are

related to financing and investing activities. For example, expenses related to interest on loan, audit fees, loss on sale of damaged goods.

Examples of Organisational Expenses

- Audit Fees
- Loss by Fire
- Loss on Sale of Damaged Goods
- Legal Fees
- Interest on Loan
- Directors' Fees
- General Manager's Salary
- Bank Charges
- Miscellaneous Office Expenses

Shown on the Debit Side of General Profit & Loss Account

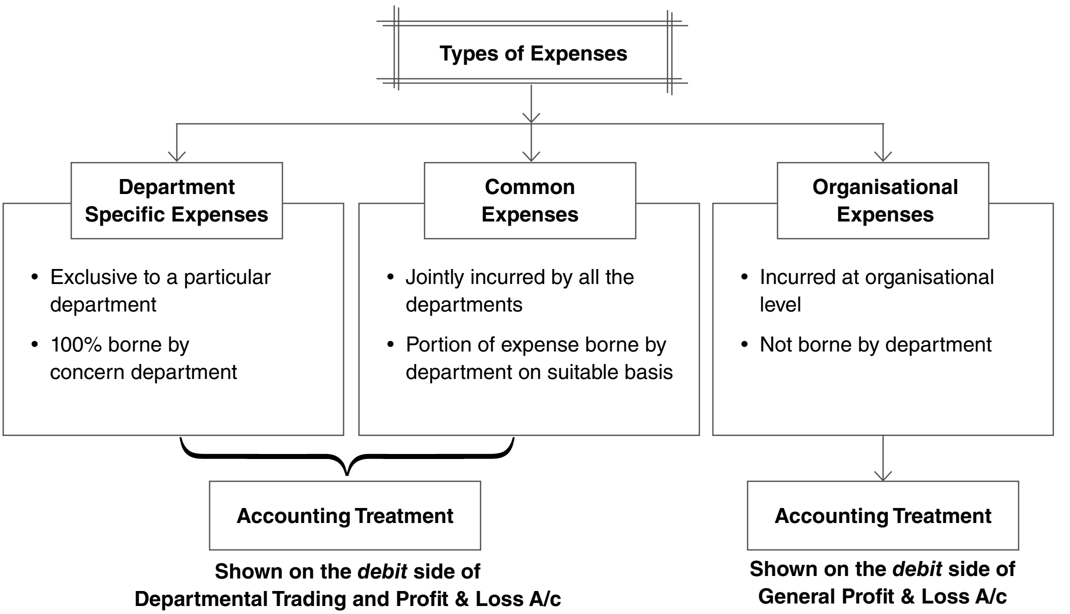


Figure 7.2 *Allocation or Appropriation of Expenses*

7.2.5 Allocation or Appropriation of Incomes: Distribution of Incomes among Departments

The common incomes of departments should be distributed among different departments in the manner tabulated below.

Incomes	Basis	Accounting Treatment
Discount received from creditors	On the net purchases of each department	Shown on the credit side of Departmental Trading and Profit and Loss Account
Other Incomes	Not to be shared by departments	Shown on credit side of General Profit and Loss Account

7.3 DEPARTMENTAL TRADING AND PROFIT AND LOSS ACCOUNT FORMAT

In order to ascertain the financial performance of each department, we need to prepare the departmental Trading and Profit and Loss Account. This is very much similar to the Trading and Profit and Loss Account as we have prepared for the manufacturing concerns.

Departmental Trading and Profit and Loss Account
For the year ended 31 March 20XX

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Total	Particulars	Dept. A	Dept. B	Total
To Opening Stock	xx	xx	xx	By Sales	xx	xx	xx
To Purchases	xx	xx	xx	*Less*: Returns	(xx)	(xx)	(xx)
Less: Returns	(xx)	(xx)	(xx)	By Net Sales	xx	xx	xx
To Net Purchases	xx	xx	xx	By Loss on Goods/Stock	xx	xx	xx
To Transfers from Other Dept.	xx	xx	xx	By Transfers from Other Dept.	xx	xx	xx
To Wages	xx	xx	xx				
To Carriage Inwards	xx	xx	xx				
To Freight Inwards	xx	xx	xx				
To Octroi	xx	xx	xx				
To Import Duty/Custom Duty	xx	xx	xx				
To Factory Lighting	xx	xx	xx				
To Gross Profit	xx	xx	xx	By Gross Loss	xx	xx	xx
	xx	xx	xx		xx	xx	xx
	xx	xx	xx		xx	xx	xx
To Gross Loss b/d	xx	xx	xx	By Gross Profit b/d	xx	xx	xx
To Salaries or Salaries and Wages	xx	xx	xx	By Commission received	xx	xx	xx
To Discount Allowed	xx	xx	xx	By Discount received from creditors	xx	xx	xx
To Printing and Stationery	xx	xx	xx				
To Office Lighting	xx	xx	xx				
To Administrative Expenses	xx	xx	xx				
To Office Electricity	xx	xx	xx				
To Rent and Rates	xx	xx	xx				
To Freight Outwards	xx	xx	xx				

(Continued)

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Total	Particulars	Dept. A	Dept. B	Total
To Carriage Outwards	xx	xx	xx				
To Insurance	xx	xx	xx				
To Ware House Charges	xx	xx	xx				
To Depreciation	xx	xx	xx				
To Selling Expenses	xx	xx	xx				
To Advertisement Expenses	xx	xx	xx				
To Travelling Expenses	xx	xx	xx				
To Bad Debts	xx	xx	xx				
To Net Profit (transferred to General P&L A/c)	xx	xx	xx	By Net Loss (transferred to General P&L A/c)	xx	xx	xx
	xx	xx	xx		xx	xx	xx

Example 1: The following is the Trial Balance of Shri Ram Manohar and Sons for the year ended 31 March 2016. Prepare Departmental Trading and Profit and Loss Account for the financial year 2015–2016 by considering the following information.

Particulars	Debit	Credit
Capital as on 1 April 2015	-	40,000
Stock as on 1 April 2015		
Refrigerator	35,000	
Television	25,000	
Sales		
Refrigerator		4,00,000
Television		3,50,000
Purchases		
Refrigerator	3,30,000	
Television	2,75,000	
Wages	15,000	
Advertisement Expenses	9,000	
Drawings	15,000	
Discount Received		6,050
Commission on Sales	12,000	
Furniture and Fittings	90,000	
Sundry Creditors		40,000
Sundry Debtors	60,000	

(Continued)

Particulars	Debit	Credit
Provision for Bad and Doubtful Debts		4,000
Interest		3,000
Loan from Bank		43,950
Cash at Bank	4,000	
Miscellaneous Expenses	15,000	
Rent, Rates and Taxes	2,000	
	8,87,000	8,87,000

Adjustments:

1. Closing stock was Refrigerator, ₹20,000, and Television, ₹10,000
2. Bad Debts amounted to ₹1,000 and provision for bad and doubtful debts to be raised to 10%
3. Outstanding expenses
   - Advertisement expenses - ₹2,000
   - Wages - ₹3,000
   - Commission - ₹2,000
4. Depreciate furniture and fittings by 10%
5. No. of workers in department of refrigerator and television are 12 and 6, respectively
6. Allocate expenses and interest received among the two departments in the ratio of 2:1

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Basis	Fridge	T.V.	Total	Particulars	Basis	Fridge	T.V.	Total
To Opening Stock	*Given*	35,000	25,000	60,000	By Sales	*Given*	4,00,000	3,50,000	7,50,000
To Purchases	*Given*	3,30,000	2,75,000	6,05,000	By Closing Stock	*Given*	20,000	10,000	30,000
To Wages (15,000 + 3,000)	*Head-count*	12,000	6,000	18,000					
To Gross Profit		43,000	54,000	97,000					
		4,20,000	3,60,000	7,80,000			4,20,000	3,60,000	7,80,000
To Commission (12,000 + 2,000)	*Sales*	7,467	6,533	14,000	By Gross Profit b/d		43,000	54,000	97,000
To Bad Debts	*Sales*	533	467	1,000	By Interest	*2:1*	2,000	1,000	3,000
To Prov for Bad and DD (5,900 – 4,000)	*Sales*	1,013	887	1,900	By Discount received	*Purchases*	3,300	2,750	6,050
To Rent and Rates	*2:1*	1,333	667	2,000					
To Misc. Expenses	*2:1*	10,000	5,000	15,000					
To Depreciation	*2:1*	6,000	3,000	9,000					
To Advt. Expenses (2,000 + 9,000)	*Sales*	5,867	5,133	11,000					
To Net Profit		16,087	36,063						
		48,300	57,750	1,06,050			48,300	57,750	1,06,050

Example 2: Consider the following information of Shri Madanmohan Departmental Stores for the month March 2017 to prepare Departmental Trading and Profit and Loss Account for the March 2017.

Particulars	Amount	Total
Capital as on 1 March 2017		4,00,000
Stock as on 1 March 2017		70,000
Dept. A	3,000	
Dept. B	40,000	
Sales		2,00,000
Dept. A	75,000	
Dept. B	1,25,000	
Return Outwards		15,000
Dept. A	5,000	
Dept. B	10,000	
Purchases		1,50,000
Dept. A	80,000	
Dept. B	70,000	
Wages		50,000
Dept. A	6,000	
Dept. B	4,000	
Freight Outwards		15,000
Octroi		10,000
Canteen Subsidy		20,000
Commission paid		15,000
Repairs on Building		25,000
Misc. Expenses		10,000
Rent, Rates and Taxes		5,000
Closing Stock on 31 March 2017		50,000
Dept. A	4,000	
Dept. B	1,000	
Building		2,00,000
ESI contribution		10,000
Advertisement Expenses		30,000
Sales Tax		5,000

Additional Information:

	Department A	Department B
No. of Employees	200	50
Area Covered	1,000 sq. ft.	750 sq. ft.

Allocate Misc. Expenses and Rent, Rates and Taxes and Commission paid equally between the two departments.

Solution

Departmental Trading and Profit and Loss Account

For the month ended 31 March 2017

Dr. **Cr.**

Particulars	Basis	Dept. A	Dept. B	Total	Particulars	Basis	Dept. A	Dept. B	Total
To Opening Stock	*Given*	3,000	40,000	43,000	By Sales (Net)		1,50,000	2,50,000	4,00,000
To Purchases (Net)	*Given*	75,000	60,000	1,35,000					
To Wages	*Given*	6,000	4,000	10,000	By Closing Stock		4,000	1,000	5,000
To Octroi	*Purchases*	5,555	4,445	10,000					
To Gross Profit		64,445	1,42,555	2,07,000					
		1,54,000	2,51,000	4,05,000			1,54,000	2,51,000	4,05,000
To Commission	*Equal*	7,500	7,500	15,000	By Gross Profit b/d		64,445	1,42,555	2,07,000
To Freight Outward (3:5)	*Sales*	5,625	9,375	15,000					
To Canteen Subsidy (4:1)	*Head-count*	16,000	4,000	20,000					
To Rent and Rates	*Equal*	2,500	2,500	5,000					
To Misc. Expense	*Equal*	12,500	12,500	25,000					
To ESI Cont. (3:2)	*Wage*	6,000	4,000	10,000					
To Sales Tax (3:5)	*Sales*	1,875	3,125	5,000					
To Advt. Exp.	*Sales*	11,250	18,750	30,000					
To Net Profit		1,195	80,805	82,000					
		64,445	1,42,555	2,07,000			64,445	1,42,555	2,07,000

Ascertaining Cost Price (or Purchase Price) on the basis of Units and Sale Price

Let us consider this example to understand the steps involved for computing cost price using units and sale price of unit sold, when Gross Profit rate is same for units sold by different departments.

Example 3: In the month ended February 2016, the following purchases were made by Venkatesh and Sons who are managing three departments. Prepare Departmental Trading and P&L Account.

Departments	Purchases	Sales	Per Unit Sale Price	Opening Stock
A	1,000 units	1,200 units	₹10	400 units
B	2,000 units	2,400 units	₹15	500 units
C	3,000 units	3,200 units	₹20	600 units
Total cost of purchases	₹75,000			

Solution

Step 1: Calculation of Sales Revenue Ratio

Row No.		A	B	C
(1)	Purchased Units	1,000	2,000	3,000
(2)	Purchase Ratio	1	2	3
(3)	Sale Price	₹10	₹15	₹20
(4) = (2) × (3)	Sale Revenue Ratio	1 × 10 = 10	2 × 15 = 30	3 × 20 = 60

Step 2: Calculation of Cost Price and Per Unit Cost Price

Now, in order to calculate share of each department in the total purchases, we will divide the total purchases (i.e. ₹75,000) in the ratio of 10:30:60.

Departments	Share of Department in Total Purchases	Per Unit Cost Price = $\frac{\text{Cost of Purchases}}{\text{Units Purchased}}$
A	$75{,}000 \times \frac{10}{100} = ₹7{,}500$	$\frac{7{,}500}{1{,}000} = ₹7.5$
B	$75{,}000 \times \frac{30}{100} = ₹22{,}500$	$\frac{22{,}500}{2{,}000} = ₹11.25$
C	$75{,}000 \times \frac{60}{100} = ₹45{,}000$	$\frac{45{,}000}{3{,}000} = ₹15$

Step 3: Calculation of Units of Closing Stock

Departments	Opening Stock		Purchases		Sales		Closing Stock
A	400	+	1,000	–	1,200	=	200
B	500		2,000		2,400		100
C	600		3,000		3,200		400

Step 4: Calculation of Closing Stock and Opening Stock

Departments	Per Unit Cost Price (from Step 2)	Opening Stock		Closing Stock	
		Units	Amount	Units	Amount
(1)	(2)	(3)	(4) = (3) × (2)	(5)	(6) = (5) × (2)
A	₹7.5	400 units	₹3,000	200 units	₹1,500
B	₹11.25	500 units	₹5,625	100 units	₹1,125
C	₹15	600 units	₹9,000	400 units	₹6,000

Step 5: Preparation of Departmental Trading and Profit and Loss Account

Departmental Trading and Profit and Loss Account
For the month ended February 2016

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Dept. C	Particulars	Dept. A	Dept. B	Dept. C
To Opening Stock	3,000	5,625	9,000	By Sales (Net)	12,000	36,000	64,000
To Purchases	7,500	22,500	45,000	By Closing Stock	1,500	1,125	6,000
To Gross Profit	3,000	9,000	16,000				
	13,500	37,125	70,000		13,500	37,125	70,000

7.4 GENERAL PROFIT AND LOSS ACCOUNT FORMAT

It records those expenses and incomes that belong to organisation as a whole. Such expenses and incomes cannot be distributed among different departments on suitable basis, hence, are recorded in General Profit and Loss Account. It begins with transferring of Net Profit (as ascertained from Departmental Trading and Profit and Loss Account) to the credit side or transferring Net Loss to the debit side. This is a nominal account, hence, all the expenses and losses are shown on the debit side, whereas, all the incomes and gains are shown on the credit side. The final balance in General Profit and Loss Account is ascertained as:

1. Net Profit (if debit side < credit side) → Added to Capital Balance in Balance Sheet

Or

2. Net Loss (if debit side > credit side) → Deducted from Capital Balance in Balance Sheet

General Profit and Loss Account
For the year ended 31 March 20XX

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Net Loss b/d	xx	By Net Profit b/d	xx
To Audit Fees	xx	By Interest earned on investments	xx
To Interest on Loan	xx	By Profit on sale of assets	xx
To Income Tax Paid	xx	By Dividend earned on shares and debentures	xx
To Legal Fees	xx		
To Director's Fees	xx		
To General Manager's Salary	xx		
To Loss by Fire	xx		
To Loss on Sale of Damaged Goods	xx		
To Legal Fees	xx		
To Bank Charges	xx		

(Continued)

Dr. **Cr.**

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To General Administrative Expenses	xx		
To Net Profit (transferred to Capital Account)	xx	By Net Loss (transferred to Capital Account)	xx
	xx		xx

Example 4: Mr. Deepak runs a departmental store consisting of two departments A and B. Consider the following balances to prepare Departmental Trading and Profit and Loss Account with General Profit and Loss Account for the year ended 31 March 2017.

Particulars	**Department A**	**Department B**	**Total**
Opening Stock	4,000	5,000	9,000
Purchases	1,20,000	80,000	2,00,000
Sales	1,50,000	1,00,000	2,50,000
Salaries	4,000	5,000	9,000
Closing Stock	10,000	20,000	30,000
Building space occupied	40%	60%	100%
Office Lighting			12,000
Repairs on Building			2,000
Legal Fees			10,000
Carriage Outwards			2,000
Carriage Inwards			3,000
Discount received			4,000
Profit on Sale of Asset			2,000

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2017

Dr. **Cr.**

Particulars	**Basis**	**Dept. A**	**Dept. B**	**Total**	**Particulars**	**Basis**	**Dept. A**	**Dept. B**	**Total**
To Opening Stock	*Given*	4,000	5,000	9,000	By Sales	*Given*	1,50,000	1,00,000	2,50,000
To Purchases	*Given*	1,20,000	80,000	2,00,000	By Closing Stock	*Given*	10,000	20,000	30,000
To Carriage Inwards (3:2)	*Purchases*	1,800	1,200	3,000					
To Gross Profit		34,200	33,800	68,000					
		1,60,000	1,20,000	2,80,000			1,60,000	1,20,000	2,80,000

(Continued)

Dr. **Cr.**

Particulars	Basis	Dept. A	Dept. B	Total	Particulars	Basis	Dept. A	Dept. B	Total
To Salaries	*Given*	4,000	5,000	9,000	By Gross Profit b/d		34,200	33,800	68,000
To Office Lighting (2:3)	*Floor area*	4,800	7,200	12,000	By Discount Received	*Purchases*	2,400	1,600	4,000
To Repairs on Building (2:3)	*Floor area*	800	1,200	2,000					
To Carriage Outwards (3:2)	*Sales*	1,200	800	2,000					
To Net Profit		25,800	21,200	47,000					
		36,600	35,400	72,000			36,600	35,400	72,000

General Profit and Loss Account

For the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Legal fees	10,000	By Net Profit b/d	47,000
To Net Profit (transferred to Capital Account)	39,000	By Profit on Sale of Assets	2,000
	49,000		49,000

__Example 5:__ The following is the financial information pertaining to M/s. Bhide & Daughters running three departments—Chinese Food, Mughlai and Continental. Prepare Departmental Trading and Profit and Loss Account for the financial year 2015–2016.

Particulars	Chinese Food (₹)	Mughlai (₹)	Continental (₹)	Total (₹)
Opening Stock	2,000	1,000	2,000	5,000
Purchases	2,00,000	2,50,000	3,00,000	7,50,000
Closing Stock	4,000	3,000	3,500	10,500
Sales	2,50,000	3,00,000	3,50,000	9,00,000
Returns Outwards	25,000	50,000	75,000	1,50,000
Returns Inwards	50,000	25,000	50,000	1,25,000
Salaries	12,000	15,000	18,000	45,000
Floor Area occupied	1,000 sq. ft.	500 sq. ft.	1,000 sq. ft.	2,500 sq. ft.
Factory Rent				20,000
Office Expenses				31,000

(Continued)

Particulars	Chinese Food (₹)	Mughlai (₹)	Continental (₹)	Total (₹)
Printing and Stationery				15,500
Publicity Expenses				62,000
Discount Received				5,200
Discount Allowed				7,750
Audit Fees				2,500
Interest paid on Bank Loan				3,000
Dividend earned				4,000

Note: Allocate office expenses, printing of stationery expenses in 8:11:12 ratio.

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Basis	Chinese (₹)	Mughlai (₹)	Contint. (₹)	Particulars	Basis	Chinese (₹)	Mughlai (₹)	Contint. (₹)
To Opening Stock	*Given*	2,000	1,000	2,000					
To Purchases	*Given*	2,00,000	2,50,000	3,00,000	By Sales	*Given*	2,50,000	3,00,000	3,50,000
Less: Returns	*Given*	(25,000)	(50,000)	(75,000)	*Less*: Returns	*Given*	(50,000)	(25,000)	(50,000)
Net Purchases		1,75,000	2,00,000	2,25,000	Net Sales		2,00,000	2,75,000	3,00,000
To Factory Rent (2:1:2)	*Floor Area*	8,000	4,000	8,000	By Closing Stock	*Given*	4,000	3,000	3,500
To Gross Profit		19,000	73,000	68,500					
		2,04,000	2,78,000	3,03,500			2,04,000	2,78,000	3,03,500
To Salaries	*Given*	12,000	15,000	18,000	By Gross Profit b/d		19,000	73,000	68,500
To Office Exp. (8:11:12)	*Given*	8,000	11,000	12,000	By Discount revd. (7:8:11)	*Net Purchase*	1,400	1,600	2,200
To Print. and Stationary (8:11:12)	*Given*	4,000	5,500	6,000					
To Publicity Exp. (8:11:12)	*Sales*	16,000	22,000	24,000					
To Net Profit			21,100	10,700	By Net Loss		19,600		
		40,000	74,600	70,700			40,000	74,600	70,700

General Profit and Loss Account

For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Net Loss b/d	19,600	By Net Profit b/d	31,800
To Audit fees	10,000	By Dividend earned	4,000
To Interest paid on bank loan	3,000		
To Net Profit (transferred to Capital Account)	3,200		
	35,800		35,800

7.5 BALANCE SHEET FORMAT

Balance Sheet

as on 31 March 20XX

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	xx		Land and Building	xx	
Add: Net Profit (from Gen. P&L)	xx		*Less*: Depreciation	(xx)	xx
Less: Net Loss (from Gen. P&L)	(xx)	xx	Plant and Machinery	xx	
			Less: Depreciation	(xx)	xx
			Furniture and Fittings	xx	
Creditors		xx	*Less*: Depreciation	(xx)	xx
Bills Payable		xx	Bills Receivables		xx
Bank Loan		xx	Closing Stock (if at transfer price)	xx	
			Less: Inter-dept. transfers Profit or Stock Reserve* (Load)	(xx)	xx
			Debtors		xx
			Cash at Bank		xx
			Cash in Hand		xx
		xxx			xxx

**Only in case when inter-departmental transfers are made at above cost.*

Departmental Trading and Profit & Loss Account

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Total	Particulars	Dept. A	Dept. B	Total
To Opening Stock	xx	xx	xx	By Sales	xx	xx	xx
To Transfer from Other Department	xx	xx	xx	By Transfer to Other Department	xx	xx	xx
To Purchases	xx	xx	xx	By Closing Stock	xx	xx	xx
To {Dept. Specific Expenses}	xx	xx	xx				
To Gross Profit	xx	xx	xx	By Gross Loss	xx	xx	xx
To Gross Loss	xx	xx	xx	By Gross Profit	xx	xx	xx
To {Common Expenses}	xx	xx	xx	By {Common Income}	xx	xx	xx
To Net Profit	xx	xx	xx	By Net Loss	xx	xx	xx

General Profit & Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Net Loss	xx	By Net Profit	xx
To Organisational/General Expenses	xx	By Organisational/ General Income	xx
To Net Profit	xx	By Net Loss	xx
	xx		xx

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	xx			
+ Net Profit	xx			
or – Net Loss	(xx)	xx		
Liabilities			Assets	xx
		xxx		xxx

Figure 7.3 *Layout of Departmental Accounts, General Profit and Loss Account and Balance Sheet*

7.6 INTER-DEPARTMENTAL TRANSFERS

As can be understood from the name, these are the transfers of goods or services from one department to another department. For instance, transfer of clothes from tailoring department to ladies wear department is an inter-departmental transfer. The inter-departmental transfers can be either:

1. At Cost Price
2. Or at Invoice Price (i.e. Selling Price, which equals Cost Price + Profit amount)

7.6.1 Inter-Departmental Transfers at Cost Price

When goods are transferred from one department to another at the Cost Price, then the following Journal Entry is recorded.

Date	Particulars	Debit	Credit
	Receiving Department A/c Dr.	Cost Price	
	To Supplying Department A/c		Cost Price

Recording in Departmental Trading and Profit and Loss Account

Departmental Trading and Profit and Loss Account

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Particulars	Dept. A	Dept. B
To Transfers to other Dept. (Receiving Department)	Cost Price		By Transfers from Other Dept. (Supplying Department)		Cost Price

Example 6: Post the following information in the Departmental Trading and Profit and Loss Account to ascertain Gross Profit earned by Department B. Also pass the necessary Journal Entry.

Particulars	Department A	Department B	Department C
Opening Stock	2,000	3,000	4,000
Purchases	30,000	45,000	35,000
Sales	50,000	65,000	75,000
Closing Stock	5,000	8,500	10,000
Wages	5,000	10,000	15,000

Additional Information:

1. Department A transferred goods worth ₹1,000 to Department B and ₹3,500 to Department C.
2. Department B transferred rendered services worth ₹1,500 and ₹2,000 to Departments A and C.

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Dept. C	Particulars	Dept. A	Dept. B	Dept. C
To Opening Stock	2,000	3,000	4,000	By Sales	50,000	65,000	75,000
To Purchases	30,000	45,000	35,000	By Dept. B	3,500	-	-
To Wages	5,000	10,000	15,000	By Dept. C	1,000	-	-
To Dept. A	-	1,000	3,500				
				By Dept. A	-	1,500	-
To Dept. B	1,500	-	2,000	By Dept. C	-	2,000	-
				By Closing Stock	5,000	8,500	10,000
To Gross Profit	21,500	18,000	25,500				
	60,000	77,000	85,000		60,000	77,000	85,000

Date	Particulars		Debit	Credit
Entry 1	Dept. B A/c	Dr.	1,000	
	Dept. C A/c	Dr.	3,500	
	To Dept. A A/c			4,500
Entry 2	Dept. A A/c	Dr.	1,500	
	Dept. C A/c	Dr.	2,000	
	To Dept. B A/c			3,500

Example 7: Using the following information, prepare Departmental Trading and Profit and Loss Account for the year ended 31 December 2016.

Particulars	Department X	Department Y	Total
Opening Stock	2,000	3,000	5,000
Purchases	40,000	60,000	1,00,000
Sales	80,000	1,20,000	2,00,000
Wages	5,000	10,000	15,000
Rent, Rate and Taxes			6,000
Lighting and Heating			12,000
Salaries			15,000
Discount allowed			21,000
Discount received			20,000
Publicity Expenses			25,000
Carriage Inwards			12,000
Furniture and Fittings (Depreciation @ 10%)			30,000

Additional Information:

1. Department X transferred goods costing ₹4,000 to Department Y.
2. Rent, Rate and Taxes, Lighting and Heating, Salaries and Carriage Inwards to be apportioned in the ratio 2:1.
3. Publicity expenses to be borne by Departments X and Y in the ration of 1:1.
4. The percentage usage of Furniture and Fittings by Departments X and Y is as 75% and 25%.
5. Closing Stock as on 31 March 2016 stands at ₹8,000 (for Department X) and ₹2,000 (for Department Y).

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Basis	Dept. X	Dept. Y	Total	Particulars	Basis	Dept. X	Dept. Y	Total
To Opening Stock		2,000	3,000	5,000	By Sales		80,000	1,20,000	2,00,000
To Purchases		40,000	60,000	1,00,000	By Transfer to Y		4,000	-	4,000
To Wages		5,000	10,000	15,000	By Closing Stock		8,000	2,000	10,000
To Carriage Inwards (2:1)	*Given*	8,000	4,000	12,000					
To Transfer from X		-	4,000	4,000					
To Gross Profit		37,000	41,000	78,000					
		92,000	1,22,000	2,14,000			92,000	1,22,000	2,14,000
To Rent, Rates & Taxes (2:1)	*Given*	4,000	2,000	6,000	By Gross Profit		37,000	41,000	78,000
To Lighting & Heating (2:1)	*Given*	8,000	4,000	12,000	By Discount received (2:3)	*Purchase*	8,000	12,000	20,000
To Salaries (2:1)	*Given*	10,000	5,000	15,000					
To Discount Allowed (2:3)	*Sales*	8,400	12,600	21,000					
To Publicity Exp. (1:1)	*Given*	12,500	12,500	25,000					
To Dep. (3:1)	*Given*	2,250	750	3,000					
To Net Profit			16,150	16,000	By Net Loss		150		
		45,150	53,000	98,000			45,150	53,000	98,000

Example 8: Using the following information, prepare Departmental Trading and Profit and Loss Account along with General Profit & Loss Account for the year ended 31 March 2017 and Balance as on that date.

Trial Balance

Particulars	Debit	Credit
Stock as on 1 April 2016		
Department A	2,000	
Department B	4,000	
Purchases		
Department A	25,000	
Department B	30,000	
Sales		
Department A		1,00,000
Department B		1,50,000
Salaries		
Department A	30,000	
Department B	40,000	
Wages		
Department A	10,000	
Department B	5,000	
Discount Allowed	4,000	
Discount Received		10,000
Carriage Inwards	5,000	
Capital		
Department A		50,000
Department B		75,000
Drawings		
Department A	27,000	
Department B	33,000	
Rent, Rates and Taxes	10,000	
Misc. Expenses	5,000	
Lighting and Heating	14,000	
Advertisement Expenses	30,000	
Furniture and Fittings (Depreciation @ 5% p.a)	40,000	
Plant & Machinery (Depreciation @ 10% p.a)	50,000	
Cash in Hand	15,000	
Cash at Bank	5,000	
Debtors	12,000	
Creditors		5,000
Interest Received		4,000
Dividend		6,000
General Expenses	4,000	
	4,00,000	4,00,000

***Additional Information*:**

1. Department A transferred goods worth ₹3,000 to Department B and Department B rendered services worth ₹4,000 to Department A.
2. The following expenses are to be borne among the two departments on suitable basis (Rents, Rates and Taxes, Lighting and Heating and Carriage Inwards).
3. Miscellaneous expenses are to be apportioned equally between the two departments.
4. The usage of Furniture & Fitting and Plant & Machinery by Departments A and B are in the ratio of 16 hours and 8 hours.
5. Closing Stock as on 31 March 2017 amounted to ₹3,500 (for Department A) and ₹3,000 (for Department B).
6. Floor area occupied by Departments A and B are in the ratio of 3:2.

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2017

Dr. **Cr.**

Particulars	Basis	Dept. A	Dept. B	Total	Particulars	Basis	Dept. A	Dept. B	Total
To Opening Stock		2,000	4,000	6,000	By Sales		1,00,000	1,50,000	2,50,000
To Purchases		25,000	30,000	55,000	By Dept. B		3,000		3,000
To Wages	*Given*	10,000	5,000	15,000	By Dept. A			4,000	4,000
To Carriage Inwards (5:6)	*Purchase*	2,273	2,727	5,000					
To Dept. A			3,000	3,000					
To Dept. B		4,000		4,000	By Closing Stock		3,500	3,000	6,500
To Gross Profit		63,227	1,12,273	1,75,500					
		1,06,500	1,57,000	2,63,500			1,06,500	1,57,000	2,63,500
To Dis. Allowed (2:3)	*Sales*	1,600	2,400	4,000	By Gross Profit		63,227	1,12,273	1,75,500
To Salaries	*Given*	30,000	40,000	70,000	By Discount received (5:6)	*Purch-ase*	4,550	5,450	10,000
To Rent, Rates & Taxes (3:2)	*Floor area*	6,000	4,000	10,000					
To Misc Exp. (1:1)	*Given*	2,500	2,500	5,000					
To Lighting & Heating (3:2)	*Floor area*	8,400	5,600	14,000					
To Adv. Exp. (2:3)	*Sales*	12,000	18,000	30,000					
To Dep. F&F (2:1)	*Floor area*	1,333	667	2,000					
To Dep. P&M (2:1)	*Floor area*	3,333	1,667	5,000					
To Net Profit		2,611	42,880	45,500					
		67,777	1,17,723	1,85,500			67,777	1,17,723	1,85,500

General Profit and Loss Account

For the year ended 31 March 2017

Dr. Particulars	Amount (₹)	Particulars	Amount (₹) Cr.
To General Expenses	4,000	By Net Profit	45,500
To Net Profit (transferred to Capital Account)	51,500	By Dividend earned	6,000
		By Interest received	4,000
	55,500		55,500

Balance Sheet

as on 31 March 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital			Plant and Machinery	50,000	
(Dept. A + Dept. B)	1,25,000		*Less*: Dep.	(5,000)	45,000
Add: Net Profit	51,500		Furniture and Fittings	40,000	
Less: Drawings	(60,000)	1,16,500	*Less*: Dep.	(2,000)	38,000
			Closing Stock		6,500
			Debtors		12,000
Creditors		5,000	Cash at Bank		5,000
			Cash in Hand		15,000
		1,21,500			1,21,500

7.6.2 Inter-Departmental Transfers at Invoice Price (i.e. Cost Price + Mark-up Price)

In this case, the Journal Entry for transferring and receiving of goods remains the same, however, there lies difference in terms of price with which the entry is recorded (transfer price).

Date	Particulars	Debit	Credit
	Receiving Department A/c Dr.	Transfer Price	
	To Supplying Department A/c		Transfer Price

Recording in Departmental Trading and Profit and Loss Account

Departmental Trading and Profit and Loss Account

Dr. Particulars	Dept. A	Dept. B	Particulars	Dept. A	Dept. B Cr.
To Transfers from Other Dept.	Transfer Price		By Transfers to Other Dept.		Transfer Price

At the end of the financial year, if the value of closing stock is positive (i.e. the receiving department is left with some amount of stock unsold), then as per the principle of conservatism, we need to ascertain the amount of unrealised profit (included in the transfer price). There exists the following two cases of inter-departmental transfers at transfer price.

Case 1: When goods are transferred at Cost Price + Mark-up% on Invoice Price
In this case, we simply need to multiply the amount of closing stock with the receiving department with the amount of mark-up percentage. For example, suppose Department A transferred goods at invoice price ₹20,000 to Department B and at the end of the financial year, Department B is left with goods worth ₹5,000 as unsold. If mark-up% is 10%, then we will calculate the amount of unrealised profit (Stock Reserve) in the following manner.

$$\text{Stock Reserve Amount} = \frac{\text{Mark-up \%}}{100} \times \text{Closing Stock of Receiving Department}$$

$$= \frac{10}{100} \times 5,000 = ₹500$$

General Profit and Loss Account
For the year ended 31 March 2017

Dr. **Cr.**

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To Stock Reserve	500		

As shown above, we debit the Stock Reserve amount in the General Profit and Loss Account. The following is the related Journal Entry for Stock Reserve amount.

Journal Entry to record Stock Reserve

Date	**Particulars**	**Debit**	**Credit**
	Profit and Loss A/c Dr.	Amount of Stock Reserve	
	To Stock Reserve A/c		Amount of Stock Reserve

Case 2: When goods are transferred at cost price + GP%
In this case, we adhere to the below-mentioned steps.

- ***Step* 1**: Calculate Gross Profit (in %) of the *supplying department* using the below formula (if it is not mentioned in the question).

$$\text{Gross Profit Rate of Supplying Department} = \frac{\text{Gross Profit (as per Dept. Trading Account)}}{(\text{Sales of Supplying Dept.} + \text{Its Inter-departmental transfer})} \times 100$$

- ***Step* 2**: Calculate Stock Reserve on Closing Stock

$$\text{Stock Reserve on Closing Stock} = \frac{\text{Gross Profit Rate (from Step 1)}}{100} \times \text{Closing Stock of Receiving Dept.}$$

- ***Step* 3**: Calculate Stock Reserve already adjusted in Opening Stock

$$\text{Stock Reserve adjusted in Opening Stock} = \frac{\text{Gross Profit Rate (Normal)}}{100} \times \text{Opening Stock of Receiving Dept.}$$

- ***Step* 4**: Calculate Net Stock Reserve as:

Net Stock Reserve = Step 2 amount ***minus*** Step 3 amount
(to be debited to General P&L A/c)

It should be noted that the Accounting treatment and related Journal Entry to record Stock Reserve (net) remain exactly the same as mentioned in Case 1.

Example 9: Calculate the amount of Stock Reserve to be shown in General Profit and Loss Account for the year ended 31 March 2017.

Particulars	Department A	Department B
Stock as on 1 April 16	3,000	4,000
Purchases	2,00,000	40,000
Transfers of good to Dept. B by Dept. A @ selling price	-	80,000
Cost of Closing Stock	5,000	2,000
Sales	3,00,000	1,50,000

Additional Information:

1. The Gross Profit Rate earned by Department A in the financial year 2015–2016 was 20%.
2. All transfers made by Department A to Department B are done at selling price (including GP).

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 December 2015

Dr. **Cr.**

Particulars	Dept. A	Dept. B	Total	Particulars	Dept. A	Dept. B	Total
To Opening Stock	3,000	4,000	3,000	By Sales	3,00,000	1,50,000	4,50,000
To Purchases	2,00,000	35,000	2,40,000	By Dept. B	80,000	-	80,000
To Dept. A		80,000	80,000	By Closing Stock	5,000	2,000	7,000
To Gross Profit	1,82,000	32,000	2,14,000	By Gross Loss			
	3,85,000	1,52,000	5,37,000		3,85,000	1,52,000	5,37,000

Working Notes

- ***Step* 1**: Calculate Current Year Gross Profit (in %) of Dept. A using the below formula.

$$\text{Gross Profit Rate of Department A} = \frac{\text{Gross Profit of Dept. A (as per Dept. Trading Account)}}{\left(\text{Sales of Dept. A + Its Inter-departmental transfer}\right)} \times 100$$

$$= \frac{1,82,000}{\left(3,00,000 + 80,000\right)} \times 100 = 48\%$$

- ***Step* 2**: Calculate Stock Reserve on Closing Stock

$$\text{Stock Reserve on Closing Stock} = \frac{\text{Gross Profit Rate (from Step 1)}}{100} \times \text{Closing Stock of Dept. B}$$

$$= \frac{48}{100} \times 2{,}000 = ₹960$$

- ***Step* 3**: Calculate Stock Reserve of Dept. B already adjusted in its Opening Stock

$$\text{Stock Reserve adjusted in Opening Stock} = \frac{\text{Gross Profit Rate (Normal)}}{100} \times \text{Opening Stock of Dept. B}$$

$$= \frac{20}{100} \times 4{,}000 = ₹800$$

- ***Step* 4**: Calculate Net Stock Reserve of Dept. B as:

Net Stock Reserve = 960 – 800 = ₹160

Accounting Treatment

General Profit and Loss Account

For the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock Reserve	160		

Journal Entry to record Stock Reserve			
Date	**Particulars**	**Debit**	**Credit**
	Profit and Loss A/c Dr.	160	
	To Stock Reserve A/c		160

Example 10: Consider the following information in order to prepare Departmental Trading and Profit and Loss Account with General Profit and Loss Account for the year ended 31 December 2017.

