GOVERNMENT OF TAMILNADU

ACCOUNTANCY

VOLUME - II

HIGHER SECONDARY FIRST YEAR

Untouchability is Inhuman and a Crime

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Dear Students!

This Accountancy textbook is the source of knowledge to provide you with the basic understanding of Accountancy and to make use of your analytical ability to make you an excellent person in applying the accounting principles to real business situations through various activities given in the textbook.

The book contains 14 units, within which the subdivisions and various student activities are given in an organised way to make learning easy, systematic and a pleasure.

The method of using this book effectively to learn the concepts and methods contained in it and explanation of the important items included in the text book are given below to have a better learning experience.

HOW TO USE THE BOOK

UNITS

Units are the broad divisions of the book which contain several subdivisions in each of them so that the students can have understanding of the specific substance in various parts of Accountancy education. Each unit gives the specialised knowledge on the content discussed. The units are to be learnt in the order given in the book to have continuity of learning and proper understanding of the subject matter.

SUBDIVISIONS

All the 14 units in the textbook have been divided into subdivisions that give the basic theory and practice of Accountancy today in an orderly manner.

Learning objectives give the level of knowledge to be attained by the students while learning the contents given in the unit.

POINTS TO RECALL

These help in proper understanding of the unit contents by providing a base for learning by recalling what is learnt earlier.

KEY TERMS

The key terms are the important concepts that the students are to be thorough within each unit. The students must be clear about these concepts to have clarity of thought and an able learning about the subject matter.

This section of the unit gives the various information about the present or past events or useful practices in the field of Accountancy relevant to the subject matter discussed in the specific unit.

This is an exercise given to the students to do as class work or home work or as field work on the chosen topic in each unit. Accountancy education requires practical exposure to various business environment around the world. Student activity will ensure practical application of the principles learnt in the real business situations and help to develop the analytical and entrepreneurial ability of the students.

This is an online support to enrich learning. Using a smart phone with applied QR code app, the students can have access to short lectures or demonstrations by experts or experienced teachers. This is to be a leisure time exercise or else teachers can display them in class rooms.

RECALL

It provides a summary of important subject matter discussed in the unit.

SELF-EXAMINATION QUESTIONS

This section contains theoretical questions and practical problems to be answered by the students. Multiple choice questions help in thorough understanding of the concepts and procedures.

CASE STUDY

Case study helps in application of accounting principles and practices learnt in real business environment by analysing a particular situation. It enables the students to reach higher levels of knowledge, namely, applying, analysing, evaluating and creating new models.

TO EXPLORE FURTHER

This section enables the students to make a further analysis of the concepts and methods learnt through browsing or learning from the reference books. This again is to enrich learning and to help the students to pursue higher education or professional courses.

GLOSSARY

This section helps in understanding the important terminologies used in the text book through comparison of corresponding Tamil terms.

We wish you a meaningful and successful learning.

Team of Authors.

SCOPE OF ACCOUNTANCY EDUCATION

"Accountancy" as a field of knowledge is all pervasive in nature. It offers enormous opportunities for higher education and employment both in India and abroad. The scope after higher secondary programme in Accountancy is given below:

EDUCATIONAL OPPORTUNITIES

Any of the following Degree Programmes can be pursued by the students both on regular mode and distance education mode	Any of the following professional courses/ programmes	Any of the following programmes in India or abroad after a formal degree programme anywhere in colleges, Universities	Any of the following professional courses/ programmes after a formal degree programme	Any of the research programme after a formal post graduation
• B.Com–Bachelor of Commerce (General) • B.Com–(Hons.) • B.Com–(Accounting & Finance) • B.Com–(Corporate Secretaryship) • B.Com–(Computer Applications) • B.Com–(International Business) • B.Com–(Bank Management) • B.B.A–(Bachelor of Business Administration) • B.B.M–(Bachelor of Bank Management) • B.Com–(Co-operation) • M.Com–(Master of Commerce–Five year Integrated programme)	• CA–Chartered Accountancy • CMA–Cost and Management Accountancy • CS–Company Secretaryship • BL–Bachelor of Law – Five year Integrated Programme • CIMA (Chartered Institute of Management Accountants • ACCA (Association of Chartered Certified Accountants (UK)) • CPA (Certified Public Accountant (USA)) • CFP–Certified Financial Planner(USA)	• M.Com– Master of Commerce • M.Com– (Accounting and Finance) • M.Com–(Corporate Secretaryship) • M.Com– (Computer Applications) • M.Com– (International Business and Banking) • M.Com– (Co operative Management) • M.B.A–Master of Business Administration • M.B.A–(Finance) • M.B.A–(Marketing) • M.B.A–(Human Resource Management) • M.B.A–(Advertisement and Salesmanship) • M.B.A–(Hospital Management) • MHRM (Master of Human Resource Management) • MLM (Master of Labour Management)	• Indian Administrative Service (IAS) • Indian Police Service (IPS) • Indian Foreign Service (IFS) • Indian Revenue Service (IRS) • Indian Audit and Account Service (IA&AS) • B.Ed., (Bachelor of Education) and followed by • M.Ed., (Master of Education) Programmes • PG Diploma programme	• M.Phil– Master of Philosophy • Ph.D– Doctor of Philosophy

EMPLOYMENT OPPORTUNITIES

Accounts assistant	Accountant
Audit assistant	Cost analyst
Investment consultant	Financial advisor
Tax practitioner	Chartered Accountant
Company Secretary	Cost and Management Accountant
Teaching	State and Central Government jobs

Details of some of the professional courses in India

Professional course	Name of the institute	Southern India Regional Office address	Chapters in Tamil Nadu
Chartered Accountancy	The Institute of Chartered Accountants of India www.icai.org	ICAI Bhawan, 122, Mahatma Gandhi Road Post box No.3314 Nungambakkam, Chennai - 600034	Coimbatore Erode Madurai Salem Tiruchirapalli Tirunelveli Tirupur Tuticorin Kanchipuram Kumbakonam Sivakasi
Company Secretaryship	The Institute of company secretaries of India www.icsi.edu	9,Wheat Crofts Road, Nungambakkam, Chennai-600034	Coimbatore Madurai Salem
Cost and Management Accountancy	The Institute of Cost Accountants of India www.icma.in	Southern India Regional Council, CMA Bhawan 4,Montieth Lane, Egmore Chennai - 600008	Coimbatore Erode Madurai Mettur-Salem Nellai-Pearl Neyveli Ranipet-Vellore Tiruchirapalli

SCOPE ABROAD

Accountancy students have a wide range of scope abroad.

1. Higher studies
2. Employment opportunities as
   - Teachers
   - Accountants
   - Auditors
   - Financial consultants
   - Export and Import consultants
   - Tax advisors
   - Project consultants.

Unit 9

RECTIFICATION OF ERRORS

Contents

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Points to recall

The following points are to be recalled before learning rectification of errors:

- The golden rules of accounting used in journalising
- Journalising of transactions
- Posting of entries from journal to ledger
- Preparation of cash book
- Preparation of other subsidiary books
- Procedure for posting from subsidiary books to ledger
- Procedure for balancing of ledger accounts
- Various accounts that normally show debit and credit balances
- Preparation of trial balance

Learning Objectives

To enable the students to

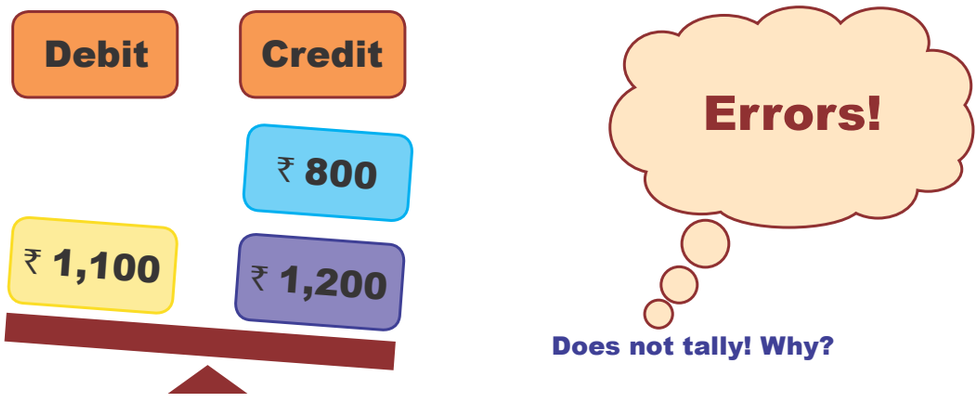
- Understand the meaning and types of errors
- Analyse the steps involved in locating the errors
- Analyse the errors and rectify the errors at different stages

Key terms to know

- Errors of commission
- Errors of omission
- Errors of principle
- Compensating errors
- Suspense account
- Rectification

9.1 Introduction

The very purpose of maintaining accounting records is to know the profit made or the loss incurred by a business entity and its financial position at the end of every accounting year. Accuracy is assured only when there are no errors in the books of accounts. To ensure accuracy, errors are identified and rectified. Many business enterprises have shifted from manual accounting to computerised accounting. Yet, errors in accounting are unavoidable. Hence, errors are to be located and rectified to find out the real profit or loss and financial position i.e., assets and liabilities at different periods, usually at the end of each financial year.



9.2 Meaning of errors

Error means recording or classifying or summarising the accounting transactions wrongly or omissions to record them by a clerk or an accountant unintentionally.

9.3 Errors at different stages of accounting

In the accounting process, errors may occur in any of the following stages:

A) At the stage of journalising

At this stage, the following types of errors may occur:

(i) Error of omission

(ii) Error of commission

(iii) Error of principle

B) At the stage of posting

At this stage, the following types of errors may occur:

(i) Errors of omission

(a) Error of complete omission

(b) Error of partial omission

(ii) Error of commission

(a) Posting to wrong account

(b) Posting of wrong amount

(c) Posting to the wrong side

C) At the stage of balancing

At this stage, the following types of errors may occur:

(i) Wrong totalling of accounts

(ii) Wrong balancing of accounts

D) At the stage of preparing trial balance

At this stage, following types of errors may occur:

(i) Error of omission

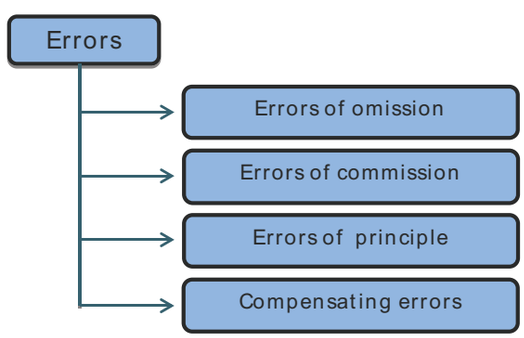
(ii) Error of commission

(a) Entering to wrong account

(b) Entering wrong amount

(c) Entering to the wrong side of trial balance, etc.

9.4 Classification of errors



The errors can be classified into four types as follows:

9.4.1 Error of omission

The failure of the accountant to record a transaction or an item in the books of accounts is known as an error of omission. It can be complete omission or partial omission.

(i) Error of complete omission

It means the failure to record a transaction in the journal or subsidiary book or failure to post both the aspects in ledger. This error affects two or more accounts.

Examples

a	Purchase of a machine from Aadhavan & Co. on credit is not recorded in the journal.
b	Sale of goods to Arivuchelvan on credit not recorded in the sales book.
c	Goods taken by the proprietor from the business for his personal use recorded in the journal but not posted in the ledger.

(ii) Error of partial omission

When the accountant has failed to record a part of the transaction, it is known as error of partial omission. This error usually occurs in posting. This error affects only one account.

Examples

a	Cash received from Ponnarasan recorded in the cash book but not posted to Ponnarasan's account in the ledger.
b	Goods sold to Cheran on credit recorded in the sales book but not posted to Cheran's account in the ledger.
c	Purchase of furniture from Thendral & Co. on credit recorded in the journal and posted to furniture account but not posted to Thendral & Co. account.

Student activity

Think: Is there any way to avoid the error of partial omission?

9.4.2 Error of commission

When a transaction is incorrectly recorded, it is known as error of commission. It usually occurs due to lack of concentration or carelessness of the accountant.

The following are the possibilities of error of commission:

(i) Entering a wrong amount in a correct subsidiary book

Examples

a	Goods sold to Kumanan on credit for ₹ 234 entered in the sales book as ₹ 243.
b	Goods of the value of ₹ 125 returned by Manimaran entered in the sales returns book as ₹ 152.

(ii) Entering a correct amount in a wrong subsidiary book

Examples

a	Goods sold to Athiyamaan on credit for ₹ 500 entered in the purchases book.
b	Goods of the value of ₹ 200 returned by Senguttuvan were entered in the purchases returns book.

(iii) Entering a wrong amount in a wrong subsidiary book

Examples

a	Goods sold to Palanisamy for ₹ 2,450 entered in the purchases book as ₹ 2,540.
b	Bought goods from Ramamurthy for ₹ 800 entered in the sales book as ₹ 8,000.

(iv) Over-casting or under-casting in a subsidiary book

Examples

a	Purchases book was undercast by ₹ 500, i.e., ₹ 500 less than the correct total.
b	Sales returns book was overcast by ₹ 100, i.e., ₹ 100 more than the correct total.

(v) Posting a correct amount to the wrong side of an account in the Ledger

Examples

a	The total of purchases returns book ₹ 10,500 were posted to the debit side of purchases returns account.
b	Bought goods from Sakthivel on credit correctly recorded in the purchases book but posted to the debit of Sakthivel's account.

(vi) Posting a wrong amount to the correct side of an account

Examples

a	The total of sales returns book ₹ 7,200 were posted to the debit side of the sales returns account as ₹ 2,700.
b	Goods sold to Nagaraj on credit for ₹ 2,460 was entered in the sales book and posted to the debit side of Nagaraj's account as ₹ 2,640.

(vii) Posting a wrong amount to the wrong side of an account

Examples

a	The total of sales book ₹ 9,240 was debited in the sales account as ₹ 9,420.
b	Goods of the value of ₹ 842 returned by Kumararaja was entered in the sales returns book correctly but was wrongly debited to Kumararaja's account as ₹ 824.

(viii) Posting a correct amount to a wrong account

Examples

a	The total of purchases book ₹ 5,500 was credited to the purchases returns account.
b	Goods of the value of ₹ 275 returned by Seetharaman were entered in the sales returns book correctly but was wrongly credited to Sethuraman's account.

(ix) Posting a wrong amount to a wrong account

Examples

a	Goods sold to Naveen on credit for ₹ 545 was entered in the sales book and posted to Praveen's account as ₹ 554.
b	Goods of the value of ₹ 998 returned to Anil was entered in the purchases returns book and posted to Akil's account as ₹ 989.

(x) Double posting in an account

Example

Goods sold to Parimalam on credit for ₹ 500 entered in the sales book and posted twice to Parimalam's account.

(xi) Entering a transaction twice in the journal

Examples

a	Goods sold to Mohanambal for ₹ 2,000 was entered twice in the sales book.
b	Cash received from Radhamani ₹ 700 was entered twice in the cash book.

(xii) Errors arising in carrying forward from one page to the next page of an account

While carrying forward the total of one page of a ledger account to the next page, the wrong amount may be recorded.

Examples

a	The total of page No.15 of the sales account of ₹ 5,765 is carried forward to page No.16 as ₹ 5,675.
b	The total of page No. 65 of the purchases book of ₹ 7,000 is carried forward to page No. 66 as ₹ 70,000.

(xiii) Error arising in the balancing of an account

Sometimes, at the time of balancing a ledger account, the wrong balance may be written.

9.4.3 Error of principle

It means the mistake committed in the application of fundamental accounting principles in recording a transaction in the books of accounts.

The following are the possibilities of error of principle:

(i) Entering the purchase of an asset in the purchases book

Example

Machinery purchased on credit for ₹ 10,000 by M/s. Anbarasi garments manufacturing company entered in the purchases book.

(ii) Entering the sale of an asset in the sales book

Example

Sale of old furniture on credit for ₹ 500 was entered in the sales book.

(iii) Treating a capital expenditure as a revenue expenditure

Examples

a	An amount of ₹ 3,000 spent on the construction of an additional room is debited to repairs account.
b	Wages of ₹ 600 paid for installation of a new machine is debited to wages account.

(iv) Treating a revenue expenditure as a capital expenditure

Example

An amount of ₹ 2,000 paid for repairs to a machine is debited to machinery account.

9.4.4 Compensating errors

The errors that make up for each other or neutralise each other are known as compensating errors. These errors may occur in related or unrelated accounts. Thus, excess debit or credit in one account may be compensated by excess credit or debit in some other account. These are also known as offsetting errors.

Examples

a	Purchases book and sales book are overcast by ₹ 1,000 each.
b	Purchases returns book and sales returns book are undercast by ₹ 100 each.

Student activity

Think: Do you think that all the errors can be revealed by trial balance?

9.5 Errors disclosed by the trial balance and errors not disclosed by the trial balance

Generally, one-sided errors are revealed by trial balance. They will cause disagreement of totals of debit balances and credit balances. Two-sided errors are not revealed by trial balance. Thus, the errors can be classified on the basis of their effect on the trial balance as follows:

9.5.1 Errors disclosed by the trial balance

Certain errors affect the agreement of trial balance. If such errors have occurred in the books of accounts, the total of debit and credit balances will not be the same. The trial balance will not tally. Error of partial omission and error of commission affect the agreement of trial balance. Examples of such errors are follows:

(i)	Entered in the journal but posted to one account and omitted to be posted to the other.
(ii)	Posting an amount to the wrong side of a ledger account.
(iii)	Posting twice in a ledger account
(iv)	Over-casting or Under-casting in a subsidiary book
(v)	Posting a wrong amount to the correct side of an account
(vi)	Posting a wrong amount to the wrong side of an account
(vii)	Errors arising in carrying forward the page total from one page to the next page of an account or subsidiary book.
(viii)	Errors arising in the balancing of an account.
(ix)	Omission to post an entry from a subsidiary book.

9.5.2 Errors not disclosed by the trial balance

Certain errors will not affect the agreement of trial balance. Though such errors occur in the books of accounts, the total of debit and credit balance will be the same. The trial balance will tally. Errors of complete omission, error of principle, compensating error, wrong entry in the subsidiary books are not disclosed by the trial balance. Examples of such errors are as follows:

(i)	Treating revenue expenditure as capital expenditure
(ii)	Omitting a transaction completely
(iii)	Entering a transaction in a wrong subsidiary book
(iv)	Entering a transaction twice in a subsidiary book or journal
(v)	Entering the amount of a transaction wrongly in the journal
(vi)	Entering the amount of a transaction wrongly in a subsidiary book

9.6 Steps to locate errors

Errors can be located by going through various steps. Such steps are as follows:

9.6.1. Location of errors before preparation of trial balance

Errors may be located before preparing the trial balance either spontaneously or by intentional scrutiny of books of accounts.

The following are the steps to be followed to locate errors before preparing trial balance:

(i)	Scrutiny of entries made in the journal proper
(ii)	Scrutiny of entries made in the subsidiary books
(iii)	Checking the totals of the subsidiary books
(iv)	Scrutiny of postings made to the ledger accounts
(v)	Scrutiny of balancing of ledger accounts

The errors located at this stage are rectified by debiting or crediting the relevant accounts in the books.

9.6.2. Location of errors after the preparation of trial balance

While preparing trial balance, if it does not tally, it is an indication of presence of errors in the books of accounts. The difference in trial balance is transferred to suspense account and then errors are to be located and rectified.

The following are the steps to be followed to locate errors after preparing trial balance:

(i)	The totals of debit and credit columns of trial balance are to be checked.
(ii)	The balances of various ledger accounts shown in the trial balance are to be checked to ensure whether they are shown in the respective columns (debit or credit).
(iii)	The difference in the trial balance must be halved and compared with balances of ledger to verify whether any ledger balance is recorded on the wrong side of the trial balance.
(iv)	The totals of all the subsidiary books are to be checked, especially if the difference is ₹ 1, ₹ 100 etc.
(v)	If the difference is divisible by '9', the difference may be due to transposition of figures in the books. (Writing ₹ 127 as ₹ 172). Hence, the possibilities of transposition of figures shall be checked.
(vi)	The accounts of all the creditors and debtors are to be verified.
(vii)	Postings from the subsidiary books to different accounts in the ledger are to be checked.
(viii)	The correctness of the balances of various ledger accounts is to be ensured.
(ix)	All the amounts carried forward from one page to the next are to be verified.
(x)	If the difference still exists, as a final step all the entries in the journals should be verified.

Student activity

Think: Is it possible to prepare final accounts, even when the trial balance does not tally?

9.7 Suspense account

9.7.1 Meaning of suspense account

When the trial balance does not tally, the amount of difference is placed to the debit (when the total of the credit column is higher than the debit column) or credit (when the total of the debit column is higher than the credit column) to a temporary account known as 'suspense account'.

Student activity

Think: If the suspense account is not balanced, what does it indicate?

9.7.2 Preparation of suspense account

Suspense account will remain in the books until the location and rectification of errors. After rectifying the errors and posting the rectification entries to the respective ledger accounts, the suspense account appearing in the ledger is to be balanced. If all the errors are located and rectified, the suspense account gets closed.

9.8 Rectification of errors

Depending on the stage at which errors are located, they are subsequently rectified at the respective stage itself.

9.8.1 Stages of rectification of errors

The following are the various stages of rectification of errors:

Stage 1
Before preparing trial balance

↓

Stage 2
While preparing trial balance

↓

Stage 3
After preparing trial balance but before preparing final accounts

↓

Stage 4
After preparing final accounts

(i) Rectification of errors before preparing trial balance

If the accountant finds time before preparing trial balance to recheck the entries made in the journal, postings in the ledger accounts, amounts carried forward and balancing of ledger accounts with the intention of ensuring their correctness, he/she will be able to locate and rectify the errors at that stage itself.

(a) Rectification of one-sided errors before preparing trial balance

When one-sided error is detected before preparing the trial balance, no journal entry is required to be passed in the books. In such cases, the error can be rectified by giving an explanatory note in the account affected as to whether the concerned account is to be debited or credited.

Student activity

Think: How many times in a year and at what intervals, the trial balance needs to be prepared?

Illustration 1 (Errors in casting)

The following errors were detected before the preparation of trial balance. Rectify them.

(a) Sales book is undercast by ₹ 100

(b) Sales book is overcast by ₹ 200

(c) Purchases book is undercast by ₹ 300

(d) Purchases book is overcast by ₹ 400

Solution

a	Sales account should be credited with ₹ 100
b	Sales account should be debited with ₹ 200
c	Purchases account should be debited with ₹ 300
d	Purchases account should be credited with ₹ 400

Note

a	In this case, the sales book is undercast by ₹ 100. The total of sales book is posted to the credit side of sales account in the ledger. The undercasting has resulted in under-crediting of sales account by ₹ 100. This is an error of commission. The error is only in sales account. There is short credit in sales account by ₹ 100. Hence, it is rectified by crediting sales account by ₹ 100.

b	In this case, the sales book is overcast by ₹ 200. The total of sales book is posted to the credit side of sales account in the ledger. The overcasting has resulted in over-crediting of sales account by ₹ 200. This is an error of commission. The error is only in sales account. There is excess credit in sales account by ₹ 200. Hence, it is rectified by debiting sales account by ₹ 200.
c	In this case, the purchases book is undercast by ₹ 300. The total of purchases book is posted to the debit side of purchases account in the ledger. The undercasting has resulted in under-debiting of purchases account by ₹ 300. This is an error of commission. The error is only in the purchases account. There is a short debit in the purchases account by ₹ 300. Hence, it is rectified by debiting purchases account by ₹ 300.
d	In this case, the purchases book is overcast by ₹ 400. The total of purchases book is posted to the debit side of purchases account in the ledger. The overcasting has resulted in over-debiting of purchases account by ₹ 400. This is an error of commission. The error is only in the purchases account. There is an excess debit in the purchases account by ₹ 400. Hence, it is rectified by crediting purchases account by ₹ 400.

Illustration 2 (Errors in casting)

The following errors were detected before preparation of trial balance. Rectify them.

(a) Purchases returns book is undercast by ₹ 500.

(b) Purchases returns book is overcast by ₹ 600.

(c) Sales returns book is undercast by ₹ 700.

(d) Sales returns book is overcast by ₹ 800.

Solution

a	Purchases returns account should be credited with ₹ 500
b	Purchases returns account should be debited with ₹ 600
c	Sales returns account should be debited with ₹ 700
d	Sales returns account should be credited with ₹ 800

Illustration 3 (Errors in carry forward)

The following errors were detected before preparation of trial balance. Rectify them.

(a) The total of purchases book is carried forward to the next page ₹ 100 short.

(b) The total of purchases returns book is carried forward to the next page ₹ 200 excess.

(c) The total of sales book is carried forward to the next page ₹ 300 excess.

(d) The total of sales returns book is carried forward to the next page ₹ 400 short.

Solution

a	Purchases account should be debited with ₹ 100.
b	Purchases returns account should be debited with ₹ 200.
c	Sales account should be debited with ₹ 300.
d	Sales returns account should be debited with ₹ 400.

Illustration 4 (Errors in carry forward)

The following errors were detected before preparation of trial balance. Rectify them.

(a) The total of rent received account is carried forward ₹ 900 short.

(b) The total of rent received account is carried forward ₹ 1,000 excess.

(c) The total of salary account is carried forward ₹ 1,100 short.

(d) The total of salary account is carried forward ₹ 1,200 excess.

Solution

a	Rent received account is to be credited with ₹ 900
b	Rent received account is to be debited with ₹ 1,000
c	Salary account is to be debited with ₹ 1,100
d	Salary account is to be credited with ₹ 1,200

Illustration 5 (Errors in posting)

The following errors were detected before preparation of the trial balance. Rectify them.

(a) A sum of ₹ 5,000 written off as depreciation on buildings has not been posted to depreciation account.

(b) Payment of wages ₹ 2,000 to Venkat was posted twice to wages account.

(c) An amount of ₹ 250 for a credit sale of goods to Nila, although correctly entered in the sales book, has been posted as ₹ 200.

Solution

a	Depreciation account should be debited with ₹ 5,000.
b	Wages account should be credited with ₹ 2,000.
c	Nila account should be debited with ₹ 50.

(b) Rectification of two-sided errors before preparing the trial balance

When a two-sided error is detected before preparing the trial balance, it must be rectified by passing a rectifying journal entry in the journal proper after analysing the error.

Practical steps to be followed in rectifying two-sided errors

Step 1	Write the wrong entry (the entry which has already been passed in the books)	Wrongly done
Step 2	Write the correct entry (the entry that should have been passed in the books)	Not done
Step 3	Make the rectifying entry [the net effect by cancelling the wrong account (debit or credit) in the wrong entry by reversing it and recording the correct account in its place (debit or credit)]	To be done

Illustration 6

The following errors were located before the preparation of the trial balance. Rectify them.

(a) Goods sold to Anand for ₹ 1,000 on credit was not entered in the sales book.

(b) An amount of ₹ 400 paid for repairs to the machinery stands wrongly posted to machinery account.

(c) Salaries ₹ 2,000 paid to Gandhiraj was wrongly debited to his personal account in the ledger.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Anand A/c Dr.		1,000	
	To Sales A/c			1,000
	(Being the sale of goods to Anand not entered in sales book, now rectified)			
b	Repairs A/c Dr.		400	
	To Machinery A/c			400
	(Being the repairs wrongly debited to machinery account, now rectified)			
c	Salaries A/c Dr.		2,000	
	To Gandhiraj A/c			2,000
	(Being salaries paid to Gandhiraj wrongly debited to his account, now rectified)			

Method of deriving the rectifying entries

	Wrong Entry	Correct Entry	Rectifying Entry
a	Nil (Complete Omission)	Anand A/c Dr. 1,000 To Sales A/c 1,000	Anand A/c Dr. 1,000 To Sales A/c 1,000
b	Machinery A/c Dr. 400 To Cash A/c 400	Repairs A/c Dr. 400 To Cash A/c 400	Repairs A/c Dr. 400 To Machinery A/c 400
c	Gandhiraj A/c Dr. 2,000 To Cash A/c 2,000	Salary A/c Dr. 2,000 To Cash A/c 2,000	Salary A/c Dr. 2,000 To Gandhiraj A/c 2,000

Note

a	In this case, it is credit sale of goods to Anand not entered in the sales book. As it is not entered in the sales book, it has affected both sales account and Anand's account. It is an error of complete omission. As it is not entered in the sales book, when the total of sales book was posted to the credit side of sales account, this amount of ₹ 1,000 would not have been credited. Hence, the sales account is yet to be credited with ₹ 1,000. As it is not entered in the sales book, the amount would not have been posted to the debit side of Anand's account. Hence, it is to be debited to Anand's account. Hence, the error is rectified by passing a rectifying journal entry in which Anand's account is debited with ₹ 1,000 and sales account is credited with ₹ 1,000.
b	In this case, the amount paid for repairs to machinery has been wrongly posted to machinery account. The error is only in posting. It means that it is entered in the cash book but the amount is posted to the debit of machinery account instead of repairs account. It is an error of principle. A revenue expense (repairs) is treated as a capital expenditure (machinery). The effect of this error is wrong debit to machinery account instead of repairs account. Both machinery account and repairs account are affected. Hence, the error is rectified by passing a rectifying journal entry in which repairs account is debited with ₹ 400 and machinery account is credited with ₹ 400.
c	In this case, salary paid to Gandhiraj was wrongly debited to Gandhiraj's account. The error is only in posting. It means that it is entered in the cash book but the amount is posted to the debit of Gandhiraj's account instead of salaries account. It is an error of principle. A personal account is debited (Gandhiraj's account) in place of a nominal account (salaries account). The effect of this error is wrong debit to Gandhiraj's account instead of salaries account. Both salaries account and Gandhiraj's account are affected. Hence, the error is rectified by passing a rectifying journal entry in which salaries account is debited with ₹ 2,000 and Gandhiraj's account is credited with ₹ 2,000.

Illustration 7

The following errors were located before the preparation of the trial balance. Rectify them.

(a) Paid ₹ 500 to Angappan were wrongly debited to Angannan's account.

(b) Sale of furniture for ₹ 750 was credited to sales account.

(c) Purchase of goods from Bagya for ₹ 2,100 was wrongly passed through sales book.

(d) Wages ₹ 1,000 paid on erection of machinery were debited to wages account.

Solution

	Particulars		L.F.	Dr. ₹	Cr. ₹
a	Angappan A/c	Dr.		500	
	To Angannan A/c				500
	(Being the amount paid to Angappan wrongly debited to Angannan's account, now rectified)				
b	Sales A/c	Dr.		750	
	To Furniture A/c				750
	(Being the sale of furniture wrongly credited to sales account, now rectified)				
c	Purchases A/c	Dr.		2,100	
	Sales A/c	Dr.		2,100	
	To Bagya A/c				4,200
	(Being purchases from Bagya wrongly passed through sales book, now rectified)				
d	Machinery A/c	Dr.		1,000	
	To Wages A/c				1,000
	(Being wages paid for erection of machinery wrongly debited to wages account, now rectified)				

Method of deriving the rectifying entries

	Wrong Entry	Correct Entry	Rectifying Entry
a	Angannan A/c Dr. 500 To Cash A/c 500	Angappan A/c Dr. 500 To Cash A/c 500	Angappan A/c Dr. 500 To Angannan A/c 500
b	Cash A/c Dr. 750 To Sales A/c 750	Cash A/c Dr. 750 To Furniture A/c 750	Sales A/c Dr. 750 To Furniture A/c 750
c	Bagya A/c Dr. 2,100 To Sales A/c 2,100	Purchases A/c Dr. 2,100 To Bagya A/c 2,100	Purchases A/c Dr. 2,100 Sales A/c Dr. 2,100 To Bagya A/c 4,200
d	Wages A/c Dr. 1,000 To Cash A/c 1,000	Machinery A/c Dr. 1,000 To Cash A/c 1,000	Machinery A/c Dr. 1,000 To Wages A/c 1,000

(ii) Rectification of errors while preparing the trial balance

Errors can be rectified at the time of preparing the trial balance as follows:

(a) Rectification of one-sided errors while preparing the trial balance

While preparing the trial balance, if the total of debit balances and credit balances are not the same, there is disagreement of trial balance. It shows that there are errors in the books of accounts. As a consequence, the accountant may start locating errors before closing the trial balance. In such cases, the errors are rectified at that stage itself. At this stage, the rectification of one-sided errors is made in the same manner as in the case of rectification before preparing trial balance. Rectifying journal entries are not required to be passed in the books. In such cases, errors can be rectified by giving an explanatory note in the account affected.

Illustration 8

The following errors were located at the time of preparation of the trial balance. Rectify them.

(a) Sale of goods to Akila on credit for ₹ 1,520 posted to her account as ₹ 1,250.

(b) Bought goods from Narendran on credit for ₹ 5,500, credited to his account as ₹ 5,050.

(c) Purchase of furniture from Ravivarman for ₹ 404 on credit were debited to furniture account as ₹ 440.

(d) Purchased machinery for cash ₹ 2,000 was not posted to machinery account.

(e) The total of purchases book ₹ 899 was carried forward as ₹ 989.

Solution

a	Akila account should be debited with ₹ 270
b	Narendran account should be credited with ₹ 450
c	Furniture account should be credited with ₹ 36
d	Machinery account should be debited with ₹ 2,000
e	Purchases account should be credited with ₹ 90

(b) Rectification of two-sided errors while preparing the trial balance

Rectification of two-sided errors at the time of preparing the trial balance is just similar to that of their rectification before preparation of trial balance.

Illustration 9

The following errors were located at the time of preparation of the trial balance. Pass rectifying entries.

(a) Goods of the value of ₹ 100 returned by Bhuvana were included in stock, but no entry was made in the books.

(b) Sale of goods to Mani on credit for ₹ 475 has been wrongly entered in the sales book as ₹ 745.

(c) A cheque of ₹ 500 received from Sandhiya was dishonoured and debited to allowances account.

(d) A sum of ₹ 300 drawn by the proprietor for personal use was debited to wages account.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Sales Returns A/c Dr.		100	
	To Bhuvana A/c			100
	(Goods returned by Bhuvana not entered in the books, now rectified)			
b	Sales A/c Dr.		270	
	To Mani A/c			270
	(Goods sold to Mani for ₹ 475 wrongly entered in the sales book as ₹ 745, now rectified)			

c	Sandhiya A/c Dr. To Allowances A/c Dr. (Dishonour of cheque received from Sandhiya wrongly debited to allowances A/c , now rectified)		500	 500
d	Drawings A/c Dr. To Wages A/c (Cash drawn by the proprietor for his personal use wrongly debited to wages account, now rectified)		300	 300

Method of deriving the rectifying entries

	Wrong Entry	Correct Entry	Rectifying Entry
a	- - -	Sales Returns A/c Dr. 100 To Bhuvana A/c 100	Sales Returns A/c Dr. 100 To Bhuvana A/c 100
b	Mani A/c Dr. 745 To Sales A/c 745	Mani A/c Dr. 475 To Sales A/c 475	Sales A/c Dr. 270 To Mani A/c 270
c	Allowances A/c Dr. 500 To Bank A/c 500	Sandhiya A/c Dr. 500 To Bank A/c 500	Sandhiya A/c Dr. 500 To Allowances A/c 500
d	Wages A/c Dr. 300 To Cash A/c 300	Drawings A/c Dr. 300 To Cash A/c 300	Drawings A/c Dr. 300 To Wages A/c 300

(iii) Rectification of errors after preparing the trial balance but before preparing the final accounts

(a) Rectification of one-sided errors after preparing the trial balance

If there is disagreement of trial balance and if it is not possible immediately to locate errors, the accountant may place the difference to 'suspense account'. After that, before the preparation of final accounts, the entries, postings, castings, balancing of accounts and amounts carried forward are scrutinised to locate the errors.

At this stage, every one-sided error is rectified by passing a rectifying journal entry with the respective account (debited or credited) and suspense account (credited or debited). The suspense account is used to rectify such errors so that the difference in trial balance placed to that account gets adjusted. Once all the one-sided errors are completely rectified, the balance in the suspense account gets eliminated.

Illustration 10

The following errors were located after the preparation of the trial balance. Assume that there exists a suspense account. Rectify them.

(a) Sale of goods on credit to Arun for ₹ 152 posted to his account as ₹ 125.

(b) Bought goods from Lakshmi on credit for ₹ 550, credited to her account as ₹ 505.

(c) Purchase of furniture from Abirupa for ₹ 404 on credit was debited to furniture account as ₹ 440.

(d) Purchased machinery for cash ₹ 200 was not posted to machinery account.

(e) The total of purchases book ₹ 89 was carried forward as ₹ 98.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Arun A/c Dr. To Suspense A/c (Wrong amount posted to Arun account rectified)		27	 27
b	Suspense A/c Dr. To Lakshmi A/c (Short credit to Lakshmi account rectified)		45	 45
c	Suspense A/c Dr. To Furniture A/c (Excess debit to furniture account rectified)		36	 36
d	Machinery A/c Dr. To Suspense A/c (Omission to debit machinery account rectified)		200	 200
e	Suspense A/c Dr. To Purchases A/c (Excess amount carried forward to purchases account rectified)		9	 9

Tutorial note

a	In this case, it is a credit sale of goods. It is to be recorded in the sales book and posted to Arun account. As it is not mentioned, it is understood that this was correctly entered in the sales book and posted to the debit side of Arun account (receiver). As it was correctly entered in the sales book, the sales account would have been correctly credited. But, the amount was posted to Arun account as ₹ 125 instead of the correct amount of ₹ 152. This is an error of commission. The error is only in Arun account. There is a short debit by ₹ 27. Hence, it is to be rectified by passing a journal entry by debiting Arun account with ₹ 27 and crediting suspense account with ₹ 27.
b	In this case, it is a credit purchase of goods. It is to be recorded in the purchases book and posted to Lakshmi account. As it is not mentioned, it is understood that this was correctly entered in the purchases book and posted to the credit side of Lakshmi account (giver). As it was correctly entered in the purchases book, the purchases account would have been correctly debited. But, the amount credited to Lakshmi account is ₹ 505 instead of the correct amount of ₹ 550. This is an error of commission. The error is only in Lakshmi account. There is short credit by ₹ 45. The error is rectified by passing a journal entry in which suspense account is debited with ₹ 45 and Lakshmi account is credited with ₹ 45.
c	In this case, it is a credit purchase of an asset. It is to be recorded in the journal proper and posted to both the accounts concerned. As it is not mentioned, it is understood that it is properly recorded in the journal proper and posted to Abirupa account and furniture account in the ledger. But, the amount debited (furniture account) was found to be wrong. The amount was debited to furniture account as ₹ 440 instead of the correct amount of ₹ 404. This is an error of commission. The error is only in furniture account. There is an excess debit by ₹ 36. This error is rectified by passing a rectifying journal entry in which suspense account is debited with ₹ 36 and the furniture account is credited with ₹ 36
d	In this case, it is a purchase of an asset for cash. It is to be recorded in the cash book and posted to the debit side of machinery account. As it is mentioned, it is understood that it is properly recorded in the cash book and not posted to machinery account in the ledger. This is an error of partial omission. The error is only in machinery account. The machinery account is yet to be debited with ₹ 200. This error is rectified by passing a rectifying journal entry in which the machinery account is debited with ₹ 200 and suspense account is credited with ₹ 200.
e	In this case, it is an error in carrying forward of total of the purchases book from one page to the next page. It is mentioned that the total of purchases book was carried forward as ₹ 98 instead of the correct amount of ₹ 89. There is an excess of ₹ 9 in the total of the purchases book. The total of the purchases book is posted to the debit side of the purchases account in the ledger. This is an error of commission. The error is only in the purchases account. The purchases account is debited in excess by ₹ 9. This error is rectified by passing a journal entry in which suspense account is debited with ₹ 9 and purchases account is credited with ₹ 9.

Illustration 11

The following errors were located after the preparation of the trial balance. Assume that there exists a suspense account. Pass journal entries to rectify them.

(a) The total of purchases book was undercast by ₹ 100.

(b) The total of the discount column on the debit side of cash book ₹ 575 were not posted.

(c) The total of one page of the sales book for ₹ 5,975 were carried forward to the next page as ₹ 5,795.

(d) Salaries ₹ 1,800 were posted as ₹ 18,000.

(e) Purchase of goods on credit from Mukilan for ₹ 150 have been posted to his account as ₹ 1,500.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Purchases A/c Dr. To Suspense A/c (Under casting of purchases book rectified)		100	 100
b	Discount allowed A/c Dr. To Suspense A/c (Omission to post the total of discount allowed, now rectified)		575	 575
c	Suspense A/c Dr. To Sales A/c (Lesser amount carried forward in the sales book rectified)		180	 180
d	Suspense A/c (18,000 –1,800) Dr. To Salaries A/c (Excess amount posted to the salaries account rectified)		16,200	 16,200
e	Mukilan A/c (1,500 –150) Dr. To Suspense A/c (Excess amount posted to Mukilan account rectified)		1,350	 1,350

(b) Rectification of two-sided errors after preparing the trial balance

At this stage, every two-sided error is rectified by passing a rectifying journal entry by debiting one of the accounts affected and crediting the other account. As these errors do not cause difference in trial balance, the suspense account is not used in the rectifying journal entries. Therefore, the rectifying entries passed for rectifying two-sided errors before preparation of trial balance and after preparation of trial balance are the same.

Illustration 12

The following errors were located after the preparation of the trial balance. Rectify them.

