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Rural Management - Rural Financial Accounting

Rural Management
Rural Financial Accounting

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About the Book

In current scenario accounting education has seen various endeavours to change the manner in which accounting is taught. These endeavours explain the requests of a consistently changing business world, open doors made by new educational innovations, and an expanded comprehension of how understudies learn. Accountancy is always considered a language to record all types of financial transactions as a way to explain in a proper systematic order. Here we are pleased to provide this text book "Financial Accounting" for our readers in a simple form. This book is primarily projected for the under graduate course

This book introduces financial accounting and provides readers a balanced discussion of practical and theoretical perspectives of accounting. Various topics of financial accounting are covered and critically discussed on the basis of theory. The book also offers practical questions to improve accounting acumen of the reader. The book offers insights to right application for mentioned financial techniques which will improve managerial and financial decision-making skills of the reader. The book is divided into five blocks. Every Chapter consists of learning objectives, chapter summary and to do activity.

The silent features of this book are as follows:

- Language is very simple and lucid.
- Theoretical base is conceptually explained.
- Proper diagrams and charts help to understand the concept.
- Every concept is explained with the help of proper illustrations.
- Practice material has been included.

I thank the Dr Prerna Baber, Guest Lecturer, Jiwaji University for her contribution to the book and her commendable work. I would like to thank MGNCRE Team Members for extending extreme support in completing the book.

Dr W G Prasanna Kumar
Chairman MGNCRE

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Introduction

Accounting has rightly been termed as the language of the business. The basic function of a language is to serve as a means of communication. Accounting also serves this function. It communicates the results of business operations to various parties who have some stake in the business viz., the proprietor, creditors, investors, Government and other agencies. Though accounting is generally associated with business, but it is not only business where accounting is involved but also include people of various categories including housewives, Government officials and officials of various sector also apply accounting. For example, a housewife has to keep a record of the money received and spent with her during a particular period. She can record her receipts of money on one page of her "household diary" while payments for different items such as milk, food, clothing, house, education, etc. on some other page or pages of her diary in a chronological order. Such a record will help her in knowing about:

- The sources from which she received cash and the purposes for which it was utilized.
- Whether her receipts are more than her payments or vice-versa?
- The balance of cash in hand or deficit, if any at the end of a period.

Objectives

- To familiarize students with the meaning and significance of accounting
- To help students define the different concept of accounting conventions and concepts
- To help students understand the meaning of GAAP and IFRS
- To familiarize with different types of accounting systems
- To help students understand co-operatives accounting system

Chapter Structure

1.1. Introduction to Accounting, Need and limitations of accounting

1.2. Basic Accounting Concepts and Conventions

1.3. GAAP and IFRS

1.4. Different Types of Accounting Systems for Different Organizations

1.5. Co-operative Accounting System

1.1. Introduction to Financial Accounting

"Language use for communication" and if we talk about business accounting became a method of communicating business information. Accounting is the systematic process of identifying, recording, classifying, summarizing, interpreting and communicating the result. So accounting is termed as "the language of business". As accounting is integral part of an institution/firm/companies and it is very useful for rural as well as urban areas. In early stage accounting concerned with limited aspects only but after industrial revolution it became an inseparable part of any organization. Nowadays, accounting system adopted in rural areas also to make their financial reports more systematic.

Meaning of Accounting

Accounting is the systematic recording of all financial transactions related to business. Accounting includes a broad range of activities regarding collecting of data, maintaining records, analysing the data and interpreting result. According to the American Institute of Certified Public Accountants ('AICPA'), accounting defined as, "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof".

According to Bierman and Derbin, "Accounting may be defined as identifying, measuring, recording and communicating of financial information."

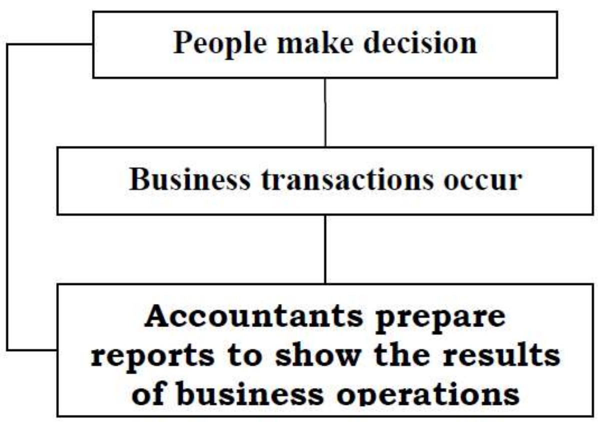

Figure 1.1: Concept of Accounting
Source: Narang & Jain, 2016

Need/ Importance of Accounting

Accounting is generally associated with business, but it is not only business where accounting is involved. People of various categories including housewives, Government officials and officials of various sectors also apply accounting. For example, a farmer has to keep a record of the money received and spent with his during a particular period. He can record his receipts of money on one page of his "diary" while payments for different items such as seeds, fertilizers, agricultural equipment, livestock etc. on some other page or pages of his diary in a chronological order.

Following are the needs of Accounting:

1. Maintain Systematic Records: All the financial transactions are kept in a systematic manner. The purpose of accounting is to keep systematic record.
2. Determining the Operational Profit/Loss: Accounting helps to find out profit and loss from the business activities within a given period of time (generally 12 months). By the help of proper accounting, measured how much profit has been earned or how much loss has been incurred. It is completed with the aid of keeping a right file of incomes and expenses of a particular time period and then matching the sales with the corresponding costs.
3. Determining the Financial Position of the Business: Mainly Balance sheet is prepared to determine the financial position of the firm at the end of a particular period (accounting period). It shows the values of all assets and the liabilities of business.
4. Facilitating Rational Decision Making: For rational decision making, accounting enables to collect, analysis and reporting all information at the required point of time from the required levels of authorities of a business.
5. Communicating the Financial Information: Communicate the relevant financial information to their users can be possible but for these maintaining proper accounting records is must. Users may be internal like employees, management or external users such as government authorities, banks etc. Users may be internal like employees, management or external users such as government authorities, banks etc.
6. Assistance to Management: For proper decision-making financial information is required and it is provided by the help of accounting records.

Accounting, being the language of business, it is used to link financial and other information to individual, organizations, and governments on various stages of business/non-business entities. For instance, whilst a firm applies for a loan from a bank, it is must to submit details of its commercial business statements in terms of working capital (income or loss) and the financial statements (assets and liabilities). Further, the shareholders need to have financial information with the objective to examine the performance of the management. Many laws require that worthy economic information to be reported to numerous government departments which includes income-tax department, sales tax department and so on.

Accounting is a set of tools by which reports collected and interprets financial information from the activities of different organizations. Therefore, accounting is related with communicating the outcomes of an organization.

Users of Accounting Information

Accounting is very significant to the owners and the manager. However, others like creditors, potential investors, etc. are also interested in the accounting information. Following are users of accounting information

1. Owners/Shareholders: The main objective of accounting is to provide essential information to the owners allied to their business. The objective of accounting is to provide all data to the proprietors related to their business.
2. Managers: Managers are controlling all the operational activities of a business, and the control totally rely on the correct information at correct time. To improve the performance managers should access periodic updates of information.

3. Prospective Investors: The individuals who are planning to invest in a business will like to know about profits and proper financial position. Investors use accounting information to judge the financial soundness of the business.
4. Creditors, Bankers and other Lending Institutions: Business creditors, banking institutes and other advancing organizations want to be satisfied that the amount will be paid back within a specific time limit. All the financial statements record, aid them in evaluating for financial position.
5. Government: The Government is interested in the financial statements of business enterprise on account of taxation, labor and corporate laws.
6. Employees: Interest in financial statements because employees raise in their salaries and wages and payment of bonus based upon the size of the profit earned.
7. Regulatory Agencies: Various Government departments and agencies such as Company Law Board, Registrar of Companies, Tax Authorities etc. use accounting reports not only as a basis for tax assessment but also in evaluating how well various businesses are running under regulatory legislation.
8. Researchers: Accounting data are utilized by the research scholars in their research in accounting theory as well as business issues and practices.

Accounting Cycle

In business one continuous process will be going on and information is generated and continuously utilize the information in the books of accounts. Repetition of same process with all transactions in our business can be called as accounting cycle. Following is the flow chart of accounting cycle which showed step by step movement of information.

Here, all the financial transaction recorded relevance with the time period and follow proper methodology of recording.

1.2. Basic Accounting Concepts

Accounting having different concepts which tries to resolve the problem of different terminology which are the following:

Figure 1.2: Accounting Cycle

Business Entity Concept

In accounting there is difference between business and its owner. Complete accounting is recorded from the perspective of the business rather than from the owner. An organization is economically separate from the owner or proprietor. In that way all business transactions are written and reported separately. Business having itself an existence is the business entity concept.

Money Measurement Concepts

In accounting all the business transactions related to money only and it can be measured in terms of money. Money is not only providing the facility of a medium of exchange but also it provided store of value, and it became significant advantage, subsequently a number of broadly different assets and liabilities can be articulated in terms of a common base i.e. money. In this concept of accounting all the events are calculated on the bases of Money.

Continuity Concept

This accounting concept are also termed as Going Concern Concept, here it assumes that the business (an accounting entity) will be continue to run for an extensive time in the future. The organization is noticed as a going concern, when the work is done for the future success and growth, all the activities are running in a continuous way. The proprietors have no purpose nor have they the requirement to wind up or liquidate their actions.

Cost Concept

The monetary value of assets is derived from the Cost Concept, assets like land, machinery, plant, buildings, patents etc. all are having its value in monetary form and that is measured by the cost concept. This concept explains that an asset is value the price paid for or cost incurred to purchase it. Therefore, assets are written at their original buying price and this cost is the basis for all succeeding accounting for the assets.

Accrual Concept

It is the basic concept of accounting, in which incomes recorded when they earned, and not when income received in cash. The accrual concept creates a difference between the receiving of cash and the right to accept it, and the compensation of cash and the legal compulsion to pay it. In genuine business operations, the compulsion to pay and the actual movement of cash may not match. The accrual concept recognizes that particular distinction.

Concept of Conservatism

The concept of conservatism, also known as the concept of prudence, is often stated as "anticipate no profit, provide for all possible losses". This means an accountant should follow a careful approach. Accountant would be written lower most possible value for all assets and all business revenues, and the uppermost possible value for all types of liabilities and all business expenses. As per this concept, revenues or gains must be acknowledged only when they are actually realized in the form of cash or assets (generally legally enforceable debts).

Materiality Concept

There are many events in business organization which are insignificant or irrelevant in nature. The cost of posting and writing such events will not be acceptable by the helpfulness of the evidence derived. Materiality concept means that objects of small importance need not be given harsh theoretically accurate treatment.

Consistency Concept

In run through, there are numerous ways to record an event or a transaction in the books of business. Like, the depreciation charged on furniture by its different methods and goods purchased on credit and trade discount on raw material purchased may be deducted from the cost of goods and net amount come into in the books, or instead of it trade discount can be presented as the income with full cost of raw material purchased written in the accounting books.

Periodicity Concept

Although the results of operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary. Those who are interested in the operating results of business obviously cannot wait till the end. The requirements of these parties therefore force the accountant to report for the changes in the wealth of a firm for short time periods like quarterly, monthly.

Accounting Conventions

Accounting conventions are the customs which used by the accountant while posting the data in the books of accounts. A proper guidance provided with these four conventions of accounts from a long period. Accountant used to follow these customs in the financial data without any error and also communicate with others. So, by the help of these conventions financial statement shows a correct meaning and also prepared easily.

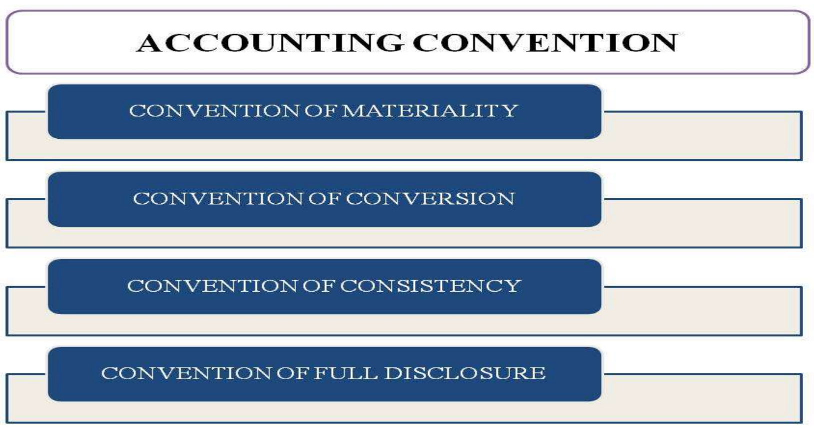

Figure 1.3: Accounting Convention
Source: Jain and Narang, 2016

Following are the types of accounting conventions:

1. Convention of Materiality: Materiality concept explains that the items of lesser impact need not be specified for strict theoretically right treatment. In the business there are so many events which are not significant in nature. The way of recording and presenting in financial statement of such events could not be well acceptable by the utility receive from that specific information. For instance, the calculator price ₹ 200 may last for five years though the determination involved in assigning its price over the five-year period is not worth the advantage that can be received from this operation.

2. Convention of Conservatism**:** When the transactions are recorded, accountant should be following the rule of safety. Accountant trail the rule, anticipate no profit but charge all possible losses, when business transactions recorded. This convention understands that an accountant would be post all lowest possible value for assets and incomes/gains, and the maximum possible value for liabilities and losses/expenses.
3. Convention of Consistency**:** This convention explains that when a firm decides its accounting policies, rules and procedure it should be used for some time. The level of consistency should be following in the organization; same process is to be followed year after year. In other ways, accounting practices should be followed same from one period to another.
4. Convention of Materiality**:** According to the convention of materiality, accountants should report only what is material and ignore insignificant details while preparing the final accounts. The decision whether the transaction is material or not should be made by the accountant on the basis of professional experience and judgment. An item may be material for one purpose while immaterial for another.

1.3. Generally Accepted Accounting Principles (GAAP)

Generally Accepted Accounting Principles are those which are created by some specialized accounting institutes like American Institute of Certified Public Accountants (AICPA) and Institute of Chartered Accountants of India (ICAI). In creating these principles, the accounting specialization has to represent the actual scenario of social factors, economical, legal and laws and political factors in which it works.

Accounting Standards

The basic concepts discussed in the foregoing paragraphs are the core elements in the theory of accounting. These concepts (postulates or conventions), however, permit a variety of alternative practices to coexist. As a result, the financial results of different companies cannot be compared and evaluated unless full information is available about the accounting methods which have been used. The varieties of accounting practices have made it difficult to compare the financial results of different companies. Further, the alternative accounting methods have also enabled the reporting of different results, even by the same company.

Requirement for Accounting Standards The information and facts which are available in printed financial statements is of specific significance to our external users, like shareholders, creditors and investors. For the purpose of investment these published information play very effective role for all type of decision-making process. As like in different countries, Parliament in India has listed in the Companies Act the kind and lowest level of information which a company would be disclose in their financial statements. Now it became the responsibility of the accounting profession to make sure that the requisite information is correctly presented.

International Financial Reporting Standards (IFRS)

International Financial Reporting Standards are the set of accounting created by an individual non-profit institute called as International Accounting Standard Board (IASB). The aim behind to prepare these set of accounting standard was only providing an equal standard global base for all public companies' financial systems. In the IFRS a system, public organisations guided that how to make their financial system and also provide a frame work that how to disclose our accounting information. IFRS gives general direction for the preparation of financial statements of companies, instead of setting rules for industrial reporting.

Having a global standard is particularly significant for those big business organizations that have subsidiaries in various nations across the world. If the same type of standards adopted by all the subsidiaries across the world will simplify the procedure of accounting and it make easy to analyse the statement of all branches and subsidiaries. From the view point of external users like auditors, investors, an uniform standard will always help from firm perspective on finances and accounts.

International Accounting Standard (IAS) was the earlier standards which were replaced by International Financial Reporting Standards. As of now, more than 100 nations allow or require IFRS for business organizations. IFRS used as a global accounting standard.

1.4. Different System for Different Type of Organisation

Section 25 Company

Section 25 companies are those companies which are registered under the Companies' Act 1956 with the non-profit objective. By the help of section 25 companies promote their charity without creating any trust or society. The basic objective to incorporate such companies is to promote religion, charity, science and art in the society. A company is formed which having a separate legal entity with its own right and its own existence. In such type of companies only charity work is done, all the generated income re-invests for the upliftment of society. A voluntary association of person is also mandatory to form such non-profit companies.

A Section 25 company is generally favoured because it is very easy to start and also exempted from legal requirements of minimum paid-up capital. Such organisations are easy to run in comparison of any Trusts and Societies, for board of directors meeting need a smaller quorum and calling for required meeting are flexible. To enter and exit from the company is also having very easy or simple procedure and also it is easier to increase the number of directors. One more aspect of such companies is that the tax benefits that enjoys by section 25 companies only. In rural areas section 25 companies are preferred because it benefited for the locals of rural area, while aids from numerous exemptions make it easy for philanthropy in the society.

Registration Procedure

Section 25 companies can be public or private non-profit company. The minimum number of persons required for public company is seven and in case of private company is two. Following are the necessary steps for its formation:

1. Apply with a name with the registrar of companies. Check the availability of name.
2. Articles and memorandum of association of the non-profit company must be approved by regional director.
3. Apply for the license for sec 25 company, submitted to the regional director.
4. Registration Certificate is usually granted within the one month after applying for license.

Non-Government Organisation

Non-Government organisations have very crucial role in the social and economic development of an economy. In India number of NGO activities increased day by day. To fulfil all the legal issues and making more conceptual accounting reports there is the need for certain varied accounting system, so that the prepared financial reporting will be more meaningful and useful as well. A systematic procedure follows to maintain all the financial policies and it's a good sign to express the good strength of an organization. Non-profit organisation follows a proper systematic accounting system which should be effective, manageable and transparent.

Essentially accounting system of a non-profit organisation consists of the following:

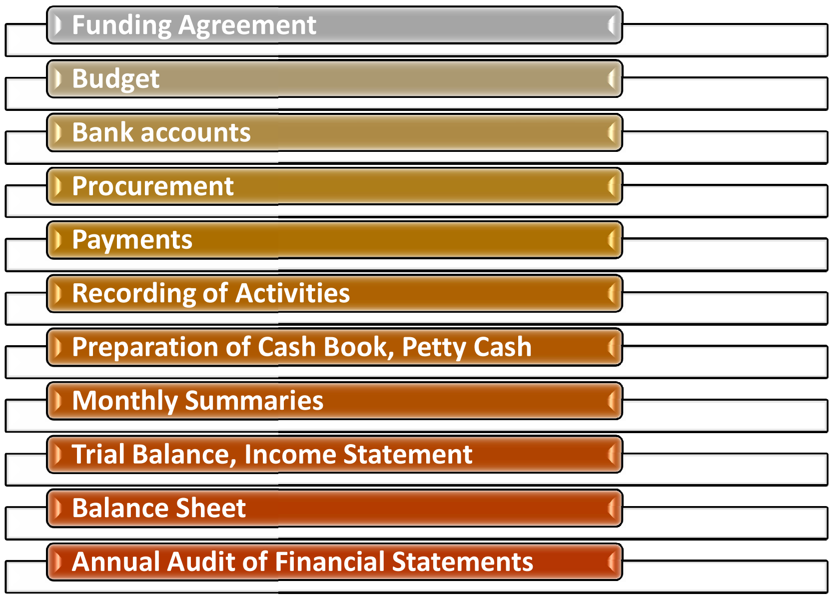

Figure 1.4: Accounting system of a non-profit organisation

1.5. Co-operative Societies

Cooperatives societies are socio financial associations of limited number of members with their solo objectives to fulfil the financial needs of their member. They are established on the standards of value and correspondence. Their conclusive point is to provide equity and equality through financial improvement. The achievement or disappointment of an organisation is, economic performance and want fulfilment ability to community which it belongs. The financial presentation of the cooperative societies must be examined, estimated and reported to the individuals, financing banks, and to the state government. A system which generated for accounting is helpful to measure economic performance or productivity of cooperative societies. Recording, classifying, summarising all the financial transaction helps to measure economic performance and as well provide accurate accounting information that used for decision making process. For rural areas upliftment government itself creates co-operative societies for the upliftment of farmers and rural people. According to co-operative societies act 1912 sec 6 of any 10 members willingly combined together and file an application to the registrar of co-operative societies may create their co-operative societies. For any kind of alteration Registrar approval is mandatory.

Types of Co-operative Societies

1. Consumer Co-operative Societies: Such type of Societies is created for the benefits of consumer only. Consumer cooperative societies fulfill the needs of general consumers by providing goods on very reasonable price. In such type of societies goods directly purchased from the producer and eliminate the role of middleman, so the goods available on minimum rate. Kendriya Bhandar will be the example of consumer cooperative societies.

2. Producer Co-operative Societies: Producer Co-operative societies created for the upliftment of small and marginal farmers. These societies protect small farmers and encourage them by providing goods which used for production like raw materials, equipment, tools etc. Handloom societies like mrignayani handloom, Haryana handloom, APPCO, etc.
3. Co-operative Marketing Societies: When small farmers or producers are not able to sell their products directly in the market, so their products collected by a consumer marketing society. Now this is the responsibility of cooperative societies to sell their product in the market. AMUL is one of the best examples of cooperative marketing society.
4. Farming Society: Such type of societies is created by a group of small land farmers and takes advantage of large-scale farming. Pani panchayat is the example of farming societies.
5. Co-operative Credit Societies: For the financial support to the members of the society, such type of cooperative is formed. The basic aim of these societies to escape rural farmers from the exploitation of local finance. The cooperative societies take deposit and grant loan to their members. Village Service cooperative society is the example of such type society.

