# Centre for Distance and online Education

# Punjabi University, Patiala

Class: BBA-Part-II Semester : III

Paper : BBA-302 (Business Accounting) Unit : I

Medium : English

## Lesson No.



**Department website: www.pbidde.org**

Updated on -13 June ,2023

## *BBA-302: BUSINESS ACCOUNTING*

Time Allowed: 3 Hrs. Max. Marks: 100

Theory: 60

Internal Assessment: 40

**Note**: The question paper covering the entire course shall be divided into three sections as follows:

**Section-A**

It wi11 consist of very short answer questions with answers to each question up to five lines in length. All questions shall be compulsory. Each question shall cany two marks; total weightage of the section shall be 20 marks.

**Section-B**

It will consist of essay type questions with answers to each question up to 7 pages in length. Four questions shall be set by the examiner from Part-l of the syllabus and the candidate shall be required to attempt two. Each

question shall carry ten marks; total weightage of the section shall be 20 marks.

**Section-c**

It wi1l consist of essay type questions with answers to each question up to 7 pages in length. Four questions shall be set by the examiner from Part-11of the syllabus and the candidate shall be required to attempt two. Each question shall carry ten marks; total weightage of the section shall be 20 marks.

**COURSE INPUT**:

Part- l

Meaning and Scope of Accounting: Need, development and definition of accounting, book-keeping and accounting, Persons interested in accounting information, Disclosures? Branches of accounting; Objectives of accounting, basic understanding of accounting standards.

Accounting Transactions: Accounting Cycle Journal Rules of debit and credit; Compound journal entry, Opening entry, Relationship between journal and ledger; Rules regarding posting, Trial Balance, Sub-division of journal. Distinction between Capital and revenue, items.

Final Accounts: Manufacturing account; Trading account, Profit and loss account; Balance-sheet; adjustment entries. Rectification of Errors: Classification of errors, Location of errors, Rectification of errors Suspense account; Effect on profit.

Part-II

Depreciation Provisions and Reserves: Concept of Depreciation; Causes of depreciation; Depreciation, depletion, amortization and dilapidation; Depreciation accounting; Methods for providing depreciation, Depreciation policy; Depreciation accounting, Provisions and reserves.

Partnership Accounts: Essential characteristics of partnership. Partnership deed; Final accounts; Adjustments after closing the accounts; Fixed and fluctuating capital; Goodwill; Joint Life Policy; Change in Profit Sharing Ratio.

Suggested Readings :


1. Anthony & Reece : Accounting Principles, Richard Irwin Inc.
2. Gupta, et al. : Financial Accounting, Sultan Chand and Sons , New Delhi
3. Monga et al. : Financial Accounting, Mayur Paper Back, Noida.
4. Shukla & Grewal : Advanced Accounts, S. Chand & Co. New Delhi.
5. Compendium of Statement and Standards of Accounting: The Institute of Chartered Accountants of India, New Delhi.

LESSON NO. 1.1 AUTHOR: MRS. DALBIR KAUR

# INTRODUCTION TO ACCOUNTING

Structure of the Lesson:



## 1.1.0 OBJECTIVES

The main purpose of this lesson is to introduce the students with the accounting system, which is required to ascertain profit or loss during a specified period, to show financial condition of the business on the particular date and to have control over the firm's property. So this lesson covers concept, objectives, functions, importance and limitations of Accounting system.

## 1.1.1. INTRODUCTION

Accounting is as old as money itself. In the early stages of civilisation, the number of transactions to be recorded were small that each businessman was able to record and check for himself the recorded transactions. However the modern system of accounting based on Principles of Double Entry owes its origin to Luco Pacioli with the increase in size of business. The complexities of business have increased the importance of accounting as the ownership and management have gone into two different hands. Now, accounting is required by management, shareholders, investors, bankers, creditors, government departments and many other authorities.

## 1.1.2. BOOK KEEPING

In the words of Carter, "Book Keeping is the science and art of correctly recording in books of accounts all those transactions that result in the transfer of money or money's worth."

Book-keeping is thus art and science of recording, classifying and summarizing business transactions in money or money's worth accurately and systematically so that the business may be able to know his profit or loss during a specified period and also his financial position on a particular date.

## 1.1.3. CONCEPT OF ACCOUNTING

The actual record making phase (i.e. recording, classifying and summarising) of accounting is usually called book-keeping. However, accounting extents for beyond the actual making of records. Accounting is concerned with the use to which these records are put, their analysis and interpretation.

According to American Accounting Association (AAA), Accounting is the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information."

The main branches of accounting are financial, cost and management accounting.

1.1.3.1 Financial Accounting: The main purpose of this branch of accounting is to ascertain profit or loss during a specific period, to show financial position of the business on a particular date. Such accounting records are used to import useful information to outsiders and to meet the legal requirements.

1.1.3.2 Cost Accounting : The main aim of this branch of accounting is to ascertain cost relating to the various activities of the business and to have cost control. The cost accountant is required to assemble and interpret cost data for the use of management in controlling current operations and in planning for the future. It also helps the business in controlling the costs by indicating avoidable losses and wastes; and thus helps in keeping the cost at the minimum level.

1.1.3.3 Management Accounting: This is another important branch of accounting which supplies the management significant information in order to assist the management to discharge its various functions such as planning, control, evaluation of performance and decision making etc. It covers, Ratio analysis, cash flow and fund flow analysis, Break-even analysis and Managerial application of Marginal costing. Management Accounting is comprised of two words". Management and Accounting thus it is the study of managerial aspect of accounting.

## 1.1.4. BASIC TERMS OF ACCOUNTING

Few basic terms of accounting are as given here:-

1. Transaction: A business deal made between two parties is called transaction. It is an exchange of goods or services for money or money's worth. A business transaction is an event which can be expressed in terms of money. When payment for a business transaction is made immediately, it is called a cash transaction and when the payment is postponed to a future date, it is called a credit transaction.

2. Goods: The term 'goods' means the articles, commodities or merchandise in which the business deals. In other words those things which are purchased for sale are called goods. Thus, books for a book-seller, furniture for a dealer in furniture and car for a car dealer are examples of goods. For the purposes of accounting, goods may be classified as purchases, sales, purchase returns or return outwards, sales returns or returns inwards, opening stock and closing stock.

3. Capital: The amount invested by the owner in the business at any given point of time is known as capital. It is the residual claim of the owner in the business at any given point of time is known as capital. It is the residual claim of the owners of the business against its assets after meeting the claims of the outsiders. Thus, Capital = Assets - Liabilities.

4. Assets: Any physical thing or right owned that has a money value is called an asset. According to the Accounting Terminology issued by the Institute of Chartered Accountants of India, assets are "tangible objects or intangible rights owned by an enterprise and carrying probable future benefits." Thus, property of all kinds owned by a business is included in the term 'assets'.

5. Liabilities: The term 'Liabilities' refers to the amount or debts owned by a firm. It includes the capital of the proprietor and debts which are owned by the firm to the outsiders.

6. Debtor: A debtor is a person who owes money to the business.

The amount due from a person as per the books of accounts is called a book debt.

7. Creditor: A person who has a claim for money against the business is called 'creditor'. He is the person to whom the business owes money.

8. Drawings: Any amount of cash or value of goods withdrawn by the owner of business for his domestic or personal use is called drawings.

9. Account: An account may be defined as a summarised record of all the transactions relating to a particular person, thing or other subject, which have taken place during a given period of time. It is usually prepared in T form having two sides. The left hand side is known as 'debit side' and the right hand side of an account is called 'credit side'. Account is usually written as A/C or a/c.

Dr. Account (A/C) Cr.

| Debit Side | Credit Side |
|---|---|

9. Account: An account may be defined as a summarised record of all

10. Entry: Recording a transaction in the books of accounts is known as 'entry'.

11. Debit: The term 'debit' means recording the transaction on the left hand side of an account.

12. Credit: Recording a transaction on the right hand side of an account is called credit.

13. Revenue: The amount charged for goods sold or services rendered is called revenue. Examples of revenue are sales, commission earned, rent accrued and fees for professional services rendered.

14. Expense: The term 'expense' includes the cost of goods sold or services rendered to a business entity in the process of generating revenue, such as salaries, rent, interest, etc. An expense should be distinguished from a loss in the sense that an expense is expected to result in some benefit to the business whereas a loss brings no benefit to the firm.

15. Capital Expenditure: Costs incurred for acquiring assets that will provide economic benefits over several accounting periods are called capital expenditures.

16. Revenue Expenditure: Cost incurred that provide economic benefits

only during the current accounting period are called revenue expenditures. Revenue expenditures are also known as expenses.

17. Invoice: It is a document prepared by the seller giving particulars of the goods sold, the price, quantity of goods, the total value of goods and the amount payable by the buyer.

18. Discount: It refers to an allowance or deduction allowed from the sale price or amount payable at the time of payment. There may be two types of discounts, trade discount and cash discount. Trade discount is allowed to the buyers from the gross or catalogue price without reference to the time factor within which the seller expects to receive the payment. It is allowed to attract the customers and the amount of trade discount is deducted in the invoice. Transactions are recorded in the books of accounts for the net amount, i.e. value of the goods less trade discount.

Cash discount is allowed to customer to attract prompt payment and is recorded in the books of accounts.

19. Voucher: It is a written document in support of a business transaction.

### 1.1.5. DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

The concepts of book keeping and accounting are already discussed in this lesson. Next is the main differences between book-keeping and Accounting as given below:

| Points of distinction | Book-keeping | Accounting |
|---|---|---|
| 1. Object | The object of book-keeping is to prepare original books of accounts, trial balance and final accounts. | The object of accounting is to record, classify, summarise, analyses and interpret the business transactions. |
| 2. Scope | It has limited scope and is concerned with recording, classifying, and summarising of business transactions. | It has a wide scope and covers book-keeping plus analysis and interpretation. |
| 3. Level of Work | It is restricted to clerical work and is done by lower levels of management. | It is concerned with all levels of management. Lower level clerks prepare the accounts, medium level report it and top level interpret it. |
| 4. Mutual dependence | It has to depend on accounting for making the accounting records more useful. | It has to depend on book-keeping for getting the required information from accounting records and for making them useful for planning, control and decision making. |
| 5. Results of the business. | It shows the net result and financial position of the business as the scope extends only upto the preparation of final accounts. | It analyses the operating results and financial position of the business. |

## 1.1.6 OBJECTIVES OF ACCOUNTING

The main purpose of accounting is to provide information which is useful for the person inside the organisation groups outside the organisation. The main objects of accounting are:

1. <u>To ascertain profitability level of business operations</u>: Accounting system helps us to know whether a business has earned profit or suffered loss during the accounting period. To determine profit or loss of the account period, a Trading and Profit and Loss Account or an Income statement is prepared by matching revenues and expired costs (i.e. revenue expenditure) incurved for earning the revenues. Thus, first of all revenue is determined

and then expenses incurred for earning the revenue are matched with the revenue for calculating the difference known as net profit or net loss.

2. To Ascertain the Financial Position of the business: The position statement or Balance sheet is prepared to give an idea of the financial position of the business on a particular date, which shows its assets and liabilities on that date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of an enterprise. A properly drawn up balance sheet gives information relating to (1) the nature and value of assets; (2) the nature and extent of liabilities; (3) whether the enterprise is solvent; and (4) whether the business concern is over trading.

3. To provide information for managerial decisions: Another objective of Account is to generate such information which are helpful to various managers and persons in planning, control, evaluation of performance and decision-making.

## 1.1.7 FUNCTIONS OF ACCOUNTING

The main functions of accounting are as following:

(i) It keep a systematic and permanent record of all financial transactions of business.

(ii) It keeps a record of income and expenses, in such a manner so that net result of business can be quickly known for any period.

(iii) It keeps a record of assets and liabilities in such a way that financial position of the business can be readily seen at any point of time.

(iv) It protects the property of the business by designing such a system of accounting which may be helpful to achieve this purpose.

(v) It keeps a track of all changes in the value of assets and liabilities.

(vi) It keeps control on all changes in the value of assets and liabilities.

(vii) It communicates the result of the business to the various categories of persons as owners, investors, creditors, employees, management, govt. etc.

(viii) It provides information for meeting various legal requirements as income tax returns, return for sales tax etc.

(ix) It helps in making decisions, concerning the acquisition, use and preservation of scarce resources.

(x) It helps in deciding remedial measures for the deviation of actual performance from the planned performance.

## 1.1.8 SYSTEMS OF ACCOUNTING

There are basically two accounting methods for measuring profit or income:

1. Cash Basis of Accounting
2. Accrual or Mercantile Basis of Accounting
3. Mixed or Hybrid basis of Accounting

1. Cash Basis of Accounting: Under this method, all incomes are considered to be earned only when they are actually received in cash. In the same manner, expenses are deemed to be incurred only when they are actually paid in cash. And, the difference between the total incomes so received in cash and total expenses so paid in cash represents the profit or loss of a firm for a particular accounting period. Government system of accounting is generally on cash basis. This method is also followed by professionals like doctors, lawyers, chartered accountants, etc.

The only advantage of this method is that it is very simple, but it fails to disclose correct profit or loss and also does not give a true and fair view of financial position of a firm.

2. Accrual or Mercantile Basis of Accounting: Under this method of accounting, incomes are recorded and considered for the period in which they are earned irrespective of the fact that whether the same have actually been received or not. Similarly expenses are charged to the period in which they are incurred irrespective of the fact that they have actually been paid or not. As such, the difference between the total incomes earned and total expenses incurred represents the profit or loss of a firm for a particular accounting period. Thus, the profit and loss account and balance sheen exhibit a true and fair view of the state of affairs. The accrual basis is generally accepted accounting convension in business accounting and that is why it is also called mercantile basis of accounting., called the Mixed or Hybrid Basis of Accounting.

3. Mixed or Hybrid Basis of Accounting: Under this method income are recorded on cash basis whereas expenses are recorded on accrual basis. This method of accounting is not commonly used in actual practice as it fails to measure correct income and does not exhibit a fair and true view of the state of affairs.

## 1.1.9 IMPORTANCE OF ACCOUNTING

The Accounting system is very much important in the business world, as it provides meaningful information about a business enterprise to those persons who are directly or indirectly interested in the performance and financial position of a business. Such person required various types of information as discussed here:

1. Owners: The owners of a business furnish capital to be used for

the purpose of business. They are interested to know whether the business has earned a profit or loss during a particular period and also its financial position on a particular date. They want accounting reports in order to have an appraisal of past performance and also for an assessment of future prospects.

2. Creditors: The creditors include supplier of goods and supplies, bankers and other lenders of money. They are interested in the financial stability of the concern before making loans or granting credit. They look to the ability of the business to pay interest and amount as and when it becomes due for payment, and the solvency of a concern.

3. Investors: Investors look not only the earning capacity of business but also its financial strength and solvency before deciding whether to subscribe or not for the shares in a Company. They are interested in steady and good return on their capital, the safety of their capital and appreciation in the value of the shares.

4. Employees: Employees are interested in earning capacity of a concern as their salaries, bonus and pension schemes are dependent on this factor.

5. Government: Government is interested in accounting statements and reports in order to see the performance of a particular unit, its cost structure and income in order to impose tax and excise duty.

6. Public: The public as consumers is interested in accounting statements in order to know whether control in exercised on production, selling and distribution expenses in order to reduce the prices of goods they buy.

7. Research Scholar: Such persons are interested in accounting statements and reports in order to get data for proving their thesis on which they are working and hence to complete their research projects.

8. Managers: The managers of a enterprise need accounting information of planning, control, evaluation of performance and decision-making. Their main responsibility is to operate the business so as to obtain maximum return on capital employed without causing any harm to the interest of the shareholders. The manager would like to have data relating to sales, output and expenses etc. relating to next year and also the flow of cash for the purpose of planning the activities of a business. He is also required to plan and see that the cost incurred is reasonable. All these require relevant accounting information.

## 1.1.10 ADVANTAGES OF ACCOUNTING

The following are main advantages of accounting:

1. Replacement of memory: In a large business it is very difficult

for a business-man to remember all the transactions. Accounting provides records which will furnish information as and when desired and thus it replaces human memory.

2. Evidence in Court: Properly maintained accounts are often treated as a good evidence in the court to settle a dispute.

3. Settlement of taxation liability: If accounts are properly maintained, it will be of great assistance to the businessman in setting the income tax and sale tax liability otherwise tax authorities may impose any amount of tax which the businessman will have to pay.

4. Comparative study : It provides the facility of comparative study of the various aspects of the business such as profits, sales, expenses etc. with that of previous year and helps the businessman to locate significant factor leading to the change, if any.

5. Sale of business: If accounts are properly maintained, it helps to ascertain the proper purchase price in case the businessman is interested to sell his business.

6. Assistance to the insolvent person: If a person is maintaining proper accounts and unfortunately he becomes insolvent (i.e. when he is unable to pay to his creditors), he can explain many things about the past with the help of accounts and can start a fresh life.

7. Assistance to various parties: It provides information to various parties, i.e., owners, creditors, investors, government, managers, research scholars, public and employees and financial position of a business enterprise from their own view point.

## 1.1.11 LIMITATIONS OF ACCOUNTING

The following are the main limitations of accounting:

1. Records only monetary transactions: Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured in monetary terms as conflict between production manager and marketing manager, efficient management etc. may be very important for a concern but not recorded in the business books.

2. Effect of price level changes not considered: Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult. For example, the sales to total assets in 1998 would be much higher than in 1990 due to rising prices, fixed assets being shown at cost and not at market price.

3. No realistic information: Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. Personal bias of Accountant affects the accounting statements: Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

5. Permits alternative treatments: Accounting permits alternative treatments within generally accepted accounting concepts and conventions. For example, method of charging depreciation may be straight line method or diminishing balance method or some other method. Similarly, closing stock may be valued by FIFO (First-in-First-Out) or LIFO or average price method. Application of different methods may given different results.

6. No real test of managerial Performance: Profit may be shown in excess by manipulation of accounts by suppressing such cost as depreciation, advertisement and R&D or taking excess value of closing stock consequently real idea of performance may not be available by manipulates profit.

7. Historical in nature: Usually accounting supplies information in the form of Profit and Loss account and Balance sheet at the end of the year. So the information provided through accounting system is historical in nature and gives post-mortem analysis.

SELF CHECK EXERCISE:

Ques. 1. Give various functions of Accounting?

Ques. 2. Define the term book-keeping and also distinguish between book-keeping and Accounting.

Ques. 3. Explain in detail various systems of Accounting.

1.1.12 Accounting Conventions and Concepts: In the modern world no business can afford to remain secretive because various parties such as creditors, employees, taxation authorities, investors, public and government etc. are interested about the affairs of the business. The affairs of the business can be studied mainly by consulting final accounts and the balance sheet of particular business. Final accounts and balance sheets are the end product of Book-keeping. Because of the importance of these statements it became necessary for the accountants to develop some principles, concepts and convention which may be regarded as fundamentals of accounting.

Conventions : Accounting is based on the following three conventions:

1. Relevance : The convention of Relevance emphasis the fact that only information should be made available by accounting as is useful and relevant for achieving its objectives. The things which are not very relevant or important should not be mentioned in the books of accounts. As business is interested in knowing about the total labour cost. It is not interested in knowing what employees spend and what they save.

2. Objectivity : The convention of Objectivity emphasizes that accounting information should be based on evidence and expressed by standards which are commonly acceptable e.g. stock of goods lying unsold at the end of the year should be valued at its cost price not at a higher price even if it is likely to be sold at a higher price in future. Reason is that no one can be sure about the price which will prevail in future.

3. Feasibility : The Convention of feasibility emphasises that the time, labour and cost of analysing accounting information should be compared with benefit arising out of it. Our benefit derived should always be much more than the money expended. As the cost of oiling and greasing is very low but it saves a lot of labour time.

## Accounting Concepts

1. Entity Concept: It is very important to note that for accounting purpose the business is treated as a unit of entity apart from its owners, creditors and other. In other words, the proprietor of an enterprise is always considered to be separate and his business has different identity.

2. Going concern concept: This concept is based on the premise that business will continue for an indefinitely long period and it will not be wound up in the near future. According to this assumption assets in the business are carried out in the books at their cost less depreciation and not at the market value. Similarly liabilities are shown at value that reflect what the business owes and not value for which the creditors would settle in case of dissolution or liquidation.

3. Dual aspect concept : This concept states that there are two aspects. The first aspect is the assets of the business and second is equities. Assets are resources owned by a firm and equities are claims of various parties against the assets owned by a firm. Equities are classified as (a) owner's equities, and (b) liabilities. According to accounting equation . Assets are

equal to Equities i.e. capital + liabilities, which is known as concept of duality.

4. Accounting Period Concept: Strictly speaking the net income can be measured by comparing the assets of the business existing at the time of its commencement with those existing at the time of its liquidation. Since life of business is assumed to be indefinite, the measurement of income according to above concept is not possible for very-very long period. Thus, in order to know at frequent intervals' "how things are going" accountants normally take twelve months period for the measurement of income.

5. Money Measurement Concept : The money measurement concept underline the fact that in accounting every worthy recording event, happening or transactions is recorded in terms of money. In other word a fact or a happening which cannot be expressed in terms of money is not recorded in accounting books.

6. Cost Concept: The underlying idea of cost concept is that:

(a) asset is recorded at the price paid to acquire it, that is, at cost.

(b) this cost is the basis of all subsequent accounting for the asset.

