Basic Concept of Accounting

Introductory Material

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Business (Hope you all understand what is Business.)

- Business is an occupation or trade and the purchase / manufacture and sale of product or Services to make a profit.

OR

- A Business is an organization where people work to make and sell products or Services.

Business is different from you. Business is separate from you even though you are the owner of this business. Business has a different identity and thus is a different entity than you.

Type of Business Organization (Generally)

1) Proprietorship -> One man is Owner.
2) Partnership -> Two or more man is Owner.
3) Company -> a) Private Limited company b) Public limited company.
4) Trust/ Society.

All such Organizations have to register in their respective Act/ Law and then they become legal entity.

Accounting: In simple words "Accounting is drawing conclusion out of a series of activities.

Suppose, in a month, you have entered into the following transactions:

a) Purchased 5 watches @ Rs. 200 per watch

b) Sold all the Watches @ Rs. 250 per watch

c) Paid commission to salesman Rs. 50 in total.

Now if you want to understand the net effect of the transactions, what you to do is "Accounting".

Sales (Rs.250*5)	Rs. 1250
Less: Purchases (Rs. 200*5)	Rs. 1000
	Rs. 250
Less: Commission	Rs. 50
Profit	Rs. 200

So, we can conclude that you have earned a profit of Rs. 200/-

Thus the function of accounting is recording the transactions and drawing conclusions thereof.

In our personal life, we earn income from different sources like salary, business, pension, interest etc. and incur different expenses like interest on home/car loans, purchase of investment and other family expenses like food, education, clothing or gift etc. We keep records of these incomes and expenses to know the total savings for the month or year and the cash balance at the end of such period.

The owner of a business also keeps records of different transactions to know the total profit or loss from the business in a particular month or year. Intentionally or unintentionally, we do accounting in every sphere of life; it may be family, business or professional life.

The accounting may be defined as the process of recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the results thereof to the persons interested in such information.

Objectives of Accounting:

- To provide a record of all business transactions in a systematic manner
- To find out the results of all such transactions
- To ascertain the amounts due to or due from others
- To find out the financial position of a business on a particular day
- To have valuable information for legal and taxation purposes
- To provide reports to owners and managers to help them in making decisions for the business
- To prevent theft, frauds and errors.

Users of Accounting Information and their needs:

Proprietor - To know the profitability and financial soundness of the business

Manager - To improve the profitability and financial position of the business

Creditors/ lenders - To know that the business will be able to repay their dues on time

Employees - To know the earning capacity of the business since their remuneration, salary depends on it

Prospective Investors - To know the profitability and safety of their investment

Government – Compliances with several tax and other laws.

Transaction

Transaction: Event which has a monetary effect.

Example: Purchase of computer, Sale of computer, Payment of salary to staff, Purchase of Stationary, Loan from Bank, Cash Payment/ Cheque, payment or Online- Payment through Bank.

Following are the features of a Transaction:

- It involves an **economic activity**
- There must be at least **two parties**
- It brings about a **change in the financial position** of the parties
- The change must be capable of being **expressed in terms of money**

Ex: State whether the following events are transactions or not

(i) Mr. Ram started business with **capital** of Rs. 5,00,000/- Transaction

(ii) Paid salaries to staff Rs. 5000/- Transaction

(iii) Placed an order to Shyam Enterprise for **goods** of Rs. 5000/- Event

(iv) Opened a bank account by depositing Rs. 4000/- Transaction

(v) Opened a bank account by nil amount- Event

(vi) Appointed Mr. Amit as Manager at a salary of Rs. 12000/- per month – Event

(vii) Received interest from Bank Rs. 500/- Transaction

(viii)Talked on business deals with a supplier- Event

Classification of Transaction: Transaction may be in Cash or Credit.

Cash Transaction: A Transaction which involves immediate payment or receipt is called cash transaction. For ex: Goods Purchased for Cash

Credit Transaction: A Transaction which does not involve immediate payment or receipt is called credit transaction. For ex: Goods sold on credit to Shyam.

Accounting

Accounting is used by business organizations for keeping records of their monetary or financial transactions. Or

Accounting is the art of recording, classifying and summarizing **financial transaction.**

Accounting = Recording + Classifying + summarizing of financial transaction.

Recording: Recording means systematically writing down the transactions in account books. This is called **passing the Journal.**

Classifying: Classifying is the process of grouping transaction or entries of the same type at one place. This is called **Ledger.**

Summarizing: summarizing involves the preparation of reports and statements from the classified data. This is called preparation of final accounts (Balance sheet and Profit & Loss Account)

Journal → Ledger → Trial Balance → Balance Sheet and Profit & Loss Account

Before understanding above, we will first understand some commonly used terms in Accounting.

Commonly used Terms in Accounting.

***Assets**: Things on which you have control i.e. **you own it** and which will give you **future economic benefit.**

Assets: A) **Fixed Assets** -> which will give benefit for more than one year.

B) **Current Assets** -> which benefit will end within one Year.

Fixed Asset: Land, Building, **Plant and Machineries**, Furniture & Fixtures, Computer, Car, Truck, etc.

Current Asset: Cash, Bank, **Stocks/ Inventory**, Debtors

***Liability:** Which the business has an obligation to pay/ return.

Liability: A) **Long Term liability**-> which you expect to pay- off after one year.

B) **Current Liability** -> which you expect to pay- off within one year.

Long Term Liability: Long Term loan from bank, Debenture

Current Liability: Creditors, Trade Payable, **Outstanding** Salary, Outstanding Expenses, Tax Payable, Overdraft/ Cash Credit.

***Expenses**: Expenses are what business spends money on.

***Income**: Income are what through which business received money.

Expenses: Salary Payment, Rent Payment, Advertisement Expenses, Printing and stationary expenses, Fuels, Insurance Expenses, Interest on Loan, Manufacturing Expenses, Cost of goods sold, **Bad Debts**

Incomes: Sales, Service Charges/ Fees received, Interest Earned, Liability Waived

Try to differentiate between Asset and Expense

Expenses – Outflow of cash } Then what is difference?

Assets - Outflow of cash

Expenses- It has incurred. No future Benefit

Assets - Future Benefit.

Purchase of Car = Asset, Purchase of Petrol = Expenses
Receipt of Hire Charges of Car = Income, Purchase of car Perfume = Expenses
Purchase of Car on Loan = Loan is Liability

Purchase of computer= Asset, Purchase of A-4 Paper = Expenses
Purchase of Cartridge = Expenses, Computer Repairing Charges = Expenses
Receipt of cyber fee from user= Income

***Proprietor:** The person who invests money and start the business and bears its risk is the proprietor. Suppose Mr. Ram started business by investing Rs. 5,00,000/-. Here Mr. Ram is the proprietor and Rs. 5,00,000/- is his capital.

***Capital:** Owner's contribution/ money/ Investment to the business is called capital. It is also a liability but not of outsider.

The excess of assets over outsider liabilities of an enterprise is termed as capital. For example, if on a particular day, the assets of the business amounts to Rs. 1,00,000/- and outsider liabilities is Rs. 70,000/-, then the capital on that date is Rs. 70,000/-.

Owner's liability – Capital
Outsider's liability – Liability

***Drawing:** Money or value of goods belonging to business used or taken by the proprietor for his personal use is drawings. For example, the proprietor of the business withdrew Rs. 10,000 cash from his business for his personal use. This is his drawings. It may be in cash or kind also. It will reduce the claim of the proprietor from the business.

Ram has started business of Biscuit Manufacturing by investing Rs. 5, 00,000/-. (Five Lac). He also takes loan from SBI Rs. 8, 00,000 (Eight Lac). He purchases plant & Machinery of Rs. 4, 00,000 (Four Lac) and office furniture of Rs. 2, 00,000(Two Lac). He has registered "Ram Enterprises" and registration expense was Rs. 1,500. He has appointed two staff on salary of Rs. 5,000.

In the books of Ram Enterprises

Investment by Ram –	5, 00,000 = Capital
Loan from SBI -	8, 00,000= Liability (Long Term)
Purchase of plant & Machinery –	4, 00,000 = Asset (Fixed)
Purchase of Furniture –	2, 00,000 = Asset (Fixed)
Registration Charges -	1,500= Expenses
Salary of Staff-	5,000= Expenses

Purchase of Raw Material (Flour, Sugar etc.) - Expenses

Sales of biscuits – Income

***Revenue**: It is the monetary value of the products sold or services provided to the customers. It results from sale, services and sources like interest received, dividend, commission etc.

***Expenses**: Money spent by an enterprise to earn revenue is termed as expense. For example, the business purchases goods for earning revenue by selling those goods to the customers. Here purchase of goods is expense.

***Debtor**: A debtor is a person or enterprise that owes money to another party.

Ram Enterprises sold 100 packets of Biscuits to Shyam on credit. Now for Ram Enterprise, Shyam is a debtor.

***Creditor**: A creditor is a person or enterprises that has supplied goods or materials on credit to another party or lent money to another party.

In the above example for Shyam Enterprise, Ram Enterprises is a Creditor.

Also in the previous example, Ram Enterprises has taken loan from SBI Rs. 8 Lac. Ram Enterprises is the debtor and SBI is the creditor.

***Profit**: The term “Profit” can be defined as what is left from revenue after all expenses have been provided for. In other words, Profit = Revenue – Expenses.

***Loss**: The term “Loss” can be defined as excess of expenses over revenue. In other words, Loss = Revenue – Expenses.

***Inventory**: Raw Materials, Finished and Unfinished Products of a business which have not yet been sold are called Inventory or Stocks.

For example, out of 10 shirts manufactured, 3 shirts costing Rs. 100 each have not been sold yet. So value of inventory is Rs. 300/-.

*Accounting Equation:

Assets= Liability+ Capital.

Every business transaction will have an effect on the enterprise financial position. The financial position of an enterprise is measured by the following three items.

A) Assets (What it Owns)

B) Liability (What it owes to others)

C) Capital/ Owner's equity.

Assets are company/ Enterprises resources – things the company **Owns**. Ex. Cash, Debtors, Inventory /Stocks, Investments, Land, Building, Equipments, Machinery etc.

Liabilities are Company/ Enterprises obligations – amounts the company **Owes**. Ex. Loan payable, Creditors, Salaries and wages payable, Interest payable etc.

Owner's equity/ Capital is the amount left over after liability are deducted from Assets. **Assets (-) Liability= Owner's equity/ Capital**

If any enterprise keeps accurate records the accounting equation will always be **"In balance"**. Meaning left side will **always equal** to the right side. **A=L+C Always Equal.**

The balance is maintained because every business transaction affects **at least two of a company's account.**

For Example: When Ram Enterprises takes loan from SBI, its assets (Bank or Cash Balance) will increase and its liability will also increase by same amount. Bank balance will increase by 8 Lac and Loan from SBI will also increase by 8 Lac. Similarly on purchase of furniture, one asset will increase and one asset will decreases i.e. Furniture account will increase by Rs. 2 lac and Cash account will decrease by Rs. 2 Lac.

Because there are **two or more accounts** affected by every transaction, the accounting system is referred to as **double entry accounting.**

What is Account and its Classification?

The business transactions are recorded under **account heads**.

An account is an **individual record of**:

- Real Account – **(An item or thing)** Machine a/c, Furniture a/c, Bank a/c, computer a/c, Cash a/c, building a/c, Truck a/c etc.
- Personal Account- **(A person or enterprise)** – Shyam a/c, Loan from SBI a/c, Ramesh Enterprises a/c, supplier a/c, customer a/c, etc.
- Nominal Account- **(An item of income or expenses)** - Rent received , Rent payment, Interest earned a/c, Interest payment a/c, Salary a/c, Wages a/c, Sales a/c, purchase a/c, petrol a/c, fuel a/c, printing a/c, etc.

Classification of Accounts: Personal Accounts

Real Accounts

Nominal Accounts

Personal Accounts: These types of accounts show the transactions with customers, suppliers, Money lenders, the banks and the owner.

May be **natural personal** account (Naresh A/c) or **artificial personal account** (Shyam Enterprise, SBI).

Real Accounts: these are account of such things which are tangible i.e. which can be seen, touched or felt physically. Example: Land, Building, Furniture etc.

Nominal Accounts: Nominal accounts are opened in the books to explain the expenses and incomes. Nominal accounts include accounts of all expenses losses, income and gains.

Now we will understand concepts of:

- **Dual aspect concept**
- **Double entry system**
- **Rules of Debit and Credit**

Dual Aspect Concept

The recognition of the **two aspects of every transaction** is known as dual aspect concept, **one entry** consists of **debit to** one or more account and **another entry** consists of **credit to** some other one or more accounts.

However, the **total amount debited** is **always equal** to the **total amount credited**. Therefore at any point of the time total assets of a business are equal to its total liabilities.