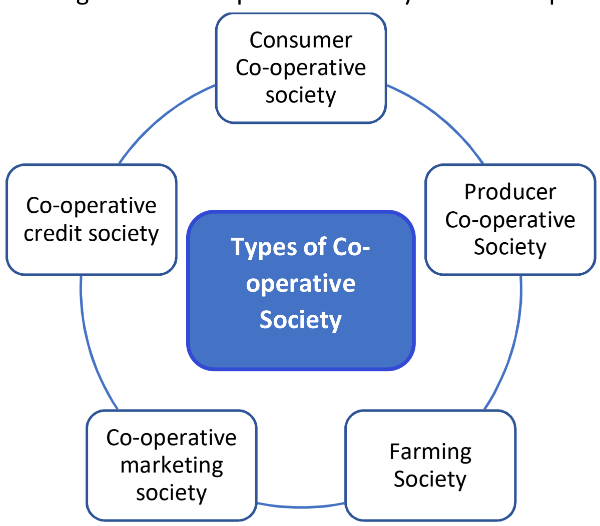

Figure 1.5: Types of Co-operative Societies

Characteristics of Co-operative Society

Following are the characteristics of co-operative society:

1. Separate Legal Entity: Cooperative societies registered under the cooperative society act. Cooperative societies having their own legal entity.
2. Membership for All: Anybody became the member of cooperative societies those who are having common interest.
3. Voluntary Registration:
4. Service Oriented
5. Source of Finance
6. Elected Representatives
7. Government Controlled

Accounting of Cooperative Societies

1. Journal (Day Book)
2. Cash Account (Ledger)
3. Cash Book with Adjustments

4. Receipt and Payment Account
5. Final Accounts

International Accounting Standards

Issued By ISAC

IAS-1 Disclosure of Accounting Policies.

IAS-2 Valuation and Presentation of Inventories in the context of historical cost system.

IAS-3 Consolidated financial statements.

IAS-4 Depreciation accounting

IAS-5 Information to be disclosed in financial statements

IAS-6 Accounting responses to changing prices

IAS-7 Cash flow statement

IAS-8 Unusual and prior period items and changes in accounting policies

IAS-9 Accounting for research and development activities

IAS-10 Contingencies and events occurring after balance sheet date

IAS-11 Accounting for construction contracts

IAS-12 Accounting for taxes on income

IAS-13 Presentation of current assets and current liabilities

IAS-14 Reporting financial information by segments

IAS-15 Information reflecting the effects of changing prices

IAS-16 Accounting for property, plant and equipment

IAS-17 Accounting for leases

IAS-18 Revenue recognition

IAS-19 Accounting for retirement benefits in the financial statements of employees

IAS-20 Accounting for government grants and disclosure of government assistance.

IAS-21 Accounting for effects of changes in Foreign Exchange Rates

IAS-22 Accounting for business combinations

IAS-23 Capitalisation of borrowing costs

IAS-24 Related party disclosures

IAS-25 Accounting for investments

IAS-26 Accounting and reported by retirement benefit plans

IAS-27 Consolidated financial statements and accounting for investments in subsidiaries

IAS-28 Consolidated financial statements and accounting for investments in subsidiaries

IAS-29 Financial reporting in Hyper inflationary economics

IAS-30 Disclosure in the financial statements of bank and similar financial institutions

IAS-31 Financial reporting of interests in joint ventures

IAS-32 Financial instruments: disclosure and presentation.

Revised ISA Issued by ISAC

IAS-2 Inventories

IAS-8 Net Profit or loss for the period, fundamental Errors changes in Accounting Policies

IAS-9 Research and Developments costs

IAS-11 Construction Contracts

IAS-16 Property, Plant and Equipment

IAS-18 Revenue

IAS-19 Retirement Benefit costs

IAS-21 The effects of changes in foreign exchanges rates

IAS-22 Business Combinations

IAS-23 Borrowing Costs

Accounting Standard Issued by ASB

AS-1 Disclosure of Accounting policies

AS-2 Valuation of Inventories

AS-3 Changes in Financial Position

AS-4 Contingencies and Events Occurring after the Balance Sheet Date

AS-5 Prior period and Extraordinary Items and changes in Accounting policies

AS-6 Depreciation Accounting

AS-7 Accounting for Construction Contracts

AS-8 Accounting for Research and Development

AS-9 Revenue Recognition

AS-10 Accounting for Fixed Assets

AS-11 Accounting for Changes in Foreign Exchange Rate

AS-12 Accounting for Government Grants

AS-13 Accounting for Investments

AS-14 Accounting for Amalgamations

AS-15 Accounting for Retirement Benefits in the Financial Statements of Employers/Employees.

Chapter Summary

Accounting is very crucial and significant service activity for all commercial and non-commercial houses. Accounting is related to the collecting, recording, evaluating and communicating all transactions in terms of money. All the financial transaction recorded in the books of accounts. Accounting treated as an art or science. Accounting helps to maintain the proper records in a systematic manner. To ascertain the amount of profit and loss and determine the financial position of the business, accounting plays a very crucial role. The whole accounting system based upon the accountancy practice. The accountancy consists of universally accepted principles which based on concepts and conventions. Accounting serves in the non-profit organization and co-operative societies. The emerging accounting concepts show its changing role in the changing social needs.

To Do Activity

1. Resignation by a production manager is not recorded in any of the account books, but the donation made by a company recorded in the books of accounts. Why? Give your reasons.
2. Kavita, the owner of M/s. K.R. & Co. bought furniture and installed it in her house. Cheque issued for the payment of furniture from the account of firm. The accountant settled this from Drawing Account (debited) whereas Kavita is of the view that the amount of furniture should be debited to the Fixed Assets Account. Explain the situation from view of accountant and Kavita and who is right and why?
3. Members of Co-Operative society have limited liability? Why
4. Wages of ₹ 500 not paid for a month of December 2019. Under which accounting concept the amount of wages should be recorded as a expenses for the year ended 31st December 2019.

Further Readings

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Chapter 2 Accounting Systems and Process

Introduction

Accounting is the systematic process of identifying, recording, classifying, summarizing, interpreting and communicating the result. So accounting is termed as "the language of business". As accounting is integral part of an institution/firm/companies and it is very useful for rural as well as urban areas.

Objectives

- To familiarize with the concept of Accounting equation
- To help students understand different types of accounts and their rules
- To help student apply concept of journal entries with its practical implication
- To help students apply ledger posting in books and its meaning and numerical
- To familiarize students with the meaning of capital and revenue receipts and expenditures

Chapter Structure

2.1. Nature of Accounting and Accounting Equation

2.2. Classification of Accounts and Rules of Accounting

2.3. Journal Entry: Meaning, Features and Posting Entries

2.4. Preparation of Ledger

2.5. Capital and Revenue: Receipts and Expenditure

2.1. Nature of Accounting

Accounting is related with the recording, classifying, summarizing as well as analyzing the data. Accounting is the integral part of business organization. Accounting is a system in which all the cash transactions are recorded and financial statement is prepared which shows the business financial position. Following are the nature of accounting:

1. Accounting is a Process: A process of recording, classifying, summarizing the financial data and interpret the results. Accounting is very useful for analysis of financial statement because it helps to take financial decision.
2. Accounting is an Art and Science: Accounting is both art and science. Art because work is getting done by others and it may call science because accounting based on some universally accepted principles.
3. Accounting handles financial information: All the cash nature transactions are recorded in the accounting books only. From the day one to the last day of the month or year all the financial information records here only.

4. Accounting is an information system: Accounting is like store house of information in any organization. This accounting information meets the requirement of their users (external and internal).
5. Helps in future planning: Accounting helps to prepare financial statement which helps to analyze the present scenario. On the basis of past data organization can take decision for future.
6. Increased efficiency: Proper accounting system always helps to increase the efficiency and productivity of an organization.

Accounting Equation

Accounting is based on double entry system which means every transaction has two sides effect. If one thing goes to debit side it has equal effect on credit side or debit side. Dual aspect concept is the core concept of accounting. Accounting equation is a mathematical expression showing assets and liabilities of an organization. Accounting equation is based on the dual aspect concept. One equation created on the basis assets and liabilities, in which assets side always equal to liability side.

Assets = Liabilities

Liabilities in the organization always equal to the assets of the organization. Here liabilities divided into two parts one is capital and another is other liabilities.

Accounting Equation and its effect on transaction

1. Every transaction effect on concerned side of equation.
2. Analyze all the business transaction.
3. All the transaction effect on increase and decrease.

Assets =	**Liabilities + Capital**
Cash and Bank balance	Owner’s capital
Fixed and current assets	Current and non-current liabilities
Investments and intangible assets	Payable amounts

Figure 2.1: Accounting Equation

Let us take an example of some transaction to explain accounting equation:

1. Ravi commenced business with ₹ 100,000 as capital

Solution:

Assets (cash = 1,00,000) =Capital (1,00,000) + Liabilities (0)

2. Bought furniture ₹ 25, 000

Solution:

Assets (Cash = 75,000 + Furniture = 25,000) = Capital (1,00,000) + Liabilities (0)

3. Bought goods for cash Rs 20, 000

Solution:

Assets (Cash = 55,000 + Furniture = 25,000 + Goods = 20,000) =Capital (100, 000) + Liabilities (0)

4. Brought goods from Mr. Nitin on credit Rs 5,000

Solution:

Assets (Cash = 55,000 + Furniture = 25,000 + Goods = 25,000) = Capital (100, 000) + Liabilities (Nitin = 5,000)

5. Sold goods for cash for Rs 15, 000

Solution**:**

Assets (Cash = 70,000 + Furniture = 25,000 + Goods = 10,000) = Capital (100,000) + Liabilities (Nitin = 5,000)

6. Sold goods to Mr. Amit on credit Rs 8,000

Solution:

Assets (Cash = 70,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 8,000) = Capital (100,000) + Liabilities (Nitin = 5,000)

7. Paid cash to Nitin Rs 4,000

Solution:

Assets (Cash = 66,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 8,000) = Capital (100,000) + Liabilities (Nitin = 1,000)

8. Received cash from Amit Rs 5,000

Solution:

Assets (Cash = 71,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 3,000) Capital (100,000) + Liabilities (Nitin = 1,000)

9. Ravi withdraw Rs 10,000 for personal use

Solution:

Assets (Cash = 61,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 3,000) = Capital (90,000) + Liabilities (Nitin = 1,000)

10. Paid ₹ 2,000 for wages and 5,000 for salaries

Solution:

Assets (Cash = 64,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 3,000) = Capital (83,000) + Liabilities (Nitin = 1,000)

Final Equation of Ravi Enterprise

Assets (Cash = 64,000 + Furniture = 25,000 + Goods = 2,000 + Amit = 3,000) = Capital (83,000) + Liabilities (Nitin = 1,000)

Where all the assets equal to liabilities

Rules for Accounting Equations

1. Capital: when capital is introduced or increased it goes to credit side (+), when capital decreases or withdrawn it goes to debit side (-).
    a. Interest on capital reduced the amount of capital and since it's an income of owner it is added in the amount of capital.
    b. Interest on Drawing treated as a profit of business so it is added in the capital and on the other hand it is a loss for the proprietor, it is deducted from capital.
2. Assets: when assets increase it added in the debit side (+) or left-hand side. But if assets decrease that decreases goes to credit side (-).
3. Liabilities: If liabilities decreases go to credit side and if increases it goes to debit side.
4. Revenue increased the amount of owners' equity.
5. Expenses decreased the amount of owners' equity.
    a. Income = Revenue – Expenses
6. Income is the profit, when profit increases it increases the owners' capital and all losses decreases the capital amount.

Classification of Accounts

All the business transactions and events are recorded in their proper accounts. An account is an individual record of a person, firm, or thing, an item of income or an expense. An account is prepared for each type of asset, liability, owner(s) equity, revenue and expense. For example, the account of cash would show the cash receipts, cash payments and balance of cash in hand, an account of a person would show the business transactions that have taken place with that person and net position in respect of money owed by or to him.

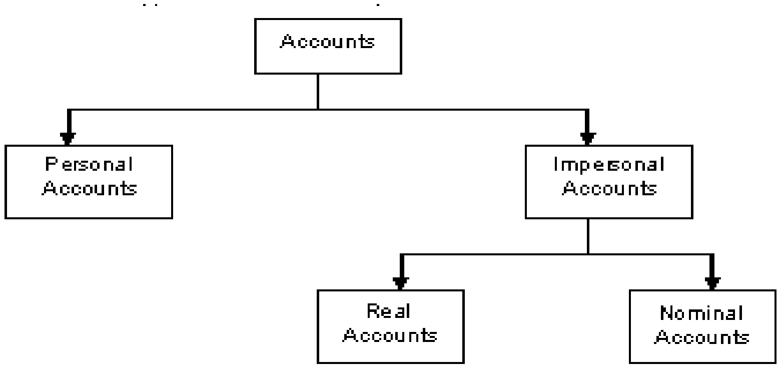

Figure 2.2: Classification of Accounts

Personal Accounts

These accounts show the transactions with customers, suppliers, moneylenders, the banks and the owner. Personal accounts can take the following types:

1. Natural Personal Accounts: The term natural persons means persons who are alive and creation of God. Like owner's account or the account of person, Vikram a customer or supplier.
2. Artificial Personal Accounts: These accounts include accounts which are created by law like business house, corporate bodies or institutions which are acknowledged as persons in business events. For instance, any limited company's account, any bank account, any firm's account, any club's account, etc.
3. Representative Personal Accounts: These are accounts which symbolize to a person or we can say a group of persons. In accounting books, the names of the person or parties will be appeared. For instance, when salary is outstanding to 15 employees of a firm, the amount may be shown against one name 'Salary Outstanding' presenting all the 15 employees. Wages outstanding, commission receivable are such other examples.

Real Accounts

Following are the different types of Real Account:

1. Tangible Real Accounts: When the object can be touched, feel and physically existed are the tangible accounts. Like: Land, Machinery and Furniture.
   (Note: please note that bank account is a personal account and is not a real account because bank account is the account of some banking company which is an artificial person).
2. Intangible Real Accounts: When the object cannot be touched and feel and it measured in terms of money. For example: Goodwill, Patents etc.
3. Nominal Accounts: Nominal accounts are related with all the expenses and incomes. Nominal accounts include accounts of all expenses, losses, income and gains.

Double Entry System: Concept

There are two main systems of keeping accounting records- one is Single Entry System and other one Double Entry System. The single-entry system is an unscientific method of accounting but it is time-saving and economical, in this system some transactions are not posted at all while some other transactions are posted partially. On the other hand, the double entry system is totally relying on rules and procedure and it based on scientific principles, therefore it became a popular method of accounting. As the name suggest here all the transaction have two side effect and records both accounts of each and every transaction. In this system, in each transaction an account is debited and some other account one credited.

Rules of Debit and Credit

The left-hand side of a ledger account is called the debit and the right-hand side is present the credit side of an account. An entry on the left side of an account is called a debit entry, or simply a debit, an entry on the right side is called a credit entry or credit. The act of recording an entry on the left side of an account is called debiting the account; and recording an entry on the right side of an account is called crediting the account. The difference between the total debits and total credits in an account is the account balance. Double entry system means the recording of both the aspects i.e. debit and credit.

1. Personal Accounts: *'Debit the receiver and credit the giver'*, i.e. debit the account of the person who receives something and credit the account of the person who gives something. For example, if you bought goods from Rohan on credit, here two accounts get effected i.e. Goods (Purchase) Account and Rohan's Account.
2. Real Accounts: *'Debit what comes in, and credit what goes out'*, i.e. debit the account of the thing which comes in the business and credit all those accounts which goes out from the business. For example, where computer is purchased for cash, computer account is debited and cash account is credited.
3. Nominal Accounts: *'Debit all expenses and losses and credit all incomes and gains'* i.e. debit the accounts of expenses and losses and credit all incomes and gains. For example, if a business paid wages to its staff, then the two accounts involved are wages account because it's an expenses and cash account. Wages account is a nominal nature.

Illustration 1: From the following transactions, classify the nature of accounts involved and find out which account will be debited and which account will be credited:

S. No	Transaction	Accounts Involved	Type of Accounts	Debit/Credit
1	Rohan starts his business with cash ₹ 1,00,000	Cash Account Capital Account	Real Personal	Debit comes in Credit Giver
2	Goods purchased for cash ₹ 45,000	Purchase A/C Cash Account	Real Real	Debit comes in Credit goes out
3	Furniture Purchased for ₹ 20,000	Furniture A/C Cash account	Real Real	Debit comes in Credit goes out
4	Sold goods for cash ₹ 30,000	Cash Account Sales A/C	Real Real	Debit comes in Credit goes out
5	Goods purchased for ₹ 17,000 from Mohit for cash	Purchase A/C Cash Account	Real Real	Debit comes in Credit goes out
6	Sold goods to Ravi for ₹ 22,000.	Ravi Sales	Personal Real	Debit Receiver Credit goes out
7	Paid ₹ 1500 for rent	Rent Account Cash Account	Nominal Real	Debit Expenses Credit goes out
8	Bought goods from Ajay of ₹ 55,000	Purchase Account Ajay	Real Personal	Debit comes in Credit Giver
9	Paid wages	Wages a/c Cash a/c	Nominal Real	Debit Expenses Credit goes out
10	Commission Received	Cash a/c Commission a/c	Real Nominal	Debit Comes in Credit Incomes
11	Outstanding for wages	Wages a/c Outstanding Wages a/c	Nominal Personal	Debit Expenses Personal

2.2. Concept of Journal

Journal is the book in which every business transaction is recorded, so it is also called as Primary entry book where all the economic transaction recorded in a chronological (day to day) order. Ledger is maintained after the journal posting. Journalizing is the systematic process to record all the transaction. Following is the specimen:

JOURNAL

Date	Particulars	L.F.	Debit ₹	Credit ₹

Figure 2.3: Proforma of a Journal

1. Date: The date column where the transaction has taken place is recorded. The current year is written on the top of the column of every page of the journal. And then the month & day of each entry are written.
2. Particulars: In the particulars column transaction are recorded in the entry form i.e. one account as debit and “Dr.” written to extreme left side of particulars column and another account written as credit preceding with “To” by following the rules of accounting.
3. L.F. (Ledger Folio): This column records the page number in the ledger in which the accounts in the Particulars column are posted.
4. Debit Amount (Debit): The debit amount is recorded in the debit amount column opposite of the account being debited.
5. Credit Amount (Credit): The credit amount is recorded in the credit amount column opposite of the account being credited.
6. Narration: In the last narration is written which explains the transaction in the sentence form.

Illustration 1:

Ravi started his business with cash ₹ 1, 00,000. Journalise it.

Solution:

Journal

Date	Particulars	L.F.	Debit	Credit
	Ravi Dr. To Capital a/c (Being business started with cash)		1,00,000	1,00,000

Recording of Journal Entries

1. Simple Journal Entry

In simple journal entry only two accounts are affected. If one account is debited, with the same amount another account is credited. Following are the simple journal entries:

Illustration 2:

Journalize the following transaction in the in the books of Ramesh Brothers:

Jan 01	Commenced business with cash	60,000
Jan 02	Purchased goods for cash	75,00
Jan 04	Bought Furniture	5,000
Jan 09	Deposited with bank	3,000
Jan 13	Purchase goods from Amit	15,000
Jan 18	Sold goods to Nalini for cash	8,000
Jan 25	Cash withdrawal for personal use	2,000
Jan 31	Paid salary	500

Solution:

Journal

Date	Particulars	L.F.	Debit	Credit
Jan 1	Cash a/c Dr. To Capital (Being business started with cash.)		60,000	60,000
Jan 2	Purchases Account Dr. To Cash Account (Being purchase of goods for cash)		75,000	75,000
Jan 04	Furniture Account Dr. To Cash Account (Being purchase of furniture for cash)		5,000	50,00
Jan 09	Bank a/c Dr. To Cash a/c (Being cash deposited into bank.)		3,000	3,000
Jan 13	Purchase a/c Dr. To Amit		15,000	15,000

	(Being goods purchased from Amit on credit)			
Jan 18	Cash a/c Dr. To sales (Being sold goods to Naman for cash)		8,000	8,000
Jan 25	Drawing a/c Dr. To Cash a/c (Being cash withdraw for personal use)		2,000	2,000
Jan 31	Salary a/c Dr. To Cash a/c (Being salary paid)		500	500

2. Compound Journal Entry

A compound journal entry is an accounting entry in which two or more accounts affected by a transaction, here more than one debit, more than one credit, or some times more than one of both debits and credits. It is basically a grouping of various simple journal entries.

When goods sold and discount allowed to a customer, Sales a/c, customer and discount allowed account effects. When a same nature of transactions recorded like wages paid, salaries paid and rent paid all are expenses so all transaction debited in a compound entry

Illustration 3:

Journalize the following transaction:

2018		₹
April 1	Commenced business with cash	3,00,000
April 3	Purchased goods for cash	1,80,000
April 4	Furniture Purchased	50,000
April 7	Deposited with bank	30,000
April 7	Purchase goods from Vishal	65,000
April 8	Sold goods to Naman for cash	25,000
April 10	Cash withdrawal for personal use	8,000
April 10	Sold goods to Mukherjee	50,000
April 13	Rent for two years paid in advance	2250
April13	Goods taken out by the proprietor for domestic use	1500
April 14	Cash withdrawn from Bank for office use	9,000
April 16	Purchase goods from Sahil	30,000
April 19	Purchased Stationery	1800
April 19	Sold goods to Mohan on credit	20,000
April 19	Purchase of goods, and payment made by cheque	18,000
April 20	Cash received from Mukherjee	
April 22	Cash Paid to Vishal and received discount of ₹ 5,000	
April 23	Cash received from sahil₹ 29,000 in his full settlement	
April 23	Mohan became insolvent and only 60 paise in a rupee received	
April 25	Sold goods to Verma & Co.	18,000
April 26	Goods returned from Verma & Co.	3,000

April 26	Purchase office equipment	10,000
April 27	Depreciation on furniture 10% pa	
April 28	Outstanding salary	2400
April 28	Bank Charges	4500
April 29	Interest Received	3000
April 30	Cartage Paid	1250
April 30	Interest on Capital on Month	500

Solution:

Journal

Date	Particulars	L.F.	Debit	Credit
April 1	Cash a/c Dr. To Capital (Being business started with cash.)		3,00,000	 3,00,000
April 3	Purchases Account Dr. To Cash Account (Being purchase of goods for cash)		1,80,000	 1,80,000
April 4	Furniture Account Dr. To Cash Account (Being purchase of furniture for cash)		50,000	 50,000
April 7	Bank a/c Dr. To Cash a/c (Being cash deposited into bank.)		30,000	 30,000
April 7	Purchase a/c Dr. To Vishal (Being goods purchased from Vishal on credit)		65,000	 65,000
April 8	Cash a/c Dr. To sales (Being sold goods to Naman for cash)		25,000	 25,000
April 10	Drawing a/c Dr. To Cash a/c (Being cash withdraw for personal use)		8,000	 8,000
April 10	Mukharjee a/c Dr. To Sales a/c (Being sold goods to Mukherjee)		50,000	 50,000
April 13	Rent Paid in Advance a/c Dr. To Rent a/c (Being Rent for two years paid in advance)		2250	 2250
April13	Drawing a/c Dr To Purchase a/c (Being Goods withdraw by the proprietor for domestic use)		1500	 1500

April 14	Office Expenses a/c Dr. To Bank a/c (Being Cash withdrawn from Bank for office use.)		9,000	 9,000
April 16	Purchase a/c Dr To Sahil (Being Purchase goods from Sahil)		30,000	 30,000
April 19	Stationary a/c Dr To Cash a/c (Being Purchased Stationery)		1800	 1800
April 19	Mohan a/c Dr To Sales a/c (Being Sold goods to Mohan)		20,000	 20,000
April 19	Purchase a/c Dr. To Bank a/c (Being goods purchased, and payment made by cheque)		18,000	 18,000
April 20	Cash a/c Dr. To Mukherjee (Being Cash received from Mukherjee)		50,000	 50,000
April 22	Vishal Dr. To Discount Received a/c To Cash a/c (Being Cash Paid to Vishal and received discount.)		65,000	 5,000 60,000
April 23	Cash a/c Dr Discount allowed a/c Dr To Sahil a/c (Being Cash received from sahil₹ 29,000 in his full settlement)		29,000 1000	 30,000
April 23	Cash a/c Dr Bad debts a/c Dr To Mohan a/c (Being Mohan became insolvent and only 60 paise in a rupee received)		12,000 8,000	 20,000
April 25	Verma & Co a/c Dr To Sales a/c (Being Sold goods to Verma & Co)		18,000	 18,000
April 26	Sales return a/c Dr To Verma & Co. a/c (Being Goods returned from Verma & Co.)		3,000	 3,000
April 26	Office Equipment a/c Dr To Cash a/c		10,000	 10,000

	(Being Purchased Office Equipment)			
April 27	Depreciation a/c Dr To Furniture a/c (Being depreciation charged on furniture @ 10% p.a)		5,000	 5,000
April 28	Outstanding Salary a/c Dr To Salary a/c (Being Salary Outstanding)		2400	 2400
April 28	Bank Charges a/c Dr To Cash a/c (Being Bank Charges paid)		4500	 4500
April 29	Cash a/c Dr To Interest Received a/c (Being Interest Received)		3000	 3000
April 30	Cartage a/c Dr To Cash a/c (Being Cartage Paid)		1250	 1250
April 30	Interest on Capital a/c Dr To Capital a/c (Being Interest on Capital Paid)		500	 500

2.3. Ledger and its Posting

After recording all the transaction in Journal, the next step is to classify on the basis of similarity. Ledger is the next stage where all the similar transaction related to particular person or assets and liabilities, incomes and expenses are recorded. Ledger is also known as the principal book of accounting. The main purpose of a ledger is to categorize all the transactions appear in the journal or other subsidiary books under their suitable accounts so that in the last of the accounting year all account will have the complete information of all the transactions relating to it in a concise form.