7. Revenue Recognition Concept : In accounting the amounts received for the sale of output are called revenues. Revenue is the gross inflow of cash, receivable or other consideration arising in the course of an enterprise from the sale of goods, from the rendering of services and rewards arising from the provision of assets.

8. Matching Concept : After the revenue recognition, all costs which are applicable to the revenue of the period shold be charged against the revenue in order to determine the net income of the business. This is essence of matching Concept. For ascertaining net income of the year, the revenue and expenses of the year are ascertained and following equation is applied :

$$P = \sum R - \sum E$$

Where P = Profit, $\sum R$ = Sum of Revenues & $\sum E$ = Sum of the expenses.

9. Accrual Concept : An associated concept to be discussed in the context of matching principle' is the accrual system of accounting which is favoured by the modern accountants as against cash system of accounting. Under this method, revenues and expenses are recognised in the period in which activities that cause those revenues and expenses occur.

## 1.1.13 SUMMARY

The traditional view of accounting as a historical description of financial activities is not longer acceptable. Over a period of time new dimensions have been added to the discipline of accounting. Thus, the accounting systems which we find today have developed with the development of institutions of trade, commerce and industry i.e. Double Entry system of book keeping. The Double Entry System of today was first propounded in Genoa (Italy) in 1340. In short we can say that accounting is the art and science of recording, classifying, and summarising of financial transactions and interpreting the results thereof.

## 1.1.14 ANSWER TO SELF CHECK EXERCISE

Ans. 1. Functions of Accounting :

1. Recording of Information
2. Classification of Data
3. Making Summaries
4. Interpreting Financial information
5. Dealing with Financial transactions
6. Communicating results
7. Making Information more reliable

Ans. 2. Points of Difference between Book-keeping and Accounting

1. Object
2. Scope
3. Level of work
4. Mutual dependence
5. Results of the business

Ans. 3. Various Systems of Accounting

1. Cash basis System of Accounting
2. Accrual basis System of Accounting
3. Hybrid or Mixed basis System of Accounting

## 1.1.15 GLOSSARY

1. Book- Keeping : System of keeping accounting books.
2. Hybrid System : System of accounting which follows both cash and accrual basis of accounting.
3. Accounting: Scientific methods of recording business transactions.
4. Cost Accounting : Branch of accounting, considers, cost aspect of accounting.
5. Management Accounting: Branch of accounting studies managerial aspects of accounting.

## 1.1.16 EXERCISE

(A) Short Questions :

Ques. 1. Define the terms 'business transactions'.

Ques. 2. What do you mean by 'Equity'.

Ques. 3. Discuss various branches of Accounting.

(B) Long Questions:

Ques. 1. Define the terms Accounting. Also state advantages and limitations of Financial of accounting.

Ques. 2. Discuss in detail the importance of accounting.

Ques. 3. Distinguish between Financial, Cost and Management accounting. And give main objectives of accounting.

## 1.1.17 SUGGESTED READINGS

1. Basic Accounting
by : S.P. Jain
K.L. Narang
Kalyani Publishers

2. Financial Accounting
by : Juneja
R.C. Chawla
K.K. Sexena
Kalyani Publishers

3. Financial Accounting
by : Dr. S.M. Shukla
Dr. S.P. Gupta

LESSON NO. 1.2

# ACCOUNTING STANDARDS

1.2.0 objective:

The objective of this lesson is to explain

i. Meaning of accounting standard
ii. International and national accounting standard
iii. Accounting standard form AS 1 to AS 32 in detail

1.2.1Introduction :- Accounting is the language of business. To convey the language make the same meaning to all people, accountants all over the world have developed certain rules, procedures and conventions which represent a consensus view by the profession of good accounting practices and procedures and are generally referred to as Generally Accepted Accounting Principles ( GAAP). Accounting statements are prepared in conformity with accounting principles becoming more apparent when we contemplate the chaotic conditions that would prevail if every accountant could follow his own principles about the measurement of revenue and expenses.

The accounting standards already published in many countries keep in view regulations (local) and customs and as a result sometimes differ in form and contents. IASC takes note of standard Accounting already issued and in the light of such knowledge produces an International Standard Accounting for world wide acceptance because one of the objectives of formation of IASC was to bring uniformity as far as possible in the diverse accounting standards and accounting policies at present in use in different countries.

1.2.2 Indian and International Accounting Standards

The institute of Chartered Accountants of India being the premier accounting body in India has tried to improve its accounting and auditing standards continuosly in the counting in last four decades. In 1964, the institute issued i ts ' Statement of Auditing Practices'. Many statements have since been issued by the institute from time to time to lay emphasis on important accounting matters. However, the most important step in developing accounting standards in country has been setting up of an Accounting Standards Board in 1977.

The establishment of the Accounting Standards Board itself marked a commendable effort by the Institute of Chartered Accountants in its endeavour to formulate and harmonise accounting practices and has played a significant role in improving corporate practices, but it has not come up to expectations of several uses of financial statements.

The Accounting Standards Board has formulated the following standards :-

| | | |
|---|---|---|
| Accounting Standard | 1. | Disclosure of Accounting Policies |
| Accounting Standard | 2. | Valuation of Inventory |
| Accounting Standard | 3. | Cash Flow Statements |
| Accounting Standard | 4. | Contingencies and events occurring after Balance Sheet date |
| Accounting Standard | 5. | Net profit for the period, Prior period, items and changes in Accounting Policies |
| Accounting Standard | 6. | Depreciation Accounting |
| Accounting Standard | 7. | Accounting for Construction Contracts. |
| Accounting Standard | 8. | Accounting for Research and Development |
| Accounting Standard | 9. | Revenue Recognition |
| Accounting Standard | 10. | Accounting for fixed Assets |
| Accounting Standard | 11. | Accounting for effects of changes in Foreign Exchange Rates |
| Accounting Standard | 12. | Accounting for Govt. Grants |
| Accounting Standard | 13. | Accounting for Investment |
| Accounting Standard | 14. | Accounting for Amalgamations |
| Accounting Standard | 15. | Accounting for Retirement Benefits in the Financial Statement of Employers |
| Accounting Standard | 16. | Borrowing Costs |
| Accounting Sandard | 17. | Segment Reporting |
| Accounting Standard | 18. | Related Party Disclosures |
| Accounting Standard | 19. | Leases |
| Accounting Standard | 20. | Earning Per Share |
| Accounting Standard | 21. | Consolidated Financial Statements |
| Accounting Standard | 22. | Accounting for Taxes |
| Accounting Standard | 23. | Accounting for Investments in Associated in Consolidated Financial Statements |
| Accounting Standard | 24. | Discontinuing Operations |
| Accounting Standard | 25. | Interim financial Reporting |
| Accounting Standard | 26. | Intangible Assets |

| | | |
|---|---|---|
| Accounting Standard | 27. | Financial Reporting of Interests in Joint Venture |
| Accounting Standard | 28. | Impairment of Assets |
| Accounting Standard | 29. | Provisions, Contingent Liabilities and Contingent Assets |
| Accounting Standard | 30. | Financial Instruments recognition and measurement |
| Accounting Standard | 31. | Financial Instrument : Presentation |
| Accounting Standard | 32. | Financial Instruments : Disclosure |

The Institute of Chartered Accountants of India has made the compliance of Accounting Standards 1,2,4,5,7,8,9,10,11,12 and 15 to 28 mandatory for all public and listed private sector companies. Accounting Standards 3,6,13,14, and 23 are recommendatory.

1.2..3 Accounting standard : 1-Disclosure of Accounting Policies :-

As-1 deals with the disclosure of significant Accounting policies followed in preparing and presenting financial statements. The standard defines accounting policies as refining to the Specfic Accounting Princples of the methods applying those principles adopted by the enterprise in the preparation and presentation of financial statements. Accounting to As-1 there is no single list of Accounting Policies, which are applicable to all circumstances. The choice of the appropriate accounting principles and the methods of applying those principles depends upon the specific circumstances of each enterprise and calls for considerable judgement by the management of enterprise. The primary consideration in the selection of accounting policies by an enterprise is that financial statements prepared on the basis of such accounting policies should present a true and far view of state affairs of the enterprise as at the Balance Sheet date and of the Profit and Loss for the period ended on that date.

## 1.2.4 Accounting Standard 2- Valuation of Inventories:-

AS- 2 deals with the determination of the value at which inventories are carried to the financial statements until the related revenues are recognized.

(1) Valuation of work in progress arising under construction contracts.

(2) Work in progress arising in the ordinary course of business

of service provides.

(3) Shares, debentures and other financial instruments held as stock in trade.

(4) Produces inventories of the livestock, agricultural and forest products and mineral oils, ores and gases to the extent that they are measure d at ne t re al izabl e v alue i n acco rdance w i th w i l l e stabli she d p racti ce s in those industries are not covered by this standard.

According to As-2 invertories are Assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

AS-2 states that the inventories should be valued at the lower of cost and net realizable value. Cost of inventories has been by As-2 as follows:-

"The cost of Inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories in their present location and condition."

For ascertaining the Cost of Inventories, the fall costs are not to be included :-

(a) Abnormal amount of waste materials, labour and other production costs

(b) Storage costs, unless those costs are necessary in the production process prior to a further production stage

(c) Administrative overheads which do not contribute to bringing the inventories to their present location and condition; and

(d) Selling and distribution costs;

The cost of inventory should be assigned by using the first- in and first- out (FIFO) or weighted average cost formula. An exception to this formula is the cost of inventories that are ordinarily interchangeable and goods or services produced and segregated for specific projects . The cost of such items should be assigned by specific identification of their individual costs

## 1.2.5 AS-3 Cash Flow Statements:-

As per AS-3 on enterprise should prepare a Cash Flow Statement and should present it for each period for which financial statements are presented because users of an enterprise financial statements are interested to know how the enterprise generates and uses cash and cash equivlents. According to this standard Cash Flow statement should report cash flows during the period from period, investing and financial activities. Some of items used in As-3 have been defined as follows:

Cash comprises cash on hand and demand deposits with banks; Cashequivalents are short term, highly liquid investments that are readilyconvertible into know amounts of cash and which are subject to an insignificant risk of changes in value Cash flows are inflows and outflows of cash and cash equivalents.

Operating Activities: are the principal revenue operating activities of the enterprise and other activities that are not investing or financial activities.

Investing Activities : are the acquisition and disposal of long term assets and other investments not included in the cash equivalents

Financing Activities: are activities that result in changes in the size and composition of the owners capital ( including preference space capital in case of company) and borrowings of enterprise.

### 1.2.6 AS-4 Contingencies and events occurring after the balance sheet date:

AS-4 deals with the treatment in financial statements of contingencies and events occuring after the Balance Sheet date. The following subjects, which may result in contingencies are excluded from the scope of this standard on account of special considerations applicable to them :

(a) Liabilities of life insurance and general insurance enterprises arising from policies issued

(b) Obligations under retirement benefit plans ; and

(c) Commitments arising from long term lease contracts.

In case of disclosure of contingencies , the following information should be provided in the financial statements:

(a) The nature of contingency

(b) The uncertanties which may effect the future outcome ; and

(c) The estimate of financial effect, or a statement that such an estimate cannot be made

### 1.2.7 AS-5 Net Profit or Loss for the period, prior period items and changes in Accounting Policies:-

The objective of AS– 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis for enhancing comparability of financial statements of an enterprise over time and with financial statements of other enterprises. This standard deals with the disclosure of profit or loss of other ordinary activities, extraordinary items and prior period items in statement of profit/ loss accounting for changes in accounting estimates and disclosure of changes in accounting policies.

As-5 defines ordinary activities as those activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprises engage in furtherance of, incidental to, or arising from, these activities.

### 1.2.8 AS 6— Depreciation Accounting :

AS-6 deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply :-

1. Forests, plantations and similar regenerative natural resources
2. wasting assets
3. Expenditure on research and developments
4. Goodwill
5. Livestock

Different accounting policies for depreciation are adopted by different enterprises. Disclosure of accounting policies for depreciation followed is necessary for appreciating the view presented in the financial statements of enterprise.

The amount of depreciation to be charged in an accounting period is usually based on following three factors :

a) Historical cost or other amount substituted for the historical cost of depreciable asset when the asset has been revalued.

b) Expected useful life of Asset.

c) Estimated residual value of depreciable asset.

### 1.2.9 Accounting Standard 7 (Revised)—Construction Contracts :

This revised standard comes into effect on or after 1.4.2002. It deals with the accounting for construction contracts in the f inancial statements of contracts. One of the main problem in this accounting is allocation of revenues and related costs to accounting period.

In accounting for construction contract in financial statements, either the % of completion method on the completed contract method may be used. When a contractor uses a particular method of accounting for a contract, then the same method should be followed for all other contracts which meet similar criteria.

As per this standard profit in case of fixed price contracts normally should not be recognized unless the work of contact has progressed to a reasonable extent while recognising the profit under % of completion method, an appropriate allowance for further unforeseeable factors should be made on either a specific or a % age basis.

**1.2.10 Accounting Standard 8—Accounting for Research and Development :-** This Accounting Standard deals with the financial statements of research and development. As per this standard following costs are included :

1) Salaries, wages and other related costs of personnel engaged in research development.
2) Cost of material and services consumed.
3) Depreciation of building, equipment and other facilities used in research and development.
4) An appropriate anortisation of cost of building, equipment and facilities which have no alternative economic use.
5) Overhead cost.
6) Payment to outsider
7) Other costs like amortisation of patents and licences.

### 1.2.11Accounting Standard —9— Revenue Recognition :

AS 9 deals with bases for recognition of revenue in the statement of profit and loss of an enterprise. The standard is concerned with the recognition of revenue arising in the course of ordinary activities of an enterprise from sale of goods, the rendering of the services and use by others of enterprise resources yielding interest royalties and dividends .This standard does not deal with followings:-

(i) Revenue recognition from construction contracts.

(ii) Revenue arising from line purchase and lease agreements.

(iii) Revenue arising from government grants and other similar subsidies.

(iv) Revenue of insurance companies arising from insurance contracts.

### 1.2.12Accounting Standard 10—Accounting for Fixed Assets :-

AS 10 deals with accounting for fixed assets such as land, buildings, plants and machinery ,vehicles, furniture, fittings, goodwilll, patents, trade marks, and designs. The gross book value of a fixed asset should be either historocal cost or revaluation computed in accordance with this standard. The cost of a fixed asset should include its purchase price and any attributable costs of bringing the assets to its working conditions for its intended use. Subsequent expenditures related to an item of fixed assets should be added to its book value only if they increase the future benefits from the existing asset. It should eliminate from financial statement an disposal or when no further profits is expected from its use and disposal Loss an such transaction should be transferred to P & L A/c.

As per AS 10 following information must be disclosed in financial statements:

(1) Show gross and net book value of beginning and end showing additions, disposal and other movements.

(2) Expenditure incurred on account of fixed asset in the course of construction or acquisition

(3) Revalued amount substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the year of any appraisal made, whether an external value was involved in case where fixed assets are stated at revalued amount.

1.2.13 Accounting Standard-11(Revised 2003). The effect of changes in Foreign Exchange Rates :

(i) in accounting for transactions in foreign currencies.

(ii) in translating the financial statements of foreign operations.

This standard does not deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest cost covered in AS-16, Borrowing costs. As pe this standard, a transaction in foreign currency should be recorded, an initial recognition in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency prevailing at the date of the transaction. Exchange rate is the ratio for exchange of two currencies :

At each Balance Sheet Date:-

(a) Foreign currency monetary items should be reported using the closing rate.

(b) Non-monetary items which are carried in terms of historical cost determined in a foreign currency should be reported using the exchange rate at the rate of the transaction.

(c) Non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rate that existed when the values were determined.

1.2.14 Accounting Standard —12 Accounting for Government Grants:- AS 12 deals with accounting for government grants such as subsidies, cash incentives, duty drawbacks etc., and has come into force w.e.f.
1.4.92. According to this standard government grants should not be recognized until there is reasonable assurance that the enterprise will comply with the conditions attached to them and grant will be received.

Government grants related to specific fixed asset should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their books value. Governments grants related to revenue should be recognized on a systematic basis in the profit and loss statement. Such grants should either be shown separately under ' other incomes' as deducted in reporting the related expenses.

1.2.15 Accounting Standard—13 – Accounting for Investments

According to AS-13, an enterprise should disclose current investment and long-term investments distinctly in its financial statements. The cost of an investment should include acquisition changes such as brokerage, fees and duties. An enterprise holding investments properties should treat them as long term investments. Current investments should be carried in the financial statements at the lower of cost and fair value determined on an individual investment basis or by category of investment, but not on overall basis. Long term investment should be carried in the financial statements at cost. On sale of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to profit and loss statements.

### 1.2.16 Accounting Standard 14— Accounting for Amalgamation

According to this standard, an amalgamation may be either an amalgamation in the nature of merger an amalgamation in the nature of purchase. An amalgamation is considered to be an amalgamation in the nature of merger when all the following conditions are satisfied :

(i) All assets and liabilities of the transfer or company became after amalgamation the assets and liabilities of the transfer company.

(ii) Shareholders holding not less than 90% of the face value of theequityshares of the transferee company because equity shareholder of the transferee company by virtue of the amalgamation.

(iii) The consideration for amalgamation by those equity shareholders of the transferor company who agree to became equity shareholder of the transferee company is discharged by the transferee company wholly by the issue of equity share in the transferee company, except the cash may be paid in respect of any transactioned share.

(iv) After amalgamation business is carried on by transferee company.

(v) No adjustment is intended to be made to the book value of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transfe re e co mp any e xcept t o e nsure uni formity of accounting policies.

### 1.2.17 Accounting Standard 15— Accounting for Retirement Benefits in the Financial Statement of Employees :-

This standard comes into force from 1.4.95. According to standard retirement benefits usually include provident fund, pension, gratuity, leave encashment, post retirement health, and welfare scheme and other retirement benefits. The contributions made by the employee in these schemes should be charged to Profit and Loss Account. Financial statement should disclose the method by which cost of retirement benefits for the period have been determined. If cost related to gratuity and other benefits are based on a valuation acturial valuation, the financial statements should disclose whether the valuation was made at the end of the period or at an earlier date.

### 1.2.18 Accounting Standard—16— Borrowing Costs :-

This standard covers the borrowing costs for borrowing funds for the qualifying assets i.e. assets that necessarily take a distributed period of time to get ready for their intended use or sale. Borrowing cost that are directly attributed to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be ascertained by applying a capitalization rate to the expenditure on that asset.

Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted. Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete when the construction of a qualifying assets is completed in parts and a completed part is capable of being used while constructed continues for other parts. The financial statements should disclose :

(a) the accounting policy adopted for borrowing cost ; and

(b) the amount of borrowing costs capitalized during the period.

I Self check exercise
a) describe AS 3
b) describe AS 15
c) describe AS 10
d) describe AS 7

### 1.2.19 Accounting Standard 17— Segment Reporting :-

This standard comes into effect w.e.f. 1.4.2001 and is mandatory in nature. The objective of this standard is to establish principles for reporting financial information about the different types of products and services an enterprise produces and the different geographical areas in which it operates. According to this standard, a business segment or geographical segment should be identified as reportable segment if :

(a) its revenue from sales to external customers and from transaction with other segments is 10% or more of total revenue, external or internal of all segments;

(b) its segments result, whether profit or loss is 10% or more of the combined result of all segments in profit or the combined result of all segments in loss, whichever is greater in absolute amount; or

(c) its segment assets are 10% or more of the total assets of all segments.

### 1.2.20 Standard 18— Related Party Disclosures :-

This standard comes into effect on or after 1.4.2001 and the objective of this standard is to establish requirements for disclosure of related party relationships and transactions between reporting enterprise and its related parties. Related party include holding companies, subsidiaries, follow subsidiaries, associates and joint ventures, key management personnel and relatives of such personnel and individual having substantial voting power of the reporting enterprise. According to this standard if there have been transactions between related parties during the existence of a related party relationship, the reporting enterprise should disclose the following:

(a) Name of transaction with related party.

(b) A description of relationship between the parties.

(c) A description of the nature of transaction.

(d) Volume of the transaction.

(e) Any other elements of related party transaction.

(f) Amount or appropriate properties of outstanding items pertaining to related parties at the balance sheet.

(g) Amount written off or written back in the period in respect of debts due from or to related parties.

### 1.2.21 Accounting Standard-19—Leases

This standard commences on or after 1.4.2001 and is mandatory in nature. The objective of this standard is to prescribe, for leasees or leasers, the appropriate accounting policies and disclosures in relation to finance leases and operating leases. A finance leaser is a lease that transfers substantially all the risks and rewards incident to ownership of asset. A lease other than a finance lease is an operating lease. Lease payments should be apportioned between the financial charge and the reduction of the outstanding liability, Accounting to this standard the finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

### 1.2.22 Accounting Standard 20—Earning per Share :

This standard is applicable on or after 1.4.2001. It is applicable to enterprise whose equity share or potential equity shares are listed to a recognized stock exchange in India. According to this standard, an enterprise should present basic and diluted earning per share, even if the amounts disclosed are negative (a loss per share). Basic earning per share should be calculated by dividing the net profit or loss for the period pertaining to equity shareholders by the weighted number of equity share outstanding during the period. For the purpose of calculating diluted earning per share, the net profit or loss attributably to equity shareholders and the weighted number of shares outstanding during the period should be adjusted for the effects of all diluted potential equity share.

