Financial Accounting - I

Revised Fourth Edition

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Preface to the Revised Fourth Edition

Firstly, we would like to thank our readers for the overwhelming support they've shown for the last ***three*** editions of this book. Throughout this book we have tried to give students a thorough knowledge of the techniques of financial accounting. This book has been structured keeping in mind the ***latest CBCS syllabus prescribed by University of Calcutta w.e.f. 2017-18***. This book has been designed and written exclusively for students appearing for their B.Com Semester-I examination.

Considering the changing students' need and valuable feedback from our readers, we have undertaken a considerable restructuration of the book especially in terms of pedagogical aspect.

- Every chapter has been supplemented with adequate number of solved examples, which have been presented in the ascending order of the difficulty level. We believe this will ensure a smooth learning experience to our readers as they transit from beginning to the end of the chapter.
- The in-chapter solved examples are then followed by ***Previous Years' C.U. Question Papers (with solutions)***. This section is further segregated as- 'For General Course Students' and 'For Honours Course Students'. These questions will enable students to assess the kinds of questions asked in the university exams and will also help them in evaluating their conceptual understanding.
- Lastly, an exclusive section '**Special Problems**' has been dedicated for the advance learners. This section includes questions that are more challenging and of higher order of difficulty.
- Considering the weightage assigned to the theory portion in the university question papers, we have added an exclusive section '**Suggested Answers of Short Questions**' at the end of the book. The answers to the theoretical questions from the previous 7 years' (2011 to 2017) C.U. Question Papers.

New to the Edition

As per the 2017-18 CBCS syllabus prescribed by University of Calcutta, the following two chapters are exclusive to the current edition.

- **Chapter-13: Introduction to Accounting Theory**
- **Chapter-14: Introduction to Accounting Standards**

Secondly, with the withdrawal of AS-6: Depreciation Accounting and amendments in AS-10: Property, Plant and Equipment, there was a need to revise the **Chapter-9: Depreciation Accounting**. Accordingly, there has been a thoroughly revision of this chapter considering the latest amendments in AS-10.

A number of colleagues, friends and students helped us in the preparation of this book. We thank each and every one of them.

Utmost care has been taken to make it an error free book, but if you still find any errors please email us at *pmhanif@gmail.com* . All suggestions are welcome.

We specially thank Mr. S. Rangarajan for typesetting and formatting this book.

AUTHORS

Preface to the First Edition

Many changes are forthcoming in the field of accounting. To keep students abreast with all such changes taking place worldwide, different universities of India are changing the coment of the undergraduate syllabus continually in a consistent manner.

In the past an accountant's job was to report past events, however, nowadays an accountant has to take more proactive role in providing and interpreting both financial and non-financial information about the organization's workflow. Still thorough accounting knowledge is of vital importance for students as well as professionals. Throughout this book, we have tried to give students a thorough knowledge in the techniques of financial accounting.

The book has been designed in accordance with the latest syllabus of the University of Calcutta. Utmost care has been taken to balance the book well, with text and problems. We have included numerous fully solved problems, interspersed within the text. In addition, a variety of chapter and exercises have been provided for the benefit of the users of this book. Special emphasis has been given to the problems set for various university question papers till 2009. More than 500 solved problems and 300 exercises have been incorporated into this text. In addition to that, more than 200 multiple choice questions have been added to help students clear every concept thoroughly.

AS-2, ***Valuation of Inventories*** and AS-9, ***Revenue Recognition***, have been dealt with as per the requirements of the syllabus.

Utmost care has been taken to make it an error free book. Still, if the readers find any errors, they may write to the authors at pmhanif@gmail.com. All suggestions for further improvement in the book are also welcome.

We thank Mr. S. Rangarjan for typesetting and formatting this book. Our students have always been a source of inspiration and happiness. They never cease to raise good points. We have tried to incorporate all such points in this book.

We especially thank Master M.H. Kabir for mapping the newly designed rupee symbol "₹" throughout this book.

AUTHORS

Syllabus

Calcutta University

CC 1.1 Ch: FINANCIAL ACCOUNTING – I

Unit	Topic	Details	Marks allotted	Where you can find in the Book
1	Introduction	• Nature of accounting; Users of accounting information; Qualitative characteristics of accounting information • Double entry book keeping system – Basic accounting equation, meaning of assets, liabilities, equity, revenue and expenses • Accounting cycle – Recording of transactions, journal, ledger and preparation of Trial Balance. • Bases of accounting; cash basis and accrual basis. • Basic concepts and conventions: entity, money measurement, going concern, cost, realisation, accruals, periodicity, consistency, prudence (conservatism), materiality, matching and full disclosures.	5	Chapter 1 Chapter 2 Chapter 3 Chapter 4 Chapter 5 Chapter 6
2	Concepts for Determination of Business Income	• Revenue recognition: Meaning of revenue; objective; timing of recognition. Recognition of expenses. • Inventories: meaning. Significance of inventory valuation. Lower of cost or market value rule; Inventory ascertainment and reconciliation.	15	Chapter 7 Chapter 8
		• The nature of depreciation. The accounting concept of depreciation. Factors in the measurement of depreciation. Methods of computing depreciation: straight line method and diminishing balance method; Disposal of depreciable assets; change in estimate and method of charging depreciation. Accounting for depreciation: Asset-depreciation, Asset-provision. • Reserves and provisions: Meaning; Objective; Types & Accounting		Chapter 9 Chapter 10
		• Capital and revenue expenditures and receipts: general introduction only. • Adjustment and rectification		Chapter 11 Chapter 12

3	Introduction to Accounting Theory	Concept of accounting theory, relation with practice; GAAP, Capital — Capital maintenance concepts. Limitations of Historic Cost accounting, Introduction to Fair Value accounting.	10	Chapter 13
	Introduction to Accounting Standard	Financial accounting standards: concept, benefits, procedure for issuing accounting standards in India. Need for a global standard, IFRS (concept only).		Chapter 14
4	Final Accounts of Trading Concern	Preparation of financial statements: of sole proprietorship business entities from a trial balance – Manufacturing, Trading, P/L A/c and Balance Sheet	15	Chapter 15 Chapter 16
5	Financial Statement of Incomplete Records and of NPO	Preparation of financial statements: a) from incomplete records b) of non-profit organisation	10	Chapter 17 chapter 18
6	Accounting for Special Sales Transaction	• Consignment: Basic features; difference with sales. Recording in the books of Consignor – at cost & at invoice price, Valuation of unsold stock; Ordinary commission. Treatment and valuation of abnormal & normal loss. Special commission; Del credere commission (with and without bad debt) - use of Consignment Debtors A/c. Recording in the books of Consignee • Accounting for sale on approval	25	Chapter 19 Chapter 20 Chapter 21 Chapter 22
	Sectional and Self Balancing Ledger	• Concept of sectional balancing, preparation of control accounts. Self balancing Ledger: advantages; Recording process; preparation of Adjustment accounts.		
	Insurance Claim for Loss of Stock and for Loss of Profit	• Loss of stock: Physical & ownership concept; concept of under-insurance and average clause; computation of claim – with price change; consideration of unusual selling line; price reduction etc. • Loss of profit: Concept – insured & uninsured standing charges, GP rate, short sales and increased cost of working, average clause and computation of claim (simple type)		
		TOTAL	**80**	

Brief Contents

Contents

1

Introduction to Accounting

Meaning of Accounting

Accounting may be defined as the process of collecting, recording, summarising and communicating financial information. Accounting is an art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.

Accounting Principles Board (APB) defines accounting in the following words : '***Accounting is a service activity. Its function is to provide quantitative information primarily financial in nature, about economic entities that is intended to be useful in making economic decisions in making reasoned choices among alternative courses of action. Accounting includes several branches, e.g., financial accounting, managerial accounting and government accounting***'.

Accounting accumulates, measures and communicates numbers and measurable quantities of economic information about an enterprise. Accumulation refers to recording and classifying data in journals and ledgers.

Measurement refers to the quantification of business transactions that have occurred, or that may occur. Communication refers to supply of reliable information to users of accounting information.

Objectives of Accounting

The objectives of accounting are :

(i) To keep a systematic record of financial transactions that affect the business enterprise.

(ii) To ascertain the profits earned or losses incurred by the business unit during a particular accounting period.

(iii) To ascertain the financial position of the business unit at the end of the accounting period.

(iv) To exercise control over business assets and properties.

(v) To facilitate business decision-making.

Advantages of Accounting

The advantages of accounting are :

(i) It provides information useful for making economic decisions.

(ii) It serves primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal sources of information about an enterprise's economic activities.

(iii) It provides information useful to investors and creditors for predicting, comparing and evaluating potential cash flows in terms of amount, timing and related uncertainty.

(iv) It supplies information useful in judging the management's ability to utilise enterprise resources effectively in achieving primary enterprise goals.

(v) It provides factual and interpretative information about transactions and other events which are useful for predicting, comparing and evaluating the enterprise's earning power.

Limitations of Accounting

The limitations of accounting are :

(i) Accounting is historical in nature, it does not reflect the current financial position or worth of a business.

(ii) The Profit and Loss Account tends to match current revenues with historical costs (expenses) rather than current costs.

(iii) Accounting statements do not show the impact of inflation.

(iv) The Profit and Loss Account does not reflect those increases in net asset values which are not considered to be realised.

(v) Accounting principles are not static —alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data.

Meaning of Book-keeping

Book-keeping is an activity concerned with the recording of financial data related to business operations in a significant and orderly manner. Book-keeping is the record-making phase of accounting. Accounting is based on a careful and efficient book-keeping system.

The main purpose of accounting for business is to ascertain profit or loss for the accounting period. In an accounting period, there may be numerous financial transactions involved in the business. Without a proper method of recording transactions, it is not possible to remember the various financial receipts and payments taking place during a period of time.

The essential idea behind maintaining book-keeping records is to show correct position regarding each head of income and expenditure. A business may sell goods on credit as well as in cash. When the goods are sold on credit, a record must be kept of the person owing money. The owner of the business may like to know, from time to time, what amount is due on credit sales and from whom.

Likewise, a business makes several payments on account of various expenses at regular intervals. If proper record is not maintained, it is not possible to get details of the transactions in regard to the expenses.

At the end of the accounting period, the owner wants to know how much profit has been earned or loss has been incurred during the course of the period. For this, a lot of information is needed which can be gathered from a proper record of the transactions. Therefore, book-keeping, the proper maintenance of books of account, is indispensable for any business.

The main objectives of book-keeping are to :

1. have a permanent record of each transaction of the business and to show its financial effect on the business.
2. ascertain the combined effect of all the transactions made during an accounting period upon the financial position of the business as a whole.

Accountancy and Accounting

The word 'accountancy' signifies, more or less, a branch of knowledge, which may be referred to as a subject of study. Accountancy is often used merely as a substitute for accounting, but it is technically incorrect. Accountancy is the activity of preparing the financial records and statements of organisations. Accounting is the subject of the process of recording and analysing financial information so as to maximise the value of the information produced. Accountancy is the art, occupation or profession of the accountant, whereas accounting refers to the process or system of accounting. Although accountancy may refer to the entire aspect of theory and practice, it is less frequently used. On the other hand, accounting is the practical application of those principles and techniques, contained in the broad framework of accountancy with preferred usage.

From the above, it can be observed that while accounting is mainly the application of the theory, accountancy covers the dual aspect of theory and practice. Therefore, accountancy is a whole of which accounting is a part.

Distinction between Book-keeping and Accounting

Book-keeping should not be confused with accounting. Persons with little knowledge of accounting may fail to understand the difference between book-keeping and accounting. Therefore, it is useful to make a distinction between the two. Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by book-keeping records. Book-keeping is a small part of the field of accounting and probably the simplest part, just as arithmetic is a small part of the broad discipline of mathematics.

The main distinction between the two is that where book-keeping is the ***recording*** phase, accounting is concerned with the ***summarising*** phase of an accounting system. Therefore, the process of accounting begins where the book-keeping process ends. Accounting includes not only the maintenance of accounting records, but also the preparation of the following two financial statements:

1. Trading, and Profit and Loss Account. (How well did the business do during an accounting period ?).
2. Balance Sheet. (How does the business stand on the last day of the accounting period ?).

The ***distinction between the two*** are as follows :

	Book-keeping		Accounting
1.	It is the recording phase of an accounting system.	1.	It is the summarising phase of an accounting system.
2.	It is the basis of accounting.	2.	It is the basis for financial data.
3.	Persons responsible for book-keeping are called book- keepers.	3.	Persons responsible for accounting are called accountants.
4.	It does not require any special skill or knowledge.	4.	It requires special skill and knowledge.
5.	Personal judgement of the book-keeper is not required.	5.	Personal judgement of the accountant is essential. ***For example***, at the time of making provision for bad debts, personal judgement is necessary.
6.	Financial statements are not prepared from book-keeping records.	6.	Financial statements are prepared from accounting records.
7.	It does not give the complete picture of the financial condition of the business unit.	7.	It gives the complete picture of the financial condition of the business unit.
8.	It does not help in complying with legal formalities.	8.	Legal formalities can be complied with the help of accounting.
9.	It does not provide any information for taking managerial decisions.	9.	It provides information for taking managerial decisions.
10.	It has no branch.	10.	It has several branches, e.g., financial accounting, cost accounting, management accounting, etc.

Evolution of Accounting

No social study has ever been static—it has always evolved. Necessarily, the present-day shape and contents of accounting are a product of history.

The origin of accounting as a social study can be traced back to very ancient days. Indeed, it is as old as the beginning of the use of money itself. Even under the barter system, some primitive form of accounting existed. For, otherwise, how could loss and gain have been calculated? The object of gain has always been the driving force of any exchange and this gave birth to the need for accounting.

But, till the 13th century, the mode of keeping accounts was primitive. Books of business were no more than mere note book transactions. A French merchant wrote in his book: 'Lent 10 gold coins to a man last year, I forgot his name'. In Europe, calculations were made largely in Roman numerals, and sums were very often wrong. Long divisions were regarded as something of a mystery, and the use of zero was not clearly comprehended.

Is it surprising, therefore, that a system of accounting, as we know, could not have been developed? However, it did develop in the fifteenth century and its genesis can be traced to Double Entry Bookkeeping which is said to have been fashioned by ***Fra Luca Pacioli*** (about 1445 – 1520), the multi-talented mathematician and philosopher of Venice. His treatise ***Summa De Arithmatica, Geometrica, Preportioni at Preportionalita*** was published in 1494. (However, ***Pacioli*** is not regarded as the inventor of the system; he is said to have just collated the different aspects of it in a comprehensive tract).

Of course, for a considerable time, the Double Entry System remained ignored in Europe; the people thereof continued following what is called *Stewardship Accounting*, the method of keeping accounts of household expenses followed by stewards. (In our country, it may be called the *munim* system of accounting. For it was the *munims* who kept accounts of big households).

When, with the advent of joint stock companies, ownership was separated from the management, the idea of financial accounting based on the Double Entry Principle came to be recognised and was valued as a principle of action. The shareholders' and others' interests were to be safeguarded; they were to be acquainted with the performance of the companies. The need was statutorily recognised, and there emerged as an information system for the investors and others such statements as Balance Sheet, Profit and Loss Account, etc. By and by, the dimension of this financial information system expanded and it came to be all-pervasive.

Since business and other concerns operate in the social setting, evolution of accounting could not come to a halt just at providing information to the investors and managers alone. Social cost as well as social benefit had to be assessed. This brought into being social accounting, an important adjunct to the system of measuring and assessing. *Economic activities*, which in economic parlance, are described as 'activities performed for making a living', and which again, in money-economy are nothing other than money-earning and money-spending activities.

Subfields of Accounting

1. Financial Accounting

Financial accounting is that part of accounting which is mainly concerned with the historical, custodial and stewardship aspects of external reporting to shareholders, government and other users of accounting information outside the business entity.

Financial accounting emphasizes the stewardship aspects of accounting rather than the control or decision-making aspects of accounting. It is the recording and processing of financial data affecting the business unit, which relates to the past and is generally for one year. The end-product of financial accounting is the Profit and Loss Account for the period ended (which shows the profit earned or losses incurred) and the Balance Sheet as on the last day of the accounting period (which shows the financial position). The preparation of the financial accounting is based on generally accepted accounting principles enunciated by the accounting profession and is heavily constrained by legal regulations and accounting standards.

2. Cost Accounting

Cost Accounting is primarily concerned with the cost to produce goods and services. Cost accounting applies the principles of accounting in such a manner that it is possible to have a detailed recording and analysis of expenditures incurred in connection with the operation of any business, e.g., manufacturing, administration or selling, or the production of an article so that it is able to measure performance and control activities.

Cost accounting is made up of the following :

(1) Mechanics of cost keeping, i.e., routines followed in reducing and classifying expenditures.
(2) Analysis of costs to measure managerial efficiency.
(3) Installation and supervision of cost systems.

3. Management Accounting

Any form of accounting which enables a business unit to be conducted more efficiently can be regarded as management accounting. Management accounting is that part of accounting which is concerned, mainly with internal reporting to the managers of a business unit. It relates to planning, control and decision-making which is useful to the management in the discharge of its functions. Thus, it emphasizes the control of decision-making aspects of accounting, which is tailor-made to suit the needs of the management of a specific enterprise, rather than stewardship aspects of accounting. Management accounting is 'forward-looking' and generally includes cost accounting and budgeting. The preparation of management accounting is not based on generally accepted accounting principles and is relatively free of constraints imposed by legal regulations and accounting standards. Therefore, management accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and the day-to-day operation of an undertaking. The technique of accounting is of extensive importance as it works in the most nearly universal medium available for the expression of facts so that facts of great diversity can be presented in the same picture. It is not the presentation of these pictures that is the function of management but the use of them.

4. Social Accounting

Social accounting is a branch of accounting which attempts to measure the social benefits that an organisation provides and the social costs that an organisation imposes. Social accounting is not a new method of keeping books of account, but a concept based on evaluating the costs and benefits relating to socially responsible actions by business enterprises. Both social cost and social benefit arise from externalities. Externalities are the benefits or costs which are not received or borne by the business unit responsible for them. Social costs as well as social benefits are a function of social perception of what is bad or good about business activity.

5. Human Resource Accounting

Human resource accounting is the accounting for the human resource of an enterprise. It is the process of identifying and measuring data about human resources and communicating this information to interested parties. Human resource accounting is, therefore, accounting for people as organisational resource. It is an act of identifying, measuring and evaluating the worth of human resources of an enterprise in a systematic manner to the organisation and to society as a whole, and recording these in a significant manner in the financial statement for presenting the information to the various users and to communicate their worth with changes over the period as also results obtained from their utilisation to those users.

6. National Accounting

National accounting is the accounting of the transactions of a national economy, as distinct from those of entities in sectors of the economy, i.e., business enterprises and public authorities. National accounting is not based on generally accepted accounting principles. It has been developed by economists and statisticians and, therefore, data for national accounting must be collected from non-accounting sources.

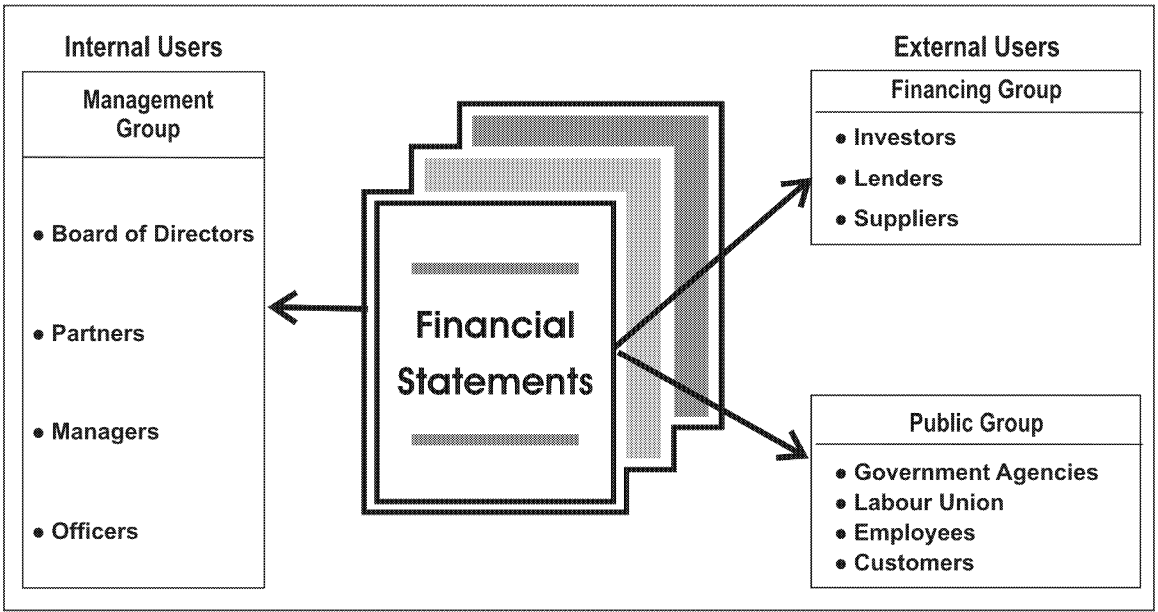
Distinction between Financial Accounting and Management Accounting

	Financial Accounting		Management Accounting
1.	It is primarily for external purposes.	1.	It is primarily for internal purposes.
2.	It records what has happened based on past transactions in a true and fair manner.	2.	It provides information which is used to take decisions about the future.
3.	It is heavily constrained by legal regulation and accounting standard.	3.	It is relatively free of constraints imposed by legal regulation and accounting standards.
4.	It must comply with statute and generally accepted accounting principles.	4.	It is tailored to suit the needs of the users.
5.	It emphasizes on the type of expenses.	5.	It emphasizes on the products, processes and departments.
6.	It emphasizes the stewardship aspect of accounting.	6.	It emphasizes the control or decision-making aspects of accounting.
7.	It provides an overall view of the business enterprise.	7.	It gives a detailed analysis of all aspects of the business unit.

Users of Accounting Information

Accounting information is needed by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.

The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.



Investors : They supply the risk capital to the business unit. Ownership is separated from management in joint stock companies, hence, investors need to know how their money is being spent by the managers.

Financial information helps them to decide about (a) making investments, (b) quantum of investment, and (c) holding on to the equities they own.

Lenders : Accounting information provides them with reasonable assurance as to the payment of interest and repayment of the principal.

Suppliers : They normally sell on credit and they must have reasonable assurance that their credit will be honoured. Financial information helps them to decide about the credibility of the firm, and whether they should continue supplying on credit.

Customers : They are a composite group, consisting of (a) producers at every stage of processing, (b) wholesalers and retailers and (c) the final consumers. Producer at the next stage of processing must be assured of the input which they obtain from the concern in question. The wholesalers and retailers must also be sure about the uninterrupted supply of materials. Otherwise, they will be hesitant to stock it. The ultimate consumer is interested in the continuous availability of the product. Should he come to think that the availability may be disrupted or stopped, he will shift his preference for another variety or brand. In all these kindred decisions, accounting information has a significant role to play.

Government agencies : Any economy of the day is, in a way, controlled and regulated by the political authorities, i.e., the government. Consequently, government agencies rely on the financial information for permitting expansion or contraction of business, for import and export of products and/or materials, for allocation of essential resources for regulating labour or taxation, etc.

Public : For members of the public the financial information is of the nature of a health examination report — it tells them about employment opportunities and general growth in the individual concern and the economy as a whole.

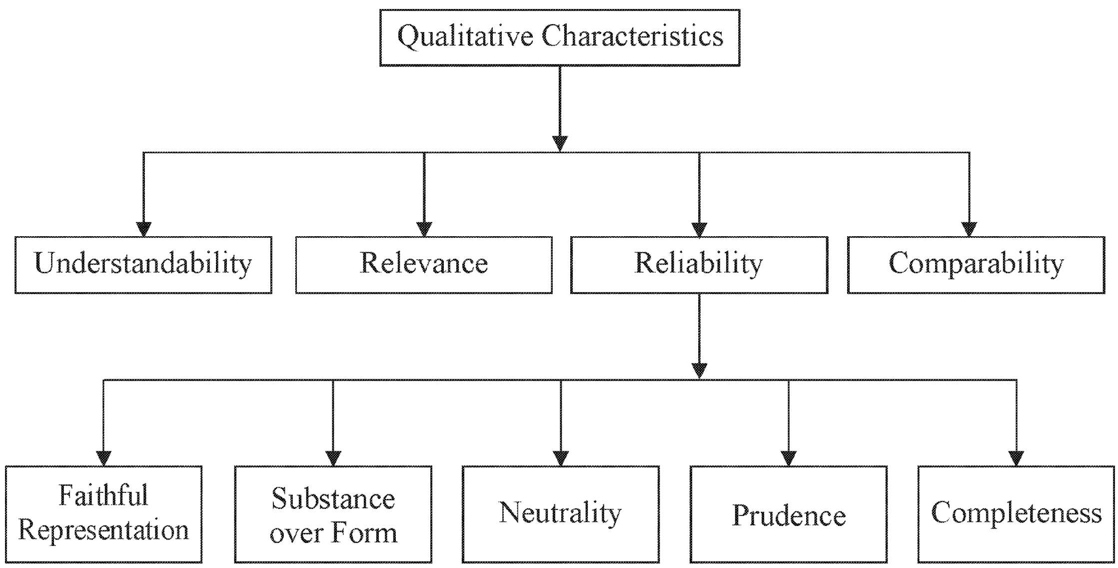
Employees : The employees of the concern are interested in the financial information because both, their present and future are tied up with the company's fortunes.

Thus, financial information serves diverse interests. Hence, the information should be gathered and disseminated in a way that benefits each interest. Information should not be biased and should not supress facts or suggest anything false.

Qualitative Characteristics of Financial Statements

Accounting information must possess some qualitative characteristics. These are the attributes that make the information provided in the financial statements useful to users. The ***four*** main qualitative characteristics are:

(1) Understandability;
(2) Relevance;
(3) Reliability; and
(4) Comparability.



Understandability

Understandability is the quality of accounting information that enables users to perceive its significance, i.e., to understand the content and significance of accounting statements and reports. If a user cannot understand the accounting information given to him, it is not useful, even though it may be relevant to whatever decision he wants to make. To have the characteristics of understandability, accounting information must be presented in a manner that users can understand, i.e., it must be expressed in terminology that is understandable to theusers. Now-a-days, business activities and transactions have become increasingly complex. It may not always be possible to describe complex transactions in simple terms. It is, therefore, necessary that the users of the accounting information must attain a minimum level of competence in understanding the terminology used in accounting statements. It is assumed that the users have a basic knowledge of business accounting, and they will spend some time and effort in studying the accounting statements. However, the accountant has a basic responsibility to describe business transactions clearly and concisely.

Relevance

Accounting information must be relevant to the user. Information is relevant if it meets the needs of the user in decision-making. Relevance is *defined* in terms of the ability to affect a decision-maker's course of action, because whether a particular set of accounting information is relevant or not depends on the specific decision-maker's objectives. Thus, for information to be relevant, it must have some bearing on the decision being made. Relevant accounting information should be capable of making a *difference* in a decision by helping users of accounting information to form predictions about the outcomes of past, present and future events. The decision *not* to modify or correct previous actions is a very important one. Financial information which does not have relevance to users is worse than no information at all, i.e., any information does not connote utility if it is not relevant to the purpose. To be relevant, it should be capable of monetary computation.

Reliability

Accounting information should be reliable. Reliability is the characteristic of accounting information which gives the user confidence and trust that the reported information is a reasonable representation of the actual items or events that have occurred. To be reliable, the accounting information should be error-free and neutral — an accountant's bias must not colour his information. The other subsidiary qualities which make information reliable are as follows :

Faithful representation : Information must faithfully represent the effects of transactions and other events. If the information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

For example, X Ltd has purchased a building for their sales office. The rights and beneficial interest in the property have been transferred but the documentation and legal formalities are pending. It is to be shown in the financial statement as own property though legally it has not been transferred in the name of X Ltd.

Substance over Form : The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form. In accounting, substance should normally take *precedence* over form in deciding how a particular transaction should be recorded. The legal form of a transaction is frequently descriptive of its economic substance. However, the form occasionally misrepresents the characteristics that are relevant to users. If the substance can be reliably determined, the accountant should describe the transaction in terms of the substance rather than the form. Accounting for hire-purchase transactions, for example, is based on the above concept, i.e., it looks at the substance of the transaction rather than its legal form. The hire-purchaser can record the asset at its cash down price, while paying for it by instalments over an agreed period of time.

Neutrality : Judgement is required in arriving at many items in the financial statements. Judgement is involved in valuing stock, determining the amount of doubtful debts, etc. Neutrality means that these judgements are made without any bias.

Prudence : Caution must be exercised while preparing financial statements and estimating the outcome of uncertain events. For example, collectability of receivable, the warranty claims that may occur etc. However, this does not mean, that the approach should be over cautious. The aim should be to report most likely outcome, with a reasonable element of caution. The financial statements must not be prepared on the most optimistic basis.

Completeness : The information in the financial statements must be complete within the bounds of materiality and cost.

Comparability

Usefulness is enhanced if accounting information can be compared with similar information for the ***same organisation*** at different times, and for ***different organisations*** at the same time. Comparability enhances the value of accounting information by enabling the users to discern and detect similarities and the dissimilarities among different concerns as also in respect of the same concern over time. Absoluteness of the information is not of much use — it is the comparability that lends itself to proper decision-making. Whether one is doing well or not is not the enquiry; the enquiry should be whether one is doing better or more (or worse) than others or than in other periods. To achieve comparability, consistency and disclosure of accounting policies are necessary.

Key Points

- Accounting is a service activity. Its function is to provide quantitative information primarily financial in nature, about economic entities that is intended to be useful in making economic decisions in making reasoned choices among alternative courses of action. Accounting includes several branches, e.g., financial accounting, managerial accounting and government accounting.
- The **objectives of accounting** are :
  (i) To keep a systematic record of financial transactions that affect the business enterprise.
  (ii) To ascertain the profits earned or losses incurred by a business unit during a particular accounting period.
  (iii) To ascertain the financial position of the business unit at the end of the accounting period.
  (iv) To exercise control over business assets and properties.
  (v) To facilitate business decision-making.
- Book-keeping is an activity concerned with the recording of financial data related to business operations in a significant and orderly manner. Book-keeping is the record-making phase of accounting. Accounting is based on a careful and efficient book-keeping system.
- Accounting information is a *statement* which provides quantitative information about the effect of transactions and other events on an accounting entity. Accounting information is used for predicting, comparing and evaluating the earning power and financial position of a business enterprise. It also serves the needs of the users who rely on accounting statements as their principal source of information for decision-making.
- Accounting information is required by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.

THEORETICAL QUESTIONS

1. Define accounting and discuss its functions.
2. What are the characteristics of modern accounting ?
   State the advantages and limitations of accounting ?
3. What are the objectives of accounting ?
4. Who are the users of accounting information ? Why do they need information ?
5. What are the qualitative characteristics of accounting information ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Which of the following is / are a sub-field(s) of accounting ?
   A financial accounting
   B cost accounting
   C management accounting
   D all the above
2. Which of the following is not an internal user of financial statement ?
   A board of directors
   B managers
   C officers
   D lenders
3. Accounting information must possess some qualitative characteristics. For example,
   (i) reliability (ii) relevance (iii) understandability
   Which of the above is / are correct ?
   A (i) and (ii) only
   B (i) only
   C (ii) and (iii) only
   D all the above
4. Which of the following is not an external user ?
   A investor **B** government agencies **C** partners **D** labour union
5. Which of the following is true ?
   A Accounting is the recording phase of past happening
   B Accounting reflects the current financial position or worth of a business
   C Accounting statements always present comparable data
   D Accounting statements show the impact of data
6. Which of the following is true ?
   A Human resources accounting is the accounting for the human resources of an enterprise that are included in the financial statements
   B Social responsibility accounting is the reporting of cost and benefits relating to socially responsible actions by business enterprises
   C Cost accounting is a division of financial accounting
   D Financial accounting is not concerned with external reporting
7. Which of the following is an advantage of accounting ?
   A accounting provides information useful for making economic decisions
   B accounting provides comparable data for comparison
   C accounting proivides information useful for predicting uncertainty
   D accounting information is useful in judging managements' ability
8. Which of the following is not a limitation of accounting ?
   A accounting information is historical in nature
   B accounting information does not show the impact of inflation
   C accounting reflects those increases in net assets that are realised
   D accounting information must possess some qualitative characteristics

Guide to Answers

Multiple Choice

1. D 2. D 3. D 4. C 5. A 6. B 7. B 8. D

2

Double Entry System

Introduction

Double entry is an almost universally used system of business record keeping. It is a system of recording business transactions which recognises that each transaction has a dual aspect. It is so named because the principles of double entry book-keeping are based upon every transaction having two aspects or two parts, i.e., two accounts are always affected by each transaction. Under this system, each transaction is seen as a flow of value from one account to another. The receiving account is debited with the amount and the giving account is credited. Therefore, every debit has an equal and offsetting credit.

If only two accounts are affected (as in the purchase of building for cash), one account, Building is debited and the other account, Cash is credited for the same amount. If more than two accounts are affected by a transaction, the sum of the debit entries must be equal to the sum of the credit entries.

Features of Double Entry System

(1) This method records both aspects of each transaction.
(2) Under this system, equal debit and credit entries are made for every transaction in two different accounts.
(3) Under this system, all transactions are recorded fully.
(4) Under this system, it is possible to prepare a Trial Balance and check the arithmetical accuracy of the books of account because it records all transactions in full.
(5) Under this system, profit / loss can be found out by showing in detail the expenses and incomes.
(6) Under this system, Balance Sheet can be prepared in detail.

Advantages of the Double Entry System

(1) A complete record of all the transactions relating to a business unit are maintained systematically.
(2) The financial position of the firm can be ascertained.
(3) The arithmetical accuracy of the books of account can be ensured.
(4) Location and rectification of errors are possible.
(5) The system can be applied to any form of organisation.
(6) Consistency can be maintained in the books of account, which help make a comparative study of current year's figures with those of the previous year(s).

(7) The profits earned or losses suffered for an accounting period can be ascertained.
(8) Amount due to suppliers and due from customers can be easily ascertained.
(9) The amount of cash balance available at any point of time can be ascertained.
(10) It helps take managerial decisions.
(11) Greater control over the affairs of the business can be exercised and, thereby, frauds and misappropriations can be minimised.
(12) The business transactions do not get mixed up with private transactions of the owner(s).

Disadvantages of the Double Entry System

(1) This system adopts money as its basic unit of measurement. But money is an inelastic yardstick for measurement.
(2) Many important events cannot be recorded in the books of account simply because they cannot be expressed in monetary terms.
(3) Transactions are all historical records and not future probabilities.
(4) If any transaction is not recorded at all in the books of account, it may remain undiscovered.
(5) If the amount of a transaction is wrongly recorded in the books of original entry, it is difficult to detect the error.
(6) A compensating error may also remain undetected.
(7) This system requires personal judgement of the accountant.
(8) This system is not suitable for small businesses where the owner(s) can directly control the affairs of the business.

Accounting Equation

The accounting equation is the basis for double entry system of accounting. Total assts of the business unit are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of the business are equal to total liabilities. Liabilities to the outsiders are known as liabilities but liability to the owners, in accounting, is referred to as 'capital'.

The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

Total Assets = Total Liabilities
OR
Total Assets = Liabilities + Capital
OR
Total Assets – Liabilities = Capital

Assets and liabilities are two independent variables and capital is the dependent variable, for it is the difference between assets and liabilities. A transaction may affect either both sides of the equation by the same amount or on one side of the equation only, by both increasing or decreasing it by equal amounts and thus netting to zero. An increase in an asset, without a corresponding increase in liability or a corresponding decrease in another asset, must represent an increase in capital. Conversely, an increase in liability without a corresponding increase in asset, or a corresponding decrease in another liability, will indicate a decrease in capital.

Concept of Debit, Credit and Duality

The rules of Debit and Credit are as follows :

1. **Debit** : Any ***increase*** on the ***left hand side*** of the equation
2. **Credit** : Any ***decrease*** on the ***left hand side*** of the equation.
3. **Debit** : Any ***decrease*** on the ***right hand side*** of the equation
4. **Credit** : Any ***increase*** on the ***right hand side*** of the equation.

Illustration 1

(a) If the liabilities of a business is ₹ 75,000 and the capital is ₹ 85,000. Find out the total assets.
(b) A business has assets of ₹ 54,321 and owner's equity is ₹ 34,215. What is the amount of liability?
(c) Cash ₹ 10,000; Stock ₹ 15,000; Building ₹ 10,000; Machinery ₹ 1,80,000; Debtors of ₹ 45,000 and Creditors ₹ 27,500. Ascertain the capital.

Solution

(a) Total Assets – Liabilities = Capital
or, Total Asset = Capital + Liabilities
∴ Total Assets = ₹ (85,000 + 75,000) = ₹ **1,60,000**.

(b) Assets – Liabilities = Capital (Owner's equity)
or Assets – Capital = Liabilities
Therefore, liabilities = ₹ (54,321 – 34,215) = ₹ **20,106**.

(c) Assets – Liabilities = Capital
or Capital = (Cash + Stock + Building + Machinery + Debtors) – Creditors
(₹ 10,000 + ₹ 15,000 + ₹ 10,000 + ₹ 1,80,000 + ₹ 45,000) – ₹ 27,500
= ₹ 2,60,000 – ₹ 27,500 = ₹ **2,32,500**.

Illustration 2

Calculate as directed using accounting equation :

(a) If the total assets of a business are ₹ 1,50,000 and capital is ₹ 75,000, calculate creditors.
(b) If the capital of a business is ₹ 80,000 and the liabilities are ₹ 60,000, calculate the total assets of the business.
(c) Calculate total assets if (i) Capital is ₹ 50,000; (ii) Creditors ₹ 30,000; (iii) Revenue during the period ₹ 52,000; and (iv) Expenses during the same period are ₹ 38,000.

Solution

(a) Total Assets – Liabilities = Capital
or Liabilities = Total Assets – Capital
or Creditors = Total Assets – Capital
= ₹ 1,50,000 – ₹ 75,000
= ₹ **75,000**.

(b) Total Assets – Liabilities = Capital
or Total Assets = Capital + Liabilities
= ₹ 80,000 + ₹ 60,000
= ₹ **1,40,000**.

(c) Total Assets – Liabilities = Capital + Profit
or Total Assets = Capital + Profit + Liabilities
= ₹ 50,000 + ₹ (52,000 – 38,000) + ₹ 30,000 = ₹ 50,000 + ₹ 14,000 + ₹ 30,0000 = ₹ **94,000**.

Illustration 3

From the following information calculate total assets of the business : Capital ₹ 40,000; Creditors ₹ 30,000; Revenue earned during the period ₹ 75,000; Expenses incurred during the period ₹ 20,000. Value of stocks unsold ₹ 20,000.

Solution

Total Assets – Liabilities = Capital + Profit
or Total Assets = Capital + Liabilities + Profit
or Total Assets = Capital + Creditors + Profit
= ₹ 40,000 + ₹ 30,000 + ₹ 55,000 (₹ 75,000 – ₹ 20,000)
= ₹ 1,25,000 (includes ₹ 20,000 closing stock).

Illustration 4

Prabhas Senapati has the following assets and liabilities as on 31st December, 2009. Ascertain his capital.

Cash ₹ 2,500; Bank ₹ 4,750; Debtors ₹ 1,800; Creditors ₹ 2,200; Plant and Machinery ₹ 8,000; Building ₹ 20,000; Furniture ₹ 2,400; Bills Receivable ₹ 5,650; Bills Payable ₹ 2,350.

Solution

Assets – Liabilities = Capital
or Capital = Assets – Liabilities
or Capital = (Cash + Bank + Debtors + Plant and Machinery + Building + Furniture + Bills Receivable)
– (Creditors + Bills Payable)
= ₹ (2,500 + 4,750 + 1,800 + 8,000 + 20,000 + 2,400 + 5,650) – ₹ (2,200 + 2,350)
= ₹ (45,100 – 4,550) = ₹ 40,550.

Illustration 5

Show the accounting equations on the basis of the following transactions.

(i) Raghunath commenced business with cash ₹ 80,000.
(ii) Purchased goods on credit ₹ 20,000.
(iii) Withdrew cash for private use ₹ 2,000.
(iv) Sold goods on credit (cost-price ₹ 15,000) ₹ 20,000.
(v) Purchased furniture ₹ 1,500.

Solution

Accounting Equation : Total Assets – Liabilities = Capital

(i) Raghunath commenced business with cash ₹ 80,000

Here business is getting ₹ 80,000 in the form of cash and owes Raghunath ₹ 80,000. Therefore, in the form of accounting equation it can be shown as follows :

	Assets	–	Liabilities	=	Capital
Cash	80,000	–	0	=	80,000

(ii) Purchased goods on credit ₹ 20,000

Here stock of the business will be increased by ₹ 20,000 and liabilities in the form of creditor will be increased by the same amount. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	80,000	–	0	=	80,000
Stock	20,000	–	Creditors 20,000	=	0
	1,00,000	–	20,000	=	80,000

(iii) Withdrew cash for private use ₹ 2,000

Here cash will be reduced by ₹ 2,000 and capital will also be reduced by ₹ 2,000. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	78,000	–	0	=	78,000
Stock	20,000	–	Creditors 20,000	=	0
	98,000	–	20,000	=	78,000

(iv) Sold goods on credit ₹ 20,000 (cost price ₹ 15,000)

Here stock will be reduced by ₹ 15,000 and asset in the form of debtors will be increased by ₹ 20,000. Capital will be increased by ₹ 5,000 profit (₹ 20,000 – ₹ 15,000). The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	78,000		0	=	*83,000
Stock	5,000		Creditors 20,000		
Debtors	20,000				
	1,03,000	–	20,000	=	83,000

* It includes profit of ₹ 5,000 (₹ 20,000 – ₹ 15,000).

(v) Purchased furniture ₹ 1,500

Here cash will be reduced by ₹ 1,500 and furniture will appear in the equation as an asset. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	76,500		0	=	83,000
Stock	5,000		Creditors 20,000		
Debtors	20,000				
Furniture	1,500				
	1,03,000	–	20,000	=	83,000

Illustration 6

Show the accounting equations on the basis of the following transactions.

(i) D. Mahapatra commenced business with cash ₹ 50,000.
(ii) Purchased goods for cash ₹ 8,000.
(iii) Sold goods costing ₹ 6,000 for ₹ 9,000.
(iv) Purchased furniture ₹ 20,000.
(v) Took a loan of ₹ 10,000 from bank.
(vi) Paid salary ₹ 4,000 and insurance ₹ 2,000.
(vii) Received rent ₹ 3,000 and interest ₹ 1,500.

(viii) Paid ₹ 800 as premium of life insurance policy.
(ix) Purchased a bicycle for the owners' son ₹ 1,200.
(x) Depreciate furniture by ₹ 300.

Solution

Accounting Equation : Total Assets = Total Liabilities OR Total Assets = Capital + Liabilities OR Total Assets – Liabilities = Capital

(i) D. Mahapatra commenced business with cash ₹ 50,000

Here business is getting ₹ 50,000 in the form of cash and owes Mahapatra ₹ 50,000. Therefore, in the form of accounting equation it can be shown as follows :

	Assets	–	Liabilities	=	Capital
Cash	50,000	–	0	=	50,000

(ii) Purchased goods for cash ₹ 8,000

Here stock of the business will be increased by ₹ 8,000 and cash will be reduced by ₹ 8,000. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	42,000	–	0	=	42,000
Stock	8,000	–	0	=	8,000
	50,000	–	0	=	50,000

(iii) Sold goods costing ₹ 6,000 for ₹ 9,000

Here stock will be reduced by ₹ 6,000 and cash will be increased by ₹ 9,000. Capital will be increased by ₹ 3,000 profit (₹ 9,000 – ₹ 6,000). The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	51,000	–	0	=	51,000
Stock	2,000	–	0	=	2,000
	53,000	–	0	=	53,000

(iv) Purchased furniture ₹ 20,000

Here cash will be reduced by ₹ 20,000 and furniture will appear in the equation as an asset. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	31,000	–	0	=	31,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	53,000	–	0	=	53,000

(v) Took a loan of ₹ 10,000 from bank

Here cash will be increased by ₹ 10,000 and liabilities in the form of loan will be increased by the same amount. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	41,000	–	Loan 10,000	=	31,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	63,000	–	10,000	=	53,000

(vi) Paid salary ₹ 4,000 and insurance ₹ 2,000

Here cash will be reduced by ₹ 6,000 and profit will be reduced by ₹ 6,000, i.e., capital will be reduced by ₹ 6,000. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	35,000	–	Loan 10,000	=	25,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	57,000	–	10,000	=	47,000

(vii) Received rent ₹ 3,000 and interest ₹ 1,500

Here cash will be increased by ₹ 4,500 and capital will be increased by the same amount in the form of profit. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	39,500	–	Loan 10,000	=	29,500
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	61,500	–	10,000	=	51,500

(viii) Paid ₹ 800 as premium of life insurance policy

Here cash will be reduced by ₹ 800 and capital will be reduced by ₹ 800 by way of drawing. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	38,700	–	Loan 10,000	=	28,700
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	60,700	–	10,000	=	50,700

(ix) Purchased a bicycle for the owner's son ₹ 1,200

Here cash will be reduced by ₹ 1,200 and capital will be reduced by ₹ 1,200 by way of drawing. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	37,500	–	Loan 10,000	=	27,500
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	59,500	–	10,000	=	49,500

(x) Depreciate furniture by ₹ 300

Here furniture will be reduced by ₹ 300 and capital will be reduced by ₹ 300 by way of loss due to depreciation. Therefore, the new equation will be:

	Assets	–	Liabilities	=	Capital
Cash	37,500	–	Loan 10,000	=	27,500
Stock	2,000	–	0	=	2,000
Furniture	19,700	–	0	=	19,700
	59,200	–	10,000	=	49,200

Elements of Financial Statements

The elements directly related to the measurement of financial position in the Balance Sheet are : ***assets***, ***liabilities*** and ***equity***.

The elements directly related to the measurement of performance in the Statement of Profit and Loss are : ***income*** and ***expenses***.

These definitions applied together with the recognition criteria, helps to understand how and when the financial effect of transactions should be recognised in the financial statements.

Definitions

(a) An ***asset*** is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.

(b) A ***liability*** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(c) ***Equity*** is the residual interest in the assets of the enterprise after deducting all its liabilities.

(d) ***Income*** is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease in liabilities, that in turn increases the equity other than those relating to contribution from equity participants.

(e) ***Expenses*** are decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Assets

Assets are those resources that the business owns. They refer to some property or legal right owned by a business enterprise which can be measured in terms of money.

An asset has the following ***three*** essential characteristics :

(1) It has the potential to provide future economic benefits to the enterprise.
(2) It is a result of past transactions or events.
(3) The enterprise has the control over it.

Liability

Liability is a present obligation expressed in terms of money, which arises from transactions or other events that have already occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the foregoing of a future cash receipt.

Obligations may arise from normal business practice, custom and a desire to maintain good business relations.

Recognition of the Elements of Financial Statements

An item that meets the definition of an element (given above) should be recognised if :

(a) it is possible that any future economic benefit associated with the item will flow to or from the enterprise; and
(b) the item has a cost or value that can be measured with reliability.

In the ***first criterion***, the concept of probability is used to refer to the degree of uncertainty. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared.

The ***second criterion*** for the recognition of an item is that it possesses a cost or value that can be measured with reliability. When, however, a reasonable estimate cannot be made, the item is not recognised in the Balance Sheet or Statement of Profit and Loss.

Recognition of Assets

An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably.

If there is any doubt about the flow of benefits to the enterprise beyond current accounting period, the expenditure incurred will not be recognised as an asset.

Recognition of Liabilities

A liability is recognised in the Balance Sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.

Recognition of Income

Income is recognised in the Statement of Profit and Loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Recognition of Expenses

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

Measurement of Elements of Financial Statements

After deciding that an item is to be recognised in the financial statements, the next step is to decide the basis for its measurement.

The framework refers to ***four*** measurement bases that are frequently used in reporting. These are :

1. Historical Cost
2. Current Cost
3. Realisable (Settlement) Value
4. Present Value

In measuring assets and liabilities, the historical cost is most commonly used. This is usually combined with other measurement bases. For example, inventories are usually carried at lower of cost and net realisable value (NRV) and pension liabilities are carried at their present value.

Key Points

- Double entry is an almost universally used system of business record keeping. It is a system of recording business transactions which recognises that each transaction has a dual aspect. It is so named because the principles of double entry book-keeping are based upon every transaction having two aspects or two parts, i.e., two accounts are always affected by each transaction.
- The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

Total Assets = Total Liabilities

OR

Total Assets = Liabilities + Capital

OR

Total Assets – Liabilities = Capital

- Liability is a present obligation expressed in terms of money, which arises from transactions or other events that have already occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the foregoing of a future cash receipt.

THEORETICAL QUESTIONS

1. What do you mean by double entry system ?
2. What are the features of double entry system ?
3. What are the advantages and disadvantages of double entry system ?
4. What is accounting equation ?
5. What are the elements of financial statements ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Which of the following equations is correct ?
   A total assets – liabilities = capital – profit
   B total assets – liabilities = capital + profit
   C total assets + profit = capital + liabilities
   D total assets + liabilities = capital – profit
2. Robin introduces his car into his business. Which parts of the business accounting equation will change?
   A capital and liability
   B liabilities and assets
   C capital and profit
   D assets and capital

3. Which of the following equation is wrong ?
   A net assets = proprietor's fund
   B net assets = capital + profit + drawings
   C net assets = capital + profit – drawings
   D fixed assets + net current assets = capital + profit – drawings
4. Which of the following is a correct version of the 'fundamental accounting equation' ?
   A assets = capital less liability
   B assets = liabilities
   C assets plus liabilities = capital
   D assets = capital + liabilities
5. Consider the following statements :
   (i) 'Double entry book-keeping' means that two sets of records are maintained.
   (ii) In double entry book-keeping we have a basic check on the accuracy of the entries as the total value of the debit entries and total value of the credit entries should be equal.

   Are the statements true or false ?

	Statement (i)	Statement (ii)
A	True	True
B	True	False
C	False	True
D	False	False

6. A business borrowed ₹ 60,000 from its bank, and used the cash to buy a new computer. How is accounting equation Affected by these transactions ?

	Assets	Liabilities
A	unchanged	decreased
B	unchange	dincreased
C	increased	increased
D	increased	decreased

PRACTICAL QUESTIONS

1. (a) If the capital of the firm is ₹ 1,50,000 and creditor is ₹ 50,000. Find out the total assets.
   (b) A business has total assets of ₹ 85,000 and capital is ₹ 35,000. What is the amount of liability ?
   (c) Plant and machinery ₹ 1,00,000; Land and Building ₹ 2,00,000; Stock ₹ 50,000; Cash in hand ₹ 10,000; Cash at Bank ₹ 40,000; Sundry Debtors ₹ 50,000 and Sundry Creditors ₹ 1,00,000. Ascertain the capital.
2. Show accounting equations on the basis of the following transactions.
   (a) Ganguly commenced business with ₹ 1,00,000.
   (b) Purchased machinery for ₹ 30,000.
   (c) Purchased goods for ₹ 40,000.
   (d) Sold all goods for cash ₹ 60,000.
3. Show the accounting equations on the basis of the following transactions.
   (a) Commenced business with cash ₹ 40,000.
   (b) Deposited ₹ 10,000 in SBI.
   (c) Purchased machine from Amar & Sons ₹ 30,000.
   (d) Purchased goods from Bijoy Bros. ₹ 30,000.
   (e) Purchased goods for cash ₹ 18,000.
   (f) Half of the goods purchased from Bijoy Bros are sold at a profit of 40% on cost price for cash. The remaining half were sold on credit to Chitra Suppliers at a profit of 50% on selling price.
   (g) Paid ₹ 15,000 cash and ₹ 7,000 by cheque to Amar & Sons.
   (h) Owner withdraw ₹ 1,000 for personal expenses.
4. Dinesh starts business with cash ₹ 50,000 and furniture ₹ 20,000. The details of his transactions are given below:
   (i) Purchased goods on credit from Eknath ₹ 60,000 at 10% discount.
   (ii) Goods costing ₹ 20,000 are sold for ₹ 35,000.
   (iii) Goods costing ₹ 10,000 are sold to Fakir & Co. for ₹ 18,000.
   (iv) Fakir returned 1/5th of the goods.

(v) Received commission ₹ 6,000.
(vi) Paid ₹ 14,000 to Eknath and accepted a Bills Payable of 3 months for the balance amount.
(vii) Paid salary ₹ 3,000 to Gumasta.
(viii) Depreciate furniture by 10%.

You are required to prepare accounting equations for Dinesh.

5. Gopinath started business with cash ₹ 30,000 and goods ₹ 10,000. His other transactions are given below. You are required to show the accounting equations.
   (i) Purchased goods from Hanuman Bhai ₹ 30,000.
   (ii) Paid ₹ 10,000 to Hanuman Bhai.
   (iii) Sold goods costing ₹ 12,000 for ₹ 19,000 to Inderjeet & Co.
   (iv) Goods costing ₹ 3,000 are destroyed during cyclone and could be sold for ₹ 1,000 only.
   (v) Paid wages ₹ 1,000.
   (vi) Goods costing ₹ 1,000 are distributed as relief during the cyclone.
   (vii) Goods costing ₹ 400 (market price ₹ 500) are taken for household use.
   (viii) Goods costing ₹ 3,000 are used for construction of a room.
   (ix) Goods costing ₹ 5,000 are sold for ₹ 20,000.
   (x) Goods worth ₹ 2,000 are destroyed in fire.

Guide to Answers

Multiple Choice

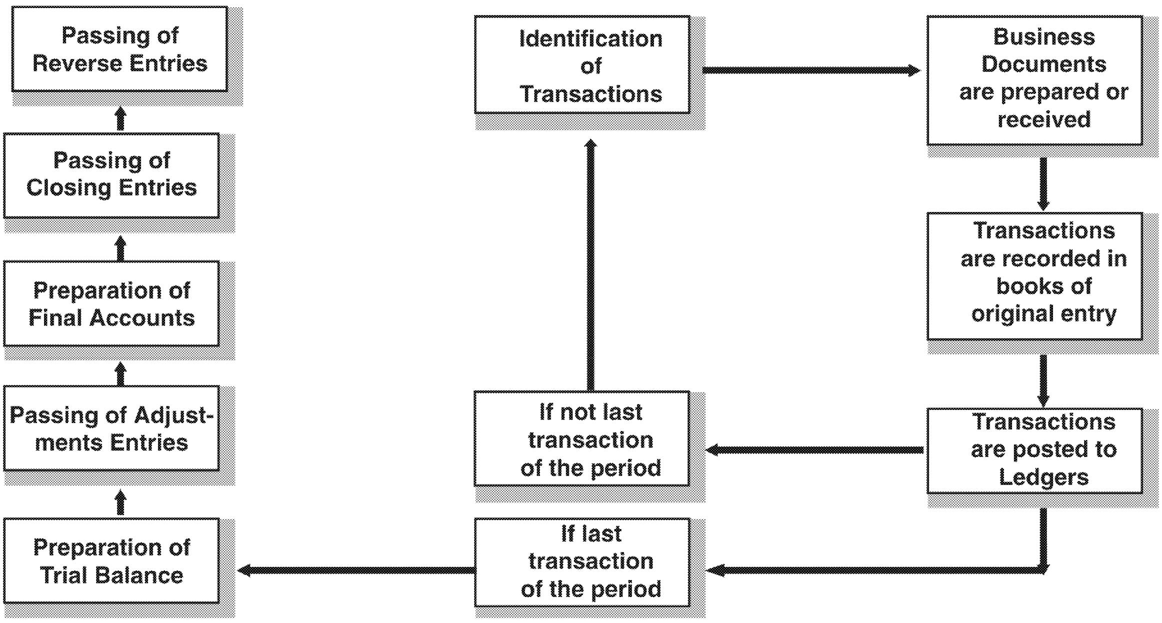
1. B   2. D;   3. B;   4. D;   5. C;   6. C.

3

Accounting Cycle

Accounting Cycle

Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise the business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise has numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. The purpose of accounting is to ascertain the cumulative effect of the transactions. For accounting, the following steps are followed.



Source Documents

Source documents are basically external documents or documents relating to external activities, which are the first input to the accounting system. These source documents come into the company through a variety of departments, in particular, and most obviously the sales and purchasing departments, and they head towards the accounting department for processing.

Source documents include the following :

1. *Sales order :* A customer place order in writing or signs an order for goods and services he wishes to buy.

2. *Purchase order :* A business makes an order from another business for the purchase of goods or services.

3. *Invoices and credit notes :* These are discussed further below.

4. *Petty cash voucher :* It is prepared for petty cash expenses.

5. *Credit card sales voucher :* When goods are sold against credit card, a credit card sales voucher is prepared by the seller and signed by the customer. Credit card sales are entered in the cash book as cash sales.

Invoices

An invoice relates to a sales order or a purchase order. When a business sells goods or services on credit to a customer, it sends out an invoice. It shows the goods sold, with descriptions, quantities, prices and trade discounts. The details in the invoice should match with the details on the sales order. It may include additional charges — for insurance, carriage and container. It also shows the total amount due from the customer.

When a business buys goods or services on credit it receives an invoice from the supplier. The details in the invoice should match with the details on the purchase order. An invoice is often prepared on multi-part stationery or carbon copied. The top copy is sent to customer and other copies are used by the different departments within the business.

A specimen of an invoice is given below :

INVOICE

No- 786/2017 Date : 19th Feb, 2017

Sony India Ltd.
40, Jawaharlal Nehru Road
Kolkata 700016

Customer's Name
Capital Electronics
42, Gariahat Road, Kolkata 700019

Qty.	Description	Rate	Amount	Total (₹)	Remarks
10 Pcs.	Colour T V	25,000	2,50,000		
	Less : Trade Discount 20%		50,000	2,00,000	
E & O E					

Credit Note

In all businesses goods are returned for different reasons. They may have been damaged in transit, the wrong size or make may have been supplied; or the goods were found to be faulty. When goods are returned by the customers, a document is prepared called "credit note" and sent it to customer to intimate him that his account has been credited.

Credit notes are similar in style and layout to invoices, but they are usually smaller and printed in red.

A credit note is also sent to the customer in the following cases :

1. When allowances is granted for defective goods.
2. When containers are returned by the customers.
3. When excessive charge was made by mistake.

A specimen of credit note is given below :

CREDIT NOTE No. 99

Kirloskar Electric Co. Ltd.
Bombay-Pune Highway
Pune
Maharashtra

Date : 19th November, 2017

To
Shyam Trading Corporation
10, Asaf Ali Road
New Delhi 110 011

We have credited your account as follows :

Goods Returned	₹
1 piece Electric Motor 15 HP	25,000
1 piece Pump	10,000
	35,000

For Kirloskar Electric Co. Ltd.

Voucher

The ***voucher*** is a document which provides the authorisation to pay and specifies the accounts to be debited and credited. It is prepared for each expenditure, regardless of whether the expenditure covers services, merchandise for resale or assets for use in the business. A voucher, as illustrated on page 3.3, is attached to each incoming invoice and given an identification number.

The voucher has space for listing the data from the invoice. Space is also provided for approval of signatures for each step in the verification and approval of the liability. It contains written evidence that :

1. All expenditures have been incurred on the basis of proper authorisation, for example, against purchase order.
2. The goods and services have been received in full.
3. The payment has been made only for the goods and services received.

Features of a Voucher

The form of a voucher will vary from organisation to organisation. Regardless of the specific form of the vouchers, the following features are usually present :

1. A separate voucher for every incoming invoice.
2. Consecutive numbering of vouchers.
3. Name and address of creditor listed on voucher.
4. Description of liability.
5. Amount due and terms of payment.
6. Approval of signature for : (a) verification of invoice; (b) recording in accounts; (c) payment of liability.
7. Cheque number and date of cheque listed on voucher.

Preparing a Voucher

A clerk prepares a voucher by filling in the appropriate blanks with data taken from the invoice, such as the invoice date, invoice number and amount, and creditor's name and address.

The voucher with invoice attached is then sent to the employees responsible for verifying and comparing prices, quantities and terms with those specified in the purchase order. After verification, the voucher and supporting documents are sent to an employee of the accounting department, who indicates on the voucher the accounts to be debited and credited. The voucher is now ready to be recorded. But before recording, it is submitted to accounts officer for final approval. After receiving this executive approval, the voucher is entered in the books of original entry.

The specimen of a voucher is given below :

Capital Electronics
Kolkata - 700 019

Pay to ______________		Voucher No.	______________
______________		Date	______________
______________		Date due	______________

Date of Invoice	______________	Gross Amount	______________
Invoice Number	______________	*Less* : Cash Discount	______________
Credit Terms	______________	Net Amount	______________

Approval

	Approved by	Date
Prices in agreement with purchase order	______________	______________
Quantities in agreement with receiving report	______________	
Credit terms in agreement with purchase order	______________	
Account distribution and recording approved	______________	
Approved for payment	______________	
		Accounts Officer

Reverse Side

Account Head		Voucher No.	______________
	Amount	Date	______________
Purchases	______________		
Transportation	______________	Date due	
Repairs	______________		
Heat, light and power	______________	Payee	
Misc. general expenses	______________	Amount of Invoice	
Telephone and telegraph	______________	Less : Cash discount	
Sales salaries	______________	Net amount	
Office salaries	______________	Paid by cheque no.	
______________		Date of cheque	______________
______________		Amount of cheque	______________
Credit vouchers payable (total)	______________		
Account distribution by	______________	Entered in voucher register by	

Illustrative Example 1

The following is a typical business transaction :

(a) The purchase of goods on credit.
(b) Allowance to credit customers upon the return of faulty goods.
(c) Refund from petty cash to an employee of an amount spent on entertaining a client.
(d) Credit card sales

For each transaction, identify clearly the original document(s) for the data.:

Solution

(a) The supplier's invoice would be the original document.
(b) The usual documentation is a credit note. Occasionally, however, a customer may himself issue a debit note.
(c) The original documents for the data would be receipts and a petty cash voucher.
(d) The original document would be the credit card sales voucher.

Meaning of Transaction

A transaction is a particular type of external event, which can be expressed in terms of money and brings change in the financial position of a business unit. A transaction involves transfer of something of value between two or more entities. A transaction may be an exchange in which each party receives as well as sacrifices value. In other words, in every transaction, there is a movement of value from one source to another. For example, when goods are purchased for cash, there is a movement of goods from the seller to the buyer and a movement of cash from the buyer to the seller.

A transaction can also be a non-reciprocal transfer in which a business unit incurs a liability (penalty imposed by a local authority) or transfer an asset to another entity (payment of income tax) or receives an asset (subsidy received from Government) or cancellation of a liability (provision for workmen's compensation) without directly receiving (or giving) value in exchange.

Transactions may be external (between a business entity and a second party, for example, goods sold on credit to X) or internal (not involving second party, for instance, depreciation charged on the machinery).

Meaning of Event

Event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit. It may be an internal event that occurs within a business unit, such as using new materials in production, death of the general manager or threat by a labour union to call a strike. It may be an external event that involves interaction between a business unit and its environment, for example, a change in the price of a product that the business unit buys or sells, or an improvement in technology by a competitor.

Illustration 1

State with reasons whether the following events are transactions or not to Mr. X (Proprietor) :

(i) Mr. X started business with capital (brought in cash) ₹ 40,000.
(ii) Paid salaries to staff ₹ 5,000.
(iii) Purchased machinery for ₹ 20,000 in cash.
(iv) Placed an order with Sen & Co. for goods for ₹ 5,000.
(v) Opened a bank account by depositing ₹ 4,000.
(vi) Received pass book from bank.
(vii) Appointed Mr. B. Sen as manager on a salary of ₹ 4,000 per month.
(viii) Received interest from bank ₹ 500.
(ix) Received a price list from B.
(x) Received free samples ₹ 1,000.
(xi) Gave lift to a supplier in the business car.
(xii) Sent peon to post office to bring the V.P.P. of ₹ 600.

Solution

Here, each event is to be considered from the view point of Mr. X's business. Those events which can be measured in terms of money and will change the financial position of the business of Mr. X, should be regarded as transaction.

(i) It is a transaction, because it changes the financial position of Mr. X's business. Cash will increase by ₹ 40,000 and Capital will increase by ₹ 40,000.
(ii) It is a transaction, because it changes the financial position of Mr. X's business. Cash will decrease by ₹ 5,000 and Salaries (expenses) will increase by ₹ 5,000.
(iii) It is a transaction, because it changes the financial position of Mr. X's business. Machinery comes in and cash goes out.
(iv) It is not a transaction, because it does not change the financial position of the business.
(v) It is a transaction, because it changes the financial position of the business. Bank balance will increase by ₹ 4,000 and cash will decrease by ₹ 4,000.
(vi) It is not a transaction, because it does not change the financial position of the business of Mr. X.
(vii) It is also not a transaction, because it does not change the financial position of the business of Mr. X.
(viii) It is a transaction, because it changes the financial position of Mr. X's business. Bank interest will increase by ₹ 500 and cash will increase by the same amount.
(ix) It is not a transaction, because it does not change the financial position of the business of Mr. X.
(x) It is not a transaction.
(xi) It is not a transaction because it does not change the financial position of the business of Mr. X.
(xii) It is not a transaction because it does not change the financial position of the business of Mr. X.

Classification of Transaction

Cash transaction: A transaction which involves immediate cash/cheque receipt or payment is called a Cash Transaction. For example, goods sold to X for cash ₹ 5,000. In a cash transaction, the name of the party to whom goods are sold or from whom goods are purchased, is not recorded. This is because, it serves no purpose.

Credit transaction: An external transaction not involving immediate cash receipt or payment is called a Credit Transaction. For example, Purchase of goods on credit from Y. In a credit transaction, delivery of goods and receipt/payment of money takes place on two different dates.

In a credit transaction, the name of the party is recorded to ascertain how much is owed to or from him.

External transaction: A transaction which involves the business entity and a second party is called an External Transaction. For example, goods sold to Ram for ₹ 2,000 on credit.

Internal transaction: A transcation which does not involve a second party is called Internal Transaction. For example, depreciation charged on machinery.

Rules for Determining Cash or Credit Transaction

Students sometimes experience a little difficulty deciding whether a transaction is for cash or on credit. The following rules will help :

(1) Cash purchases, cash sales and all transactions where the word 'paid'is mentioned are to be treated as cash transactions. For example, salary paid, goods sold for cash and so on.

(2) When a personal name or the name of a firm is mentioned in the transaction, it will be treated as credit transaction. For example, goods sold to X for ₹ 500.

(3) When both cash and personal name are mentioned in the transaction, it will be treated as a cash transaction. For example, goods sold to Y for cash ₹ 1,000.

Illustration 2

State whether the following are cash transactions or credit transactions :

1. Sachin commenced business with ₹ 1,00,000.
2. Paid rent in advance ₹ 5,000.
3. Purchased a typewriter for ₹ 7,000 from Sen & Co.
4. Bought furniture from M/s. Modern Furniture for cash ₹ 3,000.
5. Purchased goods from Sohan Brothers for cash ₹ 30,000.
6. Sold goods to Shyam for ₹ 25,000.
7. Bought goods from Ramesh ₹ 20,000.
8. Paid rent ₹ 1,000.
9. Paid salary to staff ₹ 4,000.
10. Received cash from Shyam ₹ 20,000.
11. Paid Romesh ₹ 19,000.

Solution

1. It is a cash transaction.
2. It is a cash transaction.
3. It is a credit transaction.
4. It is a cash transaction.
5. It is a cash transaction.
6. It is a credit transaction.
7. It is a credit transaction.
8. It is a cash transaction.
9. It is a cash transaction.
10. It is a cash transaction.
11. It is a cash transaction.

Illustration 3

State whether the following are external transactions or internal transactions:

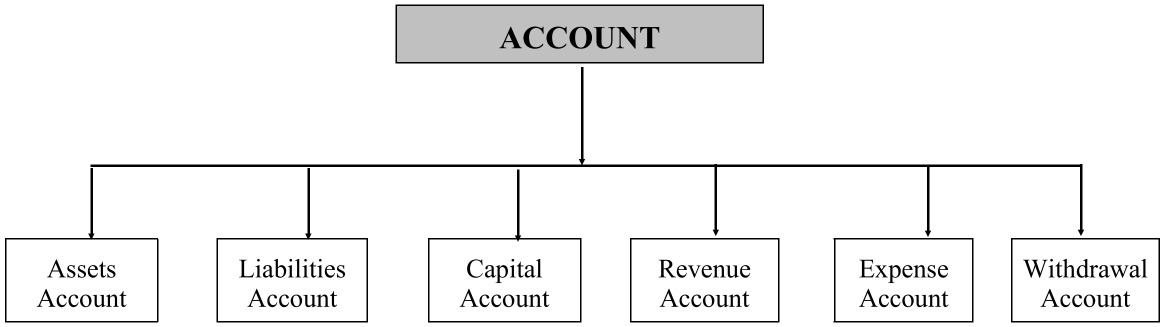
1. Purchased a computer from HCL on credit for ₹ 60,000.
2. Goods destroyed by fire ₹ 1,000 (not insured).
3. Purchased an electronic typewriter for cash ₹ 20,000.
4. Charged depreciation on furniture ₹ 400 and ₹ 200 on typewriter.

Solution

1. It is an external transaction.
2. It is an internal transaction.
3. It is an external transaction.
4. It is an internal transaction.

Classification of Accounts

Modern Classification of Accounts



According to modern approach, accounts are classified into six categories : (1) Assets Account; (2) Liabilities Account; (3) Capital Account; (4) Revenue Account; (5) Expense Account; and (6) Withdrawal Account.

Assets Account : These accounts are accounts of assets and properties such as land, building, plant, machinery, patents, cash investments, inventory, etc.

Liabilities Account : These accounts are accounts of lenders, creditors for goods, creditors for expenses, etc.

Capital Account : It is the account of the proprietor / partner who invested money in the business.

Revenue Account : These are accounts of incomes and gains. Examples are : sales, discount received, interest received, etc. These accounts accumulate data required for preparation of Trading, Profit and Loss Account.

Expense Account : These are accounts of expenses and losses. Examples are : purchases, wages paid, depreciation, rent, rates and taxes, etc. Like Revenue Account, these accounts accumulate data required for preparation of Trading, Profit and Loss Account.

Withdrawal Account : It is the account related to drawings by the proprietor / partners.

Rules for Debit and Credit

Sl. No.	Types of Account	Account to be debited	Account to be credited
1.	Assets Account	Increase ↑	Decrease ↓
2.	Liabilities Account	Decrease ↓	Increase ↑
3.	Capital Account	Decrease ↓	Increase ↑
4.	Revenue Account	Decrease ↓	Increase ↑
5.	Expense Account	Increase ↑	Decrease ↓
6.	Withdrawal Account	Increase ↑	Decrease ↓

Illustration 4

Analyse the following transactions, state the nature of accounts and state which account will be debited and which account will be credited.

(1) Kabir started his business with a cash of ₹ 50,000.
(2) Borrowed from Naresh ₹ 30,000.
(3) Purchased furniture for ₹ 20,000 in cash from Modern Furniture House.
(4) Purchased furniture from Bombay Safe for ₹ 40,000.
(5) Purchased goods for cash ₹ 15,000.
(6) Purchased goods from Romen ₹ 30,000.
(7) Sold goods for Cash to Karim ₹ 25,000.
(8) Sold goods to Shyam on Credit ₹ 30,000.

(9) Received cash from Shyam ₹ 20,000.
(10) Paid cash to Romen ₹ 20,000.
(11) Deposited cash into bank ₹ 15,000 for opening an account.
(12) Withdrew cash for personal use ₹ 1,000.
(13) Withdrew from bank for office use ₹ 5,000.
(14) Withdrew from bank for personal use ₹ 2,000.
(15) Received a cheque from Shyam ₹ 5,000.
(16) Deposited Shyam's cheque next day.
(17) Paid Romen by cheque ₹ 5,000.
(18) Paid salary to staff ₹ 10,000.
(19) Paid rent by cheque ₹ 5,000.
(20) Paid interest on loan ₹ 4,000.

Solution **Analysis of Transactions**

Transactions	Accounts involved	Nature of Account	Debit (₹)	Credit (₹)	Reason
1. Kabir started his business with a cash of ₹ 50,000.	Cash Capital	Asset Capital	50,000	 50,000	Increased Increased
2. Borrowed from Naresh ₹ 30,000.	Cash Loan from Naresh	Asset Liability	30,000	 30,000	Increased Increased
3. Purchased furniture for ₹ 20,000 in cash from Modern Furniture House.	Furniture Cash	Asset Asset	20,000	 20,000	Increased Decreased
4. Purchased furniture from Bombay Safe for ₹ 40,000.	Furniture Bombay Safe	Asset Liability	40,000	 40,000	Increased Increased
5. Purchased goods for cash ₹ 15,000.	Purchases Cash	Expense Asset	15,000	 15,000	Increased Decreased
6. Purchased goods from Romen ₹ 30,000.	Purchases Romen	Expense Liability	30,000	 30,000	Increased Increased
7. Sold goods for Cash to Karim ₹ 25,000.	Cash Sales	Asset Revenue	25,000	 25,000	Increased Increased
8. Sold goods to Shyam on Credit ₹ 30,000.	Shyam Sales	Asset Revenue	30,000	 30,000	Increased Increased
9. Received cash from Shyam ₹ 20,000.	Cash Shyam	Asset Asset	20,000	 20,000	Increased Decreased
10. Paid cash to Romen ₹ 20,000.	Romen Cash	Liability Asset	20,000	 20,000	Decreased Decreased
11. Deposited cash into bank ₹ 15,000 for opening an account.	Bank Cash	Asset Asset	15,000	 15,000	Increased Decreased
12. Withdrew cash for personal use ₹ 1,000.	Drawings Cash	Withdrawal Asset	1,000	 1,000	Increased Decreased
13. Withdrew from bank for office use ₹ 5,000.	Cash Bank	Asset Asset	5,000	 5,000	Increased Decreased
14. Withdrew from bank for personal use ₹ 2,000.	Drawings Bank	Withdrawal Asset	2,000	 2,000	Increased Decreased
15. Received a cheque from Shyam ₹ 5,000.	Cash Shyam	Asset Asset	5,000	 5,000	Increased Decreased
16. Deposited Shyam's cheque next day.	Bank Cash	Asset Asset	5,000	 5,000	Increased Decreased
17. Paid Romen by cheque ₹ 5,000.	Romen Bank	Liability Asset	5,000	 5,000	Decreased Decreased
18. Paid salary to staff ₹ 10,000.	Salary Cash	Expense Asset	10,000	 10,000	Increased Decreased
19. Paid rent by cheque ₹ 5,000.	Rent Bank	Expense Asset	5,000	 5,000	Increased Decreased
20. Paid interest on loan ₹ 4,000.	Interest Cash	Expense Asset	4,000	 4,000	Increased Decreased

Traditional Classification of Accounts

This is a very old system of classifying accounts. Nowadays, in advanced countries this system of classification of accounts is hardly used. Under this system, accounts are classified into four types.

1. Personal Accounts : These accounts show the transactions with the customers, suppliers, money lenders, the bank and the owner. A business may have many credit transactions with the above persons or organisations. A separate account is to be prepared for each of them. Persons or organisations with whom the business has credit transactions are either debtors or creditors. If they have to give some money to the firm, they are called debtors. Conversely, if the firm is to pay them some money they are known as creditors. The main purpose of preparing personal accounts is to ascertain the balances due to or due from persons or organisations.

2. Real Accounts : These accounts are accounts of assets and properties such as land, building, plant, machinery, patent, cash, investment, inventory, etc. When a machinery is purchased for cash, the two accounts involved are machinery and cash — both are Real Accounts. But if the same machine is purchased from Z & Co. on credit, the two accounts involved will be those of Machinery and Z & Co., the former being a Real Account and the latter being a Personal Account.

3. Nominal Accounts : These are the accounts of incomes, expenses, gains and losses. Examples are : Wages paid, discount allowed or received, purchases, sales, etc. These accounts generally accumulate the data required for the preparation of income statement, i.e., the Trading and Profit and Loss Account.

4. Valuation Accounts : Value is a measure, in terms of money, of the usefulness or desirability of an asset. Valuation is the process of attaching a monetary value to some asset (or liability). It is an adjustment usually made to an asset account, in order to allow for, or provide for, a fall in value as a result of, e.g., depreciation or doubtful debts. Where fixed assets are maintained in the books of accounts at original cost, to reflect the actual book value of the assets, a provision for depreciation account on the credit is maintained. In the Balance Sheet, it is shown as a deduction from the original cost of the asset.

Similarly, if the Debtors' personal accounts are retained at total amount due, a valuation account on the credit — provision for doubtful debts is required. In the Balance Sheet, it is shown as a deduction from Sundry Debtors Account to reflect estimated realisable value.

Illustration 5

Following accounts are being maintained in the books of Sri Pratap Sathpathy & Co. Classify them under Personal, Real and Nominal headings.

(i) Cash; (ii) Bank; (iii) Commission; (iv) Salaries; (v) Discount; (vi) Bills Receivable; (vii) Sohan Lal; (viii) Behera Brothers; (ix) Depreciation; (x) Bad Debt.

Solution

(i) Cash — **Real Account**; (ii) Bank — **Personal Account**; (iii) Commission — **Nominal Account**; (iv) Salaries — **Nominal Account**; (v) Discount — **Nominal Account**; (vi) Bills Receivable — **Real Account**; (vii) Sohan Lal — **Personal Account**; (viii) Behera Brothers — **Personal Account**; (ix) Depreciation — **Nominal Account**; (x) Bad Debt — **Nominal Account**.

Illustration 6

The following accounts are maintained in the books of Ghanashyam. Classify these under : Personal, Real and Nominal headings : (i) Interest; (ii) Cash; (iii) Bank; (iv) Mohan Lal; (v) Saraswati Pustak Bhandar; (vi) Vidyapuri; (vii) Motor Vehicles; (viii) Goodwill; (ix) Depreciation; (x) Commission.

Solution

(i) Interest — **Nominal Account**; (ii) Cash — **Real Account**; (iii) Bank — **Personal Account**; (iv) Mohan Lal — **Personal Account**; (v) Saraswati Pustak Bhandar — **Personal Account**; (vi) Vidyapuri — **Personal Account**; (vii) Motor Vehicles — **Real Account**; (viii) Goodwill — **Real Account**; (ix) Depreciation — **Nominal Account**; (x) Commission — **Nominal Account**.

Illustration 7

Classify the following into Real, Nominal, Personal and Valuation Accounts :

(i) Plant and Machinery; (ii) Purchases ; (iii) Investment; (iv) Bank; (v) Provision for Bad and Doubtful Debt; (vi) Tata Iron and Steel Co. Ltd.; (vii) Rent; (viii) Land and Building; (ix) Carriage Outwards; (x) Capital; (xi) Leasehold property; (xii) Trademark; (xiii) Returns outwards; (xiv) Import duty; (xv) Provision for depreciation.

Solution

(i) Plant and Machinery — **Real Account**; (ii) Purchases — **Nominal Account**; (iii) Investment — **Real Account;** (iv) Bank **— Personal Account**; (v) Provision for Bad and Doubtful Debt — **Valuation Account**; (vi) Tata Iron and Steel Co. Ltd **— Personal Account**; (vii) Rent — **Nominal Account**; (viii) Land and Building — **Real Account**; (ix) Carriage Outwards — **Nominal Account**; (x) Capital — **Personal Account**; (xi) Leasehold Property — **Real Account**; (xii) Trade Mark — **Real Account**; (xiii) Returns Outwards — **Nominal Account**; (xiv) Import Duty — **Nominal Account**; (xv) Provision for Depreciation — **Valuation Account**.

It has already been stated that each transaction involves two or more accounts. After ascertaining the accounts involved, our next problem is to decide which account should be debited and which account should be credited.

Rules for Debit and Credit (Traditional)

Debit and credit are simply additions to or subtraction from an account. In accounting, debit refers to the left hand side of any account and credit refers to the right side. Asset, expenses and losses accounts normally have debit balances; liability, income and capital accounts normally have credit balances.

The term debit is derived from the latin base *debere* (to owe) which contracts to the form 'Dr.' used in journal entries to refer to debits. Credit comes from the word *credere* (that which one believes in, including persons, like a creditor), which contracts to the form 'Cr.' used in journal entries for a credit.

1. Personal Accounts : Debit the account of the person who receives something and credit the account of the person who gives something.

2. Real Accounts : Debit the account of the asset/property which comes into the business or addition to an asset, and credit the account which goes out of the business. When furniture is purchased for cash, furniture account is debited (which comes into the business) and cash account is credited (which goes out of the business).

3. Nominal Accounts : Debit the accounts of expenses and losses, and credit the accounts of incomes and gains. When wages are paid, wages account is debited (expenses) and cash account is credited (asset goes out).

4. Valuation Account : Debit the account when the account is to be reduced and credit the account when the account is to be increased.

Rules for Debit and Credit at a Glance

Types of Account	Account to be debited	Account to be credited
1. Personal Account	Receiver	Giver
2. Real Account	What comes in	What goes out
3. Nominal Account	Expense and Loss	Income and Gain
4. Valuation Account	When account to be decreased	When account to be increased

Illustration 8

From the following transactions, state the nature of accounts and state which account will be debited and which account will be credited :

1. Mr. A started business with ₹ 50,000 in cash.
2. Purchased goods for cash ₹ 10,000.
3. Sold goods for cash ₹ 15,000.
4. Purchased goods from X for cash ₹ 5,000.
5. Sold goods to B for ₹ 6,000.
6. Purchased furniture for ₹ 4,000.
7. Purchased plant for ₹ 10,000.
8. Paid wages ₹ 400.

Solution

1. Mr. A started business with ₹ 50,000 — Here, accounts involved are (i) Cash Account and (ii) Capital Account.

(i) Cash Account → Real → Debit (Incomings)
(ii) Capital Account → Personal → Credit (Giver)

2. Purchased goods for cash ₹ 10,000 — Here, accounts involved are (i) Purchases Account and (ii) Cash Account

(i) Purchases Account → Nominal → Debit (Expenses)
(ii) Cash Account → Real → Credit (Outgoings)

3. Sold goods for cash ₹ 15,000 — Here, accounts involved are (i) Cash Account and (ii) Sales Account

(i) Cash Account → Real → Debit (Incomings)
(ii) Sales Account → Nominal → Credit (Income)

4. Purchased goods from X for cash ₹ 5,000 — Here, accounts involved are (i) Purchases Account and (ii) Cash Account

(i) Purchases Account →	Nominal →	Debit (Expenses)
(ii) Cash Account →	Real →	Credit (Outgoings)

5. Sold goods to B for ₹ 6,000 — Here, accounts involved are (i) B Account and (ii) Sales Account

(i) B Account →	Personal →	Debit (Receiver)
(ii) Sales Account →	Nominal →	Credit (Income)

6. Purchased furniture for ₹ 4,000 — Here, accounts involved are (i) Furniture Account and (ii) Cash Account

(i) Furniture Account →	Real →	Debit (Incomings)
(ii) Cash Account →	Real →	Credit (Outgoings)

7. Purchased plant for ₹ 10,000 — Here, accounts involved are (i) Plant Account and (ii) Cash Account

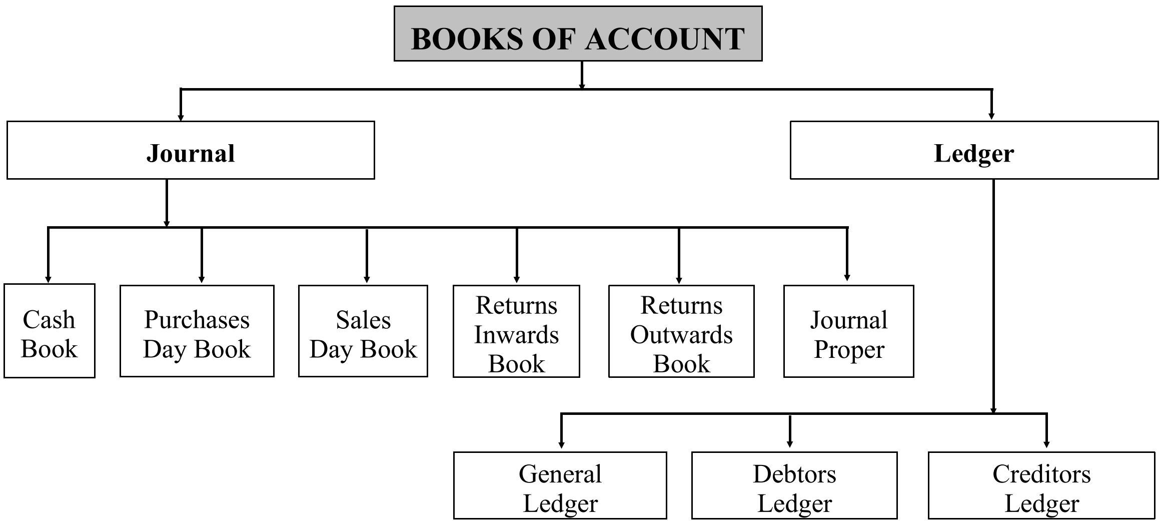
(i) Plant Account →	Real →	Debit (Incomings)
(ii) Cash Account →	Real →	Credit (Outgoings)

8. Paid wages ₹ 400 — Here, accounts involved are (i) Wages Account and (ii) Cash Account

(i) Wages Account →	Nominal →	Debit (Expenses)
(ii) Cash Account →	Real →	Credit (Outgoings)

Journal and Ledger

Nowadays, many businesses use computers for maintaining accounting records and data may be stored on floppy disks rather than in journals and ledgers. However, an understanding of accounting concepts is most easily acquired by the study of manual accounting system. For this reason, we shall use standard written accounting forms, such as journal and ledger, as the model for a study of basic accounting concepts.



The Journal and its Nature

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

A journal entry is an analysis of the effects of a transaction on the accounts, usually accompanied by an explanation (properly called as a narration). Therefore, a journal is a tool for analysing and describing the impact of various transactions upon a business unit. Before a journal entry is passed, it is necessary to decide for each transaction, what are the accounts involved. It is also necessary that the accounts to be debited or credited are identified.

Ruling of a Journal

In its usual form, a Journal is divided by vertical lines into five columns in which to enter, in respect of each transactions : (a) Date; (b) Particulars; (c) Ledger folio; (d) Amount (debit); (e) Amount (credit).

Journal **Dr.** **Cr.**

Date	Particulars	L.F.	Amount	Amount
(a)	(b)	(c)	(d)	(e)

(a) The date : The year is written at the top of the date column of each page of the journal. Thereafter, on the next line of the date column, the month and day of the first entry are written. Unless the month or year changes or until a new page is begun, neither the month nor the year is repeated on the page.

(b) Particulars : The particulars column is the column for account titles and description. The name of the account to be debited is entered at the extreme left of the particulars column next to the date column. The symbol 'Dr.' is written at the right end of the particulars column on the same line of the account debited. The amount of the account debited is entered in the left hand money column. The name of the account to be credited is entered on the next line with a prefix 'To' and is indented to the right of the date column. The amount of the account credited is entered in the right hand money column. A short explanation of the transaction known as narration begins on the line immediately below the account credited. The narration should be adequate to explain the transaction and may include any data needed to identify the transaction. It should be noted that the narration is particularly important for non-routine transactions where their nature is, otherwise, not apparent. The narration always appears within parentheses and is begun with the word "Being" — which means what it is. Finally, a thin line is drawn all through the particulars column to indicate that the entry of a transaction has been completed.

(c) Ledger folio (L.F.) : The ledger folio column to the right of the particulars columns is not filled in when transactions are recorded in the journal. When the debits and credits are posted in the ledger accounts, the page number of the ledger in which these accounts are appearing are listed in this column.

(d) Amount (Debit) : The debit amount is recorded in the amount (Dr.) column opposite the title of the account debited. The unit of measurement, i.e. ₹ is recorded at the top of this column on each page and this is not repeated.

(e) Amount (Credit) : The credit amount is recorded in the amount (Cr.) column opposite the title of the account credited. Like the amount (Dr.) column, ₹ is recorded at the top of this column on each page.

Example of a Journal Entry :

This can be illustrated by means of an example. We suppose, on 1.1.2017, a trader sells goods for cash ₹ 1,000. Here, the accounts involved are—Cash Account and Sales Account. Cash Account is to be debited and the Sales Account is to be credited.

Again, we suppose that on 2.1.2017 goods worth ₹ 500 were purchased for cash. Here, Purchases Account is to be debited and Cash Account is to be credited. The entries in the Journal will be as under :

Journal **Dr.** **Cr.**

	Date	Particulars	L.F.	Amount	Amount
	2017				
Debit Account →	Jan, 1 →	Cash Account Dr.		1,000	
Credit Account →		To Sales Account			1,000
Narration →		(Being goods sold for cash)			
Month and year not repeated →	2	Purchases Account Dr.		500	
		To Cash Account			500
		(Being goods purchased for cash)			

In connection with the journal, the following points are to be remembered :

1. ***For each transaction, the exact accounts should be debited and credited. For that, the two accounts involved must be identified to pass a proper journal entry.***
2. ***Sometimes, a journal entry may have more than one debit or more than one credit. This type of journal entry is called compound journal entry. Regardless of how many debits or credits are contained in a compound journal entry, all the debits are entered before any credits are entered. The aggregate amount of debits should be equal to the aggregate amount of credits.***

> ***3. For a business, journal entries generally extend to several pages. Therefore, the total are cast at the end of each page, against the debit and credit columns, the following words are written in the particular column, which indicates carried forward (of the amount on the next page) 'Total c/f'.***
>
> ***The debits and credits totals of the page are then written on the next page in the amount columns; and opposite to that on the left, the following words are written in the particulars column to indicate brought forward (of the amount of the previous page) 'Total b/f'. This process is repeated on every page and on the last page, 'Grand Total' is cast.***

Simple and Compound Journal Entries

A journal entry which contains only one debit entry and one credit entry is called a ***Simple Journal Entry***.

Example of a simple journal entry is given below :

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	Amount	Amount
2017 May 5	Cash A/c To Capital A/c (Being cash brought in as capital ₹ 50,000)	Dr.		50,000	 50,000

A journal entry which contains more than one debit entry or more than one credit entry or both is called a ***Compound Journal Entry***. It should be noted that total amount debited must be equal to total amount credited. In fact, a compound journal entry is nothing but a combination of two or more simple journal entries.

Example of a compound journal entry is given below :

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	Amount	Amount
2017 May 5	Building A/c Furniture A/c Cash A/c To Capital A/c (Being different assets brought in as capital)	Dr. Dr. Dr.		1,00,000 80,000 20,000	 2,00,000

> **Key Points to Remember**
>
> 1. ***Unless instructed to the contrary, assume that all transactions for the purchase or the sale of goods are on credit when a personal name or the name of a firm is mentioned in the question.***
> 2. ***No need to mention the name of buyer or seller in the case of cash purchase or a cash sale, as money is simply exchanged for goods handed over.***
> 3. ***Cash purchases, cash sales and all transactions where the word 'paid' is mentioned are obviously cash transactions.***
> 4. ***When goods are purchased or sold for cash, the name of the supplier or customer is immaterial. Therefore, it is to be ignored at the time of recording transaction.***
> 5. ***Return of goods by customer (sales returns) is recorded in the Returns Inwards Account or Sales Returns Account.***
> 6. ***Return of goods to supplier (purchase returns) is recorded in the Returns Outwards Account or Purchase Returns Account.***

Illustration 9

2017

January	1	Mr. Peter commences business as a computer merchant, trading under the name of 'Computer Point' with a capital of ₹ 4,00,000 brought in cash.
	3	He buys on credit from Hindusthan Computers Ltd., 10 computers @ ₹ 30,000 each.
	15	He receives an invoice from Janata Transport Corporation for ₹ 5,000 in respect of carriage of computers from Bangalore.
	20	He opens a bank account by depositing ₹ 3,50,000.
	25	He sells 6 computers on credit to ABC Computers @ ₹ 35,000 each.

29 He pays by cheque the amount for carriage.
31 He receives cash ₹ 2,00,000 from ABC Computers.
31 He issues a cheque to Hindusthan Computers Ltd. for ₹ 3,00,000.

You are required to pass necessary Journal entries in the books of Computer Point.

Explanation: In this illustration, there are eight distinct transactions to be recorded:

1. The commencement of business : At the very beginning, it must be clearly understood that we are concerned only with the transactions of Computer Point. From the accounting point of view, the business and its proprietor are two distinct entities. If Mr. Peter takes any computer for his personal use, his account will be debited with the cost (represented by Drawings Account). Similarly, if he introduces capital in the business, his account will be credited (being giver) with the amount of capital.

Here, Mr. Peter introduces ₹ 4,00,000 as capital (in effect lending this sum to the business). In the books of Computer Point, Cash Account will be debited because Cash (Real Account)—***comes in*** and Peter's Capital Account will be credited because Peter's Capital Account (Personal Account)—***giver***.

2. Purchase of computers on credit : Mr. Peter's business is the purchase and sale of computers. Therefore, for recording this transaction, Purchases Account will be debited (Nominal Account—***expenses***) and Hindusthan Computers Ltd. will be credited (Personal Account—***giver***).

In this respect, we must mention that if the computer is used for the purpose of maintaining accounts of the business, Office Equipment Account will be debited in place of Purchases Account.

3. Carriage of the computers : Janata Transport Corporation performs the service of transporting computers from Bangalore. To record this transaction, Carriage Inward Account will be debited and Personal Account of Janata Transport Corporation will be credited. Here, students should note that carriage paid for bringing the purchased goods to the business godown is treated as 'Carriage Inward', whereas carriage paid to deliver the sold goods is treated as 'Carriage Outward'.

4. Opening of Bank Account : Here, Bank is receiving money from the business. Bank Account will be debited (Personal Account—***receiver***) and Cash Account will be credited (Real Account—***goes out***).

5. Sale of computers on credit : ABC Computers Account will be debited (Personal Account—***receiver***) and Sales Account will be credited (Nominal Account—***income***).

6. Payment to Janata Transport Corporation : Janata Transport Corporation receives cheque in settlement of its account for carriage. So, Janata Transport Corporation Account will be debited (Personal Account—***receiver***) and Bank Account will be credited (Personal Account—***giver***).

(Note that this transaction will not affect Carriage Inward Account).

7. Cash received from ABC Computers : To record this transaction, Cash Account will be debited (Real Account—***comes in***) and ABC Computer Account will be credited (Personal Account—***giver***).

8. Payment to Hindusthan Computers : This transaction is similar to above (6). Therefore Hindusthan Computer Ltd. will be debited (Personal Account—***receiver***) and Bank Account will be credited (Personal Account—***giver***).

Solution

In the books of Computer Point
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 Jan. 1	Cash A/c	Dr.		4,00,000	
	To Capital A/c				4,00,000
	(Being business started with capital brought in cash)				
3	Purchases A/c	Dr.		3,00,000	
	To Hindusthan Computers Ltd. A/c				3,00,000
	(Being the purchase of 10 computers @ ₹ 30,000 each on credit)				
15	Carriage Inward A/c	Dr.		5,000	
	To Janata Transport Corporation A/c				5,000
	(Being carriage charges payable)				
20	Bank A/c	Dr.		3,50,000	
	To Cash A/c				3,50,000
	(Being the opening of a Bank Account)				
25	ABC Computers A/c	Dr.		2,10,000	
	To Sales A/c				2,10,000
	(Being the sale of 6 computers @ ₹ 35,000 each on credit)				

29	Janata Transport Corporation A/c Dr. To Bank A/c (Being paid by cheque)		5,000	5,000
31	Cash A/c Dr. To ABC Computers A/c (Being cash received from ABC Computers)		2,00,000	2,00,000
31	Hindusthan Computers A/c Dr. To Bank A/c (Being paid by cheque)		3,00,000	3,00,000
	Grand Total		17,70,000	17,70,000

Subdivision of Journal

The journal is inadequate as the sole book of the original entry when the transactions are numerous. The nature of operations and the volume of transactions in the particular business determine the number and type of journals needed. A medium size business generally maintains the following types of journals :

1. Cash Book — to record cash transactions;
2. Sales Day Book — to record credit sales;
3. Purchases Day Book — to record credit purchases;
4. Sales Return Day Book — to record sales returns;
5. Purchases Return Day Book — to record purchases returns;
6. Bills Receivable Book — to record bills receivable;
7. Bills Payable Book — to record bills payable;
8. Petty Cash Book — to record petty cash payments; and,
9. Journal Proper — to record residuary transactions. It is also used for rectifying errors.

The Ledger

The ledger is the principal book of accounts where similar transactions relating to a particular person or thing are recorded. The journal is used to record the transactions in the chronological order. The owner of a business is not interested to know the effect of individual transaction on the financial statements, what he wants is the accumulated effect of each ‘Chart of Accounts’. Chart of accounts is an index to all accounts contained in a double entry system. It allocates to each account a number and arranges accounts in logical subdivisions. For example, if he wants to know the total purchases for an accounting period, he will only see the ‘‘Purchase Account’’.

It is not possible to ascertain from the journal the total amount of purchases made. In the journal, record of purchases made at different dates can also be against cash or credit. Therefore, similar transactions should be sorted out and consolidated at one place to ascertain their net effect. This kind of processing is possible where different accounts are prepared in the ledger. Again, for example, to ascertain the cash position of a business, one is to look at the Cash Account; one can not know cash position with the help of a journal. Likewise, to ascertain net sales for the account period, one is to look at the Sales Account, which incorporates all information with regard to cash sales, credit sales, and the like.

Therefore, an account represents a detailed record of changes that have occured in a particular asset, liability, expense, loss, gain or capital during an accounting period.

Can Ledger suffice without a Journal ?

The owner of a business is not interested to know the effects of individual transactions on the financial statements (Trading, Profit and Loss Account and Balance Sheet), what he wants is the accumulated effect of each "Account". For example, if he wants to know the total purchases for an accounting period, he will only see the "Purchases Account". It is not possible to ascertain from the journal the total amount of purchases made. In the journal, record of purchases are made at different dates, which can also be against cash or credit. Therefore, similar transactions should be sorted out and consolidated at one place to ascertain their net effect. This kind of processing is possible where different accounts are prepared in the ledger.

The ledger is regarded as a principal book of account for the following reasons :

1. The ledger helps us preparing the trial balance to ensure the arithmatical accuracy of the books of account.
2. The ledger assists us in preparing the Trading, Profit and Loss Account and the Balance Sheet.
3. Amounts due to creditors or due from debtors can be ascertained through ledger.
4. Ledger reduces the possibility of errors, improves the probability of locating errors that do occur.

From the above, it is clear that ledger is the principal book of account but journal entry cannot be avoided for the following reasons :

1. It is a first or primary record in which transactions are analysed before they are posted to ledger.
2. A journal is the record which shows the complete story of a transaction in one entry.
3. It shows all necessary information regarding a transaction. The Ledger Account cannot provide detailed information of a transaction.
4. It provides an explanation of the transaction.
5. It provides a date-wise record of all the transactions.
6. It provides an individual source of quick reference in the future in response to queries.

Subdivisions of Ledger

While the number of transactions relating to a business is small, all the accounts may be maintained in one single ledger. However, after a business has reached a certain size, the number of transactions which require recording will become so large that the operation of one ledger will become both cumbersome and difficult to implement. As a business expands the volume of transactions will require the employment of more than one person to maintain the accounts, and some kind of division of the ledger is needed if both are to be able to work at the same time.

There are no hard and fast rules, but the generally accepted division of ledger is as follows :

1. Sales Ledger / Debtors' Ledger : It contains the personal accounts of all those to whom goods have been sold on credit. The total of the balances on this ledger will give "Sundry Debtors" for the Trial Balance and the Balance Sheet. The accounts concerned are arranged in alphabetical order and the number of accounts involved may require more than one "Sales Ledger" to contain the surnames within 'A — D'; 'E — J'; 'K — P'; and so on.

2. Bought Ledger / Creditors' Ledger : It contains the personal accounts of all those who supplied goods on credit. The total of the balances on this ledger will give "Sundry Creditors" for the Trial Balance and the Balance Sheet. Again, the accounts are arranged in alphabetical order and subdivision 'A — H'; 'I — Z' may be necessary.

3. General Ledger : It contains all the real accounts such as Building, Plant and Machinery, Office Equipments, Furniture and Fixtures and so on.

4. Nominal Ledger : It contains all those accounts which are normally looked upon as expenses (e.g., wages, salaries, rent, rates and taxes, insurance, carriage, discount allowed and so on). Accounts dealing with income (such as commission received, rent received and discount received) are also maintained in this ledger. In the category of nominal accounts we also include purchases, sales, return inwards, return outwards, depreciation, provision for bad debts, etc.

5. Private Ledger : In some cases, accounts of a confidential nature, such as capital or drawings or salaries of senior staff, may be kept in a separate private ledger.

6. Cash Book : It contains two ledger accounts — cash and bank.

It should be noted that some organisations are not maintaining nominal ledger, general ledger and private ledger separately. They are combined in a single 'general ledger'.

Standard Form of Ledger Account

'T' accounts are simplified representation of ledger accounts and is widely used. A 'T' account is divided into two sides, the left hand side represents the debit side and the right hand side represents the credit side. Each side of the ledger has columns of varying sizes for the following :

(a) Date; (b) Particulars; (c) Folio; and (d) Amount.

A specimen 'T' form account is as under :

Dr. **Title of Account** **(Account No ...)** **Cr.**

Date	Particulars	Folio	₹	Date	Particulars	Folio	₹

Running Balance form of Ledger Account

An alternative ruling of a ledger, which is generally adopted by commercial banks and some other business houses, is that the entire ledger is divided into six columns as under :

(a) Date; (b) Particulars; (c) Folio; (d); Dr. Amount; (e) Cr. Amount; and (f) Balance.

The specimen of such ruling is as under :

Bank Account **(Account No ...)**

Date	Particulars	Folio	Dr. Amount	Cr. Amount	Balance
2017			₹	₹	₹
June 1	To Balance b/d		—	—	5,000 (Dr.)
	To Sales		10,000	—	15,000 (Dr.)
5	By Salary		—	4,000	11,000 (Dr.)

The *Date* column shows the date of the transaction, which is not necessarily the same as the date on which entry is made in the account.

The *Particulars* column is used for writing the name of the accounts debited or credited.

The *Folio* column is used to list the page number of the journal in which the transaction is recorded, thus making it possible to trace ledger entries back to their source (a journal).

The *Dr. Amount* column is used for writing the amount of the account debited. Similarly *Cr. Amount* column is used for writing the amount of the account credited.

The *Balance* column is used for writing the new balance each time the account is debited or credited. Thus, the current balance of the account can always be observed at a glance.

Sequence and Numbering of Ledger Accounts

Ledger accounts are generally arranged in some logical manner, such as assets first, followed by liabilities, owner's equity, revenues and expenses. Again among assets, fixed assets are first followed by current assets and so on. The number of accounts required by a business will depend upon its size, the nature of its operations, and the policy of the management. An identification number is assigned to each account in the ledger to facilitate their location. A Chart of Accounts is a list of account titles and account numbers being used by a given business. Its main purpose is to guide those who are engaged in accounting and recording work.

Account Title	Account Number
Fixed Assets (1 — 15)	
Goodwill	01
Land	02
Building	03
Current Assets (16 — 25)	
Stock in trade	16
Sundry Debtors	17
Bills Receivable	18
Cash at bank	19
Liabilities (26 — 50)	
Bills Payable	26

Posting

The process of transferring of the debits and credits from the journal to the ledger accounts is called posting. Each amount entered in the debit column of the journal is posted by entering it on the debit side/column of an account in the ledger, and each amount entered in the credit column of the journal is posted by entering it on the credit side/column of an account in the ledger. Posting from journal to the ledger accounts are necessary in order to know how transactions have changed the account balances.

The Mechanics of Posting

The following procedures are followed for posting :

1. Locate in the ledger the 1st account named in the journal.
2. Enter on the debit side of the ledger in particulars column, the name of the account credited with a prefix 'To'.
3. Enter the date of the transaction in the date column.
4. Enter in the debit column of the ledger account, the amount of debit as shown in the journal.
5. Enter in the folio column of the ledger, the number of the journal page from which the entry is being posted.
6. Enter in the folio column of the journal, the number of the ledger page in which the posting has been done.
7. Locate in the ledger the second account named in the journal.
8. Enter in the credit side of the ledger in particulars column, the name of the account debited with a prefix 'By'.
9. Enter the date of the transaction in the date column.
10. Enter in the credit column of the ledger account the amount of credit as shown in the journal.
11. Enter in the folio column of the ledger, the number of the journal page from which the entry is being posted.
12. Enter in the folio column of the journal, the number of the ledger page in which posting has been done.

Illustration of posting process

Journal (Page 5) Dr. Cr.

Date	Particulars		L.F.	₹	₹
2017	Cash A/c	Dr.	9	10,000	
July 9	To Capital A/c		20		10,000
	(Being new capital introduced)				

Ledger

Dr. Cash Account (Page 9) Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017 July 9	To Capital A/c	5	10,000				

Dr. Capital Account (Page 20) Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
				2017 July 9	By Cash A/c	5	10,000

Balancing Ledger Accounts

Balance is the sum necessary to equalise the debit and credit totals of an account. Periodically, all the accounts in a ledger are balanced to ascertain the cumulative effect of entries on the accounts. The *balance* is an accounting term which means the difference between the two sides of an account, or the total of an account containing only debits and credits. A computerised system will usually print the balance of the account after each transaction, but in a manual system we must calculate the balance.

Where the total of the debit side exceeds the total of the credit side, the account is said to have a *debit balance*.

Where the total of the credit side exceeds the total of the debit side, the account is said to have a *credit balance*. Therefore, balancing is the process of bringing two sets of related figures into agreement.

The following steps are followed for balancing the accounts :

1. On a rough sheet of paper take the total of the two sides of the account concerned.
2. Compute the difference of the total of two sides.
3. If the debit side total is more, put the difference on the credit side amount column, by writing the words in particulars column 'By Balance c/d'. If the credit side total is more, put the difference on the debit side amount column by writing the words in particulars column 'To Balance c/d'.
4. After putting the difference in the appropriate side of the account, add both the sides of the account. Draw a thin line above and below the total.
5. Bring down the debit balance on the debit side by writing the words in particulars column 'To Balance b/d'. Similarly bring down the credit balance on the credit side by writing the words in the particulars column 'By Balance b/d'.

Dr. **Bank Account** **(Account No ...)** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.6.2017	To Capital A/c		30,000	5.6.2017	By Purchases A/c		10,000
10.1.2017	To Sales A/c		15,000	20.6.2017	By Wages A/c		5,000
				25.6.2017	By Freight A/c		2,000
				30.6.2017	By Balance c/d		28,000
			45,000				45,000
1.7.2017	To Balance b/d		28,000				

Illustration 10

Pass necessary journal entries and post them in the appropriate Ledger Accounts of P. Basak for the month of January 2017:

1 Started business with ₹ 2,00,000 in the bank and ₹ 40,000 cash;
1 Bought shop fittings ₹ 40,000 and a van ₹ 60,000 both paid by cheque;
2 Paid rent by cheque ₹ 5,000;
3 Bought goods for resale on credit from Zakir & Co ₹ 50,000;
5 Cash sales ₹ 5,000;
8 Paid wages of assistant in cash ₹ 1,000;
10 Paid insurance by cheque ₹ 500;
12 Cash sales ₹ 8,000;
15 Paid wages of assistant in cash ₹ 1,000; Goods returned to Zakir & Co ₹ 6,000;
17 Paid Zakir & Co ₹ 30,000 by cheque;
19 Bought goods for resale on credit from Rao & Co ₹ 25,000;
19 Cash sales ₹ 7,000;
22 Paid wages of assistant in cash ₹ 1,000;
24 Bought stationery, paid in cash ₹ 500;
25 Cash sales ₹ 15,000;
27 Paid Rao & Co ₹ 14,000 by cheque;
29 Paid wages of assistant in cash ₹ 1,000;
31 Paid ₹ 20,000 into the bank.

Solution **In the books of P. Basak**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017	Bank A/c	Dr.		2,00,000	
Jan 1	Cash A/c	Dr.		40,000	
	To Capital A/c				2,40,000
	(Being capital invested)				
1	Furniture & Fittings A/c	Dr.		40,000	
	Van A/c	Dr.		60,000	
	To Bank A/c				1,00,000
	(Being the purchase of furniture and fittings and van for the business)				

2	Rent A/c Dr. To Bank A/c (Being rent paid by cheque)			5,000	5,000
3	Purchases A/c Dr. To Zakir & Co. A/c (Being goods purchased on credit)			50,000	50,000
5	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			5,000	5,000
8	Wages A/c Dr. To Cash A/c (Being wages paid to assistant)			1,000	1,000
10	Insurance A/c Dr. To Bank A/c (Being insurance paid by cheque)			500	500
12	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			8,000	8,000
15	Wages A/c Dr. To Cash A/c (Being wages paid in cash)			1,000	1,000
15	Zakir & Co A/c Dr. To Returns Outwards A/c (Being goods returned to Zakir & Co.)			6,000	6,000
17	Zakir & Co A/c Dr. To Bank A/c (Being paid by cheque)			30,000	30,000
19	Purchases A/c Dr. To Rao & Co A/c (Being goods purchased on credit)			25,000	25,000
19	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			7,000	7,000
22	Wages A/c Dr. To Cash A/c (Being wages paid to assistant)			1,000	1,000
24	Stationery A/c Dr. To Cash A/c (Being purchase of stationery)			500	500
25	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			15,000	15,000
27	Rao & Co A/c Dr. To Bank A/c (Being paid by cheque)			14,000	14,000
29	Wages A/c Dr. To Cash A/c (Being wages to assistant paid in cash)			1,000	1,000
31	Bank A/c Dr. To Cash A/c (Being cash paid into bank)			20,000	20,000
	GRAND TOTAL			5,30,000	5,30,000

Dr. **Bank Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2017	To Capital A/c		2,00,000	1.1.2017	By Furniture & Fittings A/c		40,000
31.1.2017	To Cash A/c		20,000		By Van A/c		60,000
				2.1.2017	By Rent A/c		5,000
				10.1.2017	By Insurance A/c		500
				17.1.2017	By Zakir & Co A/c		30,000
				27.1.2017	By Rao & Co A/c		14,000
				31.1.2017	By Balance c/d		70,500
			2,20,000				2,20,000
1.2.2017	To Balance b/d		70,500				

Dr. **Cash Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2017	To Capital A/c		40,000	8.1.2017	By Wages A/c		1,000
5.1.2017	To Sales A/c		5,000	15.1.2017	By Wages A/c		1,000
12.1.2017	To Sales A/c		8,000	22.1.2017	By Wages A/c		1,000
19.1.2017	To Sales A/c		7,000	24.1.2017	By Stationery A/c		500
25.1.2017	To Sales A/c		15,000	29.1.2017	By Wages A/c		1,000
				31.1.2017	By Bank A/c		20,000
				31.1.2017	By Balance c/d		50,500
			75,000				75,000
1.2.2017	To Balance b/d		50,500				

Dr. **Capital Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2017	To Balance c/d		2,40,000	1.1.2017	By Bank A/c		2,00,000
				1.1.2017	By Cash A/c		40,000
			2,40,000				2,40,000
				1.2.2017	By Balance b/d		2,40,000

Dr. **Furniture & Fittings Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2017	To Bank A/c		40,000	31.1.2017	By Balance c/d		40,000
1.2.2017	To Balance b/d		40,000				

Dr. **Van Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2017	To Bank A/c		60,000	31.1.2017	By Balance c/d		60,000
1.2.2017	To Balance b/d		60,000				

Dr. **Rent Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2.1.2017	To Bank A/c		5,000	31.1.2017	By Balance c/d		5,000
1.2.2017	To Balance b/d		5,000				

Dr. **Purchases Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
3.1.2017	To Zakir & Co A/c		50,000	31.1.2017	By Balance c/d		75,000
19.1.2017	To Rao & Co A/c		25,000				
			75,000				75,000
1.2.2017	To Balance b/d		75,000				

Dr. **Zakir & Co Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
15.1.2017	To Returns Outwards A/c		6,000	31.1.2017	By Purchases A/c		50,000
17.1.2017	To Bank A/c		30,000				
31.1.2017	To Balance c/d		14,000				
			50,000				50,000
				1.2.2017	By Balance c/d		14,000

Dr. **Sales Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2017	To Balance c/d		35,000	5.1.2017	By Cash A/c		5,000
				12.1.2017	By Cash A/c		8,000
				19.1.2017	By Cash A/c		7,000
				25.1.2017	By Cash A/c		15,000
			35,000				35,000
				1.2.2017	By Balance b/d		35,000

Dr. **Wages Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
8.1.2017	To Cash A/c		1,000	31.1.2017	By Balance c/d		4,000
15.1.2017	To Cash A/c		1,000				
22.1.2017	To Cash A/c		1,000				
29.1.2017	To Cash A/c		1,000				
			4,000				4,000
1.2.2017	To Balance b/d		4,000				

Dr. **Insurance Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
10.1.2017	To Bank A/c		500	31.1.2017	By Balance c/d		500
1.2.2017	To Balance b/d		500				

Dr. **Returns Outwards Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2017	To Balance c/d		6,000	15.1.2017	By Zakir & Co A/c		6,000
				1.2.2017	By Balance b/d		6,000

Dr. **Rao & Co Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
27.1.2017	To Bank A/c		14,000	19.1.2017	By Purchases A/c		25,000
31.1.2017	To Balance c/d		11,000				
			25,000				25,000
				1.2.2017	By Balance b/d		11,000

Dr. **Stationery Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
24.1.2017	To Cash A/c		500	31.1.2017	By Balance c/d		500
1.2.2017	To Balance b/d		500				

Illustration 11

Complete in every details, the posting of the following Journal Entry in the ledger of Mr. X.

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 April 1	Cash A/c	Dr.		10,000	
	Bank A/c	Dr.		30,000	
	To Capital A/c				40,000
	(Being money invested by the owner in his new business)				

Solution

Ledger of X

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Capital A/c	10,000			

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Capital A/c	30,000			

Dr. **Capital Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			1.4.2017	By Cash A/c	10,000
			1.4.2017	By Bank A/c	30,000

Illustration 12

Prepare the Stationery Account of a firm for the year ended 31.12.2016 duly balanced off, from the following details: ₹

			₹
Jan.	1	Stock in hand	480
Apr.	5	Purchase of stationery by cheque	800
Nov.	15	Purchase of stationery on credit from Five Star Stationery Mart	1,280
Dec.	20	Purchase of stationery from petty cash	80
Dec.	31	Stock in hand	240

Solution

Dr.		Stationery Account			Cr.
Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	480	31.12.2016	By Profit & Loss A/c (Balancing figure)	2,400
5.4.2016	To Bank A/c	800	31.12.2016	By Balance c/d	240
15.11.2016	To Five Star Stationery Mart A/c	1,280			
20.12.2016	To Petty Cash A/c	80			
		2,640			2,640

Illustration 13

The following data is given by Mr. Singh, the owner, with a request to compile only the two personal accounts of Mr. Herbert and Mr. Robert, in his ledger, for the month of April 2017.

1 Mr. Singh owes Mr. Robert ₹ 15,000; Mr. Herbert owes Mr. Singh ₹ 20,000.

4 Mr. Robert sold goods worth ₹ 60,000 @ 10% trade discount to Mr. Singh.

5 Mr. Singh sold to Mr. Herbert goods prices at ₹ 30,000.

17 Record a purchase of ₹ 25,000 net from Robert, which were sold to Herbert at a profit of ₹ 15,000.

18 Mr. Singh rejected 10% of Mr. Robert's goods of 4th April.

19 Mr. Singh issued a cash memo for ₹ 10,000 to Mr. Herbert who came personally for this consignment of goods, urgently needed by him.

22 Mr. Herbert cleared half his total dues to Mr. Singh, enjoying a $^1/_2$% cash discount (of the payment received ₹ 20,000 was by cheque).

26 Robert's total dues (less ₹ 10,000 held back) were cleared by cheque, enjoying a cash discount of ₹ 1,000 on the payment made.

29 Close Herbert's Account to record the fact that all but ₹ 5,000 was cleared by him, by a cheque, because he was declared bankrupt.

30 Balance Robert's Account.

Solution

In the books of Mr. Singh

Dr.		Mr. Herbert Account			Cr.
Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	20,000	22.4.2017	By Bank A/c	20,000
5.4.2017	To Sales A/c	30,000	22.4.2017	By Cash A/c (Note 2)	24,775
17.4.2017	To Sales A/c	40,000	29.4.2017	By Discount Allowed A/c	225
			29.4.2017	By Bank A/c	40,000
			29.4.2017	By Bad Debts A/c	5,000
		90,000			90,000

Dr.		Mr. Robert Account			Cr.
Date	Particulars	₹	Date	Particulars	₹
18.4.2017	To Purchase Returns A/c	5,400	1.4.2017	By Balance b/d	15,000
26.4.2017	To Bank A/c	77,600	4.4.2017	By Purchases A/c	54,000
26.4.2017	To Discount Received A/c	1,000	17.4.2017	By Purchases A/c	25,000
30.4.2017	To Balance c/d	10,000			
		94,000			94,000
			1.5.2017	By Balance b/d	10,000

Working Notes:

(1) Sale of ₹ 10,000 on 19th April is a cash sales, therefore, it will not be recorded in the Personal Account of Mr. Herbert; and

(2) On 22nd April, Mr. Herbert owes Mr. Singh ₹ 90,000, amount paid by Mr. Herbert $^1/_2$ of ₹ 90,000 less $^1/_2$% discount, i.e. ₹ 45,000 – ₹ 225 = ₹ 44,775. Out of this amount, ₹ 20,000 paid by cheque and the balance of ₹ 24,775 in cash.

Illustration 14

The following balances appeared in the books of Jane Seymour on 1st March, 2017 :

	₹
Cash Book (Bank Balance, Debit)	8,500
General Ledger :	
Sales Account	89,000
Purchases Account	42,000
Returns Inward Account	5,000
Sales Ledger :	
D Jones	4,000
N Cross	3,000
P White Limited	2,500

Purchases Ledger :

J Freemen	18,000
Value Supplies Limited	14,000

During the month of March 2017, the following transactions took place :

			₹
1. *Purchases of goods on credit for resale :*			
March	4	Value Supplies Limited	26,000
	20	J Freemen	6,000
2. *Sales on Credit :*			
March	9	D Jones	5,000
	21	N Cross	8,000
3. *Returns Inward :*			
March	15	D Jones	600
4. *Payment received by cheque :*			
March	8	N Cross in full settlement of account at 1st March less 10% discount	2,700
5. *Payment made by cheque :*			
March	3	Value Supplies Limited	14,000

From the above information open the accounts which would appear in Jane's Ledger, and show the Cash Book (Bank Column).

Record the above transactions for the month of March, 2017 (entries in subsidiary books are not required). Balance the accounts as at 31st March, 2017.

Solution

Dr. Cash Book (Bank Column) Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		8,500	March 3	By Value Supplies Ltd. A/c		14,000
8	To N Cross A/c		2,700		(Being paid by cheque)		
	(Being a cheque received from N. Cross)						
31	To Balance c/d		2,800				
			14,000				14,000

In the General Ledger

Dr. Sales Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 31	To Balance c/d		1,02,000	March 1	By Balance b/d		89,000
				9	By D Jones A/c		5,000
				21	By N Cross A/c		8,000
			1,02,000				1,02,000

Dr. Purchases Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		42,000	March 31	By Balance c/d		74,000
4	To Value Supplies Ltd. A/c		26,000				
20	To J Freeman		6,000				
			74,000				74,000

Dr. Returns Inward Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		5,000	March 31	By Balance c/d		5,600
15	To D Jones A/c		600				
			5,600				5,600

Dr. Discount Allowed Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 8	To N Cross A/c		300	March 31	By Balance c/d		300

In the Sales Ledger

Dr. D Jones Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		4,000	March 15	By Returns Inward A/c		600
9	To Sales A/c		5,000	31	By Balance c/d		8,400
			9,000				9,000

Dr. N Cross Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		3,000	March 8	By Bank A/c		2,700
21	To Sales A/c		8,000	"	By Discount Allowed A/c		300
				31	By Balance c/d		8,000
			11,000				11,000

Dr. P White Limited Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 1	To Balance b/d		2,500	March 31	By Balance c/d		2,500

In the Purchases Ledger

Dr. J Freeman Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 31	To Balance c/d		24,000	March 1	By Balance b/d		18,000
				20	By Purchases A/c		6,000
			24,000				24,000

Dr. Value Supplied Account Cr.

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2017				2017			
March 3	To Bank A/c		14,000	March 1	By Balance b/d		14,000
31	To Balance c/d		26,000	4	By Purchases A/c		26,000
			40,000				40,000

Purchases Day Book

All credit purchases of goods are primarily recorded in this book. On receiving the goods and the invoice, the receiving department compare both with the copy of the order placed by the purchase department. If everything is found in order, the goods are sent to the stores. On the basis of the invoice received from the supplier, necessary record is made in the Purchases Day Book.

Specimen of an Inward Invoice:

INVOICE

No- 786/2017
Date : 19th Feb, 2017

M.K. & Co Ltd.
40, Jawaharlal Nehru Road
Calcutta 700016

Customer's Name P.C. Chandra & Sons
P/16 C.I.T. Road
Calcutta 700017

Qty.	Description	Rate	Amount	Total (₹)	Remarks

E. & O. E.

It is clear from the specimen that an invoice contains the following details:

1. Names and addresses of both the parties to the contract of sale.

2. An exact description of the goods, including the quantity, rate and total value of the goods.
3. The terms and conditions of sale (on the overleaf).

E.&O.E. means Errors and Omissions Excepted. The supplier reserves the right to correct any errors in the invoice.

The ruling of the Purchases Day Book is given below :

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹

(i) In the 'Date' column, the date on which the invoice is received is entered.
(ii) In the 'Particulars' column, the names of the suppliers are recorded. A brief description of each type of article purchased are also written in this column.
(iii) In the 'Invoice No.' column, the serial number of the Inward Invoice is written.
(iv) In the 'L.F.' column, the page number of creditors' account in the Creditors' Ledger is written.
(v) In the 'Details' column, the value of the goods purchased and amount of trade discount received are written.
(vi) In the 'Total' column, the actual amount payable to the creditors is written.

Illustration 15

From the following particulars given below, write up the Purchases Day Book of M/s Universal Electric Co, which deals in electric goods:

Jan. 5 Purchased on Credit from Bajaj Electric Co.—10 Electric Iron @ ₹ 70 each; 5 Electric Stoves @ ₹ 60 each;
Jan. 19 Purchased on Credit from Capital Electric Co.—30 Electric Heaters @ ₹ 100 each; 20 Electric Kettles @ ₹ 60 each;
Jan. 25 Purchased from Paul Electric Co. on Credit—10 Toasters @ 120 each; 5 Electric Heaters @ ₹ 60 each;
Jan. 30 Purchased from Bombay Electric Stores on Credit—20 Electric Shavers @ ₹ 200 each; 5 Electric Fans @ ₹ 400 each.

Solution

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 5	**Bajaj Electric Co.**				
	10 Electric Iron @ ₹ 70 each			700	
	5 Electric Stoves @ ₹ 60 each			300	1,000
Jan. 19	**Capital Electric Co.**				
	30 Electric Heaters @ ₹ 100 each			3,000	
	20 Electric Kettles @ ₹ 60 each			1,200	4,200
Jan. 25	**Pal Electric Co.**				
	10 Toasters @ ₹ 120 each			1,200	
	5 Electric Heaters @ ₹ 60 each			300	1,500
Jan. 30	**Bombay Electric Stores**				
	20 Electric Shavers @ ₹ 200 each			4,000	
	5 Electric Fans @ ₹ 400 each			2,000	6,000
					12,700

These figures are credited to Supplier's Individual Account..

This total of the book is posted periodically to the Debit of Purchases Account.

Trade Discount

Trade Discount is a reduction made in the catalogue price of an article to enable the retailer to earn a profit. Generally, it is recorded in the Purchases Book and Sales Book but it does not enter in the ledger accounts. In the ledger, only net amount of purchase and sale are entered. Observe the following illustration :

Illustration 16

Draw up a properly ruled Purchases Day Book from the following particulars:

Jan. 1 Purchased from Electronic Corporation Ltd. on credit: 50 Black & White T.V. @ ₹ 3,000 each, less 10 % Trade Discount. 10 Colour T.V. @ ₹ 6,000 each, less 10% Trade Discount.

9 Purchased from Pico Electronics Co. Ltd. on credit: 10 Pieces of Taperecorder @ ₹ 1,000 each, less 10% Trade Discount. 10 Pieces of Two-in-one @ ₹ 1,500 each, less 10% Trade Discount.

19 Purchased from Calcutta Gramophone Mart on credit: 100 pieces of Gramophone records @ ₹ 30 each, less Trade Discount @ 5%.

29 Purchased from Bharat Stationers on credit for office use —10 dozen of carbon papers @ ₹ 35 per dozen; 10 dozen of ball pens @ ₹ 25 per dozen.

Solution

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 1	**Electronic Corporation Ltd.**				
	50 Black & White T.V. @ ₹ 3,000 each			1,50,000	
	10 Colour T.V. @ ₹ 6,000 each			60,000	
				2,10,000	
	Less: Trade Discount @ 10%			21,000	1,89,000
Jan. 9	**Pico Electronics Co. Ltd.**				
	10 pieces of Taperecorder @ ₹ 1,000 each			10,000	
	10 pieces of Two-in-one @ ₹ 1,500 each			15,000	
				25,000	
	Less: Trade Discount @ 10%			2,500	22,500
Jan. 19	**Calcutta Gramophone Mart**				
	100 pieces of gramophone records @ ₹ 30 each			3,000	
	Less: Trade Discount @ 5%			150	2,850
					2,14,350

Tutorial Note : It should be noted that credit purchase of stationery will not be recorded in the Purchases Day Book. It is to be recorded in the Journal Proper.

Illustration 17

Record the following transactions in a suitably ruled Purchases Day Book.

Mar. 1 Purchased goods from M/s A. & Co., 20 bales of cotton @ ₹ 1,000 per bale, less trade discount @ 5% and cash discount @ 6%.

Mar. 12 Purchased from Madura Coats 1,500 mtrs of fabrics @ ₹ 2 per mtr, less trade discount @ 10%.

Mar. 25 Purchased from Silk House, 20 bales of silk pcs @ ₹ 3,000 per bale, less trade discount @ 5%.

Mar. 30 Purchased furniture from Bombay Safe for ₹ 5,000.

Solution

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
March 1	**M/s A & Co.**				
	20 bales of cotton @ ₹ 1,000 per bale			20,000	
	Less: Trade Discount @ 5%			1,000	19,000
March 12	**Madura Coats**				
	1,500 metres of cotton fabrics @ ₹ 2 per metre			3,000	
	Less: Trade Discount @ 10%			300	2,700
March 25	**Silk House**				
	20 bales of silk pieces @ ₹ 3,000 per bale			60,000	
	Less: Trade Discount @ 5%			3,000	57,000
					78,700

Tutorial Note : Purchase of furniture from Bombay Safe will be recorded in the Journal Proper. Similarly, cash discount will be recorded in Cash Book when payment will be made within a specified time.

Posting the Purchases Day Book into the Ledger

After the transactions are entered in the Purchases Day Book, posting those into the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the credit side of the appropriate individual account in the Creditors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the aggregate of the 'total column' is posted to the General Ledger by passing the following entry :

Purchases Account Dr.
To Sundry Creditors Account (Control Account)

Illustration 18

From the information of illustration 3, show ledger posting.

Solution

General Ledger

Purchases Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
March 31	To Sundry Creditors A/c	78,700			

Sundry Creditors Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
			March 31	By Purchases A/c	78,700

Creditors' Ledger

M/s A & Co. Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
			March 1	By Purchases A/c	19,000

Madura Coats Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
			March 12	By Purchases A/c	2,700

Murshidabad Silk House Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
			March 25	By Purchases A/c	57,000

Sales Day Book

In this book, all credit sales are recorded. It should be remembered that Sales Day Book records only those goods which are sold on credit and the goods in question must be those, which the firm generally deals in.

Procedure for Writing up the Sales Day Book

When goods are sold on credit, an outward invoice is prepared for every credit sale and are checked as to quality, quantity and price of the goods before they are despatched to the customers. The duplicate copy of the invoice remains with the firm and the original copy is sent to the customer. Sales Day Book is written up on the basis of duplicate outward invoice.

Specimen of an Outward Invoice is given below:

INVOICE

No- P-29
Date : 9th June, 2017

F.G. Cable Co. Ltd.
31, Jawaharlal Nehru Road
Calcutta 700016

Customer's Name West Bengal State Electricity Board
Block- CG, Sale Lake
Calcutta - 700091

Qty.	Description	Rate	Amount	Total (₹)	Remarks

E. & O. E.

The invoice contains the following details:
1. The names and addresses of both the parties to the contract.
2. An exact description of the goods, including the quantity, rate and total value of the goods sold.
3. The terms and conditions of sales (on the overleaf).

E. &.O. E. means Errors and Omissions Excepted. The maker reserves the right to correct any error in the invoice.
The ruling of the Sales Day Book is given below :

Sales Day Book

Date	Particulars	Outward Invoice No.	L.F.	Details ₹	Total ₹

1. In the 'Date' column, the date on which the invoice is prepared is entered.
2. In the 'Particulars' column, the names of the customers are recorded. A brief description of each type of article sold is also written in this column.
3. In the 'Outward Invoice No.' column, the serial number of Outward Invoice is written.
4. In the 'L.F.' column, the page number of the Debtors' Account in the Debtors' Ledger is written.
5. In the 'Details' column, the value of the goods sold and amount of trade discount is written.
6. In the 'Total' column, the actual amount receivable from debtors is written.

Illustration 19

From the following transactions write up the Sales Day Book of M/s X & Co. :

Jan. 1 Sold to Premier Traders 100 bags of sugar @ ₹ 650 per bag, less trade discount @ 5%.
Jan. 10 Sold to R & Co. 10 bags of milk powder @ ₹ 500 per bag, less trade discount @ 10%.
Jan. 20 Sold to Tea King (P) Ltd. 10 chests C.T.C. Tea @ ₹ 2,000 per chest, less trade discount @ 10%.
Jan. 29 Sold old office furniture on credit to Modern Furniture for ₹ 2,500.

Solution **Sales Day Book**

Date	Particulars	Outward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 1	**Premier Traders**				
	100 bags of sugar @ 650 per bag			65,000	
	Less: Trade Discount @ 5%			3,250	61,750
Jan. 10	**R. & Co.**				
	10 bags of milk powder @ ₹ 500 per bag			5,000	
	Less: Trade Discount @ 10%			500	4,500
Jan. 20	**Tea King (P) Ltd**				
	10 chests of CTC tea @ ₹ 2,000 per chest			20,000	
	Less: Trade Discount @ 10%			2,000	18,000
					84,250

These figures are debited to Customer's Individual Account..

This total of the book is posted periodically to the Credit of Salees Account.

Tutorial Note : Sale of old furniture to be passed through Journal Proper.

Sales Book With VAT Column

VAT is a tax levied at the point of sale. It is based on the selling price of goods or services. It is the duty of the seller to realise VAT from customers and deposit it to the Government. VAT is calculated at a fixed percentage on the net price of the goods, i.e, after trade discount. Generally a separate column is provided in the Sales Day

Book for VAT. Periodically, the total of VAT column is credited to VAT Account. When actual payment is made to the Government, the VAT Account is debited and Cash/Bank Account is credited and any balance of VAT Account at the end of the year is shown in the Balance Sheet as a liability.

Illustration 20

Enter the following transactions in Sales Day Book :

Apr. 1 Sold to Indian Coffee House 50 chests of coffee @ ₹ 600 per chest, less Trade Discount 5%, Excise Duty to be charged @ 10%.

Apr. 5 Sold to Subodh Bros. 100 kg. of Tea @ ₹ 30 per kg. less 5% Trade Discount. Excise Duty 5% extra.

Apr. 15 Sold to Dhar Bros. 20 bags of milk powder @ ₹ 1,000 per bag, less 2% Trade Discount. Excise Duty @10%.

Apr. 28 Sold to Robin & Co. 10 chests of tea @ ₹ 600 per chest, less 10% Trade Discount. Excise Duty 5% extra.

VAT is charged @ 8% on all sales.

Solution **Sales Day Book**

Date	Particulars	Gross Amount	Trade Discount	Excise Duty	Net Price	VAT 8%	Total Amount
		₹	₹	₹	₹	₹	₹
April 1	**Indian Coffee House** 50 chests of coffee @ ₹ 600 per chest — 5% T.D.; 10% E.D.	30,000	1,500	3,000	31,500	2,520	34,020
April 5	**Subodh Bros.** 100 kg.. of Tea @ ₹ 30 per kg. — 5% T.D.; 5% E.D.	3,000	150	150	3,000	240	3,240
April 15	**Dhar Bros.** 20 bags of milk power @ ₹ 1,000 per bag — 2% T.D.; 10% E.D.	20,000	400	2,000	21,600	1,728	23,328
April 28	**Robin & Co.** 10 chests of Tea @ ₹ 600 per chest — 10% T.D.; 5% E.D.	6,000	600	300	5,700	456	6,156
		59,000	2,650	5,450	61,800	4,944	66,744

Tutorial Note: (1) Excise duty is calculated on list price. (2) VAT is calculated on net price.

Posting the Sales Day Book into the Ledger

After the transactions are entered in the Sales Day Book, posting those into the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the debit side of the appropriate individual account in the Debtors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total is posted to the General Ledger by passing the following entry:

Sundry Debtors Account (Control Account) Dr.
To Sales Account
To VAT Payable Account

Illustration 21

Enter the following transactions in Sales Day Book and post them into ledger:

May 1 Sold to Allied Radio Stores 5 pieces of Radio @ ₹ 1,000 each, less Trade Discount 5%.

May 8 Sold to J.D. Electronics Co. 5 pieces of Colour T.V. @ 6,000 each, less 5% Trade Discount.

May 20 Sold to Anandamela Stores, 10 pieces of Car-stereo @ ₹ 900 each, less 5% Trade Discount.

All sales are subject to 10% VAT.

Solution **Sales Day Book**

Date	Particulars	Gross Amount	Trade Discount	Excise Duty	Net Price	VAT 10%	Total Amount
		₹	₹	₹	₹	₹	₹
May 1	**Allied Radio Stores** 5 pcs. of radio @ ₹ 1,000 each less 5% T.D.	5,000	250	—	4,750	475	5,225
May 8	**J.D. Electronics Co.** 5 pcs. of colour T.V. @ ₹ 6,000 each less 5% T.D.	30,000	1,500	—	28,500	2,850	31,350
May 20	**Anandamela Stores** 10 pcs. of car-stereo @ ₹ 900 each less 5% T.D.	9,000	450	—	8,550	855	9,405
		44,000	2,200	—	41,800	4,180	45,980

General Ledger

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 31	To Sales A/c To VAT Payable A/c	41,800 4,180			

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Debtors A/c	41,800

Dr. VAT Payable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Debtors A/c	4,180

Debtors' Ledger

Dr. Allied Radio Stores Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 1	To Sales A/c To VAT Payable A/c	4,750 475			

Dr. J.D. Electronics Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 8	To Sales A/c To VAT Payable A/c	28,500 2,850			

Dr. Anandamela Stores Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 20	To Sales A/c To VAT Payable A/c	8,550 855			

Purchases Returns Book

It may be necessary to return some goods that the firm has bought on credit for a variety of reasons such as defective or excess quantity of goods supplied, etc. All returns of goods are recorded primarily in the Purchases Returns Book.

When a firm returns some goods to its supplier, it prepares a 'Debit Note' and sends it along with the goods returned. The supplier, in turn, will prepare a 'Credit Note'. The original copy of the credit note will be sent to the firm. Entries in the Purchases Returns Book are made on the basis of original 'Credit Note' received from the supplier. On receipt, all credit notes should be numbered consecutively and should be filed properly for future reference. Purchases Returns Book is prepared in the same way as Purchases Day Book, except that it should, in addition, include a brief description of the reason for the return in the remarks column.

The specimen of the Purchases Returns Book is given below :

Purchases Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks

Posting the Purchases Returns into the Ledger

After transactions are entered in the Purchases Returns Book, Posting to the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the debit side of the appropriate individual account in the Creditors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total of the amount column is posted to the General Ledger passing the following entry:

Sundry Creditors Account (Control Account) Dr.
To Purchases Returns Account

Debit Note

It is a commercial document notifying a person that a debit has been made to his accounts. For example, if the goods are sold on credit and a part of that is returned, a debit note might be issued for the value of the goods returned.

Credit Note

It is a document evidencing that a credit entry has been made to a debtors' account. For example, if a customer returns a part of the goods previously sold on credit, or credit rate may be issued.

Illustration 22

From the following information, write up a Purchases Returns Book of M/s. Agarwal & Sons and post them into Ledger:

May 1 Returned to Uptron Television Co. Ltd. 4 colour T.V. @ ₹ 6,000 each.
May 15 Returned to Philips (India) Ltd. 2 pieces of Two-in-one @ ₹ 2,500 each.
May 19 Returned to Bajaj Electricals Ltd. 2 pieces of Electric heater @ ₹100 each.
May 29 Returned to BPL-India Ltd. 3 pieces of VCR @ ₹ 10,000 each.

Solution

Purchases Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks
May 1	**Uptron Television Co. Ltd.** 4 colour T.V. @ ₹ 6,000 each			24,000	
May 15	**Philips (India) Ltd.** 2 pcs. of Two-in-one @ ₹ 2,500 each			5,000	
May 19	**Bajaj Electricals Ltd.** 2 pcs. of Electric heater @ ₹ 100 each			200	
May 29	**BPL India Ltd.** 3 pcs. of VCR @ ₹ 10,000 each			30,000	
				59,200	

General Ledger

Dr. **Purchases Returns Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Creditors A/c	59,200

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 31	To Purchases Returns A/c	59,200			

Creditors' Ledger

Dr. **Uptron Television Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 1	To Purchases Returns A/c	24,000			

Dr. **Philips (India) Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 15	To Purchases Returns A/c	5,000			

Dr. **Bajaj Electricals Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 19	To Purchases Returns A/c	200			

Dr. **BPL India Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 29	To Purchases Returns A/c	30,000			

Sales Returns Book

Goods may be returned by the customers for a variety of reasons such as wrong quantity and/or quality. All goods returned by the customers are primaily recorded in this book.

When goods are returned by the customer, a 'Credit Note' is made out in his name. A Credit Note is prepared in duplicate. The original being sent to the customer for his information and record. The duplicate is preserved in the file for future reference. Duplicate credit note provides information for recording in the Sales Returns Book.

The specimen ruling of the Sales Returns Book is given below :

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks

Like Purchases Returns Book, Sales Returns Book is also prepared in the same way as Sales Day Book except that it should, in addition, include a brief description of the reasons for the return in the remarks column.

Posting the Sales Returns into the Ledger

After transactions are entered in the Sales Returns Book, posting to the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the credit side of the appropriate individual account in the Debtors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total of the amount column is posted into the General Ledger, by passing the following entry:

Sales Return Account (Control Account) Dr.
To Sundry Debtors Account

Illustration 23

From the following information, write-up a Sales Returns Book of Allied Electronics Co. Ltd. and post them into ledger:

Apr 1 Returned by Sur-O-Bani 4 pieces of Philips radio costing ₹ 1,500 each.
Apr 9 Returned by Capital Electronics 3 pieces of VCP costing ₹ 9,000 each.
Apr 29 Returned by K.B. & Co. 2 pieces of Two-in-one costing ₹ 2,000 each.

Solution

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks
April 1	**Sur-O-Bani** 4 pcs. of Philips radio @ ₹ 1,500 each			6,000	
April 9	**Capital Electronics** 3 pcs. of VCP @ ₹ 9,000 each			27,000	
April 29	**K.B. & Co.** 2 pcs. of Two-in-one @ ₹ 2,000 each			4,000	
				37,000	

General Ledger

Dr. Sales Returns Account Cr.

Date	Particulars	₹	Date	Particulars	₹
April 30	To Sundry Debtors A/c	37,000			

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 30	By Sales Returns A/c	37,000

Debtors' Ledger

Dr. Sur–O–Bani Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 1	By Sales Returns A/c	6,000

Dr. Capital Electronics Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 9	By Sales Returns A/c	27,000

Dr. K.B. & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 29	By Sales Returns A/c	4,000

Journal Proper or General Journal

Journal Proper is used for making the original record of those transactions, because of their importance or rareness of occurrence which do not find a place in any of the aforesaid books of original entry.

Entries recorded in the Journal Proper may be classified as follows:

(1) Opening entries; (2) Closing entries; (3) Transfer entries; (4) Rectification of Errors entries; (5) Adjusting entries; (6) Credit purchase of assets; (7) Credit sale of worn-out or obsolete assets; (8) Credit purchase of stationery. The specimen ruling of the Journal Proper is given below :

Journal Proper Dr. Cr.

Date	Particulars	L.F.	₹	₹
(1)	(2)	(3)	(4)	(5)

(1) Date—This column records the date of transaction.
(2) Particulars—This column records the name of the accounts debited or credited. The account debited is written first, adjacent to the line of date and the account credited is written below with the prefix 'To'. In this column, the narration is also recorded.
(3) L.F.—This column records the page number of ledger in which this account has been posted.
(4) Dr. column—It records the debit amount.
(5) Cr. column—It records the credit amount.

1. Opening Entries

Opening entries are used at the beginning of the financial year to open the books by recording the assets, liabilities and capital, appearing in the Balance Sheet of the previous year. The rule to be applied is :

Assets Account Dr.
  To Liabilities Account
  To Capital Account

Illustration 24

Balance Sheet of A. B. & Co. as at 31st December, 2016

Liabilities	₹	Assets	₹
Capital	1,50,000	Land and Building	80,000
Sundry Creditors	30,000	Plant and Machinery	30,000
Outstanding Salaries	20,000	Furniture	20,000
		Stock-in-trade	20,000
		Cash in hand	20,000
		Cash at bank	30,000
	2,00,000		2,00,000

You are required to pass Opening entry.

Solution **Journal Proper Dr. Cr.**

Date	Particulars		L.F.	₹	₹
2017 Jan.1	Land and Building A/c	Dr.		80,000	
	Plant and Machinery A/c	Dr.		30,000	
	Furniture A/c	Dr.		20,000	
	Stock-in-trade A/c	Dr.		20,000	
	Cash at bank A/c	Dr.		30,000	

	Cash in hand A/c Dr.			20,000	
	To Sundry Creditors A/c				30,000
	To Outstanding Salaries A/c				20,000
	To Capital A/c				1,50,000
	(Being last year's balances brought forward)				

(It may, however, be mentioned that some accountants do not pass this opening entry but bring forward balances from preceding year directly to the ledger of the new financial year.)

2. Closing Entries

Closing entries are used at the end of accounting year for closing off accounts relating to expenses and revenues. These accounts are closed off by transferring their balances to the Trading and Profit and Loss Accounts. Since records must not be made in the ledger without journal entries, closing entries are passed in the Journal Proper first and then posted to the ledger. For example: let there be a debit balance in the purchase account of ₹ 75,000 at the end of the accounting year 2016. Now at the time of preparation of Final Accounts we will have to close off the Purchases Account as follows:

Journal Proper (Closing Entry) **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2016 Dec.31	Trading A/c Dr.		75,000	
	To Purchases A/c			75,000
	(Being transfer of Purchases Account to Trading Account for determining gross profit)			

Dr. **Purchases Account (After Closure)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
Jan. to Dec.	To Sundry Creditors A/c	75,000	Dec. 31, 2016	By Trading A/c	75,000

Dr. **Trading Account for the year ended 31st December, 2016** **Cr.**

To Purchases	75,000		

Illustration 25

At the end of his financial year, December 31, 2016, a trader's books show the following balances in the Nominal Accounts:

Purchases ₹ 10,050; Sales ₹ 15,668; Selling expenses ₹ 1,644; Returns Outwards ₹ 233; Returns Inwards ₹ 355; Establishment expenses ₹ 878; Discounts (Cr) ₹ 109; Discounts (Dr) ₹ 87; Office Expenses ₹ 1,448.

Besides, the Closing Stock Account in the Stock Ledger shows a balance of ₹ 644; but the actual year-end stock on counting was valued at ₹ 499. Draft the closing Journal entries relating to the compilation of Trading and Profit and Loss Accounts.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2016	Trading A/c Dr.		10,405	
Dec. 31	To Purchases A/c			10,050
	To Returns Inwards A/c			355
	(Being transferred to Trading Account to determine gross profit)			
	Sales A/c Dr.		15,668	
	Returns Outwards A/c Dr.		233	
	Closing Stock A/c Dr.		499	
	To Trading A/c			16,400
	(Being transferred to Trading Account to determine gross profit)			
	Trading A/c Dr.		5,995	
	To Profit & Loss A/c			5,995
	(Being gross profit transferred to Profit and Loss Account)			
	Profit & Loss A/c Dr.		4,057	
	To Selling Expenses A/c			1,644
	To Establishment Expenses A/c			878
	To Discount Allowed A/c			87
	To Office Expenses A/c			1,448
	(Being transferred to Profit and Loss Account for determining net profit)			
	Discount Received A/c Dr.		109	
	To Profit & Loss A/c			109
	(Being transferred to Profit and Loss Account for determining net profit)			
	Profit & Loss A/c Dr.		2,047	
	To Capital A/c			2,047
	(Being net profit transferred to Capital Account)			

3. Transfer Entries

Transfer entries are passed in the Journal Proper for transferring an item, entered in one account, to another account. For example, let ₹ 20,000 to be transferred to general reserve out of profit for the year ended on 31st December 2016; the entry should be passed through Journal Proper.

Journal Proper **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2016 Dec.31	Profit & Loss A/c Dr. To General Reserve A/c (Being the amount transferred to General Reserve)		20,000	20,000

4. Rectification Entries

Mistake which has been made in passing an entry should be corrected by passing another entry in the Journal Proper and the practice of erasures should not be tolerated. *[For details see Chapter, 'Rectification of Errors'.]*

5. Adjustment Entries

Adjustment entry is an amendment to an accounting figure which is basically correct but which needs to allow for some circumstances not recorded in the bookkeeping system. Adjustment in accounts are very common. In an accrual system of accounting, adjustment entries are made to the Trial Balance at Balance Sheet date in provisions and reserves, prepaid and outstanding expenses; and, income received in advance and accrued income. Adjustment entries are passed before they are transferred to the Trading and Profit and Loss Account and Balance Sheet. This is because, adjustment entries always have a dual effect. They affect either the Trading Account or the Profit and Loss Account but definitely the Balance Sheet.

Illustration 26

For each of the following transactions, show Adjustment Entries for the purpose of preparing Final Accounts:

(i) Outstanding rent ₹ 4,500
(ii) Salary due to an employee but not received by him ₹ 1,500
(iii) Insurance premium paid in advance ₹ 1,200
(iv) Rent paid to landlord in advance ₹ 1,200
(v) Closing stock valued at ₹ 3,900
(vi) Interest due on loan but not paid. Loan of ₹ 15,000 was taken at 9% p.a., 9 months before the end of the year.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L F	₹	₹
(i)	Rent A/c Dr. To Outstanding Rent A/c (Being the adjustment of outstanding rent)		4,500	4,500
(ii)	Salaries A/c Dr. To Outstanding Salaries A/c (Being the adjustment for salaries due but not paid)		1,500	1,500
(iii)	Prepaid Insurance A/c Dr. To Insurance Premium A/c (Being the adjustment of insurance premium paid in advance)		1,200	1,200
(iv)	Rent Paid in Advance A/c Dr. To Rent A/c (Being the adjustment of rent paid in advance)		1,200	1,200
(v)	Closing Stock A/c (Note 1) Dr. To Purchases A/c (Being the adjustment of closing stock)		3,900	3,900
	Alternatively, Closing Stock A/c Dr. To Trading A/c (Being the adjustment of closing stock)		3,900	3,900
(vI)	Interest on Loan A/c (Note 2) Dr. To Outstanding Interest A/c (Being the adjustment of outstanding interest for 9 months @ 9% p.a. on ₹ 15,000)		1,013	1,013

Working Notes :

(1) Closing stock represents a part of purchased goods not yet sold. Therefore, for adjustment, Purchases Account will be credited and closing stock Account will be debited.
Alternatively, closing stock can be debited and Trading Account can be credited.

(2) Interest on loan = ₹ 15,000 x 9/100 x 9 / 12 = ₹ 1,012.50 or ₹ 1,013 (rounded off).

Illustration 27

How would you deal with the following in accounting of a going concern ?

(i) Rent amounting to ₹ 5,000 paid in advance for the next financial year and the total rent paid ₹ 20,000.

(ii) Outstanding wages for the current year amounted to ₹ 15,000.

(iii) ₹ 2,000 is due from Sri Basu, a debtor, is unrealisable from him.

Pass Journal Entries and show Profit and Loss Account relating to the entries stated above.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars		L F	₹	₹
(i)	Rent Paid in Advance A/c	Dr.		5,000	
	To Rent A/c				5,000
	(Being the adjustment of rent paid in advance)				
(ii)	Wages A/c	Dr.		15,000	
	To Outstanding Wages A/c				15,000
	(Being the adjustment of wages due but not paid)				
(iii)	Bad Debts A/c	Dr.		2,000	
	To Debtors A/c				2,000
	(Being the amount unrealisable from Sri Basu written off as bad debt)				

Dr. **Profit and Loss Account (includes . . .)** **Cr.**

Particulars	₹	Particulars	₹
To Rent A/c (Note 1)	15,000		
To Bad Debts A/c	2,000		

Working Note :

(1) Total rent paid ₹ 20,000, out of which ₹ 5,000 paid as advance rent.
Therefore, only ₹ 15,000 (₹ 20,000 – ₹ 5,000) will be debited to Profit and Loss Account.

Illustration 28

Before you prepare Final Accounts for the year ended 31st March 2017 pass necessary Journal entries in respect of the following: (i) Commission earned but not received ₹ 1,200; (ii) Closing stock as at 31st March, 2017 ₹ 20,000; (iii) To carry forward one-fifth of an Insurance Premium paid at ₹ 2,780; (iv) Unpaid salary for ₹ 340 is to be provided for in the accounts; (v) Commission due to manager @ 6% on net profit after charging such commission. The profit before charging such Commission was ₹ 26,500.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017	Accrued Commission A/c	Dr.		1,200	
March 31	To Commission Received A/c				1,200
	(Being commission earned but not yet received, now adjusted)				
	Closing Stock A/c	Dr.		20,000	
	To Trading A/c				20,000
	(Being closing stock transferred to Trading A/c)				
	Prepaid Insurance Premium A/c	Dr.		556	
	To Insurance Premium A/c				556
	(Being 1/5th of insurance premium c/f to next period)				
	Salary A/c	Dr.		340	
	To Outstanding Salary A/c				340
	(Being outstanding salary provided)				
	Commission A/c	Dr.		1,500	
	To Commission Payable to Manager A/c				1,500
	(Being commission payable to manager @ 6% on net profit after charging such commission)				

6. Purchases of Assets on Credit

When assets are purchased on credit, these are originally recorded in Journal Proper by passing the following entry:

Assets Account Dr.

To Creditors for Assets Account

7. Sale of Worn-out or Obsolete Assets (on Credit)

When obsolete assets are sold on credit, these are originally recorded in Journal Proper. The entries will depend upon the Book Value of the old assets and the actual price realised at the time of sale of such assets.

Example : On 29th May, 2017 B. Ltd. sold a machine valued on the book at ₹ 20,000 to Ideal Machinery Co. Pass necessary journal entry when the machine was sold for ₹ 15,000.

Journal Proper of B. Limited **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017	Ideal Machinery Co. A/c	Dr.		15,000	
May 29	Loss on Sale of Machinery A/c	Dr.		5,000	
	To Machinery A/c				20,000
	(Being obsolete machine was sold for ₹ 15,000)				

8. Purchase of Stationery (Credit)

When stationeries are purchased on credit, these are originally recorded in Journal Proper by passing the following entry :

Stationery Account Dr.

To Creditors for Stationery Account

Key Points

- Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise the business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses.
- Source documents are basically external documents or documents relating to external activities, which are the first input to the accounting system.
- An invoice relates to a sales order or a purchase order. When a business sells goods or services on credit to a customer, it sends out an invoice. It shows the goods sold, with descriptions, quantities, prices and trade discounts. The details in the invoice should match with the details on the sales order. It may include additional charges –– for insurance, carriage and container. It also shows the total amount due from the customer.
- When goods are returned by the customers, a document is prepared called "credit note" and sent it to customer to intimate him that his account has been credited.
- The voucher is a document which provides the authorisation to pay and specifies the accounts to be debited and credited.
- A transaction is a particular type of external event, which can be expressed in terms of money and brings change in the financial position of a business unit. A transaction involves transfer of something of value between two or more entities.
- Event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit.
- A journal entry is an analysis of the effects of a transaction on the accounts, usually accompanied by an explanation (properly called as a narration).
- The ledger is the principal book of accounts where similar transactions relating to a particular person or thing are recorded.

THEORETICAL QUESTIONS

1. What do you mean by accounting cycle ?
2. What is a voucher ? What are the features of a voucher ? How a voucher is prepared ?
3. What do you mean by source document ? Give examples.
4. What do you understand by an account? Explain the nature of different kinds of accounts.
5. Explain the rules for debit and credit. Give a suitable example for each type of account.

6. Define the term Journal and explain its present day use.
7. Define ledger. Give its ruling and explain its utility in accountancy.
8. Distinguish between Journal and Ledger.
9. 'Ledger is the principal book of accounts in a business'. Do you agree with this statement ? Give reasons.
10. How are Ledger Accounts balanced ? Explain clearly.
11. What are the books of original entry? Explain their utilities.
12. Explain the nature of use of the following books of original entry:
    (i) Purchases Day Book;
    (ii) Sales Day Book;
    (iii) Journal Proper; and
    (iv) Sales Returns Book.
13. In which Book of Original Entry, will you record each of the following transactions ?
    (i) An allowance of ₹ 50 was offered for an early payment of cash of ₹ 1,050.
    (ii) A second hand motor car was purchased on credit, from Ross Bros. for ₹ 10,000.
    (iii) Goods, the payment of which is due after 2 months, were sold to M/s Bell & Co. for ₹ 1,000.
    (iv) Accounting for the partial recovery from Mr C, of an amount of ₹ 2,000 earlier written off as bad debt.
    (v) Credit purchase of stationery worth ₹ 5,000, by a stationery dealer from Mr Dubey.
    (vi) Rectifying the error of a credit purchase of goods worth ₹ 10,000 recorded as a credit sale to Mr Lily, discovered two months later.
    (vii) A cheque of ₹ 1,000, which was received from a debtor in full settlement for a claim of ₹ 1,100, is dishonoured.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. The first book in which the transactions of a business unit are recorded is called
   A a journal
   B a ledger
   C a trial balance
   D none of the above
2. Journal records all transactions in
   A alphabetical order
   B random manner
   C chronological order
   D none of the above
3. Journal is a
   A memorandum record
   B primary record
   C secondary record
   D none of the above
4. A journal records
   A only debit part of a transaction
   B only credit part of a transaction
   C both debit part and credit part of a transaction without narration
   D both debit part and credit part of a transaction with narration
5. In its usual form, a journal is divided by vertical lines into five columns in the following order
   A (i) Date; (ii) Ledger Folio; (iii) Particulars; (iv) Debit Amount; (v) Credit Amount
   B (i) Date; (ii) Particulars; (iii) Journal Folio; (iv) Debit Amount; (v) Credit Amount.
   C (i) Date; (ii) Particulars; (iii) Ledger Folio; (iv) Credit Amount; (v) Debit Amount
   D (i) Date; (ii) Particulars; (iii) Ledger Folio; (iv) Debit Amount; (v) Credit Amount
6. Compound journal entry contains
   A more than one debit entry only
   B more than one credit entry only
   C more than one debit entry or more than one credit entry or both
   D no narration

7. How is the distribution of goods as free samples recorded in the journal ?

	Debit	*Credit*
A	Trading Account	Sales Account
B	Advertisement Account	Profit and Loss Account
C	Advertisement Account	Purchases Account
D	Purchases Account	Advertisement Account

8. Cash sale of old asset (without profit or loss) is recorded in the journal by passing the following entry

	Debit	*Credit*
A	Cash Account	Sales Account
B	Buyer's Account	Asset Account
C	Assets Account	Cash Account
D	Cash Account	Asset Account

9. How is bad debt recovered recorded in the journal ?

	Debit	*Credit*
A	Bad Debt Account	Cash Account
B	Bad Debt Account	Bad Debt Recovery Account
C	Cash Account	Bad Debt Recovery Account
D	Bad Debt Recovery Account	Cash Account

10. A debit entry in the Purchases Account is matched by a credit entry in ITC Ltd Account. What do these entries record?
   A Purchase of goods for cash from ITC Ltd.
   B Purchase of goods on credit from ITC Ltd.
   C Purchase Return to ITC Ltd.

PRACTICAL QUESTION

Transaction

1. State which of the following events may be recorded as a transaction in the books of Sri Agarwal, a trader. Give reasons.
   (a) Agarwal sent a price list of his merchandise to Biswarup, a trader.
   (b) He received an order for supply of goods worth ₹ 1,000 from Biswarup.
   (c) He delivered on credit goods for ₹ 1,000 to Biswarup.
   (d) He despatched a letter of appointment to Chittarup appointing him as a book-keeper on a monthly salary of ₹ 2,000.
   (e) Out of goods supplied to Biswarup those for ₹ 100 were returned.
   (f) His book-keeper, Chittarup left the service after defalcating ₹ 500 from the cash box.
2. State whether the following are transactions :
   (a) Purchased machinery worth ₹ 70,000.
   (b) Appointed Sandeep as accountant.
   (c) Furniture has been depreciated by ₹ 1,000.
   (d) Paid rent ₹ 6,000.
   (e) Rent paid for the month of April ₹ 10,000.
   (f) Decided to purchase shares of ITC Ltd.
   (g) Sold old newspapers for ₹ 200.
   (h) Sold a machinery for ₹ 4,000 on credit to Sri Raja Roy.
   (i) Goods lost by fire ₹ 10,000.
   (j) Submitted a tender for a work of ₹ 10,000.
   (k) Received an order for supply of goods to Roy & Co. ₹ 25,000.
   (l) Took a loan from Swapan ₹ 10,000.
   (m) Deposited cash into bank ₹ 2,000.
   (n) Supplied goods to Dutta Bros. ₹ 5,000 as per their order.
   (o) Distributed free samples ₹ 4,000.
   (p) Received free samples ₹ 2,000.
   (q) Appointed Subhas as Manager in the scale of ₹ 5,000 – 200 – 8,000.
   (r) Sent a fax message to a supplier.
3. State whether the following are cash or credit transactions :
   (a) Paid salary ₹ 1,000.
   (b) Received from X ₹ 2,600.

(c) Paid rent ₹ 500.
(d) Paid electric bill ₹ 750.
(e) Sold goods to Y ₹ 4,000.
(f) Paid rent by cheque for ₹ 1,000.
(g) Dividend accrued ₹ 700.
(h) Purchased goods from Mukherjee Bros. for ₹ 1,000.
(i) Bought an almirah from Raj & Raj for ₹ 2,000.
(j) Purchased goods for ₹ 2,800 from Uma Sankar in cash.
(k) Paid Salary ₹ 18,000.
(l) Purchased a furniture for ₹ 3,000 from Furniture House in cash.
(m) Purchased books from Banerjee & Co. for ₹ 1,000.
(n) Sold goods to Ruma for ₹ 5,000.
(o) Received from Poddar a loan of ₹ 2,000.

4. State with reasons whether the following transactions are cash transactions or credit transactions:
(a) Started business with cash ₹ 20,000.
(b) Purchased goods from Bhuban for ₹ 3,000 in cash.
(c) Purchased goods from Rajat for ₹ 1,000.
(d) Sold goods to Arif for ₹ 6,000.
(e) Paid salaries ₹ 3,000.
(f) Purchased stationery for ₹ 100 from Tuhin.
(g) Purchased an almirah for ₹ 4,000 from Indra.
(h) Electric bill due ₹ 900.
(i) Purchased a machine from Raja for ₹ 20,000.
(j) Outstanding wages ₹ 1,000.
(k) Paid electric bill for ₹ 1,440.
(l) Received a cheque of ₹ 1,000 from Balrampur Chini Ltd. for dividend.
(m) Purchased goods worth ₹ 2,400 from Ghosh on credit.
(n) Received a cheque amounting to ₹ 5,000 from Robin.
(o) Cheque deposited into Bank on the following day.
(p) Sold old newspapers to Tuhin Kumar for ₹ 850.

5. State whether the following are cash or credit transactions :
(1) Sold goods for cash ₹ 10,000.
(2) Sold goods to Ram for cash ₹ 15,000.
(3) Sold goods to Shyam ₹ 2,000.
(4) Paid salary by cheque ₹ 12,000.
(5) Purchased office equipments from Raj & Raj ₹ 30,000.
(6) Purchased a plant from L&T Ltd. ₹ 1,00,000.
(7) Sold an old plant to GEC Ltd. ₹ 20,000.
(8) Paid for advertisement in cash ₹ 10,000.
(9) Sold shares of LML Ltd. to Rajan ₹ 6,000 for cash.
(10) Purchased shares of ITC Ltd. from Sajjan ₹ 14,000 in cash.

Classification of Accounts

6. Classify the following into Real, Nominal, Personal and Valuation Accounts:
(1) Land; (2) Investments; (3) Building; (4) Interest Received; (5) Salary; (6) Excise Duty; (7) Bank Overdraft; (8) Debtors; (9) Creditors; (10) Purchases Returns; (11) Provision for Doubtfu l Debts; (12) Discount allowed; (13) Bad debts; (14) Carriage inward; (15) Customs duty; (16) Return inward; (17) Return outward; (18) Postage; (19) Maintenance; (20) Insurance premium; (21) Repairs; (22) Commission; (23) Bad debts recovery; (24) Bills receivable; (25) Bills payable; (26) Drawings; (27) Capital; (28) Prepaid insurance; (29) Outstanding salary; (30) Leasehold premises; (31) Freehold premises; (32) Motor vehicles; (33) Horses and carts; (34) Commission received in advance; (35) Reserves; (36) Purchases; (37) Sales; (38) Stock; (39) Depreciation; (40) Freight; (41) Wages; (42) Goodwill; (43) Patents; (44) Technical knowhow; (45) Royalty; (46) Subscription; (47) Stock of stationery; (48) Stationery consumed; (49) 10% Govt. Bonds; (50) Miscellaneous expenses.

7. Classify the following into assets, liability, capital, withdrawal, revenue, expense.
(1) Plant and machinery; (2) Bank loan; (3) Sales; (4) Rent; (5) Discount received; (6) Carriage inwards; (7) Carriage outwards; (8) Purchases; (9) Interest paid on bank loan; (10) Capital; (11) Drawings; (12) Wages; (13) Cash in hand; (14) Goodwill; (15) Patents; (16) Vehicles; (17) Returns; (18) Furniture and fixture; (19) Freehold

premises; (20) Leasehold premises; (21) Investments; (22) Govt. security; (23) Stock of goods; (24) Outstanding expenses; (25) Prepaid expenses; (26) Advance incomes; (27) Accrued incomes; (28) Bills payable; (29) Bills receivable; (30) Commission paid.

8. From the following transactions find out the nature of account and also state which account should be debited and which account should be credited : (a) Rent paid; (b) Salaries paid; (c) Received from Suresh the proprietor; (d) Furniture purchased on credit from Gopal; (e) Purchased goods on credit from Ramesh.

9. For transactions given below one of the accounts involved is given. State the other account and state whether the account mentioned by you will be debited or credited.

(a)	Started business with a capital of ₹ 30,000.	Cash
(b)	Bought furniture from Modern Furniture Stores ₹ 1,000.	Furniture
(c)	Bought goods from Deepak & Sons ₹ 9,000.	Purchases
(d)	Sold goods to Dalip Singh ₹ 10,000.	Sales
(e)	Cash sales ₹ 5,000.	Sales
(f)	Sold to Bombay Stores for cash ₹ 3,000.	Sales
(g)	Returned goods to Deepak & Sons ₹ 2,000.	Deepak & Sons
(h)	Opened a bank account with ₹ 10,000.	Bank

JOURNAL AND LEDGER

10. Journalise the following transactions :

2017			₹
April	2	Cash deposited into bank	20,000
	5	Withdrawn from bank for personal use	6,000
	12	Cash paid to Rahim	2,000
	14	Cash received from Ranabir	6,000
	15	Purchased furniture on credit from Roy Traders	11,000
	25	Paid Salary to Jivan	2,000
	27	Received interest on bank deposit	500
	28	Loan arranged from Basak	12,000
	30	Paid for Carriage	1,000

11. Pass Journal entries for the following transactions in the books of A :

2017			₹
January	1	Started business with cash	5,000
	2	Purchased furniture in cash	500
	3	Opened a bank Account	1,000
	4	Goods purchased in cash	2,000
	5	Goods sold in cash	1,500
	8	Goods purchased on credit from Roy	3,000
	10	Paid Salary	800
	15	Paid rent by cheque	500
	18	Goods sold on Credit to Bose	1,800
	20	Cash paid to Roy	2,500
	21	Cash collected from Bose	1,500
	25	Cash deposited into Bank	1,600
	28	Cash drawn for household purposes	500
	30	Cheque drawn for office purposes	1,000

12. On 1st January, 2017, Prasanna started a business with a capital of ₹ 10,000 in cash and ₹ 5,000 in stock. His transactions during the month were as follows. Journalise the following transactions:

2017			₹
January	1	Bought goods from Raja	1,500
	2	Purchased furniture in cash from Billu	1,200
	4	Purchased office equipments	425
	9	Sold goods to Bikash	1,560
	12	Sold goods to Samir in cash	925
	15	Paid to Jolly as advance	90
	21	Sold goods to Suresh in cash	430
	22	Bought office furniture from Radha in cash	800

13. Write up the following transactions in the ledger of Mr J Reddy for the month of July, 2017.
    1. Started business with ₹ 80,000 in bank and ₹ 30,000 in cash.
    2. Paid rent by cheque ₹ 3,000; Bought goods on credit from : Barnali Sengupta & Co ₹ 15,000;
    3. Sold goods for cash ₹ 3,000 and on credit to P Sengupta & Co ₹ 5,000;
    4. Paid insurance by cheque ₹ 250 and bought stationery for ₹ 100 in cash;
    5. Paid wages in cash ₹ 500; sold goods for cash ₹ 700;
    8. Paid cash into bank ₹ 1,000 and returned goods to Barnali Sengupta & Co ₹ 3,000;
    9. Paid by cheque to Barnali Sengupta & Co. ₹ 10,000;
    11. Sold goods on credit to G Basu ₹ 8,000;
    12. Paid wages in cash ₹ 500 and sold goods for cash ₹ 2,000;
    15. Cash paid into bank ₹ 1,500; goods returned by P Sengupta & Co ₹ 1,000; bought shop furniture, paid by cheque ₹ 500;
    17. Cheque received from P Sengupta & Co ₹ 4,000;
    19. Paid wages in cash ₹ 500 and cash sales ₹ 2,000;
    21. Bought goods on credit from Barnali Sengupta & Co ₹ 6,000;
    22. Goods sold for cash ₹ 5,000 and on credit to P Sengupta & Co ₹ 10,000;
    26. Cash paid into bank ₹ 4,000 and bought postage stamps for ₹ 50;
    27. Paid telephone bill ₹ 500 and electricity ₹ 400 by cheque;
    30. Paid wages in cash ₹ 500.
14. On 1.1.2017, Sri Pranab Chatterjee commenced a business with a Capital of ₹ 30,000. His transactions for the month of January, 2017 were as under :

			₹
January	1	Bought goods for cash	1,000
	2	Purchased furniture for cash	300
		Purchased a small machine for cash	2,500
		Purchased goods from Naresh	1,800
	3	Goods sold for cash	6,000
	4	Sold goods on credit to Sohan	1,400
	5	Goods purchased from Mohan	700
	6	Goods sold to Krishna Kant	2,000
	7	Paid to Naresh on account	600
	8	Returned goods to Mohan	50
	9	Goods returned by Sohan	80
	10	Received from Krishna Kant	1,970
		and Discount allowed	30
	11	Paid to Naresh	1,175
		Discount allowed by him	25
	15	Sold goods to M.K.Mahajan	1,500
	18	Gave away as charity — in cash	210
		in goods	130
	25	Purchased a Plant	10,000
	27	Paid Sundry Expenses	125
	28	Received from M.K.Mahajan	1,460
		and Discount allowed	40
	29	Sohan paid on account	300
	31	Salaries paid	250
		Rent paid	100
		Withdrawn by the proprietor for personal use	400
		Received interest	310

Journalise the above transactions in the books of Sri Pranab Chatterjee.

15. Enter the following transactions in the four subsidiary books for the month of October, 2016 required for the proprietor Mr Raj. (Note – all the details are required in columnar form and narrations should not be written). Thereafter, complete the monthly totalling of the books.

1 Mr A sold goods worth ₹ 50,000 @ 10% discount.

3. Mr Otter bought of Mr Raj, four cases of goods, each valued at ₹ 7,000, less 3,000 trade discount.

6 Mr Sam supplied goods valued ₹ 25,000 as per invoice prepared.

18 Mr Raj bought from Mr Taj, four cases each costing ₹ 10,000, ₹ 5,000, ₹ 6,500 and ₹ 7,400 respectively.

24 One case sold earlier, was rejected by Mr Otter.

24 Twenty percent of the consignment of the 10th of October, was ejected for the wrong size.

8 Ten percent of the goods of Mr A were rejected.

10 Record invoice for ₹ 30,000 less ₹ 3,000, received from Mr Andrews.

15 Goods bought of Sam were despatched to Mr Amour at 50% above cost.

25 Recorded a Debit Note for ₹ 2,000 and a Credit Note for ₹ 4,000 issued to Mr Hardy and Mr Jack respectively.

30 Despatched a consignment worth ₹ 65,000 to Mr Sail and sent the invoice (clearly specifying the credit period of one month), by Registered Post.

30 Recorded a Sales Return for ₹ 1,400 from Ratan, against a sale order of ₹ 45,000 executed last month.

16. Mr J Hines is a wholesale grocer. Some of the transactions recorded in his book during May, 2017 :

May 1 Credit sales to N Brooks : 1 doz. cases of soup @ ₹ 100 per case; 1 doz. cases of baked beans @ ₹ 90 percase; 1 doz. cases of salad cream @ ₹ 25 per case;

May 5 N Brooks returned half doz. cases of soup @ ₹ 100 per case. A Credit Note was sent.

May 14 Credit sales to J Beagley : Half doz. cases of baked beans @ ₹ 90 per case.

May 21 Credit sales to G Boothroyd : 2 doz. cases of tomato ketchup @ ₹ 160 per case.

May 23 G Boothroyd returned 1 case of tomato ketchup as damaged. A Credit Note was sent.

During May, the customers of J Hines made to him the following payments by cheque :

May 14 N Brooks settled the balance owing on his account, less 2.5% cash discount.

May 31 G Boothroyd paid ₹ 1,000 on account.

You are required to : (i) Enter the above transactions in the books of prime entry of J Hines; (ii) Post the entries to appropriate Ledger Accounts and the cheque payments to the Cash Book and Ledger Accounts.

17 The Purchase Book of a firm is given below :

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
2017 Mar. 5	M/s. Shah & Co., Madras	116		10,204	
Mar. 10	Mr. Kirtikumar, Delhi	117		7,985	
Mar. 18	M/s. Kamani Bros., Bombay	118		16,010	
Mar. 24	M/s. Kapoor & Sons, Nasik	119		4,050	
Mar. 28	M/s. Suresh & Co., Calcutta	120		5,000	43,249

(a) Explain briefly the advantages of maintaining the above record.

(b) Name the other three records, which could be maintained on similar lines.

(c) Show the posting necessary from the above record for March 2017.

18. Give the journal entries for :

(i) Cash withdrawal of interest on capital @ 8% earned by partner B on his capital investment of ₹ 50,000 for the year.

(ii) Transfer of the year's net profit shares of ₹ 5,000 and ₹ 3,000 appropriated to partners Karl and Steale respectively, who maintain their personal accounts on the fixed capital method.

19. Give journal entries for :

(a) An initial total investment of ₹ 80,000 by Mr. B in his business, in the form of ₹ 30,000 worth of machinery, ₹ 20,000 for vehicles and the balance equally distributed between the cash account and the bank account.

(b) Closing the Rent Account at the end of the year, which reflects a total sum of ₹ 10,000 to its debit, accounted during the year.

(c) Closing the Drawings Account at the end of the year, which showed a total withdrawal of ₹ 15,000 during the year, by the owner.

(d) Accounting the final equal distribution of remaining profits of ₹ 15,000 between partners C and D.

20. Enter the relevant transactions in the four day books for goods, for Mr. C. Kaul for the month of January, 2017.

1 Goods bought from Lata ₹ 12,000 @ 10% trade discount.

6 Sold 1/3 of the goods purchased on the 1st to Potter @ 5% on account of trade discount.

8 Purchased goods from Robert ₹ 16,000 @ 10% trade discount and 1% cash discount.

10 Received a debit note from Munira for ₹ 1,800 for goods rejected. Returned the goods to the original supplier, Donald, whose goods had been sold at a profit margin of 50%.

15 Sold an old machine to Lata, book value ₹ 20,000 at ₹ 18,000, the payment was promised in two equal instalments in February and March.

16 Reema sent goods worth ₹ 20,000 to Parikh on Mr. C. Kaul's instructions. The client was billed for the same at a margin of 75% profit for the proprietor, on the 20th, Reema's bill dated 18th, was received and recorded on 18th.

25 Record a debit note for ₹ 4,000 sent to Thomas and a debit note for ₹ 3,500 received from Bob.

Guide to Answers

Multiple Choice

1. A 2. C 3. B 4. D 5. D 6. C 7. C 8. D 9. C 10. B.

4

The Trial Balance

Meaning of Trial Balance

Before using the account balances to prepare Final Accounts, an attempt is made to prove that the total of accounts with debit balances is in fact equal to the total of accounts with credit balances. This proof of the equality of debit and credit balances is called a ***Trial Balance***.

A Trial balance is a five-column schedule listing the names and balances of all the accounts in the ledger and cash book, listed in the order in which they appear in the ledger. Last two columns are used for listing the balances of different accounts. The debit balances are listed in the left-hand column and the credit balances in the right-hand column. The total of two columns should agree. The different columns of the Trial Balance are:

(i) Serial number, (ii) Heads of Account, (iii) Ledger folio (L.F.), (iv) Debit balance, and (v) Credit balance.

A Trial Balance taken from the ledger balances of Sachin and Co is given below :

Trial Balance of Sachin and Co. as at 31st March, 2017

Serial Number	Heads of Account	L F	Debit Balance (₹)	Credit Balance (₹)
1.	Land and Building		6,00,000	
2.	Plant and Machinery		6,00,000	
3.	Furnitures and Fixtures		50,000	
4.	Purchases / Sales		5,00,000	8,00,000
5.	Wages and Salaries		1,50,000	
6.	Rent, Rates and Taxes		10,000	
7.	Cash in Hand		50,000	
8.	Creditors			60,000
9.	Loan from Bank			4,00,000
10.	Capital			7,00,000
	Total		19,60,000	19,60,000

Total of debit balances
and credit balances are equal

Key Points to Remember

1. ***The heading should show the date on which the Trial Balance is prepared.***
2. ***The heading should also contain the name of the organisation / person for whom the Trial Balance is prepared.***
3. ***The debit balances are listed in the left hand column and the credit balances are in the right hand column.***
4. ***The debit and credit columns of the Trial Balance should agree if all transactions are correctly recorded in the ledger accounts and if the balances of the accounts have also been struck correctly.***
5. ***A Trial Balance essentially proves the arithmatical accuracy of the books of account.***
6. ***A Trial Balance is prepared at regular intervals, for example on a monthly, half yearly or yearly basis, as desired.***
7. ***The Trial Balance is not part of the ledger, but is merely a statement of debit and credit balances in the ledger at a particular date.***
8. ***The order of accounts does not matter.***

Characteristics of a Trial Balance

1. It is a list of balances of all ledger accounts and cash book.
2. It is not a part of the double entry system of book-keeping. It is just a working paper.
3. It can be prepared any time during the accounting period.
4. It serves as an instrument for carrying out the job of checking and testing.
5. Arithmatical accuracy of posting of entries from journal to ledger can be ensured.
6. Some errors are not revealed by the Trial Balance, for example, errors of principle.

Objectives of Drawing up a Trial Balance

1. It ensures that all transactions have been recorded with identical debit and credit amounts and the balance of each account has been computed correctly.
2. It facilitates the preparation of the Trading, Profit and Loss Accounts and the Balance Sheet by making available the balances of all the accounts at one place.
3. It also ensures that the balance of each account, whether debit or credit, has been transferred properly to the respective columns of the trial balance and that the Trial Balance has been correctly added.
4. Some of the errors in the books of account can be detected by the Trial Balance and they can be rectified before the preparation of the final accounts.

Defects of a Trial Balance

A Trial Balance in which the credit and debit accounts match does not prove that :

1. All transactions have been correctly analysed and recorded in the proper accounts. If, for example, the wages paid for the installation of plant had been erroneously recorded by debiting the wages account in place of the plant account, the Trial Balance would still agree.
2. All transactions have been recorded in the books of original entry. If, for example, a sales invoice were to be completely omitted from being recorded in the sales day book, the error would not be disclosed in the Trial Balance.

We can say that a Trial Balance should not be regarded as conclusive proof of the correctness of the books of account.

Construction of a Trial Balance

The Trial Balance is generally prepared on a loose sheet that may have five columns :

(a) Serial Nos.; (b) Heads of Account; (c) Ledger Folio (L.F.); (d) Debit Balance; and (e) Credit Balance. For the preparation of a Trial Balance, the following steps are followed:

Step 1 Calculate the balances of the cash book and all ledger accounts.
Step 2 Write down the heading—'Trial Balance of ... as at ...' at the top of the loose sheet.
Step 3 Write down : (a) Serial numbers of the accounts in the 1st column; (b) Names of the accounts in the 2nd column; (c) L.F. number in the 3rd column; and (d) the balances in the respective columns.
Step 4 Add both the debit and credit columns to see whether they agree.

Illustration 1

Enter the following transactions in the ledger of Mr Alpha

2017			₹	2017			₹
Jan.	1	Started business with cash	6,000	Jan.	19	Sold goods for cash	350
	4	Bought goods for resale	500		20	Bought stationery	80
	7	Bought stationery	50		21	Paid wages	100
	10	Bought goods for resale	750		23	Bought goods for resale	200
	12	Paid wages	100		24	Sold goods for cash	600
	15	Sold goods for cash	350		25	Paid Postage	80
	16	Sold goods for cash	300		26	Paid for Advertisement	30
	17	Paid Electricity Bill	70		31	Sold goods for cash	700
					31	Paid wages	150

You are required to extract a Trial Balance as on 31st January 2017.

Solution

Ledger of Mr Alpha

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Capital A/c	6,000	2017 Jan. 4	By Purchases A/c	500
15	To Sales A/c	350	7	By Stationery A/c	50
16	To Sales A/c	300	10	By Purchases A/c	750
19	To Sales A/c	350	12	By Wages A/c	100
24	To Sales A/c	600	17	By Electricity Charges A/c	70
31	To Sales A/c	700	20	By Stationery A/c	80
			21	By Wages A/c	100
			23	By Purchases A/c	200
			25	By Postage A/c	80
			26	By Advertisement A/c	30
			31	By Wages A/c	150
			31	By Balance c/d	6,190
		8,300			8,300

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 4	To Cash A/c	500	2017 Jan. 31	By Balance c/d	1,450
10	To Cash A/c	750			
23	To Cash A/c	200			
		1,450			1,450

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 31	To Balance c/d	2,300	2017 Jan. 15	By Cash A/c	350
			16	By Cash A/c	300
			19	By Cash A/c	350
			24	By Cash A/c	600
			31	By Cash A/c	700
		2,300			2,300

Dr. Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 31	To Balance c/d	6,000	2017 Jan. 1	By Cash A/c	6,000

Dr. Stationery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 7	To Cash A/c	50	2017 Jan. 31	By Balance c/d	130
20	To Cash A/c	80			
		130			130

Dr. **Wages Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 12	To Cash A/c	100	2017 Jan. 31	By Balance c/d	350
Jan. 21	To Cash A/c	100			
Jan. 31	To Cash A/c	150			
		350			350

Dr. **Electricity Charges Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 17	To Cash A/c	70	2017 Jan. 31	By Balance c/d	70

Dr. **Postage Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 25	To Cash A/c	80	2017 Jan. 31	By Balance c/d	80

Dr. **Advertisement Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 26	To Cash A/c	30	2017 Jan. 31	By Balance c/d	30

Trial Balance of Mr Alpha as at 31st January, 2017

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Cash Account		6,190	
2.	Purchases Account		1,450	
3.	Sales Account			2,300
4.	Capital Account			6,000
5.	Stationery Account		130	
6.	Wages Accounts		350	
7.	Electricity Charges Account		70	
8.	Postage Account		80	
9.	Advertisement		30	
	TOTAL		8,300	8,300

Illustration 2

The Balance Sheet of Rohit Furniture as on 31st March 2017 is given below :

Liabilities	₹	Assets	₹
Capital	1,00,000	Cash	42,000
General Reserve	19,000	Sundry Debtors	90,000
Sundry Creditors	25,000	Inventory	10,000
		Prepaid Rent	2,000
	1,44,000		1,44,000

Following is the summary of transactions that occurred during April, 2017 :

	₹
(a) Collections from debtors	88,000
(b) Payments to creditors	24,000
(c) Acquisition of inventory on credit	80,000
(d) Inventory costing ₹ 70,000 was sold on credit for	85,000
(e) Recognition of rent expense in April	1,000
(f) Wages paid in cash in April	8,000

Required :

1. Prepare all ledger accounts after including the opening balances as on March 31, 2017. (Journal entries are not required).
2. Prepare the Trial Balance as on April 30, 2017 from the ledger accounts.

Solution **Ledger Accounts of Rohit Furniture**

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	42,000	?	By Sundry Creditors A/c	24,000
?	To Sundry Debtors A/c	88,000	?	By Wages A/c	8,000
			30.4.2017	By Balance c/d	98,000
		1,30,000			1,30,000
1.5.2017	To Balance b/d	98,000			

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	90,000	?	By Cash A/c	88,000
?	To Sales A/c	85,000	30.4.2017	By Balance c/d	87,000
		1,75,000			1,75,000
1.5.2017	To Balance b/d	87,000			

Dr. Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c	24,000	1.4.2017	By Balance b/d	25,000
30.4.2017	To Balance c/d	81,000	?	By Purchases A/c	80,000
		1,05,000			1,05,000
			1.5.2017	By Balance b/d	81,000

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Sundry Creditors A/c	80,000	30.4.2017	By Balance c/d	80,000
1.5.2017	To Balance b/d	80,000			

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2017	To Balance c/d	85,000	?	By Sundry Debtors A/c	85,000
			1.5.2017	By Balance b/d	85,000

Dr. Inventory Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	10,000	30.4.2017	By Balance c/d	10,000
1.5.2017	To Balance b/d	10,000			

Dr. Prepaid Rent Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	2,000	1.4.2017	By Rent Expenses A/c	1,000
			30.4.2017	By Balance c/d	1,000
		2,000			2,000
1.5.2017	To Balance b/d	1,000			

Dr. Rent Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2017	To Prepaid Rent A/c	1,000	30.4.2017	By Balance c/d	1,000
1.5.2017	To Balance b/d	1,000			

Dr. Wages Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c	8,000	30.4.2017	By Balance c/d	8,000
1.5.2017	To Balance b/d	8,000			

Dr. Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2017	To Balance c/d	1,00,000	1.4.2017	By Balance b/d	1,00,000
			1.5.2017	By Balance b/d	1,00,000

Dr. General Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2017	To Balance c/d	19,000	1.4.2017	By Balance b/d	19,000
			1.5.2017	By Balance b/d	19,000

Trial Balance of Rohit Furniture as at 30th April, 2017

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Cash Account		98,000	
2.	Sundry Debtors Account		87,000	
3.	Purchases Account		80,000	
4.	Prepaid Rent Account		1,000	
5.	Rent Expenses Account		1,000	

6.	Wages Account		8,000	
7.	Inventory Account		10,000	
8.	Sundry Creditors Account			81,000
9.	Sales Account			85,000
10.	Capital Account			1,00,000
11.	General Reserve Account			19,000
	TOTAL		2,85,000	2,85,000

Errors Disclosed by a Trial Balance

The disagreement of a Trial Balance indicates the presence of one or more of the following errors in the books of account.

1. Omission to Post an Amount in the Ledger The two sides of a Trial Balance will not agree, when a transaction has been correctly recorded in the books of original entry but has not been posted in the ledger. If a cash receipt of ₹ 500 from X has been properly recorded in the cash book, but has not been posted on the credit side of X Account, the credit side of the Trial Balance will fall short by ₹ 500.

2. Debit or Credit Entries are not Posted at all or Posted Twice If only one side of the transaction is recorded, the Trial Balance will not agree. If stationery purchased on credit from X for ₹ 300 has been properly recorded in the Stationery Account but not in the account of X, the Trial Balance will fail to agree. Similarly, if X Account is correctly credited but Stationery Account has been wrongly debited twice, the Trial Balance will not agree.

3. Debits are Wrongly Posted as Credits and Vice Versa A Trial Balance will be in disagreement when a transaction is recorded on the wrong side of an account. If a cash receipt of ₹ 1,000 as interest is properly debited in the cash book but has been recorded on the debit side of the interest account by mistake, the credit side of the Trial Balance will fall short by ₹ 2,000.

4. Wrong Totalling of Subsidiary Books If the total of any subsidiary books has been cast wrongly, it will cause a disagreement in the Trial Balance. If the sales day book is wrongly totalled as ₹ 1,800 (instead of ₹ 1,700), sales account will be credited by ₹ 1,800 but the debtor's account will be debited by ₹ 1,700, in which case the Trial Balance will fail to agree.

5. Difference in Amount between the Entries If different values of an item are posted in two different accounts, the Trial Balance will not agree. A cash receipt of ₹ 2,000 from X is correctly recorded in the cash book but the account of X is incorrectly credited by ₹ 200, the credit side of the Trial Balance would fall short by ₹ 1,800.

6. Error in the Computation of an Account Balance If the balance of an account is not correctly computed, the balance of the ledger will not show the true position and will cause disagreement of the Trial Balance.

7. Omission of Account Balance If the balance of an account is not listed in the Trial Balance at all, it will fail to agree.

8. Balance of an Account Wrongly Recorded in the Trial Balance If the balance of an account is wrongly recorded in the Trial Balance, it will not agree. For example, if the actual balance of purchase account is ₹ 1,000 but has been recorded in the Trial Balance as ₹ 100, the debit side of the Trial Balance will fall short by ₹ 900.

9. Errors in Extraction of the Trial Balance The Trial Balance will not tally if any or both the columns are wrongly totalled.

Errors Not Disclosed by a Trial Balance

1. Errors of Omission If a particular transaction is omitted altogether from the books of original entry, it will not disturb the agreement of the Trial Balance. If a sum of ₹ 100 paid to X, is not recorded either in the Cash Book or in the account of X, only the total of the Trial Balance will fall short by ₹ 100, but the debit and credit columns will show no difference.

2. Errors of Principle These errors arise because of an incorrect application of the principles of accounting, for instance, failure to differentiate between capital and revenue expenditure. The existence of this type of error is not disclosed by the Trial Balance. Examples are : (a) Wages paid for installation of machinery being debited to Wages Account; and, (b) Repairs of the building debited to Building Account and the like.

3. Compensating Errors These are a group of errors, the total effect of which is not reflected in the Trial Balance. These errors are of a neutralizing nature, i.e., one error is compensated by another error or by errors of an opposite nature. For example, an extra debit in Salary Account for ₹ 100 may be compensated by an extra credit of ₹ 100 in Sales Account.

4. Recording Wrong Amount in the Books of Original Entry If a transaction is wrongly recorded in the books of original entry and is subsequently carried through the ledgers, it will not cause disagreement in the Trial Balance. For example, if stationery purchased for cash ₹ 175 is recorded in the cash book as ₹ 751 and posted to Stationery Account in the ledger as ₹ 751, the Trial Balance will still agree.

5. Recording Both Aspects of a Transaction more than once in the Books of Account The Trial Balance will agree if both aspects of a transaction are recorded twice in the books of original entry. For example, if a credit purchase of ₹ 4,000 from Tata Chemicals Ltd. is entered in the purchase day book twice, the error will not cause a disagreement in the totals of the Trial Balance.

6. Errors in Recording a Transaction on the Correct Side of a Wrong Account If a transaction is recorded on the correct side of a wrong account, it will not cause a disagreement in the Trial Balance. For example, if ₹ 500 cash paid to Ram, is wrongly debited to Raman Account, it will not affect the agreement of the Trial Balance.

Steps to Detect Errors Through a Trial Balance

The following steps should be taken to locate the error or combination of errors that is causing a Trial Balance to disagree :

Step 1 Check whether the debit and credit columns have been added correctly by adding these columns in opposite directions, i.e. from bottom to top or from top to bottom.

Step 2 If the errors remain undetected, divide the exact difference between the totals of two columns by 9. If it is totally divisible by 9, this will mean that there is either a transposition error or a slide error. A ***transposition error*** is committed when a digit of an amount is placed wrongly, for example, if Plant Account has a balance of ₹ 5,760, but has been written as ₹ 5,670 in the Trial Balance, the resulting error is ₹ 90, which is divisible by 9. A ***slide error*** is committed when the decimal point is placed incorrectly, for example, ₹ 6,250 is copied as ₹, 62.50. The resulting error is ₹ 6,187.50 which is also divisible by 9.

Step 3 Divide the difference by 2, and scan the columns for an identical amount. If a debit balance has been entered in the credit column, or vice-versa, it will cause a difference which is twice this amount. If a debit balance of ₹ 250 in the Plant Account has been entered in the credit column of the Trial Balance, it will cause a difference of ₹ 500 in the Trial Balance total.

Step 4 Check from the ledger if any account shows a balance equal to the difference in the Trial Balance.

Step 5 Re-check the opening balances of all the accounts from the previous Balance Sheet.

Step 6 Cross check the amount in the Trial Balance with the balances in the ledger. Make sure that all the balances have been placed in the correct column of the Trial Balance.

Step 7 Re-compute the balances of each ledger account.

Step 8 If the errors remain undetected, check the postings from the journal and other books of original entry to the ledger accounts. Put tick marks with a coloured pencil in the journal and in the ledger after checking each figure. After completing the operation, look through the journal and the ledger for any unticked amount.

Step 9 If the errors still remain undetected, repeat the above steps with the help of other members of the staff, who are not in charge of maintaining the books of account.

Suspense Account

A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified. This may be so because further information has to become available or while preparing the accounts, the accountant is unsure of how to proceed with it. It is opened in the following cases: (i) to balance a disagreed Trial Balance; (ii) to post doubtful items; and (iii) to record incomplete transactions.

(i) To Balance a Disagreed Trial Balance : Sometimes, a Trial Balance does not tally despite all efforts; but one cannot wait indefinitely as accounts must be closed at the end of a financial year. In such a case, the amount of difference is entered in the lighter column against Suspense Account. The point to note is that no double entry will be possible. Later, when the mistakes are detected, the rectifying entries are passed.

(ii) To Post Doubtful Items : Sometimes, an item cannot be posted to the correct account for one reason or another. For instance, you may receive a remittance of ₹ 1,500 but you may not know who has sent it. You then pass the following entry :

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	Cash A/c	Dr.	1,500	
	To Suspense A/c			1,500
	(Being the remittance received from unknown sender)			

Later, you get the information that Ram, Shyam & Co has sent this amount. Then you should pass the following entry:

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	Suspense A/c	Dr.	1,500	
	To Ram, Shyam & Co. A/c			1,500
	(Being credit given to the sender for a remittance which had been credited previously to Suspense Account)			

(iii) To Record Incomplete Transactions : Sometimes a Suspense Account is opened to record a balance that has not yet been finalised because a particular deal has not been concluded. For example, an advance of ₹ 10,000 received from X for the goods to be delivered in the future, subject to availability. A Suspense Account can include many transactions of this nature, without involving any error.

Preparation of The Trial Balance from Given Ledger Balances

For the purpose of preparing the Trial Balance from a given list of ledger balances, the following rules should be followed:

1. The balances of all accounts relating to:
   (a) Assets; (b) Expenses; (c) Losses; (d) Drawings; and (e) Debtors, should be placed in the ***Debit*** column of the Trial Balance.
2. The balances of all accounts relating to:
   (a) Liabilities; (b) Income and Revenue; (c) Gain; and (d) Creditors, should be placed in the ***Credit*** column of the Trial Balance.

Some Important Items

Closing Stock

Generally, closing stock does not appear in the Trial Balance because a separate account for this is not opened in the general ledger. It represents the balance of goods unsold out of opening stock and purchases. When goods are purchased, Purchases Account is debited and Cash/Creditors Account is credited (Closing Stock Account is not coming into picture). At the end of the year, if the following adjustment entry is passed, then closing stock will appear in the Trial Balance.

Closing Stock Account Dr.
To Purchases Account

Cost of Goods Sold

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

Cost of Goods Sold will appear in the Trial Balance if the following entry is passed :

Cost of Goods Sold Account	Dr.		
Closing Stock Account	Dr.		
To Opening Stock Account			
To Purchases Account			

Illustrative Example

Opening Stock ₹ 5,000; Purchases ₹ 30,000; Closing Stock ₹ 10,000.

Cost of Goods Sold = ₹ 5,000 + 30,000 – 10,000 = ₹ 25,000.

Journal entry will be :

Cost of Goods Sold Account	Dr.	₹ 25,000	
Closing Stock Account	Dr.	₹ 10,000	
To Opening Stock Account			5,000
To Purchases Account			30,000

In the Trial Balance Cost of Goods Sold will be shown as a debit balance ₹ 25,000 and Closing Stock will be shown as debit balance ₹ 10,000.

Note : Cost of Goods Sold will be debited to Trading Account and Closing Stock will be shown in the Balance Sheet as a current asset.

Carriage Inwards and Carriage Outwards

Carriage paid for purchase of goods is called carriage inwards whereas carriage paid for sale of goods is called carriage outwards. Both are ***expenses***. Therefore, both carriage inward and carriage outward will be shown in the debit column of the Trial Balance.

Returns Inwards and Returns Outwards

Goods returned by customer is called the Returns Inwards. When goods are returned by the customer, Returns Inwards Account is debited and Customer Account is credited. Returns Inwards Account always will show a debit balance. Therefore, in the Trial Balance it will be shown in the debit column.

Goods returned to suppliers is called Returns Outwards. When goods are returned to supplier, Suppliers (Creditors) Account is debited and Returns Outwards Account is credited. Returns Outwards Account will always show a credit balance. Therefore, in the Trial Balance it will be shown in the credit column.

Illustration 3

From the following list of balances, prepare a Trial Balance as on 30.6.2017 :

		₹			₹
1.	Opening Stock	18,000	13.	Plant and Machinery	7,500
2.	Wages	10,000	14.	Loose Tools	1,800
3.	Sales	1,20,000	15.	Lighting	2,300
4.	Bank Loan	4,400	16.	Creditors	8,000
5.	Coal and Coke	3,000	17.	Capital	40,000
6.	Purchases	75,000	18.	Miscellaneous Receipts	600
7.	Repairs	2,000	19.	Office Salaries	2,500
8.	Carriage	1,500	20.	Office Furniture	600
9.	Income Tax	1,500	21.	Patents	1,000
10.	Debtors	20,000	22.	Goodwill	15,000
11.	Leasehold Premises	6,000	23.	Cash at Bank	5,100
12.	Cash in Hand	200	24.	Closing Stock	6,000

Solution **Trial Balance as at 30th June, 2017**

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Opening Stock		18,000	
2.	Wages		10,000	
3.	Sales			1,20,000

4.	Bank Loan			4,400
5.	Coke and Coal		3,000	
6.	Purchases		75,000	
7.	Repairs		2,000	
8.	Carriage		1,500	
9.	Income Tax		1,500	
10.	Debtors		20,000	
11.	Leasehold Premises		6,000	
12.	Cash in hand		200	
13.	Plant and Machinery		7,500	
14.	Loose Tools		1,800	
15.	Lighting		2,300	
16.	Creditors			8,000
17.	Capital			40,000
18.	Miscellaneous Receipts			600
19.	Office Salaries		2,500	
20.	Office Furniture		600	
21.	Patents		1,000	
22.	Goodwill		15,000	
23.	Cash at Bank		5,100	
	TOTAL		1,73,000	1,73,000

Correction of Trial Balance

Illustration 4

The clerk of a businessman wrongly prepared the following Trial Balance. You are required to draw up a Trial Balance correctly stating reasons in brief:

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Capital			60,000
2.	Stock at Commencement		5,000	
3.	Discount Allowed			500
4.	Commission Received			700
5.	Fixed Assets			60,000
6.	Sales		85,000	
7.	Purchases			45,000
8.	Return Outward			1,000
9.	Return Inward		2,000	
10.	Carriage Inward			600
11.	Carriage Outward			700
12.	Wages & Salary		25,000	
13.	Bills Receivable		7,000	
14.	Debtors		9,000	
15.	Bills Payable			7,000
16.	Rent		3,000	
17.	Interest Paid			2,000
18.	Cash		800	
19.	Creditors		6,900	
20.	Stock at the End		33,800	
	TOTAL		1,77,500	1,77,500

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

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Capital			60,000
2.	Stock at Commencement		5,000	
3.	Discount Allowed		500	

4.	Commission Received			700
5.	Fixed Assets		60,000	
6.	Sales			85,000
7.	Purchases		45,000	
8.	Return Outward			1,000
9.	Return Inward		2,000	
10.	Carriage Inward		600	
11.	Carriage Outward		700	
12.	Wages & Salary		25,000	
13.	Bills Receivable		7,000	
14.	Debtors		9,000	
15.	Bills Payable			7,000
16.	Rent		3,000	
17.	Interest Paid		2,000	
18.	Cash		800	
19.	Creditors			6,900
	TOTAL		1,60,600	1,60,600

Reasons

1. Discount Allowed is an expense, so its balance will be a debit balance.
2. Fixed Assets always reflect debit balance because assets coming in are debited.
3. Sales are income, so its balance will be a credit balance.
4. Purchases are expenses, so its balance will be a debit balance.
5. Carriage Inwards is an expense, so its balance will be a debit balance.
6. Carriage Outwards is an expense, so its balance will be a debit balance.
7. Interest Paid is an expense, so its balance will be a debit balance.
8. Creditor is a liability, so its balance will be a credit balance.
9. Closing Stock is not an account, so it cannot have any balance and consequently, it cannot find a place in the Trial Balance. Only when closing stock is adjusted against purchases, it appears in the Trial Balance.

Illustration 5

The total of the debit side of the Trial Balance of a large boot and shoe repairing company as at 31st December, 2016 is ₹ 1,66,590 and that of the credit side is ₹ 42,470.

After several checkings and re-checkings the following mistakes are discovered :

Name of Accounts	Correct Figure (as it should be)	Figure as it appears in the Trial Balance
Opening Stock	14,900	14,800
Repairs	61,780	61,780 (But appear on the debit side)
Rent & Rates	2,160	2,400
Sundry Creditors	6,070	5,900
Sundry Debtors	8,060	8,310

Ascertain the correct total of the Trial Balance.

Solution Ascertainment of Correct Total of Trial Balance as at 31st December, 2016

Debit Side	₹	Credit Side	₹
Total as per Trial Balance	1,66,590	Total as per Trial Balance	42,470
Less: Wrong amount of Opening Stock	14,800	Add: Repairs (Note 1)	61,780
	1,51,790		1,04,250
Add: Correct amount of Opening Stock	14,900	Less: Wrong amount of Creditors	5,900
	1,66,690		98,350
Less: Repairs (Note 1)	61,780	Add: Correct amount of Creditors	6,070
	1,04,910		
Less: Wrong amount of Rent & Rates	2,400		

	1,02,510		
Add: Correct amount of Rent & Rates	2,160		
	1,04,670		
Less: Wrong amount of Sundry Debtors	8,310		
	96,360		
Add: Correct amount of Sundry Debtors	8,060		
	1,04,420		1,04,420

Note :

(1) Repairs is an income in the case of a shoe manufacturing, therefore it will appear on the credit side of the Trial Balance.

The Adjusted Trial Balance (Recasting of a Trial Balance)

When final accounts are to be prepared, the ledger balances need to be updated to include the effects of transactions that are either unrecorded or recorded improperly, for example, outstanding expenses, depreciation, closing stock, etc. Adjusting entries are necessary to bring the ledger balances to their proper levels. After all the necessary adjusting entries have been journalized and posted, a 2nd Trial Balance is prepared to prove that the ledger is still in balance and this 2nd Trial Balance is called ***the adjusted Trial Balance***. This Trial Balance provides a complete listing of the account balances to be used in preparing the Final Accounts. The following illustration will clear the matter.

Illustration 6

Mr Vijay Kumar has been carrying on wholesale trade in textiles from September 1, 2000. His Trial Balance as on December 31, 2016 is as follows :

Name of Account	Debit (₹)	Credit (₹)
Salary	3,200	
Rent	29,000	
Sundry Debtors	43,000	
Loan from Mrs Vijay Kumar		60,000
Cash	4,000	
Sundry Creditors		27,000
Interest paid in part on loan	1,200	
Mr Vijay Kumar's Capital		32,500
Sales		75,800
Purchases	92,500	
Furniture and Fixtures	20,000	
Insurance Premium	2,400	
	1,95,300	1,95,300

Mr Vijay Kumar furnishes the following additional information :

1. Salary due to his shop assistants on December 31, is ₹ 800.
2. Rent includes a deposit of ₹ 25,000, refundable by the landlord when the premises are vacated.
3. Sundry Debtors represent the amounts invoiced but not yet collected, except for a sum of ₹ 2,200 shown as due from Mr Harinarayan in respect of goods sent to him on approval basis. Mr Harinarayan has to exercise his option by January 5, 2017, cost of the goods is ₹ 1,800.
4. Loan from Mrs Vijay Kumar taken on October 1, 2016 carries simple interest at the rate of 12 percent per year. The first instalment of ₹ 15,000 including interest falls due for payment on February 1, 2017.
5. Inventory of mill goods in the shop on December 31, 2016 is ₹ 35,000 (cost).
6. All items of shop furniture were bought on October 1, 2016. They are expected to be useful for 20 years at the end of which they are to be scrapped.
7. Insurance premium for the period September 1, 2016 to August 31, 2017 has been paid.

Required :

(1) Post the entries to ledger accounts (date is not required); and,

(2) Prepare adjusted Trial Balance as on December 31, 2016.

Solution

Ledger of Mr Vijay Kumar

Dr. **Salary Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	3,200		By Balance c/d	4,000
	To Outstanding Salaries A/c	800			
		4,000			4,000

Dr. **Rent Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	29,000		By Rent Deposit A/c	25,000
				By Balance c/d	4,000
		29,000			29,000

Dr. **Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	43,000		By Sales A/c	2,200
				By Balance c/d	40,800
		43,000			43,000

Dr. **Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	60,000		By Balance b/d	60,000

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,000		By Balance c/d	4,000

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	27,000		By Balance b/d	27,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,200		By Balance c/d	1,800
	To Outstanding Interest A/c	600			
		1,800			1,800

Dr. **Capital Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	32,500		By Balance b/d	32,500

Dr. **Furniture & Fixtures Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	20,000		By Depreciation A/c	250
				By Balance c/d	19,750
		20,000			20,000

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c	2,200		By Balance b/d	75,800
	To Balance c/d	73,600			
		75,800			75,800

Dr. **Insurance Premium Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,400		By Insurance Premium Adv A/c	1,600
				By Balance c/d	800
		2,400			2,400

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	92,500		By Closing Stock A/c	36,800
				By Balance c/d	55,700
		92,500			92,500

Dr. **Rent Deposit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Rent A/c	25,000		By Balance c/d	25,000

Dr. **Outstanding Salary Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	800		By Salary A/c	800

Dr. **Outstanding Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	600		By Interest A/c	600

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

Date	Particulars	₹	Date	Particulars	₹
	To Furniture & Fixtures A/c	250		By Balance c/d	250

Dr. **Insurance Premium paid in Advance Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Insurance Premium A/c	1,600		By Balance c/d	1,600

Dr. **Closing Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c (Note 1)	36,800		By Balance c/d	36,800

Adjusted Trial Balance of Mr Vijay Kumar as at 31st December, 2016

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Salary Account		4,000	
2.	Rent Account		4,000	
3.	Sundry Debtors Account / Sundry Creditors Account		40,800	27,000
4.	Loan Account			60,000
5.	Cash Account		4,000	
6.	Interest Account		1,800	
7.	Capital Account			32,500
8.	Furnitures & Fixtures Account		19,750	
9.	Purchases Account / Sales Account		55,700	73,600
10.	Insurance Premium Account		800	
11.	Rent Deposit Account		25,000	
12.	Outstanding Salary Account			800
13.	Outstanding Interest Account			600
14.	Depreciation Account		250	
15.	Insurance Premium paid in Advance Account		1,600	
16.	Closing Stock Account		36,800	
	TOTAL		1,94,500	1,94,500

Key Points

- A Trial balance is a five-column schedule listing the names and balances of all the accounts in the ledger and cash book, listed in the order in which they appear in the ledger.
- **Some of the objectives of Drawing up a Trial Balance are :**
  1. It ensures that all transactions have been recorded with identical debit and credit amounts and the balance of each account has been computed correctly.
  2. It facilitates the preparation of the Trading, Profit and Loss Accounts and the Balance Sheet by making available the balances of all the accounts at one place.
  3. It also ensures that the balance of each account, whether debit or credit, has been transferred properly to the respective columns of the trial balance and that the Trial Balance has been correctly added.
- A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified.

THEORETICAL QUESTIONS

1. What do you mean by a Trial Balance?
   Discuss the main objectives and limitations of the Trial Balance.
2. A Trial Balance is merely a proof of arithmetical accuracy.
   Explain this statement and bring out clearly the various classes of errors which a Trial Balance fails to disclose.
3. Explain the errors which are disclosed by the Trial Balance.
4. Explain the steps for locating errors through the Trial Balance.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Why does a business prepare a trial balance ?
   A to provide a list of all its assets and liabilities
   B to calculate its profit or loss
   C to check the accuracy of its ledger entries
   D to check its bank balance
2. The totals of a trial balance do not agree. Which type of error causes this ?
   A a compensating error
   B an error of casting
   C an error of omission
   D an error of principle
3. An error of principle would occur if
   A plant and machinery purchased was credited to a fixed assets account
   B plant and machinery purchased was debited to the purchases account
   C plant and machinery purchased was debited to the equipment account
   D plant and machinery purchased was debited to the correct account but with the wrong amount.
4. In a trial balance, which one of the following items would be correctly shown as a debit balance ?
   A returns outwards
   B discount received
   C returns inward
   D bank overdraft
5. In a trial balance, which one of the following items would be correctly shown as a credit balance ?
   A carriage inwards
   B carriage outwards
   C discount allowed
   D discount received
6. Which of the following is shown on the debit side of the trial balance ?
   A discount received
   B capital
   C sales returns
   D bank overdraft
7. If R. Singh were to post ₹ 1,000 to the debit of S. Ganguli's account instead of to the credit of S. Ganguli's account, this would be known as an error of
   A principle
   B commission
   C omission
   D compensation
8. Which one of the following is an error of principle ?
   A a gas bill credited to gas account and debited to the bank account
   B the purchase of a fixed asset credited to the asset account at cost and debited to the creditor's account
   C the purchase of a fixed asset debited to the purchases account and credited to the creditor's account
   D the payment of wages debited and credited to the correct accounts, but using the wrong amount.

9. Which of the following will cause a difference on a trial balance ?
   A an invoice omitted from the sales day book
   B an invoice for ₹ 415 entered in the sales day book as ₹ 451
   C an invoice for ₹ 600 entered in the sales day book not included in the monthly total
   D a credit note entered to the sales day book
10. After which error will a trial balance still balance ?
   A wages paid ₹ 1,500, was entered correctly in the bank account but debited to the wages account as ₹ 2,500
   B rent receivable of ₹ 200 was debited to the rent payable account
   C goods returned to supplier ₹ 150 were entered in purchases returns day book as ₹ 105
   D The sales day book was undercast by ₹ 200

PRACTICAL QUESTIONS

1. Enter the following transactions in the subsidiary books and post them into ledger and prepare a Trial Balance for the month of November 2016 and bring down the balances on 1st December, 2016. (all figures in ₹)

1	Mr X started a business with	60,000	11	Sold goods to Zakir Khan	10,000
4	Bought furniture from Modern Furniture	5,000	14	Goods returned by Zakir Khan	2,000
5	Purchased goods for cash	10,000	15	Payment to B.Sen & Co by cheque	5,000
8	Purchased from B.Sen & Co for ₹ 15,000. Trade discount 20%		20	Goods purchased on credit from Din Dayal & Co	10,000
9	Opened a bank account by depositing	14,000	25	Goods returned to Din Dayal & Co worth	1,000
10	Sold goods for cash	20,000	28	Paid electricity bill	100
10	Purchased stationery from Bharat Stationery Mart.	500	29	Cash sales	9,000
			30	Withdrew for private use from bank.	1,000

2. Correct the following Trial Balance : (all figures in ₹)

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

3. An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2017 :

Dr.			Cr.
Provision for doubtful debts	200	Capital	4,591
Bank overdraft	1,654	Creditors	1,637
Debtors	2,983	Discount allowed	733
Discount received	252	General expenses	829
Drawings	1,200	Return Inwards	330
Office Furniture	2,155	Sales	16,882
Purchases	10,923		
Rent and Rates	314		
Salaries	2,520		
Stock	2,418		
Provision for depreciation on Furniture	364		
	24,983		25,002

   Draw up a 'corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.

4. The total of debit side of the Trial Balance of a daily newspaper firm at 31st December, 2016 is ₹ 1,80,590 and that of the credit side is ₹ 36,470. After several checkings and re-checkings the following mistakes are discovered :

Name of Accounts	Correct Figure (as it should be)	Figure as it appears in the Trial Balance
Opening Stock	12,700	12,600
Advertisement Income	71,780	71,780 (But appear on the debit side)
Rent & Rates	2,260	2,500
Sundry Creditors	6,170	6,000
Sundry Debtors	8,150	8,400

   Ascertain the correct total of the Trial Balance.

5. The following Trial Balance of Sri A K Das was drafted by his son, Sri Provat Sundar Das, a Higher Secondary student. But due to his defective knowledge of the subject, it had been done incorrectly. You are now required to re-draft the Trial Balance correctly stating your reasons for correction.

Trial Balance as on 31.3.2017

Sl.No.	Heads of Account	Debit Balance (₹)	Credit Balance (₹)
1.	Capital	—	1,00,000
2.	Opening Stock	16,590	—
3.	Closing Stock	—	20,580
4.	Creditors	—	12,500
5.	Debtors	20,670	—
6.	Fixed Assets	79,000	—
7.	Gross Purchases	60,920	—
8.	Gross Sales	—	1,02,600
9.	Returns Inwards	2,400	—
10.	Returns Outwards	—	1,230
11.	Carriage Inwards	800	—
12.	Carriage Outwards	—	1,850
13.	Import Duty	1,200	—
14.	Export Duty	—	800
15.	Wages and Salaries	31,400	—
16.	Bills Receivable	15,000	—
17.	Bills Payable	—	8,000
18.	Rent Receivable	3,800	—
19.	Interest Paid	—	1,100
20.	Bank Overdraft	11,000	—
21.	Cash	380	—
22.	Commission Received	—	870
23.	Rates and Taxes	7,130	—
24.	Discount Allowed	—	760
	Total	2,50,290	2,50,290

6. The following Trial Balance of a sole trader, although it adds up to the same total on both sides, is incorrect :

Trial Balance as on 31st December, 2016

Sl. No.	Heads of Account	L F	Debit Balance (₹)	Credit Balance (₹)
1.	Capital, 1st January		4,47,500	—
2.	Drawings		—	52,500
3.	Stock, 1st January		1,86,250	—
4.	Purchases		11,55,000	—
5.	Sales		—	19,71,250
6.	Wages and Salaries		3,10,250	—
7.	Lighting and Heating		15,500	—
8.	Equipment		1,80,000	—
9.	Carriage Outwards		—	11,500
10.	Returns Inwards		5,250	—
11.	Returns Outwards		—	14,500
12.	Provision for Bad Debts		17,500	—
13.	Discount Allowed		14,250	—
14.	Discount Received		—	15,750
15.	Rent, Rates and Insurance		55,750	—

16.	Motor Vehicles		73,750	—
17.	Sundry Debtors		—	6,96,000
18.	Sundry Creditors		2,46,250	—
19.	Bank Overdraft		48,750	—
20.	Cash in hand		5,500	—
	Total		27,61,500	27,61,500

Stock in hand at 31st December ₹ 1,95,000. Draw up a corrected Trial Balance.

7. The following Trial Balance was prepared on 31.3.2017 without taking into consideration the information given below:

Debit Side	₹	Credit Side	₹
Salaries	75,000	Sales	2,75,000
Rent	15,000	Capital	2,50,000
Purchases	1,75,000	Creditors	50,000
Debtors	50,000	Bank Overdraft	27,500
Opening Stock	30,000	Bills Payable	25,000
Fixed Assets	2,30,000	Returns Outwards	2,500
Returns Inwards	5,000		
Bills Receivable	37,500		
Wages	5,000		
Insurance	7,500		
	6,30,000		6,30,000

Information :

(1) Credit purchases of ₹ 10,000 and credit sales of ₹ 20,000 have not been recorded in the books.

(2) Outstanding liabilities :

(i) Wages ₹ 5,000; (ii) Rent ₹ 2,000; (iii) Carriage inwards ₹ 1,000; (iv) prepaid insurance ₹ 500.

On the basis of the above information, (a) post entries to the ledger accounts (without date); (b) prepare adjusted Trial Balance as on 31st March, 2017.

Guide to Answers

Multiple Choice

1. C 2. B 3. B 4. C 5. D 6. C 7. B 8. C 9. C 10. C.

Practical Questions

1. **Trial Balance Total ₹ 1,21,500.**
2. **Trial Balance Total ₹ 2,66,200.**
3. **Trial Balance Total ₹ 25,550. Suspense Account (Dr.) ₹ 1,175.**
4. **Trial Balance Total ₹ 1,08,420.**
5. **Corrected Trial Balance ₹ 2,40,000.**
6. **Corrected Trial Balance ₹ 27,61,500.**
7. **Trial Balance Total ₹ 6,68,000.**

5

Bases of Accounting

Cash and Accrual Basis of Accounting

Cash Basis of Accounting

Cash basis of accounting is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid and not when the transactions take place. This method recognises revenues and gains when cash is actually received. Similarly, it recognises expenses and losses when cash is paid. No attempt is made to record prepayments or accruals.

Net profit / Net income under this method represents simply the difference between cash receipts and cash payments. This method of accounting is widely used by professionals and other service enterprises (for example, physicians, lawyers and others).

Features

1. It records transactions only when cash is actually received or paid out.
2. Income is earned when cash is received and expenses are incurred when cash is paid.
3. No record is made for prepayments or accruals.
4. It does not follow double entry system of book keeping. Therefore, profit is ascertained by means of a statement.
5. This method is not suitable for a going concern business.
6. It is widely used by professionals and other service enterprises.

Advantages

1. Transactions are recorded only when all phases of transactions are complete.
2. Recording of transactions are simple.
3. This method does not require estimates and judgements of the accountant.
4. Reliability of accounting information is increased.
5. This method reflects the actual inflow and outflow of cash.
6. This method is most suitable for firms that do not maintain significant amount of inventories and does not extend credit to their customers.

Disadvantages

1. This method of accounting is inappropriate for most businesses.
2. It does not take into account fixed assets, debtors, creditors, inventories, prepayments, accruals etc.
3. No Trading, Profit and Loss Account and Balance Sheets can be prepared.
4. Generally accepted accounting principles do not recognise this basis.
5. This method does not recognise changes in resources and obligations of a business unit.
6. An accurate view of the trend of the periodic income cannot be provided.

Computation of Net Income Under Cash Basis

At the time of calculating net income under cash basis, the following points must be remembered :

1. All incomes received in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
2. All expenses paid in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
3. Incomes accrued but not yet received in cash are not to be taken into consideration.
4. Expenses outstanding but not yet paid are not to be taken into consideration.

Illustration 1

Dr P K Srinivasan started his profession as a medical practitioner on 1.1.2016. His income and expenses for the year ended on 31st December 2016 are as follows :

	₹
Fees received in cash	35,100
Rent of chamber paid	10,800
Rent of chamber paid in advance (included in the above)	800
Fees accrued but not yet received	2,000
Salary of compounder paid	5,400
Salary of compounder outstanding	500

You are required to ascertain the net income from profession under Cash Basis of Accounting for the year ended on 31st December, 2016.

Solution **Computation of Net Income (under Cash Basis) of Dr P K Srinivasan for the year ended 31st December, 2016**

Particulars	₹	₹
Fees received in cash		35,100
Less: Expenses paid in cash —		
(i) Rent of Chamber	10,800	
(ii) Salary of Compounder	5,400	16,200
Net Income Under Cash Basis		18,900

Accrual Basis of Accounting

Accrual basis of accounting is an accounting system which records revenues and expenses as they are earned or incurred, not as cash received or paid respectively. This basis of accounting arises from the concept of periodicity. A business follows accrual basis of accounting if income and expenses are measured when the transactions take place, without taking into consideration inflow and outflow of cash. Profit, under accrual basis of accounting, is the excess of revenues over expenses for a given accounting period. But the receipts of incomes or payments of expenses may be related to a different accounting period. Therefore, profit of an accounting period does not reflect cash receipts and cash payments for that period. For proper matching of expenses against revenues, this method takes into account prepayments and accruals. In effect, the earning of income and the expenses incurred in earning it, can be accurately reflected to a specific accounting period.

Features

1. It records revenues and expenses as they are earned or incurred, not as cash received or paid.
2. It is suitable for any business entity, profit making or non-profit making.
3. This basis of accounting does not reflect the actual inflow or outflow of cash.

4. It takes into account prepayments and accruals.
5. It is the basis of double entry system of book keeping.
6. This method is not simple, as compared to cash basis of accounting.
7. This method is not suitable for terminable ventures.
8. Under this method, profit is calculated by matching expenses against revenues.

Advantages

1. This method is widely used by most businesses.
2. Trading, Profit and Loss Account and Balance Sheet can be prepared.
3. Generally accepted accounting principles recognise this basis of accounting.
4. It ensures proper matching of expenses against incomes.
5. An accurate view of the trend of periodic income can be provided.
6. It helps comparison of accounting statements.

Disadvantages

1. This method is not simple.
2. It requires estimates and judgements of the accountant. Therefore, accounting practice may be inconsistent.
3. It is possible to adopt a variety of accounting principles and procedures.
4. This method does not reflect the actual inflow and outflow of cash.
5. It is not suitable for any organisation where realisation of income is doubtful.
6. This method is suitable only for a going concern.

Distinction Between Cash Basis and Accrual Basis

	Cash Basis		Accrual Basis
1.	It records only cash transactions.	1.	It records both cash and credit transactions.
2.	It is not the basis of the double entry system of book-keeping.	2.	It is the basis of the double entry system of book-keeping.
3.	Income is earned when cash is received and expenses are incurred when cash is paid.	3.	Income and expenses are measured when transactions take place.
4.	Profit is the difference between cash receipts and cash payments.	4.	Profit is the difference between revenue and expenses.
5.	No attempt is made to record prepayments or accruals.	5.	Prepayments and accruals are recorded.
6.	Trading, Profit and Loss Account and Balance Sheet cannot be prepared.	6.	Trading, Profit and Loss Account and Balance Sheet can be prepared.
7.	Expenses for an accounting period are not matched against income.	7.	Expenses for an accounting period are properly matched against income.
8.	It is suitable for a terminable venture.	8.	It is suitable for a going concern.
9.	It is widely used by professionals and other service enterprises.	9.	It is widely used for most businesses.
10.	Generally accepted accounting principles do not recognise this basis.	10.	Generally accepted accounting principles recognise this basis.

Computation of Net Income Under Accrual Basis

At the time of calculating net income under accrual basis the following points must be remembered:

1. Incomes relating to the current year are to be taken into consideration whether received in cash or not.
2. Incomes of the previous year received in the current year are to be deducted from the total income received in cash during the year.

3. Incomes of the future year received in the current year are to be deducted from the total income received in cash during the year.
4. Accrued incomes of the current year not yet received are to be added with the total income received in cash during the year.
5. Only expenses relating to the current year are to be taken into consideration whether paid or not.
6. Outstanding expenses of the previous year paid during the current year are to be deducted from the total expenses paid during the year.
7. Prepaid expenses are to be deducted from the total expenses paid during the year.
8. Outstanding expenses of the current year are to be added with the total expenses paid during the year.

Illustration 2

Taking information of ***Illustration 1*** calculate net income of Dr P K Srinivasan under Accrual Basis for the year ended 31st December, 2016 :

Solution **Computation of Net Income (under Accrual Basis) of Dr P K Srinivasan for the year ended 31st December, 2016**

Particulars	₹	₹	₹
Fees received in cash			35,100
Add: Fees accrued but not yet received			2,000
			37,100
Less: Expenses —			
(i) Rent chamber paid	10,800		
Less: Rent paid in advance	800	10,000	
(ii) Salary of compounder paid	5,400		
Add: Outstanding salary	500	5,900	15,900
Net Income Under Accrual Basis			21,200

Mixed Basis of Accounting

Mixed basis of accounting is the mixture of cash basis of accounting and accrual basis of accounting. Under this method, income is recorded when cash is actually received. It does not take into consideration any accrued income. However, expenses are recorded as they are incurred, not when cash is paid. All outstanding and prepaid expenses are taken into consideration for calculating actual expenses of the accounting period.

Features

1. It records income when cash is actually received.
2. It records expenses when it is incurred, not when cash is paid.
3. No record is made for accrued income.
4. All outstanding and prepaid expenses are taken into consideration for calculating actual expenses of the relevant accounting period.
5. It is the most conservative method of accounting.

Computation of Net Income Under Mixed Basis

At the time of calculating net income under mixed basis, the following points must be remembered:

1. All incomes received in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
2. Incomes accrued but not yet received in cash are not to be taken into consideration.
3. Only expenses relating to the current year are to be taken into consideration ***whether paid or not***.
4. Outstanding expenses of the previous year paid during the current year are to be deducted from the total expenses paid during the year.
5. Prepaid expenses are to be ***deducted*** from the total expenses paid during the year.
6. Outstanding expenses of the current year are to be ***added*** with the total expenses paid during the year.

Illustration 3

Taking information of ***Illustration 1*** calculate net income of Dr P K Srinivasan under mixed basis for the year ended 31st December, 2016 :

Solution **Computation of Net Income (under Mixed Basis) of Dr P K Srinivasan for the year ended 31st December, 2016**

.Particulars		₹	₹
Fees received in cash			35,100
Less: Expenses			
(i) Rent of Chamber paid	10,800		
Less: Rent paid in advance	800	10,000	
(ii) Salary of compounder paid	5,400		
Add: Outstanding salary	500	5,900	15,900
Net Income Under Mixed Basis			19,200

Illustration 4

Ascertain the net income of Sri Arpan Barua for the year ended 31.12.2016 on cash basis and on accrual basis of accounting from the following particulars :

	₹
Fees received in cash in 2016 (gross)	16,200
Fees outstanding on 31.12.2016	950
Expenses paid in cash in 2016 (gross)	4,250
Expenses outstanding on 31.12.2016	500
Fees received in advance on 31.12.2016	300
Prepaid expenses on 31.12.2016	250

Solution **Computation of Net Income (under Cash Basis) of Sri Arpan Barua for the year ended 31st December, 2016**

Particulars	₹
Fees received in cash (gross)	16,200
Less: Expenses paid in cash (gross)	4,250
Net Income Under Cash Basis	11,950

Computation of Net Income (under Accrual Basis) of Sri Arpan Barua for the year ended 31st December, 2016

Particulars	₹	₹
Fees received in cash (gross)		16,200
Add: Fees outstanding on 31.12.2016		950
		17,150
Less : Fees received in advance on 31.12.2016		300
		16,850
Less : Expenses paid in cash (gross)	4,250	
Add : Expenses outstanding on 31.12.2016	500	
	4,750	
Less : Prepaid expenses on 31.12.2016	250	4,500
Net Income Under Accrual Basis		12,350

Illustration 5

Dr P K Das started his profession on 1st January, 2016 as medical practitioner. His incomes and expenses for the year 2016 relating to his profession were as under :

	₹
Fees received in cash	24,000
Fees accrued but not received	6,000
Rent paid for the chamber	6,000
Outstanding rent	2,000
Salary to staff paid	6,000
Salary paid in advance to staff (included in the above)	1,000
Miscellaneous expenses paid	200

You are required to compute the net income of Dr Das from his profession for the year ended 31.12.2016 under : (i) Cash Basis; (ii) Accrual Basis.

Solution **(i) Computation of Net Income (under Cash Basis) of Dr P K Das for the year ended 31st December, 2016**

Particulars	₹	₹
Fees received in cash		24,000
Less : Expenses paid in cash —		
Rent	6,000	
Salary to Staff	6,000	
Miscellaneous expenses	200	12,200
Net Income Under Cash Basis		11,800

(ii) Computation of Net Income (under Accrual Basis) of Dr P K Das for the year ended 31st December, 2016

Particulars	₹	₹	₹
Fees received in cash			24,000
Add : Fees accrued but not received			6,000
			30,000
Less : Expenses—			
Rent paid	6,000		
Add : Outstanding rent	2,000	8,000	
Salary paid	6,000		
Less : Paid in advance	1,000	5,000	
Miscellaneous expenses		200	13,200
Net Income Under Accrual Basis			16,800

Illustration 6

Mr A Roy gives the following information relating to his income and expenditures for the year ended 31.12.2016 :

	₹
Fees received in cash (gross)	50,500
Fees earned but not yet received	4,500
Fees received in advance	3,000
Fees for 2015 received	2,000
Staff salaries paid (gross)	8,200
Salaries paid in advance	1,200
Salaries for 2015 paid	1,000
Rent paid for office (gross)	7,100
Outstanding office rent	600
Rent for 2015 paid	500
Telephone charges paid	1,600

Calculate his net income for the year 2016.

Solution **Computation of Net Income (under Cash Basis) of A Roy for the year ended 31st December, 2016**

Particulars	₹	₹
Fees received in cash		50,500
Less : Expenses paid in cash—		
Staff salaries (gross)	8,200	
Rent paid for the office (gross)	7,100	
Telephone charges paid	1,600	16,900
Net Income Under Cash Basis		33,600

Computation of Net Income (under Accrual Basis) of A Roy for the year ended 31st December, 2016

Particulars	₹	₹	₹
Fees received in cash		50,500	
Add : Fees earned but not yet received		4,500	
		55,000	
Less : Fees received in advance		3,000	
		52,000	
Less : Fees received for 2015		2,000	50,000

Less : Expenses —			
Staff salary (gross)	8,200		
Less : Salary paid in advance	1,200		
	7,000		
Less : Salary for 2015 paid	1,000	6,000	
Rent paid for office (gross)	7,100		
Add : Outstanding office rent	600		
	7,700		
Less: Rent for 2015 paid	500	7,200	
Telephone charges paid		1,600	14,800
Net Income Under Accrual Basis			35,200

Illustration 7

From the following particulars, calculate the 'Net Income' of Sri Tapas Roy, an eminent Chartered Accountant for the year ended 31.12.2016 under (i) Cash Basis, and (ii) Accrual Basis:

	₹
Fees received in cash in 2016	1,14,000
Expenses paid in cash in 2016	30,000
Fees received in advance as on 31.12.2016	18,000
Fees accrued but not received as on 31.12.2016	3,600
Outstanding expenses as on 1.1.2016	4,800
Fees accrued but not received as on 1.1.2016	4,800
Prepaid expenses as on 1.1.2016	4,200
Outstanding expenses as on 31.12.2016	2,400
Fees received in advance as on 1.1.2016	12,000
Prepaid expenses as on 31.12.2016	3,600

Solution **(i) Computation of Net Income (under Cash Basis) of Sri Tapas Roy for the year ended 31st December, 2016**

Particulars	₹
Fees received in cash in 2016	1,14,000
Less : Expenses paid in cash 2016	30,000
Net Income Under Cash Basis	84,000

(ii) Computation of Net Income (under Accrual Basis) of Sri Tapas Ray for the year ended 31st December, 2016

Particulars	₹	₹
Fees received in cash in 2016	1,14,000	
Less : Fees received in advance as on 31.12.2016	18,000	
	96,000	
Add : Fees accrued but not received as on 31.12.2016	3,600	
	99,600	
Less : Fees accrued but not received as on 1.1.2016	4,800	
	94,800	
Add: Fees received in advance as on 1.1.2016	12,000	1,06,800
Less : Expenses —		
Expenses paid in cash 2016	30,000	
Less : Outstanding expenses as on 1.1.2016	4,800	
	25,200	
Add : Prepaid expenses as on 1.1.2016	4,200	
	29,400	
Add : Outstanding expenses as on 31.12.2016	2,400	
	31,800	
Less : Prepaid expenses as on 31.12.2016	3,600	28,200
Net Income Under Accrual Basis		78,600

Conversion of Profit Under Cash Basis into Profit Under Accrual basis

Profit / net income under cash basis and accrual basis may vary widely. Sometimes, it may be required to convert profit under cash basis into profit under accrual basis. For the purpose of conversion, the following steps are to be followed :

Step 1 Calculate profit / net income under cash basis in the usual manner.

Step 2

Add the following items —

(i) Outstanding expenses at the beginning of the year.
(ii) Income received in advance at the beginning of the year.
(iii) Income accrued but not yet received at the end of the year.
(iv) Prepaid expenses at the end of the year.
(v) Any other adjustments.

Step 3

Deduct the following items —

(i) Outstanding expenses at the end of the year.
(ii) Income received in advance at the end of the year.
(iii) Income accrued but not yet received at the beginning of the year.
(iv) Prepaid expenses at the beginning of the year.
(v) Any other adjustments.

Step 4 Find out the balance. This balance will represent profit / net income under accrual basis.

Illustration 8

Mr A K Das gives the following particulars of his incomes and expenses for the year 2016. Ascertain his net income for the year under (i) the Accrual Basis and (ii) the Mixed Basis of Accounting :

	₹
Incomes	
Received during 2016 (gross)	2,17,500
Arrear fees received this year	26,400
Advance fees received this year	8,300
This year's fees received in 2015	6,200
This year's fees not yet received	13,800
Expenses	
Paid during 2016 (gross)	58,000
Expenses for 2015 paid this year	7,300
Expenses for this year paid in 2015	1,500
Expenses for this year not yet paid	4,800
Expenses for next year paid this year	6,200

Solution **(i) Computation of Net Income (under Accrual Basis) of Dr A K Das for the year ended 2016**

Particulars	₹	₹
Income received during 2016	2,17,500	
Less : Arrear fees received this year	26,400	
	1,91,100	
Less : Advance fees received this year	8,300	
	1,82,800	
Add : This year's fees received in 2015	6,200	
	1,89,000	
Add : This year's fees not yet received	13,800	2,02,800
Less : Expenses paid during 2016 (gross)—	58,000	
Less : Expenses for 2015 paid this year	7,300	
	50,700	
Add : Expenses for this year paid in 2015	1,500	

	52,200	
Add : Expenses for this year not yet paid	4,800	
	57,000	
Less : Expenses for next year paid this year	6,200	50,800
Net Income Under Accrual Basis		1,52,000

(ii) Computation of Net Income (under Mixed Basis) of Dr A K Das for the year ended 2016

Particulars	₹	₹
Income received during 2016 (See tutorial Note)		2,17,500
Less : Expenses under accrual basis —		
Expenses paid during 2016 (gross)	58,000	
Less : Expenses for 2015 paid this year	7,300	
	50,700	
Add : Expenses for this year paid in 2015	1,500	
	52,200	
Add : Expenses for this year not yet paid	4,800	
	57,000	
Less : Expenses for next year paid this year	6,200	50,800
Net Income Under Mixed Basis		1,66,700

Tutorial Note : Under mixed basis of accounting, incomes are taken on cash basis but expenses are taken under accrual basis.

Illustration 9

From the following statement of M Deb of Calcutta, prepare a Profit and Loss Account on cash basis for the year ended 31st December, 2016:

		₹
Salary received in cash		30,000
Accrued salary		2,500
Salary for 2017, received in 2016		2,000
Expenses due but not paid		1,000
Expenses paid for —	₹	
2015	2,000	
2016	10,000	
2017	1,400	13,400

Convert the profit ascertained on cash basis to the profit on accrual basis by preparing a statement.

Solution

Profit and Loss Account of M Deb (under Cash Basis) for the year ended 31st December, 2016

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Expenses for —			By Salaries	30,000
2015	2,000			
2016	10,000			
2017	1,400	13,400		
To Net Profit		16,600		
		30,000		30,000

Statement Showing the Conversion of Profit Under Cash Basis into Profit Under Accrual Basis

Particulars	₹	₹
Net Profit Under Cash Basis		16,600
Add : (i) Expenses paid for 2015	2,000	
(ii) Accrued Salary	2,500	
(iii) Expenses paid for 2017	1,400	5,900
		22,500
Less : (i) Expenses due but not paid	1,000	
(ii) Salary for 2017 received in 2016	2,000	3,000
Net Profit Under Accrual Basis		19,500

Illustration 10

The following Income and Expenditure Account has been prepared by Md. Selim, a Chartered Accountant, on cash basis for the year ended 31.12.2016 :

Expenditure	₹	Income	₹
Salaries	96,600	Fees received from audit work	2,52,000
Membership subscription	44,800	Fees received from legal advice	1,00,800
News papers and magazines	11,200		
House rent	32,000		
Conveyance expenses	71,400		
Electricity charges	4,480		
Office expenses	21,000		
Excess of Income over Expenditure	71,320		
	3,52,800		3,52,800

Additional information —	₹
(i) Fees accrued	49,000
(ii) Fees received in advance	28,000
(iii) Arrear fees received	21,000
(iv) Salary paid in advance	8,400
(v) Outstanding rent	9,800
(vi) Outstanding office expenses	4,200

Prepare Income and Expenditure Account on accrual basis for the year ended 31st December, 2016.

Solution **Income and Expenditure Account of Md. Selim (under Accrual Basis) for the year ended 31st December, 2016**

Expenditure	₹	₹	Income	₹	₹
To Salaries	96,600		By Fees received from audit work (Note 1)		2,52,000
Less : Salary paid in advance	8,400	88,200	By Fees received from legal advice		1,00,800
To Membership Subscriptions		44,800			
To Newspapers and magazines		11,200			
To House Rent	32,000				
Add : Outstanding rent	9,800	41,800			
To Conveyance expenses		71,400			
To Electricity charges		4,480			
To Office expenses	21,000				
Add : Outstanding office expenses	4,200	25,200			
To Excess of Income over Expenditure		65,720			
		3,52,800			3,52,800

Working Note : (1) Calculation of Fees Received from Audit Work under Accrual Basis

	₹
Fees received in cash	2,52,000
Add: Fees accrued	49,000
	3,01,000
Less: Fees received in advance	28,000
	2,73,000
Less: Arrear fees received	21,000
	2,52,000

Conversion of Profit Under Accrual Basis into Profit Under Cash Basis

For the purpose of converting the profit under accrual basis into profit under cash basis, the following steps are to be followed :

Step 1

Calculate profit / net income under accrual basis in the usual manner.

Step 2

Add the following items —

(i) Outstanding expenses at the end of the year.
(ii) Income received in advance at the end of the year.
(iii) Income accrued but not yet received at the beginning of the year.
(iv) Prepaid expenses at the beginning of the year.
(v) Any other adjustments.

Step 3

Deduct the following items —

(i) Outstanding expenses at the beginning of the year.
(ii) Income received in advance at the beginning of the year.
(iii) Income accrued but not yet received at the end of the year.
(iv) Prepaid expenses at the end of the year.
(v) Any other adjustments.

Step 4

Find out the balance. This balance will represent profit / net income under cash basis.

Illustration 11

Mr D Basu is a lawyer. Particulars of the income and expenses for the year ended 31.12.2016 are as follows:

	₹
Fees received from clients in cash	64,800
Salary of clerks and assistants paid	24,000
Rent of chamber paid (gross)	27,000
Salary of clerks and assistants outstanding	2,160
Accrued fees	14,400
Rent of chamber paid in advance (included in above)	1,800
Miscellaneous expenses	5,040
Telephone charges	2,880

You are required to ascertain Mr Basu's net income for the year ended 31.12.2016 under accrual basis. Convert the net income ascertained under accrual basis into net income under cash basis.

Solution **Computation of Net Income (under Accrual Basis) of Mr D Basu for the year ended 31st December, 2016**

Particulars	₹	₹	₹
Fees received in cash		64,800	
Add : Accrued fees		14,400	79,200
Less : Expenses —			
Salary of clerks and assistant	24,000		
Add : Outstanding	2,160	26,160	
Rent of chamber (gross)	27,000		
Less : Paid in advance	1,800	25,200	
Miscellaneous expenses		5,040	
Telephone charges		2,880	59,280
Net Income Under Accrual Basis			19,920

Statement Showing the Conversion of Net Income Under Accrual Basis into Net Income Under Cash Basis

Particulars	₹	₹
Net Income Under Accrual Basis		19,920
Add : Outstanding Salary		2,160
		22,080
Less : Rent of chamber paid in advance	1,800	
Accrual fees not yet received	14,400	16,200
Net Income Under Cash Basis		5,880

Journal Entries for Conversion of Cash Basis Accounting into Accrual Basis Accounting

Under cash basis of accounting, no adjustment is made for outstanding expenses, prepaid expenses, accrued income, income received in advance. For conversion of cash basis into accrual basis, adjustments are to be made for the above items by passing the following entries :

1. For Outstanding Expenses

Profit and Loss Adjustment Account Dr.
  To Outstanding Expenses Account

2. For Prepaid Expenses

Prepaid Expenses Account Dr.
  To Profit and Loss Adjustment Account

3. For Accrued Income

Accrued Income Account Dr.
  To Profit and Loss Adjustment Account

4. For Income Received in Advance

Profit and Loss Adjustment Account Dr.
  To Income Received in Advance Account

If there is any increase in the profit due to the conversion, then it is credited to Capital Account by passing the following entry :

Profit and Loss Adjustment Account Dr.
  To Capital Account

If there is any decrease in the profit due to the conversion, the entry will be opposite, i.e.,

Capital Account Dr.
  To Profit and Loss Adjustment Account

Illustration 12

From the following, pass Journal Entries to convert cash basis into accrual basis of accounting :

Rent outstanding	₹ 600
Accrued interest	₹ 1,000
Insurance premium prepaid	₹ 100
Apprenticeship premium received in advance	₹ 1,000

Solution **Journal** **Dr. Cr.**

Date	Particulars	L.F.	₹	₹
	Profit and Loss Adjustment A/c Dr.		600	
	To Outstanding Rent A/c			600
	(Being the adjustment for outstanding rent in connection with the conversion of cash basis of accounting into accrual basis of accounting)			
	Accrued Interest A/c Dr.		1,000	
	To Profit and Loss Adjustment A/c			1,000
	(Being the adjustment for accrued interest in connection with the conversion of cash basis into accrual basis of accounting)			
	Insurance Premium Prepaid A/c Dr.		100	
	To Profit and Loss Adjustment A/c			100
	(Being the adjustment for prepaid insurance premium in connection with the conversion of cash basis into accrual basis of accounting)			
	Profit and Loss Adjustment A/c Dr.		1,000	
	To Apprenticeship Premium Received in Advance A/c			1,000
	(Being the adjustment for apprenticeship premium received in advance in connection with the conversion of cash basis into accrual basis of accounting)			

Key Points

- ***Cash basis of accounting*** is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid out and not when the transactions take place.
- ***Accrual basis of accounting*** is an accounting system which recognises revenues and expenses as they are earned or incurred, not as cash received or paid respectively.
- **Features of Cash Basis of Accounting**
  1. It records transactions only when cash is actually received or paid out.
  2. Income is earned when cash is received and expenses are incurred when cash is paid.
  3. No record is made for prepayments or accruals.
  4. It does not follow double entry system of book keeping. Therefore, profit is ascertained by means of a statement.
  5. This method is not suitable for a going concern business.
  6. It is widely used by professionals and other service enterprises.
- **Features of Accrual Basis of Accounting**
  1. It records revenues and expenses as they are earned or incurred, not as cash received or paid.
  2. It is suitable for any business entity, profit making or non-profit making.
  3. This basis of accounting does not reflect the actual inflow or outflow of cash.
  4. It takes into account prepayments and accruals.
  5. It is the basis of double entry system of book keeping.
  6. This method is not simple, as compared to cash basis of accounting.
  7. This method is not suitable for terminable ventures.
  8. Under this method, profit is calculated by matching expenses against revenues.

THEORETICAL QUESTIONS

1. What do you mean by cash and accrual basis of accounting ?
2. State the advantages and disadvantages of cash and accrual basis of accounting.
3. What are the features of cash basis of accounting ?
4. What are the features of accrual basis of accounting ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Revenue is recognised at the point of sale under
   A cash basis
   B accrual basis
   C none of these
2. Cash basis of accounting is widely used
   A by professionals
   B for most businesses
   C none of these
3. Charges and obligations of a business unit are recognised by
   A cash basis
   B accrual basis
   C none of these
4. Estimates and judgements are required in
   A cash basis
   B accrual basis
   C none of these

5. In order to determine gross profit, an adjustment is made for opening and closing stocks in
   A cash basis
   B accrual basis
   C none of these

PRACTICAL QUESTIONS

1. You are required to ascertain the income from profession under : (a) cash basis; and (b) accrual basis of Dr P K Srinivasan. His incomes and expenses for the year 2016 are as follows :

Particulars	₹	Particulars	₹
Fees received in cash	17,550.00	Accrual fees	1,485.00
Rent of chamber paid	5,400.00	Salary of compounder paid	2,700.00
Rent of chamber paid in advance (included above)	202.50	Salary of compounder outstanding	540.00

2. You are required to ascertain the net income under :
   (a) cash basis; and (b) accrual basis of Mr P L Mehta from the following information relating to his income and expenditure for the year ended 31st December, 2016 :

Particulars	₹	Particulars	₹
Fees received in cash (Gross)	1,39,175.00	Fees received in advance	6,175.00
Fees earned but not received	14,250.00	Outstanding rent of the chamber	7,600.00
Rent of chamber paid	14,962.50	Staff salaries paid in advance	2,850.00
Staff salaries paid (Gross)	15,200.00	Telephone charges paid	2,280.00

Guide to Answers

Multiple Choice

1. B 2. A 3. B 4. B 5. B

Practical Questions

1. **Income under cash basis : ₹ 9,100; Income under accrual basis : ₹ 10,205.**
2. **Income under cash basis : ₹ 1,06,732.50; Income under accrual basis : ₹ 1,10,057.50.**

6

Accounting Concepts and Conventions

Accounting Concepts and Conventions

A generally accepted set of rules can provide uniformity in the accounting system, the accounting procedure and presentation of accounting results. In developing the structure of accounting theory and to relate the theory to its practice, the accounting profession has agreed to take for granted certain basic concepts. Accounting assumptions are those broad concepts that develop generally accepted accounting principles, i.e., upon which accounting is based. Certain ideas are assumed or accepted in account in order to provide a unifying theoretical structure and internal logic of accounting. These assumptions are ***rules of the game*** and they have been developed from common accounting practices. These assumptions help accounting statements to become comparable, leading to better analysis and comparison of performances.

Basic Concepts and Conventions

1. Business Entity Concept

According to entity concept, business is considered separate and distinct from the owners of the enterprise. This concept starts with the fact that the business unit is a separate entity with its own identity. We must, for the purposes of bookkeeping, keep the owner and his business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of the business unit and not the owners. For example, Mr. X starts a business, styled 'X & Co.'; accounts are to be prepared only from the point of view of 'X & Co.'—as if it was a different person from the owner. If the owner invests capital into the business, this is treated as if the owner is lending cash to the business. If a part of the capital is taken back by the owner, this is treated as a repayment of loan. For accounting purposes, a partnership firm has a separate entity apart from its partners. Likewise, the existence of a company does not depend on the life span of any of the shareholders.

This concept is applied to all forms of business organisations for the following reasons :

(a) It gives a solution to the problem of separating out business transactions from personal transactions.
(b) To ascertain the return on capital employed.
(c) To ensure the proper use of funds provided by the owners.
(d) To hold title to property in the name of the firm.
(e) To enter into transactions with outsiders in the name of the firm.

Advantages

(1) This concept stresses the importance of the business unit.
(2) This concept can be applied to any form of business organisation.
(3) It is the basis of the double entry system of book-keeping.
(4) It helps in separating out the business transactions from the personal transactions of the owner(s).
(5) This concept can be applied along with proprietary and fund concepts.
(6) It is possible to measure how successful or otherwise the business has been in terms of profit or loss.

Disadvantages

(1) Accounting is done from the viewpoint of the business unit, which is an artificial person.
(2) This concept sometimes coincides with the legal fact.
(3) To some extent, present accounting practice is not based on this concept.
(4) The owners cannot be identified with the existence of the business unit.
(5) This concept does not stress the importance of the proprietor(s).
(6) It is not concerned with increase of wealth of the owner(s).

2. Money Measurement Concept

Money is what money does. It is the medium of exchange. It provides a uniform way to measure the value of goods and services. It makes exchange more efficient. Finally, money is a store of value. Money is one form in which wealth can be maintained. The accounting system uses money as its basic unit of measurement. All business transactions are recorded in terms of money. This is because money is a useful way of converting accounting data into a common unit. Most of the resources of a business can be expressed in terms of money value. Under this concept, *only those transactions which can be measured in terms of money are to be recorded in the books of account*.

There are two *problems* with this concept. First, the concept assumes a stability in the value of money, e.g., Re 1 a year from now will buy the same amount as it does today. Secondly, many factors of vital importance to the business are outside the purview of accounting. This is because they are matters of opinion and cannot be expressed in monetary terms. Such matters include quality of management, growth of competition, changes in the nature of demand, and so on.

For the above two reasons, the money measurement concept is not ideal. It is recognised by all accountants that the concept has its limitations and inadequacies. Yet, it is accepted for accounting purposes because there is no difficulty in adopting the money measurement rule and it is not possible to employ a better measurement scale that can be easily understood by the users of accounting information.

3. Going Concern Concept

Accounting is based on the assumption that the accounting unit is to remain in operation into the foreseeable future in pursuit of its goals and objectives. When a business is inaugurated, except for terminable ventures, it is assumed that the termination of the business is not certain. Based on this idea, this concept assumes that the business will continue in operation for as long as possible and will not be dissolved in the foreseeable future, unless we have some strong evidence to suggest that this is not the case. From the accountant's standpoint, Profit and Loss Account and Balance Sheet are drawn up on the assumption that the business unit will continue functioning in the foreseeable future. This concept can be regarded as supporting the valuation of assets at historical cost or replacement cost. If this method is not adopted, the assets of the business unit would have to be shown at the net realisable value, i.e. at the amount they would sell for in the market at the Balance Sheet date. This concept is the basis of the conventional classification scheme, for instance, fixed / current assets, long term / current liabilities.

This concept assumes that the entity will continue operating under the same economic conditions and in the same general environment, but does not assume that the business will be profitable as long as it exists. This concept also does not imply that the business will continue for ever.

This concept relates to the future which is, by definition, uncertain. Therefore, many factors can be used to determine whether a business unit is a going concern. They include the following:

(a) ***Liquidity :*** The business unit must have sufficient liquid assets (assets which can be in the form of cash or can be easily converted into cash, i.e. current assets other than stock) to pay its current liabilities at present or in the future. A shortage of liquid assets may lead to the risk of insolvency. Various ratios can be formulated and applied to ascertain the liquidity of a business unit.

(b) ***Capital structure :*** A 'going concern' business unit must have a sound capital structure (the composition of an enterprise's sources of funds, especially long-term) to overcome any short-term or long-term difficulties. Capital structure of a business unit is influenced by several factors such as cost of various sources of capital, dividend policy, the risk of insolvency, stability of earnings, and the like.

(c) ***Market :*** A business enterprise cannot continue as a going concern without a continuing demand for the goods it deals in and/or the services it supplies.

(d) ***Management ability :*** A business enterprise should be managed efficiently and effectively to produce a competitive product and to see that the objectives of the enterprise are achieved. To keep the business unit going, the plans, policies, procedures and practices are to be used properly and attention concentrated on those areas that are not going according to plan.

4. Historical Cost Concept

Historical cost refers to the cost at the time of acquisition. Since accounting is basically the recording of past happenings, accountants use the acquisition price as the most objective measurement inasmuch as it is supported by the evidence of a transaction. It is a fundamental concept of accounting which is based on the historical record of the transactions, i.e., an asset is ordinarily recorded at its cost and this cost becomes the basis for subsequent accounting for the asset. If a plot of land is purchased, say for ₹ 10,000, it will appear in the books at that figure without considering the market value of the asset at any other point of time. It follows from this concept, that if nothing is paid for acquiring an asset, it will not be recorded at all. Let us take the example of Goodwill — it should be recorded in the books only when it is purchased. This concept is modified in practice by applying the concept of conservatism (valuing closing stock at cost or market value whichever is less). Furthermore, when the real worth of an asset changes with the passage of time, for various reasons, accounting records are changed to reflect changes in market value by revaluations of assets.

This concept provides uniformity in accounting records under conditions of stable prices. Historical cost values can well be retained in view of their familiarity to accountants.

The major drawback of historical cost concept stems from rapid inflation, which leads to serious distortions in the measurement of income. Since historical costs are matched against current incomes, there is an understatement of the real-value of the non-monetary assets of the business unit and an overstatement of the net income.

The reliance of business on historical cost is no accident. Alternatives to it have been advanced before. But a pragmatic consideration of the possibilities has always found historical cost, in spite of its acknowledged limitations, to be superior.

5. Realisation Concept

Realisation is the process of converting non-cash resources and rights into money. Realisation concept is governed by the concept of conservatism. Revenue should only be brought into account when it is actually realised. However, it is not always easy to determine when revenue is realised. In determining profit, credit sales are taken into consideration. But, in future, customers may not pay their dues or may return the goods. In fact, the actual income may turn out to be less than what it was estimated to be. Therefore, the problem arises about recognising and recording revenue in the books of account for a specific accounting period. Revenue can be recognised at the point of sale or when cash is collected or at any intermediate point.

In general, revenue is recognised at the point of sale or at the performance of a service. The point at which a sale is made, depends on the terms of the contract between the buyer and the seller. But a sale is complete only when the goods are delivered by the seller and accepted by the buyer. To recognise a revenue, there is no need to wait until the cash is received. When revenue is recognised, it is included in the Profit and Loss Account.

6. Accrual Concept

The accrual concept is an accounting system which recognises revenues and expenses as they are earned or incurred, respectively, without regard to the date of receipt or payment. This concept is one of the consequences of the periodicity concept. In the preparation of a Profit and Loss Account for an accounting period, revenues and expenses are recognised as they are earned or incurred respectively, and not when cash is received or paid. The earning of a revenue and the expense incurred for earning it, can be accurately related to specific time periods, but the receipts and payments may not be related to the period under consideration. This concept requires proper apportionment of expenses to time periods by the inclusion of prepayments and accruals in a Balance Sheet.

7. Periodicity Concept

The periodicity concept requires that a Profit and Loss Account and a Balance Sheet should be prepared at ***regular intervals*** to ascertain information about the business unit for all sorts of purposes—performance evaluation, tax computation, budgetary control and the like. Period-income determination leads to a comparison of the results of successive periods. In fact, periodicity is the consistency of accounting periods. For the purpose of convenient comparison of profits and losses and of other expenses, it is necessary that the ***periods of measurement*** should be equal. Since the lifespan of the business unit is segregated into equal parts, most of the problems of accounting measurement arise out of the periodicity concept. This is because accounting periods are often out of correspondence with natural cycles of business activity. The main difficulty arises in deciding what revenues and what expenses are to be taken into consideration for one accounting period and, in consequence, much effort is demanded to prepare the periodic accounts. A business transaction should be identified with a particular period. But, there may be transactions relating to several accounting periods. For example, if a business unit buys a plant for ₹ 1,00,000 with a stipulated lifespan of 5 years, the transaction relates to five accounting periods. The transaction for one accounting period is not the cost of the asset, but the depreciation of the asset charged in one accounting period. The main implication of the periodicity concept is the application of the arbitrary allocation and apportionment of indirect costs, i.e., judgement and guessing will always be required to measure such items as depreciation, doubtful debts, and so on.

The periodicity concept results in the following advantages :

(a) Uniformity and consistency in accounting treatment for profit ascertainment and asset valuations.
(b) Proper matching of periodic revenues and expenses to achieve the objectives of accounting.
(c) Comparability of financial statements of different periods is facilitated.

8. Consistency Concept

Consistency concept relates to the method of measurement in accounting. Accounting principles are not static or unchanging. It is possible to adopt a variety of principles and procedures for financial events. If, in treating a given event, two or more contradictory methods are used, it may yield conflicting results. Whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.

It is very important that the accountant be consistent in applying principles and procedures to similar situations, because inconsistency in reporting can cause misleading interpretations and, therefore, wrong conclusions. The user must be sure that the accounts for a particular business unit for successive years are comparable with each other. Comparability does require that the entity apply the same accounting principles on a consistent basis. Therefore, consistency is essential in improving comparability across accounting periods. This concept gives confidence to the users of accounting information. Though consistency is obligatory for sound financial accounting, this does not mean that changes cannot be made in a business unit's accounts. In the event of any change (when there are good reasons for it), a note must be appended along with the statements indicating the alteration/s.

In accounting, whenever the question of consistency arises, it is spoken of in three different senses:

(i) ***Vertical consistency*** : It means the consistency within a given set of statements of a firm at a specific date and for a specific time. An example of inconsistency within a statement is the recording of an asset in the Balance Sheet at cost and charging of the related depreciation on the basis of replacement cost in the Profit and Loss Account.

(ii) ***Horizontal consistency*** : It means the intra-firm consistency between different accounting periods. There should be consistency in applying accounting methods to different accounting periods. The Profit and Loss Account and the Balance Sheet of an accounting period must be made out on the basis that the figures stated are consistent with those of the earlier years.

(iii) ***Third dimensional consistency*** : It means the inter-firm consistency between a particular organisation and the other organisations in similar industry or trade. It refers to the use of similar measurement concepts and procedures for related items by different firms in the same industry.

9. Prudence (or Conservatism) Concept

This is a basic accounting concept which requires that a degree of caution is necessary when making estimates required under conditions of uncertainty, so that assets or income are not over-stated and liabilities or expenses are not under-stated. Revenue can only be recorded in the books of account when there is a reasonable certainty about its realisation. At the same time, provision must be made for all possible liabilities. It is not important whether the amount of liability is known with certainty or is based on estimation. To illustrate, inventories are recorded at their cost or market price, whichever is lower. Likewise, if there is an anticipation that a debt may not be realised, a specific amount is set aside from profit as a provision for doubtful debts. This concept is expressed as : "Recognise all losses and anticipate no gains". This concept attempts to state the lowest likely value of assets and profits, and the highest likely amount of any losses or liabilities incurred.

Following are the three main arguments for prudence principle :

First, it is necessary to compensate for the frequent over-optimisation in preparing financial statement.

Second, overstating profit is potentially disastrous because it can lead to a reduction of capital.

Third, it is the only practical way of dealing with uncertainty about potential revenue, expenses, asset values and liabilities.

10. Materiality Concept

Materiality implies significance, substance, importance and consequence. The materiality concept permits other concepts to be ignored if the effects are not considered material. The concept of materiality is the threshold for recognition of a transaction in accounting process. Since materiality is primarily related to relevance, this concept deals with the relative importance of economic data. In the accounting sense, an item is recorded only when it is considered to be useful or important to the user of a financial statement. Thus, accountants do not record those transactions which are insignificant and recording those would create more problems than solutions.

Again, as no benefit is gained from excessive precision, accounting statements are not made complicated by including trivial matters—only a reasonable approximation is considered acceptable. It means, accountants take the simpler course of action, even though less exact. For example, a brand new pencil is an asset to the business unit. Whenever the pencil is used, a part of the asset is consumed. Although the pencil is still in use at the year-end, its original cost is so insignificant that it would be a waste of time to evaluate and include it in closing stock. Instead, it is written-off as revenue in the period it was purchased. To make the figures manageable without affecting the accuracy of the accounting data, only round figures (figures to the nearest rupee) are generally shown in the financial statement of any organisation.

Whether an item is material or not depends on personal judgement and common sense. There cannot be any hard and fast rule for that. What is important is that omission of information from the financial statements should not impair the decision of a user of accounting information.

11. Matching Concept

Since the matching concept is an essential part of accrual accounting, these two are often used interchangeably. Like accrual concept, the matching concept also results from periodicity concept. The matching concept requires that the expenses for an accounting period should be matched against related revenues, rather than recognising revenues as being earned at the time when cash is received or recognising expenses when cash is paid. For ascertaining profit, a misleading impression would be given if the cash received during a particular period is simply compared with the cash paid out during the same period. This is because, the exact period in which the cash is either received or paid may bear no relationship to the period in which the business transaction took place. As most businesses keep accounts on accrual basis, it is necessary that the accounting system match periodically the revenues earned against expenses incurred. The result of this matching being, the net income or net loss. This method requires proper allocation of costs into appropriate period so that relevant incomes and expenses are matched. The profit of an accounting period is the revenues from transactions less expenses incurred in producing those revenues. If expenses cannot be traced to specific items of revenues, they are generally written-off in the year in which they are incurred.

12. Full Disclosure

Disclosure is an accounting principle that requires full (adequate) disclosure of all material (significant) matters affecting the financial statements that would be of interest to the users of accounting information. The full disclosure principle specifies that there should be complete and understandable reporting on the financial statements of all significant information relating to the economic affairs of the entity. Full disclosure requires that financial statements be designed and prepared to portray accurately the economic events that have affected the firm for the period and to contain information sufficient to make them useful, and not misleading to the users. Full disclosure is required when alternative policies are available (FIFO, LIFO), principles peculiar to particular industry and unusual or innovative application of accounting principles.. While preparing financial statements, it should be ensured that significant facts or information are not omitted. It would increase the relevance and reliability of financial statements.

13. Substance over Form

Substance over form is an accounting concept whereby transactions and other events are accounted for and presented in accordance with their economic reality rather than their legal form. In accounting, substance should normally take precedence over form in deciding how a particular transaction should be recorded.