Name of the Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount

Debit Items: In the left side of account debit items are recorded.

Credit items: In the right side of account credit items are recorded.

Figure 2.4: Specimen of a Ledger Account

Method of Posting

A Book Store owner bought a computer for his business of ₹ 6000 for cash. In this case the debit side of Computer account in the ledger of owner "To Cash a/c" will be recorded and in the cash account in this ledger in the credit side "By Computer a/c" will be recorded.

Computer A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
	To Cash a/c		6,000				

Cash A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
					By Computer a/c		6,000

Illustration 4:

Prepare Goods account, from the following particulars for the month of March 2018:

March 1 Opening Balance of stock of goods ₹ 15,000; Credit purchase from Vimal for the month of March Rs 20,000; Credit sales to Bittu for the month of March ₹ 18,000. Cash purchase during the march ₹ 8,000; Cash sales during the march Rs 22,000; Bittu returned goods Rs 5,000; Returned goods to Vimal 3,000; withdrew by the owner for personal use at sales price ₹ 4,000.

Solution:

Ledger Account

Goods A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018			
March 1	To balance b/d		15,000	March 1	By Bittu		18,000
	To Vimal		20,000		By Cash a/c		22,000
	To Cash a/c		8,000		By Vimal		3,000
	To Bittu		5,000		By Drawing a/c		4,000
					By Balance c/d		1,000
	Total		48,000		Total		48,000

Illustration 5:

Enter the following transaction in the journal and ledger posting of Cash, Purchase, Capital and Furniture account of M/s Ramnath:

2018		₹
April 1	Commenced business with cash	3,00,000
April 3	Purchased goods for cash	1,80,000
April 4	Furniture Purchased	50,000
April 7	Deposited with bank	30,000
April 7	Purchase goods from Vishal	65,000
April 8	Sold goods to Naman for cash	25,000
April 10	Cash withdrawal for personal use	8,000
April 10	Sold goods to Mukherjee	50,000

Solution

Journal Entries in the books of Ramnath

Date	Particulars	L.F.	Debit	Credit
April 1	Cash a/c Dr. To Capital (Being business started with cash.)		3,00,000	 3,00,000
April 3	Purchases Account Dr. To Cash Account (Being purchase of goods for cash)		1,80,000	 1,80,000
April 4	Furniture Account Dr. To Cash Account (Being purchase of furniture for cash)		50,000	 50,000
April 7	Bank a/c Dr. To Cash a/c (Being cash deposited into bank.)		30,000	 30,000
April 7	Purchase a/c Dr. To Vishal (Being goods purchased from Vishal on credit)		65,000	 65,000
April 8	Cash a/c Dr. To sales (Being sold goods to Naman for cash)		25,000	 25,000
April 10	Drawing a/c Dr. To Cash a/c (Being cash withdraw for personal use)		8,000	 8,000
April 10	Mukharjee a/c Dr. To Sales a/c (Being sold goods to Mukherjee)		50,000	 50,000

Ledger Accounts

Cash Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018			
1 April	To Capital a/c		3,00,000	3 April	By Purchase a/c		1,80,000
8 April	To Sales a/c		25,000	4 April	By Furniture a/c		50,000
				7 April	By Bank a/c		30,000
				10 April	By Drawings a/c		8,000

Purchase Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018			
3 April	To Cash a/c		1,80,000	30 April	By Balance c/d		2,45,000
7 April	To Vishal a/c		65,000				

Capital Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018			
30 April	To balance c/d		3,00,000	1 April	By Cash a/c		3,00,000

Furniture Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018			
4 April	To cash a/c		50,000	30 April	By balance c/d		50,000

2.4. Capital and Revenue Expenditures

You bring about expenditure on different things consistently. You purchase eatables, seeds, animal food, farming equipment, stationery, daily care products, utensils, furniture, and so on. Some of them are consumables and some are durables. The advantage of expenditure on consumables like seeds, stationery, daily care products, and so on is inferred over a short period. In any case, in the event of durables items like farming equipment, furnishings, utensils, and so on, the advantage spreads over a number of years. Same thing is valid for business too. In business you acquire expenditure on two kinds of things: (I) routine things like stationery, postage, fixes, pay rates, and so on., where the advantage is accessible for a short period, and (ii) fixed assets like equipment, hardware, building, furniture, and so forth., whose advantage is accessible over various yea₹ In the context of bookkeeping, the main class of expenditure is called revenue expenditure and the subsequent one is called capital expenditure.

Capital Expenditure

Any expenditure which paid about the acquiring of fixed assets, for example, land, farming land, machinery, plant, furniture and fixtures, agricultural equipment, copyright, and so on. You should take note of that such capital expenditure incorporates not only the price of the fixed assets but also it includes all additional costs which incurred when assets brought. All the transportation expenses like freight, carriage on goods, cartage any kind of brokerage or commission paid, installation charges all added in the value of assets and all were treated as capital expenditure which increases the value of fixed asset.

Any expenditure incurred on a fixed resource which brings about (a) development or expansion of assets life, (b) substantial increment in assets life, and (c) improvement in its revenue gaining capacity.

Revenue earning capacity enhanced by the following form:

1. Enhanced production efficiency
2. Control cost of production
3. Enhanced the amount of sales

On the basis of above concepts if any kind of renovation in buildings or machinery such type of incurred expenditure treated as capital expenditures. Some of the time, if you purchase a second-hand machinery or old machinery and spent a heavy amount on its renovation such type of expenditures also treated as capital expenditure. Also, expenditure spent on structural enhancements or on the other hand modifications to existing fixed assets whereby their revenue generating limit is expanded, is likewise treated as capital expenditure.

Revenue Expenditure

At the point when the advantage of expenditure probably not going to be utilized after one year, it is treated as revenue expenditure. All the regular type expenses which spent in the duration of a year of business are viewed as revenue expenditures. Following are the revenue expenditure:

1. Expenses spent on everyday business activities, for example, compensation, salaries, rent, interest, postage, stationery, protection, power, and so on.
2. Expenditure spent on buying of raw material and re-sale of goods.
3. Expenditure acquired for maintaining all the fixed assets. Like repairs and renewals of fixed assets.
4. Depreciation treated as revenue loss, which charged on fixed assets.
5. Interest charged on loan and borrowings that treated as revenue expenditure in business but if any interest paid before business commenced that amount of interest treated as capital expenditure.
6. Legal charges acquired during the normal course of business, such as legal charges which incurred while collecting amount from debtors, legal charges charged on any kind of suit or damages.

Deferred Revenue Expenditure

Some expenses in business are incurred very heavy amount those certain expenditure which is normally treated as revenue but because of their heavy amount it treated as deferred revenue expenditure. Its advantage is prospective to be available in more than one year. Such type of expenditure spread into the number of accounting yea₹ Hence, it is capitalized and only a portion of the total amount spent is charged to the Profit and Loss Account for the current year. The balance is shown as an asset which will be written off during the subsequent accounting yea₹ Such expenditure is called a Deferred Revenue Expenditure because the charge to Profit and Loss Account is deferred to future yea₹ Some examples of such expenditure are:

1. Expenditure incurred on advertising campaign to introduce a new product in the market.
2. Expenditure incurred on formation of a new company (preliminary expenses).
3. Brokerage charges, underwriting commission paid and other expenses incurred in connection with the issue of shares and debentures.
4. Cost of shifting the plant and machinery to a new site which may involve dismantling, removing and re-erection of the plant and machinery.

Illustration 6:

State whether the following items of expenditure would be treated as (a) capital expenditure or (b) revenue expenditure or (c) deferred revenue: expenditure:

1. Carriage paid Rs 100 on purchase of goods.
2. ₹ 1,800 spent on repairs of plant and machinery.
3. ₹ 2,500 spent on white washing
4. ₹ 6,500 spent on import duty on the purchase of new machinery from Russia.
5. ₹ 15,000 spent on issue of debentures.

Solution:

1. It is a treated as “revenue expenditure” because it is connected to the purchase of goods.
2. It is treated as a revenue expenditure because it is spent on the maintenance of our fixed asset.
3. Same as no. (ii)
4. Here, it is treated as capital expenditure because it is spent on the purchase of a fixed asset.
5. It would be treated as deferred revenue expenditure. Heavy amount incurred related with raising of capital for the company and so capitalized. And as per the companies act it can be written off several years in the books of account.

Capital and Revenue Receipts

Receipts means any amount that is received in our business it may be cash inflows. Receipts can be classified as Capital Receipts and Revenue Receipts. It is very important to distinguish capital receipts and revenue receipts. Revenue receipts effects on the profit and loss account.

Capital Receipts

Capital receipts are the sums gotten as (an) extra capital presented in the business, (b) advances got, and (c) deal continues of fixed assets. You know that a credit taken by the business is repayable at some point or another. Thus, extra capital got speaks to an expansion in the owner's case over the business assets. In this way these two things speak to increment in liabilities of the business and clearly are not livelihoods or, revenues. These are capital receipts and ought to be treated all things considered. The deal continues of a fixed resource are additionally treated as a capital receipt in light of the fact that the sum got isn't revenue, earned in the typical course of business. The capital receipts increment the liabilities or decrease the assets. They don't influence the benefit or misfortune.

Revenue Receipts

Revenue receipts are the sums gotten in the typical and ordinary course of business. They appear as (a) deal continues of merchandise, and (b) earnings, for example, premium earned, commission earned, lease got, and so on. These receipts are because of products sold or a few administrations rendered by the business and all things considered they are not repayable. All revenue receipts are treated as wages and appeared on the credit side of the Profit and Loss Account.

Contingent Assets

When there is possibility of occurrence of particular past event is termed as contingent assets. In financial statement sometimes very important information is omitted to include such thing is applied in the case of contingent assets. Those assets which provide economic benefit to organization or it can be said as a potential asset of the business. Arising of such assets depends upon the occurrence for particular future event or set of events. For example, if a company engaged in some legal disputes and the chances of winning the case and will claim received for its damages.

International Accounting Standard 37, (IAS 37) explained the treatment of contingent assets and contingent liabilities. In India, Accounting Standard 29 published all the relevant information regarding contingent assets and liabilities.

Contingent assets do not include in the balance sheet and not be treated as like other assets of a organization. Following are the reasons:

1. Uncertainty: Occurrence of contingent assets totally depends upon the happening of events. Organization cannot be controlled or guarantee for its occurrence, so that is why such assets not included in the balance sheet of a company.
2. Conservatism: The conservatism principle explains that if any undefined future expense must be recognized instantly. But on the other hand, if in future any uncertain income arise it must not be recognized. The reason behind for this principle was to record the lowest amount of profit for to show the fairness of financial statements.

Contingent Liabilities

When there is the uncertainty for happening, a liability is termed as contingent liability. Possibility of occurrence not be in the control of organization such liability treated as contingent liability. So, there is uncertainty to record such liability in the final books of accounts. Contingent liability calculates on the basis of two methods, one method includes past event and other one is depending on future event. Arising of such liabilities depends upon the occurrence for particular future event or set of events. So accounting treatment provided for such liabilities. Contingent liabilities disclosed as a foot note in the final statements of accounts.

Chapter Summary

The fundamental equation of accounting termed as accounting equation. The total of assets of a business at any point of time equals to the total of capital and liabilities. Accounting equation shows the relationship between assets and liabilities of the firm. Accounting concerned to the continuous usefulness of all financial information. Journal is the book of original entries where first time all the business transaction recorded in the proper chronological order. Journal also termed as the primary book and ledger is treated as secondary book of the business. After posted in journal all the transaction classified and recorded in the ledger accounts. Ledger consists all the business information in separate accounts which helps to prepare trial balance. In ledger, balancing of accounts explain the totalling of both sides (debit and credit) and calculate the difference amount. Ledger helps to measure the net effect of the business transaction on different accounts of the firm.

To Do Activity

1. Journalize the following transaction and posted them into ledger:

1. On April 01, 2016 Mr Ram started business with ₹ 500,000 and goods for ₹ 70,000 other transactions for the month are:
2. Purchase Furniture for Cash ₹ 25,000.
8. Purchase Goods for Cash ₹ 48,000 and for Credit ₹ 32,000 from Rehman Retail Store.
14. Sold Goods to Ram Avtar Brothers ₹ 75,000 and Cash Sales ₹ 60,000.
18. Ram withdrew of ₹ 8,000 for his personal purpose.
22. Paid Rehman Retail Store ₹ 16,000.
26. Received ₹ 730,000 from Ram Avtar Brothers
30. Paid Salaries and Rent ₹ 6,000 and 4,000 respectively.

2. During the financial year 2018-19, Rakesh had total sales of ₹ 2,00,000, out of which credit sales of ₹ 1,10,000. His total expenses in business for the year were ₹ 90,000 out of which ₹ 50,000 is unpaid amount. Calculate Rakesh's income for the financial year 2018-19 on the basis Cash Basis of Accounting.

3. If the total assets of the business are ₹ 8,00,000 and the external liabilities are ₹ 3,50,000. Find out the amount of capital.

4. Journalise the following transactions:

July,2019 ₹

1. Started business with Cash Rs 50,000 and Goods Rs 25,000
2. Purchased furniture for cash ₹4,000
3. Cash purchases ₹ 27,500
4. Bought from Somya Rs 5,200
5. Goods sold to Manish ₹ 1600
6. Insurance for two years paid in advance ₹ 5,000
7. Drawings made by the proprietor for his household expenses ₹ 800
8. Goods taken out by the owner for personal purpose ₹ 150
9. Cash withdrawn from bank account ₹ 3,000
10. Goods sold to Mohan ₹ 2,980
11. Goods purchased and payment made by cheque Rs 1,700
12. Cash received from Priya Rs 5,000
13. Cash paid to Somya after deduction of discount ₹ 200
14. Cash received from Mohan in full settlement of his account 2,980
15. One debtor becomes insolvent. And 40 paise in a rupee is received from his estate.
16. Purchase of a typewriter for cash 26,000
17. Sold goods to Amrita ₹ 1,500
18. Goods sold to Reena ₹ 9,00.
19. Electricity charges paid ₹ 150

20. Paid cartage ₹ 50
21. Repairs to typewriter, and payment still due ₹ 100
22. Payment of cash for repairs of typewriter
23. Bought good for cash Rs 5,00
24. Purchases of other office equipment for cash 1,800
25. Paid wages ₹ 400
26. Amrita returned goods ₹ 200
27. Depreciation charged on Building ₹1,000
28. Depreciation on furniture ₹ 600
29. Rent paid ₹ 100 p.m. paid advance for next three months
30. Bank charges ₹ 70
31. Interest on capital ₹ 300

5. Journalize the following transaction in the books of Ramu:

January 2019

1. Started business with cash and furniture ₹ 10,000 and 25,000.
2. Bought furniture from Rajesh & Co. ₹ 11,500.
3. Goods purchased from Sharad ₹ 8,500 and paid cash immediately.
4. Half of the furniture returned which was purchased on 2^{nd} January.
5. Life insurance premium paid ₹ 1,200.
6. Purchased good of Rs 9,000 for cash and 6,000 from Kamal stores.
7. Sold goods to Sahil ₹ 6,200.
8. Bought furniture for official purpose ₹ 30,000.
9. Goods given to charity ₹ 250
10. Cash paid to Kamal stores after deducting 10% trade discount and 5% cash discount.
11. Sold goods ₹ 5,500.
12. Withdraw ₹ 1,000 by proprietor for his personal use.
13. Machinery purchased from ABC ltd. of ₹ 30,000, half of the amount paid cash.
14. Paid rent in advance ₹ 1,500 (including three months for next year)
15. Interest charged ₹ 400.
16. Loan taken from Bank ₹ 50,000 @5% p.a.
17. Received from Sahil after deducting 4% cash discount.
18. Repairing of the machinery ₹ 800.
19. Income tax paid ₹ 4,700.
20. Wages and salaries paid ₹300 and 700 respectively.
21. Advertisement paid ₹ 1,100.
22. Charge depreciation 5% on furniture and Machinery.
23. A cheque received from a party of ₹ 2,500 and submitted to bank on the same day.

Pass all the Journal entries in the books of Ramu.

6. Journalize the following transactions in the books of Saurav, post them into ledger June 2020:

June 1: Saurav started business with ₹20,00,000 of which 30% amount was borrowed from bank.

June 4: Purchased goods from Ankit worth ₹80,000 at 10% TD and half of the amount paid in cash.

June 7: Cash purchases ₹ 50,000.

June 10: Goods sold to Vidyaa ₹ 60,000 at 20% TD and received 25% amount in cash.

June 12: Deposited cash into bank ₹ 40,000.

June 15: Goods destroyed by fire ₹ 6,500.

June 19: Received commission from one party ₹ 4,500.

June 22: Paid to Ankit ₹ 35,500 in full settlement of A/c.

June 25: Cash stolen from business ₹ 5,000.

June 27: Received from Vidyaa ₹ 35,000 and discount allowed ₹ 500.

June 30: Interest received ₹ 2,400 and interest charges ₹1800.

Further Readings

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Chapter 3 Subsidiary Books

Introduction

Cash book is the book where all transactions related to cash receipts and cash payments are only recorded. Cash Book is maintained in the form of an account. All cash receipts entered on the debit side and all cash payment recorded on the credit side of the Cash book.

Objectives

- To explain cash book meaning and types of cash book
- To help students understand the meaning of petty cash book
- To explain the concept of subsidiary book and its types
- To help students describe the significance of journal proper
- To help students understand the need of bank reconciliation statement

3.1. Types of Cash Book and its Numericals

3.2. Petty Cash Book

3.3. Subsidiary Book: Types of Subsidiary Book

3.4. Journal Proper

3.5. Bank Reconcialiation Statement

Structure of the Chapter

3.1. Types of Cash book

Following are the characteristics of Cash Book:

(a) Here only cash transactions recorded.

(b) It implements the purposes of both journal and ledger.

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

Types of Cash Book

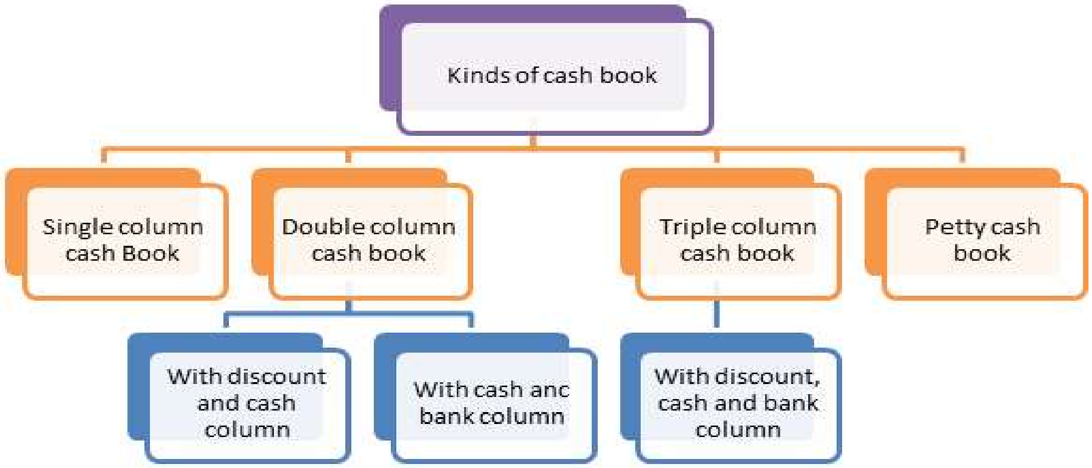

Figure 3.1.: Types of Cashbook
Source: Khan and Jain, 2006

Simple Column Cash Book

It records only cash receipts and cash payments to its debit (left hand side) and credit (right hand side). Excess of debit over credit is treated as cash balance in hand.

Date	Particulars	V.No	J.F.	Amount	Date	Particulars	V.No	J.F.	Amount

Figure 3.2: Specimen of Simple Column Cashbook

Illustration 1:

Shiva starts his business with cash ₹50,000 , Purchase goods for Rs 20,000, Paid office expenses ₹ 500, Sold goods ₹ 10,000, Paid Postage ₹ 200, Cash received from Tarun₹ 25,000, Cash paid to Mahesh ₹ 15,000, Purchased furniture ₹ 5,000, Cash withdrawal for personal use ₹ 3,000.

