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FINANCIAL ACCOUNTING

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Business Laws & Management
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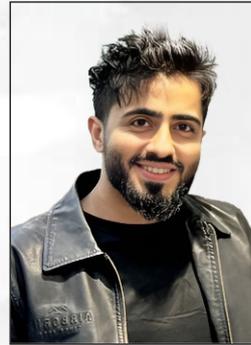
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Welcome to YES Family!!

To begin with, we endorse our heartfelt thank you for showing your trust and confidence in YES Academy. We take pride to welcome you to this prestigious Academy, foundations of which are based on commitment, quality education and integrity. It has been our constant endeavor to deliver better and better. In our attempt to achieve mark of excellence and beyond, we would be even more grateful to have received your continued faith and love. We assure you, your trust will not go in vain and as reflected by our Vision Statement, we would continue to produce top achievers and successful professionals in Chartered Accountancy, Company Secretary, Cost & Management Accountancy and Law Entrance courses as we have been doing for almost a decade now.

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On behalf of TEAM YES

CS VIKAS VOHRA
(Founder)

CA CS HARISH A. MATHARIYA
(Founder)

FROM THE AUTHOR

- ✦ This book is for all the students aspiring to make the grade in the Professional Examination.
- ✦ **FUNDAMENTALS OF FINANCIAL ACCOUNTING** subject is both interesting & easy to understand.
- ✦ This subject has utility value in day-to-day commercial activities.
- ✦ Trends shows that, there is a scope for securing high-score in this subject.
- ✦ This book is not a substitute for the Study Material prescribed by the Institute, as I believe,
- ✦ **“There is no short cut to success”**

DEDICATED TO

- ✦ **To my Family:** “Who are Divine Source of Power to me, who always stood beside me in every phase of my Life”
- ✦ **To My Love:** Manisha Soni
- ✦ **Most special regards:** Parents gave me birth, you gave me the identity. I am, who I am is because of all of you, my most lovable STUDENTS.
- ✦ **To My Competitors:** who gave me the ability to sharpen my skills and improve each day
“The only person you are destined to become is the person you decide to be”
I believe these words shall motivate you throughout this journey

HOW TO STUDY?

Step 1

- Develop a liking for the subject, for this you need to be; **Regular in class & Write down all notes neatly.**

Step 2

- For each topic **spend proper time in reading the theory part (concept)**
- Before solving problems **read question** very slowly then decide approach to solve it.
 - Read problem with **high concentration** giving importance to every punctuation
 - **Remembering** contents of question until the solution is competed; for each step you should be able to immediately pick up data without a second reading.
 - **Visualizing** steps for the solution, the layout, tabulation format, number of columns, etc.
 - **Maintain good speed** so that solution is completed within time (5 marks = 8 minutes.)
- **Write down your solutions in a note book. Do not jump to see the solution.**

Step 3

- After you finish a topic, prepare **summary notes** (covering all important points)
- **“Revise”** your hand-made summary notes periodically then **“Try to Recall”**
- **Solve Topic-wise Test**

Step 4

- Before your exams **revisit summary notes & all-important problems as many times as possible.**
- Solve two or three past exam question papers and solve them under simulated exam conditions so that you get smooth, flow of thoughts, hand – mind coordination and most importantly confidence

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CMA - FOUNDATION

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PLANNER

FUNDAMENTALS OF FINANCIAL ACCOUNTING

S.N.	Name of The Topic	Read. Time for 1st reading	R1	R2	R3	R4	TEST
1	Accounting Principles, Concepts & Conventions						
2	Capital and Revenue transactions						
3	Double entry system						
4	Depreciation						
5	Rectification of Errors						
6	Opening entries, Transfer entries, Adjustment entries, Closing entries						
7	Bank Reconciliation Statements						
8	Bills of Exchange						
9	Consignment						
10	Joint Venture						
11	Profit making concern						
12	Not-for-Profit making concern						

Abbreviation Used:

- R 1: 1st reading
- R 2: 2nd Reading
- R 3: 3rd Reading
- R 4: 4th Reading

INTRODUCTION

- Accounting is used by business entities for keeping records of their money or financial transactions.
- A businessman would like to know whether his business is making profit or incurring loss.
- The position of his assets and liabilities and whether his capital in the business has increased or decreased during a particular period.
- Every person in his day to day life performs some sort of Economic Activity, such economic activities are performed through 'transactions and events'.

Transaction is used to mean an exchange in money or money's worth, while event is used to mean 'a happening, as a consequence of transaction(s), a result.'

SOME BASIC TERMS OF ACCOUNTING

Business:

- ⇒ It is the set of activities for earning profit (Profit Motive).
- ⇒ Regularly carried on by a person or an organization for the Purpose of earning profits from such activities
- ⇒ Example – A Mango shop owner regularly purchase mango & sells it to his customers.
- ⇒ Business may be:
 - Manufacturing – Purchasing Raw Materials, Converting them into finished Goods and selling the goods.
 - Trading – Buying finished Goods and selling them as such without any conversion.
 - Service – Rendering services to clients Eg. Doctors, Chartered Accountants etc.

Goods

- Products / Articles / Items which are regularly traded by the businessman are called "Goods".
- Eg. For a Computer Shop owner, computers are "goods", as he regularly purchases and sells them.
- However, for the same Computer shop owner, if he purchases one Tempo for carrying the laptops, then the tempo is not considered as goods for him.

Finished Goods

For Manufacturer: Products manufactured by the manufacturer.

For a trader: Goods purchased and sold by him are called finished goods.

Purchase (from purchaser's point of view)

It refers to Buying of finished goods / raw materials by one person from another person for consideration. Sale for one person is the purchase for another person.

Sales (from seller's point of view)

“sales” refers to Transfer of ownership in goods from one person to another for a consideration”

Thus, following 3 Conditions for sale are –

(a) Transfer of ownership (refer below)

(b) Ownership must be in goods (refer above)

(c) Consideration – some money or money's worth must be given by one person to another.

Transfer of ownership: ownership in goods is transferred when the risks of loss and rewards relating to such goods are transferred.

Assets

In Technical Language: An Asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

In General Language: Properties of the business / Amounts receivable from others by the business Eg. Stock, Land, Building, Debtors, Receivables, etc

Debtors

Persons from whom the business has to receive money, due to credit sales made to them.

Liabilities

Amounts Payable by the business to outsiders and includes capital. For e.g. Bank loans, Expenses not yet paid

Creditors

Persons to whom the business has to pay money due to credit Purchase made from them.

Capital

Amount Invested by the owner into the business

Drawings

✓ Cash / Goods / Assets drawn by the owner for his personal purpose is called as Drawing.
It decreases the capital.

Profits

✓ Profit = Incomes – Expenses

Income / Revenue

- ✓ Amount received or receivable due to sales made OR
- ✓ Any other amount receivable arising out of the regular operations of the business. For eg. Interest, commission due or received, etc.

Expenses

- ✓ Amount spent for benefits for an accounting period. For eg. Rent paid for the benefit of Business.

Losses

- ✓ Amount spent but no benefits is derived / amount not recoverable from debtors. For eg. Bad Debt, Stocks lost due to earthquake

Bank Overdraft

- ✓ First of all Bank O/D is bank Account.
- ✓ Example: However, in this account, holder is allowed to withdraw over and above the existing balance. For eg. Assume that Mr. Ritesh has a balance of Rs. 20,000 in his Bank Account. If he draws a cheque for Rs. 25,000, normally it will be rejected by the bank. However, if the account has overdraft (O/D) facility, then the bank will pay 25,000 on the cheque, instead of insufficient balance.
- ✓ Bank O/D is current Liability

Current Assets

- ✓ Are the assets which are easily convertible into cash or cash equivalents within a single accounting period.
- ✓ E.g. Bank Balance, debtors, Bills receivables, etc.

Current Liabilities

- ✓ Are the liabilities which are payable within the single accounting period.
- ✓ E.g. Creditors, Bank Overdraft, Bills Payable, etc.

Working Capital = Current Assets – Current Liability

Fixed Assets

- ✓ Are Long Term Assets which are expected to be used in the business for a longer period of time (Generally more than one Accounting period).
- ✓ Fixed Assets are meant for usage in the business for production / rendering of service etc.
- ✓ E.g. Machinery, Building, Land, Car, etc

Inventory

- ✓ Inventory is technical term for “stock” (Unsold Goods/ Unused raw material).
- ✓ It includes Raw Material stock, work in progress and finished goods stock

Depreciation

- ✓ Decrease in the value of fixed Assets gradually due to wear and tear, use, passage of time, obsolescence (due to innovations & Technology) and other related factors.

Solvency

- ✓ Solvency is ability of the to meets its Total Liabilities i.e. Assets are > Liabilities

Window Dressing

- ✓ Manipulating the financial statements to attract investments
- ✓ Inflating the incomes, suppressing the expenses, treating revenue expenditure as capital expenditure etc.

Holding Gains

- ✓ Holding gains are the notional gains arising due to increase in prices of inventory held in the business.
- ✓ Example: Mr. X has 1,000 kgs of onion in stock. They are bought at Rs. 25/ kg. they are sold for 15 days month. After this period, their market price is Rs. 80/kg. In this case, if the stocks are sold at the end of one month, then X can earn a profit of Rs.55/kg. Since this profit is not realized as sale is not actually made and they are just kept in stock.

Notional

- ✓ It is not realized and may be earned if some event happens.
- ✓ In the above example, if sale happened then Rs. 25 per kg is earned. Till the actual sale, it is only a Notional Profits.