The legal form of a transaction is frequently descriptive of its economic substance. However, the form occasionally misrepresents the characteristics that are relevant to users. If the substance can be reliably determined, the accountant should describe the transaction in terms of the substance rather than the form. Accounting for hire-purchase transactions, for example, is based on the above concept, i.e., it looks at the substance of the transaction rather than its legal form. The hire-purchaser can record the asset at its cash down price, while paying for it by instalments over an agreed period of time.

Illustration 1

In preparing the accounts of your company, you are faced with a number of problems. These are summarised below :

(a) The managing director wishes the company's good industrial relations to be reflected in the accounts.
(b) The long-term future success of the company is extremely uncertain.
(c) Although the sales have not yet actually taken place, some reliable customers of the company have placed several large orders that are likely to be extremely profitable.
(d) One of the owners of the company has invested his drawings in some stocks and shares.
(e) At the year end, an amount is outstanding for electricity that has been consumed during the accounting period.
(f) Fixed assets would now cost a great deal more than they did when they were originally purchased.
(g) During the year, the company purchased ₹ 100 worth of pencils; these had all been issued from stock and were still in use at the end of the year.
(h) The company has had a poor trading year, and the owners believe that a more balanced result could be presented if a weighted average stock valuation method was adopted, instead of present FIFO method.
(i) A debtor who owes a large amount to the company is rumoured to be going into liquidation.
(j) The company owns some shares in a quoted company which the accountant thinks are worthless.

You are required to: (i) state which accounting concept the accountant should follow in dealing with each of the above problems; (ii) explain briefly what each concept means.

Solution

(a) **Money measurement concept**. Only those transactions which are capable of being measured in terms of money are to be recorded in the books of account.

(b) **Going concern concept**. The business will continue in operation for as long as possible and will not be dissolved in the foreseeable future, unless there is some strong evidence to suggest that this is not the case.

(c) **Realisation concept**. Revenue is recognised at the point of sale or at the performance of a service.

(d) **Entity concept**. The organisation is a separate entity with its own identity and the accounts and transactions are classified and analysed from the point of view of that entity.

(e) **Accrual concept.** An accounting system which recognises revenues and expenses as they are earned or incurred, respectively, without regard to the date of receipt or payment.

(f) **Historical cost concept**. An asset is recorded at its cost and this cost becomes the basis for subsequent accounting for the asset.

(g) **Materiality concept**. An item is recorded only when it is considered to be useful or important to the user of a financial statement.

(h) **Consistency concept.** Whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.

(i) **Conservatism concept**. Where there is a reasonable choice of accounting treatments, it is desirable to have early recognition of unfavourable events.

(j) **Cost/conservatism concept**. Shares in a quoted company should be valued at the lower of cost or market price. Both these values are objective. The accountant's opinion is subjective.

Key Points

- A generally accepted set of rules can provide uniformity in the accounting system, the accounting procedure and presentation of accounting results.
- According to entity concept, business is considered separate and distinct from the owner of the enterprise.
- Under money measurement concept, only those transactions which can be measured in terms of money are to be recorded in the books of accounts.
- Going concern concept assumes that the entity will continue operating under the same economic conditions and in the same general environment, but does not assume that the business will be profitable as long as it exists.
- Historical cost refers to the cost at the time of acquisition. Since accounting is basically the recording of past happenings, accountants use the acquisition price as the most objective measurement inasmuch as it is supported by the evidence of a transaction. It is a fundamental concept of accounting which is based on the historical record of the transactions, i.e., an asset is ordinarily recorded at its cost and this cost becomes the basis for subsequent accounting for the asset.
- In general, revenue is recognised at the point of sale or at the performance of a service. The point at which a sale is made, depends on the terms of the contract between the buyer and the seller. But a sale is complete only when the goods are delivered by the seller and accepted by the buyer. To recognise a revenue, there is no need to wait until the cash is received. When revenue is recognised, it is included in the Profit and Loss Account.
- Consistency concept relates to the method of measurement in accounting. Accounting principles are not static or unchanging. It is possible to adopt a variety of principles and procedures for financial events. If, in treating a given event, two or more contradictory methods are used, it may yield conflicting results. Whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.
- Since the matching concept is an essential part of accrual accounting, these two are often used interchangeably. Like accrual concept, the matching concept also results from periodicity concept. The matching concept requires that the expenses for an accounting period should be matched against related revenues, rather than recognising revenues as being earned at the time when cash is received or recognising expenses when cash is paid.

THEORETICAL QUESTIONS

1. Why realisation concept is important for the purpose of determination of profits ?
2. Explain vertical consistency and horizontal consistency.
3. What is materiality concept ?
4. What is 'Substance over Form' concept ?
5. What do you mean by matching concept ?
6. What do you mean by full disclosure ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. What does the going concern concept mean ?
   A a business is profitable
   B a business will continue to operate for the foreseeable future
   C the assets of a business exceed its liabilities
   D the assets of a business should be valued at disposal value
2. When a businessman introduces capital into his business, the transaction is debited in the Cash Book and credited to his Capital Account. Of which accounting concept is this an example ?
   A business entity
   B going concern
   C matching
   D prudence
3. A company does not include the value of skills gained by its employees from training programmes in its financial statements. Which accounting concept is being applied ?
   A consistency
   B materiality
   C money measurement
   D substance over form
4. There is great uncertainty about the continuance of a business. This has caused the proprietor to make a large reduction in the valuation of the year-end stock. Which accounting concept does this illustrate ?
   A going concern
   B matching
   C materiality
   D consistency
5. The treasurer of a club has decided not to include subscriptions owing by members in the Balance Sheet at the year-end. Which accounting concept is being applied ?
   A accrual
   B going concern
   C money measurement
   D prudence
6. What is an example of the prudence concept ?
   A accrued expenses are treated as a liability
   B drawings are deducted from capital
   C profit is not over-stated
   D only items with a monetary value are included in accounting
7. A trader who sells food does not include food that is past its 'sell by' date in his stock in the Balance Sheet.
   A matching
   B prudence
   C realisation
   D going concern
8. Two values of closing stock are given, i.e., the cost is ₹ 40,000 and the market value is ₹ 45,000, the lower value, i.e., the cost of ₹ 40,000 will be chosen in favour of the market value of ₹ 45,000 so that the profit will not be over-stated. The choice is the reverse if the market value is lower than the cost.
   Which concept is being applied ?
   A realisation
   B historical cost
   C conservatism
   D consistency

Guide to Answers

Multiple Choice

1. B 2. A 3. C 4. A 5. D 6. C 7. B 8. C

7

Revenue Recognition

Introduction

Determination of profit is influenced by the revenue recognition policy of the enterprise. In principle, revenue can be recognised at the point of sale or when cash is collected or at any intermediate point. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. Revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Objectives of Revenue Recognition

The main objectives of revenue recognition are :

1. The determination of correct profit for the accounting period.
2. To reduce the confusion of the users of the accounting information regarding the profit earning capacity of the enterprise.
3. It helps to design proper internal control system which can prevent financial abuses by the CEOs /CFOs.
4. It brings transparency and truthfulness in reporting transactions.

Many international and nationalaccounting scandals in the recent past was due to ***revenue manipulation***. Some of those are given below :

Sl.No.	**Name of the Company**	**Alleged Accounting Abuses**
1.	Fannie Mae	Inflated income
2.	AOL Time Warner	Inflated revenues and income
3.	Xerox	Inflated income
4.	Qwest Communications	Inflated revenues and income.
5.	Bristol-Myers Squibb	Inflated revenues and income.
6.	Nortel Networks	Understated expenses to inflate income.
7.	Halliburton	Inflated revenues and income.
8.	Global Crossing	Inflated revenues and income.
9.	Satyam Computers	Inflated revenues and income

It is clear from the above list that revenue recognition is very vital for the reliability of the profit disclosed by the companies in their Profit and Loss Account.

The Institute of Chartered Accountants of India has issued AS – 9 : 'Revenue Recognition' for this purpose.

Accounting Standard [AS–9 : 'Revenue Recognition']

Scope

This Statement does not deal with the following aspects of revenue recognition to which special consideration apply:

(i) revenue arising from construction contracts (subject matter of AS–7);
(ii) revenue arising from hire-purchase, lease agreements (subject matter of AS–19);
(iii) revenue arising from government grants and other similar subsidies (subject matter of AS–12); and
(iv) revenue of insurance companies arising from insurance contracts.

Definitions

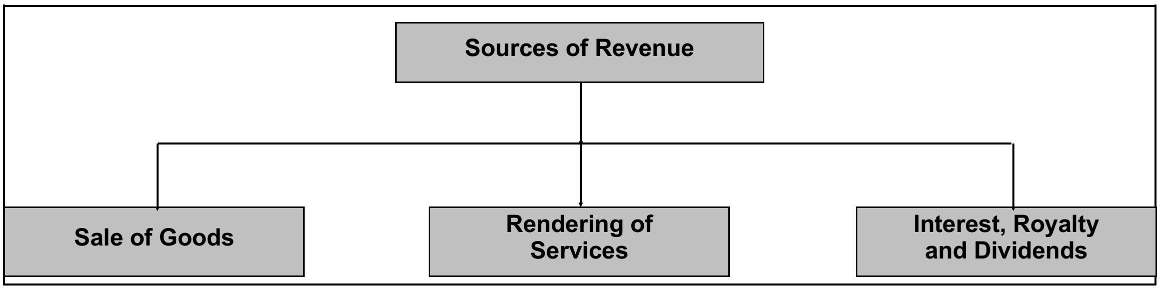
Revenue : Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the ***charges made to customers*** or ***clients*** for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

Completed Service Contract Method : Completed service contract method is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

Proportionate Completion Method : Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.

This statement deals with the basis for recognition of revenue in the Profit and Loss Account of the enterprise. It is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from :

(i) the sale of goods
(ii) the rendering of services
(iii) the use by others of enterprise resources yielding interest, royalties and dividends.



Sale of Goods

Revenue from sale of goods is recognised when all the following conditions have been satisfied :

1. the seller of goods has transferred to the buyer the property in the goods for a price;
2. all significant risks and rewards of ownership have been transferred to the buyers;
3. the seller retains no effective control of the goods transferred to a degree usually associated with ownership;
4. no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Example 1: Modern Furnitures (P) Ltd. sold a computer table to Ram for ₹ 6,000. Ram paid it by credit card.
Modern Furnitures (P) Ltd. will recognise ₹ 6,000 as revenue immediately.
Example 2 : Computer Point (P) Ltd. sold 10 computers to St. Xavier's College, Kolkata for ₹ 3,00,000 on credit. Here Computer Point will recognise the revenue of ₹ 3,00,000 immediately because normal credit risk derived from sales is not a reason to defer revenue recognition.

Illustration 1

Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with Registrar subsequent to Balance Sheet date. But before finalisation, is it possible to recognise the sale and gain at the Balance Sheet date ?

Solution

According to AS—9 "Revenue Recognition" it is possible for Bottom Ltd. to recognise the sale and gain at the Balance Sheet date. It is clear that the significant risk and rewards of ownership has passed before Balance Sheet date and the registration of the property is merely a formality.

Transfer of Legal Title

It should be noted that the transfer of legal title normally passes the risks and rewards. However, there are certain cases in which risks and rewards do not get transferred to the buyer with the transfer of legal title or passing of possessions.

For example :

1. If the sale of contract allows the goods to be returned and you cannot reasonably estimate the probability of return, the sale should not be recognised until you are sure about the acceptance by the customer.
2. If installation is an important part of the sale, recognition of revenue does not takes place until installation is complete.
3. If the sale is contingent on the buyer deriving revenue from resale of the goods, revenue is recognised at the time of resale only.

Example : In January, 2017 Tata Motors Ltd. supplied 10 Indica cars to its agent, Lexus Motors (P) Ltd. on consignment basis. The selling price was ₹ 4,00,000 each and commission is payable @ 10% on sales. By 31st March, 2017, Lexus Motors sold 5 cars only.
Here, revenue of ₹ 20,00,000 only will be recognised in March 2017.
Sales commission of ₹ 2,00,000 also will be recognised as expense in March 2017.

Illustration 2

How would you deal with the following in the annual accounts of a Company, for the year ended 31.3.2017:

Some of the transport claims, lodged in 2014-15 has been settled by the Carrier in February 2017 by paying ₹ 1.15 lakhs. These claims were not recorded in the books of the Company so far.

Solution

Since the amount has been received, the revenue is measurable. Therefore, the Company should recognise this as revenue in the current year, as part of net income. The Company was correct in not providing for the same as revenue, when the claim was lodged.

Illustration 3

How will you deal with the following:

The Board of Directors decided on 31.3.2017 to increase the sale price of certain items retrospectively from 1.1.2017. In view of this price revision, w.e.f. 1.1.2017, the Company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1.1.2017 to 31.3.2017 and the accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2016-17.

Solution

Recognition of revenue requires that it would not be unreasonable to expect ultimate collection. In other words, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

Here, in this case, the additional revenue arising out of price revision can be recognised as revenue in the current year provided there is certainty relating to collectibility.

Illustration 4

TVSM Company has taken a Transit Insurance Policy. Suddenly in the year 2016-17, the percentage of accident has gone up to 7% and the Company wants to recognise insurance claim as revenue in 2016-17 in accordance with relevant accounting standard. Do you agree?

Solution

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise. As per AS–9, recognition of revenue requires that revenue is measurable and it would not be unreasonable to expect ultimate collection.

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

Another essential criterion for the recognition of revenue is that the consideration receivable is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

Therefore, in the present case, the Company should ***postpone the revenue recognition*** as there are uncertainties in the settlement of insurance claim.

Illustration 5

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration money in 14 days and in the event of delay interest is chargeable @ 15% p.a. The company has not realised interest from the dealers in the past. However, for the year ended 31.3.2017, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per As—9 ?

Solution

As per AS—9, recognition of revenue requires that revenue is measurable and it would not be unreasonable to expect ultimate collection.

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

In this case, the company should not recognise ₹ 9 lakhs as interest income for the year ending on 31.3.2017 because there is uncertainty in respect of collection of interest.

The company should postpone the recognition until the collection of interest is made.

Rendering of Services

Revenue from rendering of services should be recognised by referring to the stage of completion at the Balance Sheet date. There are two methods for dealing with this situation :

(i) Proportionate Completion Method; and (ii) Completed Service Contract Method

(i) ***Proportionate Completion Method*** : Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the ***basis of contract value, associated costs, number of acts*** or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

Example : Your company Hindustan Constructing Co. Ltd. (HCCL) is laying a city gas pipe line for its client REL. Total revenue of the project is ₹ 40,00,000.
HCCL has incurred cost up to 31st March, 2017 ₹ 15,00,000 and the company is expecting that ₹ 10,00,000 more will be required to complete the project.
Upto 31st December, 2016 REL has approved ₹ 12,50,000 of expenditure. HCCL is confident that the balance ₹ 2,50,000 (₹ 15,00,000 – ₹ 12,50,000) will be approved by REL when their engineer will inspect the work during the 1st week of April, 2017. No payment has been received so far.
Recognise :
(a) ₹ 12,50,000 as expenses (the amount approved)
(b) ₹ 20,00,000 as (accrued) revenue

$$\frac{12,50,000}{25,00,000} \times 40,00,000$$

(ii) ***Completed Service Contract Method*** : Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

Interest, Royalty and Dividends

Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectibility exists. These revenues are recognised on the following basis:

(i) ***Interest :*** on a time proportion basis taking into account the amount outstanding and the rate applicable;

(ii) ***Royalties :*** on an accrual basis in accordance with the terms of the relevant agreement;

(iii) ***Dividends from Investments in shares :*** when the owner's right to receive payment is established.

Illustration 6

SCL Limited sells agricultural products to dealers. One of the condition of sale is that interest is payable @ 2% p.m. for delayed payment. Percentage of interest recovered is only 10% on such overdue outstanding due to various reasons. During the year 2016-17, the Company wants to recognise the entire interest receivable. Do you agree?

Solution

Revenue arising from the use by others of enterprise resources yielding interest, should only be recognised when no significant uncertainty as to measurability or collectibility exists. Interest is recognised as revenue on the following manner:

On a time proportion basis taking into account the amount outstanding and the rate applicable.

Here, in this case, as the uncertainty arises regarding collectibility of interest. The company should not recognise it as revenue of 2016-17. However, company can recognise it when cash will be received.

Illustration 7

Y Co. Ltd. used certain resources of X Co. Ltd. In return, X Co. Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respectively from Y Co. Ltd. during the year 2016-17.

You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

Solution

Revenue is measured by the charges made to customers for the use of resources by them. The use by others of such enterprise resources gives rise to —

(i) **Interest —** charges for the use of cash resources or amounts due to the enterprise.

Interest accrues, in most circumstances, on the time basis determined by the amount outstanding and the rate applicable.

(ii) **Royalties —** charges for the use of such assets as know-how, patents, trade marks and copyrights.

Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the transactions, it is more appropriate to recognise revenue on some other systematic and rational basis.

Here, X & Co. Ltd. should recognise ₹ 25 lakhs as revenue for the year 2016-17.

Disclosure

In addition to the disclosure required by Accounting Standard 1 on ***Disclosure of Accounting Policies*** (AS-1), an enterprise also has to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Specific Examples

Sale of Goods

1. **Delivery is delayed at buyer's request and buyer takes title and accepts billing**

In this case, revenue should be recognised though the physical delivery has not been done. However, the following conditions must be satisfied :

(i) the item must be on hand and (ii) the item is identified and ready for delivery

Example : Your company PP Ltd. is about to deliver the boiler to its client CESC Ltd. The site of the client is not yet ready for strike by the casual labours. CESC Ltd. requested PP Ltd. to hold the boiler at their risk until the site is ready.
The revenue is recognised immediately as the title to the goods and risk has passed to CESC Ltd.

2. **Delivered subject to Conditions**

(a) ***Installation and Inspection***: If the contract specifies delivery, installation and inspection, all must be completed to recognise revenue.

Example : HMT Ltd. sold a printing press to Swapna Printers Ltd. for ₹ 50,00,000. As per contract, the payment will be made only after successful installation and trial run. Revenue will not be recognised unless the installation and trial run has been done up to the satisfaction of the customer.

If the installation is very simple, revenue may be recognised on delivery.

Example : Your company, Sony India (P) Ltd. sells colour television to different customers through retail chain "Sony World". All televisions are factory tested. For installation, it requires unpacking and connecting to power plug and dish antennae cables.
Revenue can be recognised at the time of delivery only.

(b) ***On approval*** : Revenue is recognised if the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has passed or where no time has been fixed, a reasonable time has been passed.

Example : Your company, "Modern Toys" sell electronic toys to retailers. Written communication must be made within 15 days.
After 15 days, if nothing has been rejected the revenue can be recognised.

(c) ***Guaranteed sales, i.e., delivery is made by giving the buyer an unlimited right of return*** : Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.

(d) ***Consignment Sales***: Revenue should not be recognised until the goods are sold to a third party.

(e) ***Cash-on-delivery sale***: Revenue is recognised when delivery is complete and cash has been received by the seller or his agent.

Example : Your company "Amazon.com" sell books via internet. Customers can pay on receipt of the book. Revenue can be recognised when books have been delivered and cash has been collected by the agent on behalf of the seller.

3. **Payment by Installments followed by Delivery**

Sales where buyer makes a series of installment payments to the seller, and the seller delivers the goods only when the final payment is received.

Revenue is recognised when goods are delivered. However, when experience indicates that most customers pay all of their installments, revenue may be recognised when a significant deposit is received and the goods are ready for delivery.

Example : Your company "Ultra Soft" is developing an accounting software for its client. Price of the software is ₹ 5,00,000. As per contract, a series of payment is to be made with the progress of the work. The software is ready for delivery and so far your company has received 95% of the total price and the balance 5% is expected any time.
Revenue can be recognised fully at present.

4. **Special Order and Shipment**
When payment has been received in advance from customers for goods still to be manufactured or is to be delivered directly to the customer from a third party.

Revenue from such sales should be recognised when the goods have been manufactured, identified and ready for delivery to the buyer by the third party.

5. **Sales and Repurchases of Same Item**

Some items are sold on the condition that it will be repurchased after some time. These transactions are really financing transactions. The ***resulting cash flow will not be treated as revenue***.

Example : Your company, R.K. Securities has sold 1,000 shares of RIL @ ₹ 2,600 to Ganesh in May, 2015 on the condition that all these shares are to be repurchased after 6 months @ ₹ 2,700.
This is basically a finance transaction and no revenue should be recognised.

6. **Sales to Intermediate Parties**

Sometimes goods are sold to distributors, dealers or others for resale.

Revenue from such sales can generally be recognised if significant risks of ownership have passed.

7. **Subscriptions for Publication**

Recognise revenue on a straight line basis over time. If the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales volume of all items covered by the subscription.

8. **Installment Sales**

When the consideration is receivable in installments, revenue attributable to the sale price exclusive of interest should be recognised at the date of sale. The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.

Example : On 1st January, 2017 A sells a mini truck to B, on the installment payment system, on the following terms and conditions :
(a) The cash selling price is ₹ 1,00,000.
(b) The amount payable to A in four equal annual installments along with 12% interest p.a. on the outstanding balance, the first installment being payable on the date of sale.

Recognise immediately ₹ 1,00,000 as revenue.

Interest will be recognised as follows :	**₹**
2017 — 12% of (₹ 1,00,000 – ₹ 25,000)	**9,000**
2018 — 12% of (₹ 75,000 – ₹ 25,000)	**6,000**
2019 — 12% of (₹ 50,000 – ₹ 25,000)	**3,000**

9. **Trade Discounts and Value Rebate**

Trade discounts and value rebates are not revenue. They represent a reduction of cost.

Rendering of Services

1. **Installation Fees**

When installation fees are charged separately, they should be recognised as revenue only when the equipment is installed and accepted by the customer.

If the job consists of the excecution of more than one act, revenue is recognised proportionately.

Example : Your company, "Compu Data Services (P) Ltd." is installing a computer network in 10 identical buildings for a customer, under a single contract.
Recognise 10% of the revenue on completion of installation in each building.

2. **Advertising and Insurance Agency Commissions**

Revenue should be recognised when the service is completed. For advertising agencies, media commissions will be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency.

Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

3. **Financial Service Commissions**

The following matters should be taken into account before recognition of revenue from financial service commissions. These are :

(i) whether the service has been provided "once and for all" or on a "continuing basis" ?
(ii) the incidence of costs relating to the service;
(iii) when the payment for service will be received ?

Revenue from financial service commissions are recognised in the following manner :

(a) Commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into.

Example : Your company, SBI Housing Finance Ltd., has given a housing loan to Robin of ₹ 20,00,000. Processing fee is payable @ 0.1% on the loan amount.
As and when loan agreement will be signed between SBI Housing Finance Ltd. and Robin, ₹ 2,000 will be recognised as revenue by the company.

(b) Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the services provided and the timing of the costs relating thereto.

4. **Admission Fees**
Revenue from artistic performances, banquets and other special events should be recognised when the event take place. When a subscription to a number of event is sold, the fees should be allocated to each event on a systematic and rational basis.

5. **Tuition Fees**
Revenue should be recognised over the period of instruction.

6. **Entrance and Membership Fees**
Revenue recognition from these sources will depend upon the nature of the services being provided. Entrance fee received is generally capitalised. If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fees should be recognised when received.

If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided.

Example : To become a student member of National Library, you have to pay ₹ 500 as entrance fee and ₹ 1,200 as annual membership fee.
Entrance fee of ₹ 500 will be capitalised and the annual membership fee will be recognised as revenue @ ₹ 100 per month by the National Library.

Recognition of Expenses

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

Example: Swapna Printers (P) Ltd. replaced its offset printing machine with a modern Web Printing Machine during the year 2016-17.

The book value of the offset printing machine is ₹ 5,00,000 but it can be sold as scrap for ₹ 3,00,000 (net) only. Negotiation is going on with two buyers. Till the end of the accounting year (31st March, 2017) nothing has been finalised.

At the time of preparation of financial statements for the year 2016-17, this machine will be shown in the Balance Sheet at ₹ 3,00,000 and to be disclosed separately. The loss of ₹ 2,00,000 (₹ 5,00,000 – 3,00,000) will be recognised as expenses and is to be charged to the Profit and Loss Account of 2016-17.

Key Points

- In principle, revenue can be recognised at the point of sale or when cash is collected or at any intermediate point.
- The main objectives of revenue recognition are :
  1. The determination of correct profit for the accounting period.
  2. To reduce the confusion of the users of the accounting information regarding the profit earning capacity of the enterprise.
  3. It helps to design proper internal control system which can prevent financial abuses by the CEOs /CFOs.
  4. It brings transparency and truthfulness in reporting transactions.
- Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.
- Revenue from rendering of services should be recognised by referring to the stage of completion at the Balance Sheet date. There are two methods for dealing with this situation : (i) Proportionate Completion Method; and (ii) Completed Service Contract Method.
- Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectibility exists.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. When is a sale recognised ?
   A when cash is collected from customer
   B when certain conditions have been satisfied
   C whenever the seller decides to recognise it
2. Revenue
   A includes government grants and other subsidies
   B includes sales tax and VAT
   C is the gross inflow of cash receivables or other consideration arising in the course of the ordinary activities
3. Trade discounts and volume rebate should
   A be recognised as revenue
   B be ignored
   C be subtracted from cost
4. Normal credit risk derived from sales
   A is a reason to defer revenue recognition
   B is not a reason to defer revenue recognition
   C is disclosed in the directors' report

5. If the installation is an important part of the sales;
   A revenue recognition take place when goods are delivered at the site
   B recognition of revenue will take place at the end of the accounting period
   C recognition of revenue does not take place until installation is complete
6. Revenue from rendering of services should be recognised by referring the stage of completion
   A at the end of the calendar year
   B at the balance sheet date
   C none of the above
7. Once a credit sale has been recognised as revenue any risk of non-payment is treated as
   A a reduction in revenue
   B a finance charge
   C a bad or doubtful debt expenses
8. Interest revenue should be recognised on a
   A cash basis
   B time proportion basis taking into account the rate applicable
   C time proportion basis taking into account the amount outstanding and the rate applicable
9. Royalties revenue should be recognised
   A on an accrual basis in accordance with the terms of the relevant agreement
   B on a cash basis
   C on an actual basis
10. Dividends from investments in shares should be recognised
   A on a cash basis
   B when the shareholders' right to receive payment is established
   C on an accrual basis

Guide to Answers

1. B; 2. C; 3. C; 4. B; 5. C; 6. B; 7. C; 8. C; 9. A; 10. B.

8

Inventories

Introduction

Inventory is another term for 'Stock-in-Trade'. For most businesses, inventory is one of the largest assets (25% to 30% of the total assets of the enterprise). The major source of revenue of a trading organisation is the sale of these inventories. Inventories have an effect on the profit and loss of the organisation as opening inventories are included in and closing inventories are deducted from ***Cost of Sales***. Therefore, inventories should be properly compiled periodically and recorded in the books of account for proper measurement of periodic profit and for inclusion in the Balance Sheet at the end of the accounting period.

For a trading company, the inventory includes all goods owned and held for sale in the ordinary course of business.

But for a manufacturing business, there are three major types of inventories :

(a) raw materials;
(b) work-in-progress; and
(c) finished goods.

As inventories (stock-in-trade) on hand at the end of the accounting period affect both Profit and Loss Account and Balance Sheet, it is extremely important that inventories are accurately ***valued*** at the end of the accounting period.

The Institute of Chartered Accountants of India has issued ***Accounting Standard for Valuation of Inventories — AS-2***.

In this chapter, we will cover the accounting for and valuation of inventories.

Objectives of Accounting for Inventories

A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues (AICPA).

To ascertain the trading profit of a particular period, revenues for the period must be matched or set off by all the related expenses in producing those revenues. Proper inventory accounting will help to determine what portion of the cost of goods available for sale should be deducted from the revenues of the current period and what portion is to be carried forward as inventory to be matched against revenues in the next 'accounting period.'

Effects of Errors in Valuing Inventory

The errors in valuing inventory have effect both on the Profit and Loss Account and the Balance Sheet. When there is an error in valuing inventory, it means inventory is either overstated or understated. Also, the closing inventory of one year becomes the opening inventory for the subsequent period.

The effects are as under:

1. If the closing inventory is understated, the net profit for the period will also be understated and, in effect, the current assets of the business will be understated. The above effects will be reversed when the closing inventory is overstated.
2. If the opening inventory is understated, the net profit for the period will be overstated, and if the opening inventory is overstated, the net profit for the period will be understated.

Accounting Standard [AS-2 : Valuation of Inventories]

Meaning of Important Terms

Inventories : Inventories are assets

(a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);
(b) in the process of production for such sale (e.g., car in the assembly lines); or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).

Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular, e.g., spray guns used in the 'paint shop' of an automobile company's workshop.

Net Realisable Value (NRV) : Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.

Illustration 1

X Ltd. has an item in stock which cost ₹ 10,000 and can be sold for ₹ 12,000. However, before it can be sold, it will require to be modified at a cost of ₹ 1,500. The expected selling expenses of the item are an additional ₹ 1,000.

Calculate the Net Realisable Value (NRV) of the item.

Solution

NRV = Selling Price – Modification Cost – Expected Selling Expenses
= ₹ 12,000 – 1,500 – 1,000 = ₹ **9,500**.

Fair Value : Fair value is the value for which an item could be sold between willing independent traders.

For example, X has a contract to supply 100 quintals of sugar to a biscuit manufacturing company @ ₹ 3,500 per quintal. The price is fixed for 3 months, January to March, 2017. At the end of January the market price of sugar is ₹ 3,600 per quintal. X buys 100 quintals at the market price, i.e., ₹ 3,600 per quintal. Here, fair value is ₹ 3,600 and Net Realisable Value is ₹ 3,500 less selling cost.

Measurement of Inventories

Inventories should be valued at the ***lower of cost and net realisable value***.

Illustration 2

The following information is available from the books of account of a trader. Stock which cost ₹ 20,000 can now be replaced for ₹ 14,000. The estimated net realisable value of this stock is ₹ 17,000. It is proposed that the stock should be written down to ₹ 17,000. Give your view.

Solution

As per AS—2, inventories should be valued at cost or NRV whichever is lower. Here, cost is ₹ 20,000 and NRV is ₹ 17,000. Therefore, stock should be valued at ₹ 17,000 being the lowest. ***Replacement value will not be taken into consideration***.

Cost of Inventories

For valuation of inventories, the determination of ***cost*** is very important. The cost of inventories should comprise:

(i) all costs of purchase;
(ii) costs of conversion; and
(iii) other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase : The costs of purchase consists of the purchase price including duties and taxes (other than those can be reclaimed from the authorities), freight inwards and other expenditure directly attributable to the acquisition (e.g., brokerage on purchase, packing cost for transportation, etc.).

Trade discounts, rebates, duty drawbacks and other similar items are deducted from cost.

Illustration 3

Pepsi India Ltd. purchased 20,000 kgs. of oranges from farmers of Hosierpur @ ₹ 10 per kg. Orange collecting agents' commission were paid @ ₹ 1 per kg. ₹ 8,000 were paid for lorry hire charges for transporting it to Noida Plant. 5% of the oranges were damaged in transit and discarded. This loss is a normal loss. Calculate the cost of purchase per kg. of orange.

Solution

	₹
(i) Purchase Price (20,000 × ₹ 10)	2,00,000
(ii) Collecting agents' commission (20,000 × ₹ 1)	20,000
(iii) Transportation cost	8,000
Total Cost of (20,000 – 1,000) = 19,000 kgs.	2,28,000

Purchase cost per kg. = $\frac{2,28,000}{19,000}$ = **₹ 12**

Costs of Conversion : The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting raw materials into finished goods.

For example, Wills Ltd. is having a readymade garment factory in Ludhiana, Punjab, where two products are manufactured — sports T-shirt and Track suit. Direct labour hours of 24,000 are used in each period. Cutting is done by computer controlled automatic machine. However, stitching is done manually. Workers are paid ₹ 50 for stitching one T- shirt and ₹ 100 for stitching one Track suit. At the time of calculating cost of T-shirt ₹ 50 is to be added and for calculating cost of Tract suit ₹ 100 is to be added.

Fixed production overheads are those indirect cost of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance cost of cutting machine in the above example, depreciation of factory building and the cost of factory management and administration.

The allocation of fixed production overheads for the purpose of their inclusion in the cost of conversion is based on the ***normal capacity*** of the production facility. This is the average expected output over a number of periods, taking into account production reductions due to planned maintenance and normal holidays.

For example, before Diwali you close the factory for routine maintenance and cleaning. You follow 5 days a week and single shift each day. At the time of calculating normal capacity all these factors must be taken into consideration. It should not be calculated on the basis of calendar days.

Low production levels, or idle plant for abnormal reasons are not taken into consideration in determining the allocation rate of fixed production overheads.

For example, productions were suspended for 4 weeks for flood. The fixed production overheads incurred during that time should not be included in the cost of inventory.

Unallocated overheads are recognised as an ***expense*** in the period in which they are incurred. In periods of abnormally-high production, the overhead allocation rate is ***reduced***, so that, inventories are not measured above cost.

For example, Normal output of your factory is 20,000 units per month. You normally charge fixed overhead per unit @ ₹ 20. To complete a special order from China, your factory works overtime every weekends for last 4 months. The new level of output is 25,000 units per month.

Total fixed overhead per month = ₹ 20 × 20,000 = ₹ 4,00,000.

Under changed circumstances, the fixed overhead rate will be reduced :

$$\text{New Rate} = \frac{4,00,000}{25,000} = ₹\ 16$$

Variable production overheads are those indirect costs which vary directly or near directly, with the volume of production, such as indirect materials, indirect labour etc.

Variable production overheads are assigned to each unit of production on the basis of actual use of the production facilities.

For example, Wills Ltd.'s ready made garment factory has a centralised ironing facility. It cost ₹ 300 per productive hours to run.

T-shirt takes 1 minute and Track suit takes 2 minutes for ironing.

Therefore, variable production overhead to be assigned to T-shirt = ₹ 5 $\left(\frac{300}{60} \times 1\right)$ **and Track suit = ₹ 10** $\left(\frac{300}{60} \times 2\right)$

Joint Products and By-products

A production process may result in more than one product being produced simultaneously.

When a group of individual products is simultaneously produced, and each product has a significant relative sales volume, the outputs are usually called ***Joint Products***. Those products which are part of the simultaneous production process and have a minor sales volume or insignificant sales volume are called ***by-products***.

In case of joint products, when the costs of conversion of each product are not separately identifiable, they are allocated between products on a rational and consistent basis. The joint cost may be allocated on the basis of relative sales value of each product, either when they complete or when they are separately identifiable in the production process.

For example, Haldia Petrochemicals Ltd. incurs per batch joint product cost of ₹ 30,00,000 for the production of two joint products X and Y. Both products can be sold at split-off point. X can be sold @ ₹ 80 per unit and Y can be sold @ ₹ 40 per unit. The production were — X 50,000 units and Y 50,000 units.

In this case, the joint cost of ₹ 30,00,000 will be allocated as follows :

Joint Product Cost — ₹ 30,00,000		**Sale of 50,000 units @ ₹ 80**	**40,00,000**
		Sale of 50,000 units @ ₹ 40	**20,00,000**
	Split-off point	**Total Sales**	**60,00,000**

(i) Product X should bear 2/3 of ₹ 30,00,000 — **₹ 20,00,000**
(ii) Product Y should bear 1/3 of ₹ 30,00,000 — **₹ 10,00,000**
₹ 30,00,000

Each unit of X will bear ₹ 40 (₹ 20,00,000 / 50,000)

Each unit of Y will bear ₹ 20 (₹ 10,00,000 / 50,000)

Most by-products as well as scrap or waste materials, by its nature, is immaterial. If this is the case, then it is measured at net realisable value, and this value is deducted from the cost of the main product.

Other Costs : Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

These would include inward transport and storage cost prior to completion of production or the cost of designing products for specific customers.

It should be noted that interest and other borrowing costs are not included in the cost of inventories.

Excise Duty on Finished Goods

Excise duty is a manufacturing expense and therefore, it should be included in the valuation of finished goods. The Guide Note on "Accounting Treatment for Excise Duty" issued by the Institute of Chartered Accountants of India is very important in this respect and it is given below :

"Since the liability for excise duty arises when the manufacture of the goods is completed, it is necessary to create a provision for liability of unpaid excise duty on stock lying in factory or bonded warehouse. The estimate of such liability can be made at the rate in force on the Balance Sheet date. The excise duty paid provided on finished goods should, therefore, be included in the inventory valuation."

It should be noted that if the excise duty is refundable, it should not be included in the cost of raw materials consumed to produce the W.I.P. or the finished goods.

Cost Excluded from Inventories

In determining the cost of inventories it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are :

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

Illustration 4

(i) When valuing stock at cost, which of the following shows the correct method of arriving at cost ?

	Include inward transport cost	Include production overheads
A	YES	NO
B	NO	YES
C	YES	YES
D	NO	NO

(ii) According to AS – 2 (Inventories), which of the following costs should be included in valuing the inventories of a manufacturing company ?

(i) carriage inwards
(ii) carriage outwards
(iii) depreciation of factory plant
(iv) general administrative overheads

A all four items
B (i), (ii) and (iv) only
C (i), (iii) and (iv) only
D (i) and (iii) only

Solution

(i) At the time of valuation of stock at cost, inward transparent cost as well as production overheads are to be included. Therefore, answer "**C**" is correct.

(ii) For determining the cost of inventories, carriage inwards and depreciation of factory plant are to be taken into consideration. However, carrying outwards and general administrative overheads will not be taken into consideration. Therefore, answer "**D**" is correct.

Illustration 5

Which of the following costs may be included when arriving at the cost of finished goods inventory for inclusion in the financial statements of a manufacturing company ?

(i) carriage inwards
(ii) carriage outwards
(iii) depreciation of factory plant
(iv) finished goods storage costs
(v) factory supervisor's salary
A all five
B (i) and (v) only
C all except (iv)
D all except (ii) and (iv)

Solution

For calculating cost of finished goods inventory, carriage inwards, depreciation of factory plant and factory supervisor's salary are included. However, carriage outwards and finished goods storage cost are excluded. Therefore, answer "**D**" is correct.

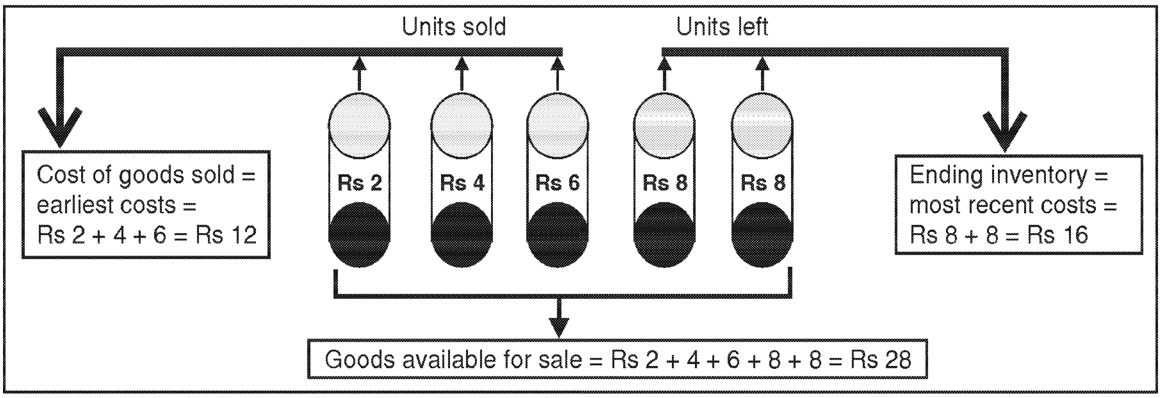
Cost Formulas

Inventory prices are seldom stable. In many cases inventories lose their identity and are substantially indistinguishable from one another, though may be acquired at varying rates. A very important valuation problem arises while assigning costs to inventory items. No problem would arise if prices never changed. Once the unit cost of each inventory item is known, some method must be used to assign costs to closing inventory and cost of goods sold. There are several methods for assigning cost to inventory items.

1. Specific Identification Method This method is adapted by the enterprises to determine the cost of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects. For example, X Ltd. deals in paintings of renowned artists. As the paintings are not interchangeable, X Ltd. should follow 'Specific Identification Method' for valuation of closing inventory and cost of goods sold.

2. First In First Out Method (FIFO) This method is based on the premise that the first item purchased is the first item sold, that is, all the inventories are sold in the order in which they are acquired. Since the oldest stock in the inventory is sold first, the calculation of the inventory is on the basis that the inventories in hand represent the ones most recently purchased or produced and the cost of goods sold represents the cost of items acquired in the earlier purchases.

FIFO METHOD

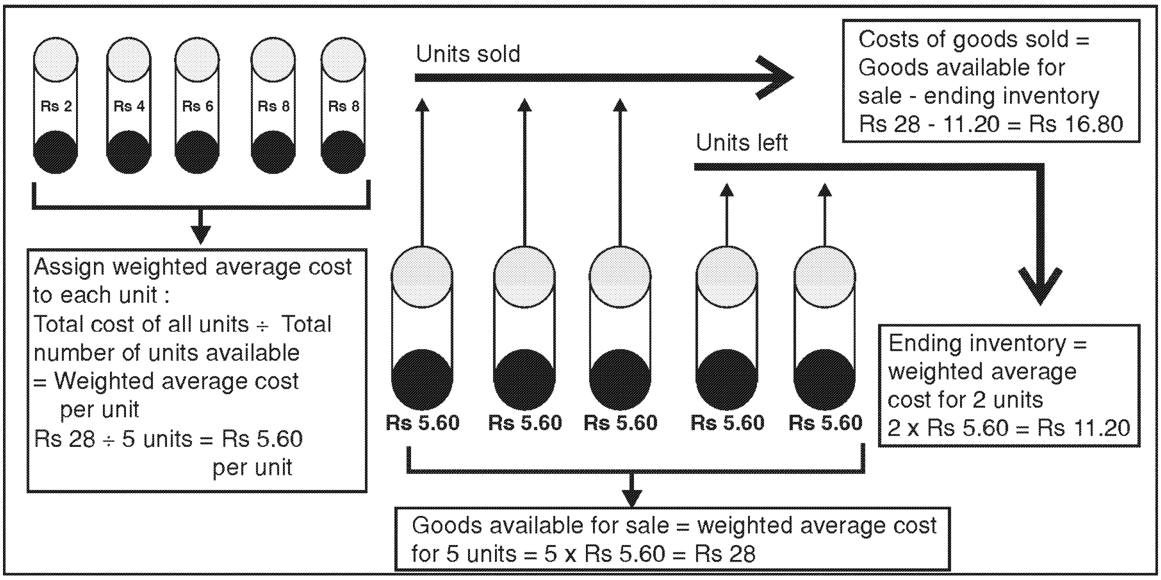


3. Weighted Average Method Under this method, the costs to be assigned to inventories are ascertained by applying to the closing inventory an average cost computed by dividing the total cost of units by the total number of such units. The average cost is calculated by applying the following formula:

$$\text{Weighted Average Cost Per Unit} = \frac{\text{Opening Inventory + Purchases (in amount)}}{\text{Opening Inventory + Purchases (in units)}}$$

The value of the closing inventory is ascertained by multiplying the number of units on hand (from the physical count) by the weighted average cost per unit (see the diagram below).

WEIGHTED AVERAGE METHOD



Techniques for the Measurement of Cost — Standard Cost Method and the Retail Method

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method may be used for convenience if the results approximate the actual cost.

Standard Cost Method: Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

The Retail Method: The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing method. The cost of the inventory is determined by reducing from the sales value of the inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Net Realisable Value (NRV)

Inventories should not be carried in excess of amounts expected to be realised from their sale or use. It may be necessary to write down the cost of the inventory to NRV for different reasons, e.g.,

(i) Damage to the inventories
(ii) Obsolescence
(iii) General decline in the market price for the goods
(iv) Estimated costs necessary to make the product saleable

For calculating NRV, the following points are to be taken into consideration :

1. Review Items Individually

Inventories are usually written down to net realisable value on an ***item-by-item*** basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line.

It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

Illustration 6

Lexus Motors Ltd. a dealer in second hand cars has 5 vehicles in stock at the end of the financial year 2008-09. These are:

Car	Fiat	Ambassador	Maruti Esteem	Maruti 800	Zen	Total (₹)
Cost (₹)	90,000	1,15,000	2,75,000	1,00,000	2,00,000	7,80,000
Net Realisable Value (₹)	95,000	1,55,000	2,65,000	1,25,000	2,30,000	8,70,000

You are required to calculate the value of stock to be included in the Balance Sheet of the company.

Solution

For calculating the value of stock, each item is to be reviewed individually. The valuation of stock is to be done as follows :

Car	Fiat	Ambassador	Maruti Esteem	Maruti 800	Zen	Total (₹)
Value (₹)	90,000	1,15,000	2,65,000	1,00,000	2,00,000	7,70,000

It should be noted that the appropriate stock figure is not ₹ 7,80,000 but ₹ 7,70,000 as calculated above.

Illustration 7

As at 31st December, 2016 the original cost of stock held by A amounted to ₹ 6,345 whilst the total net realisable value of this stock was estimated at ₹ 7,894 — A has analysed these figures as follows :

Item	Cost (₹)	Net Realisable Value (₹)
Readymade Garments	3,169	3,078
Clothing	2,789	4,157
Undergarments	387	659
	6,345	7,894

You are required to value the Stock as per AS—2.

Solution

At the time of valuation of stock, cost and net realisable value of each item is to be considered ***separately***. The value of stock as per AS—2 will be as follows :

Item	Cost (₹)	Net Realisable Value (₹)	Value to be taken (₹)
Readymade Garments	3,169	3,078	3,078
Clothing	2,789	4,157	2,789
Undergarments	387	659	387
Value of Stock			6,254

2. Contract Price and Market Price

Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices.

For example, X Ltd. purchased 10,000 barrels of crude oil @ ₹ 4,400 per barrel. At the end of the period, it has a contract to sell 10,000 barrels @ ₹ 4,000 per barrel. However, the market price is ₹ 3,600 per barrel at the year end.

Here, for the purpose of calculating net realisable value, the contract price ₹ 4,000 per barrel is to be taken into consideration. The value of stock will be : 10,000 × ₹ 4,000 = ₹ **400,00,000**.

Taking the above example, let us assume that X Ltd. has a contract to sell 9,000 barrels @ ₹ 4,000 per barrel. Here net realisable value is to be calculated as follows :

9,000 @ ₹ 4,000 per barrel	₹ 360,00,000
1,000 @ ₹ 3,600 per barrel	₹ 36,00,000
Total	₹ 396,00,000

Illustration 8

X Limited has purchased 1,00,000 units of a product @ ₹ 800 per unit on 1.1.2017. On the Balance Sheet date, i.e., 31.3.2017 there were 20,000 units in stock. Of these, 5,000 units are earmarked against sale contract at a price of ₹ 900 each. The market price of the product has dropped to ₹ 750. How the closing stock will be valued on 31.3.2017 ?

Solution

The inventory will be valued as under :	₹
Inventory held against contract 5,000 × (lower of ₹ 800 and ₹ 900)	40,00,000
Inventory held for resale 15,000 × (lower of ₹ 800 and ₹ 750)	1,12,50,000
Total value of inventory	1,52,50,000

3. No write down when finished goods will be sold at cost or above cost

Materials and other supplies held for use in production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed NRV, the materials are written down to NRV. In such circumstances, the replacement cost of the materials may be the best available measure of their NRV.

Illustration 9

Stock consists of 1,742 units of a raw material purchased at ₹ 7.30 each, but the unit price of the item has fallen to ₹ 6.50. The price reduction is apprehended to be permanent. The firm has already decided that if the price reduction last longer than six months, it will reduce the sale price of the finished goods from ₹ 10.90 to about ₹ 10.

Calculate the Value of Stock.

Solution

In this case, though the unit price has fallen to ₹ 6.50 from ₹ 7.30, the stock will be valued @ ₹ 7.30 because it will not exceed the revised selling price of ₹ 10.

Therefore, the value of stock will be : 1,742 × ₹ 7.30 = ₹ **12,716.60**.

Illustration 10

X Limited uses a single raw material and converts that into a finished product. During the year ended 31.3.2017, the manufacturing cost of the product was as follows:

	₹
Raw materials — 4 units @ ₹ 10 each	40
Conversion cost	30
Manufacturing Cost	70

The finished product is sold @ ₹ 85 per unit.

On 31.3.2017, there was a fall in the sale price of the finished product to ₹ 60, because of steep fall in the raw material prices. Currently, raw materials are available in the market @ ₹ 5 each. On 31.3.2017, there was 50,000 units of raw materials in stock purchased at the above rate.

Calculate the value of inventory on 31.3.2017.

Solution

In this case manufacturing cost is ₹ 70 but the sale of finished goods has fallen to ₹ 60, because of decline of the raw material price from ₹ 10 to ₹ 5. Inventories to be valued at net realisable value.

In this circumstances, the replacement cost of the material may be the best available measure of its net realisable value.

Therefore, the value of closing stock on 31.3.2017 will be : 50,000 × ₹ 5 = ₹ **2,50,000**.

Disclosure

The financial statements should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used; and

(b) the total carrying amount of inventories and its classification appropriate to the enterprise.

Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are raw materials and components, work in progress, finished goods, stores and spares, and loose tools.

General Illustrations

Illustration 11

DCM Ltd manufactures textiles. The company accountant asks your advice about the following product lines:

Lime Green Tartan : Manufactuing cost ₹ 9,000. This stock has been on a shelf since 2012. The accountant believes that the only way of selling it would be to shred it and bundle it (at a cost of ₹ 500) and sell it as industrial cleaning wipes for an anticipated sale price of ₹ 5,000.

Power Strangers : Originally printed to meet a high demand for garments linked to a popular television serial, there is no further demand for the textile in this country. Stocks cost ₹ 16,000, and the only possible source of revenue would be to export the material at a cost of ₹ 2,750 for use as dusters in Australia. Administration costs to handle the sale are estimated at ₹ 2,650, and the sale price is estimated at ₹ 4,000.

Explain, with reasons, how each of the above product lines should be accounted for in the annual accounts of the company for the year ended 31 March, 20171616.

Solution

Inventories should be valued at the lower of cost and net realisable value.

Lime Green Tartan : Manufacturing cost is ₹ 9,000 but the net realisable value is ₹ 4,500 (₹ 5,000 – ₹ 500). Therefore, ₹ 4,500 is to be taken as value of stock for annual accounts of the company.

Power Strangers : Cost is ₹ 16,000 but the net realisable value is negative (₹ 4,000 – ₹ 2,750 – ₹ 2,650). Therefore, the value of stock should be taken as nil.

Illustration 12

X Limited has three major categories of goods: X, Y and Z. The following information is available on 31.3.2017 in respect of these (figures in rupees):

Items	Historical Cost	Replacement Cost	Net Realisation Value
X	50,000	53,000	37,000
Y	65,000	60,000	64,000
Z	50,000	54,000	72,000

Calculate the value of inventory as on 31.3.2017.

Solution

Inventories are valued at lower of historical cost or net realisable value. Replacement cost is relevant when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. Therefore, the inventory will be valued as under:

Item	Amount (₹)
X	37,000
Y	64,000
Z	50,000
Tota l valu e of inventory	1,51,000

Illustration 13

The company deals in three products A, B and C, which are neither similar nor interchangeable. At the time of closing of its accounts for the year 2016-10, the Historical Cost and Net Realisable Value of the items of closing stock are determined as follows :

Items	Historical Cost (₹ in Lakhs)	Net Realisable Value (₹ in Lakhs)
A	40	28
B	32	32
C	16	24

What will be the value of closing stock ?

Solution

As per para 5 of AS—2, inventories should be valued at the lower of cost and net realisable value.

As per para 14 of AS—2, the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

As per para 21 of AS—2, inventories are usually written down to NRV on an item-by-item basis.

Statement Showing the Calculation of Closing Stock (figures in Lakhs)

Items	Historical Cost	Net Realisable Value	Valuation of Closing Stock
A	40	28	28
B	32	32	32
C	16	24	16
Total	88	84	76

Therefore, the value of closing stock is ₹ 76,00,000.

Illustration 14

X Ltd has included in its accounts an item of stock which had cost it ₹ 50,000. The business has no further use for this stock. It can be scrapped for ₹ 25,000 or sold for the following (all figures in rupees):

Sale Proceeds	40,000
Less: Trade discount	4,000
	36,000
Less: Cash discount	1,000
	35,000
Less: Cost of disposal	2,500
	32,500

What figure should be included in the accounts for this item ?

Solution

Cost — ₹ 50,000

Net Realisable Value	₹	
Sale Proceeds	40,000	∴ Lower of cost and net realisable value = ₹ 33,500. Therefore, ₹ 33,500 is to be included in accounts for this item. It should be noted that cash discount would appear in the Profit and Loss Account.
Less: Trade discount	4,000	
	36,000	
Less: Cost of disposal	2,500	
	33,500	

Illustration 15

How do you value the closing stock under the following situation?

Closing stock consists of 4,800 units purchased @ ₹ 5 each. At the year end, the firm realised that the closing stock is not that it would choose to acquire the market place. An equivalent product is available in the market which can be acquired @ ₹ 4 each. In effect, the firm has to reduce the selling price of the product from ₹ 6.25 to ₹ 4.75. The closing stock, in its present physical form, can be sold in the market @ ₹ 2.25 each. If the firm wants to replace the existing stock by the new equivalent product, it has to pay an additional amount of ₹ 1.50 per unit.

Solution

The firm has the following two options:

(i) To sell the stock at ₹ 2.25 each and re-acquire the stock at ₹ 4 each. In this case, it has to incur an additional cost of ₹ 1.75 (₹ 4.00 – ₹ 2.25) per unit.

OR

(ii) To replace the stock by paying at ₹ 1.50 per unit.

Obviously, the second option is cheaper. Therefore, the value of the stock = 4,800 × (₹ 4.00–1.50) = **₹ 12,000**.

Illustration 16

The Directors of ITC Limited have valued their stocks at ₹ 4,50,000 at 31 December, 2016. Some of the stock items have been drawn to the attention of the company's auditors :

(i) Two categories of stocks, VX and LX have been valued at ₹ 23,000. The auditors ascertain that the valuation was based on what the directors considered was the lower of cost and net realisable value, calculated as follows:

Item		Cost of Raw Materials [1]	Attributable Production Overheads Incurred [2]	Attributable Distribution Overheads to be Incurred [3]	Expected Selling Price [4]
VX	(₹)	16,000	2,000	2,400	17,000
LX	(₹)	4,000	1,000	2,000	8,000
	(₹)	20,000	3,000	4,400	25,000
Cost	{ [1] + [2] }	23,000			
Net Realisable Value	{ [3] + [4] }				29,400

(ii) A raw material, Opprobrium, was bought at several different prices during the year, and the closing stock was valued at ₹ 44,000. The stock has previously been valued on a FIFO basis. Stock is valued on a periodic basis. Details of the stock are :

Month	Received (Tonnes)	Cost per Tonne (₹)	Issues (Tonnes)
Jan.	500	35	200
Mar.	300	45	500
Jun.	600	65	400
Nov.	800	90	100

There were no stocks of Opprobrium on 1 January, 2016.

You are required to recalculate the value of ITC Limited's Closing Stock at 31 December on the basis of AS—2.

Solution

(i) As per Para 21 of AS—2, '***Inventories are usually written down to net realisable value on an item-by-item basis***.' Therefore, at the time of valuation of stock, cost and net realisable value of each item is to be considered separately. The value of stock as per AS—2 will be as follows :

Item	Cost [Note 1] (₹)	NRV [Note 2] (₹)	Value to be taken (₹)
VX	18,000	14,600	14,600
LX	5,000	6,000	5,000
Value of Stock			19,600

Working Notes :

(1) Calculation of Cost

Item	VX (₹)	LX (₹)
Cost of Raw Materials	16,000	4,000
Add: Attributable Production Overhead	2,000	1,000
Cost	18,000	5,000

(2) Calculation of Net Realisable Value (NRV)

Item	VX (₹)	LX (₹)
Expected Selling Price	17,000	8,000
Less: Attributable Distribution Overhead to be Incurred	2,400	2,000
NRV	14,600	6,000

(ii) As per Para 16 of AS—2, the cost of Inventories should be assigned by using FIFO, or Weighted Average Cost Formula. The company is using FIFO method. Therefore, FIFO method is to be adopted to determine the cost of raw materials — 'Opprobrium'.

Total Quantity Received	2,200 (tonnes)
Total Issue	1,200 (tonnes)
Quantity in hand	1,000 (tonnes)

Cost of Closing Inventory is Calculated as Under

	₹
800 (tonnes) @ ₹ 90	72,000
200 (tonnes) @ ₹ 65	13,000
1,000	85,000

Therefore, the cost of stock will be ₹ 85,000

Revised Value of Stock

Particulars	₹	₹
Value of Stock (as determined by the Directors)		4,50,000
Adjustment for Change in the Value of VX, LX and Opprobrium :		
(i) Reduction in the value of VX + LX (₹ 23,000 – ₹ 19,600)	(3,400)	
(ii) Increase in the value of Opprobrium (₹ 85,000 – ₹ 44,000)	41,000	37,600
Revised Value of Stock		4,87,600

Illustration 17

State with reference to Accounting Standard, how will you value the inventories in the following cases:

(i) Raw materials were purchased at ₹ 100 per kilo. Price of the raw material is on decline. Finished goods in which raw materials were incorporated are expected to be sold at below cost. 10,000 kg of raw materials are on stock at the year end. Replacement cost is ₹ 80 per kg.

(ii) In a production process, normal wastage is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end.

(iii) Per kg. of finished goods consisted of:
Material cost ₹ 100 per kg.
Direct labour cost ₹ 20 per kg.
Direct variable production overhead ₹ 10 per kg.
Fixed production charges for the year on normal capacity of one lakh kg. is ₹ 10 lakh. 2,000 kg. of finished goods are in stock at the year end.

Solution

(i) As per para 24, when there has been a decline in the prices of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.
Therefore, in this case, the materials will be valued at ₹ 80 per kg. Total value ₹ 8,00,000.

(ii) Input : 5,000 MT; Normal wastage : 5%, i.e., 5% of 5,000 MT = 250 MT.
Actual wastage : 300 MT; Abnormal wastage 300 MT – 250 MT = 50 MT.
As per para 13, in determining the cost of inventories, it is appropriate to exclude abnormal amounts of wasted materials or expenses in the period in which they are incurred.
Therefore, in this case, the entire cost of abnormal wastage, i.e., 50 × ₹ 1,000 = ₹ 50,000 should be charged to the Profit and Loss Account.

(iii) As per para 9, the allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.
Therefore, in this case, the cost per kg. of finished goods will be calculated as under:

	₹
Materials	100
Direct labour	20
Direct variable production overheads	10
Fixed production overheads	*10
	140

$$\text{Fixed production overheads per kg.} = \frac{\text{Rs } 10,00,000}{1,00,000} = \text{Rs } 10 \text{ per kg.}$$

Therefore, the value of 2,000 kg. of finished goods = 2,000 × ₹ 140 = ₹ 2,80,000.

Accounting for Inventories

There are two alternative methods that may be adopted in accounting for inventories :

1. Perpetual Inventory Method
2. Periodic Inventory Method (Physical Inventory Method)

1. Perpetual Inventory Method

Perpetual inventory method is a method where the inventory accounting is kept continuously up-to-date and involves the continual recording of additions to and issues or sales of materials on a daily basis. The method is applicable to those businesses where the sale items are of high value and have a number of sale transactions daily. Under this system, a Ledger Account (Inventory Account) is maintained which shows the cost of goods sold at any time during the accounting period. When a perpetual inventory is kept, a physical inventory should be taken at least once in a year.

2. Periodic Inventory Method

Under this method, a physical inventory is usually taken only at the year-end or at regular intervals. The inventory on hand, and hence, the cost of goods sold, are determined by means of physical count at periodic intervals or at the end of the period. This method is costly as well as inconvenient.

To ascertain the cost of goods sold under this method, the books of account must show the following:

(a) opening and closing inventory for the period; and

(b) the cost of the purchased inventory during the period.

This is generally done as under:

	₹
Inventory at the beginning of the period	***
Add: Purchases of inventory during the period	***
Cost of the goods available for sale	***
Less: Inventory at the end of the period	***
Cost of goods sold	***

Following is the system of working of the Periodic Inventory Method:

1. Last year's closing inventory becomes the opening inventory for the current year. Trading Account is debited with the opening inventory.
2. Purchases for the period are recorded in the Purchases Account and this account is closed by transferring to Trading Account as above.
3. The closing inventory, which is based on physical count, is recorded in an account called Closing Stock Account. This account is transferred to the Trading Account by debiting Closing Stock Account and crediting Trading Account. This account has a life for one day only. This is because, it becomes opening stock of the next accounting period.
4. The resultant figure (the balancing figure in the Trading Account) is the cost of goods sold.

Recording Inventory Acquisitions and Sales

Sl. No.	Perpetual Inventory System		Periodic Inventory System	
1.	**Purchase of Inventory** Inventory A/c To Suppliers A/c	Dr.	**Purchase of Inventory** Purchases A/c To Suppliers A/c	Dr.
2.	**Return of Inventory** Suppliers A/c To Inventory A/c	Dr.	**Return of Inventory** Suppliers A/c To Purchases Returns A/c	Dr.
3.	**Freight paid** Inventory A/c To Cash A/c	Dr.	**Freight paid** Carriage Inward A/c To Cash A/c	Dr.
4. (i)	**Sale of Inventory** Sundry Debtors A/c To Sales A/c	Dr.	**Sale of Inventory** Sundry Debtors A/c To Sales A/c	Dr.
(ii)	Cost of Goods Sold A/c To Inventory A/c	Dr.	No entry is passed	
5. (i)	**Return of goods by customer** Sales Returns A/c To Sundry Debtors A/c	Dr.	**Return of goods by customer** Sales Returns A/c To Sundry Debtors A/c	Dr.
(ii)	Inventory A/c To Cost of Goods Sold A/c	Dr.	No entry is passed	

In contrasting the two inventory systems, notice the following :

1. The perpetual system uses no Purchase Account. It records all purchases in the Inventory Account. The periodic system uses a Purchases Account.
2. The perpetual system records goods returned to suppliers by directly reducing the Inventory Account. The periodic system uses Purchases Returns Account.

3. The perpetual system records cost of goods and reduces inventory when goods are sold. The periodic system calculates cost of goods sold on the basis of the inventory remaining on hand at the end of the period and records cost of goods sold through the closing process.
4. The perpetual system records customer returns by reducing cost of goods sold and increasing inventory. The periodic system makes no entry in stock for goods returned.
5. The cost of goods sold and inventory amounts are readily available at any time under the perpetual system. Under periodic system cost of goods sold and inventory amounts are usually not available until they are calculated at the year end.

Recording Transaction in Stores Ledger / Stock Cards

Earlier in this chapter, it has been stated that there are a number of acceptable methods for assigning cost to inventories, such as Specific Identification, FIFO and Weighted Average Cost.

Stores Ledger is useful where an enterprise has a large number of different inventory items on hand and individual items cannot be identified / traced. The stores ledger will help to identify the quantity and cost of item on hand.

At the time of recording transaction in Stores Ledger / Stock Cards, the management will need to adopt either FIFO method or Weighted Average Method.

The following illustrations will explain the procedures of recording transaction in stores ledger / stock cards.

Illustration 18

The following transactions took place during the month of January 2017 in DCM Limited.

Jan. 1	Opening Stock 500 units @ ₹ 35	Jan. 15	Purchases 1,200 units @ ₹ 34
Jan. 5	Purchases 1,000 units @ ₹ 38	Jan. 18	Sales 1,000 units
Jan. 7	Sales 300 units	Jan. 23	Purchases 900 units @ ₹ 30
Jan. 12	Sales 800 units	Jan. 28	Sales 1,200 units

Calculate the Cost of Closing Stock based on FIFO method.

Solution

DCM Limited
Store Ledger (FIFO Method)

Date	Purchases			Sales			Balance		
2017	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1							500	35	17,500
5	1,000	38	38,000				500 1,000	35 38	17,500 38,000
7				300	35	10,500	200 1,000	35 38	7,000 38,000
12				200 600	35 38	7,000 22,800	400	38	15,200
15	1,200	34	40,800				400 1,200	38 34	15,200 40,800
18				400 600	38 34	15,200 20,400	600	34	20,400
23	900	30	27,000				600 900	34 30	20,400 27,000
28				600 600	34 30	20,400 18,000	300	30	9,000
Cost of Closing Stock									9,000

Illustration 19

The following details are available in respect of material ZA 234 for the month of September, 2016.

Sept. 1	Opening Stock 1,000 kg. @ ₹ 20 per kg.	Sept. 20	Purchases 1,000 kg. @ ₹ 26.25 per kg.
Sept. 10	Purchases 500 kg. @ ₹ 23 per kg.	Sept. 30	Issued 750 kg.
Sept. 15	Issued 750 kg.		

Calculate the Cost of Stock as on September 30, 2016 under the Weighted Average (Perpetual) Method.

Solution **Store Ledger [Weighted Average (Perpetual) Method]**

Date	Purchases			Issues			Balance		
2016	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Sept. 1							1,000	20	20,000
10	500	23	11,500				1,500	21	31,500
15				750	21	15,750	750	21	15,750
20	1,000	26.25	26,250				1,750	24	42,000
30				750	24	18,000	1,000	24	24,000
Cost of Closing Stock							1,000		24,000

Illustration 20

A Company, started on 1 January, 2016, purchased raw materials during 2016 as stated below:

January 2	800 kg @ ₹ 62 per kg.	July 10	3,000 kg @ ₹ 56 per kg
February 26	1,200 kg @ ₹ 57 per kg	September 18	1,500 kg @ ₹ 60 per kg
April 13	2,500 kg @ ₹ 59 per kg	November 29	1,000 kg @ ₹ 65 per kg

While preparing its final accounts on 31st December, 2016, the company had 1,300 kg of raw materials in its godown.

Calculate the Cost of Closing Stock of raw materials according to (1) First-in-first-out basis, and (ii) Weighted Average Basis (Periodic).

Solution **Valuation of Closing Stock**

'First-In-First-Out' Basis. Raw materials in hand were 1,300 kg. It should be valued at the rate of last two consignments. So the Cost of Closing stock will be:

		₹
300 kg	@ ₹ 60 per kg	18,000
1,000 kg	@ ₹ 65 per kg	65,000
1,300 kg		83,000

Weighted Average Basis (Periodic)

Date		Price	Quantity	Value (₹)
2016	Jan. 2	62	800	49,600
	Feb. 26	57	1,200	68,400
	Apr. 13	59	2,500	1,47,500
	Jul. 10	56	3,000	1,68,000
	Sep. 18	60	1,500	90,000
	Nov. 29	65	1,000	65,000
			10,000	5,88,500

$$\textit{Weighted Average Price} = \frac{\text{Rs } 5{,}88{,}500}{10{,}000} = \text{Rs } 58.85$$

Cost of Closing Stock = 1,300 x ₹ 58.85

= ₹ 76,505

Illustration 21

At the beginning of December 2016, Quality Brush Company had in stock 10,000 brushes valued at ₹ 10 each. Purchases and Issues during the month were as follows :

Purchases		Issues	
Dec. 7	4,000 Brushes @ ₹ 12.50	Dec. 16	16,000 Brushes
Dec. 14	6,000 Brushes @ ₹ 15.00	Dec. 28	10,000 Brushes
Dec. 24	8,000 Brushes @ ₹ 16.50		

You are required to compute the Cost of Closing Stock on the basis of Weighted Average (Perpetual) Method.

Solution **Quality Brush Company**

Stores Ledger [Weighted Average (Perpetual) Method]

Date	Receipts			Issues			Balance		
2016	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Dec. 1							10,000	10.00	1,00,000
7	4,000	12.50	50,000				14,000	10.71	1,50,000
14	6,000	15.00	90,000				20,000	12.00	2,40,000
16				16,000	12.00	1,92,000	4,000	12.00	48,000
24	8,000	16.50	1,32,000				12,000	15.00	1,80,000
28				10,000	15.00	1,50,000	2,000	15.00	30,000

Therefore, the Cost of Closing Stock will be ₹ 30,000.

Illustration 22

P Limited price the issues using the Weighted Average (Perpetual) Method. The following relate to transactions in the month of March 2017. Opening balance 2,000 units @ ₹ 10 each.

	Purchases		Issues
March 4	1,500 units @ ₹ 8 per unit	March 2	1,000 units
March 15	1,300 units @ ₹ 9.50 per unit	March 6	1,200 units
March 22	2,000 units @ ₹ 10 per unit	March 20	2,000 units
		March 26	1,500 units

Calculate the Cost of Closing Stock taking two decimal places.

Solution

P Limited
Store Ledger [Weighted Average (Perpetual) Method]

Date	Purchases			Issues			Balance		
2017	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
March 1							2,000	10	20,000
2				1,000	10	10,000	1,000	10	10,000
4	1,500	8	12,000				2,500	8.80	22,000
6				1,200	8.80	10,560	1,300	8.80	11,440
15	1,300	9.50	12,350				2,600	9.15	23,790
20				2,000	9.15	18,300	600	9.50	5,490
22	2,000	10	20,000				2,600	9.80	25,490
26				1,500	9.80	14,700	1,100	9.81	10,790
Cost of Closing Stock							1,100		10,790

Illustration 23

Slow and Steady Limited follows the First-in-First-Out (FIFO) Method of inventory valuation. The following particulars are available in respect of an item of raw material for the month of January 2017.

Jan. 1	Opening balance 2,500 kg. @ ₹ 18 per kg.	Jan. 22	Issue 7,000 kg.
Jan. 4	Purchases 3,000 kg. @ ₹ 20 per kg.	Jan. 28	Purchases 2,000 kg. @ ₹ 22 per kg.
Jan. 6	Issues 5,000 kg.	Jan. 31	Issues 4,500 kg.
Jan. 18	Purchases 10,000 kg. @ ₹ 21 per kg.		

Calculate the Cost of Closing Stock on the basis of FIFO Method.

Solution

Slow and Steady Limited
Store Ledger (FIFO Method)

Date	Purchases			Issues			Balance		
2017	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1							2,500	18	45,000
4	3,000	20	60,000				2,500 3,000	18 20	45,000 60,000
6				2,500 2,500	18 20	45,000 50,000	500	20	10,000
18	10,000	21	2,10,000				500 10,000	20 21	10,000 2,10,000
22				500 6,500	20 21	10,000 1,36,500	3,500	21	73,500
28	2,000	22	44,000				3,500 2,000	21 22	73,500 44,000
31				3,500 1,000	21 22	73,500 22,000	1,000	22	22,000
Cost of Closing Stock									22,000

Illustration 24

The following are the details of a space part of Sriram Mills :

1.1.2017	Opening stock Nil	1.1.2017	Purchases 100 units @ ₹ 30 per unit
15.1.2017	Issued for consumption 50 units	1.2.2017	Purchases 200 units @ ₹ 40 per unit
15.2.2017	Issued for consumption 100 units	20.2.2017	Issued for consumption 100 units
1.3.2017	Purchases 150 units @ ₹ 50 per unit	15.3.2017	Issued for consumption 100 units

Find out the value of stock as on 31.3.2017 if the company follows :

1. First-in-First Out basis and
2. Weighted Average (Perpetual) basis.

Solution

Sriram Mills
(1) Store Ledger (FIFO Method)

Date	Purchases			Issues			Balance		
2017	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1	100	30	3,000				100	30	3,000
15				50	30	1,500	50	30	1,500
Feb. 1	200	40	8,000				50 200	30 40	1,500 8,000
15				50 50	30 40	1,500 2,000	150	40	6,000
20				100	40	4,000	50	40	2,000
Mar. 1	150	50	7,500				50 150	40 50	2,000 7,500
15				50 50	40 50	2,000 2,500	100	50	5,000
Cost of Closing Stock							100		5,000

Sriram Mills
(2) Store Ledger [Weighted Average (Perpetual) Method]

Date	Purchases			Issues			Balance		
2017	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1	100	30	3,000				100	30	3,000
15				50	30	1,500	50	30	1,500
Feb. 1	200	40	8,000				250	38	9,500
15				100	38	3,800	150	38	5,700
20				100	38	3,800	50	38	1,900
Mar. 1	150	50	7,500				200	47	9,400
15				100	47	4,700	100	47	4,700
Cost of Closing Stock							100		4,700

Problems of Stock Taking

Under periodic inventory system, at the end of the last day of the accounting year, stocks in hand are verified and valued. But in case of big organizations, it may not be possible to verify the stock exactly on the last date of the accounting period. In such a case, stock is taken either few days earlier or later, according to the situation.

If the stock is taken on a later date, the following adjustments are required to arrive at the stock as on the closing date:

Let us start with the value of stocks on that later date...

Add: Sales (at cost) between two dates, i.e. date of taking stock and closing date.
Add: Purchases returns during the said period.
Add: Any undercasting in stock sheet.
Add: Any goods in transit.
Less: Purchases between the two dates, i.e. date of taking stock and closing date.
Less: Sales returns (at cost price) between the above two dates.
Less: Any overcasting in stock sheet.
Less: Any goods held on consignment basis.
Less: Any goods included in stock but title of such has been transferred to the buyer.

Illustration 25

Asim's financial year ends on 31st March but actual stock has not been taken till the 8th April, when it is ascertained at ₹ 12,500.

You find that :

(i) Sales are entered in the sales book on the day of despatch and in the returns inward book on the day the goods are received back.

(ii) Purchases are entered in the purchases day book on the day the invoices are received.

(iii) Sales between 31st March and 8th April as per sales day book and cash book are ₹ 860.

(iv) Purchases between 31st March and 8th April as per the purchases day book are ₹ 600 but goods amounting to ₹ 200 are not received till the stock was taken.

(v) Of goods invoiced during March, goods amounted to ₹ 500 were not received till 31st March, of which goods worth ₹ 350 were received betwen 31st March and 8th April.

(vi) Rate of gross profit is $33^1/_3$% on cost.

Ascertain the value of stock as on 31st March.

Solution

Statement showing the Value of Physical Stock on 31st March, ...

Particulars	₹	₹
Stock on 8th April (Physical)		12,500
Add: (iii) Cost of goods sold during 1st April and 8th April (Note 1)		645
		13,145
Less: (iv) Goods purchased between 1st April and 8th April (₹ 600 – 200)	400	
Less: (v) Goods purchased in March but received between 31st March and 8th April	350	750
Stock on 31st March (to be credited to Trading Account)		12,395

Working Note :

(1) Sales	860
Less: Profit @ $33^1/_3$% on Cost or 25% on Sales	215
Cost of Goods Sold	645

Illustration 26

Ashoke's financial year ends on 31st March, but actual stock is not taken until next 6th April when it is ascertained at ₹ 33,500.

You find that :

(i) Sales are entered in the sales day book on the same day as despatched and returns inward in the return book the day the goods are received back.

(ii) Purchases are entered in the purchases day book on the day the invoices are received.

(iii) Purchases between 31st March and 6th April as per the purchases day book are ₹ 120 but goods amounting to ₹ 40 were not received till the stock was taken.

(iv) Sales between 31st March and 6th April as per sales day book and cash book are ₹ 1,720.

(v) Goods invoiced during March but not received till 31st March ₹ 100, of which goods worth ₹ 70 were received with 6th April.

(vi) The rate of gross profit to Sales is 25%.

Ascertain the value of stock as on 31st March.

Solution

Statement showing the Value of Physical Stock on 31st March, ...

Particulars	₹	₹
Stock on 6th April (Physical)		33,500
Add: (iv) Cost of goods sold during 1st April and 6th April (Note 1)		1,290
		34,790
Less: (iii) Goods purchased between 1st April and 6th April (₹ 120 – 40)	80	
Less: (v) Goods invoiced during March but received between 1st April and 6th April	70	150
Stock on 31st March (to be credited to Trading Account)		34,640

Working Note :

(1) Sales	1,720
Less: Gross Profit @ 25% on Sales	430
Cost of Goods Sold	1,290

Illustration 27

FY Ltd conducts physical stock taking every year at the end of the accounting year. Owing to certain difficulties, it was not possible for it to conduct physical stock taking at the end of the accounting year ending 30th June, 2017. Physical stock was taken on 8th July, 2017 when it was valued at ₹ 34,500.

The following transactions took place during 1st July to 8th July, 2017:

1. Net sales during the period were ₹ 9,340. These goods were sold at the usual rate of gross profit of 25% on cost except goods which realized ₹ 840 on the basis of 20% profit on cost.
2. Purchase during the period were ₹ 7,500 of which ₹ 800 worth of goods were delivered to the company only on 10th July, 2017.
3. Sales returns during the period were ₹ 1,500 of which 50% were out of the sales at 20% gross profit mentioned above.
4. On 5th July 2017, goods worth ₹ 4,000 were received, which were to be sold on consignment basis.

You are required to prepare a statement showing clearly the value of the stock to be taken into account in FY Ltd's final accounts for the year ended 30th June, 2017.

Solution

FY Limited

Statement showing the Value of Physical Stock on 30th June, 2017

Particulars	₹	₹
Stock on 8th July, 2017		34,500
Add: Cost of goods sold during 1st July and 8th July 2017 (Note 1)		7,500
		42,000
Less: Cost of goods returned during 1st July and 8th July 2017 (Note 2)	1,225	
Less: Purchased during 1st July and 8th July 2017 (₹ 7,500 – ₹ 800)	6,700	
Less: Goods held on consignment	4,000	11,925
Stock on 30th June, 2017 (to be credited to Trading Account)		30,075

Working Notes

Cost of goods sold	₹	₹	Cost of goods returned	₹	₹
(a) Sales at cost plus 25% (9,340 – 840)	8,500		(a) Selling price	750	
Less: 20% profit on sales	1,700	6,800	*Less*: Profit 20% on sales	150	600
(b) Sales at cost plus 20%	840		(b) Selling price	750	
Less: 16.67% profit on sales	140	700	*Less:* Profit 16.67% on sales	125	625
		7,500			1,225

Illustration 28

Alpha Ltd. prepares accounts on 31st March each year. On 31st March 2017 its stock taking expert was ill and the preparation of the physical inventory was delayed until 3rd April 2017 on which date the stock valued at cost amounted to ₹ 2,40,000.

An examination of inventories and related financial records discloses that between 1st and 3rd April 2017:

1. Sales totalled ₹ 40,000 including: (i) ₹ 2,000 in respect of goods which left the warehouse on 29th March 2017; and (ii) ₹ 4,000 in respect of goods not despatched until 12th April 2017. The rate of gross profit to sales was 30%.
2. Returns from customers totalled ₹ 6,000.
3. Purchases totalled ₹ 18,000 which included: (i) ₹ 6,000 for goods received in March 2017; and (ii) ₹ 3,000 for goods received in 10th April, 2017.
4. Returns to suppliers totalled ₹ 4,000.
5. There were arithmetical errors in the stock sheets on 3rd April, 2017 resulting in an over-valuation of ₹ 4,600.

Prepare a statement showing the correct amount of the company's stock at cost on 31st March, 2017.

Solution

Alpha Limited

Statement showing the Value of Physical Stock on 31st March, 2017

Particulars	₹	₹
Stock on 3rd April 2017		2,40,000
Add: Cost of goods actually despatched between 1st and 3rd April 2017 (Note 1)	23,800	
Add: Returned to Supplier	4,000	27,800
		2,67,800
Less: Cost of goods actually received between 1st and 3rd April 2017 (Note 2)	9,000	
Less: Cost of goods returned (₹ 6,000 – 1,800)	4,200	
Less: Errors (over-valuation)	4,600	17,800
Value of Stock as on 31st March, 2017		2,50,000

Working Notes

(1) Out of the total sales of ₹ 40,000, goods valued at ₹ 2,000 were delivered before 1st April and goods valued at ₹ 4,000 were despatched after 3rd April. Hence goods actually despatched between 1st and 3rd April were ₹ 34,000 only. ₹ 34,000 X 0.7 = ₹ 23,800.

(2) Out of the total purchases of ₹ 18,000, goods costing ₹ 6,000 were received before 1st April and goods costing ₹ 3,000 were received after 3rd April. Hence actual goods received were ₹ 9,000 only.

Illustration 29

X's financial year ends on the last Wednesday in September, but actual stock is not taken until the following Saturday, when it is ascertained at ₹ 33,500. You find that:

(i) Sales are entered in the Sales Day Book on the same day as despatched and Returns Inwards in the Returns Book the day the goods are received back.

(ii) Purchases are entered in the Purchases Day Book as the invoices are received.

(iii) Purchases between Wednesday and Saturday as per Purchases Day Book were ₹ 120, but of these, goods amounting to ₹ 40 were not received until after the stock was taken.

(iv) Sales between Wednesday and Saturday as per Sales Day Book and Cash Sales Book were ₹ 1,720.

(v) Goods invoiced during September (prior to the last Wednesday) but not received until after Wednesday amounted to ₹ 100, of which goods worth ₹ 70 were received between Wednesday and Saturday.

(vi) Goods sold in the previous week for ₹ 60 were returned on Monday but did not reach X until Thursday.

(vii) The rate of Gross Profit to sales is 25%.

Ascertain the value of the stock as at the end of the financial year assuming that the NRV is higher than cost and that the Purchases and Sales Day Books are not to be amended.

Solution **Statement showing the Value of Physical Stock on Wednesday**

Particulars	₹	₹
Stock on Saturday		33,500
Add: Cost of goods sold and delivered during Wednesday and Saturday (Note 1)	1,290	
Add: Goods invoiced during September (prior to last Wednesday and recorded in the Purchase Day Book but not physically received before Wednesday)	100	1,390
		34,890
Less: Goods received between Wednesday and Saturday	70	
Less: Goods purchased and physically received between Wednesday and Saturday (₹ 120 – ₹ 40)	80	
Less: Cost of goods returned by customers out of last year's sale (Note 2)	45	195
Cost of Closing Stock at the year end		34,695

Working Notes

(1) Sales ₹ 1,720 less G.P. 25% on sales = ₹ 1,290.

(2) As per the policy of Mr. X, goods returned are recorded only when the goods are physically received back. Here, goods were received after Wednesday but before Saturday. These items were included in the stock on Saturday. The cost of goods returned to be deducted (₹ 60 less 25% Gross Profit) = ₹ 45.

Illustration 30

A firm prepares accounts annually up to 30th November and stock taking takes place in the following weekend. In the year 2016, stock taking commenced on 4th December when the value of stock on that date was found ₹ 25,000. From the following information, you are required to ascertain the value of stock on 30th November 2016:

1. The average rate of gross profit is 20% on sales.
2. Goods outwards are entered in the Sales Day Book as on the day of despatch.
3. Goods inward are entered in the Purchases Day Book as on the date of the invoice.
4. Sales during the period 1st to 4th December, as shown by the Sales Day Book and the Cash Book ₹ 1,500.
5. Purchase during the same period as shown by the Purchases Day Book amounted to ₹ 1,200, but of these goods to the value of ₹ 200 were not received until 4th December.
6. Goods invoiced during November and not received until December totalled ₹ 1,600. Of these, goods to the value of ₹ 1,000 were received during the period 1st to 4th December and ₹ 600 after 4th December.
7. In November, goods were sent to a customer on sale or return basis. The sale price was ₹ 1,000. The goods were still returnable by the customer on 30th November.

Solution **Statement showing the Value of Physical Stock on 30the November, 2016**

Particulars	₹	₹
Value of Stock as on 4th December 2016		25,000
Add: Cost of goods sold between 1st and 4th December (₹ 1,500 – 300)	1,200	
Add: Cost of goods with customers on sale or return (₹ 1,000 – 200)	800	
Add: Purchase made before 30th November, but goods received after 4th December	600	2,600
		27,600
Less: Goods purchased and received between 1st & 4th December (₹ 1,200 – 200)		1,000
Value of Stock on 30th November, 2016		26,600

Illustration 31

Raja makes up his annual accounts to 31st December each year. He was unable to take stock of physical inventory till 9th January 2017 on which date the physical stock at cost was valued at ₹ 75,200.

You are required to ascertain the value of physical stock at cost on 31st December 2016 from the following information regarding the period from 1st January, 2017 to 9th January, 2017.

(a) Purchases of goods amounted to ₹ 25,600 of which goods worth ₹ 4,700 had been received on 28.12.2016 and goods worth ₹ 5,900 had been received on 12.1.2017.

(b) Sales of goods amounted to ₹ 38,400 of which goods of a sale value of ₹ 3,600 had not been delivered at the time of verification and goods of a sale value of ₹ 6,000 had been delivered on 29.12.2016.

(c) Sales return amounted to ₹ 1,800 which included a return of ₹ 720 relating to the goods sold and delivered between 1.1.2017 to 9.1.2017.

(d) A sub-total of ₹ 12,000 on one of the stock sheets had been carried to the summary of stock sheets as ₹ 21,000.

(e) In respect of goods costing ₹ 4,000 received prior to 31st December 2016 invoice had not been received up to the date of verification of stock.

(f) The rate of gross profit was 20% on the cost price.

Solution **Statement showing the Value of Physical Stock on 31st December, 2016**

Particulars	₹	₹
Stock as on 9th January, 2017		75,200
Add: Cost of goods sold and despatched during 1st and 9th January, 2017 (Note 1)		24,000
		99,200
Less: Goods actually received during 1st and 9th January, 2017 (Note 2)	15,000	
Less: Cost of goods returned	900	
Less: Wrong carry forward (₹ 21,000 – 12,000)	9,000	24,900
Value of Stock on 31st December, 2016		74,300

Working Notes

(1) Cost of goods sold	₹	**(2) Goods actually received during 1st and 9th January, 2017**	₹
Sales	38,400	Purchases	25,600
Less: Goods not despatched	3,600	*Less:* Goods received on 28.12.2016	4,700
	34,800		20,900
Less: Goods despatched on 29.12.2016	6,000	*Less:* Goods received on 12.1.2016	5,900
	28,800		15,000
Less: Gross profit 20% on cost, i.e., 16.67% on sales	4,800	**(3) Cost of goods returned**	
	24,000	Return	1,800
(4) No adjustment is required for item (e) , on the assumption that the purchase was recorded at the time of receiving the goods.		*Less:* Return from Sale of 1st & 9th January	720
			1,080
		Less: Gross profit 20% on cost	180
			900

Illustration 32

Krishna Udyog Limited makes up its accounts to December 31 each year. The company was unable to take stock by physical inventory till 14th January, 2017 on which date the stock at cost was valued at ₹ 1,85,000. It was, therefore, necessary to estimate the value of stock in hand as on December 31, 2016.

You ascertain the following facts regarding the period January 1 to January 14, 2017:

1. Purchases totalled ₹ 48,000 and included: (i) ₹ 5,000 in respect of goods received in December, 2016: (ii) ₹ 6,000 in respect of goods received on January 19, 2017; (iii) ₹ 2,000 in respect of goods received but returned to suppliers on January 7, 2017 for which no credit note has been received or passed through the books.
2. Sales totalled ₹ 60,000 and included: (i) ₹ 1,500 in respect of goods which left the warehouse on December 28, 2016; (ii) ₹ 2,800 in respect of goods which were not despatched until January 16,2017; (iii) ₹ 750 in respect of goods invoiced and despatched on January 10, 2017 but returned by the customers on January 12, for which no credit note had been passed but which were, in fact, included in the stock taken on January 14, 2017.

3. Other returns to suppliers totalled ₹ 1,400 and other returns by customers were ₹ 450.
4. The rate of gross profit was 20% on the selling price with the exception of an isolated purchase on January 7, 2016 of 100 similar articles which had cost ₹ 11,000. Of these articles, 50 were sold on January 7, 2017 for ₹ 6,500 and the remainder had been included at cost in the stock taken on January 14, 2017.

Prepare a statement showing the estimated value of stock held on December 31, 2016 at Cost.

Solution **Krishna Udyog Limited**

Statement showing the Value of Physical Stock on 31st December, 2016

Particulars	₹	₹
Stock on January 14, 2017		1,85,000
Add: Cost of goods sold during 1st and 14th January, 2017 (Note 1)	45,460	
Add: Purchase returns during 1st and 14th January, 2017	1,400	46,860
		2,31,860
Less: Purchases during 1st and 14th January, 2017 (Note 2)	40,000	
Less: Cost of goods returned during 1st and 14th January, 2017 ₹ (450 – 90)	360	40,360
Value of Stock on 31st December, 2016		1,91,500

Working Notes

(1) Cost of goods sold		₹
Sales during 1st and 14th January		60,000
Less: Goods not despatched	2,800	
Less: Returned on January 12	750	3,550
		56,450
Less: Sales of isolated purchase		6,500
Sale of normal item at a profit of 20%		49,950
Less: Gross profit 20% on sales		9,990
		39,960
Add: Cost of abnormal 50 articles		5,500
		45,460

(2) Calculation of purchases	₹
Purchases as given	48,000
Less: Goods received on 19.01.2016	6,000
	42,000
Less: Goods returned on 7th January	2,000
	40,000

(3) Since the purchase of ₹ 48,000 included ₹ 5,000 in respect of goods received in December , 2016, we may assume that the entry in respect of ₹ 5,000 must have been made during Jan 1 & 14th, 2017 So it should be treated as purchase of 2017 and it should be deducted from ₹ 1,85,000. To fulfil this we must not deduct it from ₹ 48,000.

If the stocks are taken on an earlier date.

In this case, the following adjustments are necessary to arrive at the stocks as on the closing date.

Let us start with the value of goods on that earlier date ....

Add: Purchases between the two dates.

Add: Sales returns (at cost price) between the two dates.

Less: Sales (at cost) between the two dates.

Less: Purchases returns during the same period.

Add: Goods lying with consignee (at cost).

Add: Goods on approval with customers (at cost).

Illustration 33

Determine the value of stock to be taken for Balance Sheet as at 31st March, 2017 from the following information :

The stock was physically verified on 23rd March 2017 and was valued at ₹ 6,00,000. Between 23rd March 2017 and 31st March 2017 the following transactions had taken place :

1 Purchases ₹ 50,000 of this, goods worth ₹ 20,000 were delivered on 5th April, 2017.
2. Out of goods sent on consignment, goods worth ₹ 30,000 (at cost) were unsold.
3. Sales was of ₹ 1,70,000. This includes goods worth ₹ 40,000 sent on approval. Half of these were returned before 31st March. As regards remaining, no intimation was received.
4. Normally the firm sells goods on cost plus 25%. However, a lot of goods costing ₹ 30,000 was sold for ₹ 15,000.

Solution **Statement showing the Value of Physical Stock on 31st March, 2017**

Particulars	₹	₹
Stock on 23rd March, 2017		6,00,000
Add: Purchases during 23rd and 31st March (₹ 30,000 + 20,000 in transit)	50,000	
Add: Goods lying with consignee at cost	30,000	
Add: Goods on approval with customer at cost (₹ 20,000 – ₹ 4,000)	16,000	96,000
		6,96,000
Less: Cost of goods sold during 23rd and 31st March (Note 1)	1,08,000	
Less: Cost of Abnormal Sales	30,000	1,38,000
Value of Stock on 31st March, 2017		5,58,000

Working Notes : (1) Cost of goods sold during 23rd March & 31st March, 2017

	₹	₹
Sales		1,70,000
Less: Sales of abnormal items	15,000	
Less: Sent on approval	20,000	35,000
		1,35,000
Less: Gross Profit @ 25% of cost, i.e., 20% on sales		27,000
		1,08,000

Key Points

- A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues.
- Inventories are assets
  - (a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);
  - (b) in the process of production for such sale (e.g., car in the assembly lines); or
  - (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).
- Net Realisable Value (NRV) : Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.
- The cost of inventories should comprise:
  - (i) all costs of purchase;
  - (ii) costs of conversion; and
  - (iii) other costs incurred in bringing the inventories to their present location and condition.
- Perpetual inventory method is a method where the inventory accounting is kept continuously up-to-date and involves the continual recording of additions to and issues or sales of materials on a daily basis.

THEORETICAL QUESTIONS

1. What do you mean by Inventory ?
   What are the objectives of accounting for Inventories ?
2. What are the effects of errors in valuing inventory ?
3. What do you mean by Perpetual and Periodic Inventory Methods ?
   How inventory acquisitions and sales are recorded under Perpetual Inventory System and Periodic Inventory System?
4. Explain what is meant by the term '*stock is valued at the lower of cost and net realisable value*', which is found in AS—2 (Valuation of Inventories).

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Which of the following is correct ?
   A Inventories are assets held for use in the construction of the building, e.g., air conditioners
   B Inventories are assets held for sale in the ordinary course of business
   C Inventories includes machinery spares which is used irregularly
2. Net realisable value is
   A the estimated selling price *plus* cost of completion *minus* selling expenses
   B the estimated selling price *less* cost of competition
   C the estimated selling price in the ordinary course of business, *less* cost of completion less selling expenses
3. The purchase price, transport and handling cost, tax and import duties are all examples of
   A cost of purchase
   B cost of conversion
   C cost of purchase, cost of conversion and other costs

4. The cost of inventories should comprise
   A cost of purchase, cost of conversion and other cost like interest
   B cost of purchase, cost of conversion and other cost like post manufacturing storage cost
   C cost of purchase, cost of conversion and other cost like primary packing cost
5. Standard Costs Method or the Retail Method is used as a tool of measurement of cost. Retail Method is
   A sale price plus mark up
   B sale price less gross margin
   C none of the above
6. Reasons for inventories being sold for less than their cost could be:
   (i) Damage to the inventories and obsolescence
   (ii) General fall in the market price of the goods
   (iii) Fall in the production cost for use of better technology
   A all three
   B (i) and (iii) only
   C (i) and (ii) only
7. Amar restores and sells second hand motorcycles. At 31st December, 2016, he had one motorcycle in inventory. Details of this were :
   Model: Bajaj Boxer
   Details : This item cost ₹ 10,000 and in December, 2016 Amar had also spent ₹ 750 on repairs. He has not yet sold it but is confident to sell it in a motorcycle fair in February 2007 for at least ₹ 15,000. It will cost Amar ₹ 250 to transport motorcycle to the fair.
   The value of motorcycle to be included in the final account for 2006 is
   A ₹ 10,000
   B ₹ 15,000
   C ₹ 10,750
8. Amar also holds an inventory of parts, which he values on the periodic weighted average basis. During the year 2016 his purchases of parts was :

Month	Quantity (units)	Cost per unit (₹)
January	400	20
June	500	22
September	300	24

   At 31st September, 2016 he had 300 units in inventory. On 1st January, 2016 he had no parts in inventory.
   The value of inventory of parts at 31st December, 2016 is
   A ₹ 6,600
   B ₹ 6,000
   C ₹ 6,550
9. Following the physical stock taking, the value of total stock is ₹ 1,22,357. The auditors find the following additional information :
   (i) 370 units of stock which cost ₹ 0.40 per unit have been valued @ ₹ 4.00 each.
   (ii) The stock value including damaged goods at their original cost of ₹ 2,885. These goods could be sold for ₹ 3,600 after incurring repairing cost of ₹ 921.
   The correct value of year end stock is :
   A ₹ 1,20,877
   B ₹ 1,20,671
   C ₹ 1,20,819
10. X has closing stock which cost ₹ 38,750. This includes some damaged items which cost ₹ 3,660. It will cost X ₹ 450 to repair these. He will be able to sell them for ₹ 1,500 after the repairs are completed. What is the correct value of X's closing stock ?
   A ₹ 38,750
   B ₹ 36,590
   C ₹ 36,140

11. On 31 March, 2017, inventory code AXN-205 had 1,000 items in inventory. The original cost of this inventory was ₹ 4,600. Alternative valuations were obtained at 31 March, 2017 for this inventory item. Which value should be used in the accounts at 31st March, 2017 as per AS-2 ?

    A original cost ₹ 4,600

    B replacement cost ₹ 3,200

    C net realisable value ₹ 3,400

12. On 31 March, 2017, stock consists of 1,500 units of a raw material purchased @ ₹ 8 each, but the unit price of the item has fallen to ₹ 7. The price reduction is apprehended to be permanent. The firm has already decided that if the price reduction lasts longer than six months it will reduce the sale price of the finished goods from ₹ 12 to ₹ 11. The value of closing stock is :

    A ₹ 16,500

    B ₹ 10,500

    C ₹ 12,000

13. According to AS-2 Inventories, which of the following costs should be included in valuing the inventories of a manufacturing company ?

    (i) freight and insurance

    (ii) carriage outwards

    (iii) depreciation of factory plant

    (iv) general administrative overheads

    A all four items

    B (i), (ii) and (iv) only

    C (ii) and (iii) only

    D (i) and (iii) only

14. During the year to 31 December, 2016 Amar bought goods for resale at a cost of ₹ 7,55,500. His inventory at 1 January 2016 was valued at ₹ 1,57,400. He did not count his inventory at 31 December, 2016 but he knows that his sales for the year to 31 December, 2016 were ₹ 9,18,000. All sales were made at a mark up of 20%. Based on the information above, what was the value of Amar's inventory at 31 December, 2016 ?

    A ₹ 1,36,300

    B ₹ 1,47,900

    C ₹ 1,66,900

15. Karim is an antiques dealer. His inventory includes a clock which cost ₹ 15,800. Karim expects to spend ₹ 700 on repairing the clock which will mean that he will be able to sell it for ₹ 26,000.

    At what value should the clock be included in Karim's inventory ?

    A ₹ 15,100

    B ₹ 15,800

    C ₹ 25,300

PRACTICAL QUESTIONS

1. State how will you deal with each of the following ?

    (i) Stock which cost ₹ 20,000 can now be replaced for ₹ 14,000. The estimated net realisable value of this stock is ₹ 17,000. It is proposed that the stock should be written down to ₹ 17,000.

    (ii) During the stock-taking it was found that of the total stock of ₹ 8,35,000, approximately ₹ 93,000 of stock was missing and had been misappropriated. A further ₹ 50,000 of stock was estimated to be obsolete, with very little likelihood of resale.

    (iii) Some stock has been omitted from the closing stock figure. The omitted stock had originally cost ₹ 30,000 but could be sold only for ₹ 20,000.

    (iv) Stock costing ₹ 9,000 lying in godown for last 10 years. It can only be sold for ₹ 2,500 after incurring ₹ 500 delivery charges..

2. From the following transactions extracted from the books of accounts of X Ltd as on 31st December, 2016, work out the Cost of Closing stock under the following three methods of pricing:

    (i) FIFO and (ii) Weighted Average (Periodic).

Dec. 1	Opening Stock 300 units @ ₹ 9.70	Dec. 20	Issue 210 units
Dec. 3	Purchases 250 units @ ₹ 9.80	Dec. 25	Purchases 150 units @ ₹ 10.30
Dec. 11	Issue 400 units	Dec. 26	Issue 100 units
Dec. 15	Purchases 300 units @ ₹ 10.05		

3. Calculate the Cost of Closing stock under FIFO method:
   2017 Jan. 1 Opening stock 200 pieces @ ₹ 2 each.

	Purchases		Issues
Jan. 5	100 pieces @ ₹ 2.20 each	Jan. 2	150 pieces
Jan. 10	150 pieces @ ₹ 2.40 each	Jan. 7	100 pieces
Jan. 20	180 pieces @ ₹ 2.50 each	Jan. 12	100 pieces
		Jan. 28	200 pieces

4. From the following information, calculate the Cost of Closing stock on 31st March, 2017 using FIFO method.

Purchases			Issues	
Date	Units	Rate	Date	Units
3.1.2017	200	5.2	9.1.2017	1,000
15.1.2017	1,400	5.5	17.1.2017	1,000
21.1.2017	800	5.4	23.1.2017	1,000
14.2.2017	2,000	5.3	16.2.2017	1,000

5. With the help of the following information, calculate the Cost of Closing stock using Weighted Average (Perpetual) method.

Sept. 1	Opening balance 24,000 kg @ ₹ 7,500 per MT	Sept. 13	Purchases 10,000 kgs @ ₹ 7,800 per MT
Sept. 1	Purchases 44,000 kgs @ ₹ 7,600 per MT	Sept. 18	Issues 24,000 kgs
Sept. 1	Issue 10,000 kgs	Sept. 22	Purchases 50,000 kgs @ ₹ 8,000 per MT
Sept. 5	Issue 16,000 kgs	Sept. 28	Issues 30,000 kgs
Sept. 12	Issue 24,000 kgs	Sept. 30	Issues 22,000 kgs

6. From the records of an oil distributing company, the following summarized information is available for the month of March, 2017:
   (i) Sales for the month ₹ 9,45,000.
   (ii) Opening stock as on 1.3.2017 1,00,000 litres @ ₹ 3.00 per litre.
   (iii) Purchases (including freight and insurance) : March 5 2,00,000 litres @ ₹ 2.85 per litre; March 27 1,00,000 litres @ ₹ 3.03 per litre.
   (iv) Closing stock as on 31.3.2017 1,30,000 litres.
   (v) General administrative expenses for the month ₹ 25,000.

   On the basis of the above information, work out the following using FIFO method of inventory valuation: (a) Cost of Closing stock on 31.3.2017; (b) Cost of goods sold during March 2017; and (c) Profit or loss for March 2017.
7. B. Ltd started on 1st January, 2016, purchased raw materials during 2016 as given below :

Jan. 1	1,000 kg @ ₹ 70	March 15	700 kg @ ₹ 72	Sept. 15	1,000 kg @ ₹ 65
Jan. 25	1,500 kg @ ₹ 60	July 29	1,400 kg @ ₹ 70	Dec. 20	1,200 kg @ ₹ 60
Feb. 5	1,200 kg @ ₹ 65				

   While preparing its final accounts on 31st December, 2016, the company had 3,000 kg of raw materials in its godown. Calculate the Cost of Closing stock of raw materials according to FIFO method.

Problems of Stock Taking

8. On account of unavoidable circumstances M/s Mahesh Electricals could not do stock taking on 31.12.2016. However the stock was taken on January 10, 2017.
   The following are details of transactions from January 1st to 10th on which day Inventory was taken:
   Purchased in Jan. upto 10th 45,000; Goods received after 10th 5,000; Purchase returns 3,000; Purchases include special items for ₹ 11,000; Sales ₹ 80,000; Sales Returns ₹ 2,000; Sale of goods invoiced but delivered after 10th ₹ 8,000; Sales include half the quantity of special item purchased for Balance left in the Stock ₹ 6,600; Gross Profit Ratio 25%. Inventory taken on 10th Jan. ₹ 1,75,000. Find out the value of the stock as on 31.12.2016.
9. Sundaram closed his books of account on 31st March, 2017, but due to certain difficulties, it was not possible for him to conduct physical stock-taking on that date. Physical stock was taken on 7th April when it was valued at ₹ 45,000. An examination of the records of inventories from 1st to 7th April revealed the following:
   (a) Net sales during the period were ₹ 10,200. These goods were sold at the usual rate of gross profit of 25% on cost except goods which realised ₹ 1,200 on the basis of 20% profit on cost.
   (b) Purchases during the period were ₹ 8,000 of which ₹ 1,000 worth of goods were delivered on 9th April only.
   (c) Sales returns during the period were ₹ 1,200 of which 50% were out of the sales at 20% gross profit mentioned above.

(d) On 5th April, Sundaram received certain goods costing ₹ 5,000 to be sold by him on consignment basis.

You are required to prepare a statement showing clearly the value of the stock to be taken into account in Sundaram's final accounts for the year ended 31st March, 2017.

10. The financial year of Shri X ends on 31st March 2017 but the stock in hand was physically verified only on 7th April 2017. You are required to determine the Cost of Closing stock at cost at 31st March 2017 from the following information:
    (i) The stock (valued at cost) as verified on 7th April 2017 was ₹ 15,000.
    (ii) Sales have been entered in the Sales Day Book only after the dispatch of the goods and Sales Returns only on receipt of the goods.
    (iii) Purchases have been entered in the Purchases Day Book on receipt of the purchase invoice irrespective of the date of receipt of the goods.
    (iv) Sales as per the Sales Day Book for the period 1st April, 2017 to 7th April 2017 (before the actual verification) amounted to ₹ 6,000 of which goods of a sale value of ₹ 1,000 had not been delivered at the time of verification.
    (v) Purchases as per the Purchases Day Book for the period 1st April 2017 to 7th April 2017 (before the actual verification) amounted to ₹ 6,000 of which goods for purchases of ₹ 1,500 had not been received prior to 31st March 2017.
    (vi) In respect of goods costing ₹ 5,000 received prior to 31st March 2017, invoices had not been received up to the date of verification of stocks.
    (vii) The gross profit is 20% on sales.
11. Moon Ltd keeps no stocks records, but a physical inventory of Stock is made at the end of the quarter and the valuation is taken at Cost. The Company's year ends on 30.9.2016 and Draft Accounts have been prepared to that date. The Stock Inventory taken on 30.9.2016 was, however, mislaid and you have been advised to value the Closing Stock as on 30.9.2016 with the Stock figure as on 30.6.2016 and some other information as available to you are :
    (i) The Cost of Stock on 30.6.2016 as shown by the inventory was ₹ 80,000.
    (ii) On 30th June, Stock sheets showed the following discrepancies: (a) A page total of ₹ 5,000 had been carried to the summary as ₹ 6,000; and (b) The total of a page had been undercast by ₹ 200.
    (iii) Invoice of purchase entered in the Purchase Book during the months from July to September, 2016 totalled ₹ 70,000. Of this ₹ 3,000 related to goods received prior to 30th June, 2016. Invoices entered in October 2016 relating to goods received in September 2016 totalled ₹ 4,000.
    (iv) Sales invoiced to customers from July to September, 2016 totalled ₹ 90,000. Of this, ₹ 5,000 related to goods despatched on or before 30.6.2016. Goods despatched to customers before 30.9.2016 but invoiced on October 2016 totalled ₹ 4,000.
    (v) During the final quarter, Credit notes at invoiced value of ₹ 1,000 had been issued to customers in respect of goods returned during that period.
    (vi) The Gross margin earned by the Company is 25% of cost.

    You are required to prepare a statement showing the amount of stock at cost as on 30.9.2016.

Guide to Answers

Multiple Choice

1. B 2. C 3. A 4. C 5. B 6. C 7. C 8. C 9. C 10. C 11. C 12. C 13. D 14. B 15. B.

Practical Questions

1. **(i) Yes, it should be written-down to ₹ 17,000; (ii) Stock will be reduced by ₹ 1,43,000 (₹ 93,000 + ₹ 50,000); (iii) ₹ 20,000 will be added to the value of stock; (iv) Stock lying in godown for 10 years should be valued at ₹ 2,000 (₹ 2,500 – ₹ 500).**
2. **FIFO—₹ 2,952; Weighted Average—₹ 2,877.**
3. **FIFO—₹ 200.**
4. **FIFO—₹ 12,020.**
5. **Cost of Closing stock—₹ 15,952.**
6. **FIFO—(a) ₹ 3,88,500; (b) ₹ 7,84,500; (c) ₹ 1,35,500.**
7. **FIFO—₹ 1,93,000.**
8. **Value of stock ₹ 1,91,050.**
9. **Value of stock ₹ 40,220.**
10. **Value of stock ₹ 9,500.**
11. **Value of stock (at cost) on 30.9.2016 — ₹ 79,800. Adjusted cost of sales — ₹ 70,400. Cost of adjusted purchases — ₹ 71,000.**

9

Depreciation Accounting

Nature of Depreciation

Depreciation is an attempt to spread the cost of a long-lived asset, as an expense to the Profit and Loss Account, over its useful economic life.

Most fixed assets, such as building, plant, machinery, office equipments, and the like have a limited useful life. These assets are acquired not primarily for resale. These assets are used in the business for generating revenue over a number of future accounting periods.

When a fixed asset is acquired, it is recorded in the accounts at its acquisition cost, i.e. the price paid to acquire it (whether purchased against cash or credit is irrelevant). This is because, as per cost convention, the acquisition cost of an asset is capitalised (capitalisation means that an expenditure on the acquisition of an asset is not charged immediately as a cost against revenue in the Profit and Loss Account, but is carried forward as a fixed asset in the Balance Sheet), The acquisition cost should be written off as an expense during its useful life, i.e. a portion of the cost should be charged against profit as an expense in each of the accounting periods in which the asset is gainfully used. This accounting process of gradually converting the ***unexpired costs*** of fixed assets into ***expenses*** over a series of accounting periods is called ***depreciation***. In essence, ***depreciation is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner***.

Concept of Depreciation

To understand the concept of depreciation, let us take the ***example*** of a person who purchases a new mini truck at a cost of ₹ 6,00,000 to begin a delivery business. After operating for 4 years, the business is closed down. Thereafter, the truck is sold for ₹ 1,00,000. Clearly, over the 4-year period, the value of the truck has been decreased by ₹ 5,00,000 ₹ (6,00,000 – 1,00,000). It is also clear that without the truck the business could not be carried out for 4 years. To ascertain the profit or loss of the business, the person cannot ignore ₹ 5,00,000 decrease in the value of the truck. This decrease in the value must be allocated as an expense of the business at the rate of ₹ 1,25,000 (₹ 5,00,000 / 4) for each of the 4 years. This ₹ 1,25,000 charge as expense is known as ***depreciation***.

Accounting Standard AS–10 : Property, Plant and Equipment

Before the revision of As—10 there was a separate accounting standard for depreciation (AS—6). At present, AS—6 has been withdrawn and AS—10 will cover the depreciation accounting also. Some of the important areas have been discussed here.

Definitions

Depreciation : Depreciation is the systematic allocation of the ***depreciable amount*** of an asset over its useful life.

Depreciable Amount : Depreciable amount is the cost of an asset or other amount substituted for cost, less its residual value.

Residual Value : The residual value of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, ***after deducting the estimated cost of the disposal,*** if the assets were already of the age and in the condition expected at the end of its useful life.

Useful Life : Useful life is :

(a) the period over which an asset is expected to be available for use by an enterprise; or

(b) the number of production or similar units expected to be obtained from the assets by an enterprise.

Needs for Providing Depreciation

(1) Ascertaing Correct Cost of Production: The cost of production of an article manufactured should include all items of expenses incurred in the production operations. One such expense is depreciation. If depreciation is not taken into consideration, cost of production will be understated. In effect, pricing of the product will be inappropriate.

(2) Ascertaining Correct Profit or Losses To find out the net profit or loss for an accounting period, we add all the revenues of that period and deduct all the expenses incurred in that period in earning those revenues. One such expense is the periodic depreciation of fixed assets. If depreciation is not provided for, periodic expenses will be understated. In effect, profits for that period will be overstated.

(3) Ascertaining True and Fair View of Financial Position: To present a true and fair view of the state of affairs of the business, the assets must be valued correctly on the Balance Sheet. Unless depreciation is charged, the value of the assets will be overstated in the Balance Sheet. As a result, the fixed assets would stand in the books at an amount which is in excess of their true value to the business. In effect, net worth will be overstated.

(4) Ascertaining Profit or Loss on Sale: A fixed asset is to be sold at the end of its useful life or may be even before. If no depreciation is provided, the written down value of the asset on the date of sale cannot be ascertained. In effect, the profit or loss on the sale of that asset cannot be determined.

(5) Maintenance of capital: Capital is invested for purchasing fixed assets. If depreciation is not charged, expired cost of capital invested in fixed assets will not be recovered. In effect, the business will not be able to maintain its capital.

(6) Providing Funds for Replacement: A fixed asset is to be replaced by a new one after the end of its useful life. If depreciation is not charged, the profit available for distribution will be overstated. It may be possible that the whole of the profit may be withdrawn during the life of that asset. In effect, the business may not have sufficient funds to replace the asset.

(7) Making Distinction between capital and revenue expenditure: The buying of a fixed asset is a capital expenditure but charging depreciation on that against profit is a revenue expenditure. If no depreciation is provided, the distinction between the above two cannot be made.

(8) Meeting Legal Obligation:

Certain types of business organisations, ***For example***, joint stock companies are under obligation to charge depreciation on fixed assets according to the provisions of the law.

Factors in the Measurement of Depreciation

The amount of depreciation to be charged for a particular fixed asset will depend upon the following three factors :

(i) Cost of the asset
(ii) Useful life of the asset
(iii) Residual value of the asset

Meaning of Cost of the Asset

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with specific requirements of the other Accounting Standards.

Element of Cost

As per para 17 of the AS—10 : Property, Plant and Equipment, the cost comprises :

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
(b) any cost ***directly attributable*** to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management;
(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'de-commissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Examples of directly attributable cots are :

(a) cost of employee benefits (as defined in AS—15 : Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
(b) cost of site preparation
(c) initial delivery and handling costs;
(d) installation and assembly costs;
(e) cost of testing whether the asset is functioning properly, after deducting the net proceeds from selling any item produced while bringing the asset to that location and condition (such as sample produced when testing equipments); and
(f) professional fees

Example of costs that are not costs of an item of property, plant and equipment are :

(a) cost of opening a new facility or business, such as inauguration costs;
(b) cost of introducing a new product or service (including cost of advertising, promotional activities);
(c) cost of conducting business in a new location or with a new class of customers (including cost of staff training); and
(d) administration and other general overhead costs.

Useful Life of the Asset

The useful life of an asset is its ***service life*** which can be defined as the number of accounting periods during which it will be useful to the business. The physical life of an asset may be considered longer than its economic life. When the operating cost of an asset is considered to be more than the revenue which it generates, it has exceeded its economic life and should not be kept in use. Since there is no way to measure correctly how long an asset will be useful, the asset's ***useful economic life is always estimated***.

The useful life of a depreciable asset should be estimated after considering the following factors:

(i) Expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.
(ii) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the assets while idle.
(iii) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in market demand for the product or service output of the asset. Expected future reductions

in the selling price of an item that was produced using an asset could indicate the expectation technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(iv) Legal or similar limits on the use of the asset, such as the expiry date of related leases.

Estimation of useful life of the asset is very difficult. It is a matter of judgment and depending on the experience of the enterprise with similar assets. Depreciation will vary directly with the useful life of the asset. If the estimated life is too long, each year's depreciation charge will be less and profits in the periods will be more.

Residual Value of the Asset

Residual value of asset is the estimated value of a fixed asset at the end of its economic life. It is the amount which is expected to be received when the asset is sold after being removed from service. The purpose of estimating residual value is to ascertain the ***depreciable amount*** (acquisition cost – residual value), which is allocated to different accounting periods during which the asset is gainfully employed. Depreciable amount is calculated as under:

Acquisition cost (say)	₹ 11,00,000
Less : Residual Value (say)	₹ 1,00,000
Depreciable Amount	₹ 10,00,000

Example : It is the policy of Sita Travel (P) Ltd. to keep their tourist bus in service for 5 years only. The company has purchased one new tourist bus for ₹ 25,00,000. A similar bus purchased 5 years back can be sold at present for ₹ 5,00,000 (Net). Here ₹ 5,00,000 is a reasonable estimate for the residual value of the new bus.
The depreciable amount will be ₹ 20,00,000 (₹ 25,00,000 – 5,00,000).
Annual depreciation = ₹ 20,00,000 / 5 = ₹ 4,00,000.

Unless the residual value of the asset is guaranteed (e.g., buyback by the manufacturer at a guaranteed amount), the residual value will only be ***estimate*** because of future uncertainties.

In some cases, residual value is insignificant and it is taken as zero for calculating the amount of depreciation. The higher the residual value, the lower will be the depreciation charge. In effect, the profits of the previous periods will be inflated and there may be a loss on disposal of the asset.

Students should note the following important points :

(1) Each part of an item, property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Take an example of a passenger aircraft. The cost of the engine of the aircraft is very significant in relation to the total cost of the aircraft. In this case, engine should be depreciated seperately, body of the aircraft, seat and instrument panel are also to be depreciated separately.

(2) The depreciation charge for each period should be recognised in the Statement of Profit and Loss. However, depreciation of the property, plant and equipment used for manufacturing an asset should be capitalised (it means it will be added to the cost of the asset manufactured) but not to be charged to the Statement of Profit and Loss.

(3) The residual value and the useful life of an asset should be reviewed at least at each financial year end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in the accounting estimate in accordance with AS—5 : Net Profit or Loss for the period, prior period items and changes in accounting policies.

(4) Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount.

Methods of Computing Depreciation

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the Straight Line Method, the Diminishing Balance Method and the Units of Production Method [Para 63 of AS—10].

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

1. Straight Line / Equal Instalment Method

This is the most popular method because of its simplicity and consistency. It requires allocation of an equal amount to each period. A fixed amount of the original cost is charged as depreciation every year. Thus, the asset is written down in value each year by the same amount. This amount is such that the book value of the asset may be reduced to zero or its residual value, as the case may be, at the end of its life. Since this method assumes that the cost of the asset expires at a steady (straight line) function of time, the acquisition cost less salvage value is divided by the estimated economic life. *The rate of depreciation is the reciprocal of the estimated useful life.* If the useful life of an asset is 10 years, the depreciation rate will be 1/10 or 10%. This may be put in the shape of a formula as under :

$$\textit{Annual Depreciation} = \frac{\textit{Cost of the Asset} - \textit{Residual Value}}{\textit{Estimated Economic Life}}$$

Example

If a machine costs ₹ 1,20,000 on 1.1.2017, has a salvage value at ₹ 20,000 and a life of 10 years, assuming the accounting year ends on 31st December, the depreciaion per annum will be :

$$\textit{Depreciation} = \frac{1,20,000 - 20,000}{10} = ₹\ 10,000$$

The profit will not be reduced by ₹, 1,20,000 in 2017 but by ₹ 10,000 in each of the years 2017 – 2027.

This method is appropriate for those assets where the use of time is an important factor, e.g. benefits to be derived from the use of the asset within a fixed time period. Examples are: lease, patents, copyrights, etc. This method is often used for other assets, when the following two conditions are satisfied : (1) the asset renders uniform service throughout its service life; and , (2) it does not involve repair or maintenance cost (or it is equal throughout its service life).

Advantages

1. It is simple to calculate and easy to understand.
2. It can reduce the book value of the asset to zero.
3. The valuation of the asset each year in the Balance Sheet is reasonably fair.

Disadvantages

1. This method ignores the fact that the service yielding ability of the assets fall while the repairs and maintenance costs increase with the passage of time. Though each year's charge for depreciation is the same, the charge for repairs and renewals goes on increasing as the asset becomes older. Therefore, the charge to the Profit and Loss Account increases over the years.
2. If an additional asset is acquired, the amount to be charged as depreciation needs to be recalculated.

Methods of Recording Depreciation

The Ledger Account entries for depreciation are quite straightforward. There are two ways or methods of recording depreciation in the books:

The First Method — When no provision for Depreciation Account is maintained

Under this method, depreciation is directly charged to an Asset Account by debiting Depreciation Account and crediting the Asset Account. At the end of the accounting period, Depreciation Account is closed by transferring it to the Profit and Loss Account. In the Balance Sheet, the asset appears at its written down value (cost less depreciation provided to-date). Here, actual cost of an asset and the total amount of depreciation that has been provided (to-date) cannot be ascertained from the Balance Sheet.

Journal Entries

1. Depreciation Account Dr.
   To Asset Account
2. Profit and Loss Account Dr.
   To Depreciation Account

The Second Method — When Provision for Depreciation Account is maintained

Under this method (in contrast to the above), depreciation is not directly charged to the Asset Account.

The depreciation for the period is debited to Depreciation Account and credited to '***Accumulated Depreciation Account***' or ***Provision for Depreciation Account.*** As in the previous method, Depreciation Account is closed by transferring it to the Profit and Loss Account. In the Balance Sheet, asset appears at its original cost and the accumulated depreciation is shown as a deduction from the Asset Account. Here, from the Balance Sheet, the original cost of the asset and the total depreciation to-date that has been charged on that asset can be easily ascertained. As the year passes, the balance of the accumulated depreciation goes on increasing since constant credit is given to this account in each accounting year. After the expiry of the useful life, these two accounts are closed by debiting Accumulated Depreciation Account and crediting Asset Account—any balance in Asset Account is transferred to the Profit and Loss Account.

Journal Entries

1. Depreciation Account Dr.
   To Accumulated Depreciation Account
2. Profit and Loss Account Dr.
   To Depreciation Account

Illustration 1

B. Brown purchased a machine by cheque for ₹ 90,000 on 1st January, 2015. Its probable working life was estimated at 10 years and its probable scrap value at the end of that time at ₹10,000. It was decided to write off depreciation by equal annual instalments. You are required to pass necessary Journal entries for first two years and show necessary accounts and the Balance Sheet:

(a) When no Provision for Depreciation Account is maintained;
(b) When Provision for Depreciation Account is maintained.
[It was decided to close books each year on December 31.]

Solution

$$\textit{Annual Depreciation} = \frac{90{,}000 - 10{,}000}{10} = ₹\ 8{,}000$$

(a) When no Provision for Depreciation Account is maintained.

In the Books of B. Brown
Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2015 Jan. 1	Machinery A/c	Dr.	90,000	
	To Bank A/c			90,000
	(Being the purchase of machinery by cheque)			
Dec.31	Depreciation A/c	Dr.	8,000	
	To Machinery A/c			8,000
	(Being the depreciation charged to machinery)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			
2016 Dec.31	Depreciation A/c	Dr.	8,000	
	To Machinery A/c			8,000
	(Being the depreciation charged to machinery)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Jan.1	To Bank A/c	90,000	2015 Dec.31	By Depreciation A/c	8,000
			"	By Balance c/d	82,000
		90,000			90,000
2016 Jan.1	To Balance b/d	82,000	2016 Dec.31	By Depreciation A/c	8,000
			"	By Balance c/d	74,000
		82,000			82,000
2017 Jan.1	To Balance b/d	74,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Machinery A/c	8,000	2015 Dec.31	By P & L A/c	8,000
2016 Dec.31	To Machinery A/c	8,000	2016 Dec.31	By P & L A/c	8,000

Balance Sheet as on 31st December, 2015 (includes)

Liabilities	₹	Assets	₹
		Machinery	82,000

Balance Sheet as on 31st December, 2016 (includes)

Liabilities	₹	Assets	₹
		Machinery	74,000

(b) When Provision for Depreciation Account is maintained

In the Books of B. Brown

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015 Jan.1	Machinery A/c	Dr.	90,000	
	To Bank A/c			90,000
	(Being the purchase of machinery by cheque)			
Dec.31	Depreciation A/c	Dr.	8,000	
	To Accumulated Depreciation A/c			8,000
	(Being the depreciation provided for the accounting period)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			
2016 Dec.31	Depreciation A/c	Dr.	8,000	
	To Accumulated Depreciation A/c			8,000
	(Being the depreciation provided for the accounting period)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Jan.1	To Bank A/c	90,000	2015 Dec.31	By Balance c/d	90,000
2016 Jan.1	To Balance b/d	90,000	2016 Dec.31	By Balance c/d	90,000
2017 Jan.1	To Balance b/d	90,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Accumulated Depreciation A/c	8,000	2015 Dec.31	By P & L A/c	8,000
2016 Dec.31	To Accumulated Depreciation A/c	8,000	2016 Dec.31	By P & L A/c	8,000

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

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Balance c/d	8,000	2015 Dec.31	By Depreciation A/c	8,000
2016 Dec.31	To Balance c/d	16,000	2016 Jan.1	By Balance b/d	8,000
			Dec.31	By Depreciation A/c	8,000
		16,000			16,000
			2017 Jan.1	By Balance b/d	16,000

Balance Sheet as on 31st December, 2015 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	90,000
		Less: Accumulated Depreciation	8,000
			82,000

Balance Sheet as on 31st December, 2016 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	90,000
		Less: Accumulated Depreciation	16,000
			74,000

2. Diminishing Balance Method

Where the straight line method assumes that the net cost of an asset should be allocated to successive periods in uniform amounts, the diminishing balance method assumes that the rate of allocation should be constant through time. Under this method, instead of a fixed amount, a fixed rate on the reduced balance of the asset is charged as depreciation every year. Since a constant percentage rate is being applied to the written down value, the amount of depreciation charged every year decreases over the life of the asset. Though the percentage at which depreciation is charged remains fixed, the amount of depreciation goes on diminishing year after year. This method assumes that an asset should be depreciated more in the earlier years of use than later years because the maximum loss of an asset occurs in the early years of use. The fixed percentage rate, to be applied to the allocation of net costs as depreciation, can be obtained by the following formula :

$r = 1 - \sqrt[n]{\frac{s}{c}}$ (This formula cannot be applied if the asset has no or insignificant scrap value.)

where
n = the expected useful life in years;
s = the scrap value;
c = the acquisition cost;
r = the rate of depreciation to be applied.

Proof
depreciation at the end of the 1st year = rc;
written down value at the end of the 1st year = c – rc = c(1—r)
written down value at the end of the 2nd year = $c(1-r)^2$
similarly, written down value at the end of the nth year = $c(1-r)^n$

therefore, $c(1-r)^n = s$ or $r = 1 - \sqrt[n]{\frac{s}{c}}$

Example :

If the cost of a machine is ₹ 10,000 and scrap value after 4 years is ₹ 2,000, the rate of depreciation is calculated as under :

$$r = 1 - \sqrt[4]{\frac{2,000}{10,000}} = 33.33\%$$

The amount of depreciation to be charged is computed as follows :

1. The rate of depreciation to be charged (r) is calculated by applying the above formula.
2. The first year's depreciation is calculated by multiplying the rate by the acquisition cost of the asset.
3. For the second and subsequent years, the depreciation is computed by multiplying its rate by the written down value (cost *less* accumulated depreciation) of the asset at the beginning of the year.

4. No further depreciation is charged when the written down value declines to its estimated salvage value. There may be some small difference between the estimated and resulting residual values. This arises because the depreciation rate is generally calculated to the nearest to two decimal places.

Taking the above example, the calculation of depreciaton for each of the four years would be as follows:

Year	Computation	Annual Depreciation	Accumulated Depreciation	Written Down Value
1	₹ 10,000 x 33.33%	3,333	3,333	6,667
2	₹ 6,667 x 33.33%	2,222	5,555	4,445
3	₹ 4,445 x 33.33%	1,482*	7,037	2,963
4	₹ 2,963 x 33.33%	963**	8,000	2,000

* Rounded to the nearest rupee.

** In the last year, the depreciation is adjusted to the amount (₹ 24) to bring the carrying value of the asset to its estimated scrap value.

Advantages

1. As the decreasing charge for depreciation cancels out the increasing charges for repairs over the years, it gives a fair charge for depreciation.
2. No recalculation is necessary when additional assets are purchased.
3. This method is applicable for income tax purposes.
4. The impact of obsolescence can be reduced if a significant part of the cost is written off in early life.

Disadvantages

1. This method lacks simplicity—the ascertainment of the percentage to be applied.
2. This method cannot be applied for assets with a very short life.
3. The asset is never fully depreciated.
4. The cost should be spread over evenly throughout the economic life of an asset or should be spread according to use. This method follows neither principle.

Distinction Between Straight Line and Diminishing Balance Methods

Sl. No.	Straight Line	Sl. No.	Diminishing Balance
1.	A fixed amount of depreciation is charged.	1.	A fixed rate of depreciation is charged.
2.	The rate of depreciation is the reciprocal of the life of the asset.	2.	The rate of depreciation is ascertained by applying a formula.
3.	The asset may or may not have scrap value.	3.	The asset must have a significant scrap value.
4.	The amount of depreciation per year is the same.	4.	The amount of depreciation goes on reducing.
5.	In the first year, the depreciation is charged on the cost of the asset, less scrap value, if any.	5.	In the first year, the depreciation is charged on the cost of the asset.
6.	At the end of its life, the book value of the asset becomes zero.	6.	The book value of the asset never reduces to zero.

Illustration 2

Thompson Bros. purchased machinery by cheque for ₹ 1,00,000 on 1st January, 2015. The estimated scrap value of the machinery is ₹ 20,000. At the end of each year, depreciation is provided at the rate of 10% per annum by the diminishing balance method. Show Machinery Account and Balance Sheet for the first two financial years which is ending on December, 31st every year :

(a) When no Provision for Depreciation Account is maintained; and

(b) When Provision for Depreciation Account is maintained.

Solution

1. Depreciation for 2015 = 1,00,000 x 10% = ₹ 10,000;
2. Depreciation for 2016 = (1,00,000 – 10,000) x 10% = ₹ 9,000.

(a) When no provision for Depreciation Account is maintained

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Jan.1	To Bank A/c	1,00,000	2015 Dec.31	By Depreciation A/c	10,000
			"	By Balance c/d	90,000
		1,00,000			1,00,000
2016 Jan.1	To Balance b/d	90,000	2016 Dec.31	By Depreciation A/c	9,000
			"	By Balance c/d	81,000
		90,000			90,000
2017 Jan.1	To Balance b/d	81,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Machinery A/c	10,000	2015 Dec.31	By P & L A/c	10,000
2016 Dec.31	To Machinery A/c	9,000	2016 Dec.31	By P & L A/c	9,000

Balance Sheet as on 31st December, 2015 (includes)

Liabilities	₹	Assets	₹
		Machinery	90,000

Balance Sheet as on 31st December, 2016 (includes)

Liabilities	₹	Assets	₹
		Machinery	81,000

(b) When Provision for Depreciation Account is maintained

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Jan.1	To Bank A/c	1,00,000	2015 Dec.31	By Balance c/d	1,00,000
2016 Jan.1	To Balance b/d	1,00,000	2016 Dec.31	By Balance c/d	1,00,000
2017 Jan.1	To Balance b/d	1,00,000			

Dr. Accumulated Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Balance c/d	10,000	2015 Dec.31	By Depreciation A/c	10,000
2016 Dec.31	To Balance c/d	19,000	2016 Jan.1	By Balance b/d	10,000
			Dec.31	By Depreciation A/c	9,000
		19,000			19,000
			2017 Jan.1	By Balance b/d	19,000

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Accumulated Depreciation A/c	10,000	2015 Dec.31	By Profit & Loss A/c	10,000
2016 Dec.31	To Accumulated Depreciation A/c	9,000	2016 Dec.31	By Profit & Loss A/c	9,000

Balance Sheet as on 31st December, 2015 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	1,00,000
		Less: Accumulated Depreciation*	10,000
			90,000

Balance Sheet as on 31st December, 2016 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	1,00,000
		Less: Accumulated Depreciation*	19,000
			81,000

* Alternatively, it can be shown on the liabilities side of the Balance Sheet.

Charges for Depreciation and Materiality Concept

It is not fair to assume that a fixed asset is always purchased on the very first day of the accounting period. Assets are generally purchased in the course of the accounting period. When an asset is purchased in any month of the accounting period, it is not necessary to compute the amount of depreciation to be charged to the nearest day or week. As we know, the charge for depreciation is a mere estimate and the application of the concept of materiality does not allow a misleading impression of great precision. Therefore, depreciation is calculated to the nearest whole month. If an asset is acquired on 17th March and the concern follows the calender year as its accounting year, depreciation should be calculated for 9 months only (from 1st April – 31st December). If the asset is acquired on 4th March, depreciation should be calculated for 10 months only.

Another popular approach is to charge depreciation for 6 months only in the year of acquisition, ignoring the actual date of acquisition. This is known as ***'half-year convention'*** and is based on the mean of the opening and closing values of the asset. This method assumes that the actual purchase dates of several fixed assets generally 'average-out' to approximately mid-year. Therefore, any time during the accounting period, when an asset is accquired, half-year's depreciation is provided for the year of acquisition. It should be noted that the same rule is applied in the year when an asset is sold.

In examination, if no date of acquisition is given, the 'half-year convention' should be followed.

Profit and Loss on Disposal of Fixed Assets

Owing to technological developments, a depreciated asset becomes obsolete and it may be sold out before its useful life. The business enterprise may also sell an asset which it no longer requires. It is quite common that the sale value of such asset may not be equal to its written down value (net book value) carrying amount. If the asset is sold at a price which is more than its written down value, it produces a profit.

On the contrary, when the asset is sold at a price which is less than its written down value, it is a case of loss on sale of an asset. It has already been stated that depreciation is a mere estimate. Its accuracy depends on the correctness of the forecasting regarding the useful life of the asset and its scrap value. It is only on sale of an asset that the real position can be determined.

In this connection, para 75 of AS—10 is relevant. It states that ***the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the Statement of Profit and Loss when the item is derecognised***.

Para 79 of AS—10 states that ***the gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposable proceeds, if any, and the carrying amount of the item***.

Journal Entries

The Journal entries for disposal or sale of asset will depend upon the method of recording depreciation.

1. When no provision for Depreciation Account is maintained

When the asset appears in the Balance Sheet at its written down value, on disposal, the written down value of such assets (at the beginning of the year of disposal) is transferred to 'Assets Disposal Account' and profit and loss on sale of assets are ascertained with the help of that account. The detailed entries are given below:

(a) For transferring to Assets Disposal Account

Assets Disposal Account	Dr. (W.D.V. of the asset
To Asset Account	at the beginning of the year of disposal)

(b) For charging depreciation of current year on disposed asset

Depreciation Account	Dr.
To Assets Disposal Account	

(c) For sale proceeds

Bank Account	Dr.
To Assets Disposal Account	

(d) If the credit side of the Assets Disposal Account is greater than the debit side, there is profit on diposal and it is transferred to Profit and Loss Account

Assets Disposal Acount Dr.
To Profit and Loss Account

(e) If the debit side of the Assets Disposal Account is greater than the credit side, there is loss on disposal and it is transferred to Profit and Loss Account

Profit and Loss Acount Dr.
To Assets Disposal Account

Illustration 3

Mr. Vaid of Calcutta purchased the required machine on 1.4.2014 for ₹ 65,000. He engaged Kabul to erect the units, who charged ₹ 5,000 and agreed to wait a month for his payment.

The machinery was depreciated at 10% p.a. on the Fixed Instalment Method — and accounting year being April-March.

On 1.10.2016, a single unit which cost ₹ 10,000 originally was sold for a cash price of ₹ 7,000. On the same date, a new machine costing ₹ 10,000 (paid for by cheque) was installed.

Write out the Machinery Account for the years 2014-15, 2015-16, 2016-17 and Machinery Disposal Account.

Solution

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

Date	Particulars	₹	Date	Particulars	₹
2014 April 1	To Bank A/c	65,000	2015 Mar. 31	By Depreciation A/c	7,000
"	To Kabul A/c	5,000	"	By Balance c/d	63,000
		70,000			70,000
2015 April 1	To Balance b/d	63,000	2016 Mar. 31	By Depreciation A/c	7,000
			"	By Balance c/d	56,000
		63,000			63,000
2016 April 1	To Balance b/d	56,000	2016 Oct. 1	By Machinery Disposal A/c (Note 1)	8,000
Oct. 1	To Bank A/c	10,000	2017 Mar. 31	By Depreciation A/c (Note 2)	6,500
			"	By Balance c/d	51,500
		66,000			66,000
2017 April 1	To Balance b/d	51,500			

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

Date	Particulars	₹	Date	Particulars	₹
2016 Oct. 1	To Machinery A/c	8,000	2016 Oct. 1	By Cash A/c	7,000
			"	By Depreciation A/c (1/2 year)	500
			"	By Profit & Loss A/c (loss)	500
		8,000			8,000

Working Notes:
(1) Original cost of machine is ₹ 10,000. Depreciation @ 10% for 2 years = ₹ 2,000. Therefore, W.D.V. of the machine sold = ₹ 10,000 – ₹ 2,000 = ₹ 8,000. **(2) Depreciation for 2016-17:** 10% on ₹ (70,000 – 10,000) = ₹ 6,000 + 10% of ₹ 10,000 for 6 months = ₹ 500. Total ₹ 6,500.

Illustration 4

M/s Suba Pharmaceuticals has imported a machine on 1st July, 2014 for ₹ 1,60,000, paid customs duty and freight ₹ 80,000 and incurred erection charges ₹ 60,000. Another local machinery costing ₹ 1,00,000 was purchased on January, 1,2015. On 1st July, 2016, a portion of the imported machinery (value one-third) got out of order and was sold for ₹ 34,800.

Another machinery was purchased to replace the same for ₹ 50,000. Depreciation is to be calculated at 20% p.a. on the straight line method.

Show the Machinery Account for 2014, 2015 and 2016.

Assume calendar year is the accounting year.

Solution

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

Date	Particulars	₹	Date	Particulars	₹
2014 July 1	To Bank A/c (Purchase price)	1,60,000	2014 Dec.31	By Depreciation A/c (1/2 year)	30,000
"	To Bank A/c (Customs Duty and Freight)	80,000	"	By Balance c/d	2,70,000
"	To Bank A/c (Erection charges)	60,000			
		3,00,000			3,00,000
2015 Jan.1	To Balance b/d	2,70,000	2015 Dec.31	By Depreciation A/c (Note 1)	80,000
"	To Bank A/c (new machine)	1,00,000	"	By Balance c/d	2,90,000
		3,70,000			3,70,000
2016 Jan.1	To Balance b/d	2,90,000	2016 July.1	By Machinery Disposal A/c (Note 2)	70,000
July 1	To Bank A/c	50,000	Dec.31	By Depreciation A/c (Note 1)	65,000
			"	By Balance c/d	2,05,000
		3,40,000			3,40,000
2017 Jan.1	To Balance b/d	2,05,000			

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

Date	Particulars	₹	Date	Particulars	₹
2016 July.1	To Machinery A/c (Note 2)	70,000	2016 July.1	By Depreciation A/c (1/2 year)	10,000
			"	By Profit & Loss A/c (Loss)	25,200
			"	By Bank A/c (sale proceeds)	34,800
		70,000			70,000

Working Notes : **(1) Calculation of Depreciation**

	Acquired	Original cost	2014	2015	2016
1st Machinery	1.7.2014	3,00,000	30,000	60,000	**40,000
2nd Machinery	1.1.2015	1,00,000		20,000	20,000
3rd Machinery	1.7.2016	50,000			*5,000
TOTAL			30,000	80,000	65,000

* 1/2 year; ** 20% of ₹ 2,00,000 ₹ (3,00,000 – 1,00,000 machinery sold).

(2) Calculation of W.D.V. on 1.7.2016 (without depreciation for 2016)

	₹
Original cost on 1.7.2014 (1/3 of ₹ 3,00,000)	1,00,000
Less: Depreciation for 2014 (1/2 year)	10,000
	90,000
Less: Depreciation for 2015	20,000
	70,000

Alternatively, all adjustments regarding disposal of asset can be done in the Asset Account itself without opening Assets Disposal Account separately. In such a situation, the entries will be as follows :

(a) For current year's depreciation on disposed asset

Depreciation Account Dr.
To Asset Account

(b) For sale proceeds

Bank Account Dr.
To Asset Account

(c) For profit on sale

Asset Account Dr.
To Profit and Loss Account

(d) For loss on sale

Profit and Loss Account Dr.
To Asset Account

For calculating profit or loss on sale, the following points should be remembered :

1. If the sale proceeds is greater than the written down value on the date of disposal, the surplus represents profit.
2. If the sale proceeds is less than the written down value on the date of disposal, the deficit represents loss.

Illustration 5

Bajaj and Co. close their accounts on 31st March every year. They purchased the machineries as follows :

(i) Purchased the machineries costing ₹ 1,20,000 on 1.7.2014.
(ii) On 1.1.2015, some machineries were purchased costing ₹ 1,20,000.
(iii) On 1.10.2015, again purchased some machinery costing ₹ 20,000.
(iv) On 1.1.2016 purchased a new machinery for ₹ 60,000.
(v) One machinery costing ₹ 40,000 which was purchased on 1.7.2009, was sold for ₹ 12,000 on 1.4.2016.
(vi) They charged depreciation @ 33.33% on the written down value method.
(vii) They have the practice to charge depreciation for the full year even if the machinery is used for a part of the year.

Prepare Machinery Account in the books of Bajaj & Co. for the three years—2014-15, 2015-16, 2016-17.

Solution

In the books of Bajaj and Co.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014, July 1	To Bank A/c	1,20,000	2015, Mar. 31	By Depreciation A/c ($33^1/_3$% of ₹ 2,40,000)	80,000
2015, Jan. 1	To Bank A/c	1,20,000	"	By Balance c/d	1,60,000
		2,40,000			2,40,000
2015, Apr. 1	To Balance b/d	1,60,000	2016, Mar. 31	By Depreciation A/c ($33^1/_3$% of ₹ 2,40,000)	80,000
Oct. 1	To Bank A/c	20,000	"	By Balance c/d	1,60,000
2016, Jan. 1	To Bank A/c	60,000			
		2,40,000			2,40,000
2016, Apr. 1	To Balance b/d	1,60,000	2016, Apr 1	By Bank A/c (sold)	12,000
			"	By Profit & Loss A/c (Note 1)	5,778
			2017, Mar. 31	By Depreciation A/c (Note 2)	47,407
			"	By Balance c/d	94,815
		1,60,000			1,60,000

Working Notes :

(1) Calculation of Loss on Sale of Machinery		(2) Depreciation for 2016-17	
Cost of machinery on 1.7.2014	40,000	W.D.V. of machine on 1.4.2016	1,60,000
Less: Depreciation for 2014-15 @ 33-1/3%	13,333	Less: W.D.V. of machine sold on 1.4.2016	17,778
W.D.V. on 1.4.2015	26,667	W.D.V. of machine in use	1,42,222
Less: Depreciation for 2015-16	8,889	Depreciation for 2016-17 @ 33-1/3% of ₹. 1,42,222	47,407
W.D.V. on 1.4.2016	17,778		
Less: Sale value	12,000		
Loss	5,778		

Illustration 6

Kalyani Industries depreciates its machinery at 10% p.a. on straight line basis. On 1st April, 2016 the balance in Machinery Account was ₹ 8,50,000 (original cost ₹ 12,00,000). On 1st July, 2016 a new machine was purchased for ₹ 25,000. On 31st December, 2016 an old machine having written down value of ₹ 40,000 on 1.4.2016 (original cost ₹ 60,000) was sold for ₹ 30,000. Show the Machinery Account for the year ended on 31st March, 2017.

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 April 1	To Balance b/d	8,50,000	2016 Dec. 31	By Bank A/c (sale of old machine)	30,000
July 1	To Bank A/c (new machine)	25,000	"	By Depreciation A/c (Note 2)	4,500
			"	By Profit & Loss A/c (Note 2)	5,500
			2017 Mar. 31	By Depreciation A/c (Note 1)	1,15,875
			"	By Balance c/d	7,19,125
		8,75,000			8,75,000

Working Notes:

(1) Calculation of Depreciation for 2016-17	₹	(2) Calculation of Loss on Sale of Machinery	₹
Opening Balance (original)	12,00,000	Written down value on 1.4.2016	40,000
Less: Original cost of machine sold	60,000	Less: Depreciation (@ 10% p.a. on ₹ 60,000 for 9 months)	4,500
	11,40,000	written down value on 31.12.2016 (Date of sale)	35,500
Depreciation @ 10%p.a. (old machine)	1,14,000	Less: Sale value	30,000
Depreciation for 9 months (new machine)	1,875	**Loss**	5,500
	1,15,875		

Illustration 7

On 1st January, 2013, machinery was purchased by X for ₹ 50,000. On 1st July, 2014, additions were made to the extent of ₹ 10,000. On 1st April, 2015, further additions were made to the extent of ₹ 6,400. On 30th June, 2016, machinery, original value of which was ₹ 8,000 on 1st January, 2013, was sold for ₹ 6,000. Depreciation is charged @ 10% p.a. on original cost.

Show Machinery Account for the years from 2013 to 2016 in the books of X. X closes his books on 31st December.

Solution **In the Books of X**

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

Date	Particulars	₹	Date	Particulars	₹
2013 Jan. 1	To Bank A/c (Purchase)	50,000	2013 Dec.31	By Depreciation A/c	5,000
			"	By Balance c/d	45,000
		50,000			50,000
2014 Jan.1	To Balance b/d	45,000	2014 Dec.31	By Depreciation A/c (Note 1)	5,500
July 1	To Bank A/c (addition)	10,000	"	By Balance c/d	49,500
		55,000			55,000
2015 Jan.1	To Balance b/d	49,500	2015 Dec.31	By Depreciation A/c (Note 1)	6,480
Apr. 1	To Bank A/c (Addition)	6,400	"	By Balance c/d	49,420
		55,900			55,900
2016 Jan.1	To Balance b/d	49,420	2016 June30	By Bank A/c (Sales)	6,000
June 30	To Profit & Loss A/c (Note 2)	800	"	By Depreciation A/c (1/2 year)	400
			2016 Dec.31	By Depreciation A/c (Note 1)	5,840
			"	By Balance c/d	37,980
		50,220			50,220
2017 Jan.1	To Balance b/d	37,980			

Working Notes : (1) Calculation of Depreciation

	₹	₹		₹
For 2013 : On ₹ 50,000 @ 10% p.a. for 1 year		5,000	**(2) Calculation of profit on Sale of Machinery**	
For 2014 : On ₹ 50,000 @ 10% p.a. for 1 year	5,000		Sale Proceeds	6,000
On ₹ 10,000 @ 10% p.a. for 1/2 year	500	5,500	Less: written down value on 30.6.2016	
For 2015 : On ₹ 50,000 @ 10-% p.a. for 1 year	5,000		₹ (8,000 – 2,800)	5,200
On ₹ 10,000 @ 10% p.a. for 1 year	1,000		**Profit on sale**	800
On ₹ 6,400 @ 10% p.a. for 9 months	480	6,480		
For sold out machine : on 8,000 @ 10% p.a. for 6 months		400		
For 2016 : On ₹ 42,000 (50,000 – 8,000) @ 10% p.a. for 1 year	4,200			
On ₹ 10,000 @ 10% p.a. for 1 year	1,000			
On ₹ 6,400 @ 10% p.a. for 1 year	640	5,840		

Illustration 8

X Company Ltd provides depreciation on Plant and Machinery at 20% p.a. on reducing balances. On 1st April, 2007, the balance of the Plant and Machinery Account was ₹ 10,00,000. It was discovered in 2007-08 that :

(i) ₹ 50,000 being repairs to machiney incurred on 30th June, 2005 had been capitalised.

(ii) ₹ 1,00,000 being the cost of a generator purchased on 1st October, 2004 has been written off to Maintenance Account.

The company directors want to rectify the mistakes while finalising the accounts for the year ended 31st March, 2008.

A plant that cost ₹ 80,000 on 30th September, 2006 was scrapped and replaced with a more sophisticated one on 31st December, 2007 by spending ₹ 1,20,000. Scrap realised ₹ 20,000.

Prepare the Plant and Machinery Account as it would appear on 31st March, 2008 after providing depreciation for the year. ***[C.U.B.Com. (Hons.) — 2009]***

Solution

In the books of X Company Ltd.

Dr. Plant Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2007 April 1	To Balance b/d	10,00,000	2007 Dec. 31	By Depreciation A/c (Note 3)	10,800
	To Profit & Loss Adjustment A/c (Note 1&2)	23,600	"	By Bank A/c (Scrap value)	20,000
Dec. 31	To Bank A/c (Purchases)	1,20,000	"	By Profit & Loss A/c (Note 3)	41,200
			2008 Mar. 31	By Depreciation A/c (Note 4)	1,96,320
			"	By Balance c/d	8,75,280
		11,43,600			11,43,600

Working Notes :

(1) Adjustment for Repairs to Machinery wrongly Capitalised on 30th June, 2005 :

	₹
Repairs capitalised on 30.6.2005	50,000
Less: Depreciation for 9 months	7,500
W.D.V. on 1.4.2006	42,500
Depreciation for 2006-07	8,500
W.D.V. on 1.4.2007	34,000

Adjustment entry will be :

Profit and Loss Adjustment Account Dr. 34,000
To Plant and Machinery Account 34,000

(2) Adjustment for Generator wrongly written-off to Maintenance Account :

	₹
Cost of generator on 1st October, 2004	1,00,000
Less: Depreciation for 6 months	10,000
W.D.V. on 1.4.2005	90,000
Less: Depreciation for 2005-06	18,000
W.D.V. on 1.4.2006	72,000
Less: Depreciation for 2006-07	14,400
W.D.V. on 1.4.2007	57,600

Adjustment entry will be :

Plant and Machinery Account Dr. 57,600
To Profit and Loss Adjustment Account 57,600

Net Effect :

The value of plant and machinery will be increased by ₹ 23,600 (₹ 57,600 – 34,000). The same amount will be credited to Profit and Loss Adjustment Account.

	₹
(3) Cost of plant on 30.9.2006	80,000
Less: Depreciation for 6 months	8,000
W.D.V. on 1.4.2007	72,000
Less: Depreciation (1.4.2007 to 31.12.2007)	10,800
	61,200
Less: Scrap value	20,000
Loss on Disposal	41,200

(4) Depreciation for 2007-08

Opening balance (1.4.2007)	10,00,000
Add: Rectification (1.4.2007 — Note 2)	23,.600
	10,23,600
Less: W.D.V. of plant scrap (1.4.2007 — Note 3)	72,000
Total plant in use throughout the year	9,51,600
Depreciation	
(i) 20% on ₹ 9,51,600 for full year	1,90,320
(ii) 20% on ₹ 1,20,000 for 3 months	6,000
	1,96,320

2. *When Provision for Depreciation Account is maintained*

If the asset account is maintained at cost price, on disposal, the original cost of such asset is transferred to Asset Disposal Account and Accumulated Depreciation on such asset is also transferred to this account. The entries are as follows :

(a) For transferring to Assets Disposal Account

Assets Disposal Account Dr. (Original Cost)
To Asset Account

(b) For transferring accumulated depreciation on disposed asset

Accumulated Depreciation Account	Dr.
To Assets Disposal Account	

(c) For charging current year's depreciation on disposed asset

Depreciation Account	Dr.
To Assets Disposal Account	

(d) For sale proceeds

Bank Account	Dr.
To Assets Disposal Account	

(e) For profit

Assets Disposal Account	Dr.
To Profit and Loss Account	

(f) For loss

Profits and Loss Account	Dr.
To Assets Disposal Account	

Illustration 9

Goutam & Co, whose books are closed on 31.12.2014, purchased a machine for ₹ 1,50,000 on 1st January 2014. Additional machinery was acquired for ₹ 50,000 on 1st July 2014.

Certain machinery, which was purchased for ₹ 50,000 on 1st July, 2014 was sold for ₹ 30,000 on 30th June 2016.

Prepare Machinery Account and Accumulated Depreciation Account for all the years upto the year ending 31st December, 2016 taking into account depreciation @ 10% p.a. on straight line method.

And also show Machinery Disposal Account.

Solution

In the Books of Goutam & Co

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan 1	To Bank A/c (Purchase)	1,50,000	2014 Dec.31	By Balance c/d	2,00,000
July 1	To Bank A/c (Purchase)	50,000			
		2,00,000			2,00,000
2015 Jan.1	To Balance b/d	2,00,000	2015 Dec.31	By Balance c/d	2,00,000
2016 Jan.1	To Balance b/d	2,00,000	2016 June 30	By Machinery Disposal A/c (original cost)	50,000
			Dec.31	By Balance c/d	1,50,000
		2,00,000			2,00,000
2017 Jan.1	To Balance b/d	1,50,000			

Dr. Accumulated Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Balance c/d	17,500	2014 Dec.31	By Depreciation A/c	17,500
2015 Dec.31	To Balance c/d	37,500	2015 Jan.1	By Balance b/d	17,500
			Dec.31	By Depreciation A/c	20,000
		37,500			37,500
2016 Jun.30	To Machinery Disposal A/c	7,500	2016 Jan 1	By Balance b/d	37,500
Dec.31	To Balance c/d	45,000	Dec 31	By Depreciation A/c (Note 1)	15,000
		52,500			52,500

Dr. Machinery Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 June 30	To Machinery A/c (original cost)	50,000	2016 June 30	By Accumulated Depreciation A/c	7,500
			"	By Depreciation A/c (Note 2)	2,500
			"	By Bank A/c (Sale)	30,000
			"	By Profit & Loss A/c (Loss)	10,000
		50,000			50,000

Working Note : (1) Calculation of Depreciation		1st	2nd
Acquisition cost		1,50,000	50,000
Date of acquisition		1.1.2014	1.7.2014
Depreciation for 2014 @ 10% p.a.		15,000	2,500*
Depreciation for 2015 @ 10% p.a.		15,000	5,000
Accumulated Depreciation upto 31.12.2015		30,000	7,500
Depreciation for 2016 @ 10% p.a.	* 1/2 year	15,000	2,500*

Illustration 10

At the beginning of the financial year on 1st April, 2016, X Co. Ltd. had a balance on Plant Account of ₹ 18,60,000 and on Provision for Depreciation on Plant Account of ₹ 10,27,000.

On 1st September, 2016 the company sold for ₹ 68,500 some plant which it had acquired on 31st October, 2012 at a cost of ₹ 1,80,000. Additionally, installation costs totalled ₹ 20,000. During 2017 major repairs costing ₹ 31,500 had been carried out on this plant and, in order to increase the capacity of the plant, a new motor had been fitted in December 2017 at a cost of ₹ 22,000. A further overhauling cost of ₹ 13,500 had been carried out during 2015.

The company acquired new replacement plant on 30th November, 2016 at a cost of ₹ 4,80,000, inclusive of installation charges of ₹ 35,000. The company's policy is to provide depreciation using the reducing balance method applied to fixed assets held at the end of the financial year at the rate of 20% p.a.

You are required to show : (i) the balance of plant at cost at 31st March, 2017; (ii) the provision for depreciation of plant at 31st March, 2017; and, (iii) Plant Disposal Account.

Solution

In the books of X Co. Ltd.

Dr. Plant Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 April 1	To Balance b/d	18,60,000	2016 Sept. 1	By Plant Disposal A/c (Note 1)	2,22,000
Nov. 30	To Bank A/c	4,80,000	2017 Mar 31	By Balance c/d	21,18,000
		23,40,000			23,40,000

Dr. Provision for Depreciation of Plant Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Sept.1	To Plant Disposal A/c (Note 2)	1,26,000	2016 April. 1	By Balance b/d	10,27,000
2017 Mar 31	To Balance c/d	11,44,400	2017 Mar 31	By Depreciation A/c (Note 3)	2,43,400
		12,70,400			12,70,400

Dr. Plant Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Sept.1	To Plant A/c (Note 1)	2,22,000	2016 Sept.1	By Provision for Depreciation of Plant A/c	1,26,000
			"	By Bank A/c	68,500
			"	By Loss on Disposal A/c	27,500
		2,22,000			2,22,000

Working Notes :

(1) Original Cost of Plant Sold	₹	**(2) Depreciation on Disposal**	₹	₹
Cost	1,80,000	Cost as on 31.10.2012	1,80,000	
Installation	20,000	Installation on 31.10.2012	20,000	
Upgrade	22,000		2,00,000	
	2,22,000	Less: Depreciation for 2012-13 @ 20%	40,000	40,000
(3) Depreciation for 2016-17	₹		1,60,000	
Original cost of total plant	23,40,000	Less: Depreciation for 2013-2014 @ 20%	32,000	32,000
Less: Original cost plant sold	2,22,000		1,28,000	
Original cost of asset in use	21,18,000	Add: Increase in Capacity (December)	22,000	
Less: Accumulated Depreciation of plant in use			1,50,000	
(₹ 10,27,000 – 1,26,000)	9,01,000	Less: Depreciation for 2014-15 @ 20%	30,000	30,000
W.D.V. of plant in use on 31.3.2017	12,17,000		1,20,000	
Depreciation @ 20%	2,43,400	Less: Depreciation for 2015-16 @ 20%	24,000	24,000
			96,000	1,26,000

Tutorial Note : Major repairs costing ₹ 31,500 in 2014 do not form a part of the cost of this plant and, therefore, it should be charged to the Profit and Loss Account of that period. The overhauling cost in 2015 is also a revenue expense. However, new motor fitted in 2014 will be treated as capital expenditure as it will increase the capacity of the plant.

Change in the Method of Depreciation

The depreciation method applied to an asset should be reviewed ***at least at each financial year end*** and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. ***Such a change should be accounted for as a change in an accounting estimate in accordance with AS—5***.

Change in Accounting Estimates

The use of reasonable estimates is an essential part of the preparation of financial statements. The process of accounting requires estimation in many areas, ***for example***, allowance for doubtful debts, inventory obsolescence or estimated useful lives of fixed assets.

Estimation involves judgments based on the latest available information. Accounting estimates, by their very nature, can rarely be measured with precision. Where circumstances change or new information becomes available the accounting estimate may need to be revised. ***The revision of an estimate does not relate to prior periods and is not the correction of an error***.

The effect of a change in an accounting estimate should be included in the determination of net profits and losses in :

(a) the period of the change, if the change affects that period only (e.g., provision for doubtful debts);
(b) the period of change and future periods, if the change affects both (e.g., change in the estimated life of a fixed asset).

Example : Your company Delhi Transport (P) Ltd. has a fleet of 20 diesel buses which are operating in NCR (National Capital Region) area. New legislation on pollution will ban them for use in NCR, say, from 1st April, 2017, reducing their useful lives. The company will need to accelerate depreciation and review their residual values. This is a revision in estimates and will have no effect on prior periods, but the depreciation of the current year and subsequent years will increase.

Illustration 11

A company purchased machinery for ₹ 20,000 on 1st January, 2013 and followed the diminishing balance method of depreciating the value @ 15%. At the end of 2016, it was decided to follow the fixed instalment system of depreciating the machine. The remaining life of the asset is 3 years and expected residual value is ₹ 3,882. Show the Machinery Account for the period 2013 to 2016.

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan. 1	To Bank A/c	20,000	2013 Dec. 31	By Depreciation A/c	3,000
			"	By Balance c/d	17,000
		20,000			20,000
2014 Jan. 1	To Balance b/d	17,000	2014 Dec. 31	By Depreciation A/c	2,550
			"	By Balance c/d	14,450
		17,000			17,000
2015 Jan. 1	To Balance b/d	14,450	2015 Dec. 31	By Depreciation A/c	2,168
			"	By Balance c/d	12,282
		14,450			14,450
2016 Jan. 1	To Balance b/d	12,282	2016 Dec. 31	By Depreciation A/c (Note 1)	2,800
			"	By Balance c/d	9,482
		12,282			12,282
2017 Jan. 1	To Balance b/d	9,482			

Working Note: (1) :

The written-down value as on 1.1.2016	12,282
Less: Residual value	3,882
Depreciable Value (Revised)	8,400
Life of the asset	3 years

Depreciation p.a. = $\frac{8,400}{3}$ = ₹ **2,800**.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 12

Purchased a machine on 1.1.2014 at a cost of ₹ 2,00,000. The scrap value of the machine was estimated at ₹ 20,000 and its life at 5 years. On 1.1.2015, the machine was sold for ₹ 1,20,000. Another machine of same type was purchased at a cost of ₹ 1,00,000 on that date. The scrap value of the machine was estimated at ₹ 12,000 and its life at 10 years. the installation cost of the first and second machine were ₹ 20,000 and ₹ 4,000 respectively.

Show Machinery Account for the years 2014 and 2015. *[C.U.B.Com. (General) — 2016]*

Solution

In the books of ...

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Bank A/c (Cost)	2,00,000	31.12.2014	By Depreciation A/c	40,000
	To Bank A/c (Installation Cost)	20,000		By Balance c/d	1,80,000
		2,20,000			2,20,000
1.1.2015	To Balance b/d	1,80,000	1.1.2015	By Bank A/c	1,20,000
	To Bank A/c (Cost)	1,00,000		By Loss on Sale of Machinery A/c	60,000
	To Bank A/c (Installation Cost)	4,000	31.12.2015	By Depreciation A/c	9,200
				By Balance c/d	94,800
		2,84,000			2,84,000
1.1.2016	To Balance b/d	94,800			

Working Notes :

(1) Depreciation for 2014	₹	(2) Depreciation for 2015	₹
Cost of Machinery	2,00,000	Cost of Machinery	1,00,000
Add: Installation Cost	20,000	Add: Installation Cost	4,000
	2,20,000		1,04,000
Less: Scrap Value	20,000	Less: Scrap Value	12,000
Depreciable Amount	2,00,000	**Depreciable Amount**	92,000
Depreciation = ₹ 2,00,000 ÷ 5	40,000	Depreciation = ₹ 92,000 ÷ 10	9,200

Illustration 13

On 01.01.2014, the balance of Machinery Account was ₹ 97,200. On 01.07.2014, a new machine was purchased for ₹ 48,000. The installation expenses are ₹ 2,000. On 01.09.2014, an old machine was sold for ₹ 12,000 (the original cost of which was ₹ 20,000 on 01.01.2012). Machinery is depreciated at 10% p.a. under the diminishing balance method.

Show Machinery Account for 2014. The books are closed on 31st December every year.

[C.U.B.Com. (General) — 2015]

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	97,200	1.9.2014	By Depreciation A/c	1,080
1.7.2014	To Bank A/c (₹ 48,000 + ₹ 2,000)	50,000		By Bank A/c	12,000
				By Profit and Loss A/c (Loss on Sale)	3,120
			31.12.2014	By Depreciation A/c (₹ 2,500 + ₹ 8,100)	10,600
				By Balance c/d	1,20,400
		1,47,200			1,47,200

Working Notes : (1) Statement of Depreciation [all figures in ₹]

Date	Particulars	Machinery 1	Machinery 2	Machinery 3	Total Depreciation
1.1.2012	Cost	20,000			
31.12.2012	Less: Depreciation 10%	2,000			
1.1.2013	W.D.V.	18,000			
31.12.2013	Less: Depreciation 10%	1,800			

1.1.2014	W.D.V. (Note 2)	16,200	81,000		
1.7.2014	Cost			50,000	
1.9.2014	Less: Depreciation 10% for 8 months	1,080			
		15,120			1,080
	Selling Price	12,000			
	Loss on Sale	3,120			
31.12.2014	Depreciation 10%		8,100	2,500	10,600
			72,900	47,500	

(2) It has been given in the Question that the balance of Machinery Account on 1.1.2014 was ₹ 97,200. This figure includes the written-down value of the machine acquired on 1.1.2012 at a cost of ₹ 20,000. On 1.1.2014, the W.D.V. of this machine was ₹ 16,200. The remaining machine is in use. The W.D.V. of that machine on 1.1.2014 was ₹ 81,000 (₹ 97,200 – ₹ 16,200).

Illustration 14

On 1st January, 2012, X Ltd. purchased 5 machines each costing ₹ 1,50,000. A sum of ₹ 7,500 was spent on freight and insurance and total installation charges came to ₹ 7,500. On 1st July, 2013, one of the machines was sold for ₹ 1,35,000 and was replaced by another machine at a total cost of ₹ 1,20,000.

The firm closes its books on 31st December each year. It charges depreciation at 15% p.a. on fixed instalment method.

Prepare Machinery Account for the years 2012 and 2013. ***[C.U.B.Com. (General) — 2014]***

Solution **In the books of X Ltd.**

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c (Purchase Cost)	7,50,000	31.12.2012	By Depreciation A/c (Note 1)	1,14,750
	To Bank A/c (Freight and Insurance)	7,500		By Balance c/d	6,50,250
	To Bank A/c (Installation)	7,500			
		7,65,000			7,65,000
1.3.2013	To Balance b/d	6,50,250	1.7.2013	By Depreciation A/c (Note 1)	11,475
1.7.2013	To Profit and Loss A/c (Profit on Sale)	16,425	"	By Bank A/c (Sale of old machine)	1,35,000
	To Bank A/c (Purchase Cost)	1,20,000	31.12.2013	By Depreciation A/c (Note 1)	1,00,800
			"	By Balance c/d	5,39,400
		7,86,675			7,86,675

Working Note : **(1) Statement of Depreciation [Straight Line Method]** [all figures in ₹]

Date	Particulars	4 Machines (Still in use)	1 Machine (Sold out)	New Machine	Total Depreciation
1.1.2012	Original Cost	6,00,000	1,50,000		
	Add: Freight and Insurance	6,000	1,500		
	Add : Installation Charges	6,000	1,500		
	Total Cost	6,12,000	1,53,000		
31.12.2012	Less: Depreciation @ 15%	91,800	22,950		1,14,750
1.1.2013	W.D.V.	5,20,200	1,30,050		
1.7.2013	Less: Depreciation for 6 months @ 15% on ₹ 1,53,000		11,475		11,475
	W.D.V. on 1.7.2013		1,18,575		
	Less: Selling Price		1,35,000		
	Profit on Sale		16,425		
	Cost of new machine purchased on 1.7.2013			1,20,000	
31.12.2013	Less: Depreciation @ 15%	91,800		9,000	1,00,800
		4,28,400		1,11,000	

Illustration 15

ABC Industries depreciates its machines at 10% p.a. on straight line basis. On 1st April, 2010 the balance in Machinery Account was ₹ 17,00,000 (original cost ₹ 24,00,000). On 1st July, 2010 a new machine was purchased for ₹ 50,000. On 31st December, 2010 an old machine having w.d.v. of ₹ 80,000 on 1.4.2010 (original cost ₹ 1,20,000) was sold for ₹ 60,000.

Show the Machinery Account for the year ended 31st March, 2011. ***[C.U.B.Com. (General) — 2011]***

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2010	To Balance b/d (Original Cost ₹ 24,00,000)	17,00,000	31.12.2010	By Depreciation A/c (On Machine Sold) (N-1)	9,000
1.7.2010	To Bank A/c (Cost of new machines)	50,000	"	By Bank A/c (Selling Price)	60,000
			"	By Profit and Loss A/c (Loss on Sale)	11,000
			31.3.2011	By Depreciation A/c (On Balance Machines)	2,31,750
				By Balance c/d (Original Cost ₹ 23,30,000)	14,38,250
		17,50,000			17,50,000

Working Notes :

(1) Profit / Loss on Sale of Machinery as on 31.12.2010

		₹
1.4.2010	W.D.V. of Machine Sold	80,000
31.12.2010	Depreciation for 9 months @ 10% p.a. on Cost (1,20,000 × 10/100 × 9/12) 9,000	
31.12.2010	W.D.V. on Date of Sale	71,000
	Less: Selling Price of machine	60,000
	Loss on Sale	11,000

(2) Depreciation for the year ended 31.3.2011

		₹
(a) On Existing Machine		
	Original Cost of Machine as on 1.4.2010	24,00,000
	Less: Original Cost of Machine sold as on 31.12.2010	1,20,000
	Original Cost of Balance Machine	22,80,000
	Depreciation : ₹ 22,80,000 × 10 / 100	2,28,000
(b) On New Machine ₹ 50,000 × 10 / 100 × 9/12		3,750
	Total	2,31,750

[For Honours Candidates Only]

Illustration 16

Plant and Machinery to the value of ₹ 40,000 was purchased on 1st January, 2011. On 1st July, 2014, the machinery was replaced by a new machine costing ₹ 52,000, the vendor taking the old machine in part exchange at a valuation of ₹ 8,200.

Write up the Plant and Machinery Account for the four years ended 31st December, 2014 providing for depreciation by writing 10% off the diminishing value of the plant and machinery employed at the end of each year.

[C.U.B.Com. (Hons.) — 2015]

Solution

Dr. Plant and Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2011	To Bank A/c (Purchased)	40,000	31.12.2011	By Depreciation A/c (Note 1)	4,000
				By Balance c/d	36,000
		40,000			40,000
1.1.2012	To Balance b/d	36,000	31.12.2012	By Depreciation A/c (Note 2)	3,600
				By Balance c/d	32,400
		36,000			36,000
1.1.2013	To Balance b/d	32,400	31.12.2013	By Depreciation A/c (Note 3)	3,240
				By Balance c/d	29,160
		32.400			32,400
1.1.2014	To Balance b/d	29,160	1.7.2014	By Depreciation A/c (Note 4)	1,458
1.7.2014	To Bank A/c	52,000		By Vendor A/c	8,200
				By Loss on Exchange of Machinery A/c (Note 5)	19,502
			31.12.2014	By Depreciation A/c (Note 4)	2,600
				By Balance c/d	49,400
		81,160			81,160

Dr. Vendor Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Plant and Machinery A/c (Old) (taken over)	8,200	1.7.2014	By Plant and Machinery A/c	52,000
"	To Bank A/c	43,800			
		52,000			52,000

Working Notes :

(1) Depreciation of 2011

10% of ₹ 40,000 for one year — **₹ 4,000**

(1) Depreciation of 2012

10% of (₹ 40,000 – 4,000) for one year — **₹ 3,600**

(1) Depreciation of 2013

10% of (₹ 36,000 – 3,600) for one year — **₹ 3,240**

(1) Depreciation of Old Machinery

10% of (₹ 32,400 – 3,240) for half-year — **₹ 1,458**

(1) Calculation of Loss on Exchange of Old Machine

Book Value as on 1.1.2014	29,160
Less: Depreciation up to the date of sale on 1.7.2014	1,458
	27,702
Less: Exchange Value (agreed)	8,200
	19,502

Illustration 17

On 01.01.2010 Machinery was purchased by Mr. A Dasgupta for ₹ 80,000. On 01.07.2011 additions were made to the extent of ₹ 14,000. On 01.04.2012 further additions of ₹ 8,200 were made.

On 30th June, 2013, machinery, original value of which was ₹ 12,000 on 01.01.2010 was sold for ₹ 10,000. Depreciation is charged at 10% p.a. on original cost.

Show the Machinery Account for the years from 2010 to 2013 in the books of Mr. A Dasgupta who closes his books on 31st December every year. *[C.U.B.Com. (Hons.) — 2014]*

Solution

In the books of Mr A. Dasgupta

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Bank A/c (Cost – M-1)	80,000	31.12.2010	By Depreciation A/c	8,000
				By Balance c/d	72,000
		80,000			80,000
1.1.2011	To Balance c/d	72,000	31.12.2011	By Depreciation A/c	8,700
1.7.2011	To Bank A/c (Cost – M-II)	14,000		By Balance c/d	77,300
		86,000			86,000
1.1.2012	To Balance b/d	77,300	31.12.2012	By Depreciation A/c	10,015
1.4.2012	To Bank (Cost – M-III)	8,200		By Balance c/d	75,485
		85,500			85,500
1.1.2013	To Balance b/d	75,485	30.6.2013	By Depreciation A/c (Sold out machine)	600
30.6.2013	To Profit and Loss A/c (Profit)	2,200		By Bank A/c	10,000
			31.12.2013	By Depreciation A/c	9,020
				By Balance c/d	58,065
		77,685			77,685

Working Notes : **Calculation of Depreciation [Method : Straight Line]**

Date	Particulars	Machine I		Machine II	Machine III	Total Depreciation
		Sold	Retained			
1.1.2010	Cost	12,000	68,000			
31.12.2010	Depreciation @ 10% of original cost	1,200	6,800			8,000
1.1.2011	W.D.V.	10,800	61,200			
1.7.2011	Cost			14,000		
31.12.2011	Depreciation @ 10% of original cost	1,200	6,800	700		8,200
1.1.2012		9,600	54,400	13,300		
1.4.2012	Cost				8,200	
31.12.2012	Depreciation @ 10% of original cost	1,200	6,800	1,400	615	10,015
1.1.2013	W.D.V.	8,400	47,600	11,900	7,585	
30.6.2013	Depreciation @ 10% of original cost for 1/2 year	600				
		7,800				
	Selling Price	10,000				
	Pront on Sale of Machinery	2,200				
31.12.2013	Depreciation @ 10% of original cost		6,800	1,400	820	9,020
1.1.2014	W.D.V.		40,800	10,500	6,765	

1.1.2014 — Balance of Machinery Account, i.e., W.D.V. = (40,800 + 10,500 + 6,765) = ₹ **58,065**.

Special Problems

Illustration 18

Messrs Mill and Wright commenced business on 1st January, 2012, when they purchased plant and equipment for ₹ 7,00,000. They adopted a policy: (i) Charging depreciation at 15% per annum on diminishing balance basis; and (ii) charging full years depreciation on additions. Over the years, their purchases of plant have been ₹

1.8.2013	1,50,000
1.1.2016	2,00,000

On 1.1.2016 it was decided to change the method of depreciation to straight line basis The remaining life and residual value of the Plant and Equipment are as follows :

Date of Purchase	Residual value on 1.1.2016	Remaining life on 1.1.2016	Original Cost
1.1.2012	₹ 5,404	8 years	₹ 7,80,000
1.8.2013	₹ 2,119	9 years	₹ 1,50,000

The useful life of the plant and equipment purchased on 1.1.2016 is 10 years with nil residual value.

You are required to show Plant and Equipment Account for the year 2016.

[C.A. (Entrance) — Adapted] & [C.U.B.Com. (Hons.) — Adapted]

Solution

Working Note : (1) Calculation of Depreciation under Diminishing Balance Basis

Date of Acquisition	1.1.2012	1.8.2013	Total
Original Cost	7,00,000		
Less: Depreciation for 2012	1,05,000		1,05,000
Balance on 1.1.2013 (W.D.V.)	5,95,000		
Original Cost		1,50,000	
Less: Depreciation for 2013	89,250	22,500	1,11,750
Balance on 1.1.2014 (W.D.V.)	5,05,750	1,27,500	
Less: Depreciation for 2014	75,863	19,125	94,988
Balance on 1.1.2015 (W.D.V.)	4,29,887	1,08,375	
Less: Depreciation for 2015	64,483	16,256	80,739
Balance on 1.1.2016	3,65,404	92,119	3,92,477

(2) Calculation of Depreciation of Plant and Equipment for 2016

Date of Acquisition		1.1.2012	1.8.2013	1.1.2016
Written-down Value on 1.1.2016	(₹)	3,65,404	92,119	—
Less: Residual Value	(₹)	5,404	2,119	—
Depreciable Value as on 1.1.2016	(₹)	3,60,000	90,000	2,00,000
Remaining Life of the Plant and Equipment		8 years	9 years	10 years
Depreciation for 2016	(₹)	45,000	10,000	20,000

Dr. Plant and Equipment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d (₹ 3,65,404 + 92,119)	4,57,523	31.12.2016	By Depreciation A/c (45,000 + 10,000 + 20,000)	75,000
1.1.2016	To Bank A/c	2,00,000		By Balance c/d	5,82,523
		6,57,523			6,57,523

Illustration 19

On 1.1.2014, a new plant was purchased by Mrs Kalyani Basu for ₹ 1,00,000 and a further sum of ₹ 5,000 was spent on its installation. On 1.6.2015, another plant was acquired for ₹ 65,000.

On 2.10.2016, the first plant was totally destroyed and the amount of ₹ 2,500 only was realised by selling the scrap. It was not insured. On 20.10.2016, a second hand plant was purchased for ₹ 75,000 and a further sum of ₹ 7,500 was spent on repairs and ₹ 2,500 on its erection. It came into use on 15.11.2016. Depreciation has been provided at 10% on the original cost annually on 31st December. It was the practice to provide depreciation for full year on all acquisitions made at any time during any year and to ignore depreciation on any item sold during the year. The accounts are closed annually on 31st December. In December 2016, it was decided to change the method of depreciation and to follow the rate of 15% on diminishing balance method.

Show Plant Account, Plant Disposal Account and Provision for Depreciation Account for 3 years.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of Mrs Kalyani Basu

Dr. Plant Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Bank A/c (₹ 1,00,000 + 5,000)	1,05,000	2014 Dec.31	By Balance c/d	1,05,000
2015 Jan. 1	To Balance b/d	1,05,000	2015 Dec. 31	By Balance c/d	1,70,000
June 1	To Bank A/c	65,000			
		1,70,000			1,70,000
2016 Jan. 1	To Balance b/d	1,70,000	2016 Oct. 2	By Plant Disposal A/c	1,05,000
Oct. 20	To Bank A/c (Cost)	75,000	Dec. 31	By Balance c/d	1,50,000
"	To Bank A/c (₹ 7,500 + 2,500)	10,000			
		2,55,000			2,55,000
2017 Jan. 1	To Balance b/d	1,50,000			

Dr. Provision for Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	10,500	2014 Dec.31	By Depreciation A/c	10,500
2015 Dec. 31	To Balance c/d	27,500	2015 Jan. 1	By Balance b/d	10,500
			Dec. 31	By Depreciation A/c (10% of ₹ 1,70,000)	17,000
		27,500			27,500
2016 Oct. 2	To Plant Disposal A/c (10,500 + 10,500)	21,000	2016 Dec. 31	By Balance b/d	27,500
Dec. 31	To Balance c/d	28,025	"	By Depreciation A/c (Note 1)	21,525
		49,025			49,025
			2017 Jan. 1	By Balance b/d	28,025

Dr. Plant Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Oct. 2	To Plant A/c	1,05,000	2016 Oct. 2	By Provision for Depreciation A/c	21,000
			"	By Bank A/c	2,500
			Dec. 31	By Profit & Loss A/c (Loss)	81,500
		1,05,000			1,05,000

Working Note : (1) Calculation of Depreciation for 2016

Date of Acquisition	1.6.2015	20.10.2016	Total
Total Cost of Acquisition	65,000	85,000	—
Less: Accumulated Depreciation	6,500	—	—
	58,500	85,000	—
Depreciation @ 15%	8,775	12,750	21,525

Tutorial Note.

(1) When there is a change in the method of depreciation, the change should be treated as a change in the estimate. The change will be reflected in the current year's Profit and Loss Account as well as future year's Profit and Loss Account. There will be no retrospective effect for this change in the depreciation method.

3. Sinking Fund Method or Depreciation Fund Method

A Sinking Fund is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to replace an asset at a set date in the future. This method is based on concept of present values.

The previous two methods made no attempt to generate fund for replacement of asset at the end of its useful life. The sinking fund method not only takes depreciation into account but also makes provision for replacement of the asset. Under this method, a fund is created by debiting Depreciation Account and crediting Sinking Fund Account.

Depreciation Account is ultimately transferred to Profit and Loss Account. An amount equivalent to depreciation charged is invested outside the business in gilt-edged or other securities and are allowed to accumulate at compound interest so as to produce the required amount to replace the asset after a specified period of time. The main advantage of this method is that it avoids strain on working capital, if substantial sums are withdrawn from the business to replace the asset at the end of its life. However, during inflation, the depreciable cost of an asset is likely to be less than the replacement cost of the asset.

The asset is shown in the Balance Sheet, every year, at its original value. Sinking fund is shown on the liabilities side and sinking fund investment is shown on the assets side of the Balance Sheet.

At the end of the useful life of the asset, all investments are sold away. The proceeds are utilised for purchasing the new asset. The Asset Account is closed by setting it off against the Sinking Fund Account. It should be noted that profit or loss on sale of investment is also transferred to the Sinking Fund Account.

The equal amount of cash to be invested each year is ascertained from the sinking fund table.

Journal Entries

A. At the end of the first year

(i) For setting aside the required amount

Depreciation Account Dr.
To Sinking Fund Account

(ii) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
To Depreciation Account

(iii) For investing the amount

Sinking Fund Investment Account Dr.
To Bank Account

B. Second and subsequent years

(i) For interest on investment

(a) Bank Account Dr.
To Interest on Sinking Fund Investment Account
(b) Interest on Sinking fund Investment Account Dr.
To Sinking Fund Account

(ii) For setting aside the amount

Depreciation Account Dr.
To Sinking Fund Account

(iii) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
To Depreciation Account

(iv) For investing (amount of depreciation plus interest)

Sinking Fund Investment Account Dr.
To Bank Account

C. Last Year

(i) For interest on investment

(a) Bank Account Dr.
To Interest on Sinking Fund Investment Account
(b) Interest on Sinking fund Investment Account Dr.
To Sinking Fund Account

(ii) For setting aside the amount

Depreciation Account Dr.
To Sinking Fund Account

In the last year, the amount of depreciation and interest are not re-invested. Instead, all investments are sold.

(iii) For sale of investment

Bank Account Dr.
To Sinking Fund Investment Account

(iv) For transferring profit or loss on sale of investment

(a) For Profit
Sinking Fund Investment Account Dr.
To Sinking Fund Account
(b) For Loss
Sinking Fund Account Dr.
To Sinking Fund Investment Account

(v) For sale of scrap

Bank Account Dr.
To Asset Account

(vi) For closing Sinking Fund Account

Sinking Fund Account Dr.
To Asset Account

(vii) For closing Asset Account

If there is any balance in the asset account, it is transferred to Profit & Loss Account.

Illustration 20

On 1st July, 2011, Wise Ltd purchased a machine for ₹ 1,10,000 and spent ₹ 6,000 on its installation. The expected life of the machine is 4 years at the end of which the estimated scrap value will be ₹ 16,000. Desiring to replace the machine on the expiry of its life, the company establishes a sinking fund. Investments are expected to realize 5% interest. On 30th June, 2017, the machine was sold off as scrap for ₹ 18,000 and the investments were realized at 5% less than the book value. On 1st July, 2017, a new machine is installed at a cost of ₹ 1,25,000. Sinking Fund tables show that ₹ 0.2320 invested each year will produce ₹ 1 at the end of 4 years at 5%.

Show the necessary Ledger Accounts in the books of Wise Ltd for all the years.

Solution

Amount required = ₹ 1,10,000 + 6,000 – 16,000 = ₹ 1,00,000; Therefore, Annual Contribution = ₹ 1,00,000 x 0.232 = ₹ 23,200.

In the Books of Wise Ltd

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2013	To Bank A/c (Cost)	1,10,000	30.6.2014	By Balance c/d	1,16,000
	To Bank A/c (Expenses)	6,000			
		1,16,000			1,16,000
1.7.2014	To Balance b/d	1,16,000	30.6.2015	By Balance c/d	1,16,000
1.7.2015	To Balance b/d	1,16,000	30.6.2016	By Balance c/d	1,16,000
1.7.2016	To Balance b/d	1,16,000	30.6.2017	By Bank A/c (Scrap sold)	18,000
			"	By Sinking Fund A/c	96,343
			"	By Profit & Loss A/c	1,657
		1,16,000			1,16,000
1.7.2017	To Bank A/c (New)	1,25,000			

Dr. **Sinking Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To Balance c/d	23,200	30.6.2014	By Depreciation A/c	23,200
30.6.2015	To Balance c/d	47,560	1.7.2014	By Balance b/d	23,200
			30.6.2015	By Interest on Investment A/c	1,160
			"	By Depreciation A/c	23,200
		47,560			47,560
30.6.2016	To Balance c/d	73,138	1.7.2015	By Balance b/d	47,560
			30.6.2016	By Interest on Investment A/c	2,378
			"	By Depreciation A/c	23,200
		73,138			73,138
30.6.2017	To Sinking Fund Investment A/c	3,657	1.7.2016	By Balance b/d	73,138
	To Machinery A/c	96,343	30.6.2017	By Interest on Investment A/c	3,657
			"	By Depreciation A/c*	23,205
		1,00,000			1,00,000

* An adjustment has been made in the depreciation charged in 2016-17.

Dr. **Sinking Fund Investment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To Bank A/c	23,200	30.6.2014	By Balance c/d	23,200
1.7.2014	To Balance b/d	23,200	30.6.2015	By Balance c/d	47,560
30.6.2015	To Bank A/c (23,200 + 1,160)	24,360			
		47,560			47,560
1.7.2015	To Balance b/d	47,560	30.6.2016	By Balance c/d	73,138
30.6.2016	To Bank A/c (23,200 + 2,378)	25,578			
		73,138			73,138
1.7.2016	To Balance b/d	73,138	30.6.2017	By Bank A/c (Sales)	69,481
			"	By Sinking Fund A/c (Loss on sale)	3,657
		73,138			73,138

Illustration 21

On 1 January, 2001 a company purchased a machine at a cost of ₹ 80,000. In order to provide sufficient fund for replacement of the machine at the end of its working life it decided to create a Sinking fund and to invest the amount in Government Securities bearing interest @ 5% per annum. The working life of the machine was 4 years and estimated scrap value was ₹ 16,000.

The machine became obsolete and was sold at ₹ 30,000 on 31 December, 2003. The Government Securities were sold at a profit of ₹ 3,000. A new machine was purchased on 1 January, 2004 at ₹ 1,20,000. Sinking Fund Table shows that ₹ 0.2320 invested each year will produce ₹ 1 at tne end of 4 years at 5% annual interest.

Prepare Machinery Account, Sinking Fund Account and Sinking Fund Investment Account.

[C.U.B.Com. (Hons.) — 2004]

Solution

Amount required = ₹ 80,000 – ₹ 16,000 = ₹ 64.000. Annual contribution = ₹ 64,000 × 0.232 = ₹ 14,848.

In the Books of ...

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2001	To Bank A/c	80,000	30.12.2001	By Balance c/d	80,000
1.1.2002	To Balance b/d	80,000	30.12.2002	By Balance c/d	80,000
1.1.2003	To Balance b/d	80,000	30.12.2003	By Bank A/c	30,000
			"	By Sinking Fund A/c	49,808
			"	By Profit & Loss A/c (Loss on sale)	192
		80,000			80,000

Dr. **Sinking Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2001	To Balance c/d	14,848	31.12.2001	By Depreciation A/c	14,848
31.12.2002	To Balance c/d	30,438	1.1.2002	By Balance b/d	14,848
				By Interest on Investment A/c	742
			31.12.2002	By Depreciation A/c	14,848
		30,438			30,438

31.12.2003	To Machinery A/c	49,808	1.1.2003 31.12.2003 " "	By Balance b/d By Interest on Investment A/c By Depreciation A/c BySinking Fund Investment A/c (Profit)	30,438 1,572 14,848 3,000
		49,808			49,808

Dr. Sinking Fund Investment Account Cr.

Date01	Particulars	₹	Date	Particulars	₹
31.12.2001	To Bank A/c	14,848	31.12.2001	By Balance c/d	14,848
1.1.2002 31.12.2002	To Balance b/d To Bank A/c (742 + 14,838)	14,848 15,590	31.12.2002	By Balance c/d	30,438
		30,438			30,438
1.1.2003 31.12.2003	To Balance b/d To Sinking Fund A/c (Profit)	30,438 3,000	31.12.2003	By Bank A/c (Sales)	33,438
		33,438			33,438

4. Insurance Policy Method

This is similar to the sinking fund method but, instead of investing the money in securities, the amount is used in paying premium on a policy taken out with an insurance company. The policy should mature immediately after the expiry of the useful life of the asset. The money that is received from the insurance company is used to replace the asset. Though the interest received is lower than could be obtained by investing in securities, the risk of loss on realisation of securities is avoided. To be more conservative, some accountants are of the opinion that the policy account should be adjusted, at the year end, at its surrender value so as to maintain the policy in the Balance Sheet at its net realisable value. Others argue that there is no need to write down the policy to its surrender value, because the policy is for a fixed sum and there is no intention of surrendering it.

Journal Entries:

(a) For yearly depreciation

Depreciation Account Dr. [Insurance premium]
To Depreciation Reserve Fund Account

(b) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
To Depreciation Account

(c) For payment of yearly premium

Depreciation Insurance Policy Account Dr.
To Bank Account

[No entry will be passed in respect of interest which will be earned]

(d) For realisation of Insurance Policy

Bank Account Dr.
To Depreciation Insurance Policy Account

(e) If there is any balance in the Depreciation Insurance Policy Account, it should be transferred to Depreciation Reserve Account. Assuming that the realised amount of policy is greater than the total premia paid, the following entry will be passed:

Depreciation Insurance Policy Account Dr.
To Depreciation Reserve Fund Account

(f) For sale of asset (When the asset becomes worthless)

(i) Bank Account Dr.
To Asset Account
(ii) Depreciation Reserve Fund Account Dr.
To Asset Account

(g) If there is any balance lying in the Asset Account, it should be transferred to Profit and Loss Account to close the Asset Account.

Illustration 22

A company purchased a machinery for ₹ 50,000 on 1.1.2011 and incurred ₹ 10,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 5,000 at the end of its useful life of 4 years.

It was decided to take out an insurance policy to provide necessary funds for the replacement of asset at the end of its useful life. The annual insurance premium for the policy on 1st April every year was ₹ 13,000. The scrap value at the end of the 4th year realised ₹ 5,200.

Prepare Depreciation Reserve Fund Account, Depreciation Insurance Policy Account.

Solution

Dr. Depreciation Reserve Fund Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Balance c/d	13,000	2013 Dec. 31	By Depreciation A/c	13,000
2014 Dec. 31	To Balance c/d	26,000	2014 Jan. 1	By Balance b/d	13,000
			Dec. 31	By Depreciation A/c	13,000
		26,000			26,000
2015 Dec. 31	To Balance c/d	39,000	2015 Jan. 1	By Balance b/d	26,000
			Dec. 31	By Depreciation A/c	13,000
		39,000			39,000
2016 Dec. 31	To Machinery A/c	55,000	2016 Jan. 1	By Balance b/d	39,000
			Dec. 31	By Depreciation A/c	13,000
			"	By Depreciation Insurance Policy A/c (Profit)	3,000
		55,000			55,000

Dr. Depreciation Insurance Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Apr. 31	To Bank A/c	13,000	2013 Dec. 31	By Balance c/d	13,000
2014 Jan. 1	To Balance b/d	13,000	2014 Dec. 31	By Balance c/d	26,000
April 1	To Bank A/c	13,000			
		26,000			26,000
2015 Dec. 31	To Balance b/d	26,000	2015 Dec. 31	By Balance c/d	39,000
April 1	To Bank A/c	13,000			
		39,000			39,000
2016 Jan. 1	To Balance b/d	39,000	2016 Dec. 31	By Bank A/c (Note 1)	55,000
April 1	To Bank A/c	13,000			
	To Depreciation Reserve Fund A/c (Profit)	3,000			
		55,000			55,000

Working Note (1) : Amount of insurance policy required = ₹ 50,000 + ₹ 10,000 – ₹ 5,000 = ₹ 55,000.

5. Sum-of-the-Years' Digits Method

This method assumes that the depreciation charge should be more in the early years of the life of the asset. It allocates approximately two-third of the cost in the first half of the asset's estimated economic life.

Under this method, the depreciation expense is calculated by multiplying the cost by a fraction based on the sum of the number of periods of the useful economic life. The depreciation expense for each year is computed as follows:

(1) To compute the sum of the digits from one through the number of years of the asset's economic life. If n is the estimated years of useful life, the numbers 1,2,3..... n are added. If the estimated useful life of an asset is 5 years, the sum of the years' digit is 1 + 2 + 3 + 4 + 5 = 15.
Taking n as the estimated useful life, the above sum can be computed by the following formula:

$$\text{Sum of years' digits} = \frac{n\ (n+1)}{2} = \frac{5\ (5+1)}{2} = 15.$$

(2) For each year, the depreciation rate is expressed as a fraction in which the denominator is the sum of the digits n (as calculated above) and the numerator of the fraction for each year is determined by

taking the digits in increasing order. Therefore, the numerator for the first year is ‘n’, for the second year it is ‘n-1’, for the third year it is ‘n-2’ and so on. Taking the above example, the denominator is 15 and the numerator of the fraction for the first year is 5, for the second year is 4, for the third year is 3 and so on. The asset will be depreciated 5/15 in the first year, 4/15 in the second year and so on. Therefore, the formula for ascertaining depreciation:

$$\text{Depreciation} = \frac{\textit{Number of years life remaining}}{\textit{Sum of years' digits}} \times (\text{Cost} - \text{Salvage Value})$$

Example : If the cost of a machine is ₹ 5,000 and scrap value after 5 years is ₹ 100, the amount of depreciation to be charged in different years will be as under:

		₹
1st year	5/15 of ₹ 4,900	1,633
2nd year	4/15 of ₹ 4,900	1,307
3rd year	3/15 of ₹ 4,900	980
4th year	2/15 of ₹ 4,900	653
5th year	1/15 of ₹ 4,900	327
		4,900

This method is well known as ‘Rule of 78’, because it is based on the sum of the digits 1 to 12. If the method is used on the monthly intervals and if the digit 1 is assigned to January, and 2 to February, 3 to March and so on up to 12 to December, the sum of the digits for the year becomes: (1+2+3 ... + 12) = 78.

To compute depreciation for a part of the year, the annual depreciation for different years is computed first. When an asset is purchased during the year, the depreciation for one full year will fall in two accounting periods. The depreciation for the first year will be the annual depreciation multiplied by the appropriate fraction representing the portion of the year being considered. For the second and subsequent years, the depreciation will be calculated as: unallocated portion of the previous year’s depreciation will be added to the remaining portion of the current year’s depreciation.

To illustrate, we consider the above example. If the asset is purchased on 1.7.2016 and the accounting year ends on 31st December, each year, the first year of the asset’s life is 1.7.2016 to 30.6.2017. Therefore, depreciation for the first year will be 1/2 of ₹ 1,633 = ₹ 816.50. The depreciation expense for the second year will be half of the first year’s depreciation and half of the second year’s depreciation, i.e. 1/2 of ₹ 1,633 plus 1/2 of ₹ 1,307 = ₹ 816.50 + ₹ 653.50 = ₹ 1,470.

This method can best be applied to assets that provide more service benefits in the earlier years as compared to the later years, e.g. Copying machines and Computers. It is also used in allocating interest charges in hire-purchase, leasing and instalment sale accounting, and for writing off discount on issue of debentures.

6. Annuity Method

The basis of this method is to consider the time value of money and opportunity cost of capital locked up in the asset. When an amount is invested in acquiring an asset, the business has to forego some amount of interest, which could have been earned if the money was instead employed in the purchase of an income producing asset, like securities. Under this method, the total amount of depreciation written off during the life of the asset equals the net cost of the asset plus interest calculated on the reducing balance. The rate of interest (calculated at a fixed rate per cent) is applied to the cost value of the asset and the amount of interest produced added to the asset. Therefore, interest is debited to the asset (on the reducing balance) and credited to the Interest Account. Here, the asset is regarded as providing an annuity (a series of equal periodic payments occuring at equal intervals of time) and the equal amount of depreciation charged in each year is the value of the annuity. Under this system, the annual amount of depreciation is calculated from the annuity table.

This method for deprecaition can only be applied to an asset the life of which will extend to a known period, e.g. a lease. Since the depreciation charge is same and the interest charges decrease each year (because interest is calculated on reducing balance), the net charge for depreciation (depreciation less interest) gradually decreases.

Journal Entries :

1. Asset Account Dr.
   To Interest Account
2. Depreciation Account Dr.
   To Asset Account

Illustration 23

P. Ltd took a lease on 1st January, 2012, costing ₹ 1,00,000 for a period of 5 years. The company decided to amortise the lease by the annuity method, interest at the rate of 5% p.a. being charged. If annuity of ₹ 1 for 5 years at 5% is 0.230975, show Lease Account for the whole period.

Solution Annual instalment = ₹ 1,00,000 x 0.230975 = ₹ 23,097.50.

In the Books of P Ltd

Dr. Lease Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Cash A/c	1,00,000.00	31.12.2012	By Depreciation A/c	23,097.50
31.12.2012	To Interest A/c	5,000.00		By Balance c/d	81,902.50
		1,05,000.00			1,05,000.00
1.1.2013	To Balance b/d	81,902.50	31.12.2013	By Depreciation A/c	23,097.50
31.12.2013	To Interest A/c	4,095.13	"	By Balance c/d	62,900.13
		85,997.63			85,997.63
1.1.2014	To Balance b/d	62,900.13	31.12.2014	By Depreciation A/c	23,097.50
31.12.2014	To Interest A/c	3,145.00	"	By Balance c/d	42,947.63
		66,045.13			66,045.13
1.1.2015	To Balance b/d	42,947.63	31.12.2015	By Depreciation A/c	23,097.50
31.12.2015	To Interest A/c	2,147.38	"	By Balance c/d	21.997.51
		45,095.01			45,095.01
1.1.2016	To Balance b/d	21,997.51	31.12.2016	By Depreciation A/c*	23,097.38
31.12.2016	To Interest A/c	1,099.87			
		23,097.38			23,097.38

(* Note: An adjustment of 12 paise has been made in Depreciation charged on 31.12.2016)

We give below a table showing the amounts of interest and depreciation charged each year and net debit to Profit and Loss Account:

Year	Depreciation (Debited to P/L)	Interest (Credited to P/L)	Net (Debited to P/L)	Remarks
2012	23,097.50	5,000	18,097.50	Note that : Cost of lease and interest is equal to the total depreciation.
2013	23,097.50	4,095.13	19,002.37	
2014	23,097.50	3,145.00	19,952.50	
2015	23,097.50	2,147.38	20,950.12	
2016	23,097.38	1,099.87	21,997.51	
TOTAL	1,15,487.38	15,487.38	1,00,000.00	

7. Revaluation Method

This method is applied for the writing off of a fixed asset to its current market value. To ascertain the real profit for an accounting period, it is necessary to value the assets each year at the end of the period and any decrease in the value as compared with the book value should be charged against profit as depreciation. Since there are many practical difficulties in ascertaining the real value of an asset at any point of time, for obvious reasons, a depreciation method never concerns itself with measuring the value of an asset. It remains as a process of allocation only.

The revaluation method can only be used in the case of assets such as loose, tools, livestock, and the like. Here, the assets are valued at their current market values and the depreciation is calculated by finding out the difference between the written down value and the revaluation figure. We consider the following example:

Opening value of loose tools	₹ 10,000
Manufactured / Purchases of loose tools during the peirod	₹ 3,000
Value of the loose tools at the end of the period	₹ 11,000

Therefore, depreciation for the loose tools is : ₹ 10,000 + ₹ 3,000 – ₹ 11,000 = ₹ 2,000.

If any profit is arising out of revaluation of assets, it should be credited to Revaluation Reserve Account, where it will find a place on the liability side of the Balance Sheet. The revaluation method is a departure from historical cost accounting with regard to the valuation of assets.

The point to note is that, under this method, there is no formal recording of individual asset values. In effect, it is not possible to calculate profit or loss arising on sale of an individual asset.

Illustration 24

A company manufacturers loose tools for its own use. At the end of each year, depreciation is charged on revaluation method. From the following particulars, show the Loose Tools Account :

Year ended 31.12.2013 : Loose tools manufacture ₹ 5,000 (revalued on 31.12.2013 ₹ 4,100)
Year ended 31.12.2014 : Loose tools manufacture ₹ 2,700 (revalued on 31.12.2014 ₹ 5,700)
Year ended 31.12.2015 : Loose tools manufacture ₹ 1,000 (revalued on 31.12.2015 ₹ 6,000)
Year ended 31.12.2016 : Loose tools manufacture ₹ 1,500 (revalued on 31.12.2016 ₹ 5,100)

The value as on 31.12.2016 after considering the sale of old tools at the book value of ₹ 1,200 (as on 31.12.2016) for ₹ 950.

Solution

Dr. **Loose Tools Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Manufacturing A/c	5,000	2013 Dec. 31	By Depreciation A/c	900
			2013 Dec. 31	By Balance c/d	4,100
		5,000			5,000
2014 Jan. 1	To Balance b/d	4,100	2014 Dec. 31	By Depreciation A/c	1,100
Dec. 31	To Manufacturing A/c	2,700	2014 Dec. 31	By Balance c/d	5,700
		6,800			6,800
2015 Jan. 1	To Balance b/d	5,700	2015 Dec. 31	By Depreciation A/c	700
Dec. 31	To Manufacturing A/c	1,000		By Balance c/d	6,000
		6,700			6,7000
2016 Jan. 1	To Balance b/d	6,000	2016 Dec. 31	By Bank A/c	950
Dec. 31	To Manufacturing A/c	1,500	"	By Profit & Loss A/c	250
			"	By Depreciation A/c	1,200
			"	By Balance c/d	5,100
		7,500			7,500

8. Depletion Method

This method is an accounting for natural resources rather than accounting for depreciation. Wasting assets, such as mines, quarries, and the like are examples of such natural resources. The distinguishing feature of these types of assets is that they cannot be depreciated but can gradually be *depleted*. This is because these assets can be physically consumed and converted into inventory. For example, a coal mine can be considered as an underground inventory of coal. But such inventory cannot be considered as one of the current assets.

Therefore, this method is applied to wasting assets such as mines, quarries, and the like where the output for each year depends on the quantity extracted. Here, depreciation is calculated first by making an estimate in advance of the total quantity to be extracted over its life and then the cost of the asset is apportioned over the periods of the asset in proportion to the rate of extraction.

For example, suppose a mine is acquired for ₹ 10,00,000 and it is estimated that 2,50,000 tonnes of coal can be extracted over its life. Therefore, the rate of depreciation per tonne of coal is ₹ 10,00,000/2,50,000 = ₹ 4. If 50,000 tonnes are extracted in a year, then the depreciation for that year will be 50,000 x ₹ 4 = ₹ 2,00,000.

Illustration 25

Bharat Collieries Ltd. acquired a lease right for 25 years of a mine on January 1st, 2011 on a lumpsum payment of ₹ 5,00,000. Estimated coal deposit was 25,00,000 tonnes, 80% of which, it is expected, could be raised within the lease period. The company decided to depreciate the lease under the depletion method. The annual raising were: 2011—40,000 tonnes; 2012—60,000 tonnes; 2013—1,00,000 tonnes; 2014 to 2015—2,00,000 tonnes each year.

Show Lease Account from 1st January 2009 to 31st December, 2016.

Solution

In the Books of Bharat Collieries Ltd.

Dr. Lease Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2011	To Bank A/c	5,00,000	31.12.2011	By Depreciation A/c	10,000
			"	By Balance c/d	4,90,000
		5,00,000			5,00,000
1.1.2012	To Balance b/d	4,90,000	31.12.2012	By Depreciation A/c	15,000
			"	By Balance c/d	4,75,000
		4,90,000			4,90,000
1.1.2013	To Balance b/d	4,75,000	31.12.2013	By Depreciation A/c	25,000
			"	By Balance c/d	4,50,000
		4,75,000			4,75,000
1.1.2014	To Balance b/d	4,50,000	31.12.2014	By Depreciation A/c	50,000
			"	By Balance c/d	4,00,000
		4,50,000			4,50,000
1.1.2015	To Balance b/d	4,00,000	31.12.2015	By Depreciation A/c	50,000
			"	By Balance c/d	3,50,000
		4,00,000			4,00,000
1.1.2016	To Balance b/d	3,50,000	31.12.2016	By Depreciation A/c	50,000
			"	By Balance c/d	3,00,000
		3,50,000			3,50,000
1.1.2017	To Balance b/d	3,00,000			

Depreciation per tonne of coal = ₹ 5,00,000 / 20,00,000 (being 80% of 25,00,000) = ₹ 0.25. Therefore, depreciation for 2011 = 40,000 x 0.25 = ₹ 10,000; similarly for 2012 = ₹ 15,000 and so on.

9. Machine Hour Rate Method

This is a method of providing depreciation on annual machine hours in use compared with total anticipated machine hours over the life of the machine. Here, it is necessary to estimate the total effective working hours (estimated hours less idle time) during the whole life of the machine and to divide this total into the net cost of the machine and thus arriving at an hourly rate of depreciation. For example, a machine costs ₹ 50,000 with an estimated residual value of ₹ 10,000. The expected effective hours during its life is 20,000. The depreciation charge per machine hour would be :

$$Machine\ Hour\ Rate = \frac{Cost\ of\ the\ Machine - Scrap\ Value}{Effective\ Working\ Hours}$$

$$\text{Therefore, depreciation rate per machine hour is } = \frac{50{,}000 - 10{,}000}{20{,}000} = ₹\ 2.$$

Under this method, each period is charged with depreciation to the extent of the use of machine. But this method misses a vital point, i.e. depreciation also takes place even when a machine is not in use.

Illustration 26

Computer 'Meteor-500' is estimated to have effective life of 20,000 hours. The cost of the computer is ₹ 60,000. If the computer has worked for 2,000 hours in 2015 and 3,000 hours in 2016, what will be the depreciation at the end of each year? You are required to show the Computer Account for 2015 and 2016.

Solution

Depreciation per hour = $\frac{60{,}000}{20{,}000}$ = ₹ 3;

Depreciation for 2015 = ₹ 3 x 2,000 = ₹ 6,000;

Depreciation for 2016 = ₹ 3 x 3,000 = ₹ 9,000

Dr. **Computer Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 1	To Bank A/c	60,000	2015 Dec. 31	By Depreciation A/c	6,000
			"	By Balance c/d	54,000
		60,000			60,000
2016 Jan. 1	To Balance b/d	54,000	2016 Dec. 31	By Depreciation A/c	9,000
			"	By Balance c/d	45,000
		54,000			54,000
2017 Jan. 1	To Balance b/d	45,000			

10. Production Units Method

Under this method, depreciation is calculated on the basis of units of output expected to be produced per year. Here, it is necessary to estimate the total output (after considering normal loss of output) during the whole life of the machine. If the output can be predicted reasonably accurately, the above method is likely to result in a fairer allocation of depreciable value of the asset.

The depreciation charge per year would be :

$$\text{Depreciation} = \frac{\text{Cost of the Machine} - \text{Residual Value}}{\text{Total Expected Output of the Machine}} \times \text{Yearly Output}$$

Illustration 27

Woodland Hospital Ltd. purchased an X-ray machine for ₹ 50,00,000 on 1st April, 2017. The expected useful life is 5 years and the residual value is ₹ 5,00,000 (as per buy back agreement with the manufacturer).

Expected Number of X-rays :	Nos.
1st year	1,500
2nd year	2,000
3rd year	2,500
4th year	1,800
5th year	1,200
Total	9,000

You are required to calculate depreciation for 1st and 2nd year.

Solution

$$\text{Depreciation} = \frac{\text{Cost of the Machine} - \text{Residual Value}}{\text{Total Expected Output of the Machine}} \times \text{Yearly Output}$$

$$\text{(i) Depreciation for 1st year} = \frac{50,00,000 - 5,00,000}{9,000} \times 1,500 = \text{₹ } \mathbf{7,50,000}$$

$$\text{(ii) Depreciation for 2nd year} = \frac{50,00,000 - 5,00,000}{9,000} \times 2,000 = \text{₹ } \mathbf{10,00,000}$$

11. Depreciation and Repairs Fund Method

Under this method, total maintenance costs are estimated for the entire life of the asset, and added to its capital cost (less residual value) to get a composite figure, which is divided by the number of years the asset is expected to last. The resultant amount is debited to the Profit and Loss Account and credited to Depreciation and Repairs Fund Account.

The repairs and renewals (etc), incurred are debited to this fund, instead of Profit and Loss account. Practically, it is the best method of equalising the burden on Profit and Loss Account in respect of depreciation and repairs (etc).

The Depreciation and Repairs Fund will be closed at the end of the useful life of the asset, by transferring it to the Asset Account. If there is any balance in the Asset Account, it is transferred to the Profit and Loss Account.

Journal Entries

(a) For setting aside the required sum

Profit and Loss Account Dr.
To Depreciation and Repairs Fund Account

(b) For actual repairs and renewals

Repairs and Renewals Account Dr.
To Cash Account

(c) For closing the Repairing and Renewal Account

Depreciation and Repairs Fund Account Dr.
To Repairing and Renewals Account

(d) For closing Depreciation and Repairs Fund Account (at the end of the life of the asset)

Depreciation and Repairs Fund Account Dr.
To Asset Account

(e) For closing Asset Account

Any balance of the Asset Account will be transferred to Profit and Loss Account and it will close this account.

Illustration 28

A combined provision for depreciation and repairs and renewals was made every year at 15% of the original cost of a machine purchased at ₹ 50,000. The 'Provision for Depreciation and Maintenance Account' that was opened for the purpose was, therefore, debited with the actual costs of repairs and renewals which were as stated below :
1st Year—₹ 1,500; 2nd Year—₹ 1,600; 3rd Year—₹ 2,100; 4th Year—₹ 3,000; 5th Year—₹ 4,200

At the end of the fifth year, the machine was sold out at ₹ 20,000 after utilizing a few of its minor parts valued at ₹ 4,000, in installing in its place a new machine purchased at ₹ 75,000. The resulting loss in the disposal of the old machine was debited to revenue. Write up 'Provision for Depreciation and Maintenance Account' for the five years and the Old and the New Machine Accounts at the end.

Solution

Dr. Provision for Depreciation and Maintenance Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Repairs & Renewals A/c	1,500	1st Year	By Profit & Loss A/c	7,500
	To Balance c/d	6,000			
		7,500			7,500
2nd Year	To Repairs & Renewals A/c	1,600	2nd Year	By Balance b/d	6,000
	To Balance c/d	11,900		By Profit & Loss A/c	7,500
		13,500			13,500
3rd Year	To Repairs & Renewals A/c	2,100	3rd Year	By Balance b/d	11,900
	To Balance c/d	17,300		By Profit & Loss A/c	7,500
		19,400			19,400
4th Year	To Repairs & Renewals A/c	3,000	4th Year	By Balance b/d	17,300
	To Balance c/d	21,800		By Profit & Loss A/c	7,500
		24,800			24,800
5th Year	To Repairs & Renewals A/c	4,200	5th Year	By Balance b/d	21,800
	To Old Machinery A/c (Transfer)	25,100		By Profit & Loss A/c	7,500
		29,300			29,300

Dr. Old Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
5th Year	To Balance b/d	50,000	5th Year	By New Machinery A/c	4,000
				By Bank A/c	20,000
				By Provision for Depreciation & Maintenance A/c	25,100
				By Profit & Loss A/c (loss)	900
		50,000			50,000

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

Date	Particulars	₹	Date	Particulars	₹
5th Year	To Old Machinery A/c	4,000	5th Year	By Balance c/d	79,000
	To Bank A/c	75,000			
		79,000			79,000
6th Year	To Balance b/d	79,000			

Revision of the Estimated Useful Life

The residual value and the useful life of an asset should be reviewed at least at each financial year end and if expectation differs from previous estimates, the change(s) should be accounted for as a change in an ***accounting estimate*** in accordance with AS—5. Where there is a revision of the estimated useful life of an asset and/or residual value, the ***unamortised depreciable amount*** should be charged over the ***revised remaining useful life***.

Illustration 29

On 1.4.2012, ABC Limited purchased plant and machinery worth ₹ 20,00,000, useful life being 8 years. Till the year ended 31.3.2015, the amount of accumulated depreciation on this plant and machinery was ₹ 8,00,000. The remaining useful life of the plant and machinery was reviewed during 2015-16, which was estimated at 2 years due to wear and tear. Calculate the amount of depreciation to be charged from the year 2015-16 onwards.

Solution

Here, in this case, the unamortised depreciable amount is ₹ (20,00,000 – 8,00,000) = ₹ 12,00,000 and the revised remaining useful life is 2 years.

Therefore, the amount of depreciation to be charged from the year 2015-16 onwards is ₹ 12,00,000 / 2 = ₹ 6,00,000 p.a.

Depreciation on Addition or Extention of the Asset

Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset. The depreciation on such addition or extension may also be provided at the rate applied to the existing asset. Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of an estimate of its own useful life.

Example : ACC Ltd. has installed a conveyor belt system for material handling at its 25 years old cement plant. The cost of the entire conveyor belt unit is ₹ 20,00,000 and its useful life is 10 years without any residual value. However, the remaining life of the principal plant is 5 years.
The conveyor belt unit should be recognised as an item of fixed asset separate from principal plant. It will be depreciated over its useful life, i.e., 10 years. However, if the 'conveyor belt' cannot be used separately, its useful life will terminate with the life of the principal plant, i.e., 5 years. The entire amount of ₹ 20,00,000 is to be depreciated in 5 years.

Illustration 30

On 1.4.2014, the value of X Limited's plant and machinery was ₹ 1,000 lakhs. The company provided depreciation @ 15% p.a. under Reducing Balance Method. It was found that about ₹ 150 lakhs of imported asset, which is the component of plant and machinery acquired on 1.4.2014, would be obsolete in 3 years. Accordingly, X Limited wants to write off this asset over 3 years. Can the company do so as per AS–10

Solution

Any addition or extention which becomes an integral part of the existing asset should be depreciated **over the remaining useful life of that asset**.

The depreciation on such addition or extention may also be provided at the rate applied to the existing asset.

Where an addition or extention retains a separate identity and is **capable of being used after the existing asset is disposed of**, depreciation should be provided **independently** on the basis of an estimate of its own useful life.

Therefore, in this case, the company can write off the asset in 3 years, since the asset has independent useful life.

Change in the Historical Cost

Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of ***exchange fluctuations, price adjustments, changes in duties*** or ***similar factors***, the depreciation on the revised unamortised depreciable amount should be provided ***prospectively*** over the residual useful life of the asset.

Illustration 31

ABC Ltd. purchased an imported Printing Machinery from Germany for ₹ 20,00,000 on 1.4.2012. The life of the machine is 10 years without any residual value. The company followed straight line method of depreciation. During 2016-17 due to change in foreign exchange rate the amount of unpaid liability increased by ₹ 3,00,000.

Calculate amount of depreciation to be charged for the year 2016-17 and onwards.

Solution

		₹
Cost of the printing machinery		20,00,000
Less: Depreciation under SLM :		
2012-13	2,00,000	
2013-14	2,00,000	
2014-15	2,00,000	
2015-16	2,00,000	8,00,000
Unamortised depreciable amount on 1.4.2016		12,00,000
Add: Increase in liability for change in foreign exchange		3,00,000
Revised depreciable amount		15,00,000

Depreciation for the year 2016-17 and onwards :

$$\text{Depreciation p.a.} - \frac{15,00,000}{(10 - 4)} = ₹\ 2,50,000.$$

Depreciation of Revalued Assets

Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

Illustration 32

A Ltd acquired a building on 1st January, 1999 at a cost of ₹ 6,40,000. The useful life of the building was estimated as 50 years and depreciation is provided on a straight line basis. The building was revalued on 30th June 2016 for ₹ 16,80,000 and the revaluation incorporated in the accounts. Assuming no change made to the remaining useful life. You are required to calculate : (i) the surplus on revaluation; (ii) depreciation to be charged in the Statement of Profit and Loss of 2016.

Solution

(i) Surplus on Revaluation	₹
Revaluation at 30th June, 2016	16,80,000
Net book value at 30th June, 2016 (Note 1)	4,16,000
Surplus	12,64,000

This surplus of ₹ 12,64,000 should be credited directly to owners' interests under the heading of Revaluation Reserve as per the requirement of AS—10 (Revised) Para 42.

(ii) Depreciation Charged in the Profit and Loss Account of 2016

Here, it should be noted that upto 30.6.2016 depreciation will be calculated on original value and from 1.7.2019 it is to be calculated on revalued value.

		₹
(a) On historical cost (upto 30.6.2016) — $\frac{6,40,000}{50} \times \frac{1}{2}$		6,400
(b) On revalued amount (1.7.2016 to 31.12.2016) — $\frac{16,80,000}{32\frac{1}{2}} \times \frac{1}{2}$		25,846
	Total	32,246

Working Note :

(1) Net Book Value on 30th June, 2016	₹
Original cost on 1.1.1999	6,40,000
Less: Depreciation for 17.5 years (₹ 6,40,000 / 50 × 17.5)	2,24,000
	4,16,000

Is Depreciation a Source of Fund?

A popular misconception, which does create confusion, that depreciation is a source of fund. ***Under no circumstances is depreciation a source of fund***. The accounting for depreciation is an internal transaction (an adjusting entry without involving second parties) to write off the cost of an asset, i.e. a cost already incurred is charged to expense. Generally, a fund requires a connection with an outside agency. Since depreciation is simply a book entry, (a contra asset account) it has no outside connection. Just by passing some book entry, it is not possible for a business to generate a fund. When depreciation is provided, it does not depend upon a cash payment. For this reason, depreciation is regarded as a non-cash expense. As has already been stated, *when an asset is purchased, the payment of many years' depreciation is made in advance*. When the useful life of an asset ends, an even larger cash payment may be required to replace it.

Though depreciation charges neither recover nor create funds, it may affect fund in the following two ways:

First, depreciation charges affect periodic income and, hence may affect managerial decisions in regard to dividend, product pricing or the selection of a new product or machinery.

Second, depreciation charges affect taxable income and, hence affect directly the amount of income tax payable.

Key Points

- ***Depreciation*** is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner.
- The amount of depreciation to be charged for a particular fixed asset will depend upon the following ***three*** factors:
  (i) Cost of the asset
  (ii) Useful life of the asset
  (iii) Residual value of the asset
- The useful life of an asset is its ***service life*** which can be defined as the number of accounting periods during which it will be useful to the business.
- Residual value of asset is the estimated value of a fixed asset at the end of its ***economic life***.
- The change in the method of depreciation must be with retrospective effect.
- The deficiency or surplus of depreciation in respect of past years, should be debited or credited to the Profit and Loss Account of the year of change in the method of depreciation.
- A ***Sinking Fund*** is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to replace an asset at a set date in the future.
- Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset.

THEORETICAL QUESTIONS

1. What is depreciation? What are the various methods of calculating depreciation ?
   Describe one of them fully.
2. What do you understand by the Annuity System of providing depreciation ?
   State the circumstances in which you will employ this system.
3. (a) Briefly discuss two methods of calculating depreciation.
   (b) Which method of charging depreciation would you recommend for the following : Freehold building; Long-term lease?
4. Explain the Sinking Fund Method of charging depreciation.
   For what particular types of assets is this method most suitable?
5. What are the factors to be taken into consideration in selecting a depreciation method ?
6. Is depreciation a source of fund ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. AS—10 deals with depreciation accounting and applies to all depreciable assets, except :
   A assets used for administrative purposes
   B assets used for sales and service
   C wasting assets
2. Depreciable assets are assets which
   A have unlimited useful life, e.g., land
   B have a limited useful life, e.g., furniture
   C are expected to be used not for more than one year
3. Residual value is specifically
   A scrap value
   B the estimated value of a fixed asset at the end of its economic life
   C the estimated value of a fixed asset at the end of its physical life
4. The useful life of an asset is :
   A its service life
   B its physical life
   C none of the above
5. Which of the following statement is **not** correct ?
   A depreciation will vary directly with the useful life of the asset
   B the higher the residual value, the lower will be the depreciation charge
   C the higher the residual value, the higher will be the depreciation
6. Repairs and maintenance costs are :
   A normally capitalised
   B expensed in the profit and loss account as incurred
   C recorded as deferred expenses
7. Which of the following statement is correct in relation to AS—10 ?
   A only straight line method can be adopted for calculation of depreciation
   B only reducing balance method can be adopted for calculation of depreciation
   C both the methods have been specified for calculation of depreciation
8. Which of the following statement is correct in relation to AS—10 ?
   A the change in the method of depreciation should be treated as a change in estimate
   B the change in the method to depreciation should be treated as change in accounting policy but the depreciation should be computed in accordance with the new method from the date of change in the method of depreciation
   C the change in the method of depreciation should be treated as change in accounting policy but the depreciation should be recomputed in accordance with the new method from the date of first use of the asset
9. The cost of a fixed asset should comprise :
   (i) its purchase price
   (ii) any attributable cost of bringing the asset to its working condition for intended use
   (iii) overhead of purchase department relating to the purchase of asset
   Which of the following is correct ?
   A (i) only
   B (i) and (ii) only
   C (i), (ii) and (iii)
10. Depreciation charges for a period are recorded
    A only in the Profit and Loss Account
    B only in the Balance Sheet
    C in the Profit and Loss Account or as part of the Cost of another asset (such as inventory).
11. What is the purpose of charging depreciation in accounts ?
    A to allocate the cost less residual value of a fixed asset over the accounting periods expected to benefit from its use
    B to ensure that funds are available for eventual replacement of the asset
    C to comply with prudence concept

PRACTICAL QUESTIONS

Straight Line / Fixed Instalment Method

1. On 1.1.2015 B purchased a machine for ₹ 1,00,000. Assuming its life to be 10 years and its scrap value for ₹ 20,000 charge depreciation according to Straight Line Method. Show the Machine Account in the ledger upto 31.12.2016.
2. A machine was bought at ₹ 20,000. The scrap value of the machine was estimated to be ₹ 5,000 after 10 years. Show the Machinery Account and the Balance sheet for the first three years charging 10% depreciation.
3. On 1.1.2014 a company purchased a machine for ₹ 1,00,000. It was decided to write off 10% depreciation under Straight Line Method, estimating the life of the machine at 10 years and scrap value at ₹ 10,000. You are required to prepare Machinery Account upto 31.12.2016 and also show the Provision for Depreciation Account for the same period.
4. A firm purchased a machine at a cost of ₹ 2,00,000 and paid import duty of ₹ 80,000. The machine was installed on 1st April, 2014 and installation charges of ₹ 20,000 was paid. The scrap value was estimated at 10% of the cost of machine and estimated life of the machine was fixed at 10 years. They decided to charge depreciation under Straight Line Method. Show Machinery Account and Provision for Depreciation Account for 2014, 2015 and 2016. The firm closes its books on 31st December each year.

Reducing Balance / Diminishing Balance Method

5. A machine was purchased on 1.1.2015 for ₹ 5,00,000. On 1.7.2015 another machine was purchased for ₹ 3,00,000. Depreciation is to be provided @ 10% p.a. under Reducing Balance Method.
   You are required to show : (i) Machinery Account for 2015 and 2016; (ii) Provision for Depreciation Account for 2015 and 2016; (iii) How did the Machinery Account appear in the Balance Sheet at the end of 2016. [Assume that no Provision for Depreciation Account is maintained]
6. A plant is purchased for ₹ 6,00,000 on 1st April, 2013. Some additions to the plant are made on 1st July, 2013 for ₹ 1,00,000. Depreciation on the diminishing Balance Method is to be written off at 10% p.a. in 2011, at 15% p.a. in 2014 and 20% in 2015 and 2016. The books are closed on 31st December each year.
   You are required to show Machinery Account for 2013, 2014, 2015 and 2016.
7. A company maintains its fixed assets at cost. Depreciation provision accounts, one for each type of asset are in use. Machinery is to be depreciated @ 12.5% p.a., and fixtures @ 10% p.a., using the reducing balance method. Depreciation is to be calculated on assets in existence at the end of each year, giving a full year's depreciation even though the asset was bought part of the way through the year.
   The following assets were acquired : 1.1.2015 : Machinery ₹ 64,000; Fixture : ₹ 10,000; 1.7.2015 : Fixtures : ₹ 20,000; 1.10.2016 : Machinery : ₹ 72,000; Fixtures : ₹ 5,000.
   The financial year of the business is ending on 31st December. You are to show : (a) Machine Account; (b) Fixtures Account; (c) Two separate Provision for Depreciation Accounts; (d) Fixed assets section of the Balance Sheet at the end each year for the years ended 31.12.2015 and 31.12.2016.

Addition to and Disposal of Assets

8. On 1.1.2016, balance of Machinery Account was ₹ 48,600. On 1.7.2016, a new machine was purchased for ₹ 24,000, installation cost ₹ 1,000. On 1.9.2016, machinery was sold for ₹ 6,000. The original cost of the machine sold was ₹ 10,000 on 1.1.2014. Machinery is depreciated at 10% p.a. under the diminishing balance method. Show Machinery Account for the year 2016. The books are closed on 31st December every year.
9. A manufacturing concern, whose books are closed on 31st March, purchased a machine for ₹ 1,50,000 on 1st April, 2013. Additional machinery was acquired for ₹ 40,000 on 30th September, 2014 and for ₹ 25,000 on 1st April, 2016. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2014 was sold for ₹ 34,000 on 30th September, 2016.
   Give the Machinery Account for the year ending 31st March, 2017 taking into account depreciation at 10% per annum on the written down value.
10. The following relate to the business of a manufacturer for the year ended 31.12.2016 :
    (a) The debit balance of the Plant and Machinery Account as on 1.1.2016 was ₹ 2,68,400.
    (b) During the year three machines standing in the books at ₹ 12,860 were sold for ₹ 6,000.
    (c) On 1.4.2016, new machines costing ₹ 58,800 were purchased and were installed by the manufacturer's workmen at an expenditure of ₹ 2,160 (i.e. wages ₹ 1,740 and materials ₹ 420).
    (d) It is the practice of the business to write off 15% depreciation on all additions to plant and 20% on all old plants.
    Prepare Plant and Machinery Account as it would appear on 31.12.2016.

11. A firm, writes off 95% of the cost of machinery acquired over a period of 10 years by the straight line method. Full depreciation is written off even if the machinery is in use for part of a year. On 31.12.2015, the original cost of machinery in use was as : Purchased in 2004 or earlier ₹ 57,000; Purchased in 2006 ₹ 1,30,000; Purchased in 2009 ₹ 40,000. On 30.6.2016, a machine which had cost ₹ 10,000 in 2003 was disposed off for ₹ 900 and on 30.9.2016 a machine installed in 2014 at a cost of ₹ 20,000 was destroyed in an accident and ₹ 11,800 was received from the insurance company in settlement of the claim. On the same date, a new machine costing ₹ 25,000 was installed. Show the Machinery Account for the year 2016.
12. The following balances appear in the books of a firm :
January 1, 2016—Machinery Account ₹ 1,00,000; Provision for Depreciation—₹ 45,000.
The depreciation is charged at 10% on straight line method and in terms of firm's accounting policy, acquisitions during the year are depreciated for a full year irrespective of the date of purchase and no depreciation is charged on assets in the year of their disposal.
On June 30, 2016, the following transactions took place :
(a) Sold machinery for ₹ 43,500 which was purchased for ₹ 80,000 on January 1, 2010.
(b) Acquired plant costing ₹ 40,000.
You are required to prepare on December 31, 2016 :
(i) Machinery Account; (ii) Provision for Depreciation Account; and, (iii) Machinery Disposal Account.
13. The Machinery Account of a big rubber factory showed balance of ₹ 1,90,000 on 1st January 2016 : Its accounts were made up on 31st December each year and depreciation is written at 10% p.a. under the Diminishing Balance Method. On 1st June 2016, new machinery was acquired at a cost of ₹ 28,000 and installation charges incurred in erecting the machine worked out to ₹ 892 on the same date. On 1st June 2016 a machine which had cost ₹ 6,000 on 1st January 2014 was sold for ₹ 750, another machine which had cost ₹ 600 on 1st January 2015, was scrapped on the same date and it realised nothing. Write up Plant and Machinery Account for the year 2016, allowing the same rate of Depreciation as in the past calculating depreciation to the nearest multiple of a Rupee.
14. On July 1, 2014, Gopal Ltd. purchased second-hand machinery for ₹ 20,000 and spent ₹ 3,000 on reconditioning and installing it. On January 1, 2015 the firm purchased new machinery worth ₹ 12,000. On June 30, 2016 the machinery purchased on January 1, 2015 was sold for ₹ 8,000. On July 1, 2016, fresh machinery was purchased on instalment basis, payment for this machinery was to be made as follows :
July 1, 2016—₹ 5,000; June 30, 2017—₹ 6,000; June 30, 2016—₹ 5,500.
Payments in 2017 and 2016 include interest ₹ 1,000 and ₹ 500 respectively. The company writes off depreciation @ 10% p.a. on original cost. The accounts are closed every year on 31st March. Show the Machinery Account for three years ending 31st March, 2017.
15. The following details regarding machinery are available from the books of Simco Engineers Limited:
(a) Balance as on 1.4.2016 ₹ 1,00,000 on Machinery Accoiunt.
(b) The opening balance [item (a)] includes ₹ 70,000 worth of machinery bought on 31.3.2016.
(c) Bought new machinery on 1.10.2016 for ₹ 40,000.
(d) Incurred expenses on installation (to be capitalised) ₹ 8,000 on item (c)..
(e) Sold machinery on 1.1.2017 for ₹ 32,000 (its original cost was ₹ 40,000 on 1.10.2011).
(f) Mode of depreciation is Fixed Instalment System @ 10% per annum, bearing in mind the dates of purchase/ sale.
Show the Machinery Account for the year from 1st April 2016 to 31st March, 2017.

Change in the Method of Depreciation with Retrospective Effect

16. Ram Ltd. which depreciates its machinery at 10% p.a. on Diminishing Balance Method had on 1.1.2016, ₹ 9,72,000 on the debit side of Machinery Account. During the year 2016, Machinery purchased on 1.1.2014 for ₹ 80,000 was sold for ₹ 45,000 on 1.7.2016 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000. The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method. The rate of depreciation remains the same as before.
Show Machinery Account.
17. A firm charges depreciation on its plant a machinery on the Straight Line Method at 10%. Machinery was purchased on 1.1.2013. On 1.1.2016, it was decided that the Reducing Balance Method of charging depreciation on plant and machinery should be adopted, the rate of depreciation remaining at 10%. The Plant and Machinery Account stood in the books at ₹ 1,34,000 on 1.1.2016. The following are the particulars regarding purchase and sale of plant during the 3 year period :

2013 : Total depreciation charged ₹ 16,000	
April 1 : Sale of machinery ₹ 24,000 (bought on 1.7.2010) for	₹ 36,000
June 1 : Acquired a new machine at a cost of	₹ 42,000

2014 : Total depreciation charged ₹ 12,000
Feb 10 : Sale of machinery scrap ₹ 1,200 (bought on 1.1.2004) at a cost of ₹ 55,000
2015 : Total depreciation charged ₹ 14,000
Dec. 31 : Depreciation written off for 3 months on new machinery acquired ₹ 1,000

You are required to recast the Plant and Machinery Account and also to show the relevant figures in the Profit and Loss Account for the year ended 31.12.2016.

18. H Ltd. charged depreciation at 10% p.a. on diminishing balances. On 1.1.2015 there was a balance of ₹ 2,43,000 in Machinery Account.
On 1.7.2015 new machine costing ₹ 72,000 was installed. Installation charge amounted to ₹ 3,000.
On 1.7.2015 a machine was sold for ₹ 43,000 the cost of which was ₹ 60,000 as on 1.1.2013. It was decided in 2015 to change the depreciation method from diminishing balance to straight line, keeping the rate of depreciation same as before. Show the Machinery Account in the books of the company for 2015.

Miscellaneous

19.. The machinery account (at cost) of a firm for the three years ended 31.12.2015 appeared as follows :

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Cash A/c (No. 1)	50,000	2013 Dec. 31	By Balance c/d	50,000
2014 Jan. 1	To Balance b/d	50,000	2014 Dec. 31	By Balance c/d	70,000
July 1	To Cash A/c (No. 2)	20,000			
		70,000			70,000
2015 Jan. 1	To Balance b/d	70,000	2015 Dec. 31	By Balance c/d	85,000
July 1	To Cash A/c (No. 3)	15,000			
		85,000			85,000

Depreciation @ 20% on the diminishing balance method was accumulated in Provision for Depreciation Account. On 1.10.2016, machine No. 2 was damaged and had to be replaced by a new machine costing ₹ 25,000. The machine was insured and insurance claim of ₹ 12,400 was admitted by the insurers.
Show the Machinery Account, Provision for Depreciation Account and Machinery Disposal Account for the year 2016. Depreciation during the year is provided for the period for which each machine is in use.

20. A factory possessing different plant and machinery, depreciation on which is provided under 'straight line' method at the rate of 10% p.a. A full year's depreciation is provided at the end of each year on all plant not already completely written off or sold, including any plant purchased during the year. Any profit or loss which may result from sales is transferred to Profit and Loss Account at the end of the year. Accounts are prepared annually to 31st December. The balance standing on the Plant and Machinery Account at 31st December, 2014 after writing off depreciation for that year was ₹ 19,515 and subsidiary records showed that the cost of plant then on hand was made-up as follows: **Items bought** : in 2004 (or earlier) ₹ 5,800; in 2005 ₹ 3,100; in 2006 ₹ 1,700; and in 2007 (or later) ₹ 25,200. During 2015 a new plant was bought at a cost of ₹ 2,950 and one machine which had cost ₹ 550 in 2003 was sold as scrap for ₹ 35. During 2016 there were additions, costing ₹ 1,800 and a machine which had cost ₹ 700 in 2008 was sold for ₹ 350. You are required to write-up Plant and Machinery Account and Plant Disposal Account for 2015 and 2016.

21. A client of the firm of chartered accountants by which you are employed is interested in buying a road transport business from the widow of its deceased owner.
The senior partner of the practice is investigating various aspects of the business and has delegated to you the task of discovering the amount of investment in vehicles at the end of the each financial year ending 30th September 2013 to 2016 inclusive. The business commenced operations on 1st October, 2012. The only information available to you is the fact that the owner calculated deprecaition @ 20% p.a. using the reducing balance method, based on the balance at 30th September each year, and copies of certain Ledger Accounts which are reproduced below :

Dr. Provision for Depreciation of Vehicles Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Sept.30	To Balance c/d	57,600	2013 Oct 1	By Balance b/d	32,000
			2014 Sept. 30	By Profit & Loss A/c	25,600
		57,600			57,600
2015 ?	To Vehicles Disposal A/c	10,800	2014 Oct 1	By Balance b/d	57,600
Sept.30	To Balance c/d	73,440	2015 Sept.30	By Profit & Loss A/c (includes ₹ 10,000 depreciation on 2008 acquisitions)	26,640
		84,240			84,240
2016 Sept.30	To Vehicles Disposal A/c	29,280	2015 Oct 1	By Balance b/d	73,440
"	To Balance c/d	79,328	2016 Sept. 30	By Profit & Loss A/c (includes ₹ 20,000 Depreciation on 2009 acquisitions)	35,168
		1,08,608			1,08,608

Dr. Vehicles Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Sept.30	To Vehicles A/c (Vehicles originally acquired on 1st October, 2003)	30,000	2015 Sept.30	By Prov. for Depreciation of Vehicles A/c	10,800
			"	By Bank A/c	16,000
			"	By Profit & Loss A/c	3,200
		30,000			30,000
2016 Sept.30	To Vehicles A/c (Vehicles originally acquired on 1st October 2003)	60,000	2016 Sept.30	By Prov. for Depreciation of Vehicles A/c	29,280
			"	By Bank A/c	42,000
"	To Profit & Loss A/c	11,280			
		71,280			71,280

You are required to:

(a) calculate the cost of the asset, vehicles, held by the business at 30th September in each of the years 2011 to 2016 inclusive and show Vehicles Account for 2011 to 2016.

(b) show the detailed composition of the charge for depreciation of the vehicles to Profit and Loss Account at 30th September 2014, 2015 and 2016.

Guide to Answers

Multiple Choice

1. C; 2. B; 3. B; 4. A; 5. C; 6. B; 7. C; 8. A; 9. B; 10. C; 11. A.

Practical Questions

1. **Depreciation p.a. ₹ 8,000; Net book value on 31.12.2016 ₹ 60,000.**
2. **Depreciation p.a. ₹ 1,500.**
3. **Depreciation p.a. ₹ 9,000; Net book value as on 31.12.2016 ₹ 73,000.**
4. **Depreciation p.a. ₹ 27,000; Net book value ₹ 2,19,000.**
5. **Depreciation for 2015—₹ 65,000; 2016 ₹ 73,500. Accumulated depreciation ₹ 1,38,500.**
6. **Depreciation (total) : 2011 ₹ 50,000; 2014 ₹ 97,500; 2015 ₹ 1,10,500; 2016 ₹ 88,400; Balance of Machinery Account on 31.12.2016 ₹ 3,53,600.**
7. **Machinery : Depreciation for 2015—₹ 8,000; 2016—₹ 16,000; Accumulated depreciation at the end of 2016—₹ 24,000; Net book value—₹ 1,12,000.**
   Fixtures : Depreciation for 2014—₹ 3,000; 2015—₹ 3,200; Accumulated depreciation at the end of 2015—₹ 6,200; Net book value—₹ 28,800.
8. **Depreciation for 2016—₹ 5,300; W.D.V. — ₹ 60,200; Depreciation on disposed asset — ₹ 540 (for 8 months); Loss on disposal—₹ 1,560.**
   Profit on disposal of asset ₹ 1,510; depreciation on disposed asset ₹ 1,710; Net book value on 31.3.2016 ₹ 1,20,915.
10. **Loss on disposal of asset — ₹ 6,860; depreciation for the year ended on 31st December, 2016 ₹ 60,252 (20% on ₹ 2,55,540 and 15% on ₹ 60,960); Net book value ₹ 2,56,248.**
11. **Book value as on 1.1.2016 ₹ 55,050; Depreciation for the year ₹ 18,525 (₹ 12,350 + 3,800 + 2,375). Profit on disposal of asset on 30.6.2016 — ₹ 400. Profit on machine destroyed in an accident ₹ 3,200. Book value as on 31.12.2016 ₹ 52,425.**
12. **Balance of Machinery Account on 31.12.2016 ₹ 60,000. Accumulated depreciation as on that date ₹ 19,000. Loss on sale of machinery ₹ 4,500.**
13. **Loss on sale of machinery ₹ 2,645; Loss on machinery scrapped ₹ 377. Book value of machinery on 31.12.2016 ₹ 1,94,665.**
14. **Loss on sale of machinery ₹ 3,400; Net book value on 31.3.2017 ₹ 30,550.**
15. **Profit on sale of machinery ₹ 5,000. On 31.3.2017, written down value ₹ 1,08,600.**
16. **Loss on sale of machinery ₹ 16,560.**
18. **Loss on sale of machinery ₹ 3,170.**
19. **Depreciation for 2016 on disposal of machinery — ₹ 2,160. Total depreciation on remaining machineries — ₹ 9,070 (₹ 5,120 + ₹ 2,700 + ₹ 1,250).**
20. **Loss on plant disposal — ₹ 70. Book value of plant sold — ₹ 420. Depreciation for 2015 — ₹ 2,985; 2016 — ₹ 2,925.**
21. **Cost of the assets as on 30.09.2014 — ₹ 1,60,000; 30.09.2015 — 1,80,000; 30.09.2016 — ₹ 2,20,000.**
    Depreciation : 2014 — ₹ 25,600; 2015 — ₹ 26,640; 2016 — ₹ 35,168.

10

Reserves and Provisions

Section 1 : Reserves

Meaning of Reserve

A reserve is an amount of profit set aside until it is needed for some particular purpose. Usually, a reserve account is specifically named to indicate its purpose. The creation of a reserve is the result of an accounting entry and does not set aside cash or other assets of the business. It is merely a part of the net worth. A reserve generally arises from the following :

1. Retention of profits—It is an appropriation of profit, that is an amount set aside from distributable profits.
2. Capital receipts—Profit on sale of a fixed asset or issue of shares at a premium.
3. Upward revaluation of assets—It is the bringing up of assets from historical costs to their current values.

All reserves appear on the liabilities side of the Balance Sheet.

Types of Reserves

Reserves are generally classified into: (a) Capital Reserves and (b) Revenue Reserves.

(a) Capital reserves are those which are not generally distributed as profits. They arise mainly out of the following :

1. Capital receipts, e.g. issue of shares or debentures at a premium.
2. Non-trading incomes during the period prior to incorporation.

Capital reserves may or may not involve any receipts of cash.

(b) Revenue reserves are created by retaining profits. They are usually available for distribution as profits in the future. Examples of revenue reserves are credit balance of the Profit and Loss Account, General Reserve etc. Revenue reserves can further be classified into: (i) General Reserves and (ii) Specific Reserves.

1. *General reserves:* These reserves are not created for any particular purpose. They are created for safeguarding the business against unforeseen losses in the future or with a view to planning for further development of the business.

2. *Specific reserves:* These reserves are created for some specific purpose and are utilised for these purposes only. These reserves are generally earmarked against some particular asset and are expressed as 'reserve fund'. An amount of the reserve created is invested outside the business in securities for a specified period. At the end of that specified period, all investments are sold. The proceeds are utilised for meeting that particular purpose for which the reserve was created.

Meaning of Reserve Fund

Funds are cash or its equivalent. In accounting, the term 'fund' means money invested in assets which can produce income, e.g. securities. It should have a ready market and can easily be converted into cash. Funds also refer to assets for specific purposes, which are not generally available for normal business activities. In fact, a fund sets aside cash or other assets to achieve specific objectives.

Reserves are not usually represented by earmarking assets. If they are, they are expressed as 'reserve fund'. A reserve represented by an earmarked asset is usually cash or marketable securities. For example, if an organisation sets aside profits for building construction, the reserve so created is known as '***Building Funds***'. When an amount equal to the reserve created is invested outside the business in securities, it is known as '***Building Fund Investment***'. A reserve fund is usually created either to replace a fixed asset at the end of its useful life or to repay a liability in the future, e.g. redemption of debentures.

Distinction between Provisions and Reserves

	Provisions		Reserves
1.	A provision is a charge against profit (a debit in the Profit and Loss Account)	1.	A reserve is an appropriation of profit (a debit in the Profit and Loss Appropriation Account).
2.	The creation of provisions has nothing to do with the amount of net profit. In fact,provisions are created in order to assist in the calculation of a correct profit.	2.	The creation of a revenue reserve depends on the amount of profits earned by the business.
3.	Provisions are created for future liabilities and charges or for valuation adjustments of assets.	3.	Reserves are created for safeguarding the business against unforeseen losses or with a view to planning for further development of the business.
4.	Provisions are created for some specific purpose and are utilised for that particular purpose.	4.	Reserves that are created are mostly general,and/or in a few cases, particular (reserve fund).
5.	Provisions cannot be distributed as profits except in cases where the actual liabilities or charges fall short of the amount provided for.	5.	Reserves,other than capital reserves,can be distributed as profits.
6.	Provisions are adjustment entries—they are internal transactions and cause a reduction in the net profit.	6.	Capital reserves may be internal or external transactions—they may reduce the net divisible profits or can cause an increase in that or may not bear any relation with net profit.
7.	Provisions may appear in the liabilities side or in the assets side of the Balance Sheet.	7.	Reserves compulsorily appear in the liabilities side of the Balance Sheet alone.
8.	Provisions are not earmarked against any particular asset.	8.	Reserves may be earmarked against a particular asset (reserve fund).

Distinction Between Capital Reserve and Revenue Reserve

	Capital Reserve		Revenue Reserve
1.	The transaction for a capital reserve may be internal or external.	1.	It is always an internal transaction.
2.	It is always specific.	2.	It can be general or specific.
3.	It is not generally distributed as profits.	3.	It may be distributed as profits.

4.	It may or may not involve any receipts of cash.	4.	It may or may not involve any payment of cash.
5.	It may arise during the period prior to incorporation.	5.	It cannot arise during the period prior to incorporation.
6.	It is not created by retaining profits.	6.	It is created by retaining profits.

Sinking Funds

A sinking fund is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to pay off a debt or for the replacement of an asset at a set date in the future. An amount equivalent to reserve created as sinking fund is invested outside the business in gilt-edged or other securities and are allowed to accumulate at compound interest so as to produce the required amount to repay the liability or to replace the asset after a specified period of time. The main advantage of creating such a fund is that it does away with the strain on working capital, if substantial sums are withdrawn from the business to replace an asset at the end of its life or to repay a liability.

Difference between a sinking fund to replace an asset and sinking fund to repay a liability

The following are the differences between the above two:

(a) In the first case, a sinking fund is created by debiting Depreciation Account and crediting Sinking Fund Account. Depreciation Account is ultimately transferred to the Profit and Loss Account as an expense to be charged against profits. Therefore, the fund that is created is the actual amount of depreciation provided. But under the seconed case, it is an appropriation of profit and is created by debiting Profit and Loss Appropriation Account and crediting Sinking Fund Account.

(b) In the first case, at the end of the useful life of the asset, all investments are sold away and the proceeds are utilised for purchasing the new asset and writing-off the old asset. The profit or loss on sale of investments is transferred to the Sinking Fund Account. But in the second case, sinking fund investments are realised to repay the liabilities and the profit or loss on sinking fund investment is transferred to Reserve Account.

(c) In the first case, creation of sinking fund does not enhance the capital of the business unit, since it is a charge against profits. But in the second case, it is an appropriation of profits and it increases the capital of the business to the extent the liabilities are discharged.

Section 2 : Provisions

Meaning of Provision

A provision is a charge against profit for the purpose of providing for any liability or loss. The anticipated liability or loss is likely or certain to be incurred, but the amount or the date on which they will arise may or may not be ascertained with reasonable accuracy. Therefore, a provision is debited in the Profit and Loss Account to ascertain the ***correct profit***. It is an internal transaction and, therefore, does not involve any payment of cash. If the amount of a known liability or loss can be ascertained with substantial accuracy, it should be treated as a liability and not a provision. A Provision can be created for the following purposes :

1. For liabilities and charges (e.g., provision for taxation, provision for sales tax etc.);
2. Valuation adjustment for fixed assets (e.g., provision for depreciation);
3. Valuation adjustment for current assets (e.g., provision for doubtful debts).

A provision can be ***specific***, e.g. provision against a particular debtor; or ***general,*** e.g. provision expressed as a percentage of total debtors; or a combination of specific and general provisions.

Provisions for liabilities and charges are shown on the liabilities side of the Balance Sheet. But, provisions for valuation adjustment appear on the assets side of the Balance Sheet as a deduction from the assets concerned (e.g. provision for doubtful debts are deducted from sundry debtors or provisions for depreciation are deducted from the asset accounts).

Illustration 1

Which of the following should be 'charged' against profit and which should be 'appropriation' of profit ?

(i) Provision for Doubtful Debts; (ii) Provision for Depreciation; and (iii) General Reserves.

Solution

(i) Provision for Doubtful Debts is a charge against profit.
(ii) Provision for Depreciation is a charge against profit.
(iii) General Reserve is an appropriation of profit.

Illustration 2

Crimson Limited's Profit and Loss Account for the year ended 31.12.2016 includes the following information:

(i) Depreciation ₹ 57,500; (ii) Bad debts written off ₹ 21,300; (iii) Increase in doubtful debts ₹ 18,400; (iv) Proposed dividend ₹ 20,000; (v) Retained profit for the year ₹ 30,800; and (vi) Liability for tax ₹ 5,000.

State which one of the items (i) - (vi) above are —

(i) transfer to provisions; (ii) transfer to reserves; and (iii) neither related to provisions nor reserves.

Solution

(i) Transfer to provision.
(ii) Neither related to provisions nor reserves.
(iii) Transfer to provision.
(iv) Neither related to provisions nor reserves.
(v) Transfer to reserve.
(vi) Transfer to provision.

Accounting for Provision for Bad Debts

At the end of each accounting period, the firm knows that it will suffer a loss due to bad debts in future. An accurate estimate of the apprehended bad debts losses can nevertheless be made, because the firm does not know which debtor will fail to make payment in future. Therefore, the book value of the sundry debtors may not be the actual realizable value. Towards the endeavour of ascertaining the true (or fair) trading profit, a portion of the profit is set aside in a special account called 'Provision for Bad and Doubtful Debts Account,' to adjust the loss of future bad debts which is based on approximations. But, we cannot write off the accounts of the doubtful debtors at once, the value of the sundry debtors cannot be reduced directly. This is so because there may still be a chance of recovery (partly or fully) of the debt. The estimate of doubtful debts (Provision for Bad and Doubtful Debts Account) is shown as a separate figure in the Balance Sheet. The value of the sundry debtors are retained at the *sum due*, but are shown in the Balance Sheet at the *estimated realizable value*.

The following entry is passed for the provision against bad debts:

Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

Dr. Provision for Bad and Doubtful Debts Account Cr.

To Balance c/d		By Profit & Loss A/c	

Though Provision for Bad and Doubtful Debts Account is a credit balance, and should find a place on the liabilities side of the Balance Sheet, it is shown as a deduction from sundry debtors in the assets side (to reflect the net realizable amount at a glance). In the Balance Sheet, the Provision for Bad and Doubtful Debts will appear as follows:

Balance Sheet as at ...

		Sundry Debtors	...	
		Less: Bad Debts*	...	
			...	
		Less : Provision for Bad and Doubtful Debts	...	

***Bad debt occurred after preparation of Trial Balance.**

There are two methods of recording for bad and doubtful debts. Also, the treatment in the first year (when a provision is created for the first time), is different from the treatments of the subsequent years.

First Method

Under this method, a Bad Debts Account is opened and all bad debts are written off to it. A Provision for Doubtful Debts Account is also opened in the very first year. All bad debts are adjusted against this Provision for Doubtful Debts Account in the subsequent years. However, the first year's bad debts is charged to Profit and Loss Account directly.

Journal Entries in the First Year

1. When a provision is created for the first time.
Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

2. For bad debts after Trial Balance :
Bad Debts Account Dr.
To Sundry Debtors Account

3. For writing off bad debts in the Profit and Loss Account
Profit and Loss Account Dr.
To Bad Debts Account (Trial Balance figure and bad debts after Trial Balance)

Journal entries in the Second and Subsequent Years

1. For bad debts after Trial Balance
Bad Debts Account Dr.
To Sundry Debtors Account

2. For writing off bad debts against provision account
Provision for Bad and Doubtful Debts Account Dr.
To Bad Debts Account (Bad debt during the year and after the Trial Balance)

3. For creating necessary provision at the year end
Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

In the second and any subsequent year, we may consider our provision to be too large or too small. the above entry is passed to increase the provision. Conversely, to reduce the provision, we must reserve the entry.

The amount of provision to be created is calculated as under

Closing Provision required*	***
Add: Bad debts written off (total)	***
	***
Less: Provision for bad and doubtful debts at the beginning	***
Amount to be charged to Profit and Loss Account	***

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

Under this method, (excepting in the first year), bad debt account cannot find a place in the Profit and Loss Account, since it is written off against Provision for Bad and Doubtful Debts Account. First we calculate the amount to be provided against doubtful debts and then we ascertain the amount to be charged in the Profit and Loss Account as an expense. Therefore, Profit and Loss Account is debited with the Provision for Bad and Doubtful Debts Account only (instead of Bad Debt Account).

Illustration 3

The outstanding debtors of X at the end of his first year's trading on 31.12.2016 amounted to ₹ 76,800. A review of the debtors list on the same date revealed that there was a long over due of ₹ 1,500 from a debtor, the collection of which was considered doubtful.

You are required to show the relevant journal entries and ledger accounts in the books of X in the following circumstances : (i) if he decides to write off the balance due from the debtor as a bad debt; and (ii) if he decides to make a provision of ₹ 1,500 for the debt.

Solution

In the books of X

(i) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2016	Bad Debt A/c	Dr.		1,500	
Dec. 31	To Sundry Debtors A/c				1,500
	(Being bad debts written off)				
	Profit & Loss A/c	Dr.		1,500	
	To Bad Debt A/c				1,500
	(Being bad debts charged to Profit and Loss Account)				

Dr. Bad Debt Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Sundry Debtors A/c	1,500	2016 Dec. 31	By Profit and Loss A/c	1,500

(ii) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2016	Profit & Loss A/c	Dr.		1,500	
Dec. 31	To Provision for Bad Debts A/c				1,500
	(Being the creation of necessary provision)				

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Balance c/d	1,500	2016 Dec. 31	By Profit and Loss A/c	1,500

Illustration 4

Following are the balances taken from the Trial Balance of a trader as on 31.12.2016 : Provision for bad debts—₹ 5,000; Sundry Debtors—₹ 90,000; Bad Debts—₹ 5,000. You are required to prepare Provision for Bad Debts Account after considering the following : (i) further bad debts to be written off ₹ 10,000; and (ii) a provision for doubtful debts to be created @ 10% on closing debtors.

Solution

In the books of the Trader

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Bad Debts A/c (₹ 5,000 + 10,000)	15,000	2016 Jan. 1	By Balance b/d	5,000
"	To Balance c/d [10% on ₹ (90,000 – 10,000]	8,000	Dec. 31	By Profit and Loss A/c (Balancing figure)	18,000
		23,000			23,000

Tutorial Notes :

(1) Provision for bad debts appearing in the Trial Balance represents opening provisions.

(2) Bad debts are increased by ₹ 10,000 and sundry debtors are decreased by the same amount. Following is the Journal Entry :
Bad Debts Account Dr. ₹ 10,000
To Sundry Debtors Account ₹ 10,000

(3) Bad debts of ₹ 5,000 appearing in the Trial Balance represents bad debts already written off by passing the above Journal Entry for ₹ 5,000. Therefore, closing balance of sundry debtors is ₹ 80,000 (₹ 90,000-10,000).

(4) Assumed accounting year begins on 1st January every year.

Illustration 5

Mr. X, a trader, had incurred a loss of ₹ 3,000 as bad debt during the year 2015, and then decided to create a Provision for Bad and Doubtful Debts at 5% on good debtors amounting to ₹ 50,000 on 31st December, 2015. During the year ended 31st December, 2016, the bad debts loss was ₹ 2016. On 31st December, 2016, his good debtors amounted to ₹ 65,000 and decided to maintain the Provision for Bad and Doubtful Debts at 4%. Pass the necessary Journal entries in the books of Mr. X for the year 2015 and 2016.

Solution

In the books of X

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015	Bad Debt A/c	Dr.		3,000	
?	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt transferred to Profit and Loss Account)				

Dec. 31	Profit & Loss A/c Dr.		2,500	
	To Provision for Bad & Doubtful Debts A/c			2,500
	(Being the creation of necessary provision @ 5% on ₹ 50,000)			
2016	Bad Debt A/c Dr.		2,000	
?	To Sundry Debtors A/c			2,000
	(Being bad debt written off)			
Dec. 31	Provision for Bad & Doubtful Debts A/c Dr.		2,000	
	To Bad Debt A/c			2,000
	(Being bad debt of the period adjusted against the provision for bad & doubtful debts)			
Dec. 31	Profit & Loss A/c Dr.		2,100	
	To Provision for Bad & Doubtful Debts A/c			2,100
	(Being creation of necessary provision)			

Closing provision required (4% of ₹ 65,000)	₹ 2,600
Add: Bad Debt	₹ 2,000
	₹ 4,600
Less: Opening balance of provision	₹ 2,500
	₹ 2,100

Illustration 6

The Balance Sheet of A as on 31.12.2016 included the following items :

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

At the end of the following financial years, the gross amount of Debtors (before deducting a provision) were as under: As on 31.12.2015—₹ 94,000; As on 31.12.2016—₹ 1,02,000.

On each of these years there was a provision for bad debts calculated on the same percentage basis as on 31.12.2015.

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

For the year ended 31.12.2015—₹ 2,600; For the year ended 31.12.2016—₹ 2,300.

You are required to prepare Bad Debts Account and Provision for Bad Debts Account for the years 2015 and 2016.

Solution

In the books of A

Bad Debts Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Dec. 31	To Sundry Debtors A/c	2,600	2015 Dec. 31	By Provision for Bad Debts A/c	2,600
2016 Dec. 31	To Sundry Debtors A/c	2,300	2016 Dec. 31	By Provision for Bad Debts A/c	2,300

Dr. **Provision for Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Dec. 31	To Bad Debts A/c	2,600	2015 Jan. 1	By Balance b/d	2,450
"	To Balance c/d (2.5% on ₹ 94,000)	2,350	Dec. 31	By Profit and Loss A/c	2,500
		4,950			4,950
2016 Dec. 31	To Bad Debts A/c	2,300	2016 Jan. 1	By Balance b/d	2,350
"	To Balance c/d (2.5% on ₹ 1,02,000)	2,550	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,500
		4,850			4,850
			2015 Jan. 1	By Balance b/d	2,550

Percentage of provision to be created = $\left(\frac{2,450}{98,000} \times 100\right) = 2.5\%$.

Illustration 7

The Trial Balance as on 31.12.2016 of Mr. X contains the following items :

(a) Provision for Bad Debts—₹ 12,000; (b) Sundry Debtors—₹ 1,00,000; (c) Bad Debts—₹ 8,000.

On enquiry, it was ascertained that sundry debtors include the following :

(i) ₹ 10,000 due from A (creditors include ₹ 15,000 due to the same party);

(ii) ₹ 5,000 due on account of sale of furniture; and,

(iii) Bad debts ₹ 5,000.

You are required to show Bad Debts Account and Provision for Bad Debts Account. A provision for bad debts @ 2% is to be created on closing debtors.

Solution

In the books of X

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Balance b/d	8,000	2016 Dec. 31	By Provision for Bad Debts A/c	13,000
"	To Sundry Debtors A/c	5,000			
		13,000			13,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Bad Debts A/c ₹ (8,000 + 5,000)	13,000	2016 Jan. 1	By Balance b/d	12,000
	To Balance c/d [2% on ₹ 80,000)*	1,600	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,600
		14,600			14,600

* ₹ 1,00,000 – ₹ 10,000 – ₹ 5,000 – ₹ 5,000 = ₹ 80,000.

Illustration 8

Mr. X started business on 1.1.2014. Following is the information provided for the year ended 31st December:

Year	2014	2015	2016
Credit Sales	50,000	70,000	1,00,000
Received from Debtors	30,000	50,000	50,000
Discount allowed	5,000	7,000	6,000
Returns inward	3,000	2,000	23,000
Bad debts	2,000	6,000	1,000

Provision is to be created for doubtful debts @ 10% on closing debtors. You are required to prepare Sundry Debtors Account, Bad Debts Account and Provision for Bad Debts Account for the years 2014 to 2016.

Solution

In the books of X

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Sales A/c	50,000	2014 Dec. 31	By Bank A/c	30,000
				By Discount Allowed A/c	5,000
				By Returns Inward A/c	3,000
				By Bad Debts A/c	2,000
				By Balance c/d	10,000
		50,000			50,000
2015 Jan. 1	To Balance b/d	10,000	2015 Dec. 31	By Bank A/c	50,000
Dec. 31	To Sales A/c	70,000		By Discount Allowed A/c	7,000
				By Returns Inward A/c	2,000
				By Bad Debts A/c	6,000
				By Balance c/d	15,000
		80,000			80,000
2016 Jan. 1	To Balance b/d	15,000	2016 Dec. 31	By Bank A/c	50,000
Dec. 31	To Sales A/c	1,00,000		By Discount Allowed A/c	6,000
				By Returns Inward A/c	23,000
				By Bad Debts A/c	1,000
				By Balance c/d	35,000
		1,15,000			1,15,000

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Sundry Debtors A/c	2,000	2014 Dec. 31	By Profit and Loss A/c	2,000
2015 Dec. 31	To Sundry Debtors A/c	6,000	2015 Dec. 31	By Provision for Bad Debts A/c	6,000
2016 Dec. 31	To Sundry Debtors A/c	1,000	2016 Dec. 31	By Provision for Bad Debts A/c	1,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d (10% of ₹ 10,000)	1,000	2014 Dec. 31	By Profit and Loss A/c	1,000
2015 Dec. 31	To Bad Debts A/c	6,000	2015 Jan. 1	By Balance b/d	1,000
2015 Dec. 31	To Balance c/d (10% on ₹ 15,000)	1,500	2015 Dec.31	By Profit and Loss A/c (Balancing figure)	6,500
		7,500			7,500

2016 Dec. 31	To Bad Debts A/c	1,000	2016 Jan. 1	By Balance b/d	1,500
2016 Dec. 31	To Balance c/d (10% on ₹ 35,000)	3,500	2016 Dec. 31	By Profit and Loss A/c (Balancing figure)	3,000
		4,500			4,500

Illustration 9

Banik & Co is in business as a distributor of household goods on credit terms to a wide range of customers. The following balances were extracted from their ledger at 31st March, 2016 (all figures in rupees) :

Sales	9,42,520	Returns inwards	30,510
Debtors – Balance at 31.3.2015	98,412	Carriage outwards	5,760
Discount allowed	8,324	Provision for Doubtful debts as at 31.3.2015	6,876
Cash received from debtors	8,76,940		

Subsequent enquiries revealed the following information :

A cheque for ₹ 3,528 from Samar, a customer, had been returned by the bank marked "refer to drawer". Bad debts totalling ₹ 8,536 are to be written-off, and the provision for doubtful debts is to be raised to 10% of debtors balance at 31st March, 2016.

On the last day of the year a cheque is received for ₹ 1,400 from the receiver of Naresh. This customer ceased to trade in January, 2014 when he owed Banik & Co ₹ 7,000 and the debt had been written-off as bad in the year ended 31st March, 2014. No entry in respect of this cheque has yet been made in the books.