(a) Paid ₹ 50 to Anitha was wrongly debited to Vanitha account.

(b) Sale of furniture for ₹ 500 was credited to sales account.

(c) Purchased goods from Natarajan on credit for ₹ 750 were wrongly passed through sales book.

(d) Wages ₹ 1,000 paid on erection of machinery was debited to wages account.

Solution

	Particulars		L.F.	Dr. ₹	Cr. ₹
a	Anitha A/c	Dr.		50	
	To Vanitha A/c				50
	(Amount paid to Anitha wrongly debited to Vanitha account, now rectified)				
b	Sales A/c	Dr.		500	
	To Furniture A/c				500
	(Sale of furniture wrongly credited to sales account, now rectified)				
c	Purchases A/c	Dr.		750	
	Sales A/c	Dr.		750	
	To Natarajan A/c				1,500
	(Purchases from Natarajan wrongly passed through sales book, now rectified)				
d	Machinery A/c	Dr.		1,000	
	To Wages A/c				1,000
	(Wages paid for erection of machinery wrongly debited to wages account, now rectified)				

Illustration 13

Rectify the following journal entries.

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Purchases A/c Dr.		5,000	
	To Cash A/c			5,000
	(Furniture purchased for cash)			
b	Nila A/c Dr.		8,000	
	To Cash A/c			8,000
	(Salary paid to Nila)			
c	Kuralamudhu A/c Dr.		2,000	
	To Cash A/c			2,000
	(Rent paid to Kuralamudhu)			
d	Cash A/c Dr.		9,000	
	To Sales A/c			9,000
	(Furniture sold for cash)			
e	Cash A/c Dr.		6,000	
	To Kothaimalar A/c			6,000
	(Goods sold to Kothaimalar for cash)			

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Furniture A/c Dr.		5,000	
	To Purchases A/c			5,000
	(Purchase of furniture wrongly debited to purchases account rectified)			
b	Salaries A/c Dr.		8,000	
	To Nila A/c			8,000
	(Salary paid to Nila wrongly debited to her account rectified)			
c	Rent A/c Dr.		2,000	
	To Kuralamudhu A/c			2,000
	(Rent paid to Kuralamudhu wrongly debited to her account rectified)			

d	Sales A/c Dr. To Furniture A/c (Furniture sold for cash wrongly credited to sales account rectified)		9,000	 9,000
e	Kothaimalar A/c Dr. To Sales A/c (Goods sold to Kothaimalar for cash wrongly credited to her account rectified)		6,000	 6,000

Illustration 14 (One-sided errors and two-sided errors)

Pass journal entries to rectify the following errors located after the preparation of the trial balance. Assume that there exists a suspense account.

(a) The total of sales book was undercast by ₹ 2,000.

(b) The purchase of machinery for ₹ 3,000 was entered in the purchases book.

(c) A credit sale of goods for ₹ 45 to Mathi was posted in his account as ₹ 54.

(d) The purchases returns book was overcast by ₹ 200.

(e) The total of sales book ₹ 1,122 were wrongly posted in the ledger as ₹ 1,222.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Suspense A/c Dr. To Sales A/c (Under casting in the sales book rectified)		2,000	 2,000
b	Machinery A/c Dr. To Purchases A/c (Purchase of machinery wrongly entered in the purchases book rectified)		3,000	 3,000
c	Suspsense A/c Dr. To Mathi A/c (Excess amount posted to the debit of Mathi rectified)		9	 9
d	Purchase returns A/c Dr. To Suspense A/c (Overcasting in the purchase returns book rectified)		200	 200
e	Sales A/c Dr. To Suspense A/c (Excess amount carried forward in the sales book rectified)		100	 100

Illustration 15 (One-sided errors and two-sided errors with preparation of suspense account)

A book-keeper finds that the debit column of the trial balance is short by ₹ 308 and the difference is put to a suspense account. Subsequently, the following errors were located.

(a) An entry for sale of goods on credit for ₹ 102 to Mekala was posted to her account as ₹ 120.

(b) ₹ 100 being the monthly total of discount allowed to customers was credited to discount received account in the ledger.

(c) ₹ 275 paid by Mannan was credited to Kannan account.

(d) ₹ 26 appearing in the cash book as paid for the purchase of stationery for office use has not been posted to ledger.

(e) The purchases book was undercast by ₹ 100.

Rectify the errors and prepare supense account.

Solution

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Suspense A/c Dr.		18	
	To Mekala A/c			18
	(Excess amount posted to Mekala account rectified)			
b	Discount allowed A/c Dr.		100	
	Discount received A/c Dr.		100	
	To Suspense A/c			200
	(Discount allowed wrongly posted to discount received account rectified)			
c	Kannan A/c Dr.		275	
	To Mannan A/c			275
	(Wrong credit to Kannan account instead of Mannan account rectified)			
d	Stationery A/c Dr.		26	
	To Suspense A/c			26
	(Purchase of stationery not posted to stationery account rectified)			
e	Purchases A/c Dr.		100	
	To Suspense A/c			100
	(Undercasting in the purchases book rectified)			

Dr. **Suspense Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	308	By Discount allowed A/c	100
To Mekala A/c	18	By Discount received A/c	100
		By Stationery A/c	26
		By Purchases A/c	100
	326		**326**

(iv) Location and rectification of errors after preparing the final accounts

Sometimes, though there is disagreement of trial balance, due to lack of time and urgency in the completion of final accounts, the accountant may not locate and rectify the errors. Under such circumstances, the difference in trial balance is placed to the suspense account, which may show either debit balance or credit balance. If it shows a debit balance, it is shown on the assets side. If it shows a credit balance, it is shown on the liabilities side. The errors will be located and rectified by the accountant during the next accounting period. If the error to be rectified is in a nominal account, it affects the profit or loss of the business. Hence, instead of debiting or crediting them for rectification, profit and loss adjustment account is debited or credited. If the error to be rectified is in a real account or personal account, the respective real account or personal account itself is debited or credited for rectification. After all the errors are rectified, the net effect on profit is calculated by preparing profit and loss adjustment account and the balance is transferred to capital account.

9.9 Errors in computerised accounting

In the recent years, because of the technological developments, many firms have computerised their accounting. It is done to save time and to have accuracy. Though certain errors of commission such as casting errors, errors in carrying forward, etc. and errors of partial omissions can be avoided, the following errors become unavoidable:

- Errors of complete omission
- Errors of principle
- Errors of making wrong entry in the books of original entry
- Errors of entering wrong amounts in the books of original entry
- Errors of entering wrong accounts in the books of original entry
- Errors of duplication

The duality concept is applied in locating and rectifying errors.

Student activity

Think: Prepare 10 transactions with errors and ask your friend to solve.

Points to remember

- Error means recording or classifying or summarising the accounting transactions wrongly or omissions to record them by a clerk or accountant unintentionally.
- In the accounting process, errors may occur at the stage of journalising, posting, balancing or preparing trial balance.
- The failure of an accountant to record a transaction or an item in the books of accounts is known as error of omission. It may be complete omission or partial omission.
- Error of principle means the mistake committed in the application of fundamental accounting principles in recording a transaction in the books of accounts.
- The errors that make up for each other or neutralise each other are known as compensating errors.
- Certain errors are disclosed by the trial balance and certain errors are not disclosed by the trial balance.
- When the trial balance does not tally, the amount of difference is placed to a temporary account known as 'suspense account'.
- Errors can be rectified before preparing the trial balance or while preparing the trial balance or after preparing the trial balance but before preparing the final accounts or after preparing the final accounts.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. Error of principle arises when

   (a) There is complete omission of a transaction

   (b) There is partial omission of a transaction

   (c) Distinction is not made between capital and revenue items

   (d) There are wrong postings and wrong castings

2. Errors not affecting the agreement of trial balance are

   (a) Errors of principle (b) Errors of overcasting

   (c) Errors of undercasting (d) Errors of partial omission

3. The difference in trial balance is taken to

   (a) The capital account (b) The trading account

   (c) The suspense account (d) The profit and loss account

4. A transaction not recorded at all is known as an error of

   (a) Principle (b) Complete omission

   (c) Partial omission (d) Duplication

5. Wages paid for installation of machinery wrongly debited to wages account is an error of

   (a) Partial omission (b) Principle

   (c) Complete omission (d) Duplication

6. Which of the following errors will not affect the trial balance?

   (a) Wrong balancing of an account

   (b) Posting an amount in the wrong account but on the correct side

   (c) Wrong totalling of an account

   (d) Carried forward wrong amount in a ledger account

7. Goods returned by Senguttuvan were taken into stock, but no entry was passed in the books. While rectifying this error, which of the following accounts should be debited?

   (a) Senguttuvan account (b) Sales returns account

   (c) Returns outward account (d) Purchases returns account

8. A credit purchase of furniture from Athiyaman was debited to purchases account. Which of the following accounts should be debited while rectifying this error?

(a) Purchases account (b) Athiyaman account

(c) Furniture account (d) None of these

9. The total of purchases book was overcast. Which of the following accounts should be debited in the rectifying journal entry?

(a) Purchases account (b) Suspense account

(c) Creditor account (d) None of the above

10. Which of the following errors will be rectified using suspense account?

(a) Purchases returns book was undercast by ₹ 100

(b) Goods returned by Narendran was not recorded in the books

(c) Goods returned by Akila ₹ 900 was recorded in the sales returns book as ₹ 90

(d) A credit sale of goods to Ravivarman was not entered in the sales book.

Answers

1. (c)	2. (a)	3. (c)	4. (b)	5. (b)	6. (b)	7. (b)	8. (c)	9. (b)	10. (a)

II Very short answer questions

1. What is meant by rectification of errors?
2. What is meant by error of principle?
3. What is meant by error of partial omission?
4. What is meant by error of complete omission?
5. What are compensating errors?

III Short answer questions

1. Write a note on error of principle by giving an example.
2. Write a note on suspense account.
3. What are the errors not disclosed by a trial balance?
4. What are the errors disclosed by a trial balance?
5. Write a note on one-sided errors and two sided errors.

IV Exercises

1. State the account/s affected in each of the following errors:

   (a) Goods purchased on credit from Saranya for ₹ 150 was posted to the debit side of her account.

   (b) The total of purchases book ₹ 4,500 was posted twice.

2. State the account/s affected in each of the following errors:

   (a) Goods sold to Vasu on credit for ₹ 1,000 was not recorded in the sales book.

   (b) The total of sales book ₹ 2,500 was posted twice.

3. Rectify the following errors discovered before the preparation of the trial balance:

   (a) Sales book was undercast by ₹ 100

   (b) Purchases returns book was overcast by ₹ 200

4. Rectify the following errors before the preparation of trial balance:

   (a) Returns outward book was undercast by ₹ 2,000

   (b) Returns inward book total was taken as ₹ 15,000 instead of ₹ 14,000

   (c) The total of the purchases account was carried forward ₹ 100 less.

5. Rectify the following errors assuming that the trial balance is yet to be prepared:

   (a) Sales book was undercast by ₹ 400

   (b) Sales returns book was overcast by ₹ 500

   (c) Purchases book was undercast by ₹ 600

   (d) Purchases returns book was overcast by ₹ 700

   (e) Bills receivable book was undercast by ₹ 800

6. Rectify the following errors before preparing trial balance:

   (a) The total of purchases book was carried forward ₹ 90 less.

   (b) The total of purchases book was carried forward ₹ 180 more.

   (c) The total of sales book was carried forward ₹ 270 less.

   (d) The total of sales returns book was carried forward ₹ 360 more.

   (e) The total of purchase returns book was carried forward ₹ 450 less.

7. The following errors were located by the accountant before preparation of trial balance. Rectify them.

(a) The total of the discount column of ₹ 1,100 on the debit side of the cash book was not yet posted.

(b) The total of the discount column on the credit side of the cash book was undercast by ₹ 500.

(c) Purchased goods from Anbuchelvan on credit for ₹ 700 was posted to the debit side of his account.

(d) Sale of goods to Ponmukil on credit for ₹ 78 was posted to her account as ₹ 87.

(e) The total of sales returns book of ₹ 550 was posted twice.

8. The accountant of a firm located the following errors before preparing the trial balance. Rectify them.

(a) Machinery purchased for ₹ 3,000 was debited to purchases account.

(b) Interest received ₹ 200 was credited to commission account.

(c) An amount of ₹ 1,000 paid to Tamilselvan as salary was debited to his personal account.

(d) Old furniture sold for ₹ 300 was credited to sales account.

(e) Goods worth ₹ 800 purchased from Soundarapandian on credit was not recorded in the books of accounts.

9. Rectify the following errors which were located before preparing the trial balance.

(a) Wages paid ₹ 2,000 for the erection of machinery was debited to wages account.

(b) Sales returns book was short totalled by ₹ 1,000.

(c) Goods purchased for ₹ 200 was posted as ₹ 2,000 to purchases account.

(d) The sales book was overcast by ₹ 1,500.

(e) Cash paid to Mukil ₹ 2,800 which was debited to Akhil's account as ₹ 2,000.

10. Rectify the following errors which were located at the time of preparing the trial balance:

(a) The total of the discount column on the debit side of the cash book of ₹ 225 was posted twice.

(b) Goods of the value of ₹ 75 returned by Ponnarasan was not posted to his account.

(c) Cash received from Yazhini ₹ 1,000 was not posted.

(d) Interest received ₹ 300 has not been posted.

(e) Rent paid ₹ 100 was posted to rent account as ₹ 10.

11. The following errors were located at the time of preparing trial balance. Rectify them.

(a) A personal expense of the proprietor ₹ 200 was debited to travelling expenses account.

(b) Goods of ₹ 400 purchased from Ramesh on credit was wrongly credited to Ganesh's account.

(c) An amount of ₹ 500 paid as salaries to Mathi was debited to his personal account.

(d) An amount of ₹ 2,700 paid for extension of the building was debited to repairs account.

(e) A credit sale of goods of ₹ 700 on credit to Mekala was posted to Krishnan's account.

12. Rectify the following journal entries.

	Particulars	L.F.	Dr. ₹	Cr. ₹
a	Kumanan A/c Dr. To Cash A/c (Salary paid to Kumanan)		10,000	 10,000
b	Senguttuvan A/c Dr. To Cash A/c (Rent paid to Senguttuvan)		6,000	 6,000
c	Cash A/c Dr. To Sales A/c (Furniture sold for cash)		2,000	 2,000
d	Cash A/c Dr. To Kumararaja A/c (Goods sold to Kumararaja for cash)		10,000	 10,000
e	Manimaran A/c Dr. To Purchases A/c (Goods taken by the proprietor Mr. Manimaran for his personal use)		1,000	 1,000

13. Rectify the following errors discovered after the preparation of the trial balance:

(a) Rent paid was carried forward to the next page ₹ 500 short.

(b) Wages paid was carried forward ₹ 250 excess.

14. Rectify the following errors after preparation of trial balance:

(a) Salary paid to Ram ₹ 1,000 was wrongly debited to his personal account.

(b) A credit sale of goods to Balu for ₹ 450 was debited to Balan.

15. Pass necessary journal entries to rectify the following errors located after the preparation of trial balance:

(a) Sales book was undercast by ₹ 1,000.

(b) A amount of ₹ 500 paid for wages was wrongly posted to machinery Account.

16. Give journal entries to rectify the following errors discovered after the preparation of trial balance:

(a) Purchases book was overcast by ₹ 10,000.

(b) Repairs to furniture of ₹ 500 was debited to furniture account.

(c) A credit sale of goods to Akilnilavan for ₹ 456 was credited to his account as ₹ 654.

17. Rectify the following errors located after the preparation of trial balance:

(a) Purchases book was undercast by ₹ 900.

(b) Sale of old furniture for ₹ 1,000 was credited to sales account.

(c) Purchase of goods from Arul for ₹ 1,500 on credit was not recorded in the books.

18. The following errors were located after the preparation of trial balance. Pass journal entries to rectify them. Assume that there exists a suspense account.

(a) The total of sales book was undercast by ₹ 350.

(b) The total of the discount column on the debit side of cash book ₹ 420 was not posted.

(c) The total of one page of the purchases book of ₹ 5,353 was carried forward to the next page as ₹ 5,533.

(d) Salaries ₹ 2,400 was posted as ₹ 24,000.

(e) Purchase of goods from Sembiyanmadevi on credit for ₹ 180 was posted to her account as ₹ 1,800

19. Rectify the following errors assuming that the trial balance is already prepared and the difference was placed to suspense account:

(a) Sales book was undercast by ₹ 250

(b) Purchases book was undercast by ₹ 120

(c) Sales book was overcast by ₹ 130

(d) Bills receivable book was undercast by ₹ 75

(e) Purchases book was overcast by ₹ 35.

20. The following errors were located after the preparation of trial balance. The difference in trial balance has been taken to suspense account. Rectify them.

(a) The total of purchases book was carried forward ₹ 70 less.

(b) The total of sales book was carried forward ₹ 340 more.

(c) The total of purchases book was carried forward ₹ 150 more.

(d) The total of sales book was carried forward ₹ 200 less.

(e) The total of purchase returns book was carried forward ₹ 350 less.

21. The following errors were located by the accountant after the preparation of trial balance. There exists a suspense account. Rectify them.

(a) The total of the discount column of ₹ 1,180 on the debit side of the cash book was not posted.

(b) Purchase of goods from Arivuchelvan on credit for ₹ 600 was posted to the debit side of his account.

(c) The total of the discount column on the credit side of the cash book was undercast by ₹ 400.

(d) The total of sales returns book of ₹ 570 was posted twice.

(e) Sold goods to Mukil on credit for ₹ 87 was posted to her account as ₹ 78.

22. The accountant of a firm located the following errors after preparing the trial balance. Rectify them assuming that there is a suspense account.

(a) Machinery purchased for ₹ 3,500 was debited to purchases account.

(b) ₹ 1,800 paid to Raina as salary was debited to his personal account.

(c) Interest received ₹ 200 was credited to commission account.

(d) Goods worth ₹ 1,800 purchased from Amudhanila on credit was not recorded in the books of accounts.

(e) Used furniture sold for ₹ 350 was credited to sales account.

23. The book-keeper of a firm found that the trial balance was out by ₹ 922 (excess credit). He placed the amount in the suspense account and subsequently found the following errors:

(a) The total of discount column on the credit side of the cash book ₹ 78 was not posted in the ledger.

(b) The total of purchases book was short by ₹ 1,000.

(c) A credit sale of goods to Natarajan for ₹ 375 was entered in the sales book as ₹ 735.

(d) A credit sale of goods to Mekala for ₹ 700 was entered in the purchases book.
You are required to give rectification entries and prepare suspense account.

(**Answer**: Total of suspense account: ₹ 1,000)

24. The books of Raman did not agree. The accountant placed the difference of ₹ 1,270 to the debit of suspense account. Rectify the following errors and prepare the suspense account:

(a) Goods taken by the proprietor for his personal use ₹ 75 was not entered in the books.

(b) A credit sale of goods to Shanmugam for ₹ 430 was credited to his account as ₹ 340.

(c) A purchase of goods on credit for ₹ 400 from Vivek was entered in the sales book. However, Vivek's account was correctly credited.

(d) The total of the purchases returns book ₹ 300 was not posted.

(**Answer**: Total of suspense account: ₹ 1,570)

CASE STUDY

Rameela, a class 11 student, visited one of her relative's furniture shop. She met the accountant of the shop. He was busy with preparing final accounts. At that time, one of the staff approached the accountant with a list of errors found in ledger postings.

Rameela asked the accountant, in a surprised tone, "Is it possible to rectify the errors before preparing the final accounts?"

The accountant replied, "Yes, it is!".

Rameela was curious to analyse the errors. She found the following:

- Furniture sold on credit to Siva and company for ₹ 12,000 was debited to Sam and company.
- Rent paid ₹ 2,500, was debited to rent account as ₹ 250.
- The total of purchase journal was undercast by ₹ 1,000.
- A sales invoice for ₹ 2,000, completely omitted from the books.
- Stationery bought for ₹ 250, was posted to purchases account.

Can you help Rameela to identify and rectify the errors?

To explore further

Is there any possible way to reduce the errors in trial balance?

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Unit 10

DEPRECIATION ACCOUNTING

Contents

Points to recall

The following points are to be recalled before learning the depreciation accounting:

- The going concern concept
- The matching concept
- Meaning of fixed assets
- Tangible assets and intangible assets

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Learning Objectives

To enable the students to

- Understand the meaning and causes of depreciation
- Understand the various methods of providing depreciation
- Apply the different methods of depreciation and prepare asset account

Key terms to know

Depreciation

Provision for depreciation

Scrap value/residual value

Book value

Straight line method

Diminishing balance method

10.1 Introduction

Student activity

Think: Mr. Nihal bought a car for ₹ 4, 00,000. After four years he wanted to sell it for more than ₹ 4, 00,000. Is it possible? Why do you think that it is possible/it is not possible?

Business enterprises use certain fixed assets for the conduct of business operations. Such assets are building, plant and machinery, motor vehicles, furniture, office equipment, etc. These assets have a long span of life. After some years, the assets will lose their usefulness for the business operations. Purchase of such fixed assets or construction of these is a capital expenditure. Hence the amount cannot be transferred to profit and loss account of the year of purchase. But every year, a part of the capital expenditure attributable to the use during the year is charged to profit and loss account and is reduced from the cost of the asset. The portion of cost of asset attributable to the use and expiry of time is to be measured and accounted which is called depreciation. Depreciation is treated as a charge against profit and is debited to profit and loss account.

10.2 Depreciation - Meaning and definition

The process of allocation of the relevant cost of a fixed asset over its useful life is known as depreciation. It is an allocation of cost against the benefit derived from a fixed asset during an accounting period.

According to **Spicer and Pegler**, "Depreciation is the measure of exhaustion of the effective life of an asset from any cause during a given period".

According to **R.N. Carter**, "Depreciation is the gradual and permanent decrease in the value of an asset from any cause".

10.2.1 Useful life of the asset

Useful life is (a) the period over which an asset is expected to be available for use by an enterprise; or (b) the number of production or similar units expected to be obtained from the asset by an enterprise.

DO YOU KNOW?

According to Indian Accounting Standards, (AS 10) depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value.

10.2.2 Depreciable assets

Fixed assets which are meant for use in the business for more than one accounting period, the cost of which can be written off over their useful life are known as depreciable assets. Buildings, machinery, vehicles, furniture, computers and equipment are examples of depreciable fixed assets. These assets have limited useful life. They are meant for use in the business for production or supply of goods or for administrative purposes. These are not meant for resale.

10.3 Objectives of providing depreciation

Following are the objectives of providing depreciation:

(i) To find out the true profit or loss

According to matching principle, the expenses incurred during a period must be matched with revenue earned during that period. Hence, when an asset is used for generating income for a business, the cost of the asset attributable to the use, i.e., the reduction in the book value of the asset proportionate to the benefit derived from it, should be charged against the revenue. This is to be done to find out the true cost of production and profit or loss of the business for every accounting period.

(ii) To present the true and fair view of financial position

When the depreciation is charged on fixed assets, the book value of fixed assets are reduced to that extent and the remaining value is shown in the balance sheet. The balance represents the value of benefit that is yet to be derived from them. The written down value is the true value of fixed assets which represent cost not yet written off. The balance sheet must represent a true and fair view of financial status. Hence, fixed assets must be shown at their at written down value.

(iii) To facilitate replacement of fixed assets

When the depreciation is debited to profit and loss account, an equal amount is either retained in the business or invested outside the business. When the useful life of an asset comes to an end, a new asset can be purchased by using the resources available in the business.

(iv) To avail tax benefits

As per the Indian Income Tax Act, while computing tax on business income, depreciation is deductible from income. Hence, depreciation is computed and charged to profit and loss account to reduce tax liability.

(v) To comply with legal requirements

Depreciation is provided on fixed assets to comply with the provisions of law apart from Income Tax Act. For example, Section 123(1) of the Indian Companies Act, 2013, requires every company to provide depreciation on fixed assets before declaring dividend to its shareholders.

10.4 Causes of depreciation

There are different reasons causing the reduction in the book value of the fixed assets. Such causes are as follows:

(i) Wear and tear

The normal use of a tangible asset results in physical deterioration which is called wear and tear. When there is wear and tear, the value of the asset decreases proportionately.

(ii) Efflux of time

Certain assets whether used or not become potentially less useful with the passage of time.

(iii) Obsolescence

It is a reduction in the value of assets as a result of the availability of updated alternative assets. This happens due to new inventions and innovations. Though the original asset is in a usable condition, it is not preferred by the users and it loses its value. For example, preference of latest computers by the users.

(iv) Inadequacy for the purpose

Sometimes, the use of assets may be stopped due to their inadequacy for the purpose. These may become inadequate due to expansion in the capacity of a firm.

(v) Lack of maintenance

A good maintenance will naturally increase the life of the asset. When there is no proper maintenance, there is a possibility of more depreciation.

(vi) Abnormal factors

Decline in the usefulness of fixed asset may be caused by abnormal factors like damage due to fire accidents, natural calamities, etc. These may even lead to the state of an asset being discarded.

10.5 Characteristics of depreciation

Following are the characteristics of depreciation:

i. Depreciation is the process of allocation of cost of depreciable asset (capital expenditure) to revenue expenditure or to profit and loss account over the useful life of the asset.

ii. It is the process of allocation of cost and not the process of valuation.

iii. It is a decrease in the book value of the asset and not the market value of the asset.

iv. It is a gradual and continuous decrease in the book value of asset over its useful life.

v. It is calculated only for tangible depreciable fixed assets. Depreciation is not provided on intangible and wasting assets.

DO YOU KNOW?

Allocation of acquisition cost of natural resources such as mineral deposits, oil well, coal, timber is called depletion. Allocation of acquisition cost of intangible fixed assets such as goodwill, patents, copyrights, trademarks, and intellectual property rights is called amortization.

10.6 Factors determining the amount of depreciation

There are different factors that determine the amount of depreciation to be provided on a fixed asset. They are as follows:

(i) Actual cost of the asset

Actual cost means the amount incurred in acquiring or constructing the asset. It is the acquisition or construction cost or historical cost. It includes all the expenses incurred on the asset to bring the asset to present condition and location, that is, all incidental expenses incurred till it is put into use. Purchase price of the asset, freight, loading charges, unloading charges, erection cost, setting up cost and expenses of trial run are included in the cost of the asset. If the asset is a second-hand one, the initial repair to make the asset useable is also to be taken as part of actual cost of the asset.

(ii) Estimated useful life of the asset

The period for which an asset can be used in the enterprise is known as estimated useful life of an asset. It can be calculated in terms of period for which the asset is expected to be used by the entity or units of output to be obtained by the use of the asset. etc. In the case of intellectual properties like patents and copyrights, their legal life is taken as their estimated useful life. The Indian Companies Act, 2013 has prescribed useful lives of fixed assets for the purpose of computation of depreciation. For example, the useful lives prescribed in Part C of Section 123 for general plant and machinery and general furniture and fittings are 15 years and 10 years respectively.

(iii) Scrap value of an asset

The amount which is expected to be realised at the end of the estimated useful life of an asset is known as scrap value of the asset. It is also known as residual value. In determining the scrap value, costs to be incurred for removal and sale of the asset should be deducted from the estimated gross realisable value.

(iv) Other factors

Besides the above mentioned factors, legal provisions, technological factors, etc., also determine the amount of depreciation.

10.7 Methods of providing depreciation

There are various methods used for providing depreciation on fixed assets. The management of a business enterprise has to select the most appropriate method based on the consideration of various factors such as nature of the asset, use of the asset and circumstances that prevail in the business. The following are the different methods of providing depreciation:

i) Straight line method or Fixed instalment method or Original cost method
ii) Written down value method or Diminishing balance method
iii) Sum of years of digits method
iv) Machine hour rate method
v) Depletion method
vi) Annuity method

vii) Revaluation method

viii) Sinking fund method

ix) Insurance policy method

10.7.1 Straight line method/ Fixed instalment method / Original cost method

Under this method, a fixed percentage on the original cost of the asset is charged every year by way of depreciation. Hence it is called original cost method. As the amount of depreciation remains equal in all years over the useful life of an asset it is also called as fixed instalment method. When the amount of depreciation charged over its life is plotted on a graph and the points are joined together, the graph will show a horizontal straight line. Hence, it is called straight line method.

This method is suitable for those assets the useful life of which can be estimated accurately and which do not require much expense on repairs and renewals.

Under this method, the following formulae are used for calculating the amount of depreciation and the rate of depreciation respectively:

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

Tutorial note

a) In the year of purchase, if the period of use is less than a year, the amount of depreciation will be charged proportionately for the period for which the asset has been used in the business.

b) If depreciation is deducted from the cost of the asset at the end of useful life of the asset the amount left in the asset account will be equal to the scrap value if there is any scrap value or it will be zero if there is no scrap value.

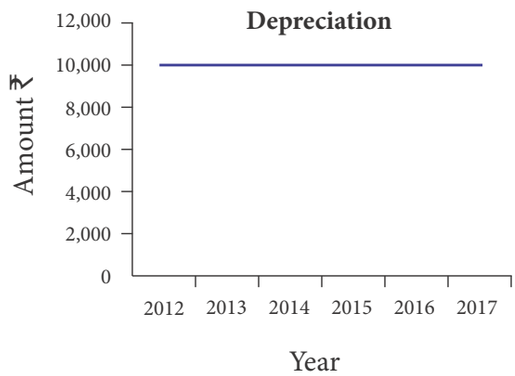
Example

On 1.1.2012, a firm purchased a machine at a cost of ₹ 1,10,000. Its life was estimated to be 10 years with a scrap value of ₹ 10,000. The amount of depreciation to be charged at the end of each year is:

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1,10,000 - 10,000}{10} = \frac{1,00,000}{10} = ₹\ 10,000 \text{ per year}$$

When it is plotted on a graph for 5 years, it appears as follows:



Merits

Following are the merits of straight line method of depreciation:

(a) Simple and easy to understand

Computation of depreciation under this method is very simple and is easy to understand.

(b) Equality of depreciation burden

Under this method, equal amount of depreciation is debited to the profit and loss account each year. Hence, the burden of depreciation on the profit of each year is equal.

(c) Assets can be completely written off

Under this method, the book value of an asset can be reduced to zero if there is no scrap value or to the scrap value at the end of its useful life. Thus the asset account can be completely written off.

(d) Suitable for the assets having fixed working life

This method is appropriate for the fixed assets having certain fixed period of working life. In such cases, the estimation of useful life is easy and in turn it helps in easy determination of rate of depreciation.

Limitations

Following are the limitations of straight line method of depreciation:

(a) Ignores the actual use of the asset

Under this method, a fixed amount of depreciation is provided on each asset by applying the predetermined rate of depreciation on its original cost. But, the actual use of the asset is not considered in computation of depreciation.

(b) Ignores the interest factor

This method does not take into account the loss of interest on the amount invested in the asset. That is, the amount would have earned interest, had it been invested outside the business is not considered.

(c) Total charge on the assets will be more when the asset becomes older

With the passage of time, the cost of maintenance of an asset goes up. Hence, the amount of depreciation and cost of maintenance put together is less in the initial period and goes up year after year. But, this method does not consider this.

(d) Difficulty in the determination of scrap value

It may be quite difficult to assess the true scrap value of the asset after a long period say 10 or 15 years after the date of its installation.

Suitability

Straight line method of depreciation is suitable in case of fixed assets in respect of which useful life can be determined and maintenance and repair cost is the same throughout the life of the asset.

Illustration 1

On 1.1.2017 a firm purchased a machine at a cost of ₹ 1,00,000. Its life was estimated to be 10 years with a scrap value of ₹ 10,000. Compute the amount of depreciation to be charged at the end of each year.

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1,00,000 - 10,000}{10} = \frac{90,000}{10} = ₹\ 9,000 \text{ per year}$$

Illustration 2

A company has purchased a machinery for ₹ 1,80,000 and spent ₹ 10,000 for its installation. The estimated life of the machinery is 5 years with a residual value of ₹ 15,000. Find out the amount of depreciation to be provided every year.

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1,90,000 - 15,000}{5} = \frac{1,75,000}{5} = ₹\ 35,000 \text{ per year}$$

Note:

Original cost = Purchase price + Installation charges

= 1,80,000 + 10,000

= ₹ 1,90,000

Illustration 3

From the following information, calculate the amount of depreciation and rate of depreciation under straight line method.

Purchase price of machine	₹ 2,00,000
Expenses to be capitalised	₹ 50,000
Estimated residual value	₹ 15,000
Expected useful life	5 years

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{2,50,000 - 15,000}{5} = \frac{2,35,000}{5} = ₹\ 47,000 \text{ per year}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

$$= \frac{47,000}{2,50,000} \times 100 = 18.8\%$$

Note:

Original cost = Purchase price + Expenses to be capitalised

= 2,00,000 + 50,000 = ₹ 2,50,000

Illustration 4

Find out the rate of depreciation under straight line method from the following details:

Original cost of the asset	= ₹ 10,000
Estimated life of the asset	= 10 years
Estimated scrap value at the end	= ₹ 2,000

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{10,000 - 2,000}{10} = \frac{8,000}{10} = ₹\ 800 \text{ per year}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

$$= \frac{800}{10,000} \times 100 = 8\%$$

10.7.2 Written down value / Diminishing balance method

Under this method, depreciation is charged at a fixed percentage on the written down value of the asset every year. Hence, it is called written down value method. Written down value is the book value of the asset, i.e., original cost of the asset minus depreciation upto the previous accounting period. As the amount of depreciation goes on decreasing year after year, it is called diminishing balance method or reducing installment method.

DO YOU KNOW?

The following formula is used to compute the rate of depreciation under written down value method:

$$\left[1-\sqrt[n]{\frac{\text{Scrap value}}{\text{Original cost}}}\right] \times 100$$

Example: Original cost ₹ 1,00,000; Scrap value ₹ 1,000; Useful life 5 years

$$\left[1-\sqrt[5]{\frac{1{,}000}{1{,}00{,}000}}\right] \times 100 = [1-(0.01)^{1/5}] \times 100$$

$$= (1 - 0.3981) \times 100$$

$$= 0.6019 \times 100 = 60.19\%$$

Rate of depreciation = 60.19%

If the scrap value is 10,000; rate of depreciation is 36.90%

If there is no scrap value, rate of depreciation will be 100%. Hence, to calculate depreciation the scrap value is taken as 1.

If the scrap value is less, rate of depreciation will be high.

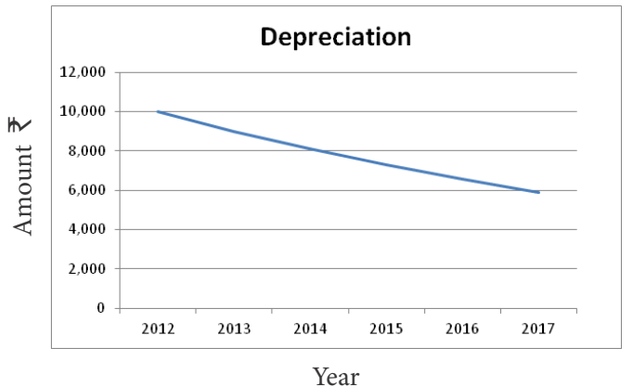
Example

On 1.1.2012, a firm purchased a machine at a cost of ₹ 1,00,000. Depreciation charged at 10% p.a. on written down value method for the five years is as follows:

Cost of the asset on 1.1.2012	₹ 1,00,000
Less: Depreciation for 2012 at 10% on 1,00,000	₹ 10,000
Written down value on 1.1.2013	₹ 90,000
Less: Depreciation for 2013 at 10% on 90,000	₹ 9,000
Written down value on 1.1.2014	₹ 81,000
Less: Depreciation for 2014 at 10% on 81,000	₹ 8,100
Written down value on 1.1.2015	₹ 72,900
Less: Depreciation for 2015 at 10% on 72,900	₹ 7,290

Written down value on 1.1.2016	₹ 65,610
Less: Depreciation for 2016 at 10% on 65,610	₹ 6,561
Written down value on 1.1.2017	₹ 59,049
Less: Depreciation for 2017 at 10% on 59,049	₹ 5,905

When depreciation is plotted on a graph for 5 years, it appears as follows:



Merits

Following are the merits of written down value method.

(a) Equal charge against income

In the initial years depreciation is high and repair charges are low. When the asset becomes older, the amount of depreciation charged is less but repair charges are high. Hence, the total burden on profit in respect of depreciation and repairs put together remains almost similar year after year.

(b) Logical method

In the earlier years, when the asset is more productive, high depreciation is charged. In the later years when the asset becomes less productive, the depreciation charge is less.

Limitations

Following are the limitations of written down value method.

(a) Assets cannot be completely written off

Under this method, the value of an asset even if it becomes obsolete and useless, cannot be reduced to zero and some balance would continue in the asset account.

(b) Ignores the interest factor

This method does not take into account the loss of interest on the amount invested in the asset. The amount would have earned interest, had it been invested outside the business is not considered.

(c) Difficulty in determining the rate of depreciation

Under this method, the rate of providing depreciation cannot be easily determined. The rate is generally kept higher because it takes very long time to write off an asset down to its scrap value.

(d) Ignores the actual use of the asset

Under this method, a fixed rate of depreciation is provided on the written down value of the asset by applying the predetermined rate of depreciation on its original cost. But, the actual use of the asset is not considered in the computation of depreciation.

Suitability

This method is suitable in case of assets having a comparatively long life and which require considerable repairs in the later years when they become older. Examples are building and plant and machinery.

Illustration 5

A firm purchased a plant on 1.1.2018 for ₹ 9,000 and spent ₹ 1,000 as erection charges. Calculate the amount of depreciation for the year 2018 @ 15% per annum under the written down value method. Accounts are closed on 31st March every year.

Solution

Original cost = 9,000 + 1,000 = 10,000

Rate of depreciation = 15%

Date of purchase = 1.1.2018

Number of months used = 1.1.2018 to 31.03.2018 = 3 months

Amount of depreciation = 15% on 10,000 for 3 months

= 10,000 ×15% × 3/12 = ₹ 375

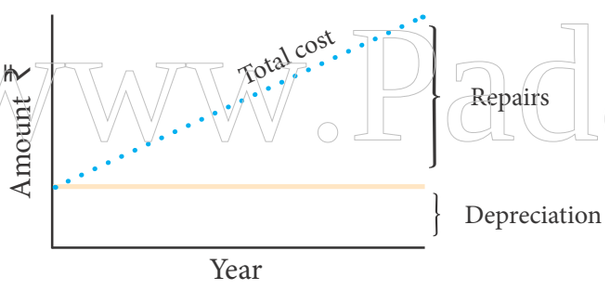
In Microsoft Excel, there are inbuilt finance functions available for calculating depreciation. For example: SLM for calculating depreciation under Straight Line Method (SLM) and DB for Diminishing Balance method (DB).

10.7.2.1 Differences between straight line method and written down value method

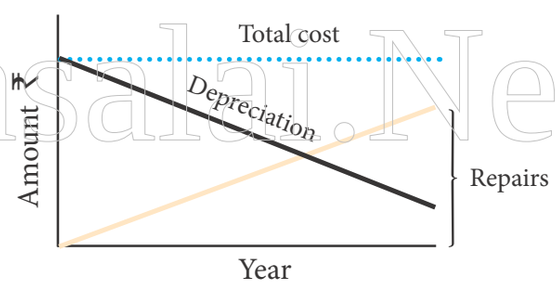
Following are the differences between straight line method and written down value method

Point of difference	Straight line method	Written down value method
1. Basis of calculation	Depreciation is calculated on the original cost of the asset for all the years.	Depreciation is calculated on the written down value of the asset year after year.
2. Amount of depreciation	The amount of depreciation is the same for all the years.	The amount of depreciation goes on decreasing year after year.
3. Book value of the asset at the end of its life	The book value of the asset becomes zero when there is no scrap value or is equal to its scrap value at the end of its life.	The book value of the asset never becomes zero.

4. Computation of rate of depreciation	It is easy to calculate the rate of depreciation.	It is very difficult to calculate the rate of depreciation.
5. Order of calculation of depreciation amount	Amount of depreciation is calculated first, followed by the rate of depreciation.	Rate of depreciation is calculated first, followed by the amount of depreciation.
6. Total charge	As the cost of repair goes on increasing with the passage of time, the total charge, i.e., the total of depreciation amount and repair amount keeps on increasing from year to year.	As the cost of repair increases and depreciation decreases with the passage of time, total of depreciation amount and repair amount charged to profit and loss account remains almost the same from year to year.
7. Suitability	It is suitable for assets for which the repair charges are less and the possibility of obsolescence is less and expiration of cost of asset depends upon time period involved.	It is suitable for assets which are affected by technological changes and assets which require more repairs with the passage of time.



Straight line method



Written down value method

10.7.3 Sum of years of digits method

This method is similar to the diminishing balance method. The amount of depreciation goes on decreasing year after year in proportion to the unexpired life of the asset. This method is suitable for those assets having more probability of obsolescence and increased repair charges as the assets grow older. Under this method, amount of depreciation per year is calculated by multiplying the cost of the asset and the number of remaining years of life and dividing it by the sum of the digits of all years of life of the asset. The following formula is used to compute the amount of depreciation under this method:

$$\text{Amount of depreciation} = \frac{\left[\begin{array}{c}\text{Total number of years of remaining}\\ \text{life of the asset}\\ \text{(including the current year)}\end{array}\right]\left[\text{Original cost - Scrap value}\right]}{\text{Sum of all the digits of all years from 1 to the life of the asset in years}}$$

Student activity

Think: Why does a business use different rates of depreciation for different types of assets?