Cost / Historical cost

- ✓ It represents the amount actually spent or the liability actually incurred.
- ✓ Example: Assume that a plot of land is purchased for Rs. 50,000, but its market value is Rs. 150,000. In this case, the Historical cost is Rs. 50,000 only.

Raw Materials

- ✓ It refers to the base material from which finished goods are manufactured.
- ✓ Example – Pencils are made from wood. In this case, pencils are finished goods whereas woods are raw materials.
- ✓ For a trader, there is no raw material as he does not produce anything.
- ✓ It Applies only for manufacturing business

Stock

- ✓ Stock is unsold finished goods / Raw materials at the beginning or end of a period.
- ✓ Closing stock – stock at the end of a specified period.
- ✓ Opening stock – Stock at the beginning of the period.

- ✓ Example –Ritu purchased 500 kgs of sugar in 2014. He sold 300 kgs throughout in 2014. In this case, the stock on 31.12. 2014 is 200 kgs, is opening stock on 01.01.2015.

MEANING OF ACCOUNTING

- ✓ “Accounting is the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof.”
- ✓ As per this definition, accounting is simply an art of record keeping.
- ✓ The process of accounting starts by first identifying the events and transactions and then be recorded in the Journal or subsidiary books (Primary books)
- ✓ After the transactions and events are recorded, they are transferred to secondary books i.e. Ledger. In ledger, transactions and events are classified in terms of income, expense, assets and liabilities according to their characteristics and then summarised in profit and loss account and balance sheet.
- ✓ Accounting also interprets the recorded, classified and summarised transactions and events.
- ✓ In today’s world requirement of communicating and motivating informed judgement has also become the part of accounting.
- ✓ In 1970, the Accounting Principles Board (APB) of American Institute of Certified Public Accountants (AICPA) enumerated the functions of accounting as follows:
- ✓ “The function of accounting is to provide quantitative information, primarily of financial nature, about economic entities, that is needed to be useful in making economic decisions.”
- ✓ Thus, accounting may be defined as the process of recording, classifying, summarising, analysing and interpreting the financial transactions and communicating the results thereof to the persons interested in such information.

OBJECTIVES OF ACCOUNTING

1. Systematic recording of transactions – Basic objective of accounting is to systematically record the financial aspects of business transactions i.e. book-keeping.
2. Ascertainment of results of above recorded transactions –If revenue exceed expenses then it is said that business is running profitably otherwise loss. The profit and loss account helps the management and different stakeholders in taking rational decisions.
3. Ascertainment of the financial position of the business –Financial position statement popularly known as Balance Sheet. The balance sheet is a statement of assets and liabilities of the business at a particular point of time and helps in ascertaining the financial health of the business.
4. Providing information to the users for rational decision-making – Accounting as a ‘language of business’ communicates the financial results of an enterprise to various stakeholders by means of financial statements.

5. To know the solvency position –B/S gives the information regarding concern's ability to meet its liabilities in the short run (liquidity position) and also in the long-run (solvency position) as and when they fall due.

+ FUNCTIONS OF ACCOUNTING

The main functions of accounting are as follows:

- (a) Measurement: Accounting measures past performance of the business entity and depicts its current financial position.
- (b) Forecasting: Accounting helps in forecasting future performance and financial position of the enterprise using past data.
- (c) Decision-making: Accounting provides relevant information to the users of accounts to aid rational decision-making.
- (d) Comparison & Evaluation: Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and contingent liabilities which play an important role in predicting, comparing and evaluating the financial results.
- (e) Control: Accounting also identifies weaknesses of the operational system and provides feedbacks regarding effectiveness of measures adopted to check such weaknesses.
- (f) Government Regulation and Taxation: Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

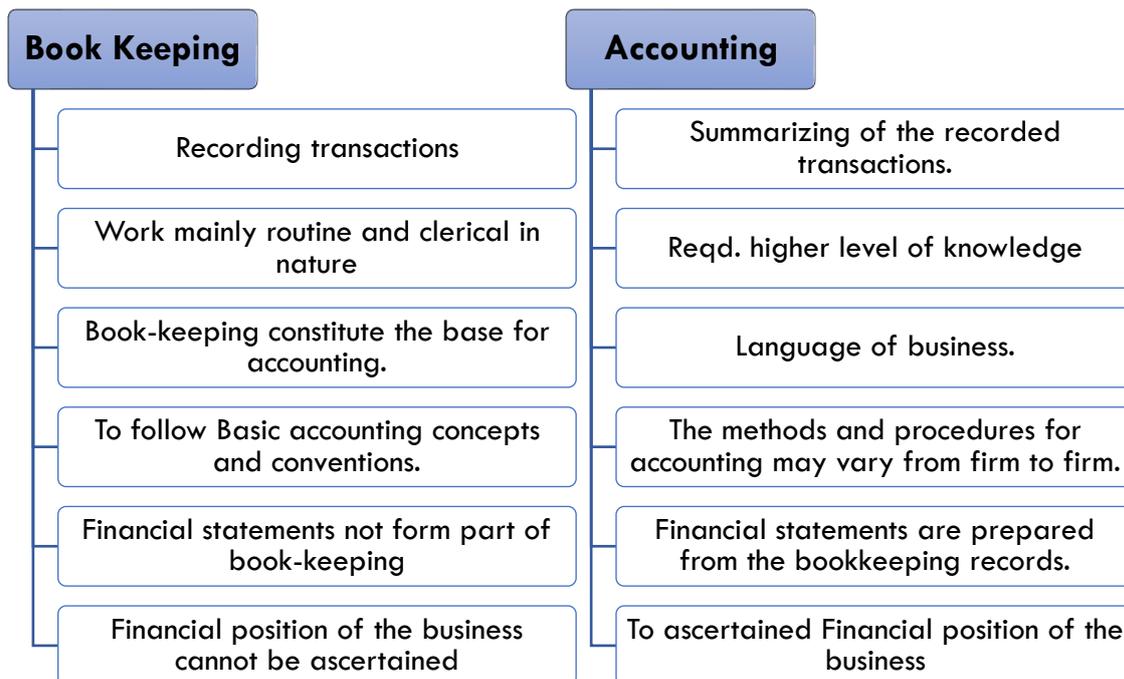
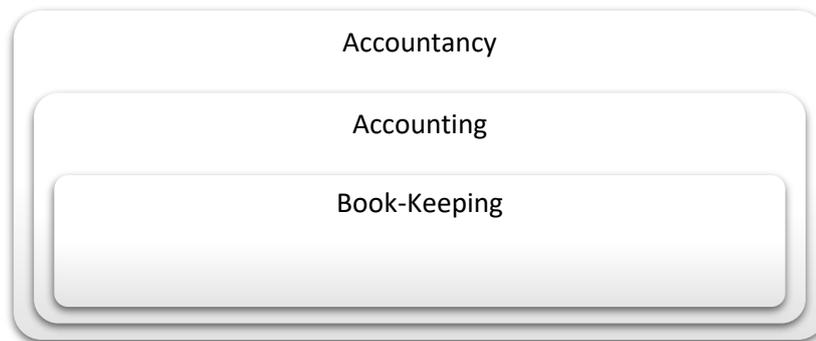
+ BOOK-KEEPING

- 1) Book-keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner.
- 2) It covers procedural aspects of accounting work and embraces record keeping function.
- 3) Book-keeping procedures are governed by the end product, the financial statements. (Profit and Loss Account and Balance Sheet including Schedules and Notes forming part of Accounts)
- 4) Book-keeping also requires suitable classification of transactions and events.
- 5) A book-keeper may be responsible for keeping all the records of a business
- 6) Accounting is based on a careful and efficient book-keeping system.
- 7) At the end of the accounting period, the proprietor wants to know how much profit has been earned or loss has been incurred during the course of the period. For this lot of information is needed which can be gathered from a proper record of the transactions.

+ OBJECTIVES OF BOOK-KEEPING

1. Complete Recording of Transactions
2. Ascertainment of Financial Effect on the Business

- Relationship between & Accounting can be explained with help of following diagram:

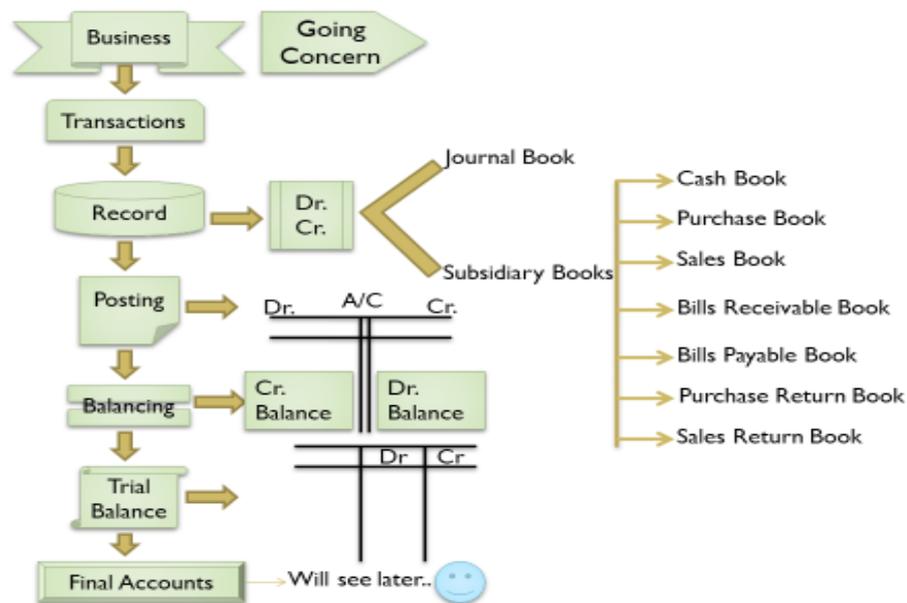


Difference between Book-Keeping and Accounting can be explained as follows:

ACCOUNTING PROCEDURE

1. Recording –
 - i. This is the basic function of accounting.
 - ii. All business transactions of a financial character, as evidenced by some documents (Vouchers) such as sales bill, pass book, salary slip etc. are recorded in the books of account.
 - iii. Recording is done in a book called “Journal.” This book may further be divided into several subsidiary books according to the nature and size of the business.
2. Classifying –
 - i. Classification is systematic analysis of the recorded data, with a view to group transactions or entries of one nature at one place.
 - ii. The book containing classified information is called “Ledger”.
 - iii. This book contains on different pages, individual account heads under which, all financial transactions of similar nature are collected.