Liabilities to outsider are known as liabilities, but a liability to Owner is referred to as capital. Thus dual aspect concept expresses the Accounting Equation among Asst, Liabilities, and Capital as

Assts = liability + Capital

Double entry system

This system recognizes the fact that **every transaction has two aspects** and records both aspects of each and every transaction.

If you have purchased a shirt for Rs. 1000, then you have paid cash of Rs. 1000 and got a shirt of the same amount. So, one aspect is payment of cash and other aspect is receipt of a shirt.

Therefore, in this system, for every debit entry, there is an equal and opposite credit entry.

Under this system, in every transaction an account is debited and some other account is credited.

An Accountant has to identity **which of the two (or more) accounts are affected** by a particular transaction and out of these two accounts (or more) which account is to be **debited** and which account is to be **credited**.

Rules of Debit (Dr) and Credit (Cr)

Golden Rules:

Personal Account : "Debit the receiver and Credit the giver".

Real Account : "Debits what comes in and Credit what goes out".

Nominal Account : "Debit all expense and losses and Credit all incomes and gains".

Personal Account: Debit the receiver and Credit the giver i.e. **Debit (Dr) the account of the person who receives something and Credit (Cr) the account of the person who gives something.**

For Example: If Ram Enterprise purchase furniture from Shyam on credit, the <u>two accounts involved are Furniture account and Shyam's account.</u>

Now for Ram enterprise, since Shyam is the giver in this transaction, his account will be credited. Similarly when Ram Enterprise pay cash to the Shyam, it will debit the Shyam account, since he is the receiver.

You have to understand in which book you are making the entries, you have to think accordingly. As in above example, for Shyam, Ram Enterprises is the receiver of furniture. So in Shyam book Ram Enterprise a/c will be debited. Similarly when Ram Enterprise will pay cash, Ram Enterprise a/c will be credited since it is the giver. We will discuss it later.

Real Account: Debit what comes in and Credit what goes out, i.e **debit (Dr.) the account of the thing which comes in and credit (Cr.) the account of the thing which goes out**.

For Example: in the previous example, for Ram Enterprise, Furniture is coming, Furniture a/c will be debited and later on when it pays cash to Shaym, Cash a/c will be credited since it is going out. Suppose furniture was purchase on 1st May 2019 and cash was paid on 3rd May 2019.

<u>In the book of Ram Enterprises</u>

Date			
01.05.2019	Furniture a/c Dr.	Rs. 2,00,000/-	
	To Shyam a/c		Rs. 2,00,000/-
01.05.2019	Shyam a/c Dr.	Rs. 2,00,000/-	
	To Cash a/c		Rs. 2,00,000/-

Above is called passing journal entries, we will discuss it later.

Nominal Accounts: Debit (Dr.) all expense and losses and Credit (Cr.) all income and gains.

For Example, if Ram Enterprises pays salary to its accountant, the two account involved are Salary a/c and Cash a/c. Salary is an expense, hence it will be debited. Similarly if interest is received, Interest a/c will be credited since it is an income.

Important Note: Analyzing Transactions for recording.

If the three fundamental rules describe above are kept in mind, it would be possible to record all the transactions:

- Identify the two (or more) **accounts involved** in the transaction.
- Find out the **type of account** for both the accounts involved in the transaction.
- **Apply the rules of debit (Dr.) and credit (Cr.)**

For Example: Payment of salary is a transaction. It involves salary account and Cash account. Salary a/c is a nominal account whereas as, cash account is a real account.

The rule of nominal account says "Debit all expense and losses". So salary account being expense, will be debited.

Whereas rule of real account says "Credit what goes out". Here cash is going out. So cash account will be credited.

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

S.N.	Transaction	Account involved	Type of Account	Debit/ credit
1	Mr. Anit Started Business with Rs. 60,000	Cash a/c Capital a/c	Real Personal	Debit Incomings Credit Giver
2	Purchased Goods for Cash Rs. 25,000	Purchases A/c Cash A/c	Real Real	Debit Incomings Credit Out goings
3	Sold goods for cash Rs. 20,000	Cash a/c Sales a/c	Real Real	Debit Incomings Credit Out goings
4	Purchased Goods from Mr Bansal for cash Rs. 10,000	Purchases A/c Cash A/c	Real Real	Debit Incomings Credit Out goings
5	Sold goods to Mr. charles for cash Rs. 8,000 on credit.	Charles Sales A/c	Personal Real	Debit Receiver Credit Out goings
6	Purchased Furniture for Rs. 16,000	Furniture a/c Cash A/c	Real Real	Debit Incomings Credit Out goings
7	Paid Rent Rs. 2000	Rent a/c Cash a/c	Nominal Real	Debit Expenses Credit Outgoings
8	Paid Wages	Wages a/c Cash a/c	Nominal Real	Debit Expenses Credit Outgoings

9	Purchase good from Ajit on Credit	Purchases a/c Ajit a/c	Real Personal	Debit Incomings Credit Giver
10	Dividend Receive	Cash a/c Dividend a/c	Real Nominal	Debit Incomings Credit Income
11	Machinery Sold	Cash a/c Machinery a/c	Real Real	Debit Incomings Credit Out goings
12	Outstanding For salaries	Salaries a/c Outstanding Salaries a/c	Nominal Personal	Debit Expenses Credit Giver

Now we will again go to the **<u>definition of Accounting</u>** and learn **Accounting Process** and understand concept of **Journal, Ledger, Cash Book and the Trial Balance.**

Journal, ledger and Cash Book

Please recall definition of Accounting:

Accounting = Recording + Classifying + Summarizing of financial transaction.

Journal Ledger Trail Balance and Balance Sheet P&L a/c

<u>Accounting process and Accounting cycle:</u>

1) **Identify the transaction** from source documents like bills, invoices, agreements, etc.
2) **Recording the transaction in journal** proper and other subsidiary books.
3) **Classifying all entries posted** in journal or subsidiary books and **posting to appropriate Ledger** account.
4) **Summarizing all the ledger balances** and preparing the **<u>trial balance</u> and <u>Final Accounts</u>.** (Balance Sheet and Profit & Loss Account)

Journal

Journal is the book of primary entry in which every transaction is recorded before being posted into the Ledger.

Journal: Every/All transactions are recorded.

Ledger: Individual account wise transactions recorded.

A Journal book is generally kept in a columnar form.

Journal book (Book of Ram Enterprise)

Date	Particulars	Debit (Dr) (Amount)	Credit (Cr) (Amount)

For Example: Ram Enterprise has purchased Computers from Shyam on Credit. The two accounts involved in this transaction are Computers and Shyam Account. Computer is Real Account and Shyam is Personal Account. For Ram Enterprise Computer is coming in (Dr. what comes in and Cr. what goes out), hence Computer a/c will be debited and since Shyam is the giver (Dr. the receiver and credit the giver) Shyam a/c will be Credited. Later on when Ram Enterprise pays cash to Shaym, Cash a/c will be credited since it is going out and Shyam a/c will be debited since he is the receiver. Suppose Computer were purchased on 02nd May 2019 and cash was paid on 4th May 2019.

In the book of Ram Enterprises

Date				
02.05.2019	Computer a/c	Dr.	Rs. 2,00,000/-	
	To Shyam a/c			Rs. 2,00,000/-
04.05.2019	Shyam a/c	Dr.	Rs. 2,00,000/-	
	To Cash a/c			Rs. 2,00,000/-

Journal

In the book of Ram Enterprises

Date	Particulars	Debit (Dr) (Amount in Rs.)	Credit (Cr) (Amount in Rs.)
02.05.2019	Computer A/C Dr. To Shyam A/C (Being Computer Purchased from Shyam on Credit)	2,00,000	 2,00,000
04.05.2019	Shyam A/C Dr. To Cash A/C (Being Payment made to Shyam)	2,00,000	 2,00,000

Particulars: The two aspects of a transaction are recorded in this column i.e. the accounts which have to be debited and credited. The name of the account(s) to be debited is entered at the extreme left of the particulars column next to the date column. The abbreviation **'Dr.'** is written at the right end of the particulars column on the same line of the account debited. The name of the account to be credited is entered in the next line with a prefix **'To'**. **A brief explanation of the transaction known as narration is written below the account titles of the transaction.** Finally, a thin line is drawn all through the particulars column to indicate that the entry of the transaction has been completed.

Procedure of Journalising

The following procedure is followed for passing journal entries-

- Analyze each transaction in terms of **accounts affected.** As a rule every transaction has at least two accounts.
- Find out the **type of accounts** affected in a transaction i.e. personal, real or nominal.
- **Apply the rules of debit and credit** to each type of accounts involved.
- The debit and credit accounts must be equal.

Some Specimen Transactions:

Capital: Started business with capital of Rs. 50,000/- on April 1, 2018

Cash is debited as it comes in. On the other hand, the owner is the giver, and owner's share in business is Capital, so Capital A/C should be credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
1.4.18	Cash A/C Dr.	50,000	
	To Capital A/C		50,000
	(Being commencement of New Business and capital introduced)		

Purchase: Purchased goods from Sunil on credit for Rs. 14,000/- on April 3, 2018

Goods (Purchase) come in and Sunil is the giver. Purchase A/c is therefore debited and Sunil is credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
3.4.18	Cash A/C Dr.	14,000	
	To Capital A/C		14,000
	(Being Purchase of Goods on Credit from Sunil)		

Sale: Sold Goods to Amitabh on credit for Rs. 5,000/- on April 4, 2018

Amitabh is the receiver, therefore his account has to be debited. Goods (Sale) goes out, hence Sales A/C is credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
4.4.18	Amitabh A/C Dr. To Sales A/C (Being sale of Goods on Credit to Amitabh)	5,000	 5,000

Purchase Return/ Debit Note:

If after purchase of goods, the purchaser returned the goods for any reason like, defect, excess than ordered or not according to sample, it is purchase return. The Purchaser sends a debit note to the supplier for adjustment. The supplier's account is debited in the books of the purchaser.

So, Debit Note is a document notifying a supplier that a debit has been made to his account in the books of the purchaser. It is generally sent when a bill is overcharged for the amount of difference. It is prepared after the supplier agrees to grant a price reduction. One copy of the debit note is sent to the supplier.

For example, out of goods purchased from Sunil on April 3, 2018, Goods valuing Rs. 2000/- is returned on 5th April because of inferior quality.

Hence, Sunil is receiving the returned goods. So Sunil A/C will be debited and Purchase Return A/C will be credited by the amount of the value of returned goods as it is goes out. The Journal entry will be:

Date	Particulars	Debit (Dr)	Credit (Cr)
5.4.18	Sunil A/C Dr. To Purchase Return A/C (Being Goods Returned because of Inferior quality)	2,000	 2,000

Sales Return/ Credit Note:

The seller after receiving the goods returned, will credit the account of the purchaser in his books and will issue a credit note. Hence Credit Note is an evidence that a credit entry has been made to a debtor's account. When goods are supplied to a customer, a bill is sent. If the customer requests for a correction in the bill for any discrepancy, a Credit Note may be issued.

A transaction (sales return or purchase return) is complete when a party issues a credit note against a debit note and vice versa.

Suppose, out of the goods sold to Amitabh on 4th April 2018, Goods valuing Rs. 1000 was returned by Amitabh on 6th April being excess of order. The Journal will be:

Goods (Sales Return) come in and Amitabh is the giver. Sales Return A/c is therefore debited and Amitabh is credited.

Date	Particulars	Debit	Credit
6.4.18	Sales Return A/C Dr. To Amitabh A/C (Being Goods Received from Amitabh because excess order)	1,000	 1,000

Receipt: Received cash from Amitabh Rs. 5000 on April 10, 2018.

Cash comes in, hence Cash A/C is debited, and Amitabh is the Giver, hence credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
10.4.18	Cash A/C Dr. To Amitabh A/C (Being Cash Received from Amitabh)	5,000	 5,000

Payment: Paid cash to Sunil Rs. 5000 on April 12, 2018.

Sunil is the receiver, hence his account is debited, and cash goes out and thus Cash A/C is credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
12.4.18	Sunil A/C Dr. To Cash A/C (Being Cash Paid to Sunil)	5,000	 5,000

Contra: Deposited cash into Bank Rs. 49,000 on April 14, 2018.

When the amount is deposited into Bank, the Bank becomes the receiver as it receives cash. Bank is therefore debited and as Cash goes out, it is credited.

Date	Particulars	Debit (Dr)	Credit (Cr)
14.4.18	Bank A/C Dr. To Cash A/C (Being Cash deposited in Bank)	49,000	 49,000

Simple and Compound Journal Entries:

A journal entry, which contains only one debit and one credit entry is called a Simple Journal Entry. If it contains more than one debit or more than one credit entries or both, the entry is a compound or combined journal entry.

Regardless of the number of debits or credits in a compound journal entry, the aggregate amount of debits should be equal to the aggregate amount of credits.