Particulars	Department A	Department B	Total
Stock as on 1 April 2015	40,000	10,000	50,000
Purchases	2,50,000	40,000	2,90,000
Wages	70,000	20,000	90,000
Transfers of good to Dept. B by Dept. A @ 25% above cost	-	50,000	50,000
Cost of Closing Stock	20,000	10,000	30,000
Sales	4,50,000	3,35,000	7,85,000
Administrative Expenses			25,000
Audit Fees			14,000

(Continued)

Particulars	Department A	Department B	Total
Land and Building			2,00,000
Repairs on Building			28,000
Work Manager's Salary (spending time equally between both the departments)			40,000
Workmen's Compensation Fund			12,000
Building Area occupied	4/5	1/5	100%

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 December 2017

Dr. **Cr.**

Particulars	Basis	Dept. A	Dept. B	Total	Particulars	Basis	Dept. A	Dept. B	Total
To Opening Stock		40,000	10,000	50,000	By Sales		4,50,000	3,35,000	7,85,000
To Purchases		2,50,000	40,000	2,90,000	By Dept. B		50,000	-	50,000
To Wages	*Given*	70,000	20,000	90,000	By Closing Stock		20,000	10,000	30,000
To Dept. A			50,000	50,000					
To Gross Profit		1,60,000	2,25,000	3,85,000					
		5,20,000	3,45,000	8,65,000			5,20,000	3,45,000	8,65,000
To Admin Exp. (30:7)	*Sales*	20,270	4,730	25,000	By Gross Profit		1,60,000	2,25,000	3,85,000
To Repairs on Building (4:1)	*Floor area*	22,400	5,600	28,000					
To Work's Manager Sal. (1:1)	*Given*	20,000	20,000	40,000					
To Workmen's Comp. (7:2)	*Wages*	9,333	2,667	12,000					
To Net Profit		87,997	1,92,003	2,80,000					
		1,60,000	2,25,000	3,85,000			1,60,000	2,25,000	3,85,000

General Profit and Loss Account

For the year ended 31 March 2017

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Audit Fees	14,000	By Net Profit	2,80,000
To Stock Reserve	2,000		
To Net Profit (transf. to Capital A/c)	2,64,000		
	2,80,000		2,80,000

Working Note: *Calculation of Stock Reserve (unrealised profit in the closing stock of Department B)*

Closing Stock = 10,000

Transfer Price @ 25% on cost

$$\text{Stock Reserve amount} = \left(10,000 \times \frac{25}{125}\right) = 2,000$$

Example 11: M/s. Kalavati Stores runs two departments—Sarees and Western Wears. Consider the following information to prepare Departmental Trading and Profit and Loss Account for the year ended 31 March 2015.

Particulars	Sarees	Western Wears	Total
Opening Stock	28,000	2,000	30,000
Purchases	40,000	20,000	60,000
Sales	1,00,000	40,000	1,40,000
Transfers to Western Wears	15,000		15,000
Closing Stock	30,000	10,000	40,000
Manufacturing Expenses			9,000
Administrative Expenses			10,000
Freight Inwards			30,000
General Expenses			15,000

***Additional Information*:**

1. All transfers to Western Wears are made at selling price.
2. The Gross Profit of Sarees department is 30% on sales.
3. The Closing Stock of Western Wears department consists of 75% from Sarees department and 25% of other expenses.
4. The items such as Manufacturing Expenses, Administrative Expenses, Freight Inwards are to be borne in the ratio of 3:1.

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2015

Dr. **Cr.**

Particulars	Basis	Sarees	Western Wears	Total	Particulars	Sarees	Western Wears	Total
To O/p Stock		28,000	2,000	30,000	By Sales	1,00,000	40,000	1,40,000
To Purchases		40,000	20,000	60,000	By Transfers	15,000	-	15,000
To Transfer from Department		-	15,000	15,000	By Closing Stock	30,000	10,000	40,000
To Manufacturing Exp. (3:1)	*Given*	6,750	2,250	9,000				
To Freight (3:1)	*Given*	22,500	7,500	30,000				
To Gross Profit		47,750	3,250	51,000				
		1,45,000	50,000	1,95,000		1,45,000	50,000	1,95,000

(Continued)

Dr. **Cr.**

Particulars	Basis	Sarees	Western Wears	Total	Particulars	Sarees	Western Wears	Total
To Admin (3:1)	*Given*	7,500	2,500	10,000	By Gross Profit	47,750	3,250	51,000
To Net Profit		40,250	750	41,000				
		47,750	3,250	51,000		47,750	3,250	51,000

General Profit and Loss Account

For the year ended 31 March 2015

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To General Expenses	15,000	By Net Profit b/d	41,000
To Stock Reserve	2,663		
To Net Profit (Transferred to Capital Account)	23,337		
	41,000		41,000

Working Notes

1. Rate of Gross Profit for Sarees Department

$$\text{Rate of Gross Profit for Sarees Dept.} = \frac{\text{Gross Profit of Sarees Dept.}}{\text{Sales + Transfers}} \times 100$$

$$= \frac{47,750}{(1,00,000 + 15,000)} \times 100 = 41.5\%$$

2. Calculation of Opening and Closing Stock of Western Wears which is from Sarees Department

75% of Opening Stock $(i.e.\ ₹2,000)$ of Western Wears that is from Sarees Dept., is

$$₹1,500 \left(i.e. \frac{75}{100} \times 2,000 \right)$$

75% of Closing Stock $(i.e.\ ₹10,000)$ of Western Wears that is from Sarees Dept., is

$$₹7,500 \left(\frac{75}{100} \times 10,000 \right)$$

3. Calculation of Stock Reserve

$$\text{Stock reserve on Closing Stock} = \frac{41.5}{100} \times 7,500 = ₹3,112.50$$

$$\text{Stock reserve already in Opening Stock} = \frac{30}{100} \times 1,500 = (₹450)$$

Stock reserve amount ₹2,662.50

7.7 COMPREHENSIVE ILLUSTRATIONS

Example 12: From the following information relating to M/s. Akbarallys Departmental Stores, prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account, for the year ended 31 March 2016.

Particulars	Dept. X (₹)	Dept. Y (₹)	Dept. Z (₹)
Opening Stock	34,000	45,000	63,000
Purchases	4,75,000	2,95,000	2,75,000
Sales	7,50,000	5,70,000	5,25,000
Salaries	75,800	87,900	65,300
Closing stock	40,500	31,500	50,400

***Common Income and Expenses*:**
Rent ₹15,000, Electricity ₹31,500, Printing and Stationery ₹5,400, Discount Allowed ₹18,450, Discount Received ₹18,000, General Expenses ₹1,00,000

***Additional Information*:**
Areas occupied by the departments X, Y and Z are 900, 600 and. 300 sq. ft., respectively. Allocate Printing and Stationery in the ratio of 3:2:1. Number of electric points in department X, Y and Z are 40, 27 and 23 respectively. Allocate the other expenses on appropriate basis, to the extent possible.

Acc&FM-I, November 2016

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March, 2016

Dr. **Cr.**

Particulars	Basis	Dept. X	Dept. Y	Dept. Z	Particulars	Dept. X	Dept. Y	Dept. Z
To Opening Stock		34,000	45,000	63,000	By Sales	7,50,000	5,70,000	5,25,000
To Purchases		4,75,000	2,95,000	2,75,000	By Closing Stock	40,500	31,500	50,400
To Gross Profit		2,81,500	2,61,500	2,37,400				
		7,90,500	6,01,500	5,75,400		7,90,500	6,01,500	5,75,400
To Salaries	*Given*	75,800	87,900	65,300	By Gross Profit b/d	2,81,500	2,61,500	2,37,400
To Rent (3:2:1)	*Floor Area*	7,500	5,000	2,500	By Discount Recvd. (95:59:55)-(*Purchase Ratio*)	8,181	5,082	4,737
To Electricity (40:27:23)	*Electric points*	14,000	9,450	8,050				
To Print and Stat. (3:2:1)	*Given*	2,700	1,800	900				
To Discount allow. (50:38:35)	*Sales*	7,500	5,700	5,250				
To Net Profit		1,82,181	1,56,732	1,60,137				
		2,89,681	2,66,582	2,42,137		2,89,681	2,66,582	2,42,137

General Profit and Loss Account
For the year ended 31 March 2016

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To General Expenses	1,00,000	By Net Profit b/d	4,99,050
To Net Profit (transferred to Capital Account)	3,99,050		
	4,99,050		4,99,050

Working Notes:
1. Rent has been apportioned on floor area ratio (3:2:1)
2. Discount allowed is apportioned on sale ratio (50:35:38)
3. Discount received on purchases basis (95:59:55)
4. Electricity expenses are apportioned on the basis of electric points i.e. 40:27:23

Example 13: Bhide Engineering Ltd. runs two departments simultaneously—Material and Production Departments. Using the following information, prepare Departmental Trading and Profit and Loss Account for the year ending 31 March 15.

Particulars	Materials	Production
Opening Stock	1,00,000	20,000
Purchases	3,00,000	10,000
Transfers to Production Department	40,000	-
Manufacturing Expenses	-	26,000
Administrative Expenses	3,000	7,000
Closing Stock	40,000	27,000
Sales	4,00,000	1,00,000

Additional Information:
1. The cost of closing stock of Production Department consists of 75% of material and 25% of manufacturing expenses.
2. The transfers from Raw Material Department to Production Department are done at selling price.
3. General Expenses amounted to ₹25,000.
4. Salaries amounted to ₹54,000 and to be apportioned in the ratio of 44:10.

I.P.C.C 2009 (adapted)

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2015

Dr. **Cr.**

Particulars	Basis	Material	Production	Total	Particulars	Basis	Material	Production	Total
To Opening Stock	*Given*	1,00,000	20,000	1,20,000	By Sales		4,00,000	1,00,000	5,00,000
To Purchases	*Given*	3,00,000	10,000	3,10,000	By Transfers		40,000	-	40,000
To Transfer from Production Dept.		-	40,000	40,000	By Closing Stock		40,000	27,000	67,000
To Manufact. Expenses	*Given*	-	26,000	26,000					
To Gross Profit		80,000	31,000	1,11,000					
		4,80,000	1,27,000	6,07,000			4,80,000	1,27,000	6,07,000
To Admin Exp.	*Given*	7,500	2,500	10,000	By Gross Profit b/d		80,000	31,000	1,11,000
To Salaries	*Given*	44,000	10,000	54,000					
To Net Profit		28,500	18,500	47,000					
		80,000	31,000	1,11,000			80,000	31,000	1,11,000

General Profit and Loss Account

For the year ended 31 March 2015

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To General Expenses	25,000	By Net Profit b/d	47,000
To Stock Reserve	956		
By Net Profit (Transferred to Capital Account)	21,044		
	47,000		47,000

Working Notes

1. Rate of Gross Profit for Material Department

$$\text{Rate of Gross Profit for Material Dept.} = \frac{\text{Gross Profit of Material Dept.}}{\text{Sales + Transfers}} \times 100$$

$$= \frac{80,000}{(4,00,000 + 40,000)} \times 100 = 18.2\%$$

2. Calculation of Opening and Closing Stock of Production Department which is from Raw Material Department

   75% of Opening Stock $\left(i.e.\ ₹20{,}000\right)$ of Production that is from Material Dept. is

   $$₹15{,}000\ \left(i.e. \frac{75}{100} \times 20{,}000\right)$$

   75% of Closing Stock $\left(i.e.\ ₹27{,}000\right)$ of Production that is from Material Dept., is

   $$₹20{,}250\ \left(\frac{75}{100} \times 27{,}000\right)$$

3. Calculation of Stock Reserve

$$\text{Stock reserve on Closing Stock} = \frac{18.2}{100} \times 20{,}250 = ₹3{,}685.50$$

$$\text{Stock reserve already in Opening Stock} = \frac{18.2}{100} \times 15{,}000 = \underline{(₹2{,}730)}$$

$$\text{Stock reserve amount} \qquad \underline{\underline{₹955.50}}$$

Example 14: From the following information relating to M/s. Apna Bazaar Departmental Stores, prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account for the year ending 31 December 2015.

Particulars	**Dept. A (₹)**	**Dept. B (₹)**	
Opening Stock	12,000	15,000	
Purchases	1,05,000	1,20,000	
Sales	1,35,000	1,80,000	
Wages	6,000	8,850	
Following are the other Common Expenses/Incomes:			**Total (₹)**
Salaries			18,300
Rent and Rates			9,000
Carriage Inward			2,250
Carriage Outward			4,200
Discount Allowed			2,100
Discount Received			1,500
Advertisement Expenses			6,300
Audit Fees			600
Legal Expenses			1,200

Additional Information

1. Salaries are to be allocated equally.
2. The area occupied is in the ratio of 1:2 between the two departments, respectively.
3. Closing Stock: Department A ₹30,000, Department B ₹37,500.

4. The remaining common expenses and income to be allocated on appropriate basis to the extent possible.

Acc&FM-I, November 2016

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 December 2015

Dr. **Cr.**

Particulars	Basis	Dept. A	Dept. B	Total	Particulars	Basis	Dept. A	Dept. B	Total
To Opening Stock	*Given*	12,000	15,000	27,000	By Sales	*Given*	1,35,000	1,80,000	3,15,000
To Purchases	*Given*	1,05,000	1,20,000	2,25,000	By Closing Stock	*Given*	30,000	37,500	67,500
To Wages	*Given*	6,000	8,850	14,850					
To Carriage Inward (7:8)	*Purch*	1,050	1,200	2,250					
To Gross Profit		40,950	72,450	1,13,400					
		1,65,000	2,17,500	3,82,500			1,65,000	2,17,500	3,82,500
To Carriage Outward (3:4)	*Sales*	1,800	2,400	4,200	By Gross Profit b/d	*Given*	40,950	72,450	1,13,400
To Salaries (1:1)	*Given*	9,150	9,150	18,300	By Discount Received (7:8)	*Purchases*	700	800	1,500
To Rent and Rates (1:2)	*Area Occupied*	3,000	6,000	9,000					
To Advertisement Exp. (3:4)	*Sales*	2,700	3,600	6,300					
To Discount allowed (3:4)	*Sales*	900	1,200	2,100					
To Net Profit		24,100	50,900	75,000					
		41,650	73,250	1,14,900			41,650	73,250	1,14,900

General Profit and Loss Account

For the year ended 31 December 2015

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Audit Fees	600	By Net Profit b/d	75,000
To Legal Expenses	1,200		
To Net Profit (transferred to Capital Account)	73,200		
	75,000		75,000

Working Notes

1. Carriage Inwards, Discount Received have been apportioned on the basis of purchases in the ratio of 7:8.
2. Discount Allowed, Advertisement Expenses and Carriage Outwards have been apportioned on the basis of sales in the ratio of 3:4.
3. Rent and Rates have been apportioned on the basis of area occupied in the ratio of 1:2.

Example 15: From the following particulars of Abhijeet Coolers, prepare Trading and Profit and Loss Account of the two departments—Compressors and Radiators for the year ended 31 December 2015.

Particulars	Compressors (₹)	Radiators (₹)	Total (₹)
Opening Stock	1,50,000	2,10,000	3,60,000
Purchases	4,50,000	5,50,000	10,00,000
Carriage Inwards			20,000
Salaries	15,000	20,000	35,000
Sales	6,00,000	7,00,000	13,00,000
Discount Received	--	--	4,000
Rent and Rates	--	--	60,000
Traveling expenses			26,000
Carriage Outwards	--	--	6,500
General Expenses	--	--	30,000
Advertising	--	--	6,500
Discount Allowed	--	--	7,800
Insurance	--	--	3,600
Selling Commission	--	--	13,000

Further information is relevant:

1. General expenses and insurance are to be allocated in the ratio 2:3.
2. The area occupied is Compressors 3/5 and Radiators 2/5.
3. The closing stocks of the two departments were Compressors ₹2,50,000 and Radiators ₹1,85,000.

F.Y.B.Com., IDOL, April 2016 (adapted)

Solution

In the Books of Abhijeet Coolers
Departmental Trading and Profit and Loss Account
For the year ended 31 December 2015

Dr. **Cr.**

Particulars	Basis	Comp.	Radiator	Total	Particulars	Basis	Comp.	Radiator	Total
To Opening Stock		1,50,000	2,10,000	3,60,000	By Sales		6,00,000	7,00,000	13,00,000
To Purchases		4,50,000	5,50,000	10,00,000					
To Carriage Inwards (9:11)	*Purchase*	9,000	11,000	20,000	By Closing Stock		2,50,000	1,85,000	4,35,000
To Gross Profit		2,41,000	1,14,000	3,55,000					
		8,50,000	8,85,000	17,35,000			8,50,000	8,85,000	17,35,000

(Continued)

Dr. **Cr.**

Particulars	Basis	Comp.	Radiator	Total	Particulars	Basis	Comp.	Radiator	Total
To Salaries	*Given*	15,000	20,000	35,000	By Gross Profit		2,41,000	1,14,000	3,55,000
To Travelling Exp. (6:7)	*Sales*	12,000	14,000	26,000	By Discount Received (9:11)	*Purch-ase*	1,800	2,200	4,000
To Rent and Rates (3:2)	*Area occu-pied*	36,000	24,000	60,000					
To Carriage (6:7)	*Sales*	3,000	3,500	6,500					
To Adv. (6:7)	*Sales*	3,000	3,500	6,500					
To General Exp. (2:3)	*Given*	12,000	18,000	30,000					
To Discount Allowed (6:7)	*Sales*	3,600	4,200	7,800					
To Selling Comm. (6:7)	*Sales*	6,000	7,000	13,000					
To Insurance (2:3)	*Given*	1,440	2,160	3,600					
To Net Profit		1,50,760	19,840	1,70,600					
		2,42,800	1,16,200	3,59,000			2,42,800	1,16,200	3,59,000

Example 16: Following figures are extracted from the Books of Rachna Super Market, Pune, having three departments namely Cheese Sandwich, Burger and Cold Drinks for the year ending 31 March 2015.

Particulars	Departments		
	Cheese Sandwich (₹)	**Burger (₹)**	**Cold Drinks (₹)**
Stock of goods on 1 April 2014	1,27,500	1,06,860	1,30,680
Stock of goods on 31 March 2015	2,80,350	2,97,690	1,60,260
Purchases	7,07,040	10,29,780	12,37,830
Sales	7,87,350	11,73,600	15,72,390
Returns Inwards	7,350	3,600	12,390
Returns Outwards	17,040	9,780	7,830
Wages	22,950	24,750	9,720
Additional information			
No. of employees	2	3	5
Area Occupied	500 sq. ft.	800 sq. ft.	200 sq. ft.

Expenses incurred during the year:	(₹)
Rent	45,000
Salaries	80,400
Office Expenses	54,000
Printing and Stationary	18,000
Advertisement	56,700
Discount Received	29,400
Discount Allowed	13,500

Allocate printing and stationery on 2:3:5 ratio.

You are required to prepare departmental Trading Profit and Loss A/c in columnar form of Rachna Super Market for the year ended 31 March 2015 allocating all the expenses on suitable basis among the different departments.

F.Y.B.Com., IDOL, October 2015 (adapted)

Solution

In the Books of Rachna Super Market, Pune
Departmental Trading and Profit and Loss Account
For the year ended 31 March 2015

Dr. **Cr.**

Particulars	Basis	Cheese Sandwich	Burger	Cold Drinks	Particulars	Basis	Cheese Sandwich	Burger	Cold Drinks
To Opening Stock		1,27,500	1,06,860	1,30,680	By Sales		7,87,350	11,73,600	15,72,390
To Purchases		7,07,040	10,29,780	12,37,830	(-) Returns		(7,350)	(3,600)	(12,390)
(-) Returns		(17,040)	(9,780)	(7,830)	Net Sales		7,80,000	11,70,000	15,60,000
Net Purchases		6,90,000	10,20,000	12,30,000					
To Wages	*Given*	22,950	24,750	9,720	By Closing Stock		2,80,350	2,97,690	1,60,260
To Gross Profit		2,19,900	3,16,080	3,49,860					
		10,60,350	14,67,690	17,20,260			10,60,350	14,67,690	17,20,260
To Salaries (2:3:5)	*No. of Employees*	16,080	24,120	40,200	By Gross Profit		2,19,000	3,16,080	3,49,860
To Office Exp. (2:3:5)		10,800	16,200	27,000	By Discount Rec. (23:34:41)	*Purch*	6,900	10,200	12,300
To Rent (5:8:2)	*Area Occupied*	15,000	24,000	6,000					
To Print and Stat. (2:3:5)	*No. of Employees*	3,600	5,400	9,000					
To Adv. (2:3:4)	*Sales*	12,600	18,900	25,200					
To Discount Allowed (2:3:4)	*Sales*	3,000	4,500	6,000					
To Net Profit		1,64,820	2,33,160	2,48,760					
		2,25,900	3,26,280	3,62,160			2,25,900	3,26,280	3,62,160

Example 17: From the following particulars of Rajendra Hardware Stores having two departments, namely, Hardware and Paints. Prepare Departmental Trading and Profit and Loss Account of the two departments in columnar form for the year ended 31 March 2014.

Particulars	Hardware (₹)	Paints (₹)
Opening Stock	86,400	1,01,300
Purchases	4,26,800	5,64,300
Carriage Inwards	5,000	4,000
Wages	14,000	11,000
Sales	7,15,700	8,12,900
Return Inwards	15,700	12,900
Return Outwards	6,800	4,300

Common Expenses	(₹)
Discount Received	7,700
Rent and Rates	38,000
Travelling Expenses	33,000
Carriage Outwards	49,500
General Expenses	18,000
Advertising	45,000
Discount Allowed	3,900
Insurance	6,800
Selling and Distribution Expenses	9,900

Additional Information

The further information is relevant:

(a) General Expenses and insurance are to be allocated in the ratio 2:3.

(b) The floor area occupied is Hardware 4/5 and Paints 1/5.

(c) The closing stocks of the two departments were Hardware ₹1,24,800 and Paints ₹1,68,700.

(d) Other expenses and incomes to be allocated between the two departments on a suitable basis.

(e) During the year Hardware Department transferred goods costing ₹15,000 to Paints department.

F.Y.B.Com., IDOL, April 2015 (adapted)

Solution

In the Books of Rajendra Hardware Stores
Departmental Trading and Profit and Loss Account
For the year ended 31 March 2014

Dr. **Cr.**

Particulars	Basis	Hardware	Paints	Total	Particulars	Basis	Hardware	Paints	Total
To Opening Stock		86,400	1,01,300	1,87,700	By Sales		7,15,700	8,12,900	15,28,600
To Purchases		4,26,800	5,64,300	9,91,100	(-) Returns		(15,700)	(12,900)	(28,600)
(-) Returns		(6,800)	(4,300)	(11,100)	Net Sales		7,00,000	8,00,000	15,00,000
Net Purchases		4,20,000	5,60,000	9,80,000					
To Wages	*Given*	14,000	11,000	25,000					
To Transfer from Hardware Dept.		-	15,000	15,000	By Transfers to Paints Dept.		15,000	-	15,000
To Carriage Inw.	*Given*	5,000	4,000	9,000	By Cl. Stock		1,24,800	1,68,700	2,93,500
To Gross Profit		3,14,400	2,77,400	5,91,800					
		8,39,800	9,68,700	18,08,500			8,39,800	9,68,700	18,08,500
To Rent (4:1)	*Floor*	30,400	7,600	38,000	By Gross Profit		3,14,400	2,77,400	5,91,800
To Travelling Exp. (7:8)	*Sales*	15,400	17,600	33,000	By Discount Rec. (3:4)	*Purchase*	3,300	4,400	7,700
To Carriage (7:8)	*Sales*	23,100	26,400	49,500					
To General Exp. (2:3)	*Given*	7,200	10,800	18,000					
To Adv. (7:8)	*Sales*	21,000	24,000	45,000					
To Discount Allowed (7:8)	*Sales*	1,820	2,080	3,900					
To Selling Exp. (7:8)	*Sales*	4,620	5,280	9,900					
To Insurance (2:3)	*Given*	2,720	4,080	6,800					
To Net Profit		2,11,440	1,83,960	3,95,400					
		3,17,700	2,81,800	5,99,500			3,17,700	2,81,800	5,99,500

Example 18: From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the ended 31 March 2014 and the Balance Sheet as on that date.

Particulars	Debit (₹)	Credit (₹)
Stock (1 April 2013)		
Department X	34,000	
Department Y	29,000	
Purchases and Sales		
Department X	70,800	1,21,600
Department Y	60,400	1,02,500
Wages		
Department X	16,400	
Department Y	5,400	
Rent, Rates and Insurance	18,780	
Sundry Expenses	7,200	
Salaries	6,000	
Light and Heating	4,200	
Discount allowed and Received	4,440	1,300
Advertising	7,360	
Carriage Inwards	4,680	
Furniture and Fittings	6,000	
Plant and Machinery	42,000	
Sundry Debtors and Creditors	12,120	37,200
Drawings and Capital	9,000	95,320
Cash in Hand	340	
Cash at Bank	19,800	
	3,57,920	**3,57,920**

***Additional Information*:**

1. Internal transfer of goods from Department X to Department Y ₹840.
2. The items Rent, Rates and Insurance, Sundry Expenses, Light and Heating, Salaries and Carriage Inwards to be apportioned to Departments X and Y in the ratio 2:1.
3. Discounts allowed and received are apportioned on the basis of departmental sales and purchases (excluding transfers).
4. Advertisements to be apportioned equally.
5. Depreciation at 10% p.a. on Furniture and Fittings and Plant and Machinery to be charged to the Departments X and Y in the ratio 3:1.
6. Services rendered by Department Y to Department X ₹1,000.
7. Stocks as at 31 March 2014, Department X ₹33,480, Department Y ₹24,100.
8. Fixed Assets remain unchanged during the year.

F.Y.B.Com., IDOL, April 2014 (adapted)

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2014

Dr. **Cr.**

Particulars	Basis	X	Y	Total	Particulars	Basis	X	Y	Total
To Opening Stock		34,000	29,000	63,000	By Sales		1,21,600	1,02,500	2,24,100
To Purchases		70,800	60,400	1,31,200	By Transfer -Y		840	-	840
To Carriage Inwards (2:1)	*Given*	3,120	1,560	4,680					
To Wages		16,400	5,400	21,800					
To Transfers from X		-	840	840	By Closing Stock		33,480	24,100	57,580
To Gross Profit		31,600	29,400	61,000					
		1,55,920	1,26,600	2,82,520			1,55,920	1,26,600	2,82,520

(Continued)

Dr.									Cr.
Particulars	**Basis**	**X**	**Y**	**Total**	**Particulars**	**Basis**	**X**	**Y**	**Total**
To Salaries (2:1)	*Given*	4,000	2,000	6,000	By Gross Profit		31,600	29,400	61,000
To Sundry Exp. (2:1)	*Given*	4,800	2,400	7,200	By Discount Rec. (177:151)	*Purch*	702	598	1,300
To Rent (2:1)	*Given*	12,520	6,260	18,780	By Services to X		-	1,000	1,000
To Adv. (1:1)	*Given*	3,680	3,680	7,360					
To Dis. Allowed (1216:1025)	*Sales*	2,409	2,031	4,440					
To Light and Heat (2:1)	*Given*	2,800	1,400	4,200					
To Dep - Fur (3:1)	*Given*	450	150	600					
To Dep - P&M (3:1)	*Given*	3,150	1,050	4,200					
To Services to X		1,000	-	1,000					
To Net Profit		-	12,027	12,027	By Net Loss		2,507		2,507
		34,809	30,998	65,807			34,809	30,998	65,807

Balance Sheet

as on 31 March 2014

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital			Plant and Machinery	42,000	
(Dept. A + Dept. B)	95,320		*Less*: Dep.	(4,200)	37,800
Less: Drawings	(9,000)		Furniture and Fittings	6,000	
Less: Net Loss-X	(2,507)		*Less*: Dep.	(600)	5,400
Add: Net Profit-Y	12,027	95,040	Closing Stock (Dept. X + Dept. Y)		57,580
			Cash at Bank		19,800
Creditors		37,200	Cash in Hand		340
			Debtors		12,120
		1,33,040			1,33,040

Example 19: M/s. Tejas Traders, Worli, has two departments namely Electronic Equipments and Electrical Appliances. From the following information, prepare Departmental Trading, Profit and Loss A/c for the year ended 31 March 2013, allocating various expenses and incomes on suitable basis.

Particulars	Electronic Equipments (₹)	Electrical Appliance (₹)
Stock of goods on 1 April 2012	2,25,450	3,46,750
Stock of goods on 31 March 2013	2,79,840	4,13,780
Purchases	6,89,720	8,56,620
Sales	8,01,490	12,06,280
Returns outwards	9,720	6,620
Returns inwards	1,490	6,280
Wages	74,630	84,740
Additional information		
No. of employees	8	16
Area occupied	500 Sq. ft	700 Sq. ft

Other Expenses:

Particulars	Amount
Salaries	36,000
Printing and Stationery	24,000
Postage	15,720
Sundry Expenses	5,750
Carriage Inwards	4,950
Carriage Outward	7,250
Discount Received	2,250
Discount Allowed	3,450
Rent and Rates	2,880
Insurance (to be allocated equally)	3,250
Advertising	5,550
Professional Charges (to be allocated equally)	6,740

Printing and Stationery, Postage and Sundry Expenses are to be allocated in 68:85 ratio.

F.Y.B.Com., IDOL, April 2013 (adapted)

Solution

In the Books of M/s. Tejas Traders, Worli

Departmental Trading and Profit and Loss Account

For the year ended 31 March 2013

Dr. **Cr.**

Particulars	Basis	Equip.	Appliance	Total	Particulars	Basis	Equip.	Appliance	Total
To Opening Stock		2,25,450	3,46,750	5,72,200	By Sales		8,01,490	12,06,280	20,07,770
To Purchases		6,89,720	8,56,620	15,46,340	(-) Returns		(1,490)	(6,280)	(7,770)
(-) Returns		(9,720)	(6,620)	(16,340)	Net Sales		8,00,000	12,00,000	20,00,000
Net Purchases		6,80,000	8,50,000	15,30,000					
To Carri. in (68:85)	*Purch.*	2,200	2,750	4,950					
To Wages	*Given*	74,630	84,740	1,59,370	By Cl. Stock		2,79,840	4,13,780	6,93,620
To Gross Profit		97,560	3,29,540	4,27,100					
		10,79,040	16,13,780				10,79,040	16,13,780	

(Continued)

Dr. **Cr.**

Particulars	Basis	Equip.	Appliance	Total	Particulars	Basis	Equip.	Appliance	Total
To Salaries (1:2)	*No. of Employees*	12,000	24,000	36,000	By Gross Profit		97,560	3,29,540	4,27,100
To Print (68:85)	*Given*	10,667	13,333	24,000					
To Post (68:85)	*Given*	6,987	8,733	15,720	By Discount Rec. (68:85)	*Purch.*	1,000	1,250	2,250
To Sundry Exp. (68:85)	*Given*	2,556	3,194	5,750					
To Adv. (2:3)	*Sales*	2,220	3,330	5,550					
To Dis. Allow (2:3)	*Sales*	1,380	2,070	3,450					
To Carriage outwards (2:3)	*Sales*	2,900	4,350	7,250					
To Rent and Rates (5:7)	*Floor*	1,200	1,680	2,880					
To Insurance (1:1)	*Given*	1,625	1,625	3,250					
To Prof. Charges (1:1)	*Given*	3,370	3,370	6,740					
To Net Profit		53,655	2,65,105						
		98,560	3,30,790	65,807			98,560	3,30,790	65,807

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Explain Departmental Accounting and state any three reasons for considering them necessary.

(2) State how the following expenses are allocated among the different departments?

- (a) Freight inwards
- (b) Lighting
- (c) PF contribution
- (d) Administrative Expenses
- (e) Travelling Expenses
- (f) Power
- (g) Air-conditioning expenses
- (h) Import Duty

(3) What are common expenses? State the different bases for appropriating these expenses.

(4) What are organisational expenses? State the accounting treatment of these expenses.

(5) How incomes are distributed among departments?

(6) Explain briefly General Profit and Loss Account. Draw the format of this account with hypothetical figures.

(7) Explain the concept of interdepartmental transfers at cost price.

(8) Explain the concept of interdepartmental transfers at cost price + mark-up%.

(9) State in brief the concept of stock reserve in Departmental Accounting.

(10) What do you understand by unrealised profit? With the help of an example, show how it calculated and accounted in the Departmental Accounting.

(11) State the accounting treatment of interdepartmental transfer of goods in Departmental Accounting.

II. Short Notes (5 marks)

(1) Concept of Departmental Accounting
(2) Objectives of Departmental Accounting
(3) Advantages of Departmental Accounting
(4) Bases for allocating different expenses among departments
(5) Stock reserve
(6) Interdepartmental Transfers

III. Objective Type Questions

(1) Based upon which of the following bases is advertisement and selling expenses are allocated among departments?
(a) Net Sales (b) Net Purchases
(c) Value of Stock (d) No. of Employees

(2) Which of the following bases is/are used to allocate rent and rates among departments?
(a) Net Sales (b) Net Purchases
(c) Area Covered (d) Number of rooms

(3) Which of the following bases is/are used to allocate reserve for discount on debtors among departments?
(a) Net Sales (b) Net Purchases
(c) Value of Debtors (d) No. of Employees

(4) Which of the following is not an advantage of Departmental Accounting?
(a) Provides a summarised view of operational affairs
(b) Facilitates in comparing performances
(c) Enables better planning
(d) Disclosing true and fair financial position of business

(5) Which of the following expenses is/are not allocated among different departments?
(a) Department Specific Expenses (b) Organisational Expenses
(c) Common Expenses

(6) Which of the following expenses is/are allocated among different departments?
(a) Audit Fees (b) Loss by Fire
(c) General Manager's Salary (d) Work Manager's Salary

(7) Which of the following bases is/are used to allocate common expenses?
(a) Equal basis (b) Given basis
(c) Suitable basis (d) None of the above

(8) Which of the following expenses is/are *not* allocated among different departments?
(a) Income Tax (b) Sale Tax
(c) General Manager's Salary (d) Work Manager's Salary

(9) Which of the following bases is used to allocate PF contribution among different departments?
(a) Amount of wages (b) No. of employees
(c) Net sales (d) Net working hours

(10) Which of the following expenses is/are allocated on the value of stock in each department?
(a) Insurance premium for stock (b) Insurance premium for assets
(c) Cost price (d) Market Price

(11) Which of the following expenses is/are allocated on the value of area covered?
(a) Lighting (b) Heating
(c) Insurance on building (d) All of the above

(12) Which of the following expenses is/are allocated among on basis of net sales of each department?
(a) Packaging Charges (b) Packing Charges
(c) Bad Debts (d) Income Tax

(13) Which of the following statements is *not* an objective of Departmental Accounting?
(a) Evaluating financial performances of each department
(b) Framing policies for major decisions
(c) Comparing financial performances of departments
(d) Ascertaining organisation's profit

(14) Which of the following expenses is/are *not* shown on the debit side of General Profit and Loss Account?
   (a) Audit Fees   (b) Sales Manager's Salary
   (c) Work Manager's Salary   (d) General Manager's Salary

(15) Which of the following expenses is/are shown on the debit side of Departmental Trading Account?
   (a) Import Duty   (b) Freight Inwards
   (c) Repairs on Building   (d) Insurance Premium on Building

(16) Which of the following incomes is not shown on the credit side of Departmental Trading and P &L Account?
   (a) Commission received on sales   (b) Discount received from creditors
   (c) Sale of scrap   (d) Loss on Goods or Stock

(17) Which of the following sequence correctly denotes the steps involved in ascertaining cost price based on unit and sales price?

1. Calculation of Closing Stock
2. Calculation of Cost Price and per unit cost price
3. Calculation of Units of Closing Stock
4. Calculation of Ratio

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

(18) Which of the following expenses is recorded in General Profit and Loss Account?
   (a) Common Expenses   (b) Organisational Expenses
   (c) Departmental Specific Expenses

(19) Which of the following bases is/are used to allocate Work Manager's Salary among departments?
   (a) Time Devoted   (b) Equally
   (c) Efficiency of Manager   (d) Profit of Departments

(20) When goods are transferred from Department X to Department Y, then in Journal entry, we debit
   (a) Department X   (b) Department Y
   (c) General Profit and Loss Account

Consider the following information to answer Q21 to Q25.

Particulars	Department X (₹)	Department Y (₹)
Stock as on 1 April 2016	3,000	1,500
Purchases	41,000	10,000
Transfers of good to Dept. Y by Dept. X @ selling price	6,000	-
Cost of Closing Stock	2,000	2,500
Manufacturing Expenses	-	10,000
Sales	50,000	35,000

***Additional Information**:*

(i) The Gross Profit Rate earned by Department X in the financial year 2015–2016 was 15%.
(ii) Stock of Department Y consists of 60% from Department X and 40% of Manufacturing Expenses.