- iv. For example, there may be separate account heads for Salaries, Rent, Printing and Stationeries, Advertisement etc.
 - v. This will help in finding out the total expenditure incurred under each of the above heads.
- 3. Summarising –**
- i. It is concerned with the preparation and presentation of the classified data in a manner useful to the internal as well as the external users of financial statements.
 - ii. This process leads to the preparation of the following financial statements: (a) Trial Balance (b) Profit and Loss Account (c) Balance Sheet (d) Cash-flow Statement.
- 4. Analysing –**
- i. 'Analysis' is methodical classification of the data (in a simplified form) given in the financial statements.
 - ii. It is concerned with the establishment of relationship between the items of the Profit and Loss Account and Balance Sheet i.e.
 - iii. it provides the basis for interpretation.
- 5. Interpreting –**
- i. This is the final function of accounting.
 - ii. It is concerned with explaining the meaning and significance of the relationship as established by the analysis of accounting data.



- iii. The recorded financial data is analysed and interpreted in a manner that will enable the end-users to make a meaningful judgement about the financial condition and profitability of the business operations.
 - iv. The financial statement should explain not only what had happened but also why it happened and what is likely to happen under specified conditions.
- 6. Communicating –**
- i. It is concerned with the transmission of summarised, analysed and interpreted information to the end-users to enable them to make rational decisions.

- ii. This is done through preparation and distribution of accounting reports, which include besides the usual profit and loss account and the balance sheet, additional information in the form of accounting ratios, graphs, diagrams, fund flow statements etc.
- iii. The first two procedural stages of the process of generating financial information along with the preparation of trial balance are covered under book-keeping while the preparation of financial statements and its analysis, interpretation and also its communication to the various users are considered as accounting stages.

SUB-FIELDS OF THE ACCOUNTING

(a) Financial Accounting

It is commonly termed as Accounting. The American Institute of Certified Public Accountants defines Accounting as “an art of recoding, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character, and interpreting the results thereof.”

(b) Cost Accounting

According to the Chartered Institute of Management Accountants (CIMA), Cost Accountancy is defined as “application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability as well as the presentation of information for the purpose of managerial decision-making.”

(c) Management Accounting

Management Accounting is concerned with the use of Financial and Cost Accounting information to managers within organizations, to provide them with the basis in making informed business decisions that would allow them to be better equipped in their management and control functions.

BASIS OF ACCOUNTING

Basis	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses/ accrued/advance Income	Under this, there may be prepaid/ outstanding expenses &	Under this, there is no prepaid/ outstanding expenses or accrued/
2. Higher/lower Income in case of prepaid expenses	Income Statement will show a relatively higher income	Income Statement will show lower income.
3. Higher/lower income in case of outstanding expenses and advance	Income Statement will show a relatively lower income.	Income Statement will show higher income.

4. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of	Under this, an accountant has options.	Under this an accountant has no option to make a choice as such.
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Hybrid or Mixed Basis

Under the hybrid system of accounting, incomes are recognised as in Cash Basis Accounting i.e. when they are received in cash and expenses are recognised on accrual basis i.e. during the accounting period in which they arise irrespective of when they are paid.

ACCOUNTING ASSUMPTIONS / CONCEPTS / PRINCIPLES

A. BASIC ASSUMPTIONS

(a) Business Entity Concept

This concept explains that the business is distinct from the proprietor. Thus, the transactions of business only are to be recorded in the books of business.

(b) Going Concern Concept

This concept assumes that the business has a perpetual succession or continued existence.

(c) Money Measurement Concept

According to this concept only those transactions which are expressed in monetary terms are to be recorded in accounting books.

(d) The Accounting Period Concept

Businesses are living, continuous organisms. The splitting of the continuous stream of business events into time periods is thus somewhat arbitrary. There is no significant change just because one accounting period ends and a new one begins. This results into the most difficult problem of accounting of how to measure the net income for an accounting period. One has to be careful in recognizing revenue and expenses for a particular accounting period. Subsequent section on accounting procedures will explain how one goes about it in practice

(e) The Accrual Concept

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

Today's accounting systems based on accrual concept are called as Accrual system or mercantile system of accounting.

B. BASIC PRINCIPLES**(a) Realization Concept**

This concept speaks about recording of only those transactions which are actually realized. For example Sale or Profit on sales will be taken into account only when money is realized i.e. either cash is received or legal ownership is transferred.

(b) Matching Concept

It is referred to as matching of expenses against incomes. It means that all incomes and expenses relating to the financial period to which the accounts relate should be taken in to account without regard to the date of receipts or payment.

(c) Full Disclosure Concept

As per this concept, all significant information must be disclosed. Accounting data should properly be clarified, summarized, aggregated and explained for the purpose of presenting the financial statements which are useful for the users of accounting information. Practically, this principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm.

(d) Duality Concept

According to this concept every transaction has two aspects i.e. the benefit receiving aspect and benefit giving aspect. These two aspects are to be recorded in the books of accounts.

(e) Verifiable Objective Evidence Concept

Under this principle, accounting data must be verifiable. In other words, documentary evidence of transactions must be made which are capable of verification by an independent respect. In the absence of such verification, the data which will be available will neither be reliable nor be dependable, i.e., these should be biased data. Verifiability and objectivity express dependability, reliability and trustworthiness that are very useful for the purpose of displaying the accounting data and information to the users.

(f) Historical Cost Concept

Business transactions are always recorded at the actual cost at which they are actually undertaken.

The basic advantage is that it avoids an arbitrary value being attached to the transactions. Whenever an asset is bought, it is recorded at its actual cost and the same is used as the basis for all subsequent accounting purposes such as charging depreciation on the use of asset, e.g. if a production equipment is bought for ₹ 1.50 crores, the asset will be shown at the same value in all future periods when disclosing the original cost. It will obviously be reduced by the amount of depreciation, which will be calculated with reference to the actual cost. The actual value of the equipment may rise or fall subsequent to the purchase, but that is considered irrelevant for accounting purpose as per the historical cost concept. The limitation of this concept is that the balance sheet does not show the market value of the assets owned by the

business and accordingly the owner's equity will not reflect the real value. However, on an ongoing basis, the assets are shown at their historical costs as reduced by depreciation

(g) Balance Sheet Equation Concept

Under this principle, all which has been received by us must be equal to that has been given by us and needless to say that receipts are clarified as debits and giving is clarified as credits. The basic equation, appears as

Debit = Credit

Naturally every debit must have a corresponding credit and vice-versa. So, we can write the above in the following form -

Expenses + Losses + Assets = Revenues + Gains + Liabilities

And if expenses and losses, and incomes and gains are set off, the equation takes the following form

Asset = Liabilities or, Asset = Equity + External Liabilities

i.e., the Accounting Equation.

c. MODIFYING PRINCIPLES

(a) The Concept of Materiality

The materiality could be related to information, amount, procedure and nature. Error in description of an asset or wrong classification between capital and revenue would lead to materiality of information.

Say, If postal stamps of ₹ 500 remain unused at the end of accounting period, the same may not be considered for recognizing as inventory on account of materiality of amount. Certain accounting treatments depend upon procedures laid down by accounting standards. Some transactions are by nature material irrespective of the amount involved, e.g., audit fees, loan to directors.

(b) Consistency Concept

This Concept says that the Accounting practices should not change or must remain unchanged over a period of several years.

(c) Conservatism Concept

Conservatism concept states that when alternative valuations are possible, one should select the alternative which fairly represents economic substance of transactions but when such choice is not clear select the alternative that is least likely to overstate net assets and net income. It provides for recognising all known expenses and losses by best estimates if amount is not known with certainty, but does not allow recognising revenues and gains on the basis of anticipation.

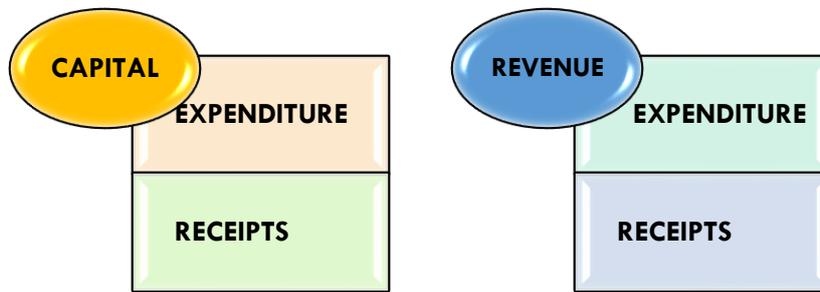
(d) Timeliness Concept

Under this principle, every transaction must be recorded in proper time. Normally, when the transaction is made, the same must be recorded in the proper books of accounts. In short, transaction should be recorded date-wise in the books. Delay in

recording such transaction may lead to manipulation, misplacement of vouchers, misappropriation etc. of cash and goods. This principle is followed particularly while verifying day to day cash balance. Principle of timeliness is also followed by banks, i.e. every bank verifies the cash balance with their cash book and within the day, the same must be completed.