Transactions which are inter-connected and have taken place simultaneously are recorded by means of a compound or combined journal entry. For example receipt of cash from a debtor and allowance of discount to him are recorded by means of a single journal entry. Similarly transactions of the same nature are recorded by means of a combined entry provided they take place the same day. For example, if amount is spent on the same day for salaries, wages, stationery, rent, etc. a combined entry can be passed debiting all the relevant nominal accounts with respective amounts and crediting cash account with the total amount spent.

Date	Particulars	Debit (Dr)	Credit (Cr)
30.4.18	Rent A/C Dr.	1,000	
	Wages A/C Dr.	2,000	
	Salary A/C Dr.	3,000	
	To Cash A/C		6,000
	(Being Payment of expenses)		

Actually a compound journal entry is a combination of two or more simple journal entries. The journal entries on 30th April is a combination of the following three simple journal entries.

Date	Particulars	Debit (Dr)	Credit (Cr)
30.4.18	Rent A/C Dr.	1,000	
	To Cash A/C		1,000
	(Being payment of Rent in cash)		

Date	Particulars	Debit (Dr)	Credit (Cr)
30.4.18	Wages A/C Dr.	2,000	
	To Cash A/C		2,000
	(Being payment of wages in Cash)		

Date	Particulars	Debit (Dr)	Credit (Cr)
30.4.18	Salary A/C Dr.	3,000	
	To Cash A/C		3,000
	(Being payment of salary in cash)		

Illustration 1:

Journalise the following transactions:

2019 March	`
" 2	Commenced business with cash 2,50,000
" 4	Purchased furniture for cash 20,000
" 4	Cash purchases 1,45,000
" 5	Deposited with bank 30,000
" 6	Purchase from Patil 40,000
	Sold to Natarajan for cash 14,300
" 7	Stationery purchased 1,050
" 7	Purchase from Salil 26,000
" 7	Sold to Mukherjee 8,080
" 9	Rent for two years paid in advance 24,000
" 9	Drawings by the proprietor for household expenses 4,000
	Goods taken out by the proprietor for domestic use 500
" 9	Cash withdrawn from Bank 25,000
" 10	Sold to Mathur on credit 9,850
" 11	Purchases made, payment through cheque 2,900
" 14	Cash received from Patil on account 10,000
" 14	Cash paid to Salil after deduction of discount Rs. 1300 24,700
" 17	Cash received from Mathur in full settlement of his account 9,750
" 18	Mukherjee becomes insolvent. A dividend of 50 paise in a rupee is received 4,040
" 18	Purchase of a Scooter for cash 30,000
" 20	Sold goods to Aggarwal 8,640
	Sales to Nayak 3,780
" 24	Cartage paid in cash 150
" 24	Repairs to Scooter, payment not yet made 170
" 26	Payment of cash for petrol 550
" 26	Purchases of goods for cash 12,000
" 26	Purchases of Office Equipment for cash 12,100
" 27	Repairs bill paid in cash 170
" 28	Aggarwal returns goods 400
" 31	Depreciation on furniture 100
	Depreciation on Scooter 200
" 31	Salary to clerk outstanding 1,800
" 31	Adjustment for the month's outstanding rent 1,000
" 31	Bank charges for the month 50
" 31	Interest on capital for the month 1,250
	Salary to be credited to proprietor 2,000
" 31	Salil agrees to take some defective goods purchased from him and immediately refunds the money 700

Journal

In the book of Ram Enterprises

Date	Particulars	Debit (Dr) (Amount in Rs.)	Credit (Cr) (Amount in Rs.)
02.03.2019	Cash Account Dr. To Capital Account (Being cash brought in by proprietor as capital)	2,50,000	 2,50,000
04.03.2019	Furniture Account Dr. To Cash Account (Being purchase of furniture for cash)	20,000	 20,000
04.03.2019	Purchases Account Dr. To Cash Account (Being purchase of goods-in-trade for cash)	1,45,000	 1,45,000
05.03.2019	Bank Account Dr. To Cash Account (Being cash deposited with bank)	30,000	 30,000
06.03.2019	Purchases Account Dr. To Patil Account (Being purchases of goods in trade, on credit, Patil being the supplier)	40,000	 40,000
06.03.2019	Cash Account Dr. To Sales Account (Being cash sales made to Natarajan)	14,300	 14,300

07.03.2019	Stationery Account Dr. To Cash Account (Being purchase of stationery for cash)	1,050	 1,050
07.03.2019	Purchases Account Dr. To Salil Account (Being credit purchases of goods from Salil)	26,000	 26,000
07.03.2019	Mukherjee Account Dr. To Sales Account (Being sales of goods on credit to Mukherjee)	8,080	 8,080
09.03.2019	**Rent Paid in Advance Account** Dr. To Cash Account (Being Rent paid in advance)	24,000	 24,000
09.03.2019	**Drawings Account** Dr. To Cash Account To Purchases Account (Being For drawings in cash and goods taken by the proprietor for personal use)	4,500	 4,000 500
09.03.2019	Cash Account Dr. To Bank Account (Being cash withdrawn from Bank)	25,000	 25,000
10.03.2019	Mathur Account Dr. To Sales Account (Being sales of goods on credit to Mathur)	9,850	 9,850

11.03.2019	Purchases Account Dr. To Bank Account (Being purchases of goods, payment being made by means of a cheque)	2,900	 2,900
14.03.2019	Cash Account Dr. To Patil Account (Being cash received from Patil)	10,000	 10,000
14.03.2019	Salil Account Dr. To Cash Account To **Discount Account** (Being cash paid to Salil and discount received from him)	26,000	 24,700 1,300
17.03.2019	Cash Account Dr. **Discount Account** Dr. To Mathur Account (Being cash received from Mathur and discount allowed to him)	9,750 100	 9,850
18.03.2019	Cash Account Dr. **Bad Debts Account** Dr. To Mukherjee Account (Being cash received from Mukherjee on his insolvency and balance amount written off as bad debt)	4,040 4,040	 8,080

18.03.2019	Scooter Account Dr. To Cash Account (Being purchase of a scooter for cash)	30,000	 30,000
20.03.2019	Aggarwal Account Dr. Nayak Account Dr. To Sales Account (Being sales of goods on credit to Aggarwal and Nayak)	8,640 3,780	 12,420
24.03.2019	Cartage Account Dr. To Cash Account (Being Cartage Paid in cash)	150	 150
24.03.2019	Repairs Account Dr. To **Repairs Outstanding Account** (Being Repairs charges)	170	 170
26.03.2019	Petrol Expense Account Dr. To Cash Account (Being petrol expenses paid in cash)	550	 550
26.03.2019	Purchases Account Dr. To Cash Account (Being Purchases of Goods in cash)	12,000	 12,000
26.03.2019	Office Equipment Account Dr. To Cash Account (Being Purchase of Office Equipment in cash)	12,100	 12,100

27.03.2019	**Repairs Outstanding Account** Dr. To Cash Account (Being Repairs outstanding paid)	170	 170
28.03.2019	**Sales Return Account** Dr. To Aggarwal Account (Being sales return from Aggarwal)	400	 400
31.03.2019	**Depreciation Account** Dr. To Furniture Account (Being depreciation on furniture)	100	 100
31.03.2019	**Depreciation Account** Dr. To Scooter Account (Being depreciation on scooter)	200	 200
31.03.2019	Salary Account Dr. To **Salary Outstanding Account** (Being salary outstanding)	1,800	 1,800
31.03.2019	Rent Account Dr. To **Rent Outstanding Account** (Being Rent outstanding)	1,000	 1,000
31.03.2019	**Bank Charges Account** Dr. To Bank Account (Being bank Charges deducted by Bank)	50	 50
31.03.2019	**Interest on Capital Account** Dr. **Salary to Proprietor Account** Dr.	1,250 2,000	

	To Capital Account (Being interest on capital, Rs. 1250 and salary for the proprietor credited with Rs. 2,000)		3,250
31.03.2019	Cash Account Dr. To **Purchases Return Account** (Being cash received from Salil on return of some defective goods sold to him)	700	700

While learning Journal entries in the above illustration, we also learn the concepts of:

- Expenses Paid in Advance i.e. **Expenses not incurred but paid** (Rent paid in Advance A/C)
- Expenses incurred but not paid i.e. **Outstanding Expenses** (Salary Outstanding A/C)
- Discount Account (Discount Allowed A/C (Expenses/Loss) and Discount Received A/C (Income/ Gain)
- Concept of Bad Debts
- Purchase Return A/C and Sales Return A/C
- Depreciation Account
- Drawing Account
- **Concept of Periodicity in Accounting**

LEDGER - PRINCIPAL BOOK OF ACCOUNTS

Ledger is the principal book of accounts where similar transactions relating to a particular account are recorded.

The main function of a ledger is to classify or sort out all the items appearing in the journal or other subsidiary books under their appropriate accounts so that at the end of the accounting period each account will contain the entire information of all the transactions relating to it in a summarized or condensed form.

For instance, all the transactions that have taken place with Mr. Mathur will be entered in Mathur's Account. Similarly, all items relating to cash, sales, purchases, salaries, discount, etc. appear in their respective accounts.

SPECIMEN RULING OF LEDGER ACCOUNT

Name of the Account

Dr. Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To, Credit Aspect			**By,** Debit Aspect	

Features of the Ledger Account:

(i) **The ledger account is divided into two sides - the left hand side is known as debit side while the right hand side is known as credit side. The abbreviations 'Dr.' and 'Cr.' are placed at the top left and right hand corners respectively as a custom.**

(ii) The name of account is written in the top middle of the account.

Difference between Journal and Ledger:

Ledger	Journal
It is the book of final entry	It is the book of original entry
Journal is the basis of ledger posting	Journal is based on primary documents
Condensed and classified record of transactions	Chronological record of transactions
Can give complete and ready answer	Cannot give any complete and ready answer

Posting:

Posting means transferring the debit and credit items from the journal to their respective accounts in the ledger.

Rules of Posting

The names of accounts used in the journal carried to the ledger should be exactly the same.

Separate accounts should be opened in the ledger for posting transactions relating to different accounts recorded in the journal.

The concerned account which has been debited in the journal should also be debited in the ledger and the account which has been credited in the journal, should also be credited in the ledger i.e., but a reference should be given of the other account (Journal Folio (J.F.) or Voucher No. in Computer Accounts)

It is customary to use the words ‘To’ and ‘By’ while making posting in the ledger. The words ‘To’ is used with the accounts shown on the debit side of the ledger account while the word ‘By’ is used with accounts which appear on the credit side of the ledger account.

Balancing Ledger Accounts:

Balancing of an account means the process of equalizing the two sides of an account by putting the difference on the side where amount is short.

Where the debit side of an account exceeds the credit side, the difference is put on the credit side, and the account is said to have a debit balance. This balance is brought down on the debit side while reopening the account. Similarly, where the credit side of an account exceeds the debit side, the difference is put on the debit side, and the account is said to have a credit balance. This is brought down on credit side while reopening the account.

The following steps are followed for balancing the accounts:

(i) Total the amounts of debit and credit entries in the account.

(ii) If the debit and credit sides are equal then there is no balance. The account stands automatically balanced or closed.

(iii) If the debit side total is more, put the difference on the credit side amount column, by writing the words in particulars column "By Balance c/d". If the credit side total is more, put the difference on the debit side amount column by writing the words in the particulars column "To Balance c/d".

(iv) After putting the difference in the appropriate side of the account, add both sides of the account and draw a thin line above and below the total.

(v) Bring down the debit balance on the debit side by writing the words in particulars column "To Balance b/d". Similarly bring down the credit balance on the credit side by writing the words in the particulars column "By Balance b/d".

Illustration 2:

Journalise the following transactions, post them in the ledger and balance the accounts in the books of Mr. Rajesh.

2019 `

Jan. 1 Started business with cash 2,00,000

Jan. 3 Purchased goods for cash 60,000

Jan. 5 Sold goods to Shyam 60,000

Jan. 6 Sold goods for cash 20,000

Jan. 9 Received cash from Shyam 40,000

Jan. 13 Goods purchased from Ram 40,000

Jan. 20 Cash paid to Ram 20,000

Jan. 25 Paid office rent 4,000

Jan. 31 Paid salaries to staff 20,000

Jan. 31 Returned goods by Shyam 10,000

In the Books of Mr. Rajesh

Journal Entries

Date	Particulars	Debit (Dr)	Credit (Cr)
01.01.19	Cash A/C Dr. To Capital A/C (Being capital introduced by the proprietor in cash)	2,00,000	 2,00,000
03.01.19	Purchases A/C Dr. To Cash A/C (Being goods purchased for cash)	60,000	 60,000
05.01.19	Shyam A/C Dr. To Sales A/C (Being goods sold on credit to Shyam)	60,000	 60,000
06.01.19	Cash A/C Dr. To Sales A/C (Being goods sold for cash)	20,000	 20,000
09.01.19	Cash A/C Dr. To Shyam A/C (Being the cash received from Shyam)	40,000	 40,000
13.01.19	Purchases A/C Dr. To Ram A/C (Being goods purchased on credit from Ram)	40,000	 40,000
20.01.19	Ram A/C Dr. To Cash A/C (Being Cash Paid to Ram)	20,000	 20,000
25.01.19	Rent A/C Dr. To Cash A/C (Being office rent paid in cash)	4,000	 4,000
31.01.19	Salaries A/C Dr. To Cash A/C (Being salaries paid to staff)	20,000	 20,000
31.01.19	Sales Return A/C Dr. To Shyam A/C (Being goods returned by Shyam)	10,000	 10,000

Ledger Accounts

Dr. Cash Account Cr.