(21) Calculate Gross Profits of Department X and Y for the financial year 2016–2017.
   (a) ₹10,000 and ₹14,000   (b) ₹14,000 and ₹10,000
   (c) ₹28,000 and ₹20,000   (d) ₹20,000 and ₹28,000

(22) Calculate Gross Profit Rate of Department X for the financial year 2016–2017.
   (a) 15%   (b) 20%   (c) 25%   (d) 30%

(23) Calculate unrealised profit in Closing Stock of Department Y.
   (a) ₹375   (b) ₹500   (c) ₹575   (d) ₹625

(24) Calculate unrealised profit in Opening Stock of Department Y.
   (a) ₹135   (b) ₹375   (c) ₹500   (d) ₹625

(25) Calculate Net Stock Reserve amount.
(a) ₹75 (b) ₹100 (c) ₹175 (d) ₹240

Consider the following information to answer Q26 to Q30.

Particulars	Department A (₹)	Department B (₹)
Stock as on 1 April 2015	20,000	25,000
Purchases	80,000	1,90,000
Transfers of good to Dept. A by Dept. B @ selling price		20,000
Cost of Closing Stock	22,000	27,000
Manufacturing Expenses	25,000	-
Sales	2,00,000	2,50,000

Additional Information:

(i) The Gross Profit Rate earned by Department B in the financial year 2014–2015 was 10%.
(ii) Stock of Department A consists of 70% from Department B and 30% of Manufacturing Expenses.

(26) Calculate Gross Profits of Department A and B for the financial year 2015–2016.
(a) ₹77,000 and ₹64,000 (b) ₹64,000 and ₹77,000
(c) ₹77,000 and ₹82,000 (d) ₹82,000 and ₹77,000

(27) Calculate Gross Profit Rate of Department B for the financial year 2015–2016.
(a) 15.78% (b) 23.73% (c) 25.67% (d) 30.37%

(28) Calculate unrealised profit in Closing Stock of Department A.
(a) ₹4,124.98 (b) ₹4,676.98 (c) ₹5,214.89 (d) ₹6,214

(29) Calculate unrealised profit in Opening Stock of Department A.
(a) ₹1,000 (b) ₹1,400 (c) ₹1,500 (d) ₹2,500

(30) Calculate Net Stock Reserve amount.
(a) ₹3,124.98 (b) ₹3,276.98 (c) ₹3,214.98 (d) ₹3,714

IV. Fill in the Blanks

(1) Departmental Accounts comprises of _________ and _________. (Trading Account/Profit and Loss Account/Balance Sheet)
(2) ____________ maintains Departmental Accounts. (Respective Departments/Head Office)
(3) Expenses specific to a particular department should be charged to _________. (concerned department/the whole organisation)
(4) Work Manager's Salary is apportioned based on ____________. (time spent in each department/profit of each department)
(5) The expenses, which are carried out at organisational level, are shown on ___________. (Departmental Accounts/General Profit and Loss Account)
(6) When one department transfers goods or renders services to another department at transfer price, then we record the entry at _______. (cost price/transfer price)
(7) When goods transferred from one department to another, it is termed as _________. (interdepartmental transfers/intradepartmental transfers)
(8) Audit fees and interest on loan are shown on the debit side of ______. (General Profit and Loss Account/Departmental Trading and Profit and Loss Account)
(9) Depreciation and repairs are apportioned based on _________. (value of asset in each department/usage of assets by each department)
(10) Recreation expenses are apportioned based on ___________. (no. of employees/amount of wages)
(11) When one department transfers goods or renders services to another department at cost price, then we record the entry at _______. (transfer price/cost price)

(12) When one department transfers goods or renders services to another department, then we debit _______ Department Account and credit _________ Department Account. (supplying/receiving)
(13) If cost of closing stock is ₹10,000 and interdepartmental transfers are made at 25% on cost, then stock reserve amount is _________. (₹2,000/₹2,500)
(14) If a department transfers goods to another department at selling price and the receiving department has unsold stock at the end of the accounting period, then there is an element of ________. (overstated stock/stock reserve)
(15) The price at which interdepartmental transfer is recorded which may be the cost or cost + profit margin is termed as ___________ (invoice price/cost price)
(16) Department Y Account Dr. to Department X Account. In this case, Department X is __________ goods and Department Y is __________ goods. (supplying/receiving)
(17) We ____________ (add/deduct) Stock Reserve amount to/from Closing Stock in Balance Sheet.
(18) Freight outward is apportioned among departments on the basis of ___________. (net sales/net purchases)
(19) Insurance on building is apportioned based on ______________. (value of building/repairs of building)
(20) Lighting and Heating expenses can be allocated based on ____________. (floor space covered/net sales) in absence of availability of electric meter reading.

V. Match the Following Columns

(A)

Column A	Column B
a. Carriage Inwards	i. Net Sales
b. Freight Outwards	ii. Time devoted
c. Lighting and Heating	iii. Net Purchases
d. Insurance on Building	iv. No. of electric points
e. Work Manager's Salary	v. Floor space covered

(B)

Column A	Column B
a. Labour Welfare Expenses	i. Net Sales
b. Discount Allowed	ii. Net Purchases
c. Import Duty	iii. Floor space covered
d. Workmen's Compensation	iv. Value of Asset in each department
e. Depreciation	v. Number of employees
	vi. Amount of wages

VI. State Whether the Following Statements are TRUE or FALSE

(1) Departmental Accounting enables management to identify the under-performing and inefficiently performing departments.
(2) Departmental Accounting facilitates management to supervise each departmental performance and to channelise their results to achieve common organisational goals.
(3) Departmental Accounting only consists of Departmental Trading and Profit and Loss Account.
(4) Balance Sheet does not form a part of Departmental Accounting.
(5) Expenses that are jointly carried out by different departments are apportioned on suitable basis.
(6) Building rent is apportioned on the basis of floor area occupied.
(7) Under Departmental Accounting, each department is regarded as a separate profit unit.
(8) Labour welfare expenses are apportioned on the basis of amount of wages paid by each department.

(9) Power expenses are apportioned on the basis of number of electric points.
(10) Director's fees are apportioned among different departments on suitable basis.
(11) Interest on loan is apportioned on the basis of loan amount forwarded to each department.
(12) Depreciation on building is divided equally among different departments.
(13) Insurance premium for assets other than building is apportioned on the basis of value of assets in each department.
(14) As there does not exist any suitable basis for allocating loss on sale of damaged goods, hence, we show it on General Profit and Loss Account.
(15) Sales manager's salary is apportioned on the basis of sales including interdepartmental transfers.
(16) Packaging expenses are apportioned on the basis of net purchases and packing expenses on the basis of net purchases.
(17) Insurance on building is apportioned on the basis of value of building.
(18) Insurance on premium on stock is apportioned on the basis of stock in each department.
(19) There does not exist any suitable basis for apportioning organisational expenses.
(20) Organisational expenses are shown on the debit side of General Profit and Loss Account.
(21) Stock reserve is added to closing stock in Balance Sheet when interdepartmental transfers are made at cost.
(22) We do not debit Stock Reserve Account when interdepartmental transfers are made at cost price.
(23) General Expenses are debited to General Profit and Loss Account.
(24) Since there is no suitable basis for appropriating bank charges, so these are shown on the General Profit and Loss Account.
(25) Office expenses are debited to General Profit and Loss Account on the basis of net sales of each department.
(26) Recreation expenses are apportioned on the basis of number of employees employed in each department.
(27) General Manager's Salary is not apportioned among departments.
(28) Transfer of goods from one department to another department is shown in Departmental Trading Account.
(29) We prepare Departmental Accounts in order to evaluate operational efficiency of different departments.
(30) Discount allowed is apportioned on the basis of net sales excluding interdepartmental transfers.
(31) Discount received is allocated on the basis of net purchases excluding interdepartmental transfers.
(32) Bad debts are charged to General Profit and Loss Account.
(33) Electricity expenses are allocated among departments on the basis of floor space occupied.
(34) Expenses which are not related to any department are charged to General Profit and Loss Account.
(35) Direct expenses are apportioned among departments on the basis of net sales of each department.

VII. Practical Questions

Q1. Consider the following information to prepare Departmental Profit and Loss Account for Department M and N.

Particulars	Department M (₹)	Department N (₹)	Other Expenses	Total (₹)
Opening Stock	80,000	90,000	Carriage Inwards	11,000
Purchases	5,00,000	6,00,000	Advertising	16,000
Sales	7,00,000	9,00,000	Carriage Outwards	32,000
Closing Stock	40,000	60,000	Contribution to Labour	
Salaries	50,000	60,000	Fund	11,000

Q2. A firm has two departments M and N. From the following figures, prepare Departmental Trading and Profit and Loss Account for the year ended 31 March 2017.

Particulars	Department M (₹)	Department N (₹)
Opening Stock	40,000	50,000
Purchases	1,50,000	1,00,000
Carriage Inwards	16,800	12,000
Sales	2,50,000	1,50,000
Closing Stock	36,000	40,000

Other Expenses	Total (₹)
General Salaries	20,000
Carriage Outwards	16,000
Advertising	12,000
Rent and Rates	18,000
Interest on Bank Loan	5,000
Lighting	2,400
Discount received	3,000
Insurance	2,000

Area occupied by two departments is in ratio of 2:1. General salaries are to be allocated equally. Insurance premium is for a comprehensive policy, allocation being inconvenient.

Q3. Prepare Department Trading Accounts with the help of the following information assuming that the rate of Gross Profit is same for each department.

Particulars	Department D (units)	Department E (units)	Department F (units)
Opening Stock	240	160	304
Purchases at cost of ₹20,000	2,000	4,000	4,800
Sales	2,040	3,840	4,992
	(@ ₹20 each)	(@ ₹22.50 each)	(@ ₹25 each)

Q4. (a) There are three departments *viz*. U, V and W. The ratio of space occupied is 3:2:3:2 (U:V:W:Common Space). The common space was utilised by the three departments in the ratio of 3:2:3. You need to apportioned rent paid of ₹66,000 among the three departments.

(b) A concern has three departments namely, X, Y and Z. The following goods were transferred at cost from one department to other.

(i) From X Department to Y Department goods worth ₹778 to Z Department ₹13,558.

(ii) From Y Department to X Department goods worth ₹10,630.

(iii) From Z Department to X Department ₹8,542 and to Y Department ₹11,602.

You need ascertain the value of goods supplied and received by each department.

Q5. P, Q, R are the three departments of a Departmental Store. The mentioned below are some mutual ratios.

Ratios	P	Q	R
Sales ratio	8	6	4
Space occupied ratio	2	2	2
Number of employees ratio	10	6	4
Purchase ratio	8	4	4

You need to allocated the following expenditure among the three departments.

Salary	₹80,000
Commission on Sale	₹9,000
Lighting	₹12,000
Bad Debts	₹4,500
Rent	₹48,000
Advertisement Expenses	₹18,000

Q6. From the following information, you are required to prepare Department Trading and Profit and Loss Account and General Profit and Loss Account for the two departments—Q and R.

Particulars	Q (₹)	R (₹)	Common Expenses	Amount (₹)
Opening Stock	1,40,000	1,80,000	Bad Debts	7,000
Purchases	8,00,000	10,40,000	Advertising Expenses	70,000
Sales	12,00,000	16,00,000	Rent (Q occupied twice the area than R)	60,000
Closing Stock	40,000	1,60,000		
Salaries	50,000	60,000	General Expenses	80,000

Q7. Mr. Harish is a sole proprietor of a Departmental Store having two departments J and K. The following information has been extracted from his Trial Balance dated 31 March 2017. You need to prepare Departmental Trading and Profit and Loss along with General Profit and Loss Account. Show the working properly and explicit mention the basis of apportioning common expenses.

Particulars	Q (₹)	R (₹)	Common Expenses	Amount (₹)
Opening Stock	7,000	2,000	Lighting	2,800
Purchases	2,40,000	1,44,000	Repairs to Building	600
Sales	4,00,000	3,00,000	Audit fees	5,000
Closing Stock	3,000	1,500	General Expenses	15,000
Salaries	30,000	15,000	Purchases Expenses	2,400
			Floor space ratio	40% : 60%

Q8. Consider the given below Trading and Profit and Loss Account of Varun Ltd. for the year ended 31 March 2017.

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

Dr. **Cr.**

Particulars		Amount (₹)	Particulars		Amount (₹)
Purchases			Sales		
Mobile	3,20,000		Mobile	3,50,000	
Laptop	2,50,000		Laptop	2,80,000	
Services and Repairs	1,60,000	7,30,000	Services and Repairs	70,000	7,00,000
Salaries and Wages		96,000	Stock as on 31 March		
Rent		21,600	Mobile	1,20,200	
Sundry Expenses		22,000	Laptop	40,600	
Net Profit		80,400	Services and Repairs	89,200	2,50,000
		9,50,000			9,50,000

Prepare Departmental Accounts for each of the three departments after considering the following adjustments.

(a) Mobile and Laptop are sold at the showroom, whereas, services and repairs are carried out at the workshop.
(b) Salaries and wages comprise of—3/4 Showroom and 1/4 Workshop.
(c) It was decided to allocate showroom salaries and wages in the ratio of 1:2 between Mobile and Laptop departments.
(d) Workshop rent is ₹1,000 per month and Showroom rent is to be divided equally between the two departments.
(e) Sundry Expenses are to be allocated on the basis of the turnover of each department.

Q9. Prepare Departmental Trading and Profit and Loss Account for the two departments i.e. Magazines and Books for the year ended 31 March 2017.

Particulars	Amount (₹)
Opening Stock	
Magazines	1,50,000
Books	50,000
Raw Materials Consumed	
Magazines plus Books	3,60,000
Wages	
Magazines	30,000
Books	60,000
Depreciation	
On Factory Equipment	32,000
On Building	16,000
Sales	
Magazines	9,00,000
Books	1,80,000
Closing Stock	
Magazines	1,20,000
Books	60,000

Common Expenses	Amount (₹)
Stores Consumed	90,000
Advertisement	15,000
Packing Expenses (Books)	6,000
Office Expenses	48,000

Additional Information:

1. Books department does not require any equipment.
2. Only 1/8th of building is occupied by Books department.
3. Divide office expenses in the ratio of 5:1.
4. Value of raw material used by Books Department is ₹20,000.
5. Divide Stores Consumed based on raw materials used.
6. Advertisement expenses are to be apportioned appropriately.

Q10. From the below information of Mr. Lucky, a proprietor having three departments T, V and M, prepare Departmental Trading and Profit and Loss Account for the year ended 31 December 2016 and Balance Sheet on that date.

Trial Balance

as on 31 December 2016

Particulars	Debit Amount	Credit Amount
Capital	-	2,00,000
Opening Stock		
T	40,000	-
V	30,000	-
M	20,000	-
Purchases		
T	1,80,000	-
V	1,40,000	-
M	1,00,000	-
Sales		
T	-	2,00,000
V	-	1,50,000
M	-	1,00,000
Salaries	50,000	
Rent and Taxes	10,000	
Selling and Distribution Expenses	18,000	
Land and Building	50,000	

Additional Information:

1. Stock in trade as on 31 December 2016 was: T - ₹70,000, V - ₹50,000 and M - ₹40,000
2. Salaries are to be allocated in the ratio of 4:3:3 among all the departments.
3. The floor space occupied by each department is in the proportion of 40%, 30% and 30%.
4. Selling and Distribution expenses are to be allocated based on sales of each department.

(Continued)

Furniture and Fixture	20,000	
Cash in Hand		
Cash at Bank		
Sundry Debtors		
Sundry Creditors		

Q11. From the following information, prepare Departmental Trading and Profit and Loss Account and General profit and Loss Account for the year ending 31 December 2016.

Particulars	Department EY	Department KP	Total
Opening Stock	32,000	40,000	72,000
Purchases	2,80,000	3,20,000	6,00,000
Sales	3,60,000	4,80,000	8,40,000
Salaries	16,000	23,600	39,600
General Salaries	-	-	4,88,000
Rent and Rates	-	-	24,000
Carriage Inwards	-	-	60,000
Carriage Outwards	-	-	11,200
Discount allowed	-	-	5,600
Discount earned	-	-	6,000
Advertisement	-	-	16,800
Audit Fees	-	-	2,400
Insurance of Goods	-	-	2,400

Additional Information:

1. General Salaries are to be allocated equally.
2. The area occupied is in the ratio of 2:1 between EY and KP.
3. Goods transferred from EY to KP worth ₹60,000 were not recorded.
4. Closing Stock—₹80,000 (EY) and ₹1,00,000 (KP)

Q12. Malad Departmental Stores has three departments M, N, and P. The following information regarding the departments is given below. You are required to prepare Departmental Trading and Profit and Loss Account.

Particulars	Department M	Department N	Department P
Opening Stock	60,000	60,000	1,20,000
Purchases	2,00,000	1,20,000	4,00,000
Sales	8,00,000	6,00,000	6,00,000
Closing Stock	40,000	80,000	80,000
Common Expenses			***Amount***
Rent and Rates			36,000
General Expenses			48,000
Discount allowed			60,000
Discount received			30,000
Sales promotional expenses			80,000
Commission received			20,000
Salesman salary			20,000

Additional Information:

1. Goods worth ₹16,000 were transferred from Department M to Department N at cost.
2. Allocated General Expenses and Rent and Rates equally among the three departments.
3. Commission received is to be divided in the ratio of 4:3:3 respectively.

Q13. Magnum Ltd. has two departments—Leather and Leather Bags. The Leather Bags are manufactured by the firm itself using the leather supplied by Leather Department at its usual selling price. Consider the following information to prepare Departmental Trading and Profit and Loss Account for the year ended 31 December 2016.

Particulars	Department Leather	Department Leather Bags
Opening Stock	6,00,000	1,00,000
Purchases	40,00,000	30,000
Sales	44,00,000	9,00,000
Transferred to Leather Bags	6,00,000	-
Expenses		
Manufacturing	-	1,20,000
Selling Expenses	40,000	12,000
Closing Stock	4,00,000	1,20,000

The stock in the Leather Bags Department may be considered as consisting of 75% Leather and 25% other expenses. The Leather Department earned gross profit at the rate of 15%. General Expenses amounted to ₹2,20,000.

Q14. Department 'G' sells goods to Department 'H' at a profit of 25% on cost and to Department 'I' at 10% profit on cost. Department H sells goods to Department G and Department I at a profit of 15% and 20% on sales respectively. Department I charges 20% and 25% profit on cost from Department G and H respectively. Department Managers are entitled to 10% commission on net profit after eliminating unrealised profit on department sales. Departmental Profit after charging manager's commission but before adjustment of unrealised profits are: Department G–₹1,44,000, Department H–₹1,08,000 and Department I–₹72,000. The following information is available for all the interdepartmental transfers.

Particulars	Department G	Department H	Department I
Transfer from:			
Department G	-	60,000	44,000
Department H	56,000	-	48,000
Department I	24,000	20,000	-

Ascertain the correct department profit after charging manager's commission.

Q15. Simple Ltd. has 3 departments Sai, Mai and Kai. The following information is available to you.

Particulars	Department Sai	Department Mai	Department Kai
Opening Stock	6,000	8,000	12,000
Consumption of direct material	16,000	24,000	-
Wages	10,000	20,000	-
Closing Stock	8,000	28,000	16,000
Sales	-	-	68,000

Stocks of each department are valued at cost to the concerned department. Stocks of Sai department are transferred to Mai department at a margin of 50% above departmental cost, Stock of Mai department are transferred to Kai department at a margin of 10% above departmental cost.

Other Expenses	Amount (₹)
Salaries	4,000
Printing and Stationery	2,000
Rent	12,000
Interest paid	8,000
Depreciation	6,000

Additional Information:

1. Allocate expenses in the ratio of departmental gross profit.
2. Opening figures of reserves for unrealised profits of Department Mai - ₹2,000 and Department Kai - ₹4,000.

You are required to prepared Departmental Trading and Profit and Loss Account.

Q16. Srija Ltd. has two departments Mu and Su. The following information is given to you for preparing Departmental Trading Account for the year ended 31 March 2017.

Particulars	Department Mu (₹)	Department Su (₹)
Opening Stock	40,000	24,000
Purchases	1,84,000	1,36,000
Carriage Inwards	4,000	4,000
Wages	24,000	16,000
Sales (excluding interdepartmental transfers)	2,80,000	2,24,000
Transfer of Purchased goods:		
By Su to Mu	20,000	-
By Mu to Su	-	16,000
Transfer of Finished goods:		
By Su to Mu	70,000	-
By Mu to Su	-	80,000
Returns of Finished goods:		
By Su to Mu	20,000	-
By Mu to Su	-	14,000
Closing Stock		
Purchased Goods	9,000	12,000
Finished Goods	48,000	28,000

Purchased goods have been transferred at their respective departmental purchase cost and finished goods at departmental market price. 20% of finished stock (closing) at each department represents finished goods received from the other department.

Q17. The following balances were extracted from the books of Mr. Prashant. You are required to prepare Departmental Trading and Profit and Loss Account for the year ended 31 December 2016 after adjusting the realised department profit, if any.

Particulars	Department E	Department F
Opening Stock	1,00,000	80,000
Purchases	13,00,000	18,20,000
Sales	20,00,000	30,00,000

General Expenses incurred for both the departments were ₹2,50,000.

Additional Information:

1. Closing Stock of Department E ₹2,00,000 including goods from Department F for ₹40,000 at cost of Department E.
2. Closing Stock of Department F ₹4,00,000 including goods from Department E for ₹60,000 at cost of Department F.

3. Opening Stock of Department E and Department F include goods of the value of ₹20,000 and ₹30,000 taken from Department E and Department F respectively, at cost to transferee departments.
4. The gross profit is uniform for years.

Q18. Ramco and Co. has two departments Alpha and Beta. Department Alpha sells goods to Department Beta at 20% on sales. Using the following information, prepare Departmental Trading and Profit and Loss Account for the year ended 31 March 2017. Also, ascertain the net profit amount that is to be transferred to the Balance Sheet.

Particulars	Alpha	Beta
Opening Stock	1,60,000	2,00,000
Purchases	14,00,000	5,00,000
Goods transferred to Beta	-	10,00,000
Wages	3,20,000	2,00,000
Travelling Expenses	2,80,000	20,000
Closing Stock	3,60,000	1,00,00,000
Sales	2,00,00,000	40,00,000
Printing and Stationery	32,000	40,000

Common Expenses	Amount (₹)
Salaries	3,00,000
Bad Debts	45,000
Miscellaneous Expenses	30,000
Advertisement	45,000

Additional Information:
1. Depreciation to be charged at the rate 25% on Machinery value of ₹1,00,000 which was used by Beta Department.
2. Advertisement Expenses, Bad Debts are to be apportioned in the turnover ratio.
3. Salaries to be apportioned in 1:2 ratio.
4. Miscellaneous Expenses to be apportioned in 1:3 ratio.
5. 80% of closing stock of Beta Department includes goods supplied by Department Alpha.

Q19. Based on the following Trial Balance and additional information, you need to prepare Departmental Trading and Profit and Loss Account along with General Profit and Loss Account and Balance Sheet for the year ended 31 March 2017.

Trial Balance
as on 31 December 2017

Particulars	Debit Amount (₹)	Credit Amount (₹)
Capital	-	6,00,000
Opening Stock		
C	2,40,000	-
D	4,80,000	-
Land and Building	4,50,000	
Purchases		
C	24,00,000	-
D	34,00,000	-
Furniture	70,000	-
Sales		
C	-	40,00,000
D	-	64,00,000
General Expenses	28,00,000	-
Debtors	4,20,000	-

Additional Information:
1. Closing Stock of Department C is ₹2,60,000 which includes goods purchased from Department D and invoiced at ₹1,00,000. Department D transferred goods to Department C at cost plus 25%.
2. Closing Stock of Department D is ₹4,20,000 which includes goods transferred by Department C at an invoice price of ₹2,16,000 which is cost plus 20% on cost.
3. Sales of Department C and D include goods transferred to the each other at ₹4,00,000 and ₹6,00,000.

(Continued)

Creditors	-	2,00,000
Drawings	5,60,000	-
Bank	3,80,000	-
	1,12,00,000	1,12,00,000

4. Depreciation is to be provided on Land and Building at the rate 5% p.a. and on furniture at the rate 10% p.a. (Depreciation cannot be apportioned between the departments due to some technicalities).

Q20. MN and Co. has three departments U, V and W. Consider the given below information to compute:

(a) Value of stock as on 31 December, 2016

(b) Departmental Trading results

Particulars	U	V	W
Opening Stock	48,000	72,000	24,000
Purchases	2,92,000	2,48,000	96,000
Actual Sales	3,45,000	3,18,000	1,49,200
Gross Profit on Normal Sales	20%	25%	33$^1/_3$%

During the year, certain items were sold at discount and these discounts were reflected in the sales values given above. The items sold at discount are as follows.

Particulars	U	V	W
Sales at normal price	20,000	6,000	2,000
Sales at actual price	15,000	4,800	1,200

Q21. M/s Right and Co. had four departments *viz*. D, E, F and G. Each of these departments being managed by a departmental manager whose commission was 10% respective of their departmental profit, subject to a minimum of ₹12,000 in each case. Interdepartmental transfers took place at a loaded price as follows.

Interdepartmental Transfers	Percentage above Cost
From Department D to Department E	10% above cost
From Department D to Department G	20% above cost
From Department F to Department G	20% above cost
From Department F to Department E	20% above cost

For the year ended 31 March 2017, the firm had already prepared and closed the Departmental Trading and Profit and Loss Account. Subsequently, it was discovered that the closing stock of departments had included interdepartmental transferred goods at loaded price instead of cost price. From the following information, prepare a Statement re-computing the departmental profit or loss.

Particulars	D	E	F	G
Final Profit/Loss	76,000 (*loss*)	1,00,800 (*profit*)	1,44,000 (*profit*)	2,16,000 (*profit*)
Interdepartmental transfers included at loaded price in departmental stock		1,40,000 (44,000 from D and 96,000 from F)		96,000 (7,200 from F and 2,400 from D)

Q22. Shriram sells two products manufactured in his own factory. The foods are made in two departments—Zii and Soni for which separate sets of accounts are maintained. Some of the manufactured goods of department Zii are used as raw materials by department Soni and vice-versa. Consider the following information to ascertain the total cost of goods manufactured in Zii and Soni.

Particulars	Zii	Soni
Total units manufactured	20,00,000	10,00,000
Total cost of manufacturing (excluding interdepartmental transfers)	₹20,000	₹10,000

Department Zii transferred 5,00,000 units to Department Soni and the latter transferred 2,00,000 units to the former.

Q23. Following figures are extracted from the books of Chandrama Super Market. Pune having three departments namely Aloo Tikki, Bun Miaska and Chatniy Sandwich for the year ending 31 March, 2013.

Particulars	Department Aloo Tikki	Department Bun Miaska	Department Chatniy Sandwich
Stock of good on 1 April, 2012	42,500	35,620	43,560
Stock of goods on 31 March, 2013	93,450	99,230	53,420
Purchases	2,35,680	3,43,260	4,12,610
Sales	2,62,450	3,91,200	5,24,130
Returns Inwards	2,450	1,200	4,130
Returns Outwards	5,680	3,260	2,610
Wages	7,650	8,250	3,240
Additional information:			
No. of employees	2	3	5
Area Occupied	500 sq.ft	800 sq.ft	200 sq.ft

Expenses incurred during the year:
Rent ₹15,000, Salaries ₹26,800, Office Expenses ₹18,000, Printing and Stationary ₹6,000, Advertising ₹18,000, Discount Received ₹9,800, Discount Allowed ₹4,500

You are required to prepare departmental Trading Profit and Loss A/c in columnar form of Chandrama Super Market for the year ended 31 March 2013 allocating all the expenses on suitable basis among the different departments.

F.Y.B.Com., IDOL, October 2014 (adapted)

CHECK YOUR ANSWERS

III. Objective Type Questions

1–a	2–c	3–a	4–d	5–b	6–d	7–c	8–a,c	9–a	10–a	11–d	12–a,c	13–d
14–b,c	15–a,b	16–c	17–b	18–b	19–a	20–b	21–b	22–c	23–a	24–a	25–d	26–c
27–d	28–b	29–b	30–b									

IV. Fill in the Blanks

1-(a) Trading Account (b) Profit and Loss Account	2-Head Office	3-Concerned Department	4-time spent in each department
5-General Profit and Loss Account	6-Transfer Price	7-Interdepartmental Transfers	8-General Profit and Loss Account
9-Value of asset in each department	10-No. of employees	11-Cost price	12-(a) Receiving (b) Supplying
13-₹2,500	14-Stock Reserve	15-Invoice Price	16-(a) Supplying (Dept. X) (b) Receiving (Dept. Y)
17-deduct	18-net sales	19-area covered	20-floor space covered

(Continued)

V. Match the Columns	
(A) (a)-(iii), (b)-(i), (c)-(iv), (d)-(v), (e)-(ii)	**(B)** (a)-(v), (b)-(i), (c)-(ii), (d)-(vi), (e)-(iv)
VI. True or False	
True 1, 2, 3, 4, 5, 6, 7, 9, 13, 14, 18, 19, 20, 22, 23, 24, 26, 27, 28, 29, 30, 31, 33, 34	**False** 8, 10, 11, 12, 15, 16, 17, 21, 25, 32, 35
VII. Practical Questions	
Q1. Gross Profit (M, N)–₹1,55,000, ₹2,64,000; Net Profit (M, N)–₹79,000 and ₹1,71,000	**Q13.** Gross Profit (Leather, Leather Bags)–₹8,00,000, ₹1,70,000; Net Profit (Leather, Leather Bags)–₹7,60,000, ₹1,58,000; Stock reserve–₹3,150; General Prof-it–6,94,850
Q2. Gross Profit (M, N)–₹90,000, ₹36,000; Net Profit (M) –₹33,900 and Net Loss (N)–₹2,100, General Profit–₹24,800	**Q14.** Correct profit after manager's commission (G, H, I)–₹1,29,600, ₹91,800 and ₹64,800
Q3. Gross Profit (D, E, F)–₹8,160, ₹17,280 and ₹24,960	**Q15.** Gross Profit (Sai, Mai, Kai)–₹12,000, ₹6,000, ₹6,000; Net Profit (Sai, Mai, Kai)–₹4,000, ₹2,000, ₹2,000; Stock reserve (Dr.) Mai–₹4,200 and Kai–₹3,636; Stock reserve (Cr.) Mai–₹2,000 and Kai–₹4,000; General Loss– ₹9,836
Q4. (i) Rent allocated (U, V, W)–₹24,750, ₹16,500 and ₹24,750 (ii) Total value of supplies of X, Y and Z is ₹14,136, ₹10,360 and ₹20,144. Total value of receipt of goods by X, Y and Z–₹19,172, ₹12,380 and ₹13,358	**Q16.** Gross Profit (Mu, Su)–₹77,000, ₹92,000
Q5. Total share of each department in all expenses: P–₹74,000, Q–₹54,500 and R–₹43,000	**Q17.** Gross Profit (E, F)–₹8,00,000, ₹15,00,000; Net Profit (E, F)–₹7,00,000, ₹13,50,000; Stock reserve: E–₹10,000, F–₹12,000; General Profit–₹20,28,000
Q6. Gross Profit (Q, R)–₹3,00,000, ₹5,40,000; Net Profit (Q, R)–₹1,77,000 and ₹4,34,000; General Profit–₹5,31,000	**Q18.** Gross Profit (Alpha, Beta)–₹14,80,000, ₹14,00,000; Net Profit (Alpha, Beta)–₹10,28,000, ₹10,25,000; Stock reserve–₹3,94,640
Q7. Gross Profit (J, K)–₹1,54,500, ₹1,54,600; Net Profit (J, K)–₹1,23,140 and ₹1,37,560; General Profit–₹2,40,700	**Q19.** Gross Profit (C, D)–₹16,20,000, ₹30,40,000; Net Profit–₹17,74,500, Stock Reserve–₹56,000; Balance Sheet total–₹20,14,500
Q8. Net Profit (A, B, C)–₹1,10,400, ₹9,000, (39,000)	**Q20.** Gross Profit (U, V, W)–₹65,000, ₹78,800, ₹49,200
Q9. Gross Profit (Magazines, Books)–₹4,70,000, ₹1,40,000; Net Profit (Magazines, Books)–₹2,86,500 and ₹1,16,500	**Q21.** Correct Profit/Loss: D–Loss of ₹80,400, Profit to E–₹1,08,000, Profit to F–₹1,28,520 and Profit to G–₹2,16,000
Q10. Gross Profit (T, V, M)–₹50,000, ₹30,000, 20,000; Net Profit (T, V, M)–₹18,000, ₹6,000 and (₹2,000); Balance Sheet Total–₹3,10,000	**Q22.** Net cost of goods manufactured by Zii–₹17,638 and by Soni–₹12,632
Q11. Gross Profit (EY, KP)–₹40,000, ₹2,48,000; Net Profit (KP)–₹1,74,720 and Net Loss to EY–₹29,120; General Prof-it–₹1,43,200.	**Q23.** *Gross Profit* *Net Profit* Aloo Tikki ₹73,300 ₹54,907 Bun Miaska ₹1,05,360 ₹77,220 Chatniy Sandwich ₹1,16,620 ₹84,653
Q12. Gross Profit (M, N, P)–₹5,96,000, ₹4,84,000, ₹1,60,000; Net Profit (M, N, P)–₹5,20,334, ₹4,19,000 and ₹1,06,666	

CHAPTER 8

Accounting for Hire Purchase

CHAPTER OUTLINE

EXERCISE

8.1 HIRE PURCHASE AGREEMENT

8.1.1 Meaning of Hire Purchase Agreement

It is a system by which a buyer pays for an asset at regular interval (say monthly, half-yearly or yearly) and in the meantime enjoys the benefits of the asset so purchased. It is basically a credit purchase. The type of asset purchased under this system is normally expensive and involves a huge amount of cash outflow, if paid in cash. Hence, a buyer prefers to purchase an expensive asset under Hire Purchase Agreement, whereby, he pays in instalments and simultaneously enjoys the benefits of the asset so purchased. Let us consider an example of car loan. Normally, people prefer to buy car on credit by taking a car loan from a bank. Suppose you have purchased a brand new car today by taking a car loan of ₹4,00,000 from a bank. You sign an agreement with the bank to repay the whole amount in the next 4 year along with some interest amount. Now, for the coming 4 year, you will be using the car, deriving the benefits and in the meantime, every year you will be making a part payment (in terms of instalment). At the end of fourth year, the car will be yours and you will be the owner of the car, since you have repaid the borrowed amount.

Meaning of Hire Purchase Agreement

It is an agreement between a buyer and a seller, wherein, the buyer agrees to repay for the asset in instalments at regular intervals of time. The seller has the full right to take back the asset or repossess the asset so sold, in case the buyer fails to make any instalment. Under this agreement, the buyer enjoys the benefits of the asset and simultaneously repays the total amount to the seller.

8.1.2 Basic Terminologies in Hire Purchase Agreement

a. ***Hire Purchaser (Buyer)***: He is the buyer who purchases the assets and obtains the possession rights (on the date of sale) and ownership rights (on the date of making the last instalment).
b. ***Hire Vendor (Seller)***: He is the seller who sells the assets and passes the right of possession immediately to the hire purchaser on the date of sale.
c. ***Cash Price (Full amount in cash)***: It is the amount at which the asset can be purchased against immediate cash payment. In other words, this price indicates the total amount to be paid **today** as full payment to get the ownership of the asset ***today***. If a buyer pays the cash price, then he needs not pay any instalment and interest amount. He becomes the owner immediately.
d. ***Down Payment (Initial payment on the date of sale)***: It is the initial payment that a hire purchaser pays at the time of signing the Hire Purchase Agreement on the date of sale.
e. ***Instalment***: It is the amount which the hire purchaser pays at regular interval. This amount is inclusive of some part of principal amount and interest on outstanding (unpaid) amount.
f. ***Hire Purchase Price (Hire Price)***: It is the total amount payable by the hire purchaser. It is sum total of all the instalments (i.e. cash price *plus* interest).

8.1.3 Concept of Hire Purchase Agreement

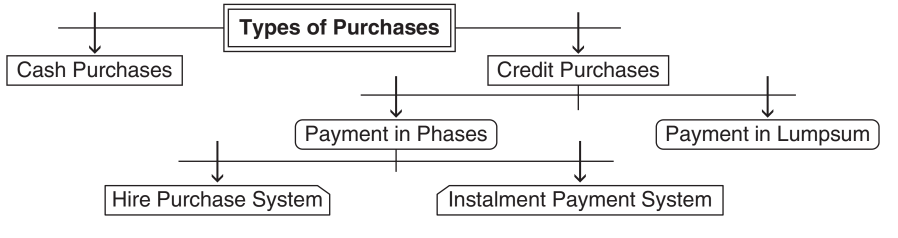


Figure 8.1 *Types of purchases in hire purchase agreement.*

From Figure 8.1, we can understand that Hire Purchase is an agreement between a seller and a buyer for selling or purchasing of goods on credit basis. Normally, the goods sold or purchased under Hire Purchase Agreement are costly and expensive as it includes interest on deferred payment. At the time of sale, the seller (or Hire Vendor) sells the goods to the purchaser (Hire Purchaser) and the purchaser repays the amount in instalments to the seller over a period of time.

Let us understand the concepts and basic terminologies with respect to the following example.