(e) Industry Practice

As there are different types of industries, each industry has its own characteristics and features. There may be seasonal industries also. Every industry follows the principles and assumption of accounting to perform their own activities. Some of them follow the principles, concepts and conventions in a modified way. The accounting practice which has always prevailed in the industry is followed by it. e.g., Electric supply companies, Insurance companies maintain their accounts in a specific manner. Insurance companies prepare Revenue Account just to ascertain the profit/loss of the company and not Profit and Loss Account. Similarly, non trading organizations prepare Income and Expenditure Account to find out Surplus or Deficit



CONSIDERATIONS IN DETERMINING CAPITAL AND REVENUE EXPENDITURES

- (a) Nature of business
- (b) Recurring nature of expenditure
- (c) Purpose of expenses
- (d) Effect on revenue generating capacity of business
- (e) Materiality of the amount involved

Capital Expenditure vs. Revenue Expenditure

Particulars	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure incurred for the purpose of – (a)Purchase / Creation / Improvement of Fixed Assets or (b)Expenses necessary for the above purchase / Creation (c)Increasing the earning capacity of the business.	It is an expenditure, the benefit of which is immediately (normally within one year) exhausted in the process of earning revenue.
2. Purpose	(a) Acquiring Fixed Assets, which are held not for resale, but for use with a view to earn profits. (b) Making additions to the existing Fixed Assets. (c) Increasing earning capacity of the business by improved facilities and equipment. (d) Reducing the cost of production. (e) Acquiring benefit of enduring nature or valuable right.	(a)Actual day – to – day running of the business, (b)Maintaining the capital assets in an efficient manner. (c)Cost of Materials & Stores (d)Salary and Wages of employees, (e)Administrative Exp. Like Stationery, Rent, Telephone and Insurance.
3. Treatment in Financial Statement	• Capital Expenditure is displayed as asset in Balance Sheet. Only	• Expenditure is charged fully in the Profit and Loss Account.

	<p>depreciation portion is debited to P & L A/c.</p> <ul style="list-style-type: none"> It is NOT directly reduced from Incomes. 	<ul style="list-style-type: none"> It is fully REDUCED from income
4. Wrong treatment	If wrongly treated as revenue, profits will be understated or reduced.	If wrongly capitalized, profits will be inflated or overstated.
5. Matching	Capital Expenditure is not matched with Capital Receipts.	Revenue Expenditure is matched with Revenue Receipts.
6. Time of incurrence	Capital Expenditure may be incurred before or after the commencement of the business.	It is incurred after the commencement of the business.
7. Recurring Nature	Normally Capital Expenditure is generally non-recurring in nature. However, certain Capital Expenditure is required once in 2-5 years, e.g. modernization of Machinery, etc.	Revenue Expenditure is of recurring / repetitive nature. It is incurred every year by the business.
8. Interest on borrowing	If Interest on Borrowings is payable for the period prior to the commencement of the Business / Production	If interest on borrowings is payable for the period on or after commencement of business / production
<p>Note: Amount involved in a transaction is not always relevant for Capital vs Revenue distinction. Hence, even a transaction involving a huge amount say Rs. 5 Crores, may be considered as Revenue Expenditure.</p>		

Deferred Revenue Expenditure

Particulars	Deferred Revenue Expenditure
1. Meaning	It is an expenditure primarily of revenue nature, but the benefit where of extends to periods more than the year of incurrence.
2. Inclusion	It also includes expenditure which gives benefits for 2/3 years, but does not result in creation or improvement of Fixed Assets. Example: Shifting of business from one location to a convenient location. This results in increase in benefits for many years, but do not result in creation of any Fixed Asset.
3. Examples	<p>(a) Expenditure on an Advertisement Campaign to introduced a product in the market,</p> <p>(b) Discount allowed on issue of Debentures,</p> <p>(c) Development Expenses in the case of Mines and Plantations.</p> <p>(d) Cost of construction/ extension to a leased building (Since the building has to be returned after the lease period is over, it s benefits are for only a limited period.)</p>

4. Time	Benefit of such expenditure relates to many years, i.e. relating to the future period.
5. Treatment	Even if the benefits from these Expenditures arise over a period of 2 or 3 years, in accordance with applicable Accounting Standards, these Expenditures are fully written off in P & L in the year of incurrence. They are not “Assets” and hence should not be carried forward. [Note: Hence the concept of “Deferral” of Revenue Expenditure is no longer relevant.]

Notes:

- DRE ≠ Losses or Exceptional Items: Exceptional losses suffered due to natural calamity, political or other social disturbances, etc. are not Deferred Revenue Expenditures. They constitute “Losses” / “Exceptional Item”, since there is no corresponding benefit, either current or future.
- DRE ≠ Prepaid Expenses: The benefits available from Prepaid Expenses can be precisely estimated (e.g. Prepaid Insurance), but such precise estimation is not possible in the case of Deferred Revenue Expenditure (e.g. substantial Advertisement Campaign).

Capital Expenditure vs Deferred Revenue Expenditure

Particulars	Capital Expenditure	Deferred Revenue Expenditure
1. Meaning	It is an expenditure incurred for the purpose of – (a) acquiring, extending or improving assets of a permanent nature or carrying on the business, or (b) increasing the earning capacity of the business.	It is an expenditure primarily of revenue nature, but the benefit where of extends to periods more than the year of incurrence.
2. Treatment	Asset is displayed in the Balance Sheet. Only Depreciation portion thereon is debited to P & L A/c.	These Expenditures are fully written off in P & L in the year of incurrence. They are not “Assets” and hence should not be carried forward.
3. Example	Purchase of Factory Building for use in the business	Substantial Advertisement Expenditure.

Criteria / Considerations for Capital vs Revenue

Whether an expenditure is Capital or Revenue in nature, depends upon the following factors

Factor	Capital Expenditure if....	Revenue Expenditure if ...
1. Nature of Business	Expenditure relates to purchase of a Fixed Asset (e.g. Land purchased by a	Expenditure relates to purchase of a Current Asset (e.g. Land

	Manufacturing Firm).	purchased by a Construction Company).
2. Recurring Nature	Expenditure is incurred infrequently, or once in 2-5 years (e.g. purchase of assets).	Expenditure is incurred frequently/ regularly, in the normal course of business (e.g. Salary, Rent, etc.)
3. Purpose of Expenses	Expenditure is for acquiring / creating capital assets or increasing their productive capacity.	Expenditure is for maintaining the capital assets in an efficient manner.
4. Period of Benefit	Expenditure helps to generate revenue over more than one accounting period	Expenditure helps to generate income / revenue in the current period only.
5. Materiality	Expenditure is material/ significant.	Expenditure is not material, i.e. insignificant.

Examples for Capital and Revenue Expenditures

Capital Expenditure	Revenue Expenditure
<ol style="list-style-type: none"> 1. Purchase of Fixed Asset (Land, Building, etc.) 2. Purchase of Second-hand Asset (e.g. Vehicle, Furniture, etc.) 3. Overhaul Expenses to put second-hand machinery in working condition. 4. Repairing & Painting of Old Building purchased recently by the Firm. 5. Expenditure incurred to reduced working expenses / operating expenses. 6. Legal Fee paid to acquire new property. 7. Licence Fee paid by Cinema Theatre to commence its business. 8. Cost of constructing Temporary Huts which are necessary for Factory Building Construction, which were demolished when the Factory was ready. 	<ol style="list-style-type: none"> 1. Expenditure for replacement of worn-out part of an existing assets. 2. Regular Advertisement Expenses in respect of products and services. 3. Expenditure on removal of stock to new site. 4. Legal Fees incurred to file suit against a Customer from whom money is due.

Capital vs Revenue Receipts

Particulars	Capital Receipt	Revenue Receipt
1. Meaning	Capital Receipts refer to receipts other than Revenue Receipts.	Revenue Receipts are moneys received in the course of normal business activities, and are recurring in nature.

2. Example	Capital contribution by Owner, Issue of Shares / Debentures, Sale Proceeds of Fixed Assets, etc.	Sales, Interest and Other Income Received, Bad Debts Recovered, etc.
3. Purpose	Capital Receipts relate to specific purpose, e.g. Capital Contribution for commencing business or expanding business, Loans taken for acquiring Fixed Assets, etc.	Revenue Receipts relate to general business purpose, and are not specifically identifiable to any purpose as such.
4. Effect on Profit	Capital Receipts do not affect profit.	Revenue Receipts have a direct impact on the profits.
5. Disclosure	They are shown as Liability or Reduction from the Asset in the Balance Sheet.	They are shown on the Credit Side of the Profit and Loss Account.
6. Matching	Capital Receipts are not matched with Capital Expenditure, in all cases.	Revenue Receipts is generally matched with Revenue Expenditure.