Date	Particulars	Amount	Date	Particulars	Amount
01.01.19	To Capital A/C	2,00,000	03.01.19	By Purchases A/c	60,000
06.01.19	To Sales A/C	20,000	20.01.19	By Ram	20,000
09.01.19	To Shyam A/C	40,000	25.01.19	By Rent A/c	4,000
			31.01.19	By Salaries A/c	20,000
			31.01.19	By Balance c/d	1,56,000
		2,60,000			2,60,000
01.02.19	To Balance b/d	1,56,000			

Dr. **Capital Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31.01.19	To Balance c/d	2,00,000	01.01.19	By Cash A/C	2,00,000
		2,00,000			2,00,000
			01.02.19	By Balance b/d	2,00,000

Dr. **Purchases Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
03.01.19	To Cash A/C	60,000	31.01.19	By Balance c/d	1,00,000
13.01.19	To Ram A/C	40,000			
		1,00,000			1,00,000
01.02.2019	To Balance b/d	1,00,000			

Dr. **Sales Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31.01.19	To Balance c/d	80,000	05.01.19 06.01.19	By Shyam A/C By Cash A/C	60,000 20,000
		80,000			80,000
			01.02.19	By Balance b/d	80,000

Dr. **Shyam Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
05.01.19	To Sales A/C	60,000	09.01.19 31.01.19 31.01.19	By Cash A/C By Sales Return A/C By Balance c/d	40,000 10,000 10,000
		60,000			60,000
01.02.19	To Balance b/d	10,000			

Dr. **Ram Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
20.01.19 31.01.19	To Cash A/C To Balance c/d	20,000 20,000	13.01.19	By Purchases A/C	40,000
		40,000			40,000
			01.02.19	By Balance b/d	20,000

Dr. **Rent Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
25.01.19	To Cash A/C	4,000	31.01.19	By Balance c/d	4,000
		4,000			4,000
01.02.19	To Balance b/d	4,000			

Dr. **Salaries Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31.01.19	To Cash A/C	20,000	31.01.19	By Balance c/d	20,000
		20,000			20,000
01.02.19	To Balance b/d	20,000			

Dr. **Sales Return Account** Cr.

Date	Particulars	Amount	Date	Particulars	Amount
31.01.19	To Shyam A/C	10,000	31.01.19	By Balance c/d	10,000
		10,000			10,000
01.02.19	To Balance b/d	10,000			

CASH BOOK

Cash book is the book in which all transactions concerning cash receipts and cash payments are recorded.

Cash Book is in the form of an account. It serves the purpose of Cash Account also. On the debit side, all cash receipts are recorded while on the credit side, all cash payments are recorded. Cash Book thus serves the purpose of a book of original entry as well as that of a ledger account.

A cash book has the following features:

(a) Only cash transactions are recorded in chronological order in the cash book.

(b) It performs the functions of both journal and ledger at the same time.

(c) All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side.

(d) **Cash balance can never be negative.**

Illustration 3:

Record the following transactions in Cash Book of Mr. Mohan Lal Singh:

2019 `

April 1 Mohan Lal commenced business with cash Rs.1,00,000/-

” 2 Bought goods for cash Rs.65,700/-

” 3 Sold goods for cash Rs.4,320/-

” 6 Received cash from Fateh Singh Rs.1,800/-

” 6 Allowed him discount Rs.50/-

” 9 Paid cash to Shugan Chand Rs.19,500/-

Discount allowed by Shugan Chand Rs.500/-

” 12 Paid for Office Furniture Rs.5,680/-

” 18 Sold goods for cash Rs.7,810/-

” 23 Received cash from Subramam Rs.9,870/-

” Discount allowed to him Rs.120/-

” 27 Paid for advertising Rs.500/-

” 28 Cash paid to Asia Trading Co. Rs.20,300/- Discount received Rs.250/-

” 30 Cash sales Rs.1,280/-

” 30 Cash received from Fateh Singh Rs.2,850/- Discount allowed to him Rs.100/-

Salary paid in cash Rs.3,150/-

Mr. Singh

Dr. Cash Book Cr.

Date 2019	Particulars	Discount	Amount	Date 2019	Particulars	Discount	Amount
1.4	To Capital A/C		1,00,000	2.4	By Purchases A/c		65,700
3.4	To Sales A/C		4,320	9.4	By Shugan Chand	500	19,500
6.4	To Fateh A/C	50	7,810	12.4	By Furniture A/c		5,680
18.4	To Sales A/C		1,800	27.4	By Advertising A/c		500
23.4	To Subrama A/C	120	9,870				1,56,000
30.4	To Sales A/C		1,280	28.4	By Asia Trading co	250	20,300
30.4	To Fateh A/C	100	2,850	30.4	By Salary		3,150
				30.4	By Balance c/d		13,100
		270	1,27,930			750	1,27,930
1.5	To Balance b/d		13,000				

Double Column Cash Book:

Sometimes, the organization maintains cash book as shown above with an extra column to record Bank transactions also, so that we can know both the cash and bank balances from a single book.

The cash column contains details of the receipts and payments made in cash whereas the bank columns contain details of payments made by cheque and money received through Bank (through cheque/DD/PO etc.) and deposited in Bank.

Three Columnar Cash Book: This type of cash book contains the following three amount columns on each side:

(a) **Discount column** for discount received and allowed;

(b) **Cash column** for cash received and cash paid; and

(c) **Bank column** for money deposited and money withdrawn from the bank.

Contra Entry: If a transaction involves both Cash and Bank A/C, it is entered on both sides of the cash book, one in the cash column and other in the bank column, though on opposite sides. These are called contra entries e.g. when cash is withdrawn from the bank, it is recorded on the debit side in cash column and on the credit side in the bank column. Similarly, when cash is deposited with the bank, the amount is recorded on the debit side in bank column and on the credit side in the cash column.

Ex: From the following transactions, prepare a double column cash book and find out the balance as on 07.04.2019

1.4.2019 Cash in Hand	1500
1.4.2019 Cash at Bank or Bank Balance	9000
2.4.2019 Sold Goods for Cash	4000
2.4.2019 Received from Amit Rs. 5000 by cheque and deposited in Bank	5000
3.4.2019 Withdrawn from Bank	2000
3.4.2019 Paid Wages in Cash	1500
4.4.2019 Deposited cash into Bank	1800
5.4.2019 Paid Pravesh by Cheque	4000

In the books of________________

Dr. Cash Book Cr.

Date 2019	Particulars	Cash	Bank	Date 2019	Particulars	Cash	Bank
1.4	To Balance b/d	1500	9000	3.4	By Cash A/c (Being cash withdrawn from Bank)		2000
2.4	To sales A/C (Being goods sold for cash)	4000		3.4	By Wages A/c (Being wages paid by cash)	1500	
2.4	To Amit A/C (Being Cheque Received from Amit)		5000	4.4	By Bank A/C (Being Cash deposited in Bank)	1800	
3.4	To Bank A/C (Being Cash withdrawn from Bank)	2000		5.4	By Pravesh A/C (Being Amount paid by Cheque)		4000
4.4	To Cash A/C (Being cash deposited in Bank)		1800	7.4	By Balance c/d	4,200	9,800
		7,500	15,800			7,500	15,800
8.4	To Balance b/d	4,200	9,800				

Trial Balance

A Trial Balance is a schedule or l**ist of debit and credit balances** extracted from various accounts in the ledger including cash and bank balances from cash book.

Since every transaction has a dual effect i.e. every debit has a corresponding credit and vice versa, the total of the debit balances and credit balances extracted from the ledger must tally.

Thus, at the end of the accounting period or at the end of each month, the balances of the ledger accounts are extracted and trial balance is prepared to test as to whether the total debits are equal to total credits or not.

Features of a Trial Balance:

1. It is a statement prepared in a **tabular form**. It has **two amounts columns** one for debit balances and other for credit balances.

2. The balances at the end of the period as shown by ledger accounts are shown in the statement.

3. It can be prepared **on any date provided accounts are balanced**.

4. It is a method of verifying the **arithmetical accuracy of entries** made in the ledger.

5. It brings together the **balances of all the accounts at one place** and this facilitates the preparation of Final Accounts and Balance Sheet.

The balances of ledger accounts are taken to respective debit and credit columns of the trial balance and then grand totals are taken out. The total of balances in the debit column must be equal to the total balances in the credit column of the trial balance.

Illustration discussion: Prepare the Trial balance on the basis of Illustration II.

Some Accounting Concepts

Business Entity Concept: According to this concept, business is treated as an entity separate from its owners. All transactions of the business are recorded in the books of the business from the point of view of the business. Transactions are also recorded between the owner and the business, for instance, when capital is provided by the owner, the accounting record will show the business as having received so much money and as owing to the proprietor.

– Only the business transactions are recorded and reported and **not the personal transactions of the owners**.

– Income or profit is the property of the business unless distributed among the owners.

– The personal assets of the owners or shareholders are not considered while recording and reporting the assets of the business entity.

Accrual System or mercantile system of Accounting: Business transactions are recorded when they occur and not when the related payments are received or made. This concept is called accrual basis of accounting.

Accrual basis of accounting attempts to record the financial effects of the transactions, events, and circumstances of an enterprise in the period in which they occur rather than recording them in period(s) in which cash is received or paid by the enterprise.

– Revenue is recognized as it is earned irrespective of whether cash is received or not;

– Costs are matched against revenues on the basis of relevant time period to determine periodic income, and

– Costs which are not charged to income are carried forward and are kept under continuous review. Any cost that appears to have lost its utility or its power to generate future revenue is written off as a loss.

Accounting Period Concept: Life of the business is divided into appropriate parts or segments for analyzing the results shown by the business. Each part or segment so divided is known as an accounting period.

It is an interval of time at the end of which the income or revenue statement and balance sheet are prepared in order to show the results of business operations and changes in the resources which have occurred since the previous statements have been prepared. Normally, the accounting period consists of twelve months.

Some Concepts

Closing Entries: Closing entries are passed at the end of the accounting year for closing of accounts relating to expenses and revenues. These accounts are closed by transferring their balances to the Trading and Profit & Loss Account.

Adjustment Entries: At the end of the accounting year, adjustments entries are passed for outstanding/prepaid expenses, accrued income/income received in advance etc. Entries for all these adjustments are passed in the journal proper.

Transfer Entries: Transfer entries are passed in the general journal for transferring an item entered in one account to another account.

Rectification Entries: Rectification entries are passed for rectifying errors which might have committed in the books of account.

Bad Debts

Most businesses sell goods on credit basis, i.e., buy now and pay later. A business enterprise gives credit facilities to its customers in order to compete with others, to increase sales and hence profit. Credit sales inevitably involve the risk of some debtors not paying even though considerable effort will be made to collect the payment. When it is decided that all possible means to obtain payment from the debtor have failed, the debt is eliminated from the books of accounts. Elimination of debt which is bad from the books of account is called bad debt written off.

A bad debt occurs when the debtor fails to pay either the whole or part of the debt. In such a case whatever sum is not received is bad debt.

Example

Goods sold to Raj Traders Rs 60,000 on 1st May, 2008. Raj Traders became insolvent on 31st October, 2010. Amount recovered on 31st January, 201O Rs 40,000 in full. Therefore, the amount of bad debt will be Rs.20, 000. The entry will be –

31.1.2010	Bank A/c	Dr	40,000	
	Bad Debt A/c	Dr	20,000	
	To, Raj Traders A/c			60,000

Adjustment Entries

Before preparation of final accounts, you should know about adjustment entries. Because, these are passed before they are transferred to Trading and Profit and Loss Account and Balance Sheet. These adjustment entries always have a dual effect. They affect either the Trading Account or the Profit and Loss Account but definitely the Balance Sheet.

Outstanding Expenses

Outstanding Expenses refer to those expenses which have become due during the accounting period for which the Final Accounts have been prepared but have not yet been paid. This happens particularly regarding those expenses which accrue from day to day business but which are recorded only when they are paid. Examples of such expenses are rent, salaries, interest etc. Here expense account will be charged to Profit & Loss Account and Outstanding Expense account will be shown in the Balance Sheet in the liabilities side.