Example 1: On 1 January 2014, Mr. Suraj & Co sold truck to Mr. Punit of ₹18,00,000. Mr. Punit immediately paid ₹3,00,000 in cash and agreed to pay the balance amount of ₹15,00,000 in three yearly instalments along with total interest amount of ₹45,000 (payable as ₹20,000, ₹15,000 and ₹10,000 at the end of each financial year). Spot the following:

(a) Hire Purchaser (b) Hire Vendor (c) Down Payment
(d) Cash Price (e) Hire Price (f) Total Interest
(g) Instalment amounts

Solution

01 January 2014	Trucks sold	₹18,00,000
01 January 2014	Cash paid	–₹3,00,000
	Balance amount	**₹15,00,000**

1st Instalment (On 31 December 2014)	
Principal	₹5,00,000
+Interest	₹ 20,000
Instalment	**₹5,20,000**

2nd Instalment (On 31 December 2015)	
Principal	₹5,00,000
+Interest	₹ 15,000
Instalment	**₹5,15,000**

3rd Instalment (On 31 December 2016)	
Principal	₹5,00,000
+Interest	₹ 10,000
Instalment	**₹5,10,000**

a. Hire Purchaser: Mr. Punit
b. Hire Vendor: Suraj & Co
c. Down Payment: ₹3,00,000
d. Cash Price: ₹18,00,000
e. Hire Price: 18,45,000 (i.e. Cash Price 18,00,000 + Interest 45,000), *Alternatively,* Hire Price: 18,45,000 (i.e. Down Payment 3,00,000 + Total of Instalments (5,20,000 + 5,15,000 + 5,10,000)
f. Interest: ₹45,000
g. Instalment: Principal + Interest (1st instalment of ₹5,20,000, i.e. 5,00,000 + 20,000; 2nd instalment of 5,15,000, i.e. 5,00,000 + 15,000; 3rd instalment of 5,10,000, i.e. 5,00,000 + 10,000)

8.1.4 When Does a Hire Purchaser Becomes the Owner?

The answer is on the date of making the last instalment. In order to understand this, let us understand the difference between two terms—'possession' and 'ownership'. Possession means the physical control over the asset. On the other hand, ownership means the legal right over the asset (that is on paper).

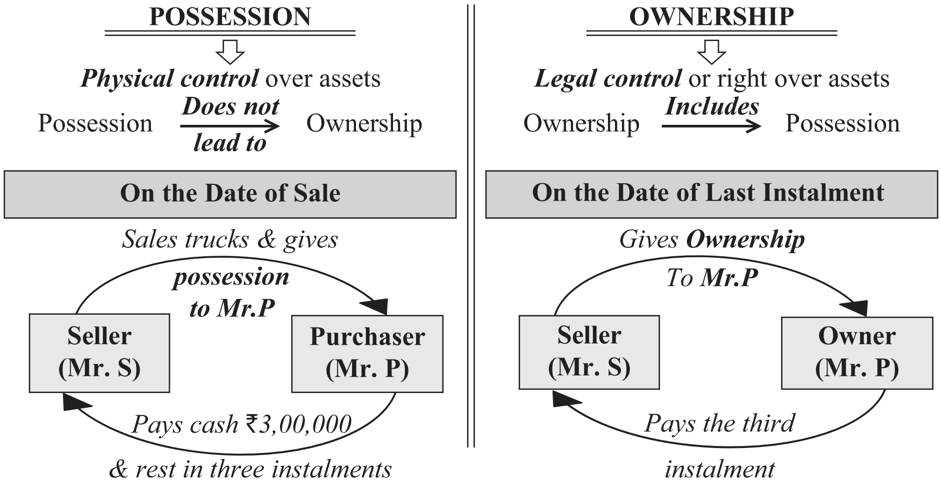


Figure 8.2

On the date of sale, the hire purchaser takes up the physical control over the asset, i.e. he takes the asset with himself, put it into use, derives benefits out of it and makes profits, but he is not the owner of the asset. It is only on the date of last instalment, when the hire purchaser pays the final instalment, he becomes the owner of the asset. This means that when the last instalment is paid, the ownership rights are transferred from the seller to the hire purchaser.

If in case, the hire purchaser fails to pay any instalments, the seller can take back the assets. This is because the ownership rights lie with the seller till the last instalment is paid.

8.1.5 Features of Hire Purchase Agreement

The following are the main features of Hire Purchase Agreement.

a. On the date of sale of an asset, hire purchaser takes the possession of the assets immediately and signs an agreement to repay in instalments.
b. Hire purchaser makes an initial payment (down payment) while signing the Hire Purchase Agreement on the date of sale.
c. If the hire purchaser fails to pay any instalment, then the seller can repossess (or take back) the assets so sold to the hire purchaser.
d. Each instalment amount consists of part of outstanding principal amount and interest on the outstanding balance (i.e. Instalment = Principal + Interest).
e. On the date when the last instalment is paid, the ownership of the asset sold gets transferred from the seller to the hire purchaser.

8.1.6 Similarities and Differences between Hire Purchase Agreement and Instalment Sale System

The similarities and differences between Hire Purchase Agreement and Instalment Sale System are explained as follows:

Similarities

a. **Credit basis:** Both the systems—Hire Purchase Agreement and Instalment Payment System—are basically the agreements related to credit sale.

b. **Payments in instalments:** Under both the systems, the purchaser agrees to repay the remaining amount in instalments at regular periods.
c. **Transfer of possession:** The possession of the asset so sold is transferred from the seller to the purchaser right at the time of sale under both the systems.

Differences

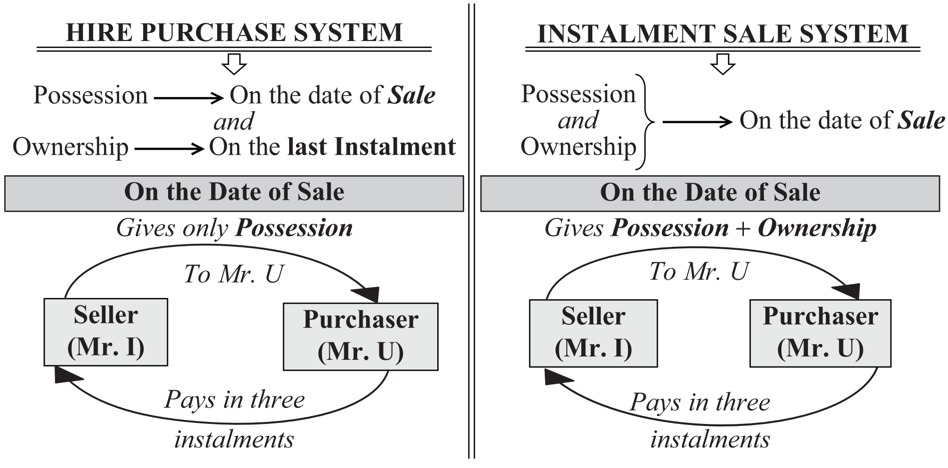


Figure 8.3 *Comparison between hire purchase agreement and instalment sale system.*

Table 8.1 *Basis of Differences between Hire Purchase Agreement and Instalment Sale System*

Basis of Difference	Hire Purchase Agreement	Instalment Sale System
Transfer of ownership rights	Only when the last instalment is paid by the purchaser	On the date of sale
Nature of instalments	Instalments are regarded as hire charges.	Instalments are regarded as repayment of principal amount along with interest amount.
Parties involved	Hire purchaser and hire vendor	Buyer and seller
Returning of asset so sold	Hire purchase can return the asset so purchased any time till the last instalment is paid.	Buyer ***cannot*** return the asset once bought.
Default in making payments	If hire purchaser fails to pay any instalment, then the hire vendor can take the asset back (or repossess)	The seller cannot take the asset, as he is no more the owner once the asset is sold.
Loss of assets due to fire, theft, etc.	***Not*** to be borne by hire purchaser *but* Will be borne by the hire vendor	To be borne by buyer *and* ***Not*** to be borne by the seller

8.2 ACCOUNTING TREATMENT IN THE BOOKS OF HIRE PURCHASER AND HIRE VENDOR

The accounting treatment of transactions under Hire Purchase Agreement is based on the amount of goods or assets sold. Figure 8.4 depicts the accounting treatment of Hire Purchase Transactions.

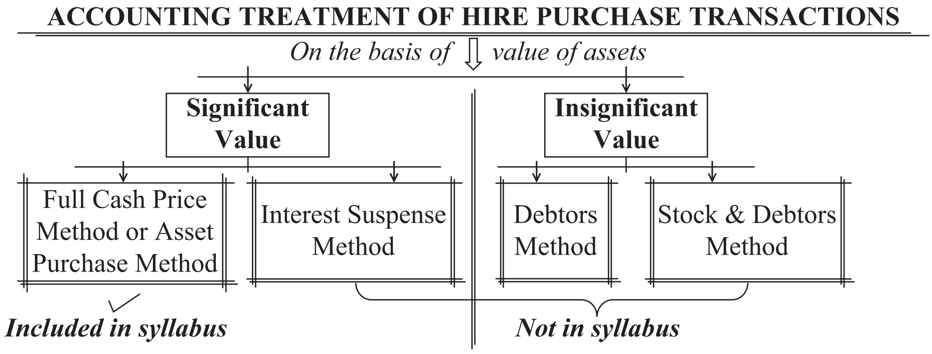


Figure 8.4 *Accounting treatment of hire purchase transactions.*

8.2.1 Journal Entries—As Per Full Cash Price Method (or Asset Purchase Method)

Under Full Cash Price Method (or Asset Purchase Method) the following Journal entries are passed in the books of hire purchaser and hire vendor simultaneously as shown in Table 8.2.

Table 8.2 *Journal Entries as per Full Cash Price Method (or Asset Purchase Method)*

Steps	In the Books of Hire Purchaser (HP)	In the Books of Hire Vendor (HV)	Amount of Entry
Step 1: At the time of Sale of Asset			
1.	Asset A/c Dr. To Hire Vendor A/c	Hire Purchaser A/c Dr. To Sales A/c	Full Cash Price
2.	Hire Vendor A/c Dr. To Bank/Cash A/c	Bank/Cash A/c Dr. To Hire Purchaser A/c	Down Payment
Step 2: When Instalment Amount is Due			
3.	Interest A/c Dr. To Hire Vendor A/c	Hire Purchaser A/c Dr. To Interest A/c	Interest on outstanding balance
4.	Hire Vendor A/c Dr. To Bank/Cash A/c	Bank/Cash A/c Dr. To Hire Purchaser A/c	Principal Part + Interest Amount
Step 3: At the End of Year			
5.	Depreciation A/c Dr. To Asset A/c	*No Entry*	On Full Cash Price of asset
6.	Profit and Loss Dr. To Depreciation A/c	*No Entry*	Same amount of Step 5
7.	Profit and Loss A/c Dr. To Interest A/c	Interest A/c Dr. To Profit and Loss A/c	Same amount of Step 3

Step 2 (entries 3 and 4) is repeated every time instalment is due.
Step 3 (entries 5, 6 and 7) is repeated at every year end as closing entries.

8.2.2 Ledgers

In the examination, we are asked to prepare the following accounts as shown in Table 8.3 for the questions of Hire Purchase Agreement.

Table 8.3 *Hire Purchase Agreement in the Books of Hire Purchaser and Hire Vendor*

In the Books of Hire Purchaser	In the Books of Hire Vendor
• Asset Account • Hire Vendor A/c • Interest Account • Depreciation Account	• Hire Purchaser A/c • Interest Account

Panel A: Books of Hire Purchaser

In the Books of Hire Purchaser
Asset Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
Sale Date	To Vendor's A/c 1	*Full Cash Price*	31 March	By Depreciation A/c 2a	
			31 March	By Balance c/d (*bal. fig*)	
2nd Year			**2nd Year**		
1 April	To Balance b/d		31 March	By Depreciation A/c 2b	
			31 March	By Balance c/d (*bal. fig*)	
3rd Year			**3rd Year**		
1 April	To Balance b/d		31 March	By Depreciation A/c 2c	
			31 March	By Balance c/d (*bal. fig*)	
4th Year					
1 April	To Balance b/d				

In the Books of Hire Purchaser
Hire Vendor's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
Sale Date	To Cash/Bank A/c	*Down Payment*	Sale Date	By Asset A/c 1	*Full Cash Price*
31 March	To Cash/Bank A/c	1st Instalment (*Principal* + *Interest*)	31 March	By Interest A/c 3a	*Interest amount*

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
31 March	Balance c/d (*bal. fig*)				
2nd Year			**2nd Year**		
		2nd Instalment	1 April	By Balance b/d	
31 March	To Cash/Bank A/c	(*Principal* + *Interest*)	31 March	By Interest A/c 3b	*Interest amount*
31 March	Balance c/d (*bal. fig*)				
3rd Year			**3rd Year**		
			1 April	By Balance b/d	
31 March	To Cash/Bank A/c	3rd Instalment (*Principal* + *Interest*)	31 March	By Interest A/c 3c (*bal. fig*)	*Interest amount*

In the Books of Hire Purchaser
Interest Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
31 March	To Hire Vendor's A/c	3a	31 March	By P&L A/c	*Interest amount*
2nd Year			**2nd Year**		
31 March	To Hire Vendor's A/c	3b	31 March	By P&L A/c	*Interest amount*
3rd Year			**3rd Year**		
31 March	To Hire Vendor's A/c	3c	31 March	By P&L A/c	*Interest amount*

In the Books of Hire Purchaser
Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
31 March	To Asset A/c	2a	31 March	By P&L A/c	*Depreciation amount*
2nd Year			**2nd Year**		
31 March	To Asset A/c	2b	31 March	By P&L A/c	*Depreciation amount*

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
3rd Year			**3rd Year**		
31 March	To Asset A/c	2c	31 March	By P&L A/c	*Depreciation amount*

Panel B: Books of Hire Vendor

In the Books of Hire Vendor
Hire Purchaser's Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
Sale Date	To Sales A/c	*Full Cash Price*	Sale Date	By Cash/Bank A/c	*Down Payment*
31 March	To Interest A/c	*Interest amount* 3a	31 March	By Cash/Bank A/c	*1st Instalment* (*Interest + Principal*)
			31 March	By Balance c/d (*bal. fig*)	
2nd Year			**2nd Year**		
1 April	To Balance b/d				
31 March	To Interest A/c	*Interest amount* 3b	31 March	By Cash/Bank A/c	*2nd Instalment* (*Interest + Principal*)
			31 March	By Balance c/d (*bal. fig*)	
3rd Year			**3rd Year**		
1 April	To Balance b/d				
31 March	To Interest A/c	*Interest amount* 3c	31 March	By Cash/Bank A/c	*3rd Instalment* (*Interest + Principal*)

In the Books of Hire Purchaser
Interest Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
1st Year			**1st Year**		
31 March	To P&L A/c	*Interest Amount*	31 March	By Hire Purchaser's A/c	3a

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
2nd Year 31 March	To P&L A/c	*Interest Amount*	**2nd Year** 31 March	By Hire Purchaser's A/c	3b
3rd Year 31 March	To P&L A/c	*Interest Amount*	**3rd Year** 31 March	By Hire Purchaser's A/c	3c

8.2.3 Disclosure in the Balance Sheets of Hire Purchaser and Hire Vendor

At the year-end, the Hire Purchase-related transactions are disclosed in the Balance Sheet of Hire Purchaser and Hire Vendor as shown in Tables 8.4 and 8.5 in the following manner.

Table 8.4 *Balance Sheet of Hire Purchaser*

Liabilities	Amount	Assets		Amount
Unsecured Loans:		**Fixed Assets:**		
Hire Purchase Creditors (Principal Instalments not yet due, i.e. balance in Hire Vendor's A/c)	xxx	Asset (Full Cash Price)	xxx	
		Less: Depreciation *(till date of Balance Sheet)*	(xxx)	xxx

Table 8.5 *Balance Sheet of Hire Vendor*

Liabilities	Amount	Assets	Amount
		Current Assets: Hire Purchase Debtors (Principal Instalments not yet due and unpaid amounts)	xxx

8.3 CALCULATION OF INTEREST

In the numerical questions of Hire Purchase, there are normally two types of styles involved. Sometimes, the rate of interest to be charged on outstanding amount will be mentioned and sometime, the rate of interest would not be mentioned. Accordingly, we can separate the calculation of interest amount on the basis of information provided in the question as shown in Figure 8.5.

CALCULATION OF INTEREST AMOUNT

Rate of Interest ✓ Cash Price ✓ Instalment Amount ✓	Rate of Interest × Cash Price ✓ Instalment Amount ✓

Figure 8.5 *Calculation of interest amount.*

8.3.1 When Rate of Interest is Mentioned

In order to understand the steps involved in this case, let us consider the following example.

Example 2: On 1 January 2014, Mr. Sathe sold two machines to Mr. Kammath for Hire Purchase Price of ₹4,50,000. The cash price of the transactions is ₹4,20,000. Mr. Kammath immediately paid ₹1,50,000 in cash and agreed to pay the balance amount in three yearly equal instalments of ₹1,00,000 including interest at the rate of 5% p.a. on the outstanding balance.

Solution

The following steps are followed in sequence mentioned below.

CALCULATION OF INTEREST AMOUNT: When Interest Rate is GIVEN

***Step 1*: Calculate Outstanding Balance**

Outstanding Balance = Cash Price − Down Payment

₹2,70,000 = 4,20,000 − 1,50,000

***Step 2*: Prepare Interest Table and Place Outstanding Balance at A1.**

Year	Opening Cash Price	Interest	Instalment	Principal	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C)	(D) = (B) − (C)	(E) = (A) − (D)
1st	2,70,000 A1	B1	C1	D1	E1
2nd	A2	B2	C2	D2	E2
3rd	A3	B3	C3	D3	E3
Total					

***Step 3*: Place the Instalment Amount year in Col. (C) as C1, C2 and C3—**₹1,00,000

First Year	***Second Year***	***Third Year***
***Step 4*: Calculate Interest: Interest = Outstanding Balance** $\times \frac{\textbf{Rate}}{\textbf{100}} \Rightarrow \left(\textbf{Col. A} \times \frac{\textbf{Rate}}{\textbf{100}}\right)$		
$= 2{,}70{,}000 \times \frac{5}{100} = 13{,}500$	$= 1{,}83{,}500 \times \frac{5}{100} = 9{,}175$	$= 92{,}675 \times \frac{5}{100} = 4{,}634$
***Step 5*: Calculate Principal: Instalment − Interest ⇒ (Col. C − Col. B)**		
(D1) = (C1) − (B1) 86,500 = 1,00,000 − 13,500	(D2) = (C2) − (B2) 90,825 = 1,00,000 − 9,175	(D3) = (C3) − (B3) 92,675 = 1,00,000 − 4,634
***Step 6*: Calculate Closing Cash Price: Opening Cash Price − Principal ⇒ (Col. A − Col. D)**		
(E1) = (A1) − (D1) 1,83,500 = 2,70,000 − 86,500	(E2) = (A2) − (D2) 92,675 = 1,83,500 − 90,825	(E3) = (A3) − (D3) NIL = 92,675 − 92,675
***Step 7*: Closing Cash Price becomes Opening Cash Price for Next Year**		
(E1) = (A2)	(E2) = (A3)	(E3) = Nil

Using the figures so calculated in each of the above steps, we can prepare a table 'Calculation of Interest Table' as shown below.

Year	Opening Cash Price	Interest	Instalment	Principal	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C)	(D) = (C) − (B)	(E) = (A) − (D)
1st	2,70,000	13,500	1,00,000	86,500	1,83,500
2nd	1,83,500	9,175	1,00,000	90,825	92,675
3rd	92,675	4,634	1,00,000	95,366 (*bal. fig*)	Nil
Total		**27,309**	**3,00,000**	**2,72,691**	

Example 3: On 1 January 2011, M/s KK & Sons purchased a second hand van from Mohmmad Ali for Hire Purchase Price of ₹93,000. The cash price is ₹74,378. M/s KK & Sons immediately paid an amount of ₹16,000 through cheque and agreed to repay the rest in five yearly equal instalments of ₹15,400 each (inclusive of rate of interest of 5% p.a. on the outstanding amount). Draw the analysis table to show the calculation of interest for the period 2011 to 2016.

Solution

Outstanding Balance = Cash Price − Down Payment

= 74,378 − 16,000 = ₹58,378

Year	Opening Cash Price	Interest	Instalment	Principal	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C)	(D) = (C) − (B)	(E) = (A) − (D)
1st	58,378	5,838	15,400	9,562	48,816
2nd	48,816	4,882	15,400	10,518	38,298
3rd	38,298	3,830	15,400	11,570	26,728
4th	26,728	2,672	15,400	12,728	14,000
5th	14,000	1,400	15,400	14,000	Nil
Total		**18,622**	**77,000**	**58,378**	

8.3.2 When Rate of Interest is *Not* Mentioned

In order to understand the steps involved in this case, let us consider the following example.

Example 4: On 1 January 2014, Mr. Vijay sold two machines to Mr. Dhaval for Hire Purchase Price of ₹9,00,000. The cash price of the transactions is ₹8,40,000. Mr. Dhaval immediately paid ₹3,00,000 in cash and agreed to pay the balance amount in three yearly equal instalments of ₹2,00,000 including interest on the outstanding balance.

Solution

Given

Hire Purchase Price = ₹9,00,000   Down Payment = ₹3,00,000   Cash Price = ₹8,40,000

Instalment = ₹2,00,000   Interest = ?

The following steps are followed in sequence mentioned below.

CALCULATION OF INTEREST AMOUNT: When Interest Rate is *NOT* GIVEN

Example 4

***Step 1*: Calculate Total Interest**

Hire Purchase Price – Cash Price

Or

$$\left[\text{Down Payment} + \begin{pmatrix}\text{Amount of each Instalment} \\ \times \text{ No. of Instalments}\end{pmatrix}\right] - \text{Cash Price}$$

***Step 1*: Calculating Total Interest**

$$9{,}00{,}000 - 8{,}40{,}000 = 60{,}000$$

***Step 2*: Calculate Outstanding Hire Purchase Price at the Beg of first year**

O/s HPP = Hire Purchase Price – Down Payment

***Step 2*: Calculating Outstanding HPP at the Beginning of 2014**

9,00,000 – 3,00,000 = 6,00,000

***Step 3*: Place the amount of Step 2 in the table like this:**

Sub-Step	Years	Outstanding HPP at Beginning	Instalment	Ratio of Outstanding HPP	Year-wise Interest
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
3(a)	1st		1st Instalment		$\frac{\text{Ratio}}{\text{Total Ratio}} \times \text{Total Interest}$
3(b)	2nd	Amount 3(a) – 1st Instalment	2nd Instalment		$\frac{\text{Ratio}}{\text{Total Ratio}} \times \text{Total Interest}$
3(c)	3rd	Amount 3(b) – 2nd Instalment	3rd Instalment		$\frac{\text{Ratio}}{\text{Total Ratio}} \times \text{Total Interest}$

Sub-Step	Years	Outstanding HPP at Beginning	Instalment	Ratio of Outstanding HPP	Year-wise Interest
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
3(a)	1st	6,00,000 (–)	2,00,000	6,~~00,000~~	$\frac{6}{12} \times 60{,}000 = 30{,}000$
3(b)	2nd	4,00,000 (–)	2,00,000	4,~~00,000~~	$\frac{4}{12} \times 60{,}000 = 20{,}000$
3(c)	3rd	2,00,000	2,00,000	2,~~00,000~~	$\frac{2}{12} \times 60{,}000 = 10{,}000$

Example 5: On 1 January 2011, M/s KK & Sons purchased a laptop from Mohmmad Ali for Hire Purchase Price of ₹77,000. The cash price is ₹74,378. M/s KK & Sons immediately paid an amount of ₹16,000 through cheque and agreed to repay the rest in five yearly equal instalments of ₹15,400 each (inclusive of rate of interest). Draw the analysis table to show the calculation of interest for the period 2011 to 2016.

Solution

Given

Hire Purchase Price = ₹77,000 Down Payment = ₹16,000 Cash Price = ₹74,378

Instalment = ₹15,400 Interest = ?

Step 1: Total Interest = Hire Purchase Price − Cash Price
= 93,000 − 74,378 = 18,622

Step 2: Outstanding Hire Purchase Price at the beginning of 2011
= Hire Purchase Price − Down Payment = 93,000 − 16,000 = 77,000

***Step 3*: Analysis Table**

Years	Outstanding HPP at Beginning	Instalment	Ratio of Outstanding HPP	Year-wise Interest
(2)	(3)	(4)	(5)	(6)
2011	77,000	15,400	5	$\frac{5}{15} \times 18{,}622 = 6{,}208$
2012	61,600	15,400	4	$\frac{4}{15} \times 18{,}622 = 4{,}965$
2013	46,200	15,400	3	$\frac{3}{15} \times 18{,}622 = 3{,}725$
2014	30,800	15,400	2	$\frac{2}{15} \times 18{,}622 = 2{,}483$
2015	15,400	15,400	1	$\frac{1}{15} \times 18{,}622 = 1{,}241$
			15	18,622

Note:*Common factor is 154

8.4 CALCULATION OF DEPRECIATION

Under Hire Purchase Agreement, we know that ownership of the asset so purchased is transferred to the Hire Purchaser only when the last instalment is made. However, the Hire Purchaser provides depreciation on the asset so purchased under Hire Purchase Agreement. This is in adherence to the basic accounting assumption of 'Substance over Form' (which we have learnt in Chapter 1 of AS-1). Depreciation can be provided either according to Straight Line Method (or Original Cost Method) or according to Written Down Value Method. But the point that should be noted is *that depreciation is calculated on the cash price of the asset and not on Hire Purchase Price of the asset*.

8.5 COMPREHENSIVE ILLUSTRATIONS

Example 6: On 1 April 2013, M/s Western Eastern purchased a television on Hire Purchase Agreement from M/s Tony TV and paid ₹33,850 as down payment. The cash price of the transaction is ₹97,000. As per the agreement, they need to pay ₹30,000 (on 31 March 2014), ₹30,000 (on 31 March 2015) and ₹29,923 (on 31 March 2016). M/s Tony TV charged interest on the outstanding amount at the rate of 20% p.a. The rate of depreciation is 10% p.a. as per WDV method. Pass the necessary Journal entries in the books of M/s Western Eastern and M/s Tony TV.

Solution

Given

Cash Price: ₹97,000 Rate of interest: 20% p.a.

Down Payment: ₹33,850 Depreciation rate: 10% p.a.

Opening Cash Price = Cash Price – Down Payment = 97,000 – 33,850 = ₹63,150

Year	Opening Cash Price	Instalment	Interest	Principal	Closing Cash Price
	(A)	(B)	(C) = $\frac{\text{Rate}}{100} \times$ (A)	(D) = (B) – (C)	(E) = (A) – (D)
1st	63,150	30,000	12,360	17,370	45,780
2nd	45,780	30,000	9,156	20,844	24,936
3rd	24,936	29,923	4,987	24,936	Nil

In the Books of M/s Western Eastern

Date	Particulars	L.F.	Debit	Credit
2013–14				
1 April	Television A/c Dr.		97,000	
	To M/s Tony TV A/c			97,000
	(Being television purchased on Hire Purchase Agreement)			
1 April	M/s Tony TV A/c		33,850	
	To Cash A/c			33,850
	(Being down payment of ₹33,850 paid in cash)			
31 March	Interest A/c Dr.		12,630	
	To M/s Tony TV A/c			12,630
	(Interest on outstanding amount is due)			
31 March	M/s Tony TV A/c Dr.		30,000	
	To Cash A/c			30,000
	(Being 1st instalment paid)			
31 March	Depreciation A/c Dr. $\left(97,000 \times \frac{10}{100}\right)$		9,700	
	To Television A/c			9,700
	(Being depreciation charged on television)			
31 March	P&L A/c Dr.		22,060	
	To Depreciation A/c			9,700
	To Interest A/c			12,360
	(Being depreciation and interest amounts transferred to P&L A/c)			
2014–2015				
31 March	Interest A/c Dr.		9,156	
	To M/s Tony TV A/c			9,156
	(Interest on outstanding amount is due)			

(Continued)

Date	Particulars	L.F.	Debit	Credit
31 March	M/s Tony TV A/c Dr.		30,000	
	To Cash A/c			30,000
	(Being 2nd instalment paid)			
31 March	Depreciation A/c Dr. $\left(87,300 \times \frac{10}{100}\right)$		8,730	
	To TV A/c			8,730
	(Being depreciation charged on TV)			
31 March	P&L A/c Dr.		17,886	
	To Depreciation A/c			8,730
	To Interest A/c			9,156
	(Being depreciation and interest amounts transferred to P&L A/c)			
2015–2016				
31 March	Interest A/c Dr.		4,987	
	To M/s Tony TV A/c			4,987
	(Interest on outstanding amount is due)			
31 March	M/s Tony TV A/c Dr.		29,923	
	To Cash A/c			29,923
	(Being 3rd instalment paid)			
31 March	Depreciation A/c Dr. $\left(78,570 \times \frac{10}{100}\right)$		7,857	
	To Television A/c			7,857
	(Being depreciation charged on TV)			
31 March	P&L A/c Dr.		12,834	
	To Depreciation A/c			7,857
	To Interest A/c			4,987
	(Being depreciation and interest amounts transferred to P&L A/c)			

In the Books of M/s Tony TV

Date	Particulars	L.F.	Debit	Credit
2013–2014				
1 April	M/s Western Eastern A/c Dr.		97,000	
	To Sales A/c			97,000
	(Being TV sold on Hire Purchase Agreement)			
1 April	Bank A/c Dr.		33,850	
	To M/s Western Eastern A/c			33,850
	(Being down payment of ₹33,850 received in cash)			

(Continued)

Date	Particulars	L.F.	Debit	Credit
31 March	M/s Western Eastern A/c Dr.		12,630	
	To Interest A/c			12,630
	(Interest on outstanding amount is due)			
31 March	Cash A/c Dr.		30,000	
	To M/s Western Eastern A/c			30,000
	(Being 1st instalment received)			
31 March	Interest A/c Dr.		12,360	
	To P&L A/c			12,360
	(Being interest amount transferred to P&L A/c)			
2014–2015				
31 March	M/s Western Eastern A/c Dr.		9,156	
	To Interest A/c			9,156
	(Interest on outstanding amount is due)			
31 March	Cash A/c Dr.		30,000	
	To M/s Western Eastern A/c			30,000
	(Being 2nd instalment received)			
31 March	Interest A/c Dr.		9,156	
	To P&L A/c			9,156
	(Being interest amount transferred to P&L A/c)			
2015–2016				
31 March	M/s Western Eastern A/c Dr.		4,987	
	To Interest A/c			4,987
	(Interest on outstanding amount is due)			
31 March	Cash A/c Dr.		29,923	
	To M/s Western Eastern A/c			29,923
	(Being 3rd instalment received)			
31 March	Interest A/c Dr.		4,987	
	To P&L A/c			4,987
	(Being interest amount transferred to P&L A/c)			

Example 7: Mr. Lal Prasad purchased a Car on Hire-Purchase Basis from Maruti Ltd. on 1 January, 2013. He paid ₹1,50,000 on signing the contract and agreed to pay three instalments of Cash Price excluding interest as follows:

On 31 December 2013 ₹1,50,000
On 31 December 2014 ₹1,65,000
On 31 December 2015 ₹1,85,000

The Cash Price of the car was ₹6,50,000. Interest is charged at 10% p.a. by Maruti Ltd. on outstanding amount. Depreciation at the rate of 20% p.a. on W.D.V. is charged on the Car. Prepare Car Account and Maruti Ltd. Account in the books of Mr. Lal Prasad for the years 2013, 2014 and 2015.

Acc&FM-I, November 2016

Solution

Given

Cash Price: ₹6,50,000 Rate of interest: 10% p.a.
Down Payment: ₹1,50,000 Depreciation rate: 20% p.a.

Opening Cash Price = Cash Price − Down Payment = 6,50,000 − 1,50,000 = ₹5,00,000

Principal amounts are given as 1,50,000, 1,65,000 and 1,85,000, thus Instalment is Interest + Principal amounts

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C) given	(D) = (B) + (C)	(E) = (A) − (C)
2013	5,00,000	50,000	1,50,000	2,00,000	3,50,000
2014	3,50,000	35,000	1,65,000	2,00,000	1,85,000
2015	1,85,000	18,500	1,85,000	2,03,500	Nil

In the Books of Mr. Lal Prasad
Car Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To Vendor's A/c	6,50,000	31 December	By Depreciation A/c	1,30,000
			31 December	By Balance c/d (*bal. fig*)	5,20,000
		6,50,000			6,50,000
2014			**2014**		
1 January	To Balance b/d	5,20,000	31 December	By Depreciation A/c	1,04,000
			31 December	By Balance c/d (*bal. fig*)	4,16,000
		5,20,000			5,20,000
2015			**2015**		
1 January	To Balance b/d	4,16,000	31 December	By Depreciation A/c	83,200
			31 December	By Balance c/d (*bal. fig*)	3,32,800
		4,16,000			4,16,000
2016					
1 January	To Balance b/d	3,32,800			

In the Books of Mr. Lal Prasad
Maruti Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To Cash/Bank A/c	1,50,000	1 January	By Asset A/c	6,50,000
31 December	To Cash/Bank A/c	2,00,000	31 December	By Interest A/c	50,000
31 December	To Balance c/d (*bal. fig*)	3,50,000			
		7,00,000			7,00,000
2014			**2014**		
			1 January	By Balance b/d	3,50,000
31 December	To Cash/Bank A/c	2,00,000	31 December	By Interest A/c	35,000
31 December	To Balance c/d (*bal. fig*)	1,85,000			
		3,85,000			3,85,000
2015			**2015**		
			1 January	By Balance b/d	1,85,000
31 December	To Cash/Bank A/c	2,03,500	31 December	By Interest A/c (*bal. fig*)	18,500
		2,03,500			2,03,500

Example 8: On 1 January 2013, M/s Sandoz Fabricators purchased one Injection Molding Machine from Larson & Toubro Ltd. on Hire Purchase Agreement. The cash price of the machine is ₹2,80,000. The firm paid down payment of ₹80,000 on 1 January 2013 and balance in three annual instalments of ₹80,000 each including interest at 10% p.a. commencing from 31 December 2013. M/s Sandoz Fabricators provide depreciation on machinery at 20% p.a. on written Down Value Method on 31 December every Year. You are required to give

1. Machine A/c
2. Larson & Toubro Ltd A/c

For the years ended 31 December 2013, 2014, 2015 in the books of M/s Sandoz Fabricators.

F.Y.B.Com., IDOL, April 2016 and October 2014 (adapted)

Solution

Given

Cash Price: ₹2,80,000 Rate of interest: 10% p.a. Instalment: ₹80,000
Down Payment: ₹80,000 Depreciation rate: 20% p.a.

Opening Cash Price = Cash Price − Down Payment = 2,80,000 − 80,000 = ₹2,00,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Instalment	Interest	Principal	Closing Cash Price
	(A)	(B) given	(C) = $\frac{\text{Rate}}{100} \times$ (A)	(D) = (B) − (C)	(E) = (A) − (D)
2013	2,00,000	80,000	20,000	60,000	1,40,000
2014	1,40,000	80,000	14,000	66,000	74,000
2015	74,000	80,000	6,000 (*adjusted bal. fig*)	74,000	Nil

In the Books of M/s Sandooz Fabricators
Machinery Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To Larson & Toubro A/c	2,80,000	31 December	By Depreciation A/c	56,000
			31 December	By Balance c/d (*bal. fig*)	2,24,000
		6,50,000			2,80,000
2014			**2014**		
1 January	To Balance b/d	2,24,000	31 December	By Depreciation A/c	44,800
			31 December	By Balance c/d (*bal. fig*)	1,79,200
		2,24,000			2,24,000
2015			**2015**		
1 January	To Balance b/d	1,79,200	31 December	By Depreciation A/c	35,840
			31 December	By Balance c/d (*bal. fig*)	1,43,360
		1,79,200			1,79,200
2016					
1 January	To Balance b/d	1,43,360			

In the Books of M/s Sandooz Fabricators
Larson & Toubro Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To Cash/Bank A/c	80,000	1 January	By Machinery A/c	2,80,000
31 December	To Cash/Bank A/c	80,000	31 December	By Interest A/c	20,000
31 December	To Balance c/d (*bal. fig*)	1,40,000			
		3,00,000			3,00,000
2014			**2014**		
			1 January	By Balance b/d	1,40,000
31 December	To Cash/Bank A/c	80,000	31 December	By Interest A/c	14,000
31 December	To Balance c/d (*bal. fig*)	74,000			
		1,54,000			1,54,000

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
2015			**2015**		
			1 January	By Balance b/d	74,000
31 December	To Cash/Bank A/c	80,000	31 December	By Interest A/c (*adjusted bal. fig*)	6,000
		80,000			80,000

Example 9: Rani Traders purchased two machines from Sunrich Ltd. on instalment system on 1 April 2011. The Cash price of each machine was ₹45,00,000. An initial payment of ₹5,00,000 each was made on the date of purchase. The balance was paid in instalments of ₹10,00,000 each plus interest at the rate of 10% p.a. on outstanding principal. Rani Traders charged depreciation at the rate of 15% p.a. on diminishing balance. Rani Traders closes their books on 31 March every year. You are required to draw Machines A/c of Sunrich Ltd. A/c in the books of Rani Traders and draw Rani Traders A/c in the books of Sunrich Ltd. for the year 2011–2012, 2012–2013, 2013–2014 and 2014–2015.