- Revenue Receipts \neq Cash Receipts: "Revenue Receipts" refers to Total Income in the period (e.g. Total Sales on Cash & Credit) while "Cash Receipts" refers to Cash Collections (i.e. Cash Sales + Collection from Debtors) in the period.
- Deposit of Money with other persons \neq Expenditure:
 - Deposit of money is not considered as an expenditure as the money is just kept with another person and it is to be recovered from that person.
 - Expenditure refers to the amount spent to earn benefit. Deposit is not considered as amount spent

Capital vs Revenue Profits

Particulars	Capital Profits	Revenue Profits
1. Meaning	Profits arising on issue / repayment of capital, borrowings or sale of fixed assets	Profits arising out of the regular operations of the business
2. Examples	(a) Premium on issue of shares/ debentures (b) Discount on redemption of shares (c) Profits on sale of Fixed Assets (exceeding cost)	(a) Profits arising out of normal trading operations (b) Profits on sale of Fixed Assets (exceeding Book Value but less than cost)
3. Treatment	Taken to Capital Reserve or under any other head in Balance Sheet (unless realized in cash)	Revenue Profits taken to Profit & Loss Account

Capital vs Revenue Losses

Particulars	Capital Losses	Revenue Losses
1. Meaning	Loss on issue/ repayment of capital, borrowings, Loss of Fixed Assets due to fire / accidents	Losses arising out of the regular operations of the business
2. Examples	(a)Discount on issue of shares / debentures (b)Premium or redemption of shares (c)Loss of Fixed Assets	(a)Losses on normal trading operations (b)Bad Debts (c)Losses on sale of Fixed Assets (S.V. < B.V.)
3. Treatment	Taken to Profit and Losses Accounts. however, a specific note shall be given that the profits / losses are arrived after considering the capital loss	Taken to Profit and Loss Account.

DOUBLE ENTRY SYSTEM

1. **Origin:** Modern Accounting is based on Double Entry System which was developed in the 15th Century by **Luca Pacioli** 
2. **Meaning:**
 - (a) Is a system which analyses transactions and event into **two aspects**, as per the Dual Aspect Concept. These two aspects are called Debit and Credit.
 - (b) This system recognizes and **records both the aspects** (i. e. Debit and Credit) of every transaction and event in a systematic manner.
3. **Significance / Advantages:** The Double Entry System –
 - (a) Ensures **arithmetical accuracy** of accounting process, so that all points of time the total of Debits equal to the sum of Credits.
 - (b) Provides **basis for the fundamental accounting equation**, i.e. Equity + Liabilities = Assets.
 - (c) Permits maintenance of accounts, in details and **provides a useful information**
 - (d) Helpful **comparison** of financial information over various time periods.
 - (e) Helps to **find out correct profit/ loss**, along with details thereof.
 - (f) Aids in reporting the **financial position** as on a particular date
 - (g) Ensures compliance with **legal requirements**

ACCOUNT

1. **Meaning:** Under the Double Entry System, the Dual Aspects (Dr & Cr) **relating to each transaction** are presented in a “T” Form. This is called as an Account.
2. An “Account” represents a **detailed record of transactions** and changes that have occurred **in a particular Asset**, Liability Expense, Loss, Gain or Capital during an accounting period.
3. The **Left Hand Side** of the “T” Form Account is called **Debit** side (in short Dr.), and the **Right Hand Side** of the Account is called as **Credit** Side (in short Cr.).
4. The terms Debit (Dr.) and Credit (Cr.) only describe the two sides of the Account.

Que. Set the Accounting Equation for the following data and calculate the Profit

Particulars	As at the beginning of year	As at the end of the year
Machinery	1,00,000	90,000
Furniture and Fixtures	60,000	50,000
Stock	85,000	1,25,000
Trade Debtors / Receivables	38,000	56,000
Cash and Bank Balances	25,000	28,000
Bank Loan (long – term)	75,000	50,000
Trade Creditors	35,000	42,000
Expense Creditors	15,000	18,000

ACCOUNTING PROCESS – TRADITIONAL APPROACH



- Journalisation** of Transactions and Events: Journal is the Initial Accounts Book in which the transactions are RECORDED on their occurrence. Here Transaction is recorded date – wise (Chronological). In some cases, Subsidiary Books are prepared instead of Journal.
- Ledger Posting** and Balancing: Based on the entries in the Journal, Accounts are prepared in the Ledger. Here, all transactions related to a particular Account Head are grouped under a particular account.
- Preparation of Trial Balance**: After ledger posting, a Statement called as “Trial Balance” is prepared, which contains the balances in all the ledger accounts. The total of Debit Balance Column must be equal to the Total of the Credit Balance Column. (Consolidation of all ledger balances)
- Preparation of Financial Statements**: For Determination of Operating Results and the Financial Position of the business, the following accounts or statements are prepared –

(a) Performance Statement i.e. Trading Account and Profit & Loss Account	To find out the profit made or loss sustained in a particular accounting period through transactions and events,
(b) Position Statement, i.e. the Balance Sheet	To explain the financial position of the reporting entity at the end of the accounting period, and
(c) Cash Flow Statement	To analyze the pattern of movement in cash and Bank

JOURNAL

1. Meaning:

- Journal is the Book of **Primary Entry / Book of Original** Entry.
- Initial Accounts Book in which the transactions are **RECORDED on their occurrence**.
- Entry is made in this book to **show which A/c should be debited or Credited**.

2. Features of Journal:

- (a) Once a transaction happens, it is analyzed to determine the Dr. aspect and Cr. aspect
- (b) All transactions are first recorded in the Journal Book in chronological, i.e. Date – wise

3. Purposes of Journal: Based on Dual Aspect Concept, every transaction has two equal aspects – Debit and Credit. Hence, it is essential to identify the account to be debited / credited.

4. Journalizing: Recording entries in Journal is called “Journalising the Entries”

5. Source for recording: The sources available for recording in the Journal are (a) Vouchers (b) Documents (c) Invoices.

6. Types of Journal Entries:

Type	Meaning	Example
Simple Journal Entry	One Debit and One Credit present for equal amount	Refer Journal Entries under “Capital”
Compound or Composite Journal Entry	It is a journal entry which contains one debits and one credit / two or more debits and one credit / two or more debits and credits.	Refer Journal Entry for “Profit / Loss on sale of fixed assets”

7. Advantages of Journal:

- (a) Complete information on day-to-day transactions can be obtained.
- (b) Journal forms the basis for posting entries into the Ledger
- (c) Narration to Journal Entries provides explanation for the nature and purpose of transaction.

8. Subsidiary Books: In certain cases, instead of Journal, Subsidiary Books are maintained.

NATURE AND TYPE OF A/C – PERSONAL, REAL & NOMINAL

Identify the following –

- (a) Type of A/c – Assets, liability, Income, Gains, Expense, Loss
- (b) Nature of A/c – Real, Personal or Nominal Account
- (c) Nature of balance – Debit Balance or Credit Balance

Item	Item	Item	Item
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1. Trade Mark	16. Sales Returns	32. Insurance Premium	48. Accounts Payable
2. Bills payable	17. Bank Charges Account	33. Unexpired Insurance	49. Membership Fees earned
3. Livestock Account	18. Wages	34. Insurance Company	50. Stock
4. Goodwill Account	19. Subscription paid	35. Telephone Deposit	51. Building
5. O/S Salaries A/c	20. Repairs to Machinery	36. Lease of Land for 20 years	52. Profits
6. Machinery	21. Prepaid Salary	37. Receipt of Loan	53. Theft on cash
7. Rent	22. Stationery	38. Loan to Contractor	54. Depreciation
8. Cash	23. Loans given	39. Current A/c of Partner	55. Discount received
9. Creditor	24. Drawings	40. Current A/c with Bank	56. Bank Fixed Deposits
10. Patent Right	25. Interest received	41. Interest recd. In advance	57. Loans taken
11. Vikas & Co. (creditor)	26. Gavaskar Debtor	42. Reserve for doubtful debts	58. Company Shares / Bonds
12. Bank Overdraft	27. Bank Account	43. Typewriter purchased	59. Investments
13. Compensation to injured workers	28. Interest paid	44. Advertising	60. Bad Debts
14. Bills Receivable	29. Rent for premise sublet	45. Carriage Inwards	
15. Salaries	30. Fixtures	46. Accounts Receivable	
	31. Accrued Interest	47. Equipment	

Types of Accounts					
Assets	Liabilities	Incomes	Gains	Expenses	Losses
1,3,4,6,8,10,14,21,23,26,27,30,31,33,34,35,36,38,40,43,46,47,50,51,56,58,59	2, 5, 9, 11, 12, 24, 37, 39, 41, 42, 48, 57	25,29,49,55	52	7,15,16,17,18,19,20,22,28,32,44,45, 54	13,53,60

Nature of Balance	
Debit Balance	Credit Balance
1,3,4,6,7,8,10,13,14,15,16,17,18,19,20,21,22,23,26,27,28,30,31,32,33,34,35,36,38,40,43,44,45,46,47,50,51,53,54,56,58,59,60	2,5,9,11,12,24,25,29,37,39,41,42,,48,49,52,55,57

Nature of Accounts		
Personal Account	Real Account	Nominal Account
2,5,9,11,12,14,21,23,24,26,27,31,33, 34,35,37,38,39,40,41,42,46,48,57	1,3,4,6,8,10,30,36,43,4 7,50,51,56,58,59	7,13,15,16,17,18,19,20,22,25,28, 29,32,44,45,49,52,53,54,55,60

MEANING AND SIGNIFICANCE OF LEDGER

1. **Meaning:** Ledger is an **Accounts Book** which **contains all Account Heads**, which are opened in Journal / Subsidiary Books.

2. **Advantages / Significance:**

- Ledger helps to **identify the list of transactions under a particular Account Head** and also show balances. This helps in ascertaining the status of that account.
- For Example, Cash Account contains all transactions involving cash. Hence, by looking at the cash account, the reader can find out the sources from which cash is received and also the reasons for use of such cash. It also shows the cash balance in the business on a specified date.