Example

Salary of March'10 Rs. 4,000 not paid. The entry will be –

31.3.2010	Salary A/C	Dr	4,000	
	To, Outstanding Salary A/C			4,000

Prepaid Expenses

Prepaid Expenses are those expenses which have been paid in advance. In other words, these are the expenses which have been paid during the accounting period for which the Final Accounts are being prepared but they relate to the next period. For Example, during the accounting year ending 31st March, 2010, salaries for the month of April'201o of Rs. 10,000 has been paid. This amount of Rs. 10,000 relates to the year 2010-11 which has been paid in the year 2009-10. This is prepaid expenses.

Only expense relating to the current accounting period should be charged to Profit & Loss Account and the amount of prepaid expense will be shown in the Balance Sheet in the assets side.

Example

Rent of Apr '10 paid on 31st Mar'10 - Rs 2,000. The entry will be -

31.3.2010	Rent A/c	Dr	2,000	
	To, Cash A/c			2,000
	Prepaid rent A/c	Dr	2,000	
	To, Rent A/c	Dr	2,000	

Accrued Income

Accrued income means income which has become due during the accounting year but which has not so far been received by the firm. For Example, a loan of Rs. 1, 00,000 has been given @12% p.a. and interest is payable monthly. If interest for one month, i.e Rs. 1,000 has not been received by the business, the income will be termed as accrued income. The income part will come in Profit & Loss account and accrued income will be shown in the Balance Sheet in the assets side.

Example

Rent of Rs. 1,000 for March'2010 not received. The entry will be -

31.3.2010	Accrued Rent A/c	Dr	1,000	
	To, Rent A/c			1,000

Pre received Income

Pre received income means income which has been received by the business before it is being earned by the business. This includes certain prepayments which the business may receive during the accounting year. Only income relating to the current accounting period will come in the Profit & Loss Account and pre received income will come in the liabilities side of the Balance Sheet.

Example

Rent of April'10 Rs 4,000 received on 31st March, 2010. The entry will be –

31.3.2010	Cash A/c	Dr	4,000	
	To, Rent A/c			4,000
	Rent A/c	Dr	4,000	
	To, Pre Received Rent A/c			4,000

ERRORS

Accounting errors are the errors committed by Accountant in the course of accounting process.

These errors may be in the form of **omitting the transactions to record**, **recording in wrong books, or wrong account or wrong totaling and so on**.

While discussing about the trial balance, we have seen that preparation of trial balance is a method of verifying the **arithmetical accuracy of entries** made in the ledger.

But it may be noted that tallying of the trial balance does not prove that- (i) all transactions have been recorded in the books of original entry; and (ii) all transactions have been correctly analyzed and recorded in the proper accounts.

Hence, we can say that a trial balance should not be regarded as a conclusive proof of the correctness of the books of account that is if the trial balance does not agree, there are errors or mistakes but even if the trial balance agrees, there still may be errors in the accounts.

1. Errors of Omission: These errors arise as a result of some act of omission on the part of the Accountant. It refers to the omission of a transaction at the time of recording in subsidiary books or posting to ledger.

(a) Complete Omission: When any particular transaction has not at all been entered in the journal or in the book of original entry, it cannot be posted into the ledger at all and complete error of omission will occur. The trial balance is not affected at all by such errors e.g. failure to record completely credit sales in sales book. However, the trial balance will agree, if debit side as well as credit side of a journal entry is not posted to ledger.

(b) Partial Omission: This means that the transaction is entered in the subsidiary book, but is not posted to the ledger, such errors affect the agreement of trial balance e.g. omitting to post the discount columns of the cash book.

2. Errors of Commission: These errors arise due to some positive act of commission on the part of Accountant because of ignorance, lack of proper accounting knowledge and carelessness of the accounting staff. They are committed while recording transactions. These errors may or may not affect the agreement of trial balance.

For example:

– Mistake in posting in so far as the amount is wrongly written. A common mistake, for example, is to transpose figures - to write Rs. 115 instead of Rs. 151. This will cause a mistake of Rs. 36.

– Making an entry on the wrong side. For example, if instead of debiting an account with Rs. 500 it is credited with the amount, the debit balance, in the trial balance will be shorter by Rs. 1,000. A mistake on the wrong side causes the difference to be double of the amount involved.

– A mistake in the casting (totaling) of subsidiary books.

3. Compensating Errors: They are group of errors, the total effect of which is not reflected in the trial balance. These errors are neutralizing in nature, hence one error is compensated by other error or errors of opposite nature. For example, an extra debit in purchase account may be compensated by an extra credit in sales account. Thus, compensating errors do not affect the agreement of trial balance.

4. Errors of Principle: Errors of principle like furniture purchased debited to purchase account, building sold credited to sales account, commission paid for purchase of land debited to commission account etc. will not affect trial balance as they are related to allocation of amount received or spent between revenue and capital. There will be no effect on trial balance because double entry will be passed and one account will be debited and other credited. So the debit and credit side of trial balance will definitely agree.

For example, debiting purchase of furniture to office expenses account, crediting sale of furniture to sales account, etc.

RECTIFICATION OF ERRORS

For rectification of these types of errors, following steps may be taken:

(i) Write down in the rough sheet, the correct entry necessary for recording the transaction.

(ii) Write down in the rough sheet the entry that has actually been passed.

(iii) Compare and pass in the journal the requisite rectification entry.

Example: A purchase of Rs. 5,000 from Rajesh entered in the purchases day book as Rs. 500. The rectification of this error shall involve:

(a)	Purchases A/c Dr.	Rs. 5,000/-		(correct entry)
	To Rajesh		Rs. 5,000/-	
(b)	Purchases A/c Dr.	Rs. 5,00/-		(entry passed)
	To Rajesh		Rs. 5,00/-	
(c)	The rectifying entry in the journal will be:			
	Purchases A/c Dr.	Rs. 4,500/-		(rectifying entry)
	To Rajesh		Rs. 4,500/-	

Under Computerized Accounting Rather than to delete the entry, it will be better if you pass a reverse entry with narration and then pass a fresh entry.

Exercise:

Pass journal entries necessary to rectify the following errors:

1. An amount of Rs. 2,000/- withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.

2. A purchase of goods from Nathan amounting to Rs. 3,000/- has been wrongly entered in the Sales Book.

3. A credit sale of Rs. 1,000/- to Santhanam has been wrongly passed through the Purchases Book.

4. Rs. 1,500/- received from Malhotra have been credited to Mehrotra.

5. Rs. 3,750/- paid on account of salary to the cashier Dhawan stands debited to his personal account.

6. A contractor's bill for extension of premises amounting to Rs. 2,75,000/- has been debited to Building Repairs Account.

7. On 25th March, goods of the value of Rs. 5,000/- were returned by Akash Deep and were taken into stock but the returns were entered in the books under date 3rd April, i.e.; after the expiration of the financial year on 31st March.

8. A bill of Rs. 2,000/- for old office furniture sold to Sethi was entered in the Sales Day Book.

9. An amount of Rs. 800/- received on account of interest was credited to Commission Account.

Rectification Entries

1. Drawings Account Dr. 2,000
To Trade Expenses Account 2,000
(For the amount withdrawn for personal use wrongly charged to the trade expenses account)
2. (a) Sales Account Dr. 3,000
To Nathan 3,000
(Being the cancellation of the entry passed through the Sales Book)
(b) Purchases Account Dr. 3,000
To Nathan 3,000
(To record the credit purchases from Nathan)
Alternatively: It is better to pass a combined entry:
Sales Account Dr. 3,000
Purchases Account Dr. 3,000
To Nathan 6,000
(For cancellation of entry passed through the Sales Book and record the credit purchases from Nathan)
3. Santhanam Dr. 2,000
To Purchases Account 1,000
To Sales Account 1,000
(Rectification of the mistake caused by entering sale for Rs. 1,000 to Santhanam in the Purchases Book)

4. Mehrotra Dr. 1,500

To Malhotra 1,500

(Being the rectification of wrong credit given to Mehrotra instead of Malhotra)

5. Salaries Account Dr. 3,750

To Dhawan 3,750

(Being the adjustment of salary wrongly debited to the personal account of the cashier)

6. Building Account Dr. 2,75,000

To Building Repairs Account 2,75,000

(Being the adjustment of amount wrongly debited to the building account for building repairs)

7. Returns Inwards Account Dr. 5,000

To Akash Deep 5,000

(Being the entry necessary to record the return inwards within the financial year)

Entry in the books of next accounting year's

Akash Deep Dr. 5,000

To Return Inwards Account 5,000

(Cancellation of unwanted entry)

8. Sales Account Dr. 2,000

To Office Furniture Account 2,000

(Being the sale of old office furniture wrongly passed through the sales book)

9. Commission Account Dr. 800

To Interest Account 800

(Being the adjustment of amount wrongly credited to the commission account for interest received)

Suspense Account:

When a trial balance does not agree, efforts are made to locate errors and rectify them. However, if reason for disagreement of trail balance cannot be found, a new account called suspense account is opened in order to give trial balance an appearance of agreement. Then final accounts are prepared. Debit balance in suspense account is shown on assets side while credit balance is recorded on liabilities side.

A suspense account is opened in two instances i.e.

(i) To balance a disagreed trial balance – In the trial balance, if the debits are short the difference has to be debited to Suspense Account and if the credits are short, Suspense Account has to be credited to make trial balance agree apparently. Thus trial balance is tallied and final accounts are prepared.

Later, when errors are detected, the rectifying entries are passed. The suspense account will show balance until all entries are corrected. When all errors affecting the trial balance have been rectified by means of journal entries, the Suspense Account will show no balance.

(ii) To post uncertain items: Sometimes, an item cannot be posted to the correct account because of lack of information. In this case, the error is rectified by means of journal entry opening suspense account. Thus, suspense account is opened and is given the debit or credit as the case may be. When debit is short of credit, the difference is debited to Suspense Account making the debits equal to the credits. Similarly, if in a rectifying journal entry, credit is otherwise short of debit, the difference is credited to Suspense Account. Later when error is detected, the rectifying entry is passed.

You received a remittance of Rs. 2,000, but you may not know who has sent the amount. Therefore, for the time being you may pass the following entry:

Cash/Bank Account Dr.	2,000	
To Suspense Account		2,000

(Being remittance received from unknown person)

Later when you get the information that Mr. Ram Singh had sent the amount, then pass the following entry:

Suspense Account Dr.	2,000	
To Ram Singh		2,000

(Being credit given for the sender for remittance which had been credited previously to suspense)

Example:

Pass journal entries to rectify the following errors assuming the existence of Suspense Account:

(i) Goods bought from Mukesh amounting to Rs. 5,500 was posted to the credit of his account as Rs. 5,000.

(ii) Sales book was overcast by Rs. 10,000.

(iii) While carrying forward the total of one page of the Purchases Book to the next, the amount of Rs. 2,12,350 was written as Rs. 2,13,250.

(iv) Cartage Rs. 780 paid on machinery newly acquired was debited to carriage inward account.

(v) Purchases returns to Shivalker Bros. Rs. 3,100 were not recorded in purchases returns book but the account of Shivalker Bros. was duly debited with the amount.

(vi) Drawings of goods costing 300 were not recorded in the books of account.

(vii) Whitewashing expenses, Rs. 670 were posted from cash book to the nominal account as Rs. 760.

Also prepare Suspense Account starting it with debit balance of Rs. 320. Have you any comments to offer on Suspense Account?

Journal

(i) Suspense Account Dr. 500

To Mukesh 500

(For rectification of short credit to Mukesh)

(ii) Sales Account Dr. 10,000

To Suspense Account 10,000

(For rectification of wrong total of Sales Book)

(iii) Suspense Account Dr. 900

To Purchases Account 900

(For rectification of wrong carry forward of total from one page to another in the Purchases Book)

(iv) Machinery Account Dr. 780

To Carriage Inwards Account 780

(For rectification of wrong debit to carriage inwards for cartage paid on newly acquired machinery)

(v) Suspense Account Dr. 3,100

To Purchases Returns Account 3,100

(For rectification of omission of credit to Purchases Returns Account for goods returned to Shivalkar Bros.)

(vi) Drawings Account Dr. 300

To Purchases Account 300

(For rectification of omission of drawings of goods costing ` 300 by the proprietor)

(vii) Suspense Account Dr. 90

To Whitewashing Account 90

(For rectification of excess debit to whitewashing account)

LEDGER

Dr. Suspense Account Cr.

Particulars	Rs.	Particulars	Rs.
To Differnce in trial balance	320	By sales A/C	10000
To Mukesh	500		
To Purchases Account	900		
To Purchases Return	3100		
To Whitewashing Account	90		
To Balance c/d	5090		
	10000		10000
		By Balance b/d	5090

Comment: As suspense account still shows a balance, it means all errors have not yet been rectified.

Capital and Revenue Items

Capital Expenditure:

Capital expenditure is that expenditure which results in acquisition of an asset or which results in an increase in the earning capacity of a business. The benefit of such expenditure lasts for a long period of time. Examples: Purchases of land, buildings, machinery, furniture, patents, etc. All these assets stay in business and are used again and again. Money spent to reduce working expenses like conversion of hand-driven machinery to power-driven machinery and expenditure enabling a firm to produce a large quantity of goods.