Solution:

In the Books of Shiva

Cash Book

Date	Particulars	V.No	J.F.	Amount	Date	Particulars	V.No	J.F.	Amount
	To Capital a/c			50,000		By Purchase a/c			20,000
	To Sales a/c			10,000		By Postage			200
	To Tarun			25,000		By Mahesh			15,000
						By Furniture a/c			5,000
						By Drawing a/c			3,000
						By Balance c/d			41,800
	Total			85,000		Total			85,000

Double Column Cash Book / Two Column Cash Book

It has two amount columns on both sides; one is for cash and another is for discount. Cash column is meant for recording cash receipts and payments while discount column is meant for recording discount received and allowed. The discount column on the debit side represents the discount

Date	Particulars	V.No	J.F.	Cash	Bank	Date	Particulars	V.No	J.F.	Cash	Bank

Figure 3.3: Specimen of Two Column Cashbook

allowed while discount column on the credit side represents the discount received. Bank column on both sides; one is for bank receipts and another for bank payments.

Methods of Recording in Two column and Three Column Cash Book:

1. Record of Receipts When amount is received in cash or by cheque, it is recorded in the debit side in cash column and the discount allowed to the party concerned in this connection is recorded in discount column of debit side.
2. Record of Payments: When payment is made in cash, it is recorded in the credit side in cash column, but when payment is made by cheque, it is recorded in the credit side in bank column. When payment is made through bank it is recorded in the credit side in bank column. Discount related with these payments, le, discount received is recorded in the discount color of credit side.

3. Contra Entry: When cash or cheque is received and the same day it is sent to bank for deposit, then in the debit side cash account is debited and credit side cash account is credited and then in the debit side bank account is debited, such entries are called Contra entries. The letter 'C Is recorded in case of contra entries in the L.F. Column. Transfer of amount from Bank Account to Cash Account or from Cash Account to Bank Account is called contra entry Contra entries show the fact that double entry record of this transaction has been made in cash book, therefore there is no need of its postings in ledger Contra entries of Cash Book are not posted in ledger.
4. Record of Crossed and Uncrossed Cheques: When crossed cheque is received, it is recorded in the debit side in bank column, but when bearer or order cheque is received, it is recorded in the debit side in cash column.

Method of Posting

Cash and bank accounts are not opened in ledger, these accounts in this book act as ledger accounts. Other accounts are opened and the amount of discount is also taken to the discount account. Discount account is posted in the same manner as has been discussed earlier in two columnar cash book.

Illustration 2

Record the following transactions in a bank column cash book for December 2018

01	Started business with cash	1,80,000
04	Deposited in bank	2,50,000
10	Received cash from Rahul	1,00,000
15	Bought goods for cash	40,000
22	Bought goods by cheque	30,000
25	Paid to Shyam by cash	25,000
30	Drew from Bank for office use	9,000
31	Rent paid by cheque	2,000

Solution:

Cashbook									
Dr.									**Cr.**
Date	**Receipts**	**L.F.**	**Cash₹**	**Bank₹**	**Date**	**Payments**	**L.F.**	**Cash₹**	**Bank₹**
2018					2018				
01 Dec	Capital		1,80,000		04 Dec	Bank	C		2,50,000
04 Dec	Cash	C		2,50,000	15 Dec	Purchases		40,000	
10 Dec	Rahul		1,00,000		22 Dec	Purchases			30,000
30 Dec	Bank	C	9,000		25 Dec	Shyam		25,000	
					30 Dec	Cash	C		9,000
					31 Dec	Rent			2,000
					31 Dec	Balance c/d			

Three Column/ Triple Colum Cashbook

In this cash book three columns opened in both sides. Cash column, Discount received and discount allowed column and bank column. The triple column cash book (also referred to as three column cash book) is the best comprehensive practice of cash book where it has three money columns on both receipt (Dr) and payment (Cr) sides to record transactions involving cash, bank and discounts. A triple column cash book is usually maintained by large firms which make and receive payments in cash as well as by bank and which frequently receive and allow cash discounts.

Date	Particulars	V.No	J.F.	Disc.	Cash	Bank	Date	Particulars	V.No	J.F.	Disc.	Cash	Bank

Figure 3.4: Specimen of Three Column Cashbook

Illustration 3:

Record the following in three columnar cash book of Ajay traders:

2018

January 1 Opening balance: Cash ₹ 5,000 and bank balance ₹ 7,000.

January 3 Purchased goods and payment made by cheque ₹ 4,000.

January 4 Cash Sales 4000.

January 8 Withdrew ₹ 100 by cheque for personal use.

January 9 Received 500 from Varun and allowed him discount ₹ 20

January 9 Paid to Hari ₹ 600 and he allowed discount ₹ 10

January 9 Deposited ₹200 into bank.

Solution:

In the Books of Ajay Traders

Cash Book (with, cash, bank and discount column)

Date	Particulars	V.F. No.	J.F. No.	Disc.	Cash	Bank	Date	Particulars	V.F. No.	J.F. No.	Disc.	Cash	Bank
2018							2018						
Jan 1	To Balance b/d				5,000	7,000	Jan 3	By Purchase a/c					4,000
Jan 4	To Sales a/c				4,ooo		Jan 8	By Drawings a/c		C			100
Jan 9	To Varun		C	20	500		Jan 9	By Hari			20		600
Jan 9	To Cash a/c					200	Jan 9	By Bank a/c				200	
								By Balance c/d					

3.2. Petty Cash Book

Payments in cash of small amounts like travelling expenses, postage, carriage etc. are petty cash expenses. These petty cash expenses are recorded in the petty cash book. The petty cash book is maintained by separate cashier known as petty cashier. The firm may adopt Imprest System of maintaining petty cash. The petty cashier is given a certain sum of money at the beginning of the fixed period (e.g. a month/fortnight) which is called float. The amount of float is so fixed that it may be adequate to meet petty expenses of the prescribed period. The balance in the petty cash book shows cash lying with the petty cashier.

-COMPANY-

Dr. PETTY CASH BOOK Cr.

Receipt	Date	Details	VN	Total	expense 1	Expense 2	Expense 3	Expense 4

Figure 3.5: Specimen of Petty Cashbook

Source: Khan and Jain, 2006

3.3. Subsidiary Book- Types of Subsidiary Books

Every business transaction, goes through a process i.e. at the first stage, all transactions are recorded in the journal book of original entry and then second stage transaction posted into the ledger on the basis of double entry system of book-keeping. This procedure can apply only on those business houses where numbers of transactions are very less and it is practically applied in small business, where an individual can handle all the business transactions. But in case of big business organisation where the large number of transactions held in a day that are varied and enormous than to apply the same is practically very difficult, rather impossible, because of the following reasons:

1. The process of recording every transaction in a journal needed, writing down the name of the account holder who involved as many times as the transactions occur and repetitive journalising for same person for different transactions.
2. Such type of complex system does not deliver the information on urgent basis.
3. The journal becomes massive and voluminous because of large number of transactions recorded.
4. In Journal the installation of an internal check system not provided because it can be handled by only an individual.

Therefore, to come out from all lacunas of the use of the journal, the journal is subdivided into special journals. It is separated in such a way that a particular book is used for separately category of business transactions which are repetitive in nature, similar and are suitably large in number. These special journals are also known as a “Subsidiary Books” or “Day Books”.

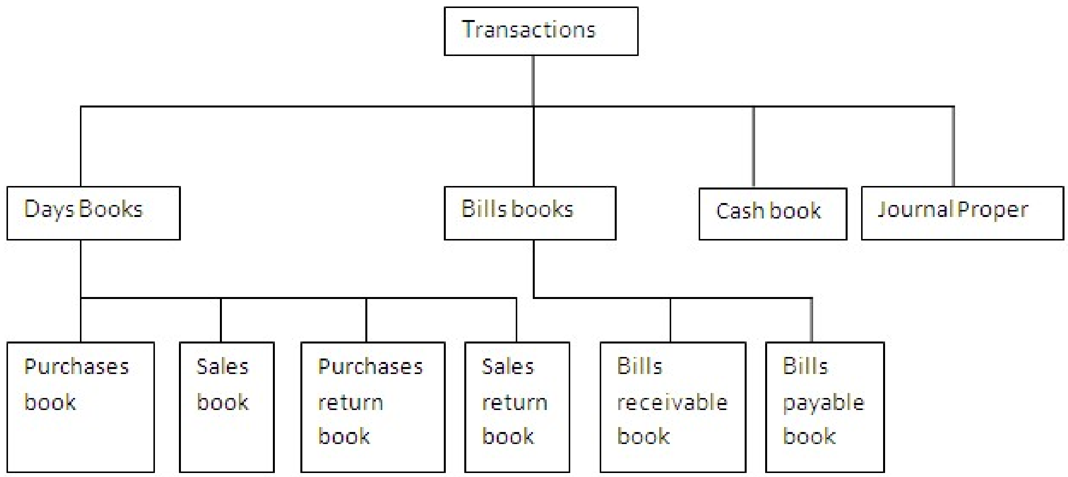

Figure 3.6: Different Type of Subsidiary Books

Source: Goyal, 2007

Following are the different types of journals:

1. Cash Book: In cash book only cash and bank related transaction recorded. This book is prepared only for cash and cheque transactions.
2. Purchases Book: Total credit purchase record here only. For all credit purchased of goods related transactions recorded.
3. Sales Book: Total credit sales record here only. For all credit sales of goods related transactions recorded.
4. Purchases Return Book: When purchased goods returned to suppliers' records purchase return book.
5. Sales Return Book: When sold goods returned by customers, records in sales return book.
6. Bills Receivable Book: Its record bills receivables entries. The details of all bills are provided in this book.
7. Bills Payable Book: Its record bills payables entries. The details of all bills are provided in this book.
8. Journal Proper: All those entries which are not posted in any of the above-mentioned books are recorded in the Journal Proper.

Meaning of Goods, Purchases and Sales

1. Goods: Goods refer to those items which are used for trade or part of stock-in-trade. When any items purchase or resold for earning a profit terms as a goods. If any assets purchased for official use and not for resale purpose, they are not termed as goods.
2. Purchases: When any goods purchased for the purpose of resale are comes under purchase. If any assets or stationery purchased for the office use not refers as a purchase.
3. Sales: When any goods sold for the purpose to earn profit are comes under sales. If any assets or stationery sold not refers as sales.

Advantages of Subsidiary Book

Following are the advantages of using Special Journals or Subsidiary books:

1. Division of work: Transactions are divided according to their nature, like cash and credit entries posted in different accounts. The accounting work also divided among different persons.
2. Reduce time and labour: By the help of subsidiary book a system is followed for the recording of transaction which reduce the time as well as efforts of person. For example, when a Purchase Book is kept, the name of the Purchase Account will not be required to be written down in the Journal as many times as the purchases transactions occur and at the same time, Purchase Account will not be required to be posted again and again since, only a periodic total of Purchase Book is posted to the Purchase Account.
3. Specialised skill required: For the posting of all transaction, requires specialised skill in the person to which work is assigned. With the use of their specialised skill, fast, efficient and more precise supply of accounting information may be obtained.
4. Installation of internal check system: All the accounting work can be separated in such a way that the work of an individual is automatically crisscross by another person. By the help of internal check system, the chances of occurrence of error/fraud may be reduced.

Purchase Book

Purchases Book (also known as Invoice Journal/Bought Journal/Purchases Journal) is used for posting of only credit purchases of goods and merchandise in which the business is involving, i.e. goods purchased for resale purpose for generating profit. The aim to prepare purchase book is only to record cash transaction, all the credit transaction and purchased of other than goods not recorded here.

In the process of purchasing goods on credit, purchaser receives a slip or a statement from the vendor which consist all the information of goods. The statement is termed as an Invoice. The invoice contains the information of quality, quantity, price and the terms and condition for payment of goods supplied. If any discount allowed (cash and credit) or any tax charged invoice provides all information.

On the basis of invoice all the entries passed in the purchase book which received from the supplies also with the amounts of trade discount/quantity discount. The purpose of allowing any discount (trade in this case) is to enable the retailer to sell the goods to the customer at list price and still leaving margin for meeting business expenses and his profit. Entries in the books of both supplier as well as retailer are made on the basis of net amount i.e. invoice price less trade discount.

Posting in Purchase Book

Firstly, all the transaction posed in the Purchases Book, and then after all the purchase book entries posted in ledger accounts. The posting from the Purchases Book is made as follows:

1. In the Purchases Account debited all the total of the Purchases Book of particular time period. On the debit side of the Purchases Account write “To total as per Purchase Book” or “To Sundries” in the particular’s column.
2. All individual supplier account is credited with the net amount of Invoice recorded in Purchases Book and by writing “By Purchases”.

Illustration 4:

Prepare the Purchases Book for the month of Sep, 2018 from the following particulars of M/s Sharma & Co. and also post them into Ledger.

Feb. 4	Purchased on credit from Rama Bros. & Co.
	14 Bags of Tea @ ₹ 1000 per bag
	10 Bags of Coffee @ ₹ 1500 per bag
	Trade discount @ 10%
Feb. 16	Purchased from Shiva Enterprises on credit
	30 bags of Rice @ ₹ 500 per bag
	10 bags of Wheat @ ₹ 800 per bag
	Trade discount @ 5%
Feb. 20	Purchased Furniture on Credit from Golden Furniture House
	for ₹ 3000
Feb 24	Bought on credit from Anwar & Co.
	50 tin Ghee @ ₹ 700 per tin
	05 tin Oil @ ₹ 200 per tin
	Trade Discount 15%

Solution:

Purchase Book of M/s Sharma & Co.

Date	Particulars	Invoice No.	L.F.	Details	Amount
2018					
Sep 04	Rama Bros. & Co.				
	14 bags of Tea @ ₹ 1,000 per			14,000	
	bag				
	10 bags of Coffee @ ₹ 15,00			15,000	
	per bag			29,000	
	Less: Trade discount @ 10%			2,900	
	Shiva Enterprises			15,000	26,100
	30 bags of Rice @ ₹ 500 per				
	bag			8,000	
Sep 16	10 bags Wheat @ ₹ 800 per				
	bag			23,000	
				1,150	
	Less Trade discount @ 5%				
	Anwar & Co.			35,000	
	50 tin Ghee @ ₹700 per tin				
	05 tin Oil @ ₹ 200 per tin			1,000	
Sep 24				36,000	21,850
	Less Trade discount @ 15%			5,400	
	Total				30,600
					78,550

Note: Purchase of furniture being an asset is not to be recorded in purchase book, however, it will be recorded in Journal.

Ledger Posting:

Purchases A/C

Dr. Cr.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018 30 Sep	To Sundries		78,550				

Rama Bros & Co.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018 Sep 06	By Purchases		26,100

Shiva Enterprises

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018 Sep 06	By Purchases		21,850

Anwar & Co.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2018				2018 Sep 06	By Purchases		30,600

Sales Book

Sales Book or Sales Journal is prepared only to record all the credit transaction of sales. In the Sales Book only those transactions record in which goods sold on credit and here the goods mean those, in which the firm basically deals. All the cash sales transaction recorded in Cash Book only and if any sale of assets that is recorded in the Journal proper.

The entries in the Sales Book are posted from the invoice only which have been sent to our customers along with the goods. Such copies of the invoices may be known as an Outward Invoice. Every outward invoice has a numbered consecutively and recorded as a reference in the Sales Book along with the entry.

The Sales book is maintained for a particular time period. The total amount of all the invoices recorded in Sales Book and then posted in to ledger as follows:

1. Personal accounts of the customers debited with the amount of sales.
2. Totaling of Credit Sales Account with the particular time period.

Illustration 5:

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

2019

Feb. 1 Sold to M/s Ravi and Co. 1,000 kilos of Potato @ ₹ 15 per kilo.

2,00 kilo Tomato of @ ₹ 40 per kilo.

Trade discount 10%.

Nov. 16 Sold to Vegetable House, 1,00 Kilo Onion @ ₹ 50 each.

50 Kilo of Garlic @ Rs 100 per kilo

Trade discount 20%

Nov. 25 Sold to Panwar Bros.

10 Kilo Mushroom @ ₹ 1,500 per kilo.

15 Kilo Cauliflower @ ₹ 80 per kilo.

10 Kilo Capsicum @ ₹ 120 per kilo.

Solution:

Sales Book

Date	Particulars	Invoice No.	L.F.	Details	Amount
2018					
Feb 1	M/s Ravi and Co.				
	1,000 Kilo of Potatoes			15,000	
	@ Rs 15 per kilo				
	2,000 Kilo of Potatoes				
	@ Rs 15 per kilo			8,000	
				23,000	
	Less: Trade Discount 10%			2,300	20,700
Feb 16	Vegetable House				
	100 Kilo of Onion			50,00	

	@ Rs 50 per kilo				
	50 Kilo of Garlic			5,000	
	@ Rs 100 per kilo			10,000	
	Less: Trade Discount 20%			2,000	8,000
Feb 25	Panwar Bro₹			15,00	
	10 Kilo Mushroom @ ₹ 150 per kilo				
	15 Kilo Cauliflower @ ₹ 80 per kilo.			12,00	
	10 Kilo Capsicum @ ₹ 120 per kilo.			12,00	
					39,00
	Total				32,600

Ledger Accounts:

Sales Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2019				2019 28 Feb	By Total Sales as per sales book		32,600

M/S Ravi & Co

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2019 Feb 1	To Sales A/C		20,700				

Vegetable House

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2019 Feb 16	To Sales A/C		8,000				

Pan Bros.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2019 Feb 25	To Sales A/C		39,00				

Purchase Return Book

In every business, it is very common when goods returned by the suppliers. All the returned goods are recorded in the purchase return book. So many reasons attached with return of goods like goods are defective; goods are not according to order, goods not delivered within time period. A separate book maintained to record all purchase returned goods and it also termed as Outward Return Book. The base of entries is the Debit Note, which issued by the supplier and all the entries recorded in the Purchases Returns Book. A duplicate Debit Note prepared, when a firm returns some goods to it suppliers. The Debit Note is very important because the supplier's account is debited with the amount of the goods returned. Following is the standard form of a debit note:

Specimen of a Debit Note

INDIAN FERTILIZER HOUSE
DARYA GANJ, NEW DELHI-110002

Grams: Fertilizer
No.10
Aug 11 2019
Your Reference: Invoice No. 201 dated 15 June 2019

To
M/s National Fertilizer House,
Hyderabad (Telengana)

Purchase Return Book

After recording the transaction in Purchases Returns Book, then all the transaction posted in to ledger and involves the following:

1. The sum total of the Purchases Return Book for a particular time period is posted in to the credit of the Purchases Return Account.
2. The personal account of each supplier is debited with the amount of Debit Note.

Illustration 6:

From the following transactions prepare Purchases Returns Book and also post them into Ledger.

2016

Nov.1 Returned to Bhuwan

10 Fans @ ₹ 1000 per fan

Nov. 12 Returned to Satya

5 electric lamp @ 500 per lamp

Nov. 25 Returned to Balveer goods values ₹ 5,000

<u>Solution:</u>

Purchase Return Book or Returns Outward Book

Date	Particulars	Invoice No.	L.F.	Details	Amount
2016					
Nov 1	Bhuwan				
	10 Electric fans @ ₹1000 per fan			10,000	
Nov 12	Satya				
	5 Electric Lamp @ ₹ 500 per lamp			2,500	
Nov 25	Balveer			<u>5,000</u>	
	Total				

Bhuwan's A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 1 Nov	To Purchase Return		10,000	2016			

Subhash's A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 Nov 12	To Purchase Return		5,000	2016			

Balwinder's A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 Nov 25	To Purchase Return		2,500	2016			

Purchase Return's A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016 Nov 30	By Total as per purchase return book		17,500

Sales Return Book

When goods sold on credit, it recorded in a separate book which known as Sales Return Book or Returns Inwards. If goods are sold on cash and then returned or exchanged with other goods not to be recorded in the sales return book. As like purchase book, sales book is prepared except a column to record Invoice No. and the Credit Note number. Credit Note is just inverse of Debit Note and is forward by vendor to its buyer. This note is used as an acknowledgment of the goods that returned as well as evidence to credit the amount from the debtor account with the amount mentioned.

Illustration 7:

From the following transactions, prepare the Sales Returns Book of Jindal & Co. Book House, Agra and post them to the Ledger:

5.1.19 Credit note 201 Global Book depot, Bengaluru, returned to us –

10 Accounting Books @ ₹250 per book

10.1.19 Creditnote 202 Accepted return of goods (which were sold for cash)

from Bharat Stationary, Delhi,

15 English Literature Book @ ₹ 200 per saree

17.1.19 Credit note 203 Universal Book House, Jaipur

returned to us – 20 Grammar Book @ ₹ 100 per book

31.1.19 Mohan returned to us one old typewriter worth ₹ 500

Sales Return Book

Date	Credit No	Name of Customer	L.F.	Amount
Jan 5	201	Global Book Depot, Bengaluru		
		10 Accounting Books @ ₹250 per book		2,500
Jan 17	203	Universal Book House, Jaipur		
		20 Grammar Book @ ₹ 100 per book		2,000
				4,500

Note: Return of English Literature will be recorded in the Cash Book and return of typewriter will be recorded in the Journal Proper since the Sales Returns Book records only the returns of purchased on credit.

LEDGER OF JINDAL & CO.

Global Book Depot

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				2019 Jan 05	 By Sales Return		 2,500

Universal Book House

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
				2019 Jan 17	 By Sales Return		 2,000

Sales Return Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2019							
Jan 10	To Cash A/c		3,000				
Jan 31	To Sundries A/c		4,500				

Bills Receivable Book

Credit transaction became very common in between purchase and sales transactions. At that time seller wants a written commitment from the buyer for the due payment. When a payment for a transaction is not made instantly but is due or postponed for a few months, a bill is drawn as a commitment from the buyer side. The bill of exchange is then accepted by the drawer representing that the payment done on a date which is written on a bill. To the buyer, who draws the bill on behalf of his seller, it is called as Bills Receivable that represent, money to be received at a specific future date; to the seller.

Credit transactions related with the drawing of a bill, the acceptance and negotiation of bills are recorded in Bills Receivable and Bills Payable Books respectively. Bills Receivable Book is prepared to post all the entries of bills receivable on which the business organisation will receive the amounts from other parties in future. Posting: The sum total of the amount column of the Bills Receivable Book is debited to the Bills Receivable Account while the amount of each bills receivable is posted to the credit of the account of the party from whom it is received.