10.7.4 Machine hour rate method

Under this method, depreciation per machine hour is calculated. The cost of the machinery after deducting the residual value, if any, is divided by the estimated working hours of the machine to find the depreciation per hour. The actual depreciation for any given period depends upon the working hours during that year. The special feature of this method is that depreciation is found directly in proportion to the actual use of the asset. Under this method life of the asset is estimated in hours and not in years. The following formula is used to determine the rate of depreciation:

$$\text{Rate of depreciation per machine hour} = \frac{\text{Original cost} - \text{Estimated scrap value}}{\text{Life of the asset in hours}}$$

Amount of depreciation = Number of machine hours used × Rate of depreciation per hour

10.7.5 Depletion method

Depletion means exhaustion of natural resources. That is, depletion means quantitative reduction in the content of assets. This is applicable to those assets that get exhausted due to extraction and exploitation. Examples: mines, oil fields, etc. Under this method, depreciation rate is calculated on the basis of the estimated quantities of the output during the whole life of the asset.

$$\text{Rate of depreciation per unit} = \frac{\text{Original cost}}{\text{Life of the asset in quantities of output}}$$

Amount of depreciation = Units of output during the year × Rate of depreciation per unit

Note: Even though it is not depreciated, it is used to write off the cost of the asset as per matching principle.

10.7.6 Annuity method

Under this method, not only the original cost of the asset but also the amount of interest on the investment is taken into account while computing depreciation. The idea of considering interest is that if the investment is made in any other asset instead of the relevant fixed asset, it would have earned a certain rate of interest. To calculate the amount of depreciation, annuity factor is used. Annuity factor can be found out from the annuity table or by using formula.

Amount of depreciation is computed as follows:

Amount of depreciation = Annuity factor × Original cost of the asset

The following formula is used to compute annuity factor:

$$\text{Annuity factor} = \frac{i(1+i)^n}{(1+i)^n - 1}$$

where, i = interest rate;

n = estimated life of the asset in number of years

10.7.7 Revaluation method

Under this method, the amount of annual depreciation is calculated by comparing the value of the assets at the end of the year and their value at the beginning of the year. The value of the asset at the end of the year is determined with the consultation of relevant experts. The excess of opening value over the closing value of the asset is the amount of depreciation for that year. This method is used for live stock, loose tools, etc.

10.7.8 Sinking fund method

This method is adopted especially when it is desired not merely to write off an asset but also to provide enough funds to replace an asset at the end of its working life. Under this method, the amount charged as depreciation is transferred to depreciation fund and invested outside the business. The investment is made in safe securities which offer a certain rate of interest. Interest is received annually and reinvested every year along with the amount of annual depreciation. On the expiry of the life of the asset, the investments are sold and the sale proceeds are used for replacement of the asset. This method of depreciation is suitable for assets of higher value. This method is also known as depreciation fund method. Thus, this method not only takes into account depreciation but also makes provision for the replacement of the asset.

10.7.9 Insurance policy method

Under this method, an insurance policy is taken for an amount equal to the cost of replacement of the asset. The amount of depreciation is paid by way of insurance premium every year to the insurance company. On maturity of the policy, the policy amount is received from the insurance company and it is used for the purchase of new asset.

The process of allocating the cost of an intangible asset over a period of time is called amortisation.

10.8 Methods of recording depreciation

There are two methods followed to record depreciation.

(i) Charging depreciation to asset account

(ii) Charging depreciation to provision for depreciation account.

10.8.1 Charging depreciation to asset account

Under this method at the end of every accounting period, the amount of depreciation charged is debited to depreciation account and the amount of depreciation is credited to asset account. Hence the asset appears in the balance sheet at its depreciated value. Depreciation being revenue charge is transferred to profit and loss account.

The following journal entries are to be passed in the books for depreciation and related transactions:

(a) For purchase of asset

Asset A/c	Dr.	xxx	
To Bank A/c			xxx

(b) For providing depreciation at the end of the accounting year

Depreciation A/c	Dr.	xxx	
To Asset A/c			xxx

(c) For closing the depreciation account

Profit and loss A/c	Dr.	xxx	
To Depreciation A/c			xxx

(d) For sale of asset

Bank A/c	Dr.	xxx	
Profit and loss* A/c	Dr.	xxx	
To Asset A/c			xxx

***Note**: Profit and loss A/c will be credited if there is profit on sale.

DO YOU KNOW?

Creating provision for depreciation account

In this method, a provision for depreciation account is created. The amount of depreciation charged every year is transferred to provision for depreciation account and not to asset account. Hence, asset account appears in the balance sheet at its original cost. Amount in the provision for depreciation account is shown on the liabilities side of the balance sheet under the head current liabilities and provisions. Depreciation for every year being nominal item is closed by debiting to profit and loss account of the respective year.

Example:

Original cost of plant and machinery ₹ 10,000 Depreciation ₹ 1,000

Method 1: When provision for depreciation account is not created

Balance sheet (extract)				
Liabilities	**₹**	**Assets**		**₹**
		Plant and machinery	10,000	
		Less: Depreciation	1,000	9,000

Method 2: When provision for depreciation account is created

Balance sheet (extract)			
Liabilities	**₹**	**Assets**	**₹**
Provision for depreciation	1,000	Plant and machinery	10,000

DO YOU KNOW?

The following journal entries are made under provision for depreciation account method:

a) For purchase of asset

Asset A/c	Dr.	xxx	
To Bank A/c			xxx

b) For providing depreciation at the end of the accounting year

Depreciation A/c	Dr.	xxx	
To Provision for depreciation A/c			xxx

c) For closing the depreciation account

Profit and loss A/c	Dr.	xxx	
To Depreciation A/c			xxx

On sale of asset

d) For transferring accumulated depreciation on asset sold to asset account

Provision for depreciation A/c	Dr.	xxx	
To Asset A/c			xxx

*Note: After making this entry, the asset account gets reduced by the amount of accumulated depreciation upto the date of sale. In other words the asset appears at book value.

e) For sale of asset

Bank A/c	Dr.	xxx	
Profit and loss A/c	Dr.	xxx	
To Asset A/c			xxx

* Note: Profit and loss A/c will be credited if there is profit on sale.

Tutorial note

Transactions relating to sale of asset may also be transferred to a temporary account called asset disposal account and completed. Each time an asset is sold, a separate asset disposal account is opened and the balance in the asset account is transferred to asset disposal account. All transactions relating to sale are entered in the asset disposal account. The asset disposal account is closed immediately after the sale.

Illustration 6

Calculate the amount of depreciation and depreciation rate from the following by using 'straight line method'. Also give journal entries for the first two years. The books are closed on 31st December every year.

January 1, 2016 Payment to vendor for purchase of machinery	₹ 1,00,000
January 1, 2016 Transportation cost	₹1,000
January 1, 2016 Installation cost	₹ 9,000
Estimated scrap value at the end of the life	₹ 5,000
Estimated life	10 years

Solution

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$= \frac{1,10,000 - 5,000}{10} = \frac{1,05,000}{10} = ₹\ 10,500 \text{ per year}$$

$$\text{Rate of depreciation per year} = \frac{\text{Amount of depreciation}}{\text{Original cost}} \times 100$$

$$= \frac{10,500}{1,10,000} \times 100 = 9.55\%$$

Note:

Cost of the asset = Purchase price + Transportation cost + Installation cost

= 1,00,000 + 1,000 + 9,000 = ₹ 1,10,000

Journal entries

Date	Particulars	Debit ₹	Credit ₹
2016 January 1	Machinery A/c Dr. To Bank A/c (Machinery bought)	1,00,000	 1,00,000
January 1	Machinery A/c Dr. To Bank A/c (Transportation and installation cost incurred on purchase of machinery)	10,000	 10,000

Date	Particulars		Debit ₹	Credit ₹
December 31	Depreciation A/c To Machinery A/c (Depreciation provided)	Dr.	10,500	 10,500
December 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation transferred to profit and loss account)	Dr.	10,500	 10,500
2017 December 31	Depreciation A/c To Machinery A/c (Depreciation provided)	Dr.	10,500	 10,500
December 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to profit and loss account)	Dr.	10,500	 10,500

Illustration 7

Ramu Brothers purchased a machine on 1st July 2016 at a cost of ₹ 14,000 and spent ₹ 1,000 on its installation. The firm writes off depreciation at 10% of original cost every year. The books are closed on 31st December every year. Give journal entries and prepare machinery account and depreciation account for 2 years.

Solution

Note: Cost of the asset = Purchase price + Installation cost

= 14,000 + 1,000 = ₹ 15,000

Journal entries

Date	Particulars		Debit ₹	Credit ₹
2016 July 1	Machinery A/c To Bank A/c (Machinery bought)	Dr.	14,000	 14,000
July 1	Machinery A/c To Bank A/c (Installation expenses on machinery incurred)	Dr.	1,000	 1,000
December 31	Depreciation A/c To Machinery A/c (15,000 × 10/100 × 6/12) (Depreciation provided)	Dr.	750	 750

Date	Particulars	Debit ₹	Credit ₹
December 31	Profit and Loss A/c Dr. Dr. To Depreciation A/c (Depreciation transferred to profit and loss account)	750	 750
2017 December 31	Depreciation A/c (15,000 × 10/100) Dr. To Machinery A/c (Depreciation provided)	1,500	 1,500
December 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation transferred to profit and loss account)	1,500	 1,500

Ledgers

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
July 1	To Cash A/c	15,000	Dec 31	By Depreciation A/c	750
			Dec 31	By Balance c/d	14,250
		15,000			15,000
2017	To Balance b/d	14,250	2017		
Jan 1			Dec 31	By Depreciation A/c	1,500
			Dec 31	By Balance c/d	12,750
		14,250			14,250
2018					
Jan1	To Balance b/d	12, 750			

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec 31	To Machinery A/c	750	Dec 31	By Profit and Loss A/c	750
		750			750
2017			2017		
Dec 31	To Machinery A/c	1,500	Dec 31	By Profit and Loss A/c	1,500
		1,500			1,500

Illustration 8

Anand bought a machinery for ₹ 1,00,000 on 1-1-2015. On 1-6-2016, he bought another machine for ₹ 50,000. On 1-10-2017, he purchased another machine for ₹ 20,000. Provide depreciation at 10% p.a. on straight line method. Prepare machinery account for the years 2015 to 2017 by using accounts by assuming accounts are closed on 31st December every year.

Solution
Ledger accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jan 1	To Bank A/c	1,00,000	Dec 31	By Depreciation A/c	10,000
			Dec 31	By Balance c/d	90,000
		1,00,000			1,00,000
2016			2016		
Jan 1	To Balance b/d	90,000	Dec 31	By Depreciation A/c	12,500
June 1	To Bank A/c	50,000	Dec 31	By Balance c/d	1,27,500
		1,40,000			1,40,000
2017			2017		
Jan 1	To Balance b/d	1,27,500	Dec 31	By Depreciation A/c	15,500
Oct 1	To Bank A/c	20,000	Dec 31	By Balance c/d	1,32,000
		1,47,500			1,47,500
2018 Jan1	To Balance b/d	1,32,000			

Note:

Depreciation for 2015: 1,00,000 × 10% = 10,000

2016: 1,00,000 × 10% = 10,000

(+) 50,000 x 10% x 6/12 = 2,500 12,500

2017: 1,00,000 x 10% = 10,000

(+) 50,000 x 10% = 5,000

(+) 20,000 x 10% x 3/12 = 500 15,500

10.9 Calculation of profit or loss on sale of asset

Sometimes, a business may sell an asset. In that case, the profit or loss on sale is to be calculated and accounted in the books. To find the profit or loss on sale of asset, the book value of the asset on the date of sale and the sale price are to be compared. Book value of

the asset on the date of sale is calculated by subtracting the total depreciation provided on the asset from the date of its purchase or construction to the date of sale from the original cost of the asset. If the sale price is more than the book value of the asset, the difference is profit. On the other hand, if the book value of the asset is more than the sale price, the difference is loss.

Book value = Cost of the asset – Total depreciation provided upto the date of sale

Profit on sale = Sale price – Book value (Sale Price > Book Value)

Loss on sale = Book Value – Sale price (Sale Price < Book Value)

Illustration 9

Joy and Co. purchased machinery on 1st April 2016 for ₹ 75,000. On 31st March 2018, it sold the machinery for ₹ 62,000. Depreciation is to be provided every year at 10% per annum on the fixed instalment method. Accounts are closed on 31st March every year. Find out the profit or loss on sale of machinery.

Solution

Calculation of profit or loss on sale of machinery

Particulars		₹
Cost price		75,000
Less: Depreciation for 2016-17	(75,000 x 10%)	7,500
		67,500
Less: Depreciation for 2017-18	(75,000 x 10%)	7,500
Book value on the date of sale		60,000
Less: Selling price		62,000
Profit on sale		- 2,000

The selling price is more than the book value on the date of sale of machinery. Hence, the difference ₹ 2,000 is profit on sale of machinery.

Student activity

Think: Will the method of depreciation affect the profit or loss made on the sale of an asset?

Illustration 10

On 1st April 2015, Kumar purchased a machine for ₹ 80,000 and spent ₹ 20,000 on its installation. The residual value at the end of its expected useful life of 8 years is estimated at ₹ 4,000. On 30th September 2017, the machine is sold for ₹ 50,000. Depreciation is to be provided according to straight line method. Prepare Machinery Account. Accounts are closed on 31st December every year.

Solution

$$\text{Amount of depreciation} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated life of the asset in years}}$$

$$= \frac{1,00,000 - 4,000}{8}$$

$$= ₹\ 12,000 \text{ per year}$$

$$\text{Rate of depreciation per year} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

$$= \frac{12,000}{1,00,000} \times 100 = 12\%$$

Note:

Cost of the asset = Purchase price + Installation cost

= 80,000 + 20,000 = ₹ 1,00,000

Ledger accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
April 1	To Bank A/c	80,000	Dec 31	By Depreciation A/c	9,000
April 1	To Bank A/c	20,000		(1,00,000 ×12/100 × 9/12)	
			Dec 31	By Balance c/d	91,000
		1,00,000			1,00,000
2016			2016		
Jan 1	To Balance b/d	91,000	Dec 31	By Depreciation A/c	12,000
				(1,00,000 ×12/100)	
			Dec 31	By Balance c/d	79,000
		91,000			91,000
2017			2017		
Jan 1	To Balance b/d	79,000	Sep 30	By Depreciation A/c	9,000
				(1,00,000 ×12/100 × 9/12)	
			Sep 30	By Bank A/c	50,000
			Sep 30	By Profit and Loss A/c	20,000
				(Loss on sale)	
		79,000			79,000

Illustration 11

M/s Ramco textile mills purchased machinery on 1st April 2014 for ₹ 2,00,000 on credit from M/s. Nila & Co. and spent ₹ 10,000 on its installation. Depreciation is provided at 10% per annum on the written down value method. Prepare machinery account and depreciation account for the first three years. Books are closed on 31st March every year.

Solution
Ledger accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2015		
April 1	To Nila & Co. A/c	2.00,000	March 31	By Depreciation A/c	21,000
April 1	To Bank A/c	10,000		(2,10,000 ×10%)	
			March 31	By Balance c/d	1,89,000
		2,10,000			2,10,000
2015			2016		
April 1	To Balance b/d	1,89,000	March 31	By Depreciation A/c	18,900
				(1,89,000 ×10%)	
			March 31	By Balance c/d	1,70,100
		1,89,000			1,89,000
2016			2017		
April 1	To Balance b/d	1,70,100	March 31	By Depreciation A/c	17,010
				(1,70,100 ×10%)	
			March 31	By Balance c/d	1,53,090
		1,70,100			1,70,100
2017					
April 1	To Balance b/d	1,53,090			

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
March 31	To MachineryA/c	21,000	March 31	By Profit & Loss A/c	21,000
		21,000			21,000
2016			2016		
March 31	To MachineryA/c	18,900	March 31	By Profit & Loss A/c	18,,900
		18,900			18,900
2017			2017		
March 31	To MachineryA/c	17,010	March 31	By Profit & Loss A/c	17,010
		17,010			17,010

Illustration 12

A company purchased machinery costing ₹ 90,000 on January1, 2015 and spent ₹ 10,000 on its erection. On July 1, 2017, the machinery was sold for ₹ 58,000. The company writes off depreciation at 20% p.a. under written down value method. Prepare machinery account. The books are closed on 31st December every year.

Solution

Ledger accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jan 1	To Bank A/c	90,000	Dec 31	By Depreciation A/c	20,000
	To Bank A/c	10,000		(1,00,000 × 20%)	
			Dec 31	By Balance c/d	80,000
		1,00,000			1,00,000
2016			2016		
Jan 1	To Balance b/d	80,000	Dec 31	By Depreciation A/c	16,000
				(80,000 ×20%)	
			Dec 31	By Balance c/d	64,000
		80,000			80,000
2017			2017		
Jan 1	To Balance b/d	64,000	July 1	By Depreciation A/c	6,400
				(64,000 ×20/100 × 6/12)	
	To Profit & Loss A/c	400	July 1	By Bank A/c	58,000
	(Profit on sale)				
		64,400			64,400

Illustration 13

A Ltd., purchased a machine on 1st January 2014 for ₹ 60,000. On 1st July 2014, it purchased another machine for ₹ 50,000. On 1st July 2015, the company sold the machine purchased on 1st January 2014 for ₹ 40,000. It was decided that the machine be depreciated at 10% per annum on diminishing balance method. Show the machinery account for the years 2014 to 2016. The accounts are closed on December 31st, every year.

Solution

Ledger accounts

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan 1	To Bank A/c	60,000	Dec 31	By Depreciation* A/c	8,500
July 1	To Bank A/c	50,000	Dec 31	By Balance c/d	1,01,500
		1,10,000			1,10,000

2015			2015		
Jan 1	To Balance b/d	1,01,500	July 1	By Depreciation A/c	2,700
			July 1	By Bank A/c	40,000
			July 1	By Profit and Loss A/c	11,300
			Dec 31	By Depreciation A/c*	4,750
			Dec 31	By Balance c/d	42,750
		1,01,500			1,01,500
2016			2016		
Jan 1	To Balance b/d	42,750	Dec 31	By Depreciation A/c	4,275
				(42,750 ×10%)	
			Dec 31	By Balance c/d	38,475
		42,750			42,750
2017					
Jan 1	To Balance b/d	38,475			

* Note:

1. Computation of depreciation for the year 2014

Asset purchased on 1.1.14: 60,000 x 10% = 6,000

Asset purchased on 1.7.14: 50,000 x 10%x6/12 = 2,500 ₹ 8,500

2. Computation of depreciation on the asset sold on 1.7.2015

Original cost on 1.1.2014	= 60,000
Less: Depreciation for 2014 (60,000 x 10%)	= 6,000
Written down value on 1.1.2015	54,000
Less: Depreciation for 2015 upto 1.7.2015 (54,000 x 10%x6/12)	= 2,700
Book value	51,300
Sale price	40,000
Loss on sale of asset	11,300

3. **Depreciation for 2015 for the asset purchased on 1.7.2014**

Original cost on 1.7.2014	= 50,000
Less: Depreciation for 2014 (50,000 x 10%x6/12)	= 2,500
Written down value on 1.1.2015	47,500
Less: Depreciation for 2015 (47,500 x 10%)	= 4,750

Points to remember

- The process of allocation of the relevant cost of a fixed asset over its useful life is known as depreciation.
- Cost of an asset is not merely the purchase price but also the expenses incurred on the asset till it is put into use including cost of trial run.
- Cost of a second-hand asset includes the initial repairs charges also.
- Under the straight line method, the book value of the asset at the end of its useful life is reduced to zero or its scrap value.
- The book value of the asset on any date is calculated by subtracting the depreciation provided to date from its original cost.
- The excess of sale proceeds of an asset over its book value represents profit on sale.
- The excess of book value of an asset over its sale price represents loss on sale.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. Under straight line method, the amount of depreciation is
   (a) Increasing every year
   (b) Decreasing every year
   (c) Constant for all the years
   (d) Fluctuating every year

2. If the total charge of depreciation and maintenance cost are considered, the method that provides a uniform charge is
   (a) Straight line method
   (b) Diminishing balance method
   (c) Annuity method
   (d) Insurance policy method

3. Under the written down value method of depreciation, the amount of depreciation is
   (a) Uniform in all the years
   (b) Decreasing every year
   (c) Increasing every year
   (d) None of the above

4. Depreciation provided on machinery is debited to
   (a) Depreciation account
   (b) Machinery account
   (c) Trading account
   (d) Provision for depreciation account
5. Cash received from sale of fixed asset is credited to
   (a) Profit and loss account
   (b) Fixed asset account
   (c) Depreciation account
   (d) Bank account
6. Depreciation is provided on
   (a) Fixed assets
   (b) Current assets
   (c) Outstanding charges
   (d) All assets
7. Depreciation is caused by
   (a) Lapse of time (b) Usage
   (c) Obsolescence (d) a, b and c

8. Depreciation is the process of
   (a) Allocation of cost of the asset to the period of its useful life
   (b) Valuation of assets
   (c) Maintenance of an asset in a state of efficiency
   (d) Adding value to the asset
9. For which of the following assets, the depletion method is adopted for writing off cost of the asset?
   (a) Plant and machinery (b) Mines and quarries
   (c) Buildings (d) Trademark
10. A depreciable asset may suffer obsolescence due to____
   (a) Passage of time (b) Wear and tear
   (c) Technological changes (d) None of the above.
11. Which method shall be efficient, if repairs and maintenance cost of an asset increases as it grows older.
   (a) Straight line method (b) Reducing balance method
   (c) Sinking fund method (d) Annuity method

12. Depreciation is to be calculated from the date when
    (a) Asset is put to use
    (b) Purchase order is made
    (c) Asset is received at business premises
    (d) Invoice of assets is received
13. If the rate of depreciation is same, then the amount of depreciation under straight line method vis-à-vis written down value method will be
    (a) Equal in all years
    (b) Equal in the first year but higher in subsequent years
    (c) Equal in the first year but lower in subsequent years
    (d) Lower in the first year but equal in subsequent years.
14. Residual value of an asset means the amount that it can fetch on sale at the ____of its useful life.
    (a) Beginning (b) End
    (c) Middle (d) None

Answers

1(c)	2 (b)	3 (b)	4 (a)	5(b)	6(a)	7(d)	8(a)	9(b)	10(c)	11(b)	12(a)	13(b)	14(b)

II Very short answer questions

1. What is meant by depreciation?
2. List out the various methods of depreciation.
3. Give the formula to find out the amount and rate of depreciation under straight line method of depreciation.
4. What is annuity method?
5. What is sinking fund method?

III Short answer questions

1. What are the objectives of providing depreciation?
2. What are the causes for depreciation?
3. State the advantages and limitations of straight line method of depreciation.
4. State the advantages and limitations of written down value method of depreciation.
5. Distinguish between straight line method and written down value method of providing depreciation.

IV Exercises

Straight line method

1. A firm purchased a plant for ₹ 40,000. Erection charges amounted to ₹ 2,000. Effective life of the plant is 5 years. Calculate the amount of depreciation per year under straight line method.

(**Answer**: ₹ 8,400)

2. A company purchased a building for ₹ 50,000. The useful life of the building is 10 years and the residual value is ₹ 2,000. Find out the amount and rate of depreciation under straight line method.

(**Answer**: Amount of depreciation: ₹ 4,800; Rate of depreciation 9.6%)

3. Furniture was purchased for ₹ 60,000 on 1-7-2016. It is expected to last for 5 years. Estimated scrap at the end of five years is ₹ 4,000. Find out the rate of depreciation under straight line method.

(**Answer**: Amount of depreciation ₹ 11,200; Rate of depreciation 18.67%)

4. Calculate the rate of depreciation under straight line method from the following information:

Purchased a second hand machinery on 1.1.2018 for ₹ 38,000

On 1.1.2018 spent ₹12,000 on its repairs

Expected useful life of machine is 4 years

Estimated residual value ₹6,000

(**Answer**: Amount of depreciation ₹ 11,000; Rate of depreciation 22%)

5. Calculate the rate of depreciation under straight line method.

Purchase price of a machine ₹ 80,000

Expenses to be capitalised ₹ 20,000

Estimated residual value ₹ 4,000

Expected useful life 4 years

(**Answer**: Amount of depreciation ₹ 24,000, Rate of depreciation 24%)

6. Machinery was purchased on 1st January 2015 for ₹ 4,00,000. ₹ 15,000 was spent on its erection and ₹ 10,000 on its freight charges. Depreciation is charged at 10% per annum on straight line method. The books are closed on 31st March each year. Calculate the amount of depreciation on machinery for the first two years.

(**Answer**: Amount of depreciation on 31-03-2015: ₹ 10,625; on 31-03-2016: ₹ 42,500)

7. An asset is purchased on 1.1.2016 for ₹25,000. Depreciation is to be provided annually according to straight line method. The useful life of the asset is 10 years and its residual value is ₹ 1,000. Accounts are closed on 31st December every year. You are required to find out the rate of depreciation and give journal entries for first two years.

(**Answer**: Amount of depreciation ₹ 2,400, Rate of depreciation 9.6%)

8. From the following particulars, give journal entries for 2 years and prepare machinery account under straight line method of providing depreciation:

Machinery was purchased on 1.1.2016

Price of the machine ₹ 36,000

Freight charges ₹ 2,500

Installation charges ₹ 1,500

Life of the machine 5 years

(**Answer**: Amount of depreciation: ₹ 8,000; Balance in machinery A/c: ₹ 24,000)

9. A manufacturing company purchased on 1 April, 2010, a plant and machinery for ₹4,50,000 and spent ₹ 50,000 on its installation. After having used it for three years, it was sold for ₹ 3,85,000. Depreciation is to be provided every year at the rate of 15% per annum on the fixed instalment method. Accounts are closed on 31st March every year. Calculate profit or loss on sale of machinery.

(**Answer**: Profit on sale ₹ 1,10,000)

10. On 1st April 2008, Sudha and Company purchased machinery for ₹ 64,000. To instal the machinery expenses incurred was ₹ 28,000. Depreciate machinery 10% p.a. under straight line method. On 30th June, 2010 the worn out machinery was sold for ₹ 52,000. The books are closed on 31st December every year. Show machinery account.

(**Answer**: Loss on sale ₹ 19,300)

11. Ragul purchased machinery on April 1, 2014 for ₹ 2,00,000. On 1st October 2015, a new machine costing ₹ 1,20,000 was purchased. On 30th September 2016, the machinery purchased on April 1, 2014 was sold for ₹ 1,20,000. Books of accounts are closed on 31st March and depreciation is to be provided at 10% p.a. on straight line method. Prepare machinery account and depreciation account for the years 2014-15 to 2016-17.

(**Answer**: Amount of depreciation: 2014-15: ₹ 20,000; 2015-16: ₹ 26,000; 2016-17: ₹ 22,000; Loss on sale of 1st machine: ₹ 30,000; Balance in machinery a/c: ₹ 1,02,000).

Written down value method

12. An asset is purchased for ₹ 50,000. The rate of depreciation is 15% p.a. Calculate the annual depreciation for the first two years under diminishing balance method.

(**Answer**: Amount of depreciation I year ₹ 7,500; II year ₹ 6,375)

13. A boiler was purchased on 1st January 2015 from abroad for ₹10,000. Shipping and forwarding charges amounted to ₹2,000. Import duty ₹ 7,000 and expenses of installation amounted to ₹ 1,000. Calculate depreciation for the first 3 years @10% p.a. on diminishing balance method assuming that the accounts are closed 31st December each year.

(**Answer**: Amount of depreciation: 2015: ₹ 2,000; 2016: ₹ 1,800; 2017: ₹ 1,620)

14. A furniture costing ₹ 5,000 was purchased on 1.1.2016, the installation charges being ₹1,000. The furniture is to be depreciated @10% p.a. on the diminishing balance method. Pass journal entries for the first two years.

(**Answer**: Amount of depreciation I year ₹ 600; II year ₹ 540)

15. A firm acquired a machine on 1st April 2015 at a cost of ₹ 50,000. Its life is 6 years. The firm writes off depreciation @ 30% p.a. on the diminishing balance method. The firm closes its books on 31st December every year. Show the machinery account and depreciation account for three years starting from 1st April 2015.

(**Answer**: Amount of depreciation: 2015: ₹ 11,250; 2016: ₹ 11,625; 2017: ₹ 8,138; Balance in machinery a/c on 31-12-17 ₹ 18,987)

16. A firm purchased a machine for ₹ 1,00,000 on 1-7-2015. Depreciation is written off at 20% on reducing balance method. The firm closes its books on 31st December each year. Show the machinery account upto 31-12-2017.

(**Answer**: Amount of depreciation: 2015: ₹ 10,000; 2016: ₹ 18,000; 2017: ₹ 14,400; Balance in machinery a/c on 31-12-17 ₹ 57,600)

17. On 1st October 2014, a truck was purchased for ₹ 8,00,000 by Laxmi Transports Ltd. Depreciation was provided @ 15% p.a. under diminishing balance method. On 31st March 2017, the above truck was sold for ₹5,00,000. Accounts are closed on 31st March every year. Find out the profit or loss made on the sale of the truck.

(**Answer**: Amount of depreciation: 2014-15: ₹ 60,000; 2015-16: ₹ 1,11,000; 2017: ₹ 94,350; Loss on sale ₹ 34,650)

18. On 1st January 2015, a second hand machine was purchased for ₹ 58,000 and ₹ 2,000 was spent on its repairs. On 1st July 2017, it was sold for ₹ 28,600. Prepare the machinery account for the years 2011 to 2013 under written down value method by assuming the rate of depreciation as 10% p.a. and the accounts are closed on 31st December every year.

(**Answer**: Amount of depreciation: 2015: ₹ 6,000; 2016: ₹ 5,400; 2017: ₹ 2,430; Loss on sale ₹ 17,570)

19. Raj & Co purchased a machine on 1st January 2014 for ₹ 90,000. On 1st July 2014, they purchased another machine for ₹ 60,000. On 1st January 2015, they sold the machine purchased on 1st January 2014 for ₹ 40,000. It was decided that the machine be depreciated at 10% per annum on diminishing balance method. Accounts are closed on 31st December every year. Show the machinery account for the years 2014 and 2015.

(**Answer**: Amount of depreciation: 2014: ₹12,000; 2015: ₹ 5,700; Loss on sale ₹ 41,000; Balance in machine a/c on 31-12-14 ₹1,38,000; on 31-12-15 ₹ 51,300).

CASE STUDY

Lucky & Co's income statement shows a loss of ₹ 3,000. The owner thinks that there is no need to provide for depreciation as the company has made a loss. He also suggests his accountant to change the method of depreciation for the next year so as to avoid the loss. But, the accountant is hesitant to make the necessary changes suggested by his owner.

Now, discuss on the following points:

- Do you agree on the point that there is no need to charge depreciation when the company has made a loss?
- Why does the accountant hesitate to make the changes suggested by his owner?
- What are the accounting principles not followed if the accountant agrees to his owner's suggestion?
- Do you think charging depreciation could be the only reason for the company's loss?

To explore further

Is it possible to exchange the old fixed asset with a new one? In such a case, what do you think will be the adjustment in terms of payment and accounting treatment?

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Unit 11

CAPITAL AND REVENUE TRANSACTIONS

Contents

Points to recall

The following points are to be recalled before learning capital and revenue transactions:

- Matching concept
- Periodicity concept
- Income and expenditure

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Learning Objectives

To enable the students to

- Understand the meaning of capital and revenue expenditure and capital and revenue receipts
- Understand the meaning of deferred revenue expenditure
- Analyse the transactions to classify into capital and revenue items

Key terms to know

- Capital expenditure
- Revenue expenditure
- Deferred revenue expenditure
- Capital receipts
- Revenue receipts

11.1 Introduction

Student activity

Think: How often the business entities buy stationery items? How often they buy machinery? Is it fair if the business entity treats both these type of expenditure the same?

The main objective of accounting of business transactions is to ascertain the results of operations and the financial position of the business concern. The transactions carried on may yield benefit only for the current accounting period or they may yield benefit for more than one accounting period. According to matching principle, the expenses incurred in the current accounting period must be matched with the revenues earned during that period.

In case of certain expences, the benefit accrues only in the relevant accounting period. They are called revenue expenditrues. For example, salaries, rent, etc. But in case of certain expenditrues benefit extends beyond one accounting period. They are called capital expenditrues.

To exhibit a true and fair view of profitability and state of affairs, proper allocation of capital and revenue items is required. The revenue items are to be shown in the trading and profit and loss account and capital items are to be shown in the balance sheet.

11.2. Considerations in determining capital and revenue expenditures

The basic considerations to differentiate between capital and revenue expenditures are:

(i) Nature of business

Expenditure on purchase of goods is revenue expenditure. Expenditure on purchase of asset is capital expenditure. Whether an item of expenditure is goods or asset depends on the nature of business. Goods include articles or commodities in which the business is dealing with. For example, for a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset. Therefore, the nature of business is very important criteria in classifying expenditure between capital and revenue.

(ii) Effect on revenue generating capacity of business

If expenditure helps to generate income or revenue in the current accounting period, it is revenue expenditure. On the other hand, if expenditure helps to generate revenue for more than one accounting period, it is capital expenditure.

(iii) Purpose of expenditure

If expenditure is incurred in the normal course of maintenance of an asset, it is revenue expenditure. On the other hand, if expenditure is incurred for major repair of an asset which increases its productive capacity, it is capital expenditure.

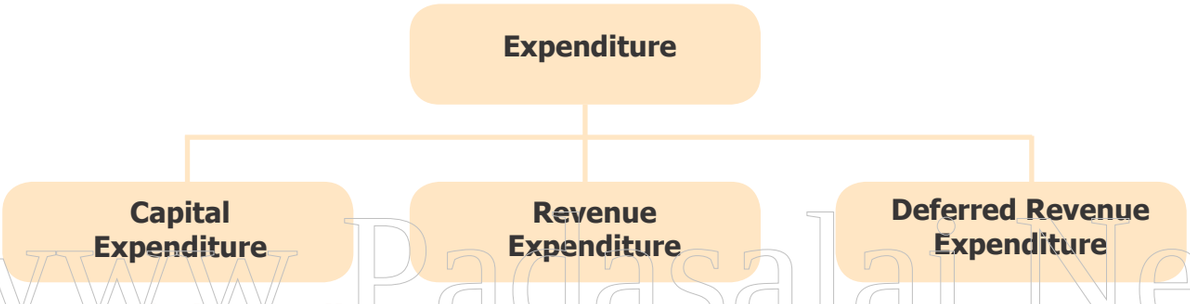
(iv) Materiality of the amount involved

Relative proportion of the amount involved is considered in distinguishing between revenue expenditure and capital expenditure. If the amount of expenditure is material, it is treated as capital expenditure even if the expenditure does not increase the productive capacity of the asset. On the other hand, when the amount of expenditure is immaterial, it is treated as revenue even if the benefit of the expenditure extends beyond one accounting period. For example cost of waste basket is treated as revenue expenditure.

11.3 Classification of expenditure

Expenditures may be classified into the following three categories:

i) Capital expenditure
ii) Revenue expenditure
iii) Deferred revenue expenditure.



11.4 Capital expenditure

It is an expenditure incurred during an accounting period, the benefits of which will be available for more than one accounting period. It includes any expenditure resulting in the acquisition of any fixed asset or contributes to the revenue earning capacity of the business. It is non- recurring in nature.

11.4.1 Features of capital expenditure

Following are the features of capital expenditure:

i) It gives benefit for more than one accounting period.
ii) It includes acquisition of fixed assets and all expenditure incurred upto the point an asset is ready for use.
iii) It contributes to the revenue earning capacity of the business.
iv) It is non-recurring in nature.
v) It is shown on the assets side of the balance sheet.

Examples

- Cost of acquisition of land and building.
- Cost of acquisition of office equipment, computer and air-conditioner.
- Cost of acquisition of plant and machinery including installation charges and trial run.

11.5 Revenue expenditure

The expenditure incurred for day to day running of the business or for maintaining the earning capacity of the business is known as revenue expenditure. It is recurring in nature. It is incurred to generate revenue for a particular accounting period. The revenue expenditure may be incurred in relation with revenue or in relation with a particular accounting period. For example, cost of purchases is a revenue expenditure related to sales revenue. Rent and salaries are related to a particular accounting period.

11.5.1 Features of revenue expenditure

Following are the features of revenue expenditure:

i) It is recurring in nature.

ii) It is incurred for maintaining the earning capacity of the business.

iii) Its benefit expires in the same accounting period.

iv) It is shown on the debit side of the trading and profit and loss account.

Examples

- Purchase of goods for resale.
- Administrative, selling and distribution expenses.
- Manufacturing expenses.

Student activity

Think: Identify and list down capital and revenue expenditures at home and at school.

11.6 Deferred revenue expenditure

An expenditure, which is revenue expenditure in nature, the benefit of which is to be derived over a subsequent period or periods is known as deferred revenue expenditure. The benefit usually accrues for a period of two or more years. It is for the time being, deferred from being charged against income. It is charged against income over a period of certain years.

11.6.1 Features of deferred revenue expenditure

Following are the features of deferred revenue expenditure:

a) It is a revenue expenditure, the benefit of which is to be derived over a subsequent period or periods.

b) It is not fully written off in the year of actual expenditure. It is written off over a period of certain years.

c) The balance available after writing off (i.e., Actual expenditure - Amount written off) is shown on the assets side balance sheet.

Examples

- Considerable amount spent on advertising
- Major repairs to plant and machinery

11.7 Comparison of capital, revenue and deferred revenue expenditure

Following are the points of comparison among capital, revenue and deferred revenue expenditure:

Basis	Capital expenditure	Revenue expenditure	Deferred revenue expenditure
i) Nature	It is non – recurring in nature.	It is recurring in nature.	It is non- recurring in nature.
ii) Purpose	To contribute to the revenue earning capacity of the business.	To carry on the day to day activities of the business.	To get benefit for certain years.
iii) Period of benefits	Its benefit is available for a longer period.	Its benefit is obtained within one accounting period.	Its benefit is available for more than one accounting period.
iv) Effect on profit earning capacity	It increases the profit earning capacity of the business.	It maintains the profit earning capacity of the business.	It is of benefit to the business for certain years.
v) Accounting treatment	It will appear on the assets side of the balance sheet.	It will be shown on the debit side of the trading and profit and loss account depending on whether direct or indirect in nature.	The amount written off during the year is shown on the debit side of profit and loss account and the unwritten off portion is shown on the asset side.

11.8 Capital and revenue receipts

Student activity

Think: A textile business sells some part of its unused land and receives the amount. Can it be considered as normal sale? Can it be shown in the trading account?

11.8.1 Capital receipt

Receipt which is not revenue in nature is called capital receipt. It is non-recurring in nature. The amount received is normally substantial. It is shown on the liabilities side of the balance sheet.

Examples

- Proceeds from issue of shares and debentures
- Long term loan raised from bank and other financial institutions
- Proceeds of sale of fixed assets
- Proceeds of sale of long-term investments
- Receipt of special donations

11.8.2 Revenue receipt

Receipts which are obtained in the normal course of business are called revenue receipts. It is recurring in nature. The amount received is generally small.

Examples

- Proceeds from sale of goods
- Interest on investments received
- Rent received
- Dividend from investment in shares.

11.9 Distinction between capital and revenue receipts

Following are the main differences between capital and revenue receipts:

Basis	Capital receipts	Revenue receipts
i) Nature	Non-recurring in nature.	Recurring in nature.
ii) Size	Amount is generally substantial.	Amount is generally smaller.
iii) Distribution	These amounts are not available for distribution as profits.	The excess of revenue receipts over the revenue expenses can be used for distribution as profits.

Examples of capital and revenue items

Capital expenditure	Revenue expenditure	Deferred revenue expenditure	Capital receipts	Revenue receipts
i) Purchase cost of fixed assets ii) Purchase cost of long term investments iii) Expenses to increase the earning capacity of fixed assets iv) Loan given to outsiders	i) Maintenance expenses of fixed assets ii) Insurance premium iii) Postage and stationery iv) Administrative, selling and distribution expenditure	i) Heavy amount on advertisement. ii) Cost of major repairs on fixed assets	i) Life membership fees ii) Special donations received iii) Loan borrowed iv) Sale of fixed assets	i) Sale proceeds of goods ii) Commission received iii) Sale of old news paper iv) Rent received

Capital expenditure	Revenue expenditure	Deferred revenue expenditure	Capital receipts	Revenue receipts
v) Cost of acquisition of goodwill, copyright, trademark, etc. vi) Installation expenditure of fixed assets vii) Expenses incurred for trial run of a machinery	v)Advertisement expenditure, the benefit of which will accrue for one accounting period vi) Payment of honorarium vii) Annual subscription vii) Entertain-ment expenses		v) Contribution towards capital fund vi) Long term investment sold vii) Government grants. (specific purpose) viii) Amount received not in normal course of business	v) Interest on investments vi) Government grants (general purpose) vii) Bad debts recovered

Illustration 1

State with reasons whether the following are capital or revenue expenditure:

i. Expenses incurred in connection with obtaining a licence for starting the factory for ₹ 25,000.

ii. A factory shed was constructed at a cost of ₹ 2,00,000. A sum of ₹ 10,000 had been incurred in the construction of temporary huts for storing building material.

iii. Overhaul expenses of second-hand machinery purchased amounted to₹ 5,000.