Expenditure which does not result in an increase in capacity or in reduction of day-to-day expenses is not capital expenditure, unless there is a tangible asset to show for it.

All sums spent up to the point an asset is ready for use should also be treated as capital expenditure.

Examples are: fees paid to lawyer for drawing a purchase deed of land, overhauling expenses of second hand machinery, cartage paid for bringing machinery to the factory from supplier's premises and money spent to install a machinery; and even interest on loans taken to acquire fixed assets only for the period before the asset becomes operational.

Revenue Expenditure:

Expenses whose benefit expires within the year of expenditure and which are incurred to maintain the earning capacity of existing assets are termed as revenue expenditure. Amounts paid for wages, salary, carriage of goods, repairs, rent and interest, etc., are examples of revenue expenditure. **Depreciation on fixed assets is also a revenue expenditure. To the extent the materials are used up, they will be revenue expenditure.**

Similarly, cost of goods sold is revenue expenditure. Costs incurred to acquire an asset are capital but costs incurred to keep them in working condition or to defend their ownership are revenue. Fee paid to a lawyer for checking whether all the papers are in order before land is purchased is capital expenditure. But if later a suit is filed against the purchaser, the legal costs will be of revenue type.

Difference between Capital and Revenue Expenditure:

The following are the points of distinction between capital expenditure and revenue expenditure:

(i) Capital expenditure is incurred in acquiring or improving permanent assets which are not meant for resale. But revenue expenditure is a routine expenditure incurred in the normal course of business and includes cost of sales as also the upkeep of fixed assets etc.

(ii) Capital expenditure seeks to improve the earning capacity of the business whereas revenue expenditure is incurred to maintain the earning capacity of the business.

(iii) Capital expenditure is normally a non-recurring outlay but revenue expenditure is usually a recurring features.

(iv) Capital expenditure produces benefits over several years. Hence, only a small part is charged as depreciation to income statement and the rest appears in the balance sheet. But revenue expenditure is consumed within an accounting year and the entire amount is charged to the (current year's) income statement. Hence, it does not appear in the balance sheet. Deferred revenue expenditure is however an exception to this rule.

Capital and Revenue Receipts

Capital receipts comprise of payments or contributions into the business by the proprietor, partners or companies towards the capital of the firm and also any sum received from debenture-holders, any loans and the proceeds of sale of any fixed assets of a business enterprise.

Revenue receipts are the outcome of a firm's activity in the accounting period, part of its rewards for offering goods or services to the public e.g. sales, commission, fees received for services, interest on investment, etc.

Revenue receipts must be set off against the revenue expenses in order to calculate the profit or loss of the business in an accounting period. Capital receipts and expenditure have no bearing on the profit or loss for the accounting period. The distinction between capital receipts and revenue receipts can be drawn as follows:

Difference between Capital Receipts and Revenue Receipts:

Capital Receipts	Revenue Receipts
Amount realized by the sale of fixed assets or by issue of shares or debentures is a capital receipt.	Amount realized by sale of goods or rendering services is always a revenue receipt.
Amount realized from the sale of a capital asset or investment is capital receipt.	Amount realized from the sale of an asset kept for sale is revenue receipt.

Capital and Revenue Profits:

While preparing the final accounts, distinction has to be made between capital profits and revenue profits.

Revenue profits are earned in the ordinary course of business. They appear in the profit and loss account and are available for distribution as profit, or for creating reserves and funds, or for being used in the business.

However, capital profits are those which are earned as a result of selling some fixed assets, or in connection with raising capital for the firm. For instance, a building purchased for Rs. 4,50,000 was subsequently sold for Rs. 4,75,000, this Rs. 25,000 will be profit of capital nature. Capital profits are either capitalized i.e. transferred to capital account or transferred to capital reserve account which may be utilized for meeting capital losses.

Capital and Revenue Losses:

Revenue losses are the losses which arise during the normal course of business whereas capital losses are those which occur when selling fixed assets or raising share capital. If a building purchased for Rs. 5,00,000 is sold for Rs. 4,50,000, there will be capital loss of Rs. 50,000.

Treatment of capital losses is not different from that of capital profits. Just as capital profits are not shown in the profit and loss account, similarly capital losses are not shown in the profit and loss account. They are shown in the balance sheet on the assets side. As and when capital profits arise, capital losses are gradually written off against them. If however, capital losses are huge, the common practice is to spread them over a number of years and charge a part thereof to profit and loss account of each such year. But if they are negligible, they are debited to profit and loss account of the year in which they occur.

Capital Expenditure: Expenditure incurred in acquiring or improving an asset which is not meant for sale.

Revenue Expenditure: Expenditure of a routine nature and incurred to maintain an asset.

Deferred Revenue Expenditure: Heavy expenditure of revenue nature

Capital Receipts: Payments or contributions into the business by the sole proprietor, partners or other shareholders towards the capital of the firm.

Revenue Receipts: Outcome of a firm's activity as rewards for offering goods or services to the public.

Revenue Profits: Earned in the ordinary course of business.

Capital Profits: Earned as a result of selling some fixed assets or raising capital for the firm.

Revenue Losses: They arise during the normal course of business

Capital Losses: They occur on selling the fixed assets or in raising of share capital.

Example:

State which of the following expenditures are capital, revenue, deferred revenue expenditures and capital loss:

(i) Cost of overhauling and painting a second-hand truck newly purchased.

(ii) Cost of making more exits in a cinema hall under order of the Government.

(iii) Rs. 25,000 were spent on air conditioning the office of the General Manager.

(iv) An old machine which stood in the books at Rs. 15,000 was sold for Rs. 13,000.

(v) Rs. 2,000 were paid as municipal tax in connection with a building which was purchased last year for Rs. 2,00,000.

(vi) Rs. 30,000 were spent on heavy advertising in connection with the introduction of a new product.

(vii) Rs. 500 was paid out in connection with carriage on goods purchased.

(viii) A temporary room constructed for Rs. 25,000 for storing raw material for the construction of a big building.

(ix) Rs. 5,00,000 was spent on putting up a gallery in a theatre hall.

(x) Freight and cartage amounting to Rs. 4,000 were paid on purchase of a new plant and a sum of Rs. 2,000 was spent as erection charges of that plant.

Solution:

(i) When a second hand machine is purchased, the entire expenditure incurred in the beginning to make it fit for working is treated as capital expenditure. The value of the machine is increased by the amount spent. Therefore, the cost of overhauling and painting the truck will be treated as capital expenditure.

(ii) Making more exits in a cinema hall does not increase the capacity of the hall and therefore, it should be treated as revenue expenditure.

(iii) The sum of Rs. 25,000 spent on air conditioning the office of General Manager is capital expenditure because it represents a fixed asset. Moreover, the effect of air conditioning will be available for several years to come, and it can possibly be disposed of, if desired, at a future date, when it will fetch some amount.

(iv) The old machine costing Rs. 15,000 was sold for Rs. 13,000 only, and the loss of Rs. 2,000 is clearly a capital loss.

(v) Rs. 2,000 paid by way of municipal tax on a building purchased is an item of revenue nature. It is an expenditure of routine nature, which was necessary for using the building.

(vi) Since the benefit of Rs. 30,000 spent on advertising will occur for several years, it is of capital nature. It may be treated as a deferred revenue expenditure and be written off against the profit and loss account of a number of years.

(vii) The expenditure of Rs. 500 incurred on carriage on goods purchased is of revenue nature because the goods are meant for resale.

(viii) Rs. 25,000 spent on construction of temporary room should be treated as capital expenditure because it was necessary for the construction of the main building. The cost of the room will be added to the cost of the building.

(ix) When a new gallery is put up, it will increase the number of seats (capacity) of the hall. Therefore, this cost of Rs. 5,00,000 should be treated as a capital expenditure.

(x) The expenditure incurred by way of freight and cartage amounting to Rs. 4,000 and the erection charges of Rs. 2,000 are both of capital nature. The former has been incurred in connection with the receipt of a capital asset while the latter has been incurred for erecting it so that it may be used for business purposes.

Example:

State whether the following expenses are capital, revenue or deferred revenue expenditure:

(i) A Ltd. spent Rs. 2,00,000 for overhauling the machinery which improved the capacity utilization and saved running expenditure by ` 15,000 p.a.

(ii) M/s Capital Properties, property dealers, purchased ten flats @ Rs. 7,00,000 each.

(iii) A firm incurred Rs. 10,000 to retain the title of a land purchased for business in litigation with third party.

(iv) Compensation paid to undesirable employees.

(v) M/s Durga & Co. spent Rs. 2,50,000 for organizing an Inter-school Cricket Tournament in Delhi. This was held for advertising their new school bag and certain books and stationery which they wanted to market.

(vi) Rs. 12,000 paid to Mahanagar Telephone Nigam Ltd. for installing a telephone in the office.

(vii) Damages paid on account of breach of contract to supply certain goods.

(viii) Rs. 25,000 has accrued during the year on term loan obtained and utilized for the construction of factory building and purchase of machinery, however, the production did not commence till the last date of the year.

(ix) Imported goods worth Rs. 1,75,000 confiscated by customs authorities for non-disclosure of material facts.

(x) Rs. 20,000 spent for the trial run of newly installed machinery.

Solution:

(i) Expenses for overhauling the machinery increased capacity utilization which contributes to increase the revenue generating capacity. Also, saving in revenue expenditure for more than one accounting period will accrue from this overhauling which will increase future profits. Hence, this expense is capital in nature.

(ii) Purchase of flats in the ordinary course of business by property dealers is revenue expenditure as flats are stock in trade for it.

(iii) Legal expenses incurred to retain the title of land are expenses for maintaining the asset. The expenses will not generate any revenue in future directly. Hence, it is revenue in nature.

(iv) Compensation paid to retrench undesirable employees is expected to increase revenue earning capacity of the business because such undesirable employees would either waste resources or time with adverse effect on profit. The expenditure is capital in nature.

(v) The purpose of expenses incurred for organizing the Inter-School Cricket Tournament is to advertise for some new products. This advertisement has some enduring effect so far as the marketability of the new products is concerned. The expense may be treated as deferred revenue expenditure.

(vi) The money deposited with Mahanagar Telephone Nigam Ltd. for acquiring a telephone connection is treated as an asset; hence it is a capital expenditure.

(vii) Damages paid on account of the breach of contract to supply certain goods are treated as revenue expenditure incurred in the ordinary course of the business.

(viii) Interest accrued on term loan obtained and utilized for the construction of factory building and purchase of machinery should be treated as capital expenditure since commercial production did not start till the last date of the accounting year.

(ix) The confiscation of imported goods by the customs authorities is a loss arisen on account of negligence and is of abnormal nature. It is appropriate to write it off to profit and loss account over a period of 2 to 5 years treating it as a deferred revenue expenditure.

(x) Expenses incurred for trial-run of newly installed machinery is capital expenditure in nature.

Bank Reconciliation Statement

A bank is an institution which deals in money. Its main business is to accept deposits and to lend money. It also collects money and makes payments on behalf of its clients. Bank account is a personal account and the account-holders record their transaction with the bank in a similar manner as they do with any other person.

Deposits:

A deposit is made by filling up a form called pay-in-slip. There is a counterfoil which is stamped by the bank's cashier and signed by him and returned to the client. This counterfoil is evidence that money has been duly received by the bank. Separate pay-in-slips have to be filled in for depositing cash and cheques. Also, there are different pay in slips for local and out-station cheques.

Withdrawals:

Withdrawals are made by means of cheques.

The money deposited with bank is debited to bank account while money withdrawn from the bank is credited to bank account. The record of money deposited and withdrawn from the bank is maintained by the business in its cash book with bank columns which can be balanced on any date and the balance so arrived at is known as **bank balance as per cash book.**

Bank Pass Book:

The bank on its part maintains in its ledger the account of its customers. Pass book is a copy of the client's account in the bank's ledger. Bank issues pass book to its client. The money deposited by the customer is credited to his account and the money withdrawn from the bank is debited to his account. The balance as per bank ledger indicated in the bank pass book is called the bank balance as per pass book.

Bank Reconciliation Statement

The bank pass book and bank columns of the cash book record the same transactions.

In the pass book, the transactions are recorded from the point of view of the bank whereas in cash book they are recorded from the point of view of the client or us.

The bank balance as per pass book, can therefore, be expected to be equal to the bank balance as revealed by the cash book.

However, in actual practice the two balances rarely agree because of the time-lag of a few days between the entries made by the firm in cash book and by the bank in the pass book.

Thus, a comparison is necessary to find out the items on account of which difference has arisen and a need to reconcile the two balances. Thus, a bank reconciliation statement is a statement which is prepared as on a particular date to reconcile the bank balance as per cash book with balance as per pass book by showing all causes of difference between the two.