Write-up the following accounts for the year ended 31st March, 2016 :

(a) Sundry Debtors Account; (b) Provision for Doubtful Debts Account.

Solution

In the books of Banik & Co

Sundry Debtors Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2016		
Apr. 1	To Balance b/d	98,412	?	By Discount Allowed A/c	8,324
2016			?	By Bank A/c	8,76,940
?	To Sales A/c	9,42,520	?	By Returns Inwards A/c	30,510
Mar. 31	To Bank A/c (Cheque dishonoured)	3,528	?	By Bad Debts A/c	8,536
			Mar. 31	By Balance c/d	1,20,150
		10,44,460			10,44,460

Provision for Doubtful Debts Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
.2016			2015		
Mar. 31	To Bad Debts A/c	8,536	Apr. 1	By Balance b/d	6,876
	To Balance c/d (10% on ₹ 1,20,150)	12,015	2016		
			Mar. 31	By Profit and Loss A/c (Balancing figure)	13,675
		20,551			20,551

Tutorial Notes :

(1) Cheque received from the receiver of Naresh will be credited to Bad Debt Recovery Account. This account will be closed by transferring to Profit and Loss Account.

(2) Carriage outward has nothing to do with Sundry Debtors Account.

Illustration 10

Because of their doubtful nature, Sri A K Sinha instructed his accountants to make a specific provision in the accounts for the year ended 31st December, 2015 against the following debts :

Roy — ₹ 280; Das — ₹ 60; Ghosh — ₹ 240; Saha — ₹ 2,040.

He also instructed that a general provision of 5% for doubtful debts should be created on the other debtors, which at 31st December, 2015 amounted to ₹ 80,000.

No further business transactions were entered into with any of these debtors during the year ended 31st December, 2016 but an amount of ₹ 90 was received from Roy's trustee in bankruptcy by way of a first dividend; a first and final dividend of ₹ 700 was received from the liquidator of Saha and Ghosh paid his debt in full. A further debt of ₹ 950 due from Sarkar proved to be bad.

On 31st December, 2016 Sri A K Sinha instructured his accountants to maintain the provision existing against Das's debt and to provide for the balance due from Roy, and to make further provision for doubtful debts due from Bose ₹ 190 and Ganguli ₹ 150. The other debtors amounted to ₹ 75,000 and the accountants were instructed to make the provision for doubtful debts equal to 5% of these debts.

Prepare Bad Debts Account and Provision for Doubtful Debts Account.

Solution

In the books of Sri A K Sinha

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 31	To Debtors A/c (Note 1)	2,290	Dec. 31	By Provision for Doubtful Debts A/c	2,290
		2,290			2,290

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 31	To Bad Debts A/c	2,290	Jan. 1	By Balance b/d (Note 2)	6,620
"	To Profit and Loss A/c (Balancing figure)	10			
"	To Balance c/d (Note 3)	4,320			
		6,620			6,620

Working Notes :

(1) Bad Debts

	₹
Saha (₹ 2,040 – 700)	1,340
Sarkar	950
	2,290

Illustration 11

Dinesh Goel has an accounting year ending on 31st December. At 31.12.2015, the ledger contained the following balances:

Sundry Debtors ₹ 10,760; Provision for Doubtful Debts ₹ 1,260.

The provision for doubtful debts consists of a general provision of ₹ 500 and specific provision comprising :

A ₹ 320; B ₹ 180; and C ₹ 260.

The following transactions occurred during 2015 :

30th April A was declared bankrupt and a first dividend of ₹ 70 was received from the trustee.

15th June A debt of ₹ 210 due from D that is included in the debtors at 31.12.2015 was found to be bad.

3rd August B paid his debt in full.

7th October C was declared bankrupt and a first and final dividend of ₹ 110 was received from the estate.

The sundry debtors at 31.12.2016 were ₹ 12,610. This figure is after recording all money received but does not take into account any of the above bad debts.

The relevant specific provisions and a general provision for doubtful debts should be maintained at 31.12.2016.

You are required to prepare Bad Debts Account and Provision for Doubtful Debts Account.

Solution

In the books of Dinesh Goel

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Jan. 15	To Sundry Debtors A/c (D)	210	Dec. 31	By Provision for Doubtful Debts A/c	360
Oct. 7	To Sundry Debtors (C — ₹ 260 – 110)	150			
		360			360

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 31	To Bad Debts A/c	360	Jan. 1	By Balance b/d	1,260
"	To Profit and Loss A/c (Balancing figure)	50			
?	To Balance c/d (Note 1)	850			
		1,260			1,260

Working Notes :

(1) Closing Provision

	₹
A (₹ 320 – 70)	250
General [5% of ₹ 12,000 (Note 3)]	600
	850

(2) Percentage of General Opening Provision

$$\frac{500}{10,760 - (320 + 180 + 260)} \times 100 = 5\%$$

(3) General Provision required on Debtors

	₹
Closing balance of Sundry Debtors	12,610
Less: Bad Debts (₹ 210 + ₹ 150)	360
	12,250
Less: Specific Provision for A (₹ 320 – ₹ 70)	250
	12,000

Illustration 12

A trader had incurred a loss of ₹ 2,500 as bad debt during the year 2014 and then decided to create a provision for bad and doubtful debts at 5% on the good debtors amounting to ₹ 75,000 on 31st December, 2014.

During the year ended 31st December, 2015, his debtors worth ₹ 1,500 failed to pay their dues. On 31st December, 2015, his good debtors amounted to ₹ 40,000 and he decided to maintain the provision for bad and doubtful debts at 4% on Debtors. During 2016 his bad debts amounted to ₹ 3,000. He decided to increase the Provision for Bad and Doubtful Debts to 5% on good debtors, which amounted to ₹ 80,000 on 31st December, 2016.

Pass necessary Journal entries and show the Bad Debt Account Provision for Bad and Doubtful Debts Account and also appropriate entries in the Profit and Loss Account and Balance Sheet of 2014, 2015 and 2016.

Solution **Journal** **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
2014	Bad Debt A/c	Dr.		2,500	
?	To Sundry Debtors A/c				2,500
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		2,500	
	To Bad Debt A/c				2,500
	(Being bad debt charged to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		3,750	
	To Provision for Bad & Doubtfuls Debts A/c				3,750
	(Being the creation of provision for bad & doubtful debts @ 5% on ₹ 75,000)				
2015	Bad Debt A/c	Dr.		1,500	
?	To Sundry Debtors A/c				1,500
	(Being bad debt written off)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		1,500	
	To Bad Debt A/c				1,500
	(Being bad debt loss transferred to provision for bad & doubtful debts account)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		650	
	To Profit & Loss A/c				650
	(Being the excess provision credited to Profit and Loss Account)				
2016	Bad Debt A/c	Dr.		3,000	
?	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt loss transferred to Provision for Bad & Doubtful Debts Account)				
Dec. 31	Profit & Loss A/c	Dr.		5,400	
	To Provision for Bad & Doubtful debts A/c				5,400
	(Being the creation of necessary provision for doubtful debts)				

Dr. **Bad Debt Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Sundry Debtors A/c	2,500	2014 Dec. 31	By P&L A/c	2,500
2015 ?	To Sundry Debtors A/c	1,500	2015 Dec. 31	By Provision for Bad & Doubtful Debts A/c	1,500
2016 ?	To Sundry Debtors A/c	3,000	2016 Dec. 31	By Provision for Bad & Doubtful Debts A/c	3,000

Dr. **Provision for Bad & Doubtful Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Balance c/d	3,750	2014 Dec.31	By P & L A/c	3,750
2015 Dec.31	To Bad Debt A/c	1,500	2015 Jan.1	By Balance b/d	3,750
"	To P & L A/c	650			
"	To Balance c/d	1,600			
		3,750			3,750
2016 Dec.31	To Bad Debt A/c	3,000	2016 Jan.1	By Balance b/d	1,600
"	To Balance c/d	4,000	2016 Dec.31	By P & L A/c	5,400
		7,000			7,000
			2017 Jan. 1	By Balance c/d	4,000

Dr. **P & L Account for the year ended on 31st December, 2014 (includes)** **Cr.**

To Bad Debt A/c	2,500		
To Provision for Bad & Doubtful Debts A/c	3,750		

Dr. **P & L Account for the year ended on 31st December, 2015 (includes)** **Cr.**

		By Provision for Bad & Doubtful Debts A/c	650

Dr. **P & L Account for the year ended on 31st December, 2016 (includes)** **Cr.**

To Provision for Bad & Doubtful Debts A/c	5,400		

Balance Sheet as at 31st December, 2014 (includes)

		Sundry Debtors	₹ 75,000	
		Less: Prov. for Bad & Doubtful Debts @ 5%	₹ 3,750	71,250

Balance Sheet as at 31st December, 2015 (includes)

		Sundry Debtors	₹ 40,000	
		Less: Prov. for Bad & Doubtful Debts @ 4%	₹ 1,600	38,400

Balance Sheet as at 31st December, 2016 (includes)

		Sundry Debtors	₹ 80,000	
		Less: Prov. for Bad & Doubtful Debts @ 5%	₹ 4,000	76,000

Second Method

Under this method, a Bad Debts Account is opened and all bad debts are written off to it. At the end of each year, Bad Debts Account is closed by transferring to Profit and Loss Account. In the first year, a provision is created by debiting the Profit and Loss Account and it is carried to the next period. The amount of provision needed at the end of each subsequent year is established and necessary adjustment made to the balance on the Provision Account.

Journal Entries in the First Year

1. For the bad debts of the period for which no entry has been made

Bad Debts Account Dr.
    To Sundry Debtors Account

2. For writing off bad debts in the Profit and Loss Account

Profit and Loss Account Dr.
    To Bad Debts Account

3. When provision is created for the first time

Profit and Loss Account Dr.
    To Provision for Bad and Doubtful Debts Account

The total charge to the Profit and Loss Account for the first year is thus the sum of the bad debts written off and the amount transferred to the Provision for Bad and Doubtful Debts Account.

Journal Entries in the Second and Subsequent Years

1. For the bad debts of the period for which no entry has been made

Bad Debts Account Dr.
To Sundry Debtors Account

2. For writing off bad debts in the Profit and Loss Account

Profit and Loss Account Dr.
To Bad Debts Account

3. For creating provision at the year end

(a) (Closing provision > Opening provision)

Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

(b) (Closing provision < Opening Balance)

Provision for Bad and Doubtful Debts Account Dr.
To Profit and Loss Account

Unlike the first, this method shows the bad debts as well as provision for bad and doubtful debts in the Profit and Loss Account since the bad debts are not adjusted against the Provision for Bad and Doubtful Debts Account.

The Provision for Bad and Doubtful Debts Account is often labelled as Reserve for Bad and Doubtful Debts Account . This is wrong and causes confusion. The reserve is an appropriation of profit, a sum of money set aside from distributable profits after the profits have been calculated whereas a provision is a charge against profit (appears with Profit and Loss Account to assist in the calculation of a correct profit). The Provision for Bad and Doubtful Debts Account is purely in the nature of a suspended credit against doubtful customers.

Illustration 13

The figure of sundry debtors in a Trial Balance is ₹ 90,000. You are asked to write off ₹ 5,000 as bad debts and make a provision for doubtful debts @ 5% on sundry debtors. Pass the necessary Journal Entries and prepare the Ledger Accounts.

Solution

In the books of ...

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bad Debt A/c	Dr.		5,000	
	To Sundry Debtors A/c				5,000
	(Being bad debt written off)				
?	Profit & Loss A/c	Dr.		5,000	
	To Bad Debt A/c				5,000
	(Being bad debt transferred to P & L Account)				
?	Profit & Loss A/c	Dr.		4,250	
	To Provision for Bad & Doubtful Debts A/c (Note 1)				4,250
	(Being the creation of necessary provision)				

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Sundry Debtors A/c	5,000	?	By Profit and Loss A/c	5,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Balance c/d	4,250	?	By Profit and Loss A/c	4,250

Working Note : (1) Provision for bad debts is to be calculated after writing off bad debts of ₹ 5,000 for sundry debtors of ₹ 90,000. Therefore, the amount of provision will be 5% of (₹ 90,000 – ₹ 5,000) = ₹ 4,250.

Illustration 14

Mr. X, a trader, had incurred a loss of ₹ 3,000 as bad debt during the year 2015, and then decided to create a Provision for Bad and Doubtful Debts at 5% on good debtors amounting to ₹ 50,000 on 31st December, 2015. During the year ended

31st December, 2016, the bad debts loss was ₹ 2016. On 31st December 2016 his good debtors amounted to ₹ 65,000 and decided to maintain the Provision for Bad and Doubtful Debts at 4%.

Pass the necessary Journal entries in the books of Mr. X for the year 2015 and 2016.

Solution

In the books of X
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015	Bad Debt A/c	Dr.		3,000	
?	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt transferred to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		2,500	
	To Provision for Bad & Doubtful Debts A/c				2,500
	(Being the necessary provision created)				
2016	Bad Debt A/c	Dr.		2,000	
?	To Sundry Debtors A/c				
	(Being bad debt written off)				2,000
Dec. 31	Profit & Loss A/c	Dr.		2,000	
	To Bad Debt A/c				2,000
	(Being the bad debt transferred to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		100	
	To Provision for Bad & Doubtful Debts A/c				100
	(Being necessary provision created - ₹ 2,600 – 2,500)				

Illustration 15

You are given the following balances on 1st January, 2015 : Debtors—₹ 10,000; Provision for doubtful debts ₹ 400. You ascertain the following information :

Sales for the year 2015 (all on credit) : ₹ 1,00,000; Sales returns for the year 2015—₹ 1,000; Collection from debtors during 2015—₹ 90,000; Bad debt written off during 2015—₹ 500; Discount allowed during 2015—₹ 400.

At the end of 2015 the provision for doubtful debts is required to be 5% of debtors, after making a specific provision for a debt of ₹ 200 from a customer who has been declared bankrupt.

Sales for the year 2016 (90% on credit)—₹ 1,00,000; Sales returns for the year 2016 (90% relating to credit customers) —₹ 2,000; Collection from debtors during 2016—₹ 95,000; Debtors balances settled by contra against creditors balances during 2016—₹ 3,000; Bad debts written off during 2016 (including 50% of the debt due from the customer who had gone bankrupt), other 50% having been received in cash during 2016—₹ 1,500; Discount allowed during 2016—₹ 500. At the end of 2016, the provision for doubtful debts is still required to be 5% of debtors. You are required to write up the Sundry Debtors Account and the Provision for Doubtful Debts Account for the year 2015 and 2016.

Solution

Dr. Sundry Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Jan.1	To Balance b/d	10,000	2015 ?	By Returns Inward A/c	1,000
Dec. 31	To Sales A/c	1,00,000	?	By Cash A/c	90,000
			?	By Bad Debts A/c	500
			?	By Discount Allowed A/c	400
			Dec. 31	By Balance c/d	18,100
		1,10,000			1,10,000
2016 Jan. 1	To Balance b/d	18,100	2016 ?	By Returns Inward A/c	1,800
Dec. 31	To Sales A/c	90,000	?	By Cash A/c	95,000
			?	By Sundry Creditors A/c	3,000
			?	By Bad Debts A/c	1,500
			?	By Discount Allowed A/c	500
			Dec. 31	By Balance c/d	6,300
		1,08,100			1,08,100

Dr. **Provision for Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Dec. 31	To Balance c/d (Note 1)	1,095	2015 Jan.1	By Balance b/d	400
			Dec. 31	By Profit and Loss A/c	695
		1,095			1,095
2016 Dec. 31	To Profit and Loss A/c	780	2016 Jan. 1	By Balance b/d	1,095
"	To Balance c/d (Note 2)	315			
		1,095			1,095

Working Notes :

(1) On 31st December 2015, the balance of Sundry Debtors is ₹ 18,100. This amount includes ₹ 200 due from a debtor who has been declared bankrupt. Therefore, provision for doubtful debts is to be created 100% on ₹ 200 and 5% on ₹ (18,100 – 200). Total provision on 31st December 2015 = ₹ 200 + ₹ 895 = ₹ 1,095.

(2) On 31st December 2016, the balance of Sundry Debtor is ₹ 6,300. It does not include any balance due from bankrupt debtor. Therefore, provision is to be created @ 5% on ₹ 6,300, which is equal to ₹ 315.

Provision for Discount on Debtors

In a sales transaction, payment is made either at the point of sale or after a specified period of time. Since many sellers offer a cash discount (sales discount), if payment is made within a specified period of time, cash discounts allowed are conveniently treated as an expense of the period. The book value of the debtors may not be the net realizable value. Like Provision for Bad and Doubtful Debts, it is desirable to reduce the debtors figure by the amount of probable cash discount to be allowed. This is because, customers are always debited with the full amount invoiced at the time of sale, but credited with the discount when they earn it.

The difficulties, however, are that nobody knows how many debtors will take the opportunity of cash discount and, hence, discounts allowed to debtors are less predictive. (Here, we must mention that if the cash discount is not more than or equal to the opportunity cost of liquid fund, a majority of the debtors may not avail cash discount.) Therefore, all that is possible is to make a rough estimate based on a percentage of outstanding debtors. A separate 'Provision for Discount on Debtors Account' is opened, which is very similar to Provision for Bad and Doubtful Debts Account. The only difference is that provision for discount is calculated on the debtors' balance after deducting the Provision for Bad and Doubtful Debts. Like Provision for Bad and Doubtful Debts it is also shown in the Balance Sheet as a deduction from Sundry Debtors. Like the treatment of Bad Debts, the accounting treatment of Provision for Discount on Debtors allowed in the first year is different from the treatment in the 2nd and subsequent years.

Accounting Entries in the First Year

1. *When discount is allowed to debtors*

Discount Allowed Account Dr.
  To Sundry Debtors Account

---

2. *For closing the discount allowed account against Profit and Loss Account*

Profit and Loss Account Dr.
  To Discount Allowed Account

---

3. *When Provision is created for the first time*

Profit and Loss Account Dr.
  To Provision for Discount on Debtors Account*

This figure will be calculated by applying a percentage on Sundry Debtors after adjusting bad debts (after Trial Balance) and Provision for Bad and Doubtful Debts (new).

Accounting Entries in the Second and Subsequent Years

1. *When discount is allowed*

Discount Allowed Account Dr.
  To Sundry Debtors Account

---

2. *At the end of the accounting year the discount account is closed by passing the following entry:*

Provision for Discount on Debtors Account Dr.
  To Discount Allowed Account

3. The balance left in the Provision for Discount on Debtors Account at the end of a period is adjusted with the provision required to be made for next financial year and accounting entry to be passed according to situation.

(i) If the required provision is more than the balance left:
Profit and Loss Account Dr.
To Provision for Discount on Debtors Account*
(ii) If the required provision is less than the balance left:
Provision for Discount on Debtors Account Dr.
To Profit and Loss Account

*This figure will be calculated as follows:

Closing Provision required	***
Add: Discount allowed during the period	***
	***
Less: Opening Provision	***
Amount to be provided	***

The Bad Debts (after Trial Balance), Provision for Bad and Doubtful Debts and Provision for Discount on Debtors together will appear in the Balance Sheet as follows:

Balance Sheet As At ...

		Sundry Debtors	. . .	
		Less: Bad Debts	. . .	
		Less: Provision for Bad & Doubtful Debts	. . .	
		Less : Provision for Discount on Debtors	. . .	....

Illustration 16

The Sundry Debtors at 31.12.2016 were ₹ 10,000. A provision for bad debts @ 4% was made and also a provision for discount on debtors @ 5% was required. The discount allowed during the year amounted to ₹ 400. The business was commenced on 1.1.2016. Pass Journal Entries; and prepare Discount Allowed Account, Provision for Bad Debts Account and Provision for Discount on Debtors Account. Also, show how they appear in the Profit and Loss Account and in the Balance Sheet.

Solution

In the books of ...

Journal **Dr. Cr.**

Date	Particulars	L.F.	₹	₹
2016 Dec. 31	Discount Allowed A/c Dr.		400	
	To Sundry Debtors A/c			400
	(Being discount allowed on debtors)			
?	Profit and Loss A/c Dr.		400	
	To Discount Allowed A/c			400
	(Being the discount allowed transferred to Profit and Loss Account)			
?	Profit and Loss A/c Dr.		400	
	To Provision for Bad Debts A/c			400
	(Being the provision for bad debts @ 4% on ₹ 10,000)			
?	Profit and Loss A/c Dr.		480	
	To Provision for Discount on Debtors A/c			480
	(Being the provision for discount on debtors created @ 5% on ₹ 9,600)			

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Sundry Debtors A/c	400	2016 Dec.31	By Profit and Loss A/c	400

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Balance c/d	400	2016 Dec.31	By Profit and Loss A/c	400

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Balance c/d	480	2016 Dec.31	By Profit and Loss A/c	480

Dr. **Profit and Loss Account for the year ended 31st December, 2016 (includes)** **Cr.**

Particulars	₹	Particulars	₹
To Discount Allowed A/c	400		
To Provision for Bad Debts A/c	400		
To Provision for Discount on Debtors A/c	480		

Balance Sheet as at 31st December, 2016 (includes)

Liabilities	₹	Assets		₹
		Sundry Debtors	10,000	
		Less: Provision for Bad Debts	400	
			9,600	
		Less: Provision for Discount on Debtors	480	9,120

Illustration 17

Following are the balances taken from the Trial Balance of a trader as on 31.12.2016.

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

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

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

Solution

In the books of the Trader

Dr. **Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Sundry Debtors A/c	7,000	2016	By Provision for Bad Debts A/c	10,000
Dec. 31	To Sundry Debtors A/c	3,000	Dec. 31		
		10,000			10,000

Dr. **Discount Allowed Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Sundry Debtors A/c	3,000	2016	By Provision for Discount on Debtors A/c	5,000
Dec. 31	To Sundry Debtors A/c	2,000	Dec. 31		
		5,000			5,000

Dr. **Provision for Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016	To Bad Debts A/c	10,000	2016 Jan. 1	By Balance b/d	12,000
Dec. 31	To Balance c/d (10% on ₹ 95,000)	9,500	Dec. 31	By Profit and Loss A/c (Balancing figure)	7,500
		19,500			19,500

Dr. **Provision for Discount on Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016	To Discount Allowed A/c ₹ (3,000 + 2,000)	5,000	2016 Jan. 1	By Balance b/d	6,000
Dec. 31	To Balance c/d (5% on ₹ 85,500)	4,275	Dec.31	By Profit and Loss A/c (Balancing figure)	3,275
		9,275			9,275

Dr. **Profit and Loss Account for the year ended 31st December, 2016 (includes)** **Cr.**

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	7,500		
To Provision for Discount on Debtors A/c	3,275		

Balance Sheet as at 31st December, 2016 (includes)

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

Working Notes :

(1) Provision for bad debts and provision for discount on debtors appearing in the Trial Balance represent opening provisions.

(2) Bad debts are increased to ₹ 10,000 (₹ 7,000 + ₹ 3,000) and discount allowed to ₹ 5,000 (₹ 3,000 + ₹ 2,000).
Following are the required Journal Entries.

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

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

(4) Assumed accounting year begins on 1st January every year.

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

Reserve for Discount on Creditors

If the firm is to allow cash discount to customers for early payments, it is quite possible that the firm may receive discount by making early payment which can be treated as income in the Profit and Loss Account. Such discount will be received in the next year but should be taken into account in current year's account because it relates to creditors of current year. Generally accepted accounting principles (also the concept of conservatism), state that we should provide a loss only when we apprehend that, but should never take a profit until it is actually made. ***It is seldom found in actual practice that a reserve has been created for discount to be received by making prompt payment to creditors (except in examination problems)***.

Journal Entries for Reserve for Discount on Creditors in the First Year

1. *When discount is received from the creditors*
   Sundry Creditors Account Dr.
   To Discount Received Account

2. *For closing the discount received to Profit and Loss Account*
   Discount Received Account Dr.
   To Profit and Loss Account

3. *When a Reserve is created for the first time*
   Reserve for Discount on Creditors Account Dr.
   To Profit and Loss Account

Journal Entries in the Second Year and Subsequent Years

1. *When discount is received from the creditors*
   Sundry Creditors Account Dr.
   To Discount Received Account

2. *At the end of the accounting year, the discount received account is closed by transferring it to the Reserve for Discount on Creditors Account as under:*
   Discount Received Account Dr.
   To Reserve for Discount on Creditors Account

3. *For creating a Reserve for the next year*
   Reserve for Discount on Creditors Account Dr.
   To Profit & Loss Account*

*This is calculated as under:

Closing Reserve required	***
Add: Discount received during the year	***
	***
Less: Opening Balance of Reserve	***
Amount to be credited to P & L A/c	***

In the Balance Sheet, the Reserve for Discount on Creditors is shown by way of deduction from Sundry Creditors.

Balance Sheet As At ...

Sundry Creditors	...			
Less: Reserve for Discount on Creditors	...	...		

In regard to the provision for discount on debtors and reserve for discount on creditors, the following points are worth noting:

1. ***The basic source of accounting, the total of discount allowed and discount received are the two discount columns of the Cash Book.***
2. ***Like bad debts, the profit on a credit sale may be taken in one year but the discount allowed as expenses may be a charge against profit of the subsequent year. Similarly, the cost of total purchase may be charged against the profit in one period, but the gain arising out of discount received may be taken to credit in another accounting period.***

Recovery of Bad Debts

We have already mentioned that when the seller apprehends any loss due to bad debt, he immediately writes it off by debiting Bad Debt Account and crediting the Sundry Debtors Account. In case of bad debt, the seller takes the initiative for closing the account of the customer and he does it immediately. After writing off any bad debt, if any amount is received from that customer in respect of that old debt, it is called recovery of bad debt. Occasionally, sundry debtors that have been charged off as bad debts, are unexpectedly collected (generally in a subsequent accounting period). When any bad debt is recovered, the accounting entries are as follows:

1. *When the bad debt is recovered*

Bank Account Dr.
 To Bad Debt Recovery Account

2. *For closing bad debt recovery*

(a) If the seller is maintaining a Provision for Bad and Doubtful Debts Account and adjusting the bad debt against such provision, the bad debt recovery should be closed by transferring it to the Provision for Bad Debt Account.

Bad Debt Recovery Account Dr.
 To Provision for Bad and Doubtful Debts Account

(b) In all other cases, it should be transferred to Profit and Loss Account

Bad Debt Recovery Account Dr.
 To Profit and Loss Account

Treatment of Bad Debt Recovery in the Books of the Buyer

1. If the account of the seller (in the buyer's book) has not been closed

Seller Account Dr.
 To Bank Account

2. If the Seller's Account has been closed

Goodwill Account* Dr.
 To Bank Account

*The amount is paid for maintaining the goodwill of the business.

Illustration 18

Coalman Ltd. had:

(a) Sundry Debtors worth ₹ 68,000, ₹ 48,000 and ₹ 92,000; and

(b) Sundry Creditors worth ₹ 38,000; ₹ 45,000 and ₹ 55,000 as on 31st December, 2014, 2015 and 2016 respectively.

Show from the following data the Provision for Bad and Doubtful Debts Account, Provision for Discount on Debtors Account and Reserve for Discount on Creditors Account at 5%, 2% and 2% respectively, for the years 2014, 2015 and 2016 :

During the year	Bad Debts written off	Discount Allowed	Discount Received
2014	3,000	1,000	700
2015	1,800	500	980
2016	2,900	1,200	620

All the provisions / reserves were created for the first time on 31.12.2016 and maintained accordingly in the following years.

Solution

In the books of Coalman Ltd.

Dr. Provision for Bad and Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	3,400	2014 Dec. 31	By Profit and Loss A/c (5% on ₹ 68,000)	3,400
2015 Dec. 31	To Bad Debts A/c	1,800	2015 Jan. 1	By Balance b/d	3,400
	To Balance c/d (5% on ₹ 48,000)	2,400		By Profit and Loss A/c (Balancing figure)	800
		4,200			4,200
2016 Dec. 31	To Bad Debts A/c	2,900	2016 Jan. 1	By Balance b/d	2,400
2016 Dec. 31	To Balance c/d (5% on ₹ 92,000)	4,600	2016 Dec.31	By Profit and Loss A/c (Balancing figure)	5,100
		7,500			7,500

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d (2% on ₹ 68,000 – 3,400)	1,292	2014 Dec. 31	By Profit and Loss A/c	1,292
2015 Dec. 31	To Discount Allowed A/c	500	2015 Jan. 1	By Balance b/d	1,292
2015 Dec. 31	To Balance c/d (2% on ₹ 48,000 – 2,400)	912	2015 Dec.31	By Profit and Loss A/c (Balancing figure)	120
		1,412			1,412
2016 Dec. 31	To Discount Allowed A/c	1,200	2016 Jan. 1	By Balance b/d	912
2016 Dec. 31	To Balance c/d (2% on ₹ 92,000 – 4,600)	1,748	2016 Dec.31	By Profit and Loss A/c (Balancing figure)	2,036
		2,948			2,948

Dr. Reserve for Discount on Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Profit and Loss A/c (2% on ₹ 38,000)	760	2014 Dec. 31	By Balance c/d	760
2015 Jan. 1	To Balance b/d	760	2015 Dec.31	By Discount Received A/c	980
2015 Dec. 31	To Profit and Loss A/c (Balancing figure)	1,120	2015 Dec.31	By Balance c/d (2% on ₹ 45,000)	900
		1,880			1,880
2016 Jan. 1	To Balance b/d	900	2016 Dec.31	By Discount Received A/c	620
2016 Dec. 31	To Profit and Loss A/c (Balancing figure)	820	2016 Dec.31	By Balance c/d (2% on ₹ 55,000)	1,100
		1,720			1,720

Note : In 2014, Bad debts, Discount allowed and Discount received will be transferred to Profit and Loss Account directly.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 19

On 01.01.2014, B Sen had the following balances :

Sundry Debtors ₹ 1,20,000 and Provision for Doubtful Debts ₹ 6,000.

During the year ending 31.12.2014, B Sen sold goods on credit amounting to ₹ 15,00,000. During the year customers returned goods of ₹ 5,000, while the firm collected in cash from debtors ₹ 12,00,000, allowed discounts of ₹ 2,000 and received acceptance (B/R) amounting to ₹ 2,00,000. The firm could not collect ₹ 5,000 from Debtors and had to write off the amount. It was decided to maintain provision for doubtful debts @ 5% on Debtors as on 31.12.2014.

You are required to show Sundry Debtors and Provision for Doubtful Debts Accounts.

[C.U.B.Com. (General) — 2015]

Solution

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	1,20,000	?	By Sales Return A/c	5,000
?	To Sales A/c (Credit)	15,00,000	?	By Cash A/c	12,00,000
			?	By Discount Allowed A/c	2,000
			?	By Bills Receivable A/c	2,00,000
			?	By Bad Debts A/c	5,000
			31.12.2014	By Balance c/d	2,08,000
		16,20,000			16,20,000

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bad Debts A/c	5,000	1.1.2014	By Balance b/d	6,000
	To Balance c/d (₹ 2,08,000 x 5%)	10,400	31.12.2014	By Profit and Loss A/c (Balancing figure)	9,400
		15,400			15,400

Illustration 20

Trial Balance as on 31st December, 2013 of Mr. S. Saha contains the following items : ₹

Provision for Doubtful Debts	15,000
Bad Debts	10,000
Sundry Debtors	1,40,000

On enquiry it was ascertained that Debtors include :

(a) ₹ 15,000 due from Mr. B. Sen and Creditors include ₹ 20,000 due to Mr. B. Sen.

(b) ₹ 10,000 due on account of sale of Furniture.

(c) Bad Debts ₹ 7,500.

Prepare Provision for Doubtful Debts Account and Bad Debts Account.

Provision for Doubtful Debts is to be created at 5% on Trade Debtors. ***[C.U.B.Com. (General) — 2014]***

Solution

In the books of Mr. S. Saha

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Balance b/d	10,000	31.12.2013	By Provision for Doubtful Debts A/c	15,000
	To Debtors A/c	7,500	"	By Profit and Loss A/c	2,500
		17,500			17,500

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Bad Debts A/c	15,000	1.1.2013	By Balance b/d	15,000
"	To Balance c/d (Note 1)	5,375	31.12.2013	By Profit and Loss A/c	5,375
		20,375			20,375

Working Note : (1) Calculation of Provision for Doubtful Debts

	₹
Sundry Debtors	1,40,000
Less: Mutual Set-off (Mr. B. Sen)	15,000
Less: Due on account of Sale of Furniture	10,000
Less: Further Bad Debts	7,500
	1,07,500
Less: Provision for Doubtful Debts @ 5%	5,375
	1,02,125

Illustration 21

The following balances were extracted from the ledger of Mr X for the year ended 31.03.2013 : ₹

Debtors balance on 01.04.2012	98,412
Sales (including cash sales ₹ 1,00,000)	10,42,520
Discount allowed	8,324
Cash received from debtors	8,76,940
Return inward	30,510

Carriage outwards	5,760
Provision for doubtful debts as at 31.03.2012	6,876

Subsequent enquiries reveal the following information :

(i) A cheque for ₹ 3,528 from a customer has been returned by bank.

(ii) Bad debts totalling ₹ 8,536 are to be written off.

(iii) It was decided to maintain provision for doubtful debts @ 10% on debtors balance as on 31.03.2013.

(iv) On 31.03.2013 a cheque is received for ₹ 1,400 from a customer who owed to Mr X ₹ 7,000 and the debts had been written off as bad debts in the year ended 31.03.2012. No entry in respect of this cheque has yet been made in the books.

Write up (a) Sundry Debtors Account and (b) Provision for Doubtful Debts Account, for the year ended 31.03.2013.

[C.U.B.Com. (General) — 2013]

Solution

In the books of Mr X

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2012	To Balance b/d	98,412	?	By Discount Allowed A/c	8,324
?	To Sales A/c (Credit)	9,42,520	?	By Cash / Bank A/c	8,76,940
?	To Bank A/c (Dishonour of cheque)	3,528	?	By Return Inward A/c	30,510
			?	By Bad Debts A/c	8,536
			31.3.2013	By Balance c/d	1,20,150
		10,44,460			10,44,460
1.4.2013	To Balancecb/d	1,20,150			

Dr. Provision for Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Bad Debts A/c	8,536	1.4.2012	By Balance b/d	6,876
31.3.2013	To Balance c/d (10% of ₹ 1,20,150)	12,015	31.3.2013	By Profit and Loss A/c	13,675
		20,551			20,551
			1.4.2013	By Balance b/d	12,015

Tutorial Note :

(1) Carriage outward has nothing to do with Sundry Debtors Account or Provision for Doubtful Debts Account.

(2) Cheque received for ₹ 1,400 from a customer in respect of a debt of ₹ 7,000 which has been written off will be recorded in the books of account by passing the following entries :

(i) Bank Account	Dr.	1,400	
To Bad Debts Recovery Account			1,400
(ii) Bad Debts Recovery Account	Dr.	1,400	
To Profit and Loss Account			1,400

[For Honours Candidates Only]

Illustration 22

A company maintains its Provision for Bad Debts @ 5% and Provision for Discount on Debtors @ 3%.

From the following particulars, you are required to show (i) Provision for Bad Debts Account; and (ii) Provision for Discount on Debtors Account for the year 2015.

Bad Debts ₹ 800; Discount Allowed ₹ 1,200; Recovery of Bad Debt written off in earlier years ₹ 500. Sundry Debtors (before writing off bad debts and allowing discounts) amounted to ₹ 60,000 as on 31st December, 2015. On 1.1.2015 Provision for Bad Debts ₹ 4,550 and Provision for Discount on Debtors was ₹ 800.

[C.U.B.Com. (Hons.) — 2016]

Solution

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Bad Debts A/c	800	1.1.2015	By Balance b/d	4,550
	To Profit and Loss A/c (Excess Provision)	1,350	31.12.2015	By Bad Debts Recovery A/c	500
	To Balance c/d (Note 1)	2,900			
		5,050			5,050

Tutorial Note : When bad debts are adjusted against provision for bad debts, the 'Bad Debt Recovery' should be credited to Provision for Bad Debts Account.

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Discount Allowed A/c	1,200	1.1.2015	By Balance b/d	800
"	To Balance c/d	1,653	31.12.2015	By Profit and Loss A/c	2,053
		2,853			2,853

Working Note :

(1) Calculation of Provision for Bad Debts

	₹
Sundry Debtors balance as on 31.12.2015 (gross)	60,000
Less: Bad Debts	800
Less: Discount Allowed	1,200
	58,000

Provision for Bad Debts @ 5% of ₹ 58,000 = ₹ 2,900.

Provision for Discount on Debtors @ 3% of (₹ 58,000 – 2,900) = ₹ **1,653**.

Illustration 23

On 31st December, 2013 sundry debtors and provision for bad debts stood at ₹ 90,000 and ₹ 6,750 respectively. During the year 2014 Bad Debts amounting to ₹ 4,560 were written off. On 30th June, 2014 an amount of ₹ 580 was received on account of a debt written off as bad debt last year. The Debtors list on 31st December, 2014 was verified and it was found that amongst Sundry Debtors amounting to ₹ 65,940 an amount of ₹ 940 was to be written off as bad. It was decided to maintain the provision for bad debts at the same percentage as it was on 31st December, 2013.

Prepare Bad Debts Account and Provision for Bad Debts Account. Also show how the relevant items would appear in the Profit and loss Account and Balance Sheet as on 31.12.2014. ***[C.U.B.Com. (Hons.) — 2015]***

Solution

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Debtors A/c	4,560	31.12.2014	By Provision for Bad Debts A/c	5,500
31.12.2014	To Debtors A/c (Further Bad Debts)	940			
		5,500			5,500

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bad Debts A/c	5,500	1.1.2014	By Balance c/d	6,750
	To Balance c/d (Note 2)	4,875	31.12.2014	By Profit and Loss A/c (Balancing figure)	3,625
		10,375			10,375

Dr. Profit and Loss Account for the year ended 31st December, 2014 (Includes) Cr.

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	3,625	By Bad Debts Recovery	580

Balance Sheet as at 31st December, 2014 (Includes)

Liabilities	₹	Assets		₹
		Debtors	65,940	
		Less: Bad Debts	940	
			65,000	
		Less: Provision for Bad Debts A/c @ 7.5%	4,875	60,125

Working Notes :

(1) Percentage of Provision for Bad Debts in 2013 = $\frac{6,750}{90,000} \times 100 = 7.5\%$

(2) Calculation of Provision for Bad Debts

	₹
Debtors balances as on 31.12.2014	65,940
Less: Further Bad Debts	940
	65,000
Less : Provision for Bad Debts @ 7.5%	4,875
	60,125

Illustration 24

The following is the extract from the Trial Balance of Mr A Banerjee as on 31st December, 2012 :

Particulars	Dr. (₹)	Cr. (₹)
Bad Debts	8,000	—
Sundry Debtors	3,00,000	—
Provision for Bad and Doubtful Debts	—	12,000

It is desired to maintain a provision of 5% for bad and doubtful debts,.

Prepare the Bad Debts Account and Provision for Bad and Doubtful Debts Account. Also show how the relevant items would appear in the Profit and Loss Account and Balance Sheet. ***[C.U.B.Com. (Hons.) — 2013]***

Solution

In the books of Mr A Banerjee

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Balance b/d	8,000	31.12.12	By Provision for Bad Debts A/c	8,000
		8,000			8,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Bad Debts A/c	8,000	31.12.12	By Balance b/d	12,000
	To Balance c/d	15,000		By Profit and Loss A/c (Balancing figure)	11,000
		23,000			23,000

Dr. Profit and Loss Account for the year ended on 31st December, 2012 Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Provision for Bad Debts A/c	11,000			

Balance Sheet of A Banerjee as at 31st December, 2012

Liabilities	₹	₹	Assets	₹	₹
			Sundry Debtors	3,00,000	
			Less: Provision for Bad Debts A/c	15,000	2,85,000

Special Problems

Illustration 25

The following balances on accounts appeared in a company's Ledger at 30th September, 2014: (all figures in ₹)

Sundry Debtors Account—63,158; Sundry Creditors Account—32,000 Provision for bad debts—3,158; Reserve for discount receivable—800; Provision for discount allowable—1,500.

During the year to 30th September, 2015 the following summarized transactions occurred (all figures in ₹):

Sales on credit	5,50,000	Discount allowed to customers	12,790
Purchases on credit	2,76,000	Bad Debts written off against the provision	4,100
Sales returns	6,000	Amount recovered from debtor whose debt had been written off as bad in previous years	542
Purchases returns	4,000	Debtor and creditor accounts settled by setting off one against the other	4,000
Cash received from customers (excluding bad debt recovered)	5,14,268		
Cash paid to suppliers	2,58,100	Discount received from suppliers	5,900

The company's policy is to pass all transactions for bad debts written off and recovered through the provision for bad debts account, and to make the provision at the year-end equal to 5% of the debtors. The company also makes provisions for discounts allowable equal to 2.5% of the year-end debtors minus the provision for bad debts, and for discount receivable equal to 2.5% of the year-end creditors.

You are required to enter the above information in the following Ledger Accounts, to carry down the balances at 30th September, 2015, and in the case of (c), (d) and (e), show the amount transferred to Profit and Loss Account:

(i) Sundry Debtors Account;
(ii) Sundry Creditors Account;
(iii) Provisions for Bad Debts Account;
(iv) Reserve for Discount Receivable Account; and
(v) Provision for Discount Allowable Account.

Solution

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 1st Oct.	To Balance b/d	63,158	2014 Oct.	By Sales Returns A/c	6,000
?	To Sales A/c	5,50,000	?	By Cash A/c	5,14,268
			?	By Discount Allowed A/c	12,790
			?	By Bad Debts A/c	4,100
			?	By Sundry Creditors A/c	4,000
			2015 Sept.30	By Balance c/d	72,000
		6,13,158			6,13,158

Dr. Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Purchases Returns A/c	4,000	2014 1st Oct.	By Balance b/f	32,000
?	To Cash A/c	2,58,100	?	By Purchases A/c	2,76,000
?	To Discount Received A/c	5,900			
?	To Sundry Debtors A/c	4,000			
2015 Sept.30	To Balance c/d	36,000			
		3,08,000			3,08,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Bad Debt A/c	4,100	2014 Oct. 1	By Balance b/f	3,158
2015 Sept.30	To Balance c/d (5% on ₹ 72,000)	3,600	?	By Bad Debt Recovered A/c	542
			2015 Sept.30	By P & L A/c	4,000
		7,700			7,700

Dr. Reserve for Discount Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Oct. 1	To Balance b/f	800	2014 ?	By Discount Received A/c	5,900
2015 Sept.30	To P & L A/c	6,000	2015 Sept.30	By Balance c/d (2.5% of ₹ 36,000)	900
		6,800			6,800

Dr. Provision for Discount Allowable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Discount Allowed A/c	12,790	2014 Oct.1	By Balance b/f	1,500
2015 Sept.30	To Balance c/d (2.5% of ₹ 68,400)	1,710	2015 Sept.30	By P & L A/c	13,000
		14,500			14,500

Illustration 26

A. Ltd. makes provision for doubtful debts at the end of each year against specific debtors.

On 31st December, 2015 the following debtors' balances were considered doubtful and provided for B—₹ 1,500; C—₹ 400; D—₹ 250.

Following are the particulars for the year ended 31st December, 2016:

(a) Bad Debts written off: B—₹ 1,200; E- ₹ 300; P—₹ 200.

(b) Bad Debts recovered: R—₹ 700; S - ₹ 600; N—₹ 500.

(c) Bad Debts considered doubtful at the end of the year: G—₹ 800; H—₹ 900; K—₹ 1,000

Debts considered doubtful at the commencement of the year 2016 were either realized or written off as bad debt.

Write up the Bad Debts Account and Provision for Doubtful Debts Account for the year ended 31.12.2016.

Solution

Dr. Bad Debt Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Sundry Debtors A/c (₹ 1200+300+200)	1,700	2016 Dec. 31	By Provision for Doubtful Debts	1,700

Dr. **Provision for Doubtful Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec.31	To Bad Debt A/c	1,700	2016 Jan 1	By Balance b/f (₹ 1,500 + 400 + 250)	2,150
	To Balance c/d (₹ 800 + 900 + 1,000)	2,700	Dec.31	By Bad Debt Recovery A/c	1,800
				By Profit & Loss A/c	450
		4,400			4,400

Note: Amount realised from past bad debts should be credited to Provision for Bad and Doubtful Debts Account. Alternatively, it can be credited to Profit and Loss Account.

Illustration 27

On January 1, 2016 the Provision for Bad and Doubtful Debts Account of a concern showed a balance of ₹ 60,000 and the Debtors amounted to ₹ 15,00,000. Out of these, during 2016, Debtors amounting to ₹ 10,75,000 paid in full, but the following debts proved bad or doubtful: A (₹ 20,000)—bad to the full extent; B (₹ 40,000)—insolvent, estate expected to pay 50 paise in the rupee; C (₹ 12,000)—realised 33.1/3 % in full settlement.

The remaining debts were considered somewhat doubtful on December 31. The following further debts became due during 2016 but outstanding on December 31:

D (₹ 20,000)—expected to prove totally bad; E (₹ 80,000)—expected to prove 5% bad; F (₹ 6,40,000)—expected to prove 4% bad; G (₹ 4,00,000)—expected to prove bad to some extent; H (₹ 12,60,000)—expected to prove wholly good.

It was decided to write off actual debts and to make reserve of 5% on debts of unknown doubtful nature. Draw up the Provision for Bad and Doubtful Debts Account and show the balance of the account as at December, 31,2016.

Solution

Calculation of Actual Bad Debts		Creation of Provision		Calculation of Other Debtors*	
Amount due from A (fully bad)	₹ 20,000	50% amount due from B	20,000	Debtor at the beginning	15,00,000
Amount due from C (2/3 bad)	8,000	Full amount due from D	20,000	Less: Paid during the year	10,75,000
	28,000	5% amount due from E	4,000		4,25,000
		4% amount due from F	25,600	Less: Amount due from A, B and C	72,000
		5% amount due from others*	37,650		3,53,000
			1,07,250	Add: Amount due from G	4,00,000
					7,53,000

Dr. **Provision for Bad and Doubtful Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec.31	To Bad Debt A/c	28,000	2016 Jan.1	To Balance b/f	60,000
"	To Balance c/d	1,07,250	2016 Dec.31	To P & L A/c (balancing figure)	75,250
		1,35,250			1,35,250
			2017 Jan.1	By Balance b/f	1,07,250

Illustration 28

On 31.12.2015, the Trial Balance of G. Gupta contained the following Ledger Balances:

Provision for Bad and Doubtful Account (1.1.2015) was ₹ 1,000. Provision for Discount on Debtors Account (1.1.2015) was ₹ 4,750. Sundry Debtors Account was ₹ 40,400 (of the Debtors, ₹ 400 are bad and should be written off).

On 31.12.2016, the Sundry Debtors Account was ₹ 20,500 (of which ₹ 500 are bad and should be written off). It is desired to maintain the Provision for Bad and Doubtful Debts Account at 5% on Sundry Debtors and the Provision for Discount on Debtors at 2.5%. Show by means of Ledger Accounts how the Provision for Bad and Doubtful Debts Account and the Provision for Discount on Debtors Account will appear in the books of G. Gupta for the year 2015 and 2016 and bring down the balance on 1.1.2017.

Solution

In the Books of G. Gupta

Dr. **Provision for Bad and Doubtful Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Bad Debts A/c	400	2015 Jan.1	By Balance b/f	1,000
"	To Balance c/d (5% of ₹ 40,000)	2,000	"	By Profit & Loss A/c	1,400
		2,400			2,400
2016 Dec.31	To Bad Debts A/c	500	2016 Jan.1	By Balance b/d	2,000
"	To Profit & Loss A/c	500			
"	To Balance c/d (5% of ₹ 20,000)	1,000			
		2,000			2,000
			2017 Jan.1	By Balance b/d	1,000

Dr. **Provision for Discount on Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Dec.31	To Profit & Loss A/c	3,800	2015 Jan.1	By Balance b/f	4,750
"	To Balance c/d (2.5% of ₹ 38,000)	950			
		4,750			4,750
2016 Dec.31	To Profit & Loss A/c	475	2016 Jan.1	By Balance b/d	950
"	To Balance c/d (2.5% of ₹ 19,000)	475			
		950			950
			2017 Jan.1	By Balance b/d	475

Key Points

- A ***reserve*** is an amount of profit set aside until it is needed for some particular purpose.
- ***Reserves*** are generally classified into: (a) Capital Reserves and (b) Revenue Reserves.
- A ***provision*** is a charge against profit for the purpose of providing for any liability or loss.

THEORETICAL QUESTIONS

1. Define the following:
   (a) Reserve; (b) Reserve Fund; (c) Capital Reserve; (d) Specific Reserve; (e) General Reserve; and (f) Secret Reserve.
2. Distinguish between the following:
   (a) Reserves and Provisions; (b) Capital Reserves and Revenue Reserves; (c) General Reserves and Specific Reserves; (d) Reserve and Reserve Fund.
3. Is reserve a charge against profit or an appropriation of profits? Discuss.
4. What do you mean by Provision for Bad and Doubtful Debts? Justify its creation.
5. What are Bad Debts and how are they treated? In this context, explain the way in which provisions are created for such a contingency.
6. Why should provisions for discounts be provided for? Explain fully its working.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. The term 'provision' is generally used to indicate known :
   A depreciation
   B losses
   C none of these
2. Reserves are the items of :
   A current liabilities
   B owners' equity
   C none of these
3. Reserves arise from capital receipts are known as :
   A capital reserve
   B reserve fund
   C none of these
4. Provisions are :
   A external transactions
   B internal transactions
   C none of these.
5. Reserves that are created are mostly :
   A general
   B specific
   C none of these.

6. Goods are sold on credit to —
   A known customers
   B unknown customers
   C employees.

PRACTICAL QUESTIONS

1. On 1.1.2014 M/s A & Co had a provision for bad debts of ₹ 10,880. The bad debts during the year 2014 amounted to ₹ 9,040. The debtors as at 31.12.2014 were ₹ 2,24,000. Provision for bad debts @ 5% is maintained by the business. Bad debts during 2015 and 2016 were ₹ 11,680 and ₹ 4,160 respectively. The sundry debtors as at 31.12.2015 and 31.12.2016 were ₹ 2,88,000 and ₹ 1,36,000 respectively.

   Prepare necessary Ledger Accounts in the books of M/s A & Co. Also show how these would appear in the Profit and Loss Account and Balance Sheet for the year 2014 to 2016.

2. A provision for bad and doubtful debts, equal to five per cent of debtors, is created every year-end by a business concern. From the particulars given below, write up the Provision for Bad and Doubtful Debts Accounts for five consecutive years, assuming that accumulated bad debts are, for their necessary adjustment, transferred to the said provision account each year before the new provision is made for the next year: Balance extracted from the Trial Balance:

Years	1st	2nd	3rd	4th	5th
Sundry Debtors (₹)	45,000	48,500	56,800	62,000	58,400
Bad Debts written off (₹)	1,800	2,000	4,000	2,700	2,800
Past Bad Debts recovered (₹)	—	—	—	520	—
Closing Adjustments : Bad Debts written off (₹)	200	140	420	260	300

   Balance of the Provision for Bad and Doubtful Debts Account at the beginning of the 1st year was ₹ 2,500.

3. Docks Limited, a window replacement company, offers fairly generous credit terms to its high risk customers. Provision is made for bad debts at a varying percentage based on the level of outstanding trade debtors, and an assessment of general economic circumstances, resulting in the following data for the last three accounting periods:

Year to 31st March	2014	2015	2016
Trade Debtors at the year end (before allowing for any bad debts) (₹)	1,86,680	1,41,200	2,06,200
Estimated Bad Debts (companies in liquidation) (₹)	1,680	1,200	6,200
Provision for Bad Debts	10%	12.5%	15%

   The provision for Bad Debts at 1st April, 2013 amounted to ₹ 13,000.

   Required:

   (a) Prepare the Provision for Bad Debts Account for each of the three years to 31st March 2014, 2015 and 2016 respectively, showing how the balances would appear on the Balance Sheets at these dates.

   (b) Assuming that a debt of ₹ 1,000 written off as bad in 2014 was subsequently recovered in cash in 2015, state briefly how this would have affected the profit for the year to 31st March, 2014, and also how it would be treated in the accounts for the year to 31st March, 2015.

4. Certain Balances in a company's ledger at 30th June, 2016 were: (all figures in rupees)

   Debtors—20,000; Provision for bad debts—1,000; Stock of coke—630; Electricity accrued—920.

During the year to 30th June, 2017 the following transaction occurred:	₹
Sales on credit	2,00,000
Cash received from Debtors	1,93,000
Certain debtors became bankrupt, and their debts were written off against the provision	3,000
Certain debts which had been written off as bad in previous years were recovered in cash and transferred to the provision	1,000
Purchases of coke	8,000
Payments for electricity for the year ended 30th April, 2017	6,000

   At 30th June, 2017, the stock of coke was valued at ₹ 750, and the provision for bad debts was adjusted to be equal to 5% of the Debtors. On 6th August, 2017, the Company paid its electricity account of ₹ 1,010 for the quarter ended 31st July, 2017.

   You are required to show the debtors and provision for bad debts accounts in the company's Ledger for the year ended 30th June, 2017.

5. Theta Ltd. in a business which acts as a distributor of washing machines entirely on credit term to a wide range of customers. The following balances were extracted from its ledgers at 30th June, 2017: (all figures in ₹)

Sales	7,23,869	Cash received from debtors	6,88,267
Creditors – Balance at 30th June, 2016	49,781	Cash paid to creditors	3,21,853

Debtors – Balance at 30th June, 2016	84,611	Returns inwards	36,925
Purchases of washing machines	3,42,916	Carriage outwards	5,264
Discounts allowed	8,214	Overdraft interest	12,748
Discounts received	6,978	Provision for Doubtful debts as on 30.6.2016	4,813

Subsequent enquiries reveal the following information:

A cheque for ₹ 1,246 from A. Brown, a customer, has been returned by the bank marked 'refer to drawer'. Bad Debts totalling ₹ 6,854 are to be written off, and the provision for doubtful debts is to be raised to 8% of the debtor balances at 30th June, 2017. On the last day of the year a cheque is received for ₹ 1,000 from the liquidator of J. Smith Ltd. This customer had owed Theta Ltd ₹ 7,500 when it ceased to trade in March 2014, and the debt had been written off as a bad debt in the year ended 30th June, 2016. No entry in respect of this cheque has yet been made in the books.

You are required to write up for the year ended 30th June, 2017: (a) The Sundry Debtors Account; (b) The Provision for Bad and Doubtful Debts Account; and, (c) Show the Balance Sheet entry for debtors as at that date.

6. X Company Ltd maintains provisions for bad debts at 5% and a provision for discounts at 2.5%. The company also maintains a reserve for discounts on creditors at 2%.

   From the following particulars, write up the Provision Accounts : (a) Provision for Bad Debts—₹ 10,000; (b) Provision for Discount on Debtors—₹ 5,000; (c) Reserve for Discount on Creditors—₹ 4,000.

   Total Debtors as on 31.12.2015 were ₹ 2,40,000 after writing off bad debts ₹ 6,000 and allowing discount ₹ 2,000. On 31.12.2016, the total Debtors were ₹ 2,00,000 after writing off bad debts ₹ 1,000 and allowing discounts ₹ 500.

   The creditors as on 31.12.2015 and 31.12.2016 were ₹ 1,00,000 and ₹ 1,50,000 respectively. Discount received during each of the years amounted to ₹ 500, ₹ 3,000 respectively.

7. The following details as to bad and doubtful debts are extracted from the books of the Nellore Co. Ltd:

   December 31, 2014 – Bad debts to be written off: Chandu ₹ 60; Ehsan ₹ 95; both being totally irrecoverable. Five per cent is to be provided for bad and doubtful debts on ₹ 1,100 that being the total amount owing by the debtors then outstanding.

   December 31, 2015 – Five per cent is to be provided for bad and doubtful debt ₹ 2,500, that being the total amount owing by the debtors then outstanding.

   December 31, 2016 – Bad debts to be written off : Ganesh ₹ 60; Lodha ₹ 50; Five per cent is to be provided for bad and doubtful debts on ₹ 1,500 that being the total amount owing by the debtors then outstanding.

   You are required to show the Ledger entries involved in the following accounts:
   (a) Bad Debts Account; and (b) The Provision for Bad and Doubtful Debts Accounts.

8. The firm had the following balances on January 1, 2015 : (a) Provision for Bad and Doubtful Debts—₹ 2,500; (b) Provision for Discount on Debtors—₹ 1,200; and, (c) Reserve for Discount on Creditors—₹ 1,000

   During the year, bad debts amounted to ₹ 2,000, discount allowed were ₹ 100 and discount received were ₹ 200. During 2016 bad debts amounting to ₹ 1,000 were written off while discount allowed and received were ₹ 2,000 and ₹ 500 respectively. Total Debtors on December 31, 2015 were ₹ 48,000 before writing off bad debts but after allowing discounts. On December 31, 2016, the amount was ₹ 19,000 after writing off the bad debts but before allowing discounts. Total creditors of these two dates were ₹ 20,000 and ₹ 25,000 respectively.

   It is the firm's policy to maintain a provision of 5% against bad and doubtful debts and 2% for discount on debtors and a reserve for discount on creditors @ 3%. Show : (a) Provision for Bad and Doubtful Debts Account; (b) Provision for Discount on Debtors Account; and (c) Reserve for Discount on Creditors Account.

9. On 1.1.2014 the Provision for Doubtful Debts Account in the books of S. Soman, stood at ₹ 1,200 and the Provision for Discount on Debtors Account at ₹ 150.

   On 31.12.2014, the Sundry Debtors were ₹ 20,400 of which ₹ 400 are bad and are to be written off. The discount allowed to Debtors during 2014 were ₹ 300.

   On 31.12.2015, the Sundry Debtors were ₹ 10,100 of which ₹ 100 are bad and to be written off. The discount allowed to debtors during 2015, were ₹ 50. On 31.12.2016 the Sundry Debtors were ₹ 36,200 of which ₹ 200 are bad and are to be written off. The discount allowed to Debtors during 2016 was ₹ 50.

   It is desired to maintain aprovision for doubtful debts at 5% on Sundry Debtors and a provision for discount on debtors at 2% on Debtors. Show how the Provision for Doubtful Debts Account and the Provision for Discount on Debtors Account would appear in the ledger of S .Soman for the year 2014, 2015 and 2016, bringing down the balance on 1.1.2017.

10. A Company maintains its Provision for Bad Debts @ 5% and Provision for Discount on Debtors @ 2%. You are given the following details:

Year	2015	2016
Bad Debts (₹)	800	1,500
Discount Allowed (₹)	1,200	500
Recovery of Bad Debts written off in earlier years (₹)	500	300

Sundry Debtors (before writing off Bad Debts and Discounts) amounted to ₹ 60,000 on 31st December, 2015, and ₹ 42,000 on 31st December, 2016. On 1st January, 2015, Provision for Bad Debts and Provision for Discount on Debtors had balances of ₹ 4,550 and ₹ 800 respectively. Show the Provision for Bad Debts Account and Provision for Discount on Debtors Account for 2015 and 2016.

11. A trader maintained Provision for Doubtful Debts @ 5%; a Provision for Discount @ 2% on Debtors; and Reserve for Discount @ 2% on Creditors, which on 1st January, 2015 stood at ₹ 1,500, ₹ 500 and ₹ 400 respectively. His balances on 31.12.2015 and on 31.12.2016 were: (all figures in ₹)

	31.12.2015	31.12.2016
Bad Debts written off	1,800	300
Discount allowed	600	200
Sundry Debtors	20,000	6,000
Discount received	300	50
Sundry Creditors	15,000	10,000

Show necessary accounts in the ledger.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. A; 4. B; 5. A; 6. A.

Practical Questions

1. **2014 : Amount charged to Profit and Loss Account—bad debts ₹ 9,040 and provision for bad debts—₹ 320. Net balance of debtors in Balance Sheet—₹ 2,12,800. 2015 : Amount charged to Profit and Loss Account—bad debts ₹ 11,680 and provision for bad debts—₹ 3,200; Net balance of debtors in Balance Sheet—₹ 2,73,600. 2016 : Amount charged to Profit and Loss Account—bad debts ₹ 4,160; Amount credited to Profit and Loss Account in respect of excess provision—₹ 7,600; Net balance of debtors in Balance Sheet—₹ 1,29,200.**
2. **Provision for bad and doubtful debts debited to Profit and Loss Account : 1st year—₹ 1,740; 2nd year—₹ 2,318; 3rd year—₹ 4,821; 4th year—₹ 2,708 (after crediting ₹ 520 for bad debt recovery); 5th year—₹ 2,918.**
3. **(a) (i) Provision for bad debts debited to Profit and Loss Account of: 2014—₹ 7,180; 2015—₹ 200; 2016—₹ 18,700**
   (ii) Balance of Debtors in Balance Sheet : ₹ 1,86,680 less ₹ 1,680 less ₹ 18,500 = ₹ 1,66,500 in 2014; ₹ 1,41,200 less ₹ 1,200 less ₹ 17,500 = ₹ 1,22,500 in 2015; ₹ 2,06,200 less ₹ 6,200 less ₹ 30,000 = ₹ 1,70,000 in 2016. (b) By charging bad debts of ₹ 1,000 in 2014, the profit would have been reduced by ₹ 1,000. It is better to credit the bad debt recovered in 2015 to the provision for Bad Debts Account in 2015, alternatively it can be credited to Profit and Loss Account of 2015 also.
4. **Balance of Sundry Debtors on 30th June 2016 ₹ 24,000; provision for bad debts debited to Profit and Loss Account ₹ 2,200 (after adjusting ₹ 1,000 bad debts recovery).**
5. **Balance of Sundry Debtor on 30th June 2016: ₹ 69,466; Provision for Doubtful Debts debited to Profit and Loss Account ₹ 6,598 (after adjusting ₹ 1,000 bad debts recovery).**
6. **In 2015: Profit and Loss Account is debited by ₹ 8,000 for provision for bad debts; by 2,700 for provision for discount on debtors and by ₹ 1,500 for reserve for discount on creditors; In 2016: Profit and Loss Account is credited by ₹ 1,000 for provision for bad debts; by ₹ 450 for provision for discount on debtors and by ₹ 4,000 for reserve for discount on creditors.**
7. **In 2014: Profit and Loss Account is debited by ₹ 155 for bad debts and by ₹ 55 for provisions for bad debts; In 2015: Profit and Loss Account is debited by ₹ 70 for provision for bad debts only; In 2016: Profit and Loss Account is debited by ₹ 60 for provision for bad debt.**
8. **In 2015: Profit and Loss Account is debited by ₹ 1,800 for provision for bad debts and by ₹ 200 for reserve for discount on creditors. Profit and Loss Account is credited by ₹ 226 for provision for discount on debtors; In 2016: Profit and Loss Account is debited by ₹ 1,449 for Provision for discount on debtors; Profit and Loss Account is credited by ₹ 450 for provision for bad debts and by ₹ 650 for reserve for discount on creditors.**
9. **In 2014 : Profit and Loss Account is debited by ₹ 200 for Provision for Doubtful Debts and by ₹ 530 for Provision for Discount on Debtors. In 2015 : Profit and Loss Account is credited by ₹ 400 for Provision for Doubtful Debts and ₹ 140 for Provision for Discount on Debtors. In 2016 : Profit and Loss Account is debited by ₹ 1,500 for Provision for Doubtful Debts and ₹ 544 for Provision for Discount on Debtors.**
10. **2015 : Provision for bad debts credited to Profit and Loss Account ₹ 850; Bad debts recovery credited to Profit and Loss Account ₹ 500. 2016 : Provision for bad debts debited to Profit and Loss Account ₹ 600; Bad debts recovery debited to Profit and Loss Account ₹ 300.**
11. **2015 : Provision for bad debts debited to Profit and Loss Account ₹ 1,300;**
    2016 : Provision for bad debts credited to Profit and Loss Account ₹ 400.

11

Capital and Revenue

Capital and Revenue — Income and Expenditure

Meaning of Capital Expenditure

Capital expenditure is the money spent on buying fixed assets or adding to their value. These assets are expected to provide benefits to the business for more than one accounting period. Purchase of land or cost of extentions of existing building are examples of capital expenditure.

Capital expenditure is debited to a fixed asset account which appears on the Balance Sheet. Therefore, it is an expenditure on assets which is not written off completely against income in the accounting period in which it is incurred. A capital expenditure has the following characteristics :

(1) The amount involved in such an expenditure is generally large;
(2) The benefit accruing from such an expenditure is available for more than one accounting period;
(3) The expenditure is of non-recurring nature.
(4) It results in an increase in the value of fixed assets already possessed (for example development of property).

Meaning of Revenue Expenditure

Any form of income is called revenue, but, the term 'revenue' refers to either income or expenditure. Revenue income implies profit, whereas revenue expenditure is the money spent on running the business on a day-to-day basis. Salaries paid to the employees and payment for miscellaneous expenses are the examples of revenue expenditure. Therefore, a revenue expenditure is incurred to carry on the normal course of business and maintain the fixed assets in good condition. Since a revenue expenditure is of benefit for the current accounting period only, it is debited to an expense account which is ultimately transferred to the Trading Account or Profit and Loss Account.

A revenue expenditure has the following characteristics :

(1) The amount involved in such an expenditure is relatively small;
(2) The benefit accruing from such an expenditure is available for one accounting period only;
(3) The expenditure is of recurring nature.
(4) It is incurred in pursuance of trading activities.

Necessity for Distinction Between Capital Expenditure and Revenue Expenditure

The distinction between capital expenditure and revenue expenditure is necessary, because of the following :

1. The distinction affects the measurement of profit in a number of accounting periods.
2. The distinction also affects the valuation of assets in the Balance Sheet.
3. Capital expenditure results in the acquisition of fixed assets, whereas revenue expenditure represents the expenses incurred in the business.
4. Accrual basis of accounting requires a clear distinction between capital and revenue expenditure.
5. The accounting treatment of capital expenditure and revenue expenditure is different.
6. Capital expenditures appear in the Balance Sheet as an asset, whereas revenue expenditures appear in the Profit and Loss Account as expenses.
7. Most of the capital expenditures of a business become revenue expenditures (for example, charging of depreciation on fixed assets).
8. Some revenue expenditures eventually become a capital expenditure (for example, heavy advertisement expenses carried forward to next period).
9. Capital expenditure increases the revenue earning capacity of the business. But revenue expenditure maintains that.
10. Capital expenditure may add to the value of an existing asset, while the revenue expenditure can decrease the value of net assets.

Distinction Between Capital Expenditure and Revenue Expenditure

	Capital Expenditure		Revenue Expenditure
1.	It is the outflow of money to acquire fixed assets of a business or adding to their value.	1.	It is the outflow of money to meet running expenses of a business.
2.	It is always an external transaction.	2.	It may be internal (e.g., depreciation) or external transaction.
3.	It is debited to an asset account.	3.	It is debited to an expense account.
4.	It is a real account.	4.	It is a nominal account.
5.	It is incurred for more than one accounting period.	5.	It is incurred for a particular accounting period.
6.	It finds a place in the Balance Sheet.	6.	It finds a place in the Trading Account or Profit and Loss Account.
7.	It is of non-recurring nature.	7.	It is of recurring nature.
8.	All capital expenditures eventually become revenue expenditures.	8.	Revenue expenditures do not generally become capital expenditures.
9.	Capital expenditures are not matched against capital receipts.	9.	All revenue expenditures are matched against revenue receipts.
10.	It does not affect the profit for an accounting period directly.	10.	It directly affects the profit for an accounting period.
11.	It does not affect the net worth of a business.	11.	It directly affects the net worth of a business.
12.	It may be incurred before or after the commencement of the business.	12.	It is always incurred after the commencement of the business.

Rules For Determining Capital Expenditure

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

1. An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in business to earn profits and not meant for resale, will be treated as a capital expenditure. For example, if a second hand car dealer buys a piece of furniture with a view to use it in business, it will be a capital expenditure. But if he buys second hand cars, it will be a revenue expenditure because he deals in second hand cars.

2. When an expenditure is incurred to improve the present condition of an existing fixed asset that enhances its value to the business, e.g., by increasing its capacity, effectiveness or useful life; or putting an old asset into working condition, is recognised as a capital expenditure. The expenditure is capitalised and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure. For example, if one buys a machine for ₹ 5,00,000, and pays ₹ 20,000 as transportation charges and ₹ 40,000 as installation charges, the total cost of the machine comes upto ₹ 5,60,000. Similarly, if a building is purchased for ₹ 1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹ 1,05,000.
3. If an expenditure is incurred, to increase earning capacity of a business, it will be considered as of capital nature. For example, expenditure incurred for shifting the factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.
4. Wages paid to the firm's own employees engaged on the erection work of a machine or building extention is also capital expenditure and should be debited to the cost of the asset.
5. Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.

Thus, one useful way of recognising an expenditure as capital is to see that the business will own something which qualifies as an asset at the end of the accounting period.

Examples of Capital Expenditure

(1) Purchase of land, building, machinery or furniture;
(2) Cost of leasehold land and building;
(3) Cost of acquisition of long-term rights and benefits (e.g., patents, copyrights);
(4) Preliminary expenditures;
(5) Cost of additions or extensions to existing assets;
(6) Cost of overhauling second-hand machines;
(7) Expenditure on putting an asset into working condition; and
(8) Cost incurred for increasing the earning capacity of a business.

Rules For Determining Revenue Expenditure

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

1. Expenditure for day-to-day conduct of the business, the benefits of which last less than one year. Examples are wages of workmen, interest on borrowed capital, rent, selling expenses, and so on.
2. Expenditure on consumable items, on goods and services for resale either in their original or improved form. Examples are purchases of raw materials, office stationery, and the like. At the end of the year, there may be some revenue items (stock, stationery, etc.) still in hand. These are generally passed over to the next year though they were acquired in the previous year.
3. Expenditures incurred for maintaining fixed assets in working order. For example, repairs, renewals and depreciation.

From the above, we can see that any expenditure which is incurred in the process of earning of the profits is a revenue expenditure. It is incurred to maintain the earning capacity of the business unit including the maintenance of the fixed assets.

It should be noted that revenue expenditure is transferred to the Trading or Profit and Loss Account only to the extent to which goods or services bought have been consumed. For example, the purchase of goods for reale is a revenue expenditure, but only the cost of goods sold is transferred to the Trading Account. Again, the payment of an insurance premium would be revenue expenditure, but only that part of it that had expired would be transferred to the Profit and Loss Account.

Examples of Revenue Expenditure

(1) Salaries and wages paid to the employees;
(2) Rent and rates for the factory or office premises;
(3) Depreciation on plant and machinery;
(4) Consumable stores;
(5) Inventory of raw materials, work-in-progress and finished goods;
(6) Insurance premium; and
(7) Taxes and legal expenses.

Capital and Revenue Receipts

A receipt of money may be of a capital or revenue nature. A clear distinction, therefore, should be made between capital receipts and revenue receipts.

A receipt of money is considered as capital receipt when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year. Capital receipts can take one or more of the following forms:

1. Additional capital introduced by the proprietor; by partners, in case of partnership firm, by issuing fresh shares, in case of a company; and,
2. By selling assets, previously not intended for resale.

A receipt of money is considered as revenue receipt when it is received from customers for goods supplied, or fees received for services rendered in the ordinary course of business, which is a result of the firm's activity in the current period. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period.

The following are the points of distinction between capital receipts and revenue receipts :

Sl. No.	Capital Receipts	Sl. No.	Revenue Receipts
1.	Capital receipts are not available for distribution as profits.	1.	Revenue receipts are available for distribution as profits only after deducting revenue expenses.
2.	Capital receipts cannot be utilised for creating a reserve fund.	2.	Revenue receipts can be utilised for creating a reserve fund after deducting revenue expenses.
3.	A business can survive without any capital receipts during an accounting period.	3.	The survival of a business mainly depends on the revenue receipts during an accounting period.
4.	Capital receipts are the sources for creating capital reserves.	4.	Revenue receipts are the sources for creating revenue reserves.

Capital and Revenue Profits

While ascertaining the trading profit of a business for a particular period, a proper distinction is to be made between capital and revenue profits. If a profit arises out of an ordinary nature, being the outcome of the ordinary function and object of the business, it is termed as 'revenue profit'. But, when a profit arises out of a casual and non-recurring transaction, it is termed as capital profit. Revenue profit arises out of the sale of the merchandise that the business deals in.

Generally, capital profits arise out of the sale of assets other than inventory at a price more than its book value or in connection with the raising of capital or at the time of purchasing an existing business. For example, if an asset, whose book value is ₹ 5,000 on the date of sale, is sold for ₹ 6,000—₹ 1,000 will be considered as capital profit. Likewise, issue of shares at a premium is also a capital profit. Revenue profits are distributed to the owners of the business or transferred to General Reserve Account, being shown in the balance sheet as a retained earning. Capital profits are generally capitalised—transferred to a capital reserve account which can only be utilised for setting off capital losses in future. Capital profits of a small amount (arising out of selling of one asset) is taken to the Profit and Loss Account and added with the revenue profit—*applying the concept of materiality.*

Capital and Revenue Losses

While ascertaining profit, revenue losses are differentiated from capital losses, just as revenue profits are distinguished from capital profits. Revenue losses arise from the normal course of business by selling the merchandise at a price less than its purchase price or cost of goods sold or where there is a decline in the current value of inventories. Capital losses may result from the sale of assets, other than inventory for less than written down value or the diminution or elimination of assets other than as the result of use or sale (flood, fire, etc.) or in connection with raising capital of the business (issue of shares at a discount) or on the settlement of liabilities for a consideration more than its book value (debenture issued at par but redeemed at a premium). Treatment of capital losses are same as that of capital profits. Capital losses arising out of sale of fixed assets generally appear in the Profit and Loss Account (being deducted from the net profit). But other capital losses are adjusted against the credit balance of capital profits. Where the capital losses are substantial, the treatment is different. These losses are generally shown on the balance sheet as fictitious assets and the common practice is to spread that over a number of accounting years as a charge against revenue profits till the amount is fully exhausted.

Illustration 1

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

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

Solution

(i) Carriage of ₹ 7,500 paid for machinery purchased and installed should be treated as a ***Capital Expenditure***.
(ii) Advertising expenses for launching a new product of the company should be treated as a ***Deferred Revenue Expenditure***.
(iii) ₹ 250 paid for servicing and oil change should be treated as a ***Revenue Expenditure***.
(iv) Construction cost of basement should be treated as a ***Capital Expenditure***.

Illustration 2

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

(i) ₹ 50,000 spent towards addition to the machinery;
(ii) Second-hand motor car purchased for ₹ 2,00,000 and spent ₹ 20,000 for repairs immediately;
(iii) ₹ 10,000 spent for whitewashing the factory building;
(iv) Carriage of ₹ 15,000 spent on machinery purchased and installed. ***[C.U.B.Com. (General) — 2012]***

Solution

(i) ₹ 50,000 spent towards machinery addition will be treated as Capital Expenditure. The machine will help to generate revenue for several years.
(ii) ₹ 20,000 spent on repairing of a second-hand motor car will be treated as Capital Expenditure. This repairing is necessary to make the old car usable.
(iii) ₹ 10,000 spent for whitewashing the factory building will be treated as Revenue Expenditure.
(iv) Carriage of ₹ 15,000 spent on machinery purchased and installed will be treated as Capital Expenditure. It is necessary to make the machinery useful.

Illustration 3

State whether the following are capital or revenue expenditure.

(i) Paid a bill of ₹ 10,000 of Mr. Kumar, who was engaged as the erection engineer to set up a new automatic machine costing ₹ 20,000 at the new factory site.
(ii) Incurred ₹ 26,000 expenditure on varied advertisement campaigns undertaken yearly, on a regular basis, during the peak festival season.
(iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent ₹ 90,000 being the budgeted allocation for the year 2010.

Solution

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

Illustration 4

Classify the following items as capital or revenue expenditure : (i) An extension of railway tracks in the factory area; (ii) Wages paid to machine operators; (iii) Installation costs of new production machine; (iv) Materials for extensions to foremen's offices in the factory; (v) Rent paid for the factory; (vi) Payment for computer time to operate a new stores control system; (vii) Wages paid to own employees for building the foremen's offices. Give reasons for your classification.

Solution

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

Illustration 5

For each of the cases numbered (i) to (iv) below, indicate whether the income/expenditure is ***capital*** or ***revenue***.

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

Solution

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

Illustration 6

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

(1) Freight and cartage on the new machine ₹ 150, and erection charges ₹ 500.
(2) Fixtures of the book value of ₹ 2,500 sold off at ₹ 1,600 and new fixtures of the value of ₹ 4,000 were acquired, cartage on purchase ₹ 5.
(3) A sum of ₹ 400 was spent on painting the factory.
(4) ₹ 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Solution

(1) Freight and cartage totalling ₹ 650 should be treated as a ***Capital Expenditure*** because it will benefit the business for more than one accounting year.
(2) Loss on sale of fixtures ₹ (2,500 – 1,600) = ₹ 900 should be treated as a ***Capital Loss***. The cost of new fixtures and carriage thereon should be treated as a ***Capital Expenditure*** because the fixture will be used for a long period.
(3) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
(4) Repairing cost of second hand car should be treated as a ***Capital Expenditure*** because it will benefit the business for more than one accounting year.

Illustration 7

State the nature (capital or revenue) of the following expenditure which were incurred by Harikishore & Co. during the year ending 30th June, 2010:

(i) ₹ 350 was spent on repairing a second hand machine which was purchased on 8th July, 2009 and ₹ 200 was paid on carriage and freight in connection with its acquisition.
(ii) A sum of ₹ 500 was paid as compensation to two employees who were retrenched.
(iii) ₹ 150 was paid in connection with carriage on goods purchased.

(iv) ₹ 20,000 customs duty is paid on import of a machinery for modernisation of the factory production during the current year and ₹ 6,000 is paid on import duty for purchase of raw materials.

(v) ₹ 18,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution

(i) Repairing and carriage totalling ₹ 550 for second hand machine should be treated as a ***Capital Expenditure***.

(ii) Compensation paid to employees shall be treated as a ***Revenue Expenditure***.

(iii) Carriage paid for goods purchased should be treated as a ***Revenue Expenditure***.

(iv) Customs duty paid on import of a machinery should be treated as a ***Capital Expenditure***. However, import duty paid for raw materials should be treated as a ***Revenue Expenditure***.

(v) Interest paid during pre-construction period should be treated as a ***Capital Expenditure***.

Illustration 8

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

1. A truck costing ₹ 1,00,000 and standing in the books at ₹ 60,000 was sold for ₹ 70,000.
2. ₹ 50,000 received from issue of shares including ₹ 10,000 by way of premium.
3. Purchased agricultural land for the mill for ₹ 60,000. ₹ 500 also paid for land revenue.
4. ₹ 5,000 paid as contribution to PWD for improving roads of sugar producing area.
5. ₹ 40,000 paid for exise duty on sugar manufactured.
6. ₹ 70,000 spent for constructing railway siding.

Solution

(i) Profit on sale of truck ₹ 10,000 should be treated as a ***Capital Profit.***

(ii) ₹ 40,000 (₹ 50,000 – ₹ 10,000) received from issue of shares will be treated as a ***Capital Receipt***. The premium of ₹ 10,000 should be treated as a ***Capital Profit.***

(iii) Cost of land ₹ 60,000 will be treated as a ***Capital Expenditure*** and land revenue of ₹ 500 will be treated as a ***Revenue Expenditure.***

(iv) Contribution paid to PWD should be treated as a ***Revenue Expenditure.***

(v) Excise duty of ₹ 40,000 should be treated as a ***Revenue Expenditure.***

(vi) ₹ 70,000 spent for constructing railway siding should be treated as a ***Capital Expenditure.***

Illustration 9

State with reasons whether the following are Capital Expenditure or Revenue Expenditure :

(i) Expenses incurred in connection with obtaining a licence for starting the factory were ₹ 10,000.

(ii) ₹ 1,000 paid for removal of stock to a new site.

(iii) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get full efficiency.

(iv) ₹ 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.

(v) ₹ 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.

(vi) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Solution

(i) ₹ 10,000 incurred in connection with obtaining a licence for starting the factory is a ***Capital Expenditure***. It is incurred for acquiring a right to carry on business for a long period.

(ii) ₹ 1,000 incurred for removal of stock to a new site is treated as a ***Revenue Expenditure*** because it is not enhancing the value of the asset and it is also required for starting the business on the new site.

(iii) ₹ 5,000 incurred for changing Rings and Pistons of an engine is a ***Revenue Expenditure*** because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

(iv) ₹ 2,000 incurred for defending the title to the firm's assets is a ***Revenue Expenditure***.

(v) ₹ 10,000 incurred on advertising is to be treated as a ***Deferred Revenue Expenditure*** because the benefit of advertisement is available for 4 years, ₹ 2,500 is to be written off every year.

(vi) Cost of construction of Factory shed of ₹ 1,00,000 is a ***Capital Expenditure***, similarly cost of construction of small huts for storing building materials is also a ***Capital Expenditure***.

Key Points

- **Capital expenditure** is the money spent on buying fixed assets or adding to their value.
- A **revenue expenditure** is incurred to carry on the normal course of business and maintain the fixed assets in good condition.
- A receipt of money is considered as **capital receipt** when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business.
- A receipt of money is considered as **revenue receipt** when it is received from customers for goods supplied, or fees received for services rendered in the ordinary course of business, which is a result of the firm's activity in the current period.

THEORETICAL QUESTIONS

1. Explain the basic principles which would guide you in allocating expenditure as between capital & revenue. Illustrate your answer with example.
2. Define capital expenditure, revenue expenditure and deferred revenue expenditure.
3. Distinguish between capital expenditure and revenue expenditure.
4. Distinguish between capital receipts and revenue receipts.

PRACTICAL QUESTIONS

1. Classify the following between Capital and Revenue giving reasons for the same:
   (a) ₹ 10,000 spent towards additions to the machinery.
   (b) Repairs for ₹ 2,000 necessitated by negligence.
   (c) ₹ 1,500 spent to remove a worn-out part and replace it with a new one.
   (d) ₹ 400 wages paid in connection with the erection of a new machinery.
   (e) Old machinery of book value of ₹ 10,000 wornout, dismantled at a cost of ₹ 2,000 and scraps realised for ₹ 500.
   (f) Second hand motor-car purchased for ₹ 20,000 and spent ₹ 2,000 for repairs immediately.
   (g) Employees' State Insurance premium ₹ 800 paid.
   (h) Insurance claim of ₹ 5,000 received from the Insurance Company for loss of goods by fire of ₹ 6,000.
2. State which of the following items whould be charged to capital and which to revenue:
   (i) A second-hand truck was purchased for ₹ 50,000 and ₹ 12,000 was spent on overhauling and painting it.
   (ii) ₹ 10,000 was spent for whitewashing the factory building.
   (iii) An old machine which stood in the books at ₹ 50,000 was sold for ₹ 30,000.
   (iv) Wages paid to workmen for installation of a new machinery ₹ 10,000.
   (v) Legal expenses ₹ 5,000 incurred for purchasing a land.
3. The Swadeshi Industries removed their works to more suitable premises:
   (a) A sum of ₹ 4,750 was expended on dismantling, removing and reinstalling plant, machinery and fixtures.
   (b) The removal of stock from the old works to the new one costs ₹ 500.
   (c) Plant and machinery which stood in the books at ₹ 75,000 included a machine at a book value of ₹ 1,700. This being obsolete was sold off at ₹ 450 and was replaced by a new machine which cost ₹ 2,400.
   (d) The freight and cartage on the new machine amounted to ₹ 150 and the erection charge cost ₹ 275.
   (e) The fixtures and furniture appeared in the books at ₹ 7,500. Of these, some portion of the book value of ₹ 1,500 was discarded and sold off at ₹ 600 and new furniture of the value of ₹ 1,200 was acquired.
   (f) A sum of ₹ 1,100 was spent on painting the new factory. State which items of expenditure would be charged to Capital and which to Revenue.

Guide to Answers

1. (a) Capital expenditure; (b) Revenue expenditure; (c) Revenue expenditure; (d) Capital expenditure; (e) ₹ 10,000 capital loss; and ₹ 2,000 – ₹ 500 = ₹ 1,500 should be treated as revenue expenses; (f) Capital expenditure; (g) Revenue receipt.

2. (i) Capital expenditure ₹ 50,000 + ₹ 12,000 = ₹ 62,000. (ii) Revenue expenditure. (iii) ₹ 50,000 – ₹ 30,000 = ₹ 20,000 should be treated as capital loss. (iv) Capital expenditure. (v) Capital expenditure.

3. (a) Capital Expenditure; (b) Revenue Expenditure; (c) Capital Expenditure; (d) Capital Expenditure; (e) ₹ 900 Capital Loss; ₹ 1,200 Capital Expenditure; (f) Capital Expenditure.

12

Rectification of Errors

Introduction

Errors are unintentional misstatements or omission of amounts or disclosures in financial statements. They include mistakes in gathering or processing accounting data from which financial statements are prepared. Errors can also result from incorrect accounting estimates arising from oversight or misinterpretation of facts, and mistakes in the application of accounting principles relating to account classification, manner of presentation or disclosure.

Therefore, accounting errors result from mistakes or omissions in the financial accounting process. Typical errors include (i) Mathematical mistakes; (ii) Mistake in the application of accounting principles; (iii) Oversight; and (iv) Misuse of facts.

Students are advised to reread carefully Chapter 4 (Errors Revealed and Not Revealed By Trial Balance and Types of Errors).

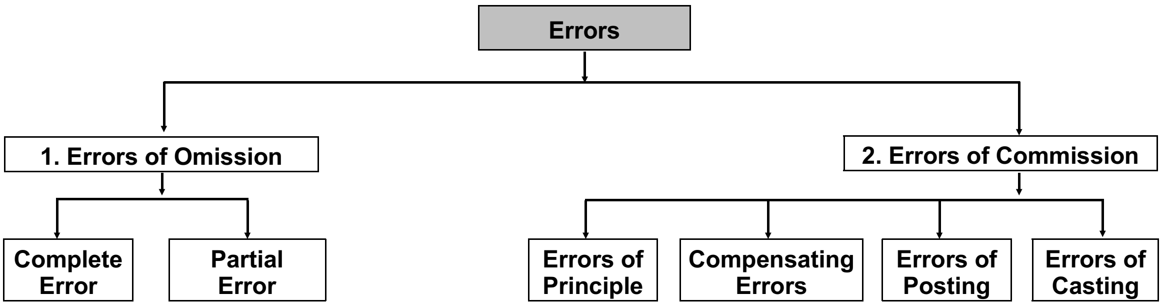
When errors are detected, it is necessary to analyse them to determine what action is appropriate under the circumstances. Since the Trial Balance is prepared to ensure that there is no mathematical error in recording ledger entries or in adding or balancing the accounts, the first step in the process of locating errors is to find out the difference in the Trial Balance totals.

Whenever a Trial Balance disagrees, it indicates that an error has been committed, which must be located and rectified. If the location and rectification of errors takes time and, in the meanwhile, the Trial Balance can not be allowed to remain out of balance, a new account—'Suspense Account' is opened in the Ledger and the difference in Trial Balance is transferred to that account, and the Trial Balance can thus be totalled up and balanced. Afterwards when the errors are located, those can be rectified through the Suspense Account.

Types of Errors

Before explaining how errors are located and rectified, we should know the kinds of errors that usually occur in the books of account. These errors can broadly be divided into two classes —

1. Errors of Omission; and
2. Errors of Commission.



1. Errors of Omission

Errors of omission are errors resulting from the complete failure to enter a transaction in the books. Such errors creep in as a result of some act of omission on the part of the person responsible for the maintenance of the books of account. These errors can further be classified into: (a) Complete error; and (b) Partial error.

(a) Complete Error : When any particular transaction has not at all been entered in the Journal or a book of original entry, it cannot be posted into the Ledger , and a 'complete error of omission' will occur. A complete error will affect both the debit and the credit side of the entry and it will not hamper the agreement of the Trial Balance. Instances of complete errors are :

(i) A receipt of ₹ 1,000 from Ravi is omitted from being entered in the Cash Book.
(ii) Goods sold to Ramesh on credit for ₹ 500 has not been entered in the 'Sales Day Book'.

(b) Partial Error : If a transaction has been journalised or recorded in a subsidiary book but has not been posted in both the Ledger Accounts, it will be an error of partial omission and it will not hamper the agreement of the Trial Balance. For example, discount allowed to a customer has not been debited to 'Discount Allowed Account' in the General Ledger and has also not been credited to Customer Account in the Customer Ledger.

2. Errors of Commission

These errors are the result of some positive act of commission on the part of the person responsible for the maintenance of the books of account. For example, if wrong accounts are entered either in the Journal or in the Ledger, or when the totals are wrongly made, or when the posting is done to wrong accounts, errors of commission are occurred. Errors of commission may further be classified into :

(a) Errors of Principle : These errors arise because of an incorrect application of the principles of accounting, and failure to differentiate between capital and revenue expenditure. Their existence are not usually disclosed by the Trial Balance. Instances of errors of principle are:

(i) Wages paid for the installation of machinery debited to Wages Account. Here, Machinery Account should be debited in place of Wages Account.
(ii) A purchase of furniture passed through the Purchases Day Book. Here, Furniture Account should be debited in place of Purchases Account.

(b) Compensating Errors : These are a group of errors, the total effect of which are not reflected in the Trial Balance. These errors are of a neutralizing nature. One error is compensated by the other error or errors of an opposite nature. For example, an extra debit in Salary Account for ₹ 100 may be compensated by an extra credit of ₹ 100 in Sales Account.

Neither the original error nor the compensating error will thus be detected by a failure to balance, since one error conceals another error. The point to note is that there is no connection between an error and its compensating error other than the coincidence that they are equal and opposite in amount.

(c) Errors of Posting : If a transaction has been journalised or recorded in a subsidiary book but has been posted wrongly in the Ledger Account, it is an error of posting. The following are examples of errors of posting:

(a) Goods sold to Ram on credit for ₹ 210 have been posted in Ram Account as ₹ 21.
(b) Goods purchased from Robin for ₹ 300 have been posted to Rahim Account.

(d) Errors of Casting : Casting is an accounting term for addition. These errors may occur due to short casting or excess casting in any subsidiary book or in any account in the Ledger. These errors are reflected in the Trial Balance unless it is compensated by other errors.

Opportunities may arise to detect and rectify errors in accounts in any of the following stages:

1. Before the preparation of the Trial Balance.
2. After the preparation of the Trial Balance but before the preparation of the Final Accounts.
3. After the preparation of the Final Accounts.

Procedure for correcting errors

The three questions which must be answered before an error can be corrected are :

1. What should have happened ?
2. What has happened ?
3. What action will correct the error ?

1. Rectification of errors before the preparation of the Trial Balance

When errors are detected before the preparation of the Trial Balance, it should be assessed whether they are one-sided errors or two-sided errors. According to the nature of errors, different steps are taken for their rectification.

(a) One-sided errors: For rectification of these types of errors, no journal entry is required to be passed. Only the relevant account in the Ledger is to be debited (for short debit or excess credit) or to be credited (for short credit or excess debit), according to the situation. The following illustrations are self-explanatory.

Illustration 1

Purchases Day Book was cast ₹ 1,500 in place of ₹ 2,000. It means Purchases Account has been debited ₹ 500 short. Therefore, to rectify, the Purchases Account should be debited further by ₹ 500. The following shows it more clearly.

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Creditors A/c	1,500			
	To Sundry Creditors A/c (Error in casting)	500			

It is assumed that Individual Creditors' Account is maintained in the General Ledger.

Illustration 2

Sales Day Book was cast ₹ 2,000 in place of ₹ 1,800. It means Sales Account has received excess credit for ₹ 200. Therefore, to rectify, the Sales Account should be debited by ₹ 200.

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c (Error in casting)	200		By Sundry Debtors A/c	2,000

It is assumed that Individual Debtors' Account is maintained in the General Ledger.

Illustration 3

Return Outward Book was cast ₹ 1,000 in place of ₹ 1,600. It means that Return Outward Account has been credited ₹ 600 short. Therefore, to rectify, the Return Outward Account is to be credited further with ₹ 600.

Dr. **Return Outward Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
				By Sundry Creditors A/c	1,000
				By Sundry Creditors A/c (Error in casting)	600

It is assumed that Individual Creditors' Account is maintained in the General Ledger.

(b) Two-sided errors: For rectification of these types of errors, the following steps should be taken:

Step 1 Write down in the rough sheet the correct entry necessary for recording the transaction.

Step 2 Write down in the rough sheet the entry that has actually been passed.

Step 3 Pass in the Journal, the required entry to arrive at the correct entry of Step 1 and to cancel the entry of Step 2.

The following illustrations explain it more clearly:

Illustration 4

A purchase of ₹ 1,000 from Rahim entered in the Day Book as ₹ 100.

Solution

The Rectification of this error shall call for:

(a)	Purchases Account	Dr. 1,000		Correct entry
	To Rahim Account		1,000	
(b)	Purchases Account	Dr. 100		Entry as passed
	To Rahim Account		100	
(c)	*The rectifying entry in the journal will be* :			
	Purchases Account	Dr. 900		Rectifying entry
	To Rahim Account		900	

Illustration 5

A cash sales of ₹ 600 has completely been omitted to be recorded in the books.

Solution

The Rectification of this error shall call for:

(a)	Cash Account	Dr. 600		Correct entry
	To Sales Account		600	
(b)	Nil			Entry as passed
(c)	*The rectifying entry in the journal will be* :			
	Cash Account	Dr. 600		Rectifying entry
	To Sales Account		600	

Illustration 6

₹ 500 received from B. Sen entered as ₹ 300 in the Cash Book.

Solution

The Rectification of this error shall call for:

(a)	Cash Account	Dr. 500		Correct entry
	To B. Sen Account		500	
(b)	Cash Account	Dr. 300		Entry as passed
	To B. Sen Account		300	
(c)	*The rectifying entry in the journal will be* :			
	Cash Account	Dr. 200		Rectifying entry
	To B. Sen Account		200	

Illustration 7

The following errors have been detected before the preparation of the final Trial Balance. You are required to pass the journal entries, where necessary, or if no journal entry is required, state how they will be corrected:

(i) The Sales Day Book has been undercast by ₹ 800; (ii) The total of the discount column on the debit side of the Cash Book was cast short by ₹ 50. (iii) Repairs to Building charged to Building Account ₹ 500. (iv) Goods worth ₹ 645 sold to Zishan Ali, but the latter's account was credited with ₹ 654. (v) Wages paid for installation of the machinery debited to Wages Account ₹ 1,000.

Solution

(i) The total of Sales Day Book is credited to Sales Account in the Ledger. Here, Sales Day Book has been undercast by ₹ 800. It means that Sales Account has been under-credited by ₹ 800. This error can be corrected by crediting Sales Account further by ₹ 800 (After correcting the total of the Sales Day Book).

(ii) The discount column of the debit side of the Cash Book represents discount allowed. Here, it was cast short by ₹ 50. It means that the Discount Allowed Account was short-debited by ₹ 50. This error can be corrected by debiting Discount Allowed Account further by ₹ 50.

(iii) Repairs to building should be treated as revenue expenditure and it should be debited to Repairs Account in place of Building Account. So, to rectify the error, the following Journal entry should be passed:

Repairs Account	Dr.	₹ 500	
To Building Account			₹ 500

(iv) Goods have been sold to Zishan Ali for ₹ 645. His account should be debited but his account has actually been credited by ₹ 654. To rectify this error, Zishan's account should be debited by ₹ (645+654) = ₹ 1,299.

(v) Wages paid for installation of machinery should be debited to Machinery Account because it is a capital expenditure. So, to rectify, the following entry should be passed:

Machinery Account	Dr.	₹ 1,000	
To Wages Account			₹ 1,000

Illustration 8

Pass rectification entries for the following transactions:

1. A builder's bill for ₹ 4,600 for the erection of a small shed was debited to Repairs Account.
2. Repairs to plant amounting to ₹ 900 had been charged to Plant and Machinery Account.
3. Wages paid to the firm's workmen for making certain additions to machinery amounting to ₹ 340 were debited to Wages Account.
4. A cheque for ₹ 750 received from S Desai was credited to the account of R Ram.
5. Goods to the value of ₹ 700 returned by X were included in closing stock, but no entry was made in the books.
6. Goods costing ₹ 2,000 were purchased for various members of the staff and the cost was included in Purchases. A similar amount was deducted from the salaries of the staff members concerned and the net payments to them debited to Salaries Account.
7. A bill of exchange (received from Hari) for ₹ 3,000 had been returned by the Bank, with whom it had been discounted, as dishonoured and had been credited to Bank Account and debited to Bills Receivable Account.
8. Goods sold to Z for ₹ 475 have been wrongly entered in the Sales Book as ₹ 745.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
1.	Building A/c	Dr.		4,600	
	To Repairs A/c				4,600
	(Being expenses for erection of a small shed had been wrongly debited to repairs account, in place of building account, now rectified)				
2.	Repairs A/c	Dr.		900	
	To Plant & Machinery A/c				900
	(Being repairs to Plant & Machinery had been wrongly charged to Plant & Machinery A/c, now rectified)				
3.	Plant & Machinery A/c	Dr.		340	
	To Wages A/c				340
	(Being wages paid for addition to machinery had been wrongly debited to Wages A/c in place of Machinery A/c, now rectified)				
4.	R. Ram A/c	Dr.		750	
	To S. Desai A/c				750
	(Being cheque from S. Desai wrongly credited to R. Ram, now rectified)				
5.	Return Inward A/c	Dr.		700	
	To X A/c				700
	(Being goods returned by X not recorded in the book, now rectified)				
6.	Salaries A/c	Dr.		2,000	
	To Purchases A/c				2,000
	(Being goods purchased for staff members not debited to Salaries A/c, now rectified)				
7.	Hari A/c	Dr.		3,000	
	To Bills Receivable A/c				3,000
	(Being bill accepted by Hari was dishonoured but wrongly debited to Bills Receivable A/c, now rectified)				
8.	Sales A/c (₹ 745 – 475)	Dr.		270	
	To Z A/c				270
	(Being sales to Z of ₹ 475 wrongly recorded in the sales book as ₹ 745, now rectified)				

2. Rectification of errors after the preparation of Trial Balance but before the preparation of Final Accounts

When errors are detected after the preparation of the Trial Balance, it should be rectified in the following manner:

(a) One-sided errors: Most of the one-sided errors will be rectified by passing a journal entry via Suspense Account.

Suspense Account

A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified. This may be so because further information has to become available or while preparing the accounts, the accountant is unsure of how to proceed with it.It is opened in the following cases: (i) to balance a disagreed Trial Balance; (ii) to post doubtful items; and (iii) to record incomplete transactions.

(i) To Balance a Disagreed Trial Balance Sometimes, a Trial Balance does not tally despite all efforts; but one cannot wait indefinitely as accounts must be closed at the end of a financial year. In such a case, the amount of difference is entered in the lighter column against Suspense Account. ***The point to note is that no double entry will be possible.*** Later, when the mistakes are detected, the rectifying entries are passed.

(ii) To Post Doubtful Items Sometimes, an item cannot be posted to the correct account for one reason or another. For instance, you may receive a remittance of ₹ 1,500 but you may not know who has sent it. You then pass the following entry:

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
	Cash A/c	Dr.		1,500	
	To Suspense A/c				1,500
	(Being remittance, received from unknown sender)				

Later, you get the information that Ram, Shyam & Co has sent this amount. Then you should pass the following entry:

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
	Suspense A/c	Dr.		1,500	
	To Ram, Shyam & Co A/c				1,500
	(Being credit given to the sender for a remittance which had been credited previously to Suspense Account)				

(iii) To Record Incomplete Transactions Sometimes a Suspense Account is opened to record a balance that has not yet been finalised because a particular deal has not been concluded. For example, an advance of ₹ 10,000 received from X for the goods to be delivered in the future, subject to availability. A Suspense Account can include many transactions of this nature, without involving any error.

Now, the following illustrations show the way for rectification of one-sided errors:

Illustration 9

Goods worth ₹ 1,000 were sold to Mr R Sharma on credit. This was entered in the Sales Day Book, but was not posted into R Sharma Account.

Here, only Sales Account has been credited by ₹ 1,000 without a corresponding debit. In effect, the Trial Balance will show a short debit for ₹ 1,000. Now, if the difference in Trial Balance has been transferred to Suspense Account, it implies that Suspense Account has been debited by ₹ 1,000. For rectification, R Sharma Account is to be debited and Suspense Account is to be cancelled by crediting it. Therefore, the effective entry will be:

R Sharma Account	Dr.	1,000	
To Suspense Account			1,000

Illustration 10

Cash paid to Ram ₹ 400 was posted to the credit of his account as ₹ 440 from Cash Book.

Here, Cash Account has been credited by ₹ 400 without any debit and Ram Account has also been credited by ₹ 440 without corresponding debit. In effect, the Trial Balance will show a short debit of (₹ 400 + ₹ 440) ₹ 840. If the difference in account has been transferred to Suspense Account, it implies that Suspense Account has been debited by ₹ 840 to bring the Trial Balance in agreement. For rectification : (i) Ram Account should be debited by ₹ 840 so that he gets a net debit of ₹ 400; and (ii) The Suspense Account should also be cancelled.

The effective entry will be :

Ram Account	Dr.	840	
To Suspense Account			840

(b) Two-sided Error For rectification of two-sided errors, the following steps should be taken:

Step 1 Write down in the rough sheet the correct entry necessary for recording the transaction.

Step 2 Write down in the rough sheet the entry that has actually been passed.

Step 3 Pass in the Journal, the required entry to arrive at the correct entry of Step 1 and to cancel the entry of Step 2.

Illustration 11

Purchase of stationery for ₹ 400 has been recorded in the Cash Book as ₹ 40.

Solution

			Dr.	Cr.	
(a)	Stationery Account	Dr.	400		Correct entry
	To Cash Account			400	
(b)	Stationery Account	Dr.	40		Entry as passed
	To Cash Account			40	
(c)	*The rectifying entry in the journal will be* :				
	Stationery Account	Dr.	360		Rectifying entry
	To Cash Account			360	

Illustration 12

Sale of old furniture has been credited to Sales Account for ₹ 200

Solution

			Dr.	Cr.	
(a)	Cash Account	Dr.	200		Correct entry
	To Furniture Account			200	
(b)	Cash Account	Dr.	200		Entry as passed
	To Sales Account			200	
(c)	*The rectifying entry in the journal will be* :				
	Sales Account	Dr.	200		Rectifying entry
	To Furniture Account			200	

Illustration 13

a) An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2017 :

Heads of Accounts	Dr. ₹	Cr. ₹
Provision for Doubtful Debts	200	
Bank Overdraft	1,654	
Capital		4,591
Creditors		1,637
Debtors	2,983	
Discount Received	252	
Discount Allowed		733
Drawings	1,200	
Office Furniture	2,155	
General Expenses		829
Purchases	10,923	
Returns Inward		330
Rent & Rates	314	
Salaries	2,520	
Sales		16,882
Stock	2,418	
Provision for Depreciation on Furniture	364	
Total	24,983	25,002

Required : (a) Draw up a 'Corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.
(b) Further investigation of the Suspense Account, ascertained in (a) above reveals the following errors:

(i) Goods bought from J Jones amounting to ₹ 13 had been posted to his account as ₹ 33.
(ii) Furniture which had cost ₹ 173 had been debited to the General Expenses Account.
(iii) An invoice from Suppliers Ltd., for ₹ 370 had been omitted from the Purchases Account, but credited to Suppliers Ltd. Account.
(iv) Sales on credit to A Hope Ltd, for ₹ 450 had been posted to the Sales Account, but not to A Hope Ltd Account.
(v) The balance on the Capital Account had been incorrectly brought forward in the Ledger, and should have been ₹ 4,291.
(vi) An amount of ₹ 86 received from A. Blunt, a debtor, in settlement of his account had been treated as a cash sale.
(vii) Discount allowed has been undertotalled by ₹ 35.

Required : Prepare Journal entries correcting each of the above errors and write up the Suspense Account.

Solution **Trial Balance as on 30th June, 2017**

Heads of Accounts	Dr. ₹	Cr. ₹
Provision for Doubtful Debts		200
Bank Overdraft		1,654
Capital		4,591
Creditors		1,637
Debtors	2,983	
Discount Received		252
Discount Allowed	733	
Drawings	1,200	
Office Furniture	2,155	
General Expenses	829	
Purchases	10,923	
Returns Inward	330	
Rent & Rates	314	
Salaries	2,520	
Stock	2,418	
Provision for Depreciation on Furniture		364
Sales		16,882
Suspense (Balancing figure)	1,175	
Total	25,580	25,580

Journal

Date		Particulars	L.F.	Dr. ₹	Cr. ₹
2017 June 30	(i)	J. Jones A/c Dr. To Suspense A/c (Being goods purchased from J. Jones for ₹ 13 had been wrongly posted to his account as ₹ 33, now rectified)		20	20
	(ii)	Furniture A/c Dr. To General Expenses A/c (Being purchase of furniture had been wrongly debited to General Expenses A/c, now rectified)		173	173
	(iii)	Purchases A/c Dr. To Suspense A/c (Being a purchase of ₹ 370 had been omitted from Purchases A/c, now rectified)		370	370
	(iv)	A. Hope Ltd A/c Dr. To Suspense A/c (Being goods sold to A. Hope Ltd had not been posted to his account, now rectified)		450	450
	(v)	Capital A/c ₹ (4,591 – 4,291) Dr. To Suspense A/c (Being the balance of capital account brought forward as ₹ 4,591 in place of ₹ 4,291, now rectified)		300	300
	(vi)	Sales A/c Dr. To A. Blunt A/c (Being cash received from A. Blunt, a debtor, treated as cash sales, now rectified)		86	86
	(vii)	Discount Allowed A/c Dr. To Suspense A/c (Being discount allowed had been undertotalled by ₹ 35, now rectified)		35	35

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

Date	Particulars	₹	Date	Particulars	₹
2017 June 30	To Balance b/f	1,175	2017 June 30	By J Jones A/c By Purchases A/c By A Hope Ltd A/c By Capital A/c By Discount Allowed A/c	20 370 450 300 35
		1,175			1,175

Illustration 14

Pass necessary Journal Entries to rectify the following errors :

(a) Sales day book undercast by ₹ 500
(b) Sales day book overcast by ₹ 1,000
(c) Sales returns day book undercast by ₹ 600
(d) Sales returns day book overcast by ₹ 1,600
(e) Purchases day book undercast by ₹ 500
(f) Purchases day book overcast by ₹ 1,500
(g) Purchases returns day book undercast by ₹ 500
(h) Purchases returns day book overcast by ₹ 1,000
(i) Bills receivable book undercast by ₹ 500
(j) Bills payable book undercast by ₹ 1,000
(k) Bills receivable book overcast by ₹ 600
(l) Bills payable book overcast by ₹ 500

Solution

The question is solved assuming subsidiary ledger is not maintained.

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
(a)	Suspense A/c	Dr.		500	
	To Sales A/c				500
	(Being sales day book was undercast by ₹ 500, now rectified)				
(b)	Sales A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being sales day book was overcast by ₹ 1,000, now rectified)				
(c)	Sales Returns A/c	Dr.		600	
	To Suspense A/c				600
	(Being sales returns day book was undercast by ₹ 600, now rectified)				
(d)	Suspense A/c	Dr.		1,600	
	To Sales Returns A/c				1,600
	(Being sales returns day book was overcast by ₹ 1,600, now rectified)				
(e)	Purchases A/c	Dr.		500	
	To Suspense A/c				500
	(Being purchases day book was undercast by ₹ 500, now rectified)				
(f)	Suspense A/c	Dr.		1,500	
	To Purchases A/c				1,500
	(Being purchases dayy book was overcast by ₹ 1,500, now rectified)				
(g)	Suspense A/c	Dr.		500	
	To Purchases Returns A/c				500
	(Being purchases returns day book was undercast by ₹ 500, now rectified)				
(h)	Purchases Returns A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being purchases returns day book was overcast by ₹ 1,000, now rectified)				
(i)	Bills Receivable A/c	Dr.		500	
	To Suspense A/c				500
	(Being bills receivable book was undercast by ₹ 500, now rectified)				
(j)	Suspense A/c	Dr.		1,000	
	To Bills Payable A/c				1,000
	(Being bills payable book was undercast by ₹ 1,000, now rectified)				
(k)	Suspense A/c	Dr.		600	
	To Bills Receivable A/c				600
	(Being bills receivable book was overcast by ₹ 600, now rectified)				
(l)	Bills Payable A/c	Dr.		500	
	To Suspense A/c				500
	(Being bills payable book was overcast by ₹ 500, now rectified)				

Illustration 15

At 31st March, 2017, the accountant of ABC & Co. has failed to balance his books of account. The difference has been carried to Suspense Account. Subsequently, the following errors are discovered before finalisation of account. Give journal entries to rectify these errors.

(a) Cash discount allowed for ₹ 600 and discount received for ₹ 400 have been posted to the wrong sides of the Discount Account in the ledger.

(b) An amount of ₹ 2,000 withdrawn by the proprietor for his personal use had been debited to Travelling Expenses Account.

(c) Return inward book was overcast by ₹ 300.

(d) A cheque for ₹ 3,456 received from Mr P after allowing him a discount of ₹ 46, was endorsed to Mr N in full settlement for ₹ 3,500. The cheque was finally dishonoured but no entries for dishonour were passed in the books.

[C.U.B.Com. (Hons.) — Adapted]

Solution **In the books of ABC & Co.**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
(a)	Discount Allowed A/c	Dr.		1,200	
	To Discount Received A/c				800
	To Suspense A/c				400
	(Being discount allowed ₹ 600 and discount received ₹ 400 posted on the wrong sides of the respective accounts, now rectified)				

(b)	Drawings A/c Dr. To Travelling Expenses A/c (Being cash withdrawn by the proprietor for personal use, debited to Travelling Expenses Account, now rectified)		2,000	2,000
(c)	Suspense A/c Dr. To Return Inward a/c (Being the overcasting in the Return Inward Book, now rectified)		300	300
(d)	P A/c Dr. Discount Received A/c Dr. To N A/c To Discount Allowed A/c (Being cheque received from P for ₹ 3,456 after allowing him discount of ₹ 46 endorsed in favour of N in full settlement for ₹ 3,500. The cheque was dishonoured but no entry were passed, now rectified)		3,502 44	3,500 46

Illustration 16

Ravi Shastri could not agree the Trial Balance. He transferred to the Suspense Account amount of ₹ 296, being excess of the debit side total. The following errors were subsequently discovered:

(i) Sales Book was overcast by ₹ 300; (ii) Purchase of furniture for ₹ 615 passed through Purchase Book; (iii) An amount of ₹ 55 received from Yograj Singh was posted to his account as ₹ 550; (iv) Purchase Return Book total on a folio was carried forward as ₹ 221 instead of ₹ 112; (v) A cash sale of ₹ 1,235 duly entered in the Cash Book but posted to Sales Account as ₹ 235; and (vi) Rest of the difference was due to incorrect total in the Salaries Account in the Ledger. Give journal entries to rectify the above and prepare Suspense Account.

Solution **In the books of Ravi Shastri**

Journal **Dr. Cr.**

Date	Particulars	L.F.	₹	₹
(i)	Sales A/c Dr. To Suspense A/c (Being Sales Book was overcast by ₹ 300, now rectified)		300	300
(ii)	Furniture A/c Dr. To Purchases A/c (Being purchase of furniture passed through Purchases Day Book, now rectified)		615	615
(iii)	Yograj Singh A/c Dr. To Suspense A/c (Being an amount of ₹ 55 recd. from Yograj was wrongly entered in his account as ₹ 550 ,now rectified)		495	495
(iv)	Purchases Return A/c Dr. To Suspense A/c (Being total of purchases return book was carried forward as ₹ 221 in place of ₹ 112, now rectified)		109	109
(v)	Suspense A/c Dr. To Sales A/c (Being Cash Sales of ₹ 1,235 wrongly posted in the Sales Account as ₹ 235, now rectified)		1,000	1,000
(vi)	Suspense A/c Dr. To Salaries A/c (Being Salaries Account was overcasted by ₹ 200, now rectified)		200	200

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

Date	Particulars	₹	Date	Particulars	₹
	To Sales A/c	1,000		By Balance b/f	296
	To Salaries A/c (Balancing figure)	200		By Sales A/c	300
				By Yograj A/c	495
				By Purchases Return A/c	109
		1,200			1,200

Illustration 17

The trial balance of Shri Govind shows a difference of ₹ 500, the credit side being in excess. The difference is subsequently found due to the following mistakes:

(a) The purchase of an office table costing ₹ 2,000 had been passed through the Purchases Day Book.

(b) A motor car had been purchased for ₹ 3,400. Cash had been correctly credited but the Motor Car Account had been debited with ₹ 3,140 only.

(c) Interest on deposits received ₹ 60 had been debited in the Cash Account, but had not been credited to the Interest Account.

(d) The balance in the account of Mr Rahim ₹ 100 had been written off as bad but no other account had been debited.
(e) A debit balance of ₹ 200 on the personal account of Mr John (correctly shown in the Ledger) had been omitted when extracting a Trial Balance.

Give the necessary journal entries and show the Suspense Account. ***[C.A. (Entrance) — Adapted]***

Solution

In the books of Shree Govind
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Furniture A/c	Dr.		2,000	
	To Purchases A/c				2,000
	(Being the purchase of office table wrongly passed through Purchases Day Book, now rectified)				
(b)	Motor Car A/c	Dr.		260	
	To Suspense A/c				260
	(Being motor car of ₹ 3,400 has been posted as ₹ 3,140, now rectified)				
(c)	Suspense A/c	Dr.		60	
	To Interest Received A/c				60
	(Being interest received had not been credited to Interest Account, now recorded)				
(d)	Bad Debt A/c	Dr.		100	
	To Suspense A/c				100
	(Being bad debt written off had not been debited to Bad Debt Account, now rectified)				
(e)	Sundry Debtors A/c	Dr.		200	
	To Suspense A/c				200
	(Being the debit balance of John's account had been omitted in the Trial Balance, now rectified)				

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	500		By Motor Car A/c	260
	To Interest Received A/c	60		By Bad Debt A/c	100
				By Sundry Debtors A/c	200
		560			560

Illustration 18

Ganesh drew a Trial Balance of his operations for the year ended 31.03.2017. There was a difference in the Trial Balance which he closed with a Suspense Account. On a scrutiny by the auditors, the following errors were found :

(i) Purchases Day Book for the month of April 2016 was undercast by ₹ 1,000.
(ii) Sales Day Book of October 2016 was overcast by ₹ 10,000.
(iii) A furniture purchased for ₹ 8,100 was entered in the Furniture Account as ₹ 810.
(iv) A bill for ₹ 10,000 drawn by Ganesh was not entered in the Bills Receivable Book.
(v) A machinery purchased for ₹ 10,000 was entered in the Purchases Day Book.

Pass necessary Journal Entries to rectify the same and ascertain the difference in the Trial Balance that was shown under the Suspense Account in respect of the above items.

[C.A. (Foundation) — Adapted]

Solution

In the books of Ganesh
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 March 31 (i)	Purchases A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being the Purchases Day Book undercast by ₹ 1,000, now rectified)				
(ii)	Sales A/c	Dr.		10,000	
	To Suspense A/c				10,000
	(Being the Sales Day Book overcast by ₹ 10,000, now rectified)				
(iii)	Furniture A/c ₹ (8,100 – 810)	Dr.		7,290	
	To Suspense A/c				7,290
	(Being the purchase of furniture of ₹ 8,100 entered in the Furniture Account as ₹ 810, now rectified)				
(iv)	Bills Receivable A/c	Dr.		10,000	
	To Sundry Debtors A/c				10,000
	(Being the bill drawn on debtors not recorded in the Bills Receivable Book, now recorded)				
(v)	Machinery A/c	Dr.		10,000	
	To Purchases A/c				10,000
	(Being the purchase of machinery wrongly entered in the Purchases Day Book, now rectified)				

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

Date	Particulars	₹	Date	Particulars	₹
2017 March 31	To Balance b/f (Balancing figure)	18,290	2017 March 31	By Purchases A/c	1,000
				By Sales A/c	10,000
				By Furniture A/c	7,290
		18,290			18,290

Illustration 19

In taking out a Trial balance, a book-keeper finds that debit total exceeds the credit total by ₹ 352. The amount is placed to the credit of a newly opened Suspense Account. Subsequently, the following mistakes were discovered.

You are required to pass the necessary entries for rectifying the mistakes and show the Suspense Account.

(a) Sales Day Book was overcast by ₹ 100;
(b) A sale of ₹ 50 to Shri Ram was wrongly debited to Sri Krishna;
(c) General expenses ₹ 18 was posted as ₹ 80;
(d) Cash received from Shri Govind was debited to his account ₹ 150;
(e) While carrying forward the total of one page of the Purchases Day Book to the next, the amount of ₹ 1,235 was entered as ₹ 1,325. ***[C.A. (Entrance) — Adapted]***

Solution **Journal** **Dr.** **Cr.**

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Sales A/c Dr.		100	
	To Suspense A/c			100
	(Being Sales Day Book was overcast by ₹ 100, now rectified)			
(b)	Shri Ram A/c Dr.		50	
	To Shri Krishna A/c			50
	(Being sale of ₹ 50 to Shri Ram wrongly debited to Shri Krishna, now rectified)			
(c)	Suspense A/c ₹ (80 – 18) Dr.		62	
	To General Expenses A/c			62
	(Being general expenses of ₹ 18 was posted as ₹ 80, now rectified)			
(d)	Suspense A/c ₹ (150 x 2) Dr.		300	
	To Shri Govind A/c			300
	(Being cash received from Shri Govind was debited to his account, now rectified)			
(e)	Suspense A/c ₹ (1,325 – 1,235) Dr.		90	
	To Purchases A/c			90
	(Being the total of Purshases Day Book of ₹ 1235 was entered as ₹ 1325, now rectified)			

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

Date	Particulars	₹	Date	Particulars	₹
	To General Expense A/c	62		By Balance b/d	352
	To Shri Govind A/c	300		By Sales A/c	100
	To Purchases A/c	90			
		452			452

Illustration 20

Rectify the following errors found in the books of Mr S K Sharma. The Trial balance had ₹ 1,860 excess credit. The difference has been posted to a Suspense Account:

(i) The total of Returns Inward Book has been cast ₹ 2,000 short.
(ii) The purchase of an office table costing ₹ 6,000 has been passed through the Purchases Day Book.
(iii) ₹ 7,500 paid for wages to workman for making showcases had been charged to Wages Account.
(iv) A purchase of ₹ 1,340 had been posted to the Creditor's Account as ₹ 600.
(v) A cheque for ₹ 4,000 received from Mr P C Joshi had been dishonoured and was passed to the debit of 'Allowances Account'.

After rectification, reflect the transactions in the Suspense Account.

Solution **In the books of S K Sharma**
Journal **Dr.** **Cr.**

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Returns Inward A/c Dr.		2,000	
	To Suspense A/c			2,000
	(Being the Returns Inward Book cast short by ₹ 2,000, now rectified)			

(ii)	Furniture A/c Dr. To Purchases A/c (Being purchase of office table passed through the Purchases Day Book, now rectified)	6,000	6,000
(iii)	Furniture A/c Dr. To Wages A/c (Being wages paid for making showcases wrongly debited to Wages Account, now rectified)	7,500	7,500
(iv)	Suspense A/c ₹ (1,340 – 600) Dr. To Creditors A/c (Being purchase of ₹ 1,340 wrongly credited to Creditors Account for ₹ 600, now rectified)	740	740
(v)	Mr. P.C. Joshi A/c Dr. To Allowances A/c (Being a cheque recd. from Mr. Joshi dishonoured but debited to Allowances Account ,now rectified)	4,000	4,000

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,860		By Returns Inward A/c	2,000
	To Creditors A/c	740		By Balance c/d (See Note)	600
		2,600			2,600

Note: The balance in the Suspense Account indicates that there are other undetected errors in the books.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 21

Mr P. Sen could not agree his Trial Balance on March 31, 2015. The difference has been carried to Suspense Account. The following errors were subsequently discovered :

(a) Sales Day Book was over cast by ₹ 6,000.

(b) Purchase of machinery ₹ 12,300 was passed through Purchases Day Book.

(c) An amount of ₹ 1,100 received from Mr Dey was posted to his account as ₹ 11,000.

(d) Purchase Return Book total on a page was carried forward as ₹ 4,420 instead of ₹ 2,240.

Rectify the above errors by passing necessary Journal entries.

[C.U.B.Com. (General) — 2016]

Solution **In the Books of Mr P Sen**

Journal **Dr.** **Cr.**

Date	Particulars	₹	₹
(a)	Sales A/c Dr. To Suspense A/c (Being the over-casting of Sales Day Book, now rectified)	6,000	6,000
(b)	Machinery A/c Dr. To Purchases A/c (Being the purchase of machinery wrongly passed through the Purchases Day Book, now rectified)	12,300	12,300
(c)	Dey A/c Dr. To Suspense A/c (Being an amount of ₹ 1,100 received from Mr Dey wrongly credited to his account with ₹ 11,000, now rectified)	9,900	9,900
(d)	Return Outward A/c Dr. To Suspense A/c (Being the total of Purchase Return Book wrongly carried forward as ₹ 4,420 instead of ₹ 2,240, now rectified)	2,180	2,180

Illustration 22

Rectify the following errors after preparation of Trial Balance but before preparing Final Accounts by passing necessary Journal entries.

(a) Goods taken by proprietor ₹ 2,500 for gift to his daughter, were not recorded at all.

(b) ₹ 2,000 received from Bimal against debts previously written off as bad debts have been credited to his personal account.

(c) Received interest ₹ 1,500, posted to Loan Account.

(d) A cheque received from Amal, a debtor, for ₹ 4,000 was directly received by the proprietor who deposited it into his personal Bank Account. ***[C.U.B.Com. (General) — 2015]***

Solution **Journal** **Dr. Cr.**

Date	Particulars		₹	₹
(a)	Drawings A/c	Dr.	2,500	
	To Purchases A/c			2,500
	(Being goods taken over for personal use were not recorded, now rectified)			
(b)	Bimal A/c	Dr.	2,000	
	To Bad Debts Recovery A/c			2,000
	(Being bad debt recovered wrongly credited to Customers' Account, now rectified)			
(c)	Loan A/c	Dr.	1,500	
	To Interest Received A/c			1,500
	(Being interest received wrongly credited to Loan Account, now rectified)			
(d)	Drawings A/c	Dr.	4,000	
	To Debtors A/c			4,000
	(Being cheque from debtors wrongly deposited in the personal account of the proprietor, now rectified)			

Illustration 23

The following errors were discovered after preparation of the Trial Balance. Pass journal entries to rectify the errors.

(a) a cheque for ₹ 3,500 received as insurance claim for loss of goods-in-transit at the time of import was deposited by the proprietor into his private bank account.

(b) A purchase of ₹ 2,500 from X and Co. on the last day of the year was taken into stock, but the invoice was not passed through the Purchase Book.

(c) Bad Debts aggregating ₹ 675 were written-off during the year in Sales Ledger but were not recorded in the General Ledger.

(d) A payment of ₹ 9,500 towards cost of stamps and registration of new building acquired was posted to the Legal Charges Account as ₹ 5,900. ***[C.U.B.Com. (General) — 2014]***

Solution **Journal** **Dr. Cr.**

Date	Particulars		₹	₹
(a)	Drawings A/c	Dr.	3,500	
	To Insurance Claim A/c			3,500
	(Being a cheque received on account of insurance claim for the business wrongly deposited to the personal account of the proprietor, now rectified)			
(b)	Purchase A/c	Dr.	2,500	
	To X and Co. A/c			2,500
	(Being goods received but invoice was not passed through Purchase Day Book, now rectified)			
(c)	General Ledger Adjustment A/c	Dr.	675	
	To Sales Ledger Adjustment A/c			675
	(Being bad debts of ₹ 675 was written-off during the year in Sales Ledger but was not recorded in General Ledger, now rectified)			
(d)	Building A/c	Dr.	9,500	
	To Legal Charges A/c			5,900
	To Suspense A/c			3,600
	(Being registration expenses for purchase of building ₹ 9,500 wrongly debited to Legal Charges Account as ₹ 5,900, now rectified)			

Illustration 24

On 31.03.2013 Mr B could not agree his Trial Balance. He transferred ₹ 1,596 (being excess of the debit side total) to Suspense Acount. The following errors were subsequently discovered :

(i) ₹ 55 received from Mr A was posted to his account as ₹ 550.
(ii) Purchases Return Book's total on a page was carried forward as ₹ 5,221 instead of ₹ 5,112.
(iii) A cash sale of ₹ 2,935 duly entered in the cash book but posted to Sales Account as ₹ 1,235.
(iv) Salary paid was recorded in the Salaries Account ₹ 12,500 instead of ₹ 12,000.

Make necessary journal entries to correct these errors and close the Suspense Account.

[C.U.B.Com. (General) — 2013]

Solution

In the books of B
Journal

Date	Particulars		Dr. ₹	Cr. ₹
(i)	A A/c	Dr.	495	
	To Suspense A/c			495
	(Being cash received ₹ 55 from X has been posted to his account as ₹ 550, now rectified)			
(ii)	Purchase Return A/c	Dr.	109	
	To Suspense A/c			109
	(Being purchase return book total was carried forward as ₹ 5,221 instead of ₹ 5,112, now rectified)			
(iii)	Suspense A/c	Dr.	1,700	
	To Cash A/c			1,700
	(Being cash sales of ₹ 2,935 has been posted in the Sales Account as ₹ 1,235, now rectified)			
(iv)	Suspense A/c	Dr.	500	
	To Salary A/c			500
	(Being salary of ₹ 12,000 posted as ₹ 12,500, now rectified)			

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Sales A/c	1,700		By Balance b/d	1,596
	To Salary A/c	500		By A A/c	495
				By Purchase Return A/c	109
		2,200			2,200

Illustration 25

At 31st March, 2011 the Accountant finds a difference in the Trial Balance. The difference has been carried to Suspense Account. Subsequently,the following errors are discovered before finalisation of accounts. Give Journal Entries to rectify these errors and prepare the Suspense Account:

(i) Purchase of furniture for ₹ 1,000 passed through Purchase Book.
(ii) An amount of ₹ 550 received from Raja was posted to his account as ₹ 5,500.
(iii) Cash received from A ₹ 800 wrongly recorded as Cash Sales.
(iv) Discount allowed ₹ 150 was wrongly credited to Discount Received Account. ***[C.U.B.Com. (General) — 2011]***

Answer

In the books of ...
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2011	Furniture A/c	Dr.		1,000	
March 31	To Purchases A/c				1,000
(i)	(Being purchase of furniture wrongly passed through Purchase Day Book, now rectified)				
	Raja A/c	Dr.		4,950	
(ii)	To Suspense A/c (₹ 5,500 – 550)				4,950
	(Being cash received from Raja ₹ 550 wrongly credited to his account as ₹ 5,500, now rectified)				
(iii)	Sales A/c	Dr.		800	
	To Debtors A/c				800
	(Being cash received from A ₹ 800 wrongly recorded as cash sales, now rectified)				
(iv)	Discount Allowed A/c	Dr.		150	
	Discount Received A/c	Dr.		150	
	To Suspense A/c				300
	(Being discount allowed ₹ 150 was wrongly credited to Discount Received Account, now rectified)				

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 March 31	To Balance b/d (Balancing figure) (Note 1)	5,250	2011 March 31	By Raja A/c	4,950
				By Discount Allowed A/c	150
				By Discount Received A/c	150
		5,250			5,250

Note 1 : It is assumed that there is no other errors.

[For Honours Candidates Only]

Illustration 26

The following errors were detected after preparing the Trial Balance but before the preparation of Final Accounts in the books of Mr. Basu :

(a) The total of Return Inwards Books has been cast ₹ 1,000 short.
(b) A sum of ₹ 4,000 written off from machinery has not been posted to Depreciation Account.
(c) The purchase of an office furniture costing ₹ 13,000 has been passed through the Purchase Day Book.
(d) ₹ 600 received from Mr. Roy has been debited to Mr. Sen.

Show the Journal entries for rectifying the above errors. ***[C.U.B.Com. (Hons.) — 2016]***

Solution

In the Books of Mr Basu
Journal

Date	Particulars	Dr. ₹	Cr. ₹
(a)	Return Inward A/c Dr.	1,000	
	To Suspense A/c		1,000
	(Being the Return Inward Book cast short, now rectified)		
(b)	Depreciation A/c Dr.	4,000	
	To Suspense A/c		4,000
	(Being the depreciation account not being debited wrongly, now rectified)		
(c)	Office Furniture A/c Dr.	13,000	
	To Purchases A/c		13,000
	(Being the purchase of office furniture wrongly passed through Purchases Day Book, now rectified)		
(d)	Suspense A/c Dr.	1,200	
	To Mr Sen A/c		600
	To Mr Roy A/c		600
	(Being cash received from Mr Roy wrongly debited to Mr Sen, now rectified)		

Illustration 27

The following errors were discovered after preparation of Trial Balance but before preparation of Final Accounts. ShowJournal entries to rectify the above errors :

(a) A sale of ₹ 3,400 made to Mr. X was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Y as ₹ 340.
(b) Goods of the value of ₹ 2,500 returned by Mr. Sengupta were entered in the Sales Day Book and posted there from to the credit of his account.
(c) A cheque of ₹ 5,348 received from Mr. Sarkar after allowing him a discount of ₹ 58 was endorsed to Mr. Karmakar in full settlement for ₹ 5,400. The cheque was finally dishonoured but no entries for dishonour were passed in the books.
(d) A payment of ₹ 8,500 towards cost of stamps and registration of new building acquired was posted to the Legal Charges Account as ₹ 5,800.

[C.U.B.Com. (Hons.) — 2015]

Solution

Journal

Date	Particulars	Dr. ₹	Cr. ₹
(a)	Y A/c Dr.	3,060	
	To Suspense A/c		3,060
	(Being goods sold to Y for ₹ 3,400 wrongly posted to his account as ₹ 340, now rectified)		

(b)	Return Inward A/c Dr. Sales A/c Dr. To Suspense A/c (Being goods returned by Mr. Sengupta wrongly entered in the Sales Day Book. However, it was posted to the credit of Mr. Sengupta, now rectified)	2,500 2,500	 5,000
(c)	Karmakar A/c Dr. Discount Received A/c Dr. To Sarkar A/c To Discount Allowed A/c (Being a cheque of ₹ 5,348 received from Sarkar after allowing discount of ₹ 58 was endorsed to Karmakar for ₹ 5,400 in full settlement. The cheque was dishonoured but no entry was passed, now rectified)	5,400 6	 5,348 58
(d)	Building A/c Dr. To Legal Expenses A/c (Being cost of stamps and registration fees for purchase of building wrongly debited to Legal Expenses Account, now rectified)	8,500	 8,500

Illustration 28

The Trial Balance of Mr. A K Roy did not tally as on 31.03.2014 and it has been tallied with the help of a Suspense Account. The following errors were detected as a result of checking of the books of accounts.

(i) An item of purchase of ₹ 351 was entered in the Purchases Book as ₹ 35 and posted to the supplier's account as ₹ 51.

(ii) Bills Receivable from Mr X of ₹ 2,500 was posted to the credit of Bills Payable Account and also credited to the account of Mr X.

(iii) A sale of ₹ 1,500 has been passed through Purchase Journal. The customer's account has, however, been correctly debited.

(iv) Discount amounting to ₹ 300 received from a supplier had been entered in his account but not posted to the Discount Account.

Pass the necessary Journal entries to rectify the above errors.

[C.U.B.Com. (Hons.) — 2014]

Solution

In the books of A. K. Roy
Journal

Date	Particulars	Dr. ₹	Cr. ₹
(i)	Purchases A/c (₹ 351 – 35) Dr. To Creditors A/c To Suspense A/c (Being an item of purchase of ₹ 351 was wrongly entered in Purchase Book as ₹ 35. It was posted to Supplier's Account as ₹ 51, now rectified)	316	 300 16
(ii)	Bills Receivable A/c Dr. Bills Payable A/c Dr. To Suspense A/c (Being bills receivable from X ₹ 2,500 wrongly posted to the credit of Bills Payable Account, now rectified)	2,500 2,500	 5,000
(iii)	Suspense A/c Dr. To Purchase A/c To Sales A/c (Being sale of ₹ 1,500 wrongly posted through Purchase Journal, now rectified)	3,000	 1,500 1,500
(iv)	Suspense A/c Dr. To Discount Received A/c (Being discount received was wrongly posted, now rectified)	300	 300

Illustration 29

A trader agreed his Trial Balance by putting the difference in a Suspense Account. On subsequent scrutiny, the books disclosed certain errors detailed below :

(i) A credit sale of goods to X for ₹ 700 had been credited to his account.

(ii) Goods purchased from Q for ₹ 1,500 was entered in the Purchase Day Book but omitted to be posted to his account in the Creditors Ledger.
(iii) Goods returned by Z of ₹ 1,000 was not debited to Return Inward Account.
(iv) An office typewriter purchased for ₹ 1,000 had been debited to Purchase Account.

Pass necessary rectification entries. ***[C.U.B.Com. (Hons.) — 2013]***

Solution

In the books ...
Journal

Date	Particulars	Dr. ₹	Cr. ₹
	X A/c Dr.	1,400	
	To Suspense A/c		1,400
	(Being goods sold to X on credit had been credited to his account, now rectified)		
	Suspense A/c Dr.	1,500	
	To Q A/c		1,500
	(Being goods purchased from Q has not been posted to his account, now rectified)		
	Return Inwards A/c Dr.	1,000	
	To Suspense A/c		1,000
	(Being goods returned by Z has not been debited to Return Inwards Account, now rectified)		
	Office Typewriter A/c Dr.	1,000	
	To Purchases A/c		1,000
	(Being purchase of typewriter wrongly debited to Purchase Account, now rectified)		

Special Problems

Illustration 30

At 31.12.2016, the accountant of TTC & Co has failed to balance the books of accounts. The difference has been carried to a Suspense Account. Subsequently, the following errors are discovered :

(a) The total of the Purchases Day Book for September has been posted in the Nominal Ledger as ₹ 3,850. The Day Book total is ₹ 3,580.
(b) Cash discounts allowed for the month of November ₹ 750, and discounts received ₹ 430 have been posted to the wrong sides of the Discount Account in the ledger.
(c) A return of goods by a customer ₹ 150 has been posted to the debit side in the Sales Ledger.
(d) A book debt of ₹ 260 due by Sujay Sen has been omitted from the list of Sales Ledger Balances.
(e) Cash drawings of the proprietor, amounting to ₹ 500, have not been posted to the ledger.
(f) An amount of ₹ 200, being insurance paid in advance in the previous year, had not been brought forward as an opening balance in the Insurance Account.

After the discovery and correction of errors mentioned, the book balanced.

You are required to :

(i) Prepare and complete the Suspense Account showing the requisite corrective entries in it. (Journal entries are not required but the appropriate names of the opposite accounts should be written in the Suspense Account).
(ii) State the incorrect total of the credit column of the Trial Balance, given that the incorrect total of the debit column was ₹ 1,37,560.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of TTC & Co
Dr. (i) Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 31	To Balance b/f (Balancing figure)	1,030	Dec. 31	By Discount Allowed A/c (₹ 750 x 2)	1,500
"	To Purchases A/c (₹ 3,850 – 3,580)	270	"	By Sundry Debtors A/c	260
"	To Discount Received A/c (₹ 430 x 2)	860	"	By Drawings A/c	500
"	To Sundry Debtors A/c (₹ 150 x 2)	300	"	By Insurance A/c	200
		1,600			1,600

(ii) Ascertainment of the Incorrect Total of the Credit Column of the Trial Balance

Particulars	Dr. (₹)	Cr. (₹)
Incorrect total of Trial Balance (debit column — as given)	1,37,560	
Suspense Account balance (as above)	1,030	
Incorrect total of Trial Balance (credit column)		1,38,590

Illustration 31

Rectify the following errors by way of Journal Entries and work out their effect on the Profit and Loss Account of the concern:

1. Returns Inwards Book for December was short-totalled by ₹ 100.
2. ₹ 5,810 being cash paid to Hira Chand was debited to Ram Chand as ₹ 5,010.
3. ₹ 1,500 worth of furniture purchased on credit was debited to Purchases Account.
4. A purchase made for ₹ 500 was posted to the Purchases Account as ₹ 50.
5. Wages paid for the erection of machinery amounting to ₹ 700 was debited to Wages Account.
6. Goods purchased for proprietor's use for ₹ 1,000 was debited to Purchases Account.
7. A sum of ₹ 1,000 written off from machinery has not been posted to Depreciation Account.
8. ₹ 100 received from Raghu has been debited to Sunder.
9. ₹ 1,150 received from Radhey Mohan was debited to his account.
10. Purchase returns worth ₹ 980 to Shri Hari Kishan were not recorded in the books.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
1.	Returns Inwards A/c Dr.		100	
	To Suspense A/c			100
	(Being Returns Inwards Book undercast by ₹ 100, now rectified)			
2.	Hirachand A/c Dr.		5,810	
	To Ramchand A/c			5,010
	To Suspense A/c			800
	(Being cash of ₹ 5,810 paid to Hira was wrongly debited to Ramchand A/c as ₹ 5,010, now rectified)			
3.	Furniture A/c Dr.		1,500	
	To Purchases A/c			1,500
	(Being purchase of furniture was wrongly debited to Purchases Account, now rectified)			
4.	Purchases A/c Dr.		450	
	To Suspense A/c			450
	(Being purchase of ₹ 500 was wrongly posted as ₹ 50 to the Purchases Account, now rectified)			
5.	Machinery A/c Dr.		700	
	To Wages A/c			700
	(Being wages paid for erection of machinery was wrongly debited to Wages Account, now rectified)			
6.	Drawings A/c Dr.		1,000	
	To Purchases A/c			1,000
	(Being goods purchased for personal use was wrongly debited to Purchases Account, now recorded)			
7.	Depreciation A/c Dr.		1,000	
	To Suspense A/c			1,000
	(Being depreciation on machinery was not posted to Depreciation Account, now rectified)			
8.	Suspense A/c Dr.		200	
	To Sundar A/c			100
	To Raghu A/c			100
	(Being ₹ 100 received from Raghu was wrongly debited to Sundar's Account, now rectified)			
9.	Suspense A/c Dr.		2,300	
	To Radhey Mohan A/c (₹ 1,150 x 2)			2,300
	(Being cash recd. from Radhey Mohan of ₹ 1,150 was wrongly debited to his account, now rectified)			
10.	Hari Krishan A/c Dr.		980	
	To Purchases Return A/c			980
	(Being purchases return to Hari Krishan were not recorded in the book, now recorded)			

Effect of Rectification of Errors on Net Profit

Items	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	Total
Increase (₹)	—	—	1,500	—	700	1,000	—	—	—	980	4,180
Decrease (₹)	100	—	—	450	—	—	1,000	—	—	—	1,550

Net Increase in Profit = 2,630

Illustration 32

The difference in Trial Balance is kept in Suspense Account. Before preparing the final accounts, the following errors were detected:

(a) Purchase for ₹ 540 was written in Sales Day Book, but was posted to the correct side of party's account.
(b) Salary Account total ₹12,600 on page 32 was carried over to the next page as ₹ 1,260 on the wrong side.
(c) Interest on overdraft ₹ 650 was not posted to the Ledger from the Cash Book.
(d) ₹ 600 collected from a party in respect of the old dues from him which had been written off as bad two years ago, was credited to the party's Account.

Show rectification entries and Suspense Account. State to what extent the Profit and Loss Account would have been affected if the above errors had not been detected and corrected.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
(a)	Purchases A/c	Dr.		540	
	Sales A/c	Dr.		540	
	To Suspense A/c				1,080
	(Being Purchase was wrongly posted through Sales Day Book, now rectified)				
(b)	Salary A/c ₹ (12,600 + 1,260)	Dr.		13,860	
	To Suspense A/c				13,860
	(Being salary account total of ₹ 12,600 carried forward to next page as ₹ 1,260 on the wrong side, now rectified)				
(c)	Interest A/c	Dr.		650	
	To Suspense A/c				650
	(Being interest on overdraft was not posted to the ledger from cash book, now recorded)				
(d)	Party A/c	Dr.		600	
	To Bad Debt Recovery A/c				600
	(Being bad debt recovered was wrongly credited to party's account, now rectified)				

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Balancing figure)	15,590		By Purchases A/c	540
				By Sales A/c	540
				By Salary A/c	13,860
				By Interest A/c	650
		15,590			15,590

Effect of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	Total
Increase (₹)	—	—	—	600	600
Decrease (₹)	1,080	13,860	650	—	15,590
				Decrease in Net Profit =	14,990

Tutorial Note : When bad debt is recovered, Cash Account is debited and Bad Debt Recovery Account, is credited. At the end of the accounting period it is transferred to the credit side of the Profit and Loss Account.

Illustration 33

The Trial Balance of Tony Ltd at 31st December 2016 is as follows :

Heads of Accounts	Dr. (₹)	Cr. (₹)
Equity Share Capital — ₹ 10 each		1,00,000
Profit and Loss Account		1,90,000
Sales and Purchases	6,10,000	10,00,0000
Sales Returns and Purchases Returns	20,000	40,000
Debtors and Creditors	2,00,000	70,000
Land and Building (at cost)	4,00,000	
Plant (at cost and provision for depreciation on 1st January, 2016)	5,00,000	2,20,000
10% Debentures		3,00,000
Opening Stock	1,50,000	
Operating Expenses	90,000	
Administrative Expenses	70,000	
Selling Expenses	60,000	

Bank		80,000
Suspense Account		1,00,000
TOTAL	21,00,000	21,00,000

Additional information :

(1) 5,000 new shares were issued during the year at ₹ 16 per share. The proceeds have been credited to the Suspense Account.

(2) Sales returns of ₹ 10,000 have been entered in the sales day book as if they were sales.

(3) The book keeper has adjusted the opening provision for doubtful debts of ₹ 8,000 in the Selling Expenses Account in the Trial Balance.

(4) The remaining balance on the Suspense Account after the above, represents the sales proceeds of a fully depreciated item of plant, costing ₹ 1,00,000. No other entries (except bank) have made concerning this disposal.

You are required to pass necessary Journal Entries to rectify the above errors and also show the Suspense Account.

Solution **Journal** **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
2016	Suspense A/c	Dr.		80,000	
Dec. 31	To Equity Share Capital A/c				50,000
	To Share Premium A/c				30,000
	(Being issue of 5,000 equity shares of ₹ 10 each at a premium of ₹ 6 each wrongly credited to Suspense Account, now rectified)				
"	Sales Returns A/c	Dr.		10,000	
	Sales A/c	Dr.		10,000	
	To Debtors A/c				20,000
	(Being sales returns wrongly entered in the book as credit sales, now rectified)				
"	Selling Expenses A/c	Dr.		8,000	
	To Provision for Doubtful Debts A/c				8,000
	(Being opening balance of provision for Doubtful Debts Account adjusted against selling expenses, now rectified)				
"	Suspense A/c	Dr.		20,000	
	To Profit on Sale of Plant A/c				20,000
	(Being profit on sale of plant not credited to Profit on Sale of Plant Account, now rectified)				
"	Provision for Depreciation on Plant A/c	Dr.		1,00,000	
	To Plant A/c				1,00,000
	(Being the adjustment for disposal of fully depreciated plant)				

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

Date	Particulars	₹	Date	Particulars	₹
2016	To Equity Share Capital A/c	50,000	2016	By Balance b/d	1,00,000
Dec. 31	To Share Premium A/c	30,000	Dec. 31		
"	To Profit on Sale of Plant A/c	20,000			
		1,00,000			1,00,000

Illustration 34

You are presented with a Trial Balance of Saxena as on 30.6.2017, showing the credit is in excess by ₹ 415, which has been carried to Suspense Account. On close scrutiny of the books, the following errors are revealed:

(a) A cheque of ₹ 3,456 received from Sankar, after allowing him a discount of ₹ 46 was endorsed to Sharma in full settlement for ₹ 3,500. The cheque was finally dishonoured but no entries were passed in the books.

(b) Goods valued ₹ 230 returned by Swaminathan were entered in the Purchases Book and posted therefrom to Swaika's Account for ₹ 320.

(c) Bad debt amounting to ₹ 505 written-off during the year in Sales Ledger but were not recorded in the General Ledger

(d) Bill for ₹ 750 received from Sureka for repairs to machinery was entered in the Inward Invoice Book as ₹ 650.

(e) Goods worth ₹ 1,234 purchased from Sharaf on 29.6.2017 had been entered in the Purchase Day Book and credited to him but were not delivered till 5th July, 2017, stock being taken on 30.6.2017. The title of the goods was, however, passed on 29.6.2017.

(f) ₹ 79 paid for freight on machinery was debited to Freight Account as ₹ 97.

You are required to pass the necessary Journal entries for correcting the above errors.

Solution **In the books of Saxena**

Journal

Date		Particulars	L.F.	Dr. ₹	Cr. ₹
2017 June 30	(a)	Sankar A/c Dr.		3,502	
		Discount Received A/c Dr.		44	
		To Sharma A/c			3,500
		To Discount Allowed A/c			46
		(Being a cheque received from Sankar for ₹ 3,456 after allowing discount of ₹ 46 — was endorsed to Sharma for ₹ 3,500. The cheque was dishonoured and no entry was made in the books, now recorded)			
	(b)	Returns Inward A/c Dr.		230	
		Swaika A/c Dr.		320	
		To Purchases A/c			230
		To Swaminathan A/c			230
		To Suspense A/c			90
		(Being goods returned by Swaminathan for ₹ 230 — was wrongly entered in the Purchases Day Book and credited to Swaika's Account for ₹ 320, now rectified)			
	(c)	Bad Debt A/c Dr.		505	
		To Suspense A/c			505
		(Being bad debt written-off but were not recorded in the General Ledger, now recorded)			
	(d)	Repairs to Machinery A/c Dr.		750	
		To Purchases A/c			650
		To Sureka A/c			100
		(Being repairs to machinery ₹ 750 wrongly passed through Purchases Day Book as ₹ 650, now rectified)			
	(e)	No journal entry is required. Only closing stock is to be increased by ₹ 1,234			
	(f)	Machinery A/c Dr.		79	
		Suspense A/c Dr.		18	
		To Freight A/c			97
		(Being freight of ₹ 79 paid for machinery wrongly debited to Freight Account as ₹ 97, now rectified)			

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

Date	Particulars	₹	Date	Particulars	₹
2017 June 30	To Balance b/f	415	2017 June 30	By Swaika A/c	90
"	To Freight A/c	18		By Bad Debt A/c	505
"	To Balance c/d	162			
		595			595

Note : The balance in the Suspense Account indicates that there are other undetected errors in the books.

Illustration 35

The bookkeeper of a firm having been unable to agree the Trial Balance, raised a Suspense Account, in which he entered the amount by which he was out of balance. The following errors were discovered:

(a) The addition of the analysis column in the tabular Purchases Journal posted to Goods Purchased for Resale Account was found to be ₹ 150 short, though the addition of the total column was correct.

(b) Goods bought from a supplier amounting to ₹ 77 had been posted to the credit of his account at ₹ 770.

(c) A dishonoured bill of exchange receivable for ₹ 1,600 returned by the firm's bank had been credited to the Bank Account and debited to the Bills Receivable Account. A cheque was received later from the customer for ₹ 1,600 and duly paid.

(d) An item of ₹ 80 entered in the Sales Returns Book had been posted to the debit of the customers who returned the goods.

(e) Sundry items of plant sold amounting to ₹ 3,000 had been entered in Sales Day Book, the total of which book had been posted to the credit of Sales Account.

(f) An account of ₹ 800 owing by a customer, had been omitted from the list of Sundry Debtors.

(g) Discount amounting to ₹ 30 allowed to a customer, had been duly entered in his account, but not posted to the Discount Account.

(h) An amount of ₹ 100, being rates treated as paid in advance in the previous year, had not been brought forward as a balance on the Rates Account.

You are required to : (i) Pass necessary Journal entries; (ii) Show the Suspense Account.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
(a)	Goods Purchased for Resale A/c Dr. To Suspense A/c (Being casting error in Day Book, now rectified)		150	150
(b)	Sundry Creditors A/c ₹ (770 – 77) Dr. To Suspense A/c (Being Supplier's Account has been credited by ₹ 770 in place of ₹ 77, now rectified)		693	693
(c) (i)	Customer A/c Dr. To Bills Receivable A/c (Being bill dishonoured wrongly debited to Bills Receivable A/c, now rectified)		1,600	1,600
(c) (ii)	Bank A/c Dr. To Customer A/c (Being cheque received from customer and paid into bank)		1,600	1,600
(d)	Suspense A/c (₹ 80 x 2) Dr. To Customer A/c (Being goods returned by customer wrongly debited to his account, now rectified)		160	160
(e)	Sales A/c Dr. To Plant A/c (Being sale of plant wrongly credited to Sales Account, now rectified)		3,000	3,000
(f)	Sundry Debtors A/c Dr. To Suspense A/c (Being an amount of ₹ 800 was omitted from Sundry Debtors list, now recorded)		800	800
(g)	Discount Allowed A/c Dr. To Suspense A/c (Being discount allowed to a customer was not posted to Discount Allowed Account, now recorded)		30	30
(h)	Rates A/c Dr. To Suspense A/c (Being advance rates had not been brought forward, now rectified)		100	100

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/f (Balancing figure)	1,613		By Goods Purchased for Resale A/c	150
	To Customer A/c	160		By Sundry Creditors A/c	693
				By Sundry Debtors A/c	800
				By Discount Allowed A/c	30
				By Rates A/c	100
		1,773			1,773

Illustration 36

Prosperity & Co has produced a Trial Balance as on March 31, 2017 which does not balance, the difference of ₹ 1,760 being transferred to the Suspense Account. On examination of the Company's books discloses the following errors:

(a) The Sales Day Book has been undercast by ₹ 800 and posted to the Debtors Control Account accordingly.

(b) Goods received from XYZ Limited on March 31, 2017 costing ₹ 9,690 have been included in stock but the invoice has not been received.

(c) Sales Account in the General Ledger has been credited with a credit note for ₹ 950 being trade-in-allowance given on a company van. This amount had already been taken into account when dealing with the replacement in the motor van account.

(d) An invoice from Joseph & Co, amounting ₹ 4,450 for goods purchased has been omitted from the Purchases Day Book and posted direct to Purchases Account in the General Ledger and Joseph & Co. Account in the Suppliers' Ledger but has not been included in the Suppliers' Ledger Control Account in the Trial Balance.

(e) Discount allowed for the month of March amounting to ₹ 1,740 has not been posted to Discount Allowed Account in the General Ledger.

(f) A cheque for ₹ 1,920 received from Jolly Limited, a debtor, has been posted directly to the Sales Account in the General Ledger.

You are required : (i) to give the journal entries, where necessary, to correct these errors, or if no journal entry is required, state how they will be corrected; (ii) to prepare a statement showing the effect the corrections would have on the company's profit for the year; and (iii) to prepare Suspense Account.

Solution

In the books of Prosperity & Co.

Journal

Date		Particulars		L.F.	Dr. ₹	Cr. ₹
2017 Mar. 31	(a)	Debtors Control A/c	Dr.		800	
		To Sales A/c				800
		(Being Sales Day Book was undercast by ₹ 800, now rectified)				
	(b)	No Journal entries are required — only ₹ 9,690 should be deducted from Stock Sheet				
	(c)	Sales A/c	Dr.		950	
		To Suspense A/c				950
		(Being trade-in-allowance wrongly credited to Sales Account, now recorded)				
	(d)	Suspense A/c	Dr.		4,450	
		To Suppliers' Ledger Control A/c				4,450
		(Being credit purchase had not been posted in the general ledger, now rectified)				
	(e)	Discount Allowed A/c	Dr.		1,740	
		To Suspense A/c				1,740
		(Being discount allowed to customers had not been posted to Discount Allowed Account in general ledger, now reorded)				
	(f)	Sales A/c	Dr.		1,920	
		To Debtors Control A/c				1,920
		(Being cheque received from debtors wrongly credited to Sales Account, now rectified)				

Effects of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	(e)	(f)	Total
Increase (₹)	800	—	—	—	—	—	800
Decrease (₹)	—	—	950	—	1,740	1,920	4,610
						Net Decrease in Profit =	3,810

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

Date	Particulars	₹	Date	Particulars	₹
2017 Mar 31	To Supplier's Ledger Control A/c	4,450	2017 Mar 31	By Balance b/d	1,760
				By Sales A/c	950
			"	By Discount Allowed A/c	1,740
		4,450			4,450

Tutorial Note : (i) When ledgers are kept under 'Self Balancing System', in the general ledger Supplier's Ledger Control Account is kept in place of Sundry Creditors Account. In this case, Purchases Account has been debited without a corresponding credit in the Supplier's Ledger Control Account. Therefore, Supplier's Ledger Control Account is to be credited and Suspense Account is to be debited. (ii) Stock has been adjusted, therefore, it will not affect profit.

Illustration 37

How would you rectify the following errors discovered after the preparation of the Trial Balance :

(a) A cheque for ₹ 12,500 received as insurance claim for loss of goods in transit at the time of import was deposited by the proprietor into his Private Bank Account. The full value of the invoice was passed through the Purchases Book.

(b) A purchase of ₹ 500 from A & Co, on the last date of the year was taken into stock, but the invoice was not passed through the Purchase Book.

(c) Sale of goods on approval amounting to ₹ 300 was included in Sales Account, out of which goods to the value of ₹ 125 were returned. No record of the return was made in the books, though the returned goods were included in the stock at their cost of ₹ 100.

(d) A typewriter which stood in the books at ₹ 2,000 was sold for ₹ 1,250 in part exchange of a new typewriter costing ₹ 6,250 and net invoice of ₹ 5,000 was passed through the Purchases Book.

(e) Four per cent G.P. Notes of the face value of ₹ 5,000 purchased through Lakhotia at 96% ex-dividend, brokerage ₹ 25. Accrued interest to date of purchase was ₹ 130. The total payment of ₹ 4,955 stands debited in the books in the name of the broker Lakhotia.

Solution **Journal**

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Drawings A/c	Dr.		12,500	
	To Purchases A/c				12,500
	(Being chq recd. for Insurance claim for loss of goods was deposited into personal Bank A/c, now rectified)				
(b)	Purchases A/c	Dr.		500	
	To A & Co A/c				500
	(Being goods purchased from A & Co but no entry was made, now recorded)				
(c)	Return Inward A/c	Dr.		125	
	To Customer A/c				125
	(Being goods returned by customer, (sold on approval), not entered in the books, now recorded)				
(d)	Typewriter (New) A/c	Dr.		6,250	
	Loss on Sale of Old Typewriter A/c	Dr.		750	
	To Purchases A/c				5,000
	To Old Typewriter A/c				2,000
	(Being a new typewriter purchased in part exchange of an old typewriter but it was wrongly entered in the Purchases Day Book, now rectified)				
(e)	Investment A/c ₹ (5,000 x 96/100 + 25)	Dr.		4,825	
	Interest on Investment A/c	Dr.		130	
	To Lakhotia A/c				4,955
	(Being G.P. notes purchased and accrued interest wrongly debited to Lakhotia A/c, now rectified)				

Illustration 38

Messrs Modern Chemicals were unable to agree the Trial Balance on 30th June, 2017 and have raised a Suspense Account for the difference. Later, the following errors were discovered and rectified and the Suspense Account was closed:

(a) The addition of the ‘Sundry Purchases’ column in the tabular Purchases Journal was short by ₹ 150 and other totals were in order.

(b) A bill of exchange (received from Gupta) for ₹ 2,000 had been returned by the bank as dishonoured and had been credited to the bank and debited to Bills Receivable Account.

(c) Goods to the value of ₹ 105 returned by a customer, Thomas, had been posted to the debit of Thomas and also to Sales Returns.

(d) Sundry items of furniture sold for ₹ 3,000 had been entered in the Sales Day Book, the total of which had been posted to Sales Account.

(e) An amount of ₹ 600 due from Z, a customer, had been omitted from the schedule of sundry debtors.

(f) Discount amounting to ₹ 30 allowed to a customer, had been posted in his account, but not posted to Discount Account.

(g) Insurance premium of ₹ 450 paid on June 30, 2016 for the year ended 30th June, 2017 had not been brought forward.

You are required to: (i) Pass journal entries to rectify the above mistakes; and (ii) Draw up the Suspense Account after rectifying the above mistakes and explain how the above errors affect the book profits for the year ended June 30, 2017.

Solution **In the books of Messrs Modern Chemical**
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 (a) June 30	Sundry Purchases A/c	Dr.		150	
	To Suspense A/c				150
	(Being Sundry Purchases journal was cast short by ₹ 150, now rectified)				
(b)	Gupta A/c	Dr.		2,000	
	To Bills Receivable A/c				2,000
	(Being B/R was dishonoured by bank but wrongly debited to B/R A/c in place of Gupta A/c, now rectified)				
(c)	Suspense A/c	Dr.		210	
	To Thomas A/c (₹ 105 x 2)				210
	(Being goods returned by Thomas wrongly debited to his Account, now rectified)				
(d)	Sales A/c	Dr.		3,000	
	To Furniture A/c				3,000
	(Being sale of furniture wrongly passed through Sales Day Book, now rectified)				
(e)	Sundry Debtors A/c	Dr.		600	
	To Suspense A/c				600
	(Being an amount of ₹ 600 due from Z has not been included in the Sundry Debtors list, now rectified)				

(f)	Discount Allowed A/c Dr. To Suspense A/c (Being discount allowed has not been posted in the Discount Allowed Account, now recorded)	30	30
(g)	Insurance Premium A/c Dr. To Suspense A/c (Being insurance premium for the year ended on 30.6.09 has not been brought forward, now rectified)	450	450

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 June 30	To Balance b/f (Balancing figure)	1,020	2017 June 30	By Sundry Purchases A/c	150
	To Thomas A/c	210		By Sundry Debtors A/c	600
			"	By Discount Allowed A/c	30
			"	By Insurance Premium A/c	450
		1,230			1,230

Effects of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	(e)	(f)	(g)	Total
Increase (₹)	—	—	—	—	—	—	—	—
Decrease (₹)	150	—	—	3,000	—	30	450	3,630
							Net Decrease in Profit =	3,630

3. Rectification of errors after preparation of Final Accounts

When errors are detected after preparation of Final Accounts, the following points should be kept in mind:

1. ***All the Nominal Accounts have been closed, after transferring to Trading Account, or Profit and Loss Account.***
2. ***The Suspense Account, if any, has been carried forward to the next period. It should appear in the Balance Sheet under current assets if it has a debit balance and under current liabilities if it has a credit balance.***
3. ***Real and Personal Accounts have also been carried forward to the next period.***

The rectification of errors at this stage should be done in the same manner as we do in case of Stage 2. The only exception is that all Nominal Accounts in the rectification entries shall be substituted by 'Profit and Loss Adjustment Account'. The following illustrations shall clear the conception.

Example : (a) Wages of ₹ 1,000 paid for installation of machinery charged to Wages Account.

In the ordinary course, the rectifying entry would be :

Machinery Account Dr. ₹ 1,000
    To Wages Account ₹ 1,000

Now, as the Final Accounts have been prepared, the Wages Account has been closed by transferring to Trading Account.

Therefore, the rectifying entry will be:

Machinery Account Dr. ₹ 1,000
    To Profit and Loss Adjustment Account ₹ 1,000

Example : (b) Purchase of furniture has been passed through Purchases Day Book worth ₹ 2,000.

In the ordinary course, the rectifying entry would be:

Furniture Account Dr. ₹ 2,000
    To Purchases Account ₹ 2,000

Now, as the Final Accounts have been prepared, the Purchase Account has been closed by transferring to Trading Account

Therefore, the rectifying entry will be:

Furniture Account Dr. ₹ 2,000
    To Profit and Loss Adjustment Account ₹ 2,000

Example : (c) Wages paid ₹ 200 posted to Salaries Account in the Ledger.

In the ordinary course, the entry would be:

Wages Account Dr. ₹ 200
    To Salaries Account ₹ 200

Now, as the Final Accounts have been prepared, no entry is required to be passed because both the accounts are Nominal Accounts.

The main purpose of preparing a Profit and Loss Adjustment Account is to show the net effect on the profit and loss of the preceding year. After rectification, the balance of this account is transferred to Capital Accounts in case of a sole proprietorship or partnership business. In case of a company, the revised balance is transferred to Balance Sheet.

Illustration 39

The Trial Balance extracted from a set of books showed a difference which was placed in a Suspense Account to prepare the Final Accounts at that time. Subsequently, the following mistakes were detected :

(a) A dishonoured cheque for ₹ 500 received from A and returned by the Bank has been credited to the Bank Account and debited to Sundry Creditors Account.

(b) Several items of Furniture sold for ₹ 2,500 had been entered in the Sales Day Book.

(c) Goods purchased from X, a supplier, for ₹ 155 had been posted to the debit of his account as ₹ 150.

(d) ₹ 600 due from B had been omitted from the schedule of Sundry Debtors.

Show the necessary entries in the jounral properly ruled and with suitable narration to rectify these errors. Show also how non-detection of these errors affected last year's Profit and Loss Account.

[C.U.B.Com. (Hons.) — 2007]

Solution

In the books of ...
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Sundry Debtors A/c (A A/c) Dr.		500	
	To Sundry Creditors A/c			500
	(Being a cheque received from A for ₹ 500 was deposited into bank but it was dishonoured and Sundry Creditors Account was wrongly debited, now rectified)			
(b)	Profit and Loss A/c Dr.		2,500	
	To Furniture A/c			2,500
	(Being sale of furniture wrongly recorded in the Sales Day Book, now rectified)			
(c)	Suspense A/c Dr.		305	
	To X A/c			305
	(Being goods purchased from X for ₹ 155 wrongly debited to his account by ₹ 150, now rectified)			
(d)	Sundry Debtors A/c Dr.		600	
	To Suspense A/c			600
	(Being ₹ 600 due from B had been omitted from the schedule of sundry debtors, now rectified)			

Note : Effect of correction on last year's profit — Profit will be reduced by ₹ 2,500 subject to depreciation on furniture of ₹ 2,500.

Illustration 40

The books of account of A Co. Ltd for the year ending 31st December, 2016 were closed with a difference in books carried forward. The following errors were detected in 2017 :

(a) Returns Outward Book was undercast by ₹ 150.

(b) ₹ 1,500 being the total of the discount column on the credit side of the Cash Book was not posted in General Ledger.

(c) ₹ 6,000 being the cost of purchase of office furniture was entered in the Purchase Account.

(d) A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the Customer's Account in the Sales Ledger.

(e) Closing stock was overstated by ₹ 9,000, being casting error in the schedule of inventory.

Pass rectification entries, prepare Suspense Account and find out the effect of corrections on 2016 profit.

Solution

In the books of A. Co Ltd
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2017 (a)	Suspense A/c Dr.		150	
	To Profit & Loss Adjustment A/c			150
	(Being return outward book undercast by ₹ 150, now rectified)			
(b)	Suspense A/c Dr.		1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Being discount received not posted from Cash Book to Ledger, now recorded)			
(c)	Office Furniture A/c Dr.		6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Being purchase of office furniture wrongly entered in the Purchases Account, now rectified)			

(d)	Customer A/c Dr. To Suspense A/c (Being credit sale of ₹ 760 wrongly posted as ₹ 670 to the Customer's Account, now rectified)		90	90
(e)	Profit & Loss Adjustment A/c Dr. To Opening Stock A/c (Being closing stock overcast by ₹ 9,000, now rectified)		9,000	9,000

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

Date	Particulars	₹	Date	Particulars	₹
2017	To Profit & Loss Adjustment A/c	150	2017	By Balance b/f (Balancing figure)	1,560
	To Profit & Loss Adjustment A/c	1,500		By Customer A/c	90
		1,650			1,650

Dr. **Profit & Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock A/c	9,000	By Suspense A/c	150
		By Suspense A/c	1,500
		By Office Furniture A/c	6,000
		By Net Profit (transferred)	1,350
	9,000		9,000

Note : **Effect of correction on 2016 profit —** Profit will be reduced by ₹ 1,350 subject to Depreciation on Furniture of ₹ 6,000.

Illustration 41

A trader agreed his Trial Balance by putting the difference in a Suspense Account and prepared a Trading and Profit and Loss Account and a Balance Sheet. On subsequent scrutiny the books disclosed several errors as detailed below :

(a) A cheque of ₹ 750 received for loss of stock by fire had been deposited in the proprietor's private bank account.

(b) An item of purchase of ₹ 151 was entered in the Inward Invoice Book as ₹ 15 and posted to the Supplier's Account as ₹ 51.

(c) A sales return of ₹ 500 was not entered in the financial accounts though it was duly taken in the stock book.

(d) An amount of ₹ 300 was received in full settlement from a customer after he was allowed a discount of ₹ 50, but while writing the books, the amount received was entered in the discount column and the discount allowed was entered in the amount received column.

(e) Bills receivable from Mr X of ₹ 1,000 was posted to the credit of Bills Payable Account and also credited to the account of Mr X.

Prepare Suspense Account and Profit and Loss Adjustment Account. ***[C.U.B.Com. (Hons.) — 2003]***

Solution

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Balancing figure)	2,036		By Profit and Loss Adjustment A/c	36
				By X A/c (Note 1)	2,000
		2,036			2,036

Dr. **Profit and Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Creditors A/c	100	By Capital A/c	750
To Suspense A/c	36	By Bank A/c	250
To Debtors A/c	500		
To Capital A/c	364		
	1,000		1,000

Working Note :

(1) Bills receivable received from X is nothing but Bills payable of the trader. Bills Payable Account has been correctly credited but X was not debited. However, X Account was credited wrongly. Therefore, for rectification — X Account will be debited with ₹ 2,000 and Suspense Account will be credited by the same amount.

Illustration 42

After getting an agreed Trial Balance, the accountant of M/s Senco Brothers drafted the Trading and Profit and Loss Account, and the Balance Sheet.

The following errors were then detected by the auditors :

(a) ₹ 2,500 received from the insurance company in full settlement of the claim for loss of stock-in-transit, was deposited by the proprietor into his private bank account and was not recorded in the business books.

(b) Goods purchased for ₹ 2,000 were included in stock, but the invoice was not entered in the books for the period under review.

(c) There were compensating errors in the books, namely —

(i) a payment of ₹ 300 as commission to a sales agent had not been posted from the Cash Book;

(ii) dividends received were undercast by ₹ 100;

(iii) purchases amounting to ₹ 190 were not posted to the account of the supplier from Purchases Journal; and

(iv) debit side of a customer's account in the Sales Ledger was overcast by ₹ 10.

(d) Goods sold for ₹ 500 were returned by a customer, but no record of the return was made in the books although the returned goods were included in the stock at their cost price of ₹ 380.

Show the Journal Entries and the effect of these errors and summarise the alterations necessary in the originally drafted statement of Accounts. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of Senco Brothers
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Capital A/c Dr. To Profit and Loss Adjustment A/c (Being insurance claim received for loss of stock-in-transit wrongly deposited by the proprietor to his private bank account, now rectified)		2,500	2,500
(b)	Profit and Loss Adjustment A/c A/c Dr. To Sundry Creditors A/c (Being credit purchases not recorded in the books, now rectified)		2,000	2,000
(c)	(i) Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being sales commission not posted from the Cash Book, now rectified)		300	300
	(ii) Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being dividends received undercast, now rectified)		100	100
	(iii) Suspense A/c Dr. To Sundry Creditors A/c (Being purchases not posted from purchases journal to suppliers account, now rectified)		190	190
	(iv) Suspense A/c Dr. To Sundry Debtors A/c (Being the debit side of a customer's account overcast, now rectified)		10	10
(d)	Profit and Loss Adjustment A/c Dr. To Sundry Debtors A/c (Being goods returned not recorded in the books, now rectified)		500	500
	Capital A/c Dr. To Profit & Loss Adjustment A/c (Being the net loss transferred to Capital Account)		200	200

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Profit and Loss Adjustment A/c	100		By Profit and Loss Adjustment A/c	300
	To Sundry Creditors A/c	190			
	To Sundry Debtors A/c	10			
		300			300

Dr. Profit and Loss Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Creditors A/c	2,000		By Capital A/c	2,500
	To Suspense A/c	300		By Suspense A/c	100
	To Sundry Debtors A/c	500		By Capital A/c (Loss)	200
		2,800			2,800

Illustration 43

The Trial Balance of M/s Roy & Sen & Co at 31.3.2017 did not agree. In order to close the books, the accountant placed the difference to the Suspense Account newly opened and carried forward this difference to the next period for necessary adjustments. Later, the following errors, arising in 2016-10 were detected:

(a) A purchase of ₹ 162 was recorded in the Day Book as ₹ 62 and posted to debit side Supplier's Account as ₹ 26.

(b) Sales Day Book was overcast by ₹ 100 in January, 2017.

(c) Furniture purchased for ₹ 2,500 cash was posted to the Purchase Account in the Ledger.

(d) Credit sale of ₹ 97 was posted to the credit of the Customer's Account as ₹ 79.
(e) ₹ 50 allowed as cash discount to a trade debtor was not debited to the Discount Account.

Show the necessary Journal entries to rectify these errors and show Suspense Account; and Profit and Loss Adjustment Account and state the ultimate effect of these correcting entries in the books for 2016-10.

Solution **In the books of M/s Roy & Sen & Co**

Journal

Date		Particulars		L.F.	Dr. ₹	Cr. ₹
2017 April 1	(a)	Profit & Loss Adjustment A/c ₹ (162 – 62)	Dr.		100	
		Suspense A/c ₹ (26 + 62)	Dr.		88	
		To Supplier A/c				188
		(Being purchase of ₹ 162 entered in the Purchases Book as ₹ 62 but posted to the debit of Supplier A/c as ₹ 26, now rectified)				
	(b)	Profit & Loss Adjustment A/c	Dr.		100	
		To Suspense A/c				100
		(Being Sales Day Book was overcast by ₹ 100, now rectified)				
	(c)	Furniture A/c	Dr.		2,500	
		To Profit & Loss Adjustment A/c				2,500
		(Being furniture purchased has been posted to the Purchases Account, now rectified)				
	(d)	Customer A/c ₹ (97 + 79)	Dr.		176	
		To Suspense A/c				176
		(Being credit sale of ₹ 97 wrongly posted to the credit of Customer's Account, as ₹ 79, now rectified)				
	(e)	Profit & Loss Adjustment A/c	Dr.		50	
		To Suspense A/c				50
		(Being discount allowed not posted to Discount Allowed Account, now rectified)				

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

Date	Particulars	₹	Date	Particulars	₹
2017 April 1	To Balance b/f (Balancing figure)	238	2017 April 1	By Profit & Loss Adjustment A/c	100
	To Supplier A/c	88		By Customer A/c	176
			"	By Profit & Loss Adjustment A/c	50
		326			326

Dr. **Profit & Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Supplier A/c	100	By Furniture A/c	2,500
To Suspense A/c	100		
To Suspense A/c	50		
To Partners' Capital A/c (Balancing figure)	2,250		
	2,500		2,500

Effect of corrections

(i) Suspense Account will be nil; (ii) Sundry Debtors Account will be increased by ₹ 176; (iii) Sundry Creditors Account will be increased by ₹ 188; (iv) Furniture Account will be increased by ₹ 2,500; and (v) Partners' Capital Accounts will be increased due to increase in profit by ₹ 2,250 subject to depreciation on furniture wrongly posted to the Purchase Account.

Illustration 44

There was a difference in Trial Balance of Mr S Basu, a trader, on 31.12.2016 and the difference in books was carried to a Suspense Account and the books were closed. Subsequently, on going through the books, the following errors were located :

(a) ₹ 2,296 paid for repairs to motor car, was debited to Motor Car Account as ₹ 696.
(b) A sale of ₹ 1,400 to J Das entered in the sales book as ₹ 2,120.
(c) A cash discount of ₹ 800 received was entered in the cash book but was not posted in the ledger.
(d) ₹ 400 being purchase returns posted to the debit of Purchases Account.
(e) The purchase of a machine on 1.4.2016 for ₹ 24,000 was entered in the purchases book.
(f) While carrying forward total of one page in N Das's Account, the amount of ₹ 1,000 was written on the credit side instead of the debit side.
(g) A cheque of ₹ 6,192 received from S Das (after allowing a discount of ₹ 92) was endorsed to P. Ghosh in full settlement for ₹ 7,000. The cheque was finally dishonoured but no entry is passed in the books.

Give Journal Entries to rectify the above errors and prepare Suspense Account. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution **In the books of S. Basu**

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
2016 (a) Dec. 31	Profit & Loss Adjustment A/c	Dr.		2,296	
	To Motor Car A/c				696
	To Suspense A/c				1,600
	(Being repairs to motor car of ₹ 2,296 wrongly debited to Motor Car Account as ₹ 696, now rectified)				
(b)	Profit & Loss Adjustment A/c	Dr.		720	
	To J. Das A/c (Note 1)				720
	(Being a sale of ₹ 1,400 wrongly entered in the Sales Day Book as ₹ 2,120, now rectified)				
(c)	Suspense A/c	Dr.		800	
	To Profit & Loss Adjustment A/c				800
	(Being discount received entered in the cash book but wrongly not posted in Ledger, now rectified)				
(d)	Suspense A/c	Dr.		800	
	To Profit & Loss Adjustment A/c				800
	(Being purchase return of ₹ 400 posted wrongly to the debit of Purchases Account, now rectified)				
(e)	Machiney A/c (Note 2)	Dr.		24,000	
	To Profit & Loss Adjustment A/c				24,000
	(Being purchase of machinery for ₹ 24,000 entered wrongly in the Purchases Day Book, now rectified)				
(f)	N. Das A/c	Dr.		2,000	
	To Suspense A/c				2,000
	(Being a debit amount of ₹ 1,000 wrongly carried forward as credit amount, now rectified)				
(g)	S. Das A/c (₹ 6,192 + 92)	Dr.		6,284	
	Profit & Loss Adjustment A/c	Dr.		716	
	To P. Ghosh A/c				7,000
	(Being a cheque of ₹ 6,192 received from Mr. S. Das endorsed to P. Ghosh for full settlement of ₹ 7,000 and dishonoured but no entry was passed, now rectified)				

Working Note : (1) It is assumed that all customers accounts are maintained in the general ledger itself. Sale of ₹ 1,400 wrongly recorded in the Sales Day Book as ₹ 2,120 affects Sales and J. Das Account. therefore, no amount will be carried to Suspense Account.

(2) For lack of information regarding depreciation rate, no effect has been given in the Profit and Loss Adjustment Account.

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

Date	Particulars	₹	Date	Particulars	₹
2016	To Balance b/d (Balancing figure)	2,000	2016	By Profit & Loss Adjustment A/c	1,600
Dec. 31	To Profit & Loss Adjustment A/c	800	Dec. 31	By N. Das A/c	2,000
"	To Profit & Loss Adjustment A/c	800			
		3,600			3,600

Illustration 45

A Mukherjee has agreed his Trial Balance by putting the difference in a Suspense Account and has prepared a Trading and Profit and Loss Account and the Balance Sheet. On subsequent scrutiny, the books disclosed several errors as detailed below. Rectify these errors and ascertain the amount carried to Suspense Account:

(i) A sale of goods to X for ₹ 350 has been credited to his account.

(ii) Goods purchased from Y amounting to ₹ 750 were entered in the Purchases Day Book but were omitted from Y's Account in the Creditors' Ledger.

(iii) An office typewriter purchased for ₹ 500 has been passed through the Purchase Account.

(iv) Goods returned to S Sen valued at ₹ 75 were debited to P Sen's Account.

(v) Repairs to office car valued at ₹ 750 were debited to the Office Car Account.

(vi) Goods sold to R Banerjee valued at ₹ 730 have been posted into his account as ₹ 370.

Will the above rectification affect the profit figure? If so, to what extent?

Solution **In the books of A. Mukherjee**

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
(i)	X A/c (₹ 350 x 2)	Dr.		700	
	To Suspense A/c				700
	(Being sale of goods to X for ₹ 350 wrongly credited to his account, now rectified)				

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(ii)	Suspense A/c Dr. To Y A/c (Being goods purchased from Y wrongly not credited to his account, now rectified)		750	750
(iii)	Typewriter A/c Dr. To Profit & Loss Adjustment A/c (Being purchase of typewriter passed through Purchases Account, now rectified)		500	500
(iv)	S. Sen A/c Dr. To P. Sen A/c (Being goods returned to S. Sen wrongly debited to P. Sen Account, now rectified)		75	75
(v)	Profit & Loss Adjustment A/c Dr. To Office Car A/c (Being repair to car debited to office car account, now rectified)		750	750
(vi)	R. Banerjee A/c Dr. To Suspense A/c (Being goods sold to R. Banerjee for ₹ 730 wrongly posted to his account as ₹ 370 , now rectified)		360	360
(vii)	Capital A/c Dr. To Profit & Loss Adjustment A/c (Being net profit transferred to Proprietor's Capital Account)		250	250

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	310		By X A/c	700
	To Y A/c	750		By R. Banerjee A/c	360
		1,060			1,060

Dr. **Profit & Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Office Car A/c	750	By Typewriter A/c	500
		By Capital A/c	250
	750		750

Illustration 46

A book keeper while preparing his Trial Balance finds that the debit exceeds by ₹ 7,250. For preparing Final Accounts he places the difference to a Suspense Account. In the next year, the following mistakes were discovered :

(a) A sale of ₹ 4,000 has been passed through the Purchases Day Book. The entry in customer's Account has been correctly recorded.
(b) Goods worth ₹ 2,500 taken away by the proprietor for his use has been debited to Repairs Account.
(c) A bill receivable for ₹ 1,300 received from Krishna has been dishonoured on maturity but no entry passed.
(d) Salary of ₹ 650 paid to a clerk has been debited to his Personal Account.
(e) A purchase of ₹ 750 from Raghubir has been debited to his account. Purchases Account has been correctly debited.
(f) A sum of ₹ 2,250 written off as depreciation on furniture has not been debited to Depreciation Account.

Draft the journal entries for rectifying the above mistakes and prepare Suspense Account.

[C.A. (Foundation) — Adapted]

Solution

In the books of ...
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being credit sales of ₹ 4,000 wrongly passed through Purchases Day Book, now rectified)		8,000	8,000
(b)	Drawings A/c Dr. To Profit and Loss Adjustment A/c (Being goods taken for personal use wrongly debited to Repairs Account, now rectified)		2,500	2,500
(c)	Sundry Debtors A/c Dr. To Bills Receivable A/c (Being the bill of Krishna dishonoured on maturity but no entry was passed, now rectified)		1,300	1,300
(d)	Profit and Loss Adjustment A/c Dr. To Clerk's Personal A/c (Being salary paid to a clerk wrongly debited to his Personal Account, now rectified)		650	650

(e)	Suspense A/c Dr. To Raghubir A/c (Being purchase from Raghubir wrongly debited to his account, now rectified)		1,500	1,500
(f)	Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being depreciation on furniture not posted to Depreciation Account, now rectified)		2,250	2,250

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

Date	Particulars	₹	Date	Particulars	₹
	To Profit and Loss Adjustment A/c	8,000		By Balance b/d	7,250
	To Raghubir A/c	1,500		By Profit and Loss Adjustment A/c	2,250
		9,500			9,500

Illustration 47

The following Balance Sheet was prepared by a novice on 31.12.2016 :

Liabilities	₹	Assets	₹
Capital	98,500	Furniture and other Fixed Assets	59,500
Net Profit during the year	45,700	Stock	61,000
Loan	50,000	Debtors	38,190
Creditors	22,150	Fixed Deposits	25,750
Suspense Account	2,110	Bank	19,820
		Drawings	14,200
	2,18,460		2,18,460

On close scrutiny, the following errors were discovered :

(a) Closing stock was overvalued by ₹ 4,000.

(b) A sale of ₹ 2,300 was recorded in Sales Day Book as ₹ 3,200, though it was rightly posted in Sales Account.

(c) The total of one page of Purchases Day Book was carried forward as ₹ 3,800 instead of ₹ 8,300.

(d) Outstanding telephone bill of ₹ 510 was not recorded in the books.

(e) A collection of ₹ 2,000 from a customer was posted in Creditors Account.

(f) Rent for one month ₹ 2,500 was recorded in the books as rent of the residential house of the proprietor.

(g) Some old furnitures were purchased at ₹ 2,000 for resale. But they were recorded in the books as fixed assets and depreciation was charged @ 10%.

(h) A fixed deposit of ₹ 5,000 was matured and ₹ 7,500 was realised. But the entire amount was credited to Fixed Deposit Account.

Show the necessary journal entries to rectify the errors, prepare a Profit and Loss Adjustment Account and a Balance Sheet after rectification. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution **Journal** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
(a)	Profit & Loss Adjustment A/c Dr. To Stock A/c (Being closing stock overvalued by ₹ 4,000, now rectified)		4,000	4,000
(b)	Suspense A/c Dr. To Debtors A/c (Being sale of ₹ 2,300 wrongly entered in the Sales Day Book as ₹ 3,200 and posted correctly in the Sales Account, now rectified)		900	900
(c)	Profit & Loss Adjustment A/c (₹ 8,300 – 3,800) Dr. To Suspense A/c (Note 1) (Being total of one page of Purchases Day Book carried forward as ₹ 3,800 in place of ₹ 8,300, now rectified)		4,500	4,500
(d)	Profit & Loss Adjustment A/c Dr. To Outstanding Telephone Bill A/c (Being outstanding telephone bill not recorded in the books, now rectified)		510	510
(e)	Creditors A/c Dr. To Debtors A/c (Being collection from debtors wrongly posted in the Creditors Account, now rectified)		2,000	2,000
(f)	Profit & Loss Adjustment A/c Dr. To Drawings A/c (Being business rent wrongly recorded in the books as private rent, now rectified)		2,500	2,500

(g)	Stock A/c Dr.		2,000	
	To Fixed Assets A/c			1,800
	To Profit & Loss Adjustment A/c (Note 2)			200
	(Being old furniture purchased for resale wrongly recorded in the books as fixed assets, now rectified)			
(h)	Fixed Deposits A/c Dr.		2,500	
	To Profit & Loss Adjustment A/c			2,500
	(Being interest on fixed deposit wrongly credited to Fixed Deposit Account, now rectified)			

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c	900		By Balance b/d	2,110
	To Balance c/d	5,710		By Profit and Loss Adjustment A/c	4,500
		6,610			6,610

Dr. Profit and Loss Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	4,000	By Balance b/d	45,700
To Suspense A/c	4,500	By Stock A/c	200
To Outstanding Telephone Bill A/c	510	By Fixed Deposit A/c	2,500
To Drawings A/c	2,500		
To Balance c/d	36,890		
	48,400		48,400

Working Notes :

(1) It is assumed that the Individual Creditors' Account is maintained in the General Ledger itself and Creditors' Account has been credited correctly.

(2) Depreciation rate is 10% (not 10% p.a.). Therefore, it has been calculated ignoring the time of purchase.

Balance Sheet as at 31st December, 2016

Liabilities		₹	Assets	₹
Capital	98,500		Furniture and other Fixed Assets ₹ (59,500 – 1,800)	57,700
Add: Profit (as above)	36,890		Stock ₹ (61,000 – 4,000 + 2,000)	59,000
	1,35,390		Debtors ₹ (38,190 – 900 – 2,000)	35,290
Less : Drawings	11,700	1,23,690	Fixed Deposits ₹ (25,750 + 2,500)	28,250
Loan		50,000	Bank	19,820
Creditors (₹ 22,150 – ₹ 2,000)		20,150		
Outstanding Telephone Bill		510		
Suspense Account		5,710		
		2,00,060		2,00,060

Tutorial Note : It should be noted that after rectification of given errors, the balance of Suspense Account has been increased to ₹ 5,710. It means that there are other undetected errors in the books of account.

Illustration 48

Balance Sheet of J Thomson as at 31st March, 2017

Liabilities		₹	Assets		₹
Capital at April 1, 2016		18,900	Land and Building at valuation		15,500
Profit for the year ended 31.3.2017	4,500		Machinery (Cost)	13,000	
Less : Drawings	1,500	3,000	*Less* : Depreciation	7,500	5,500
Creditors		6,300	Stock at cost		5,700
Overdraft		2,700	Debtors		4,200
		30,900			30,900

Further investigation reveals the following information:

(i) The Closing Stock includes damaged goods which, although they had costed ₹ 100, have an estimated sale value of ₹ 75.

(ii) Debtors include ₹ 200 in respect of a customer who had gone bankrupt. A doubtful debt provision of $2^1/_2$% is also required.

(iii) The machinery was acquired five years ago, and it is being depreciated down to its scrap value on a straight-line basis over eight years. A more realistic estimate indicates that the life span will be ten years.

(iv) The land and building were revalued in December 2016 by Mr. Thompson. The original cost was ₹ 13,500 and the surplus was credited to the Profit and Loss Account for the year.

(v) Wages owing at March 31, 2017 amounted to ₹ 95 but this has not been reflected in the accounts.

(vi) Charges for the bank overdraft, amounting to ₹ 80, have not been recorded in the accounts.

(vii) In arriving at the profit for the period, a salary of ₹ 1,000 paid to Mr. Thompson had been deducted as an expense.

(viii) ₹ 200 rent owing to Mr. Thompson for the letting of part of his business premises had not been received, and no entry had been made in the books in respect of this item.

Required to: (a) Prepare Journal entries to reflect such corrections as you consider necessary; (b) Draw up a statement of revised profit for the period, and prepare a new Balance Sheet as at 31st March, 2017.

Solution

In the books of J Thompson

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 (i)	Profit & Loss Adjustment A/c	Dr.		25	
	To Stock A/c				25
	(Being the value of the stock adjusted)				
(ii) (a)	Profit & Loss Adjustment A/c	Dr.		200	
	To Debtors A/c				200
	(Being bad debt written-off)				
(ii) (b)	Profit & Loss Adjustment A/c	Dr.		100	
	To Provision for Doubtful Debts A/c				100
	(Being the creation of provision @ 2.5 % on ₹ 4,000)				
(iii)	Depreciation Provision A/c (Note 1)	Dr.		1,500	
	To Profit & Loss Adjustment A/c				300
	To Capital A/c				1,200
	(Being depreciation overcharged, now adjusted)				
(iv)	Profit & Loss Adjustment A/c	Dr.		2,000	
	To Capital A/c				2,000
	(Being revaluation profit transferred to Profit & Loss A/c, now rectified)				
(v)	Profit & Loss Adjustment A/c	Dr.		95	
	To Outstanding Wages A/c				95
	(Being outstanding wages provided for)				
(vi)	Profit & Loss Adjustment A/c	Dr.		80	
	To Bank A/c				80
	(Being bank charges previously not recorded, now rectified)				
(vii)	Drawings A/c	Dr.		1,000	
	To Profit & Loss Adjustment A/c				1,000
	(Being salary paid to Proprietor, wrongly treated as an expense, now rectified)				
(viii)	Rent Receivable A/c	Dr.		200	
	To Profit & Loss Adjustment A/c				200
	(Being rent due but not received, now adjusted)				

Dr. Profit & Loss Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	25	By Balance b/d	4,500
To Debtors A/c	200	By Depreciation Provision A/c	300
To Provision for Doubtful Debts A/c	100	By Drawings A/c	1,000
To Capital A/c	2,000	By Rent Receivable A/c	200
To Outstanding Wages A/c	95		
To Bank A/c	80		
To Balance c/d	3,500		
	6,000		6,000

Balance Sheet of J Thompson as at 31st March, 2017

Liabilities		₹	Assets		₹
Capital at April 1, 2016	18,900		Land and Building at valuation		15,500
Profit for the year ended 31.3.2017	3,500		Machinery (Cost)	13,000	
Add: Over-depreciation	1,200		*Less* : Depreciation (₹ 7,500 – 1,500)	6,000	7,000
Revaluation Profit	2,000		Stock at cost		5,675
Less : Drawings	(2,500)	23,100	Debtors	4,200	
Outstanding Wages		95	Less : Bad Debt	200	
Creditors		6,300		4,000	
Overdraft (₹ 2,700 + ₹ 80)		2,780	Less : Provision for doubtful debt	100	3,900
			Rent Receivable		200
		32,275			32,275

Notes : (a) Total Depreciation 7,500/5 x 8 = ₹ 12,000; (b) Revised Depreciation per year 12,000/10 = ₹ 1,200; (c) Depreciation to be written back 5 x (₹ 1,500 – ₹ 1,200) = ₹ 1,500; (d) Out of ₹ 1,500, only ₹ 300 to be adjusted with current year's profit and balance to be credited to Capital Account.

Key Points

- **Errors** are unintentional misstatements or omission of amounts or disclosures in financial statements.
- **Typical errors** include : (i) Mathematical mistakes; (ii) Mistake in the application of accounting principles; (iii) Oversight; and (iv) Misuse of facts.
- Errors of Omission are errors resulting from the complete failure to enter a transaction in the books.
- **Errors of Principle** arise because of an incorrect application of the principles of accounting, and failure to differentiate between capital and revenue expenditure.
- **Compensating Errors** are a group of errors, the total effect of which are not reflected in the Trial Balance.
- **Errors of Posting** : If a transaction has been journalised or recorded in a subsidiary book but has been posted wrongly in the Ledger Account, it is an error of posting.
- **Errors of Casting** : Casting is an accounting term for addition. These errors may occur due to short casting or excess casting in any subsidiary book or in any account in the Ledger.

THEORETICAL QUESTIONS

1. What are the different types of errors? Explain each one of them with examples.
2. What is Suspense Account? When is it used?
3. What are the different types of errors that affect the agreement of Trial Balance?
4. What are one-sided and two-sided errors? How will you rectify these if detected before preparation of a Trial Balance?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. A trial balance failed to agree and a suspense account was opened. It was then found that rent received of ₹ 500 had been debited to the rent payable account. Which entries are required to correct this error?

	Rent Received Account		Rent Payable Account		Suspense Account	
A	credit	500	credit	500	debit	1,000
B	credit	500	debit	500	no entry	
C	debit	500	credit	500	debit	1,000
D	debit	500	credit	500	no entry	

2. The total of the sales day book for one month is ₹ 9,160. It has been entered in the sales account as ₹ 9,610. Which entries are required to correct the error ?

	Debit		Credit	
A	Sales account	₹ 450	Sales day book	₹ 450
B	Sales day book	450	Sales account	450
C	Sales account	450	Suspense account	450
D	Suspense account	450	Sales account	450

3. An invoice for repairs to machinery ₹ 500, has been entered in the Machinery account. Which entries are required to correct the error ?

	Debit		Credit	
A	Machinery account	500	Repairs to machinery account	500
B	Repairs to machinery account	500	Machinery account	500
C	Repairs to machinery account	500	Suspense account	500
D	Suspense account	500	Machinery account	500

4. When Sachin's trial balance was extracted, the total of the debit balances was ₹ 450 less than the total of the credit balances so a suspense account was opened. After checking he found that :
   (i) a supplier's invoice for ₹ 225 had been debited to both the expenses account and the creditors' control account.
   (ii) a cash sale for ₹ 900 had been omitted from the accounting records.
   When these errors are corrected, what is the balance on the suspense account ?
   A ₹ 900 debit
   B ₹ 900 credit
   C ₹ 1,800 debit

5. A book-keeper has made the following errors :
   (i) A cash transaction of ₹ 100 has not been entered in the books at all.
   (ii) A discount received of ₹ 30 was entered in the debit side of the discounts allowed and correctly posted to the creditors account.
   (iii) ₹ 300 cash drawings were entered in the repair expense account and correctly recorded in the cash book.
   What would be the balance on the suspense account before these errors were corrected ?
   A ₹ 30 (Cr.)
   B ₹ 100 (Dr.)
   C ₹ 300 (Cr.)
   D ₹ 60 (Cr.)
6. After calculating your company's profit for 2016, you discover the following :
   (a) A fixed asset costing ₹ 50,000 has been included in the purchases account.
   (b) Stationery costing ₹ 10,000 has been included as closing stock of raw materials, instead of stock of stationery.
   These two errors have had the effect of :
   A understating gross profit by ₹ 40,000 and understating net profit by ₹ 50,000
   B understating both gross profit and net profit by ₹ 40,000
   C understating gross profit by ₹ 60,000 and understating net profit by ₹ 50,000
   D overstating both gross profit and net profit by ₹ 60,000
7. An organisation's year end is 30 September on 1.1.2016. The organization took out a loan of ₹ 1,00,000 with annual interest of 12%. The interest is payable in equal instalments on the first day of April, July, October and January in arrears. How much should be charged to the profit and loss account for the year ended 30 September, 2016 and how much should be accrued on the Balance Sheet ?

	Profit and Loss Account	Balance Sheet
A	₹ 12,000	₹ 3,000
B	₹ 9,000	₹ 3,000
C	₹ 9,000	Nil
D	₹ 3,000	₹ 9,000

8. The trial balance of a business does not agree. The difference has been entered in a suspense account.
   The error was caused by a cheque for ₹ 400 from X being debited to X's account. The correct journal entry is :

	Debit	**Credit**	**With**
A	Bank	Suspense	₹ 400
B	Suspense	X	₹ 400
C	Suspense	X	₹ 800
D	Suspense	Bank	₹ 800

9. A company's trial balance failed to agree and a suspense account was opened for the difference.
   Subsequent checking revealed that discount allowed ₹ 12,500 has been credited to discount received account.
   Which of the following journal entry will correct the errors ?

A	Discount Allowed A/c	Dr.	12,500	
	To Discount Received A/c			12,500
B	Discount Allowed A/c	Dr.	12,500	
	Discount Received A/c	Dr.	12,500	
	To Suspense A/c		25,000	
C	Suspense A/c	Dr.	12,500	
	To Discount Allowed A/c			12,500

PRACTICAL QUESTIONS

1. The Trial Balance as on 31.12.2016 of Moon Light Pvt. Ltd showed a difference and the Trial Balance was made to agree with the help of a Suspense Account. The following errors were detected afterwards. (a) The Sales Day Book was overcast by ₹ 3,000; (b) A sum of ₹ 1,000 received from R. Bose was wrongly credited to B. Bose; (c) A creditor's balance was extracted as ₹ 1,345 instead of ₹ 345; (d) A Sales Bill for ₹ 9,289 was wrongly debited to Customer's Account as ₹ 9,810; (e) The Purchase Day Book was undercast by ₹ 1,000; (f) An invoice of ₹ 2,000 for the purchase of a typewriter was debited to Purchases Account. Pass Journal entries to rectify the above errors.

2. The Trial Balance extracted from a set of books of X showed a difference which was placed in a Suspense Account. Subsequently, the following mistakes were detected:
   (i) A cheque for ₹ 1,000 received from B was dishonoured and returned by the bank had been credited to the Bank Account and debited to Sundry Creditors Account.
   (ii) Several items of furniture sold for ₹ 5,000 had been entered in the Sales Day Book.
   (iii) Goods purchased from Z for ₹ 310 had been posted to the debit of his Account as ₹ 130.
   (iv) ₹ 1,200 for goods sold on credit to A had been omitted to be entered in his account.
   Show the necessary entries in the Journal properly ruled and with suitable narrations to rectify these errors and also indicate the amount of the difference in the Trial Balance.
3. On 31st March 2017, while balancing the books of account of Shri M Singh, they did not agree. The difference in Trial Balance amounting to ₹ 783 was debited to Suspense Account. Later, the following errors were noticed. Give the Journal entries for rectification of errors and prepare the Suspense Account:
   (a) The total of Purchases Day Book for March, 2017 has been undercast by ₹ 300.
   (b) ₹ 220 paid for repairing the Machinery has been debited to Machinery Account.
   (c) The Sales Day Book has been overcast by ₹ 150.
   (d) A sale of ₹ 1,200 to Mr Kapur has been passed through the Purchases Day Book.
   (e) Cash ₹ 117 received from Shri Shankaran though entered in the Cash Book has not been posted to Shri Shankaran Account.
   (f) Goods returned by Mr Charan Singh, ₹ 225 have been entered in the Returns Outward Book. However, Mr Charan Singh's Account is correctly posted.
4. The Trial Balance of Skreen and Co. as on 30th June 2017 shows a difference of ₹ 16,646, the debit side being in excess of the credit side, this difference was placed in 'Suspense' Account while closing the books. The following errors were subsequently noticed:
   (a) Returns Outward Book was undercast by ₹ 1,818 on 28th June, 2017.
   (b) Repairs to Plant and Machinery, amounting to ₹ 2,200 was debited to Plant and Machinery Account on 9th June, 2017.
   (c) Advance of ₹ 2,002 given to one of the suppliers, Mr X on 20th May 2017 was entered correctly in the Cash Book but was posted in his account on the credit side.
   (d) A cheque for ₹ 1,858 deposited in the Bank on 29th May, 2017 was wrongly entered in Cash Book as ₹ 18,458 though the correct amount was posted in the account of the Customer.
   (e) Closing stock as on 30th June, 2016 was ₹ 1,91,400 but the same was wrongly carried forward as ₹ 1,95,000 in the books on 1st July, 2016.
   (f) ₹ 1,368 being the discount allowed by Mr Y on 25th June, 2017 was omitted to be posted in his account.
   Pass rectification entries for the above and draw the 'Suspense' Account.
5. There was an error in the Trial Balance of Mr. Arora on 31st December, 2016 and the difference in the books was carried to Suspense Account. On going through the books, you find that :
   1. ₹ 5,400 received from Mr. Rajiv was posted to the debit of his account.
   2. ₹ 1,000 being purchases returned were posted to the debit of Purchases Account.
   3. Discount of ₹ 2,000 received were posted to the debit of Discount Received Account
   4. ₹ 2,740 paid for repairs to motor car was debited to Motor Car Account as ₹ 1,740.
   5. ₹ 4,000 paid to R. Sanjay was debited to S. Sanjay Account.
   Give Journal entries to rectify the above errors and ascertain the amount transferred to Suspense Account on 31st December, 2016 by showing the Suspense Account, assuming that the Suspense Account is balanced after the above corrections.
6. The Trial Balance of Dilip and Co, showed a difference. On scrutiny of the books, the following errors were detected:
   (a) Total of the debit side of the Stationery Account has been overcast by ₹ 100.
   (b) Sales Account has been totalled in short by ₹ 200.
   (c) One item of purchase of ₹ 50 has been correctly recorded in the Purchases Day Book, but posted to the supplier's account (shown under Sundry Creditors) as ₹ 500.
   (d) Sales Return of ₹ 200 from a customer has not been posted to that account although the Customer's Account has been credited.
   (e) A cheque of ₹ 1,000 issued to a supplier (shown under Sundry Creditors) towards his dues has been debited to the Purchase Account through error.
   (f) A credit sale of ₹ 100 has been credited to the Sales Account and also to the Sundry Debtors Account.
   (i) Show the Journal entries to rectify the errors; (ii) Draw up the Suspense Account as it would appear in the ledger of the firm; (iii) Show also how they affect the profits of the firm.

7. The trial balance of A. Bose did not agree and the difference was carried to a Suspense Account. It was found that :
   (i) A sales invoice for ₹ 1,000 for goods sold on credit to B. Ghosh was entered in the Purchases Book, but in the Ledger, the amount was correctly debited in the Account of B. Ghosh.
   (ii) Goods bought on credit from P. Roy for ₹ 1,500 were wrongly debited to his account at ₹ 5,100.
   (iii) A cash discount of ₹ 50 allowed to S. Gupta remained unposted to his A/c in the Ledger from the Cash Book.
   (iv) The sales book for the month of April was undercast by ₹ 100.
   (v) ₹ 460 paid for repairs to building was debited to Building Account.

   Pass necessary Journal entries to rectify the errors and state what amount was carried to the Suspense Account.
8. The books of A. Vikram did not agree. The accountant put the difference in a Suspense Account. Rectify the following errors and prepare a Suspense Account.
   (a) The total of the Returns Outwards Book, ₹ 200 has not been posted in the Ledger.
   (b) A purchase of ₹ 1,400 from Saran has been entered in the Sales Book. However, Saran's Account has been correctly credited.
   (c) A sale of ₹ 430 to Ramakant has been credited in his account as ₹ 340.
   (d) A sale of ₹ 296 to Krishan has been entered in the Sales Book as ₹ 269.
   (e) Old furniture sold for ₹ 540 has been entered in the Sales Account as ₹ 450.
   (f) Goods taken by the proprietor, ₹ 500 have not been entered in the books at all.
9. Write out the Journal entries to rectify the following errors using a Suspense Account:
   (a) The total of "Discount Allowed" from the Cash Book for the month of December 2016 amounting to ₹ 350 was not posted.
   (b) An amount of ₹ 175 entered in the Sales Return Book has been posted to the debit of Mr. Roberts who returned the goods.
   (c) Bad debts aggregating ₹ 250 were written off during the year in the Sales Ledger but were not adjusted in the General Ledger.
   (d) Goods to the value of ₹ 500 returned by Mr. Smith were entered in the Sales Day Book and posted therefrom to the credit of his account.
   (e) A sale of ₹ 800 made to Mr. Peter was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Armstrong as ₹ 80.
10. Rectify the following errors. Calculate the difference in the Trial Balance. Prepare a Suspense Account and find out the effect of these errors on the Net Profit.
   (a) Purchased goods from Mathai ₹ 300, passed through Sales Book. Mathai's account was correctly credited.
   (b) Received a bill of exchange from Arun for ₹ 500, passed it through Sales Book.
   (c) An item of ₹ 150 relating to Prepaid Rent Account was omitted to be brought forward.
   (d) ₹ 500 paid to Mehta Bros. against our acceptance were debited to Malhotra Bros. Account.
   (e) Received final dividend of ₹ 200 from Ajit whose account had already been written off as bad debt, was credited to his newly opened account and was included in the list of creditors.
   (f) Bill received from Janki Das for repairs done to radio ₹ 150 and radio supplied for ₹ 950 was entered in the Invoice Book as ₹ 1,000.
11. Misbal Co has produced a Trial Balance for the year ended March 31, 2017, which does not balance. An examination of the company's books discloses the following errors:
   1. An invoice from J. Smith amounting to ₹ 100, for goods purchased, has been omitted from the Purchases Day Book and posted direct to purchases account in the Nominal Ledger and J. Smith's account in the Purchases Ledger, but has not been included in the Creditors Control Account in the Trial Balance.
   2. The Sales Day Book has been undercast by ₹ 240 and posted to the Debtors Control Account accordingly.
   3. Discount allowed for the month of March amounting to ₹ 489 has not been posted to the Nominal Ledger.
   4. Goods received from Why Ltd on 31 March 2017, costing ₹ 2,410 have been included in stock, but the invoice has not yet been received.
   5. A cheque for ₹ 192 received from J. Jones, a debtor, has been posted direct to Sales Account in the Nominal Ledger.
   6. Sales Account in the Nominal Ledger has been credited with a credit note for ₹ 250 being trade-in allowance given on a company van. This amount had already been taken into account when dealing with the replacement in the Motor Van Account.

   You are required :

   (a) to give the Journal entries, where necessary, to correct these errors, or if no journal entry is required, state how they will be corrected;

   (b) to prepare a statement showing the effect the corrections would have on the company's profit for the year, and;

   (c) to prepare a statement showing the net adjustment to the trial balance.

12. Mr Mehrotra closes his books on 31st March, every year. In August, 2017 he found that his books for the year 2015-14 contained some errors in spite of an agreed Trial Balance. The errors were:
    (a) ₹ 800 paid for purchase of office furniture was posted to the Purchase Account.
    (b) The Sales Book was overcast by ₹ 250.
    (c) ₹ 275 paid for freight on machinery was debited to Freight Account for ₹ 525.
    (d) Closing stock was overcast by ₹ 3,000 by a wrong casting in the inventory.
    (e) An amount of ₹ 700 was received in full settlement from a customer after he was allowed a discount of ₹ 70, but while writing the books, the amount received was entered in the discount column and the discount allowed was entered in the cash column.
    (f) A cheque of ₹ 7,330 received from Mr Rao, after allowing him a discount of ₹ 70 was endorsed to Mr Roy in full settlement, for ₹ 7,500. The cheque was finally dishonoured but no entries for dishonour was passed in the books.

    Give journal entries to rectify the above errors using Suspense Account, where necessary.
13. After the preparation of Profit and Loss Account, the following transactions were overlooked :
    (a) The opening and closing stock were correctly valued amounted to ₹ 40,000 and ₹ 35,000 respectively, but they have both been included in the Trading Account at 20% less.
    (b) ₹ 1,000 received from a customer in respect of a debt previously written off credited to his personal account.
    (c) Goods costing ₹ 1,500 were sent on sale or return basis for ₹ 2,000 which was included in sales, though no information was received from the customers.
    (d) An account of ₹ 5,000 on account of a claim against the merchant was in dispute and it was estimated that ₹ 2,000 would probably have to be paid on this account.
    (e) Actual cash balance in the office cash box is ₹ 8,000 though the books of account shows ₹ 8,500.

    Show the necessary adjusting entries in the merchant's journal.
14. As the trial balance failed to agree, the accountant of X decided to open a Suspense Account. The final accounts were then produced for the year ended 31 December, 2016.

    Further investigations revealed the following :
    1. The Cash Book had been debited with ₹ 125, which was a receipt from C, a customer. C's account in the sales ledger had been debited with ₹ 152.
    2. A general ledger debit balance for Advertising ₹ 34,000 had been correctly transferred to Profit and Loss Account, but incorrectly entered in the trial balance as ₹ 34,400.
    3. I, a creditor of the company who was owed ₹ 2,000, was paid by a personal cheque from J, wife of X. The only ledger entry recording this was a debit in I's account for ₹ 2,000.
    4. The addition of the debit side of the trial balance had been undercast by ₹ 1,000.
    5. Discounts allowed of ₹ 300 had been correctly posted to the personal ledger, but had not been transferred to the Discount Allowed Account.

    (a) Prepare Journal Entries to correct the discrepancies shown in notes 1 to 5 above.
    (b) Show the Suspense Account with the original trial balance difference and all relevant entries required to correct the errors.
    (c) Which, if any, of notes 1 to 5 above did not affect the double-entry book-keeping system of X in any way ?
15. A firm's accountant has agreed a Trial Balance, and drafted the Trading and Profit and Loss Account and the Balance Sheet. You discover the following errors:
    (a) Sales on approval amounting to ₹ 1,000 have been included in the Sales Account; ₹ 750 of these goods were returned. No record of the return was made in the books, but the returned goods were included in stock at their cost price of ₹ 500.
    (b) A cheque for ₹ 2,500 received for a loss of stock sustained by fire has been paid by the proprietor into his private bank account and not recorded in the business books.
    (c) Purchased goods amounting to ₹ 2,000 are included in stock, but the invoice was dated forward, and is not entered for the period under review.
    (d) There were two compensating errors, viz. discounts received were undercast by ₹ 50. Sales Account was overcast by ₹ 50. State the effect of each of these errors, and pass rectifying Journal entries in a summarized form.
16. Chi Knitwear Ltd. is an old fashioned firm with a hand-written set of books. A Trial Balance is extracted at the end of each month, and Profit and Loss Account and Balance Sheets are computed. This month however, the Trial Balance will not balance, the credits exceeding debits by ₹ 1,536.

    You are asked to help and after inspection of the Ledgers discover the following errors:
    (a) A balance of ₹ 87 on a Debtors Account has been omitted from the schedule of debtors, the total of which was entered as debtors in the Trial Balance.
    (b) A small piece of machinery purchased for ₹ 1,200 had been written off to repairs.

(c) The receipts side of the Cash Book had been undercast by ₹ 720.
(d) The total of one page of the Sales Day Book had been carried forward as ₹ 8,154, whereas the correct amount was ₹ 8,514.
(e) A credit note for ₹ 179 received from a supplier had been posted to the wrong side of his account.
(f) An electricity bill in the sum of ₹ 152, not yet accrued for, is discovered in a filing tray.
(g) Mr. Smith whose past debts to the company had been the subject of a provision, at last paid ₹ 731 to clear his account. His personal account has been credited but the cheque has not yet passed through the Cash Book.

Required :
(i) Necessary Journal entries for rectification of errors;
(ii) Write up the Suspense Account to clear the difference; (iii) State the effect of correcting each error.

17. The Trial Balance of M/s Roy and Smith not having agreed, their book-keeper, in order to close the books places the difference in a Suspense Account. In the next accounting period, he discovers the following:
(a) An item of ₹ 575.33 paid for the purchase of a new typewriter for the Accounts Department has been wrongly passed through the Purchases Book.
(b) An item of ₹ 68.36 in the Sales Day Book has been posted at ₹ 86.36 in the Personal Ledger Account.
(c) An addition in Returns Inwards Day Book has been cast ₹ 23 short.
(d) An item of ₹ 35 appearing in the discount column in the credit side of the Cash Book has been posted to the credit side of the Personal Account as ₹ 53.
(e) A bill of exchange for ₹ 365 accepted by Ranganathan & Co and later discounted with the firm's bankers has been returned by the bankers as dishonoured. On dishonour, this amount has been debited to the Sales Account. Give the correcting entries and also show the Suspense Account.

18. The Trial Balance of S Das & Co, did not tally as on 31st December, 2016. The following errors were detected afterwards. Pass the necessary Journal Entries to rectify the errors and find out the difference in Trial Balance.
(a) ₹ 600 received from Bidhan Nandy on 31.12.2016 was entered in the Cash Book on 2nd January, 2017.
(b) Returns Inward Book was undercast by ₹ 300.
(c) The purchase of typewriter for ₹ 5,000 was entered in the Purchase Day Book.
(d) Wages of workmen engaged in construction of Building amounting to ₹ 500 were debited to Wages Account.
(e) A purchase of ₹ 671 had been posted to the debit of Supplier Account as ₹ 617.
(f) Goods amounting to ₹ 1,000 had been returned by Ramesh and were taken into stock, but no entry was passed for the transaction.
(g) ₹ 4,000 paid for purchase of TV for proprietor's own purpose had been charged to Miscellaneous Expenses Account.
(h) A Sales of ₹ 600 to 'S' was credited to his account by ₹ 60.
(i) A sale of ₹ 2,000 has been passed through Purchase Journal.
(j) ₹ 75 paid for repairs of furniture had been entered in the total column of Petty Cash Book, but not extended in the appropriate analysis column, the total of which has been posted.

19. After completing a draft Profit and Loss Account for the year ended April 30, 2017 of ABC Limited, the following balances remained and a Suspense Account entry was required for the difference which had arisen: (all figures in ₹)

Fixed Assets at Cost	60,000	
Provision for Depreciation		31,000
Ordinary Share Capital		35,000
Retained earnings		12,300
Stock in trade, at cost	14,000	
Sales Ledger Control Account	9,600	
Purchases Ledger Control Account		6,500
Balance at Bank	1,640	
Suspense Account (Difference on balance)		440
	85,240	85,240

After investigation, the following discoveries were made:
(i) A rent payment of ₹ 350 in March 2017 had been debited in the Sales Ledger Control Account.
(ii) Although instructed to do so, the accounts clerk had not set a debt due from B Bell of ₹ 1,560 in the Sales Ledger Control Account against an amount due to B Bell in the Purchases Ledger Control Account.
(iii) Discounts allowed of ₹ 500 during the year ended 30 April, 2017 had not been recorded in the company's accounts.
(iv) No entry had been made for the refund of ₹ 2,620 made by cheque to L. Green in March 2017, in respect of defective goods returned to the company. [*Note*: The correct entries had been made previously for the return of the goods to ABC Limited.]
(v) The Purchases Day Book for February, 2017 had been undercast by ₹ 300.

(vi) A payment of ₹ 1,000 to K. Bloom in January, 2017 for cash purchases had debited in the Purchases Ledger Control Account. [*Note*: The company does not maintain a credit account with K. Bloom.]

(vii) No entries had been made in the company's books for cash sales of ₹ 2,450 on April 30, 2017 and banked on that date.

(viii) No entries had been made in the company's books for the bank charges of ₹ 910 debited in the company's bank account in December, 2016.

(ix) The company's Cash Book (bank debit column) had been overcast by ₹ 1,900 in March 2017.

(x) A cheque payment of ₹ 8,640 for new fixtures and fittings in April, 2017 had not been recorded in the company's books.

(xi) A payment by cheque for ₹ 1,460 in June 2016 for stationery had not been posted to the appropriate nominal account.

You are required to prepare :

(a) Journal entries to reflect the above; (b) The Suspense Account, clearing the balance and;

(c) A corrected Balance Sheet.

Guide to Answers

Multiple choice

1. A 2. C 3. B 4. A 5. D 6. A 7. B 8. C 9. B.

Practical Questions

1. **Credit balance of Suspense Account ₹ 4,479.**
2. **Amount of difference in the Trial Balance is ₹ 760.**
3. **After rectification there will be no balance in Suspense Account.**
   Total of Suspense Account ₹ 900.
4. **After rectification there will be no balance in Suspense Account.**
   Total of Suspense Account ₹ 22,018.
5. **Amount transferred to Suspense Account ₹ 15,800.**
6. **(ii) Dr. ₹ 100; ₹ 200. Cr. ₹ 450; ₹ 200; ₹ 200.**
   (iii) Profit will be increased by items (a); (b); (e). Profit will be decreased by item (d). Net increase in profit ₹ 1,100.
7. **Dr. ₹ 2,000; ₹ 6,600; ₹ 50; ₹ 100. Cr. nil.**
   Amount carried to Suspense A/c ₹ 8,750 (Cr.)
8. **Dr. ₹ 200; ₹ 27; ₹ 90. Cr. ₹ 2,800; ₹ 770.**
   Amount carried to Suspense A/c ₹ 3,253 (Dr.).
9. **Dr. ₹ 350. Cr. ₹ 350; ₹ 250; ₹ 500; ₹ 500; ₹ 720.**
   Amount carried to Suspense A/c ₹ 1,970 (Dr.).
10. **Difference in trial balance ₹ 750,**
    Net decrease in profit ₹ 1,050.
11. **Profit will be increased by ₹ 691.**
12. **Net decrease in profit ₹ 1,935.**
13. **Decrease in profit ₹ 2,500.**
15. **Profit will be decreased by ₹ 250.**
16. **Dr. Opening Balance ₹ 1,536; ₹ 360. Cr. ₹ 87; ₹ 720; ₹ 358; ₹ 731. Profit will be increased by ₹ 2,443.**
17. **Dr. ₹ 18. Cr. ₹ 23; ₹ 88.**
18. **Difference in Trial Balance — ₹ 4,253.**
19. **Balance Sheet total — ₹ 61,450.**

13

Introduction to Accounting Theory

Introduction

Accounting is an art, and not a science like physics or mathematics, where methods can be validated by natural laws. A generally accepted set of rules can provide a unity of understanding and also a unity of approach in the practice of accounting. In developing the structure of accounting theory and to relate the theory to accounting practice, the accounting profession has agreed to take for granted certain *basic concepts*.

Accounting assumptions are those broad concepts that underlie generally accepted accounting principles, i.e. upon which accounting is based. Certain ideas are assumed or accepted in accounting in order to provide a unifying theoretical structure and internal logic of accounting. To be acceptable in accounting practice, accounting rules must satisfy the following : (a) they rest on realistic assumptions; (b) they are internally consistent; (c) they represent the simplest, most readily understandable explanation of the field of accounting; (d) they have the greatest predictive value; and, (e) they satisfy the information needs of the users.

We should take a look at those assumptions, which most of us refer to (either in theory or in practice). These assumptions are sometimes referred to as concepts. Some speak of conventions or doctrines. Others refer to various combinations of concepts, conventions, principles, postulates, doctrines, axioms and the like. These terms in financial accounting are used synonymously and thus cause confusion in the mind of the reader. To avoid this, the use of the term ***concept*** has been preferred here.

Generally Accepted Accounting Principles (GAAP)

Generally accepted accounting principles are the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. These principles provide a foundation for measuring and disclosing the results of business transactions and events. They include both conventions, bases and presentation practices.

Generally accepted accounting principles are conventional — that is, they become generally accepted by agreement rather than by formal derivation from a set of postulates or basic concepts. The principles have developed on the basis of experience, reason, custom, usage, and, to a significant extent, practical necessity. These principles are so widely used and accepted that may be produced to underlie all accounting statements.

From the above, it can be comprehended that generally accepted accounting principles instruct an accountant what to do in the usual case when he has no reason to doubt that the affairs of the organisation are being honestly conducted. Since he has reason to believe that this basic assumption is false, an entirely different situation confronts him.

Capital Maintenance Concepts

Capital maintenance is central to the measurement of total accounting profit. If we assume that in a particular period, there is no capital introduced or withdrawn, accounting profit is the difference between a firm's opening capital and closing capital. A firm can only be considered to have made a profit if it has increased its net assets, which are represented by its capital, over and above that necessary to maintain its opening capital. Thus, total accounting profit can be measured only once a definition has been established as to what capital is to be maintained.

There are at least ***two*** different concepts of capital maintenance :

1. Operating Capital Maintenance; and
2. Financial Capital Maintenance.

Operating capital maintenance, although it can be measured in a variety of different ways, generally seeks to ensure that the business's physical operating capacity is maintained.

Financial capital maintenance attempts to conserve the value of the funds that shareholders have invested in the business. Financial capital maintenance can either be the monetary value of capital attributable to shareholders or a value adjusted by a general purchasing power index to maintain capital as a fund of real purchasing power.

The main difference between the two concepts of capital maintenance is the treatment of the effect of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that is required to maintain the capital at the beginning of the period is ***profit.***

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital in the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

Under concept of operating capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity, hence, they are treated as capital maintenance adjustments that are part of the equity and not as profit.

Example : Capital Maintenance Concept

True Value Pvt. Ltd. started a business of buying and selling 2nd hand 'Maruti Cars'. In the first year of operation, it purchased one car for ₹ 1,00,000 and sold it for ₹ 2,00,000. At the time of selling the car, the cost of buying an equivalent car was ₹ 1,20,000 and general inflation between the date of buying and selling was 10%.

Under financial capital maintenance (monetary and real terms) and operating capital maintenance, the company's income statement would be as follows :

Income Statement Under Different Capital Maintenance Concepts

Capital Maintenance Concepts	Financial Capital Maintenance		Operating Capital Maintenance
	Monetary Capital ₹	General Purchasing Power ₹	₹
Sales	2,00,000	2,00,000	2,00,000
Less: Cost of Sales	1,00,000	1,00,000	1,20,000
Operationg Profits	1,00,000	1,00,000	80,000
Less: Inflation adjustment to Opening Capital	—	10,000	—
Total Profit	1,00,000	90,000	80,000

Monetary financial capital maintenance, which is the basis most commonly used in accounting, takes no account of the effects of inflation. The profit of ₹ 1,00,000 is the amount in excess of the company's original capital. In the second column, the inflation adjustment shows the effect of the general increase in the prices on the opening financial capital of ₹ 1,00,000 and seeks to ensure that profit is measured only after preserving the opening capital in the business in terms of its general purchasing power. The profit of ₹ 90,000 leaves capital of ₹ 1,10,000 in the business to maintain its purchasing power.

Operating capital maintenance, on the other hand, is concerned with preserving the productive capacity of the business. In the above example, this is the company's ability to replace the item of stock sold.

Under operating capital maintenance, the company has a profit of ₹ 80,000 and capital in the business of ₹ 1,20,000 which is sufficient to purchase a car to start the next year's trade.

Limitations of Historical Cost Accounting

Indian accounting system is mainly based on historical cost accounting system where the acquisition of assets is recorded in the books of account at the amount paid at the time of purchase. This system is very reliable because the monetary amount of the transaction is known, verifiability is straight forward and, documentation exists. However, critics of historical cost accounting points out the following limitations :

1. Historical cost accounting system does not reflect the current financial position or worth of a business.
2. The Profit and Loss Account tends to match current revenues with historical costs (expenses) rather than the current costs.
3. Financial statements prepared under historical cost accounting system do not show the impact of inflation.
4. The Profit and Loss Account does not reflect those increases in the net asset values which are not considered to be realised.
5. At the time of calculating taxable income, tax authority takes the accounting profit as its starting point and therefore, the tax payable is dictated by outdated accounting figures.
6. Financial statements prepared under historical cost accounting system do not always present comparable data.

Fair Value Accounting

Introduction

During the last few years it has been noticed that the basis of accounting is changing. For a long period of time, accountants were used to record different assets and liabilities at their historical cost. Although this method of recording assets and liabilities are meaningful when there is no change in the price level. However, the method is not useful when prices are rising. In such a situation, it may disturb the reports of profits and Balance Sheet values. To overcome the weakness of historical cost method of recording assets and liabilities, many national and international accounting standards body have moved towards a ***fair value approach***.

Definition

Fair value is defined in IAS 39 as "***the amount for which asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction***."

Features

1. Fair value incorporates market information into the financial statements. The information contained in the financial statements are useful to investors as all the values of assets and liabilities are close to 'current' values at the Balance Sheet date.
3. It focusses on the fair value of assets and liabilities.
4. Fair value is Balance Sheet based. The result of changes in the carrying values of assets and liabilities are reflected in the Profit and Loss Statement.
5. Fair value accounting meets the conceptual farework criteria in terms of qualitative characteristics of accounting information.

Advantages

1. Fair value accounting reflect present economic conditions relating to economic resources and obligations.
2. The values of assets and liabilities are represented faithfully in the Balance Sheet which in turn helps the investors to take informed decisions.
3. Fair value accounting is unbiased.
4. Fair value accounting enhances consistency because it measures all assets and liabilities, acquired or incurred during different periods, using same base.
   For example, X Ltd. purchased office space of 1,000 sq.ft. in 2009 @ ₹ 6,000 per sq.ft. in a particular building. In 2014, again the Company acquired 1,000 sq.ft. @ ₹ 10,000. On 31st March, 2016 the rate of office space in the same building is ₹ 12,000 per sq.ft. At the Balance Sheet of 31st March, 2016 both the office spaces will be shown at the same rate, i.e., ₹ 12,000 per sq.ft.
5. The use of fair value accounting would minimise the undesirable effects of the mixed measurement approach to financial reporting as we use today.

Limitations

1. In a stable economy, this method of accounting is not cost effective.
2. There is no clear definition of fair value.
3. Fair value of assets and liabilities may widely vary with future outlook of the economic condition of the country. ***For example***, during economic boom a plot of land of one acre could be sold for ₹ 10 crore but during recession it may not fetch even ₹ 6 crore. Therefore, the reported profit will fluctuate widely which may misguide the investors.
4. Management may not be in a position to fix fair value of highly technology based assets. ***For example***, valuation of 2G / 3G spectrum.
5. Lack of verifiability reduces the confidence of the investors.

Current Practice in India

In India, almost all companies are preparing financial statements on historical cost basis. However, global trend is the adoption of fair value accounting. Recent survey by US SEC on 'mark to market' accounting standards support the fair value accounting. Most investors and other users of financial reports indicated a view that the fair value accounting reflect scientifically and transparently the value of assets and liabilities under the prevailing economic conditions. In our opinion, suspending fair value accounting would result in incomplete information and it will affect the confidence of the investors. Therefore, Indian accounting authority should take necessary steps for adopting fair value accounting at the earliest.

THEORETICAL QUESTIONS

1. What is GAAP ?
2. What are the limitations of historical cost accounting system ?
3. What do you mean by capital maintenance ?
4. What is fair value ? What are the features of fair value accounting ?

14

Introduction to Accounting Standard

Introduction

Accounting standards are accounting rules and procedures relating to measurement, valuation and disclosure issued by the Council of The Institute of Chartered Accountants of India. Accounting standards are stated to be the norms of accounting policies and practices by way of guidelines that should be followed while preparing accounts and disclosed in the annual financial statements. The accounting standards are intended to apply only to items which are material.

Since accounting standards are the rules to be followed in the preparation of financial statements, these are regarded as a *mechanism* for resolving the conflicts of interest among various preparers and users of accounting information. Accounting standards are generally appropriate to the normal conduct of business and are in conformity with local conditions. Accounting standards serve public interest and are based on a conceptual framework of accounting. Necessarily, the utility of accounting standards results in a consequential improvement in the quality of preparation of financial statements.

Nature

Accounting standards are *mandatory* in nature. They are mainly applicable to the published accounts of limited companies. However, ***in case of sole proprietorships or partnerships, accounting standards mandatorily apply when the financial statements are statutorily required to be audited***.

The accounting standards apply to the preparation of general purpose financial statements, i.e., Balance Sheet, Profit and Loss Account, and other statements and statutory notes which form part of the financial statements. It is necessary to examine whether the mandatory accounting standards are complied with in the preparation of financial statements. If there is any deviation, adequate disclosure should be made so that the users of financial statements become aware of such deviations.

Accounting policies have a *direct effect* on the working results and the financial position of a business concern. Accounting policies are the specific accounting bases adopted and constantly followed by a business unit in the preparation of its financial statements. Owing to varying circumstances, different accounting policies are adopted by different business enterprises. Accounting standards, therefore, require that all significant policies adopted in the preparation and presentation of financial statements should be disclosed and should form part of the financial statements. Any change in the accounting policies which has a material effect, and the amount by which any item in the financial statement is affected by such a change should be disclosed. Lastly, if a fundamental *accounting assumption* is not followed, the fact should be disclosed.

Accounting standards could be national, international or both. Every national institute frames its own accounting standards, which generally are in keeping with the international norms. In effect, the development of accounting standards in India has been contemporaneous with that of the International Accounting Standards, which are formulated by global organisations of accounting bodies. As such, there is not much difference among the parameters of these standards.

Scope

1. Accounting Standards are to be issued in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. If there is any conflict between the accounting standards and laws (because of subsequent amendments in the law), ***the provisions of the said law will prevail and financial statements should be prepared in conformity with such law***.
2. Accounting Standards can not override the local regulations.
3. Accounting Standards are intended to apply only to items which are material.
4. The Institute will use its best endeavours to persuade the government, appropriate authorities, industrial and business community to adopt these standards in order to achieve uniformity in the preparation of financial statements.
5. In carrying out the task of formulation of Accounting Standards, the intention would be to concentrate on basic matters.

Purposes

The concepts of accounting have permitted a variety of practices to follow and, in effect, different results can be drawn from the same set of data. Consequently, the lack of uniformity of such practices has made it difficult for users of accounting information to compare the results of different firms. The overall direction of the accountant should be towards *uniformity*, so that accounting information may become comparable, leading to better analysis and comparison of performances.

The need for accounting standards is based on the necessity of harmonising the diverse policies and practices adopted by different business firms. When accounting standards are followed, accounting information become transparent and, in effect, it helps towards meaningful comparison and study. It also ensures consistency in the accounting statements of a business enterprise from year to year. In effect, it facilitates a more meaningful comparison among accounting statements of different enterprises. As a result, the users of accounting information can understand and make proper use of accounting statements for decision-making.

The need for the *uses* of accounting standards are as follows :

(1) Accounting standards promote better understanding of accounting statements, the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the statements.

(2) Accounting information is more useful if it is published on a comparable basis, and *comparability* is not possible without accounting standards.

(3) Accounting standards provide a generally accepted language for financial statements that renders them more comprehensible to the users of accounting information.

(4) Accounting standards may be regarded as a means to establish that the collective wisdom and experience rather than the viewpoint of individual accountant may prevail in the matter.

Accounting Standard Board (ASB)

On April 21, 1977, The Institute for Chartered Accountants of India constituted the Accounting Standard Board (ASB) for formulation of Accounting Standards in India.

The main functions of the Accounting Standard Board are the following :

1. To suggest area in which accounting standards should be developed.
2. To formulate different accounting standards after taking into consideration the applicable laws, customs, usage and business environment.
3. To issue guidance notes om the accounting standards and give clarifications on issue arising therefrom.
4. To review regularly the accounting standards and revise the same according to the need of the stakeholders.
5. To proactively participate with the national and international bodies in charge of setting accounting standards.

Procedure for Issuing Accounting Standards

Broadly, the following procedures are adopted by ASB for formulating Accounting Standards :

1. Determination of the broad areas in which Accounting Standards need to be formulated.
2. Formulation of Study Groups. At the time of formation of study groups, provisions will be made for wide participation by the members of the Institute and others. The study groups will help ASB in the preparation of the Accounting Standards.
3. Holding of dialogue by ASB with the representatives of the Government, Public Sector Undertakings, Industry and other organisations for ascertaining their views.
4. Preparation and publication of an exposure draft of the proposed standard for comments by members of the Institute and the public at large. An exposure draft is prepared on the basis of the work of the study groups and the dialogue with the different parties as mentioned above.

The draft of the proposed standard will include the following basic points :

(a) A statement of concepts and fundamental accounting principles relating to the Standard.
(b) Definitions of the terms used in the Standard.
(c) The manner in which the accounting principles have been applied for formulating the Standard.
(d) The presentation and disclosure requirements in complying with the Standard.
(e) Class of enterprises to which the Standard will apply.
(f) Date from which the Standard will be effective.

5. Finalisation of the draft by ASB after considering the comments received from different corners.
6. Submission of the final draft to the Council of the Institute of Chartered Accountants of India.
7. The Council will consider the final draft of the proposed standard and if found necessary modify the same in consultation with ASB.
8. Publication of the Standard on the relevant subject under the authority of the Council.

National and International Accounting Authorities

In response to the long felt need for standardisation of accounting on a global scale, the International Accounting Standards Committee (IASC) was formed in 1973. This leading professional accounting institute of nine developed countries was set up for securing more sophistication and precision in accounting procedure worldwide. In 2001, the IASC was dissolved and the IASB (International Accounting Standard Board) was established.

The sixteen accounting bodies from these nine nations are as follows :

Sl. No.	Nations	Sl. No.	Bodies
1.	Australia	1. 2.	The Institute of Chartered Accountants in Australia. Australian Society of Accountants.

2.	Canada	3.	The Canadian Institute of Chartered Accountants.
3.	France	4.	Order des Experts Compatables et des Compatables Agrees.
4.	Germany	5.	Institut der Wirtschaftspirufer in Deutschland e.V.
		6.	Wirtschaftspruferkammer.
5.	Japan.	7.	The Japanese Institute of Certified Public Accountants.
6.	Mexico.	8.	Instituto Mexican de Contadores Publicos
7.	Netherlands	9.	Netherlands Institute van Register - Accountants.
8.	United Kingdom & Ireland	10.	The Institute of Chartered Accountants in England & Wales.
		11.	The Institute of Chartered Accountants of Scotland.
		12.	The Institute of Chartered Accounts in Ireland.
		13.	The Association of Certified Accountants.
		14.	The Institute of Cost and Management Accountants.
		15.	The Chartered Institute of Public Finance and Accountancy.
9.	United States of America	16.	The American Institute of Certified Public Accountants.

The revised agreement and constitution were signed in November 1982. Both the Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India are the members of the IASC.

Adoption of International Financial Reporting Standard (IFRS)

Introduction

In the last decade of the past century phenomenal growth in the fields of communication and transportation has created the concept of an economic global village and this has given tremendous thrust in trade and commerce worldwide.

In the present scenario, the corporate entities are going for cross border businesses. More and more countries are opening their doors to foreign investments. Many foreign companies, e.g., Nokia, Toyota, Honda, HP and Dell computers are investing huge amount of capital in India and China. Similarly, many Indian companies are also investing in foreign countries, for example, Tata Motors Ltd., has invested in UK, Korea and Thailand, etc. In the same way, Reliance Industries Ltd. has invested in Brazil, Iraq, etc.

In addition, more and more Indian companies are increasingly accessing the global capital market to fulfill their capital needs.

For example:
During 2014-15, more than ₹ 1,20,000 crores of capital were arranged from global market by the Indian Companies [Source: Hindu Business Line]

There has been a paradigm shift in the economic environment of our country too, so the need for a country-specific accounting standard has given way to a need for global or international accounting standards. In present scenario, the corporate entities are going for cross border businesses. You must be hearing about the multinational companies everyday in newspapers and other media. So, do you understand what huge amount of capitals will be required and raised by these companies and how these can change the economic prospects of all of us, you and me and all learned persons who are actually investing in these companies? Yes, it involves humongous amount of money and so we the users and our investors need to understand their working to put so much money in them. Well, we can just study the reports they present us and these reports better be based on an uniform standard which is followed by every country taking part in the world-wide trade and commerce.

The International Accounting Standards Board (IASB), has developed and issued the International Financial Reporting Standards (IFRS) which has been recognized as Global Reporting Standards. More than 120 countries like the European Union, Australia, New Zealand and Russia has either already adopted or permitted the IFRSs as a tool for financial reporting.

The Ministry of Corporate Affairs (MCA) has issued 39 converged Accounting Standards on 16th February, 2015. The list of Accounting Standards are given in the next page.

The list of these new standards are given below. It is called 'Ind-AS". However, the MCA has not notified the date from when these Ind-AS will be effective.

1. **Ind-AS : 1 Presentation of Financial Statements**
2. **Ind AS : 2 Inventories**
3. **Ind AS : 7 Statement of Cash Flows**
4. **Ind AS : 8 Accounting Policies, Changes in Accounting Estimates and Errors**
5. **Ind AS : 10 Events after the Reporting Period**
6. **Ind AS : 12 Income Taxes**
7. **Ind AS : 16 Property, Plant and Equipment**
8. **Ind AS : 17 Leases**
9. **Ind AS : 19 Employee Benefits**
10. **Ind AS : 20 Accounting for Government Grants and Disclosure of Government Assistance**
11. **Ind AS : 21 The Effects of Changes in Foreign Exchange Rates**
12. **Ind AS : 23 Borrowing Costs**
13. **Ind AS : 24 Related Party Disclosures**
14. **Ind AS : 27 Separate Financial Statements**
15. **Ind AS : 28 Investments in Associates and Joint Ventures**
16. **Ind AS : 29 Financial Reporting in Hyperinflationary Economies**
17. **Ind AS : 32 Financial Instruments: Presentation**
18. **Ind AS : 33 Earnings per Share**
19. **Ind AS : 34 Interim Financial Reporting**
20. **Ind AS : 36 Impairment of Assets**
21. **Ind AS : 37 Provisions, Contingent Liabilities and Contingent Assets**
22. **Ind AS : 38 Intangible Assets**
23. **Ind AS : 40 Investment Property**
24. **Ind AS : 41 Agriculture**
25. **Ind-AS : 101 First-time Adoption of Indian Accounting Standards**
26. **Ind AS : 102 Share-based Payment**
27. **Ind AS : 103 Business Combinations**
28. **Ind AS : 104 Insurance Contracts**
29. **Ind AS : 105 Non-current Assets Held for Sale and Discontinued Operations**
30. **Ind AS : 106 Exploration for and Evaluation of Mineral Resources**
31. **Ind AS : 107 Financial Instruments: Disclosures**
32. **Ind AS : 108 Operating Segments**
33. **Ind AS : 109 Financial Instruments**
34. **Ind AS : 110 Consolidated Financial Statements**
35. **Ind AS : 111 Joint Arrangements**
36. **Ind AS : 112 Disclosure of Interests in Other Entities**
37. **Ind AS : 113 Fair Value Measurement**
38. **Ind AS : 114 Regulatory Deferral Accounts**
39. **Ind AS : 115 Revenue from Contracts with Customers**

Obligation to comply with Indian Accounting Standards (Ind AS)

The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely :

(i) any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after **1stApril, 2015**, with the comparatives for the periods ending on 31st March, 2015, or thereafter;

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after **1st April, 2016**, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely :

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) of clause (ii) of subrule (1) and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) of clause (ii) of sub- rule (1) and sub-clause (b) of clause (ii) of sub- rule (1) as the case may be; and

(iii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after **1st April, 2017**, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely :

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;

(b) companies other than those covered in clause (ii) of sub- rule (1) and sub-clause (a) of clause (iii) of sub-rule (1), that is, unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.

(c) holding, subsidiary, joint venture or associate companies of companies covered under sub-clause (a) of clause (iii) of sub- rule (1) and sub-clause (b) of clause (iii) of sub- rule (1), as the case may be.

Provided that nothing in this sub-rule, except clause (i), shall apply to companies whose securities are listed or are in the process of being listed on SME exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 1. **–** SME Exchange shall have the same meaning as assigned to it in Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 2. **–** 'Comparatives' shall mean comparative figures for the preceding accounting period.

Benefits of Achieving the Convergence with IFRSs

To understand the benefits of achieving the convergence with the IFRSs, you need to understand who or what are exactly the prime beneficiaries. The beneficiaries are:

1. The economy of our country
2. The investors
3. The industry
4. The accounting professionals

Let us now consider the advantages of having a uniform global accounting standard and regulatory framework from the viewpoint of all the above-mentioned aspects.

1. The Economy of Our Country

Globalization has given birth to lots of hope and scopes for the economic benefit of our country. With globalization and liberalization of policies, the entire world has taken the form of an economic village. Advent of Internet and the revolution in telecommunication has made it possible for businesses to reach out to foreign shores crossing borders. More and more countries are opening their doors to foreign investments and more and more markets are emerging to fulfill the capital needs as well as the end users or customers for the businesses. In such a situation, convergence of our accounting principles with an international standard is of vital importance. It helps the economy to:

- Expand.
- Be more dynamic.
- Be more strategic.
- Be more competitive
- Maintain the capital markets more efficiently.
- Encourage investment from foreign investors.
- Bring more foreign capital.

2. The Investors

Investors could be stated as the party most benefited by the convergence. They are the people to invest money into different companies and markets. So they are in need of relevant, reliable and comparable financial reports available at right time. They are taking the risks of investing money crossing not only geographic borders but also crossing different jurisdiction. Convergence with IFRSs will help them in:

- Acquiring relevant, reliable, comparable and timely information regarding businesses across the globe.
- Understanding the business opportunities better.
- Reducing cost of interpretation of different accounting standards for different countries.
- Gaining confidence.

3. The Industry

A global market with a global and standard regulatory framework gives tremendous thrust to the industry. A global market will bring more foreign capital and give boost to the country's economy. A globally accepted accounting standard will simplify the process of financial reporting which in turn will reduce cost. So if we list out the benefits, these are:

- More foreign investors.
- More foreign capital.
- Simplicity in financial reporting.
- Reduced cost of reporting.

4. The Accounting Professionals

Accounting professionals provide their services and expert knowledge to different business entities and enterprises. Presence of a global accounting standard will help in opening doors for our professionals to different parts of the world. You must have observed our engineers, doctors and technicians have gone to foreign countries and have done extremely well in all aspects of life. But it was not the case for our accounting professionals. India traditionally had followed her own 'Generally Accepted Accounting Principles' which was substantially different from other developed countries. It hindered the scope for our accounting professionals to sell their expertise and knowledge in these countries. With convergence to IFRSs they can:

- Provide their skills and knowledge in different parts of the world.
- Can provide recommendation in financial reporting to different MNCs and foreign companies both as professionals in industry or private practice.

List of Current Accounting Standards

AS– 1 : Disclosure of Accounting Policies
AS– 2 : Valuation of Inventories
AS– 3 : Cash Flow Statement
AS– 4 : Contingencies and Events Occurring After the Balance Sheet Date
AS– 5 : Net Profit or Loss for the Period, Prior Period Items and Change in Accounting Policies
AS– 6 : Depreciation Accounting (It has been withdrawn)
AS– 7 : Construction Contracts

AS– 9 : Revenue Recognition
AS–10 : Accounting for Fixed Assets
As–11 : Accounting for the Effects of Changes in Foreign Exchange Rates
AS–12 : Accounting for Government Grants
AS–13 : Accounting for Investments
AS–14 : Accounting for Amalgamation
AS–15 : Accounting for Retirement Benefits in the Financial Statements of Employees
AS–16 : Borrowing Costs
AS–17 : Segment Reporting
AS–18 : Related Party Disclosures
AS–19 : Accounting for leases
AS–20 : Earnings Per Share
AS–21 : Consolidated Financial Statements
AS–22 : Accounting for Taxes on Income
AS–23 : Accounting for Investments in Associates in Consolidated Financial Statement
AS–24 : Discounting Operations
AS–25 : Interim Financial Reporting
AS–26 : Accounting for Intangible Assets
AS–27 : Financial Reporting of Interests in Joint Ventures
AS–28 : Impairment of Assets
AS–29 : Provisions, Contingent Liabilities and Contingent Assets
AS–30 : Financial Instruments : Recognition and Measurement
AS–31 : Financial Instruments : Presentation
AS–32 : Financial Instruments : Disclosure

THEORETICAL QUESTIONS

1. (a) What is 'Accounting Standard' ?
   (b) State the nature of Accounting Standard.
2. What are the needs for uses of 'Accounting Standard' ?
3. What are the procedures for issuing 'Accounting Standards' ?
4. What are the benefits of achieving the convergence with IFRS ?
5. What are the main functions of Accounting Standard Board (ASB) ?

15

Final Accounts of Trading Concern

Introduction

The main goal of a business concern is the earning of profits. The sole proprietor does so with the hope and expectation that the business will operate at a profit, thereby increasing his/her capital in the business. From the standpoint of the individual firm, profitable operation is must for its survival.

After the preparation of a Trial Balance, the next level of work in accounting is called "Final Accounts" level. Preparation of Final Accounts involves the following:

(a) Preparation of a Trading Account;
(b) Preparation of a Profit and Loss Account; and
(c) Preparation of a Balance Sheet.

The trial balance contains all of the account balances from the ledger. It includes assets, liabilities, expenses, income, capital and drawings. You should remember that :

(i) Debit balances usually represent either assets, expenses or drawings and these are always shown in the left hand column of the Trial Balance.

(ii) Credit balances are usually either income, liabilities or capital and these are always shown in the right hand column of the Trial Balance.

(iii) The expenses and income are shown in the Trading Account and Profit and Loss Account.

(iv) Assets, liabilities, capital and drawings are shown in the Balance Sheet.

(v) Additional information given by way of a note have not been recorded in the Ledger Accounts and consequently will require both a debit and a credit entry (which is usually effected by entering them in both the Trading and Profit and Loss Account and the Balance Sheet). Accounts appearing in the Trial Balance will be shown in the Trading Account or Profit and Loss Account or Balance Sheet. No double entry is required for these Accounts.

Trading Account

The main objective of preparing the Trading Account is to ascertain gross profit or gross loss of a business during an accounting period — usually a year. In accounting parlance, gross profit means overall profit. Gross Profit is the difference between sale proceeds of a particular period and the cost of the goods actually sold. Since gross profit means overall profit, no deduction of any sort is made, i.e. general, administrative or selling and distribution expenses. Gross Profit is said to be made when the sale proceeds exceed the cost of goods sold. Conversely, when sale proceeds are less than the cost of the goods sold, gross loss is incurred.

Features of Trading Account

1. It is a Nominal Account and part of the double-entry system.
2. It is the first stage in the preparation of final accounts of a trading concern and second stage in case of a manufacturing concern.
3. It records only sales and direct costs of goods sold.
4. The balance of this account discloses the gross profit or gross loss.
5. This account does not include any income from other sources.
6. The balance of this account is transferred to the Profit and Loss Account.
7. This account relates to a particular accounting period and is prepared at the end of that period.
8. It is often treated as a sub-section of the Profit and Loss Account.

Needs of Preparing Trading Account

1. The preparation of Trading Account helps to calculate the result of buying and selling of goods and services.
2. The preparation of Trading Account helps to calculate the percentage of gross profit on sales.
3. The percentage of gross profit on sales can be compared with that of the previous year(s), to have an idea about the progress of the business.
4. A Trading Account helps to make a distinction between direct and indirect expenses.
5. A Trading Account can easily eliminate abnormal profits and losses, for example, loss of stock by fire.
6. The preparation of Trading Account helps to make a comparison among purchases, sales and direct expenses for different years.
7. The preparation of Trading Account helps to adjust the future prices of the products, if the required percentage of gross profit on sale is not being earned.

Style of a Trading Account

The styling of a Trading Account is very important, because we should have a clear presentation of how gross profit is achieved.

While preparing a Trading Account, one important point must be kept in mind that a closing journal entry is to be made in the journal proper. At the end of each accounting period, revenues and expenses accounts (direct) are closed by transferring their balances to Trading Account. The balances of these accounts disappear once they are absorbed by Trading Account.

Trading Account can be prepared either in horizontal format ('T' form) or vertical format.

The horizontal format of a Trading Account is given below :

Name of the Trader ... (1)
Trading Account .. (2)
Dr. For the year ended 31st December, 2016 ... (3) Cr.

Particulars			Rs	Particulars			Rs
To Opening Stock	... (4)		20,000	By Sales	... (7)	1,51,500	
To Purchases	... (5)	87,500		Less: Returns inwards	... (8)	1,500	1,50,000
Less: Returns outwards	... (6)	2,500	85,000	By Closing stock	... (9)		32,000
To Wages		10,000					
Add : Outstanding		5,000	15,000				
To Carriage Inwards			2,500				
To Royalty on Production	... (10)		1,500				

To Factory Expenses		1,000			
To Customs Duty and Insurance		5,000			
To Gas, Water and Fuel		2,500			
To Gross Profit ... (11) (Transferred to Profit and Loss Account)		50,000			
		1,82,500			1,82,500

Reference 1 : The business entity must be identified because it is the business unit, whose profit is being measured.
Reference 2 : This indicates the statement which is being prepared.
Reference 3 : Indicates the period of time covered by the statement.
Reference 4 : This is the value of the items in stock at the beginning of the year.
Reference 5 : All purchases made during the accounting period (for resale).
Reference 6 : The actual amount of goods returned to supplier during the accounting period.
Reference 7 : This is the total sales actually made in the accounting period.
Reference 8 : The actual amount of goods returned by customers during the accounting period.
Reference 9 : This is the value of the items in stock at the end of the accounting period.
Reference 10 : These expenses are directly attributable to the purchase of goods or to bring the goods into saleable condition.
Reference 11 : It is the difference between the credit side total and debit side total. It is transferred to the Profit and Loss Account for finding out the net profit of the business.

The vertical format of a Trading Account is given below. Now-a-days, this format is more commonly used for profit statements and reporting.

Trading Account of X for the year ended 31st December, 2016

Particulars	₹	₹	₹
Sales			3,03,000
Less : Returns inwards			3,000
			3,00,000
Opening Stock		40,000	
Purchases	1,75,000		
Less: Returns outwards	5,000	1,70,000	
Direct expenses:			
Freight & carriage	5,000		
Customs & insurance	10,000		
Wages	30,000		
Gas, water & fuel	3,000		
Lighting and Heating	2,000		
Factory expenses	2,000		
Royalty on production	3,000	55,000	
		2,65,000	
Less : Closing Stock		65,000	
Cost of Goods Sold			2,00,000
Gross Profit			1,00,0000

Trading Account Items

Debit Side

1. Opening Stock : In case of a merchandising business, the opening stock consists of different types of finished goods. In case of a manufacturing concern, opening stock consists of raw materials, work-in-progress and finished goods. Where a separate manufacturing account is prepared, opening stock consists of only finished goods. In case of a newly set up business, there will be no opening stock — at the beginning of the first year. The amount of the opening stock is available in the Trial Balance.

2. Purchases : The balance of the Purchase Account, as appeared in the Trial Balance, shows the total purchases made during the accounting period which includes both cash and credit purchases. ***In respect of purchases the following points must be noted :***

(i) Purchase of capital asset should not be added with the purchases. If it is already included in purchases, it should be deducted therefrom.

(ii) If goods purchased for personal use and added with the purchases, it should be excluded. This type of purchases should be treated as drawings and following journal entry is to be passed :
Drawings Account Dr.
To Purchases Account

(iii) If some of the goods purchased are still in transit at the year end, it is better to debit Stock-in-transit Account and credit Cash or Supplier's Account.

(iv) If the amount of purchases include goods received on consignment, or on approval or on hire purchase, these should be excluded from purchases.

(v) Cost of goods sent on consignment must be deducted from the purchases in case of a trading concern.

3. Purchases Returns : When goods are returned to the supplier, for some reasons, in the books of account supplier is debited and purchases returns or returns outwards is credited. In the Trial Balance, it appears in the credit side. There are two ways of showing the purchases returns in the Trading Account. It may be shown by way of deduction from purchases in the Trading Account. An alternative way to show the purchases returns in the credit side of the Trading Account.

4. Direct Expenses : Direct expenses are shown separately in the Trading Account. Direct expenses are those expenses which are directly attributable to the purchase of goods or to bring the goods in saleable condition. Some examples of direct expenses are as under :

(a) ***Freight and insurance*** : Freight and insurance paid in connection with acquiring goods or making them saleable is debited to Trading Account. Freight and insurance paid in connection with the sale of goods is charged to Profit and Loss Account. Freight and insurance paid for acquisition of fixed assets must be capitalised.

(b) ***Carriage inwards*** : Carriage paid for bringing the goods to the godown is treated as carriage inwards and it is debited to Trading Account.

(c) ***Wages*** : Wages incurred in a business is direct, when it is incurred on manufacturing or merchandise or on making it saleable. Other wages are indirect wages. Only direct wages are debited to the Trading Account. Other wages are debited to the Profit and Loss Account. If it is not mentioned whether wages are direct or indirect, it should be assumed as direct and should appear in the Trading Account.

(d) ***Octroi*** : When goods are purchased within municipality limits, generally octroi duty has to be paid on it. It is debited to Trading Account.

(e) ***Fuel, power, lighting and heating expenses*** : Fuel and power expenses are incurred for running the machines. These are considered as direct expenses since directly related with the production and debited to Trading Account. Lighting and heating expense of factory is also charged to Trading Account but lighting expenses of administrative office or sales office are charged to Profit and Loss Account.

(f) ***Packing charges :*** There are certain types of goods which cannot be sold without a container or proper packing. These form a part of the finished product. One example is ink, which cannot be sold without a bottle. These type of packing charges are debited to Trading Account. But if the goods are packed for their safe despatch to customers, i.e. packing meant for transportation or fancy packing meant for advertisement will appear in the Profit and Loss Account.

(g) ***Duty on purchases*** : Any duty paid in connection with the purchase of goods is debited to Trading Account.

Credit Side

1. Sales: The balance of the sales account, as appears in the Trial Balance, shows the total sales made during the accounting period which includes both cash and credit sales. In respect of sales, the following points must be noted:

(a) If the goods are sold but yet to be despatched, it should not be included in sales, but the closing stock will be increased by the cost of such goods (if the property in goods has not yet been transferred).

(b) If sale of fixed asset is included in sales, it should be deducted from sales.

(c) Goods sold on approval or on consignment or on hire purchase, should be recorded separately. If these are included in sales, these should be deducted.

2. Sales Returns: When goods are returned by the buyers, for some reasons, in the books of account "Returns Inwards Account" or "Sales Returns Account" is debited and buyer is credited. In the Trial Balance, it is appearing in the debit side. There are two ways of showing sales returns in the Trading Account. It may be shown by way of deduction from sales in the Trading Account. An alternative way to show the sales returns in the debit side of the Trading Account.

3. Closing Stock: The last item in the credit side of the Trading Account is the closing stock—which is the value of goods which remain unsold at the end of the period. In case of a merchandising business, the closing stock consists of different types of finished goods. In case of a manufacturing concern, closing stock consists of raw materials, work-in-progress and finished goods. Where a separate manufacturing account is prepared, closing stock consists of only finished goods.

Closing stock is an item which is not generally available in the Trial Balance. However, if the closing stock is adjusted against the purchases it will appear in the Trial Balance. When closing stock is shown in the Trial Balance, it will not be included in the Trading Account. It is to be shown in the Balance Sheet.

In this connection, it should be noted that closing stock is valued at cost or net realisable value (NRV), whichever is lower. Therefore, in the Trading Account and/or in the Balance Sheet we will include it at cost price or NRV, whichever is lower.

Balancing of Trading Account

After recording the above items, in the respective sides of the Trading Account, the balance is calculated to ascertain Gross Profit or Gross Loss. If the total of credit side is more than that of the debit side, the excess represents Gross Profit. Conversely, if the total of debit side is more than that of the credit side, the excess represents Gross Loss. Gross Profit is transferred to the credit side of the Profit and Loss Account and Gross Loss is transferred to the debit side of the Profit and Loss Account.

It is common for the gross profit to be expressed as a percentage of the sales value when it is known as the **GROSS PROFIT MARGIN** ***or as a percentage of cost of sales when it is known as the*** **GROSS PROFIT MARK-UP.**

Closing Entries

(i) For the items of debit side

Trading Account	Dr.
To Opening Stock Account	
To Purchases Account (Net)	
To Direct Expenses Account	

(ii) For the items of credit side

Sales Account (Net)	Dr.
Closing Stock Account	Dr.
To Trading Account	

(iii) For gross profit

Trading Account	Dr.
To Profit and Loss Account	

(iv) For gross loss

Profit and Loss Account	Dr.
To Trading Account	

Some Important Items

1. Carriage Inwards / Carriage Outwards

Carriage on purchases is called carriage inwards and similarly carriage on sales is called carriage outwards. Carriage inwards is an additional expense on the goods bought, increasing the cost of the materials or commodities, and, as such, is a trading account expense.

Carriage outwards is a selling and distribution expense and is debited to the Profit and Loss Account along with the other administration and distribution expenses.

It should be noted that both carriages are *debits*, and must not be confused with returns inwards and returns outwards. The following diagram will clear the concept.

Carriage → An Expense
- **Carriage Inwards (Debit balance)** → **Debited to Trading Account**
- **Carriage Outwards (Debit balance)** → **Debited to Profit and Loss Ac-**

Returns → A return of goods
- **Returns Inwards (Debit balance)** → **Deducted from Sales in the Trading Account**
- **Returns Outwards (Credit balance)** → **Deducted from Purchases in the Trading Account**

2. Production Wages and Office Salaries

The wages of production or of warehousing (where goods are prepared for sales) are direct expenses and are debited to the Trading Account as part of the cost of the goods produced.

The salaries of the office and administrative staff are charged to the Profit and Loss Account.

In this connection, it should be noted that if wages are not related to production, then it should not be charged to Trading Account. For example, wages paid to office cleaners are chargeable to Profit and Loss Account. Likewise, if the salaries are related to production, then it should be charged to Trading Account. For example, salaries paid to designers of the garment factory or salaries paid to works manager are chargeable to Trading Account.

The rule is that if the wages / salaries are part of the cost of the article being sold, it should appear in the Trading Account. If the wages / salaries are administrative, selling or distribution expenses, it should appear in the Profit and Loss Account.

Sometimes, Wages Account and Salaries Account are not maintained separately. One single account called Wages and Salaries Account or Salaries and Wages Account is maintained. At the time of preparation of Trading Account, students should follow the above rule.

In the examination, if nothing is mentioned, wages will be charged to Trading Account (assuming they are direct in nature) and salaries will be charged to Profit and Loss Account. For combined account — Wages and Salaries or Salaries and Wages — a proper note should be given.

3. Discount

There are basically two kinds of discounts :

(a) Trade Discount and (b) Cash Discount.

Trade Discount represents an allowance which is made by the manufacturer to the wholesalers or by the wholesalers to the retailers. Trade discount is deducted from the catalogue price of the goods when the goods are purchased. As such, trade discounts have the effect of reducing the purchase or sales figure. Since the prediscount figures (catalogue price) are typically never recorded, the sales and purchases figures are shown at net figure (i.e., catalogue price *minus* trade discount).

Cash discount is allowed to encourage a debtor to pay-off his debt within a specified time after the purchase. It should be noted that this discount is not really a reduction in the price, but an incentive to pay promptly. The sales and purchases are taken into the trading account at their full price (net of trade discount, if any), any cash discounts allowed to credit customers are treated as an expense in the Profit and Loss Account, and any cash discounts received from suppliers are treated as incomes in the Profit and Loss Account. Thus, cash discounts do not affect the ***gross profit***.

Key Points to Remember

1. ***The heading of the Trading Account should show the name of the concern or trader, the period covered and the date to which the account is made up.***
2. ***Unless stated to the contrary, wages are normally taken to the Trading Account and salaries to the Profit and Loss Account.***
3. ***Carriage inwards is debited to the Trading Account and carriage outwards is debited to the Profit and Loss Account.***
4. ***Returns inwards are deducted from sales whereas returns outwards are deducted from the purchases in the Trading Account.***
5. ***Closing stock is valued at cost or market price, whichever is lower. This value of closing stock is credited to Trading Account. However, if the closing stock has already been adjusted against the purchases, it will not be credited to Trading Account.***
6. ***Cash discount on purchases will not affect the Trading Account.***

Profit and Loss Account

After preparing Trading Account, the next step is to prepare Profit and Loss Account with a view to ascertain net profit or net loss during an accounting period. ***The Profit and Loss Account can be defined as a report that summarises the revenues and expenses of an accounting period to reflect the changes in various critical areas of firm's operations***. As pointed out earlier, the balance of the Trading Account (gross profit or gross loss) is transferred to the Profit and Loss Account, which is the starting point of the preparation of this account. This is why, Trading Account, is treated as a sub-section of the Profit and Loss Account. Profit and Loss Account shows the profit or loss on ordinary activities, profit or loss on the sale of a capital asset, other abnormal losses and gains but excludes the payment of taxation, transfer to or withdrawal from reserves or from the business and the distribution of profit. After transferring the Gross Profit or Gross Loss from the Trading Account to the Profit and Loss Account, the sources of other incomes like commission or discount received are shown on the credit side of the Profit or Loss Account. The credit side also includes the non-trading income like interest on bank deposits or securities, dividend on shares, rent of property let-out, profit arising out of sale of fixed assets, etc. On the debit side, all other expenses appearing in the Trial Balance which cannot find a place in the Trading Account, will appear. The debit side will also include the losses arising out of sale of assets and any abnormal losses.

The Profit and Loss Account measures net income by matching revenues and expenses according to the accounting principles. Net income is the difference between total revenues and total expenses. In this connection, we must remember that all the expenses, for the period are to be debited to this account —whether paid or not. If it is paid in advance or outstanding, proper adjustment are to be made (discussed later). Likewise all revenues, whether received or not are to be credited. Revenue if received in advance or accrued but not received, proper adjustment is required.

After transferring all the nominal accounts from the Trial Balance to the Profit and Loss Account, it is necessary to balance the Profit and Loss Account. If the credit side is more than the debit side, it indicates net profit for the period. Conversely, if the debit side is more than credit side, it indicates net loss for the period.

Features of a Profit and Loss Account

1. It is a nominal account and part of the double entry system.
2. It is the second stage in the preparation of final accounts of a trading concern and the third stage in case of a manufacturing concern.
3. It relates to a particular accounting period and is prepared at the end of that period.
4. This account is credited with the gross profit and income from other sources and debited with indirect expenses and losses.
5. Accrual basis of accounting is followed in the preparation of this account.
6. This account is prepared by matching revenues and expenses for an accounting period.
7. The balance of this account is the net profit or net loss.
8. The preparation of this account depends upon the accounting bases and policies of the business.
9. The capital of the owner is increased or decreased by the balance of this account.
10. This account shows how successfully and how effectively the business is being run.
11. It can be used as a basis for forecasting the future of the business.
12. This account shows whether the business can maintain its capital or not.