1.2.23 Accounting Standard—21— Consolidated Financial Statements : This accounting standard come in effect 1.4.2001. The objective of this standard is to lay down principles and procedures for preparation and
presentation of consolidated financial statement.

For preparing consolidated financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like item of assets, liabilities, income and expenses. To see that the consolidated financial statement present financial information about the group as that of a single enterprise, the following steps should be taken :

(a) The cost to the parent (i.e. holding company) of its investment in each subsidiary and the parent's portion of equity of each subsidiary should be eliminated.

(b) Any excess of cost to the parent of its investment in a subsidiary over the period.

1.2.24 Accounting Standard —22— Accounting for Taxes on Income : The AS comes into effect on and after 1.4.2001.
According to this standard, accounting income/loss is the net profit or loss for a period,
as reported on the statement of profit or loss, before deducting income tax expenses or adding income tax saving. Expenses or saving related to taxes on income in respect of an accounting period should be determined and such an amount should be disclosed in the financial statement. According to this standard tax expense for the period, comprising current tax and deferred tax should be included in the determination of net Profit/Loss for the period. Deferred tax should be recognized for all the timing differences subject to the consideration of prudence in respect of defended tax assets. Current tax is the amount of income tax determined to be payable or recoverable in respect of the taxable income as tax loss for a period using the applicable tax rates and tax laws.

### 1.2.25 Accounting Standard 23 — Accounting for investmens in Association in Consolidated Financial Statements:

This standard came into effect on or after 1.4.2001. An enterprise that presented consolidated financial statement should account for investments in associates in the consolidated financial statement in accordance with this standard. An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. significant influence mean power to participate in the financial and operating policy decision of investor.

An investment in an associate should be accounted for in consolidated financial statements under the equity method except

(a) The investment is acquired and held exclusively with a view its subsequent disposal in near future.

(b) The associate operate under several long term restrictions that significantly unpair its ability to transfer funds to the investor.

Goodwill/capital reserve should be shown as investment but should not disclosed separately. Unrealized profit and losses resulting from transactions between the investor and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealized losses should not be eliminated if and to the extent the loss of the transferred assets can't be recovered.

### 1.2.26 Accounting Standard 24—Discontinuing operations :

This standard is applicable to all discounted operations of an enterprises and the requirements pertaining to cash flow statement contained in this statement are applicable where an enterprise prepares and presents a cash flow statement. Following information will be provided in this relations-:

(a) a description of the discontinuing operations.

(b) the business or geographical segment.

(c) the date and nature of initial disclosure event.

(d) the date and period in which the discontinuing is expected to be completed if known a determinable.

(e) the carrying amount of the total assets to dispersed and total liabilities to be settled.

(f) the amount of revenue and expenses.

(g) the amount of pre-tax profit and loss from aiding activities

(h) the amount of net cash flows attributably to operating, and financial activities of the discontinuing operation during the asset financial report period.

### 1.2.27 Accounting Standard—25— Interim Financial Reporting

This standard commencing on or after 1.4.2001. Timely and reliable financial reporting enhances the ability of investor, creditors, bankers and others to understand an enterprise's capacity to generate earning and cash flows, its financial portion & l liquidity. In case of new enterprise financial reporting containing either a complete set of financial reporting containing either a complete set of financial statement. This may shorter than a financial year and that shorter period is not to be taken as interim report.

An enterprise should include the following information as a minimum, in the notes to its interim financial statements :

(a) A statement that the same accounting policies are followed in the preparation of interim financial statements as were followed in the most recent annual financial statements. If the accounting policies have been changed, a description of the nature and effect of change should also be stated.

(b) Explanatory comments about the reasonality of interim operations.

(c) The nature and amount of items affecting asset, liabilities, equity, net income or cash flows that are increase because of their nature, size or incidences.

(d) The nature and amount of changes in estimates of amounts reported in prior interim periods.

(e) Insurance, buy-backs, repayments and restructuring of debts, equity and potential equity shares.

(f) Dividend, aggregate or per share separately for equity shares and other shares.

(g) Segment revenue, segment capital employed and segment results.

(h) Material changes in contingent liabilities since the last annual Balance Sheet date.

### 1.2.28 Accounting Standard 26— Intangible Assets :-

AS 26 defines an intangible asset as "an identifiable" non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purpose." According to this standard an intangible asset should be recognized only if :

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise ; and

(b) the cost of the asset can be measured reliably. An intangible asset should be measured initially at cost and internally generated goodwill should not be recognized as an asset. Intangible asset arising from re search should not be recognized. Expenditure on search should be recognized as an expense when it is incurred. Internally generated brands, publishing titles, customers lists and items similar in substance should not be recognized as intangible asset.

### 1.2.29 Accounting Standard 27— Financial Reporting of Interest in Joint Ventures :

AS-27 comes into effect on or after 1.4.2002. The definitions of some terms as per the standard are as follows :-

A joint venture is a contractual agreement between two or more parties.

A venture is a party who has control over joint venture.

An investor who is a party but does not have any control over joint venture.

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entry is reported as separate line items in the venturer's financial statements.

### 1.2.30 Accounting Standard 28— Impairment of Assets

This standard comes into effect on or after 1.4.2004. The financial statements should disclose :-

(a) the amount of impairment losses recognized in the statement of Profit and Loss during the period and the line items of the statement of Profit and Loss in which these impairment losses are included.

(b) The mount of reversal of impairment losses recognized in the statement of Profit and Loss during the period and the line of the statement of Profit and Loss in which these impairment losses are reversed.

(c) the amount of impairment losses recognized directly against revaluating surplus during the period ; and

(d) the amount of reversals of impairment of losses recognized directly in revaluation surplus during the period.

### 1.2.31 Accounting Standard 29— Provisions, Contingent Liabilities and Contingent Assets :

This standard is issued with effect from 1-4-2004 and is mandatory in nature. The objective of this statement is to ensure that appropriate recognition criterion and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statement to enable users to understand their nature, timing and amount. The aim of this statement is also to lay down appropriate accounting for contingent assets.

### 1.2.32 Accounting Standard 30— Financial Instruments : Recognition and Measurement :

This standard comes into effect in respect of accounting periods commencing on or after 1-4-2009 and is recommendatory in nature for an initial period of two years. This accounting standard will become mandatory in respect of accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entities except to a Small and Medium sized entity. The objective of this standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in Accounting Standard (AS-31).

### 1.2.33 Accounting Standard 31— Financial Instruments : Presentation

This standard comes into effect in respect of accounting period commencing or after 1-4-2009 and is recommendatory in nature for an initial period of two years. This accounting standard will become mandatory in respect of accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entities except to a small and medium sized entity. The objective of this standard is to establish principles for presenting financial instruments as liability or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issues, into financial assets, financial liabilities and equity instruments, the classification of related interest, dividends, losses and gains and the circumstances in which financial assets and financial liabilities should be offset.

1.2.34 Accounting Standard 32— Financial Instruments : Disclosures This standard comes into effect in respect of accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This accounting standard will become mandatory in respect of accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entitites except to a small and medium sized entity. The objective of this standard is to require entities to provide disclosures in their financial statements that enable use rs to evaluate : ( a) the significance of financial instruments for the entity's financial position and performance and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date and how the entity manages those risks.

II self check exercise

a) describe AS 20
b) describe as 25
c) Describe AS 30
d) describe AS 32

1.2.35 SUMMARY
After going through this chapter, we have learnt about meaning of accounting standards. In this chapter accounting standards from AS1 to AS 32 are explained. Accounting treatments according to various standards are explained in detail in this chapter. There are 32 accounting standards explained in this chapter.

1.2.36 Glossary
AS2= valuation of inventory
AS3= cash flow statement
AS6=depreciation accounting
AS10 = accounting for fixed assets

1.2.37 Answers to self check exercise
I a) see para 1.2.5
b) see para 1.2.17
c) see para 1.2.12
d) see para 1.2.9

II a) see para 1.2.22
b) see para 1.2.27
c) see para 1.2.32
d) see para 1.2.34

1.2.38 Exercise

Short questions

Q.1 describe AS 1
Q.2 Describe AS 7
Q.3 Describe AS 17
Q.4 what is to AS 22 is related?

Long questions

Q.1 explain various accounting standards issued by institute of chartered accountants of India.
Q.2 explain provisions of AS 2 related to valuation of inventory.

1.2.39 Suggested readings

1. Basic Accounting
by : S.P. Jain
K.L. Narang
Kalyani Publishers
2. Financial Accounting
by : Juneja
R.C. Chawla
K.K. Sexena
Kalyani Publishers
3. Financial Accounting
by : Dr. S.M. Shukla
Dr. S.P. Gupta

# BOOK OF ORIGINAL ENTRY : JOURNAL



## 1.3.0 OBJECTIVES

Journal is the first book of original entry in which all transactions are recorded eventwise and date-wise. This book may be divided into sub-journals also. The main objective of this lesson is to introduce the students with this step of Accounting process i.e. Recording of transactions in Journal.

## 1.3.1 INTRODUCTION

The word journal comes from the French word ‘Jour’ which means a day'. In accounting process the journal is considered as a form of diary for business transactions. So, journal is a book of original entry written up from the various source documents.

Definitions :

1. Journal : "Journal is a book, employed to classify, or sort out transactions in a form convenient for their subsequent entry in the ledger."
2. Journal Entry : "Journal entry means recording the business transactions in the Journal."
3. Journalising : 'Journalising' is the process of recording the journal entries in the journal. It is a systematic act of entering the transactions in a day book in the order of their occurrence."
4. Narration : "Narration is the short explanation of an entry."
5. Voucher : "Any documentary support of financial transaction is known as voucher."

### 1.3.2 SOURCE DOCUMENTS

The printed documents that business use in the process of completing transactions are called business papers or source documents. These documents are the starting point in the accounting process and foundation of all accounting records. All business transactions should be evidenced by documentary evidences. The common documents that are generally uses are as under :

1. Cash memo
2. Invoice
3. Sales slips
4. Receipts
5. Debit and Credit notes
6. Pay - in - slips
7. Counterfoils of cheques
8. Agreements
9. Purchase orders
10. Bank statements
11. Salary and wage sheets
12. Bills payables and receivables

### 1.3.3 DOUBLE ENTRY SYSTEM OF BOOK KEEPING

This system owes its origin to an Italian merchant names Luco Paceoli who wrote the first book entitled 'De Computis et Scrituris' on double entry system of accounting in 1494. We have seen that every business has two aspects i.e. when we receive something we give something in return, which is known by dual aspect expressed by a debit amount and an equal and offsetting credit amount. For example, when we purchase goods for cash, we receive goods and give cash in return. Similarly, in the credit sale of goods, goods are given to the customer and the customer becomes debtor for the amount of goods sold to him. This method of writing every transaction in two accounts is known as Double Entry System of Accounting. Of the two accounts one account is debited while the other is credited with an equal amount. So the total of credit and debits is always equal.

### Advantages of Double Entry System

The following are the main advantages which can be derived from the use of this system:

1. It provides complete record of business transactions.
2. It provides a check on the arithmetical accuracy of the books of account as the total of debit entries must be equal to the total of credit entries.
3. The amount owing to outsiders and the amount due to the business can be ascertained with the help of personal accounts.
4. The Profit and Loss account can be prepared with the help of nominal accounts which is helpful to the business to ascertain the operating results of the business.
5. It helps to prepare balance sheet of the business which is helpful to ascertain the financial position of the business.
6. It helps to reduce the occurrence of errors and frauds and when occurred can be easily detected.

### Disadvantages of Double Entry System

The following are disadvantages of the Double Entry System :

1. This system requires the maintenance of a number of books of accounts which is not practical in small concerns.
2. The system is costly because a large number of records are to be maintained.
3. There is no guarantee of absolute accuracy of books of account inspite of agreement of trial balance.

## 1.3.4 JOURNAL

The first principle of Double entry is that every transaction before being posted or classified in the ledger must be subject of an originating in the book of prime or original entry. "Journal" is one of the "Books or original entry" such books are also known as subsidiary books. The use of journal is restricted for recording special entries like opening, closing, transfer, rectification and those entries which are not covered by other subsidiary books maintained by the business.

Recording of the entries in "Journal" is known as "Journalising" or passing 'journal entries':

Journal

| Date | | Particulars | L.F. | Dr. Amount Rs. | Cr. Amount Rs. |
|---|---|---|---|---|---|
| Year Month | Date | Name of the account........ Dr.<br>to be debited<br>To Name of the account to<br>be credited (Narration) | | | |

Column 1 (Date) : The date of the transaction which it takes place is written in this column. The year is written only in the first entry appearing on each page. This column is divided into two parts the first part is used for writing the month and the second part is used for writing the date.

Column 2 (Particulars) : In this column, the name of the account to be debited is written first. In the next line the account to be credited is written preceded by the word 'To' leaving a few spaces away from the line where column starts. An explanation of the entry known as "Narration" is also recorded in this columns below the line giving credit to the account.

Column 3 (L.F.) : L.F. stands for ledge folio which means page of the ledger. In this column the page numbers are entered on which various accounts appear in the ledger.

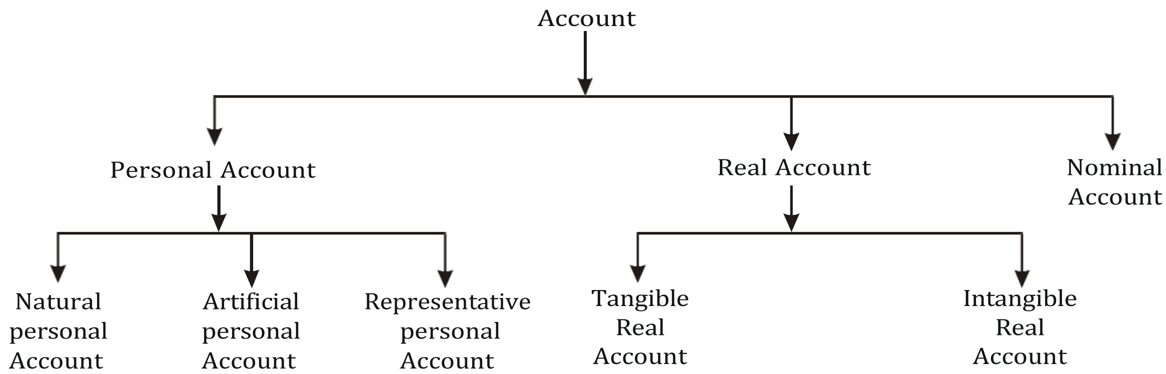
Column 4 (Dr. Amount) : In this column, the amount to be debited against the debit account is written along with the nature of currency.

## 1.3.5 CLASSIFICATION OF ACCOUNTS

As we earlier discussed, for each transaction, a separate entry is recorded. Before recording the transactions is analysed to determine which accounts are involved and which is to be debited and which is to be credited. To do this analysis accounting system first needs to classify the accounts. There are two approaches of classification of accounts.

1. Traditional Approach
2. Modern Approach

23.5.1 Traditional Approach : Traditional approach based classification of Account is done as shown under :




1. Personal Accounts :

   Account which are related with accounts of individuals, firms, Companies are known as personal accounts. The personal accounts may further be classified into three categories.

(i) Natural Personal Accounts

   Accounts of individuals relating to natural person such as Akhil's A/c Rajesh's A.c, Sohan's A/c are natural personal accounts.

(ii) Artificial Personal Accounts

   Accounts of Companies, institutions such as Reliance industries Ltd; Lions club, M/s Sham & Sons, National College account are artificial personal accounts.

(iii) Representative Personal Accounts

   The accounts which represent some person such as "wage outstanding account, prepaid insurance account, accrued interest account are considered as representative personal accounts.

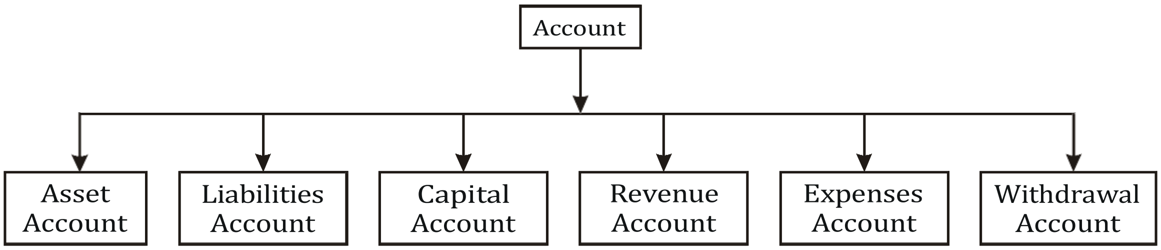
2. Real Accounts

Real accounts are the accounts related to assets. These may be classified into tangible real account and intangible real account. The accounts relating to tangible assets such as building, plant, machinery, cash, furniture etc. are classified as tangible real accounts. Intangible real accounts are the accounts related to intangible assets such as goodwill, trademarks, copyrights and franchises.

3. Nominal Accounts

The accounts relating to income, expenses, losses and gains are classified as nominal accounts. For example wages account, Rent account, Interest Account, Salary Account, bad debts accounts etc.

3.5.2 Modern Approach : Modern approach based classification of account is done as shown under:




Rules for Debit and Credit

| S.No. | Types of Account | Account to be Debited | Account to be Credited |
|---|---|---|---|
| 1. | Assets Accounts | Increase ↑ | Decrease ↓ |
| 2. | Liabilities | Decrease ↓ | Increase ↑ |
| 3. | Capital Account | Decrease ↓ | Increase ↑ |
| 4. | Revenue Account | Decrease ↓ | Increase ↑ |
| 5. | Expenses Account | Increase ↑ | Decrease ↓ |
| 6. | Withdrawal Account | Increase ↑ | Decrease ↓ |

### 1.3.6 RULES FOR DEBIT AND CREDIT

Following are the rules for debit and credit when the accounts are classified as Personal, Real and Nominal Accounts.

Rules of Double Entry:

| | | |
|---|---|---|
| Personal Account | : | Debit the receiver |
| | | Credit the giver |
| Real Account | : | Debit What Comes in |
| | | Credit what goes out |
| Nominal Account | : | Debit Expenses and Losses |
| | | Credit Incomes and gains |

SELF CHECK EXERCISE

Ques. 1. From the following transactions, state the nature of accounts and state which account will be debited and which will be credited.

1. Anthony started business with Rs. 50,000
2. Purchased goods for cash Rs. 10,000.

3. Sold goods for cash Rs. 15,000.
4. Purchased goods from X for cash Rs. 5,000.
5. Sold goods to Bonnie for Rs. 6,000.
6. Purchased furniture for Rs. 4,000.
7. Purchased Plant and Machinery for Rs. 10,000.
8. Paid wages Rs. 400.

Ques. 2. Mention the rules of Double Entry system of book keeping.

### 1.3.7 STEPS IN JOURNALISING

The process of journalising is a thinking process. After analysing the business transactions, the following steps in Journalising are followed:

i) Find out what accounts are involved in business transaction.
ii) Ascertain what is the nature of accounts involved.
iii) Ascertain the golden rule of debit and credit is applicable for each of the accounts involved.
iv) Find out what account is to be debited which is to be credited.
v) Recorded the date of transaction in the "Date Columns".
vi) Write the name of the account to be debited very near to the left hand side in the particulars column along with the word 'Dr' on the same line against the name of the account in the particulars column and the amount to be debited in the 'Debit Amount column' against the name of the account.
vii) Record the name of the account to be credited in the next line preceded by the word 'To' at a few space towards right in the 'Particulars Column' and the amount to be credited in the 'Credit Amount Column' in front of the name of the account.
viii) Record narration (i.e. a brief explanation of the transaction) within brackets in the following line in 'Particulars column'.
ix) A thin line is drawn all through the particulars column to separate one Journal entry from the other and it shows that the entry of a transaction has been completed.

### 1.3.8 ILLUSTRATION-I

Journalise the following transitions in the book of Aminoor creations:

1. Machinery purchased from HMT ltd for Rs. 10,000 on credit.
2. Depreciate the machinery (mentioned above) at 10% per annum for full year.
3. Amount due from Chand Ji Rs. 1000 is irrecoverable as he is untraceable.

4. Received Rs. 1000 from Triloki Nath in full settlement against the amount due from him Rs. 1050.
5. Paid Rs. 960 to Darbara Singh in full settlement against amount due to him Rs. 1000.
6. Sarkar who owed us Rs. 1000 is declared insolvent, and Rs. 60 paise in the rupees is received as final dividend from his estate.
7. Exchanged old furniture for new, the value of old furniture was Rs. 500 while the value of new furniture was Rs. 12000 balance paid in cash.
8. Withdrew goods from the business costing Rs. 200 for the personal use by the proprietor.
9. Chand Ji remitted Rs. 400 against the amount already written as bed debt.
10. Supplied goods cost Rs. 2000 to Mahesh. Issued invoice at 10% above cost less 5% trade Discount.
11. Sold goods to Ram Manohar list price Rs. 1000 trade discount 10% cash discount 5%. He issued cheque on the same day and availed the cash discount.