Date	Particulars	V.No	J.F.	Disc.	Cash	Bank	Date	Particulars	V.No	J.F.	Disc.	Cash	Bank

Figure 3.74: Specimen of Bills Receivable Book

Illustration 8:

X received the following bills of exchange. Record all transaction in Bills Receivable Book and posted into the ledger:

2019

1 Apr Ravi received a bill of exchange of ₹ 5,000 for 4 months, which was accepted and return on the same day.

12 Apr Drawn on Sameer a bill of exchange for Rs 8,500 for 3 months, which was accepted on the same day.

Solution:

Bill Receivable Book

S.No	Date of Receipt	From whom received	Acceptor	Date of Bill Drawn	Term	Date of Maturity	Amount	How Disposed
1.	1 April	Ravi	Ravi	1 April	4month	4 Aug	5,000	---------
2.	12 April	Sameer	Sameer	12 April	3month	15 July	8,500	---------

Bills Payable Book

This is a book to record all bills payable entries which accepted by the business organisations for the fulfilment of paying at one specific that future date amounts due by it (the business organisation or trader) to its or his buyer. The entries to be posted in this original book records the name of the drawer, the name of the payee, the period, the due date, and other particulars. Then the acceptance is duly returned to the drawer.

Posting: The total amount of separate bills is recorded to the debit side of the drawer's account in the ledger account and the total of the amount column of the Bills Payable Book is recorded to the credit side of the Bills Payable Account in the ledger.

Date	Particulars	V.No	J.F.	Disc.	Cash	Bank	Date	Particulars	V.No	J.F.	Disc.	Cash	Bank

Figure 3.8: Specimen of Bills Payable Book

Illustration 9:

A accepted the following bills of exchange. Record all transaction in Bills Payable Book and posted into the ledger:

2018

1 June Accepted Rohan's bill for ₹ 15,000 for 3 months

23 June Accepted the bill drawn by Meera for ₹ 20,000 at 2 months payable.

Solution:

Bills Payable Book

S.No	Date of Bill	Name of the drawer	Payee	Term	Date of Maturity	Amount	Remark
	2018						
1.	1 June	Rohan	Rohan	3 months	4 Sep	15,000	-
2.	23 June	Meera	Meera	2 months	26 Aug	20,000	-

3.4. Journal Proper

Journal Proper is a type of book which prepared to record all those transactions which cannot be recorded anywhere like in journal or any other subsidiary book such as:

1. Cash Book,
2. Purchases Book,
3. Sales Book,
4. Purchases Returns Book,
5. Sales Returns Book,
6. Bills Receivable Book, and

7. Bills Payable Book.

Cash transaction posted into cash book, credit transaction posted in the subsidiary books but some transaction like opening closing entries do not find place in above book, so such type of entries will be passed in journal proper.

Following are the several examples of transactions which go through in a Journal Proper are given below:

1. Opening entry: An Opening Entry is the entry which passed to bring down all the balance of ledger accounts like various assets, liabilities and capital appearing in the Balance Sheet of the previous and current accounting period.
2. Closing entries: All the ledger accounts closed or we can say balanced with closing Entries and entries are passed in the journal for closing the nominal accounts by transferring them to the Trading and Profit and Loss Account. This process is necessary in the end of every accounting year to prepare final accounts.
3. Transfer entries: In journal some entries transferred from one account to another account are the transfer entries like transfer of total drawings from drawings account to capital account.
4. Adjusting entries: All the unrecorded items recorded by the help of adjustment entries like closing stock, depreciation on fixed assets, outstanding and prepaid items. These are also very necessary process while preparing the final accounts.
5. Rectifying entries: Rectifying Entries are those which passed to rectify any errors or omissions of account.
6. Miscellaneous entries: This include the following:

- Capital brought in kind.
- Purchase of Assets (other than Stock-in-trade) on credit
- Sales of Assets (other than Stock-in-trade) which were sold on credit.
- Return of Assets (other than Stock-in-trade) which were sold on credit.
- Return of Assets (other than Stock-in-trade) which were bought on credit.
- Endorsement of Bills Receivable to a creditor.
- Dishonor of Bills Receivables (not discounted with bank).
- Cancellation of Bills Payable.
- Abnormal Loss of Stock-in-trade/other assets by theft, accident, fire, etc.
- Writing-off Bad Debts.

Illustration 10

1. Opening Balances: Assets - Cash in hand 2,000; Cash at Bank 10,000; Sundry Debtors 25,000; Stock 50,000 and Building 2,00,000.

   Liabilities – Bills Payable 15,000 and Sundry Creditors 40,000.
2. Bought Furniture Rs 80,000 from Radhey and Sons on credit.
3. Goods withdrawn for personal use worth Rs, 6,000.
4. Received from Ritu Rs 20,000. Discount allowed Rs 200.

Pass the entries in journal.

Solution:

Journal Book

Date	Particulars	L.F.	Debit	Credit
1	Cash in hand a/c Dr.		2,000	
	Cash at Bank a/c Dr.		10,000	
	Sundry Debtors a/c Dr.		25,000	
	Stock a/c Dr.		50,000	
	Building a/c Dr.		2,00,000	
	To Sundry Creditors a/c			40,000
	To Bills Payable a/c			15,000
	To Capital			2,32,000
	(Being pervious year balances brought forward and balancing amount is capital)			
2	Furniture a/c Dr.		80,000	
	To Radhey and sons a/c			80,000
	(Being purchase of furniture for credit)			
3	Drawing a/c Dr.		50,000	
	To Purchase			50,000
	(Being goods withdrawn for personal use)			
4	Discount allowed a/c Dr.		200	
	To Ritu			200
	(Being discount allowed.)			

3.5. Bank Reconciliation Statement

In current scenario all the business transaction done by the help of cheques and for this organisation maintain a proper record of all banking transaction. To be more transparent in the business relationship, banking transactions are preferred and it is suitable also. Fear of theft reduced by transferring money from one account to another and by using of cheques made all the payment and receiving very easy. In accounts all the transaction has to be recorded at a place so all the banking transaction recorded in the ledger account of bank and also calculate a balance. The derived balance must be matched with the pass book balance which issued by the bank itself, in that case a statement was prepared to find out the gaps or omissions or errors of recording while posting all the bank related transactions. That statement is known as Bank reconciliation Statement.

From the above, the following features of the statement emerge:

1. It is only a statement not an account.
2. This statement is prepared for a specific time period.
3. Only for a day it is prepared and then after a day it has no use.
4. To prepare this statement is not part of our double entry system.
5. The basic reason to prepare this, to find out all the errors committed in either cash book or pass book.

Cause/ Reasons for Differences in two Balances

The relationship between the client and the banker is that of a debtor and a creditor. So, if the bank column of the cash book shows a credit balance as on a specified date, the pass book should show an equal amount of debit balance as on that date and vice-versa.

However, the balances shown by the two independent records may not agree due to the following:

1. Cheques issued but not yet presented for payment: If any cheque is issued for third party payment of third party, in the cash book an entry is passed on credit side but on the other hand the bank debited the customer’s account only when the cheque is presented in the bank and it is also paid by the bank.
2. Cheques paid into bank but not yet collected by the bank: collection of cheques made by bank only. If any cheque paid into bank but bank not collected till date of statement prepared create the imbalance in cash book and pass book.
3. Bank Charges: Bank charged so many charges or fees on various type of services that rendered to their customers. Like collection charges, interest on overdraft, incidental charges and normally these charges debited from the customer account directly by bank only.

4. Interest credited by bank but not entered in cash book: Sometimes banks provide interest to their customers and directly deposited in their account and the entry was not passed in cash book.
5. Interest or dividend on investments etc. collected by the bank: In today's era every investment done by the help of bank account and the amount of any interest directly credited bank account itself. The Like interest or dividend on investments, rent on property etc. to the banker for which they charge commission.
6. Amount directly deposited into the bank by customers: Sometimes our customers directly deposited the due amount in our bank account directly and our account credited but in cash book that entry not made.
7. Payments made by the bank on behalf of clients: Standing instruction given by the customer to their bank account to deduct a specific amount on specific date like insurance, rent, licence fee and other payments on his behalf when they fall payable.
8. Bills Collected by the bank on behalf of Customers: The clients may permit his banker to collect the amount of bills receivable from the drawee when the final date and that amount goes to credit side of bank.
9. Dishonour of Bills or cheques: Cheques and bill receivable send to the bank for their realization and the amount debited in the cash book and those cheques and bill dishonoured will affect the balances of cash book and pass book.
10. Rebate on retiring of Bills: When the proprietor made payment of his own bills payable via bank or to bank before its maturity, businessman is allowable for a rebate or discount by bank.
11. Cheques paid into bank but omitted to be entered in cash book: Due to large number of transaction sometime owner deposits their cheques into bank omitted to enter in the books of accounts. This also may be a cause for arising a difference between the balances of cash book and pass book.
12. Wrong debit or credit given by the banks: If in the books of account any amount is wrongly debit or credit then it also became a reason to create a difference in the balances of cash book and pass book of the customer. A wrong amount debit or credit may be provided by the bank in the following ways:
    - Any other account holders' cheque wrongly debited or credited in the custom
    - Passing the entry on the wrong side of the pass book by the bank.

Procedure for Preparation of Reconciliation Statement

The bank reconciliation statement is made normally at the end of a month, a quarter, a half year or year as per the requirement of business and organisation or we can say when it may be found convenient and necessary by the businessman taking into account the several of transactions involved. Bank reconciliation statements prepared by cash book balance or pass book balance, any one balance taken for the beginning of this statement. These balances can be debit side balance or credit side balance of cash book and pass book.

Cash Book Balances, if:

- Our bank reconciliation statement starts from cash book debit balance; it is favourable balance as per cash book.
- Our bank reconciliation statement starts from cash book credit balance; it is unfavourable balance as per cash book.

Bank Pass Book Balances, if:

- Our bank reconciliation statement starts from bank pass book debit balance; it is unfavourable balance as per pass book.
- Our bank reconciliation statement starts from cash book credit balance; it is favourable

The following table will help to learn the preparation of the bank reconciliation statement-

	Dr. balance as per Cash Book or Overdraft as per Pass Book	Cr. Balance as per pass Book or Overdraft as per Cash Book
I. *Those items which affect the debit side of Cash Book:* i) Cheques deposited but not collected by bank ii) Cheque though entered in Cash Book but omitted to be sent to the Bank.	-	+
II. *Those items which affect the credit side of Cash Book:* i) Cheques issued but not presented for payment.	+	-
III. *Those items which affect the Credit side of pass Book:* i) Interest/Dividend credited by bank. ii) Amount deposited direct by a customer into bank account. iii) Cheques sent to the bank but omitted to be entered into the Cash Book.	+	-
IV. *Those items which affect the debit side of Pass Book:* i) Bank charges charged by bank. ii) Interest on overdraft. iii) Payment made by bank on standing instructions of customer.	-	+

balance as per pass book.

Figure 3.9: Format for Bank Reconciliation Statement

Pandikumar, 2007

Case 1: When Cash Book has Debit Balance (Favourable Balance)

Illustration 11:

The bank column of cash book showed a debit balance of Rs 38,000 on 30th Sep. 2018. Following are the differences come after compared cash book and pass book. You are required to prepare a Bank reconciliation Statement as on 30th Sep, 2018.

1. Rohit a debtor deposited a cheque directly into bank account of Rs 14,000.
2. Bank charged Rs 500 as bank charges.
3. Cheques of Kamal Rs 6,000 and Krishnan Rs 11,000 were deposited but not collected upto 30th Sep 2018.
4. Bank allowed Rs 1,000 as interest.
5. Bank debited Rs 5,000 for insurance premium.
6. Cheques for Rs 11,000 issued to Rama were not yet presented for payment.

Solution:

Bank Reconciliation Statement

as on 30th Sep, 2018

Particulars	Details	₹ Amount
Balance as per the Cash Book (Dr.)		38,000
Add: Cheques directly deposited by Rohit	14,000	
Interest allowed by Bank	1,000	
Cheques issued but not presented for payment	11,000	26,000
Less: Cheques deposited but not yet cleared		
Kamal		
Krishnan	17,000	
Insurance Premium paid by bank	5,000	
Bank charges charged	500	22,500
Balance as per Pass Book (Cr)		41500

Case 2: When Cash Book has Credit Balance (Unfavourable Balance)

Illustration 12:

Amar & Son's cash book showed a credit balance of 35,650 as on 31st December, 2018. The following are the reasons:

1. Cheques deposited but not yet collected ₹50,900
2. Cheques issued but not yet presented for payment ₹38,000
3. Payment received 8,600 directly by customer in the bank account. No entry passed in the cash book.
4. Interest charged by bank 750 and not recorded into cash book.

Solution:

Bank Reconciliation Statement

as on 31st December, 2018

Particulars	Plus Item	Minus Item
Balance as per the Cash Book		35,650
Cheques deposited but not yet collected		50,900
Cheques issued but not presented for payment	38,000	
Payment directly received from customer	8,600	
Interest charged by bank		750
Balance as per pass book	40,700	

Case 3: When Pass Book has Favourable Balance

Illustration 13:

The bank passbook of Ram Bros. showed a balance of ₹ 58,000 on January 31, 2019.

1. Cheques issued amounted ₹ 32,000 before January 31, 2019, not yet presented for encashment.
2. Two cheques amounting ₹ 4,200 and ₹ 2,650 were deposited into the bank on January 31 but the bank provided credit for the same in February, 2019.
3. A cheque dishonoured amounting Rs 3,100 debited in the pass book.

Prepare a bank reconciliation statement as on January 31, 2019

Solution:

Bank Reconciliation Statements on 31st December, 2018

Particulars	**Plus Item**	**Minus Item**
Balance as per passbook	58,000	
Cheques deposited but not collected by the bank	6,850	
Cheque dishonoured not recorded cash book	3,100	
Cheques issued but not presented for payment		32,000
Balance as per cash book		35,950
	67,950	67,950

Case 4: When Pass Book has Unfavourable Balance

Illustration 14:

From the following particulars of Amita & Co. prepare a bank reconciliation statement on March 31, 2019.

1. Showed overdraft as per passbook 12,000
2. Interest on bank overdraft 1,200
3. Insurance Premium paid by the bank as a standing instruction ₹ 1,050
4. Cheque issued but not presented for payment 8,000
5. Cheque deposited into bank but not yet cleared 4,000
6. ₹ 400 Wrongly debited by bank

Solution:

Bank Reconciliation Statement of Amita & Co

as on March 31, 2019

Particulars	Plus, Item	Minus Item
Balance as per passbook (Overdraft)		12,000
Cheques deposited but not collected by the bank	4,000	
Interest on bank overdraft	1,200	
Cheques issued but not presented for payment		8,000
Insurance Premium paid	1,050	
Wrongly debited by bank	400	
Balance as per Cash Book (overdraft)	13,350	
	20,000	20,000

Chapter Summary

In business two types of transaction frequently occurred viz cash transaction and credit transaction. Cash book records all the cash transaction and banking transactions. Purchase book, sales book, purchase return book, sales return book, bills receivable book, bills payable book, journal proper are the subsidiary books which recorded only credit transaction. Petty cash book prepared to record all petty type (small amount) expenses in cash. Bank reconciliation statement prepared to identify the causes for the difference, which exist between the cash book balance and bank pass book balance. All the information recorded in the form of statement on a particular date. There are number of reasons due to which cash book balance and pass book balance not matched. Bank reconciliation statement helps to locate errors and any type of mis-presentation of figures in the accounting books.

To Do Activity

1. From the following information prepare subsidiary books of Krishnan Chand and sons:

2018

1. Purchased goods from Sanjay ₹ 1,8000 less 10% trade discount and 5% VAT on goods.
2. Bought from Chetan goods ₹ 900 less 5% trade discount.
3. Sold to Kabir on credit goods worth ₹ 700 less 10% trade discount and 50 as carriage.
4. Sold goods to Vishesh₹ 9,000 after allowing 10% trade discount and charge 10% goods tax.
5. Booked order with Mohinder for goods ₹ 12,000 less 15% trade discount.
6. Returned to Sanjay goods of ₹ 5,000.

2. Pass all the entries in the Purchase Book of M/s Bansal Book Traders, of August 2019.

1. Purchase from Rama Traders, invoice no. 1008
   20 Registers @ 80 Rs each
   100 Gel pens @ 20 Rs each
   40 Notebooks @50 Rs each

   Trade discount @5% and other charges ₹ 100.
2. Bought from Vidhya Bharti traders, invoice no. 1198
   30 inkpads @ 10 Rs each
   20 file folder @ 50 Rs each
   70 Sheets @ 150 Rs each
   Trade discount @10%
3. Purchase furniture for Ram Traders, invoice no. 2064
   5 Chairs @ 500 Rs per chair
   10 Tables @1200 Rs per table
   Charges Rs 500, incurred at the time of purchase
4. Bought goods from the M/s, Kala Vidhya, invoice no. 2112
   18 Paper Rim @ 200 Rs each
   40 Packets paper pins @20 ₹ Per packet
   Trade discount 4%.
5. Purchase a computer for official purpose of ₹ 40,000 and Rs 1000 charged at the time of installation.

Pass the entries in the books of M/s Bansal Book Trade₹

3. Pass all the entries in the Sales Book of M/s Yogesh Electricals, of January 2020.

1. Sold goods to M electricals, New Delhi.
   100blubs @ 50 Rs each
   500 Gel Tube lights @ 200 Rs each
   600 LEDs@ 120 Rs each

   Trade discount @10% and other charges ₹400.

2. Goods sold to Rutu traders, Chandigarh
   650 switch boards @ 250 Rs each
   200 table lamps @ 500 Rs each
   10 ceiling fans @ 1500 Rs each
   Trade discount @20%

3. Purchase furniture for office use
   15 Chairs @ 500 Rs per chair
   5Tables @1200 Rs per table
   Trade discount @5%

4. Rajan from Dehradun, bought goods from us
   30electric bells @ 450 Rs each
   120tv remote @50₹ Per remote
   Trade discount 10%.

4. Enter the following transactions in cash book with cash, discount and bank columns.

2019 ₹

Jan 1 Cash in hand 16,000
1 Bank balance 6,000
3 Bought goods and paid by cheque 2,000
4 Goods sold for cash 1,000
5 Sold good for cash 600
6 Sale proceeds of Jan. 5 deposited in bank
9 Received from Mahesh 800 Discount allowed to him 20
12 Withdrew by cheque for personal use 1,000
14 Withdrew cash from business for his personal use 100
15 Paid bills payable 1,200
17 Paid to Sahil by cheque 800 He allowed discount 20
20 Received a cheque of ₹ 1,000 from Damodar in full settlement of his account of ₹ 1,050.
21 Cheque of Damodar endorsed to Bheema.
23 Received a cheque from Naman and sent it 600 To bank.
Discount allowed to him 12
25 In regarding with cash sales received cash ₹ 600 and cheque for ₹1,000
27 Received cheque from Pranjal which was deposited into the bank the same day 400

28 Deposited in bank 400

29 Received cheque from Harish and immediately sent it to bank 800
Discount allowed to him 20

30 Received cheque from Pramod 300 Discount allowed to him 20

30 Pramod's cheque endorsed to Kailash 300
He allowed discount 20

30 Bank notifies that Harish cheque has been dishonored

30 Sourav paid directly into our Bank account 1,000

30 Bank notifies that Naman's cheque has been dishonored and returned.

30 The bank has charged ₹ 100 as bank charges and bank allowed interest ₹600

5. Make a Bank Reconciliation Statement as per the favourable cash book:

Debit balance as per cash book ₹ 30,000

Cheques deposited but not cleared ₹ 2,000

Cheques issued but not presented ₹ 3,000

Bank Interest ₹ 400

6. From the following particulars prepare Bank Reconciliation Statement.

(i) Bank overdraft shown a balance as per the Cash Book. 8,000

(ii) A cheque deposited as per Bank Statement but not recorded in the Cash Book Rs 300

(iii) Debit side of the Bank Column short cast Rs 50

(iv) A cheque for ₹2,500 deposited but collection of that cheque as per the Bank Statement was only Rs 2,495

(v) One cheque returned dishonoured as per the Bank Statement Rs 250

(vi) Directly bills collected by the bank ₹1700

(vii) Bank charges recorded twice in the Cash Book ₹ 20

(viii) A bill for ₹4,000 discounted for ₹3,960 returned dishonoured by the bank, noting Charges being ₹10

(ix) Cheques deposited but not yet collected by the bank ₹ 1,250

(x) Cheques issued but not yet presented for payment ₹ 650.

Further Readings

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Chapter 4 Trial Balance

Introduction

Trial balance is a statement where accuracy of journal and ledger posting is evaluated. All the balances of ledger posted into trial balance in debit and credit side. Each transaction has a double effect i.e. every debit has a matching credit and vice versa, the sum total of the debit balances and credit balances derived from the ledger should be equal. Thus, as per the requirement of a business house trial balance prepared i.e.at the end of the accounting period for a year or at the end of every month basis.

Learning Objectives

- To explain the concept of Trial Balance
- To familiarize objectives of trial balance
- To orient on the methods of preparation of Trial Balance
- To familiarize Numericals
- To familiarize on types of Errors

Structure of the Chapter

4.1. Meaning of Trial Balance

4.2. Objectives of Trial Balance

4.3. Methods of Preparation of Trial Balance

4.4. Numericals

4.5. Types of Errors

4.1. Trial Balance: Meaning

As per dual aspect concept in accounts each entry that is posted on the debit side of an account must have entered on the credit side of other account. This is the basic principle of double entry system of accounting. As result, in this method all the debit side items should always equal to the total of credit side balances. In fact, all organisations calculate with in a time period their debit and credit balances separately in a type of statement to check whether the total of debit balances matches with the total of credit balances or not. Such type of a statement is called as Trial Balance in accounting. When trial balances match with debit side and credit side equally, it is a sign of relief for accountant that the work done correctly. Still there are chances of occurrence of error so it can't be said like this is a conclusive proof of accuracy.

For the arithmetical accuracy the two side must be tally. And if both sides not tally with each other the difference came out in the form of "*suspense*". In case of mismatching of both debit and credit side balances the difference, amount transferred in to suspense account, which rectified in future. After preparing trial balance suspense amount corrected by passing rectifying journal entries. It means the books of accounts are arithmetically accurate.