Causes of Difference between Bank Balance Shown By Cash Book and that Shown By Pass Book

(i) Cheques issued but not presented for payment:

When a cheque is drawn or issued in favour of a third party, it is immediately recorded in the cash book by debiting the party and crediting the bank and this has the effect of reducing the bank balance in the cash book. But the bank will not debit client's account until that cheque is presented for payment, and honoured.

So long as it is not presented, the balance shown in the pass book is more than the balance shown by the cash book.

(ii) Cheques deposited for collection but not yet collected:

The client debits bank column of cash book as soon as he deposits cheques with the bank for collection, but the bank credits client's account only when it has collected cash on the cheque so deposited. It results in bank balance as per cash book being higher than the balance as per pass book.

(iii) Bank charges not entered in the cash book:

The bank charges some amount from each customer by way of incidental charges, collection charges, etc. and debits his account for this reason from time to time. As soon as these charges are made, the bank debits the customer's account in its own books and this reduces the bank balance. But the customer will know such charges only when he receives a statement of account from the bank, until then, bank balance as per pass book will be less than bank balance as per cash book.

(iv) Interest credited or debited by bank, not entered in the cash book:

When bank allows interest to a customer for deposits, it will credit customer's account and his bank balance as per pass book will increase. But the customer will not pass the entry in cash book simultaneously till he knows the fact, thus the balances will differ. Likewise, interest on overdraft is debited to the customers' account and till the same is not entered in the cash book, it will result in a difference in the balances.

(v) Direct collections on behalf of customers:

A banker may receive amounts due to the customer by way of dividends, rent, interests etc. directly from the persons concerned on account of standing instructions of the customer to such persons. Similarly, debtors may also deposit the amounts directly to the bank. The bank credits the account of the customer for such collections as soon as it gets such payments. But same will be entered in the cash book only when customer receives the statement from the bank. Thus the balances differ.

(vi) Direct payment by bank:

Usually, the bank is given standing instructions for certain payments to be made, such as payment of insurance premium, interest on loan, electricity bill etc. Bank, while making payments, debits pass book but the customer has no information of the same till he is informed. It results in a difference in balances.

(vii) Dishonour of cheques/bills:

When cheque or bill of exchange discounted with the bank is dishonoured, the same is debited in the pass book but not given effect in the cash book until the intimation is received. It will cause a difference in the two balances.

(viii) Cheques received and entered in the cash book but omitted to be deposited into the bank.

When cheque is received, the same is entered in the cash book but it may not be deposited into the bank immediately. This will cause a difference in the two balances.

(ix) Errors:

There may be errors in the accounts maintained by the customer or/ and by the bank. A wrong debit or credit given by the customer or the bank leads to a difference in the balances.

Significance of Bank Reconciliation Statement:

(i) It highlights the causes of difference between the bank balance as per cash book and the balance as per pass book. Necessary adjustments can, therefore, be carried out at an early date.

(ii) It reduces the chance of fraud by the staff dealing with cash and cash bring.

(iii) It acts as a moral check on the staff of the organization to keep the cash records always up to date.

(iv) Bank balance as per cash book cannot be accepted as final unless it is supported by statement of passbook. When these two balances do not tally, reconciliation becomes essential to determine the correct bank balance that can be used while finalizing the accounts.

(v) It helps in finding out actual position of the bank balance.

Steps for preparing a bank reconciliation statement:

(i) The cash book should be completed and the balance as per bank column on a particular date should be found out covering the period for which the statement has to be prepared.

(ii) The bank should be requested to complete and send to the firm the bank pass book.

(iii) Check the entries of the debit and credit sides of the bank columns of the cash book with corresponding entries on the credit and debit sides of the pass book relating to the same period.

(iv) The items not tallying should be classified into common groups according to their characteristics.

(v) The balance as shown by any one book (i.e. the cash book or the bank pass book) should be taken as the base. This is, as a matter of fact, the starting point for determining the balance as shown by the other book after making suitable adjustments taking into account the causes of difference.

(vi) The effect of the particular cause of difference on the balance shown by the other book should be noted.

(vii) In case, the cause has resulted in an increase in the balance shown by the other book, the amount of such increase should be added to the balance as per the former book which has been taken as the base.

(viii) In case, the cause has resulted in a decrease in balance shown by the other book, the amount of such decrease should be deducted from the balance as per the former book which has been taken as the base.

Preparation of Bank Reconciliation Statement

Transactions	Starting with the Bank Balance as per Pass Book	Starting with the Bank Balance as per Cash Book
Cheques issued but not presented	Deduct: The amount of unpresented cheques.	Add : The amount of Unpresented cheques.
Cheques deposited but not yet collected	Add : The amount of cheques deposited	Deduct : The amount of cheques deposited
Cheques received and entered in the bank column of the cash book but not deposited	Add: The amount of cheques.	Deduct: The amount of cheques.
Dishonour of cheques deposited with banks earlier	Add : The amount of dishonoured cheques	Deduct : The amount of dishonoured cheques
Collection of interest and dividends and interest allowed by the banker not yet recorded in the cash book.	Deduct : The amount of these items	Add : The amount of these items.
Bank charges	Add: The amount of bank charges	Deduct: The amount of bank charges.
Balance	Bank Balance as per Cash Book	Bank Balance as per Pass Book

Example:
On 31st March, 2013 the pass book of Mitra showed a credit balance of Rs.2,16,000. A comparison of pass book and cash book revealed the following:

(i) Cheques deposited but not cleared by 31st March Rs. 1,08,150
(ii) Cheques issued by Mitra but not presented for payment before 1st April, 2013 Rs. 26,000
(iii) Insurance premium paid by bank on behalf of Mitra but not yet recorded in cash book Rs. 52,075
(iv) Commission charged by bank not yet recorded in cash book Rs. 750

(v) Interest on bonds collected by bank on behalf of Mitra not yet recorded in cash book Rs. 25,000

Bank balance as per cash book as on 31st March, 2013 is Rs. 3,25,975/-. Prepare a Bank Reconciliation Statement as on 31st March, 2013.

Bank Reconciliation Statement of Mitra
as on 31st March, 2013

Particulars	**Rs.**	**Rs.**
Balance as per Pass Book		2,16,000
Add :		
➢ Cheques deposited with bank but not yet collected	1,08,150	
➢ Commission charged	52,075	
➢ Insurance premium paid by the bank	750	1,60,975
		3,76,975
Less:		
➢ Cheques issued but not yet presented for payment	26,000	
➢ Interest on bonds received by the bank	25,000	51,000
Balance as per Cash Book		3,25,975

Alternatively:

Bank Reconciliation Statement of Mitra
as on 31st March, 2013

Particulars	**Rs.**	**Rs.**
Balance as per Cash Book		3,25,975
Add :		
➢ Cheques issued but not yet presented for payment	26,000	
➢ Interest on bonds received by the bank	25,000	51,000
		3,76,975
Less:		
➢ Cheques deposited with bank but not yet collected	1,08,150	
➢ Commission charged	52,075	
➢ Insurance premium paid by the bank	750	1,60,975
Balance as per Pass Book		2,16,000

Depreciation:

Meaning of Depreciation: A business enterprise acquires different types of fixed assets depending upon its requirements and financial conditions. Fixed assets have a long life and are held for use in the business for production of goods and services.

Whenever an asset is used in business its value gets reduced and sooner or later the asset becomes useless. Depreciation is a permanent, continuous and gradual shrinkage in the book value of a fixed asset. It is the fall in the quality or value of a fixed asset through physical wear and tear due to use or passage of time or from any other cause. Depreciation takes place irrespective of regular repairs and maintenance.

As the asset is used for business purpose, the annual loss in the value of the asset is like any other expenditure. Hence, the cost of fixed assets has to be written off over its useful economic life as a loss.

Thus, depreciation is a process of allocating the cost of a fixed asset over its estimated useful life in a rational and systematic manner.

Depreciable Assets are assets which:
– are expected to be used for more than one accounting period;
– have a limited useful life and
– are held by the organization for use in the production or supply of goods and services.

When a fixed asset is purchased, it is recorded in the books of accounts at its original cost. But, the fixed asset is used to earn revenues for a number of accounting periods in future with the same acquisition cost until the concerned fixed asset is sold or discarded. It is therefore, necessary that a part of the acquisition cost of the fixed asset is treated or allocated as an expense in each of the accounting periods in which the asset is used. This allocation of cost in the form of an expense is known as depreciation in accounting.

Suppose, a business purchases a machinery for Rs. 10,00,000/- and after using it for five years, it is sold for Rs. 2,00,000/-. The cost of the machinery used in the business is Rs.8,00,000/- (Rs. 10,00,000 – Rs. 2,00,000). This cost must be allocated as an expense of the business at the rate of Rs. 1,60,000 (8,00,000 ÷ 5) for each of

five accounting periods in which the machinery has been used to earn revenues. This Rs.1,60,000 charge as expense is called accounting concept of depreciation.
It is the cost for the services obtained from the use of the asset in the same manner as the cost of wages, rent, etc. Depreciation is the expense charged to profit and loss account before arriving at the net profit for the year. In other words, the cost of fixed asset in the form of depreciation has to be matched against the revenues of the years over which the asset is used.
Thus, in accounting, depreciation means apportionment or allocation of the cost of the fixed asset over its useful life. Its aim is to spread over and allocate or distribute the cost of the fixed asset to the years of its use and charge the depreciable cost to profit and loss account before arriving at the profits of each of the accounting periods in which the fixed asset utilized.

Purpose of Depreciation Accounting: The primary purpose of depreciation accounting is cost allocation.
Provision for depreciation in the profit and loss account does not involve the outflow of cash and hence funds to the extent of depreciation charged over the years will remain in the business and these funds can be easily used for replacement of asset.

Causes of Depreciation:

(i) Physical Wear and Tear Resulting from Use: Tangible fixed assets like, machinery, buildings, furniture etc. get worn out or torn out on account of friction, strain, weathering, intensity of use, chemical reaction, handling etc. This is the most important cause of charging depreciation in respect of such assets which are in constant use.
(ii) Physical Deterioration Resulting from Atmospheric Exposure: Number of assets deteriorates for being continually exposed nature.
(iii) Passage of Time: A machine also becomes potentially useless by the passage of time. It is so even if the machine is kept continuously idle.
(iv) Depletion: Wasting assets such as mines and quarries lose their value because they get exhausted on account of continuous extractions.
(v) Obsolescence: Sometimes an asset becomes useless because of technical changes within the industry, technical progress in other industries, changes in tastes and habits of consumers, changes in supply and locations of natural resources etc.

Objectives of Providing Depreciation:

The objectives of providing depreciation are as follows:

(i) To ascertain the correct profit: When a particular asset is used for earning the income of the business, the depreciation in the value of assets should be deducted from the income in order to calculate the correct and real profit of the business.

(ii) To present true financial position: In order to show the true financial position of the business in the balance sheet, it is necessary that assets must be shown at their true values after deducting reasonable depreciation. If depreciation is not provided, the assets will be overstated in the financial statements and it will be against sound business principles.

(iii) To make provision for replacement of assets: Since depreciation is a non-cash expense, the amount charged can be kept separately and utilised for the replacement of the fixed asset after the expiry of the useful life of the asset.

(iv) To ascertain the proper cost of the product: In order to ascertain the cost of production, it is necessary to charge depreciation as an item of cost of production.

(v) To maintain the capital invested in the cost of the asset intact in the business so that it can be reinvested in profit earning process.

(vi) To derive maximum tax benefit.

(vii) To meet the legal requirements: In the case of joint stock companies, it is necessary to charge depreciation on fixed assets before declaring dividends.

Methods Of Calculating Depreciation

Straight Line Method | Diminishing Balance Method

Straight Line Method:-

It is the simplest method of charging depreciation. Every year a fixed amount is written off as depreciation. The amount is arrived at by dividing the original cost (less the estimated scrap value) of the asset by the number of years of the estimated life. For example, if a company has a machine costing Rs 5, 20,000 which has an estimated life of 10 years and scrap or salvage value of Rs 20,000, the annual depreciation will be calculated as follows.

$$\textbf{Depreciation} = \frac{\text{(Cost)- (Estimated scrap value)}}{\text{(Estimated useful life)}} = \frac{\text{(Rs.5,20, 000)-(Rs20,000)}}{\text{(10years)}} = \text{Rs.50, 000}$$

Depreciation calculated on straight line method can be expressed as a fixed percentage of original cost as under

$$\frac{\text{(Annual Depreciation)}}{\text{(Original Cost)– (scrap value)}} \times 100 = \frac{\text{Rs.50, 000}}{\text{Rs.5, 00,000}} \times 100 = 10\%$$

__Diminishing Balance Method__

Also known as reducing balance method or written down value method. Under his method, a larger amount of depreciation is charged in the earlier years of asset's life than in the later years. Depreciation is calculated by applying a fixed percentage of the diminishing value and not on the original cost of the asset. In the above example, if the rate of depreciation is 20%, then in 1st year, amount of depreciation will be Rs. 1,04,000 (20% of Rs. 5,20,000) and in 2nd year, the amount of depreciation will be Rs.83,200 [Rs.20% on Rs. 4,16,000 (5,20,000-1,04,000)] i.e. the balance amount after charging 1st year's depreciation).