3. Ledger **also called** as:

Other Names	Reasoning
(a) Principal Book	Debit and Credit aspect of each transaction is recorded here, and is the basis for preparation of Trial Balance and Final Accounts.
(b) Secondary Book of Entry	It is the second stage in the Accounting Process.
(c) Book of Final Entry	The Ledger is the Final Destination of all transactions.

4. **Source of Ledger:**

- The **Entries in the Journal / Subsidiary Books** from the basis for preparation of Ledger
- Transactions in the ledger are recorded in an analytical order.

TRIAL BALANCE

1. **Meaning:** Trial Balance is a **statement which lists down the debit and credit balances** of all accounts, as at a particular date (i.e. end of the period) under two separate columns.

2. **Features:**

- Trial Balance is a **statement** and **not an Account**.
- The Totals of all **Debit Balances** and **Credit Balances** **will be equal**.
- It has **two columns** – Debit Column and Credit Column.
- It is the **third stage** in the Accounting Process
- Trial Balance can be prepared on any day of the accounting period.

3. **Objectives / Advantages:**

- It summarizes the Ledger balances in four columns.

- (b) The Ledger itself may be referred to only when further details are required in respect of that Account.
- (c) Services as a check on Arithmetical Accuracy of books, since Debit and Credit Totals must agree.
- (d) Provides the basis of preparation of Final Accounts, i.e. Financial Statements – P & L A/c & B/Sheet.

4. **Source for Trial Balance:** Ledger Accounts

5. **Limitations:** Mere tallying / agreement of Trial Balance is not a conclusive proof of arithmetical accuracy. The Trial Balance may still tally with the following errors –

- (a) Complete omission of a transaction, either in journalizing or in ledger posting therefrom,
- (b) Recording of a transaction at a wrong amount,
- (c) Debiting or Crediting correctly in the Ledger, but in the wrong account head,
- (d) Compensating Errors, i.e. errors whose effects nullify each other.

METHODS OF PREPARATION OF TRIAL BALANCE:

Method	What is written in Trial Balance	Remarks
(a) Total Method	The Total of Debit and Credit Side of each Ledger is recorded.	Merit: Time taken to balance each Ledger A/c is saved . Demerit: Not useful for FS preparation
(b) Balances Method	Only the balance in each Ledger A/c is recorded in Trial Balance.	Most popularly used method, (Since, helps in FS preparation)
(c) Total & Balances Method	This is a combination of above 2 methods . Both Totals and Balances are indicated	Not regularly used .

MEANING OF SUBSIDIARY BOOKS

1. **Meaning:**

- (a) “Subsidiary Books” refer to **Specific Purpose Books** for transactions.
- (b) The **special transactions of each type** are listed in the respective books. From each Subsidiary Book, the total of transactions for each period, are posted into Ledger.
- (c) These books are also called as “Books of **Original Entry**” or “**Books of Prime Entry**”.

2. **Need for Subsidiary Books:**

- (a) **when transactions are many**, it is inconvenient to record all the transactions in one Journal Book. (Hence Subsidiary book)
- (b) To avoid the Journal Book from becoming bulky and voluminous, the Journal Book is sub – divided into Subsidiary Books, (also known as Special Journals / Subsidiary Journals / Day Books / Journals).
- (c) Each Subsidiary Book records a **specific type of transaction**.

TYPES OF SUBSIDIARY BOOKS

The various types of Subsidiary Books for recording specific types of transactions are.

Journal	Purpose
(a) Purchases Day Book	To record transactions relating to Credit Purchases
(b) Sales Day Book	To record transactions relating to Credit Sales
(c) Purchases Return Book	To record transactions relating to Purchase Returns made to Suppliers. (cash is not involved).
(d) Sales Return Book	To record transactions relating to Sales Returns made by Customer. (cash is not involved)
(e) Cash Book (triple column)	To record Cash, Bank and Discount transactions .
(f) Bills Receivable Book	To record transactions in respect of Bills Receivable . (i.e. Promissory Notes, Bills of Exchange and Hundies from Debtors / other parties)
(g) Bills Payable Book	To record transactions in respect of Bills Payable , (i.e. Promissory Notes, Bills of Exchange and Hundies issued to Creditors / other parties)
(h) Journal Proper	To record other transactions for which no specific book is maintained.

Financial Books of Account

Principal Books	Subsidiary Books
1. Ledger 2. Cash Book (See Note below) <ul style="list-style-type: none"> • Simple Cash Book (Cash Column only) • Cash and Bank Book (2 – Column) • Cash Book with Discount Column • Cash Book with Bank & Discount Columns (3 – Column) • Petty Cash Book 	1. Purchases Book, 2. Sales Book, 3. Purchase Returns Book, 4. Sales Returns Book, 5. Cash Book 6. Bills Receivable Book, 7. Bills Payable Book, 8. Journal Proper.

Note: The Cash Book is both a Principal Book (since Debit and Credit Aspects are involved therein), as well as a Subsidiary Book (since all Cash and Bank transactions are first recorded therein).

PURCHASES AND SALES BOOK

Book	Purchase Book	Sales Book
1. Purpose / Inclusions	To record all Credit Purchases of goods and materials .	To record all Credit Sales of goods and materials

2. Source	Purchase Invoice is the base document	Sales Invoice is the base document
3. Posting in Parties Ledger A/c	Supplier's / Creditors' Account will be credited for the amount of credit purchases as "By Purchases Account". This posting is on individual basis.	Customers' / Debtors' A/c will be debited for the amount of credit sale as "To Sales Account". This posting is on individual basis.
4. Posting in Nominal A/c	Total of Purchases Book is posted to the debit side of Purchases A/c as "To Sundries as per Purchases Book".	Total of Sales Book is posted to credit side of Sales A/c as "By Sundries as per Sales Book".

PURCHASE RETURNS AND SALES RETURNS BOOKS

Book	Purchase Returns Book (also called Returns Outward Book)	Sales Returns Book (also called Returns Inward Book)
1. Purpose / Inclusions	When goods / materials earlier purchased on credit are returned by the Firm to the Supplier, they are recorded in Purchase Returns book.	When goods / materials earlier sold on credit are returned to the Firm by the Customer, they are recorded in Sales Returns Book.
2. Entry in Subsidiary Book	Individual items of Purchases Returns are posted in this book along with the date and amount.	Individual items of Sales Returns are posted in this book along with the date and amount.
3. Source	Debit Note	Credit Note
4. Posting in Parties Ledger A/c	Suppliers' Creditors' A/c will be debited for the amount of purchase returns as "To Purchases Returns A/c". This posting is on individual basis.	Customers' / Debtors' A/c will be credited for the amount of sales returns as "By Sales Returns A/c". This posting is on individual basis.
5. Posting in Nominal Account	Total of Purchases Returns Book is posted in the credit side of Purchases Returns A/c as "By Sundries as per Purchase Returns Book".	Total of Sales Returns Book is posted in the debit side of Sales Returns A/c as "To Sundries as per Sales Returns Book".

TRADE DISCOUNT VS CASH DISCOUNT

1. Trade Discount:

- Trade Discount refers to **reduction in price offered by the seller for HIGHER QUANTITY** of purchases.
- It is deduction from the List Price. (**Trade Discount = % of discount X List Price**)
- The price after deducting the trade discount is called **Invoice Price**.

(d) Trade Discount is **not recorded in Accounts Books**.

2. Cash Discount:

(a) Cash Discount refers to **reduction in AMOUNT DUE** offered by seller if payment is received before due date.

(b) It is some-times **technically referred as "2/10 net 30"**. This implies 2% cash discount is allowed if payment is made within in 10 days. Otherwise payment has to be made within 30 days from date of sale.

(c) Cash Discount is **recorded in Accounts Books**. i.e. It is an **Expense**

(d) Cash Discount = **% of discount X Amount actually payable** (Invoice Price)

JOURNAL PROPER

1. Significance: "Journal Proper" is **used to record those transactions which cannot be recorded in any of the specific Subsidiary Books**.

2. Features:

(a) Journal Proper is a **Residuary Subsidiary Book** to record the residuary transactions.

(b) The format of Journal is exactly similar to the format of a normal Journal Book

3. Transactions recorded in Journal Proper: Opening Entries; Closing Entries, etc

ADVANTAGES OF SUBSIDIARY BOOKS

1. **Information Management**: Since a separate register or book is kept for each class of transactions, the information relating to each class of transactions will be available at one place.

2. **Division of Work**: The accounting work may be divided amongst a number of clerks since there will be separate books for recording various transactions.

3. **Specialization**: When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.

4. **Saving of time**: Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.

5. **Control**: When the Trial Balance does not agree, the location of the error(s) is facilitated by the existence of separate books. Further, the possibility of errors and frauds will be checked by the use of various Subsidiary Books.

DEBIT NOTE & CREDIT NOTE

Term	Meaning
Debit Note	<p>1. Document which is sent by the Buyer of goods to their Supplier during Purchase Returns.</p> <p>2. It is used by the buyer to communicate seller that the seller's account is debited by the buyer in his books (at time of purchase returns)</p>

	3. Example: A is the buyer of chocolates from B. A returned some chocolates to B. while returning them, A will credit B's Account in his ledger. To inform this debit, A will send a Debit Note to B.
Credit Note	<p>1. A document which is sent by the Seller of goods to their buyer during Sales Returns. (opposite to Debit Note)</p> <p>2. It is used by the seller to communicate buyer that the buyer's account is debited by the seller in his books (at the time of sales returns)</p> <p>3. Example: A is the buyer of chocolates from B. B received back some chocolates from A. While returning them, B will credit A's A/c in his Ledger. To inform this credit, B will send a Credit Note to A.</p>

CASH BOOK

1. Meaning of Cash Book: Cash Book is **one of the Subsidiary Books** which directly records transactions involving cash. Hence, it groups together all cash related transactions.