Trial balance is a statement in which all the derived balances of Ledger accounts are showed to check the arithmetical accuracy of the posted transactions. After a particular time period it is prepared i.e. – in the end of financial year, half year or quarter depends upon the size of a company or as their policies. Final account statement is prepared by the help of trial balance only. After preparing trial balance, the financial statements – Trading account, Profit &Loss Account and Balance Sheet are prepared to disclose the financial position of the business after a particular time period. The proforma of a trial balance is given under:

Date	Particulars	V.No	J.F.	Disc.	Cash	Bank	Date	Particulars	V.No	J.F.	Disc.	Cash	Bank

Figure 4.1: Proforma of Trial Balance

4.2. Objectives of Trial Balance

1. To check accuracy of all transaction: Trial balance is prepared on the basis of ledger account balances, so the accuracy of all accounts is checked. Whether all the transaction posted in corrected manner or some errors existed there.
2. Provide Base for financial statements: As per accounting cycle after trial balance final accounts will be prepared, so the trial balance is the statement on which final accounts based.
3. Summary of all accounts: Trial Balance is the statement which shows the final balances of all ledger accounts.
4. Locate the errors if any: The total of debit side always equal to credit side of trial balance. But if in any case the total is not equal, it indicates any errors or omission done in our ledger posting and journal entries.

4.3. Methods of Preparation of Trial Balance

A trial balance is prepared by the following three methods:

1. Balance Method
2. Total Method
3. Balance and Total Method or Combined Method

From the all three above methods the balance method is the most common and statutory methods adopt to prepare Trial Balance. In this method the balance of all the ledger accounts are recorded. If any account shows a debit balance in the ledger, this balance is recorded in the debit side of the trial balance and if it has a credit balance, it is written in the credit side of the trial balance. In case if any account has both side equal means, its total of debit side is equal to the total of credit side, it is not recorded in the Trial Balance. After recording the balances of all accounts of the Ledger, the amounts of both the sides are totalled to check the arithmetical accuracy of the ledger. If the total of debit side agrees with the total of credit side, it proves that books are at least arithmetically correct. Though, the trial balance is not the only proof of correctness of the books of Ledger.

Total Method: Total amount considered instead of using balance of each account in our ledger book, and the total of both the sides debit and credit of each account is taken. In Combined method i.e., balance as well as total method are used which explained earlier. This method is not preferred because its time taking process which need more efforts in comparison of balance method.

4.4. Numerical

Illustration 1:

Journalise the following transactions in the books of trade. Also make their Ledger Postings and prepare a Trial Balance.

Debit Balances as on April. 1, 2016: Cash in hand ₹ 16,000; Cash at Bank ₹ 50,000; Stock of goods ₹ 40,000; Furniture ₹ 4,000; Building ₹ 20,000; Sundry Debtors-Varun ₹ 4,000, Amit ₹ 2,000 and Madhav ₹ 4,000.

Credit Balances on April. 1, 2016: Sundry Creditors- Anil ₹ 10,000; Loan from Babu ₹ 20,000.

The following were further transactions in the month of April, 2016:

April. 1: Purchased goods worth ₹ 10,000 for cash less 20% trade discount and 5% cash discount.

April. 4: Received ₹ 3,960 from Varun and allowed him ₹ 40 as discount.

April: Purchased goods from Bharat ₹ 10,000.

April. 8: Purchased plant from Mukesh for ₹ 10,000 and paid ₹ 200 as cartage for bringing the plant to the factory and another ₹ 400 as installation charges.

April. 12: Sold goods to Rahim on credit ₹ 1200.

April. 15: Rahim became insolvent and could pay only 50 paise in a rupee.

April. 18: Sold goods to Ram for cash ₹ 2,000

April. 20: Paid salary to Ratan ₹ 4,000

April 21: Paid Anil ₹ 9,600 in full settlement.

April. 26: Interest received from Madhav ₹ 400

April. 28: Paid to Babu interest on Loan ₹ 1,000

April. 31: Sold goods for cash ₹ 1,000

April. 31: Withdraw goods from business for personal use ₹ 400

Solution:

Journal

Date	Particulars	L.F.	Debit	Credit
2016				
April 1	Cash A/c Dr.		16,000	
	Bank A/c Dr.		50,000	
	Stock A/c Dr.		40,000	
	Furniture A/c Dr.		4,000	
	Building A/c Dr.		20,000	
	Varun		4,000	
	Dr.		2,000	
	Amit Dr.		4,000	
	Madhav Dr.			10,000
	To Anand			20,000
	To Babu's Loan A/c			1,10,000
	To Capital A/c			
	(Being balances brought forward from last year)			
April 1	Purchase A/c Dr.		8,000	
	To Cash A/c			7,600
	To Discount A/c			4,00
	(Being purchase of goods on discount)			
April 4	Cash A/c Dr.		3,960	

	Discount A/c Dr To Varun (Being cash received from Varun, allowed discount ₹ 40)		40	 4,000
April 6	Purchase A/c Dr To Bharat (Being goods purchased)		10,000	 10,000
April 08	Plant A/c Dr. To Mukesh To Cash A/c (Being plant purchased and payment of charges of ₹ 300)		10,600	 10,000 600
April 12	Rahim Dr. To Sales A/c (Being sale of goods to Rahim)		1,200	 1,200
April 15	Cash A/c Dr. Bad Debts A/c Dr. To Rahim (Being cash received from Rahim 50 paise in a rupee).		600 600	 1,200
April 18	Cash A/c Dr To Sales A/c (Being cash sale)		2,000	 2,000
April 20	Salary A/c Dr. To Cash A/c (Being salary paid)		4,000	 4,000
April21	Anil Dr. To Cash A/c To Discount A/c (Being cash paid to Anand and discount received ₹ 400)		10,000	 9,600 400
April 26	Cash A/c Dr. To Interest (Being receipt of interest)		400	 400

April 28	Interest on Loan A/c Dr. To Cash A/c (Being payment of interest on loan)		1,000	1,000
April 31	Cash A/c Dr. To Sales A/c (Being cash sale)		1,000	1,000
April 31	Drawings A/c Dr. To Purchase A/c (Being goods withdrawn for personal use)		400	400
	Total		1,93,800	1,93,800

Ledger Posting:

Cash Account

Dr. Cr.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
April 1	To balance b/d		16,000	April 1	By Purchase		7,600
April 4	To Varun		3,960	April 8	By Plant a/c		600
April 15	To Rahim		600	April 20	By Salary a/c		4,000
April 18	To Sales		2,000	April 21	By Anil a/c		9,600
April 26	To Interest		400	April 28	By Interest on Loan		1,000
April 31	To Sales		1,000				1,000
				April 31	By Balance c/d		1,160
	Total		23,960		Total		23,960
May 1	To Balance b/d		1,160				

Interest A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 30 April	To balance c/d		400	2016 1 April	By Cash a/c		400

Bank A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	To balance c/d		50,000	2016 30 April	By balance c/d		50,000

Stock A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	To balance c/d		40,000	2016 30 April	By balance c/d		40,000

Furniture A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	To balance c/d		4,000	2016 30 April	By balance c/d		4,000

Building A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	To balance c/d		20,000	2016 30 April	By balance c/d		20,000

Varun A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	To balance c/d		4,000	2016 04 April	By cash a/c By Discount a/c		3,96040

Amit A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	 To balance b/d		 2,000	2016 30 April	 By balance c/d		 2,000

Madhav A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	 To balance b/d		 4,000	2016 30 April	 By balance c/d		 4,000

Anil A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 21 April	 To Cash a/c To Discount a/c		 9,600 400	2016 01 April	 By balance b/d		 10,000

Capital A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April	 To balance c/d		 1,10,000	2016 30 April	 By balance b/d		 1,10,000

Babu's Loan a/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 30 April	 To balance c/d		 20,000	2016 01 April	 By balance b/d		 20,000

Purchase a/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016 01 April 01 April 06 April	 To Cash a/c To Discount a/c To Bharat		 7,600 400 10,000	2016 30 April 30 April	 By Drawings a/c By balance c/d		 400 17,600

Discount A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
04 April	To Varun a/c		40	01 April	By Purchase a/c		400
30 April	To balance c/d		760	21 April	By Anil		400

Bharat A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
30 April	To balance c/d		10,000	06 April	By purchase a/c		10,000

Plant A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
08 April	To Mukesh		10,000	30 April	By balance c/d		10,600
08 April	To Cash		600				

Interest on Loan A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
28 April	To Cash a/c		1,000	30 April	By balance c/d		1,000

Mukesh A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
30 April	To balance c/d		10,000	08 April	By Plant a/c		10,000

Sales A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
30 April	To balance c/d		4,200	21 April	By Rahim		1,200
				18 April	By Cash a/c		2,000
				31 April	By Cash a/c		1,000

Rahim A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
12 April	To Sales a/c		1,200	15 April	By Cash a/c		600
				15 April	By Bad debts a/c		600

Bad Debts A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
15 April	To Rahim a/c		600	30 April	By balance b/d		600

Salary A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
20 April	To Cash a/c		4,000	30 April	By balance c/d		4,000

Drawing A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
2016				2016			
30 April	To Purchase a/c		400	30 April	By balance c/d		400

TRIAL BALANCE
(AS ON 30th April, 2016)

Ledger Accounts	L.F.	Debit	Credit
Cash Account		1,160	
Interest Account			400
Bank Account		50,000	
Stock Account		40,000	
Furniture Account		4,000	
Building Account		20,000	
Amit		2,000	
Madhav		4,000	
Capital Account			1,10,000
Babu's Loan Account			20,000
Purchases Account		17,600	
Discount Account			760
Bharat			10,000
Plant Account		10,600	
Interest on Loan Account		1,000	
Mukesh			10,000
Sales Account			4,200
Bad Debts Account		600	
Salary Account		4,000	
Drawings Account		400	
Total		1,55,360	1,55,360

Illustration 2

From the following transaction, prepare Trial balance:

Particulars	Amount (₹)
Building	1,20,000
Machinery	34,000
Return Outwards	5,200
Bad debts	5,600
Cash	800
Discount Received	6,000
Bank Overdraft	20,000
Creditors	1,00,000
Purchases	2,00,000
Capital	1,47,200
Fixtures	11,200
Sales	2,08,000
Debtors	1,20,000
Interest Received	5,200

Solution:

Trial Balance
(as on 31st December, 2018)

Ledger Accounts	L.F.	Debit	Credit
Building		1,20,000	
Machinery		34,000	
Return Outwards			5,200
Bad debts		5,600	
Cash		800	
Discount Received			6,000
Bank Overdraft			20,000
Creditors			1,00,000
Purchases		2,00,000	
Capital			1,47,200
Fixtures		11,200	
Sales			2,08,000
Debtors		1,20,000	
Interest Received			5,200
Total		4,91,600	4,91,600

How to prepare Trial Balance with the help of balances

Trial balance prepared on the basis of ledger account balances. But sometime ledger accounts balance not given in the question and only balances of assets and liabilities given. With the help of those balance trial balance prepared by following rules:

1. The balances of all assets (current and fixed) recorded in the debit side of the statement.
2. The balances of all liabilities (current and non-current) recorded in the credit side of the statement.
3. Drawing account balance recorded in the debit side of statement.
4. Capital of the business recorded in the credit side of the statement.
5. All the expenses and losses of the business recorded in the debit side.
6. All the balances of all incomes and gains of the business recorded in the credit side of Trial balance.
7. The balances of purchase recorded in the debit side and purchase return recorded in the credit side of the statement.
8. The balances of sales recorded in the credit side and sales return recorded in the debit side of the statement.

Illustrative Trial Balance			
Account Title	L.F	Debit Amount	Credit Amount
• Capital			3
• Land and Machinary		3	
• Plant and Machinary		3	
• Equipments		3	
• Furniture & Fixtures		3	
• Cash in hand		3	
• Cash at Bank		3	
• Debtors		3	
• Bills Receivable		3	
• Stock of Raw Materials		3	
• Work-in-progress		3	
• Stock of finished Good		3	
• Prepaid Insurance		3	
• Purchases		3	
• Cassiage inward		3	
• Carriage outward		3	
• Sales			3
• Sales Return		3	
• Purchase Return			3
• Interest paid		3	
• Commission/Discont Recieved			3
• Salaries		3	
• Long tum loan			3
• Bills payable			3
• Creditors			3
• Outstanding Salaries			3
• Outstanding Interest earned		3	
• Advance from customers			3
• Deawings		3	
• Reserve Fund			3
• Prof. for doubtful debts			3
Total		xx x	xx x

Figure 4.2: Illustrative Trial Balance

Source: NCERT Book, Financial Accountancy

4.5. Types of Errors

When both sides of trial balance do not match, it means that some error occurred. When the difference of debit side and credit side not equal a suspense account temporarily opened to transfer the difference balance. It is neither a real account nor a nominal account. So, the accountant works to wipe out suspense account as early as possible.

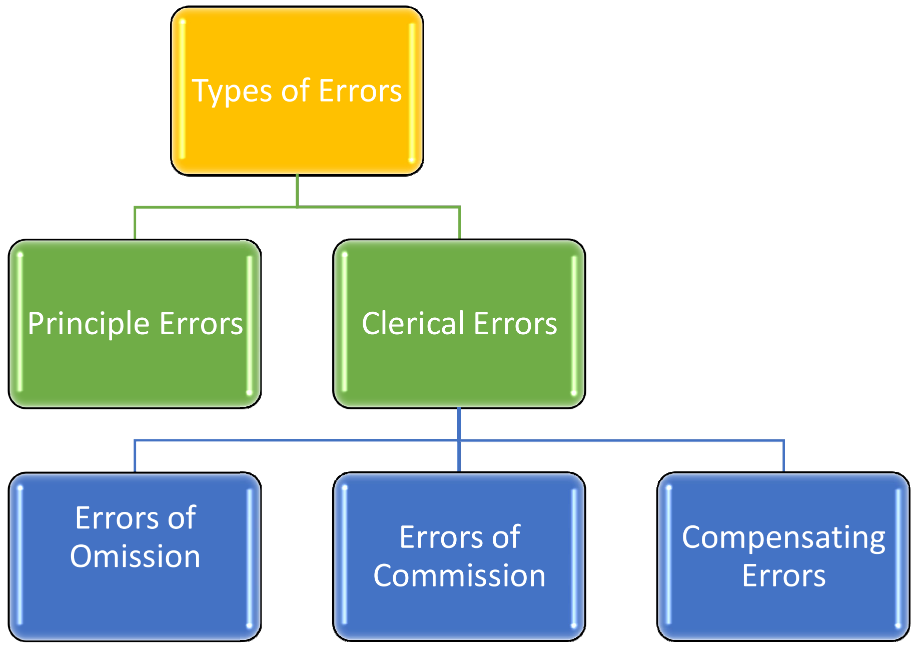

Figure 4.3: Types of Error in Accounting

Source: Pandikumar, 2007

Error in accounting can be divided into two parts:

1. Principle Error: Double entry system has its rules and principles. When the transaction recorded not according to follow the basic principles of accounting, are termed as principle error.
2. Clerical Errors: Following are the types of clerical errors
   a) Errors of Omission: When a transaction is omitted in the books of account partially or fully which is supposed to be documented in the books of accounts, are termed as Error of Omission. For example, credit purchase of goods from to Meera of ₹1,50,000 not recorded in the purchase book.
   b) Errors of Commission: While posting transactions error of commission occurred. Like, when the transaction recorded, totaling of both sides, balancing amount of accounts if any error committed termed as errors of commission. For example.: Posting of a right amount but in the wrong account for example, Ravi& co. paid ₹25,000 to Amit Trade₹ The transaction is recorded with correct amount but instead of Amit Traders, it posted into Kalpana & Co. account.
   c) Compensating Error: When one error compensates the other error, such type of errors is called as compensating errors. For Example: if wages account is overcast by ₹5000 and

salaries account is undercast by ₹5000; both the errors will compensate each other and there will be no effect on the agreement of the Trial Balance.

Chapter Summary

After ledger, trial balance is the next step in the accounting cycle. Trial balance is the statement prepared on the basis of accounts seemed in ledger. Trial balance is prepared to check the accuracy of the accounts. On the basis of trial balance, final accounts being prepared. Trial balance prepared on the balances of debit side and credit side of the ledger accounts. The main purpose of trial balance is to check at a glance all the balances of ledger accounts. Trial balance is also useful in identifying the errors too. Few errors occur, while recording entries in journal and ledger accounts. Different types of errors exist in the accounting procedures and these errors tend to create an imbalance in the trial balance. Sometimes it is easy to find out those errors but sometime it is difficult to locate them, at that time the difference amount transferred into suspense account.

To Do Activity

Q.1 From the following transactions, pass journal entries, prepare ledger accounts and also Q.1 1. 1.Prepare Trial Balance under:

1.Anil started business with 8,000

2. Purchased furniture 1,000

3. Purchased goods 6,000

4. Sold goods 7,000

5. Purchased from Raja 4,000

6. Sold to Somu 5,000

7. Paid to Raja 2,500

8. Received from Somu 3,000

9. Paid rent 200

10. Received commission 100

Q.2. Prepare Trial Balance as on 31.03.2018 from the following balances of Ms. Ritu and Firm:

Drawings ₹ 74,800	Purchases ₹ 295,700	Stock (1.04.2011) ₹ 30,000
Bills receivable ₹ 52,500	Capital ₹ 250,000	Furniture ₹ 33,000
Discount allowed ₹ 950	Sales ₹ 335,350	Rent ₹ 72,500
Freight ₹ 3,500	Printing charges ₹ 1,500	Sundry creditors 75,000
Insurance ₹ 2,700	Sundry expenses ₹ 21,000	Discount received ₹ 1,000
Bank loan ₹ 120,000	Stock (31.03.2012) ₹ 17,000	Income tax ₹ 9,500

Machinery ₹ 215,400 Bills payable ₹ 31,700

3 Prepare Journal, Ledger and Trial Balance from the following information. On 1st January, 2020, the following were the ledger balances of Rahul & Co.:

Cash in hand ₹ 1,800; Cash at bank ₹ 42,000; Sameer (Cr.) ₹ 6,000; Zoya (Dr.) ₹ 4,800; Stock ₹ 4,000; Param (Cr.) ₹ 12,000.

Transactions during the month were:

2020 ₹

Jan. 2 Purchased goods from Param 5,400

Jan.22 Paid cash for printing and stationery 100

Jan.3 Goods sold to Prasad 6,000

Jan.29 Paid to Param by cheque 5,300

Jan.5 Bought goods from Lalit for cash and payment made by cheque 7,200

Jan.7 Goods taken for personal use 400

Jan. 30 Charged interest on capital 200

Jan.13 Fully received from Zoya ₹ 4,700

Jan. 30 Rent due to landlord 400

Jan.17 Paid to Sameer in full settlement 5,840

4. Prepare a Trial Balance from the following balances as at 31st March 2019: -

Stock on 1-4-2018 28,800

Returns Inwards 7,500

Purchases 82,000

Returns Outwards 5,600

Sales 1,60,000

Carriage Inwards 1,640

Wages 16,160

Carriage Outwards 3,200

Salaries 6,400

Furniture 12,000

Repair Charges 500

Motor Car 80,000

Commission Received 800

Cash in Hand 4,700

Sundry Debtors 24,200

Bank Overdraft 25,400

Sundry Creditors 7,300

Investments 20,000

Capital 90,000

Interest on Investments 2,400

Drawings 4,400

Further Readings:

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Chapter 5 Final Accounts

Introduction

Accounting has rightly been termed as the language of the business. It records, classifies, analyses and communicates all the business transactions that have taken place during a particular period. It is a system of recording and reporting business transactions in financial terms, to interested parties. According to American Institute of Certified Public Accounts "Accounting is the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results there of." Thus, accounting is the art of recording, classifying, summarizing, analysing and interpreting the financial transactions and communicating the results thereof to the interested person.

Final accounts or Financial Statements are the end products of the financial accounting process which involves the preparation of a summary of the accounts with a view to determine:

1. Net Profit from the trading activities in terms of profit made or loss incurred for a given period
2. Its financial position in terms of assets and liabilities as on the last date of the given period.

Final accounts are prepared from the balance appearing in the trail balance. Debit balances of assets are transferred on the right-hand side of the balance sheet while expenses and losses are debited to the Trading account or to the Profit and Loss Account, depending upon the nature of expenditure or loss. Credit account balances like capital, liabilities, provisions, resource are entered on the left-hand side of the balance sheet while incomes and gains are credited to the Trading account or Profit and Loss account.

Objectives

- To orient on final accounts
- To enable preparation of final account
- To familiarize treatment of adjustments in final accounts
- To familiarize the meaning of non-profit organization
- To orient on preparation of accounts for non-profit organization

Chapter Structure

5.1. Introduction of Final Accounts

To know the financial position of a sole proprietorship, a financial statement is prepared on the basis of trial balance is termed as final accounts. In order to know profit and loss at the end of financial year some accounting records is made, that records are termed as Final Accounts. Final accounts include:

1. Trading Account
2. Profit and Loss Account
3. Balance Sheet

5.2. Preparation of Final Accounts

Trading Account

Trading account is prepared to know the gross profit or gross loss of a business, so it is the first step in the process of preparing the final accounts during an accounting year. Before preparing profit and loss account, trading account has to be prepared. It always based on trading activities of business-like purchases, sales of goods and services, direct expenses relate to business and balances of stock then calculate gross profit or gross loss.

Gross Profit = Net Sales – Cost of Goods Sold

Gross Loss = Cost of Goods Sold – Net Sales

Net Sales = Total Sales- Credit Sales

Cost of Goods Sold = Opening stock of goods + net purchases - closing stock of goods at the end + All direct expenses

Net Purchases = Total Purchases- Purchases Return

Format of Trading Account:

TRADING ACCOUNT (Horizontal Format)
for the year ended.....

Dr. Particulars	Rs.	Particulars	Cr. Rs.
To Opening Stock	xxx	By Sales xxx	
To Purchases xxx		*Less*: Returns inwards (xxx)	xxx
Less: Returns		By Closing Stock	xxx
outwards **(xxx)**	xxx	By Gross Loss c/d*	xxx
To Frieght & Carriage	xxx		
To Customs & Insurance	xxx		
To Wages	xxx		
To Gas, Water & **Fuel**	xxx		
To Factory Expenses	xxx		
To Royalty on Production	xxx		
To Cargo Expenses	xxx		
To Shipping Expenses	xxx		
To Import Duty	xxx		
To Custom Duty			
To Dock Charges			
To Octroi			
To Commission on Purchases			
To Gross Profit c/d*			
	xxx		xxx

* Either of two will appear

Figure 5.1: Format of Trading Account

Source: Jain and Narang, 2014

Illustration 1:

Opening stock	1,20,000
Purchases	3,20,000
Carriage inward	6,800
Carriage outward	10,000
Wages	64,000
Sales return	3,800
Purchase return	4,000
Sales	9,60,000

*Closing stock was valued 1,80,000.