Solution

i) It is a capital expenditure since it is incurred to acquire the right to carry on business.

ii) Cost of construction of building including cost of temporary huts is capital expenditure.

iii) It is a capital expenditure because overhaul expenses are incurred to put second-hand machinery in working condition to get long-term advantage.

Illustration 2

State with reasons whether the following are capital or revenue or deferred revenue expenditure:

i) Advertisement expenses amounted to ₹ 10 crores to introduce a new product.

ii) Expenses on freight for purchasing new machinery.

iii) Freight and insurance on the new machinery and cartage paid to bring the new machinery to the factory.

Solution

i) The effect of heavy advertisement expenses will extend to more than one accounting period, but it does not create any property of tangible or intangible nature and hence it is deferred revenue expenditure.

ii) It is a capital expenditure since it is incurred up to the point the machine is ready for use.

iii) These are capital expenditures since they are incurred up to the point the machine is ready for use.

Illustration 3

State whether the following are capital, revenue or deferred revenue expenditure.

i) Carriage of ₹ 1,000 spent on machinery purchased and installed.

ii) Office rent paid ₹ 2,000.

iii) Wages of ₹ 5,000 paid to machine operators.

iv) Hire charges for the use of motor vehicle, hired for five years, but paid yearly.

Solution

i) Carriage of ₹ 1,000 spent on machinery purchased and installed is capital expenditure.

ii) Office rent paid ₹ 2,000 is revenue expenditure.

iii) Wages of ₹ 5,000 paid to machine operators is revenue expenditure.

iv) Hire charges for the use of motor vehicle, hired for five years, but paid yearly is revenue expenditure.

Illustration 4

State whether the following are capital or revenue items.

i. ₹ 5,000 spent towards additions to buildings.

ii. Second-hand motor car purchased for ₹30,000 and paid ₹2,000 as repairs immediately.

iii. ₹ 10,000 was spent on painting the new factory.

iv. Freight and cartage on the new machine ₹ 150, erection charges ₹ 200.

v. ₹ 150 spent on repairs before using a second hand car purchased recently.

Solution

i. ₹ 5,000 spent towards additions to buildings is capital expenditure.

ii. The entire amount of ₹ 32,000 should be treated as capital expenditure.

iii. ₹ 10,000 spent on painting the new factory should be treated as capital expenditure.

iv. Freight, cartage and erection charges are capital expenditures.

v. ₹ 150 being expense to bring the asset in usable condition, is a capital expenditure.

Illustration 5

Classify the following expenses as capital or revenue.

i) The sum of ₹ 3,200 has been spent on a machine as follows:

a) ₹ 2,000 for additions to double the output.

b) ₹ 1,200 for repairs necessitated by negligence.

ii) Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency.

Solution

i) a) ₹ 2,000 spent on additions should be treated as capital expenditure

b) ₹ 1200 spent on repairs should be treated as revenue expenditure.

ii) Overhauling expenses are incurred for the engine of a motor car to get better fuel efficiency. So this expenditure should be treated as capital expenditure.

Illustration 6

Classify the following expenditures and receipts as capital or revenue:

i) ₹ 10,000 spent as travelling expenses of the directors on trips abroad for the purchase of fixed assets.

ii) Amount received from trade receivables during the year.

iii) Amount spent on demolition of building to construct a large building on the same site.

iv) Insurance claim received on account of a machinery damaged by fire.

Solution

i) Capital expenditure

ii) Revenue receipt

iii) Capital expenditure

iv) Capital receipt.

Points to remember

- Expenditures of a business can be classified into capital, revenue and differred revenue expenditure.
- Capital expenditure is an expenditure incurred during an accounting period, the benefits of which will be available for more than one accounting period.
- Revenue expenditure is the expenditure incurred for day today running of the business or for maintaining the earning capacity of the business.
- Deferred revenue expenditure is expenditure of revenue nature incurred for getting benefits which extends to two or more years.
- Revenue receipts are incomes derived from the normal activities of the business. Capital receipts are derived from transactions that are not the usual activities of the business.
- Revenue expenditure is a routine expenditure incurred in the normal course of business.

Self–examination questions

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I Multiple choice questions

Choose the correct answer

1. Amount spent on increasing the seating capacity in a cinema hall is

   (a) Capital expenditure

   (b) Revenue expenditure

   (c) Deferred revenue expenditure

   (d) None of the above.

2. Expenditure incurred ₹ 20,000 for trial run of a newly installed machinery will be

   (a) Preliminary expense

   (b) Revenue expenditure

   (c) Capital expenditure

   (d) Deferred revenue expenditure

3. Interest on bank deposits is

(a) Capital receipt

(b) Revenue receipt

(c) Capital expenditures

(d) Revenue expenditures

4. Amount received from IDBI as a medium term loan for augmenting working capital

(a) Capital expenditures

(b) Revenue expenditures

(c) Revenue receipts

(d) Capital receipt

5. Revenue expenditure is intended to benefit

(a) Past period

(b) Future period

(c) Current period

(d) Any period

6. Pre-operative expenses are

(a) Revenue expenditure

(b) Prepaid revenue expenditure

(c) Deferred revenue expenditure

(d) Capital expenditure

Answers

1 (a)	2 (c)	3 (b)	4 (d)	5 (c)	6 (d)

II Very short answer questions

1. What is meant by revenue expenditure?
2. What is capital expenditure?
3. What is capital profit?
4. Write a short note on revenue receipt.
5. What is meant by deferred revenue expenditure?

III Short answer questions

1. Distinguish between capital expenditure and revenue expenditure.
2. Distinguish between capital receipt and revenue receipt.
3. What is deferred revenue expenditure? Give two examples.

IV Exercises

1. State whether the following expenditures are capital, revenue or deferred revenue.
   i) Advertising expenditure, the benefits of which will last for three years.
   ii) Registration fees paid at the time of registration of a building.
   iii) Expenditure incurred on repairs and whitewashing at the time of purchase of an old building in order to make it usable.

   (**Answer**: Capital Expenditure: ii , iii Deferred revenue expenditure: i)

2. Classify the following items into capital and revenue.
   i) Registration expenses incurred for the purchase of land.
   ii) Repairing charges paid for remodelling the old building purchased.
   iii) Carriage paid on goods purchased.
   iv) Legal expenses paid for raising of loans

   (**Answer**: Capital : i, ii, iv Revenue: iii)

3. State whether they are capital and revenue.
   i) Construction of building ₹ 10,00,000.
   ii) Repairs to furniture ₹ 50,000.
   iii) White-washing the building ₹ 80,000
   iv) Pulling down the old building and rebuilding ₹ 4,00,000

   (**Answer**: Capital: i, iv. Revenue: ii, iii)

4. Classify the following items into capital and revenue.
   i) ₹ 50,000 spent for railway siding.
   ii) Loss on sale of old furniture
   iii) Carriage paid on goods sold.

   (**Answer**: Capital: i, Revenue: ii, iii)

5. State whether the following are capital, revenue and deferred revenue.

i) Legal fees paid to the lawyer for acquiring a land ₹ 20,000.

ii) Heavy advertising cost of ₹ 12,00,000 spent on introducing a new product.

iii) Renewal of factory licence ₹ 12,000.

iv) A sum of ₹ 4,000 was spent on painting the factory.

(**Answer**: Capital: i, Revenue: iii, iv Deferred revenue: ii)

6. Classify the following receipts into capital and revenue.

i) Sale proceeds of goods ₹ 75,000.

ii) Loan borrowed from bank ₹ 2,50,000

iii) Sale of investment ₹ 1,20,000.

iv) Commission received ₹ 30,000.

v) ₹ 1,400 wages paid in connection with the erection of new machinery.

(**Answer**: Capital: ii, iii, v Revenue: i, iv)

7. Identify the following items into capital or revenue.

i) Audit fees paid ₹ 10,000.

ii) Labour welfare expenses ₹ 5,000.

iii) ₹ 2,000 paid for servicing the company vehicle.

iv) Repair to furniture purchased second hand ₹ 3,000.

v) Rent paid for the factory ₹ 12,000

(**Answer**: Capital: iv Revenue: i, ii, iii, v)

CASE STUDY

Sadhana decides to start a business of selling air-conditioners. She buys different brands of air-conditioners. She also buys a delivery van, some furniture and some tools to fix air-conditioners. She buys some stationery items and cleaning liquid. She spends some amount on advertising her shop. She records the entire amount spent in the trading account.

Now, discuss on the following points:

- Is it correct to record the entire amount spent in the first year of trading in the trading account? What impact will it have on the profit for the year?
- What are her fixed assets?
- Does she apply accounting concepts? If not which is the concept she does not apply?
- Can you help Sadhana to classify the expenditure?
- What other capital, revenue and deferred revenue expenditure her business may incur in the future?

To explore further

Do you think that the amount of the expenditure determines whether it is capital or revenue in nature? Justify.

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Unit 12

FINAL ACCOUNTS OF SOLE PROPRIETORS - I

Contents

AK16G6

Points to recall

Following points are to be recalled before learning final accounts of sole proprietors - I:

- Accounting process
- Trial balance
- Dual aspect concept, Historical cost concept, Periodicity concept and Matching concept
- Differences between capital expenditure and revenue expenditure
- Differences between capital receipts and revenue receipts

Learning Objectives

To enable the students to

- Understand the meaning of final accounts and the purpose they serve
- Prepare trading and profit and loss account and balance sheet

Key terms to know

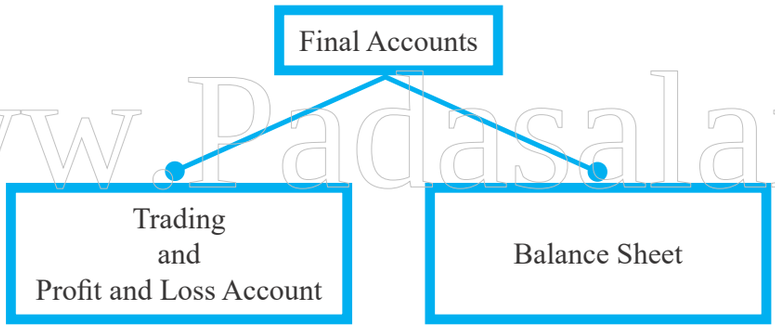
- Final accounts
- Financial statements
- Income statement
- Trading account
- Profit and loss account
- Cost of goods sold
- Gross profit
- Net profit
- Financial position
- Balance sheet

12.1 Introduction to final accounts

Student activity

Think: A trader wants to know the profit earned by him, at the end of his first year of trading. Do you think the trial balance shows the profit earned? How will he find the profit?

Business entities raise funds, acquire assets and incur various expenses for the purpose of carrying on business operations and earning income from such operations. These transactions are first recorded in the journal and then classified under common heads in the ledger. Preparation of trial balance from ledger balances helps to verify the arithmetical accuracy of entries made in the books of accounts, but it is not the end in itself. The business entities are interested in knowing periodically the results of business operations carried on and the financial soundness of the business. In other words, they want to know the profitability and the financial position of the business. These can be ascertained by preparing the final accounts or financial statements. The final accounts are usually prepared at the end of the accounting period on the basis of balances of ledger accounts shown by the trial balance.



The final accounts or financial statements include the following:

a. Income Statement or Trading and Profit and Loss Account and

b. Position Statement or Balance Sheet.

The purposes of preparing the financial statements are:

i. To ascertain the financial performance of an enterprise and

ii. To ascertain the financial position of an enterprise.

The income statement and balance sheet are prepared for these purposes respectively. Income statement gives the manner in which the profit or loss for an accounting period is arrived at. The revenues earned and expenses incurred to earn the revenues during the period are shown in the income statement under appropriate heads as per matching principle. All the nominal accounts and accounts relating to goods during an accounting period are to be considered only in the relevant accounting period and are not to be carried forward. Moreover, only these items are to be compared for determining the financial performance. Hence, at the close of

the accounting period, all nominal accounts (i.e. expenses, losses, revenues, gains, purchases, purchases returns, sales and sales returns) are to be closed by transferring to the income statement or trading and profit and loss account.

While transferring the items, it is desirable that the results of buying and selling of goods and the results of overall operations and financial performance are given separately. Hence, income statement is divided into two parts. The first part, i.e., trading account shows the results of buying and selling and the second part shows the results of overall financial performance. The second part may also be presented in such a manner to give the operating results and overall financial performance separately. All the direct expenses and items relating to goods are transferred to trading account which is the first part of income statement. All indirect expenses and losses and indirect incomes and gains are transferred to profit and loss account along with the net result of trading account.

12.2 Closing entries and Opening entry

12.2.1 Closing entries

Balances of all the nominal accounts are required to be closed on the last day of the accounting year to facilitate the preparation of trading and profit and loss account. It is done by passing necessary closing entries in the journal proper. Purchases has debit balance and purchases returns has credit balance. At the end of the accounting year, the balance in purchases returns account is closed by transferring to purchases account.

Similarly, sales account has credit balance and sales returns has debit balance. At the end of the accounting year, the balance in sales returns account is closed by transferring to sales account. The various closing entries are as follows:

1. For closing purchases returns account

Particulars		Debit ₹	Credit ₹
Purchases returns A/c	Dr.	xxx	
To Purchases A/c			xxx
(Closing of purchase returns account by transferring to purchases account)			

2. For closing sales returns account

Particulars		Debit ₹	Credit ₹
Sales A/c	Dr.	xxx	
To Sales returns A/c			xxx
(Closing of sales returns account by transferring to sales account)			

3. For closing opening stock and direct expenses, i.e., items that appear on the debit side of trading account

Particulars		Debit ₹	Credit ₹
Trading A/c	Dr.	xxx	
To Opening stock A/c			xxx
To Purchases A/c			xxx
To Carriage inwards A/c			xxx
To Wages A/c			xxx
To All other direct expenses A/c (individually)			xxx
(Closing of various items by transferring them to trading account)			

4. For closing sales and closing stock, i.e., items that appear on the credit side of trading account

Particulars		Debit ₹	Credit ₹
Sales A/c	Dr.	xxx	
Closing stock A/c	Dr.	xxx	
To Trading A/c			xxx
(Closing of various iteams by transferring them to trading account)			

5. For transfer of gross profit or gross loss to profit and loss account

(a) For gross profit

Particulars		Debit ₹	Credit ₹
Trading A/c	Dr.	xxx	
To Profit and loss A/c			xxx
(Transfer of gross profit to the profit and loss account)			

(b) For gross loss

Particulars		Debit ₹	Credit ₹
Profit and loss A/c	Dr.	xxx	
To Trading A/c			xxx
(Transfer of gross loss to the profit and loss account)			

6. For closing indirect expenses and losses, i.e., items that appear on the debit side of profit and loss account

Particulars		Debit ₹	Credit ₹
Profit and loss A/c	Dr.	xxx	
To Office expenses A/c			xxx
To Administration expenses A/c			xxx
To Selling expenses A/c			xxx
To Distribution expenses A/c			xxx
To Financial expenses A/c			xxx
To Provisions A/c			xxx
To Depreciation A/c			xxx
To Other indirect expenses and losses A/c (individually)			xxx
(Closing of various items by transferring them to profit and loss account)			

7. For closing the indirect incomes, i.e. items that appear on the credit side of profit and loss account

Particulars		Debit ₹	Credit ₹
Discount earned A/c	Dr.	xxx	
Commission earned A/c	Dr.	xxx	
Other indirect incomes A/c (individually)	Dr.	xxx	
To Profit and loss A/c			xxx
(Closing of various items by transferring them to profit and loss account)			

8. For transfer of net profit or net loss to capital account

(a) For net profit

Particulars		Debit ₹	Credit ₹
Profit and loss A/c	Dr.	xxx	
To Capital A/c			xxx
(Transfer of net profit to capital account)			

(b) For net loss

Particulars		Debit ₹	Credit ₹
Capital A/c	Dr.	xxx	
To Profit and loss A/c			xxx
(Transfer of net loss to capital account)			

12.2.2 Opening entry

The balances of various accounts which are not closed at the end of the accounting period are carried forward to the next accounting period. In fact, the balances appearing in the balance sheet at the end of an accounting period becomes the opening balances for the next accounting period. Hence, at the beginning of every accounting year, an opening entry is made in the journal proper to bring forward the balances in various accounts. The entry passed is as follows:

Particulars		Debit ₹	Credit ₹
Assets A/c (individually)	Dr.	xxx	
To Liabilities A/c (individually)			xxx
To Capital A/c			xxx
(Assets and liabilities brought forward)			

12.3 Trading account

Trading refers to buying and selling of goods with the intention of making profit. The trading account is a nominal account which shows the result of buying and selling of goods for an accounting period. According to J. R. Batliboi, "The trading account shows the results of buying and selling of goods. In preparing this account, the general establishment charges are ignored and only the transactions in goods are included."

Trading account is prepared to find out the difference between the revenue from sales and cost of goods sold. Cost of goods sold refers to directly related cost. Direct cost includes the purchase price of goods purchased and all other expenses which are incurred to bring the goods to the business premises or godown and to make these ready for sale. All the goods purchased during the accounting period may not be sold during the same accounting period. Hence, it is necessary to calculate the cost of goods sold during the period. Matching principle is applied here. Hence, the cost of stock not sold must be deducted, i.e., value of closing stock must be deducted. But if there is any opening stock of goods that will be sold during the accounting period, it is to be added to the cost of purchases made during the period. If there is cost of goods manufactured, it must also be added to find out the cost of goods sold.

Cost of goods sold = Opening stock + Net purchases + Direct expenses – Closing stock

If the amount of sales exceeds the cost of goods sold, the difference is gross profit. On the other hand, the excess of cost of goods sold over the amount of sales results in gross loss.

Sales – Cost of goods sold = Gross profit

Sales – Gross profit = Cost of goods sold

12.3.1 Need for preparation of trading account

Preparation of trading account serves the following purposes:

(i) Provides information about gross profit or gross loss

It shows the gross profit or gross loss of the business for an accounting year. This helps the business persons to find out gross profit ratio by expressing the gross profit as a percentage of sales. It helps to compare and analyse with the ratios of the previous years. Thus, it provides data for comparison, analysis and planning for a future period.

(ii) Provides an opportunity to safeguard against possible losses

If the ratio of gross profit has decreased in comparison to the preceding years, effective measures can be taken to safeguard against future losses. For example, the sale price of goods may be increased or steps may be taken to analyse and control the direct expenses.

(iii) Provides information about direct expenses and direct incomes

All the expenses incurred on the purchase of goods are direct expenses. They are recorded in the trading account. Trading account also shows sales revenue, which is a direct income. With the help of trading account, percentage of such expenses on sales revenue can be calculated and compared with similar ratios of the previous years. Thus, it enables the management to have control over the direct expenses.

12.3.2 Preparation of trading account

Trading account is a nominal account. The opening stock, net purchases and all expenses relating to purchase of goods are shown on the debit side and the net sales and closing stock are shown on the credit side of it.

A) Items shown on the debit side of the trading account

The following are the items shown on the debit side of the trading account:

(i) Opening stock

The stock of goods remaining unsold at the end of the previous year is the opening stock of the current year. This item will not be there in a newly started business. It will not appear if it is adjusted with purchases. As opening stock would have been sold during the year, the cost of opening stock is included in trading account.

(ii) Purchases and purchases returns

Goods which have been bought for resale are termed as purchases. Goods purchased which are returned to suppliers are termed as purchases returns or returns outward. Purchases include both cash purchases and credit purchases. Net purchases, i.e., purchases minus purchases returns are shown in the debit side of the trading account.

(iii) Direct expenses

All the expenses incurred on the purchase of goods and for bringing the goods to the go down or place of business and to make them to saleable condition are known as direct expenses. They are debited to trading account. Direct expenses include the following:

(a) Carriage inwards or Freight inwards

Amount paid for transporting the goods purchased to the godown or business premises is called carriage inwards or carriage on purchases or freight inwards.

(b) Wages

Amount paid to workers who are directly engaged in loading, unloading and handling of goods purchased is known as wages.

(c) Dock Charges

These are the charges levied for shipping the cargo while entering or leaving docks. When they are paid on import of goods, they are treated as direct expenses.

(d) Octroi

This is a tax levied by the local authority when the purchased goods enter the municipal limits.

(e) Import duty

Taxes paid on import of goods are known as import duties.

(f) Royalty

This is the amount paid to the owner of a mine or a patent for using owner's right. When the royalty is based on cost of production or output, it is treated as a direct expense.

(g) Coal, gas, fuel and power

Cost incurred towards coal, gas and fuel to make the goods saleable is also considered as direct expenses.

(iv) Cost of goods manufactured

If the sole proprietor is also engaged in manufacture of goods, a separate account, namely, manufacturing account is to be prepared in which expenses incurred for manufacture of goods will be entered. Examples of such expenses are raw materials, coal, gas, fuel, water, power, factory rent, packaging, factory lighting, royalty on manufactured goods, etc. The total cost of goods manufactured is transferred to the debit side of trading account.

B) Items shown on the credit side of the trading account

Following are the items shown on the credit side of the trading account:

(a) Sales and Sales returns

Both cash and credit sales of goods will be included in sales. The sales account will show credit balance whereas the sales returns account will show debit balance. The amount of net sales is shown on the credit side of the trading account by deducting sales returns from sales.

(b) Closing stock

The goods remaining unsold at the end of the accounting period are known as closing stock. They are valued at cost price or net realisable value (market price) whichever is lower as per Accounting Standard 2 (Revised).

Student activity

Think: 'Closing stock need to be valued at cost price or market price whichever is less'. Which is the accounting principle applied here?

12.3.3 Closing of trading account

The difference between the totals of two sides of the trading account indicates either gross profit or gross loss. If the total of the credit side is more, the difference represents gross profit. On the other hand, if the total of the debit side is higher, the difference represents gross loss. The gross profit or gross loss is transferred to profit and loss account.

12.3.4 Format of trading account

Dr. **Trading account for the year ended . . .** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales returns	xxx	xxx
Less: Purchases returns	xxx	xxx	By Closing stock		xxx
To Direct expenses:			By **Gross loss c/d***		xxx
Carriage/Freight inwards		xxx			
Wages		xxx			
Dock charges		xxx			
Octroi		xxx			
Royalty		xxx			
Import duty		xxx			
To Cost of goods manufactured		xxx			
To **Gross profit c/d***		xxx			
		xxx			xxx

* The difference in trading account will be either gross profit or gross loss.

The heading of the trading account contains the words 'for the year ended……' as it discloses the sales and cost of goods sold of the business for the whole accounting year.

Illustration 1

From the following information, prepare trading account for the year ended 31.12.2016.

Particulars	₹
Opening stock (1.1.2016)	10,000
Purchases	26,100
Sales	40,600
Closing Stock (31.12.2016)	13,500

Solution

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

Particulars	₹	Particulars	₹
To Opening stock	10,000	By Sales	40,600
To Purchases	26,100	By Closing stock	13,500
To Gross profit c/d	**18,000**		
	54,100		54,100

Student activity

Think: Do you think a business that provides service such as a travel agency, insurance and an auditing firm needs to prepare a trading account?

Illustration 2

From the following balances extracted from the books of M/s. Lavanya and sons, prepare trading account for the year ended 31st March, 2017:

Particulars	₹	Particulars	₹
Opening stock	16,500	Carriage inwards	1,200
Purchases	45,000	Wages	4,800
Sales	72,000	Fuel and power	3,200
Purchases returns	500	Closing stock	18,000
Sales returns	1,500		

Solution

In the books of M/s. Lavanya and sons

Dr. **Trading account for the year ended 31st March, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		16,500	By Sales	72,000	
To Purchases	45,000		Less: Sales returns	1,500	70,500
Less: Purchases returns	500	44,500	By Closing stock		18,000
To Carriage inwards		1,200			
To Wages		4,800			
To Fuel and power		3,200			
To Gross profit c/d*		**18,300**			
		88,500			88,500

Illustration 3

Prepare trading account for the year ended 31st December, 2017, from the following balances:

Particulars	₹	Particulars	₹
Opening stock	4,00,000	Purchases returns	1,20,000
Purchases	20,00,000	Carriage on purchases	2,00,000
Net sales	48,00,000	Carriage on sales	1,00,000
Freight and octroi	65,000	Advertisement	1,20,000
Selling expenses	1,10,000	Office rent	75,000
Coal, gas and water	22,000	Import duty on goods purchased	7,28,000

Closing stock is valued at ₹ 6, 00,000.

Solution

Dr. **Trading account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		4,00,000	By Net sales		48,00,000
To Purchases	20,00,000		By Closing stock		6,00,000
Less: Purchases returns	1,20,000	18,80,000			
To Freight and Octroi		65,000			
To Carriage on purchases		2,00,000			
To Coal, gas and water		22,000			
To Import duty		7,28,000			
To Gross Profit c/d		**21,05,000**			
		54,00,000			54,00,000

Note: Selling expenses, carriage on sales, advertisement and office rent will not appear in trading account, as they are indirect expenses.

Illustration 4

Following is the extract of a trial balance as on 31st December, 2017. Prepare trading account.

Particulars	Dr. ₹	Cr. ₹
Closing stock	25,000	
Adjusted purchases	70,000	
Freight inwards	5,700	
Royalty on goods purchased	4,300	
Sales		1,70,000
Wages	8,000	
Octroi on purchase of goods	4,000	

Solution

Dr. **Trading account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Adjusted purchases		70,000	By Sales		1,70,000
To Freight inwards		5,700			
To Royalty on goods Purchased		4,300			
To Wages		8,000			
To Octroi on purchase of goods		4,000			
To Gross profit c/d		**78,000**			
		1,70,000			1,70,000

Note: Closing stock will not appear in trading account as it is adjusted with purchases, it will appear in balance sheet.

Illustration 5

From the following information, prepare trading account for the year ending 31st December, 2017.

Particulars	₹	Particulars	₹
Opening stock	50,000	Dock charges on purchases	4,000
Cost of goods manufactured	12,000	Import duty on purchases	3,500
Cash purchases	60,000	Wages	11,000
Cash sales	85,000	Sales returns	3,000
Purchases returns	2,000	Credit purchases	35,000
Carriage inwards	4,000	Credit sales	60,000
Freight outwards	3,000	Other direct expenses	7,000
Coal and fuel	2,500		

Solution

Dr. **Trading account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		50,000	By Sales:		
To Cost of goods			Cash	85,000	
manufactured		12,000	Credit	60,000	
To Purchases:				1,45,000	
Cash	60,000		Less: Sales returns	3,000	1,42,000
Credit	35,000		By Gross loss c/d		**45,000**
	95,000				
Less: Purchases returns	2,000	93,000			
To Carriage inwards		4,000			
To Coal and fuel		2,500			
To Dock charges on					
Purchases		4,000			
To Import duty on					
Purchases		3,500			
To Wages		11,000			
To Other direct expenses		7,000			
		1,87,000			1,87,000

Note: Freight outwards will not appear in trading account as it is not a direct expense.

Illustration 6

Compute cost of goods sold from the following information:

Particulars	₹
Opening stock	8,000
Purchases	60,000
Direct expenses	5,000
Indirect expenses	6,000
Closing stock	9,000

Solution

Cost of goods sold = Opening stock + Net purchases + Direct expenses – Closing stock

= 8,000 + 60,000 + 5,000 – 9,000

= ₹ 64,000

Note: Indirect expenses do not form part of cost of goods sold.

Illustration 7

Find out the amount of sales from the following information.

Particulars	₹
Opening stock	20,000
Purchases less returns	70,000
Direct expenses	10,000
Closing stock	30,000
Gross profit margin (on sales)	20%

Solution

Cost of goods sold = Opening stock + Net purchases + Direct expenses – Closing stock

= 20,000 + 70,000 + 10,000–30,000

= ₹ 70,000

Let the sales be	100
Less: Gross profit (20% on sales, i.e., 100)	20
Cost of goods sold	80

Therefore, percentage of Gross profit on Cost of goods sold is $\frac{20}{80}$ x 100 = 25 %

Gross profit = 25 % on ₹ 70,000 i.e: $\frac{25}{100}$ x 70,000 = ₹ 17,500

Sales = Cost of goods sold + Gross profit

= 70,000 + 17,500 = ₹ 87,500

When gross profit is 25% on cost, it is 20% on sales

When gross profit is 33 $\frac{1}{3}$ % on cost, it is 25% on sales

12.4 Profit and loss account

Profit and loss account is the second part of income statement. It is a nominal account in nature. A business entity is interested in knowing not only the gross profit or loss but also the net profit earned or net loss incurred during the year. Hence, profit and loss account is prepared to ascertain the net profit or net loss during the year. Profit and loss account contains all the items of indirect expenses and losses and indirect incomes and gains in addition to gross profit or gross loss pertaining to the accounting period. The difference is net profit or net loss. According to Prof. Carter, "A Profit and Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or vice-versa".

Student activity

Think: What will be the effect on the profit, if purchase of fixed asset is shown as expense in profit and loss account?

12.4.1 Need for preparing profit and loss account

Profit and loss account is prepared for the following purposes:

(i) Ascertainment of net profit or net loss

The profit and loss account discloses the net profit available to the proprietor or net loss to be borne by him. Ascertainment of profitability helps in planning for the growth and efficiency of a business enterprise. Inter-firm comparison and intra-firm comparison of profit and loss account items help in assessing efficiency in comparison with other enterprises and other departments of the same enterprise respectively.

(ii) Comparison of profit

The net profit of the current year can be compared with the profit of the previous years. It helps to know whether the business is conducted efficiently or not.

(iii) Control on expenses

Profit and loss account helps in comparing various expenses with the expenses of the previous years. The percentage of individual expenses to net sales can be calculated and compared with the similar ratios of previous years. Such a comparison will be helpful in taking effective steps for controlling unnecessary expenses.

(iv) Helpful in the preparation of balance sheet

A balance sheet can be prepared only after ascertaining the net profit or loss through profit and loss account. Net profit or loss is shown in the balance sheet. Thus, it facilitates preparation of balance sheet.

12.4.2 Preparation of profit and loss account

The amount of gross profit or gross loss brought down from the trading account is the first item in the profit and loss account. All the indirect expenses and losses are debited to profit and loss account. Indirect expenses include office and administrative expenses, selling expenses, distribution expenses, etc. As the profit and loss account is a nominal account, all the indirect expenses and losses are shown on the debit side and all the indirect incomes and gains are shown on the credit side.

Items shown on the debit side of profit and loss account are as follows:

(i) Gross loss

If trading account discloses gross loss, it is shown on the debit side of the profit and loss account.

(ii) Indirect expenses

Expenses which are not connected with purchase of goods are indirect expenses, i.e., expenses incurred in administration, office, selling and distribution of goods are indirect expenses.

(a) Office and administrative expenses

Expenses incurred for office and administration such as salary of office employees, office rent, lighting, postage, printing, legal charges, audit fee, depreciation and maintenance of office equipment, etc. are classified as office and administrative expenses.

(b) Selling and distribution expenses

Expenses incurred for selling, promotion of sales and distribution of goods such as advertisement charges, commission to salesmen, carriage outwards, bad debts, godown rent, packing charges, etc., are classified as selling and distribution expenses.

(c) Other indirect expenses and losses

The expenses such as interest on loan, repair charges, depreciation, charity, loss on sale of fixed assets and abnormal losses such as loss due to fire, theft, etc. not covered by insurance are shown under this category.

Items shown on the credit side of profit and loss account are as follows:

(i) Gross profit

The first item on the credit side of profit and loss account is the gross profit brought down from the trading account if there is gross profit.

(ii) Other incomes and gains

All items of indirect incomes and gains are shown on the credit side of the profit and loss account. Income from investments, rent earned, discount received, commission earned, interest earned and dividend received are indirect incomes. Profit on sale of fixed assets and investments are examples of gains.

12.4.3 Closing of profit and loss account

After debiting indirect expenses and losses and crediting all indirect incomes and gains, if the total of the credit side of the profit and loss account exceeds the debit side, the difference is termed as net profit. On the other hand, if the total in the debit side exceeds the credit side, the difference is termed as net loss. Net profit or net loss is transferred to the capital account.

12.4.4 Format of profit and loss account

Dr. **Profit and loss account for the year ended .....** **Cr.**

Particulars	₹	Particulars	₹
To Gross loss b/d	xxx	By Gross profit b/d	xxx
To Office and administrative expenses:		By Indirect incomes:	
Salaries	xxx	Rent earned	xxx
Rent, rates and taxes	xxx	Discount received	xxx
Printing and stationery	xxx	Commission earned	xxx
Postage	xxx	Interest on investments	xxx
Legal charges	xxx	Dividend on shares	xxx
Audit fees	xxx	Bad debts recovered	xxx
Establishment expenses	xxx	Profit on sale of fixed assets	xxx
Trade expenses	xxx	Apprenticeship premium	xxx
General travelling expenses	xxx	Miscellaneous receipts	xxx
Lighting	xxx	By Net loss*	xxx
Insurance premium	xxx	(transferred to capital account)	
To Selling and distribution expenses:			
Carriage outwards	xxx		
Advertisement	xxx		
Commission	xxx		
Brokerage	xxx		
Bad debts or provision for bad debts	xxx		
Export duty	xxx		
Packing charges	xxx		
To Other expenses and losses:			
Repairs	xxx		
Depreciation	xxx		
Interest charges	xxx		
Discount allowed	xxx		
Provision for discount on debtors	xxx		
Bank charges	xxx		
Interest on capital	xxx		
Donation and charity	xxx		
Loss on sale of fixed assets	xxx		
Abnormal loss due to fire, theft etc. not covered by insurance	xxx		
To Net profit* (transferred to capital account)	xxx		
	xxx		xxx

* The balance will be either net profit or net loss.

Tutorial note

The expenses which are not related to the business are not shown in the profit and loss account. Examples are personal expenses of the proprietor such as domestic and household expenses of the proprietor, income-tax and life insurance premium of the proprietor, etc. These expenses are classified as drawings by the proprietor and are deducted from capital on the liabilities side of the balance sheet if they are paid out of business funds

Only revenue receipts and revenue expenses are shown in the trading and profit and loss account. Capital receipts, capital gains, capital expenditure and capital losses are not shown in trading and profit and loss account. That part of capital items that relate to that accounting period only are shown. For example, depreciation on fixed assets. Purchase of fixed asset is a capital expenditure. But depreciation is a revenue item which relates to the use of the fixed asset in the current accounting period.

Student activity

Think: A furniture trader takes some furniture from his business, for his domestic use. How do you treat this transaction?

Illustration 8

From the following information, prepare profit and loss account for the year ended 31st March, 2018.

Particulars	₹	Particulars	₹
Gross profit b/d	1,50,000	Advertisement expenses	3,800
Carriage outward	25,500	Bad debts	8,500
Office rent	7,000	Dividend received	9,000
Office stationery	3,500	Discount received	4,600
Distribution expenses	2,000	Rent received	7,000

Solution

Dr. Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Carriage outward	25,500	By Gross profit b/d	1,50,000
To Office rent	7,000	By Dividend received	9,000
To Office stationery	3,500	By Discount received	4,600
To Distribution expenses	2,000	By Rent received	7,000
To Advertisement expenses	3,800		
To Bad debts	8,500		
To Net profit transferred to capital account	**1,20,300**		
	1,70,600		1,70,600

Illustration 9

From the following information, prepare profit and loss account for the year ended 31st December, 2017.

Particulars	₹	Particulars	₹
Gross profit b/d	60,000	Interest received	2,100
Freight outward	15,000	Financial charges	4,000
Packing charges (on sales)	12,000	Repairs on vehicles used in office	8,000
Salesmen commission paid	1,300	Depreciation on vehicles used in office	3,000
Promotional expenses	10,200	Interest paid	9,000
Office telephone expenses	22,400	Rent received	7,000
Bad debts recovered	4,000	Carriage inwards	4,000

Solution

Dr. Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Freight outward	15,000	By Gross profit b/d	60,000
To Packing charges	12,000	By Bad debts recovered	4,000
To Salesmen commission	1,300	By Interest received	2,100
To Promotional expenses	10,200	By Rent received	7,000
To Office telephone expenses	22,400	By Net loss transferred to	
To Financial charges	4,000	capital account	**11,800**
To Repairs on vehicles	8,000		
To Depreciation on vehicles	3,000		
To Interest paid	9,000		
	84,900		84,900

Note: Carriage inwards will not appear in profit and loss account as it is a direct expense.

Illustration 10

From the following particulars, prepare profit and loss account for the year ended 31st December, 2017.

Particulars	₹	Particulars	₹
Gross profit	21,05,000	Discount allowed	30,000
Trade expenses	20,000	Office lighting	19,800
Carriage on sales	1,00,000	Commission received	14,400
Office salaries	2,38,000	Interest on loan	22,000
Postage (office)	2,200	Stationery (office)	14,000

Legal charges	4,000	Export duty (on sales)	23,000
Audit fees	16,000	Miscellaneous receipts	5,000
Donation given	11,000	Travelling expenses related to sales	66,000
Sundry expenses	3,600	Selling expenses	53,200

Solution

Dr. Profit and loss account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Trade expenses	20,000	By Gross Profit b/d	21,05,000
To Carriage on sales	1,00,000	By Commission received	14,400
To Office salaries	2,38,000	By Miscellaneous receipts	5,000
To Postage	2,200		
To Legal charges	4,000		
To Audit fees	16,000		
To Donation given	11,000		
To Sundry expenses	3,600		
To Selling expenses	53,200		
To Discount allowed	30,000		
To Office lighting	19,800		
To Interest on loan	22,000		
To Stationery (office)	14,000		
To Export duty	23,000		
To Travelling expenses	66,000		
To Net Profit (transferred to capital account)	**15,01,600**		
	21,24,400		21,24,400

Student activity

Think: From the income statement, is it possible to know how much the business owns or owes?

12.5 Balance sheet

Balance sheet is a statement which gives the position of assets and liabilities on a particular date. Assets are the resources owned by the business. Liabilities are the claims against the business. After ascertaining the net profit or net loss of the business enterprise, a business person would like to know the financial position of the business. For this purpose, balance sheet is prepared which contains amounts of all the assets and liabilities of the business enterprise as on a particular date. The statement so prepared is called 'balance sheet' because it gives the balances of ledger accounts which are still there, after the closure of all nominal accounts by transferring to the trading and profit and loss account. Balances of all the personal and real accounts are grouped into assets and liabilities. In the balance sheet, liabilities are shown on the left hand side and assets on the right hand side.

According to J.R. Batliboi, "A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date."

12.5.1 Need for preparing a balance sheet

The purposes of preparing a balance sheet are as follows:

(a) The main purpose of preparing a balance sheet is to ascertain the true financial position of the business at a particular point of time.

(b) It helps in comparing the cost of various assets of the business such as the amount of closing stock, amount due from debtors, amount of fictitious assets, etc. Moreover as assets and liabilities of similar nature are grouped and presented in balance sheet, a comparative study of these assets and liabilities is facilitated. It helps in comparing the various liabilities of the business.

(c) It helps in finding out the solvency position of the firm. The firm's solvency position is favourable if the assets exceed the external liabilities. The firm's solvency position is not favourable it the external liabilities exceed the assets.

12.5.2 Characteristics of balance sheet

The following are the characteristics of a balance sheet:

(a) A balance sheet is a part of the final accounts. However, the balance sheet is a statement and not an account. It has no debit or credit sides and as such the words 'To' and 'By' are not used before the names of the accounts shown therein.

(b) A balance sheet is a summary of the personal and real accounts, which have balances. Personal and real accounts having debit balances are shown on the right hand side known as assets side, whereas personal and real accounts having credit balances are shown on the left hand side known as liabilities side.

(c) The totals of the two sides of the balance sheet must be equal. If the totals are not equal, it indicates existence of error. It must satisfy the accounting equation, ie., Assets = Capital + Liabilities, following the dual aspect concept.

(d) Balance sheet is prepared on a particular date and not for a fixed period. It discloses the financial position of a business on a particular date. It gives the balances only for the date on which it is prepared.

(e) It shows the financial position of the business according to the going concern concept.

12.5.3 Grouping and Marshalling of assets and liabilities in a balance sheet

The assets and liabilities shown in the balance sheet are grouped and presented in a particular order. The term 'grouping' means showing the items of similar nature under a common heading. For example, the amount due from various customers will be shown under the head 'Sundry debtors.' Similarly, under the head 'Current assets', the balance of cash, bank, debtors, stock and other current assets will be shown.

'Marshalling' is the arrangement of various assets and liabilities in a proper order. Marshalling can be made in one of the following two ways:

(a) In the order of liquidity

According to this method, an asset which is most easily convertible into cash, i.e., cash in hand is shown first and then will follow those assets which are comparatively less easily convertible, so that the least liquid asset i.e., goodwill is shown last. In the same way, the liabilities which are to be paid at the earliest will be shown first. In other words, current liabilities are shown first, then fixed or long-term liabilities and finally the proprietor's capital.

(b) In the order of permanence

This method is exactly the reverse of the first method. Asset which is more permanent, i.e., goodwill is shown first followed by assets which are less permanent. Similarly, those liabilities which are to be paid last will be shown first. In other words, the proprietor's capital is shown first, then fixed or long-term liabilities and lastly the current liabilities. Joint stock companies are required under the Companies Act to prepare their balance sheet in the order of permanence.

12.5.4 Methods of drafting a balance sheet

The balance sheet of business concern can be presented in the following two forms.

a) Horizontal form

b) Vertical form

a) Horizontal form of balance sheet

In the horizontal form, assets are shown on right hand side of the balance sheet and the liabilities are shown on the left hand side of the balance sheet.