F.Y.B.Com., IDOL, October 2015

Solution

Given

Cash Price: ₹90,00,000 (4,50,000 × 2 machines)
Principal: ₹20,00,000
Depreciation rate: 15% p.a.
Rate of interest: 10% p.a.
Down Payment: ₹10,00,000

Opening Cash Price = Cash Price − Down Payment = 90,00,000 − 10,00,000 = ₹80,00,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100}$ × (A)	(C) given	(D) = (B) + (C)	(E) = (A) − (C)
2011–2012	80,00,000	8,00,000	20,00,000	28,00,000	60,00,000
2012–2013	60,00,000	6,00,000	20,00,000	26,00,000	40,00,000
2013–2014	40,00,000	4,00,000	20,00,000	24,00,000	20,00,000
2014–2015	20,00,000	2,00,000	20,00,000	22,00,000	Nil

In the Books of Rani Traders
Machinery Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2011–2012			**2011–2012**		
1 April	To Surich Ltd. A/c	90,00,000	31 March	By Depreciation A/c (***WN-1***)	13,50,000
			31 March	By Balance c/d (*bal. fig*)	76,50,000
		90,00,000			90,00,000

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
2012–2013			**2012–2013**		
1 April	To Balance b/d	76,50,000	31 March	By Depreciation A/c (***WN-2***)	11,47,500
			31 March	By Balance c/d (*bal. fig*)	65,02,500
		76,50,000			76,50,000
2013–2014			**2013–2014**		
1 April	To Balance b/d	65,02,500	31 March	By Depreciation A/c (***WN-3***)	9,75,375
			31 March	By Balance c/d (*bal. fig*)	55,27,125
		65,02,500			65,02,500
2014–2015			**2014–2015**		
1 April	To Balance b/d	55,27,125	31 March	By Depreciation A/c (***WN-4***)	8,29,069
			31 March	By Balance c/d (*bal. fig*)	46,98,056
		55,27,125			55,27,125
2015–2016			**2015–2016**		
1 April	To Balance b/d	46,98,056			

In the Books of Rani Traders
Sunrich Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2011–2012			**2011–2012**		
1 April	To Cash/Bank A/c	10,00,000	1 April	By Machine A/c	90,00,000
31 March	To Cash/Bank A/c	28,00,000	31 March	By Interest A/c	8,00,000
31 March	To Balance c/d (*bal. fig*)	60,00,000			
		98,00,000			98,00,000
2012–2013			**2012–2013**		
			1 April	By Balance b/d	60,00,000
31 March	To Cash/Bank A/c	26,00,000	31 March	By Interest A/c	6,00,000
31 March	To Balance c/d (*bal. fig*)	40,00,000			
		66,00,000			66,00,000
2013–2014			**2013–2014**		
			1 April	By Balance b/d	40,00,000
31 March	To Cash/Bank A/c	24,00,000	31 March	By Interest A/c (*bal. fig*)	4,00,000
31 March	To Balance c/d (*bal. fig*)	20,00,000			
		44,00,000			44,00,000
2014–2015			**2014–2015**		
			1 April	By Balance b/d	20,00,000
31 March	To Cash/Bank A/c	22,00,000	31 March	By Interest A/c (*bal. fig*)	2,00,000
		22,00,000			22,00,000

In the Books of Sunrich Ltd.
Rani Traders Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2011–2012			**2011–2012**		
1 April	To Sales A/c	90,00,000	1 April	By Cash/Bank A/c	10,00,000
31 March	To Interest A/c	8,00,000	31 March	By Cash/Bank A/c	28,00,000
			31 March	By Balance c/d (*bal. fig*)	60,00,000
		98,00,000			98,00,000
2012–2013			**2012–2013**		
1 April	To Balance b/d	60,00,000	31 March	By Cash/Bank A/c	26,00,000
31 March	To Interest A/c	6,00,000	31 March	By Balance c/d (*bal. fig*)	40,00,000
		66,00,000			66,00,000
2013–2014			**2013–2014**		
1 April	To Balance b/d	40,00,000	31 March	By Cash/Bank A/c	24,00,000
31 March	To Interest A/c	6,00,000	31 March	By Balance c/d (*bal. fig*)	20,00,000
		46,00,000			46,00,000
2014–2015			**2014–2015**		
1 April	To Balance b/d	20,00,000	31 March	By Cash/Bank A/c	22,00,000
31 March	To Interest A/c	2,00,000			
		22,00,000			22,00,000

Working Notes:

WN - 1 : Depreciation for the FY 2011–2012

Cost of Machines	90,00,000
Less: Dep. @ 15%	(13,50,000)
W.D.V of Machines	76,50,000

WN - 2 : Depreciation for the FY 2012–2013

W.D.V of Machines	76,50,000
Less: Dep. @ 15%	(11,47,500)
W.D.V of Machines	65,02,500

WN - 3 : Depreciation for the FY 2013–2014

W.D.V of Machines	65,02,500
Less: Dep. @ 15%	(9,75,375)
W.D.V of Machines	55,27,125

WN - 4 : Depreciation for the FY 2014–2015

W.D.V of Machines	55,27,125
Less: Dep. @ 15%	(8,29,069)
W.D.V of Machines	46,98,056

Example 10: The City Transport Ltd. purchased equipment from the Jeet Motors Ltd. on Hire Purchase basis. The cash price of the equipment was ₹3,20,000. The amounts were payable as ₹1,00,000 on 1 April 2014, ₹80,000 on 31 March 2015, ₹80,000 on 31 March 2016 and ₹82,478 on 31 March 2017. The Jeet Motors Ltd. charged interest at 5% p.a. on the outstanding amounts. The City Transport Ltd. provided depreciation at the rate of 20% on the written down value balance each year. It closes its books every year on 31 March. You are required to prepare Equipment Account,

Jeet Motors Ltd. Account and Interest Account in the books of City Transport Ltd. according to Asset Purchase Method for the year 2014–2015 to 2016–2017.

F.Y.B.Com., IDOL, April 2013 (adapted)

Solution

Given

Cash Price: ₹3,20,000
Down Payment: ₹1,00,000
Instalment: ₹80,000, 80,000 and 82,748

Rate of interest: 5% p.a.
Depreciation rate: 20% p.a.
No. of Instalments: 3 annual

Opening Cash Price = Cash Price − Down Payment = 3,20,000 − 1,00,000 = ₹2,20,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C) given	(D) = (B) + (C)	(E) = (A) − (C)
2014–2015	2,20,000	11,000	69,000	80,000	1,51,000
2015–2016	1,51,000	7,550	72,450	80,000	78,550
2016–2017	78,550	3,928 (*adjusted bal. fig*)	78,550	82,478	Nil

In the Books of City Transport Ltd.
Equipment Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 April	To Jeet Motors Ltd. A/c	3,20,000	31 March	By Depreciation A/c (***WN-1***)	64,000
			31 March	By Balance c/d (*bal. fig*)	2,56,000
		3,20,000			3,20,000
2015–2016			**2015–2016**		
1 April	To Balance b/d	2,56,000	31 March	By Depreciation A/c (***WN-2***)	51,200
			31 March	By Balance c/d (*bal. fig*)	2,04,800
		2,56,000			2,56,000
2016–2017			**2016–2017**		
1 April	To Balance b/d	2,04,800	31 March	By Depreciation A/c (***WN-3***)	40,960
			31 March	By Balance c/d (*bal. fig*)	1,63,840
		2,04,800			2,04,800
2017–2018			**2017–2018**		
1 April	To Balance b/d	1,63,840			

In the Books of City Transport Ltd.
Jeet Motors Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 April	To Cash/Bank A/c	1,00,000	1 April	By Equipment A/c	3,20,000
31st Mar	To Cash/Bank A/c	80,000	31 March	By Interest A/c	11,000
31st Mar	To Balance c/d (*bal. fig*)	1,51,000			
		3,31,000			3,31,000
2015–2016			**2015–2016**		
			1 April	By Balance b/d	1,51,000
31 March	To Cash/Bank A/c	80,000	31 March	By Interest A/c	7,550
31 March	To Balance c/d (*bal. fig*)	78,550			
		1,58,550			1,58,550
2016–2017			**2016–2017**		
			1 April	By Balance b/d	78,550
31 March	To Cash/Bank A/c	82,478	31 March	By Interest A/c (*adjusted bal. fig*)	3,928
		82,478			82,478

In the Books of City Transport Ltd.
Interest Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
31 March	To Jeet Motors Ltd. A/c	11,000	31 March	By P&L A/c	11,000
		11,000			11,000
2015–2016			**2015–2016**		
31 March	To Jeet Motors Ltd. A/c	7,550	31 March	By P&L A/c	7,550
		7,550			7,550
2016–2017			**2016–2017**		
31 March	To Jeet Motors Ltd. A/c	3,928	31 March	By P&L A/c	3,928
		3,928			3,928

Working Notes:

WN - 1 : Depreciation for the FY 2014–2015

W.D.V of Equipment	3,20,000
Less: Dep. @ 20%	(64,000)
W.D.V of Machines	2,56,000

WN - 2 : Depreciation for the FY 2015–2016

W.D.V of Equipment	2,56,000
Less: Dep. @ 20%	(51,200)
W.D.V of Machines	2,04,800

WN - 3 : Depreciation for the FY 2016–2017

W.D.V of Equipment	2,04,800
Less: Dep. @ 20%	(40,960)
W.D.V of Machines	1,63,840

Example 11: Abhijit Fabricators purchased a molding machine from Machinocraft Industries on instalment system on 1 April 2014. ₹60,000 were paid on signing the contract and the balance in three instalments of ₹50,000 each on 31 March every year. The cash price of the computer was ₹1,84,500. Interest charged by the seller was at 10% per annum. Abhijit Fabricators charges depreciation at the rate of 20% p.a. on W.D.V. method on molding machine on 31 March every year. In the books of Abhijit Fabricators prepare the following accounts for the accounting years 2014–2015, 2015–2016 and 2016–2017.

1. Molding Machine A/c
2. Machinocraft Industries A/c
3. Interest A/c
4. Depreciation A/c

S.Y.B.Com., IDOL, October 2014 (adapted)

Solution

Given

Cash Price: ₹1,84,500
Down Payment: ₹60,000
Instalment: ₹50,000 each

Rate of interest: 10% p.a.
Depreciation rate: 20% p.a.
No. of Instalments: 3 annual

Opening Cash Price = Cash Price − Down Payment = 1,84,500 − 60,000 = ₹1,24,500

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Instalment	Interest	Principal	Closing Cash Price
	(A)	(B)	(C) = $\frac{\text{Rate}}{100} \times$ (A)	(D) = (B) − (C)	(E) = (A) − (D)
2014–15	1,24,500	50,000	12,450	37,550	86,950
2015–16	86,950	50,000	8,695	41,305	45,645
2016–17	45,645	50,000	4,355 (*bal. fig*)	45,645	Nil

In the Books of Abhijit Fabricators
Molding Machine A/c

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 April	To Machinocraft Industries A/c	1,84,500	31 March	By Depreciation A/c (***WN-1***)	36,900
			31 March	By Balance c/d (*bal. fig*)	1,47,600
		1,84,500			1,84,500
2015–2016			**2015–2016**		
1 April	To Balance b/d	1,47,600	31 March	By Depreciation A/c (***WN-2***)	29,520
			31 March	By Balance c/d (*bal. fig*)	1,18,080
		1,47,600			1,47,600
2016–2017			**2016–2017**		
1 April	To Balance b/d	1,18,080	31 March	By Depreciation A/c (***WN-3***)	23,616
			31 March	By Balance c/d (*bal. fig*)	94,464
		1,18,080			1,18,080
2017–2018			**2017–2018**		
1 April	To Balance b/d	94,464			

In the Books of Abhijit Fabricators
Machinocraft Industries Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 April	To Cash/Bank A/c	60,000	1 April	By Molding Machine A/c	1,84,500
31 March	To Cash/Bank A/c	50,000	31 March	By Interest A/c	12,450
31 March	To Balance c/d (*bal. fig*)	86,950			
		1,96,950			1,96,950
2015–2016			**2015–2016**		
			1 April	By Balance b/d	86,950
31 March	To Cash/Bank A/c	50,000	31 March	By Interest A/c	8,695
31 March	To Balance c/d (*bal. fig*)	45,645			
		95,645			95,645
2016–2017			**2016–2017**		
			1 April	By Balance b/d	45,645
31 March	To Cash/Bank A/c	50,000	31 March	By Interest A/c (*bal. fig*)	4,355
		50,000			50,000

In the Books of Abhijit Fabricators
Interest Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
31 March	To Machinocraft Industries A/c	12,450	31 March	By P&L A/c	12,450
		12,450			12,450
2015–2016			**2015–2016**		
31 March	To Machinocraft Industries A/c	8,695	31 March	By P&L A/c	8,695
		8,695			8,695
2016–2017			**2016–2017**		
31 March	To Machinocraft Industries A/c	4,355	31 March	By P&L A/c	4,355
		4,355			4,355

In the Books of Hire Purchaser
Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
31 March	To Molding Machine A/c	36,900	31 March	By P&L A/c	36,900
		36,900			36,900
2015–2016			**2015–2016**		
31 March	To Molding Machine A/c	29,250	31 March	By P&L A/c	29,250
		29,250			29,250
2016–2017			**2016–2017**		
31 March	To Molding Machine A/c	23,616	31 March	By P&L A/c	23,616
		23,616			23,616

Working Notes:

WN - 1 : Depreciation for the FY 2014–2015

Cost of Molding Machine	1,84,500
Less: Dep. @ 20%	(36,900)
W.D.V of Machines	1,47,600

WN - 2 : Depreciation for the FY 2015–2016

W.D.V of Molding Machine	1,47,600
Less: Dep. @ 20%	(29,520)
W.D.V of Machines	1,18,080

WN - 3 : Depreciation for the FY 2016–2017

W.D.V of Molding Machine	1,18,080
Less: Dep. @ 20%	(23,616)
W.D.V of Machines	94,464

Example 12: On 1 July 2010, M/s Monika Metals purchased one compressing machine from HMT Ltd. on Hire Purchase Agreement; the cash price of the machine is ₹2,50,000. The firm paid down payment of ₹40,000 on 1 July 2010 and balance in three Annual instalments of ₹70,000 each plus interest at 5% p.a. commencing from 31 December 2010. M/s. Monika Metals provide depreciation on machinery at 20% p.a. on 31 December, every year. You are required to prepare the following accounts in the books of M/s Monika Metals for the years ended 31 December 2010, 2011, 2012.

1. Machine A/c
2. HMT Ltd A/c

F.Y.B.Com., IDOL, October 2013 (adapted)

Solution

Given

Cash Price: ₹2,50,000	Rate of interest: 5% p.a.
Down Payment: ₹40,000	Depreciation rate: 20% p.a.
Principal: ₹70,000	No. of Instalments: 3 annual

Opening Cash Price = Cash Price − Down Payment = 2,50,000 − 40,000 = ₹2,10,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C) given	(D) = (B) + (C)	(E) = (A) − (C)
2010	2,10,000	5,250	70,000	75,250	1,40,000
2011	1,40,000	7,000	70,000	77,000	70,000
2012	70,000	3,500	70,000	73,500	Nil

In the Books of M/s Monika Metals
Machine Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2010			**2010**		
1 July	To HMT Ltd. A/c	2,50,000	31 December	By Depreciation A/c (***WN-1***)	25,000
			31 December	By Balance c/d (*bal. fig*)	2,25,000
		2,50,000			2,50,000
2011			**2011**		
1 January	To Balance b/d	2,25,000	31 December	By Depreciation A/c (***WN-2***)	45,000
			31 December	By Balance c/d (*bal. fig*)	1,80,000
		2,25,000			2,25,000
2012			**2012**		
1 January	To Balance b/d	1,80,000	31 December	By Depreciation A/c (***WN-3***)	36,000
			31 December	By Balance c/d (*bal. fig*)	1,44,000
		1,80,000			1,80,000
2013			**2013**		
1 January	To Balance b/d	1,44,000			

In the Books of M/s Monika Metals
HMT Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2010			**2010**		
1 January	To Cash/Bank A/c	40,000	1 January	By Machine A/c	2,50,000
31 December	To Cash/Bank A/c	75,250	31 December	By Interest A/c	5,250
31 December	To Balance c/d (*bal. fig*)	1,40,000			
		2,55,250			2,55,250
2011			**2011**		
			1 January	By Balance b/d	1,40,000
31 December	To Cash/Bank A/c	77,000	31 December	By Interest A/c	7,000
31 December	To Balance c/d (*bal. fig*)	70,000			
		1,47,000			1,47,000
2012			**2012**		
			1 January	By Balance b/d	70,000
31 December	To Cash/Bank A/c	73,500	31 December	By Interest A/c (*bal. fig*)	3,500
		73,500			73,500

Working Notes:

WN - 1 : Depreciation for the CY 2010

Cost of Machines (1 July 2010)	2,50,000
Less: Dep. @ 20% for 6 months	(25,000)
W.D.V of Machines	2,25,000

WN - 2 : Depreciation for the CY 2011

W.D.V of Machines	2,25,000
Less: Dep. @ 20%	(45,000)
W.D.V of Machines	1,80,000

WN - 3 : Depreciation for the CY 2012

W.D.V of Machines	1,80,000
Less: Dep. @ 20%	(36,000)
W.D.V of Machines	1,44,000

Example 13: Patil Associate purchased computer from Sangita Comp. Ltd. on instalment system on 1 July 2014; ₹1,00,000 were paid on signing the contract and the balance in three instalments of ₹1,00,000 each on 31st March every year. The cash price of the computer was ₹4,00,000. Interest charged by the seller was at 5% per annum. Patil Associates charges depreciation at the rate of 25% p.a. on W.D.V. method on computer on 31 March every Year. Prepare the following accounts in the books of Patil Associates Sons for the accounting years 2014–2015, 2015–2016 and 2016–2017.

a. Computer A/c.
b. Sangita Comp. Ltd. A/c.
c. Interest A/c.

S.Y.B.Com., IDOL, April 2012 (adapted)

Solution

Given

Cash Price: ₹4,00,000
Down Payment: ₹1,00,000
Principal: ₹1,00,000 each

Rate of interest: 5% p.a.
Depreciation rate: 25% p.a.
No. of Instalments: 3 annual

Opening Cash Price = Cash Price − Down Payment = 4,00,000 − 1,00,000 = ₹3,00,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C) given	(D) = (B) + (C)	(E) = (A) − (C)
2014–2015	3,00,000	11,250	1,00,000	1,11,250	2,00,000
2015–2016	2,00,000	10,000	1,00,000	1,10,000	1,00,000
2016–2017	1,00,000	5,000	1,00,000	1,05,000	NIL

In the Books of Patil Associate Sons
Computer A/c

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 July	To Sangita Comp. Ltd. A/c	4,00,000	31 March	By Depreciation A/c (***WN-1***)	75,000
			31 March	By Balance c/d (*bal. fig*)	3,25,000
		4,00,000			4,00,000
2015–2016			**2015–2016**		
1 April	To Balance b/d	3,25,000	31 March	By Depreciation A/c (***WN-2***)	81,250
			31 March	By Balance c/d (*bal. fig*)	2,43,750
		3,00,000			3,00,000
2016–2017			**2016–2017**		
1 April	To Balance b/d	2,43,750	31 March	By Depreciation A/c (***WN-3***)	60,938
			31 March	By Balance c/d (*bal. fig*)	1,82,812
		2,43,750			2,43,750
2017–2018			**2017–2018**		
1 April	To Balance b/d	1,82,812			

In the Books of Patil Associate Sons
Sangita Comp. Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 July	To Cash/Bank A/c	1,00,000	1 July	By Machine A/c	4,00,000
31 March	To Cash/Bank A/c	1,11,250	31 March	By Interest A/c	11,250
31 March	To Balance c/d (*bal. fig*)	2,00,000			
		4,11,250			4,11,250
2015–2016			**2015–2016**		
			1 April	By Balance b/d	2,00,000
31 March	To Cash/Bank A/c	1,10,000	31 March	By Interest A/c	10,000
31 March	To Balance c/d (*bal. fig*)	1,00,000			
		2,10,000			2,10,000
2016–2017			**2016–2017**		
			1 April	By Balance b/d	1,00,000
31 March	To Cash/Bank A/c	1,05,000	31 March	By Interest A/c (*bal. fig*)	5,000
		1,05,000			1,05,000

In the Books of Patil Associate Sons
Interest Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
31 March	To Sangita Comp. Ltd A/c	11,250	31 March	By P&L A/c	11,250
		11,250			11,250
2015–2016			**2015–2016**		
31 March	To Sangita Comp. Ltd A/c	10,000	31 March	By P&L A/c	10,000
		10,000			10,000
2016–2017			**2016–2017**		
31 March	To Sangita Comp. Ltd A/c	5,000	31 March	By P&L A/c	5,000
		5,000			5,000

Working Notes:

WN - 1 : Depreciation for the FY 2014 – 2015

Cost of Machines	4,00,000
Less: Dep. @ 25% for 9 months	(75,000)
W.D.V of Machines	3,25,000

WN - 2 : Depreciation for the FY 2015 – 2016

W.D.V of Machines	3,25,000
Less: Dep. @ 25%	(81,250)
W.D.V of Machines	2,43,750

WN - 3 : Depreciation for the FY 2016 – 2017

Cost of Machines	2,43,750
Less: Dep. @ 25%	(60,938)
W.D.V of Machines	1,82,812

Example 14: Mukta Traders purchased five machines from Hindusthan Manufactures Ltd. on instalment system on 1 January 2013. The cash price of each machine was ₹10,50,000. An initial payment of ₹1,50,000 each was made on the date of purchase. The balance was paid in instalments of ₹2,25,000 each plus interest at the rate of 10% p.a. on outstanding principal And instalments depreciation at the rate of 12% p.a. on Written Down Value. Mukta Traders closes their books on 31 March every year. You are requested to draw Machines Account of Hindusthan Manufactures Ltd. in the books of Mukta Traders for the year 2013–2014, 2014–2015, 2015–2016 and 2016–2017.

S.Y.B.Com., IDOL, April 2014 (adapted)

Solution

Given

Cash Price: ₹52,50,000 (10,50,000 × 5)
Down Payment: ₹7,50,000 (1,50,000 × 5)
Principal: ₹11,25,000 each (2,25,000 × 5)

Rate of interest: 10% p.a.
Depreciation rate: 12% p.a.

Opening Cash Price = Cash Price − Down Payment = 52,50,000 − 7,50,000 = ₹45,00,000

Calculation of Interest and Instalment Amounts

Year	Opening Cash Price	Interest	Principal	Instalment	Closing Cash Price
	(A)	(B) = $\frac{\text{Rate}}{100} \times$ (A)	(C) given	(B) = (C) + (D)	(E) = (A) − (C)
2013–2014	45,00,000	Interest for 3 months (January 2013 to March 2013) $\frac{10}{100} \times \frac{3}{12} \times 45,00,000$ $= 1,12,500$	11,25,000	12,37,500	33,75,000
2014–2015	33,75,000	3,37,500	11,25,000	14,62,500	22,50,000
2015–2016	22,50,000	2,25,000	11,25,000	13,50,000	11,25,000
2016–2017	11,25,000	1,12,500	11,25,000	12,37,500	Nil

In the Books of Mukta Traders
Machines A/c

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013–2014			**2013–2014**		
1 January	To Hindustan Ltd. A/c	52,50,000	31 March	By Depreciation A/c (***WN-1***)	1,57,500
			31 March	By Balance c/d (*bal. fig*)	50,92,500
		52,50,000			52,50,000

(Continued)

Date	Particulars	Amount	Date	Particulars	Amount
2014–2015			**2014–2015**		
1 April	To Balance b/d	50,92,500	31 March	By Depreciation A/c (***WN-2***)	6,11,100
			31 March	By Balance c/d (*bal. fig*)	44,81,400
		50,92,500			50,92,500
2015–2016			**2015–2016**		
1 April	To Balance b/d	44,81,400	31 March	By Depreciation A/c (***WN-3***)	5,37,768
			31 March	By Balance c/d (*bal. fig*)	39,43,632
		44,81,400			44,81,400
2016–2017			**2016–2017**		
1 April	To Balance b/d	39,43,632	31 March	By Depreciation A/c (***WN-4***)	4,73,236
			31 March	By Balance c/d (*bal. fig*)	34,70,396
		39,43,632			39,43,632

In the Books of Mukta Traders
Hindustan Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013–2014			**2013–2014**		
1 January	To Cash/Bank A/c	7,50,000	1 January	By Machine A/c	52,50,000
31 March	To Cash/Bank A/c	12,37,500	31 March	By Interest A/c	1,12,500
31 March	To Balance c/d (*bal. fig*)	33,75,000			
		53,62,500			53,62,500
2014–2015			**2014–2015**		
			1 April	By Balance b/d	33,75,000
31 March	To Cash/Bank A/c	14,62,500	31 March	By Interest A/c	3,37,500
31 March	To Balance c/d (*bal. fig*)	22,50,000			
		37,12,500			37,12,500
2015–2016			**2015–2016**		
			1 April	By Balance b/d	22,50,000
31 March	To Cash/Bank A/c	12,37,500	31 March	By Interest A/c (*bal. fig*)	2,25,000
31 March	To Balance c/d (*bal. fig*)	12,37,500			
		24,75,000			24,75,000
2016–17			**2016–2017**		
			1 April	By Balance b/d	12,37,500
31 March	To Cash/Bank A/c	12,37,500	31 March	By Interest A/c (*bal. fig*)	1,12,500
		12,37,500			12,37,500

Working Notes:

WN - 1 : Depreciation for the FY 2013–2014

Cost of Machines	52,50,000
Less: Dep. (3 months) @ 12%	(1,57,500)
W.D.V of Machines	50,92,500

WN - 2 : Depreciation for the FY 2014–2015

W.D.V of Machines	50,92,500
Less: Dep. @ 12%	(6,11,100)
W.D.V of Machines	44,81,400

WN - 3 : Depreciation for the FY 2015–2016

W.D.V of Machines	44,81,400
Less: Dep. @ 12%	(5,37,768)
W.D.V of Machines	39,43,632

WN - 4 : Depreciation for the FY 2016–2017

W.D.V of Machines	39,43,632
Less: Dep. @ 12%	(4,73,236)
W.D.V of Machines	34,70,396

Example 15: On 1 January 2013, M/s Renu Fabricators purchased one Lathe Machine from HMT Ltd. on Hire Purchase Agreement. The cash price of the machine is ₹1,50,000. The firm paid down payment of ₹20,000 on 1 January 2013 and the balance in five half-yearly instalments of ₹30,000 each commencing from 30 June 2013. HMT Ltd. charges interest at 10% p.a. M/s Renu Fabricators provides depreciation on machinery at 20% p.a. on 31 December every year. You are required to prepare the followings accounts in the books of M/s Renu Fabricators for the years ended 2013, 2014 and 2015.

1. Lathe Machinery Account
2. HMT Ltd. Account

S.Y.B.Com., IDOL, October 2010 (adapted)

Solution

Given

Cash Price: ₹1,50,000 — Rate of interest: 10% p.a. or 5% ***half yearly***

Down Payment: ₹20,000 — No. of Instalments: 5 ***half yearly***

Instalment: ₹30,000 each — Depreciation rate: 20% p.a. (assumed SLM as nothing being mentioned)

Opening Cash Price = Cash Price − Down Payment = 1,50,000 − 20,000 = ₹1,30,000

Calculation of Interest and Instalment Amounts

Year	Month	Opening Cash Price	Instalment	Interest	Principal	Closing Cash Price
		(A)	(B)	(C) = $\frac{\text{Rate}}{100} \times$ (A)	(D) = (B) − (C)	(E) = (A) − (D)
2013	30 June	1,30,000	30,000	6,500	23,500	1,06,500
	31 December	1,06,500	30,000	5,325	24,765	81,825
2014	30 June	81,825	30,000	4,091	25,909	55,916
	31 December	55,916	30,000	2,796	27,204	28,712
2015	30 June	28,712	30,000	1,288 (*bal. fig.*)	28,712	Nil

In the Books of Renu Fabricators
Lathe Machine A/c

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To HMT Ltd. A/c	1,50,000	31 March	By Depreciation A/c	30,000
			31 March	By Balance c/d (*bal. fig*)	1,20,000
		52,50,000			1,50,000
2014			**2014**		
1 April	To Balance b/d	1,20,000	31 March	By Depreciation A/c	30,000
			31 March	By Balance c/d (*bal. fig*)	90,000
		1,20,000			1,20,000
2015			**2015**		
1 April	To Balance b/d	90,000	31 March	By Depreciation A/c	30,000
			31 March	By Balance c/d (*bal. fig*)	60,000
		90,000			90,000
2016–17					
1 April	To Balance b/d	60,000			

In the Books of Renu Fabricators
HMT Ltd. Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2013			**2013**		
1 January	To Cash/Bank A/c	20,000	1 January	By Machine A/c	1,50,000
30 June	To Cash/Bank A/c	30,000	30 June	By Interest A/c	6,500
30 June	To Balance c/d (*bal. fig*)	1,06,500			
		1,56,500			1,56,500
2013			**2013**		
31 December	To Cash/Bank A/c	30,000	1 July	By Balance b/d	1,06,500
31 December	To Balance c/d (*bal. fig*)	81,825	31 December	By Interest A/c	5,325
		1,11,825			1,11,825
2014			**2014**		
30 June	To Cash/Bank A/c	30,000	1 January	By Balance b/d	81,825
30 June	To Balance c/d (*bal. fig*)	55,916	30 June	By Interest A/c (*bal. fig*)	4,091
		85,916			85,916
2014			**2014**		
31 December	To Cash/Bank A/c	30,000	1 July	By Balance b/d	55,916
31 December	To Balance c/d (*bal. fig*)	28,712	31 December	By Interest A/c (*bal. fig*)	2,796
		58,712			58,712
2015			**2015**		
30 June	To Cash/Bank A/c	30,000	1 January	By Balance b/d	28,712
			30 June	By Interest A/c (*bal. fig*)	1,288
		30,000			30,000

EXERCISE

I. Descriptive Questions (7 to 8 marks)

(1) Explain the concept of Hire Purchase System with the help of its features?
(2) Highlight the similarities and differences between Hire Purchase System and Instalment Sale System.
(3) Explain in detail the steps involved in calculating interest amount when interest rate is given.
(4) Explain in detail the steps involved in calculating interest amount when interest rate is not given.
(5) Explain how Accounting is done in the books of Hire Purchaser under full Cash Price Method.
(6) Explain how Accounting is done in the books of Hire Vendor under full Cash Price Method.

II. Short Notes (5 marks)

(1) Concept of Hire Purchase
(2) Instalment Sale System
(3) Cash Price
(4) Hire Purchase Price
(5) Accounting in the Books of Hire Purchaser and Hire Vendor

III. Objective Type Questions

(1) Which of the following terms is technically used for the Cash Payment made on the date of sale?
   (a) Hire Purchase Price   (b) Cash Price
   (c) Sale Price   (d) Down Payment
(2) Which of the following items is usually traded under Hire Purchase System?
   (a) Perishable goods   (b) Very expensive products
   (c) Inexpensive Products   (d) Expensive fixed assets
(3) Which of the following items is usually traded under Instalment Sale System?
   (a) Perishable goods   (b) Very expensive products
   (c) Inexpensive Products   (d) Expensive fixed assets
(4) Which of the following statements underlies the basic difference between Hire Purchase and Instalment Sale?
   (a) Ownership and Possession are distinct under Hire Purchase System
   (b) Relatively lower rate of interest is charged under Instalment Sale System
   (c) The buyer under Instalment Sale System can return the goods anytime till the last payment is made.
   (d) All of the above
(5) Which of the following actions can a hire vendor take, if hire purchaser fails to make any instalment?
   (a) Can take-back the asset so sold   (b) Can sue the purchaser in the court
   (c) Persuade him to pay the dues   (d) All of the above
(6) Which of the following statements is not a feature of Hire Purchase System?
   (a) Seller continues to enjoy the ownership even after sale
   (b) Purchaser takes the possession of the asset
   (c) Purchaser becomes the owner on the date of purchase
   (d) Instalment = Opening cash price + Interest
(7) Which of the following statements is not a similarity between Hire Purchase and Instalment Sale?
   (a) Credit based systems
   (b) Payments made instalments
   (c) Transfer of Possession and Ownership on sale
(8) Which of the following statements is a difference between Hire Purchase and Instalment Sale?
   (a) Nature of instalments
   (b) Return of Asset
   (c) Transfer of Possession and Ownership
   (d) All of the above

(9) Who among the following parties will bear the loss to the Asset due to theft?
 (a) Hire Vendor
 (b) Hire Purchaser
 (c) Partly by Hire Purchaser and partly by Vendor

(10) Which of the following methods is not used for assets of insignificant values?
 (a) Full Cash Price Method (b) Interest Suspense Method
 (c) Debtors Method

(11) Which of the following Accounts is not prepared by hire vendor?
 (a) Hire Purchaser A/c
 (b) Interest A/c
 (c) Depreciation A/c

(12) Which of the following Accounts is not prepared by hire purchaser?
 (a) Hire Vendor A/c (b) Interest A/c
 (c) Depreciation A/c (d) Hire Purchaser A/c

(13) Which of the following amounts is Hire Vendor's Account being debited in Asset Account in the Books of Hire Purchaser?
 (a) Hire Purchase Price (b) Full Cash Price
 (c) Cash Price–Down Payment (d) Instalment

(14) Which of the following amounts is Sales Account being credited in Hire Purchaser's Account in the books of hire vendor?
 (a) Hire Purchase Price (b) Full Cash Price
 (c) Cash Price–Down Payment (d) Instalment

(15) On which of the following amounts is interest calculated for the first year of purchase?
 (a) Hire Purchase Price (b) Full Cash Price
 (c) Cash Price–Down Payment (d) Instalment

(16) On which of the following amounts is interest calculated for the subsequent years?
 (a) Outstanding Hire Purchase Price
 (b) Full Cash Price
 (c) Closing Cash Price of preceding year

(17) On which of the following amounts is depreciation calculated for all the years till the last instalment?
 (a) Outstanding Hire Purchase Price
 (b) Full Cash Price
 (c) Closing Cash Price of preceding year

(18) Which of the following Accounting assumptions is adhered to when hire purchaser charges depreciation on asset purchased under Hire Purchase System?
 (a) Going concern
 (b) Substance over form
 (c) Materiality
 (d) Consistency

(19) A hire purchaser becomes owner of the asset
 (a) On the date of sale
 (b) When down payment is made
 (c) On signing hire purchase agreement
 (d) On the payment of last instalment

(20) Under Instalment Sale System, the buyer becomes the owner of the asset
 (a) On the date of sale
 (b) When down payment is made
 (c) On signing hire purchase agreement
 (d) On the payment of last instalment

Consider the following information to answer Q 21 to Q 31.

On 1 April 2013 M/s Unnat Bhavishy Ltd. purchased a HUV from TATA Motors on Hire Purchase basis at a purchase price of ₹16,00,000. The payment was made as ₹5,00,000 on 1 April 2013, ₹4,00,000 each on 31 March 2014 and 31 March 2015 and ₹4,12,390 on 31 March 2016. The interest amount was charged at the rate of 5% p.a. on the outstanding amount and rate of depreciation was 20% on the diminishing balance of the machine.

(21) Spot the hire purchase price of the HUV.
   (a) 5,00,000 (b) 12,12,390
   (c) 16,00,000 (d) 17,12,390

(22) Which of the following amounts is the Cash price of the HUV?
   (a) 5,00,000 (b) 12,12,390
   (c) 16,00,000 (d) 17,12,390

(23) What is the total amount of interest charged by TATA Motors from M/s Unnat Bhavishy?
   (a) 80,000 (b) 1,12,390
   (c) 4,12,390 (d) 5,00,000

(24) What is the Depreciation Amount for the year 2015–16?
   (a) 3,20,000 (b) 2,20,000
   (c) 3,42,478 (d) 1,00,000

(25) What is the Principal Amount at the closing of the first year of purchase?
   (a) 5,00,000 (b) 7,00,000
   (c) 7,50,000 (d) 7,55,000

(26) What is the Interest Amount charged by the TATA Motors for the first year of purchase?
   (a) 1,12,390 (b) 37,750
   (c) 19,640 (d) 55,000

(27) What is the opening cash price as on 1 March 2013?
   (a) 5,00,000 (b) 11,00,000
   (c) 16,00,000 (d) 17,12,390

(28) On which date, M/s Unnat Bhavishy becomes the owner of the HUV?
   (a) 1 April 2013 (b) 31 March 2014
   (c) 31 March 2015 (d) 31 March 2016

(29) Which of the following amounts will be considered for providing depreciation during 2013–14?
   (a) 5,00,000 (b) 11,00,000
   (c) 16,00,000 (d) 17,12,390

(30) What is the amount of principal in the second instalment?
   (a) 1,12,390 (b) 37,750
   (c) 19,640 (d) 55,000

(31) With which of the following amounts will TATA Motors credit Hire Purchaser Account in its books of account on the date of sale?
   (a) 5,00,000 (b) 11,00,000
   (c) 16,00,000 (d) 17,12,390

IV. Fill in the Blanks

(1) Depreciation on asset purchased under hire purchased system is provided by________. (hire vendor/ hire purchaser)
(2) Instalment amounts are regarded as ________. (repayment of sale price/hire charges)
(3) Interest is calculated on __________. (outstanding cash price/outstanding hire purchase price)
(4) Depreciation is calculated on ____________. (outstanding cash price/outstanding hire purchase price)

(5) In his books, Hire Purchaser debits Hire Vendor's Account with ___________ on the date of purchase. (cash price of asset/down payment)
(6) Under Hire Purchase System, the hire purchaser on the date of sale takes ______________ and takes _________________ on the date making last instalment. (ownership/possession)
(7) Difference between Hire Purchase Price and Cash Price is ______________. (down payment/interest)
(8) Hire purchase is a _____________ purchase. (credit/lump-sum)
(9) The hire vendor credits _________ at the time of hire sales transaction. (Sales A/c/Hire Purchaser's A/c)
(10) Under Instalment Sale System, the purchaser on the date of sale takes _________. (ownership/ possession)
(11) In his books, Hire Vendor debits Sales Account in Hire Purchaser's Account with ___________ on the date of purchase. (full cash price of asset/full hire purchase price)

V. Match the Following Columns

(A)

Column A	Column B
Opening Cash Price = *a* – Down Payment	i. Interest
Hire Purchase Price – Down Payment = *b*	ii. Instalment
Hire Purchase Price – Cash Price = *c*	iii. Outstanding Hire Purchase Price
[Down Payment + (Instalment amount × No. of Instalments)] – Cash Price = *d*	iv. Full Cash Price
Instalment – Principal = *e*	v. Total Interest

(B)

Column A	Column B
a. Interest is calculated on	i. Hire Purchase Price
b. Depreciation is provided by	ii. Hire Purchaser
c. Loss of hire purchase asset is to borne by	iii. Hire Vendor
d. Depreciation is charged on	iv. Closing Cash Price
	v. Full Cash Price

VI. State Whether the Following Statements are TRUE or FALSE

(1) Interest amount is included in Hire Purchase Price.
(2) Items purchased from e-commerce website for instalments of over 1 year relates to Hire Purchase System.
(3) Interest is calculated on Hire Purchase Price.
(4) Depreciation on asset is calculated on Cash Price of asset.
(5) Full Cash Price includes total interest amount.
(6) Ownership title is transferred from hire vendor to hire purchaser at the time of signing the agreement.
(7) Full cash price indicates the amount that one has to pay in order to acquire the ownership immediately.
(8) We address Full Cash Price Method as Asset Purchase Method.
(9) Interest is charged on the Outstanding or Closing Cash Price.
(10) Depreciation is charged by the hire vendor, as she/he enjoys the ownership of asset even after sale.
(11) Under Hire Purchase System, normally, goods dealt are expensive and durable in nature.
(12) If down payment amount is deducted from Hire Purchase Price, we get Full Cash Price.