2. Features:

(a) Subsidiary Book: On the **occurrence of cash transactions**, they are recorded in Cash Book directly. Hence, no Journal Entry is passed. From cash book, the other aspect of the same transaction is posted to Ledger Accounts.

(b) Principal Book: The **Cash Book itself serves as an Account** since the balance are entered in the Trial Balance directly. Hence, the Cash Book is part of the Ledger also and should also be regarded as a Principal Book. The format of cash book is also in the form of a ledger account.

(c) The Cash Book is thus **both a Subsidiary Book and a Principal Book**

3. Various types of Cash Book:

(a) **Single** Cash Book — Having Cash Colum only on both sides.

(b) **Two — Column** Cash Book — Having Cash and Discount columns / Cash and Bank Columns on both sides

(c) **Three — Column** Cash Book — Having Cash, Bank and Discount columns on both sides.

Certain enterprises maintain a "Petty Cash Book" on imprest basis, which is purely a Subsidiary Book.

Simple Cash Book

1. **Meaning**: Simple Cash Book is also called as Single Column Cash Book. It appears like an ordinary Ledger Account with one amount column on each side.

2. **Contents**: Dr. Side is for recording all Cash Receipts while Cr. Side is for recording all Cash Payments.

3. The **difference between Debit and Credit Side** (i.e. Closing Balance) is written as "By balance c/d" on the credit side of the Cash Book. [Note: Cash balance cannot be negative, i.e. Cash Payments cannot exceed Cash Receipts]

4. The Closing Balance of this period will be brought forward to the subsequent period by writing as "To Balance b/d" the Debit Side of the Cash Book in the next period.

5. **Format** of Single Column Cash Book:

Dr.

Cash Book for the period ended

Cr.

Date	Receipts	L.F.	Amount	Date	Payments	L.F.	Amount
Beginning	To Balance b/d		xxx	During the Month	By Payment		xxxx
During the month	To Receipts		xxx	Month End	By Balance c/d		xxx
	Total		Xxxx	Total			xxxx

Double Column Cash Book

1. **Meaning:** Double Column Cash Book has two amount columns on both side, i.e. two each on Dr. and Cr. Side.

2. **Types:** Double Column Cash Book may be maintained in any of the following ways –

Type of Double Column	Dr. Side is for recording	Cr. Side is for recording
(a) Cash & Bank Columns	Cash and Cheque Receipts	Cash and Cheque Payments
(b) Cash & Disc. Columns	Cash Receipts and Discount Allowed to Customers / Debtors	Cash Payments & Discount Received from Suppliers / Creditors

3. **Nature of Accounts / Columns:**

Column	Nature	Closing Balance
Cash	Cash Column represents Cash Account. It is a Real Account.	<ul style="list-style-type: none"> Cash balances cannot be negative, since payments of cash cannot exceed receipts thereof. So, this column always have Dr. Bal.
Bank	Bank Column represents Bank Account. It is a Personal Account.	<ul style="list-style-type: none"> If Dr. Side > Cr. Side (favourable Bank Balance) If Cr. Side > Dr. Side (Overdraft balance)
Discount	Discount Column represents Discount Allowed / Received.	<ul style="list-style-type: none"> Discount Columns are not balanced. They are totalled and entered in the Discount Account in the Ledger.

4. **Format of Two – Cash Book:**

(a) Cash and Discount Columns

Date	Receipts	L.F.	Discount allowed	Cash	Date	Payments	L.F.	Discount Received	Cash
	To Balance b/d		N.A.	xxx		By Payments			xxxx
	To Receipts			xxxx		By Creditors		xx	xxxx
	To Debtors		Xx	xxxx		By Balance c/d			xxx

	Total		xx	xxxx		Total		xx	xxxx
--	-------	--	----	------	--	-------	--	----	------

(b) Cash and Bank Columns

Date	Receipts	L.F.	Discount allowed	Cash	Date	Payments	L.F.	Discount Received	Cash
Note	To Balance b/d		xxx	xxx	Note	By Balance b/d		Xxx	N.A.
	To Receipts		xxxx	xxxx		By Payments		Xxxx	xxxx
	To Debtors			xxxx		By Creditors		Xxxx	xxxx
Note	To Balance c/d		xxx	N.A.	Note	By Balance c/d		Xxx	xxx
	Total		xxxx	xxxx		Total		Xxxx	xxxx

Triple Column Cash Book

1. **Meaning:** Three Column Cash Book has three amount columns on both sides i.e. Cash, Bank and Discount amounts. [Note: The principles for recording are the same as for Two Column Cash Book as described in the previous questions.]

2. **Format:**

Date	Receipts	L.F.	Discount allowed	Bank	Cash	Date	Payments	L.F.	Discount Received	Bank	Cash

3. **Advantages:**

- (a) Cash and Bank Accounts are prepared simultaneously, so there is saving in time.
- (b) Information regarding Cash in Hand and Bank Balances can be obtained simultaneously.
- (c) If there are two or more Bank Accounts, the Firm can introduce multi – column Cash Book, one each for the various Bank Accounts.

Contra Entry

- 1. **Meaning:** Inter-Column transactions, i.e. Cash deposited into Bank, Cash withdrawn from Bank for business etc. are recorded on **both Dr. and Cr. sides of the same Cash Book** in appropriate columns. They are called “Contra Entries”.
- 2. **Need:** Contra Entries **arise in Two-Column Cash Book** (with Cash and Bank Columns) or Three-Column Cash Book.
- 3. **Treatment:** In case of Contra Entries, the amount is entered in the Bank Column and the Cash Column on the appropriate (Dr. or Cr) Sides. Such entries will be marked as “C” in

the Ledger Folio Column to indicate that these are contra transaction and no further posting is required.

Transaction	In Bank Column	In Cash Column
Cash deposited into Bank	Debit Bank Column of Cash Book.	Credit Cash Column of Cash Book.
Cash withdrawn from Bank for business purposes	Credit Bank Column of Cash Book.	Debit Cash Column of Cash Book.

Petty Cash Book and Imprest System

- Meaning:** Petty Cash Book is used to maintain the record of all petty cash expenses, i.e. expenses of small amount say upto Rs. 100, e.g. Auto Fare, Postage Stamps purchase, Minor Repairs, etc. Petty Cash balance is an asset for the business and shown directly on the assets side of the balance sheet under "Cash Balances"
- Purposes / Advantages:**
 - Saving of time of the Chief Cashier.
 - Saving in labour in writing up the Cash Book and posting into the Ledger, and
 - Effective Control over small payments.
- Format**

ANALYTICAL PETTY CASH BOOK

Receipts Rs	Date	Voucher Number	Particulars	Total Payments Rs.	Expense 1 Rs.	Expense 2 Rs.	Expense 3 Rs.	Expense 4 Rs.

- Imprest System:** The Petty Cashier is entrusted with a certain amount of Cash, say Rs. 500 to pay petty expenses during a period, say a week. After that week, the Petty Cashier submits a statement of expenses paid by him, e.g. Rs. 430, which will be reimbursed to him by the Main Cashier. Thus, the Petty Cashier will have Rs. 500 again with him (Rs. 70 Petty Cash in Hand + Rs. 430 Reimbursement received), to meet expenses during the next week. This reimbursement system is called Imprest System.

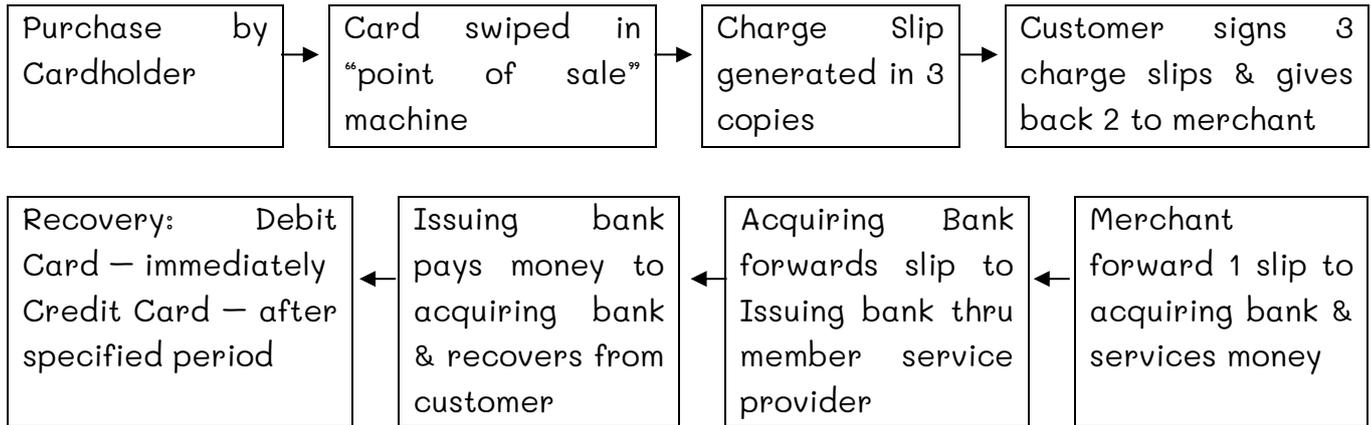
Sale through Credit / Debit Cards.

- Card Contents:** Credit Card / Debit Card issued by a Bank is a small plastic card containing – (a) Name of the Cardholder, (b) Card Number (16 digit Number), (c) Date of Issue, (d) Date of Expiry, and (e) Magnetic Strip at the back.
- Debit vs Credit Card:** In a Credit Card, the Cardholder can buy now and pay later, whereas in a Debit Card, the Cardholder has to pay earlier (i.e. have a minimum balance in his account) in order to buy now. Nowadays, ATM Cards issued by a Bank can also be used as Debit Card.