Advantages of Profit and Loss Account

1. It is an account of an enterprise's revenues, expenses and profit.
2. It is a link between two consecutive Balance Sheets.
3. It shows the earning power of the business.
4. It makes a distinction between trading and non-trading incomes.
5. It also makes a distinction between expenses incurred for earning revenue and losses suffered during the accounting period.
6. It is a critical study of the past happening.
7. It can be used as a basis for forecasting the future of the business.
8. It is the basis of the amount of drawings to be made by the owner.
9. Many accounts from the Trial Balance are closed by transferring them to the Profit and Loss Account.
10. It can be easily related to the Balance Sheet.

Like Trading Account, Profit and Loss Account can also be prepared either in horizontal format or vertical format.

The ***horizontal format*** of a Profit and Loss Account is given below :

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

Particulars	₹	Particulars	₹
Management expenses		**By Gross Profit b/d**	1,00,000
To Salaries (administrative)	25,000	**Other income**	
To Office rent, rates and taxes	5,000	By Discount received	12,000
To Printing and stationery	500	By Commission received	3,000
To Telephone charges	1,500	**Non-trading Income**	
To Postage and telegrams	500	By Bank Interest	13,000
To Insurance	1,000	By Rent of property let-out	16,000
To Audit fees	1,000	By Dividend from shares	11,000
To Legal charges	500	**Abnormal Gains**	
To Electricity charges	1,500	By Profit on sale of machinery	12,000
Maintenance expenses		By Profit on sale of investment	23,000
To Repairs & renewals	1,000		
To Depreciation on :			
Office equipment	200		
Office furniture	300		
Office buildings	500		
Selling and Distribution expenses			
To Salaries (selling staff)	15,000		
To Advertisement	1,000		
To Godown rent	1,200		
To Carriage outward	800		
To Bad debts	500		
To Provision for bad debts	200		
To Selling commission	1,800		

Financial expenses			
To Bank charges	100		
To Interest on loans	200		
To Discount on bills	300		
To Discount allowed to customers	400		
Abnormal losses			
To Loss on sale of machinery	Nil		
To Loss on sale of investment	Nil		
To Loss by fire	Nil		
To Net Profit (transferred to Capital A/c)	1,30,000		
	1,90,000		1,90,000

Note : (i) Gross loss will appear in the debit side of the Profit and Loss Account at the top;
(ii) Net loss will appear in the credit side of the Profit and Loss Account.

The ***vertical format*** of a Profit and Loss Account is given below. This, too is more commonly used for profit statements and reporting.

Profit and Loss Account of X for the year ended 31st December, 2016

Particular	₹	₹	₹
Gross Profit			1,00,000
Add : Other Income :			
Discount received	12,000		
Commission received	3,000	15,000	
Add : Non-Trading Income :			
Bank Interest	13,000		
Rent of property let out	16,000		
Dividend from shares	11,000	40,000	
Add : Abnormal Gains :			
Profit on sale of machinery	12,000		
Profit on sale of investments	23,000	35,000	90,000
			1,90,000
Less: Management expenses			
Salaries (administrative)	25,000		
Office rent, rates and taxes	5,000		
Printing and stationery	500		
Telephone charges	1,500		
Postage and telegrams	500		
Insurance	1,000		
Audit fees	1,000		
Legal charges	500		
Electricity charges	1,500	36,500	
Less : Maintenance expenses			
Repairs & renewals	1,000		
Depreciation on :			
Office equipment	200		
Office furniture	300		
Office buildings	500	2,000	
Less : Selling and Distribution expenses			
Salaries (selling staff)	15,000		
Advertisement	1,000		
Godown rent	1,200		
Carriage outward	800		
Bad debts	500		
Provision for bad debts	200		
Selling commission	1,800	20,500	
Less : Financial expenses			
Bank charges	100		
Interest on loans	200		
Discount on bills	300		
Discount allowed to customers	400	1,000	
Less : Abnormal losses			
Loss on sale of machinery	Nil		
Loss on sale of investment	Nil		
Loss by fire	Nil	Nil	60,000
Net Profit (transferred to Capital A/c)			1,30,000

Profit and Loss Account Items

The Debit Side

The items that will appear in the debit side of a Profit and Loss Account can broadly be classified as under :

(a) Management expenses; (b) Maintenance expenses; (c) Selling and distribution expenses; (d) Financial expenses; and (e) Abnormal losses.

(a) Management Expenses : These are the expenses incurred for carrying out the day-to-day administration of a business. Expenses under this head include office salaries, office rent and lighting, printing and stationery and telegrams, telephone charges, etc.

(b) Maintenance Expenses : These expenses are incurred for maintaining the fixed assets of the administrative office in a good condition. They include repairs and renewals, etc.

(c) Selling and Distribution Expenses : These expenses are incurred for promoting sales and distribution of sold goods. Example of such expenses are godown rent, carriage outwards, advertisement , cost of after-sales service, selling agents' commission, etc.

(d) Financial Expenses : These expenses are incurred for arranging finance necessary for running the business. These include interest on loans, discount on bills, brokerage and legal expenses for raising loan, etc.

(e) Abnormal Losses : There are some abnormal losses that may occur during the accounting period. All types of abnormal losses are treated as extraordinary expenses and debited to Profit and Loss Account. Examples are stock lost by fire and not covered by insurance, loss on sale of machinery, cash defalcation etc.

Following are the expenses not to appear in the Profit and Loss Account.

(i) Domestic and household expenses of proprietor or partners.
(ii) Drawings in the form of cash, goods by the proprietor or partners.
(iii) Personal income tax and life insurance premium paid by the firm on behalf of proprietor or partners.

The expenses of a particular accounting period include the cost of the product sold in that accounting period though these products were purchased or manufactured in an earlier period. The wages and salaries earned by the worker—whether paid or not — and rent, electricity, telephone expenses are to be taken into consideration, whether paid during the accounting period or not. To ascertain the amount of expenses to be debited to the Profit and Loss Account, four types of events are needed to be considered and the cash payment made in connection with these events. They are as under :

(i) Expenses incurred and paid out in that year: If an expenditure is incurred in one year and also paid for in the same year, the transaction becomes simplest and least troublesome. Most of the expenses for a period are generally paid before the accounting period is over. Here, when the expenses are incurred and payment is made , we debit expense account and credit cash or bank account. At the year end, the Expense Account cannot have any balance, since closed by transferring it to the Profit and Loss Account by debiting Profit and Loss Account and crediting the Expense Account.

(ii) Expenses incurred but not paid out, partly or fully, during the current year: There are some expenses, which are incurred in the current accounting period, but not paid for, partly or fully, by the end of the period, are called ***'Outstanding Expenses'***.

Outstanding expenses include outstanding salaries, interest, rent, wages and other expenses. These must be duly accounted for because the parties who furnished goods or service have a claim against the business for the amount due to them and these amounts, therefore, become the liabilities of the business at the end of the accounting period.

In fact, on the date of the final accounts, outstanding expenses, both an expense and a liability exist without having been recorded in the books of account. For recording it, the following entry is to be passed:

Expenses Account	Dr.	(Will be shown in the Profit and Loss Account)
To Outstanding Expenses Account		(Will appear in the liabilities side of the Balance Sheet)

Illustrative Example 1

Salaries paid during the year ₹ 40,000; Salaries outstanding at the end of the accounting period ₹ 5,000.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Outstanding Salaries Account		Cr.
	₹		₹

Dr.	Salaries Account		Cr.
	₹		₹
To Cash A/c	40,000		

(b) ***After Adjusting Entry*** is posted :

Dr.	Outstanding Salaries Account		Cr.
	₹		₹
To Balance c/d	5,000	By Salaries	5,000

Dr.	Salaries Account		Cr.
	₹		₹
To Cash A/c	40,000	By P/L A/c	45,000
To Out. Salary A/c	5,000		
	45,000		45,000

Balance Sheet			
Liabilities	₹	Assets	₹
Outstanding Salaries	5,000		

Dr.	Profit & Loss Account		Cr.
	₹		₹
To Salaries A/c	45,000		

Note : At the beginning of the next accounting year, a reverse entry will be passed :

Outstanding Salaries Account	Dr.	₹ 5,000	
To Salaries Account			₹ 5,000

Illustrative Example 2

P & Co. is in business dealing in pest control. Its owner, K. Mondal, employs a team of eight workers who were paid ₹ 3,000 per month each in the year to 31 December, 2015. At the start of 2016 he raised salaries by 10% to ₹ 3,300 per month each.

On 1 July, 2016, he hired a trainee at a salary of ₹ 2,100 per month. He pays his work force on the first working day of every month, one month in arrear, so that his employees receive their salary for January on the first working day in February etc.

You are required to :

(a) Calculate the amount of salaries which would be charged in the Profit and Loss Account of P & Co. for the year ended on 31 December, 2016.

(b) Calculate the amount actually paid in salaries during the year.

(c) Calculate the amount of outstanding salaries which would appear in the Balance Sheet of P & Co. as at 31 December, 2016.

Solution

		₹
(a)	**Salaries to be charged to Profit and Loss Account for the year ended 31 December, 2016** :	
	(i) Salaries of 8 employees for full year @ ₹ 3,300 per month each	3,16,800
	(ii) Salaries of trainee for 6 months @ ₹ 2,100 per month	12,600
		3,29,400
(b)	**Salaries actually paid in 2016 :**	
	(i) December, 2015 Salaries paid in January 2016 (8 x ₹ 3,000)	24,000
	(ii) Salaries of 8 employees for January to November, 2016 paid in February - December, 2016 @ ₹ 3,300 per month for 11 months	2,90,400
	(iii) Salaries of trainee for July to November paid in August - December @ ₹ 2,100 for 5 months	10,500
		3,24,900
(c)	**Outstanding salaries as at 31 December, 2016 :**	
	(i) 8 employees @ ₹ 3,300 each for 1 month	26,400
	(ii) 1 trainee @ ₹ 2,100 for 1 month	2,100
		28,500

(iii) Expenses paid for during the current year, but not yet incurred, partly or fully : Sometimes, it happens that some expenses are paid for during the current year, but not yet incurred, partly or fully, are known as '***Prepaid Expenses***'. Prepaid Expenses include prepaid insurance premium, rent, taxes, interest, etc. A prepaid expense is an asset and will be shown in the Balance Sheet. The adjusting entry to be passed :

Prepaid Expenses Account Dr. (To be shown as asset in the Balance Sheet)
To Expenses Account (Balance of this account is to be debited to Profit and Loss Account)

Illustrative Example 3

On 30th June, 2016 insurance premium paid for one year ₹ 1,200. The accounts are prepared on 31st December, 2016.

Out of ₹ 1,200 only ₹ 600 is related to the accounting year 2016 and the remaining ₹ 600 should be carried forward to the next period.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr. Insurance Premium Account Cr.

	₹		₹
To Bank A/c	1,200		

Dr. Prepaid Insurance Premium Account Cr.

	₹		₹

(b) ***After Adjusting Entry*** is posted :

Dr. Insurance Premium Account Cr.

	₹		₹
To Bank A/c	1,200	By Prepaid Insurance Premium A/c	600
		By Profit & Loss A/c	600
	1,200		1,200

Dr. Prepaid Insurance Premium Account Cr.

	₹		₹
To Ins. Prem. A/c	600	By Balance c/d	600

Balance Sheet

Liabilities	₹	Assets	₹
		Prepaid Ins. Prem.	600

Dr. Profit & Loss Account Cr.

	₹		₹
To Ins. Prem. A/c	600		

Note : At the beginning of the next accounting year, a reverse entry will be passed :
Insurance Premium Account Dr. ₹ 600
To Prepaid Insurance Premium Account ₹ 600

Illustrative Example 4

During the year to 31 December, 2016 payments were made in respect of insurance premium.

January 2nd : ₹ 16,000 for the 3 months ending 31 March, 2016
April 19th : ₹ 32,000 for the 6 months ending 30 September, 2016
October 6th : ₹ 35,000 for the 6 months ending 31 March, 2017.

You are required to calculate the amount of prepaid insurance premium for the year ending on 31 December, 2016 and also show the completed Insurance Premium Account.

Solution

You have notice that total payments of ₹ 83,000 cover a period of 15 months to 31 March 2017 whereas the accounting period ends on 31 December, 2016. The last payment made for ₹ 35,000 can be split as to ₹ 17,500 for the last quarter of 2016 and ₹ 17,500 for the first quarter of 2017. Therefore, prepaid insurance premium is ₹ 17,500. The completed Insurance Premium Account will be:

Dr. Insurance Premium Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Jan. 2	To Bank A/c	16,000	Dec. 31	By Profit & Loss A/c	65,500
April 19	To Bank A/c	32,000	Dec. 31	By Prepaid Insurance Premium A/c	17,500
Oct. 6	To Bank A/c	35,000			
		83,000			83,000
2017					
Jan. 1	To Prepaid Insurance Premium A/c	17,500			

(iv) Expenses of the current year likely to arise in subsequent period: Sometimes, an expense or a loss may arise in the future in connection with current year's business. In such a case, we make a provision of the anticipated loss and a charge is created against the profit for the current period. This provision is shown either as a liability or as a contingent asset, i.e. it appears in the Balance Sheet as a deduction from some other asset. The best example of this anticipated expense is ***provision for bad debts.***

The Credit Side

The items that appear on the credit side of a Profit and Loss Account can broadly be classified as under:

(a) Gross Profit;
(b) Other incomes;
(c) Non-trading income; and
(d) Abnormal gains.

Gross Profit: This is the balance of the Trading Account transferred to the Profit and Loss Account. If the Trading Account shows a gross loss, it will appear on the debit side.

Other Incomes: During the course of the business, other than income from the sale of goods, the business may have some other income of financial nature. The examples are discount or commission received.

Non-trading Income: The business may have various transactions with the bank. At the end of the year, the business may earn some amount of interest which will find a place in the Profit and Loss Account as non-trading income. The business may have some investment outside the business in the form of shares or debentures or units. Any income received from these investments are also considered as non-trading income and are treated in the same way.

Abnormal Gains: There may be capital gains arising during the course of the year, e.g., profit arising out of sale of a fixed asset. The profit is shown as a separate income on the credit side of the Profit and Loss Account.

In this connection, we are to remember that all the other incomes or abnormal gains are to be credited to the Profit and Loss Account if they arise or accrue during the period. Similarly, income received in advance is to be deducted from the income. The following adjustments are to be considered:

(i) Income accrued but not received, partly or fully: Accrue means increase. Certain income such as interest on debentures, dividend on shares accrued during the accounting period but are not received. Adjusting entry is required to recognise these unrecorded increases (accruals) in income. For recording, the following entry will be passed:

Accrued Income Account	Dr. (Will be shown in the Assets side of the Balance Sheet)
To Income Account	(To be credited to Profit and Loss Account)

Illustrative Example 5

Interest on debenture received during the year, ₹ 1,000. Interest accrued but not received during the year, ₹ 200.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Interest Received Account		Cr.
	₹		₹
		By Cash A/c	1,000

Dr.	Accrued Interest Account		Cr.
	₹		₹

(b) ***After Adjusting Entry*** is posted :

Dr.	Interest Received Account		Cr.
	₹		₹
To Profit & Loss A/c	1,200	By Cash A/c	1,000
		By Accrued Int. A/c	200
	1,200		1,200

Dr.	Accrued Interest Account		Cr.
	₹		₹
To Int. Recd. A/c	200	By Balance c/d	200
	200		200

Dr.	Profit & Loss Account		Cr.
	₹		₹
		By Int. Recd. A/c	1,200

Balance Sheet

Liabilities	₹	Assets	₹
		Accrued Interest	200

(ii) Income received in advance during the current period: Income received in advance is not the revenue of the current accounting period. It will be recognised as income in the coming year. Income received in advance is treated as a liability and shown in the Balance Sheet. The adjusting entry will be:

Income Account Dr. (balance to be credited to Profit and Loss Account)
To Income Received in Advance Account (to be shown in the liability side of the Balance Sheet)

Illustrative Example 6

On November 1, 2016, X & Co. leases one of its Buildings to the Z & Co, for one year. Z & Co. paid ₹ 6,000 rent for one year in advance . The Books are being closed on December 31, 2016.

Out of ₹ 6,000 received as rent, only ₹, 1,000 (November + December) should be treated as revenue for the year 2016 and the balance of ₹ 5,000 should be treated as rent received in advance for 2017, so ₹ 5,000 should be carried to next accounting period.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr. Rent Received in Advance Account Cr.

	₹		₹

Dr. Rent Received Account Cr.

	₹		₹
		By Cash A/c	6,000

(b) ***After Adjusting Entry*** is posted :

Dr. Rent Received in Advance Account Cr.

	₹		₹
To Balance c/d	5,000	By Rent Recd. A/c	5,000
	5,000		5,000

Dr. Rent Account Cr.

	₹		₹
To Rent Recd in Adv.	5,000	By Cash	6,000
To Profit & Loss A/c	1,000		
	6,000		6,000

Balance Sheet

Liabilities	₹	Assets	₹
Rent Recd in Adv.	5,000		

Dr. Profit & Loss Account Cr.

	₹		₹
		By Rent Recd A/c	1,000

Note : At the beginning of the next accounting year a reverse entry will be passed :

Rent Received in Advance Account Dr. ₹ 5,000
To Rent Received Account ₹ 5,000

Closing Entries

Following are the journal entries to be passed in connection with the preparation of the Profit and Loss Account:

(i) ***For the items of debit side:***

Profit and Loss Account Dr.
To Expenses /Losses Account

(ii) ***For Gross Profit:***

Trading Account Dr.
To Profit and Loss Account

(iii) ***For Other Income/Abnormal Gain:***

Other Income/ Abnormal gain Account Dr.
To Profit and Loss Account

Balancing the Profit and Loss Account

The balance in the Profit and Loss Account represents the net profit or net loss. If the credit side is more than the debit side, it shows the net profit, and if the debit side shows more than the credit side, it shows net loss.

When the Profit and Loss Account shows a net profit, we pass the following entry:

Profit and Loss Account Dr.
To Net Profit Account

If the Profit and Loss Account shows a net loss, the entry will be reverse.

Balance Sheet

A Balance Sheet is a list of assets and claims of a business at some specific point of time and is prepared from an adjusted Trial Balance. It shows the financial position of a business by detailing the sources of funds and the utilisation of these funds. A Balance Sheet shows the assets and liabilities grouped, properly classified and arranged in a specific manner.

It has already been stated that after a Trial Balance is prepared and adjusting entries are passed and incorporated in the Trial Balance, some accounts are closed by transferrring to the Trading Account and some accounts are closed by transferring to the Profit and Loss Account. These accounts are in the nature of expenses and revenues. With the remaining accounts lying in the Trial Balance, which mainly represent assets and liabilities and adjusting accounts, a Balance Sheet is prepared to ascertain the financial position on a given date. In this connection, we must remember that one account appearing in the unadjusted Trial Balance, has to be shown either in the Trading Account or in the Profit and Loss Account or in the Balance Sheet. However, an adjusting account figures both in the Trading, Profit and Loss Account and in the Balance Sheet. For example, ₹ 200 to be provided for outstanding salaries. In the Profit and Loss Account, Salaries Account to be increased by ₹ 200 and in the Balance Sheet outstanding salaries to be shown in the liabilities side.

Functions of a Balance Sheet

The main functions of the Balance Sheet are as under:

(1) It is a summary of various assets provided to the business and the claims to these assets. It provides information regarding the assets owned by the business and the debts owed to the outsiders, and indicates the capital of the owners in the business.

(2) It serves as a measure of liquidity. If necessary, it also shows the various assets provided to the business and claims to those assets to indicate the ability of the business to pay its debts, as and when required. The ascertainment of working capital is a basic measure of the firm's liability.

(3) It serves as a measure of solvency by providing information about the assets owned, obligations to outsiders and capital — the residual interest of the owners in the business. The solvency of a firm is measured by ascertaining the relationship of total assets to total liabilities and indicates the firm's ability to meet eventually all its short- and long-term debts.

Balance Sheet and Profit and Loss Account — Relationship

The primary relationship between a Profit and Loss Account and a Balance Sheet is that a Profit and Loss Account is a link between the Balance Sheet at the beginning of a period and the Balance Sheet at the end of that period. The fundamental problem in the process of measuring periodic income is the division of costs incurred between the present and future accounting periods. The Profit and Loss Account and the Balance Sheet are the two technical instruments used in reporting this division. Both are necessary, because the absence of one will not exhibit the picture clearly. The Profit and Loss Account shows the division of costs assigned to current period, whereas the Balance Sheet exhibits the costs incurred which are reasonably applicable to future years. The Balance Sheet thus serves as a means of carrying forward unexpired acquisition costs of assets. It also stands as a connecting link joining successive Profit and Loss Accounts — as mentioned earlier. Moreover, the amount of net profit reported on the Profit and Loss Account explains the changes in owners' capital between the two Balance Sheets prepared as at the beginning and the end of the accounting period.

Uses of the Balance Sheet

The Balance Sheet is regarded as a prominent accounting report. The various interested parties may derive different information for their own use. Generally the following information can be derived from a Balance Sheet:

1. It enables us to ascertain the proprietary interest of a person or business organisation.
2. It enables us to calculate the actual capital employed in the business.
3. The lender can ascertain the financial position of the business.
4. It may serve as the basis for determining purchase consideration of the business.
5. The trends of working capital of the business can be determined by comparing the Balance Sheets of successive years and corrective measures can be taken, where necessary.

Limitations of the Balance Sheet

Though the Balance Sheet is prepared by every organisation for disclosing its financial position, yet it suffers from the following limitations :

1. Fixed assets are shown in the Balance Sheet at historical cost less depreciation up-to-date. A conventional Balance Sheet cannot reflect the true value of these assets. Again intangible assets are shown in the Balance Sheet at book values which may bear no relationship to market values.
2. Sometimes, Balance Sheet contains some assets which command no market value such as preliminary expenses, debenture discount, etc. The inclusion of these assets unduly inflate the total value of assets.
3. The Balance Sheet cannot reflect the value of certain factors such as skill and loyalty of staff.
4. A conventional Balance Sheet may mislead untrained readers in inflationary situations.
5. The value of a major number of current assets depends upon some estimates, so it cannot reflect the true financial position of the business.

Distinction between Profit and Loss Account and the Balance Sheet

The difference betwen a Profit and Loss Account and a Balance Sheet is that while the former provides a 'historical' review of the accounts of the past transactions (how the profit is earned or loss is incurred) the latter gives a 'static' picture of the financial position as on the last day of the accounting period.

The main differences between a Profit and Loss Account and a Balance Sheet are as under:

1. Profit and Loss Account itself is an account whereas a Balance Sheet is a statement of assets and liabilities.
2. Profit and Loss Account shows the profits earned or losses incurred for the accounting period whereas the Balance Sheet shows the financial position of the business.
3. Profit and Loss Account is prepared for the accounting period ended whereas a Balance Sheet is prepared as at the last day of the accounting period.
4. The accounts that are transferred to the Profit and Loss Account are closed and cease to exist . But the accounts that are transferred to the Balance Sheet do not lose their identity and become the opening balances for the next period.

Balance Sheet Formats

A Balance Sheet may be prepared in one of two forms : (i) Horizontal (Traditional) format and (ii) Vertical format.

Horizontal (Traditional) Format

Under this format, the left hand side lists liabilities of the business as on the last day of the accounting period as well as details of its capital position; and on the right hand side are listed various assets of the enterprise. A Balance Sheet is so designed that it discloses the financial interest of the owner(s) in the business and its liabilities to outsiders— and how those amounts are represented by its various assets. Therefore, the Balance Sheet includes the net profit or net loss as disclosed by the Profit and Loss Account . There are two ways of recording net profit in the Balance Sheet. It can be shown as an addition to (in case of profit) or a deduction (in case of loss) from the capital(s) — as in the case of sole proprietorship or partnership firms. Alternatively, it may be shown as a seperate item — as in case of a limited company.

Arrangement of Assets and Liabilities

The assets on the right-hand side and liabilities and capital on the left-hand side must be properly *marshalled*, i.e. they should be shown in a certain order. Subject to any particular law, which requires the assets and liabilities are to be shown in certain order, assets and liabilities can be arranged in any form that exists in the particular organisation. There are two common ways in which the assets and liabilities can be arranged . They are as under:

(a) In the order of liquidity or dischargeability

According to this basis, assets are arranged in order of the case with which they can be converted into cash. Here, the cash in hand will come first, then cash at bank followed by other assets and land and building at the bottom of the list. In regard to the liabilities, they are so arranged in the order they are to be discharged. Bills payable appears first , then trade creditors and followed by loans, outstanding expenses. Thereafter, reserves and surplus will appear and capital at the bottom. Under this method, assets and liabilities are arranged as under:

Balance Sheet as at ...

Liabilities	₹	Assets	₹
Bills Payable		Cash in Hand	
Trade Creditors		Cash at Bank	
Loans		Government Securities	
Outstanding Expenses		Other Investments	
Reserves & Surplus		Bills Receivable	
Capital		Sundry Debtors	
		Stock	
		Furniture & Fixtures	
		Plant & Machinery	
		Land and Building	

(b) In the order of permanence

According to the second basis, assets are listed in order of permanence, i.e. starting with those least *'realisable'* and working down to the most 'liquid' assets. Liabilities are also recorded in order of their permanence, i.e. the liability which will have to be discharged last is shown first. On the assets side, the most fixed asset is land and building, will come first followed by plant and machinery, furniture and fixture, stock, debtors and cash in hand at the bottom. In regard to the liabilities, capital account heads the list, followed by reserve and surplus , and then by any creditors for outstanding expenses. Thereafter, loans from outsiders, followed by creditors will appear and bills payable at the bottom. Under this method, assets and liabilities are arranged as under:

Balance Sheet as at ...

Liabilities	₹	Assets	₹
Capital		Land and Building	
Reserves & Surplus		Plant & Machinery	
Outstanding Expenses		Furniture & Fixtures	
Loans		Stock	
Trade Creditors		Sundry Debtors	
Bills Payable		Bills Receivable	
		Other Investments	
		Government Securities	
		Cash at Bank	
		Cash in Hand	

In this connection, following are the points to be noted :

1. Assets of the same class are grouped together—all fixed assets together and all current assets together.
2. The balance of the Capital Account is shown as under.

Capital		
Opening balance	***	
Add: Profit for the period	***	
	***	
Less : Drawings for the period	***	***

Vertical Format

The Balance Sheet presentation used so far is known as the horizontal format. The disadvantages with the above presentation is that it does not show the value of the organisation. The networth of an organisation to the owner is the value of the owner's capital. The vertical format clearly displays the networth of the business to the owner — i.e. the capital. This format also displays the amount of investment in the fixed assets and in working capital (which is the difference between the current assets and current liabilities).

The vertical format merely involves a re-arrangement of the information shown by a Balance Sheet presented in Horizontal format. Many non-accountant managers are now required to make decisions based on accounting information. The vertical format is intended to help them gain a batter understanding of the financial information presented by the accountants and therefore improve their decision-making. The information shown previously is now presented in the vertical format.

Balance Sheet of X as at 31 December, 2016

	₹	₹	₹
Fixed Assets :			
Land		2,00,000	
Building		4,00,000	
Plant and Machinery		3,00,000	
Furniture		1,00,000	
Delivery Van		2,00,000	12,00,000
Current Assets :			
Stock	1,50,000		
Debtors	2,50,000		
Bills Receivable	50,000		
Cash at Bank	30,000		
Cash in Hand	20,000	5,00,000	
Current Liabilities :			
Creditors	1,00,000		
Bills Payable	50,000		
Outstanding Expenses	50,000	2,00,000	
Working Capital			3,00,000
NET ASSETS EMPLOYED			15,00,000
FINANCED BY :			
Capital		13,70,000	
Add : Net Profit		1,30,000	15,00,000

Balance Sheet — A Statement of Assets, Liabilities and Capital

A Balance Sheet is a statement of the assets, liabilities and capital of an organisation at a particular date which gives a true and fair view of the *state of affairs* of the business. The financial position of a business is indicated by its assets on a given date and its liabilities (excluding capital) on that date. Assets and liabilities are two independent variables and the capital is the dependent variable, because capital is the resultant of these two varying factors, assets and liabilities. Excess of assets over liabilities represents capital and is indicative of the financial soundness of the business.

Assets and their Classification

Assets are resources, tangible or intangible, from which probable future economic benefits are obtained and the rights to which have been acquired by a paricular entity as a result of past transactions or events. An asset (other than cash) has four essential characteristics :

1. It embodies a probable future benefit that increases a capacity, either singly or in combination with other resources, to contribute directly or indirectly to future cash inflows.
2. A particular business entity must be able to obtain the benefit from the resource and control others access to it. It must be owned by the business, i.e. an entity must have the title to the asset.
3. It is a result of past transactions or events, i.e. the transactions giving rise to the claim to or control of the benefit must already have accrued.
4. The probable future benefits must be quantifiable or measurable in monetary units.

From the above, it is clear that assets are valuable resources owned by a business which are acquired at a measurable money cost. Following are the important points of the above definition :

(i) The resource must be valuable;
(ii) The resource must be owned by a business enterprise; and

(iii) It must be acquired at a measurable money cost.

Assets of a business are generally classified into four groups: (a) Fixed Assets; (b) Current Assets; (c) Fictitious Assets; and (d) Intangible Assets.

(a) Fixed Assets : Fixed assets are defined by the CIMA Terminology (Chartered Institute of Management Accountants) as :

'Any asset . . . acquired for retention by an entity for the purpose of providing a service to the business, and not held for resale in the normal course of trading'.

These assets are tangible in nature — relatively long lived resources of a business. A business generally require these types of assets in order to use them in the production of goods and services . If the assets are held for re-sale they are classified as inventories, even though they are long lived. Therefore, fixed assets are long lived assets whose usefulness is likely to extend beyond one accounting period in the operations of the business. Fixed assets appear in the Balance Sheet at their historical costs minus accumulated depreciation. The expression "accumulated depreciation" means the portion of the original cost of the asset which has already been charged as an expense in the previous years as a cost of doing business.

The examples of fixed assets are land and building, plant and machinery, furniture and fixtures, etc. Fixed assets are generally divided into *wasting assets* and *non-wasting assets*. Wasting assets lose their value by wear and tear (plant and machinery) or by the passage of time (leasehold land) or through being worked (mines). Non-wasting assets are those which do not lose their value by any of the above reasons. A good example of a non-wasting assets is freehold land.

(b) Current Assets : Current assets are defined by the CIMA Terminology as :

'Cash or other asset, e.g., stock, debtors and short term investments, held for conversion into cash in the normal course of trading'.

These assets are reasonably expected to be realised in cash or consumed during normal operating cycle of the business. The distinction between fixed assets and current assets is important. The essence of the distinction is time. Current Assets are those that is owned by the business generally not for more than a year from the Balance Sheet date whereas fixed assets are those that are expected to be owned for more than one year. Following are the examples of the current assets :

Cash consists of funds which are readily available for disbursement without restriction. Most of these funds are usually on deposit with the banker (known as bank balance) and the balance in the temporary storage facilities (cash box) on the business premises.

Investments are easily marketable securities and are generally converted into cash within the accounting period. A business invests money, which is temporarily idle, to get some return in cash. Investments are valued in the Balance Sheet at cost or current market value, whichever is lower. It is valued at cost only when the decline in the market value is believed to be only temporary.

Sundry Debtors are amounts owed to the business generally by its customers arising out of credit sales. Sundry debtors appear in the Balance Sheet at their net expected realisable value, i.e, at their book values less an allowance for that portion of the amount owed which is not expected to be collected.

Bills Receivable are acknowledgements of debts of the customers. When the amount owed by debtors are evidenced by a written acknowledgement of obligation, it would appear not under the head "Sundry Debtors" but under the head "Bills Receivable". Generally, Bills Receivable is a method of converting Sundry Debtors into acceptor of bills.

Stock is the inventory of raw materials, work-in-progress and finished goods. Stock is needed by a business either for sale in the ordinary course of business, or for use in the process of production for such sale or are to be currently consumed in the production of goods and services to be available for sale. Stock is recorded in the Balance Sheet at its cost or current market value which ever is lower.

Prepaid expenses and deferred charges represent certain kinds of assets, usually of an intangible nature, usefulness of which will expire with the near future. In fact, these are expenses which are already incurred, but the entire portion could not be recognised in the current accounting period because the benefit is spread over to more than one accounting period.

(c) Fictitious Assets : These are intangible properties which are not represented by anything concrete. The examples of fictitious assets are preliminary expenses, accumulated losses, etc.

(d) Intangible Assets : Intangible assets are capital assets having no physical existence whose value depends on the rights and benefits that possession confers upon owner. These represents immaterial rights, privileges and competitive advantages owned by a business. Examples of intangible assets are Goodwill, Patents, Copyrights, Trademarks, etc.

Liabilities and their Classification

Liabilities are obligations which arise from transactions or other events that have already been occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the forgoing of a future cash receipt. The amount of the liability and the date of settlement of such liabilities are the claims of the outsiders against the business or the amounts that the business owes to some person or persons other than its owners. A liability need not be a legally enforceable claim. Generally, all the liabilities are not claims against any specific asset or a group of assets. Liabilities are stated in the Balance Sheet at either the amount of cash (or its equivalent) ultimately payable including interest accumulated to that date. Interest payable subsequent to the Balance Sheet is excluded.

The liability of the business may take one of the following forms:

(a) those with fixed amounts and date of payment;
(b) those with fixed amount but date of payment is estimated;
(c) those for which the amount and the date of payment are estimated;
(d) those arise from the advances made by the cutomers.

Liabilities of a business can be classified into : (a) Fixed Liabilities; (b) Current Liabilities; and (c) Contingent Liabilities.

(a) Fixed Liabilities : Fixed liabilities are not defined as such by CIMA Terminology but these are long-term liabilities which are generally redeemed after a long period of time. These include long-term loan, redeemable debentures of a company, etc.

(b) Current Liabilities : Current liabilities are defined by CIMA Terminology as :

'Liabilities which fall due for payment within one year. They include that part of the long term loans due for repayment within one year'.

These are obligations of the business which are payable in the near future, usually within the next accounting period. Therefore, a liability which is expected to have been paid within one year from the date of the Balance Sheet, is termed as ''Current Liability''. When a current liability is created, it increases the resources of a business in the form of current assets, e.g., buying inventory on credit. On the other hand, when the obligation for a current liability is paid for, it reduces the current assets. Current liabilities are generally obligations for the items which are entered into the operating cycle of a business, such as sundry creditors and bills payable in the acquisition of inventory, supplies to be used in the production cycle, collection received in advance against the delivery of goods, debts which arise from operations directly relating to the operating cycle such as outstanding salaries, wages, commission, royalty, rent, and so forth. It also includes income tax and other freight and taxes.

There may be other liabilities, which also fall under this category, though not related to the production cycle. These include short-term debts arising from acquisitions of capital assets, serial maturity of long term obligations (interest payment at regular intervals), and so forth. Now, we discuss some important components of current liabilities.

Sundry creditors are the claims of the suppliers against the business for the delivery of the goods on credit — which may not be evidenced by a written acknowledgement of debt.

Bills payable are the claims of the suppliers which is evidenced by a note or some other written acknowledgement of debt.

Liability for taxes are the provisions made for the estimated tax liability which is owed to the government for taxes.

Outstanding expenses are expenses which are already incurred but not paid for. These are the converse of prepaid expenses. These liabilities may be intangible in nature in the sense that they are evidenced by a legal document. The examples of outstanding expenses are outstanding wages and salary, outstanding rent, etc.

Deferred Income represents the short-term liability of a business that arises because the business has received money in advance for a service to be rendered in future. An example is rent received in advance, which means rental payment is received by the business in advance for which the business agrees to permit the tenant to make use of a property during near future.

(iii) Contingent Liabilities : These liabilities are conditions which exist at the Balance Sheet date, the outcomes of which can only be confirmed on the occurrence or non-occurrence of one or more uncertain future events. A contingent liability may also exist when a current situation may result in a future liability, but the amount of the liability in the monetary terms cannot be reasonably anticipated as on the Balance Sheet date. They do not include uncertainties connected with accounting estimates, e.g., provision for doubtful debts or provision for discount on debtors. Also, the situation must exist currently; hence, future losses from fire or flood, natural calamities or outbreak of war are not contingent liabilities. Examples of contingent liabilities are possible penalties, discounting of bills receivable, fines and penalties payable to the government or income tax authorities, etc. By contrast, if an obligation, whose amount can be reasonably estimated as a current liability, and it is not recorded in the books of account even though the exact amount is not known now.

Contingent liabilities are not recorded in the books of account; hence it does not appear on the liability side of the Balance Sheet. They are disclosed as a footnote at the bottom of the Balance Sheet.

Capital — A Liability of Business

In the accounting sense, capital is the money contributed by the owner to an organisation to enable it to function. It is measured by the excess of assets over liabilities. Capital can be brought in by a person into the business in different forms — cash or kind. When capital is brought in the form of cash, it is spent away on various items of assets that make the business a running concern.

Capital Account is the account that shows the interest of the owner in the net assets of the business.

Adjustments

1. Goods Distributed as Free Samples

This is one kind of advertisement. When goods are distributed to the prospective customers as free samples, an expense is incurred (known as advertisement expense) and there is an usual reduction from the stock of goods. The following entry is passed :

Advertisement Account Dr.
 To Purchases Account (For a trader)
 or
 To Trading Account (For a manufacturer)

At the year end, Advertisement Account is closed by transferring to the Profit and Loss Account Account:

Profit and Loss Account Dr.
 To Advertisement Account

2. Income Tax

Income tax is not an expense to earn revenue. Therefore, while ascertaining the profit of a concern, income tax is not treated as an expense to be deducted from the profit. For a sole proprietor, income tax is payable by the owner and not by the business. Therefore, if income tax appears in the Trial Balance, it should be treated as drawings and should be deducted from capital. Following are the entries to be passed:

(a) Income Tax Account Dr. (When paid)
 To Cash / Bank Account
(b) Drawings Account Dr.
 To Income Tax Account

But for a registered partnership firm, it is payable by the business itself and not by the partners. It generally appears as an appropriation of the net profits. The following entry is passed :

Profit and Loss Appropriation Account Dr.
 To Income Tax Account

3. Advance Tax

For a sole proprietor, advance tax is payable by the owner and not by the business. Therefore, if the advance tax appears in the Trial Balance, it should be treated as drawings and should be deducted from capital. The following are the entries to be passed :

(a) Advance Tax Account Dr. (When paid)
To Cash / Bank Account
(b) Drawings Account Dr.
To Advance Tax Account

4. Interest on Advance Tax

If any interest is received on advance tax, it is not the income of the business. ***It is the income of the proprietor.*** Therefore, if the interest on advance tax appears in the Trial Balance (it is shown in the credit column of the Trial Balance) it should be added with the capital.

The following are the entries to be passed :

(a) Bank Account Dr.
To Interest on Advance Tax Account
(b) Interest on Advance Tax Account Dr.
To Capital Account

Illustrative Example 7

The following balance of accounts are appearing in the Trial Balance of X. How do you deal with them at the time of preparing the final accounts ?

Trial Balance of X (includes)

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Income Tax.		50,000	
	Advance Income Tax		35,000	
	Interest on Advance Income Tax			1,000

Solution

(i) Income tax paid ₹ 50,000 will be treated as the drawings of the proprietor and it is to be deducted from his capital in the Balance Sheet.
(ii) Advance income tax paid ₹ 35,000 will also be treated as the drawings of the proprietor and it is to be deducted from his capital in the Balance Sheet.
(iii) Interest on advance income tax will be treated as private income of the proprietor and it will be treated as additional capital brought in by him. Therefore, it will be added with the capital in the Balance Sheet.

5. Drawings Made by the Proprietor

Drawings made by the proprietor(s) may be in cash or in kinds. Drawings relate to the resources of the business and the capital of the owner(s).

Drawings made in cash : In this case, following entries are passed:

(a) Drawings Account Dr.
To Cash/ Bank Account
(b) Capital Account Dr.
To Drawings Account

Drawings made in kinds : When some of the stocks withdrawn from the business, the following entry should be passed:

(a) Drawings Account Dr.
To Purchases Account
(b) Capital Account Dr.
To Drawings Account

If the drawings made by the owner is included in sales, we are to pass a reverse entry to cancel the original entry. For the drawings, the above two entries are to be passed:

6. Mutual Indebtedness

Sometimes, a debtor may also be a creditor for the business. If finished goods sold to X for ₹ 1,000 and raw materials purchased from him ₹ 500, the name of X will appear both in the debtors and creditors list. Generally, we set off these types of accounts. We transfer the account which has a smaller balance to the account having a bigger balance and, in effect, one account is closed. The following entry is passed (the amount will be the smaller of the two figures):

Sundry Creditors Account	Dr.	₹ 500	
To Sundry Debtors Account			₹ 500

7. Debtors arising out of Dishonour of Cheques or Bills

When a cheque previously received from a debtor, is dishonoured, the old position of debtor and creditor is restored between the buyer and the seller respectively. Here, Debtor Account is debited and Bank Account is credited. In effect, the value of the sundry debtors is increased and the bank balance is decreased.

When a bill, previously drawn on a debtor, is dishonoured, Debtor Account is debited and the person who is holding the bill is credited. Here the value of the sundry debtors is increased and one of the following is credited, depending on the manner in which it has been previously dealt with:

Sundry Debtors Account	Dr. (Dishonour of bill)
To Bills Receivable Account	(When the bill is retained)
To Bills for Collection Account	(When the bill is sent to bank for collection)
To Bank Account	(When the bill is discounted with banker)
To Endorsee Account	(When the bill is endorsed)

If a provision for doubtful debts is to be created, it will be on the value of the sundry debtors after making the above adjustments.

8. Abnormal Loss of Stock by Accident, e.g., by Fire

If a portion of the stock is lost, the value of such loss is first to be ascertained. Thereafter, Abnormal Loss Account is to be debited and Trading Account is to be credited. Abnormal loss account is closed by transferring to the Profit and Loss Account, i.e. Profit and Loss Account is to be debited and abnormal loss account is to be credited. If the above loss is insured against risk, Insurance Claim Account (or Insurance Company Account) is to be debited and Abnormal Loss Account is to be credited. Till the time, money is not received, Insurance Claim (or Insurance Company Account) will find a place in the asset side of the Balance Sheet. When the money is received, Bank Account is debited and the Insurance claim (Insurance Company Account) is credited. If the goods are partially insured, the portion not covered by insurance, is to be charged to Profit and Loss Account.

Journal entry to be passed is as follows:

(i) Accidental Loss Account	Dr. (Actual loss of stock)
To Trading Account / Purchases Account	
(ii) (a) Insurance Claim Account	Dr. (Insurance claim admitted by the insurance Co.)
or (b) Insurance Company Account	Dr. (Insurance claim admitted by the insurance Co.)
Profit and Loss Account	Dr. (Claim not admitted)
To Accidental Loss Account	

9. Goods Sent on Approval Basis

When goods are sold to the customers on sale or return or on approval basis, it is not considered as sale till the time it is not approved by the customers or the expiring of a fixed period as agreed by the parties. When goods are sold initially to a customer on approval basis, we pass the entry for the sales. At the year end, if the goods are still lying with the customers awaiting approval, the following entries are to be passed:

(i) To cancel previous entry:

Sales Account	Dr. (Sales value)
To Sundry Debtors Account	

(ii) To add the value of the closing stock (Cost of goods lying with the customer):

Stock with Customers Account Dr.
To Trading Account

In the Balance Sheet, it will be deducted from sundry debtors at sales price and the closing stock will be increased by the cost of such sales.

Illustrative Example 8

Sales include goods worth ₹ 30,000 sent out to S M & Co. on approval basis and remain unsold as on 31st March, 2017, the date of closing the books of account. The cost of the goods was ₹ 25,000. How will you deal with this at the time of preparing Final Accounts ?

Solution

First, the entry for sales is to be cancelled by passing the following entry :

Sales Account Dr. ₹ 30,000
To Sundry Debtors Account ₹ 30,000

Second, the cost of the goods lying with the customers is to be added with closing stock. The entry will be :

Stock with Customers Account Dr. ₹ 25,000
To Trading Account ₹ 25,000

Net Effect

(i) Reduce sales by ₹ 30,000;
(ii) Reduce the balance of Sundry Debtors by ₹ 30,000;
(iii) Credit Trading Account by ₹ 25,000;
(iv) Show in the assets side of the Balance Sheet Stock with customer — ₹ 25,000.

Remember, the goods lying with customer must be valued at cost or NRV whichever is lower.

10. Goods Received on Approval Basis

Goods may be received on approval basis from the supplier. These goods are not recorded in the books of account when these are received. Only when these goods are accepted, it is recorded as purchase. Before acceptance of these goods, supplier is the owner of these goods. Therefore, these goods are not to be included in the closing stock also.

However, if these goods are recorded wrongly as purchase, the following adjustment entry is to be passed:

Suppliers / Creditors Account Dr.
To Purchases Account

From the closing stock, cost of such goods are to be eliminated (if costs of such goods were taken into consideration at the time of closing stock valuation).

11. Interest on Loan — Not yet Paid — Fully or Partly

In the Trial Balance, the amount of the loan appears in the credit column. The amount of interest paid appears in the debit column. If a portion of the interest is still outstanding at the year end, we pass the following entry to make the adjustment:

Interest on Loan Account Dr.
To Loan Account

If nothing has been paid as interest, we are to find out the amount by applying the rate with the amount of the loan and pass the above entry. The total amount of unpaid interest will appear in the Balance Sheet as a liability.

12. Interest on Capital

Sometimes, it may be required to make a provision for interest on the capital contributed by the proprietor or the partners. Such interest is not a charge against profit but an appropriation of profit. In this connection, the following two entries have to be passed :

(i) Profit and Loss Appropriation Account Dr.
To Interest on Capital Account
(Being interest on capital payable)

(ii) Interest on Capital Account Dr.
To Capital/Current Account
(Being interest on capital transferred to Capital/Current Account)

13. Interest on Drawings

Sometimes, interest on drawings may be charged to restrict the frequent drawings by the partners. Such interest increases the divisible profit. The following two entries have to be passed:

(i) Interest on Drawings Account Dr.
To Profit and Loss Appropriation Account
(ii) Capital/Current Account Dr.
To Interest on Drawings Account
(Being interest on drawings transferred to Capital/Current Account)

14. Goods and Services Tax (GST)

When goods are sold to customers either in cash or credit, GST is collected from him along with the price of the goods sold. Periodically, this GST is deposited with the Government through the bank. Generally, in the Sales Day Book, a separate column is provided for GST. When goods are sold, GST is entered in that separate column and sales are entered in other column.

When these are posted in the ledger, the following entry is passed :
Sundry Debtors Account Dr.
To Sales Account
To GST Account
When goods are sold for cash the entry will be :
Cash Account Dr.
To Sales Account
To GST Account
When GST is paid to the Government, the following entry is passed :
GST Account Dr.
To Bank Account

Any balance in the GST Account represents amount unpaid and it is to be shown in the Balance Sheet as a liability. Sometimes, GST is not recorded separately but it is added with the sales. In this case, an adjusting entry is to be passed by debiting Sales Account and crediting GST Account. Unpaid amount of GST is to be shown in the Balance Sheet as a liability.

15. Provident Fund

As per the provision of the Provident Fund Act, both the employer and the employee must contribute a minimum fixed percentage of salary towards provident fund.

When salaries are paid to employees, employer deducts the employees' share of contribution from salary and net salary is paid to the employees. Employer's own contribution as well as deducted amount of employees are deposited within a specified period with the proper authority.

When salaries are paid, the following entry is passed :
Salary Account Dr. [Total amount payable to employees]
To Bank / Cash Account (Net amount paid)
To Provident Fund Deduction Account [Amount deducted from employees]
For employer's own contribution to Provident Fund, the following entry is passed :
Salary Account Dr.
To Own Contribution to Provident Fund Account
When both the amounts are deposited, the following entry is passed :
Provident Fund Deduction Account Dr.
Own Contribution to Provident Fund Account Dr.
To Bank / Cash Account

If the amount has not been deposited within the accounting period, it is to be shown in the Balance Sheet as a ***current liability***.

Illustrative Example 9

The following items are appearing in the Trial Balance of Mr A as on 31st March, 2017.

Trial Balance [Extract]

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Salaries		16,000	
	P.F. Deducted from Salaries			1,000

Additional information : Provide employer's share of Provident Fund ₹ 1,000. How will you deal with these items at the time of preparation of final accounts ?

Solution

For employer's share of Provident Fund, Salary Account will be debited and Provident Fund Outstanding Account will be credited.

Net effect :

(i) Salary Account is to be charged to Profit and Loss Account with ₹ 17,000 (16,000 + 1,000); (ii) In the Balance both 'P.F. deducted from Salaries' and 'P.F. Outstanding' ₹ 1,000 each are to be shown as liabilities.

Illustrative Example 10

The following items are appearing in the Trial Balance of Mr X as on 31st March, 2017.

Trial Balance [Extract]

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Salaries *less* P.F.		5,400	
	P.F. Remittance including Proprietor's Contribution — 50%		1,200	.

How will you deal with the above items at the time of preparation of final accounts ?

Solution

Out of ₹ 1,200 Provident Fund remittance, 50% i.e. ₹ 600 is proprietor's contribution and 50% i.e. ₹ 600 was deducted from the salary of the employees. In this case, net amount paid was debited to Salaries Account. Therefore, both employees' share and proprietor's share are to be added with the salaries. The entry will be :

Salaries Account Dr. ₹ 1,200
    To P.F. Remittance Account ₹ 1,200

Net Effect :

The Salaries Account will be increased by ₹ 1,200. The total salary (₹ 5,400 + ₹ 1,200) of ₹ 6,600 will be debited to Profit and Loss Account.

Alternatively, only employees' share, i.e. ₹ 600 can be added with the Salary Account and ₹ 6,000 is to be shown in the Profit and Loss Account as salary. The proprietor's share of ₹ 600 will also be shown in the Profit and Loss Account as a separate item as employer's contribution to P.F. However, the effect on Profit and Loss Account will be the same.

16. Closing Stock

(i) Closing stock appearing in the additional information will be credited in Trading Account and is to be shown as a current asset in the Balance Sheet.
(ii) If closing stock is appearing in the Trial Balance it is to be shown in the Balance Sheet only.

It should be noted that the closing stock should be valued at lower of cost and net realisable value.
Para 3 of AS—2 defines net realisable value as : Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale.
[For details see Chapter 8 — Inventories.]

Illustration 1

Show by means of Journal Entries how the following items should be adjusted when preparing the Final Accounts of a firm for the year ended 31st March, 2017.

(i) Closing stock at market value as on March 31, 2017 was ₹ 1,00,000 (cost ₹ 80,000). Stock is being valued on a consistent basis of cost or market price whichever is lower.
(ii) No entry had been passed in the books for stock withdrawn from the business by the proprietor ₹ 10,000.
(iii) Legal charges include ₹ 20,000 for cost of stamp and registration of new building acquired during the year.
(iv) Patents and trademarks were acquired at a cost of ₹ 28,000 in 2016 and every year 1/10th is being written-off.
(v) Proprietor had withdrawn for personal use goods for which the cost was ₹ 3,500 but the market value on the date of withdrawal was ₹ 4,500. Sales were credited by ₹ 3,000.

(vi) Purchase include purchase of furniture for office use worth ₹ 10,000.
(vii) An amount of ₹ 25,000 received in respect of new capital introduced by the proprietor was wrongly credited to Sundry Debtors Account.
(viii) An amount of ₹ 5,000 received from a debtor was wrongly credited to Sales Account.
(ix) Goods costing ₹ 8,000 were despatched out on 29th March. The sale, however, took place on 2nd April, 2017, when an invoice of ₹ 9,000 was raised against the customer.

Solution **In the books of ...**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 (i) March 31	Closing Stock A/c (Note 1) To Trading A/c (Being the adjustment for Closing Stock)	Dr.		80,000	80,000
(ii)	Drawings A/c To Purchases A/c (Being the adjustment for goods withdrawn by the proprietor)	Dr.		10,000	10,000
(iii)	Building A/c To Legal Charges A/c (Being cost of stamps & registration charges wrongly debited to Legal Charges Account, now adjusted)	Dr.		20,000	20,000
(iv)	Depreciation on Patent & Trademarks A/c To Patent & Trademarks A/c (Being the amount of depreciation written-off)	Dr.		2,800	2,800
(v)	Drawings A/c (Note 2) To Sales A/c (₹ 3,500 – ₹ 3,000) (Being the adjustment for goods withdrawn by the proprietor)	Dr.		500	500
(vi)	Furniture A/c To Purchases A/c (Being the purchase of furniture for office use wrongly debited to Purchases Account, now rectified)	Dr.		10,000	10,000
(vii)	Sundry Debtors A/c To Capital A/c (Being capital introduced by the proprietor wrongly credited to Sundry Debtors Account, now rectified)	Dr.		25,000	25,000
(viii)	Sales A/c To Sundry Debtors A/c (Being cash paid by a debtor wrongly credited to Sales Account, now rectified)	Dr.		5,000	5,000
(ix)	Goods-in-Transit A/c To Trading A/c (Being the adjustment for goods in transit)	Dr.		8,000	8,000

Working Notes :

(1) Closing stock is to be valued at cost or market price whichever is lower. In this case, cost price is ₹ 80,000 which is lower than the market price ₹ 1,00,000. Therefore, only ₹ 80,000 is to be adjusted.

(2) Cost of goods withdrawn by the proprietor will be treated as drawings. The market value of goods ₹ 4,500 is immaterial. Sales Account has already been credited by ₹ 3,000. Therefore, the balance (₹ 3,500 – ₹ 3,000) ₹ 500 is to be adjusted by debiting Drawings Account and crediting Sales/Purchases Account.

Illustration 2

Show by means of Journal Entries how the following matters should be adjusted when preparing the Annual Accounts of a firm for the year ended 30th September, 2016:

(a) Goods sold and recorded as sales for ₹ 4,000 were packed and the invoice for them sent to the customer. Stock taking intervened, and the parcel of goods was not despatched but was included in stock-in-hand.
(b) Several employees took their salary in advance in the month of September 2016, which was payable to them in October 2016 amounting to ₹ 2,500.
(c) A purchase made for a staff member of ₹ 1,000 and the cost was included in purchases. A deduction of similar amount was made from his salary and net payment to him posted to Salaries Account.
(d) Wages paid to the firm's own workmen for making certain additions to machinery amounting to ₹ 750, were posted to Wages Account.

(e) A dishonoured bill receivable for ₹ 500 returned by the bank with whom it had been discounted, had been credited to Bank Account and debited to Bills Receivable Account.

(f) A cheque amounting to ₹ 270 received from a customer, Mr X, was dishonoured. The returned cheque was correctly entered in the Cash Book but was posted therefrom to Allowances Account.

(g) A duplicate invoice for a purchase of machinery costing ₹ 10,000 was erroneously passed again and entered into the books.

(h) A sum of ₹ 1,000 drawn by the proprietor was debited to Travelling expenses.

Solution

In the books of ...
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2016 (a) Sept. 30	Trading A/c	Dr.		4,000	
	To Closing Stock A/c				4,000
	(Being goods already sold was wrongly included in the stock at the closing of the year, now rectified)				
(b)	Advance Salary A/c	Dr.		2,500	
	To Salaries A/c				2,500
	(Being salaries paid in advance in September 2016 transferred to Advance Salaries Account)				
(c)	Salaries A/c	Dr.		1,000	
	To Purchases A/c				1,000
	(Being goods purchased for a staff was wrongly included in purchases, now transferred to Salaries A/c)				
(d)	Machineries A/c	Dr.		750	
	To Wages A/c				750
	(Being wages paid to workers for addition to machinery was wrongly debited to Wages A/c, now adjusted)				
(e)	Sundry Debtors (Drawee) A/c	Dr.		500	
	To Bills Receivable A/c				500
	(Being dishonoured of discounted bill was wrongly debited to Bills Receivable A/c in place of Sundry Debtors A/c, now adjusted)				
(f)	Mr X A/c	Dr.		270	
	To Allowance A/c				270
	(Being a cheque received from Mr X was dishonoured but wrongly debited to Allowance Account, now adjusted)				
(g)	Creditors for Machinery A/c	Dr.		10,000	
	To Machinery A/c				10,000
	(Being a duplicate invoice for purchase of machinery was wrongly recorded in the book twice, now adjusted)				
(h)	Drawings A/c	Dr.		1,000	
	To Travelling Expenses A/c				1,000
	(Being an amount withdrawn by proprietor was wrongly debited to Travelling Expenses A/c, now adjusted)				

Suggested Steps for Preparation of Final Accounts

The students may follow the following suggested steps for the preparation of Final Accounts from a given Trial Balance with some year-end adjustments.

Step 1 : Set out a pro-forma Trading Account, Profit and Loss Account and Balance Sheet. Already you know that Final Accounts can be prepared either in Horizontal Format or in Vertical Format. Pro-forma is to be drawn up according to the requirement of the question.

Step 2 : Go down the Trial Balance and identify the items which are to be entered in the Trading Account, which are to be entered in the Profit and Loss Account and which are to be entered in the Balance Sheet. Mark these as 'T', 'P' and 'B'. In addition, it is useful to mark those values with an asterisk (*) which are to be affected by the additional information (i.e. adjustments).

Step 3 : Put all the assets and liabilities (with the mark 'B') into their appropriate position on the Balance Sheet, all the revenues and expenses (with the mark 'T' or 'P' without asterisk) into their appropriate position in the Trading, Profit and Loss Accounts. No double entry is needed since the Trial Balance figures are the result of the double entry.

Step 4 : Make necessary year end adjustment in the items marked with asterisk(*). Since no double entry have been made for these, there will be a double effect on the Final Accounts. Most adjustments will affect both the Balance Sheet and Trading / Profit and Loss Account.

Step 5 : Balance the Trading Account to find out Gross Profit / Loss and transfer it to Profit and Loss Account.

Step 6 : Balance the Profit and Loss Account to find out Net Profit / Loss and transfer it to the capital section of the Balance Sheet and total the Balance Sheet.

Illustration 3

Prepare a Trading Account and a Profit and Loss Account for the year ended 31st December 2016 and a Balance Sheet as on that date from the following Trial Balance and the adjustment items:

Particulars	Dr. (₹)	Cr. (₹)
Opening stock	46,000	
Purchases and Sales	4,42,000	8,20,000
Sales returns and Purchases returns	8,000	12,000
Discount received		2,200
Wages	43,500	
Salaries	66,000	
Carriage inwards	39,100	
Advertising expenses	10,200	
Bills receivable and payable	9,000	10,000
12% Bank loan (taken on 1st November 2016)		1,50,000
Office equipment	1,99,700	
Land and building	3,36,000	
Provision for doubtful debts		3,200
Sundry Debtors and Sundry Creditors	45,000	40,000
Rates and taxes	5,300	
Office electricity expenses	9,400	
Telephone charges	4,400	
Cash at Bank	18,000	
Printing and Stationery	11,200	
Postage stamps	1,090	
Furniture	2,00,000	
Petty cash	210	
Prepaid printing	1,200	
Insurance premium	3,000	
Carriage outwards	12,000	
Bad debts	800	
Interest on Bank loan paid	1,500	
Capital Account		4,76,900
Reserve for Discount on creditors	1,700	
TOTAL	15,14,300	15,14,300

Adjustment items:

(a) Closing stock was valued at ₹ 38,000 on 31st December 2016.

(b) Goods worth ₹ 2,500 were distributed by salesmen as free samples, but no entry has been made for this.

(c) Depreciate furniture by $7^1/_2$% p.a and office equipment by 10% p.a.

(d) Reserve for discount on creditors to be maintained at 2%.

(e) Provision for doubtful debts to be maintained at 5% on debtors.

(f) Create a provision for discount on debtors at 2%.

(g) Commission of ₹ 1,300 was earned but not yet received.
(h) Rates and taxes of ₹ 800 was paid in advance for 2017.
(i) Creditors include a debt of ₹ 4,000 to Mr Nayak who is also included in the list of debtors for ₹ 5,000 and, therefore, to be set off before calculating the reserves.

Solution

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

	₹	₹		₹	₹
To Opening Stock		46,000	By Sales	8,20,000	
To Purchases	4,42,000		Less: Sales Returns	8,000	8,12,000
Less: Purchases Returns	12,000	4,30,000	By Advertisement expenses		2,500
To Wages		43,500	By Closing stock		38,000
To Carriage inward		39,100			
To Gross Profit c/d		2,93,900			
		8,52,500			8,52,500
To Salaries		66,000	By Gross Profit b/d		2,93,900
To Advertisement expenses	10,200		By Reserve for discount on creditors (Note 1)		1,220
Add: Goods distributed as free sample	2,500	12,700	By Accrued commission		1,300
To Bank interest	1,500		By Provision for Doubtful debts:		
Add: Outstanding	1,500	3,000	Old	3,200	
To Rates & Taxes	5,300		Less: New 5% on ₹ 41,000	2,050	1,150
Less: Paid in advance	800	4,500			
To Office electricity		9,400			
To Telephone charges		4,400			
To Printing & stationery		11,200			
To Postage & stamps		1,090			
To Insurance premium		3,000			
To Carriage outwards		12,000			
To Bad debts		800			
To Depreciation:					
On Furniture	15,000				
On Office equipment	19,970	34,970			
To Prov. for disc. on Debtors @ 2% on ₹ 38,950		779			
To Net Profit (transferred to capital)		1,33,731			
		2,97,570			2,97,570

Balance Sheet as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital (1.1.2016)	4,76,900		Land & Building		3,36,000
Add: Net Profit	1,33,731	6,10,631	Office Equipment	1,99,700	
12% Bank Loan	1,50,000		Less: Depreciation	19,970	1,79,730
Add: Outstanding Interest	1,500	1,51,500	Furniture	2,00,000	
Sundry Creditors	40,000		Less: Depreciation	15,000	1,85,000
Less: Debtors Set-off	4,000		Closing Stock		38,000
	36,000		Sundry Debtors	45,000	
Less: Reserve for Discount on Creditors	720	35,280	Less: Creditors set-off	4,000	
Bills Payable		10,000		41,000	
			Less: Provision for doubtful debts	2,050	
				38,950	
			Less: Provision for discount on Debtors	779	38,171
			Bills Receivable		9,000
			Cash at Bank		18,000
			Petty Cash		210
			Rates Paid in Advance		800
			Accrued Commission		1,300
			Prepaid Printing		1,200
		8,07,411			8,07,411

Working Notes: **(1)** When Reserve for Discount on Creditors Account is maintained, any discount received is credited to this account. For creating a new reserve, the balance of Reserve for Discount on Creditors is also taken into consideration. Thus,

Dr. Reserve for Discount on Creditors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,700	By Discount Received A/c	2,200
To Profit and Loss A/c (Balancing figure)	1,220	By Balance c/d (2% of ₹ 36,000)	720
	2,920		2,920

(2) Provision for Doubtful Debts and Discount

	₹
Debtors as per Trial balance	45,000
Less: Set-off with creditors	4,000
	41,000
Less: Provision for bad debts (new) 5%	2,050
	38,950
Less: Provision for Discount @ 2%	779
	38,171

Illustration 4

The following is the Trial Balance of Mr Bharat on 31st December, 2016 :

Particulars	Dr. (₹)	Cr. (₹)
Capital		4,000
Sundry creditors		5,200
Plant & Machinery	5,000	
Office furniture and fittings	260	
Stock as on 1st January, 2016	4,800	
Motor van	1,200	
Sundry debtors	4,570	
Cash in hand	40	
Cash at bank	650	
Wages	15,000	
Salaries	1,400	
Purchases	21,350	
Sales		48,000
Bills payable		560
Bills Receivable	720	
Returns inwards	930	
Provision for doubtful debts		250
Drawings	700	
Returns outwards		550
Rent	600	
Factory lighting and heating	80	
Insurance	630	
General expenses	100	
Bad debts	250	
Discount	650	370
TOTAL	58,930	58,930

The following adjustments are to be made :

(i) Stock on 31st December, 2016 ₹ 5,200;

(ii) 3 months factory lighting and heating is due, but not paid ₹ 30;

(iii) 5% depreciation to be written-off on furniture;

(iv) Write-off further bad debts ₹ 70;

(v) The provision for doubtful debts to be increased to ₹ 300 and provision for discount on debtors @ 2% to be made;

(vi) During the year machinery was purchased for ₹ 2,000, but it was debited to Purchases Account.

You are required to make the necessary Journal entries and prepare Trading and Profit and Loss Account and the Balance Sheet.

Solution

In the books of Bharat
Journal

Date	Particulars	Dr. ₹	Cr. ₹
2016	**Adjustment Entries**		
Dec. 31	Factory Lighting and Heating A/c Dr.	30	
	To Outstanding Factory Lighting and Heating A/c		30
	(Being adjustment for outstanding factory lighting and heating)		
	Depreciation A/c Dr.	13	
	To Office Furniture & Fittings A/c		13
	(Being amount written-off as depreciation on furniture @ 5% on ₹ 260)		
	Bad Debts A/c Dr.	70	
	To Sundry Debtors A/c		70
	(Being bad debts written-off)		
	Plant & Machinery A/c Dr.	2,000	
	To Purchases A/c		2,000
	(Being purchase of machinery wrongly debited to Purchases Account, now rectified)		
	Profit & Loss A/c Dr.	134	
	To Provision for Bad & Doubtful Debts A/c (₹ 300 – ₹ 250)		50
	To Provision for Discount on Debtors A/c		84
	(Being the creation of necessary provision for bad and doubtful debts and discount on Debtors)		
	Closing Entries		
	Trading A/c Dr.	38,710	
	To Opening Stock A/c		4,800
	To Purchases A/c		18,800
	To Wages A/c		15,000
	To Factory Lighting and Heating A/c		110
	(Being various accounts transferred to the Trading Account)		
	Sales A/c Dr.	47,070	
	To Trading A/c		47,070
	(Being Sales Account transferred to the Trading Account)		
	Closing Stock A/c Dr.	5,200	
	To Trading A/c		5,200
	(Being closing stock transferred to the credit of the Trading Account)		
	Trading A/c Dr.	13,560	
	To Profit & Loss A/c		13,560
	(Being gross profit transferred to Profit & Loss Account)		
	Profit & Loss A/c Dr.	3,713	
	To Salaries A/c		1,400
	To Rent A/c		600
	To Insurance A/c		630
	To General Expenses A/c		100
	To Discount A/c		650
	To Bad Debts A/c		320
	To Depreciation on Furniture & Fittings A/c		13
	(Being various expenses transferred to the debit of the Profit & Loss Account)		
	Discount A/c Dr.	370	
	To Profit & Loss A/c		370
	(Being discount received transferred to the credit of the Profit & Loss Account)		
	Profit & Loss A/c Dr.	10,083	
	To Capital A/c		10,083
	(Being net profit transferred to Capital Account)		

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

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		4,800	By Sales	48,000	
To Purchases	21,350		Less: Returns inwards	930	47,070
Less: Returns outwards	550		By Closing stock		5,200
	20,800				
Less: Machinery purchase	2,000	18,800			
To Wages		15,000			
To Factory lighting & heating	80				
Add: Outstanding	30	110			
To Gross Profit c/d		13,560			
		52,270			52,270

To Salaries		1,400	By Gross Profit b/d		13,560
To Rent		600	By Discount		370
To Insurance		630			
To General expenses		100			
To Discount		650			
To Bad debts	250				
Add: Further bad debts	70	320			
To Provision for doubtful debts					
New	300				
Less: Old	250	50			
To Prov. for disc. on debtors @ 2% on ₹ 4,200		84			
To Depreciation on furniture @ 5% on ₹ 260		13			
To Net Profit (transferred to Capital Account)		10,083			
		13,930			13,930

Balance Sheet of Bharat as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital: Opening balance	4,000		Plant & Machinery	5,000	
Add: Net Profit	10,083		Addition	2,000	7,000
	14,083		Motor van		1,200
Less: Drawings	700	13,383	Office furniture	260	
Bills payable		560	Less: Depreciation @ 5%	13	247
Sundry creditors		5,200	Sundry debtors	4,570	
Outstanding factory lighting & heating		30	Less: Further bad debts	70	
				4,500	
			Less: Provision for bad debts	300	
				4,200	
			Less: Provision for discount on debtors	84	4,116
			Closing stock		5,200
			Bills receivable		720
			Cash at bank		650
			Cash in hand		40
		19,173			19,173

Illustration 5

From the following figures extracted from the books of Govind, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2017 and a Balance Sheet as on that date after making the necessary adjustments:

Particulars	₹
Shri Govind's capital	2,28,800
Shri Govind's drawings	13,200
Plant and Machinery	99,000
Freehold property	66,000
Purchases	1,10,000
Returns outwards	1,100
Salaries	13,200
Office expenses	2,750
Office furniture	5,500
Discounts A/c. (Dr.)	1,320
Sundry Debtors	29,260
Loan to Shri Krishna @ 10% p.a. balance on 1.4.2016	44,000
Cash at bank	29,260
Bills payable	5,500
Sales	2,31,440
Stock 1.4.2016	38,500
Wages	35,200
Sundry Creditors	44,000
Postage & Telegrams	1,540
Insurance	1,760
Gas and fuel	2,970
Bad debts	660
Office rent	2,860

Freight	9,900
Loose tools	2,200
Factory lighting	1,100
Provision for Doubtful Debts	880
Interest on loan to Shri Krishna	1,100
Cash in hand	2,640

Adjustments :

1. Stock on 31st March, 2017 was valued at ₹ 72,600.
2. A new machine was installed during the year costing ₹ 15,400 but it was not recorded in the books as no payment was made for it. Wages ₹ 1,100 paid for its erection have been debited to wages account.
3. Depreciate Plant and Machinery by $33^1/_3$%; Furniture by 10%; and Freehold property by 5%.
4. Loose tools were valued at ₹ 1,760 on 31.3.2017.
5. Of the Sundry Debtors ₹ 660 are bad and should be written-off.
6. Maintain a provision of 5% on Sundry Debtors for doubtful debts.
7. The manager is entitled to a commission of 10% of the net profits after charging such commission.

[C.A. (Entrance) — Adapted]

Solution

Govind

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (1.4.2016)		38,500	By Sales		2,31,440
To Purchases	1,10,000		By Closing Stock		72,600
Less: Returns	1,100	1,08,900			
To Wages	35,200				
Less: Wages for erection of machinery	1,100	34,100			
To Gas & Fuel		2,970			
To Freight		9,900			
To Factory lighting		1,100			
To Gross Profit c/d		1,08,570			
		3,04,040			3,04,040
To Salaries		13,200	By Gross Profit b/d		1,08,570
To Office expenses		2,750	By Interest	1,100	
To Postage and Telegram		1,540	Add: Outstanding	3,300	4,400
To Insurance		1,760			
To Office rent		2,860			
To Discount		1,320			
To Bad Debts		1,320			
To Provision for Doubtful debts:					
New provision	1,430				
Less: Old provision	880	550			
To Depreciation:					
On Machinery	38,500				
On Furniture	550				
On Freehold property	3,300				
On Loose tools	440	42,790			
To Commission to Manager (Note 1)		4,080			
To Net Profit (transferred to capital)		40,800			
		1,12,970			1,12,970

Balance Sheet of Govind as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital:	2,28,800		Plant and Machinery	99,000	
Add: Net Profit	40,800		Add: New Machinery (15,400 + 1,100)	16,500	
	2,69,600			1,15,500	
Less: Drawings	13,200	2,56,400	Less: Depreciation	38,500	77,000
Bills Payable		5,500	Freehold property	66,000	
Sundry Creditors (₹ 44,000 + ₹ 15,400)		59,400	Less: Depreciation	3,300	62,700
Manager's Commission payable		4,080	Office furniture	5,500	
			Less: Depreciation	550	4,950
			Loose tools	2,200	
			Less: Depreciation	440	1,760
			Closing Stock		72,600

			Sundry Debtors	28,600	
			Less: Provision for doubtful debts	1,430	27,170
			Loan to Shri Krishna	44,000	
			Add: Interest outstanding	3,300	47,300
			Cash at bank		29,260
			Cash in hand		2,640
		3,25,380			3,25,380

Working Note : (1) Before charging manager's commission profit is ₹ 44,880. Let the profit after charging manager's commission be ₹ 100. Commission is payable @ 10%, i.e. ₹ 10. Therefore, profit before commission will be : ₹ 100 + 10 = ₹ 110. When profit before commission is ₹ 110 then commission will be ₹ 10. Therefore, when profit before commission is ₹ 44,800 then the commission will be : 10 / 110 x ₹ 44,880 = ₹ 4,080..

Illustration 6

From the following particulars extracted from the books of Ganguli, prepare Trading and Profit and Loss Account and Balance Sheet as at 31st March, 2017 after making the necessary adjustments :

Particulars	₹
Ganguli's Capital Account (Cr.)	54,050
Stock on 1.4.2016	23,400
Sales	1,44,800
Sales Returns	4,300
Purchases	1,21,550
Purchases Returns	2,900
Carriage Inwards	9,300
Rent	2,850
Salaries	4,650
Sundry Debtors	12,000
Sundry Creditors	7,400
Loan from Dena Bank Ltd. (at 12%)	10,000
Interest Paid	450
Printing and Stationery	1,700
Advertising	5,600
Interest Received	725
Cash with Traders Bank Ltd.	4,000
Discounts Received	1,495
Investments (at 5%) as on 1.4.2016	2,500
Furniture as on 1.4.2016	900
Discounts Allowed	3,770
General Expenses	1,960
Audit Fees	350
Fire Insurance Premium	300
Travelling Expenses	1,165
Postage and Telegrams	435
Cash on Hand	190
Deposits at 10% as on 1.4.2016 (Dr.)	15,000
Drawings	5,000

Adjustments :

(1) Value of stock as on 31st March, 2017 is ₹ 39,300. This includes goods returned by customers on 31st March, 2017 to the value of ₹ 1,500 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 2017 for ₹ 1,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The Loan Account from Dena Bank in the books of Ganguly appears as follows :

31.3.2017 To Balance c/d	10,000	1.4.2016 By Balance b/d	5,000
		31.3.2017 By Bank A/c	5,000
	10,000		10,000

(5) Sundry Debtors include ₹ 2,000 due from Robert and Sundry Creditors include ₹ 1,000 due to him.

(6) Interest paid include ₹ 300 paid to Dena Bank.

(7) Interest received represent ₹ 100 from the Sundry Debtors and the balance on investments and deposits.

(8) Provide for interest payable to Dena Bank and for interest receivable on investments and deposits.

(9) Make a provision for doubtful debts at 5% on the balance under "Sundry Debtors". No such provision need be made for the deposits.

Solution

Ganguli

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		23,400	By Sales	1,44,800	
To Purchases	1,21,550		Less: Sales Returns : ₹ (3,400 + 1,500)	5,800	1,39,000
Less: Purchase Returns	2,900		By Closing Stock		39,300
	1,18,650				
Less: Furniture purchase	1,000	1,17,650			
To Carriage Inwards		9,300			
To Gross Profit c/d		27,950			
		1,78,300			1,78,300
To Rent		2,850	By Gross Profit b/d		27,950
To Salaries		4,650	By Interest Received (Note 4)		1,725
To Interest (Note 1) : ₹ (450 + 300)		750	By Discount Received		1,495
To Printing and Stationery		1,700			
To Advertisement		5,600			
To Discount Allowed		3,770			
To General Expenses		1,960			
To Audit Fees		350			
To Fire Insurance Premium		300			
To Travelling Expenses		1,165			
To Postage and Telegrams		435			
To Provision for Doubtful Debts (Note 3)		475			
To Depreciation on Furniture : ₹ (90 + 25)		115			
To Net Profit (transferred to capital)		7,050			
		31,170			31,170

Balance Sheet of Ganguly as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital:			Furniture	900	
Opening balance	54,050		Addition during the year	1,000	
Less: Net Profit during the year	7,050			1,900	
	61,100		Less : Depreciation	115	1,785
Less: Drawings	5,000	56,100	Investments		2,500
Loan from Dena Bank Ltd.		10,000	Deposits		15,000
Accrued Interest on Bank Loan (Note 1)		300	Accrued Interest on Deposits (Note 2)		1,000
Sundry Creditors : ₹ (7,400 – 1,000)		6,400	Stock-in-trade		39,300
			Sundry Debtors (Note 3)	9,500	
			Less: Provision for Doubtful Debts (Note 3)	475	9,025
			Cash with Traders Bank		4,000
			Cash in Hand		190
		72,800			72,800

Working Notes :

(1) Accrued Interest on Bank Loan		₹
Annual Interest @ 12% on ₹ 5,000		600
Less: Interest paid to Dena Bank		300
Accrued Interest		300
(2) Interest Accrued on Deposits		₹
Annual interest on investments @ 5%	125	
Annual interest on deposits @ 10%	1,500	1,625
Less: Interest received on investments and deposits		625
		1,000

(3) Calculation of Provision for Doubtful Debts	₹
Sundry Debtors as per Trial Balance	12,000
Less: Sales Returns not recorded	1,500
	10,500
Less: Cancellation against Sundry Creditors	1,000
Final Balance of Sundry Debtors	9,500
Provision for doubtful debts to be created @ 5%	475

(4) Total interest received = ₹ 1,625 + 100 = ₹ 1,725.

Illustration 7

From the following balances taken from the Ledger of Krishna on 31st March 2017, prepare the Trading and Loss Account for the year ended 31st March, 2017 and the Balance Sheet as at 31st March 2017 of Krishna **in vertical format** :

Particulars	₹
Sundry Creditors	19,000
Building	15,000
Income tax	1,025
Loose tools	1,000
Cash at Bank	16,200
Sundry Expenses	1,990
Bank Interest (Cr.)	75
Purchases	1,57,000
Wages	10,000
Carriage inwards	1,120
Sales	1,85,000
Motor Van	12,500
Cash in hand	335
Bad Debts	100
Loan from Ram	2,500
Sundry Debtors	9,500
Investments	6,500
Provision for Bad Debts	1,600
Rent and Rates	850
Furniture	3,000
Stock (1-4-2016)	27,350
Capital	47,390
Discount allowed	630
Dividends received	535
Drawings	2,000
Bills payable	10,000

Adjustments to be taken into account:

(a) Write-off further ₹ 300 as bad out of Sundry Debtors and create a provision for bad debts at 20% on Debtors.

(b) Dividends accrued and due on Investments is ₹ 135. Rates paid in advance ₹ 100 and wages owing ₹ 450.

(c) On 31.3.2017 stock was valued at ₹ 15,000 and Loose tools were valued at ₹ 800.

(d) Write-off 5% for depreciation on Buildings and 40% on Motor Van.

(e) Provide for interest at 12% p.a. due on Loan taken on 1.6.2016.

(f) Income-tax paid has to be treated as Drawings.

Solution

Krishna

Trading and Profit and Loss Account for the year ended 31st March, 2017

Particulars	₹	₹	₹
Sales			1,85,000
Opening Stock		27,350	
Purchases		1,57,000	
Wages	10,000		
Add: Outstanding	450	10,450	
Carriage inwards		1,120	
		1,95,920	
Less: Closing stock		15,000	1,80,920
Cost of goods sold			4,080
Gross Profit			75
Bank Interest			
Dividend on Investment		535	
Add: Accrued and due		135	670
			4,825
Less: Rent and Rates	850		
Less: prepaid	100	750	
Sundry expenses		1,990	
Interest on Loan (note 1)		250	

Depreciation:			
On Building @ 5%	750		
On Motor Van @ 40%	5,000		
On Loose tools @ 20%	200	5,950	
Discount allowed		630	
Bad debts (₹ 100 + ₹ 300)		400	
Provision for Bad Debts :			
New	1,840		
Less: Old	1,600	240	10,210
Net Loss (transferred to capital)			5,385

Balance Sheet of X as at 31 March, 2017

Particulars		₹	₹	₹
A. **Fixed Assets** :				
Building		15,000		
Less : Depreciation		750	14,250	
Motor Van		12,500		
Less : Depreciation		5,000	7,500	
Furniture (Note 2)			3,000	
Investment			6,500	31,250
Current Assets (x) :				
Loose Tools (Note 3)		1,000		
Less : Depreciation		200		
		800		
Dividend Accrued & Due		135		
Closing Stock		15,000		
Sundry Debtors	9,500			
Less: Bad Debts	300			
Less: Provision for bad debts	1,840	7,360		
Cash at bank		16,200		
Cash in hand		335		
Prepaid rates		100	39,930	
Current Liabilities (y) :				
Creditors for goods		19,000		
Outstanding wages		450		
Interest accrued on loans from Ram		250		
Bills payable		10,000	29,700	
B. **Working Capital** (x) – (y)				10,230
NET ASSETS EMPLOYED (A + B)				41,480
FINANCED BY :				
Capital		47,390		
Less: Net Loss		5,385	42,005	
Less: Drawings : ₹ (2,000 + 1,025)			3,025	38,980
Loan from Ram				2,500
				41,480

Working Notes : **(1)** Interest accrued on loan from Ram on ₹ 2,500 @ 12% for 10 months = ₹ 250.
(2) No Depreciation has been provided on Furniture for lack of information.
(3) Loose tools are treated as current assets.

Illustration 8

The following is the Trial Balance of Mr Mahesh as on 31.12.2016. Prepare a Trading and Profit and Loss Account for the year 2016 and the Balance Sheet as at 31.12.2016 from it :

Particulars	Dr. (₹)	Cr. (₹)
Purchases	1,80,000	
Opening stock	10,000	
Salaries less P.F.	5,400	
P.F. remittance incl. proprietor's contribution 50%	1,200	
Rent @ ₹ 250 p.m.	2,750	
Machinery	29,000	
Wages	3,000	
Furniture & fittings	5,000	
Electricity	550	
Trade expenses	1,500	

Debtors	10,500	
Interest on loan	900	
Commission	200	
Building	30,000	
Sales		2,05,000
Loans (10% interest)		10,000
Creditors		15,000
Capital		55,000
Drawings	5,000	
TOTAL	2,85,000	2,85,000

Adjustments:

(1) On 1.1.2016 machinery worth ₹ 5,000 was sold for ₹ 4,000 and credited to Machinery Account. (2) Wages include ₹ 1,000 paid for machinery erection charges. (3) Purchases include cost of moped scooter for ₹ 5,000. (4) Proprietor has taken goods costing ₹ 1,000 for which no entry has been made. (5) Sundry debtors include ₹ 500 which had become bad. (6) Provide 10% provision for bad debts. (7) Electricity outstanding ₹ 50. (8) Goods costing ₹ 5,000 were destroyed by fire and insurance claim was received for ₹ 4,000. (9) Provide depreciation at 10% on machinery, furniture and moped. (10) Provide depreciation at 5% on Building. (11) Closing stock is ₹ 12,000.

Solution

Mahesh

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		10,000	By Sales		2,05,000
To Purchases	1,80,000		By Goods destroyed by fire (Note 1)		1,000
Less: Cost of Moped scooter	5,000	1,75,000	By Closing stock		12,000
To Wages	3,000		By Drawings (goods taken by proprietor)		1,000
Less: Wages for erection of machinery	1,000	2,000			
To Gross Profit c/d		32,000			
		2,19,000			2,19,000
To Salary	5,400		By Gross Profit b/d		32,000
Add: Provident Fund	600	6,000			
To Employer contribution to Provident Fund		600			
To Rent	2,750				
Add: Outstanding	250	3,000			
To Electricity	550				
Add: Outstanding	50	600			
To Commission		200			
To Trade expenses		1,500			
To Interest	900				
Add: Outstanding interest	100	1,000			
To Goods destroyed by fire		1,000			
To Bad debts		500			
To Provision for bad debts		1,000			
To Loss on sale of machinery		1,000			
To Depreciation on :					
Building	1,500				
Machinery	2,900				
Moped	500				
Furniture	500	5,400			
To Net Profit (transferred to Capital Account)		10,200			
		32,000			32,000

Balance Sheet of Mahesh as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital Account	55,000		Building	30,000	
Add: Net Profit	10,200		Less: Depreciation	1,500	28,500
	65,200				
Less: Drawings (₹ 5,000 + 1,000)	6,000	59,200	Machinery	29,000	
Creditors		15,000	Add: Wages for erection	1,000	
10% Loan		10,000		30,000	
Outstanding Liabilities : Interest	100		Less: Loss on sale	1,000	
Rent	250			29,000	
Electricity	50	400	Less: Depreciation	2,900	26,100

			Moped Scooter	5,000	
			Less: Depreciation	500	4,500
			Furniture	5,000	
			Less: Depreciation	500	4,500
			Closing Stock		12,000
			Debtors	10,500	
			Less: Bad debts	500	
				10,000	
			Less: Provision for bad debts	1,000	9,000
		84,600			84,600

Working Note: **(1)** Total goods destroyed by fire is ₹ 5,000. Insurance claim of ₹ 4,000 has already been received and has been properly accounted for by debiting Cash Account and crediting Purchases Account. Now, adjustment is required for ₹ 1,000 only.

For adjustment of ₹ 1,000, the following entries are to be passed:

(i) Goods Destroyed by Fire Account	Dr.	1,000	
To Trading Account			1,000
(ii) Profit and Loss Account	Dr.	1,000	
To Goods Destroyed by Fire Account			1,000

Illustration 9

The accountant of M/s Kasturi Agencies extracted the following Trial Balance as on March 31, 2017.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000	Stock as at 31.3.2017		32,000
Drawings		18,000	Establishment expenses	15,000	
Building	15,000		Freight inwards	2,000	
Furniture and fittings	7,500		Freight outwards		1,000
Motor van	25,000		Commission received		7,500
Loan from Hari @ 12% interest	15,000		Sundry debtors	28,100	
Interest paid on above	450		Bank balance	20,500	
Sales		1,00,000	Sundry creditors		10,000
Purchases	75,000				
Stock as at 1.4.2016	25,000		**TOTAL**	2,28,550	2,68,500

The accountant located the following errors but is unable to proceed any further.

(a) Totalling errors in bank column of payment side of Cash Book whereby the column was under totalled by ₹ 500.

(b) Interest on loan paid for the quarter ending December 31, 2016 ₹ 450, was omitted to be posted in the ledger. There was no further payment of interest.

(c) Goods received, on sale or return basis from Suppliers Ltd on 30th March, 2017 at a 'Proforma Invoice' cost of ₹ 5,000 have been recorded as purchase.

(d) Income tax refund of ₹ 1,900 has been recorded as receipt from debtors.

You are required to prepare the Trading and Profit and Loss Account for the year ended March 31, 2017 and the Balance Sheet as at that date, after carrying out the following:

Depreciation to be provided on: Building @ 2.5%; Furniture and fittings @ 10% p.a.; Motor van @ 25% p.a.

M/s Kasturi Agencies

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

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		25,000	By Sales		1,00,000
To Purchases (Note 1)		70,000	By Closing stock (Note 2)		27,000
To Freight inwards		2,000			
To Gross Profit c/f		30,000			
		1,27,000			1,27,000
To Establishment expenses		15,000	By Gross Profit b/d		30,000
To Depreciation on :			By Commission		7,500
Building @ 2.5%	375				
Furniture @ 10%	750				
Motor van @ 2.5%	6,250	7,375			
To Freight outwards		1,000			
To Interest	900				
Add: Outstanding	450	1,350			
To Net Profit (transferred to Capital Account)		12,775			
		37,500			37,500

Balance Sheet of M/s Kasturi Agencies as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital A/c	1,00,000		**Fixed Assets**		
Add: Net Profit	12,775		Building	15,000	
	1,12,775		Less: Depreciation @ 2.5%	375	14,625
Less: Drawings	18,000		Furniture & fitxture	7,500	
	94,775		Less: Depreciation @ 10%	750	6,750
Add: Capital introduced (Note 3)	1,900	96,675	Motor van	25,000	
Loan from Hari		15,000	Less: Depreciation @ 2.5%	6,250	18,750
Interest outstanding on Loan		450	**Current Assets**		
Sundry creditors (Note 1)		5,000	Stock (Note 2)		27,000
			Sundry Debtors (Note 3 and 4)		30,000
			Bank balance		20,000
		1,17,125			1,17,125

Working Notes :

(1) Purchases of ₹ 75,000 includes goods of ₹ 5,000 which was received on sale or return basis. Therefore, to rectify this, the following entry is to be passed :

Creditors Account	Dr.	₹ 5,000	
To Purchases Account			₹ 5,000

Net effect :

(i) Purchases will be reduced by ₹ 5,000.

(ii) Sundry Creditors will be reduced by ₹ 5,000.

(2) Goods received on sale or return basis were included in the Stock also. Therefore, these are to be deducted from the value of closing stock. Final value of closing stock will be ₹ 27,000.

(3) Income tax refund has been recorded wrongly as payment by debtors. To rectify this, the following entry is to be passed :

Sundry Debtors Account	Dr.	₹ 1,900	
To Capital Account*			₹ 1,900

* New capital introduced.

(4) Final balance of Sundry Debtors = ₹ 28,100 + ₹ 1,900 = ₹ 30,000.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 10

Following is the Trial Balance of Mr H Basak as on 31.03.2015. You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2015 and Balance Sheet as on the same date :

Debit Balance	₹	Credit Balance	₹
Opening Stock	10,000	Capital	1,66,000
Plant and Machinery	80,000	Sundry Creditors	20,000
Furniture	50,000	Sales	70,000
Drawings	10,000	Commission Received	1,600
Sundry Debtors	30,000		
Wages	4,000		
Salaries	6,000		
Commission Paid	1,600		
Purchases	40,000		
bad Debts	7,000		
Insurance	2,000		
Cash in Hand	11,000		
	2,51,600		2,51,600

Additional information :

(i) Stock as on 31.3.2015 ₹ 16,000.

(ii) Create a provision for doubtful debts @ 6% on Sundry Debtors and write off ₹ 3,000 as further bad debts.

(iii) Goods worth ₹ 12,000 were lost by fire and insurance claim of ₹ 8,000 was received.

(iv) Wages include ₹ 400 for installation of plant.

(v) Provide depreciation @ 15% on Machinery and 10% on Furniture. ***[C.U.B.Com. (General) — 2016]***

Solution

Mr H Basak

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		10,000	By Sales	70,000
To Purchases		40,000	By Goods Destroyed by Fire	12,000
To Wages	4,000		By Closing Stock	16,000
Less: Wages Paid for Installation of Machinery	400	3,600		
To Gross Profit c/d		44,400		
		98,000		98,000
To Salaries		6,000	By Gross Profit b/d	44,400
To Commission Paid		1,600	By Commission Received	1,600
To Bad Debts	7,000			
Add: Further Bad Debts	3,000	10,000		
To Goods Destroyed by Fire (₹ 12,000 – 8,000)		4,000		
To Depreciation :				
on Plant and Machinery (Note 1)		12,060		
on Furniture		5,000		
To Insurance		2,000		
To Provision for Bad Debts		1,620		
To Net Profit (Transferred to Capital Account)		3,720		
		46,000		46,000

Balance Sheet of Mr H Basak as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital Account	1,60,000		**Fixed Assets :**		
Add : Net Profit	3,720		Plant and Machinery	80,000	
	1,63,720		Add: Wages for Installation	400	
Less: Drawings	10,000	1,53,720		80,400	
Sundry Creditors		20,000	Less: Depreciation @ 15% (Note 1)	12,060	68,340
			Furniture	50,000	
			Less: Depreciation @ 10%	5,000	45,000
			Current Assets :		
			Stock		16,000
			Sundry Debtors	30,000	
			Less: Further Bad Debts	3,000	
				27,000	
			Less: Provision for Bad Debts @ 6%	1,620	25,380
			Insurance Claim		8,000
			Cash in Hand		11,000
		1.73.720			1.73.720

Working Note :

(1) Depreciation on Plant and Machinery :

Depreciation is to be charged @ 15%. Therefore, it has been calculated for whole year. The depreciation will be :
15% of (₹ 80,000 + 400) = **₹ 12,060**.

Illustration 11

From the following Trial Balance and other information of Mr. S. Basu, prepare Trading and Profit and Loss Account of Mr. Basu for the year ended 31.3.2015 and a Balance Sheet as on that date :

	Debit (₹)	Credit (₹)
Capital	—	100,000
Drawings	10,000	—
Land and Buildings	90,000	—
Plant and Machinery	20,000	—
Furniture	5,000	—
Sales	—	1,40,000
Return Outward	—	4,000
Debtors	18,400	—
Loan taken on 01.07.2014 @ 6% p.a.	—	30,000

Purchases	80,000	—
Return Inward	5,000	
Carriage Inward	10,000	
Sundry Expenses	600	
Insurance Expenses	1,500	
Provision for Bad Debts	—	1,380
Bad Debts	400	
Stock on 01.04.2014	21,300	
Salaries and Wages	18,500	
Creditors	—	12,000
Trade Expenses	800	
Cash at bank	4,600	
Cash in Hand	1,280	
	2,87,380	2,87,380

Additional information :

(a) Stock on 31.3.2015 — ₹ 27,300.

(b) A fire broke out on 23.03.2015 and ₹ 10,000 worth of goods were destroyed..

(c) Bad Debts amounting to ₹ 400 are to be written-off. Provision for bad debts is to be made at 8%.

(d) Mr. Basu took away goods worth ₹ 2,000 for personal use but no record was made thereof.

(e) Charge Depreciation at 2% on Land and Building, 20% on Plant and Machinery and 5% on Furniture.

(f) Insurance prepaid amounts to ₹ 200. *[C.U.B.Com. (General) — 2015]*

Solution

Mr S Basu

Trading and Profit and Loss Account for the year ended 31st March, 2015

Particulars		₹	Particulars		₹
To Opening Stock		21,300	By Sales	1,40,000	
To Purchases	80,000		Less: Return Inward	5,000	1,35,000
Less: Return Outward	4,000		By Abnormal Loss of Stock		10,000
Less: Drawings (Goods taken away)	2,000	74,000	By Closing Stock		27,300
To Carriage Inward		10,000			
To Gross Profit c/d		67,000			
		1,72,300			1,72,300
To Sundry Expenses		600	By Gross Profit b/d		67,000
To Outstanding Interest on Loan		1,350			
To Insurance Premium	1,500				
Less: Prepaid	200	1,300			
To Provision for Bad Debts :					
Bad Debt	400				
Add: Further Bad Debts	400				
Add: New Provision	1,440				
	2,240				
Less: Old Provision	1,380	860			
To Salaries and Wages		18,500			
To Trade Expenses		800			
To Abnormal Loss		10,000			
To Depreciation on Land and Building @ 2%		1,800			
To Depreciation on Plant and Machinery @ 20%		4,000			
To Depreciation on Furniture @ 5%		250			
To Net Profit		27,540			
		67,000			67,000

Balance Sheet of Mr. S Basu as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital	1,00,000		Land and Building	90,000	
Add: Net Profit	27,540		Less: Depreciation @ 2%	1,800	88,200
	1,27,540		Plant and Machinery	20,000	
Less: Drawings (Goods taken)	2,000		Less: Depreciation @ 2%	4,000	16,000
Less: Drawings (Cash)	10,000	1,15,540	Furniture	5,000	
Loan Taken		30,000	Less: Depreciation @ 5%	250	4,750
Creditors		12,000	Closing Stock		27,300

Outstanding Interest on Loan	1,350	Debtors	18,400	
		Less: Bad Debts	400	
			18,000	
		Less: Provision for Bad Debts (8%)	1,440	16,560
		Prepaid Insurance		200
		Bank		4,600
		Cash		1,280
	1,58,890			1,58,890

Illustration 12

Following is the Trial Balance of Mr. A. Bose as on 31st March, 2014. You are required to prepare Trading and Profit and Loss Account for the year ended 31st March, 2014 and a Balance Sheet as on that date after making necessary adjustments:

Trial Balance as on 31.03.2014

	Debit (₹)	Credit (₹)
Capital and Drawings	18,000	1,50,000
Cash in Hand	1,800	
Cash at Bank	21,900	
Plant and Machinery	90,000	
Furniture	9,000	
Insurance Charges	1,200	
Miscellaneous Expenses	600	
Trade Mark Rights	30,000	
Stock on 01.04.2013	40,500	
Loan from M. Roy (taken on 1st October, 2013 @ 6% p.a.)		15,000
Interest on above loan	300	
Salary and Wages	27,300	
Debtors and Creditors	34,200	25,200
Rent, Rates and Taxes	9,300	
Trade Expenses	900	
Purchases and Sales	1,42,800	2,40,000
Bad Debts	2,400	
TOTAL	4,30,200	4,30,200

Adjustments:

(a) Stock on 31st March, 2014 ₹ 38,200.

(b) Depreciate Plant and Machinery @ 10% p.a. and Furniture @ 5% p.a.

(c) Out of the Debtors ₹ 1,200 are bad and should be written-off.

(d) Create a provision of 5% on Debtors for bad and doubtful debts. *[C.U.B.Com. (General) — 2014]*

Solution

Mr A Bose

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2014 Cr.

Particulars		₹	Particulars	₹
To Stock (1.4.2013)		40,500	By Sales	2,40,000
To Purchases		1,42,800	By Closing Stock	38,200
To Gross Profit c/d		94,900		
		2,78,200		2,78,200
To Provision for Bad Debts		1,650	By Gross Profit b/d	94,900
To Insurance Charges		1,200		
To Miscellaneous Expenses		600		
To Depreciation on Machinery		9,000		
To Interest on Loan	300			
Add: Outstanding Interest	150	450		
To Depreciation on Furniture		450		
To Salaries and Wages		27,300		
To Rent, Rates and Taxes		9,300		
To Trade Expenses		900		
To Bad Debts	2,400			
Add: Further Bad Debts	1,200	3,600		
To Net Profit (Transferred)		40,450		
		94,900		94,900

Balance Sheet of Mr. A. Bose as at 31st March, 2014

Liabilities		₹	Assets		₹
Capital		1,50,000	Machinery	90,000	
Add: Net Profit	40,450		Less: Depreciation (10%)	9,000	81,000
	1,90,450		Furniture	9,000	
Less: Drawings	18,000	1,72,450	Less: Depreciation (5%)	450	8,550
Loan from M Roy		15,000	Trade Mark Rights		30,000
Outstanding Interest on Loan		150	Closing Stock		38,200
Creditors		25,200	Debtors	34,200	
			Less: Bad Debts	1,200	
				33,000	
			Less: Provision for Bad Debts	1,650	31,350
			Cash at Bank		21,900
			Cash in Hand		1,800
		2,12,800			2,12,800

Illustration 13

Following is the Trial Balance of Mr X as on 31.03.2013. You are required to prepare Trading and Profit and Loss Accounts for the year ended 31.03.2013 and a Balance Sheet as on that date after making necessary adjustments.

Trial Balance as on 31.03.2013

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Purchases	1,20,000	Sales	2,00,000
Sales Ledger Balance	60,800	Purchase Ledger Balance	48,800
Return Inward	4,000	Discount Received	1,200
Discount Allowed	4,000	Return Outward	4,800
Building	90,400	Capital	1,22,400
Depreciation on Building	4,000	Annual Apprenticeship Premium for the period upto 30.6.13	4,800
Income Tax	4,000	Provision for Bad Debts	4,000
Wages	8,000	Commission	3,200
Salaries	12,000		
Stock in trade (01.04.2012)	40,000		
Trade Expenses	8,000		
Insurance	800		
Cash in Hand and Bank	33,200		
	3,89,200		3,89,200

Adjustments :

(i) Stock in trade on 31.03.2013 ₹ 40,000.

(ii) Stock valued at ₹ 8,000 was destroyed by fire on 15.03.2013 for which insurance company admitted a claim of ₹ 4,800.

(iii) Out of purchase, goods of ₹ 8,000 was distributed as free sample.

(iv) Maintain provision for bad debts @ 5% on Debtors and provision for discount @ 2% on Debtors.

[C.U.B.Com. (General) — 2013]

Solution

Mr X

Trading, Profit and Loss Account for the year ended 31st March, 2013

Particulars		₹	Particulars		₹
To Opening Stock		40,000	By Sales	2,00,000	
To Purchases	1,20,000		Less: Return Inward	4,000	
Less: Return Outward	4,800	1,15,200		1,96,000	
To Wages		8,000	Add: Advertisement (Note 1)	8,000	2,04,000
To Gross Profit c/d		88,800	By Closing Stock		40,000
			By Goods Lost by Fire		8,000
		2,52,000			2,52,000
To Advertisement (Note 2)		8,000	By Gross Profit b/d		88,800
To Discount Allowed		4,000	By Discount Received		1,200
To Depreciation on Building		4,000	By Apprenticeship Premium (9/12 x 4,800)		3,600
To Salaries		12,000	By Commission		3,200

	₹			₹
To Trade Expenses	8,000	By provision for Bad Debts :		
To Insurance	800	Old	4,000	
To Goods Lost by Fire	3,200	Less: New	3,040	960
To Provision for Discount on Debtors (2% on ₹ 57,760)	1,155			
To Net Profit	56,605			
	94,760			94,760

Balance Sheet of Mr X as at 31st March, 2013

Liabilities		₹	Assets		₹
Capital	1,22,400		Building		90,400
Add: Net Profit	56,605		Sales Ledger Balance	60,800	
	1,79,005		Less: Provision for Bad Debts	3,040	
Less: Drawings (Income Tax)	4,000	1,75,005		57,760	
Purchase Ledger Balance		48,800	Less: Provision for Discount on Debtors	1,155	56,605
Apprenticeship Premium Received in Advance		1,200	Closing Stock		40,000
			Insurance Claim (Loss of Stock)		4,800
			Cash in Hand and at Bank		33,200
		2,25,005			2,25,005

Notes : (1) Alternatively, it can be deducted from Purchases.
(2) Goods distributed as free sample will be treated as advertisement.

Illustration 14

The following is the Trial Balance of Mr G as on 31st March, 2012 :

Particulars	₹	Particulars	₹
Plant and Machinery	3,10,000	Capital	4,20,000
Opening Stock	30,000	Sundry Creditors	20,000
Sundry Debtors	40,000	Sales	2,10,000
Wages	10,000	Return Outward	20,000
Salaries	15,000	Provision for Doubtful Debts	1,000
Rent (April 2011 to June 2012)	18,000	Interest	4,000
Purchases	1,50,000		
Return Inward	10,000		
Bad Debt	9,000		
Insurance	3,000		
Office Expenses	5,000		
Cash in Hand	30,000		
Cash at Bank	45,000		
	6,75,000		6,75,000

Additional information :

(i) Stock on 31st March, 2012 was valued at ₹ 35,000.

(ii) Further bad debt of ₹ 1,000 is to be written off and a provision for doubtful debts @ 5% on Sundry Debtors is to be maintained.

(iii) Goods costing ₹ 5,000 have been distributed as free sample.

(iv) Purchase of machinery worth ₹ 20,000 on 01.10.2011 has been wrongly included in Purchases Account. Depreciation @ 10% p.a. is to be charged on machinery.

(v) Office expenses outstanding ₹ 500.

Prepare Trading Account, Profit and Loss Account for the year ended 31.03.2012 and a Balance Sheet of Mr. G as on that date. ***[C.U.B.Com. (General) — 2012]***

Solution

Mr. G

Dr. Trading and Profit and Loss Account for the year ended 31.3.2012 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		30,000	By Sales	2,10,000	
To Purchases	1,50,000		Less: Return Inward	10,000	2,00,000
Less: Machinery	20,000		By Closing Stock		35,000
Sample	5,000				
Return Outward	20,000	1,05,000			

To Wages		10,000		
To Gross Profit c/d		90,000		
		2,35,000		2,35,000
To Salaries		15,000	By Gross Profit b/d	90,000
To Rent	18,000		By Interest	4,000
Less: Prepaid (18,000 ÷ 15 x 3)	3,600	14,400		
To Provision for Bad Debts:				
Bad Debts (9,000+1,000)	10,000			
Add: New Provision	1,950			
Less: Old Provision	(1,000)	10,950		
To Insurance		3,000		
To Office Expenses	5,000			
Add: Outstanding	500	5,500		
To Advertisement (Sample)		5,000		
To Depreciation on Machinery		32,000		
To Net Profit		8,150		
		94,000		94,000

Balance Sheet of Mr. G as on 31.3.2012

Liabilities		₹	Assets		₹
Capital		4,20,000	Plant and Machinery	3,10,000	
Add: Net Profit	8,150	4,28,150	Add: Further Purchase on 1.10.2011	20,000	
Creditors		20,000		3,30,000	
Outstanding Office Expenses		500	Less: Depreciation	32,000	2,98,000
			Closing Stock		35,000
			Debtors		40,000
			Less: Further bad debts	1,000	
				39,000	
			Less: Provision for bad debt (5%)	1,950	37,050
			Cash in Hand		30,000
			Cash at Bank		45,000
			Prepaid Rent		3,600
		4,48,650			4,48,650

Working Note :

Depreciation on Machinery :

	₹
On Opening balance (₹ 3,10,000 × 10%)	31,000
Add: (₹ 20,000 × 10% × 6/12)	1,000
	32,000

Illustration 15

Mr. S. N. Roy started a business on 1.4.2010 with ₹ 10,000 cash, ₹ 5,000 in goods and ₹ 15,000 in furniture. His Trial Balance as on 31.3.2011 was as follows :

Debit Balances : Bad Debt ₹ 3,500; Stock-in-trade ₹ 5,000; Furniture ₹ 15,000; Drawings ₹ 3,500; Wages ₹ 1,800; Purchases ₹ 18,000; Advertisement ₹ 1,600; Debtors ₹ 9,000; Cash ₹ 4,700; Salaries ₹ 2,400; Interest on Loan ₹ 200; Commission paid ₹ 800; Insurance Premium ₹ 800; Machinery ₹ 30,000.

Credit Balances : Capital ₹ 30,000; Creditors ₹ 5,000; Bank Loan ₹ 32,400; Commission Received ₹ 200; Sales ₹ 28,700.

Additional information :

(i) Mr. Roy used goods of ₹ 1,000 for personal consumption. the value of remaining stock ₹ 9,000.
(ii) Goods valued at ₹5,000 were lost by fire for which insurance claim of ₹ 2,000 was to be received.
(iii) Depreciate Furniture @ 5% p.a. and Machinery @ 10% p.a. The machinery was purchased on 1.10.2010.
(iv) Interest on Bank Loan was payable @ 10% p.a. The loan was taken at the beginning of the year.
(v) A further Bad Debts of ₹ 1,000 is to be written off and a provision for doubtful debt is to be provided @ 5%.
(vi) 1/4th of the Advertisement Expenses is to be carried forward.
(v) Included in Debtors is ₹ 3,000 due from Mr P, included in creditors ₹ 1,000 due to the same person.

Prepare Trading Account, Profit and Loss Account for the year ended 31.3.2011 and a Balance Sheet of Mr S. N. Roy as on that date.

[C.U.B.Com. (General) — 2011]

Solution

S. N. Roy

Dr. Trading and Profit and Loss Account for the year ended 31.3.2011 Cr.

Particulars		₹	Particulars	₹
To Stock		5,000	By Sales	28,700
To Purchases	18,000		By Stock Lost by Fire	5,000
Less: Drawings of Goods	1,000	17,000	By Closing Stock	9,000
To Wages		1,800		
To Gross Profit c/d		18,900		
		42,700		42,700
To Advertisement	1,600		By Gross Profit b/d	18.900
Less: Carried forward (1/4) (Note 1)	400	1,200	By Commission Received	200
To Abnormal Loss		3,000		
To Salaries		2,400		
To Interest on Loan	200			
Add: Outstanding(Note 2)	3,040	3,240		
To Commission Paid		800		
To Insurance Premium		800		
To Bad Debts	3,500			
Add: Further Bad Debt	1,000	4,500		
To Provision for Doubtful Debt		350		
To Depreciation on :				
Furniture	750			
Machinery	1,500	2,250		
To Net Profit (Transferred to Capital)		560		
		19,100		19.100

Tutorial Note(1) : Advertisement expenses is not generally carried forward. It is totally charged to the Profit and Loss Account of the year in which it is incurred. If it is totally charged to Current Profit and Loss Account, the Net Profit will be ₹ 160.

Balance Sheet of S. N. Roy as at 31.3.2011

Liabilities		₹	Assets		₹
Capital		30,000	Furniture		15,000
Add: Net Profit	560		Less: Depreciation @ 5% p.a.	750	14,250
	30,560		Machinery	30,000	
Less: Drawings	3,500		Less: Depreciation @ 10% p.a.	1,500	28,500
	27,060		Debtors	9,000	
Less: Drawings of Goods	1,000	26,060	Less: Set Off (Due to P)	1,000	
Creditors		5,000		8,000	
Less: Set off	1,000	4,000	Less: Further Bad Debt	1,000	
Bank Loan		32,400		7,000	
Outstanding Interest on Loan		3,040	Less: Provision for Doubtful Debts	350	6,650
			Advertisement (Carry forward))		400
			Insurance Claim (Admitted)		2,000
			Closing Stock		9,000
			Cash		4,700
		65,500			65,500

Note 2 :

	₹
Interest on Loan = ₹ 32,400 × 10%	3,240
Less: paid during the year	200
Outstanding	3,040

[For Honours Candidates Only]

Illustration 16

The following Trial Balance is extracted from the books of Mr. S.K. Sen as on 31.3.2015 :

Debit Balance	₹	Credit Balance	₹
Plant and Machinery	4,00,000	Capital	5,70,000
Opening Stock	45,000	Sundry Creditors	36,000
Sundry Debtors	50,000	Sales	2,40,000
Wages	15,000	Return Outward	30,000
Salaries	20,000	Provision for Doubtful Debts	2,000
Rent	22,000		
Income Tax	2,500		
Purchases	1,80,000		
Return Inward	15,000		
Bad Debt	12,500		
Insurance	4,000		
Office Expenses	7,000		
Cash in Hand	45,000		
Cash at Bank	60,000		
	8,78,000		8,78,000

Additional infromation :

(i) Stock as on 31.03.2015 ₹ 50,000.

(ii) Machinery purchased on 01.10.2014 for ₹ 40,000 was wrongly debited in Purchases Account. Depreciation @ 15% p.a. to be charged on machinery.

(iii) Outstanding office expenses amounted to ₹ 1,500.

(iv) Goods worth ₹ 7,000 was distributed as free sample.

(v) Create a provision for doubtful debts @ 5% on Sundry Debtors after writing off ₹ 2,500 as further bad debts.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2015 and Balance Sheet as on the same date. ***[C.U.B.Com. (Hons.) — 2016]***

Solution

Mr. S K Sen

Trading and Profit and Loss Account for the year ended 31st March, 2015

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		45,000	By Sales	2,40,000	
To Purchases	1,80,000		Less: Return Inwards	15,000	2,25,000
Less: Return Outwards	30,000		By Closing Stock		50,000
	1,50,000				
Less: Purchase of Machinery	40,000				
	1,10,000				
Less: Goods Distributed as Free Samples	7,000	1,03,000			
To Wages		15,000			
To Gross Profit c/d		1,12,000			
		2,75,000			2,75,000
To Advertisement (Free Sample)		7,000	By Gross Profit b/d		1,12,000
To Salaries		20,000	By Net Loss (Transferred to Capital Account)		27,875
To Rent		22,000			
To Bad Debts	12,500				
Add: Further Bad Debts	2,500	15,000			
To Insurance		4,000			
To Office Expenses	7,000				
Add: Outstanding Office Expenses	1,500	8,500			
To Depreciation on :					
Machinery (Note 1)		63,000			
To Provision for Bad Debts :					
New	2,375				
Less: Old	2,000	375			
		1,39,875			1,39,875

Balance Sheet of Mr S K Sen as at 31st March, 2015

Particulars	₹	₹	Particulars	₹	₹
Capital Account	5,70,000		Plant and Machinery	4,00,000	
Less: Net Loss	27,875		Add: New Machinery Purchased	40,000	
	5,42,125			4,40,000	
Less: Income Tax (Drawings)	2,500	5,39,625	Less: Depreciation (Note 1)	63,000	3,77,000
Sundry Creditors		36,000	Closing Stock		50,000
Outstanding Office Expenses		1,500	Sundry Debtors	50,000	
			Less: Bad Debts	2,500	
				47,500	
			Less: Provision for Bad Debts	2,375	45,125
			Cash at Bank		60,000
			Cash in Hand		45,000
		5,77,125			5,77,125

Working Notes :

	₹
(1) Calculation of Depreciation on Plant and Machinery	
(a) Depreciation on old Plant and Machinery @ 15% p.a. on ₹ 4,00,000	60,000
(b) Depreciation on new Machinery @ 15% p.a. on ₹ 40,000 for 6 months	3,000
	63,000

(2) Goods distributed as free sample will be treated as advertisement. The cost of the sample will be deducted from Purchases.

Illustration 17

From the following Trial Balance of Mr. S. Roy as on 31.3.2015, you are required to prepare a Trading and Profit and Loss Account for the year ended 31.3.2015 and a Balance Sheet as on that date after making necessary adjustments :

Trial balance as on 31.03.2015

	Debit (₹)	Credit (₹)
Sundry Debtors / Creditors	5,00,000	2,00,000
Wages	1,00,000	
Carriage Outward	1,10,000	
Carriage Inward	50,000	
General Expenses	70,000	
Cash Discount	20,000	
Bad Debts	10,000	
Motor Car	2,40,000	
Printing and Stationery	70,000	
Furniture and Fittings	1,10,000	
Advertisement	45,000	
Insurance	45,000	
Motor Car Expenses	40,000	
Salesmen's Commission	87,500	
Postage and Telephone	57,500	
Salaries	1,60,000	
Rates and Taxes	25,000	
Capital / Drawings	20,000	14,43,000
Purchases / Sales	15,50,000	19,87,500
Stock on 1.4.2014	2,50,000	
Cash at Bank	60,000	
Cash in Hand	10,500	
	36,30,500	36,30,500

Adjustments :

(a) Stock on 31.3.2015 was valued at ₹ 7,25,000.
(b) A provision for Doubtful Debts is to be created to the extent of 5% on Sundry Debtors.
(c) Depreciate Furniture and Fittings by 10%, Motor Car by 20%
(d) Mr. Roy had withdrawn goods worth ₹ 25,000 during the year for personal use.
(e) Debtors include Bad Debts of ₹ 25,000.
(f) 1/4th of Motor Car Expenses and depreciation on Motor Car should be charged to Mr. Roy's Personal Account for personal use of Motor Car. ***[C.U.B.Com. (Hons.) — 2015]***

Solution

Mr S Roy

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars		₹	Particulars	₹
To Stock on 1.4.2014		2,50,000	By Sales	19,87,500
To Purchases	15,50,000		By Closing Stock	7,25,000
Less: Drawings of Goods	25,000	15,25,000		
To Wages		1,00,000		
To Carriage Inwards		50,000		
To Gross Profit c/d		7,87,500		
		27,12,500		27,12,500
To Carriage Outward		1,10,000	By Gross Profit b/d	7,87,500
To General Expenses		70,000	By Net Loss	38,250
To Cash Discount		20,000		
To Bad Debts	10,000			
Add: Further Bad Debts	25,000	35,000		
To Printing and Stationery		70,000		
To Depreciation on Furniture		11,000		
To Advertisement		45,000		
To Insurance		45,000		
To Motor Car Expenses	40,000			
Less: For Personal Use (1/4)	10,000	30,000		
To Salesmen's Commission		87,500		
To Postage and Telephone		57,500		
To Salaries		1,60,000		
To Rates and Taxes		25,000		
To Provision for Bad Debts		23,750		
To Depreciation on Car (20% of ₹ 2,40,000)	48,000			
Less: For Personal Use	12,000	36,000		
		8,25,750		8,25,750

Balance Sheet of Mr S Roy as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital	14,43,000		Motor Car	2,40,000	
Less: Net Loss	38,250		Less: Depreciation (20%)	48,000	1,92,000
	14,04,750		Furniture	1,10,000	
Less: Drawings	20,000		Less: Depreciation (10%)	11,000	99,000
Less: Drawings of Goods	25,000		Closing Stock		7,25,000
Less: Motor Car Expenses and Depreciation	22,000	13,37,750	Sundry Debtors	5,00,000	
Sundry Creditors		2,00,000	Less: Further Bad Debts	25,000	
				4,75,000	
			Less: Provision for Bad Debts (5%)	23,750	4,51,250
			Bank		60,000
			Cash		10,500
		15,37,750			15,37,750

Illustration 18

The following Trial Balance was extracted from the books of Mr. S. Sengupta as on 31st December, 2013:

Particulars	Debit (₹)	Credit (₹)
Capital		3,25,000
Freehold Land and Building	1,17,000	
Furniture and Fittings	17,420	
Stock in Trade (1.1.2013)	1,48,200	
Electricity	2,314	
Drawings	75,400	
Purchases	10,21,800	
Sales		12,37,600
General Expenses	46,826	

Balance at Bank	10,712	
Motor Van	3,120	
Discount Received		22,932
Discount Allowed	28,964	
Trade Debtors	1,23,500	
Trade Creditors		99,450
Rates and Insurance	2,496	
Wages and Salaries	64,610	
Goodwill	15,600	
Bad Debts Written Off	11,180	
Provision for Bad Debts (1.1.2013)		4,160
	16,89,142	16,89,142

Prepare a Trading and Profit and Loss Account for the year ended 31st December, 2013 and the Balance Sheet as on that date after taking into consideration the following information :

(a) The stock in trade on 31st December, 2013 was valued at ₹ 2,05,400.

(b) Rates and Insurance paid in advance on 31st December, 2013 amounted to ₹ 650.

(c) The Motor Van shown in the Trial Balance was sold on 31.12.2013 for ₹ 1,040 for cash, which Mr. Sengupta retained for private use. No entry for this transaction was made in the books.

(d) The provision for Doubtful Debts is to be increased to ₹ 5,980.

(e) Provide depreciation on Furniture and Fittings ₹ 1,742. *[C.U.B.Com. (Hons.) — 2014]*

Solution

Mr. S. Sengupta

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2013 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		1,48,200	By Sales	12,37,600
To Purchases		10,21,800	By Closing Stock	2,05,400
To Gross Profit c/d		2,73,000		
		14,43,000		14,43,000
To Depreciation on Furniture		1,742	By Gross Profit b/d	2,73,000
To Loss on Sale of Motor Van (Note 1)		2,080	By Discount Received	22,932
To Electricity		2,314		
To General Expenses		46,826		
To Discount Allowed		28,964		
To Rates and Insurance	2,496			
Less: Prepaid	650	1,846		
To Wages and Salaries (Note 2)		64,610		
To Bad Debts		11,180		
To Provision for Bad Debts :				
New	5,980			
Less: Old	4,160	1,820		
To Net Profit		1,34,550		
		2,95,932		2,95,932

Balance Sheet of Mr S. Sengupta as at 31st December, 2013

Liabilities		₹	Assets		₹
Capital		3,25,000	Goodwill		15,600
Add: Net Profit	1,34,550		Freehold Land and Building		1,17,000
	4,59,550		Furniture and Fittings	17,420	
Less: Drawings	75,400		Less: Depreciation	1,742	15,678
	3,84,150		Closing Stock		2,05,400
Less: Sale of Motor Van (Drawings)	1,040	3,83,110	Trade Debtors	1,23,500	
Trade Creditors		99,450	Provision for Bad Debts	5,980	1,17,520
			Prepaid Rates and Insurance		650
			Bank		10,712
		4,82,560			4,82,560

Working Notes :

Dr. (1) Motor Van Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	3,120		By Drawings (Sold)	1,040
				By Profit and Loss (Loss on Sale)	2,080
		3,120			3,120

(2) It is assumed that wages and salaries are indirect in nature. If it is treated as direct, the gross profit will be ₹ 2,08,390. However, there will be no change in the Net Profit figure.

Illustration 19

The following Trial Balance was extracted from the books of Mr A Bose as on 31st December, 2012 :

Debit Balance	₹	Credit Balance	₹
Plant and Machinery	40,000	Capital	1,60,000
Manufacturing Wages	69,000	Sundry Creditors	89,120
Salaries	31,700	Bank Loan	30,000
Furniture	20,000	Purchase Returns	3,480
Freight on Purchases	3,720	Sales	5,01,700
Freight on Sales	4,280	Provision for Bad Debts	4,000
Building	48,000		
Manufacturing Expenses	19,000		
Insurance and Tax	8,500		
Goodwill	50,000		
Factory Fuel and Power	2,560		
Sundry Debtors	1,56,400		
General Expenses	16,400		
Factory Lighting	1,900		
Opening Stock	68,400		
Motor Car	24,000		
Purchases	2,04,000		
Sales Returns	6,200		
Bad Debts	2,800		
Interest and Bank Charges	800		
Cash at Bank	8,400		
Cash in Hand	2,240		
	7,88,300		7,88,300

Prepare a Trading and Profit and Loss Account for the year ended 31st December, 2012 and the Balance Sheet as on that date after taking into consideration the following information :

(a) Closing stock ₹ 61,000.

(b) Depreciate Plant and Machinery by 10%, Furniture by 5% and Motor Car by ₹ 2,000.

(c) Maintain Provision for Bad Debts at 5% on Sundry Debtors.

(d) A commission of 1% on the gross profit is to be provided for works manager. ***[C.U.B.Com. (Hons.) — 2013]***

Solution

Mr A Bose

Dr. Trading, Profit and Loss Account for the year ended 31st December, 2012 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		68,400	By Sales	5,01,700	
To Purchases	2,04,000		Less: Sales Return	6,200	4,95,500
Less: Purchase Returns	3,480	2,00,520	By Closing Stock		61,000
To Manufacturing Wages		69,000			
To Freight on Purchases		3,720			
To Factory Fuel and Power		2,560			
To Factory Light		1,900			
To Manufacturing Expenses		19,000			
To Gross Profit c/d		1,91,400			
		5,56,400			5,56,500
To Salaries		31,700	By Gross Profit b/d		1,91,400
To Depreciation on :					
Machinery	4,000				
Furniture	1,000				
Motor Car	2,000	7,000			
To Freight on Sales		4,280			
To Insurance and Tax		8,500			
To General Expenses		16,400			
To Interest and Bank Charges		800			
To Provision for Bad Debts :					
Bad Debts	2,800				
Add: New Provision	7,820				
	10,620				
Less: Old Provision	4,000	6,620			
To Work's Manager Commission		1,914			
To Net Profit (Transferred to Capital A/c)		1,14,186			
		1,91,400			1,91,400

Balance Sheet of Mr A Bose as at 31st December, 2012

Liabilities		₹	Assets		₹
Capital	1,60,000		Goodwill		50,000
Add: Net Profit	1,14,186	2,74,186	Buildings		48,000
Sundry Creditors		89,120	Plant and Machinery	40,000	
Bank Loan		30,000	Less: Depreciation @ 10%	4,000	36,000
Outstanding Manager's Commission		1,914	Furniture	20,000	
			Less: Depreciation @ 5%	1,000	19,000
			Motor Car	24,000	
			Less: Depreciation	2,000	22,000
			Closing Stock		61,000
			Sundry Debtors	1,56,400	
			Less: Provision for Bad Debts	7,820	1,48,580
			Cash at Bank		8,400
			Cash in Hand		2,240
		3,95,220			3,95,220

Special Problems

Illustration 20

The following is the schedule of balances as on 31.3.2017 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar & Co., at Bombay:

Particulars	Dr. (₹)	Cr. (₹)
Cash in hand	1,400	
Cash at bank	2,600	
Sundry Debtors	86,000	
Stock on 1.4.2016	62,000	
Furniture & fixtures	21,400	
Office equipment	16,000	
Buildings	60,000	
Motor car	20,000	
Sundry creditors		43,000
Loan from Viswanath		30,000
Provision for bad debts		3,000
Purchases	1,40,000	
Purchase Returns		2,600
Sales		2,30,000
Sales Returns	4,200	
Salaries	11,000	
Rent for godown	5,500	
Interest on loan from Viswanath	2,700	
Rates & taxes	2,100	
Discount allowed to Debtors	2,400	
Discount received from creditors		1,600
Freight on purchases	1,200	
Carriage outwards	2,000	
Drawings	12,000	
Printing and Stationery	1,800	
Electricity charges	2,200	
Insurance premium	5,500	
General office expenses	3,000	
Bad debts	2,000	
Bank charges	1,600	
Motor car expenses	3,600	
Capital A/c		1,62,000
TOTAL	4,72,200	4,72,200

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2017 and the Balance Sheet as at that date after making provision for the following :

1. Depreciate : (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for ₹ 1,400 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for ₹ 4,000 has been wrongly debited to purchase; and (d) Motor car by 20 percent.
2. Stock consists of 11,000 units of goods purchased @ ₹ 4 per unit, but unit price has fallen to ₹ 3.25. This price reduction is anticipated to be permanent. The firm has already decided that if the price reduction lasts longer than two months it will reduce sale price of the item from ₹ 6.50 to ₹ 5.75.
3. One month's rent for godown is outstanding.
4. One month's salary is outstanding.
5. Interest on loan from Viswanath is payable at 12 percent per annum, this loan was taken on 1.5.2016.
6. Provision for bad debts is to be maintained at 5 per cent of Sundry Debtors.
7. Insurance premium includes ₹ 4,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2016 to 30.6.2017.
8. Half of the buildings are used for residential purposes of Shri Gavaskar.
9. A debit balance of ₹ 420 existed in the creditors ledger at the end of March 2017, representing advance to supplier, the suppliers concerned cannot be traced and it has been decided to write-off the balance.
10. The actual cash balance in office cash box is ₹ 1,300.

Solution **M/s Gavaskar & Co.**

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

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		62,000	By Sales	2,30,000	
To Purchases	1,40,000		Less: Sale of furniture included in sale	1,400	
Less: Typewriter included in purchases	4,000			2,28,600	
	1,36,000		Less: Sales Returns	4,200	2,24,400
Less: Purchase Returns	2,600	1,33,400	By Closing stock (Note 4)		44,000
To Freight on purchase		1,200			
To Gross Profit c/d		71,800			
		2,68,400			2,68,400
To Salaries	11,000		By Gross Profit b/d		71,800
Add: Outstanding	1,000	12,000	By Discount received		1,600
To Rent for Godown	5,500				
Add: Outstanding	500	6,000			
To Provision for Doubtful debts					
New	4,300				
Less: Old	3,000	1,300			
To Rent and taxes		2,100			
To Discount allowed		2,400			
To Carriage outwards		2,000			
To Printing and stationery		1,800			
To Electricity charges		2,200			
To Insurance premium (Note 1)		1,200			
To Depreciation (Note 2)		10,500			
To General office expenses		3,000			
To Bad debts		2,000			
To Bank charges		1,600			
To Interest on loan	2,700				
Add: Outstanding (Note 3)	600	3,300			
To Creditors A/c (Note 5)		420			
To Miscellaneous Expenses (Note 6)		100			
To Motor car		3,600			
To Net Profit (transferred to capital)		17,880			
		73,400			73,400

Balance Sheet of M/s Gavaskar & Co. as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital Account	1,62,000		Fixed Assets		
Add: Net Profit	17,880		Building	60,000	
	1,79,880		Less: Depreciation	3,000	57,000
Less: Drawings	12,000		Motor Car	20,000	
	1,67,880		Less: Depreciation	4,000	16,000

Less: Insurance premium	4,000		Office equipment (₹ 16,000 + ₹ 4,000)	20,000	
Less: 1/2 of Depreciation on Buildings	1,500	1,62,380	Less: Depreciation	3,000	17,000
Loan from Viswanath	30,000		Furniture & fixtures (₹ 21,400 – ₹ 1,400)	20,000	
Add: Outstanding	600	30,600	Less: Depreciation	2,000	18,000
Sundry Creditors (Note 5)		43,420	Current Assets		
Outstanding expenses :			Stock in trade		44,000
Salaries	1,000		Sundry Debtors	86,000	
Rent	500	1,500	Less: Provision for doubtful debts	4,300	81,700
			Cash at bank		2,600
			Cash in hand		1,300
			Prepaid insurance (Note 1)		300
		2,37,900			2,37,900

Working Notes : (1) Insurance Premium	₹	**(2) Calculation of Depreciation**		₹
Insurance premium as per Trial Balance	5,500	On Building @ 5% on ₹ 60,000	3,000	
Less: Proprietor's life insurance policy premium	4,000	Less: 1/2 for private use	1,500	1,500
Premium for 15 months	1,500	On Motor car @ 20% on ₹ 20,000		4,000
Less: Prepaid for 3 months	300	On Furniture & fittings @ 10% (₹ 21,400—₹ 1,400)		2,000
Charged to Profit and Loss A/c	1,200	On Office equipment as per Trial Balance	16,000	
		Addition (typewriter)	4,000	
			20,000	3,000
				10,500

(3) **Calculation of Interest on Loan :** (₹ 30,000 x 12 x 11) / 100 x 12 = ₹ 3,300; Outstanding ₹ 3,300 – ₹ 2,700 = ₹ 600.

(4) Para 24 of AS—2 states that ***materials and other supplies held for use in the production of inventories are not written down below cost, if the finished products in which they will be incorporated are expected to be sold at or above cost***.
In this case, though the unit price has fallen to ₹ 3.25 from ₹ 4.00, the stock will be valued @ ₹ 4.00 because it will not exceed the revised selling price of ₹ 5.75.
Therefore, the value of the stock will be : 11,000 × ₹ 4.00 = ₹ **44,000**.

(5) In the creditors ledger a debit balance of ₹ 420 existed representing advance to supplier. At the time of preparation of trial balance net amount of creditors was shown.
Actual position was as follows :
₹ 43,420 (Cr.) less 420 (Dr.). Therefore, net amount ₹ 43,000.
Now the supplier can not be traced. Therefore, it is to be written-off by passing the following entry :

Profit and Loss Account Dr.	₹ 420	
To Suppliers / Creditors Account		₹ 420

Final balance of creditors in the Balance Sheet will be ₹ 43,420 (Cr.) after cancellation of ₹ 420 (Dr.)

(6) Cash book balance is ₹ 1,400 but Cash box balance is ₹ 1,300. This difference can be treated as miscellaneous expenses and charged to Profit and Loss Account. The final balance of cash in the Balance Sheet will be ₹ 1,300.

Advanced Adjustments

1. Pre-payment and Outstanding

Illustrative Example 1

Beta, a sole proprietor, prepares his financial statements for the year to 31st March each year. He pays rent for his premises quarterly in advance on 1 December, 1 March, 1 June and 1 September. The annual rent was ₹ 84,000 until 31st May, 2016. It was increased from that date to ₹ 96,000 per year. What rent expenses and end year prepayment should be included in the financial statements for the year end 31st March, 2017 ?

Solution

	₹
Rent Expenses	
(i) 2/12 × ₹ 84,000 (April + May)	14,000
(ii) 10/12 × ₹ 96,000	80,000
	94,000
Prepayment	
2/12 × ₹ 96,000	16,000

Tutorial Note :
On 1st March, 2017 Beta paid ₹ 24,000 for the month of March, April and May, 2017. Payment for April and May 2017 will be treated as prepayments.

Illustrative Example 2

During the year 2016, cash payments of ₹ 1,56,000 were made in respect of general operating expenses. As at 31st December 2015, outstanding and prepayments in respect of such expenses were ₹ 6,744 and ₹ 3,328 respectively. The following information is relevant for determining the equivalent figures at 31st December, 2016.

Item	Amount (₹)	Payment Date	Details
Rates	13,000	30 November, 2016	Quarter ending 28 February, 2017
Electricity	9,678	1 January, 2017	Quarter ending 31 December, 2016
Heat and Light	5,167	11 December, 2016	Six months ending 30 November, 2016
Telephone	2,978	30 October, 2016	Quarter ending 30 October, 2016 (includes ₹ 1,905 rental for lease line for internet for quarter ending 31 January, 2017)
Telephone	3,148 (Estimated)	31 January, 2017	Quarter ending 31 January, 2017 (includes ₹ 1,905 rental for lease line for internet for quarter ending 30 April, 2017)

You are required to :

(i) calculate the amount of outstanding and prepayments of general operating expenses which will be shown in the Balance Sheet as at 31 December, 2016.

(ii) calculate the amount of general operating expenses which will be charged to Profit and Loss Account for the year ended 31 December, 2016.

Solution

(1) Calculation of Outstanding and Prepayments of General Operating Expenses

Expenses	Notes	Outstanding (₹)	Prepayments (₹)
Rates	(1)	—	8,667
Electricity	(2)	9,678	—
Heat and Light	(3)	861	—
Telephone	(4)	829	635
Total		11,368	9,302

Dr. **General Operating Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Jan. 1	To Prepaid Expenses A/c	3,328	Jan. 1	By Oustanding Expenses A/c	6,744
?	To Bank / Cash A/c	1,56,000	Dec. 31	By Profit and Loss A/c	1,54,650
Dec. 31	To Outstanding Expenses A/c	11,368	"	By Prepaid Expenses A/c	9,302
		1,70,696			1,70,696

Amount of General Operating Expenses to be charged to Profit and Loss Account = ₹ 1,54,650.

Working Notes :

(1) Rates : ₹ 13,000 was paid on 30 November, 2016 for three months, i.e., for December, 2016, January and February, 2017. Therefore, prepaid amount of rates = ₹ 13,000 / 3 × 2 = ₹ 8,667.

(2) Electricity : ₹ 9,678 was payable for the quarter ending on 31 December, 2016 but it was paid on 1 January, 2017. Therefore, the entire amount will be treated as outstanding expenses for the year 2016.

(3) Heat and Light : ₹ 5,167 was paid for 6 months ending on 30th November. Therefore, outstanding amount for the year 2016 will be : ₹ 5,167 / 6 × 1 = ₹ 861.

(4) Telephone : (i) ₹ 1,905 was paid on 30 October for lease line for 3 months, i.e., for November and December 2016 plus January 2017. Therefore, prepaid amount will be : ₹ 1,905 / 3 × 1 = ₹ 635.

(ii) ₹ 1,243 (₹ 3,148 – ₹ 1,905) is payable on 31 January, 2017 for November and December 2016 and January 2017. Therefore, the amount of outstanding will be : ₹ 1,243 / 3 × 2 = ₹ 829.

2. Inventories

Illustrative Example 3

Cost of inventory obtained from physical count on 31st March, 2017 — ₹ 77,700. This figure does not include any amounts for the two items below :

(i) An inventory line which had cost ₹ 1,800 was found to be damaged. Remedial work costing ₹ 300 is needed to enable the items to be sold for ₹ 1,700. Selling expenses of ₹ 100 would also be incurred in selling these items.

(ii) Goods sent to a customer on approval in February, 2017 were not included in the inventory. The sale price of the goods was ₹ 4,000 and the cost ₹ 3,000. The customer notified his acceptance of the goods in April, 2017.

You are required to compute the adjusted closing inventory figures from this information.

Solution **Computation of Adjusted Closing Inventory**

As per inventory count	₹ 77,700
Damaged items (₹ 1,700 – ₹ 300 – ₹ 100)	*1,300
Goods on approval	3,000
	82,000

* Inventory is valued at lower of cost and net realisable value. Here, cost is ₹ 1,800 but NRV is ₹ 1,300. Therefore, the value of damaged items will be ₹ 1,300.

3. Depreciation

Illustrative Example 4

J K is the sole proprietor of a business which is involved in the purchase and resale of software packages for use on personal computers. He is currently engaged in preparing his annual accounts for the year ended on 31st December, 2016, and has asked your assistance for calculating the amount of depreciation for the year 2016. The following information is available in respect of fixed assets. As at 1st January, 2016, the original cost and accumulated depreciation of the fixed assets held by the business were as follows :

Asset	Original Cost (₹)	Accumulated Depreciation (₹)
Buildings	3,56,782	1,55,985
Furnitures	1,01,545	46,328
Motor Vehicles	92,874	51,301
Total	5,51,201	2,53,614

During the year, the business acquired new assets as follows :

Asset	Six Months to 30th June, 2016 (₹)	Six Months to 31st December, 2016 (₹)	Total (₹)
Buildings	—	65,800	65,800
Furnitures	27,385	10,100	37,485
Motor Vehicles	28,954	—	28,954
Total	56,339	75,900	1,32,239

During the year, the following fixed asset disposals were made :

Asset	Original Cost (₹)	Accumulated Depreciation at 31st December, 2015 (₹)	Proceeds (₹)
Furnitures — 7th April, 2016	6,300	2,175	2,000
10th September, 2016	31,907	10,548	52,058
Motor Vehicles — 31st August, 2016	21,560	10,870	14,300
Total	59,767	23,593	68,358

The fixed assets are depreciated on a straight-line basis and to an estimated residual value of zero over the following economic lives :

Buildings	20 years
Furnitures	7 years
Motor Vehicles	4 years

Depreciation is calculated on a semi-annual basis, with a full six months' charge in the half-year of acquisition and no charge in the half-year of disposal.

You are required to calculate the amount of depreciation for the year 2016.

Solution **Depreciation Charge for the year 2016**

Particulars	Original Cost ₹	Depreciation ₹
Buildings		
Balance b/d	3,56,782	
Less: Disposal	—	
Add: Acquisition	—	
Balance at 30.6.2016	3,56,782	
Depreciation for 6 months (₹ 3,56,782 / 20 x 6/12)		8,920
Less: Disposal	—	
Add: Acquisition	65,800	
Balance at 31.12.2016	4,22,582	
Depreciation for 6 months (₹ 4,22,582 / 20 x 6/12)		10,565
Total		19,485

Furnitures			
Balance b/d		1,01,545	
Less: Disposal		(6,300)	
Add: Acquisition		27,385	
Balance at 30.6.2016		1,22,630	
Depreciation for 6 months (₹ 1,22,630 / 7 x 6/12)			8,759
Less: Disposal		(31.907)	
Add: Acquisition		10,100	
Balance at 31.12.2016		1,00,823	
Depreciation for 6 months (₹ 1,00,823 / 7 x 6/12)			7,202
	Total		15,961
Motor Vehicles			
Balance b/d		92,874	
Less: Disposal		—	
Add: Acquisition		28,954	
Balance at 30.6.2016		1,21,828	
Depreciation for 6 months (₹ 1,21,828 / 4 x 6/12)			15,229
Less: Disposal		(21,560)	
Add: Acquisition		—	
Balance at 31.12.2016		1,00,268	
Depreciation for 6 months (₹ 1,00,268 / 4 x 6/12)			12,534
	Total		27,763

4. Commission to Manager

Sometimes, the manager of a concern is given a percentage of the net profit as commission. Since it is an expense like salaries, we must account for it. The entry will be :

Profit and Loss Account Dr.
To Commission Account

If the amount is not paid within the accounting period, it will be shown in the liability side of the Balance Sheet. The problem arises as to the ascertainment of the amount payable as commission. This is because the commission may be paid at a certain percentage before or after charging such commission.

The calculation of commission in the above two cases are different.

Case 1 : When commission is paid at a fixed percentage of net profit before charging such commission.

$$\text{Commission} = \text{Net Profit before commission} \times \text{Rate of commission}$$

Illustrative Example 5

The manager is entitled to a commission of 10% on net profit before charging such commission. Net Profit before charging such commission is ₹ 1,10,000. Find out the commission payable to manager.

Solution

Commission = Net Profit before Commission x Rate of Commission = ₹ 1,10,0000 x 10% = ₹ 11,000.

Case 2 : When commission is paid at a fixed percentage of net profit after charging such commission.

$$\text{Commission} = \text{Net Profit before such commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

Illustrative Example 6

The manager is entitled to a commission of 10% on net profit after charging such commission. Net Profit before charging such commission is ₹ 1,10,000. Find out the commission payable to manager.

Solution

$$\text{Commission} = \text{Net Profit before such commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}} = ₹\ 1,10,000 \times \frac{10}{110} = ₹\ 10,000.$$

Alternatively,

Let total commission payable be x

x = 10% (₹ 1,100,000 – x) or x = 11,000 – .1x or 1.1x = 11,000 or x = ₹ 10,000.

Illustrative Example 7

(i) The General Manager is to be given commission of 10% after charging the commission of Works Manager and his own on net profits.
(ii) The Works Manager is to be given commission of 5% after charging commission of General Manager and his own on net profits. Such commission shall be calculated to the nearest multiple of a rupee.
(iii) Net profit before charging commission = ₹ 82,960.

Calculate the commission of general manager and works manager.

Solution

In this case, commission payable to General Manager and Works Manager are to be calculated with the help of simultaneous equations.
Let x be the total commission to General Manager
Let y be the total commission to Works Manager
Therefore,
x = 10/110 (₹ 82,960 – y) . . . . (1)
y = 5/105 (₹ 82,960 – x) . . . . (2)
or, x = .09091 (₹ 82,960 – y)
or, x + .091y = 7541.818 . . . . (3)
Similarly, y = .04762 (₹ 82,960 – x)
or, .04762x + y = ₹ 3,950.476 . . . . (4)

Multiplying equation 4 by 21 and 3 by 1 we get the following :
x + 21y = 82,960 . . . . (5)
x + .091y = 7,541.818 . . . . (6)
20.909y = 75,418.18 (Subtracting 6 from 5)
y = 75,418.18 / 20.909 = ₹ **3,607**
x = 82,960 – 21 x 3,609.97 = ₹ 7,213.58, say ₹ **7,214**.

5. Stationery Included in Opening Stock and Closing Stock

Illustrative Example 8

From the following information, calculate the amount of stationery is to be charged to Profit and Loss Account and also show the effect on opening stock, closing stock, purchases and trade expenses, etc.

(i) Opening stock ₹ 50,000.
(ii) Closing stock ₹ 45,000.
(iii) Opening stock and closing stock include stock of stationery, amounting to ₹ 2,000 and ₹ 1,500 respectively. Trade expenses include payment for stationery of ₹ 18,000. Credit purchases of stationery for ₹ 4,500 recorded as ordinary purchases. Stationery of ₹ 500 is consumed by the proprietor.

Solution

(i) Amount of Stationery to be Charged to Profit and Loss Account

Particulars	₹
Opening Balance of Stationery	2,000
Add : Cash Purchases of Stationery included in Trade Exp.	18,000
Add: Credit Purchases of Stationery included in Purchase	4,500
	24,500
Less: Closing Balance of Stationery	1,500
	23,000
Less: Stationery Consumed by the Proprietor	500
	22,500

(ii) Opening stock is to be reduced by ₹ 2,000.
The balance of ₹ 48,000 is to be debited to Trading Account.
(iii) Closing stock is to be reduced by ₹ 1,500.
The balance of ₹ 43,500 is to be credited to Trading Account.
(iv) Purchases is to be reduced by ₹ 4,500
(v) Trade expenses is to be reduced by ₹ 18,000
(vi) Drawings will be increased by ₹ 500.
(vii) Stock of stationery will be shown in the Balance Sheet as a separate item.

6. Loss or Profit on Sale / Exchange of an Asset

Any loss on sale / exchange of an asset will be debited to Profit and Loss Account. Similarly, any profit on sale / exchange will be credited to Profit and Loss Account. For calculating loss / profit on sale or exchange, the W.D.V. on the date of sale and exchange or sale value are to be compared. If the exchange or sale value is less than the W.D.V., then there is a loss. If the exchange or sale value is more than the W.D.V., then there is a profit.

[*See Chapter 9 for details*.]

Illustrative Example 9

(i) Furniture appearing in the Trial Balance of X as on 31.12.2017 at ₹ 56,000.
(ii) Rate of depreciation on furniture 10% p.a.

(iii) Furniture appearing in the book on 1.1.2017 at ₹ 16,000 was disposed of on 30.6.2017 at ₹ 13,500 in part exchange of a new furniture costing ₹ 15,000. The net invoice for ₹ 1,500 was passed through Purchases Day Book.

Calculate : (a) Loss on exchange of furniture; (b) Total depreciation is to be charged to Profit and Loss Account and (c) Book value of furniture on 31.12.2017.

Solution

(i) Depreciation on old furniture in use = 10% (₹ 56,000 – ₹ 16,000) = ₹ 4,000. Depreciation on new furniture for 6 months @ 10% p.a. on ₹ 15,000 = ₹ 750. Therefore, total depreciation on furniture in use = ₹ 4,000 + ₹ 750 = ₹ 4,750.

(ii) Depreciation on furniture disposed of = 10% of ₹ 16,000 for 6 months = ₹ 800.

(iii) Total amount of depreciation is to be charged to Profit and Loss Account = ₹ 4,750 + ₹ 800 = ₹ **5,550**.

(iv) Loss on Exchange

Particulars	₹
Book value of furniture on 1.1.2017	16,000
Less : Depreciation for 6 months @ 10%	800
Written-down value on 30.6.2017	15,200
Less : Exchange value	13,500
	1,700

(v) Book Value of Furniture on 31.12.2017

	₹
Opening balance	56,000
Less : Book value of Furniture sold	16,000
	40,000
Add: Purchase of new furniture	15,000
	55,000
Less : Depreciation (i)	4,750
	50,250

7. Goods Sent on Consignment

When goods are sent on consignment basis, the cost of the goods sent either deducted from Purchases or credited to Trading Account. Profit or loss from consignment is transferred to Profit and Loss Account. Any stock on consignment left with the consignee will be valued at cost or market price (N.R.V.) whichever is lower. The value of such goods is shown in the Balance Sheet only. For calculating profit, Consignment Account is to be prepared.

Illustrative Example 10

Trial Balance of X as at 31.3.2017

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2016	4,00,000	
Purchases	8,00,000	
Suspense Account of P		40,000
Capital		6,00,000
Other balances	2,00,000	7,60,000
	14,00,000	14,00,000

Additional information : Goods costing ₹ 1,00,000 were consigned to P for sale on 10% commission basis. P sold 4/5th of the goods at a profit of 20% on sales. The unsold stock was to be valued at cost. P sent an advance of ₹ 40,000 which was credited to his Suspense Account.

You are required to make necessary adjustments for consignment transactions and also show relevant Ledger Accounts.

Solution

No entry has been made in respect of transaction relating to consignment except cash received from P which has been credited to Suspense Account of P. The following adjustment entries are to be passed in this respect:

Journal **Dr.** **Cr.**

Date	Particulars		Dr. ₹	Cr. ₹
2017 March 31	(i) **For Goods Sent on Consignment**			
	Consignment to P A/c	Dr.	1,00,000	
	To Goods Sent on Consignment A/c			1,00,000
	(ii) **For Sale of Goods by P**			
	P A/c (Note 1)	Dr.	1,00,000	
	To Consignment to P A/c			1,00,000
	(iii) **For Commission at 10% on Sales**			
	Consignment to P A/c	Dr.	10,000	
	To P A/c			10,000
	(iv) **For Stock on Consignment**			
	Stock on Consignment A/c	Dr.	20,000	
	To Consignment to P A/c			20,000
	(v) **For Adjusting Purchases**			
	Goods Sent on Consignment A/c	Dr.	1,00,000	
	To Purchases A/c			1,00,000
	(vi) **For Closing Suspense Account of P**			
	Suspense Account of P	Dr.	40,000	
	To P A/c			40,000

Dr. P Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to P A/c (Sales)	1,00,000		By Suspense Account of P	40,000
				By Consignment to P A/c (Commission)	10,000
				By Balance c/d	50,000
		1,00,000			1,00,000

Dr. Consignment to P Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,00,000		By P A/c (Note 1)	1,00,000
	To P A/c (commission)	10,000		By Stock on Consignment A/c	20,000
	To Profit on Consignment A/c	10,000			
		1,20,000			1,20,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c	1,00,000		By Consignment to P A/c	1,00,000

Net Effect

(1) Profit on consignment of ₹ 10,000 will be credited to Profit and Loss Account.
(2) ₹ 1,00,000 will be deducted from Purchases. Net purchases of ₹ 7,00,000 will be shown in the Trading Account.
(3) Stock on consignment of ₹ 20,000 will be shown in the assets side of the Balance Sheet.
(4) Suspense Account of P will be eliminated.
(5) Amount due from P of ₹ 50,000 will be shown in the assets side of the Balance Sheet.

Working Notes :

(1) Cost of goods sold = 4/5 of ₹ 1,00,000 = ₹ 80,000. Goods are sold at a profit of 20% on sales i.e. 25% on cost. Therefore, sales = ₹ 80,000 + 25% of ₹ 80,000 = ₹ 1,00,000.
(2) Cost of goods unsold = 1/5 of ₹ 1,00,000 = ₹ 20,000.

8. Profit / Loss on Joint Venture

Any profit earned from Joint Venture will be credited to Profit and Loss Account.

Illustrative Example 11

Trial Balance of X as at 31.3.2017

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2016	4,00,000	
Purchases	8,00,000	
Suspense Account of Q	20,000	
Capital and other Balances		12,20,000
	12,20,000	12,20,000

Additional information :

(i) A joint venture was made with Q for which an advance of ₹ 20,000 was made. The venture yield a profit of ₹ 18,000, 2/3 of which is attributable to X.

You are required to make necessary adjustments for joint venture transactions and also show relevant Ledger Accounts.

Solution

No entry has been made in respect of transaction relating to joint venture except cash sent to Q which has been debited to Suspense Account of Q. The following adjustment entries are to be passed :

Journal Dr. Cr.

Date	Particulars		₹	₹
2017 March 31	(i) **For Closing Suspense Account of Q**			
	Q A/c	Dr.	20,000	
	To Suspense Account of Q			20,000
	(ii) **For Profit on Joint Venture**			
	Q A/c (Note 1)	Dr.	12,000	
	To Profit and Loss A/c			12,000

Dr. Q Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Suspense Account of Q	20,000		By Balance c/d	32,000
	To Profit and Loss A/c	12,000			
		32,000			32,000

Net Effect

(1) Share of profit on joint venture of ₹ 12,000 will be credited to Profit and Loss Account.
(2) Balance of ₹ 32,000 in the Q Account will be shown in the Balance Sheet in the assets side.
(3) Suspense Account of Q will be eliminated.

Working Note :

(1) Total profit on joint venture is ₹ 18,000; 2/3rd belongs to X. Therefore, ₹ 12,000 will be credited to Profit and Loss Account of X.

Illustrative Example 12

Trial Balance of X as at 31.3.2017

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2016	40,000	
Purchases and Sales	1,60,000	3,00,000
Joint Venture Suspense Account	2,000	
Sundry Debtors and Sundry Creditors	88,000	60,000
Other Assets	3,10,000	
Capital		1,40,000
Other Liabilities		1,00,000
	6,00,000	6,00,000

Additional information : On 1.1.2017, X entered into a joint venture with Y on an equal profit sharing basis. Y supplied goods costing ₹ 30,000 which were recorded through Purchases Day Book. X sold these goods at a gross profit of 25% on sales and included these in Sales Account. Y spent ₹ 1,000 in despatching goods for which no entry was made. Joint Venture Suspense Account represented the expenses incurred by X. You are required to make necessary adjustments in respect of joint venture transactions and also show the relevant Ledger Accounts.

Solution

Goods sent by Y in connection with joint venture was wrongly recorded through Purchases Day Book. In the ledger, Purchases Account was debited and Sundry Creditors Account was credited. For joint venture transactions, the following adjustment entries are to be passed:

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2017 March 31	(i) **For Cancelling Purchases**			
	Joint Venture with Y A/c	Dr.	30,000	
	To Purchases A/c			30,000
	(ii) F**or Adjusting Creditors**			
	Sundry Creditors A/c	Dr.	30,000	
	To Y A/c			30,000
	(iii) **For Recording Expenses paid by Y**			
	Joint Venture with Y A/c	Dr.	1,000	
	To Y A/c			1,000
	(iv) **For Cancelling Joint Venture Suspense Account**			
	Joint Venture with Y A/c	Dr.	2,000	
	To Joint Venture Suspense A/c			2,000
	(v) **For Joint Venture Sales**			
	Sales A/c	Dr.	40,000	
	To Joint Venture with Y A/c			40,000

Dr. **Y Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	34,500		By Sundry Creditors A/c	30,000
				By Joint Venture with Y A/c (expenses)	1,000
				By Joint Venture with Y A/c (share of profit)	3,500
		34,500			34,500

Dr. **Joint Venture with Y Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c	30,000		By Sales A/c (Note 1)	40,000
	To Y A/c (Expenses)	1,000			
	To Joint Venture Suspense A/c (expenses)	2,000			
	To Profit and Loss A/c (share of profit)	3,500			
	To Y A/c (share of profit)	3,500			
		40,000			40,000

Net Effect

(1) Purchases will be reduced by ₹ 30,000.
(2) Sales will be reduced by ₹ 40,000.
(3) Sundry Creditors will be reduced by ₹ 30,000.

(4) Joint Venture Suspense Account will be eliminated.
(5) Balance due to Y ₹ 34,500 will be shown in the Balance Sheet as a liability.
Working Note : **(1)** Profit on sale is 25%, i.e. $33^1/_3$% profit on cost. Therefore, sales = ₹ 30,000 + $33^1/_3$ of ₹ 30,000 = ₹ 40,000.

9. Petty Cash

For meeting small expenses, e.g. purchase of stationery, purchase of newspaper, and so on, head cashier transfers a small amount to a petty cashier. At the time of transferring money, Petty Cash Account is debited and Cash Account is credited. When the given amount of money is exhausted, the petty cashier submits the petty cash vouchers to get the reimbursement from the head cashier. For recording petty expenses different Petty Expenses Accounts are debited and Petty Cash Account is credited. At the end of the accounting period, the above entries are passed (even if the money is not exhausted) to record the petty expenses upto the closing date. The balance in the petty cash account is carried forward to the next accounting period.

Illustrative Example 13

Trial Balance (Extract)

Heads of Account	Dr. (₹)	Cr. (₹)
Petty Cash Account	1,000	
Petty Cash Expenses	9,600	

Additional information : The petty cash balance represents the month-end imprest system. As on the closing date the petty cashier had vouchers totalling ₹ 400 for which he had not received reimbursement from the head cashier.

You are required to pass adjusting entry for petty expenses.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		₹	₹
	Petty Cash Expenses	Dr.	400	
	To Petty Cash A/c			400
	(Being the adjustment for petty cash expenses)			

Net Effect
(1) Petty cash expenses of ₹ 10,000 (₹ 9,600 + ₹ 400) will be debited to Profit and Loss Account.
(2) Petty cash of ₹ 600 (₹ 1,000 – ₹ 400) will be shown in the Balance Sheet.

Illustration 21

From the following balances extracted from the books of a trader on December 31, 2007, prepare a Trading and Profit and Loss Account for the year ended on that date and also a Balance Sheet as on the same day :

Particulars	₹	Particulars	₹
Cash in hand	480	Capital Account	42,500
Drawings	7,100	Sales	1,19,060
Plant and Machinery	9,500	Purchases Return	2,910
Stock in Trade	14,600	Bank Overdraft	1,200
Purchases	1,03,620	Creditors	10,000
Sales Return	2,100	Provision for Doubtful Debts	1,050
General Expenses	2,000		
Wages	2,400		
Rent and Rates	3,200		
Bad Debts	1,720		
Debtors	30,000		
	1,76,720		1,76,720

Note :
(a) Provide 10% depreciation on plant and machinery.
(b) Provision for doubtful debts is to be increased to 5% of debtors.
(c) A credit sale of ₹ 2,000 has not been recorded in the books.
(d) Plant and machinery worth ₹ 1,000 purchased during the year (on September 30, 2007) has been included in Purchases.
(e) Rent paid in advance ₹ 800.
(f) Stock on December 31, 2007 was valued at ₹ 17,300. These does not include the value of the machinery bought on 30.9.2007.
(g) Wages include ₹ 200 for installation of plant.

[C.U.B.Com. (Hons.) — 2008]

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2007 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		14,600	By Sales	1,19,060	
To Purchases	1,03,620		Add: Unrecorded Sales	2,000	
Less: Purchase of Machine	1,000			1,21,060	
	1,02,620		Less: Sales Return	2,100	1,18,960
Less: Purchase Return	2,910	99,710	By Closing Stock		17,300
To Wages	2,400				
Less: Installation of Machine	200	2,200			
To Gross Profit c/d		19,750			
		1,36,260			1,36,260
To General Expenses		2,000	By Gross Profit b/d		19,750
To Rent and Rates	3,200				
Less: Prepaid	800	2,400			
To Bad Debts		1,720			
To Depreciation on machinery (Note 1)		980			
To Provision for Doubtful Debts :					
New Provision	1,600				
Less: Old Provision	1,050	550			
To Net Profit (Transferred to Capital)		12,100			
		19,750			19,750

Balance Sheet as at 31st December, 2007

Liabilities	₹	₹	Assets	₹	₹
Capital	42,500		Plant and Machinery	9,500	
Add: Net Profit	12,100		Add: Purchase	1,000	
	54,600			10,500	
Less: Drawings	7,100	47,500	Add: Installation Charge	200	
Creditors		10,000		10,700	
Bank Overdraft		1,200	Less: Depreciation (Note 1)	980	9,720
			Stock		17,300
			Debtors	30,000	
			Add: Unrecorded Sales	2,000	
				32,000	
			Less: Provision for Doubtful Debts (Note 2)	1,600	30,400
			Prepaid Rent		800
			Cash		480
		58,700			58,700

Working Note :

(1) Depreciation on Plant and Machinery ₹

On existing plant and machinery (₹ 9,500 × 10/100) 950

On new purchase for 3 months (₹ 1,000 + ₹ 200) × 10/100 × 3/12 30

980

(2) Required provision for doubtful debts = 50% of ₹ 32,000 = ₹ **1,600**.

Illustration 22

From the following prepare the Trading and Profit and Loss Account for the year ended 31st March, 2004 and Balance Sheet of Mr Z as on that date :

Particulars	₹
Capital	50,450
Trade Creditors	10,000
Bills Payable	1,000
General Reserve	5,000
Provision for Bad and Doubtful Debts	1,000
Sales	75,000
Discount Allowed	750
Stock at April 1, 2003	15,000
Purchases	48,000

Discount Received	400
Building	10,000
Machinery, Plant and Furniture (cost ₹ 25,000)	15,000
Book Debts	16,400
Bank Balance (Dr.)	3,400
Investment, 4% Government Loan at par	10,000
Bills Receivable	5,050
Salaries and Wages	13,000
Audit Fee	2,000
Office Expenses	2,000
Repairs and Renewals	1,800
Interest Paid	700
Bad Debts Recovered	250

Additional information :

(a) The value of Stock on hand as at 31st March, 2004 was ₹ 18,000 included goods costing ₹ 900 received on 30th March, 2004 in respect of which supplier's bill had not yet been received.

(b) Goods of the cost of ₹ 1,500 were sent to a customer on sale on approval basis but recorded in Sales Book at sales price of ₹ 2,000. Approval for the sale were not received till 31st March, 2004.

(c) Provisions were made for doubtful debts to the extent of ₹ 400 and for depreciation on building at 2% per annum.

(d) Machinery, Plant and Furniture was depreciated at 20% on the diminishing value; Mr. Z, however, considered that the proper method would be 8% on the original cost and wanted to adopt it from April 1, 2002.

[C.U.B.Com. (Hons.) — 2005]

Solution

Mr. Z

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2004 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,000	By Sales	75,000	
To Purchases	48,000		Less: Goods sent on approval basis		
Add: Unrecorded Purchases	900	48,900	not yet approved	2,000	73,000
To Gross Profit c/d		28,600	By Closing Stock	18,000	
			Add: Cost of goods lying with customers	1,500	19,500
			on approval basis		
		92,500			92,500
To Salaries and Wages		13,000	By Gross Profit b/d		28,600
To Office Expenses		2,000	By Discount Received		400
To Repairs and Renewals		1,800	By Bad Debt Recovery		250
To Discount Allowed		750	By Provision for Doubtful Debts :		
To Audit Fee		2,000	Old Provision	1,000	
To Interest		700	Less: New Provision	400	600
To Depreciation on :			By Interest on Investment (Note 2)		400
Building	200		By Machinery, Plant and Furniture (Note 1)		1,750
Machinery, Plant and Furniture	2,000	2,200	(Excess depreciation written back)		
To Net Profit (Transferred to Capital)		9,550			
		32,000			32,000

Balance Sheet of Mr. Z as at 31st March, 2004

Liabilities	₹	₹	Assets	₹	₹
Capital	50,450		Building	10,000	
Add: Net Profit	9,550	60,000	Less: Depreciation	200	9,800
General Reserve		5,000	Machinery, Plant and Furniture	15,000	
Trade Creditors	10,000		Add: Excess Depreciation provided	1,750	
Add: Unrecorded Purchases	900	10,900		16,750	
Bills Payable		1,000	Less: Depreciation for 2003-04	2,000	14,750
			Closing Stock	18,000	
			Add: Cost of goods lying with customers	1,500	19,500
			Book Debts	16,400	
			Less: Sale Price of goods lying with	2,000	
			customers on approval basis		

				14,400	
			Less: Provision for Doubtful Debts	400	14,000
			Bills Receivable		5,050
			Investment (4% Govt. Loan at par)	10,000	
			Add: Accrued Interest	400	10,400
			Bank		3,400
		76,900			76,900

Working Notes :

(1) Machinery, Plant and Furniture - Change in Method of Depreciation

W.D.V. on 1.4.2002 = ₹ 15,000 + 20/80 of ₹ 15,000 = ₹ 18,750.

Depreciation to be provided = 8% of ₹ 25,000 = ₹ 2,000.

Excess depreciation to be written back = ₹ 3,750 – ₹ 2,000 = ₹ 1,750.

Depreciation for 2003-04 = 8% of ₹ 25,000 = ₹ 2,000.

(2) Accrued Interest = 4% of ₹ 10,000 = ₹ **400**.

Illustration 23

From the following balances extracted from the books of a trader on December 31, 2005, prepare a Trading and Profit and Loss Account for the year ended on that date and also a Balance Sheet as on same date :

Debit Balances	₹	Credit Balances	₹
Drawings Account	7,100	Capital Account	42,500
Plant and machinery	9,500	Sales	1,19,060
Stock on 1.1.2014	14,600	Purchases Return	2,910
Purchases	1,03,620	Bank Overdraft	1,200
Sales Return	2,100	Creditors	10,000
General Expenses	2,000	Provision for Doubtful Debts	1,050
Wages	2,400		
Rent and Rates	3,200		
Bad Debts	1,720		
Debtors	30,000		
Cash in Hand	480		
	1,76,720		1,76,720

Notes :

(i) Provide 10% depreciation on plant and machinery.

(ii) Provision for doubtful debts is to be increased to 5% of Debtors.

(iii) A credit sale of ₹ 2,000 has not been recorded in the books.

(iv) Plant and machinery worth ₹ 1,000 purchased during the year (on September 30, 2005) has been included in Purchases.

(v) Stock on 31.12.2005 has been valued at ₹ 17,300. This does not include the value of the plant and machinery bought on 30.09.2005.

(vi) Wages includes ₹ 200 for installation of plant.

(vii) Goods costing ₹ 600 have been stolen by a dishonest employee.

(viii) ₹ 510 received from a Debtor whose balance was written off as bad, has been recorded as cash sale.

(ix) A sales return of ₹ 500 was not entered in the accounts though it was duly taken in the stock.

(x) Goods (cost price ₹ 720) (minimum sale price ₹ 900) was consigned to an agent. But those remain still unsold.

[C.U.B.Com. (Hons.) — 2006]

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2005 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		14,600	By Sales	1,19,060	
To Purchases	1,03,620		Less: Sales Return (2,100 + 500)	2,600	
Less: Purchase Return	2,910			1,16,460	
	1,00,710		Less: Bad Debts recovery included in Sales	510	
Less: Goods Stolen	600			1,15,950	
	1,00,110		Add: Unrecorded Credit Sales	2,000	1,17,950
Less: Purchase of Plant and Machinery	1,000		By Closing Stock		17,300
	99,110				
Less: Goods Sent on Consignment (cost)	720	98,390			

	₹	₹		₹	₹
To Wages	2,400				
Less: Installation of Plant	200	2,200			
To Gross Profit c/d		20,060			
		1,35,250			1,35,250
To General Expenses		2,000	By Gross Profit b/d		20,060
To Rent and Rates		3,200	By Bad Debts Recovery		510
To Bad Debts		1,720			
To Goods Stolen		600			
To Provision for Doubtful Debts					
Provision required 5% of ₹ 31,500	1,575				
Less: Existing Provision	1,050	525			
To Depreciation on Plant and Machinery (Note 1)		980			
To Net Profit (Transferred to Capital)		11,545			
		20,570			20,570

Balance Sheet as at 31st December, 2005

Liabilities	₹	₹	Assets	₹	₹
Capital	42,500		Plant and Machinery	9,500	
Add: Net Profit	11,545		Add: Purchase of Machinery	1,000	
	54,045		Add: Installation charges	200	
Less: Drawings	7,100	46,945		10,700	
Creditors		10,000	Less: Depreciation (Note 1)	980	9,720
Bank Overdraft		1,200	Stock		17,300
			Consignment Stock (at cost)		720
			Debtors	30,000	
			Add: Unrecorded Sales	2,000	
				32,000	
			Less: Unrecorded Sales Return	500	
				31,500	
			Less: Provision for Doubtful Debts @ 5%	1,575	29,925
			Cash		480
		58,145			58,145

Working Note :

(1) Depreciation on Plant and Machinery

	₹
On existing plant and machinery (₹ 9,500 × 10/100)	950
On new purchase for 3 months (₹ 1,000 + ₹ 200) × 10/100 × 3/12	30
	980

Illustration 24

X started a business on January 1, 2006 with ₹ 10,000 in cash, ₹ 5,000 in goods and ₹ 10,000 in furniture. His Trial Balance on December 31, 2006 was drawn as follows :

Particulars	₹	Particulars	₹
Bad Debts	3,500	Capital	30,000
Stock in Trade	5,000	Creditors	5,000
Furniture	15,000	Loan	2,400
Drawings	4,500	Commission Received	200
Wages	1,800	Sales	28,700
Purchases	18,000		
Advertisement	1,400		
Debtors	9,000		
Cash	3,200		
Interest on Loan	400		
Commission Paid	600		
Miscellaneous Expenses	700		
Insurance Premium	800		
Salaries	2,400		
	66,300		66,300

Prepare Trading Account, Profit and Loss Account for the year ended December 31, 2006 and a Balance Sheet as at December 31, 2006 after taking into consideration the following :

(i) Goods valued at ₹ 15,000 were destroyed by fire; against this an insurance claim of ₹ 10,000 was to be received.

(ii) During the year, proprietor had taken goods of ₹ 2,000 for personal consumption. The value of the remaining stock in hand was ₹ 8,000.

(iii) Depreciate furniture by 10% p.a.. The addition to furniture was made on 1st April.
(iv) Y, a debtor for ₹ 2,000 was declared insolvent, only 50 paise in the rupee was receivable against his estate.
(v) Create a provision for doubtful debts at 5% and provision for discount at 20% on Debtors as well as on Creditors.
(vi) Goods sold to Robin for ₹ 500 wrongly debited to Rathin's Account.
(vii) Cheque issued to a Creditor for ₹ 800 was wrongly debited to Purchase Account.
(viii) 1/4th of advertisement expenses is to be carried forward. ***[C.U.B.Com. (Hons.) — 2007]***

Solution

X

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2006 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Stock in Trade		5,000	By Sales		28,700
To Purchases	18,000		By Goods destroyed by Fire		15,000
Less: Drawings	2,000		By Closing Stock		8,000
	16,000				
Less: Cheque paid to Creditor, wrongly debited to Purchases A/c	800	15,200			
To Wages		1,800			
To Gross Profit c/d		29,700			
		51,700			51,700
To Bad Debts		3,500	By Gross Profit b/d		29,700
To Goods Destroyed by Fire (Loss)		5,000	By Commission Received		200
To Depreciation on Furniture (Note 6)		1,375	By Provision for Discount on Creditors		840
To Advertisement	1,400		(20% of ₹ 4,200)		
Less: Unexpired (1/4 of ₹ 1,400)	350	1,050			
To Interest on Loan		400			
To Commission Paid		600			
To Miscellaneous Expenses		700			
To Insurance Premium		800			
To Salaries		2,400			
To Provision for Doubtful Debts (Note 2)		1,350			
To Prov. for Discount on Debtors (Note 3)		1,530			
To Net Profit (Transferred to Capital)		12,035			
		30,740			30,740

Balance Sheet of X as at 31st December, 2006

Liabilities	₹	₹	Assets	₹	₹
Capital (10,000 + 5,000 + 10,000)	25,000		Furniture	10,000	
Add: Additional Capital Introduced	5,000		Add: Purchases	5,000	
	30,000			15,000	
Less: Drawings (4,500 + 2,000)	6,500		Less: Depreciation	1,375	13,625
	23,500		Closing Stock		8,000
Add: Net Profit	12,035	35,535	Debtors (Note 1)	9,000	
Loan		2,400	Less: Provi. for Doubtful Debts (Note 3 & 4)	1,350	
Creditors	5,000			7,650	
Less: Cheque issued wrongly included			Less: Prov. for Disc. on Debtors (Note 3)	1,530	6,120
in Purchases	800		Insurance Company — Claim receivable		10,000
	4,200		Cash		3,200
Less: Provision for Discount			Advertisement (Note 5)		350
(20% of ₹ 4,200)	840	3,360			
		41,295			41,295

Working Notes :

(1) For goods sold to Robin wrongly debited to Rathin's Account, the following rectification entry will be passed :

Robin's Account Dr. 500
To Rathin's Account 500

(2) Provision for Doubtful Debtors

	₹
Specific provision (for Debtory Y) ₹ 2,000 × 50/100	1,000
General provision (for other Debtors) (₹ 9,000 – ₹ 2,000) × 5/100	350
Total provision required	1,350
(3) Provision for Discount on Debtors = ₹ 7,650 × 20/100	1,530

(4) Specific provision for doubtful debt (Debtor Y) has been created as the amount is still receivable.
(5) It has been assumed that 1/4 of the advertisement expenses is prepaid.

(6) Depreciation on Furniture :

	₹
On ₹ 10,000 @ 10% for full year	1,000
On ₹ 5,000 @ 10% for 9 months	375
	1,375

Illustration 25

The following Trial Balance was extracted from the books of Mr Roy as on 31st March, 2008 :

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Plant and Machinery	2,00,000	Capital Account	8,00,000
Manufacturing Wages	3,45,000	Sundry Creditors	4,65,060
Salaries	1,58,500	Bank Loan @ 12% Interest taken on 01.08.2007	1,50,000
Furniture	1,00,000	Purchase Returns	17,400
Freight on Purchase	18,600	Sales	25,08,500
Freight on Sales	21,400	Provision for Doubtful Debts	20,000
Buildings	2,40,000		
Manufacturing Expenses	95,000		
Insurance and Tax	42,500		
Patent and Trademark	2,50,000		
General Expenses	74,000		
Factory Fuel and Power	12,800		
Sundry Debtors	8,02,000		
Factory Lighting	9,500		
Stock (31.3.2007)	3,42,000		
Motor Car	1,20,000		
Purchases	10,20,000		
Sales Returns	31,000		
Bad Debts	14,000		
Bank Charges	4,000		
Interest on Bank Loan	8,000		
Cash at Bank	42,000		
Cash in Hand	11,200		
	39,61,500		39,61,500

Prepare the Trading and Profit and Loss Accounts for the year ended 31st March, 2008 and a Balance Sheet as on that date taking into consideration the following information :

(a) Stock in hand as on 31st March, 2008 was :
Cost price — ₹ 3,05,000
Net realisable value — ₹ 3,20,000.

(b) Depreciate plant and machinery @ 10% p.a.; furniture @ 5% p.a.; and motor car by ₹ 10,000.

(c) Mr Basak, a customer from whom ₹ 15,000 was due, declared insolvent and nothing is expected to be realised out of his estate. Create provision for doubtful debts at 5% on general debtors.

(d) ₹ 5,000 is due from Mr Basu Ray and at the same time ₹ 8,000 is due to him.

(e) A commission of 1% on the gross profit is to be provided to Works Manager.

(f) General Manager is to be allowed a commission @ 2% on net profit after charging Works Manager's commission and before charging General Manager's commission.

(g) Two cheques of ₹ 2,000 and ₹ 5,000 were deposited into bank on 29th March, 2008 but were credited by the bank on 5th April, 2008.

[C.U.B.Com. (Hons.) — 2009]

Solution

Mr. Roy

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2008 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		3,42,000	By Sales	25,08,500	
To Manufacturing Wages		3,45,000	Less: Sales Returns	31,000	24,77,500
To Freight on Purchases		18,600	By Closing Stock (Note 4)		3,05,000
To Manufacturing Expenses		95,000			
To Factory Fuel and Power		12,800			
To Factory Lighting		9,500			
To Purchases	10,20,000				
Less: Purchases Returns	17,400	10,02,600			
To Gross Profit c/d		9,57,000			
		27,82,500			27,82,500

To Salaries		1,58,500	By Gross Profit b/d		9,57,000
To Freight on Sales		21,400			
To Insurance and Tax		42,500			
To General Expenses		74,000			
To Bad Debts		14,000			
To Bank Charges		4,000			
To Interest on Bank Loan	8,000				
Add: Outstanding (Note 5)	4,000	12,000			
To Depreciation on :					
Plant and Machinery	20,000				
Furniture	5,000				
Motor Car	10,000	35,000			
To Provision for Doubtful Debts :					
New Provision	54,100				
Less: Old Provision (Note 2)	20,000	34,100			
To Net Profit before Commission		5,61,500			
		9,57,000			9,57,000
To Commission to Works Manager (Note 6)		9,570	By Net Profit before Commission		5,61,500
To Commission to General Manager (Note 7)		11,039			
To Net Profit (Transferred to Capital)		5,40,891			
		5,61,500			5,61,500

Balance Sheet of X as at 31st March, 2008

Liabilities	₹	₹	Assets	₹	₹
Capital	8,00,000		Buildings		2,40,000
Add: Net Profit	5,40,891	13,40,891	Plant and Machinery	2,00,000	
Bank Loan @ 12%	1,50,000		Less: Depreciation	20,000	1,80,000
Add: Outstanding	4,000	1,54,000	Furniture	1,00,000	
Sundry Creditors	4,65,600		Less: Depreciation	5,000	95,000
Less: Mutual Debt	5,000	4,60,600	Motor Car	1,20,000	
Commission Payable to :			Less: Depreciation	10,000	1,10,000
Works Manager	9,570		Patent and Trademark		2,50,000
General Manager	11,039	20,609	Closing Stock		3,05,000
			Debtors	8,02,000	
			Less: Mutual Debt	5,000	
				7,97,000	
			Less: Provision for Doubtful Debts	54,100	7,42,900
			Bank		42,000
			Cash in Hand		11,200
		19,76,100			19,76,100

Working Notes :

(1) Specific provision should be created for Mr Basak as nothing is yet realised from his estate.

(2) Required Provision for Doubtful Debts

	₹
Specific provision (Mr Basak)	15,000
Provision on general debtors (₹ 8,02,000 – ₹ 5,000 – ₹ 15,000) × 5/100	39,100
	54,100

(3) For two cheques of ₹ 2,000 and ₹ 5,000 deposited into bank on 29th March, 2008 which were credited on 5th April, 2008, nothing is required to be done as Balance Sheet is prepared with Bank Balance as per Cash Book.

(4) Closing Stock is valued at cost or Net Realisable Value (NRV) whichever is lower. Here, cost ₹ 3,05,000 is lower than NRV (₹ 3,20,000). Therefore, the value of closing stock will be ₹ 3,05,000.

(5) Interest on bank loan for 8 months = (₹ 1,50,000 × 12% × 8/12) = ₹ 12,000. ₹ 8,000 has already been paid. Therefore, ₹ 4,000 (₹ 12,000 – ₹ 8,000) is outstanding.

(6) Commission Payable to Works Manager = 1% of Gross Profit = 1% of ₹ 9,57,000 = ₹ 9,570.

(7) Commission Payable to General Manager

	₹
Net Profit before Commission of Works Manager	5,61,500
Less: Works Manager's Commission (Note 6)	9,570
Net Profit after Commission of Works Manager	5,51,930
Less: General Manager's Commission @ 2% of ₹ 5,51,930	11,039
Net Profit after General Manager's Commission	5,40,891

Illustration 26

Rico Traders prepared the following Trial Balance with the balances of the accounts drawn on 31 December, 2003 :

Particulars	Dr. (₹)	Cr. (₹)
Capital		5,00,000
Sundry Creditors		45,000
Goods Sent on Consignment		30,000
Provision for Doubtful Debt		10,000
Provision for Depreciation		15,000
Bank Loan (Interest rate 15% p.a.)		10,000
Consignment (Profit)		5,000
Land	3,20,000	
Furniture	40,000	
Debtors	80,000	
Opening Stock	60,000	
Closing Stock	75,000	
Purchase (Less Closing Stock)	1,30,000	
Rent	9,000	
Carriage inward	1,000	
Carriage outward	5,000	
Return inward	4,000	
Salary	40,000	
Advertisement	10,000	
Stationery and Printing	5,000	
Discount	6,000	4,000
Advance Salary	3,500	
Electricity and Telephone	6,800	
Sales		2,10,000
Bills Payable		15,000
Cash in Hand	28,700	
Cash at Bank	20,000	
TOTAL	8,44,000	8,44,000

Adjustments :

(a) The closing stock was valued at market price. But the cost price per unit of product was ₹ 12 which at that time was lower than market price by ₹ 3.

(b) ₹ 35,000 which was receivable from the consignee was included in Debtors Account. Bad debt was ₹ 3,000 and 5% provision for doubtful debt was to be made on Debtors.

(c) Depreciation on depreciable fixed assets was to be charged @ 10% per annum on diminishing balance method.

(d) The benefits from advertisement would be received for 5 years.

(e) Cash found short by ₹ 1,000 at the time of cash counting.

Prepare Trading and Profit & Loss Account for the year ended 31 December, 2003 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — 2004]

Solution

Rico Traders

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2003 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		60,000	By Sales	2,10,000	
To Purchases (including Closing Stock)		2,05,000	Less: Return Inwards	4,000	2,06,000
To Carriage Inwards		1,000	By Goods Sent on Consignment		30,000
To Gross Profit c/d		30,000	By Closing Stock	75,000	
			Less: Reduction in Value of Stock (Note 1)	15,000	60,000
		2,96,000			2,96,000
To Rent		9,000	By Gross Profit b/d		30,000
To Salary		40,000	By Consignment – Profit		5,000
To Advertisement (Note 4)		10,000	By Discount Received		4,000
To Carriage Outwards		5,000	By Provision for Doubtful Debts :		
To Printing and Stationery		5,000	Old Provision	10,000	
To Discount Allowed		6,000	Less: New Provision	2,100	7,900

To Electricity and Telephone To Cash (Shortage) (Note 3) To Depreciation on Furniture (Note 2) To Interest on Bank Loan To Bad Debts		6,800 1,000 2,500 1,500 3,000	By Net Loss (Transferred to Capital)		42,900
		89,800			89,800

Balance Sheet of Rico Traders as at 31st December, 2003

Liabilities	₹	₹	Assets	₹	₹
Capital Less: Net Loss	5,00,000 42,900	4,57,100	Land Furniture	3,20,000 40,000	
Bank Loan Add: Outstanding Interest	10,000 1,500	11,500	Total Fixed Assets Less: Provision for Depreciation	3,60,000 17,500	3,42,500
Sundry Creditors		45,000	(₹ 15,000 + 2,500)		
Bills Payable		15,000	Stock		60,000
			Debtors Less: Due from Consignee	80,000 35,000	
				45,000	
			Less: Bad Debts	3,000	
				42,000	
			Less: Provision for Doubtful Debts	2,100	39,900
			Due from Consignee Advance Salary Bank		35,000 3,500 20,000
			Cash Less: Shortage	28,700 1,000	27,700
		5,28,600			5,28,600

Working Notes : (1) Reduction in Stock	**(2) Depreciation on Furniture**
Cost price per unit ₹ 12 Market price pre unit ₹ 12 + ₹ 3 = ₹ 15 Closing stock (at cost) ₹ 75,000 x (₹ 12 / ₹ 15) = ₹ 60,000 Reduction in stock ₹ 75,000 – ₹ 60,000 = ₹ 15,000.	(₹ 40,000 – ₹ 15,000) × 10/100 = ₹ 2,500 **(3)** Cash shortage will be treated as misappropriation by employees and it is assumed that there is no insurance coverage. It is incidental to business and normal and should be charged to Profit and Loss Account.

(4) Though the effects of advertisement is expected to last for 5 years, 4/5 of ₹ 10,000, i.e., ₹ 8,000 cannot be shown as an asset in the Balance Sheet as Deferred Revenue Expenditure. Because the framework for preparation and presentation of Financial Statements states that "***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably***.
Therefore, the entire amount of advertisement expenses of ₹ 10,000 is to be charged to the Profit and Loss Account.
[For details, see ***Chapter 7 : 'Revenue Recognition – Page 7.8 (Recognition of Expenses).]***

Illustration 27

The following Trial Balance has been prepared by Acharya as on 31.3.1999 :

Particulars	Dr. (₹)	Cr. (₹)
Capital and Drawings	3,600	90,400
Stock (1.4.1998)	12,300	
Wages	16,400	
Plant and Machinery	34,000	
Sundry Debtors	13,160	*1,000
Sundry Creditors		12,750
Purchases and Sales	52,300	99,150
Freehold Property	29,700	
Returns	320	540
Salaries	12,800	
Rent	2,400	
Outstanding Rent		200
Trade Expenses	2,060	
Furniture and Fixtures	3,100	
Bad Debts	560	
Provision for Bad Debts		480
Patent and Trademark	4,100	

Electricity	1,290	
Loose Tools	1,510	
Advertisement Suspense	4,200	
Gas and Fuel	2,050	
Insurance	1,330	
Bank	5,200	
Cash	2,140	
TOTAL	2,04,520	2,04,520

*Advance

Additional information :

(i) Stock was not taken on 31.3.1999 but actually taken on 7.4.2015 at ₹ 10,200. Transactions during the week ended 7.4.1999 were :
Sales — ₹ 12,800; Purchases — ₹ 8,100
A uniform $16^2/_3$% profit is made on the selling price.

(ii) ₹ 510 received from a debtor whose balance had been written-off as bad, was recorded as Cash Sale.

(iii) Private goods of Acharya costing ₹ 2,400 sold for ₹ 2,880 was included in Sales.

(iv) Advance from customers is entitled to 12% interest which is due for 2 months.

(v) Electricity expenses include a deposit of ₹ 600 to the W.B. State Electricity Board.

(vi) The effect of advertisement is expected to last for the coming two years also.

(vii) A furniture costing ₹ 1,600 purchased on 31.12.1998 from M/s Assam Furniture Mart on credit was omitted to be recorded.

(viii) Cash embezzled by a dishonest employee — ₹ 900.

(ix) Patent and Trademark is to be amortized in 10 equal instalments.

(x) Provision for Bad Debts is to be adjusted to 5% of Sundry Debtors; Loose Tools are valued at ₹ 1,020. Provide depreciation : @ 10% p.a. on Plant and Machinery; and @ 15% p.a on Furniture.

You are required to prepare Trading and Profit and Loss Account for the year ended 31st March, 1999 and a Balance Sheet as on that date. ***[C.U.B.Com. (Hons.) — 2000]***

Solution

Acharya

Dr. Trading and Profit and Loss Account for the year ended 31st March, 1999 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		12,300	By Sales	99,150	
To Purchases	52,300		Less: Returns	320	
Less: Returns	540	51,760		98,830	
To Wages		16,400	Less: Bad Debts Recovery	510	
To Gas and Fuel		2,050		98,320	
To Gross Profit c/d		25,697	Less: Sale of Private Goods	2,880	95,440
			By Closing Stock (Note 1)		12,767
		1,08,207			1,08,207
To Salaries		12,800	By Gross Profit b/d		25,697
To Rent		2,400	By Bad Debts Recovered		510
To Trade Expenses		2,060	By Net Loss (transferred to Capital Account)		3,756
To Bad Debts		560			
To Electricity	1,290				
Less: Deposit	600	690			
To Advertisement Suspense (Note 3)		4,200			
To Insurance		1,330			
To Cash Embezzlement		900			
To Interest on Customers' Advance		20			
To Provision for Bad Debts :					
New	658				
Less: Old	480	178			
To Depreciation on :					
Plant and Machinery	3,400				
Furniture (Note 2)	525				
Loose Tools (₹ 1,510 – 1,020)	490	4,415			
To Amortization of Patent and Trademark		410			
		29,963			29,963

Balance Sheet of Acharya as at 31st March, 1999

Liabilities	₹	₹	Assets	₹	₹
Capital :			Freehold Property		29,700
Opening balance	90,400		Plant and Machinery	34,000	
Add: Capital Introduced (private goods)	2,880	93,280	Less: Depreciation	3,400	30,600
Less: Net Loss	3,756		Furniture and Fixtures	3,100	
Drawings	3,600	7,356	Add: Further Purchased	1,600	
		85,924		4,700	
Customers' Advance	1,000		Less: Depreciation (Note 2)	525	4,175
Add: Outstanding Interest	20	1,020	Patent and Trademark	4,100	
Sundry Creditors		12,750	Less: Amortization	410	3,690
Creditors for Furniture		1,600	Loose Tools	1,510	
Outstanding Rent		200	Less: Depreciation	490	1,020
			Closing Stock (Note 1)		12,767
			Sundry Debtors	13,160	
			Less: Provision for Bad Debts	658	12,502
			Deposit with WBSEB		600
			Bank		5,200
			Cash	2,140	
			Less: Embezzlement	900	1,240
		1,01,494			1,01,494

Working Notes: (1) Calculation of Closing Stock : Valuation of stock is given as ₹ 10,200 on 7.4.1999. But we are to find out the value of stock as on 31.3.1999. For that, we are to prepare a Memorandum Trading Account for the period 31.3.1999 to 7.4.1999, as under:

Dr. Memorandum Trading Account for the Period 31.3.1999 to 7.4.1999 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	12,767	By Sales	12,800
To Purchases	8,100	By Closing Stock	10,200
To Gross Profit ($16^2/_3$ % of ₹ 12,800)	2,133		
	23,000		23,000

Therefore, the value of closing stock on 31st March, 1999 was ₹ 12,767.

(2) Depreciation on ₹ 3,100 has been charged for the full year and on ₹ 1,600 for 3 months. Therefore, total depreciation : ₹ 465 + 60 = ₹ 525.

(3) Though the effect of advertisement is expected to last for the coming two years also, 2/3rd of ₹ 4,200, i.e., ₹ 2,800 cannot be shown as an asset in the Balance Sheet as Deferred Revenue Expenditure. This is because of the following :
"***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably***."
Therefore, the entire amount of advertisement suspense of ₹ 4,200 is to be charged to the Profit and Loss Account.

Illustration 28

From the following Trial Balance of Sri Samaddar, prepare a Trading and Profit and Loss Account for the year ending on 31st December, 1998 and a Balance Sheet as on that date after taking into consideration the necessary adjustments :

Particulars	Dr. (₹)	Cr. (₹)
Capital and Drawings	10,200	95,000
Stock (1.1.1998)	18,900	
Purchases and Sales	1,38,600	2,02,000
Printing and Stationery	2,600	
Debtors and Creditors	22,800	16,020
Freehold Premises	39,000	
Deposit with Das at 10% (since 30.6.1998)	18,000	
Salaries (including advance ₹ 3,500)	28,200	
Returns	890	1,580
Provident Funds		6,550
Interest on Deposit with Das		450
Furniture and Fixture	8,600	
Trade Expenses	12,650	
Outstanding Trade Expenses		1,600
Provision for Doubtful Debts		2,200
Bad Debt Recovered		700
Income Tax	7,900	

Bank Balance	6,950	
Cash in Hand	6,310	
Patent Right	5,400	
Suspense Account		900
TOTAL	3,27,000	3,27,000

Adjustments :

(i) Last year's closing stock was valued at 10% below cost. Sri Samaddar wants to revert to cost. Stock as on 31.12.1998 was valued at ₹ 16,400 (at cost).

(ii) Goods costing ₹ 650 pilferred by a dishonest employee and furniture (book value on 1.1.1998 ₹ 700) destroyed by an accidental fire on 31.12.1998.

(iii) Bhowmick is included in both debtors and creditors — the amount due from him is ₹ 430 and the amount due to him is ₹ 200.

(iv) New furniture costing ₹ 1,200 was purchased on 31.12.1998 on credit but not yet recorded.

(v) Suspense Account represents a cheque received from a debtor in full settlement of a claim of ₹ 1,000. The cheque was deposited into bank and duly collected also.

(vi) The employer's contribution to provident fund ₹ 1,240 is yet to be paid.

(vii) Write-off ₹ 400 as bad and maintain provision for doubtful debts @ 5% on debtors.

(viii) Depreciate all tangible fixed assets @ 10% p.a. Patent was acquired in 1997 and annual amortization equal to 1/10th of the cost started last year.

(ix) Creditors include suppliers of stationery ₹ 200.

[C.U.B.Com. (Hons.) — 1999]

Solution

Samaddar

Dr. Trading and Profit and Loss Account for the year ended 31st December, 1998 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (Note 1)		21,000	By Sales	2,02,000	
To Purchases	1,38,600		Less: Sales Returns	890	2,01,110
Less: Purchases Returns	1,580		By Closing Stock		16,400
	1,37,020				
Less: Goods Pilferred	650	1,36,370			
To Gross Profit c/d		60,140			
		2,17,510			2,17,510
To Goods Pilferred		650	By Gross Profit b/d		60,140
To Printing and Stationery		2,600	By Interest on Deposit	450	
To Salaries	28,200		Add: Accrued Interest	450	900
Less: Advance Salary	3,500		By Provision for Doubtful Debts :		
	24,700		Old	2,200	
Add: Employer's contribution to P.F.	1,240	25,940	Less: New (Note 2)	1,060	1,140
To Trade Expenses		12,650	By Bad Debts Recovered		700
To Loss on Furniture Destroyed (Note 3)		630			
To Discount Allowed (₹ 1,000 – 900)		100			
To Bad Debts		400			
To Depreciation on :					
Freehold Premises	3,900				
Furniture and Fixture (Note 4)	860	4,760			
To Amortization of Patent Right (₹ 5,400 / 9)		600			
To Net Profit c/d (Current)		14,550			
		62,880			62,880
To Net Profit c/d (Transferred to Capital A/c)		16,650	By Net Profit b/d		14,550
			By Opening Stock		2,100
		16,650			16,650

Balance Sheet of Samaddar as at 31st December, 1998

Liabilities	₹	₹	Assets	₹	₹
Capital :			Freehold Premises	39,000	
Opening Balance	95,000		Less: Depreciation	3,900	35,100
Add: Net Profit	16,650	1,11,650	Furniture and Fixture (Note 4)	9,100	
Less: Drawings	10,200		Less: Depreciation	790	8,310
Income Tax	7,900	18,100	Patent Right	5,400	
		93,550	Less: Amortization	600	4,800
Provident Fund	6,550		Debtors (Note 2)	21,200	
Add: Employer's Contribution	1,240	7,790	Less: Provision for Doubtful Debts	1,060	20,140

Creditors for :			Deposit with Das	18,000	
Goods	16,020		Add: Accrued Interest	450	18,450
Less: Mutual Indebtedness	(200)		Closing Stock		16,400
Creditors for Stationery	(200)		Advance Salaries		3,500
	15,600		Bank Balance		6,950
Furniture	1,200		Cash in Hand		6,310
Stationery	200	17,020			
Outstanding Trade Expenses		1,600			
		1,19,960			1,19,960

Working Notes :

(1) Last year's closing stock is this year's opening stock, which is valued at 10% below cost. Therefore, it appears in the Trial Balance at 90%. In effect, the actual cost of opening stock = ₹ 18,900 / 90% = ₹ 21,000. Assuming that the market value of opening stock is more than ₹ 21,000, the value of opening stock is to be increased by ₹ 2,100 (₹ 21,000 – 18,900).

Tutorial Note : Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.*** This is a prior period item.Therefore,it is to be shown in the Profit and Loss Account itself. It is better to show this after determination of current year's profit.

(2) Closing Value of Debtors

	₹
Debtors as per Trial balance	22,800
Less: Received from a Debtor	1,000
	21,800
Less: Mutual Indebtedness	200
	21,600
Less: Bad Debts	400
Closing Value of Debtors	21,200

Provision is required = 5% on ₹ 21,200 = ₹ 1,060.

(3) Loss on Furniture Destroyed

Book value of furniture destroyed ₹ 700. Depreciation @ 10% p.a. for 1 year = 10% of ₹ 700 = ₹ 70.
Therefore, loss on furniture destroyed = ₹ (700 – 70) = ₹ 630.

(4) Closing Value of Furniture and Fixture and Depreciation Thereon

		₹
Book value as per trial balance		8,600
Less: Book value of furniture destroyed on 31.12.1998		700
		7,900
Add: Purchase of furniture		1,200
		9,100
Depreciation @ 10% p.a. on ₹ 700		70
	₹ (8,600 – 700)	790
	₹ 1,200	—
		860

Illustration 29

The accountants of Mr P Sundaram, a sole proprietor of a business, extracted the following Trial Balance as on 31.3.2002:

Particulars	Dr. (₹)	Cr. (₹)
Cash	16,000	
Bank	25,000	
Petty Cash	1,000	
Furniture and Fixture	10,000	
Plant and Machinery	50,000	
Capital		60,000
Drawings	10,000	
Insurance	1,000	
Salaries	12,000	
Wages	5,000	
Sundry Debtors	22,000	
Stock (as on 1.4.2001)	28,000	
Trademark Rights (10 years from 1.4.1999)	32,000	
Rent and Rates	5,000	
Purchases	1,40,000	
Freight Inward	10,000	
Postage and Trade Expenses	5,000	
Bad Debts	1,000	

9% Loan taken from D Kumaran (1.10.2001)		15,000
Interest on Loan	500	
Creditors		37,500
Bills Receivable	10,000	
Sales		2,60,000
Outstanding Liability for Expenses	1,000	
Petty Cash Expenses	3,000	
Bills Payable		15,000
TOTAL	3,87,500	3,87,500

Adjustments :

(i) Stock lying in godown as on 31.3.2002 ₹ 38,000.

(ii) Invoices of the value of ₹ 5,000 were recorded in Sales Book on 27.3.2002 but goods were not dispatched until 5.4.2015. The cost of such goods was ₹ 4,000.

(iii) The Petty Cash balance represents the month-end imprest amount. As on 31.3.2002 the petty cashier had vouchers totalling to ₹ 400 for which he had not received reimbursement from the main cashier.

(iv) Rent and rates of ₹ 1,000 relating to 2000-01 had not been provided in that year but were paid in May, 2014 by debiting outstanding liability for expenses.

(v) Bills receivable of ₹ 5,000 were endorsed in favour of creditors during the year 2001-02. Of these bills, a bill for ₹ 2,000 was dishonoured but not recorded in the books. Other bills would mature in June 2002.

(vi) Two dishonoured cheques of ₹ 400 and ₹ 600 respectively had not been entered in the Cash Book. The first cheque for ₹ 400 was known to be bad. In case of the second cheque, it was expected that the debtor would be in a position to pay only 50 paise in a rupee. For other debtors, provision for doubtful debts to be provided @ 5%.

(vii) Provide depreciation on all tangible fixed assets @ 10% p.a.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2002 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — 2003]

Solution

P. Sundaram

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2002 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		28,000	By Sales		2,60,000
To Purchases	1,40,000		By Closing Stock (₹ 38,000 – 4,000)		34,000
Add: Freight Inward	10,000	1,50,000			
To Wages		5,000			
To Gross Profit c/d		1,11,000			
		2,94,000			2,94,000
To Insurance		1,000	By Gross Profit b/d		1,11,000
To Salaries		12,000			
To Rent and Rates		5,000			
To Postage and Other Trade Expenses		5,000			
To Bad Debts (₹ 1,000 + 400)		1,400			
To Provision for Doubtful Debts (Note 2)		1,500			
To Petty Cash Expenses (₹ 3,000 + 400)		3,400			
To Interest on Loan	500				
Add: Outstanding Interest	175	675			
To Depreciation on :					
Plant and Machinery	5,000				
Furniture and Fixture	1,000	6,000			
To Amortization of Trademark Rights (Note 4)		4,000			
To Net Profit c/d (Current)		71,025			
		1,11,000			1,11,000
To Outstanding Liability for Expenses (Note 1)		1,000	By Net Profit b/d		71,025
To Net Profit (Transferred to Capital Account)		70,025			
		71,025			71,025

Balance Sheet of P. Sundaram as at 31st March, 2002

Liabilities	₹	₹	Assets	₹	₹
Capital :			Plant and Machinery	50,000	
Opening Balance	60,000		Less: Depreciation	5,000	45,000
Add: Net Profit	70,025		Furniture and Fixture	10,000	
	1,30,025		Less: Depreciation	1,000	9,000
Less: Drawings	10,000	1,20,025	Trademark Rights	32,000	
9% Loan	15,000		Less: Amortization (Note 4)	4,000	28,000
Add: Outstanding Interest (Note 5)	175	15,175	Closing Stock		34,000
Creditors	37,500		Sundry Debtors (Note 2)	24,600	
Add: Endorsed Bill Dishonoured	2,000	39,500	Less: Provision for Doubtful Debts	1,500	23,100
Bills Payable		15,000	Bills Receivable		10,000
			Bank (Note 3)		24,000
			Cash		16,000
			Petty Cash (₹ 1,000 – 400)		600
		1,89,700			1,89,700

Working Notes :

(1) An amount of ₹ 1,000 paid during the year for rent and rates is actually related to the previous year. When this payment was made, Outstanding Liability for Expenses Account was debited and cash Account was credited.
Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.***
This is a prior period item. Therefore, it is to be shown in the Profit and Loss Account itself. It is better to show this after determination of current year's profit.

(2) Ascertainment of Closing Debtors and Provision for Doubtful Debts

	₹
Debtors as per Trial Balance	22,000
Add: Dishonoured cheque	600
Endorsed bill dishonoured	2,000
	24,600
Provision for Doubtful Debts :	
50% on ₹ 600	300
5% on ₹ (24,600 – 600)	1,200
	1,500

(3) Bank Balance

Balance as per Trial Balance	25,000
Less: Dishonoured cheques (₹ 400 + 600)	1,000
	24,000

(4) Remaining life of trade mark right is 8 years. The amount is to be amortized = ₹ 32,000 / 8 = ₹ 4,000.

(5) Interest on loan from D Kumaran = ₹ 15,000 × 9/100 × 1/2 = ₹ 675. Out of ₹ 675 only ₹ 500 has been paid. Therefore, ₹ 125 is outstanding.

Illustration 30

From the following balances and information, prepare Trading and Profit and Loss Account of Mr A Sen for the year ended 31st December, 2001 and a Balance Sheet as on that date :

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Stock (1.1.2001)	15,100	Sales	1,67,200
Purchases	94,500	Returns Outward	1,500
Wages	30,900	Provision for Doubtful Debts	3,200
Electricity	3,750	Sundry Creditors	35,600
Furniture	12,500	Capital	80,000
Machinery	18,000	Discount Received	1,280
Motor Car	10,240		
Fuel	3,180		
Rent @ ₹ 450 p.m.	4,050		
Printing and Stationery	5,200		
Fixed Deposit (at 10% p.a.)	25,000		
Sundry Debtors	42,000		
Discount Allowed	1,400		
Insurance Premium	4,800		
Telephone Charges	3,750		
Bad Debts	500		
Bank	11,300		
Cash	2,610		
	2,88,780		2,88,780

Other information :

(i) Stock on 31.12.2001 is ₹ 26,700. The stock includes goods returned by a customer on 31st December, 2001 to the value of ₹ 2,200 for which no entry has been made.

(ii) Stock valuing ₹ 5,000 destroyed by fire. ₹ 500 realised through sale of damaged goods and insurance company paid ₹ 3,000 only against the claim.

(iii) Mr A Sen has been providing for depreciation on motor car @ 20% under Diminishing Balance Method. Now he wants to provide depreciation @ 6% under Straight-line Method with effect from 1.1.1998(the date of purchase of the motor car).

(iv) Mr A Sen's bank has debited ₹ 150 in the Pass Book as clearing charge which has not been entered in the Cash Book.

(v) Creditors include a balance of ₹ 1,600 to the credit of S Chand in respect of which it has been decided and settled with the party to pay only ₹ 1,000.

(vi) Provide depreciation on machinery @ 15% and on furniture @ 10% per annum.

(vii) A debtor of ₹ 12,000 accepted a bill drawn by Mr Sen.

(viii) Create a provision for doubtful debts at 5% on Sundry Debtors. *[C.U.B.Com. (Hons.) — 2002]*

Solution

A. Sen

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2001 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,100	By Sales	1,67,200	
To Purchases	94,500		Less: Returns Outward	(2,200)	
Less: Returns Outward	1,500	93,000	Sale of Damaged Goods	(500)	1,64,500
To Wages		30,900	By Stock Destroyed by Fire		5,000
To Fuel		3,180	By Closing Stock		26,700
To Gross Profit c/d		54,020			
		1,96,200			1,96,200
To Electricity		3,750	By Gross Profit b/d		54,020
To Rent	4,050		By Discount Received		1,280
Add: Outstanding	1,350	5,400	By Interest on Fixed Deposit		2,500
To Printing and Stationery		5,200	By Creditors (₹ 1,600 – 1,000)		600
To Discount Allowed		1,400	By Provision for Doubtful Debts :		
To Insurance Premium		4,800	Old	3,200	
To Telephone Charges		3,750	Less : New (Note 1)	1,390	1,810
To Bad Debts		500	By Motor Car (Note 2)		6,160
To Loss on Stock Destroyed by Fire (₹ 5,000 – 500 – 3,000)		1,500			
To Depreciation on :					
Machinery	2,700				
Motor Car (Note 2)	1,200				
Furniture	1,250	5,150			
To Bank Charges		150			
To Net Profit (transferred to Capital Account)		34,770			
		66,370			66,370

Balance Sheet of A. Sen as at 31st December, 2001

Liabilities	₹	₹	Assets	₹	₹
Capital :			Machinery	18,000	
Opening Balance	80,000		Less: Depreciation	2,700	15,300
Add: Net Profit	34,770	1,14,770	Furniture	12,500	
Sundry Creditors (₹ 35,600 – 600)		35,000	Less: Depreciation	1,250	11,250
Outstanding Rent		1,350	Motor Car (Note 2)	16,400	
			Less: Depreciation	1,200	15,200
			10% Fixed Deposit	25,000	
			Add: Accrued Interest	2,500	27,500
			Sundry Debtors (Note 1)	27,800	
			Less: Provision for Doubtful Debts	1,390	26,410
			Bills Receivable		12,000
			Closing Stock		26,700
			Bank (Note 3)		14,150
			Cash		2,610
		1,51,120			1,51,120

Working Notes :

(1) Closing Value of Debtors and Related Provision

	₹
Debtors as per Trial Balance	42,000
Less: Returns not recorded	2,200
	39,800
Less: Debtor accepted bill	12,000
	27,800

Provision for doubtful debts : @ 5% on ₹ 27,800 = ₹ 1,390.

(2) Let the original cost of motor car on 1.1.1998

Let the original cost of motor car on 1.1.1998	100.00
Less: Depreciation @ 20% for 1998	20.00
	80.00
Less: Depreciation @ 20% on ₹ 80 for 1999	16.00
	64.00
Less: Depreciation @ 20% on ₹ 64 for 2000	12.80
Written-down Value on 31.12.2000	51.20

When written-down value is ₹ 51.20 the original cost is ₹ 100.
When written-down value is ₹ 1.00 the original cost is 100 / 51.20
When written-down value is ₹ 10.240 the original cost is 100 / 51.20 × 10.240 = ₹ **20,000**.

Adjustment for Depreciation

Diminishing Balance Method	₹	Straight Line Method	₹
1998 (20% x ₹ 20,000)	4,000	1998	1,200
1999 (20% x ₹ 16,000)	3,200	1999	1,200
2000 (20% x ₹ 12,800)	2,560	2000	1,200
	9,760		3,600

Depreciation over-charged = ₹ 9,760 – 3,600 = ₹ 6,160.
Valuation of motor car after adjustment of over-depreciation will be : ₹ 10,240 + 6,160 = ₹ **16,400**.
For adjusting over-depreciation, the following entry is passed :

Motor Car Account	Dr.	₹ 6,160	
To Profit and Loss Account			₹ 6,160

Tutorial Note : This problem has been solved as per AS—6. It should be noted that at present, AS—6 has been withdrawn.

	₹
Bank balance as per Trial Balance	11,300
Add: Insurance claim received	3,000
	14,300
Less: Bank charges	150
	14,150

Illustration 31

Following is the Trial Balance of X as on 31.3.2017. You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2017 and a Balance Sheet as on that date.

Particulars	Dr. (₹)	Cr. (₹)
Capital		60,000
Plant and Machinery	18,000	
Depreciation on Plant and Machinery	2,000	
Repairs to Plant	1,600	
Wages	28,000	
Salaries	4,000	
Income Tax	500	
Cash in Hand	2,000	
Land	24,500	
Depreciation on Building	2,500	
Purchases less Returns	1,23,500	
Sales		2,49,000
Bank Overdraft		13,800
Accrued Income	1,500	
Salaries Outstanding		2,000

Bills Receivable	30,000	
Bills Payable		3,000
Provision for Bad and Doubtful Debts		6,000
Bad Debts	1,000	
Discount Received		4,000
Sundry Debtors	35,000	
Sundry Creditors		23,300
Opening Stock (1.4.2016)	37,000	
Building	50,000	
TOTAL	3,61,100	3,61,100

Additional information :

(1) Stock on 31.3.2017 was ₹ 30,000.

(2) Write-off ₹ 3,000 as bad debts and maintain a provision for bad and doubtful debts at 5% on sundry debtors.

(3) Goods costing ₹ 5,000 were sent to a customer on "Sale or Approval Basis" on 30.3.2017. These were recorded as actual sales. The rate of gross profit was 1/6th of sales.

(4) ₹ 1,200 paid as rent of the office were debited to landlord account and were included in sundry debtors.

(5) General Manager is to be paid commission at 10% after charging the commission of Works Manager and his own on net profits.

(6) Works Manager is to be given commission at 5% after charging commission of General Manager and his own on net profits. Such commission shall be calculated to the nearest multiple of rupee.

Solution

Mr. X

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

Particulars		₹	Particulars		₹
To Opening Stock		37,000	By Sales	2,49,000	
To Purchase (less returns)		1,23,500	Less: Sale or Approval	6,000	2,43,000
To Wages		28,000	By Closing Stock	30,000	
To Gross Profit c/d		89,500	Add: Sale or Approval (Note 3)	5,000	35,000
		2,78,000			2,78,000
To Salaries		4,000	By Gross Profit b/d		89,500
To Rent		1,200	By Provision for Bad and Doubtful Debts (Note 2)		760
To Depreciation :			By Discount Received		4,000
Plant and Machinery	2,000				
Building	2,500	4,500			
To Repairs to Plant		1,600			
To General Manager's Comm. (Note 1)		7,214			
To Works Manager's Commission (Note 1)		3,607			
To Net Profit (transferred to Capital)		72,139			
		94,260			94,260

Working Notes (1) : Net profit before charging Commission ₹ 82,960

Less : Works Manager's Commission (see below)	₹ 3,607	
General Manager's Commission	₹ 7,214	₹ 10,821
Net Profit after charging Commission		₹ 72,139

Let x be the total commission to General Manager and y be the total commission to Works Manager.

$x = 10/110$ (₹ $82{,}960 - y$) . . . . (1)

$y = 5/105$ (₹ $82{,}960 - x$) . . . . (2)

or, $x = .09091$ (₹ $82{,}960 - y$) . . . . (1) $y = .04762\ (82{,}960 - x)$

or, $x + .091\ y = 7{,}541.818$

or, $x + 21\ y = 82{,}960$

$x + .09091\ y = 7541.818$

$20.909\ y = 75418.18$

or, $y =$ **3,607** and $x = .82960 - 21 \times 3{,}606.97$

or $x = 7{,}213.58$ (say) **7,214.**

Balance Sheet of Mr X as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital : Opening	60,000		Plant and Machinery	20,000	
Add: Net Profit	72,139		Less: Depreciation	2,000	18,000
	1,32,139		Land		24,500
Less: Drawings (Income tax)	500	1,31,639	Building	52,500	
Commission payable to General Manager		7,214	Less: Depreciation	2,500	50,000
Commission payable to Works Manager		3,607	Closing Stock	30,000	
Sundry Creditors		23,300	Add: Sales or Approval	5,000	35,000
Bills Payable		3,000	Sundry Debtors	24,800	
Bank Overdraft		13,800	Less: Prov. for Bad & Doubtful Debts	1,240	23,560
Salaries Outstanding		2,000	Bills Receivable		30,000
			Cash in hand		2,000
			Accrued Income		1,500
		1,84,560			1,84,560

(2) Provision for Bad and Doubtful Debts Account

	₹		₹
To Bad Debts	1,000	By Balance b/f	6,000
To Bad Debts	3,000		
To Profit & Loss A/c	760		
To Balance c/d	1,240		
	6,000		6,000

Calculation of Closing Debtors

Sundry Debtors		35,000
Less: Sale or Approval	6,000	
Bad debts	3,000	
Rent	1,200	10,200
		24,800
Less: New prov. for bad debts		1,240
Closing Sundry Debtors		23,560

(3) Cost price of stock of goods sent on sale or approval = ₹ 6,000 – 1/6 (₹ 6,000) = ₹ 5,000.

Illustration 32

Following is the Trial Balance of Sri Rahul as at 31.12.1993. You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.1993 and a Balance Sheet as on that date after making necessary adjustments:

Debit Balances	₹	Credit Balances	₹
Purchases	60,000	Sales	1,00,000
Sales Ledger Balances	30,400	Purchases Ledger Balances	24,400
Returns Inward	2,000	Discount Received	600
Discount Allowed	2,000	Returns Outward	2,400
Building	44,000	Capital	53,200
Depreciation on Building	2,000	Suspense Account	2,000
Income Tax	2,000	Goods Sent on Consignment	5,000
Wages	4,000	Profit on Consignment	1,000
Salaries	6,000	Apprenticeship Premium (for the year ending 31.3.1994)	2,400
Consignment Stock (31.12.1993)	1,200	Provision for Bad Debts	2,000
Stock-in-Trade (1.1.1993)	20,000	Commission	1,600
Trade Expenses	4,000		
Insurance	400		
Cash at Bank	12,600		
Deposit with Asha	4,000		
	1,94,600		1,94,600

Adjustments :

(i) Stock-in-trade on 31.12.1993 was valued at ₹ 20,000.

(ii) Stock valued at ₹ 4,000 was destroyed by fire on 25.12.1993 for which insurance company admitted a claim of ₹ 2,400 only.

(iii) Deposit with Asha was realised together with interest @ 10% p.a. for 6 months and deposited the same into Fixed Deposit Account with Bank of India on 1.10.1993 bearing interest @ 16% p.a., but no entry had since been made.

(iv) Out of purchases, goods of ₹ 4,000 was distributed as free samples.

(v) Suspense Account represents a cheque received from Bapi, a customer, in settlement of ₹ 2,400 due from him. The cheque was duly deposited and credited by the Bank.

(vi) Maintain provision for bad debts @ 5% on Debtors and provision for discount @ 2% on both Debtors and Creditors.

[C.U.B.Com. (Hons.) — 1994]

Solution

Sri Rahul

Dr. Trading and Profit and Loss Account for the year ended 31st December, 1993 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Stock-in-trade		20,000	By Sales	1,00,000	
To Purchases	60,000		Less: Returns Inward	2,000	98,000
Less: Goods distributed as free sample	4,000		By Stock Lost by Fire		4,000
	56,000		By Closing Stock		20,000
Less: Goods Sent on Consignment	5,000				
	51,000				
Less: Returns Outward	2,400	48,600			
To Wages		4,000			
To Gross Profit c/d		49,400			
		1,22,000			1,22,000
To Salaries		6,000	By Gross Profit b/d		49,400
To Trade Expenses		4,000	By Profit on Consignment		1,000
To Insurance		400	By Discount Received		600
To Discount Allowed	2,000		By Apprenticeship Premium	2,400	
Add: Discount Allowed to Bapi (Note 2)	400	2,400	Less: Received in Advance	600	1,800
To Depreciation on Building		2,000	By Commission		1,600
To Prov. for Discount on Debtors (Note 4)		532	By Interest on Deposit with Asha		200
To Stock Lost by Fire (₹ 4,000 – 2,400)		1,600	By Accrued Interest on Deposit with SBI		168
To Advertisement		4,000	By Provision for Bad Debts :		
(Goods distributed as free sample)			Old	2,000	
To Net Profit (transferred to Capital)		34,924	Less: New (Note 3)	1,400	600
			By Reserve for Disc. on Creditors (Note 5)		488
		55,856			55,856

Balance Sheet of Sri Rahul as at 31st December, 1993

Liabilities	₹	₹	Assets	₹	₹
Capital :			Building		44,000
Opening balance	53,200		Stock-in-trade		20,000
Add: Net Profit	34,924		Consignment Stock		1,200
	88,124		Sales Ledger Balances (30,400 – 2,400)	28,000	
Less: Income Tax (Drawings)	2,000	86,124	Less: Provision for Bad Debts (Note3)	1,400	
Purchase Ledger Balances (Note 6)	24,400			26,600	
Less: Reserve for Discount on Creditors	488	23,912	Less: Provision for Discount on Debtors	532	26,068
Apprenticeship Premium recd. in advance		600	Deposit with Bank of India		4,200
			Accrued Interest on Deposit with BOI		168
			Insurance Claim		2,400
			Cash and Bank		12,600
		1,10,636			1,10,636

Working Notes :

(1) Deposit with Asha was realised alongwith interest @ 10% p.a. on 30.6.1993 and ₹ 4,200 was received. It was deposited with Bank of India at a interest of 16% p.a. on 1.10.1993 Therefore, accrued interest on this deposit will be ₹ 168 (3/12 x 16/100 x ₹ 4,200).

(2) For adjustment of Suspense Account, the following entry is to be passed :

Suspense Account	Dr.	₹ 2,000	
Discount Allowed Account	Dr.	₹ 400	
To Sundry Debtors Account			₹ 2,400

(3) Calculation of Provision for Bad Debts

	₹
Sales Ledger Balance (i.e. Sundry Debtors)	30,400
Less : Adjustment of cheque received from Bapi	(2,000)
Less : Discount allowed to Bapi	(400)
Final balance of Debtors	28,000

Provision for bad debts to be maintained @ 5% on Debtors, i.e. 5% of ₹ 28,000 = ₹ 1,400.

(4) Provision for discount on debtors will be @ 2% on ₹ (28,000 – 1,400) = ₹ 532.

(5) Reserve for discount on creditors will be @ 2% on ₹ 24,400 = ₹ 488.

(6) Purchases Ledger balances means Sundry Creditors. Similarly, Sales Ledger balances means Sundry Debtors.

Illustration 33

The following is the Trial Balance of M/s Ray Traders as at 31st December, 1992. You are asked to prepare the Trading and Profit and Loss Account for the year ended 31st December, 1992 and Balance Sheet as on that date: (all figures in ₹)

Particulars	Dr.	Cr.
Ray's Capital		2,16,000
Stock as on 1st January 1992	93,600	
Sales and sales returns	17,200	5,79,200
Purchase and purchase returns	4,86,200	11,600
Freight and carriage	37,200	
Rent and taxes	11,400	
Salaries and wages	18,600	
Sundry debtors	48,000	
Sundry creditors		29,600
Bank loan (at 12% p.a.)		40,000
Bank Interest on above	3,800	
Advertisement	20,200	
Drawings	20,000	
Income from investments		500
Cash at bank	23,000	
Discount received		8,560
Investments	10,000	
Furniture and fittings	13,600	
Discounts paid	5,080	
General expenses	7,820	
Audit fees	1,400	
Insurance	1,200	
Travelling expenses	4,660	
Postage and telegram	1,740	
Cash in hand	20,760	
Fixed deposit with State Bank of India	40,000	
TOTAL	8,85,460	8,85,460

Additional information:

(a) Closing stock as on 31.12.1992 ₹ 1,57,200.

(b) Included amongst the Debtors is ₹ 6,000 from Mr S. Naha and included amongst the creditors is ₹ 2,000 to Mr S. Naha.

(c) The effect of advertisement being not yet expired, a quarter of the amount of Advertisement is to be carried forward to the next year.

(d) Provide 2% for Discount on Debtors and create a provision for Bad and Doubtful Debts at 5% on Debtors.

(e) Depreciation of 10% is to be written-off on Furniture and fittings.

(f) Wages owing on 31st December, 1992 ₹ 600, and salaries owing ₹ 1,000.

(g) Insurance was paid in advance upto 31st March, 1993.

(h) Furniture which stood at ₹ 1,200 in the books on 1st January, 1992 was disposed of at ₹ 580 on 30th June, 1992 in part exchange for a new furniture costing ₹ 1,040. The net amount payable ₹ 460 was passed through the purchase book by mistake.

(i) Two dishonoured cheques for ₹ 400 and ₹ 600 respectively had not been entered in the cash book. The first for ₹ 400 is known to be bad. In the case of the second cheque for ₹ 600, it is expected that the Debtor would be in a position to pay a dividend of 60 paise in the rupee.

(j) Interest receivable from Fixed Deposit with State Bank of India @ 12% p.a. and provide for interest on Bank loan for the whole year. (working notes must be shown).

[C.U.B.Com. (Hons.) — 1993]

M/s. Ray Traders

Dr. Trading and Profit and Loss Account for the year ended 31st December, 1992 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		93,600	By Sales	5,79,200	
To Purchases (Note 1)	4,85,740		Less: Sales returns	17,200	5,62,000
Less: Purchases returns	11,600	4,74,140	By Closing Stock		1,57,200
To Freight & Carriage		37,200			
To Gross Profit c/d		1,14,260			
		7,19,200			7,19,200
To Rent and Taxes		11,400	By Gross Profit b/d		1,14,260
To Salaries & Wages	18,600		By Income from investments		500
Add: Outstanding salaries & wages	1,600	20,200	By Accrued interest on fixed deposit		4,800
To Advertisement (see Tutorial Note)		20,200	By Discount received		8,560
To Bad debt (dishonoured cheque)		400			
To Discount		5,080			
To General expenses		7,820			
To Audit fees		1,400			
To Interest on loans	3,800				
Add: Accrued interest	1,000	4,800			
To Travelling expenses		4,660			
To Postage & telegram		1,740			
To Provision for bad & doubtful debts (Note 2)		2,540			
To Provision for discount on Debtors (Note 4)		874			
To Loss on exchange of furniture (Note 5)		620			
To Depreciation on furniture & fittings (Note 5)		1,344			
To Insurance premium	1,200				
Less: Prepaid (Note 6)	240	960			
To Net Profit (transferred to Capital)		44,082			
		1,28,120			1,28,120

Balance Sheet of M/s Ray Trader as at 31st December, 1992

Liabilities	₹	₹	Assets	₹	₹
Capital: Opening	2,16,000		Furniture (Note 5)	13,440	
Add: Net profit	44,082		Less: Depreciation 10% (Note 7)	1,344	12,096
	2,60,082		Fixed Deposit with SBI		40,000
Less: Drawings	20,000	2,40,082	Investments		10,000
Sundry Creditors (₹ 29,600 – ₹ 460)	29,140		Closing Stock		1,57,200
Less: Due to S. Naha	2,000	27,140	Sundry Debtors (Note 2)	46,600	
12% Bank Loan	40,000		Less: Provision for bad and doubtful debts	2,540	
Add: Accrued interest (not yet paid)	1,000	41,000		44,060	
Outstanding expenses:			Less: Provision for discount on Debtors	874	43,186
Salaries	1,000		Accrued interest on fixed deposit		4,800
Wages	600	1,600	Prepaid insurance premium		240
Creditors for purchase of furniture		460	Cash at Bank (Note 3)		22,000
			Cash in hand		20,760
		3,10,282			3,10,282

Working Notes: **(1)** Purchases as per Trial Balance ₹ 4,86,200; Less: Purchase of furniture ₹ 460; Net amount = ₹ 4,85,740.

(2) Sundry Debtors	₹	(3) Cash at Bank	₹
As per Balance Sheet	48,000	As per trial balance	23,000
Less: Due from S.Naha	2,000	Less: Dishonoured cheques : ₹ (400 + 600)	1,000
	46,000		22,000
Add: Dishonoured cheque	600	**(4) Provision for Discount on Debtors**	₹
	46,600	@ 2% on (₹ 46,000 – ₹ 2,300)	874
Provision for doubtful debts @ 5% on ₹ 46,000	2,300	No provision for discount is to be created for dishonoured	
Add: Additional provision @ 40% on ₹ 600	240	cheque of ₹ 600.	
	2,540		

(5) Loss on exchange of furniture: Book value of furniture sold is ₹ 1,200. It was exchanged for ₹ 580. Therefore, loss on exchange will be ₹ 1,200 – ₹ 580 = ₹ 620. (No depreciation has been charged on old furniture). To rectify the error for purchase of new furniture, the following entry is to be passed:

New Furniture Account	Dr.	₹ 1,040	
Profit and Loss Account	Dr.	₹ 620	
To Purchases Account			₹ 460
To Old Furniture Account			₹ 1,200

The final balance of Furniture Account will be: ₹ 13,600 – ₹ 1,200 + ₹ 1,040 = ₹ 13,440. Therefore, depreciation will be 10% of ₹ 13,440 = ₹ 1,344.

(6) Insurance of ₹ 1,200 paid for 15 months. Therefore, three month's insurance premium should be carried forward = ₹ 1,200 ÷ 15 × 3 = ₹ 240.

(7) It should be noted that depreciation on furniture is to be charged @ 10% (not 10% p.a.). Therefore, depreciation on new furniture has been charged for the full year and no depreciation has been charged on exchanged furniture.

Tutorial Note :Though it has been given in the problem, a quarter of the amount of Advertisement is to be carried forward to the next year. However, it cannot be shown in the Balance Sheet as deferred revenue expenditure because the Accounting Standards states that "***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably***." So, the entire Advertisement Expenses has been charged to Profit and Loss Account.

Illustration 34

The following is the Trial Balance of Mr. Tendulkar as at 31.3.1995 :

Particulars	Dr. (₹)	Cr. (₹)
Stock (1.4.1994)	45,000	
Sales		3,25,000
Purchases	2,40,000	
Capital		1,30,000
Wages	10,000	
Salaries	15,000	
Discount Allowed	3,000	
Creditors		35,000
Rent and Rates	2,000	
Trade Expenses	15,000	
Purchases Return		3,000
Furniture (1.4.1994)	18,000	
Building	35,000	
Discount Received		2,300
Drawings	10,000	
Bank Current Account	24,000	
Fixed Deposit Bank Account	16,000	
Provision for Doubtful Debts		1,500
Debtors	45,000	
Bills Receivable	10,000	
Cash	8,000	
Sales Return	2,000	
Sale of Furniture		1,200
TOTAL	4,98,000	4,98,000

Prepare Trading and Profit and Loss Account for the year ended 31.3.1995 and the Balance Sheet as on that date after taking into account the following adjustments :

(a) Stock on 31.3.1995 ₹ 40,000.

(b) Opening and Closing stock includes stock of stationery amounting to ₹ 200 and ₹ 150 respectively. Trade Expenses include payment of stationery of ₹ 1,800. Credit purchase of stationery for ₹ 450 recorded as ordinary purchases. Stationery of ₹ 300 is consumed by the proprietor.

(c) Furniture which stood in the books of ₹ 2,000 on 1.4.1994 was sold on 30.9.1994.

(d) Bills receivable include a dishonoured bill of ₹ 1,500 and debtors include an amount of ₹ 1,000 in respect of an insolvent customer whose estate is expected to realise only 50 paise in the rupee.

(e) Tendulkar received ₹ 15,000 from Kambli in respect of joint business with him. The sum received so credited to Sundry Creditors Account. It is noted that a sum of ₹ 5,000 is due to Tendulkar as his share of profit from the business.

(f) During the year the proceeds of a matured fixed deposit amounting to ₹ 14,000 has been credited to Fixed Deposit Account. The original amount was ₹ 10,000.

(g) Provide depreciation on all fixed assets @ 10% p.a. and provide 5% for doubtful debts of unknown nature.

[C.U.B.Com. (Hons.) — 1995]

Solution

Mr. Tendulkar

Dr. Trading and Profit and Loss Account for the year ended 31st March, 1995 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock	45,000		By Sales	3,25,000	
Less: Stock of Stationery	200	44,800	Less: Sales Returns	2,000	3,23,000
To Purchases	2,40,000		By Closing Stock	40,000	
Less: Purchases of Stationery	450		Less: Stock of Stationery	150	39,850
	2,39,550				
Less: Purchases Return	3,000	2,36,550			
To Wages		10,000			
To Gross Profit c/d		71,500			
		3,62,850			3,62,850
To Salaries		15,000	By Gross Profit b/d		71,500
To Discount Allowed		3,000	By Discount Received		2,300
To Rent and Rates		2,000	By Interest on Fixed Deposit		4,000
To Trade Expenses	15,000		By Share of Profit of Joint Business		5,000
Less: Payment for Stationery	1,800	13,200			
To Depreciation on :					
Building	3,500				
Furniture (Note 4)	1,700	5,200			
To Loss on Sale of Furniture (Note 3)		700			
To Stationery (Note 1)		2,000			
To Provision for Doubtful Debts :					
New (Note 2)	2,775				
Less: Old	1,500	1,275			
To Net Profit (transferred to Capital)		40,425			
		82,800			82,800

Balance Sheet of Mr. Tendulkar as at 31st March, 1995

Liabilities	₹	₹	Assets	₹	₹
Capital :			Building	35,000	
Opening Balance	1,30,000		Less: Depreciation (10%)	3,500	31,500
Add: Net Profit	40,425		Furniture	18,000	
	1,70,425		Less: Sale of Furniture	2,000	
Less: Drawings : ₹ (10,000 + 300)	10,300	1,60,125		16,000	
Creditors	35,000		Less: Depreciation	1,600	14,400
Less: Amount received from Kambli	15,000	20,000	Closing Stock	40,000	
Amount due to Kambli	15,000		Less: Stock of Stationery	150	39,850
Less: Share of Profit	5,000	10,000	Stock of Stationery		150
			Fixed Deposit Bank Account	16,000	
			Add: Interest wrongly credited	4,000	20,000
			Sundry Debtors	45,000	
			Add: Dishonoured Bill	1,500	
				46,500	
			Less: Prov. for Doubtful Debts (Note 2)	2,775	43,725
			Bills Receivable	10,000	
			Less: Dishonoured Bill	1,500	8,500
			Bank Current Account		24,000
			Cash		8,000
		1,90,125			1,90,125

Working Notes :

(1) Stationery Consumed

Particulars	₹
Opening Balance	200
Add: Cash Purchases*	1,800
Add: Credit Purchases**	450
	2,450
Less: Closing Balance	150
	2,300

(2) Provision for Doubtful Debts

Particulars	₹
Debtors	45,000
Add: Dishonoured Bill	1,500
	46,500
On ₹ 1,000 @ 50%	500
On ₹ 45,500 @ 5%	2,275
	2,775

Less: Consumed by the Proprietor	300
	2,000
(4) Depreciation on Furniture	₹
Book value on 1.4.1994	18,000
Less: Sale of Furniture	2,000
Book value on 31.3.1995	16,000
Total Depreciation on furniture = 10% of 16,000 = ₹ 1,600	
Add : Depreciation on furniture sold = ₹ 100	1,700

(3) Loss on Sale of Furniture	₹
Book Value of Furniture on 1.4.2014	2,000
Less: Depreciation upto 30.9.2014 (See note below)	100
	1,900
Less: Sale proceeds	1,200
	700

* (included in Trade Expenses)
** (included in Purchases)

Tutorial Note : In this problem, depreciation on furniture sold has been charged for 6 months because it has been asked to charge depreciation on all fixed assets @ 10% p.a. However, in the previous illustration, no depreciation has been charged on furniture disposed off because in that problem, it was asked to charge depreciation @ 10% only (not 10% p.a.)

Illustration 35

Sri Amit is in business as stationery merchant. He also acts as a selling agent of Sri Asit and for this he is given a commission @ 10% on sales. From the following Trial Balance, you are required to prepare Trading and Profit and Loss Account for the year ended 31.12.1995 and a Balance Sheet as on that date after taking into consideration the adjustments noted below:

Particulars	Dr. (₹)	Cr. (₹)
Furniture and fittings	36,000	
Opening Stock	80,000	
Sundry Debtors	75,000	
Sales		6,65,000
Bills Receivable	40,000	
Cash at Bank	36,000	
Cash in Hand	10,000	
Capital		1,90,000
Purchases	5,20,000	
Wages	5,000	
Sundry Creditors		60,000
Salaries	25,000	
Sales Return	3,000	
Purchases Return		2,000
Printing and Advertising	12,000	
Postage	4,500	
Discount Allowed	2,500	
Discount Received		2,000
Drawings	15,000	
Other Trade Expenses	10,000	
Cash Sent to Consignor	75,000	
Consignor's Balance (1.1.1995)		30,000
TOTAL	9,49,000	9,49,000

Adjustments :

(1) Stock on 31.12.1995 valued at cost ₹ 64,000.

(2) The effect of advertising is expected to last for coming year also and as such half of printing and advertising is to be carried forward.

(3) A cheque of ₹ 5,000 received from a customer was returned dishonoured by bank but the same has not been recorded in the books. The customer has become insolvent and 60% is expected to realise from his estate.

(4) Furniture appearing in the books on 1.1.1995 at ₹ 6,000 was disposed of on 30.6.1995 at ₹ 3,500 in part exchange of a new furniture costing ₹ 5,000. A net invoice for ₹ 1,500 was passed through Purchases Day Book.

(5) Provide depreciation on furniture and fittings @ 10% p.a.

(6) Sales include ₹ 75,000 for goods sold in cash on behalf of Sri Asit. Trade expenses also include ₹ 4,000 as expenses in connection with this sale.

(7) Opening stock has been valued at 20% below cost but final accounts should be prepared by taking stock at cost.

[C.U.B.Com. (Hons.) — 1996]

Solution

Sri Amit

Dr. Trading and Profit and Loss Account for the year ended 31st December, 1995 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (Note 1)		1,00,000	By Sales	6,65,000	
To Purchases	5,20,000		Less: Goods sold on Consignment	75,000	
Less: Purchases Return	2,000		(on behalf of Asit)	5,90,000	
Less: Purchase of Furniture	1,500	5,16,500	Less: Sales Return	3,000	5,87,000
To Wages		5,000	By Closing Stock		64,000
To Gross Profit c/d		29,500			
		6,51,000			6,51,000
To Salaries		25,000	By Gross Profit b/d		29,500
To Printing and Advertising	12,000		By Discount Received		2,000
Less: Unexpired Amount	6,000	6,000	By Commission Received (from Asit)		7,500
To Postage		4,500	By Net Loss		12,750
To Discount Allowed		2,500			
To Other Trade Expenses	10,000				
Less: Exp. for Consignment Sale	4,000	6,000			
To Provision for Bad Debts (Note 2)		2,000			
To Depreciation on :					
Furniture in use (Note 3)		3,250			
Furniture Disposed off (Note 4)		300			
To Loss on Exchange of Furniture (Note 5)		2,200			
		51,750			51,750
To Net Loss		12,750	By Opening Stock (See Tutorial Note)		20,000
To Net Profit (Transferred to Capital A/c)		7,250			
		20,000			20,000

Balance Sheet of Sri Amit as at 31st December, 1995

Liabilities	₹	₹	Assets	₹	₹
Capital :			Furniture and Fitting (Note 6)		31,750
Opening balance	1,90,000		Closing Stock		64,000
Add: Net Profit	7,250		Sundry Debtors	75,000	
	1,97,250		Add: Cheque dishonoured	5,000	
Less: Drawings	15,000	1,82,250		80,000	
Sundry Creditors		60,000	Less: Prov. for Bad Debts (Note 2)	2,000	78,000
Balance due to Sri Asit (Note 7)		18,500	Bills Receivables		40,000
			Unexpired Printing and Advertising		6,000
			Cash at Bank : ₹ (36,000 – 5,000)		31,000
			Cash in Hand		10,000
		2,60,750			2,60,750

Working Notes :

(1) Opening stock has been under-valued by 20%. Therefore, it appears in the Trial Balance at 80%. So, the actual cost of opening stock = 80,000 / 80% = ₹ 1,00,000. Assuming that the market value of opening stock is more than ₹ 1,00,000, the value of opening stock is to be increased by ₹ 20,000.

Tutorial Note : Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.*** This is a prior period item.Therefore,it is to be shown in the Profit and Loss Account itself. It is better to show it after determination of current year's profit.

(2) 60% is expected to be realised from the estate of the insolvent debtor owing ₹ 5,000. Therefore, a provision for bad debts is to be created @ 40% on ₹ 5,000, i.e. ₹ 2,000.

(3) Depreciation on old furniture in use = 10% ₹ (36,000 – 6,000) = ₹ 3,000. Depreciation on new furniture for 6 months @ 10% p.a. on ₹ 5,000 = ₹ 250. Therefore, total depreciation on furniture in use = ₹ 3,000 + ₹ 250 = ₹ 3,250.

(4) Depreciation on furniture disposed off = 10% of ₹ 6,000 for 6 months = ₹ 300.

(5) Calculation of Loss on Exchange of Furniture

Particulars	₹
Book value of furniture (exchanged) on 1.1.1995	6,000
Less: Depreciation for 6 months @ 10% p.a.	300
Written-down value on 30.6.1995	5,700
Less: Exchange value	3,500
	2,200

(6) Book Value of Furniture as on 31.12.1995

Particulars	₹
Opening Balance	36,000
Less: Book value of furniture sold	6,000
	30,000
Add: New furniture purchased	5,000
	35,000
Less: Depreciation for 2015 (Note 3)	3,250
	31,750

Dr. (7) Sri Asit (Consignor) Account Cr.

Particulars	₹	Particulars	₹
To Cash Sent to Consignor A/c	75,000	By Balance b/d	30,000
To Trade Expenses	4,000	By Sales	75,000
To Commission on Sale @ 10%	7,500		
To Balance c/d	18,500		
	1,05,000		1,05,000

Illustration 36

From the following Trial Balance of Sri Sengupta and the additional information, prepare a Trading and Profit and Loss Account for the year ending on 31.12.1997 and a Balance Sheet as at that date :

Debit Balances	₹	Credit Balances	₹
Materials Consumed	1,75,000	Capital	75,000
Stock on 31.12.1997	37,500	Sales	3,00,000
Debtors	30,000	Creditors	25,000
Wages — Productive	45,000	Commission Received	1,500
Wages — Others	7,500	Special Rebate Received	2,000
Salaries	7,500	Suspense Account — Sri Roy	27,500
Electric Charges	2,500		
Freight and Insurance on Purchases	1,500		
Delivery Charges	1,000		
Depreciation	5,000		
Commission Paid	1,000		
Special Rebate Allowed	1,000		
Plant and Machinery	32,500		
Furniture	6,500		
Land and Building	47,500		
Suspense Account — Smt. Banerjee	10,000		
Drawings	7,500		
Cash	2,000		
Bank	10,500		
	4,31,000		4,31,000

Additional information :

(a) Salary includes the proprietor's salary of ₹ 3,000 for the year.

(b) Suspense Account of Sri Roy represents a cheque received from him against sale proceeds of goods sent to him on consignment. Goods costing ₹ 32,500 were sent to him on consignment. 4/5th of the goods were sold by him for ₹ 45,000. He is entitled to a commission at 10% on sale proceeds. The only entry passed in this connection was for the cheque received from him.

(c) Suspense Account of Smt. Banerjee represents an advance of ₹ 10,000 to her in connection with a joint venture agreement entered into with her for which she is to get 2/5th share of profit. It is ascertained that the venture has earned a profit of ₹ 7,500.

(d) The scrutiny of the Schedule of Debtors reveals the following :
(i) ₹ 7,500 fully realisable; (ii) ₹ 5,000 — 75% realisable; (iii) ₹ 2,500 — 50% realisable; (iv) Provision for doubtful debts has to be provided for at 5% on the balance besides the amount that may be required as above.

[C.U.B.Com. (Hons.) — 1998]

Solution

Sri Sengupta

Dr. Trading and Profit and Loss Account for the year ended 31st December, 1997 Cr.

Particulars		₹	Particulars	₹
To Materials Consumed		1,75,000	By Sales	3,00,000
To Wages — Productive		45,000	By Goods Sent on Consignment	32,500
To Freight and Insurance on Purchases		1,500		
To Gross Profit c/d		1,11,000		
		3,32,500		3,32,500
To Wages — Others		7,500	By Gross Profit b/d	1,11,000
To Salaries	7,500		By Commission Received	1,500
Less: Proprietor's salary	3,000	4,500	By Special Rebate Received	2,000
To Electric Charges		2,500	By Profit on Consignment (Note 1)	14,500
To Delivery Charges		1,000	By Profit on Joint Venture (3/5th of ₹ 7,500)	4,500
To Depreciation		5,000		
To Commission Paid		1,000		
To Special Rebate Allowed		1,000		
To Provision for Doubtful Debts (Note 4)		3,250		
To Net Profit (transferred to Capital)		1,07,750		
		1,33,500		1,33,500

Balance Sheet of Sri Sengupta as at 31st December, 1997

Liabilities	₹	₹	Assets	₹	₹
Capital :			Land and Building		47,500
Opening Balance	75,000		Plant and Machinery		32,500
Add: Net Profit	1,07,750		Furniture		6,500
	1,82,750		Closing Stock		37,500
Less: Drawings : ₹ (7,500 + 3,000)	10,500	1,72,250	Stock on Consignment		6,500
Creditors		25,000	Debtors	30,000	
			Less: Provision for Doubtful Debts	3,250	26,750
			Amount Due from Smt. Banerjee (Note 3)		14,500
			Amount Due from Sri Roy (Note 2)		13,000
			Cash at Bank		10,500
			Cash in Hand		2,000
		1,97,250			1,97,250

Working Notes :

Dr. (1) Consignment to Sri Roy Account Cr.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	32,500	By Sri Roy A/c — Sales Proceeds	45,000
To Sri Roy A/c — Commission 10% on ₹ 45,000	4,500	By Stock on Consignment A/c (1/5 of ₹ 32,500)	6,500
To Profit on Consignment A/c	14,500		
	51,500		51,500

Dr. (2) Sri Roy Account Cr.

Particulars	₹	Particulars	₹
To Consignment to Sri Roy A/c	45,000	By Suspense A/c — Sri Roy	27,500
		By Consignment A/c (commission)	4,500
		By Balance c/d	13,000
	45,000		45,000

Dr. (3) Smt. Banerjee Account Cr.

Particulars	₹	Particulars	₹
To Suspense A/c — Smt. Banerjee	10,000	By Balance c/d	14,500
To Share of Profit — 3/5 of ₹ 7,500	4,500		
	14,500		14,500

(4) Calculation of Provision for Doubtful Debts

	₹	
(i) On ₹ 7,500	Nil	
(ii) On ₹ 5,000 @ 25%	1,250	
(iii) On ₹ 2,500 @ 50%	1,250	
(iv) On ₹ 15,000 @ 5%	750	3,250

Key Points

- Trading Account is prepared to know the gross profit or overall profit. Profit and Loss Account discloses net profit or clear profit of the business. The Balance Sheet shows the financial position of the business on a given date — generally on the last date of the accounting period.
- Freight and insurance paid in connection with acquiring goods or making them saleable is debited to Trading Account. Freight and insurance paid in connection with the sale of goods is charged to Profit and Loss Account.
- When goods are purchased within municipality limits, generally octroi duty has to be paid on it. It is debited to Trading Account.
- Needs of Preparing Trading Account
  1. The preparation of Trading Account helps to calculate the result of buying and selling of goods and services.
  2. The preparation of Trading Account helps to calculate the percentage of gross profit on sales.
  3. The percentage of gross profit on sales can be compared with that of the previous year(s), to have an idea about the progress of the business.
  4. A Trading Account helps make a distinction between direct and indirect expenses.
- The Profit and Loss Account can be defined as a report that summarises the revenues and expenses of an accounting period to reflect the changes in various critical areas of firm's operations
- A Balance Sheet is a list of assets and claims of a business at some specific point of time and is prepared from an adjusted Trial Balance. It shows the financial position of a business by detailing the sources of funds and the utilisation of these funds. A Balance Sheet shows the assets and liabilities grouped, properly classified and arranged in a specific manner.

THEORETICAL QUESTIONS

1. What is a Trading Account? Why is it prepared?
2. What do you mean by Profit and Loss Account? Why is it prepared?
3. What adjustments are usually necessary at the time of preparing the Final Accounts?
4. What are closing entries? How are various accounts closed?
5. What adjusting entries would you pass in respect of (i) Income received in advance; (ii) Outstanding expenses; (iii) Accrued Income; and (iv) Depreciation?
6. What is Balance Sheet? Distinguish between Profit and Loss Account and Balance Sheet. What are the uses and limitations of the Balance Sheet?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Relating to the 'closing stock' for an accounting period, which of following is true ?
   A the figure is shown only in the trading account
   B the figure is shown only in the balance sheet
   C the figure is shown in the trading account and the balance sheet
   D the figure is shown as part of purchases in the trading account
2. Depreciation of a delivery van used for carriage inwards and carriage outwards will appear in
   A profit and loss account
   B trading account
   C trading account and profit and loss account
   D profit and loss account and balance sheet
3. A profit on the disposal of a fixed asset can also be described as an :
   A over-provision for depreciation on the asset
   B increase in fixed assets on the balance sheet
   C increase in the bank balance
   D under-provision for depreciation on the asset

4. What is the effect of overvaluing closing stock on the current year's profits ?
   A decreases the gross profit and net profit
   B increases the gross profit but decreases net profit
   C decreases the gross profit and increases net profit
   D increases the gross profit and net profit
5. Which of the following would appear in a trading account ?
   A discount allowed
   B carriage outward
   C carriage inward
   D discount received
6. How should a contingent liability be included in a firm's financial statements if the likelihood of a transfer of economic benefit to settle it is remote ?
   A disclosed by note with some provisions being made
   B disclosed by note with no provision being made
   C neither disclosure nor provision is required
   D adequate provision should be made
7. Which of the following should be classified as current liabilities ?
   (i) sundry debtors
   (ii) sales tax payable
   (iii) sundry creditors
   (iv) investments
   A (i) and (ii)
   B (i) and (iv)
   C (ii) and (iii)
   D (iii) and (iv)
8. Which of the following would be classified as revenue expenditure for a shop ?
   (i) assistant's wages
   (ii) trade licence fee paid
   (iii) purchase of a new shop counter
   (iv) repainting of the outside of the shop
   A (i) and (ii)
   B (i) and (iv)
   C (i) and (iii)
   D (i); (ii) and (iv)
9. Relating to the opening and closing stock for a financial period, which of the following is true ?
   A both figures are shown in the trading account but only the opening stock is shown in the balance sheet
   B only the opening stock is shown in the trading account, but both figures are shown in the balance sheet
   C both figures are shown in the trading account but only the closing stock is shown in the balance sheet
   D only the closing stock is shown in the trading account, but both figures are shown in the balance sheet
10. Which of the following is capital expenditure ?
   A cost of installing a new machine
   B interest paid on loan borrowed to finance the purchase of a new machine
   C cost of replacing parts to maintain the efficiency of a machine
   D cost of electricity to run a machine
11. Which of the following is not capital expenditure ?
   A a major overhaul to the motor of a delivery van to extend its useful life
   B an air-conditioner fixed to a delivery van
   C cost of replacing tyres of a delivery van
   D an extra body is added to a delivery van to increase the carrying capacity
12. Which of the following is not shown in the balance sheet ?
   A fixed deposit
   B opening stock
   C mortgage on land
   D bank overdraft

13. Gross profit is
    A sales less purchases
    B net sales less cost of goods sold
    C net profit less expenses
    D sales less purchases plus opening stock
14. Net profit is determined in the
    A trial balance
    B balance sheet
    C profit and loss account
    D trading account
15. Salaries are expenses incurred in making goods into a saleable condition, they should be charged to the
    A balance sheet
    B trading account
    C profit and loss account
    D trial balance
16. The accounts of a business have been prepared, but no adjustments have been made for accrued expenses at the end of the year.
    What effect will these omissions have on the accounts ?

	Net Profit	Current Assets	Current Liabilities
A	overstated	no effect	understated
B	understated	no effect	overstated
C	overstated	understated	no effect
D	understated	overstated	no effect

PRACTICAL QUESTIONS

1. From the following Trial Balance of Mr Krishna Gupta, prepare Trading and Profit and Loss Account for the year ended 31st December, 2016 and a Balance Sheet as on that date, after giving effect to the adjustments :

	Dr. (₹)	Cr. (₹)
Capital		1,80,000
Drawings	32,500	
Stock (1.1.2016)	1,74,450	
Return inwards	5,540	
Carriages inwards	12,400	
Deposits with Mr Kamal (interest free)	13,750	
Carriage outwards	7,250	
Loan to Anil @ 5% given on 1.1.2016	10,000	
Returns outwards		8,400
Interest on the above loan		250
Rent	8,200	
Rent outstanding		1,300
Sales		12,79,140
Debtors	40,000	
Goodwill	17,300	
Creditors		30,000
Advertisement expenses	9,540	
Provision for doubtful debts		12,000
Bad debts	4,000	
Patents and trade marks	5.000	
Cash in hand	620	
Discount allowed	3,300	
Wages	7,540	
Plant and machinery (purchased on 1.2016	30,000	
Purchases	11,29,700	
TOTAL	15,11,090	15,11,090

Adjustments :

1. Increase bad debts by ₹ 6,000. Make provision for doubtful debts @ 10% and provision for discount on debtors @ 5%.
2. The value of the closing stock is ₹ 1,87,920.
3. Wages include ₹ 2,000 paid for the erection of machinery on 1.1.2016.
4. Provide depreciation machinery @ 10% p.a.

2. From the following balances of Amal, Bimal as on 31.12.2016, prepare Trading Account, Profit and Loss Account for the year ended 31.12.2016 and the Balance Sheet as at 31.12.2016.

	₹		₹
Opening stock	30,000	Machinery at cost (including ₹ 10,000 new)	60,000
Purchases	1,10,000	Sundry Debtors	20,000
Sales	2,50,000	Bad debts	3,000
Building	55,000	Depreciation fund	25,000
Wages	23,000	Sundry Creditors	24,000
Carriage inwards	3,000	Rent,rates and taxes	4,000
Bills payable	10,000	Trade expenses	4,000
Furniture	9,000	Capital : Amal	50,000
Salaries	42,000	Capital : Bimal	40,000
Advertisement	24,000	Petty expenses	4,000
Coal and coke	2,000	Provision for bad debts	1,000
Cash at bank	14,000	Gas and water	1,200
Prepaid wages	1,000	Cash in hand	800
Depreciation fund investment	25,000	Outstanding rent	400
		Bank loan	34,600

The following additional information is supplied :

(a) The partners share profits and losses as Amal 2/5 and Bimal 3/5.
(b) Closing stock — ₹ 15,000.
(c) Stock valued at ₹ 10,000 was destroyed by fire but the Insurance Company admitted a claim of ₹ 8,500 only, and the claim is not yet paid.
(d) Wages include ₹ 2,000 for installation of a new machinery on 1.9.2016.
(e) Depreciate machinery at 10% p.a.

3. Mr P. Sharma is in business as a stationery merchant. From the following business extracted from his books of accounts, you are required to prepare Trading and Profit and Loss Account for the year ended 31st December, 2016 and a Balance Sheet as on that date :

	Dr. (₹)	Cr. (₹)
Cash in hand	20,000	
Cash at bank	25,000	
Plant and machinery	50,000	
Furniture and fixtures	10,000	
Drawings	10,000	
Capital		90,000
Insurance charges	1,000	
Salaries and wages	25,000	
Sundry debtors	35,000	
Opening stock	20,000	
Trade mark rights (10 years from 1.1.2016)	40,000	
Purchases	1,50,000	
Postages and telegrams	2,000	
Bad debts	1,000	
Loan from R.D. Bansal @ 6% p.a. (taken on 1.7.2016)		15,000
Interest on loan from Bansal	200	
Creditors		54,200
Sales		2,30,000
TOTAL	3,89,200	3,89,200

Additional information :

1. Stock on 31.12.2016 — ₹ 38,000.
2. Depreciate plant and machinery at 10% and furniture and fixtures at 5% p.a.
3. Invoices of the value of ₹ 3,000 were recorded in the Sales Book on 29th December, 2016, but goods were not despatched until 7th January, 2017 and were included in the closing stock.
4. Of the sundry debtors ₹ 1,000 are bad and should be written-off.
5. Sundry debtors include ₹ 6,000 due from B N Sen whereas sundry creditors include ₹ 1,000 also due to him.
6. Create a provision of 5% on Sundry debtors for bad and doubtful debts.

4. From the following particulars prepare the Trading and Profit and Loss A/c for the year 2016 and the Balance Sheet as on 31.12.2016 of Prem Niwas :

	Dr. (₹)	Cr. (₹)
Building	50,000	
Machinery	22,000	
Furniture	10,000	
Bank	9,000	
Cash	1,000	
Loans (since 1.1.2016)		30,000
Capital		52,000
Debtors/Creditors	50,000	40,000
Opening stock	12,000	
Purchase/Purchase returns	2,50,000	10,000
Sales returns/Sales	12,000	3,22,000
Rent	6,000	
Establishment	16,000	
P.F. deducted from salaries		1,000
Interest (10%)	2,000	
Electricity	1,000	
Phone	1,000	
Commission	6,000	
Insurance premium	1,000	
Bad debts	2,000	
Bills receivable	4,000	
TOTAL	4,55,000	4,55,000

Provide depreciation on building @ 5%, machinery @ 15% and furniture @ 10%. Stock was not taken on 31.12.2016 but only on 7.1.2017. The transactions from 1.1.2017 to 7.1.2017 are Sales ₹ 25,000; Purchases ₹ 15,000; Stock on 7.1.2017 ₹ 18,000; and Gross Profit 20%. During the year machinery to the value of ₹ 10,000 was destroyed by fire and the insurance claim was settled at ₹ 8,000 and credit to Machinery Account. Also provide Employer's share of P.F. ₹ 1,000, Provision for bad debts at 5%, Commission to the manager @ 10% on net profit after providing the commission.

5. From the following Trial Balance of Hari and additional information prepare Trading and Profit and Loss Account for the year ended 31st March, 2017 and a Balance Sheet as on that date :

Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000
Furniture	20,000	
Purchases	1,50,000	
Debtors	2,00,000	
Interest earned		4,000
Salaries	30,000	
Sales		3,21,000
Purchase returns		5,000
Wages	20,000	
Rent	15,000	
Sales Return	10,000	

Bad Debt written-off	7,000	
Creditors		1,20,000
Drawings	24,000	
Provision for bad debts		6,000
Printing and Stationery	8,000	
Insurance	12,000	
Opening stock	50,000	
Office expenses	12,000	
Provision for Depreciation		2,000
TOTAL	5,58,000	5,58,000

Additional information :

(1) Depreciate Furniture by 10% on original cost.

(2) A Provision for Doubtful Debts is to be created to the extent of 5% on Sundry Debtors.

(3) Salaries for the month of March 2017 amounting to ₹ 3,000 were unpaid which must be provided for. However, salaries included ₹ 2,000 paid in advance.

(4) Insurance amounting to ₹ 2,000 is prepaid.

(5) Provide for outstanding office expenses ₹ 8,000.

(6) Stock used for private purpose ₹ 6,000; and Closing Stock-in-trade ₹ 60,000.

6. The following is the Trial Balance of Shri Paras, as on 31st March, 2017. You are requested to prepare the final accounts in vertical format, after giving effect to the adjustments:

Particulars	(Dr.) ₹	(Cr.) ₹
Sundry Creditors	—	63,000
Sundry Debtors	1,45,000	—
Capital Account	—	7,10,000
Drawings	52,450	—
Insurance	6,000	—
General Expenses	30,000	—
Salaries	1,50,000	—
Patents	75,000	—
Machinery	2,00,000	—
Freehold Land	1,00,000	—
Building	3,00,000	—
Stock on 1.4.2016	57,600	—
Carriage on Purchases	20,400	—
Carriage on Sales	32,000	—
Fuel and Power	47,300	—
Wages	1,04,800	—
Returns Outwards	—	5,000
Returns Inwards	6,800	—
Sales	—	9,87,800
Purchases	4,06,750	—
Cash at Bank	26,300	—
Cash in hand	5,400	—
TOTAL	17,65,800	17,65,800

The following adjustment are to be made: (1) Stock on 31st March, 2017 was valued at ₹ 68,000; (2) A provision for bad and doubtful debts is to be created to the extent of 5% on Sundry Debtors; (3) Depreciate Machinery by 10% and Patents by 20%; (4) Wages include a sum of ₹ 20,000 spent on the erection of a cycle shed for employees and customers; (5) Salaries for the month of March, 2017 amounting to ₹ 15,000 were unpaid; (6) Insurance includes a premium of ₹ 1,700 on a policy, expiring on 30 September, 2017.

7. The Trial Balance of M/s R.S. Corporation as on December 31, 2016 was as under :

Particulars	Dr. (₹)	Cr. (₹)
Rajeev's Capital A/c		80,000
Suresh's Capital A/c		1,00,000
Stock as on 1.1.2016		
Raw materials	2,500	
Finished goods	6,500	

Purchases	64,500	
Sales		1,19,000
Sales returns	2,000	
Wages	16,000	
Manufacturing expenses	12,000	
Salaries	8,000	
Insurance	1,500	
Postage	100	
Advertisement	1,000	
Bad debts	300	
Bills payable		12,000
Discount		500
Land and Building	90,000	
Plant and machinery	70,000	
Furniture	1,000	
Sundry Debtors	25,400	
Sundry Creditors		42,000
Drawings :		
Rajeev	1,800	
Suresh	1,400	
Cash in hand	500	
Cash at bank	49,000	
TOTAL	3,53,500	3,53,500

Rajeev and Suresh share profits and losses equally. Prepare Trading, Profit & Loss Account for the year ended 31st December 2016, and also the Balance Sheet as on that date after taking into consideration the following adjustments:

1. Stock on 31st December, 2016 : Raw materials ₹ 4,000; Finished goods ₹ 12,000.
2. Provide depreciation on land and building @ 5%; on furniture @ 10%; and on plant & machinery @ 5%.
3. Outstanding expenses : Salaries ₹ 1,500; Wages ₹ 2,100.
4. Insurance paid for 15 months upto March, 2017.
5. Write-off bad debts of ₹ 400
6. Reserve for doubtful debts @ 5% of Debtors.
7. Goods withdrawn by Rajeev for personal use ₹ 2,000.

8. Smt. Ghosal submits you the following Trial Balance which she has not been able to agree. Prepare the Trial Balance after correcting the errors committed by her and prepare a Trading and Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as at that date after giving effect to the undermentioned adjustments :

Particulars	Dr. (₹)	Cr. (₹)
Capital		15,000
Drawings	3,250	
Stock (1.1.2016)	17,445	
Returns Inward		554
Carriage Inward	1,240	
Deposit with Basak		1,375
Returns Outward	840	
Carriage Outward		725
Loan to Chatterjee @ 5% p.a. on 1.1.2016		1,000
Interest on the above Loan		25
Rent	820	
Rent Outstanding	130	
Stock (31.12.2016)		18,792
Purchases	12,970	
Debtors	4,000	
Creditors		3,000
Provision for Doubtful Debts		1,200
Advertisement Expenses	954	
Bad Debts	400	
Patents	500	

Sales		27,914
Discount Allowed		330
Wages	754	
Cash	62	
Goodwill	1,730	
TOTAL	45,095	69,915

(i) The manager of Smt. Ghosal is entitled to a commission of 10% of the net profit calculated after charging such commission.

(ii) Increase bad debts by ₹ 600. Provision for doubtful debts is to be @ 10% and provision for discount on debtors is to be @ 5% on Sundry Debtors.

(iii) Stock valued at ₹ 1,500 was destroyed by fire on 25.12.2016 but the Insurance Company admitted a claim of ₹ 950 only and paid it in 2017.

(iv) ₹ 200 out of the advertisement expenses are to be carried forward to the next year.

9. Mr A, a shopkeeper, had prepared the following Trial Balance from his ledger as on 31st March, 2017 :

Particulars	Dr. (₹)	Cr. (₹)
Purchases	3,10,000	
Sales		4,15,000
Stock of goods as on 1.4.2016	50,000	
Cash in hand	2,100	
Cash at bank	12,000	
Mr A's capital		2,88,600
Drawings	4,000	
Rates and taxes	5,000	
Salaries	32,000	
Postage and telephone	11,500	
Salesmen's commission	35,000	
Insurance	9,000	
Advertisement	17,000	
Furniture and fittings	22,000	
Printing and stationery	3,000	
Motor car	48,000	
Bad debts	2,000	
Cash discounts	4,000	
General expenses	14,000	
Carriage inwards	10,000	
Carriage outwards	22,000	
Wages	20,000	
Outstanding liability for expenses	11,000	
Sundry creditors		40,000
Sundry debtors	1,00,000	
TOTAL	7,43,600	7,43,600

You are requested to prepare Trading and Profit and Loss Account for the year ended 31st March, 2017 and the Balance Sheet as on that date. You are also given the following further information :

(a) Cost of goods in stock as on 31st March, 2017 — ₹ 1,45,000;

(b) Mr A had withdrawn goods worth ₹ 5,000 during the year;

(c) Printing and stationery expenses of ₹ 11,000 relating to 2015-16 accounting year had not been provided in that year but was paid in this year by debiting outstanding liabilities;

(d) Purchases include purchase of furniture worth ₹ 10,000;

(e) Debtors include ₹ 5,000 bad debts;

(f) Creditors include a balance of ₹ 4,000 to the credit of L.M. Corporation in respect of which it has been decided and settled with the party to pay only ₹ 1,000;

(g) Sales include goods worth ₹ 15,000 sent out to S.M. & Co on approval and remained unsold as on 31st March, 2017. The cost of the goods was ₹ 10,000;

(h) Provision for bad debts is to be created at 5% on Sundry debtors;

(i) Depreciation on furniture and fittings by 10%; motor car by 20%;

(j) The salesmen are entitled to a commission of 10% on total sales.
(k) The purchase department has informed the accounts department that it is in possession of a number of free samples given to them by the potential suppliers. Their estimated value at purchase cost is ₹ 5,000. They were not included in the stock referred to (a) above.