Solution :

| Sr. No. | Particulars | L.F. | Debit amount | Credit amount |
|---|---|---|---|---|
| | | | Rs. | Rs. |
| 1 | Machinery A/c ...Dr. | | 10,000 | |
| | To H.M.T. Ltd. | | | 10,000 |
| | (Purchased machinery on credit) | | | |
| 2. | Depreciation A/c ...Dr. | | 1,000 | |
| | To Machinery A/c | | | 1,000 |
| | (Being the depreciation on machinery charged @ 10%) | | | |
| 3. | Bad Debts A/c ...Dr. | | 1,000 | |
| | To Chand Ji A/c | | | 1,000 |
| | (Being the amount irrecoverable hence bad debts) | | | |

| | | | | |
|---|---|---|---|---|
| 4. | Cash A/c ..............................Dr.<br>Discount Allowed A/c............Dr.<br>To Tarloki Nath<br>(Being amount received and discount allowed to Triloki Nath) | | 1,000<br>50 | <br><br>1,050 |
| 5. | Darbara Singh A/c ............ Dr.<br>To cash A/c<br>To Discount Received A/c<br>(Being the amount paid to and discount received from Darbara S.) | | 1,000 | <br>960<br>40 |
| 6. | Cash A/c ...Dr.<br>Bad Debts A/c ...Dr.<br>To Sarkar A/c<br>(Being the amount recovered @ 60P. per rupees and the balance written off as bad debts. | | 600<br>400 | <br><br>1,000 |
| 7. | Furniture A/c ...Dr.<br>To cash A/c<br>(Cash paid for the exchange of furniture is Rs. 1200-500=700 | | 700 | <br>700 |
| 8. | Drawing A/c ...Dr.<br>To purchase A/c<br>(Goods withdrawn at cost price for personal use) | | 200 | <br>200 |
| 9. | Cash A/c ...Dr.<br>To Bad Debts Recovered A/c<br>(Received the amount against bad debts) | | 400 | <br>400 |
| 10. | Mahesh A/c ...Dr.<br>To Sales A/c<br>(Sales of goods costing 2000 add 10% deduct 5% from 2200 i.e. Rs. 110) | | 2,090 | <br>2,090 |
| 11. | Bank A/c ...Dr.<br>Discount Allowed A/c<br>To Sales A/c<br>(Sales of list price Rs. 1000 less trade discount 10%) | | 855<br>45 | <br><br>900 |

## 1.3.9 Illustration - II

## ILLUSTRATION - II

Journalise the transactions in the book of the trader : April, 2009

| | | |
|---|---|---|
| Debit Balances | : | Cash in hand Rs. 8000, Cash at bank Rs. 25,600, Stock of goods Rs. 20,000, Furniture Rs. 4,000 and Building Rs. 10,000. |
| Debtors | : | Vijay Rs. 2,700, Anil Rs. 1,500, Ashwani Rs. 2000, Anupam Rs. 1800 and Madhu Rs. 100. |
| Creditors | : | Anand Rs. 5,400, Arya and Co. Rs. 7,700, Balwant Rai Rs. 5,200 Mrs. Loan Rs. 10,000.2009 |

Apr. 1. Purchased goods worth Rs. 5000 less 20% trade discount and 5% cash discount.

Apr. 3. Rs. 2626 received from Vijay and allowed him discount and 5% cash discount.

Apr. 5. Bought 100 shares in Bharat Ltd. @ Rs. 15 per share, brokerage paid Rs. 30.

Apr. 8. Goods worth Rs. 500 were damaged in transit, a claim was made on railway authorities for the same.

Apr. 10. Cash Rs. 5292 paid to Anand and Discount allowed by him Rs. 108.

Apr. 13. Received cash from the railway in full settlement of claim for damages in transit.

Apr. 15. Anupam is declared insolvent and a dividend of 50 paise in the rupee is received from him in full settlement.

Apr. 18. Sold 40 shares of Bharat Ltd. @ Rs. 18 per share, brokerage paid Rs. 15.

Apr. 20. Bought a horse for Rs. 2000 and a carriage for Rs. 1000 for delivering goods to customers.

| | | | |
|---|---|---|---|
| Apr. 22. | Paid for : | Charity | Rs. 101 |
| | | Postage | Rs. 200 |
| | | Stationery | Rs. 199 |

Apr. 30 One month's interest on Mrs. Loan @ 12% P.A. become due but could not be paid.

Apr. 30 The horse bought on Jan. 20 died its carcass was sold for Rs. 50.

Apr. 30. 'Received from travelling salesman Rs. 3000 for goods sold by him after deducting his travelling expenses Rs. 150.

| | | | |
|---|---|---|---|
| Apr. 30. | Paid for : | Salaries | Rs. 3500 |
| | | Rent | Rs. 1500 |

Apr. 30. Sold goods worth Rs. 10,000 less 10% trade discount.

Solution:

| Date | Particulars | L.F. | Debit amount | Credit amount |
|---|---|---|---|---|
| 2009 | | | | |
| Apr. 1 | | | | |
| | Cash Account ... Dr. | | 8,000 | |
| | Bank Account ... Dr. | | 25,600 | |
| | Stock Account ... Dr. | | 20,000 | |
| | Furniture Account ... Dr. | | 4,000 | |
| | Building Account ... Dr. | | 10,000 | |
| | Vijay A/c ... Dr. | | 2,700 | |
| | Anil A/c ... Dr. | | 1,500 | |
| | Ashwani A/c ... Dr. | | 2,000 | |
| | Anupam A/c ... Dr. | | 1,800 | |
| | Madhu A/c ... Dr. | | 100 | |
| | To Anan A/c | | | 5,400 |
| | To Aryan & Co. A/c | | | 7,700 |
| | To Balwant Rai A/c | | | 5,200 |
| | To Mrs. Loan A/c | | | 10,000 |
| | To Capital Account | | | 47,400 |
| | (Being balances bought in from last year) | | | |
| Apr. 1 | Purchase Account ... Dr. | | 4,000 | |
| | To cash Account | | | 3,800 |
| | To Discount Account | | | 200 |
| | (Being goods worth Rs. 5,000 purchased for cash less 20% trade and 5% cash discount) | | | |
| Apr. 3 | Cash Account ... Dr. | | 2,646 | |
| | Discount Account ... Dr. | | 54 | |
| | To Vijay a/c | | | 2700 |
| | (Being cash received from Vijay and discount allowed) | | | |

| | | | | |
|---|---|---|---|---|
| Apr. 5 | Investment in share Account ...Dr.<br>To cash Account<br>(Being purchase of 100 shares in Bharat Ltd. @ Rs. 15 per share plus brokerage Rs. 30) | | 1,530 | <br>1,530 |
| Apr. 8 | Railway claim Account ...Dr.<br>To Railway Purchases A/c<br>(Being claim sent to Railway for goods sent in transit) | | 500 | <br>500 |
| Apr. 10 | Anand A/c ...Dr.<br>To Cash Account<br>To discount Account<br>(Being cash paid to Anand and discount allowed by him) | | 5,400 | <br>5,292<br>108 |
| Apr. 13 | Cash Account ...Dr.<br>To Railway Claim A/c<br>(Being cash received in full settlement of railway claim) | | 500 | <br>500 |
| Apr. 15 | Cash Account ...Dr.<br>Bad Debts Account ...Dr.<br>To Anupam A/c<br>(Being half the dues received from Anupam and balance written off as Bad Debts) | | 900<br>900 | <br><br>1800 |
| Apr. 18 | Cash Account ...Dr.<br>To Investment in shares A/c<br>(Being 40 shares sold @ Rs. 18 per shares less broken Rs. 15) | | 750 | <br>750 |
| Apr. 20 | Livestock Account ...Dr.<br>Carriage Account ...Dr.<br>To cash Account<br>(Being horse and carriage charges bought for delivering good to customers) | | 2,000<br>1,000 | <br><br>3,000 |

| | | | | |
|---|---|---|---|---|
| Apr. 22 | Charity Account ...Dr.<br>Postage Account ...Dr.<br>Stationary Account ...Dr.<br>To Cash Account<br>(Being cash paid for charity, Postage and stationary) | | 101<br>200<br>199 | <br><br><br>500 |
| Apr. 30 | Interest Account ...Dr.<br>To Mrs. Loan Account<br>(Being interest payable on Mrs. Loan Rs. 100 @ 12% p.a. for month) | | 100 | <br>100 |
| Apr. 30 | Cash Account ...Dr.<br>Travelling Exp. A/c ...Dr.<br>To Sale Account<br>(Being Rs. 300 cash received from travelling Rs. 300 cash received from travelling salesman for sales after deducting his travelling expenses Rs. 150) | | 3000<br>150 | <br><br>3150 |
| Apr. 30 | Salaries Account ...Dr.<br>Rent Account ...Dr<br>To Cash Account<br>(Being payments of salaries & Rent) | | 3500<br>1500 | <br><br>5000 |
| Apr. 30 | Cash Account ...Dr.<br>To Sales Account<br>(Being sale of goods worth Rs. 10,000 less 10% trade discount) | | 9000 | <br>9000 |

## 1.3.10 SUMMARY

The 'Journal' or 'Daily Record' as originally used was a book of prime entry in which transactions were copied in order of date from a memorandum or waste book. The entries as they were copied, were classified into debit and credits, go as to facilitate their being correctly posted afterwards in the ledger. The rules of debits and credits are applied after classifying the accounts into personal, real and normal as per their nature. Thus, any economic transaction or event of a business which can be expressed in monetary terms should be recorded under the double entry system of accounting.

### 1.3.11 ANSWERS TO SELF CHECK QUESTIONS

Ans. 1 Analysis of Transaction
(A=L + C + Revenue-expenses)

| Transaction | Accounts Involved | Nature of Account | Debit Rs. | Credit Rs. | Reason |
|---|---|---|---|---|---|
| 1. Mr. Anthony started business with Rs. 50,000 | Cash<br>Capital | Asset<br>Liability | 50,000 | <br>50,000 | Increased<br>Increased |
| 2. Purchaed goods for cash Rs. 10,000 | Purchases<br>Cash | Expense<br>Asset | 10,000 | <br>10,000 | Increased<br>Decreased |
| 3. Sold goods for cash Rs. 15,000 | Cash<br>Sales | Asset<br>Revenue | 15,000 | <br>15,000 | Increase<br>Decreased |
| 4. Purchased goods from x for Rs. 5,000 | Purchases<br>Cash | Expenses<br>Asset | 5,000 | <br>5,000 | Increased<br>Decreased |
| 5. Sold goods to Bonnie for 6,000 | Bonnie<br>Sales | Asset<br>Revenue | 6,000 | <br>6,000 | Increased<br>Decreased |
| 6. Purchased Furniture for Rs. 4,000. | Furniture<br>Cash | Asset<br>Asset | 4,000 | <br>4,000 | Increased<br>Decreased |
| 7. Purchased Plant and Machinery for Rs. 10,000 | Plant<br>Cash | Asset<br>Asset | 10,000 | <br>10,000 | Increased<br>Decreased |
| 8. Paid wages Rs. 400 | Wages<br>Cash | Expenses<br>Asset | 400 | <br>400 | Increased<br>Decreased |

Ans.2. Rules of Debit and Credit must be applied after the classification of Account, that is:

1. Personal Account,
2. Real Account, and
3. Nominal Account.

### 1.3.12 GLOSSARY

1. Journal : A Book of original entry
2. Debit Note : A source document evidencing a debit to be raised against a party.

3. Credit Note : A source document evidencing a credit to be given to a party

4. Ledger Folio (L.F.) : The page number of the ledger where a transaction is recorded is written in this column.

5. Double entry system : Transactions having dual aspects, two accounts, one account is debited and other is credit.

## 1.3.13 EXERCISE

### (A) Short Questions:

Ques. 1. Define the term Journal.

Ques. 2. Distinguish between Journalising and Journal entry.

Ques. 3. Define the concept of Business Transactions. Also give important examples of source documents.

### (B) Long Questions:

Ques. 1. Define the term 'Account'. Discuss in detail main classes of Accounts.

Ques. 2. What do you mean by 'Journalising'. Give various steps of Journalising. Also discuss the rules of Journalising.

Ques. 3. Explain Double entry System of Book-keeping. Also mention advantages and disadvantages of double entry system.

## 1.3.14 SUGGESTED READINGS

1. Accounting and Financial Management

By : Shashi K. Gupta

R.K. Sharma

2. Basic Accounting

By : S.P. Jain

K.L. Narang

Kalyani Publishers

* * *

Lesson No. 1.4 Author: Mrs. Dalbir Kaur

# LEDGER

## Structure of the Lesson:



## 1.4.0 OBJECTIVE

The Ledger is the most important book of the accounting system in every business concern and there is no exception to it. So the main purpose of this Lesson is to introduce the students with the concept and practical use of Ledger in the accounting world.

## 1.4.1 INTRODUCTION

As discussed in the earlier Lessons, when the transactions by a business for a given period of time have been recorded in the Journal, the next thing is to classify Journal entries according to the accounts affected, that is, posting of transactions into various Leger/account.

According to L.C.Cropper, "The book in which all the transactions of a trader are recorded in a classified permanent form is called Ledger." Ledger is also called the principal book.

### 1.4.2 PERFORMA OF A LEDGER ACCOUNT

Ledger is a collection of all the three types of accounts personal, Real and Nominal. In Ledger we maintain accounts. Each account is allotted one or more pages depending upon the requirements.

Account is an accounting device used in recording and summarising the increase and decrease in money terms in a specific asset, liability, owner's equity, revenue or expenses etc.

Ledger is usually ruled in following manner as shown in its Performa.

Name of Account

Dr. Cr.

| Date | Particulars | J.F. | Rs. Amount | Date | Particulars | J.F. | Rs. Amount |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

Ledger account has a T form. There are two sides of every account, the left hand side is known as the debit side and the right hand side is known as the credit side. Each side has four columns. These are as follows.

(i) Date (ii) Particulars (iii) Journal folio and (iv) Amount

The columns are explained as under:

(i) Date columns

In this column, the date of every transaction is to be written, indicating year, month and day of each item of an account.

(ii) Particulars Column

On the debit side in this column, the entry written is prefixed by the word "To" whereas on the credit side the entries are prefixed by "By"

a) on the debit side, after the words "To" write:
Name of the credit part of the journal entry.

b) on the credit side, after the word "By", write.
Name of the debit part of the Journal entry.

(iii) Journal Entry Column

Write here the page number of the journal from where the entry is posted into the ledger to facilitate reference in future.

### (iv) Amount Column

In this column of an account, the amount is written. The amount in the debit column of the journal, on the debit side and the amount in the credit column of the journal, on the credit side.

An alternative form of the ledger account is also given as follows :

| Date | Particulars | Journal Folio | Debit | Credit Rs. | Dr. or Rs. | Balance Cr. Rs. |
|---|---|---|---|---|---|---|
| | | | | | | |

In this type of ledger account, the balance of an account is ascertained after every transaction, but in the general, the first type of ledger account i.e. T-shape account ahs been used.

### 1.4.3 SUB-DIVISION OF LEDGER

For a small businessman, it may be possible to keep all the accounts in one ledger because the number of transactions is limited. But for a large business, it will be convenient to sub-divide the ledger as given below.

#### (a) The Debtors Ledger

This part of the ledger contains the accounts of all the customers of the business to whom goods have been sold on credit, showing the goods sold, cash received and discount allow etc. From this ledger, the businessman can know immediately, what is the total amount due to the business by various customers. This is also known as the sales ledger.

#### (b) The Creditors Ledger

This is known as the purchase ledger. This section contains the accounts of the persons or firms who supply goods to the business on credit. These accounts shows goods purchased, cash paid and discount received etc. This ledger helps the businessman to know the balance due to each creditor.

### 1.4.4 ADVANTAGES OF THE LEDGER

The following are the advantages of the Ledger.

1. It can presents information about total purchases and sales as and when required.
2. The total debtors and total creditors can be known from personal accounts.

3. The ledger records every assets separately hence, it can readily give the present book value of the asset.
4. The ledger helps in preparing the profit and loss account of the business.
5. The ledger accounts help the business to know the amounts of different incomes and expenditures.
6. The ledger accounts are helpful in preparing trial balance to know the arithmetical accuracy of the accounts.
7. It is the ledger which helps the business to prepare the balance sheet to know the financial position of the business.

### 1.4.5 Procedure of Posting into the Ledger

Every journal entry involves at least two accounts, indicating the accounts to be debited and credited. As each transaction is posted in two accounts i.e. in one account on the debit side and the other account on the credit side. When an account is to be debited, we shall write on the debit side of that account, the name of the other account and the corresponding amount will also be written on the same side. When an account is to be credited, we shall write on the credit side of that account the name of the other account and the corresponding amount will also be written on the credit side. The word 'To' is always written on the debit side before the name of the account and 'By' on the credit side before the name of the account.

### 1.4.6 ILLUSTRATION-I

Journalise the following transactions in the books of Arvind and post then into ledger:

2009 April 1: Commenced business with Rs. 20,000, paid into the Bank Rs. 10,000.
April 3 Bought furniture for Rs. 900.
April 4 Bought goods from Ram Krishan for Rs. 4,000 for cash.
April 5 Sold goods for Rs. 1700.
April 7 Paid Telephone expenses Rs. 400.
April 8 Purchased goods for Rs. 1,000 from Gupta and Sons.
April 9 Paid Rs. 100 for advertisement by cheque.
April 12 Purchased a typewriter for Rs. 8,000 on credit from Yogesh.
April 12 Sold goods to Ragav for Rs. 2,900.
April 14 Withdraw Rs. 350 from bank for private use.
April 16 Sold goods to Ram for Rs. 900 for cash.
April 24 Received cash from Ragav Rs. 2,850, discount allowed Rs. 50.
April 28 Paid into the bank Rs. 2,500.
April 30 Issued a cheque for Rs. 300 in favour of landlord for rent for the month of April.
April 30 Paid salaries to staff Rs. 2,000
April 30 Issued a cheque in favour of Gupta and sons for Rs. 950 in full settlement of their account.

Journal of Arvind Mahajan

| Date | Particulars | L.F. | Rs. Dr. | Rs. Cr. |
|---|---|---|---|---|
| 2009<br>April | Cash Account Dr.<br>To Capital Account<br>(Cash brought in as capital) | | 20,000 | <br>20,000 |
| April1 | Bank Account Dr.<br>To Cash Account Dr.<br>(Cash deposited in the bank) | | 10,000 | <br>10,000 |
| April 3 | Furniture Account Dr.<br>To Cash Account<br>(Being furniture purchased) | | 900 | <br>900 |
| April 4 | Purchases Account Dr.<br>To Cash Account<br>(Being goods purchased for cash) | | 4,000 | <br>4,000 |
| April 5 | Cash Account Dr.<br>To Sales Account<br>(Being goods sold for cash) | | 1,700 | <br>1,700 |
| April 7 | Telephone Expenses Account Dr.<br>To Cash<br>(Being goods sold for cash) | | 400 | <br>400 |
| April 8 | Purchases Account Dr.<br>To Gupta & Sons<br>(Goods purchased on credit) | | 1,000 | <br>1,000 |
| April 9 | Advertisement Account Dr.<br>To Bank Account<br>(Payment for Advertisement paid by cheque) | | 100 | <br>100 |

| | | | | |
|---|---|---|---|---|
| April 12 | Office Equipment Account Dr.<br>To Yogesh<br>(Purchased one typewriter on credit) | | 8,000 | <br>8,000 |
| April 12 | Ragav Dr.<br>To Sales Account<br>(Being goods sold on credit) | | 2,900 | <br>2,900 |
| April 14 | Drawing Account Dr.<br>To Bank Account<br>(Amount withdrawn for personal use) | | 350 | <br>350 |
| April 16 | Cash Account Dr.<br>To Sales Account<br>(Goods sold for cash) | | 900 | <br>900 |
| April 24 | Cash Account<br>Discount Account Dr.<br>To Ragav<br>(Being cash received and discount allowed) | | 2850<br>50 | <br><br>2900 |
| April 28 | Bank Account Dr.<br>To Cash Account<br>(Cash deposited) | | 2,500 | <br>2,500 |
| April 30 | Rent Account Dr.<br>To Bank Account | | 300 | <br>300 |
| April 30 | Salaries Account Dr.<br>To Cash Account<br>(Salary paid) | | 2,000 | <br>2,000 |
| April 30 | Gupta & Sons Account Dr.<br>To Bank Account<br>To Discount Account<br>(Cheque paid in full settlement) | | 1,000 | <br>950<br>50 |

Dr. Cash Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April1 | To Capital Account | 20,000 | April1 | By Bank Account | 10,000 |
| April5 | To Sales Account | 1,700 | April3 | By Furniture Account | 900 |
| April 16 | To Sales Account | 900 | April 4 | By Purchase Account | 4,000 |
| April 24 | To Ragav | 2,850 | April 7 | By Telephone Exp. Account | 400 |
| | | | April 28 | By Bank Account | 2,500 |
| | | | April 30 | By Salaries | 2,000 |
| | | | April 30 | By Balance c/d | 5,650 |
| | | 254,50 | | | 25,450 |
| May1 | To Balance b/d | 25,650 | | | |

Dr. Capital Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 30 | To Balance c/d | 20,000 | April1 | By Cash Account | 20,000 |
| | | | May 1 | By Balance b/d | 20,000 |

Dr. Bank Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | | 2009 | |
| April1 | To Cash Account | 10,000 | April 9 | By Advertisement | 100 |
| April 28 | To Cash Account | 2,500 | April 14 | By Drawing Account | 350 |
| | | | April 30 | By Rent Account | 300 |
| | | | April 30 | By Gupta & sons | 950 |
| | | | April 30 | By Balance c/d | 10,800 |
| | | 12,500 | | | 12,500 |
| May 1 | To Balanced b/d | 10,800 | | | |

Dr. Furniture Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 3 | To Cash Account | 900 | April 30 | By Balance c/d | 900 |
| May 1 | To Balance b/d | 900 | | | |

Dr. **Discount Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 24 | To Ragav Account | 50 | April 30 | By Gupta & sons | 50 |

Dr. **Telephone Expenses Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | | 2009 | |
| April 7 | To Cash Account | 400 | April 30 | By Balance c/d | 400 |
| May 1 | To Balance b/d | 400 | | | |

Dr. **Advertisement Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 9 | To Bank | 100 | April 30 | By Balance c/d | 100 |
| May 1 | To Balance b/d | 100 | | | |

Dr. **Gupta & Sons Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 3 | To Bank Account | 950 | April 8 | By Purchase Account | 1,000 |
| April 30 | To Discount Account | 50 | | | |
| | | 1,000 | | | 1,000 |

Dr. **Drawing Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 14 | To Bank Account | 350 | April 30 | By Balance c/d | 350 |
| May 1 | To Balance b/d | 350 | | | |

Dr. **Rent Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 30 | To Bank Account | 300 | April 30 | By Balance c/d | 300 |
| May 1 | To Balance b/d | 300 | | | |

Dr. **Salaries Account** Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 30 | To Cash Account | 2,000 | April 30 | By Balance c/d | 2,000 |
| May 1 | To Balance c/d | 2,000 | | | |

Dr. Office Equipment Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 12 | To Yogesh | 8,000 | April 30 | By Balance c/d | 8,000 |
| May 1 | To Balance b/d | 8.000 | | | |

Dr. Yogesh's Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 30 | To Balance c/d | 8,000 | April 12 | By office Equipment Account | 8,000 |
| | | | April 30 | By Balance b/d | 8,000 |

Dr. Ragav's Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 12 | To Sales Account | 2,900 | April 24 | By Cash | 2,850 |
| | | | April 24 | By Discount | 50 |
| | | 2,900 | | | 2,900 |

Dr. Purchases Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 4 | To Cash Account | 4,000 | April 30 | By Balance c/d | 5,000 |
| April 8 | To Gupta & Sons | 1,000 | | | |
| | | 5,000 | | | 5,000 |
| May 1 | To Balance b/d | 5,000 | | | |

Dr. Sales Account Cr.

| | | | | | |
|---|---|---|---|---|---|
| 2009 | | | 2009 | | |
| April 30 | To Balance c/d | 5,500 | April 5 | By Cash | 1,700 |
| | | | April 12 | By Ragav | 2,900 |
| | | | April 16 | By Cash | 900 |
| | | 5,500 | | | 5,500 |
| | | | May 1 | By Balance b/d | 5,500 |

## 4.7 BALANCING AN ACCOUNT

First of all the transactions are recorded in the journal and then these are posted to the ledger account. The next step after ledger-posting is balancing the accounts. The process of finding out the difference between the totals of the two sides of a ledger account is known as balancing and the difference of the total debits and total credits of accounts is known as balance.