(13) Opening Cash Price includes down payment
(14) Under Hire Purchase System, a hire vendor cannot sue hire purchaser in case of any default of instalments.
(15) Under Instalment Sale System, a seller cannot sue buyer in case of any default of instalments.
(16) Instalment amounts are treated as hire or rent charges.
(17) Hire Purchase Price includes Cash Price.
(18) In a Journal entry, if Asset Account is debited and Ram's Account is credited, then Ram is hire vendor.
(19) If Interest Account is debited and P&L Account is credited, then it belongs to books of hire vendor.
(20) Hire Vendor debits Bank Account and credits Hire Purchaser Account on receipt of an instalment.
(21) In a Journal entry, if Mohan's A/c is debited and Sales Account is credited, then Mohan is hire purchaser.
(22) A hire purchaser accounts interest amount to his credit side of P&L Account.
(23) A hire vendor accounts interest amount to his debit side of P&L Account.
(24) In Instalment Sale Method, a buyer becomes owner and possessor after sale date, even if he has paid down payment amount only.
(25) A hire vendor can take back possession of the asset, if hire purchaser makes any default on instalments.
(26) A hire purchaser cannot return goods once sold.
(27) It is hire purchaser's obligation to bear any loss of asset due to fire or theft, as he is using it.

VII. Practical Questions

Q1. Ram purchases a fridge from M/s Aman Ltd. at ₹70,000. It is also available on Hire Purchase basis on the following terms:
(a) Initial amount of ₹10,000 is to be paid
(b) Interest will be charged on balance amount at the rate of 6% which is ₹16,000
(c) Total 4 instalments is to be paid
Find out the different parties and terminologies involved in the above contract.

Q2. Mr. Rajesh purchased an iphone 7 on Hire Purchase System. The cash price of the phone was ₹36,000. He agrees to pay the whole amount in four quarterly instalments of ₹10,000. Calculate interest for each quarter.

Q3. From the following information determine the principal amount and interest included in each instalment.
(a) Cash Price—₹25,788
(b) Rate of Interest—5% p.a.
(c) Down Payment—₹4,000
The balance amount is to be paid in three equal annual instalments of ₹8,000 due on 31 December, each year.

Q4. On 1 November 2011, M/s XYZ & Co. took delivery of tools on Hire Purchase System and paid ₹6,000 on delivery. The balance amount is to be paid in five annual instalments, each of ₹12,000. The cash price of the tools is ₹60,000. Calculate the amount of interest for each year.

Q5. D-mart Company purchased a motor car from a Car Bazaar Company on Hire Purchase Agreement on 1 January 2013 by paying cash ₹20,000 and the balance in three annual instalments of ₹20,000 due on 31 December each year. The cash price of the car is ₹74,500. The vendor charged interest at the rate of 5% p.a. D-mart Company writes-off 10% p.a. depreciation on the reducing instalment system. Compute the amount of yearly depreciation.

Q6. Mr. Hari purchased a computer from I-card Ltd. on Hire Purchase Basis on 1 January 2014. The cash price of the computer was ₹3,10,000; payable ₹1,00,000 as down payment on the date of purchase and thereafter, ₹1,00,000 every year for 3 year starting from 31 December 2014. Calculate interest and show the allocation of the same during the hire purchase period.

Q7. On 1 April 2014, Mandar Ltd. ordered a motor car of cash price ₹50,000 and entered into a Hire Purchase Agreement to pay in four instalments of ₹13,200 each. The first payment is to be paid on 31 March 2014. The rate of interest is 5% p.a. and the car is to be depreciated at 10% p.a. on the diminishing balance. Show Motor Car Account in the books of the purchaser for the 2 year ended 31 March 2016.

Q8. Radhika purchased a motor cycle on Hire Purchase System. The total cash price of the motorcycle is ₹31,960; payable ₹8,000 as down payment and three further instalments of ₹12,000, 10,000 and ₹4,000 payable at the end of the first, second and third years, respectively. Interest is charged at 5% p.a. Pass the necessary Journal entries in the books of Radhika.

Q9. A machine of cash price ₹1,63,600 was purchased for ₹1,80,000 on Hire Purchase System. Hire purchase price is made after the date of purchase in the following manner. At the end of first 4 months from purchase ₹20,000 is payable, ₹30,000 at the end of 6 months, ₹60,000 at the end of 9 months and ₹70,000 at the end of 12 months. Machine was purchased on 1 January 2015 and the date of payment of each instalment is counted from this date. Prepare Hire Purchaser's Account in the books of Vendor, showing the balance left after payment of each instalment.

Q10. On 1 January 2014, MM & Sons purchased machinery on instalment system. ₹12,000 were payable on delivery and three further annual instalments of ₹12,800, ₹17,800 and ₹17,600, respectively were payable later. The vendor AB & Co. Ltd. charged interest at the rate of 10% p.a. It was decided to charge depreciation at the rate of 15% on Diminishing Balance Method. Prepare Machinery Account and AB & Co. Ltd. Account in the books of MM & Sons.

Q11. Shivam & Co. purchased one motor car from TMC Ltd. on instalment payment system. On 1 January 2013, the cash price of which is ₹1,20,000. At the time of agreement, the purchaser paid 5% of cash value of the motor car. On 31 December 2013, 40% of cash value was paid as first instalment (including interest), then on 31 December 2014, another 40% of cash value was paid as second instalment (including interest) and the remaining balance was paid as third instalment on 31 December 2015. The hire vendor realised interest at the rate of 10% every year on unpaid amount. Depreciation was charged at the rate of 20% p.a. on Reducing Balance Method. Prepare the necessary ledger Accounts in the books of Shivam & Co.

Q12. Mr. Dubey purchased a motorcycle on Hire Purchase System from M/s Varun Sales Limited. The Cash Price of the motorcycle was ₹31,000. The payment under the agreement was to be made as:

On signing the agreement on 1 January 2014	₹6,000
At the end of first year on 31 December 2014	₹10,000
At the end of second year on 31 December 2015	₹10,000
At the end of third year on 31 December 2016	₹10,000

Mr. Dubey provides depreciation at the rate of 10% p.a. on Fixed Instalment Method. Pass the necessary Journal entries in his books.

Q13. A motor company purchased two trucks on 1 January 2014, the cash price being ₹1,12,000. The purchase is on hire purchase basis. ₹30,000 is being paid on signing the agreement and thereafter, ₹30,000 being paid annually for 3 yr. Interest was charged at 5% p.a. Depreciation was calculated at the rate of 20% p.a. as per reducing instalment system. Prepare Truck Account and Vendor Account in the books of Motor Company. Also, show the posting in the Balance Sheet for the hire purchase period.

Q14. Mr. Prakash purchased a motorcycle on Hire Purchase System from M/s Ayush Ltd. The cash price of the motorcycle was ₹46,500. The payment was to be made in the following manner:

Down payment paid on 1 April 2014	₹9,000
At the end of first year on 31 March 2015	₹15,000
At the end of second year on 31 March 2016	₹15,000
At the end of third year on 31 March 2017	₹15,000

Mr. Prakash provides depreciation at the rate of 10% p.a. on Fixed Instalment Method. Pass the necessary Journal entries and ledger of Prakash in the books of Ayush Ltd.

Q15. Sanjay Ltd. purchased a machine from Vivo printers on Hire Purchase Basis on 1 July 2013. The terms of the contract are as follows:

(a) The Cash Price of the machine was ₹1,50,000.
(b) ₹30,000 was paid on signing the contract on 1 July 2013.
(c) The balance was paid in instalment of ₹40,000 plus interest at 15% p.a.
(d) The instalments were paid every year on 31 December commencing from 31 December 2013.
(e) Sanjay Ltd. charged depreciation at the rate of 20% p.a. as per Straight Line Method.

Prepare the necessary Accounts in the books of Sanjay Ltd., if books are closed on 31 December every year. Also, show the posting in the Balance Sheet for the Hire Purchase Period.

Q16. On 1 January 2014, Mayur Ltd. purchased Mahindra Trucks from M Ltd. on hire purchase basis. The cash price of the trucks was ₹6,40,000. The amounts were payable as mentioned below.

On 31 December 2014	₹2,00,000
On 31 December 2015	₹1,60,000
On 31 December 2016	₹1,64,956

The M Ltd. charged interest at the rate of 5% p.a. on the unpaid amount. The purchasing company decided to provide depreciation at the rate of 20% on the diminishing balance every year. Prepare Trucks Account, M Ltd. Account and Interest Account in the books of Mayur Ltd. as per Credit Purchase Method.

Q17. On July 2014, Western Ltd. purchased a machine of cash price of ₹60,000 on a hire purchase basis. Payments are to be made as ₹20,000 on the above date and the balance in three half-yearly instalments of ₹16,400, ₹14880 and ₹12,600 commencing from December 2014. The vendor charged interest at the rate of 10% p.a. calculated on half-yearly instalments. Western Ltd. closes their books annually on 31 December every year and provides depreciation at the rate of 10% p.a. on diminishing balance each year. Prepare the necessary ledger Accounts in the books of Western Ltd.

Q18. Mr. Mahindra purchased a car on hire purchase basis from Honda Ltd. On 1 January 2015 for ₹5,20,000; He paid ₹40,000 on signing the contract and the rest in four half-yearly instalments of ₹1,20,000 each on 30 June and 31 December every year thereafter. The cash value of the car was ₹4,20,000. Honda Ltd. charged interest at the rate of 20% p.a. on W.D.V of the car. Prepare Ledger Accounts for Mahindra and Interest Account in the books of Honda Ltd. along with its Balance Sheet.

Q19. Suraj delivers Machine on Hire Purchase System for ₹10,000 (cash price- ₹8,620) to be paid as

Down payment	₹1,600
At the end of the first year	₹2,400
At the end of the second year	₹4,400
At the end of the third year	₹1,600

Interest included in ₹10,000 is charged at the rate of 10% p.a on cash value. Prepare the Hire Purchaser's Account in the books of Suraj.

Q20. Axe Ltd. purchased a machine on Hire Purchase System from Wye Ltd. The cash price of the machinery on the date of agreement was ₹55,000. Axe Ltd. would pay ₹20,000 as down payment and the rest balance in four annual instalments of ₹11,000 each commencing from the beginning of the next year. Axe Ltd. charged depreciation at the rate of 10% p.a on diminishing balance of cash price. Wye Ltd. charged interest at the rate of 10% p.a. on the outstanding balance. Prepare Machinery Account and Wye Ltd. Account for the 5 year in the books of Axe Ltd. **S.Y.B.Com., IDOL, October 2007**

CHECK YOUR ANSWERS

III. Objective Type Questions

1–d	2–d	3–c	4–a	5–d	6–c	7–c	8–d	9–a	10–a	11–c	12–d	13–b
14–b	15–c	16–c	17–c	18–b	19–d	20–a	21–d	22–c	23–b	24–a	25–d	26–d
27–b	28–d	29–b	30–b	31–c								

IV. Fill in the Blanks

1 – hire purchaser	2 – hire charges	3 – outstanding cash price	4 – outstanding cash price
5 – cash price of asset	6 – (a) possession and (b) ownership	7 – interest	8 – credit
9 – sales	10 – ownership and possession	11 – full cash price of asses	

V. Match the Columns

(A)	(B)
(a)–(iv), (b)–(iii), (c) and (d)–(v), (e)–(i)	(a)–(iv), (b)–(ii), (c)–(iii), (d)–(v)

(Continued)

VI. True or False	
True	**False**
1, 4, 7, 8, 9, 11, 15, 16, 17, 18, 19, 20, 21, 24, 25	2, 3, 5, 6, 10, 12, 13, 14, 22, 23, 26, 27

VII. Practical Questions	
Q1. Hire Purchaser - Ram, Hire Vendor - Aman Ltd., Interest - ₹16,000, Down Payment - ₹10,000, Cash Price - ₹70,000, Hire Purchase Price - 86,000, Instalment = 19,000 each **Q2.** Interest Ratio = 4:3:2:1, Interest amounts 1,600, 1,200, 800 and 400 **Q3.** Interest: 1,089, 744, 379; Principal: 6,911, 7,256 and 7,621 **Q4.** Total interest amount = ₹6,000 and Interest Ratio is 5:4:3:2:1 **Q5.** Depreciation = 7,450, 6,705 and 6,035 **Q6.** Total interest amount = ₹90,000 and Interest Ratio 3:2:1 **Q7.** Depreciation amounts = 5,000 and 4,500 **Q8.** 1st year interest = 1,198, 2nd year interest = 658, 3rd year interest = 184 **Q9.** Total interest amount = ₹16,400; Interest ratio = 4:2:3:3 **Q10.** 1st year interest = 3,957, 2nd year interest = 3,072 and 3rd year interest = 1,600 **Q11.** Depreciation = 24,000, ₹19,200, ₹15,360 and Interest: 11,400, 7,740 and 3,714	**Q12.** Total interest amount = 5,000, Interest Ratio = 5:3:1, Depreciation = 3,100 each year **Q13.** Depreciation = 22,400, 17, 920, 14,336; Interest = 4,100, 2,805, 1,094 **Q14.** Total interest amount = 7,500, Interest Ratio = 5:3:1 (4,167; 2,499; 834) **Q15.** Depreciation = 15,000, 30,000, 30,000; Interest = 9,000; 12,000; 6,000 **Q16.** Interest = 22,000; 15,100; 7,856 **Q17.** Depreciation = 3,000, 5,700; Interest = 2,000, 1,280, 600 **Q18.** Interest = 38,000, 29,800; 20,780, 11,420 **Q19.** Interest = 702, 532, 146 **Q20.** Interest = 3,500, 2,750, 1,925, 825; Depreciation = 5,500, 4,950, 4,455, 4,010

Theory Question Bank

Theoretical Questions from last 5 years IDOL Question Papers

(From April 2012 to April 2016)

Type I: State whether following statement are True or False. [8 Marks]

April 2012

1. Revenue expenses are non-recurring expenses.
2. Outstanding expenditures are fixed liabilities.
3. AS-2 is applicable to goodwill.
4. Advance subscription is a current asset.
5. Inventories include furniture.
6. AS-1 is not applicable to all the enterprises.
7. AS-8 is applicable to wasting assets
8. Manufacturing account is prepared to ascertain the net profit.
9. Carriage inward is allocated on the basis of purchases of each department.
10. In Periodic system of stock valuation inventory control is not possible.
11. Discount allowed is allocated on the basis of sales of each department.
    [**Ans**: True - 9, 10, 11 False - 1, 2, 3, 4, 5, 6, 7, 8]

October 2012

1. Amount of depreciation remains the same for all the years under straight line method of depreciation.
2. Some fixed assets are depreciable assets.
3. Fixed assets are those assets which are tangible or intangible.
4. Outstanding expenses are shown on the asset side of the Balance Sheet.
5. An expense incurred on repairs of machinery is a revenue expense.
6. Carriage on purchase of new machinery is debited to Trading Account.
7. Bank overdraft shows credit balances.
8. FIFO method of stock valuation is recognised by AS-2.
9. Cost of goods sold can be ascertained by preparing stores ledger.
10. Opening reserve for Doubtful Debts Account shows credit balance and closing reserve for Doubtful Debts Account shows debit balance.
11. Transfer of goods from the department to another department is shown in departmental Profit and Loss A/c.
    [**Ans**: True - 1, 3, 5, 7, 8, 9, 10 False - 2, 4, 6, 11]

April 2013

1. Depreciation is provided to arrive at correct amount of profit.
2. Land is non-depreciable asset.
3. All factory expenses are debited to manufacturing A/c.
4. Income received in advance is shown on the asset side of the Balance Sheet.
5. Sale of scrap is debited to Manufacturing A/c.

6. Depreciation on office Equipment is debited to Manufacturing A/c.
7. Manufacturing A/c gives us the cost of production.
8. Installation expenses of new machinery are debited to machinery account.

[**Ans**: True - 1, 3, 7, 8 False - 2, 4, 5, 6]

October 2013

1. Cost of purchase does not include duties and taxes.
2. Deferred revenue expenditure is current year's revenue expenditure to be paid in the previous year.
3. When the fixed assets are revalued, they are not to be shown as revalued price in financial statements.
4. Under Written Down Value Method depreciation is computed on the reduce balance of the fixed asset.
5. The buyer purchases the goods, takes the title and accepts billing, the revenue will be recognised.
6. Gross margin is excess of sales over cost of goods sold.
7. Advance incomes are the current liabilities of the business.
8. Perpetual inventory system makes available stock at the end of the year only.
9. Welfare expenses should be allotted on the basis of number of workers in each department.
10. Grouping is the process of classification of accounts into different categories.
11. Bad debts are charged to General Profit & Loss Account in Departmental Accounting.
12. FIFO method of stock valuation is a logical method.

[**Ans**: True - 4, 5, 6, 7, 9, 12 False - 1, 2, 3, 8, 10, 11]

April 2014

1. Compliance with any Accounting Standard is mandatory.
2. Fees paid for renewal of license of factory is revenue expenditure.
3. Carriage Inward and Returns Inward both show debit balance.
4. Bad debts are charges to General Profit and Loss Account.
5. Under FIFO method, closing stock is valued at quite closer to the present value.
6. Selling price is not to be taken into consideration while preparing stores ledger.
7. Departmental Accounts are necessary for evaluating departmental efficiency.
8. Cost of Insurance is allocated on the basis of purchases of each department.

[**Ans**: True - 1, 2, 3, 5, 6, 7 False - 4, 8]

April 2015

1. Income receivable is shown on the asset side of the Balance Sheet.
2. Loss by fire is shown on Debit side of Profit and Loss A/c.
3. Over valuation of closing stock results in over statement of profit.
4. Hire purchase price = Cash price + Interest.
5. All office expenses are debited to Manufacturing A/c.
6. Discount received is allocated among different departments on the basis of sales.
7. Returns Inward are deducted from purchases.
8. Last-in-first-out method of stock valuation is recognised by Accounting Standard.

[**Ans**: True - 1, 3, 4 False - 2, 5, 6, 7, 8]

October 2015

1. Carriage on purchase of machinery is debited to Trading Account.
2. Right to ownership is transferred to the buyer on payment of first instalment under Hire Purchase System.
3. Legal expenses incurred for abuse of trademark is a capital expenditure.
4. No purpose is served by issuing Accounting Standards by ICAI.
5. Perpetual inventory system makes available stock at the end of the year only.
6. When goods are installed at the buyer's place to his satisfaction, the revenue can be recognised.
7. Lighting charges are allocated on the basis of H.P. of machines in each department.
8. Cost of purchase does not include duties and taxes.

[**Ans**: False - 1, 2, 3, 4, 5, 6, 7, 8]

April 2016

1. Outstanding wages is Nominal Account.
2. Wages paid for installation of machinery is debited to Wages Account.
3. Personal expenses of the proprietor are debited to Profit and Loss Account.
4. Carriage Inward is allocated among various departments on the basis of Departmental Sales.
5. Closing stock is always valued at market price.
6. All capital expenses are debited to Profit and Loss Account.
7. Manufacturing Account gives us gross profit.
8. Sale of scrap is credited to Manufacturing Account.

[**Ans**: True - 8 False - 1, 2, 3, 4, 5, 6, 7]

Type II: State with reasons whether the following are Capital, Revenue or Deferred Revenue Expenditure, Receipts, Profit or Loss. [16 Marks]

April 2012

1. Wages paid to the workers for construction of railway platform.
2. Received ₹8,00,000 on the issue of 9% cumulative preference shares.
3. Direct wages of ₹3,25,000 paid for the month of January 2012.
4. Paid ₹12,800 underwriting commission on issue of preference shares.
5. Legal Expenses ₹54,875 paid in connection with purchase of machinery.
6. Paid to the Government of Maharashtra on account of M VAT.
7. Premium ₹1,60,000 received on issue of new 9% cumulative preference shares.
8. Paid legal fees of ₹64,500.

[**Ans**: Capital Expenditure - 1, 3, 5 Capital Receipts - 2, 7
Revenue Expenditure - 6, 8 Deferred Revenue Expenditure - 4]

April 2013

M/s. Sirona Industries manufactures and sells special chairs required by the dentists. They have incurred following expenses during the year ended 31 March 2013. You are requested to state whether these expenses are capital expenses, revenue expenses or deferred revenue expenses.

1. Rent paid ₹25,000.00 to the landlord for the month of May 2012 during the month of June 2012.
2. Import duty paid ₹35,000.00 on purchase of new machinery.
3. Professional fees paid ₹25,000.00 to the advocate for preparing documents for purchase of new office premises.
4. Annual membership fees paid ₹5,000.00 to the Machinery Manufactures Association of India.
5. Bank interest paid ₹35,000 on loan taken for purchase of land and buildings.
6. VAT paid ₹15,000.00
7. Printing charges paid ₹28,000.00
8. Transfer fees paid ₹25,000.00 to the society where it has purchased new office premises.

[**Ans**: Capital Expenses - 2, 3, 5, 8 Revenue Expenses - 1, 4, 6, 7]

April 2015

1. Interest paid on bank overdraft ₹50,000,00 to State Bank of India for quarter ended 31 December 2014.
2. Custom duty paid ₹35,000,00 on import of raw materials.
3. Purchased old plant for ₹20,000.
4. ₹300 were paid for the upkeep of a water pump.
5. Paid audit fees ₹5,000 to Mr. Jayesh, our Chartered Accountant.
6. Paid ₹1,000 for annual renewal of factory license.
7. Reimbursed ₹12,500 as travelling expenses to Mr. Abhishek, our salesman.
8. Purchased 20 box files for office use at ₹20 per file.

[**Ans**: Capital Expenditure - 3 Revenue Expenses - 1, 2, 4, 5, 6, 7, 8]

Type III: Rewrite the following statements by using the proper choice given under the statement. [8 Marks]

October 2012

1. The following asset is intangible asset:
   (a) Freehold land (b) Mines
   (c) Goodwill (d) Motor vehicles
2. Following are shown on the Asset side of the Balance Sheet:
   (a) Accrued income and prepaid expense
   (b) Outstanding expense and prepaid expense
   (c) Outstanding income and outstanding expense
   (d) Income received in advance and outstanding expense
3. Stock is valued at cost or market value whichever is lower as per
   (a) Realisation concept (b) Matching concept
   (c) Cost concept (d) Entity concept
4. Loss by fire is shown on
   (a) Debit side of Trading Account (b) Debit side of Sales Account
   (c) Debit side of Profit and Loss Account (d) Credit side of Purchases Account
5. Prepaid insurance appearing in the trial balance should be shown on
   (a) Credit side of Trading Account (b) Debit side of Trading Account
   (c) Liability side (d) Asset side
6. Carriage on Sales is
   (a) Added to cost of inventory (b) Deducted from cost of inventory
   (c) Multiplied by cost of inventory (d) Not considered in the cost of inventory
7. Items of Incomes not pertaining to any department are
   (a) Allocated to various departments on the basis of purchases
   (b) Charged to General P&L Account
   (c) Charged to that department which shows more sales
   (d) Shown in Balance Sheet as income
8. Staff welfare expenses are allocated among different departments on the basis of
   (a) Sales (b) Purchases
   (c) Number of employees (d) Floor space area
9. Advertising is allocated among different departments on the basis of
   (a) Sales (b) Purchases
   (c) Number of employees (d) Floor space area

   [**Ans**: 1-c, 2-a, 3-c, 4-c, 5-d, 6-b, 7-b, 8-c, 9-a]

April 2013

1. Following is deferred revenue expense
   (a) Salesman salaries and commission (b) Heavy advertisement expenses
   (c) Rent of the warehouse (d) Depreciation of delivery van
2. Stock is always valued at
   (a) Cost price (b) Cost price or Market price whichever is higher
   (c) Market price (d) Cost price or Market price whichever is lower
3. Goods lost by fire is shown on
   (a) Credit side of Trading Account (b) Debit side of Sales Account
   (c) Debit side of Profit and Loss Account (d) Credit side of Purchases Account
4. Outstanding expense appearing in the trial balance should be shown on
   (a) Credit side of Trading Account (b) Debit side of Trading Account
   (c) Liability side (d) Asset side
5. Revenue expense is that expense
   (a) which is not recurring in nature
   (b) benefit of which is exhausted in 1 year

(c) which increases useful life and productivity of asset
(d) is shown on asset side of Balance Sheet

6. Following method of stock valuation is recognised by AS-2
   (a) FIFO method (b) LIFO method
   (c) Simple Average method (d) Sliding Scale method
7. Carriage on Sales is
   (a) Added to cost of inventory (b) Deducted from cost of inventory
   (c) Multiplied by cost of inventory (d) Not considered in the cost of inventory
8. Items of Incomes not pertaining to any department are
   (a) Allocated to various departments on the basis of purchases
   (b) Charged to General P&L account
   (c) Charged to that department which shows more sales
   (d) Shown in Balance Sheet as income
9. Staff welfare expenses are allocated among different departments on the basis of
   (a) Sales (b) Purchases
   (c) Number of employees (d) Floor space area
10. Carriage Inwards is allocated between the various departments on the basis of
    (a) Departmental sales (b) Departmental purchases
    (c) Ratio of area occupied (d) Ratio of purchase returns
11. G.P. Ratio 25% means
    (a) Gross profit is 25% on sales (b) Gross profit is 25% on purchases
    (c) Gross profit is 25% on capital (d) Gross profit is 25% on cost

[**Ans**: 1-b, 2-d, 3-a, 4-c, 5-b, 6-a, 7-d, 8-b, 9-c, 10-b, 11-a]

October 2014

1. Carriage on purchases is
   (a) Added to cost of inventory (b) Deducted from cost of inventory
   (c) Multiplied by cost of inventory (d) Not considered in the cost of inventory
2. Hire Purchase Price =
   (a) Cash Price + Down Payment (b) Cash Price – Down Payment
   (c) Cash Price + Interest (d) Cash Price – Interest
3. Items of Expenses/Incomes not pertaining to any department are
   (a) Allocated to various departments on the basis of purchases
   (b) Charged to General Profit and Loss Account
   (c) Charged to the department which shows more sales
   (d) Shown in the Balance Sheet as income
4. Commission paid to salesman is allocated among different departments on the basis of
   (a) Sales (b) Purchases
   (c) Number of employees (d) Floor space area
5. Prepaid Insurance Account is
   (a) Real Account (b) Nominal Account
   (c) Personal Account (d) Impersonal Account
6. Carriage paid on purchase of Machinery is
   (a) Capital Expenditure (b) Revenue Expenditure
   (c) Deferred Revenue Expenditure (d) Trading Expenditure
7. Custom Duty paid on purchase of raw materials
   (a) Capital Expenditure (b) Revenue Expenditure
   (c) Deferred Revenue Expenditure (d) All of the above
8. Salary paid to the Managing Director
   (a) Capital Expenditure (b) Revenue Expenditure
   (c) Deferred Revenue Expenditure (d) Trading Expenditure

[**Ans**: 1-a, 2-c, 3-b, 4-a, 5-c, 6-a, 7-b, 8-b**]**

October 2015

1. Under periodical inventory system, closing stock is values
   (a) by actually counting the stock on a particular date
   (b) from the store ledger
   (c) by deducting value of sales from value of purchases
   (d) on estimate basis
2. The system in which fluctuation in prices are average out
   (a) Weighted Average Method (b) FIFO Method (c) LIFO Method
3. Legacies are generally
   (a) Capitalised and taken to Balance Sheet
   (b) Treated as income
   (c) Treated as expenditure
   (d) None of the above
4. Productive wages are
   (a) Debited to Trading Account (b) Debited to Profit and Loss Account
   (c) Shown as assets (d) None of the above
5. As per AS-1 the effect of any change in Accounting Policy on the value of any item in the Final Accounts should
   (a) be reported to Directors (b) be reported to CEO
   (c) be disclosed (d) be ignored
6. Paid to an advocate to defend a suit claiming that the factory site belongs to the firm, the suit was unsuccessful.
   (a) Revenue Expenditure (b) Capital Expenditure
   (c) Deferred Revenue Expenditure (d) None of the above
7. Item of expenses not connected with any departments are
   (a) Charged to departments on the basis of total sales
   (b) Charged to the General Profit and Loss Account
   (b) Charged to departments on the basis of fixed assets employed
8. Revenue from dividend is recognised when
   (a) Dividend received
   (b) Right to receive dividends is established
   (c) Amount is credited to Bank Account
   (d) Dividend warrant is dispatched by the company

   [**Ans**: 1-a, 2-a, 3-a, 4-a, 5-c, 6-a, 7-b, 8-b**]**

Type IV: Fill in the blanks with the most suitable words and rewrite the sentence. [8 Marks]

April 2014

1. Goodwill is_____ Asset.
2. Interest on drawings is credited to_______.
3. Profit on sale of asset is debited to_______Account.
4. _______Expenditure is intended to maintain the fixed assets.
5. Repayment of bank loan is an example of_______Expenditure.
6. Provision for unrealised profit on opening stock should be ________ to General Profit & Loss A/c.
7. Under________ method of stock valuation, fluctuations in prices are overcome.
8. __________ are the debts from customers, which are not recoverable.

   [**Ans**: 1. Intangible, 2. Profit and Loss, 3. Asset, 4. Revenue, 5. Capital, 6. credited,
   7. Weighted Average, 8. Bad Debts]

Type V: Rewrite the statements given in Group A with the corresponding most appropriate statement from Group B. [8 Marks]

October 2014

Group A	Group B
(1) Disclosure of accounting policies (2) Revenue recognition (3) Hire purchase of goods (4) Valuation of inventories (5) Prepaid insurance in the trial balance (6) Discount received (7) Bad debts (8) Outstanding expenses	(a) Balance Sheet asset side (b) To be allocated in ratio of departmental purchases (c) Principal and agent relationship (d) Balance Sheet liability side (e) AS-1 (f) Down payment (g) AS-2 (h) AS-4 (i) AS-9 (j) To be allocated in ratio of departmental sales

[Ans: (1)-(e), (2)-(i), (3)-(f), (4)-(g), (5)-(a), (6)-(b), (7)-(j), (8)-(d)**]**

April 2015

Group A	Group B
(1) Sales of Scrap (2) Depreciation of Plant and Machinery (3) Inventory Valuation (4) Revenue Receipt (5) Revenue Expenditure (6) Capital Expenditure (7) Revenue Recognition (8) Disclosure of Accounting Policies	(a) AS-1 (b) AS-2 (c) AS-9 (d) Credited to Manufacturing A/c (e) Repairs to Plant and Machinery (f) Debited to Manufacturing A/c (g) Purchase of Furniture (h) Interest received on Investments (i) Debited to Profit & Loss Account

[Ans: (1)-(d), (2)-(f), (3)-(b), (4)-(h), (5)-(e), (6)-(g), (7)-(c), (8)-(a)**]**

April 2016

Column A	Column B
(1) Disclosure of Accounting Policies (2) Revenue Recognition (3) Purchase of Furniture (4) Factory wages paid (5) Hire purchase price (6) Valuation of inventory (7) Cash price (8) Balance Sheet	(a) Capital expenditure (b) AS-4 (c) Includes Interest (d) AS-1 (e) Excludes Interest (f) AS-9 (g) Revenue Expenditure (h) AS-2 (i) Statement of assets and liabilities

[Ans: (1)-(d), (2)-(f), (3)-(a), (4)-(g), (5)-(c), (6)-(h), (7)-(e), (8)-(i)**]**

Previous Year's Question Papers from Mumbai University

F.Y.B.Com Semester-I, March, 2017

(New Question Paper Pattern, w.e.f. 2016–17)

Accountancy and Financial Management-I

Discipline Specific Elective (DSE) Course

[Time: 3 hours] **[Total Marks: 100]**

N.B.

1. *Strictly avoid resorting to any unfair means during the examination and abide by all the rules and relating thereto.*
2. *Figures in bracket to the right indicate full marks allotted to the question.*
3. *Working notes should form part of your answers.*
4. *All six questions are compulsory, although, there are internal options in case of Questions 2 and 6.*
5. *Use of simple calculator is allowed.*

Q1A. Fill in the blanks with the appropriate given options and rewrite complete sentences. (Any 10)

1. Accounting Standard 2 (AS-2) deals with ___________________.
   (Disclosure of Accounting Policies/Revenue Recognition/Valuation of inventory)
2. Total amount payable by the purchaser in a Hire Purchase transaction is called ________________.
   (Hire Purchase Price/Down Payment/Cash Price)
3. In a Manufacturing Organisation, Manufacturing Account is prepared to find out _____________________. (Gross Profit/Cost of Production/Net Profit)
4. In Departmental Accounts, Rent is allocated on the basis of ___________________ of each department. (Sales Turnover/Area Occupied/Purchases)
5. Income received in advance is shown in the _______________________ . (Balance Sheet / Profit and Loss Account/Manufacturing Account)
6. Amount received on issue of Shares is a _______________. (Capital Expenditure/Capital Receipt/Revenue Receipt)
7. As per Accounting Standard-1, Accounting policies used to prepare the final accounts should ______________. (be scattered over the Final accounts / be disclosed at one place, forming a part of final account / not form a part of final account)
8. For a books manufacturing company, paper is a________________. (Raw Material/Work-in-Progress/Finished Goods)
9. The person who receives goods under Hire Purchase System is called _______________.
   (Hire Vendor/Hire Purchaser/Agent)
10. In Departmental Accounts, Comprehensive Insurance (if ratio is not given) is taken in _____________________. (Departmental Trading Account/General Profit and Loss Account/ Departmental Profit & Loss)
11. In a Manufacturing Organisation, purchase of machinery spares will appear in the __________________. (Balance Sheet/ Profit & Loss Account/ Manufacturing Account)
12. Interest received under Hire Purchase System by the hire vendor is his ___________________________. (Expenditure/ Income/Capital Receipt)

Q1B. State whether the following statements are TRUE or FALSE after rewriting the same. (Attempt any 10) (10)

1. AS-1 deals with Disclosure of Accounting Policies.
2. For valuation of stock under FIFO method, the Cost of the latest items is compared with their Net realisable value.
3. As per AS-9, Revenue from interest is recognised only when it is actually received.
4. Profit and loss Account shows the financial position of a concern.
5. Expenditure that results in acquisition of a permanent asset is a capital expenditure.
6. Loss by fire in a Departmental is charged to General P & L A/c in Departmental Accounting.
7. Under Hire Purchase System, Depreciation on Asset is charged by the Vendor until the payment of last installment.
8. Down payment includes interest.
9. Freight inward is allocated on the basis of purchase of the department.
10. Inventory is a current assets.
11. If the buyer fails to pay the installment, the seller has a right to repossess the asset sold under Hire purchase system.
12. Under FIFO Method, the stock includes goods held for resale.

Q2. From the following Trial Balance of Mr. Shiva, Prepare Manufacturing Account, Trading Account, Profit and Loss Account for the year ended 31st March, 2016 and Balance sheet as on that date. (15)

Trial Balance of Mr. Shiva as on 31 March 2016

Particulars	Dr. (₹)	Cr. (₹)
Creditors		71,000
Machinery	80,000	
Opening Stock - Raw Material	26,000	
Opening Stock - Work in Progress	2,000	
Opening Stock - Finished Goods	30,000	
Purchase of Raw Materials	2,80,000	
Carriage Inward on Raw Material	5,000	
Direct Wages	56,000	
Factory Rent	27,000	
Drawings	30,000	
Sales		5,00,000
Cash at Bank	19,000	
Salaries	9,000	
Discount Allowed	7,000	
Capital Account		1,00,000
Sundry Debtors	1,00,000	
Total	**6,71,000**	**6,71,000**

Following further information is provided:

1. Closing stock as on 31 March 2016:
   Raw Material ₹32,000, Work-in-progress ₹4,000, Finished Goods ₹35,000.
2. Depreciate Machinery @ 10% p.a.
3. On 1st January, 2016, there was a fire in the godown of Mr. Shiva, destroying finished goods worth ₹12,000, insurance company admitted the claim for ₹8,000.This transaction was not recorded in the books.
4. Provide Reserve for Doubtful Debts @ 5% on debtors.