Balance sheet of ... as on...

Liabilities	₹	₹	Assets	₹	₹
Capital	xxx		**Fixed assets:**		
Add: Net profit/ Less: Net loss	xxx		**i) Intangible assets**		
	xxx		Goodwill		xxx
Less: Drawings	xxx	xxx	Patent rights		xxx
Reserves		xxx	Copy rights		xxx
Long term loans		xxx	Trade marks		xxx
Current liabilities:			Computer software		xxx
Bank overdraft, Cash credit	xxx		**ii) Tangible assets**		
Outstanding expenses	xxx		Land		xxx
Unearned income	xxx		Buildings	xxx	
Short term loans from banks	xxx		Less: Depreciation	xxx	xxx
Sundry creditors	xxx		Plant and machinery	xxx	
Bills payable	xxx	xxx	Less: Depreciation	xxx	xxx
Provisions			Vehicles	xxx	
Provision for employee benefits		xxx	Less: Depreciation	xxx	xxx
Provision for tax		xxx	Furniture and Fittings	xxx	
			Less: Depreciation	xxx	xxx
			Investments		xxx
			Current assets		
			Stock		xxx
			Advances given		xxx
			Sundry debtors		xxx
			Bills receivable		xxx
			Prepaid expenses		xxx
			Accrued income		xxx
			Cash at bank		xxx
			Cash in hand		xxx
			Fictitious assets		
			Preliminary expenses		xxx
			Miscellaneous expenses		xxx
		xxx			xxx

b) Vertical form of balance sheet

The balance sheet of a sole proprietor can be presented in a vertical statement form as given below:

Balance sheet of ... as on...

Particulars	₹	₹
Current assets:		
Stock in trade	xxx	
Sundry debtors	xxx	
Marketable securities	xxx	
Prepaid expenses	xxx	
Accrued income	xxx	
Bills receivable	xxx	
Advances given	xxx	
Cash at bank	xxx	
Cash in hand	xxx	
Total Current assets		xxx
Less: Current liabilities:		
Sundry creditors	xxx	
Bills payable	xxx	
Bank overdraft	xxx	
Short term loans	xxx	
Outstanding expenses	xxx	
Total current liabilities		xxx
Net working capital		xxx
Add: Long term investments		xxx
Add: Fixed Assets:		
Goodwill	xxx	
Land and building	xxx	
Plant and machinery	xxx	
Furniture	xxx	
Total fixed assets		xxx
Capital Employed (both owner's funds and outsiders' funds)		xxx
Less: Long term liabilities:		
Loans	xxx	
Total long term liabilities		
Net Assets		xxx
		xxx
Represented by:		
Owners' Capital	xxx	
Reserves and surplus	xxx	xxx
Proprietor's fund		**xxx**

12.5.5 Preparation of Balance Sheet

There is no prescribed format for preparing the balance sheet of sole proprietor and partnership. For Joint Stock Company, the format of preparing balance sheet is given under Schedule III of Indian Companies Act, 2013. After transferring all nominal accounts, the items left out in trial balance are real account and personal accounts. These are grouped under assets (debit balance) and liabilities (credit balance) and presented in a balance sheet.

12.5.6 Classification of assets and liabilities

The resources acquired by the business entity out of funds provided by owners or creditors are called assets. These are the resources owned by the business. Assets of a business include cash, stock, plant and machinery, etc.

A) Classification of assets

According to the nature of assets, they may be classified into the following:

a) Fixed assets

Fixed assets are those assets which are acquired or constructed for continued use in the business and last for many years such as land and building, plant and machinery, motor vehicles, furniture, etc. According to Finney and Miller, "Fixed assets are assets of a relatively permanent nature used in the operations of business and not intended for sale." As the purpose of keeping such assets is not to sell but to use them, changes in their realisable values are ignored and these are always shown in the balance sheet at cost less depreciation. Fixed assets can be classifed into i) Tangible fixed assets ii) Intangible fixed assets.

i) Tangible fixed assets

Tangible fixed assets are those which have physical existence or which can be seen and felt. Examples: plant and machinery, building and furniture.

ii) Intangible fixed assets

Intangible fixed assets are those which do not have any physical existence or which cannot be seen or touched. Examples: goodwill, trade-marks, copy rights and patents. Intangible assets are as much valuable as tangible assets because they also help the firm in earning profits. For example, goodwill helps in attracting customers and patents represent the know-how which helps in producing the goods.

DO YOU KNOW?

Cash in hand and stock are tangible assets.

b) Current assets

Current assets are those assets which are either in the form of cash or can be easily converted into cash in the normal course of business or within one year. In the words of Hovard and Upton, "The current assets are usually defined as those assets which are convertible into cash through the normal course of business within a short time, ordinarily in a year." Current assets include cash in hand, cash at bank, short-term investments, bills receivable, debtors, prepaid expenses, accrued income, closing stock, etc. Among these, closing stock is valued at cost or realisable value whichever is lower and debtors are shown after deducting a reasonable provision for bad and doubtful debts.

Tutorial note

Prepaid expenses are treated as current assets. Though cash cannot be realised from prepaid expenses, the service will be available against these without further payment.

c) Liquid assets

Liquid assets are the assets which are either in the form of cash or which can be immediately converted into cash within a very short period of time, such as cash at bank, bills receivable, short-term investments, debtors and accrued incomes. In other words, if prepaid expenses and closing stock are excluded from current assets, the balance is known as liquid assets.

d) Investments

Amount invested outside the business in shares, debentures, bonds and other securities is called investments. If it is invested for a period more than a year they are called long-term investments. If they are invested for a period less than a year they are short term investments and shown under current assets.

e) Wasting assets

These are the assets which get exhausted gradually in the process of excavation. Examples: mines and quarries.

f) Fictitious or Nominal assets

These are assets only in name but not in reality. These assets are not really assets but are shown on the assets side only for the purpose of writing off by transferring them to the profit and loss account gradually over a period of time in future. Such assets include the expenditures, the benefit of which lasts for more than a year, not yet written off, such as advertisement expenses, preliminary expenses, etc.

B) Classification of liabilities

Liabilities or equities are claims against the business entity. These are the amounts owed by a business entity to the outsiders (outsiders equity) and owners (owners equity).

Liabilities may be classified according to their nature as follows:

(a) Fixed or long-term liabilities

The liabilities which are to be repaid after one year or more are termed as long-term liabilities. Example: Long-term loans.

(b) Current or short-term liabilities

The liabilities which are expected to be paid within the normal operating cycle or one year are termed as current or short-term liabilities. These include bank overdraft, creditors, bills payable, outstanding expenses, etc.

(c) Contingent liabilities

These are the liabilities which are not certain at the time of preparation of balance sheet. These liabilities may or may not occur. These are the liabilities which will become payable only on the happening of some specific event which itself is not certain, otherwise these need not be paid. Such liabilities are as follows:

- Liabilities for bills discounted
  In case a bill discounted with the bank is dishonoured by the acceptor on the due date, the firm will become liable to the bank.
- Liability in respect of a suit pending in a court of law
  This would become an actual liability if the suit is decided against the firm.
- Liability in respect of a guarantee given for another person
  The firm would be liable to pay the amount if the person for whom the guarantee is given fails to meet his obligation.

Tutorial note

i) Contingent liabilities are not shown in the balance sheet. They are, however, shown as a foot note just below the balance sheet so that the existence of such liabilities may be revealed.

ii) Capital: Capital is money or money's worth contributed by the owner to the business for the purpose of carrying on business. The difference between assets and liabilities is owner's equity = capital contributed + accumulated profits.

12.6 Differences between trial balance and balance sheet

The following are the differences between trial balance and balance sheet:

Basis	Trial balance	Balance sheet
1. Nature	Trial balance is a list of ledger balances on a particular date.	Balance sheet is a statement showing the position of assets and liabilities on a particular date.

Basis	Trial balance	Balance sheet
2. Purpose	Trial balance is prepared to check the arithmetical accuracy of the accounting entries made.	Balance sheet is prepared to ascertain the financial position of a business.
3. Contents	It is a summary of balances of all accounts – personal, real and nominal accounts.	It is a statement showing the closing balances of only personal and real accounts.
4. Format	The trial balance contains columns for debit balances and credit balances.	The items are grouped as assets and liabilities.
5. Stage	It is prepared before the preparation of final accounts.	It is prepared after preparing trial balance and trading and profit and loss account.
6. Period	It can be prepared periodically, say at the end of the month, quarterly, half yearly, etc.	It is generally prepared at the end of the accounting period.
7. Order	Balances shown in the trial balance need not be in order.	Balances shown in the balance sheet must be in order.
8. Compulsion	Preparation of trial balance is not compulsory.	Preparation of the balance sheet is compulsory in certain cases.

Tutorial note

If a trial balance is not given in the question, trial balance has to be prepared first. If there is a difference in the trial balance, the difference is placed to 'suspense account' and shown in the balance sheet.

Illustration 11

From the following balances of Niruban, prepare balance sheet as on 31st December, 2017.

Particulars	Dr. ₹	Cr. ₹
Plant and machinery	8,00,000	
Land and building	6,00,000	
Furniture	1,50,000	
Cash in hand	20,000	
Bank overdraft		1,80,000
Debtors and Creditors	3,20,000	2,40,000
Bills receivable and Bills payable	1,00,000	60,000
Closing stock	4,00,000	
Investments (short-term)	80,000	
Capital		15,00,000
Drawings	1,30,000	
Net Profit		6,20,000
	26,00,000	26,00,000

Solution

In the books of Niruban

Balance sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	15,00,000		Land and building		6,00,000
Add: Net profit	6,20,000		Plant and machinery		8,00,000
	21,20,000		Furniture		1,50,000
Less: Drawings	1,30,000	19,90,000	Investments (short-term)		80,000
Creditors		2,40,000	Stock in trade		4,00,000
Bills payable		60,000	Debtors		3,20,000
Bank overdraft		1,80,000	Bills receivable		1,00,000
			Cash in hand		20,000
		24,70,000			24,70,000

Illustration 12

From the following information, prepare trading and profit and loss account of Abdul Rahuman for the year ending 31st December, 2016 and balance sheet as on that date. The closing stock on 31st December, 2016 was valued at ₹ 2,000.

Particulars	₹	Particulars	₹
Opening stock	500	Purchases	1,300
Sales	5,000	Wages	700
Discount received	500	Salary	500
Building	50,000	Capital	50,000
Cash in hand	4,500		

Solution

In the books of Abdul Rahuman

Dr.Trading and profit and loss account for the year ending 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening stock	500	By Sales	5,000
To Purchases	1,300	By Closing stock	2,000
To Wages	700		
To Gross profit c/d	**4,500**		
	7,000		7,000
To Salary	500	By Gross profit b/d	4,500
To Net profit	**4,500**	By Discount received	500
(transferred to capital account)			
	5,000		5,000

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	50,000		Building		50,000
Add: Net profit	4,500	54,500	Cash in hand		4,500
		54,500			54,500

Illustration 13

From the following trial balance of Sharan, prepare trading and profit and loss account for the year ending 31st December, 2017 and balance sheet as on that date. The closing stock on 31st December, 2017 was valued at ₹ 2,50,000.

Debit Balances	₹	Credit Balances	₹
Stock (1-1-2017)	2,00,000	Sundry creditors	12,000
Purchases	7,50,000	Purchases returns	30,000
Carriage inwards	75,000	Sales	10,20,000
Wages	3,65,000	Commission received	53,000
Salaries	1,20,000	Capital	33,00,000
Repairs	12,000		
Rent and taxes	2,80,000		
Cash in hand	97,000		
Land	21,50,000		
Drawings	1,66,000		
Bank deposits	2,00,000		
	44,15,000		44,15,000

Solution

In the books of Sharan

Dr. Trading and profit and loss account for the year ending 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		2,00,000	By Sales		10,20,000
To Purchases	7,50,000		By Stock (closing)		2,50,000
Less: Purchases returns	30,000	7,20,000	By Gross loss c/d		**90,000**
To Carriage inwards		75,000			
To Wages		3,65,000			
		13,60,000			13,60,000
To Gross loss b/d		90,000	By Commission received		53,000
To Salaries		1,20,000	By Net loss		
To Repairs		12,000	(transferred to capital account)		**4,49,000**
To Rent and taxes		2,80,000			
		5,02,000			5,02,000

Balance sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	33,00,000		Land		21,50,000
Less: Net loss	4,49,000		Stock in trade		2,50,000
	28,51,000		Bank deposits		2,00,000
Less: Drawings	1,66,000	26,85,000	Cash in hand		97,000
Sundry creditors		12,000			
		26,97,000			26,97,000

Tutorial note

Trading account and profit and loss account are prepared together. The first part is trading account, whereas the second part is profit and loss account.

Points to remember

- Trading and profit and loss account is a nominal account in nature. It means that while preparing this account, the rule of nominal account is followed.
- On the debit side of trading account, direct expenses and opening stock are shown.
- Direct expenses include the purchase price of goods purchased and all other expenses which are incurred to bring the goods to the business premises or godown and to make these ready for sale.
- On the credit side of trading account direct income, i.e. sales and closing stock are shown.
- On the debit side of profit and loss account, indirect expenses and losses are shown.
- On the credit side of this account, indirect incomes and gains are shown.
- Indirect expenses are those expenses incurred for office, administration and selling and distribution.
- Indirect incomes and gains are the incomes or gains which are not directly related to the operation of business enterprise. For example, interest received on the deposits in the bank.
- Balance sheet is a statement and not an account. On the left side liabilities including capital and on the right side the assets are shown in the balance sheet.
- Assets are the resources owned by a business entity. Liabilities are claims against the business or the amounts owed by business to outsiders and owners.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. Closing stock is an item of _____.
   (a) Fixed asset
   (b) Current asset
   (c) Fictitious asset
   (d) Intangible asset

2. Balance sheet is _____
   (a) An account
   (b) A statement
   (c) Neither a statement nor an account
   (d) None of the above

3. Net profit of the business increases the _____
   (a) Drawings
   (b) Receivables
   (c) Debts
   (d) Capital

4. Carriage inwards will be shown
   (a) In the trading account
   (b) In the profit and loss account
   (c) On the liabilities side
   (d) On the assets side

5. Bank overdraft should be shown
   (a) In the trading account
   (b) Profit and loss account
   (c) On the liabilities side
   (d) On the assets side

6. Balance sheet shows the _____ of the business.
   (a) Profitability
   (b) Financial position
   (c) Sales
   (d) Purchases

7. Drawings appearing in the trial balance is
   (a) Added to the purchases
   (b) Subtracted from the purchases
   (c) Added to the capital
   (d) Subtracted from the capital

8. Salaries appearing in the trial balance is shown on the
   (a) Debit side of trading account
   (b) Debit side of profit and loss account
   (c) Liabilities side of the balance sheet
   (d) Assets side of the balance sheet

9. Current assets does not include
   (a) Cash
   (b) Stock
   (c) Furniture
   (d) Prepaid expenses

10. Goodwill is classified as
   (a) A current asset
   (b) A liquid asset
   (c) A tangible asset
   (d) An intangible asset

Answers

1 (b)	2 (b)	3 (d)	4 (a)	5 (c)
6 (b)	7 (d)	8 (b)	9 (c)	10 (d)

II Very short answer questions

1. Write a note on trading account.
2. What are wasting assets?
3. What are fixed assets?
4. What is meant by purchases returns?
5. Name any two direct expenses and indirect expenses.
6. Mention any two differences between trial balance and balance sheet.
7. What are the objectives of preparing trading account?
8. What is the need for preparing profit and loss account?

III Short answer questions

1. What are final accounts? What are its constituents?
2. What is meant by closing entries? Why are they passed?
3. What is meant by gross profit and net profit?
4. "Balance sheet is not an account"- Explain.
5. What are the advantages of preparing a balance sheet?
6. What is meant by grouping and marshalling of assets and liabilities?

IV Exercises

1. Prepare trading account in the books of Sivashankar from the following figures

Particulars	₹	Particulars	₹
Opening stock	1,500	Purchases	3,500
Sales	4,600	Closing stock	1,300

(**Answer**: Gross profit: ₹ 900)

2. Prepare trading account in the books of Mr.Sanjay for the year ended 31st December 2017:

Particulars	₹	Particulars	₹
Opening stock	570	Purchases	15,800
Sales	26,200	Purchases returns	90
Sales returns	60	Closing stock	860

(**Answer**: Gross profit: ₹ 10,720)

3. From the following balances taken from the books of Saravanan, calculate gross profit for the year ended December 31, 2017

Particulars	₹	Particulars	₹
Opening stock	1,50,000	Net sales during the year	4,00,000
Direct expenses	8,000	Net purchases during the year	1,50,000
Closing Stock	25,000		

(**Answer**: Gross profit: ₹ 1,17,000)

4. From the following details for the year ended 31st March, 2018, prepare trading account.

Particulars	₹	Particulars	₹
Opening stock	2,500	Returns inwards	7,000
Purchases	27,000	Coal and gas	3,300
Sales	40,000	Carriage inwards	2,600
Wages	2,500	Closing stock	5,200
Returns outwards	5,200		

(**Answer**: Gross profit: ₹ 5,500)

5. Ascertain gross profit or gross loss from the following:

Particulars	₹	Particulars	₹
Opening stock	20,000	Carriage on purchases	5,000
Closing stock	15,000	Carriage on sales	3,000
Purchases	90,000	Office rent	2,200
Sales	2,00,000		

(**Answer**: Gross profit: ₹ 1,00,000)

6. From the following balances taken from the books of Victor, prepare trading account for the year ended December 31, 2017:

Particulars	₹	Particulars	₹
Adjusted purchases	80,000	Closing stock	7,000
Sales	90,000	Carriage inwards	3,000
Royalty on purchases of goods	4,000	Import duty on purchases of goods	6,000
Octroi on purchase of goods	2,000	Dock charges on purchases	5,000
Cost of goods manufactured	5,000		

(**Answer**: Gross loss: ₹ 15,000)

(**Hint**: Closing stock will not appear in trading account)

7. Compute cost of goods sold from the following information:

Particulars	₹	Particulars	₹
Opening stock	10,000	Indirect expenses	5,000
Purchases	80,000	Closing stock	15,000
Direct expenses	7,000		

(**Answer**: Cost of goods sold: ₹ 82,000)

(**Hint**: Indirect expenses do not form part of cost of goods sold)

8. Find out the amount of sales from the following information:

Particulars	₹	Particulars	₹
Opening stock	30,000	Closing stock	20,000
Purchases less returns	2,00,000	Gross profit margin (on sales)	30%

(**Answer**: Sales ₹ 3,00,000)

9. Prepare profit and loss account in the books of Kirubavathi for the year ended 31st December, 2016 from the following information:

Particulars	₹	Particulars	₹
Gross Profit	12,500	Interest received	100
Discount allowed	60	Carriage outwards	100
Rent	500		

(**Answer**: Net profit: ₹ 11,940)

10. Ascertain net profit or net loss from the following:

Particulars	₹	Particulars	₹
Gross profit	12,000	Administration expenses	4,000
Salary (office)	9,000	Freight outwards	3,000
Apprenticeship premium received	5,000	Advertisement	2,000

(**Answer**: Net loss: ₹ 1,000)

11. From the following details, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	50,000	Interest received	2,000
Office rent	10,000	Discount received	3,000
Depreciation on office assets	8,000	Carriage outwards	2,500
Discount allowed	12,000	Insurance on office building	3,500
Advertisement	4,000	General expenses	3,000
Audit fees	1,000	Freight inwards	1,000

(**Answer**: Net profit ₹ 11,000)

(**Hint**: Freight inwards will not appear in profit and loss account as it is a direct expense)

12. From the following information, prepare profit and loss account for the year ending 31st December, 2016.

Particulars	₹	Particulars	₹
Gross loss	60,000	Printing and stationery (office)	2,000
Promotional expenses	5,000	Legal charges	5,000
Distribution expenses	15,000	Bad debts	1,000
Commission paid	7,000	Depreciation	2,000
Interest on loan paid	5,000	Rent received	4,000
Packing charges (on sales)	4,000	Loss by fire not covered by insurance	3,000
Dividend received	3,000		

(**Answer**: Net loss: ₹ 1,02,000)

13. From the following balances obtained from the books of Mr. Ganesh, prepare trading and profit and loss account.

Particulars	₹	Particulars	₹
Stock on 01.01.2017	8,000	Bad debts	1,200
Purchases for the year	22,000	Trade expenses	1,200
Sales for the year	42,000	Discount allowed	600
Expenses on purchases	2,500	Commission allowed	1,100
Financial charges paid	3,500	Selling expenses	600
Expenses on sale	1,000	Repairs on office vehicles	600

Closing stock on December 31.12.2017 was ₹ 4,500

(**Answer**: Gross profit: ₹ 14,000; Net profit: ₹ 4,200)

14. From the following balances extracted from the books of a trader, ascertain gross profit and net profit for the year ended March 31, 2017.

Particulars	₹	Particulars	₹
Sales	72,250	Purchases	32,250
Opening stock	7,600	Sales returns	1,250
Purchases returns	250	Rent	300
Stationery and printing (office)	250	Salaries	3,000
Miscellaneous expenses	200	Travelling expenses (on sales)	1,800
Advertisement	500	Commission paid	150
General expenses	2,500	Office Expenses	1,600
Dividend received	2,500	Wages	2,600
Loss on sale of old furniture	300	Profit on sale of investments	500

(**Answer**: Gross profit: ₹ 28,800; Net profit: ₹ 21,200)

15. From the following particulars, prepare balance sheet in the books of Bragathish as on 31st December, 2017:

Particulars	₹	Particulars	₹
Capital	80,000	Cash in hand	20,000
Debtors	12,800	Net profit	4,800
Drawings	8,800	Plant	43,200

(**Answer**: Balance sheet total: ₹ 76,000)

16. Prepare trading and profit and loss account in the books of Ramasundari for the year ended 31st December, 2017 and balance sheet as on that date from the following information:

Particulars	₹	Particulars	₹
Opening stock	2,500	Sales	7,000
Wages	2,700	Purchases	3,300
Closing Stock	4,000	Salary	2,600
Discount received	2,500	Capital	52,000
Machinery	52,000	Cash at Bank	6,400
Creditors	8,000		

(**Answer**: Gross profit: ₹ 2,500; Net profit: ₹ 2,400; Balance sheet total: ₹ 62,400)

17. From the Trial balance, given by Saif, prepare final accounts for the year ended 31st March, 2018 in his books.

Debit Balances	₹	Credit Balances	₹
Land	40,000	Purchases returns	15,000
Opening stock	40,000	Bill payable	7,000
Machinery	66,000	Capital	1,50,000
Purchases	1,30,000	Sales	2,20,000
Wages	35,000	Creditors	60,000
Interest paid	13,000		
Cash	2,300		
Debtors	80,000		
Bill receivable	15,000		
Office rent paid	12,700		
Furniture	3,000		
Drawings	5,000		
Sales returns	10,000		
	4,52,000		**4,52,000**

Closing stock (31-12-2017) ₹ 14,500

(**Answer**: Gross profit: ₹ 34,500; Net profit: ₹ 8,800; Balance sheet total: ₹ 2, 20,800)

18. Prepare trading and profit and loss account and balance sheet in the books of Deri, a trader, from the following balances as on March 31, 2018.

Debit Balances	₹	Credit Balances	₹
Stock	10,000	Sales	1,22,500
Cash	2,500	Creditors	5,000
Bank	5,000	Bills payable	2,000
Freight inwards	750	Capital	1,00,000
Purchases	95,000		
Drawings	4,500		
Wages	27,500		
Machinery	50,000		
Debtors	13,500		
Postage (office)	150		
Sundry expenses	850		
Rent paid	2,500		
Furniture	17,250		
	2,29,500		**2,29,500**

Closing stock (31st March, 2018) ₹ 8,000

(**Answer**: Gross loss: ₹ 2,750; Net loss: ₹ 6,250; Balance sheet total: ₹ 96,250)

DO YOU KNOW?

Operating profit is the profit earned from the normal operating activities of a business entity. Operating profit is the difference between operating revenue and operating cost.

Operating profit = Operating revenue – Operating Cost

= Net sales – (Cost of goods sold + other operating expenses)

= Net sales – (Cost of goods sold + office and administration expenses + selling and distribution expenses)

Operating profit is also called Earning Before Interest and Tax, ie., EBIT

Operating activities mean the activities relating to normal or main business of an enterprise. Operating revenues are the revenues earned in the normal course of business and operating cost is the cost incurred in the normal course of business of an enterprise.

Operating cost includes cost of goods sold and other indirect operating expenses such as office and administration and selling and distribution expenses. Purely financial expenses interest on loan and incomes such as dividend received are not included in operating expenses.

CASE STUDY

Mr. Abhinav started a small shop of selling dairy products. He wanted to maintain proper books of accounts. But, he had very little knowledge of accounting. He maintained only three books – purchases, sales and cash book by himself. He bought some dairy products and a refrigerator to store the milk products for which the payment was made by cheque but recorded the same in the purchases book. He also spent for the transportation charges and paid some money to the person who unloaded the stock. He recorded the same in the cash book.

He made both cash and credit sale for the next few weeks. He entered the entire sales in the sales book. In the middle of the month, he was in need of some money for his personal use. So he took some money, but did not record in the books.

Now, discuss on the following points:

- Do you think Mr. Abhinav needs an accountant? Why do you think so?
- Does he maintain enough books of accounts?
- What other books do you think that he needs to maintain?
- What will be the impact on the profit, if he records the purchase of refrigerator in the purchases book?
- Is it important to record the money taken for personal use? Will it affect the final accounts?
- Identify some of the accounting principles relevant to this situation.

To explore further

Do you think the presentation of final accounts is the same for all forms of business?

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Unit 13

FINAL ACCOUNTS OF SOLE PROPRIETORS-II

Contents

Points to recall

The following points are to be recalled before learning final accounts of sole proprietors-II

- Final accounts
- Revenue recognition principle
- Matching principle
- Accrual principle
- Periodicity principle

AKIXJG

Learning Objectives

To enable the students to

- Understand the accounting treatment for adjustments
- Pass adjusting entries
- Prepare final accounts when adjustments are given

Key terms to know

Adjustment entries

Outstanding expenses

Prepaid expenses

Accrued income

Income received in advance

Bad debts

Provision for bad and doubtful debts

Provision for discount on debtors

13.1 Introduction

Student activity

Think: A trader has to pay rent of ₹5,000 per month, for the building occupied for is business. His accounting period ends on 31st December, every year. He has paid totally ₹40,000 for the period from 1st January, 2017 to 31st December, 2017. How much do you think that he should show as his expense for rent in the income statement?

The principal function of final accounts is to exhibit a true and fair view of the profitability and the financial position of the business to which they relate. Final accounts are prepared based on the ledger account balances as shown by the trial balance for an accounting period as a whole. The expenses and incomes for the whole accounting period must be taken into account while preparing the final accounts.

Sometimes, it is possible that certain expenses have been incurred but not paid and certain incomes have been earned but not received during the accounting period. Similarly, there may be expense or income which have been paid or received in the accounting period but they may pertain to another accounting period. These items are to be adjusted to include correct amounts of them in the final accounts at the end of the accounting period. Certain items like value of stock at the end might have been ascertained after closing the ledger accounts for the accounting period. Such items might also be included in the financial statements so that they represent a true and fair view of profitability and financial status. It becomes necessary to make adjustments for such items after the preparation of trial balance by passing journal entries, called adjustment entries. Both debit as well as credit aspects of these adjustments are to be recorded at the time of preparation of final accounts.

13.1.1 Rationale of making adjustments at the time of preparing final accounts

The important considerations in the preparation of final accounts with adjustments are as under:

(i) **Revenue recognition principle**
It requires that the revenue should be recognised in the period in which the sale is deemed to have occurred.

(ii) **Matching principle**
Revenues earned during the period must be compared with the expenses incurred during that period.

13.2 Adjustment entries and accounting treatment of adjustments

13.2.1 Meaning of adjustment entries

Adjustment entries are the journal entries made at the end of the accounting period to account for items which are omitted in trial balance and to make adjustments for outstanding and prepaid expenses and revenues accrued and received in advance.

13.2.2 Purpose of adjustment entries

The main purpose of adjustment entries are to match current year revenue with the expenses incurred to earn these revenues. Other purposes are:

(i) To exhibit true and fair view of profitability

(ii) To exhibit true and fair view of financial status.

13.2.3 Need for adjustment entries

The need arises to pass adjusting entries for the following reasons:

(i) To record omissions in trial balance such as closing stock, interest on capital, interest on drawings, etc.

(ii) To bring into account outstanding and prepaid expenses.

(iii) To bring into account income accrued and received in advance.

(iv) To create reserves and provisions.

13.2.4 Adjustments and adjustment entries

The following are the common adjustments and adjustment entries which are made while preparing the final accounts.

(i) Closing stock

(ii) Outstanding expenses

(iii) Prepaid expenses

(iv) Accrued income

(v) Income received in advance

(vi) Interest on capital

(vii) Interest on drawings

(viii) Interest on loan

(ix) Interest on investment

(x) Depreciation

(xi) Bad debts

(xii) Provision for bad and doubtful debts

(xiii) Provision for discount on debtors

(xiv) Income tax paid

(xv) Manager's commission

(i) Closing stock

The unsold goods in the business at the end of the accounting period are termed as closing stock. As per AS-2 (Revised), the stock is valued at cost price or net realisable value, whichever is lower.

According to Indian Accounting Standards, AS-2 (Revised), "Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale."

The principle of valuation of stock is based on the convention of conservatism.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Stock (closing) A/c Dr.		xxx	
To Trading A/c			xxx
(Closing stock brought into account)			

Presentation in final accounts

In the Trading Account	Shown on the credit side.
In the Balance Sheet	Shown on the assets side under current assets.

Tutorial note

Closing stock is the opening stock for the next accounting period. At the beginning of the next accounting period this entry is reversed to bring into account the opening stock.

Example

The value of closing stock shown as adjustment on 31st March, 2016 is ₹ 10,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Stock - in trade (closing) A/c Dr.		10,000	
	To Trading A/c			10,000
	(Closing stock brought into account)			

In final accounts, it is presented as follows:

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

Particulars	₹	₹	Particulars	₹	₹
			By Closing stock		10,000

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Stock-in-trade		10,000

Tutorial note

If closing stock is already adjusted, adjusted purchases account and closing stock will appear in trial balance. Adjusted purchases account will be shown on the debit side of the trading account and closing stock will be shown on the assets side of the balance sheet.

(ii) Outstanding expenses

Expenses which have been incurred in the accounting period but not paid till the end of the accounting period are called outstanding expenses. In other words, if certain benefits or services are received during the year but payment is not made for the services received and utilised, these are termed as outstanding expenses. Outstanding expense account is a representative personal account and expense account is a nominal account.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Concerned expense A/c Dr.		xxx	
To Outstanding expense A/c			xxx
(Expense outstanding adjusted)			

Presentation in final accounts

In the Trading A/c or Profit and loss A/c	Amount outstanding is added to particular expense account in the trading account if it is direct expense and in the profit and loss account if it is an indirect expense.
In the Balance Sheet	Amount of outstanding expense is a current liability and is shown on the liabilities side of the balance sheet.

Tutorial note

1. If outstanding expenses account appears in the trial balance with credit balance, it means that journal entry has been made already for outstanding expenses. Hence, the outstanding expenses account will be shown only in the liabilities side of balance sheet. No adjustment is therefore necessary in expenses account as already expenses would have been adjusted.
2. At the beginning of the next accounting period the above entry is reversed to bring into account outstanding expenses at the beginning so that it is reduced from amount of expense of next year.

Example

For the year 2017, rent is payable @ ₹ 2,000 p.m. and during the year ₹ 20,000 is paid on account of rent.

Total rent for the year 2017 is ₹ 24,000 i.e., 2,000 p.m. x 12 months. The difference between total rent payable and actual rent paid ₹ 4,000 (i.e. ₹ 24,000 - ₹ 20,000) is outstanding rent. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Rent A/c Dr.		4,000	
Dec 31	To Outstanding rent A/c			4,000
	(Rent outstanding adjusted)			

In final accounts, it is presented as follows:

Dr. Trading Account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Rent	20,000				
Add: Outstanding	4,000	24,000			

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Rent outstanding		4,000			

(iii) Prepaid Expenses

Prepaid expenses refer to any expense or portion of expense paid in the current accounting year but the benefit or services of which will be received in the next accounting period. They are also called as unexpired expenses. Though these expenses are paid in the accounting period, they are not incurred during the accounting period. Prepaid expense account is a representative personal account. Expense account is a nominal account.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Prepaid expense A/c Dr.		xxx	
To Concerned expense A/c			xxx
(Expense paid in advance adjusted)			

Presentation in final accounts

In Trading A/c or Profit and loss A/c	Amount prepaid is deducted from particular expense in the trading account or profit and loss account depending upon whether it is direct or indirect respectively.
In Balance Sheet	Amount of prepaid expense is shown on the assets side under current assets.

DO YOU KNOW?

Deferred revenue expenses Vs. Prepaid expenses

Deferred revenue expenditure is that expenditure which yields benefits which extend beyond the current accounting period, but relatively a short period as compared to a capital expenditure. Prepaid expenses refer to amount paid in the current accounting period benefit of which will be received in the next accounting period.

Tutorial note

1. If prepaid expense already appears in trial balance it means that it is already adjusted and journal entry has already been made. Hence, prepaid expense is shown only in balance sheet.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account prepaid expenses at the beginning so that it is added to amount of expense of next year.

Example

Insurance premium of ₹ 6,000 for one year is paid on 1st January, 2016 and the accounting year closes on 31st March, 2016.

In this example, insurance premium has been paid in advance or prepaid for nine months, i.e. from 1st April to 31st December amounting to ₹ 4,500 (i.e., ₹ 6000 × 9/12). The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Prepaid insurance premium A/c Dr. To Insurance premium A/c (Insurance premium paid in advance adjusted)		4,500	4,500

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Insurance premium	6,000				
Less: Prepaid insurance	4,500	1,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	Assets	₹
		Insurance premium prepaid	4,500

(iv) Accrued income

Accrued income is income or portion of income which has been earned during the current accounting year but not received till the end of that accounting year. It generally happens in case of amount to be received on account of commission, interest, dividend, etc.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Accrued income A/c Dr. To Concerned income A/c (Income accrued adjusted)		xxx	xxx

Presentation in final accounts

In Profit and loss A/c	Amount accrued is added to particular income.
In Balance Sheet	Amount of accrued income is shown on the assets side under current assets.

Tutorial note

1. If accrued income account appears in the trial balance with debit balance, it means that journal entry has been made already for accrued income. Hence, the accrued income account will be shown only in the assets side of balance sheet. No adjustment is necessary in income account as already it would have been adjusted.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account accrued income at the beginning, so that it is reduced from amount of income in the next year.

Example

A business has a fixed deposit of ₹1,00,000 with a bank for 12 months in the accounting period ending 31st March, 2018 @ 9% interest p.a. Interest received during the year was ₹6,750.

In this example, income earned is ₹9,000 (i.e., 1,00,000 × 9%). Income received is ₹6,750. Hence, the income earned but not received, is the accrued interest ie., ₹2,250 (9,000 - 6,750). The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2018 March 31	Accrued interest on fixed deposit A/c Dr. To Interest on fixed deposit A/c (Interest accrued but not received adjusted)		2,250	2,250

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2018 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Interest on fixed deposit	6,750	
			Add: Accrued interest	2,250	9,000

Balance Sheet as on 31st March, 2018

Liabilities	₹	Assets	₹
		Accrued interest on fixed deposit	2,250

v. Income received in advance

Income received in advance refers to income or portion of income received in an accounting year which is not earned in the accounting period. It is also known as unearned income or unexpired income. Though the amount is received in the current accounting year, the benefit is yet to be offered to the concerned person in the next accounting year.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Concerned income A/c Dr.		xxx	
To Income received in advance A/c			xxx
(Income received in advance adjusted)			

Presentation in final accounts

In Profit and loss A/c	Amount received in advance is deducted from particular income.
In Balance Sheet	Amount of income received in advance being current liability is shown on the liabilities side of the balance sheet.

Tutorial note

1. If income received in advance account appears in the trial balance with credit balance, it means that journal entry has been made already for income received in advance. Hence, the income received in advance account will be shown only in the liabilities side of balance sheet. No adjustment is necessary in income account as already it would have been adjusted.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account income received in advance at the beginning, so that it is added to the amount of income in the next year.

Example

The trial balance as on 31st March, 2017 shows commission received as ₹7,500.

Adjustment: One-third of the commission received is in respect of work to be done in the next accounting year.

Commission received includes one-third of the commission for the next accounting period. ₹7,500 × 1/3, that is ₹2,500 is received in advance. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Commission received A/c Dr.		2,500	
March 31	To Commission received in advance A/c			2,500
	(Commission received in advance adjusted)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Commission received	7,500	
			Less: Received in advance	2,500	5,000

Balance Sheet as on 31st March, 2017

Liabilities	₹	Assets	₹
Commission received in advance	2,500		

(vi) Interest on capital

According to separate entity concept business and proprietor are two separate entities. Capital contributed by proprietor is a liability to the business. Hence, interest may be provided on capital contributed by proprietor. It is treated as a business expense. The purpose is to know the true profit of the business.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Interest on capital A/c Dr.		xxx	
To Capital A/c			xxx
(Interest on capital provided)			

Transfer entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and Loss A/c Dr.		xxx	
To Interest on capital A/c			xxx
(Interest on capital transferred)			

Presentation in final accounts

In Profit and loss A/c	Amount of interest on capital is shown on the debit side.
In Balance Sheet	Amount of interest on capital is added to capital on the liabilities side of the balance sheet.

Tutorial note

Interest on capital is calculated on the opening balance of capital if there is no change in the capital account during the accounting year. If there is any additional capital introduced or capital withdrawn, then interest on capital is to be calculated proportionately on the balance outstanding.

Example

The trial balance prepared on 31st December, 2016 shows Capital of ₹ 5,00,000.
Adjustment: Provide interest on capital @ 4% p.a.

Interest on capital = ₹ 5,00,000 × 4/100 = ₹ 20,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Interest on capital A/c Dr.		20,000	
Dec. 31	To Capital A/c			20,000
	(Interest on capital provided)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		20,000	
Dec. 31	To Interest on capital A/c			20,000
	(Interest on capital transferred)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on capital		20,000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	Debit ₹	Credit ₹
Capital	5,00,000				
Add: Interest on Capital	20,000	5,20,000			

(vii) Interest on drawings

Drawings represent the amount or goods withdrawn by the proprietor from the business for his personal use. As business is separate from owner, interest charged on drawings, if any, is to be treated as business income.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Capital A/c Dr.		xxx	
To Interest on drawings A/c			xxx
(Interest on drawings provided)			

Transfer entry

Particulars		Debit ₹	Credit ₹
Interest on drawings A/c	Dr.	xxx	
To Profit and loss A/c			xxx
(Interest on drawings transferred)			

Presentation in final accounts

In Profit and loss A/c	Amount of interest on drawings is shown on the credit side as it is an income / gain.
In Balance Sheet	Amount of interest on drawings is deducted from the capital on the liabilities side of the balance sheet.

Example

The trial balance on 31st March, 2016 shows capital as ₹1,50,000 and drawings as ₹10,000. Adjustment: Charge interest on drawings at 4%.

Interest on drawings = ₹10,000 × 4/100 = ₹400. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Capital A/c	Dr.		400	
March 31	To Interest on drawings A/c				400
	(Interest on drawings provided)				

Transfer entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Interest on drawings A/c	Dr.		400	
Marh 31	To Profit and loss A/c				400
	(Interest on drawings transferred)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Interest on drawings		400

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,50,000				
Less: Drawings	10,000				
	1,40,000				
Less: Interest on drawings	400	1,39,600			

(viii) Interest on loan

Business entities may have loans borrowed from banks and other financial institutions, private money lenders, etc. If any interest is payable on loan and not yet provided at the time of preparation of trial balance, it is necessary to provide for outstanding interest on loan. It is an outstanding expense.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Interest on loan A/c Dr.		xxx	
To Outstanding interest on loan A/c			xxx
(Interest on loan outstanding)			

Presentation in final accounts

In Profit and loss A/c	Amount outstanding is added to interest on loan on the debit side.
In Balance Sheet	Amount of interest outstanding is added to loan on the liabilities side as it is payable along with the loan.

Tutorial note

1. If the trial balance contains loan account specifying the percentage of interest and date of borrowing and interest paid appears in the trial balance, it is to be checked whether interest for the whole year is paid. If it is not paid, outstanding interest must be adjusted.
2. Similar to any other expenses outstanding, this entry also will be reversed at the beginning of the next accounting period.

Example

Extracts from the trial balance as on 31st December, 2017 is given below:

Particulars	Debit ₹	Credit ₹
Loan @ 12% p.a.		5,00,000
Interest paid on loan	45,000	

Adjustment: Interest on loan is unpaid for three months.