Balancing is done either weekly, monthly, quarterly, bi-annually or annually, depending on the requirements of the business concern.

Balancing of different Accounts:

The balancing of various accounts are ascertained as under:

1. Personal Accounts: Personal accounts are balanced regularly to know the amounts due to the persons or due from the persons. In the case of a Bank Ledger, Personal accounts are balanced after every transaction. A debit balance of this account indicate that the person concerned is a debtor of the business concern and a credit balance indicate that he is a creditor of the business concern.
2. Real Account: Real account are generally balanced at the end of the accounting year when final accounts are prepared. However cash account is invariably balanced daily to know the cash in hand at the end of each day.
3. Nominal Account: The Nominal accounts are not balanced, as they are to be closed by transferring them to the final accounts.

   Note: When the totals of the debit and credit sides are similar, i.e. equal the account is not said to be balanced, but closed.

## 1.4.8 CONCEPT AND POSTING OF AN OPENING ENTRY

In case of going concern, at the beginning of the new year, new books of accounts are opened and the balances appearing in the books ate close of the previous year are brought forward in new books. For this purpose the entry in the books is called opening entry.

Rule of passing an opening entry is to Dr. each asset A/C and Cr. each liability A/C including capital.

If amount of capital is not given then this can be found out with the help of the accounting equation as shown below.

Assets = Liablities + Capital Capital = Assets - Liabilities

Posting of an Opening entry: The posting of an opening entry is different from the posting of ordinary entry. The account which have been debited in the journal are also debited in the ledger with their respective amounts by writing 'To balance b/d'. The accounts of liabilities and capital which are credited in the journal are incorporated in the ledger by writing 'By Balance b/d" on the credit side.

## 1.4.9 CONCEPT AND POSTING OF COMPOUND ENTRY

When two or more transactions of similar nature take place on the same date, then instead of recording separate entries, a single entry may be written which is known as compound or combined entry. Such entry can be recorded in the following ways:

1. One account debit and two or more accounts credit.
2. One account credit and two or more accounts debit.
3. Two or more than two accounts debit and credit.

Posting of compound Entry: While posting a compound entry due care must be exercised as it may involve one debit but more than one credits of equal value of vice-versa. Such entry can be posted in the following manner:

1. In the particular column of the debit side the respective accounts, begin with the word To and write the name of the other accounts which has been credited in the journal, with the amount as written before such accounts in the journal.
2. In the particular column on the credit side of the account, begin with the word By and write the name of the other account which has been debited in the journal, with the same amount as written before such accounts in the journal.

## 1.4.10 DISTINCTION BETWEEN JOURNAL AND LEDGER

Ledger and Account are two different terms and are used for different purposes. The term 'Account' indicates the manner in which the information is set out and the term 'Ledger' is the name given to the book in which accounts are kept.

Distinction between Journal and Ledger:

| Journal | Ledger |
|---|---|
| 1. It is a book of original entry. | 1. Ledger is the main book of account |
| 2. In journal transactions are recorded as and when occur. | 2. In Ledger posting is done periodically, may be weekly, fortnightly etc. |
| 3. The both debit and credit aspects of a transaction are entered in the journal. | 3. In the Ledger, entries are posted in respective accounts only with aspect only i.e. either debit or credit aspect. |
| 4. Journal does not disclose the complete position of an account. | 4. The Ledger indicates the position of each account debit wise or credit wise. |
| 5. In Journal transactions are recorded in the form of Journal entries. | 5. In Ledger transactions are recorded in the form of an account. |
| 6. Entering the transactions in the Journal is called Journalising. | 6. The act of recording in the ledger is called posting. |
| 7. The journal carries more evidential value. | 7. The ledger carries less evidential value. |

### Self Check Exercise

Ques 1. Define Ledger and give its Performa in detail.

Ques 2. Post the following entries into the ledger:

1. Purchased goods on credit from A Rs. 800.
2. Paid Sundry Expenses for Rs. 50.
3. Cash sales for Rs. 1500.
4. Sold goods to X for Rs. 750.
5. Paid A Rs. 750 and received discount for Rs. 50.
6. Received cash Rs. 500 from X.
7. Paid salaries Rs. 500 and Rent Rs. 100.

## 1.4.11 SUMMARY

A Journal, Prime book of entries fails to achieve the main purpose of book-keeping, of disclosing the amount of debtors, creditors, assets, profits earned or losses incurred. etc. This shortcoming of the journal is made good by the ledger, as all the transactions are recorded at one place in a ledger.

So, the first step of accounting process is journalising the business transactions and the next step is to classify the journal entries according to the accounts of a trader, personal, real or nominal for permanent record in the ledger book. After this Ledger accounts may be balanced as and when it is required, and then finally transferred to the trial balance statement.

## 1.4.12 ANSWERS TO SELF CHECK QUESTIONS

Answer No.1 Ledger : Ledger is also known the principal book of accounts. It has T form, which has two sides of every account. The left side is known as the debit side and the right side is known as the credit side. E ach side has four columns.

Answer No. 2 To post these entries open following accounts:

1. Purchases and A account
2. Sundry expenses and cash A/c
3. Cash and sales A/c.
4. Sales and X A/C.
5. A, cash and discount received A/C.
6. Cash and X A/C.
7. Salaries, Rent and Cash A/C.

## 1.4.13 GLOSSARY

1. Ledger : Principal book of Accounts
2. Dr. : Debit
3. Cr. : Credit
4. To bal b/d : It is used to balance brought down in the account in the beginning.
5. By bal. b/d : It is used to balance carried down at the time of closing of an account.

## 1.4.14 EXERCISE

(A) Short Questions:

Ques. 1. Give the advantages of the ledger.

Ques. 2. Define an opening entry.

Ques. 3. Give the concept and posting procedure of the compound entry.

(B) Long Questions:

Ques 1. What are the rules for posting the entries into ledger?

Ques. 2. Define the term 'Account'. Distinguish between Journal and Ledger.

Ques. 3. Enter the following transactions in the Journal and post them into ledger:

2009 June 1. Mukesh started business with a capital of Rs. 1,00,000.

June 2. Deposited Rs. 20,000 into bank.

June 3. Purchased furniture for Rs. 3,000.

June 5. Purchased goods from Rafi on credit for Rs. 15,000.

June 5. Sold goods to lata for Rs. 8,000.

June 7. Paid cash to Rafi Rs. 10,000 on account.

June 12. Received Rs. 5,000 from Lata.

June 15. Paid rent for the shop Rs. 1500.

June 20. Sold goods to Jatin for Rs. 7000.

June 30. Paid Salary by cheque Rs. 2000.

## 1.4.15 SUGGESTED READINGS

1. Accounting and Financial Management

By : Shashi K. Gupta

R.K.Sharma (Kalyani Publishers)

2. Basic Accounting

By : S.P. Jain

K.L. Naang (Kalyani Publishers)

LESSON NO. 1.5 AUTHOR: MRS. DALBIR KAUR

# TRIAL BALANCE

Structure of the Lesson:



## 1.5.0 OBJECTIVES

The main objective of this lesson is to explain the students basic concepts methods and procedure of preparing trial Balance. To highlight the utility of trial balance this lesson also explaining various errors which can be revealed and cannot be revealed by preparing Trial Balance.

## 1.5.1 INTRODUCTION

The fundamental principle of double entry system of accounting is that for every debit, there must be a corresponding credit. Thus for every debit or a series of debits given to one or several accounts, there is a corresponding credit or a series of credits of an equal amount given to some other account or accounts and vice versa. It follows, therefore, that the sums total of debit amounts should equal the credit amounts of the ledger at any date.

Thus at the end of financial year or at any other time, the balances of all the ledger accounts are entranced and are written up in a statement known as Trial Balance.

The agreement of the Trial Balance reveals that both the aspects of each transaction have been recorded and that the books are arithmetically accurate. If the Trial Balance does not agree, it shows that there are some errors which must be detected and rectified if the correct final accounts are to be prepared. Thus, Trial Balance forms a connecting link between the ledger accounts and the final accounts. Balance forms a connecting link between the ledger accounts and the final accounts.

## 1.5.2 OBJECTS AND LIMITATIONS OF PREPARING TRIAL BALANCE

The main objects of preparing the Trial Balance are as follows :

(i) To Check the accuracy of Double Entry System : According to the principle of double entry every transaction has two aspects : One debit and the other is credit. The trial balance is a proof of accuracy of double entry system.

(ii) Helpful in preparing financial accounts : The Trial Balance records the balances of various ledgers at one place which helps in the preparation of profit and loss account and Balance Sheet which can be used for knowing the financial position of the business.

(iii) Arithmetical Accuracy : To have arithmetical accuracy of the books of accounts because of the agreement of the Trial Balance.

(iv) Summary : This is summary of various ledger. The ledger can be used for detailed information, if need so arises.

### Limitations of the Trial Balance

The main limitations of the Trial balance are as follows :

(i) Trial Balance can be prepared only in those concerns, where double entry system of accounting is adopted.

(ii) Though Trial Balance gives arithmetical accuracy of the books of accounts but there are certain errors which are not disclosed by the Trial Balance.

(iii) If trial Balance is not prepared correctly then the final accounts prepared will not reflect the true and fair view of the state of affairs of the business.

(iv) Conclusions and decisions are made by various groups of persons will mislead such persons, as trial balance is not a conclusive proof of accuracy of the books of accounts.

### 1.5.3 PREPARATION OF TRIAL BALANCE

Trial Balance can be prepared by the following methods :

1.5.3.1 Total Method : In this method, the debit and credit totals of each account are shown in the two amount columns, one for the debit total and other for the credit total against it.

1.5.3.2 Balance Method : In this method, the difference of each account is extracted. If debit side of an account is bigger, the difference is written in the debit column of the Trial Balance and if credit side is bigger, the difference is written in the credit column of the Trial Balance.

1.5.3.3 Total and Balance Method : In this method debit total and credit total of all accounts as well as balances of all accounts are shown as given below.

| Sr. No. | Name of the Account | L.F | Total debit (Rs.) | Total credit (RS.) | Dr. Balance Rs. | Cr. Balance Rs. |
|---|---|---|---|---|---|---|
| | | | | | | |

1.5.3.4 Totals Excluding closed Account Method : In this method, the debit and credit figures of the accounts are written in the Trial Balance just like the first methods, with the difference that the totals of those accounts of which the debit and credit sides are equal, are not entered in the trial balance.

### 1.5.4 ILLUSTRATION 1

Following are the transactions of Sumirat and Sons of Company. Write up the books and prepare trial balance.

Jan. 2009 Assests : Goodwill Rs. 18,000, Building Rs. 27,000, Stock Rs. 52,000, Bank Balance Rs. 7000, Cash in hand Rs. 1480, Due from Ram Chander Rs. 960, Due from Desh Pandey Rs. 2000, Machinery Rs. 15,000

Liabilities : Loan from X @9% Rs. 30,000 Due to Radha Rs. 7,000

Jan. 2 Drawn from bank Rs. 2,000

3 Wages Paid RS. 1800

5 Purchases from Radha on Credit Rs. 6,000

6 Return to Radha Rs. 500

8 Sales to Badshah Khan on credit Rs. 8,000

10 Received from Desh Pandey Rs. 1900 by cheque in full settlement.

12 Paid by cheque to Radha in full settlement of the amount due on Jan. 1 Rs. 6900

13 Cash paid for machine repair Rs. 300

14 Sales to Desh Pandey on Credit Rs. 9,000

15 Received from Ram Chander by cheque Rs. 960

16 Salaries paid Rs. 500

17 Purchases on credit from Inder Mal Rs. 2000

18 Purchases from Prakash on credit R. 500

19 Sales on cash Rs. 5000, received cheque

20 Rent paid Rs. 300 by cheque

20 Insurance premium paid Rs. 350 by cheque

21 Drawn from bank for private use Rs. 1,000

23 Sales to X and Co. on credit Rs. 2500

25 Paid for advertisement Rs. 500 by cheque

26 Paid for repair to building for month Rs. 200

31 Bank charged interest for month Rs. 50

31 Allow interest on capital @ Rs. 10% p.a

31 Received from X and Co. by cheques Rs. 2,000

## General Journal

| Date | Particulars | | L.F. | Dr. (Rs.) | Cr. (Rs.) |
|---|---|---|---|---|---|
| 2009 | | | | | |
| Jan. 1 | Goowill A/c | Dr. | | 18,000 | |
| | Building A/c | Dr. | | 27,000 | |
| | Stock | Dr. | | 52,000 | |
| | Bank | Dr. | | 7,000 | |
| | Cash | Dr. | | 1,480 | |
| | Ram Chander | Dr. | | 960 | |
| | Desh Pandey | Dr. | | 2,000 | |
| | Machinery | Dr. | | 15,000 | |
| | To Loan | | | | 30,000 |
| | To Radhaswamy | | | | 7,000 |
| | To Capital A/c (B/F) | | | | 86,400 |
| | (Opening entry Capital A/c is excess of Asset over liabilites) | | | | |
| Jan. 31 | Interest A/c | Dr. | | 725 | |
| | To Capital A/c | | | | 725 |
| | (Interest @ 10% allowed on Opening Balance of Capital) | | | | |

## Cash Book

| Date | Particulars | L.F | Disc. | Bank | Cash | Date | Particulars | L.F | Disc. | Bank | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2009 | | | | | | 2 09 | | | | | |
| Jan.1 | To balance | | | 7,000 | 1480 | Jan.2 | By Cash | C | — | 20 0 | — |
| 2 | To Bank | C | — | | 2 0 | 3 | By Wages | | — | — | 18 0 |
| 10 | To Desh Pandey | | 1 0 | 19 0 | — | 12 | By Radha | | 1 0 | 69 0 | — |
| 15 | To Ram Chander | | — | 960 | — | 13 | By Repairs | | — | — | 3 0 |
| 19 | To Sales | | — | 50 0 | — | 15 | By Salaries | | — | — | 5 0 |
| 31 | To X and Co. | | — | 20 0 | — | 18 | By Purchases | | — | — | 5 0 |
| | | | | | | 20 | By Rent | | — | 3 0 | — |
| | | | | | | 20 | By Insurance | | — | 350 | — |
| | | | | | | 21 | By Capital A/c | | 1 0 | — | |
| | | | | | | 25 | By Advt. | — | 5 0 | — | |
| | | | | | | 26 | By Repairs | | | — | 2 0 |
| | | | | | | 31 | By Interest | | — | 50 | — |
| | | | | | | | By Bal. C/d | | | 5760 | 180 |
| | | | 1 0 | 16,860 | 3480 | | | | 1 0 | 16,860 | 3480 |

Purchase Book

| Date | Particulars | Invoice No. | L.F. | Rs. |
|---|---|---|---|---|
| 2009 | | | | |
| Jan. 5 | Radha | | | 6,000 |
| Jan. 17 | Inder Mal | | | 2,000 |
| | | | | 8,000 |

Sales Book

| Date | Particulars | Invoice No. | L.F. | Rs. |
|---|---|---|---|---|
| 2009 | | | | |
| Jan. 8 | Badshah Khan | | | 8,000 |
| Jan. 13 | Desh Pandey | | | 9,000 |
| Jan. 23 | X and Co. | | | 2,500 |
| | | | | 19,500 |

Purchase Returns Book

| Date | Particulars | Invoice No. | L.F. | Rs. |
|---|---|---|---|---|
| 2009 | | | | |
| Jan. 6 | Radha | | | 500 |
| | | | | 500 |

Ledger

Capital Account

Dr. Cr.

| Date | Particulars | J.F. | Rs. | Date | Particulars | J.F. | Rs. |
|---|---|---|---|---|---|---|---|
| 2009 | | | | 2009 | | | |
| Jan. 21 | To Bank | | 1000 | Jan. 1 | To Balance b/d | | 86,940 |
| Jan. 31 | To Bal. c/d | | 86,665 | Jan. 31 | By Interest | | 725 |
| | | | 87,665 | | | | 87,665 |
| | | | | | By Balance b/d | | 87,665 |

Radha A/c

Dr. Cr.

| Date | Particulars | J.F. | Rs. | Date | Particulars | J.F. | Rs. |
|---|---|---|---|---|---|---|---|
| 2009 | | | | 2009 | | | |
| Jan. 12 | To Bank | | 7,000 | Jan. 1 | By Balance b/d | | 7,000 |
| Jan. 6 | To Purchase Returns | | 500 | | By Purchase | | 6,000 |
| Jan. 31 | To bal. C/d | | 5,500 | | | | |
| | | | 13,000 | | | | 13,000 |
| | | | | | By bal b/d | | 5,500 |

Interest A/c

Dr. Cr.

| Date | Particulars | J.F. | Rs. | Date | Particulars | J.F. | Rs. |
|---|---|---|---|---|---|---|---|
| 2009 | | | | 2009 | | | |
| Jan. 31 | To Capital | | 725 | Jan. 31 | By Balance c/d | | 775 |
| | To Bank | | 50 | | | | |
| | To bal. b/d | | 775 | | | | 775 |

Loan A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | 2009 | | | |
| | | | | Jan. 1 | By bal. b/d | | 30,000 |

Sales Account

Dr. Cr.

| Date | Particulars | J.F. | Rs. | Date | Particulars | J.F. | Rs. |
|---|---|---|---|---|---|---|---|
| 2009 | | | | 2009 | | | |
| Jan. 31 | To Bal. c/d | | 24,500 | Jan. 19 | By Bank | | 5,000 |
| | | | | Jan. 31 | By Sales as per Sales Book | | 19,500 |
| | | | 24,500 | | | | 24,500 |
| | | | | | By Bal. b/d | | 24,500 |

X and Co. A/c

Dr. Cr.

| Date | Particulars | J.F | Rs. | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| 2009 | | | | 2009 | | | |
| Jan. 23 | To Sales | | 2,500 | Jan. 31 | By Bank | | 2,000 |
| | | | | Jan. 31 | By Balance c/d | | 500 |
| | | | 2500 | | | | 2500 |
| Feb. 1 | To Bal. b/d | | 500 | | | | |

Good will A/c

Dr. Cr.

| Date | Particulars | J.F | Rs. | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 18000 | | | | |

Building A/c

Dr. Cr.

| Date | Particulars | J.F | Rs. | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 27,000 | | | | |

Stock A/c

Dr. Cr.

| Date | Particulars | J.F | Rs. | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 52,000 | | | | |

Ram Chander A/c

Dr. Cr.

| Date | Particulars | J.F | Rs. | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 960 | Jan. 15 | By Bank | | 960 |

Desh Pandey A/c

Dr. Cr.