10. Hari Singh has extracted the following Trial Balance from his books as on March 31, 2017 :

	Dr. (₹)	Cr. (₹)
Drawings	16,000	
Cash	6,760	
Petty cash	1,000	
Leasehold land	20,000	
Opening stock at market value	50,000	
Salary	12,000	
Sundry debtors	50,000	
Wages	40,000	
Bank	21,000	
Capital		34,000
Rent	9,000	
Electricity	6,000	
Motor car	10,240	
Advertising	9,000	
Sundry creditors		35,000
Purchases / Sales	4,00,000	6,00,000
Postage and telephone	3,000	
Discount	11,400	
General charges	4,000	
Petty cash expenses	9,600	
Suspense		10,000
TOTAL	6,79,000	6,79,000

You are required to prepare a Trading, Profit and Loss Account and the Balance Sheet using the following information:

(a) Closing stock as on 31st March, 2017 amounted to ₹ 76,000 at cost. A review of inventory items revealed the need for some adjustments for the following :
Items which had cost ₹ 8,000 and which would normally sell for ₹ 12,000 were found to have deteriorated. Remedial work costing ₹ 2,000 would be needed to enable the item to be sold for ₹ 9,000.
(b) The petty cash balance represents the month-end imprest amount. As on the closing date, the petty cashier had vouchers totalling to ₹ 400 for which he had not received reimbursement from the main cashier.
(c) Discounts allowed amounting to ₹ 1,000 had been posted to the debit of Sundry Debtors.
(d) Cash withdrawn from bank ₹ 4,000 had not been entered in the bank column of the cash book.
(e) Sales Account had been undercast on the credit side by ₹ 4,000.
(f) The motor car which had been purchased in 2012-13 was being depreciated at 20% on the reducing balance method. The original cost of the car is ₹ 20,000. It is now decided to charge depreciation at 6% on the straight line method and to make the change effective from the year of purchase of the car.
(g) The leasehold land was purchased during the year. On the date of purchase the unexpired period of the lease was 5 years.
(h) No entry had been passed in the books for stock withdrawn from the business by the proprietor ₹ 10,000.
(i) Telephone bills amounting to ₹ 1,000 remained unpaid.

11. Mr X, a trader, has extracted the following Trial Balance from his books as on 31st March, 2017 :

	Dr. (₹)	Cr. (₹)
Purchases	4,00,000	
Sundry debtors	1,50,000	
Cash in hand	4,000	
Cash at bank	8,000	
Rent, rates and taxes	3,000	
Insurance premium	9,000	
Salaries	42,000	

Carriage outwards	21,000	
Carriage inwards	18,000	
Sundry creditors		50,000
Claim recoverable	5,000	
Research and Development	9,000	
Furniture and fittings	23,000	
Deposit with supplier	6,000	
Office equipment	10,000	
Bills receivable	6,000	
Bad debts	4,000	
Sales		7,00,000
Opening stock	30,000	
Electricity expenses	2,000	
TOTAL	7,50,000	7,50,000

The following further information is provided :

1. A purchase invoice for ₹ 15,000, received from a creditor, has not been entered through oversight.
2. The claim recoverable has been settled with the insurance company for ₹ 2,000.
3. Break-up for Research and Development is ₹ 3,000 reserach and ₹ 6,000 development. It has been decided to amortise it over a period of 4 years.
4. Depreciation is to be provided on straight-line method on furniture and fittings and office equipment at 5%. The original costs were : Furniture and fittings ₹ 30,000; Office equipment ₹ 15,000.
5. Goods costing ₹ 5,000 were despatched out on 29th March. The sale, however, took place on 2nd April, 2017, when an invoice for ₹ 7,500 was raised against the customer.
6. Insurance premium includes a prepaid amount of ₹ 1,000.
7. The deposit with a supplier was made on 1st October, 2016. It carried interest @ 12% p.a.
8. Two bills receivable from customers of ₹ 700 and ₹ 1,300, were dishonoured on 30th March. These had earlier been discounted with the bank.
9. Provide 2% on sundry debtors for doubtful debts.
10. Physical stock of goods on hand on 31st March, 2017 at cost was ₹ 1,00,000.

Prepare Trading, Profit and Loss Account and the Balance Sheet from the above information.

12. The following are the closing balance as on 31.12.2016 extracted from the books of Mr Mehta. Prepare the Trading and Profit and Loss Account for the year ending 31.12.2016 and the Balance Sheet as on that date after making the necessary adjustments :

	₹		₹
Mr Mehta's Capital Account	1,65,000	Interest received from A.N. Sen	400
Stock on January 1, 2016	70,200	Cash at bank	12,000
Sales	4,34,400	Discounts received	6,300
Purchases	3,64,650	Investment	7,500
Carriage inwards	27,900	Furniture and fittings	2,700
Rent and rates	8,550	Discounts paid	11,310
Sales returns	12,900	General expenses	6,000
Salaries	13,950	Audit fees	1,050
Purchases returns	8,700	Insurance	900
Sundry debtors	36,000	Travelling expenses	3,500
Sundry creditors	26,350	Postage and telegrams	4,070
Bank loan at 6% (1.1.2016)	30,000	Cash in hand	570
Interest paid on above	1,350	Deposit with Mr A N Sen (1.1.2016) Interest @ 9%	45,000
Printing and advertising	21,900	Drawings Account : Mr Mehta	15,000
Motor Van, at cost	8,000	Disposal of Motor Van	250
Provision for Depreciation on motor van at 31.12.2015	3,600		

Adjustments :

(a) Stock as on December 31, 2016 was ₹ 1,20,000.

(b) Sundry Debtors included a sum of ₹ 3,000 due from Mr Nair and Sundry creditors included a sum of ₹ 4,000 due to Mr Nair.

(c) (i) During 2016 a motor van which was purchased during 2006 for ₹ 1,000, was sold for ₹ 250. The only entry which has been made is to credit the ₹ 250 to Disposal of Motor Van Account.

(ii) Depreciation has been and is to be charged on motor van at 20% of cost. A full year's depreciation is charged in the year of purchase none in the year of sale.

(d) Provide 5% for bad debts and 2% on the balance for discount for prompt payment.

(e) Write off depreciation at 10% of furniture and fittings. Depreciation in respect of items sold off during the year need not to be provided.

(f) As on December 31, 2016 salaries and carriage inwards that remain unpaid were ₹ 1,200 and ₹ 150 respectively.

(g) Insurance paid in advance as on 31.12.2016 was ₹ 120.

(h) Furniture of the book value of ₹ 900 as on 1.1.2016 had been disposed off for ₹ 500 on 30.6.2016. The sale proceeds had been credited to the Furniture Account but the loss on sale of furniture had not been written off in the books.

(i) Furniture purchased for ₹ 1,000 on 1.1.2016 had been debited in the Purchases Account.

(j) Purchases to the value of ₹ 1,800 had been omitted from the books.

(k) Personal purchase of ₹ 700 made by Mr Mehta had been included in the purchase.

(l) Provide for interest on: (i) the Deposits with Mr A N Sen; and (ii) Bank loan.

13. The books of Mr X, a trader in tea, showed the following balances as on 31st March, 2017 :

	₹		₹
Opening stock of tea	1,00,000	Commission to sales manager	32,400
Purchases : Tea	4,00,000	Furniture and fittings	35,000
Salaries paid	80,000	Airconditioners	30,000
Buildings	95,000	Sundry debtors	1,00,000
Cash in hand	2,000	Sundry creditors	80,000
Cash at bank	1,35,000	Loan on mortgage	70,000
Rent, rates and taxes	15,000	Interest paid on above	3,000
Insurance premium paid	3,000	Prepaid expenses	4,000
Miscellaneous receipts	10,000	Drawings	18,000
Sales	7,20,000	Bills payable	30,000
Cash discount allowed	4,750	Bank charges	2,000
Bad debts	3,250	Legal charges	6,000
Repairs — Buildings	2,900	Motor vehicles	80,000
Miscellaneous expenses	8,700	Travelling and conveyance	10,000
Advertisement	20,000	Capital	2,80,000

The following further information was obtained :

1. Closing stock ₹ 55,000.
2. Legal charges include ₹ 5,000 for cost of stamps and registration of new building acquired during the year.
3. Purchases include 4,000 kg tea valued at ₹ 20,000 which was found totally spoiled. Insurance claim lodged in this respect is expected to realise ₹ 15,000.
4. Travelling and conveyance include proprietor's personal travelling for which he is to be charged with ₹ 4,800.
5. Loan on mortgage bears interest at 12% p.a.. The loan was taken on 1st June, 2016. One instalment of ₹ 10,000 was repaid on 1st December, 2016.
6. The sales manager is entitled to a commission of 7.5% of total sales. However, the actual bad debts incurred during the year is deductible from such commission entitlements.
7. Debtors include : (a) ₹ 10,000 due from M. & Co. (creditors include ₹ 18,000 due to the same party); (b) ₹ 5,000 due on account of sale of furniture; (c) Bad debts of ₹ 2,000;
8. Provision for bad debts is to be created at 2% of net outstanding debtors.
9. Depreciation is chargeable as follows : (a) Buildings at 2.5%; (b) Furniture and fittings at 10%; (c) Airconditioners at 15%; (d) Motor vehicles at 20%.
10. Miscellaneous receipts represent sale proceeds of furniture, written down value of which was ₹ 12,000.
11. Prepaid expenses include insurance premium of ₹ 1,000 for period from 1st April, 2016 to 30th September, 2016 paid in 2015-16.
12. Bills payable include a bill of ₹ 10,000 which fell due on 31st March, 2017 and was paid by the bank as per standing instructions. The bank charges in this connection amounted to ₹ 100.
13. The balance as per bank as on 31st March, 2017 was ₹ 1,24,900.

Prepare Trading and Profit and Loss Account for the year ended on 31st March, 2017 and the Balance Sheet as on that date from the above information.

14. Padmanabhan, who commenced business as a retail trader on January 1, 2016 extracted the following balances as on 31st December, 2016 :

	₹		₹
Capital A/c	6,00,000	Establishment charges	20,000
Drawings A/c	12,000	Electricity charges	6,575
Building A/c	2,00,000	Postage and telegram	1,284

Furniture and fitting	30,000	Travelling and conveyance	3,816
Depreciation reserve — Buildings	10,000	Advance for salesman's commission	1,000
Depreciation reserve — Furniture	3,000	Insurance	2,500
Depreciation for the year	13,000	Rent received	12,000
Purchases	4,00,000	Motor van (purchased on 1.1.2016)	80,000
Sundry creditors	40,000	Motor van maintenance	23,425
Sales	5,00,000	Fixed deposit (deposited on 1.9.2016)	1,00,000
Sundry debtors	1,20,000	Cash in hand	1,823
Cash at bank	1,47,977		

In view of the difference in Trial Balance, an examination of the books was conducted which revealed the following errors :

(i) ₹ 25 conveyance paid was debited to Motor Van Maintenance Account;
(ii) ₹ 2,000 drawn from bank towards establishment charges for November, was omitted to be posted into ledger.
(iii) The cash column in the cash book on the receipts side, stands excess totalled by ₹ 400.

You are required to prepare Trading and Profit and Loss Account for the year 2016 and a Balance Sheet at the end of the year after taking into consideration the under noted adjustments :

1. Establishment charges have been paid only upto November and provision of ₹ 2,000 has to be made for December.
2. Electricity charges are outstanding to the tune of ₹ 25.
3. 1/2% commission on total sales is payable to the salesman towards which ₹ 1,000 has been paid as advance.
4. Fixed deposit earns interest @ 9% p.a.
5. Provide depreciation @ 20% p.a. on motor van.
6. Closing stock as on 31.12.2016 ₹ 1,00,000.

15. From the following Trial Balance of R. Ramnath as at September 30, 2016 you are required to prepare a Trading and Profit and Loss Account for the year ending September 30, 2016 and a Balance Sheet as on that date, after making the necessary adjustments :

	Dr. (₹)	Cr. (₹)
R. Ramnath — Capital A/c		1,00,000
R. Ramnath — Drawings	12,000	
Land and buildings	60,000	
Plant and machinery	20,000	
Furniture and fixtures	5,000	
Leasehold premises (lease to run for 5 years from 1.10.2016)	30,000	
Sales		1,40,000
Returns outwards		4,000
Sundry debtors	18,400	
Loan from D. Das @ 6% taken on 1.1.2016		30,000
Purchases	80,000	
Returns inwards	5,000	
Freight and duty	10,000	
Sundry expenses	600	
Printing and stationery	500	
Insurance charges	1,000	
Provision for doubtful debts		1,000
Provision for discounts on debtors		380
Bad debts	400	
Profit of textiles department		10,000
Stock of general goods on 1.10.2016	21,300	
Salaries and wages	18,500	
Sundry creditors	12,000	
Trade expenses	800	
Stock of textiles goods on 30.9.2016	8,000	

Cash at bank	4,600	
Cash in hand	1,280	
TOTAL	2,97,380	2,97,380

Adjustments :

(a) The stock on hand on September 30, 2016 was valued at ₹ 27,300.

(b) On September 23, 2016 a fire broke out and destroyed stock of the value of ₹ 10,000. The insurance company admitted the claim for loss of stock to the value of ₹ 6,000 only, and paid the amount on October 10, 2016.

(c) Of the Sundry Debtors ₹ 400 are bad and should be written-off. The Provison for doubtful debts should be maintained at 5% on Debtors and the provision for discount on debtors at 2%. Also maintain a reserve for discount on creditors at 2%.

(d) Goods of the value of ₹ 6,000 has been received on September 27, 2016 but the purchase invoice was omitted from the Purchase Book.

(e) Ramnath had utilised goods of the value of ₹ 2,000 for his personal use, but no record was made of it.

(f) Depreciate land and buildings at 2%, plant and machinery at 20% and furniture and fixtures at 5%.

(g) Prepaid insurance was ₹ 200.

16. From the following Trial Balance and accompanying adjustments of Jailal Billu & Sons, prepare Trading and Profit and Loss Account for the year ended 31st December, 2016 and a Balance Sheet as on that date :

	₹		₹
Plant and machinery	10,000	Sales	2,00,000
Purchases *less* returns	90,000	Capital	80,000
Factory building	50,000	Interest on income tax paid in advance	400
Wages	10,000	Suspense A/c of Choti Lal	30,000
Fuel and power	2,000	Interest received in advance	3,600
Commission paid to purchase manager	1,000	Creditors	15,000
Insurance and taxes	4,000		
Life insurance	1,000		
Goodwill	30,000		
Debtors	70,000		
Bad debts	1,000		
Income tax advance payment	4,000		
Income tax	10,000		
Cash in hand and at bank	15,000		
Stock on 31.12.2016	20,000		
Suspense A/c of Moti Lal	10,000		
Commission paid in advance	1,000		
	3,29,000		3,29,000

Additional information :

1. On investigation, it was found that goods costing ₹ 40,000 were sent to Choti Lal under consignment; 3/4ths of the goods were sold by him for ₹ 60,000. Remaining stock was valued at cost. A cheque of ₹ 30,000 was received from Choti Lal. Entry for cash received was passed and credited to his Suspense Account. Commission of 5% on sale is payable to Choti Lal.
2. Similarly, a joint venture agreement was made with Moti Lal for which an advance of ₹ 10,000 was entered. It is now ascertained that venture earned a profit of ₹ 6,000 of which Jailal Billu & Sons are entitled to get 2/3rd share.
3. Debtors included an amount due from Chandi Ram ₹ 2,000 and creditors included amount due to Chandi Ram ₹ 3,000.
4. Purchases included purchase of materials used for the building for ₹ 2,000.
5. During the year a new plant was erected and firm's own man had spent time thereon amounting to ₹ 200. The amount was included in Wages Account.
6. Goods costing ₹ 600 (sales price ₹ 900) were sent on approval on 28th December and recorded as sale, but no consent has been received up to 31st December.
7. Make provision for doubtful debts at 5% and depreciate plant at 10% and building at 5%.

17. R retired from a company and started a business in Madras. On retirement, he got ₹ 1,00,000 from his employer which he invested in his business on 1.4.2016. He got from Life Insurance Corporation ₹ 20,000 on maturity of his policy which he also invested in his business. He draws ₹ 1,000 for his personal expenses every month from 30th April, 2016. The following figures are extracted from his books on 31st December, 2016 :

	₹		₹
Purchases	3,10,000	Bad debts	2,000
Cartage	5,000	Sundry debtors	45,000

Salaries and wages	24,000	Bills receivable	30,000
Electricity charges	4,500	Cash in hand	7,997
Travelling	8,900	Sales	3,00,000
Telephone	4,300	Income from personal investment	20,000
Advertisement	10,000	Creditors	85,000
Repairs and renewals	3,303	Bank overdraft	80,000
Plant and machinery	1,50,000	Building (Cr)	10,000

You are requested to prepare a Trading and Profit and Loss Account of the business for the period ended 31st December, 2016 and also the Balance Sheet as on that date after taking into consideration the following further information :

1. Purchase include ₹ 10,000 representing the value of furniture purchased.
2. ₹ 4,000 representing erection wages on plant and machinery was debited to salaries and wages.
3. Electricity charges include ₹ 2,500 paid as deposits to Electric Supply Company. There are bills outstanding to the extent of ₹ 500.
4. Advertisement includes ₹ 4,000 representing the cost of a neon sign.
5. A dishonoured bill of ₹ 5,000 stands debited to the debtor. 50% thereof considered doubtful and has to be provided accordingly.
6. A debtor for ₹ 1,000 was declared insolvent on 30th December, 2016, and it is expected that nothing would be recovered from his estate.
7. Provide 5% discount on net realisable debtors.
8. R received ₹ 25,000 in respect of a business with B. The sum received stood credited to sundry creditors. It is noted that, a sum of ₹ 5,000 was due to R as his share of profit from that business.
9. During the period there was a fire damaging stock costing ₹ 50,000. The damaged goods were sold for ₹ 20,000.
   This sum of ₹ 20,000 is included in sales. The insurance company paid ₹ 25,000 towards the loss of stock. The godown containing the stock was also damaged to the extent of ₹ 15,000, which has also been paid by the insurance company.
   The total amount received from the insurance company was credited to Building Account.
10. The bank overdraft was given on the hypothecation of stock-in-trade. You are informed that the bank had a margin of $33^1/_3$% and the overdraft balance on 31st December, 2016, was the maximum which could have been drawn on the basis of this margin.
11. The manager of the business is entitled to a commission of 10% of net profit after charging such commission.
12. Provide 10% depreciation on plant and machinery and on furniture and fittings and 5% on building. Depreciation to be provided on closing balance.

18. Mr Reddy, a retired government official who started business in Calcutta on 1st April, 2016, gives you the following balances relating to the year ending 31st March, 2017 :

	₹		₹
Sundry Debtors	84,000	Salaries	18,910
Sundry creditors	38,000	Suspense A/c (Dr.)	3,000
Stock in trade (1.4.2016)	40,000	Bad debts	1,200
Machineries	56,000	Reserve for doubtful debts	3,200
Furniture	8,500	Purchases	4,95,000
Bills receivable	4,900	Sales	6,76,000
Bills payable	3,700	Printing charges	2,300
Building rent	9,600	Postage	1,500
Cash in hand	4,250	Travelling expenses	7,900
Cash at bank	17,394	Telephone	1,600
Drawings	12,000	Miscellaneous expenses	41,806
Capital A/c (Cr)	90,000	Insurance	1,040

Additional information :

1. An old furniture which stood at ₹ 1,200 in the books on 1st April, 2016 was disposed of at ₹ 580 on 30th September, 2016 in part exchange for a new furniture costing ₹ 1,040. A net invoice at ₹ 460 was passed through the Purchases Day Book.
2. Sales include ₹ 20,000 as hire purchases sale. Hire purchase sales prices are determined after adding $33^1/_3$ % to cost price. 40% of the instalments have not fell due as yet (profit or loss on H.P. sales is to be shown in Profit and Loss Account).

3. Suspense Account represents money advanced to sales manager who was sent to Delhi in August, 2016 for sales promotion. On returning to Calcutta he submitted a statement disclosing that ₹ 1,200 was incurred for travelling, ₹ 500 for legal expenses and ₹ 900 for miscellaneous expenses. The balance lying with him is yet to be refunded.
4. Mr Reddy desires to change the method of depreciation on machineries from straight line method (i.e. on original cost), to diminishing balance method with retrospective effect from April 2007 and adjust the difference in the accounting year 2016-15. The rate of depreciation will, however, remain unchanged.
5. Business is carried on in a rented house. The ground floor being 50% of the accommodation, is used for business. Mr Reddy lives with his family on the first floor.
6. Total bad debts for the period amounted to ₹ 2,000. Reserve for doubtful debt is to be maintained at 5% on outstanding debtors.
7. Insurance premium covers a period of one month in advance.
8. Depreciation on time basis is to be provided on machineries at 10% per annum as instructed and on furniture at 5% per annum on diminishing balance method.
9. Closing stock amounted to ₹ 50,000.

Prepare Mr Reddy's Trading and Profit and Loss Account for the year ended 31st March, 2017 and a Balance Sheet as on that date after taking into consideration the above-mentioned information.

19. Mr Gavaskar is the proprietor of a large business. The following Trial Balance was prepared from his book as on 31st March, 2017.

	₹		₹
Land and Building	40,000	12% Bank Loan (S.B.I.)	
Cash at bank	25,000	(No movement during the year)	50,000
Motor car	20,000	Capital of Gavaskar	75,000
Furniture	10,000	Bills payable	5,000
Sundry Debtors	60,000	Sundry Creditors	65,000
Cash in hand	5,000	Returns outwards	4,000
Stock (1.4.2016)	55,000	Discount received	1,000
Returns inwards	5,000	Sales	4,50,000
Printing and Stationery	2,000		
Drawings	8,000		
Bills receivable	5,000		
Travelling expenses	6,000		
Discount allowed	2,000		
Miscellaneous expenses	19,000		
Postage	1,000		
Joint Venture Suspense A/c	1,000		
Investments (Market value ₹ 14,000)	15,000		
Interest on Bank Loan	4,000		
Salaries (including Advance for ₹ 2,000)	27,000		
Entertainment expenses	2,000		
Purchases	3,25,000		
Carriage inwards	4,000		
Advertisements	9,000		
	6,50,000		6,50,000

Additional Information:

1. On 1st October, 2016 Mr Gavaskar entered into a joint venture with Mr Kapil with an agreement to share the profits and losses equally. Kapil supplied goods totalling ₹ 30,000 which wrongly passed through the Purchase Day Book.
   The goods were sold for cash at a profit of 25% on sales and stood credited to Sales Account. Kapil had earlier incurred amount of ₹ 2,000 on account of Freight and Insurance. Joint Venture Suspense Account represents expenses incurred by Gavaskar on Joint Venture.
2. Bills Receivable for ₹ 4,000 endorsed on 21st December, 2016 in favour of creditors were subsequently dishonoured but no entry for the dishonoured has been passed.
3. Three cheques of ₹ 1,500, ₹ 2,000 and ₹ 3,000 issued to parties on 30th March, 2017, were lying unpresented on 31st March, 2017.
4. Sales included a sum of ₹ 30,000 received from sale of goods on behalf of Mr Salvey. The cost of these goods to Mr Salvey was ₹ 25,000, Mr Gavaskar is entitled to a commission of 5% on Sales, for which effect should be given, and reimbursement of selling expenses of ₹ 1,000 were debited to Miscellaneous Expenses Account.
5. 1/3rd of the advertisement expenses are to be carried forward.
6. Of the Debtors a sum of ₹ 1,000 is to be written-off as bad debt.
   Create provision for doubtful debts @ 2%.

7. Depreciate Fixed Assets by 10% except Motor car which is to be depreciated at 20%.
8. Stock at the end ₹ 45,000.
9. During the year some goods (invoiced at ₹ 10,000) were sent to sundry customers on sale or approval. On 31st March, 2017 of these goods remained with customers as the period of approval did not expire as yet. Proper adjustment should be made in respect of the above.
   Mr Gavaskar makes his invoices at cost plus 25%.

You are required to prepare Trading and Profit and Loss Account for the year ended 31st March, 2017 and a Balance Sheet as on that date.

Guide to Answers

Multiple Choice

1. C 2. C 3. A 4. D 5. C 6. C 7. C 8. D 9. C 10. A 11. C 12. B 13. B 14. C 15. B 16. A

Practical Questions

1. **Gross Profit ₹ 1,47,830; Net Profit ₹ 1,13,910; Balance Sheet total ₹ 2,92,710.**

2. **Gross Profit ₹ 1,07,800; Net Profit ₹ 19,900; Balance Sheet total ₹ 1,78,900.**

3. **Gross Profit ₹ 95,000; Net Profit ₹ 53,400; Balance Sheet total ₹ 2,01,850.**

4. **Gross Profit ₹ 81,000; Net Profit ₹ 30,000; Closing Stock ₹ 23,000; Manager's Commission ₹ 3,000; Balance Sheet total ₹ 1,58,000.**

5. **Gross Profit ₹ 1,62,000; Net Profit ₹ 69,000; Balance Sheet total ₹ 2,70,000.**

6. **Gross Profit ₹ 5,43,850; Net Profit ₹ 2,74,400; Net Assets employed ₹ 8,20,300.**

7. **Gross Profit ₹ 31,400; Net Profit ₹ 10,050; Balance Sheet total ₹ 2,42,450.**

8. **Total of Trial balance ₹ 48,109; Gross Profit ₹ 16,083; Net Profit ₹ 11,510; Balance Sheet total ₹ 27,541.**

9. **Gross Profit ₹ 1,80,000; Net Profit ₹ 1,700; Net Loss transferred to Capital ₹ 9,300; Balance Sheet total ₹ 3,12,300.**

1. **Gross Profit ₹ 1,99,000; Net Profit transferred to Capital ₹ 1,34,560; Balance Sheet total ₹ 1,78,560.**

11. **Gross Profit ₹ 3,42,000; Net Profit ₹ 2,49,570; Balance Sheet total ₹ 3,14,570.**

12. **Gross Profit ₹ 87,200; Net Profit ₹ 18,883; Balance Sheet total ₹ 2,25,133.**

13. **Gross Profit ₹ 2,95,000; Net Profit ₹ 57,290; Balance Sheet total ₹ 4,95,440.**

14. **Gross Profit ₹ 2,00,000; Net Profit ₹ 1,21,875; Balance Sheet total ₹ 7,53,400.**

15. **Gross Profit ₹ 61,000; Net Profit ₹ 32,698; Balance Sheet toal ₹ 1,67,688.**

16. **Gross Profit ₹ 1,38,900; Net Profit : from Business ₹ 1,26,925; from Joint Venture ₹ 4,000; Profit from Consignment ₹ 27,000; Balance Sheet total ₹ 2,39,925.**

17. **Gross Profit ₹ 1,45,000; Net Profit from business ₹ 63,520; Income from Joint Venture ₹ 5,000; Balance Sheet total ₹ 3,65,372; Commission to Manager ₹ 6,352.**

18. **Gross Profit ₹ 1,86,460; Net Profit ₹ 1,00,001; Balance Sheet total ₹ 2,14,901. Loss on sale of furniture ₹ 590; Sales for Trading Account ₹ 6,76,000 – ₹ 20,000 = ₹ 6,56,000; Hire Purchase Profit ₹ 3,000; Purchase for Trading Account ₹ 4,79,540; Provision for Doubtful Debts ₹ 3,760.**

19. **Gross Profit ₹ 68,000; Net loss ₹ 5,060; Balance Sheet total ₹ 2,20,940; Share of Profit on Joint Venture ₹ 3,500; Balance of Kapil Account ₹ 35,500.**

16

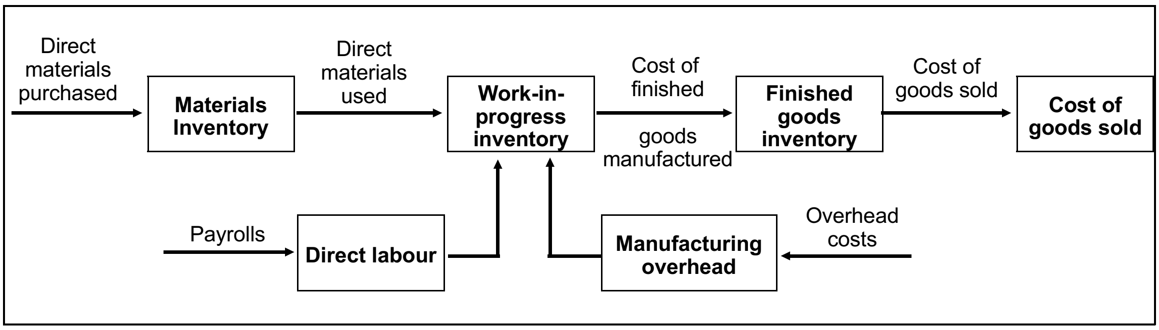
Manufacturing Account

Introduction

In the Final Accounts chapter, we have seen that the main objective of preparing a Trading Account is to find out the profit from trading, that is the buying and selling of goods. There are many firms which instead of buying saleable products from outside suppliers, make the product themselves. The main objective of such a firm is to make a saleable product and to sell that product at a profit. These firms prepare a Manufacturing Account, in addition to the Trading and Profit and Loss Account, to show separately the cost of goods manufactured during the period.

The Cycle of Production

The production cycle is the sequence of operations which transforms raw materials into finished goods. Each operation will have costs which give rise to expenses. The flow of costs through the manufacturing process is shown as below:



Raw materials are the basic materials that enter into the production of finished goods.
Work-in-Progress are partly completed products that are in the manufacturing process.
Finished goods are the completed products which are ready for sale.

Elements of Cost

In the preparation of a Manufacturing Account, it is necessary to identify all the costs of manufacturing goods. The costs of manufacturing a product consist of three major elements : (a) Materials; (b) Labour; and (c) Expenses.

(a) Materials : Materials are classified as Direct Materials and Indirect Materials.

Direct Materials are those which can be identified with the product, that is, these are directly traceable to an article being manufactured. For example, wood, screws, and the like in a furniture factory.

Indirect Materials are those which do not form a part of the finished product but are necessary for production. For example, sandpaper used in a furniture factory for smoothing surfaces.

Here, we discuss the nature of a few materials. These are :

(i) Raw Materials : The term, raw material is referred to a material that has to be further worked upon for converting into a finished product. The raw materials used in production are treated as *Direct materials*.

(ii) Packing Materials : Primary packing materials are treated as *Direct Materials* where as secondary packing materials are treated as *Indirect Materials***.** Examples of primary packing materials are—bottles and plastic containers, tins, product labels, and the like. Examples of secondary packing materials are—wooden cases, binding wire, string, etc.

(iii) Consumable Materials : These are treated as *Indirect Materials***.** Examples will include cotton waste, grease, lubricating oil, and the like.

(iv) Maintenance Materials : These are required for keeping plant and machinery in working condition. Examples will include gears, bushes and bearings etc. These are treated as *Indirect Materials*.

(b) Labour : Labour is also classified as Direct Labour and Indirect Labour.

Direct Labour is the remuneration paid to production workers who are directly associated with the manufacture of particular articles.

Indirect Labour is the remuneration paid to those workers who are not involved in the actual manufacturing of the product.

Examples will include the remuneration of supervisors, works manager, security staff, and others.

(c) Expenses : Expenses are also classified as Direct Expenses and Indirect Expenses.

Direct Expenses are those which can be directly identified with a particular product other than direct materials and direct labour. Examples are hire charges of special plant, royalties paid on production, etc.

Indirect Expenses are those which cannot be identified with the product such as rent, rates and taxes, etc.

Types of Cost in Manufacturing Account

The total cost of manufacturing are divided into two groups:

(a) **Prime cost** is the aggregate of: (i) Direct Materials; (ii) Direct Labour; and (iii) Direct Expenses.

(b) **Overheads** is the aggregate of: (i) Indirect Materials; (ii) Indirect Labour; and (iii) Indirect Expenses. Overheads are classified into three classes: (i) Factory Overhead; (ii) Administrative Overhead; and (iii) Selling and Distribution Overhead. In Manufacturing Account we only consider the *Factory Overhead***.**

The Format of a Manufacturing Account

In the Manufacturing Account all the elements of production cost, that is, Direct Materials, Direct Labour, Direct Expenses and Factory Overhead are debited. As the Manufacturing Account is concerned with the production cost of goods finished during the year, any opening work-in-progress and closing work-in-progress must be adjusted at the time of preparing the Manufacturing Account of that year. The necessary details required to draw up a Manufacturing Account are shown below.

Dr. Manufacturing Account for the year ended ... Cr.

To Raw materials consumed (Note 1)	***	By Closing Stock of WIP	***
To Direct Labour	***	By Trading Account c/d	***
To Direct Expenses	***	(cost of goods finished and transferred)	
Prime Cost	***		
To Factory overhead (Note 2)	***		
To Opening Stock of W.I.P.	***		
	***		***

Working Notes :

(1) Raw Materials Consumed

Opening stock of raw materials	***
Add: Purchases of raw materials	***
	***
Less: Returns of raw materials	***
Less : Closing stock of raw materials	***
	***
Add: Freight, carriage inward, import duty, excise duty, etc. on materials	***
	***

(2) Factory Overhead

Indirect Materials	Indirect Labour	Indirect Expenses
(i) Secondary packing materials (ii) Maintenance materials (iii) Stores (iv) Grease (v) Lubricating oil (vi) Cotton waste	Wages of : (i) Foreman (ii) Timekeeper (iii) Supervisor (iv) Factory Manager (v) Securitymen	Factory : (i) Rent (ii) Rates (iii) Taxes (iv) Insurance (v) Electricity (vi) Lighting (vii) Heating (viii) Depreciation

Valuation of Stocks in Manufacturing Account

Valuation of manufacturing stock creates problem. At the beginning of the accounting period there will be opening stock of raw materials but at the end of the accounting period there will not only be stocks of raw materials but also stocks of W.I.P. Raw materials will be valued *at cost or market price, whichever is lower*. ***However, it will be a matter to decide what value to place upon work-in-progress. It is common to value the work-in- progress at*** **"***Factory Cost* ", that is, at prime cost plus a proportionate factory overhead.

Distinction Between Trading Account and Manufacturing Account

	Trading Accounnt		Manufacturing Account
1.	It shows the gross profit or gross loss.	1.	It shows the cost of production.
2.	It is prepared by all types of businesses.	2.	It is prepared by manufacturers.
3.	It may have a debit balance or a credit balance.	3.	It always has a debit balance.
4.	It is prepared after the Manufacturing Account.	4.	It is prepared before the Trading Account.
5.	The balance of this account is transferred to the Profit and Loss Account.	5.	The balance of this account is transferred to the Trading Account.
6.	It is a part of the Profit and Loss Account	6.	It is a part of the Trading Account.
7.	Any error in the Trading Account will affect the Profit and Loss Account.	7.	Any error in the Manufacturing Account will affect the Trading Account.
8.	It shows the matching of sales and direct costs.	8.	It is not the matching of sales and cost of production.

Key Points to Remember

1. ***Hire charges of special plant, royalty on production and cost of design will be treated as direct expenses. These are to be treated as part of the prime cost.***
2. ***Opening stock of W.I.P. (Work-in-progress) will be debited to Manufacturing Account. Closing stock of W.I.P. will be credited to Manufacturing Account.***
3. ***All indirect expenses relating to factory will be treated as factory overheads. Examples are : (i) Wages and salary of Durwan and security staff. (ii) Salary of works manager, supervisors, factory/ works staff etc. (iii) Depreciation on plant. (iv) Repairs to plant. (v) Repairs to factory shed etc.***
4. ***Opening stock and closing stock of finished goods will be shown in the Trading Account.***
5. ***Bad debts, discount allowed, audit fees etc. will be debited to Profit and Loss Account.***

Illustration 1

The following information is given to you from the books of a manufacturer in respect of the year ended 31st March, 2017.

Particulars	₹	Particulars	₹
Stock of Raw Materials (1.4.2016)	25,000	Electricity and telephone	6,000
Freight — Inward	8,500	Selling expenses	6,000
Freight — Outward	6,000	Miscellaneous expenses	14,000
Wages — Direct	18,000	Stock of raw materials (31.3.2017)	22,000

Wages — Indirect	14,000	Stock of finished goods	
Sales	4,18,000	Opening	30,000
Stationery	1,500	Closing	40,000
Travelling expenses	5,000	Provision for doubtful debts	8,500
Salaries (H.Q.)	26,000	Depreciation on plant	4,000
Factory expenses	26,000	Depreciation on office furniture and equipments	3,000
Interest on loan paid	1,800	Repairs to plant and machinery	4,650
Returns inwards	5,000	Scrap sale	3,700
Returns outwards	3,500	Purchase of raw materials	2,50,000
Power and fuel	8,000	Coal consumed	9,000
Work-in-progress (1.4.2016)	7,000	Bank interest received	2,600
Work-in-progress (31.3.2017)	4,000		

Adjustments necessary for the following :

(i) Finished goods worth ₹ 5,000 was distributed as free samples.

(ii) A loan was obtained on 1st October, 2012 for ₹ 50,000 carrying interest @ 10 p.a.

(iii) Bad debts to be written off ₹ 750 and Provision for Doubtful Debts to be maintained at ₹ 7,000.

(iv) Electricity and telephone to be apportioned as: Factory 3/5th and office 2/5th.

(v) A fire occurred destroying finished goods worth ₹ 15,000. Insurance company admitted a claim of ₹ 12,000 not yet received.

(vi) Stock of stationery in hand (31.3.2017) ₹ 150.

You are required to prepare the Manufacturing Account and Trading Account and Profit and Loss Account for the year ended 31st March, 2017.

Solution

Dr. Manufacturing Account for the year ended 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Materials Consumed (Note 1)	2,58,000	By Closing Stock of Work-in-Progress	4,000
To Direct Wages	18,000	By Sale of Scrap	3,700
Prime cost	2,76,000	By Trading Account (cost of goods manufactured and transferred)	3,44,550
To Factory overhead (Note 2)	69,250		
To Opening Stock of Work-in-Progress	7,000		
	3,52,250		3,52,250

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

Particulars		₹	Particulars		₹
To Opening stock of finished goods		30,000	By Sales	4,18,000	
To Manufacturing A/c		3,44,550	Less: Returns inwards	5,000	4,13,000
To Gross Profit c/d		98,450	By Goods distributed as free sample		5,000
			By Goods destroyed by fire		15,000
			By Closing stock of finished goods		40,000
		4,73,000			4,73,000
To Salaries		26,000	By Gross Profit b/d		98,450
To Electricity and telephone (2/5 of ₹ 6,000)		2,400	By Bank interest received		2,600
To Stationery (₹ 1,500 — 150)		1,350	By Provision for doubtful debts :		
To Interest on loan	1,800		Old	8,500	
Add: Outstanding interest	700	2,500	New	7,000	1,500
To Travelling expenses		5,000			
To Selling expenses		6,000			
To Bad debts		750			
To Freight outward		6,000			
To Miscellaneous expenses		14,000			
To Loss on fire (₹ 15,000 — ₹ 12,000)		3,000			
To Depreciation on office furniture		3,000			
To Advertisement (free sample)		5,000			
To Net Profit (transferred)		27,550			
		1,02,550			1,02,550

Working Notes :

(1) Materials Consumed	₹	(2) Factory Overhead	₹
Opening stock of raw materials	25,000	Indirect wages	14,000
Add: Purchases of raw materials	2,50,000	Factory expenses	26,000
Add: Freight inward	8,500	Power and fuel	8,000
	2,83,500	Coal consumed	9,000
Less: Return of raw materials	3,500	Electricity and telephone (3/5 of ₹ 6,000)	3,600
	2,80,000	Depreciation on plant	4,000
Less: Closing stock	22,000	Repairs to plant	4,650
	2,58,000		69,250

Illustration 2

Prepare the Manufacturing, Trading and Profit and Loss Account for the year ended on 31.12.2016 and a Balance Sheet as at that date from the following balances extracted from the books of Md. Arif.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Plant (1.1.2016)	50,000		General expenses :		
Plant bought (1.7.2016)	5,000		Office	1,000	
Purchases	65,000		Factory	400	
Packing and Transport	2,000		Insurance	1,800	
Rent, rates and taxes	3,000		Light and heat	900	
Repairs to plant	1,500		Sales		1,62,200
Salaries — Office	7,500		Stock on 1.1.2016 :		
Advertising	1,700		(a) Raw materials	10,000	
Bad debts	1,200		(b) Finished goods	14,000	
Provision for bad debts		2,000	(c) Work-in-progress	3,000	
Bank charges	200		Factory wages	40,000	
Capital Account		75,000	Debtors	20,000	
Current Account		3,000	Creditors		12,000
Drawings	10,000		Cash in hand	500	
Discount		800	Cash at bank	7,500	
Factory power	7,000				
Furniture	1,800		**TOTAL**	2,55,000	2,55,000

Additional Information :

1. Stock at 31.12.2016	₹	2. Following liabilities are to be provided :	₹
Raw materials	7,000	Factory Power	1,000
Work-in-progress	3,500	Rent and rates	600
Finished goods	20,000	Light and heat	300
Packing materials	250	General expenses: Factory	50
3. Insurance prepaid	300	General expenses:Office	100

4. Provide depreciation on Plant @ 10% per annum and on furniture @ 5%; per annum increase bad debts provision by ₹ 1,000.
5. 5/6th of the rent and rates, light and heat and insurance are to be allocated to the factory and 1/6th to office.

Solution

Dr. Manufacturing Account of Md. Arif for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Materials Consumed (Note 1)	68,000	By Work-in-progress (closing)	3,500
To Factory Wages	40,000	By Trading Account (finished goods transferred)	1,27,950
Prime cost	1,08,000		
To Factory overhead (Note 2)	20,450		
To Work-in-progress (opening)	3,000		
	1,31,450		1,31,450

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

Particulars	₹	Particulars	₹
To Stock of finished goods	14,000	By Sales	1,62,200
To Manufacturing A/c	1,27,950	By Closing stock of finished goods	20,000
To Gross Profit c/d	40,250		
	1,82,200		1,82,200
To Salaries	7,500	By Gross Profit b/d	40,250
To Rent and Taxes (Note 3)	600	By Discount received	800
To Light and heat (Note 5)	200		

To Insurance (Note 4)		250			
To General expenses	1,000				
Add: outstanding	100	1,100			
To Depreciation on furniture		90			
To Advertisement		1,700			
To Packing and transport		2,000			
Less: Closing stock of packing materials	250	1,750			
To Bank charges		200			
To Bad debts		1,200			
To Provision for bad debts		1,000			
To Net Profit (transferred)		25,460			
		41,050			41,050

Balance Sheet of Md. Arif as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital Account		75,000	Plant and machinery	50,000	
Current Account			Addition	5,000	
Opening balance	3,000			55,000	
Add: Net Profit	25,460		Less: Depreciation	5,250	49,750
	28,460		Furniture	1,800	
Less: Drawings	10,000	18,460	Less: Depreciation	90	1,710
Trade creditors		12,000	Stock :		
Outstanding expenses :			Raw materials	7,000	
General factory expenses	50		W.I.P.	3,500	
General office expenses	100		Finished goods	20,000	
Factory power	1,000		Packing materials	250	30,750
Light and heat	300		Debtors	20,000	
Rent and taxes	600	2,050	Less: Provision for bad debts	3,000	17,000
			Prepaid insurance		300
			Cash at bank		7,500
			Cash in hand		500
		1,07,510			1,07,510

Working Notes :

(1) Materials Consumed

	₹
Opening stock of raw materials	10,000
Add: Purchases	65,000
	75,000
Less: Closing stock of raw materials	7,000
	68,000

(2) Factory Overhead

		₹
Factory power	7,000	
Add: Outstanding	1,000	8,000
Rent and taxes (Note 3)		3,000
Insurance (Note 4)		1,250
Light and Heat (Note 5)		1,000
Repairs to plant		1,500
General expenses	400	
Add: Outstanding	50	450
Depreciation on plant (Note 6)		5,250
		20,450

(3) Rent and Taxes

	₹
As per trial balance	3,000
Add: Outstanding	600
	3,600
Factory 5/6 = 3,000; Office 1/6 = 600	

(4) Insurance

	₹
As per trial balance	1,800
Less: Prepaid	300
	1,500
Factory 5/6 = ₹ 1,250; Office 1/6 = ₹ 250	

(5) Light and Heat

	₹
As per trial balance	900
Add: Outstanding	300
	1,200
Factory 5/6 = ₹ 1,000; Office 1/6 = ₹ 200	

(6) Depreciation — On ₹ 50,000 @ 10% for 1 year = ₹ 5,000 and On ₹ 5,000 @ 10% for 1/2 year = ₹ 250; Total = ₹ 5,250

Manufacturing Account Showing Manufacturing Profit

When the goods are transferred from the factory to the warehouse at ‘Factory Cost’, they do not give any indication of the profitability of the factory. The Gross Profit achieved by a business is the result of two processes : (a) The manufacturing process, and (b) The trading process. A better control can be exercised over the activities of the business if the results of these two processes can be segregated. A Manufacturing Account can be prepared to ascertain manufacturing profit. In this case, the manufacturing department is treated as a separate ***profit centre***. If this is decided, manufactured goods are transferred from the factory to the warehouse at a profit in any of the following two ways : (a) at sales price, or (b) at cost price plus a fixed percentage of profit.

When goods are transferred to the warehouse at selling price, such transfer price becomes the selling price for the manufacturing department and the purchase price for the trading department. This helps in deciding whether the manufacturing department is running at a profit or at a loss. If the cost per unit is more than the selling price (prevailing in the market), the department will show a loss and the management is to decide whether to close down the manufacturing department or not.

When it is not possible to get a ready market price for the product being transferred to the trading department, goods are transferred at cost plus a fixed percentage of profit. The percentage of profit that is added with the cost is purely on an arbitrary basis.

In both the above cases, the Manufacturing Account is credited with the 'Transfer price' (i.e. selling price or cost plus certain percentage of profit). Since the credit side becomes heavier (for adding the profit with the cost price of the goods transferred), the balancing figure will show the manufacturing profit and will appear on the debit side. Other items in the Manufacturing Account will appear as usual. The manufacturing profit is really the Gross Profit earned by the manufacturing department.

Elimination of Unrealised Profit in Closing Stock

When the goods are transferred from manufacturing department to the trading department at a profit, and at the year end a part of the stock remains unsold, some amount of unrealised profit remains in the closing stock. Applying the concept of conservatism (anticipate no profit but provide for all possible losses), the unrealised profit on closing stock is removed by passing the following journal entry :

Profit and Loss Account Dr.
To Stock Reserve Account

In the Balance Sheet, closing stock appears at its usual value less stock reserve, that is, strictly at cost.

Illustration 4

Leek and Bean were in partnership as lawnmower manufacturers, Leek being responsible for the factory and Bean for the warehouse. All completed lawnmowers were transferred from the factory to the warehouse, at agreed prices. Profits are to be shared as follows :

Factory—Leek (75%); Bean (25%); Trading—Leek (25%); Bean (75%).

The following trial balance has been extracted from the books on 30th June, 2017 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital Account — Leek		48,000	Stock at 30th June, 2016 — W.I.P.	3,400	
Capital Account — Bean		49,000	Lawn mowers completed (1,200 at ₹ 40 each)	48,000	
Drawings — Leek	6,000		Sales (1,820 lawn mowers)		1,11,020
Drawings — Bean	5,000		Purchase of raw materials	28,650	
Freehold factory, at cost	42,150		Factory wages	15,020	
Factory plant, at cost	25,750		Warehouse wages	6,030	
Provision for depreciation to 30.6.2016		6,050	Expenses — Factory	12,070	
Delivery vans, at cost	8,050		Expenses — Warehouse	10,020	
Provision for depreciation to 30.6.2016		3,450	Provision for doubtful debts		1,600
Stock at 30th June, 2013 — Raw materials	4,028		Trade debtors and creditors	18,000	6,000
Bank overdraft		7,048	**TOTAL**	2,32,168	2,32,168

1,520 lawn mowers at ₹ 45 each were transferred to the warehouse in 2016; lawn mowers in stock at the end of the year were to be valued at ₹ 45 each. Stock of raw materials was ₹ 3,180 and work in progress was valued at prime cost of ₹ 5,050 at 30th June, 2017. Accrued expenses outstanding as on 30th June, 2017 were : Factory Expenses ₹ 2,090; Factory Wages ₹ 280; Warehouse Expenses ₹ 1,080; Factory Wages nil.

The general provision for bad debts was to be maintained at 10% of the trade debtors. Bad debts for the year to 30 June 2017 have already been written-off against last year's provision.

Provision for depreciation is to be made as follows : Factory plant 10% p.a. on cost; Motor vehicles 20% p.a. on cost.

You are required to prepare : (a) Manufacturing, Trading and Profit and Loss Accounts for the year ended 30 June 2017; and (b) a Balance Sheet as at that date.

Solution

Dr. **Manufacturing Account for the year ended 30th June, 2017** **Cr.**

Particulars		₹	Particulars	₹
To Raw materials consumed		29,498	By Closing W.I.P.	5,050
To Factory wages	15,020		By Value of goods transferred to warehouse (1,520 x ₹ 45)	68,400
Add: Outstanding	280	15,300		
Prime cost		44,798		

To Factory overhead (Note 2)	16,735		
To Opening W.I.P.	3,400		
To Factory Profit c/d	8,517		
	73,450		73,450

Dr. Trading and Profit and Loss Account for the year ended 30th June, 2017 Cr.

Particulars		₹	Particulars	₹
To Opening stock of finished goods		48,000	By Closing Stock of finished goods (₹ 45 x 900)	40,500
To Value of goods transferred to warehouse		68,400	By Sales (1,820 Units)	1,11,020
To Gross Profit c/d		35,120		
		1,51,520		1,51,520
To Depreciation : Motor vehicles		1,610	By Gross Profit b/d	35,120
To Warehouse wages		6,030		
To Warehouse expenses	10,020			
Add: Outstanding	1,080	11,100		
To Provision for bad debts		200		
To Net Trading Profit c/d		16,180		
		35,120		35,120
To Share of Factory Profit			By Factory Profit b/d	8,517
Leek — 75%	6,388		By Net Profit b/d	16,180
Bean — 25%	2,129	8,517		
To Share of Trading Profit				
Leek — 25%	4,045			
Bean — 75%	12,135	16,180		
		24,697		24,697

Balance Sheet of Leek and Bean as at 30th June, 2017

Liabilities		₹	Assets		₹
Capital Account — Leek	48,000		**Fixed Assets**		
Add: Profit (₹ 6,388 + 4,045)	10,433		Freehold factory (at cost)		42,150
	58,433		Factory plant (at cost)	25,750	
Less: Drawings	6,000	52,433	Less: Depreciation to date	8,625	17,125
Capital Account — Bean	49,000		Delivery van (at cost)	8,050	
Add: Profit (₹ 2,129 + 12,135)	14,264		Less: Depreciation to date	5,060	2,990
	63,264		**Current Assets**		
Less: Drawings	5,000	58,264	Stock :		
Current Liabilities			Raw materials	3,180	
Creditors	6,000		W.I.P.	5,050	
Bank	7,048		Finished goods	40,500	48,730
Accrued Expenses (₹ 2,090 + 280 + 1,080)	3,450	16,498	Debtors	18,000	
			Less: Provision for bad debt	1,800	16,200
		1,27,195			1,27,195

Key Points

- The **production cycle** is the sequence of operations which transforms raw materials into finished goods.
- **Direct Materials** are those which can be identified with the product, that is, these are directly traceable to an article being manufactured.
- **Direct Labour** is the remuneration paid to production workers who are directly associated with the manufacture of particular articles.
- **Direct Expenses** are those which can be directly identified with a particular product other than direct materials and direct labour.
- **Prime cost** is the aggregate of: (i) Direct Materials; (ii) Direct Labour; and (iii) Direct Expenses.
- **Overheads** is the aggregate of: (i) Indirect Materials; (ii) Indirect Labour; and (iii) Indirect Expenses.

THEORETICAL QUESTIONS

1. What do you mean by Manufacturing Account ? Why is it prepared ?
2. What do you mean by Direct Materials, Direct Labour and Direct Expenses ? Give suitable examples.
3. What is a Cost Sheet ? Why is it prepared ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Primary packing materials are
   A treated as indirect materials and included in the factory overhead
   B treated as indirect materials and included in the selling and distribution overhead
   C treated as direct materials and included in prime cost
   D treated as indirect materials and included in the administrative overhead
2. Direct materials are those which
   A cannot be identified with the product
   B are directly not traceable to an article being manufactured
   C are very costly materials used in the production of an article
   D can be identified with the product
3. Which of the following is not an example of direct expenses ?
   A royalties paid on production
   B hire charge of special plant
   C rent and taxes of the factory
   D designing cost
4. Which of the following is an example of direct material ?
   A cotton waste
   B binding wire
   C lubricating oil
   D screws in a furniture factory
5. Direct labour cost is the remuneration paid to a
   A supervisor
   B production worker
   C security staff
   D works manager
6. Which of the following expense is not an item of factory overhead ?
   A insurance of the factory
   B time keeper's salary
   C freight on raw materials
   D stores
7. Prime cost is the aggregate of
   A direct materials consumed + direct labour
   B direct materials purchased + direct labour + direct expense
   C direct materials consumed + direct labour + direct expenses
   D direct materials consumed + direct labour + factory overhead
8. Generally work-in-progress is valued at
   A prime cost
   B factory cost
   C factory cost + administrative overhead
   D prime cost + variable factory overhead
9. Secondary packing materials is treated as
   A direct expenses
   B factory overhead
   C selling overhead
   D distribution overhead
10. Which of the following is an item of overhead ?
    A audit fees
    B bad debts
    C discount allowed
    D delivery van expenses

PRACTICAL QUESTIONS

Manufacturing Account

1. From the following list of balances, prepare Manufacturing Account, Trading Account and Profit and Loss Account for the year ended 31.12.2016. Prepare also a Balance Sheet as on that date.
   Stock on 1.1.2016 : Raw Materials ₹ 30,000, Work-in-Progress ₹ 20,000, Finished Goods ₹ 1,50,000. Purchase of Materials ₹ 3,00,000, Carriage Inwards ₹ 11,000, Wages ₹ 2,00,000, Works Manager's Salary ₹ 56,000, Factory Expenses ₹ 59,000. Sales ₹ 7,34,000, Discount (Cr) ₹ 11,000, Office Expenses ₹ 1,24,000, Advertisement, etc. ₹ 30,000, Carriage Outward ₹ 6,000, Discount (Dr) ₹ 10,000, Cash-in-hand and at Bank ₹ 62,000, Sundry Debtors ₹ 2,50,000, Plant and Machinery ₹ 2,00,000, Land and Buildings ₹ 1,15,000, Sundry Creditors ₹ 4,70,000, Loan @ 5% (Cr.) ₹ 48,000, Drawings ₹ 60,000, Provision for Doubtful Debts ₹ 10,000, Capital ₹ 4,10,000. Additional information available is as follows :
   (a) Stock on 31.12.2016 : Raw Materials ₹ 40,000; Work-in-Progress 45,000; Finished Goods 2,80,000.
   (b) Outstanding Expenses : Wages ₹ 6,000 ; Office Salary ₹ 3,000 and Interest on Loan for the whole year.
   (c) Depreciate : Land and Building @ 2% p.a. and Plant and Machinery @ 5% p.a.
   (d) Provision for doubtful debt is to be raised to 5% on Sundry Debtors.
2. From the following information relating to the business of Lutfur Rahman, prepare a full Manufacturing Account and also prepare Trading, Profit and Loss Account and Balance Sheet for the year ended 30th September, 2016:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	18,61,000	
Sales		41,54,500
Opening Stock:		
Raw materials	1,42,100	
W.I.P.	73,800	
Finished goods	88,500	
Debtors / Creditors	1,89,600	2,01,600
Discount allowed	66,800	
Discount received		89,400
Bank and cash	2,49,400	
General factory expenses	2,10,100	
Rent and rates	41,200	
Light and heat	96,300	
Factory power	1,56,500	
Insurance	12,500	
Sales staff — salary and commission	1,79,900	
Royalties	1,89,000	
Production wages :		
Direct	4,34,700	
Indirect	2,69,800	
Administrative salaries	1,43,300	
Drawings	1,10,000	
Land and Building	24,50,000	
Plant and machinery at cost	12,50,000	
Vehicles	6,25,000	
Depreciation upto date		
Vehicle		2,11,000
Plant and machinery		3,33,000
Capital		38,50,000
TOTAL	88,39,500	88,39,500

Notes at 30th September, 2016 :
1. Stock of : Raw Materials ₹ 1,68,100, Work-in-progress ₹ 82,500 and Finished Goods ₹ 1,03,400.
2. Light and heat, rent and rates, insurance are to be apportioned : Factory 3/5ths, Administration 2/5ths.
3. Depreciation provisions are to be applied to cost on the basis of : Plant and Machinery 10%, Vehicles 20%.

3. Prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31st December, 2016 and Balance Sheet as at that date of Shri S. Singh, manufacturer, from the following Trial Balance and information:

Trial Balance as at 31st December, 2016

Particulars	Dr. (₹)	Cr. (₹)
Advertising	1,660	
Bad debts	1,210	
Bad debts provision		2,000
Bank charges	240	
Capital Account of Sri S. Singh		70,000
Current Account of Sri S. Singh		3,246
Drawings Account of Sri S. Singh	16,000	
Discount		824
Factory power	7,228	
Furniture	1,800	
General expenses — Factory	410	
General expenses — Office	692	
Insurance	1,804	
Light and heat	964	
Plant and machinery (1.1.2016)	30,000	
Plant and machinery bought (30.6.2016)	4,000	
Purchases	67,336	
Packing and transport	2,170	
Rent and rates	2,972	
Repair to plant	1,570	
Salaries — Office	7,380	
Sales		1,58,348
Stock on 1.1.2016:		
(a) Raw materials	10,460	
(b) Finished goods	14,760	
(c) Work-in-progress	3,340	
Wages — Factory	41,400	
Debtors	21,120	
Creditors		12,300
Cash at bank	7,852	
Cash in hand	350	
TOTAL	2,46,718	2,46,718

1. Stock at 31st December, 2016 was : Raw materials ₹ 7,120; W.I.P. ₹ 3,480; Finished goods ₹ 19,300; Packing materials ₹ 250.
2. The following liabilities are to be provided for : Factory power ₹ 1,124; Rent and rates ₹ 772; Light and heat ₹ 320; General expenses : Factory ₹ 50; Office ₹ 80.
3. Prepaid Insurance ₹ 340.
4. Increase bad debt provision by ₹ 1,000.
5. Provide depreciation at 10% p.a on Plant and Machinery and 5% p.a. on furniture.
6. 5/6th of Rent and rates, Light and heat, and Insurance are to be allotted to the factory and 1/6th to the office.

Guide to Answers

Multiple Choice

1. C 2. D 3. C 4. D 5. B 6. C 7. C 8. B 9. B 10. D

Practical Questions

1. **Prime cost ₹ 5,07,000; Cost of finished goods ₹ 6,07,000.**
2. **Prime cost ₹ 24,58,700; Cost of finished goods ₹ 34,26,400.**
3. **Materials consumed ₹ 70,676; Prime cost ₹ 1,12,076; Cost of finished goods — ₹ 1,30.928; G.D. ₹ 31,960; Net Profit ₹ 17, 430; Balance Sheet total ₹ 89,322.**

17

Non-profit Organisation

Introduction

In the previous chapters, the main emphasis was on recording and reporting for trading and manufacturing organisations which are formed for the exclusive purpose of earning a profit for the owner / stakeholders. There are, however, a large number of organisations that do not operate for the profits or gains of their individual members. These organisations are known as ***Non-profit organisations***.

A non-profit organisation is operated for the benefit of the society as a whole, rather than for the benefit of a sole proprietor or a group of partners or shareholders. In every society, some organisations or associations are found which do not have profit making as their objective. Their main objective may be social, educational, religious or charitable and they take the form of clubs, societies or charitable bodies and so on.

Many government activities fall into this category, such as hospitals, schools and colleges. Their main objective is to provide service to the members or beneficiaries. The main idea is to spend the funds of the organisation in such a way that it provides maximum benefit to the members. Nonetheless, in the long run, these forms of organisation must have sufficient surplus after meeting the expenses from the income.

These organisations have no 'owner' as such and these are managed on a voluntary basis. Many social clubs are democratically managed just like a company and the members or beneficiaries get information similar to that provided to a shareholder. But the surplus of these organisations is not distributed among its members by way of dividends as it is done in case of a company. However, we may find certain charitable institutions which are autocratic. They are managed by a small group of trustees who retain the power to appoint their own successors.

Formation of a Non-Profit Organisation

A non-profit organisation is formed when a number of like-minded people decide to formalise their association. After formation, the founder member elect / select a management comittee. They also formulate the rules and regulations for managing the organisation. These matters are formalised in a document called a '***Constitution***' or '***By-laws***'.

The Constitution of the Organisation

At the time of the drafting the constitution of the organisation, the nature of the organisation, the activities of the organisation and the requirements of its members are to be taken into consideration. Generally, the following matters are included in the constitution of the organisation :

1. Purpose of the organisation (education, sports, medical aid, etc.);
2. Qualification for membership;
3. Admission / Joining fees, annual membership subscriptions;
4. Power of different committees, meeting procedures;
5. Financial records and reports;
6. Audit of financial records;
7. Members record;
8. Cheque signing authority;
9. Dissolution procedures of the organisation;
10. Procedures for addressing grievances of the members;
11. Procedures for cancellation of membership;
12. Procedures for acquisition and disposal of fixed assets.

Composition of Management Committee

The management committee of a non-profit organisation generally comprise of the following office bearers:

(a) ***President*** : President is the chief representative of the organisation. All meetings of the organisation are held under his chairmanship.

(b) ***General Secretary*** : General secretary is responsible for correspondence and issue of notice of the meetings. He is also responsible for preparing minutes of the meeting and other administrative works.

(c) ***Treasurer*** : Treasurer is responsible for maintenance of financial records and preparation for financial statements. He also manages the finance of the organisation.

In addition to the above, additional posts are created according to the needs of the organisation. For example, the organisation may have cultural secretary, game secretary, food and beverage secretary and other such office bearers.

Characteristics of a Non-profit Organisation

1. ***Management*** : A non-profit profit organisation is governed by elected members.
2. ***Motive*** : Non-profit entities do not operate with the motive of earning a profit.
3. ***Main Objectives*** : Their main objective may be social, educational, religious or charitable and they take the form of clubs, societies or charitable bodies and so on.
4. ***Area of Service*** : They render services to the members of the public which may range from a limited members of citizens of a community to almost the entire population of a city, state or nation.
5. ***Sources of Income*** : These entities, generally, depend on subscriptions and the donations given by members or outsiders.
6. ***Utilisation of Funds*** : A non-profit profit organisation should spend the funds in such a way that provides maximum benefits to the members.
7. ***Annual Budget*** : It is very important for a non-profit profit organisation to prepare an annual budget.
8. ***Basis of Accounting*** : A non-profit profit organisation generally employs the accrual basis of accounting.
9. ***Utilisation of Surplus*** : 'Surplus' of the year is not distributed among the members. It is added with the 'Capital Fund'. Similarly, deficit is deducted from th 'Capital Fund'.
10. ***Separate Entity*** : Non-profit profit organisation is separate from its members,. the death or resignation of any member will not affect its duration. It will continue in the usual manner.

Accounting Records

The extent of records kept by a non-profit organisation will depend upon the size of the organisation. All big organisations are keeping detailed record of all transactions under double entry system, normally with the help of a suitable accounting package. However, small organisations keep accounting records under single entry method where mainly cash transactions are recorded regularly. Generally, the following books of accounts are maintained :

(i) Petty Cash Book
(ii) Cash Book
(iii) Purchase Journal
(iv) Sales Journal
(v) General Journal

The functions of all the books of accounts are similar to that of a trading organisation.

Non-accounting Records

A non-profit organisation needs to maintain a range of non-accounting records. These records are almost common to all non-profit organisations. Mainly the following non-accounting records are maintained :

(i) Register of Members;
(ii) Minute Book; and
(iii) Correspondence file.

Register of Members : It is extremely important for a non-profit organisation to maintain accurate up-to-date records relating to its members. Nowadays all records relaing to membership are maintained in the computer. A hard copy (print out) is also maintained by the organisation. The register of members should include : the name of the member, date of joining, age of the member, category of membership, permanent address, phone number, mobile number, e-mail address, etc.

A s***pecimen of Register of Members*** is given below :

<table>
<tr><td colspan="5">Bengal Rowing Club
Register of Members</td></tr>
<tr><td colspan="4">Name : Mr P. Gupta
Address : 42, Park Street
Kolkata - 700 016
Telephone No. : 033-2343638
Mobile No. : 93-4645569
E-mail: pgupta@gmail.com</td><td>Membership No. : Ord/0159
Date of Joining : 31st March, 2015
Age Group : Senior</td></tr>
<tr><td colspan="5">Financial Details</td></tr>
<tr><td>Details</td><td>Due Date</td><td>Date Received</td><td>Amount (₹)</td><td>Receipt Number</td></tr>
<tr><td>Admission Fees</td><td>31st March, 2015</td><td>31st March, 2015</td><td>50,000</td><td>A/204</td></tr>
<tr><td>Annual Subscription</td><td>1st April, 2016</td><td>16th May, 2016</td><td>2,000</td><td>S/115</td></tr>
<tr><td>Annual Subscription</td><td>1st April, 2016</td><td>20th June, 2017</td><td>2,500</td><td>S/120</td></tr>
</table>

Minute Book : All the records of the proceedings of the meetings are maintained in the Minute Book. For a non-profit organisation, regular meeting is very common. The accurate records of these meetings are maintained by the Secretary of the organisation. It is used as an evidence in case of any disputes.

Correspondence File : This file is also maintained by the Secretary of the organisation. All important documents (e.g., constitution of the organisation) copy of the correspondences (inward and outward) are kept in this file.

Distinction Between Non-profit Profit Organisation and Profit-seeking Organisation

S. No.	Basis for Distinction	Non-profit Profit Organisation	Profit-seeking Organisation
1.	Main Objective	The main objective may be social, education, religious or charitable.	The main objective is to earn maximum profit through sale of product or services or both.
2.	Sources of Income	Main sources of income are : (i) Subscriptions (ii) Donation (iii) Grants (iv) Interest from investments	Main sources of income are : (i) Sale of goods (ii) Sale of services (iii) other income
3.	Management	It is managed by management committee electred by the members	It is managed by the proprietor or partners or board of directors according to the form of business.
4.	Key Accounting Statements	Three key statements are prepared at the end of the year. These are : (i) Receipts and Payments Account (ii) Income & Expenditure Account (iii) Balance Sheet	Main financial statements are : (i) Trading, Profit and Loss Account (ii) Balance Sheet (iii) Cash Flow Statement (in case of a company form of business)
5.	Financial Result	At the end of the year, surplus or deficit is calculated by preparing 'Income and Expenditure Account'.	At the end of the year, profit or loss is calculated by preparing Profit and Loss Account.
6.	Distribution of Surplus / Profit	The 'surplus' is not distributed amongst the members. It is added to Capcital fund.	The profit is distributed amongst partners in case of a partnership form of business. In case of company form of business, certain portion of the profit is distributed as dividend.

Financial Statements

Non-profit organisations must prepare regularly annual accounts reflecting the financial affairs of the organisation for submitting to the members and government departments for financial grants and the like. A majority of the organisations keep their accounting records under the single entry system. They mainly maintain cash book, suppliers' ledger and members' register. Where the size of the organisation is large, the accounts are kept under complete double entry system. Whatever may be the system of accounting, these organisations prepare, at the year end, the following three key statements:

1. Receipts and Payments Account;
2. Income and Expenditure Account; and
3. Balance Sheet.

Now, we explain below the nature of the above three statements.

1. Receipts and Payments Account

A Receipts and Payments Account is a summary of the Cash Book. This is the primary report prepared by the treasurers of clubs, societies etc to present the result of the year's cash position. Since it is a cash basis of reporting, the Receipts and Payments Account gives the opening cash and bank, the receipts and payments in cash or by cheque during an accounting period and the resultant balance of cash and bank at the end of the accounting period. All the receipts and payments (whether in cash or cheque) are shown on the left-hand side, and all payments (whether in cash or cheque) are shown on the right-hand side.

Features of a Receipts and Payments Account

1. It is the summary of the cash and bank transactions; like cash book, all the receipts (capital or revenue) are debited, similarly all the payments (capital or revenue) are credited.
2. It starts with opening cash and bank balances (though sometimes they are merged) and also ends with their closing balances.
3. This account is usually not a part of the double entry system. It is the duplicate of cash book in concise form.
4. It includes all cash and bank receipts and payments, whether they are related to current, past or future periods.
5. Surplus or deficit for an accounting period cannot be ascertained from this account, since it shows only the cash position and excludes all non-cash items.
6. This account is not a Trial Balance but a 'Cash Trial'.

A specimen of a Receipts and Payments Account is given below.

(Name of the Institution/Club etc.)
Receipts & Payments Account for the year ended 31st March, 2017

Receipts		₹	Payments		₹
To Opening Balance :			By Salaries		***
Cash	***		By Rent		***
Bank	***	***	By Electricity		***
To Subscriptions :			By Purchase of Investment		***
2015-16		***	By Purchase of Furniture		***
2016-17		***	By Closing Balance :		
2017-18		***	Cash	***	
To Donation		***	Bank	***	***
To Sale of Sports Equipment		***			

2. Income and Expenditure Account

The Income and Expenditure Account is equivalent to the Profit and Loss Account of a business enterprise. It is prepared by matching the revenues against the expenses for a specified period, usually a year. Since non-profit organisations do not earn profit (or incur loss) they do not prepare Profit and Loss Account but for evaluating the financial condition of the organisation, they prepare Income and Expenditure Account at the year-end. This account shows surplus or deficit of income over expenditure.

The title 'Income and Expenditure Account' is not strictly correct as the financial report actually records expenses rather than expenditure for the period. An expense is an amount of benefit that has been used up during an accounting period. Expenditure usually means an outlay of money (the benefits of the outlay may or may not be used up during the accounting period in which the outlay occured). Nevertheless, this title is in general usage and will be employed in this chapter.

The method and technique of the preparation of an Income and Expenditure Account is similar to that which is followed in the preparation of a Profit and Loss Account of a profit-seeking concern. The main sources of revenue of these organisations are subscriptions, admission fees, donations and government or other grants. The whole of the revenue income and revenue expenditure for the period is taken into consideration, irrespective of the fact whether they have been actually received or paid or not. Just like Profit and Loss Account, all accrued incomes and outstanding expenditures are shown in this account.

All incomes are shown on the right-hand side (income side) and all expenditures are shown on the left-hand side (expenditure side). No capital expenditure or receipt is taken in the Income and Expenditure Account. If the right-hand total of this account exceeds the left-hand side total, the balance is a surplus and it is called 'Excess of Income over Expenditure'.

Conversely, if the the left-hand side total exceeds the right-hand side total, the balance is a deficit and it is called 'Excess of Expenditure over Income'.

Features of an Income and Expenditure Account

1. It is a revenue account prepared at the end of the financial period for finding out the surplus or deficit of that period.
2. It is prepared by matching expenses against the revenues of the period concerned.
3. Both cash and non cash items, such as depreciation, are taken into consideration.
4. All capital expenditures and incomes are excluded.
5. Only current year's incomes and expenses are considered.

(Name of the Institution/Club etc.)
Income and Expenditure Account for the year ended ...

Expenditure		₹	Income		₹
To Salaries	***		By Subscriptions	***	
Add: Outstanding	***	***	Add: Outstanding	***	
To Rent	—	***	Less: Paid in Advance	***	***
To Insurance Premium	***			—	
Less: Prepaid	***	***	By Donation		***
To Excess of Income over Expenditure	—	***	By Admission fees		***
		***			***

Distinction between the Receipts and Payments Account and the Income and Expenditure Account

	Receipts and Payments Account		Income and Expenditure Account
1.	It is merely a summary of the cash transactions — which begins with the opening balances of cash and bank and ends with the closing balances of cash and bank.	1.	It is a comparable account of a profit and loss account which shows the incomes, expenses and surplus/deficit for the period.
2.	It is almost like a Real Account	2.	It is almost like a Nominal Account.
3.	It records all monies received or paid during a year, irrespective of revenue or capital nature and also relating to the past, current or following year.	3.	It records only expenses and revenues for the current year. Items of capital nature or relating to the past or future period are excluded.
4.	Here, receipts are shown on left-hand side and payments on the right-hand side.	4.	Items appearing on the Receipts and Payments Account cross over sides as they enter into Income and Expenditure Account, that is, incomes on the right-hand side and expenses on the left-hand side.
5.	The balance of this account represents closing balances of cash and bank.	5.	The balance represents either surplus or deficit for the period.
6.	This is followed by an Income and Expenditure Account.	6.	This is followed by a Balance Sheet.

Distinction between the Income and Expenditure Account and the Profit and Loss Account

	Income and Expenditure Account		Profit and Loss Account
1.	It is a revenue account prepared at the end of the accounting period for finding out the surplus or deficit of that period.	1.	It is a revenue account prepared at the end of the accounting period for measuring net profit or net loss by matching revenues and expenses according to the accounting principles.
2.	The surplus or deficit of an accounting period arises as a result of saving the income from subscriptions, small and recurring donations, profit from trading activities and from the expenses and losses incurred to render the necessary services.	2.	The net profit of an accounting period is the difference between total revenue and total expenses. Total revenue is the aggregate of gross profit, other incomes, non-trading income and abnormal gains. Likewise, total expenses combine management expenses, maintenance expenses, selling and distribution expenses, financial expenses and abnormal losses.

3.	When the organisation undertakes trading activities, a separate trading account is prepared and this is used as a subsidiary statement alongwith income and expenditure account.	3.	After preparing trading account the balance of which is transferred to the profit and loss account which is the starting point of the preparation of the profit and loss account.
4.	The surplus of an accounting period cannot be withdrawn by the members, it is added with the general fund.	4.	The net profit may be withdrawn wholly or partly by the owners.

3. Balance Sheet

The Balance Sheet of a non-profit concern is prepared on the same principles as the Balance Sheet of a profit-seeking business. It may be prepared either in the order of liquidity or in the order of permanence.

Balance Sheet of ... as at ...

Liabilities		₹	Assets	₹
Capital Fund	***		Building	***
Add: Surplus	***	***	Furniture	***
Subscriptions Received in advance		***	Sports Equipment	***
Outstanding Wages		***	Cash at Bank	***
			Cash in Hand	***
		***		***

Terminology Used in Accounts of Non-Profit Organisations

1. Capital Fund

It is an item on the Balance Sheet of a non-profit organisation representing the net investment in the organisation of its contributing members. It is nothing but the capital of non-profit organisations. It represents the surplus of assets over liabilities of the organisation. It may be made up in part by special donation or by capitalising admission fees etc. This fund is increased (or decreased) by any surplus (or deficit) on the income and expenditure account. It is also called 'General Fund' or 'Accumulated Fund'.

2. Donation

It is the amount contributed by the supporters, members and well-wishers of the organisation in the form of cash or kind. The donation may be general or special (such as donation for building, prize etc.)

3. Legacy

It is an amount or other item of value received from a deceased person under the terms of a will. When anything is personally given away by a will, it is treated as a gift in the eye of law. The gift which is made by a will, out of general fund of an estate, it is described as 'legacy'. The amount received as legacy may be big or small. A legacy may be 'demonstrative' when it is made out of a particular fund or 'specific' when a particular portion of the estate is assigned. The legacy may be for a specific purpose or just general. If it is for a specific purpose, then it should be capitalised in the name of the 'fund' for that particular purpose. Otherwise, it is directly added to capital fund.

4. Subscriptions

It is the amount paid by the members at regular intervals to keep his membership alive. Subscriptions are the normal main source of revenue of non-profit organisations. At the beginning of the accounting period all subscriptions normally become due and almost all members pay it immediately, since the organisations usually have rules which provide for members to be deleted from the membership roll if they do not pay their subscriptions within a decided period.

5. Sectional Subscriptions

It is the special subscriptions collected from the members who participate in a particular activity because of the cost involved in providing these may vary considerably.

6. Life Membership

This is a system whereby a member pays a lumpsum and then becomes a member for the whole life.

7. Honorarium

A token payment made to a person who has voluntarily undertaken a service which would normally command a fee. It is thus an expression of gratitude rather than a payment for the work done.

Sources of Income of Non-profit Organisations

1. Membership subscriptions
2. Donations
3. Life membership fees
4. ‘Profits’ from bar sales
5. ‘Profits’ from the sale of food in the club, restaurant or cafeteria
6. ‘Profits’ from social events, such as dinner-dance
7. Interest received on investments

Treatment of Few Items used in the Accounts of Non-profit Organisations

1. Membership Subscriptions

Annual membership subscriptions of clubs and societies are payable at the time of renewal of the membership. It should be treated as income of the period concerned after being adjusted for outstanding and advance subscriptions. In practice,outstanding subscriptions are seldom taken into consideration. It may be taken as revenue, provided there is a strong expectation that defaulting members will pay in future. (In examinations, we generally take these into consideration).

Illustration 1(a)

(i)	Subscriptions received during the year 2016	₹ 7,000
(i)	Subscriptions outstanding at the beginning of 2016	₹ 1,400
(iii)	Subscriptions outstanding at the closing of 2016	₹ 1,600

Calculate the amount of subscriptions to be credited to Income and Expenditure Account of the year 2016.

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Outstanding Subscriptions A/c	1,400	?	By Cash A/c	7,000
31.12.2016	To Income and Expenditure A/c	7,200	31.12.2016	By Outstanding Subscriptions A/c	1,600
		8,600			8,600

Alternatively,

	₹
Subscriptions received during the year 2016	7,000
Less: Subscriptions outstanding at the beginning of 2016	1,400
	5,600
Add: Subscriptions outstanding at the closing of 2016	1,600
Amount to be credited to Income and Expenditure Account	7,200

Illustration 1(b)

Calculate the amount of subscriptions to be credited to Income and Expenditure Account of the year 2016.

		₹
(i)	Subscriptions received during 2016	12,000
(ii)	Subscriptions received in advance for 2017	1,600
(iii)	Subscriptions outstanding at the beginning of 2016	2,000
(iv)	Subscriptions outstanding at the closing of 2016	700

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Outstanding Subscriptions A/c	2,000	?	By Cash A/c	12,000
31.12.2016	To Subscriptions received in advance for 2017	1,600	31.12.2016	By Outstanding subscriptions	700
31.12.2016	To Income and Expenditure A/c	9,100			
		12,700			12,700

Alternatively,	₹
Subscriptions received during the year 2016	12,000
Less: Subscriptions outstanding at the beginning of 2016	2,000
	10,000
Less: Subscriptions received in advance for 2017	1,600
	8,400
Add: Subscriptions outstanding at the closing of 2016	700
Amount to be credited to Income and Expenditure Account	9,100

Illustration 1(c)

Mr Flier, the treasurer of Fly-High Club for the accounting year April 2016 to March 2017, submits the following data for membership fees.

(i) Cash/cheque received in the year totalled ₹ 1,00,000.

(ii) As on 1.4.2016, ₹ 2,000 was in arrears for 2015-16 (but cleared by 31-3-2017) and ₹ 800 was received by the previous year's treasurer for Mr Flier.

(iii) Mr Flier received ₹ 1,500 towards next year's fees, but failed to recover ₹ 1,700 from his current year's members.

Show the final subscriptions income of the year 2016-17.

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Outstanding Subscriptions A/c (2015-16)	2,000	1.4.2016	By Sub. Recd. in Adv. A/c for 2016-17	800
31.3.2017	To Sub. Recd. in Adv. A/c for 2017-18	1,500	?	By Cash A/c	1,00,000
31.3.2017	To Income and Expenditure A/c		31.3.2017	By Outstanding Subscriptions A/c	1,700
	— Subscriptions income for the year	99,000			
		1,02,500			1,02,500

Illustration 1(d)

Calculate the amount of subscriptions to be credited to Income and Expenditure Account for the year 2016. ₹

(i)	Subscriptions received during 2016	15,000
(ii)	Subscriptions outstanding at the end of 2015	2,000
(iii)	Subscriptions received in advance on 31st December 2015	1,000
(iv)	Subscriptions received in advance on 31st December 2016	3,000
(v)	Subscriptions outstanding on 31st December 2016	5,000

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Outstanding subscriptions A/c for 2015	2,000	1.1.2016	By Subscriptions received in advance for 2016	1,000
31.12.2016	To Subscriptions received in advance for 2017	3,000	?	By Cash A/c	15,000
31.12.2016	To Income and Expenditure A/c	16,000	31.12.2016	By Outstanding subscriptions A/c	5,000
		21,000			21,000

Alternatively,	₹
Subscriptions received during the year 2016	15,000
Less: Subscriptions outstanding at the end of 2015	2,000
	13,000
Add: Subscriptions received in advance on 31.12.2015 for 2016	1,000
	14,000
Less: Subscriptions received in advance on 31.12.2016 for 2017	3,000
	11,000
Add: Subscriptions outstanding on 31.12.2016	5,000
Amount to be credited to Income and Expenditure Account	16,000

Illustration 1(e)

Prepare a statement showing subscriptions received in 2016-17 as per Receipts and Payments Account. ₹

(i)	Subscriptions Income for 2016-17 as per Income and Expenditure Account	82,000
(ii)	Advance subscriptions received in 2015-16	4,000
(iii)	Subscriptions outstanding at the end of 2016-17 including ₹ 1,000 for 2015-16	9,500
(iv)	Advance subscriptions received for 2017-18	2,000
(v)	Subscriptions written-off during 2016-17	500

(vi)	Subscriptions receivable on 1.4.2016	5,000
(vii)	Subscriptions collected for 2016-17 by the Secretary but not deposited	1,000

Solution

Statement Showing Subscriptions Received in 2016-17 as per Receipts and Payments Account

Subscriptions Income for 2016-17 as per Income and Expenditure Account			82,000
Less :	Advance subscriptions received in 2015-16	4,000	
	Outstanding subscriptions (2016-17) — ₹ (9,500 – 1,000)	8,500	12,500
			69,500
Add:	Outstanding subscriptions collected in 2016-17 (Note 1)	3,500	
	Subscriptions received in advance for 2017-18	2,000	5,500
			75,000
Less:	Subscriptions collected by the Secretary but not deposited		1,000
			74,000

Working Note : (1) Subscriptions receivable at 1.4.2016 ₹ 5,000. Out of this, ₹ 500 has been written off during 2016-17 and at the end of 2016-17 subscriptions outstanding for 2015-16 was ₹ 1,000. Therefore, subscriptions collected in 2016-17 in respect of previous year is ₹ 3,500 (₹ 5,000 – ₹ 500 – ₹ 1,000).

Alternatively

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Subscription Receivable on 1.4.2016	5,000	1.4.2016	By Subscription Received in Advance A/c	4,000
31.3.2017	To Income and Expenditure A/c	82,000		By Income and Expenditure A/c	
31.3.2017	To Subscriptions Received in Advance A/c			(Subscriptions Written-off)	500
	(2017-18)	2,000		By Secretary A/c	1,000
				By Cash / Bank A/c (Balancing figure)	74,000
			31.3.2017	By Subscriptions Receivable A/c	
				2015-16	1,000
				2016-17	8,500
		89,000			89,000

Illustration 1(f)

The following information was obtained from the Secretary of the Crazy Jay Club :

	₹
Subscriptions received in 2016-17 as per Receipts and Payments Account	89,000
Advance subscriptions received in 2015-16	5,000
Subscriptions outstanding at the end of 2016-17 (including ₹ 1,500 for 2015-16)	12,500
Advance subscriptions received for 2017-18	3,000
Subscriptions written-off during 2016-17	600
Subscriptions receivable on 1.4.2016	8,400

Prepare (i) a Statement or Account showing the Subscriptions Income for the year ended 31.3.2017 and (ii) show how the relevant items will appear in the Income and Expenditure Account for the year and in the Balance Sheet as at the end of the year.

Solution

Dr. **(i) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Subscriptions Receivable	8,400	1.4.2016	By Subscriptions Received in Advance	5,000
31.3.2017	To Income and Expenditure A/c	95,700		By Bank A/c	89,000
31.3.2017	To Subscriptions Received in Advance	3,000		By Income and Expenditure A/c	600
				(Written-off subscriptions)	
			31.3.2017	By Subscriptions Receivable :	
				2015-16	1,500
				2016-17	11,000
		1,07,100			1,07,100

(ii) In Income and Expenditure Account ₹ 95,700 will be shown as income and ₹ 600 will be shown as expense.
In the Balance Sheet, subscriptions receivable ₹ 12,500 (₹ 11,000 for 2016-17 and ₹ 1,500 for 2015-16) will be shown on the **assets side**.
Subscription received in advance for 2017-18 ₹ 3,000 will be shown on the **liabilities side**.

Illustration 1(g)

Anderson Club has 300 annual members. In the annual general meeting held on 31st December, 2015, it was decided to raise the subscriptions from the current ₹ 200 p.a. to ₹ 300 p.a. from the year 2016. The members who have paid in advance will be allowed subscriptions at the old rates.

Subscriptions received in advance on 31.12.2015 was ₹ 2,000 and subscriptions in arrear on 31.12.2015 was ₹ 3,000.

Subscriptions in arrear on 31.12.2015 were received during 2016 with the exception of those due from 5 members.

Subscriptions in arrear for the year 2016 are in respect of 15 members.

You are required to prepare Subscriptions Account for the year 2016 and calculate the amount of subscriptions received in cash during the year 2016.

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Subscriptions in Arrear A/c (15 x ₹ 200)	3,000	1.1.2016	By Subscriptions Received in Advance A/c (10 x ₹ 200)	2,000
31.12.2016	To Income and Expenditure A/c (Note 1)	89,000	?	By Cash / Bank A/c (Balancing figure)	84,500
			31.12.2016	By Subscriptions in Arrear A/c	
				2015 (5 x ₹ 200)	1,000
				2016 (15 x ₹ 300)	4,500
		92,000			92,000

Working Note : **(1) Calculation of Subscriptions for the year 2016**

	₹	₹
Subscriptions received at new rate ₹ 300 from 290 members (300 – 10)	87,000	
Subscriptions received at old rate ₹ 200 from 10 members who paid in advance in 2015	2,000	89,000

2. Donation

(i) Donations received from persons, firms, companies in the form of money should be added directly to the capital fund if the amount is *large and non-recurring*.

(ii) *Small and recurring* donations collected or received should be credited to Income and Expenditure Account of the period concerned.

(iii) Donations received in the form of an asset should be credited to the particular fund, for which the amount has been donated and in the absence thereof, to the Capital Fund Account.

(iv) When specific direction has been given in the rules and regulations of the organisation, it should be treated accordingly.

3. Entrance or Admission Fee

(i) Admission fee payable by a member only once, at the time of becoming a member, should be treated as capital receipts and credited to Capital Fund Account.

(ii) Where the amount is small, just to cover the expenses of admission, it should be treated as revenue receipts and credited to Income and Expenditure Account.

(iii) When a specific direction has been given in the rules and regulations of the organisation, it should be treated accordingly.

4. Life Membership Fee

(i) Amount received from life membership should be *credited to a special fund* called ***Life Membership Fund*** and an amount equal to annual subscriptions or other agreed amount is transferred every year to the Income and Expenditure Account, the balance of this fund is carried forward till it is fully exhausted. If any life member dies before the entire amount paid by him has been transferred in the above way, the balance should be transferred to the Capital Fund on the date of his death.

(ii) Alternatively, the entire amount can be credited to the Capital Fund in the year in which it is received.

There is no universal practice and a constituent treatment of such items as either revenue or capital would be acceptable.

Illustration 2(a)

A club received the following life membership fees in each of its first two years : 2015 : ₹ 15,000; 2016 : ₹ 8,000.

The club's policy is to take credit for life membership fees in equal amounts over 10 years.

Show their Life Membership Fund Account for the years 2015 and 2016. State the income from life membership fees to be shown in the Income and Expenditure Account in both the years.

Solution

Dr. **Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Income and Expenditure A/c	1,500	2015	By Bank A/c	15,000
	To Balance c/d	13,500			
		15,000			15,000
2016	To Income and Expenditure A/c (Note 1)	2,300	2016	By Balance b/d	13,500
	To Balance c/d	19,200		By Bank A/c	8,000
		21,500			21,500

Working Note : (1) The amount transferred to income and expenditure account in 2nd year is made up of :

10% of 1st year = 10% of ₹ 15,000	1,500
10% of 2nd year = 10% of ₹ 8,000	800
	2,300

Illustration 2(b)

From the following information show the Life Membership Fund Account

For many years, life membership of the Club cost ₹ 1,000 but with effect from 1.1.2016, the rate has been increased to ₹ 1,200. The life membership details on 31.12.2015 were as follows :

	Number of Members
Joined more than 19 years ago	32
Joined within the last 19 years	64
	96

The balance of Life Membership Fund as on 1st January, 2016 was ₹ 37,800.

The club's policy is to take credit for life membership fees in equal amount over 20 years, beginning with the year of enrollment. During 2016, 4 new members were enrolled and one member (who had joined in 2012) died.

Solution

In respect of 32 members, those who joined more than 19 years ago, life membership fees so received have already been exhausted. Therefore, nothing will be credited to Income and Expenditure Account.

Till 31.12.2015, life membership was ₹ 1,000. Therefore, ₹ 50 (₹ 1,000 / 20) per member is credited to Income and Expenditure Account every year.

In respect of deceased members who joined in 2012, ₹ 200 (4 years — 2012 to 2015) has already been credited to Income and Expenditure Account. The balance of ₹ 800 (₹ 1,000 – 200) is to be transferred to Capital Fund Account. The Life Membership Fund Account will be as follows :

Dr. **Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Capital Fund A/c (See Note above)	800	1.1.2016	By Balance b/d	37,800
31.12.2016	To Income and Expenditure A/c (Note 1)	3,390	?	By Cash / Bank A/c (4 x ₹ 1,200)	4,800
31.12.2016	To Balance c/d	38,410			
		42,600			42,600

Working Note :

(1) Amount to be transferred to Income and Expenditure Account in respect of Life Membership Fees

	₹	₹
(i) In respect of 63 (64 – 1) members those who joined within the last 19 years @ ₹ 50 each	3,150	
(ii) In respect of 4 new members @ ₹ 60 (₹ 1,200 / 20)	240	3,390

5. Legacy

Legacy received is directly added to Capital Fund after deducting any tax payable under the law for the time being in force.

6. Restaurant or Bar Trading

In order to calculate the restaurant or bar profit, a restaurant or bar trading account is prepared in the same way as we prepare trading accounts for trading organisations. The restaurant or bar profit is then transferred to the income and expenditure account. Likewise, a trading account can also be prepared for any subsidiary activity carried on by the organisation.

7. Other Club Activities

Other club activities can be netted off on the face of the Balance Sheet. For example, surplus from charity show can be added with the excess of income over expenditure in the Balance Sheet. Alternatively, charity show receipts should appear as an income and charity show payments as an expense in the income and expenditure account.

Fund Based and Non-Fund Based Accounting

Funds are cash or its equivalents. In accounting, the term 'fund' is used to include securities (money invested in income-bearing assets) which have a ready market and can be converted into cash. Funds also refer to assets for specific purposes, which are not generally available for normal business activities. In fact, a fund sets aside cash or other assets to achieve specific objectives. Non-profit organisations can be distinguished by the difference in the source of its financial resources. One type includes organisations whose financial resources are obtained from subscription dues, interest or dividends on investments, and from the sale of goods or services. Normally, such revenue is inadequate to cover the expenses of the organisations. The other type obtains a significant quantum of its resources when they solicit support and capital additions from various donors. **Support** consists primarily of contributions from individuals, other non-profit organisations, etc. to be used for current operations. ***Capital additions*** are non-expendable gifts, grants, etc. restricted by the owner or granted for a particular purpose, either for an unlimited or a limited period of time.

Accounting for capital additions is known as ***fund based accounting***, while accounting for resources from sources, other than capital additions, is known as ***non-fund based accounting***.

Under fund based accounting, in order to keep a record for the funds received or raised for a particular purpose, a capital fund account is opened. At the same time, to prevent the funds being used for other purposes, a separate fund investment account is opened to record the investments made out of those funds. The Balance Sheet shows funds on the liabilities side and funds investments on the assets side. At the end of the specified period, all investments are sold away. The proceeds are utilised for meeting that particular purpose for which the fund was created, and that fund is transferred to capital fund. It should be noted that fund based accounting has nothing to do with the preparation of income and expenditure account.

Under non-fund based accounting, all financial resources, other than capital additions, are treated as income for the current period and taken to the income and expenditure account.

Special Kinds of Funds

Non-profit organisations may also set up a fund for a special purpose. For example, a cricket club may wish to acquire an electronic score board and may set up a special fund for this purpose. It should be noted that any amount received through donation or fund raising activities for a particular purpose should be transferred directly to the fund rather than to the income and expenditure account. Similarly, all expenses relating to the special purpose should be charged to the fund rather than the income and expenditure account.

(1) Unrestricted Fund : An unrestricted fund includes all the assets of a non-profit organisation that are available for use as authorised by the managing committee, and are not restricted for specific purposes.

(2) Restricted Fund : A restricted fund is generally established by a non-profit organisation to account for assets available for current operations, but expendable only as authorised by the donor of the assets.

(3) Endowment Fund : 'Endow' means to provide permanent income for. An endowment fund is generally a non- expendable fund. A pure endowment fund is one for which the principal must be maintained indefinitely in income producing investments. Only the income can be expended.

A ***term endowment fund*** can be expended only after a specified period of time or the occurrence of an event specified by the donor. A ***quasi endowment fund*** is created by the non-profit organisation itself, rather than by an outside donor, for a specific purpose (as explained earlier).

(4) Annuity Fund : An annuity fund is established when a non-profit organisation receives assets from a donor with the stipulation that the organistaion pay specified amounts periodically to designated recipients, for a specified time period.

(5) Loan Fund : A loan fund may be established by any non-profit organisation to grant loans to the members. Loan funds, generally, are revolving, i.e., as old loans are repaid, new loans are made from receipts.

(6) Agency Fund : An agency fund is used to account for money held by a non-profit organisation as a custodian. The money is disbursed only as instructed by their owner. For example, for lending books, a club may ask for a deposit from members. The deposit is refunded to the member when he does not want to avail of this facility. An agency fund is shown as a ***liability*** than as a fund balance.

Types of Problems

1. Preparation of Income and Expenditure Account and Balance Sheet when Trial Balance and other information are given.
2. Preparation of Income and Expenditure Account and Balance Sheet when Receipts and Payments Account and other information are given.
3. Preparation of Income and Expenditure Account and Balance Sheet from incomplete records.
4. Preparation of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet when ledger balances and other information are given.
5. Preparation of Receipts and Payments Account when Income and Expenditure Account, Balance Sheet and other information are given.
6. Preparation of opening and closing Balance Sheet when Receipts and Payments Account and Income and Expenditure Account are given.

1. Preparation of Income and Expenditure Account and Balance Sheet when Trial Balance and other Information are Given

The method of preparation of an Income and Expenditure Account is similar to that which is used in the preparation of a Profit and Loss Account. The following points are worth noting about the Income and Expenditure Account:

(i) All the incomes are shown on the right hand side of the account and all the expenses are shown on the left hand side of the account.

(ii) It should be carefully noted that the incomes and expenses shown are those which relate to the period for which such an account is prepared. The whole of income and expenditure for the year are taken into account, irrespective of the fact whether they have been actually received and paid respectively or not. If an income is accrued or if an expenditure is outstanding, it is to be adjusted properly in the account.

(iii) All capital income and expenditure are shown in the Balance Sheet.

(iv) If the total of the right hand side is greater than the total of the left-hand side, the balance is a surplus and is called 'Excess of Income over Expenditure'. If, on the other hand, the total of the left-hand side is greater than the total of the right-hand side, the balance is a deficit and is called 'Excess of Expenditure over Income'.

(v) The surplus is not distributed as profit among the members but it is added to the Accumulated/Capital Fund in the Balance Sheet. Similarly, the deficit is deducted from the Accumulated Fund.

Illustration 3

From the following Trial Balance of Calcutta Club prepare an Income and Expenditure Account for the year ended on 31st March, 2017 and a Balance Sheet as on that date (all figures in Rupees):

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
General Fund		30,000	Subscriptions received in advance		1,500
Cash in hand	2,000		Steward's and servant's wages	5,800	

Cash at Bank	3,000		Extension of Club house	10,000	
Sundry Debtors	2,400		Printing and stationery	1,000	
Sundry Creditors		1,500	Law charges	500	
Loan @ 15% (01.07.2016)		20,000	Annual subscriptions		30,000
Furniture and Fixture	10,000		Card and Billiard room receipts		4,000
Club house	40,000		Washing of liveries and sundries	1,600	
Stock of Cigar (01.04.2016)	500		Wines, Cards and Cigars sold		5,000
Rent	6,000		Repairs to Club house and furniture	400	
Rates, Taxes and Insurance	600		Conversion expenses	1,000	
Secretary's Honorarium	1,200		Wine Cards and Cigars purchased	4,000	
Entrance Fees	1,000		Interest on Loan	1,000	
			TOTAL	92,000	92,000

Additional Information : (i) Subscriptions for 2016-17 outstanding ₹ 2,000; (ii) Write-off depreciation @ 10% p.a. on furniture and 2% on Club house including the extention; and (iii) Stock of Cigars ₹ 400; Wine ₹ 600 on 31.03.2017.

Solution

Calcutta Club
Income and Expenditure Account for the year ended 31st March, 2017

Expenditure		₹	Income		₹
To Stock of Cigar		500	By Subscriptions	30,000	
To Wine, cards & cigars purchased		4,000	Add: Outstanding	2,000	32,000
To Rent		6,000	By Card & Billiard Room receipts		4,000
To Rates, Taxes & Insurance		600	By Wine, Cards & Cigars sold		5,000
To Secretary's Honorarium		1,200	By Closing Stock :		
To Entrance Fees		1,000	Cigars	400	
To Steward's and Servant's wages		5,800	Wine	600	1,000
To Printing and Stationery		1,000			
To Law charges		500			
To Washing of liveries & sundries		1,600			
To Repairs to Club house and furniture		400			
To Conversion expenses		1,000			
To Interest on Loan	1,000				
Add: Outstanding	1,250	2,250			
To Depreciation on :					
Furniture @ 10% p.a.		1,000			
Club house @ 2%		1,000			
To Excess of Income over Expenditure — Surplus		14,150			
		42,000			42,000

Balance Sheet of Calcutta Club as at 31st March, 2017

Liabilities		₹	Assets		₹
General Fund	30,000		Club house	40,000	
Add: Surplus	14,150	44,150	Add: Extension	10,000	
Sundry Creditors		1,500		50,000	
15% Loan		20,000	Less: Depreciation	1,000	49,000
Interest on Loan (outstanding)		1,250	Furniture & Fixture	10,000	
Subscriptions received in advance		1,500	Less: Depreciation	1,000	9,000
			Stock in hand :		
			Cigars	400	
			Wine	600	1,000
			Sundry Debtors		2,400
			Subscriptions due		2,000
			Cash at Bank		3,000
			Cash in hand		2,000
		68,400			68,400

2. Preparation of Income and Expenditure Account and Balance Sheet when Receipts and Payments Account and other Information are Given

The following steps are to be followed for preparing the Income and Expenditure Account and Balance Sheet from a given Receipts and Payments Account :

Step 1

Prepare Balance Sheet at the beginning of the period after taking into account (i) the opening balances of cash and bank as per Receipts and Payments Account, and (ii) Assets and Liabilities (supplied through additional information) at the beginning. The difference between the Assets and Liabilities represents Accumulated Fund. This Accumulated Fund is also called General Fund or Capital Fund.

Step 2

Identify, from the Payments side of the Receipts and Payments Account, the Capital Payments and Revenue Payments. Now,

(i) Post revenue payments in which no adjustments to be made directly, to the expenditure side (left hand side/debit side) of the Income and Expenditure Account.
(ii) Prepare statements or open ledger accounts in respect of revenue payments in which adjustment to be made. Post the adjusted amount to the expenditure side of the Income and Expenditure Account.
(iii) Post capital payments to appropriate assets or liabilities accounts for being incorporated in the Balance Sheet.

Step 3

Identify, from the Receipts side of the Receipts and Payments Account, the Capital Receipts and Revenue Receipts. Now,

(i) Post revenue receipts in which no adjustment is to be made, directly to the income side (right hand side/credit side) of the Income and Expenditure Account.
(ii) Prepare statement or open ledger accounts in respect of revenue receipts in which adjustment is to be made. Post the adjusted amount is to the income side of the Income and Expenditure Account.
(iii) Post capital receipts to appropriate assets and liabilities for being incorporated in the Balance Sheet.

Step 4

Analyse the additional information given and make necessary entries in the Income and Expenditure Account for depreciation on fixed assets, loss or profit on sale of assets etc.

(i) Depreciation ⟶ Post to the expenditure side of the Income and Expenditure Account.
(ii) Loss on sale of Assets ⟶ Post to the expenditure side of the Income and Expenditure Account.
(iii) Profit on sale of Assets ⟶ Post to the income side of the Income and Expenditure Account.

Step 5

Calculate surplus or deficit in the Income and Expenditure Account. (i) If the income side is greater than expenditure side, there is a 'surplus' and put it in the expenditure side as 'To Excess of Income over Expenditure'; (ii) If the expenditure side is greater than the Income side, there is a 'deficit' and put it on the Income side as 'By Excess of Expenditure over Income'; (iii) Transfer the surplus or deficit of the Income and Expenditure Account to the Accumulated Fund Account; and (iv) Prepare Balance Sheet at the end of the period after taking into account opening balance, addition and/or, sale during the year and other adjustments like depreciation etc. in respect of the assets.

Illustration 4

Calcutta Golf Club prepared the following Receipts and Payments Account for the year ended 31.12.2016 :

Receipts	₹	Payments	₹
To Balance b/d	3,800	By Sports Equipments (purchased on 1.9.2016)	10,000
To Subscriptions :		By Tournament Expenses	4,000
2015	2,000	By Electricity	500

2016	18,500	By Printing	300
2017	900	By Salaries and Wages	3,400
To Entrance Fees (capital receipts)	800	By Expenses for Exhibition	2,100
To Interest on Investment	1,500	By Balance c/d	7,200
	27,500		27,500

Additional information : (i) Fixed assets of the club on 1.1.2016 include the following : Sports Equipment — ₹ 15,500; Club Ground—₹ 62,000; Furniture—₹ 2,000; (ii) Subscriptions for 2016 collected in 2015—₹ 500; (iii) Unpaid subscriptions for 2016—₹ 300; (iv) Depreciation to be provided @ 20% p.a. on sports equipment and @ 5% p.a. on furniture.

Prepare an Income and Expenditure Account for the year ended on 31.12.2016.

Solution

Calcutta Golf Club
Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income		₹
To Tournament Expenses	4,000	By Subscriptions	18,500	
To Electricity	500	Add: Received in 2015	500	
To Printing	300		19,000	
To Salaries and Wages	3,400	Add: Subscriptions in arrear	300	19,300
To Expenses for Exhibition	2,100	By Interest on Investment		1,500
To Depreciation on :				
Sports Equipments (Note 1)	3,767			
Furniture	100			
To Excess of Income over Expenditure	6,633			
	20,800			20,800

Working Note : (1) Depreciation on sports equipments — 20% on ₹ 15,500 for 1 year + 20% on ₹ 10,000 for 4 months = ₹ 3,100 + ₹ 667 = ₹ 3,767.

Illustration 5

A summary of receipts and payments of Medical Aid Society for the year ended 31.12.2016 is given below:

Receipts	₹	Payments	₹
To Balance (1.1.2016)	7,000	By Payment for medicines	30,000
To Subscriptions	50,000	By Honorarium to doctors	10,000
To Donations	14,500	By Salaries	27,500
To Interest on investments @ 7% p.a.	7,000	By Sundry expenses	500
To Charity show proceeds	10,000	By Equipment purchased	15,000
		By Charity show expenses	1,000
		By Balance (31.12.2016)	4,500
	88,500		88,500

Additional information (in Rupees):	1.1.2016	31.12.2016		1.1.2016	31.12.2016
Subscriptions due	500	1,000	Amount due to Medicine suppliers	8,000	12,000
Subscriptions received in advance	1,000	500	Value of equipments	21,000	30,000
Stock of medicines	10,000	15,000	Value of Buildings	40,000	38,000

You are required to prepare Income and Expenditure Account for the year ended 31st December, 2016 and the Balance Sheet as on that date.

Solution

Medical Aid Society
Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Medicines consumed (Note 4)	29,000	By Subscriptions (Note 2)	51,000
To Honorarium to Doctors	10,000	By Interest on investment	7,000
To Salaries	27,500	By Charity show proceeds	10,000
To Sundry Expenses	500	By Excess of Expenditure over Income	8,000
To Charity show expenses	1,000		
To Depreciation :			
On Equipment	6,000		
On Buildings	2,000		
	76,000		76,000

Balance Sheet of Medical Aid Society as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital Fund :	1,69,500		Building	40,000	
Add: Donations	14,500		Less: Depreciation	2,000	38,000
	1,84,000		Equipments	21,000	
Less: Excess of Expenditure over Income	8,000	1,76,000	Add: Purchased	15,000	
Subscriptions received in advance for 2017		500		36,000	
Creditors for Medicines		12,000	Less: Depreciation (Note 7)	6,000	30,000
			Stock of medicines		15,000
			Investments		1,00,000
			Subscriptions outstanding for 2016		1,000
			Cash in hand		4,500
		1,88,500			1,88,500

Working Notes : **(1) Balance Sheet of Medical Aid Society as at 1st January 2016**

Liabilities	₹	Assets	₹
Capital Fund (balancing figure)	1,69,500	Building	40,000
Creditors for Medicines	8,000	Equipment	21,000
Subscriptions received in advance	1,000	Stock of medicines	10,000
		Subscriptions outstanding	500
		Investment (Note 5)	1,00,000
		Cash in hand	7,000
	1,78,500		1,78,500

Dr. **(2) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Outstanding subscriptions for 2015	500	1.1.2016	By Subscriptions received in advance for 2016	1,000
31.12.2016	To Income and Expenditure A/c (balancing fig.)	51,000	?	By Cash	50,000
31.12.2016	To Subscriptions received in advance in 2016	500	31.12.2016	By Outstanding subscriptions for 2016	1,000
		52,000			52,000

Dr. **(3) Creditors for Medicines Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c (payments)	30,000	1.1.2016	By Balance b/d	8,000
31.12.2016	To Balance c/d	12,000	31.12.2016	By Purchase of medicines (balancing figure)	34,000
		42,000			42,000

(4) Medicines Consumed = Opening stock ₹ 10,000 + Purchases ₹ 34,000 – Closing stock ₹ 15,000 = ₹ 29,000

(5) Interest on investment received ₹ 7,000 in 2016 indicates that there was investments at the beginning of 2016. The rate of interest is 7%. So, the value of investment = 100/7 x ₹ 7,000 = ₹ 1,00,000

(6) Donation has been transferred to capital fund.

Dr. **(7) Equipment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	21,000	31.12.2016	By Income and Expenditure A/c	6,000
?	To Cash (purchase)	15,000	31.12.2016	By Balance c/d	30,000
		36,000			36,000

Illustration 6

The following summary of the Cash Book has been prepared by the Treasurer of a Club:

Receipts	₹	Payments	₹
Cash in hand and at bank on April 1, 2016	4,740	Wages — Outdoor staff	13,380
Members' subscriptions	29,720	Restaurant purchases	50,400
Entrance fees	3,200	Rent — 18 months to June 30, 2017	7,500
Restaurant receipts	56,800	Rates	2,200
Games competition receipts	13,640	Secretary's salary	3,120
Due to secretary for petty expenses	80	Lighting, cleaning and sanitary services	7,700
		Competition prizes	4,000
		Printing, postage and sundries	6,000
		Placed in fixed deposits with bank	8,000
		Balance in hand and at bank on March 31, 2017	5,880
	1,08,180		1,08,180

On April 2016, the Club's assets were: Furniture and Equipment ₹ 48,000; Restaurant Stocks ₹ 2,600; Stock of Prizes ₹ 800. ₹ 5,200 was owing for supplies to the Restaurant.

On March 31, 2017 the Restaurant Stocks were ₹ 3,000 and prizes in hand were ₹ 500 while the Club owed ₹ 5,600 for Restaurant Supplies.

It was also found that Members' Subscriptions unpaid at March 31, 2017, amounted to ₹ 1,000 and that the figure of ₹ 29,720 shown in the Cash Book included ₹ 700 in respect of the previous year and ₹ 400 paid in advance for the following year.

Prepare an account showing the profit or loss made on the Restaurant and a General Income ad Expenditure Account for the year ended 31st March, 2017 together with a Balance Sheet at that date, after writing 10 per cent off on the furniture and equipment.

Solution

Dr. **Restaurant Trading for the year ended 31st March, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Opening stock	2,600	By Restaurant receipts	56,800
To Purchases (Note 2)	50,800	By Closing Stock	3,000
To Profit (transferred to Income and Expenditure A/c)	6,400		
	59,800		59,800

Income and Expenditure Account for the year ended 31st March, 2017

Expenditure	₹	Income	₹
To Wages—Outdoor staff	13,380	By Members' subscriptions (Note 3)	29,620
To Rent	5,000	By Games competition receipts	13,640
To Rates	2,200	By Restaurant profit	6,400
To Secretary's salary	3,120		
To Lighting, cleaning and sanitary services	7,700		
To Competition Prizes (Note 4)	4,300		
To Printing , postage and sundries	6,000		
To Depreciation on Furniture & Equipment—10%	4,800		
To Excess of Income over Expenditure	3,160		
	49,660		49,660

Balance Sheet as at 31st March, 2017

Liabilities		₹	Assets		₹
Capital Fund :			Furniture & Equipment	48,000	
Opening Balance	50,390		Less: 10% Depreciation	4,800	43,200
Add: Entrance Fees	3,200		Restaurant Stock		3,000
Add: Excess of Income over Expenditure	3,160	56,750	Prizes in hand		500
Subscriptions received in advance		400	Fixed deposit with bank		8,000
Creditor for restaurant supply		5,600	Cash in hand and at bank		5,880
Due to Secretary		80	Prepaid Rent (April to June 2017)		1,250
			Subscriptions outstanding		1,000
		62,830			62,830

Working Notes : **(1) Balance Sheet as at 1st April, 2016**

Liabilities	₹	Assets	₹
Capital Fund (balancing figure)	50,390	Furniture & Equipment	48,000
Outstanding rent (₹ 7,500 / 18) x 3	1,250	Stock of prizes	800
Creditor for restaurant supply	5,200	Restaurant Stock	2,600
		Cash in hand and at bank	4,740
		Subscriptions outstanding	700
	56,840		56,840

Dr. **(2) Creditors for Restaurant Supply Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash (payments)	50,400	1.4.2016	By Balance b/f	5,200
31.3.2017	To Balance c/d	5,600	31.3.2017	By Purchases (balancing figure)	50,800
		56,000			56,000

Dr. **(3) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/f	700	?	By Cash	29,720
31.3.2017	To Income and Expenditure A/c	29,620	31.3.2017	By Subscriptions outstanding	1,000
31.3.2017	To Subscriptions received in advance	400			
		30,720			30,720

Dr. **(4) Prizes Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/f	800	31.3.2017	By Income and Expenditure A/c	4,300
?	To Cash (purchases)	4,000	31.3.2017	By Balance c/d	500
		4,800			4,800

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 7

Following is the Receipts and Payments Account of N.G. Sports Club for the year ended 31st December, 2015 :

Receipts	₹	Payments	₹
To Balance as on 1.1.2015	1,930	By Prize and Competition Expenses	3,780
To Subscriptions	9,680	By Printing and Stationery	830
To Competition Fees	2,700	By Rent	3,000
To Entrance Fees	1,360	By Salaries to Staff	4,200
To Interest on Investments	650	By Purchase of Furniture	1,600
To Sundry Receipts	120	By Purchase of Investment	2,000
		By Balance on 31st December, 2015	1,030
	16,440		16,440

Additional information :

(i) At the beginning of the year :
   (a) The club had investments of ₹ 3,500; Furniture ₹ 2,860;
   (b) Outstanding subscriptions ₹ 530 (received during the year); Outstanding printing charges ₹ 130 (paid during the year).

(ii) At the end of the year :
   (a) Outstanding subscriptions ₹ 460
   (b) Outstanding printing charges ₹ 170.
   (c) Charge depreciation @ 10% on the closing balance of the furniture.

Prepare an Income and Expenditure Account for the year ended 31st December, 2015 and a Balance Sheet as on that date.

[C.U.B.Com. (General) — 2016]

Solution

N. G. Sports Club
Income and Expenditure Account for the year ended 31st December, 2015

Expenditure	₹	Income	₹
To Prize and Competition Expenses	3,780	By Subsriptions (Note 1)	9,610
To Printing and Stationery (Note 2)	870	By Competition Fees	2,700
To Rent	3,000	By Interest on Investment	650
To Salaries to Staff	4,200	By Sundry Receipts	120
To Depreciation on Furniture (Note 3)	446		
To Excess of Income over Expenditure	784		
	13,080		13,080

Balance Sheet of N. G. Sports Club as at 31st December, 2015

Liabilities	₹	Assets		₹
Capital Fund :		Furniture on 1.1.2015	2,860	
Opening Balance (Note 4)	8,690	Add: New Purchase	1,600	
Add: Entrance Fees	1,360		4,460	
	10,050	Less: Depreciation @ 10%	446	4,014
Add: Excess of Income over Expenditure	784	Investment on 1.1.2015	3,500	
Outstanding Printing Charges	170	Add: New Purchase	2,000	5,500
		Subscription of 2015 — Outstanding		460
		Cash in Hand		1,030
	11,004			11,004

Working Notes :

(1) Calculation of Subscription Income for the year 2015 :

	₹
Subscriptions received in 2015	9,680
Less: Subscriptions of 2014 received in 2015	530
	9,150
Add: Subscriptions not yet received for 2015	460
	9,610

(2) Calculation of Printing and Stationery Expenses

Amount paid for printing and stationery	830
Less: Outstanding printing charges for 2014	130
	700
Add: Outstanding printing charges for 3015	170
	870

(3) Calculation of Depreciation on Furniture

Opening Balance of Furniture	2,860
Add: Purchases during the year	1,600
	4,460

Depreciation - 10% of ₹ 4,460 = ₹ **446**.

(4) Balance Sheet as at 1st January, 2017

Liabilities	₹	Assets	₹
Capital Fund (Balacncing figure)	8,690	Furniture	2,860
Outstanding Printing Charges	130	Investments	3,500
		Subscription of 2014 — Outstanding	530
		Cash in Hand	1,930
	8,820		8,820

(6) Entrance fees have been capitalised.

Illustration 8

The following shows the position of Bhibhuti Bhushan Library as at 01.01.2014 :

Liabilities	₹	Assets	₹
Capital Fund	3,00,000	Building	1,00,000
Outstanding Expenses	10,000	Furniture	10,000
		Library	50,000
		Investments	1,00,000
		Outstanding Subscription	40,000
		Cash in Hand	10,000
	3,10,000		3,10,000

Cash Book during the year is as follows :

Receipts	₹	Payments	₹
To Balance b/d	10,000	By Salaries	7,200
To Subscription	1,50,000	By Purchase of Books	80,000
To Donations	1,00,000	By Rent and Taxes	7,200
To Interest on Investment	1,200	By Outstanding Expenses	10,000
To Sale of Old Furniture	1,000	By Insurance Premium	3,000
		By Printing and Stationery	900

		By Purchase of Furniture	15,000
		By Investment	1,34,000
		By Sundry Expenses	900
		By Balance c/d	4,000
	2,62,200		2,62,200

Additional Information :

(i) Accrued Subscription ₹ 30,000.

(ii) Outstanding Liabilities for expenses ₹ 15,000.

(iii) Insurance Premium amounting to ₹ 600 was paid in advance.

(iv) Depreciate Building at 5%; Library Books at 10% and write-off Investment by 5%.

Depreciation is to be calculated on the opening balances of assets.

Prepare an Income and Expenditure Account for the year ended 31st December, 2014 and a Balance Sheet as at that date. *[C.U.B.Com. (General) — 2015]*

Solution

Income and Expenditure Account of Bhibhuti Bhusan Library for the year ended 31st December, 2014

Expenditure		₹	Income	₹
To Salaries		7,200	By Subscription (Note 1)	1,40,000
To Rent and Taxes		7,200	By Donations	1,00,000
To Insurance Premium	3,000		By Interest on Investments	1,200
Less: Prepaid	600	2,400		
To Printing and Stationery		900		
To Sundry Expenses	900			
Add: Outstanding Expenses	15,000	15,900		
To Depreciation on Buildings @ 5%	5,000			
To Depreciation on Library Books	5,000			
To Depreciation on Investments	5,000	15,000		
(5% of ₹ 1,00,000)				
To Excess of Income over Expenditure		1,92,600		
		2,41,200		2,41,200

Balance Sheet of Bhibhuti Bhusan Library as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund	3,00,000		Building	1,00,000	
Add: Excess of Income over Expenditure	1,92,600	4,92,600	Less: Depreciation @ 5%	5,000	95,000
Outstanding Expenses		15,000	Furniture	10,000	
			Less: Sold	1,000	
				9,000	
			Add: Purchased	15,000	24,000
			Library	50,000	
			Add: Purchase of Books	80,000	
				1,30,000	
			Less: Depreciation	5,000	1,25,000
			Investments (Note 2)		2,29,000
			Accrued Subscription		30,000
			Prepaid Insurance		600
			Cash		4,000
		5,07,600			5,07,600

Working Notes :

(1) Calculation of Subscription for 2014 **(2) Calculation of Interest at the End of 2014**

Particulars	₹	Particulars	₹
Subscription received during the year	1,50,000	Opening Balance of Investment	1,00,000
Add: Subscription for 2014 not yet received	30,000	Add: Purchased during 2014	1,34,000
	1,80,000		2,34,000
Less: Outstanding Subscription of 2013	40,000	Less: Written-off @ 5% of ₹ 1,00,000	5,000
Transferred to Income and Expenditure Account	1,40,000		2,29,000

Illustration 9

Following is the Receipts and Payments Account of a Club for the year ended 31st December, 2013 :

Receipts	₹	Payments	₹
To Balance b/d	5,200	By Sports Equipments (Purchased on 1.9.2013)	20,400
To Subscriptions :		By Salary and Wages	6,000
For 2013	34,500	By Printing and Stationery	1,000
for 2012	1,500	By Electricity Charges	1,500
for 2014	2,000	By Telephone Charges	1,400
To Interest on Govt. Securities @ 8% of cost	800	By Tournament Expenses	12,500
To Entrance Fees	5,000	By Balance c/d	6,200
	49,000		49,000

The fixed assets of the Club on 01.01.2013 included the following :

Sports Equipments ₹ 18,500; Club Ground ₹ 10,000; Furniture ₹ 3,000.

You are required to prepare the Income and Expenditure account for the year ended 31st December, 2013 and a Balance Sheet as on that date after considering the following :

(a) Subscription for 2013 collected in 2012 ₹ 750.

(b) Subscription for 2013 still to be collected ₹ 500.

(c) Provide depreciation @ 20% p.a. on Sports Equipment and @ 10% p.a. on Furniture.

(d) 60% of Entrance Fees should be capitalised. ***[C.U.B.Com. (General) — 2014]***

Solution **Income and Expenditure Account for the year ended 31st December, 2013**

Expenditure	₹	Income	₹
To Salaries and Wages	6,000	By Subscription (Note 2)	35,750
To Printing and Stationery	1,000	By Interest on Government Securities	800
To Electric Charges	1,500	By Entrance Fees (40% of ₹ 5,000)	2,000
To Telephone Charges	1,400		
To Tournament Expenses	12,500		
To Depreciation on Sports Equipment (3,700 + 1,360)	5,060		
To Depreciation on Furniture	300		
To Excess of Income over Expenditure	10,790		
	38,550		38,550

Balance Sheet as at 31st December, 2013

Liabilities		₹	Assets		₹
Capital Fund (Note 1)	47,450		Club Ground		10,000
Add: Entrance Fees (Capitalised)	3,000		Sports Equipments	18,500	
Add: Excess of Income over Expenditure	10,790	61,240	Add: Purchase	20,400	
				38,900	
Subscriptions Received in Advance for 2014		2,000	Less: Depreciation (Note 3)	5,060	33,840
			Furniture	3,000	
			Less: Depreciation	300	2,700
			Subscription in Arrear		500
			Investment		10,000
			Cash		6,200
		63,240			63,240

Working Notes : **(1) Balance Sheet as at 1st January, 2013**

Liabilities	₹	Assets	₹
Subscription Received in Advance	750	Sports Equipments	18,500
Capital Fund (Balancing figure)	47,450	Club Ground	10,000
		Furniture	3,000
		Cash	5,200
		Subscription in Arrear	1,500
		Investments	10,000
	48,200		48,200

(2) Calculation of Subscription for 2013

Particulars	₹
Subscription received for 2013	34,500
Add: Subscription in arrear for 2013	500
	35,000
Add: Subscription received in 2012 for 2013	750
	35,750

(3) Depreciation on Sports Equipments

Particulars	₹
20% on ₹ 18,500 for one year	3,700
20% on ₹ 20,400 for 4 months	1,360
	5,060

Illustration 10

From the following Receipts and Payments Account of Evergreen Club for the year ended 31.03.2012 and additional information, prepare an Income and Expenditure Account for the year ended 31.03.2012 and a Balance Sheet as on the same date :

Receipts	₹	Payments	₹
Opening Cash in Hand and at Bank	10,000	Secretary's Salary	8,000
Subscription	40,000	Salaries to Staff	12,000
Sale of old Newspapers	6,000	Charities	2,000
Entrance Fees	8,000	Printing and Stationery	1,000
Proceeds of Sports and Concerts	6,000	Postage Expenses	200
		Rates and Taxes	2,000
		Upkeep of the Land	3,000
		Purchase of Sports Materials	12,000
		Telephone Expenses	4,000
		Closing Cash in Hand and at Bank	25,800
	70,000		70,000

Assets and Liabilities as on 31.3.2011 and 31.03.2012 were as follows :

	31.03.2011 (₹)	31.03.2012 (₹)
Arrear subscription	4,000	2,000
Subscription received in advance	1,000	800
Furniture	2,000	1,800
Land	20,000	20,000

Depreciation on Furniture has been charged at 10% p.a. Entrance fees received shall be capitalized. Stock of sports materials on 31.03.2012 were useless and to be completely written off. ***[C.U.B.Com. (General) — 2012]***

Answer

Balance Sheet of Evergreen Club as at 1.4.2011.

Liabilities	₹	Assets	₹
Pre-receipt Subscription	1,000	Accrued Subscription	4,000
Capital Fund (Balancing figure)	35,000	Furniture	2,000
		Land	20,000
		Cash	10,000
	36,000		36,000

Dr. Income and Expenditure Account of Evergreen Club for the year ended 31.3.2012 Cr.

Expenditure	₹	Income		₹
To Secretary Salary	8,000	By Subscription	40,000	
To Staff Salary	12,000	Add: Closing accrued	2,000	
To Charities	2,000	Add: Opening Pre-receipt	1,000	
To Printing and Stationery	1,000		43,000	
To Postage Expenses	200	Less: Opening accrued	4,000	
To Rates and Taxes	2,000	Less: Closing pre-receipt	800	38,200
To Upkeep of Land	3,000	By Sale of Newspaper		6,000
To Sports Material consumed	12,000	By Proceeds of Sports and Concerts		6,000
To Telephone expenses	4,000			
To Depreciation on Furniture	200			
To Excess of Income over Expenditure	5,800			
	50,200			50,200

Balance Sheet of Evergreen Club as at 1.4.2012

Liabilities		₹	Assets	₹
Capital Fund	35,000		Land	20,000
Add: Surplus	5,800		Furniture	1,800
Add: Entrance Fees	8,000	48,800	Arrear Subscription	2,000
Pre-receipt Subscription		800	Cash	25,800
		49,600		49,600

Illustration 11

The following is the Receipts and Payments Account of the Calcutta Football Club for the year ended 31.12.2010 :

Receipts		₹	Payments		₹
1.1.10	Cash in hand	2,500	31.12.10	Remuneration to Coach	6,000
	Cash at bank	22,300		Groundman's Salary	2,500
31.12.10	Bank interest	500		Purchase of Equipments	15,500
	Entrance fees	5,000		Bar Room Expenses	2,000
	Subscriptions	25,000		Ground Rent	4,500
	Bar Room Receipts	4,000		Night Club Expenses	4,800
	Sale of Equipments	800		Printing and Stationery	2,500
	Proceeds of Night Club	10,800		Repairs to Equipments	4,500
				Cash at Bank	25,600
				Cash in Hand	3,000
		70,900			70,900

Additional information :	***1.1.2010***	***31.12.2010***
Subscription Due (₹)	1,500	1,000
Sum due for Printing and Stationery (₹)	1,000	800
Estimated Value of Equipments (₹)	8,000	17,500

You are required to prepare :

(a) An Income and Expenditure Account for the year ended 31.12.2010.

(b) A Balance Sheet as on that date. ***[C.U.B.Com. (General) — 2011]***

Solution

Calcutta Football Club
Income and Expenditure Account for the year ended 31.12.2010

Expenditure	₹	Income	₹
To Remuneration to Coach	6,000	By Bank Interest	500
To Groundman's Salary	2,500	By Entrance Fees (Note 5)	5,000
To Bar Room Expenses	2,000	By Subscriptions (Note 2)	24,500
To Ground Rent	4,500	By Bar Room Receipts	4,000
To Night Club Expenses	4,800	By Proceeds of Night Club	10,800
To Repairs to Equipments	4,500		
To Depreciation on Equipments (Note 4)	5,200		
To Printing and Stationery Consumed	2,300		
To Excess of Income over Expenditure	13,000		
	44,800		44,800

Balance Sheet of Calcutta Football Club as at 31.12.2010

Liabilities		₹	Assets	₹
Capital Fund	33,300		Equipments	1,000
Add: Excess of Income over Expenditure	13,000	46,300	Subscription (Due)	17,500
Outstanding amount for Printing and Stationery		800	Bank	25,600
			Cash	3,000
		47,100		47,100

Working Notes : **(1) Balance Sheet of as at 1.1.2010**

Liabilities	₹	Assets	₹
Outstanding for Printing and Stationery	1,000	Accrued Subscription	1,500
Capital Fund (Balancing figure)	33,300	Equipments	8,000
		Cash	2,500
		Bank	22,300
	34,300		34,300

Dr. **(2) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Balance b/d	1,500		By Bank	25,000
	To Income and Expenditure A/c	24,500	31.12.2010	By Balance c/d	1,000
		26,000			26,000

Dr. **(3) Creditor for Printing and Stationery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Bank	2,500	1.1.2010	By Balance b/d	1,000
31.12.2010	To Balance c/d	800	?	By Purchases	2,300
		3,300			3,300

Dr. **(4) Equipments Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Balance b/d	8,000	?	By Bank	800
?	To Receipts and Payments A/c (Purchases)	15,500	?	By Depreciation (Balancing figure)	5,200
			31.12.2010	By Balance c/d	17,500
		23,500			23,500

(5) It is assumed that Entrance Fees are Revenue Receipts

[For Honours Candidates Only]

Illustration 12

Following is the Receipts and Payments Account of Viveknagar Social Club for the year ended 31st December, 2015 :

Receipts	₹	Payments	₹
Balance as on 1.1.2015	3,560	Salaries	2,450
Subscriptions :		Electricity	410
2014	180	Charity	1,680
2015	6,940	General Expenses	320
2016	240	Rent and Taxes	450
Donations	2,500	Expenses of Annual Function	2,300
Sale of Tickets of Annual Function	2,800	Newspaper, etc.	460
Sales of Waste Paper	130	Investments	5,000
		Balance on 31st December, 2015	3,280
	16,350		16,350

Additional information :

(a) Salaries outstanding for the year 2015 are ₹ 150.

(b) Rent and Taxes include ₹ 75 for the year 2014.

(c) Value of building ₹ 12,000 as on 1.1.2015 and depreciation @ 5% to be provided.

(d) Interest on investment is due for 3 months @ 10% p.a.

(e) The club has 360 members and subscription is ₹ 20 per annum.

Prepare an Income and Expenditure Account for the year ended 31st December, 2015 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — 2016]

Solution **Viveknagar Social Club**

Income and Expenditure Account for the year ended 31st December, 2015

Expenditure		₹	Income	₹
To Salaries	2,450		By Subscription (360 x ₹ 20)	7,200
Add: Outstanding	150	2,600	By Sale of Ticket (Annual Function)	2,800
To Electricity		410	By Sale of Waste Paper	130

To Charity		1,680	By Accrued Interest on Investment (10 / 100 x 5,000 x 3/12)	125
To General Expenses		320		
To Rent and Taxes	450			
Less: Last year's rent	75	375		
To Expenses for Annual Function		2,300		
To Newspaper		460		
To Depreciation on Building @ 5%		600		
To Excess of Income over Expenditure		1,510		
		10,255		10,255

Balance Sheet of Viveknagar Social Club as at 31st December, 2015

Liabilities		₹	Assets		₹
Capital Fund :			Building	12,000	
Opening Balance (Note 1)	15,665		Less: Depreciation	600	11,400
Add: Excess of Income over Expenditure	1,510	17,175	Investment		5,000
Donations (Note 2)		2,500	Accrued Interest on Investment		125
Outstanding Salaries		150	Subscription in Arrear for 2015 (₹ 7,200 – 6,940)		260
Subscription Received for 3016		240	Cash in Hand		3,280
		20,065			20,065

Working Notes : **(1) Balance Sheet as at 1st January, 2015**

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	15,665	Building	12,000
Outstanding Rent and Rates of 2014	75	Subscriptions in Arrear — 2014	180
		Cash in Hand	3,560
	15,740		15,740

(2) **It is assumed that the donations are capital receipt.**

Illustration 13

Following is the Receipts and Payments Account of City Club for the year ended 31st December, 2014 :

Receipts and Payments Account for the year ended 31.12.2014

Receipts		₹	Payments		₹
To Balance b/d			By Salary to Secretary		24,000
Cash	1,650		By Honorarium		10,000
Bank	7,800	9,450	By Wages		4,400
To Subscriptions (including ₹ 1,000 for 2013)		42,000	By Charities		15,000
To Sale of Old Furniture on 1.1.2014		7,500	By Printing and Stationery		1,800
To Sale of Old Newspapers		200	By Postage		650
To Donations		5,000	By Rates and Taxes		2,400
To Interest on Investment (Cost of Investment ₹ 20,000)		2,000	By Upkeep of Land		2,500
To Endowment Fund		20,000	By Sports Materials		3,500
To Proceeds of Concerts		2,000	By Balance c/d		
To Advertisement in Souvenir		2,400	Cash	2,450	
			Bank	23,850	26,300
		90,550			90,550

Assets and Liabilities as on 31.12.2013 and 31.12.2014 are as follows :

	31.12.2013	31.12.2014
	₹	₹
Subscriptions in Arrear	1,200	4,200
Subscriptions in Advance	450	1,200
Furniture	20,000	10,800

Depreication @ 10% p.a. was charged on Furniture left after selling a part of it. It was decided that 50% of the Donation received would be capitalised.

Prepare Income and Expenditure Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — 2015]

Solution

Income and Expenditure Account of City Club for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Salary to Secretary	24,000	By Subscription (Note 2)	44,250
To Honorarium	10,000	By Sale of Old Newspapers	200
To Wages	4,400	By Donation (1/2)	2,500
To Charities	15,000	By Interest on Investment	2,000
To Printing and Stationery	1,800	By Proceeds of Concerts	2,000
To Postage	650	By Advertisement in Souvenir	2,400
To Rates and Taxes	2,400	By Excess of Expenditure over Income	13,680
To Upkeep of Land	2,500		
To Sports Materials Consumed	3,500		
To Loss on Sale of Furniture (Note 3)	1,700		
To Depreciation on Furniture (10% of ₹ 10,800)	1,080		
	67,030		67,030

Balance Sheet of City Club as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund (Note 1)	50,200		Furniture	10,800	
Add: Donation (1/2)	2,500		Less: Depreciation @ 10%	1,080	9,720
	52,700		Investments		20,000
Less: Excess of Expenditure over Income	13,680	39,020	Subscription in Arrear		4,200
Endowment Fund		20,000	Bank		23,850
Subscription Received in Advance		1,200	Cash		2,450
		60,220			60,220

Working Notes : **(1) Balance Sheet of City Club as at 31st December, 2013**

Liabilities	₹	Assets	₹
Subscription in Advance	450	Subscription in Arrear	1,200
Capital Fund (Balancing figure)	50,200	Furniture	20,000
		Cash	1,650
		Bank	7,800
		Investment	20,000
	50,650		50,650

(2) Subscription Account

Particulars	₹	Particulars	₹
To Subscription in Arrear A/c	1,200	By Subscription Received in Advance A/c	450
To Income and Expenditure A/c (Balancing figure)	44,250	By Bank A/c	42,000
To Subscription Received in Advance A/c	1,200	By Subscription in Arrear A/c	4,200
	46,650		46,650

(3) Loss on Sale of Furniture :

	₹
Book value of furniture sold (20,000 – 10,800)	9,200
Less: Sale value of furniture	7,500
	1,700

Illustration 14

Following is the Receipts and Payments Account of Kalyani Medical Aid Society for the year ended 31st December, 2013 :

Receipts	₹	Payments	₹
To Balance (1.1.2013)	9,500	By Payment for Medicines	45,500
To Subscriptions	70,000	By Honorarium to Doctors	15,000
To Donations	16,500	By Salaries	30,500
To Interest on Investment @ 9% p.a.	9,000	By Sundry Expenses	1,000
To Charity Show Proceeds	15,000	By Equipment Purchased	20,000
		By Charity Show Expenses	2,500
		By Balance (31.12.2013)	5,500
	1,20,000		1,20,000

Additional information :	01.01.2013	31.12.2013
(i) Subscriptions due	1,500	2,500
(ii) Subscriptions received in advance	2,500	1,500
(iii) Stock of medicine	12,000	16,000
(iv) Amount due to medicine suppliers	10,000	14,000
(v) Value of equipment	25,000	38,000
(vi) Value of building	45,000	42,750

You are required to prepare Income and Expenditure Account for the year ended 31st December, 2013 and the Balance Sheet as on that date. ***[C.U.B.Com. (Hons.) — 2014]***

Solution Income and Expenditure Account for the year ended 31st December, 2013

Expenditure		₹	Income		₹
To Medicines Consumed :			By Subscription	70,000	
Opening Stock	12,000		Add: Cl. Accrued	2,500	
Add: Purchases	49,500		Add: Received in Advance in 2012	2,500	
	61,500			75,000	
Less: Closing Stock	16,000	45,500	Less: Op. Accrued	(1,500)	
To Honorarium to Doctors		15,000	Less: Received in Advance for 2014	(1,500)	72,000
To Salaries		30,500	By Donations (Note 3)		16,500
To Sundry Expenses		1,000	By Interest on Investment		9,000
To Charity Show Expenses		2,500	By Charity Show Proceeds		15,000
To Depreciation on Building (₹ 45,000 – 42,750)		2,250			
To Depreciation on Equipment (25,000 + 20,000 – 38,000)		7,000			
To Excess of Income over Expenditure		8,750			
		1,12,500			1,12,500

Balance Sheet of Kalyani Medical Aid Society as at 31st December, 2013

Liabilities		₹	Assets	₹
Capital Fund	1,80,500		Buildings	42,750
Add: Excess of Income over Expenditure	8,750	1,89,250	Equipments	38,000
Subscription Received for 2014		1,500	Stock of Medicines	16,000
Medicine Suppliers		14,000	Investment	1,00,000
			Accrued Subscription	2,500
			Cash	5,500
		2,04,750		2,04,750

Working Notes : (1) Balance Sheet of Kalyani Medical Aid Society as at 1st January, 2013

Liabilities	₹	Assets	₹
Subscription Received in Advance in 2012	2,500	Accrued Subscription	1,500
Medicine Suppliers	10,000	Stock of Medicines	12,000
Capital Fund (Balancing figure)	1,80,500	Equipments	25,000
		Buildings	45,000
		Cash	9,500
		Investment (9,000 / 9 x 100)	1,00,000
	1,93,000		1,93,000

Dr. (2) Medicine Suppliers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	45,500		By Balance b/d	10,000
	To Balance c/d	14,000		By Purchases b/f	49,500
		59,500			59,500

(3) Donations have been treated as revenue income.

Illustration 15

Following is the Receipts and Payments Account of a library for the year ended 31st December, 2012 :

Receipts	₹	Payments	₹
To Balance	9,000	By Salary and Wages	13,600
To Admission Fees	11,000	By Rent	16,500
To Subscription from Members	39,000	By Investments	7,000

To Lecture Hall Hire Charges	5,000	By Postage and Stationery	2,500
To Miscellaneous Receipts	700	By Electric Charges	1,460
To Interest on Investments	1,200	By Books	12,000
		By Outstanding Expenses	1,400
		By Balance	11,440
	65,900		65,900

You are required to prepare an Income and Expenditure Account for the year 2012 and a Balance Sheet as at 31.12.2012. The following further information is also made available to you :

(a) On 31.12.2011 the library had the following assets : furniture ₹ 11,000; books ₹ 90,000 and investments ₹ 40,000.

(b) Subscriptions realised in advance this year amounted to ₹ 1,200 and outstanding liabilities on 31.12.2012 are for salary and wages ₹ 2,400 and for rent ₹ 1,500.

(c) 60% of the admission fees should be capitalised.

(d) Furniture and library books are to be depreciated at 6% and 10% p.a. respectively. ***[C.U.B.Com. (Hons.) — 2013]***

Solution **Income and Expenditure Account for the year ended 31st December, 2012**

Expenditure			₹	Income		₹
To Salaries & Wages		13,600		By Subscriptions	39,000	
Add: Outstanding		2,400	16,000	Less: Received in Advance	1,200	37,800
To Rent	16,500			By Admission Fees (40% of ₹ 11,000)		4,400
Add: Outstanding		1,500	18,000	By Lecture Hall Charges		5,000
To Postage and Stationery			2,500	By Miscellaneous Receipts		700
To Electric Charges			1,460	By Interest on Investment		1,200
To Depreciation on :						
Furniture			660			
Books (₹ 9,000 + 600)			9,600			
To Excess Income over Expenditure			880			
			49,100			49,100

Balance Sheet as at 31st December, 2012

Liabilities		₹	Assets		₹
Capital Fund	1,48,600		Furniture	11,000	
Add: Surplus	880		Less: Depreciation	660	10,340
Add: Admission Fees	6,600	1,56,080	Books	90,000	
Outstanding Salaries		2,400	Add: Purchases	12,000	
Outstanding Rent		1,500		1,02,000	
Subscription Received in Advance		1,200	Less: Depreciation	9,600	92,400
			Investments	40,000	
			Add: Purchases	7,000	47,000
			Cash		11,440
		1,61,180			1,61,180

Working note: (1) **Balance Sheet as at 1st January, 2012**

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	1,48,600	Furniture	11,000
Outstanding Expenses	1,400	Books	90,000
		Investments	40,000
		Cash	9,000
	1,50,000		1,50,000

Special Problems

Illustration 16

New Delhi Recreation Club consists of a Tennis section and a Badminton section. The Balance Sheet of the Club as on 1.1.2016 is as under :

Liabilities	₹	Assets	₹
Accumulated Fund	4,17,500	Club House	2,50,000
		Courts : Tennis (cost ₹ 1,00,000)	80,000
		Badminton (cost ₹ 50,000)	35,000
		Furniture	25,000

		Bank Deposit	10,000
		Cash and Bank	17,000
		Petty Cash	500
	4,17,500		4,17,500

The following is the Receipts and Payments Account for the year ended 31.12.2016 :

Receipts	₹	Payments	₹
To Balance b/d	17,000	By New Tennis Court	1,00,000
To Ten-year Tennis Memberships	60.000	By Annual Dinner — Expenses	10,500
To Subscriptions :		By Expenses on Tournament :	
General	25,000	Tennis	15,000
Sectional :		Badminton	4,000
Tennis	32,000	By Bank Deposits	3,000
Badminton	21,000	By General Expenses on :	
To Tournament Entry Fees :		Tennis	12,000
Tennis	20,000	Badminton	10,000
Badminton	5,000	By Rates of Club House	12,000
To Annual Dinner — Sale of Tickets	12,000	By Miscellaneous Expenses	14,000
		By Petty Cash	700
		By Balance c/d	10,800
	1,92,000		1,92,000

Additional information :

(1) In order to help pay for the new tennis court, ten-year tennis memberships were offered for sale at the beginning of 2016 at ₹ 2,000 each.

(2) It is the club's policy to write-off the cost of the tennis and badminton courts over a ten-year period.

(3) The petty cash balance on 31.12.2016 was ₹ 200. The petty cash float is used exclusively for postage.

(4) ₹ 10,000 received as donations during the year for the new coaching scholarship fund. This will be utilised for the provision of training facilities for promising young sportspersons. It is expected to make the first award during 2014. Though the amount has been invested in short-term securities, no entry has been made in the books.

(5) The balance of the Bank Deposit Account on 31.12.2016 was ₹ 14,200.

(6) Furniture is to be depreciated at 10%.

Prepare an Income and Expenditure Account for the year ended 31.12.2016 showing the net surplus or deficit arising separately from the tennis section and badminton section. Also prepare the Balance Sheet of the Club as on 31.12.2016.

Solution

New Delhi Recreation Club

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	Tennis ₹	Badminton ₹	Income		Tennis ₹	Badminton ₹
To Expenses on Tournament	15,000	4,000	By Ten-year Tennis Membership			
To Depreciation on Court :			(1/10th of ₹ 60,000)		6,000	—
Tennis [10% on ₹ (1,00,000 + 1,00,000)]	20,000	—	By Sectional Subscriptions		32,000	21,000
Badminton (10% on ₹ 50,000)	—	5,000	By Tournament Entry Fees		20,000	5,000
To General Expenses	12,000	10,000				
To Net Surplus c/d	11,000	7,000				
	58,000	26,000			58,000	26,000
To Depreciation on Furniture (10% on ₹ 25,000)		2,500	By Net Surplus b/d — ₹ (11,000 + 7,000)			18,000
To Postage — ₹ (500 + 700 – 200)		1,000	By General Subscriptions			25,000
To Rates of Club House		12,000	By Profit on Annual Dinner :			
To Miscennaleous Expenses		14,000	Sale of tickets	12,000		
To Excess of Income over Expenditure		16,200	Less: Expenses	10,500		1,500
			By Interest on Bank Deposit — ₹ (14,200 – 10,000 – 3,000)			1,200
		45,700				45,700

Balance Sheet of New Delhi Recreation Club as on 31st December, 2016

Liabilities	₹	Assets		₹
Accumulated Fund	4,17,500	Club House		2,50,000
Add: Excess of Income over Expenditure	16,200	Courts :		
	4,33,700	Tennis (₹ 80,000 + 1,00,000)	1,80,000	
Ten-year Tennis Membership (₹ 60,000 – 6,000)	54,000	Less: Depreciation	20,000	1,60,000

Coaching Scholarship Fund	10,000	Badminton	35,000	
		Less: Depreciation	5,000	30,000
		Furniture	25,000	
		Less: Depreciation	2,500	22,500
		Coaching Scholarship Fund Investments		10,000
		Bank Deposit :		
		Opening Balance	10,000	
		Add: Further Deposit	3,000	
		Accrued Interest	1,200	14,200
		Cash and Bank		10,800
		Petty Cash		200
	4,97,700			4,97,700

Illustration 17

From the following information, you are required to prepare an Income and Expenditure Account for the year ended 31.3.2017 and a Balance Sheet as on that date :

(i) **Dover Lane Music Society**
Receipts and Payments Account for the year ended 31st March, 2017

Receipts	₹	Payments	₹
To Balance b/d	7,200	By Rent	30,000
To Members' Joining Fees	35,000	By Electricity	12,400
To Annual Subscriptions	35,500	By Salaries	21,300
To Training Fees	76,600	By Training Expenses	40,200
To Interest on Investments	600	By Purchase of Investments	15,600
		By Short-term Deposits	10,000
		By Balance c/d	25,400
	1,54,900		1,54,900

(ii) On joining the society, members pay a non-returnable fee of ₹ 1,000 (before 1.4.2014, the fee had been ₹ 500). It had been found from experience that, on average, members remain in the society for five years. On this basis, one-fifth of each joining fee is credited to Income and Expenditure Account each year.

New members' statistics are :

During year ended 31st March	Number of new members (No.)	Joining fees in Suspense at 31.3.2016 (₹)
2013	20	2,000
2014	24	4,800
2015	32	19,200
2016	27	21,600
2017	35	Nil
		47,600

(iii) Annual subscriptions are due on 1st April each year. It is the society's policy to credit these to Income and Expenditure Account on an actual receipts basis, not on an accrual basis. However, if subscriptions are received in advance, the amounts are credited to Income and Expenditure Account for the year for which they are paid. Subscriptions received in advance included in the actual receipts for the year are as under :

2016-17 — ₹ 3,000; 2017-18 — ₹ 4,000.

(iv) The society has a permanent training room. Non-members can use the facilities on payment of a fee. In order to guarantee a particular facility, advance booking is allowed. Advance booking fees received before 31.3.2017 in respect of 2017-18 total ₹ 4,700. The corresponding amount paid up to 31.3.2016 in advance of 2016-17 was ₹ 3,250. Members can use the facilities free of charge.

(v) The club received interest on investments bought a number of years ago at a cost of ₹ 50,000 (current valuation ₹ 52,000). At the end of March, 2017, the club acquired further investments which cost ₹ 15,600 (current valuation ₹ 16,000) and at the same time, placed ₹ 10,000 in a short-term deposit account.

Solution

Dover Lane Music Society
Income and Expenditure Account for the year ended 31st March, 2017

Expenditure	₹	Income		₹
To Rent	30,000	By Members' Joining Fees (Note 2)		23,200
To Electricity	12,400	By Annual Subscriptions (Note 4)		34,500
To Salaries	21,300	By Training Fees (Note 5)	75,150	
To Excess of Income over Expenditure	29,550	Less: Training Expenses	40,200	34,950
		By Interest on Investments		600
	93,250			93,250

Balance Sheet of Dover Lane Music Society as on 31st March, 2017

Liabilities		₹	Assets	₹
Capital Fund :			Investments at cost (Current valuation ₹ 68,000)	65,600
Opening balance (Note 1)	3,350		Short-term Deposit	10,000
Add: Excess of Income over Expenditure	29,550	32,900	Cash and Bank	25,400
Joining Fees in Suspense (Note 3)		59,400		
Subscriptions in Advance		4,000		
Joining Fees in Advance		4,700		
		1,01,000		1,01,000

Working Notes :

(1) Balance Sheet as on 1st April, 2016

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	3,350	Investments	50,000
Joining Fees in Suspense	47,600	Cash and Bank	7,200
Subscriptions in Advance	3,000		
Training Fees in Advance	3,250		
	57,200		57,200

(2) Members' Joining Fees Credited to Income and Expenditure Account

Year ended	Amount Received (Number of New Members x Joining Fees)	Total ₹
31.3.2013	20 x ₹ 500	10,000
31.3.2014	24 x ₹ 500	12,000
31.3.2015	32 x ₹ 1,000	32,000
31.3.2016	27 x ₹ 1,000	27,000
31.3.2017	35 x ₹ 1,000	35,000
		1,16,000

1/5th of ₹ 1,16,000 is to be credited to Income and Expenditure Account, i.e., ₹ 1,16,000 / 5 = ₹ 23,200.

(3) Joining Fees in Suspense at 31.3.2017

	₹
Joining fees in suspense at 31.3.2016	47,600
Add: Joining fees received during the year ended 31.3.2017	35,000
	82,600
Less: Joining fees credited to Income and Expenditure Account	23,200
	59,400

(4) Annual Subscriptions Credited to Income and Expenditure Account

	₹
Annual subscriptions received	35,500
Add: Subscriptions received in advance before 1.4.2016	3,000
	38,500
Less: Subscriptions received in advance for 2017-18	4,000
	34,500

(5) Training Fees Credited to Income and Expenditure Account

	₹
Training fees received	76,600
Add: Training fees received in advance before 1.4.2016	3,250
	79,850
Less: Training fees received in advance for 2017-18	4,700
	75,150

Illustration 18

The Receipts and Payments Account for the year ended 31.12.2016 of The Gardeners' Club is as follows :

Receipts		₹	Payments	₹
To Balance b/d		87,280	By Creditors of Seeds and Fertilisers	1,64,000
To Subscriptions :	Individuals	33,700	By Cost of Visit to Research Centre	24,700
	Groups	10,000	By Purchase of Garden Equipments	73,800
To Sale of Tickets to Visit Research Centre		23,200	By Repairs to Garden Equipments	10,200
To Debtors of Seeds and Fertilisers		1,30,000	By Annual Garden Show :	
To Annual Garden Show :			Hire of marquee	36,400
	Sale of tickets	82,900	Prizes	65,000
	Competition Fees	41,000	By Cost of Printing Pamphlets	3,500
To Annual Garden Party		20,100	By Annual Garden Party Expenses	15,000
To Sales of Pamphlets		4,000	By Balance c/d	39,580
		4,32,180		4,32,180

The assets and liabilities as on 1.1.2016 and 31.12.2016 are as follows (all figures in ₹) :

Date	Garden Equipments	Stock of Pamphlets	Seeds and Fertilisers		
			Debtors	Creditors	Stock
1.1.2016	24,200	2,500	22,200	80,400	26,100
31.12.2016	89,400	2,000	42,400	54,700	39,000

Additional information :

(1) Annual subscriptions are ₹ 100 for an individual member and ₹ 250 for a group. On 31.12.2016, 4 group members had paid in advance and 15 individual members were in arrear. There were no subscriptions in advance on 31.12.2015, but 10 individual members were in arrears.

(2) Cash received from annual garden party was banked after deducting payments of ₹ 1,800 general expenses and ₹ 290 postage.

(3) The employee who had handled sales of seeds and fertilisers, had disappeared taking with him monies he had received from the debtors of seeds and fertilisers. It was not known how much he had stolen, but seeds and fertilisers were sold at a profit of $33^{1}/_{3}$ on cost price.

(4) ₹ 1,500 is yet to be received for pamphlets sold.

You are required to prepare Income and Expenditure Account for the year ended 31.12.2016 and the Balance Sheet as on that date.

Solution

The Gardeners' Club

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Loss on Visit to Research Centre (Note 4)	1,500	By Subscriptions (Note 1) :	
To Cash Stolen (Note 7)	17,000	Individuals	34,200
To Repairs to Garden Equipments	10,200	Groups	9,000
To General Expenses	1,800	By Profit on Pamphlets (Note 2)	1,500
To Postage	290	By Profit on Annual Garden Party (Note 3)	7,190
To Depreciation on Garden Equipments		By Profit on Annual Garden Show (Note 5)	22,500
(₹ 24,200 + 73,800 – 89,400)	8,600	By Profit on Seeds and Fertilisers (Note 8)	41,800
To Excess of Income over Expenditure	76,800		
	1,16,190		1,16,190

Balance Sheet of Gardeners' Club as on 31st December, 2016

Liabilities	₹	Assets	₹
Accumulated Fund	82,880	Garden Equipments	89,400
Add: Excess of Income over Expenditure	76,800	Stock : Pamphlets	2,000
	1,59,680	Seeds and Fertilisers	39,000
Creditors for Seeds and Fertilisers	54,700	Debtors : Pamphlets	1,500
Subscriptions in Advance (Groups)	1,000	Seeds and Fertilisers	42,400
		Subscriptions in Arrear (Individuals)	1,500
		Cash and Bank	39,580
	2,15,380		2,15,380

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	Individuals ₹	Groups ₹	Date	Particulars	Individuals ₹	Groups ₹
2016 Jan. 1	To Subscriptions in Arrear (10 x ₹ 100)	1,000		2016 ?	By Bank	33,700	10,000
Dec. 31	To Income and Expenditure A/c (Balancing figure)	34,200	9,000	Dec. 31	By Subscriptions in Arrear (15 x ₹ 100)	1,500	—
Dec. 31	To Subscriptions in Advance	—	1,000				
		35,200	10,000			35,200	10,000

Dr. **(2) Pamphlets Trading Account** **Cr.**

Particulars	₹	Particulars		₹
To Opening Stock	2,500	By Sales :		
To Cost of Printing Pamphlets	3,500	Cash	4,000	
To Profit on Pamphlets	1,500	Credit	1,500	5,500
		By Closing Stock		2,000
	7,500			7,500

(3) Calculation of Profit / Loss on Annual Garden Party

			₹
Cash Deposited		20,100	
Add: Paid for — General expenses	1,800		
Postage	290	2,090	22,190
Less: Expenses			15,000
Profit on Annual Garden Party			7,190

(4) Calculation of Profit / Loss on Visit to Research Centre

	₹
Sale of tickets	23,200
Less: Cost	24,700
Loss on visit to Research Centre	1,500

(5) Calculation of Profit / Loss on Annual Garden Show

		₹
Receipts — Sale of tickets	82,900	
Competition fees	41,000	1,23,900
Less: Payments — Hire of marquee	36,400	
Prizes	65,000	1,01,400
Profit on Annual Garden Show		22,500

Dr. (6) Creditors for Seeds and Fertilisers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
?	To Cash	1,64,000	Jan. 1	By Balance b/d	80,400
Dec. 31	To Balance c/d	54,700	Dec. 31	By Purchases (Balancing figure)	1,38,300
		2,18,700			2,18,700

Dr. (7) Debtors for Seeds and Fertilisers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Jan. 1	To Balance b/d	22,200	?	By Bank	1,30,000
Dec. 31	To Sales (Note 8)	1,67,200	Dec. 31	By Cash Stolen (Balancing figure)	17,000
				By Balance c/d	42,400
		1,89,400			1,89,400

Dr. (8) Seeds and Fertilisers Trading Account Cr.

Particulars	₹	Particulars	₹
To Opening Stock	26,100	By Sales	1,67,200
To Purchases (Note 6)	1,38,300	By Closing Stock	39,000
To Profit on Seeds and Fertilisers	41,800		
	2,06,200		2,06,200

Cost of seeds and fertilisers sold = Opening stock + Purchases — Closing Stock = ₹ (26,100 + 1,38,300 – 39,000) = ₹ 1,25,400. Seeds and fertilisers are sold at a profit of $33^1/_3$ on cost. Therefore, profit = $33^1/_3$ on ₹ 1,25,400 = ₹ 41,800; and sales = ₹ (1,25,400 + 41,800) = ₹ 1,67,200.

Dr. (9) Balance Sheet as at 1st January, 2016 Cr.

Liabilities	₹	Assets	₹
Accumulated Fund (Balancing figure)	82,880	Garden Equipments	24,200
Creditors of Seeds and Fertilisers	80,400	Stock : Pamphlets	2,500
		Seeds and Fertilisers	26,100
		Debtors of Seeds and Fertilisers	22,200
		Cash and Bank	87,280
		Subscriptions in Arrear	1,000
	1,63,280		1,63,280

Illustration 19

The following is the Receipts and Payments Account of The Calcutta Football Club for the year ended 31.12.2016 :

Receipts	₹	Payments	₹
1.1.2016		31.12.2016	
Cash in hand	2,000	Remuneration to Club coach	5,000
Balance as per Bank Pass Book :		Groundmen's pay	2,500
Saving Account	19,300	Purchase of equipments	15,500
Current Account	6,000	Bar room expenses	2,000
31.12.2016		Ground rent	2,500
Bank interest	500	Club night expenses	3,800
Entrance fees	1,800	Printing and stationery	3,000
Donations and subscriptions	25,000	Repairs to equipment	5,000
Bar room receipts	4,000	Honorarium to Secretary for the year 2015	4,000

Contribution to Club night	1,000	Balance at Bank as per Pass Book :	
Sale of equipment	800	Savings Account	20,400
Net proceeds of Club night	7,800	Current Account	2,000
		Cash in hand	2,500
	68,200		68,200

You are given the following additional information (all figures in rupees) :

Particulars	1.1.2016	31.12.2016
(a) Subscriptions due from members	1,500	1,000
(b) Sums due for printing and stationery	1,000	800
(c) Unpresented cheques on Current Account being payments for repairs	3,000	2,500
(d) Interest on Savings Bank Account, not entered in Pass Book	—	200
(e) Estimated value of equipments	8,000	17,500
(f) For the year ended 31.12.2016, the honorarium to Secretary are to be increased by a total of ₹ 2,000 and the Groundman is to receive a bonus of ₹ 2,000.		

You are required to prepare :

(a) An Income and Expenditure Account for the year ended 31.12.2016; and (b) A Balance Sheet as on that date.

Solution

Calcutta Football Club

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income		₹
To Remuneration to Club Coach	5,000	By Donations and Subscriptions (Note 4)		24,500
To Groundmen's pay	2,500	By Profit from bar room :		
To Groundmen's bonus	2,000	Bar room receipts	4,000	
To Ground rent	2,500	Less: Bar room expenses	2,000	2,000
To Printing and Stationery (Note 1)	2,800	By Profit from Club night :		
To Repairs to Equipments (Note 2)	4,500	Contribution to club night	1,000	
To Honorarium to Secretary : ₹ (4,000 + 2,000)	6,000	Net proceeds of Club night	7,800	
To Depreciation on Equipments (Note 3)	5,200		8,800	
To Excess of Income over Expenditure	1,700	Less : Club night expenses	3,800	5,000
		By Bank interest	500	
		Add: Accrued interest	200	700
	32,200			32,200

Balance Sheet of Calcutta Football Club as on 31st December, 2016

Liabilities		₹	Assets		₹
Capital Fund :			Equipments (Note 3)		17,500
Opening balance (Note 5)	28,800		Subscriptions Due		1,000
Add: Surplus	1,700		Bank : Saving Account	20,400	
Add: Entrance fees	1,800	32,300	Add: Accrued interest	200	20,600
Outstanding Expenses :			Cash		2,500
Groundman's bonus		2,000			
Printing and Stationery		800			
Honorarium to Secretary		6,000			
Bank Overdraft (Note 6)		500			
		41,600			41,600

Working Notes :

Dr. (1) Printing and Stationery Account Cr.

To Bank	3,000	By Outstanding Printing	1,000
To Outstanding Printing	800	By Income and Expenditure (Balancing figure)	2,800
	3,800		3,800

(2) Repairs to Equipment = ₹ 5,000 – ₹ 3,000 + ₹ 2,500 = ₹ 4,500

Dr. (3) Equipments Account Cr.

To Balance b/d	8,000	By Bank - sale	800
To Bank - purchase	15,500	By Depreciation (Balancing figure)	5,200
		By Balance c/d	17,500
	23,500		23,500

Dr. (4) Donations and Subscriptions Account Cr.

To Subscriptions due	1,500	By Receipts and Payments	25,000
To Income and Expenditure (Balancing figure)	24,500	By Subscriptions due	1,000
	26,000		26,000

(5) Balance Sheet of Calcutta Football Club as on 1st January, 2016

Liabilities	₹	Assets		₹
Outstanding Expenses :		Equipments		8,000
Printing and Stationery	1,000	Subscriptions Due		1,500
Honorarium to Secretary	4,000	Bank : Saving Account	19,300	
Capital Fund (Balancing figure)	28,800	Current Account (Note 6)	3,000	22,300
		Cash in hand		2,000
	33,800			33,800

(6) Bank Balance of Current Account as per Cash Book (figures in rupees)

Particulars	1.1.2016	31.12.2016
Balance as per Pass Book	6,000	2,000
Less : Cheque issued but not presented	3,000	2,500
Balance as per Cash Book *	3,000	(O/D) (500)

* **Tutorial Note :** When Balance Sheet is prepared, balance as per Cash Book is taken into consideration in place of balance as per Pass Book.

Illustration 20

The following is the Receipts and Payments Account of Sydney Club for the year ended 31st March, 2017 :

Receipts	₹	Payments	₹
Opening Balance :		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and Stationery	70,000
Subscriptions Received	2,02,750	Postage	40,000
Entrance Donation	1,00,000	Telephones and Telex	52,000
Interest Received	58,000	Repairs and Maintenance	48,000
Sale of Assets	8,000	Glass and Table Linen	12,000
Miscellaneous Income	9,000	Crockery and Cutlery	14,000
Receipts at :		Garden Upkeep	8,000
Coffee Room	10,70,000	Membership Fees	4,000
Wines and Spirits	5,10,000	Insurance	5,000
Swimming Pool	80,000	Electricity	28,000
Tennis Court	1,02,000	Closing Balance :	
		Cash	8,000
		Bank	2,24,600
	21,53,600		21,53,600

The Assets and Liabilities as on 01.04.2016 were as follows :

Particulars	₹	Particulars	₹
Fixed Assets (net)	5,00,000	Sundry Creditors	1,12,000
Stock	3,80,000	Subscriptions Received in Advance	15,000
Investment in 12% Government Securities	5,00,000	Entrance Donation Received pending Membership	1,00,000
Outstanding Subscriptions	12,000	Gratutity Fund	1,50,000
Prepaid Insurance	1,000		

The following adjustments are to be made while drawing up the Accounts :

(i) Subscriptions received in advance as on 31st March, 2017 was ₹ 18,000.
(ii) Outstanding subscriptions as on 31st March, 2017 was ₹ 7,000.
(iii) Outstanding expenses are salaries ₹ 8,000 and electricity ₹ 15,000.
(iv) Fifty per cent of the Entrance Donation was to be capitalised. There was no pending membership as on 31st March, 2017.
(v) The cost of assets sold net as on 01.04.2016 was ₹ 10,000.
(vi) Depreciation is to be provided at the rate of 10% on assets.
(vii) A sum of ₹ 20,000 received in October 2016 as Entrance Donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 03.06.2017.
(viii) Purchases made during the year amounted to ₹ 15,00,000.
(ix) The value of closing stock was ₹ 2,10,000.
(x) The club as a matter of policy charges-off to Income and Expenditure Account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2017 and the Balance Sheet as on 31st March, 2017 alongwith necessary workings. ***[C.A. (Foundation) — Adapted]***

Solution

Sydney Club

Income and Expenditure Account for the year ended 31st March, 2017

Expenditure	₹	Income	₹
To Salaries (₹ 1,20,000 + 8,000)	1,28,000	By Subscriptions (Note 3)	1,94,750
To Printing and Stationery	70,000	By Entrance Donation (Note 6)	90,000
To Postage	40,000	By Interest (12% on ₹ 5,00,000)	60,000
To Telephone and Telex	52,000	By Miscellaneous Income	9,000
To Repairs and Maintenance	48,000	By Profit from Operations (Note 5)	92,000
To Glass and Table Linen	12,000	By Excess of Expenditure over Income	30,250
To Crockery and Cutlery	14,000		
To Garden Upkeep	8,000		
To Membership Fees	4,000		
To Insurance (₹ 1,000 + ₹ 5,000)	6,000		
To Electricity Charges (₹ 28,000 + ₹ 15,000)	43,000		
To Loss on sale of assets (Note 2)	2,000		
To Depreciation on Fixed Assets (Note 2)	49,000		
	4,76,000		4,76,000

Balance Sheet of Sydney Club as on 31st March, 2017

Liabilities		₹	Assets	₹
Capital Fund :			Fixed Assets	4,41,000
Opening balance (Note 1)	10,29,850		Stock	2,10,000
Add: Entrance donation capitalised	90,000		Investment in 12% Government Securities	5,00,000
	11,19,850		Accrued Interest (₹ 60,000 – ₹ 58,000)	2,000
Less: Excess of expenditure over income	30,250	10,89,600	Outstanding Subscriptions :	7,000
Gratuity Fund		1,50,000	Bank	2,24,600
Sundry Creditors (Note 4)		92,000	Cash	8,000
Subscriptions received in advance		18,000		
Entrance donation refundable (Note 6)		20,000		
Outstanding expenses :				
Salaries	8,000			
Electricity	15,000	23,000		
		13,92,600		13,92,600

Working Notes :

(1) Balance Sheet as on 1st April, 2016

Liabilities	₹	Assets	₹
Sundry Creditors	1,12,000	Fixed Assets (Note 2)	5,00,000
Subscriptions received in advance	15,000	Stock	3,80,000
Entrance donation received in advance	1,00,000	Investment in 12% Government Securities	5,00,000
Gratuity Fund	1,50,000	Outstanding Subscriptions	12,000
Capital Fund (Balancing figure)	10,29,850	Prepaid Insurance	1,000
		Cash	10,000
		Bank	3,850
	14,06,850		14,06,850

Dr. (2) Fixed Assets Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,00,000	By Bank A/c (sold)	8,000
		By Loss on Sale of Assets (₹ 10,000 – ₹ 8,000)	2,000
		By Depreciation A/c (10% on ₹ 5,00,000 – ₹ 10,000)	49,000
		By Balance c/d	4,41,000
	5,00,000		5,00,000

Dr. (3) Subscriptions Account Cr.

Particulars	₹	Particulars	₹
To Outstanding Subscriptions A/c (1.4.2016)	12,000	By Subscriptions Received in Advance A/c (1.4.2016)	15,000
To Income and Expenditure A/c (Balancing figure)	1,94,750	By Bank A/c (Subscriptions received)	2,02,750
To Subscriptions Received in Advance A/c (31.3.2017)	18,000	By Outstanding Subscriptions A/c (31.3.2017)	7,000
	2,24,750		2,24,750

Dr. (4) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	15,20,000	By Balance b/d	1,12,000
To Balance c/d	92,000	By Credit Purchases A/c	15,00,000
	16,12,000		16,12,000

Dr. (5) Profit and Loss Account on Operations Cr.

Particulars	₹	Particulars	₹
To Opening Stock	3,80,000	By Receipts from Operations :	
To Purchases A/c	15,00,000	Coffee Room	10,70,000
To Profit from Operations	92,000	Wines and Spirits	5,10,000
		Swimming Pool	80,000
		Tennis Court	1,02,000
		By Closing Stock	2,10,000
	19,72,000		19,72,000

Dr. (6) Entrance Donation Account Cr.

Particulars	₹	Particulars	₹
To Entrance Donation Refundable	20,000	By Balance b/d	1,00,000
To Income and Expenditure A/c [50% capitalised — i.e., 50% of ₹ 1,80,000 (₹ 2,00,000 – ₹ 20,000)]	90,000	By Bank A/c	1,00,000
To Capital Fund	90,000		
	2,00,000		2,00,000

Illustration 21

The accountant of City Club gave the following information about the receipts and payments of the club for the year ended 31st March, 2017 :

Receipts	₹	Payments	₹
Subscriptions	62,130	Premises	30,000
Fair Receipts	7,200	Rent	2,400
Variety Show Receipts (net)	12,810	Rates and Taxes	3,780
Interest	690	Printing and Stationery	1,410
Bar Collections	22,350	Sundry Expenses	5,350
		Wages	2,520
		Fair Expenses	7,170
		Honorarium to Secretary	11,000
		Bar Purchases (payments)	17,310
		Repairs	960
		New Car (less proceeds of old car ₹ 9,000)	37,800

The following additional information could be obtained (all figures in ₹):

Particulars	1.4.2016	31.3.2017	Particulars	1.4.2016	31.3.2017
Cash in hand	450	—	Accumulated Depreciation on Premises	56,400	?
Bank balance as per Cash Book	24,420	10,350	Car at cost	36,570	46,800
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the Cash Book)	270	90	Accumulated Depreciation on car	30,870	?
			Bar Stock	2,130	2,610
			Creditors for Bar Purchases	1,770	1,290
Subscriptions Due	3,600	2,940			
Premises — at cost	87,000	1,17,000			

Annual honorarium to Secretary is ₹ 12,000. Depreciation on premises is to be provided at 5% p.a. on written-down value. Depreciation on new car is to be provided at 20%.

You are required to prepare the Receipts and Payments Account and Income and Expenditures Account for the year ended 31.3.2017.

Solution

City Club

Receipts and Payments Account for the year ended 31st March, 2017

Receipts	₹	Payments	₹
To Balance b/d :		By Premises	30,000
Cash in hand	450	By Rent	2,400
Bank balance	24,420	By Rates and Taxes	3,780
To Subscriptions	62,130	By Printing and Stationery	1,410
To Fair Receipts	7,200	By Sundry Expenses	5,350
To Variety Show Receipts (net)	12,810	By Wages	2,520
To Interest	690	By Fair Expenses	7,170
To Bar Collections	22,350	By Honorarium to Secretary	11,000
To Sale proceeds of old car	9,000	By Bar Purchases (payments)	17,310

		By Repairs	960
		By New Car — ₹ (37,800 + 9,000)	46,800
		By Balance c/d :	
		Cash in hand	—
		Bank balance	10,350
	1,39,050		1,39,050

Income and Expenditure Account of City Club for the year ended 31st March, 2017

Expenditure	₹	Income	₹
To Rent	2,400	By Subscriptions (Note 1)	61,470
To Rates and Taxes	3,780	By Fair Receipts	7,200
To Printing and Stationery	1,410	By Variety Show Receipts (Net)	12,810
To Wages	2,520	By Interest	690
To Fair Expenses	7,170	By Profit on Bar (Note 3)	6,000
To Honorarium to Secretary — ₹ (11,000 + 1,000)	12,000	By Profit on sale of Car (Note 4)	3,300
To Sundry Expenses	5,350		
To Repairs	960		
To Depreciation :			
On Premises @ 5% on ₹ (1,17,000 – 56,400)	3,030		
On Car @ 20% on ₹ 46,800	9,360		
To Excess of Income over Expenditure	43,490		
	91,470		91,470

Working Notes :

Dr. (1) Subscriptions Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,600	By Bank A/c	62,130
To Income and Expenditure A/c (Balancing figure)	61,470	By Balance c/d	2,940
	65,070		65,070

Dr. (2) Creditors for Bar Purchases Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	17,310	By Balance b/d	1,770
To Balance c/d	1,290	By Bar Purchases (Balancing figure)	16,830
	18,600		18,600

Dr. (3) Bar Profit and Loss Account Cr.

Particulars	₹	Particulars	₹
To Opening Stock	2,130	By Bank A/c (Bar collection)	22,350
To Purchases (Note 2)	16,830	By Closing Stock	2,610
To Profit on Bar	6,000		
	24,960		24,960

Dr. (4) Car Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	36,570	By Bank (Sale proceeds of old car)	9,000
To Bank A/c (new car)	46,800	By Accumulated Depreciation	30,870
To Profit on Sale of Car (Balancing figure)	3,300	By Balance c/d	46,800
	86,670		86,670

Illustration 22

The following information is supplied to you by the Treasurer of The Delhi Boys Club. From these details, prepare the Income and Expenditure Account for the year ended 31.12.2016, and the Balance Sheet as on that date :

(a) The club was founded five years before when a loan of ₹ 2,00,000 was obtained, free of interest, from a local authority. A club house was erected at the cost of ₹ 1,75,000 and paid for out of the Loan Account. ₹ 80,000 has now been repaid on account of the loan.

(b) Subscriptions received during 2016 totalling ₹ 56,950, made up of the following —

for 2015 ₹ 2,750; for 2016 ₹ 53,000; for 2018 ₹ 1,200.

In 2015, some subscriptions for 2017 were received in advance, amounting to ₹ 2,350. When the annual accounts for 2015 were prepared, it was estimated that 2015 subscriptions arrears amounting to ₹ 4,400 would be collected in 2016.

On 31.12.2016, it was considered that 2016 subscriptions arrears of ₹ 3,800 would be received in 2017, but the subscriptions still in arrears for 2015 should be written-off.

(c) As an alternative to paying annual subscriptions, members can at any time opt to pay a lump sum which gives them membership for life without further payment. Amounts so received are held in suspense in a Life Membership Fund Account and then credited to Income and Expenditure Account in equal instalments over 10 years; the first such transfer takes place in the year in which the lump sum is received. On 31.12.2015, the credit balance on the Life Membership Fund Account was ₹ 47,200, of which ₹ 8,500 is to be taken as income for the year ended 31.12.2016. During 2016, amount received in respect of life membership amounted to ₹ 27,000.

(d) The net profit on bar during the year was ₹ 10,500 after charging 1/2 of salaries. Purchases and sales of bar during the year amounted to ₹ 15,000 and ₹ 30,000 respectively. The stock of bar on 31.12.2016 was ₹ 8,000.

(e) During the year ended, among others, the club paid for the following —
Loan repayment ₹ 20,000; Salaries ₹ 15,000; Electricity ₹ 5,500; Cleaning ₹ 2,600;
Sundry expenses ₹ 8,200.

(f) The other assets and liabilities as on 1.1.2016 and 31.12.2016 were as follows (all figures in rupees) —

Date	Cash and Bank	Equipments	Vehicles	Furniture
1.1.2016	25,150	15,000	80,000	40,000
31.12.2016	?	12,000	65,000	36,000

Solution

The Delhi Boys' Club

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Salaries (1/2 of ₹ 15,000)	7,500	By Subscriptions (Note 1)	56,800
To Electricity	5,500	By Life Membership Fund (Note 2)	11,200
To Cleaning	2,600	By Net Profit on Bar	10,500
To Sundry Expenses	8,200		
To Bad Debts (Note 1)	1,650		
To Depreciation on :			
Equipments (₹ 15,000 – 12,000)	3,000		
Vehicles (₹ 80,000 – 65,000)	15,000		
Furniture (₹ 40,000 – 36,000)	4,000		
To Excess of Income over Expenditure	31,050		
	78,500		78,500

Balance Sheet of Delhi Boys' Club as on 31st December, 2016

Liabilities	₹	Assets	₹
Capital Fund	1,55,000	Building	1,75,000
Add: Excess of Income over Expenditure	31,050	Equipments	12,000
	1,86,050	Vehicles	65,000
Life Membership Fund (Note 2)	63,000	Furniture	36,000
Loan from Local Authority (₹ 2,00,000 – 80,000)	1,20,000	Bar Stock	8,000
Subscriptions in Advance (Note 1)	3,550	Cash and Bank (Note 5)	72,800
		Subscriptions in Arrear	3,800
	3,72,600		3,72,600

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Jan. 1	To Subscriptions in Arrear	4,400	Jan. 1	By Subscriptions Received in Advance A/c	2,350
Dec. 31	To Income and Expenditure A/c (Balancing figure)	56,800	?	By Cash and Bank A/c	56,950
			Dec. 31	By Bad Debts (See Note below (i)]	1,650
"	To Subscriptions Received in Advance A/c [See Note below (ii)]	3,550	"	By Subscriptions in Arrear	3,800
		64,750			64,750

(i) Subscriptions in arrear for 2015 was ₹ 4,400, out of which only ₹ 2,750 was collected in 2016. The balance of ₹ 1,650 (₹ 4,400 – 2,750) is to be written-off as bad debts.

(ii) ₹ 2,350 was received in 2015 for 2017 and ₹ 1,200 was received in 2016 for 2018. Therefore, total amount to be carried forward to next year = ₹ (2,350 + 1,200) = ₹ 3,550.

Dr. **(2) Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 31	To Income and Expenditure A/c	11,200	Jan. 1	By Balance b/d	47,200
	(₹ 8,500 + 10% of ₹ 27,000)		?	By Cash and Bank A/c	27,000
"	To Balance c/d	63,000			
		74,200			74,200

Dr. **(3) Bar Trading and Profit and Loss Account** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	5,000	By Sales	30,000
To Purchases	15,000	By Closing Stock	8,000
To Gross Profit c/d	18,000		
	38,000		38,000
To Salaries (1/2 of ₹ 15,000)	7,500	By Gross Profit b/d (Balancing figure)	18,000
To Net Profit on Bar	10,500		
	18,000		18,000

Dr. **(4) Balance Sheet as at 1st January, 2016** **Cr.**

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	1,55,000	Building	1,75,000
Life Membership Fund	47,200	Equipments	15,000
Loan from Local Authority (See Note below)	1,40,000	Vehicles	80,000
Subscriptions in Advance	2,350	Furniture	40,000
		Bar Stock (Note 3)	5,000
		Cash and Bank	25,150
		Subscriptions in Arrear	4,400
	3,44,550		3,44,550

Total loan upto 31.12.2016 was ₹ 80,000. During 2016, ₹ 20,000 was paid. Therefore, upto 31.12.2015 only ₹ 60,000 (₹ 80,000 – 20,000) was paid. Loan outstanding on 1.1.2016 was ₹ (2,00,000 – 60,000) = ₹ 1,40,000.

Dr. **(4) Receipts and Payments Account for the year ended 31st December, 2016** **Cr.**

Particulars	₹	Particulars	₹
To Opening Cash and Bank	25,150	By Bar Purchases	15,000
To Subscriptions	56,950	By Loan Repayment	20,000
To Life Membership Fund	27,000	By Salaries	15,000
To Bar Sales	30,000	By Electricity	5,500
		By Cleaning	2,600
		By Sundry Expenses	8,200
		By Closing Cash and Bank	72,800
	1,39,100		1,39,100

Illustration 23

The following is the Receipts and Payments Account of Barisha Recreation Club for the year ended 31.12.2016 :

Receipts	₹	Payments	₹
To Cash in Hand	500	By Rent of Club House	1,300
To Cash at Bank	6,000	By Painting of Club House	700
To Members' Subscriptions :		By Wages of Ground Maintenance	1,500
Ordinary for 2015	100	By General Expenses	1,300
Ordinary for 2016	1,800	By Electricity Charges	1,800
Ordinary for 2017	200	By Investment	10,000
To Life Membership Subscriptions	2,000	By Secretary's Honorarium	600
To Sale of Tickets for Annual Exhibition	10,000	By Annual Meeting Expenses	400
To Sale of Refreshments	12,000	By Sports Equipments	1,800
To Interest on Investments	1,300	By Purchase of Refreshments	5,500
To Sale of Furniture (original cost on 1.1.2015 was ₹ 500)	100	By Printing and Stationery	500
		By Insurance	300
		By Cash in Hand	2,000
		By Cash at Bank	6,300
	34,000		34,000

The following information are also available :

(a) On 31.12.2015, outstanding subscriptions for 2015 was ₹ 150.

(b) On 31.12.2015, advance subscriptions for 2016 received was ₹ 50.

(c) On 31.12.2016, outstanding subscriptions for 2016 was ₹ 300.

(d) A life membership scheme was introduced in 2015. Under the scheme, life membership subscription is ₹ 500 and it was to be apportioned to income 1/10th every year over a period of 10 years. Life membership subscriptions totalling ₹ 2,500 were collected during 2015.

(e) On 1.1.2016, Investment was ₹ 20,000 and interest accrued on investment on 31.12.2016 was ₹ 1,200.

(f) On 1.1.2015, Furniture costing ₹ 8,000 were purchased and it was decided to write off depreciation on furniture and sports equipments @ 10% p.a. on cost.

(g) In 2015, a plot of land was purchased for ₹ 20,000 to construct club house.

(h) Other assets and liabilities of the club were : (all figures in rupees)

	Stock of refreshment	Insurance prepaid	Rent accrued	Creditors for refreshment
31.12.2015	1,900	70	200	400
31.12.2016	2,100	50	100	500

You are required to prepare an Income and Expenditure Account for the year ended 31.12.2016 and also a Balance Sheet as on that date.

Solution

Barisha Recreation Club

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income		₹
To Rent of Club House (Note 1)	1,200	By Subscriptions : ordinary (Note 6)		2,150
To Painting of Club House	700	life (Note 7)		450
To Wages of Ground Maintenance	1,500	By Sale of Tickets for Annual Exhibition		10,000
To General Expenses	1,300	By Sale of Refreshment		12,000
To Electricity Charges	1,800	By Interest on Investment	1,300	
To Secretary's Honorarium	600	Add : Accrued Interest	1,200	2,500
To Annual Meeting Expenses	400			
To Printing and Stationery	500			
To Insurance Premium (Note 2)	320			
To Loss on Sale of Furniture (Note 3)	350			
To Refreshments Consumed (Note 5)	5,400			
To Depreciation on :				
Furniture	750			
Sports Equipments	180			
To Excess of Income over Expenditure	12,100			
	27,100			27,100

Balance Sheet of Barisha Recreation Club as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital fund :			Land		20,000
Opening balance (Note 8)	52,920		Furniture : ₹ (8,000 – 800)	7,200	
Add: Surplus	12,100	65,020	Less: W.D.V. of furniture sold :₹ (500 – 50)	450	
Rent accrued of Club House		100		6,750	
Creditors for Refreshment		500	Less: Depreciation @ 10% p.a. on ₹ (8,000 – 500)	750	6,000
Advance Subscriptions for 2017		200	Sports Equipments	1,800	
Life Subscriptions (Note 7)		3,800	Less: Depreciation @ 10% p.a.	180	1,620
			Investments	20,000	
			Add: Purchase	10,000	30,000
			Accrued Interest on Investment		1,200
			Stock of Refreshment		2,100
			Prepaid Insurance		50
			Outstanding subscriptions :		
			2015 (₹ 150 – 100)	50	
			2016	300	350
			Bank		6,300
			Cash		2,000
		69,620			69,620

Working Notes :

Dr. **(1) Rent of Club House Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank	1,300		By Rent Accrued	200
	To Rent Accrued	100		By Income and Expenditure (Balancing figure)	1,200
		1,400			1,400

Dr. **(2) Insurance Premium Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Insurance Prepaid	70		By Income and Expenditure (Balancing figure)	320
	To Bank	300		By Insurance Prepaid	50
		370			370

(3) Calculation of Loss on Sale of Furniture

Particulars	₹
Written down value of the furniture sold on 1.1.2015 : ₹ (500 – 50)	450
Less: Selling price	100
Loss on Sale of Furniture	350

Dr. **(4) Creditors for Refreshment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank	5,500		By Balance b/d	400
	To Balance c/d	500		By Purchases (Balancing figure)	5,600
		6,000			6,000

Dr. **(5) Stock of Refreshment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,900		By Income and Expenditure (Balancing figure)	5,400
	To Purchases	5,600		By Balance c/d	2,100
		7,500			7,500

Dr. **(6) Subscriptions Account (for 2016)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Income and Expenditure (Balancing figure)	2,150		By Advance subscriptions	50
				By Receipts and payments	1,800
				By Outstanding subscriptions	300
		2,150			2,150

Outstanding subscriptions of : ₹ (150 – 100) = ₹ 50 for 2015 is still due. And, advance subscriptions for 2017 is ₹ 200.

Dr. **(7) Life Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Income and Expenditure A/c	250	?	By Bank A/c	2,500
"	To Balance c/d	2,250			
		2,500			2,500
31.12.2016	To Income and Expenditure A/c : ₹ (250 + 200)	450	1.1.2016	By Balance c/d	2,250
"	To Balance c/d	3,800	?	By Bank A/c	2,000
		4,250			4,250

(8) Balance Sheet of Barisha Recreation Club as at 1st January, 2016

Liabilities		₹	Assets		₹
Rent Accrued		200	Land		20,000
Creditors for Refreshment		400	Furniture	8,000	
Advance Subscriptions for 2016		50	Less: Depreciation	800	7,200
Life Subscriptions : ₹ (2,500 – 250)		2,250	Investment		20,000
Capital Fund (Balancing figure)		52,920	Stock of Refreshment		1,900
			Prepaid Insurance		70
			Outstanding Subscriptions for 2015		150
			Bank		6,000
			Cash		500
		55,820			55,820

3. Preparation of Income & Expenditure Account and Balance Sheet from Incomplete Records

Examination questions often require candidates to prepare an Income and Expenditure Account and Balance Sheet from incomplete records. Generally, a summary of bank and cash transactions is provided along with information relating to opening and closing assets and liabilities. To solve these types of problems, the following steps are followed :

Step 1 Prepare a cash book with cash and bank columns.

Step 2 Open such ledger accounts as are deemed necessary.

Step 3 Draft a proforma Income and Expenditure Account and Balance Sheet.

Step 4 Post the balances from the opening Balance Sheet into an appropriate ledger accounts, or in the appropriate place in the Income and Expenditure Account / Closing Balance Sheet.

Step 5 Post the cash book entries to the appropriate ledger accounts or draft Income and Expenditure / Balance Sheet.

Step 6 Enter the closing adjustments (outstanding accruals, depreciation) either in the appropriate ledger account or the draft final accounts, making sure that the double entry is carried out.

Step 7 Post the balancing figure of the Ledger Accounts to the Income and Expenditure Account / Balance Sheet.

Step 8 Find out the surplus or deficit of the Income and Expenditure Account and transfer it to Balance Sheet.

Illustration 24

The Comrades club makes up its account to 31st December in each year. On 31st December, 2016 the treasurer left the club premises and has not been seen since. An examination of the records showed that the books had not been written up for a considerable time, and it was decided to reconstruct the figures from 1st January 2016.

A summary of the Bank Account for the year showed the following:

Receipts	₹	Payments	₹
Balance (1.1.2016)	416	Rent & Rates	460
Bank deposits	42,610	Insurance	40
		Light & heat	156
		Bar purchases	35,067
		Telephone	59
		Cash withdrawn	5,848
		Balance as on 31.12.2016	1,396
	43,026		43,026

The following information is also obtained:

1. The barman places takings in the bank 'night safe' on his way home for crediting to the club account. The duplicate paying-in-slips total ₹ 40,612 for the year. The treasurer had no access to bar takings or stock.
2. The receipt counterfoils for members' subscriptions total ₹ 3,050 for the year.
3. A summary of expenditure for petty cash and wages was as follows:
   Glasses, crockery and maintenance—₹ 1,310; Wages—₹ 2,658; National Insurance—₹ 210; Sundry expenses—₹ 257.
4. Outstanding amounts and prepayments at 31st December, were :

	2015	2016
Rates prepaid	26	28
Rent outstanding	40	82
Electricity outstanding	24	18

5. The Bar stock on 1st January, 2016 was ₹ 3,607 and on 31st December, 2016 was ₹ 2,916. The cash in hand with the treasurer at the beginning of the year was ₹ 35.

You are required to prepare :

(i) A summary of the cash position for the year ended 31st December, 2016 indicating the amount, if any, to be claimed under the club's fidelity insurance policy;

(ii) An Income and Expenditure Account for the year 2016.

Solution

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/f	35	2016	By Bank (deposits) (₹ 42,610 — ₹ 40,612)	1,998
?	To Subscriptions	3,050	?	By Glasses, crockery and maintenance	1,310
	To Bank (withdrawals)	5,848		By Wages	2,658
				By Insurance	210
				By Sundry expenses	257
				By Insurance claim (balancing figure)	2,500
		8,933			8,933

The Comrades Club
Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Rent & Rates (Note 1)	500	By Subscriptions	3,050
To Insurance (Note 3)	250	By Bar takings	40,612
To Electricity (Note 2)	150		
To Bar stock consumed (Note 4)	35,758		
To Telephone charges	59		
To Glasses, crockery and maintenance	1,310		
To Wages	2,658		
To Sundry expenses	257		
To Excess of Income over Expenditure	2,720		
	43,662		43,662

Working Notes :

Dr. (1) Rent & Rates Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/f (rates)	26	1.1.2016	By Balance b/f (rent)	40
?	To Bank A/c	460	31.12.2016	By Income & Expenditure A/c (balancing fig.)	500
31.12.2016	To Balance c/d (rent)	82	31.12.2016	By Balance c/d (rates)	28
		568			568

Dr. (2) Light and heat (Electricity) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c	156	1.1.2016	By Balance b/f	24
31.12.2016	To Balance c/d	18	31.12.2016	By Income & Expenditure A/c (balancing fig.)	150
		174			174

Dr. (3) Insurance Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Cash (National insurance)	210	31.12.2016	By Income & Expenditure A/c	250
?	To Bank A/c	40			
		250			250

Dr. (4) Bar Stock Consumed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/f	3,607	31.12.2016	By Income & Expenditure A/c	35,758
?	To Bank A/c (purchases)	35,067	31.12.2016	By Balance b/d	2,916
		38,674			38,674

Illustration 25

Universal Brotherhood Club does not maintain complete double entry books of account. From the following details, prepare a Receipts and Payment Account, and an Income and Expenditure Account for the year ended 31.12.2016, and a Balance Sheet as on that date (all figures in rupees) :

Date	Outstanding Subscriptions	Advance Subsriptions	Outstanding Salaries	Advance Salaries	Cash and Bank	5% Investments	Furniture	Sports Goods
1.1.2016	14,000	2,800	1,400	—	14,000	14,000	2,800	5,600
31.12.2016	19,600	5,600	700	700	?	7,000	1,400	11,200

Subscriptions for the year amount to ₹ 70,000. Salaries paid ₹ 15,400. Face value of investments was ₹ 16,800. 50% of investments was sold at 80% of face value. Interest on investments left unsold was received. ₹ 1,400 furniture was sold for ₹ 700 at the beginning of the year. Sports goods were purchased at the end of the year. Charge 20% depreciation on sports goods and 10% on furniture. Sports expenses amount ₹ 14,000. Miscellaneous expenses are ₹ 4,200 and rent amount to ₹ 8,400.

Solution **Universal Brotherhood Club**

Dr. **Receipts and Payments Account for the year ended 31st December, 2016** **Cr.**

Receipts	₹	Payments	₹
To Balance b/d	14,000	By Salaries	15,400
To Subscriptions (Note 1)	67,200	By Sports Expenses	14,000
To Sale of Investments ₹ (16,800 x 50% x 80%)	6,720	By Purchase of Sports Goods ₹ (11,200 – 5,600)	5,600
To Interest on Investments ₹ (16,800 x 50% x 5%)	420	By Miscallenous Expenses	4,200
To Sale of Furniture	700	By Rent	8,400
		By Balance c/d	41,440
	89,040		89,040

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Salaries (Note 2)	14,000	By Subscriptions	70,000
To Sports Expenses	14,000	By Interest on Investments	420
To Miscellanous Expenses	4,200		
To Rent	8,400		
To Loss on Sale of Investment —₹ (7,000 – 6,720)	280		
To Loss on Sale of Furniture — ₹ (1,400 – 700)	700		
To Depreciation on —			
Furniture (10% on ₹ 1,400)	140		
Sports Goods (20% on ₹ 5,600)	1,120		
To Excess of Income over Expenditure	27,580		
	70,420		70,420

Balance Sheet of Universal Brotherhood Club as on 31st December, 2016

Liabilities		₹	Assets		₹
Capital Fund :			Furniture	1,400	
Opening balance (Note 3)	46,200		Less: Depreciation	140	1,260
Add: Surplus	27,580	73,780	Sports Goods	11,200	
Advance Subscriptions		5,600	Less: Depreciation	1,120	10,080
Outstanding Salaries		700	Investments (Face value ₹ 8,400)		7,000
			Cash and Bank		41,440
			Outstanding Subscription		19,600
			Advance Salaries		700
		80,080			80,080

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Oustanding Subscriptions (Opening)	14,000	1.1.2016	By Advance Subscriptions (Opening)	2,800
31.12.2016	To Income and Expenditure A/c	70,000	31.12.2016	By Receipts and Payments A/c (Bal. fig.)	67,200
31.12.2016	To Advance Subscriptions (Closing)	5,600	31.12.2016	By Outstanding Subscriptions (Closing)	19,600
		89,600			89,600

Dr. **(2) Salaries Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Bank	15,400	1.1.2016	By Outstanding Salaries (Opening)	1,400
31.12.2016	To Outstanding Salaries (Closing)	700	31.12.2016	By Income and Expenditure A/c (Bal. fig.)	14,000
			31.12.2016	By Advance Salaries (Closing)	700
		16,100			16,100

(3) Balance Sheet of Universal Brotherhood Club as on 1st January, 2016

Liabilities	₹	Assets	₹
Advance Subscriptions	2,800	Furniture	2,800
Outstanding Salaries	1,400	Sports Goods	5,600
Capital Fund (Balancing figure)	46,200	5% Investments (Face value ₹ 16,800)	14,000
		Cash and Bank	14,000
		Outstanding Subscriptions	14,000
	50,400		50,400

Illustration 26

The Noida Sports Club provides the following information :

(1) The Club conducts all its transactions in cash — any surplus being paid into a Building Society Account. Interest credited to this account for the year to 31.3.2017 was ₹ 3,500.

(2) The Club has 100 members who pay an annual subscription of ₹ 50 each. However, on 31.3.2016, ten members had already paid their subscriptions for 2016-17.
On 31.3.2017, two members who had not been seen in the Club since august 2016 had not paid subscriptions for 2016-17 and it has been decided that the amount due be written-off and that their names be removed from the list of members.

(3) The Club has only two sources of income : subscriptions from members and bar sales. A profit margin of 30% of selling price is normally applied to determine bar selling prices but during the year ₹ 3,970 of goods were sold at cost.

(4) A summary of the payments for the year is as follows (all figures in rupees) :

Purchase of Equipments	1,000	Rental of Premises	10,000
Lighting	2,620	Club Match Expenses	6,750
Repairs to Equipments	1,760	Trophies (treated as an expense)	4,240
Bar Creditors	74,550	Refreshments for Visiting Teams	2,350

(5) The Club has the following other assets and liabilities (all figures in rupees) :

Date	Equipments	Building Society Account	Bar Stock	Bar Creditors
1.4.2016	40,000	46,000	8,400	6,300
31.3.2017	?	?	9,200	4,700

(6) Equipments are depreciated at 10% of the value of equipments held on 31st March each year.

You are required to prepare :

(a) A Bar Trading Account for the year ended 31.3.2017;

(b) A Receipts and Payments Account for the year ended 31.3.2017;

(c) An Income and Expenditure Account for the year ended 31.3.2017; and

(d) A Balance Sheet as at 31.3.2017.

Solution

The Noida Sports Club

Dr. Bar Trading Account for the year ended 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	8,400	By Sales (Note 2)	1,01,370
To Purchases (Note 1)	72,950	By Closing Stock	9,200
To Profit on Bar	29,220		
	1,10,570		1,10,570

Receipts and Payments Account for the year ended 31st March, 2017

Receipts	₹	Payments	₹
To Subscriptions (Note 3)	4,400	By Purchase of Equipments	1,000
To Bar Sales	1,01,370	By Lighting	2,620
		By Repairs to Equipments	1,760
		By Bar Creditors	74,550
		By Rental of Premises	10,000
		By Club Match Expenses	6,750
		By Trophies	4,240
		By Refreshment for Visiting Teams	2,350
		By Deposit to Building Society Account (Balancing figure)	2,500
	1,05,770		1,05,770

Income and Expenditure Account for the year ended 31st March, 2017

Expenses	₹	Income	₹
To Lighting	2,620	By Subscriptions (98 x ₹ 50)	4,900
To Repairs to Equipments	1,760	By Profit on Bar	29,220
To Rental of Premises	10,000	By Interest on Building Society Account	3,500
To Club Match Expenses	6,750		
To Trophies	4,240		
To Refreshment for Visiting Teams	2,350		

To Depreciation on Equipments [10% on ₹ (40,000 + 1,000)]	4,100		
To Excess of Income over Expenditure	5,800		
	37,620		37,620

Balance Sheet of Noida Sports Club as on 31st March, 2017

Liabilities		₹	Assets		₹
Capital Fund :			Equipments	40,000	
Opening balance (Note 4)	87,600		Add: Purchases	1,000	
Add: Excess of Income over Expenditure	5,800	93,400		41,000	
Bar Creditors		4,700	Less: Depreciation	4,100	36,900
			Bar Stock		9,200
			Building Society Account :		
			Opening balance	46,000	
			Add: Further deposit	2,500	
			Interest credited	3,500	52,000
		98,100			98,100

Working Notes :

Dr. (1) Bar Creditors Account Cr.

Particulars	₹	Particulars	₹
To Cash	74,550	By Balance b/d	6,300
To Balance c/d	4,700	By Bar Purchases (Balancing figure)	72,950
	79,250		79,250

(2) Calculation of Bar Sales

Cost of goods sold = Opening stock + Purchases – Closing stock
= ₹ (8,400 + 72,950 – 9,200) = ₹ 72,150

Out of ₹ 72,150, goods costing ₹ 3,970 were sold at cost.

Therefore, sales are :

	₹
at cost	3,970
at 30% margin — ₹ (72,150 – 3,970) / 70%	97,400
	1,01,370

(3) Calculation of Subscriptions Received in Cash

Subscriptions from 98 (100 – 2) members @ ₹ 50 each	4,900
Less: Received in advance in the previous year (10 × ₹ 50)	500
	4,400

(4) Balance Sheet as on 1st April, 2016

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	87,600	Equipments	40,000
Bar Creditors	6,300	Bar Stock	8,400
Subscriptions in Advance (10 x ₹ 50)	500	Building Society Account	46,000
	94,400		94,400

4. Preparation of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet when Ledger Balances and other Information are Given

A Receipts and Payments Account is a summary of the Cash Book. Therefore, as in the Cash Book, receipts are shown on the debit side, that is, left-hand side and payments on the credit side, that is, right-hand side. The following points are worth noting about the preparation of a Receipts and Payments Account:

(i) Any opening balance of Cash and Bank are shown first on the receipts side separately.

(ii) It includes all receipts and payments whether they are of revenue or capital nature.

(iii) It does not exclude receipts and payments relating to preceding years or the subsequent years. For example, if a member pays his subscriptions in advance for the coming year, it is shown on the receipts (debit) side.

(iv) It excludes outstanding expenses of the period.

(v) Closing balance represents cash-in-hand and at Bank at the end of the period.

However, Income and Expenditure Account and Balance Sheet are prepared in the usual manner.

Illustration 27

From the following information, prepare a Receipts and Payments Accounts for the year ended 31st December, 2016.

Receipts:

Donation for Building ₹ 60,000; Sale of old news papers ₹ 500; Fees for coaching ₹ 2,000; Sundries ₹ 200; Subscriptions realised for 2015 ₹ 4,000; Subscriptions for 2016 ₹ 25,000; Subscriptions for 2017 ₹ 600.

Payments:

Salaries ₹ 6,000; Repairs ₹ 1,000; Newspaper ₹ 1,000; Printing and Stationery ₹ 500; Rates and Taxes ₹ 1,000; Electricity ₹ 400; Sundries ₹ 200; Construction of Building ₹ 50,000.

Cash-in-Hand:

1st January ₹ 1,000; 31st December 2016 ₹ 33,200.

Other Information:

(i) Subscriptions to be realised for 2016 ₹ 1,200; (ii) Outstanding Expenses: Repairs ₹ 100; Printing ₹ 400.

Solution **Receipts & Payments Account for the year ended 31st December, 2016**

Receipts	₹	Payments	₹
To Balance b/f	1,000	By Salaries	6,000
To Donation for building	60,000	By Repairs	1,000
To Sale of old newspaper	500	By Newspaper	1,000
To Fees for coaching	2,000	By Printing & Stationery	500
To Sundries	200	By Rates & Taxes	1,000
To Subscriptions :		By Electricity	400
2015	4,000	By Sundries	200
2016	25,000	By Construction of building	50,000
2017	600	By Balance c/d	33,200
	93,300		93,300

Illustration 28

The following balances are obtained from the books of Kanpur Cricket Club as on 31.3.2016 and 31.3.2017 (all figures in rupees):

Particulars	31.3.2016	31.3.2017	Particulars	31.3.2016	31.3.2017
Buildings	80,000	85,500	Outstanding Expenses	3,000	1,200
Furniture	40,000	30,600	Sports Equipments	24,000	21,600
Advance Subscriptions	1,500	1,000	Investments	—	12,000
Arrears of Subscriptions	3,000	5,000	Books	15,000	16,200
Prepaid Expenses	800	1,000	Cash	16,000	17,100

Consider the following information relevant to the year 2016-17 :

(i) Depreciation provided for the year : Building—₹ 4,500; Furniture—₹ 3,400; Sports equipments—₹ 5,400; Books—₹ 1,800.

(ii) Some old furniture standing in the books for ₹ 6,000 as on 1.4.2016 was sold for ₹ 4,000 on the same date.

(iii) The Club had 300 members on 31.3.2017 as per the Register of Members. No fresh members were admitted during the year but 10 members left the Club on 1.10.2016.

(iv) Subscriptions payable—₹ 15 per month.

(v) Donation received ₹ 5,000 has been capitalised.

(vi) Considerable expenses were paid during the year.

You are required to prepare Receipts and Payments Accounts and Income and Expenditure Account for the year ended 31.3.2017 and the Balance Sheet as on that date.

Solution **Kanpur Cricket Club**

Receipts and Payments Account for the year ended 31st March, 2017

Receipts	₹	Payments	₹
To Balance b/d — Cash	16,000	By Investment (Note 2)	12,000
To Subscriptions (Note 1)	52,400	By Buildings (Note 3)	10,000
To Sale of Furniture	4,000	By Sports Equipments (Note 4)	3,000
To Donation	5,000	By Books (Note 5)	3,000
		By Expenses (Balancing figure)	32,300
		By Balance c/d — Cash	17,100
	77,400		77,400

Income and Expenditure Account for the year ended 31st March, 2017

Expenditure	₹	Income	₹
To Expenses (Note 6)	30,300	By Subscriptions (Note 1)	54,900
To Depreciation on :			
Building	4,500		
Furniture	3,400		
Sports Equipments	5,400		
Books	1,800		
To Loss on Sale of Furniture : ₹ (6,000 – 4,000)	2,000		
To Excess of Income over Expenditure	7,500		
	54,900		54,900

Balance Sheet of Kanpur Cricket Club as at 31st March, 2017

Liabilities		₹	Assets	₹
Capital fund :			Buildings	85,500
Opening balance (Note 7)	1,74,300		Furniture	30,600
Add: Surplus	7,500		Sports Equipments	21,600
Donation	5,000	1,86,800	Books	16,200
Advance Subscriptions		1,000	Investments	12,000
Outstanding Expenses		1,200	Arrears of Subscriptions	5,000
			Prepaid Expenses	1,000
			Cash	17,100
		1,89,000		1,89,000

Working Notes : (1) Calculation of Subscriptions due and received : There are 300 members as on 31.3.2017 and 10 members left the club on 1.10.2016. Therefore, the number of members at the beginning of the year were 300 + 10 = 310.

Total subscriptions for the year 2016-17 are as under : ₹

300 members @ 15 per month for the whole year = 300 x ₹ 15 x 12 = 54,000

10 members @ 15 per month for 6 months = 10 x ₹ 15 x 6 = 900 ₹ 54,900

Subscriptions received can be ascertained by preparing the Subscriptions Account as under :

Dr. Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Arrears of subscriptions (opening balance)	3,000		By Advance Subscriptions (opening balance)	1,500
	To Income and Expenditure A/c (as above)	54,900		By Receipts and Payments A/c (balancing figure)	52,400
	To Advance Subscriptions (closing balance)	1,000		By Arrears of Subscriptions (closing balance)	5,000
		58,900			58,900

Dr. (2) Investment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	12,000		By Balance c/d	12,000

Dr. (3) Buildings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	80,000		By Depreciation A/c	4,500
	To Bank A/c	10,000		By Balance c/d	85,500
		90,000			90,000

Dr. (4) Sports Equipments Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	24,000		By Depreciation A/c	5,400
	To Bank A/c	3,000		By Balance c/d	21,600
		27,000			27,000

Dr. (5) Books Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	15,000		By Depreciation A/c	1,800
	To Bank A/c	3,000		By Balance c/d	16,200
		18,000			18,000

Dr. (6) Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Prepaid Expenses (opening)	800		By Outstanding Expenses (opening)	3,000
	To Bank A/c (Balance of Receipts & Payments A/c)	32,300		By Income and Expenditure A/c (Balancing figure)	30,300
	To Outstanding Expenses (closing)	1,200		By Prepaid Expenses (closing)	1,000
		34,300			34,300

(7) Balance Sheet of Kanpur Cricket Club as at 1st April, 2016

Liabilities	₹	Assets	₹
Subscriptions Received in Advance	1,500	Buildings	80,000
Outstanding Expenses	3,000	Furniture	40,000
Capital Fund (Balancing figure)	1,74,300	Sports Equipments	24,000
		Books	15,000
		Arrears of Subscriptions	3,000
		Cash	16,000
		Prepaid Expenses	800
	1,78,800		1,78,800

5. Preparation of Receipts and Payments Account when Income and Expenditure Account, Balance Sheet and other Information are Given

The following steps are to be followed for preparing a Receipts and Payments Account:

Step 1 Draw up a proforma of Receipts and Payments Account. Opening Balance of Cash and Bank are to be written first on the receipts side separately. If no information regarding opening balance of Cash and Bank has been given, leave space for that.

Step 2 Analyse the figure given in the expenditure side of the Income and Expenditure Account. Now,

(i) Post those items of expenditure in which no adjustment to be made, directly to the payments side of the Receipts and Payments Account.

(ii) Prepare statement or open ledger accounts in respect of items of expenditure in which adjustment to be made. Post the adjusted amount to the payments side of the Receipts and Payments Account.

Step3 Analyse the given information and Balance Sheet and post capital expenditure (involving outflow of Cash and/or Bank) to the payments side of the Receipts and Payments Account.

Step4 Analyse the figures given in the income side of the Income and Expenditure Account. Now,

(i) Post those items of income in which no adjustment to be made, directly to the receipts side of the Receipts and Payments Account.

(ii) Prepare statement or open ledger accounts in respect of items of income in which adjustment to be made. Post the adjusted amount to the receipts side of the Receipts and Payments Account.

Step 5 Analyse the given information and Balance Sheet and post capital receipts, if any, to the receipts side of the Receipts and Payments Account.

Step 6 Now, balance the Receipts and Payments Account. The closing balance will represent balance of cash and bank at the end of the period.

In this respect the following points are important:
(i) If both the opening and closing balances of Cash and Bank are given, both payments side and receipts side of the Receipts and Payments Account will be equal.
(ii) If only the opening balances of Cash and Bank have been given, the balance will represent closing balances of Cash and Bank.
(iii) If only the closing balances of Cash and Bank have been given, the balancing figure will represent opening Cash and Bank.

Illustration 29

Prepare a Receipts and Payments Account of Woodburn Club for the year ended 31.12.2016.

Income & Expenditure Account for the year ended 31.12.2016

Expenditure	₹	Income	₹
To Salaries	700	By Donations	420
To General expenses	200	By Subscriptions	800
To Depreciation of assets	120		
To Surplus for the year	200		
	1,220		1,220

Adjustments were also to be made for the following items: Subscriptions for 2015 outstanding on 1.1.2016, ₹ 80 but ₹ 72 only of this amount were realised in 2016. Subscriptions received in advance on 31.12.2015 were ₹ 20 and 31.12.2016 were ₹ 16. Subscriptions for 2016 outstanding at 31.12.2016 were ₹ 28. Sundry Assets on 1.1.2016 were ₹ 1,040. Sundry Assets (after depreciation) were ₹ 1,080 on 31.12.2016. Cash in hand on 31.12.2016 was ₹ 264.

Solution **Woodburn Club**

Receipts & Payments Account for the year ended 31st December, 2016

Receipts	₹	Payments	₹
To Balance b/f (balancing figure)	64	By Salaries	700
To Donations	420	By General expenses	200
To Subscriptions (Note 1)	840	By Purchase of assets (Note 2)	160
		By Balance c/d	264
	1,324		1,324

Working Notes :

(1) Subscriptions	₹	**(2) Purchase of Assets**	₹
As per Income & Expenditure A/c	800	Closing balance of Sundry assets	1,080
Add: Subscriptions for 2015 realised in 2016	72	Add: Depreciation	120
Add: Subscriptions for 2017 received in advance in 2016	16		1,200
	888	Less: Opening balance	1,040
Less: Subscriptions for 2016 received in advance in 2015	20		160
	868		
Less: Subscriptions for 2016 outstanding	28		
	840		

Illustration 30

From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account and Subscriptions Account for the year ended 31.3.2017.

Income and Expenditure Account for the year ended 31st March, 2017

Expenditure	₹	Income	₹
To Upkeep of ground	10,000	By Subscriptions	17,320
To Printing	1,000	By Sale of newspapers (old)	260
To Salaries	11,000	By Lectures	1,500
To Depreciation on furniture	1,000	By Entrance fees	1,300
To Rent	600	By Miscellaneous income	400
		By Deficit	2,820
	23,600		23,600

Balance Sheet as at 31st March, 2017

Liabilities		₹	Assets	₹
Subscriptions in advance (2017-18)		100	Furniture	9,000
Prize fund :			Ground and building	47,000
Opening balance	25,000		Prizes fund investment	20,000
Add: Interest	1,000		Cash in hand	2,300
	26,000		Subscriptions (2016-17)	700
Less: Prizes	2,000	24,000		
General fund :				
Opening balance	56,420			
Less: Deficit	2,820			
	53,600			
Add: Entrance fees	1,300	54,900		
		79,000		79,000

The following adjustments have been made in the above accounts:

1. Upkeep of ground ₹ 600 and Printing ₹ 240 relating to 2015-16 were paid in 2016-17.
2. One-half of entrance fee has been capitalised by transfer to General fund.
3. Subscriptions outstanding in 2015-16 was ₹ 800 and for 2016-17 was ₹ 700.
4. Subscriptions received in advance in 2015-16 was ₹ 200 and in 2016 for 2017-18 was ₹ 100.

Solution **Receipts & Payments Account for the year ended 31st March, 2017**

Receipts	₹	Payments	₹
To Balance b/f (balancing figure)	4,660	By Upkeep of ground (Note 3)	10,600
To Subscriptions (Note 1)	17,320	By Printing (Note 4)	1,240
To Sale of old newspaper	260	By Salaries	11,000

	₹		₹
To Lecture fees	1,500	By Rent	600
To Entrance fees (Note 2)	2,600	By Prizes	2,000
To Miscellaneous income	400	By Balance c/d	2,300
To Interest on prize fund investment	1,000		
	27,740		27,740

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Subscriptions outstanding for 2015-16	800	1.4.2016	By Subscriptions received in advance for 2015-16	200
	To Subscriptions received in advance for 2017-18	100		By Cash (balancing figure)	17,320
31.3.2017	To Income & Expenditure A/c	17,320	31.3.2017	By Subscriptions outstanding for 2016-17	700
		18,220			18,220

(2) Entrance fees	₹	(4) Printing	₹
As per Income & Expenditure A/c	1,300	As per Income & Expenditure A/c	1,000
Add: Capitalised	1,300	Add: Outstanding expenses for 2015-16 paid in 2016-17	240
	2,600		1,240

(3) Upkeep of Ground	₹
As per Income & Expenditure A/c	10,000
Add: Outstanding expenses for 2015-16	600
	10,600

Illustration 31

The Income and Expenditure Account of Ganga Boat Club for the year ended on 31.12.2016 stood as follows :

Expenditure	₹	Income	₹
To Salaries	19,500	By Subscriptions	38,000
To General Expenses	10,000	By Entrance Fees	10,500
To Audit Fees	2,500	By Donation	12,000
To Printing and Stationery	6,000	By Sale of Old Periodicals	500
To Interest and Bank Charges	3,000		
To Rent	3,000		
To Periodicals	4,000		
To Travelling Expenses	2,500		
To Depreciation on Furniture	1,500		
To Surplus	9,000		
	61,000		61,000

The following is the Balance Sheet of the Club as at 31.12.2015 :

Liabilities		₹	Assets	₹
Liabilities for :	Salaries	1,500	Furniture	7,500
	Rent	500	Sports Equipment	10,000
Advance Subscriptions (2016)		1,000	Subscriptions Receivable	4,000
General Fund		37,000	Cash and Bank	18,500
		40,000		40,000

Other details on 31.12.2016 : Salaries outstanding — ₹ 2,500; Subscriptions outstanding — ₹ 3,000; Subscriptions received in advance — ₹ 1,000. Prepare Receipts and Payments Account for 2016 and Balance Sheet as at 31.12.2016.

Solution

Ganga Boat Club
Receipts and Payments Account for the year ended 31st December, 2016

Receipts		₹	Payments	₹
To Balance b/d		18,500	By Salaries (Note 2)	18,500
To Subscriptions (Note 3) :			By General Expenses	10,000
2015 (Opening Balance Sheet)	4,000		By Audit Fees	2,500
2016 (Balancing figure)	34,000		By Printing and Stationery	6,000
2017 (Note 1)	1,000	39,000	By Interest and Bank Charges	3,000
To Entrance Fees		10,500	By Rent : ₹ (3,000 + 500)	3,500
To Donations		12,000	By Periodicals	4,000
To Sale of Old Periodicals		500	By Travelling Expenses	2,500
			By Balance c/d (Balancing figure)	30,500
		80,500		80,500

Balance Sheet of Ganga Boat Club as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital Fund :			Furniture	7,500	
Opening balance	37,000		Less : Depreciation	1,500	6,000
Add : Surplus	9,000	46,000	Sports Equipments		10,000
Advance Subscriptions (Note 1)		1,000	Subscriptions Receivable (Note 1)		3,000
Salaries Outstanding		2,500	Cash and Bank		30,500
		49,500			49,500

Working Notes : (1) All the figures are given in the question.

Dr. (2) Salaries Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Receipts and Payments (Balancing figure)	18,500		By Outstanding Salaries	1,500
	To Outstanding Salaries	2,500		By Income and Expenditure	19,500
		21,000			21,000

Dr. (3) Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Subscriptions Receivable	4,000		By Advance Subscriptions	1,000
	To Income and Expenditure	38,000		By Receipts and Payments (Balancing figure)	39,000
	To Advance Subscriptions	1,000		By Subscriptions Receivable	3,000
		43,000			43,000

6. Preparation of Opening and Closing Balance Sheets when Receipts and Payments Account and Income & Expenditure Account are Given

Illustration 32

Adult Education Society submits to you the following Receipts and Payments Account and Income and Expenditure Account for the year ended 31.3.2017 :

Receipts and Payments Account (2016-17)

Receipts			₹	Payments	₹
To Balance b/d			450	By Printing Charges	75
To Interest :	2015-16	100		By Advertisement	141
	2016-17	150	250	By Salary to Staff (including payment for 2015-16)	1,300
To Tution Fees :	2016-17	1,000		By Rent	520
	2017-18	100	1,100	By Miscellaneous Expenses	110
To Entrance Fees :	2016-17		420	By Furniture Purchase	670
To Membership Fees :	2015-16	300		By Balance c/d	1,374
	2016-17	1,150			
	2017-18	390	1,840		
To Miscellaneous Income			130		
			4,190		4,190

Income and Expenditure Account (2016-17)

Expenditure	₹	Income	₹
To Printing Charges	80	By Tuition Fees	1,100
To Advertisement	150	By Membership Fees	1,150
To Rent	600	By Miscellaneous Income	130
To Salary to Staff	1,200	By Interest	160
To Miscellaneous Expenses	110		
To Excess of Income over Expenditure	400		
	2,540		2,540

You are asked to prepare the Balance Sheets of the Society as on 31.3.2016 and 31.3.2017.

Additional information :

The Society had the following assets on 31.3.2016 :

Investments ₹ 4,000; Furniture ₹ 2,000; Library Books ₹ 1,500.

Solution **Balance Sheet of Adult Education Society as at 31st March, 2016**

Liabilities	₹	Assets	₹
Capital fund (Balancing figure)	8,250	Furniture	2,000
Outstanding Salaries : ₹ (1,300 – 1,200)	100	Investments	4,000
		Library Books	1,500
		Membership Fees Receivable (2015-16)	300
		Interest Receivable	100
		Bank	450
	8,350		8,350

Balance Sheet of Adult Education Society as at 31st March, 2017

Liabilities		₹	Assets	₹
Capital fund :			Furniture — ₹ (2,000 + 670)	2,670
Opening Balance	8,250		Investments	4,000
Add : Surplus	400		Library Books	1,500
Entrance fees	420	9,070	Tuition Fees Receivable : ₹ (1,100 – 1,000)	100
Tuition Fees received in Advance		100	Interest Receivable : ₹ (160 – 150)	10
Membership Fees Received in Advance		390	Bank	1,374
Outstanding Expenses :				
Printing charges : ₹ (80 – 75)		5		
Advertisement : ₹ (150 – 141)		9		
Rent : ₹ (600 – 520)		80		
		9,654		9,654

Illustration 33

The following are the items of receipts and payments of the All India Sports Club summarized from the books of account maintained by the secretary:

Receipts	₹	Payments	₹
Opening balance (1.1.2016)	4,200	Manager's salary	1,000
Entrance fees (2015)	1,000	Printing & stationery	2,600
Entrance fees (2016)	10,000	Advertising	1,200
Subscriptions (2015)	600	Fire Insurance	1,800
Subscriptions (2016)	15,000	Investments purchased	20,000
Interest received on investments	3,000	Closing balance (31.12.2016)	7,600
Subscriptions (2017)	400		
	34,200		34,200

It was ascertained from enquiry that the following represented a fair picture of the income and expenditure of the club for the year 2016 for audit purposes :

Expenditure		₹	Income	₹
Manager's salary		1,500	Entrance fees	10,500
Printing & stationery	2,000		Subscriptions	15,600
Add: Outstanding	400	2,400	Interest on investments	4,000
Advertising		1,600		
Audit fees		500		
Fire insurance		1,000		
Depreciation		4,940		
Excess of income over expenditure		18,160		
		30,100		30,100

You are required to prepare the Balance Sheets of the club as on 1.1.2016 and 31.12.2016, it being given that the book values of the fixed assets as on 1.1.2016 were Building ₹ 44,000, Cricket Equipment ₹ 25,000 and Furniture ₹ 4,000. The rates of depreciation on Building 5%, Cricket Equipment 10%, Furniture 6%.

Solution **Balance Sheet of All India Sports Club as at 1st January, 2016**

Liabilities	₹	Assets	₹
Capital fund (balancing figure)	78,000	Building	44,000
Outstanding expenses:		Furniture	4,000
Advertisement (₹ 1,800 – ₹ 1,600)	200	Cricket equipment	25,000
Printing and stationery (₹ 2,600 – ₹ 2,000)	600	Entrance fees outstanding (2015)	1,000
		Subscriptions outstanding (2016)	600
		Cash in hand	4,200
	78,800		78,800

Balance Sheet of All India Sports Club as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital fund			Building	44,000	
Opening balance	78,000		Less: Depreciation @ 5%	2,200	41,800
Add: Excess of income over expenditure	18,160	96,160	Furniture	4,000	
Subscriptions received in advance		400	Less: Depreciation @ 6%	240	3,760

Outstanding expenses :			Cricket equipment	25,000	
Printing & stationery	400		Less: Depreciation @ 10%	2,500	22,500
Manager's salary (Note 5)	500		Investments		20,000
Audit fees (Note 6)	500	1,400	Subscriptions outstanding (Note 1)		600
			Entrance fees outstanding (Note 2)		500
			Accrued interest (Note 3)		1,000
			Prepaid Fire insurance (Note 4)		200
			Cash in hand		7,600
		97,960			97,960

Working Notes :

(1) Subscriptions Outstanding	₹	(2) Entrance fees outstanding	₹
As per Income & Expenditure A/c	15,600	As per Income & Expenditure A/c	10,500
Less: As per Receipts and Payments A/c	15,000	Less: As per Receipts and Payments A/c	10,000
	600		500
(3) Accrued Interest	₹	**(4) Prepaid Fire Insurance**	₹
As per Income & Expenditure A/c	4,000	As per Income & Expenditure A/c	1,200
Less: As per Receipts and Payments A/c	3,000	Less: As per Receipts and Payments A/c	1,000
	1,000		200
(5) Outstanding Manager's Salary	₹	**(6) Outstanding Audit Fees**	₹
As per Income & Expenditure A/c	1,500	As per Income & Expenditure A/c	500
Less: As per Receipts and Payments A/c	1,000	Less: As per Receipts and Payments A/c	Nil
	500		500

Illustration 28

The Secretary of The Systematic Club has prepared the following draft Balance Sheet of the Club as on 30.9.2017 :

Liabilities		₹	Assets		₹
Capital Account :			Fixtures and Fittings :		
Balance as on 30.9.2017	14,300		As on 30.9.2017	10,600	
Less : Loss for the year	2,100	12,200	Less: Depreciation for the year	1,000	9,600
Subscriptions in Advance		600	Stock		3,200
Creditors		2,400	Debtors		1,400
			Balance at Bank		950
			Cash in Hand		50
		15,200			15,200

You ascertain the following :

(1) The amount of loss was only a balancing figure as the books had been kept on a single entry basis.

(2) The balance at bank was that shown by the bank statement at the close of the business on 30.9.2017.

(3) The following amounts had been paid into bank on 30.9.2017 but had not been credited by the bank :

(i) Two cheques of ₹ 50 each had been cashed for a member—one had since been duly honoured but the other had been returned marked 'refer to drawer' and, on being approached, the member repaid ₹ 50 in cash.

(ii) A member's subscriptions of ₹ 80 for the year 2017-18.

(4) The following cheques had been drawn in September but has not been presented until October :

(i) ₹ 480 for bar supplies which had been delivered but had not been included in stock;

(ii) ₹ 350 for additional typewriter received on October 2;

(iii) ₹ 100 as bonus of the professional included under the creditors;

(iv) ₹ 140 for fuel which had been included in the stock figure but not in the creditors and this cheque was dated October 1, 2017.

You are required to prepare :

(a) a bank reconciliation statement as on 30.9.2017; and (b) a revised Balance Sheet as on the date to give effect to the consequential adjustments, assuming that otherwise the items in the draft Balance Sheet were correct.

Solution **(a) Bank Reconciliation Statement of The Systematic Club as on 30th September, 2017**

Bank balance as per Bank Statement			950
Add :	Cheque dishonoured but not entered in the Cash Book	50	
	Cheque deposited but not credited	80	130
			1,080

Less:	Cheques issued but not presented for payment :		
	Bar supplies	480	
	Advance for office equipment	350	
	Bonus of the professional	100	
	Fuel (Note 1)	—	930
Bank Balance as per Cash Book			150

(b) Balance Sheet of The Systematic Club as at 30th September, 2017

Liabilities		₹	Assets		₹
Capital Fund :			Furniture and Fittings	10,600	
Opening balance	14,300		Less: Depreciation	1,000	9,600
Less: Excess of Expenditure over Income (Balancing figure)	2,140	12,160	Stock : ₹ (3,200 + 480)		3,680
			Debtors		1,400
Subscriptions in Advance ₹ (600 + 80)		680	Advance for Office Equipment (Note 2)		350
Creditors (Note 3)		2,440	Bank		150
			Cash : ₹ (50 + 50)		100
		15,280			15,280

Working Notes :

(1) No adjustment is required for ₹ 140 for fuel since the cheque was dated October 1.

(2) Since the typewriter was not received before 30.9.2017, it should be shown as an advance for office equipment in the Balance Sheet on 30.9.2017.

(3) Ascertainment of correct balance of creditors.

Dr. **Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bonus of Professional (cancelled)	100		By Balance c/d	2,400
	To Balance c/d	2,440		By Fuel (previously not recorded)	140
		2,540			2,540

Key Points

- A non-profit organisation is operated for the benefit of the society as a whole, rather than for the benefit of a sole proprietor or a group of partners or shareholders.
- A non-profit organisation is formed when a number of like-minded people decide to formalise their association.
- A Receipts and Payments Account is a summary of the Cash Book. This is the primary report prepared by the treasurers of clubs, societies etc to present the result of the year's cash position.
- The Income and Expenditure Account is equivalent to the Profit and Loss Account of a business enterprise. It is prepared by matching the revenues against the expenses for a specified period, usually a year.
- Amount received from life membership should be *credited to a special fund* called ***Life Membership Fund*** and an amount equal to annual subscriptions or other agreed amount is transferred every year to the Income and Expenditure Account, the balance of this fund is carried forward till it is fully exhausted.

THEORETICAL QUESTIONS

1. What do you mean by Non-Profit Organisation ?
2. How a non-profit organisation is formed ?
3. What are the characteristics of non-profit organisation ?
4. What are the books of accunts maintained by a non-profit organisation ?
5. What are the non-acounting records maintained by the non-profit organisation ?
6. Distinguish between non-profit organisation and profit seeking organisations.
7. What are the main features of Receipts and Payments Account ?
8. What are the main features of Income and Expenditure Account ?
9. Distinguish between Receipts and Payments Account and Income and Expenditure Account.
10. How do you treat the following at the time of preparation of final accounts of a non-profit organisation ?
    (i) Donations (ii) Legacy (iii) Life Membership Fees (iv) Admission Fees (v) Sectional Subscriptions.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. The Income and Expenditure Account begins with :
   A debit balance
   B credit balance
   C no balance
2. The Receipts and Payments Account records receipts and payments of :
   A revenue nature only
   B capital nature only
   C revenue as well as capital nature.
3. A profit on the sale of furniture of a club will be taken to :
   A cash account
   B receipts and payments account
   C income and expenditure account
4. Entrance fees are generally :
   A capitalised
   B taken as income
   C treated as a liability
5. Legacy for specific purpose is:
   A added to the specific fund
   B shown in the income and expenditure account
   C shown as a separate liability

PRACTICAL QUESTIONS

Preparation of Income and Expenditure Account

1. The following is the Receipts and Payments Account of Silver Streek Cricket Club for the year ended 31.12.2016. You are to prepare the Income and Expenditure Account for 2016 and Balance Sheet as at 31.12.2016 of the Club:

Receipts	₹	Payments	₹
Opening Balance — Cash	290	New building constructed	75,000
Bank	3,710	Souvenir	2,000
Subscriptions	12,000	Salaries	6,000
Donations	13,000	Postage	500
Activities collection	6,900	Telephone	500
Sale of old newspapers	300	Electricity	600
Souvenir advertisement	5,800	Maintenance expenses	12,000
Endowment income	3,000	Newspapers	500
Sale proceeds of old building at book value	60,000	Closing balance — Cash	300
Income from investments @ 10%	4,000	Bank	11,600
	1,09,000		1,09,000

Subscriptions : For 2015 (due as at 31.12.2015, ₹ 1,500) received ₹ 1,000; For 2017 advance ₹ 1,200; Due for 2016 ₹ 800; Expenses outstanding : Salaries ₹ 1,200; Electricity ₹ 100; Telephones ₹ 100; Postage ₹ 100; Provide depreciation on Building @ 5%.

2. The following is the Receipts and Payments Account of the Calcutta Club for the year ending 31.12.2016:

Receipts	₹	Payments	₹
Opening Balance :		Salaries	6,000
Cash	1,025	Sports expenses	6,900
Stamps	50	Electricity	1,000
Bank F.D.	10,000	Telephone	1,200
S/B Account	4,200	Postage expenses	200
Current Account	2,100	General body expenses	700
Subscriptions		Printing & Stationery	850
2015	1,010	Building purchase account	12,000
2016	18,900	Repairs	400
2017	900	Closing Balance :	

Donations	7,000	Cash	1,740
Bank interest received	1,340	Stamps	25
Receipts from sports	2,600	Bank F.D.	11,000
Telephone recoveries	900	S/B A/c	4,310
		Current A/c	3,700
	50,025		50,025

A building costing one lakh of rupees was purchased during the last year and ₹ 88,000 was paid for it.

Subscriptions outstanding for 2016 — ₹ 1,100; Interest accrued on bank deposits but not received ₹ 200; and Salaries outstanding ₹ 200. From the above, prepare Income and Expenditure Account for the year 2016 and also the Balance Sheet as on 31.12.2016 of the Calcutta Club.

[C.U.B.Com. (Hons.) — Adapted]

3. Given below is the Receipts and Payments Account of a club for the year ending 31st December, 2016:

Receipts	₹	Payments	₹
To Balance	1,500	By Salaries	600
To Subscriptions:		By Expenses	100
2015	50	By Drama Expenses	500
2016	2,000	By Newspapers	120
2017	80	By Municipal Taxes	60
To Donations	550	By Charity	400
To Sale of Drama tickets	1,050	By Investments	2,000
To Sale of waste paper	50	By Electric Charges	200
To Entrance fees	300	By Payment on new furniture	1,000
		By Balance	600
	5,580		5,580

Prepare the club's Income and Expenditure Account for the year ended 31st December, 2016 and its Balance Sheet as at that date after taking the following information into account:

(i) There are 400 members each paying ₹ 5 as annual subscriptions, ₹ 60 subscriptions still outstanding for 2015;
(ii) Municipal Taxes amounting to ₹ 60 per annum have paid upto 31st March 2017;
(iii) 6 per cent has accrued on investment for five months; and
(iv) Building stands in the books at ₹ 5,000 on 1.1.2016. ***[C.U.B.Com. (General) — Adapted]***

4. The following is the Receipts and Payments Account of the Sanatan Sangha for the year ended 31st December 2016.

Receipts	₹	Payments	₹
To Balance b/d	800	By Salaries	300
To Subscriptions :		By Stationery	300
2015	50	By Rates	300
2016	1,000	By Telephone charges	100
2017	200	By Investments on 4% Govt. securities (pur. on 30.6.2016)	1,000
To Admission fees	400	By Sundry expenses	150
To Dividends on investments	200	By Balance c/d	500
	2,650		2,650

The following additional information are given below:

1. There are 600 members paying annual subscriptions of ₹ 2 per head, ₹ 90 being in arrear for 2015 at the beginning of 2016.
2. Stock of stationery at 31st December 2015 was ₹ 200, at 31st December 2016 ₹ 100
3. The rates were paid for fifteen months upto 31st March, 2017.
4. Sundry Expenses outstanding at 31st December 2015 was ₹ 50.
5. The telephone charges for 3 months is outstanding, amount acrrued being ₹ 40.
6. At 31st December 2015 the building stood in the books at ₹ 10,000 and it is required to write off depreciation at 5% p.a.
7. At 31st December 2015 Investments were ₹ 4,000.

You are required to prepare an Income and Expenditure Account for the year ended 31st December 2016 and a Balance Sheet as at that date

[C.U.B.Com. (Hons.) — Adapted]

5. Prantik Boys' Club prepared the following Receipts and Payments Account for the year ended 31st December, 2016:

Receipts	₹	Payments	₹
To Balance b/d	7,600	By Sports Equipment purchased on 1.10.2016	30,000
To Subscriptions :		By Postage and stationery	700
2015	2,000	By Salaries and wages	5,000
2016	37,000	By Upkeep of ground	1,000
2017	3,000	By Electric charges	2,300
To Admission fees	4,000	By Tournament expenses	8,000
To Locker rents	1,000	By Balance c/d	8,800
To Interest on Govt. Securities	1,200		
	55,800		55,800

The fixed assets of the club on 1st January, 2016 include the following: sports equipments ₹ 40,000, furniture ₹ 6,000, 10% Government securities ₹ 16,000 and club ground ₹ 25,000.

Prepare Income and Expenditure Account of Prantik Boys' Club for the year ended 31st December, 2016 and a Balance Sheet as at that date after taking into account the following information :

(a) Subscriptions for 2016 collected in 2015 for ₹ 1,500; (b) Subscriptions for 2016 are outstanding for ₹ 1,000; (c) Depreciation to be provided at 15% p.a. on sports equipment and at 7.5% p.a. on furniture.

[C.U.B.Com. (Hons.) — Adapted]

6. The following is the Receipts and Payments Account of an Amusement Club :

Receipts	₹	Payments	₹
Balance b/d :		Salary of secretary	3,600
Cash	60	Honorarium	450
Bank	3,000	Wages	2,400
Subscriptions (including subscriptions for 2015 ₹ 150)	9,000	Charities	2,000
Sale of old furniture on January 1, 2016	750	Printing & stationery	300
Sale of newspapers	50	Postage	100
Legacies	3,000	Rates and taxes	1,200
Interest on Investments (cost of investments ₹ 20,000)	1,200	Upkeep of the land	500
Endowment fund receipts	10,000	Sports materials	2,500
Proceeds of concerts	800	Balance c/d	14,850
Advertisement in the year book	40		
	27,900		27,900

Current assets and liabilities as on December 31, 2015 and 2016 were as follows :		31.12.2015	31.12.2016
Subscriptions in arrears	₹	200	750
Subscriptions in advance	₹	300	600
Furniture	₹	2,000	1,080

Depreciation was 10% p.a. on the furniture left after selling a part of it. Legacies to be capitalised.

Prepare Income & Expenditure Account and the Balance Sheet as on that date.

[C.U.B.Com. (General) — Adapted]

7. Citizen's Club was registered in a city and the accountant prepared the following Receipts and Payments Account for the year ended October 31, 2016 and showed a deficit of ₹ 14,520.

Receipts	₹	Payments	₹
Subscriptions	62,130	Premises	30,000
Fair receipts	7,200	Honorarium to Secretary	12,000
Variety show receipts (net)	12,810	Rent	2,400
Interest	690	Rates & taxes	3,780
Bar collection	22,350	Printing & stationery	1,410
Cash spent more	1,000	Sundry expenses	5,350
Deficit	14,520	Wages	2,520
		Fair expenses	7,170
		Bar purchases payments	17,310
		Repair	960
		New car (less proceeds of old car — ₹ 9,000)	37,800
	1,20,700		1,20,700

The following additional information could be obtained :	1.11.2015	31.10.2016
Cash in hand	450	—
Bank balances as per pass book	24,690	10,440
Cheques issued not presented for sundry expenses	270	90
Subscriptions due	3,600	2,940
Premises at cost	87,000	1,17,000
Accumulated depreciation on premises	56,400	—
Car at cost	36,570	46,800

Accumulated depreciation on car	30,870	—
Bar stock	2,130	2,610
Creditors for bar purchases	1,770	1,290

Cash over spent represent honorarium to Secretary not withdrawn due to cash deficit. His annual honorarium is ₹ 12,000. Depreciation on premises and car is to be provided at 5% and 20% on written down value.

You are required to prepare the correct Receipts and Payments Account, Income and Expenditure Account and Balance Sheet on October 31, 2016.

8. The following is the Receipts and Payments Accounts of Apollo Club in respect of the year 31st March, 2017:

Date	Receipts	₹	Date	Payments	₹
1.4.2016	To Balance c/d :		31.3.2017	By Salaries	3,000
	Cash in hand	2,000		By Rates & Taxes	300
31.3.2017	To Subscriptions :			By Stationery	1,000
	2015-16	3,000		By Telephone charges	1,500
	2016-17	4,000		By 8% securities at par	5,000
	2017-18	1,000		By Sundry expenses	200
	To Profit on sports	3,000		By Balance c/d — Cash in hand	3,000
	To Interest on 8% securities	1,000			
		14,000			14,000

The following additional facts are ascertained:

(a) There are 500 members, each paying an annual subscriptions of ₹10, ₹ 3,500 being in arrears for 2015-16 at the beginning of 2016-17. During 2015-16, subscriptions were paid in advance by 30 members for 2016-17.

(b) Stock of Stationery at 31st March 2016 was ₹ 400 and at 31st March 2017 ₹ 500.

(c) At 31st March, 2016, the rates and taxes were prepaid to the following 31st January, the yearly charge being ₹ 300.

(d) A quarter's charge for telephone is outstanding, the amount accrued being ₹ 300. The charge for each quarter is same for both 2015-16 and 2016-17.

(e) Sundry Expenses accruing at 31st March 2016 were ₹ 50 and at 31st March 2017 ₹ 60.

(f) At 31st March 2016, Building stood in the books at ₹ 30,000 and it is required to write off depreciation @ 10% p.a.

(g) Value of 8% securities at 31st March 2016 was ₹ 15,000 which was purchased at that date at par, additional securities worth ₹ 5,000 are purchased on 31st March 2017.

You are required to prepare :

(i) Income & Expenditure Account for the year ended 31st March 2017; and (ii) Balance Sheet as at that date.

[C.U.B.Com. (Hons.) — Adapted]

9. The following information was obtained from the books of Delhi Club as on 31.3.2017 at the end of the first year of the club. You are required to prepare Receipts and Payments Account, Income and Expenditure Account for the year ended 31.3.2017, and a Balance Sheet as at 31.3.2017 on mercantile basis :

(i) Donations received for building and library room ₹ 2,00,000.

(ii) Other revenue income and actual receipts (figures in rupees) :

	Entrance Fees	Subscriptions	Locker Rents	Sundry Income	Refreshments Account
Revenue Income	17,000	20,000	600	1,600	—
Actual Receipts	17,000	19,000	600	1,060	16,000

(iii) Other revenue expenditure and actual payments (figures in rupees) :

	Land (Cost ₹ 10,000)	Furniture (Cost ₹ 1,46,000)	Salaries	Maintenance of Playgrounds	Rent	Refreshments Account
Revenue Expenses	—	—	5,000	2,000	8,000	—
Actual Payments	10,000	1,30,000	4,800	1,000	8,000	8,000

Donations to the extent of ₹ 25,000 were utilised for the purchase of library books, balance was still unutilised. In order to keep it safe, 9% Govt. Bonds of ₹ 1,60,000 were purchased on 31.3.2017. Remaining amount was put in the bank on 31.3.2017 under the term deposit. Depreciation at 10% p.a. was to be provided for the whole year on furniture and library books. ***[C.A. (Foundation) — Adapted]***

10. The Sports Writers Club give the following Receipts and Payments Account for the year ended March 31, 2017.

Receipts	₹	Payments	₹
To Balance b/d	4,820	By Salaries	12,000
To Subscriptions	28,600	By Rent & electricity	7,220
To Miscellaneous	700	By Library books	1,000

To Interest on fixed deposit	2,000	By Magazines and newspaper By Sundry expenses By Sports equipments By Balance c/d	2,172 10,278 1,000 2,450
	36,120		36,120

Figure of other assets and liabilities are furnished as follows:	As at March, 31 2016	2017
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines & newspapers	226	340
Fixed deposit (10%) with Bank	20,000	20,000
Interest accrued thereon	500	500
Subscriptions receivable	1,263	1,575
Prepaid expenses	417	620
Furniture	9,600	?
Sports equipments	7,200	?
Library books	5,000	?

The closing values of furniture and sports equipments are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The clubs library books are revalued at the end of every year and the value at the end of March 31, 2017 were ₹ 5,250.

From the above information, you are required to prepare :

(a) The club's opening Balance Sheet as at March 31, 2016;

(b) The club's Income and Expenditure Account for the year ended on that date; and

(c) The club's closing Balance Sheet as at March 31, 2017.

[C.U.B.Com. (Hons.) — Adapted]

11. From the following ledger balances of SBI Recreation Club prepare Income and Expenditure Account for the year ended on 31st March 2017 and Balance Sheet as on that date. The profit or loss on Bar and Restaurant should be shown separately.

Capital Fund Balance (1.4.2016)	17,720	Bar Collections	21,250
Stock on Bar (1.4.2016)	1,560	Restaurant collections	14,360
Stock on Restaurant (1.4.2016)	510	Tennis receipts	7,620
Purchases for Restaurant	11,735	Furniture purchased	500
Purchases for Bar	14,365	Subscriptions	25,730
Rent & Rates	6,700	Electric charges	1,720
China, Cutlery, Linen (1.4.2016)	2,400	Establishment :	
Furniture (1.4.2016)	15,000	Bar	4,960
Tennis Accessories (1.4.2016)	5,500	Restaurant	3,540
Interest	480	General	4,260
Outstanding subscriptions on 31.3.2017	3,650	Purchases of China cutlery	1,200
Creditors on 31.3.2017	5,000	Investment	4,000
Cash and Bank (31.3.2017)	10,560		

Additional Information:

(i) Stock in Bar on 31.3.2017 ₹ 4,000; Stock in Restaurant on 31.3.2017 ₹ 1,230; and

(ii) Provide depreciation on opening balances: Furniture @ 20% (1/2 to be charged to Bar and Restaurant on collection basis); Tennis Accessories @ 20%; China Cutlery, Linen @ 30% (to be charged on collection basis).

12. From the following Receipts and Payments Account of Kapil Cricket Club and the additional information prepare the Income and Expenditure Account for the year ended 31st March, 2017 and the Balance Sheet as on that date. Receipts and Payments Account for the year ended 31st March, 2017.

Date	Receipts	₹	Date	Payments	₹
1.4.2016	Cash in hand	4,400	31.3.2017	Wages	36,000
"	Current Account balance as per Pass Book	9,400	"	Ground rent	12,000
31.3.2017	Membership fees	48,000	"	Cost of refreshments	90,000
"	Income from refreshments	1,20,000	"	Fun fair expenses	10,000
"	Fun fair receipt	3,000	"	Equipment purchased	40,000
"	Interest received from bank	500	"	Administration expenses	4,500
"	Interest @ 7.5% p.a. on securities	15,000	"	Repairs and maintenance	16,000
"	Sale proceds of Plant & Equipment	28,200	"	Caretaker's salary	15,000
"	Net proceeds of fund-raising match	35,350	"	Cash in hand	5,350
			"	Current Account balance as per Pass Book	35,000
		2,63,850			2,63,850

Other information :

Particulars	1.4.2016	31.3.2017
Value of Plant and Equipment	45,000	50,000
Membership fees due	5,000	2,000
Interest not entered in the Pass Book	—	150
Cheques issued for repair works but not presented	1,500	3,500
Administrative expenses outstanding	1,000	500

Depreciation is to be provided on the closing balance of plant and equipment at 10%. Bonus payable to workers ₹ 3,000 is to be provided. Caretaker's salary in the Receipts and Payments Account pertains to the accounting year 2015-16. The salary for 2016-17 ₹ 18,000 has not yet been paid.

[C.U.B.Com. (Hons.) — Adapted]

13. From the following Receipts and Payments Account of Janak Puri Football Club and additional information, prepare an Income and Expenditure Account for the year ending 31.3.2017 and a Balance sheet as on that date.

Receipts	₹	Payments	₹
Cash in hand on 1.4.2016	10,200	Purchase of Balls	65,000
Cash at Bank as per Bank Pass Book	30,000	Tournament Fees	10,000
Subscriptions	2,45,000	Affiliation Fees for 5 years	2,000
Interest on Investment	1,800	Rent of Playground	6,000
Sale of Tickets for variety programme	20,000	Expenses on variety programme	15,000
Sale of furniture on 30.9.2016	9,000	Refreshment expenses	4,000
Donation for Club building	50,000	Travelling expenses	20,000
Legacy	11,000	Furniture bought on 1.10.2016	5,000
		Repairs to Building	5,000
		Advance paid to Contractor for pavilion building	50,000
		Salary	15,000
		Telephone bill	1,500
		Miscellaneous Exp. (including Honorarium of ₹ 3,000)	8,000
		12% Investments (F.V. ₹ 1,70,000 bought on 31.12.2016)	1,50,000
		Cash in Hand on 31.3.2017	8,500
		Balance in the Bank as per Pass Book on 31.3.2017	12,000
	3,77,000		3,77,000

Additional information :

(i) Subscriptions received include ₹ 9,000 outstanding subscriptions of the year 2015-16. Subscriptions for the year 2016-17 amounting to ₹ 16,000 is still outstanding. Some members have paid subscriptions for the year 2017-18 amounting to ₹ 8,000 which is included in the subscriptions received.

(ii) Face value of 12% investments on 31.3.2016 was ₹ 15,000 (cost price ₹ 12,000).

(iii) Book value of furniture sold on 1.4.2016 was ₹ 12,000, depreciation being 20% p.a. Provide depreciation on new furniture at the same rate.

(iv) Telephone bill for one quarter of ₹ 300 is outstanding. The charge for each quarter is same for 2015-16 and 2016-17.

(v) Unrepresented cheques for repairs to Building ₹ 4,000 for 2015-16 and ₹ 12,000 for 2016-17.

(vi) Stock of balls with the Club on 31.3.2017 amounted to ₹ 6,000.

14. The assets and liabilities of the Barley Sports Club at 31st December, 2015 were as follows :

	₹		₹
Pavilion at cost less depreciation	13,098	Bar creditors	427
Bank and cash	1,067	Loans to sports club	1,080
Bar stock	291	Accruals :	
Bar Debtors	231	Water	13
Rates prepaid	68	Electricity	130
Contributions owing to sports club by users of sports club facilities	778	Miscellaneous	75
Contribution paid in advance to sports club by users of sports club facilities	398	Loan interest	33

The treasurer has analysed the cash book for the year, and produced the following receipts and payments account for the year ended 31st December, 2016 :

Receipts	₹	Payments	₹
Opening balance	1,067	Bar purchases	2,937
Bar sales	4,030	Repayment of loan capital	170
Telephone	34	Rent of ground	79
Contribution from users of club facilities	1,780	Rates	320
Socials	177	Water	38
Miscellaneous	56	Electricity	506
		Insurance	221
		Repairs to equipment	326

		Expenses of socials	67
		Maintenance of ground	133
		Wages of groundmen	140
		Telephone	103
		Bar sundries	144
		Loan interest	97
		Miscellaneous	163
		Closing balance	1,700
	7,144		7,144

The treasurer also provides the following information as at 31st December, 2016 :

	₹		₹
Bar stock	394	Creditors for bar sundries	65
Bar Debtors	50	Contribution by users of sports club facilities —	
Bar Creditors	901	owing to sports club	425
Rent prepaid	16	paid in advance to sports club	657
Water charges owing	23	Rates prepaid	76
Electricity owing	35	Depreciation on the pavilion for the year	498

You are required : (a) Ascertain the balance on the accumulated fund as at 1st January, 2016; (b) Prepare a statement showing the gross and net profit earned by the bar; and (c) Prepare an Income and Expenditure Account for the year ended 31st December, 2016 and a Balance Sheet as at that date.

[C.A. (Entrance) — Adapted]

15. From the following information relating to the Bengal Club you are required to prepare:
    1. An Income and Expenditure Account (showing separately profit or loss on the bar) for the year ended on 31st December, 2016;
    2. A Balance Sheet as on that date;

(a) A summary of the Cash Book for the year 2016 is as follows:

Particulars	₹	Particulars	₹
Opening bank balance	850	Salaries & wages	1,500
Annual subscriptions	4,000	Bar wages	1,000
Bar receipts	15,950	Office expenses	450
Hire of rooms	500	Lighting and heating	360
Sale of investments (original cost ₹ 250)	350	Rates and insurance	250
Income from investments	350	Bar supplies	13,350
		Miscellaneous expenses	250
		Investments	1,500
		Furniture (30.6.2016)	1,000
		Closing bank balance	2,340
	22,000		22,000

(b) The balance at bank on 1st January, 2016 represents ₹ 350 on current account and ₹ 500 on deposit account. All the receipts shown in the above summary were paid into the current account except for ₹ 50 deposit account interest (included in income from investments) and all payments were made from the current account. During 2016 ₹ 400 was transferred from the current account to the deposit account.

(c) The following items were outstanding on 31st December:

Particulars	2015	2016	Particulars	2015	2016
Subscriptrions in arrear	100	150	Debtors for bar sales	25	75
Salaries & wages accrued	50	90	Repairs account outstanding	20	60
Creditors for bar supplies	1,225	1,400	Stock of coal	100	70
Stock of stationery	75	85	Bar wages accrued	50	25
Subscriptions in advance	25	40	Rates and insurance prepaid	150	75
Telephone account outstanding	100	50	Stock of bar supplies	1,500	2,000
Electricity account outstanding	30	40			

(d) At 31st December 2016 the club owned the following assets which are shown at the amounts they cost on purchase. At 31st December 2015, they had been in the ownership of the club for the number of years indicated;

	₹	
Freehold premises	10,000	12 years
Furniture	3,000	12 years
Furniture	800	5 years
Investments	10,000	4 years

(e) The club is providing for the depreciation on freehold premises at 2.5 % p.a. and on furniture at 10% p.a., both rates calculated on original cost.

[C.A. (Inter) — Adapted]

16. The following receipts and payments account for the year ended 31st March 2017 for the Reserve Bank Sports Club has been prepared by the treasurer, Md. Jafar Ali.

Receipts	₹	Payments	₹
To Balance b/f on 1st April 2016 :		By Painting of club house	600
Cash in hand	200	By Maintenance of grounds	1,400
Bank current account	5,500	By Bar steward's salary	6,000
To Members' subscriptions :		By Insurance	240
Ordinary	1,600	By General expenses	1,200
Life	800	By Building society investment account	1,500
To Annual dinner ticket sales	500	By Secretary's honorarium	200
To Bar takings	22,000	By Annual dinner — expenses	600
		By New furniture and fittings	1,870
		By Bar purchases	13,000
		By Rent of club house	500
		By Balance c/d on 31st March, 2017 :	
		Bank current account	3,200
		Cash in hand	290
	30,600		30,600

The following additional information has been given:

1. Ordinary membership subscriptions received in advance at 31st March 2016 was ₹ 200. The subscriptions received during the year ended 31st March 2017 included ₹ 150 in advance for the following year.
2. A life membership scheme was introduced on 1st April 2015. Under the scheme, life membership subscriptions are ₹ 100 and are apportioned to revenue over a ten year period. Life membership subscriptions totalling ₹ 1,100 were received during the first year of the scheme.
3. The Club's building society investment account balance at 31st March, 2016 was ₹ 2,676; during the year ended 31st March, 2017 interest of ₹ 278 was credited to the account.
4. All the furniture and fittings in the Club's account at 31st March, 2016 were bought in January, 2016 at a cost of ₹ 8,000. It is the Club's policy to provide depreciation annually on fixed assets at 10% of the cost of such assets held at the relevant year end.
5. Other assets and liabilities of the club were : As at 31st March

	2016	2017
Bar stock	1,860	2,110
Insurance prepaid	70	40
Rent accrued	130	140
Bar purchase creditors	370	460

You are required to prepare: (a) the Bar Trading and Profit and Loss Account for the year ended 31st March 2017; and (b) Income and Expenditure Account for the same period and Balance Sheet as at 31st March 2017.

[C.U.B.Com. (Hons.) — Adapted]

Preparation of Receipts and Payments Account

17. From the following Income and Expenditure Account of Victoria Club for the year ended 31st December 2016 and Balance Sheet as on 31st December 2015 and other information available as on 31st December 2016, prepare Receipts and Payments Account for the year ended 31st December, 2016 and a Balance Sheet as at that date:

Income and Expenditure Account for the year ended 31st December, 2016

Expenditure	₹	Income	₹
To Salaries	50,000	By Subscriptions	94,000
To Rent	11,000	By Entrance fees	6,000
To Travelling expenses	500	By Donations	10,000
To Printing & stationery	1,000	By Interest	5,000
To General charges	1,500		
To Periodicals	500		
To Excess of Income over Expenditure	50,500		
	1,15,000		1,15,000

Balance Sheet as at 31st December, 2015

Liabilities	₹	Assets	₹
General fund	1,72,500	Furniture	40,000
Liabilities :		Sports equipments	20,000

For Rent	1,000	Investments	1,00,000
For Salaries	6,500	Subscriptions receivable	5,000
		Interest receivable	1,000
		Bank balance	14,000
	1,80,000		1,80,000

Other details as on 31.12.2016 are : Subscriptions Receivable — ₹ 8,000; Salaries outstanding — ₹ 4,000; Rent outstanding ₹ 2,000.

18. The Income and Expenditure Account of Repose Club for the year ended 31.12.2016 is as follows:

Expenditure	₹	Income	₹
To Salaries	1,750	By Subscriptions	2,000
To General expenses	500	By Donations	1,050
To Depreciation	300		
To Excess of Income over expenditure	500		
	3,050		3,050

Adjustments were made in respect of the following:

1. Subscriptions for 2015 unpaid at 1st January 2016, ₹ 200; ₹ 180 of which was received in 2016.
2. Subscriptions paid in advance at 1.1.2016, ₹ 50.
3. Subscriptions paid in advance at 31.12.2016, ₹ 40.
4. Subscriptions for 2016 unpaid at 31.12.2016, ₹ 70.
5. Sundry Assets at beginning of the period ₹ 2,600; Sundry Assets after depreciation ₹ 2,700 at the end of the period.
6. Cash balance at 1st January 2016, ₹ 160.

Prepare Receipts and Payments Account for the year ended 31.12.2016.

[C.U.B.Com. (Hons.) — Adapted]

19. The following Income and Expenditure Account of Joyous Club is given for the year ended on 31st December, 2016:

Expenditure	₹	Income	₹
To Opening Stock of provisions	10,000	By Subscriptions	26,000
To Purchases of provisions	30,000	By Donations	30,000
To Salaries	10,000	By Entrance fees	8,000
To General expenses	3,000	By Sale of provisions	28,000
To Printing & stationery	5,000	By Closing stock of provisions	5,000
To Depreciation on equipment	1,000		
To Excess of income over expenditure	38,000		
	97,000		97,000

The following further information is given :

Balance Sheet of the Club as on 31st December, 2015

Liabilities	₹	Assets	₹
Creditors for provisions	8,000	Equipment at written down value	10,000
General fund	37,000	Stock of provisions	10,000
		Cash in hand & at bank	20,000
		Subscriptions receivable	5,000
	45,000		45,000

Balance Sheet of the Club as on 31st December, 2016

Liabilities	₹	Assets	₹
Creditors for provisions	10,000	Equipment at written down value	15,000
General fund	75,000	Stock of provisions	5,000
		Cash in hand & at bank	45,000
		Subscriptions receivable	20,000
	85,000		85,000

Prepare a Receipts and Payments Account of the club, for the year ended on 31st December, 2016.

[C.U.B.Com. (Hons.) — Adapted]

20. The United Club closes its accounts on calendar year basis. It runs a pantry and general services. On 1st January, 2016 on the persuasion of some members, it laid a tennis court on the understanding that half of the cost of laying the court would be met by the said members individually and that the maintenance of the court would be subsidised fully by them.

The following figures are furnished to you by the accountant of the Club for the year ended 31st December, 2016:

	₹		₹
General Fund	1,25,000	Salaries and wages	30,000
Admission fees from members	10,000	Tennis court laying expenses	4,000

Membership subscriptions	57,000	Marker's wages	1,800
Audit fees	250	Salaries of stewards, bearers and cooks	24,080
Subscriptions outstanding on 1.1.2016	3,000	Sundry creditors for pantry purchases	2,630
Pantry stock on 1.1.2016	300	Subscriptions to books and periodicals	17,060
Bank balance	1,275	Sports equipments	19,800
Cash in hand	95	Furniture & Fittings (pantry)	24,770
Pantry sales	70,000	Fixed deposits with bank	70,000
Tennis court maintenance collections	5,000	Library	8,000
Rent outstanding on 1.1.2016	1,500	Rent	21,000
Pantry purchases	40,000	Printing & Stationery	5,700

1. 2016 subscriptions in arrears are ₹ 1,400 and 2015 subscriptions received during the year are ₹ 480.
2. The monthly rent is ₹ 1,500.
3. Fixed deposits in Banks were made: ₹ 15,000 on 1st April 2016; ₹ 30,000 on 1st September, 2017 and the balance on 1st October, 2016. Interest on these deposits for the current year has not been received and is at 8% p.a.
4. Depreciation at the rate of 15% on Library, 10% on Furniture and Fittings and 30% on Sports Equipments is to be provided.
5. In connection with the inauguration of the tennis court, the club on its own brought out a souvenir. Printing expenses on this came to ₹ 1,000 and these remain unpaid on 31st December. Amounts due from the advertisers are ₹ 1,500. These figures have not been taken into account by the accountant.
6. Salaries and wages of ₹ 30,000 include salary of ₹ 9,000 to the managers of the club. Manager's salary is to be distributed between Pantry, General and Tennis court in the ratio of 3:2:1 and the rest among the departments in the ratio 5:4:1.
7. Bills of supplies of provisions to the Pantry in December 2016 amounting to ₹ 1,750 have not been paid and taken into account.
8. Pantry stock on hand on 31st December, 2016 is valued at cost of ₹ 250.
9. Subscriptions to periodicals to the extent of ₹ 3,950 have been paid in advance.

You are required to prepare the Income and Expenditure Account in columnar form for the year ended 31st December, 2016 and the Balance Sheet on that date.

Preparation of Income and Expenditure Account from Incomplete Records

21. The Chief Accountant of Best Club Limited suddenly expired on December, 31, 2016 and the following informations were available on that date:

(a) The Books of Account were maintained improperly and the last Balance Sheet as at December 31, 2015 showed the following:

Assets:	₹	₹
Furniture and Fixtures	76,570	
Less : Depreciation to-date	36,570	40,000
Bar Stocks	26,560	
Members' Subscriptions due	720	
Bank balance	96,820	
Cash in hand	1,900	1,26,000
Total		1,66,000
Liabilities:		
General fund		1,52,540
Creditors for bar purchases		13,100
Members' subscriptions in advance		360
Total		1,66,000

(b) Members of the club paid an annual subscriptions of ₹ 60. Duplicate receipts issued showed that as at December 31, 2016, 540 members had paid the current year's subscriptions, 10 members paid arrears of previous year and 5 members paid advance for 2017. Two members resigned without paying their arrears of previous year and as at the end of the year, there were 550 members as per records.

(c) The Cash Book was not written up to date and the records showed that the following bills were paid : Food for bar— ₹ 33,280; Sundry expenses— ₹ 5,440; Repairs and Renewals— ₹ 2,400; Salaries— ₹ 36,690; and Stationery— ₹ 2,290.

(d) The Club's source of income was from bar sales and the bartender generally hands over daily cash collections to the accountant along with cash collection list.

On enquiry, it was found that certain cash collection lists were misplaced or lost. The bartender stated that the average gross profit on bar sales were fifty per cent of sales. Bar stocks as on December 31, 2016 were ₹ 30,260 and cash in hand ₹ 125.

(e) Bank statements were summarized and showed the following:

Balance on 1.1.2016	96,820	Bar purchases	2,39,040
Cash deposited	3,92,310	Salaries	1,19,450
		Rent	62,420
		Power	12,570
		Telephone	910
		Repairs & Renewals	18,510
		Washing machine	5,940
		Balance on 31.12.2016	30,290
	4,89,130		4,89,130

(f) The accountant's records were searched and following unpaid bills were located :
Bar purchases — ₹ 62,540; Power — ₹ 1,830; Stationery — ₹ 2,170; and Telephone — ₹ 460.

You are required to prepare :

(1) Income and Expenditure Account for the year ended December 31, 2016. (2) Balance Sheet as at that date after providing depreciation at 20 per cent on written down value of Fixed Assets.

[C.A. (Inter) — Adapted]

22. Suresh runs a Circulating Library and his accounts are in a mess. One Bank Account has been used for both the business as well as his personal transactions. After looking into his records you gather the following information:-
1. Payments for magazines in the year ended 31st March 2017 ₹ 9,700.
2. Payment of delivery peon's wages for the year ended 31st March 2017 ₹ 2,200.
3. Payment of other expenses for the year ended 31st March 2017 ₹ 3,080.
4. Subscriptions collected ₹ 21,695.
5. He has taken ₹ 500 per month in cash from the subscriptions collections to pay to his wife for their household and personal expenses, depositing the balance of the collections into Bank.
6. During the year he bought a second-hand car (not used for the business) from a friend for ₹ 4,000. However, as the friend owned him ₹ 250 for subscriptions, the matter was settled by a cheque for the difference.
7. An assurance policy on his life matured during the year and realised ₹ 7,000.
8. Suresh issued a cheque for ₹ 1,200 to a friend as loan. The friend is repaying by instalments in cash, and owes ₹ 500 on 31.3.2017.
9. Magazine subscriptions for the year amounting to ₹ 400 had to be written off by Suresh as irrecoverable.
10 Other personal payments by cheques total ₹ 2,350.
11. Cash collected includes ₹ 600 in respect of magazine subscriptions written-off as irrecoverable in a previous year.
12. Suresh runs the business from his flat for which a rent of ₹ 90 per month is included in the payments for other expenses ₹ 3,080. The living accommodation may be regarded as two-thirds of the whole.
13. The following balances may be accepted as correct:

	31st March 2016	31st March 2017
Cash in hand	115	70
Bank balance	4,720	5,880
Subscriptions receivable (Debtors) considered good	1,830	2,105
Creditors for purchase of magazines	900	840
Stock of magazines, at cost	2,450	830

You are required to prepare:
1. A Cash and Bank Account for the year;
2. Suresh (Proprietor's) Account for the year;
3. An Income and Expenditure Account of the Circulating Library for the year ended 31st March 2017; and,
4. A Balance Sheet of the Business as at 31st March 2017. (Show your workings.)