Solution:

Trading Account

(For the year ended 31st March 2018)

To Opening Stock		1,20,000	By Sales	9,60,000	
To Purchase	3,20,000		Less Returns		9,56,200
Less Return	4000	3,16,000	3,800		1,80,000
To Carriage inward		6,800	By Closing Stock		
To Wages		64,000			
To Gross Profit transferred to P&L account		6,29,400			
		11,36,200			11,36,200

Profit and Loss Account

Profit and loss account are prepared to know the net profit and net loss on the basis of trading account balance i.e. gross profit or gross loss. When the total of debit side is more than credit side it called as net loss and if the total of credit side is more than debit side it called as net profit. In profit and loss account all the incomes and gains are recorded on credit side and all the losses and expenses recorded on debit side.

Difference between Trading and Profit and Loss account

Trading Account	**Profit and Loss Account**
Gross profit and gross loss extracted from trading account	Net profit and net loss derived from profit and loss account.
In trading account items shown like purchases, sales, stock and all direct expenses.	In profit and loss account all indirect expenses and all incomes recorded.
The balance of the trading account transferred to profit and loss account	The balances of profit and loss account is adjusted to capital in the balance sheet.

Net profit and net loss are calculated by the help following formula:

Net Profit = Total Incomes and gains – Total expenses and losses

Net Loss = Total expenses and losses - = Total Incomes and gains

From the help of above equation net profit and net loss can be easily calculated in the following prescribed format of profit and loss account and trading account:

Particulars	Amount (Rs)	Particulars	Amount (Rs)
To opening stock	....	By sales .... less: returns	....
To purchases .... less: returns	....	By closing stock	....
To carriage inward	....		
To wages	....		
To gross profit c/d (in case of gross profit)	....	By gross loss c/d (in case of gross loss)	....
	....		**........**
To gross loss b/d (in case of gross loss)	....	By gross profit b/d (in case of gross profit)	....
To salaries	....	By interest earned	....
To carriage outward	....	By dividend earned	....
To rates and taxes	....	By rent earned	....
To insurance	....	By discount received	....
To depreciation	....	By profit on sale of fixed assets	....
To bad debts	....	By profit on sale of investments	....
To advertising	....		
To interest paid	....		
To travelling expenses	....		
To discount allowed	....		
To loss on sale of fixed assets	....		
To loss on sale of investments	....		
To loss by fire	....		
To net profit transferred to B/S (in case of net profit)	....	By net loss transferred to B/S (in case of net loss)	....
	....		**........**

Figure 5.2: Format for Profit and Loss Account

Source: Jain and Narang, 2014

Preparation of Balance Sheet

Business financial position is represented by financial statements. Balance Sheet is a financial statement which is prepare after profit and loss account on a prescribed date or at the end of a financial year. A balance sheet is prepared for all assets and liabilities.

According to Francis R. Stead," *A Balance Sheet is a Screen picture of the financial position of a going business at a certain moment".*

Assets = Liabilities + Capital

The total of both sides must be tally in the balance sheet. If the total is mismatched it means that there was some error in previous process. All the real accounts and personal accounts items recorded here. Right hand side termed as Assets side and left-hand side termed as Liabilities side. Following are the format of Balance Sheet:

Figure:3 Format of Balance Sheet

Balance Sheet of (firm's name) as on (closing date)

Liabilities	Amount	Assets	Amount
Current Liabilities:		**Current Assets:**	
Bills Payables		Cash in hand	
Sundry Creditors		Cash at bank	
Bank Overdraft		Sundry debtors	
Outstanding Expenses		Bills Receivables	
Income received in advance		Prepaid Expenses	
Long-term Liabilities:		Accrued Income	
Mortgage Loans		Closing Stock	
Debentures		**Investments:**	
Owner's Equity:		Government Securities	
Reserves and Surplus		Other investments	
Capital		**Fixed Assets:**	
Add Net Profit		Furniture	
Interest on Capital		Plant and Machinery	
Less Drawings		Land and Buildings	
Income tax		Patents	
		Goodwill	

Figure 5.3: Format of Balance Sheet

Source: Jain and Narang, 2014

5.3. Treatment of Adjustments

Generally, trial balance is main source or base statement to prepare final accounts. But, sometimes balances in the trial balance do not show the right 'amount' after measured in relative to accounting period. Like, receipt on account of incomes, say, interest, may be less or more than the actual receipt that should have been made during the particular accounting period. Like the same condition may arise in respect of some expense items also, say rent and wages.

This requires adjustment entries which are utilized to set up right estimations of record balances towards the finishing of a book keeping period. In this manner, adjustment entries are those entries which are passed toward the finish of each bookkeeping period to adjust different ostensible and different records with the goal that genuine net profit or loss is demonstrated in profit and loss account and the balance sheet speaks to a genuine and reasonable perspective on the budgetary state of an undertaking.

Transaction which occurs after preparing trial balance effects two or three (in particular some cases) places and transaction which recorded in trial balance effects to one time in any of three accounts. Each adjustment entry has a dual effect on final account.

Following are the common adjustment entries which are considered while preparing final accounts.

Closing Stock

Closing stock is stock of goods which is unsold at the end of the accounting year, it occurs as an adjustment.

Adjustment Entry:

Closing Stock a/c Dr ....

To Trading a/c ....

Effect on Final Account

- It should be coming to credit side of Trading a/c
- And it will be shown on Assets side of Balance Sheet.

Outstanding Expenses

Outstanding expenses are those expenses which are not paid but the benefits have been derived during the accounting year.

Adjustment Entry:

Expenses a/c Dr ....

To Outstanding Expenses a/c ....

Effect on Final Account

- It will be added to their respective expenses shown in Trading account or Profit and loss account.
- These expenses amount shown in liabilities side of Balance sheet.

For example: Wages ₹5,000 and Outstanding amounted ₹ 1,000

Adjustment Entry:

Wages a/c Dr 1,000

To Outstanding Wages, a/c 1,000

Accounting Treatment:

Trading Account

To Wages 5,000 Add: outstanding 1,000	6,000		

Balance Sheet

as on 31st March 2018

Liabilities	₹	Assets	₹
Outstanding Wages	1,000		

Prepaid Expenses or Unexpired Expenses

Amount of expenses which is paid in advance are termed as prepaid expenses. Its amount paid extends to the next year so it is also called as un-expired expenses.

Adjustment Entry:

Prepaid Expenses a/c Dr

To Expenses a/c

Effect on Final Accounts

- It will be deducted from their respective expenses shown in Profit and Loss account.
- These expenses amount shown in assets side of Balance sheet.

Accrued Income or Earned Income

Accrued income is the income which is earned by the business but not received in the accounting year. It is a due income, which not so far received by the firm.

Adjustment Entry:

Accrued Commission a/c Dr.

To Commission a/c

Effect on Final Accounts

- It will show in the credit side of profit and loss account.
- These expenses amount shown in assets side of Balance sheet.

Unearned Income or Income received in advance

When an income received in advance at the end of the accounting year and the services yet not be given are termed as Unearned Income. The income is received but the services relates for the next year are the unearned income.

Adjustment Entry:

Income a/c   Dr

To Unearned Income a/c

Effect on Final Account:

- Unearned income will be deducted from concerned income in the credit side of Profit and loss account.
- It will also be shown in the Liability side of Balance Sheet.

Interest on Capital

Interest on capital is treated as the business expenses, which is charged on capital. Interest on capital calculated with the specific percentage for a given year.

Adjustment Entry:

Interest on Capital a/c   Dr.

To Capital a/c

Effect on Final Account:

- Interest on capital charges as an expense so it will be recorded in debit side of Profit and Loss a/c
- It will be added in the capital in Balance sheet

Interest on Drawings

Interest on drawings is treated as the business income which charged on drawings.

Adjustment Entry:

Drawings a/c Dr.

To interest on drawing a/c

Effect on Final Account:

- It shown in the credit side of Profit and Loss account.
- Amount of interest added in the drawings and total drawings deducted from capital in Balance Sheet.

Deferred Revenue Expenditure

When any heavy expenditure incurred on some income head and its paybacks will be received in the upcoming years, then the complete amount is not written in the profit and loss account of the expenses, for the same accounting year instead of some portion of such expenses recorded in the profit and loss account are known as deferred revenue expenditure. For example, advertisement expenditure, Preliminary expenses etc.

Adjustment Entry:

Expenditure a/c Dr.

To Cash a/c

Bad and Doubtful Debts, Provision and Discount

Bad Debts

When a debtor fails to pay us, or those debts which are not recovered are called as bad and doubtful debts.

Adjustment Entry:

Bad debts a/c Dr.

To Debtor's a/c

If the amount of bad debts given in the trial balance then it will not be treated as an adjustment, it will be recorded in the debit side of profit and loss account, but if the amount of bad debts given outside of trial balance its termed as "further Bad Debts" and it's an adjustment and following are the treatment:

Effect on Final Account:

- Further bad debts amount added in the bad debts in debit side of profit and loss account.
- It will be deducted from the debtors in the balance sheet.

Provision for Bad and Doubtful Debts

Provision for bad and doubtful debts is an estimation of the expected amount of debts that will need to be written off during the next financial year. A provision is created on debtors that are considered as doubtful.

Adjustment Entry:

Provision for Bad and Doubtful Debts a/c Dr

To Bad debts a/c

Effect on Final Account:

- It will be recorded in the debit side of Profit and Loss account
- It will be deducted from debtors in the Balance Sheet.

For Example:

If debts of 2016-17, prove to be bad in 2017-18 the loss is to be treated as one for 2016-17. But on 31st March, 2017 when final accounts are be prepared, it will not be possible to know accurately, which debts will prove bad in 2017-18. Hence, only an estimate is made on the base of previous practice. If it is expected that 8% of the debts may prove bad and on 31st March, 2017 Debtors amount to 1,000,000, then 8,000 will be provided for future bad debts.

Recovery of Bad debts

When an amount declared as bad debts in the past year books and is recovered or received later on in any future years, it is the concept of bad debts recovered.

Adjustment Entry:

Cash a/c Dr

To Bad Debts Recovered a/c

Provision on Discount on Debtors

If a debtor makes the payment on the due date some discount is allowed to encourage them for cash payment. For the purpose of that discount one provision is made on debtors are termed as Provision on Discount on Debtors. The process to make a provision is same like provision on doubtful debts made.

Debtors	....
Less: Further bad debt (If Any)	....
Less: Provision on bad and doubtful debts	....

After deducting above items from debtors, now a provision on discount on debtors is made on the final amount of debtors.

Adjustment Entry:

Profit and Loss a/c Dr

To Provision on Discount on Debtors a/c

Effect on Final Account:

- It will be recorded in the debit side of Profit and loss account
- It will be deducted from debtors.

Provision on discount on Creditors

In our business can like to make a reserve for our creditors i.e. discount on its creditors in which discount received entered in the books and a provision is also created for the expected receipts.

Adjustment Entry:

Provision on Discount on Creditors Dr.

To Profit and Loss a/c

Effect on Final Account:

- It will be shown on the credit side of Profit and loss account.
- It will be deducted from the creditors in the balance sheet.

Note: As per the conservatism principle of accounting, the provision for discount on creditors is frequently not created in practical.

Depreciation

Depreciation is the amount which reduces from the value of any fixed assets, fixed assets (except land) are used in business for increasing the productivity and because of continuous usage, wear and tear and passage of time, the value of fixed assets decreases. That reduction is known as depreciation, which is charged on fixed assets at a specific percentage. There are so many methods to calculate amount of depreciation, but usually fixed instalment method and written down value methods used.

If Delivery Van purchased for ₹ 50,000 on 1 January 2017, charged depreciation @ 10% p.a. by fixed installment method. Books closes on 31st December every year.

Calculation of Depreciation:

Depreciation = 50,000 * 10/100 = 5,000 ₹

Entry will be:

Depreciation a/c	Dr	5,000	
To Delivery Van a/c			5,000

Depreciation ₹5,000 posted in profit and loss account as To depreciation a/c and 50,000 - 5,000= 45,000 posted in delivery van account in Balance Sheet.

<u>Adjustment Entry</u>:

Depreciation a/c Dr.

To Assets a/c

Effect on Final Account:

- It will be shown on the debit side of Profit and Loss account
- It will be deducted from concerned assets in the Balance Sheet

Loss of Stock by Fire

In business sometimes goods are damaged or destroyed by fire, stolen or due to some natural causes. If the goods are not insured then the whole amount of loss is bear by the business but if the goods insured partial loss is bear and cash received from insurance company:

<u>Adjustment Entry</u>:

1. When goods are not insured:

Profit and Loss a/c Dr

To Trading a/c

The whole amount of loss is borne by the business.

2. When goods are fully insured:

Insurance Company a/c Dr

To Trading a/c

3. When goods are not fully insured and partial amount is received from insurance company:

Profit and Loss a/c Dr

Insurance Company a/c Dr

To Trading a/c

Effect on Final Account:

- Total Loss deducted from the purchase in the Trading account.
- Loss of goods/stock recorded in the Profit and Loss account.
- Insurance claim amount shown in the Balance Sheet.

Goods Distributed as Samples and Charity

Several times goods are distributed as a free sample or given in charity or donation. It can be taken as an advertisement by the business firm

Adjustment Entry:

Advertisement a/c Dr.

To Purchases a/c

OR

Charity/ Donation a/c Dr

To Purchases a/c

Effect on Final Account:

- It will be deducted from the purchases in Trading account or it can be shown in the credit side of Trading account.
- It will also show in the debit side of Profit and Loss account.

Goods Taken out for Personal Use

When some goods are taken out by the owner for his/her personal purpose are treated as the drawing of goods.

Adjustment Entry:

Drawing a/c Dr

To Purchases a/c

Effect on Final Account:

- It will be deducted from the purchases in Trading account

- It will also added in the drawings.

Interest on Loan

Interest is charged on loan amount with specific percentage and that is an expenses for a business.

Adjustment Entry:

Interest on Loan a/c Dr.

To Loan a/c

Effect on Final Account:

- Interest on loan credit in the profit and loss account.
- It will be added in the loan in liabilities side of Balance Sheet.

Manager's Commission

Some times in the business firm manager charged commission for his work on the net profit with the specific percentage. There are two option for charging commission:

1. If the manager charged commission on the net profit before charging such commission, then the calculation is like:

$$\frac{\text{Net Profit before Charging such Commission} \times \text{Percentage of Commission}}{100}$$

2. If the manager charged commission on the net profit after charging such commission, then the calculation is like:

$$\frac{\text{Net Profit before Charging such Commission} \times \text{Percentage of Commission}}{100 + \text{Percentage of Commission}}$$

Adjustment Entry:

Profit and Loss a/c Dr

To Manager's Commission a/c

Effect on Final Account:

- It will be recorded in the debit side of profit and loss account.
- It will be shown on the Liabilities side of Balance Sheet.

Goods Sale on Approval Basis

Sometimes goods are sold to consumers on approval basis. If goods are not approved during the accounting year it will not be treated as sales.

Adjustment Entry:

On Sales Price:

Sales a/c Dr.

To debtors a/c

On Cost Price:

Stock a/c Dr

To Trading a/c

Effect on Final Account:

- It will be deducted from sales in trading account on sales price and added in the closing stock on cost price.
- It will be deducted from debtors on sales price and added in the closing stock on the cost price in the assets side of balance sheet.

Illustration 2:

Prepare a trading and P & L A/c for the year ending 31.03.2018 and a balance sheet as on that date from the following trial balance:

Particulars	**Dr. ₹**	**Cr ₹**
Opening Stock	32,000	
Capital		90,000
Salaries	26,000	
Drawing	8,000	
Carriage inwards	1,000	
Carriage outwards	2,000	
Sales Return/Purchase return	2,000	1,400
Loan to Mr.R	22,000	
Loan from Mr. Q		14,000
Outstanding Wages		400
Rent	2,600	
Purchases/Sales	80,000	1,46,200
Debtors/ Creditors	50,000	16,000
Bad Debts	1,600	
Provision for Bad and Doubtful Debts		2,400
Discount Received /Allowed	1,200	600
Furniture	23,400	
Cash	1,400	
Bank	16,000	
Wages	1,000	
Insurance Premium	24,00	
Rent by Sub-letting		1,600
Total	2,72,600	2,72,600

Adjustments:

1. Closing Stock ₹ 21,000 but the market value of closing stock was ₹ 19,000.
2. Insurance premium prepaid ₹ 400.
3. Loan to Mr. X, given at 20% interest p.a. and loan taken from Mr. Y carries 18% interest p.a.
4. Depreciation is to be provided at 10% on furniture.
5. Goods worth ₹ 1,000 have been taken by the proprietor for private use.
6. Bad and doubtful debts are to be provided at 20%.

Solution:

Trading and Profit and Loss Account

For the year ended 31st March 2018

Particular		Amount	Particular		Amount
To Opening Stock		32,000	By Sales:		
To Purchase:	80,000			1,46,200	1,44,200
Less Return:	1,400	78,600	Less Return		1,000
To Carriage Inward		1,000		2,000	19,000
To Wages		1,000	By Proprietor		
To Gross Profit b/d		51,600	By Closing Stock		
Total		1,63,200	Total		1,63,200
To Salary		26,000	By Gross Profit c/d		51,600
To Carriage Outward		2,000	(From Trading A/c)		
To Rent		2,600	By Discount Received		600
To Bad Debts	1,600		By Rent by Sub-letting		1,600
Add Further Bad Debts	5,000		By Interest Receivable		2,200
Less: Old Provision	2400	4,200			
To Discount Allowed		1,200			
To Insurance Premium:	2,400				
Less prepaid	400	2,000			
To Interest Payable to Mr. Y		1,260			
To Depreciation A/c		1,170			
To Net Profit		15,570			
Total		56,000	Total		56,000

Balance Sheet as on March 31, 2018

Liabilities	Amount	Assets	Amount
Capital 90,000		Furniture 23,400	
Less Drawings 8,000		Less Depreciation 1,170	22,230
Less Goods taken by 1,000			
owner		Loan to Mr. X	
Add Profit during year 15,570	96,570	22,000	24,200
		Add Outstanding interest	
Loan from Mr. Y 14,000		2200	45,000
Add Interest 1,260	15,260	Debtors	400
		50,000	16,000
Rent Outstanding	400	Less Provision for Bad Debts	1,400
Creditors	16,000	5,000	19,000
		Prepaid Insurance	
	1,28,230	Cash	1,28,230
		Bank	
		Closing Stock	

5.4. Concepts of Non-Profit Organizations

All the business organization are engaged in the buying and selling of goods and services in terms of money, with the objective to earn more and more profit. Apart of this some institutes are established not to earn profit but to provide their services to common public are termed as Non-Profit Organizations. For example, charitable institutes, schools, Sports club, hospitals etc.

Such type of organization provides services to their members and common public and also engaged in financial transactions and the sources of income like donation, fees, subscription and grants and meet expenses of an organization. For recording of all financial transaction some accounts are maintained. To find out some results statements and account are prepared for the particular time period. These statements and accounts maintained with the objective of statutory requirement and also to control and manage the funds of an organization.

Characteristics of Non-for-Profit-Organization

Following are the characteristics or essential features of Non-For-Profit Organizations:

1. Such organization is not to earn profit but provide services to the society.
2. In NPOs source of income generated by donation, subscription and charities.
3. One managing committee manage all the organization functions, committee elected by the members themselves.
4. Likewise, business organization, non-profit organization also maintained their accounts and statements on the same accounting principles.

5.5. Accounting for Non-Profit Organizations

Following are the financial statements that are usually prepared by the Non-Profit organizations:

1. Receipt and Payment Account
2. Income and Expenditure Account
3. Balance Sheet

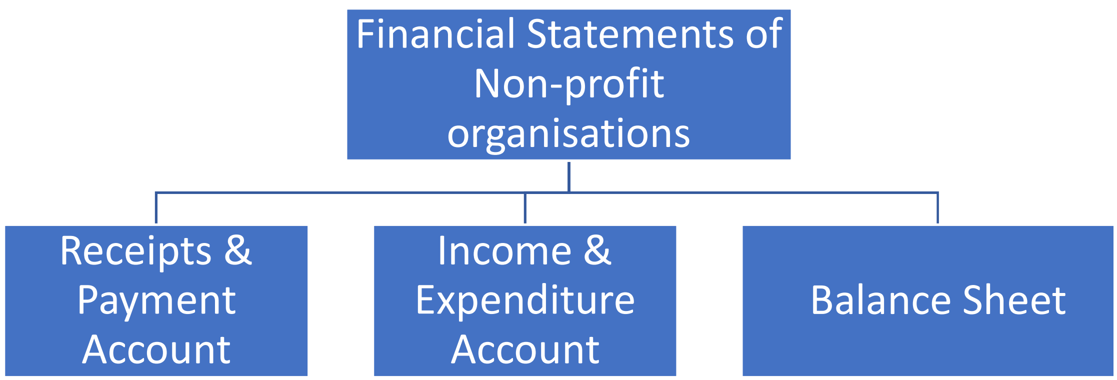

Figure5.4:Types of Financial Statement in Non- Profit Organizations

Receipt and Payment Account

In Non-Profit-Organization receipt and payment account maintained where all cash receipts and cash payments recorded and it is prepared at the end of the year. It is based on same accounting principles as follows in the cash book so the debit side is the receipt side and credit side is the payment side. It is starts with opening balance of cash and bank and closes with the closing balance of cash and bank; bank overdraft is also treated as same in the cash book.

Specimen of Receipts and Payment Account:

Format

Receipts	Amount	Payments	Amount
To Bal b/d Cash xxxx		By Bal b/d (Bank O/D)	xxx
Bank xxxx	xxx	By Revenue Payments	
To Revenue Receipts		Wages & Salaries	xxx
Subscription	xxx	Rent, Rates & Taxes	xxx
General Donations	xxx	Insurance	xxx
Sale of newspaper	xxx	Printing & Stationary	xxx
Sale of periodicals	xxx	Postage	xxx
Sale of old sports material	xxx	Advertising	xxx
Locker rent	xxx	Sundry Expenses	xxx
Sale of scraps	xxx	Telephone charges	xxx
Proceeds of show	xxx	Audit fees	xxx
Miscellaneous Receipts	xxx	Honorarium	xxx
Entrance fee	xxx	Conveyance	xxx
Grant in aid	xxx	Newspapers	xxx
To Capital Receipts		Repairs	xxx
Legacies	xxx	By Capital Payments	xxx
Life Membership fees	xxx	Purchase of fixed Assets	xxx
Specific Donation	xxx	Purchase of investments	xxx
Sale of Investment	xxx	Fixed deposits	xxx
Sale of fixed assets	xxx	By Bal Bank xxx	
Endowment Fund	xxx	Cash xxx	xxxx
To Bal c/d (Bank O/D)	xxx		

Figure 5.5: Receipts and Payments Account for the year ended on...