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Rs. |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 2,000 | Jan. 10 | By Bank | | 2,000 |
| 13 | To Sales | | 9,000 | Jan. 31 | By balance c/d | | 9,000 |
| | | | 11,000 | | | | 11,000 |
| Feb.1 | To Bal. b/d | | 9,000 | | | | |

Machinery A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 1 | To Bal. b/d | | 15,000 | | | | |

Wages A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 3 | To Cash | | 1,800 | | | | |

Repairs A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 13 | To Cash | | 300 | Jan. 31 | By Balance c/d | | 500 |
| | To Cash | | 200 | | | | |
| | | | 500 | | | | 500 |
| Feb. 1 | To Bal. b/d | | 500 | | | | |

Purchases A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 18 | To Cash | | 500 | Jan. 31 | By balance c/d | | 8,500 |
| Jan. 31 | To Purchase as per Purchase book | | | 8,000 | | | |
| | | | 8,500 | | | | 8,500 |

Purchase Return A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | Jan. 31 | By Purchases returns as per purchase book | | 500 |
| | | | | | | | 500 |

Salaries A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 15 | To Cash | | 500 | | | | |

Rent A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 20 | To Bank | | 300 | | | | |

Insurance A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 20 | To bank | | 350 | | | | |

Discount A/c

Dr. Cr.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 31 | To Cash book | | 100 | Jan. 31 | By Cash Book | | 100 |
| | | | 100 | | | | 100 |

Inder Mal's A/c

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | Jan. 17 | By Purchases | | 2,000 |

Badshah Khan's A/c

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 8 | To Sales | | 8,000 | | | | |

Advertisement A/c

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Jan. 25 | To Bank | | 500 | | | | |

Trial Balance

| Serial No. | Name of Account | Dr. (Rs.) | Cr. (Rs.) |
|---|---|---|---|
| 1 | Capital | —— | 86,665 |
| 2 | Goodwill | 18,000 | —— |
| 3 | Building | 27,000 | —— |
| 4 | Stock | 52,500 | —— |
| 5 | Machinery | 15,000 | —— |
| 6 | Desh Pandey | 9,000 | —— |
| 7 | Radha | —— | 5,500 |
| 8 | Loan | —— | 30,000 |
| 9 | Interest | 775 | —— |
| 10 | Sales | —— | 24,500 |
| 11 | X and Co. | 500 | —— |
| 12 | Wages | 1,800 | —— |
| 13 | Repairs | 500 | —— |
| 14 | Purchases | 8,500 | —— |
| 15 | Purchase Return | —— | 500 |
| 16 | Salaries | 500 | —— |
| 17 | Rent | 300 | —— |
| 18 | Insurance | 350 | —— |
| 19 | Inder Mal | —— | 2,000 |
| 20 | Badshah Khan | 8,000 | —— |
| 21 | Advertisement | 500 | —— |
| 22 | Cash in Hand | 180 | —— |
| 23 | Cash at bank | 5,760 | —— |
| | | 1,49,165 | 1,49,165 |

## 1.5.5 ERRORS REVEALED AND NOT REVEALED BY TRIAL BALANCE

If the two sides of a trial balance agree it is prime facie evidence of the arithmetical accuracy of the entries made in the ledger. But even if the balance agree, it does not necessarily mean that accounting records are free from all errors, because there are certain types of errors which are not revealed by trial balance. Therefore a trial balance should not be regarded as a conclusive proof of accuracy of accounts.

### 1.5.5.1 Errors Revealed by Trial Balance

(i) Omission to post an amount into Ledger : If an item is not posted from Journal or subsidiary book to ledger, two sides of trial balance shall not agree, e.g. if goods sold on credit to A recorded properly in sales book but not debited to A's account in ledger, the debit side of trial balance shall fall short.

(ii) Omission to post an amount in Trial balance : It is natural that if balance of an account is not recorded in trial balance, two sides of trial balance shall not agree. This is an indication of error in accounts.

(iii) Wrong totaling or Balancing of ledger account : If any account in the ledger is wrongly totaled or balanced then also the trial balance shall not agree.

(iv) Wrong totaling of Subsidiary Books : If total of any of the subsidiary book is wrong, the trial balance will not agree.

(v) Posting on wrong side : If any entry which was to be posted on the debit side of some account is posted on credit side of same account or any other account will create difference in both sides of trial balance.

(vi) Posting of wrong amount : If while posting some entry in the ledger the amount entered is wrong, the trial balance will not agree.

### 1.5.5.2 Errors not Revealed by Trial Balance

(i) Error of Omission : If a transaction is not recorded in books of original entry, then both debit and credit effects of transaction will be omitted and trial balance shall not be effected.

(ii) Error of Commission : These errors are the result of carelessness of accounting staff and in some cases such errors do not effect the totals of trial balance e.g. wrong recording in the books of original entry or posting to the wrong account with correct amount and correct side. e.g. goods sold to A on credit but amount debited to B's account.

(iii) Compensating Error : Such errors neutralize the effect of errors committed earlier. When one error is committed which effects the total, another error of opposite effect is committed which neutralises the effect of earlier error.

(iv) Error of Principle : Whenever any income or expenditure is not properly allocated between capital and revenue, such mistake is called a mistake of principle.

(v) Error of duplication : Any error due to recording and posting a transaction twice also does not effect the totals of the two sides of trial balance.

## 1.5.6 LOCATION OF ERRORS THROUGH TRIAL BALANCE

(i) Divide the difference by two and find out if some figure equal to that appears in the trial balance. It is possible that such item might have been recorded in the wrong side of trial balance, thus causing double the difference.

(ii) If the mistake is not located the difference should be divide by 9 and if difference is evenly divisible by 9 the error may be due to transportation of figures e.g. Rs. 590 wrongly recorded as Rs. 950.

(iii) The next step is to recheck the debit and credit totals of trial balance to satisfy that balance has been cast correctly.

(iv) If mistake remains undetected, make sure that balances of totals of the ledger accounts have been correctly shown in the trial balance.

(v) Check the totals of schedule of debtors and creditors and find out that all balances have been included in the list.

(vi) Check all the figures badly written.

## SELF CHECK EXERCISE

Ques. 1 Is Trial Balance a conclusive proof of accuracy? Explain.

Ques. 2. Explain the errors which are revealed by trial balance and which are not.

## 1.5.7 SUMMARY

In the previous lessons, we have studied the procedure of entering and posting of transactions in the journal and ledger, for ascertaining net balances of various ledger accounts. This chapter deals with the preparation of trial balance. Trial balance is a statement containing balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger postings. but even then, this is not a conclusive proof of the accuracy of Books of accounts.

## 1.5.8 ANSWERS TO SELF CHECK QUESTIONS

Answer no. 1 Trial balance is prepared to check the arithmetical accuracy of books of accounts but it does not give a conclusive proof of the accuracy of books of accounts, as errors may exist even if the trial balance agrees. These errors are like

1. Errors of omission in books of original entry.
2. Incorrect amount recorded in the books of original entry.
3. Posting an item to wrong account but with correct amount and side.
4. Compensatory error.
5. Error of Principle.

Answer No. 2 (A) Errors revealed by the trial balance :

(i) Posting of wrong amount

(ii) posting to wrong side

(iii) Omission to post from journal or subsidiary book

(iv) Duplication in posting

(v) Omission to carry a balance from ledger to trial balance

(vi) Carry wrong amount to trial balance

(vii) Wrong totalling or balancing of ledger accounts

(viii) Wrong totalling of subsidiary books.

(ix) Wrong totalling of trial balance.

(B) Errors not revealed by the trial balance : These errors are as mentioned in question number one.

## 1.5.9 GLOSSARY

1. Trial Balance : List of debit and credit balances.
2. Total Method : Trial balance is prepared by taking up the total of both debits and credits as per this method.
3. Balance Method : Trial balance is prepared by taking up the balance of each account as per this method.
4. Compound Method : This method is the combination of above two methods.
5. Ledger : A book in which various accounts are opened.

## 1.5.10 EXERCISE

(A) Short Questions :

Ques. 1 Define the term Trial Balance

Ques. 2. List the errors revealed by the trial balance

Ques. 3 Give main objectives of preparing trial balance.

(B) Long Questions :

Ques. 1 "A trial balance is only a prima facia evidence of the accuracy of the books of accounts." Comment.

Ques. 2 Discuss the various methods of preparing trial balance with examples.

Ques. 3. From the following trial balance containing (obvious errors )prepare a correct trial balance:

| | Dr. | Cr. |
|---|---|---|
| | Dr. | Cr. |
| Purchases | 60,000 | ——- |
| Reserve fund | 20,000 | —— |
| Sales | —— | 1,00,000 |
| Purchases returns | 1,000 | —— |
| Sales returns | ——- | 2,000 |
| Opening Stock | 30,000 | —— |
| Closing Stock | —— | 40,000 |
| Expenses | —— | 20,000 |
| Outstanding Expenses | 2,000 | —— |
| Bank Balance | 5,000 | —— |
| Assets | 50,000 | —— |
| Creditors | —— | 80,000 |
| Capital | —— | 30,000 |
| Suspense Account (difference in Books) | 10,000 | —— |
| | 2,72,000 | 2,72,000 |

## 1.5.11 SUGGESTED READINGS

1. Accounting and Financial Management
By : Shashi K. Gupta, R.K. Sharma
(Kalyani Publishers)

2. Basic Accounting
By : S.P. Jain,K.L. Narang
(Kalyani Publishers)

# CAPITAL AND REVENUE ITEMS

Contents



## 1.6.0 Objectives

(i) To explain the concept of capital and revenue.

(ii) To define capital expenditure and revenue expenditure and differentiate between them.

(iii) To elaborate the concept of capital and revenue profit.

(iv) To define capital receipts and revenue receipts and differentiate between the two.

(v) To explain the concept of capital and revenue losses.

**1.6.1 Introduction :-** For correct accounting there is the need for proper distinction between capital and revenue items regarding expenditure payments, profits, receipts and losses. If this difference is properly observed the accounting results will be correct, on the other hand if it is not properly observed the whole accounting system will be failure e.g., when plant and machinery is purchased and it is charged to the purchase A/c or any fixed asset is sold and whole proceeds is taken as profits, then all the above cases the both the profit and loss A/c and balance sheet will be effected give incorrect and misleading results.

As all the revenue items goes to Trading and Profit and Loss A/c and all capital items goes to balance sheet, it is necessary that the proper distinction should be made between capital and revenue while preparing the final accounts of a business at the end of financial year.

There are not any fixed rule regarding difference between capital and revenue items. However the following rules may help for making difference between capital and revenue expenditure.

### 1.6.2 Rules regarding the Capital Expenditure:

Capital expenditure is that expenditure whose benefit is not fully consumed in one particular period but over several periods. The main purpose behind the capital expenditure is for the purpose of earning and for resale, improving and extending fixed assets, increasing the earning capacity of business and raising capital for business, These expenses are taken to Balance sheet. The main rules regarding capital expenditure are as follows:

(1) The expenses are in relation to acquisition of fixed asset so that business can commence or continue its operations.

(2) The expenditure sshould result iinto long term benefitit to the business.

(3) This expenditure must increase the earning capacity or reduce working expenses. Mainly it must be related with acquisition of any permanent asset or to earn revenue, e. g., any permanent asset is purchased any expenses in addition to its cost of asset like installation, er act ion cost , traveling tri p t o abroad to purchase such asset, all are the capital expenditure because it is related with directly in the acquisition of any permanent asset.

Examples:

(i) Purchase of land, building, plant and machinery .

(ii) Amount spent on eraction of plant and machinery .

(iii) Expenses on major repairs and replacement s of pl ant and machinery or any other fixed as set, which may increase t he efficiency of that asset.

### 1.6.3 Rules regarding Revenue Expenditure :

The expenditure incurred in one period of account and the full benefit of which is consumed in that period; is revenue expenditure. Such expenses are made to perform the day-to day working of the business smoothly and easily. These items appear in Trading and Profit and Loss A/c. The test for such expenditure is that whether the expenditure made is incurred for the maintenance of the earning capacity or for the upkeep of fixed asset in an efficient condition.

Examples:

(1) Purchase of assets acquired for resale at a profit.

(2) Expenses on maintaining fixed assets in good working order.

(3) Meeting certain day to day expenses like cost of goods, raw material, rent, rates, repairs, wages, and salaries, carriage, insurance etc.

(4) Depreciation on fixed assets.

## 1.6.4 Difference Between Capital Expenditure And Revenue Expenditure:

| Capital Expenditure | Revenue Expenditure |
|---|---|
| 1. It is related with acquisition of fixed asset which are meant for use & not for resale purpose. Such asset is sold only when it become unfit for business on obsolete. | 1. It is not related with acquisition of any fixed asset. But it is concerned with meeting day-to-day expenses of business. |
| 2. Such expenditure increase the earning capacity of any fixed asset e.g. the repair or overhaul of any machine will increase the earning capacity for that asset. | 2. Such expenditure is more for the smooth running of the business. It helps in improving day to day expenditure of business. |
| 3. It is an expired cost i.e. the cost can give benefit to the future also. | 3. It is an expired cost i.e. the benefit of cost is related with present only. |
| 4. It is non-recurring expenses. | 4. It is recurring expense. |
| 5. The whole expenses is not change to Trading and Profit and Los s Account . Beca use such expenditure is for more then one year. Only yearly depreciation from that fixed asset is charged to Profit & Loss A/ c. Balance amount is shown as asset in Balance Sheet. | 5. The amount of expenditure expires during every year . Th e w hole expenses are charged to Profit and Loss A/ c in the same year. No balance of such expenditure is shown in Balance Sheet. Only if these are outstanding it is shown as liability. |
| 6. All items of Capital expenditure which are not written off are shown in the Balance Sheet as assets and are carried forward for next year. | 6. Generally these expenditures are not carry forward for next year; because these are fully exhausted during t he same year. Only y ' Deferred Revenue Expenditure' like advertisement is carry forward to next year. |

Self check exercise1

a) what is capital expenditure

b) what is revenue expenditure

1.6.5 Cases when Revenue Expenses becomes Capital Expenses:

There are certain examples which show that when a revenue expense can become a capital expense

(i) Repairs:-It is a revenue item, but when we purchase a second hand plant and pay immediately necessary repair expenses to make such asset efficient it becomes a capital expenditure.

(ii) Wage:- It is also a revenue item but wages to workers to fit a new machinery, becomes the part of fixed asset. Therefore a capital asset

(iii) Legal Expenses:- Generally it is a revenue item, but legal expenses in correction purchase of fixed asset is capital item.

(iv) Transportation Expenses:- These are also revenue expenses. But transportation expenses or purchase of any fixed asset is capital expenditure.

(v) Interest on Capital:- Such interest, if paid during t he construction of Works or building a plant will be capital Expenditure.

(vi) Raw Material and stores:- Normally it is a revenue item But cost of raw material or stores used for making any fixed asset are capital expenditure.

(vii) Carriage and Freight :- If these are related with any fixed asset, the these are capital expenditure .

(viii) Advertising:- For introducing new line of goods i f any advertisement is made it is the capital expenditure, Because its benefit will be for future also.

(ix) Development Expenditure:- Some concerns like tea, rubber, plantation, horticulture, etc require a very long period of development before they can begin its earning . All such expenditure during development period is capital expenditure

(x) Pr eliminary or For mation Ex pense s:- Expenses bef o re incorporation of a company are preliminary expenses and are capital in nature.

1.6.6 CAPITAL AND REVENUE PROFIT

Capital Profit:

It is that profit which is made on the sale of any fixed asset or profit earned on getting capital for the business is a capital profit.

Examples:

(i) If furniture costing Rs. 8000, sold at Rs.10000 then the profit of Rs. 2000 is the capital profit.

(ii) Premium received on issue of share and debenture is a capital profit. Such profit is not transferred to Profit and Loss A/c but it is transferred to capital revenue which would appear as a liability in Balance Sheet.

Revenue Profit :

Profits made by day–to-day trading activities of the business are revenue profits. These are the trading profits of the business which arise due to sale purchase of goods of the business. These profits are credited to Profit and Loss A/c of the business.

Examples:

(1) Profit on sale of goods.

(2) Income from investments.

(3) Discount received.

## 1.6.7 CAPITAL AND REVENUE RECEIPTS:

Capital Receipts:

The receipts arising from the capital invested in the business, loans taken, and the sale proceeds of the business. These receipts are shown in Balance Sheet.

Revenue Receipts:-

The normal business receipts are revenue receipts. These are cash from sales, discount received, commission, interest on investments etc. are all revenue receipts. These are transferred to Profit and Loss Account.

## 1.6.8 Difference between Capital and Revenue Receipts :

| Capital Receipts | Revenue Receipts |
|---|---|
| 1. The amount realised by sale of fixed assets or by issue of share or debentures is capital receipts. | 1. The amount realised by sale of fixed assets or by issue of share or debentures is capital receipts. |
| 2. It is a receipt in substitution of a source of income. | 2. It is a receipt in substitution of an income. |
| 3. It is the amount received for surrender of certain rights under an agreement as a capital asset is being given up in the form of these rights. | 3. It is the amount received as compensation under an agreement for the loss of future profit. |

## 1.6.9 CAPITAL AND REVENUE LOSSES:

Capital losses:

Those losses which occur as selling fixed asset or raising share capital are capital losses. These losses are not debited to Profit and Loss A/c but will be shown at the asset side in the Balance Sheet. Such losses are adjusted out of business profit. But if the amount of capital losses is very large, then it must be adjusted by making proportionate amount over no. of years. This proportionate amount must be debited to Profit and Loss A/c yearly; the balance amount must be carry forward to Balance Sheet and to be written off for the future years.

### Revenue Loses:

The losses which arise due to normal course of business or revenue losses. e.g., loss due to trading operations like loss or sale of goods. These losses are debited to Profit and Loss Account.

Examples:- Explain clearly the circumstances under which the following expenses will be Revenue Expenses or Capital Expenses:

(i) A sum of Rs.47,500 was spent on dismanting removing and reinstalling plant and machinery.

(ii) The removal of stock from old works to new works costed Rs.5,000.

(iii) Plant and Machinery having book value of 15,000 were being obsolete was sold of Rs.5,000 and was replaced by new machine costing Rs. 24,000 .

(iv) A sum of Rs.11,000 was spent on painting the new factory.

Solution:-

(i) Amount spent as dismantle, removing and reinstalling plant and machinery is to be treated as revenue expenditure. It may also be treated as Deferred Revenue Expenditure and can be spread over the time.

(ii) The removal of stock will also be treated as revenue expenditure and can be given same treatment as given in point(i).

(iii) Book value of plant and machinery is Rs 15,000 and sold for Rs. 5000 ; so difference of Rs. 10 , 000 will be treated as depreciation as revenue expenditure. Cost of purchase of new machine is capital expenditure .

(iv) Painting expenditure on new factory is the capital expenditure; because it will increase overall cost of the building .

### 1.6.10 Deferred Revenue Expenditure

A revenue expenditure of which the benefit is not fully exhausted in current accounting period in which it is incurred is called as deferred revenue expenditure. A fairly heavy revenue expenditure has been made in lump sum, but its use will be divided over a long period. A part of such expenditure is shown in profit and loss account and the remaining unutilized part is shown in the asset side of balance sheet. The examples of deferred revenue expenditure are preliminary expenses, brokerage on issue of shares and debentures, underwriting commission. Research and development expenses and heavy expenditure on special advertising campaign. However, prepaid expenses are those which have paid in advance and of which the benefit will be available in the future period.

Self check exercise2

a) deferred revenue expense

b) examples of revenue profit

### 1.6.11 Summary

The expenditure incurred during an accounting period is divided into capital and revenue expenditure on the basis of its recuringness in relation to accounting period and effect on revenue earning capacity etc. Revenue expenditure subject to adjustment for prepaid or outstanding account is treated as expense of the and transferred to either trading account or profit and loss account. On the other hand, capital incurred on acquisition of fixed assets and subjects to adjustment for depreciation (which is treated as one expenses of the period and transferred to either manufacturing account or profit and loss account) is recorded on asset side of balance sheet. However the recovery of revenue expenditure is partially deferred to subsequent accounting period which is called as deferred revenue expenditure.

16.12 Glossary

Revenue expenditure= expenditure on day to day operations of the business
Capital expenditure= expenditure on acquisition of fixed assets
Revenue profit= profit from normal activities of the business
Capital profit= profit from sale of fixed assets or other occasional activities of the business.

1.6.13 Answers of self check exercise
1 a) see para 1.6.2
b) see para 1.6.3
2 a) see para 1.6.10
b) see para 1.6.6

1.6.14 Exercise
Short questions
Q.1 differentiate between capital and revenue receipts.
Q.2 what is revenue expenditure?
Q.3 what are capital and revenue receipts?
Long questions

Q.1. Discuss the circumstances which decide whether a particular item is Capital Expenditure or Revenue Expenditure ?

Q.2. A firm incurred the following expenses; state whether the expenses are revenue or capital.

(a) Purchase price of second-hand machinery Rs.20,000.
(b) Cost of complete overhavling Rs.9000.
(c) Carriage and installation charges Rs.500.
(d) Ordinary repair Rs.300.
(e) Special repair on accidental damage Rs. 2000.
(f) Cost of removal and installation Rs. 700.