OR

Q2. From the following Trial Balance of Mr. Neelkanth, prepare Manufacmring Account, Trading Account, Profit and Loss Account for the year ended 31 March, 2016 and the Balance Sheet as on that date.

Trial Balance of Neelkanth as on 31 March 2016

Particulars	Dr. (₹)	Cr. (₹)
Carriage Inward	10,000	
Purchase of Raw Material	1,95,000	
Sales		3,70,000
Furniture	32,000	
Bills payable		10,000
Opening Stock - Raw Material	22,000	
Opening Stock - Work-in-Progress	25,000	
Opening Stock - Finished Goods	30,000	
Capital		1,29,000
Direct Wages	60,000	
Factory Power and Fuel	18,000	
Machinery	1,00,000	
Office Salaries	20,000	
Cash at Bank	10,000	
Selling and Distribution Expenses	29,000	
Creditors		90,000
Provisions for Bad Debts		2,000
Sundry Debtors	50,000	
Total	**6,01,000**	**6,01,000**

Following further information is provided to you:

1. Closing Stock as on 31 March 2016:
   Raw Material ₹20,000, Work-in-Progress ₹6,000, Finished Goods ₹39,000.
2. Outstanding Factory, Power and Fuel is ₹2,000.
3. Depreciate Machinery @5% p.a. and Furniture @5% p.a.
4. Provide Reserve for Doubtful Debts @5% on Sundry Debtors.

Q3. Following figures are extracted from the books of Swadeshi Stores Ltd. Prepare Departmental Trading & Profit and Loss Account for the year ended 31 December, 2016 in columnar form, of the three departments allocating the expenses indicating the basis on which they are allocated. (15)

	Department A (₹)	Department B (₹)	Department C (₹)
Purchases	2,00,000	3,00,000	8,00,000
Return Outwards	20,000	10,000	30,000
Sales	6,10,000	12,20,000	18,30,000
Return Inward	10,000	20,000	30,000
Wages	40,000	60,000	80,000
Stock as on 1 January 2016	50,000	70,000	10,000
Stock as on 31 December 2016	80,000	50,000	40,000

Goods transferred from Department A to:	Dept. B	10,000
	Dept. C	20,000
Goods transferred from Department B to:	Dept. A	5,000
	Dept. C	10,000
Goods transferred from Department C to:	Dept. A	7,000
	Dept. B	9,000

1. Following expenses are to be allocated equally.
   (a) Telephone charges ₹3,000
   (b) Insurance charges ₹6,000
   (c) Office Expenses ₹9,000
2. Rent ₹24,000 is to be divided in proportion of space occupied: Department A ¼, Department B ¼ and Department C ½.
3. Other Expenses were: Discount allowed ₹18,000, and Bad Debts ₹15,000.

OR

Q3. Find out the value of Closing Stock as on 31 March, 2016 of M/s Shankar Traders using-
(a) FIFO Method **(07)**
(b) Weighted Average Method **(07)**
Also find the Cost of Goods sold on FIFO Basis. **(01)**

Date	Particulars	Unit	@₹
01 April 2015	Opening Stock	500	35
5 June 2015	Purchases	1000	38
31 August 2015	Sales	300	--
19 September 2015	Sales	800	--
1 October 2015	Purchases	1200	34
20 February 2016	Sales	1000	--
31 March 2016	Purchases	600	30

Q4. Following is the information relating purchase and sale of cloth made by Jagjivan Textiles Ltd in the month of March 2016. Find out from the given information.
A. The value of Closing Stock as on 31st March, 2016 applying FIFO Method. **(09)**
B. The Cost of goods sold and profit if the selling price of goods sold is ₹1,20,000 **(06)**

Transaction	Date	Metres	₹ Per metre
Opening Stock	01 March 2016	500	@ ₹80
Purchases	15 March 2016	420	@ ₹82
	25 March 2016	380	@ ₹89
	28 March 2016	150	@ ₹90
	30 March 2016	100	@ ₹92
Sales	19 March 2016	700	-
	21 March 2016	180	-
	27 March 2016	320	-

OR

Q4. State whether the following expenditure and receipts are capital or revenue. Give reasons for your answers.

1. **Sold Government Securities (held as Investment) for ₹10,00,000 and earned a profit of ₹20,000. (03)**
2. **Paid ₹1,20,000 as Customs Duty on machinery purchased from Germany. (02)**
3. **Paid ₹20,000 towards Factory Rent. (02)**
4. **Paid subscription charges of ₹6,000 for a trade journal. (02)**
5. **Paid ₹1,00,000 for obtaining business license. (02)**
6. **Loss of ₹10,000 was incurred on goods destroyed by fire. (02)**
7. **Cost of ₹30,000 was incurred for replacement of defective parts of machinery. (02)**

Q5. M/s. Presto Plast Company purchased Machinery from M/s. Kabra Ltd. on Hire Purchase System on 1st April 2013. The cash price of the machine was ₹10,00,000. An initial payment of ₹2,50,000 was made on the date of purchase. The balance was paid in 3 annual installments including interest @ 8% p.a as follows:

31 March 2014	₹3,10,000
31 March 2015	₹2,90,000
31 March 2016	₹2,70,000

M\s. Presto Plast Company charged Depreciation @ 10% p.a. on Written Down Value Method. You are required to Prepare Machinery Account and M/s. Kabra Ltd A/c. in the books of M/s. Presto Plast Company for 3 years ending 31 March 2014, 31 March 2015 and 31 March 2016. (15)

OR

Q5. Following figures are extracted from-the books of Sadguru Electronics. Prepare Departmental Trading and Profit and Loss Account, of the Radio and Television Departments for the year ended 31 March, 2016 by allocating the income and expenses on appropriate basis:

	Radio (₹)	**Television (₹)**	**Total (₹)**
Opening Stock	65,000	50,000	1,15,000
Purchases	2,70,000	1,80,000	4,50,000
Carriaee Inwards			6,000
Salaries	24,000	21,000	45,000
Discount received			4,500
Rent and Rates			28,000
Carriage Outwards			24,000
General Expenses			15,000
Advertising			36,000
Discount			4,500
Insurance			3,500
Selling and Distribution Expenses			1,500
Sales	3,20,000	2,80,000	6,00,000

Further information is given:

1. General Expenses and insurance are to be allocated equally.
2. The areas occupied is Radio 4/5 and Television 1/5.
3. The closing stock of the two departments were Radio ₹1,10,000 and Television ₹55,000.
4. Other expenses and incomes are to be allocated between the two departments on suitable basis.

Q6. Answer the following: (20)

1. What are the main features or requirements of AS-2?
2. How would you allocate expenses on different basis in case of Departmental Accounts?

OR

Q6. Write short notes on any Four of the following: (20)

1. Cost of production.
2. Interdepartmental transfers.
3. Factors influencing choice of Accounting Policy.
4. Distinguish between Capital Expenditure and Revenue Expenditure.
5. Importance of Stock Valuation.
6. Revenue as per AS-9.

F.Y.B.Com Semester-I, November, 2016

(New Question Paper Pattern, w.e.f. 2016–17)

Accountancy and Financial Management-I

Discipline Specific Elective (DSE) Course

[Time: 3 hours] **[Total Marks: 100]**

N.B.

1. *Strictly avoid resorting to any unfair means during the examination and abide by all the rules and relating thereto.*
2. *Figures in bracket to the right indicate full marks allotted to the question.*
3. *Working notes should form part of your answers.*
4. *All six questions are compulsory, although, there are internal options in case of Questions 2 and 6.*
5. Use of simple calculator is allowed.

Q1A. Fill in the blanks with the appropriate given options and rewrite complete sentences. (Any 10) (10)

1. Accounting Standard 2 deals with ___________________. (Disclosure of Accounting Policies/ Revenue Recognition/Inventory Valuation)
2. The initial amount payable at the time of signing the agreement in Hire Purchase transaction is _________________. (Hire Purchase Price/Down Payment/Cash Price)
3. The Manufacturing Account is prepared to find out _____________________. (Gross Profit/ Cost of Production/Net Profit)
4. In Departmental Accounts, Office Rent is allocated on the basis ___________________ of each department. (Sales Turnover/Area Occupied/Purchases)
5. In ______________________Method of Stock Valuation, items received first are issued first, so that the latest purchased items are left in stock. (Weighted Average/FIFO/Simple Average)
6. Wages paid for installation of new machinery is a _______________. (Capital Expenditure/ Capital Receipt/Revenue Expenditure)
7. As per the rules, Stock is to be valued at Cost or Net Realisable Value whichever is ______________. (Higher/Lower/Available)
8. For a Book Manufacturing Company, Book is a________________. (Raw Material/Work-in-Progress/Finished Goods)
9. The person who sells goods on Hire Purchase Basis is called a ____________________. (Hire Purchaser/Hire Vendor/Consignor)
10. ______________________shows the financial position of the company at the end of the year. (Trading Account/Profit and Loss Account/Balance Sheet)

11. In case of a manufacturer, Sale of Scrap appears on the credit side of ___________________Account. (Trading/Profit and Loss/Manufacturing)
12. Under Credit Purchase Method of Hire Purchase System, Depreciation on Asset purchased is charged for the first year on ___________________________. (Full Cash Price/Hire Purchase Price/Down Payment)

Q1B. State whether the following statements are TRUE or FALSE after rewriting the same. (Attempt any 10) (10)

1. Inventories which are held for sale in the ordinary course of business are current assets.
2. AS-9 does not cover revenue arising from government grants and subsidies.
3. It is not necessary to disclose the change in accounting policy.
4. Revenue expenses are non-recurring expenses.
5. The Manufacturing Account always shows a debit balance.
6. Departmental Accounts are necessary for evaluating departmental efficiency.
7. Disclosures under AS-1 need not form a part of final accounts.
8. Income received in advance is shown on the Asset side of the Balance Sheet.
9. Hire Purchase Price is the total of cash price and interest.
10. Full Cash Price Method is also known as Credit Purchase Method.
11. Amount paid as carriage inward is included in cost of inventory.
12. Under Hire Purchase System, the seller is the owner of goods until the payment of last instalment.

Q2. From the following Trial Balance of Mr. Aditya, prepare Manufacturing Account, Trading Account, Profit and Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date. (15)

Trial Balance of Mr. Aditya as on 31 March 2016

Particulars	Dr. (₹)	Cr. (₹)
Opening Stock - Raw Materials	12,000	
Opening Stock - Work-in-Progress	7,000	
Opening Stock - Finished Goods	20,000	
Purchase of Raw Materials	1,05,000	
Carriage Inward on Raw Materials	4,000	
Direct Wages	56,000	
Factory Rent	8,000	
Factory Power and Fuel	11,000	
Machinery	80,000	
Sales		3,25,000
Office Expenses	50,000	
Cash at Bank	11,000	
Creditors		21,000
Bad Debts	1,000	
Provisions for Bad Debts		2,000
Sundry Debtors	53,000	
Capital		82,000
Drawings	12,000	
Total	**4,30,000**	**4,30,000**

Following further information is provided to you:

1. Closing stock as on 31 March 2016 is:
   Raw Material ₹15,000, Work-in-progress ₹8,000, Finished Goods ₹25,000.
2. Depreciate Machinery @ 10% p.a.

3. During the year, finished goods worth ₹5,000 were distributed as free samples but were not recorded.
4. Provide Reserve for Doubtful Debts @ 5% on debtors.

OR

Q2. From the following Trial Balance of Mr. Gangadhar, prepare Manufacturing Account, Trading Account, Profit and Loss Account for the year ended 31 March 2016 and Balance Sheet as on that date: (15)

Trial Balance of Mr. Gangadhar as on 31 March 2016

Particulars	Dr. (₹)	Cr.(₹)
Capital Account		1,00,000
Opening Stock - Raw Materials	24,000	
Opening Stock - Work-in-Progress	4,000	
Opening Stock - Finished Goods	31,000	
Purchase of Raw Materials	2,50,000	
Direct Wages	36,000	
Factory Rent	8,000	
Machinery	1,00,000	
Sales		4,35,000
Cash at Bank	6,000	
Travelling and Conveyance	20,000	
Salaries	24,000	
Discount Allowed	7,000	
Sundry Creditors		90,000
Sundry Debtors	40,000	
Vehicles	75,000	
Total	**6,25,000**	**6,25,000**

Following further information is provided to you:

1. Closing Stock as on 31 March 2016:
   Raw Material ₹25,000, Work-in-Progress ₹8,000, Finished Goods ₹35,000.
2. Depreciate Machinery @10% p.a. and Vehicles @10% p.a.
3. Provide Reserve for Doubtful Debts @5% on Debtors.
4. During the year, Raw Materials worth ₹5,000 purchased on credit basis were not recorded in the books.

Q3. From the following information relating to M/s. Akbarallys Departmental Stores, prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account for the year ended 31 March 2016. (15)

Particulars	Dept. X (₹)	Dept. Y (₹)	Dept. Z (₹)
Opening Stock	34,000	45,000	63,000
Purchases	4,75,000	2,95,000	2,75,000
Sales	7,50,000	5,70,000	5,25,000
Salaries	75,800	87,900	65,300
Closing stock	40,500	31,500	50,400

Common Income and Expenses:

Rent ₹15,000, Electricity ₹25,000, Printing and Stationery ₹5,800, Discount Allowed ₹15,000, Discount Received ₹18,000, General Expenses ₹10,000.

Additional Information:

(i) Area occupied by the three departments are 900, 600 and 300 sq.ft., respectively.
(ii) Allocate Electricity and Printing and Stationery in the Ratio of Gross Sales of the respective departments.
(iii) Allocate the other expenses on appropriate basis to the extent possible.

OR

Q3. From the following information relating to M/s. Apna Bazaar Departmental Stores, prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account for the year ending 31 December 2015. (15)

Particulars	Dept. A (₹)	Dept. B (₹)	
Opening Stock	12,000	15,000	
Purchases	1,05,000	1,20,000	
Sales	1,35,000	1,80,000	
Wages	6,000	8,850	
Following are the other Common Expenses/Incomes:			**Total (₹)**
Salaries			18,300
Rent and Rates			9,000
Carriage Inward			2,250
Carriage Outward			4,200
Discount Allowed			2,100
Discount Received			1,500
Advertisement Expenses			6,300
Audit Fees			600
Legal Expenses			1,200

Additional Information:

(1) Salaries are to be allocated equally.
(2) The area occupied is in the ratio of 1:2 between the two departments, respectively.
(3) Closing Stock: Department A ₹30,000, Department B ₹37,500.
(4) The remaining common expenses income to be allocated on appropriate basis to the extent possible.

Q4. The following particulars have been extracted in respect of raw materials of Ultra Chemicals. Find the value of closing stock as on 30 June 2016 on the basis of (i) First In First Out Method and (ii) Weighted Average Method. (15)

Receipts:

1 January 2016	Opening Stock	100 units at ₹35 per unit
3 February 2016	Purchased	400 units at ₹40 per unit
13 April 2016	Purchased	900 units at ₹45 per unit
23 June 2016	Purchased	600 units at ₹50 per unit

Issues:

5 March 2016	Issued	400 units
15 May 2016	Issued	600 units
30 June 2016	Issued	600 units

OR

Q4. Find out the value of Closing Stock of M/s. Mayur Ltd. using (A) FIFO Method (B) Weighted Average Method from the following details of Material 'X' as on 31 January 2016. (15)

Date	Particulars	Unit	@ ₹
2016			
5 January	Opening Stock	700	25
6 January	Issues	400	-
9 January	Purchases	900	35
11 January	Issues	600	-
16 January	Purchases	200	40
21 January	Purchases	900	45
31 January	Issues	500	-

Q5. Mr. Lal Prasad purchased a Car on Hire Purchase Basis from Maruti Ltd. on 1 January 2013. He paid ₹1,50,000 on signing the contract and agreed to pay 3 instalments of Cash Price excluding interest as follows: (15)

On 31 December 2013	₹1,50,000
On 31 December 2014	₹1,65,000
On 31 December 2015	₹1,85,000

The Cash Price of the car was ₹6,50,000. Interest is charged at 10% p.a. by Maruti Ltd. on outstanding amount. Depreciation @ 20% p.a. on WDV is charged on the Car. Prepare Car Account and Maruti Ltd. Account in the Books of Mr. Lal Prasad for the years 2013, 2014 and 2015.

OR

Q5. State whether the following expenditure or receipts are capital or revenue. Give reasons for your answers. (15)

1. Purchased a plot of land for ₹25,00,000 and paid ₹1,00,000 fees for registration and allotment.
2. Received ₹3,00,000 on Issue of 15% Debentures.
3. Interest of ₹8,000 paid on Bank Overdraft.
4. Paid ₹6,000 as Excise duty on goods manufactured.
5. A petrol engine of a passenger bus was replaced by a diesel engine in ₹70,000.
6. Paid ₹1,00,000 as fees for renewal of license for factory.
7. Received ₹2,000 as dividend on shares.

Q6. Answer the following: (20)

(a) What are the provisions of Revenue Recognition as per AS-9?
(b) Explain the Provisions of Disclosure of Accounting Policies as per AS-1.

OR

Q6. Write short notes on any four of the following: (20)

1. Manufacturing Account
2. FIFO Method of Inventory Valuation
3. Main Features of AS-2
4. Stock Reserve
5. Fundamental Accounting Assumptions
6. Importance of Departmental Accounts

F.Y.B.Com. Examination

IDOL-October 2016

Accountancy and Financial Management-1

[Time: 3 hours] **[Total Marks: 100]**

N.B.

1. *From Section I, Question Nos. 1 and 2 are compulsory and attempt any one question from Question Nos. 3 and 4.*
2. *From Section II, Question Nos. 5 and 6 are compulsory and attempt any one question from Question Nos. 7 and 8.*
3. *Figures to the right indicate full marks.*
4. *Working notes should form part of answer wherever it necessary.*

Section I

Q1. The following is the Trial Balance of Mr. Gyan on 30 June 2015:

Particulars	(₹)	(₹)
Cash in Hand	540	-
Cash at Bank	2,630	-
Purchases Account	40,675	-
Sales Account	-	98,780
Returns Inward Account	680	-
Returns Outward Account	-	500
Wages Account	10,480	-
Fuel & Power Account	4,730	-
Carriage on Sales Account	3,200	-
Carriage on Purchase Account	2,040	-
Stock Account (1 July 2014)	5,760	-
Building Account	30,000	-
Freehold Land Account	10,000	-
Machinery Account	20,000	-
Patent Account	7,500	-
Salaries Account	15,000	-
General Expenses Account	3,000	-
Insurance Account	600	-
Drawings Account	5,245	-
Capital Account	-	71,000
Sundry Debtors Account	14,500	-
Sundry Creditors Account	-	6,300
Total	1,76,580	1,76,580

Additional Information:

Taking into account the following adjustments, Prepare Trading Account and Profit and Loss Account and the Balance Sheet:

(a) Stock on hand on 30 June 2015 is ₹6,800.

(b) Machinery is to be depreciated at rate of 10% and the patents at the rate of 20%.

(c) Salaries for the month of June 2015 amounting to ₹1,500 were unpaid.

(d) Insurance includes a premium of ₹170 on a policy expiring on 31 December 2015.

(e) Wages include a sum of ₹2,000 spent on the erection of a cycle shed for employees and customers.

(f) A provision of Bad and Doubtful Debts is to be created to the extent of 5% on Sundry Debtors.

Q2(a). Rewrite the statement given in Group A with corresponding most appropriate statement from Group B.

Group A	Group B
1. AS-1 2. Capital expenditure 3. Revenue receipts 4. Conveyance 5. Gross Profit 6. Receipt and Payment A/c 7. AS-9 8. Capital assets 9. Revenue expenditure 10. AS-2	a. Income from investing and financing activities b. P/L Account c. Trading Account d. Major investment of capital e. Subscription f. Revenue recognition g. Shorter terms of expenditure h. Income from operating activities i. Valuation of inventories j. Disclosure of Accounting policies

Q2(b). Rewrite the following statement by using the proper choice given under the statement.

1. Capital Expenditure
   (a) Shown in Balance Sheet (b) Shown in Revenue Account
   (c) Loss to a business concern (d) Intends to benefit current period only
2. Depreciation
   (a) Addition to the Assets (b) Charge against Profit
   (c) Repairs to Assets (d) Stock
3. Cash Discount
   (a) For delay in payment to creditors (b) For delay in receipt from debtors
   (c) For prompt payments of debts (d) For bad debts incurred
4. Sale of Assets
   (a) Treated as sales (b) Shown in P/L Account
   (c) Shown in Trading Account (d) Deducted from respective Assets in Balance Sheet
5. Manufacturing Account deals with
   (a) All cost and expenses of manufacture
   (b) Finished goods and expenses with cost of manufacture
   (c) Capital expenditure
   (d) Sale and Purchase of Assets
6. Freight paid on goods purchased is charged to
   (a) Profit/Loss Account (b) Trading Account
   (c) Balance Sheet (d) Carriage Outward Account
7. Advertising campaign to launch new product
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred Revenue Expenditure (d) Capital Receipt
8. Sale of Scrap
   (a) Debit Profit/Loss Account (b) Credit Profit/Loss Account
   (c) Debit Manufacturing Account (d) Credit Manufacturing Account

Q3. State with reasons whether the fallowing items of expenditure are capital or revenue.

1. A new machinery was purchased for ₹80,000 and a sum of ₹1,000 was spent on installation and erection.
2. Premium paid on the redemption of debentures.
3. Commission paid on issue of debentures.
4. Cost of air-conditioning the office of the director of a company.
5. Damages paid on account of the breach of contract to supply certain goods.
6. Cost of replacement of an old and worn out part of machinery.
7. Repairs to a motor car met with an accident.
8. Cost of redecorating a cinema hall.

Q4. From the following particulars, you are required to prepare Departmental Profit and Loss Account for Departments A and B:

Particulars	**Department A (₹)**	**Department B (₹)**
Opening stock	60,000	90,000
Purchases	3,60,000	5,40,000
Sales	6,00,000	8,00,000
Closing stock	20,000	80,000
Salaries	25,000	30,000
Wages	12,000	15,000
Common Expenses		***Total* (₹)**
Advertising expenses		28,000
Rent		20,000
General expenses		60,000
Conveyance		25,000
Insurance		10,000
Postages		15,000

Transfer stock worth ₹20,000 from Dept. A to Dept. B Advertising expense should be apportioned in the ratio of sales; rent equally and general expenses in the ratio of 2:3 between Departments A and B. Also prepare General P/L Account.

Section II

Q5. Shri Ashutosh keeps his Books by Single Entry. On 1 January 2015 his capital was ₹69,000. An analysis of his Cash Book for the year gives the following particulars.

Debit side	**(₹)**	**Credit side**	**(₹)**
Received form Sundry Debtors	60,000	Due to Bank (January 1)	7,400
Debtors Paid on Capital Account	5,000	Payment to creditors	25,000
		General Expenses	10,000
		Wages	15,500
		Drawings	3,000
		Balance at Bank	4,000
		Balance in Hand	100
	65,000		65,000

Particulars	**1 January 2015 (₹)**	**31 December 2015 (₹)**
Debtors	53,000	88,000
Creditors	15,000	19,500
Stock	17,000	19,000
Plant and Machinery	20,000	20,000
Furniture and Fittings	1,400	1,400

From the above materials, prepare a Profit and Loss Account for the year ended 31 December 2015 and a Balance Sheet as on that date, after providing 5% interest on capital (ignoring payment in and drawings), 10% depreciation Plant, 5% depreciation on Furniture and Fittings and reserve of 5% on Sundry Debtors.

Q6(a). State whether the statements are True or False.

1. The consignor owns the goods until it is sold.
2. Depreciation of Branch fixed Assets is not shown in the Branch Account.
3. Consignment Account is a nominal Account.
4. Goods-in-transit is the difference between goods sent by Head Office and received by the Branch.
5. Consignee sends the document called Accounts sales.
6. When the Branch has sold fixed Asset for cash, the proceeds are remitted to Head Office.
7. Additional commission to consignee is delcredre commission.
8. Petty expenses, paid by the Branch Manager out of petty cash, are shown in the Branch Account.

Q6(b). Rewrite the statement given in Group A with corresponding most appropriate statement from Group B.

Group A	Group B
1. *Delcredre*	a. Goods despatched but not received
2. Sundry Debtors A/c	b. Bad debts recovery commission
3. Single Entry system	c. Difference is invoice and cost price
4. Gross Profit	d. Commission due to sales
5. Branch Account	e. Consignment
6. Account Sales	f. Stock debtor system
7. Stock Reserves	g. Trading A/c
8. Goods in Transit	h. Open Balance Sheet
	i. Seller
	j. Credit Sales

Q7. M/s. Vidhi & Co. of Mumbai consigned 5000 woolen blankets @ ₹1200 per blanket to Samy of Kolhapur to be sold on consignment Vidhi @ Co. incurred ₹2,500 for freight, 9,000 for insurance. Samy paid transport charges ₹12,000 and received only 4,800 blankets. Samy sold 4,000 blankets at ₹1,800 per blankets and remitted the amount after deducting his commission @ 8%. Prepare Consignment A/c and Consignee A/c.

Q8. M/s. Vimal & Co. Mumbai, has its branch at Surat Goods are invoiced at 25% on cost to Branch. Consider the following details to prepare Surat Branch Account.

Particulars	(₹)
Goods sent to branch at invoice price	4,20,000
Goods returned by branch (Invoice Price)	24,000
Cash sales by Branch	6,00,000
Cash sent to branch for wages	20,000
Cash sent to branch for advertising expenses	40,000
Opening balance: Debtors	20,000
Cash	50,000
Stock	40,000
Furniture	80,000
Closing balance: Cash	40,000
Credit Sales	10,000
Closing to Debtors	12,000
Cash remitted to H.O.	4,50,000

Additional Information: Depreciation on furniture is to be charged 10% p.a.

Solutions to Question Papers

F.Y.B.Com Semester-I, March, 2017
(New Question Paper Pattern, w.e.f. 2016–17)

Accountancy and Financial Management-I
Discipline Specific Elective (DSE) Course

Q1A. Fill in the blanks.

1. Valuation of Inventory
2. Hire Purchase Price
3. Cost of Production
4. Area Occupied
5. Balance Sheet
6. Capital Receipt
7. Be disclosed at one place, forming a part of Final Accounts
8. Raw Material
9. Hire Purchaser
10. General Profit and Loss Account
11. Balance Sheet
12. Income

Q1B. True or False.

True Statements - 1, 2, 5, 6, 9, 10, 11 and 12 False Statements - 3, 4, 7 and 8

Rewriting the incorrect statements

3. As per AS-9, Revenue from Interest is recognised on a time proportion basis considering the outstanding amount and the rate of interest.
4. Profit and Loss Account shows the financial performance of a concern.
7. Under Hire Purchase System, Depreciation on Asset is charged by the Hire Purchaser until the last instalment is paid.
8. Down Payment excludes interest.

Q2.

In the books of SHIVA
Manufacturing Trading and Profit and Loss Account
For the year ended 31 March 2016

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Opening Stock - Raw Material	26000			
Add: Purchase of Raw Material	280000		By Closing stock - WIP	4000
	306000		By Trading Account	368000
Less: Closing stock Raw Material	(32000)	274000	(Cost of Production Transferred)	
To Opening stock - WIP		2000		
To Carriage Inward on RM		5000		
To Direct Wages		56000		
To Factory Rent		27000		

(Continued)

Dr.					**Cr.**
	Particulars		**₹**	**Particulars**	**₹**
To	Depreciation on Machinery		8000		
			372000		372000
To	Opening Stock - Finished Goods		30000	By Sales	500000
To	Manufacturing Account			By Goods Destroyed by Fire	12000
	(Cost of Production Transferred)		368000	By Closing Stock - Finished Goods	35000
To	Profit and Loss Account (Gross Profit Transferred)		149000		
			547000		547000
To	Salaries		9000	By Trading Account	149000
To	Discount Allowed		7000	(Gross Profit transferred)	
To	New Reserve for Doubtful Debts		5000		
To	Loss Due to Fire - Goods Lost	12000			
	Less: Insurance Claim Receivable	(8000)	4000		
To	Net Profit Transferred to Capital		124000		
			149000		149000

Balance Sheet of Mr. Shiva as on 31 March, 2016

Liabilities		**₹**	**Assets**		**₹**
Capital Account	100000		Machinery	80000	
Add: Net Profit	124000		*Less*: Dep. @ 10%	(8000)	72000
	224000		Insurance Claim Receivable		8000
Less: Drawings	(30000)	194000			
Creditors		71000	Sundry Debtors	100000	
			Less: RDD @5%	(5000)	95000
			Closing stock - Raw Material		32000
			Closing stock - Work in Progress		4000
			Closing Stock - Finished Goods		35000
			Cash at Bank		19000
		265000			265000

OR

Q2.

In the Books of Neelkanth
Manufacturing Trading and Profit and Loss Account
For the year ended 31 March 2016

Dr. **Cr.**

Particulars			₹	Particulars	₹
To	Opening Stock - Raw Material	22000			
	Add: Purchase of Raw Material	195000		By Closing stock -Work-in-Progress	6000
	Add: Carriage inward	10000			
		227000			
	Less: Closing stock of Raw Material	(20000)	207000	By Trading Account (Cost of Production Transferred)	311000
To	Opening stock - Work in Progress		25000		
To	Direct Wages		60000		
To	Factory Power and Fuel	18000			
	Add: Outstanding	2000	20000		
To	Deprciation on Machinery		5000		
			317000		317000
To	Opening Stock-Finished Goods		30000	By Sales	370000
To	Manufacturing Account			By Closing Stock Finished Goods	39000
	(Cost of Production Transferred)		311000		
To	Profit and Loss Account (Gross Profit Transferred)		68000		
			409000		409000
To	Office Salaries		20000	By Trading Account	68000
To	Selling and Distribution Expenses		29000	(Gross Profit Transferred)	
To	New Reserve for Doubtful Debts	2500			
	Less: Old Reserves	(2000)	500		
To	Depreiation on Furniture		1600		
To	Net Profit Transferred to Capital		16900		
			68000		68000

Balance Sheet

Liabilities		₹	Assets		₹
Capital Account	129000		Machinery	100000	
Add: Net Profit	16900	145900	*Less*: Dep. @ 5%	5000	95000
			Furniture	32000	
Creditors		90000	*Less*: Dep. @ 5%	1600	30400
Bills payable		10000			
Outstanding Factory Power and Fuel		2000	Sundry Debtors	50000	
			Less: RDD @5%	2500	47500
			Closing stock - Raw Material		20000
			Closing stock - Work-in-Progress		6000
			Closing Stock - Finished Goods		39000
			Cash at Bank		10000
		247900			247900

Q3. Departmental Trading and Profit and Loss Account of Swadeshi Stores for the year ended 31 December, 2016

Particulars	Basis	A	B	C	Particulars	Basis	A	B	C
To Stock	*Given*	50,000	70,000	10,000	By Sales [Net]	*Given*	6,00,000	12,00,000	18,00,000
To Purchases [Net]	*Given*	1,80,000	2,90,000	7,70,000	By Closing stock	*Given*	80,000	50,000	40,000
To Wages	*Given*	40,000	60,000	80,000	By Departmental				
To Departmental	*Given*				B&C		30,000		
A	*Given*	-	10,000	20,000	A&C			15,000	
B	*Given*	5,000	-	10,000	A&B				16,000
C	*Given*	7,000	9,000	-					
To Gross Profit		4,28,000	8,26,000	9,66,000					
		7,10,000	12,65,000	18,56,000			7,10,000	12,65,000	18,56,000
To Telephone charges	*Equal*	1,000	1,000	1,000	By Gross Profit		4,28,000	8,26,000	9,66,000
To Insurance charges	*Equal*	2,000	2,000	2,000					
To Office Expenses	*Equal*	3,000	3,000	3,000					
To Rent	*1:1:2*	6,000	6,000	12,000					
To Discount allowed	*Sales*	3,000	6,000	9,000					
To Bad Debts	*Sales*	2,500	5,000	7,500					
To Net Profit		4,10,500	8,03,000	9,31,500					
		4,28,000	8,26,000	9,66,000			4,28,000	8,26,000	9,66,000

OR

Q3A.

M/s Shankar Traders
STOCK LEDGER (FIFO Method)
for the year ended 31 March 2016

Date	Receipts			Issues			Balance		
	Units	Rate	₹	Units	Rate	₹	Units	Rate	₹
1-4-2015	Opening Stock						500	35.00	17,500
5-6-2015	1000	38.00	38,000	--	--	--	500 1000	35.00 38.00	17,500 38,000
31-8-2015	--	--	--	300	35.00	10,500	200 1000	35.00 38.00	7,000 38,000
19-9-2015	--	--	--	200 600	35.00 38.00	7,000 22,800	400	38.00	15,200
1-10-2015	1200	34.00	40,800	--	--	--	400 1200	38.00 34.00	15,200 40,800
20-02-2016	--	--	--	400 600	38.00 34.00	15,200 20,400	600	34.00	20,400
31-03-2016	600	30.00	18,000	--	--	--	600 600	34.00 30.00	20,400 18,000
Total			**96,800**			**75,900**	**1200**		**38,400**
Therefore, the value of Closing stock as on 31 March 2016 was 1200 units for ₹38,400									

B.

M/s Shankar Traders
STOCK LEDGER (Weighted Average Method)
for the year ended 31 March 2016

Date	Receipts			Issues			Balance		
	Units	Rate	₹	Units	Rate	₹	Units	Rate	₹
1-4-2015	Opening Stock						500	35.00	17,500
5-6-2015	1000	38.00	38,000	--	--	--	1500	37.00	55,500
31-8-2015	--	--	--	300	37.00	11,100	1200	37.00	44,400
19-9-2015	--	--	--	800	37.00	29,600	400	37.00	14,800
1-10-2015	1200	34.00	40,800	--	--	--	1600	34.75	55,600
20-02-2016	--	--	--	1000	34.75	34,750	600	34.75	20,850
31-03-2016	600	30.00	18,000	--	--	--	1200	32.37	38,850
Therefore, the value of Closing stock as on 31 March 2016 was 1200 units at ₹38,850									

C. Cost of Goods Sold (FIFO Basis) = Opening Stock + Purchases – Closing Stock
= 17,500 + 96,800 – 38,400 = **75,900**

Q4A.

Jagjivan Textiles Ltd. STOCK LEDGER (FIFO Method)

for the month of March 2016

Date	Receipts			Issues			Balance		
	Units	Rate	₹	Units	Rate	₹	Units	Rate	₹
1-3-2016	Opening Stock						500	80.00	40,000
15-3-2016	420	82.00	34,440	--	--	--	500 420	80.00 82.00	40,000 34,440
19-3-2016	--	--	--	500 200	80.00 82.00	40,000 16,400	220	82.00	18,040
21-3-2016	--	--	--	180	82.00	14,760	40	82.00	3,280
25-3-2016	380	89.00	33,820		--	--	40 380	82.00 89.00	3,280 33,820
27-3-2016	--	--	--	40 280	82.00 89.00	3,280 24,920	100	89.00	8,900
28-3-2016	150	90.00	13,500	--	--	--	100 150	89.00 90.00	8,900 13,500
30-3-2016	100	92.00	9,200				100 150 100	89.00 90.00 92.00	8,900 13,500 9,200
Total			**90, 960**			**99,360**	**350**		**31,600**
Therefore, the value of Closing stock as on 31 March 2016 was 350 mtrs. at ₹31,600									

B. Cost of Goods Sold = Opening stock + Purchases – Closing Stock
= 40,000 + 90,960 – 31,600 = 99,360

Profit = Selling Price – Cost of Goods sold
= 1,20,000 – 99,360 = 20,640

OR

Q4. State whether the following expenses or incomes are capital and/ or revenue. Give reasons for your answers.

1. Sold Government Securities held as Investment for ₹10,00,000 and earned a profit of ₹20,000	**Capital Receipt:** Amount received on sale of investment is treated as capital receipt as it is sale of asset. **Revenue Receipt:** Profit on sale of Investment may be credited to Profit and loss account as Revenue Receipt.
2. Paid ₹1,20,000 as custom duty on machinery purchased from Germany.	**Capital Expenditure:** It is direct cost for acquiring an asset which is to be capitalised as per AS-10
3. Paid ₹20,000 for Factory Rent.	**Revenue expenditure:** It is an expense incurred in the ordinary course of business.
4. Paid subscription charges of ₹6000 a trade journal.	**Revenue Expenditure:** Annual subscription is a running expenditure spent in normal course of business.
5. Paid ₹1,00,000 for obtaining business license.	**Capital Expenditure:** As it is to start a business activity. It gives rise to intangible asset which is long term source of income.

6. Loss of ₹10,000 was incurred on goods destroyed by fire.	**Revenue Loss:** It is debited to profit and loss account as it is loss of goods suffered in normal course of business.
7. Cost of ₹30,000 incurred for replacement of defective parts of machinery.	**Revenue Expenditure:** As replacement of Part of Machinery is a cost incurred to maintain it in working condition.

Q5A.