Illustration 3

On the basis of above discussion prepare Receipt and Payment account for the following information:

Cash in hand 1500, Purchase of Books 8000, Cash at Bank 16000, Purchase of Sports Material 18000, Subscription 15000, Purchase of Bicycle 4500, Entrance Fees 1800, Sale of Investment 22000, Donation 20000, Life Membership Fees 3500, Salaries 14000, Rent paid 11000, Stationery 200, Purchase of Development Bonds 10000, Insurance Premium 1000, Lockers Rent 5000, Sale of old Furniture 1400, Interest on Securities 2500.

Solution:

Receipts & Payments A/c

for the year ending 31st Dec. 2018

Receipt	Amount	Payment	Amount
Balance b/d		Salaries	14,000
Cash in Hand	1,500	Stationary	200
Cash at Bank	16,000	Insurance premium	1,000
Entrances Fees	1,800	Purchase of Books	8,000
Donation	20,000	Purchase of sports	18,000
Sale of Old Furniture	1,400	material	4,500
Interest on Securities	2,500	Purchase of bicycle	11,000
Lockers Rent	5,000	Rent Paid	10,000
Sale of Investment	22,000	Purchase of	
Subscription	15,000	development- --	
Life membership Fees	3,500	bonds	
		Balance c/d	
		Cash	
		Bank	
Total		Total	

Income and Expenditure Account

Income and Expenditure account is just like a Profit and Loss account where all the income and expenditure recorded on accrual basis. In profit and loss account net profit and net loss calculate but here net profit termed as surplus and net loss termed as deficit for the particular one accounting period. All the incomes and expenses related to current year only recorded. This account is prepared on the basis of Receipt and Payment account. Depreciation, Profit and Loss on sale of fixed assets and Provisions are also considered while preparing Income and Expenditure account. Following is the example of income and expenditure account with some items:

Income and Expenditure Account

For the year ended 31st march 2018

Expenditure	Amount	Incomes	Amount
Lighting		Subscriptions	
Telephone Charges		Donation	
Rent		Life membership fees	
Insurance Premium		Interest on Investment	
Postage and Courier		Locker Rent	
Printing and Stationary		(if any)	
Interest Received			
Depreciation			
Surplus (if any)			

Balance Sheet

As like business houses, Non-for-Profit Organizations made their Balance Sheet for determining the financial position of the organization. The way to prepare their Balance Sheet is almost similar like the business accounting follows. It appears all the assets and liabilities as at the closing of the year. Though, instead of capital here capital fund exists and the amount of surplus and deficit derive from Income and Expenditure Account which is one or the other added to/deducted from the capital fund. It is too a normal exercise in which some of the capitalized items like legacies, entrance fees and life membership fees directly added in the capital fund.

In addition, Capital or General Fund, some other specific funds generated for particular purposes like match fund, Prize fund building fund, sports fund, etc. Such types of funds are recorded individually in the liabilities side of the balance sheet.

In some cases, opening balance sheet also prepare to calculate the opening balance of the capital fund.

BALANCE SHEET

as at ....

Liabilities		₹	Assets		₹
Capital Fund:			**Fixed Assets:**		
Opening Balance	xxx		Opening Balance	xxx	
Add: Surplus	xxx		*Add:* Additions	xxx	
(or less Deficit)	(xxx)			xxx	
	xxx				
Add: Life Membership Fees	xxx		*Less:* Book value of		
	xxx				
Add: Entrance Fees	xxx		assets sold		
	xxx		during the year	xxx	
Add: Legacies	xxx	xxx		xxx	
Specific Fund/ Donations:			*Less:* Depreciation	xxx	xxx
Opening Balance	xxx				
Add: Receipts during			**Investments:**		
the year	xxx		Specific Fund Investments		
	xxx		(like Building Fund Invest-		
Add: Income earned			ments, Prize Funds		
on fund investments	xxx		Investments etc)		

Figure 5.6: Format of Balance Sheet for Non-Profit Organizations,

Source: Goyal, 2007

Specific items of Non-Profit Organization

1. Subscription

It is a consistent fee paid by the members to the organization. Usually the amount of subscription received yearly and it is the main source of revenue for such organization. In the Receipts and Payments Account it comes on the debit side. Amount of subscription is written for current year as well previous year and for next year also.

Subscription for the current year	....
Less: Outstanding for the beginning of the year	....
Less: Advances for the ending of the year	....
Add: Outstanding for the ending of the year	....
Add: Advances for the beginning of the year	....
Income from the subscription for the Current Year	

2. Admission Fees

Every time when a new one is wanted to take membership in the organization, one definite amount is charged from him/her and then give permission to be a part of an organization, this is termed as the admission fee or it also calls entrance fees. In the Receipts and Payments Account it is recorded as an income to the debit side.

3. Life Membership Fees

When a person wants membership for a lifetime some special fees charged from him/her is called as Life Membership Fees. The fees are charged once in a life of a member. It is a capital nature of receipt.

4. Endowment Fund

An endowment fund is an investment fund recognized by a foundation that creates regular taking out from the invested capital. The capital in endowment funds, frequently used by universities, non-profit organizations and hospitals, is mostly applied for specific necessities or to further a company's operating process. Endowment funds are typically funded entirely by donations that are deductible for the contributors.

5. Donation

When a person, a firm and a company give some amount by his own will to the Organization as a gift are called as Donation. It is the receipt item; it can be two types:

- Specific Donation
- General Donation

6. Legacy

Legacy means when deceased person donate his property by will to the organization. It is capital nature receipt.

7. Honorarium

This is another entry of compensation. This is an amount paid to persons who are not the personnel of the organization but takings part in the management of the organization. Payment paid to them is termed as honorarium. For example, payment made to the secretary of the club as honorarium. This is the revenue nature payment.

Illustration 3:

Record the following information in financial statements of a Non-Profit Organization

Match Expenses	20,000
Match Fund	10,000
Sale of Match tickets	8,000
Donation for Match Fund	5,000

Solution:

Balance Sheet

As on 31st March 20…..

Liabilities	Amount	Assets	Amount
Match Fund 10,000 Add: Donation 5,000 Add: Sale of tickets 8,000 23,000 Less: Match Expenses 20,000	4,000		
	4,000		

Illustration 4:

Prepare Income and Expenditure Account and Balance Sheet for the year ended March 31, 2018 from the following information.

Receipt and Payment Account

for the year ending March 31, 2018

Receipts	Amount	Payments	Amount
Balance b/d	82,000	Salaries and Wages	
Subscriptions		2016-17 9,600	
2016-17 14,400		2017-18	1,76,000
2017-18 6,75,200		1,66,400	74,000
2018-19 24,000	7,13,600	Sundry Expenses	1,20,000
Entrance fees	32,000	Freehold Land	32,000
Locker Rent	1,16,000	Stationary	48,000
Revenue from	96,000	Rates	75,000
Refreshment	1,12,000	Refreshment Expenses	8,000
Income from Investments		Telephone Charges	5,00,000
		Investments	12,000
		Audit fee	1,06,600
		Balance c/d	

The following additional information is provided to you:

1. There are 1800 members each paying an annual subscription of ₹ 400, ₹ 16,000 were in arrears for 2016-17 as on April 1, 2017.
2. On March 31, 2018 the rates were prepaid to June 2018; the charge paid every year being ₹ 48,000.
3. There was an outstanding telephone bill for ₹ 2,800 on March 31, 2018.
4. Outstanding sundry expenses as on March 31, 2017 totalled₹ 5,600.
5. Stock of stationery as on March 31, 2017 was ₹ 4000; on March 31, 2018, it was ₹ 7,200.
6. On March 31, 2017 Building stood at ₹ 8,00,000 and it was subject to depreciation @ 2.5% p. a.
7. Investment on March 31, 2017 stood at ₹ 16,00,000.
8. On March 31, 2018, income accrued on investments purchased during the year amounted to ₹ 3,000.

Solution:

Income and Expenditure Account

For the year ended 31st March 2018

Expenditure		Amount	Income	Amount
Salaries and Wages		1,66,400	Subscriptions	7.20,000
Sundry Expenses			Entrance fees	32,000
74,000		68,400	Locker rent	1,16,000
Less: Outstanding			Income from refreshment:	
5,600			Revenue from	
Stationery :(consumed)			96,000	
Opening stock	4,000	28,800	Refreshment	21,000
Add: Purchases	32,000		*Less:* Refreshment Exp.	
Less: Closing stock	7,200		75,000	
Rates	48,000	48,000	Income from	1,15,000
Less: Paid for 2015-16	12,000		1,12,000	
Add: Prepaid in 2014-15	12,000		Investment	
		10,800	*Add:* Accrued income	
Telephone charges	8,000		3,000	
Add: Outstanding	2,800	12,000		
		20,000		
Audit fee		6,49,600		

Depreciation on building Surplus (excess of Income over expenditure)	 1,004,000		 1,004,000

Balance Sheet as on March 31st, 2018

Liabilities	Amount	Assets	Amount
Outstanding Telephone	2,800	Cash and Bank Balance	1,06,600
Expenses		Subscription in Arrears	46,400
Subscription received in advance	24,000	Stock of Stationery	7,200
Advance		Rates Prepaid	12,000
General Fund 2,498,800		Accrued interest on investment	
Add: Surplus 6,49,600		Investments 16,00,000	3,000
	3,148,400	Additions 5,00,000	21,00,000
		Building 8,00,000	
		Less: Depreciation 20,000	7,80,000
		Land	1,20,000
	3,175,200		3,175,200

Balance Sheet

as on March 31st, 2017

Liabilities	Amount	Assets	Amount
Outstanding Sundry Expenses	5,600	Cash and Bank balance	82,000
Outstanding Salary and Wages	9,600	Subscription in arrears	16,000
General Fund	2,498,800	Stock of stationery	4,000
(Balancing figure)		Rates prepaid	12,000
		Investments	16,00,000
		Building	8,00,000
	2,514,000		2,514,000

Chapter Summary

Financial Statements are considered as systematic summaries of complete accounting information about the financial position and effective performance of business and firms. Financial statements are also termed as final accounts which include Trading account, Profit & loss account and Balance sheet. Trading and Profit & Loss account prepared to calculate gross profit and net profit of the business for a particular time period. Trading and Profit & Loss account generally showed the financial position of firm on the basis of profit earned. All the direct, indirect incomes and expenses recorded in the prescribed format only. Balance sheet is the statement which showed the financial position on the basis of assets and liabilities of the firms. Balance sheet is very crucial statement for the analysis purpose also. While preparing final accounts of the firm some adjustments are also keep in mind. Adjustments helps to ascertain true and fair position of the financial statements on the last date of the particular accounting period. Non-profit organisations are those who operates with the objective of social upliftment and render services free of cost. Their prime objective is not to earn profit but provide services in the society. These organisations prepare Receipt and Payment account and Income and Expenditure account in place of Trading and Profit and Loss account. Some special items also treated here only like life membership fees, donation, subscription, entrance fees.

To Do Activity

1. Trial balance shows Bad Debts ₹ 400; provision for Bad Debts and doubtful debts ₹ 1,800; Debtors ₹ 16,000. Make a Provision on Debtors at 5% for Bad and Doubtful debts.

2. Prepare a Trading Account of a businessman for the year ending 31st December, 2019 from the following data:

Stock on 1.1.2019	1,20,000
Cash purchases for the year	1,04,000
Credit purchases for the year	2, 00,000
Cash sales for the year	1,75,000
Credit sales for the year	3,00,000
Purchases returns during the year	4,000
Sales returns during the year	5,000

Direct expenses incurred:

Freight 5,000

Carriage 1,000

Import Duty 4,000

Clearing Charges 6,000

Cost of goods distributed as free samples during the year 2,500

Goods withdrawn by the trader for personal use 1,000

Stock damaged by fire during the year 6,500

The cost of unsold stock on 31st December, 2019 was ₹60,000 but its market value was ₹75,000.

3.From the following trial balance and additional information, prepare a trading and profit and loss account for the year ended 31 March 2007 and a balance sheet as at the same date.

Trial balance

as at 31 March 2017:

	Dr (Rs)	Cr (Rs)
Tax payable		45,000
Net sales		465,000
Net purchases	160,000	
Stock	15,000	
Salaries & wages	90,000	
Rent & rates	70,000	
Water & electricity	10,500	
Trade creditors		59,800
Trade debtors	160,500	
Insurance	25,500	
Cash in hand	10,000	
Cash at bank	67,000	
Plant & machinery	210,000	
Furniture & fittings	48,800	
Capital		350,000
Drawings	75,000	
Fixed deposits with bank	150,000	
Bank loan		65,000
Provision for depreciation – plant & machinery		15,000
Provision for depreciation – furniture & fittings		5,000
	1,024,800	1,024,800

Additional information:

(a) Closing stock amounted to Rs 35,000.

(b) Provision for depreciation is to be made for the current year:

- Plant & machinery @ 10% on book value.
- Furniture & fittings @ 8% on book value

(c) Accrued expenses: Wages 4,000.

Water & electricity 1500.

(d) Prepaid expenses: Rent & rates 7,000

Insurance 12,500.

(e) Accrued income: Accrued interest up to and including 31 March 2017: 6,500.

(f) Provide for doubtful debts: 4% of total debtors

Required:

Prepare a trading and profit and loss account for the year ended 31 March 2017 and a balance sheet as at that date.

4. A manager of a company entitled to the commission of 10% on Net Profit after charging such commission. Net profit before charging such commission is ₹ 1,10,000. Find out the amount of commission of a manager.

5. Write down the meaning offollowing terms and also explain with examples, that how to deal with them while preparing final accounts for non-profit organisations:

a) Life membership fees
b) Donations
c) Entrance fees
d) Any receipts of funds

6.There were 600 members in a club. Each member pays ₹100 as the annual subscription. Rs 600 were as arrears as at 31st March 2018. Subscription received during 2019 were ₹ 25,000 including Rs 600, for 2018 and ₹ 900 for 2020. Calculate the amount of subscription in arrears as at 31st March, 2019 with the help of subscription account.

7. The books of Raj Traders show the following balances as on 31st March 2019. You are required to prepare a trading and profit and loss account and balance sheet.

Stock on 1st April 2018 67,000

Sales5,24,600

Bills payable1,500

Purchases 4,88,000

Salaries and wages 9,800

Rent 1,100

Travelling expenses 2,600

Sundry creditors 57,000

Postage and telegrams 620

General charges 2,250

Printing and stationery 350

Capital account 75,000

Interest and commission 2,200

Lighting charges175

Repairs 35

Sundry receipts 175

Furniture 3,000

Bills receivable 4,000

Bad debts 475

Sundry debtors 85,000

Raj Traders's current account 17,000

Cash with bank 6,500

Cash in hand 2,170

Adjustments:

- Depreciate furniture by 6 % p.a.
- Outstanding salaries and rent were rs.1,100 and rs.100 respectively.
- Stock at 31st March 2019 was valued at rs.70,350.

7.The following is the Receipts and Payments Account items of Yogi's Football Club for the first year ending 31 December 2018:

Debit balances

Donation 1,00,000; Reserve Fund (Life membership fees entrance fees received) 8,000; Receipts from football matches 16,000.

Revenue Receipts

Subscriptions 10,400; Locker Rents 100; Interest on Securities 480; Sundries 700.

Credit balances

Pavilion offices (constructed) 40,000; and Expenses in connection with matches 1800; Furniture 4,200; Investment at cost 32,000;

Revenue Payments

Salaries 3,600; Wages 1200; Interest on Securities 480; Insurance 700; Telephone 500; Electricity 220; Sundry expenses 420; Balance on hand 11,040.

Additional Information

(i) Subscriptions outstanding for 2018 are Rs. 500

(ii) Salaries unpaid for 20018 are Rs. 340

(iii) Wages unpaid for 2018 are 180.

(iv) Outstanding Bill for sundry expenses is Rs. 80

v) Donations received have to be capitalised.

Prepare from the details given above, an Income and Expenditure Account for the year ended 31.12.2018 and the Balance Sheet on the Association as on 31.12.2018

8.The Income and Expenditure Account items of National Sports Club of the year 2019 is as follows:

Expenditure		**Income**	
ToSalaries	19,000	BySubscription 30,000	
To General Expenses	2,000	By Entrance Fee	1000
To Audit Fee	1000	By Contribution to Annual Dinner	4,000
To Secretaries Honorarium	3,000	By Surplus of Annual sports meet	2,000
To Printing & Stationary	1800		
To Annual Dinner expenses	6,000		
To Bank charges	600		
To Depreciation	1200		
To Excess of Income over Expenditure 2400			

This Account had been prepared after the following adjustments:

- Subscription outstanding at the end of 2018 Rs. 2,400
- Subscription received in advance on 31.12.18 Rs. 1800
- Subscription outstanding on 31.12.19 Rs. 3,000
- Subscription received in advance on 31.12.19 Rs. 1080
- Salaries outstanding at the beginning of 2019 and at the end of 2019 were Rs. 1600 and Rs. 1800 respectively.
- General expenses include Insurance prepaid to the extent of Rs. 240.
- Audit fee for 2019 is as yet unpaid.
- During 2019 Audit fee for 2018 was paid amounting to Rs. 8,000. This was outstanding throughout 2019.
- On 31.12.19, Cash in hand was Rs. 6400.

Prepare the Receipts and Payments Account for the year 2019 and Balance Sheet as on 31.12.19.

Further Readings:

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Narang, K. L., & Jain, S. P. (2016). *Practical problems in Advanced Accountancy.* Ludhiana: Kalyani Publishers

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Editors' Profile

Dr W G Prasanna Kumar

Dr. W G Prasanna Kumar, Chairman, Mahatma Gandhi National Council of Rural Education (MGNCRE), holds Ph.D in Education with basic degree in Social Work and Master's Degree in Sociology, Public Administration and Political Science. He also has professional education in Environmental Economics, Public Relations, Communication, and Training and Development. Under his leadership MGNCRE has done instrumental work in building rural resilience including rural community engagement and NaiTalim - Experiential Learning.

The several areas of functional work envisaged and implemented successfully by Dr. W G Prasanna Kumar include Curriculum Development Programmes, Course Material Preparation, Faculty Development Programmes, Workshops, Roundtables, Rural Immersion Training Programmes, Swachhta Action Plan Activities, Community Engagement Programmes, Rural Management Programmes, NaiTalim Programmes, WASH Volunteerism Programmes in collaboration with UNICEF and UBA Activities.

The national initiative of reviving Mahatma Gandhi's ideas of NaiTalim, spearheaded by Dr. W G Prasanna Kumar, has met unprecedented success at both national and state levels. The primary objective of this initiative is to promote Gandhiji's ideas on Experiential Learning, NaiTalim, Work Education and Community Engagement, and mainstreaming them in School Education and Teacher Education Curriculum & Pedagogy. The pilot developmental project is a product of intensive workshop based interactions and consultations with Departments of Education in Universities in India, National Council of Educational Research and Training (NCERT), and State Council of Educational Research and Training (SCERTs) across all Indian States/UTs. He considers this initiative as a great tribute to Mahatma Gandhi.

Dr. W G Prasanna Kumar has been instrumental in developing MGNCRE's state-of-the-art e-Learning Centre with infrastructure for conferencing and training facilities which include training programs, skill building sessions and workshops with facility for video linking the entire country and sharing online educational resources for rural community engagement and development. The compilation, development and nationwide release of Swachh Campus and Jal Shakti Manuals are his major contributions to Higher Educational Institutions. These Manuals have been directed by the Ministry to be put into usage by Higher Education Institutions including Universities, Colleges and Polytechnics in developing strategies, action plans and implementation plans for water conservation on the campuses and in the villages with which the campuses are engaged with in National Service Scheme (NSS), Swachhta Action Plan (SAP) and Unnat Bharat Abhiyan (UBA).

As Professor and Head, Centre for Climate Education and Disaster Management in Dr. MCRHRD Institute, he conducts several capacity building and action research programmes in climate education, disaster management and crowd management. He has handled many regional, national and international environmental education programmes and events including UN CoP11 and Convention on Biological Diversity and Media Information Management on Environmental Issues.

As Director in National Green Corps in the State Government for over 11 years and Senior Social Scientist in State Pollution Control Board for 6 years Dr. W G Prasanna Kumar conducted various curriculum and non-curriculum related training programmes in environmental education. He was awarded Best State Nodal Officer of National Green Corps by Centre for Science and Environment, New Delhi in 2008. He was recipient of Jal Mithra Award from Earthwatch Institute of India and Water Aid New Delhi, 2014 and Certificate of Commendation for the services in UN Conference of Parties and Convention for Biodiversity conducted at Hyderabad in 2012. He was a Resource Person for AP Judicial Academy, AP Police Academy, AP Forest Academy, EPTRI, Commissonerate of Higher Education and Intermediate Education, State Council for Educational Research and Training and National Council for Educational Research and Training New Delhi, CCRT, BharathiyaVidyapeet University Pune, CPR Environmental Education Centre Chennai and Centre for Environment Education Ahmedabad.

Dr W G Prasanna Kumar underwent training in Community Consultation for Developmental Projects in EPA Victoria Australia in 1997; as State Chief Information Officer by IIM Ahmedabad and Dr. MCRHRDI Government of Andhra Pradesh in 2004; and in Environmental Education and Waste Management Techniques at JICA, Japan in 2011.

Dr K N Rekha

Dr K N Rekha, is a PhD Graduate from IIT Madras. She has 14 years of experience in training and education Industry. She works at Mahatma Gandhi National Council of Rural Education (MGNCRE), Hyderabad as Senior Faculty. She is involved in curriculum development on Rural Management and Waste Management. Prior to this, she worked as a researcher at Indian School of Business, Hyderabad, a short stint at Centre for Organisation Development (COD), Hyderabad. She has co-authored a book on “Introduction to Mentoring”, written book chapters, peer reviewed research papers, book reviews, Case studies, and caselets in the area of HR/OB. She also presented papers in various national and international conferences. Her research areas include Mentoring, Leadership, Change Management, and Coaching. She was also invited as a guest speaker at prominent institutions like IIT Hyderabad.

Authors' Profile

Dr Prerna Baber

Dr. Prerana Baber is presently associated with School of Studies in Management, Jiwaji University, Gwalior as Guest Lecturer. She completed her MBA in international business from IPS Academy in year 2009affiliated to D.A.V.V, Indore. She was awarded her Ph.D.in management from Jiwaji University in year 2016. She has a rich blend of experience of more than eight in corporate and academics. She has authored more than 10 research articles and has presented papers in various national and international conferences. She has published number of research articles in national and international journals indexed in Scopus and other data bases. She has a keen interest in marketing, organisational behaviour and accounting.

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