[C.A. (Inter) — Adapted]

Preparation of Opening and Closing Balance Sheet

23. The following particulars related to Fast Sports Club :

Receipts and Payments Account for the year ended 31.12.2016

Receipts	₹	Payments	₹
To Balance	5,000	By Salary (including advance)	7,500
To Admission fees:		By Printing & stationery	2,500
2015	2,500	By Advertising	1,000
2016	13,500	By Insurance charges (partly for next year)	1,200
To Subscriptions:		By Electricity charges	500
2015	1,000	By Purchase of fixed assets	20,000
2016	23,000	By Balance	17,900
2017	2,000		
To Rent	3,600		
	50,600		50,600

On 1st January, 2016 the club had the following assets :

Land and Buildings — ₹ 60,000; Sports equipments — ₹ 30,000; Furniture — ₹ 4,500.

Prepare opening and closing Balance Sheets.

Guide to Answers

Multiple Choice

1. C 2. C 3. C 4. A 5. A.

Practical Questions

1. **Surplus ₹ 3,250. Balance Sheet total ₹ 1,24,450. Subscriptions ₹ 10,600. Opening capital fund ₹ 1,05,500.**
2. **Surplus ₹ 7,590. Balance Sheet total ₹ 1,22,075. Donations have been capitalised. Opening capital fund ₹ 1,06,385.**
3. **Surplus ₹ 1,735. Balance Sheet total ₹ 8,725. Donations have not been capitalised. Opening capital fund ₹ 6,610.**
4. **Deficit ₹ 260. Balance Sheet total ₹ 15,420. Opening capital fund ₹ 15,040. Admission fees have been capitalised.**
5. **Excess of income over expenditure ₹ 17,525. Total of Balance Sheet ₹ 1,19,625. Opening Capital Fund ₹ 95,100. Subscriptions income ₹ 39,500. Admission fees have been capitalised. Depreciation on sports equipments ₹ 7,125.**
6. **Excess of expenditure over income ₹ 2,180; Total of Balance Sheet ₹ 36,380. Opening Capital Fund ₹ 24,960. Subscriptions income ₹ 8,950.**
7. **Cash at bank ₹ 10,350 (₹ 10,440 – ₹ 90).**
   Excess of increase over expenditure ₹ 43,490. Total of Balance Sheet ₹ 1,10,910. Opening Capital Fund ₹ 65,130.
8. **Excess of income over expenditure ₹ 590; Total of Balance Sheet ₹ 52,150. Opening Capital Fund ₹ 50,200.**
9. **Bank Overdraft ₹ 1,08,140.**
   Excess of income over expenditure ₹ 15,100. Total of Balance Sheet ₹ 3,40,440.
10. **Deficit ₹ 2,888. Balance Sheet total ₹ 45,595. Subscriptions ₹ 28,912. Opening capital fund ₹ 47,000.**
11. **Bar profit ₹ 3,033. Restaurant loss ₹ 1,083. Surplus ₹ 20,500. Balance Sheet total ₹ 43,220. Depreciation — 3 : 2 (App.)**
12. **Surplus ₹ 16,200. Balance Sheet total ₹ 2,84,000. Repairs and maintenance ₹ 18,000.**
13. **Excess of income over expenditure ₹ 1,15,800. Total of Balance Sheet ₹ 2,53,700. Opening Capital Fund ₹ 68,500. Subscription Income ₹ 2,44,000.**
14. **Deficit ₹ 707. Bar net profit ₹ 332. Balance Sheet total ₹ 15,261. Opening accumulated fund ₹ 13,377.**
15. **Surplus ₹ 3,660. Bar profit ₹ 2,000. Balance Sheet total ₹ 24,065. Capital fund ₹ 18,700. Subscriptions ₹ 4,035. Depreciation on furniture (₹ 80 + 50) = ₹ 130.**
16. **Deficit ₹ 267. Bar profit ₹ 3,160. Balance Sheet total ₹ 16,577. Subscriptions : ordinary ₹ 1,650. Life ₹ 190.**
17. **Closing balance of Receipts and Payment Account ₹ 61,000. Subscriptions collected ₹ 91,000. B/S total ₹ 2,29,000.**
18. **Closing balance of Receipts and Payment Account ₹ 660. Subscriptions collected ₹ 2,100.**
19. **Subscriptions collected ₹ 11,000. Donations ₹ 30,000. Entrance fees ₹ 8,000. Sales ₹ 28,000.**
20. **Excess of Income over Expenditure (General) ₹ 1,620.**
    Excess of Expenditure over Income (Pantry) ₹ 13,357.
    Balance Sheet Total ₹ 1,29,123.
21. **Bar purchases ₹ 2,88,480. Bar materials consumed ₹ 2,84,780. Bar sales ₹ 6,36,120. Subscriptions collected ₹ 33,300. Subscriptions credited ₹ 33,000. Surplus ₹ 76,612. Balance Sheet total ₹ 2,96,452.**
22. **Capital fund ₹ 8,215. Subscriptions ₹ 22,020. Surplus ₹ 6,400. Balance Sheet total ₹ 8,885.**
23. **Opening capital fund ₹ 1,03,000. Total of opening Balance Sheet ₹ 1,03,000. Total of closing Balance Sheet ₹ 1,26,900.**

18

Incomplete Records

Introduction

Many small businesses have neither the time nor the experience necessary to maintain a full set of accounting records using the double entry system; and cannot afford the expense of outside staff to keep such records. However, every business is interested to know its profit from time to time. Any set of procedures for ascertaining profits that does not provide for the ***analysis of each transaction*** in terms of the double entry system of bookkeeping is generally referred to as 'Single Entry System'. Strictly speaking, single entry constitutes ***incomplete records*** rather than single entry accounting. Under this system, certain transactions are recorded just like the double entry system; for example : cash collected from debtors — it is recorded in the Debtors Account as well as in the Cash Account. Again, certain transactions are recorded partially, e.g., cash sales, cash purchases, etc. Similarly, certain transactions are not recorded at all, e.g., Bad Debt, Depreciation, etc. Since all the transactions are not recorded strictly on the double entry principle, it is not possible to prepare a Trial Balance and check the arithmetical accuracy of the books of account. Consequently, the system engenders a spirit of laxity and invites frauds and misappropriation.

In India, there are many small-scale business which do not keep complete records for all their financial transactions because the proprietors of these businesses are untrained in accounting and regard it better to keep an additional productive employee rather than a bookkeeper. They assume that without an elaborate accounting system, they can exercise control over assets, expenses, revenues and liabilities. They record few transactions completely just like the double entry system but a majority of the transactions are recorded only partially.

Features of Incomplete Records (Single Entry System)

1. This system is a mixture of: (i) double entry; (ii) single entry; and (iii) no entry.
2. This system is suitable for small businesses where the proprietor or partners can directly control the affairs of the business.
3. In this system, generally Personal Accounts are kept but Real and Nominal Accounts are ignored. This is because, a single entry takes account only of the personal transactions and leaves the impersonal transactions of the business unit entirely unrecorded.
4. In the absence of record of the two-fold aspect of every transaction, it is not possible to prepare a trial balance and check the arithmetical accuracy of the books of account. Similarly, no Balance Sheet can be prepared in the absence of balances in ledger.

5. This system is highly changeable and flexible and it is not governed by any definite rules of operation.
6. Under this system the profit or loss can be found out but its composition will not be available.

Limitations of Incomplete Records (Single Entry System)

Single entry system ignores the concept of duality and, therefore, transactions are not recorded in their two-fold aspects. As a result, the final accounts of the business concern cannot be prepared in the usual way. The other limitations are as under :

1. Since no trial balance can be prepared, arithmetical accuracy of the books of account cannot be checked.
2. This system engenders a spirit of laxity and invites frauds and misappropriations.
3. Since no Nominal Accounts are maintained, the Trading and Profit and Loss Account cannot be prepared and, consequently, the different ratios such as gross profit ratio, net profit ratio and operating ratio, etc., cannot be computed.
4. Owing to incompleteness of record, proper appraisal of the financial position of the business is not possible.
5. No limited company can keep account under this system, because of legal restrictions.

Difference between Double Entry System and Single Entry System

	Double Entry System		Single Entry System
1.	Under this system, both aspects of each transaction are recorded.	1.	Under this system, both aspects of each transaction are not recorded.
2.	In this system, Personal, Real and Nominal Accounts are kept fully.	2.	In this system, only Personal Accounts are kept and Real and Nominal Accounts are ignored. (However, in some cases Cash Account is maintained.)
3.	In this system, Cash Book, General Ledger, Debtors' Ledger and Creditors' Ledger are maintained.	3.	In this system, only Debtors' Ledger and Creditors' Ledger are kept. Cash Book is also kept but personal transactions get mixed up with business transactions.
4.	Under this system, arithmetical accuracy can be checked by preparing Trial Balance at any moment of time.	4.	Under this system, arithmetical accuracy cannot be checked because no Trial Balance can be prepared.
5.	In this system, Trading, Profit and Loss Accounts and Balance Sheet can be prepared.	5.	In this system, Trading, Profit and Loss Accounts and Balance Sheet cannot be prepared.
6.	For interpretation of financial statement, we can compute different ratios, if the accounts are maintained under this method.	6.	Vital ratios cannot be computed (such as gross profit ratio, net profit ratio, etc), if the accounts are maintained under this system.
7.	This system is scientific and follows certain rules.	7.	This system is unscientific and does not follow any concrete rules.

Ascertainment of Profit or Loss

There are mainly two approaches for income determination :

(a) The Transaction Approach, and (b) The Balance Sheet Approach.

(a) The Transaction Approach

When books of account are maintained under complete double entry principles of bookkeeping, this approach is followed for determining the profit or loss of a particular period. In this approach, every transaction is analysed and the following steps are followed:

1. We record only transactions to business — events which can be translated into monetary terms.
2. Every transaction involves two accounts — one of these accounts is debited and the other is credited in the books of primary entry.

3. From books of primary entry, we prepare Ledger Accounts and, thereafter, accounts are balanced.
4. A Trial Balance is prepared from the Ledger; balances to ensure the arithmetical accuracy of the records.
5. After preparing the Trial Balance, adjusting entries are passed to record the internal transactions such as provision for bad debts, depreciation, etc.
6. A second Trial Balance (called Adjusted Trial Balance) is prepared to incorporate the adjusting entries.
7. From the Trial Balance, nominal accounts are transferred to Trading and Profit and Loss Account.
8. The Trading Account shows the gross profit and the Profit and Loss Account shows the net profit or loss.

The above procedures have been discussed here just for comparison of the two approaches.

(b) The Balance Sheet Approach

When books of account are maintained under single entry system, it is not possible to determine profit or loss by the transaction approach because we cannot get full information regarding all transactions.

The problems that arise in the single entry system for the determination of profit can be solved within the context of the fundamental Balance Sheet equation, as under:

Capital = Assets – Liabilities

Under this method, two Balance Sheets (better to say, Statement of Affairs) are prepared. One, at the beginning of the period for finding out ***the Opening Capital*** and the other at the end of the period for finding out ***the Closing Capital.*** A comparison is made between the opening and closing capital. If the closing capital is more than the opening capital, it shows an increase in capital, which means a ***profit.*** Conversely, if the closing capital is less than the opening capital, it shows a decrease in capital, which means a loss for the period. In other words:

Closing Balance Sheet: Assets = Liabilities + Capital
Opening Balance Sheet: Assets = Liabilities + Capital
Change in period : Δ Assets = Δ Liabilities + Δ Capital

The change (Δ) in assets may be due to change in liabilities or capital or both. The increase in assets due to increase in capital represents profit.

Let us take a simple example in which Mr X keeps no adequate records. The firm was set up on 1st January, 2016 with a capital in cash ₹ 50,000. At the end of the year, the following assets and liabilities were revealed:

Assets : Building at cost — ₹ 30,000; Stock — ₹ 10,000; Trade debtors — ₹ 20,000; Cash — ₹ 15,000

Liabilities : Trade creditors — ₹ 5,000. From this, it appears that the changes for the year are :

	Assets =	Liabilities +	Capital
Closing position (₹)	75,000	5,000	70,000
Opening position (₹)	50,000	—	50,000
Net changes (₹)	25,000	5,000	20,000

Assets have increased by ₹ 25,000. Out of this increase, ₹ 5,000 owing to increase in liabilities and ₹ 20,000 owing to increase in capital and it is nothing but profit earned during the year 2016.

We can also calculate the above profit as follows :

Statement of Profit and Loss

	₹
Closing Capital (Assets — Liabilities)	70,000
Less: Opening Capital	50,000
Profit for the year	20,000

The above are only the initial figures for income. Any fresh capital introduced during the period by the owner or any withdrawal by him will definitely affect the size of the profit calculated. The ascertainment of profit by the above process needs to be adjusted for the introduction or withdrawal of capital. This is because, ignoring capital introduced during the period would be an overstatement of income. Similarly, ignoring withdrawals would show an understatement of income. Therefore, if there is any introduction of fresh capital or withdrawal by the proprietor, then the profit or loss should be calculated as follows :

Statement of Profit and Loss

	₹
Closing Capital (Assets — Liabilities)	***
Add: Drawings (Since if they had not been withdrawn from the business, the increase in capital would have been greater)	***
	***
Less: Opening Capital	***
	***
Less: New Capital paid in (Since without the increase in capital would have been smaller)	***
Profit for the year	***

However, the above profit figure is not really a very satisfactory one, because no adjustments have so far been made for depreciation on assets or provision for doubtful debts etc. The above profit is termed as 'Trading Profit' or 'Profit before adjustments'. Therefore, net profit can be ascertained only when we deduct the depreciation, provision, etc from the above trading profit.

Steps For Ascertaining Profit

Step 1 – Calculate Opening Capital : It can be calculated by preparing a Statement of Affairs at the beginning of the year. The Statement of Affairs is just similar to a Balance Sheet. All the assets are shown on the right-hand side and all the liabilities are shown on the left-hand side of the Statement of Affairs. If the total of the right-hand side is greater than the total of the left-hand side, it represents 'Opening Capital'. The assets and liabilities are ascertained as follows:

1. Amount of cash is ascertained by physical count;
2. Bank balance is ascertained from the Pass Book;
3. The closing stock is ascertained by physical stock taking;
4. The balances of debtors and creditors can be ascertained from the list, the trader maintains;
5. Regarding other assets, the trader prepares a list and values them; and
6. Other relevant information is supplied by the trader from his memory.

Step 2

Ascertain the Drawings During the Period : Ascertainment of drawings for the period is a most difficult task. Drawings increase the personal capital but decrease the business capital. Since the entries are recorded from the point of the proprietor, personal affairs of the proprietor get mixed up with the business affairs. To take an account of drawings, all withdrawals from the business must be traced. For calculating drawings, the following are to be considered: (i) How much is drawn from the business at regular intervals for household or private purposes ? and (ii) How much has been utilized for household or private purposes from the sale proceeds or other receipts before depositing it into the bank ?

Step 3 – Ascertain the Capital Introduced During the Period : A trader may introduce new capital (in the form of cash or assets) during the period. The trader is to make a list of the amount of capital introduced during the period.

Step 4 – Calculate Closing Capital : It can be calculated by preparing the closing Statement of Affairs in the same manner we prepare the opening Statement of Affairs in Step 1. However, in the closing Statement of Affairs, we will consider assets and liabilities at the end of the period (***before adjustments***).

Step 5 – Prepare Statement of Profit : The statement of profit is to be prepared as follows:

Statement of Profit and Loss for the year ended ...

		₹
Closing Capital (before adjustment)		***
Add: Drawings for the period		***
		***
Less: Opening Capital	***	
New Capital introduced	***	***
Profit before adjustments		***
Less : Adjustments :		
(i) Depreciation	***	
(ii) Provision for Bad debts, etc	***	***
Net profit for the period		***
Less: Appropriations :		
(i) Salary of the partners*	***	
(ii) Interest on capital*	***	***
Divisible profit *		***

*Applicable to partnership firms.

Final Statement of Affairs

After ascertaining profit by following the above procedures, a final Statement of Affairs is prepared at the end of the period after incorporating adjustment for depreciation, provision for bad debts, etc. The final Statement of Affairs will appear as follows :

Statement of Affairs as at ...

Liabilities	₹	₹	Assets	₹	₹
Opening Capital	***		Plant & Machinery	***	
Add: New Capital introduced	***		*Less:* Depreciation	***	***
Add: Profit for the year	***		Furniture	***	
	***		*Less:* Depreciation	***	***
Less: Drawings	***	***	Debtors	***	
Creditors		***	*Less:* Provision for bad debts	***	***
			Stock		***
			Cash at bank		***
			Cash in hand		***
		***			***

Difference Between Statement of Affairs and Balance Sheet

A Statement of Affairs is a statement of the assets, liabilities and capital prepared from incomplete records whereas a Balance Sheet is a statement of the assets, liabilities and capital extracted from ledger balances maintained under the double entry system.

Under the double entry system, the basic purpose of the Balance Sheet is to show the financial position of the business on the last day of the accounting period. Under single entry, the same purpose is served by the Statement of Affairs. Also, it is used as the basis for calculating the trading profit or loss for the period.

Illustration 1

Mr Sunanda Sanyal, who keeps his books on single entry system, tells you that his capital on 31.12.2016 is ₹ 18,700 and on 1st January, 2016 was ₹ 19,200. He further informs you that he gave loan of ₹ 3,500 to his brother on private account and withdrew ₹ 300 p.m. for personal purposes. He also used a flat for his personal purposes, the rent of which @ ₹ 100 per month and electric charges ₹ 10 per month were paid from the business account. He sold his 7% Government Bond of ₹ 2,000 at 3% premium and brought that money into business. Besides this, there is no other information.

You are required to prepare his Statement of Profit for the year ended 31.12.2016.

Solution

Sunanda Sanyal

Statement of Profit and Loss for the year ended 31st December, 2016

	₹	₹
Closing Capital (31.12.2016)		18,700
Add: Drawings :		
Loan given to brother	3,500	
Withdrawals for personal purposes (₹ 300 x 12)	3,600	
Rent of the flat (₹ 100 x 12)	1,200	
Electric charges (₹ 10 x 12)	120	8,420
		27,120
Less: Capital introduced during the period — 7% of Govt. Bond of ₹ 2,000 at 3% premium, i.e., (₹ 2,000 x 103) / 100		2,060
		25,060
Less: Opening Capital (1.1.2016)		19,200
Profit for the period		5,860

Illustration 2

On January 1, 2016 a trader started a business with a capital of ₹ 1,00,000 with which he opened a bank account. On the same day, he bought furniture and fittings for shop costing ₹ 4,800 and goods for trade costing ₹ 25,000.

On December 31, his stock-in-hand was valued at ₹ 29,000 and furniture and fittings stood at ₹ 6,300. On that date, his book debts amounted to ₹ 78,000 of which ₹ 1,200 was considered to be bad. Creditors amounted to ₹ 15,000. His balance as per Cash Book was ₹ 5,500 a cheque for ₹ 400 sent for deposit on December 30, was not realized till after December 31, and cheque for ₹ 700 issued on December 29, was not presented to Bank till after December 31. Bank charges for the year amounted to ₹ 50 but this was not known to the trader on December 31. His drawings during the year amounted to ₹ 9,300. He had also taken for personal use goods from the shop valued at ₹ 1,500.

Prepare a Statement showing the trader's profit or loss during 2016.

Solution **Ascertainment of Closing Capital (before adjustments)**

Liabilities	₹	Assets	₹
Creditors	15,000	Stock	29,000
Closing capital (balancing figure)	1,03,800	Furniture & Fittings	6,300
		Book debts	78,000
		Cash-at-bank (Note 1)	5,500
	1,18,800		1,18,800

Statement of Profit and Loss for the year ended 31st December, 2016

	₹	₹
Closing Capital (as above)		1,03,800
Add: Drawings during the year :		
Cash	9,300	
Goods	1,500	10,800
		1,14,600
Less: Opening Capital (as given)		1,00,000
Profit before adjustment		14,600
Less: Adjustments :		
Bad debts	1,200	
Bank charges (See Note)	50	1,250
Profit for the period		13,350

Note Since the amended Cash Book balance is to be taken as the closing balance of cash at Bank, there will be no adjustment for: (a) Cheque deposited into bank but not realised, and (b) cheque issued but not presented.

Therefore, in this problem, when we prepare the closing Statement of Affairs, Cash-at-Bank will be ₹ 5,450 (₹ 5,500 – ₹ 50).

Illustration 3

The Statement of Affairs of Sri S. Roy as on 1st April, 2016 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	16,500	Cash	7,450
Accrued expenses	3,500	Sundry Debtors	25,350
Capital	50,000	Stock	30,300
		Furniture	6,900
	70,000		70,000

During the year ended 31st March, 2017 his drawings amounted to ₹ 15,000. He also withdrew goods worth ₹ 600 for his personal use. On 1st July, 2016, S. Roy transferred some of his household furniture to the business at a value of ₹ 2,100. His assets and liabilities as on 31st March, 2017 were:

Liabilities	₹	Assets	₹
Sundry Creditors	18,600	Cash	6,580
Accrued expenses	4,300	Sundry Debtors	36,900
		Stock	40,320
		Furniture	9,000
		Prepaid Rent	400

Furniture is to be depreciated @ 10% p.a. and a provision is to be created on debtors @ 5%, Interest 5% to be allowed on capital as at the beginning of the year. Ascertain the profit or loss for the year ended 31st March, 2017 and prepare the Statement of Affairs as on that date.

Solution **Ascertainment of Closing Capital (before adjustments)**

Liabilities	₹	Assets	₹
Sundry Creditors	18,600	Cash	6,580
Accrued expenses	4,300	Sundry Debtors	36,900
Closing Capital (balancing figure)	70,300	Stock	40,320
		Furniture	9,000
		Prepaid Rent	400
	93,200		93,200

Statement of Profit and Loss of Sri S. Roy for the year ended 31st March, 2017

		₹
Closing Capital (as above)		70,300
Add: Drawings during the year		
Cash	15,000	
Goods	600	15,600
		85,900

Less : Capital introduced during the year	2,100	
Opening Capital (as given)	50,000	52,100
Profit before adjustments		33,800
Less : Adjustments :		
(i) Depreciation on Furniture (₹ 690 + 158)	848	
(ii) Provision for doubtful debts	1,845	2,693
Net profit for the period		31,107
Less: Interest on Capital (5% of ₹ 50,000)		2,500
Net profit		28,607

Statement of Affairs of Sri S. Roy as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Opening Capital	50,000		Furniture (₹ 6,900 + ₹ 2,100)	9,000	
Add: New Capital introduced	2,100		Less: Depreciation	848	8,152
Add: Interest on Capital	2,500		Stock		40,320
Add: Profit for the year (Net)	28,607		Sundry Debtors	36,900	
	83,207		Less: Provision for Doubtful debts	1,845	35,055
Less: Drawings	15,600	67,607	Prepaid rent		400
Accrued expenses		4,300	Cash		6,580
Sundry Creditors		18,600			
		90,507			90,507

Illustration 4

R had ₹ 3,00,000 in bank on 1st January 2016 when he started his business. He closed his accounts on 31st March, 2017. His single entry books (in which he did not maintain any account for the bank) showed his position as follows:

	31.3.2016	31.3.2017
Cash in hand	2,000	3,000
Stock in trade	19,000	29,000
Debtors	1,000	2,000
Creditors	5,000	3,000

On 1st February, 2016, he began drawing ₹ 700 per month for his personal expenses from the Cash Box of the business.

His account in the bank had the following entries :

	Deposits	Withdrawals
1.1.2016	3,00,000	—
1.1.2016 to 31.3.2016	—	2,23,000
1.4.2016 to 31.3.2017	2,30,000	2,70,000

The above withdrawals included payments by cheques of ₹ 2,00,000 and ₹ 60,000 respectively during the period from 1st January, 2016 to 31st March, 2016 and from 1st April, 2016 to 31st March, 2017 for the purchase of machinery for the business. The deposits after 1st January, 2016 consisted wholly of sale price received from customers by cheques. Draw up R's Statement of Affairs as at 31st March, 2016 and 31st March, 2017 respectively and work out his profit or loss for the year ended 31st March, 2017.

Solution **Ascertainment of Opening Capital (31st March, 2016)**

Liabilities	₹	Assets		₹
Sundry Creditors	5,000	Cash in hand		2,000
Capital (Balancing figure)	2,94,000	Cash at bank	3,00,000	
		Less: Withdrawals	2,23,000	77,000
		Stock in trade		19,000
		Debtors		1,000
		Machinery		2,00,000
	2,99,000			2,99,000

Ascertainment of Closing Capital (31st March, 2017)

Liabilities	₹	Assets	₹
Sundry Creditors	3,000	Cash in hand	3,000
Capital (balancing figure)	3,28,000	Cash at bank (Note 2)	37,000
		Stock in trade	29,000
		Sundry Debtors	2,000
		Machinery	2,60,000
	3,31,000		3,31,000

Statement of Profit and Loss of R for the year ended 31st March, 2017

		₹
Closing Capital (as above)		3,28,000
Add: Drawings during the year (₹ 700 x 12)		8,400
		3,36,400
Less: Opening Capital (as above)		2,94,000
Net profit for the year		42,400

Notes : 1. The above profit of ₹ 42,400 is earned by R subject to depreciation on machinery;
2. Opening balance + Deposit – Withdrawals = ₹ 77,000 + 2,30,000 – 2,70,000 = ₹ 37,000.

Illustration 5

On 1.1.2016, the assets and liabilities of Sougata Roy, a retailer, were as follows :

Building ₹ 5,00,000; Motor van ₹ 1,00,000; Furniture ₹ 80,000; Stock ₹ 60,000; Debtors ₹ 40,000; Provision for Doubtful Debts ₹ 4,000; Cash ₹ 2,500; Creditors ₹ 42,000; Loan ₹ 1,00,000; Bank Overdraft ₹ 15,000.

The following information was available at 31.12.2015 :

(1) Stock ₹ 60,000; Debtors ₹ 50,000; Cash ₹ 4,500; Creditors ₹ 37,000; Loan ₹ 80,000; Bank Overdraft ₹ 10,000.
(2) No fixed assets had been bought or sold during the year.
(3) Fixed assets are to be depreciated as follows :
(i) Motor van by 20% p.a.; and (ii) Furniture by 25% p.a.
(4) A provision for doubtful debts is to be maintained at 10% of year-end debtors.
(5) Sougata withdrew ₹ 6,000 p.m. for his own use.
(6) On 1.3.2016, Sougata brought further ₹ 30,000 as capital into the business.

You are required to prepare a Statement of Profit and Loss for the year ended 31.12.2016 and a Statement of Affairs as on that date.

Solution **Opening Statement of Affairs as on 1.1.2016**

Liabilities	₹	Assets		₹
Opening Capital (Balancing figure)	6,21,500	Building		5,00,000
Loan	1,00,000	Motor van		1,00,000
Creditors	42,000	Furniture		80,000
Bank Overdraft	15,000	Stock		60,000
		Debtors	40,000	
		Less : Provision for doubtful debts	4,000	36,000
		Cash		2,500
	7,78,500			7,78,500

Closing Statement of Affairs as on 31.12.2016

Liabilities	₹	Assets	₹
Closing Capital (Balancing figure)	6,67,500	Building	5,00,000
Loan	80,000	Motor van	1,00,000
Creditors	37,000	Furniture	80,000
Bank Overdraft	10,000	Stock	60,000
		Debtors	50,000
		Cash	4,500
	7,94,500		7,94,500

Statement of Profit and Loss of Sougata Roy for the year ended 31st December, 2016

Particulars	₹	₹
Closing Capital (as above)	6,67,500	
Add : Drawings (₹ 6,000 x 12)	72,000	7,39,500
Less : Opening Capital (as above)	6,21,500	
Capital introduced during the year	30,000	6,51,500
Profit before Adjustments		88,000
Less: Adjustments —		
(1) Depreciation on motor vehicles	20,000	
(2) Depreciation on furniture	20,000	
(3) Provision for doubtful debts	5,000	45,000
Net Profit for the year		43,000

Final Statement of Affairs of Sougata Roy as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital :			Building		5,00,000
Opening balance	6,21,500		Motor van	1,00,000	
Add : Capital introduced	30,000		Less : Depreciation	20,000	80,000
Net profit	43,000		Furniture	80,000	
	6,94,500		Less : Depreciation	20,000	60,000
Less : Drawings	72,000	6,22,500	Stock		60,000
Loan		80,000	Debtors	50,000	
Creditors		37,000	Less : Provision for doubtful debts	5,000	45,000
Bank Overdraft		10,000	Cash		4,500
		7,49,500			7,49,500

Illustration 6

The following balances are obtained from the books of Mr Chetri as on 31st March, 2017 and 31st March, 2016 :

Particulars	31.3.2017	31.3.2016	Particulars	31.3.2017	31.3.2016
Sundry Creditors	1,50,000	2,20,000	Sundry Debtors	1,70,000	1,60,000
Furniture and Fixtures	1,26,000	92,000	Stock	75,000	50,000
Oiffice Equipments	95,400	96,000	Bills Payable	10,000	18,000
Outstanding Salary	6,000	2,000	Outstanding Audit Fees	1,500	1,000
Motor Car	75,200	94,000	Outstanding Printing	560	800
Advance Salary	4,500	2,500	Outstanding Rent	2,500	1,200
Prepaid Insurance	500	300	Outstanding Repairs	1,200	—
Cash and Bank	76,000	90,000			

The following information is relevant for the year 2016-17 :

(i) Cash drawings as per books during 2016-17 amounted to ₹ 30,000.

(ii) He sold one building at New Delhi for ₹ 2,00,000 out of which he invested ₹ 50,000 in his business.

(iii) One sales invoice amounting to ₹ 10,000 dated 2.9.2016 was omitted in the books.

(iv) Outstanding audit fees on 31.3.2017 includes ₹ 300 for 2015-16.

(v) Cash collected from debtors ₹ 12,000 was deposited in his private Bank Account.

You are required to show by means of a statement as to how would you arrive at the Net Profit for the year ended 31.3.2017 if the accounts were maintained on cash basis.

Solution

Chetri

Statement of Profit and Loss for the year ended 31st March, 2017 (under cash basis)

Particulars			₹
Closing Capital (Note 1)			4,48,840
Add: Drawings (₹ 30,000 + 12,000)			42,000
			4,90,840
Less:	Capital introduced	50,000	
	Opening Capital (Note 1)	3,41,800	3,91,800
	Net Profit on Accrual Basis		99,040
Add:	Outstanding Expenses as on 31.3.2017 : Salary — ₹ 6,000; Audit fees — ₹ 1,200 (₹ 1,500 – 300); Printing — ₹ 560; Rent — ₹ 2,500; Repairs — ₹ 1,200		11,460
			1,10,500
Add:	Expenses paid in advance on 31.3.2016 : Advance salary — ₹ 2,500; Prepaid insurance — ₹ 300		2,800
			1,13,300
Less:	Outstanding expenses as on 31.3.2016 : Salary — ₹ 2,000; Audit fees — ₹ 700 (₹ 1,000 – 300); Printing — ₹ 800; Rent — ₹ 1,200		4,700
			1,08,600
Less:	Expenses paid in advance on 31.3.2017 : Advance Salary — ₹ 4,500; Prepaid Insurance — ₹ 500		5,000
	Net Profit on Cash Basis		1,03,600

Working Note : (1) Ascertainment of Opening and Closing Capital (figures in ~)

Liabilities	31.3.2016	31.3.2017	Assets	31.3.2016	31.3.2017
Capital (Balancing figure)	3,41,800	4,48,840	Furniture and Fixtures	92,000	1,26,000
Sundry Creditors	2,20,000	1,50,000	Office Equipments	96,000	95,400

Bills Payable	18,000	10,000	Motor Car	94,000	75,200
Outstanding Salary	2,000	6,000	Stock	50,000	75,000
Outstanding Audit Fees	1,000	1,500	Sundry Debtors	1,60,000	*1,68,000
Outstanding Printing	800	560	Cash and Bank	90,000	76,000
Outstanding Rent	1,200	2,500	Advance Salary	2,500	4,500
Outstanding Repairs	—	1,200	Prepaid Insurance	300	500
	5,84,800	6,20,600		5,84,800	6,20,600

* Final balance of debtors : Balance as given ₹ 1,70,000 + Sales omitted ₹ 10,000 – Collections from debtors ₹ 12,000 = ₹ 1,68,000.

Tutorial Note : Opening capital and Closing capital can be ascertained on cash basis, ignoring outstanding expenses and prepaid expenses as well as advance salary. In that case, opening capital will be ₹ 3,44,000 and closing capital will be ₹ 4,55,600. However, profit will be the same, i.e., ₹ 1,03,600; ₹ (4,55,600 + 42,000 – 3,44,000 – 50,000).

Illustration 7

Mr Kothari does not keep complete records of his business but gives you the following information:

His assets on 31.3.2017 consisted of Machineries ₹ 1,50,000; Furniture ₹ 60,000; Motor Car ₹ 40,000; Stock-in-trade ₹ 50,000; Debtors ₹ 80,000; Cash in hand ₹ 12,000 and Cash at Bank ₹ 30,000; Creditors on that date amounted to ₹ 1,20,000.

On further information received, you come to know that:

On 1.10.2016 he purchased a new machinery costing ₹ 50,000.

Sales are made for cash as well as on credit. There is no cash purchases. He always sells his goods at cost plus 25%. Cash sales for the year 2016-17 were accounted for ₹ 80,000.

During the year 2016-17 collection from debtors amounted to ₹ 5,00,000 and a sum of ₹ 4,25,000 was paid to creditors. He obtained a Bank loan for ₹ 50,000 on 1.2.2016. The entire amount was repaid in February, 2017 with interest ₹ 2,500.

In November, 2016 his life insurance policy for ₹ 50,000 became matured and the same was invested in the business. His drawings were ₹ 2,500 p.m. all through the year.

On 1.4.2016 he had ₹ 1,500 as cash in hand and balance at bank for ₹ 40,000. Debtors and Creditors on that date amounted to ₹ 60,000 ad ₹ 90,000 respectively.

Provide depreciation on Machineries @ 15% p.a., on Furniture @ 10% p.a. and on Motor Car @ 20% p.a.

Mr Kothari requests you to prepare a statement of Profit & Loss for the year ended 31.3.2017.

Solution

Working Notes

(1) Ascertainment of Opening Capital

Liabilities	₹	Assets	₹
Creditors	90,000	Machineries (Note 6)	1,00,000
Bank Loan	50,000	Furniture	60,000
Outstanding Interest (Note 7)	417	Motor Car	40,000
Capital (balancing figure)	2,36,083	Stock in trade (Note 5)	75,000
		Debtors	60,000
		Cash in hand	1,500
		Cash at bank	40,000
	3,76,500		3,76,500

(2) Ascertainment of Closing Capital (before adjustments)

Liabilities	₹	Assets	₹
Creditors	1,20,000	Machineries	1,50,000
Capital (balancing figure)	3,02,000	Furniture	60,000
		Motor Car	40,000
		Stock in trade	50,000
		Debtors	80,000
		Cash in hand	12,000
		Cash at bank	30,000
	4,22,000		4,22,000

Dr. **(3) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c	4,25,000	1.4.2016	By Balance b/d	90,000
31.3.2017	To Balance c/d	1,20,000	?	By Credit purchases (balancing figure)	4,55,000
		5,45,000			5,45,000

Dr. **(4) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	60,000	?	By Bank A/c	5,00,000
?	To Credit sales (balancing figure)	5,20,000	31.3.2017	By Balance c/d	80,000
		5,80,000			5,80,000

(5) Ascertainment of Opening Stock : Total Sales = Credit sales + Cash sales = ₹ 5,20,000 + ₹ 80,000 = ₹ 6,00,000.

Gross profit is 25% on cost or 20% on sales. Therefore, cost of goods sold is 80% of Sales = 80% of ₹ 6,00,000 = ₹ 4,80,000.

We know, Opening stock + Purchases = Cost of goods sold + Closing stock

Or Opening Stock + ₹ 4,55,000 = ₹ 4,80,000 + ₹ 50,000; Or Opening Stock = ₹ 75,000.

Dr. **(6) Machineries Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d (balancing figure)	1,00,000	31.3.2017	By Balance c/d	1,50,000
	To Bank A/c	50,000			
		1,50,000			1,50,000

(7) Statement showing allocation of interest

Total interest from 1.2.2016 to 1.2.2017 = ₹ 2,500; Therefore, interest from 1.2.2016 to 31.3.2016 = ₹ 417;

And, interest from 1.4.2016 to 1.2.2017 = ₹ 2,083.

(8) Depreciation on Machinery

On ₹ 1,00,000 @ 15% for 1 year = ₹ 15,000 + On ₹ 50,000 @ 15% for 1/2 year = ₹ 3,750; Therefore, total = ₹ 18,750.

Statement of Profit and Loss of Kothari for the year ended 31st March, 2017 ₹

Closing Capital		3,02,000
Add: Drawings for the period (₹ 2,500 x 12)		30,000
		3,32,000
Less: Opening Capital	2,36,083	
New Capital introduced	50,000	2,86,013
Profit before adjustments		45,917
Less : Adjustments :		
(i) Depreciation on Machinery @ 15% p.a.	18,750	
(ii) Depreciation on Furniture @ 10% p.a.	6,000	
(iii) Depreciation on Motor Car @ 20% p.a.	8,000	32,750
Net Profit		13,167

Single Entry System as Applied to Partnerships

When the single entry system is adopted by a partnership firm, the calculation of profit or loss is made along the lines indicated before. The Statement of Affairs would yield the amount of the combined capital of the partners; and the Statement of Profit and Loss would show the profit made during the year, which should be divided among the partners in agreed proportions.

Therefore, in case of a partnership firm, the Statement of Profit and Loss will be as under :

Statement of Profit and Loss for the year ended ... ₹

Combined closing Capital		***
Add: Combined drawings for the period		***
		***
Less: Combined opening Capital	***	
Combined new Capital introduced	***	***
Profit before adjustments		***
Less : Adjustments :		
(i) Depreciation	***	
(ii) Provision for Doubtful debts etc	***	***
Net profit for the period		***
Less: Appropriations :		
(i) Salary of the partners	***	
(ii) Interest on Capital	***	***
Add: Interest on Drawings		***
Divisible profit		***

Illustration 8

Akash and Bikash are partners in a firm sharing profits and losses in the proportion of 3 and 2. They keep their books on the Single Entry System. On 31st December, 2015, the following Statement of Affairs was extracted from their books:-

Liabilities	₹	Assets	₹
Capital Accounts		Plant & Machinery	30,000
Akash	25,000	Stock	20,000
Bikash	20,000	Sundry Debtors	35,000
Loan — Bikash	25,000	Cash at bank	15,000
Sundry Creditors	30,000		
	1,00,000		1,00,000

On 31st December, 2016, their assets and liabilities were: Sundry Debtors ₹ 40,000; Sundry Creditors ₹ 25,000; Plant and Machinery ₹ 50,000; Stock ₹ 30,000; Bills Receivable ₹ 5,000; Cash at Bank ₹ 25,000; Loan —Bikash ₹ 25,000.

You are required to prepare a Profit and Loss Statement for the year ended 31st December, 2016 and a Statement of Affairs as at that date after taking into consideration the following:

(a) Plant and machinery is to be depreciated by 10% p.a.

(b) Stock is to be reduced to ₹ 25,000.

(c) A provision for bad debts to be raised at 5% on Sundry Debtors.

(d) Interest on loan is to be allowed at 6% p.a.

(e) During the period Akash and Bikash drew ₹ 5,000 and ₹ 3,000 respectively.

Solution **Ascertainment of Combined Closing Capital (Before adjustments)**

Liabilities	₹	Assets	₹
Sundry Creditors	25,000	Sundry Debtors	40,000
Loan — Bikash	25,000	Plant & Machinery	50,000
Capital (balancing figure)	1,00,000	Stock	30,000
		Bills Receivable	5,000
		Cash at bank	25,000
	1,50,000		1,50,000

Statement of Profit and Loss of Akash and Bikash for the year ended 31st December, 2016

		₹
Combined closing Capital (as above)		1,00,000
Add: Combined Drawings during the year (₹ 5,000 + ₹ 3,000)		8,000
		1,08,000
Less : Combined Opening Capital (₹ 25,000 + ₹ 20,000)		45,000
Profit before adjustments		63,000
Less : Adjustments :		
(i) Stock written-off	5,000	
(ii) Depreciation on Plant & Machinery (₹ 3,000 + ₹ 1,000)	4,000	
(iii) Provision for Doubtful debts (5% on ₹ 40,000)	2,000	
(iv) Interest on loan (6% of ₹ 25,000)	1,500	12,500
Divisible profit :		50,500
Akash — 3/5th of ₹ 50,500	30,300	
Bikash 2/5th of ₹ 50,500	20,200	50,500

Statement of Affairs of Akash & Bikash as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital — Akash			Plant & Machinery	50,000	
Opening balance	25,000		Less: Depreciation	4,000	46,000
Add: Profit	30,300		Stock		25,000
	55,300		Sundry Debtors	40,000	
Less: Drawings	5,000	50,300	Less: Provision for Doubtful debts	2,000	38,000
Capital — Bikash			Bills Receivable		5,000
Opening balance	20,000		Cash at bank		25,000
Add: Profit	20,200				
	40,200				
Less: Drawings	3,000	37,200			
Loan — Bikash	25,000				
Add: Outstanding interest	1,500	26,500			
Sundry Creditors		25,000			
		1,39,000			1,39,000

Illustration 9

A and B are carrying on business in partnership sharing profits and losses equally. They were unable to maintain full and complete records. From the following available information, compute the profits of the firm and prepare a Balance Sheet:

	1.1.2016 (₹)	31.12.2016 (₹)
Land and Building (cost)	50,000	50,000
Machinery (cost)	60,000	75,000
Furniture (cost)	20,000	25,000
Stock	12,000	30,000
Debtors	17,000	22,000
Bank	4,900	5,000
Cash	1,100	5,000
Prepaid Insurance Premium	5,000	—
Bills Receivable	—	8,000
Creditors	60,000	50,000
Bills Payable	10,000	—

At the beginning of the year, the capital of the partners were equal. During the year, A brought in ₹ 15,000 and B has withdrawn ₹ 5,000. An insurance policy matured during the year for ₹ 10,000. A sum of ₹ 4,000 has become bad out of debtors. Provision has to be made for depreciation @ 10% on Land and Building, Machinery and Furniture.

Solution

Ascertainment of Combined Opening Capital

Liabilities	₹	Assets	₹
Creditors	60,000	Land and Building	50,000
Bills Payable	10,000	Machinery	60,000
Capital (balancing figure)		Furniture	20,000
A — 1/2 of ₹ 1,00,000	50,000	Stock	12,000
B — 1/2 of ₹ 1,00,000	50,000	Debtors	17,000
		Bank	4,900
		Cash	1,100
		Prepaid Insurance Premium	5,000
	1,70,000		1,70,000

Ascertainment of Combined Closing Capital (before adjustments)

Liabilities	₹	Assets	₹
Creditors	50,000	Land and Building	50,000
Capital (balancing figure)	1,70,000	Machinery	75,000
		Furniture	25,000
		Stock	30,000
		Debtors	22,000
		Bank	5,000
		Cash	5,000
		Bills Receivable	8,000
	2,20,000		2,20,000

Statement of Profit and Loss of A and B for the year ended 31st December, 2016

		₹
Combined closing Capital (as above)		1,70,000
Add: Drawings by B		5,000
		1,75,000
Less : Capital introduced by A	15,000	
Opening combined Capital	1,00,000	1,15,000
Profit before adjustments		60,000
Less: Profit on insurance policy (₹ 10,000 — ₹ 5,000)		5,000
Trading profit before adjustments		55,000
Less : Adjustments :		
(i) Depreciation on (Land & Building ₹ 5,000; Machinery ₹ 7,500; Furniture ₹ 2,500)	15,000	
(ii) Bad debts	4,000	19,000
Divisible profit :		36,000
A — 1/2 of ₹ 36,000	18,000	
B — 1/2 of ₹ 36,000	18,000	36,000

Balance Sheet as at 31st December, 2016

Liabilities		₹	Assets		₹
Capital — A			Land and Building	50,000	
Opening Balance	50,000		Less: Depreciation	5,000	45,000
Add: Introduced	15,000		Machinery	75,000	
Profit	18,000		Less: Depreciation	7,500	67,500
Profit on insurance	2,500	85,500	Furniture	25,000	
			Less: Depreciation	2,500	22,500
Capital — B			Stock in trade		30,000
Opening Balance	50,000		Sundry Debtors	22,000	
Add: Profit	18,000		Less: Bad debts	4,000	18,000
Profit on insurance	2,500		Bills Receivable		8,000
	70,500		Cash at bank		5,000
Less: Drawings	5,000	65,500	Cash in hand		5,000
Sundry Creditors		50,000			
		2,01,000			2,01,000

Preparation of Final Accounts from Incomplete Records

The procedure to be adopted for preparation of final accounts from incomplete (single entry) records depends upon the nature of the records and data available. It is not possible to give a formula which can be applied in every situation. However, as a general rule, the following steps are followed :

Step 1 Prepare opening Balance Sheet, if last year's Balance Sheet is not available. In examination problem on incomplete records, it may not be possible to prepare the opening Balance Sheet due to the missing out of opening balances of certain assets and liabilities. For example, opening debtors or opening creditors or opening cash in hand may be missing. In such a situation, students are advised to prepare the Balance Sheet as far as possible with the available information and leave it for the time being. (I have discussed the procedures of calculating missing figures in the next few pages.)

Step 2 If no Cash Account or Bank Account is maintained properly, a careful scrutiny of the Bank Statement or Pass Book shall be made and enquiry should be done in respect of the amount of cash takings which has been used by the trader for meeting personal expenses, business expenses or for cash purchases, etc. After collecting information through enquiry and scrutiny, a Cash Book (with cash and bank columns etc.) should be prepared as follows :

Dr. **Cash Book** **Cr.**

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/d			By Sundry Creditors (Payments)		
To Sundry Debtors (Collection)			By Assets (Purchased)		
To Sales (Cash)			By Drawings		
To Income from Interest			By Wages		
To Sale of Assets			By Balance c/d		

In examination problems, the opening or closing balance of cash or bank may be missing. The balance of the Cash Book will represent the respective figure at the beginning or at the end. Cash Book must be prepared even when both the opening and closing balances of cash and bank are given. The shortage on the debit side of cash column represents cash sales or capital introduced or sundry income. Similarly, shortage on the credit side of the cash column represents cash purchases, drawing or sundry expenses. Where the Cash Book is maintained, care should be taken in respect of private income and private expenditure which have been entered in the Cash Book. All the private income such as interest on private investment, etc should be credited to Capital Account. Similarly, all the private payments should be debited to Capital Account.

Step 3 Prepare Total Debtors Account, Total Creditors Account, Bills Receivable Account and Bills Payable Account, Total Sales Account and Total Purchases Account. The preparation of these accounts will help for finding out different missing information regarding; (i) opening/closing debtors balances; (ii) opening/closing creditors balances; (iii) credit purchases; and (iv) credit sales, etc.

Step 4 Now complete the opening Balance Sheet (left incomplete at Step 1) with the available information. The balance of the Balance Sheet represents ***Opening Capital***.

Step 5 Draft a pro-forma Profit and Loss Account and Balance Sheet (this is without figures).

Step 6 Enter the balances from the opening Balance Sheet into the appropriate ledger accounts or the appropriate place in the final accounts

Step 7 Post the cash and bank accounts entries either to the appropriate ledger accounts or to the draft final accounts.

Step 8 Enter the closing adjustments (depereciation, outstanding, prepaid, bad debts, stock etc.) either in the appropriate ledger account or the draft final accounts, making sure that the double entry is followed.

Step 9 Transfer the balancing figures of the ledger account to the final accounts.

Step 10 Complete the final accounts.

Initially these steps may look complicated and difficult to remember. Actually they should not cause too many problems, if you practice a little.

Calculation of Missing Figures

In examination problems on incomplete records, there must be certain missing figures. For finding out those, the relevant account is prepared. Missing figures come out by way of ***balancing figures***.

Illustration 10

S, a trader, does not keep a complete set of books. On May 1, 2016 his debtors were ₹ 24,500 and creditors ₹ 7,500.

A summary of his Cash Book for the year to 30th April, 2017 showed the following totals:

	Cash (₹)	Bank (₹)
Credits — Payments to Creditors for purchases	1,350	11,250
Deibis — Receipts from Debtors for sales	—	21,250
Sale of machinery	13,000	—
Rent of warehouse sublet	390	—
Cash sales	5,000	3,750
Cash Capital introduced on November 1, 2016	—	2,500

At April 30, 2017 the debtors and creditors respectively amounted to ₹ 44,000 and ₹ 9,750; Cash discount allowed to debtors were ₹ 230 and those received from creditors were ₹ 810.

Ascertain Total Sales and Total Purchases for the year.

Solution

Dr. **Total Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.5.2016	To Balance b/f	24,500	30.4.2017	By Bank	21,250
30.4.2017	To Credit Sales (balancing figure)	40,980	30.4.2017	By Discount allowed	230
			30.4.2017	By Balance c/d	44,000
		65,480			65,480

Dr. **Total Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.4.2017	To Cash	1,350	1.5.2016	By Balance b/f	7,500
30.4.2017	To Bank	11,250	30.4.2017	By Credit purchases (balancing figure)	15,660
30.4.2017	To Discount received	810			
30.4.2017	To Balance c/d	9,750			
		23,160			23,160

Calculation of Total Sales and Total Purchases : Total Sales = Cash ₹ 8,750 + Credit ₹ 40,980 = ₹ 49,730;
Total Purchases = Cash ₹ Nil + Credit ₹ 15,660 = ₹ 15,660.

Illustration 11

Sri Bose kept his books under Single Entry System. From the following particulars obtained from his books, you are required to calculate : Total Sales and Total Purchases during the year 2016-17.

	₹
Balance as on 1.4.2016 :	
Debtors	56,250
Creditors	43,525
Bills Receivable	30,200
Bills Payable	15,275
Transactions during the year :	
Cash Sales	10,280
Cash Purchases	18,530
Cash paid to Creditors (including ₹ 2,000 for purchase of office furniture)	26,500
Cash received from Debtors	31,960
Discount earned from suppliers	2,325
Bad Debts written off	3,200
Return Inward	2,650
Discount allowed to customers	3,150
Return Outward	2, 000
Payment made against Bills Payable	16,000
Cash received against Bills Receivable	28,300
Balance as on 31.3.2017 :	
Debtors	52,450
Creditors	39,000
Bills Receivable	27,200
Bills Payable	27,900

[C.U.B.Com. (Hons.) — Adapted]

Solution

Dr. **Bills Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Cash A/c	16,000	1.4.2016	By Balance b/d	15,275
31.3.2017	To Balance c/d	27,900		By Total Creditors A/c (Balancing figure)	28,625
		43,900			43,900

Dr. **Total Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 ?	To Cash A/c (₹ 26,500 – 2,000)	24,500	1.4.2016	By Balance b/d	43,525
	To Discount Received A/c	2,325		By Credit Purchases (Balancing figure)	52,925
	To Purchase Returns A/c	2,000			
	To Bills Payable A/c	28,625			
31.3.2017	To Balance c/d	39,000			
		96,450			96,450

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	30,200	?	By Cash A/c	28,300
	To Debtors A/c (Balancing figure)	25,300	31.3.2017	By Balance c/d	27,200
		55,500			55,500

Dr. **Total Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	56,250	?	By Cash A/c	31,960
	To Credit Sales (Balancing figure)	62,460		By Bad Debts A/c	3,200
				By Return Inward A/c	2,650
				By Discount Allowed A/c	3,150
				By Bills Receivable A/c	25,300
			31.3.2017	By Balance c/d	52,450
		1,18,710			1,18,710

(a) Total Sales = Cash Sales + Credit Sales = ₹ 10,280 + ₹ 62,460 = ₹ **72,740**.

(b) Total Purchases = Cash Purchases + Credit Purchases = ₹ 18,530 + ₹ 52,925 = ₹ **71,455**.

Illustration 12

From the following facts supplied by A, who keeps his books on single entry, you are required to calculate Total Purchases and Bills Payable Account:

	₹		₹
Opening balance of Bills payable	5,000	Bills payable discharged during the year	8,900
Opening balance of Creditors	6,000	Cash paid to Creditors during the year	30,200
Closing balance of Bills payable	9,000	Returns outwards	1,200
Closing balance of Creditors	4,000	Cash purchases	25,800

Solution

Dr. **Bills Payable Account** **Cr.**

Particulars	₹	Particulars	₹
To Cash	8,900	By Balance b/f	5,000
To Balance c/d	9,000	By Total creditors (balancing figure)	12,900
	17,900		17,900

Dr. **Total Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Cash	30,200	By Balance b/f	6,000
To Returns outwards	1,200	By Credit purchases (balancing figure)	42,300
To Bills payable (Acceptance given)	12,900		
To Balance c/d	4,000		
	48,300		48,300

Total purchases = Cash ₹ 25,800 + Credit ₹ 42,300 = ₹ 68,100.

Illustration 13

From the following facts supplied by Mr X, who keeps his books on the single entry system, you are required to calculate ''Total Sales'' :

Opening balance of bills receivable ₹ 2,500; Opening balance of sundry debtors ₹ 3,900; Closing balance of bills receivable ₹ 3,500; Closing balance of Sundry debtors ₹ 2,540; Bills receivable encashed during the year ₹ 10,000; Cash received from Debtors during the year (Including ₹ 300 being the sales proceeds of an old typewriter sold on credit received during the year) ₹ 29,000; Returns Inwards ₹ 560; Bad debts written-off ₹ 700; Bills receivable dishonoured ₹ 500; Cash Sales ₹ 7,000.

Solution

Dr. **Bills Receivable Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/f	2,500	By Cash	10,000
To Total Debtors A/c	11,500	By Total Debtors A/c (Bills receivable dishonoured)	500
(Bills receivable recd. during the year — balancing figure)		By Balance c/d	3,500
	14,000		14,000

Dr. **Total Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/f	3,900	By Cash (₹ 29,000 — ₹ 300)	28,700
To Bills Receivable (dishonoured)	500	By Returns Inwards	560
To Credit sales (balancing figure)	39,600	By Bad debts	700
		By Bills Receivable	11,500
		By Balance c/d	2,540
	44,000		44,000

Total sales = Cash ₹ 7,000 + Credit ₹ 39,600 = ₹ 46,600.

Illustration 14

From the following information, calculate Drawings in cash by the proprietor :

Opening cash in hand	10,000	Cash purchases	15,000
Opening cash at bank	5,000	Purchase of furniture (for office use) in cash	600
Cash sales	20,000	Expenses — Cash	1,000
Cash collected from Debtors	50,000	Expenses — Cheque	1,500
Drawings by cheque	5,000	Cash deposited	60,000
Cheque issued to creditors	30,000	Closing cash in hand	12,500
Closing cash at bank	8,500		

Solution

Dr. **Cash Book** **Cr.**

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/f	10,000	5,000	By Drawings		5,000
To Sales	20,000		By Creditors		30,000
To Sundry Debtors	50,000		By Purchases	15,000	
To Cash "C"		60,000	By Office furniture	600	
To Bank "C"	20,000		By Sundry expenses	1,000	1,500
			By Bank "C"	60,000	
			By Cash (balancing) "C"		20,000
			By Drawings (balancing figure)	10,900	
			By Balance c/d	12,500	8,500
	1,00,000	65,000		1,00,000	65,000

Therefore, the drawings for the period is ₹ 10,900 in cash.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 15

Mr. Roy maintained accounts under Single Entry System. On 30.09.2015, the following information were furnished by him :

(i) Bank Statement for the year ended 30.09.2015 :

Particulars	₹	Particulars	₹
To Deposits in Cash	95,820	By Overdraft Balance (01.01.2014)	9,600
		By Personal Drawings	4,800
		By Wages	20,400
		By General Expenses	19,020
		By Interest and Bank Charges	180
		By Payment to Creditors	36,000
		By Balance (30.09.2015)	5,820
	95,820		95,820

(ii) Other balances as on 30.09.2015 : Stock ₹ 24,480; Debtors ₹ 72,000; Creditors ₹ 13,200.

(iii) Collection from Debtors in cash ₹ 60,000.

(iv) Cash Sales ₹ 38,400.

(v) Balance as on 1.10.2014 :

	₹
Debtors	52,800
Creditors	19200
Stock	21,600
Building	36,000
Furniture	2,400
Cash in Hand	200

(vi) He purchased as old machine for ₹ 2,400 in cash on 01.07.2015.

You are required to prepare Trding and Profit and Loss Account for the year ended 30.9.2015 and a Balance Sheet as on that date. Rate of depreciation on all fixed assets to be charged @ 15% p.a.

[C.U.B.Com. (General) — 2016]

Solution

Mr Roy

Dr. **Trading and Profit and Loss Account for the year ended 30th September, 2015** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		21,600	By Sales : Cash	38,400	
To Purchases		30,000	Credit	79,200	1,1,17,600
To Wages		20,400	By Closing Stock		24,480
To Gross Profit c/d		70,080			
		1,42,080			1,42,080

To General Expenses		19,020	By Gross Profit b/d		70,080
To Interest and Bank Charges		180			
To Depreciation on :					
Building	5,400				
Furniture	300				
Machinery	90	5,790			
To Net Profit c/d		45,030			
		70,080			70,080

Balance Sheet of Mr Roy as at 30th September, 2015

Liabilities		₹	Assets		₹
Capital : Opening Balance		84,200	Building	36,000	
Add : Net Profit		45,030	Less: Depreciation	5,400	30,600
		1,29,230	Machinery	2,400	
Less: Drawings		4,800	Less: Depreciation	90	2,310
		1,24,430	Furniture	2,400	
Creditors		13,200	Less: Depreciation	360	2,040
			Stock in Hand		24,480
			Debtors		72,000
			Cash at Bank		5,820
			Cash in Hand		320
		1,27,630			1,27,630

Working Notes :

Dr. **(1) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	36,000	1.10.2014	By Balance b/d	19,200
30.9.2015	To Balance cd	13,200		By Purchases A/c (Cash)	30,000
		49,200			49,200

Dr. **(2) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.10.2014	To Balance b/d	52,800	?	By Cash A/c	60,000
	To Sales (Credit)	73,200		By Balance c/d	72,000
		1,32,000			1,32,000

(3) Balance Sheet as at 1st October, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	84,200	Building	36,000
Creditors	19,200	Furniture	2,400
Bank Overdraft	9,600	Stock	21,600
		Debtors	52,800
		Cash in Hand	200
	1,13,000		1,13,000

Dr. **(4) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.10.2014	To Balance b/d	500	?	By Machinery A/c	2,400
?	To Debtors A/c	60,000	?	By Bank A/c	45,800
?	To Sales (Cash) A/c	38,400	30.9.2015	By Balance c/d	380
		98,600			98,600

Illustration 16

Mr. Ghosh, a retailer, does not keep any books of accounts, but operate a business bank account. A summary of the bank statement for the year ended 31.03.2015 is given below : :

	₹		₹
Opening Balance	5,280	Cash Paid to Creditors	74,500
Cash Received from Debtors	97,000	Salaries	11,000
Closing Balance	4,420	Rent	3,600
		General Expenses	7,000
		Advertisement	600
		Drawings	10,000
	1,06,700		1,06,700

His assets and liabilities on 31st March, 2014 and 2015 were as follows : :

	31.03.2014 ₹	31.03.2015 ₹
Fixed Assets	20,800	20,800
Stock	10,480	12,600
Debtors	13,000	13,600
Rent Prepaid	600	1,200
Creditors	9,200	9,400
Outstanding Advertisement Bill	200	150

Fixed Assets should be depreciated at 10%. Prepare Trading and Profit and Loss Account of Mr. Ghosh for the year ended 31st March, 2015 and a Balance Sheet as at that date.

[C.U.B.Com. (General) — 2015]

Solution

Trading and Profit and Loss Account of Mr. Ghosh for the year ended 31st March, 2015

Particulars	₹	Particulars	₹
To Stock	10,480	By Sales (Note 2)	97,600
To Purchases (Note 3)	74,700	By Stock	12,600
To Gross Profit c/d	25,020		
	1,10,200		1,10,200
To Salaries	11,000	By Gross Profit b/d	25,020
To Rent (Note 4)	3,000		
To General Expenses	7,000		
To Advertisement Expenses	550		
To Depreciation on Fixed Assets @ 10% (Note 5)	2,080		
To Net Profit	1,390		
	25,020		25,020

Balance Sheet of Mr. Ghosh as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital	40,760		Fixed Assets	20,800	
Add: Net Profit	1,390		Less: Depreciation	2,080	18,720
	42,150		Stopck		12,600
Less: Drawings	10,000	32,150	Debtors		13,600
Creditors		9,400	Prepaid Rent		1,200
Outstanding Advertisement Bill		150			
Bank Overdraft		4,420			
		46,120			46,120

Working Notes : (1) Balance Sheet of Mr. Ghosh for the year ended 31st March, 2014

Liabilities	₹	Assets	₹
Creditors	9,200	Fixed Assets	20,800
Outstanding Advertisement Bill	200	Stock	10,480
Capital (Balancing figure)	40,760	Debtors	13,000
		Prepaid Rent	600
		Bank	5,280
	50,160		50,160

Dr. (2) Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	13,000	By Bank A/c	97,000
To Sales (Credit)	97,600	By Balance c/d	13,600
	1,10,600		1,10,600

Dr. (3) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	74,500	By Balance b/d	9,200
To Balance c/d	9,400	By Purchases (Credit)	74,700
	83,900		83,900

(4) Calculation of Rent Expenses

Particulars	₹
Rent paid during the year	3,600
Add: Prepaid of last year	600
	4,200
Less: Prepaid of current year	1,200
Charged to Profit and Loss Account	3,000

(5) Advertisement Expenses

Particulars	₹
Advertisement Expenses paid	600
Add: Outstanding of current year	150
	750
Less: Outstanding of last year	200
Charged to Profit and Loss Account	550

Illustration 17

Ratan Sarkar does not maintain proper books of account. From the following information, prepare Trading and Profit and Loss Acccount for the year ended 31st December, 2013 and a Balance Sheet as on that date:

Assets and Liabilities	On 31.12.2012 ₹	On 31.12.2013 ₹
Debtors	10,000	14,500
Stock	5,500	7,800
Furniture	1,000	1,250
Creditors	4,000	3,500

Analysis of the other transactions are :	₹
Cash collected from Debtors	32,500
Cash paid to Creditors	25,000
Salaries	9,000
Rent	900
Office Expenses	1,200
Drawings	2,000
Fresh Capital Introduced	4,000
Cash Sales	1,500
Cash Purchases	3,000
Discount Received	400
Discount Allowed	250
Return Inward	1,000
Return Outward	500
Bad Debts	250

He had ₹ 4,000 cash at the beginning of the year. Provide depreciation on Furniture @ 10% p.a. Addition of Furniture was made on 31st December, 2013.

[C.U.B.Com. (General) — 2014]

Solution

Trading and Profit and Loss Account of Ratan Sarkar for the year ended 31st December, 2013

Particulars		₹	Particulars		₹
To Stock (1.1.2013)		5,500	By Sales :		
To Purchases :			Cash	1,500	
Cash	3,000		Credit	38,500	
Credit	25,400			40,000	
	28,400		Less: Return Inward	1,000	39,000
Less: Return Outward	500	27,900	By Closing Stock		7,800
To Gross Profit c/d		13,400			
		46,800			46,800
To Salaries		9,000	By Gross Profit b/d		13,400
To Rent		900	By Discount Received		400
To Office Expenses		1,200			
To Discount Allowed		250			
To Bad Debts		250			
To Depreciation on Furniture		100			
To Net Profit — Transferred		2,100			
		13,800			13,800

Balance Sheet of Ratan Sarkar as at 31st December, 2013

Liabilities		₹	Assets		₹
Capital	16,500		Furniture	1,250	
Add: Net Profit	2,100		Less: Depreciation	100	1,150
Add: Further Capital	4,000		Stock		7,800
	22,600		Debtors		14,500
Less: Drawings	2,000	20,600	Cash		650
Creditors		3,500			
		24,100			24,100

Working Notes :

(1) Balance Sheet of Ratan Sarkar as at 31st December, 2012

Liabilities	₹	Assets	₹
Capital (Balancing figure)	16,500	Furniture	1,000
Creditors	4,000	Stock	5,500
		Debtors	10,000
		Cash in Hand	4,000
	20,500		20,500

Dr. (2) Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Cash	32,500
To Sales A/c	38,500	By Discount Allowed	250
		By Return Inward	1,000
		By Bad Debts	250
		By Balance c/d	14,500
	48,500		48,500

Dr. (3) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Cash	25,000	By Balance b/d	4,000
To Discount Received	400	By Purchases	25,400
To Return Outwards	500		
To Balance c/d	3,500		
	29,400		29,400

Dr. (4) Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	4,000	By Creditors	25,000
To Debtors	32,500	By Salaries	9,000
To Capital	4,000	By Rent	900
To Sales	1,500	By Office Expenses	1,200
		By Drawings	2,000
		By Purchases	3,000
		By Furniture (Purchase)	250
		By Balance c/d	650
	42,000		42,000

Illustration 18

The books of Mr Y showed the following figures :

Particulars	31.03.2012 ₹	31.03.2013 ₹
Cash at Bank	3,500	8,500
Cash in Hand	410	850
Stock in Trade	22,500	25,500
Sundry Debtors	18,000	?
Sundry Creditors	8,000	7,300
Bills Payable	20,000	18,000
Furnitures and Fittings	5,000	?
Outstanding Salary	200	?

The cash book analysis showed the following figures amongst others :

Particulars	₹	Particulars	₹
Receipts from Customers	1,05,000	Furniture purchased on 01.10.2012	1,000
Discount allowed to Customers	1,300	Drawings	6,000
Salary up to 31.03.2013	2,600	Payment to Creditors	19,000
Rent	3,600	Discount received from Creditors	2,600
Sundry Trade Expenses	8,500	Payment for Bills Payable	80,000

Depreciation is provided on furniture and fittings @ 10% per annum. No figures are available for total sales. However, Mr Y informs you that he maintains a steady gross profit rate of 25% on sales.

Prepare Mr Y's Trading and Profit and Loss Account for the year ended 31st March, 2013 and a Balance Sheet as on that date.

[C.U.B.Com. (General) — 2013]

Solution **Mr Y**

Trading, Profit and Loss Account for the year ended on 31st March, 2013

Particulars		₹	Particulars	₹
To Opening Stock		22,500	By Sales :	
To Purchases (Note 2)		98,900	Cash (Note 4)	21,140
To Gross Profit (25% of Sales)		31,967	Credit (Note 6)	1,06,727
			By Closing Stock	25,500
		1,53,367		1,53,367
To Discount Allowed		1,300	By Gross Profit	31,967
To Salary	2,600		By Discount Received	2,600
Less: Opening Outstanding	200	2,400		
To Rent		3,600		
To Sundry Trade Expenses		8,500		
To Depreciation on Furniture (₹ 500 + 50)		550		
To Net Profit		18,217		
		34,567		34,567

Balance Sheet of Mr Y as at 31st March, 2013

Liabilities		₹	Assets		₹
Capital :			Furniture and Fittings :		
Opening Balance (Note 1)	21,210		Opening Balance	5,000	
Add: Net Profit	18,217		Purchases	1,000	
	39,427			6,000	
Less: Drawings	6,000	33,427	Less: Depreciation	550	5,450
Bills Payable		18,000	Stock		25,500
Sundry Creditors		7,300	Sundry Debtors (Note 5)		18,427
			Cash at Bank		8,500
			Cash in Hand		850
		58,727			58,727

Working Notes : **(1) Balance Sheet of Mr Y as at 1st April, 2012**

Liabilities	₹	Assets	₹
Capital (Balancing figure)	21,210	Furniture and Fittings	5,000
Creditors	8,000	Stock	22,500
Bills Payable	20,000	Sundry Debtors	18,000
Outstanding Salary	200	Cash at Bank	3,500
		Cash in Hand	410
	49,410		49,410

Dr. **(2) Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Cash / Bank	19,000	1.4.2012	By Balance b/d	8,000
	To Discount Received	2,600	?	By Purchases (Balancing figure)	98,900
	To Bills Payable (Note 3)	78,000			
31.3.2013	To Balance c/d	7,300			
		1,06,900			1,06,900

Dr. **(3) Bills Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Cash / Bank	80,000	1.4.2012	By Balance b/d	20,000
	To Balance c/d	18,000		By Creditors (Balancing figure)	78,000
		98,000			98,000

Dr. **(4) Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2012	To Balance b/d :			By Salaries	2,600
	Bank	3,500		By Rent	3,600
	Cash	410		By Sundry Trade Expenses	8,500
	To Sundry Debtors	1,05,000		By furniture	1,000
	To Sales (Balancing figure)	21,140		By Drawings	6,000
				By Sundry Creditors	19,000
				By Bills Payable	80,000
				By Balance c/d :	
				Bank	8,500
				Cash	850
		1,30,050			1,30,050

Dr. **(5) Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2012	To Balance b/d	18,000		By Cash / Bank	1,05,000
	To Sales (Note 6)	1,06,727		By Discount Allowed	1,300
			31.3.2013	By Balance c/d (Balancing figure)	18,427
		1,24,727			1,24,727

(6) Cost of Goods Sold and Credit Sales

Opening Stock	22,500
Add: Purchases	98,900
	1,21,400
Less: Closing Stock	25,500
Cost of Goods Sold	95,900
Profit — (25% on Sales or 1/3 of Cost of Goods Sold)	31,967
Total Sales	1,27,867

Credit Sales = Total Sales – Cash Sales
= ₹ 1,27,867 – ₹ 21,140 (Note 4)
= ₹ **1,06,727**

Illustration 19

The following balances are extracted from the books of Mr S for the year ended 31.12.2011 :

	01.01.2011 (₹)	31.12.2011 (₹)
Stock	15,000	?
Debtors	40,000	60,000
Creditors	20,000	40,000

(i) During the year, he paid his creditors ₹ 60,000 and received from debtors ₹ 90,000.
(ii) Bad debts written off ₹ 5,000.
(iii) Discount received from creditors ₹ 1,000.
(iv) Cash sales are 20% of total sales.
(v) Credit purchases are 75% of total purchases.
(vi) Rate of gross profit 20% of sales.

Calculate **:**
(a) Total Sales; (b) Total Purchases; and
(c) Value of stock on 31.12.2011. ***[C.U.B.Com. (General) — 2012]***

Solution

Dr. **Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2011	To Balance b/d	40,000	?	By Cash A/c	90,000
	To Sales (Credit)	1,15,000		By Bad Debts A/c	5,000
			31.12.2011	By Balance c/d	60,000
		1,55,000			1,55,000

Dr. **Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Cash A/c	60,000	1.1.2011	By Balance b/d	20,000
	To Discount Received A/c	1,000		By Purchases A/c (Credit)	81,000
	To Balance c/d	40,000			
		1,01,000			1,01,000

Working Notes :

(a) Calculation of Total Sales

	₹
Credit Sales (as per Debtors Account)	1,15,000
Add: Cash Sales [₹ 1,15,000 ÷ 80% × 20%]	28,750
Total Sales	1,43,750

(b) Calculation of Total Purchases

Credit Purchases (as per Creditors Account)	81,000
Add: Cash Purchases [₹ 81,000 ÷ 75% × 25%]	27,000
Total Purchases	1,08,000

(c) Calculation of Closing Stock

Opening Stock	15,000
Add: Total Purchases	1,08,000
	1,23,000
Less: Cost of Goods Sold [1,43,750 × 80%]	1,15,000
Closing Stock	8,000

Illustration 20

Mr. Z keeps his books under Single Entry System. He furnishes the following information for the year ended 31.12.2010:

(i) Cash Collection from Debtors ₹ 30,000

(ii) Cash Sales ₹ 19,200

(iii) The Bank transactions for the year ended 31.12.2010 are as below :

Particulars	₹	Particulars	₹
Cash Deposits out of Collections	47,910	Overdraft as on 1.1.2010	4,800
		Interest and Bank Charges	90
		Personal Drawings	2,400
		Salaries to Staff	10,200
		General Expenses	9,510
		Payment to Creditors	18,000
		Balance on 31.12.2010	2,910
	47,910		47,910

(iv) Other balances as on 1.1.2010 were : Stock ₹ 10,800; Debtors ₹ 26,400; Furniture ₹ 1,200; Buildings ₹ 18,000; Creditors ₹ 9,600; Cash in hand ₹ 100.

(v) He purchased one old machine for ₹ 1,200 on 1.10.2010.

(vi) Besides the cash balance with the cashier, the following are the other balances on 31.12.2010 : Stock ₹ 12,240; Debtors ₹ 36,000; Creditors ₹ 6,600.

Prepare Trading and Profit and Loss Account for the year ended 31.12.2010 and the Balance Sheet as on that date. Provide depreciation @ 10% p.a. on all fixed assets.

[C.U.B.Com. (General) — 2011]

Solution

Working Notes :

Dr. **(1) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Balance b/d	26,400	?	By Cash A/c (Collection)	30,000
?	To Credit Sales (during the year)	39,600	31.12.2010	By Balance c/d	36,000
		66,000			66,000

Dr. **(2) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c (Payments)	18,000	1.1.2010	By Balance b/d	9,600
31.12.2010	To Balance c/d	6,600	?	By Purchases A/c (Credit Purchases)	15,000
		24,600			24,600

Dr. (3) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Balance b/d	100	?	By Machinery	1,200
?	To Sales A/c (Cash Sales)	19,200	?	By Bank A/c (Deposit)	47,910
?	To Debtors A/c (Collection)	30,000	31.12.2010	By Balance c/d (Closing balance)	190
		49,300			49,300

(4) Balance Sheet as at 1.1.2010

Liabilities	₹	Assets	₹
Capital (Balancing figure)	42,100	Stock	10,800
Bank O/D	4,800	Debtors	26,400
Creditors	9,600	Furniture	1,200
		Buildings	18,000
		Cash	100
	56,500		56,500

(5) Depreciation for the year ended 31.12.2010

Particulars	Furniture	Buildings	Old Machine
1.1.2010 Balance	1,200	18,000	—
1.10.2010 Purchase	—	—	1,200
31.12.2010 Depreciation @ 10% p.a.	120	1,800	30
	1,080	16,200	1,170

Dr. Trading and Profit and Loss Account for the year ended 31.12.2010 Cr.

Particulars		₹	Particulars			₹
To Opening Stock		10,800	By Sales			
To Purchases (Note 2)		15,000	Cash		19,200	
To Gross Profit c/d		45,240	Credit (Note 1)	39,600		58,800
			By Closing Stock			12,240
		71,040				71,040
To Interest and Bank Charges		90	By Gross Profit b/d			45,240
To Staff Salaries		10,200				
To General Expenses		9,510				
To Depreciation on Fixed Assets (Note 5) :						
Furniture	120					
Buildings	1,800					
Machine	30	1,950				
To Capital A/c (Net Profit transferred)		23,490				
		45,240				45,240

Balance Sheet as at 31.12.2010

Liabilities	₹	Assets	₹
Capital	42,100	Building	16,200
Add: Net Profit	23,490	Machinery	1,170
	65,590	Furniture	1,080
Less: Drawings	2,400	Closing Stock	12,240
	63,190	Debtors	36,000
Creditors	6,600	Bank	2,910
		Cash	190
	69,790		69,790

[For Honours Candidates Only]

Illustration 21

Mr. Mukherjee kept his books under Single Entry System. The following particulars are obtained from his books. You are required to preapre Trading and Profit and Loss Account for the year ended 31.12.2015 and a Balance Sheet as on that date :

	31.12.2014 (!)	31.12.2015 ()₹)
Debtors	18,000	25,000
Stock	9,800	13,200
Furniture	1,000	1,500
Creditors	6,000	4,500

Cash balances as on 1.1.2015 ₹ 5,000.

The following transactions taken place during 2015 are also to be taken into consideration :	₹
Cash collected from Debtors	60,800
Cash paid to Creditors	44,000
Salaries	12,000
Rent	1,500
Office Expenses	1,800
Drawings	3,000
Fresh Capital Introduced	2,000
Cash Purchases	5,000
Cash Sales	1,500
Discount Received	700
Discount Allowed	300
Return Inward	1,000
Return Outward	800
Bad Debts	200

[C.U.B.Com. (Hons.) — 2016]

Solution

Mr Mukherjee

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		92,000	By Sales : Cash	1,500	
To Purchases : Cash	5,000		Credit (Note 2)	69,300	
Credit (Note 1)	44,000			70,800	
	49,000		Less: Returns Inward	1,600	69,200
Less: Returns Outward	800	48,200	By Closing Stock		13,200
To Gross Profit c/d		25,000			
		83,000			83,000
To Salaries		12,000	By Gross Profit bd		25,000
To Rent		1,500	By Discount Received		700
To Office Expenses		1,800			
To Discount Allowed		300			
To Bad Debts		200			
To Net Profit (Transferred to Capital)		9,900			
		25,700			25,700

Balance Sheet of Mr Mukherjee as at 31st December, 2015

Liabilities	₹	Assets	₹
Capital : Opening Balance (Note 3)	27,800	Furniture	1,000
Add: Capital Introduced	2,000	Stock	13,200
	29,800	Debtors	25,000
Net Profit	9,900	Cash (Note 4)	1,500
	39,700		
Less: Drawings	3,000		
	36,700		
Creditors	4,500		
	41,200		41,200

Working Notes :

Dr. **(1) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Cash A/c	44,000	1.1.2015	By Balance b/d	6,000
	To Discount Received	700		By Credit Purchases (Balancing figure)	44,000
	To Returns Outwards	800			
31.12.2015	To Balance cd	4,500			
		50,000			50,000

Dr. **(2) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	18,000		By Cash A/c	60,800
	To Credit Sales (Balancing figure)	69,300		By Discount Allowed A/c	300
				By Return Inward A/c	1,000
				By Bad Debts	200
			31.12.2015	By Balance c/d	25,000
		87,300			87,300

(3) Balance Sheet as at 1st January, 2015

Liabilities	₹	Assets	₹
Capital (Balancing figure)	27,800	Furniture	1,000
Creditors		Stock	9,800
	6,000	Debtors	18,000
		Cash	5,000
	33,800		33,800

Dr. **(4) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	5,000		By Creditors A/c	44,000
	To Debtors A/c	60,800		By Salaries A/c	12,000
	To Capital	2,000		By Rent a/c	1,500
	To Sales	1,500		By Office Expenses A/c	1,800
				By Drawings A/c	3,000
				By Purchases A/c	5,000
				By Furniture A/c	500
			31.12.2015	By Balance c/d	1,500
		69,200			69,200

Illustration 22

Mr. S Sarkar keeps the books of account under single entry system. On 31st March, 2014 his Statement of Affairs stood as follows :

Liabilities	₹	Assets	₹
Trade Creditors	3,48,000	Furniture and Fixtures	60,000
Bills Payable	75,000	Stock	3,66,000
Outstanding Expenses	27,000	Trade Debtors	88,000
Capital Account	1,50,000	Bills Receivable	36,000
		Unexpired Insurance	2,000
		Cash in Hand and at Bank	48,000
	6,00,000		6,00,000

The following was the summary of Cash Book for the year ended on 31st March, 2015 :

Receipts	₹	Payments	₹
Cash in Hand and at Bank on 1.4.2014	48,000	Payment to Trade Creditors	45,04,000
Cash Sales	44,28,600	Payment for Bills Payables	4,90,000
Receipts from Trade Debtors	9,06,400	Sundry Expenses Paid	3,72,400
Receipts from Bills Receivables	2,07,000	Drawings	1,46,000
		Cash in Hand and at Bank on 31.3.2015	77,600
	55,90,000		55,90,000

Discount allowed to Trade Debtors and received from Trade Creditors amounted to ₹ 21,000 and ₹ 16,800 respectively. Bills Receivable endorsed amounted to ₹ 10,000. Annual fire insurance premium of ₹6,000 was paid every year on 1st August for renewal of the policy. Furniture and Fixtures were subject to depreciation @ 15% p.a. on W.D.V. method.

You are also informed about the following balances as on 31.3.2015 :	₹
Stock	3,94,000
Trade Debtors	91,000
Bills Receivable	45,000
Bills Payable	86,000
Outstanding Expenses	4,500

Mr. Sakar maintains a steady gross profit ratio of 10% on Sales.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — 2015]

Solution

Trading and Profit and Loss Account of Mr. S Sarkar for the year ended 31st March, 2015

Particulars		₹	Particulars		₹
To Stock		3,66,000	By Sales :		
To Purchases (Balancing figure)		50,54,500	Cash	44,28,600	
To Gross Profit c/d (10% of ₹ 55,85,000)		5,58,500	Credit	11,56,400	55,85,000
			By Closing Stock		3,94,000
		59,79,000			59,79,000
To Discount Allowed		21,000	By Gross Profit b/d		5,58,500
To Depreciation on Furniture @ 15%		9,000	By Discount Received		16,800
To Sundry Expenses Paid	3,72,400				
Less: Opening Outstanding	(27,000)				
Add: Closing Outstanding	4,500	3,49,900			
To Insurance Premium (See Tutorial Note)		6,000			
To Net Profit		1,89,400			
		5,75,300			5,75,300

Balance Sheet of Mr S Sarkar as at 31st March, 2015

Liabilities			₹	Assets			₹
Capital	1,50,000			Furniture	60,000		
Add: Net Profit		1,89,400		Less: Depreciation @ 15%		9,000	51,000
		3,39,400		Stock			3,94,000
Less: Drawings		1,46,000	1,93,400	Trade Debtors			91,000
Trade Creditors			3,70,700	Bills Receivable			45,000
Bills Payable			86,000	Unexpired Insurance Premium (April to July)			2,000
Outstanding Expenses			4,500	Bank and Cash			77,600
Creditors for Expenses (Note 5)			6,000				
			6,60,600				6,60,600

Working Notes :

(1) Trade Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	88,000	By Cash A/c	9,06,400
To Sales (Credit) (Balancing figure)	11,56,400	By Discount Allowed A/c	21,000
		By Bills Receivable A/c	2,26,000
		By Balance c/d	91,000
	12,44,400		12,44,400

(2) Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d	36,000	By Cash A/c	2,07,000
To Trade Debtors A/c (Balancing figure)	2,26,000	By Trade Creditors A/c (Endorsed)	10,000
		By Balance c/d	45,000
	2,62,000		2,62,000

(3) Trade Creditors Account

Particulars	₹	Particulars	₹
To Cash / Bank A/c	45,04,000	By Balance b/d	3,48,000
To Discount Received a/c	16,800	By Purchases	50,54,500
To Bills Receivable A/c (Endorsed)	10,000		
To Bills Payable	5,01,000		
To Balance c/d (balancing figure)	3,70,700		
	54,02,500		54,02,500

(4) Bills Payable Account

Particulars	₹	Particulars	₹
To Bank / Cash A/c	4,90,000	By Balance b/d	75,000
To Balance c/d	86,000	By Trade Creditors (Balancing figure)	5,01,000
	5,76,000		5,76,000

(5) It has been given in the Question that ₹ 6,000 was paid every year for renewal of insurance policy. However, in the summary of Cash Book (payment side) this is not reflected. Therefore, it is assumed that the amount of premium ₹ 6,000 was paid by the insurance agent on behalf of Mr. Sarkar. So, it has been treated as 'Creditors for Expenses'.

Tutorial Note :

Insurance policy is for 12 months. It is renewed on 1st August. It means 4 months (April to July) insurance premium will be treated as unexpired. The amount will be $\frac{6,000}{12} \times 4$ = ₹ **2,000**.

Last year's unexpired premium was ₹ 2,000. This will be treated as expenses of current year. Therefore, current year's insurance premium expense will be : ₹ 2,000 + (6,000 – 2,000) = ₹ **6,000**.

Illustration 23

Mr. P.K. Banerjee kept no books of accounts for his business. An analysis of his rough Cash Book for the calendar year 2013 shows the following particulars :

Receipts	₹	Payments	₹
Received from Debtors	80,000	Overdraft on 1.1.2013	5,000
Further Capital Introduced	10,000	Paid to Creditors	42,000
		Business Expenses	12,000
		Wages paid	17,500
		Proprietor's Drawings	5,000
		Balance at Bank on 31.12.20013	6,500
		Cash in Hand on 31.12.2013	2,000
	90,000		90,000

The following particulars are also available :

	31.12.2012	31.12.2013
Debtors	60,000	90,000
Creditors	20,000	22,500
Stock in trade	16,000	18,000
Plant and Machinery	30,000	30,000
Furniture	2,000	2,000

All his sales and purchases were on credit. From the above particulars, prepare Trading and Profit and Loss Account for the year ended 31st December, 2013 and a Balance Sheet as at that date. Provide depreciation on Plant and Machinery @ 10% p.a. and on Furniture @ 5% p.a. ***[C.U.B.Com. (Hons.) — 2014]***

Solution

Dr. Trading and Profit and Loss Account for the year ended 31.12.2013 Cr.

Particulars	₹	Particulars	₹
To Stock -in-Trade	16,000	By Sales (Note 1)	1,10,000
To Purchases (Note 2)	44,500	By Closing Stock	18,000
To Wages	17,500		
To Gross Profit c/d	50,000		
	1,28,000		1,28,000
To Business Expenses	12,000	By Gross Profit b/d	50,000
To Depreciation on Machinery	3,000		
To Depreciation on Furniture	100		
To Net Profit	34,900		
	50,000		50,000

Balance Sheet as at 31.12.2013

Liabilities		₹	Assets		₹
Capital	83,000		Plant and Machinery	30,000	
Add: Net Profit	34,900		Less: Depreciation	3,000	27,000
	1,17,900		Furniture	2,000	
Less: Drawings	5,000		Less: Depreciation	100	1,900
	1,12,900		Stock		18,000
Add: Further Capital Introduced	10,000	1,22,900	Debtors		90,000

Creditors	22,500	Bank Cash	6,500 2,000
	1,45,400		1,45,400

Working Notes :

Dr. (1) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	60,000		By Cash A/c	80,000
	To Credit Sales (Balancing figure)	1,10,000	31.12.2013	By Balance c/d	90,000
		1,70,000			1,70,000

Dr. (2) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Cash A/c	42,000		By Balance b/d	20,000
	To Balance c/d	22,500	31.12.2013	By Credit Purchase (Balancing figure)	44,500
		64,500			64,500

(3) Balance Sheet as at 31.12.2012

Liabilities	₹	Assets	₹
Capital (Balancing figure)	83,000	Debtors	60,000
Creditors	20,000	Stock-in-Trade	16,000
Bank O/D	5,000	Plant and Machinery	30,000
		Furniture	2,000
	1,08,000		1,08,000

Illustration 24

From the information given below, prepare a Trading and Profit and Loss Account for the year ended 30th June, 2012 and a Balance Sheet as at that date :

	Balances on 1.7.2011	Balances on 30.6.2012
Debtors	16,000	14,800
Creditors for Purchases	6,000	4,800
Outstanding Rent	100	60
Cash	1,500	6,500
Stock	15,000	16,000
Plant	10,000	12,000

(i) Cah transactions :

Receipts : Cash sales ₹ 1,000 : Debtors ₹ 71,000

Payments : Purchases of plant	2,000
Rent	1,240
Cash purchases	2,000
Payment to creditors	31,200
Salaries	20,000
Wages	6,000
Electricity	2,000

(ii) Shortage in cash balance is to be treated as drawings.

(iii) Bad debts written off ₹ 200.

(iv) Depreciation on plant has to be provided at 10%. ***[C.U.B.Com. (Hons.) — 2013]***

Answer Trading, Profit and Loss Account for the year ended 30th June, 2012

Particulars	₹	Particulars	₹
To Opening Stock	15,000	By Sales :	
To Purchases :		Cash	1,000
Cash	2,000	Credit (Note 2)	70,000
Credit (Note 3)	30,000	By Closing Stock	16,000
To Wages	6,000		
To Gross Profit c/d	34,000		
	87,000		87,000

To Rent	1,240		By Gross Profit b/d	34,000
Add: Outstanding (Closing)	60			
	1,300			
Less: Outstanding (Opening)	100	1,200		
To Salaries		20,000		
To Electricity		2,000		
To Bad Debts		200		
To Depreciation on Plant (Note 5)		1,200		
To Net Profit		9,400		
		34,000		34,000

Balance Sheet as at 30th June, 2012

Liabilities	₹	Assets		₹
Capital (Note 1)	36,400	Plant	12,000	
Add: Net Profit	9,400	Less: Depreciation	1,200	10,800
	45,800	Stock		16,000
Less: Drawings	2,560	Debtors		14,800
	43,240	Cash		6,500
Creditors for Purchases	4,800			
Outstanding Rent	60			
	48,100			48,100

Working Notes :

(1) Opening Balance Sheet as at 1st July, 2011

Liabilities	₹	Assets	₹
Capital (Balancing figure)	36,400	Plant	10,000
Creditors for Purchases	6,000	Stock	15,000
Outstanding Rent	100	Debtors	16,000
		Cash	1,500
	42,500		42,500

Dr. (2) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	16,000		By Cash	71,000
	To Sales (Balancing figure)	70,000		By Bad Debts	200
				By Balance c/d	14,800
		86,000			86,000

Dr. (3) Creditors for Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Cash	31,200		By Balance b/d	6,000
	To Balance c/d	4,800		By Purchases (Balancing figure)	30,000
		36,000			36,000

Dr. (4) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,500		By Plant	2,000
	To Cash Sales	1,000		By Rent	1,240
	To Debtors	71,000		By Purchases	2,000
				By Creditors	31,200
				By Salaries	20,000
				By Wages	6,000
				By Electricity	2,000
				By Drawings (Balancing figure)	2,560
				By Balance c/d	6,500
		73,500			73,500

(5) Depreciation on Plant is to be charged @ 10% and not 10% p.a. Therefore, full depreciation has been charged for the Plant purchased during the year.

Special Problems

Illustration 25

Mr Sen did not keep the books of accounts of his business in double entry system. But he maintained the following record of cash transactions :

Receipts	₹	Payments	₹
Opening (1.1.2016) :		Purchase	30,000
Cash in Hand	30,000	Payment to Creditors	45,000
Cash at Bank	40,000	Wages	20,000
Sales	80,000	Salary	22,000
Collection from Debtors	75,000	Rent	6,000
Sale of Furntirue	5,000	Outstanding rent of last year	2,000
		Selling Expenses	3,000
		Closing (31.12.2016) :	
		Cash in Hand	12,000
		Cash at Bank	90,000
	2,30,000		2,30,000

The following information is also received :

Particulars	On 31.12.2015 ₹	On 31.12.2016 ₹
Debtors	60,000	75,000
Creditors	20,000	15,000
Stock-in-trade	13,000	18,000
Machinery	80,000	80,000
Furntirue	30,000	17,000

Furniture was sold on 1 January, 2016 and on the same date Mr Sen took furniture worth ₹ 5,000 for his personal use. Depreciation on machinery and furniture was charged @ 10% per annum. Debt of ₹ 1,000 became bad.

Prepare Trading and Profit and Loss Account for the year ended 31 December, 2016 and Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Mr Sen

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

Particulars		₹	₹	Particulars		₹	₹
To Opening Stock			13,000	By Sales :	Cash	80,000	
To Purchases :	Cash	30,000			Credit (Note 2)	91,000	1,71,000
	Credit (Note 1)	40,000	70,000	By Closing Stock			18,000
To Wages			20,000				
To Gross Profit c/d			86,000				
			1,89,000				1,89,000
To Salary			22,000	By Gross Profit b/d			86,000
To Rent			6,000				
To Selling Expenses			3,000				
To Bad Debts			1,000				
To Loss on Sale of Furniture (Note 4)			3,000				
To Depreciation :							
	Furniture (Note 5)	1,700					
	Machinery	8,000	9,700				
To Net Profit c/d			41,300				
			86,000				86,000

Balance Sheet of Mr Sen as at 31st December, 2016

Liabilities	₹	Assets		₹
Capital : Opening Balance (Note 3)	2,31,000	Machinery	80,000	
Add: Net Profit	41,300	Less: Depreciation	8,000	72,000
	2,72,300	Furniture	17,000	
Less: Drawings (Furniture taken over)	5,000	Less: Depreciation	1,700	15,300
	2,67,300	Debtors		75,000

Creditors	15,000	Stock	18,000
		Bank	90,000
		Cash	12,000
	2,82,300		2,82,300

Working Notes :

Dr. **(1) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Cash A/c	45,000	1.1.2016	By Balance b/d	20,000
31.12.2016	To Balance c/d	15,000		By Purchases A/c (Balancing figure)	40,000
		60,000			60,000

Dr. **(2) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	60,000	2016 ?	By Cash A/c	75,000
	To Sales A/c (Balancing figure)	91,000		By Bad Debts A/c	1,000
			31.12.2016	By Balance c/d	75,000
		1,51,000			1,51,000

(3) Balance Sheet of Mr Sen as at 1st January, 2016

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,31,000	Machinery	80,000
Creditors	20,000	Furniture	30,000
Outstanding Rent (Last year's)	2,000	Debtors	60,000
		Stock	13,000
		Bank	40,000
		Cash	30,000
	2,53,000		2,53,000

(4) Loss on Sale of Furniture

Cost of furniture sold ₹ 30,000 – ₹ (17,000 + 5,000) = ₹ 8,000.

Loss on sale = ₹ (8,000 – 5,000) = ₹ 3,000.

(5) Depreciation on Furniture = 10% of ₹ 17,000 = ₹ 1,700.

Illustration 26

Mr X carries on a small business, but he does not maintain a complete set of books of accounts. He banks all receipts and makes all payments only by means of cheques. He maintains properly a Cash Book, a Sales Ledger and a Purchase Ledger. He also makes a proper record of the assets and liabilities as at the close of every accounting year. From such records you are able to gather the following facts :

Receipts for the year ended March 31, 2017 :	₹
From Sundry Debtors (Sales Ledger Account)	17,625
Cash Sales	4,125
Paid in by Mr X, the proprietor	2,500
Payments made in the year ended March 31, 2017 :	
New Furniture Purchased	625
Drawings	1,500
Wages	6,725
Salaries	1,125
Interest paid	75
Telephone	125
Rent	1,200
Light and Power	475
Sundry Expenses	2,125
Sundry Creditors (Purchase Ledger Accounts)	7,625

Assets and Liabilities:

Particulars	As on 31.3.2016 ₹	As on 31.3.2017 ₹
Purchase Ledger Balance (Creditors)	2,525	2,400
Sales Ledger Balance (Debtors)	3,750	6,125
Bank	625	—
Stock	6,250	3,125
Furniture	7,500	7,315

From the above data prepare the Trading and Profit and Loss Account for the year ended 31st March, 2017 and the Balance Sheet as on that date. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

X

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

Particulars	₹	Particulars			₹
To Opening Stock	6,250	By Sales :	Cash	4,125	
To Purchases (Note 1)	7,500		Credit	20,000	24,125
To Wages	6,725	By Closing Stock			3,125
To Light and Power (Note 6)	475				
To Gross Profit c/d	6,300				
	27,250				27,250
To Salaries	1,125	By Gross Profit b/d			6,300
To Sundry Expenses	2,125				
To Telephone	125				
To Interest	75				
To Rent	1,200				
To Depreciation on Furniture (Note 5)	810				
To Net Profit (Transferred to Capital)	840				
	6,775				6,775

Balance Sheet of X as at 31st March, 2017

Liabilities	₹	Assets	₹
Opening Capital (Note 4)	15,600	Furniture	7,315
Less: Capital introduced	2,500	Stock	3,125
Net Profit	840	Sales Ledger Balance (Debtors)	6,125
	18,940	Bank (Note 3)	3,275
Less: Drawings	1,500		
	17,440		
Purchases Ledger Balance (Creditors)	2,400		
	19,840		19,840

Working Notes :

Dr. (1) Purchases Ledger Control (Creditors) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Bank A/c	7,625	1.4.2016	By Balance b/d	2,525
31.3.2017	To Balance c/d	2,400	?	By Purchases A/c (Balancing figure)	7,500
		10,025			10,025

Dr. (2) Sales Ledger Control (Debtors) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	3,750	2016 ?	By Bank A/c	17,625
	To Sales A/c (Balancing figure)	20,000	31.3.2017	By Balance c/d	6,125
		23,750			23,750

Dr. (3) Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Opening balance	625	1.4.2016	By Furniture A/c	625
	To Debtors A/c	17,625		By Drawings A/c	1,500
	To Sales A/c	4,125		By Wages A/c	6,725
	To Capital A/c	2,500		By Salaries A/c	1,125
				By Interest A/c	75

				By Telephone A/c	125
				By Rent A/c	1,200
				By Light and Power A/c	475
				By Sundry Expenses A/c	2,125
				By Sundry Creditors A/c	7,625
				By Balance c/d	3,275
		24,875			24,875

Balance Sheet of X as at 1st April, 2017

Liabilities	₹	Assets	₹
Capital (Balancing figure)	15,600	Furniture	7,500
Purchase Ledger Control (Creditors)	2,525	Stock	6,250
		Sales Ledger Control (Debtors)	3,750
		Bank	625
	18,125		18,125

(5) Depreciation on Furniture

	₹
Opening balance	7,500
Add: Purchases	625
	8,125
Less: Closing balance	7,315
	810

(6) It is assumed that light and power is direct in nautre.

Illustration 27

Lucky does not maintain a proper books of account. However, he maintains a record of his bank transactions and is also to give the following information from which you are requested to prepare his final accounts for the year 2016 :

Particulars	1.1.2016 (₹)	31.12.2016 (₹)
Debtors	1,02,500	?
Creditors	?	46,000
Stock	50,000	62,500
Bank Balance	?	50,000
Fixed Assets	7,500	9,000

Details of his bank transactions were as follows :

Particulars	₹
Received from Debtors	3,40,000
Additional Capital Brought in	5,000
Sale of Fixed Assets (Book value ₹ 2,500)	1,750
Paid to Creditors	2,80,000
Expenses Paid	49,250
Personal Drawings	25,000
Purchase of Fixed Assets	5,000

No cash transactions took place during the year. Goods are sold at cost plus 25%. Cost of goods sold was ₹ 2,60,000.

Solution

Lucky

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

Particulars	₹	Particulars	₹
To Opening Stock	50,000	By Sales A/c (Note 6)	3,25,000
To Purchases (Note 7)	2,72,500	By Closing Stock	62,500
To Gross Profit c/d	65,000		
	3,87,500		3,87,500
To Expenses	49,250	By Gross Profit b/d	65,000
To Depreciation on Fixed Assets	1,000		
To Loss on Sale of Fixed Assets	750		
To Net Profit c/d	14,000		
	65,000		65,000

Balance Sheet of Lucky as at 31st December, 2016

Liabilities	₹	Assets	₹
Capital Account :		Fixed Assets	9,000
Opening Balance (Note 7)	1,69,000	Stock	62,500
Add: Capital Introduced	5,000	Debtors (Note 3)	87,500
Add: Net Profit	14,000	Bank	50,000
	1,88,000		
Less: Drawings	25,000		
	1,63,000		
Creditors	46,000		
	2,09,000		2,09,000

Working Notes :

Dr. **(1) Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (Balancing figure)	62,500	By Creditors A/c	2,80,000
To Debtors A/c	3,40,000	By Expenses A/c	49,250
To Capital A/c	5,000	By Drawings A/c	25,000
To Fixed Assets A/c (Sale)	1,750	By Fixed Assets A/c (Purchases)	5,000
		By Balance c/d	50,000
	4,09,250		4,09,250

Dr. **(2) Fixed Assets Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	7,500	By Bank A/c	1,750
To Bank A/c	5,000	By Loss on Sale of Fixed Assets A/c	750
		By Depreciation A/c (Balancing figure)	1,000
		By Balance c/d	9,000
	12,500		12,500

Dr. **(3) Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,02,500	By Bank A/c	3,40,000
To Sales A/c (Note 6)	3,25,000	By Balance c/d (Balancing figure)	87,500
	4,27,500		4,27,500

Dr. **(4) Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	2,80,000	By Balance b/d (Balancing figure)	53,500
To Balance c/d	46,000	By Purchases A/c (Note 7)	2,72,500
	3,26,000		3,26,000

(5) Balance Sheet as at 1st January, 2016

Liabilities	₹	Assets	₹
Capital (Balancing figure)	1,69,000	Fixed Assets	7,500
Creditors (Note 4)	53,500	Debtors	1,02,500
		Stock	50,000
		Bank (Note 1)	62,500
	2,22,500		2,22,500

(6) Calculation of Sales

	₹
Cost of goods sold	2,60,000
Profit 25%	65,000
Sales	3,25,000

(7) Opening Stock + Purchases – Closing Stock = Cost of Goods sold
or, Purchases = Cost of Goods Sold – Opening Stock + Closing Stock
or, Purchases = ₹ 2,60,000 – ₹ 50,000 + ₹ 62,500 = ₹ **2,72,500**.

Illustration 28

P maintains accounts under single entry system and furnishes the following information for the year ending 31.12.2001 (all figures in ₹) :

Date	Bank	Stock	Debtors	Furniture (after depreciation)	Building	Creditors
1.1.2001	28,000	30,000	45,000	15,000	1,50,000	32,000
31.12.2001	?	40,000	33,000	18,000	?	36,000

Cost of goods sold during the year was ₹ 3,60,000, which constituted 75% of the sales for the year. The rate of gross profit is 25% on sales.

All purchases and sales are on credit and amounts received from customers and payments to suppliers are by cheques. P realised ₹ 10,000 in cash on the sale of scrap from which he paid ₹ 6,000 as freight on purchases and the balance was retained for his personal use.

Details of his other transactions with the bank are as under :

Receipts

Capital invested ₹ 1,50,000; Sale of furniture (book value ₹ 1,000) ₹ 800.

Payments

10% Govt. Bonds (face value ₹ 1,40,000 purchased on 1.7.2001) ₹ 1,50,000; Salaries ₹ 60,000; Taxes (11 months ending 30.11.2001) ₹ 11,000; Printing and stationery ₹ 7,800; Miscellaneous expenses ₹ 12,000; Drawings ₹ 26,000.

Bad Debts written-off during the year were ₹ 7,000. Furniture has been depreciated by 10% and Building is to be depreciated by 2%.

The shop assistant is entitled to a commission of 10% of net profit after charging his commission.

Prepare Trading and Profit and Loss Account for the year ending 31.12.2001 and Balance Sheet as on that date.

[I.C.W.A. (Foundation) — Dec., 2002]

Solution

P

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2001 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		30,000	By Sales (₹ 3,60,000 / 75%)	4,80,000
To Purchases (Balancing figure)		3,64,000	By Closing Stock	40,000
To Freight on Purchases		6,000		
To Gross Profit c/d (25% of ₹ 4,80,000)		1,20,000		
		5,20,000		5,20,000
To Salaries		60,000	By Gross Profit b/d	1,20,000
To Taxes	11,000		By Sale of Scrap	10,000
Add: Outstanding	1,000	12,000	By Interest on Investments	
To Printing and Stationery		7,800	(@ 10% p.a. on ₹ 1,40,000 for 6 months)	7,000
To Miscellaneous Expenses		12,000		
To Bad Debts		7,000		
To Loss on Sale of Furniture (₹ 1,000 – 800)		200		
To Depreciation on :				
Furniture (Note 3)	2,000			
Building	3,000	5,000		
To Commission to Shop Assistant (Note 6)		3,000		
To Net Profit — transferred to Capital		30,000		
		1,37,000		1,37,000

Balance Sheet of P as at 31st December, 2001

Liabilities	₹	Assets		₹
Capital : Opening balance (Note 5)	2,36,000	Building	1,50,000	
Add: Introduced	1,50,000	Less: Depreciation	3,000	1,47,000
Net Profit	30,000	Furniture	15,000	
	4,16,000	Less: Sold	1,000	
Less: Drawings (₹ 26,000 + 4,000)	30,000		14,000	
	3,86,000	Add: Purchased	6,000	
Outstanding Shop Assistant's Commission	3,000		20,000	
Creditors	36,000	Less: Depreciation	2,000	18,000
Outstanding Taxes	1,000	Investments (10% of Govt. Bonds — face value ₹ 1,40,000)		1,50,000
		Stock		40,000

		Debtors	33,000
		Bank (Note 4)	31,000
		Outstanding Interest on Investment	7,000
	4,26,000		4,26,000

Working Notes :

Dr. (1) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
?	To Bank A/c (Balancing figure)	3,60,000	Jan. 1	By Balance b/d	32,000
Dec. 31	To Balance c/d	36,000	?	By Purchases A/c	3,64,000
		3,96,000			3,96,000

Dr. (2) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	45,000	?	By Bank A/c (Balancing figure)	4,85,000
?	To Sales A/c	4,80,000	?	By Bad Debts A/c	7,000
			Dec. 31	By Balance c/d	33,000
		5,25,000			5,25,000

Dr. (3) Furniture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	15,000	?	By Bank A/c	800
?	To Bank A/c (Purchases)	6,000	?	By Profit and Loss A/c (Loss)	200
			?	By Depreciation A/c (₹ 18,000 / 9)	2,000
			Dec. 31	By Balance c/d	18,000
		21,000			21,000

Dr. (4) Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	28,000	?	By Investments A/c (10% of Govt. Bonds)	1,50,000
?	To Capital A/c	1,50,000	?	By Salaries A/c	60,000
?	To Furniture A/c	800	?	By Taxes A/c	11,000
?	To Debtors A/c (Note 2)	4,85,000	?	By Printing and Stationery A/c	7,800
			?	By Miscellaneous Expenses A/c	12,000
			?	By Creditors A/c (Note 1)	3,60,000
			?	By Furniture A/c (Note 3)	6,000
			?	By Drawings A/c	26,000
			Dec. 31	By Balance c/d	31,000
		6,63,800			6,63,800

(5) Balance Sheet as at 1st January, 2001

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,36,000	Building	1,50,000
Creditors	32,000	Furniture	15,000
		Stock	30,000
		Debtors	45,000
		Bank	28,000
	2,68,000		2,68,000

(6) Net Profit before shop assistant's commission = ₹ 33,000. Therefore, commission = ₹ 33,000 × 10/110 = ₹ 3,000.

Illustration 29

On 1.1.2016, Mr S. Sen commenced business. He did not maintain proper books of account. At the end of the year, the following information is obtained after going through the records :

(i) All cash received from cash sales was banked after keeping ₹ 1,000 p.m. for petty expenses and after withholding monthly drawings of ₹ 500.

(ii) Counter foils of pay-in-slip revealed the following deposits : capital contributed ₹ 1,00,000; balance of cash sales ₹ 78,000; collections from debtors ₹ 1,00,000.

(iii) Counter foils of cheques revealed the following payments :
payment to creditors ₹ 1,50,000; salary ₹ 35,000; purchase of furniture ₹ 10,000.
(iv) Sales were effected at a uniform rate of gross profit at 25% on sales.
(v) Discount allowed ₹ 2,000, discount received ₹ 3,000 and bad debts ₹ 1,000.
(vi) Petty cash expenses were : postage ₹ 200; stationery ₹ 1,000; conveyance ₹ 2,000 and rent ₹ 2,200.
(vii) On 31.12.2016 amount due from debtors ₹ 10,000 and amount owing to creditors were ₹ 20,000.

Prepare Trading and Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — Adapted]

Solution

S. Sen

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

Particulars	₹	Particulars		₹
To Purchases	1,73,000	By Sales — Cash	96,000	
To Gross Profit c/d (25% of ₹ 2,09,000)	52,250	Credit	1,13,000	2,09,000
		By Closing Stock (Balancing figure)		16,250
	2,25,250			2,25,250
To Salaries	35,000	By Gross Profit b/d		52,250
To Petty Expenses (₹ 200 + 1,000 + 2,000 + 2,200)	5,400	By Discount Received		3,000
To Discount Allowed	2,000			
To Bad Debts	1,000			
To Net Profit (transferred to capital)	11,850			
	55,250			55,250

Balance Sheet of S Sen as on 31st December, 2016

Liabilities		₹	Assets	₹
Capital : Drawings	1,00,000		Furniture	10,000
Net Profit	11,850		Stock	16,250
	1,11,850		Debtors	10,000
Less: Drawings	6,000	1,05,850	Bank	83,000
Creditors		20,000	Petty Cash (Note 2)	6,600
		1,25,850		1,25,850

Working Notes :

Dr. (1) Cash Book Cr.

Particulars	Cash	Bank	Particulars	Cash	Bank
To Capital	—	1,00,000	By Bank (c)	78,000	—
To Sales (Note 5)	96,000	—	By Petty Cash	12,000	—
To Debtors	—	1,00,000	By Drawings	6,000	—
To Cash (c)	—	78,000	By Creditors	—	1,50,000
			By Salaries	—	35,000
			By Furniture	—	10,000
			By Balance c/d	—	83,000
	96,000	2,78,000		96,000	2,78,000

Dr. (2) Petty Cash Book Cr.

Particulars	₹	Particulars	₹
To Cash A/c	12,000	By Postage	200
		By Stationery	1,000
		By Conveyance	2,000
		By Rent	2,200
		By Balance c/d	6,600
	12,000		12,000

Dr. (3) Total Debtors Account Cr.

Particulars	₹	Particulars	₹
To Credit Sales (Balancing figure)	1,13,000	By Bank	1,00,000
		By Discount Allowed	2,000
		By Bad Debts	1,000
		By Balance c/d	10,000
	1,13,000		1,13,000

Dr. **(4) Total Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank	1,50,000	By Credit Purchases (Balancing figure)	1,73,000
To Discount received	3,000		
To Balance c/d	20,000		
	1,73,000		1,73,000

(5) Amount of cash sales = ₹ 78,000 + 6,000 (Drawings @ ₹ 500 p.m.) + ₹ 12,000 (Petty expenses @ ₹ 1,000 p.m.) = ₹ 96,000.
(6) For lack of information, depreciation on furniture has not been provided.

Illustration 30

A fire in the office of Pioneer Trading Limited occured in the evening of 31.3.2017, as a result of which the Cash Book and the Nominal Ledger kept in the cupboard were completely destroyed. The cash box containing cash representing the day's taking for 31.3.2017 was also destroyed. The insurance company concerned requests you to ascertain the amount of cash lost in the fire accident.

The Balance Sheet of the Company as at 31.12.2016 was as follows :

Liabilities	₹	Assets		₹
Share Capital	60,000	Office Furniture (at cost)	14,616	
Reserve and Balance of Profit and Loss Account	85,028	Less: Depreciation	7,204	7,412
Creditors	14,140	Stock (at cost)		75,742
Dividend Unpaid	6,000	Debtors		71,212
		Bank		10,802
	1,65,168			1,65,168

From the records and documents saved from the accident, the following information was obtained :

Balance on 31.3.2017 —

Debtors : ₹ 1,19,612; Creditors : ₹ 31,610;

Bank balance after adjusting outstanding ₹ 14,822.

Transactions from 1.1.2017 to 31.3.2017 were as follows —

Cash and Credit sales less returns ₹ 8,21,154; Miscellaneous expenses ₹ 2,03,124; Wages and salaries ₹ 90,634; Office furniture purchased ₹ 1,300; Dividend paid ₹ 6,000; Goods purchased on credit ₹ 4,69,212; Depreciation on furniture ₹ 360.

All receipts have been banked except those for 31.3.2017. Stock on 31.3.2017 (value at cost) was ₹ 53,816.

Required :

(i) A statement showing the computation of the amount of cash lost in the fire accident; and

(ii) Trading, and Profit and Loss Account for 3 months ending on 31.3.2017 and a Balance Sheet as at that date.

[C.U.B.Com. (Hons.) —Adapted]

Solution (i) Statement Showing the Computation of the Amount of Cash Lost in Fire

Particulars	₹
Opening balance of Debtors	71,212
Add : Cash and Credit sales less returns	8,21,154
	8,92,366
Less : Balance of Debtors on 31.3.2017	1,19,612
Cash Available for Deposit into the Bank	7,72,754
Less : Cash Deposited into the Bank (Note 2)	7,56,820
Cash Lost by Fire	15,934

Pioneer Trading Limited

Dr. **(ii) Trading and Profit and Loss Account for the year ended 31st March, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	75,742	By Sales (Credit + Cash)	8,21,154
To Purchases	4,69,212	By Closing Stock	53,816
To Wages & Salaries (Note 3)	90,634		
To Gross Profit c/d	2,39,382		
	8,74,970		8,74,970

To Miscellaneous Expenses	2,03,124	By Gross Profit b/d	2,39,382
To Depreciation on Furniture	360		
To Loss of Cash (Note 4)	15,934		
To Net Profit	19,964		
	2,39,382		2,39,382

Balance Sheet of Pioneer Trading Limited as at 31st March, 2017

Liabilities	₹	Assets		₹
Share Capital	60,000	Office Furniture (at cost) : ₹ (14,616 + 1,300)	15,916	
Reserve and Profit and Loss Account : ₹ (85,028 + 19,964)	1,04,992	Less: Depreciation : ₹ (7,204 + 360)	7,564	8,352
Creditors	31,610	Stock (at cost)		53,816
		Debtors		1,19,612
		Bank		14,822
	1,96,602			1,96,602

Working Notes :

Dr. (1) Creditors Account Cr

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c (Balancing figure)	4,51,742	1.1.2017	By Balance b/d	14,140
31.3.2017	To Balance c/d	31,610	?	By Credit Purchases	4,69,212
		4,83,352			4,83,352

Dr. (2) Bank Account Cr

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	10,802	?	By Creditors (Note 1)	4,51,742
?	To Cash (Balancing figure)	7,56,820	?	By Miscellaneous Expenses	2,03,124
			?	By Wages and Salaries	90,634
			?	By Office Furniture	1,300
			?	By Dividend	6,000
			31.3.2017	By Balance c/d	14,822
		7,67,622			7,67,622

(3) It is assumed that wages and salaries of ₹ 90,634 is a direct expense. If it is taken as an indirect expense, the gross profit will be ₹ 3,30,016.

(4) For lack of information in respect of insurance claim for loss of cash by fire, it has been charged to Profit and Loss Account. If any amount is received from the insurance company in the subsequent period, Cash Account will be debited and Profit and Loss Adjustment Account will be credited as a prior period adjustment.

Illustration 31

The following balances are available from the books of Sanjoy as on 31.12.2015 and 31.12.2016 (all figures in ₹) :

Date	Building	Equipments	Furniture	Debtors	Creditors	Stock	Bank Loan	Cash
31.12.2015	60,000	1,20,000	10,000	?	32,000	?	20,000	32,000
31.12.2016	60,000	1,34,000	10,000	48,000	?	34,000	16,000	22,000

The transactions of Sanjoy during the year ended 31.12.2016 were the following :

Collection from Debtors ₹ 1,86,000; Payment to Creditors ₹ 1,22,000; Cash Purchases ₹ 32,000; Expenses ₹ 20,000; Sale of one Equipment (book value ₹ 10,000) ₹ 6,000; Drawings ₹ 20,000.

Cash sales amounted to 10% of total sales. Credit sales amounted to ₹ 1,80,000. Credit purchases were 80% of total purchases. Sanjoy sells goods at cost plus $33^1/_3$%. His suppliers allowed him discount ₹ 2,000.

Equipments and furniture are to be depreciated by 10% p.a. and building by 2% p.a.

Prepare the Trading and Profit and Loss Account for the year ended 31.12.2016, and a Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Sanjoy

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

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	24,000	By Sales (Note 1)	2,00,000
To Purchases (Note 2)	1,60,000	By Closing Stock	34,000
To Gross Profit c/d (Note 3)	50,000		
	2,34,000		2,34,000

	₹		₹
To Expenses	20,000	By Gross Profit b/d	50,000
To Loss on Sale of Equipments (Note 4)	4,000	By Discount Received	2,000
To Depreciation on (Note 5) :			
(Furniture : 1,000; Equipments : 12,200; Building : 1,200)	14,400		
To Net Profit	13,600		
	52,000		52,000

Balance Sheet of Sanjoy as on 31st December, 2016

Liabilities		₹	Assets		₹
Capital :			Building	60,000	
Opening Balance (Note 8)	2,48,000		Less : Depreciation	1,200	58,800
Add : Net Profit	13,600		Equipments	1,20,000	
	2,61,600		Less: Sold	10,000	
Less : Drawings	20,000	2,41,600		1,10,000	
Bank Loan		16,000	Add: Additions	24,000	
Creditors (Note 7)		36,000		1,34,000	
			Less : Depreciation	12,200	1,21,800
			Furniture	10,000	
			Less : Depreciation	1,000	9,000
			Debtors		48,000
			Stock		34,000
			Cash		22,000
		2,93,600			2,93,600

Working Notes :

(1) Since cash sales were 10% of total sales, credit sales were 90% of total sales which were ₹ 1,80,000. Therefore, cash sales were ₹ 1,80,000 / 9 = ₹ 20,000. Total sales were ₹ 2,00,000.

(2) Since credit purchases were 80% of total purchases, cash purchases were 20% of total purchases which were ₹ 32,000. Therefore, credit purchases were ₹ 32,000 x 4 = ₹ 1,28,000. Total purchases were ₹ 1,60,000.

(3) Gross profit was $33^1/_3$% on cost or 25% on sales. Therefore, gross profit was 25% on ₹ 2,00,000 = ₹ 50,000.

(4) Loss on sale of equipments = ₹ (10,000 – 6,000) = ₹ 4,000.

(5) Depreciation on : Furniture — 10% on ₹ 10,000 = ₹ 1,000; Equipments — 10% on ₹ 1,10,000 (1,20,000 – 10,000) for full year and 10% on ₹ 24,000 (addition) for half year = ₹ (11,000 + 1,200) = ₹ 12,200; Building — 2% on ₹ 60,000 = ₹ 1,200.

Dr. (6) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d (Balancing figure)	54,000	31.12.2016	By Cash	1,86,000
31.12.2016	To Credit Sales	1,80,000	31.12.2016	By Balance c/d	48,000
		2,34,000			2,34,000

Dr. (7) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Cash	1,22,000	1.1.2016	By Balance b/d	32,000
31.12.2016	To Discount Received	2,000	31.12.2016	By Credit Purchases (Note 2)	1,28,000
31.12.2016	To Balance c/d (Balancing figure)	36,000			
		1,60,000			1,60,000

(8) Balance Sheet of Sanjoy as on 1st January, 2016

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,48,000	Building	60,000
Bank Loan	20,000	Equipments	1,20,000
Creditors	32,000	Furniture	10,000
		Debtors (Note 6)	54,000
		Stock (Note 9)	24,000
		Cash	32,000
	3,00,000		3,00,000

(9) Opening stock = Sales + Closing Stock – Purchases – Gross Profit = ₹ (2,00,000 + 34,000 – 1,60,000 – 50,000) = ₹ 24,000.

Tutorial Note. It should be noted that depreciation on equipments is to be charged @ 10% p.a. Therefore, on addition, depreciation has been charged for 1/2 year.

Illustration 32

Following are the particulars of Arpita and Co. :

(i) Assets and liabilities (all figures in ₹) :

Date	Furniture	Stock	Debtors	Creditors	Prepaid Expenses	Outstanding Expenses	Cash and Bank
1.1.2016	36,000	48,000	96,600	66,000	3,600	12,000	7,200
31.12.2016	38,100	42,000	?	90,000	4,200	10,800	3,750

(ii) Cash transactions during the year 2016 :

Particulars	₹	Particulars	₹
Receipts from Debtors (after allowing 2.5% discount)	3,51,000	Freight Inwards	18,000
Bills Receivable discounted at an average rate of 2%	36,750	Drawings	42,000
4% Investment purchased at ₹ 96 (on 1.7.2016)	57,600	Furniture purchased	6,000
Paid to Creditors (discount at 2%)	2,35,200	Miscellaneous receipts	3,000
Expenses	87,000		

(iii) During the year Bills Receivable received was ₹ 60,000; ₹ 12,000 of which were endorsed in favour of creditors. Of the latter, a bill for ₹ 2,400 was dishonoured.

(iv) Goods costing ₹ 5,400 were used as advertising materials.

(v) Goods are invariably sold to show a profit of 50% on cost.

(vi) Difference in Cash Book, if any, is to be treated as drawings or introduction of capital by the proprietor.

(vii) Provision @ 2.5% on debtors for doubtful debts is to be provided for.

Prepare Trading and Profit and Loss Account for the year ended 31.12.2016 and Balance Sheet as on that date.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Arpita and Co.

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

Particulars	₹	Particulars	₹
To Opening Stock	48,000	By Sales (Note 7)	4,38,300
To Purchases (Note 4)	2,73,600	By Advertisement	5,400
To Freight Inwards	18,000	By Closing Stock	42,000
To Gross Profit c/d (1/3 of Sales)	1,46,100		
	4,85,700		4,85,700
To Expenses (Note 5)	85,200	By Gross Profit b/d	1,46,100
To Discount Allowed (Note 3)	9,000	By Miscellaneous Receipts	3,000
To Discount on Bills (Note 6)	750	By Interest on Investment (Note 8)	1,200
To Advertisement	5,400	By Discount Received	4,800
To Depreciation on Furniture	3,900		
To Provision for Bad Debts (2.5% of ₹ 1,17,300)	2,933		
To Net Profit (transferred to Capital)	47,917		
	1,55,100		1,55,100

Balance Sheet of Arpita and Co. as on 31st December, 2016

Liabilities		₹	Assets		₹
Capital : Opening balance (Note 2)	1,13,400		Furniture	36,000	
Introduced (Note 1)	51,600		Add: Purchased	6,000	
Net Profit	47,917			42,000	
	2,12,917		Less: Depreciation (Balancing figure)	3,900	38,100
Less: Drawings	42,000	1,70,917	Investments (Face value ₹ 60,000)	57,600	
Creditors (Note 4)		90,000	Add : Accrued Interest	1,200	58,800
Outstanding Expenses		10,800	Stock		42,000
			Debtors (Note 3)	1,17,300	
			Less: Provision for Bad Debts	2,933	1,14,367
			Bills Receivable (Note 6)		10,500
			Cash and Bank (Note 1)		3,750
			Prepaid Expenses		4,200
		2,71,717			2,71,717

Working Notes :

Dr. (1) Cash and Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	7,200	By Investments	57,600
To Debtors	3,51,000	By Creditors	2,35,200
To Bills Receivable	36,750	By Expenses	87,000
To Miscellaneous Receipts	3,000	By Freight Inwards	18,000
To Capital (Balancing figure)	51,600	By Drawings	42,000
		By Furniture	6,000
		By Balance c/d	3,750
	4,49,550		4,49,550

(2) Ascertainment of Opening Capital

Liabilities	₹	Assets	₹
Capital (Balancing figure)	1,13,400	Furniture	36,000
Creditors	66,000	Stock	48,000
Outstanding Expenses	12,000	Debtors	96,600
		Cash and Bank	7,200
		Prepaid Expenses	3,600
	1,91,400		1,91,400

Dr. (3) Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	96,600	By Bills Receivable	60,000
To Creditors	2,400	By Bank	3,51,000
To Credit Sales (Note 7)	4,38,300	By Discount Allowed	9,000
		By Balance c/d	1,17,300
	5,37,300		5,37,300

Dr. (4) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank	2,35,200	By Balance b/d	66,000
To Discount Received	4,800	By Debtors	2,400
To Bills Receivable	12,000	By Credit Purchases (Balancing figure)	2,73,600
To Balance c/d	90,000		
	3,42,000		3,42,000

Dr. (5) Expenses Account Cr.

Particulars	₹	Particulars	₹
To Prepaid Expenses	3,600	By Outstanding Expenses	12,000
To Bank	87,000	By Profit and Loss	85,200
To Outstanding Expenses	10,800	By Prepaid Expenses	4,200
	1,01,400		1,01,400

Dr. (6) Bills Receivable Account Cr.

Particulars	₹	Particulars	₹
To Debtors	60,000	By Bank	36,750
		By Discount on Bills	750
		By Creditors	12,000
		By Balance c/d	10,500
	60,000		60,000

(7) Ascertainment of Sales

Particulars		₹
Opening Stock		48,000
Purchases (Note 4)		2,73,600
Freight		18,000
		3,39,600
Less: Advertisement	5,400	
Closing Stock	42,000	47,400
Cost of Goods sold		2,92,200
Add: Profit 50%		1,46,100
Sales		4,38,300

(8) Face value of investment purchased on 1.7.2016 = ₹ 57,600 / 96 x 100 = ₹ 60,000. Interest is payable @ 4% on face value of ₹ 60,000 for 6 months. Therefore, interest accrued = ₹ 60,000 x 4% x 1/2 = ₹ 1,200.

Illustration 33

M.H. Kabir owns a small business and keeps all the accounting records himself on a computer using basic accounting package. He does not understand financial statements and therefore never uses this part of the software. He does, however, regularly print out the analysis of the receipts and payments in and out of his bank account. Unfortunately, his computer's hard disk was crashed and his accountant now wants to prepare his accounts. The accountant has the Balance Sheet of the previous year and this is given below :

Balance Sheet as at 31st March, 2016

Liabilities	₹	Assets		₹
Capital	8,20,000	**Fixed Assets :**		
Long-term Loan (10%)	1,00,000	Machinery		2,50,000
Current Liabilities :		Vehicles		5,00,000
Trade Creditors	1,60,000	**Current Assets :**		
Outstanding Vehicles Expenses	10,000	Stock		1,20,000
		Sundry Debtors	1,90,000	
		Less: Provision for Bad Debts	10,000	1,80,000
		Prepaid Advertising		30,000
		Bank		10,000
	10,90,000			10,90,000

The accountant has asked Kabir for some additional information and Kabir has prepared the following schedule (all figures in ₹) :

1. The following payments appeared on the bank statement for the year ended on 31st March, 2017 :

(i)	Wages	1,50,000	
(ii)	Payment to Suppliers	13,50,000	Kabir takes a cash discount of 10% on invoice amount on all payments to suppliers.
(iii)	Vehicle Expenses	90,000	
(iv)	New Vehicle	1,20,000	
(v)	General Expenses	80,000	
(vi)	Advertising	30,000	This includes a prepayment of ₹ 10,000.
(vii)	Loan Interest	5,000	₹ 5,000 was paid on 1st April, 2017.
(viii)	Drawings	2,00,000	Kabir also took goods from the business worth ₹ 20,000.
	TOTAL	20,25,000	

2. The following receipts appeared on the bank statement in the year ended 31st March, 2017 :

Receipts from sale	₹ 21,50,000
Sale of old vehicle	20,000
	21,70,000

3. The following amounts relate to cheques dated before 31st March, 2017, but not presented by that date :

	₹
General expenses	60,000
Vehicle expenses	30,000

4. At 31st March, 2017 :
   Sundry Debtors were ₹ 2,10,000 (after excluding bad debts for ₹ 20,000);
   Sundry Creditors ₹ 1,80,000; and Stock ₹ 1,00,000.

The accountant has the following information on his file :

(i) The net book value of the old vehicle which was sold was ₹ 30,000.

(ii) Depreciation is charged on the net book value at the year ended :
Vehicles 25% and Machinery 20%.

(iii) A general provision is made for doubtful debts of 5% of debtors, after bad debts have been written off.

You are required to prepare :

(i) Profit and Loss Account for the year ended on 31st March, 2017;

(ii) Balance Sheet as at 31st March, 2017.

Solution

M.H. Kabir

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

Particulars	₹	Particulars	₹
To Opening Stock	1,20,000	By Sales (Note 5)	21,90,000
To Purchases (Note 2)	15,20,000	By Drawings (Goods taken over)	20,000
To Wages	1,50,000	By Closing Stock	1,00,000
To Gross Profit c/d	5,20,000		
	23,10,000		23,10,000

		₹		₹
To Vehicle Expenses (Note 3)		80,000	By Gross Profit b/d	5,20,000
To General Expenses		80,000	By Discount Received	1,50,000
To Loss on Sale of Vehicles		10,000		
To Advertising Expenses (Note 4)		50,000		
To Interest on Bank Loan	5,000			
Add: Outstanding Interest	5,000	10,000		
To Bad Debts		20,000		
To Depreciation on :				
Vehicles @ 25% on ₹ 5,90,000		1,47,500		
Machinery @ 20% on ₹ 2,50,000		50,000		
To Provision for Bad Debts				
New	10,500			
Less: Old	10,000	500		
To Net Profit (Transferred to Capital A/c)		2,22,000		
		6,70,000		6,70,000

Balance Sheet of M.H. Kabir as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	8,20,000		**Fixed Assets :**		
Add: Net Profit	2,22,000		Machinery	2,50,000	
	10,42,000		Less: Depreciation @ 20%	50,000	2,00,000
Less: Drawings	2,20,000	8,22,000	Vehicles	5,90,000	
Long-term Loan		1,00,000	Less: Depreciation @ 25%	1,47,500	4,42,500
Current Liabilities :			**Current Assets :**		
Trade Creditors		1,80,000	Stock		1,00,000
Outstanding Interest on Long-term Loan		5,000	Sundry Debtors	2,10,000	
			Less: Provision for Bad Debts	10,500	1,99,500
			Prepaid Advertising		10,000
			Bank (Note 1)		1,55,000
		11,07,000			11,07,000

Working Notes :

Dr. **(1) Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Wages	1,50,000
To Vehicles A/c (Sale)	20,000	By Trade Creditors A/c	13,50,000
To Sundry Debtors	21,50,000	By Vehicle Expenses A/c	90,000
		By Vehicles (New)	1,20,000
		By General Expenses	80,000
		By Advertising	30,000
		By Bank Interest	5,000
		By Drawings	2,00,000
		By Balance c/d	1,55,000
	21,80,000		21,80,000

Dr. **(2) Trade Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	13,50,000	By Balance b/d	1,60,000
To Discount Received A/c	1,50,000	By Purchases (Balancing figure)	15,20,000
To Balance c/d	1,80,000		
	16,80,000		16,80,000

Dr. **(3) Vehicles Expenses Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	90,000	By Outstanding Vehicles Expenses A/c	10,000
		By Profit and Loss A/c	80,000
	90,000		90,000

Dr. **(4) Advertising Account** **Cr.**

Particulars	₹	Particulars	₹
To Prepaid Advertising A/c	30,000	By Profit and Loss A/c	50,000
To Bank A/c	30,000	By Prepaid Advertising A/c	10,000
	60,000		60,000

Dr. **(5) Sundry Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,90,000	By Bad Debts A/c	20,000
To Sales A/c (Balancing figure)	21,90,000	By Bank A/c	21,50,000
		By Balance c/d	2,10,000
	23,80,000		23,80,000

Dr. **(6) Vehicles Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	5,00,000	By Bank A/c	20,000
To Bank A/c (Purchases)	1,20,000	By Loss on Sale of Vehicles A/c	10,000
		By Balance c/d	5,90,000
	6,20,000		6,20,000

(7) Unpresented cheques for expenses will not be taken into consideration for calculating balance at Bank. In the Balance Sheet bank balances as per cash book / ledger is shown.
Unpresented cheques will be taken into consideration at the time of preparing Bank Reconciliation Statement.

Illustration 34

The following is the Balance Sheet of the retail business of Mr Padamsi as at 31st December, 2016.

Particulars	₹	Particulars	₹
Mr Padamsi's Capital	1,25,000	Furniture & Fittings	25,000
Creditors for goods	30,000	Stocks	75,000
Outstanding expenses (Rent)	1,000	Sundry Debtors	20,000
		Cash at bank	35,000
		Cash in hand	1,000
	1,56,000		1,56,000

You are furnished with the following information :

1. Mr Padamsi always sells his goods at a profit of 25% on sales.
2. Goods are sold for cash and credit. Credit customers pay by cheques only.
3. Payments for purchases are always made by cheques.
4. It is the practice of Mr Padamsi to send to the bank every weekend the takings of the week after paying every week salaries of ₹ 250 to the clerk, sundry expenses of ₹ 50 and personal expenses of ₹ 100.

An analysis of the Bank Pass Book for the period ending 31st March, 2017 disclosed the following:

Payment to Creditors ₹ 75,000; Payment of rent ₹ 4,000; Amount remitted into the bank ₹ 1,35,000 including cheques for ₹ 10,000 received from customers to whom the goods were sold on credit.

The following are the balances on 31st March, 2017 :

Stocks ₹ 32,500; Creditors for goods ₹ 32,500; Sundry Debtors ₹ 30,000.

On the evening of 31st March, 2017 the cashier absconded with the cash available in the cash box.

You are required to prepare a statement showing the amount of cash defalcated by the cashier and also a Profit and Loss Account for the period ended 31st March, 2017 and a Balance Sheet as on that date.

Solution

Padamsi

Dr. **Trading and Profit and Loss Account for the period ended 31st March, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Opening stock	75,000	By Cash sales	1,40,000
To Purchases	77,500	By Credit sales	20,000
To Gross profit c/d	40,000	By Closing stock	32,500
	1,92,500		1,92,500
To Salaries (₹ 250 x 13)	3,250	By Gross profit b/d	40,000
To Sundry expenses (₹ 50 x 13)	650		
To Rent (₹ 4,000 — ₹ 1,000)	3,000		
To Defalcation loss	10,800		
To Net profit	22,300		
	40,000		40,000

Balance Sheet of Padamsi as at 31st March, 2017

Liabilities		₹	Assets		₹
Capital:			Furniture & fittings		25,000
Opening balance	1,25,000		Stock		32,500
Add: profit	22,300		Sundry Debtors		30,000
	1,47,300		Cash at bank		91,000
Less: Drawings (₹ 100 x 13)	1,300	1,46,000			
Creditors		32,500			
		1,78,500			1,78,500

Working Notes : [Taking 13 weeks; (52/12) x 3]

Dr. Cash Book Cr.

To Balance b/f	1,000	By Bank	1,25,000
To Sales	1,40,000	By Salary	3,250
		By Sundry expenses	650
		By Drawings	1,300
		By Defalcation (bal.fig)	10,800
	1,41,000		1,41,000

Dr. Bank Account Cr.

To Balance b/f	35,000	By Creditors	75,000
To Cash	1,25,000	By Rent	4,000
To Debtors	10,000	By Balance c/d	91,000
	1,70,000		1,70,000

Dr. Sundry Debtors Account Cr.

To Balance b/f	20,000	By Bank	10,000
To Sales	20,000	By Balance c/d	30,000
	40,000		40,000

Dr. Sundry Creditors Account Cr.

To Bank	75,000	By Balance b/f	30,000
To Balance c/d	32,500	By Purchases	77,500
	1,07,500		1,07,500

Cost of Sales = Opening Stock + Purchases — Closing Stock = ₹ 75,000 + ₹ 77,500 – ₹ 32,500 = ₹ 1,20,000. Total Sales = ₹ 1,20,000/75 x 100 = ₹ 1,60,000. Credit Sales ₹ 20,000. So Cash Sales = ₹ 1,40,000. **No depreciation has been charged on furniture for lack of information.**

Illustration 35

Dear Mr Hanif,

I am most relieved that you have agreed to assist me by sorting out the financial affairs of my second-hand business, which, as you know, commenced on 1 January, 2016. Such records as I have kept are, unfortunately, to be found on now rather scruffy scraps of paper stored in a large cardboard box. Doubtless, you will want to examine these records for yourself, but I thought it might assist you if I were to summarize my business dealings up to 31 December, 2016.

In December, 2015, I was lucky enough to win ₹ 5,000 on the football pools, and this, together with ₹ 1,000 loaned to me by a friend — I agreed, incidentally, to pay him 10% per year interest — formed the initial capital of ₹ 6,000. I put ₹ 5,500 into the bank immediately, in a separate business account, I needed a lorry to enable me to collect and deliver the second-hand goods, a dealer was asking ₹ 1,300 for a second-hand lorry, but, I beat him down to ₹ 840. I've only paid by cheque ₹ 200 of this so far, but as I will finish paying the full ₹ 840 in three years, it will be mine before it falls to pieces in another five years from now. I rent some business premises, and, as they are fairly dilapidated, I only pay ₹ 350 a year. I've paid by cheque this year's rent and also ₹ 50 in respect of next year.

My first bit of business was to buy a job lot of 2,000 pairs of jeans for ₹ 6,000. I've paid a cheque for ₹ 4,000 so far, and my supplier is pressing me for the balance. To date, I've sold 1,500 pairs, and received ₹ 5,800, but I reckon I'm still owed ₹ 500, most of which I should be able to collect. I promptly banked the ₹ 5,800 as it was all in cheques.

I bought 800 T-shirts for ₹ 1,200 out of my bank account. I've sold 700 of these for cash — ₹ 1,500 in all — but as the remainder have got damaged, I'd be lucky if I get ₹ 50 for them.

I managed to get some pocket-calculators cheaply — 50 of them only cost me ₹ 400, but I'm rather pleased I haven't paid for them yet, as I think there is something wrong with them. My supplier has indicated that he will in fact accept ₹ 200 for them, and I intend to take up his offer, as I reckon I can repair them for Re 1 each and then sell them at ₹ 8 a time — a good profit.

I haven't paid my cash into the bank at all, as the cash I got for the T-shirts and my initial float enabled me to pay for my petrol ₹ 400 and odd expenses ₹ 250. Also, it enabled me to draw ₹ 20 per week for myself. As I've done so well, I also took my wife on holiday it made a bit of a hole in the bank account but it was worth all ₹ 600 of it.

Perhaps, from what I've told you, you can work out what profit I've made, only keep it as small as possible as I don't want to pay too much tax.

Yours sincerely,
P. Ali

Required: a) From the data provided by Mr P. Ali prepare a business Trading and Profit and Loss Account for the period ended 31 December, 2016, and a Balance Sheet as at that date. Show clearly all your workings and assumptions as notes to the accounts.

Solution

P. Ali

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

Particulars		₹	Particulars		₹
To Purchases			By Sales		
Jeans	6,000		Jeans	6,300	
T Shirts	1,200		T Shirts	1,500	7,800
Calculators	200	7,400	By Closing stock		
To Gross Profit c/d		2,150	Jeans	1,500	
			T Shirts	50	
			Calculators	200	1,750
		9,550			9,550
To Provision for doubtful debts		50	By Gross Profit b/d		2,150
To Interest on loan		100			
To Depreciation on lorry		140			
To Rent		350			
To Petrol		400			
To Sundry expenses		250			
To Net profit		860			
		2,150			2,150

Balance Sheet of P. Ali as on 31st December, 2016

Liabilities		₹	Assets		₹
Capital:			Lorry at cost	840	
Opening	5,000		Less: Depreciation	140	700
Add: Profit	860		Debtors	500	
	5,860		Less: Provision for bad debts	50	450
Less: Drawings	1,640	4,220	Closing stock		1,750
Loan		1,000	Cash at bank		4,900
Interest on loan		100	Cash in hand		310
Creditors for lorry		640	Prepaid rent		50
Creditors for goods		2,200			
		8,160			8,160

Assumptions : (1) 52 weeks in a year; (2) Provision for doubtful debts 10%.
Working Notes:

(1) Cash Book

Dr.		Cr.	
To Capital	5,000	By Bank	5,500
To Loan	1,000	By Petrol	400
To Sales	1,500	By Sundry expenses	250
		By Drawings	1,040
		By Balance c/d	310
	7,500		7,500

(2) Bank Account

Dr.		Cr.	
To Cash	5,500	By Lorry	200
To Debtors	5,800	By Rent	350
		By Adv. rent	50
		By Creditors	4,000
		By Purchases	1,200
		By Drawings	600
		By Balance c/d	4,900
	11,300		11,300

(3) Depreciation on lorry = 840/6 = ₹ 140 (2016 + 5 years)

Illustration 36

On April 1, 2016 Mr Silgardo bought for ₹ 50,000 a business whose assets and liabilities are shown below. The business carried on its operations in a rented shop from which it sold cosmetics and confectionery. The business did not keep double entry accounts, but you are provided with the following information:

(i) Balance Sheet of the company as on 31st March, 2016:

Liabilities	₹	Assets	₹
Capital	50,000	**Fixed Assets :**	
Profit & Loss A/c	10,500	Furniture & fixtures (at cost)	30,000
Creditors :		**Current Assets :**	
Cosmetics	2,500	Stock of Cosmetics (at cost)	5,000
Confectionary	2,000	Stock of Confectionary (at cost)	3,000
Outstanding rent	500	Sundry Debtors : Confectionary	500
		Prepaid : Rent & Insurance	2,500

		Balance with bank	23,500
		Cash in hand	1,000
	65,500		65,500

(ii) *Analysis of the Bank statements for the year ended March 31, 2017 :*		(iii) *The following were paid in cash* :	₹
Paid in : Cash	2,45,000	Salaries	15,000
Withdrawn for :		Confectionary purchases	1,500
Purchase of cosmetics	1,00,000	Trade expenses	1,250
Purchase of confectionary	1,10,000	Cosmetic purchases	5,000
Repairs	4,000	(iv) Mr Silgardo had taken from the shop Cosmetics for his own consumption and paid into the till the cost price of ₹ 4,550.	
Rent	6,000		
Rates & Insurance	10,000	(v) The following are the gross profit percentages with reference to sales: Cosmetics — 9%; Confectionery — 30%	
Electricity	4,000		
Mr Silgardo	15,000		

(vi) On 31st March, 2017 there were :		Stock at cost	Debtors/Prepayments and Cash	Liabilities
Cosmetics	(₹)	4,850	Nil	2,000
Confectionary	(₹)	3,500	1,000	3,000
Rent	(₹)			500
Rates & Insurance	(₹)		2,750	
Cash in hand	(₹)		250	
Accountancy / Audit fees	(₹)			2,000

(vii) Mr Silgardo has instructed you to regard any shortage in cash as being due to amounts withdrawn by him.

You are required to prepare:

(a) The Trading and Profit and Loss Account for the year ended March 31st, 2017 showing separately the gross profit from (i) Cosmetics; and (ii) Confectionery.

(b) The Balance Sheet as at March 31, 2017;

(c) Total Debtors and Total Creditors Accounts; and

(d) An Account in columnar form for cash and bank transactions.

Solution

Silgardo

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

Particulars	Cos-metics	Confec-tionary	Total ₹	Particulars	Cos-metics	Confec-tionary	Total ₹
To Opening stock	5,000	3,000	8,000	By Sales	1,10,000	1,60,000	2,70,000
To Purchases	1,04,500	1,12,500	2,17,000	By Drawings	4,550	—	4,550
To Gross profit c/d	9,900	48,000	57,900	By Closing stock	4,850	3,500	8,350
	1,19,400	1,63,500	2,82,900		1,19,400	1,63,500	2,82,900
To Salaries			15,000	By Gross profit b/d :			
To Rates & Insurance		10,000		Cosmetics		9,900	
Add: Paid in 2015-16		2,500		Confectionary		48,000	57,900
		12,500					
Less: Paid for 2017-18		2,750	9,750				
To Rent		6,000					
Add: Outstanding for 2016-17		500					
		6,500					
Less: Outstanding for 2015-16		500	6,000				
To Repairs			4,000				
To Electricity			4,000				
To Trade expenses			1,250				
To Accountancy/Audit fees			2,000				
To Net Profit			15,900				
			57,900				57,900

Balance Sheet of Silgardo as at 31st March, 2017

Liabilities		₹	Assets		₹
Capital:			Furniture & fittings (at cost)		30,000
Opening balance	60,500		Stock-in-trade :		
Add: Net profit	15,900		Cosmetics		4,850
	76,400		Confectionary		3,500
Less: Drawings	22,050	54,350	Sundry Debtors : Confectionary		1,000

Creditors			Cash at bank		19,500
Cosmetics		2,000	Cash in hand		250
Confectionary		3,000	Prepaid expenses		2,750
Outstanding Accountancy/Audit fees		2,000			
Rent outstanding		500			
		61,850			61,850

Dr. **Total Debtors Account** **Cr.**

Particulars	Cosmetics	Confectionary	Particulars	Cosmetics	Confectionary
To Balance b/d	—	500	By Cash A/c (balancing figure)	1,10,000	1,59,500
To Sales	1,10,000	1,60,000	By Balance c/d	—	1,000
	1,10,000	1,60,500		1,10,000	1,60,500

Dr. **Total Creditors Account** **Cr.**

Particulars	Cosmetics	Confectionary	Particulars	Cosmetics	Confectionary
To Bank A/c	1,00,000	1,10,000	By Balance b/d	2,500	2,000
To Cash A/c	5,000	1,500	By Purchases (balancing figure)	1,04,500	1,12,500
To Balance c/d	2,000	3,000			
	1,07,000	1,14,500		1,07,000	1,14,500

Dr. **Cash Book** **Cr.**

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/d	1,000	23,500	By Total Creditors:		
To Total Debtors:			Cosmetics		1,00,000
Cosmetics	1,10,000		Confectionary		1,10,000
Confectionary	1,59,500		By Bank (contra)	2,45,000	
To Sales (cash)	4,550		By Repairs		4,000
To Cash (contra)		2,45,000	By Rent		6,000
			By Rates & Insurance		10,000
			By Electricity		4,000
			By Drawings		15,000
			By Salary	15,000	
			By Total Creditors A/c :		
			Cosmetics	5,000	
			Confectionary	1,500	
			By Trade expenses	1,250	
			By Drawings	7,050	
			By Balance c/d	250	19,500
	2,75,050	2,68,500		2,75,050	2,68,500

Working Notes : **Ascertainment of the Sales Proceeds**

Particulars	Cosmetics	Confectionary
Opening Stock	5,000	3,000
Add: Purchases	1,04,500	1,12,500
	1,09,500	1,15,500
Less: Stock used for personal purpose (at cost)	4,550	—
	1,04,950	1,15,500
Less: Closing stock	4,850	3,500
Cost of goods sold	1,00,100	1,12,000

Therefore, sale proceeds for cosmetics is $\frac{1,00,100 \times 100}{91}$ = ₹ 1,10,000.

And, sale proceeds for confectionary is $\frac{1,12,000 \times 100}{70}$ = ₹ 1,60,000.

Drawings = Goods ₹ 4,550 + Cash ₹ 2,500 + Bank ₹ 15,000 = ₹ 22,050.

Key Points

- Any set of procedures for ascertaining profits that does not provide for the ***analysis of each transaction*** in terms of the double entry system of bookkeeping is generally referred to as 'Single Entry System'.
- There are mainly two approaches for income determination : (a) the Transaction Approach, and (b) the Balance Sheet Approach.
- A Statement of Affairs is a statement of the assets, liabilities and capital prepared from incomplete records.
- A Balance Sheet is a statement of the assets, liabilities and capital extracted from ledger balances maintained under the double entry system.

THEORETICAL QUESTIONS

1. What are the essentials of the Single Entry System of Book-keeping?
   In what respects is the Double Entry System superior to it?
2. What is a Statement of Affairs? How does it differ from a Balance Sheet?
3. How are profits calculated under the Single Entry System ?
4. How would you convert a set of books of accounts from the Single Entry to the Double Entry System ?
5. What are the advantages of Single Entry Book-keeping?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. From incomplete records, it is possible to prepare
   A Trial Balance
   B Balance Sheet
   C Statement of Affairs
   D none of the above
2. Under single entry system, opening capital is calculated by preparing
   A Closing Balance Sheet
   B Final Statement of Affairs
   C Opening Statement of Affairs
   D Opening Balance Sheet
3. Under single entry system details of
   A expenses will not be available
   B income will not be available
   C both expenses and income will not be available
   D both income and expenses will be available
4. Final Statement of Affairs is prepared for ascertaining
   A net profit of the business
   B capital of the owner
   C financial position of the business at the end of the accounting period
   D financial position of the business at the beginning of the accounting period
5. The shortage on the debit side of the Cash Book represents
   A credit Sales
   B cash Purchases
   C cash Sales
   D credit Purchases
6. The fundamental Balance Sheet equation is :
   A Capital – Liabilities = Assets
   B Assets = Capital
   C Capital = Assets – Liabilities
   D none of the above

PRACTICAL QUESTIONS

Preparation of Statement of Profit and Statement of Affairs

1. Sri R. Mitra commenced business on 1st January 2016, with ₹ 20,000 as Capital. He kept his books on Single Entry System. On 31st December, 2016, his books disclosed the following : Sundry Creditors ₹ 7,500; Plant ₹ 15,000; Stock-in-trade ₹ 12,000; Debtors ₹ 13,500; and Cash at Bank ₹ 3,000. He drew from his business at the rate of ₹ 225 at the end of each month. On 1st July, 2016, he introduced a further capital amounting to ₹ 6,000.
   You are required to prepare a statement of Profit and Loss for the year ended 31.12.2016 and a Statement of Affairs as on that date after taking into consideration the following: (i) 7.5% of sundry debtors proved to be bad; (ii) plant suffered depreciation @ 10%; and (iii) a provision for doubtful debts was required to be made at 2.5% of debtors.
2. Mr A does not maintain complete double entry books of account. From the following details, determine the profit for the year and statement of affairs at the end of the year:
   ₹ 1,000 (Cost) furniture was sold for ₹ 5,000 on 1.1.2016; 10% depreciation is to be charged on furniture. Mr A has drawn ₹ 1,000 per month, ₹ 2,000 was invested by Mr A in 2016. (all figures in ₹)

	1.1.2016	31.12.2016
Stock	40,000	60,000
Debtors	30,000	40,000
Cash	2,000	1,000
Bank	10,000	(O.D.) 5,000
Creditors	15,000	25,000
Outstanding Expenses	5,000	8,000
Furniture (Cost)	3,000	2,000

   Bank balance on 1.1.2016 is as per Cash Book, but the bank overdraft on 31.12.2016 is as per bank statement ₹ 2,000, Cheques drawn in December, 2016 have not been encashed within the year.
3. X is a small cloth merchant, who has not kept full double entry records. His position as on 1st January 2016 stood as follows:- Cash in hand ₹ 760; Balance at Bank ₹ 6,950; Stock ₹ 12,600; Sundry Debtors ₹ 4,500; Furniture ₹ 2,000 and Sundry Creditors ₹ 4,310.
   His position at the end of 2016 was as : Cash in hand ₹ 470; Balance at Bank, as per Bank Pass Book ₹ 5,930; Stock ₹ 16,700; Sundry Debtors ₹ 6,320; Furniture ₹ 2,000; Mobike ₹ 4,000; and Sundry Creditors ₹ 5,300.
   During the year, he had withdrawn ₹ 400 per month for his personal expenses and purchased a new mobike for his business use for ₹ 4,000. A cheque of ₹ 1,000 issued on 29.12.2016 was presented for payment on 12.1.2017.
   Prepare a Statement, showing his trading result for the year ended 31st December, 2016 and a Balance Sheet as on 31st December, 2016 after (a) providing 10% depreciation on furniture and 20% depreciation on mobike; (b) writing-off ₹ 320 as actual bad debts; and (c) making a 5% provision for likely bad debts.
4. K and D are partners in a firm sharing profits and losses as K 60% and D 40%. Their Statement of Affairs as at 31st March 2016, is given below:

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		40,000	Plant		40,000
Capital Accounts			Furniture		15,000
K	50,000		Stock		25,000
D	30,000	80,000	Debtors		30,000
			Cash		10,000
		1,20,000			1,20,000

   The partners keep their books by Single Entry System. On 31st March 2017, the position of the business was : Plant ₹ 50,000; Furniture ₹ 20,000; Stock ₹ 40,000; Debtors ₹ 45,000; Cash ₹ 11,000 and Sundry Creditors ₹ 30,000. On 30th September, 2016 K and D withdrew from the business ₹ 6,000 and ₹ 4,000 respectively.
   You are required to ascertain the profit made by the partners during the year and draw up a Statement of Affairs as at 31st March, 2017 by taking into consideration the following further information:
   Plant and Furniture are to be depreciated at 10% and 20% p.a. respectively. A Bad Debts Reserve of 2.5% to be raised against Sundry Debtors, Interest on Capital is to be allowed at 5% per annum and Interest on drawings at 12% p. a.
5. Ram, Shyam and Jadu were in partnership and towards the end of 2016, most of their books and records were destroyed in a fire. The Balance Sheet of the firm as on 31.12.2015 was as follows:

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		15,040	Cash at Bank		6,000
Capital A/cs:			Debtors		8,800
Ram	10,000		Stock		12,500
Shyam	5,000		Plant & Machinery		4,950
Jadu	5,000	20,000	Fixture & Furniture		2,800

Current A/c:			Current A/c:		
Ram	300		Jadu		500
Shyam	210	510			
		35,550			35,550

Partners' Drawings during the year were : Ram ₹ 3,000; Shyam ₹ 2,500; and Jadu ₹ 1,500. On 31.12.2016 Cash at Bank was 8,000; Debtors ₹ 9,500; Stock ₹ 12,000; Creditors ₹ 10,000; Plant and Machinery to be depreciated at 10% and fixture and furniture at 7.5%. The partners share profits in the proportion of 2 : 1 : 1.

You are required to prepare a Statement showing net profit for the year 2016 and the division of the same between the partners, together with the Balance Sheet as at 31.12.2016.

6. A, B and C are in partnership and keep their books by single entry system. They are entitled to 5% interest on the amounts standing to their credits at the beginning of each year, and B and C are entitled to salary of ₹ 250 and ₹ 175 per month respectively, in addition. The remaining profits are to be shared as A — 1/2, B — 1/3rd, C — 1/6th.

   On 1st January, 2016 their Capital Accounts were: A — ₹ 27,600, B — ₹ 10,800 and C — ₹ 1,200 and their Plant was valued at ₹ 8,200.

   In the half-year ended 30.6.2016, each partner had drawn interest on capital to which he was entitled: B and C had received their salaries. They had also drawn at the end of each month : A — ₹ 500, B — ₹ 300 and C — ₹ 250. They had bought Plant costing ₹ 2,200 and now valued the whole at ₹ 9,500. Creditors were for ₹ 10,700, Cash — ₹ 4,600, Debtors — ₹ 30,400 and Stock — ₹ 18,900.

   Prepare Statement of Profit and Loss for half-year ended 30th June, 2016 and Balance Sheet as on that date.

7. A and B started business on January 1, 2015 with ₹ 50,000 as capital contributed equally but the profit-sharing ratio was 3 : 2. Their drawings were ₹ 300 and ₹ 200 per month respectively. They had kept no accounts except the following information :

	31.12.2015	31.12.2016
	₹	₹
Machinery at cost	20,000	25,000
Stock in trade	30,000	30,000
Debtors	50,000	60,000
Cash	2,000	500
Creditors	30,000	20,000
Outstanding expenses	4,000	3,000
Bank balance (as per pass book)	6,000	8,000

   Provision is to be made for depreciation at 10% on the cost of the machinery as at the end of the each year. Debtors on 31.12.2015, include ₹ 5,000 for goods sent out on consignment at 25% above cost, and the goods were not sold until 2016. A cheque for ₹ 1,000 had been deposited on 31.12.2015 but was credited on 2.1.2016.

   A cheque for ₹ 2,000 issued on 26.12.2016 was presented on 3.1.2017. A cheque for ₹ 1,000 was directly deposited by a customer on 27.12.2016 and a cheque for ₹ 500 deposited in December 2016 was dishonoured. No adjustment for these was made. Determine the profits for 2015 and 2016 and draw up a Balance Sheet as on 31.12.2016.

8. Naresh, Ramesh and Dinesh are partners in a firm sharing profits and losses in the ratio 5 : 3 : 2 respectively. They kept their books on the Single Entry System. On 31st March, 2016, the following Statement of Affairs are extracted from their books:

Liabilities	₹	Assets	₹
Creditors	20,000	Plant	45,000
Ramesh — Loan A/c	10,000	Land & Building	30,000
Capital		Stock	20,000
Naresh	50,000	Debtors	15,000
Ramesh	40,000	Cash	8,000
		Capital — Dinesh	2,000
	1,20,000		1,20,000

   On 31.3.2017 the Assets and Liabilities were as follows :

   Plant ₹ 50,000; Land and Building ₹ 30,000; Stock ₹ 30,000; Debtors ₹ 25,000; Creditors ₹ 25,000; Cash ₹ 15,000.

   You are required to prepare a Profit and Loss Statement for the year ended 31.3.2017 and a Statement of Affairs as at that date after taking into consideration the following additional information:

   (i) Plant is to be depreciated by 10% p.a.;

   (ii) A Reserve for Bad Debts is to be raised at 2.5%;

   (iii) Interest on Partners' Capital is to be allowed at 5% p.a.; and

   (iv) During 2016-17, Naresh and Ramesh withdrew from business ₹ 7,500 and ₹ 5,000 respectively.

9. A and B are in partnership, sharing profits and losses, two-thirds and one-third respectively. The books are kept on the single entry system and their Statement of Affairs dated 31st December, 2015 showed their position to be as follows:

Statement of Affairs of A and B as at 31st December, 2015

Liabilities	₹	Assets	₹
Capital :		Freehold Building	6,000
A	10,000	Plant and Machinery	2,000
B	4,000	Office Furniture	500
Creditors	5,000	Stock	4,000
Loan	1,000	Debtors	6,000
Bills Payable	500	Bills Receivable	1,500
		Cash	500
	20,500		20,500

On 31st December, 2016 the books disclosed the following facts: Debtors ₹ 8,000, Creditors on open accounts ₹ 8,500, Creditors for loan ₹ 1,600 and Cash ₹ 800. The Stock was valued at ₹ 4,200 and the bills receivable amounted ₹ 1,400.

An examination of the Cash Book showed that during the year, A had drawn on account of profits ₹ 1,500 and B ₹ 600. A had, in addition, withdrawn ₹ 2,000 from his Capital Account on 30th June, 2016.

The partners agree to reduce the existing valuation of the Plant and Machinery by 5 per cent and the office furniture by 10 per cent by way of depreciation, and to charge 5 per cent by way of interest on capital.

You are required to prepare:

(1) A Statement of Profit, dividing the balance between A and B; and

(2) A Statement of Affairs showing the position as at 31st December, 2016.

Preparation of Final Accounts from Incomplete Records

10 Anandam is a wholesaler in textile goods. On January 1, 2017, he had stocks of main varieties A and B valued at ₹ 14,000 and ₹ 24,000 respectively. During the six months ended June 30, 2017, his purchases were ₹ 72,000 and ₹ 1,44,000 respectively. He had taken for personal and family use one bale of variety A costing ₹ 6,000. On 30th June, his stocks were : A, ₹ 8,000 and B ₹ 18,000.

Goods were sold by Anandam at the retail prices fixed by the manufacturer, which yield 25% gross profit on sales. Determine the total sales figure of Anandam for the six months.

11. From the following particulars for the years 2015 and 2016 determine the value of closing stock at the end of 2016 :

	2015 (₹)	2016 (₹)
Opening Stock	20,000	30,000
Purchases	1,20,000	1,90,000
Sales	2,00,000	2,40,000

Uniform rate of gross profit may be assumed.

12. You are required to calculate for each product of the company as a whole:

(a) Value of Stock at 31st December, 2016, at cost;

(b) The amount of Gross Profit, as they would appear in the company's Trading Account.

The company sells three products A, B and C on which it earns gross profit percentages, calculated on normal selling prices, of 20, 25 and $33^1/_3$ respectively.

The value of its stock at 1st January, 2016 valued at cost, were A ₹ 24,000; B ₹ 36,000; C ₹ 12,000.

During the year ended 31st December 2016 the actual purchases and sales were :

Purchases : A ₹ 1,46,000; B ₹ 1,24,000; C ₹ 48,000; **Sales** : A ₹ 1,72,500; B ₹ 1,59,400; C ₹ 74,600.

However, certain items were sold during the year at a discount on the normal selling prices and these discounts were reflected in the values of sales shown above. The items sold at a discount were :

Normal Sales Price : A ₹ 10,000; B ₹ 3,000; C ₹ 1,000;

Actual Sales Price : A ₹ 7,500; B ₹ 2,400; C ₹ 600.

These discounts were not provided for in the cost values at 1st January, 2016 given above.

13. S.K.S. does not maintain proper books of account. However, he provides you with the following details:

(a) **Sales and Purchases policy :** Total sales during the year 2016 — ₹ 6,00,000. Volume of sales during 2nd half of 2016 was 1/3 that of 1st half. Volume of credit sales was twice that of cash sales throughout the year. All purchases were on credit and were made evenly throughout the year.

(b) **Credit policy :** Closing debtors represent last two months' sales, whereas closing creditors represent last 3 months' purchases.

(c) **Price Policy :** Goods are sold at 10% profit on credit sales. Cash selling price was always at a profit of 5% of Sales.

(d) **Inventory Policy :** The firs two months' requirement was held as opening stock whereas the last month's requirement was held as closing stock. From the above details, ascertain the following: (i) Opening Stock; (ii) Closing Stock; (iii) Total Purchases; and (iv) Closing Debtors and Creditors.

14. You are preparing an income statement and balance sheet for Longman, a sole trader who does not keep adequate accounting records.

The following information is available to you to compute the figures for inclusion in the accounts for sales revenue and purchases for the year ending 31 March, 2017 (all figures in Rupees) :

(a) Sales revenue		**(b) Purchases**	
Cash received from credit customers	2,18,500	Payment to suppliers	1,14,400
Cash sales receipts paid into bank	1,14,700	Trade Creditors : 31 March, 2016	22,900
Expenses paid out of cash sales before banking	9,600	31 March, 2017	24,800
Trade Debtors : 31 March, 2016	41,600	Cost of items taken from inventory by Longman for	
31 March, 2017	44,200	personal use	400
Refunds to customers	800	Amount due from credit customer deducted by Longman	
Discounts allowed	2,600	in settling supplier's account	700
Bad debts written off	1,500		
Amount due from credit customer deducted by Longman			
in paying supplier's account	700		

You are required to compute the sales revenue figure and the purchases figure.

15. X does not maintain proper books of account. From the following information, prepare Trading and Profit and Loss Account for the year ended December 31, 2016 and a Balance Sheet as on that date :

Assets and Liabilities	On 31.12.2017 ₹	On 31.12.2016 ₹
Debtors	9,000	12,500
Stock	4,900	6,600
Furniture	500	750
Creditors	3,000	2,250

Analysis of other transactions are :	₹
Cash collected from Debtors	30,400
Cash paid to Creditors	22,000
Salaries	6,000
Rent	750
Office Expenses	900
Drawings	1,500
Fresh Capital introduced	1,000
Cash Sales	750
Cash Purchases	2,500
Discount Received	350
Discount Allowed	150
Return Inward	500
Return Outward	400
Bad Debts	100

He had ₹ 2,500 cash at the beginning of the year. ***[C.U.B.Com. (Hons.) — Adapted]***

16. Mr Mukherjee commenced business on 1st January, 2016, with a capital of ₹ 45,000. He immediately purchased Furniture of ₹ 24,000. During the year he received from his uncle a gift of ₹ 3,000 and he borrowed from his father a sum of ₹ 5,000. He had withdrawn ₹ 600 per month for his household expenses. He had no Bank Account and all dealings were in cash. He did not maintain any books but the following information is given:

Sales (including cash sales ₹ 30,000)	1,00,000	Salaries	6,200
Purchases (including cash purchases ₹ 10,000)	75,000	Bad debts written off	1,500
Carriage Inwards	700	Trade expenses	1,200
Wages	300	Advertisements	2,200
Discount allowed to Debtors	800		

He used goods worth ₹ 1,300 for personal purposes and paid ₹ 500 to his son for examination and college fees.
On 31st December, 2016, his Debtors were worth ₹ 21,000 and Creditors ₹ 15,000. Stock in trade was valued at ₹ 10,000. Furniture to be depreciated by 10% p.a.
Prepare Trading and Profit and Loss Account for the year ended on 31st December, 2016 and Balance Sheet as at 31st December, 2016.

17. Motilal is a small trader, and is financially incapable of engaging the services of an accountant. He keeps no books but only an account with a bank in which all takings are lodged after meeting business expenses and his personal drawings and through which all payments for business purchases are passed.
You are required to ascertain his trading result for the year ended 31.3.2017 and the financial position of his business as on that date from the following information supplied by him :
(a) The bank statement shows deposits during the year of ₹ 12,020 and withdrawals of ₹ 11,850.
(b) ₹ 1,000 had been placed in fixed deposit account on 31.12.2015 at 10% p.a. and withdrawn with interest on 30.6.2016.
(c) The assets and liabilities on 31.3.2017 were : Stock ₹ 1,100; Book Debts ₹ 1,150; Bank balance ₹ 320, Furniture ₹ 2,000; and Trade Creditors ₹ 400.
(d) In the absence of reliable information, estimates are supplied on the following matters :
(i) The stock and book debts have each increased by ₹ 100 during the year.
(ii) The trade creditors were ₹ 200 on 1.4.2016.
(iii) During the year, personal expenses amounted to ₹ 800 and business expenses ₹ 700. Ignore fractions.

18. X does not maintain regular books of account. The following information is available for the year ended 31.12.2016:
(i) Cash sales ₹ 38,400;
(ii) Cash collections from debtors ₹ 60,000;
(iii) A summary of the bank transactions for the year ended 31.12.2016 :
Deposits : cash ₹ 95,820.
Withdrawals : expenses ₹ 19,020; interest ₹ 180; salaries ₹ 20,400; drawings ₹ 4,800; creditors ₹ 36,000.
(iv) Balances as on 1.1.2016 were as follows : Bank overdraft : ₹ 9,600; Stock : ₹ 21,600; Debtors : ₹ 52,800; Furniture ₹ 2,400; Buildings ₹ 36,000; Creditors ₹ 19,200; Cash ₹ 200.
(v) X purchased an old motor cycle for ₹ 2,400 on 1.10.2016.
(vi) The other balances on 31.12.2016 were : Creditors ₹ 13,200; Stock ₹ 24,480 and Debtors ₹ 72,000.
Prepare a Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as on that date after charging depreciation @ 10% p.a. on fixed assets.

19. Shri V.L. Srivastav does not maintain regular books but keeps only memoranda of his transactions. He furnishes the following information from the memoranda for the year ended 30.9.2016:
(a) Total collection from Debtors (in cash) ₹ 30,000;
(b) Cash Sales ₹ 19,200;
(c) The abstract of Bank Account for the year ended 30.9.2016: (all figures in ₹)

To Deposits (cash)	47,910	By Balance (overdraft) (1.10.2015)	4,800
		By Interest & bank charges	90
		By Drawings	2,400
		By Salaries	10,200
		By General expenses	9,510
		By Creditors	18,000
		By Balance on 30.9.2016	2,910
	47,910		47,910

(d) Other balances as on 1.10.2015 were: Stock ₹ 10,800; Debtors ₹ 26,400; Furniture ₹ 1,200; Buildings ₹ 18,000; Creditors ₹ 9,600; Cash in hand ₹ 100;
(e) He purchased an old scooter at ₹ 1,200 on 30.6.2016.
(f) Besides cash balance other balances on 30.9.2016 were: Stock ₹ 12,240; Debtors ₹ 36,000; Creditors ₹ 6,600.
Prepare a Profit and Loss Account for the year ended 30.9.2016 and a Balance Sheet on that date after charging depreciation @ 10% p.a. on Buildings, Furniture and Scooter.

20. Rama Reddi is a retail merchant who keeps only a memorandum of his transactions. By going through his notes and records, you are able to ascertain the following:

(a) Summary of Bank Account (1.4.2016 to 31.3.2017)

	₹		₹
To Balance b/d	2,500	By Payment to Creditors	2,20,000
To Cash deposited	2,30,000	By Rent paid	12,000
To Balance c/d	13,100	By Electric charges	3,600
		By Drawings	10,000
	2,45,600		2,45,600

(b) Other cash transactions : Cash purchases — ₹ 20,000; Office expenses paid — ₹ 20,500; Cash balance on 1.4.2016 — ₹ 500; and Cash balance on 31.3.2017 — ₹ 1,000.

(c) Other information :

(i) Stock in trade : As on 1.4.2016 — ₹ 50,000; As on 31.3.2017 — ₹ 75,000.

(ii) A deposit of ₹ 3,000 for rent lies with the landlord.

(iii) Furniture with a written-down value of ₹ 30,000 on 1.4.2016 is subject to depreciation at 10% p.a.

(iv) Electricity bills to be paid on 1.4.2016 and 31.3.2017 were for ₹ 400 and ₹ 600 respectively.

(v) Amounts due to creditors on 1.4.2016 and 31.3.2017 were ₹ 10,600 and ₹ 21,000 respectively.

(vi) An amount of ₹ 2,000 being irrecoverable from a customer is to be written-off as bad.

(vii) Debtors on 1.4.2016 and 31.3.2017 were ₹ 20,000 and ₹ 17,400 (excluding bad debts of ₹ 2,000) respectively.

From the above information, prepare Rama Reddi's:

1. Trading and Profit and Loss Account for the year ended 31st March 2017; and
2. Balance Sheet as at 31st March, 2017.

21. Bhuvanabhoopati who commenced business as a retail trader on 1.1.2016 has not kept proper records of his transactions for the year ended 31.12.2016. He, however, has kept a cash diary from which he has extracted the following:

Cash Account

Receipts	₹	Payments	₹
Amount withdrawn from Bank on various dates	3,520	Postage expenses	720
		Conveyance expenses	2,400
		Licence fees	60
		Miscellaneous expenses	220
		Balance c/d	120
	3,520		3,520

An analysis of his Bank Statements reveals the following :

Deposits: Capital introduced ₹ 50,000; Cash sales ₹ 2,40,000; Collection from debtors ₹ 20,000;

Withdrawals : Cash withdrawals for petty expenses ₹ 3,520; Rent paid ₹ 2,200; Electricity bills paid ₹ 660; Payments to suppliers ₹ 1,80,000; Insurance ₹ 12,000; Salaries ₹ 3,600; Furniture & Fixtures purchased ₹ 24,000; Advance income-tax paid ₹ 12,000; Typewriter purchased ₹ 2,000; Personal drawings ₹ 36,000.

You also ascertain the following additional information:

(a) All fixed assets were purchased in each January. Furniture is to be depreciated at 10% and Typewriter at 15%.

(b) Rent and electricity payable to the landlord are in arrears for December, 2016.

(c) At the end of the year, debtors were ₹ 5,000, creditors ₹ 2,700 and stock ₹ 39,000.

You are required to prepare:

(i) A summary of the Bank Account and ascertain the closing balance; (ii) Trading and Profit and Loss Account for the year ended 31.12.2016; and (iii) Balance Sheet as at that date.

22. The following is a summary of the Bank Account of Mr Khanna, a trader, for the year 2016.

Bank Summary

Particulars	₹	Particulars	₹
Balance on January 1, 2016	5,140	Payment to trade creditors	1,87,860
Cash receipts on account of credit sales	2,43,720	General expenses	16,970
Balance on December 31, 2016	1,180	Rent & rates	7,710
		Drawings	37,500
	2,50,040		2,50,040

All business takings had been paid into the bank except ₹ 21,180, out of which he paid wages amounting to ₹ 12,800. He retained ₹ 8,380 for private purposes. The following information is obtained from the books:

Particulars	31.12.2015	31.12.2016	Particulars	31.12.2015	31.12.2016
Stock in trade	24,300	31,500	Rates paid in advance	420	450
Creditors for goods	19,450	17,090	Creditors for general expenses	810	1,340
Debtors for goods	22,400	26,900	Amount owing to a customer who had overpaid his account	600	—
Furniture and fittings	10,000	10,000			

Discounts received from trade creditors during 2016 amounted to ₹ 1,500. No discounts were allowed to customers. The amount due to the customer who overpaid his account was set off against sales to him in 2016.
You are required to prepare a Trading and Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as on that date.

23. Anand started business on 1.1.2016 with his own capital of ₹ 20,000, and an interest free loan of ₹ 20,000 from a friend.
His business makes toys, which are selling at ₹ 40 each. Anand, who has little knowledge of accountancy, produced the following information at the end of the first year's trading :
Cash received : Sale proceeds of 2,000 toys ₹ 80,000.
Cash paid : Wages ₹ 28,000; Raw materials ₹ 13,600; Rent ₹ 8,000; General expenses ₹ 4,800; Loan repaid ₹ 6,000.
You ascertain the following additional information :
(1) A further 300 toys were sold in 2016, but not paid for at the year end.
(2) ₹ 3,600 of raw materials received in the year, but not paid for.
(3) The only stock at 31.12.2016 was ₹ 1,600 raw materials.
(4) The rent covered the period from 1.1.2016 to 31.3.2017.
(5) Expenses included ₹ 800 withdrawn by Anand for his own use.
(6) The initial capital and loan of ₹ 40,000 was used to buy machinery with 4-year life and an anticipated residual value of ₹ 8,000.
(7) The wages figure included ₹ 10,000 for installing the machinery.
(8) The machinery is to be depreciated under reducing balance method @ 25% p.a. for the whole year.
Prepare a Trading and Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as on that date.

24. Sanjay is in business but does not keep full accounting records. For the year ended 31.12.2016, he is able to provide you with the following information (all figures in ₹) :

Date	Stock	Debtors	Creditors	Furniture
1.1.2016	29,500	3,250	7,360	12,000
31.12.2016	32,710	5,010	10,140	10,500

You are able to prepare the following summary of his cash and bank transactions for 2016 :

Cash	₹	₹	Bank	₹	₹
Opening balance		490	Opening balance		9,200
Receipts —			Receipts —		
Cash Sales	53,600		Cheques from Customers	17,330	
Cheque Cashed	2,600	56,200	Paid into Bank	39,950	57,280
		56,690			66,480
Payments —			Payments —		
Purchases	3,400		Creditors	29,500	
Wages	1,020		Wages	3,710	
Other Expenses	2,260		Other Expenses	7,700	
Drawings	8,200		Rent	12,500	
Paid into Bank	39,950	54,830	Cash Withdrawn	2,600	56,010
Closing Balance		1,860	Closing Balance		10,470

You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2016 and a Balance Sheet as on that date.

25. X is a tobacco merchant. He follows the practice of paying creditors for goods purchased through his bank account and making payments in cash on all nominals accounts.
X had not kept his books on the double entry principles nor had he balanced his Cash Book.
However, the following information has been extracted from X's accounting records (all figures in Rupees).

Date	Cash	Bank	Debtors	Creditors	Investments	Stock
1.1.2016	30	1,000	1,750	3,410	6,250	2,500
31.12.2016	50	1,500	2,500	3,750	6,250	1,870

Transactions during the year 2016 were the following (all figures in Rupees) :

Salaries paid	1,500	Payments to creditors through bank and of trade expenses in cash	20,000
General expenses paid	3,500	Payments into bank - business	18,750
Payment for stationery	870	Payments into bank - additional capital	250
Payment of rent and rates	700	Payments from bank account - personal	3,250
Lighting charges paid	250	Cash payments - personal	910
Cash receipts from debtors	31,250		
Stock taken for personal use	140		

Prepare Trading and Profit and Loss Account for the year ended 31.12.2016 and Balance Sheet on that date.

[Delhi University — B.Com. (Hons.) — Adapted]

26. The following is the Balance Sheet of Sri Govind as on 30th June 2016 :

Liabilities	₹	Assets	₹
Capital Account	96,000	Buildings	65,000
Loan	30,000	Furniture	10,000
Creditors	62,000	Motor car	18,000
		Stock	40,000
		Debtors	34,000
		Cash in hand	4,000
		Cash at bank	17,000
	1,88,000		1,88,000

A riot occurred on the night of 30th June 2017 in which all books and records were lost. The cashier had absconded with the available cash. Shri Govind gives you the following information :

(a) His sales for the year ended 30th June 2017 were 20% higher than the previous years. He always sells his goods at cost plus 25%. 20% of the total sales for the year ended 30th June 2017 was for cash. There were no cash purchases.
(b) On 1st July, 2016, the stock level was raised to ₹ 60,000 and the stock was maintained at this level throughout the year.
(c) Collection from Debtors amounted to ₹ 2,80,000 of which ₹ 70,000 was received in cash. Business expenses amounted to ₹ 40,000 of which ₹ 10,000 was outstanding on 30th June 2017 and ₹ 12,000 was paid by cheques.
(d) Analysis of the pass books revealed on the following : Payment to creditors ₹ 2,75,000; Personal drawings ₹ 15,000; Cash deposited in bank ₹ 1,43,000; Cash withdrawn from bank ₹ 24,000.
(e) Gross profit as per last year's audited accounts was ₹ 60,000.
(f) Provide depreciation on building and furniture at 5% and on motor car at 20%.
(g) The amount defalcated by the cashier may be treated as recoverable from him.

Prepare the Trading and Profit and Loss Account for the year ended 30th June 2017 and Balance Sheet as on that date.

27. The following are the assets and liabilities of Sanjoy as on 31.3.2016 (all figures in ₹ '000) :
Liabilities : Capital 200; Creditors 50. **Assets :** Fixed assets : 145; Stock 40; Debtors 50; Cash 5; Bank 10.
A fire destroyed the accounting records as well as the closing cash on 31.3.2017.
However, the following information was available :

(a) Debtors and Creditors on 31.3.2017 showed an increase of 20% as compared to 31.3.2016.
(b) Credit period : Debtors 1 month; Creditors 2 months.
(c) Stock was maintained at the same level throughout the year.
(d) Cash sales constituted 20% of total sales.
(e) All purchases were for credit only.
(f) Current ratio as on 31.3.2017 was exactly 2.
(g) Total expenses excluding depreciation for the year amounted to ₹ 2,50,000.

(h) Depreciation was provided at 10% on the closing value of fixed assets.

(i) Bank and cash transactions :
(i) Payments to creditors included ₹ 50,000 by cash; (ii) Receipts from debtors included ₹ 5,90,000 by way of cheques; (iii) Cash deposited into the bank ₹ 1,20,000; (iv) Personal drawings from bank ₹ 50,000; and (v) Fixed assets purchased and paid by cheques ₹ 2,25,000.

You are required to prepare :

(a) Trading and Profit and Loss Account for the year ended 31.3.2017; and

(b) A Balance Sheet on that date. For your exercise assume that cash destroyed by fire is written off in the Profit and Loss Account.

28. The following information is supplied from which you are requested to prepare the Profit and Loss Account for the year ended 31st December, 2016 and Balance Sheet as at that date :

	1.1.2016	31.12.2016
Assets and Liabilities	₹	₹
Sundry Assets	18,000	20,000
Stock	14,000	19,000
Cash in hand	8,200	4,800
Cash at bank	2,200	8,000
Debtors	?	26,000
Creditors	12,000	9,800
Miscellaneous expenses outstanding	1,000	600

Details relative to the year's transactions are :

Receipts in the year from Debtors after discount	2,45,000	Salary and wages paid out of bank	18,000
Returns from Debtors	6,000	Miscellaneous expenses paid by cash	5,000
Bad debts	1,000	Drawings by cash	9,400
Sales — cash and credit	3,00,000	Purchase of sundry assets by cheque	2,000
Returns to creditors	3,000	Cash withdrawn from bank	21,000
Payments to creditors by cheque	2,36,200	Cash sales deposited in bank	?
Receipts from Debtors deposited into bank	2,43,000	Discount allowed by creditors	4,000
Cash purchases	10,000		

29. From the following information of M/s Pradip & Company, prepare Trading and Profit and Loss Account for the year ending on 31.3.2017 and the Balance Sheet as on that date (all figures in ₹) :

Date	Car	Furniture	Stock	Debtors	Bank	Creditors
31.3.2016	90,000	10,000	70,000	62,000	9,000	60,000
31.3.2017	90,000	10,000	90,000	46,000	16,000	?

The following further information is also provided :

(a) M/s Pradip & Company purchases goods for resale from manufacturers who allow discount of 3% on goods purchased in excess of ₹ 5,00,000 in a year. The discount for the year ended 31.3.2017 was ₹ 12,480.

(b) All goods are sold at a gross profit margin of 30% on selling price.

(c) Bank statement for the year reveals the following payments (all figures in ₹) : Creditors 9,03,520; Salaries 60,000; Car expenses 23,000; Rent 30,000; Printing and Stationery 6,400; Rates and Taxes 3,000; Carriage outwards 18,600; Travelling expenses 14,900; Delivery van purchased 1,70,000; Miscellaneous expenses 9,580; and Drawings 50,000.

(d) Depreciation on car and van @ 20% and furniture @ 10% is to be provided on balances as on 31.3.2017.

30. From the following information obtained from Mr X, a trader, who does not prepare proper accounts, prepare a Trading and Profit and Loss Account for the year ending on 31.3.2017 and the Balance Sheet as on that date:

(a) Withdrawal as per Pass Book (all figures in ₹) :

Postage and Telegrams	1,000	X's Drawings	10,000
Rents, rates, taxes and insurance	12,000	Paid for purchases	50,000
Furniture purchased on 1.4.2016	2,000	Salaries	8,000
Printing charges	1,000	Wages	8,000
Advertisement expenses	1,000		

(b) Balance at bank on 31.3.2017 was ₹ 3,000.

(c) Stock on 1.4.2016 was ₹ 24,000 and stock on 31.3.2017 was ₹ 4,000 less than of stock on 1.4.2016. Out of stock on 1.4.2016, spoiled stocks were sold for ₹ 2,000 which were not deposited into bank account.

(d) Payments for purchases include ₹ 4,000 for last year's purchase. ₹ 1,000 of previous year's purchase is still unpaid on 31.3.2017. Current year's list of unpaid invoice not ticked off in purchase register amounted to ₹ 5,000.

(e) Collections for sale were ₹ 1,00,000 which includes ₹ 12,000 in respect of previous year's sale. Balance of unticked bills of last year's sale still amounted to ₹ 8,000 on 31.3.2017. Unticked bills of the current year totalled to ₹ 20,000.
(f) Salaries ₹ 500 and Wages ₹ 500 was outstanding on 31.3.2017.
(g) Furniture on 31.3.2016 amounted to ₹ 6,000 and machinery on the same date were ₹ 50,000.
(h) Prepaid insurance on 31.3.2017 amounted to ₹ 400.
(i) Depreciation at 10% p.a. shall be provided on Furniture and at 25% p.a. on machinery.

He maintained purchases and sales register and items are ticked off on collection or payment. All collections are deposited and payments are all in cheques. Petty expenses of ₹ 1,000 were paid out of his drawings. All purchases and sales were made on credit basis.

31. A is importer of fancy goods, operating from rented premises, which is on lease of ₹ 1,000 per month. He prepares his accounts as on 31st December, each year. On the night of December 31st, 2016, all his books and records were destroyed in a fire.

The following was his summarized financial position as on 31st December, 2015:

Fixed Assets : Motor car ₹ 20,000; Furniture ₹ 10,000

Current Assets : Stock-in-trade (at cost) ₹ 2,00,500; Debtors ₹ 24,000; Balance at bank ₹ 27,060; Cash in hand ₹ 590; Prepaid rent ₹ 500;

Current Liabilities : Creditors for purchases ₹ 1,10,200; Accrued rent ₹ 2,000; Due for hire purchase instalments ₹ 2,790;

The following further information is also available:

(a) A buys goods for resale only from one manufacturer in Japan, who allows a rebate of 3% of the goods purchased by him in excess of ₹ 5,00,000 in a calendar year. The rebate due for the year ended 31st December, 2016 was ₹ 12,480.
(b) All goods are sold at a standard gross profit margin of 40% on selling price. Any rebate due is to be ignored.
(c) Stock at cost on 31st December, 2016 amounted to ₹ 90,200.
(d) Weekly cash expenses out of cash sales (before depositing the same into the bank) have been :
Drawings ₹ 300; Carriage outward ₹ 500; Petrol ₹ 100; General expenses ₹ 50,
Cash in hand on 31st December, 2016 amounted to ₹ 1,670.
(e) His bank statements for the year reveal the following information :

	₹		₹
Paid for purchases of goods	10,10,500	Salaries	1,12,460
Car expenses	6,680	Travelling expenses	36,800
Rent	13,000	Printing & stationery	6,400
Rates for the year ended 31.03.2017	3,200	Advertisement	12,280
Hire purchase instalments (final payment)	3,040	Insurance for business	3,000
Lorry hire charges	48,700	General expenses	36,230
Drawings	37,000	Balance as on 31.12.2016	2,31,800

(f) Depreciation on motor car and furniture is to be provided @ 30% and @ 15% respectively.

Prepare Trading and Profit and Loss Account for the year ended on 31st December 2016 and Balance Sheet as on that date.

32. From the following data, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2017 and a Balance Sheet as on that date. All workings should form a part of your answer.

	1.4.2016	31.3.2017
Assets and Liabilites	₹	₹
Creditors	15,770	12,400
Sundry expenses outstanding	600	330
Sundry assets	11,610	12,040
Stock in trade	8,040	11,120
Cash in hand and cash at bank	6,960	8,080
Trade Debtors	?	17,870

Details relating to transactions in the year :

	₹		₹
Cash and discount credited to Debtors	64,000	Cash purchases	1,030
Sales return	1,450	Cash expenses	9,570
Bad debts	420	Paid by cheque for machinery purchased	430
Sales (cash and credit)	71,810	Household expenses drawn from bank	3,180
Discount allowed by trade creditors	700	Cash paid into bank	5,000

Purchases returns	400	Cash drawn from bank	9,240
Additional capital paid into bank	8,500	Cash in hand on 31.3.2017	1,200
Realisation from Debtors — paid into bank	62,500	Cheque issued to trade creditors	60,270

Guide to Answers

Multiple Choice

1. C 2. C 3. C 4. C 5. C.

Practical Questions

1. **Closing Capital ₹ 36,000; Profit before adjustment ₹ 12,700; Net Profit ₹ 9,875; Balance Sheet ₹ 40,675.**
2. **Opening Capital ₹ 65,000; Closing Capital ₹ 63,000; Profit Before Adjustment ₹ 4,000; Net Profit (trading) ₹ 3,800; Profit on Sale of Furniture ₹ 4,000; Statement of Affairs ₹ 1,02,800.**
3. **Opening Capital ₹ 22,500; Closing Capital ₹ 29,120; Bank Balance as per Cash Book ₹ 4,930; Profit Before Adjustment ₹ 7,420; Net Profit ₹ 5,800; Balance Sheet ₹ 32,800.**
4. **Closing Capital ₹ 1,36,000; Profit Before adjustment ₹ 66,000; Net profit ₹ 56,875; Divisible profit ₹ 53,475; K ₹ 32,085; D ₹ 21,390; Statement of Affairs ₹ 1,56,875; K's Capital ₹ 78,225; D's Capital ₹ 48,650.**
5. **Opening Capital ₹ 20,010; Closing Capital ₹ 27,250; Profit Before Adjustment ₹ 14,240; Net Profit ₹ 13,535; Current Accounts : Ram ₹ 4,067; Shyam ₹ 1,094; Jadu ₹ 1,384; Balance Sheet : ₹ 36,545.**
6. **Closing Capital ₹ 53,600; Profit Before Adjustment ₹ 23,840; Net Profit ₹ 22,940. Divisible Profit ₹ 19,400; Capital Accounts : A ₹ 34,300; B 15,467; C ₹ 2,933; Balance Sheet ₹ 63,400.**
7. **Combined Closing Capital (before adjustments) : 2015 — ₹ 74,000; 2016 — ₹ 98,000.**
   Divisible Profit : 2015 — ₹ 28,000; 2016 ₹ 27,500. Balance Sheet Total of 2016 : ₹ 1,16,500.
8. **Combined Closing Capital — ₹ 1,25,000; Combined Opening Capital — ₹ 88,000.**
   Net Profit — ₹ 44,125; Divisible Profit — ₹ 39,625. Total of Statement of Affairs — ₹ 1,44,625.
9. **Combined Closing Capital — ₹ 12,800; Combined Opening Capital — ₹ 14,000.**
   Net Profit — ₹ 2,750; Divisible Profit — ₹ 2,100. Total of Statement of Affairs — ₹ 22,750.
10. **Sales : Variety A — ₹ 96,000; Variety B — ₹ 2,00,000.**
11. **Rate of Gross Profit in 2015 — 45%. Value of Closing Stock of 2016 — ₹ 88,000.**
12. **Value of Closing Stock : Product A — ₹ 30,000; Product B — ₹ 40,000; Product C — ₹ 10,000;**
    Gross Profit : A — ₹ 32,500; B — ₹ 39,400; C — ₹ 24,600.
13. **(i) Opening Stock — ₹ 1,37,500; (ii) Closing Stock — ₹ 22,916; (iii) Total Purchases — ₹ 4,35,416;**
    (iv) Debtors — ₹ 33,333 and Creditors — ₹ 1,08,854.
14. **Credit Sales : ₹ 2,25,100; Cash Sales (₹ 1,14,700 + 9,600) = ₹ 1,24,300; Total Sales : ₹ 3,49,400. Purchases : ₹ 1,16,600.**
15. **Gross Profit : ₹ 12,000; Net Profit : ₹ 4,950; Balance Sheet Total ₹ 20,600.**
15. **Gross Profit : ₹ 35,300; Net Profit : ₹ 21,000; Balance Sheet Total : ₹ 80,000.**
16. **Gross Profit : ₹ 620; Net Loss : ₹ 55; Balance Sheet Total : ₹ 4,570; Opening Capital : ₹ 5,025.**
17. **Gross Profit : ₹ 90,480; Net Profit : ₹ 46,980; Balance Sheet Total : ₹ 1,39,580.**
18. **Capital ₹ 42,100; Credit Sales ₹ 39,600; Credit Purchases ₹ 15,000; Cash Sales ₹ 19,200; Gross Profit ₹ 45,240; Net Profit ₹ 23,490; Balance Sheet 69,790**
19. **Capital ₹ 95,000; Cash collected from Debtors ₹ 2,71,000; Credit Sales ₹ 2,70,000; Credit purchases ₹ 2,30,400; Gross Profit ₹ 44,600; Net Profit ₹ 3,300; Balance Sheet ₹ 1,23,000.**
20. **Closing bank balance ₹ 34,020; Gross Profit ₹ 1,21,300; Net Profit ₹ 96,480; Credit Sales ₹ 25,000; Credit purchases ₹ 1,82,700; Balance Sheet ₹ 1,01,440.**
21. **Net Profit — ₹ 53,720; Balance Sheet total — ₹ 68,850.**
22. **Net Profit — ₹ 35,500; Balance Sheet total — ₹ 72,300.**
23. **Net Profit — ₹ 11,530; Balance Sheet total — ₹ 60,550.**
24. **Net Profit — ₹ 4,350; Balance Sheet total — ₹ 12,170.**
25. **Net Profit — ₹ 24,650; Balance Sheet total — ₹ 2,40,650.**
26. **Net Profit — ₹ 2,43,000; Balance Sheet total — ₹ 4,53,000.**
    Total Sales — ₹ 9,00,000; Total Purchases — ₹ 3,60,000.
27. **Opening Debtors ₹ 18,000; Cash Sales deposited into Bank ₹ 40,000; Opening Capital ₹ 47,600; Net Profit ₹ 29,400; Balance Sheet ₹ 77,800.**
28. **Gross Profit : ₹ 3,84,000; Net Profit : ₹ 1,78,000; Balance Sheet Total : ₹ 3,69,000.**
29. **Gross Profit : ₹ 46,500; Net Profit : ₹ 9,100; Balance Sheet Total : ₹ 96,100.**
30. **Gross Profit : ₹ 5,78,750; Net Profit : ₹ 4,88,300; Balance Sheet Total : ₹ 6,65,000.**
31. **Gross Profit : ₹ 14,810; Net Profit : ₹ 4,290; Balance Sheet Total : ₹ 49,110.**

19

Consignment Accounts

Introduction

Business organisations sometimes market their goods through agents as an alternative to selling goods themselves. Consignment is a kind of business expansion without actually opening a branch in a new potential market. In consignment, a manufacturer or wholesaler despatches goods to an agent who has a better knowledge of the local market, for the purpose of sale. The person sending the goods is called the ***consignor*** and the agent who receives the goods is called the ***consignee***. The consignee markets the product within his own periphery and receives commission at a stipulated rate on the total sales. He is also entitled to recover such expenses which he incurs in connection with the consignment. The consignee does not only market the product but discharges the function of sales promotion also. If he fails to perform this function, he may well be replaced by another. On the other hand, if the consignee finds that the business is not remunerative enough for him, he may well give it up and may not be interested to renew the contract for consignment. Consignment accounts are the accounts recording the transactions relating to the goods sent on consignment.

Economics of Consignment

Consignment flourishes because of its inherent economies. ***First***, it is cost saving. It dispenses with the need of branch opening at distant place or places with heavy cost implications. ***Secondly***, the manufacturer may not have the capacity to open branches while he intends to tap distant markets. Consignment fulfils both the needs. Consignment facilitates expansion without much initial and on-going costs. In short, it is the simplest and more economical way of territorial expansion and, as such, a mode of growth for manufacturing companies.

Distinction Between Sale and Consignment

	Sale		Consignment
(a)	In case of a sale, property in goods is transferred to the buyer along with the transfer of goods.	(a)	In case of a consignment, goods remain the property of the consignor until the time they are sold by the consignee.
(b)	Goods once sold cannot be returned to the seller except when they are defective or the seller agrees to take those back.	(b)	Unsold goods of consignment are the property of the consignor and can be returned to him.

(c)	When goods are sold on credit, the buyer becomes the debtor of the seller. The relationship between the buyer and seller is that of debtor and creditor.	(c)	When goods are sold on credit, the buyer becomes the debtor of the consignor. The relationship between the consignor and the consignee is that of a principal and an agent.
(d)	When goods are lost after delivery to the buyer, it is the buyer who will bear the loss.	(d)	When goods are lost on consignment, it is the consignor who will bear the loss.

Procedure for Consignment Transactions

The consignor sends goods to the consignee along with a ***Proforma Invoice***. An invoice is a document sent by a seller to a buyer giving details of goods or services sold, their price and terms of payments. A proforma invoice is a document to show what the invoice would be. It is not a demand for payment. It is a memorandum invoice and serves as a guide to the consignee in respect of (1) description of the goods and (2) minimum selling price to be realised. In the case of foreign consignments, the 'Proforma Invoice' serves as a prime document for customs clearance.

When goods are sent to the consignee the consignor makes a record of the consignment giving full details of the goods, their cost prices and the expenses incurred.

After receiving goods, the consignee tries to sell them at the best possible price. ***It should be noted that mere receipt of the goods does not make the consignee a debtor of the consignor***. He becomes indebted to the consignor when he sells the goods and realizes the money. The consignee may have to spend some money in respect of the consignment such as unloading charges, godown rent and the like for which he is entitled to be reimbursed. It is the duty of the consignee to remit the proceeds of sales after deducting his expenses in respect of the consignment and his own commission, to the consignor. The details of sale proceeds, expenses and commission are contained in an accompanying statement known as **'*Account Sales.*'**

An ***Account Sales*** is a statement which is periodically rendered by the consignee to the consignor, showing the details about the goods sold, price realized, his own commission, and the expenses incurred in connection with the sale.

Illustrative Example

On 15th November 2016, Kapil & Co of Chandigarh consigned 250 bicycles to Arun & Co Calcutta. On 31st December 2016, Arun forwarded an Account Sales, with a bank draft for the balance, showing the following transactions:

1. 200 bicycles sold @ ₹ 600 each and 50 @ ₹ 560 each.
2. Unloading charges ₹ 500.
3. Storage and Insurance ₹ 1,000.
4. Commission on Sales @ 10%.

You are required to prepare the Account Sales.

Arun & Co **35, Park Street, Calcutta 700 016**
31st December, 2016

Account Sales of 250 bicycles sold by order and for account of Kapil & Co.

Gross Proceeds	₹	₹
200 @ ₹ 600 each	1,20,000	
50 @ ₹ 560 each	28,000	1,48,000
Less: Charges		
Unloading charges	500	
Storage & Insurance	1,000	
Commission @ 10% on ₹ 1,48,000	14,800	16,300
Net proceeds		1,31,700

Bank draft enclosed, ₹ 1,31,700 (Rupees one lakh thirty one thousand seven hundred only) E. & O. E.

(Signed) Arun & Co Calcutta

Entries in the Books of the Consignor

The primary objective for preparing the Consignment Account is to ascertain the profit or loss on each consignment separately. For that, the consignor prepares a ***Consignment Account*** for each consignment. This special account is always named with either the consignee or the place, for example 'Consignment to Arun & Co Account' or 'Consignment to Calcutta Account'—just to distinguish one consignment from another. Consignment account is a ***Nominal Account***. In fact, it is a combined Trading and Profit and Loss Account related solely to the consignment. This account is debited with : (1) opening stock on consignment (if any); (2) cost of goods sent on consignment; (3) expenses incurred by the consignor, such as freight, insurance for sending goods; (4) expenses incurred by the consignee such as unloading charges, godown rent and the like; and (5) consignee's commission on sales. This account is credited with : (1) gross sales proceeds; and (2) closing stock (if any). The balance of this account represents profit or loss which is transferred to ***'Profit & Loss on Consignment Account'***. At the year end, the balance of the Profit and Loss on Consignment Account is transferred to the General Profit and Loss Account.

The secondary objective of the consignor is to ascertain the amount due from the consignee. For this purpose, he opens a personal account of the consignee. The Consignee Account is debited with gross sales proceeds and credited with: (1) advance made by him (if any); (2) expenses incurred by him in respect of the consignment; and (3) his own commission on sales. The balance shows the amount due from the consignee.

The consignor may price the goods sent on consignment either at 'cost price' or at a higher price which is called 'invoice price'. The accounting procedure in the two cases is slightly different. Therefore, we discuss them separately.

Cost Price Method

Journal entries are as under:

1. For sending goods to the consignee

Consignment to ... Account	Dr.	[cost price]
To Goods Sent on Consignment Account		[cost price]

2. For payment of expenses by the consignor

Consignment to ... Account	Dr.	
To Cash or Bank Account		[If paid]
To Creditors for Expenses Account		[If unpaid]

3. For receipts of advance from the consignee

(a) When payment is received in cash or Bank Draft

Cash or Bank Account	Dr.
To Consignee Account	

(b) When a bill is accepted by the consignee

Bills Receivable Account	Dr.
To Consignee Account	

4. When Account Sales is received from the consignee

Immediately after receiving the Account Sales, the consignor passes the following entries:

(a) For sale of goods by the consignee

Consignee Account	Dr. [Gross sales proceeds]
To Consignment to ... Account	

(b) For expenses incurred by the consignee

Consignment to ....Account	Dr.
To Consignee Account	

(c) For the commission of the consignee

Consignment to ... Account	Dr.
To Consignee Account	

(d) For receiving remittance from the consignee
Cash or Bank Account Dr.
To Consignee Account

5. If the consignee completes the sales before the end of the consignor's accounting year, the consignor closes the Consignment Account by passing the following entry :

(a) When there is a profit on consignment
Consignment to ... Account Dr.
To Profit and Loss on Consignment Account

(b) When there is a loss on consignment
Profit and Loss on Consignment Account Dr.
To Consignment to ... Account

The students should note that a transfer to the Profit and Loss Account would close the Consignment Account but, it is not possible to wait until the Profit and Loss Account is prepared at the end of the accounting year. To overcome this hardship, the profit or loss on consignment is transferred to a special account called 'Profit and Loss on Consignment Account.' This account will also serve the purpose of combining the profits and losses of all consignments in the accounting year. At the end of the year it is transferred to the Profit and Loss Account.

6. At the end of the financial year, the Goods Sent on Consignment Account is closed by passing the following entry:

(a) If the consignor is a manufacturer
Goods Sent on Consignment Account Dr.
To Trading Account

(b) If the consignor is a wholesaler
Goods Sent on Consignment Account Dr.
To Purchase Account

The above adjustment entry should be passed to find out the correct profit of 'General Profit and Loss Account'. We know that every manufacturer prepares Manufacturing Account and the total cost of goods produced is transferred to Trading Account by debiting Trading Account and crediting Manufacturing Account. Now, if any goods have been sent on consignment, out of those goods, the Trading Account must be credited with the cost of goods sent on consignment. If this is not done, the general profit will be understated. Similarly, when the consignor is a wholesaler, whatever he purchases he debits his Purchases Account. Now if any goods that have been sent on consignment out of these goods, ***the Purchases Account must be reduced to that extent*** and the adjusted purchases should be debited to General Trading Account. If this adjustment is not done, the general profit will be understated.

Illustration 1

On 1st March, 2016 Kamal of Calcutta sends 1,000 boxes of tea to Bimal of Bombay on consignment basis. Each box costs ₹ 500. Kamal pays railway freight ₹ 1,000 and insurance ₹ 2,000 and draws upon Bimal a bill for ₹ 2,00,000 for 3 months which was duly accepted and returned.

On 30th September, 2016 Bimal forwards an Account Sales to Kamal showing that 500 boxes have been sold @ ₹ 560 each while 300 boxes were sold @ ₹ 550 each and the remaining boxes were sold @ ₹ 540 each. The expenses incurred by Bimal consisted of carriage charges ₹ 500; and godown rent ₹ 3,500. Bimal is entitled to a commission @ 5% on gross sales proceeds. He encloses a cheque for the balance due to Kamal.

Show how these transactions would be recorded in the books of Kamal, assuming that the bill of exchange was met on its due date. Also assume that Kamal closes the books on 31st December.

Solution

In the books of Kamal
Journal

Date	Particulars		Dr. ₹.	Cr. ₹.
2016 Mar. 1	Consignment to Bimal A/c To Goods sent on Consignment A/c (Being goods sent on consignment to Bombay)	Dr.	5,00,000	5,00,000

	*Consignment to Bimal A/c To Cash A/c (Being freight ₹ 1,000 and insurance ₹ 2,000 paid for sending goods)	Dr.	3,000	3,000
	Bills Receivable A/c To Bimal A/c (Being a bill drawn on Bimal for 3 months)	Dr.	2,00,000	2,00,000
June 4	*Bank A/c To Bills Receivable A/c (Being the bill met at maturity)	Dr.	2,00,000	2,00,000
Sept 30	Bimal A/c To Consignment to Bimal A/c (Being goods sold by Bimal)	Dr.	5,53,000	5,53,000
	Consignment to Bimal A/c To Bimal A/c (Being expenses paid by Bimal in respect of consignment)	Dr.	4,000	4,000
	Consignment to Bimal A/c To Bimal A/c (Being commission charged by Bimal @ 5% on ₹ 5,53,000)	Dr.	27,650	27,650
	*Bank A/c To Bimal A/c (Being a cheque received for the balance due)	Dr.	3,21,350	3,21,350
	Consignment to Bimal A/c To Profit & Loss on Consignment A/c (Being profit on consignment transferred to Profit and Loss on Consignment Account)	Dr.	18,350	18,350
Dec 31	Profit & Loss on Consignment A/c To Profit & Loss A/c (Being transferred to Profit and Loss Account)	Dr.	18,350	18,350
	Goods sent on Consignment A/c To Purchases A/c (Being the adjustment for goods sent on consignment)	Dr.	5,00,000	5,00,000

*These entries should be recorded in the Cash Book.

Ledger

Dr. **Consignment to Bimal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 1	To Goods sent on Consignment A/c	5,00,000	Sept 30	By Bimal A/c (Sales)	5,53,000
	To Cash A/c (Expenses)	3,000			
Sept 30	To Bimal A/c				
	Carriage	500			
	Godown Rent	3,500			
	Commission	27,650			
	To Profit & Loss on Consignment A/c transfer	18,350			
		5,53,000			5,53,000

Dr. **Goods sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec 31	To Purchases A/c	5,00,000	Mar 1	By Consignment to Bimal A/c	5,00,000

Dr. **Bimal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Sept 30	To Consignment to Bimal A/c	5,53,000	Mar 1	By Bills Receivable A/c	2,00,000
			Sept 30	By Consignment to Bimal A/c	31,650
				By Bank A/c	3,21,350
		5,53,000			5,53,000

Dr. **Profit & Loss on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec 31	To Profit & Loss A/c	18,350	Sept 30	By Consignment to Bimal A/c	18,350

Dr. — Bills Receivable Account — Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Mar 1	To Bimal A/c	2,00,000	2016 June 4	By Bank A/c	2,00,000

Dr. — Purchases Account (inclusive) — Cr.

Date	Particulars	₹	Date	Particulars	₹
			2016 Dec 31	By Goods sent on Consignment A/c	5,00,000

Profit & Loss Account for the year ended 31st December, 2016 [Extract]

Particulars	₹	Particulars	₹
		By Profit & Loss on consignment A/c	18,350

Incomplete Consignment and Valuation of Closing Stock

It is not necessary that all consignments should be completed during the accounting year. There may be certain consignments which are incomplete when the consignor's accounting year comes to an end. Under such a situation, the consignee will be required to submit an Account Sales stating sales, expenses and commission upto the ***last date*** of the accounting year. After receiving the Account Sales, the unsold stock with the consignee should be valued. The stock so valued should be credited to the Consignment Account. The entry is:

Stock on Consignment Account Dr.
  To Consignment to ... Account

In the Balance Sheet, this stock is shown as an asset. In the ***next accounting year***, this stock is transferred to Consignment Account. The following entry is passed:

Consignment to .... Account Dr.
  To Stock on Consignment Account

Valuation of Unsold Stock

Now, we discuss the principles and procedures for valuation of consignment stock. We know that stock should be valued at ***cost or market price, whichever is lower***. This, principle applies to consignment stock as well.

The main problem is to ascertain 'cost price' and 'market price.' ***'Cost' includes all expenditure incurred in bringing the goods to a saleable condition and all expenses incurred for sending goods upto the consignee's place. These include freight, carriage, export or import duties, insurance on goods sent, loading and unloading charges, and the like. It should be noted that the expenses may be incurred either by the consignor or by the consignee. All the above expenditures which are included in the cost are popularly known as Non-Recurring Expenditures***. The expenditure incurred after the goods have reached the consignee's place should be ignored for the valuation of stock on consignment. These include godown rent, carriage on sales, establishment expenses, insurance for godown or any other selling expenses.

In the examination, the following format should be followed for valuation of consignment stock :

Valuation of Closing Stock

Particulars	₹.	₹.
Cost price of goods sent		*****
Add : *Consignor's Expenses*	****	
Freight	****	
Carriage	****	
Loading & Unloading charges	****	
Insurance on goods sent	****	
Export & Import duties	****	
Dock dues etc.	****	*****
Add : *Consignee's Expenses*	****	
Cartage	****	
Landing charges	****	
Unloading Expenses	****	*****
Total Cost		*****

$$\text{The cost of unsold goods} = \frac{Total\ \ Cost}{Total\ \ quantity}\ \text{x}\ \ Unsold\ \ quantity$$

Alternatively,

Valuation of Closing Stock

Particulars	₹.	₹.
Cost price of goods unsold		*****
Add : Proportionate non recurring Expenses by:		
Consignor	****	
Consignee	****	*****

At the end of the accounting year, if some part of the goods are still in transit, the expenses of the consignee are generally not taken into consideration for the valuation of stock in transit

Here, ***'Market Price'*** refers to ***Net Realizable Value (NRV). Applying the concept of conservatism, all other possible expenses to be incurred in selling those goods are to be provided for, which will include the amount of commission payable to the consignee.***

After computing the ***'Cost Price'*** and ***'Market Price'*** in the above manner, the smaller one should be taken as the value of stock on consignment. ***In the examination problem, if there is no indication regarding market price, we should assume that market price is more than the cost price and valuation should be done accordingly.***

Illustration 2

On 30th September, 2016, Dey's Medical of Calcutta sends 500 cases of medicine costing ₹ 1,000 per case to Medicine Corner of Delhi on consignment basis. Dey's Medical incurred the following expenses: packing expense @ ₹ 20 per case (paid in cash); insurance premium ₹ 2,000 (paid by cheque); freight ₹ 10,000 (paid in cash); forwarding agent's expenses ₹ 1,000 (due).

On 31st December, 2016, Medicine Corner forwards an Account Sales to Dey's Medical showing that 200 cases have been sold @ ₹ 1,250 per case while 250 cases were sold @ ₹ 1,200 per case and the 50 cases remained unsold. Medicine Corner paid the following expenses : cartage ₹ 2,000; unloading ₹ 1,000 and ₹ 2,000 as godown rent. Account Sales accompanying an account payee cheque for ₹ 4,00,000.

Under the agreement Medicine Corner was to receive 5% commission on sales.

You are required to show: (1) Consignment to Delhi Account; (2) Medicine Corner Account; (3) Stock on Consignment Account; and (4) Goods sent on Consignment Account in the Ledger of Dey's Medical and Balance Sheet.

Solution

In the books of Dey's Medical

Dr. Consignment to Delhi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016	To Goods Sent on Consignment A/c	5,00,000	2016	By Medicine Corner A/c	
Sept 30	To Cash A/c		Dec 31	200 @ ₹ 1,250	2,50,000
	Packing	10,000		250 @ ₹ 1,200	3,00,000
	Freight	10,000	"	By Stock on Consignment A/c (Note 1)	52,600
	To Bank A/c				
	Insurance premium	2,000			
	To Creditors for Expenses A/c				
	Forwarding Agent's expenses	1,000			
Dec 31	Medicine Corner A/c				
	Cartage	2,000			
	Unloading	1,000			
	Godown Rent	2,000			
	Commission	27,500			
"	To Profit & Loss on Consignment A/c	47,100			
		6,02,600			6,02,600

Dr. Medicine Corner Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016	To Consignment to Delhi A/c	5,50,000	2016	By Bank A/c	4,00,000
Dec 31			Dec 31	By Consignment to Delhi A/c	32,500
			"	By Balance c/d	1,17,500
		5,50,000			5,50,000

Dr. **Stock on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Consignment to Delhi A/c	52,600	2016 Dec 31	By Balance c/d	52,600

Dr. **Goods sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Trading A/c	5,00,000	2016 Sept 30	By Consignment to Delhi A/c	5,00,000

Balance Sheet of Dey's Medical as at 31st December, 2016 [Extract]

Liabilities	₹	Assets	₹
		Medicine Corner	1,17,500
		Stock on consignment	52,600

Working Notes :

(1) Valuation of Closing Stock

	₹
Cost price : 500 cases @ ₹ 1,000 per case	5,00,000
Consignor's Expenses	
Packing (₹ 10,000) + Freight (₹ 10,000) + Insurance (₹ 2,000) + Forwarding Agent's Expenses (₹ 1,000)	23,000
Consignee's Expenses	
Cartage (₹ 2,000) + Unloading (₹ 1,000)	3,000
Total cost :	5,26,000

$$\text{Value of unsold stock} = \frac{5,26,000}{500} \times 50 = ₹\ 52,000.$$

Illustration 3

On 1st January, 2016 Chatterjee Bros of Calcutta shipped to Shanton Bros of Tokyo 400 musical instruments at the rate of ₹ 350 each. Chatterjee Bros incurred the following expenses on the consignment: cartage ₹ 150, freight ₹ 1,950 and Insurance ₹ 2,500.

The charges incurred by Shanton Bros were landing charges ₹ 450; storage ₹ 1,500 and ₹ 1,250 as fire insurance premium on stock.

On 31st December, 2016, an Account Sales was received from Shanton Bros disclosing that 350 instruments were sold out at ₹ 950 per instrument. Towards the close of the year, suddenly a new type of instrument appeared in the market and there was no possiblity of selling the balance of the goods at a high price. The market price fell down to ₹ 250 per instrument. In the Account Sales, besides their expenses Shanton Bros., charged commission at 15% on the gross sale proceeds. The unsold goods were held by them. A bank draft for the amount due was sent along with the Account Sales.

You are required to prepare:

(1) Consignment to Tokyo Account; (2) Shanton Bros Personal Account; and (3) Goods Sent on Consignment Account in the Ledger of Chatterjee Bros.

Solution **In the books of Chatterjee Bros**

Dr. **Consignment to Tokyo Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016	To Goods sent on Consignment A/c	1,40,000	2016	By Shanton Bros A/c	
Jan 1	To Cash A/c		Dec 31	350 @ ₹ 950 each	3,32,500
	Cartage	150	"	By Stock on Consignment A/c (Note 1)	10,625
	Freight	1,950			
	Insurance	2,500			
Dec. 31	To Shanton Bros A/c				
	Landing charges	450			
	Storage	1,500			
	Insurance	1,250			
	Commission	49,875			
"	To Profit & Loss on Consignment A/c	1,45,450			
		3,43,125			3,43,125

Dr. Shanton Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Consignment to Tokyo A/c	3,32,500	2016 Dec 31	By Consignment to Tokyo A/c	53,075
				By Bank A/c (Balance)	2,79,425
		3,32,500			3,32,500

Dr. Goods sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Purchases A/c	1,40,000	2016 Jan 1	By Consignment to Tokyo A/c	1,40,000

Valuation of Closing Stock

Particulars	₹
Cost price : 400 instruments @ ₹ 350 each	1,40,000
Consignor's Expenses	
Cartage (₹ 150) + Freight (₹ 1,950) + Insurance (₹ 2,500)	4,600
Consignee's Expenses	
Landing charges	450
Total cost	1,45,050

(a) Cost price of 50 instruments = $\frac{1,45,050}{400} \times 50$ = ₹ 18,131.25.

(b) Market Price of an instrument (₹ 250 × 50) = ₹ 12,500; Less: Commission @ 15% — 1,875 = ₹ 10,625;
Therefore, the value of closing stock = ₹ 10,625

Entries in the Books of the Consignee

The following entries are to be made in connection with the consignment:

1. For goods received on Consignment

No entry is made in the books of the consignee because he holds these goods on behalf and on account of the consignor. He may, however, record the details of the goods received in a separate book, called the Consignment Inward Book.

2. For advance made to the consignor

(a) When payment is made by cash or bank draft

Consignor Account Dr.
 To Cash or Bank Account

(b) When a bill of exchange is accepted

Consignor Account Dr.
 To Bills Payable Account

3. For Payment of Expenses in respect of the consignment

Consignor Account Dr.
 To Cash or Bank Account

(4) For Sale of goods

(a) When goods are sold for cash

Cash or Bank Account Dr.
 To Consignor Account

(b) When goods are sold on credit

[*See 'Credit Sales and Del credere Commission'*]

5. For Commission

The calculation of actual commission will depend on the agreement between the consignor and the consignee. The entry to be passed:

Consignor Account Dr.
 To Commission Received Account

6. For sending a remittance

Consignor Account Dr.

To Cash or Bank Account

On the last date of the accounting year, if there is any balance (Debit/Credit) in the Consignor Account, it should be shown in the Balance Sheet under Sundry Debtors or Sundry Creditors, depending upon the nature of the balance.

The student should note that the consignee will not make any entry in respect of stock on consignment. Similarly, he will not ascertain any profit or loss in respect of goods sold by him on behalf of the consignor. The commission received should be transferred to his Profit and Loss Account at the year end.

Illustration 4

Taking the particulars from ***Illustration 2***, the entries in the books of consignee would be as under :

Solution **In the books of Medicine Corner**

Journal **Dr.** **Cr.**

Date	Particulars		₹.	₹.
2016 Mar. 1	*Dey's Medical A/c To Cash A/c (Being expenses incurred in respect of consignment)	Dr.	5,000	5,000
?	*Cash A/c To Dey's Medical A/c (Being goods sold for cash on behalf of Dey's Medical, Calcutta)	Dr.	5,50,000	5,50,000
?	Dey's Medical A/c To Commission Received A/c (Being commission on goods sold on behalf of the consignor)	Dr.	27,500	27,500
Dec 31	*Dey's Medical A/c To Bank A/c (Being remittance by cheque)	Dr.	4,00,000	4,00,000
	Commission Received A/c To Profit & Loss A/c (Being commission received, transferred to Profit & Loss A/c)	Dr.	27,500	27,500

*These entries should be recorded in the Cash Book.

Ledger

Dr. **Dey's Medical Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar. 1	To Cash A/c	5,000	?	By Cash A/c	5,50,000
Dec 31	To Commission Received A/c	27,500			
"	To Bank A/c	4,00,000			
"	To Balance c/d	1,17,500			
		5,50,000			5,50,000

Dr. **Commission Received Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Profit & Loss A/c	27,500	2016 Dec. 31	By Dey's Medical A/c	27,500

Illustration 5

Auto Agencies have sold the following goods on behalf of different parties for which they have incurred some expenses and are entitled to commission and reimbursement of expenses.

Parties	Stock in hand	Goods received	Goods sold	Expenses	Remittances	Commission
Life Light (₹)	8,000	20,000	24,000	600	20,000	10%
Silac (₹)	12,000	30,000	26,000	400	22,000	6%
Akriti (₹)	12,000	36,000	44,000	800	40,000	5%

Prepare the Consignors' Accounts in the books of Auto Agencies.

Solution **In the books of Auto Agencies**

Dr. **Consignors' Accounts** **Cr.**

Particulars	Life Light	Silac	Akriti	Particulars	Life Light	Silac	Akriti
To Bank A/c - expenses	600	400	800	By Bank A/c - sales	24,000	26,000	44,000
To Commission Received A/c	2,400	1,560	2,200				
To Bank A/c - remittances	20,000	22,000	40,000				
To Balance c/d (amount due)	1,000	2,040	1,000				
	24,000	26,000	44,000		24,000	26,000	44,000

Credit Sales and Del Credere Commission

It is not necessary that all the goods are to be sold by the consignee in cash. He may require to sell some part of the goods on credit. When goods are sold on credit, the problem of bad debt arises.

Whether the bad debts loss will be borne by the consignor or the consignee depends upon the fact whether del credere commission is given to the consignee or not.

Remember: (1) The consignor will bear the bad debts loss if no del credere commission is given to the consignee. (2) The consignee will bear the bad debts loss if del credere commission is given to him.

Del Credere Commission is an additional commission paid to a consignee who guarantees the payment in case of credit sale. Where the consignee gets del credere commission, he indemnifies the consignor for all bad debts. To the consignor, it is a ***form of credit insurance.*** **Like ordinary commission, del credere commission is also paid, generally, at a predetermined percentage of the Gross Sales Proceeds. However, there may be a separate agreement between the parties for calculation of the del credere commission.**

Accounting Entries for Credit Sales where no Del Credere Commission is given

In the books of the consignor

1. For Credit Sales

Consignment Debtors Account Dr.
To Consignment to . . . Account

2. For Collections from Debtors

Bank or Cash Account Dr.(collected by consignor)
Consignee Account Dr. (collected by consignee)
To Consignment Debtors Account

3. For Bad Debts / Discount Allowed

Bad Debts /Discount Allowed Account Dr.
To Consignment Debtors Account

4. For Closing Bad Debts / Discount Allowed Account

Consignment to... Account Dr.
To Bad Debts /Discount Allowed Account

Entries (3) and (4) can be clubbed and the following entry can be passed :

Consignment to . . . Account Dr.
To Consignment Debtors Account

In the books of the Consignee

1. For credit sales *No Entry*

2. For Collections from Debtors

Cash or Bank Account Dr.
To Consignor's Account

3. For Bad Debts *No Entry*

Accounting Entries for Credit Sales where del credere commission is given

In the books of the consignor

1. *For Credit Sales*
   Consignee Account Dr.
   To Consignment to ... Account

2. *For Bad Debts* *No Entry*

3. *For Commission (Ordinary + del credere)*
   Consignment to... Account Dr.
   To Consignee Account

In the books of the Consignee

1. *For Credit Sales*
   Consignment Debtors Account Dr.
   To Consignor Account

2. *For Collections from Debtors*
   Bank Account Dr.
   To Consignment Debtors Account

3. *For Bad Debts*
   Bad Debts Account Dr.
   To Consignment Debtors Account

4. *For Closing Bad Debts*

Bad debts arising out of credit sale on consignment are adjusted against the commission received. The net balance of the commission received account is transferred to the Profit and Loss Account at the year end.

(i) Commission Received Account Dr.
To Bad Debts Account

(ii) Commission Received Account Dr.
To Profit and Loss Account

Illustration 6

(a) On 1st November, 2016, C of Calcutta sends goods costing ₹ 1,00,000 to D of Delhi on consignment basis. C paid ₹ 5,000 as railway freight and ₹ 2,000 as insurance. On 31st December, 2016, an Account Sales was received from D disclosing that the entire quantity of goods were sold for ₹ 1,50,000 — out of which, ₹ 30,000 was sold on credit. A customer who purchased goods for ₹ 5,000 failed to pay and the debt proved bad. All other debts were collected by D in full. As per agreement, D is allowed a commission @ 10% on sales. D sends the amount due to C by a cheque.

Prepare necessary ledger accounts in the books of C and D.

(b) Will your answer be different, if in the above Illustration, the consignee is given a del credere commission of 5% on sales (in addition to ordinary commission)—other things remaining the same?

Solution (a)

In the books of C

Dr. Consignment to D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Nov 1	To Goods Sent on Consignment A/c	1,00,000	2016 Dec 31	By D A/c (Cash Sales)	1,20,000
	To Cash A/c			By Consignment Debtors A/c (Credit Sales)	30,000
	Railway Freight	5,000			
	Insurance	2,000			
Dec 31	To D A/c (Commission @ 10%)	15,000			
"	To Consignment Debtors A/c (Bad Debts)	5,000			
"	To Profit & Loss on Consignment A/c	23,000			
		1,50,000			1,50,000

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Consignment to D A/c	1,20,000	2016 Dec 31	By Consignment to D A/c	15,000
	To Consignment Debtors A/c	25,000		By Bank A/c	1,30,000
		1,45,000			1,45,000

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Consignment to D A/c	30,000	2016 Dec. 31	By D A/c (Cash Collected)	25,000
				By Consignment to D A/c (Bad Debt)	5,000
		30,000			30,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Purchases A/c	1,00,000	2016 Nov. 1	By Consignment to D A/c	1,00,000

In the Books of D

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Commission Received A/c	15,000	2016 Dec. 31	By Bank A/c (cash sales)	1,20,000
	To Bank A/c	1,30,000		By Bank A/c (collection from debtors)	25,000
		1,45,000			1,45,000

Dr. Commission Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Profit & Loss A/c	15,000	2016 Dec. 31	By C A/c	15,000

Solution (b)

In the Books of C

Dr. Consignment to D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Nov 1	To Goods Sent on Consignment A/c	1,00,000	2016	By D A/c (Sales)	1,50,000
	To Cash A/c				
	Railway Freight	5,000			
	Insurance	2,000			
Dec 31	To D A/c				
	Ordinary commission	15,000			
	Del Credere commission	7,500			
"	To Profit & Loss on Consignment A/c	20,500			
		1,50,000			1,50,000

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Consignment to D A/c	1,50,000	2016 Dec 31	By Consignment to D A/c	
				Ordinary commission	15,000
				Del Credere commission	7,500
				By Bank A/c	1,27,500
		1,50,000			1,50,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Purchases A/c	1,00,000	2016 Nov. 1	By Consignment to D A/c	1,00,000

In the Books of D

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Commission Received A/c		2016 Dec. 31	By Bank A/c (Cash Sales)	1,20,000
	Ordinary commission	15,000		By Consignment Debtors A/c	30,000
	Del Credere commission	7,500			
	To Bank A/c	1,27,500			
		1,50,000			1,50,000

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To C A/c	30,000	2016 Dec. 31	By Bank A/c (collection)	25,000
				By Commission Received A/c (Bad Debts)	5,000
		30,000			30,000

Dr. Commission Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 31	To Consignment Debtors A/c	5,000	2016 Dec 31	By C A/c	22,500
	To Profit & Loss A/c	17,500			
		22,500			22,500

Illustration 7

Somali of Mumbai consigned 100 units of a commodity to Mohua of Kolkata. The goods were invoiced at ₹ 300 so as to yield a profit of 50% on cost. Somali incurred ₹ 2,000 on freight and insurance. Mohua incurred ₹ 1,000 on Salesmen's salary and ₹ 1,600 on godown rent. Mohua sold 50 units for cash at ₹ 320 per unit and 20 units on credit at ₹ 350 per unit. She retained her commission @ 6 per cent (including 1 per cent for the del credere arrangements) and remitted the balance due. Mohua informed that 10 units were damaged on account of bad packing and that she would be able to sell them only for ₹ 160 per unit. A debtor for ₹ 2,000 to whom the goods were sold by Mohua became insolvent and only 50 paise in a rupee was recovered.

Show necessary ledger accounts in the books of Mohua.

Solution

In the Books of Mohua

Somali Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Commission Received A/c :			By Bank A/c (cash sales)	16,000
	Ordinary commission	1,150		By Consignment Debtors A/c	7,000
	Del credere commission	230			
	To Bank A/c (Expenses)	2,600			
	To Bank (Final remittance)	19,020			
		23,000			23,000

Consignment Debtors Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Somali A/c	7,000		By Bank A/c	6,000
				By Discount Received A/c (Bad Debts)	1,000
		7,000			7,000

Commission Received Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment Debtors A/c (Bad Debts)	1,000		By Somali A/c	1,380
	To Profit and Loss A/c	380			
		1,380			1,380

Treatment of Discount on Bills in Consignment Account

A consignor may draw a bill on the consignee as an advance on the goods sent to the consignee. After acceptance, the consignor may discount the bill with his banker. ***The discounting charges, however, should not be charged to the Consignment Account*** because it is purely a financial expense. This discounting charge is transferred to the General Profit and Loss Account of the consignor.

Advance Made by the Consignee

An advance is a payment on account. When the consignee makes an advance to the consignor, the advance is adjusted against the amount due from the consignee. The problem of adjusting the advance arises when only a part of the goods are sold. The portion of the advance to be adjusted against the amount due depends on the *nature of the advance* made by the consignee. The consignee may make an advance which is to be *adjusted against the future payment* or the advance may be made by the consignee *as a security of the goods* received on behalf of the consignor. Accounting entries are made according to situations.

When an Advance is *Not Given* as a Security

In the books of the Consignor

(i) For advance received from the Consignee

Cash / Bank / Bills Receivable Account Dr.

To Advance Against Consignment Account

(ii) For adjustment at the end of the period

Advance Against Consignment Account Dr. [Full amount]

To Consignee Account

In the books of the Consignee

(i) For advance given to Consignor

Advance Against Consignment Account Dr.
    To Cash / Bank / Bills Receivable Account

(ii) For adjustment at the end of the period

Consignor Account Dr. [Full amount]
    To Advance Against Consignment Account

It should be noted that when an advance is not given as a security, the entire amount of advance is to be adjusted against the amount due—even when a part of the goods are sold.

Illustration 8

Arun of Calcutta sent goods costing ₹ 75,000 to Barun of Bombay on consignment basis. Arun paid ₹ 3,000 on various accounts for sending the goods. Barun paid ₹ 1,800 as railway charges and ₹ 750 as godown rent. The consignee sent a bank draft for ₹ 45,000 as advance against the consignment. 4/5ths of the goods were sold at ₹ 87,000. A customer who purchased goods for ₹ 500 failed to pay for which the debt proved bad. The Account Sales sent by the consignee showed that he charged 10 per cent as ordinary commission and 2.5 per cent as Del Credere commission.

You are required to give in the books of Arun :

(1) Consignment Account; (2) Barun Personal Account; (3) Advance against Consignment Account.

Solution

In the Books of Arun

Dr. Consignment to Bombay Account Cr.

Date	Particulars		₹	Date	Particulars	₹
	To Goods sent on Consignment A/c		75,000		By Barun A/c (sale proceeds)	87,000
	To Bank A/c — expenses		3,000		By Stock on Consignment A/c	
	To Barun A/c — expenses				1/5th of (₹ 75,000 + 3,000 + 1,800)	15,960
	Railway charges	1,800				
	Godown rent	750	2,550			
	To Barun A/c — commission					
	Ordinary @ 10%	8,700				
	Del Credere @ 2-$^1/_2$%	2,175	10,875			
	To Profit and Loss on Consignment A/c		11,535			
			1,02,960			1,02,960

Dr. Barun Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	87,000		By Consignment to Bombay A/c (expenses)	2,550
				By Consignment to Bombay A/c (comm.)	10,875
				By Advance Against Consignment A/c	45,000
				By Balance c/d (amount due)	28,575
		87,000			87,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Barun A/c	45,000		By Bank A/c	45,000

When an Advance is *Given* as a Security of the Goods

In the books of the Consignor

(i) For advance received from the Consignee

Cash / Bank / Bills Receivable Account Dr.
    To Advance Against Consignment Account

(ii) For adjustment at the end of the period

Advance Against Consignment Account Dr. [Proportionate amount]
    To Consignee Account

In the books of the Consignee

(i) For advance given to Consignor

Advance Against Consignment Account Dr.
To Cash / Bank / Bills Receivable Account

(ii) For adjustment at the end of the period

Consignor Account Dr. [Proportionate amount]
To Advance Against Consignment Account

It should be noted that in this case a proportionate adjustment of advance is to be made against the amount due. For example, if the consignee receives 100 units of goods and makes an advance of ₹ 10,000. At the year end, if 80 units are sold, only ₹ 8,000 of the advance can be adjusted against the amount due.

Illustration 9

Gavaskar of Bombay sent 100 TV sets to Kapil of Chandigarh on consignment basis. The cost price of each set is ₹ 5,000. Gavaskar paid ₹ 100 for cartage, ₹ 1,500 for railway freight and ₹ 400 for insurance premium.

He drew a bill, payable after two months for ₹ 50,000, which was accepted by Kapil, by way of security against the consignment. He then discounted the bill for ₹ 49,900.

Kapil paid ₹ 600 as godown rent and ₹ 400 as sundry expenses. He sold 90 sets @ ₹ 5,400 per set. But he could not realize the sale proceeds of 5 sets from the customers. He was entitled to receive 4% ordinary commission and 1% del credere commission. The net amount due from Kapil was received in time.

Prepare the Consignment Account, Kapil Account and Advance Against Consignment Account in the books of Gavaskar.

Solution

In the books of Gavaskar

Dr. Consignment to Kapil Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	5,00,000		By Kapil A/c	4,86,000
	To Cash A/c			By Stock on Consignment A/c (Note 1)	50,200
	Cartage	100			
	Railway Freight	1,500			
	Insurance	400			
	To Kapil A/c				
	Godown Rent	600			
	Sundry Expenses	400			
	Commission	24,300			
	To Profit & Loss on Consignment A/c	8,900			
		5,36,200			5,36,200

Dr. Kapil Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Kapil A/c	4,86,000		By Consignment to Kapil A/c	25,300
				By Advance against Consignment A/c	45,000
				By Bank A/c	4,15,700
		4,86,000			4,86,000

Dr. Advance against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Kapil A/c (9/10)	45,000		By Bills Receivable A/c	50,000
	To Balance c/d	5,000			
		50,000			50,000

Working Note : (1) Valuation of Closing Stock

Cost price : 100 TV sets @ ₹ 5,000 each	5,00,000	
Add: non recurring expenses (₹ 100 + ₹ 1,500 + ₹ 400)	2,000	Value of Unsold TV = $\frac{5,02,000}{100}$ x 10 = ₹ 50,200
Value of goods sent	5,02,000	

Tutorial Notes:

(1) Sundry expenses should not be considered for valuation of closing stock.
(2) Discount on bill should not be charged to Consignment Account because it is purely a financial expense.
(3) When del credere commission is given to the consignee, the consignor has nothing to do with the bad debts.

Loss of Goods on Consignment

It is possible that a portion of the consignment stock may be stolen or otherwise lost (may be in transit or in the consignee's godown). The consignor will have to bear the loss, but not the consignee. There may also be some inevitable normal losses. In accounting for consignment, losses are classified as *normal and abnormal*. Therefore, in the books of the consignor, accounting treatment for normal and abnormal losses are different.

Accounting for normal losses

Normal losses are inevitable or unavoidable. These may arise due to natural causes like breaking in bulk, evaporation, leakage, drying, etc. No effort can prevent these losses.

Normal loss is treated by ignoring the loss. It means that the value of remaining stock absorbs this loss. Therefore, when there is some normal loss, the value of the remaining goods are artificially inflated to cover the normal loss. For example, a consignment of 100 units costing @ ₹ 0.95 is sent. Due to normal loss, the consignee receives 95 units. The value of stock will become ₹ 1 per unit (instead of the actual price of ₹. 0.95 per unit).

Therefore, when there is no stock remaining unsold, there will be no treatment for normal loss. But where there is some stock remaining unsold, the value of the stock on consignment will be ascertained by applying the following formula:

$$\frac{\textit{Value of the goods received by the consignee}}{\textit{Net quantity received (after normal loss) by the consignee (in units)}} \times \textit{Unsold goods (in units)}$$

Illustration 10

A informed you of the following particulars of his transactions relating to goods consigned to B for the year ended 31.12.2016. Goods sent (10,000 kgs)—₹ 1,00,000; A's expenses—₹ 10,000; B's expenses—freight and insurance—₹ 2,000; selling—₹ 5,000; Sold (8,000 kgs)—₹ 1,12,000; Loss due to natural wastage 100 kgs; Commission @ 5% on gross sales.You are asked to prepare the Consignment Account only with the detailed calculation of unsold stock in the books of A.

Solution

In the Books of A

Consignment to B Account

Dr. **Cr.**

Date	Particulars		₹	Date	Particulars	₹
2016	To Goods sent on Consignment A/c		1,00,000	2016	By B A/c - sale proceeds	1,12,000
?	To Bank A/c - expenses		10,000	Dec. 31	By Stock on Consignment A/c (Note 1)	21,495
Dec. 31	To B A/c - expenses					
	Freight and Insurance	2,000				
	Selling	5,000	7,000			
"	To B A/c - commission @ 5% on ₹ 1,12,000		5,600			
"	To Profit and Loss on Consignment A/c		10,895			
			1,33,495			1,33,495

Working Note: (1) Ascertainment of the value of Stock: We know, when there is a normal loss, it is treated by ignoring the loss, i.e. the value of the remaining goods are artificially inflated. It means remaining goods absorb the normal loss. Therefore, in such a case, closing stock is to be ascertained by applying the following formula :

$$\frac{\text{Value of Goods Sent}}{\text{Quantity received by the Consignee after normal loss}} \times \text{Stock in hand}$$

$$= \frac{1{,}00{,}000 + 10{,}000 + 2{,}000}{10{,}000 - 100} \times 1{,}900 = ₹\ 21{,}495 \text{ (approx.)}$$

Accounting for abnormal losses

Abnormal losses in consignment may arise owing to reasons such as, theft, fire and the like. Again, these may occur either in transit or at the consignee's place. Normal loss is unavoidable but abnormal loss can be avoided. To ascertain the true profit on consignment, abnormal losses are eliminated from the Consignment Account. Therefore, abnormal losses should be charged to the General Profit And Loss Account and Consignment Account should be given due credit for the value of goods lost abnormally. Abnormal losses can be dealt with in two different ways as under:

Method I

(a) When the goods are not insured:
Profit and Loss Account Dr.
To Consignment Account
(b) When the goods are fully insured:
Insurance Claim Account Dr.
To Consignment Account
(c) When the value of goods lost is more than the amount admitted by the insurance company:
Insurance Claim Account Dr. (claim admitted)
Profit and Loss Account Dr. (claim not admitted)
To Consignment Account (value of goods lost)

Method II

Under this method, the whole amount of abnormal loss is transferred to a special account called Abnormal Loss Account by passing the following entry:

Abnormal Loss Account Dr.
To Consignment Account

Now, for closing the Abnormal Loss Account, the following entries are made according to the situation:

(a) When the goods are not insured:
Profit and Loss Account Dr.
To Abnormal Loss Account
(b) When the goods are fully insured:
Insurance Claim Account Dr.
To Abnormal Loss Account
(c) When the value of goods lost is more than the amount admitted by the insurance company:
Insurance Claim Account Dr.
Profit and Loss Account Dr.
To Abnormal Loss Account

The following entry is to be passed under both methods, when the actual claim is received from the insurance company:

Bank Account Dr.
To Insurance Claim Account

Valuation of Abnormal Loss

Particulars	₹.	₹.	
Cost price of goods sent		*****	Value of abnormal loss = $\frac{Total\ Cost}{Total\ Quantity} \times Quantity\ Lost$
Add : Non-recurring expenses upto the point of loss (consignor's + consignee's)		*****	
Total Cost just before loss		*****	

Illustration 11

Romesh of Calcutta consigned 100 packets of medicine, each costing ₹ 500, to his agent Md. Arif of Ahmedabad. He paid ₹ 1,000 towards freight and insurance. 10 packets were destroyed in transit. The consignee took delivery of the remaining packets and spent ₹ 500 as godown rent, ₹ 2,000 as clearing charges and ₹ 500 as selling expenses. The consignee sold 80 packets @ ₹ 600 each.

You are required to calculate the cost of damage and cost of goods in hand at the end.

Solution

Valuation of goods lost in transit	₹	Valuation of goods in hand at the end	₹
Cost of 100 packets @ ₹ 500 each	50,000	Cost of 100 packets just before lost in transit	51,000
Add: Non-recurring expenses up to accident	1,000	Less: Value of 10 packets lost in transit	5,100
Cost of 100 packets just before loss in transit	51,000	Cost of 90 packets after loss in transit	45,900
Therefore, Value of 10 packets = ₹ 51,000 / 100 x 10 =	5,100	Add: Non-recurring exp. after accident (cledaring charges)	2,000
		Total cost of 90 packets	47,900
		Therefore, Value of 10 packets = ₹ 47,900 / 90 x 10 =	5,322

Illustration 12

100 cycles, costing ₹ 150 each were consigned to the agent at Jaipur. Expenses incurred on sending them were ₹ 1,000. On the way, 5 cycles were damaged due to bad handling and insurance claim of ₹ 700 was accepted. Consignee took delivery of the rest and incurred direct expenses of ₹ 285 and indirect expenses of ₹ 150. He sold 80 cycles at ₹ 200 per cycle. Prepare Consignment Account when consignee gets 5% commission on gross sales. also show how abnormal loss and stock at the end is to be calculated. ***[C.U.B.Com. (Hons.) — 2005]***

Solution

In the Books of ...

Consignment to Jaipur Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	15,000		By Abnormal Loss A/c (Note 1)	800
	To Cash A/c (Expenses)	1,000		By Consignee A/c (Sales)	16,000
	To Consignee A/c :			By Stock on Consignment A/c (Note 2)	2,445
	Direct expenses	285			
	Indirect expenses	150			
	To Consignee A/c (Commission @ 5%)	800			
	To Profit or Loss on Consignment A/c	2,010			
		19,245			19,245

Working Notes :

(1) Valuation of goods lost in transit	₹	(2) Valuation of goods in hand at the end	₹
Cost of 100 cycles @ ₹ 150 each	15,000	Cost of 100 cycles just before loss in transit	16,000
Add: Non-recurring expenses	1,000	Less: Value of 5 cycles lost in transit	800
Cost of 100 cycles just before lost in transit	16,000	Cost of 95 cycles	15,200
Therefore, value of 5 cycles = ₹ 16,000 / 100 x 5	800	Add: Direct expenses	285
		Total cost of 95 cycles	15,485
		Value of 15 cycles = ₹ 15,485 / 95 x 15	2,445

Illustration 13

Arup consigned 2,000 kg of fine Basmati rice @ ₹ 10 per kg to Sintu. He paid freight ₹ 3,000, dock charges ₹ 2,500 and insurance ₹ 1,500. 800 kg. rice was destroyed in transit due to an accident. Claim admitted by the insurance company was ₹ 4,500. Sintu sold in cash and on credit 1,000 kg. rice @ ₹ 15 per kg. He incurred the following expenses :

Clearing charges ₹ 2,000; Carrying charges ₹ 1,000; Godown rent ₹ 1,200 and Selling expenses ₹ 1,500.

Sintu received commission @ 10% on sales. ₹ 2,000 could not be realised from a debtor.

Show the Consignment Account and determine profit or loss from consignment. ***[C.U.B.Com. (Hons.) — 2004]***

Solution

In the Books of Arup

Consignment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	20,000		By Accidental Loss A/c (Note 1)	10,800
	To Bank A/c (Expenses) :			By Sintu A/c (Sales)	15,000
	Freight	3,000		By Stock on Consignment A/c (Note 2)	3,200
	Dock charges	2,500		By Profit and Loss on Consignment A/c	7,200
	Insurance	1,500			
	To Sintu A/c :				
	Commission @ 10%	1,500			
	Bad Debts	2,000			
	Clearing Charges	2,000			
	Carrying Charges	1,000			
	Godown Rent	1,200			
	Selling Expenses	1,500			
		36,200			36,200

Working Notes :

(1) Valuation of goods lost in transit	₹	(2) Valuation of goods in hand at the end	₹
Cost of 2,000 kg rice @ ₹ 10	20,000	Cost of 2,000 kg rice just before loss in transit	27,000
Add: Non-recurring expenses	7,000	Less: Value of 800 kg lost in transit	10,800
Cost of 2,000 kg rice just before loss in transit	27,000	Cost of 1,200 kg after loss in transit	16,200
Value of 800 kg = ₹ 27,000 / 2,000 x 800	10,800	Add: Non-recurring expenses :	
		Clearing charges	2,000
		Carrying charges	1,000
		Total cost of 1,200 kg	19,200
		Value of 200 kg = ₹ 19,200 / 1,200 x 200	3,200

Normal and Abnormal Losses Simultaneously

Illustration 14

(a) A consigned to B 5,000 kg. of tea costing ₹ 40 per kg. A incurred ₹ 3,000 on freight and ₹ 2,000 on insurance. 500 kg of tea were lost in transit. The insurance company admitted the claim for ₹ 15,000. After receiving the goods, B spent ₹ 1,000 on carriage, ₹ 500 on selling and ₹ 500 on godown rent, B was allowed a commission of 5% on sales. 3,000 kg of tea were sold at ₹ 64 per kg. 25 kg of tea were lost due to breakage of a chest which was considered to be normal. Prepare necessary Ledger Accounts in the books of A and B.

(b) Will your answer be different, if in the above example, abnormal loss of 500 kg took place in the consignee's godown by theft—other things remaining the same?

Solution (a)

In the Books of A

Consignment to B Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
	To Goods sent on Consignment A/c	2,00,000		By Abnormal Loss A/c (Note 1)	20,500
	To Bank A/c - expenses:			By B A/c (sale proceeds) (3000 x ₹ 64)	1,92,000
	Freight 3,000			By Stock on Consignment A/c (Note 2)	61,142
	Insurance 2,000	5,000			
	To B A/c (expenses)				
	Carriage 1,000				
	Selling 500				
	Godown rent 500	2,000			
	To B A/c - commission (5% on ₹ 1,92,000)	9,600			
	To Profit and Loss on Consignment A/c	57,042			
		2,73,642			2,73,642

B Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
	To Consignment to B A/c	1,92,000		By Consignment to B A/c - expenses	2,000
				By Consignment to B A/c - commission	9,600
				By Balance c/d (amount due)	1,80,400
		1,92,000			1,92,000

Abnormal Loss Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
	To Consignment to B A/c	20,500		By Insurance Company A/c (claim admitted)	15,000
				By Profit and Loss A/c	5,500
		20,500			20,500

Goods sent on Consignment Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
	To Trading A/c - transfer	2,00,000		By Consignment to B A/c	2,00,000

In the Books of B

A Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
	To Bank A/c (expenses)			By Bank A/c (sale proceeds)	1,92,000
	Cartage	1,000			
	Selling	500			
	Godown rent	500			
	To Commission A/c	9,600			
	To Balance c/d (balance due)	1,80,400			
		1,92,000			1,92,000

Working Notes:

1. Calculation of Abnormal Loss

	₹
Cost of 5,000 kgs @ ₹ 40 per kg.	2,00,000
Add: Expenses prior to the loss (₹ 3,000 + 2,000)	5,000
Value of 5,000 kgs	2,05,000

Therefore, value of 500 kg. is
₹ 20,500 (₹ 2,05,000 x 500 ÷ 5,000).

2. **Calculation of Stock on Consignment**

	₹
Value of 5,000 kgs (Note 1)	2,05,000
Less: Abnormal loss of 500 kgs (Note 1)	20,500
Value of the goods received by the consignee	1,84,500
Add: Non-recurring expenses of the consignee (Cartage)	1,000
Total value of the goods sent to the consignee	1,85,500

The consignee received 4,475 kgs (5,000 kgs – 500 kgs abnormal loss – 25 kgs normal loss). Out of that 3,000 kgs sold by him. Therefore, stock in hand is 1,475 kgs (4,475 – 3,000).
Thus, ₹ 1,85,500 / 4,475 x 1,475 = ₹ **61,142**.

Solution (b)

When the abnormal loss of 500 kgs takes place in the consignee's godown (other things remaining the same) the value of abnormal loss and stock on consignment will be different — which are calculated as under:

Ascertainment of Abnormal Loss and Unsold Stock	₹
Value of the goods received by the consignee	2,05,000
Add: Proportionate expenses of the consignee (cartage)	1,000
	2,06,000

The consignee received 4,975 units (5,000 kgs – 25 kgs normal loss)

Therefore, Value of Abnormal Loss = $\frac{2,06,000}{4,975} \times 500$ = ₹ 20,704 (approx.)

Value of Unsold Stock = $\frac{2,06,000}{4,975} \times 1,475$ = ₹ 61,075 (approx.). Profit on consignment will be ₹ 57,179.

Illustration 15

On 1st January, 2017 ITC Ltd. of Calcutta consigned 10,000 kg of Sunflower Oil, costing ₹ 40 per kg to Dinesh & Co. of Delhi. ITC Ltd. paid ₹ 40,000 as freight and insurance. 200 kg of oil were lost on 15.1.2017 in transit. The insurance claim was settled for ₹ 7,500 and was paid to the consignor directly. Dinesh & Co. took delivery of the consignment on 29th January 2017, and accepted a bill drawn upon them by ITC Ltd. for ₹ 2,00,000 for 2 months. On 31st March, 2017 an Account Sales was received from Dinesh & Co. containing the following information:

(i) 8,000 kg were sold @ ₹ 55 per kg.; (ii) Unloading charges ₹ 9,500; (iii) Godown rent ₹ 1,250; (iv) Printing & Advertisement ₹ 10,000; and (v) 200 kg were lost due to leakage which is considered as normal. Dinesh & Co. is entitled to a commission @ 5% on sales. They paid the amount due in respect of the consignment on 31st March itself.

You are required to show: (i) Consignment to Delhi Account; (ii) Dinesh & Co. Account; and (iii) the Loss in Transit Account in the Books of ITC Ltd.

Solution

In the books of ITC Ltd

Dr. Consignment to Delhi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Goods Sent on Consignment A/c	4,00,000	15.1.2017	By Loss in transit A/c (Note 1)	8,800
	To Cash A/c (Freight & Insurance)	40,000	31.3.2017	By Dinesh & Co A/c (Sales)	4,40,000
31.3.2017	To Dinesh & Co A/c		31.3.2017	By Stock on Consignment A/c (Note 2)	73,450
	Unloading	9,500			
	Godown Rent	1,250			
	Printing & Advertisement	10,000			
31.3.2017	To Dinesh & Co A/c (commission @ 5%)	22,000			
31.3.2017	To Profit & Loss on Consignment A/c	39,500			
		5,22,250			5,22,250

Dr. Dinesh & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2017	To Consignment to Delhi A/c	4,40,000	29.1.2017	By Bills Receivable A/c	2,00,000
			31.3.2017	By Consignment to Delhi A/c	20,750
			31.3.2017	By Consignment to Delhi A/c	22,000
			31.3.2017	By Bank A/c	1,97,250
		4,40,000			4,40,000

Dr. Loss in Transit Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.1.2017	To Consignment to Delhi A/c	8,800	?	By Bank A/c (claim received)	7,500
			31.3.2017	By Profit & Loss A/c	1,300
		8,800			8,800

Working Notes :

(1) Valuation of goods lost in transit	₹	**(2) Valuation of goods in hand at the end**	₹
Cost of 10,000 kg oil @ ₹ 40 per kg	4,00,000	Total cost of 10,000 kg oil	4,40,000
Add: Freight & Insurance upto accident	40,000	Less: Cost of goods destroyed	8,800
Total cost of 10,000 kg oil	4,40,000	Cost of 9,800 kg (10,000 — 200)	4,31,200
Value of 200 kg = ₹ (4,40,000 / 10,000) x 200	8,800	Add: Unloading charges	9,500
		Total cost of 9,800 kg	4,40,700
		Less: Normal Loss 200 kg	—
		Total cost of 9,600 kg	4,40,700
		Therefore, Value of 1,600 Kg. (4,40,700 / 9,600) x 1,600 = ₹ 73,450.	

General Illustrations

Illustration 16

X, whose accounting year ends on 31st May each year, consigned 100 cases of medicine costing ₹ 3,000 each to Y of Madras on 1.4.2017. he paid ₹ 5,000 towards freight and insurance. 15 cases were damaged in transit and on 30.5.2017, the consignor received ₹ 10,000 on account of the damaged cases from the insurance company. Y took delivery of the goods on 10.4.2017 and immediately accepted a bill drawn on him for ₹ 2,00,000 for 60 days.

On 30.5.2017, the consignee reported that : (i) 75 cases were sold at ₹ 4,500 per case; and (ii) he incurred the following expenses : Godown rent ₹ 4,000; Clearing charges ₹ 8,500; Carriage outwards ₹ 3,000. He is entitled to a commission of 10% on the sale proceeds.

Assuming that Y remits the balance by bank draft on 30.5.2017, show the Ledger Accounts in the books of X and the personal account of X in the books of Y.

Solution

In the books of X

Dr. Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017	To Goods Sent on Consignment A/c	3,00,000	2017 ?	By Abnormal Loss A/c (Note 1)	45,750
April 1	To Bank A/c (freight and insurance)	5,000	May 30	By Y A/c (Sales)	3,37,500
May 30	To Y A/c		"	By Stock on Consignment A/c (Note 2)	31,500
	Godown rent	4,000			
	Clearing charges	8,500			
	Carriage outwards	3,000			
	Commission - 10%	33,750			
"	To Profit & Loss on Consignment A/c	60,500			
		4,14,750			4,14,750

Dr. Abnormal Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
?	To Consignment A/c	45,750	May 5	By Bank A/c (Insurance claim)	10,000
			May 31	By Profit & Loss A/c	35,750
		45,750			45,750

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
May 30	To Consignment A/c	3,37,500	Apr. 4	By Bills Receivable A/c	2,00,000
			May 30	By Consignment A/c (expenses and comm.)	49,250
			"	By Bank A/c (remittances)	88,250
		3,37,500			3,37,500

Dr. Bills Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Apr. 4	To Y A/c	2,00,000	June 7	By Bank Receivable A/c	2,00,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
May 30	To Purchases A/c	3,00,000	April 1	By Consignment A/c	3,00,000

In the books of Y

Dr. X Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Apr. 4	To Bills Payable A/c	2,00,000	?	By Bank A/c	3,37,500
?	To Bank A/c (expenses)	15,500			
May 30	To Commission Received A/c	33,750			
"	To Bank A/c (remittances)	88,250			
		3,37,500			3,37,500

Working Notes :

(1) Valuation of Goods Damaged in Transit	₹	(2) Valuation of Closing Stock	₹
Cost of 100 cases @ ₹ 3,000	3,00,000	Total cost of 100 cases	3,05,000
Add: Freight & Insurance upto accident	5,000	Less: Cost of goods damaged	45,750
Total cost of 100 cases	3,05,000	Cost of 85 cases (100 – 15)	2,59,250
Value of 15 cases	45,750	Add: Clearing charges	8,500
		Total Value of 85 cases	2,67,750
		Value of 10 cases	31,500

Illustration 17

Ramesh consigned 2,000 metric tonne of chemicals at a cost of ₹ 800 per metric tonne to John. Ramesh paid freight and insurance charges of ₹ 20,000. Of the above, 500 metric tonne of chemicals were destroyed by fire during transit. John cleared the balance of 1,500 metric tonne of chemicals and sold 1,000 metric tonne at an average price of ₹ 1,000 per metric tonne John incurred the following expenses : Godown rent ₹ 5,000; Insurance ₹ 3,000; and Clearing charges ₹ 4,500. Insurance claim received against fire ₹ 4,00,000 after admitting the salvage value of stock destroyed by fire at ₹ 10,000. John was entitled to a commission of 10% on sale proceeds. John sends the balance to Ramesh after adjusting his commission and expenses out of the sales proceeds.

Prepare a Consignment Account and John's Account in the books of Ramesh.

Solution

In the books of Ramesh

Dr. Consignment to John Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	16,00,000		By Abnormal Loss A/c (Note 1)	3,95,000
	To Bank A/c (Freight and Insurance)	20,000		By John A/c (Sales)	10,00,000
	To John A/c (Total Expenses)	12,500		By Stock on Consignment A/c (Note 2)	4,16,500
	To John A/c (Commission)	1,00,000			
	To Profit & Loss on Consignment A/c	79,000			
		18,11,500			18,11,500

Dr. John Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to John A/c	10,00,000		By Consignment to John A/c (Expenses)	12,500
				By Consignment to John A/c (Commission)	1,00,000
				By Bank A/c (Final payment)	8,87,500
		10,00,000			10,00,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	(2) Value of Closing Stock	₹
Cost of goods sent (2,000 mt.)	16,00,000	Total cost of goods sent (2,000 mt.)	16,20,000
Add: Non-recurring expenses upto the accident	20,000	Less: Abnormal Loss	4,05,000
Total cost of goods sent (2,000 mt.)	16,20,000	Value of the goods received by John	12,15,000
Therefore, value of abnormal loss (₹ 16,20,000 / 2,000 x 500)	4,05,000	Add: Non-recurring expenses of John (clearing charges)	4,500
Less: Salvage Value	10,000	Total cost of goods received by John (1,500 mt.)	12,19,500
Actual value of Abnormal Loss	3,95,000	Therefore, value of closing stock (₹ 12,19,500 / 1,500 x 500)	4,06,500
		Add: Salvage value of damaged stock	10,000
			4,16,500

Illustration 18

Messrs Goswami Brothers were appointed agents by Sunrise Limited in 2001. You are given the following particulars relating to the year 2016-17 :

(i) Cost of goods despatched by the Company on consignment ₹ 7,50,000.

(ii) Goods fully destroyed in transit (original cost) ₹ 50,000.

(iii) Expenses incurred by the company towards : Freight ₹ 2,500; Insurance ₹ 1,500.

(iv) Expenses incurred by Goswami Brothers :
Landing and clearing ₹ 1,500; Godown rent ₹ 1,000; Transport charges ₹ 1,000; Advertisement ₹ 800; Insurance ₹ 800.

(v) Advance remitted by the Agent ₹ 1,50,000.

(vi) Bills payable accepted ₹ 25,000.

(vii) Goods destroyed by fire (at original cost) in Agent's godown ₹ 35,000.

(viii) Bad debts ₹ 3,000.

(ix) Unsold stock with Agent at the close of the year (at original cost) ₹ 50,000.
(x) Insurance claim recovered by the consignor towards loss in transit ₹ 48,000.
(xi) Insurance claim recovered by the consignee towards loss by fire ₹ 35,000.

All sales were affected by the Agent at 25% on original cost. He is entitled to a commission of 10% on gross sales.

You are required to show the Consignor's Account (Sunrise Ltd.) as would appear in the books of Goswami Brothers.

Solution

In the books of Goswami Brothers

Dr. Sunrise Ltd. Account Cr.

Date	Particulars		₹	Date	Particulars	₹
	To Bank A/c (Advance)		1,50,000		By Bank A/c - Sales (Note 1)	7,68,750
	To Bills Payable A/c		25,000		By Bank A/c - Insurance claim	35,000
	To Bank A/c - expenses :					
	Landing and clearing	1,500				
	Godown rent	1,000				
	Transport charges	1,000				
	Advertisements	800				
	Insurance	800	5,100			
	To Commission A/c		76,875			
	To Balance c/d - amount due		5,46,775			
			8,03,750			8,03,750

Working Note : (1) Calculation of Sale Proceeds

			₹	
Cost of the goods sent			7,50,000	
Less :	Goods lost-in-transit	50,000		Sales were made at 25% of original cost. Therefore, sales are
	Goods lost-in-godown	35,000		= ₹ 6,15,000 + 25% of ₹ 6,15,000 = ₹ **7,68,750**.
	Unsold stock	50,000	1,35,000	
Cost of goods sold			6,15,000	

Illustration 19

A of Calcutta sent on Consignment basis goods to B of Bombay at an invoice price of ₹ 29,675 and paid for freight ₹ 762, cartage ₹ 231 and insurance ₹ 700. Half the goods were sold by the agents for ₹ 17,500 subject to an agent's commission of ₹ 875, storage expenses of ₹ 200 and other selling expenses of ₹ 350. One-fourth of the consignment was lost in a fire and a claim of ₹ 5,000 recovered.

Draw up the necessary accounts in the books of A and ascertain the profit or loss assuming the closing stock to be one-fourth of the consignment. The agent reported that rest of the goods were also damaged and would need ₹ 700 for repairs.

Solution

In the books of A

Dr. Consignment to Bombay Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	29,675		By B A/c (sale proceeds)	17,500
	To Bank A/c			By Abnormal Loss A/c	7,842
	Freight	762		By Stock on Consignment A/c	7,842
	Cartage	231		By Profit & Loss on Consignment A/c	309
	Insurance	700			
	To B A/c				
	Storage	200			
	Selling expenses	350			
	Commission	875			
	To Provision for repairs A/c	700			
		33,493			33,493

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	17,500		By Consignment to Bombay A/c	1,425
				By Balance c/d	16,075
		17,500			17,500

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Trading A/c (transfer)	29,675		By Consignment to Bombay A/c	29,675

Dr. **Abnormal Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	7,842		By Bank A/c (claim) By Profit & Loss A/c	5,000 2,842
		7,842			7,842

Tutorial Note: : To repair the damaged stock, an expense of ₹ 700 will be incurred. Therefore, we would make a provision of that amount by debiting 'Consignment Account' and crediting 'Provision for Repairs Account'—applying the concept of conservatism, 'anticipate no profit but provide for all possible losses.' In the Balance Sheet, the stock will appear as :

Stock on Consignment	₹ 7,842
Less: Provision for Repairs	₹ 700
	₹ 7,142

When the actual expenses will be incurred, we will pass the following entry:

Provision for Repairs Account	Dr.	700	
To Cash Account			700

Illustration 20

Star Mills Ltd. Surat, sends regular consignments of yarn to X who is the selling agent of the Mill and is entitled to a commission of 10 paise per kg of yarn sold. This includes del credere commission. The following further information is furnished to you:

On 1st July, 2016, stock of yarn with the agent 20,000 kg costing ₹ 50,000.

During the year ended 30th June, 2017 :

Total quantity of yarn consigned 1,60,000 kg. at ₹ 3 per kg

Total quantity of yarn sold 1,50,000 kg at ₹ 3.75 per kg including the opening stock of 20,000 kg.

Total remittances by the agent ₹ 5,10,000.

Railway freight paid by the agent ₹ 40,000.

Of the sales made, X could not collect ₹ 11,000 due to the insolvency of the customer.

5,000 kg of yarn were damaged in transit by the railway for which the agent recovered ₹ 6,000. The damaged goods were sold at the rate of ₹ 1.50 per kg. Show the following Ledger Accounts in the books of Star Mills Ltd for the year ended 30th June, 2017: (a) Consignment Account; (b) Goods Damaged in Transit Account; and (c) X Account.