In the books of Presto Plast Co. (Hire Purchaser)
Machine Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.04.2013	To Kabra Ltd. A/c	10,00,000	31.03.2014	By Depreciation	1,00,000
			31.03.2014	By Bal c/d	9,00,000
		10,50,000			10,00,000
01.04.2014	To Bal b/d	9,00,000	31.03.2015	By Depreciation	90,000
			31.03.2015	By Bal c/d	8,10,000
		9,00,000			9,00,000
01.04.2015	To Bal b/d	8,10,000	31.03.2016	By Depreciation	81,000
			31.03.2016	By Bal c/d	7,29,000
		8,10,000			8,10,000

Kabra Ltd. Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.04.2013	To Bank	2,50,000	01.04.2013	By Machine a/c	10,00,000
31.03.2014	To Bank	3,10,000	31.03.2014	By Interest	60,000
31.03.2014	To Bal c/d	5,00,000			
		10,60,000			10,60,000
31.03.2015	To Bank	2,90,000	01.04.2014	By Bal b/d	5,00,000
31.03.2015	To Bal c/d	2,50,000	31.03.2015	By Interest	40,000
		5,40,000			5,40,000
31.03.2016	To Bank	2,70,000	01.04.2015	By Bal b/d	2,50,000
			31.03.2016	By Interest	20,000
		2,70,000			2,70,000

Working Notes:

1. Calculation of Interest:

Particulars	DP	31.3.2013	31.3.2014	31.3.2015
1. Opening Cash Price	10,00,000	7,50,000	5,00,000	2,50,000
2. DP/ Instalment (given)	2,50,000	3,10,000	2,90,000	2,70,000
3. Interest (12% on Opening CP)	–	60,000	40,000	20,000
4. Cash Price paid (Instalment – Interest)	2,50,000	2,50,000	2,50,000	2,50,000
5. Closing Cash Price (Op CP – CP paid)	7,50,000	5,00,000	2,50,000	0

2. Calculation of Depreciation:

	31.3.2013	31.3.2014	31.3.2015
Machine account	10,00,000	9,00,000	8,10,000
Less: Depreciation (10% on WDV)	1,00,000	90,000	81,000
WDV	9,00,000	8,10,000	7,29,000

OR

Q5. Departmental Trading and Profit and Loss Account of Sadguru Electronics for the year ended 31 March, 2016.

Particulars	Basis	Radio	TV	Particulars	Basis	Radio	TV
To Stock	*Given*	65,000	50,000	By Sales	*Given*	3,20,000	2,80,000
To Purchases	*Given*	2,70,000	1,80,000	By Closing Stock	*Given*	1,10,000	55,000
To Carriage Inwards	*Given*	3,600	2,400				
To Gross Profit		91,400	1,02,600				
		4,30,000	3,35,000			4,30,000	3,35,000
To Salaries	*Given*	24,000	21,000	By Gross Profit		91,400	1,02,600
To Rent Rates	*[4:1]*	22,400	5,600	By Discount	*[3:2]*	2,700	1,800
To Carriage Outwards	*[8:7]*	12,800	11,200				
To General Exp	*[1:1]*	7,500	7,500				
To Advertisement	*[8:7]*	19,200	16,800				
To Discount	*[8:7]*	2,400	2,100				
To Insurnace	*[1:1]*	1,750	1,750				
To S&D	*[8:7]*	800	700				
To Net Profit		3,250	37,750				
		94,100	1,04,400			94,100	1,04,400

Q6. Answer the following

1. Refer to paragraph **2.3.2 Important Features of AS-2** of Chapter 2: AS-2: Valuation of Inventories

   Refer to paragraph **7.2.4 Allocation or Appropriation of Expenses: Distribution of Expenses among Departments** of Chapter 7: Departmental Accounts

OR

Q6. Short Notes

1. *Cost of Production* - It indicates the cost incurred by a business for undertaking production of given units of goods or providing service. It includes all those expenses that have been directly or indirectly incurred during the production process. For instance, labour expenses, cost of raw materials, carriage, freight and cartage paid on the movement of raw materials, semi-finished goods to the factory, power, fuel, etc. are all considered to ascertain the cost of production. In short, cost of production is ascertained by considering all the factory-related expenses (including depreciation or expired cost of fixed Assets of factory) and factory-related incomes (such as sale of scrap). The amount of cost of production is balancing figure of Manufacturing Account. On the debit side of Manufacturing Account, we record all the factory-related production expenses along with opening stock of WIP and raw materials consumed. On the credit side, we record closing stock of WIP and factory-related income, such as proceeds from sale of scrap. The

debit side of Manufacturing Account will always be more than its credit side. The balancing figure (i.e. excess of debit balance over credit balance) is the cost of production. This amount is thereafter transferred to the debit side of Trading Account.

Algebraically, Cost of Production can be represented as:

$$\begin{array}{c}\text{Gross Cost of Production}\\ +\text{ Opening WIP}\end{array} - \left(\begin{array}{c}\text{Closing WIP}\\ +\text{ Sale of Scrap}\end{array}\right) = \text{Net Cost of Production}$$

2. *Interdepartmental Transfers* - Refer to paragraph **7.6 Inter-Departmental Transfers** of Chapter 7: Departmental Accounts
3. *Factors influencing choice of Accounting Policy* - Refer to paragraph **1.4.5 Factors affecting Selection and Application of Accounting Policies** of Chapter 1: Accounting Standards and Disclosure of Accounting Policies
4. *Distinguish between Capital Expenditure and Revenue Expenditure* - Refer to paragraph **1.4.5 Difference between Capital Expenditure and Revenue Expenditure** of Chapter 5: Capital And Revenue: Expenditure and Receipts
5. *Importance of Stock Valuation* **-** Refer to paragraph **4.1.2 Need and Significance of Inventory Valuation** of Chapter 4: Inventory Valuation
6. *Revenue as per AS*-9 - Refer to paragraph **3.2 Revenue and Its Recognition** and **3.3.3 Implications of AS-9** of Chapter 3: Accounting Standard-9: Revenue Recognition.

F.Y.B.Com Semester-I, November, 2016

(New Question Paper Pattern)

Accountancy and Financial Management-I

Q1A. Fill in the blanks

1. Inventory Valuation	2. Down Payment	3. Cost of Production
4. Area Occupied	5. FIFO	6. Capital Expenditure
7. Lower	8. Finished Goods	9. Hire Vendor
10. Balance Sheet	11. Manufacturing	12. Full Cash Price

Q1B. True or False

True Statements- 1, 2, 5, 6, 9, 10, 11 and 12 False Statements- 3, 4, 7 and 8

Rewriting the incorrect statements

3. It is very much necessary to disclose any change in accounting policy.
4. Revenue expenses are recurring expenses.
7. Disclosures under AS-1 need to form a part of final accounts.
8. Income received in advance is shown on the Liabilities side of the Balance Sheet.

Q2. Refer to Example-52 of Chapter 6: Final Accounts of Manufacturing Concerns.

OR

Q2. Refer to Example-53 of Chapter 6: Final Accounts of Manufacturing Concerns.

Q3. Refer to Example-12 of Chapter 7: Departmental Accounts

OR

Q3. Refer to Example-14 of Chapter 7: Departmental Accounts

Q4. Refer to Example-11 of Chapter 4: Inventory Valuation

OR

Q4. Refer to Example-12 of Chapter 4: Inventory Valuation

Q5. Refer to Example-7 of Chapter 8: Accounting for Hire Purchase

OR

Q5. Refer to Example-6 of Chapter 5: Capital and Revenue: Expenditure and Receipts

Q6. Answer the following:

(a) Refer to paragraph **3.3.3 Implications of AS-9** of Chapter 3: Accounting Standard-9: Revenue Recognition

(b) Refer to paragraph **1.4.6 Disclosure Requirements as per AS-1** of Chapter 1: Accounting Standards and Disclosure of Accounting Policies

OR

Q6. Short Notes:

1. Refer to paragraph **6.3.1 Meaning and Proforma of Manufacturing Account** of Chapter 6: Final Accounts of Manufacturing Concerns
2. Refer to paragraph **4.3.1 First-in-First-out Method (FIFO)** and **4.3.2 Format of Stock Ledger Account under FIFO Method** of Chapter 4: Inventory Valuation
3. Refer to paragraph **2.3.2 Important Features of AS-2 (Revised)** of Chapter 2: AS-2: Valuation of Inventory
4. Refer to paragraph **7.6.2 Interdepartmental Transfers at Invoice Price (Case-1 and 2)** of Chapter 7: Departmental Accounts
5. Refer to paragraph **1.4.3 Fundamental Accounting Assumptions** of Chapter 1: Accounting Standards and Disclosure of Accounting Policies
6. Refer to paragraph **7.2.2 Advantages of Departmental Accounts** of Chapter 7: Departmental Accounts

F.Y.B.Com IDOL, October 2016

(New Question Paper Pattern)

Accountancy and Financial Management-I

Section I

Q1. Refer to Example-55 of Chapter 6: Final Accounts of Manufacturing Concerns

Q2(a). Groups Matched

Group A	Group B
1. AS-1	j. Disclosure of Accounting policies
2. Capital expenditure	d. Major investment of capital
3. Revenue receipts	h. Income from operating activities
4. Conveyance	b. Profit and Loss Account
5. Gross Profit	c. Trading Account
6. Receipt and Payment A/c	e. Subscription
7. AS9	f. Revenue recognition
8. Capital assets	a. Income from investing and financing activities
9. Revenue expenditure	g. Shorter terms of expenditure
10. AS2	i. Valuation of inventories

Q2(b). 1-a, 2-b, 3-c, 4-d, 5-a, 6-b, 7-c, 8-d

Q3. Capital Expenditure- 1, 2, 3, 4, 5, 8 Revenue Expenses- 6, 7

Q4.

Departmental Trading and Profit & Loss Account

For the year ended ...

Dr. **Cr.**

Particulars	Basis	A	B	Total	Particulars	A	B	Total
To O/p Stock		60,000	40,000	1,00,000	By Sales	6,00,000	8,00,000	14,00,000
To Purchases		3,60,000	5,40,000	9,00,000	By Transfers	20,000	-	20,000
To Transfer from Department		-	20,000	20,000	By Closing Stock	20,000	80,000	1,00,000
To Wages	*Given*	12,000	15,000	27,000				
To Gross Profit		2,08,000	2,65,000	4,73,000				
		6,40,000	8,80,000	15,20,000		6,40,000	8,80,000	15,20,000
To Salaries	*Given*	25,000	30,000	55,000	By Gross Profit	2,08,000	2,65,000	4,73,000
To Rent	*Equal*	10,000	10,000	20,000				
To Postages	*Sales*	6,429	8,571	15,000				
To Conveyance	*Sales*	10,714	14,286	25,000				
To General Exp (2:3)	*Given*	24,000	36,000	60,000				
To Advertising (3:4)	*Sales*	12,000	16,000	28,000				
To Net Profit		1,19,857	1,50,143	2,70,000				
		2,08,000	2,65,000	4,73,000		2,08,000	2,65,000	4,73,000

General Profit and Loss Account

For the year ended ...

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Insurance	10,000	By Net Profit b/d	2,70,000
To Net Profit (Transferred to Capital Account)	2,60,000		
	2,70,000		2,70,000

It should be noted that Insurance Amount was difficult to be apportioned among the departments because of absence of information related to insurance, i.e. whether insurance is related to Asset, or stock or building. Hence, insurance has been debited in General Profit and Loss Account.

Section II

Q5. ***Out of syllabus*** of Accounting & Financial Management-I (Semester-I)
Q6(a). ***Out of syllabus*** of Accounting & Financial Management-I (Semester-I)
Q6(b). ***Out of syllabus*** of Accounting & Financial Management-I (Semester-I)
Q7. ***Out of syllabus*** of Accounting & Financial Management-I (Semester-I)
Q8. ***Out of syllabus*** of Accounting & Financial Management-I (Semester-I)

MODERATE LEVEL

Model Test Paper-1

F.Y.B.Com Semester-I

(New Question Paper Pattern as per Revised Scheme effective from 2016–17)

Accountancy and Financial Management-I

Based on Analyses of November 2016 and March 2017

[Time: 3 hours] **[Total Marks: 100]**

N.B.

1. Strictly avoid resorting to any unfair means during the examination and abide by all the rules and relating thereto.
2. Figures in bracket to the right indicate full marks allotted to the question.
3. Working notes should form part of your answers.
4. All six questions are compulsory, although, there are internal options in case of Questions 2 and 6.
5. Use of simple calculator is allowed.

Q1A. Fill in the blanks with the appropriate given options and rewrite complete sentences. (Attempt any 10) **10**

1. In India, the Accounting Standards are issued by ___________________. (ASB/Council of ICAI)
2. While calculating cost of purchases, ______________ (packing cost/packaging cost) is ignored.
3. The fixed production overheads are allocated on the basis of _________. (normal capacity/ actual use)
4. Weighted Average Price Method ignores _____________ principle. (matching/conservatism)
5. Expenses incurred to maintain the existing capacity of fixed assets are of ______nature. (Capital/ Revenue)
6. Manufacturing Account is prepared to ascertain __________. (Gross Profit/Gross Loss/Cost of production)
7. Recreation expenses are apportioned on the basis of ___________. (no. of employees/amount of wages)
8. Sale of scrap and by-products is shown on the credit side of ____________. (Manufacturing Account/Trading Account/Profit and Loss Account)
9. Difference between hire purchase price and cash price is ______________. (down payment/ interest)
10. Depreciation is calculated on ____________ outstanding. (hire purchase price/cash price)
11. Down Payment + (Instalment amount × No. of Instalments) – Cash Price = _____ (Total Hire Purchase Price/Total Interest)
12. _____________ (Freight/Carriage Outwards) is not recorded on the debit side of Profit and Loss Account.

Q1B. State whether the following statements are TRUE or FALSE after rewriting the same. (Attempt any 10) **10**

1. Accounting Standards override laws in India.
2. Variable production overhead costs are allocated on the basis of normal capacity.
3. For a manufacturing firm, the term 'revenue' includes income from sale of goods and interest earned on its investments.
4. FIFO method mitigates the changes due to price fluctuations.
5. Capital receipts reduce firm's assets.
6. Balance Sheet does not form a part of Departmental Accounting.
7. It is hire purchaser's obligation to bear any loss of asset due to fire or theft, as he is using it.
8. If Interest Account is debited and P&L Account is credited, then it belongs to Books of hire vendor.
9. Opening Cash Price includes down payment.
10. When new provision for bad debts exceeds old provision, then the difference amount is shown on the credit side of Profit and Loss Account.
11. In the Books of a manufacturer, depreciation of plant and machinery is debited to Profit and Loss Account.
12. Profit and Loss Account reveals the financial position of a business at the end of an accounting period.

Q2. The given below is the Balance Sheet of M/s. Salim as on 31 March 2016.

Balance Sheet
for the year ended 31 March 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	6,00,900	Land and Building	2,28,000
Bills Payable	75,600	Plant and Machinery	1,65,000
Sundry Creditors	1,03,500	Sundry Debtors	84,000
		Investments @ 10% p.a. interest	45,000
		Cash at Bank	52,500
		Closing Stock	2,05,500
	7,80,000		7,80,000

Profit and Loss for the year ending 31 March 2017 disclosed a net profit of ₹1,18,620. The net profit has been ascertained without considering the following adjustments.

(a) Prepaid insurance of ₹1,380
(b) Interest on investment was due for 6 months
(c) ₹9,000 were unpaid as salary
(d) Depreciation of ₹4,560 on Land and Building, and on Plant and Machinery is ₹18,150.
(e) Closing Stock amounted to ₹1,78,000

Additional Information as on 31 March 2017

(a) Sundry Debtors were valued at ₹84,000.
(b) Closing Stock was valued at ₹1,33,000.
(c) Bank balance on the above date was ₹1,34,620.

On the basis of the above information, you are required to prepare Balance Sheet of M/s. Salim as on 31 March 2017.

OR

Q2. Considering the below given Trial Balance and the additional information, you are required to prepare the Manufacturing Account, Trading Account, Profit and Loss Account along with Balance Sheet.

Trial Balance
as on 31 March 2017

Particulars	Debit Amount	Credit Amount	Particulars	Debit Amount	Credit Amount
Stock as on 1 April 16			Cash at Bank	24,000	-
Raw Materials	24,000	-	Other Direct Wages	24,000	-
Work-in-progress	14,000	-	Machinery	1,20,000	-
Finished Goods	40,000	-	Indirect Wages	16,000	-
Purchase of Materials	1,94,000	-	Factory Rent	14,000	-
Bills Payable	-	14,000	Direct Wages	1,14,000	-
Capital	-	1,70,000	Octroi on Raw Material	22,000	-
Drawings	42,000	-	Creditors	-	50,000
Sundry Debtors	1,00,000	-	Selling Expenses	26,000	-
Provision for Bad Debts	-	6,000	Administrative Expenses	62,000	-
Discount allowed	8,000	-	Sales	-	6,20,000
Interest	14,000	-	Bad Debts	2,000	-
				8,60,000	8,60,000

Additional Information:

(a) Closing Stock: Raw Materials - ₹44,000, WIP - ₹25,000 and Finished Goods - ₹2,00,000

(b) Depreciation to be provided @ 5% on Machinery

(c) 25% of admin expenses pertain to factory

(d) Provision for doubtful debt is to be maintained @ 10%.

Q3. Malad Departmental Stores has three departments M, N and P. The following information regarding the departments is given below. You are required to prepare Departmental Trading and Profit and Loss Account.

Particulars	Department M	Department N	Department P
Opening Stock	60,000	60,000	1,20,000
Purchases	2,00,000	1,20,000	4,00,000
Sales	8,00,000	6,00,000	6,00,000
Closing Stock	40,000	80,000	80,000
Common Expenses			***Amount***
Rent and Rates			36,000
General Expenses			48,000
Discount allowed			60,000
Discount received			30,000
Sales promotional expenses			80,000
Commission received			20,000
Salesman salary			20,000

Additional Information:

1. Goods worth ₹16,000 were transferred from Department M to Department N at cost.
2. Allocated General Expenses and Rent and Rates equally among the three departments.
3. Commission received is to be divided in the ratio of 4:3:3, respectively.

(15)

OR

Q3 Prepare Departmental Trading and Profit and Loss Account for the two departments i.e. Magazines and Books for the year ended 31 March 2017. (15)

Particulars	Amount
Opening Stock	
Magazines	1,50,000
Books	50,000
Raw Materials Consumed	
Magazines plus Books	3,60,000
Wages	
Magazines	30,000
Books	60,000
Depreciation	
On Factory Equipment	32,000
On Building	16,000
Sales	
Magazines	9,00,000
Books	1,80,000
Closing Stock	
Magazines	1,20,000
Books	60,000

Common Expenses	Amount
Stores Consumed	90,000
Advertisement	15,000
Packing Expenses (Books)	6,000
Office Expenses	48,000

Additional Information:

1. Books department does not require any equipment.
2. Only 1/8th of building is occupied by Books department.
3. Divide office expenses in the ratio of 5:1.
4. Value of raw material used by Books Department is ₹20,000.
5. Divide stores consumed on the basis of raw materials used.
6. Advertisement expenses are to be apportioned appropriately.

Q4. From the following particulars, prepare stock ledgers by FIFO as well as Weighted Average method and also find out Cost of Goods sold by both the methods. (15)

Date	Transactions	Units	Rate per Unit
1 May 2017	Opening Stock	300	8.00
3 May 2017	Purchases	350	10.00
7 May 2017	Sales	450	-
11 May 2017	Purchases	550	7.00
15 May 2017	Sales	600	-
20 May 2017	Purchases	700	9.00
31 May 2017	Sales	600	-

OR

Q4. Calculate by FIFO and Weighted Average cost of inventory valuation, the cost of goods sold and Value of Closing inventory from the following data **(15)**

Purchases			Sales	
Date	**Units**	**Rate per Unit**	**Date**	**Units**
1 August 16	800	30	2 August 16	600
4 August 16	1000	40	7 August 16	800
9 August 16	1800	34	11 August 16	600
16 August 16	400	44	18 August 16	400
25 August 16	600	50	27 August 16	1,000
31 August 16	800	42		

Q5. On 1 January 2013, M/s. Congo Metals purchased one compressing machine from Hugo Machines and Spares Ltd. on Hire Purchase System. The cash price of the machine was ₹5,00,000. The firm paid ₹80,000 on aforementioned date while signing the agreement. The balance amount was to be paid in three annual instalments of ₹1,40,000 each excluding interest @ 5% p.a. commencing from 31 December 2013. The hire purchaser provided depreciation on machinery at 20% p.a. every year on reducing balance. With the help of these details, prepare the following accounts for the years ending 31 December 2013, 2014 and 2015.

In the Books of M/s. Congo Metals Ltd.	***In the Books of M/s. Hugo Machine and Spares Ltd.***
• Machine Account • Hugo Machines and Spares Ltd. Account	• M/s. Congo Metals Ltd. Account • Interest Account

(15)

OR

Q5. State in each of the following cases, whether the expenditure or receipt are capital or revenue.

1. ₹1,00,000 as travelling expenses were incurred for manager travelling to foreign for purchase of imported raw materials. **(2)**
2. ₹2,50,000 as wages paid to technical staff for erection of machinery. **(2)**
3. Cost of repainting factory shed amounted to ₹15,000. **(2)**
4. Security premium received for ₹90,000 on issue of 9% preference shares. **(2)**
5. Interest amounting to ₹4,500 was received on fixed deposits. **(2)**
6. Tax refund of ₹1,50,000 was received from Income Tax Department. **(2)**
7. A dealer in timber acquired wood worth ₹2,00,000 and made furniture out of it at a total cost of ₹4,20,000 and sold it to a customer for ₹4,50,000. **(3)**

Q6. Answer the following: **(20)**

1. 'Accounting Standards lead to rigidity and at times are being subsidised by law'. Comment.
2. What do you understand by unrealised profit? With the help of an example show how it calculated and accounted in the Departmental Accounting.

OR

Q6. Write short notes on any four of the following: **(20)**

1. Deferred Revenue Expenditure and its accounting treatment in Final Accounts
2. Concept of Hire Purchase
3. Manufacturing Account
4. Bases for allocating different expenses among departments
5. Substance over form
6. Cost of conversion

DIFFICULT LEVEL

Model Test Paper-2

F.Y.B.Com Semester-I

(New Question Paper Pattern as per Revised Scheme effective from 2016–17)

Accountancy and Financial Management-I

Based on Analyses of November 2016 and March 2017

[Time: 3 hours] **[Total Marks: 100]**

N.B.

1. Strictly avoid resorting to any unfair means during the examination and abide by all the rules and relating thereto.
2. Figures in bracket to the right indicate full marks allotted to the question.
3. Working notes should form part of your answers.
4. All six questions are compulsory, although, there are internal options in case of Questions 2 and 6.
5. Use of simple calculator is allowed.

Q1A. Fill in the blanks with the appropriate given options and rewrite complete sentences. (Attempt any 10) **10**

1. ____________ (Valuation of investment/Valuation of goodwill) is an accounting policy.
2. In a production-house producing textiles, ______________ method/s is/are used to ascertain cost of inventories. (FIFO/weighted average/specific identification)
3. Costs of designing customised products on special demand are __________ (included/excluded) in the cost of inventories.
4. Valuation of Closing Inventories = (Opening Stock + _________ − ________) × Weighted Average Price (Sales/Purchases/Total cost of inventory/Total number of units in inventory)
5. If an equity share of face value ₹10 is issued at ₹15, then the difference amount is ______ profit. (Capital/Revenue).
6. Lighting and Heating expenses can be allocated on the basis of ____________ (floor space covered/net sales) in absence of availability of electric meter reading.
7. Depreciation on Asset purchased under hire purchased system is provided by________. (hire vendor /hire purchaser)
8. In his Books, Hire Vendor debits Sales Account in Hire Purchaser's Account with ___________ on the date of purchase. (full cash price of asset/full hire purchase price)
9. Interest is calculated on __________. (outstanding cash price/outstanding hire purchase price)
10. In the order of permanency, Bills Payable is shown at the ______ (top-most/bottom-most) on the Liabilities side of Balance Sheet.
11. Prepaid expenses are shown on the ____________ (assets/liabilities) side of the Balance Sheet.
12. Insurance claim amount due from the Insurance Company on account of loss of stock due to fire is shown on the __________ (assets/liabilities) side of the Balance Sheet.

Q1B. State whether the following statements are TRUE or FALSE after rewriting the same. (Attempt any 10) 10

1. Prudence is one of the fundamental accounting assumptions.
2. Duty drawbacks and Rebates are deducted while calculating cost of purchases.
3. Government grants and subsidies are excluded from revenue recognition criteria.
4. Under Perpetual Inventory System, the weighted average price is calculated by considering all the purchases made during the accounting period.
5. Lawyer's fee to defend a case in Court is revenue expenditure, if the verdict is against firm's favour.
6. Office expenses are debited to General Profit and Loss Account on the basis of net sales of each department.
7. Under Instalment Sale System, a seller cannot sue buyer in case of any default of instalments.
8. Instalment amounts are treated as hire or rent charges.
9. Hire Purchase Price includes Cash Price.
10. Balance Sheet reveals the financial performance of a business during an accounting period.
11. Unearned income is shown on the Liabilities side of the Balance Sheet.
12. Old Bad Debt amount is deducted from the Debtors amount on the Assets side of the Balance Sheet.

Q2 Consider the following Trial Balance as on 31 March 2017 to prepare Manufacturing Account, Trading Account, Profit and Loss Account along with Balance Sheet.

Trial Balance

as on 31 March 2017

Particulars	Debit Amount	Credit Amount	Particulars	Debit Amount	Credit Amount
Opening Stock			Capital	-	17,00,000
Raw Materials	5,00,000	-	Sundry Creditors	-	1,04,000
Work-in-progress	1,60,000	-	Wages	1,66,000	-
Finished Goods	4,40,000	-	Factory Taxes	8,000	-
Purchase of Materials	4,30,000	-	Power	18,000	-
Building	3,00,000	-	Factory Insurance	10,000	-
Plant and Machinery	7,20,000	-	Salary to Staff	22,000	-
Furniture	80,000	-	Office Rent	21,000	-
Trade Marks	60,000	-	Carriage Inwards	5,000	-
Printing & Stationery	10,400	-	Sundry Debtors	1,65,000	-
Bank Charges	5,000	-	Discount	-	5,000
Travelling Expenses	20,000	-	Misc. Expenses	11,000	-
Discount	6,600	-	Bills Payable	-	68,000
Sales Return	22,000	-	Bills Receivables	32,000	-
Advertisement	11,000	-	Bank balance at	2,14,000	-
Sales	-	15,60,000	Bank of Baroda		
				34,37,000	34,37,000

***Additional Information*:**

1. Closing Stock: Raw Materials - ₹1,70,000, WIP - ₹60,000 and Finished Goods - ₹4,10,000
2. Factory tax prepaid - ₹4,000

3. Depreciation on furniture @ 10%, on Plant and Machinery @15%, on Trade Marks @20% and on Building @5% p.a.

OR

Q2. From the following information, prepare the Manufacturing Account, Trading and Profit and Loss Account of M/s. Diwakar Rai for the year ended 31 March 2017.

Particulars	Amount (₹)	Particulars	Amount (₹)
Opening stock of raw materials	2,000	General expenses	4,000
Advertisement expenses	15,000	Purchase returns	1,500
Carriage inwards	4,500	Coal	3,500
Carriage outwards	5,000	Interest paid on loan taken from Jai	500
Direct Wages	9,000	Salaries (paid for 10 months)	20,000
Sales	2,00,000	Interest received from bank	200
Purchase of raw material	1,00,000	Consumption of diesel	2,500
Provision for Doubtful Debts	5,500	Sale of scrap	4,500
Opening Stock of finished goods	15,000	Depreciation on machine	2,000
Sales returns	2,500	Depreciation on office furniture	1,500
Debtors	40,000	Opening stock of work-in-progress	2,300

Additional Information:

1. On 1 April 2016, loan of ₹1,00,000 was taken from Jai @ 10% p.a. interest.
2. During the year, bad debts amounted to ₹1,000 and new provision for doubtful debts is ₹1,500
3. Due to fire, goods worth ₹2,000 got destroyed. Insurance company accepted the claim of only 90% of the damaged goods.
4. Goods worth ₹4,000 were distributed as free samples.
5. Wages outstanding amount to ₹3,000.
6. Invoices of value ₹6,000 were recorded in the sales Book on 29 March 2017 but the goods were not dispatched till 7 April 2017.
7. Closing stock: Raw Materials - ₹3,500, Work-in-progress - ₹3,700, Finished Goods - ₹18,000.

Q3. Ramco and Co. has two departments Alpha and Beta. Department Alpha sells goods to Department Beta at 20% on sales. Using the following information, prepare Departmental Trading and Profit and Loss Account for the year ended 31 March 2017. Also, ascertain the net profit amount that is to be transferred to the Balance Sheet.

Particulars	Alpha	Beta	Common Expenses	Amount
Opening Stock	1,60,000	2,00,000	Salaries	3,00,000
Purchases	14,00,000	5,00,000	Bad Debts	45,000
Goods transferred to Beta	-	10,00,000	Miscellaneous Expenses	30,000
Wages	3,20,000	2,00,000	Advertisement	45,000
Travelling Expenses	2,80,000	20,000		
Closing Stock	3,60,000	10,000,000		
Sales	20,000,000	40,00,000		
Printing and Stationery	32,000	40,000		

Additional Information:

1. Depreciation to be charged @ 25% on Machinery value of ₹1,00,000 which was used by Beta Department.

2. Advertisement Expenses, Bad Debts are to be apportioned in the turnover ratio.
3. Salaries to be apportioned in 1:2 ratio.
4. Miscellaneous Expenses to be apportioned in 1:3 ratio.
5. 80% of closing stock includes goods supplied by Department Alpha to Department Beta. **(15)**

OR

Q3. Magnum Ltd. has two departments—Leather and Leather Bags. The Leather Bags are manufactured by the firm itself using the leather supplied by Leather Department at its usual selling price. Consider the following information to prepare Departmental Trading and Profit and Loss Account for the year ended 31 December 2016.

Particulars	Department Leather	Department Leather Bags
Opening Stock	6,00,000	1,00,000
Purchases	40,00,000	30,000
Sales	44,00,000	9,00,000
Transferred to Leather Bags	6,00,000	-
Expenses		
Manufacturing	-	1,20,000
Selling Expenses	40,000	12,000
Closing Stock	4,00,000	1,20,000

The stock in the Leather Bags Department may be considered as consisting of 75% Leather and 25% other expenses. The Leather Department earned Gross Profit at the rate of 15%. General Expenses amounted to ₹2,20,000. **(15)**

Q4. You are required to ascertain: Cost of Stock on hand as on 31 March 2017 under each of the following methods—(a) FIFO (b) Weighted Average Method

Value of opening stock on 1 January 2017 was 26,000 units at ₹10 per unit, other information are as under.

Date	Particulars
On 22 January	Sales of 12,000 units
On 28 January	Purchases (Carriage Inwards ₹3,000) 24,000 units @ ₹34 each unit
On 5 February	Sales of 14,000 units
On 25 February	Purchased (Carriage Inwards ₹2,000) 22,000 units @ ₹44 each units
On 31 March	Sales 28,000 units

(15)

OR

Q4A. Determine the value of stock to be taken for Balance Sheet of PQR Ltd. as on 31 March 2017 from the given information. The stock was valued on 25 March 2017 and was valued at ₹6,00,000. Between 25 March 2017 and 31 March 2017, following transaction had taken place:

1. Purchase of ₹1,30,000 was made, out of which 10,000 was Purchase return.
2. Out of goods sent on consignment goods worth ₹30,000 were unsold.
3. Sales were ₹1,80,000, these include goods worth ₹20,000 were sent on approval, still no confirmation has come yet.
4. Goods are sold at 25% on cost. **(7)**

Q4B. A trader prepared his accounts on 30 June 2016. Due to some unavoidable reasons, no stock taking could be possible till 15 July 2016. On which date, total cost of goods in his godown came to ₹80,000. Following transaction took place between 1 July 2016 and 15 July 2016:

1. The trader has received goods on consignment basis costing ₹15,000 in June, which remain unsold.

2. Purchases during this period as per purchase day Book ₹35,000. These purchases include goods worth ₹8,000 which were not actually received till date.
3. Sales during the period were ₹45,000 and returns from customer were ₹3,000.
4. There was overvaluation in stock costing ₹2,300 due to arithmetical error on 5 July 2016.
5. Goods are sold at 33.33% on Cost.

You are required to ascertain the value of inventory as on 30 June 2016. **(8)**

Q5. Srija Builders purchased a concrete grinder from JBC Ltd. on 1 January 2014. The cash price of the grinder was ₹3,72,500. However, Srija Builders opted for the purchase on the basis of Hire Purchase System on the following terms.

(a) Prompt down payment of ₹1,00,000
(b) Interest will be charged on balance amount @ 5%
(c) The balance amount to be payable in three equal instalments of ₹1,00,000 each.

You are required to calculate the amount of interest payable by Srija Builders at the end of each year. Also, prepare Interest Amount and Concrete Grinder Account in the Books of Srija Builders considering the rate of depreciation is 10% p.a. on the reducing balance of grinder. **(15)**

OR

Q5. How would you treat the following items while preparing Final Accounts?

1. A firm of estate brokers and dealers purchase premises at a cost of ₹10,00,000 and spent ₹50,000 for repairing and repainting it. **(3)**
2. Expenses incurred to prepare separate cabins: **(3)**
   i. Architect fees - ₹15,000
   ii. Wood purchased to create partition walls - ₹60,000
   iii. Labour cost incurred - ₹40,000
3. Due to excessive rain leakage, the building has to be repaired and repainted at a very heavy cost of ₹2,00,000 **(2)**
4. Furniture was sold for ₹10,000; original cost of furniture was ₹25,000. Provision for depreciation till the date of sale was ₹10,000. **(3)**
5. Municipal and water tax of ₹10,000 was paid during the year. **(2)**
6. Amount of ₹1,500 was spent on account of uniform of liftman and watchman. **(2)**

Q6. Answer the following: (20)

1. What is historical cost method? Explain the different methods followed under historical cost method with the help of numerical examples.
2. Explain how accounting is done in the Books of hire purchaser under full cash price method.

OR

Q6. Write short notes on any four of the following: (20)

1. Cost of Production
2. Concept of Revenue as per AS-9
3. Weighted Average Method of Inventory Valuation
4. Objectives of Departmental Accounting
5. Differentiate between Capital Receipts and Revenue Receipts
6. Fundamental Accounting Assumptions

CHECK YOUR ANSWERS

Model Test Paper-1

Q1(A) Fill in the Blanks

1-Council of ICAI	2-packaging cost	3-normal capacity	4-conservatism
5-Revenue	6-cost of production	7-no. of employees	8-Manufacturing Account
9-interest	10-cash price	11-Total Interest	12-Freight

Q1(B) True or False

True	False
3, 5, 6, 8	1, 2, 4, 7, 9, 10, 11, 12

Practical Questions

Q2 Total of Balance Sheet - ₹8,69,160 ***OR*** **Q2** Cost of Manufacturing - ₹3,74,500; Gross Profit - ₹4,05,500; Net Profit - ₹3,05,000 and Total of Balance Sheet - ₹4,97,000	**Q3** Gross Profit (M, N, P) - ₹5,96,000, ₹4,84,000, ₹1,60,000; Net Profit (M, N, P) - ₹5,20,334, ₹4,19,000 and ₹1,06,666 ***OR*** **Q3** Gross Profit (Magazines, Books) - ₹4,70,000, ₹1,40,000; Net Profit (Magazines, Books) - ₹2,86,500 and ₹1,16,500
Q4 COGS - ₹15,900, Valuation ₹2,250 (FIFO) COGS - ₹13,866, Valuation ₹2,184 (WAV) ***OR*** **Q4** COGS - ₹1,18,400, Valuation - ₹88,000 (FIFO), COGS - ₹1,24,470, Valuation - ₹81,936 (WAV)	**Q5** Depreciation - ₹1,00,000, ₹80,000, ₹6,40,000 Interest - ₹21,000, ₹14,000, ₹7,000 ***OR*** **Q5** Revenue Receipts - 5, 6 and Capital Receipts - 4, Revenue Expenditure - 1, 3 and Capital Expenditure - 2 7. Revenue Expenditure (₹4,20,000); Revenue Receipt - (₹4,50,000) and Revenue Profit - (₹30,000)

Model Test Paper-2

Q1(A) Fill in the Blanks

1-Valuation of investment	2-FIFO, Weighted Average	3-included	4- + Purchases, – Sales
5-Capital	6-floor space covered	7-hire purchaser	8-full cash price of asset
9-outstanding cash price	10-bottom-most	11-assets	12-assets

Q1(B) True or False

True	False
2, 3, 5, 7, 8, 9, 11	1, 4, 6, 10, 12

Practical Questions

Q2 Cost of Manufacturing - ₹11,71,000; Gross Profit - ₹3,37,000; Net Profit - ₹2,00,000 and Total of Balance Sheet - ₹20,72,000 ***OR*** **Q2** Cost of Manufacturing - ₹1,15,600; Gross Profit - ₹84,900; Net Profit - ₹26,000	**Q3** Gross Profit (Alpha, Beta) - ₹14,80,000, ₹14,00,000; Net Profit (Alpha, Beta) - ₹10,28,000, ₹10,25,000; Stock reserve - ₹3,94,640 ***OR*** **Q3** Gross Profit (Leather, Leather Bags)- ₹8,00,000, ₹1,70,000; Net Profit (Leather, Leather Bags) - ₹7,60,000, ₹1,58,000; Stock reserve - ₹3,150; General Profit- 6,94,850
Q4 ₹7,93,620 (FIFO) and ₹6,16,680 (WAV) ***OR*** **Q4 (1)** ₹6,42,000 **Q4 (2)** ₹67,200	**Q5** Interest for 2014 - ₹13,625; for 2015 - ₹9,306 and for 2016 - ₹4,569 ***OR*** **Q5** Capital Expenditure - 1, 2 and Revenue Expenditure - 3, 5, 6; 4 - Capital Receipt (₹10,000 sale of furniture) and Capital Loss (₹5,000)