Difference between Straight Line and Diminishing Balance Method

Straight Line Method	Diminishing Balance Method
The asset may or may not have scrap value	The asset must have a scrap value
A fixed amount of depreciation is charged	A fixed rate of depreciation is charged
The amount of depreciation per year is same	The amount of depreciation per year goes on reducing
In the first year, depreciation is charged on the cost of the asset less the scrap value	In the first year, depreciation is charged on the original cost of the asset.

Methods of recording Depreciation

- Provision for Deprecation Account is maintained
- Provision for Deprecation Account is not maintained

When no provision for depreciation A/c is maintained

Example

On 1st April, 2007, ABC ltd. Purchased machinery costing Rs.2, 50,000. Its life was estimated to be 4 years and estimated Scrap value to be Rs. 10,000. Show Machinery A/c and Depreciation A/c for 3 years to 31st March, 2010 when the machinery was sold for Rs.20,000.

Solution In book of ABC LTD

Machinery Account.

Date	Particulars	J.F	Rs.	Date	Partculars	J.F	Rs.
1 April 2007	To, Bank A/c		2,50,000	2008 mar 31	By, Depreciation A/c		60,000
					By Balance c/d		1,90,000
			2,50,000				2,50,000
1 April 2008	To, Balance b/d		1,90,000	2009 mar 31	By, Depreciation A/c		60,000
					By Balance c/d		1,30,000
			1,90,000				1,90,000
1 April 2009	To, Balance b/d		1,30,000	2010 mar 31	By, Depreciation A/c		60,000
					By, Bank A/c		20,000
					By,Profit & Loss A/c		50,000
					Loss on sale		
			1,30,000				1,30,000

Depreciation Account

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
2008 mar 31	To, Machinery A/c		60,000	2008 mar 31	By, profit & loss A/c		60,000
			60,000				60,000
2009 mar 31	To, Machinery A/c		60,000	2009 mar 31	By, profit & loss A/c		60,000
			60,000				60,000
2010 mar 31	To, Machinery A/c		60,000	2010 mar 31	By, profit & loss A/c		60,000
			60,000				60,000

Amount of Depreciation =Rs 2 50 000 – Rs. 10 000/4 years=60 000

When provision for depreciation A/c is maintained

Example- Basak & Co.purchased a machine for Rs. 1,50,000 on 1.1.2008. Additional machinery costing Rs.50,000 was purchas1ed On 1.7.2008. Certain machinery, which was purchased for Rs. 50,000 on 1.7.2008, was sold for Rs.30,000 on 30.6.200. Prepare Machinery A/c and Provision for Depreciation Ne for 3 years ending on 31st December every year. The company charged depreciation under the straight line method @ 10%.

Machinery Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2008 Jan 1	To, Bank a/c	1,50,000			
1-July	To, Bank a/c	50,000	2008 Dec-31	By Balance c/d	2,00,000
		2,00,000			**2,00,000**
1.Jan 2009	To, Bank a/c	2,00,000	2009 Dec-31	By Balance c/d	2,00,000
		2,00,000			**2,00,000**
2010 Jan-1	To, Bank a/c		2010 Jun 20	By machinery Disposal account	50,000
			31 Dec	By Balance c/d	1,50,000
		2,00,000			**2,00,000**

Provision for Deprecation Account

Date	Particulars	J.F	Rs.	Date	Particulars	J.F	Rs.
2008 Dec 31	To Balance c/d		17,500	2008 Dec 31	By Deprecation Account		17,500
			17,500				**17,500**
2009 Dec-31	To Balance c/d		37,500	2009 Jan-1	By Balance c/d		17,500
				Dec-31	By Deprecation Account		20,000
			2,00,000				**2,00,000**
2010 Jun-30	To machinery Disposal account		7,500	2010 JAn-1	By Balance c/d		37,500
31 Dec	To Balance c/d		45,000	31 Dec	By Deprecation Account		15,000
			52,500				**52,500**

Final Accounts

When the trial balance is prepared, the immediate task is to prepare the final accounts. Preparation of final accounts involves the following:

a) Preparation of Trading Account;

b) Preparation of Profit and Loss Account and

c) Preparation of Balance Sheet.

Trading Account is prepared to know the gross profit or loss of the business and Profit and Loss Account discloses net profit or loss of the business. The Balance Sheet shows the financial position of the business on a given date.

Trading Account:

A Trading Account shows the result of buying and selling of goods and services. This account shows only the total sales less the Cost of Goods Sold and any changes in the value of Stock. It gives the Gross Profit or Loss of the business. For example, total sales of the business during a particular period is Rs 1,00,000 and total purchases is Rs 80,000 and at the end of the period, value of the stock is Rs 10,000, then the gross profit from the business is Rs 30,000 (1,00,000 + 10,000- 80,000).

Specimen of a Trading Account:

Trading A/c of...for the year ended..........

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Opening	-------------	By Sales ……………..	
To Purchase ……….		Less: return Inwards…..	……………….
Less: Return outward…..	………….		
To Wages	………….	By Other Direct Income	…………………
To Carriage Inward	……………..		
To Fright	…………	By Stock Destroyed	……………..
To Royalty on Production	…………	(e. g. by fire)	
To Direct Expenses	…………		
To Gross Profit	………..	By Closing	……………
(Gross Profit transferred)			
	--------------		---------------

Profit and Loss Account:

The Profit and loss Account shows the Net profit or loss for an accounting period, which is the difference between total income and total expenses. This account shows how successfully and how efficiently the business is being run.
Specimen of Profit and Loss Account

Profit Loss A/c of..............
for the year ended..............

Dr. Cr.

To Salary	....	By Gross Profit b/d	....
To Carriage Outward	....	By Interest earned	....
To Selling/ Trading Expenses	....	By Discount earned	....
To Export Duty	....	By Commission earned	....
To Packing cost of finished Goods	....	By Bad Debt Recovery	....
To Advertisement	....	By Miscellaneous Income	....
To Sales Tax	....	By Profit on Sale of Asset	....
To Rent, Rates & taxes	....	By Rent Received	....
To Stationery	....		
To Conveyance I Travelling	....		
To Repairs	....		
To Interest Paid	....		
To Bad Debt	....		
To Depreciation on Assets	....		
To Discount Allowed	....		
To Loss on Sale of Assets .	....		
To Miscellaneous/General Expenses	....		
To Net Loss of Stock	....		
To Charity/Donation	....		
To Net Profit	....		....

Difference between Trading Account and Profit and Loss Account

Trading Account	Profit and Loss Account
Prepared to find out the trend of the business	Prepared to know the ultimate result of the business
Shows Gross Profit or Loss	Shows Net Profit or Loss
Reflects efficiency in purchase and sale only	Reflects all-round development of the business
Balance transferred to Profit and Loss Account	Balance transferred to Capital Account

Different Between Gross Profit and Net Profit

Gross Profit	Net Profit
Excess of Sale Proceeds over Cost of Goods Sold	Excess of Gross Profit over all the expenses and charges
Revealed by Trading Account	Revealed by Profit and Loss Account
Not available for distribution	Available for distribution
Used to measure the trend of the business	Used to measure the return on capital invested
Transferred to the Profit and Loss Account	Transferred to Capital Account

From the following particulars, prepare Trading and Profit & Loss Accounts. Rs

Purchase of goods	10,000
Returns Inward	200
Stock on 01.01.09	2,000
Direct Wages	2500
Salaries	2500
General Expenses	1700
Stock on 31.12.09	1,500
Depreciation on Machinery	2100
Depreciation on Furniture	1250
Sales	35000
Carriage Outward	500
Sale of Scrap	1200

Solution

Particulars	Amount	Particulars		Amount
To Opening stock	2,000	By Sales	35,000	
To Purchases	10,000	Less: Returns Inward	200	34,800
To Direct Wages	2,500			1,500
To Gross Profit c/d	21,800	By Closing Stock		------------
	36,300			36300
To Salaries	2,500			
To General Expenses	1,700	By Gross Profit b/d		21,800
To Depreciation on Machinery	2,100			1,200
To Depreciation on Furniture	1,250	By Sale of Scrap		
To Carriage Outward	500			
To Net Profit	14,950			
	23,000			23,000

Balance Sheet:

This from of balance sheet also goes by the name account form or T form. This type of Balance Sheet has two sides. The assets are normally placed on the right hand side and the capital and liabilities on the left hand side. The horizontal form of balance sheet is as follows.

Balance Sheet as at 31.3.2010

Liability	**Rs.**	**Rs.**	**Assets**	**Rs**	**Rs.**
Share Capital		1,00,000	Fixed Assets		
Reserve and Surplus			Computer	600,000	
Profit and Loss	250,000		Less: Deprecation	360,000	240,000
Reserve	100,000	350,000	Office Equipments	500,000	
Loan Fund			Less: Depreciation	50,000	450,000
Secured Loan		500,000	Furniture and Fixture	800,000	
Current Liability and			Less: Depreciation	80,000	720,000
Provision:			Current Assets, loan and		
Sundry Creditors	400,000		Advances		
Sundry Expenses	300,000	700,000	Stock	220,000	
			Debtors	700,000	
			Cash at Bank	207,250	
			Cash in hand	12,750	1,140,000
		2,550,000			2,550,000

Example on Preparation of a Final Accounts on the basis of a Trial Balance.

Trail Balance of Mr. Parimal as on 31.3.2009 is as under—	Rs.	Rs.
Capital and Drawings	44,000	1,64,000
Opening Stocks	56,000	
Secured Loans		50,000
Sundry Creditors		1,12,000
Misc. Expenses	5,600	
Office Expenses	24,00	
Interest on loan	6,000	
Commissions	1,200	
Insurance	2,400	
Office rent	3,600	
Salaries	18,000	
Wages	18,000	
Sales		1,28,000
Purchases	72,000	
Goods return	8,000	4,000
Travelling Expenses	5,000	
Bad debts	9,000	
Cash at Bank	52,000	
Cash in Hand	3,000	
Sundry Debtors	1,06,300	
Furniture	14,000	
Buildings	20,000	
Plant and Machinery	20,000	

Additional Information:

1.Closing stock was valued at Rs.88,000;
2.Insurance paid during the year was for 18 months;
3.Bonus declared but not paid Rs.1,800;
3.Rent paid during the year was for 10 months;
4.Wages outstanding were Rs.600;
5.Totalbad debts to be written off during the year were Rs.'1,200;
6.B_ad Debts written off during the year Rs.1,200;
7.Depreciation to be provided -
Furniture & fixture – 10%, plant & Machinery- 10% and Building- 2.5%

Prepare Trading and Profit & Loss Account for the year ending 31st March, 2009 and Balance Sheet as on that date.

Solution

Mr. Parimal

Trading and Profit & Loss Account for the year ending 31st March, 2009

Particulars	Rs	Rs	Particulars	Rs.	Rs
To, Opening Stock		56,000			
To, Purchase	72,000		By Sales	1,28.000	
Less: Returns	4,000	68,000	Less:	8,000	1,20,000
To, Wages	18,000		By Closing Stock		88,000
Add: Outstanding	600	18,600			
To Gross Profit c/d		65,400			
					2,08,000
		2,08,000			
To, Salary	18,000		By Gross Profit b/d		65,400
Add: bonus	1,800	19,800			
To office Rent	3,600				
Add: outstanding	720	4,320			
To, bad debts		1,200			
To travelling Expenses		5,000			
To, insurance	2,400				
Less: Prepaid	800	1,600			
To, commission		1,200			
TO, Interest on loan		6,000			
To, Office Expenses		2,400			
To, Misc. Expenses		5,600			
To, Depreciation on Building	500				
On Plant and Machinery	2,000				
On furniture	1,400	3,900			
To Net profit		14,380			
Transfer to capital		65,400			

Balance as on 31 March 2009

Liabilities	Rs	Rs	Assets	Rs.	Rs
Opening Capital	1,64,400		Fixed Assets		
Add: Net Profit	14,380		Buildings	20,000	
	1,78,780				
Less: Drawing	44,000	1,34,780	Less: Deprecation	500	19,500
Secured Loans		50,000	Plant & machinery	20,000	
Currents Liabilities			Less: Deprecation	2,000	18,000
Sundry Creditors		1,12,000	Furniture	14,000	
Out Standing Expenses			Less: Deprecation	1,400	12,600
Rent	720		Current Assets		
Wages	600		Stock in trade		88,000
Bonus	1,800	3,120	Sundry Debtors	1,06,300	
			Less: Bad Debts		
			1,200 - 900	300	1,06,000
			Cash at bank		52,000
			Cash in Hand		3,000
			Prepaid Insurance		800
	2,99,900				**2,99,900**