[I.C.W.A. (Inter) — Adapted]

Solution

In the books of Star Mills Ltd

Dr. **Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.7.2016	To Stock on Consignment A/c	50,000	30.6.2017	By X A/c (sales)	5,62,500
	To Goods Sent on Consignment A/c	4,80,000	"	By Goods Damaged in Transit A/c	16,250
30.6.2017	To X A/c		"	By Stock on Consignment A/c	81,250
	Railway freight	40,000			
	Commission	15,000			
"	To Profit & Loss on Consignment A/c	75,000			
		6,60,000			6,60,000

Dr. **Goods Damaged in Transit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2017	To Consignment A/c	16,250	30.6.2017	By X A/c (amount recovered from Railway)	6,000
"	To X A/c (commission)	500	"	By X A/c (sale of damaged goods)	7,500
			"	By Profit & Loss A/c (Abnormal loss)	3,250
		16,750			16,750

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2017	To Consignment A/c	5,62,500	30.6.2017	By Consignment A/c	40,000
"	To Goods Damaged in Transit A/c	6,000	"	By Consignment A/c (commission)	15,000
"	To Goods Damaged in Transit A/c	7,500	"	By Goods Damaged in Transit A/c	500
			"	By Bank A/c (Remittance)	5,10,000
			"	By Balance c/d	10,500
		5,76,000			5,76,000

Working Notes : Valuation of Goods Damaged in Transit	₹
Cost of goods sent	4,80,000
Add: Railway freight	40,000
Total cost of 1,60,000 kg	5,20,000

Therefore, 1. The value of 5,000 kg damaged goods = (₹ 5,20,000 / 1,60,000) x 5,000 = ₹ 16,250;

2. The value of closing stock (25,000 kg) = (₹ 5,20,000 / 1,60,000) x 25,000 = ₹ 81,250.

Illustration 21

A consigned to B on 1st January, 2017, 500 bales of cotton costing ₹ 100 per bale. Freight charges incurred in the consignment were ₹ 5,000. A drew a bill on B for ₹ 50,000 payable on 30th June, 2017 which B accepted. The bill was discounted by A with his banker on 31st January, 2017 at 12% p.a.

B rendered Account Sales to A on 31st March, 2017 showing sales of 300 bales for ₹ 80,000 and selling expenses of ₹ 5,000. B's commission was 10%. On this date, B remitted to A net amount due to him.

On 31st May, 2017 B sold the balance stock for ₹ 30,000 after incurring expenses of ₹ 4,000. He remitted ₹ 20,000 to A, the balance being treated as commission earned by him. On 30th June, 2017 the bill accepted by B was dishonoured by him and the amount due to the bank was paid off by A along with incidental charges of ₹ 200.

Pass journal entries in the books of A (including bank transactions).

Solution

In the books of A

Journal

Date	Particulars		Dr. ₹.	Cr. ₹.
2017 Jan 1	Consignment to B A/c To Goods Sent on Consignment A/c (Being 500 bales of cotton sent to B on consignment @ ₹ 100 per bale as per proforma invoice No ...)	Dr.	50,000	50,000
	Consignment to B A/c To Bank A/c (Being freight charges incurred on the consignment to B)	Dr.	5,000	5,000
	Bills Receivable A/c To B A/c (Being a bills drawn on B for 6 months)	Dr.	50,000	50,000
Jan 31	Bank A/c Discount on Bills A/c To Bills Receivable A/c (Being bills receivable of B discounted @ 12% p.a. for 5 months)	Dr. Dr.	47,500 2,500	50,000
Mar 31	B A/c To Consignment to B A/c (Being sale of 300 bales of cotton as per Account Sales)	Dr.	80,000	80,000
	Consignment to B A/c To B A/c (Being expenses incurred by B ₹ 5,000 and commission payable to him ₹ 8,000 as per Account Sales)	Dr.	13,000	13,000
	Bank A/c To B A/c (Being the amount received from B in settlement of sales to date after adjusting bill receivable expenses and commission)	Dr.	17,000	17,000
May 31	B A/c To Consignment to B A/c (Being sale of remaining goods as per Account Sales)	Dr.	30,000	30,000
	Consignment A/c (see note) To B A/c ₹ (4000 + 6000) (Being expenses and commission payable to B)	Dr.	10,000	10,000
	Bank A/c To B A/c (Being the amount received from B in full settlement)	Dr.	20,000	20,000
	Consignment to B A/c To Profit & Loss on Consignment A/c (Being the profit on consignment transferred)	Dr.	32,000	32,000
June 30	B A/c To Bank A/c (Being the bill accepted by B dishonoured and incidental charges ₹ 200 paid)	Dr.	50,200	50,200

Note: Total sales ₹ 30,000 and expenses ₹ 4,000. So net proceeds = (₹ 30,000 – 4,000) = ₹ 26,000, but the amount sent by B is ₹ 20,000. The balance of ₹ 6,000 should be treated as commission.

Illustration 22

Sri Mehta of Bombay consigns 1,000 cases of goods costing ₹ 100 each to Sri Sundaram of Madras. Sri Mehta pays the following expenses in connection with the consignment: carriage ₹ 1,000; freight ₹ 3,000; and loading charges ₹ 1,000.

Sri Sundaram sells 700 cases at ₹ 140 per case and incurs the following expenses : clearing charges ₹ 850; warehousing and storage ₹ 1,700; and packing and selling expenses ₹ 600. It is found that 50 cases have been lost in transit and 100 cases are still in transit. Sri Sundaram is entitled to a commission of 10% on gross sales. Draw up Consignment Account and Sundaram Account in the books of Mehta.

Solution

In the books of Mehta

Dr. Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,00,000		By Sundaram A/c (sales)	98,000
	To Cash A/c			By Abnormal Loss A/c	5,250
	Carriage	1,000		By Stock on Consignment A/c	15,900
	Freight	3,000		By Stock in Transit A/c	10,500
	Loading charges	1,000			
	To Sundaram A/c				
	Clearing charges	850			
	Warehousing & storage	1,700			
	Packing and selling	600			
	Commission	9,800			
	To Profit & Loss on Consignment A/c	11,700			
		1,29,650			1,29,650

Dr. Sundaram Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment A/c	98,000		By Consignment A/c (expenses)	3,150
				By Consignment A/c (commission)	9,800
				By Balance c/d	85,050
		98,000			98,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	(3) Valuation of Closing Stock	₹
Cost of 1,000 cases @ ₹ 100 each	1,00,000	Total cost of 1,000 cases	1,05,000
Add: Non recurring expenses upto accident	5,000	Less : Cost of 50 cases lost in transit	5,250
Total cost of 1,000 cases	1,05,000		99,750
Therefore, value of 50 cases = ₹ (1,05,000 / 1,000) x 50 =	5,250	Less: Cost of 100 cases still in transit	10,500
(2) Valuation of Stock in Transit	₹	Cost of 850 cases	89,250
Total cost of 1,000 cases (as above)	1,05,000	Add: Non recurring expenses of consignee (clearing charge)	850
Therefore, value of 100 cases (₹ 1,05,000 / 1,000) x 100 =	10,500	Total cost of 850 cases	90,100
		Therefore, value of 150 cases = (₹ 90,100 / 850) x 150 =	15,900

Overriding Commission

It is an extra commission which, in addition, to the ordinary commission is allowed by the consignor to the consignee. This commission is normally granted in case sales exceed a specified amount. It can also be an incentive to the consignee for creating market for a new product.

Illustration 23

On 1.10.2015, S Mittal of Faridabad sent on consignment to S Bros of Kolkata 100 boxes of goods costing ₹ 1,200 each and incurred ₹ 4,600 as freight, ₹ 300 as cartage and ₹ 600 as insurance in consigning the goods.

S Bros accepted a bill on 12.10.2015 at 3 months for 60% of the normal selling price of goods and S Mittal discounted the bill on 15.11.2015 at a discount of 12% p.a. The normal selling price was cost plus 45%.

S Bros had incurred ₹ 1,500 as unloading charges, ₹ 700 as godown rent and ₹ 1,600 as selling expenses. He was entitled to a commission @ 6% on normal selling price plus 20% of any surplus over and above the normal selling price.

He reported that 3/5th of the goods received had been sold for ₹ 1,16,400 and 10 boxes of goods were damaged on account of bad packing which would be sold only for ₹ 725 per box. It was found that 10 boxes of goods were still in transit on 31.12.2015 when the accounts of the consignor were closed. The amount due to S Mittal was remitted by a bank draft. Prepare necessary accounts in the books of S Mittal. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of S Mittal

Dr. Consignment to Kolkata Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Oct. 1	To Goods Sent on Consignment A/c	1,20,000	Dec. 31	By S Bros A/c (Sale proceeds)	1,16,400
	To Bank A/c (Expenses) :			By Goods in Transit A/c (Note 1)	12,550
	Freight	4,600		By Stock on Consignment A/c (Note 2) :	
	Cartage	300		Good boxes	33,063
	Insurance	600		Damaged boxes	6,815

Dec. 31	To S Bros A/c :				
	Unloading charges	1,500			
	Godown rent	700			
	Selling expenses	1,600			
	Commission (Note 3)	10,126			
	To Profit and Loss on Consignment A/c	29,402			
		1,68,828			1,68,828

Dr. S Brothers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec. 31	To Consignment to Kolkata A/c	1,16,400	Oct. 12	By Bills Receivable A/c (Note 5)	1,04,400
"	To Balance c/d (Note 4)	31,494	Dec. 31	By Consignment to Kolkata A/c :	
				Unloading charges	1,500
				Godown rent	700
				Selling expenses	1,600
				Commission	10,126
			"	By Bank A/c	29,568
		1,47,894			1,47,894

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec. 31	To Purchases A/c (Transfer)	1,20,000	Oct. 1	By Consignment to Kolkata A/c	1,20,000
		1,20,000			1,20,000

Dr. Goods in Transit Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec. 31	To Consignment to Kolkata A/c	12,550	Dec. 31	By Balance c/d	12,550
		12,550			12,550

Dr. Stock on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec. 31	To Consignment to Kolkata A/c :		Dec. 31	By Balance c/d	39,878
	Good boxes	33,063			
	Damaged boxes	6,815			
		39,878			39,878

Working Notes :

(1) Calculation of Goods in Transit

	₹
Cost price of 10 boxes	12,000
Add: Proportionate expenses of the consignor (₹ 5,500 × 10 / 100)	550
Value of goods in transit	12,550

(2) Out of 100 boxes sent, 10 boxes are still in transit at the year end. Therefore, number of boxes received by the consignee is 100 – 10 = 90 boxes. The consignee sold 3/5th of 90 boxes = 54 boxes. Therefore, boxes in hand is calculated as :

damaged boxes	10 boxes
good boxes (36 – 10)	26 boxes
	36 boxes

Calculation of Stock on Consignment (good boxes)

	₹
Cost of 26 boxes (26 × ₹ 1,200)	31,200
Add: Proportionate expenses of the consignor (₹ 5,500 / 100 × 26)	1,430
Add: Proportionate non-recurring expenses of the consignee (₹ 1,500 / 90 × 26)	433
Value of stock on consignment (good boxes)	33,063

Calculation of Stock on Consignment (damaged boxes)

Sales value of 10 boxes (10 × ₹ 725)	7,250
Less: Ordinary commission payable (6% on ₹ 7,250)	435
Value of stock on consignment (damaged boxes)	6,815

(3) Calculation of Commission

Normal selling price per unit = Cost price + 45% of cost price = ₹ 1,200 + 45% of ₹ 1,200 = ₹ 1,740

Ordinary commission (6% on 54 × ₹ 1,740)	5,638
Special commission [20% on (₹ 1,16,400 – 54 × 1,740)]	4,488
	10,126

(4) It is assumed that the bill was drawn as an advance against the security of the goods sent. Therefore, the advance will be adjusted proportionately, which is calculated as under :

60% of (26 × ₹ 1,740 + 10 × ₹ 725) = ₹ 31,494.

(5) Amount of the bill = 60% of (₹ 1,740 × 100) = ₹ 1,04,400.

(6) Discounting charges of the bill is a financial charge. It should be debited in the Profit and Loss Account.

Illustration 24

X of Calcutta sent 80 machines to Y of Bombay on 1st January, 2016 on the following terms:

1. All the machines were to be sold 25% above the cost price of ₹ 20,000 each. Any deficit in selling price was to be borne by Y and 50% of the surplus selling price was to be retained by him.
2. Y would get 3% commission and 2% Del Credere commission on all sales. X incurred transport charges of ₹ 80,000. Y sent Account Sales on 31st December, 2016 as: (i) 20 machines sold for ₹ 24,000 each; (ii) 40 machines sold for ₹ 30,000 each; (iii) 5 machines sold for ₹ 25,000 each. (iv) Unloading charges ₹ 8,000; and (v) Selling expenses ₹ 5,000. Y sent a bank draft for the net amount due to X along with the Account Sales.

On 30th June, 2017 Y sent a further Account Sales as: (a) 5 machines sold for ₹ 22,000 each; (b) 10 machines sold for ₹ 40,000 each and sent a bank draft for the amount due.

X closed its books on 31st December each year. Prepare Ledger Accounts in the books of X.

Solution

In the books of X

Dr. Consignment to Bombay Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Goods Sent on Consignment A/c	16,00,000	31.12.2016	By Y A/c (sales)	18,05,000
"	To Bank A/c (transport charges)	80,000	"	By Stock on Consignment A/c (Note 3)	3,16,500
31.12.2016	To Y A/c : Unloading	8,000			
	Selling expenses	5,000			
	Commission (Note 2)	1,70,250			
"	To Profit & Loss on Consignment A/c	2,58,250			
		21,21,500			21,21,500
1.1.2017	To Stock on Consignment A/c	3,16,500	30.6.2017	By Y A/c (sales)	5,10,000
"	To Y A/c (commission) (Note 2)	85,500			
"	To Profit & Loss on Consignment A/c	1,08,000			
		5,10,000			5,10,000

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Consignment to Bombay A/c	18,05,000	31.12.2016	By Consignment to Bombay A/c	13,000
			"	By Consignment to Bombay A/c	1,70,250
			"	By Bank A/c	16,21,750
		18,05,000			18,05,000
30.6.2017	To Consignment to Bombay A/c	5,10,000	30.6.2017	By Consignment to Bombay A/c	85,500
			"	By Bank A/c	4,24,500
		5,10,000			5,10,000

Working Notes :

(1) Minimum selling price = Cost + 25% Profit on cost = ₹ 20,000 + 5,000 = ₹ 25,000

(2) Calculation of Commission

	₹
2016 5% on Sales proceeds of ₹ 18,05,000	90,250
50% of surplus realization : 40 × (₹ 30,000 – ₹ 25,000)	1,00,000
	1,90,250
Less: Deficit in selling price : 20 × (₹ 25,000 – 24,000)	20,000
	1,70,250
2017 5% on Sales proceeds of ₹ 5,10,000	25,500
50% of surplus realization : 10 × (₹ 40,000 – 25,000)	75,000
	1,00,500
Less: Deficit in selling price : 5 × (25,000 – 22,000)	15,000
	85,500

(3) Valuation of Closing Stock

Particulars	₹.	
Cost price of 80 machines	16,00,000	Therefore, value of closing stock
Add : Non-recurring expenses (₹ 80,000 + ₹ 8,000)	88,000	= ₹ 16,88,000 / 80 x 15 = ₹ 3,16,500.
Total Cost	16,88,000	

Illustration 25

X of Calcutta sent on15th January, 2017, a consignment of 500 bicycles costing ₹ 100 each to Y of Bombay Expenses of ₹ 700 were met by the consignor. Y of Bombay spent ₹ 1,500 for clearance and the selling expenses were ₹ 10 per bicycle.

Y sold on 4th April, 2017, 300 bicycles @ ₹ 160 each and again on 20th June, 2017, 150 bicycles @ ₹ 172 each.

Y was entitled to a commission of ₹ 25 per bicycle sold plus one-fourth of the amount by which gross sale proceeds, less total commission thereon, exceeded a sum calculated @ ₹ 125 per bicycle sold. Y sent the amount due to X on 30th June, 2017. You are to show necessary accounts in the books of X.

Solution

In the books of X

Dr. Consignment to Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.1.2017	To Goods Sent on Consignment A/c	50,000	30.6.2017	By Y A/c (sales)	73,800
"	To Bank A/c (expenses)	700	"	By Consignment Stock A/c	5,220
30.6.2017	To Y A/c				
	Clearance	1,500			
	Selling expenses	4,500			
	Commission (Note 1)	12,510			
"	To Profit & Loss on Consignment A/c	9,810			
		79,020			79,020

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2017	To Consignment to Y A/c	73,800	30.6.2017	By Consignment to Y A/c	6,000
			"	By Consignment to Y A/c	12,510
			"	By Bank A/c	55,290
		73,800			73,800

Working Notes: (1) Calculation of Commission

Let total commission payable to Y = X

x = [(450 x 25) + 1/4 {(73,800 – x) – (450 x 125)}]

or x = 11,250 + 1/4 (73,800 – 56,250 – x)

or x = 11,250 + 1/4 (17,550 – x)

or x = 11,250 + 4,387.5 – 1/4x or x+1/4x = 15,637.5 or 5x = 62,550 or x = ₹ 12,510.

(2) Valuation of Closing Stock

	₹
Cost @ ₹ 100 =	50,000
Add: Non recurring exp (700 + 1,500)	2,200
Cost of 500 bicycles	52,200
Therefore, cost of 50 bicycles	5,220

Return of Goods from the Consignee

Owing to wrong policy, it is quite possible that some part of the goods may be returned by the consignee to the consignor. When goods are returned, the consignor passes the following entry:

Goods Sent on Consignment Account Dr.
  To Consignment to ... Account

When goods are returned, there will definitely be some expenses. These expenses will be paid either by the consignor or by the consignee. ***The problem arises whether the expenses incurred should be charged to the Consignment Account or not.***

Some accountants say that since the expense are related to the consignment, it should be charged to the Consignment Account. Others argue that the expenses on returning the goods are not expenses for the consignment, rather it is a policy cost, so it should be charged to General Profit and Loss Account in place of Consignment Account.

In examinations, the expenses on returning the goods are generally charged to the Consignment Account.

The consignor passes the following entry:

Consignment to ... Account Dr.
  To Cash/Bank Account [when paid by consignor]
  To Consignee Account [when paid by the consignee]

Illustration 26

On 1.4.2016 Mr Doshi of Darjeeling consigned 2,000 kg of tea costing ₹ 60 per kg. to Mr. Naik of Nagpur. Mr Doshi incurred the following expenses: Freight ₹ 2,000; insurance ₹ 400 and sundry expenses ₹ 600.

During the year ended 31.3.2017, Mr. Naik incurred the following expenses: Freight ₹ 600; godown rent ₹ 500 and carriage to godown ₹ 1,000. On 1.12.2016 Mr. Naik sold 1,200 kg of tea for cash at a profit of 25% on sales. On 15.12.2016, Mr. Naik returned 150 kg. of tea, which were of poor quality to Mr. Doshi and paid returned freight and carriage charges of ₹ 250. Out of the remaining tea, 200 kg being partially damaged were valued at 30% less than cost. Mr. Naik charged his commission at 5% and the balance so far due from him to Mr. Doshi on 31.3.2017. Mr Doshi closes his books every year on 31st March.

You are required to prepare the following accounts in the books of Mr Doshi:

(a) Consignment to Nagpur Account; (b) Goods Sent on Consignment Account; (c) Personal Account of Mr Naik.

Solution **In the books of Mr Doshi**

Dr. **Consignment to Nagpur Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Goods Sent on Consignment A/c	1,20,000	1.12.2016	By Naik A/c (Sales)	96,000
"	To Bank A/c		15.12.2016	By Goods Sent on Consignment A/c	9,000
	Freight	2,000		By Abnormal Loss A/c (Note 1)	4,420
	Insurance	400	31.3.2017	By Stock on Consignment A/c	
	Sundry expenses	600		Good units	27,900
15.12.2016	To Mr Naik A/c (Freight & carriage return)	250		Damaged units	7,980
31.3.2017	To Mr Naik A/c				
	Freight	600			
	Godown rent	500			
	Carriage to godown	1,000			
	Commission	4,800			
"	To Profit & Loss on Consignment A/c	15,150			
		1,45,300			1,45,300

Dr. **Mr Naik Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.12.2016	To Consignment to Nagpur A/c	96,000	31.12.2016	By Consignment to Nagpur A/c	250
			31.3.2017	By Consignment to Nagpur A/c	6,900
			"	By Bank A/c (remittance)	88,850
		96,000			96,000

Dr. **Goods Sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
15.12.2016	To Consignment to Nagpur A/c	9,000	1.4.2017	By Consignment to Nagpur A/c	1,20,000
31.3.2017	To Trading A/c	1,11,000			
		1,20,000			1,20,000

Working Notes :

(1) Valuation of Abnormal Loss		₹	(2) Valuation of Closing Stock	₹
Cost of 200 kg @ ₹ 60 per kg		12,000	Cost of 450 kg @ ₹ 60 per kg	27,000
Add: 1/10 (2,000 + 400 + 600 + 1,000) non recurring exp.		400	Add: Proportionate non recurring exp. (4,000 / 2,000) x 450	900
		12,400	(i) Value of good quality tea	27,900
Less: Estimated value			(ii) Value of damaged quality tea	7,980
Cost	12,000		Value of closing stock	35,880
Less: 30%	3,600			
	8,400			
Less: Commission @ 5%	420	7,980		
Abnormal Loss		4,420		

Invoice Price Method

Sometimes, the consignor may prefer to send goods to the consignee at a higher price than the cost price and, accordingly, prepares the 'Proforma Invoice' by adding some profit on cost or on sales. For example, C of Calcutta consigned 100 cases of goods to D of Delhi on 1st January, 2017. The cost per case is ₹ 500. The Proforma Invoice was made to show a 20% profit on cost.

Here, Proforma Invoice will be prepared @ ₹ 600 (₹ 500 + 20% of 500) per case and the Consignment Account will be debited with ₹ 60,000 though the actual cost of goods is ₹ 50,000.

The goods are charged to the consignee not at cost but at higher price with a view

(i) to keep the profit on consignment secret;
(ii) to give incentive to the consignee to realize the highest possible price; and
(iii) to make him charge a uniform price.

The method of preparation of accounts is the same as in the *cost price method*, except for a few adjustments which are explained below. ***Journal Entries*** are as under:

1. For sending goods to the consignee

Consignment to .... Account	Dr.	
To Goods Sent on Consignment Account		(Invoice value of goods sent)

2. For payment of expenses by the consignor

Consignment to ... Account	Dr.	
To Cash/Bank Account		(If paid)
To Creditors for Expenses Account		(If unpaid)

3. For receipts of advance from the consignee

(a) When payment is received in cash or bank draft

Cash or Bank Account	Dr.
To Consignee Account	

(b) When a bill is accepted by the consignee

Bills Receivable Account	Dr.
To Consignee's Account	

4. For Abnormal Loss

Abnormal Loss Account	Dr.
To Consignment to ... Account	

5. For closing Abnormal Loss Account

Insurance Claim Account	Dr. [claim admitted]
Consignment Account	Dr. [loading on goods lost]
Profit and Loss Account	Dr. [balance]
To Abnormal Loss Account	

6. When Account Sales is received from the consignee

Immediately after receiving the Account Sales, the consignor will pass the following entries:

(a) For sale of goods by the consignee

Consignee Account	Dr. (Gross sales Proceeds)
To Consignment to ... Account	

(b) For expenses incurred by the consignee

Consignment to ... Account	Dr.
To Consignee Account	

(c) For commission of the Consignee

Consignment to ... Account	Dr.
To Consignee Account	

(d) For receiving remittance from the consignee

Bank Account	Dr.
To Consignee Account	

7. For bringing down the value of goods sent to its cost

Goods sent on Consignment Account	Dr. (Difference between Invoice value and cost)
To Consignment to ... Account	

8. For stock on consignment

Stock on Consignment Account	Dr. (Proportionate Invoice value plus proportionate non recurring expenses)
To Consignment to ... Account	

9. For adjusting value of Closing Stock

Consignment to ... Account	Dr. (Total loading / Total qty x Unsold qty)
To Stock Reserve Account	

10. The profit should be calculated in the usual manner

(a) For profit on consignment

Consignment to ... Account Dr.
 To Profit and Loss on Consignment Account

(b) For loss on consignment

Profit and Loss on Consignment Account Dr.
 To Consignment to ... Account

11. The balance of the 'Goods sent on Consignment Account' should be transferred to Trading Account (If the consignor is a manufacturer) or to a Purchases Account (if the consignor is a trader).

12. The balance of the 'Stock on Consignment Account' and 'Stock Reserve Account' should be carried down on the respective side of the account. In the Balance Sheet Stock on Consignment Account should be shown on the assets side and Stock Reserve should be shown by way of deduction from stock on consignment.

Balance Sheet as at ....

Liabilities	₹	Assets	₹
		Stock on Consignment Less: Stock Reserve	**** ****

13. At the beginning of the next accounting year, the balance of the Stock on Consignment Account will be transferred to the debit side of the Consignment Account and the Stock Reserve will be transferred to the credit side of the Consignment Account.

Illustration 27

Tilak of Tatanagar consigned goods costing ₹ 2,00,000 to his agent Pulak of Patna. The invoice was made pro-forma so as to show a profit of 25% on cost. Tilak paid freight and insurance ₹ 4,000. Pulak sold part of the consignment for ₹ 1,76,000 at a uniform price of 10% over invoice price and spent ₹ 6,000 as warehousing charges and ₹ 2,000 as selling expenses. Pulak is entitled to a commission of 5% on sales and 20% of the net profit after charging commission on sales. Draw up the Consignment Account in the books of Tilak.

Solution

In the books of Tilak

Dr. Consignment to Patna Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	2,50,000		By Goods Sent on Consignment A/c	50,000
	To Bank A/c (freight and insurance)	4,000		By Pulak A/c (Sale proceeds)	1,76,000
	To Pulak A/c :			By Stock on Consignment A/c (Note 2)	91,440
	Warehousing Charges	6,000			
	Selling Expenses	2,000			
	Commission (5% on ₹ 1,76,000)	8,800			
	To Stock Reserve A/c (Note 3)	18,000			
	To Profit c/d	28,640			
		3,17,440			3,17,440
	To Pulak A/c (Share of Profit — 20% on ₹ 28,640)	5,728		By Profit b/d	28,640
	To Profit and Loss on Consignment A/c	22,912			
		28,640			28,640

Working Notes :

1. Invoice price = Cost price + 25% profit on cost (loading) = ₹ 2,00,000 + ₹ 50,000 = ₹ 2,50,000.

2. Valuation of Stock on Consignment

	₹
Invoice price of the goods sent	2,50,000
Less: Invoice price of the goods sold (₹ 1,76,000 / 110 × 100)	1,60,000
Invoice price of the stock on consignment	90,000
Add: Proporationate non-recurring expenses (₹ 4,000 × 90,000 / 2,50,000) — Freight and Insurance	1,440
	91,440

3. Loading on Stock on Consignment = ₹ 90,000 × 25 / 125 = ₹ 18,000.

Illustration 28

On 1st January, 2016 Seth Bros. of Kandla consigned 200 cycles to Panigrahi & Sons of Paradeep. Each cycle costing ₹ 800. The goods were charged at a proforma invoice price to show a 25% profit on cost. On the same date, the consignor paid ₹ 4,000 as freight and insurance. On 30th April, the consignee sent a bank draft for ₹ 1,00,000 to the consignor as advance. On 31st December, 2016 the consignee sent an Account Sale informing that 180 cycles have been sold for ₹ 1,200 each. They have incurred the following expenses in respect of the consignment: (i) Unloading charges ₹ 1,000; (ii) Cycle fitting charges ₹ 2,000; and (iii) Godown rent ₹ 4,200. With the Account Sale the consignee sent a remittance for the balance due to the consignor after deducting commission of 5% on gross sale proceeds.

You are required to show necessary Ledger Accounts in the books of Seth Bros and Seth Bros Account in the books of Panigrahi & sons.

Solution

In the books of Seth Bros

Dr. Consignment to Paradeep Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Goods Sent on Consignment A/c	2,00,000	31.12.2016	By Panigrahi & Sons A/c (sale proceeds)	2,16,000
"	To Bank A/c (freight & insurance)	4,000	"	By Goods Sent on Consignment A/c (loading)	40,000
31.12.2016	To Panigrahi & Sons A/c		"	By Stock on Consignment A/c (Note 5)	20,700
	Unloading charges	1,000			
	Cycle Fitting charges	2,000			
	Godown rent	4,200			
	Commission @ 5%	10,800			
"	To Stock Reserve A/c	4,000			
"	To Profit & Loss on Consignment A/c	50,700			
		2,76,700			2,76,700

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Consignment to Paradeep A/c	40,000	1.1.2016	By Consignment to Paradeep A/c	2,00,000
	To Trading A/c	1,60,000			
		2,00,000			2,00,000

Dr. Stock on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Consignment to Paradeep A/c	20,700	31.12.2016	By Balance c/d	20,700
1.1.2017	To Balance b/d	20,700	1.1.2017	By Consignment to Paradeep A/c	20,700

Dr. Panigrahi & Sons Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Consignment to Paradeep A/c	2,16,000	31.12.2016	By Advance Against Consignment A/c	1,00,000
			"	By Consignment to Paradeep A/c	18,000
			"	By Bank A/c (final payment)	98,000
		2,16,000			2,16,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Balance c/d	4,000	31.12.2016	By Consignment to Paradeep A/c	4,000
1.1.2017	To Consignment to Paradeep A/c	4,000	1.1.2017	By Balance b/d	4,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Panigrahi & Sons A/c	1,00,000	30.4.2016	By Bank A/c	1,00,000

Working Notes :

1. **Invoice Price** = Cost price + 25% profit on cost = ₹ 800 + ₹ 200 = ₹ 1,000;
2. **Loading per cycle** = Invoice price – Cost price = ₹ 1,000 – 800 = ₹ 200;
3. **Total Loading** = 200 x 200 = ₹ 40,000;
4. **Loading on Unsold stock** = (₹ 40,000 / 200) x 20 = ₹ 4,000;
5. **Valuation of Closing Stock**

	₹
Invoice price of goods sent	2,00,000
Add: Freight & insurance : 4,000 + Unloading charges : 1,000 + Fitting charges : 2,000	7,000
Value of 200 cycles at Invoice price	2,07,000

Therefore, value of 20 unsold cycles = ₹ 20,700.

6. Advance of ₹ 1,00,000 has not been treated as security on goods sent.

In the books of Panigrahi & Sons

Dr. Seth Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c		2016 ?	By Bank A/c (sales)	2,16,000
	Unloading charges	1,000			
	Fitting charges	2,000			
	Godown rent	4,200			
	To Commission Received A/c	10,800			
31.12.2016	To Advance Against Consignment A/c	1,00,000			
	To Bank A/c (final payment)	98,000			
		2,16,000			2,16,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2016	To Bank A/c	1,00,000	31.12.2016	By Seth Bros. A/c	1,00,000

Invoice Price—Memorandum Column Method

When goods are sent at a proforma invoice price this method may be used for writing up the Consignment Account and Goods sent on Consignment Account. This method is a modification of the cost price method. Under this method, Consignment Account is provided with an additional column in which memorandum entries in respect of invoice value of goods consigned, amount of sales and value of unsold stock are recorded. This memorandum column is meant only for information and the profit or loss on consignment will not be affected. *The solution of the previous illustration under this method is given below:*

Dr. Consignment to Paradeep Account Cr.

Date	Particulars	Memo	Amount	Date	Particulars	Memo	Amount
1.1.2016	To Goods Sent on Consignment A/c	2,00,000	1,60,000	31.12.2016	By Panigrahi & Sons A/c	2,16,000	2,16,000
	To Bank A/c (freight)	4,000	4,000		By Stock A/c	20,700	16,700
31.12.2016	To Panigrahi & Sons A/c						
	Unloading	1,000	1,000				
	Fitting charges	2,000	2,000				
	Godown rent	4,200	4,200				
	Commission	10,800	10,800				
	To Profit & Loss on Consignment A/c	14,700	50,700				
		2,36,700	2,32,700			2,36,700	2,32,700

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	Memo	Amount	Date	Particulars	Memo	Amount
31.12.2016	To Purchases A/c	2,00,000	1,60,000	1.1.2016	By Consignment to Paradeep A/c	2,00,000	1,60,000

It should be noted that the memo column may be added and balanced but the profit or loss disclosed by that column is immaterial. The actual profit or loss will be disclosed by amount column of the Consignment Account. Other accounts will appear as usual, so these accounts have not been shown.

Illustration 29

Goods at an invoice value of ₹ 1,32,000 were consigned by Choudhury & Co. of Calcutta to their agent Gupta & Co. of Allahabad at a proforma invoice of 20% profit on cost.

Freight paid by the consignor amounted to ₹ 5,000. Gupta & Co. was allowed 5% ordinary commission and 3% del credere commission on gross sales. They were also allowed 5% of the net profits as extra commission after charging such commission. Allahabad expenses were : landing and clearing charges ₹ 1,020, godown insurance premium ₹ 2,500.

3/4th of the goods were sold at 25% profit on sales, 1/10th of the balance of goods were destroyed by fire and a claim for ₹ 8,500 was settled by the insurance company.

Prepare Consignment Account, Gupta & Co. Account, Stock Destroyed Account and Consignment Stock Account in the books of Choudhury & Co.

Solution

In the books of Choudhury & Co.

Consignment to Allahabad Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,32,000		By Goods Sent on Consignment A/c (loading)	22,000
	To Bank A/c (freight)	5,000		By Gupta & Co. A/c (sales)	1,10,000
	To Gupta & Co. A/c :			By Stock Destroyed A/c (invoice price)	3,450
	Landing charges	1,020		By Consignment Stock A/c	31,055
	Godown insurance premium	2,500			
	Commission (8% on ₹ 1,10,000)	8,800			
	To Stock Destroyed A/c (loading)	550			
	To Gupta & Co. A/c (extra commission)	556			
	To Stock Reserve A/c	4,950			
	To Profit & Loss on Consignment A/c	11,129			
		1,66,505			1,66,505

Gupta & Co. Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment Stock A/c	1,10,000		By Consignment to Allahabad A/c	12,320
				By Consignment to Allahabad A/c	556
				By Balance c/d	97,124
		1,10,000			1,10,000

Stock Destroyed Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Allahabad A/c (I.P.)	3,450		By Consignment to Allahabad A/c (loading)	550
	To Profit & Loss A/c	5,600		By Insurance Company A/c (Note 6)	8,500
		9,050			9,050

Consignment Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Allahabad A/c	31,055		By Balance c/d	31,055

Working Notes : (1) Loading on Goods Sent	₹	**(2) Calculation of Sales**	
Invoice price of goods sent	1,32,000	Cost price of goods sent (₹ 1,32,000 – 22,000)	1,10,000
Loading is 1/5th on cost, or, 1/6th of invoice price, i.e. **22,000**		Sales = ₹ 1,10,000 x 3/4 x 4/3 = **1,10,000**	
(3) Valuation of Goods Destroyed and Closing stock	₹	**(4) Calculation of Loading on Stock Destroyed and Unsold Stock**	
Invoice price of goods sent	1,32,000	Total loading	32,000
Add: Consignor's expenses	5,000	Loading on stock destroyed = 1/40 x ₹ 22,000	550
Consinee's expenses (Non-recurring)	1,020	Loading on unsold stock = 9/40 x ₹ 22,000	4,950
	1,38,020	**(5) Extra Commission**	
3/4th of the goods are sold. Therefore, balance remains 1/4th Goods destroyed 1/4 x 1/10 = 1/40		Profit before special commission = ₹ 11,685. Therefore extra commission is = 5/105 x ₹ 11,685	556
Invoice price of goods destroyed = 1/40 x ₹ 1,38,200	3,450	**(6)** In practice, insurance company compensates the policy-holder to the extent of actual loss. Actual loss is ₹ 2,900 but in the question, it is given that claim admitted by the insurance company is ₹ 8,500, which in our opinion is not correct.	
Closing stock 1/4 x 9/10 = 9/40 Invoice price of unsold stock = 9/40x ₹ 1,38,020	31,055		

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 30

Mr Saha of Kolkata sent 2,500 cases of goods on concignment to Mr Kole of Mumbai, each case costing ₹ 150. The following expenses were borne by Mr Saha for sending the goods :

Freight ₹ 6,000; Carriage ₹ 3,000 and Loading charges ₹ 2,000.

Mr Kole sold 1,750 cases at ₹ 210 per case and made the following expenses in this connection :

Packaging and selling expenses ₹ 1,200; Storage expenses ₹ 3,400 and clearing charges ₹ 1,700. In the transit 125 cases have been lost. Mr Kole is entitled to a commission of 10% on gross sales. Show Consignment Account in the books of Mr Saha. ***[C.U.B.Com. (General) — 2016]***

Solution

In the Books of Mr Saha

Dr. Consignment to Mumbai Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods sent on Consignment A/c	3,75,000		By Kole A/c (Sales)	3,67,500
	To Cash A/c :			By Abnormal Loss A/c (Note 1)	19,300
	Freight	6,000		By Stock on Consignment A/c (Note 2)	96,947
	Carriage	3,000			
	Loading Charges	2,000			
	To Kole A/c :				
	Commission @ 10%	36,750			
	Packing and Selling Expenses	1,200			
	Storage Expenses	3,400			
	Clearing Charges	1,700			
	To Profit and Loss on Consignment A/c	54,697			
		4,83,747			4,83,747

Working Notes :

(1) Valuation of Abnormal Loss	₹	(2) Valuation of Closing Stock	₹
Cost of 2,500 cases @ ₹ 150 per case	3,75,000	Cost of 2,500 cases @ ₹ 150 per case	3,86,000
Add: Non recurring expenses :		Less: Value of 125 cases lost-in-transit	19,300
Freight	6,000	**Cost of 2,375 cases**	3,66,700
Carriage	3,000	Add: Clearing charges	1,700
Loading Charges	2,000	Total Cost of 2,375 cases	3,68,400
Cost of 2,500 cases just before lost-in-transit	3,86,000	Value of 625 unsold cases = ₹ 3,68,400 / 2,375 x 625	96,947
Therefore, value of 150 cases = ₹ 3,86,000 / 2,500 x 125	19,300		

Illustration 31

A & Co. consigned 100 bicycles costing ₹ 1,500 each to its agent B & Co. of Jaipur. A & Co. incurred the following expenses :

	₹
Freight	8,000
Insurance	6,000
Coolie & Cartage	4,000

On the way 5 bicycles were damaged due to bad handling and insurance company admitted a claim of ₹ 7,000.

Consignee took delivery of the rest and incurred the following expenses :

	₹
Clearing charges	1,200
Carrying charges	800
Godown rent	1,400
Selling expenses	1,600

The consignee sold 80 bicycles at ₹ 2,100 each. He is entitled to a commission of 5% on Sales.

Prepare Consignment Account in the books of Consignor. ***[C.U.B.Com. (General) — 2015]***

Solution

In the books of A & Co.

Dr. Consignment to Jaipur Account Cr.

Particulars		₹	Particulars	₹
To Goods Sent on Consignment		1,50,000	By Abnormal Loss A/c (Note 1)	8,400
To Cash A/c :			By B & Co. A/c (Sold 80 bicycles @ ₹ 1,200)	1,68,000
Freight	8,000		By Consignment Stock A/c (Note 1)	25,516
Insurance	6,000			
Coolie	4,000	18,000		
To B & Co. A/c :				
Clearing	1,200			
Carrying	800			
Godown Rent	1,400			
Selling Expenses	1,600			
Commission @ 5% on ₹ 1,68,000	8,400	13,400		
To Profit and Loss on Consignment A/c		20,516		
		2,01,916		2,01,916

Working Notes : **(1) Calculation of Value of Unsold Stock**

Partners	Cycles (Nos.)	Amount (₹)
Goods Sent on Consignment	100	1,50,000
Add: Consignor's Expenses		18,000
	100	1,68,000
Less: Damaged in transit (₹ 1,68,000 ÷ 100 × 5)	5	8,400
	95	1,59,600
Add: Non-recurring Expenses of Consignee		2,000
	95	1,61,600
Less: Sold	80	
Unsold Stock	15	

Value of Unsold Stock = $\frac{1,61,600}{95} \times 15$ = ₹ **25,516**.

Illustration 32

K of Kolkata consigned goods to D of Delhi for sale at loaded price. D is entitled to a commission on sale at 7.5% on proforma invoice price and 20% of any surplus price realised.

Goods consigned by K to D during the year ended 31st March, 2014 cost to K ₹ 41,800 and invoiced at ₹ 56,800. K paid ₹ 2,500 freight and received ₹ 15,000 as advance from D. 80% of the goods were sold by D for ₹ 50,000. D remitted the balance of proceeds after deducting his commission.

Show Consignment Account in the books of K. ***[C.U.B.Com. (General) — 2014]***

Solution **In the books of K**

Dr. **Consignment to Delhi Account** **Cr.**

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c (at Invoice price)	56,800	By Goods Sent on Consignment A/c	
To Bank A/c (Freight Paid)	2,500	(Loading on goods sent)	15,000
To D A/c (Commission — Note 1)	4,320	By D A/c (80% goods sold)	50,000
To Stock Reserve A/c (₹ 15,000 x 20%)	3,000	By Consignment Stock A/c (₹ 56,800 + 2,500) x 20%	11,860
To Profit on Consignment A/c	10,240		
	76,860		76,860

Working Notes : **(1) Calculation of Commission Payable**

Partners	(₹)
Sales Value of 80% Goods	50,000
Less: Invoice Price of 80% Goods (₹ 56,800 x 0.8)	45,440
Excess Price Realised	4,560

Commission on ₹ 45,440 @ 7.5%	3,408
on ₹ 4,560 @ 20%	912
	4,320

Illustration 33

Sun of Siliguri consigned goods costing ₹ 90,000 to Moon of Mumbai. The invoice price was made so as to show a profit of $33^{1}/_{3}$% on cost. Sun paid ₹ 600 as carriage and ₹ 2,400 as freight and insurance. Goods costing ₹ 10,000 were destroyed while in transit and the insurance company admitted the full claim.

In Mumbai, Moon paid ₹ 480 as carriage and ₹ 1,200 as godown rent. Two-third of the goods received by Moon was sold by her at invoice price.

Moon sent a cheque to Sun for the sale proceeds after deducting the expenses incurred by her and the commission due to her — ordinary @ 5% and del-credere @ $2^{1}/_{2}$%.

Show the Consignment Account and Moon's Account in Sun's ledger.

[C.U.B.Com. (General) — 2013]

Solution **In the books of Sun**

Dr. **Consignment to Mumbai Account** **Cr.**

Date	Particulars		₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c		1,20,000		By Goods Sent on Consignment A/c (Loading)	30,000
	To Cash :				By Abnormal Loss (Note 1)	13,666
	Carriage	600			By Moon A/c :	
	Freight	2,400	3,000		Sales (Note 2)	71,110
	To Abnormal Loss (Loading)		3,333		By Stock on Consignment A/c (Note 3)	36,604
	To Moon A/c :					
	Carriage		480			
	Godown Rent		1,200			
	Ordinary Commission		3,556			
	Del Commission		1,778			
	To Stock Reserve		8,889			
	To Profit and Loss on Consignment A/c		9,144			
			1,51,380			1,51,380

Working Notes :

(1) Abnormal Loss **(2) Calculation of Sales**

Particulars	₹	Particulars	₹
Original Cost of Goods Destroyed	10,000	Original Cost of Goods Sent	90,000
Add: Proportionate Consignor's Expenses	333	Less: Cost of Goods Lost	10,000
(3,000 / 90,000 x 10,000)	10,333		80,000
Add: Loading (10,000 / 3)	3,333	Less: Cost of Goods Sold (2/3 of 80,000)	53,333
	13,666	Unsold Goods at Original Cost	26,667
		Cost	53,333
		Add: Profit 1/3	17,777
		Total Sales	71,110

(3) Calculation of Unsold Stock

Original cost of goods unsold	26,667
Add: Proportionate expenses of Consignor (30,000 / 90,000 × 26,667)	888
Add: Proportionate expenses of Consignee (480 / 80,000 × 26,667)	160
	27,715
Add: Loading	8,889
	36,604

Illustration 34

From the following information calculate the value of goods lost-in-transit and the value of unsold stock on consignment:

On 1st January, 2012, P Ltd of Kolkata consigned 10,000 kg of an item costing ₹ 80 per kg to R Ltd of Mumbai and paid ₹ 80,000 as freight and insurance. 200 kg of the item were lost-in-transit. R Ltd took delivery of the remaining consignment and paid unloading charges ₹ 19,000. Godown rent ₹ 2,500, Printing and Advertisement ₹ 20,000. 200 kg were lost due to leakage in the godown of R Ltd which is to be considered as normal loss. R Ltd has sold 8,000 kg of the item.

[C.U.B.Com. (General) — 2012]

Solution **Estimation of Abnormal Loss and Unsold Stock**

Particulars	Kgs	₹.
Original cost of goods sent	10,000	8,00,000
Add: Expenses of Consignor, Freight and Insurance		80,000
	10,000	8,80,000
Less: Abnormal Loss in transit (₹ 8,80,000 ÷ 10,000) x 200	200	17,600
	9,800	8,62,400
Add: Non-recurring expenses of Consignee — unloading charges		19,000
	9,800	8,81,400
Less: Normal Loss	200	—
Value of Goods after Normal Loss	9,600	8,81,400
Less: Sold	8,000	
	1,600	

Value of Closing Stock (₹ 8,81,400 ÷ 9,600) × 1,600 = ₹ **1,46,900**.

Illustration 35

Tumpa consigned 1,000 kg of rice @ ₹ 20 per kg to Pintu. She paid freight ₹ 2,500; dock charges ₹ 1,500 and insurance ₹ 1,000. 200 kg of rice was destroyed in transit due to an accident.

An insurance claim of ₹ 3,500 was admitted by the insurance company. Pintu sold 720 kg rice @ ₹ 30 per kg and incurred Clearing charges ₹ 1,800; Carrying charges ₹ 1,200; Godown rent ₹ 1,500 and Selling expenses ₹ 1,000.

Pintu is to receive an ordinary commission @ 8% on sales. He could not realise ₹ 2,000 from debtors and it was proved bad. Pintu remits ₹ 10,000 by a bank draft to Tumpa.

Show the Consignment Account in the books of Consignor. *[C.U.B.Com. (General) — 2011]*

Solution **In the books of Tumpa (Consignor)**

Dr. **Consignment Account** **Cr.**

Particulars		₹	Particulars	₹
To Goods Sent on Consignment A/c		20,000	By Abnormal Loss A/c (Note 1)	5,000
To Cash A/c			By Consignment Debtors A/c (720 kg rice @ ₹ 30 per kg)	21,600
Freight	2,500		By Consignment Stock A/c (Note 1)	2,300
Dock Charges	1,500		By Consignment Profit and Loss A/c (Loss on Consignment)	5,328
Insurance	1,000	5,000		
To Pintu A/c :				
Clearing Charges	1,800			
Carrying Charges	1,200			
Godown Rent	1,500			
Selling Expenses	1,000	5,500		
To Pintu A/c :				
Ordinary Commission @ 8% on Sales		1,728		
To Consignment Debtors A/c (Bad Debts)		2,000		
		34,228		34,228

Working Note : (1) Calculation of Abnormal Loss and Unsold Stock

Particulars	Kg	₹
Original Cost of Goods Sent	1,000	20,000
Add: Expenses of Consignor		5,000
	1,000	25,000
Less: Abnormal Loss in Transit (25,000 / 1,000) x 200	200	5,000
	800	20,000
Add: Non-recurring Expense of Consignee (1,800 + 1,200)		3,000
	800	23,000
Less: Sold (in kg)	720	
Unsold (in kg)	80	
Unsold Stock = 23,000 / 800 x 80 = ₹ **2,300**		

[For Honours Candidates Only]

Illustration 36

Prepare Consignment Account in the books of M/s. Ramkrishna Concern as on 31st December, 2015 from the following particulars given below :

On 1.1.2015, M/s. Ramkrishna Concern of Kolkata consigned 20,000 kg. of a particular variety of goods to M/s. Vasudha of Delhi at a cost of ₹ 120 per kg and paid ₹ 1,20,000 on insurance and freight. 400 kg of the item was lost in transit. M/s. Vasudha took delivery of the remaining goods consigned and paid unloading charges of ₹ 38,000. Printing and Advertisemnt expenses were ₹ 40,000 and godown rent ₹ 5,000. 450 kg. was lost due to leakage in the godown of M/s. Vasudha (which was considered as normal loss). 16,000 kg of the goods consigned was sold by M/s. Vasudha @ ₹ 150 per kg. Commission @ 10% on sales is payable to M/s. Vasudha.

[C.U.B.Com. (Hons.) — 2016]

Solution **In the books of M/s Ramkrishna Concern**

Dr. **Consignment to Delhi Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Goods Sent on Consignment A/c	24,00,000	31.12.2015	By M/s Vasudha A/c (sales)	24,90,000
	To Bank A/c :			By Accidental Loss A/c (Note 1)	50,400
	Insurance and Freight	1,20,000		By Stock on Consignment A/c (Note 2)	3,33,910
	To M/s Vasudha A/c :				
	Unloading Charges	38,000			
	Printing and Advertisement Expenses	40,000			
	Godown Rent	5,000			
	Commission	2,49,000			
	To Profit and Loss on Consignment A/c	22,310			
		28,74,310			28,74,310

Working Notes :

(1) Valuation of Goods Lost-in-Transit	₹	(2) Valuation of Closing Stock	₹
Cost of 20,000 kg @ ₹ 120	24,00,000	Cost of 20,000 kg	25,20,000
Add: Freight and Insurance	1,20,000	Less: Accidental Loss	50,400
Cost of 20,000 kg of goods before lost-in-transit	25,20,000	**Cost of 19,600 kg**	24,69,600
Value of 400 kg lost-in-transit :		Add: Unloading charges	38,000
$\frac{25,20,000}{20,000} \times 400$	50,400	Cost of 19,150 kg (after taking into consideration the normal loss of 450 kg)	25,07,600
		Value of Stock in hand = ₹ 25,07,600 / 19,150 x 2,550	3,33,310

Illustration 37

B. K. Traders of Kolkata consigned goods costing ₹ 75,000 to Ramesh Traders of Patna. The invoice was made so as to show a profit of $33^1/_3$% on cost. B. K. Traders paid ₹ 900 as carriage and ₹ 1,400 as freight and insurance. Goods costing ₹ 7,500 were destroyed while in transit and the Insurance company admitted the full claim.

Ramesh Traders in Patna paid ₹ 600 as carriage and ₹ 800 as godown rent. Two-thirds of the goods received by Ramesh Traders were sold by them at invoice price. Ramesh Traders sent a cheque to B.K. Traders for the sale proceeds after deducting the expenses incurred by them and the commission due to them. Ramesh Traders was entitled to ordinary commission ₹ 7.5% and del-credere commission @ 2.5% on sales. Show Consignment Account in the books of B.K. Traders.

C.U.B.Com. (Hons.) — 2015]

Solution **In the books of B. K. Traders**

Dr. **Consignment to Patna Account** **Cr.**

Particulars		₹	Particulars	₹
To Goods Sent on Consignment A/c		1,00,000	By Goods Sent on Consignment (Load on Goods Sent)	25,000
To Cash A/c :			By Abnormal Loss A/c (Note 1)	10,230
Carriage	900		By Ramesh Traders A/c (Note 4)	60,000
Freight	1,400	2,300	By Stock on Consignment A/c (Note 3)	30,890
To Abnormal Loss (Loading)		2,500		
To Ramesh Traders A/c :				
Carriage	600			
Godown Rent	800			
Ordinary Commission @ 7.5%	4,500			
Del-credere Commission @ 2.5%	1,500	7,400		
To Stock Reserve A/c		7,500		
To Profit and Loss on Consignment A/c		6,420		
		1,26,120		1,26,120

Working Notes :

(1) Calculation of Abnrmal Loss in Transit

	₹
Original cost of goods destroyed	7,500
Add: Proposed non-recurring expenses of consignor $\frac{2,300}{75,000} \times 7,500$	230
Cost of goods destroyed	7,730
Add: Loading (7,500 × 1/3)	2,500
Invoice Price of Abnormal Loss	10,230

(2) Calculation of Original Cost of Goods Unsold

Original cost of goods sent	75,000
Less: Destroyed in transit	7,500
Original cost of goods received by consignee	67,500
Less: Sold by consignee (67,500 × 2/3)	45,000
Original cost of goods unsold	22,500

(3) Unsold Stock in Hands of Consignee

Original cost of goods unsold	22,500
Add: Proportionate consignor expenses : $\frac{2,300}{75,000} \times 22,500$	200
	23,390
Add: Loading (₹ 22,500 × 1/3)	7,500
	30,890

(4) Sales by Consignee

Original cost of goods sold	45,000
Add: Loading (45,000 × 1/3)	15,000
	60,000

Illustration 38

1,000 kg. of goods were consigned @ ₹ 32 per kg. Consignor paid freight and carriage ₹ 4,140. Consignee sold 650 kg. @ ₹ 45 per kg and incurred ₹ 2,500 as unloading expenses, ₹ 2,400 as godown rent and ₹ 1,200 as selling expenses. Normal loss due to leakage was 80 kg. Show how the loss and unsold stock will be treated in the books of the Consignor.

C.U.B.Com. (Hons.) — 2014]

Solution

Computation of Unsold Stock

	Kgs.	Amount (₹)
Sent	1,000	32,000
Add : Consignor Expenses (Freight and Carriage)		4,140
		36,140
Add: Non-recurring Expenses of Consignee		2,500
	1,000	38,640
Less: Sold	(650)	
Less: Normal Loss	(80)	
Unsold Stock	270	

$\therefore$ Value of Consignment Stock = $\frac{38,640}{1,000 - 80} \times 270$ = ₹ **11,340**.

Cost of normal loss due to leakage will be absorbed by the remaining goods, i.e., 920 kg.The cost per kg. will be increased for the normal loss. Value of unsold stock will be crexited to Consignment Account.

Illustration 39

Calcutta Ayurvedic Ltd. produces a bottle of "Draksharista" at a cost of ₹ 10. They appointed Madras Medical Stores of Madras as their agent on the terms that the agent would get commission @ 10% on invoice price of goods sold and also an extra commission at 25% on any excess amount realised over invoice price.

On 1.7.2016, Calcutta Ayurvedic Ltd. sent 50 boxes of "Draksharista" each box containing 50 bottles at invoice price showing a profit of $33^1/_3$% on such invoice price. They spent ₹ 3,000 for freight and ₹ 2,000 for insurance. 5 boxes were completely destroyed in transit and insurance claim of ₹ 2,300 was realised from the insurance company. The agent took delivery of the remaining goods and spent ₹ 2,000 for duty and ₹ 1,000 for freight to carry the goods to the rented godown. He also sent a Bill of Exchange for ₹ 20,000 payable after 2 months to the consignor as advance.

At the end of the year, the agent reported that 40 boxes were sold at ₹ 18 per bottle and 1 box of goods was lost due to bad packaging. This would be treated as normal loss. The agent remitted a bank draft for the net amount after deducting his commission, advance money, godown rent ₹ 800 and selling expense ₹ 200.

On 1.1.2017, Calcutta Ayurvedic Ltd. discounted the bill of ₹ 20,000 for ₹ 19,800. On 1.3.2017, bank informed that the bill was dishonoured. Calcutta Ayurvedic Ltd. demanded the entire amount along with an additional amount of ₹ 200 as interest. The Madras agent sent a bank draft for the amount on 15.3.2017.

You are asked to show the following Ledger Accounts in the books of the consignor : (a) Consignment to Madras Account; (b) Madras Medical Stores Account; (c) Consignment Stock Account; (d) Consignment Stock Destroyed Account; (e) Consignment Stock Reserve Account.

[C.U.B.Com. (Hons.) — Adapted]

Solution **In the books of Calcutta Ayurvedic Limited**

Dr. **Consignment to Madras Account** **Cr.**

Date	Particulars		₹	Date	Particulars	₹
2016 July 1	To Goods Sent on Consignment A/c		37,500	2016 July 1	By Goods Sent on Consignment A/c (Loading)	12,500
?	To Cash A/c :			?	By Consignment Stock Destroyed A/c (Note 2)	4,250
	Freight	3,000		Dec. 31	By Madras Medical Stores A/c (Sales)	36,000
	Insurance	2,000	5,000	"	By Consignment Stock A/c (Note 4)	3,750
Dec. 31	To Madras Medical Stores A/c :					
	Duty	2,000				
	Freight	1,000				
	Godown rent	800				
	Selling	200				
	Commission (Note 1)	4,500	8,500			
"	To Consignment Stock Destroyed A/c (Note 3)		1,250			
"	To Consignment Stock Reserve A/c (Note 5)		1,023			
"	To Profit & Loss on Consignment A/c		3,227			
			56,500			56,500

Dr. **Madras Medical Stores Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Consignment to Madras A/c	36,000	2016 Dec. 31	By Advance against Consignment A/c	20,000
			"	By Consignment to Madras A/c (exp. + comm.)	8,500
			"	By Bank A/c (remittance)	7,500
		36,000			36,000
2017 Mar. 1	To Bank A/c (bill dishonoured)	20,000	2017 Mar. 15	By Bank A/c (final remittance)	20,200
	To Interest Received A/c	200			
		20,200			20,200

Dr. **Consignment Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Consignment to Madras A/c	3,750	2016 Dec. 31	By Balance c/d	3,750

Dr. **Consignment Stock Destroyed Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Consignment to Madras A/c (Invoice price)	4,250	2016 ?	By Consignment to Madras A/c (loading)	1,250
			?	By Bank A/c (insurance claim)	2,300
				By Profit & Loss A/c (abnormal loss)	700
		4,250			4,250

Dr. **Consignment Stock Reserve Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Balance c/d	1,023	2016 Dec. 31	By Consignment to Madras A/c	1,023

Dr. **Advance Against Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	To Madras Medical Stores A/c	20,000	2016 July 1	By Bills Receivable A/c	20,000

Working Notes :

(1) Calculation of Commission	₹	**(2) Valuation of Abnormal Loss at Invoice Price**	₹
Sales at invoice price (40 x 50 x ₹ 15)	30,000	Invoice price of the goods sent	37,500
Ordinary commission (10% on ₹ 30,000)	3,000	Add : Expenses of the consignor	5,000
Extra commission 25% of ₹ (36,000 – 30,000)	1,500	Invoice price of 50 boxes	42,500
Total commission	4,500	Value of abnormal loss — 5 boxes (₹ 42,500 / 50 x 5)	4,250
(3) Loading on Abnormal Loss	₹	**(4) Valuation of Closing Stock at Invoice Price**	₹
Total loading on goods sent	12,500	Value of the goods sent at invoice price (Note 2)	42,500
Loading on abnormal loss 12,500 / 50 x 5	1,250	Less: Value of abnormal loss at invoice price	4,250
(5) Loading on Closing Stock	₹	Invoice price of 45 boxes	38,250
Total loading	12,500	Add: Expenses of the consignee (non-recurring)	3,000
Less: Loading on abnormal loss	1,250	Total value of the goods at invoice price (44 boxes)	41,250
	11,250	Value of closing stock 41,250 / 44 x 4	3,750
Loading on closing stock 11,250 / 44 x 4	1,023		

Illustration 40

The Account Sales of 1,200 transistor sets received from and sold on account of and the risk of Sri U. Chopra, Kolkata.

Particulars		₹	₹
1,200 Transistor sets @ ₹ 1,200			14,40,000
Less : Expenses :	₹		
Unloading expenses	3,000		
Selling Expenses	4,000		
Transport Charges	6,100		
Godown Rent	6,000		
Advertisements	2,000	21,100	
Less: Commission :			
5% Ordinary Commission	72,000		
1% Del Credere Commission	14,400	86,400	1,07,500
			13,32,500
Less : Advance sent on 10.1.2017			2,50,000
			10,82,500
Bank draft enclosed; Stock in hand (31.3.2017) — 100 sets			E. & O. E.
Dated, Madras, the 26th April, 2017			S. Raman

On further information you come to know that :

(i) Bad Debts amounted to ₹ 2,400 against 2 sets;

(ii) 20% above the invoice price is the sale price which is equal to cost plus 50%;

(iii) Chopra incurred forwarding expenses @ ₹ 10 per set; and

(iv) During transit 10 sets became fully damaged and Chopra recovered from insurance the full amount of the original cost.

You are required to prepare the Consignment Account, Goods Sent on Consignment Account and Loss in Transit Account in the books of Chopra.

Solution

In the books of Mr. Chopra

Dr. Consignment to Madras Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	13,10,000		By Goods Sent on Consignment A/c - loading	2,62,000
	To Bank A/c — forwarding expenses	13,100		By Loss in Transit A/c	10,100
	To S. Raman A/c — expenses :			By S. Raman A/c	14,40,000
	Unloading expenses 3,000			By Stock on Consignment A/c	1,01,230
	Selling expenses 4,000			100 x ₹ 1,000 1,00,000	
	Transport charges 6,100			100 x ₹ 10 1,000	
	Godown rent 6,000			3,000 / 1,300 230	
	Advertisements 2,000	21,100		1,01,230	
	To S. Raman A/c - Commission: ₹				
	5% Ordinary 72,000				
	1% Del Credere 14,400	86,400			
	To Loss in Transit A/c - Loading (₹ 200 x 10)	2,000			
	To Stock Reserve A/c (₹ 200 x 100)	20,000			
	To Profit & Loss on Consignment A/c	3,60,730			
		18,13,330			18,13,330

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	2,62,000		By Consignment to Madras A/c	13,10,000
	To Purchases A/c - transfer	10,48,000			
		13,10,000			13,10,000

Dr. Loss in Transit Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	10,100		By Consignment to Madras A/c (Loading)	2,000
				By Bank A/c - Insurance claim (Note 2)	8,000
				By Profit and Loss A/c	100
		10,100			10,100

Working Notes :

(1) Sale price of each set is ₹ 1,200 (₹ 14,40,000 ÷ 1,200). Therefore, invoice price of each set is ₹ 1,000 (₹ 1,200 × 100 ÷ 120). Invoice price of (1,200 + 100 + 10) 1,310 sets is 1,310 × ₹ 1,000 = ₹ 13,10,000. Cost plus 50% = Selling price. Therefore, cost price of each transistor = ₹ 1,200 / 150 x 100 = ₹ 800. Loading per set = ₹ 1,000 – ₹ 800 = ₹ 200.

(2) It is assumed that the original cost does not include forwarding expenses of ₹ 10 per set.
The original cost will be 10 x ₹ 800 = ₹ 8000

Illustration 41

Rahim of Bombay consigned to Raju of Madras goods to be sold at invoice price which represents 125% of cost. Raju is entitled to a commission of 10% on sales at invoice price and 25% of any excess realised over invoice price. The expenses on freight and insurance incurred by Rahim were ₹ 10,000. The account sales received by Rahim shows that Raju effected sales aggregating to ₹ 1,00,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were ₹ 8,000, 10% of the consignment goods of the value of ₹ 12,500 were destroyed by fire at the Madras godown and the insurance company paid ₹ 12,000 net of salvage. Raju remitted the balance in favour of Rahim. Prepare the Consignment Account and the account of Raju in the books of Rahim along with necessary working.

[C.A. (Foundation) — Adapted]

Solution

In the books of Rahim

Consignment to Madras Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	1,25,000		By Goods Sent on Consignment A/c (Loading)	25,000
	To Bank A/c (freight & insurance)	10,000		By Raju A/c (Sales)	1,00,000
	To Raju A/c (Expenses — selling)	8,000		By Abnormal Loss A/c (Note 2)	13,500
	To Raju A/c — Commission (Note 4)	10,938		By Stock on Consignment A/c (Note 3)	20,250
	To Stock Reserve A/c (Note 5)	3,750		By Profit and Loss on Consignment A/c	1,438
	To Abnormal Loss A/c (Note 6)	2,500			
		1,60,188			1,60,188

Raju Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c — Sales	1,00,000		By Consignment to Madras A/c (Selling Exp.)	8,000
				By Consignment to Madras A/c (Commission)	10,938
				By Bank A/c (Final payment)	81,062
		1,00,000			1,00,000

Working Notes :

(1) The value of 10% of the goods destroyed by fire is ₹ 12,500.
Therefore, the invoice value of the goods sent is ₹ 12,500 / 10% = ₹ 1,25,000.

(2) Valuation of Abnormal Loss	₹
Value of stock lost by fire	12,500
Add: Proportionate expenses upto fire (10% of ₹ 10,000)	1,000
Value of abnormal loss at invoice price	13,500

(3) Valuation of Stock on Consignment	₹
Invoice value of unsold stock (15% of ₹ 1,25,000)	18,750
Add: Proportionate non-recurring expenses (15% of ₹ 10,000)	1,500
	20,250

(4) Calculation of Commission	₹
Sale proceeds (75% of Consignment)	1,00,000
Less: Invoice value of sale proceeds (75% of ₹ 1,25,000)	93,750
Excess sale proceeds received over invoice price	6,250
Therefore, commission is :	
(1) @ 10% on sales in invoice price	9,375
(2) @ 25% on excess sale proceeds	1,563
	10,938

(5) Calculation of Stock Reserve	₹
Total loading on goods sent	25,000
Therefore, loading on closing stock is 15% of ₹ 25,000	3,750

(6) Loading on Abnormal Loss	₹
Total loading on goods sent	25,000
Therefore, loading on goods lost by fire (10%)	2,500

Abnormal Loss Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	13,500		By Bank A/c — claim received	12,000
	To Profit and Loss A/c	1,000		By Consignment to Madras A/c (Loading)	2,500
		14,500			14,500

Illustration 42

Tanya Motors of Delhi purchased 50 used Maruti cars for ₹ 50,00,000. Out of these, 30 cars were sent on consignment to Hari Motors of Kanpur at a selling price of ₹ 1,20,000 per car. The consignor paid ₹ 60,000 in sending the cars to Kanpur. Hari Motors sold 25 cars for ₹ 33,00,000. Hari Motors incurred ₹ 30,000 as the selling expenses. Out of the remaining 5 cars, Hari Motors kept one car for their personal use at an agreed price of ₹ 1,25,000. 2 cars got damaged and were sold for ₹ 2,00,000 only. Owing to fall in market price of old cars, the value of remaining cars in stock be reduced by 10%. Tanya Motors sold 20 cars at Delhi for ₹ 25,00,000. Hari Motors is entitled to 5% commission on sales.

Prepare the Consignment Account, Trading and Profit and Loss Account of Tanya Motors and the account of Tanya Motors in the books of the consignee, Hari Motors.

[C.A. — Adapted]

Solution

In the books of Tanya Motors

Dr. Consignment to Kanpur Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	36,00,000		By Goods Sent on Cosignment A/c (Loading)	6,00,000
	To Bank A/c (expenses)	60,000		By Hari Motors A/c (sale proceeds) :	
	To Hari Motor A/c :			25 good cars 33,00,000	
	Selling expenses	30,000		1 car taken over 1,25,000	
	Commission (5% on ₹ 36,25,000)	1,81,250		2 damaged cars 2,00,000	36,25,000
	To Stock Reserve A/c (Note 1)	73,000		By Stock on Consignment A/c (Note 1)	2,44,000
	To Profit and Loss on Consignment A/c	5,24,750			
		44,69,000			44,69,000

Dr. Trading, and Profit and Loss Account for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Purchases A/c (₹ 50,00,000 – 30,00,000)	20,00,000	By Sales A/c	25,00,000
To Gross Profit c/d	5,00,000		
	25,00,000		25,00,000
To Net Profit	10,24,750	By Gross Profit b/d	5,00,000
		By Profit and Loss on Consignment A/c	5,24,750
	10,24,750		10,24,750

In the books of Hari Motors

Dr. Tanya Motors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Selling expenses)	30,000		By Cash A/c (Sale proceeds) :	
	To Commission Received A/c	1,81,250		25 good cars 33,00,000	
	To Balance c/d	34,13,750		2 damaged cars 2,00,000	35,00,000
				By Drawings A/c (car taken over)	1,25,000
		36,25,000			36,25,000

Working Note :

(1) Valuation of Stock on Consignment and Stock Reserve

			₹
Invoice price of 2 cars (₹ 1,20,000 × 2)			2,40,000
Add: Proportionate non-recurring expenses (₹ 60,000 / 30 × 2)			4,000
Value of Stock at Invoice price			2,44,000
Less: Net realisable value of stock :			
Market price (₹ 90,000* × 2)		1,80,000	
Less: 5% Commission**		9,000	1,71,000
Stock Reserve			73,000

* Original cost = ₹ 1,00,000 less 10% = ₹ 90,000.

** Applying the concept of conservatism, all other possible expenses to be incurred in selling those goods are to be provided for, which will include the commission payable to the consignee.

Illustration 43

P of Calcutta consigned goods costing ₹ 45,000 to Q of Delhi. The invoice was made so as to show a profit of 33-$^{1}/_{3}$% on cost. P paid ₹ 300 as carriage and ₹ 1,200 as freight and insurance. Goods costing ₹ 5,000 were destroyed in transit and the insurance company admitted the full claim.

In Delhi Q paid ₹ 240 as carriage and ₹ 600 as godown rent. Two-thirds of the goods received by Q were sold by him. Q sent a cheque to P for the sale proceeds after deducting the expenses incurred by him and the commission due to him — ordinary 5% and del credere 2$^{1}/_{2}$%.

Show the Consignment Account and Q Account in P's Ledger.

Solution

In the books of P

Consignment to Delhi Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	60,000		By Q A/c (sales) (Note 2)	35,556
	To Bank A/c			By Abnormal Loss A/c (invoice price)	6,833
	Carriage	300		By Goods Sent on Consignment A/c (loading)	15,000
	Freight and Insurance	1,200		By Stock on Consignment A/c (Note 3)	18,302
	To Q A/c				
	Carriage	240			
	Godown Rent	600			
	Commission	2,667			
	To Abnormal Loss A/c (loading) (Note 5)	1,667			
	To Stock Reserve A/c (loading)	4,444			
	To Profit & Loss on Consignment A/c	4,573			
		75,691			75,691

Q Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Delhi A/c	35,556		By Consignmet to Delhi A/c	3,507
				By Bank A/c (balance received)	32,049
		35,556			35,556

Working Notes :

(1) Valuation of Abnormal Loss	₹	**(2) Calculation of Sale Proceeds**	₹
Invoice price of goods sent	60,000	Cost price of goods sent	45,000
Add: Expenses of consignor prior to loss	1,500	Less: Cost of goods lost	5,000
Value of goods sent at invoice price	61,500	Cost of goods reached to Consignee	40,000
Value of Abnormal Loss : (61,500 / 45,000) x 5,000	6,833	Add: Loading — 33-1/3% of 40,000	13,333
(3) Valuation of Stock on Consignment		Invoice price of goods received	53,333
Invoice price of goods sent	60,000	Sales : 2/3 (₹ 53,333)	35,556
Add: Expenses of consignor	1,500	**(4) Loading on Goods Lost**	
	61,500		
Less: Abnormal loss (Note 1)	6,833	$= \frac{\text{Rs } 15,000}{\text{Rs } 45,000} \times \text{Rs } 5,000 =$ ₹ **1,667**	
	54,667		
Add: Expenses of the consignee after loss (non-recurring)	240	**(5) Loading on Unsold Stock**	
Total value of goods at invoice price	54,907	1/3 (₹ 15,000 — ₹ 1,667)	4,444
Value of unsold goods (1/3rd of goods received)	18,302		

Abnormal Loss Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Delhi A/c	6,833		By Consignment to Delhi A/c (loading)	1,667
				By Insurance Co A/c (claim admitted)	5,166
		6,833			6,833

Illustration 44

On 1st July, 2001, M of Madras consigned goods to the value of ₹ 50,000 to P of Patna. This was made by adding 25% on the cost. M paid ₹ 2,500 for freight and ₹ 1,500 for insurance. During transit 1/10th of the goods was totally destroyed by fire and a sum of ₹ 2,400 was realised from the insurance company.

On arrival of the goods, P paid ₹ 1,800 as carriage to godown. During the year ended 30th June, 2002, P paid ₹ 3,600 for godown rent and ₹ 1,900 for selling expenses. 1/9th of the remaining goods were again destroyed by fire in godown and nothing was recovered from the insurance company. Upto 30th June, 2002, P sold half of the original goods for ₹ 30,000 and charged a commission of 5% on sales. On 30th June, 2002, P sent a bank draft to M for the amount so far due from him. You are required to prepare Consignment Account in the books of M of Madras for the year ended 30th June, 2002.

[C.U.B.Com. (Hons.) — 2003] [Same as C.U.B.Com. — 2007]

Solution **In the books of M**

Dr. **Consignment to Patna Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.7.2001	To Goods Sent on Consignment A/c	50,000	1.7.2001	By Goods Sent on Consignment A/c (loading)	10,000
	To Bank A/c :			By Abnormal Loss A/c (during transit : Note 1)	5,400
	Freight	2,500	30.6.2002	By P A/c (Sales)	30,000
	Insurance	1,500	30.6.2002	By Abnormal Loss A/c (in godown : Note 2)	5,600
	To Abnormal Loss A/c (loading : Note 1)	1,000	30.6.2002	By Stock on Consignment A/c (Note 3)	16,800
30.6.2002	To P A/c :				
	Carriage	1,800			
	Godown rent	3,600			
	Selling expenses	1,900			
	Commission	1,500			
30.6.2002	To Abnormal Loss A/c (loading : Note 2)	1,000			
30.6.2002	To Stock Reserve A/c (loading : Note 3)	3,000			
		67,800			67,800

Working Notes :

(1) Valuation of Abnormal Loss in Transit

	₹
Invoice price of goods sent	50,000
Add: Expenses of the consignor prior to loss (₹ 2,500 + 1,500)	4,000
Value of goods sent at invoice price	54,000

Value of abnormal loss at invoice price = 1/10th of ₹ 54,000 = ₹ 5,400.

The insurance claim received will not affect the Consignment Account. It will be shown in the Abnormal Loss Account. The difference between the cost and insurance claim received will be transferred to Profit and Loss Account.

Loading on Abnormal Loss in Transit

Total loading = ₹ (50,000 – 40,000) = ₹ 10,000.

Loading on abnormal loss = 10% on ₹ 10,000 = ₹ **1,000**.

(2) Valuation of Abnormal Loss in Godown

	₹
Value of goods sent at invoice price (Note 1)	54,000
Less: Abnormal loss in transit (Note 1)	5,400
Value of goods received by the consignee	48,600
Add: Expenses of consignee (non-recurring) prior to loss	1,800
Value of goods prior to loss	50,400

Value of abnormal loss at invoice price = 1/9th of ₹ 50,400 = ₹ **5,600**.

Loading on Abnormal Loss in Godown

	₹
Total loading	10,000
Less: Loading on abnormal loss in transit	1,000
Loading on goods received by the consignee	9,000

Loading on abnormal loss in godown = 1/9th of ₹ 9,000 = ₹ **1,000**.

(3) Valuation of Stock on Consignment

Let, the consignor sent 100 units. 10% lost in transit. Therefore, consignee received 90 units. Out of that 1/2 of the original goods sold, i.e., 50 units. Destroyed in transit 10 units (1/9th of 90 units). Therefore, stock in hand [100 – (10 + 10 + 50)] = **30 units**.

Valuation of stock at invoice price = ₹ 50,400 / 90 × 30 = ₹ **16,800**.

Stock reserve = ₹ 10,000 / 100 × 30 = ₹ **3,000**.

Illustration 45

Modern Breweries of Bombay consigned 5000 litres of liquor to Saha Brothers of Calcutta on 1st February, 2017. The goods are charged at a Proforma Invoice value of ₹ 2,00,000 including profit of 20% on invoice. Modern Breweries paid ₹ 5,000 as freight and insurance charges.

During transit 200 litres were destroyed for which the insurance company paid directly to the consignor ₹ 5,000 in full settlement of the claim.

On 25th February, Saha Brothers paid for carriage and clearing charges ₹ 3,100 and sent to the consignor a bank draft for ₹ 40,000 as security. Other expenses paid by the consignee were godown rent ₹ 1,200 and salesman's salary ₹ 900. Saha Brothers were entitled to a commission of 4% plus 2% del credere on sales.

On 31st March, 2017 Saha Brothers reported that 4,000 litres were sold at ₹ 1,65,000 and 50 litres were lost due to evaporation. A customer who bought liquor for ₹ 1,500 was able to pay 40% of the amount due from him.

Assuming that Saha Brothers paid the amount by a bank draft, show the Consignment Account and Saha Bros Account, Advance Against Consignment Account in the books of Modern Breweries.

On the date of closing the accounts, market price of liquor was ₹ 33.50 per litre.

Solution

In the books of Modern Breweries Ltd

Dr. Consignment to Calcutta Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.2.2017	To Goods Sent on Consignment A/c	2,00,000	25.2.2017	By Goods Sent on Consignment A/c	40,000
"	To Cash A/c (freight & insurance)	5,000	"	By Abnormal Loss A/c (invoice price)	8,200
31.3.2017	To Saha Bros A/c		31.3.2017	By Saha Bros A/c (sales)	1,65,000
	Carriage	3,100	"	By Stock on Consignment A/c (Note 2)	31,563
	Godown rent	1,200			
	Salesman salary	900			
	Ordinary commission	6,600			
	Del credere commission	3,300			
"	To Abnormal Loss A/c (loading)	1,600			
"	To Stock Reserve A/c	7,946			
"	To Profit & Loss on Consignment A/c	15,117			
		2,44,763			2,44,763

Dr. Saha Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2017	To Consignment to Calcutta A/c	1,65,000	31.3.2017	By Advance Against Consignment A/c	34,000
			"	By Consignment to Calcutta A/c (Expenses)	5,200
			"	By Consignment to Calcutta A/c (Commission)	9,900
			"	By Bank A/c (balance paid)	1,15,900
		1,65,000			1,65,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2017	To Saha Bros. A/c	34,000	25.2.2017	By Bank A/c	40,000
"	To Balance c/d (Note 6)	6,000			
		40,000			40,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	**(2) Valuation of Closing Stock**		₹
Invoice price of 5,000 litres	2,00,000	Value of 5,000 litres at invoice price		2,05,000
Add: Freight & insurance before accident	5,000	Less: Value of 200 litres at invoice price		8,200
Value of 5,000 litres at invoice price	2,05,000	Value of 4,800 litres at invoice price		1,96,800
Value of 200 litres (₹ 2,05,000 / 5,000) x 200	8,200	Add: Carriage & clearance paid by consignee		3,100
(3) Loading on Goods Sent		Value of (4,800 – 50) = 4,750 litres at invoice price		1,99,900
1/5 (₹ 2,00,000)	40,000	Value of 750 litres (₹1,99,900 / 4,750) x 750		31,563
(4) Loading on Abnormal Loss		Less: Market price (₹ 33.5 x 750)	25,125	
(40,000 / 5,000) x 200	1,600	Less: Commission @ 6%	1,508	23,617
		Stock Reserve		7,946

(5) Liquor in Stock	₹
Sent out (in litres)	5,000
Lost in transit	200
	4,800
Less: Normal loss	50
	4,750
Less: Sold	4,000
Closing Stock	750

(6) Adjustment for Security

Security for 5,000 litres is ₹ 40,000.
So, security for 750 litres = ₹ 6,000.

Correction of Errors

We know that goods sent on consignment is not a sale but sometimes it is recorded as sales in the consignor's books by debiting the Consignee Account and crediting the Sales Account. For correction, the following entry should be passed:

When goods were sent at cost price

	Entries already passed		Correcting Entries
(1)	**For Goods sent** (a) Consignee A/c Dr. (cost price) To Sales/Goods A/c	(1)	**For Goods sent** (a) Sales/Goods A/c Dr. (cost price) To Consignee A/c
			(b) Consignment A/c Dr. (cost price) To Goods Sent on Consignment A/c

	OR (b) Consignee A/c Dr. (cost price) To Goods Sent on Consignment A/c		OR (b) Consignment A/c Dr . (cost price) To Consignee A/c
(2)	**For Goods sold by consignee** Bank A/c Dr. To Consignee A/c	(2)	**For Goods sold by consignee** Consignee A/c Dr. To Consignment A/c
(3)	**For closing stock** Nil	(3)	**For closing stock** Stock on Consignment A/c Dr. To Consignment A/c

When goods were sent at invoice price

	Entries already passed		Correcting Entries
(1)	**For Goods sent** (a) Consignee A/c Dr. (invoice price) To Sales A/c OR (b) Consignee A/c Dr. (invoice price) To Goods Sent on Consignment A/c	(1)	**For Goods sent** (a) Sales A/c Dr. (invoice price) To Consignee A/c (b) Consignment A/c Dr. (invoice price) To Goods Sent on Consignment A/c OR (b) Consignment A/c Dr. (invoice price) To Consignee A/c
(2)	**For Goods sold by consignee** Bank A/c Dr. (sales value) To Consignee A/c	(2)	**For Goods sold by consignee** Consignee A/c Dr. (sales value) To Consignment A/c
(3)	**For closing stock** Nil	(3)	**For closing stock** Stock on Consignment A/c Dr. (invoice price) To Consignment A/c
		(4)	**For Loading on Goods sent** Goods Sent on Consignment A/c Dr. To Consignment A/c
		(5)	**For Loading on Unsold goods** Consignment A/c Dr. To Stock Reserve

Illustration 46

In the Sales Ledger of XY Goods Co, the following account appears :

Dr. **Ram** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 10	To Goods To Expenses	12,000 720	2017 July 5 July 31	By Cash By Balance c/d	5,000 7,720
		12,720			12,720

Upon enquiry you find that the debit to Ram of ₹ 12,000 represented goods costing ₹ 10,000 delivered to him on the understanding that he will try to sell them in his own make, or otherwise return them. For this he is to be allowed a commission of 10 per cent on all sales effected, out of which he is to defray the expenses that he may incur.

On 31st July, 2017 when XY Goods Co make up their annual accounts, it is learnt that Ram has sold half the goods at the prices at which they were invoiced to him but is doubtful about his ability to sell the remaining. He, therefore, proposes to offer his customers a special trade discount of 20 per cent and to waive any further sales commission. To this, XY Goods Co agreed and took this information into account when closing their books. You are required: (a) to show the necessary corrective entries in the firm's journal; (b) to set out the account of Ram as it will appear when the Journal entries have been posted; and (c) to state clearly the resultant profit or loss on the matter.

Solution : In the above question, the goods sent on consignment to Ram has been wrongly treated as Sales. In order to set the accounts right, the following correcting entries will have to be passed in the books of the Company.

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2017 July 31	Goods (Sales) A/c Consignment to Ram A/c To Ram A/c	Dr. Dr.	12,000 720	 12,720
	(Being cancellation of wrong entry and expenses on consignment charged to Consignment A/c)			
	Consignment to Ram A/c To Goods Sent on Consignment A/c	Dr.	12,000	 12,000
	(Being the invoice price of goods sent to Ram on consignment)			

Ram A/c To Consignment to Ram A/c (Being goods sold by Ram)	Dr.	6,000	6,000
Consignment to Ram A/c To Ram A/c (Being commission payable to Ram)	Dr.	600	600
Goods Sent on Consignment A/c To Consignment A/c (Being loading on goods sent to Ram)	Dr.	2,000	2,000
Stock on Consignment A/c To Consignment A/c (Being value of stock at invoice price)	Dr.	6,360	6,360
Consignment A/c To Stock Reserve A/c (Being required reserve on stock)	Dr.	1,560	1,560
Profit & Loss on Consignment A/c To Consignment to Ram A/c (Being loss on consignment transferred)	Dr.	520	520
Goods Sent on Consignment A/c To Purchases A/c (Being the adjustment to goods sent on consignment)	Dr.	10,000	10,000

Dr. **Ram Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.7.2017	To Balance c/d	7,720	31.7.2017	By Goods A/c (sales)	12,000
"	To Consignment to Ram A/c (sales)	6,000	"	By Consignment to Ram A/c	720
			"	By Consignment to Ram A/c	600
			"	By Balance c/d	400
		13,720			13,720

Dr. **Consignment to Ram Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.7.2017	To Goods Sent on Consignment A/c	12,000	31.7.2017	By Ram A/c	6,000
"	To Ram A/c (expenses)	720	"	By Goods Sent on Consignment A/c	2,000
"	To Ram A/c (commission)	600	"	By Stock on Consignment A/c	6,360
"	To Stock Reserve A/c	1,560	"	By Profit & Loss on Consignment A/c	520
		14,880			14,880

Working Notes : **Valuation of Closing Stock**

	₹		₹
Invoice price of goods sent	12,000	Value of 1/2 goods	6,360
Add: Expenses	720	Less: Market value (₹ 6,000 – ₹ 1,200)	4,800
Value of goods at invoice price	12,720	Stock Reserve	1,560

Illustration 47

Nripesh consigns goods to Dharani, his agent at Dhanbad, at cost price of ₹ 40,000. Nripesh's accountant, at the end of the year, drew up the agent's account as under (all figures in rupees) :

Dr. **Dharani Account** **Cr.**

To Goods	40,000	By Cash	25,000
To Cash — freight and insurance	3,000	By Balance c/d	19,300
To Profit and Loss A/c	1,300		
	44,300		44,300

Dharani sold part of the goods for ₹ 45,000, which exceeded by ₹ 9,000 over invoice price. He collected ₹ 38,000 after allowing discount of ₹ 2,000 to customers, bad debts came to ₹ 1,000 and his expenses ₹ 800 (including ₹ 200 for unloading and cartage). Dharani was entitled to a commission of 5% on cash collected.

From the above information, draw up the following accounts in the books of Nripesh :

(a) Consignment Account; (b) Consignment Debtors Account; (c) Dharani Account. *[C.U.B.Com. (Hons.) — Adapted]*

Solution

In the books of Nripesh

Dr. **Consignment to Dhanbad Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	40,000		By Consignment Debtors A/c	45,000
	To Dharani A/c :			By Stock on Consignment A/c (Note 1)	4,320

	Freight and Insurance	3,000			
	Unloading and Cartage	200			
	Other Expenses	600			
	Commission (5% on ₹ 38,000)	1,900			
	To Consignment Debtors A/c :				
	Discount Allowed	2,000			
	Bad Debts	1,000			
	To Profit and Loss on Consignment A/c	620			
		49,320			49,320

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Dhanbad A/c	45,000		By Dharani A/c (cash collected)	38,000
				By Consignment to Dhanbad A/c :	
				Discount Allowed	2,000
				Bad Debts	1,000
				By Balance c/d	4,000
		45,000			45,000

Dr. Dharani Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Note 3)	19,300		By Goods A/c (Note 2)	40,000
	To Consignment Debtors A/c	38,000		By Profit and Loss A/c (Note 2)	1,300
				By Consignment to Dhanbad A/c :	
				Freight and Insurance	3,000
				Unloading and Cartage	200
				Other Expenses	600
				Commission	1,900
				By Balance c/d	10,300
		57,300			57,300

Working Notes :

(1) Calculation of Stock on Consignment

Here, invoice price means the price indicated in the proforma invoice which is nothing but **cost price**.

	₹
Cost of goods sent	40,000
Less: Cost of goods sold ₹ (45,000 – 9,000)	36,000
Cost of stock on consignment	4,000
Add: Proportionate non-recurring expenses (₹ 3,000 + 200) / 40,000 × 4,000	320
Value of stock on consignment	4,320

(2) Goods and profit debited to Dharani have been reversed.

(3) Dharani account starts with the balance given in the question.

Key Points

- The person sending the goods is called the ***consignor*** and the agent who receives the goods is called the ***consignee***.
- An ***Account Sales*** is a statement which is periodically rendered by the consignee to the consignor, showing the details about the goods sold, price realized, his own commission, and the expenses incurred in connection with the sale.
- The primary objective for preparing the Consignment Account is to ascertain the profit or loss on each consignment separately.
- ***Del Credere Commission*** is an additional commission paid to a consignee who guarantees the payment in case of credit sale. Where the consignee gets del credere commission, he indemnifies the consignor for all bad debts.

THEORETICAL QUESTIONS

1. What is a Consignment Account? Distinguish between sale and consignment.
2. What is an Account Sales? Prepare an Account Sales with assumed data.
3. What is del credere commission? Why is it given to the consignee?
4. What are non-recurring expenses? Give some examples.
5. What is a Proforma Invoice? Prepare a Proforma Invoice with assumed figures.
6. State the procedure of valuation of closing stock on consignment.

7. How is abnormal loss treated in Consignment Account ? ***[C.U.B.Com. (General) — 2012]***
8. (a) When consignor sends goods to the consignee, why no entry is passed in the books of consignee ?
   (b) Why recurring expenses are not considered for valuing unsold stock on consignment ?
   [C.U.B.Com. (Hons.) — 2013]
9. Who pays del credere commission ? Why is commission paid ? ***[C.U.B.Com. (Hons.) — 2014]***

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Consignee becomes a debtor of the consignor when
   A the goods are despatched
   B the goods are received
   C the goods are sold.
2. An account sales is a statement which shows the details about the
   A goods received
   B goods sold
   C goods lying unsold.
3. Del credere commission is given when the consignee
   A sells all the goods on credit
   B gets no ordinary commission
   C bears the loss of bad debts.
4. No journal entry is required to be passed when there is
   A normal loss
   B abnormal loss in transit
   C abnormal loss in consignee's godown.
5. Del credere commission that is given to the consignee is to cover
   A normal loss
   B abnormal loss
   C loss of bad debts.
6. Del credere commission is calculated on
   A total sales
   B cash sales
   C credit sales.
7. Consignee account is in the nature of
   A personal account
   B real account
   C nominal account.

PRACTICAL QUESTIONS

Cost Price Method

1. C of Calcutta sent 100 bicycles to B of Mumbai to be sold on consignment basis on 1.1.2016. The cost of each bicycle was ₹ 800, C incurred ₹ 500 for freight, ₹ 750 for cooli charges and ₹ 850 for insurance premium.

   On 31.12.2016, C received on Account Sales from B, which showed that he sold 80 bicycles @ ₹ 1,200 each and after deducting his commission and expenses amounting to ₹ 20,000, he sent the balance amount by a draft with the Account Sales. According to contract, B is entitled to get ordinary commission @ 10% and del credere commission @ 5% on sale proceeds. Show important Ledger Accounts in the books of both the parties.
2. On 1st January, 2016 Sadhan Sen of Sodepur sent 1,000 units of silk goods to Biren Bose of Berhampur .The goods cost ₹ 75,000 to Sadhan and these were sent on consignment basis. Sadhan had to incur an expenditure of ₹ 1,500 on the goods. On the due date, the goods reached the destination and Biren had to spend on the goods ₹ 1,000 on various accounts.

   On 30th September, 2016 an Account Sales was received by Sadhan showing that 750 units were sold at ₹ 150 each. Biren charged 5% ordinary commission and $7^1/_2$% del credere commission. The consignee sent with the Account Sales a sight draft for ₹ 90,000 only.

You are required to prepare the Account Sales and the necessary Journal entries and Ledger accounts in the books of both the parties.

3. On 1st January, 2017, C of Calcutta sends 1,000 boxes of clothing to M of Madras on consignment basis. The goods in each box cost ₹ 200. C pays railway freight and insurance ₹ 500 and draws upon M a bill for ₹ 10,000 which is duly accepted.

   On 2nd April, 2017, M forwards an Account Sales to C showing that 500 boxes have been sold at ₹ 250 per box while 300 boxes were sold at ₹ 260 per box and 200 boxes remained in stock unsold. The expenses incurred by M consisted of carriage ₹ 100 and other charges ₹ 2,000. M is entitled to a commission @ 5% on the gross sale proceeds. He encloses a cheque for the balance due to C.

   Show the Consignment Account and M Account in the books of C.

4. On 1.1.2017, Amar Mills of Calcutta consigned 5,000 Kg of oil to Vijay Stores of Madras. Each Kg of oil costs ₹ 8. Amar Mills paid ₹ 50 as carriage, ₹ 250 as freight and ₹ 200 as insurance. During transit, 500 Kg were accidentally destroyed for which the Insurance company paid directly to consignor ₹ 2,500 in full settlement of the claim. On 1.4.2017, Vijay Stores of Madras reported that 3,500 Kg of oil were sold @ ₹ 9.50 per Kg. and expenses being: Godown rent ₹ 500 and salesman's salary ₹ 750. Vijay Stores is entitled to a 5% commission on sales. Vijay Stores also reported a loss of 20 Kg due to leakage. Show (i) Consignment to Madras Account; (ii) Vijay Stores Account; (iii) Consignment Stock Account in the books of the consignor.

5. Karnath sold goods on behalf of Vijay Sales Corporation on consignment basis. On January 1, 2016, he had with him a stock of ₹ 20,000 on consignment.

   Karnath had instructions to sell the goods at cost plus 25% and was entitled to a commission of 4% on sales, in addition to 1% del credere commission on total sales for guaranteeing collection of all the sale proceeds.

   During the year ended 31st December, 2016, cash sales were ₹ 1,20,000, credit sales ₹ 1,05,000 and Karnath's expenses relating to the consignment ₹ 3,000 being salaries and insurance. Bad debts were ₹ 3,000 and goods sent on consignment ₹ 2,00,000.

   From the above, prepare Consignment Account in the books of Vijay Sales Corporation, and important ledger accounts in the books of Karnath.

6. On 1st July, 2016, Sengupta of Calcutta sent 150 cases of goods at a cost of ₹ 750 per case to Kapoor of Bombay on consignment basis and paid ₹ 1,900 for insurance premium, ₹ 3,500 for freight and ₹ 2,600 for dock charges. On arrival of the goods, Kapoor sent a bank draft for ₹ 10,000 to Sengupta on 30th July, 2016 and paid ₹ 2,500 for clearing charges, ₹ 870 for cartage and ₹ 750 for godown rent. 5 cases were damaged in transit and a sum of ₹ 3,500 was realized by way of compensation from the insurance company. Up to 31st December, 2016, 100 cases were sold for ₹ 1,05,000 incurring a bad debt of ₹ 1,150. Kapoor was entitled to a commission of 5% on the gross sales with further 2% as del credere commission. The amount due to Sengupta up to 31st December, 2016 was remitted by a bank draft.

   Show (a) Consignment Account; (b) Kapoor Account; and (c) Consignment Stock Account in the books of Sengupta.

7. Raja of Calcutta consigned on 1st April, 2016 to Praja of Burdwan 50 TV sets at ₹ 6,000 per set. Raja incurred the following expenses on the consignment : Freight ₹ 1,000; Insurance and other charges ₹ 500. The consignee paid ₹ 980 as non-recurring and ₹ 1,000 as recurring expenses. On the way a set was damaged in full for which the insurance company admitted ₹ 5,600. Praja sent an Account Sales on 1st December, 2016 indicating that 45 sets had been sold at ₹ 6,800 per set. The Account Sales was accompanied by the necessary bank draft deducting commission @ 5% and del credere commission @ $2^1/_2$%.

   Assuming Raja closes his books on 31st December, 2016 give the ledger accounts to record the above transactions.

8. Naresh consigns 1,000 bats costing ₹ 500 each to Swaroop for sales and incurs ₹ 4,000 towards freight and ₹ 1,000 for insurance. Swaroop was able to take delivery of 900 bats only and 100 bats were destroyed in transit. The insurance company admitted the claim and paid the same. Swaroop will be entitled to a commission of 5% on sales and 2% del credere commission on credit sales only. He will be entitled for additional commission of 25% of the excess if the sale price exceeds the cost price by more than 20%. Swaroop has spent ₹ 2,000 towards sales expenses. The sales are as follows : 500 bats at ₹ 600 per bat cash; 200 bats at ₹ 700 per bat credit

   Consignment debtors paid their dues except one customer to whom 4 bats were sold for ₹ 2,800 could pay only ₹ 800.

   Show the Consignment Account, the Consignment Debtors Account, Swaroop Account and commission calculation

   [C.A.(Entrance) —Adapted]

9. Ramesh Oil Mills, Bombay, consigned 40,000 kg of castor oil in 10 kg tins to B N Chatterjee, Calcutta, on 1st April, 2017. The cost of oil was ₹ 2 per kg. The consignors paid ₹ 10,000 as freight and insurance. During transit 50 tins were totally destroyed for which the insurance company paid directly to the consignor, ₹ 900 in full settlement of the claim. B N Chatterjee took delivery of the consignment on 10th April, and accepted a bill drawn on him by the

Ramesh Oil Mills for ₹ 20,000 for three months. On June 30, 2017 B N Chatterjee reported that 35,000 kg were sold @ ₹ 3 per kg. The expenses were as follows: Godown rent ₹ 400; advertisement ₹ 2,000; and salaries of salesmen ₹ 4,000.

B N Chatterjee charged a commission of 3% plus 3% del credere commission. He sold ₹ 19,000 worth of oil, the remaining stock, to X & Co who were declared bankrupt after two months and only 50 paise per rupee were realised from them.

Show accounts in the books of both the parties assuming that the consignee paid the amount due by bank draft.

10. On July 1, 2016 A had consigned to B goods costing ₹ 50,000, on which A paid freight and insurance amounting to ₹ 2,500. On September 30, 2016, B's first Account Sales was received, showing that he had effected sales for ₹ 32,000 of which ₹ 30,000 had been received in cash. His expenses to date were ₹ 2,000 and commission 5% on gross sales. On receipt of the Account Sales the Consignment Account was balanced off, stock being valued at ₹ 28,000. A further Account Sales was received on December 31, 2016 showing that the balance of the goods had been sold for ₹ 36,000 and the cash collected. Debtors had also paid their dues less discount of 3%. The expenses of B were ₹ 2,500. The rate of his commission was the same as before.

    Write up the Consignment Account and B Account up to December 31, in the books of A assuming that B remitted the balance due with each Account Sales.

11. M/s Abubacker and Sons, Madras, sent to their agents, M/s Chinnadurai and Bros in Ceylon on February 12, 2017 a consignment of hides and skins costing ₹ 24,000. They incurred ₹ 1,200 on freight and packing and ₹ 300 towards insurance. They drew a bill on the agent for ₹ 20,000 at three months' sight. It was accepted by the agent and returned on February 20. A commission at 5% and a del credere commission at 1% was agreed to be payable on sales to the agent. It was found that due to faulty packing, goods invoiced at ₹ 2,200 were damaged and the claim was not admitted by the insurer.

    However, these damaged goods were sold by the consignor as scrap for ₹ 1,250. Half of the goods on consignment were sold for cash on March 7 for ₹ 14,600 and the balance on March 12, 2017 on credit for ₹ 18,200. The agent incurred landing and storage expenses of ₹ 600 and ₹ 800 respectively in connection with these sales. Deducting his commission and expenses, he remitted the balance by draft on March 15, 2017 which was received in Madras on March 18. Show the Consignment Account and the Consignee Account as they would appear in the books of M/s. Abubacker and Sons.

12. Oil India Ltd of Bombay consigned 1,000 barrels of Lubricant oil costing ₹ 800 per barrel to Central Oil Company, Calcutta, on 1st Jan 2017. Oil India Ltd paid ₹ 50,000 as freight and insurance. 25 barrels were destroyed on 7.1.2017 in transit. The insurance claim was settled at ₹ 15,000 and was paid directly to the consignor.

    Central Oil Co took delivery of the consignment on 19th Jan 2017 and accepted a bill drawn upon them by Oil India Ltd for ₹ 5,00,000 for 3 months on 31st March, 2017. Central Oil Co reported as follows:

    (i) 750 barrels were sold at ₹ 1,200 per barrel.
    (ii) Other expenses: unloading ₹ 2,500; wages of salesman ₹ 50,000; printing ₹ 21,300; and godown rent ₹ 10,000.
    (iii) 25 barrels of oil were lost due to leakage which is considered to be a normal loss.

    Central Oil Co is entitled to a commission of 5% on all the sales effected by them. Central Oil Co paid the amount due in respect of the consignment on 31st March itself.

    Show the Consignment Account, the account of Central Oil Co. and the loss in transit account as they will appear in the books of Oil India Ltd.

13. Rahim of Calcutta consigned 100 cases of medicine. Costing ₹ 1,000 per case to Karim of Kanpur on 1.1.2017. The goods were to be sold at 25% above cost. Any deficiency in the selling price was to be borne by Karim. Karim was, however, entitled to a special commission @ 25% of any surplus price realised. Karim was further entitled to an ordinary commission of 5% and del credere commission of $2^1/_2$% on all sales.

    Rahim incurred the following expenses:

    Packing charges ₹ 6,000; loading charges ₹ 1,000; lorry charges ₹ 12,000; and railway freight ₹ 21,000

    The cases were received by Karim on 15.1.2017. The Account Sales received from Karim on 30.6.2017 revealed the following: 40 cases sold on 21.3.2017 @ ₹ 1,500 per case, 30 cases sold on 24.5.2017 @ ₹ 1,200 per cases, 10 cases sold on 30.6.2017 @ ₹ 1,300, 5 cases were stolen by a dishonest employee.

    A compensation of ₹ 2,000 was realised from him. Karim incurred unloading charges of ₹ 2,000 and warehouse rent ₹ 3,000. Karim enclosed a bank draft for the balance due. Write up necessary accounts in the books of Rahim.

14. X consigned goods costing ₹ 1,60,000 to A. The terms of the consignment were:

    (a) Consignee to get commission of 5% on cash sales and 4% on credit sales.
    (b) Any goods taken by consignee himself or goods lost through consignee's negligence, shall be valued at original cost plus $12^1/_2$% and no commission will be allowed on them.

The expenses incurred by the consignor were: Carriage and freight ₹ 6,720 and insurance ₹ 3,440. The consignor received ₹ 50,000 as advance against the consignment. Account Sales together with a draft for the balance due was received by the consignor showing the following position:

Goods costing ₹ 1,28,000 were sold for cash at ₹ 1,40,000 and on credit at ₹ 1,08,000. Goods costing ₹ 8,000 were taken by A and goods costing ₹ 4,000 were lost through A's negligence. The expenses incurred by A were: advertisement ₹ 1,720; and other selling expenses ₹ 1,080.

Show the ledger accounts in the books of X.

15. Mr Krishna Murty requests you to prepare a Consignment Account for the year ended 30.6.2017 and for this purpose gives you the following information to ascertain the profit earned on consignment.

    (i) Agent's commission @ 5% on gross sales ₹ 20,000.

    (ii) Cost of goods fully damaged in transit (insurance claim recovered ₹ 18,000).

    (iii) Expenses incurred by the agent : godown rent ₹ 400; landing and clearing ₹ 1,000; advertisements ₹ 200; transport charges ₹ 900; selling expenses ₹ 1,000.

    (iv) Freight expenses incurred by Krishna Murty ₹ 2,000.

    (v) Cost of unsold stock lying with the agent at the end of the year ₹ 60,000.

    All sales were effected by the agent at a profit of 25% on cost.

16. B of Bombay consigned 400 packages of coffee to K of Kanpur. The cost of each package was ₹ 300. A sum of ₹ 2,000 was paid towards freight and insurance by B. In the transit, 60 packages were damaged. However, the consignor received ₹ 400 for the damaged packages from the insurance company.

    The consignee accepted a Bill of Exchange for ₹ 60,000 for 60 days as an advance to B of Bombay. The operating statement from the consignment disclosed the following information :

    (a) 280 packages were sold @ ₹ 360 per package.

    (b) The damaged packages were sold @ ₹ 100 per package.

    (c) He also paid ₹ 1,400 towards godown rent, ₹ 1,000 for carriage outward and ₹ 3,400 towards clearing charges.

    The consignee is entitled to a commission of 10% on the sale proceeds.

    At the end of the consignment period, K of Kanpur sent a bank draft to B of Bombay You are required to prepare the necessary accounts on the books of consignor B of Bombay.

17. On 1.4.2017, X of Delhi consigned 550 tins of oil to Y of Calcutta. Each tin contains 1.5 Kg of oil. The cost is ₹ 21 per kg. This is to be sold at $33^1/_3$% above cost. Y is to be paid 3% ordinary and 2% del credere commission on sales on the basis of the price specified above.

    Any deficiency in the selling price is to be fully borne by Y, while only 50% of any surplus price realised may be retained by him. X incurred freight and insurance ₹ 3,300. 20 tins were stolen in transit and the insurance company paid ₹ 5,500 in final settlement. Y accepted a bill for 3 months for ₹ 40,000 which was discounted by X for ₹ 39,600. Y sent an account sales which showed that 50 tins were sold @ ₹ 29 per Kg, 200 Kg @ ₹ 32 per kg and from the remaining tins 3,750 Kg of oil were sold @ ₹ 34 per Kg.

    Y paid ₹ 4,270 on clearing charges and ₹ 1,200 as selling expenses. 50 Kg of oil were lost due to leakage which was considered as normal loss. Y collected entire sale proceeds except ₹ 400 which became irrecoverable.

    Prepare the Ledger Account in the books of X.

18. Reema consigns goods to Sunita to be sold at above invoice price, Sunita is to get commission of 5% on sales at invoice price, plus 25% of any surplus price realised. Reema received from Sunita on advance of 75% of the invoice price; the accounts being settled by Bank Drafts immediately on sales.

    During the year Reema consigned to Sunita goods worth ₹ 3,60,000, the invoice price of which was ₹ 5,00,000. This includes freight, sales by Sunita during the year amounted to ₹ 4,30,000, goods unsold on 31.3.12017 with Sunita were of invoice price of ₹ 1,50,000 (cost including freight ₹ 1,00,000). Reema had received from Sunita by bank draft during the year ₹ 90,000, certain remittances being in transit on 31.3.2017.

    Show the Consignment to Sunita Account and Consingee's (Sunita) Account in the books of Reema.

Invoice Price Method

19. A of Bombay sent goods on consignment basis, to B of Calcutta at an invoice price of 25% on cost which was to be sold for general commission of 10% on gross sales plus a special commission of 25% on excess of sale proceeds less all commission over the invoice price. A sent 100 boxes of tea at an invoice price of ₹ 500 per box and incurred ₹ 1,000 as freight, ₹ 500 as insurance and ₹ 300 as general expenses. B paid the following expenses: Clearing charges ₹ 400; carriage ₹ 200; godown rent ₹ 600; insurance ₹ 300 and miscellaneous selling expenses ₹ 200.

    It was found that 10 boxes were lost in transit and another 10 boxes were still in transit. Insurance claim in respect

of goods lost was settled at ₹ 3,500. B sold 50 boxes for ₹ 35,000 and sent a bank draft for the amount due.
You are required to show the necessary ledger accounts in the books of A (Calculations are to be shown separately).

20. Mr Achut of Bombay consigned 100 units of a commodity to Mr. Rao of Delhi. The goods were invoiced at ₹ 150 so as to yield a profit of 50 per cent on cost. Mr.Achut incurred ₹ 1,000 on freight and insurance. Mr. Rao incurred ₹ 500 on freight and ₹ 800 on rent. Before December 31, 2016, he sold 50 units for cash at ₹ 160 per unit, 20 units for ₹ 175 on credit. He retained his commission at 5% and 1% for the del credere arrangements and remitted the balance on December 31, 2016. Mr. Rao noticed that 10 units were damaged on account of bad packing and he could sell them only for ₹ 80 per unit. A debtor for ₹ 1,000 to whom the goods were sold by Mr Rao became insolvent and only 50 paise in a rupee was recovered. Mr Rao sent an Account Sales on March 31, 2017 detailing the transactions for the quarter ended on that date and he remitted the balance due. Make necessary ledger accounts in the books of Achut and Mr Rao assuming that Mr Achut closes his books every 31st March.

21. X of Delhi purchased 10,000 meters of cloth for ₹ 2,00,000 of which 5,000 meters were sent on consignment to Y of Agra at the selling price of ₹ 30 per meter. X paid ₹ 5,000 for freight and ₹ 500 for packing etc.

Y sold 4,000 meters at ₹ 40 per meter and incurred ₹ 2,000 as selling expenses. Y is entitled to a commission of 5% on total sale proceeds plus a further 20 per cent on any surplus price realised over ₹ 30 per meter. 3,000 meters were sold at Delhi at ₹ 30 per meter less ₹ 3,000 for expenses and commission. Owing to a fall in the market price, the stock of cloth in hand is to be reduced by 10 per cent. Prepare the Consignment Account and the Trading and Profit and Loss Account in the books of X and his Account in the books of Y.

22. On 1st December, 2016, 100 radio sets were sent on consignment by Kolay & Co of Bombay to Paul & Co of Calcutta at a Proforma Invoice price of ₹ 1,800 each (including a profit of 20% on cost). Kolay & Co paid freight, insurance and other charges amounting to ₹ 8,000. 2 radio sets were totally damaged in transit and as such were thrown away. Paul & Co incurred an expenditure of ₹ 980 for loading and unloading of the consignment and took delivery of the remaining radio sets and sent a cheque for ₹ 90,000 as security against the goods to Kolay & Co. On 31st December, 2016, Paul & Co sent an Account Sales showing that 90 radio sets were sold at 10% above their proforma invoice price and expenses incurred in connection with sales amounted to ₹ 2,208.

Paul & Co was entitled to an ordinary commission of 5% and del credere commission of 1% on sales. Paul & Co could not realize ₹ 500 from a customer to whom a radio set was sold on credit and accordingly that became a bad debt. Along with the Account Sales Paul & Co sent a bank draft to Kolay & Co for the net amount due.

You are required to show the Consignment Account and the Consignee Account and Advance Against Consignment Account in the books of the consignor.

23. Rama consigned goods to Ravindran, his agent at New Delhi at cost price of ₹ 40,000. Rama's accountant, at the end of the year, drew up the agent's account as under:

Dr. **Ravindran** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods To Profit & Loss A/c	40,000 3,300		By Cash By Balance c/d	24,000 19,300
		43,300			43,300

Ravindran sold the goods for ₹ 45,000, which exceeded by ₹ 9,000 their invoice value. He collected ₹ 38,000 after allowing discount of ₹ 2,000 to customers. Bad debts come to ₹ 1,000 and his expenses to ₹ 800. Ravindran was entitled to a 5% commission on cash collected. Balance of stock is to be valued at invoice prices. From the above information, draw the accounts of Ravindran, Consignment and Consignment Debtors in the books of Rama.

24. On 1st September, 2016 goods which cost to X ₹ 33,000 were consigned by him to his agent Y at a proforma invoice price which was 20% over cost. X paid insurance and freight charges amounting to ₹ 1,250. Y was allowed 3,000 per annum towards establishment cost, 5% commission on gross sales and 3% del credere commission. He was also allowed 5% extra commission on the profit on such consignment sales after charging such commission. Y incurred expenses of ₹ 255 as landing charges. 3/4th of the goods were sold at $33^1/_3$% profit on cost, half of which were on credit; half of the remaining goods were damaged and a claim on insurance company was made for ₹ 4,400 which was settled at a discount of 10%. You are required to prepare a Consignment Account and an Abnormal Loss Account in the books of X for the year ended 31st December, 2016.

25. Roy Brothers of Calcutta sent goods costing ₹ 60,000 to Patel Brothers of Bombay on 10th September, 2015, on consignment basis. The invoice price was made by adding 25% of the cost. Roy Brothers of Calcutta paid the following expenses in connection with the despatch of goods : Packing ₹ 350, carriage ₹ 550 and other expenses ₹ 960.

On 25th September 2015, after receiving the goods Patel Brothers paid ₹ 850 as freight and ₹ 450 as carriage for taking goods to their godown and forwarded a three months' bill for ₹ 15,000 to Roy Brothers.

On 31st December, 2015 Patel Brothers sent an Account Sales to Roy Brothers. Roy Brothers of Calcutta came to know from the Account Sales that Patel Brothers had sold half of the goods at ₹ 40,000 in cash and ₹ 20,000 on credit out of which ₹ 7,000 had already been collected by Patel Brothers. The expenses deducted by Patel Brothers also include ₹ 450 for fire insurance. Patel Brothers were entitled to an ordinary commission of 5% and del credere commission of $2^1/_2$% on gross sales.

On April 30, 2016 a second Account Sales was sent by Patel Brothers. It showed that half of the remaining goods were sold by Patel Brothers at ₹ 15,000 in cash and ₹ 10,000 on credit. Their expenses during the period were ₹ 250 for fire insurance and ₹ 150 for other expenses. The remaining goods could not be sold and were brought back by Roy Brothers on 31st August 2016, at a further cost of ₹ 1,000. These goods were damaged on the way and were valued at 40% below their cost price. Patel Brothers remitted with each Account Sales the balance due from them and Roy Brothers close their books of accounts on 31st December each year. Patel Brothers were able to collect all that was due from the debtors till 31st December, 2016 except ₹ 1,500 from a debtor, which was treated as bad debt.

Draw up the Consignment Account, Patel Brothers' Personal Account and Goods sent on Consignment Account in the books of Roy Brothers of Calcutta.

Guide to Answers

Multiple Choice

1. C 2. B 3. C 4. A 5. C 6. A 7. A.

Practical Questions

1. **Loss on Consignment ₹ 4,080; Stock ₹ 16,420; Amount received ₹ 61,600.**
2. **Profit ₹ 40,062; Stock ₹ 19,125; Amount due ₹ 7,437.**
3. **Profit ₹ 30,370; Stock ₹ 40,120; Final Payment ₹ 1,80,750.**
4. **Profit on Consignment ₹ 1,860; Stock on Consignment ₹ 7,973;**
   Balance due ₹ 30,337; Abnormal Loss ₹ 1,550.
5. **Profit on Consignment ₹ 30,750; Value of Stock on Consignment ₹ 40,000.**
6. **Profit on Consignment ₹ 14,243; Abnormal Loss ₹ 4,017; Stock on consignment ₹ 37,196.**
7. **Profit ₹ 9,800; Stock ₹ 24,200; Abnormal Loss ₹ 6,030; Final Payment ₹ 2,81,070.**
8. **Profit ₹ 54,700; Stock ₹ 1,01,000; Abnormal Loss ₹ 50,500;**
   Commission (₹ 22,000 + ₹ 2,800 + ₹ 5,000) ₹ 29,800.
9. **Profit ₹ 21,285; Abnormal Loss ₹ 1,125; Final Payment received ₹ 90,160.**
10. **Profit (₹ 3,900 + ₹ 3,640) = ₹ 7,540; Payment (₹ 26,400 + 31,700).**
11. **Profit ₹ 6,325; Abnormal Loss ₹ 2,393 (₹ 2,200 + ₹ 138 + ₹ 55).**
12. **Profit ₹ 1,17,450; Abnormal Loss ₹ 21,250; Stock (8,31,250 / 950) x 200 = ₹ 1,75,000.**
13. **Loss ₹ 16,900; Commission (8,175 + 2,625 – 1,500) = ₹ 9,300;**
    Goods stolen ₹ 7,100; Stock on Consignment ₹ 21,300.
14. **Profit ₹ 98,490; Stock ₹ 21,270; Goods lost ₹ 4,500; Goods taken over ₹ 9,000; Commission ₹ 11,320.**
15. **Profit on consignment ₹ 55,200; Stock on consignment ₹ 60,600;**
    Abnormal Loss charged to Profit and Loss Account ₹ 2,100.
16. **Profit on consignment ₹ 120; Abnormal Loss ₹ 12,500; Stock on consignment ₹ 18,900.**
17. **Profit on consignment ₹ 50,315; Stock on consignment ₹ 8,830; Abnormal Loss ₹ 920.**
18. **Profit on consignment ₹ 1,32,500.**
19. **Profit ₹ 7,825; Abnormal Loss ₹ 5,180 (Invoice price); Loading on Abnormal Loss ₹ 1,000; Stock ₹ 20,945; (₹ 5,180 + ₹ 15,765); Stock Reserve (total) ₹ 4,000. Final Payment ₹ 28,500.**
20. **Profit ₹ 1,960; Stock (Good units) ₹ 3,300 (invoice price); Damaged Stock ₹ 752 (₹ 800 – ₹ 48) at cost;**
    Stock Reserve on good units ₹ 1,000; Abnormal Loss charged to P/L 398 (₹ 1,150 – 752).
21. **Profit on Consignment ₹ 53,600; Gross Profit ₹ 26,000; Net Profit ₹ 76,600; Stock Reserve ₹ 14,000.**
22. **Profit on Consignment ₹ 22,200; Stock on Consignment ₹ 15,120; Amount received from Pal & Co ₹ 81,520.**
23. **Profit on Consignment ₹ 3,300; Stock on Consignment ₹ 4,000; Balance due from Consignment Debtors ₹ 4,000.**
24. **Profit on Consignment ₹ 3,315; Stock on Consignment ₹ 5,138; Abnormal Loss at invoice price ₹ 5,138;**
    Profit before extra commission ₹ 3,481. Extra commission ₹ 166.
25. **Profit on consignment for the year 2015 ₹ 23,470. Value of unsold stock on 31.12.2015 ₹ 39,080; Stock reserve ₹ 7,500.**
    Loss for the year 2016 ₹ 855 (charging expenses for goods returned); Value of returned goods ₹ 9,000.

20

Accounting for Sale on Approval

Introduction

With a view of pushing up the sales or for introducing a new product in the market, goods are sometimes sent to the customers on sale or approval basis. This means that a business delivers the goods to the customers with the option to retain or reject them within a specified period. A contract of goods on sale or return permits the buyer to return the goods for a full refund (then cash is received) or allow for an adjustment to be made to the amount owed. Generally, these transactions take place between a manufacturer (or a wholesaler) and a retailer. When the goods are transferred from the wholesaler to the retailer, under a sale or return basis, it implies a change in the possession of goods only and not a transfer of the ownership of goods. The ownership is passed only when the retailer gives his approval or if the goods are not returned within that specified period. The retailer (customer) does not incur any liability when the goods are merely sent to him.

The Sale of Goods Act, 1893, therefore, provides that when goods are sent on sale or approval basis, the sale will take place or the property in the goods passes to the buyer :

(i) When he signifies his approval or acceptance to the seller, or
(ii) Does any other act adopting the transactions, or
(iii) If, without signifying his approval or acceptance, the buyer retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiry of such time, and if no time is fixed, on the expiration of a reasonable time. *[Section 24]*

Under a sale or return agreement, revenue is not recognised from the sale until all of the following criteria are met :

(1) The sales price is fixed or determinable at the date of sale.
(2) The buyer has paid or will pay the seller, and the obligation is not contingent upon resale of the product.
(3) The buyer's obligation to the seller would not be changed by theft or damaged to the merchandise.
(4) The buyer has an economic substance apart from the seller.
(5) The seller does not have sufficient obligations for future performance to directly bring about the resale of the product by the buyer.

Economics of Sale or Return

Goods sent on sale or return are beneficial to either party, i.e., the seller gets a larger sale and the buyer is able to make a right choice. But in every bargain, the economies and diseconomies go hand in hand. Since some of the provisional purchasers may return the commodity, the actual sales fall below the target. Also some of the units returned may not be in their original condition. Therefore, the cost of marketing and bringing back the replaced units to their original quality should be put under to the total selling cost. Since no hire charges are generally made on these goods, the fixation of the price of the product should take into consideration the above mentioned factors.

Accounting Record

Accounting entries depend on the fact whether the business sends goods on sale or approval basis — (i) casually; (ii) frequently; and (iii) numerously.

(i) When the Business Sends Goods Casually on Sales or Return

When the transactions are few, the seller, while sending the goods, treats them as an ordinary sale. If the goods are accepted, or not returned, or the business receives no intimation within that specified time limit, no further entry is required to be passed. Because, a transaction for sale or return becomes entry after the expiry of that specified period. If the goods are returned within a specified time limit, a reverse entry is passed to cancel the previous transaction. If, at the year-end, goods are still lying with the customers and the specified time limit is yet to expire, the original entry for sales is cancelled and the value of the goods lying with the customers ***must be reduced from the selling price to the cost price***, and treated as an ordinary stock for Balance Sheet purposes.

Journal Entries

1. When goods are sent on approval or on sale or return basis

Customers/Sundry Debtors Account	Dr. [Invoice price]
To Sales Account	

2. When goods are rejected or returned within the specified time

Sales/Return Inwards Account	Dr. [Invoice price]
To Customers/Sundry Debtors Account	

3. When goods are accepted at invoice price or not returned within the specified time limit

[No Entry]

4. When goods are accepted at a higher price than the invoice price

Customers/Sundry Debtors Account	Dr. [Difference in price]
To Sales Account	

5. When goods are accepted at a lower price than the invoice price

Sales Account	Dr. [Difference in price]
To Customers/Sundry Debtors Account	

6. At the year-end, when goods are lying with customers and the specified time limit is yet to expire

Sales Account	Dr. [Invoice price]
To Customers/Sundry Debtors Account	

These goods should be considered as stock with customers and the following adjustment entry is to be passed:

Stock with Customers on Sale or Return Account	Dr. [Cost price or market price whichever is less]
To Trading Account	

It should be noted that no entry is to be passed for goods returned by the customers on a subsequent date.

Illustration 1

Capital Electronics sends goods to his customers on Sale or Return. The following transactions took place during 2017:

2017		₹
Sept. 15	Sent goods to customers on sale or return basis at cost plus $33^{1}/_{3}$%	1,00,000
Oct. 20	Goods returned by customers	40,000
Nov. 25	Received letters of approval from customers	40,000
Dec. 31	Goods with customers awaiting approval	20,000

Capital Electronics records sale or return transactions as ordinary sales. You are required to pass the necessary Journal Entries in the books of Capital Electronics assuming that accounting year closes on 31st December, 2017.

Solution **In the books of Capital Electronics**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 Sept. 15	Sunday Debtors A/c	Dr.		1,00,000	
	To Sales A/c				1,00,000
	(Being the goods sent to customers on sale or return basis)				
Oct. 20	Return Inwards A/c (Note 1)	Dr.		40,000	
	To Sundry Debtors A/c				40,000
	(Being the goods returned by custormers to whom goods were sent on sale or return basis)				
Dec. 31	Sales A/c	Dr.		20,000	
	To Sundry Debtors A/c (Note 3)				20,000
	(Being the cancellation of original entry of sale in respect of goods on sale or return basis)				
Dec. 31	Stock with Customers on Sale or Return A/c	Dr.		15,000	
	To Trading A/c (Note 4)				15,000
	(Being the adjustment for cost of goods lying with customers awaiting approval)				

Tutorial Notes :

(1) Alternatively, Sales Account can be debited in place of Return Inwards Account.
(2) No entry is required for receiving letter of approval from customer.
(3) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.
(4) Cost of goods with customers = ₹ 20,000 $\times \frac{100}{133.33}$ = ₹ 15,000.

Illustration 2

S.S. Ltd. sends out its goods to dealers on Sale or Return. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the accounting year on 31.12.2017, 200 such goods have been sent to a dealer at ₹ 250 each (cost ₹ 200 each) on sale or return and debited to his account. Of these goods, on 31.12.2017, 50 were returned and 70 were sold, for the other goods date of return has not yet expired.

Pass necessary adjustment entries on 31.12.2017.

Solution **In the books of S.S. Ltd.**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 Dec. 31	Return Inwards A/c (Note 1)	Dr.		12,500	
	To Sundry Debtors A/c				12,500
	(Being the adjustment for 50 units of goods returned by customers to whom goods were sent on sale or return basis)				
Dec. 31	Sales A/c (₹ 250 x 80)	Dr.		20,000	
	To Sundry Debtors A/c (Note 2)				20,000
	(Being the cancellation of original entry for sale in respect of 80 units of goods not yet returned or approved by customers)				
Dec. 31	Stock with Customers on Sale or Return A/c	Dr.		16,000	
	To Trading A/c				16,000
	(Being the cost of goods sent to customers on sale or return basis not yet approved, adjusted)				

Tutorial Notes :

(1) Alternatively, Sales Account can be debited in place of Return Inwards Account.
(2) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.

Illustration 3

Modern Electrical Ltd. sends electrical heaters costing ₹ 100 each to their customers on Sale or Return. These are, however, treated like actual sales and passed through the Sales Day Book. A few days before the end of financial year, 120 such heaters were sent out at a invoice price of ₹ 150 each. Of these, 10 are accepted by the customers at ₹ 140 each. There was no report as to the rest of the articles. You are required to pass necessary Journal Entries at the end of the accounting period.

Solution **In the books of Modern Electricals Ltd.**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Sales A/c (₹ 10 x 10) Dr. To Sundry Debtors A/c (Being the adjustment for reduction in the selling price of 10 heaters @ ₹ 10 each)		100	100
?	Sales A/c (₹ 150 x 110) Dr. To Sundry Debtors A/c (Note 1) (Being the cancellation of original entry for sale in respect of 110 heaters not yet returned or approved by customers)		16,500	16,500
?	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Being the cost of goods sent to customers on sale or return basis not yet approved, adjusted)		11,000	11,000

Tutorial Note : (1) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.

Illustration 4

Calcutta Company sends out its gas containers to dealers on Sale or Return. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the financial year, 100 gas containers, which cost them ₹ 900 each have been sent to the dealer on 'sale or return' and have been debited to his account at ₹ 1,200 each. Out of this only 20 gas containers are sold at ₹ 1,500 each.

You are required to pass necessary adjustment entries for the purpose of Profit and Loss Account and Balance Sheet.

Solution **In the books of Calcutta Company**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Sundry Debtors A/c Dr. To Sales A/c (Being the adjustment for excess price of 20 gas containers @ ₹ 300 each)		6,000	6,000
?	Sales A/c Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of 80 gas containers @₹ 1,200 each)		96,000	96,000
?	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Being the adjustment for cost of 80 gas containers lying with customers awaiting approval)		72,000	72,000

Illustration 5

P & Co. has credited certain items of sales on Approval aggregating ₹ 10,000 to the Sales Account. Of these, goods to the value of ₹ 3,000 have been returned and taken into stock at cost of ₹ 1,500 though the record of return was omitted in the accounts; and in respect of another parcel of ₹ 1,000 (sale price being cost plus 100%) the period of approval did not expire on the closing date. Show adjustment and correcting entries in the books of the trader.

Solution **In the books of P & Co.**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Return Inwards A/c Dr. To Sundry Debtors A/c (Being the goods returned by customer taken into stock but not recorded in the books of account, now adjusted)		3,000	3,000
	Sales A/c Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of goods not yet approved by the customers)		1,000	1,000

	Stock with Customer on Sale or Return A/c Dr. To Trading A/c (Being adjustment for cost of goods lying with customers awaiting approval)		500	500

Illustration 6

On 1st November, 2017, M/s Tini and Tubai Traders sent goods valuing ₹ 1,50,000 at invoice price to the customers on sale or return basis. On 10th December, goods worth ₹ 40,000 were returned by the customers. On 23rd December, intimation was received that goods worth ₹ 80,000 has been accepted by the customers but at a reduced price of 5% which was agreed by the Traders. The customers could not yet decide anything about the rest of the goods.

Show the journal entries in the books of M/s Tini and Tubai Traders at the end of financial year 31st December, 2017. Goods are invoiced to the customers at 25% above cost.

Solution **In the books of M/s Tini and Tubai Traders**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2017 Dec. 31	Sales A/c (Note 3) Dr. To Sundry Debtors A/c (Being the adjustment for reduction in the selling price @ 5%)		4,000	4,000
	Sales A/c (₹ 1,50,000 – ₹ 40,000 – ₹ 80,000) Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of goods sent to customers on approval basis)		30,000	30,000
	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Note 4) (Being the cost of goods sent to customers, on approval basis not yet approved, adjusted)		24,000	24,000

Working Notes :

(1) It is assumed that goods sent on approval basis was recorded as normal sales.
(2) It is assumed that entries for sale and returned by customers have already been passed.
(3) It is assumed that no entry has been passed for price adjustment in respect of goods accepted by the customers.
(4) Cost of goods with customers = 100/125 × ₹ 30,000 = ₹ 24,000.

Illustration 7

Guha Traders sends out the goods on Sale or Approval to customers and includes the same in sales account. On 31st December, 2017, the stock in hand amounted to ₹ 40,000 and the Sundry Debtors balance stood at ₹ 75,000 which included ₹ 5,000 being invoice value of goods sent on 'sale or return' against which no intimation was received during the year. These goods were sent out at 25% above cost and were sent to S. Dutta — ₹ 2,000 and R. Mitra — ₹ 3,000.

Make necessary adjustment entries and show how these items will appear in the Balance Sheet on 31st December, 2017.

Solution **In the books of Guha Traders**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2017 Dec. 31	Sales A/c (₹ 2,000 + ₹ 3,000) Dr. To Sundry Debtors A/c (Note 1) (Being the cancellation of original entry for sale in respect of goods sent to customers — S. Dutta and R. Mitra, on approval basis)		5,000	5,000
	Stock with Customers on Sale or Return A/c (Note 2) Dr. To Trading A/c (Being the cost of goods sent to customers on approval basis not yet approved, adjusted)		4,000	4,000

Balance Sheet as on 31st December, 2017 [Extract]

Liabilities	₹	Assets	₹	₹
		Sundry Debtors ₹ (75,000 – 5,000)		70,000
		Stock-in-hand	40,000	
		Add : Stock with Customers on Sale or Return	4,000	44,000

Tutorial Notes :

(1) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.
(2) Cost of goods with customers = 100/125 x ₹ 5,000 = ₹ 4,000.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 8

A trader sends out goods on approval basis to customers and include the same in Sales Account. On 31.03.2013 the stock in hand amounted to ₹ 80,000 and the sundry debtors balance stood at ₹ 1,50,000 which included ₹ 10,000 being invoice value of goods sent on 'sale or return' against which no intimation was received during the year. These goods were sent out at 25% above cost and were sent to Mr Amit ₹ 4,000 and Mr Ranjit ₹ 6,000.

Make necessary adjustment entries and show how these items will appear in the Balance Sheet on 31st March, 2013.

[C.U.B,.Com. (General) — 2013]

Solution

In the books of a Trader
Journal

Date	Particulars		Dr. ₹	Cr. ₹
31.3.2013	Sales A/c	Dr.	10,000	
	To Debtors A/c			10,000
	(Being goods sold on approval basis now adjusted)			
	Stock with Customers A/c (₹ 10,000 / 125 x 100)	Dr.	8,000	
	To Trading A/c			8,000
	(Being cost of goods lying with customers now adjusted)			

Balance Sheet as at 31st March, 2013 (included)

Liabilities	₹	Assets		₹
		Debtors	1,50,000	
		Less: Unapproved Sales	10,000	1,40,000
		Stock with Customers		8,000
		Closing Stock		80,000

Illustration 9

A trader sents out goods on approval to some customers and includes the same in the Sales Account. On 31st December, 2010 the Sundry Debtors balance (₹ 2,00,000) includes ₹ 14,000 regarding goods sent on approval against which no intimation was received as on 31st December, 2010. These goods were sent out at 25% above cost price and were sent to A ₹ 8,000 and B ₹ 6,000. Stock-in-trade in godown was valued at ₹ 46,800 on 31st December, 2010.

A sent intimation of acceptance on 31st January, 2011 and B returned the goods on 15th January, 2011.

Pass adjustment entries on 31.12.2010. Show also the entries to be made during January, 2011.

[C.U.B,.Com. (General) — 2011]

Solution

In the books of ...
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
31.12.2010	Sales A/c	Dr.		14,000	
	To Debtors A/c				14,000
	(Being cancellation of original entry for sale in respect of goods lying with customers awaiting approval)				
	Stock with Customers on Sale or Return A/c	Dr.		11,200	
	To Trading A/c (Note 1)				11,200
	(Being the adjustment for cost of goods lying with customers awaiting approval)				
31.3.2011	Debtors A/c	Dr.		8,000	
	To Sales A/c				8,000
	(Being goods costing ₹ 6,400 sent to Mr. A on sale or return basis has been accepted by him)				

Notes :

(1) Cost of goods lying with customers = (14,000 / 125) × 100 = ₹ **11,200**.

(2) No entry is required on 15.1.2011 for goods returned by B. Goods should be included physically in the stock-in-trade.

Illustration 10

A & Co. sends out goods on approval to a few customers and includes the same in the Sales Account. On 31.3.2015 the Sundry Debtors balance stood at ₹ 1,00,000 which included ₹ 7,000 goods sent on approval against which no intimation was received during the year. These goods were sent out at 25% over and above cost price and were sent to Mr. X — ₹ 4,000 and Mr. Y — ₹ 3,000.

Mr. X sent intimation of acceptance on 30th April and Mr. Y returned the goods on 10th April, 2015.

Make the adjustment entries and show how these items will appear in the Balance Sheet on 31st March, 2015. Show also the entries to be made during April, 2015. Value of closing stock as on 31st March, 2015 was ₹ 60,000.

[I.C.W.A. (Inter) — Adapted]

Solution

In the books of A & Co.
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 March 31	Sales A/c Dr. To Sundry Debtors A/c (Note 1) (Being the cancellation of original entry for sale in respect of goods lying with customers awaiting approval)		7,000	7,000
March 31	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Note 2) (Being the adjustment for cost of goods lying with customers awaiting approval)		5,600	5,600
April 30	Sundry Debtors A/c Dr. To Sales A/c (Being goods costing ₹ 3,200 sent to Mr. X on sale or return basis has been accepted by him)		4,000	4,000

Balance Sheet of A & Co. as on 31st March, 2015

Liabilities	₹	Assets	₹	₹
		Sundry debtors (₹ 1,00,000 – ₹ 7,000)		93,000
		Stock-in-trade	60,000	
		Add : Stock with customers on Sale or Return	5,600	65,600
				1,58,000

Tutorial Notes :

(1) Alterantively, Debtors Suspense Account may be credited in place of Sundry Debtors Account.

(2) Cost of goods lying with customers = 100/125 x ₹ 7,000 = ₹ 5,600.

(3) No entry is required on 10th April, 2017 for goods returned by Mr. Y. Goods should be included physically in the stock-in-trade.

(ii) When the Business Sends Goods Frequently on Sale or Return

When the number of transactions are moderate, a separate specially ruled Sale or Return Day Book is maintained to incorporate all the relevant details relating to Sale or Return transactions. This Day Book is divided into 4 main columns — (1) Goods Sent on Approval; (2) Goods Returned; (3) Goods Approved; and (4) Balance.

At the time of sending the goods on a sale or return basis, all information is recorded in the first column. It is a memorandum record and nothing is transferred to the actual books of account.

When goods are returned by the customers, it is recorded in the second column. It is also a memorandum record and nothing is transferred to the actual books of account.

When goods are approved, it is recorded in the third column. A periodical total of this column is credited to Sales Account in the General Ledger. In the Debtors Ledger the respective Customers' Account is debited.

In the fourth column, the balance of goods at invoice price is recorded. It represents the balance of goods with customers, awaiting approval.

The balance amount is calculated as follows:

Balance Value of Goods Sent on Sale or Return
Less Value of Goods Returned
Less Value of Goods approved.

At the time of preparing the Final Accounts, an adjustment entry is required for these goods which is as follows:

Goods with Customers on Sale or Return Account Dr. [Cost or market price, whichever is lower]
To Trading Account

The format of this Sale or Return Book is given below:

Sale or Return Day Book

Date	(1) Goods Sent on Approval		(2) Goods Returned		(3) Goods Approved			(4) Balance	
	Particulars	₹	Particulars	₹	Particulars	S.L. Folio	₹	Value (₹)	Remarks

No entry is made from this column in the General Ledger or Debtors Ledger

No entry is made from this column in the General Ledger or Debtors Ledger

Entry for sale is made in the General Ledger as well as in the Debtors Ledger

Cost or market price whichever is lower is adjusted at the time of preparing the Final Accounts, debiting Stock with Customers on Sale or Return Account and crediting Trading Account

(iii) When the Business Sends Goods Numerously on Sale or Return

When the transactions are numerous, a business maintains the following books : (a) Sale or Return Day Book; (b) Sale or Return Day Book; and (c) Sale or Return Ledger. It is important to remember is that these are all ***Memorandum Books***.

In this case, when the goods are sent to the customers on a sale or return basis, they are recorded in the Sale or Return Day Book. Thereafter, in the Sale or Return Ledger, all the customers are individually debited and the Sale or Return Account is credited with the periodical total of the Sale or Return Day Book.

When the goods are returned by the customers within the specified time, they are recorded initially in the Sale or Return Day Book. Thereafter, in the Sale or Return Ledger, the Sale or Return Account is debited with the periodical total of the Sale or Return Day Book and the individual customers are credited. The above records are all memoranda and hence can not find a place in the regular books.

When the business receives information about the acceptance of the goods or no intimation is received within the specified time, they are recognised as sales and are recorded in the original Sales Day Book. Periodically, the total of the Sales Day Book is credited to Sales Account and debited to the Individual Customers Account. To cancel the earlier memoranda entries, individual customers are credited and the Sale or Return Account is debited. The entries for the approved goods are shown below :

In the Memorandum Sale or Return Ledger		In the Regular General Ledger	
Sale or Return Account	Dr.	Individual Customer's Account	Dr.
To Individual Customer's Account		To Sales Account	

At the year end, in the Sale or Return Ledger, the sum of the debit balances of the Individual Customers' Account must be equal to the credit balance of the Sale or Return Account. It represents stock with customers awaiting approval at invoice price. To adjust the cost of such goods with customers in the Final Accounts, the following entry is passed :

Stock with Customers on Sale or Return Account Dr. [Cost or market price, whichever is less]
To Trading Account

Illustration 11

Hindusthan Automobiles Ltd. sent out motor cars on Sale or Return. They maintained a separate set of books for this type of business. During the month of April, 2015 they sent out motor cars on Sale or Return as follows:

2015	Name of the Customers	₹	2015	Remarks
April 2	Y & Co. Ltd.	1,00,000	April 7	Returned
April 16	X & Co. Ltd.	1,50,000	April 20	Retained
April 20	Y & Co. Ltd.	1,60,000	April 25	Returned
April 28	Y & Co. Ltd.	2,00,000		No intimation recd. as to approval and car not yet returned

Show Day Books and Ledger Accounts. ***[I.C.W.A. — Adapted]***

Solution

[Memorandum Records]
Sale or Return Day Book

Date	Particulars	Folio No.	Amount (₹)
2015 April 2	Y & Co. Ltd.		1,00,000
April 16	X & Co. Ltd.		1,50,000
April 20	Y & Co. Ltd.		1,60,000
April 28	Y & Co. Ltd.		2,00,000
	TOTAL		6,10,000

Sale or Return Sold and Returned Day Book

Date	Particulars	Sale or Return L.F.	Sales L.F.	Goods Sold ₹	Goods Returned ₹
2015 April 7	Y & Co. Ltd.			—	1,00,000
April 20	X & Co. Ltd.			1,50,000	—
April 25	Y & Co. Ltd.			—	1,60,000
	TOTAL			1,50,000	2,60,000

Sale or Return Ledger

Dr. Sale or Return Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 April 30	To Sundries : Sales	1,50,000	2015 April 30	By Sundries : (Goods sent on sale or return basis)	6,10,000
April 30	To Sundries : Returned	2,60,000			
April 30	To Balance c/d	2,00,000			
		6,10,000			6,10,000
			May 1	By Balance b/d	2,00,000

Dr. Y & Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 April 2	To Sale or Return A/c	1,00,000	2015 April 7	By Sale or Return A/c	1,00,000
April 20	To Sale or Return A/c	1,60,000	April 25	By Sale or Return A/c	1,60,000
		2,60,000			2,60,000

Dr. X & Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 April 16	To Sale or Return A/c	1,50,000	2015 April 20	By Sale or Return A/c	1,50,000
April 28	To Sale or Return A/c	2,00,000		By Balance c/d	2,00,000
		3,50,000			3,50,000
May 1	To Balance b/d	2,00,000			

Tutorial Note : Balance of Sale or Return Account represents goods with customers on Sale or Return at invoice price, awaiting approval.

Illustration 12

A firm sends goods on sale or return basis. Customers having the choice of returning the goods within a month.

During May 2017, the following are the details of goods sent :

Date (May)	2	8	12	18	20	27
Customers	P	B	Q	D	E	R
Value (₹)	15,000	20,000	28,000	3,000	1,000	26,000

Within the stipulate time, P and Q returned the goods and B, D and E signified that they have accepted the goods. Show in the books of the firm, the Sale or Return Account and Customers for Sale or Return Account on 15th June, 2017.

Solution

Dr. Sale or Return Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 May 31	To Sundries : Sales	24,000	2017 May 31	By Sundries (Goods sent on sale or return basis)	93,000
June 15	To Sundries : Returned	43,000			
June 15	To Balance c/d	26,000			
		93,000			93,000
			June 16	By Balance b/d	26,000

Dr. **P Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 2	To Sale or Return A/c	15,000	2017 May ?	By Sale or Return A/c	15,000

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 8	To Sale or Return A/c	20,000	2017 May ?	By Sale or Return A/c	20,000

Dr. **Q Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 12	To Sale or Return A/c	28,000	2017 May ?	By Sale or Return A/c	28,000

Dr. **D Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 18	To Sale or Return A/c	3,000	2017 May ?	By Sale or Return A/c	3,000

Dr. **E Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 20	To Sale or Return A/c	1,000	2017 May ?	By Sale or Return A/c	1,000

Dr. **R Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 May 27	To Sale or Return A/c	26,000	2017 May 15	By Balance c/d	26,000
June 16	To Balance b/d	26,000			

Key Points

- A contract of goods on sale or return permits the buyer to return the goods for a full refund (then cash is received) or allow for an adjustment to be made to the amount owed.
- The ownership is passed only when the retailer gives his approval or if the goods are not returned within that specified period.
- Under a sale or return agreement, revenue is not recognised from the sale until all of the following criteria are met:
  (1) The sales price is fixed or determinable at the date of sale.
  (2) The buyer has paid or will pay the seller, and the obligation is not contingent upon resale of the product.
  (3) The buyer's obligation to the seller would not be changed by theft or damaged to the merchandise.
  (4) The buyer has an economic substance apart from the seller.
  (5) The seller does not have sufficient obligations for future performance to directly bring about the resale of the product by the buyer.

THEORETICAL QUESTIONS

1. If the goods are sent on sale or approval basis, when will the sale take place or the property in the goods passes to the buyer ?
2. Under a sale or return agreement, when revenue is recognised ?
3. What are the benefits of selling goods on sale or approval basis ?

OBJECTIVE QUESTIONS

Multiple choice

Select the best choice to complete each statement or answer each question below :

1. Under a sale or return basis, when goods are transferred from wholeseller to retailer, it implies a change
   A in the possession of the goods only
   B in the ownership of the goods
   C in the possession and the ownership of goods

2. Under a sale or return basis, the property in the goods passes to the buyer
   A when he gives his approval subject to certain conditions
   B when he gives his approval unconditionally
   C when a bill receivable is accepted
3. Goods sent on sale or return basis are beneficial to the
   A seller only
   B buyer only
   C seller and the buyer
4. Under sale or return agreement, revenue is recognised
   A at the time of delivery of goods
   B when the buyer signifies his approval but sale price has not be fixed
   C when the buyer signifies his approval and the sale price has been fixed
5. When the transaction are few, the seller, while sending the goods on sale or return basis treats them as
   A ordinary sale
   B no sale
   C profit

PRACTICAL QUESTIONS

1. A Gas Company sends out its gas stoves to dealers on Sale or Return. All such transactions are, however, treated like actual sales and are passed through the Day Book. Just before the end of the financial year, 100 stoves which cost them ₹ 150 each, are sent to a dealer on sale or return and are debited to his account at ₹ 200 each out of which only 20 stoves are sold at ₹ 180 each.
   Show Journal Entries to adjust these transactions for the purpose of Company's Profit and Loss Account and Balance Sheet.
2. X Ltd. sends out its gas stoves to dealers on Sale or Return. All such transactions are, however, treated like actual sales and are passed through the Day Book. Just before the end of the financial year, 100 stoves, which cost them ₹ 150 each, are sent to a dealer on Sale or Return and are debited to his account at ₹ 200 each, out of which only 20 stoves are sold at ₹ 220 each. Show the entries in the Journal of the Company to adjust these transactions for the purpose of preparing the Final Accounts for the year ended December 31, 2017.
3. In preparing the final accounts of a company it is found that Sundry Debtors of ₹ 42,000 includes ₹ 4,000 representing price of goods sent out on approval for which the date of return has not yet expired.
   Give the adjustment entries assuming that the goods were invoiced at a price of 25% above cost. How will the related items appear in the Balance Sheet of the Company ?
4. A merchant sells goods to his customers on "sale or return" basis treating all such transactions as actual sale at the time of despatch. On 10.12.2017, just before the end of accounting year on 31.12.2017, the merchant sent some goods costing ₹ 6,000 at 20% profit on sale, and was passed through Sales Day Book. Out of these, goods to the value of ₹ 2,000 have been returned on 15.12.2017. The merchant received sales approval from customers on 20.12.2017 for goods valued at ₹ 2,000. For the remaining goods with the customers, approval was pending on 31.12.2017. Record the transactions in the books of the merchant.
5. Messrs. Sound of Music supplied goods on Sale or Return basis, the particulars of which are as under:

Date of Despatch	Customer's Name	Amount (₹)	Other Particulars
2015 March, 10	ABC Co.	2,600	2015 March 14 — Returned
March 15	XYZ Co.	3,400	17 — Retained
March 20	PQR Co.	1,900	25 — Goods worth ₹ 800 returned
March 27	XYZ Co.	2,200	No intimation till 31.03.2015
March 28	PQR Co.	1,700	-do-

   The books of Messrs. Sound of Music are closed on 31st March each year.
   You are required to show Day Books and Ledger Accounts. ***[C.A. (Inter) — Adapted]***
6. A Mehta who keeps a special set of books for this type of business sends out goods on sale or return as follows :

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	B. Bose	500	4.1.2015	All retained	
9.1.2015	C. Chatterjee	250	10.1.2015	Returned	150
				Retained	100
16.1.2015	D. Dutta	700	19.1.2015	All retained	

23.1.2015	C. Chatterjee	250	25.1.2015	All returned	
30.1.2015	B. Bose	400		No intimation received as to sale and	
31.1.2015	E. Edward	500		goods not yet returned	

Show Day Books, Goods on Sale or Return Account, and Ledger Accounts for January, 2015.
What does the balance on the Sale or Return Account represent ?

7. Modern Furnitures Ltd. sends plastic chairs and tables to the retailers on sale or return basis. These are, however, treated like actual sales and passed through Sales Day Book. In the month of March, 2017, 400 chairs @ ₹ 300 and 200 tables @ ₹ 400 were sent out to M/s North Bengal Furniture on sale or return basis. Till 31st March, 2017, 350 chairs and 150 tables were sold by M/s North Bengal Furniture. The cost of each chair is ₹ 250 and table ₹ 350.
The remaining chairs and tables were lying with the customer.
You are required to pass necessary Journal Entries at the end of the accounting period endng on 31st March, 2017).
[I.C.W.A. (Inter) — Adapted]

Guide to Answers

Multiple Choice

1. A 2. B 3. C 4. C 5. A.

Practical Questions

1. **Invoice value of goods not yet approved — ₹ 16,000; Customers are to be credited for price change — ₹ 400; Cost of goods with customers on Sale or Return — ₹ 12,000.**
2. **Invoice value of goods not yet approved — ₹ 16,000; Customers are to be debited for excess price charged — ₹ 400; Cost of goods with customers on Sale or Return — ₹ 12,000.**
3. **Cost of goods with customers on approval — ₹ 3,200.**
7. **Cost of goods with customers on approval :**

	₹
Chairs : 50 × ₹ 250	**12,500**
Tables : 50 × ₹ 350	**17,500**
	30,000

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Self-Balancing Ledger

Classification of Ledgers

In the case of a small business, all the accounts can be accommodated in one ***single ledger***. For a big business, when numerous transactions take place every day and a number of book-keepers are to work at the same time, it becomes necessary to maintain several ledgers. Therefore, in such a case, ledgers are subdivided into various categories. The division of the ledgers will vary according to the nature and size of the business, but the broadest division is as follows :

(i) Creditors Ledger/Bought Ledger: This ledger contains the accounts of all the creditors for goods purchased. Entries are made in this ledger mainly from Purchases Day Book, Cash Book, Return Outward Book and Bills Payable Book, etc.

(ii) Debtors Ledger/Sales Ledger: This ledger contains the accounts of all debtors for goods sold. Entries are made in this ledger mainly from Sales Day Book, Cash Book, Return Inward Book and Bills Receivable Book, etc.

(iii) General Ledger: This ledger contains all other accounts. It is used to denote all ledgers, other than Debtors Ledger and Creditors Ledger, however subdivided. In this context, it should be noted that Cash Book which functions as a Cash Account is deemed to be a part of the General Ledger.

When General Ledger, Creditors Ledger and Debtors Ledger are maintained by a concern, quite often, the debit and credit entries relating to a transaction are posted in different ledger. For example, goods sold to X for ₹. 5,000 on credit. X Account will be debited in the Debtors Ledger but the corresponding credit will be made in the Sales Account appearing in the General Ledger. Similarly, goods purchased on credit from Y for ₹. 4,000. Purchase Account will be debited in the General Ledger but the corresponding credit will be made in the Y Account appearing in the Creditors Ledger.

If the above two transactions are posted in the respective ledgers, it will appear as follows :

In the General Ledger

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			?	By X Account	5,000

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Y Account	4,000			

In the Debtors Ledger

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sales Account	5,000			

In the Creditors Ledger

Dr. **Y Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			?	By Purchases Account	4,000

In this case, if we want to prove the accuracy of posting of any one ledger, it will be necessary to take out the balances of all accounts of all the ledgers (General Ledger, Debtors Ledger and Creditors Ledger); a small mistake in one ledger will lead to checking of the balances of all the ledgers.

In such a situation, the detection and rectification of the error involves considerable labour and time. Sometimes, it may delay the preparation of the Final Accounts.

To minimize the trouble and time, sometimes the system of ***Sectional Balancing*** or ***Self-Balancing*** of Ledger is employed.

Sectional Balancing System

Under this system, in the General Ledger, two additional accounts

(i) Total Debtors Account / Sales Ledger Control Account / Debtors Ledger Control Account; and

(ii) Total Creditors Account / Purchases Ledger Control Account / Creditors Ledger Control Account are kept, so that double entry is completed in the General Ledger itself.

The customers', and suppliers' individual accounts are kept in the respective ledgers.

At the end of each month, the total of Sales Day Book will be debited to 'Total Debtors Account' and credited to 'Sales Account' in the General Ledger — thus completing double entry in the General Ledger itself. Similarly, total amount received from customers, total discount allowed to them, total returns inwards, total bills receivable will be credited to 'Total Debtors Account' and debited to the respective accounts appearing in the General Ledger.

Again, the monthly total of Purchases Day Book will be credited to 'Total Creditors Account' and debited to 'Purchases Account' in the General Ledger. Similarly, total amount paid to creditors, total discount received from them, total returns outwards, total bills payable accepted will be debited to Total Creditors Account and credited to the respective accounts in the General Ledger.

In the 'Debtors Ledger' individual customer's account is debited with credit sales and credited with payments, discount allowed, bills receivable, etc. Similarly in the 'Creditors Ledger' individual supplier's account is credited with credit purchases and debited with payments, discount received, bills payable, etc.

The accuracy of individual customer's account can be checked by comparing the total of their balance with balances of the ***Total Debtors Account*** in General Ledger.

In the same manner, the accuracy of individual supplier's account can be checked by comparing the total of their balance with the balance of the ***Total Creditors Account***.

The summaries of entries are shown below :

Books of Original Entry	General Ledger	Debtors Ledger
Sales Day Book **Cash Book Credit** (For noting charges as cheques dishonoured) **Journal Proper** (for interest etc.)	Total Debtors Account Dr. To Sales Account To Cash Account To Interest Account etc.	Individual customer's account is debited for each item.
Sales Returns Book **Bills Receivable Book** **Cash Book Debit** (Discount allowed) **Journal Proper** (for bad debts)	Sales Returns Account Dr. Cash Account Dr. Discount Allowed Account Dr. Bad Debts Account Dr. To Total Debtors Account	Individual customer's account is credited for each item.

Books of Original Entry	General Ledger	Creditors Ledger
Purchases Day Book **Cash Book Debit** (for other charges, allowances, etc.) **Journal Proper** (for overdue interest)	Purchases Account Dr. Cash Account Dr. Interest Account Dr. To Total Creditors Account	Individual supplier's account is credited for each item.
Purchases Returns Book **Bills Payable Book** **Cash Book Credit** **Journal Proper** (for allowances)	Total Creditors Account Dr. To Purchases Returns Account To Bills Payable Account To Cash Account To Discount Received Account	Individual supplier's account is debited for each item.

Students should note that, under this system, double entry will be completed only in the General Ledger and Trial Balance can be prepared for General Ledger only. No Trial Balance can be prepared in the Debtors Ledger or Creditors Ledger.

Temporary Adverse Balances

It must be noted that, in practice, Debtors Ledger may contain a few accounts showing credit balances (e.g., where allowances are made for defective goods or empties are returned by the customers after full payment has been made). In such a situation, balances should be brought down on both sides of the 'Total Debtors Account' in respect of the total debit balances and the total credit balances. Likewise, the 'Total Creditors Account' may have both balances . For example, advance payment made to the suppliers for the goods to be received in future or allowances to be received for defective goods or empties return after full payment.

Debtors Ledger Control Account / Total Debtors Account will contain the totals of :

Sl.No.	Debit side	Sl.No.	Credit side
1.	Opening debit balances	1.	Opening credit balances (if any)
2.	Credit sale made during the period	2.	Cash and cheque received from debtors during the year
3.	Dishonoured bills and cheques (if any)	3.	Discount allowed to debtors
4.	Cash paid to debtors (if any)	4.	Returns inwards and allowances
5.	Transfer (if any)	5.	Bills receivables
6.	Other items (if any)	6.	Bad debt written-off
		7.	Transfer (if any)
		8.	Other items (if any)

Creditor Ledger Control Account / Total Creditors Account will contain the totals of :

Sl.No.	Debit side	Sl.No.	Credit side
1.	Opening debit balances (if any)	1.	Opening credit balances
2.	Cash and cheque paid to creditors during the period	2.	Credit purchase of goods during the period
3.	Returns outwards	3.	Bills payable renewed
4.	Discount received	4.	Bills payable dishonoured
5.	Bills payable	5.	Transfer (if any)
6.	Transfer (if any)	6.	Other items (if any)
7.	Other items (if any)		

It is to be noted that at any time :

(i) the balance in the Debtors Control Account should be equal to the total balances of individual debtors.

(ii) the total balance in the Creditors Control Account should be equal to the balances of individual creditors.

Purposes of Using Control Accounts

The various purposes of using Control Accounts are as follows :

1. Control accounts provide a check on the accuracy of entries made in the personal accounts in the Debtors ledger as well in the Creditors ledger. Regular comparison of the balances on the Debtors Control Account with the total of Individual Personal Account balances in the Debtors ledger will help to detect if any errors have occurred. Similarly, comparison of the balances on the Creditors Control Account with the total of Individidial Personal Account balances in Creditors ledger will help to detect if any errors have occurred.

2. Control accounts assist in locating the errors. A regular comparison of the balances of the Control Accounts with individual balances will quickly fix up the errors. This means that the volumes of transactions to be checked will be lowered and this will make it easier to locate errors.
3. Control accounts can assist in speeding up the preparation of final accounts by providing the total debtors and total creditors balances.
4. Control accounts can be used to calculate missing figures. For example, if we know the opening debtor balance and closing debtors balance and the amount collected from debtors during the accounting period, we can calculate the amount of credit side.
5. Control accounts provide an internal check. The staff posting the entries to the Control Accounts will act as a check on different staff(s) posting entries in the Debtors ledger and Creditors ledger.

Illustration 1

The Balance Sheet of H on 1st January 2017 disclosed the following assets and liabilities.

Liabilities	₹	Assets	₹
Capital	4,00,000	Freehold Premises	2,00,000
Total Creditors	1,00,000	Furniture & fittings	50,000
		Stock-in-trade	40,000
		Total Debtors	60,000
		Cash at bank	1,00,000
		Cash in hand	50,000
	5,00,000		5,00,000

List of Debtors : X ₹ 30,000; Y ₹ 20,000; Z ₹ 10,000.

List of Creditors : A ₹ 40,000; B ₹ 30,000; C ₹ 30,000

Mr. H. keeping his ledgers under Sectional Balancing System. You are required to enter the following transactions in the proper subsidiary books, post them in the respective ledger and extract a Trial Balance for General Ledger as on 31st January 2017. The following transactions occurred during the month of January, 2017:

Jan.		₹	Jan.		₹
2	Bought goods from A	20,000	25	Bought goods from B	10,000
3	Paid to C by cheque	10,000	26	Sold goods to Z	10,000
8	Sold goods to X	25,000	28	Paid rent in cash	1,000
16	Received a cheque from Z	8,000	30	Paid to A by cheque	30,000
20	Bought goods from C	15,000	31	Paid to B by cheque	12,000
24	Sold goods to Y	11,000	31	Paid salary in cash	2,000

Solution

Sales Day Book

Date	Particulars	Outward Invoice	L.F.	Details ₹	Total ₹
8.1.2017	X				25,000
24.1.2017	Y				11,000
26.1.2017	Z				10,000
					46,000

In the General Ledger :

Total Debtors Account Dr. ₹. 46,000

To Sales Account ₹. 46,000

Purchases Day Book

Date	Particulars	Inward Invoice	L.F.	Details ₹	Total ₹
2.1.2017	A				20,000
20.1.2017	C				15,000
25.1.2017	B				10,000
					45,000

In the General Ledger :

Purchases Account Dr. ₹. 45,000

To Total Creditors Account ₹. 45,000

Dr. Cash Book (without narration) Cr.

Date	Particulars	Cash ₹	Bank ₹	Date	Particulars	Cash ₹	Bank ₹
2017				2017			
Jan. 1	To Balance b/d	50,000	1,00,000	Jan. 3	By C A/c	—	10,000
Jan. 16	To Z A/c	—	8,000	Jan. 28	By Rent A/c	1,000	—
				Jan. 30	By A A/c	—	30,000
				Jan. 31	By B A/c	—	12,000
				Jan. 31	By Salary A/c	2,000	—
				Jan. 31	By Balance c/d	47,000	56,000
		50,000	1,08,000			50,000	1,08,000

General Ledger

Dr. Freehold Premises Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	2,00,000	31.1.2017	By Balance c/d	2,00,000

Dr. Furniture & Fittings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	50,000	31.1.2017	By Balance c/d	50,000

Dr. Stock-in-Trade Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	40,000	31.1.2017	By Balance c/d	40,000

Dr. Total Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	60,000	31.1.2017	By Bank A/c (Z)	8,000
31.1.2017	To Sales A/c	46,000	31.1.2017	By Balance c/d	98,000
		1,06,000			1,06,000

Dr. Total Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Bank A/c (C ₹ 10,000; A ₹ 30,000; B ₹ 12,000)	52,000	1.1.2017	By Balance b/d	1,00,000
	To Balance c/d	93,000	31.1.2017	By Purchases A/c	45,000
		1,45,000			1,45,000

Dr. Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	4,00,000	31.1.2017	By Balance c/d	4,00,000

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Balance b/d	46,000	31.1.2017	By Total Debtors A/c	46,000

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Total Creditors A/c	45,000	31.1.2017	By Balance c/d	45,000

Dr. Rent Account Cr.

Date	Particulars	₹	Date	Particulars	₹
28.1.2017	To Cash A/c	1,000	31.1.2017	By Balance c/d	1,000

Dr. Salary Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Salary A/c	2,000	31.1.2017	By Balance c/d	2,000

Trial Balance of H as at 31st January, 2017

S.N.	Head of Accounts	L.F.	Dr. ₹	Cr. ₹
1.	Freehold Premises		2,00,000	
2.	Furniture and Fittings		50,000	
3.	Stock-in-trade		40,000	
4.	Total Debtors		98,000	
5.	Cash at Bank		56,000	

6.	Cash in hand		47,000	
7.	Total creditors			93,000
8.	Capital Account			4,00,000
9.	Sales			46,000
10.	Purchases		45,000	
11.	Rent		1,000	
12.	Salary		2,000	
	TOTAL		5,39,000	5,39,000

Debtors Ledger

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	30,000	31.1.2017	By Balance c/d	55,000
8.1.2017	To Sales A/c	25,000			
		55,000			55,000

Dr. **Y Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	20,000	31.1.2017	By Balance c/d	31,000
24.1.2017	To Sales A/c	11,000			
		31,000			31,000

Dr. **Z Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	10,000	16.1.2017	By Bank A/c	8,000
26.1.2017	To Sales A/c	10,000	31.1.2017	By Balance c/d	12,000
		20,000			20,000

Creditors Ledger

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.1.2017	To Bank A/c	30,000	1.1.2017	By Balance b/d	40,000
31.1.2017	To Balance c/d	30,000	2.1.2017	By Purchases A/c	20,000
		60,000			60,000

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Bank A/c	12,000	1.1.2017	By Balance b/d	30,000
31.1.2017	To Balance c/d	28,000	25.1.2017	By Purchases A/c	10,000
		40,000			40,000

Dr. **C Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
3.1.2017	To Bank A/c	10,000	1.1.2017	By Balance b/d	30,000
31.1.2017	To Balance c/d	35,000	20.1.2017	By Purchases A/c	15,000
		45,000			45,000

Check :		Total Debtors (₹)		Total Creditors (₹)
	X	55,000	A	30,000
	Y	31,000	B	28,000
	Z	12,000	C	35,000
TOTAL		98,000		93,000

Illustration 2

From the following information, prepare a Total Debtors Account as appearing in the General Ledger in the Books of M/s Singh and Company:

Debit balance as on 1.7.2016, ₹ 87,200; Credit balance as on 1.7.2016 in Debtors Account ₹ 600.

Transactions during 6 months ended on 31.12.2016 : Total sales were ₹ 94,000 including cash sales of ₹ 4,000. Debtors whose balance were in credit were paid off ₹ 600. Payments received by cheques from Debtors ₹ 60,000; Payments received by cash from Debtors ₹ 48,000; Payment received by bills receivable ₹ 26,000.

Bills receivable received from Debtors were dishonoured for ₹ 6,000 and noting charges of ₹ 60 were paid. Cheques received from customers were dishonoured for ₹ 800. Out of bills receivable received and included in ₹ 26,000 above, bills of ₹ 5,000 were endorsed to suppliers.

Bad debts written-off during the period were ₹ 1,000. Discount allowed for prompt payment were ₹ 700 and bad debts written off in 2014 and now recovered from debtors amounted to ₹ 900.

Interest debited for delay in payments were ₹ 1,250. On 31.12.2016 provision for doubtful debts was created for ₹ 2,100.

M/s Trade Syndicates Account appeared in Debtors Ledger and also in Creditors Ledger. The balance in Creditors Ledger was ₹ 900 and the same was transferred to Debtors Ledger. Goods of ₹ 2,760 were rejected by the customers.

Solution **In the General Ledger of M/s. Singh & Company**

Dr. **Total Debtors Accounts** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.7.2016	To Balance b/f	87,200	1.7.2016	By Balance b/f	600
31.12.2016	To Sales (₹ 94,000 – ₹ 4,000)	90,000	31.12.2016	By Bank	60,000
"	To Cash	600	"	By Cash	48,000
"	To Bills Receivable (dishonoured)	6,000	"	By Bills receivable	26,000
"	To Bank (noting charges)	60	"	By Bad debts	1,000
"	To Bank (cheque dishonoured)	800	"	By Discount allowed	700
"	To Interest	1,250	"	By Total Creditors A/c – Transfer	900
			"	By Sales Return	2,760
			"	By Balance c/d	45,950
		1,85,910			1,85,910

Tutorial Notes :

(1) Bad debts of 2014 recovered in 2016 will not appear in the Total Debtors Account. It should be credited to Profit and Loss Account.

(2) Bills Receivable of ₹ 5,000 endorsed to suppliers has nothing to do with Total Debtors Account, because at the time of endorsement, Suppliers Account is debited and Bills Receivable Account is credited.

Illustration 3

The following details were extracted from the books of a company for the 6 months ended 31.3.2017 (all figures in ₹):

Debtor balances total on 1.10.2016	1,927	Purchases returns	182
Supplier balances total on 1.10.2016	1,215	Interest charged to debtors	5
Cash paid to suppliers	7,613	Debtor's cheque dishonoured	76
Cash received from debtors	12,993	Discount allowed	356
Purchases	8,849	Bills payable accepted (including renewals)	891
Discount received	286	Bills payable withdrawn upon renewal	200
Bad debts written-off	56	Interest on bills payable renewed	3
Sales returns	93	Sales	13,308

The total of the balances extracted from the Trade Ledgers on 31.3.2017 were : Sales Ledger ₹ 1,808; Bought Ledger ₹ 1,290.

Prepare Total Debtors Account and Creditors Account from the details given above and show whether the balance agree with the balances per schedule as extracted from the Trade Ledgers as on 31.3.2017.

Solution

Dr. **Total Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.10.2016	To Balance b/d	1,927	31.3.2017	By Cash	12,993
31.3.2017	To Interest charged	5	"	By Bad debts	56
"	To Bank (cheque dishonoured)	76	"	By Sales returns	93
"	To Sales (credit)	13,308	"	By Discount allowed	356
			"	By Balance c/d	1,818
		15,316			15,316

Dr. **Total Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2017	To Cash	7,613	1.10.2016	By Balance b/f	1,215
"	To Discount received	286	31.3.2017	By Purchases	8,849
"	To Purchases returns	182	"	By Bills payable (renewed)	200
"	To Bills payable	891	"	By Interest on bills payable (renewed)	3
"	To Balance c/d	1,295			
		10,267			10,267

31.3.2017	Debtors balance as per schedule	1,808	31.3.2017	Creditors balance as per schedule	1,290
	Debtors bal. as per Total Account	1,818		Creditors bal. as per Total Account	1,295
	Difference	10		Difference	5

From the above, it is clear that the total accounts do not agree with the balance as per schedule.

Illustration 4

Modern Traders operates a computerised accounting system for its debtors and creditors ledgers. The control accounts for the month of March 2017 are in balance and incorporate the following totals :

Debtors Ledger :		**Creditors Ledger :**	
Balance at 1 March, 2017	₹	Balance at 1 March, 2017	₹
Debit	3,86,430	Credit	1,84,740
Credit	190	Debit	520
Sales	1,63,194	Purchases	98,192
Cash received	1,58,288	Cash paid	1,03,040
Discount allowed	2,160	Discount received	990
Returns inwards	590	Returns outwards	1,370
Credit balance at 31 March, 2017	370	Debit balance at 31 March, 2017	520

Although the control accounts agree with the underlying ledgers, a number of errors have been found, and there are also several adjustments to be made. These errors and adjustments are detailed below:

(1) Four sales invoices totalling ₹ 1,386 have been omitted from the records.

(2) A cash refund of ₹ 350 paid to a customer, A Sen, was mistakenly treated as a payment to a supplier with the same name.

(3) A contra settlement offsetting a balance of ₹ 870 due to supplier against the debtors ledger account for the same party is to be made.

(4) Bad debts totalling ₹ 1,360 are to be written-off.

(5) During the month, a settlement was reached with a supplier over a disputed account. As a result, the supplier issued a credit note for ₹ 2,000 on March 26. No entry has yet been made for this.

(6) A purchases invoice for ₹ 1,395 was keyed in as ₹ 1,359.

(7) A payment of ₹ 2,130 to a supplier, B Rao, was mistakenly entered to the account of R Rao.

You are required to : (i) prepare the Debtors Ledger Control Accounts; (ii) prepare Creditors Ledger Control Accounts; as they should appear after allowing, where necessary, for the errors and adjustments listed above.

Solution

Dr. **Debtors Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2017	To Balance b/d	3,86,430	1.3.2017	By Balance b/d	190
31.3.2017	To Sales (₹ 1,63,194 + 1,386)	1,64,580	31.3.2017	By Cash	1,58,288
	To Creditors Ledger Control A/c (Refund)	350		By Discount Allowed	2,160
	To Balance c/d	370		By Bad Debts	1,360
				By Returns Inwards	590
				By Creditors Ledger Control A/c (Transfer)	870
				By Balance c/d	3,88,272
		5,51,730			5,51,730

Dr. **Creditors Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2017	To Balance b/d	520	1.3.2017	By Balance b/d	1,84,740
31.3.2017	To Cash	1,03,040	31.3.2017	By Purchases (₹ 98,192 + 36)	98,228
	To Discount Received	990		By Debtors Ledger Control A/c (Refund)	350
	To Allowances	2,000		By Balance c/d	520
	To Debtors Ledger Control A/c (Transfer)	870			
	To Returns Outwards	1,370			
	To Balance c/d	1,75,048			
		2,83,838			2,83,838

Self-Balancing System

When ledgers are kept under Sectional Balancing System, the double entry is not completed in the Debtors Ledger and Creditors Ledger. As a result, no Trial Balance can be prepared from these ledgers.

Self-Balancing is a system of ledgers keeping by means of which each ledger can be balanced independently with the other ledgers. Under this system, a 'General Ledger Adjustment Account' is prepared in the Debtors Ledger as well as in the Creditors Ledger to complete double entry in these ledgers. In the General Ledger, double entry is completed by preparing the following two accounts :

(i) Debtors Ledger Adjustment Account (in reality Total Debtors Account)

(ii) Creditors Ledger Adjustment Account (in reality Total Creditors Account).

Now, we explain the procedures for passing entries in the different Ledgers and Adjustment Accounts from the various books of original entry.

1. Books of Original Entry used for Self Balancing Debtors Ledger

(a) Sales Day Book: The monthly total of Sales Day Book is posted to the credit side of the Sales Account in the General Ledger. In the Debtors Ledger, Individual Customer's Account is debited datewise. If we want to make both the Debtors Ledger and General Ledger Self- balancing, the following entry is to be passed:

In the General Ledger:
Debtors Ledger Adjustment Account Dr.
In the Debtors Ledger:
To General Ledger Adjustment Account

(b) Returns Inwards Book: The monthly total of Returns Inwards Book is posted to the debit side of the Returns Inwards Account in the General Ledger. In the Debtors Ledger, Individual Customer's Account is credited. If we want to make both the Debtors Ledger and General Ledger Self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account

(c) Bills Receivable Book: The monthly total of Bills Receivable Book is posted to the debit side of Bills Receivable Account in the General ledger. In the Debtors Ledger, Individual Customer's Account is credited. If we want to make both the ledgers self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account

(d) Cash Book: In the Debtors Ledger, cash collected from debtors is posted to the credit side of the Individual Customer's Account. To make both the ledgers self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account
Similar entries are to be passed for discount allowed, bad debts, and so forth.

(e) Others: The following entry is to be passed for Bills Receivable dishonoured, interest charged, notary charges and cash paid.

In the General Ledger:
Debtors Ledger Adjustment Account Dr.
In the Debtors Ledger:
To General Ledger Adjustment Account

The summaries of entries are given below:

Books of Original Entry	General Ledger	Debtors Ledger
Sales Day Book **Cash Book Credit** (For noting charges and cheques dishonoured) **Journal Proper** (for interest etc.)	The totals, in each case, are ***debited to the 'Debtors Ledger Adjustment Account';*** Credit is given to Sales Account, Cash Account and other Nominal Accounts.	Individual customer's account is debited for each item. The totals are posted to the ***credit of the 'General Ledger Adjustment Account'.***
Sales Returns Book **Bills Receivable Book** **Cash Book Debit** **Journal Proper** (allowances, etc.)	The totals, in each case, are ***credited to the 'Debtors Ledger Adjustment Account';*** Debit is given to Sales Returns Account, Cash Account and other Nominal Accounts.	Individual customer's account is credited for each item. The totals are posted to the ***debit of the 'General Ledger Adjustment Account'.***

2. Books of Original Entry used for Self-balancing Creditors Ledger

(a) Purchases Day Book The monthly total of Purchases Day Book is posted to the debit side of the Purchases Account in the General Ledger. In Creditors Ledger, Individual Supplier's Account is credited. If we want to make both the Creditors Ledger and General Ledger Self-balancing, the following entry is to be passed:

In the Creditors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Creditors Ledger Adjustment Account

(b) Returns Outwards Book The monthly total of Returns Outwards Book is posted to the credit side of the Returns Outwards Account in the General Ledger. In the Creditors Ledger, Individual Supplier's Account is debited. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account

(c) Bills Payable Book: The monthly total of Bills Payable Book is posted to the credit side of Bills Payable Account in the General Ledger. In the Creditors Ledger, Individual Supplier's Account is debited. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account

(d) Cash Book: In the Creditors Ledger, cash paid to creditors is posted to the debit side of the Individual Suppplier's Account. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account
Similar entry is to be passed for discount received from suppliers.

(e) Others: The following entry is to be passed for Bills Payable dishonoured, interest paid, notary charges, cash received from suppliers, etc.

In the Creditors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Creditors Ledger Adjustment Account

The summaries of entries are given below:

Books of Original Entry	General Ledger	Creditors Ledger
Purchases Day Book **Cash Book Debit** (for over charges, allowances, etc.) **Journal Proper** (for overdue interest)	The totals, in each case, are ***credited to the 'Creditors Ledger Adjustment Account';*** Debit is given to Purchases Account, Cash Account and other Nominal Accounts.	Individual supplier's account is credited for each item. The totals are posted to the ***debit of the 'General Ledger Adjustment Account'.***
Purchases Returns Book **Bills Payable Book** **Cash Book Credit** **Journal Proper** (for allowances)	The totals, in each case, are ***debited to the 'Crediors Ledger Adjustment Account';*** Credit is given to Purchases Returns Account, Bills Payable Account, Cash Account and other Nominal Accounts.	Individual supplier's account is debited for each item. The totals are posted to the ***credit of the 'General Ledger Adjustment Account'.***

Temporary adverse balances should be brought down on both sides of the Adjustment Accounts in respect of the total debit balances and the total credit balances.

Advantages of Self-Balancing Ledger

1. Since errors can be localized, delay in detection is minimised, thereby saving labour and time of the book-keepers.
2. Arithmatic accuracy of each ledger can be proved independently.
3. A complete Trial Balance can be prepared without balancing subsidiary ledgers, thus facilitating the quick preparation of Final Accounts.
4. A number of book-keepers can work on different ledgers.
5. Each ledger is of a suitable size.

Though Self-Balancing System is employed mainly in connection with Debtors and Creditors Ledgers, this system can be used in Plant Ledgers, Share Registers, etc.

Distinction Between Self-Balancing Ledger and Sectional Balancing Ledger

Sl. No.	Self-Balancing Ledger	Sl. No.	Sectional Balancing Ledger
1.	Under self-balancing system, each ledger (e.g., General Ledger, Debtors' Ledger and Creditors' Ledger) can be balanced independently.	1.	Under sectional balancing system, Debtors' Ledger and Creditors' Ledger cannot be balanced independently.
2.	Under self balancing system, two adjustment accounts (e.g., Debtors' Adjustment Account and Creditors' Adjustment Account) are opened to complete the double entry in the General Ledger.	2.	Under sectional balancing system, two "total accounts" are opened to complete the double entry. These accounts are (a) Total Debtors' Account; and (b) Total Creditors' Account.
3.	Under self balancing system, General Ledger Adjustment Account is opened in the Debtors' Ledger and Creditors' Ledger to complete the double entry in these ledgers.	3.	Under sectional balancing system, no separate account is opened in the Debtors' Ledger or Creditors' Ledger in respect of General Ledger.
4.	Errors can be detected easily under self balancing system.	4.	It is very difficult and time consuming to detect errors under sectional balancing system,

The students should note the following alternative terms used for different ledgers :

(i) The General Ledger is also called as Nominal Ledger
(ii) The Debtors Ledger is also called as Sales Ledger or Customers' Ledger.
(iii) The Creditors Ledger is also called as Purchases Ledger or Suppliers' Ledger or Bought Ledger.

The specimen of Adjustment/Control Accounts in the General Ledger are given below :

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/f		1.1.2017	By Balance b/d (if any)	
31.1.2017	To General Ledger Adjustment A/c :		31.1.2017	By General Ledger Adjustment A/c :	
	Sales (credit)			Sales Returns	
	Cheques and B/R dishonoured			Cash and cheque received	
	Interest charged			Bills receivable	
	Notary charges			Discount allowed	
	Cash paid			Bad debts	
				Transfer (if any)	
31.1.2017	To Balance c/d (if any)		31.1.2017	By Balance c/d	

Dr. Creditors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d (if any)		1.1.2017	By Balance b/d	
31.1.2017	To General Ledger Adjustment A/c :		31.1.2017	By General Ledger Adjustment A/c :	
	Cash & cheques paid			Purchases (credit)	
	Returns outwards			Cheques and B/P dishonoured	
	Discount received				
	Bills payable accepted				
	Transfer (if any)				
31.1.2017	To Balance c/d		31.1.2017	By Balance c/d (if any)	

In the Debtors Ledger

General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d (if any)		1.1.2017	By Balance b/d	
31.1.2017	To Debtors Ledger Adjustment A/c :		31.1.2017	By Debtors Ledger Adjustment A/c :	
	Sales returns			Sales (credit)	
	Cash and cheque received			Interest charged	
	Discount allowed			Cheques and B/R dishonoured	
	Bills receivable received			Notary charges	
	Bad debts			Cash paid	
	Transfer (if any)				
31.1.2017	To Balance c/d		31.1.2017	By Balance c/d (if any)	

In the Creditors Ledger

General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d		1.1.2017	By Balance b/d (if any)	
31.1.2017	To Creditors Ledger Adjustment A/c :		31.1.2017	By Creditors Ledger Adjustment A/c :	
	Purchases (credit)			Returns outwards	
	Cheques and B/P dishonoured			Cash and cheques paid	
				Discount received	
				Bills payable accepted	
31.1.2017	To Balance c/d (if any)		31.1.2017	By Balance c/d	

Illustration 5

Samaresh keeps his Ledger on Self-balancing system. From the following particulars, you are required to write up the Individual Debtor's Account and the General Ledger Adjustment Account (in Sales Ledger) during the month of January 2017. Also prepare a Trial Balance in Sales Ledger.

(i) Individual Debtors balances on 1.1.2017 : A – ₹ 1,530; B – ₹ 1,620; C – ₹ 1,890; D – ₹ 1,170.

(ii) Transactions during the month (all figures in ₹) :

2.1.2017	Sold Goods to A	1,710	19.1.2017	Recd. from A, a B/R, accepted by X payable on 25.1.2017	1,200
9..1.2017	Received from B on A/c	300			
11.1.2017	Recd. from A in full settl. of his bal. on 1.12017	1,500	22.1.2017	Received from B	900
12.1.2017	Sold goods to B	600	25.1.2017	A's bill returned dishonoured	
14.1.2017	B returned goods (damaged in transit)	180	28.1.2017	D is insolvent, 30% is recd. as final settlement	
18.1.2017	Recd. from C and allowed discount ₹ 90	1,800	30.1.2017	Sold goods to C	1,020

Solution

In the Sales Ledger

A Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/f	1,530	11.1.2017	By Cash A/c	1,500
2.1.2017	To Sales A/c	1,710	11.1.2017	By Discount allowed A/c	30
25.1.2017	To B/R (dishonoured) A/c	1,200	19.1.2017	By Bills receivable A/c	1,200
			31.1.2017	By Balance c/d	1,710
		4,440			4,440

B Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/f	1,620	9.1.2017	By Cash A/c	300
12.1.2017	To Sales A/c	600	14.1.2017	By Returns inwards A/c	180
			22.1.2017	By Cash A/c	900
			31.1.2017	By Balance c/d	840
		2,220			2,220

C Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/f	1,890	18.1.2017	By Cash A/c	1,800
31.1.2017	To Sales A/c	1,020	18.1.2017	By Discount allowed A/c	90
			31.1.2017	By Balance c/d	1,020
		2,910			2,910

Dr. **D Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/f	1,170	28.1.2017	By Cash (30% of ₹ 1,170)	351
			31.1.2017	By Bad Debts A/c	819
		1,170			1,170

Dr. **General Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Sales Ledger Adjustment A/c :		1.1.2017	By Balance b/d (Note 1)	6,210
	Cash (Note 2)	4,851		By Sales Ledger Adjustment A/c :	
	Discount allowed (Note 4)	120		Sales (Note 3)	3,330
	Returns inwards	180		Bills receivable dishonoured	1,200
	Bills receivable	1,200			
	Bad debts	819			
31.1.2017	To Balance c/d	3,570			
		10,740			10,740

Trial Balance of the Sales Ledger as at 31st January, 2017

Head of Accounts	Dr. ₹	Cr. ₹
A Account	1,710	
B Account	840	
C Account	1,020	
General Ledger Adjustment Account		3,570
	3,570	3,570

Working Notes :

(1) Total Debtors Balance

		₹
	A	1,530
	B	1,620
	C	1,890
	D	1,170
		6,210

(2) Total Cash Received

		₹
9.1.2017	B	300
11.1.2017	A	1,500
18.1.2017	C	1,800
22.1.2017	B	900
28.1.2017	D	351
		4,851

(3) Total Sales

		₹
2.1.2017	A	1,710
12.1.2017	B	600
30.1.2017	C	1,020
		3,330

(4) Discount Allowed (Total)

		₹
11.1.2017	A	30
18.1.2017	C	90
		120

Illustration 6

Following are the balances of creditors in the ledger of a trader as on 1.1.2017. A - ₹ 1,360; B - ₹ 1,440; C - ₹ 1,320; D - ₹ 1,680; E - ₹ 1,040; F - ₹ 1,520. Following transactions occurred during January :

2017			₹	2017			₹
Jan.	2	Bought goods from A	1,480	Jan.	22	Bought goods from D	1,280
	8	Paid to F on account	720		25	Returned goods to G	184
	9	Bills accepted from A (disc. recd. ₹. 40)	760		27	Paid to B (discount received ₹ 48)	1,392
	11	Returned goods to E	240		28	Bought goods from E	1,760
	12	Bought goods from G	1,600		28	Paid to G (discount received ₹ 56)	1,360
	14	Paid to E (discount recd. ₹ 8)	792		29	Bills accepted from F (discount recd. ₹ 32)	800
	19	Bought goods from B	1,200		30	Bought goods from F	1,280
	21	Paid to D (discount recd. ₹ 80)	1,600		31	Paid to A on account	560

You are required to prepare Individual Creditor's Accounts, General Ledger Adjustment Account (in the Purchases Ledger) and Purchases Ledger Adjustment Account (in the General Ledger).

Solution

In the Purchases Ledger

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
9.1.2017	To Bills Payable A/c	760	1.1.2017	By Balance b/d	1,360
9.1.2017	To Discount Received A/c	40	2.1.2017	By Purchases A/c	1,480
31.1.2017	To Bank A/c	560			
31.1.2017	To Balance c/d	1,480			
		2,840			2,840

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
27.1.2017	To Bank A/c	1,392	1.1.2017	By Balance b/d	1,440
27.1.2017	To Discount Received A/c	48	19.1.2017	By Purchases A/c	1,200
30.1.2017	To Balance c/d	1,200			
		2,640			2,640

Dr. **C Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To Balance c/d	1,320	1.1.2017	By Balance b/d	1,320

Dr. **D Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
21.1.2017	To Bank A/c	1,600	1.1.2017	By Balance b/d	1,680
21.1.2017	To Discount Received A/c	80	22.1.2017	By Purchases A/c	1,280
31.1.2017	To Balance c/d	1,280			
		2,960			2,960

Dr. **E Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
11.1.2017	To Returns Outwards A/c	240	1.1.2017	By Balance b/d	1,040
14.1.2017	To Bank A/c	792	28.1.2017	By Purchases A/c	1,760
14.1.2017	To Discount Received A/c	8			
31.1.2017	To Balance c/d	1,760			
		2,800			2,800

Dr. **F Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
8.1.2017	To Bank A/c	720	1.1.2017	By Balance b/d	1,520
29.1.2017	To Bills Payable A/c	800	30.1.2017	By Purchases A/c	1,280
29.1.2017	To Discount Received A/c	32			
31.1.2017	To Balance c/d	1,248			
		2,800			2,800

Dr. **G Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
25.1.2017	To Returns Outwards A/c	184	12.1.2017	By Purchases A/c	1,600
28.1.2017	To Bank A/c	1,360			
28.1.2017	To Discount Received A/c	56			
		1,600			1,600

Dr. **General Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	8,360	31.1.2017	By Purchases Ledger Adj. A/c:	
31.1.2017	To Purchases Ledger Adj. A/c:			Bank	6,424
	Credit purchases	8,600		Discount received	264
				Bills payable	1,560
				Returns outwards	424
			31.1.2017	By Balance c/d	8,288
		16,960			16,960

Trial Balance of the Purchases Ledger as at 31st January, 2017 **Dr.** **Cr.**

S.N.	Head of Accounts	L.F.	₹	₹
1.	A Account			1,480
2.	B Account			1,200
3.	C Account			1,320
4.	D Account			1,280
5.	E Account			1,760
6.	F Account			1,248
7.	General Ledger Adjustment Account		8,288	
			8,288	8,288

Working Notes :

(1) Total Creditors Balance as on 1.1.2017	**₹**	**(2) Total Cash Paid**	**₹**
A	1,360	8.1.2017	720
B	1,440	14.1.2017	792
C	1,320	21.1.2017	1,600
D	1,680	27.1.2017	1,392
E	1,040	28.1.2017	1,360
F	1,520	31.1.2017	560
	8,360		6,424

(3) Purchases (credit)	**₹**	**(4) Bills Payable**	**₹**
2.1.2017	1,480	9.1.2017	760
12.1.2017	1,600	29.1.2017	800
19.1.2017	1,200		1,560
22.1.2017	1,280	**(5) Discount Received**	**₹**
28.1.2017	1,760	9.1.2017	40
30.1.2017	1,280	14.1.2017	8
	8,600	21.1.2017	80
(6) Returns Outwards	**₹**	27.1.2017	48
11.1.2017	240	28.1.2017	56
25.1.2017	184	29.1.2017	32
	424		264

In the General Ledger

Dr. Purchases Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2017	To General Ledger Adjustment A/c:		1.1.2017	By Balance b/d	8,360
	Bank	6,424	31.1.2017	By General Ledger Adjustment A/c :	
	Discount received	264		Credit purchases	8,600
	Bills payable	1,560			
	Returns outwards	424			
31.1.2017	By Balance c/d	8,288			
		16,960			16,960

Temporary Adverse Balances

It should be noted that in practice, Debtors Ledger may contain a few accounts showing credit balances (e.g., where allowances are made for defective goods or empties are returned by the customers after full payment has been made). In this case, balances should be brought down on the both sides of the Debtors Ledger Adjustment / Control Account in respect of the total debit balances and the total credit balances. Likewise, Creditors Ledger Account may contain a few accounts showing debit balances (e.g., advance payment made to the Suppliers for goods to be received in future or allowance to be received for defective goods etc). In this case also, balances should be brought down on the both sides of the Creditors Ledger Adjustment / Control Account is respect of the total credit balances and the total debit balances.

Illustration 7

X deals in specialised electronic equipment. The following information is extracted from his records for the three months ended on 31.12.2016 (all in ₹).

		October	November	December
Balances on purchases ledger on 1.10.2016	(Dr.)	6,250		
	(Cr.)	3,20,000		
Purchases at retail price		15,00,000	20,00,000	18,00,000
Purchases returns at retail prices		40,000	60,000	50,000
Cheques sent to creditors		10,02,000	14,80,000	13,00,000
Discounts received		25,000	38,000	27,000
Temporary debit balances at month end		4,100	5,700	2,200

X buys his goods at 20% less than the retail price. You are required to prepare Purchases Ledger Control Account for each of the above three months for the period in question.

Solution

In the General Ledger

Purchases Ledger Control Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.10.2016	To Balance b/d	6,250	1.10.2016	By Balance b/d	3,20,000
31.10.2016	To General Ledger Control A/c :		31.10.2016	By General Ledger Control A/c :	
	Purchases returns (₹ 40,000 *less* 20%)	32,000		Purchases (₹ 15,00,000 *less* 20%)	12,00,000
	Cheques issued	10,02,000	31.10.2016	By Balance c/d	4,100
	Discounts received	25,000			
31.10.2016	To Balance c/d	4,58,850			
		15,24,100			15,24,100
1.11.2016	To Balance b/d	4,100	1.11.2016	By Balance b/d	4,58,850
30.11.2016	To General Ledger Control A/c :		30.11.2016	By General Ledger Control A/c :	
	Purchases returns (₹ 60,000 *less* 20%)	48,000		Purchases (₹ 20,00,000 *less* 20%)	16,00,000
	Cheques issued	14,80,000	30.11.2016	By Balance c/d	5,700
	Discounts received	38,000			
30.11.2016	To Balance c/d	4,94,450			
		20,64,550			20,64,550
1.12.2016	To Balance b/d	5,700	1.12.2016	By Balance b/d	4,94,450
31.12.2016	To General Ledger Control A/c :		31.12.2016	By General Ledger Control A/c :	
	Purchases returns (₹ 50,000 *less* 20%)	40,000		Purchases (₹ 18,00,000 *less* 20%)	14,40,000
	Cheques issued	13,00,000	31.12.2016	By Balance c/d	2,200
	Discounts received	27,000			
31.12.2016	To Balance c/d	5,63,950			
		19,36,650			19,36,650

Tutorial Note : Since trade discount is not recorded in double entry book-keeping, the entries in the Control Accounts should be net of trade discount.

Illustration 8

From the books of X Limited you ascertain that on 1.1.2016, the Debtors Ledger balance was ₹ 40,000 and the Suppliers Ledger balance was ₹ 31,155. The following particulars were available for the year ended 31.12.2016 :

	₹		₹
Sales	3,18,700	Bills receivable dishonoured	1,300
Purchases	1,99,800	Returns inwards	5,000
Cash received from debtors	2,76,000	Returns outwards	2,600
Cash paid to creditors	1,26,500	Bad debts	1,600
Discount allowed	11,600	Cash recd. in respect of debts previously written-off bad	600
Bills payable matured during the year	49,000	Discount received	7,300
Bills receivable received	20,300	Bills payable accepted	60,000

From the above particulars, you are required to show the Debtors Ledgers Control Account, the Suppliers Ledgers Control Account as they would appear in the General Ledger of X Limited for the year ended 31.12.2016.

Solution

In the General Ledger of X Limited

Debtors Ledger Control Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	40,000	31.12.2016	By General Ledger Adj. A/c :	
31.12.2016	To General Ledger Adj. A/c :			Cash received	2,76,000
	Sales	3,18,700		Discount allowed	11,600
	Bills receivable dishonoured	1,300		Bills receivable	20,300
				Returns inward	5,000
				Bad debts	1,600
			31.12.2016	By Balance c/d	45,500
		3,60,000			3,60,000

Suppliers Ledger Control Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To General Ledger Adj. A/c :		1.1.2016	By Balance b/d	31,155
	Cash paid	1,26,500	31.12.2016	By General Ledger Adj. A/c :	
	Returns outwards	2,600		Purchases (credit)	1,99,800
	Discount received	7,300			
	Bills payable accepted	60,000			
31.12.2016	To Balance c/d	34,555			
		2,30,955			2,30,955

Tutorial Note : Bad debt recovery and reserve for bad debts do not affect the debtors balance. Therefore, these are to be ignored in Adjustment Accounts. Similarly, bills payable matured ₹ 49,000 during the year will not affect Adjustment Accounts.

Illustration 9

The following information is available from the books of a trader from 1.1.2017 to 31.3.2017 :

(1) Total sales amounted to ₹ 60,000, including the sale of old furniture for ₹ 1,200 (Book value ₹ 3,500). The total cash sales were 80% less than the credit sales.

(2) Cash collected from debtors amounted to 60% of the aggregate of the opening debtors and credit sales for the period. Debtors were allowed cash discount for ₹ 2,600.

(3) Bills receivable drawn during the three months totalled to ₹ 6,000 of which bills amounting to ₹ 3,000 were endorsed in favour of suppliers. Out of these endorsed bills receivable, a bill for ₹ 600 was dishonoured for non-payment as the party became insolvent, his estate realising nothing.

(4) Cheques received from Sundry Customers for ₹ 6,000 were dishonoured; a sum of ₹ 500 is irrecoverable; bad debts written-off in the earlier years realised ₹ 2,500.

(5) Sundry Debtors as on 1.1.2017, stood at ₹ 40,000.

You are required to show the Debtors Ledger Adjustment Account in the General Ledger.

Solution

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	40,000	31.3.2017	By General Ledger Adjustment A/c :	
31.3.2017	To General Ledger Adjustment A/c :			Cash received (Note 2)	53,400
	Credit Sales (Note 1)	49,000		Discount allowed	2,600
	Bills receivable dishonoured	600		Bad debts (₹ 500 + ₹ 600)	1,100
	Cheques dishonoured	6,000		Bills receivable	6,000
			31.3.2017	By Balance c/d	32,500
		95,600			95,600

Working Notes : (1) Cash sales were 80% less than the credit sales. If credit sales are 100, then cash sales are 20. Therefore, when total sales is ₹ 120 then credit sale is 100, i.e., 5/6 of total sales. Total sales is ₹ 60,000 – ₹ 1,200 = ₹ 58,800. Therefore, credit sales are ₹ 58,800 x 5/6 = ₹ 49,000.

(2) Aggregate of opening value of debtors and credit sales = ₹ (40,000 + 49,000) = ₹ 89,000. Therefore, cash realised from debtors is 60% of ₹ 89,000 = ₹ 53,400.

More than One Debtors Ledger

Where a business enterprise has got many Debtors Accounts, it may maintain more than one Debtors Ledger. The division of Debtors Ledger may be alphabetical or geographical, etc..

Alphabetical Sub-division	Geographical Sub-division
Debtors : A to G	Debtors : East Zone
Debtors : H to P	Debtors : South Zone
Debtors : Q to T	Debtors : North Zone
Debtors : U to Z	Debtors : West Zone

The same procedures described above, as applied to Self-balancing of Ledgers, to be followed even when ledgers are subdivided. In this case, each ***Debtors Ledger*** will contain a General Ledger Adjustment Account. In the General Ledger, there will be a separate Debtors Ledger Adjustment Account for each ***group of ledger***.

Where Debtors Ledger is sub-divided, it is necessary to rule the books of original entry accordingly. For example, Sales Day Book would be ruled as follows:

Sales Day Book

Date	Invoice No.	Particulars	Folio	Debtors A to G	Debtors H to P	Debtors Q to T	Debtors U to Z

Illustration 10

X Ltd. divides its Debtors Ledger into two sections, A-L, and M-Z, each being Self-balancing. The following details have been extracted from the books of the company for the month of March, 2017:

		A – L	M – Z
Ledger Balances : 1st March	Dr.	1,11,125	67,970
Ledger Balances : 1st March	Cr.	980	210

Ledger Balances : 31st March	Dr.	1,51,445	59,815
Ledger Balances : 31st March	Cr.	1,645	595
Credit sales for the month		79,100	23,870
Cash received		34,090	31,395
Discount allowed		455	175
Returns Inwards		2,275	770
Bad Debts written-off		280	70
Bills Receivable		2,345	—
Bad debts recovery		300	200

Prepare necessary Adjustment Accounts.

Solution

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	A – L (₹)	M – Z (₹)	Date	Particulars	A – L (₹)	M – Z (₹)
1.3.2017	To Balance b/d	1,11,125	67,970	1.3.2017	By Balance b/d	980	210
31.3.2017	To General Ledger			31.3.2017	By General Ledger		
	Adjustment A/c :				Adjustment A/c:		
	Sales (credit)	79,100	23,870		Cash received	34,090	31,395
					Discount allowed	455	175
					Returns Inwards	2,275	770
					Bad Debts	280	70
					Bills Receivable	2,345	—
31.3.2017	To Balance c/d	1,645	595	31.3.2017	By Balance c/d	1,51,445	59,815
		1,91,870	92,435			1,91,870	92,435

In Debtors Ledger (A – L)

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.3.2017	To Balance b/d	980	1.3.2017	By Balance b/d	1,11,125
31.3.2017	To Debtors Ledger Adj. A/c :		31.3.2017	By Debtors Ledger Adj. A/c:	
	Cash received	34,090		Sales (credit)	79,100
	Discount allowed	455	31.3.2017	By Balance c/d	1,645
	Returns Inwards	2,275			
	Bad debts	280			
	Bills Receivable	2,345			
31.3.2017	To Balance c/d	1,51,445			
		1,91,870			1,91,870

In Debtors Ledger (M – Z)

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.3.2017	To Balance b/d	210	1.3.2017	By Balance b/d	67,970
31.3.2017	To Debtors Ledger Adjustment A/c:		31.3.2017	By Debtors Ledger Adjustment A/c:	
	Cash received	31,395		Sales (credit)	23,870
	Discount allowed	175	31.3.2017	By Balance c/d	595
	Returns Inwards	770			
	Bad debts	70			
31.3.2017	To Balance c/d	59,815			
		92,435			92,435

Illustration 11

The Trial Balance of a firm when abstracted shows a difference of ₹ 27. From the undermentioned figure prepare Sales and Bought Ledger Adjustment Accounts and show in which ledger the error arises.

Jan 1st : Balance in Bought Ledger ₹ 11,805; Balance in Sales Ledger ₹ 20,201.

Dec..31st	₹		₹
Bad debts written-off	320	Purchases returns	288
Bills receivable	1,200	Sales	57,360
Bills payable	5,940	Sales returns	2,166
Cash paid for purchases	37,350	Bought Ledger (Dr. balances)	15
Cash received from customers	60,260	Bought Ledger (Cr. balances)	8,317
Discount allowed	1,050	Sales Ledger (Dr. balances)	12,727
Purchases	40,325	Sales Ledger (Cr. balances)	189
Discount received	250		

Solution

In the General Ledger

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	20,201	Dec. 31	By General Ledger Adjustment A/c :	
Dec. 31	To General Ledger Adjustment A/c :			Bad debts	320
	Sales	57,360		Bills receivable	1,200
Dec. 31	To Balance c/d	189		Cash received	60,260
				Discount allowed	1,050
				Sales returns	2,166
			Dec. 31	By Balance c/d	12,754
		77,750			77,750

Dr. Bought Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
Dec. 31	To General Ledger Adjustment A/c :		Jan.1	By Balance b/f	11,805
	Bills payable	5,940		By General Ledger Adjustment A/c :	
	Cash paid to creditors	37,350		Purchases	40,325
	Discount received	250	Dec. 31	By Balance c/d	15
	Purchase returns	288			
Dec. 31	To Balance c/d	8,317			
		52,145			52,145

Working Notes : Debit balance of Sales Ledger is ₹ 12,754, but the balance has been given as ₹ 12,727. Therefore, in Sales Ledger, an error of ₹ 27 arises.

Transfer between Subsidiary Ledgers

Sometimes, a business enterprise may purchase from and sell to the same person on credit. In that case, the person is a creditor as well as a debtor of the business unit. Where no separate ledger is maintained, both credit purchases and credit sales are recorded in the same account. But in the case of the Self-balancing Ledgers, for such a person, two separate accounts are maintained to record credit purchases and credit sales.

One account is maintained in the Debtors Ledger to record credit sales and another in the Creditors Ledger to record credit purchases. Where this occurs it is the common practice to settle both accounts by transferring the balance of the smaller account to the account with the higher balance. In effect, the smaller account is closed. It should be noted that this transfer affects not only the two personal accounts adjusted, but also Debtors Ledger Adjustment Account, Creditors Ledger Adjustment Account and the two General Ledger Adjustment Accounts.

Suppose that, in the books of Y, at 31st January, 2017, X Account in Creditors Ledger shows a balance of ₹ 5,000 and in Debtors Ledger a balance of ₹ 7,500. For settlement of two accounts the following entries are necessary.

In the books of Y

Journal

Date	Particulars		Dr. ₹	Cr. ₹
31.1.2017	X A/c (In the Creditors Ledger)	Dr.	5,000	
	To X A/c (In the Debtors Ledger)			5,000
	(Being the balance of X's Account in the Creditors Ledger transferred to his account in the Debtors Ledger)			
	Creditors Ledger Adjustment A/c (In the General Ledger)	Dr.	5,000	
	To General Ledger Adjustment A/c (In the Creditors Ledger)			5,000
	General Ledger Adjustment A/c (In the Debtors Ledger)	Dr.	5,000	
	To Debtors Ledger Adjustment A/c (In the General Ledger)			5,000

Illustration 12

Write up the Sales Ledger Adjustment Account as would appear in the General Ledger from the following particulars :

Particulars		₹
Opening Balance of Debtors	Dr.	25,200
Opening Balance of Debtors	Cr.	800
Sales		62,400
Returns		6,340
Cash Received		40,100
Discount Allowed		2,600
Bad Debts written off		7,420

Provision for Doubtful Debts		11,000
Bad Debts previously written off, now received		600
Allowances		840
Bills Receivable		2,600
Bills Dishonoured		1,000
Trade Discount		300
Transfer from Bought Ledger		2,400
Closing Balance of Debtors	Dr.	27,980
Closing Balance of Debtors	Cr.	2,480

Solution

In the General Ledger

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Balance b/d	25,200	?	By Balance b/d	800
	To General Ledger Adjustment A/c :			By General Ledger Adjustment A/c :	
	Sales (Note 1)	62,400		Return (from Customers)	6,340
	Bills Dishonoured	1,000		Cash received	40,100
	To balance b/d	2,480		Discount allowed	2,600
				Bad Debts (written off)	7,420
				Allowance	840
				Bills Receivable	2,600
				Transfer from Bought Ledger	2,400
				By Balance c/d	27,980
		91,080			91,080

Working Notes: (1) Assumed to be all on credit..

Tutorial Notes :

(1) Provision for doubtful debts will affect the debtors balance so it will not affect the Adjustment Account.

(2) Bad Debts previously written off, now received will not affect the debtors balance, so it is also ignored.

(3) Trade discount is not accounted for. Therefore, it will not affect debtors balance.

Illustration 13

From the following particulars for the year ended 31st March, 2017 extracted from the books of X Ltd., prepare Sales Ledger Adjustment Account in the General Ledger :

Particulars		₹
Sales Ledger Balances : 1st April, 2016	Dr.	12,500
Sales Ledger Balances : 1st April, 2016	Cr.	300
Sales during the year (including cash sales of ₹ 2,000)		60,400
Cash received from customers		40,100
Return by customers		5,750
Discount Allowed		2,600
Bad Debts written off		5,680
Bad Debts previously written off recovered in cash during the year		900
Provision for bad debts		5,950
Allowances to customers		740
Bills Receivable from customers		3,400
Bills Dishonoured		700
Transfer from Sales Ledger to Purchase Ledger		2,500
Payment to clear Credit balances on Sales Ledger Accounts		100
Closing Credit Balances		1,440

Solution

In the General Ledger of X Ltd.

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	12,500	1.4.2016	By Balance b/d	300
31.3.2017	To General Ledger Adjustment A/c :		31.3.2017	By General Ledger Adjustment A/c :	
	Sales (credit)	58,400		Cash received	40,100
	Bills dishonoured	700		Returned by customers	5,750
	payment to customers	100		Discount allowed	2,600
	To Balance c/d	1,440		Bad Debt (written off)	5,680
				Allowance to customers	740
				Bills receivable	3,400
				Transfer from Sales to Purchase Ledger	2,500
				By Balance c/d	12,070
		73,140			73,140

Tutorial Notes :

(1) Bad debt recovered will not affect debtors balance. Therefore, it has been ignored.

(2) Provision for bad debts will not affect debtors balance. Therefore, it has been ignored.

Illustration 14

The following details extracted from the Books of Mr Abu for the period ended on 31st December 2016 :

Jan. 1 : Sales Ledger balances ₹ 12,400; Provision for doubtful debts ₹ 1,000.

Dec.. 31st	₹		₹
Sales (including cash sales ₹ 4,000)	23,000	Bills receivable as endorsed dishonoured	120
Cash received from customers	18,500	Bills receivable discounted	500
Bills receivable received	3,000	Bad debts written-off	50
Returns from customers	380	Interest charged to customers	10
Bills endorsed	480	Bad debts previously written-off recovered	60
Bills dishonoured	300	Transferred from Bought Ledger	150
Cheques dishonoured	100	Sundry charges debited to consumers	20

Prepare the necessary Adjustment Accounts.

Solution

In the General Ledger of Mr Abu

Sales Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	12,400	31.12.2016	By General Ledger Adj. A/c :	
31.12.2016	To General Ledger Adj. A/c :			Cash received	18,500
	Sales (credit)	19,000		Bills receivable received	3,000
	Bills dishonoured	300		Returns from customers	380
	Cheque dishonoured	100		Bad debts	50
	B/R as endorsed dishonoured	120		Transfer from Bought Ledger	150
	Interest charged to customers	10	31.12.2016	By Balance c/d	9,870
	Sundry charges debited to customers	20			
		31,950			31,950

In the Sales Ledger

General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Sales Ledger Adjustment A/c :		1.1.2016	By Balance b/d	12,400
	Cash received	18,500	31.12.2016	By Sales Ledger Adjustment A/c :	
	Bills receivable received	3,000		Sales (credit)	19,000
	Returns from customers	380		Bills dishonoured	300
	Bad debts	50		Cheque dishonoured	100
	Transfer from Bought Ledger	150		B/R as endorsed dishonoured	120
31.12.2016	To Balance c/d	9,870		Interest charged to customers	10
				Sundry charges debited to customers	20
		31,950			31,950

Tutorial Notes :

(1) Provision for bad debts will not affect the debtors balance so it will not affect the adjustment accounts.

(2) Bills receivable discounted will not affect the debtors balance, so it is to be ignored.

(3) Bad debts previously written-off, now recovered will not affect the debtors balance, so it is also ignored.

Illustration 15

From the following particulars, as extracted from the books of a trader, prepare the General Ledger Adjustment Account as it would appear in the Sales Ledger on December 31, 2016 :

Particulars	₹
January 01, 2016	
Sales Ledger Balances	62,710
Provision for Doubtful Debts	1,720
December 31, 2016	
Sales	1,08,290
Bills accepted by Debtors	14,430
Bills dishonoured	540
Cash and Cheque received from customers	88,625
Cheques dishonoured	220
Goods returned by customers	4,710
Transfer from Bought Ledger	780
Bad Debts written off	1,610

Cash Discount allowed	2,460
Interest on customers' overdue accounts	330
Carriage charged to customers	1,220
Bad Debts previously written off, now recovered	850

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the Sales Ledger

Dr. Genera Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Sales Ledger Adjustment A/c :		1.1.2016	By Balance b/d	62,710
	Bills receivable	14,430		By Sales Ledger Adjustment A/c :	
	Cash and cheques received	88,625		Sales (Note 1)	1,08,290
	Goods returned by customers	4,710		Bills dishonoured	540
	Transfer from Bought Ledger	780		Cheques dishonoured	220
	Bad Debts (written off)	1,610		Interest on overdue balance	330
	Discount allowed	2,460		Carriage charged to customers	1,220
	To Balance c/d	60,695			
		1,73,310			1,73,310

Working Note :
(1) It is assumed to be all on credit.
Tutorial Note :
(1) Bad debts recovered will not be taken into consideration at the time of preparation of Adjustment Account.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 16

From the following particulars for the year ended 31st December, 2015, prepare Sales Ledger Adjustment Account in the General Ledger :

	₹
Sales (including cash sales ₹ 6,000)	30,000
Cash received from customers	19,000
Bills receivable received	4,500
Bills endorsed	1,960
Bills dishonoured	600
Returns from customers	760
Bills receivable as endorsed dishonoured	480
Cheque dishonoured	400
Bills receivable discounted	750
Bad Debts written off	200
Bad Debts written off previously now recovered	240
Sundry Charges debited to customers	60
Interest on customers overdue accounts	430
Cash discount allowed	1,400
Transferred from Bought Ledger	650

Sales Ledger balances as on 1.1.2015 ₹ 26,800; Provision for Doubtful Debts ₹ 2,500.

[C.U.B.Com. (General) — 2016]

Solution

In the General Ledger of ...

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	26,800	31.12.2015	By General Ledger Adj. A/c :	
	To General Ledger Adj. A/c :			Cash received	19,000
	Sales (credit)	24,000		Bills receivable received	4,500
	Bills dishonoured	600		Returns Inward	760
	Cheque dishonoured (Note 1)	400		Bad debts	200

	B/R as endorsed dishonoured	480		Transfer from Bought Ledger	650
	Interest charged to customers	430		Cash Discount allowed	1,400
	Sundry charges debited to customers	60	31.12.2015	By Balance c/d	26,260
		52,770			52,770

Working Note :

(1) It is assumed that the cheque was previously received from the Debtors.

Tutorial Notes :

(1) Provision for Bad Debts has nothing to do with the Sales Ledger Adjustment Account. Therefore, it is to be ignored.

(2) Bills endorsed, Bills discounted will not affect Sales Ledger Adjustment Account. Therefore, these are to be ignored.

(3) Bad Debts recover will be credited to Profit and Loss Account. It has nothing to do with the Sales Ledger Adjustment Account. Therefore, it is to be ignored.

Illustration 17

From the following particulars, prepare Sales Ledger Adjustment Account and Bought Ledger Adjustment Account in the General Ledger :

	Dr. (₹)	Cr. (₹)
Balances on Bought Ledger	10,000	96,000
Balances on Sales Ledger	1,41,000	2,250

Transactions during the year 2014 :	
Purchases	5,40,000
Purchase Return	20,000
Total Sales	9,68,000
Cash Sales	40,000
Sales Return	10,000
Cash Received from Customers	6,24,000
Discount Allowed	11,200
Cash Paid to Suppliers	4,80,000
Provision for Bad Debts	9,000
Discount Received	7,200
Bills Receivable Received	40,000
Bills Payable Issued	22,400
Bills Receivable Dishonoured	6,000
Closing Bought Ledger Balance (Dr.)	10,400
Closing Sales Ledger Balance (Cr.)	13,200

[C.U.B.Com. (General) — 2015]

Solution

In General Ledger

Dr. Sales Ledger Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d		By Balance b/d	2,250
To General Ledger Adjustment A/c :	1,41,000	By General Ledger Adjustment A/c :	
Credit Sales	9,28,000	Sales Return	10,000
Bills Receivable Dishonoured	6,000	Bank (Collected from customers)	6,24,000
To Balance c/d	13,200	Discount Allowed A/c	11,200
		Bills Receivable Received	40,000
		By Balance c/d	4,00,750
	10,88,200		10,88,200

Dr. Bought Ledger Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Balance b/d	96,000
To General Ledger Adjustment A/c :		By General Ledger Adjustment A/c :	
Purchase Return	20,000	Purchases (Credit)	5,40,000
Cash Paid	4,80,000	By Balance c/d	10,400
Discount Received	7,200		
Bills Payable (Accepted)	22,400		
To Balance c/d	1,06,800		
	6,46,400		6,46,400

Illustration 18

From the following particulars which have been extracted from the books of Mr D, for the year ended 31.03.2013, prepare the 'Nominal Ledger Adjustment' Account in the 'Bought Ledger'.

Particulars	₹	Particulars	₹
Creditors Ledger balances on 01.04.2012 (Dr.)	1,800	Acceptances renewed	2,000
on 01.04.2012 (Cr.)	14,000	Interest on renewal of bills	500
Purchases (including cash purchases ₹ 2,000)	36,500	Sundry charges for dishonoured bills payable	100
Cash paid to Creditors	21,000	Bills receivable endorsed to Creditors	4,500
Discount received	400	Bills receivable as endorsed dishonoured	1,000
Return outward	1,500	Transfer from :	
Bills payable accepted (including renewed bills and interest thereon)	14,000	Debtors Ledger to Creditors Ledger	500
		Creditors Ledger to Debtors Ledger	700
Acceptances matured	5,000	Creditors Ledger balance on 31.03.2013 (Dr.)	1,200
Acceptances dishonoured	3,000		

[C.U.B.Com. (General) — 2013]

Solution

In the Bought Ledger of Mr D

Dr. Nominal Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2012	To Balance b/d	14,000	1.4.2012	By Balance b/d	1,800
31.3.2013	To Bought Ledger Adj. A/c :		31.3.2013	By Bought Ledger Adj. A/c :	
	Credit purchases	34,500		Cash paid	21,000
	Bills payable dishonoured	3,000		Discount received	400
	Sundry charges	100		Returns outward	1,500
	B / R endorsed dishonoured (Note 1)	1,000		B / P renewed	2,000
	Interest on renewed bill	500		B/R endorsed	4,500
	B / P cancelled for renewal (Note 2)	2,000		Transferred from Debtors Ledger	500
31.3.2013	To Balance c/d	1,200		Transferred to Debtors Ledger	700
				B / P accepted (excl. renewed)	12,000
			31.3.2013	By Balance c/d	11,900
		56,300			56,300

Working Notes :

(1) Bills receivable endorsed dishonoured will increase both debtors and creditors balances.
(2) For renewal, bills payable is to be cancelled first by debiting Bills Payable Account and crediting Creditors Account.
(3) Both transfer from Debtors Ledger to Creditors Ledger and from Creditors Ledger to Debtors Ledger will decrease both debtors and creditors balances at the same time.
(4) Cash sales, provision for doubtful debts, bills receivable discounted will not affect Adjustment Account.
(5) Cash purchases, acceptance matured will not affect Adjustment Account.

Illustration 19

From the following particulars extracted from the books of Mr Z, prepare General Ledger Adjustment Account in the Debtors Ledger :

01.01.2011 - Debtors Ledger Balance ₹ 2,74,000.

Transactions during the year :	₹
Credit Sales	1,39,000
Cash received from customers	1,54,000
Returns from customers	4,000
Bad Debts written off	14,400
Acceptances received from customers	51,000
Cash Sales	1,00,000
Sundry Charges debited to customers	1,000
Discount Allowed to customers	2,600
Bills Receivable dishonoured	4,200
Bills Receivable discounted	6,000
Transfer from Bought Ledger to Sales Ledger	3,000

[C.U.B.Com. (General) — 2012]

Solution

In the books of Z
In the Debtors Ledger
General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Debtors Ledger Adjustment A/c :		1.1.2011	By Balance b/d	2,74,000
	Cash received	1,54,000	31.12.2011	By Debtors Ledger Adjustment A/c	
	Sales return	4,000		Credit sales	1,39,000
	Bad debts	14,400		Sundry charges	1,000
	Bills receivable	51,000		Bills receivable dishonoured	4,200
	Discount allowed	2,600			
	Transfer	3,000			
	To Balance c/d	1,89,200			
		4,18,200			4,18,200

Illustration 20

From the following particulars for the year ended 31.3.2011 extracted from the books of Sri Gautam, prepare Sales Ledger Adjustment Account in the General ledger.

Particulars	₹	Particulars	₹
Sales Ledger Balance on 1.4.2010 (Dr.)	12,500	Provision for Doubtful Debts	1,000
Sales Ledger Balance on 1.4.2010 (Cr.)	300	Sales (includes Cash Sales ₹ 4,000)	23,000
Bills Receivable Received	4,000	Cash Received from Customers	18,300
Bills Receivable Dishonoured	420	Return from Customers	380
Bills Endorsed	480	Bills Receivable Discounted	500
Cheques Dishonoured	100	Bad Debt	90
Bad Debts Recovered	60	Transfer from Bought Ledger	150
		Balance on 31.3.2011 (Cr.)	1,000

[C.U.B.Com. (General) — 2011]

So;ution

In the General Ledger
Sales Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2010	To Balance b/d	12,500	1.4.2010	By Balance b/d	300
31.3.2011	To General Ledger Adjustment A/c :		31.3.2011	By General Ledger Adjustment A/c:	
	Credit Sales (Note 5)	19,000		Bills Received	4,000
	Bills Receivable Dishonoured	420		Cash Received from Customers	18,300
	Cheques Dishonoured	100		Sales Return	380
	To Balance c/d	1,000		Bad Debt	90
	(Closing Credit Balance —given)			Transfer from Bought Ledger	150
				By Balance c/d	9,800
				(Closing Debit balance — balancing figure)	
		33,020			33,020
1.4.2011	To Balance b/d	9,800	1.4.2011	By Balance b/d	1,000

Working Notes :

(1) Bad Debt recovered will not affect debtors balance. Therefore, it has been ignored.
(2) Provision for bad debts will not affect debtors balance. Therefore, it has been ignored.
(3) Bills Receivable discounted will not affect the debtors balance. Therefore, it has been ignored.
(4) Bills endorsed will not affect the debtors balance. Therefore, it has been ignored.
(5) Credit Sales = Total Sales – Cash Sales
= ₹ 23,000 – ₹ 4,000 = ₹ **19,000**.

[For Honours Candidates Only]

Illustration 21

From the following particulars, prepare Sales Ledger Adjustment Account as would appear in the Nominal Ledger of a concern where Self Balancing Ledgers are kept.

01.04.2013 :	
Debtors Balance in Nominal Ledger Adjustment Account :	₹
Credit	45,000
Debit	1,000
31.03.2014 :	
Cash received from Debtors	3,20,000
Bad Debts written off	1,650
Sales	4,10,000
Bills Received	30,000
Returns Inward	5,000
Bills Dishonoured	1,500
Allowances to customers for goods damaged in transit	1,000
Discount Allowed	7,500
Cash Received in respect of debt previously written off as bad	450
Amount due from a customer as shown by Debtor's Ledger, set off against amount due to the same customer as shown by the Creditor's Ledger	2,500

On 31.03.2014 there was no credit balance in Debtor's Ledger.

[C.U.B.Com. (Hons.) — 2014]

Solution

In Nominal Ledger

Dr. **Sales Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Balance b/d	45,000	1.4.2013	By Balance b/d	1,000
31.3.2014	To Nominal Ledger Adjustment A/c :		31.3.2014	By Nominal Ledger Adjustment A/c :	
	Sales (Credit)	4,10,000		Cash Received	3,20,000
	Bills Dishonoured	1,500		Bad Debts	1,650
				Bills Receivable	30,000
				Return Inward	5,000
				Allowances	1,000
				Discount Allowed	7,500
				Transfer	2,500
				By Balance c/d	87,850
		4,56,500			4,56,500

Illustration 22

The books of ABC Co show :

(i) a sum of ₹ 6,000 due from PQR Co in the Debtors Ledger; and

(ii) a sum of ₹ 2,000 due to PQR Co in the Creditors Ledger.

Pass the transfer entries assuming that the ledgers are maintained on self balancing system.

[C.U.B.Com. (Hons.) — 2013]

Solution

In the books of ABC & Co

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	PQR Co A/c (In the Creditors Ledger)	Dr.	2,000	
	To PQR Co A/c (In the Debtors Ledger)			2,000
	(Being the balance of PQR Co's Account in the Creditors Ledger transferred to his account in the Debtors Ledger)			
	Creditors Ledger Adjustment A/c (In the General Ledger)	Dr.	2,000	
	To General Ledger Adjustment A/c (In the Creditors Ledger)			2,000
	General Ledger Adjustment A/c (In the Debtors Ledger)	Dr.	2,000	
	To Debtors Ledger Adjustment A/c (In the General Ledger)			2,000

Special Problems

Illustration 23

Mr. Patel maintains his ledgers on self-balancing system. The transactions from 1.1.2017 to 30.4.2017 are given below.

You are required to prepare the General Ledger Adjustment Account as will appear in the Debtor's Ledger:

(1) Opening balance (1.1.2017) Debtors' Ledger ₹ 78,000.

(2) Cash sales : ₹ 12,000 (being 10% of total sales).

(3) Collection from customers (other than collections on bills receivable) amounted to ₹ 1,10,000 which included the following:
(a) A sum of ₹ 3,000 realised from the estate of an insolvent (at 0.60 paise per rupee);
(b) ₹ 6,500 received from a customer as advance for sale;
(c) ₹ 4,000 received from a debtor after adjustment of an advance of ₹ 2,000 made in December 2016;
(d) ₹ 1,250 received from a party where account was written-off in earlier years;

(4) Interest charged to customers on overdue accounts ₹ 2,600.

(5) Bills receivable drawn during the period of ₹ 18,500.

(6) Bills receivable collected during the period ₹ 10,600 (including ₹ 5,900 collected on bills receivable drawn during November and December 2016).

(7) Bills receivable dishonoured on maturity ₹ 1,700.

(8) Bills receivable endorsed to suppliers — ₹ 6,000 out of which bills receivable for ₹ 2,000 discounted by creditors at 5% duly met at maturity. Bills receivable for ₹ 3,000 were dishonoured on maturity (noting charges being ₹ 20) and bills receivable amounting to ₹ 1,000 will mature in May 2017.

(9) Returns inwards ₹ 11,600.

(10) Transfer from creditors ledger ₹ 6,900.

Solution

In the Debtors Ledger

General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d (Note 1)	2,000	1.1.2017	By Balance b/d (Note 3)	78,000
30.4.2017	To Debtors Ledger Adjustment A/c:		30.4.2017	By Debtors Ledger Adjustment A/c:	
	Cheques received	1,08,750		Credit Sales (Note 4)	1,08,000
	(₹ 1,10,000 – 1,250)			Interest charged	2,600
	Bad debts (Note 2)	2,000		Bills receivable (dishonoured)	1,700
	Bills receivable	18,500		B/R endorsed & dishonoured	3,020
	Returns inward	11,600		(Noting charges ₹ 20)	
	Transfer	6,900	30.4.2017	By Balance c/d (Note 5)	6,500
30.4.2017	To Balance c/d (Balancing figure)	50,070			
		1,99,820			1,99,820

Working Notes :

(1) ₹ 2,000 represents temporary adverse balance in the debtors' account.

(2) 60% of the debt which is realised is ₹ 3,000. Therefore, the total amount due is ₹ 3,000 / 60% = ₹ 5,000. In effect, bad debt is ₹ (5,000 – 3,000) = ₹ 2,000.

(3) Debtors balance of ₹ 78,000 appears on the credit side of General Ledger Adjustment Account in the Debtors' Ledger.

(4) Cash sale is 10% of total sales which is ₹ 12,000. Therefore, credit sale is 90% of total sales, which is ₹ 12,000 / 10 x 90 = ₹ 1,08,000.

(5) Advance received from a customer to be carried forward as adverse balance.

Illustration 24

From the following extracted from the books of Mr X, prepare the necessary adjustment accounts in the General Ledger:

1.1.2016 — Debtors Ledger balance ₹ 1,37,000; Creditors Ledger balance ₹ 1,64,000

Transactions during the year:	₹		₹
Credit purchases	62,500	Cash sales	50,000
Credit sales	69,500	Sundry charges debited to customers	500
Cash received from customers	77,000	Allowances from creditors	1,600
Cash paid to suppliers	92,000	Bills payable dishonoured	9,000
Returns from customers	2,000	Discount allowed to debtors	1,300
Returns outwards	2,000	Cash purchases	30,900

Discount received	1,800	Bills receivable dishonoured	2,100
Bad debts written-off	7,200	Bad debts written-off, now recovered	900
Acceptances received from customers	25,500	Transfer from Bought Ledger to Sales Ledger	1,500
Bills payable accepted	36,000	Bills receivable discounted	3,000

Solution

In the General Ledger of Mr X

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/f	1,37,000	31.12.2016	By General Ledger Adj. A/c :	
31.12.2016	To General Ledger Adj. A/c :			Cash received	77,000
	Sales (credit)	69,500		Returns from customers	2,000
	Sundry charges	500		Bad debts written-off	7,200
	Bills receivable dishonoured	2,100		Bills receivable	25,500
				Discount allowed	1,300
				Transfer	1,500
			31.12.2016	By Balance c/d	94,600
		2,09,100			2,09,100

Dr. Creditors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To General Ledger Adj. A/c :		1.1.2016	By Balance b/d	1,64,000
	Cash paid	92,000		By General Ledger Adj. A/c :	
	Returns outward	2,000		Purchases (credit)	62,500
	Discount received	1,800		Bills payable dishonoured	9,000
	Bills payable accepted	36,000			
	Allowances from creditors	1,600			
	Transfer	1,500			
31.12.2016	To Balance c/d	1,00,600			
		2,35,500			2,35,500

Tutorial Notes :

(1) Cash sales or Cash purchases will not affect Debtors and Creditors balance respectively, so it is to be ignored.

(2) Bills receivable discounted will not affect Debtors balance, so it should be ignored.

Illustration 25

K. Hassan has three ledgers in use : a Sales Ledger, a Bought Ledger and a Nominal Ledger, all of which are kept in Self-balancing system. From the following particulars, prepare Sales Ledger Adjustment Account in the General Ledger and Nominal Ledger Adjustment Account in the Bought Ledger (all figures in ₹).

2016 April 1 : Balance of Creditors — (Dr.) 150; (Cr.) 4,500; Balance of Debtors — (Cr.) 250; (Dr.) 8,700

2017 March 31 :

Credit purchases	45,000	B/R endorsed to supplier (all these bills were duly honoured)	300
B/R drawn on customers (excluding bill renewed)	3,000	B/R dishonoured and fresh bills drawn with interest of ₹ 200	1,200
Bills payable accepted	2,000	Cash paid to suppliers	25,000
Sales (including cash sales of ₹ 5,000)	60,000	Allowances to customers	100
Return outward	1,500	Allowances received	150
Interest on customers account over due for payment	300	Bad debts written-off	150
Sales returns	450	Bad debts reserve	500
Cash and cheques received from customers	32,000	Credit bal. transferred from Sales Ledger to Bought Ledger	100
Credit bal. transferred from Bought Ledger to Sales Ledger	85	Purchases Ledger balances (Dr.)	84
Cheques dishonoured	500	Sales Ledger balances (Cr.)	112

Solution

In the General Ledger of K. Hassan

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	8,700	1.4.2016	By Balance b/d	250
31.3.2017	To General Ledger Adjustment A/c :		31.3.2017	By General Ledger Adjustment A/c :	
	Credit Sales	55,000		B/R ₹ (3,000 + 1,200)	4,200
	Interest on overdue amount	300		Sales return	450
	Cheques dishonoured	500		Cheque and Cash received	32,000
	Bills dishonoured	1,000		Allowances to customers	100
	Interest charged	200		Bad debts written-off	150
	Credit balance transferred to Bought Ledger (Note 1)	100		Credit balance transferred from Bought Ledger (Note 2)	85
31.3.2017	To Balance c/d	112	31.3.2017	By Balance c/d	28,677
		65,912			65,912

In the Bought Ledger of K. Hassan

Dr. Nominal Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	4,500	1.4.2016	By Balance b/d	150
31.3.2017	To Bought Ledger Adjustment A/c :		31.3.2017	By Bought Ledger Adjustment A/c :	
	Credit purchases	45,000		Bills payable accepted	2,000
	Credit balance transferred from			Return outward	1,500
	Sales Ledger (Note 1)	100		Allowance received	150
				Cash paid	25,000
				Bills endorsed	300
				Credit balance transferred	
				to Sales Ledger (Note 2)	85
31.3.2017	To Balance c/d	84	31.3.2017	By Balance c/d	20,499
		49,684			49,684

Working Notes :

(1) For credit balance transferred from Sales Ledger to Bought Ledger ₹ 100 will increase both debtors and creditors balance by ₹ 100. This is because, sundry debtors have debit balance but opposite (i.e., credit) balance is being transferred.

(2) For credit balance transferred from Bought Ledger to Sales Ledger ₹ 85 will reduce both debtors and creditors balance by ₹ 85. This is because sundry creditors have credit balance and such balance is being transferred.

(3) Bad debts reserve will not affect the adjustment account.

Illustration 26

Prepare a Sales Ledger Adjustment Account and a Purchase Ledger Adjustment Account in the General Ledger, for the year ended 31st March, 2017 from the following information (all figures in ₹) :

Customers' Account debit balance as on 1.4.2016	23,000	Goods returned by debtors	20,000
Customers' Account credit balance as on 1.4.2016	2,000	Cash discount allowed to debtors	6,000
Suppliers' Account credit balance as on 1.4.2016	40,000	Cash discount received from creditors	1,300
Suppliers' Account debit balance as on 1.4.2016	5,400	Trade discount received from the suppliers	80,000
Credit sales during the year	2,94,000	Bad debts written-off during the year	4,000
Credit purchases during the year	2,78,000	Bad debts recovered during the year	800
Cash sales during the year	2,26,000	Transfer from creditors ledger to debtors ledger	2,400
Cash purchases during the year	58,000	Bills receivable dishonoured	3,200
Cheques received from credit customers	1,80,000	Bills payable dishonoured	1,800
Cash received from credit customers	20,000	Cheques recd from debtors returned dishonoured	7,500
Cheques issued to the creditors during the year	2,10,000	Cheques issued to creditors returned dishonoured	2,900
Goods returned to the creditors	14,000	Customers' Account credit balance as on 31.3.2017	3,100
Bills payable accepted during the year	18,000	Suppliers' Account debit balance as on 31.3.2017	4,200
Bills received during the year	15,000		

Solution

In the General Ledger of ...

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	23,000	1.4.2016	By Balance b/d	2,000
31.3.2017	To General Ledger Adjustment A/c :		31.3.2017	By General Ledger Adjustment A/c :	
	Credit Sales	2,94,000		Cheque received	1,80,000
	Bills receivable (dishonoured)	3,200		Cash received	20,000
	Cheque dishonoured	7,500		Bills receivable	15,000
31.3.2017	To Balance c/d	3,100		Sales return	20,000
				Discount allowed	6,000
				Bad debts	4,000
				Transfer	2,400
			31.3.2017	By Balance c/d	81,400
		3,30,800			3,30,800

Dr. Purchases Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Balance b/d	5,400	1.4.2016	By Balance b/d	40,000
31.3.2017	To General Ledger Adjustment A/c :		31.3.2017	By General Ledger Adjustment A/c :	
	Cheque issued	2,10,000		Credit purchases	2,78,000
	Bills payable accepted	18,000		Bills payable dishonoured	1,800
	Discount received	1,300		Cheque issued dishonoured	2,900
	Goods returned	14,000	31.3.2017	By Balance c/d	4,200
	Transfer	2,400			
31.3.2017	To Balance c/d	75,800			
		3,26,900			3,26,900

Tutorial Note : Trade discount received from suppliers is not recorded in the books of accounts. Therefore, it will not affect the Adjustment Accounts.

Illustration 27

Indian Radicals Limited has three ledgers — Debtors' Ledger, Creditors' Ledger and General Ledger, which are kept under Self-balancing system. From the following particulars, prepare the relevant Adjustment Accounts that would appear in each of the Ledgers (all figures in ₹) :

Particulars	₹	Particulars	₹
Debtors Ledger balance on 1.1.2016 (Dr.)	16,000	Sundry charges for dishonoured bills payable	100
Debtors Ledger balance on 1.1.2016 (Cr.)	2,000	Bills receivable drawn	10,000
Creditors Ledger balance on 1.1.2016 (Dr.)	1,800	Bills receivable dishonoured	2,500
Creditors Ledger balance on 1.1.2016 (Cr.)	14,000	Bills receivable discounted	4,000
Purchases (including cash purchases ₹ 2,000)	36,500	Bills receivable endorsed	4,500
Sales (including cash sales ₹ 8,000)	80,000	Bills receivable as endorsed dishonoured	1,000
Cash paid to creditors	21,000	Bad debts	400
Collection from debtors	62,000	Provision for doubtful debts	1,500
Discount allowed	300	Transfer from Debtors' Ledger to Creditors' Ledger	500
Discount received	400	Debtors' Ledger balance on 31.12.2016 (Cr.)	1,300
Returns inwards	2,500	Creditors' Ledger balance on 31.12.2016 (Dr.)	1,200
Returns outwards	1,500	Transfer from Creditors Ledger to Debtors' Ledger	700
Acceptance matured	5,000	Bills payable accepted (including renewed	
Acceptance dishonoured	3,000	bills and interest thereon)	14,000
Acceptance renewed	2,000	Interest on renewed bills	500

Solution

In the General Ledger of Indian Radical Limited

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	16,000	1.1.2016	By Balance b/d	2,000
31.12.2016	To General Ledger Adj. A/c :		31.12.2016	By General Ledger Adj. A/c :	
	Credit sales (Note 4)	72,000		Collection from debtors	62,000
	Bills receivable (dishonoured)	2,500		Discount allowed	300
	B/R endorsed dishonoured	1,000		Returns inwards	2,500
31.12.2016	To Balance c/d	1,300		Bills receivable drawn	10,000
				Bad debts	400
				Trans. to Creditors Ledger (Note 3)	500
				Transfer from Creditors Ledger	700
			31.12.2016	By Balance c/d	14,400
		92,800			92,800

Dr. Creditors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	1,800	1.1.2016	By Balance b/d	14,000
31.12.2016	To General Ledger Adj. A/c :		31.12.2016	By General Ledger Adj. A/c:	
	Cash paid	21,000		Purchases (credit)	34,500
	Discount received	400		Bills payable dishonoured	3,000
	Returns outwards	1,500		Sundry charges	100
	Bills payable renewed	2,000		B/R endorsed dishonoured (Note 1)	1,000
	Bills receivable endorsed	4,500		Interest on renewed bills	500
	Trans. from Debtors Ledger (Note 3)	500		Bills payable cancelled for renewal	2,000
	Trans. to Debtors Ledger	700		(Note 2)	
	Bills payable accepted*	12,000	31.12.2016	By Balance c/d	1,200
31.12.2016	To Balance c/d	11,900			
		56,300			56,300

* excluding renewal

In the Debtors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	2,000	1.1.2016	By Balance b/d	16,000
31.12.2016	To Debtors Ledger Adj. A/c :		31.12.2016	By Debtors Ledger Adj. A/c :	
	Collection from Debtors	62,000		Credit Sales (Note 4)	72,000
	Discount allowed	300		Bills receivable dishonoured	2,500
	Returns inwards	2,500		Bills receivable endorsed	
	Bills receivable	10,000		dishonoured (Note 1)	1,000
	Bad debts	400	31.12.2016	By Balance c/d	1,300

	Transferred to Creditors Ledger	500			
	Transferred from Creditors Ledger	700			
31.12.2016	To Balance c/d	14,400			
		92,800			92,800

In the Creditors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	14,000	1.1.2016	By Balance b/d	1,800
31.12.2016	To Creditors Ledger Adj. A/c :		31.12.2016	By Creditors Ledger Adj. A/c :	
	Credit purchases	34,500		Cash paid	21,000
	Bills payable dishonoured	3,000		Discount received	400
	Sundry charges	100		Returns outward	1,500
	B / R endorsed dishonoured (Note 1)	1,000		B / P renewed	2,000
	Interest on renewed bill	500		B/R endorsed	4,500
	B / P cancelled for renewal (Note 2)	2,000		Transferred from Debtors Ledger	500
31.12.2016	To Balance c/d	1,200		Transferred to Debtors Ledger	700
				B / P accepted (excl. renewed)	12,000
			31.12.2016	By Balance c/d	11,900
		56,300			56,300

Working Notes :

(1) Bills receivable endorsed dishonoured will increase both debtors and creditors balances.
(2) For renewal, bills payable is to be cancelled first by debiting Bills Payable Account and crediting Creditors Account.
(3) Both transfer from Debtors Ledger to Creditors Ledger and from Creditors Ledger to Debtors Ledger will decrease both debtors and creditors balances at the same time.
(4) Cash sales, provision for doubtful debts, bills receivable discounted will not affect Adjustment Account.
(5) Cash purchases, acceptance matured will not affect Adjustment Account.

Rectification of Errors relating to Self-Balancing System

We have already discussed in Chapter 16, the details procedures of rectification of errors. The same procedures are to be applied here with some modifications.

For rectification of errors relating to Self-balancing system, the following steps should be followed:

Step 1 Rectify the errors in the usual manner, as if the ledgers are not kept under self-balancing system.

Step 2 Assess the nature of the error. If it is affecting the totals of some subsidiary books, (e.g., sales day book, purchases day book, returns inwards book, returns outwards book, bills receivable book, bills payable book) it is to be rectified by passing a self-balancing entry. No self-balancing entry is required if it is not affecting the totals of subsidiary books.

Illustration 28

The following errors were detected on 31st December, 2016.

(i) Purchases Day Book was undercast by ₹ 500; (ii) Sales Day Book was undercast by ₹ 300; (iii) A cheque of ₹ 2,000 issued to Karmakar & Co was recorded as having been issued to M/s K. M. Kar & Co; (iv) Goods worth ₹ 250 returned by Das & Co, were entered in the Day Book as ₹ 2,500.

You are required to show all the Journal entries necessary to rectify the above errors assuming that the ledgers are maintained on self-balancing system.

Solution **Journal** **Dr. Cr.**

Date	Particulars		₹	₹
2016 Dec.31	(a) Purchases A/c	Dr.	500	
(i)	To Suspense A/c			500
	(Being the undercasting in Purchase Day Book, now rectified)			
	(b) General Ledger Adjustment A/c (In the Creditors Ledger)	Dr.	500	
	To Creditors Ledger Adjustment A/c (In the General Ledger)			500
	(Being the necessary adjustment for undercasting error in the Purchases Day Book)			
(ii)	(a) Suspense A/c	Dr.	300	
	To Sales A/c			300
	(Being the undercasting in Sales Day Book, now rectified)			

	(b) Debtors Ledger Adjustment A/c (In the General Ledger) Dr. To General Ledger Adjustment A/c (In the Debtors Ledger) (Being the adjustment for undercasting error in the Sales Day Book)	300	300
(iii)	Karmakar & Co A/c Dr. To K.M. Kar & Co A/c (Being cheque issued to Karmakar & Co wrongly debited to K.M. Kar & Co, now rectified)	2,000	2,000
(iv)	(a) Das & Co A/c Dr. To Returns Inwards A/c (Being goods worth ₹ 250 returned by Das & Co were entered in the Day Book as ₹ 2,500, now rectified)	2,250	2,250
	(b) Debtors Ledger Adjustment A/c (In the General Ledger) Dr. To General Ledger Adjustment A/c (In the Debtors Ledger) (Being adjustment for excess credit to Debtors for goods returned)	2,250	2,250

Illustration 29

Following errors are detected after opening Suspense Account but before preparing Final Accounts:

1. Goods of the value of ₹ 100 returned by Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account.
2. An amount of ₹ 150 entered in the Sales Returns Book, has been posted to the debit of Philip, who returned the goods.
3. A sale of ₹ 200 made to Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Radheshyam (a customer) as ₹ 20.
4. No entry appeared for Bad Debts aggregating ₹ 450 except writing-off the individual debtors in the Sales Ledger.
5. The total of "Discount Allowed" column in the Cash Book for the month of September amounting to ₹ 250 was not posted.

Rectify by journal entries under (a) Single Ledger and (b) Self-balancing Ledgers.
Ignore narrations.

Solution **Journal**

Date	Particulars	Dr. ₹	Cr. ₹
	(a) Rectification under Single Ledger		
1.	Sales A/c Dr. Sales Returns A/c Dr. To Suspense A/c	100 100	 200
2.	Suspense A/c Dr. To Philip A/c	300	 300
3.	Ghaneshyam A/c Dr. To Radheshyam A/c To Suspense A/c	200	 20 180
4.	Bad Debts A/c Dr. To Suspense A/c	450	 450
5.	Discount A/c Dr. To Suspense A/c	250	 250
	(b) Rectification under Self-Balancing System		
1.	(i) Sales A/c Dr. Sales Return A/c Dr. To Suspense A/c (In Debtors Ledger)	100 100	 200
	(ii) General Ledger Adjustment A/c (In Debtors Ledger) Dr. To Debtors Ledger Adjustment A/c (In General Ledger)	200	 200
2.	Suspense A/c Dr. To Philip A/c (In Debtors Ledger)	300	 300
3.	Ghaneshyam A/c Dr. To Radheshyam A/c To Suspense A/c (In Debtors Ledger)	200	 20 180
4.	(i) Bad Debts A/c Dr. To Suspense A/c (In Debtors Ledger)	450	 450
	(ii) General Ledger Adjustment A/c (In Debtors Ledger) Dr. To Debtors Ledger Adjustment A/c (In General Ledger)	450	 450

5.	(i) Discount A/c To Suspense A/c (In Debtors Ledger)	Dr.	250	 250
	(ii) General Ledger Adjustment A/c (In Debtors Ledger) To Debtors Ledger Adjustment A/c (In General Ledger)	Dr.	250	 250

Balancing and Reconciling Control Accounts

The Control Account should be balanced at regular intervals (at least once in a month). This balance must be checked with the total of individual personal account balances in the Debtors ledger / Creditors ledger.

The balance of the Control Account may not agree with the total of individial personal account balances because of the following reasons :

1. Wrong amount has been posted in the Control Account because of casting error in the day book.
2. Transaction has been recorded in the Control Account without posting to individual personal accounts.
3. Wrong balancing of individual personal accounts in the Debtors / Creditors ledger.
4. A transposition error may occur in an individual balance, e.g., ₹ 240 has been posted as ₹ 420.

Illustration 30

At 31st December, 2016 the balance on the Debtors Control Account in Sourav's general ledger was ₹ 39,982. The total of the list of balances on the customers' personal accounts was ₹ 39,614.

Sourav has discovered the following errors :

(i) An invoice of ₹ 288 was entered correctly in the general ledger, but no entry was made in the personal account.

(ii) A payment of ₹ 1,300 was accepted in full settlement of a balance of ₹ 1,309. No entry was made to record the discount.

(iii) A credit note issued to a credit customer for ₹ 120 was incorrectly treated as an invoice.

(iv) An addition error on a personal account meant that the balance was understated by ₹ 27.

(v) A customer had lodged a payment of ₹ 325 directly to Sourav's bank account. The balance on the personal account was adjusted, but no entry was made in the general ledger.

(vi) An invoice for ₹ 644 was posted as ₹ 466 in the general ledger.

(vii) A credit balance of ₹ 47 on a customer's account was treated as a debit balance.

Required :

(a) Show the Debtors Control Account, including the necessary correcting entries and the corrected balance.

(b) Prepare a Reconciliation of the list of balances to the corrected balance on the Debtors Control Account.

(c) State the correct Debtors balance for inclusion in the final accounts and indicate where it should be reported on the Balance Sheet.

Solution

(a) In the General Ledger

Dr. Debtors Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec. 31	 To Balance b/d To Sales A/c (Invoice Error)	 39,982 178	2016 Dec. 31	 By Discount Allowed A/c By Sales A/c (₹ 120 x 2) By Bank A/c (Direct payment) By Balance c/d	 9 240 325 39,586
		40,160			40,160

(b) Reconciliation Statement of Debtors Control Account

Particulars	₹	₹
List of balance (Total)		39,614
Add: Invoice omitted	288	
Addition error on a personal account	27	315
		39,929
Less: Discount omitted	9	
Credit Note wrongly treated as invoice	240	
Credit balance of a customer treated as debit balance (₹ 47 x 2)	94	343
Correct Total		39,586

(c) The correct ledger balances of ₹ 39,586 should be shown in the Balance Sheet as ***Current Assets***.

Illustration 31

You are assisting in the preparation of the year end accounts of A & Co. The balance on the Creditors Ledger Control Account in the general ledger is ₹ 45,505. The total amount of the list of balances on the Suppliers' Personal Account is ₹ 46,886.

You have noted the following :

(i) An invoice from a supplier for ₹ 739 has been entirely omitted from the accounting records.

(ii) A credit note received from a supplier for ₹ 266 was entered in the day book as an invoice.

(iii) No entries have been made in respect of an agreement to offset a credit balance of ₹ 864 in the Creditors ledger against a debit balance in the Debtors ledger.

(iv) Payments to a supplier totalling ₹ 1,800 have been recorded in the general ledger, but no entries have been made in the supplier's personal account.

(v) A payment of ₹ 17,500 was made to settle a balance of ₹ 17,585. The balance on the supplier's personal account was fully written off, but only the payment of ₹ 17,500 was entered in the general ledger.

(vi) A payment of ₹ 340 to a supplier was recorded in the cheques issued day book as ₹ 430.

(vii) A credit balance of ₹ 167 on a supplier's account was listed as a debit balance.

Required :

(a) Prepare the Creditors Ledger Control Account including the necessary adjusting entries and the corrected balance. (**NB** : You must present your answer in a format which clearly indicates whether such entry is a debit entry or a credit entry.)

(b) Prepare the Reconciliation of the list of balances to the corrected balance on the Creditors Ledger Control Account.

(c) State the correct payables balance for inclusion in the final accounts and where it should be reported.

Solution

(a) In the General Ledger

Creditors Ledger Control Account

Dr. | | | | | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Purchases (₹ 266 x 2)	532	?	By Balance b/d (Given)	45,505
	To Debtors Ledger Control A/c	864		By Purchases A/c	739
	To Discount Received A/c	85		By Bank A/c (Payment overstated)	90
	To Balance c/d	44,853			
		46,334			46,334

(b) Reconciliation Statement of Creditors Ledger Control Account

Particulars		₹	₹
List of balances (Total)			46,886
Add:	(i) Purchase invoice omitted	739	
	(ii) Payment overstated	90	
	(iii) Balance incorrectly listed (₹ 167 x 2)	334	1,163
			48,049
Less:	(i) Credit Note recorded as invoice in the day book (₹ 266 x 2)	532	
	(ii) Offset	864	
	(iii) Payment omitted	1,800	3,196
Adjusted List of Balances			44,853

(c) The correct ledger balances of ₹ 44,853 should be shown in the Balance Sheet as ***Current Liabilities***.

Illustration 32

As at 31 March, 2017, the balance on the sales ledger control account of ITC Ltd was ₹ 1,56,300, whilst the total of the list of balances on the sales ledger was ₹ 1,51,835. At the same time, the balance on the purchase ledger control account was ₹ 1,70,690. The total of the list of balances on the purchase ledger as at that date was ₹ 1,37,645 — this is after deducting debit balances of ₹ 900 (Telco Ltd) and ₹ 16,200 (Reliance Ltd).

You are also given the following information :

(1) The debit balance on the account of Telco Ltd arose as a result of posting a payment of ₹ 4,500 as ₹ 5,400.

(2) The debit balance on the account of Reliance Ltd represent a payment in advance for goods to be delivered and invoiced in April 2017.

(3) The purchase day book for 29 March 2017 had been incorrectly cast, overcasting the total by ₹ 1,260.

(4) A purchase of ₹ 7,050 from HPCL had not been posted to HPCL's account in the purchase ledger.

(5) An invoice received from H M Ltd for ₹ 15,000 had been entered in the purchase day book as ₹ 1,500.

(6) A bad debt of ₹ 3,695 written-off the Sare Gama Ltd in the sales ledger had been posted to the purchase ledger control account.

(7) Discount received amounting to ₹ 19,370 had been posted to the relevant accounts in the purchase ledger but no posting had been made to either the purchase ledger control account or the discount received account.

(8) A contra entry of ₹ 770 between the accounts of Tisco Ltd in the sales and purchase ledger had not been posted to either the sales ledger control account or the purchase ledger control account.

You are required to :

(a) Prepare a Sales Ledger Control Account Reconciliation and a Purchase Ledger Control Account Reconciliation as at 31 March 2017.

(b) Prepare any journal entries required to reflect the information contained in (1) to (8) above.

(c) Calculate the amouts to be shown on the Balance Sheet as at 31 March 2017 in respect of trade debtors and trade creditors.

Solution **Reconciliation Statement of Sales Ledger Control Account**

Particulars	₹	₹
Balance as per Sales Ledger Control Account		1,56,300
Less: (6) Bad Debts written-off (wrongly posted)	3,695	
(8) Tisco Ltd — Contra	770	4,465
Adjusted Balance		1,51,835
List of Balance		1,51,835

Reconciliation Statement of Purchases Ledger Control Account

Particulars	₹	₹
Balance as per Purchases Ledger Control Account		1,70,690
Add: (5) Correction of H M Ltd's invoice		13,500
		1,84,190
Less: (3) Overcasting of Purchase Day Book total	1,260	
(6) Bad Debts wrongly posted	3,695	
(8) Tisco Ltd. — Contra	770	
(7) Discount Received not recorded in the General Ledger	19,370	25,095
Adjusted Balance		1,59,095
List of Balances		1,37,645
Correct Telco Balance		900
Purchase from HPCL not posted		7,050
HM Ltd's invoice of ₹ 15,000 recorded as 1,500		13,500
Adjusted List of Balances		1,59,095

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Purchase Ledger Control A/c	Dr.	1,260	
	To Purchases A/c			1,260
	(Being the overcasting of purchases day book, now adjusted)			
	Purchase Ledger Control A/c	Dr.	19,370	
	To Discount Received A/c			19,370
	(Being the discount received not posted in the general ledger, now adjusted)			
	Purchase Ledger Control A/c	Dr.	3,695	
	To Sales Ledger Control A/c			3,695
	(Being the adjustment for bad debts written-off)			
	Purchases A/c	Dr.	13,500	
	To Purchase Ledger Control A/c			13,500
	(Being invoice of ₹ 15,000 wrongly recorded as ₹ 1,500, now rectified)			
	Purchase Ledger Control A/c	Dr.	770	
	To Sales Ledger Control A/c			770
	(Being the contra for Tisco Ltd. Account)			

Amount to be Shown in the Balance Sheet

Trade Debtors	₹	Trade Creditors	₹
Adjusted Sales Ledger Control Account balance	1,51,835	Adjusted Purchase Ledger Control Account bal.	1,59,095
Add: Advance from Reliance Ltd	16,200	Add: Debit balance of Reliance Ltd	16,200
	1,68,035		1,75,295

Key Points

- Under Sectional Balancing System, two additional accounts are kept in General Ledger. These are : (i) Total Debtors Account; and (ii) Total Creditors account.
- The balance in the Debtors Control Account should be equal to the total balances of individual debtors.
- The total balance in the Creditors Control Account should be equal to the balances of individual creditors.
- Control accounts provide an internal check. The staff posting the entries to the Control Accounts will act as a check on different staff(s) posting entries in the Debtors ledger and Creditors ledger.
- Self-Balancing is a system of ledgers keeping by means of which each ledger can be balanced independently with the other ledgers.

THEORETICAL QUESTIONS

1. State the purposes of using Control Accounts.
2. (a) What is 'Self-Balancing Ledger' ? (b) Why adjustments are necessary in the Self-Balancing System?
3. State the advantages of Self-Balancing System.
4. What is Sectional Balancing System ? State the advantages of Sectional Balancing.
5. On account of the very large number of his transactions, a merchant keeps a separate Bought Ledger and a separate Sold Ledger as also a General Ledger. What matters would you expect to find in each of the above ledgers ? How would you make each of the above ledgers Self-Balancing ?
6. It is said that "In a business of any magnitude it is desirable to raise total accounts in respect of Debtors and Creditors Ledgers". What are these total accounts and why is it desirable to raise them ?
7. What is Self-Balancing Ledger ? How is it different from Sectional Balancing Ledger ? What are the advantages of Self Balancing Ledger ?

   [C.U.B.Com. (Hons.) — 2016]
8. (a) What is Self Balancing System ?
   (b) Why transactions like 'Cash Sales' and 'Provision for Doubtful Debts' are not recorded under Self Balancing Ledger System ?

   [C.U.B.Com. (Hons.) — 2015]

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. When carrying out the reconciliation of the balance on the Debtors' Ledger Control Account with the list of balance from debtors ledger, X found the following :
   (i) total of the sales day book was overcast by ₹ 900;
   (ii) a sales invoice for Ram was posted to Raman's Account;
   (iii) an invoice to a customer for ₹ 650 has been recorded as ₹ 560 in the sales day book.
   Which of the errors will require an entry in the general ledger ?
   A all three
   B (i) and (ii) only
   C (i) and (iii) only
   D (ii) and (iii) only
2. Which of the following statements is / are correct ?
   (i) the debtors ledger control account balance ***must be correct*** if it agrees with the total of the list of balances from the receivable ledger;
   (ii) if there is a different between the balance on the debtors ledger control account and the total of the list of balances from the debtors ledger, the balance in the control account is always correct;
   A both (i) and (ii)
   B neither (i) nor (ii)
   C (i) only
   D (ii) only

3. Kabir's book keeper has prepared the following trade creditors ledger reconciliation :

	₹
Balance on general ledger control account	78,553
Less: Discount not recorded in general ledger	128
	78,425
Add: Debit balance of ₹ 100 included on list of balances as credit balance	200
Total list of balances	78,625

What is the correct trade creditors balance to be reported in the Balance Sheet ?

A ₹ 78,425
B ₹ 78,553
C ₹ 78,625
D ₹ 78,753

4. Sriram has prepared the following reconciliation of the balance on the debtors ledger control account in his general ledger to the total of the list of balances on customer's personal accounts :

	₹
Balance on debtors ledger control account	35,776
Less: Balance omitted from list of balances	452
	35,324
Add: Sales day book undercast	900
	36,224

What is the correct balance of debtors to be reported on the Balance Sheet ?

A ₹ 35,324
B ₹ 35,776
C ₹ 36,224
D ₹ 36,676

5. Consider the following statements about control accounts.
(i) Control accounts can help to speed up the preparation of draft accounts by providing the balance sheet value for trade debtors and trade creditors.
(ii) Control accounts are used in double entry book-keeping only.

	(i)	(ii)
A	True	False
B	True	True
C	False	True
D	False	False

6. While preparing the creditors ledger reconciliation for a client, you noted the following errors :
(i) An invoice for ₹ 215 from a supplier was not entered in the accounting records.
(ii) An invoice for ₹ 465 was recorded as ₹ 456 in the purchase day book.
Which of the errors will cause a difference between the balance on the control account in the general ledger and the total of the list of balances from the personal ledger ?

A (i) only
B (ii) only
C both (i) and (ii)
D neither (i) nor (ii)

7. Praveen prepared the following creditors ledger reconciliation statement.

	₹
Balance on general ledger control account	46,865 (Credit)
Payment entered twice in general ledger control account	573 (Credit)
	47,438 (Credit)
Purchase day book overcast	900 (Debit)
Total of list of balances	46,538 (Credit)

How should the payable ledger balance be reported in the Balance Sheet ?

A ₹ 46,538 as a current asset
B ₹ 46,538 as a current liability
C ₹ 46,865 as a current asset
D ₹ 46,865 as a current liability

8. On checking the list of balances on the creditors ledger accounts, it was found that the total is ₹ 2,250 more than the balance on the creditors control account in the general ledger.
   Which of the following erros could, by itself, account for this difference ?
   A The total of contra entries against debtor accounts is overstated by ₹ 1,125.
   B Purchases day book has been overcast by ₹ 2,250.
   C A credit note to the value of ₹ 1,125 has been omitted from a creditors ledger account.
   D A creditors ledger account with a debit balance of ₹ 1,125 has been treated as a credit balance.

The following information relates to questions 9 and 10.

Robin is preparing a reconciliation of the balance on the creditors ledger control account in the general ledger to the total of the list of balances of individual accounts in the creditors ledger. He has discovered the following:

(i) A debit balance on a suppliers' account was listed as a credit balance.
(ii) An invoice for ₹ 376 was entered in the purchase day book as ₹ 387.

9. Which of the errors will require an adjustment to the creditors ledger control account in the general ledger?
   A neither (i) nor (ii)
   B (i) only
   C (ii) only
   D both (i) and (ii)
10. Which of the errors will require an adjustment to the list of balances ?
   A neither (i) nor (ii)
   B (i) only
   C (ii) only
   D both (i) and (ii)

PRACTICAL QUESTIONS

Sectional Balancing System

1. From the following information, prepare: (i) Total Debtors Account; and (ii) Total Creditors Account.

1.1.2017 : Balance of Sundry Debtors ₹ 32,000; Balance of Sundry Creditors ₹ 37,000.

30.6.2017 : Balances of other Accounts

	₹		₹
Credit purchases	9,000	Bills receivable received	6,000
Credit sales	19,600	Returns inwards	1,750
Cash sales	1,500	Returns outwards	1,200
Cash purchases	1,000	Rebate allowed to debtors	550
Paid to creditors	19,750	Rebate allowed by creditors	300
Discount received	650	Provision for doubtful debts	320
Cash received from debtors	15,600	Bad debts	900
Discount allowed	400	Bills receivable dishonoured	750
Bills payable accepted	3,000	Bad debts, previously written off, now recovered	500

2. From the following informations, prepare Total Debtors Account in the General Ledger. (all figures in ₹)

Debtors - opening balances : Dr.	2,00,000	Bills receivable received	1,00,000
Debtors - opening balances : Cr.	10,000	Bills receivable discounted	40,000
Discount allowed	30,000	Provision for bad debts	10,000
Cash and cheques receipts	8,00,000	Bad debts recovered	5,000
Credit sales	10,00,000	Transfer from Debtors to Creditors Ledger	5,000
Returns inwards	20,000	Transfer from Creditors to Debtors Ledger	6,000
Bad debts	15,000	Closing credit balance in Debtors	30,000

3. Prepare Total Accounts from the following particulars in the General Ledger. (all figures in ₹)

1.1.2017	Balance on Bought Ledger (Dr.)	1,740	Cash received from customers	1,52,420
	Balance on Bought Ledger (Cr.)	23,880	Discount allowed thereon	5,640
	Balance on Sales Ledger (Dr.)	29,240	Cash paid to suppliers	1,16,860
	Balance on Sales Ledger (Cr.)	480	Discount received thereon	3,320
31.1.2017	Purchases	1,32,360	Cash paid to customers	260
	Purchases returns	5,120	Bills receivable	8,240
	Sales	1,74,980	Bills payable	4,500
	Sales returns	2,340	Bills receivable dishonoured	500
	Bought Ledger balances (Dr.)	1,540	Sales Ledger balances (Cr.)	36,700

4. From the following information prepare Total Debtors Account and Total Creditors Account in the General Ledger of ABC Ltd. (all figures in ₹)

Debtors on 1.1.2017	4,575	Cash paid to suppliers	3,070
Creditors on 1.1.2017	5,490	Discount received	67
Transactions for the year :		Allowances from creditors	28
Credit purchases	2,050	Acceptances received from Debtors	850
Credit sales	2,270	Acceptances given to creditors	1,200
Returns inwards	40	Bills receivable dishonoured	120
Returns outwards	60	Bills payable dishonoured	300
Cash received from customers	2,550	Bad debts written-off	250
Discount allowed	45	Sundry charges debited to customers	35

5. HP Ltd has prepared the following sales ledger control account for December 2016 :

Dr. **Sales Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 1	Balance b/d	32,168	Dec. 31	Bank	59,861
Dec. 31	Sales	45,972		Discount allowed	2,563
	Returned cheque	123		Returns inwards	1,879
				Balance c/d	13,960
		78,263			78,263
2017					
Jan. 1	Balance b/d	13,960			

The following errors are then discovered:

(1) The sales day book total has been overcast by ₹ 2,500.

(2) The returns inwards figure should have been ₹ 1,789.

(3) There is a contra entry with the purchase ledger of ₹ 560, representing an account settled with a supplier, which has been omitted.

(4) An account for J M Ltd was credited with a cheque for ₹ 769; this should have been credited to J B M and Son.

Redraft the sales ledger control account making the entries necessary to show the correct balance to be brought down.

6. You are carrying out a reconciliation between the balance on the trade debtors control account (which is ₹ 64,969) and the total of the list of the balances on the customers' personal accounts (which is ₹ 65,132). You have found the following reasons for the difference :

(i) A sales invoice for ₹ 320 was entered in the sales day book as ₹ 230.

(ii) The total of the sales returns day book was understated by ₹ 900.

(iii) A credit note for ₹ 460 was treated as an invoice when the entries were being made in the personal ledger.

(iv) A customer paid ₹ 1,700 in full settlement of a balance of ₹ 1,715. The discount was correctly recorded in the personal ledger, but was not entered in the control account.

(v) The total value of cheques received from customers was ₹ 67,908 but ₹ 67,980 was posted to the control account.

(vi) A debit balance of ₹ 20 on a customer's account was omitted.

(vii) A credit balance of ₹ 53 on a customer's account was treated as a debit balance.

Required :

(a) Show the trade debtors control account, including any necessary correcting entries and the corrected closing balance.

(b) Prepare a reconciliation of the total of the list of balances on the customers' personal accounts to the corrected balance on the trade debtors control account.