Interest unpaid = ₹5,00,000 × 12/100 × 3/12 = ₹15,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Interest on loan A/c Dr.		15,000	
Dec. 31	To Outstanding interest on loan A/c			15,000
	(Interest on loan outstanding provided)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on loan	45,000				
Add: Outstanding	15,000	60,000			

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Loan @12%	5,00,000				
Add: Interest outstanding	15,000	5,15,000			

(ix) Interest on investment

Business entities may have investments in outside securities carrying specified rate of interest. If interest is due but not yet received, adjustment is to be made for the same in the accounting records before preparation of final accounts. Interest receivable on any investments in the form of shares, deposits, etc. made outside the business is called accrued interest. It is an accrued income.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Accrued interest on investment A/c Dr.		xxx	
To Interest on investment A/c			xxx
(Interest on investment due adjusted)			

Presentation in final accounts

In Profit and loss A/c	Amount accrued is added to interest on investment on the credit side.
In Balance Sheet	Amount of accrued interest being current asset is shown on the assets side of the balance sheet.

Example

Extracts from the trial balance as on 31st December, 2017 is given below:

Particulars	Debit ₹	Credit ₹
Investment @ 12%	1,00,000	
Interest received on investment		9,000

Adjustment: Provide for accrued interest on investment ₹3,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Accrued Interest on investment A/c Dr.		3,000	
Dec. 31	To Interest on investment A/c			3,000
	(Interest on investments accrued)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Interest on investment	9,000	
			Add: Accrued interest	3,000	12,000

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
			Investment @ 12%		1,00,000
			Accrued interest		3,000

(x) Depreciation

The decrease in book value of fixed assets due to usage or passage of time is called depreciation. It is a loss to the business. Therefore, it must be written off from the value of asset. Generally, a certain percentage on the value of the asset is calculated as the amount of depreciation.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Depreciation A/c Dr.		xxx	
To Concerned fixed asset A/c			xxx
(Depreciation provided)			

Transfer entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and loss A/c Dr.		xxx	
To Depreciation A/c			xxx
(Depreciation transferred)			

Presentation in final accounts

In Profit and loss A/c	Depreciation is shown on the debit side.
In Balance Sheet	Amount of depreciation is deducted from concerned fixed asset on the assets side.

Tutorial note

When depreciation already appears in trial balance, it means journal entry is already made and asset account has been already reduced to the extent of depreciation. Hence, depreciation will be shown only in profit and loss account.

Example

The trial balance prepared on 31st March, 2016 shows the value of buildings as ₹50,000. Adjustment: Depreciate buildings @ 10% p.a.

Amount of depreciation = ₹50,000 x 10/100 = ₹5,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Depreciation A/c Dr.		5,000	
Mar. 31	To Buildings A/c			5,000
	(Depreciation on buildings provided)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		5,000	
Mar. 31	To Depreciation A/c			5,000
	(Depreciation transferred)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Depreciation on buildings	5,000				

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Buildings	50,000	
			Less: Depreciation	5,000	45,000

When a provision for depreciation account is created, the entry is

Profit and Loss A/c Dr. xxx

To Provision for depreciation A/c xxx

Here the asset account is not reduced with depreciation. It will appear in the balance sheet at its original cost. Provision for depreciation accumulated up to date will appear on the liabilities side of balance sheet.

(xi) Bad debts

When it is definitely known that amount due from a customer (debtor) to whom goods were sold on credit, cannot be realised at all, it is treated as bad debts. In other words, debts which cannot be recovered or irrecoverable debts are called bad debts. It is a loss for the business and should be charged against profit.

Student activity **Think:** Why do business entities sell goods on credit?

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Bad debts A/c	Dr.		xxx	
To Sundry debtors A/c				xxx
(Bad debts written off)				

Transfer entry
(if provision for bad and doubtful debts account is not maintained)

Particulars		L.F.	Debit ₹	Credit ₹
Profit and Loss A/c	Dr.		xxx	
To Bad debts A/c				xxx
(For transfer of bad debts)				

Transfer entry
(if provision for bad and doubtful debts account is maintained)

Particulars		L.F.	Debit ₹	Credit ₹
Provision for bad and doubtful debts A/c	Dr.		xxx	
To Bad debts A/c				xxx
(Bad debts transferred)				

Presentation in final accounts

In Profit and loss A/c	Amount of bad debt is shown on the debit side.
In Balance Sheet	Amount of bad debts is deducted from sundry debtors on the assets side.

Tutorial note

1. When bad debts already appears in the trial balance it means journal entry is already made, i.e., debtors is already reduced. Hence, bad debt is taken only to debit side of profit and loss account.
2. If there is bad debt in trial balance as well as in adjustments, total bad debt is debited in profit and loss account. Additional bad debt only is deducted from debtors in the balance sheet.

Example

The trial balance as on 31st December, 2016 shows sundry debtors as ₹1,02,000.

Adjustment: Write off ₹2,000 as bad debts. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Bad debts A/c	Dr.		2,000	
Dec. 31	To Sundry debtors A/c				2,000
	(Bad debts written off)				

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		2,000	
Mar. 31	To bad debts A/c			2,000
	(Bad debts transferred to profit and loss A/c)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	2,000				

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	1,02,000	
			Less: Bad debts	2,000	1,00,000

(xii) Provision for bad and doubtful debts

Provision for bad and doubtful debts refers to amount set aside as a charge against profit to meet any loss arising due to bad debt in future. At the end of the accounting period, there may be certain debts which are doubtful, i.e., the amount to be received from debtors may or may not be received. The reason may be incapacity to pay the amount or deceit.

In general, based on past experience, the amount of doubtful debts is calculated on the basis of some percentage on debtors at the end of the accounting period after deducting further bad debts (if any). Since the amount of loss is impossible to ascertain until it is proved bad, doubtful debts are charged against profit and loss account in the form of provision. A provision for doubtful debts is created and is charged to profit and loss account. When bad debts occur, it is transferred to provision for doubtful debts account and not to profit and loss account.

This is according to the convention of conservatism. Moreover, according to matching principle, all costs related to earning revenue in a period must be charged in the relevant period itself. Hence, it is appropriate that provision is created in the current year against debtors of current year.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and loss A/c Dr.		xxx	
To Provision for bad and doubtful debts A/c			xxx
(Provision for bad and doubtful debts created)			

Presentation in final accounts

In Profit and loss A/c	Amount of provision for bad and doubtful debts is shown on the debit side.
In Balance Sheet	Amount of provision for bad and doubtful debts is deducted from sundry debtors on the assets side.

Example

The trial balance prepared on 31st December, 2016 shows sundry debtors as ₹ 1,50,000.

Adjustment: Provide 5% for bad and doubtful debts on sundry debtors.

Provision for bad and doubtful debts = ₹ 1,50,000 x 5/100 = ₹ 7,500. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and loss A/c Dr.		7,500	
Dec. 31	To Provision for bad and doubtful debts A/c			7,500
	(Provision for bad and doubtful debts made)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Provision for bad and doubtful debts	7,500				

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	1,50,000	
			Less: Provision for bad and doubtful debts	7,500	1,42,500

Tutorial note

When provision already exists and appears in trial balance, the accounting treatment is as below:

1. If the provision required at the end plus the bad debts written off, is higher than the existing provision, the difference amount will be created as provision in the current year and will appear on the debit side of profit and loss account.
2. If the provision required at the end plus bad debts written off, is lesser than the existing provision, the excess is written back and will appear on the credit side of profit and loss account.

The journal entries are:

(a) For bad debts written off

Bad debts A/c Dr. xxx

To Debtors A/c xxx

(b) For transferring bad debts

Provision for doubtful debts A/c Dr. xxx

To Bad debts A/c xxx

(c) For creating provision to the extent of difference

Profit and Loss A/c Dr. xxx

To Provision for doubtful debts A/c xxx

(d) For writing back provision to the extent of difference

Provision for doubtful debts A/c Dr. xxx

To Profit and Loss A/c xxx

(xiii) Provision for discount on debtors

Cash discount is allowed by the suppliers to customers for prompt payment of amount due either on or before the due date. A provision created on sundry debtors for allowing such discount is called provision for discount on debtors. This provision is a charge against profit and hence profit and loss account is debited.

Provision for discount on debtors is made on the basis of past experience at an estimated rate on sundry debtors. Discount should be calculated on sundry debtors after deducting bad debts and provision for bad debts.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and loss A/c Dr.		xxx	
To Provision for discount on debtors A/c			xxx
(Provision for discount on debtors created)			

Presentation in final accounts

In Profit and loss A/c	Amount of provision for discount on debtors is shown on the debit side.
In Balance Sheet	Amount of provision for discount on debtors is deducted from sundry debtors on the assets side.

Tutorial note

1 Provision for discount on debtors is calculated on the balance of debtors after deducting bad debts and provision for doubtful debts. This is because provision for discount is to be expected only on good book debts. When the amount realisable itself is doubtful, provision for discount is not to be made. Similar to bad debts and provision for doubtful debts, here also discount allowed to debtors must be transferred to provision for discount on debtors account if a provision exists.

2. When provision already exists and appears in trial balance, the accounting treatment is as below:

a. If the provision required at the end plus the discount allowed, is higher than the existing provision, the difference amount will be created as provision in the current year and will appear on the debit side of profit and loss account.

b. If the provision required at the end plus discount allowed, is lesser than the existing provision, the excess is written back and will appear on the credit side of profit and loss account.

The presentation in the balance sheet is as below:

Debtors	xxx
Less Bad debts (in adjustments)	xxx
	xxx
Less Provision for doubtful debts (end) (adjustment)	xxx
	xxx
Less Provision for discount on debtors (end) (adjustment)	xxx
Balance to be shown in balance sheet	xxx

Example

The trial balance for the year ended 31st March, 2016 shows sundry debtors as ₹ 50,000.
Adjustment: Create a provision for discount on debtors @ 1%.

Provision for discount on debtors = ₹ 50,000 x 1/100 = ₹ 500. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Profit and loss A/c Dr. To Provision for discount on debtors A/c (Provision for discount on debtors made)		500	500

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Provision for discount on debtors		500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors Less: Provision for discount on debtors	50,000 500	49,500

Student activity

Think: Is it possible to change the rate of provision for bad and doubtful debts? Under what circumstances will the trader decide this?

(xiv) Income tax paid

As per the Indian Income Tax Act, 1961, business income of the sole proprietor is not assessed and taxed separately. It is the sole proprietor who is assessed to tax for his total income including the business income. Hence, income tax paid by the business is not a business expenditure and is treated as drawings.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Drawings A/c Dr.		xxx	
To Bank A/c			xxx
(Income tax of the proprietor paid)			

Presentation in final accounts

Trading / Profit and loss account	Not shown.
In Balance Sheet	Shown as deduction from capital on the liabilities side. Shown as a deduction from bank balance on the assets side.

Example

Trial balance of Sibi as on 31st December, 2017 shows the capital as ₹ 1,05,000 and cash at bank as ₹ 80,000.

Adjustment: Income tax paid ₹ 15,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017 Dec. 31	Drawings A/c Dr.		15,000	
	To Bank A/c			15,000
	(Income tax paid)			

In final accounts, it is presented as follows:

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	1,05,000		Cash at bank	80,000	
Less: Drawings (income tax)	15,000	90,000	Less: Income tax	15,000	65,000

(xv) Manager's commission

Sometimes the manager is given commission as a percentage on profit of the business. It may be given at a certain percentage on the net profit before charging such commission or after charging such commission. Calculation procedure is explained below:x

a) Commission on net profit before charging such commission:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{100}$$

b) Commission on net profit after charging such commission:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{(100 + \text{Rate of commission})}$$

The purpose of giving such commission may be to motivate the managers to work with their full potential, to reward the managers for their efficiency and to retain the efficient managers by rewarding them sufficiently. Such commission can be calculated only at the end of the accounting period after calculating net profit. Hence, it remains outstanding at the end of the accounting period.

Student activity

Think: Do you think only money can motivate managers? What other factors can effect motivation?

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Manager's Commission A/c Dr.		xxx	
To Outstanding Manager's commission A/c			xxx
(Manager's commission on profit provided)			

Transfer entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and loss A/c Dr.		xxx	
To Manager's commission A/c			xxx
(Commission on profit transferred)			

Presentation in final accounts

In Profit and loss account	Commission being an indirect expense is shown on the debit side of profit and loss account.
In Balance Sheet	Commission outstanding being a current liability is shown on the liabilities side of the balance sheet.

Example

On 31st March, 2017, Net profit before charging commission is ₹ 11,000.
The manager is entitled to receive 10% as commission on the profit before charging such a commission.

Commission = 11,000 x 10/100 = ₹ 1,100. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Manager's Commission A/c Dr.		1,100	
March 31	To Outstanding Manager's commission A/c			1,100
	(Manager's commission on profit provided)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		1,100	
Mar. 31	To Manager's commission A/c			1,100
	(Manager's commission transferred to profit and loss A/c)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Manager's commission		1,100			
To Net profit (transferred to capital a/c)		9,900			

Balance Sheet as on 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Manager's commission outstanding		1,100			

Example

On 31st March, 2017, Net profit before charging commission is ₹ 11,000.

Adjustment: Provide manager's commission at 10% on the profit after charging such Manager's commission.

$$\text{Manager's commission} = 11{,}000 \times \frac{10}{(100+10)} = ₹\ 1{,}000.$$ The adjusting entry is.

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Manager's commission A/c Dr.		1,000	
March 31	To Outstanding Manager's commission A/c			1,000
	(Commission on profit provided)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		1,000	
Mar. 31	To Manager's commission A/c			1,000
	(Manager's commission A/c transferred to profit and loss A/c)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Manager's commission		1,000			
To Net profit (transferred to capital a/c)		10,000			

Balance Sheet as on 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Manager's commission outstanding		1,000			

Illustration 1

Show necessary entries to adjust the following on 31st December, 2017.

(i) Outstanding salaries ₹ 1,200

(ii) Outstanding rent ₹ 300

(iii) Prepaid insurance premium ₹ 450

(iv) Interest on investments accrued ₹ 400

(v) Bad debts written off ₹ 200

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017 Dec. 31	Salaries A/c Dr. To Outstanding salaries A/c (Salaries outstanding provided)		1,200	 1,200
Dec. 31	Rent A/c Dr. To Outstanding rent A/c (Provided for rent outstanding)		300	 300
Dec. 31	Prepaid insurance premium A/c Dr. To Insurance premium A/c (Insurance prepaid)		450	 450
Dec. 31	Accrued Interest on investment A/c Dr. To Interest on investment A/c (Provided for interest accrued)		400	 400
Dec. 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		200	 200

Illustration 2

Pass adjusting entries for the following on 31st March, 2018.

(i) Charge interest on drawings at ₹ 50

(ii) Write off bad debts by ₹ 500

(iii) Depreciate furniture by ₹ 1,000

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2018 March 31	Capital A/c Dr. To Interest on drawings A/c (Interest on drawings provided)		50	 50
March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		500	 500
March 31	Depreciation A/c Dr. To Furniture A/c (Depreciation provided on furniture)		1,000	 1,000

Illustration 3

Sundry debtors as per trial balance as on 31st March, 2016 is ₹ 10,000.

Adjustment: Write off bad debts amounting to ₹ 300.

Give adjusting entry and show how these appear in the final accounts as on 31st March, 2016.

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		300	 300

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts		300			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors Less: Bad debts	10,000 300	 9,700

Illustration 4

Sundry debtors as per trial balance ₹ 26,000

Bad debts as per trial balance ₹ 1,000

Adjustment: Additional bad debts amounted to ₹ 2,500

Give adjusting entry and show how these appear in the final accounts on 31st March, 2016.

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		2,500	2,500

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	1,000				
Add: Additional bad debts	2,500	3,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	26,000	
			Less: Additional Bad debts	2,500	23,500

Illustration 5

An abstract of the trial balance as on 31st December, 2016 is as follows:

Particulars	₹
Sundry Debtors	20,000
Bad debts	500

Adjustment: Create a provision for bad and doubtful debts @ 5% on sundry debtors. Pass the adjusting entry and show how these items will appear in final accounts.

Solution

Provision for bad and doubtful debts = ₹20,000 x 5/100 = ₹1,000

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and loss A/c Dr.		1,000	
Dec. 31	To Provision for bad and doubtful debts A/c			1,000
	(Provision for bad and doubtful debts created)			

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts		500			
Add: Provision for bad and doubtful debts		1000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	20,000	
			Less: Provision for bad and doubtful debts	1,000	19,000

Illustration 6

Abstracts from the trial balance as on 31st March, 2016:

Particulars	Debit ₹
Sundry debtors	52,000
Bad debts	1,000

Adjustments:

(i) Additional bad debts ₹2,000

(ii) Create 5% provision for bad and doubtful debts

You are required to pass necessary adjusting entries and show how these items will appear in final accounts.

Solution

Working note:

Particulars	₹
Sundry debtors	52,000
Less: Additional Bad debts	2,000
	50,000

Provision for bad and doubtful debts = ₹50,000 x 5/100 = ₹2,500

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		2,000	 2,000
March 31	Profit and Loss A/c Dr. To Provision for bad and doubtful debts A/c (Provision for bad and doubtful debts created)		2,500	 2,500

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	1,000				
Add: Additional bad debts	2,000	3,000			
To Provision for bad and doubtful debts		2,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	52,000	
			Less: Additional bad debts	2,000	
				50,000	
			Less: Provision for bad and doubtful debts	2,500	47,500

Illustration 7

Abstracts from the trial balance as on 31st December, 2016:

Particulars	Debit ₹	Credit ₹
Sundry debtors	1,04,000	
Bad debts	5,000	
Provision for bad and doubtful debts		2,000

Adjustments:

(i) Additional bad debts amounted to ₹4,000.

(ii) Create a provision for bad and doubtful debts @ 5% on sundry debtors.

Pass necessary adjusting entries and show how the different items appear in final accounts.

Solution

Working note:

Particulars	Debit ₹
Sundry debtors	1,04,000
Less: Additional bad debts	4,000
	1,00,000

Provision for bad and doubtful debts = ₹ 1,00,000 x 5/100 = ₹ 5,000

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 Dec. 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		4,000	 4,000
Dec. 31	Provision for bad and doubtful debts A/c Dr. To Bad debts A/c (Bad debts transferred to provision for bad and doubtful debts account (5000 + 4000))		9,000	 9,000
Dec. 31	Profit and Loss A/c Dr. To Provision for bad and doubtful debts A/c (Provision for bad and doubtful debts created) (9,000 + 5,000 - 2,000 = 12,000)		12,000	 12,000

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Provision for bad and doubtful debts (closing)	5,000				
Add: Bad debts	5,000				
Add: Additional bad debts	4,000				
	14,000				
Less: Provision for bad and doubtful debts (Opening)	2,000	12,000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	1,04,000	
			Less: Additional bad debts	4,000	
				1,00,000	
			Less: Provision for bad and doubtful debts (closing)	5,000	95,000

Illustration 8

Abstracts from trial balance as on 31st December, 2016 are as follows:

Particulars	Debit ₹	Credit ₹
Bad debts written off	1,800	
Discount allowed	600	
Sundry debtors	20,000	
Provision for bad and doubtful debts		1,500
Provision for discount on debtors		500

A provision for doubtful debts @ 5% and a provision for discount @ 2% on sundry debtors are to be maintained by the trader. Show how these items would appear in the final accounts.

Solution

Working note:

Particulars	₹
Sundry debtors	20,000
Less: Provision for bad and doubtful debts (closing) (20,000 x 5/100)	1,000
	19,000
Less: Provision for discount on debtors (19,000 x 2/100)	380
	18,620

Dr. **Profit and loss account for the year ended 31st December, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Provision for bad and doubtful debts (closing)	1,000				
Add: Bad debts	1,800				
	2,800				
Less: Provision for bad and doubtful debts (opening)	1,500	1,300			
To Provision for discount(closing)	380				
Add: Discount allowed	600				
	980				
Less: Provision for discount (opening)	500	480			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	20,000	
			Less: Provision for bad and doubtful debts	1,000	
				19,000	
			Less: Provision for discount on debtors	380	18,620

13.3 Summary of adjusting entries and accounting treatment of adjustments

Sl.No.	Adjustment	Journal entry	Treatment in	
			Trading A/c or P & L A/c	Balance Sheet
1	Closing stock	Stock in trade A/c Dr. To Trading A/c	Shown on the credit side of the trading A/c.	Shown on the assets side as a current asset.
2	Outstanding expenses	Concerned expense A/c Dr. To Outstanding expense A/c	Added to the concerned expense on the debit side of trading account if direct expense and profit and loss account if indirect expense.	Shown on the liabilities side as a current liability.
3	Prepaid expenses	Prepaid expense A/c Dr. To Concerned expense A/c	Deducted from the concerned expense on the debit side. of trading account if direct expense and profit and loss account if indirect expense.	Shown on the assets side as a current asset.

4	Accrued income	Accrued income A/c Dr. To Income A/c	Added to the concerned income on the credit side of profit and loss A/c.	Shown on the assets side as a current asset.
5	Income received in advance	Concerned income A/c Dr. To Income received in advance A/c	Deducted from the concerned income on the credit side of profit and loss account.	Shown on the liabilities side as a current liability.
6	Interest on capital	Interest on capital A/c Dr. To Capital A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as an addition to capital.
7	Interest on drawings	Capital A/c Dr. To Interest on drawings A/c	Shown on the credit side of profit and loss A/c.	Shown on the liabilities side as a deduction from capital.
8	Interest on loan outstanding	Interest on loan A/c Dr. To Outstanding interest on loan A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as a current liability.
9	Interest on investments accrued	Accrued interest on investments A/c Dr. To Interest on investment A/c	Shown on the credit side of profit and loss A/c.	Shown on the assets side as a current asset.
10	Depreciation	Depreciation A/c Dr. To Concerned fixed asset A/c	Shown on the debit side of profit and loss A/c.	Shown on the assets side as a deduction from the value of concerned fixed asset.
11	Bad debts	Bad debts A/c Dr. To Sundry debtors A/c	Shown on the debit side of profit and loss A/c when there is no provision for bad and doubtful debts. (If there is a provision for bad and doubtful debts account existing, bad debts is to be transferred to provision for bad debts A/c).	Shown on the assets side by way of deduction from the amount of sundry debtors.
12	Provision for bad and doubtful debts	Profit & Loss A/c Dr. To Provision for bad and doubtful debts A/c	Shown on the debit side of profit and loss A/c	Shown on the assets side as a deduction from sundry debtors.

13	Provision for discount on debtors	Profit & Loss A/c Dr. To Provision for discount on debtors A/c	Shown on the debit side of profit and loss A/c.	Shown on the assets side as a deduction from sundry debtors.
14	Income tax paid	Drawings A/c Dr. To Bank A/c	Shown on the liabilities side as a deduction from capital.	Shown on the assets side as a deduction from bank balance.
15	Manager's commission	Manager's commission A/c Dr. To Outstanding manager's commission A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as a current liability.

13.4 Final accounts with adjustments

Illustration 9

Prepare trading account from the following ledger balances presented by P. Sen as on 31st March, 2016.

Particulars	₹	Particulars	₹
Stock (1-4-2015)	10,000	Sales	3,00,000
Purchases	1,60,000	Returns inward	16,000
Wages	30,000	Returns outward	10,000
Carriage inwards	10,000	Gas and Fuel	8,000
Freight inwards	8,000		

Additional information:

(a) Stock on 31st March, 2016 ₹ 20,000

(b) Outstanding wages amounted to ₹ 4,000

(c) Gas and fuel was paid in advance for ₹ 1,000

Solution

Dr. Trading account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		10,000	By Sales	3,00,000	
To Purchases	1,60,000		Less: Returns inward	16,000	2,84,000
Less: Returns outward	10,000	1,50,000	By Closing Stock		20,000
To Wages	30,000				
Add: Outstanding	4,000	34,000			
To Carriage inwards		10,000			
To Freight inwards		8,000			
To Gas and fuel	8,000				
Less: Prepaid	1,000	7,000			
To Gross profit c/d		**85,000**			
		3,04,000			3,04,000

Illustration 10

From the following particulars presented by Thilak for the year ended 31st March, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	1,00,000	Interest received	6,000
Rent paid	22,000	Bad debts	2,000
Salaries	10,000	Provision for bad debts (1-4-2016)	4,000
Commission (Cr.)	12,000	Sundry debtors	40,000
Discount received	2,000	Buildings	80,000
Insurance premium paid	8,000		

Adjustments:

(a) Outstanding salaries amounted to ₹4,000

(b) Rent paid for 11 months

(c) Interest due but not received amounted to ₹2,000

(d) Prepaid insurance amounted to ₹2,000

(e) Depreciate buildings by 10%

(f) Further bad debts amounted to ₹3,000 and make a provision for bad debts @ 5% on sundry debtors

(g) Commission received in advance amounted to ₹2,000

Solution

Dr. Profit and Loss Account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Rent	22,000		By Gross profit b/d	-	1,00,000
Add: Outstanding	2,000	24,000	By Commission	12,000	
(22,000x1/11)	10,000		Less: Received in	2,000	10,000
To Salaries	4,000		advance	6,000	2,000
Add: Outstanding	8,000	14,000	By Discount received	2,000	8,000
To Insurance premium	2,000		By Interest received		
Less: Prepaid insurance	1,900	6,000	Add: Accrued		
To Provision for bad and	2,000				
doubtful debts (closing)	3,000				
Add: Bad debts	6,900				
Add: Further bad debts					
	4,000				
Less: Opening provision for					
bad and doubtful debts		2,900			
To Depreciation on building		8,000			
(80,000x10%)					
To Net profit (transferred to					
capital A/c)		**65,100**			
		1,20,000			1,20,000

Working Note:

Debtors	:	40,000
Less: Further bad debts	:	2,000
		38,000

Provision for bad and doubtful debts at 5% : 38,000 x 5% = ₹ 1,900

Illustration 11

From the following balances as on 31st December, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	50,000	Rent received	2,000
Salaries	18,000	Discount received	3,000
Office rent paid	12,000	Carriage outwards	2,500
Advertisement	8,000	Fire insurance premium	6,500

Adjustments:

(a) Rent accrued but not yet received ₹ 500

(b) Fire insurance premium prepaid to the extent of ₹ 1,500

(c) Provide manager's commission at 10% on profits before charging such commission.

Dr. Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Salaries		18,000	By Gross profit b/d		50,000
To Office rent		12,000	By Rent received	2,000	
To Advertisement		8,000	Add: Rent accrued	500	2,500
To Carriage outwards		2,500	By Discount received		3,000
To Fire insurance premium	6,500				
Less: Prepaid	1,500	5,000			
To Manager's commission		1,000			
To Net profit (transferred to capital account)	-	**9,000**			
		55,500			55,500

Working note:

$$\text{Manager's Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{100}$$

Net profit = 55,500 – (18,000 + 12,000 + 8,000 + 2,500 + 5,000) = ₹ 10,000

$$\text{Manager's commission} = 10{,}000 \times \frac{10}{100} = 1{,}000$$

Illustration 12

From the following balances obtained from the books of Siva, prepare trading and profit and loss account.

Particulars	₹	Particulars	₹
Stock on 01.01.2016	9,000	Bad debts	1,200
Purchases	22,000	Sundry expenses	1,800
Sales	42,000	Discount allowed	1,700
Expenses on purchases	1,500	Expenses on sale	1,000
Bank charges paid	3,500	Repairs on office furniture	600

Adjustments:

a) Closing stock on, 31st December, 2016 was ₹ 4,500

b) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening stock	9,000	By Sales	42,000
To Purchases	22,000	By Closing stock	4,500
To Expenses on purchases	1,500		
To Gross profit c/d	**14,000**		
	46,500		46,500
To Bank charges	3,500	By Gross profit b/d	14,000
To Bad debts	1,200		
To Sundry expenses	1,800		
To Discount allowed	1,700		
To Expenses on sale	1,000		
To Repairs on office furniture	600		
To Manager's commission	200		
To Net profit (transferred to capital A/c)	**4,000**		
	14,000		14,000

Working note:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{(100 + \text{Rate of commission})} \times 100$$

Net profit = 14,000 – (3,500 + 1,000+1,200+1,800+1,700+600) = ₹ 4,200

$$\text{Manager's commission} = 4{,}200 \times \frac{5}{105} = ₹\ 200$$

Illustration 13

From the following particulars, prepare the balance sheet of Madhu, for the year ended 31st March, 2018.

Particulars	₹	Particulars	₹
Capital	2,00,000	Sundry creditors	40,000
Drawings	40,000	Bills payable	20,000
Cash in hand	15,000	Goodwill	60,000
Loan from bank	40,000	Sundry debtors	80,000
Bank overdraft	20,000	Land and building	50,000
Investments	20,000	Vehicles	80,000
Bills receivable	10,000	Cash at bank	25,000

The following adjustments were made at the time of preparing final accounts:

(a) Outstanding liabilities: Salaries ₹10,000; Wages ₹20,000; Interest on Bank overdraft ₹3,000 and Interest on bank loan ₹6,000

(b) Provide interest on capital @ 10% p.a.

(c) Bad debts amounted to ₹10,000 and make a provision for bad debts @ 10% on sundry debtors.

(d) Closing stock amounted to ₹1,20,000

(e) Depreciate vehicles @ 10% p.a.

Net profit for the year amounted to ₹96,000 after considering all the above adjustments.

Solution

In the books of Madhu
Balance Sheet as on 31st March, 2018

Particulars	₹	₹	Particulars	₹	₹
Capital	2,00,000		Goodwill		60,000
Add: Net profit	96,000		Land and Building		50,000
Add: Interest on capital	20,000		Vehicles	80,000	
	3,16,000		Less: Depreciation	8,000	72,000
Less: Drawings	40,000	2,76,000	Investments		20,000
Loan from bank	40,000		Stock-in-trade		1,20,000
Add: Interest outstanding	6,000	46,000	Sundry debtors	80,000	
Bills payable		20,000	Less: Bad debts	10,000	
Sundry creditors		40,000		70,000	
Bank overdraft	20,000		Less: Provision for bad and doubtful debts	7,000	63,000
Add: Interest outstanding	3,000	23,000			
Outstanding liabilities:			Bills receivable		10,000
Salaries	10,000		Cash at bank		25,000
Wages	20,000	30,000	Cash in hand		15,000
		4,35,000			4,35,000

Illustration 14

The following balances were extracted from the books of Thomas as on 31st March, 2018

Particulars	₹	Particulars	₹
Purchases	75,000	Capital	60,000
Returns inward	2,000	Creditors	30,000
Opening stock	10,000	Sales	1,20,000
Freight inwards	4,000	Returns outward	1,000
Wages	2,000		
Investments	10,000		
Bank charges	1,000		
Land	30,000		
Machinery	30,000		
Building	25,000		
Cash at bank	18,000		
Cash in hand	4,000		
	2,11,000		2,11,000

Additional information:

(a) Closing stock ₹9,000

(b) Provide depreciation @ 10% on machinery

(c) Interest accrued on investment ₹2,000

Prepare trading account, profit and loss account and balance sheet.

Solution

In the books of Thomas

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		10,000	By Sales	1,20,000	
To Purchases	75,000		Less: Returns inward	2,000	1,18,000
Less: Returns outward	1,000	74,000			
To Freight inwards		4,000	By Closing stock		9,000
To Wages		2,000			
To Gross profit c/d		**37,000**			
		1,27,000			1,27,000
To Depreciation on machinery		3,000	By Gross Profit b/d		37,000
To Bank charges		1,000	By Accrued interest on investment		2,000
To Net profit (transferred to capital a/c)		**35,000**			
		39,000			39,000

Balance Sheet as on 31st March, 2018

Particulars	₹	₹	Particulars	₹	₹
Capital	60,000		Land		30,000
Add: Net profit	35,000	95,000	Building		25,000
Creditors		30,000	Machinery	30,000	
			Less: Depreciation	3,000	27,000
			Investment	10,000	
			Add: Accrued interest	2,000	12,000
			Stock-in-trade		9,000
			Cash at bank		18,000
			Cash in hand		4,000
		1,25,000			1,25,000

Illustration 15

Given below are the balances extracted from the books of Nagarajan as on 31st March, 2016.

Particulars	₹	Particulars	₹
Purchases	10,000	Sales	15,100
Wages	600	Commission received	1,900
Freight inwards	750	Rent received	600
Advertisement	500	Creditors	2,400
Carriage outwards	400	Capital	5,000
Cash	1,200		
Machinery	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2016	1,000		
	25,000		25,000

Prepare the trading and profit and loss account for the year ended 31st March, 2016 and the balance sheet as on that date after adjusting the following:

(a) Commission received in advance ₹ 400

(b) Advertisement paid in advance ₹ 150

(c) Wages outstanding ₹ 200

(d) Closing stock on 31st March 2016, ₹ 2,100

Solution

In the books of Nagarajan

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		1,000	By Sales		15,100
To Purchases		10,000	By Closing stock		2,100
To Wages	600				
Add: Outstanding	200	800			
To Freight inwards		750			
To Gross profit c/d		**4,650**			
		17,200			17,200
To Advertisement	500		By Gross profit b/d		4,650
Less: Prepaid	150	350	By Commission received	1,900	
advertisement		400	Less: Received in	400	1,500
To Carriage outwards			advance		600
To Net profit (transferred to capital a/c)		**6,000**	By Rent received		
		6,750			6,750

Balance Sheet as on 31st March, 2016

Particulars	₹	₹	Particulars	₹	₹
Capital	5,000		Machinery		8,000
Add: Net profit	6,000	11,000	Stock in trade		2,100
Creditors		2,400	Debtors		300
Commission received in			Bills receivable		2,250
advance		400	Advertisement prepaid		150
Outstanding wages		200	Cash		1,200
		14,000			14,000

Illustration 16

Consider the following balances extracted from the books of Jain as on 31st December, 2016. Prepare the final accounts.

Particulars	₹	Particulars	₹
Capital	20,000	Office Salaries	6,600
Debtors	8,000	Establishment expenses	4,500
Creditors	10,500	Selling expenses	2,300
Purchases	60,000	Furniture	10,000
Sales	80,000	Cash at bank	2,400
Income tax of Jain paid	500	Miscellaneous receipts	600
Opening stock	12,000	Drawings	4,800

Adjustments

(a) Salaries outstanding for December, 2016 amounted to ₹ 600

(b) Provide depreciation on furniture @ 10% p.a.

(c) Provide interest on capital for the year @ 5% p.a.

(d) Stock on 31st December, 2016 ₹ 14,000

Solution

In the books of Jain

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		12,000	By Sales		80,000
To Purchases		60,000	By Closing Stock		14,000
To Gross Profit c/d		**22,000**			
		94,000			94,000
					22,000
To Office salaries	6,600		By Gross Profit b/d		
		7,200			600
Add: Outstanding	600		By Miscellaneous receipts		
To Establishment expenses		4,500			
To Selling expenses		2,300			
To Depreciation on furniture (10,000 x 10%)		1,000			
To Interest on capital (20,000 x 5%)		1,000			
To Net profit (transferred to capital A/c)		**6,600**			
		22,600			22,600

Balance Sheet as on 31st December, 2016

Liabilities		₹	₹	Assets	₹	₹
Capital		20,000		Furniture	10,000	
Add: Net profit		6,600		Less: Depreciation	1,000	9,000
Add: Interest on capital		1,000		Stock in trade		14,000
		27,600		Debtors		8,000
Less: Drawings	4,800			Cash at bank		2,400
Income tax	500	5,300	22,300			
Creditors			10,500			
Office salaries outstanding			600			
			33,400			33,400

Illustration 17

Edward's books show the following balances. Prepare his trading and profit and loss A/c for the year ended 31st December, 2016 and a balance sheet on at that date.

Debit balances	₹	Credit balances	₹
Drawings	5,000	Capital	1,31,500
Sundry debtors	60,000	Loan at 6% p.a.	20,000
Coal, gas and water	10,500	Sales	3,56,500
Returns inward	2,500	Interest on investments	2,550
Purchases	2,56,500	Sundry creditors	40,000
Stock on 1-1-2016	89,700		
Travelling expenses	51,250		
Interest on loan paid	300		
Petty cash	710		
Repairs	4,090		
Investments	70,000		
	5,50,550		5,50,550

Adjustments:

(a) Closing stock was ₹ 1,30,000 on 31st December, 2016.

(b) Create 5% provision for bad and doubtful debts on sundry debtors

(c) Create provision at 2% for discount on debtors

(d) Interest on loan due for 9 months.

Solution

In the books of Edward

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		89,700	By Sales	3,56,500	
To Purchases		2,56,500	Less: Returns inward	2,500	3,54,000
To Coal, gas and water		10,500	By Closing stock		1,30,000
To Gross profit c/d		**1,27,300**			
		4,84,000			4,84,000
To Travelling expenses		51,250	By Gross Profit b/d		1,27,300
To Interest on loan paid	300		By Interest on		
Add: Interest outstanding	900	1,200	investments		2,550
(20,000 x 6/100 x 9/12)					
To Repairs		4,090			
To Provision for bad and doubtful debts		3,000			
To Provision for discount on debtors		1,140			
To Net profit (transferred to capital A/c)		**69,170**			
		1,29,850			1,29,850

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,31,500		Investments		70,000
Add: Net profit	69,170		Stock in trade		1,30,000
	2,00,670		Sundry debtors	60,000	
Less: Drawings	5,000	1,95,670	Less: Provision for bad and doubtful debts (60,000 x 5/100)	3,000	
6% Loan	20,000				
Add: Interest outstanding	900	20,900			
Sundry creditors		40,000	Less: Provision for discount on debtors (57,000 x 2/100)	57,000 1,140	55,860
			Petty cash		710
		2,56,570			2,56,570

Illustration 18

Following is the trial balance of Brijesh. Prepare final accounts for the year ended on 31st March, 2016.

Particulars	Debit ₹	Credit ₹
Stock as on 01-04-2015	2,00,000	
Purchases and Sales	22,00,000	33,00,000
Returns	1,00,000	80,000
Carriage inwards	50,000	
Salaries	2,60,000	
Insurance	1,20,000	
Wages	80,000	
Bad debts	10,000	
Furniture	7,00,000	
Capital		7,50,000
Printing and stationery	80,000	
Cash at bank	3,15,000	
Petty cash	5,000	
Commission	10,000	
	41,30,000	41,30,000

Adjustments:

(i) Stock on 31st March, 2016 was valued at ₹ 4,00,000.

(ii) Depreciate furniture @ 10% p.a.

(iii) Insurance of ₹ 60,000 was paid in advance

(iv) Commission receivable ₹ 50,000.

Solution

In the books of Brijesh

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		2,00,000	By Sales	33,00,000	
To Purchases	22,00,000		Less: Returns	1,00,000	32,00,000
Less: Returns	80,000	21,20,000	By Closing stock		4,00,000
To Carriage inwards		50,000			
To Wages		80,000			
To Gross profit c/d		**11,50,000**			
		36,00,000			36,00,000
To Salaries		2,60,000	By Gross profit b/d		11,50,000
To Insurance	1,20,000		By Commission		
Less: Prepaid	60,000	60,000	receivable		50,000
To Bad debts		10,000			
To Printing and stationery		80,000			
To Depreciation on furniture (7,00,000 x 10/100)		70,000			
To Commission		10,000			
To Net profit (transferred to capital A/c)		**7,10,000**			
		12,00,000			12,00,000

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	7,50,000		Furniture	7,00,000	
Add: Net profit	7,10,000	14,60,000	Less: Depreciation	70,000	6,30,000
			Stock in trade		4,00,000
			Commission receivable		50,000
			Insurance prepaid		60,000
			Cash at bank		3,15,000
			Petty cash		5,000
		14,60,000			14,60,000

Illustration 19

Given below are the balances of Pandian as on 31st March, 2016.

Particulars	Debit ₹	Credit ₹
Capital		1,20,000
Sundry debtors and creditors	22,000	22,500
Sales		59,700
Drawings	2,000	
Cash in hand	8,200	
Cash at bank	30,000	
Wages	2,500	
Purchases	10,000	
Opening stock	30,000	
Business premises	60,000	
Bills receivable	14,500	
Office telephone expenses	3,500	
General expenses	9,000	
Goodwill	10,500	
	2,02,200	2,02,200

Adjustments:

(a) The stock value at the end of the accounting period was ₹ 5,000

(b) Interest on capital at 6% is to be provided

(c) Interest on drawing at 5% is to be provided

(d) Write off bad debts amounting to ₹ 2,000

(e) Create provision for bad and doubtful debts on sundry debtors @ 10%

Prepare final accounts for the year ended 31st March, 2016.

Solution

In the books of Pandian

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		30,000	By Sales		59,700
To Purchases		10,000	By Closing Stock		5,000
To Wages		2,500			
To Gross Profit c/d		**22,200**			
		64,700			64,700
To Office telephone expenses		3,500	By Gross profit b/d		22,200
To General expenses		9,000	By Interest on drawings		100
To Interest on capital		7,200	(2000 x5/100)		
(1,20,000 x 6/100)			By Net loss		**1,400**
To Bad debts		2,000	(transferred to capital		
To Provision for bad and			account)		
doubtful debts		2,000			
		23,700			23,700

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,20,000		Goodwill		10,500
Less: Net loss	1,400		Business premises		60,000
	1,18,600		Stock in trade		5,000
Add: Interest on capital	7,200		Sundry debtors	22,000	
	1,25,800		Less: Bad debts	2,000	
Less: Drawings and Interest on drawings (2000+100)	2,100	1,23,700		20,000	
Sundry creditors		22,500	Less: Provision for bad and doubtful debts (20,000 x 10/100)	2,000	18,000
			Bills receivable		14,500
			Cash at bank		30,000
			Cash in hand		8,200
		1,46,200			1,46,200

Illustration 20

From the trial balance of Ajith and the adjustments given below, prepare trading and profit and loss A/c for the year ended 31st March, 2016 and the balance sheet as on that date.