LESSON NO. 1.7 AUTHOR : Ms. RAJINDER KAUR

# FINAL ACCOUNTS



## 1.7.0 Objective

The objective of this lesson is to explain

i. Preparation of trading account
ii. Preparation of profit and loss account
iii. Preparation of balance sheet

## 1.7.1 Introduction

When the transactions of a business for a certain period have been entered in the journal, posted therefrom into the ledger and the arithmetical accuracy of the ledger tested by means of a trial balance, we enter upon the last stage of book keeping, namely the preparation of a summary of the accounts. The summary consists of transactions profit and loss account and balance sheet.

### 1.7.2 Trading Account :

Trading account is a part of profit and loss account. Usually profit and loss account of the business is divided into two parts. The first part is termed as trading account which is so prepared as to show the amount of profit or loss account of purchasing the goods of selling them. Such profit is termed as Gross Profit and Loss as Gross loss. Gross profit is difference between the cost of goods that have been sold and the proceeds of their sales without any deductions in respect of the indirect expenses. The following items usually appear on the debit and credit side of trading accounts.

(i) On the debit side :

(a) Opening Stock : This is stock which remained unsold at the end of previous accounting period.

(b) Purchases : Purchases means total purchases. i.e. Cash Plus Credit. If there is any purchases returns, these should be deducted and net purchases be shown in the trading account.

(c) Direct Expenses : Those expenses which are incurred while purchasing the goods or while manufacturing it are called direct expenses. These direct expenses generally are wages paid for manufacturing the goods, carriage inwards, freight, duty, clearing charges, motive power, gas, fuel, stores, royalties etc.

(ii) Item on credit side of trading account :

(a) Sales : Sales mean total sales i.e. cash plus credit sales. If there are any sales returns, these should be deducted from sales. So net sales are credited to trading account.

(b) Closing Stock : It is the value of stock lying unsold in the godown or shop on the last day of accounting period. Normally closing stock is given outside

the trial balance, in that case it is to be shown on the credit side of trading account. But if it is given inside the trial balance, it is not to be shown on the trading side of the trading account but appears only in the balance sheet as asset.

### 1.7.3 PROFORMA OF TRADING ACCOUNT :

Trading Account for the year ended....

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| To Opening Stock | | By Sales | |
| | | Less sales returns | |
| To Purchase | | By Closing Bank | |
| Less : purchases returns | | | |
| To Carriage | | By Gross Loss | |
| Inward or Carriage | | Transferred to Profit | |
| on purchases | | & Loss Account | |
| To freight | | | |
| To Wages, manufacturing | | | |
| or productive wages | | | |
| To Factory expenses | | | |
| To Store Consumers | | | |
| To Royalities | | | |
| To Motive Power | | | |
| To Coal & Coke | | | |
| To Water | | | |
| To Oil | | | |
| To Billing | | | |
| To Octroi | | | |
| To Dock Charges | | | |
| To Custom Duty | | | |
| To Gross Profit | | | |
| Transferred to Profit & | | | |
| Loss A/c | | | |

### 1.7.4 Profit and Loss Account :

The aim of profit and loss account is to ascertain the net profit or net loss for a particular period. For earning net profit a businessman has to incur many expenses in addition to direct expenses. These expenses are deducted from gross profit and the resultant figure is net profit. Net profit is the surplus remaining after charging against gross profit all the expenses. When such expenses are more than gross profit the result is net loss and if profit exceeds these expenses, the result is net profit. Only indirect expenses are taken to profit and loss account and deducted from gross profit. Such expenses are of the following types :

(i) Selling and Distribution Expenses :

Godown rent, advertisement, agents, salaries, commission and bad debts etc.

(ii) Management or Office Expenses :

These are the expenses paid from office for whole of the business. It includes office salaries and wages, insurance, rent, printing and stationary, postage and telephone, auditor's fee, legal expenses, bank charges etc.

(iii) Financial Expenses :

The expenses which are incurred to obtain necessary finances for the business are called financial expenses. These include interest on capital, interest on loans, cash discount etc.

(iv) Maintenance and Depreciation Expenses :

These expenses include repairs to building, machinery and furniture, depreciation on fixed assets. All these expenses are shown on debit side of profit and loss account.

(v) Credit side of profit and loss accounts :

On credit side of profit and loss account we record various income such as discount received, commission received, rent received, interest received, income from investment. Profit on sale of assets, bad debt recovered and dividend received.

### 1.7.5 Preparation of Profit and Loss Account :

The gross profit from trading account is transferred to profit and loss account. With the result that trading account shall be closed and profit and loss account is opened. Then the profit and loss account is debited with all indirect expenses which results in the closing of all accounts relating to indirect expenses. The profit and loss account is then credited with the accounts of income by which all income accounts are closed. After debiting all indirect expenses and crediting the incomes, the differences of two sides of profit and loss accounts shall be net profit or net loss. If credit side is more, the result is net profit and if debit exceeds the result is net loss.

PROFORMA OF PROFIT AND LOSS ACCOUNT :

Profit and Loss Account for the year ending...............

Dr. Cr.

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| To selling and distribution : | | | |
| Expenses | | By Gross Profit | |
| Godown rent | | By Discount received | |
| Packing expenses | | By Income from investment | |
| Advertising | | By interest received | |
| Agents Commission | | By Dividends | |
| Bad Debts | | By Interest on drawings | |
| To Management expenses : | | | |
| Office Salaries and Wages | | | |
| Rent & Taxes | | | |
| Lighting and insurance | | | |
| Printing and Stationary | | | |
| Postage and Telephone | | | |
| Legal Expenses | | | |
| Audit Fees | | | |
| General Expenses | | | |
| To Financial expenses : | | | |
| Discount allowed | | | |
| Interest on capital | | | |
| Interest on loans | | | |
| To Maintenance : | | | |
| Repairs to building | | | |
| Repairs to furniture and machinery | | | |
| To Depreciation | | | |
| on Building | | | |
| on machinery | | | |
| on furniture | | | |

### 1.7.6 self check exercise1

a)trading account

b) profit and loss account

### 1.7.7Balance Sheet :

A balance sheet is a statement of financial position of a concern at a given date. Therefore, balance sheet shows the financial position of a concern and it shows its financial position on a given date, usually the last date of accounting period. Balance sheet is prepared from the trial balance after all the balances of nominal accounts are transferred to trading and profit and loss account and the corresponding accounts in ledger are closed. Balances left in the trial balance either represent assets or liabilities existing at the date of the financial close. All assets and liabilities are displayed in the balance sheet according to certain principles such as :

(i) All real and personal accounts having debit balance should be shown on asset side of balance sheet.

(ii) All the real and personal accounts having credit balances should be shown on liability side of balance sheet.

#### Classification of Assets :

(i) Fixed Assets :

These assets with a durable nature are used in business and are acquired to be retained permanently for the purpose of carrying on the business such as land, building machinery and furniture etc.

(ii) Floating or Circulating Assets :

Those temporarily held assets which are meant for resale or which frequently undergo change e.g. Cash, stock, stores, debtors and bills receivable.

(iii) Fictitious Assets :

Those assets which are not represented by any thing concrete or tangible. Preliminary expenses, debit balance of Profit and losses account are the examples of such assets.

#### Classification of Liabilities :

(i) Fixed Liabilities :

Those liabilities which are to be redeemed after long period of time. These includes long term loans.

(ii) Current Liabilities :

Those liabilities which are to be redeemed in near future usually within a year. Trade creditors, bank loan, bills payable etc. are the examples of current liabilities.

(iii) Contingent Liabilities :

These are not actual liabilities but their becoming actual liability is contingent on the happening of a certain event. In other words they would become liabilities in the future provided the contemplated event occurs. If it does not occur no liability is incurred. Since such a liability is not an actual liability, it is not shown in balance sheet. Usually it is mentioned in the form of footnote.

## Form of Balance Sheet :

A Balance sheet is divided into two parts, on the left hand side are listed various liabilities and capital and on the right hand side are listed various assets. The left hand side is termed as liabilities and right hand side is titled assets.

## 1.78 PERFORMA OF BALANCE SHEET :

Balance Sheet as on......................

| Liabilities | Amount | Assets | Amount |
|---|---|---|---|
| Bills Payable | | Cash in hand | |
| Loans | | Cash at Bank | |
| Sundry Creditors | | Investments | |
| Outstanding expenses | | Sundry debtors | |
| Reserves | | Bills receivable | |
| Capital | | Stock-in-trade | |
| | | Loose Tools | |
| | | Fixtures and fittings | |
| | | Plant and Machinery | |
| | | Building | |
| | | Land | |
| | | Goodwill | |

Illustration : Prepare trading and Profit and Loss account and balance sheet from the following Trial Balance.

Trial Balance as on..................................

| | Dr. Rs. | Cr. Rs. |
|---|---|---|
| Ram's Drawing and capital | 15,000 | 40,000 |
| Leasehold land | 25,000 | |
| Freehold premises | 20,000 | |
| Goodwill | 7,000 | |
| Trademarks | 13,000 | |
| Machinery and Plant | 15,000 | |
| Fixtures and fittings | 2,000 | |

| | | |
|---|---|---|
| Stock at commencement | 18,000 | |
| Bills receivable and payable | 4,000 | 6,000 |
| Sundry debtors and creditors | 16,000 | 24,000 |
| Purchases and Sales | 80,000 | 1,50,000 |
| Returns | 1,000 | 2,000 |
| Carriage inwards | 15,000 | |
| Carriage outwards | 5,000 | |
| Freight duty | 1,200 | |
| Manufacturing wages | 22,000 | |
| Coal, Fuel and gas | 800 | |
| Factory expenses | 4,500 | |
| Salaries | 18,000 | |
| Rent, taxes and insurance | 6,000 | |
| Commission | 25,000 | |
| Interest | | 3,000 |
| Discount | 4,000 | 6,000 |
| Stationary | 500 | |
| Trading Expenses | 1,800 | |
| Cash in hand | 700 | |
| Bankers | | 39,000 |
| | 2,70,000 | 2,70,000 |

Solution :

Trading and Profit and Loss Account of Mr. Ram for year ending 1997

| | | | | | |
|---|---|---|---|---|---|
| To Opening Stock | | 18,000 | Sales | 1,50,000 | |
| To Purchases | 80,000 | | (–) Returns | 1,000 | 1,49,000 |
| (–) Returns | 2,000 | 78,000 | | | |
| To Carriage inwards | | 1,500 | | | |
| To Freight Duty etc. | | 1,200 | | | |
| To Manufacturing Wages | | 22,000 | | | |
| To Coal, fuel and gas | | 800 | | | |
| To Factory expenses | | 4,500 | | | |
| To Gross Profit c/d | | 23,000 | | | |
| | | 1,49,000 | | | 1,49,000 |

| | | | |
|---|---|---|---|
| To Carriage outward | 500 | By Gross Profit b/f | 23,000 |
| To Salaries | 18,000 | By Interest | 3,000 |
| To Rent, Taxes, Insurance | 6,000 | By Discount | 6,000 |
| To Commission | 2,500 | By net loss | 1,300 |
| By Discount | 4,000 | | |
| To Stationary | 500 | | |
| To Trading Expenses | 1,800 | | |
| | 33,300 | | 33,300 |

Balance Sheet of Mr. Ram as on 31st December, 1997

| Liabilities | | Amount | Assets | Amount |
|---|---|---|---|---|
| Bill Payable | | 6,000 | Cash in hand | 700 |
| Sundry Creditors | | 24,000 | Sundry debtors | 16,000 |
| Bankers | | 39,000 | Bills Receivable | 4,000 |
| Capital : | | | Fixtures and Fittings | 2,000 |
| Opening Balance | 40,000 | | Machinery and Plant | 15,000 |
| (–) Loss | 1,300 | | Trade Mark | 13,000 |
| (–) Drawings | 5,000 | 33,700 | Lease hold land | 25,000 |
| | | | Freehold Premises | 20,000 |
| | | | Goodwill | 7,000 |
| | | 1,02,700 | | 1,02,700 |

Illustration : Prepare Trading, Profit and Loss account for the year ending 31 Dec. and a Balance Sheet as on that date from the following Trial Balance :

| | Dr. Rs. | Cr. Rs. |
|---|---|---|
| Capital | -- | 10,000 |
| Cash | 1,500 | -- |
| Bank overdraft | -- | 2,000 |
| Purchase and Sales | 12,000 | 15,000 |
| Returns | 1,000 | 2,000 |
| Establishment expenses | 2,200 | -- |
| Taxes and Insurance | 500 | -- |

| | | |
|---|---|---|
| Bad Debts and B/D reserve | 500 | 500 |
| Debtors and Creditors | 5,000 | 2,000 |
| Commission | -- | 500 |
| Deposits | 4,000 | -- |
| Opening Stock | 3,000 | -- |
| Drawings | 1,400 | -- |
| Furniture | 600 | -- |
| B/R and B/P | 3,000 | 2,500 |
| | 34,700 | 34,700 |

Adjustments :

1. Salaries Rs. 100 and taxes Rs. 200 are outstanding but insurance Rs. 50 is prepaid.
2. Commission Rs. 100 received in advance for the next year.
3. Interest Rs. 210 is to be received on deposits and interest on Bank overdraft Rs. 300 is to be paid.
4. Bad Debts reserve is to be maintained at Rs. 7,000.
5. Depreciation on Furniture is provided at 10%.
6. Stock on at the end is Rs. 4,500.

Solution :

Trading and Profit & Loss Account
For the year ending 31 Dec.

| Particulars | | Amount (Rs.) | Particulars | | Amount (Rs.) |
|---|---|---|---|---|---|
| To Opening Stock | | 3,000 | By Sales | 15,000 | |
| To Purchases | 12,000 | | Less : Returns | 1,000 | 14,000 |
| Less : Returns | 2,000 | 10,000 | By Closing Stock | | 4,500 |
| To Gross profit c/d | | 5,500 | | | |
| | | 18,500 | | | 18,500 |
| To Establishment Expenses | | 2,200 | By Gross Profit b/d | | 5,500 |
| To Outstanding | | 100 | By Commission | 500 | |
| | | | Less : Commission | | |
| | | | in advance | 100 | 400 |
| To Taxes & Insurance | 500 | | | | |
| Add : Outstanding Tax | 200 | | By Accrued Interest | | 210 |
| | 700 | | By Bad Debts Reserve | | 700 |
| Less : Prepaid Insurance | 50 | 650 | | | |
| To Outstanding Interest | | | | | |
| on Bank Overdraft | | 300 | | | |
| To Bad Debts | | 500 | | | |
| To New Reserves for bad debts | | 500 | | | |
| Furniture | | 60 | | | |
| To Net Profit | | 2,000 | | | |
| | | 6,810 | | | 6,810 |

Balance Sheet on 31st December,

| Liabilities | | Amount (Rs.) | Assets | | Amount (Rs.) |
|---|---|---|---|---|---|
| Bills Payable | | 2,500 | Cash in hand | | 1,500 |
| Creditors | | 2,000 | Bill Receivable | | 3,000 |
| Outstanding Exp. : Taxes | | 200 | Debtors | 5,000 | |
| Establishment Exp. | | 100 | Less : Provision | | |
| Advance Commission | | | for bad debts | 1,000 | 4,000 |
| Overdraft | 2000 | | Closing stock | | 4,500 |
| Add : Outstanding | | | Prepaid Insurance | | |
| Interest | 300 | 2,300 | | | |
| Capital | 10,000 | | Fixed Deposit | 4,000 | |
| Add : Net Profit | 2,000 | | Add : Accrued Interest | 210 | 4,210 |
| | 12,000 | | | | |
| Less : Drawing | 1,400 | 10,600 | Furniture | 600 | |
| | | | Less : Depreciation | 60 | 540 |
| | | 17,800 | | | 17,800 |

Illustration : Following is the Trial Balance of Amit Sales Corporation as on 31 Dec.

TRIAL BALANCE

| | | | |
|---|---|---|---|
| Plant & Machinery | 5,000 | Capital | 4,000 |
| Furniture & fittings | 260 | S.Creditors | 5,200 |
| Stock | 4,800 | Bills payable | 560 |
| Motor Van | 1,200 | Prov. for D. Debts | 250 |
| S.Debtors | 4,570 | Returns outward | 550 |
| Cash | 40 | Discount Received | 370 |
| Bank | 650 | Sales | 48,000 |
| Wages | 15,000 | | |
| Salaries | 1,400 | | |
| Purchases | 21,350 | | |
| Bills Receivables | 720 | | |
| Returns Inward | 930 | | |
| Drawings | 700 | | |
| Rent | 600 | | |
| Factory Lighting | 80 | | |
| Insurance | 630 | | |
| G. Expenses | 100 | | |
| Bad Debts | 250 | | |
| Discount Allowed | 650 | | |
| | 58,930 | | 58,930 |

The following adjustments are to be made :

(i) Stock on 31 Dec. Rs. 5,200.

(ii) 3 months factory lighting is due Rs. 30.

(iii) 5% depreciation to be written off on furniture.

(iv) Write off further bad debts Rs. 70

(v) The provision for doubtful to be increased to Rs. 300 and provision on for discount on debtors @ 2%

(vi) During the year machinery was purchased for Rs. 2.000 but it was debited to purchase account.

You are required to make Trading & Profit & Loss account for the year ending 31 Dec. 1997 and Balance Sheet as on that date :

Trading and Profit & Loss Account
for the year ending 31st Dec.

| | | | | | |
|---|---|---|---|---|---|
| To Opening Stock | | 4,800 | By Sales | 48,000 | |
| To purchases | 21,350 | | Less : Returns | 930 | 47,070 |
| Less : Returns | 550 | | | | |
| Machinery purchased | 2,000 | 18,800 | By closing stock | | 5,200 |
| To factory lighting | 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 Received | | 370 |
| To Insurance | | 630 | | | |
| To General Expenses | | 100 | | | |
| To Discount Allowed | | 650 | | | |
| To Bad Debts | 250 | | | | |
| Add : Further | 70 | | | | |
| New Prov. | 300 | | | | |
| | 620 | | | | |
| Less : Old Prov. | 250 | 370 | | | |
| To provision for Debtors | | 84 | | | |
| To Depreciation on furniture | | 13 | | | |
| To net profit | | 10,083 | | | |
| | | 13,930 | | | 13,930 |

Balance Sheet as on 31st December,

| Liabilities | | Amount (Rs.) | Assets | | Amount (Rs.) |
|---|---|---|---|---|---|
| Capital Account | 4,000 | | Plant & Machinery | 5000 | |
| Add : Net Profit | 10,083 | | Add : Purchased | 2000 | 7000 |
| | 14,083 | | Furniture & Fittings | 260 | |
| Less : Drawings | 700 | 13,383 | Less: Depreciation | 13 | 247 |
| Sundry Creditors | | 5,200 | Closing Stock | | 5,200 |
| Bills Payable | | 560 | S. Debtors | 4,570 | |
| Outstanding Factory Lighting | | 30 | Less : B.Debts | 70 | |
| | | | | 4,500 | |
| | | | Less : New Prov. | 300 | |
| | | | Less : Prov for | | |
| | | | Discount | 84 | 4,116 |
| | | | Bills Receivable | | 720 |
| | | | Cash | | 650 |
| | | | Bank | | 40 |
| | | 19,173 | | | 19,173 |

Illustration : X and Y are equal partners in a business. The following were the balances of the firm as on 31st March, :

| | Rs. |
|---|---|
| Taxes and insurance | 1,120 |
| Creditors | 7,920 |
| Provision for bad and doubtful debts | 435 |
| Bad debts | 392 |
| General charges | 1000 |
| Advertisement | 3800 |
| Rent received | 138 |
| Cash in hand | 510 |
| Purchases | 63,220 |
| Motor lorry | 3,250 |
| Carriage on purchases | 2,300 |
| Repairs and renewals | 1,200 |
| Allowances received from creditors | 2,400 |
| Coal consumed | 6,718 |
| Plant and machinery | 25,000 |
| Wages | 6,780 |
| Land and building | 13,840 |
| Salaries | 2,863 |
| Debtors | 8,000 |
| Sales | 75,000 |
| Cash at bank | 2,000 |
| Stock on 1-4-1986 | 25,000 |
| X's loan account | 10,000 |
| X's capital account | 49,400 |
| X's drawing account | 4,250 |
| Y's capital account | 30,000 |
| Y's drawing account | 2,050 |
| Stock of coal | 2,000 |

Prepare trading and profit & loss account for the year ended 31st March, and a balance sheet as on that date after making the following adjustments :-

1. Stock on 31st March, was Rs. 30,000
2. Transfer Rs. 3,000 from purchases account and Rs. 250 from wages account to land and buildings account as these sums were actually incurred on extensions to land and buildings.
3. X's loan bears interest @ 7½% per annum.
4. Increase the provision of doubtful debts to Rs. 543.
5. Write off one-half of advertisement expenses.
6. Interest on partner's capital account is to be allowed @ 5 per cent per annum.
7. Write off 10 per cent on motor lorry and plant and machinery.