(c) State the amount to be reported in the final accounts for trade debtors and indicate how this balance will be reported.

7. You are employed as a Trainee Accountant in Robin and Co. One of your task is to prepare the monthly reconciliation of the balance on the creditors control account in the general ledger (₹ 98,524) to the list of balances from the creditors ledger (₹ 97,264).

When preparing the reconciliation at 31st December, 2016, you have noted the following :

(i) One of the suppliers agreed to accept ₹ 1,500 in payment of a balance of ₹ 1,514. The full balance of ₹ 1,514 was deducted from the supplier's personal account, but only the cheque issued was recorded in the general ledger.

(ii) There is an ongoing agreement to offset balances with Rahul, who is both a customer and a supplier. The amount for December is ₹ 2,856. No entries have yet been made.

(iii) A credit balance of ₹ 623 on the account of Anil was listed as a debit balance.

(iv) An invoice for ₹ 462 received from Mukesh was incorrectly recorded in the purchase day book as a credit note.

(v) Your company makes direct payments to Amar. The payment of ₹ 974 made in December has not been recorded.

(vi) An invoice for ₹ 760 from Zahir was entered in the purchase day book as ₹ 670.

Required :

(a) Show the Creditors Control Account in the general ledger, including the necessary adjusting entries and the corrected balance. (**NB**: You must present your answer in a format which clearly indicates whether each entry is a debit entry or a credit entry.)

(b) Prepare a reconciliation of the total of the list of balances on the Creditors Control Account in the General Ledger.

(c) State the correct creditors balance for inclusion in the final accounts and indicate where it should be reported on the Balance Sheet.

8. The sales ledger supervisor of H Ltd has been taken ill and the inexperienced ledger clerk is having problems balancing the ledgers for the month of February 2017. He presents you with the following information and asks for your help.

The balances on the individual accounts at 28 February are :	₹
R & Sons	100
S Ltd	1,160
C Lion & Co Ltd	2,835
Sea Food Ltd	490
A Ltd	195
B Ltd	235
C Ltd	180
D Ltd	740
	5,935

The balance brought forward on the control account for 1 February is ₹ 6,830.

The clerk says he has entered the following items on the customers' accounts to get the above balances:

	₹	₹	₹	₹
R & Sons	250	190	—	—
S Ltd	490	960	40	—
C Lion & Co ltd	365	745	15	125
Sea Food Ltd	45	85	—	30
A Ltd	—	25	—	—
B Ltd	70	50	—	—
C Ltd	230	30	—	—
D Ltd	510	290	30	
	1,960	2,375	85	155

When he enters the above totals in the sales ledger control account it does not balance to the total of the customer's accounts.

On investigation you find that :

(a) Sales to S Ltd have been mistakenly entered on S Lal's account in the creditors ledger.

(b) A contra has been entered on the account of B Ltd for ₹ 65 against his account on the creditors ledger. This has not been recorded on the control account.

(c) An invoice for ₹ 210 in respect of C Lion & Co Ltd has been omitted from the list of sales and is not included in the individual account balances on 28 February.

(d) The account for Mr C Rao showing a balance of ₹ 165 has been removed from the sales ledger as the debt has been proven to be bad.

(e) The cheque from R & Son has been returned by the bank marked 'refer to drawer'.

(f) A credit note for ₹ 450 has been posted to the account of D Ltd but not to the control account.

(g) The cash received from C Lion & Co had not been entered in the customer account.

(h) The chief accountant has been looking at the account of G Ltd. You have reason to believe the customer account showing a credit balance of ₹ 185 is locked in his filing cabinet.

You are required to :

(a) complete the sales ledger control account; and

(b) reconcile the list of individual debtors account balances to the control account balance.

9. The following information has been taken from the books of Southern Chemicals in respect of the year ended 31 March, 2017 :

	₹
Sales ledger control account balance at 1 April, 2016	49,251
Return by credit customers	6,144

Credit sales	5,44,382
Cash sales	36,243
Settlement discounts allowed to credit customers	1,316
Cash received from credit customers	5,26,139

The following additional information has been established :

(a) The list of balances on the sales ledger at 31 March, 2017 totals to ₹ 62,183; a similar list at 31 March, 2016, agreed with the sales ledger control account at their date.

(b) Credit balances on the sales ledger at 31 March, 2017 amounting to ₹ 1,066 were entered as debit balances on the list extracted at that date.

(c) An amount of ₹ 62, received during the year from Salmon & Co., a supplier, in settlement of a debit balance on the bought ledger was entered in the sales ledger column in the cash book, and was posted to the account of Solomon Brothers in the sales ledger.

(d) Cash received from customers includes ₹ 315 in respect of a debt which was written-off at 31 March, 2016. This has not been posted to the sales ledger as no account exists.

(e) A sub-total of ₹ 3,456 in the sales day book total column has been carried forward as ₹ 3,654.

(f) A total in the sales ledger column of the cash book has been undersummed by ₹ 100.

(g) An amount of ₹ 39 received during the year from H Co Ltd., has been posted to the account of B & Co. (Holdings) Ltd.

(h) It was agreed during the year that an amount of ₹ 52 owing by M B & Sons would be settled by contra with a similar balance on their account in the bought ledger. No entries have yet been made in respect of this contra.

You are required to prepare the sales ledger control account for the year ended 31 March, 2017 and to reconcile the balance with the list of debtors' balances.

Self Balancing System

10. M/s XYZ Limited maintains its books under the Self-balancing system. From the following particulars at the close of the year, write up the necessary adjustment accounts as they would appear in the General Ledger :

Closing Debtor's balance as per General Ledger Adjustment Account (Cr.) ₹ 60,000; Credit sales ₹ 40,000; Cash sales ₹ 10,000; Purchases (50% on credit) ₹ 30,000; Payment to creditors ₹ 7,500; Discount allowed ₹ 1,500; Discount received ₹ 500; Payment from customers ₹ 20,000; Bad debts ₹ 5,000.

Closing Creditor's balance as per General Ledger Adjustment Account(Dr.) ₹ 30,000; Bills payable accepted ₹ 5,000; Bills receivable received ₹ 3,000.

Discount allowed to Debtors amounting to ₹ 500 was recorded as Discount received from creditors.

11. Prepare Purchase and Sales Ledger Adjustment Account as would appear in the Nominal Ledger from the following particulars :

On 1st Jan 2016 : Balance on Purchases Ledger ₹ 174(Dr.) 2,388 (Cr.);
Balance on Sales Ledger ₹ 2,924 (Dr.) 48 (Cr.)

31.12.2016	Purchases	13,036	Purchases returns	512
	Cash paid to suppliers	11,686	Discounts received thereon	336
	Sales	17,498	Sales returns	234
	Cash received from customers	15,248	Discount allowed thereon	564
	Bills payable	450	Bills receivable	824
	Transfer from purchases to sales ledger	152	Purchases ledger balances (Dr.)	154
	Sales ledger balances (Cr.)	84		

12. You have been furnished with the following information by M/s Mehra & Sons, New Delhi :

Opening Balances : Bought Ledger : Credit Balances ₹ 2,70,900; Debit Balances ₹ 29,000; Sales Ledger : Debit Balances ₹ 3,27,000

	₹		₹
Purchases returns	2,700	Cheques issued in favour of creditors	8,32,800
Acceptance of Bills payable	1,00,000	Credit sales	18,27,000
Credit purchases	9,27,600	Discount received	22,500
Receipts from Debtors	13,42,000	Bills receivable	6,00,000
Discount allowed	7,500		

You have to prepare :

(i) Bought Ledger Adjustment Account in General Ledger;

(ii) Sales Ledger Adjustment Account in General Ledger; and

(iii) General Ledger Adjustment Account in the Sales Ledger.

13. X Co. Ltd. have three Ledgers — Debtors Ledger, Creditors Ledger and General Ledger which are all kept under self-balancing. From the following particulars, prepare the relevant adjustment accounts that would appear in the General Ledger.

Particulars	₹	Particulars	₹
Debtors balance on 1.1.2016 (Dr.)	15,000	Bills receivable drawn	7,500
Debtors balance on 1.1.2016 (Cr.)	1,000	Bills receivable dishonoured	2,000
Creditors balance on 1.1.2016 (Dr.)	600	Bills receivable discounted	1,500
Creditors balance on 1.1.2016 (Cr.)	12,800	Bills receivable endorsed to creditors	4,300
Purchases (including cash ₹ 1,500)	36,000	Bills receivable as endorsed to creditors dishonoured	1,000
Sales (including cash ₹ 3,000)	75,000	Bad Debt	800
Cash paid to creditors	21,000	Provision for bad debts	1,100
Collection from debtors	62,000	Transfer from Debtors Ledger to Creditors Ledger	500
Discount allowed	260	Bills payable accepted	4,000
Discount received	320	Debtors balance on 31.12.2016 (Cr.)	300
Returns inwards	2,400	Creditors balance on 31.12.2016 (Dr.)	200
Returns outwards	1,600		

14. Prepare Bought Ledger Adjustment Account and Sales Ledger Adjustment Account as would appear in the General Ledger of Sonali Enterprises for the year ended 31.12.2016 from the following information (all figures in ₹) :

Debtor balance on 1.1.2016 ₹ 15,000; Creditors balance on 1.1.2016 ₹ 17,100

Sales (including cash sales of ₹ 19,000)	45,000	Bills receivable dishonoured (incl. endorsed ₹ 300)	1,400
Purchases (including cash purchases ₹ 12,000)	30,000	Bad debts recovered	375
Cash paid to suppliers in full settlement of ₹ 19,800	19,000	Purchase returns	2,500
Cash recd. from customers in full settlement of ₹ 17,400	16,900	Sales returns	1,600
Bills payable accepted	1,300	Bad debts	750
Bills receivable received	2,900	Reserve for bad and doubtful debts	2,000
Bills receivable endorsed	800		

Included in the Debtors was an amount of ₹ 1,500 due from Barnali from whom goods worth ₹ 1,050 had been purchased. Barnali agreed to set off her claim against the amount due from her.

15. From the following information prepare Sales Ledger Adjustment Account and Bought Ledger Adjustment Account in the General Ledger :

On 1.1.2016 : Balance on Bought Ledger (Dr.) ₹ 5,000; (Cr.) ₹ 48,000; Balance on Sold Ledger (Dr.) ₹ 70,940; (Cr.) ₹ 1,120

		₹		₹
31.12.2016	Purchases	2,70,000	Reserve for doubtful debts	4,580
	Purchases returns	10,000	Cash paid to customers	920
	Total sales	3,84,000	Discount received	3,600
	Cash sales	20,000	Bills receivable received	20,000
	Sales returns	5,000	Bills payable issued	11,200
	Cash received from customers	3,12,000	Bills receivable dishonoured	3,000
	Discount allowed	5,600	Bought Ledger balance (Dr.)	5,200
	Cash paid to suppliers	2,40,000	Sales Ledger balance (Dr.)	91,600
	Transfer from Sales to Bought Ledger	10,400		

16. From the following particulars as extracted from the books of Wadia and Co., who keeps a Debtors Ledger, a Creditors Ledger and a General Ledger on self balancing system, show how the Debtors and Creditors Ledger Adjustment Accounts will appear in the General Ledger for the year 2016 (all figures in ₹):

1.1.2016	Debtors balance	45,750	Creditors balance	54,900
31.12.2016	Credit purchase	20,500	Credit sales	22,700
	Returns inwards	400	Returns outwards	600
	Cash received from customers	25,500	Discount allowed to customers	450
	Cash paid to creditors	30,700	Discount received from creditors	670
	Acceptances received from debtors	8,500	Creditors bill accepted	12,000
	Bills receivable returned dishonoured	1,200	Bills payable dishonoured	3,000
	Bad debts written-off	2,500	Misc. Exp. wrongly debited to Customers A/c	345
	Allowances from creditors	275		

17. From the following particulars, which have been extracted from the books of Gulzar and Co., for the year ended 31.12.2016 prepare General Ledger Adjustment Account in the Creditors Ledger Account and Debtors Ledger Adjustment Account in the General Ledger :

		₹		₹
1.1.2016	Debtors balance (Dr.)	20,000	Debtors balance (Cr.)	300
	Creditors balance (Dr.)	200	Creditors balance (Cr.)	15,000
31.12.2016	Purchases (including cash ₹ 4,000)	12,000	Sales (including cash ₹ 6,000)	25,000
	Paid to suppliers in full settlement of ₹ 9,000	8,500	Recd. from customers in full settlement of ₹ 15,000	14,100
	Bills payable accepted (incl. renewals)	2,000	Bills payable withdrawn upon renewals	500
	Interest on Bills payable renewed	20	Bills receivable received	3,000
	Bills receivable endorsed	800	Bills receivabled as endorsed dishonoured	300
	Bills receivable discounted	1,400	Bills receivable dishonoured	400
	Interest charged on dishonoured bills	30	Transfer from one ledger to another	600
	Returns to creditors	700	Debtors balance on 31.12.2016 (Cr.)	450
	Creditors balance on 31.12.2016 (Cr.)	10,870		

18. Messrs Pioneer and Co. are maintaining accounts on self-balancing system. On 31.12.2016 the General Ledger discloses the following balances :
(Sales Ledger Adjustment Account (Dr.) ₹ 35,235; Purchases Ledger Adjustment Account (Cr.) ₹ 15,530.
On scrutinising the ledgers, the following mistakes were notices :
(a) A credit purchase of ₹ 4,350 has been credited to the Sales Ledger Adjustment Account though the payment has been debited to the Purchase Ledger Adjustment Account. However, in the subsidiary books, these two entries have been entered only in the Purchase Ledger.
(b) ₹ 1,000 paid to Mr Holdger for goods purchased have been debited to the Sales Ledger Adjustment Account. In the subsidiary books, the party's account shows a debit balance in the Sales Ledger and a credit balance in the Purchase Ledger.
(c) ₹ 4,750 were due from Mr Albert in the Sales Ledger as against ₹ 7,740 due to him for purchases made and entered in the Purchase Ledger.
(d) The Sales Ledger balances disclose the sums aggregating ₹ 740 have to be written off as bad debts and discounts.
Prepare the necessary journal entries in the General Ledger and other Subsidiary Books.

Guide to Answers

Multiple choice

1. C 2. B; 3. A 4. D 5. A 6. D 7. B 8. D 9. C 10. D.

Practical Questions

1. Balance of Total Debtors Account is ₹ 27,150 (Dr.)
Total Creditors Account is ₹ 21,100 (Cr.).

2. Balance of Total Debtors Account is ₹ 2,44,000.

3. Balance of : Total Debtors Account is ₹ 72,560 (Dr.);
Total Creditors Account is ₹ 26,240 (Cr.).

4. Balance of : Total Debtors Account is ₹ 3,265 (Dr.);
Total Creditors Account is ₹ 3,415 (Cr.).

5. Balance of Sales Ledger Control Account is ₹ 10,990.

6. (a) Correct balance of Trade Debtors Control Account is ₹ 64,216.
(c) ₹ 64,216 will be shown as a current liability in the Balance Sheet.

7. (a) Correct balance of Creditors Control Account is ₹ 95,694.
(c) ₹ 95,694 will be shown as a current liability in the Balance Sheet.

8. Final Balance of Sales Ledger Control Account is ₹ 5,895;
Reconciliation : ₹ (5,935 + 490 + 210 + 190) *Less* ₹ (745 + 185) = ₹ 5,895.

9. Final Balance of Sales Ledger Control Account is ₹ 60,061;
Reconciliation : ₹ (62,183 + 62) *Less* ₹ (232 + 52) = ₹ 60,061.

10. Discount allowed was wrongly recorded as discount received. Therefore, the final debtors balance will be (₹ 60,000 – 500) = ₹ 59,500 and that of creditors balance will be (₹ 30,000 + 500) = ₹ 30,500.

11. Balance of Sales Ledger Adjustment Account ₹ 3,436 (Dr.)
Balance of Purchase Ledger Adjustment Account ₹ 2,268 (Cr.)

12. Balance of Sales Ledger Adjustment Account ₹ 2,04,500 (Dr.)
Balance of Bought Ledger Adjustment Account ₹ 2,11,500 (Cr.)

13. Balance of Debtors Ledger Adjustment Account ₹ 15,840 (Dr.)
Balance of Creditors Ledger Adjustment Account ₹ 16,180 (Cr.)

14. **Balance of Bought Ledger Adjustment Account ₹ 9,950 (Cr.)**
Balance of Sales Ledger Adjustment Account ₹ 18,700 (Dr.)

15. **Balance of Sales Ledger Adjustment Account ₹ 91,600 (Dr.)**
Balance of Bought Ledger Adjustment Acoount ₹ 43,000 (Cr.)

16. **Balance of : Debtors Ledger Adjustment Account is ₹ 31,955;**
Creditors Ledger Adjustment Account is ₹ 34,155.

17. **Balance of : General Ledger Adjustment Account in the Creditors Ledger is ₹ 350 (Dr.);**
Debtors Ledger Adjustment Account is ₹ 21,280.

18. **No answer is required.**

22

Insurance Claims

Introduction

A business may suffer abnormal losses due to different reasons such as fire, theft, burglary, strike, etc. Among them, the most common which destroys or causes severe damage to the assets like stock, building, plant, machinery, furniture, etc., is fire. When a fire takes place, the business naturally incurs heavy losses and, in turn, the normal business operations are disrupted. There may arise a tremendous strain on the working capital if the business does not possess adequate funds to replace the assets so destroyed. To cover the risk of loss from such events, a business may take on an insurance policy with an Insurance Company.

The business has to pay insurance premium at regular intervals as per the terms of the agreement — the insurance premium is charged to the Profit and Loss Account as an expense at the year-end. The insurance policy matures on the occurrence of any such mishap and the business is entitled to recover from the insurance company, the full value of the insurance policy or the actual cost of the assets lost, whichever is lower. When a business suffers a loss from an insured event, it has to notify the insurance company regarding the loss of the assets and to file a claim for compensation against those losses. Such claims are known as Insurance Claims. When a fire takes place, to file a claim with the Insurance Company for the loss of assets damaged or destroyed, a set of procedures is to be followed. Apart from the legal formalities, one of the most important problems that a business has to face is the determination of the amount of the claim to be lodged.

Types of Claims

A business takes a fire insurance policy to cover (i) the loss of assets including stock; and (ii) loss of profit (consequential loss). A business may take insurance policy for loss of cash due to theft or misappropriation.

When a fixed asset is destroyed, the computation of loss is simple. The value of such assets on the date of fire can be ascertained from the books of account of the business because most of them usually maintain proper records of the fixed assets. Fixed assets are recorded in the books of accounts at their acquisition cost, which becomes the basis for calculation of claim for the loss of fixed assets.

When a stock is destroyed the computation of loss is not so simple because the prices of different items of stock are seldom stable and are acquired at varying rates. For most of the businesses, particularly for trading concerns, stock taking is not maintained up to date. Therefore, at the time of accident no readymade value of stock is available. If the Stock Register is maintained properly, the value of stock lost by fire can be ascertained from it. However, the business may face a problem, even when the Stock Register is maintained up to date, if the books of account are also destroyed along with the stock.

Loss of Stock Policy

There are two steps for determination of claim for loss of stock:

(1) Ascertainment of the value of stock on the date of fire; and
(2) Ascertainment of actual amount of claim to be lodged.

1. Ascertainment of the Value of Stock on the Date of Fire

When it is not possible to ascertain the exact value of stock (destroyed by fire) from the Stock Register, the value of stock on the date of fire can be ascertained by constructing a Memorandum Trading Account for a period starting from the first day of the accounting period and ending on the date of fire. The following is a specimen of the Memorandum Trading Account.

Memorandum Trading Account
Dr. For the period from 1st day of the accounting year to the date of fire Cr.

Particulars	₹	Particulars	₹

To Opening Stock
To Purchases A/c
  Less: Return Outwards
To Direct Expenses A/c
To Carriage Inward A/c
To Wages A/c
To Gross Profit (% on sales)
		By Sales
		  Less: Return Inwards
		By Closing Stock
		(Balancing figure)	

The different items of the above Memorandum Trading Account are gathered as follows:

Debit Side

(i) Opening Stock: It is nothing but the closing stock of the last accounting period. Therefore, it can be ascertained from the Balance Sheet of the last accounting period.

(ii) (a) Purchases: These can be ascertained from the Purchase Day Book (credit purchases) and Cash Book (cash purchases).

(b) Return Outwards: It can be ascertained from the Return Outwards Book.

(iii) Direct Expenses: These can be ascertained from the Cash Book.

(iv) Carriage Inwards: It can be ascertained from the Cash Book.

(v) Wages: These can be ascertained from the Wages Register and Cash Book.

(vi) Gross Profit: It is calculated on sales, based on ***usual*** gross profit percentage of the last few years.

In the examination, sometimes readymade gross profit percentage may not be available. In that case, it is to be calculated on the basis of given information. Generally, information is related to last accounting year. At the time of calculation of gross profit percentage on sales, all the necessary adjustments must be made for:

(i) the slow moving items;
(ii) goods distributed as free sample;
(iii) goods taken by the proprietor/partners for personal use; and
(iv) over-valuation or under-valuation of stock.

Credit Side

(i) (a) Sales: These can be ascertained from the Sales Day Book (credit sales) and Cash Book (cash sales).

(i) (b) Return Inwards: It can be ascertained from the Return Inwards Book.

The difference between the debit side total and credit side total of the Memorandum Trading Account represents the estimated ***closing stock on the date of fire***.

2. Ascertainment of Actual Amount of Claim to be Lodged

The amount of loss to be compensated by the insurance company is always stipulated in the insurance policy, but under no circumstances, the claim for loss can exceed over the actual loss suffered by the business. When the business is fully compensated by the insurance company for the loss of stock, the insurance company becomes the owner of the stock, salvaged (saved), if any.

The Memorandum Trading Account shows the value of stock which is supposed to exist at the time of fire. Therefore, to ascertain the actual amount of claim to be lodged, we have to deduct the value of stock salvaged from the estimated value of closing stock on the date of fire, as ascertained from the Memorandum Trading Account. The actual amount of claim to be lodged is as follows:

Statement of Claim for Loss of Stock as on ...

	₹
Book value of Stock (as per Memorandum Trading Account)	****
Less: Salvaged (Retained by the business)	****
	****
Loss of Stock (claim to be lodged)*	****
	****

* Subject to average clause (discussed after Illustration 5)

Illustration 1

A fire occurred in the premises of Mr X on June 15, 2017 and a considerable part of the stock was destroyed. The value of the stock saved was ₹ 4,000.

The books disclosed that on 1st April, 2017 the stock was valued at ₹ 45,000; the purchases up to the date of fire amounted to ₹ 1,25,000 and the sales to ₹ 1,80,000. On investigation, it was found that during the past five years, the average gross profit on sales was 30%.

You are required to prepare a statement showing the amount Mr X should claim from the insurance company in respect of stock destroyed by the fire.

[B.Com (Delhi) — Adapted]

Solution

Mr. X

Dr. Memorandum Trading Account for the period 1st April to 15th June, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	45,000	By Sales	1,80,000
To Purchases A/c	1,25,000	By Closing Stock (Balancing figure)	44,000
To Gross Profit (30% on sales of ₹ 1,80,000)	54,000		
	2,24,000		2,24,000

Statement of Claim for Loss of Stock as on 15th June, 2017

Particulars	₹
Book value of Stock	44,000
Less: Salvaged	4,000
Claim to be Lodged	40,000

Illustration 2

The godown of Purple Ltd. caught fire on 15th June, 2017. Records saved from fire showed the following particulars:

Particulars	₹	Particulars	₹
Stock at cost on 1st January, 2016	60,000	Sales less returns for the year 2016	7,20,000
Stock at cost on 31st December, 2016	84,000	Purchases less returns from January 1 to June 15, 2017	1,80,000
Purchases less returns for the year 2016	5,08,000	Sales less returns from January 1 to June 15, 2017	2,46,000
Wages for the year 2016	20,000	Wages from January 1 to June 15, 2017	16,200

Gross profit remained at a uniform rate. The stocks salvaged was worth ₹ 7,200 and it was retained by Purple Ltd.

The godown was insured. Show the amount of claim.

Solution

Purple Ltd.

Dr. Memorandum Trading Account for the period 1st January to 15th June, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	84,000	By Sales	2,46,000
To Purchases A/c	1,80,000	By Closing Stock (Balancing figure)	1,08,000
To Wages A/c	16,200		
To Gross Profit (30% on sales of ₹ 2,46,000)	73,800		
	3,54,000		3,54,000

Statement of Claim for Loss of Stock as on 15th June, 2017

Particulars	₹
Book value of Stock	1,08,000
Less: Salvaged	7,200
Claim to be Lodged	1,00,800

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	60,000	By Sales	7,20,000
To Purchases A/c	5,08,000	By Closing Stock	84,000
To Wages A/c	20,000		
To Gross Profit (Balancing figure)	2,16,000		
	8,04,000		8,04,000

(2) Rate of gross profit = ₹ 2,16,000/₹ 7,20,000 x 100 = 30%.

Illustration 3

The fire insurance policy taken out by Sultan Limited included stock purchased by the company for re-sale and stock sent to the company on approval for which a pro-forma invoice was sent by the supplier.

A disastrous fire took place at the warehouse on 1.10.2017 and you have been asked to prepare the claim for submission to the insurance company. Unfortunately, many of the records of Sultan Limited were destroyed by the fire, but the following information was available :

(a) Value of stock salvaged after the fire ₹ 68,640.
(b) Goods supplied on approval and lost in the fire ₹ 4,000.
(c) Sales for nine months to 30.9.2017, ₹ 6,26,500.
(d) Purchases for nine months to 30.9.2017, ₹ 6,02,100.
(e) Stock (as per accounts) at 31.12.2016, ₹ 1,65,206 — but on examination of the stock sheets it was found that the stock had been undervalued by ₹ 7,534.
(f) The average rate of gross profit during last few years were 20% — it was expected that this rate would have been maintained during the year 2017.

Show the claim that you would submit to the insurance company.

Solution

Sultan Limited

Dr. Memorandum Trading Account for the period 1st January to 30th September, 2017 Cr.

Particulars		₹	Particulars	₹
To Opening Stock	1,65,206		By Sales	6,26,500
Add: Undervalued Stock	7,534	1,72,740	By Closing Stock (Balancing figure)	2,73,640
To Purchases		6,02,100		
To Gross Profit (20% of ₹ 6,26,500)		1,25,300		
		9,00,140		9,00,140

Statement of Claim for Loss of Stock as on 30th September, 2017

Particulars	₹
Book Value of Stock	2,73,640
Less: Salvage	68,640
	2,05,000
Add : Goods received on approval and destroyed by fire	4,000
Claim to be Lodged	2,09,000

Illustration 4

On 31st August, 2015 the premises and stock of a firm were totally destroyed by fire, the books of accounts, however, were saved. In order to make a claim on their fire policy, they ask you to advise on the basis of the following information. The stock in hand has always been valued at 5% below cost :

Particulars	2012-13 (₹)	2013-14(₹)	2014-15 (₹)	2015-16 (₹)
Opening Stock as valued	22,800	30,400	36,100	39,900
Purchases less returns	91,000	1,10,000	1,20,000	41,000
Sales less returns	1,40,000	1,70,000	1,86,000	75,000
Wages	28,400	31,200	34,200	12,000
Closing Stock	30,400	36,100	39,900	?

Prepare a statement for submission to the insurance company in support of your claim for loss of stock. The company closes its books of account every year on 31st March.

[C.S. (Inter) — Adapted]

Solution

Dr. Memorandum Trading Account for the period 1st April to 31st August, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	42,000	By Sales	75,000
To Purchases less Returns	41,000	By Closing Stock (Balancing figure)	35,000
To Wages	12,000		
To Gross Profit (20% of ₹ 75,000)	15,000		
	1,10,000		1,10,000

Statement of Claim for Loss of Stock as on 31st August, 2015

Particulars	₹
Book Value of Stock	35,000
Less: Salvage	Nil
Claim for Loss of Stock	35,000

Working Notes :

Dr. (1) Trading Account for the year ended 31st March, 2013, 2014 and 2015 Cr.

Particulars	2012-13 ₹	2013-14 ₹	2014-15 ₹	Particulars	2012-13 ₹	2013-14 ₹	2014-15 ₹
To Opening Stock (Note 2)	24,000	32,000	38,000	By Sales less Returns	1,40,000	1,70,000	1,86,000
To Purchases less Returns	91,000	1,10,000	1,20,000	By Closing Stock (Note 2)	32,000	38,000	42,000
To Wages	28,400	31,200	34,200				
To Gross Profit (Balancing figure)	28,600	34,800	35,800				
	1,72,000	2,08,000	2,28,000		1,72,000	2,08,000	2,28,000

(2) Stock is valued at 5% below cost. It means stock is shown in the accounts at 95%. Therefore, actual value of stock is :

(i) Opening stock of 2012-13 — ₹ 22,800 / 95 × 100 = ₹ 24,000
(ii) Closing stock of 2012-13 — ₹ 30,400 / 95 × 100 = ₹ 32,000
(iii) Closing stock of 2013-14 — ₹ 36,100 / 95 × 100 = ₹ 38,000
(iv) Closing stock of 2014-15 — ₹ 39,900 / 95 × 100 = ₹ 42,000.

(3) Rate of Gross Profit :

2012-13 — ₹ 28,600 / ₹ 1,40,000 × 100 = 20.43%
2013-14 — ₹ 34,800 / ₹ 1,70,000 × 100 = 20.47%
2014-15 — ₹ 35,800 / ₹ 1,86,000 × 100 = 19.25%

Average Rate of Gross Profit = $\frac{20.43 + 20.47 + 19.25}{3} = 20.05\%$ Say, 20%.

Illustration 5

The premises of X Ltd caught fire on 22nd January, 2017 and the stock was damaged. The firm had made up accounts to 31st March each year and on 31st March, 2016, the stock at cost was ₹ 13,27,200 as against ₹ 9,62,200 on 31st March, 2015.

Purchases from 1st April, 2016 to the date of fire were ₹ 34,82,700 as against ₹ 45,25,000 for the full year 2015-14 and the corresponding sales figures were ₹ 49,17,000 and ₹ 52,00,000 respectively. You are given the following further information :

(i) In July 2016, goods costing ₹ 1,00,000 were given away for advertising purposes, no entries being made in the books.

(ii) During 2016-17, a clerk had misappropriated unrecorded cash sales. It is estimated that the defalcation averaged ₹ 2,000 per week from 1st April, 2016 until the clerk was dismissed on 21st August, 2016.

(iii) The rate of gross profit is constant.

From the above information make an estimate of the stock in hand on the date of fire.

Solution

X Limited

Dr. Memorandum Trading Account for the period 1st April, 2016 to 22nd January, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	13,27,200	By Sales	49,17,000
To Purchases	34,82,700	By Advertisement	1,00,000
To Gross Profit [20% on (₹ 49,17,000 + ₹ 40,000)]	9,91,400	By Cash Sales (Note 3)	40,000
		By Closing Stock (Balancing figure)	7,44,300
	58,01,300		58,01,300

Statement of Claim for Loss of Stock as on 22nd January 2017

Particulars	₹
Book Value of Stock	7,44,300
Less: Salvage	Nil
Loss of Stock	7,44,300

Working Notes :

Dr. (1) Trading Account for the year ended 31st March, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,62,200	By Sales	52,00,000
To Purchases	45,25,000	By Closing Stock	13,27,200
To Gross Profit (Balancing figure)	10,40,000		
	65,27,200		65,27,200

(2) Rate of Gross Profit = ₹ 10,40,000 / 52,00,000 × 100 = 20%.

(3) Assuming that the clerk misappropriated cash sales for 20 weeks (1.4.2015 to 21.8.2015). Therefore, total amount of misappropriation = 20 × ₹ 2,000 = ₹ 40,000.

Average Clause

The amount of insurance premium to be paid at regular intervals depends on the value of stock insured. More the value of stock insured, more is the amount of premium to be paid. To reduce the burden of insurance premium, the average stock of a business may not be adequately insured with the assumption that fire may not destroy the whole stock. When a business takes an insurance policy, the value of which is less than the value of the average stock lying in the godown, it is known as "Under-insurance".

Generally, fire insurance policies contain an "average clause" to discourage under-insurance. At the time of calculating insurance claim, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value. In the event of a ***partial*** loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows:

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

Example: X took out a fire insurance policy containing an average clause covering his stock for ₹ 30,000. On the date of fire the value of stock was ₹ 36,000. The loss was assessed at ₹ 24,000.

In this case, the value of stock on the date of fire was more than the policy value. Therefore, the average clause is applicable. X can recover from the insurance company:

$$₹\ 24{,}000 \times \frac{30{,}000}{36{,}000} = ₹\ 20{,}000$$

It should be noted that average clause is applied after deduction for salvage stock.

Illustration 6

On 17th June, 2017 a fire occured in the premises of M/s Taraporewalla, a bookseller. Most of the stock was destroyed, with the cost of salvaged stock being ₹ 11,200. In addition, some stock was salvaged in damaged condition and its value was estimated at ₹ 10,400. From books of account the following particulars are available:

(1) Stock at close of accounts on 31st December, 2016 was valued at ₹ 83,500.

(2) Purchases from 1.1.2017 – 17.6.2017 amounted to ₹ 1,12,000 and sales during that period amounted to ₹ 1,54,000.

(3) On the basis of past 3 years it appears that on an average gross profit of 25% is earned on sales.

(4) Stock was insured for ₹ 75,000.

Compute the amount of claim.

Solution **M/s. Taraporewalla**

Dr. Memorandum Trading Account for the period 1st January to 17th June, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	83,500	By Sales	1,54,000
To Purchases A/c	1,12,000	By Closing Stock (Balancing figure)	80,000
To Gross Profit (25% on sales on ₹ 1,54,000)	38,500		
	2,34,000		2,34,000

Statement of Claim for Loss of Stock as on 17th June, 2017

Particulars	₹
Book value of Stock	80,000
Less: Salvaged (₹ 11,200 + ₹ 10,400)	21,600
Loss of Stock	58,400

The insurance policy was taken for ₹ 75,000 but the value of stock on the date of fire was ₹ 80,000. Therefore, the average clause is applicable.

Net claim $= \text{Loss of stock} \times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$

$$= ₹\ 58{,}400 \times \frac{75{,}000}{80{,}000} = ₹\ 54{,}750.$$

Illustration 7

A trader took out a fire policy containing an average clause covering his stock for ₹ 15,000. His practice was to base his selling price at cost plus $33^1/_3$%.

He closes his books on 30th June every year.

On 31st March, 2017, a fire occured at his premises and destroyed his stock.

The salvaged stock was worth ₹ 6,000.

During the period of 9 months preceding the fire his purchases amounted to ₹ 61,000 and sales to ₹ 84,000. His stock at 1st July, 2016 was valued at ₹ 20,000.

You are required to prepare a statement showing the amount of claim.

Solution

Dr. Memorandum Trading Account for the period 1st July 2016 to 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	20,000	By Sales	84,000
To Purchases A/c	61,000	By Closing Stock (Balancing figure)	18,000
To Gross Profit (25% on sales)*	21,000		
	1,02,000		1,02,000

* Rate of gross profit $33^1/_3$% on cost, i.e., 25% on selling price.

Statement of Claim for Loss of Stock as on 31st March, 2017

Particulars	₹
Book value of Stock	18,000
Less: Salvaged	6,000
Loss of Stock	12,000

The insurance policy was taken for ₹ 15,000; but the value of stock on the date of fire was ₹ 18,000. Therefore, the average clause is applicable.

Net claim = Loss of stock $\times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$ = ₹ 12,000 $\times \dfrac{15,000}{18,000}$ = ₹ 10,000

Illustration 8

The godown of A Ltd. caught fire on March 31, 2017. As a result stock of goods in the godown of the company were gutted. Goods worth ₹ 41,360 could, however, be saved from the accident. The following particulars are supplied to you:

	₹
Stock on January 1, 2017	60,000
Purchases to the date of fire	2,60,000
Carriage paid on purchases	1,600
Sales to the date of fire	1,80,000
Commission paid to the Purchase Manager, at 2% on purchases	
Average Gross Profit on Sales	$33^1/_3$%

The company had a fire policy of ₹ 1,60,000 covering its stock of goods in the godown. The policy is subject to Average Clause.

You are to ascertain (a) total loss of stock; and (b) the amount of insurance claim to be made.

Solution

A Ltd.

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	60,000	By Sales	1,80,000
To Purchases	2,60,000	By Closing Stock (Balancing figure)	2,06,800
To Carriage on Purchases	1,600		
To Commission on Purchases	5,200		
To Gross Profit ($33^1/_3$% of ₹ 1,80,000)	60,000		
	3,86,800		3,86,800

(a) Statement of Claim for Loss of Stock as on 31st March, 2017

Particulars	₹
Book value of Stock	2,06,800
Less: Salvaged	41,360
Loss of Stock	1,65,440

The insurance policy was taken for ₹ 1,60,000 but the value of stock on the date of fire was ₹ 2,06,800. Therefore, the average clause is applicable.

(b) **Net claim** = Loss of stock $\times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$ = ₹ 1,65,440 $\times \dfrac{1,60,000}{2,06,800}$ = ₹ 28,000

Illustration 9

Due to a fire in the godown of a company on 30th September, 2016, the entire stock was burnt except some stock costing ₹ 70,000. The books were, however, saved.

From the information available, it was found that —

(i) The company's average gross profit was 25% on sales.
(ii) The stock on 31st March, 2016 valued at 10% above cost was ₹ 2,20,000.
(iii) The purchases and sales from 1st April, 2016 upto the date of fire were ₹ 3,00,000 and ₹ 6,80,000 respectively.
(iv) The wages for the period amounted to ₹ 1,44,000.
(v) The company got the stock insured for ₹ 1,20,000.
(vi) The policy had an average clause.

You are required to prepare a statement showing the amount of stock lost by fire and the amount of claim to be lodged with the insurance company. ***[C.S. (Inter) — Adapted]***

Solution

Dr. Memorandum Trading Account for the period 1st April to 30th September, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 1)	2,00,000	By Sales	6,80,000
To Purchases	3,00,000	By Closing Stock (Balancing figure)	1,34,000
To Wages	1,44,000		
To Gross Profit (25% of ₹ 6,80,000)	1,70,000		
	8,14,000		8,14,000

Working Note : (1) Value of Opening Stock = ₹ 2,20,000 / 110 × 100 = ₹ 2,00,000.

Statement of Claim for Loss of Stock as on 30th September, 2016

Particulars	₹
Book Value of Stock	1,34,000
Less: Salvage	70,000
Loss of Stock	64,000

The insurance policy was taken for ₹ 1,20,000 but the value of stock on the date of fire was ₹ 1,34,000. Therefore, the average clause is applicable.

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\ 64{,}000 \times \frac{1{,}20{,}000}{1{,}34{,}000} = ₹\ 57{,}313.$$

Amount of claim to be lodged = ₹ **57,313.**

Illustration 10

The premises of E.F. Limited were damaged due to fire on 21st December, 2016. The company made up its accounts on 30th June, each year. On 30th June, 2016 the stock at cost was ₹ 13,272 as against ₹ 9,614 on 30th June, 2015.

The purchases for full year 2015-16 were ₹ 45,258 and that for current year up to date of fire were ₹ 34,827.

Corresponding sales were ₹ 52,000 and ₹ 29,170, respectively.

In October 2016 goods costing ₹ 943 were given as samples for which no entries were made.

During August to November a clerk had misappropriated unrecorded cash sales. It is estimated that defalcation was at ₹ 20 per week for 20 weeks. A part of stock is salvaged for ₹ 300. Rate of Gross profit is constant.

The policy is for ₹ 18,800 with average clause. Ascertain the amount of claim.

Solution

E.F. Ltd.

Dr. Memorandum Trading Account for the period 1st July to 21st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	13,272	By Sales	29,170
To Purchases A/c	34,827	By Advertisement (sample)	943
To Gross Profit 20% on (₹ 29,170 + ₹ 400)	5,914	By Cash Sales (Misappropriation)	400
		By Closing Stock (Balancing figure)	23,500
	54,013		54,013

Statement of Claim for Loss of Stock as on 21st December, 2016

Particulars	₹
Book value of Stock	23,500
Less: Salvaged	300
Loss of Stock	23,200

The insurance policy was taken for ₹ 18,800 but the value of stock on the date of fire was ₹ 23,500. Therefore, the average clause is applicable.

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} \quad ₹\ 23{,}200 \times \frac{18{,}800}{23{,}500} = ₹\ 18{,}560.$$

Working Notes:

Dr. (1) Trading Account for the year ended 30th June, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,614	By Sales	52,000
To Purchases A/c	45,258	By Closing Stock	13,272
To Gross Profit (Balancing figure)	10,400		
	65,272		65,272

Rate of gross profit = ₹ 10,400/₹ 52,000 x 100 = 20%.

Illustration 11

On 20th July 2017, the godown and the business premises of a merchant were affected by fire. From the accounting records salvaged, the following information is made available to you: (all figures in ₹)

Stock of goods on 1st April, 2016	1,00,000	Sales for the same period	6,00,000
Stock of goods at 10% lower than cost as on 31st Mar.,'17	1,08,000	Purchases less returns from 1st Apr. '17 to 20th July '17	1,40,000
Pur. of goods for the year from 1st Apr. '09 to 31st Mar. '17	4,20,000	Sales less returns for the above period	3,10,000

Sales up to 20th July 2017 included ₹ 40,000 for which goods had not been despatched. Purchases up to 20th July 2017 did not include ₹ 20,000 for which purchase invoices had not been received from suppliers, though goods have been received at the godown.

Goods salvaged from the accident were worth ₹ 12,000 and these were handed over to the insured.

Ascertain the value of the claim for the loss of goods/stock which could be preferred on the insurer.

Solution

Dr. Memorandum Trading Account for the period 1st April to 20th July, 2017 Cr.

Particulars		₹	Particulars		₹
To Opening Stock (Note 2)		1,20,000	By Sales	3,10,000	
To Purchases A/c	1,40,000		Less: Goods not yet delivered	40,000	2,70,000
Add: Goods included in stock but not recorded	20,000	1,60,000	By Closing Stock (Balancing figure)		1,00,000
To Gross Profit (@ 33-1/3% on ₹ 2,70,000)		90,000			
		3,70,000			3,70,000

Statement of Claim for Loss of Stock as on 20th July, 2017

Particulars	₹
Book value of Stock	1,00,000
Less: Salvaged	12,000
Claim to be Lodged	88,000

Working Notes:

Dr. (1) Trading Account for the year ended 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,00,000	By Sales	6,00,000
To Purchases A/c	4,20,000	By Closing Stock (Note 2)	1,20,000
To Gross Profit (Balancing figure)	2,00,000		
	7,20,000		7,20,000

Rate of gross profit = ₹ 2,00,000/₹ 6,00,000 x 100 = $33^1/_3$%.

(2) The closing stock on 31st March 2017 was valued at 10% less than cost. Therefore, the actual cost of closing stock will be : ₹ 1,08,000/90 x 100 = ₹ 1,20,000.

Illustration 12

The Trading Account of A & Co. for the year ending 31st March, 2016 is given below: (all figures in ₹)

To Opening Stock	68,480	By Sales less returns	1,96,000
To Purchases less returns	1,56,940	By Closing Stock	58,820
To Gross Profit c/d	29,400		
	2,54,820		2,54,820

A fire occurs in their godown on 31st December, 2016, and a considerable part of the stock of readymade garments is destroyed. The salvaged stock is worth ₹ 1,520. The stock is fully insured against fire risks.

Considering the following further particulars, prepare a statement showing the amount of claim to be lodged by A & Co. with insurer for the loss of stock.

Sales for the period ending 31st December, 2016 are ₹ 1,09,200.

The amount paid for purchases is ₹ 88,016 including a cheque for ₹ 562 which remains unpresented to the bankers up to 31.12.2016 as shown by the books of account.

Trade creditors on 31st March 2016 amount to ₹ 24,608 and on 31st December, 2016 are ₹ 22,112.

Goods worth ₹ 6,390 are returned to creditors during the period ending 31st December, 2016.

Solution

Dr. Memorandum Trading Account for the period 1st April to 31st December, 2016 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		58,820	By Sales	1,09,200
To Purchases A/c (Note 1)	91,910		By Closing Stock (Balancing figure)	51,520
Less: Returns	6,390	85,520		
To Gross Profit (15% on ₹ 1,09,200)		16,380		
		1,60,720		1,60,720

Statement of Claim for Loss of Stock as on 31st December, 2016

Particulars	₹
Book value of Stock	51,520
Less: Salvaged	1,520
Claim to be Lodged	50,000

Working Notes:

Dr. (1) Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 ?	To Returns A/c	6,390	2016 Apr. 1	By Balance b/d	24,608
?	To Bank A/c	88,016	?	By Purchases A/c (Balancing figure)	91,910
Dec. 31	To Balance c/d	22,112			
		1,16,518			1,16,518

(2) Rate of Gross Profit = ₹ 29,400 / ₹ 1,96,000 x 100 = 15%.

(3) Cheque not yet presented by Creditors for ₹ 562 will not affect the Creditors balance.

Illustration 13

A fire occured in the premises of Shri Romesh on 1st April 2017 and a considerable part of the stock was destroyed. The stock salvaged was worth ₹ 1,12,000. Shri Romesh had taken a fire insurance policy for ₹ 6,84,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim due from the insurance company for the loss of stock by fire. The following particulars are available: (all figures in ₹)

Purchases for the year 2016	37,52,000	Stock on 1st January 2016	5,76,000
Sales for the year 2016	46,40,000	Stock on 31st December 2016	9,68,000
Purchases from 1st January 2017 to 1st April 2017	7,28,000	Wages paid during the year 2016	4,00,000
Sales from 1st January 2017 to 1st April 2017	9,60,000	Wages paid during 1st January 2017 to 1st April 2017	72,000

Shri Romesh had in June 2016 consigned goods worth ₹ 2,00,000 which were lost in an accident. As there was no insurance the loss was borne by him in full.

Stocks at end of each year for and till the end of calendar year 2015 had been valued at cost less 10%. From 2016 however, there was a change in the valuation of closing stock which was ascertained by adding 10% to its cost.

Solution

Dr. Memorandum Trading Account for the period 1st January to 1st April, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 3)	8,80,000	By Sales	9,60,000
To Purchases A/c	7,28,000	By Closing Stock (Balancing figure)	9,12,000
To Wages	72,000		
To Gross Profit (@ 20% on ₹ 9,60,000)	1,92,000		
	18,72,000		18,72,000

Statement of Claim for Loss of Stock as on 1st April, 2017

Particulars	₹
Book value of Stock	9,12,000
Less: Salvaged	1,12,000
Loss of Stock	8,00,000

The insurance policy was taken for ₹ 6,84,000 but the value of stock on the date of fire was ₹ 9,12,000. Therefore, the average clause is applicable.

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\,8{,}00{,}000 \times \frac{6{,}84{,}000}{9{,}12{,}000} = ₹\,6{,}00{,}000.$$

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 2)	6,40,000	By Sales	46,40,000
To Purchases	37,52,000	By Accidental Loss (not covered by insurance)	2,00,000
To Wages	4,00,000	By Closing Stock (Note 3)	8,80,000
To Gross Profit (Balancing figure)	9,28,000		
	57,20,000		57,20,000

Rate of Gross Profit = ₹ 9,28,000 / ₹ 46,40,000 x 100 = 20%.

(2) On 31.12.2015, stock was valued at cost less 10%, i.e., at 90% of cost. Therefore, the actual value of stock will be : ₹ 5,76,000 / 90 x 100 = ₹ 6,40,000.

(3) On 31.12.2016, stock was valued at cost plus 10%, i.e., at 110% of cost. Therefore, the actual cost of stock will be : ₹ 9,68,000 / 110 x 100 = ₹ 8,80,000.

Illustration 14

A fire occured on 1st October, 2016 in the premises of X Co. Ltd. From the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock: (all figures in ₹)

Stock at cost on 1.1.2015	90,000	Purchases from 1.1.2016 to 30.9.2016	6,00,000
Stock at cost on 1.1.2016	70,000	Sales during 2015	6,00,000
Purchases during 2015	4,00,000	Sales from 1.1.2016 to 30.9.2016	8,80,000

You are informed that:

(a) In 2016 the cost of purchases has risen by 20% over the levels prevailing in 2015; (b) In 2016 the selling prices have gone up by 10% over the levels prevailing in 2015; and (c) Salvaged value is ₹ 5,000.

Solution

X & Co. Ltd.

Dr. Memorandum Trading Account for the period 1st January to 30th September, 2016 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		70,000	By Sales: (Note 2)		
To Purchases A/c		6,00,000	Out of opening stock	1,10,000	
To Gross Profit: On opening stock (Note 2)	40,000		Out of current purchases	7,70,000	8,80,000
On current year items (Note 4)	1,82,000	2,22,000	By Closing Stock (Balancing figure)		12,000
		8,92,000			8,92,000

Statement of Claim for Loss of Stock as on 30th September, 2016

Particulars	₹
Book value of Stock	12,000
Less: Salvaged	5,000
Claim to be Lodged	7,000

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	90,000	By Sales	6,00,000
To Purchases	4,00,000	By Closing Stock — at cost	70,000
To Gross Profit	1,80,000		
	6,70,000		6,70,000

Rate of Gross Profit = ₹ 1,80,000 / ₹ 6,00,000 x 100 = 30%.

(2) Sales out of Opening Stock	₹		₹
Let selling price in 2015	100	Selling price in 2016 gone up by 10%, i.e.,	110
Less: Profit 30%	30	Less: Cost of Sales	70
Cost of Sales in 2015	70	Gross Profit	40

(i) Sales value of opening stock = ₹ 70,000 / 70 x 110 = ₹ 1,10,000.

(ii) Gross Profit on sale of opening stock = ₹ 1,10,000 – ₹ 70,000 = ₹ 40,000.

(3) Sales and Gross Profit out of 2016 Purchases:

Selling price has gone up by 10% in 2016. So Selling price	=	₹ 110
Less: Cost of Sales — 2015 rate plus 20% : ₹ 70 + ₹ 14	=	₹ 84
Gross Profit	=	₹ 26

Rate of Gross Profit in 2016 = 26 / 110 x 100 = **23.6364%.**

(4) Total sales of 2016 = ₹ 8,80,000. Sales out of opening stock [2(i)] ₹ 1,10,000. Therefore, sale out of current purchases = ₹ 8,80,000 – ₹ 1,10,000 = ₹ 7,70,000. Gross Profit from sales of purchases of 2016 = 23.6364% of ₹ 7,70,000 = ₹ 1,82,000.

Illustration 15

From the following figures, calculate the amount of claim for loss of stock with the insurance company:

	₹
Stock at cost on 1st January, 2016	1,35,000
Stock at cost on 1st January, 2017	1,50,000
Purchases during 2016	9,15,000
Purchases from 1st January, 2017 to 30th June 2017	8,00,000
Sales during 2016	12,00,000
Sales from 1st January, 2017 to 30th June 2017	9,90,000

You are informed that —

(a) In 2017 the costs of purchases have risen by 20% above the level prevailing in 2016.

(b) In 2017 the selling prices have gone up by 10% over the level prevailing in 2016.

(c) Salvage value of stock ₹ 20,000.

(d) Fire insurance policy for ₹ 1,48,750 to cover the loss of stock by fire.

Solution

Dr. Memorandum Trading Account for the period 1st January to 30th June, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,50,000	By Sales (Note 2)	
To Purchases	8,00,000	Out of Opening Stock	2,20,000
To Gross Profit :		Out of Current Purchases	7,70,000
On Opening Stock (Note 2)	70,000	By Closing Stock (Balancing figure)	1,70,000
On Current year purchased item (Note 4)	1,40,000		
	11,60,000		11,60,000

Statement of Claim for Loss of Stock as on 30th June, 2017

Particulars	₹
Book Value of Stock	1,70,000
Less: Salvage	20,000
Loss of Stock	1,50,000

The insurance policy was taken for ₹ 1,48,750 but the value of stock on the date of fire was ₹ 1,70,000. Therefore, the average clause is applicable.

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\,1{,}50{,}000 \times \frac{1{,}48{,}750}{1{,}70{,}000} = ₹\,1{,}31{,}250..$$

Working Notes :

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,35,000	By Sales	12,00,000
To Purchases	9,15,000	By Closing Stock (Given)	1,50,000
To Gross Profit (Balancing figure)	3,00,000		
	13,50,000		13,50,000

Rate of Gross Profit = ₹ 3,00,000 / ₹ 12,00,000 × 100 = 25%.

(2) Sales Out of Opening Stock

Particulars	₹	Particulars	₹
Let selling price in 2016 be	100	Selling price in 2017 gone up by 10%, i.e.,	110
Less: Profit 25%	25	Less : Cost of sales	75
Cost of Sales	75	Gross Profit	35

(i) Sale value of opening stock = ₹ 1,50,000 / 75 × 110 = ₹ 2,20,000.

(ii) Gross Profit on sale of opening stock = ₹ 2,20,000 – ₹ 1,50,000 = ₹ 70,000.

(3) Sales and Gross Profit out of 2017 Purchases:

	₹
Selling price in 2017 has gone up by 10%. Therefore, selling price	110
Less: Cost of sales — 2016 rate plus 20% (₹ 75 + 15)	90
Gross Profit	20

Rate of Gross Profit in 2017 = 20/110 × 100 = **18.1818%**.

(4) Total sales of 2017 — ₹ 9,90,000. Sales out of opening stock [2(i)] ₹ 2,20,000. Therefore, sales out of current purchases = ₹ 9,90,000 – ₹ 2,20,000 = ₹ 7,70,000. Gross profit from sales of purchases of 2017 = 18.1818% of ₹ 7,70,000 = ₹ **1,40,000**.

Illustration 16

The warehouse of Cores (India) Ltd was destroyed by fire on 1.5.2016. The goods in stock were insured to a value of ₹ 25,000.

The following information is available :

Balance Sheet figures at 31.12.2015 —

Stock (including goods held by agent ₹ 700); ₹ 16,900; Debtors ₹ 31,300; Creditors ₹ 12,900.

Transactions to 30.4.2016 include —

Receipts from debtors ₹ 1,48,600; Payment to creditors ₹ 1,07,300; Bad debts ₹ 300; Discount received ₹ 100.

Balances at 30.4.2016 —

Debtors ₹ 31,000; Creditors ₹ 13,600.

The closing debtors' figure includes an amount owing from the agent for sales to date ₹ 1,800, less 10% commission and his expenses of ₹ 20. At 30.4.2016, the agent still held goods from the company valued at their selling price of ₹ 1,500.

The total sales for the period includes ₹ 600 for goods which have had the selling price reduced by 50% and ₹ 2,400 where the selling price was reduced by 20%.

The normal mark-up is 50% and, except as indicated differently above, all sales can be assumed to be at the full selling price. All of the stock in the warehouse was destroyed and there was no salvage value.

You are required to calculate the amount of insurance claim.

Solution

Cores (India) Ltd

Dr. Memorandum Trading Account for the period 1st January to 30th April, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock	16,900		By Sales (Note 1)	1,47,000	
Less: Goods held by Agent	700	16,200	Less: Sale of Goods below Normal Selling		
To Purchases (Note 2)	1,08,100		Price (Note 8)	3,000	1,44,000
Less: Goods Sent to Agent (Note 4)	1,500		By Closing Stock (Balancing figure)		24,000
	1,06,600				
Less: Cost of Goods Sold below Normal					
Selling Price (Note 8)	2,800	1,03,800			
To Gross Profit*		48,000			
		1,68,000			1,68,000

*Mark-up is 50%. It means profit is 50% of cost. If the cost is ₹ 100, then profit will be ₹ 50 and selling price will be ₹ 150. It means, rate of gross profit on sales is 1/3 of sales. Therefore, gross profit = 1/3 of ₹ 1,44,000 = ₹ **48,000**.

Tutorial Note : A mark-up is always at cost, whereas a margin is on selling price.

Statement of Claim for Loss of Stock as on 30th April, 2016

Particulars	₹
Book Value of Stock	24,000
Less: Salvage	—
Loss of Stock	24,000

Working Notes :

Dr. (1) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	31,300	?	By Cash	1,48,600
	To Sales (Balancing figure)	1,47,000	?	By Bad Debts (written off)	300
			30.4.2016	By Balance c/d (Note 5)	29,400
		1,78,300			1,78,300

Dr. **(2) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash	1,07,300	1.1.2016	By Balance b/d	12,900
	To Discount Received	100	?	By Purchases (Balancing figure)	1,08,100
30.4.2016	To Balance c/d	13,600			
		1,21,000			1,21,000

Dr. **(3) Agent's Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sales	1,800	?	By Commission (10% of ₹ 1,800)	180
			?	By Expenses	20
			30.4.2016	By Balance c/d	1,600
		1,800			1,800

Dr. **(4) Stock with Agent Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	700		By Cost of Goods Sold (Note 6)	1,200
	To Goods Sent to Agent (Balancing figure)	1,500		By Balance c/d (Note 7)	1,000
		2,200			2,200

(5) Balance of debtors at 30.4.2016 = ₹ 31,000 which include amount due from agent ₹ 1,600 (Note 3). Therefore, actual amount due from debtors = ₹ 31,000 – ₹ 1,600 = ₹ 29,400.

(6) Normal mark-up is 50%.

Let, cost =	₹ 100
Add : Profit (50%)	₹ 50
Selling price	150

When selling price is ₹ 150 then cost = ₹ 100
When selling price is Re 1 then cost = ₹ 100 / 150
When selling price is ₹ 1,800 then cost = ₹ 100 / ₹ 150 × ₹ 1,800 = ₹ **1,200**

(7) Goods held by the agent at selling price = ₹ **1,500**.
When selling price is ₹ 150 then cost = ₹ 100
When selling price is Re 1 then cost = ₹ 100 / ₹ 150
When selling price is ₹ 1,500 then cost = ₹ 100 / ₹ 150 × ₹ 1,500 = ₹ **1,000**

(8) Calculation of Cost of Goods Sold below Normal Selling Price

Sales (₹)	Normal Selling Price (₹)	Cost (₹)
600	600 / 50 x 100 = 1,200	1,200 / 150 x 100 = 800
2,400	2,400 / 80 x 100 = 3,000	3,000 / 150 x 100 = 2,000
3,000		2,800

Poor Selling Goods

It is quite possible that there may be some poor-selling goods included in the stock. These goods are generally valued at below cost and, in effect, gross profit is reduced. To determine the normal rate of gross profit, the stock and sales proceeds of these goods are to be eliminated from the total sales and stock. In this case, Trading Account is prepared in columnar form to show separately normal and abnormal items.

Illustration 17

On 1st October, 2015, the godown of XYZ Ltd was destroyed by fire. The record of the company revealed the following:

	₹
Stock on 1st April, 2014	9,50,000
Stock on 31st March, 2015	8,00,000
Purchases for the year ended 31st March, 2015	31,00,000
Sales for the year ended 31st March, 2015	40,00,000
Purchases from 1st April, 2015 to the date of fire	7,50,000
Sales from 1st April, 2015 to the date of fire	10,00,000

While valuing stock on 31st March, 2015, a sum of ₹ 10,000 was written-off on the goods, cost of which was ₹ 48,000. A part of this stock was sold in June, 2015 at a loss of ₹ 4,000 on the original cost of ₹ 24,000. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, gross profit remained at a uniform rate throughout.

Stock salvaged was ₹ 50,000. The godown was fully insured.

Calculate the amount of the insurance claim for the loss. ***[C.S. (Inter) — Adapted]***

Solution

XYZ Ltd

Dr. Memorandum Trading Account for the period 1st April to 1st October, 2015 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	7,62,000	48,000	8,10,000	By Sales	9,80,000	20,000	10,00,000
To Purchases	7,50,000	—	7,50,000	By Loss	—	4,000	4,000
To Gross Profit (Note 1)	1,86,200	—	1,86,200	By Closing Stock	7,18,200	24,000	7,42,200
	16,98,200	48,000	17,46,200		16,98,200	48,000	17,46,200

Statement of Claim for Loss of Stock as on 1st October, 2015

Particulars	₹
Book Value of Stock	7,42,200
Less : Salvage	50,000
Claim to be Lodged	6,92,200

Working Note :

Dr. (1) Trading Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,50,000	By Sales	40,00,000
To Purchases	31,00,000	By Closing Stock : Normal Items (₹ 8,00,000 – ₹ 38,000)	7,62,000
To Gross Profit (Balancing figure)	7,60,000	Abnormal Items (Cost)	48,000
	48,10,000		48,10,000

Rate of Gross Profit = ₹ 7,60,000 / ₹ 40,00,000 × 100 = 19%. Gross Profit = 19% of ₹ 9,80,000 = ₹ 1,86,200.

Illustration 18

On 1st April 2017, the godown of Hindustan Ltd. was destroyed by fire. From the books of account, the following particulars are gathered: (all figures in ₹)

Stock at cost on 1st January 2016	27,570	Sales during 2016	3,51,000
Stock as per Balance Sheet on 31st December 2016	51,120	Sales from 1st January 2017 to 31st March 2017	91,500
Purchases during 2016	2,71,350	Value of goods salvaged	6,300
Purchases from 1st January 2017 to 31st March 2017	75,000		

Goods of which original cost was ₹ 3,600 had been valued at ₹ 1,500 on 31st December 2016. These were sold in March 2017 for ₹ 2,700. Except this transaction, the rate of gross profit has remained constant.

On 31st March 2017 goods worth ₹ 15,000 had been received by the godown keeper, but had not been entered in the Purchase Account.

Calculate the value of goods destroyed by fire.

Solution

Hindustan Ltd.

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2017 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	49,620	3,600	53,220	By Sales	88,800	2,700	91,500
To Purchases A/c (Note 2)	90,000	—	90,000	By Loss	—	900	900
To Gross Profit (30% of ₹ 88,800)	26,640	—	26,640	By Closing Stock	77,460	—	77,460
	1,66,260	3,600	1,69,860		1,66,260	3,600	1,69,860

Statement of Claim for Loss of Stock as on 31st March, 2017

Particulars	₹
Book value of Stock	77,460
Less: Salvaged	6,300
Value of Goods Destroyed by Fire	71,160

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	27,570	By Sales	3,51,000
To Purchases	2,71,350	By Closing Stock:	
To Gross Profit (Balancing figure)	1,05,300	Normal items (₹ 51,120 – 1,500)	49,620
		Abnormal items (cost)	3,600
	4,04,220		4,04,220

Rate of Gross Profit = ₹ 1,05,300/3,51,000 x 100 = 30%.

(2) Total Purchases = ₹ 75,000 + goods received but not recorded ₹ 15,000 = ₹ 90,000.

Illustration 19

On 15th June 2017, the business house of Maneka & Co. was destroyed by fire. The following particulars are given to you: (all figures in ₹)

Stock at cost 1st January 2016	4,41,000	Sales less returns year ended 31.12.2016	29,22,000
Stock at cost 31st December 2016	4,77,600	Purchases less returns Jan 1-15th June 2017	9,72,000
Purchases less returns year ended 31.12.2016	23,88,000	Sales less returns Jan 1-15th June 2017	13,87,200

In valuing stock for Balance Sheet at 31.12.2016, ₹ 13,800 had been written-off on certain stock which was a poor selling line, having cost ₹ 41,400. A portion of these goods was sold in March 2017 at a loss of ₹ 1,500 on the original cost of ₹ 20,700. The remainder of this stock is now estimated to be worth the original cost. Subject to the above exception, Gross profit remained at a uniform rate throughout. The stock salvaged from fire was valued at ₹ 34,800. You are to ascertain the amount of claim to be placed.

Solution

Maneka & Co.

Dr. Memorandum Trading Account for the period 1st January to 15th June, 2017 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	4,50,000	41,400	4,91,400	By Sales	13,68,000	19,200	13,87,200
To Purchases	9,72,000	—	9,72,000	By Loss	—	1,500	1,500
To Gross Profit (20%)	2,73,600	—	2,73,600	By Closing Stock	3,27,600	20,700	3,48,300
	16,95,600	41,400	17,37,000		16,95,600	41,400	17,37,000

Statement of Claim for Loss of Stock as on 15th June, 2017

Particulars	₹
Book value of Stock	3,48,300
Less: Salvaged	34,800
Claim to be Lodged	3,13,500

Working Note:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	4,41,000	By Sales	29,22,000
To Purchases A/c	23,88,000	By Closing Stock:	
To Gross Profit	5,84,400	Nominal items (₹ 4,77,600 – 27,600)	4,50,000
		Abnormal items (cost)	41,400
	34,13,400		34,13,400

Rate of Gross Profit = ₹ 5,84,400/29,22,000 x 100 = 20%.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 20

On 27th May, 2016 the godown of a company was destroyed by fire. From the following records of the company, ascertain the amount of loss of stock to be claimed from insurance company.

Particulars	₹	Particulars	₹
Stock as on 1.1.2015	31,000	Sales during 2015	8,00,000
Stock as on 31.12.2015	77,000	Purchase from 1.1.2016 to 27.5.2016	2,75,000
Purchase duringr 2015	5,50,000	Sales from 1.1.2016 to 27.5.2016	4,00,000

The value of salvaged goods was ₹ 18,000. The amount of policy was ₹ 75,000.

[C.U.B.Com. (General) — 2016]

Solution

Dr. Memorandum Trading Account for the period 1st January to 27th May, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	77,000	By Sales A/c	4,00,000
To Purchases A/c	2,75,000	By Closing Stock (Balancing figure)	1,00,000
To Gross Profit (37% of ₹ 4,00,000)	1,48,000		
	5,00,000		5,00,000

Statement of Claim for Loss of Stock as on 27th May, 2016

Particulars	₹
Book value of Stock	1,00,000
Less: Salvaged Goods	18,000
Loss of Stock	82,000

The insurance policy was taken for ₹ 75,000 but the value of stock as on the date of fire was ₹ 1,00,000. Therefore, the average clause is applicable :

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\,82{,}000 \times \frac{75{,}000}{1{,}00{,}000} = ₹\,\mathbf{61{,}500.}$$

Working Note:

Dr. (1) Trading Account for the year ended 31st December, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	31,000	By Sales	8,00,000
To Purchases	5,50,000	By Closing Stock:	77,000
To Gross Profit (Balancing figure)	2,96,000		
	8,77,000		8,77,000

Rate of Gross Profit = ₹ 2,96,000 / 8,00,000 × 100 = 37%.

Illustration 21

A fire broke out in the godown of P Ltd. on 31st March, 2014. As a result stock of goods in the godown were damaged. Goods worth ₹ 82,720 could, however, be saved from the accident.

The following particulars are supplied to you :	₹
Stock on 01.01.2014	1,20,000
Purchase up to the date of fire	5,20,000
Carriage paid on purchases	4,240
Sales up to the date of fire	3,60,000
Average Gross Profit on Sales	$33\frac{1}{3}$%

The company had a fire policy of ₹ 3,20,000 covering its stock of goods in the godown. The policy is subject to Average Clause.

You are required to ascertain :

(i) total loss of stock; and

(ii) the amount insurance claim to be made.

[C.U.B.Com. (General) — 2015]

Solution

P. Ltd.

Dr. Memorandum Trading Account for the Period 1.1.2014 to 31.3.2014 Cr.

Particulars	₹	Particulars	₹
To Stock on 1.1.2014	1,20,000	By Sales	3,60,000
To Purchases	5,20,000	By Stock on Date of Fire (Balancing figure)	4,04,240
To Carriages	4,240		
To Gross Profit (₹ 3,60,000 x 1/3)	1,20,000		
	7,64,240		7,64,240

Statement of Claim

	₹
Estimated Stock on Date of Fire	4,04,240
Less: Salvaged	82,720
Actual Loss subject to Average Clause	3,21,520

The insurance policy was taken for ₹ 3,20,000 but the value of stock on the date of fire was ₹ 4,04,240. Therefore, the average clause is applicable :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}}$$

$$= ₹\ 3{,}21{,}520 \times \frac{3{,}20{,}000}{4{,}04{,}240} = \mathbf{₹\ 2{,}54{,}518}$$

Illustration 22

A fire broke out in the godown of Z Ltd. on 31.12.2013. The company decided to file a claim with the Insurance Company for loss of stock and gives you the following information to determine the amount to be claimed :

	₹
(a) The last accounts of the company were prepared on 31st March, 2013	
(b) Sundry Debtors on 31.03.2013	50,000
(c) Sundry Debtors on 31.12.2013	40,000
(d) Cash received from Debtors	1,60,000
(e) Stock on 31.03.2013	25,000
(f) Purchases from 01.04.2013 to 31.12.2013	1,30,000
(g) Rate of gross profit to cost of Sales	25%

Ascertain the amount of claim.

[C.U.B.Com. (General) — 2014]

Solution

Z. Ltd.

Dr. Memorandum Trading Account for the Period 1.4.2013 to 31.12.2013 Cr.

Particulars	₹	Particulars	₹
To Stock A/c	25,000	By Sales (Credit)	1,50,000
To Purchases A/c	1,30,000	By Stock A/c (Balancing figure)	35,000
To Gross Profit (1/5th of Sales)	30,000		
	1,85,000		1,85,000

Amount of Claim = ₹ 35,000.

In the books of Z Ltd.

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Balance b/d	50,000		By Cash A/c	1,60,000
	To Sales A/c (Balancing figure)	1,50,000	31.12.2013	By Balance c/d	40,000
		2,00,000			2,00,000

Illustration 23

The godown of Y Ltd caught fire on March 31, 2011. As a result, stock of goods in the godown of the company were lost. Goods worth of ₹ 82,720 could, however, be saved from the accident. The following particulars are supplied to you :

	₹
Stock on 01.01.2011	1,20,000
Purchases to the date of fire	5,20,000
Carriage paid on purchases	3,200
Sales to the date of fire	3,60,000
Commission paid to the Purchase Manager at 2% on purchases	—
Average gross profit on sales	$33^1/_3$%

The company had a fire policy of ₹ 3,20,000 covering its stock of goods in the godown. The policy is subject to average clause.

You are to ascertain :

(a) total loss of stock; (b) the amount of insurance claim to be made. ***[C.U.B.Com. (General) — 2012]***

Solution

Dr. Memorandum Trading Account for the period 1.1.2011 to 31.3.2011 Cr.

Particulars	₹	Particulars	₹
To Stock	1,20,000	By Sales	3,60,000
To Purchases	5,20,000	By Stock (balancing figure)	4,13,600
To Carriage	3,200		
To Commission to Purchase Manager (5,20,000 x 2%)	10,400		
To Gross Profit (3,60,000 x 1/3)	1,20,000		
	7,73,600		7,73,600

Statement of Claim

Estimated stock as on date of fire	₹ 4,13,600
Less: Salvaged	82,720
Actual Loss subject to Average Clause	3,30,880

Insurance policy was taken for ₹ 3,20,000 but the value of stock on the date of fire was ₹ 4,13,600. Therefore, the average clause is applicable :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}}$$

$$= ₹\ 3{,}30{,}880 \times \frac{3{,}20{,}000}{4{,}13{,}600} = \textbf{₹ 2,56,000}$$

[For Honours Candidates Only]

Illustration 24

On 7th June, 2016 the godown of a company was destroyed by fire. From the records of the company, the following particulars were extracted :

Particulars	₹	Particulars	₹
Stock as on 1.1.2015	45,000	Sales less return for 31.12.2015	3,73,000
Stock as on 31.12.2015	60,000	Purchase less return from 1.1.2016 to 7.6.2016	1,25,000
Purchase less returns for 31.12.2015	3,00,000	Sales less returns from 1.1.2016 to 7.6.2016	1,80,000

Poor selling goods worth ₹ 5,000 were written off while valuing closing stock as on 31.12.2015. The original cost of such goods were ₹ 8,000. a portion of this stock (original cost of which was ₹ 4,000) was sold during March, 2016 at a loss of ₹ 1,000.

The balance of this stock is worth the original cost. Value of salvaged goods was ₹ 10,000. Gross profit remained at an uniform rate throughout.

You are required to ascertain the amount of loss of stock to be claimed from insurance company.

[C.U.B.Com. (Hons.) — 2016]

Solution

Dr. Memorandum Trading Account for the period 1st January to 7th June, 2016 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	57,000	8,000	65,000	By Sales	1,77,000	3,000	1,80,000
To Purchases	1,25,000	—	1,25,000	By Profit and Loss A/c	—	1,000	1,000
To Gross Profit *	44,126	—	44,126	By Closing Stock	49,126	4,000	53,126
	2,26,126	8,000	2,34,126		2,26,126	8,000	2,34,126

Statement of Claim for Loss of Stock as on 7th June, 2016

Particulars	₹
Book value of Stock	53,126
Less: Salvaged Goods	10,000
Claim to be Lodged	43,126

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	45,000	By Sales less: Returns	3,73,000
To Purchases less: Returns	3,00,000	By Closing Stock : Normal Item (₹ 60,000 – ₹ 3,000)	57,000
To Gross Profit (Balancing figure)	93,000	Abnormal Item (Cost)	8,000
	4,38,000		4,38,000

Rate of Gross Profit = ₹ 93,000 / ₹ 3,73,000 × 100 = 24.93%   * 24.93% of ₹ 1,77,000.

Illustration 25

A fire occurred in the godown of P Ltd. on 20th March, 2015 destroying the entire stock. The books and records were salvaged from which the following particulars were ascertained :

	₹
Sales for the year 2014	6,20,100
Sales for the period from 1.1.2015 to 20.3.2015	1,82,000
Purchases for the year 2014	4,96,600
Purchases for the period from 1.1.2015 to 20.3.2015	75,600
Stock on 1.1.2014	1,98,640
Stock on 31.12.2014	2,33,090

The company has been following the practice of valuing the stock of goods at actual cost plus 10%. Included in the stock on 1.1.2014 were some damaged goods which originally cost ₹ 1,250 but were valued at ₹ 640. These goods were sold during the year 2014 for ₹ 500. Subject to this, the rate of gross profit and the valuation of stock were uniform. Ascertain the value of stock destroyed.

[C.U.B.Com. (Hons.) — 2015]

Solution

Working Note:

P. Ltd.

Trading Account for the year ended 31st December, 2014

Particulars	₹	Particulars		₹
To Opening Stock :	1,98,640	By Sales		6,20,100
Less: Damaged Stock	640	Less: Abnormal Goods Sold	500	6,19,600
	1,98,000	By Closing Stock (at cost) (2,33,000 / 110 x 100)		2,11,900
Less: Overvalued	18,000 1,80,000			
To Purchases	4,96,600			
To Gross Profit	1,54,900			
	8,31,500			8,31,500

$$\text{Rate of Gross Profit} = \frac{1,54,900}{6,19,600} \times 100 = 25\%$$

Dr. Memorandum Trading Account for the period 1st January to 20th March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	2,11,900	By Sales	1,82,000
To Purchases	75,600	By Stock (Balancing figure)	1,51,000
To Gross Profit (25% of ₹ 1,82,000)	45,500		
	3,33,000		3,33,000

Value of Stock Destroyed = ₹ **1,51,000**.

Illustration 26

The godown of X Ltd. caught fire on 31.03.2014. As a result part of the stock was destroyed. Goods worth ₹ 30,000 could, however, be saved from the accident.

The following particulars are supplied to you :

	₹
Stock of goods at 10% lower than the cost as on 01.01.2014	1,08,000
Purchases less returns to the date of fire	2,30,000
Sales less returns to the date of fire	3,00,000
Average rate of gross profit on sales $33^{1/}{}_{3}$%.	

Sales up to 31.03.2014 included ₹ 30,000 for which goods had not been despatched. Purchases up to 31.03.2014 did not include ₹ 20,000 for which invoice had not been received from the suppliers, though goods have been received at the godown.

The company had a fire policy of ₹ 1,50,000 covering its stock of goods in the godown. The policy is subject to Average Clause.

Ascertain the amount of insurance claim to be made. ***[C.U.B.Com. (Hons.) — 2014]***

Solution Memorandum Trading Account for the period 1.1.2014 to 31.3.2014

Particulars		₹	Particulars	₹
To Opening Stock : (1,08,000 / 90 x 100)		1,20,000	By Sales	3,00,000
To Purchases	2,30,000		By Goods Sold but not Despatched	30,000
Add: Unrecorded Purchases	20,000	2,50,000		2,70,000
To Gross Profit (1/3 x ₹ 2,70,000)		90,000	By Closing Stock (Balancing figure)	1,90,000
		4,60,000		4,60,000

Statement of Claim

	₹
Estimated Stock on date of fire	1,90,000
Less : Salvaged Stock	30,000
Actual Loss subject to Average Clause	1,60,000

The insurance policy was taken for ₹ 1,50,000 but the value of stock on the date of fire was ₹ 1,90,000. Therefore, the average clause is applicable :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\ 1,60,000 \times \frac{1,50,000}{1,90,000} = ₹\ \mathbf{1,26,316}$$

Special Problems

Illustration 27

On Friday, 13.5.2016, a fire at the premises of Rustam Limited destroyed a substantial part of the stock. It also destroyed some of the office records. The company has a loss of stock insurance policy under which the amount insured is ₹ 84,000. The amount of the claim for stock lost in the fire will have to be calculated from what information is available. For the accounting year ended 31.12.2015, the following figures were included in the profit calculation :

Sales ₹ 4,06,000; Purchases ₹ 3,06,000; Stock (1.1.2015) ₹ 70,000; Stock (31.12.2015) ₹ 80,000.

Notes :

(i) The stock at 1.1.2015 included ₹ 6,000 representing goods which had been reduced in value at the stock taking and were all sold during 2015 for the same reduced amount.

(ii) The stock at 31.12.2015 included ₹ 10,000 representing goods which were reduced to half-cost at the stock taking. Of these, ₹ 6,000 were sold at the reduced amount in January, 2016, ₹ 2,000 were scrapped in February 2016 without any revenue at all, and the balance had not been disposed of at the time of fire.

The cost price of stock at 13.5.2016 unaffected by the fire was ₹ 26,143 but the rest of the stock was completely destroyed, and this included the balance of the marked-down stock referred to in (ii) above.

The mix of products sold up to 13.5.2016 was substantially the same as for 2015. No writing-down of stock values takes place except at annual stocktaking and, with the exception of the items mentioned, there have been no alterations to normal selling prices.

Purchases from 1.1.2016 to 13.5.2016 total ₹ 1,45,500. Sales for the same period total ₹ 1,90,000, and there were returns from customers of ₹ 4,000.

Calculate the amount which you expect the company could claim for the loss of stock.

Solution

Rustam Limited

Dr. Memorandum Trading Account for the period 1st January to 13th May, 2016 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	70,000	20,000	90,000	By Sales	1,84,000	6,000	1,90,000
To Purchases	1,45,500	—	1,45,500	Less: Returns	4,000	—	4,000
To Gross Profit	54,000	—	54,000		1,80,000		1,86,000
(30% of ₹ 1,80,000)				By Loss (Note 3)	—	12,000	12,000
				By Closing Stock	89,500	2,000	91,500
	2,69,500	20,000	2,89,500		2,69,500	20,000	2,89,500

Statement of Claim for Loss of Stock as on 13th May, 2016

Particulars	₹
Book Value of Stock (Total)	91,500
Less: Stock Unaffected	26,143
Loss of Stock	65,357

The policy was taken for ₹ 84,000 but the value of stock on the date of fire was ₹ 91,500. Therefore, the average clause is applicable:

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\,65{,}357 \times \frac{84{,}000}{91{,}500} = ₹\,60{,}000.$$

Working Notes :

Dr. (1) Trading Account for the the year ended 31st December, 2015 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	64,000	6,000	70,000	By Sales	4,00,000	6,000	4,06,000
To Purchases	3,06,000	—	3,06,000	By Closing Stock (Note 2)	90,000	—	90,000
To Gross Profit	1,20,000	—	1,20,000				
	4,90,000	6,000	4,96,000		4,90,000	6,000	4,96,000

Rate of Gross Profit = ₹ 1,20,000 / ₹ 4,00,000 × 100 = 30%.

(2) On 31.12.2015 stock representing ₹ 10,000 were reduced to half cost. It means the actual cost of those goods were ₹ 10,000 × 2/1 = ₹ 20,000. Cost of other goods were ₹ 80,000 – ₹ 10,000 = ₹ **70,000**.
Total closing stock on 31.12.2015 = ₹ 70,000 + ₹ 20,000 = ₹ 90,000.

(3) Original cost of abnormal item = ₹ 20,000. ₹ 10,000 was reduced for stock taking purpose and further ₹ 2,000 were scrapped. Therefore, total loss = ₹ 12,000. Closing stock at reduced price = ₹ 20,000 – ₹ 6,000 – ₹ 12,000 = ₹ 2,000.

Illustration 28

On 1st April 2017, the stock of Shri Ramesh was destroyed by fire but sufficient records were saved from which following particulars were ascertained: (all figures in ₹)

Stock at cost 1st January 2016	73,500	Sales for the year ended 31st December 2016	4,87,000
Stock at cost 31st December 2016	79,600	Purchases from January 1 to March 31 2017	1,62,000
Purchases for the year ended 31st December 2016	3,98,000	Sales from January 1 to March 31 2017	2,31,200

In valuing the stock for the Balance Sheet at 31st December 2016, ₹ 2,300 had been written-off on certain stock which was a poor selling line having cost ₹ 6,900. A portion of these goods was sold in March 2017 at a loss of ₹ 250 on the original cost of ₹ 3,450. The remainder of this stock is now estimated to be worth its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout the year.

The value of stock salvaged was ₹ 5,800. The insurance policy was for ₹ 50,000 and was subject to the average clause. Work out the amount of the claim of loss by fire. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

Sri Ramesh

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2017 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	75,000	6,900	81,900	By Sales	2,28,000	3,200	2,31,200
To Purchases	1,62,000	—	1,62,000	By Loss	—	250	250
To Gross Profit (20%)	45,600	—	45,600	By Closing Stock	54,600	3,450	58,050
	2,82,600	6,900	2,89,500		2,82,600	6,900	2,89,500

Statement of Claim for Loss of Stock as on 31st March, 2017

Particulars	₹
Book value of Stock (Total)	58,050
Less: Salvaged	5,800
Loss of Stock	52,250

The insurance policy was taken for ₹ 50,000 but the value of stock on the date of fire was ₹ 58,050. Therefore, the average clause is applicable:

Net claim = Loss of stock $\times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$ = ₹ 52,250 $\times \dfrac{50,000}{58,050}$ = ₹ 45,004 .

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	73,500	By Sales	4,87,000
To Purchases	3,98,000	By Closing Stock: (Note 2)	
To Gross Profit	97,400	Nominal items (₹ 79,600 – 4,600)	75,000
		Abnormal items	6,900
	5,68,900		5,68,900

Rate of Gross Profit = ₹ 97,400/4,87,000 x 100 = 20%.

(2) Cost of abnormal items was ₹ 6,900. These were valued on 31st December 2016 after writing-off ₹ 2,300, i.e., at ₹ 6,900 – ₹ 2,300 = ₹ 4,600.

Illustration 29

On 1st July 2016, a fire took place in the godown of Ram Kumar which destroyed the stock. Calculate the amount of insurance claim for stock from the following details: (all figures in ₹)

Sales in 2014	2,00,000	Stock as on 1.1.2016	2,70,000
Gross Profit in 2014	60,000	Purchases from 1.1.2016 to 30.6.2016	4,00,000
Sales in 2015	3,00,000	Sales from 1.1.2016 to 30.6.2016	7,20,000
Gross Profit in 2015	60,000		

The following are also to be taken into consideration:

1. Stock as on 31st December 2015 had been undervalued by 10%.
2. A stock taking conducted in March 2016 had revealed that stock costing ₹ 80,000 was lying in a damaged condition. 50% of this stock was sold in May 2016 at 50% of cost and the balance was expected to be sold at 40% of cost.

Solution

Ram Kumar

Dr. Memorandum Trading Account for the period 1st January to 30th June, 2016 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	2,20,000	80,000	3,00,000	By Sales	7,00,000	20,000	7,20,000
To Purchases	4,00,000	—	4,00,000	By Loss	—	44,000	44,000
To Gross Profit (30%)	2,10,000	—	2,10,000	By Closing Stock	1,30,000	16,000	1,46,000
	8,30,000	80,000	9,10,000		8,30,000	80,000	9,10,000

Statement of Claim for Loss of Stock as on 30th June, 2016

Particulars	₹
Book value of Stock	1,46,000
Less: Salvaged	Nil
Loss of Stock	1,46,000

Working Notes:

(1) Rate of Gross Profit in 2014 = ₹ 60,000 / 2,00,000 x 100 = 30%.

(2) Rate of Gross Profit in 2015 = *₹ 90,000 / 3,00,000 x 100 = 30%.

*Gross Profit as given	₹ 60,000
Add: Increase in the value of Closing stock ₹ 2,70,000 / 90 x 10	₹ 30,000
	₹ 90,000

(3) Sales of the abnormal items = 50% of (1/2 of ₹ 80,000) = ₹ 20,000.

(4) Value of abnormal items unsold = 40% of (1/2) of ₹ 80,000) = ₹ 16,000.

Illustration 30

On 30th September 2016 the stock of Fred Perry was lost in a fire accident. From the records, the following information is made available to enable you to prepare a statement of claim on the insurers: (all figures in ₹)

Stock at cost on 1st April 2015	37,500	Sales less returns for the year ended 31st March 2016	3,15,000
Stock at cost on 31st March 2016	52,000	Purchases less returns up to 30th September 2016	1,45,000
Purchases less returns for the year ended 31st March 2016	2,53,750	Sales less returns up to 30th September 2016	1,84,050

In valuing the stock on 31st March 2016, due to obsolescence 50% of the value of the stock which originally cost ₹ 6,000 has been written-off. In May 2016, three-fourths of this stock had been sold at 90% of the original cost and it is now expected that the balance of the obsolete stock is also expected to realise the same price. Subject to the above, gross profit had remained uniform throughout. The stock salvaged was worth ₹ 7,200.

Solution **Fred Perry**

Dr. Memorandum Trading Account for the period 1st April to 30th September, 2016 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	49,000	6,000	55,000	By Sales (Note 2)	1,80,000	4,050	1,84,050
To Purchases	1,45,000	—	1,45,000	By Loss	—	600	600
To Gross Profit (25%)	45,000	—	45,000	By Closing Stock	59,000	1,350	60,350
	2,39,000	6,000	2,45,000		2,39,000	6,000	2,45,000

Statement of Claim for Loss of Stock as on 30th September, 2016

Particulars	₹
Book value of Stock	60,350
Less: Salvaged	7,200
Loss of Stock	53,150

Working Notes:

Dr. (1) Trading Account for the year ended 31st March, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	37,500	By Sales	3,15,000
To Purchases	2,53,750	By Closing Stock:	
To Gross Profit	78,750	Nominal items (₹ 52,000 – 3,000)	49,000
		Abnormal items (cost)	6,000
	3,70,000		3,70,000

Rate of Gross Profit = ₹ 78,750/3,15,000 x 100 = 25%.

(2) Sales of the abnormal items = 90% of (3/4 x ₹ 6,000) = ₹ 4,050.

(3) Value of abnormal items unsold = 90% of (1/4 of ₹ 6,000) = ₹ 1,350.

Illustration 31

Victory Co. suffered a loss of stock due to fire on 31.3.2017. From the following information, prepare a statement showing claim for the loss to be submitted:

Stock on 1.1.2016	76,800	Closing stock on 31.12.2016	63,600
Purchases during the year 2016	3,20,000	Purchases from 1.1.2017 to 31.3.2017	1,08,000
Sales during the year 2016	4,05,200	Sales from 1.1.2017 to 31.3.2017	1,22,800

An item of goods purchased in 2015 at a cost of ₹ 20,000 were valued at ₹ 12,000 on 31.12.2015. Half of these goods were sold for ₹ 5,200 during 2016, and the remaining stock was valued at ₹ 4,800 on 31.12.2016. One-fourth of the original stock was sold for ₹ 2,800 in February 2017 and the remaining was valued at 60% of the original cost. With this exception of this item, the rate of gross profit remained uniform. There was an average clause in the insurance policy which was for ₹ 3,00,000. The stock salvaged was ₹ 24,000. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution **Victory Co.**

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2017 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	58,800	10,000	68,800	By Sales	1,20,000	2,800	1,22,800
To Purchases	1,08,000	—	1,08,000	By Loss	—	4,200	4,200
To Gross Profit (18.5%)	22,200	—	22,200	By Closing Stock	69,000	3,000	72,000
	1,89,000	10,000	1,99,000		1,89,000	10,000	1,99,000

Statement of Claim for Loss of Stock as on 31st March, 2017

Particulars	₹
Book value of Stock	72,000
Less: Salvaged	24,000
Claim to be Lodged	48,000

The insurance policy was taken for ₹ 3,00,000 but the value of stock on the date of fire was ₹ 72,000, the average clause is not applicable.

Working Notes

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock (Note 2)	64,800	20,000	84,800	By Sales	4,00,000	5,200	4,05,200
To Purchases	3,20,000	—	3,20,000	By Loss	—	4,800	4,800
To Gross Profit	74,000	—	74,000	By Closing Stock	58,800	10,000	68,800
	4,58,800	20,000	4,78,800		4,58,800	20,000	4,78,800

Rate of Gross Profit = ₹ 74,000/4,00,000 x 100 = 18.5%.

(2) On 31.12.2015 an item costing ₹ 20,000 was valued for ₹ 12,000. This ₹ 12,000 is included in the stock of 1.1.2016 ₹ 76,800. After deducting abnormal item, the value of normal item would be ₹ 76,800 – ₹ 12,000 = ₹ 64,800.

Illustration 32

On 16th August, 2017 a fire occurred in the godown of Ganges Jute Mill and the godown was destroyed. From the following information, prepare a statement showing the claim to be lodged to the Insurance Company :

	₹
Stock of 1st January, 2016	36,000
Wages paid 2016	6,000
(Out of that ₹ 1,000 paid for construction of a stage for performing a cultural programme by the Staff Recreation Club of Jute Mill)	
Carriage Inwards — 2016	3,000
Purchases for the year ended 31st December,, 2016	1,42,000
Sales for the year ended 31st December, 2016	2,03,400
Closing Stock on 31st December, 2016	32,000
Purchases from 1st January 2017 to 16th August, 2017	74,000
Sales from 1st January 2017 to 16th August, 2017	82,600

An item of stock purchased in 2015 at a cost of ₹ 10,000 was valued at ₹ 6,000 on 31st December, 2015. Half of the stock was sold in 2016 for ₹ 3,400. The remaining stock was valued at ₹ 2,000 on 31st December, 2016. One-fourth of the original stock was sold in April, 2017 for ₹ 2,600. The remaining stock was considered to be worth 40% of its original cost. Stock of the value of ₹ 15,000 was salvaged. The amount of the policy was for ₹ 42,000. There was an average clause in the policy. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution **Ganges Jute Mill**

Dr. Memorandum Trading Account for the period 1st January to 16th August, 2017 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	30,000	5,000	35,000	By Sales	80,000	2,600	82,600
To Purchases	74,000	—	74,000	By Loss (Revaluation)	—	1,500	1,500
To Wages (Note 7)	2,000	—	2,000	By Closing Stock	47,200	1,000	48,200
To Carriage Inwards (Note 7)	1,200	—	1,200				
To Profit on Sale of Abnormal Items (Note 5)	—	100	100				
To Gross Profit (25% of 80,000)	20,000	—	20,000				
	1,27,200	5,100	1,32,300		1,27,200	5,100	1,32,300

Statement of Claim for Loss of Stock as on 16th August, 2017

Particulars	₹
Book Value of Stock (Normal + Abnormal)	48,200
Less: Salvage	15,000
Loss of Stock	33,200

Insurance policy was taken for ₹ 42,000, but the value of stock on the date of fire was ₹ 48,200. Therefore, the average clause is applicable :

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\,33{,}200 \times \frac{42{,}000}{48{,}200} = ₹\,28{,}929.46$$

Working Notes :

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock (Note 2)	30,000	10,000	40,000	By Sales	2,00,000	3,400	2,03,400
To Purchases	1,42,000	—	1,42,000	By Loss	—	1,600	1,600
To Wages (Note 3)	5,000	—	5,000	By Closing Stock (Note 4)	30,000	5,000	35,000
To Carriage Inwards	3,000	—	3,000				
To Gross Profit	50,000	—	50,000				
	2,30,000	10,000	2,40,000		2,30,000	10,000	2,40,000

Rate of Gross Profit = ₹ 50,000 / ₹ 2,00,000 × 100 = 25%.

(2) On 31.12.2015 an item costing ₹ 10,000 was valued for ₹ 6,000. This ₹ 6,000 is included in the stock of 1.1.2016 ₹ 36,000. After deducting abnormal item, the value of normal items would be ₹ 36,000 – ₹ 6,000 = ₹ 30,000.

(3) Total wages paid in 2016 — ₹ 6,000. Out of that ₹ 1,000 paid for construction of the stage. Therefore, wages related to business = **₹ 5,000**.

(4) Closing stock on 31.12.2016 — ₹ 32,000 which includes ₹ 2,000 abnormal item (original cost ₹ 5,000). Therefore, closing stock on normal items = **₹ 30,000**.

(5) Original cost of all abnormal items = ₹ 10,000. 1/4 of this i.,e., ₹ 2,500 was sold for ₹ 2,600. Therefore, profit on sale of abnormal items = ₹ 100.

(6) Original cost of abnormal items unsold = ₹ 5,000 – ₹ 2,500 = ₹ 2,500. Present worth of unsold items = 40% of ₹ 2,500 = ₹ 1,000.

(7) Information in respect of wages and carriage inwards for 2017 has not been given. It is assumed that in 2017, these expenses were incurred, proportionately in relation to cost of goods sold as in 2016. Therefore, wages and carriage inwards have been calculated as follows :

When cost of goods is ₹ 1,50,000 (2016) then wages is ₹ 5,000 and carriage inwards ₹ 3,000

When cost of goods is Re 1 (2016) then wages is ₹ 5,000 / ₹ 1,50,000 and carriage inwards ₹ 3,000 / ₹ 1,50,000

When cost of goods is ₹ 60,000 (2017) then wages is ₹ 5,000 / ₹ 1,50,000 × ₹ 60,000 = ₹ 2,000.

and carriage inwards ₹ 3,000 / ₹ 1,50,000 × ₹ 60,000 = ₹ 1,200

Loss of Profit Policy

Besides insuring against loss of stocks or assets, businesses often take out loss of profit insurance to cover them against loss of profits if a fire (or other perils) interrupts their business. This insurance is designed to provide for indemnification of the insured for losses ensuing from the interruption, wholly or in part, of the normal business activities consequent upon a fire or other perils. Therefore, loss of profit insurance is an insured protection against loss of gross profit. Insuring from interruption of or interference as a result of destruction of or damage to any building or any other property of the insured premise by fire. While a fire policy covers loss of or damage to insured property, a loss of profit policy covers loss of gross profit sustained in consequence of a business interruption.

The terms of such policies vary widely, but they are usually framed to meet the requirements of the insured. A business interruption due to destruction of / or damage to property by fire is likely to result in :

(a) the reduction in turnover during the period of indemnity and

(b) the increased cost of working incurred for the purpose of avoiding or reducing the reduction in turnover.

The claim for loss of profit insurance is granted only when the insured has a valid claim in respect of the property, the loss of / or damage to which results in interruption, being admissible under a corresponding fire policy. Therefore, it is a basic condition that a business unit cannot have a loss of profit insurance policy without the presence of a fire policy covering property damage, giving rise to the loss of profit claim. The period of indemnity is the contemplated period of disorganisation for which loss of insurance policy is effected. The length of this period may vary with the nature of the business and required time to obtain new plant and machinery.

Some Important Terms / Expressions

Gross Profit For loss of profit insurance purposes Gross Profit is the sum produced by adding the amount of the insured standing charges to the Net Profit. If there is net loss, gross profit is the amount of insured standing charges less such a proportion of any net trading loss as the amount of the insured standard charges bears to all the standing charges (insured + uninsured) of the business.

Net Profit The net trading profit (exclusive of all capital receipts and accretions and all outlay properly chargeable to Capital) resulting from the business of the insured at the premises after due provision has been made for all standing and other charges including depreciation but before the deduction of any taxation chargeable on profits.

Insured Standing Charges The insured standing charges are those charges specified in the policy which the insured desires to recover in the case of an accident. It may include the following :

(i) Rent, rates and taxes (not related with the profit of the business);
(ii) Interest on debentures and loans;
(iii) Salaries of permanent staff;
(iv) Wages of skilled workers;
(v) Directors' fees;
(vi) Auditor's fees;
(vii) Advertising;
(viii) Travelling; and
(ix) Unspecified standing charges (not exceeding 5% of the amount of specified standing charges).

Turnover The money paid or payable to the insured for goods sold and delivered and for services rendered in course of the business at the premises.

Indemnity Period The period beginning with the occurrence of the Damage and ending not later than 12 months thereafter during which the results of the business shall be affected in consequence of the damage.

Rate of Gross Profit The rate of Gross Profit earned on the turnover during the financial year immediately before the date of the damage

Annual Turnover The turnover during the twelve months immediately before the date of the damage

Standard Turnover The turnover during that period in the twelve months immediately before the date of damage which corresponds with the indemnity period

to which such adjustments shall be made as may be necessary to provide for the trend of the business and for variations in or special circumstances affecting the business either before or after the damage or which would have affected the business had the damage not occurred, so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results of which but for the damage would have been obtainbed dring the relative period after the damage.

Memo 1 : If during the Indemnity Period goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business either by the insured or by others on his behalf the money paid or payable in respect of such sales or services shall be brought into account in arriving at the turnover during the Indemnity Period.

Memo 2 : If any standing charges of the business be not insured by this policy then in computing the amount recoverable hereunder as increase in cost of working that proportion only of the additional expenditure shall be brought into account which the sum of the net profit and the insured standard charges bears to the sum of the net profit and all standing charges.

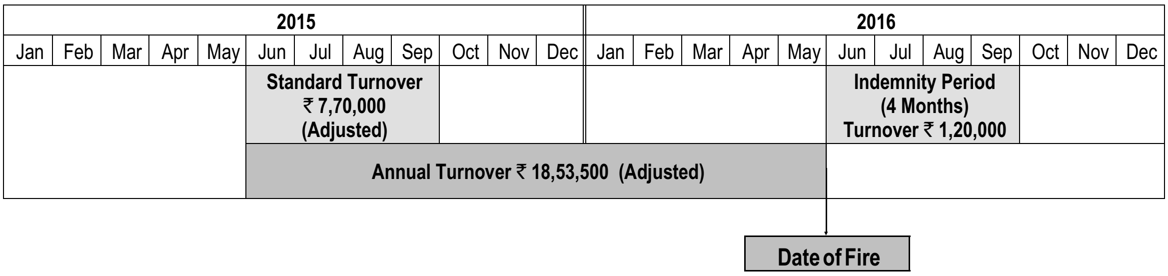
Example

From the following information calculate: (i) Standard Turnover; (ii) Short Sales; and (iii) Annual Turnover.

X Ltd. had taken a loss of profit policy for ₹ 1,50,000 being ₹ 65,000 for net profit and ₹ 85,000 for standing charges. On 1st June, 2016 there was a fire as a result of which sales suffered a lot for a period of 6 months. The indemnity period was 4 months.

Month	2015 (₹)	2016 (₹)	Month	2015 (₹)	2016 (₹)
January	1,00,000	1,10,000	July	2,00,000	25,000
February	1,00,000	1,10,000	August	1,70,000	30,000
March	1,25,000	1,37,500	September	1,50,000	40,000
April	1,25,000	1,37,500	October	1,25,000	55,000
May	1,50,000	1,65,000	November	1,25,000	75,000
June	1,80,000	25,000	December	75,000	80,000

Solution



Calculation of Standard Turnover

Particulars	₹
Sales from 1st June 2015 to 30th September 2015	7,00,000
Add : 10% for upward trend*	70,000
	7,70,000

* Sales from 1st January 2015 to 31st May 2016 are ₹ 6,00,000; for the corresponding months of 2016, Sales is ₹ 6,60,000. Therefore, increase in sales is 10%.

Calculation of Short Sales

Particulars	₹
Standard Turnover	7,70,000
Less: Sales from 1st June 2016 to 30th September 2016	1,20,000
	6,50,000

Calculation of Annual Turnover (Adjusted)

Particulars	₹
Sales for 12 months immediately preceding the month of fire (i.e., 1st June, 2015 to 31st May 2016)	16,85,000
Add: 10% increase for upward trend as noticed between 1.1.2016 and 31.5.2016	1,68,500
	18,53,500

Procedures to Ascertain Amount of Claim

The following steps are followed to arrive at the amount of a claim under loss of profit insurance :

Step 1 Calculate rate of gross profit (adjust to provide for the trend of the business, if any).

Step 2 Calculate short sales. (It is the difference between the standard sales (adjusted) and actual sales of dislocated period.

Step 3 Calculate gross profit on short sales.

Step 4 Calculate the amount of admissible additional expenses as follows :
The least of the following shall be taken as admissible additional expenses.
(i) Actual expenses incurred
(ii) Gross Profit on additional sales

(iii) Additional Expenses $\times \dfrac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover} + \text{Uninsured standing charges}}$

OR

Additional Expenses $\times \dfrac{\text{Net Profit} + \text{Insured standing charges}}{\text{Net Profit} + \text{All standing charges}}$

Step 5 Deduct from the sum of 3 and 4 any savings in insured standing charges during the period of indemnity.

Step 6 Apply average clause : $\text{Net Claim} = \text{Gross Claim} \times \dfrac{\text{Policy value}}{\text{G.P. on Annual Turnover}}$

Illustration 33

From the following information, find the claims under a loss of profit policy: (all figures in ₹)

Sales in 2013	1,00,000	Policy value	50,000
Sales in 2014	1,20,000	Date of dislocation by fire	1.1.2017
Sales in 2015	1,44,000	Period of dislocation	3 months
Sales in 2016	1,72,800	Indemnity period	9 months
Standing charges (all insured) in 2016	7,280	Sales from 1.1.2016 to 31.3.2016	43,200
Net profit in 2016	10,000	Sales from 1.1.2017 to 31.3.2017	11,840

There was no reduction in standing charges during the dislocation period, nor were there any additional costs.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2016	10,000	Rate of Gross Profit $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	7,280	$= \dfrac{17{,}280}{1{,}72{,}800} \times 100 = 10\%.$
Gross Profit	17,280	

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislocated period = ₹ 11,840
Sales from 1.1.2016 to 31.3.2016	43,200	Short Sales = Standard Sales – Actual Sales
Add: 20% increase	8,640	= ₹ 51,840 – ₹ 11,840 = ₹ 40,000
	51,840	
*Sales figures of 2013 to 2016 clearly indicate 20% increase every year. So standard sales are to be adjusted accordingly.		(3) Amount of Claim = Short Sales x Gross Profit ratio = ₹ 40,000 x 10% = ₹ 4,000 (The claim is payable in full, since the policy is adequate)

Illustration 34

From the following particulars, prepare a claim for loss of profit under the consequential loss policy :

Date of fire	30.6.2012
Period of indemnity	six months
	₹
Sum insured	80,000
Turnover for the year ended June 30, 2012	4,00,000
Net Profit for the accounting year ending March 31, 2012	25,000
Standing charges for the accounting year ended March 31, 2012	57,000
Turnover for the year ended March 31, 2012	4,10,000
Turnover for the indemnity period from 1.7.2012 to 31.12.2012	1,12,000
Turnover for the period from 1.7.2011 to 31.12.2011	2,20,000

The turnover of the year 2012-13 had been shown an increasing trend of 10% over the turnover of the preceding year.

[C.U.B.Com. (Hons.) — 2013]

Solution

(1) Gross Profit Ratio

	₹	
Net Profit (2011-12)	25,000	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges*	57,000	
Gross Profit	82,000	$= \frac{82,000}{4,10,000} \times 100 = 20\%.$
* Assumed all are insured standing charges.		

(2) Short Sales

(A) Standard Sales (adjusted)	₹	(B) Actual Sales of dislodged period = ₹ 1,12,000
Sales from 1.7.2011 to 31.12.2011	2,20,000	Short Sales = (A – B) = ₹ 2,42,000 – ₹ 1,12,000 = ₹ **1,30,000**
Add: 10% Increase in 2011-12	22,000	
	2,42,000	

(3) Loss of Gross Profit = Short sales × Gross Profit ratio = ₹ 1,30,000 × 20% = ₹ 26,000.

(4) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3 — Above)	26,000
Admissible increased working cost	Nil
	26,000
Less: Saving in insured standing charges	Nil
Gross Claim	26,000

Sum assured is ₹ 50,000 but gross claim is ₹ 26,000. Therefore, the average clause will not be applicable.

Illustration 35

From the following particulars, prepare a claim for loss of profits under the Consequential Loss Policy :

	₹
Date of fire — June 30, 2006; Period of Indemnity — Six months.	
Sum Insured	50,000
Turnover for the year ended June 30, 2006	2,00,000
Net Profit for the accounting year ending March 31, 2006	12,500
Standing charges for the accounting year ending March 31, 2006	28,500
Turnover for the year ending March 31, 2006	1,98,000
Turnover for the indemnity period from 01.07.2006 to 31.12.2006	56,000
Turnover for the period from 01.07.2005 to 31.12.2005	1,10,000

The turnover of the year 2006-07 had shown a tendency of increase of 10% over the turnover of the preceding year.

[C.U.B.Com. (Hons.) — 2007]

Solution

(1) Gross Profit Ratio

	₹	
Net Profit (2005-06)	12,500	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	28,500	
Gross Profit	41,000	$= \frac{41,000}{1,98,000} \times 100 = 20.7070\%.$

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislodged period = ₹ 56,000
Sales from 1.7.2005 to 31.12.2005	1,10,000	Short Sales = Standard Sales – Actual Sales
Add: 10% Increase in 2006-07	11,000	= ₹ 1,21,000 – ₹ 56,000 = ₹ 65,000
	1,21,000	

(3) Loss of Gross Profit = Short sales × Gross Profit ratio = ₹ 65,000 × 20.7070 = ₹ 13,460.

(4) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3 — Above)	13,460
Admissible increased working cost	Nil
	13,460
Less: Saving in insured standing charges	Nil
Gross Claim	13,460

Sum assured is ₹ 50,000 but gross claim is ₹ 13,460. Therefore, the average clause will not be applicable.

Illustration 36

Bright Ltd. has a 'loss of profit' insurance policy of ₹ 12,60,000. The period of indemnity is three months. A fire occured on 31st March 2017. The following information is available (all figures in ₹) :

Sales for the year ended 31st December 2016	42,00,000	Standing charges for 2016	9,60,000
Sales for the period from 1st April 2016 to 31st Mar. 2017	48,00,000	Profit for 2016	3,00,000
Sales for the period from 1st April 2016 to 30th June 2016	10,80,000	Saving in standing charges because of fire	30,000
Sales for the period from 1st April 2017 to 30th June 2017	72,000	Additional expenses to reduce loss of turnover	60,000

Assuming no adjustment has to be made for the upward trend in turnover, compute the claim to be made on the insurance company.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2016	3,00,000	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	9,60,000	
Gross Profit	12,60,000	$= \frac{12,60,000}{42,00,000} \times 100 = 30\%.$

(2) Short Sales

	₹	
(a) Standard Sales (adjusted)		(b) Actual Sales of dislocated period = ₹ 72,000
Sales for the corresponding period in the preceding year, i.e., 1.4.2016 to 30.6.2016	10,80,000	Short Sales = Standard Sales – Actual Sales = ₹ 10,80,000 – ₹ 72,000 = ₹ 10,08,000

(3) Loss of Gross Profit = Short Sales x Gross Profit ratio = ₹ 10,08,000 x 30% = ₹ 3,02,400.

(4) Admissible increased working cost :

Lower of the following: (a) Actual additional expenses to reduce loss of turnover = ₹ 60,000.
(b) Gross profit on additional sales = ₹ 72,000 x 30% = ₹ 21,600.

(5) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	3,02,400
Admissible increased working cost (Note 4)	21,600
	3,24,000
Less: Saving in insured standing charges	30,000
Gross Claim	2,94,000

6. Application of Average Clause

Net claim $= \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\, 2,94,000 \times \frac{12,60,000}{30\% \text{ of } 48,00,000} = ₹\, 2,57,250$

Therefore, amount of claim under the policy = ₹ 2,57,250.

Assumptions:

(1) All standing charges are insured. (2) All sales during indemnity period have been effected by incurring additional expenses.

Illustration 37

A businessman took out a 'loss of profit policy' for ₹ 40,000 with an indemnity period of 6 months. The financial year of the business ended on 30th June. Gross profit for the last financial year was ₹ 50,000 and turnover for that period was ₹ 2,00,000. Turnover for the 12 months immediately preceding the fire was ₹ 2,20,000. A fire occured on 31st March, 2017. Turnover for 6 months immediately following the fire, compared with the turnover of corresponding months in the previous year was:

	April	May	June	July	August	September
2016 (₹)	16,000	17,000	18,000	16,000	17,000	19,000
2017 (₹)	—	6,000	9,000	14,000	16,000	18,000

₹ 1,000 was spent on putting the fire out. During the indemnity period, increase in the cost of working directly attributable to sales amounted to ₹ 8,050. All standing charges of the business were insured and paid.

From the above particulars, you are required to assess the loss and the amount payable by the insurance company as claim under the policy.

Solution

1. $\text{Gross Profit Ratio} = \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100 = \dfrac{50{,}000}{2{,}00{,}000} \times 100 = 25\%.$

2. Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales from April to Sept. 2017 = ₹ 63,000
Sales from 1.4.2016 to 30.9.2016	1,03,000	Short Sales = Standard Sales – Actual Sales
Add: 10% increase (Note 1)	10,300	= ₹ 1,13,300 – ₹ 63,000 = ₹ 50,300
	1,13,300	

3. Loss of Gross Profit = Short sales x Gross Profit ratio = 50,300 x 25% = ₹ 12,575.

4. Admissible increased working cost
Lower of the following:
(a) Gross Profit on additional sales = 25% of ₹ 63,000 = ₹ 15,750.

(b) $\text{Additional Expenses} \times \dfrac{\text{G.P. on Annual Turnover (Adjusted)}}{\text{G.P. on Annual Turnover (Adjusted)} + \text{Uninsured standard charges}}$

$= ₹\, 8{,}050 \times \dfrac{55{,}000}{55{,}000 + \text{nil}} = ₹\, 8{,}050.$

5. Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	12,575
Admissible insured working cost (Note 4)	8,050
Gross Claim	20,625

6. Application of Average Clause

Net claim $= \text{Gross Claim} \times \dfrac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\, 20{,}625 \times \dfrac{40{,}000}{55{,}000} = ₹\, 15{,}000.$

7. **Total Claim**

Amount of claim under policy	= ₹ 15,000
Expenses for putting off fire	= ₹ 1,000
	₹ 16,000

Tutorial Note: Insurance company is liable to pay all expenses for putting off fire.
Working Note:
(1) Calculation of Upward Trend in Turnover
Turnover for the 12 months immediately preceding fire was ₹ 2,20,000 and Sales of the previous accounting period were ₹ 2,00,000. Increase in Sales ₹ 20,000. Therefore, % of increase = 20,000/2,00,000 x 100 = 10%.

Illustration 38

A fire occured on 1st February 2017 in the premises of Pioneer Ltd., a retail store, and business was partially disorganised up to 30th June 2017. The company was insured under a 'loss of profit' for ₹ 1,25,000 with a six months period indemnity. From the following information, compute the amount of claim under the loss of profit policy. (all figures in ₹)

Actual turnover from 1st February to 30th June 2017	80,000	Turnover from 1st February to 30th June 2016	2,00,000
Turnover from 1st February 2016 to 31st January 2017	4,50,000	Net profit for last financial year	70,000
Insured standing charges for last financial year	56,000	Total standing charges for last financial year	64,000
Turnover for the last financial year	4,20,000		

The company incurred additional expenses amounting to ₹ 6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of ₹ 2,450 in the insured standing charges as a result of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it has been agreed that an adjustment of 15% be made in respect of the upward trend in turnover.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit for last financial year	70,000	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	56,000	
Gross Profit	1,26,000	$= \frac{\text{Rs } 1,26,000}{\text{Rs } 4,20,000} \times 100 = 30\%.$

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of disorganised period = ₹ 80,000
Sales from 1.2.2016 to 30.6.2016	2,00,000	Short Sales = Standard Sales – Actual Sales
Add: 15% increase (expected)	30,000	= ₹ 2,30,000 – ₹ 80,000 = ₹ 1,50,000
	2,30,000	

(3) Loss of Gross Profit = Short Sales x Gross Profit ratio = ₹ 1,50,000 x 30% = ₹ 45,000.

(4) Annual Turnover

Particulars	₹
Turnover for 12 months immediately preceding the month of fire i.e. from 1.2.2016 to 31.1.2017	4,50,000
Add: 15% expected increase	67,500
	5,17,500
Gross Profit on Annual Turnover = 30% of 5,17,500	1,55,250

(5) Admissible increased working cost:

Lower of the following:

(a) Gross Profit on additional Sales = 30% of ₹ 80,000 = ₹ 24,000.

(b) $\text{Additional Expenses} \times \frac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover} + \text{Uninsured Standing Charges}}$

$= ₹\, 6{,}700 \; \frac{1{,}55{,}250 \text{ (Note 4)}}{1{,}55{,}250 + 8{,}000*} = ₹\, 6{,}372$ *(Total standing charges – Insured standing charges)

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	45,000
Admissible increased working cost (Note 5)	6,372
	51,372
Less: Saving in insured standing charges	2,450
Gross claim	48,922

(7) Application of Average Clause

$$\textbf{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}} = ₹\, 48{,}922 \times \frac{1{,}25{,}000}{1{,}55{,}250} = ₹\, 39{,}390$$

Amount of claim under the policy = ₹ 39,390.

Assumption : (1) All sales during indemnity period have been effected by increasing additional expenses only.

Illustration 39

From the following information, you are required to work out the claim under the 'loss of profit' insurance policy.

(1) Cover — Gross profit ₹ 1,00,000.
(2) Indemnity period — Six months.
(3) Damage — due to a fire accident on 28th December, accounting year ends on 31st December.
(4) Net profit plus all standing charges in the prior accounting year — ₹ 1,30,000.
(5) Standing charges uninsured — ₹ 25,000.
(6) Turnover of the last accounting year was ₹ 5,00,000, the rate of gross profit being 25%.
(7) The annual turnover — namely the turnover for 12 months immediately preceding the fire — ₹ 5,20,000.
(8) As a consequence of fire, there was a reduction in certain insured standing charges at the rate of ₹ 25,000 per annum.
(9) The standard turnover was ₹ 2,60,000.
(10) Increased costs of working during the period of indemnity were ₹ 20,000.
(11) Turnover during the period of indemnity was ₹ 1,00,000 and out of this, turnover of ₹ 80,000 was maintained due to increased costs of working.

Solution

1. Gross Profit Ratio = 25% (given).
2. Short Sales = Standard Sales – Actual Sales = (₹ 2,60,000 (given) – ₹ 1,00,000) = ₹ 1,60,000.
3. Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 1,60,000 x 25% = ₹ 40,000.
4. Annual Turnover = ₹ 5,20,000. Gross Profit on Annual Turnover = ₹ 5,20,000 x 25% = ₹ 1,30,000.
5. **Admissible Increased Working Cost:**
   Lower of the following:
   (a) Gross Profit on additional Sales = 25% of ₹ 80,000 = ₹ 20,000.
   (b) $\text{Additional Exp.} \times \dfrac{\text{G.P. on Annual Turnover (Adjusted)}}{\text{G.P. on Annual Turnover (Adjusted)} + \text{Uninsured standing charges}}$

$$= ₹\ 20,000 \times \frac{1,30,000}{1,30,000 + 25,000} = ₹\ 16,774$$

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	40,000
Add: Admissible Increased Working Cost (Note 5)	16,774
	56,774
Less: Saving in Standing Charges (6 months)	12,500
Gross Claim	44,274

(7) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} \quad ₹\ 44,274 \times \frac{1,00,000}{1,30,000} = ₹\ 34,057$$

Assumption: (1) Annual Turnover and Standard Turnover as given in the problem have already been adjusted for upward trend.

Illustration 40

The premises of a company was partly destroyed by fire on 1st March 2017, as a result of which the business was disorganised from 1st March to 31st July, 2017. Accounts are closed on 31st December every year. The Company is insured under a 'loss of profit' policy for ₹ 7,50,000. The period of indemnity specified in the policy is 6 months. From the following information, you are required to compute the amount of claim under the loss of profit policy. (all figures in ₹)

Turnover for the year 2016	40,00,000	Standard turnover for the corresponding period in the preceding year i.e. from 1.3.2016 to 31.7.2016	20,00,000
Net profit for the year 2016	2,40,000		
Insured standing charges	4,80,000	Annual turnover for the year immediately preceding the fire i.e. from 1.3.2016 to 28.2.2017	44,00,000
Uninsured standing charges	80,000		
Turnover during the period of disloc. i.e. from 1.3.17 to 31.7.17	8,00,000	Increased cost of working	1,50,000
Savings in insured standing charges	30,000	Reduction in turnover avoided through increase in working cost	4,00,000

Owing to reasons acceptable to the insurer, the "Special circumstances clause" stipulates for: (a) Increase of turnover (standard and annual) by 10% and (b) Increase of rate of gross profit by 2%.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2016	2,40,000	$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	4,80,000	
Gross Profit	7,20,000	$= \frac{7,20,000}{40,00,000} \times 100 = 18\%.$
		Revised Rate of G.P. = 18% + 2% increase = 20%.

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislocated period = ₹ 8,00,000
Sales from 1.3.2016 to 31.7.2016	20,00,000	Short Sales = Standard Sales – Actual Sales
Add: 10% increase (agreed)	2,00,000	= ₹ 22,00,000 – ₹ 8,00,000 = ₹ 14,00,000
	22,00,000	

(3) Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 14,00,000 x 20% = ₹ 2,80,000.

(4) Annual Turnover

Particulars	₹
Turnover for 12 months immediately preceding the month of fire, i.e. from 1.3.2016 to 28.2.2016	44,00,000
Add: 10% increase (agreed)	4,40,000
	48,40,000
Gross Profit on Annual turnover = 20% of ₹ 48,80,000 = ₹ 9,68,000	

(5) Admissible Increased Working Cost:

Lower of the following:

(a) Gross Profit on additional Sales = 20% of ₹ 4,00,000 = ₹ 80,000.

(b) $$\text{Additional Exp.} \times \frac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover} + \text{Uninsured standing charges}}$$

$$= ₹\ 1,50,000 \times \frac{9,68,000}{9,68,000 + 80,000} = ₹\ 1,38,550$$

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	2,80,000
Add: Admissible Increased Working Cost (Note 5) being lower	80,000
	3,60,000
Less: Saving in Insured standing charges	30,000
Gross Claim	3,30,000

(7) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\ 3,30,000 \times \frac{7,50,000}{9,68,000} = ₹\ 2,55,682$$

Illustration 41

A fire occured in the premises of a businessman on 31st January 2017, which destroyed stock. However, stock worth ₹ 5,940 was salvaged. The company's insurance policy covers the following:

Stock — ₹ 6,00,000; Loss of profit (including standing charges) — ₹ 3,75,000; and Period of indemnity — 6 months.

The summarised Profit and Loss Account for the year ended 31st December, 2016 is as follows: (all figures in ₹)

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

To Opening Stock	6,18,750	By Sales	30,00,000
To Purchases	27,18,750	By Closing Stock	7,87,500
To Standing charges	2,51,250		
To Variable expenses	1,20,000		
To Net Profit	78,750		
	37,87,500		37,87,500

The transactions for the month of January, 2017 were: (i) Turnover — ₹ 1,50,000; and (ii) Payment to creditors — ₹ 1,60,020.*Trade Creditors*: 1st January, 2017 — ₹ 2,26,000; 31st January, 2017 — ₹ 2,30,980.

The company's business was disrupted until 30th April, 2017, during which period the reduction in the turnover amounted to ₹ 2,70,000 as compared with the corresponding turnover of same period in the previous year.

You are required to submit the claim for insurance for loss of stock and loss of profit.

Solution

Loss of Stock

Dr. Memorandum Trading Account for the period 1st January to 31st January, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	7,87,500	By Sales	1,50,000
To Purchases (Note 3)	1,65,000	By Closing Stock (Balancing figure)	8,25,000
To Gross Profit @ 15% on Sales (Note 2)	22,500		
	9,75,000		9,75,000

Statement of Claim for Loss of Stock as on 31st January, 2017

Particulars	₹
Book value of Stock	8,25,000
Less: Salvaged	5,940
Loss of Stock	8,19,060

The insurance policy for loss of stock was taken for ₹ 6,00,000 but the value of stock on the date of fire was ₹ 8,25,000. Therefore, the average clause is applicable.

$$\text{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$$

$$= ₹\ 8,19,060 \times \frac{6,00,000}{8,25,000} = ₹\ 5,95,680$$

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	6,18,750	By Sales	30,00,000
To Purchases	27,18,750	By Closing Stock	7,87,500
To Gross Profit	4,50,000		
	37,87,500		37,87,500

(2) Rate of Gross Profit = ₹ 4,50,000 / ₹ 30,00,000 x 100 = 15%.

Dr. (2) Trade Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	1,60,020	By Balance b/d	2,26,000
To Balance c/d	2,30,980	By Purchases (credit)	1,65,000
	3,91,000		3,91,000

Loss of Profit

(1) Gross Profit Ratio

	₹
Net Profit in 2016	78,750
Insured standing charges	2,51,250
Gross Profit	3,30,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{3,30,000}{30,00,000} \times 100 = 11\%.$$

(2) Short Sales = ₹ 2,70,000 (given).

(3) Amount of Claim = Short Sales x Gross Profit Ratio = ₹ 2,70,000 x 11% = ₹ 29,700. (The claim is payable in full, since the policy is adequate).

Illustration 42

A "loss of profit" policy was taken for ₹ 80,000. Fire occured on 15th March, 2017. Indemnity period was for three months. Net profit for 2016 year ending on 31st December was ₹ 56,000 and standing charges (all insured) amounted to ₹ 49,600. Determine insurance claims from the following details available from quarterly sales tax returns:

Sales	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
From 1st January to 31st March	1,20,000	1,30,000	1,42,000	1,30,000
From 1st April to 30th June	80,000	90,000	1,00,000	40,000
From 1st July to 30th September	1,00,000	1,10,000	1,20,000	1,00,000
From 1st October to 31st December	1,36,000	1,50,000	1,66,000	1,60,000

Sales from 16.3.2016 to 31.3.2016 were ₹ 28,000.
Sales from 16.3.2017 to 31.3.2017 were ₹ Nil.
Sales from 16.6.2016 to 30.6.2016 were ₹ 24,000 and
Sales from 16.6.2017 to 30.6.2017 were ₹ 6,000.

Solution

(1) Gross Profit Ratio

	₹
Net Profit in 2016	56,000
Insured standing charges	49,600
Gross Profit	1,05,600

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,05,600}{{}^{*}5,28,000} \times 100 = 20\%.$$

*(₹ 1,42,000 + ₹ 1,00,000 + ₹ 1,20,000 + ₹ 1,66,000)

(2) Short Sales

(a) Standard Sales (adjusted)	
Indemnity period : 16.3.2017 to 15.6.2017.	
Standard sales are to be calculated on the basis of sales of corresponding period of the previous year, i.e., 16.3.2016 to 15.6.2016. In this problem, however, sales value for this period has not been given directly. Therefore, it is to be calculated part by part from the given information :	₹
(i) Sales for the period 16.3.2016 to 31.3.2016 (given)	28,000
(ii) Sales for the period 1.4.2016 to 15.6.2016 (Note 1)	76,000
	1,04,000
Add: Upward trend in Sales 10% (Note 2)	10,400
	1,14,400
(b) Actual Sales of disorganised period	₹
Sales value from 16.3.2017 to 15.6.2017 has not been given directly. So it is also to be calculated part by part from the given information:	
(i) Sales for the period 16.3.2017 to 31.3.2017	Nil
(ii) Sales for the period 1.4.2017 to 15.6.2017 (Note 3)	34,000
	34,000
Short Sales = Standard Sales – Actual Sales = ₹ 1,44,400 – ₹ 34,000 = ₹ 80,400	

(3) Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 80,400 x 20% = ₹ 16,080.

(4) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}}$$

$$= ₹\ 16{,}080 \times \frac{80{,}000}{1{,}19{,}680} = ₹\ 10{,}749 \text{ (approx.)}$$

Amount of claim under the policy = ₹ 10,749.

Working Notes:

(1) Sales for the period 1.4.2016 to 30.6.2016 (given)	1,00,000
Less: Sales for the period 16.6.2016 to 30.6.2016 (given)	24,000
Sales for the period 1.4.2016 to 15.6.2016	76,000

(2) Calculation of Upward Trend in Sales

(a) Total Sales of 2015 = ₹ 4,80,000 less total sales of 2014 = ₹ 4,36,000. Increase of Sales in 2015 over 2014 = ₹ 44,000.
Therefore, % of increase = ₹ 44,000 / ₹ 4,36,000 x 100 = 10.09%.

(b) Total Sales of 2016 = ₹ 5,28,000 less total Sales of 2015 = ₹ 4,80,000. Increase of Sales in 2016 over 2014 = ₹ 48,000.
Therefore, % of increase = ₹ 48,000 / ₹ 4,80,000 x 100 = 10%.

Average Percentage of increase = (10.09% + 10%) / 2 = 10% (Approx.)

(3) Annual Sales	₹	₹
Sales from 16.3.2016 to 31.3.2016	28,000	
Sales from 1.4.2016 to 30.6.2016	1,00,000	
Sales from 1.7.2016 to 30.9.2016	1,20,000	
Sales from 1.10.2016 to 31.12.2016	1,66,000	
Sales from 1.1.2017 to 5.3.2017 (₹ 30,000 – Nil between 16.3.2017 to 31.3.2017)	1,30,000	
Sales for 12 months just before fire		5,44,000
Add: 10% increase (upward trend)		54,400
Adjusted sales of 12 months just before fire		5,98,400
Gross Profit on Annual Sales = ₹ 5,98,400 x 20% =		1,19,680

Key Points

- A business takes a fire insurance policy to cover (i) the loss of assets including stock; and (ii) loss of profit (consequential loss). A business may take insurance policy for loss of cash due to theft or misappropriation.
- There are two steps for determination of claim for loss of stock: (1) Ascertainment of the value of stock on the date of fire; and (2) Ascertainment of actual amount of claim to be lodged.
- $\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$
- **Indemnity Period** is the period beginning with the occurrence of the Damage and ending not later than 12 months thereafter during which the results of the business shall be affected in consequence of the damage.
- The turnover during the twelve months immediately before the date of the damage is known as the **Annual Turnover**.

THEORETICAL QUESTIONS

1. Explain the various steps for ascertaining the loss of stock by fire.
2. How is the gross profit computed for the purpose of insurance on loss of profit?
3. Write short notes on:
   (a) Average clause; (b) Indemnity period; (c) Annual sales; (d) Short sales; and (e) Increased cost of working.
4. Explain the different steps for ascertaining the amount of claim for loss of profit.
5. Why is it necessary to insure the assets of the business while taking up a policy on loss of profit?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. When a fire takes place, the business naturally incurs heavy
   A expenditure
   B losses
   C none of these
2. A business takes a fire insurance policy to cover the loss of asets including
   A liabilities
   B stock
   C none of these
3. Gross profit is calculated on sales, based on usual gross profit percentage of the
   A last few years
   B last year
   C none of these
4. Fire insurance policies may contain an "average clause" to
   A discourage under-insurance
   B encourage under-insurance
   C none of these
5. The terms of loss of profit policies are usually framed to meet the requirements of the
   A insurer
   B insured
   C none of these

PRACTICAL QUESTIONS

Loss of Stock

1. A fire occured on 15th April, 2017 and destroyed the business premises of Johnson & Co. The books of account and stock amounting to ₹ 18,000 were saved and the following information was available from the books:

Year ended 31st December	2012	2013	2014	2015	2016
Sales (₹)	8,60,000	7,10,000	6,00,000	5,50,000	4,80,000
Gross Profit (₹)	2,15,000	2,13,000	2,10,000	1,87,000	1,72,800

   The stock on 31st December, 2016 was valued at ₹ 97,000. The purchases, sales and productive wages from 1st January, 2017 to 14th April, 2017 were ascertained at ₹ 75,000, ₹ 1,59,000 and ₹ 30,000 respectively.
   Prepare a statement in support of the claim for loss of stock against the insurance company.
2. There was a fire in godown of Spark Ltd. on 1.7.2017. Stock worth ₹ 30,000 was saved. The goods were insured and fully covered.
   (i) An average gross profit of 20% on sales is maintained by the company.
   (ii) The stock is valued at 10% above cost.
   The purchases and sales for first 6 months of the year were ₹ 2,10,000 and ₹ 4,50,000 respectively. Stock on January 1, 2017 was ₹ 1,48,500. the wages for that period amounted to ₹ 90,000.
   Find out the cost of stock burnt.

3. M owns a retail stationery shop which is partly destroyed by fire on 27th June 2017. The stock is insured for ₹ 10,500 and is subject to average clause. The opening Balance Sheet drawn on January 1, 2017 includes, inter alia, the following items:
   Stock — ₹ 12,500; Trade creditors — ₹ 3,500.
   On examination of the books of account for the subsequent period up to the date of fire, the following particulars are obtained:
   Sales — ₹ 88,800; Payment to creditors for goods — ₹ 75,000; Trade creditors as on 27.6.2017 — ₹ 1,800.
   An inspection of stock after the fire shows that items undamaged are ₹ 7,000. The normal rate of gross profit is 25% on purchases but the stock on January 1, 2017 includes items of discontinued lines costing ₹ 3,800 which are all sold during the next two months at cost.
   You are required to compute the amount of claim to be made to the insurer.
4. The premises of Bombay Sports House caught fire on 1st April, 2017 and its stock was damaged. The firm made up accounts to 31st May each year. The following information is available: (all figures in ₹)

	1st June 2015 to 31st May 2016	1st June 2016 to 1st April 2017
Stock at commencement conventionally valued at 10% above cost	1,05,754	1,45,992
Purchases	4,52,580	3,48,270
Sales	5,20,000	4,91,700

   In December 2016, goods which cost ₹ 10,000 were given away to Gymkhana Secretaries of various colleges for advertising purposes. No entry was made in the books. During the same month a salesman misappropriated unrecorded cash sales of ₹ 4,000. The rate of gross profit is constant. From the above, make an estimate of stock in hand on the date of fire.
5. The premises of Eagle Pen Company caught fire on 22nd October 2016 and the stock was damaged. The firm made up accounts to 31st December each year, and on 31st December 2015 the stock at cost was ₹ 13,272 as against ₹ 9,614 on 31st December 2014.
   Purchases from 1st January 2016 to the date of fire were ₹ 34,827 as against ₹ 45,258 for the full year 2015 and the corresponding sales figures were ₹ 49,170 and ₹ 52,000 respectively.
   You are given the following further information:
   (a) In April 2016 goods which cost ₹ 1,000 were given away for advertising purposes, with no entries being made in the books.
   (b) During 2016 a clerk misappropriated unrecorded cash sales. It is estimated that the defalcation averaged ₹ 20 per week from 1st January 2016 until the clerk was dismissed on 21st May 2016.
   (c) The rate of gross profit is constant.
   From the foregoing information make an estimate of the stock on hand on the date of fire.
6. A fire occured on 15th September 2017 in the premises of X Co. Ltd. From the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock:

	₹		₹
Stock at cost as on 1st January 2016	20,000	Purchases from 1st January 2017 to 1st Sept. 2017	88,000
Stock at cost as on 1st January 2017	30,000	Sales — 2016	60,000
Purchases — 2016	40,000	Sales from 1st January 2017 to 15th Sept. 2017	1,05,000

   During the current year cost of purchases has risen by 10% above last year's level. Selling prices have gone up by 5%. Salvage value of stocks after fire was ₹ 2,000.
7. A fire on October 1, 2017 destroyed the stocks of a firm. The business records were saved and from them the following particulars were ascertained:

	₹		₹
Stock at cost on April 30, 2016	44,300	Sales for the year to April 30, 2017	1,52,500
Stock at cost on April 30, 2017	37,550	Purchases from May 1, 2017 to September 30, 2017	37,350
Purchases for the year to April 30, 2017	1,03,850	Sales from May 1, 2017 to September 30, 2017	59,000

   In valuing the stock on April 30, 2017 ₹ 800 were written-off a particular line of goods which originally cost ₹ 1,800 and which were sold in June 2017 for ₹ 1,750. Except this transaction, the ratio of gross profit remained unchanged throughout.
   The value of stock salvaged from the fire was ₹ 5,105. You are required to calculate the amount of claim to be presented to the insurance company in respect of the loss of stock.

8. On 1st April, 2017 the godown of Stone Ltd. was destroyed by fire. The records of the company revealed the following particulars:

	₹		₹
Stock on 1st January, 2016	75,000	Sales during 2016	4,00,000
Stock on 31st December, 2016	80,000	Purchases from 1st January, 2017 to the date of fire	75,000
Purchases during 2016	3,10,000	Sales from 1st January, 2017 to the date of fire	1,00,000

In valuing closing stock of 2016, ₹ 5,000 were written-off whose cost was ₹ 4,800. Part of this stock was sold in 2017 at a loss of ₹ 400, ₹ 2,400. Stock salvaged was ₹ 5,000. The godown and the cost of which was fully insured. Indicate from above, amount of the claim to be made against the insurance company.

9. The premises of a company was destroyed by fire on 15th June, 2017. The records were, however, saved which from the following particulars were available (all figures in ₹):

Stock at cost as on 1st January 2016	30,000	Sales less returns for the year ended Dec. 31, 2016	2,50,000
Stock at cost as on 31st December 2016	40,000	Purchases less returns from 1.1.2017 to 15.6.2017	85,000
Purchases less returns for the year ended Dec. 31, 2016	2,00,000	Sales less returns from 1.1.2017 to 15.6.2017	1,20,000

₹ 2,500 were written-off a certain stock, which was a poor selling line, while valuing the stock for the Balance Sheet as at December 31, 2016. The cost of such stock was ₹ 4,000. A portion of this stock was sold in March 2017 at a loss of ₹ 500 on the original cost of ₹ 2,000. The balance of this stock is now estimated to be worth the original cost. Excepting the above, the gross profit remained at a uniform rate throughout. The stock saved was ₹ 5,000. You are required to ascertain the amount of loss of stock which is to be claimed from the insurance company.

10. A fire occured in the godown of M/s. Krishna Traders on 31st March 2017. The stock as on 31st December 2016 was valued at ₹ 5,88,000. From the following particulars relating to the period from 1st January 2017 to 31st March 2017, you are required to ascertain the amount of claim to be lodged with the insurance company in respect of the value of goods destroyed by fire:
(1) The purchases during the above period amounted to ₹ 2,13,000 of which goods costing ₹ 30,000 were received on 8th May, 2017.
(2) Goods costing ₹ 15,000 were found defective and were sold for ₹ 9,000. The goods in question had been included in the closing stock as at 31st December 2016, at cost.
(3) The closing stock as at 31st December 2016 was undervalued by ₹ 12,000.
(4) The sales during the above period amounted to ₹ 2,79,000 of which "sales on approval" basis amounted to ₹ 30,000. No intimation was received from the customers in respect of 60% of the goods sold on approval basis.
(5) On 20th February 2017, goods costing ₹ 68,000 were sent to consignee and the same were lying unsold with them.
(6) The accounting year of the firm ends on 31st December every year and the sales and gross profits of the preceding 5 years are as under:

Year	Sales (₹)	Gross Profit (₹)
2012	13,97,500	3,49,375
2013	11,53,750	3,46,125
2014	9,75,000	3,25,000
2015	8,93,750	3,03,875
2016	9,75,000	3,37,050

The gross profit during the period of fire should be taken on the basis of the weighted average of last five years' profits, giving more weightage to the results of the later years.
(7) The value of the goods salvaged was estimated at ₹ 1,20,000.
(8) The insurance policy taken out by the company was for ₹ 3,00,000. The policy was subject to average clause.

11. A fire occurred in the premises of Malcom Marshall & Co on 15.5.2014 causing destruction of a large part of the stock. The firm had taken a fire insurance policy for ₹ 5,47,200 to cover the loss of stock by fire. From the records saved, the following particulars were ascertained :

	₹
Purchases for the year 2013	30,01,600
Sales for the year 2013	37,12,000
Purchases from 1st January 2014 to 15th May 2014	5,82,400
Sales from 1st January 2014 to 15th May 2014	7,68,000
Stock on 1st January 2013	4,60,800
Stock on 31st December 2013	7,74,400
Wages paid during 2013	3,20,000
Wages paid during 1st January 2014 to 15th May 2014	57,600
Stock salvaged was	89,600

In 2013 some goods were destroyed by fire. The cost of such goods were ₹ 1,60,000. These goods were not covered by any insurance policy.
In valuing the stock on 31st December, 2013 stocks costing ₹ 34,000 were found to be poor selling line and ₹ 6,000 in relation to such stock were written-off. A portion of these goods (original cost ₹ 5,000) were sold in April, 2014 at a loss of ₹ 1,000 on original cost. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, gross profit has remained at a uniform rate throughout.
You are required to ascertain the insurance claim available to the firm. ***[C.U.B.Com. (Hons.) — Adapted]***

Loss of Profit

12. On 31st December 2016, a fire damaged the premises of Shanker Ltd. and the business of the company got disorganised till 31st March, 2017. The company was insured under a loss of profit for ₹ 1,95,000 with a six month's period indemnity. The company's account for the year ended 31st October, 2016 showed a turnover of ₹ 5,25,000 with a net profit of ₹ 60,000. The amount of standing charges covered by the insurance and debited in that year was ₹ 1,50,000. The turnover for the twelve months ended 31st December, 2016 was ₹ 5,85,000. The turnover during the period the business was dislocated amounted to ₹ 60,000 while during the corresponding period in the preceding year it was ₹ 1,27,500. A sum of ₹ 15,000 was spent as additional expenses to mitigate the effect of the loss, there being no saving, however, in standing charges as a result of fire.
Prepare a claim to be submitted in respect of the consequential loss policy.
13. There was a serious fire in the premises of M/s. Fortunate on 1st September, 2016. Their business activities were interrupted till 31st December, 2016 when normal trading conditions were re- established. M/s Fortunate are insured under the loss of profit policy for ₹ 42,000, the period of indemnity being six months.
You are able to ascertain the following information:
(1) The net profit for the year ended 31st December 2015 was ₹ 20,000;
(2) The annual insurable standing charges amounted to ₹ 30,000 of which ₹ 2,000 were not included in the definition of insured standing charges under the policy;
(3) The additional cost of working in order to mitigate the damage caused by the fire amounted to ₹ 600, and, but for this expenditure, the business would have had to shut down;
(4) The saving in insured charges in consequence of the fire amounted to ₹ 1,500;
(5) The turnover for the period of four months ended April 30th, August 31st and December 31st in each of the years 2015 and 2016 was as under:

	April 30 (₹)	August 31 (₹)	December 31 (₹)
2015	65,000	80,000	95,000
2016	70,000	80,000	15,000

You are required to compute the relevant claim under the terms of the loss of profit policy.
14. A fire occurred on 1st July 2016 in the premises of Arolite Ltd., and business was disorganised up to 30th November 2016.
From the books of account, the following information was extracted (all figures in ₹) :

Actual turnover from 1st July 2016 to 30th Nov. 2016	60,000	Turnover for the last financial year	5,00,000
Turnover from 1st July 2015 to 30th Nov. 2015	2,00,000	Turnover for the year ending 30th June 2016	5,50,000
Net Profit for the last financial year	90,000	Total standing charges for the year	72,000
Insured standing charges for the last financial year	60,000		

The company incurred additional expenses amounting to ₹ 9,000 which reduced the loss in turnover. There was also a saving of ₹ 2,486 during the indemnity period.
The company holds a "Loss of profit" policy for ₹ 1,65,000 having an indemnity period for 6 months. There was a considerable increase in trade and it was agreed that an adjustment of 20% be made in respect of upward trend in turnover. Compute claim under "Loss of profit insurance".
15. On 1st November 2016, a severe fire broke out in the premises of Good Luck Co. Ltd. The indemnity period lasted for 4 months during which the sales of the Company were reduced to ₹ 2,00,000 only. The company closes its accounts on 30th June each year. The Profit and Loss Account for the year ended 30th June 2016 is given below:

	₹		₹
Opening Stock	5,00,000	Sales	47,50,000
Purchases	30,00,000	Closing Stock	2,50,000
Variable Expenses	7,87,500		
Standing charges	3,62,500		
Net Profit	3,50,000		
	50,00,000		50,00,000

The Company took a loss of profit policy for a sum of ₹ 6,00,000. The sales of the company for the 12 months ending the date of fire were ₹ 50,00,000 and for the 4 months from 1st November, 2015 to 29th February 2016 were ₹ 15,00,000. It was noted that the sales for the first four months of the year under indemnity were 20% higher than the previous year. Compute the claim for loss of profit.

16. From the following information, compute a consequential loss claim:
Financial year ends on 31st December : Turnover ₹ 2,00,000; Indemnity period — 6 months.
Period of interruption — 1st July to 31st October.
Net profit — ₹ 18,000. Standing charges — ₹ 42,000 out of which ₹ 10,000 have not been insured.
Sum assured — ₹ 50,000. Standard turnover — ₹ 65,000.
Turnover in the period of interruption — ₹ 25,000 out of which ₹ 6,000 was from a rented place at ₹ 600 p.m.
Annual turnover — ₹ 2,40,000. Savings in standing charges — ₹ 4,725 per annum.
Date of fire — night of 30th June.
It was agreed between the insurer and the insured that the business trends would lead to an increase of 10% in the turnover.

17. From the following details, determine the amount of claim under a loss of profit policy :

Indemnity period	4 months
Date of fire	1.4.2016
Dislocation continued upto	1.8.2016
	₹
Sum insured	60,000
Sales for the last accounting year	2,40,000
Net profit for the last accounting year	34,000
Standing charges for the last accounting year all insured	26,000
Sales for the dislocation period, i.e., 1.4.2016 to 1.8.2016	30,000
Sales for the year 1.4.2015 to 31.3.2016	3,20,000
Sales for the corresponding period in the preceding year, i.e., 1.4.2015 to 1.8.2015	1,00,000

The policy contains special circumstances clause which stipulates for increase of turnover (standard and annual) by 10% as there is an upward trend in the business.

18. Calculate the amount of claim for consequential loss from the following information :
(i) The policy is for ₹ 4,90,000 with a six months period of indemnity.
(ii) On 1st July, 2016 fire broke out and sales of 3 months were affected.
(iii) Sales for 12 months ended 30th June, 2016 amounted to ₹ 5,00,000.
(iv) A sum of ₹ 1,000 was spent as additional expenses to mitigate the effect of loss.
(v) After debiting insured standing charges of ₹ 25,000, the net profit for the year 2015 amounted to ₹ 2,00,000.
(vi) Sales for the year 2015 amounted to ₹ 4,50,000.
(vii) Accounts are closed each year on 31st December.
(viii) Sales for 3 months ending 30th September, 2015 were ₹ 1,00,000.
(ix) Sales for 3 months ending 30th September, 2016 were ₹ 40,000.

19. Mitra & Co. has taken out a policy against consequential loss, the amount of the policy being ₹ 60,000 for 2015-16 and the indemnity period being 18 months. A fire occurred on 1st September, 2015 in the premises of Mitra & Co., which interrupted business for a period of 12 months. The Profit and Loss Account for the year ended 31st March, 2015 showed a sale of ₹ 2,40,000 and a profit of ₹ 20,000 after debiting ₹ 30,000 standing charges of which ₹ 2,000 were not insured. You have ascertained the turnover for the various periods as :

Year		2014	2015	2016
5 Months ended 31st August	(₹)	1,00,000	1,10,000	20,000
7 Months ended 31st March	(₹)	1,40,000	1,40,000	10,000

Additional expenses totalled ₹ 7,800 and the saving in expenses was ₹ 1,500.
Compute the claim for loss of profit in respect of the policy.

Guide to Answers

Multiple Choice

1. B 2. B 3. A 4. A 5. B.

Practical Questions

1. **Rate of gross profit on sales — 25%; 30%; 35%; 34%; 36%. Average rate of gross profit — 32%; Stock on the date of fire — ₹ 93,880; Insurance claim ₹ 75,880.**
2. **Insurance claim — ₹ 75,000 – ₹ 30,000 = ₹ 45,000. It is assumed that in the preceding years there was no difference between the amount of opening stock and closing stock. Thus the gross profits of all the years were same, i.e., 20%.**

3. **Insurance claim — ₹ 5,250.**
4. **Gross profit on sales — 20%; Stock in hand on the date of fire ₹ — 74,430.**
5. **Stock in hand on the date of fire — ₹ 7,443.**
6. **Rate of gross profit on sales — 50%; Insurance claim — ₹ 64,000.**
7. **Insurance claim ₹ 27,575.**
8. **Rate of gross profit on sales — 25%; Insurance claim — ₹ 79,100.**
9. **Rate of gross profit on sales — 25%; Total stock on the date of fire — ₹ 36,625; Insurance claim — ₹ 31,625.**
10. **Average rate of gross profit — (500 / 15) = $33^1/_3$%. Loss of stock — ₹ 4,00,000. Net Claim (after average clause) — ₹ 2,30,769.**
11. **Rate of Gross Profit — 23.4375%; Loss of Stock — ₹ 7,40,863; Net Claim — ₹ 4,88,162.**
12. **Upward trend — 80/7%; Short sales — ₹ 82,071; Rate of gross profit — 40%; Additional expenses incurred — ₹ 15,000; Loss of profit = ₹ 47,828. Net claim after average clause — ₹ 39,857.**
13. **Gross profit — 20% (₹ 48,000/2,40,000). Short sales — ₹ 80,000; Additional expenses admissible — ₹ 576;**
    Loss of profit — ₹ 15,076; Net claim — ₹ 12,922.
14. **Rate of gross profit — ₹ 30%; Short sales — ₹ 1,80,000; Additional expenses admissible — ₹ 8,486;**
    Gross claim — ₹ 60,000; Net claim — ₹ 50,000.
15. **Short sales — ₹ 16,00,000; Claim for loss of profit — ₹ 1,92,000.**
16. **Rate of gross profit (after adjustment) — 28% for loss of stock; Value of stock on the date of fire — ₹ 83,200;**
    Claim for loss of stock will be limited to ₹ 80,000.
    Gross profit for loss of profit — 20%; Short sales (after adjustment) — ₹ 2,28,000; Groff profit on short sales ₹ 45,600 + Additional expenses ₹ 12,000 = Total claim ₹ 57,600. Average clause is not applicable.
17. **Gross profit ratio = 25%. Short sales ₹ 80,000. Amount of net claim = ₹ 13,636 (after applying average clause).**
18. **Gross profit ratio = 50%. Short sales ₹ 60,000. Net claim = ₹ 31,000 (the average clause will not be applicable).**
19. **Gross profit = 20%. Short sales — ₹ 2,45,000. Amount of insurance claim = ₹ 53,500. Increased cost of workings (admissible) ₹ 6,000.**

CALCUTTA UNIVERSITY
Financial Accounting – I
Suggested Answers of Short Questions

2011 [General]

Group - A

Answer the following questions : *[2 × 10]*

1. (a) Who are the users of accounting information ? (Mention any four.)

Answer

The users of accounting information can be classified into ***two*** categories —

(a) **Internal users** : (i) Directors, (ii) Mangers, (iii) Partners, (iv) Officers; and

(b) **External users** : (i) Investors, (ii) Government agencies, (iii) Lenders, and (iv) Customers.

1. (a) Or, Mention two qualitative characteristics of accounting information.

Answer

Accounting information must possess some qualitative characteristics; ***two most important qualitative characteristics are : (1) Understandability; and (2) Relevance.***

Understandability : It is the quality of accounting information that enables the users to understand the content and significance of accounting statements and report.

Relevance : Accounting information must be relevant to the users. Information is relevant if it meets the needs of the user in decision-making.

1. (b) Using accounting equation, calculate total assets if —

(i) Capital ₹ 5,00,000; (ii) Creditors ₹ 3,00,000; (iii) Revenue during the period ₹ 5,20,000; and (iv) Expenses during the period ₹ 3,80,000.

Answer

Total Assets = Capital + Liabilities + Profit

Total Assets = ₹ 5,00,000 + ₹ 3,00,000 + ₹ 1,40,000 (Note 1)

= **₹ 9,40,000**

Working Note : (1) Profit = Revenue – Expenses

= ₹ 5,20,000 – ₹ 3,80,000 = **₹ 1,40,000**

1. (c) What do you mean by accrual basis of accounting ?

Answer

Accrual basis of accounting is an accounting system, which recognises revenues and expenses as they are earned or incurred, not as cash received or paid . ***For example***, revenue for sales must be accounted for in the year in which goods are sold, regardless of when cash is received.

1. (c) Or, From the following ascertain income for the year ended 31.12.2010, according to Cash Basis of accounting :

	₹
(i) Income received in cash for the year ended 31.12.2010	*50,000*
(ii) Accrued income as on 31.12.2010	*5,000*
(iii) Income received in advance during 2010	*15,000*
(iv) Accrued income of 2009, received in 2010	*7,000*

Answer

Ascertainment of Income Under Cash Basis of Accounting for the year ending on 31.12.2010

Particulars	₹	₹
Income received in cash for the year ended 31.12.2010		50,000
Add: Income received in advance during 2010	15,000	
Accrued Income of 2009 received in 2010	7,000	22,000
Total Income		72,000

1. (d) What is Entity Concept ?

Answer

According to Entity Concept, business is considered separate and distinct from the owner of the business. Only those economic events which affect the business unit are recorded. Accounting records are kept only from the point of view of the business unit, not the owner's point of view. ***For example***, if the owner pays capital into the business, this is treated as if the owner is lending cash to the business.

1. (d) Or, Mention the names of accounting concept or convention being followed in the following instances:

(i) Provision for depreciation is created

(ii) Unsold stock is valued at lower of cost or net realisable value.

Answer

(i) Matching Concept

(ii) Prudence (or Conservatism) Concept

1. (e) What is meant by Recognition of Revenue ?

Answer

Revenue recognition means the process of transfer of revenue to Income Statement / Profit and Loss Account of relevant accounting period so that profit of that period can be ascertained.

Revenue recognition is mainly concerned with the timing of recognition of revenue in the Statement of Profit or Loss.

1. (f) What do you mean by expense in accounting ?

Answer

Expenses are a decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity, other than those related to distributions to equity participants.

1. (g) What will be the effect on profit for a period —

(i) if the value of closing inventory is understated

(ii) if the value of opening inventory is overstated

Answer

(i) If the value of ***closing inventory is understated***, the profit for the period will be ***less.***

(ii) If the value of ***opening inventory is overstated***, the profit of the period will be ***less.***

1. (h) Y Ltd. has an item in stock which costs ₹ 30,000 and can be sold for ₹ 24,000. However, before it can be sold, it will require to be modified at a cost of ₹ 3,000. The expected selling expenses of the item are ₹ 2,000.

Calculate the Net Realisable Value (NRV) of the item.

Answer

Calculation of Net Realisable Value (NRV)

Particulars	₹	₹
Selling Price		24,000
Less: Modification Cost	3,000	
Expected Selling Expenses	2,000	5,000
Net Realisable Value (NRV)		19,000

1. (i) Who pays Del Credere Commission ? Why is this commission paid ?

Answer

Del Credere Commission is an additional commission paid by the consignor to the consignee.

Where the consignee gets the del credere commission, he indemnifies the consignor for all bad debts arising out of credit sales. To the consignor, it is a form of ***credit insurance***.

1. (i) Or, Find out the cost price of an item consigned at an invoice price of ₹ 1,50,000 load being 20% on cost price.

Answer

Calculation of Cost Price of Goods Sent on Consignment

Particulars	₹	₹
Invoice Price		1,50,000
Less: Loading 20% on Cost Price (i.e., 1/6th of Invoice Price)		25,000
Cost Price of Goods Sent		1,25,000

1. (j) When is the 'average clause' applicable in calculating insurance claim for loss of stock ?

Answer

At the time of calculating insurance claims, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value.

In the event of a partial loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}}$$

1. (j) Or What do you mean by 'Standing Charges' ?

Answer

Standing Charges are fixed expenses which can not be avoided during the interruption of business due to fire or other perils. The examples are :

(i) Rent, Rates and Taxes
(ii) Interest on debenture and loans
(iii) Salaries of permanent staff
(iv) Wages of skilled workers
(v) Auditor's fees
(vi) Directors' fees, etc.

2012 [General]

Group - A

Answer the following questions : ***[2 × 10]***

1. (a) What do you mean by 'accounting cycle' ?

Answer

Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise takes part in numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. Accounting cycle demonstrates different stages of accounting.

1.(a) Or What do you mean by accounting equation ?

Answer

The accounting equation is the basis for double entry system of accounting. Total assets of the business unit are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of the business are equal to total liabilities. Liabilities to the outsiders are known as ***liabilities*** but liability to the owners, in accounting, is referred to as '***capital***'.

The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

Total Assets = Total Liabilities

OR

Total Assets = Liabilities + Capital

OR

Total Assets – Liabilities = Capital

1. (b) Mention any two characteristics of asset ?

Answer

1. It embodies a probable future benefit that increases a capacity, either singly or in combination with other resources, to contribute directly or indirectly to future cash inflows.
2. It is a result of past transactions or events, i.e. the transactions giving rise to the claim to or control of the benefit must already have accrued.

1. (b) Or Give two examples of current liabilities.

Answer

Two examples of current liabilities are : (i) Sundry Creditors and (ii) Bills Payable (maturing within 12 months from the date of closing the books of accounts).

1. (c) What is meant by money-measurement concept ?

Answer

Money has been adopted by the accounting system as its basic unit of measurement because money is the only universally known way of comparing values. It is a useful way of converting accounting data into a common unit. Otherwise, it would be impossible to make any fair comparison between various types of assets (such as plant and stock), or different types of transactions (sale of cotton and purchase of stationery). Most of the resources of a business can be expressed in terms of a money value. Since money is the medium of exchange and the standard of economic value, ***this concept requires that those transactions alone which are capable of being measured in terms of money are to be recorded in the books of account***.

1.(c) Or Which accounting concepts are being followed in the following cases :

(i) A business will continue its operation for an indefinite period and will not be dissolved in the near future.

Answer

Here, going concern concept has been followed.

This concept assumes that the entity will continue operating under the same economic conditions and in the same general environment, but does not assume that the business will be profitable as long as it exists. This concept also does not imply that the business will continue for ever.

(ii) A business is considered as an artificial person different from the owner.

Answer

Here business entity concept has been followed.

According to business entity concept, business is considered separate and distinct from the owners of the enterprise. We must, for the purposes of book-keeping, keep the owner and his business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of the business unit and not the owners. For example, Mr. X starts a business, styled 'X & Co.'—accounts are to be prepared only from the point of view of 'X & Co.'—as if it was a different person from the owner.

1. (d) Define deferred revenue expenditure.

Answer

Deferred revenue expenditure represent certain types of expenditures whose usefulness do not expire in the year of their occurrence but generally expire in the near future. These types of expenditures are carried forward and are written-off in future accounting periods. Sometimes, we make some revenue expenditure but it eventually becomes a capital asset. Examples of deferred revenue expenditure is promotion cost of a new product in the market.

1. (e) What is meant by revenue in accounting ?

Answer

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the ***charges made to customers*** or ***clients*** for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

1. (e) or Is there any difference between revenue and gain ? Explain in brief.

Answer

Revenue and gains are not same. Revenue is the gross inflow of cash receivables or other consideration arising in the course of the ordinary activities of an enterprise from sale of goods or services, etc.

Gain may arise from non-operating activities such as sale of investment or sale of land at a profit may lead to gain for the organisation. Gain is not recurring in nature whereas revenue is recurring one for a going concern.

1. (f) What do you mean by inventory ?

Answer

Inventories are assets

(a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);

(b) in the process of production for such sale (e.g., car in the assembly lines); or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).

Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular, e.g., spray guns used in the ‘paint shop’ of an automobile company’s workshop.

1. (g) Value of physical stock as on 8th April, 2011 was ₹ 34,500. Purchases during the period from 1st April to 8th April, 2011 was ₹ 7,500 of which ₹ 800 worth of goods were delivered only on 10th April, 2011. Determine the value of stock as on 31st March, 2011.

Answer

Value of stock as on 8th April, 2011	34,500
Less: Physical stock taken in godown between 1st April and 8th April (₹ 7,500 - 800)	6,700
Value of stock on 31st March, 2011	27,800

1.(h) What do you mean by ’Matching of revenue against expenses’ ?

Answer

As most businesses keep accounts on accrual basis, it is necessary that the accounting system match periodically the revenues earned against expenses incurred. The result of this matching being, the net income or net loss. This method requires proper allocation of costs into appropriate period so that relevant incomes and expenses are matched. The profit of an accounting period is the revenues from transactions less expenses incurred in producing those revenues. If expenses cannot be traced to specific items of revenues, they are generally written-off in the year in which they are incurred.

1. (i) What do you mean by goods sold on sale or return basis ?

Answer

With a view of pushing up the sales or for introducing a new product in the market, goods are sometimes sent to the customers on sale or return basis. This means that a business delivers the goods to the customers with the option to retain or reject them within a specified period. A contract of goods on sale or return permits the buyer to return the goods for a full refund (then cash is received) or allow for an adjustment to be made to the amount owed. Generally, these transactions take place between a manufacturer (or a wholesaler) and a retailer. When the goods are transferred from the wholesaler to the retailer, under a sale or return basis, it implies a change in the possession of goods only and not a transfer of the ownership of goods. The ownership is passed only when the retailer gives his approval or if the goods are not returned within that specified period. The retailer (customer) does not incur any liability when the goods are merely sent to him.

1. (j) What do you mean by sectional balancing system ?

Answer

Under this system, in the General Ledger, two additional accounts

(i) Total Debtors Account / Sales Ledger Control Account / Debtors Ledger Control Account; and

(ii) Total Creditors Account / Purchases Ledger Control Account / Creditors Ledger Control Account are kept, so that double entry is completed in the General Ledger itself.

The customers', and suppliers' individual accounts are kept in the respective ledgers.

At the end of each month, the total of Sales Day Book will be debited to 'Total Debtors Account' and credited to 'Sales Account' in the General Ledger — thus completing double entry in the General Ledger itself. Similarly, total amount received from customers, total discount allowed to them, total returns inwards, total bills receivable will be credited to 'Total Debtors Account' and debited to the respective accounts appearing in the General Ledger.

Again, the monthly total of Purchases Day Book will be credited to 'Total Creditors Account' and debited to 'Purchases Account' in the General Ledger. Similarly, total amount paid to creditors, total discount received from them, total returns outwards, total bills payable accepted will be debited to Total Creditors Account and credited to the respective accounts in the General Ledger.

In the 'Debtors Ledger' individual customer's account is debited with credit sales and credited with payments, discount allowed, bills receivable, etc. Similarly in the 'Creditors Ledger' individual supplier's account is credited with credit purchases and debited with payments, discount received, bills payable, etc.

The accuracy of individual customer's account can be checked by comparing the total of their balance with balances of the ***Total Debtors Account*** in General Ledger.

In the same manner, the accuracy of individual supplier's account can be checked by comparing the total of their balance with the balance of the ***Total Creditors Account***.

1.(j) Or What are the adjustment accounts opened in the general ledger under self-balancing system ?

Answer

Under self-balancing system, the following ***two accounts*** are opened in the general ledger to complete the double entry in the general ledger itself. The adjustment accounts are :

(i) Debtors Ledger Adjustment Account; and (ii) Creditors Ledger Adjustment Account.

2013 [General]

Group - A

Answer the following questions : ***[2 × 10]***

1. (a) State the two uses of accounting information.

Answer

The following are the two uses of accounting information :

(a) Accounting information helps investors to decide about (i) making investment; and (ii) quantum of investment etc.

(b) Accounting information provides shareholders vital information about the performance of the organisation as well as the financial health of the organisation.

1, (a) Or Distinguish between financial and management accounting. (any two)

Answer

	Financial Accounting		**Management Accounting**
1.	It is primarily for external purposes.	1.	It is primarily for internal purposes.
2.	It records what has happened based on past transactions in a true and fair manner.	2.	It provides information which is used to take decisions about the future.

1. (b) What do you mean by 'double entry' book keeping system ?

Answer

Double entry is an almost universally used system of business record keeping. It is a system of recording business transactions which recognises that each transaction has a dual aspect. It is so named because the principles of double entry book-keeping are based upon every transaction having two aspects or two parts, i.e., two accounts are always affected by each transaction. Under this system, each transaction is seen as a flow of value from one account to another. The receiving account is debited with the amount and the giving account is credited. Therefore, every debit has an equal and offsetting credit.

1. (b) Or What is contingent liability ?

Answer

Contingent Liabilities are conditions which exist at the Balance Sheet date, the outcomes of which can only be confirmed on the occurrence or non-occurrence of one or more uncertain future events. A contingent liability may also exist when a current situation may result in a future liability, but the amount of the liability in the monetary terms cannot be reasonably anticipated as on the Balance Sheet date.

1. (c) Why is ledger called a book of final entry ?

Answer

The ledger is regarded as a book of final entry for the following reason :

Transactions are recorded first in the book of primary entry, i.e., Day Books, Cash Book, Journal Proper, etc. From book of primary entry these are transferred to the ledger. After posting into the ledger, no further transfer is done. The ledger accounts are balanced and Trial Balance is prepared and from Trial Balanec, Trading, Profit and Loss Account and Balance Sheet is prepared.

1. (c) Or What do you mean by journal proper ?

Answer

Journal Proper is a book of primary entry. It is used for recording transactions which do not find a place in any of the specialised book of primary entry, e.g., Purchases Day Book, Sales Day Book, etc.

1. (d) From the following information, ascertain income for the year ended 31.03.2013, according to accrual basis of accounting :

(i) Income received in cash for the year ended 31.03.2013 ₹ 1,00,000

(ii) Accrued income as on 31.03.2013 ₹ 35,000

(iii)Income received in advance during the year ended 31.03.2013 ₹ 10,000

(iv) Outstanding expenses as on 31.03.2013 ₹ 30,000

(v) Prepaid expenses as on 31.03.2013 ₹ 5,000

Answer

Calculation of Income Under Accrual Basis

Particulars	₹	₹
Income Received in Cash		1,00,000
Add: Accrued Income as on 31.3.2013		35,000
		1,35,000
Less: Income Received in Advance as on 31.3.2013		10,000
Gross Income		1,25,000

Less: Expenses :		
Outstanding on 31.3.2013	30,000	
Less: Prepaid on 31.3.2013	5,000	25,000
Income Under Accrual Basis		1,00,000

1. (e) What is meant by recognition of expenses ?

Answer

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

1. (f) Name four methods of valuation of closing stock.

Answer

Four methods of valuation of closing stock are :

(i) First-in-First-Out (FIFO)

(ii) Weighted Average (WAV)

(iii) Specific Identification

(iv) Last-in-First-out (LIFO)

1. (g) What do you mean by stock reconciliation statement ?

Answer

Stock Reconciliation Statement is a statement which explains in full the difference in stock as per accounting record and physical stock verified.

1. (g) Or Calculate the value of closing stock as on 31.03.2013 from the following information :

(i) Value of physical stock taken on 10.04.2013 (for the year ended 31.03.2013) was ₹ 5,00,000.

(ii) Purchased during the period from 01.04.2013 to 10.04.2013 was ₹ 50,000 out of which ₹ 10,000 worth of goods was received on 15.04.2013.

(iii) Freight paid on above purchases was ₹ 5,000.

(iv) Goods sold during the period from 01.04.2013 to 10.04.2013 (making a profit of 25% on cost) was ₹ 55,000.

Answer

Statement Showing the Physical Stock on 31st March, 2013

Particulars	₹	₹
Stock as on 10.4.2013		5,00,000
Add: Cost of Goods sold		44,000
		5,44,000
Less: Goods Purchased actually received between 1.4.2013 and 10.4.2013		40,000
Value of Stock on 31st March, 2013		5,04,000

Working Note :

(1) Cost of Goods Sold between 1.4.2013 and 10.4.2013

	₹
Sales	55,000
Less: Profit 25% on Cost or 20% on Sales	11,000
	44,000

1. (h) What is meant by revenue in accounting ?

Answer

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

1. (i) What is the treatment of 'Normal Loss' on valuation of stock in consignment account ?

Answer

Normal loss is treated by ignoring the loss. It means that the value of remaining stock absorbs this loss. Therefore, when there is some normal loss, the value of the remaining goods are artificially inflated to cover the normal loss. For example, a consignment of 100 units costing @ ₹ 0.95 is sent. Due to normal loss, the consignee receives 95 units. The value of stock will become ₹ 1 per unit (instead of the actual price of ₹. 0.95 per unit).

1. (i) Or What do you mean by Del Credere Commission ?

Answer

Del Credere Commission is an additional commission paid to a consignee who guarantees the payment in case of credit sale. Where the consignee gets del credere commission, he indemnifies the consignor for all bad debts. To the consignor, it is a form of credit insurance. Like ordinary commission, del credere commission is also paid, generally, at a predetermined percentage of the Gross Sales Proceeds. However, there may be a separate agreement between the parties for calculation of the del credere commission.

1. (j) How do you treat the 'Salvaged Goods' for calculating insurance claim for loss of stock ?

Answer

When the business is fully compensated by the insurance company for the loss of stock, the insurance company becomes the owner of the stock salvaged. Generally, salvaged stock is adjusted with gross claim. ***For example***, book value of stock lost is ₹ 44,000. Goods salvaged is ₹ 4,000. Insurance company will adjust this ₹ 4,000 with claim and will pay ₹ 40,000 only.

2013 [HONOURS]

Group A

Answer the following questions : ***[2 × 10]***

1. (a) Name two users of accounting information.

Answer

Accounting information is needed by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.

The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.

1/ (a) Or What do you mean by 'comparability' of accounting information ?

Answer

Usefulness is enhanced if accounting information can be compared with similar information for the ***same organisation*** at different times, and for ***different organisations*** at the same time. Comparability enhances the value of accounting information by enabling the users to discern and detect similarities and the dissimilarities among different concerns as also in respect of the same concern over time.

1. (b) What do you mean by 'balance' of an account ?

Answer

Balance is the sum necessary to equalise the debit and credit totals of an account. Periodically, all the accounts in a ledger are balanced to ascertain the cumulative effect of entries on the accounts. The *balance* is an accounting term which means the difference between the two sides of an account, or the total of an account containing only debits and credits.

1. (b) Or Mention the names of two intangible assets.

Answer

Two intangible assets are :

(i) Goodwill;

(ii) Patent and Copyrights

1. (c) Give examples of two entries which are recorded in the journal proper.

Answer

Two journal entries recorded in the Journal Proper are :

(i) Opening Entries; and

(ii) Adjusting Entries.

1. (c) Or Show the application of accounting equation in the following transaction :

Mr A started business with cash ₹ 50,000.

Answer

Assets – Liabilities = Capital

Cash ₹ 50,000 – 0 = ₹ 50,000

1. (d) Which accounting concept is being followed in the following cases :

(i) The life of business is assumed to be indefinite, yet businesses prepare their accounts annually.

(ii) Profit is being determined by comparing the sales of an accounting period with the corresponding cost of goods sold.

Answer

(i) Periodicity Concept; and

(ii) Matching Concept

1. (e) What do you mean by revenue ?

Answer

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use of enterprise resources yielding interest, royalties and dividends,by others.

1. (e) Or When revenue will be recognised in case of a concern engaged in rendering services ?

Answer

Revenue from rendering of services should be recognised by referring to the stage of completion at the Balance Sheet date. There are two methods for dealing with this situation :

(i) Proportionate Completion Method; and (ii) Completed Service Contract Method

1. (f) State the difference between expense and expenditure.

Answer

An expense is an amount of benefit that has been used up during an accounting period. Expenditure usually means an outlay of money (the benefits of the outlay may or may not be used up during the accounting period in which the outlay occured).

1.(g) State one effect of valuing inventory wrongly.

Answer

If the closing inventory is understated, the net profit for the period will also be understated and, in effect, the current assets of the business will be understated. The above effects will be reversed when the closing inventory is overstated.

1. (h) What is FIFO method of valuing inventory ?

Answer

First In First Out Method (FIFO) : This method is based on the premise that the first item purchased is the first item sold, that is, all the inventories are sold in the order in which they are acquired. Since the oldest stock in the inventory is sold first, the calculation of the inventory is on the basis that the inventories in hand represent the ones most recently purchased or produced and the cost of goods sold represents the cost of items acquired in the earlier purchases.

1. (i) What is average clause ?

Answer

Generally, fire insurance policies contain an "average clause" to discourage under-insurance. At the time of calculating insurance claim, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value. In the event of a ***partial*** loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows:

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

1. (i) Or What is short sales ?

Answer

Short sales is the difference between standard turnover and actual sales of interrupted period. The 'standard turnover' is the turnover during the period in the 12 months immediately before the date of damage which correspondences with the indemnity period.

1. (j) Mention two advantages of preparing Self Balancing Ledger.

Answer

1. Since errors can be localized, delay in detection is minimised, thereby saving labour and time of the book-keepers.
2. Arithmatic accuracy of each ledger can be proved independently.

2014 [General]

Group - A

Answer the following questions : ***[2 × 10]***

1. (a) Who are the users of accounting information ? (any two)

Answer

The users of accounting information can be classified into ***two*** categories —

(a) **Internal users** : (i) Directors, (ii) Managers, (iii) Partners, (iv) Officers; and

(b) **External users** : (i) Investors, (ii) Government agencies, (iii) Lenders, and (iv) Customers.

1. (a) Or Mention two objectives of accounting.

Answer

The objectives of accounting are :

(i) to provide reliable information about the changes in financial position arising from different transactions of the accounting period.

(ii) to provide reliable information about the earning of an enterprise during an accounting period.

1. (b) State two features of Double Entry System.

Answer

The features of double entry system are :

(i) all transactions are recorded in full.

(ii) equal debit and equal credit entries are made for every transaction in two different accounts.

1.(b) Or What is meant by Accounting Information ?

Answer

Accounting information is the information available from the Financial Statements (e.g., Balance Sheet, Profit and Loss Account and Cash Flow Statement). It is the end product of the accounting system. Accounting information is used by different categories of users (e.g., investors, employees, management, etc.) for taking important decisions.

1. (c) Using accounting equation, calculate total assets from the following information :

(i) Capital ₹ 5,00,000;
(ii) Creditors ₹ 3,00,000;
(iii) Revenue during the period ₹ 5,20,000; and
(iv) Expenses during the period ₹ 3,80,000.

Answer

Assets – Liabilities = Capital + Profit
or, Assets = Capital + Profit + Liabilities
or, Assets = ₹ 5,00,000 + (5,20,000 – 3,80,000) + 3,00,000
= ₹ 5,00,000 + 1,40,000 + 3,00,000
= **₹ 9,40,000**

1.(c) Or Mention two errors which are not disclosed by the Trial Balance.

Answer

The following errors are not disclosed in Trial Balance : (i) Errors of Omission and (ii) Errors of Principle.

1. (d) What do you mean by Accrual Basis of Accounting ?

Answer

Accrual basis of account is an accounting system which recognises revenues and expenses as they are earned or incurred. In this method, both cash transactions and credit transactions are taken into consideration for calculation of profit or loss. Prepaid and outstanding expenses arise from this concept.

1. (e) What is meant by Recognition of Revenue ?

Answer

Revenue recognition means the amount of revenue to be taken into consideration for calculating profits and losses of a particular accounting period. The main objective of revenue recognition is the determination of correct profit or loss for the accounting period.

1. (e) Or Mention two features of Expenses.

Answer

The following are the features of expenses : (i) it is an expired cost and it is not carried forward to next period; and (ii) it is to be debited to Profit and Loss Account of the accounting period in which it is recognised.

1. (f) What is FIFO method of valuing inventory ?

Answer

FIFO stands for 'First-in-First-Out'. In this method, stocks are valued at ***current*** cost. First materials are issued from old price according to the date of purchase. Stock will consist of goods from ***latest*** arrival.

1. (g) What will be the effect on profit for a period if opening stock is overstated and closing stock is understated?

Answer

If the opening stock is overstated, the profit will be understated.
If the closing stock is understated, the profit will be understated.

1. (g) Or Value of physical stock as on 10th April, 2014 was ₹ 40,500. Purchases during the period from 1st April, 2014 to 10th April, 2014 was ₹ 8,500 of which ₹ 800 worth of goods were delivered only on 15th April, 2014.

Determine the value of stock on 31st March, 2014.

Answer

	₹
Physical stock of goods on 10.04.2014	*40,500*
Less: Goods received physically between 1.4.2014 and 10.4.2014	*7,700*
Value of stock on 31.3.2014	32,800

1. (h) *What do you mean by separate entity concept ?*

Answer

Separate entity concept means that the enterprise is different from its owner. Based on this concept, goods taken over by the proprietor will be treated as drawings. Any increase in the personal wealth of the owner will not be recorded. This concept is reflected mainly in company form of business.

1. (i) *What do you mean by 'Sale on Approval Basis' ?*

Answer

Sale on approval basis means goods are despatched to dealers or customers on the condition that they can return the goods within a certain period. If it is not returned within that time, it will be treated as ***sales***. When goods are sent, it is not treated as sale in the books of the sender. It is treated as stock transfer.

1. (j) How is abnormal loss treated in consignment accounts ?

Answer

Abnormal losses in consignment may arise owing to reasons such as fire, theft, etc. Abnormal loss can be avoided. At the time of calculating profit of the consignment, abnormal loss are eliminated from Consignment Account. It is charged to General Profit and Loss Account.

2014 [Honours]

Group - A

Answer the following questions : ***[2 × 10]***

*1. (a) Distinguish between Financial Accounting and Management Accounting (**any two**).*

Answer

	Financial Accounting		Management Accounting
1.	It is primarily for external purposes.	1.	It is primarily for internal purposes.
2.	It records what has happened based on past transactions in a true and fair manner.	2.	It provides information which is used to take decisions about the future.

1.(a) Or Mention two qualitative characteristics of accounting information.

Answer

Accounting information must possess some qualitative characteristics; ***two most important qualitative characteristics are : (1) Understandability; and (2) Relevance***.

Understandability : It is the quality of accounting information that enables the users to understand the content and significance of accounting statements and report.

Relevance : Accounting information must be relevant to the users. Information is relevant if it meets the needs of the user in decision-making.

1. (b) What do you mean by Fictitious Assets ?

Answer

Fictitious assets are those assets which are not represented by anything having recoverable value. It is intangible in nature. ***Examples*** : accumulated losses, preliminary expenses, discount on issue of debentures, etc.

1.(b) Or Mention the names of two Contingent Assets.

Answer

Two contingent assets are :

(i) Claim for damages from manufacturer; and

(ii) Reserve for discount on creditors.

1. (c) Why is Journal called a book of original entry ?

Answer

Journal is called ***book of original entry because*** :

(i) It is the first book where transactions are recorded from source documents.

(ii) The transactions are recorded in chronological order.

(iii) After recording the transactions in this book, it is posted to Ledger.

1.(c) Or Briefly mention why a Fixed Assets Account cannot show a credit balance.

Answer

When fixed assets (land, building, plant and machinery) are purchased, the Fixed Assets Account is debited. When it is sold or depreciated, it is credited. The balance of fixed assets may become zero after sale or depreciation, but it cannot be ***negative***.

1. (d) Distinguish between Return Inward Book and Return Inward Account.

Answer

	Return Inward Book		**Return Inward Account**
1.	It is a book of primary entry	1.	It is a ledger account.
2.	The periodical total of this book is posted to Return Inward Account.	2.	The total of this account is shown in the Trading Account as a deduction from Sales
3.	It is not balanced at the end of the period.	3.	It is always balanced and reflect only debit balance.
4.	At the time of preparing Trial Balance this book is not taken into consideration.	4.	In the Trial balance it is shown in the 'Debit' column.

1.(d) Or Mention two differences between Revenue and Receipts.

Answer

	Revenue		**Receipts**
1.	Revenue is earning of a certain period.	1.	Receipt is the inflow of cash. It may be capital receipt or revenue receipt.
2.	There are some conditions for recognition of revenue.	2.	There is no such condition for receipts.
3.	Revenue is taken into consideration for calculating profit or loss of the business.	3.	Receipts are not taken into consideration for calculating profit or loss under accrual method of accounting.
4.	Revenue is not shown in the Balance Sheet.	4.	Capital receipt is shown in the Balance Sheet.

1. (e) From the following information, ascertain income for the year ended 31.03.2014 according to the cash basis of accounting :

	₹
(i) Income received in cash for the year ended 31.03.2014	*1,40,000*
(ii) Accrued income as on 31.03.2014	*2,500*
(iii) Income received in advance during the year ended 31.03.2014	*15,000*
(iv) Outstanding expenses as on 31.03.2014	*3,500*
(v) Prepaid expenses as on 31.03.2014	*5,000*

Calculation of Income for the year ended 31st March, 2014 (under Cash Basis)

Particulars	₹
Income received in cash for the year ended on 31.3.2014 Add : Income received in advance during the year ended 31.3.2014	1,40,000 15,000
Total Income	1,55,000

Tutorial Notes :

(1) Accrued income of ₹ 2,500 will not be taken into consideration under cash basis of accounting.

(2) It has been asked to ascertain ***income*** for the year ended 31.3.2014. Therefore, expenses (outstanding + prepaid) will not be taken into consideration.

1. (f) Show the application of accounting equation in the following transaction :
Purchased goods on credit for ₹ 30,000.

Answer

Here stock of the business will be increased by ₹ 30,000 and the liability in the form of creditor will increase by the same amount. The equation will be :

Assets – Liabilities = Capital

Stock ₹ 30,000 – Creditors ₹ 30,000 = 0

1. (g) What will be the effect on profit for a period in the following cases ?

(i) if the value of closing inventory is overstated.

(ii) if the value of opening inventory is understated.

Answer

(i) Over stating of closing stock will increase the profit (Credit side of Trading will be more).

(ii) Under stating of opening stock will increase the profit (Debit side of Trading will be less).

1. (h) From the following particulars for the year ended 31.03.2014, determine the value of the closing stock at the end of the year :

	₹
Opening stock on 01.04.2013	*40,000*
Purchases	*2,25,000*
Sales	*3,00,000*

At the end of the year goods purchased on credit for ₹ 25,000 were received but no entry was passed for non-receipt of invoice.

Uniform rate of gross profit is 30%.

Answer

Calculation of Closing Stock at the year end

Particulars	₹
Opening Stock on 1.4.2013 Add: Purchases	40,000 2,25,000
Add: Goods purchased on credit but not recorded. (However, it has been received physically.)	25,000
 Less: Cost of goods sold ₹ 3,00,000 x 70%	2,90,000 2,10,000
Closing Stock at the end of the year	80,000

1. (i) Why Self Balancing Ledger is prepared ?

Answer

Self-balancing ledger is prepared so that each ledger (e.g., debtors ledger and creditors ledger) can be balanced independently with other ledgers. Under self balancing ledger system, a 'General Ledger Adjustment Account' is prepared in the Debtors Ledger as well as in Creditors Ledger to complete double entry in these ledgers.

1.(i) Or When 'Average clause' is applied in respect of insurance claim ?

Answer

Generally, fire insurance policies contain an "average clause" to discourage under-insurance. At the time of calculating insurance claim, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value. In the event of a ***partial*** loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows:

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

1. (j) What do you mean by "Standing Charges" ?

Answer

Standing Charges are fixed expenses which can not be avoided during the interruption of business due to fire or other perils. The examples are :

(i) Rent, Rates and Taxes

(ii) Interest on debenture and loans

(iii) Salaries of permanent staff

(iv) Wages of skilled workers

2015 [General]

Group - A

Answer the following questions : ***[2 × 10]***

1. (a) What is meant by 'revenue' in accounting ?

Answer

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

1. (b) What do you mean by 'Asset' ?

Answer

Assets are resources, tangible or intangible from which probable future economic benefits are obtained and the right to which have been acquired by a particular entity as a result of past transactions or events. Examples are plant and machinery, patents, goodwill, buildings, etc.

1.(b) Or What are the characteristics of liabilities ?

Answer

The characteristics of Liabilities are as follows :

(i) Liabilities are obligations which arise from past transactions or events.

(ii) It involves transfer of cash, goods or services in future.

(iii) It can be a short-term liability or a long-term liability.

1. (c) Explain Going-Concern Concept.

Answer

The 'going concern' concept assumes that the business will continue in operation for as long as possible and will not be dissolved in the foreseeable future. The different assets are shown in the Balance Sheet based on this assumption. If it is not a going concern, the valuation of different assets will be lower than what is disclosed in the Balance Sheet.

1.(c) Or Explain the doctrine of Conservatism.

Answer

The doctrine of conservatism is a basic accounting concept which requires that a degree of caution is necessary when making estimates required under conditions of uncertainty, so that assets or income are not overstated and liabilities or expenses are not understated. The valuation of closing stock at cost or NRV whichever is less is an example of this concept.

1. (d) Why is Journal called a book of original entry ?

Answer

Journal is called ***book of original entry because*** :

(i) It is the first book where transactions are recorded from source documents.

(ii) The transactions are recorded in chronological order.

(iii) After recording the transactions in this book, it is posted to Ledger.

1.(d) Or Show the application of accounting equation in the following transaction :

Creditors are paid a sum of ₹ 20,000.

Answer

Here, cash will be reduced by ₹ 20,000 and liabilities will also be reduced by ₹ 20,000. There will be no change in capital. The equation will be :

Assets – Liabilities = Capital

Cash ₹ 20,000 – Creditors ₹ 20,000 = 0

1. (e) A business has an item of closing stock which costs ₹ 10,000. It can be sold at ₹ 11,000. But selling expenses would be ₹ 1,100. What is the Net Realisable Value of the item ?

Answer

Net Realisable Value = Selling Price – Incidental Expenses for Sale

= ₹ 11,000 – ₹ 1,100 = **₹ 9,900**

1. (f) Write two differences between Cash basis and Accrual basis of accounting.

Answer

	Cash Basis		Accrual Basis
1.	It records only cash transactions	1.	It records both cash and credit transactions,
2.	Income earned when cash is received and expenses are incurred when cash is paid.	2.	Income and expenses are measured when transactions take place.

1.(f) Or What is meant by Accounting Information ?

Answer

Accounting information is the information available from the Financial Statements (e.g., Balance Sheet, Profit and Loss Account and Cash Flow Statement). It is the end product of the accounting system. Accounting information is used by different categories of users (e.g., investors, employees, management, etc.) for taking important decisions.

1. (g) Why Stock Reconciliation Statement is prepared ?

Answer

Under periodic inventory system, at the end of the last day of the accounting year, stocks in hand are verified and valued. But in case of big organizations, it may not be possible to verify the stock exactly on the last date of the accounting period. In such a case, stock is taken either few days earlier or later, according to the situation. The stock reconciliation statement is prepared to find out the stock on the ***last day of the accounting year*** after making necessary adjustment in stock of later date or earlier date.

1. (g) Or Show the impact of the following on Gross Profit :

(i) If closing stock is overvalued by ₹ 10,000; and

(ii) If opening stock is overvalued by ₹ 10,000.

Answer

(i) If closing stock is overvalued by ₹ 10,000, the gross profit will be overstated by ₹ 10,000.

(ii) If opening stock is overvalued by ₹ 10,000, the gross profit will be understated by ₹ 10,000.

1. (h) What is 'Average Clause' in respect of insurance claim ?

Answer

'Average Clause' is related to fire insurance policy. This clause is included to discourage under insurance. At the time of calculating insurance claim, this clause is applicable if the value of stock on the date of fire was ***more*** than that of the policy value. In the event of a partial loss, the insurance company pays proportional amount of claim. The net claim is calculated as follows :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

1. (i) How is normal loss treated in consignment account ?

Answer

Normal loss is treated by ignoring the loss. It means that the value of remaining stock absorbs this loss. Therefore, when there is some normal loss, the value of the remaining goods are artificially inflated to cover the normal loss. For example, a consignment of 100 units costing @ ₹ 0.95 is sent. Due to normal loss, the consignee receives 95 units. The value of stock will become ₹ 1 per unit (instead of the actual price of ₹. 0.95 per unit).

1. (j) What do you mean by Inventory ?

Answer

Inventories are assets

(a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);

(b) in the process of production for such sale (e.g., car in the assembly lines); or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).

Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular, e.g., spray guns used in the 'paint shop' of an automobile company's workshop.

2015 [Honours]

Group - A

Answer the following questions : ***[2 × 10]***

1. (a) What do you mean by GAAP ?.

Answer

Generally accepted accounting principles are the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. These principles provide a foundation for measuring and disclosing the results of business transactions and events. They include both conventions, bases and presentation practices.

1.(a) Or Name two users of accounting information.

Answer

Accounting information is needed by two sets of people—internal and external.

The internal users are associated with the management of the organisation for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.

The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.

1. (b) What do you mean by Money Measurement Concept ?

Answer

Money has been adopted by the accounting system as its basic unit of measurement because money is the only universally known way of comparing values. It is a useful way of converting accounting data into a common unit. Otherwise, it would be impossible to make any fair comparison between various types of assets (such as plant and stock), or different types of transactions (sale of cotton and purchase of stationery). Most of the resources of a business can be expressed in terms of a money value. Since money is the medium of exchange and the standard of economic value, ***this concept requires that those transactions alone which are capable of being measured in terms of money are to be recorded in the books of account***.

1.(b) Or Which accounting concepts are being followed in the following cases ?

(i) A business will continue its operation for an indefinite period and will not be dissolved in the near future.

(ii) A business is considered as an artificial person different from its owner.

Answer

(i) Going Concern Concept

(ii) Business Entity Concept

1. (c) What is the Fundamental Accounting Equation ?

Answer

The accounting equation is the basis for double entry system of accounting. Total assets of the business unit are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of the business are equal to total liabilities. Liabilities to the outsiders are known as ***liabilities*** but liability to the owners, in accounting, is referred to as '***capital***'.

The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

Total Assets = Total Liabilities

OR

Total Assets = Liabilities + Capital

OR

Total Assets – Liabilities = Capital

1.(c) Or What do you mean by Accounting Cycle ?

Answer

Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise takes part in numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. Accounting cycle demonstrates different stages of accounting.

1. (d) What is meant by Recognition of Expenses ?

Answer

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

1.(d) Or What do you mean by Inventories ?

Answer

Inventories are assets

(a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);

(b) in the process of production for such sale (e.g., car in the assembly lines); or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).

Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular, e.g., spray guns used in the 'paint shop' of an automobile company's workshop.

1. (e) From the following information, ascertain income for the year ended 31.12.2014 according to the accrual basis of accounting :

	₹
(i) Income received in cash for the year ended 31.12.2014	*1,48,000*
(ii) Accrued income as on 1.1.2014	*10,000*
(iii) Accrued income as on 31.12.2014	*12,000*
(iv) Income of 2014 received in 2013	*5,000*

Answer

Ascertainment of Income under Accrual Basis of Accounting for the year ended 31.12.2014

Particulars		₹
Income received in cash during the year ended 31.12.2014		1,48,000
Add: Accrued income as on 31.12.2014	12,000	
Add: Income of 2014 received in 2013	5,000	17,000
		1,65,000
Less: Accrued income as on 1.1.2014		10,000
Total Income		1,55,000

1. (f) What do you mean by Account Sales ?

Answer

An ***Account Sales*** is a statement which is periodically rendered by the consignee to the consignor, showing the details about the goods sold, price realized, his own commission, and the expenses incurred in connection with the sale.

1.(f) Or Distinguish between Consignment Sales and Ordinary Sales.

Answer

	Consignment Sale		Ordinary Sale
1.	In case of consignment sale, the property in goods is not transferred to consignee.	1.	In case of ordinary sale, the property in goods is transferred to the customer immediately.
2.	When goods are lost on consignment, it is the consignor who will bear the loss	2.	When goods are lost after delivery to the buyer, it is the buyer who will bear the loss.

1. (g) What is the LIFO method of valuing inventory ?

Answer

Under LIFO method, value of inventories consists of old stock. Last purchse is issued first. It should be pointed out that the method is not acceptable as per As—2 : Inventories for Valuation of Closing Inventory.

1. (h) Mention two advantages of preparing Self Balancing Ledger.

Answer

1. Since errors can be localized, delay in detection is minimised, thereby saving labour and time of the book-keepers.
2. Arithmatic accuracy of each ledger can be proved independently.

1. (i) What do you mean by Net Realisable Value in the context of valuation of inventories ?

Answer

Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.

1. (j) What do you mean by Revenue ?

Answer

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

2016 [General]

Group - A

Answer the following questions : ***[2 x 10]***

1. (a) Who are the users of Accounting Information ?

Answer

The users of accounting information can be classified into ***two*** categories **—**

(a) **Internal users** : (i) Directors, (ii) Mangers, (iii) Partners, (iv) Officers; and

(b) **External users** : (i) Investors, (ii) Government agencies, (iii) Lenders, and (iv) Customers.

1. (b) Distinguish between financial and management accounting.

Answer

	Financial Accounting		**Management Accounting**
1.	It is primarily for external purposes.	1.	It is primarily for internal purposes.
2.	It records what has happened based on past transactions in a true and fair manner.	2.	It provides information which is used to take decisions about the future.

1. (c) Using accounting equation, calculate total assets from the following data :

Capital ₹ 4,00,000; Creditors ₹ 2,00,000; Revenue earned during the period ₹ 4,00,000; Expenses incurred during the period ₹ 2,50,000.

Answer

Assets – Liabilities = Capital + Profit

Assets = Capital + Profit + Liabilities

Assets = ₹ 4,00,000 + 1,50,000 + 2,00,000

= ₹ 7,50,000

1. (d) What do you mean by Accounting Cycle ?

Answer

Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise takes part in numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. Accounting cycle demonstrates different stages of accounting.

1. (e) Why is ledger called the Book of Final Entry ?

Answer

The ledger is regarded as a book of final entry for the following reason :

Transactions are recorded first in the book of primary entry, i.e., Day Books, Cash Book, Journal Proper, etc. From book of primary entry these are transferred to the ledger. After posting into the ledger, no further transfer is done. The ledger accounts are balanced and Trial Balance is prepared and from Trial Balanec, Trading, Profit and Loss Account and Balance Sheet is prepared.

1. (f) What is Money Measurement Concept ?

Answer

Money has been adopted by the accounting system as its basic unit of measurement because money is the only universally known way of comparing values. It is a useful way of converting accounting data into a common unit. Otherwise, it would be impossible to make any fair comparison between various types of assets (such as plant and stock), or different types of transactions (sale of cotton and purchase of stationery). Most of the resources of a business can be expressed in terms of a money value. Since money is the medium of exchange and the standard of economic value, ***this concept requires that those transactions alone which are capable of being measured in terms of money are to be recorded in the books of account***.

1. (g) Which accounting concept is followed in the following case and Why ? A business is considered as an artificial person different from the owner.

Answwee

Here, business entity concept has been followed.

According to business entity concept, business is considered separate and distinct from the owners of the enterprise. We must, for the purposes of book-keeping, keep the owner and his business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of the business unit and not the owners. For example, Mr. X starts a business, styled 'X & Co.'—accounts are to be prepared only from the point of view of 'X & Co.'—as if it was a different person from the owner.

1. (h) What is 'FIFO' method of valuing inventory ?

Answer

First In First Out Method (FIFO) : This method is based on the premise that the first item purchased is the first item sold, that is, all the inventories are sold in the order in which they are acquired. Since the oldest stock in the inventory is sold first, the calculation of the inventory is on the basis that the inventories in hand represent the ones most recently purchased or produced and the cost of goods sold represents the cost of items acquired in the earlier purchases.

1. (i) What do you mean by Net Realisable Value (NRV) ?

Answer

Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.

1. (j) What is meant by Recognition of Revenue ?

Answer

Revenue recognition means the process of transfer of revenue to Income Statement / Profit and Loss Account of relevant accounting period so that profit of that period can be ascertained.

Revenue recognition is mainly concerned with the timing of recognition of revenue in the Statement of Profit or Loss.

1. (k) What do you mean by Perpetual Inventory Method ?

Answer

Perpetual inventory method is a method where the inventory accounting is kept continuously up-to-date and involves the continual recording of additions to and issues or sales of materials on a daily basis. The method is applicable to those businesses where the sale items are of high value and have a number of sale transactions daily. Under this system, a Ledger Account (Inventory Account) is maintained which shows the cost of goods sold at any time during the accounting period. When a perpetual inventory is kept, a physical inventory should be taken at least once in a year.

1. (l) The value of physical stock was verified on 23rd December, 2015 at ₹ 4,50,000. Determine the value of closing stock as on 31.12.2015 given that the following transactions took place between 23.12.2015 and 31.12.2015 :

(i) Out of purchases worth ₹ 60,000, goodw worth ₹ 25,000 was delivered on 8th January, 2016.

(ii) Out of the goods sent for consignment, goods worth ₹ 15,000 remained unsold.

Answer

Statement Showing the Value of Physical Stock on 31.12.2015

Particulars	₹	₹
Stock on 23.12.2015		4,50,000
Add: Purchases and delivered within 31.12.2015 (₹ 60,000 – 25,000)	35,000	
Add: Goods with consignee at cost	15,000	50,000
Value of Stock on 31.12.2015		5,00,000

1. (m) How do you treate 'Salvaged goods' for calculating insurance claim for loss of stock ?

Answer

When the business is fully compensated by the insurance company for the loss of stock, the insurance company becomes the owner of the stock salvaged. Generally, salvaged stock is adjusted with gross claim. ***For example***, book value of stock lost is ₹ 44,000. Goods salvaged is ₹ 4,000. Insurance company will adjust this ₹ 4,000 with claim and will pay ₹ 40,000 only.

1. (n) What is short sales ?

Answer

Short sales is the difference between standard turnover and actual sales of interrupted period. The 'standard turnover' is the turnover during the period in the 12 months immediately before the date of damage which correspondences with the indemnity period.

(o) What do you mean by Sectional Balancing System ?

Answer

Under this system, in the General Ledger, two additional accounts

(i) Total Debtors Account / Sales Ledger Control Account / Debtors Ledger Control Account; and

(ii) Total Creditors Account / Purchases Ledger Control Account / Creditors Ledger Control Account are kept, so that double entry is completed in the General Ledger itself.

The customers', and suppliers' individual accounts are kept in the respective ledgers.

At the end of each month, the total of Sales Day Book will be debited to 'Total Debtors Account' and credited to 'Sales Account' in the General Ledger — thus completing double entry in the General Ledger itself. Similarly, total amount received from customers, total discount allowed to them, total returns inwards, total bills receivable will be credited to 'Total Debtors Account' and debited to the respective accounts appearing in the General Ledger.

Again, the monthly total of Purchases Day Book will be credited to 'Total Creditors Account' and debited to 'Purchases Account' in the General Ledger. Similarly, total amount paid to creditors, total discount received from them, total returns outwards, total bills payable accepted will be debited to Total Creditors Account and credited to the respective accounts in the General Ledger.

In the 'Debtors Ledger' individual customer's account is debited with credit sales and credited with payments, discount allowed, bills receivable, etc. Similarly in the 'Creditors Ledger' individual supplier's account is credited with credit purchases and debited with payments, discount received, bills payable, etc.

The accuracy of individual customer's account can be checked by comparing the total of their balance with balances of the ***Total Debtors Account*** in General Ledger.

In the same manner, the accuracy of individual supplier's account can be checked by comparing the total of their balance with the balance of the ***Total Creditors Account***.

2016 [Honours]

Group - A

Answer the following questions : ***[2 × 10]***

1 (a) Mention two qualitative characteristics of accounting information.

Answer

Accounting information must possess some qualitative characteristics; ***two most important qualitative characteristics are : (1) Understandability; and (2) Relevance.***

Understandability : It is the quality of accounting information that enables the users to understand the content and significance of accounting statements and report.

Relevance : Accounting information must be relevant to the users. Information is relevant if it meets the needs of the user in decision-making.

1. (b) Mention two objectives of accounting.

Answer

The objectives of accounting are :

(i) To keep a systematic record of financial transactions that affect the business enterprise.

(ii) To ascertain the profits earned or losses incurred by the business unit during a particular accounting period.

1. (c) What do you mean by asset ?

Answer

Assets are resources, tangible or intangible from which probable future economic benefits are obtained and the right to which have been acquired by a particular entity as a result of past transactions or events. Examples are plant and machinery, patents, goodwill, buildings, etc.

1. (d) Using accounting equation, calculate the value of creditors from the following data :
Total assets – ₹ 1,50,000 and capital ₹ 75,000.

Answer

Assets = Capital + Liabilities
Or, Assets – Capital = Liabilities
Or, Liabilities = Assets – Capital
Or, Creditors = ₹ 1,50,000 – ₹ 75,000
= ₹ 75,000

1. (e) What is meant by Doctrine of Conservatism ?

Answer

The doctrine of conservatism is a basic accounting concept which requires that a degree of caution is necessary when making estimates required under conditions of uncertainty, so that assets or income are not overstated and liabilities or expenses are not understated. The valuation of closing stock at cost or NRV whichever is less is an example of this concept.

1. (f) What do you mean by 'matching concept' ?

Answer

As most businesses keep accounts on accrual basis, it is necessary that the accounting system match periodically the revenues earned against expenses incurred. The result of this matching being, the net income or net loss. This method requires proper allocation of costs into appropriate period so that relevant incomes and expenses are matched. The profit of an accounting period is the revenues from transactions less expenses incurred in producing those revenues. If expenses cannot be traced to specific items of revenues, they are generally written-off in the year in which they are incurred.

1. (g) State two effects of valuing inventory wrongly.

Answer

The two effects of valuing inventory wrongly are :

(i) If the closing inventory is understated, the gross profit as well as net profit of the period will be understated and, in effect, the current assets of the business will be understated in the Balance Sheet.

(ii) If the closing inventory is overstated, the gross profit as well as the net profit will be overstated and, in effect, the current assets of the business will be overstated in the Balance Sheet.

1. (h) What is meant by 'Recognition of Revenue' ?

Answer

Revenue recognition means the process of transfer of revenue to Income Statement / Profit and Loss Account of relevant accounting period so that profit of that period can be ascertained.

Revenue recognition is mainly concerned with the timing of recognition of revenue in the Statement of Profit or Loss.

1. (i) Mention two features of expenses.

Answer

The following are the features of expenses : (i) it is an expired cost and it is not carried forward to next period; and (ii) it is to be debited to Profit and Loss Account of the accounting period in which it is recognised.

1. (j) The value of physical stock was verified on 4th April, 2015 at ₹ 75,000. Determine the value of Closing Stock as on 31.03.2015, given that the following transactions took place between 31.03.2015 and 04.04.2015 :

(i) Purchases made between 31.03.2015 and 04.04.2015 amounted to ₹ 1,600, but out of these goods worth ₹ 400 were not received until 4th April, 2015.

(ii) Arithmetical error in the stock sheet on 4th April, 2015 resulted in an overvaluation of ₹ 600.

Answer

Statement Showing the Value of Physical Stock on 31.3.2015

Particulars	₹
Stock on 4th April, 2015	75,000
Less: Goods purchased and received between 31.3.2015 and 4.4.2015 (₹ 1,600 – 400)	1,200
Less: Over valuation of Stock	600
Value of Closing Stock on 31.12.2015	73,200

1. (k) From the following particulars ascertain the net income of Mr. Roy for the year ended 31.12.2015 according to Cash Basis Accounting :

	₹
Income received in cash for the year ended 31.12.2015	*45,000*
Income received in advance during 2015	*10,000*
Accrued income as on 31.12.2015	*4,000*
Accrued income of 2014 received in 2015	*6,500*

Answer

Calculation of Net Income (Under Cash Basis) of Mr Roy for the year ended on 31st December, 2015

Particulars	₹
Income received in cash for the year ended 31.12.2015	45,000
Add: Income received in advance during 2015	10,000
Add: Accrued income of 2014 received in 2015	6,500
Income for the year under Cash Basis	61,500

1. (l) What is FIFO method of valuing inventory ?

Answer

First In First Out Method (FIFO) : This method is based on the premise that the first item purchased is the first item sold, that is, all the inventories are sold in the order in which they are acquired. Since the oldest stock in the inventory is sold first, the calculation of the inventory is on the basis that the inventories in hand represent the ones most recently purchased or produced and the cost of goods sold represents the cost of items acquired in the earlier purchases.

1. (m) What do you mean by 'Standing Charges' ?

Answer

Standing Charges are fixed expenses which can not be avoided during the interruption of business due to fire or other perils. The examples are :

(i) Rent, Rates and Taxes
(ii) Interest on debenture and loans
(iii) Salaries of permanent staff
(iv) Wages of skilled workers
(v) Auditor's fees
(vi) Directors' fees, etc.

1. (n) When is average clause applicable to calculate insurance claim for loss of stock ?

Answer

At the time of calculating insurance claims, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value.

In the event of a partial loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows :

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}}$$

1. (o) What dqo you mean by Preference Shares ?

Answer

Preference Shares are those shares which has preferential rights to dividends at a fixed rate or fixed amount as the case may be. It has preferntial rights to assets of the Company in the case of liquidation.

Calcutta University
FINANCIAL ACCOUNTING – I (GENERAL)
Paper — CC – 1.1 Cg
Full Marks – 80

2017

Candidates are required to give their answers in their own words as far as practicable.
The figures in the margin indicate full marks.

Group - A

Answer the following questions :

1. *From the following information, ascertain income for the year ended 31.03.2017 according to accrual basis of accounting :*
   - *(a) Income received in cash for the year ended 31.03.2017 ₹ 50,000.*
   - *(b) Accrual income as on 31.03.2017 ₹ 25,000.*
   - *(c) Income received in advance during the year ended 31.03.2017 ₹ 15,000.*
   - *(d) Outstanding expenses as on 31.03.2017 ₹ 20,000.*
   - *(e) Prepaid expenses as on 31.03.2017 ₹ 10,000.* ***5***

Answer

Computation of Net Income (under Accrual Basis)
for the year ended 31st March, 2017

Particulars	₹
Income received in cash	50,000
Add: Accrued Income as on 31.3.2017	25,000
	75,000
Less: Income received in advance during the year ended 31.3.2017	15,000
	60,000
Less: Net Expenses (Note 1)	10,000
Net Income Under Accrual Basis	50,000

Working Note : (1) Net Expenses = Outstanding Expenses – Prepaid Expenses
= ₹ 20,000 – ₹ 10,000 = ₹ 10,000.

OR

Write short notes on : ***$2^1/_2$×2***

(a) Going Concern Concept.
(b) Entity Concept.

Answer

(a) The '***going concern***' concept assumes that the business will continue in operation for as long as possible and will not be dissolved in the foreseeable future. The different assets are shown in the Balance Sheet based on this assumption. If it is not a going concern, the valuation of different assets will be lower than what is disclosed in the Balance Sheet.

(b) According to ***entity concept***, business is considered separate and distinct from the owners of the enterprise. This concept starts with the fact that the business unit is a separate entity with its own identity. We must, for the purposes of bookkeeping, keep the owner and his business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of the business unit and not the owners. ***For example***, Mr. X starts a business, styled 'X & Co.'; accounts are to be prepared only from the point of view of 'X & Co.'—as if it was a different person from the owner. If the owner invests capital into the business, this is treated as if the owner is lending cash to the business. If a part of the capital is taken back by the owner, this is treated as a repayment of loan. For accounting purposes, a partnership firm has a separate entity apart from its partners. Likewise, the existence of a company does not depend on the life span of any of the shareholders.

2. *The book value of Plant and machinery of a firm shows ₹ 2,50,000 on 01.01.2017. One of the machinery which was purchased on 01.01.2016 at ₹ 20,000 is sold for ₹ 10,000 on 30.06.2017. In place of this machine, another new machine was purchased at ₹ 40,000 on 30.09.2017.*

   Show the Plant and Machinery Account in the books of the concern for the year 2017, charging depreciation @ 10% p.a. on diminishing balance method. (Year ending date : 31st December). **5**

Answer

Dr. **Plant and Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	2,50,000	30.6.2017	By Depreciation A/c (Note 1)	900
30.9.2017	To Bank A/c	40,000		By Cash A/c	10,000
				By Loss on Sale of Machinery A/c	7,100
			31.12.2017	By Depreciation A/c (Note 2)	24,200
			"	By Balance c/d	2,47,800
		2,90,000			2,90,000

Working Notes :

(1) Calculation of Loss on Sale of Machinery

	₹
Cost of machine on 1.1.2016	20,000
Less: Depreciation for 2016 @ 10% p.a.	2,000
W.D.V. on 1.1.2017	18,000
Less: Depreciation upto the date of Sale on 30.6.2017 (10% of ₹ 18,000 × 6 ÷ 12)	900
W.D.V. on 30.6.2017	17,100
Less: Sale Proceeds	10,000
Loss on Sale of Machinery	7,100

(2) Depreciation for 2017 (Machine in use)

(a) Old machine's W.D.V. on 1.1.2017	2,50,000
Less: W.D.V. on 1.1.2017 of machine sold (Note 1)	18,000
Old machine in use	2,32,000
Depreciation @ 10% p.a. = 2,32,000 × 10% = ₹ **23,200**.	
(b) Cost of new machine purchsed on 30.9.2017	40,000
Depreciation @ 10% p.a. for 3 months [(₹ 40,000 × 10% × 3) ÷ 12]	1,000

Total depreciation (a) + (b) = (23,200 + 1,000) = ₹ **24,200**.

3. *The following errors were detected before the preparation of Trial Balance. Pass necesary rectification entries for them :*

   (a) *Goods worth ₹ 2,000 drawn by the proprietor for private use has been debited to Trade Expenses Account.*

   (b) *Wages paid ₹ 2,500 for installation of new machine were debited to Wages Account.*

   (c) *₹ 170 allowed as discount has been credited to the Discount Account and debited to Creditors Account.* ***2+1+2***

Answer

Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
(a)	Drawings A/c Dr.		2,000	
	To Trade Expenses A/c			2,000
	(Being the goods withdrawn by the proprietor for personal use wrongly debited to Trade Expenses, now rectified)			

(b)	Machinery A/c Dr. To Wages A/c (Being the wages paid for installation of a new machinery wrongly debited to Wages Account, now rectified)		2,500	 2,500
(c)	Discount A/c Dr. To Creditors A/c To Debtors A/c (Being discount allowed wrongly credited to Creditors Account, now rectified)		340	 170 170

OR

The following information has been extracted from the books of Das Enterprises :

	₹
Balance of Provision for Bad Debts on 01.01.2017	*2,500*
Bad Debt written off during the year	*1,800*
Sundry Debtors on 31.12.2017	*34,000*

Of the debtors, ₹ 1,000 was bad and hence to be written off. Provision for bad debts to be made @ 10% on Debtors. Prepare Provision for Bad Debts Account and Bad Debts Account. **5**

Answer

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			1.1.2017	By Balance b/d	2,500
31.12.2017	To Balance c/d (Note 1)	3,300	31.12.2017	By Profit and Loss A/c	800
		3,300			3,300

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Debtors A/c	1,800			
	To Debtors A/c	1,000	31.12.2017	By Profit and Loss A/c	2,800
		2,800			2,800

Working Notes :

(1) Calculation of New Balance of Provision for Bad Debts :

	₹
Sundry Debtors on 31.12.2017	34,000
Less: Bad Debts written-off	1,000
	33,000

Provision for Bad Debts @ 10% of ₹ 33,000 = ₹ **3,300**.

Tutorial Note : Total amount charged to Profit and Loss Account = ₹ 800 + ₹ 2,800 = ₹ **3,600**.

4. *State which of the following expenditures are of capital nature and which are of revenue nature :*
   - *(a) Purchase of machinery ₹ 50,000.*
   - *(b) Carriage paid for bringing the machine ₹ 3,000.*
   - *(c) Wages paid for installation of the machinery ₹ 4,000.*
   - *(d) Repairing cost for the machinery ₹ 2,000 after installation.*
   - *(e) Insurance premium paid for machinery ₹ 1,000.* **5**

Answer

(a) Purchase of machinery for ₹ 50,000 is a ***capital expenditure***.
(b) Carriage paid ₹ 3,000 for bringing machinery will be treated as ***capital expenditure***.
(c) Wages paid ₹ 4,000 for installation of machinery will be treated as ***capital expenditure***.
(d) Repairing cost of ₹ 2,000 after installation will be treated as ***revenue expenditure***.
(e) Insurance premium paid ₹ 1,000 will be treated as ***revenue expenditure***.

OR

A trader prepared his accounts on 31.03.2017. However, stock taking was done on 10.04.2017, amounting to ₹ 40,000. The following transactions took place between 1st April to1 0th April, 2017 :

(a) Sales amounted to ₹ 75,000.

(b) Purchase during the period ₹ 30,000.

(c) Purchase Return ₹ 5,000.

(d) Sales Return ₹ 2,000.

(e) Rate of Gross Profit on Sales 20%.

Determine the value of Closing Stock as on 31.03.2017. **5**

Answer

Statement showing the Value of Physical Stock on 31st March, 2017

Particulars	₹
Value of Stock on 10.4.2017	40,000
Add: Cost of goods sold (Net) (75,000 – 2,000) x 80%)	58,400
	98,400
Less: Purchases (Net) (30,000 – 5,000)	25,000
Value of Stock on 31.3.2017	73,400

5. *A trader sends out goods on approval basis to customers and include the same in Sales Account. On 31.03.2017, the stock in hand amounted to ₹ 1,60,000 and the sundry debtors balance stood at ₹ 3,00,000 which include ₹ 20,000 being invoice value of goods sent on 'sale or return' against which no intimation was received during the year. These goods were sent out at 25% above cost and were sent to Mr X ₹ 8,000 and Mr Y ₹ 12,000.*

Make necessary adjustment entries on 31.03.2017. **5**

Answer

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
	Sales A/c	Dr.		20,000	
	To Mr X A/c				8,000
	To Mr Y A/c				12,000
	(Being goods sold on approval basis in respect of which no information was received, now cancelled)				
	Goods with Customer A/c	Dr.		16,000	
	To Trading Account (Note 1)				16,000
	(Being cost of goods lying with customers)				

Working Note :

Cost Price = 100

Profit = 25

Selling Price = 125

Profit as a percentage of Sales = $\frac{25}{125} \times 100 = 20\%$

	₹
Sale value of goods with customers	20,000
Less: Profit 20% of ₹ 20,000	4,000
Cost of Goods with customers	16,000

Group - B

Answer the following questions

6. *What is Financial Accounting Standard ? Discuss the procedures for issuing Accounting Standards in India. What is IFRS ?* ***2+6+2***

Answer

Financial Accounting standards are accounting rules and procedures relating to measurement, valuation and disclosure issued by the Council of The Institute of Chartered Accountants of India. Accounting standards are stated to be the norms of accounting policies and practices by way of guidelines that should be followed while preparing accounts and disclosed in the annual financial statements. The accounting standards are intended to apply only to items which are material.

Since accounting standards are the rules to be followed in the preparation of financial statements, these are regarded as a *mechanism* for resolving the conflicts of interest among various preparers and users of accounting information. Accounting standards are generally appropriate to the normal conduct of business and are in conformity with local conditions. Accounting standards serve public interest and are based on a conceptual framework of accounting. Necessarily, the utility of accounting standards results in a consequential improvement in the quality of preparation of financial statements.

Broadly, the ***following procedures*** are adopted by Accounting Standards Board (ASB) for formulating Accounting Standards :

1. Determination of the broad areas in which Accounting Standards need to be formulated.
2. Formulation of ***Study Groups***. At the time of formation of study groups, provisions will be made for wide participation by the members of the Institute and others. The study groups will help ASB in the preparation of the Accounting Standards.
3. Holding of dialogue by ASB with the representatives of the Government, Public Sector Undertakings, Industry and other organisations for ascertaining their views.
4. Preparation and publication of an exposure draft of the proposed standard for comments by members of the Institute and the public at large. An exposure draft is prepared on the basis of the work of the study groups and the dialogue with the different parties as mentioned above.
5. Finalisation of the draft by ASB after considering the comments received from different corners.
6. Submission of the final draft to the Council of the Institute of Chartered Accountants of India.
7. The Council will consider the final draft of the proposed standard and if found necessary modify the same in consultation with ASB.
8. Publication of the Standard on the relevant subject under the authority of the Council.

IFRS stands for ***International Financial Reporting Standards***. The IFRS Foundation and The ***International Accounting Standards Board (IASB)*** has developed and issued the International Financial Reporting Standards which has been recognized as ***Global Reporting Standards***. The main purpose of IFRS is to harmonise accounting across the globe. However, USA has not adopted IFRS. More than 120 countries like the European Union, Australia, New Zealand and Russia has either already adopted or permitted the IFRSs as a tool for financial reporting.

OR

Write short notes on :
(a) GAAP (b) Fair Value Accounting ***5+5***

Answer

(a) Generally accepted accounting principles are the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. These principles provide a foundation for measuring and disclosing the results of business transactions and events. They include both conventions, bases and presentation practices.

Generally accepted accounting principles are conventional — that is, they become generally accepted by agreement rather than by formal derivation from a set of postulates or basic concepts. The principles have developed on the basis of experience, reason, custom, usage, and, to a significant extent, practical necessity. These principles are so widely used and accepted that may be produced to underlie all accounting statements.

From the above, it can be comprehended that generally accepted accounting principles instruct an accountant what to do in the usual case when he has no reason to doubt that the affairs of the organisation are being honestly conducted. Since he has reason to believe that this basic assumption is false, an entirely different situation confronts him.

(b) Fair value is defined in IAS 39 as "***the amount for which asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction***."

Following are its features :

1. Fair value incorporates market information into the financial statements. The information contained in the financial statements are useful to investors as all the values of assets and liabilities are close to 'current' values at the Balance Sheet date.
3. It focusses on the fair value of assets and liabilities.
4. Fair value is Balance Sheet based. The result of changes in the carrying values of assets and liabilities are reflected in the Profit and Loss Statement.
5. Fair value accounting meets the conceptual farework criteria in terms of qualitative characteristics of accounting information.

7. *On 1st April, 2016, K of Kolkata sent 200 packets of rice to D of Delhi to be sold on consignment basis. The cost price of each packet was ₹ 1,000. K incurred ₹ 1,200 for freight and ₹ 800 for insurance premium. On 31st March, 2017, K received an Account Sales from D, which showed that he sold 180 packets @ ₹ 1,400 each out of which ₹ 5,000 was bad debt. D paid ₹ 6,000 as clearing charges, ₹ 1,000 for carriage to godown and ₹ 2,000 for godown rent. D is entitled to get ordinary commission @ 10% and del credere commission @ 5% on sale proceeds.*

Show Consignment Account and D Account in the books of K. ***7+3***

Answer

In the books of K

Dr. **Consignment to Delhi Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2016	To Goods Sent on Consignment A/c	2,00,000	31.3.2017	By D A/c : Sales (180 x ₹ 1,400)	2,52,000
	To Bank A/c :		31.3.2017	By Stock on Consignment A/c (Note 1)	20,900
	Freight	1,200			
	Insurance Premium	800			
31.3.2017	To D A/c :				
	Clearing Charges	6,000			
	Carriage to Godown	1,000			
	Godown Rent	2,000			
	Ordinary Commission @ 10%	25,200			
	Del-credere Commission @ 5%	12,600			
31.3.2017	To Profit and Loss on Consignment A/c	24,100			
		2,72,900			2,72,900

Working Note : **(1) Calculation of Valuation of Closing Stock**

Particulars		₹
Cost of Goods Sent to D (200 x 1,000)		2,00,000
Add : Non-recurring expenses of K :		
Freight	1,200	
Insurance Premium	800	2,000
Add: Non-recurring expenses of D :		
Clearing Charges	6,000	
Carriage to Godown	1,000	7,000
Total cost of 200 Packets		2,09,000

Packet Unsold = 200 – 180 = 20. Value of Closing Stock on Consignment = $\frac{2,09,000}{200} \times 20$ = ₹ **20,900.**

OR

A fire occurred at the godown of Royja Industries (P) Ltd. on 10.03.2017. The stock of the company was fully insured against fire. From the following details, compute the amount of insurance claim :

	₹
Stock on 1st January, 2016	*50,000*
Stock on 31st December, 2016	*80,000*
Purchases for the year 2016	*5,40,000*
Sales for the year 2016	*6,80,000*
Purchase for the period from 01.01.2017 to 10.03.2017	*1,80,000*
Sales for the period from 01.01.2017 to 10.03.2017	*2,40,000*

Gross profits rate was uniform and value of stock salvaged ₹ 15,500. ***10***

Answer

Royja Industries (P) Ltd.

Dr. Memorandum Trading Account for the period 1st January to 10th March, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	80,000	By Sales A/c	2,40,000
To Purchases A/c	1,80,000	By Closing Stock (Balancing figure)	80,000
To Gross Profit (25% of ₹ 2,40,000)	60,000		
	3,20,000		3,20,000

Statement of Claim for Loss of Stock as on 10th March, 2017

Particulars	₹
Book value of Stock	80,000
Less: Salvaged Goods	15,500
Amount of Insurance Claim	64,500

Working Note:

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

Particulars	₹	Particulars	₹
To Opening Stock	50,000	By Sales	6,80,000
To Purchases	5,40,000	By Closing Stock	80,000
To Gross Profit (Balancing figure)	1,70,000		
	7,60,000		7,60,000

Rate of Gross Profit = (₹ 1,70,000 ÷ 6,80,000) × 100 =25%.

8. *From the following particulars, prepare Sales Ledger Adjustment Account in General Ledger and General Ledger Adjustment Account in Sales Ledger in the books K Ray for the year ended 31st December, 2016:*

	₹
Sales Ledger balances on 01.01.2016	*(Dr.) 62,620*
Sales Ledger balances on 01.01.2016	*(Cr.) 620*
Total Sales	*1,20,000*
Cash Sales	*10,000*
Bills accepted by Debtors	*12,500*
Bills received dishonoures	*500*
Cheque received from customers	*86,200*
Cheque dishonoured	*1,200*
Return inward	*4,800*
Bad Debt written off	*1,300*
Discount allowed	*450*

Carriage charged to customers	*950*	
Bad Debts recovered	*600*	
Transfer from Bought Ledger	*800*	
Sales Ledger balances on 31.12.2016	*(Cr.) 300*	***10***

Answer

In the General Ledger

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	62,620	1.1.2016	By Balance b/d	620
31.12.2016	To General Ledger Adjustment A/c :			By General Ledger Adjustment A/c :	
	Credit Sales (Note 1)	1,10,000		Bills Received	12,500
	Bill Dishonoured	500		Cheque Received	86,200
	Cheque Dishonoured	1,200		Returns Inward	4,800
	Carriage Charged	950		Bad Debts	1,300
"	To Balance c/d	300		Discount Allowed	450
				Transfer from Bought Ledger	800
				By Balance c/d — Closing Stock (Balancing figure)	68,900
		1,75,570			1,75,570

In the Sales Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	620	1.1.20-16	By Balance b/d	62,620
31.12.2016	To Sales Ledger Adjustment A/c :		31.12.2016	By Sales Ledger Adjustment A/c :	
	Bills Received	12,500		Credit Sales (Note 1)	1,10,000
	Cheque Received	86,200		Bills Dishonoured	500
	Return Inwards	4,800		Cheque Dishonoured	1,200
	Bad Debts	1,300		Carriage Charged	950
	Discount Allowed	450	31.12.2016	By Balance c/d	300
	Transfer from Bought Ledger	800			
31.12.2016	To Balance c/d	68,900			
		1,75,570			1,75,570

Working Notes :

(1) Credit Sales = Total Sales – Cash Sales = ₹ 1,20,000 – ₹ 10,000 = ₹ 1,10,000.

(2) Bad Debts recovered will not affect Debtors balance. Therefre, it has been ignored.

9. *The following is the Receipts and Payments Account of a club on 31.12.2017 :*

Receipts	₹	Payments	₹
To Opening Balance :		By Books	7,000
In hand	500	By Salaries	7,000
At Bank	500	By Rent	2,000
To Subscription	15,000	By Newspapers	3,000
To Sale of Old Newspapeers	3,000	By Balance c/d (at Bank)	2,000
To Donation	2,000		
	21,000		21,000

Other information :

	01.01.2017	*31.12.2017*
Accrued subscription	*800*	*1,100*
Pre-received subscription	*2,500*	*1,500*
Outstanding Salary	*600*	*900*
Prepaid Rent	*200*	*100*

Prepare Income and Expenditure Account of the Club for the year ended 31st December, 2017. ***10***

Answer

Income and Expenditure Account for the year ended 31st December, 2017

Expenditure		₹	Income	₹
To Salaries	7,000		By Subscription (Note 1)	16,300
Add: Outstanding (Closing)	900		By Sale of Newspaper	3,000
	7,900			
Less: Outstanding (Opening)	600	7,300		
To Rent	2,000			
Less: Prepaid (Closing)	100			
	1,900			
Add: Prepaid (Opening)	200	2,100		
To Newspaper Purchased		3,000		
To Excess of Income over Expenditure		6,900		
		19,300		19,300

Working Notes :
(1) Calculation of Subscription Income

Particulars	₹
Subscription received in 2017	15,000
Add: Accrued (Closing)	1,100
	16,100
Less: Accrued (Opening)	800
	15,300
Add: Prepaid (Opening)	2,500
	17,800
Less: Prepaid (Closing)	1,500
Total	16,300

(2) Donation has been treated as capital receipt. It has been directly added with Capital Fund.

Group - C

10. *Following is the Trial balance of Mr. R. Roy as on 31st December, 2017. You are required to prepare Trading and Profit and Loss Account for the year ended 31st December, 2017 and a Balance Sheet as on that date.*

	Dr. (₹)	*Cr (₹).*
Capital	—	*2,40,000*
Plant and Machinery	*1,20,000*	
Furniture		*40,000*
Stock on 01.01.2017	*30,000*	
Debtors and Creditors	*80,000*	*50,000*
Drawings	*20,000*	
Purchase and Sales	*2,40,000*	*3,60,000*
Bank Overdraft	*40,000*	
Wages	*30,000*	
Trade Expenses	*20,000*	
Rent	*24,000*	
Salaries	*34,000*	
Bad Debts	*2,000*	
Purchase and Sales Return	*10,000*	*6,000*
Cash	*14,000*	
Bank	*36,000*	
Provision for Bad Debts		*4,000*
	7,00,000	*7,00,000*

Additional information :

(a) *Stock on 31.12.2017 : Cost price ₹ 36,000. Market price ₹ 40,000.*

(b) *A credit sale of ₹ 10,000 has not been recorded,.*

(c) *Wages paid for installation of machinery included in Wages Account ₹ 5,000.*

(d) *Provide depreciation on machinery @ 10% p.a.*

(e) *Provision for bad debt to be maintained @ 5% on Debtors.* ***15***

Answer

Mr. R Roy

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		30,000	By Sales	3,60,000	
To Purchases	2,40,000		Add: Credit Sales not yet recorded	10,000	
Less: Purchase Returns	6,000	2,34,000		3,70,000	
To Wages	30,000		Less: Sales Return	10,000	3,60,000
Less: Wages for Installation of Machinery	5,000	25,000	By Closing Stock (Note 1)		36,000
Tol Gross Profit c/d		1,07,000			
		3,96,000			3,96,000
To Trade Expenses		20,000	By Gross Profit b/d		1,07,000
To Rent		24,000			
To Salaries		34,000			
To Bad Debts		2,000			
To Depreciation on Machinery (Note 2)		12,500			
To Provision for Bad Debts (Note 3)		500			
To Net Profit (Transferred to Capital)		14,000			
		1,07,000			1,07,000

Balance Sheet as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	2,40,000		Plant and Machinery	1,25,000	
Add: Net Profit	14,000		Less: Depreciation	12,500	1,12,500
	2,54,000		Furniture		40,000
Less: Drawings	20,000	2,34,000	Debtors	90,000	
Creditors		50,000	Less: Provision for Bad Debts	4,500	85,500
Bank Overdraft		40,000	Closing Stock		36,000
			Cash at Bank		36,000
			Cash in Hand		14,000
		3,24,000			3,24,000

Working Notes :

(1) Closing Stock should be valued at cost or NRV whichever is less :

Cost is ₹ 36,000 and NRV (Market Value) is ₹ 40,000

Therefore, the closing stock is to be valued at ₹ **36,000**.

(2) Depreciation on Machinery :

	₹
Value of Plant and Machinery	1,20,000
Add: Wages for Installation (assuming that it was not included previously)	5,000
	1,25,000

Depreciation = ₹ 1,25,000 × 10% = ₹ 12,500.

(3) New Provision for Bad Debts :

Debtors as per Trial Balance	80,000
Add:: Credit Sales not recorded	10,000
	90,000

New provision for Bad Debts = 5% of ₹ 90,000 = ₹ **4,500**.

Provision for Bad Debts to be created = ₹ 4,500 – ₹ 4,000 = ₹ **500**.

Calcutta University
FINANCIAL ACCOUNTING – I (HONOURS)
First Paper
(CC – 1.1 Ch)
Full Marks – 80

2017

The figures in the margin indicate full marks.
Candidates are required to give their answers in their own words as far as practicable.

Group - A

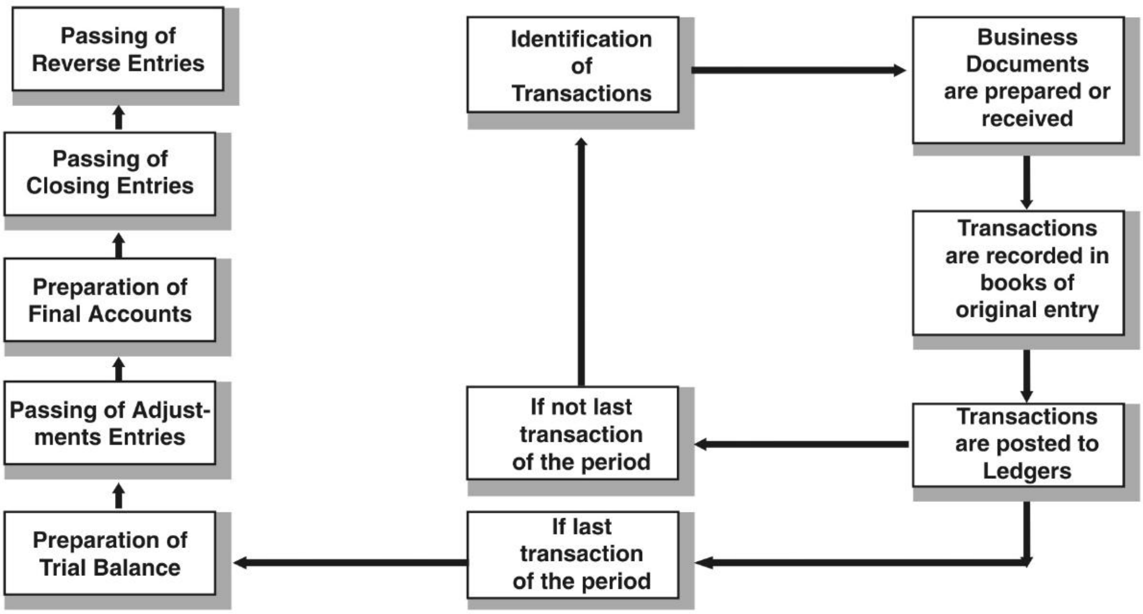
Answer the following questions

1. (a) *What is 'Accounting Cycle' ? Mention the steps involved in an 'accounting cycle'.*
   (b) *What do you mean by cash basis of accounting ?* *3+2*

Answer

(a) Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise the business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise has numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. The purpose of accounting is to ascertain the cumulative effect of the transactions.

For accounting, the following steps are followed.



(b) **Cash Basis of Accounting** : Cash basis of accounting is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid and not when the transactions take place. This method recognises revenues and gains when cash is actually received. Similarly, it recognises expenses and losses when cash is paid. No attempt is made to record prepayments or accruals.

Net profit / Net income under this method represents simply the difference between cash receipts and cash payments. This method of accounting is widely used by professionals and other service enterprises (for example, physicians, lawyers and others).

OR

State the name of the accounting concept or convention applied in each of the following cases :

(a) Recording of capital contributed by the owner in a sole proprietorship business as liability.

(b) Valuation of inventories at lower of cost or net realisable value.

(c) Omission of paisa and showing the round figures in financial statements.

(d) Assets are classified into fixed assets and current assets.

(e) Showing outstanding expenses in the Balance Sheet. **5**

Answer

(a) Business Entity Concept

(b) Prudence (or Conservatism) Concept

(c) Materiality Concept

(d) Historical Cost Concept as fixed assets are recorded at 'Historical Cost'. Here 'Going Concern' concept is also involved as all the assets are valued on Balance Sheet date assuming that 'going concern' status is to be maintained.

(e) Accrual Concept

2. *(a) Define Revenue.*

(b) How would you recognise revenue from the sale of goods ? ***2+3***

Answer

(a) AS-9 : "Revenue Recognition" has defined '***Revenue***' as "Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the ***charges made to customers*** or ***clients*** for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration".

(b) ***Revenue from sale of goods*** is recognised when all the following conditions have been satisfied :

1. the seller of goods has transferred to the buyer the property in the goods for a price;
2. all significant risks and rewards of ownership have been transferred to the buyers;
3. the seller retains no effective control of the goods transferred to a degree usually associated with ownership;
4. no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

For example, Modern Furnitures (P) Ltd. sold a computer table to Ram for ₹ 6,000. Ram paid it by credit card. Modern Furnitures (P) Ltd. will recognise ₹ 6,000 as revenue immediately.

For example : Computer Point (P) Ltd. sold 10 computers to St. Xavier's College, Kolkata for ₹ 3,00,000 on credit. Here Computer Point will recognise the revenue of ₹ 3,00,000 immediately because normal credit risk derived from sales is not a reason to defer revenue recognition.

OR

The Trial Balance of Mr. A as on 31.12.2017 did not agree and the book-keepr transferred the difference to Suspense Account. Rectify the following errors detected later by the book-keeper :

(a) Purchased goods from Mr. D for ₹ 18,000 but entered into Sales Day Book.

(b) An item of ₹ 2,000 in respect of purchase returns had been wrongly entered in the Purchase Book.

(c) Salary paid to Mr. M, the manager ₹ 25,000 was debited to his personal account. ***2+2+1***

Answer

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
(a)	Purchases A/c	Dr.		18,000	
	Sales A/c	Dr.		18,000	
	To D A/c				36,000
	(Being goods purchsed from D wrongly recorded in Sales Day Book, now rectified)				
(b)	Creditors A/c	Dr.		4,000	
	To Purchase Return A/c				2,000
	To Purchases A/c				2,000
	(Being purchase returns has been wrongly entered in the Purchase Book, now rectified)				
(c)	SalaryA/c	Dr.		25,000	
	To Mr M A/c				25,000
	(Being salary paid to Mr M, manager, has been debited to his personal account, now rectified)				

Tutorial Note :

(1) It is assumed that D Account was debited when posting was made from the Sales Day Book.

(2) It is assumed that the posting was made to Creditors Account from Purchase Day Book.

3. *What do you mean by maintenance of Financial Capital ? Why is it important to maintain capital for an entity ?* ***2+3***

Answer

Financial capital maintenance attempts to conserve the value of the funds that shareholders have invested in the business. Financial capital maintenance can either be the monetary value of capital attributable to shareholders or a value adjusted by a general purchasing power index to maintain capital as a fund of real purchasing power.

The main difference between the two concepts of capital maintenance is the treatment of the effect of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that is required to maintain the capital at the beginning of the period is ***profit.***

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital in the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

4. *State the limitations of 'Historical Cost Accounting'.* ***5***

Answer

Indian accounting system is mainly based on historical cost accounting system where the acquisition of assets is recorded in the books of account at the amount paid at the time of purchase. This system is very reliable because the monetary amount of the transaction is known, verifiability is straight forward and, documentation exists. However, ***critics of historical cost accounting points out the following limitations*** :

1. Historical cost accounting system does not reflect the current financial position or worth of a business.
2. The Profit and Loss Account tends to match current revenues with historical costs (expenses) rather than the current costs.
3. Financial statements prepared under historical cost accounting system do not show the impact of inflation.
4. The Profit and Loss Account does not reflect those increases in the net asset values which are not considered to be realised.

5. At the time of calculating taxable income, tax authority takes the accounting profit as its starting point and therefore, the tax payable is dictated by outdated accounting figures.
6. Financial statements prepared under historical cost accounting system do not always present comparable data.

OR

State the need for having a global financial reporting standard. ***5***

Answer

At present, different countries are preparing financial statements as per their local accounting standards. ***For example***, in India, majority number of companies follow Indian Account Standards (IND-AS).

Similarly, USA follows US-GAAP.

Financial Statements prepared by adopting different accounting standards will disclose different profits from same set of accounting data. At present, it is creating confusion amongst the stakeholders. Therefore, a global accounting standard should be adopted by all the countries.

Benefits of one global financial reporting standards :

To understand the benefits of Global Accounting Standard, you need to understand who or what are exactly the prime beneficiaries. The beneficiaries are:

1. The economy of our country
2. The investors
3. The industry
4. The accounting professionals

Let us now consider the advantages of having a uniform global accounting standard and regulatory framework from the viewpoint of all the above-mentioned aspects.

1. The Economy of Our Country

Globalization has given birth to lots of hope and scopes for the economic benefit of our country. With globalization and liberalization of policies, the entire world has taken the form of an economic village. Advent of Internet and the revolution in telecommunication has made it possible for businesses to reach out to foreign shores crossing borders. More and more countries are opening their doors to foreign investments and more and more markets are emerging to fulfill the capital needs as well as the end users or customers for the businesses. In such a situation, convergence of our accounting principles with an international standard is of vital importance. It helps the economy to:

- Expand.
- Be more dynamic.
- Be more strategic.
- Be more competitive
- Maintain the capital markets more efficiently.
- Encourage investment from foreign investors.
- Bring more foreign capital.

2. The Investors

Investors could be stated as the party most benefited by the convergence. They are the people to invest money into different companies and markets. So they are in need of relevant, reliable and comparable financial reports available at right time. They are taking the risks of investing money crossing not only geographic borders but also crossing different jurisdiction. Convergence with IFRSs will help them in:

- Acquiring relevant, reliable, comparable and timely information regarding businesses across the globe.
- Understanding the business opportunities better.
- Reducing cost of interpretation of different accounting standards for different countries.
- Gaining confidence.

3. The Industry

A global market with a global and standard regulatory framework gives tremendous thrust to the industry. A global market will bring more foreign capital and give boost to the country's economy. A globally accepted accounting standard will simplify the process of financial reporting which in turn will reduce cost.

So if we list out the benefits, these are:

- More foreign investors.
- More foreign capital.
- Simplicity in financial reporting.
- Reduced cost of reporting.

4. The Accounting Professionals

Accounting professionals provide their services and expert knowledge to different business entities and enterprises. Presence of a global accounting standard will help in opening doors for our professionals to different parts of the world. You must have observed our engineers, doctors and technicians have gone to foreign countries and have done extremely well in all aspects of life. But it was not the case for our accounting professionals. India traditionally had followed her own 'Generally Accepted Accounting Principles' which was substantially different from other developed countries. It hindered the scope for our accounting professionals to sell their expertise and knowledge in these countries. With convergence to IFRSs they can:

- Provide their skills and knowledge in different parts of the world.
- Can provide recommendation in financial reporting to different MNCs and foreign companies both as professionals in industry or private practice.

5. *M/s. Bose Brothers, a trader sends goods to his customers on 'Sale or Return' basis. The following transactions took place during 2017 :*

Date	Particulars	₹
25.9.2017	Sent goods to customers on sale or return basis at cost plus 30%	1,50,000
23.10.2017	Goods returned by customers	40,000
18.11.2017	Received letters of approval from customers confirming purchase of goods	71,000
31.12.2017	Goods with customers awaiting approval (date of return has not yet expired)	39,000

M/s. Bose Brothers records sale or return transactions as ordinary sales. You are required to pass necessary journal entries in the books of M/s. Bose Brothers assuming that accounting year closes on 31st December, 2017.

Answer

In the books of M/s Bose Brothers

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 Sept. 25	Ddebtors A/c	Dr.		1,50,000	
	To Sales A/c				1,50,000
	(Being goods sold on 'Sale or Return Basis')				
Oct. 23	Return Inward A/c	Dr.		40,000	
	To Debtors A/c				40,000
	(Being goods return by the customers)				
Dec. 31	Sales A/c	Dr.		39,000	
	To Debtors A/c				39,000
	(Being goods with customers awaiting approval)				
	Stock with Customers A/c	Dr.		30,000	
	To Trading A/c (Note 1)				30,000
	(Being the cost of goods with customers awaiting approval)				

Working Note :

(1) Cost of Goods with Customers :	₹
Selling price of the goods	39,000
Less: Profit (39,000 ÷ 130) × 30	9,000
Cost	30,000

Group - B

Answer the following questions

6. *Mr. X is engaged in car rental buisiness. On 1.4.2014 he purchased 3 second-hand motor cars at ₹ 3,00,000 each and paid ₹ 60,000 each for overhauling and reconditioning of each of the cars purchased, which was completed on 30.4.2014. These cars were put to use from 01.05.2014.*

   He writes off depreciation @ 20% per annum on original cost from the date cars were put to use and closes books on 31st December every year.

   On 1.10.2016, one car is completely destroyed in a road accident and a sum of ₹ 1,70,000 is received from the Insurance Company in settlement of the claim.

   On the same day he purchasd 3 new cars at ₹ 6,00,000 each and put to use from that date.

   Prepare Motor Car Account from 2014 to 2016 in the books of Mr. X. Working notes should form part of the answer. ***10***

Answer

In the books of Mr X

Dr. **Motor Car Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Bank A/c (Purchase of 3 cars)	9,00,000	31.12.2014	By Depreciation A/c (Note 1)	1,44,000
"	To Bank A/c (Overhauling expenses)	1,80,000	"	By Balance c/d	9,36,000
		10,80,000			10,80,000
1.1.2015	To Balance b/d	9,36,000	31.12.2015	By Depreciation A/c	2,16,000
			"	By Balance c/d	7,20,000
		9,36,000			9,36,000
1.1.2016	To Balance b/d	7,20,000	1.10.2016	By Depreciation A/c	54,000
1.10.2016	To Bank A/c (Purchase of new cars)	18,00,000	"	By Bank A/c (Claim received)	1,70,000
			"	By Loss on Accident A/c	16,000
			31.12.2016	By Depreciation A/c	2,34,000
				By Balance c/d	20,46,000
		25,20,000			25,20,000
1.1.2017	To Balance b/d	20,46,000			

Statement of Depreciation (Straight Line Method @ 20% p.a.)

Date	Particulars	1st Car	2nd car	3rd Car	3 New Cars	Total
1.4.2014	Cost (Purchase)	3,00,000	3,00,000	3,00,000		
	Add: Overhauling Cost	60,000	60,000	60,000		
1.5.2014	Depreciable Value	3,60,000	3,60,000	3,60,000		
31.12.2014	Depreciation for 8 months (May to December)	48,000	48,000	48,000		1,44,000
1.12.2015	**Written-down Value**	3,12,000	3,12,000	3,12,000		
31.12.2015	Depreciation (Full Year)	72,000	72,000	72,000		2,16,000
1.1.2016	**Written-down Value**	2,40,000	2,40,000	2,40,000		
1.10.2016	Depreciation for 9 months @ 20%	54,000				54,000
		1,86,000				
	Less: Insurance Claim received	1,70,000				
	Loss on Accident	16,000				
1.10.2016	Cost of 3 New Cars				18,00,000	
31.12.2016	Depreciation		72,000	72,000	*90,000	2,34,000
	Written-down Value		1,68,000	1,68,000	17,10,000	

* Depreciation @ 20% for 3 months.

7. *Mr. D, a trader maintains an incomplete record for his business. However, he keeps a detailed record of cash and bank transactions and provides you the following summary of receipts and payments for the year ended 31.12.2016.*

Receipts	₹	Payments	₹
Cash in hand on 1.1.2016	3,600	Payment to Creditors	2,30,000
Cash at Bank on 1.1.2016	62,000	Purchase of Furniture (on 1.9.2016)	12,000
Collection from Debtors	2,20,000	Salaries	28,000
Cash Sales	70,000	General Expenses	8,000
Capital Introduced	60,000	Rent and Rates	15,000
Interest received on Investment	5,000	Drawings	36,000
		Cash Purchases	47,000
		Cash in hand on 31.12.2016	1,600
		Cash at Bank on 31.12.2016	43,000
	4,20,600		4,20,600

Particulars of other assets and liabilities are as follows :

	01.01.2016	*31.12.2016*
	₹	₹
Sundry Debtors	*1,45,000*	*1,66,000*
Sundry Creditors	*2,90,000*	*2,23,000*
Furniture	*48,000*	*?*
Stock	*57,000*	*70,000*
Investments in 10% Bond	*50,000*	*50,000*

Debtors and Creditors balances on 31.12.2016 have been arrived at after considering discount allowed and discount received amounting to ₹ 9,000 and ₹ 7,000 respectively. Furniture is to be depreciated @ 10% p.a. and a provision for doubtful debt is to be created for ₹ 3,300.

Prepare a Trading and profit and Loss Account for the year ended 31st December, 2016 and a Balance Sheet as on that date. **10**

Answer

Mr D

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		57,000	By Sales :		
To Purchases :			Cash	70,000	
Cash	47,000		Credit	2,50,000	3,20,000
Credit	1,70,000	2,17,000	By Closing STock		70,000
To Gross Profit c/d		1,16,000			
		3,90,000			3,90,000
To Salaries		28,000	By Gross Profit b/d		1,16,000
To General Expenses		8,000	By Discount Received		7,000
To Rent and Rates		15,000	By Interest on Investment		5,000
To Discount Allowed		9,000			
To Provision for Bad Debts		3,300			
To Depreciation on Furniture (Note 4)		5,200			
To Net Profit (Transferred to Capital)		59,500			
		1,28,000			1,28,000

Balance Sheet of Mr D as at 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital (Note 1)	75,600		Furniture (Note 4)		54,800
Add: Net Profit	59,500		Investment in 10% Bonds		50,000
Add: New Capital Introduced	60,000		Stock		70,000
	1,95,100		Sundry Debtors	1,66,000	
Less: Drawings	36,000	1,59,100	Less: Provision for Bad Debts	3,300	1,62,700
Sundry Creditors		2,23,000	Cash at Bank		43,000
			Cash in Hand		1,600
		3,82,100			3,82,100

Working Notes : **(1) Balance Sheet of Mr D as at 1st January, 2016**

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		2,90,000	Furniture		48,000
Capital (Balancing figure)		75,600	Investment in 10% Bonds		50,000
			Stock		57,000
			Sundry Debtors		1,45,000
			Cash at Bank		62,000
			Cash in Hand		3,600
		3,65,600			3,65,600

Dr. **(2) Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	1,45,000	?	By Bank A/c (Collection from Debtors)	2,20,000
?	To Sales (Cash) (Balancing figure)	2,50,000	?	By Discount Allowed	9,000
			31.12.2016	By Balance c/d	1,66,000
		3,95,000			3,95,000

Dr. **(3) Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Discount Received	7,000	1.1.2016	By Balance b/d	2,90,000
?	To Bank (Payment to Creditors)	2,30,000	?	By Purchases (Credit)	1,70,000
31.12.2016	To Balance c/d	2,23,000			
		4,60,000			4,60,000

(4) Calculation of W.D.V. and Depreciation on Furniture :

		₹
Balance as at 1.1.2016		48,000
Add: Purchases on 1.9.2016		12,000
		60,000
Less: Depreciation @ 10% p.a. on		
(₹ 48,000 × 10%)	4,800	
[(₹ 12,000 × 10% × 4) ÷ 12]	400	5,200
W.D.V. on 31.12.2016		54,800

OR

The following is the Receipts and Payments Account of Park View Club in respect of the year ended 31st March, 2017 :

Receipts		₹	Payments	₹
Opening Balance		1,02,500	Salaries	2,08,000
Subscription Received :		2,23,000	Stationery Purchased	40,000
2015-16	4,500		Rent	60,000
2016-17	2,11,000		Telephone Expenses	10,000
2017-18	7,500		Investments	1,25,000
Net Cash realised from Sports Meet		1,55,000	Sundry Expenses	92,500
Income from Investments		1,00,000	Closing Balance	45,000
		5,80,500		5,80,500

Additional information :

(a) *There are 450 members each paying an annual subscription of ₹ 500. On 1st April, 2016, outstanding subscription was ₹ 5,000.*

(b) *There was an outstanding Telephone Bill of ₹ 3,500 on 31st March, 2017.*

(c) *Outstanding Sundry Expenses as on 31st March, 2016, totalled to ₹ 7,000.*

(d) *Stock of Stationery on 31st March, 2016 — ₹ 5,000 and 31st March, 2017 — ₹ 9,000.*

(e) *On 31st March, 2016, Building stood in the books at ₹ 10,00,000 and it was subject to depreciation at 5% p.a.*

(f) *Investment on 31st March, 2016 stood at ₹ 20,00,000.*

(g) *On 31st March, 2017, Income accrued on Investment purchased during the year amounted to ₹ 3,750.*

Prepare an Income and Expenditure Account for the year ended 31st March, 2017 and a Balance Sheet as on that date. **10**

Answer

Park View Club
Income and Expenditure Account for the year ended 31st March, 2017

Expenditure		₹	Income		₹
To Salaries		2,08,000	By Subscriptions (450 x ₹ 500)		2,25,000
To Stationery (Note 1)		36,000	By Income from Sports Meet (Net)		1,55,000
To Rent		60,000	By Income from Investment	1,00,000	
To Telephone Expenses	10,000		Add: Accrued but not received	3,750	1,03,750
Add: Outstanding	3,500	13,500			
To Sundry Expenses	92,500				
Less: Opening Outstanding	7,000	85,500			
To Depreciation on Building		50,000			
To Excess of Income over Expenditure		30,750			
		4,83,750			4,83,750

Balance Sheet of Park View Club as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital Fund :			Building	10,00,000	
Opening Balance (Note 2)	31,05,500		Less: Depreciation @ 5%	50,000	9,50,000
Add: Excess of Income over Expenditure	30,750	31,36,250	Investments	20,00,000	
Outstanding Telehpone Bills		3,500	Add: Purchased during the year	1,25,000	21,25,000
Subscription Received for 2017-18		7,500	Stock of STationery		9,000
			Subscription in Arrear :		
			2015-16 (₹ 5,000 – 4,500)	500	
			2016-17 (Note 3)	14,000	14,500
			Accrued Income on Investment		3,750
			Cash in Hand		45,000
		31,47,250			31,47,250

Working Notes :

(1) Stationery Consumed

	₹
Opening stock of stationery	5,000
Add: Purchased during the year	40,000
	45,000
Less: Closing stock of stationery	9,000
	36,000

(2) Balance Sheet of as at 1st April, 2016

Liabilities	₹	₹	Assets	₹	₹
Outstanding Sundry Expenses		7,000	Building		10,00,000
Capital Fund (Balancing figure)		31,05,500	Investment in Bonds		20,00,000
			Stock of Stationery		5,000
			Subscriptions Accrued		5,000
			Cash in Hand		1,02,500
		31,12,500			31,12,500

(3) Subscriptions in Arrear for 2016-17

	₹
Subscription income for 2016-17 (450 ö ₹ 5,000)	2,25,000
Less: Actual Subscriptions received for 2016-17	2,11,000
	14,000

8. *M/s Poddar & Co. of Kolkata deals with 'body oil' which is sold in one litre plastic bottle. Poddar & Co. consigned 2,500 bottles of 'body oil' costing ₹ 240 per bottle to Sharma & Co. of Jalandhar, to be sold at ₹ 400 per bottle and paid ₹ 50,000 as freight and insurance.*

200 bottles were lost in transit and a sum of ₹ 49,000 was received by M/s Poddar & Co. as compensation from the insurance company.

Sharma & Co. took delivery of the remaining goods consigned and paid carriage inward and unloading charges of ₹ 32,000. He is entitled to a commission of 10% on sales made by him. Sharma & Co. also incurred other expenses covered under agreement amounting to ₹ 18,000.

Sharma & Co. reported that 100 bottles were lost due to leakage in the godown (loss due to leakage upto 5% of goods received by the consignee is considered as normal loss) and 1,700 bottles were sold. Sharma & Co. paid a cheque of ₹ 5,50,000 in favour of Poddar & Co.

You are required to prepare Consignment Account in the books of M/s Poddar & Co.

Note : Working should form part of the answer. **10**

Answer

In the books of M/s Poddar & Co.

Dr. **Consignment to Jalandhar Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Goods Sent on Consignment A/c			By Sharma & Co. (Sales Proceeds)	6,80,000
	(2,500 x ₹ 240)	6,00,000		By Goods Lost in Transit (Note)	52,000
	To Bank A/c (Freight and Insurance)	50,000		To Stock on Consignment (Note)	1,43,227
	To Sharma & Co. A/c				
	Carriage and Unloading	32,200			
	Commission @ 10% on Sales	68,000			
	Other Expenses	18,000			
	To Profit and Loss on Consignment A/c	1,07,027			
		8,75,227			8,75,227

Working Notes :

(1) Valuation of Goods Lost-in-transit and Unsold Goods

Particulars	Bottle	Amount (₹)
Original Cost of Goods Sent	2,500	6,00,000
Add: Freight and Insurance		50,000
	2,500	6,50,000
Goods Lost-in-Transit ($\frac{6,50,000}{2,500} \times 200$)	(200)	52,000
Goods Received by the Consignee	2,300	5,98,000
Add: Carriage Inward and Unloading (Non-recurring expenses)		32,200
	2,300	6,30,200
Less: Normal Loss (Less than 5% of 2,300)	(100)	—
	2,200	6,30,200
Less: Goods Sold	1,700	
Unsold Goods	500	

$$\text{Value of Unsold Stock} = \frac{6,30,200}{2,200} \times 500 = ₹\ \mathbf{1,43,227}.$$

OR

From the following details prepare a General Ledger Adjustment Account in the Creditors Ledger of ABC & Co. :

Particulars	₹	Particulars	₹
Credit Purchases	2,80,000	Bills Payable accepted	16,000
Cash Purchases	75,000	Bills Payable renewed for two more months	2,000
Bills Receivable drawn	1,10,000	Return Inward	10,500
Cash Discount received	5,000	Return Outward	5,000
Bills Payable paid	6,500	Overpayments refunded by suppliers	600
Bills Receivable endorsed to Creditors	10,000	Endorsed Bills Receivable dishonoured	4,000
Opening Balances of :		Payment to Creditors	2,52,000
Sundry Debtors	78,000		
Sundry Creditors	85,000		

Answer

In the Creditors' Ledger of ABC & Co.

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Balance b/d	85,000	?	By Balance b/d	Nil
	To Creditors' Ledger Adjustment A/c :			By Creditors' Ledger Adjustment A/c :	
	Credit Purchase	2,80,000		Cash discount received	5,000
	B/P cancelled on renewal	2,000		B/R endorsed	10,000
	B/R endorsed dishonoured	4,000		B/P accepted	16,000
	Over-payment refunded by the			Return outward	5,000
	Suppliers	600		Cash paid	2,52,000
				B/P renewed	2,000
				By Balance c/d	81,600
		3,71,600			3,71,600

9. *On 1.1.2017 there was a fire in the godown of M/s ABC & Co. destroying a part of stock. The entity furnished the following information :*

	₹
Stock on 1.4.2015	*56,000*
Purchases during 2015-16	*3,80,000*
Sales during 2015-16	*5,00,000*
Stock on 31.3.2016	*30,000*
Purchases from 1.4.2016 to 1.1.2017	*2,00,000*
Sales from 1.4.2016 to 1.1.2017	*2,00,000*

Stock on 31.3.2016 includes abnormal items costing ₹ 15,000 which was written down by ₹ 6,000. Two-third of the abnormal items were sold on 30.6.2016 at a loss of ₹ 5,000. This amount is included in sales during the relevant period. Balance of the abnormal items were valued at cost. Value of goods salvaged ₹ 7,000 and policy value was ₹ 50,000.

Compute the insurance claim to be made by M/s ABC & Co. **10**

Answer

M/s ABC & Co.

Dr. Memorandum Trading Account for the period 1st April to 1st January, 2017 Cr.

Particulars	Normal Items	Abnormal Items	₹	Particulars	Normal Items	Abnormal Items	₹
To Opening Stock	21,000	15,000	36,000	By Sales A/c	1,95,000	5,000	2,00,000
To Purchases A/c	2,00,000	—	2,00,000	By Loss	—	5,000	—
To Gross Profit (20% of ₹ 1,95,000)	39,000	—	39,000	By Closing Stock (Balancing figure)	65,000	5,000	75,000
	2,60,000	15,000	2,75,000		2,60,000	15,000	2,75,000

Statement of Claim for Loss of Stock as on 1st January, 2017

Particulars	₹
Estimated Stock as on the date of fire	70,000
Less: Salvage	7,000
Actual Loss Subject to Average Clause	63,000

The insurance policy was taken for ₹ 50,000 but the value of stock as on the date of fire was ₹ 70,000. Therefore, the average clause is applicable :

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}}$$

$$= ₹\ 63{,}000 \times \frac{50{,}000}{70{,}000} = ₹\ \mathbf{45{,}000.}$$

Working Note:

Dr. (1) Trading Account for the year ended 31st March 2016 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	56,000	By Sales	5,00,000
To Purchases	3,80,000	By Closing Stock:	
To Gross Profit (Balancing figure)	1,00,000	Normal Items (Note 2)	21,000
		Abnormal Items	15,000
	5,36,000		5,36,000

Rate of Gross Profit = ₹ 1,00,000 / 5,00,000 × 100 = 20%.

(2) Total value of Closing Stock on 31.3.2016 was ₹ 30,000. It includes abnormal items costing ₹ 15,000. However, it was valued at (₹ 15,000 – 6,000) = ₹ 9,000. Therefore, value of Closing Stock of normal items = ₹ 30,000 – 9,000 = ₹ 21,000.

(3) Actual value of abnormal items = ₹ 15,000. 2/3rd was sold at a loss of ₹ 5,000. Therefore, sales proceeds of abnormal items included in the sales of ₹ 2,00,000 = [2/3 of ₹ 15,000) – 5,000] = ₹ 5,000. Sales proceeds of normal items = ₹ 2,00,000 – ₹ 5,000 = ₹ **1,95,000**.

Group - C

10. *The following is the Trial Balance of Mr H as on 31st March, 2017 :*

Debit Balances	₹	Credit Balances	₹
Drawings	10,000	Capital	1,70,000
Office Equipment	1,10,000	Sales	1,65,000
Purchases	84,000	Returns	4,000
Returns	5,000	Bad Debts Recovered	26,450
Bad Debts	5,000	Discount Received	1,000
Carriage Inward	5,000	Creditors	2,02,000
Carriage Outward	7,000	Bills Payable	5,600
Discount Allowed	2,000	Bank Overdraft	29,000
Sales Commission	4,000	10% Loan (taken on 1.4.2016)	30,000
Rent	4,000		
Interest	1,500		
Office Expenses	16,000		
Debtors	2,15,000		
Bills Receivable	10,000		
Investment	50,000		
Opening Stock	54,000		
Cash	50,550		
	6,33,050		6,33,050

Additional information :

(a) *Closing Stock at market price as on 31st March, 2017 was ₹ 61,500. However, the cost of such stock was ₹ 80,000.*

(b) *Provide for depreciation on office equipment @ 10% p.a.*

(c) Goods costing ₹ 10,000 was destroyed due to fire on 30th March, 2017, the insurance company accepted a claim to the extent of 60% only and paid the claim money only on 10th April, 2017.

(d) Of the bill receivables, a bill of ₹ 4,000 is dishonoured. No entry has been made in the books of account.

(e) Write off ₹ 9,000 as bad debt and maintain a provision for bad debt @ 5%.

(f) Manager is entitled to a commission of 5% of net profit before charging his commission.

You are required to prepare a Trading and Profit and Loss Account for the year ended on 31.3.2017 and a Balance Sheet on that date.

15

Answer

Mr H

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

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		54,000	By Sales	1,65,000	
To Purchases	84,000		Less: Returns	5,000	1,60,000
Less: Returns	4,000	80,000	By Goods Destroyed by Fire		10,000
To Carriage Inward		5,000	By Closing Stock (Note 1)		61,500
To Gross Profit c/d		92,500			
		2,31,500			2,31,500
To Bad Debts	5,000		By Gross Profit b/d		92,500
Add: Further Bad Debts	9,000	14,000	By Bad Debts Recovered		26,450
To Carriage Outwards		7,000	By Discount Received		1,000
To Discount Allowed		2,000			
To Sales Commission		4,000			
To Rent		4,000			
To Office Expenses		16,000			
To Interest on Loan (Note 3)		3,000			
To Depreciation on :					
Office Equipment @ 10% p.a.		11,000			
To Abnormal Loss of Goods		4,000			
To Provision for Bad Debts (Note 2)		10,500			
To Net Profit c/d (Before Manager's Comm.)		44,450			
		1,19,950			1,19,950
To Outstanding Manager's Commission (Note 4)		2,223	By Net Profit b/d		44,450
To Net Profit (Transferred to Capital)		42,227			
		44,450			44,450

Balance Sheet of Mr H as at 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	1,70,000		Office Equipment	1,10,000	
Add: Net Profit	42,227		Less: Depreciation @ 10% p.a.	11,000	99,000
	2,12,227		Investments		50,000
Less: Drawings	10,000	2,02,227	Debtors (Note 2)	2,10,000	
10% Loan		30,000	Less: Provision for Bad Debts	10,500	1,99,500
Creditors		2,02,000	Bills Receivable (10,000 – 4,000)		6,000
Bills Payable		5,600	Closing Stock		61,500
Outstanding Interest on Loan (Note 3)		1,500	Insurance Claim		6,000
Outstanding Manager's Commission		2,223	Cash		50,550
Bank Overdraft		29,000			
		4,72,550			4,72,550

Working Notes

(1) Closing Stock is valued at cost or NRV, whichever is less. In this case cost was ₹ 80,000 but NRV (market price) was ₹ 61,500. Therefore, the value of Closing Stock will be ₹ **61,500**.

(2) Calculation of Provision for Bad Debts

	₹
Debtors as per Trial Balance	2,15,000
Less: Bad Debts after Trial Balance was prepared	9,000
	2,06,000
Add: Bills Receivable Dishonoured	4,000
	2,10,000
Closing provision for bad debts @ 5% of ₹ 2,10,000	10,500
(3) Interest on Loan = 10% of ₹ 30,000	3,000
Less: Already paid	1,500
Outstanding Interest	1,500

(4) Manager's Commission is payable @ 5% on profit before commission. Therefore, commission = 5% of ₹ 44,450 = ₹ **2,223** (rounded off).