Particulars	Debit ₹	Particulars	Credit ₹
Opening stock	15,000	Capital	25,000
Furniture and fixtures	30,000	Returns outward	1,000
Purchases	40,000	Bills payable	10,000
Sales returns	2,000	Sales	1,24,000
Carriage inwards	10,000	Provision for doubtful debts	500
Office rent	23,000	Provision for discount on debtors	100
Sundry debtors	20,100		
Bank balance	19,600		
Bad debts	900		
	1,60,600		1,60,600

Adjustments:

(a) Stock at the end of the year was ₹ 8,000

(b) Further bad debts amounted to ₹ 100

(c) Create 2% provision for doubtful debts on sundry debtors

(d) Create 1% provision for discount on sundry debtors

In the books of Ajith

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,000	By Sales	1,24,000	
To Purchases	40,000		Less: Sales returns	2,000	1,22,000
Less: Returns outward	1,000	39,000	By Closing stock		8,000
To Carriage inwards		10,000			
To Gross profit c/d		**66,000**			
		1,30,000			1,30,000
To Office rent		23,000	By Gross profit b/d		66,000
To Provision for bad and doubtful debts (closing)	400				
Add: Bad debts	900				
Add: Further bad debts	100				
	1,400				
Less: Provision for bad and doubtful debts (opening)	500	900			
To Provision for discount on debtors (closing)	196				
Less: Provision for discount on debtors (opening)	100	96			
To Net profit (transferred to capital A/c)		**42,004**			
		66,000			66,000

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	25,000		Furniture and fixtures		30,000
Add: Net profit	42,004	67,004	Sundry debtors	20,100	
Bills payable		10,000	Less: Further bad debts	100	
				20,000	
			Less: Provision for bad and doubtful debts (20,000 × 2%)	400	
				19,600	
			Less: Provision for discount (19,600 × 1%)	196	19,404
			Stock-in-trade		8,000
			Cash at bank		19,600
		77,004			**77,004**

Illustration 21

The following trial balance has been extracted from the books of Rajesh on 31st December, 2016.

Debit balance	₹	Credit balance	₹
Drawings	44,000	Capital	1,76,000
Plant and machinery	1,00,000	Cash sales	1,72,000
Opening stock	20,000	Provision for bad and doubtful debts	2,000
Purchases	2,70,000	Bank overdraft	20,000
Wages	62,000	Discount received	6,000
Salaries	70,000	Credit sales	3,00,000
Insurance	45,000	Sundry creditors	24,000
Rent and taxes	17,000		
Sundry debtors	50,000		
Suspense A/c	22,000		
	7,00,000		7,00,000

The following adjustments are to be made:

(a) Stock on 31st December, 2016 was ₹28,000

(b) Unexpired insurance was ₹15,000

(c) Provision for doubtful debts is to be maintained at 5% on sundry debtors.

(d) Depreciate plant and machinery at 20%.

You are required to prepare trading and profit and loss account for the year ended 31st December, 2016 and a balance sheet as on that date.

Solution

In the books of Rajesh

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		20,000	By Sales: Cash	1,72,000	
To Purchases		2,70,000	Credit	3,00,000	4,72,000
To Wages		62,000	By Closing stock		28,000
To Gross profit c/d		**1,48,000**			
		5,00,000			5,00,000
To Salaries		70,000	By Gross profit b/d		1,48,000
To Insurance	45,000		By Discount received		6,000
Less: Unexpired	15,000	30,000	By Provision for bad and doubtful debts (opening)	2,000	
To Rent and taxes		17,000			
To Depreciation on plant and machinery (1,00,000 × 20%)		20,000	Less: Closing provision	1,000	1,000
To Net profit (transferred to capital A/c)		**18,000**			
		1,55,000			**1,55,000**

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,76,000		Plant & Machinery	1,00,000	
Add: Net profit	18,000		Less: Depreciation	20,000	80,000
	1,94,000		Stock-in-trade		28,000
Less: Drawings	44,000	1,50,000	Sundry debtors	50,000	
Sundry creditors		24,000	Less: Provision for bad and doubtful debts (2%)	1,000	49,000
Bank overdraft		20,000	Unexpired insurance		15,000
			Suspense A/c		22,000
		1,94,000			**1,94,000**

Points to remember

- Adjustment entries are the journal entries made at the end of the accounting period to bring into account items which are omitted in trial balance but which relate to the relevant accounting period.
- Adjustment entries are made so that the financial statements represent a true and fair view of profitability and financial position.
- Closing stock is valued at cost price or net realisable value whichever is lower.
- Outstanding expense and income received in advance are current liabilities.
- Prepaid expense and accrued income are current assets.
- Provision is created for bad and doubtful debts and discount on debtors in the current accounting period against debtors of current accounting period.

Self-examination questions

I Multiple choice questions

Choose the correct answer

AKSTL4

1. A prepayment of insurance premium will appear in
   (a) The trading account on the debit side
   (b) The profit and loss account on the credit side
   (c) The balance sheet on the assets side
   (d) The balance sheet on the liabilities side

2. Net profit is

(a) Debited to capital account

(b) Credited to capital account

(c) Debited to drawings account

(d) Credited to drawings account

3. Closing stock is valued at

(a) Cost price

(b) Market price

(c) Cost price or market price whichever is higher

(d) Cost price or net realisable value whichever is lower

4. Accrued interest on investment will be shown

(a) On the credit side of profit and loss account

(b) On the assets side of balance sheet

(c) Both (a) and (b)

(d) None of these

5. If there is no existing provision for doubtful debts, provision created for doubtful debts is

(a) Debited to bad debts account

(b) Debited to sundry debtors account

(c) Credited to bad debts account

(d) Debited to profit and loss account

Answers

1 (c)	2 (b)	3 (d)	4 (c)	5 (d)

II Very short answer questions

1. What are adjusting entries?
2. What is outstanding expense?
3. What is prepaid expense?
4. What are accrued incomes?
5. What is provision for discount on debtors?

III Short answer questions

1. What is the need for preparing final accounts?
2. What is meant by provision for doubtful debts? Why is it created?
3. Explain how closing stock is treated in final accounts.
4. Give the adjusting entries for interest on capital and interest on drawings.
5. Explain the accounting treatment of bad debts, provision for doubtful debts and provision for discount on debtors.

IV Exercises

1. Pass adjusting entries for the following:
   (a) The closing stock was valued at ₹ 5,000
   (b) Outstanding salaries ₹ 150
   (c) Insurance prepaid ₹ 450
   (d) ₹20,000 was received in advance for commission.
   (e) Accrued interest on investments is ₹ 1,000.

2. For the following adjustments, pass adjusting entries:
   (a) Outstanding wages ₹ 5,000.
   (b) Depreciate machinery by ₹ 1,000.
   (c) Interest on capital @ 5% (Capital: ₹20,000)
   (d) Interest on drawings ₹ 50
   (e) Write off bad debts ₹ 500

3. On preparing final accounts of Suresh, bad debt account has a balance of ₹ 800 and sundry debtors account has a balance of ₹ 16,000 of which ₹ 1,200 is to be written off as further bad debts. Pass adjusting entry for bad debts. And also show how it would appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹2,000 (Dr.);
Balance of sundry debtors in balance sheet: ₹14,800)

4. The trial balance on March 31, 2016 shows the following:
   Sundry debtors ₹ 30,000; Bad debts ₹ 1,200
   It is found that 3% of sundry debtors is doubtful of recovery and is to be provided for. Pass journal entry for the amount of provision and also show how it would appear in the profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹900 (Dr.);
Balance of sundry debtors in balance sheet: ₹29,100)

5. The trial balance of a trader on 31st December, 2016 shows sundry debtors as ₹ 50,000.
   Adjustments:
   (a) Write off ₹ 1,000 as bad debts
   (b) Provide 5% for doubtful debts
   (c) Provide 2% for discount on debtors
   Show how these items will appear in the profit and loss A/c and balance sheet of the trader.

(**Answer**: Profit and loss account: ₹4,381 (Dr.),
Balance of sundry debtors in balance sheet: ₹45619)

6. On 1st January, 2016, provision for doubtful debts account had a balance of ₹ 3,000. On December 31, 2016, sundry debtors amounted to ₹ 80,000. During the year, bad debts to be written off were ₹ 2,000. A provision for 5% was required for next year. Pass journal entries and show how these items would appear in the final accounts.

(**Answer**: Profit and loss account: ₹2,900 (Dr.);
Balance of sundry debtors in balance sheet: ₹74,100)

7. The following are the extracts from the trial balance.

Sundry debtors ₹30,000; Bad debts ₹5,000

Additional information:

(a) Write off further bad debts ₹ 3,000.

(b) Create 10% provision for bad and doubtful debts.

You are required to pass necessary adjusting entries and show how these items will appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹10,700 (Dr.),
Balance of sundry debtors in balance sheet: ₹24,300)

8. The following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry debtors	50,000	
Provision for doubtful debts		5,000
Bad debts	3,000	

Additional information:

(a) Additional bad debts ₹ 3,000.

(b) Keep a provision for bad and doubtful debts @ 10% on sundry debtors.

You are required to pass necessary adjusting entries and show how these items will appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹ 5,700 (Dr.),
Balance of sundry debtors in balance sheet: ₹ 42,300)

9. The accounts of Lakshmi traders showed the following balance on 31st March, 2016.

Sundry debtors ₹ 60,000; Bad debts ₹ 2,000

Provision for doubtful debts ₹ 4,200

At the time of preparation of final accounts on 31st March, it was found that out of sundry debtors, ₹ 1,000 will be irrecoverable. It was decided to create a provision of 2% on debtors to meet any future possible bad debts.

Pass necessary journal entries and show how these items would appear in the final accounts.

(**Answer**: Profit and loss account: ₹20 (Cr.);
Balance of sundry debtors in balance sheet: ₹57,820)

10. The following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry debtors	50,000	
Discount on debtors	2,000	
Bad debts	3,000	

Additional information:

(a) Create a provision for doubtful debts @ 10% on sundry debtors.

(b) Create a provision for discount on debtors @ 5% on sundry debtors.

You are required to pass necessary adjusting entries and show how these items will appear in the final accounts.

(**Answer**: Profit and loss account: Provision for bad and doubtful debts ₹ 8,000 (Dr.),
Provision for discount on debtors: ₹ 4,250 (Dr.);
Balance of sundry debtors in balance sheet: ₹ 42,750).

11. Following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry debtors	50,000	
Discount on debtors	1,000	
Bad debts	3,000	
Provision for doubtful debts		5,000
Provision for discount on debtors		2,000

Additional information:

(a) Additional bad debts ₹ 1,000

(b) Create a provision for doubtful debts @ 5% on sundry debtors.

(c) Create a provision for discount on debtors @ 2% on sundry debtors.

You are required to pass necessary journal entries and show how these items will appear in the final accounts.

(**Answer**: Profit and loss account: Provision for bad and doubtful debts: ₹ 1,450 (Dr.)
Provision for discount on debtors: ₹ 69 (Cr.)
Balance of sundry debtors in balance sheet: ₹ 45,619)

12. The following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry Creditors	--	30,000
Discount received	--	1,000

You are required to show how these items will appear in the profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹ 1,000 (Cr.),
Balance of sundry creditors in balance sheet: ₹ 30,000)

13. Prepare trading account of Archana for the year ending 31st December, 2016 from the following information.

Debit balance	₹	Credit balance	₹
Opening stock	80,000	Purchases returns	10,000
Purchases	8,60,000	Sales returns	3,16,000
Freight inwards	52,000	Import duty on purchases	30,000
Wages	24,000	Sales	14,40,000

Adjustments:

(a) Closing stock ₹ 1,00,000

(b) Wages outstanding ₹ 12,000

(c) Freight inwards paid in advance ₹ 5,000

(**Answer**: Gross Profit: ₹ 1,81,000)

14. Prepare profit and loss account of Manoj for the year ending on 31st March, 2016

Particulars	₹	Particulars	₹
Gross profit	25,000	Travelling expenses	500
Salaries	5,600	Stationery	75
Insurance	200	Rent	650
Discount allowed	400	Interest on loan	225
Discount received	300	Repairs	125
Commission received	100	Office expenses	55
Advertisement	450	General expenses	875
Printing charges	375	Postage	175

Adjustments:

(i) Salary outstanding ₹ 400

(ii) Rent paid in advance ₹ 50

(iii) Commission receivable ₹ 100

(**Answer**: Net profit: ₹ 15,445)

15. From the trial balance of Sumathi and the adjustments prepare the trading and profit and loss account for the year ended 31st March, 2016, and a balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock on April 1, 2015	900	
Purchases	2,000	
Sales		4,000
10% Loan		2,000
Carriage on purchases	200	
Rent from tenant		250
Interest on loan	100	
Machinery	400	

Adjustments

(a) Six months interest on loan is outstanding.

(b) Two months rent is due from tenant, the monthly rent being ₹ 25.

(c) Salary for the month of March 2016, ₹ 75 is unpaid.

(d) Stock in hand on March 31, 2016 was valued at ₹ 1,030.

(**Answer**: Gross profit: ₹ 1,930; Net profit ₹ 1,405, Balance sheet total ₹ 5,555)

16. The following trial balance was extracted from the books of Arun Traders as on 31st March, 2018.

Particulars	Debit ₹	Credit ₹
Buildings	17,500	
Plant and machinery	12,000	
Cash purchases	30,000	
Credit purchases	8,500	
Sales		63,250
Bills receivable	6,750	
Coal and water	1,625	
Office expenses	5,250	
Rent received		1,750
Carriage outwards	2,875	
Repairs and maintenance	500	
Wages	9,250	
Debtors and creditors	9,000	8,500
Cash	2,000	
Capital		44,750
Opening stock	13,000	
	1,18,250	1,18,250

Prepare trading and profit and loss account for the year ending 31st March, 2018 and balance sheet as on that date after considering the following:

(a) Depreciate Plant and machinery @ 20%

(b) Wages outstanding amounts to ₹ 750.

(c) Half of repairs and maintenance paid is for the next year.

(d) Closing stock was valued at ₹ 15,000.

(**Answer**: Gross profit: ₹ 15,125; Net profit ₹ 6,100, Balance sheet total ₹ 60,100)

17. The following is the trial balance of Babu as on 31st December, 2016.

Particulars	Debit ₹	Credit ₹
Stock (01-01-2016)	8,000	
Goodwill	13,600	
Investments	7,500	
Capital		16,650
Purchases and Sales	24,750	40,500
Returns	750	1,000
Discount	1,100	650
Bad debts	400	
Debtors and Creditors	10,000	9,100
Provision for bad debts		600
Bank overdraft		1,250
Printing and stationery	650	
Wages	1,250	
Salaries	1,750	
	69,750	69,750

Prepare trading and profit and loss account for the year ended 31st December, 2016 and a balance sheet as on that date after the following adjustments.

(a) Salaries outstanding ₹ 500

(b) Interest on investments receivable at10%.

(c) Provision required for bad debts is 5%.

(d) Closing stock is valued at ₹ 9,900.

(**Answer**: Gross profit: ₹ 16,650; Net profit ₹ 13,750, Balance sheet total ₹ 41,250)

18. From the following trial balance of Ramesh as on 31st March, 2017, prepare the trading and profit and loss account and the balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock (01.04.2016)	40,000	
Purchases	85,000	
Sales		1,90,000
Sundry creditors		48,000
Furniture and fixtures	65,000	
Debtors	45,000	
Cash at bank	21,000	
Wages	37,500	
Drawings	15,000	
Telephone charges	3,000	
Bad debts	2,000	
Provision for bad debts		2,500
Discount received		3,000
Capital		85,000
Advertising	15,000	
	3,28,500	3,28,500

Adjustments:

(a) Closing stock was valued at ₹ 35,000

(b) Unexpired advertising ₹ 250

(c) Provision for bad and doubtful debts is to be increased to ₹ 3,000

(d) Provide 2% for discount on debtors.

(**Answer**: Gross profit ₹ 62,500; Net profit ₹ 44,410; Balance sheet total ₹ 1,62,410)

19. Following are the ledger balances of Devi as on 31st December, 2016.

Debit balance	₹	Credit balance	₹
Purchases	35,000	Goodwill	40,000
Salaries	11,750	Sundry debtors	20,500
Drawings	4,500	Furniture	31,000
Opening Stock	6,250	General expenses	3,250
Capital	50,000	Commission received	2,750
Sales	78,500	Loan	44,000
Carriage inwards	21,800	Cash at bank	3,100
Bad debts	600	Provision for bad debts	2,500

Prepare trading and profit and loss account for the year ended 31st December, 2016 and balance sheet as on that date.

(a) Stock on 31st December, 2016 ₹ 5,800.

(b) Write off bad debts ₹ 500.

(c) Make a provision for bad debts @ 5%.

(d) Provide for discount on debtors @ 2%.

(**Answer:** Gross profit: ₹21,250; Net profit ₹9,020, Balance sheet total ₹98,520)

20. From the following trial balance of Mohan for the year ended 31st March, 2017 and additional information, prepare trading and profit and loss account and balance sheet.

Particulars	Debit ₹	Credit ₹
Capital		1,00,194
Drawings	7,500	
Purchases	8,28,890	
Promotional expenses	58,405	
Sales		9,17,600
Bad debts	4,925	
Discount	7,745	
Provision for doubtful debts		250
Wages	16,000	

Plant and machinery	41,500	
Land and building	26,450	
Sundry creditors		20,000
Sundry debtors	32,500	
Cash in hand	11,629	
Opening stock	2,500	
	10,38,044	10,38,044

Additional information:

(a) Closing stock is valued at ₹ 15,500

(b) Write off ₹ 500 as bad debts and create a provision for bad debts @ 10% on debtors.

(c) Depreciation @ 10% required

(**Answer**: Gross profit ₹ 85,710; Net profit ₹ 7,035; Balance sheet total: ₹ 1,19,729)

21. From the following trial balance of Subramaniam, prepare his trading and profit and loss account and balance sheet as on 31st December, 2016.

Debit balance	₹	Credit balance	₹
Stock (on 1-1-2016)	36,000	Sundry creditors	44,000
Furniture	62,600	Capital	50,000
Sundry Debtors	32,000	Sales	1,60,000
Cash at bank	6,000	Returns outward	4,000
Purchases	80,000	Discount received	2,200
Drawings	1,000	Bills payable	10,600
Returns inward	10,000		
Salaries	21,200		
Freight on purchases	22,000		
	2,70,800		2,70,800

Take into account the following adjustments:

(a) Charge interest on drawings at 8%.

(b) Outstanding salaries ₹ 3,000

(c) Closing stock was valued at ₹ 48,000

(d) Provide for 5% interest on capital.

(**Answer**: Gross profit ₹ 64,000; Net profit ₹ 39,580; Balance sheet total ₹ 1,48,600)

22. Prepare trading and profit and loss account and balance sheet from the following trial balance of Madan as on 31st March, 2018

Debit balance	₹	Credit balance	₹
Sundry debtors	61,000	Capital	70,000
Plant and machinery	80,000	Purchases return	2,000
Bank charges	4,200	Sales	2,55,000
Wages	7,000	Bank overdraft	77,000
Sales return	5,000		
Purchases	1,52,000		
Opening stock	30,000		
Drawings	22,000		
Establishment expenses	20,000		
Bad debts	800		
Business premises	22,000		
	4,04,000		4,04,000

Adjustments:

(a) The closing stock was ₹ 80,000

(b) Provide depreciation on plant and machinery @ 20%

(c) Write off ₹ 800 as further bad debts

(d) Provide the doubtful debts @ 5% on sundry debtors

(**Answer**: Gross profit ₹ 1,43,000; Net profit ₹ 98,190; Balance sheet total ₹ 2,23,190)

23. From the following information prepare trading and profit and loss account and balance sheet of Kumar for the year ending 31st December, 2017.

Debit balance	₹	Credit balance	₹
Purchases	14,500	Sales	20,100
Coal and fuel	600	Bills payable	400
Carriage inwards	750	Rent received	2,500
Advertisement	500	Creditors	2,000
Carriage outwards	400	Capital	5,000
Bank	1,200		
Furniture	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2017	1,500		
	30,000		30,000

Adjustments:

a) The closing stock on 31st December, 2017 was valued at ₹ 3,900.
b) Carriage inwards prepaid ₹ 250
c) Rent received in advance ₹ 100
d) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

(**Answer**: Gross profit ₹ 6,900; Manager's commission ₹ 400; Net profit ₹ 8,000; Balance sheet total ₹ 15,900)

24. From the following information, prepare trading and profit and loss account and balance sheet in the books of Sangeetha for the year ending 31st March, 2018.

Debit balance	₹	Credit balance	₹
Capital	20,000	Salaries	6,600
Bills receivable	8,000	Establishment expenses	4,500
Bills payable	10,500	Advertisement	2,300
Purchases	75,000	Furniture	10,000
Sales	95,000	Cash at bank	3,200
Opening stock	12,000	Miscellaneous receipts	600
Drawings	4,500		

Adjustments:

a) Stock on 31st March, 2018 ₹ 14,200
b) Income tax of Sangeetha paid ₹ 800
c) Charge interest on drawings @ 12% p.a.
d) Provide managerial remuneration @ 10% of net profit before charging such commission.

(**Answer**: Gross profit ₹ 22,200; Manager's commission ₹ 794; Net profit ₹ 7,146; Balance sheet total ₹ 34,600)

CASE STUDY

James is a trader who sells washing machines on credit. But, he does not remember the due date to collect the money from his debtors. Some of his customers do not pay on time. His cash inflow is becoming worse. As a result, he could not pay his telephone bill and rent at the end of the accounting period. Hence, he showed only the amount paid as expense. He has many washing machines unsold at the year end. He is worried about the performance of his business. So, he is planning to appoint a manager to take care of his business. The new manager insists James to apply the accounting principle of prudence and matching and also to allow cash discount.

Now, discuss on the following points:

- Why does James sell on credit?
- Are there any ways to encourage his debtors to make the payment on time?
- What might happen if the debtors do not pay?
- In what ways prudence and matching principles can be applied for the business of James?
- What will be the impact on income statement and the balance sheet, if the outstanding expenses are not adjusted?
- On what basis the unsold washing machines should be valued?
- What can be done to motivate the new manager to retain him in the business of James?

To explore further

'Profit does not necessarily mean cash inflow' – Do you agree?

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Unit 14

COMPUTERISED ACCOUNTING

Contents

Points to recall

The following points are to be recalled before learning computerised accounting:

- Accounting cycle
- Invoice
- Concept of depreciation

AL2PMR

Learning Objectives

To enable the students to:

- Understand the usage of computers in maintaining accounts
- Evaluate the advantages and limitations of Computerised Accounting System
- Apply MS Word and MS Excel in maintaining accounts

Key terms to know

- Computerised Accounting System (CAS)
- Input, CPU, output
- Accounting software
- Grouping and codification

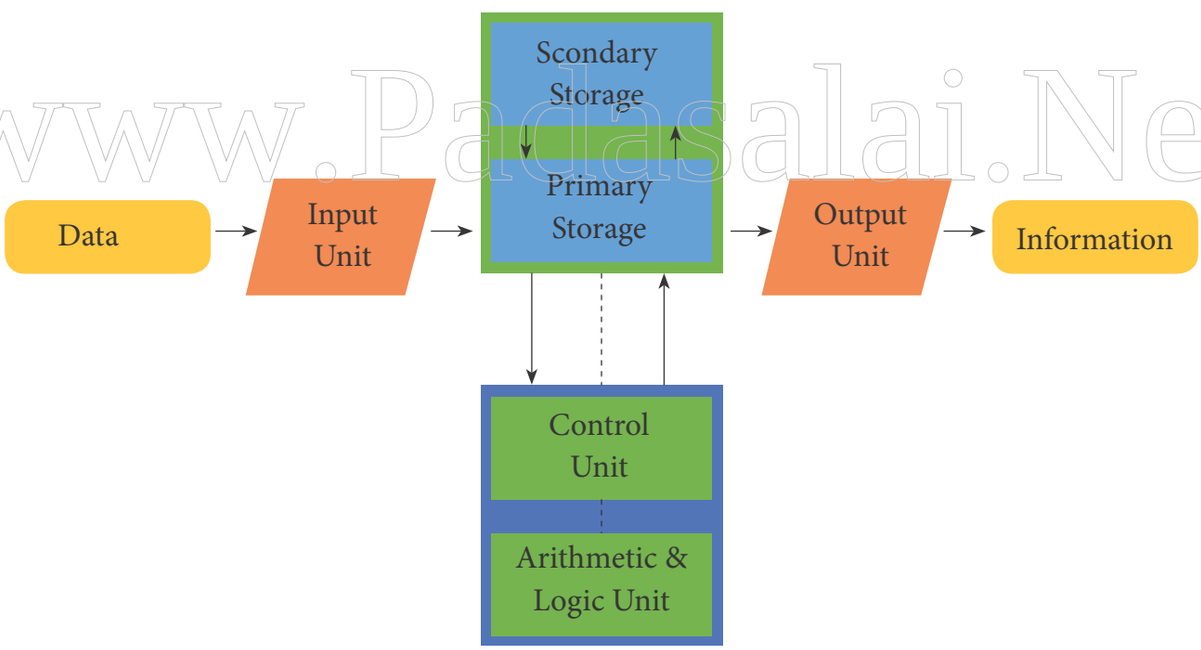
14.1 Introduction to computers

Student activity

Think: A trader has more than 10 years of accounting records. He finds it difficult to keep them all, because it requires a large store room. Is there any way to overcome this difficulty?

A computer can be described as an electronic device designed to accept raw data as input, processes them and produces meaningful information as output. It has the ability to perform arithmetic and logical operations as per given set of instructions called program. Today, computers are used all over the world in several areas for different purposes.

A computer system has mainly three components namely, input unit, central processing unit and output unit. These components are the building blocks of a computer and define its architecture. The relationship among these components is established by the following diagram:



CPU (Central Processing Unit)

Computers are nowadays widely used in scientific research, education, business, accounting, transportation, communication, banking, defence, etc. With the expansion of business, the number of transactions has increased tremendously and as a result in accounting the manual method of keeping and maintaining records have become unmanageable. The manual method of accounting is being gradually replaced with the introduction of computers in business.

14.2 Computerised Accounting System (CAS)

Computerised accounting system refers to the system of maintaining accounts using computers. It involves the processing of accounting transactions through the use of hardware and software in order to keep and produce accounting records and reports. Computerised accounting system takes accounting transactions as inputs that are processed through accounting software to generate the following reports:

- Day books /Journals
- Ledger
- Trial balance
- Trading account
- Profit and loss account
- Balance sheet, etc.

In accounting, computer is commonly used in the following areas:

a) Recording of business transactions

b) Payroll accounting

c) Stores accounting and

d) Generation of accounting reports

It is to be noted that the fundamentals of accounting do not change whether books of accounts are maintained manually or computerised. The same principles of debit and credit are equally applicable in a computerised environment.

14.2.1 Features of computerised accounting system

Computerised Accounting System (CAS) facilitates the management and other users to maintain accounts and prepare financial statements using computers. The reports generated through CAS are used to analyse financial status of a business and take necessary decisions to strengthen the financial soundness of the business. The CAS possesses the following features:

i) Simple and integrated

CAS is designed to automate and integrate all the business operations such as purchase, sales, finance, inventory and manufacturing. The CAS may be integrated with enhanced Management Information System (MIS), multi-lingual and data organisation capabilities to simplify all the business processes of the organisation easily and cost-effectively.

ii) Speed

It can perform functions at much higher speed than doing the same manually.

iii) Accuracy

Computers perform functions with high degree of accuracy. If hardware, software and input by people are proper, the computerised accounting system can assure of accurate outcome.

iv) Reliability

Computers are used to process large volumes of data and hence, data provided by it are reliable.

v) Versatility

Computer and accounting software have the ability to perform diverse tasks. For example, by simply recording accounting entries through accounting software, one can get trial balance, trading account, profit and loss account, balance sheet and diverse reports.

vi) Transparency

With computerised accounting, the organisation will have greater transparency of day-to-day business operations and access to the vital information.

vii) Scalability

CAS enables processing of any volume of data in tune with the change in the size of the business.

viii) On-line facility

CAS offers online facility to store and process transaction and data so as to retrieve information to generate and view financial reports in any part of the world.

ix) Security

In CAS, only the authorised users are permitted to have access to accounting data. Under manual accounting system, it is very difficult to secure such information as it is open to inspection by any person dealing with the books of accounts.

14.2.2 Components of Computerised Accounting System

Components of CAS can be classified into six categories, namely, i) Hardware ii) Software iii) People iv) Procedure v) Data and vi) Connectivity.

i) Hardware

The physical components of a computer constitute its hardware. Hardware consists of input devices and output devices that make a complete computer system. Examples of input devices are keyboard, optical scanner, mouse, joystick, touch screen and slylus which are used to feed data into the computer. Output devices such as monitor and printer are media to get the output from the computer.

ii) Software

A set of programs that form an interface between the hardware and the user of a computer system are referred to as software. The following are the various types of software:

a) System software: A set of programs to control the internal operations such as reading data from input devices, giving results to output devices and ensuring proper functioning of components is called system software. The system software includes the following:

   (1) Operating system: A set of tools and programs to manage the overall working of a computer using a defined set of hardware components is called an operating system. It is the interface between the user and the computer system. Example: DOS, Windows, UBUNTU, imac, etc.

   (2) Programming software: Special software to accept data and interpret them in the form of machine/assembly language understandable by a computer. Example: C, PASCAL, COBOL, etc.

   (3) Utility software: These are designed specifically for managing the computer device and its resources. Example: File manager, Anti-virus software, etc.

b) Application software: Programs designed to perform a specific function for a user. An application software can be classified as follows:

   (i) General purpose software: This type of application can be used for a variety of tasks and not limited to one particular function. Example: MS-Office.

   (ii) Specific purpose software: This software is created to execute one specific task and they are customised to the needs of user. Example: Accounting software, payroll software, etc.

Finacle is a banking software.

iii) People

The most important element of a computer system is its users. They are also called live-ware of the computer system. The following types of people interact with a computer system.

a) System analysts: People who design the operation and processing of the system.

b) System programmers: People who write codes and programs to implement the working of the system.

c) System operators: People who operate the system and use it for different purposes. They are also called as end users.

iv) Procedure

Procedure is a step by step series of instructions to perform a specific function and achieve desired output. In a computer system there are three types of procedures.

a) Hardware oriented procedure: It defines the working of a hardware component.

b) Software oriented procedure: It is a set of detailed instructions for using the software.

c) Internal procedure: It maintains the overall working of each part of a computer system by directing the flow of information.

v) Data

The facts and figures that are fed into a computer for further processing are called data. Data are raw input until the computer system interprets them using machine language, stores them in memory, classifies them for processing and produces results in conformance with the instructions given to it. Processed and useful data are called information which is used for decision making.

vi) Connectivity

When two or more computers are connected to each other, they can share information and resources such as sharing of files (data/music, etc), sharing of printer, sharing of facilities like the internet. This sharing is possible using wires, cables, satellite, infra-red, bluetooth, microwave transmission, etc.

14.3 Advantages of Computerised Accounting System

The main advantages of computerised accounting system are as follows:

(i) Faster processing

Computers require far less time than human beings in performing a particular task. Therefore, accounting data are processed faster using a computerised accounting system.

(ii) Accurate information

There is less space for error because only one account entry is needed for each transaction unlike repeated posting of the same accounting data in manual system.

(iii) Reliability

Computer systems are immune to boredom, tiredness or fatigue. Therefore, these can perform repetitive functions effectively and are highly reliable.

(iv) Easy availability of information

The data are easily available and can be communicated to different users at the same time.

(v) Up-to-date information

Account balances will always be up to date since the records are automatically updated as and when accounting data are entered or stored.

(vi) Efficiency

The computer based accounting system ensures better use of time and resources.

(vii) Storage and retrieval

Computer based systems require a fractional amount of physical space as compared to the books of accounts in the form of journals, ledgers and accounting registers.

(viii) Works as a motivator to employees

Employees using computer systems feel more valued as they are trained and specialised for the job.

(ix) Automated document production

Accounting reports like trial balance and financial statements are generated automatically and are easily accessible just by a click of the mouse.

(x) MIS Reports

It is easier to monitor and control the business using the real time management reports generated by the computerised information systems.

Student activity

Think: Businesses can benefit by introducing computerised accounting system. But, how would employees feel about this change?

14.4 Limitations of Computerised Accounting System

The main limitations of CAS are being dependent upon the operating environment they work in. Some of them are listed as follows:

(i) Heavy cost of installation

Computer hardware needs replacement and software needs to be updated from time to time with the availability of newer versions.

(ii) Cost of training

To ensure effective and efficient use of computerised system of accounting, newer versions of hardware and software are to be introduced. These require special training and hence, cost is incurred to train the staff personnel.

(iii) Fear of unemployment

On account of the introduction of computerised accounting system, the employees feel insecure that they may lose employment and show less interest in computer related work.

(iv) Disruption of work

When computerised system is introduced, the existing process of accounting and other works are interrupted. This results in certain changes in the working environment.

(v) System failure

The danger of a system crashing due to some failure in hardware can lead to subsequent interruption of work. This is more when no back-up is made.

(vi) Time consuming

When there is system failure, an alternative arrangement needs to be made to avoid loss of work. This consumes some time to bring the regular processes back.

(vii) Unanticipated errors not known

Unlike human beings, computers do not have the capability to judge or detect unanticipated errors in the system.

(viii) Breaches of security

The danger of viruses and hacking into the system from outside creates a strong need for security of the system. Similarly, the person who has created the specific programme can easily defraud by tampering with the original records.

(ix) Health dangers

Extensive use of computers may lead to many health problems such as eye strain, muscular complaints, back ache, etc. resulting in reducing work efficiency as well as increased medical expenditure.

Student activity

Think: "People even without accounting knowledge can work on computerised accounting system" – Do you agree?

It is possible to track the origins of figures in the accounting system, from the original source document through to figures in the end-of-year final accounts. This is called audit trail.

14.5 Differences between manual and computerised accounting system

The differences between manual accounting and computerised accounting are given below:

Basis	Manual accounting	Computerised accounting
i) Recording of transactions	Transactions are recorded manually.	Transactions are recorded using computers.
ii) Storage	Transactions are stored in volumes of books.	Transactions are stored in well-designed databases.
iii) Preparation of ledger accounts, trial balance and financial statements	Ledger accounts, trial balance and financial statements are prepared manually.	Once journal entries are passed or subsidiary books are entered, data are processed automatically and ledger accounts, trial balance and balance sheet are automatically prepared.
iv) Preparation of report	Analysis of financial statements and preparation of report are to be done manually.	Financial statement analysis such as ratio analysis, preparation of cash flow statement, etc. is automatically done.
v) Time involved	It takes lot of time as everything from journalising to report generation is done manually.	It saves lot of time. Time is taken only for passing journal entries or entering data in subsidiary books. Once date are entered, preparation of ledger, trial balance, financial statements or report generation is done within seconds.
vi) Cost involved	The cost is high in manual accounting as several books of account are to be maintained.	The cost is less compared to manual accounting as all the records are kept in soft copy.
vii) Retrieval of data	It becomes difficult and time consuming to retrieve data as several books have to be gone through.	Retrieval of data is easier as the records are kept in soft copy in data base. By giving instructions, data can be retrieved quickly.
viii) Accuracy	Certain clerical errors such as arithmetical, error in carrying forward, etc. can happen.	If the input given is correct, the output will also be correct. Arithmetical error, error in carrying forward will not happen provided the programming is correct.

ix) Communication of report	Communication of report takes time and it is difficult as it has to be done manually to the users of information.	It is easier and takes lesser time. The report is in soft copy and if online facility is available, it can be communicated to the users very easily at any time and at any place.

14.6 Accounting software

The main function of CAS is to perform the accounting activities in an organisation and generate reports as per the requirements of the users. To obtain the desired results optimally, need based software or packages are to be installed in the organisation. Depending upon the suitability of business requirements there are three types of software, namely, (i) Readymade software, (ii) Customised software and (iii) Tailormade software.

(i) Readymade software

These packages are standardised or readymade packages which can be used by the business enterprises immediately on procurement. These packages are used by small and conventional business enterprises. Cost of installation and maintenance is very low. Training cost is negligible and sometimes the vendor provides free of cost training. These softwares are used by those enterprises where financial transactions are simple, uniform and routine in nature. Few examples of such type of software are Tally, Busy, Marg, Profitbooks.

(ii) Customised software

Many a time, it is not possible that ready-to-use packages suit the requirements of the business enterprise. In such circumstances, customised packages may help the business enterprise for fulfilling their requirements. Customised packages can be modified according to the need of the enterprise. For example, software can record attendance of the employees and on the requirement of the customer it can also count the absence of employees in a month, etc.

These packages are used by medium or large business enterprises. Cost of installation, maintenance and training is relatively higher than that of ready-to-use packages. These softwares are used by those enterprises where financial transactions are somewhat peculiar in nature.

(iii) Tailormade software

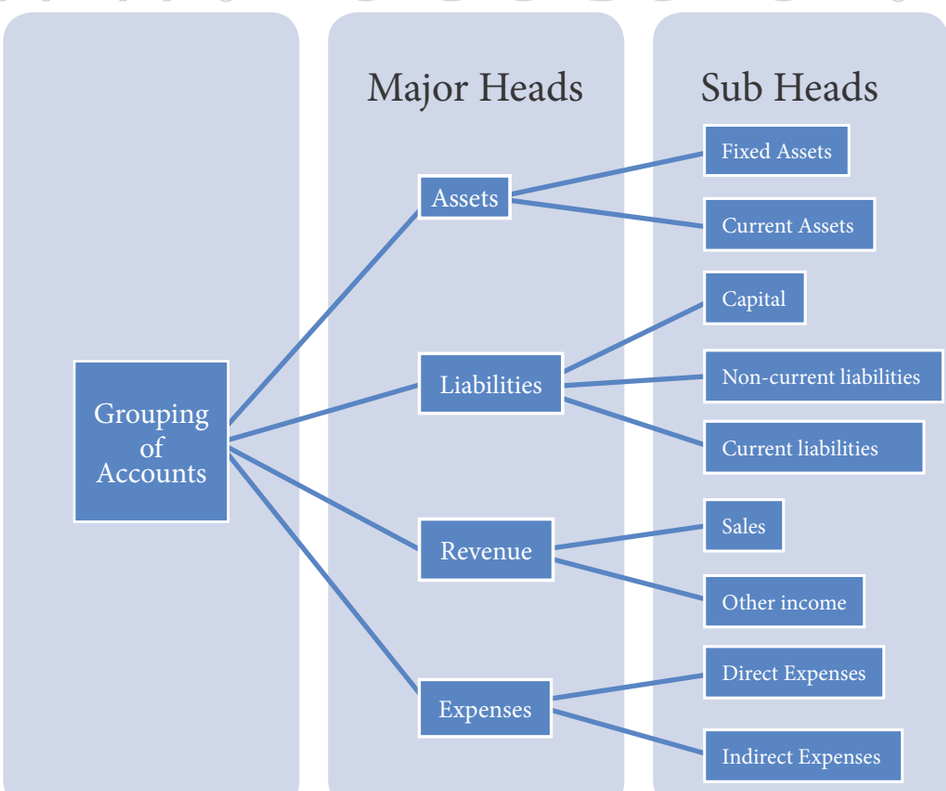
Large enterprises have their own way of functioning. For effective management information system, varied and specific information is frequently required by many users which may not be needed in case of small or medium scale enterprises. In such enterprises, depending upon their functioning, need based softwares known as tailored packages are installed. The cost of these packages is very high and specific training for using these packages is also required.

The following are the differences among the three types of software:

Basis	Ready to use software	Customised software	Tailor made software
(i) Nature of business	Small, conventional business	Large, medium business	Large
(ii) Cost of installation and maintenance	Low	Relatively high	High
(iii) Expected level of secrecy (software and data)	Low	Relatively high	Relatively high
(iv) Number of users and their interface	Limited	As per specifications	Unlimited
(v) Linkage to other information system	Restricted	Not restricted	Not restricted
(vi) Adaptability	High	Relatively high	Specific
(vii) Training Requirements	Low	Medium	High

14.7 Grouping and codification of accounts

When the volume and size of the business increase, the number of transaction increases. Therefore, it becomes necessary to have proper classification of data.



14.7.1 Grouping of accounts

In any organisation, the main unit of classification is the major head which is further divided into minor heads. Each minor head may have number of sub-heads. After classification of accounts into various groups namely, major, minor and sub-heads and allotting codes to each account these are programmed into the computer system.

A proper codification requires a systematic grouping of accounts. The major groups or heads could be Assets, Liabilities, Revenues and Expenses. The sub-groups or minor heads could be capital, non-current liabilities, current assets, sales and so on.

In general, the basic classifications of different accounts embodied in a transaction are resorted through accounting equation.

Assets = Liabilities + Capital + (Revenues – Expenses)

Each component of the above equation can be divided into groups of accounts as follows:

A. Liabilities and capital

Capital

- Capital
- Reserves and surplus

Non-Current Liabilities

- Long-term borrowings
- Other long-term liabilities

Current liabilities

- Short term borrowings
- Trade payables
- Other current liabilities

B. Assets

Fixed tangible assets

- Land and building
- Plant and machinery
- Furniture and fixtures

Intangible assets

- Goodwill
- Copyright
- Patents

Current Assets

- Short term investments
- Inventories

- Trade receivables
- Cash and cash equivalents
- Short term loans and advances
- Other current assets

C. Revenues

- Sales
- Other income

D. Expenses

- Material consumed
- Wages
- Manufacturing expenses
- Depreciation
- Administrative expenses
- Interest
- Selling and distribution expenses, etc.