Solution :

Trading and Profit & Loss Account of M/s X and Y
for the year ending 31st March

| | | | Rs. | | Rs. |
|---|---|---|---|---|---|
| To Opening Stock | | | 25,000 | By Sales | 75,000 |
| To purchases | | 63,220 | | By Closing stock | 30,000 |
| Less : Allowances | | | | | |
| from creditors | 2,400 | | | | |
| Transferred to | | | | | |
| land & building | 3,000 | 5,400 | 57,820 | | |
| To carriage on purchases | | 2,300 | | | |
| To coal consumed | | | 6,718 | | |
| To wages | | 6,780 | | | |
| Less transferred to land | | | | | |
| and building | | 250 | 6,530 | | |
| To Gross profit c/d | | | 6,632 | | |
| | | | 1,05,000 | | 1,05,000 |
| To Taxes & insurance | | | 1,120 | By Gross profit b/d | 6,632 |
| To General charges | | | 1,000 | By rent received | 138 |
| To Advertisement | | 3,800 | | By Net loss | 9,358 |
| *Less* carried | | | | | |
| forward 50% | | 1,900 | 1,900 | | |
| To Repair & | | | | | |
| replacement | | | 1,200 | | |
| To Salaries | | | 2,863 | | |
| To Interest on X's loan | | | 750 | | |
| To Bad debts : | | | | | |
| w/off during | | | | | |
| the year | | 392 | | | |
| Add new provision | | 543 | | | |
| | | 935 | | | |
| Less old provision | | 435 | 500 | | |
| To Interest on capital : | | | | | |
| X | | 2,470 | | | |
| Y | | 1,500 | 3,970 | | |
| To Depreciation | | | | | |
| on motor lorry | | 325 | | | |
| on plant & | | | | | |
| machinery | | 2,500 | 2,825 | | |
| | | | 16,128 | | 16,128 |

Balance Sheet of M/s X and Y
as on 31st March

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | Rs. | | | Rs. |
| Creditors | | | 7,920 | Cash in hand | | 510 |
| X's loan account | | | 10,000 | Cash at bank | | 2,000 |
| Capital : | | | | Debtors | 8,000 | |
| X's capital-opening | | | | *Less* provision for | | |
| balance | | 49,400 | | bad debts | 543 | 7,457 |
| *Add* interest on capital | | 2,470 | | Closing stock | | 30,000 |
| | | 51,870 | | Motor lorry | 3,250 | |
| *Less* : Loss 1/2 | 4,679 | | | *Less* depreciation | 325 | 2,925 |
| Drawing | 4,250 | 8,929 | 42,941 | Plant & | | |
| Y's capital-opening | | | | machinery | 25,000 | |
| balance | | 30,000 | | *Less* depreciation | 2,500 | 22,500 |
| *Add* interest on capital | | 1,500 | | Land & building | | |
| | | 31,500 | | Balance as per T/B | 13,840 | |
| *Less* : Loss 1/2 | 4,679 | | | *Add* extension | | |
| Drawing | 2,050 | 6,729 | 24,771 | during the year | 3,250 | 17,090 |
| Outstanding interest | | | 750 | Stock of coal | | 2,000 |
| | | | | Unexpired advertising | | 1,900 |
| | | | 86,382 | | | 86,382 |

1.7.10 self check exercise 2

a) what is balance sheet?

b) classification of assets in balance sheet

1.7.11 summary

After going through this lesson we have learnt about trading account, profit and loss account and balance sheets. Preparation of these accounts is also explained in detail in this lesson. Trading account show the result operating activities of the business in the form of gross profit and gross loss. Profit and loss account shows the net result of the business activities in the form of net profit or net loss. Balance sheet shows the assets and liabilities of the business. It shows the financial position of the business.

1.7.12 Glossary

Net profit= Gross profit + indirect incomes- indirect expenses

Gross profit= opening stock+ purchases +direct expenses- sales- closing stock

1.7.13answers to self check exercise

1 a) see para 1.7.2

b) see para 1.7.4

2 a) see para 1.7.7

b) see para 1.7.7

1.7.14 exercise

Short questions

Q.1 what you meant by trading account?

Q.2 what is balance sheet?

Long questions

Q.1 prepare trading and profit and loss account with imaginary figures.

Q.2 draw Performa of balance sheet.

1.7.15 Suggested Readings :

1. Advanced Accounting By Jain & Narang
2. Book Keeping & Accountancy By R.R. Gupta & V.S. Gupta
3. Financial Accounting Juneja, Chawla & Saksena
4. Advanced Accountancy S.N. Maheshwari

Lesson No. 1.8 AUTHOR : SHALLU JAIN

# Rectification of Errors



## 1.8.0 objective

The objective of this lesson is to explain

i. Meaning of errors
ii. Types of errors
iii. Journal entries for rectification of errors
iv. Suspense account
v. effect of errors in final accounts

## 1.8.1 introduction

"To err is human". Accountant, as a human being is likely to commit mistakes while recording the transactions in the books of original entry, posting them to Ledger accounts or in preparing a trial balance itself.. It is essential to locate and rectify errors, otherwise profit and loss account will not disclose the true profit or loss of the business and the Balance Sheet will not represent a true and fair view of the financial position of the business.

Errors should never be corrected by overwriting or erasing because it reduces the authenticity of accounting records and gives the impression that something is being concealed.

Method of rectification depends on the stage at which the errors are rectified. If an error is located in the books of original entry before its posting to the Ledger, it may be corrected by neatly crossing out the wrong figure by a single line and writing the correct figure above the crossed figure. Similarly, if a wrong figure has been posted to the Ledger Account, it may also be corrected in the same manner.

If, however an error is located after some time, it should be corrected by passing a suitable journal entry, called rectifying entry.

## 1.8.2 types of errors

All errors of accounting procedure can be classified as follows :

(1) Errors of Principle :

When a transaction is recorded against the fundamental principles of accountancy, it is an error of principle e.g. treating a revenue receipt, a capital receipt or vice versa.

(2) Clerical Errors:

These errors can be subcloned as follows :

(i) Errors of Omission : When a transaction is either partially or wholly not recorded in the books, it is an error of omission. It may be with regard to omission to enter a transaction in books of original entry or with regard to omission to post a transaction from the books of original entry to the accounts concerned in the ledger.

(ii) Errors of Commission : When an entry is incorrectly recorded either wholly or partially – incorrect posting, incorrect calculation, incorrect casting or balancing. Some of the errors of commission effect Trial Balance whereas others do not. Errors effecting trial balance can be revealed by preparing a trial balance.

(iii) Compensating Errors : Sometimes an error is counter balanced by another error or errors in such a way that it is not disclosed by trial balance. Such errors are called Compensating Errors.

From the rectification point of view, all errors can be classified into the following two categories :

(A) Two-sided Errors

(B) One-sided Errors

(A) Two-sided Errors :

Errors which affect two accounts simultaneously are called two sided errors. Such errors may include the following types of errors :

(I) Omission to pass an entry in the books of original records.

(II) Wrong Recording of a transaction in the books or original records.

(III) Posting to the wrong account,

(IV) Errors of Principle

### 1.8.3 rectification of errors

All these errors are rectified by passing a Journal entry, one account being debited and the other account being credited. Following rules should be observed while passing entries to rectify the two sided errors:

(I) The account showing an excess debit should be credited in the rectifying entry.

(II) The account showing a short debit should be debited in the rectifying entry.

(III) The account showing an excess credit should be debited in the rectifying entry.

(IV) The account showing a short credit should be credited in the rectifying entry.

(V) When an account has wrongly been debited in place of another account e.g. Machinery purchased for Rs.5000 has been debited to Purchases A/C.

This error effects the two accounts in the following manner :

| | |
|---|---|
| Machinery A/C | Purchases A/C |
| Short by Rs.5000 | Excess by 5000 |

While rectifying this mistake Machinery A/C will be debited because it was no debited earlier and the Purchase A/C will be credited because it was wrongly debited.

Rectifying entry:

| | | |
|---|---|---|
| Machinery Account | Dr. | 5000 |
| To Purchases Account | | 5000 |

(For purchase of machinery wrongly debited to Purchases A/C)

(i) When an account has wrongly been credited in place of other accounting. Rs. 3000 being the sale proceeds of old furniture has been credited to sales A/C.

This errors effects the two accounts in the following manner :

| Furniture A/C | Sales A/C |
|---|---|
| Short by Rs.3000 | Excess by Rs.3000 |

While rectifying this mistake Sales A/C will be debited because it has been credited by mistake and the Furniture A/C will be credited because it was not credited earlier.

Rectifying Entry:

| | |
|---|---|
| Sales A/C | Dr.3000 |
| To Furniture A/C | 3000 |

(For sale of old furniture wrongly credited to Sales A/C)

(II) When there is a short debit in one account and a short credit in other account:

e.g. Goods purchased from Sanjay for Rs. 2000 was entered in Purchase Book as Rs.200 only.

Effect of error:

| Purchases A/C | Sanjay Account |
|---|---|
| Dr. Short by Rs.1800 | Short by Rs.1800 Cr. |

While rectifying this mistake Purchase A/C will be debited by Rs. 1800 because There will be a short debit in the Purchase A/C and Sanjay's A/C will be credited because it has been credited by a lesser amount.

Rectifying Entry:

| | |
|---|---|
| Purchases Account | Dr. 1800 |
| To Sanjay | 1800 |

(For goods purchased from Sanjay for Rs.2000 wrongly entered as Rs.200)

(III) When there is excess debit in one account and an excess credit in another account:

e.g. Goods sold to Mohan for Rs.380 on credit was recorded in Sales Book as Rs.830

Effect of Error :

| Mohan | Sales A/C Cr. |
|---|---|
| Dr. Excess by Rs.450 | Excess by Rs.450 |

While rectifying this mistake Mohan will be credited Rs.450 because it has been excess debited by a similar amount and Sales A/C will be debited by Rs.450 because it has been excess credited by a similar amount.

Rectifying Entry :

| | | |
|---|---|---|
| Sales A/C Dr. | 450 | |
| To Mohan | | 450 |

(For sales to Mohan for Rs.380 wrongly entered as Rs.830)

Illustration : Rectify the following errors:

(1) An amount of Rs.2500 spent for the extension of machinery has been debited to wages account.

(2) Rs.100 paid as cartage for the newly purchased furniture posted to Cartage A/C.

(3) A builder's bill for is 5000 for erection of a small cycle shed was debited to Repairs account.

(4) A cheque of Rs. 1700 received from Shyam Sunder was dishonoured and had been posted to debit side of "Allowance A/c."

(5) Rs.800 paid for the newly purchased 'far' posted to 'Purchaser Account'.

(6) Rs.4000 the amount of sale of an old Machinery has been credited to sales Account.

(7) Rs.1000 received from 'X' has been credited to his account .

Solution:

| | | | |
|---|---|---|---|
| (1) | Machinery A/c Dr. | 2500 | |
| | To Wages A/c | | 2500 |
| | (Being amount wrongly debited to Wages A/c) | | |
| (2) | Furniture A/c Dr. | 100 | |
| | To Cartage A/c | | 100 |
| | (Being amount wrongly debited Cartage account) | | |
| (3) | Buildings A/c Dr. | 500 | |
| | To Repairs A/c | | 500 |
| | (Being extension of building wrongly debited to Repairs A/c) | | |
| (4) | Shyam Sunder A/c Dr. | 1700 | |
| | To Allowance A/c | | 1700 |
| | Being dishonor of cheque received from shyam sunder wrongly debited to Allowance A/c | | |
| (5) | Furniture A/c Dr. | 800 | |
| | To Purchases A/c | | 800 |
| | (Being purchase of fan wrongly posted to purchases A/c) | | |
| (6) | Sales A/c Dr. | 4000 | |
| | To Machinery A/c | | 4000 |
| | (Being sale of machinery wrongly credited to sales A/c now rectified) | | |
| (7) | Y Dr. | 1000 | |
| | To X | | 1000 |
| | (For amount wrongly credited to Y instead of X,now rectified) | | |

Self check exercise1

Pass Journal Entries to Rectify the following errors :

(1) Goods costing Rs.1000 have been purchased on credit from Sohan, but no entry has been made in the books although the goods were taken into stock.

(2) Goods amounting to Rs. 4000 have been sold on credit, but no entry has been made in the books.

(3) No entry has been made for Purchases Return of Rs. 200

(4) No entry has been made for Sales Return of Rs. 450

(5) Goods purchased from Ramesh Chandra on credit for Rs. 5000 was recorded in the purchase Book as Rs. 500

(6) Sales of Rs. 600 to Siya Ram were recorded as Rs. 60 in the Sales Book.

(7) Goods purchased on Credit from Pawan for Rs. 400 was recorded as Rs. 4000 in Purchase Book.

(B) One-Sided Errors :

These errors affect only one account. If e.g. A sum of Rs. 2500 given to Ajay is correctly recorded in cash book but omitted to be posted to Debit side of Ajay the error will be termed as one-sided error because the error exists in the account of Ajay only.

Such types of errors occur in the following cases.

(I) When a subsidiary book is undercast or overcast.

(II) When the posting to an account is altogether omitted.

(III) When the posting is made on wrong side of an account.

(IV) When the posting is made from the wrong amount.

(I) When a subsidiary book is undercast or overcast e.g. Sales book undercast by Rs.200 :

This error will make the total of sales account less by Rs. 200.

While rectifying this error sales account is credited by Rs. 200.

(II) When the posting to an account is altogether omitted :

e.g. Discount allowed to Sunder Rs. 80 not posted to discount account:

With this error discount account is debited less by Rs. 80.

For rectifying this error we will debit discount account by Rs.80.

(III) When the posting is made on wrong side of an account:

e.g. Rs.500 paid to Sonu has been credited to his account Sonu Account has been credited instead of being debited. Rectification will be made by double the amount of the entry. Hence Rs.1000 will be written on debit side of Sonu's account by writing the words:

To errors in posting to wrong side———Rs.1000

(IV) When the posting is made from the wrong amount :

e.g. Rs.500 paid to Suresh were debited to his account as Rs.50. Suresh Account has been credited by Rs.50 instead of being debited by Rs.500. As such, the rectification will be debit side of Suresh Account.

To error in posting with wrong amount in wrong side Rs.550.

## Stages of Correction of Errors

All types of errors can be rectified at two stages :

(A) when the errors are located and rectified before the preparation of final account.

(B) when the errors are not located and rectified after the preparation of final accounts.

In the first care errors are specified as above. In the 2nd case when errors are rectified after preparation of trial balance then rectification is done by passing journal entries. As and with reference to suspense account. When all errors are disclosed and rectified account shall be closed automatically.

## 1.8.5 SUSPENSE ACCOUNT

Meaning and utility: When in spite of the best efforts, the Trial Balance does not tally, the difference is put to a newly opened account named 'Suspense Account'. and Trial Balance is thus made to tally. This is done to avoid the delay in the preparation of final accounts.

In case, debit side of Trial Balance exceeds the credit side, the difference is put on the credit side of the Trial Balance. In this case, suspense Account will show a credit balance.

Likewise, if credit side of Trial Balance exceeds the debit side, the difference is put on th debit side set the Trial Balance. In this case, Suspense Account will show a debit balance.

Following points should be noted while passing rectification entries with the help of Suspense Account.

(1) Suspense account is used to rectify only those errors which affect the Trial Balance .

(2) (i) If the account which is to be rectified is debited in the rectifying entry, Suspense Account will be credited to complete the double entry.

(ii) If the account which is to be rectified is credited in the rectifying entry, Suspense Account will be debited to complete the double entry.

There was a difference of Rs.725 in a Trial Balance. It has been transferred to credit side of Suspense A/c later on following errors were discovered Pass the Journal Rectifying Entries and prepare Suspense A/c.

(i) An account of Rs.375 has been posted on debit side of commission account instead of Rs.275.

(ii) Goods of Rs.200 purchased from Sohan Lal has been posted to his account as Rs.250.

(iii) Total of Sales Returns Boot was overcost by Rs.475.

(iv) A credit amount of Rs.50 was posted at Rs.150 to the debit side of a personal account.

(v) Goods of Rs.300 were sold to Mahesh, but it was recorded in Purchase Book.

Solution:

| | | | |
|---|---|---|---|
| (1) | Suspense A/c | Dr 100 | |
| | To Commission A/c | | 100 |
| | (Being excess amount on debit side of Commission A/c now rectified) | | |
| (2) | Sohan Lal A/c | Dr 50 | |
| | To suspense A/c | cr 50 | |
| | (Being excess amount credited now debited) | | |
| (3) | Suspense A/c | Dr. 475 | |
| | To Sales Return A/c | | 475 |
| | (For the correction of overcost of Sales Return book) | | |
| (2) | Suspense A/c | Dr. 200 | |
| | To account not credited | 50 | |
| | To Personal A/c | 150 | |
| | (For credit item of Rs.50, posted to debit of another personal account | | |
| (5) | Mahesh A/c | Dr.600 | |
| | To sales A/c | 300 | |
| | To Purchases A/c | 300 | |
| | (For goods sold wrongly passed through Purchases Book) | | |

Suspense Account

| | | | |
|---|---|---|---|
| To Commission A/c | 100 | | |
| To Sales Return A/c | 475 | By Difference in Trial Balance | 725 |
| To Account not credited | 50 | | |
| To Personal A/c | 150 | By Sohan Lal | 50 |
| | 775 | | 775 |

### 1.8.6 Effect of Errors in Final Accounts:

#### (1) Errors effecting Profit and Loss account:

Only those accounts which are transferred to Trading and Profit and Loss account at the time of preparation of final accounts affect the profit. It means that only mistakes in nominal accounts and goods accounts will affect the profits errors in there items will either increase or decrease the existing profits.

(i) If because of an error a nominal account has been given some debit, the profit will decrease and losses will increase.

e.g. machinery is overhauled for Rs.10,000 but the amount debited to machinery repairs account. This error will reduce the profits.

(ii) If because of an error the amount is omitted from recording on the debit side of a nominal account it results in increase in profits or decrease in losses.

e.g. Rent paid to landlord but amount has been debited to personal account of landlord it will increase the profit as the expenditure on rent is reduced.

(iii) Profits will increase or losses will decrease if a nominal account is wrongly credited.

e.g. Investments were sold and amount was credited to sales accounts instead of investment account .This error will increase profits.

(iv) Profit will decrease or loss will increase if an item is omitted to be posted to credit side of an account.

e.g. interest received is omitted to be posted to credit side of interest account. This error will decrease profits.

If due to any error the profits or losses are effected it will have its effect on capital account also because profits are credited and losses are debited to capital account. So any error in nominal account will also affect balance sheet as capital is shown as liabilities side of Balance Sheet.

#### (2) Errors affecting Balance Sheet only:

If error is committed in real or personal account it will affect assets, liabilities, debtors or creditors of the firm and it will have its impact on Balance Sheet alone.

1.8.7 self check exercise2

a) compensating errors

b) suspense account

1.8.8 summary

After going through this lesson students will be able to understand meaning of error. Types of errors are explained in this lesson. Errors can be error of principle which means accounting concepts are not clear to the accountant. Error of omission means entry is not passed in the books of accounts. Error of commission means entry is passed on wrong side or with wrong amount. Effect of errors on final accounts is also explained in this lesson.

1.8.9glossary

Error of principle= error due to lack of knowledge of accounting principles

Error of omission= entry is not passed in the books of accounts wholly or partly.

Error of commission= passing entry with wrong amount or on wrong side

1.8.10answers to self check exercise

1 see para 1.8.3

22 a) see para 1.8.2

b) see para 1.8.5

## 1.8.11Exercise Questions

### Short questions

Q.1 what do you mean by compensating errors?

Q.2 what do you meant but error of commission?

Q.3 what is suspense account?

### Long questions

(1) On 31st Dec. 1993 Sagar Chand finds that he has omitted some entries:

(i) Goods costing Rs1200 were sent to a customer on sale or return basis for Rs 1500.The entry was made in the Sales Book but the customer has not informed regarding their acceptance by 31st Dec. 1993.

(ii) Rs.7500 was outstanding on account of wages.

(iii) Unexplored insurance Rs. 600 has not been taken into A/c while preparing Profit & Loss A/c.

(iv) An amount of Rs. 10 , 000 on account of claim against the merchant was in dispute, and it was estimated that Rs.4000 would probably have to be paid on this account.

(v) Interest accrued on investments was Rs.1500.

(vi) Closing stock was over costed by Rs. 2000.

Give necessary adjusting entries :

(2) In taking out a Trial Balance, an Account finds an excess debit of Rs.1098. Being desirous of closing his books, he places the difference to Suspense A/.c later on he detects the following errors :

(i) Goods purchased from Surinder for Rs 350 has been credited to his account as Rs. 530.

(ii) Goods sold to Dinesh for Rs. 800 have been debited to his account as Rs. 880.

(iii) A cheque of Rs.1250 received from a debtor had been correctly entered in the Cash Book but posted to his personal A/c as Rs.1200

(iv) Rs. 780 paid for freight on machinery purchased was debited to freight Account as Rs. 708.

(v) Goods to the value of Rs.130 returned by a customer Narain Kumar had been posted to debit of his account.

(vi) Rs. 1440 paid for repairs to Motor Car were debited to Motor car A/C as Rs. 1400.

(vii) Rs.500 being purchase return were posted to debit of Purchase A/c Give necessary rectifying entries and prepare Suspense Account (Suspense A/c Rs.1390)

(3) Is Trail Balance a conclusive proof of accuracy ? Explain

(4) Explain different types of errors in detail.

Mandatory Student Feedback Form

https://forms.gle/KS5CLhvpwrpgjwN98

Note: Students, kindly click this google form link, and fill this feedback form once.