14.7.2 Codification of accounts

Code is an identification mark. Generally, computerised accounting involves codification of accounts. Codification of accounts is needed where there are numerous accounts heads in an organisation. There is a hierarchical relationship between the groups and its components. In order to maintain the hierarchical relationships between a group and its sub-groups, proper codification is required.

The coding scheme of account heads should be such that it leads to grouping of accounts at various levels so as to generate various reports. For example, the codes for various accounts may be allotted as follows:

1 Liabilities and Capital

2 Assets

3 Revenues

4 Expenses

Under Liabilities and Capital

11 Capital

12 Non-current liabilities

13 Current liabilities

Under Assets

21 Non-current assets

22 Current assets

The above codification scheme utilises the hierarchy present in grouping of accounts. Major advantage of such coding is that if the account codes are listed in ascending order, these will be automatically listed as per the desired hierarchy.

14.7.3 Methods of codification

Following are the three methods of codification.

a. Sequential codes

In sequential code, numbers and/or letters are assigned in consecutive order. These codes are applied primarily to source documents such as cheques, invoices, etc. A sequential code can facilitate document search. For example:

Code	Accounts
CL001	ABC LTD
CL002	XYZ LTD
CL003	SCERT

b. Block codes

In a block code, a range of numbers is partitioned into a desired number of sub-ranges and each sub-range is allotted to a specific group. In most of the cases of block codes, numbers within a sub-range follow sequential coding scheme, i.e., the numbers increase consecutively. For example:

Code	Dealer type
100 – 199	Small pumps
200 – 299	Medium pumps
300 – 399	Pipes
400 – 499	Motors

c. Mnemonic codes

A mnemonic code consists of alphabets or abbreviations as symbols to codify a piece of information. For example:

Code	Information
SJ	Sales Journals
HQ	Head Quarters

14.8 Microsoft Office - MS Word and MS Excel Practical

14.8.1 MS-Word

i) Creation of a word file : Start – All Programs – Microsoft Office – Microsoft Word – File Save As – File name – Save

ii) Opening of a word file : File – Open – File name – Open

iii) Saving an existing file : File Save (Short cut key: Control+S)

iv) For closing a file : File Close

v) Table creation: Insert – Table – Choose number of rows and columns

vi) Formatting the text	:	To bold	: Control+B;
		To italicise	: Control+I
		To underline	: Control+U
vii) Paragraph alignment	:	To align text left	: Control+L
		To align text right	: Control+R
		To align text centre	: Control+E
		To align text justify	: Control+J
viii) Line spacing	:	Single line spacing	: Control+1
		Double line spacing	: Control+2
		1.5 line spacing	: Control+5
ix) Page lay out	:	Margin (normal, narrow, wide, etc.)	
		Orientation (Portrait, Landscape)	
		Size (A4, A5, etc)	
		Columns (1,2,3, etc.)	
x) Page number	:	Insert Page Number (top of the page, bottom of the page, etc.)	

14.8.1(a) MS Word Practical

Illustration 1

Type the given below passage in MS-Word and format as directed.

Fra Luca Bartolomeo de Pacioli was an Italian mathematician (1447 – 1517). He is referred to as The Father of Accounting and Book keeping in Europe and he was the first person to publish a work on the double-entry system of book keeping.

Solution

Procedure

(i) Select and bold the name Fra Luca Bartolomeo de Pacioli.

(ii) Add single quote before The Father and after Book keeping.

'The Father of Accounting and Bookkeeping'

(iii) Select and italicise the word Europe.

Europe

(iv) Select and underline the word double-entry.

double-entry

(v) Select the full text and change the font style to Arial and font size to 10

Output:

Fra Luca Bartolomeo de Pacioli was an Italian mathematician (1447 – 1517). He is referred to as 'The Father of Accounting and Book keeping' in *Europe* and he was the first person to publish a work on the double-entry system of book keeping.

Illustration 2

Prepare invoice for the following items.

1. Financial Accounting – RL Gupta - 40 Nos.
2. Advanced Accounting – MC Shukla - 20 Nos.
3. Income Tax Law & Practice – HC Mehrothra - 20 Nos.
4. Practical Auditing – B N Tandon - 30 Nos.

Solution

Procedure

i) Enter name and address of the vendor, number and date of invoice

ii) Type billing address

(iii) To create a table – Select Insert menu -> Click Table / Insert Table-> Enter number of rows and columns-> Click OK.

iv) Enter the data.

Output

SOUTH INDIA Ltd.,
100, Kamarajar Salai,
Chennai – 600006.

INVOICE

Invoice # 009876

Invoice date 31-12-2017

Bill To

Prof. A. Rajesh
HSC College,
123, PH Road,
Chennai – 600001.

S. No.	Description	Qty	Unit Price ₹	Amount ₹
1	Financial Accounting – RL Gupta	40	200	8,000
2	Advanced Accounting – MC Shukla	20	300	6,000
3	Income Tax Law & Practice -– HC Mehrothra	20	400	8,000
4	Practical Auditing – B N Tandon	30	150	4,500
	Sub total			**26,500**
	Less: Discount at 20%			5,300
	Invoice total			**21,200**
	(Rupees twenty one thousand two hundred only)			
	Thank you			

Cashier

14.8.2 MS-Excel

i) Functions

a. Statistical functions

There are several statistical functions such that are inbuilt in MS Excel. The following are explained.

AVERAGE	Returns the average	=AVERAGE(cell1, cell2…)
MAX	Returns the largest value	=MAX(number1,number2)
MIN	Returns the lowest value	=MIN(number1,number2…)
COUNT	Counts the number of cells that contain numbers	=COUNT(value1,value2…)
COUNTA	Counts the number of cells that are not empty.	=COUNTA(range)
COUNTIF	Counts the number of cells that meet the given condition.	=COUNTIF(range,criteria)

b. Text functions

There are several text functions such that are inbuilt in MS Excel. The following are explained.

CONCATENATE	Joins several text strings into one text string	=CONCATENATE(text1, text2…)
UPPER	Converts all letters into Uppercase letters	=UPPER(text)
LOWER	Converts all letters into Lowercase letters	=LOWER(text)

c. Logical functions

There are several logical functions such that are inbuilt in MS Excel. The following are explained.

AND	Returns TRUE if all arguments are TRUE	=AND(logical1,logical2…)
OR	Returns TRUE if any one argument is TRUE else returns FALSE	=OR(logical1,logical2…)
IF	Returns one value if condition is true, and another value if false.	=IF(logical_test,value_if_true,value_if_false)

d. Financial functions

There are several financial functions such that are inbuilt in MS Excel. The following are explained.

SLN	Returns the depreciation of an asset for a specified period using the Straight Line method.	=SLN(cost,salvage,life)
PMT	Calculates the payment for a loan.	=PMT(rate,nper,pv,fv,type)
RATE	Returns interest rate per period of loan.	=RATE(nper,pmt,pv,fv,type)

14.8.2(a) MS-Excel practical

Illustration 3

The following are the scores obtained by some students in a competitive examination. Find out the average, the highest and the lowest score using appropriate function in spreadsheet.

	A	B	C	D	E	F	G	H
1	NAME	Anbu	Balu	Gobu	Ramu	Somu	Raju	Anu
2	SCORES	60	80	164	192	104	64	204

Solution

Procedure

i) Open a new spreadsheet in MS-Excel

ii) Enter all given values as given in the question.

iii) To find the Average mark in cell B5 give the formula

=AVERAGE(B2:H2)

iv) To calculate the highest score, in cell B3 give the formula

=MAX(B2:H2)

v) To find the lowest rank in cell B4 give the formula

=MIN(B2:H2)

Answer:

The average score is 124, the highest score is 204 and the lowest score is 60.

Illustration 4

The following table is given to you. Find solution for the following questions.

	A	B	C	D	E	F	G	H	I	J
1	550	156			852	584	TAX	573	GST	1234
2	340	1285	468	584	268	222	CASH	BRS	STOCK	DEBT

A) How many cells contain numbers only?

B) Count the number of cells that contain any value.

C) Count the number of cells containing the value exceeding 1000.

Solution

Procedure

i) Open a new spread sheet in MS-Excel.

ii) Enter the data in cells from A1 to J2 as in the question

iii) To get the Number of cells containing numbers only, write the formula in B3

=COUNT(A1:J2)

iv) To get Number of cells that contain any value, write the formula in B4

=COUNTA(A1:J2)

v) To get the Number of cells which have values exceeding 1000, write the formula in B5

=COUNTIF(A1:J2,”>1000”)

Answer

A) 12 B) 18 C) 2 b) Text functions

Illustration 5 (CONCATENATE)

From the data given below

i) Fill the address in B3 using CONCATENATE Function.

ii) Change KAMARAJAR SALAI given in C2 as lower case in C3

iii) Change Chennai given in D2 as upper case in D3

	A	B	C	D	E
1	NAME	HOUSE NO.	STREET	PLACE	PINCODE
2	ANAND	123	KAMARAJAR SALAI	Chennai	600018

Solution

Procedure

i) To fill the address

a. Open a new spreadsheet in MS-Excel

b. Enter all given values as given in the question

c. Enter the formula in the cell B3 as

=CONCATENATE(A2," ",B2," ",C2," ",D2," ",E2)

Answer

ANAND 123 KAMARAJAR SALAI Chennai 600018

ii) To change KAMARAJAR SALAI given in C2 as lower case in C3

Enter the formula in the cell C3 as

=LOWER(C2)

Answer

kamarajar salai

iii) To change Chennai given in D2 as upper case in D3

Enter the formula in the cell D3 as

=UPPER(D2)

Answer

CHENNAI

Illustration 6 (AND function)

There are three salesmen. Two days of sales achievement is given. You are required to find out the salesmen who have achieved a minimum sale of ₹ 400 on each day.

Salesman	Day 1 ₹	Day 2 ₹
Anand	500	250
Balu	600	500
Cibi	250	300

Solution

Procedure

1. Open new excel sheet.
2. Input the table as given in the question.
3. Enter the data "Achieved" in Cell D1.
4. Type the following in Cell D2:

   =AND(B2>=400,C2>=400)
5. Copy the formula in D2 into D3 and D4

Output

Salesman	Day 1 ₹	Day 2 ₹	Achieved
Anand	500	250	FALSE
Balu	600	500	TRUE
Cibi	250	300	FALSE

Illustration 7 (OR function)

Find out from the following data, minimum collection of ` 500 on any one day achieved by the sales counters.

Counter	Day 1 sales ₹	Day 2 sales ₹
Ground floor	600	600
First floor	850	300
Second floor	350	400

Solution

Procedure

1. Open new excel sheet.
2. Input the table as given in the question.
3. Enter the data "Achieved" in Cell D1.
4. Type the following in Cell D2:

   =OR(B2>=500,C2>=500)
5. Copy the formula from D2 into D3 and D4

Output

Counter	Day 1 sales ₹	Day 2 sales ₹	Achieved
Ground Floor	600	600	TRUE
First Floor	850	300	TRUE
Second Floor	350	400	FALSE

Illustration 8 (IF function)

Following is the list of students and percentage of marks obtained by them. If a student has secured a minimum of 50%, he is declared pass, else fail.

Student	Percentage of marks
1	59
2	60
3	65
4	45
5	35

Solution

Procedure

1. Open new excel sheet.
2. Input the table as given in the question.
3. Enter the data "Result" in Cell A3.
4. Type the following in Cell B3

   B3=IF(B1>=50,"Pass","Fail")

5. Copy the formula from B3 to C3, D3 and E3

Output

Student	% of marks	Result
1	59	Pass
2	60	Pass
3	65	Pass
4	45	Fail
5	35	Fail

Illustration 9 (Depreciation – SLN method)

Calculate depreciation under Straight Line Method using Spreadsheet based on the details given below.

A	B	C	D	E	F
Asset	Cost of purchase ₹	Installation charge ₹	Transportation charge ₹	Salvage value ₹	Life in years
1. Machinery	200000	20000	5000	25000	10
2. Furniture	50000	4000	2000	5000	8

Solution

Procedure and answer

(i) Open a new spreadsheet in MS-EXCEL

(ii) Enter labels and values in the cells as given above

(iii) Write total cost in G1 and annual depreciation in H1

(iv) Calculate total cost in the cell G2 by the formula

=Sum(B2:D2) and copy formula to cell G3

(v) Calculate annual depreciation in the cell H2 by the formula

=SLN(G2,E2,F2) and copy formula to cell H3

Output

	A	B	C	D	E	F	G	H
1	**Asset**	**Cost of purchase ₹**	**Installation charge ₹**	**Transportation charge ₹**	**Salvage value ₹**	**Life in years**	**Total cost ₹**	**Annual depreciation ₹**
2	Machinery	200000	20000	5000	25000	10	225000	20,000
3	Furniture	50000	4000	2000	5000	8	56000	6,375

Illustration 10 (PMT)

Consider the following information:

Loan amount ₹ 3,00,000

Number of payment periods 48 months

Annual rate of interest 10%

Calculate periodic payment using PMT function.

Solution

Procedure

i) Open a new spreadsheet in MS-Excel

ii) Enter values in the cells as given below

	A	B
1	Rate of interest (p.a.)	10%
2	Number of instalments (nper)	48
3	Loan amount (pv)	-300000
4	FV	0
5	Type	0

iii) Compute PMT in the cell B6 by the formula

=PMT(B1/12,B2,B3,B4,B5)

Answer ₹ 7,608.78

Illustration 11 (RATE)

Mr. Vivek took a loan of ₹ 2,00,000 from State Bank of India, Chennai and number of installments is 84 months. Calculate the rate assuming payments ₹ 3,300 per month using appropriate function.

Solution

Procedure

(i) Open a new spreadsheet in MS-Excel

ii). Enter values in the cells as given below

	A	B
1	Number of instalments (nper)	84
2	Periodic payment (pmt)	3300
3	Loan amount (pv)	-200000
4	FV	0
5	Type	0

iii) Compute RATE in the cell B6 by the formula

=RATE(B1,B2,B3,B4,B5)*12

Answer 10%

Illustration 12 (Computation of interest on overdue)

Sara Ltd., sells goods on credit basis. Their policy is to charge interest @ 2% p.a., for the period of default. From the following data, find out the amount to be collected from each customer. Assume 365 days in the year.

Customer	Sales ₹	Date of Sales	Period of Credit (days)	Date of Settlement
M	25,000	10-04-2016	60	05-07-2016
N	14,000	28-05-2016	30	25-07-2016
P	28,000	14-07-2016	45	25-08-2016
R	54,000	03-08-2016	90	02-01-2017

Solution

Procedure

(i) Open a new spreadsheet in MS-Excel

(ii) Enter the table headings as given below in different cells

A1 Customer

B1 Sales (₹)

C1 Date of sales
D1 Period of credit (days)
E1 Date of settlement
F1 Credit period availed (days)
G1 Days of default
H1 Interest
I1 Amount collected

(iii) Enter customer names in A2:A5
(iv) Enter sales figures in B2:B5
(v) Enter date of sales in C2:C5
(vi) Enter period of credits in D2:D5
(vii) Enter date of settlements in E2:E5
(viii) In the cell F2 enter the formula =E2-C2 to calculate the period of credit availed in days.
(ix) In the cell G2 enter the formula =IF(F2-D2>0,F2-D2,0) to calculate the default days. (IF condition is used to avoid negative values in the case of payment before due date)
(x) In the cell H2 enter the formula =ROUNDUP((B2*2%)*(G2/365),0) to calculate interest for the default days and to round it to the nearest rupee.
(xi) In the cell I2 enter the formula =B2+H2 to add the amount of Sales and Interest.
(xii) Select the range F2:I2 and copy these cells down to the last customer.

Output

Customer	Sales (₹)	Date of sales	Period of credit (days)	Date of settlement	Credit period availed	Days of default	Interest	Amount to be collected
M	25,000	10-04-2016	60	05-07-2016	86	26	36	25,036
N	14,000	28-05-2016	30	25-07-2016	58	28	22	14,022
P	28,000	14-07-2016	45	25-08-2016	42	0	0	28,000
R	54,000	03-08-2016	90	02-01-2017	152	62	184	54,184

Illustration 13 (Payroll preparation)

Prepare payroll of the following employees.

	A	B
1	Name	Basic pay (`)
2	Sasi	8000
3	Hari	10000
4	Karthi	6500
5	Viji	12000
6	Soni	9000

Additional information:

a. DA: 125% of basic pay

b. HRA: ₹ 4,000 for employees basic pay greater than ₹ 8,000, for others ₹ 2,500.

c. PF Contribution: 12% of basic pay and DA

d. TDS: 10% for Gross pay greater than ₹ 25,000, otherwise NIL.

Procedure

(i) Open a new spreadsheet in MS-EXCEL

(ii) Enter labels and values in the cells as given above

iii) To calculate DA in Cell C2

= B2*125%

iv) To calculate HRA in Cell D2

= IF(B2>8000,4000,2500)

v) To calculate Gross Pay in Cell E2

=SUM(B2:D2)

vi) To calculate PF in Cell F2

=(B2+C2)*12%

vii) To calculate TDS in Cell G2

=IF(E2>25000,E2*10%,0)

viii) To calculate Net Pay in Cell H2

=E2-(F2+G2)

Output

	A	B	C	D	E	F	G	H
1	**Name**	**Basic Pay ₹**	**DA ₹**	**HRA ₹**	**Gross pay ₹**	**PF ₹**	**TDS ₹**	**Net pay ₹**
2	Sasi	8000	10000	2500	20500	2160	0	18340
3	Hari	10000	12500	4000	26500	2700	2650	21150
4	Karthi	6500	8125	2500	17125	1755	0	15370
5	Viji	12000	15000	4000	31000	3240	3100	24660
6	Soni	9000	11250	4000	24250	2430	0	21820

Illustration 14 (Column chart and Line chart)

The total sales volume (Product wise) of TECH Ltd for the year 2016-2017 is given below:

Product	Sales ₹
Toothpaste	22000
Toothbrush	11000
Hair Oil	9000
Shampoo	13000
Toilet Soap	9500

a) Present the data in a column chart

b) Change the chart type to line chart.

Procedure

(a) **Column chart**

(i) Enter the data given in the table in a new spreadsheet.

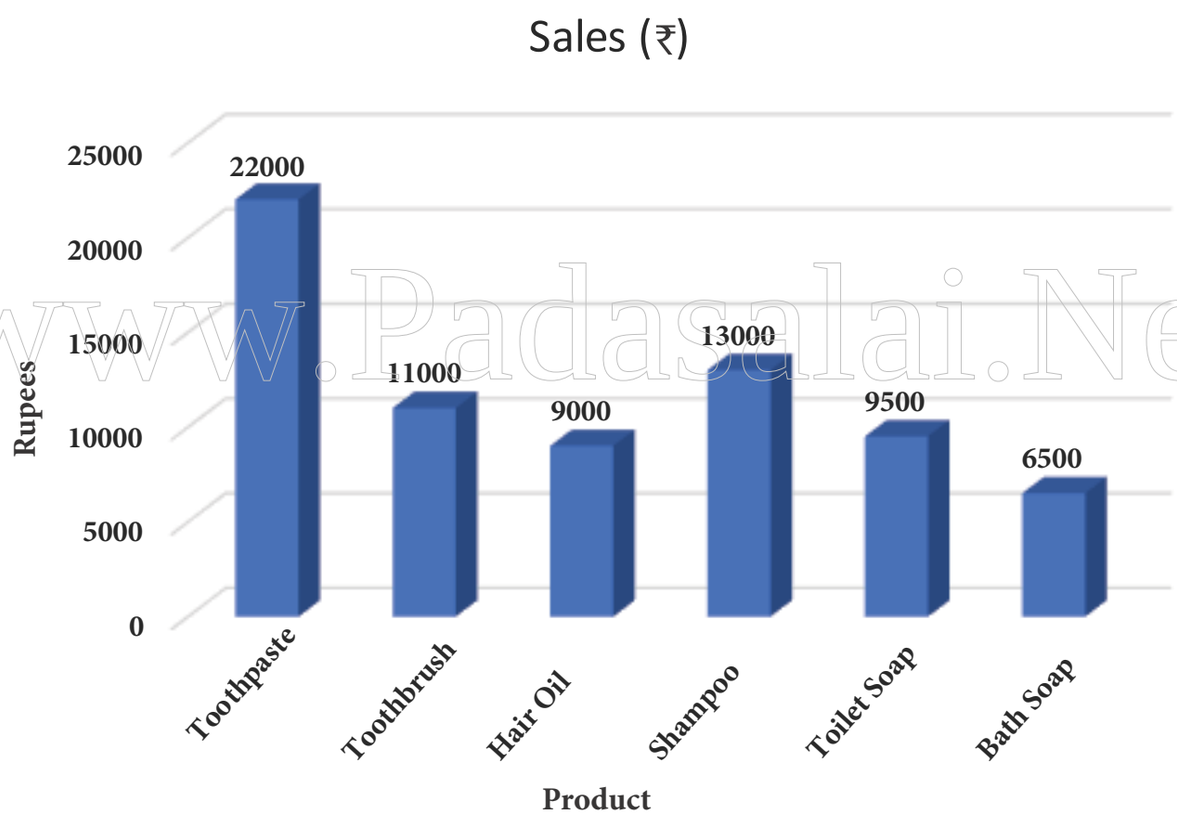
(ii) Select the data range from A1 to B7.

(iii) Go to Insert menu and select Column Chart (3D)

(iv) Right click column chart and select 'Add Data Labels'

(v) Choose layout tab under Chart tools.

(vi) Select Axis title and name them.



(b) Line Chart

(i) Select the data range from A1 to B7.

(ii) Go to Insert menu and select Line Chart (2D)

(iii) Right click chart and select 'Add Data Labels'

(iv) Choose layout tab under Chart tools.

(v) Select Axis title and name them.

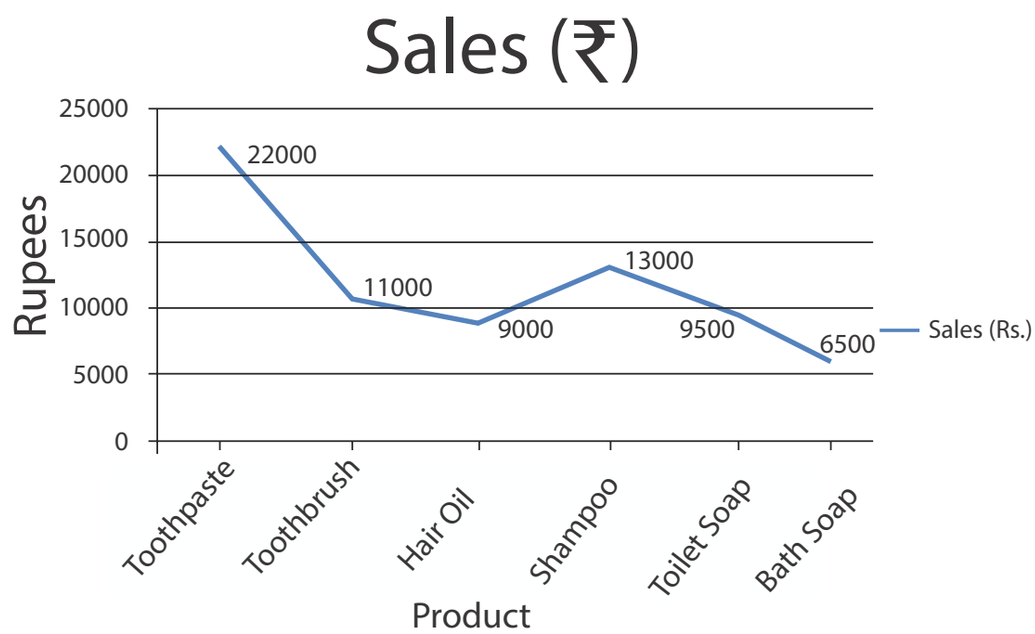


Illustration 15 (Pie Chart and Doughnut)

Sales volume of Moon Ltd during 2017 is given below.

Draw

(a) Pie chart

(b) Doughnut

	A	B	C	D	E	F	G
1	**CITY**	Chennai	Coimbatore	Madurai	Trichy	Tanjore	Tirunelveli
2	**SALES** (₹ in lakhs)	500	350	250	250	200	150

Procedure

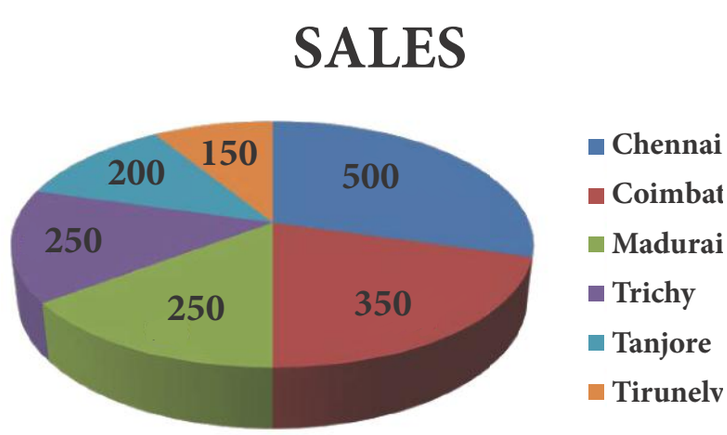
(a) Pie chart

(i) Enter the data given in the table in a new spreadsheet.

(ii) Select the data range from A1 to G2.

(iii) Go to Insert menu and select Pie Chart (3D Type)

(iv) Right click pie chart and select 'Add Data Labels'

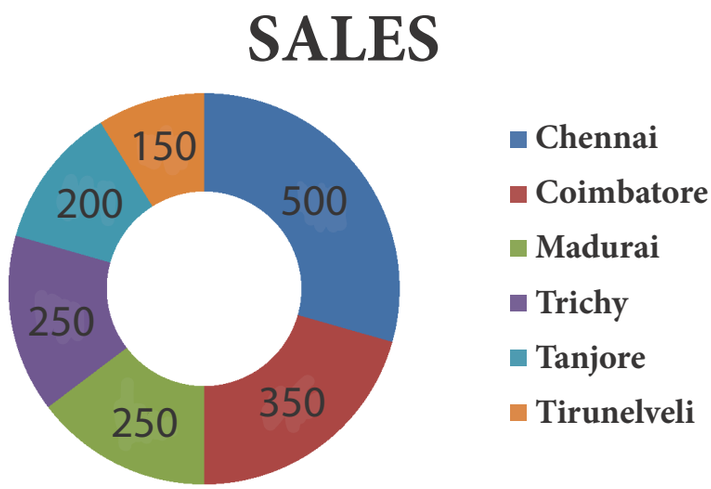


Output (Pie chart)

(b) Doughnut

(i) Go to Insert menu -> Other Charts and select Doughnut

(ii) Right click doughnut chart and select 'Add Data Labels'



Output (Pie chart)

Points to remember

- Computers play a major role in various business activities.
- In accounting computer is commonly used in many areas such as, recording business transactions, payroll accounting etc.
- Accounting softwares are classified as (i) Readymade software, (ii) Customised software and (iii) Tailormade software.
- Few of the software commonly used in business include, MS-office, (Word, Excel etc.), Tally, SAP, Finacle.

Self - examination questions

I Multiple Choice Questions

Choose the correct answer

1. In accounting, computer is commonly used in the following areas:
   (a) Recording of business transactions
   (b) Payroll accounting
   (c) Stores accounting
   (d) All the above

2. Customised accounting software is suitable for
   (a) Small, conventional business
   (b) Large, medium business

AU2GGW

(c) Large, typical business
(d) None of the above

3. Which one is not a component of computer system?

(a) Input unit (b) Output unit
(c) Data (d) Central Processing Unit

4. An example of output device is

(a) Mouse
(b) Printer
(c) Scanner
(d) Keyboard

5. One of the limitations of computerised accounting system is

(a) System failure
(b) Accuracy
(c) Versatility
(d) Storage

6. Expand CAS

(a) Common Application Software
(b) Computerised Accounting System
(c) Centralised Accounting System
(d) Certified Accounting System

7. Which one of the following is not a method of codification of accounts?

(a) Access codes
(b) Sequential codes
(c) Block codes
(d) Mnemonic codes

8. TALLY is an example of

(a) Tailor-made accounting software
(b) Ready-made accounting software
(c) In-built accounting software
(d) Customised accounting software

9. People who write codes and programes are called as

(a) System analysts
(b) System designers
(c) System operators
(d) System programmers

10. Accounting software is an example of
    (a) System software
    (b) Application software
    (c) Utility software
    (d) Operating software

Answer

1 (d)	2 (b)	3 (c)	4 (b)	5 (a)	6 (b)	7 (a)	8 (b)	9 (d)	10 (b)

II Very short answer questions

1. What is a computer?
2. What is CAS?
3. What is hardware?
4. What is meant by software?
5. What is accounting software?
6. Name any two accounting packages.
7. Give any two examples of readymade software.
8. What is coding?
9. What is grouping of accounts?
10. What are mnemonic codes?

III Short answer questions

1. What are the various types of accounting software?
2. Mention any three limitations of computerised accounting system.
3. State the various types of coding methods.
4. List out the various reports generated by computerised accounting system.
5. State the input and output devices of a computer system.

CASE STUDY

The manager of a medium- sized business is considering the introduction of computerised accounting system. Some staff feels that it is an opportunity to learn new skill. The manager has promised free training for their staff. So, the staff realise that their own skill can be enhanced. Also, there is a demand for highly skilled staff. But, some staff feels threatened by these changes. They feel that they may not be able to learn new skill. Moreover, some of them are nearing their retiring age. So they think that it is not needed for them. But the manager expects the cooperation from all the staff.

Now, discuss on the following points:

- Will it be expensive for the business to introduce computerised accounting system?
- Will everyone get the access to use the computers? In such a case, how to protect data?
- "People at the retirement age are not required to learn new skill" – Do you think so?
- What are the factors to be considered by the managers before introducing CAS?

To explore further

Is it possible to maintain the confidentiality in computerised accounting system? How is it possible?

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GLOSSARY

Account (A/c)	கணக்கு (க/கு)
Accountancy	கணக்குப் பதிவியல்
Accountant	கணக்காளர்
Accounting	கணக்கியல்
Accounting concepts	கணக்கியல் கருத்துகள்
Accounting conventions	கணக்கியல் மரபுகள்
Accounting cycle	கணக்கியல் சுழல்
Accounting equation	கணக்கியல் சமன்பாடு
Accounting principles	கணக்கியல் கொள்கைகள்
Accounting standards	கணக்கியல் தரம்
Accounting Standards Board	கணக்கியல் தரக்குழு
Accounting terminologies	கணக்கியல் கலைச்சொற்கள்
Accrued income	பெறவேண்டிய வருமானம்
Adjusted purchases	சரிக்கட்டப்பட்ட கொள்முதல்
Adjusting entries	சரிக்கட்டுப் பதிவுகள்
Amortisation	போக்கெழுதுதல்
Analytical petty cash book	பாகுபடுத்தப்பட்ட சில்லறை ரொக்க ஏடு
Annuity method	ஆண்டுத் தொகை முறை
Artificial person	சட்டமுறை அமைப்புகள்
Assets	சொத்துகள்
Bad debts	வாராக் கடன்
Balance	இருப்பு
Balance b/d	இருப்பு கீ/கொ (கீழ் கொண்டு வரப்பட்டது)

Balance c/d	இருப்பு கீ/இ (கீழ் இறக்கப்பட்டது)
Balance method	இருப்பு முறை
Balance Sheet	இருப்பு நிலைக் குறிப்பு
Balancing	இருப்புக் கட்டுதல்
Bank	வங்கி
Bank overdraft	வங்கி மேல்வரைப் பற்று
Bank pass book	வங்கிச் செல்லேடு
Bank reconciliation statement	வங்கிச் சரிகட்டும் பட்டியல்
Bank statement	வங்கிப் பட்டியல்
Bank transactions	வங்கி நடவடிக்கைகள்
Barter system	பண்டமாற்று முறை
Bill of exchange	மாற்றுச்சீட்டு
Bills payable	செலுத்துதற்குரிய மாற்றுச்சீட்டு
Bills receivable	பெறுதற்குரிய மாற்றுச்சீட்டு
Book keeping	கணக்கேடுகள் பராமரிப்பு
Books of prime entry	முதன்மைப் பதிவு ஏடுகள்
Branches of accounting	கணக்கியல் பிரிவுகள்
Capital	முதல்
Capital expenditure	முதலினச் செலவினம்
Capital receipts	முதலின வரவுகள்
Capital transaction	முதலின நடவடிக்கை
Carriage	தூக்குக் கூலி
Carriage inwards	உள் தூக்குக் கூலி
Carriage outwards	வெளி தூக்குக் கூலி
Cash	ரொக்கம்
Cash book	ரொக்க ஏடு

Cash discount	ரொக்கத் தள்ளுபடி
Cash receipt	ரொக்கச் சீட்டு
Cash transaction	ரொக்க நடவடிக்கை
Cheque	காசோலை
Closing balance	இறுதி இருப்பு
Closing entries	இறுதிப் பதிவுகள்
Closing stock	இறுதிச் சரக்கிருப்பு
Columnar petty cash book	பல பத்திகளுடையச் சில்லறை ரொக்க ஏடு
Company	நிறுமம்
Compensating errors or Offsetting errors	ஈடுசெய் பிழைகள்
Compound journal entry	கூட்டுக் குறிப்பேட்டுப் பதிவு
Computer	கணினி
Computerised accounting	கணினிமயமாக்கப்பட்ட கணக்கியல்
Contra entry	எதிர்ப் பதிவு
Cost accounting	அடக்கவிலைக் கணக்கியல்
Credit	வரவு
Credit balance	வரவு இருப்பு
Credit card	கடன் அட்டை
Credit note	வரவுக் குறிப்பு
Credit side	வரவுப் பக்கம்
Credit transaction	கடன் நடவடிக்கை
Creditor	கடனீந்தோர்
Current account	நடப்புக் கணக்கு
Current asset	நடப்புச் சொத்து
Current liability	நடப்புப் பொறுப்பு
Days of Grace	சலுகை நாட்கள்

Debit	பற்று
Debit balance	பற்று இருப்பு
Debit card	எடுப்பு அட்டை
Debit note	பற்றுக் குறிப்பு
Debit side	பற்றுப் பக்கம்
Debtor	கடனாளி
Deferred revenue expenditure	நீள்பயன் வருவாயினச் செலவு
Depreciation	தேய்மானம்
Discount	கழிவு
Discounting	தள்ளுபடி செய்தல்
Dishonour	மறுக்கப்படுதல்
Dividend	பங்காதாயம்
Double column cash book	இருபத்தி ரொக்க ஏடு
Double entry system	இரட்டைப் பதிவுமுறை
Drawings	எடுப்புகள்
Error	பிழை
Error of complete omission	முழு விடு பிழை
Error of partial omission	பகுதி விடு பிழை
Errors in accounting	கணக்கியல் பிழைகள்
Errors of recording	பதிவு செய்தல் பிழைகள்
Errors of balancing	இருப்புக் கட்டல் பிழைகள்
Errors of carrying forward	முன் எடுத்து எழுதுதல் பிழைகள்
Errors of casting	கூட்டல் பிழைகள்
Errors of commission	செய் பிழைகள்
Errors of omission	விடு பிழைகள்
Errors of posting	எடுத்தெழுதுதல் பிழைகள்

Errors of principle	விதிப்பிழைகள்
Expenses	செலவுகள்
Fictitious assets	கற்பனைச் சொத்துகள்
Final Accounts	இறுதிக் கணக்குகள்
Financial accounting	நிதிநிலைக் கணக்கியல்
Financial statement	நிதிநிலை அறிக்கை
Fixed assets	நிலைச் சொத்துகள்
Freight	வண்டிக் கட்டணம்
Furniture	அறைகலன்
General reserve	பொதுக் காப்பு
Goods	சரக்கு
Goodwill	நற்பெயர்
Gross profit	மொத்த இலாபம்
Hardware	வன்பொருள்
Human resources accounting	மனிதவளக் கணக்கியல்
Impersonal accounts	ஆள்சாராக் கணக்குகள்
Imprest system	முன்பண மீட்பு முறை
Income	வருமானம்
Income received in advance	முன்கூட்டிப் பெற்ற வருமானம்
Insolvency	நொடிப்பு நிலை
Institute of Chartered Accountants of India	இந்தியப் பட்டயக் கணக்காளர் நிறுவனம்
Insurance	காப்பீடு
Intangible asset	புலனாகாச் சொத்துகள்
Interest	வட்டி
Interest on capital	முதல் மீது வட்டி
Interest on drawings	எடுப்புகள் மீது வட்டி

Interest on investments	முதலீடுகள் மீதான வட்டி
Interest on loan	கடன் மீதான வட்டி
International Accounting Standards Committee	பன்னாட்டு கணக்கியல் தரக்குழு
International Financial Reporting Standards	பன்னாட்டு நிதி அறிக்கை தரம்
Investments	முதலீடுகள்
Invoice	இடாப்பு
Journal	குறிப்பேடு
Journal entry	குறிப்பேட்டுப் பதிவு
Journal proper	உரிய குறிப்பேடு
Journalising	குறிப்பேட்டில் பதிவு செய்தல்
Ledger	பேரேடு
Ledger posting	பேரேட்டில் எடுத்தெழுதுதல்
Liabilities	பொறுப்புகள்
Liquidity	நீர்மைத் தன்மை
Long term liabilities	நீண்டகாலப் பொறுப்புகள்
Loss	நட்டம்
Machinery	இயந்திரம்
Management accounting	மேலாண்மைக் கணக்கியல்
Merger	இணைப்பு
Narration	விளக்கக் குறிப்பு
Net profit	நிகர இலாபம்
Nominal Accounts	பெயரளவுக் கணக்குகள்
Opening balance	தொடக்க இருப்பு
Opening entry	தொடக்கப் பதிவு
Opening Stock	தொடக்கச் சரக்கிருப்பு

Outstanding	கொடுபட வேண்டியது
Pay-in-slip	செலுத்துச்சீட்டு
Personal A/c	ஆள்சர் கணக்கு
Petty cash book	சில்லறை ரொக்க ஏடு
Posting	எடுத்தெழுதுதல்
Preliminary expenses	தொடக்கச் செலவுகள்
Premium	முனைமம்
Prepaid	முன் கூட்டிச் செலுத்தியவை
Profit	இலாபம்
Profit and Loss A/c	இலாபநட்டக் கணக்கு
Provision	ஒதுக்கீடு
Provision for bad and doubtful debts	வாரா ஐயக்கடன் ஒதுக்கு
Provision for discount on debtors	கடனாளிகள் மீதான தள்ளுபடி ஒதுக்கு
Purchase returns / Return outwards	கொள்முதல் திருப்பம் / வெளித் திருப்பம்
Purchases	கொள்முதல்
Purchases book	கொள்முதல் ஏடு
Purchases returns book	கொள்முதல் திருப்ப ஏடு
Real accounts	சொத்துக் கணக்குகள்
Rectification of errors	பிழைகளைத் திருத்துதல்
Rectifying entries	திருத்தப் பதிவுகள்
Rent	வாடகை
Representative personal account	பிரதிநிதித்துவ நபர் கணக்கு
Reserve	காப்பு
Revenue	வருவாய்
Revenue expenditure	வருவாய்சர் செலவுகள்

Revenue receipts	வருவாய்சர் வரவுகள்
Revenue transactions	வருவாயின நடவடிக்கைகள்
Salary	ஊதியம்
Sale	விற்பனை
Sales book	விற்பனை ஏடு
Sales returns / Returns inwards	விற்பனைத் திருப்பம் / உள்திருப்பம்
Sales returns book	விற்பனைத் திருப்ப ஏடு
Savings account	சேமிப்புக் கணக்கு
Scrap	எறி மதிப்பு
Share	பங்கு
Single column cash book	தனிப்பத்தி ரொக்க ஏடு
Single entry system	ஒற்றைப் பதிவுமுறை
Social Responsibility Accounting	சமூகப் பொறுப்புக் கணக்கியல்
Software	மென்பொருள்
Sole proprietor	தனி ஆள் உரிமையாளர்
Solvency	கடன் தீர்க்கும் சக்தி
Source documents	ஆதார ஆவணங்கள்
Stock	சரக்கிருப்பு
Straight line method	நேர்கோட்டு முறை
Subsidiary books	துணை ஏடுகள்
Sundry creditors	பற்பல கடனீந்தோர்
Sundry debtors	பற்பல கடனாளிகள்
Sundry expenses	பற்பல செலவுகள்
Suspense account	அனாமத்துக் கணக்கு
Tangible assets	புலனாகும் சொத்துகள்

Three column cash book	மூப்பத்தி ரொக்க ஏடு
Total method	மொத்தத் தொகை முறை
Trade discount	வியாபாரத் தள்ளுபடி
Trading account	வியாபாரக் கணக்கு
Transaction	நடவடிக்கை
Transfer entries	மாற்றுப் பதிவுகள்
Travel expenses	பயணச் செலவுகள்
Trial Balance	இருப்பாய்வு
Voucher	சான்று ஆவணம்
Wage	கூலி
Written down value	குறைந்து செல் மதிப்பு

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