3. Parties involved:

- (a) Cardholder (Who buys goods using a Credit / Debit Card)
- (b) Merchant (Who sells goods to a customer using a Credit / Debit Card)
- (c) Issuing Bank (A bank who has issued a card to the Cardholder Eg. Standard Chartered Bank)
- (d) Acquiring Bank (A bank with whom the merchant has an account Eg. HSBC Bank)
- (e) Member Service Provider (Visa / Master)

4. Process Flow of Card Transactions:



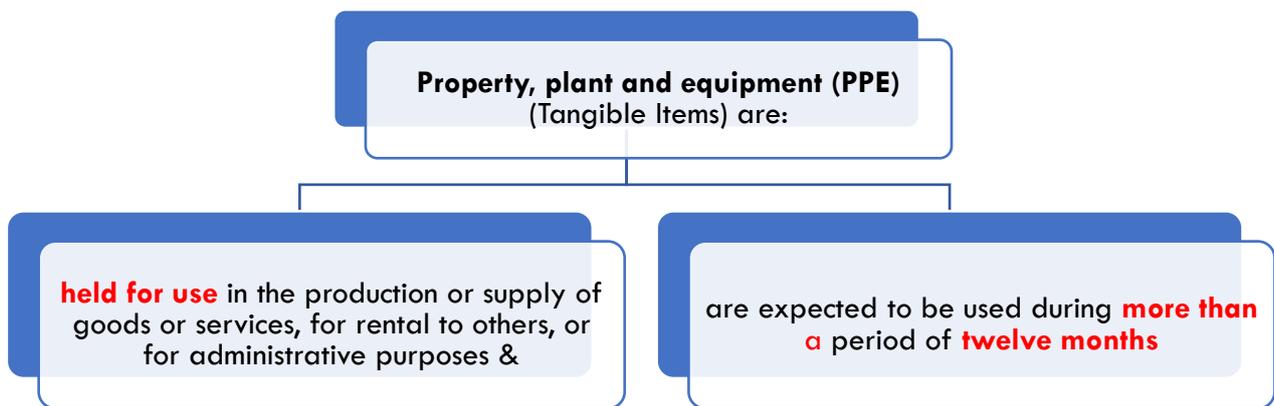
5. Accounting Entries in the books of the Merchant

<p>(a) For recording Sales</p>	<p>(b) For recording Commission charged by Bank</p>								
<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Bank Account</td> <td style="width: 40%; text-align: right;">Dr.</td> </tr> <tr> <td style="text-align: right;">To Sales Account</td> <td></td> </tr> </table>	Bank Account	Dr.	To Sales Account		<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Commission Account</td> <td style="width: 40%; text-align: right;">Dr.</td> </tr> <tr> <td style="text-align: right;">To Bank Account</td> <td></td> </tr> </table>	Commission Account	Dr.	To Bank Account	
Bank Account	Dr.								
To Sales Account									
Commission Account	Dr.								
To Bank Account									
<p>Bank has to pay the money to the merchant. Hence bank becomes a debtor. Sales is an income</p>	<p>Commission charged by the bank is an expense for the business and it is payable to the Bank.</p>								

INTRODUCTION

- As Business enterprises acquire different types of fixed assets
- And fixed assets **have long life and are held for use in the business** for production of goods & services and have a material value.
- As asset is used in business **its value is getting reduced** & asset will become useless.

Depreciation is the reduction in book value of a Depreciable fixed asset (PREOPERTY, PLANT & EQUIPMENT) due to its use, wear/tear, passage of time, innovation & technologies,



DEPRECIATION

- PPE are **also called fixed assets** in common parlance.
- However, fixed assets **are used for a number of accounting periods** in future with the same acquisition cost until the concerned fixed asset is sold or discarded.
- Therefore, that **part of the acquisition cost is treated or allocated as an expense** in each of the accounting period in which the asset is utilized.
- The **amount or value of fixed assets allocated to respective accounting period is called depreciation.**
- **Value** of such assets **decreases** with passage of time mainly due to following **reasons**.
 - (i) **Wear and tear** due to its use in business
 - (ii) **Efflux of time** even when it is not being used
 - (iii) **Obsolescence** due to technological or other changes
 - (iv) Decrease in **market value**
 - (v) **Depletion** mainly in case of mines and other natural reserves

Companies Act Vs Depreciation

As per **Schedule II** under the Companies Act, 2013,

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**.

- The useful life of an asset is the **period over which an asset is expected to be available for use** by an entity, or the number of production or similar **units** expected to be obtained from the asset by the entity.

Thus there are 3 important **factors** for computing depreciation:

- **Estimated useful life** of the asset
- **Cost** of the asset
- **Residual** value of the asset at the end of the of its estimated useful life

Note:

- Depreciation of an asset **begins when it is available for use**, Thus it is not necessary that an asset must be used to be depreciated. There is **decrease in value** of assets due to normal wear and tear **even when these are not physically used**.

DEPRECIATION ON COMPONENTS OF AN ASSETS

Part of Property, Plant & Equipment to be identified as a separate component should have both:

- significant cost** when compared to overall cost of item of property, plant and equipment
- Estimated useful** life or depreciation method different from rest of the parts of the property plant and equipment.

Example: Airframe (i.e. the body of the aircraft), engines & interiors have different individual useful lives. If life of the airframe (being the longest of the individual lives of the three major types of components) is taken as the life of the aircraft, it is important that other two major components i.e. engine and interiors are depreciated over their respective useful life and not over the life of airframe. Other components (usually small and low value) which will require replacement very frequently may be depreciated over the useful life of airframe and their frequent replacement cost may be charged to expense as and when it is incurred.

OBJECTIVES (NEED) FOR PROVIDING DEPRECIATION

- 1) **Correct income measurement:** Depreciation should be charged for proper estimation of periodic profit or loss.
- 2) **True position statement:** Value of the fixed assets should be adjusted for depreciation charged in order to depict the actual financial position.
- 3) **Funds for replacement:** Generation of adequate funds in the hands of the business for replacement of the asset at the end of its useful life. (**depreciation by itself does not create funds** it merely draws attention to the fact that out of gross revenue receipts, a certain amount should be retained for replacement)
- 4) **Ascertainment of true cost of production:** For ascertaining the cost of the production, it is necessary to charge depreciation as an item of cost of production.

FACTORS IN THE MEASUREMENT OF DEPRECIATION

As Estimation of exact amount of depreciation is not easy. Generally following factors are

taken into consideration for calculation of depreciation.

1. **Cost of asset** including expenses for installation, commissioning, trial run etc.
2. **Estimated useful life** of the asset.
3. **Estimated scrap value** (if any) at the end of useful life of the asset.

Cost of a depreciable asset represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to or improvement thereof for the purpose of increase in efficiency

Cost of Property, Plant and Equipment comprises:

- a) its purchase price, including non-refundable import duties and purchase taxes, after deducting trade discounts and rebates.
- b) any cost directly attributable to bring the asset to the location and condition necessary for it to be capable of operating in a manner intended by the enterprise.
- c) the initial estimate of the costs of dismantling, removing, the item and restoring the site on which an asset is located.

Examples of costs directly attributable costs are:

- (a) Cost of **employee benefits arising directly from acquisition** or construction of an item of property, plant and equipment.
- (b) cost of **site preparation**
- (c) **initial delivery** and **handling** costs
- (d) **installation** and **assembly** costs
- (e) **cost of testing** whether asset is functioning properly, after deducting the net proceeds from selling the items produced while testing (such as samples produced while testing)
- (f) **professional fees** e.g. engineers hired for helping in installation of a machine

Thus all the expenses which are **necessary for asset to bring it in condition** and location of desired used will become part of cost of the asset.

However, following expenses should not become part of cost of asset:

- (a) costs of opening new facility or business, such as inauguration costs;
- (b) Cost of introducing new product or service (for example cost of advertisement or promotional activities).
- (c) cost of conducting business in a new location or with a new class of customer (including cost of staff training); and
- (d) Administration and other general overhead costs.

Few Important Points:

- **Once** an asset has been **ready for use**, no cost should recognized as part of cost of the asset unless there is major repair or addition which increases the useful life of the asset or improves the production capacity of the asset.

- Accordingly, cost incurred while an item is capable of operating in its intended manner but it is **not yet put to use or is used at less than full capacity should not be capitalized** as part of the cost of the asset.
- Cost of **relocation** of an asset should **not be capitalized**.
- **Any additions** made to a particular item of property, plant and equipment after it is initially put to use are depreciated over the remaining useful life of the asset.

'Useful Life' is either (i) the **period** over which a depreciable asset is expected to be used by the enterprise or (ii) the **number of production or similar units** expected to be obtained from the use of the asset by the enterprise. Determination of the useful life is a matter of estimation

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value. (Cost-ESV)

METHODS OF PROVIDING DEPRECIATION:

I. Straight Line method (SLM)

Equal amount is written off every year

so as to reduce the cost of the asset to nil or its residual value at the end of its useful life

It is simple to apply and gives accurate results especially in case of leases, patents and copy rights, and also in case of plant and machinery.

Also known as Fixed Instalments Method / HC / EIM / OC

$$\text{Straight Line method} = \frac{\text{Cost of Asset} - \text{Scrap Value}}{\text{Useful life}}$$

$$\text{Straight Line method Rate} = \frac{\text{Straight Line Depreciation}}{\text{Cost of Asset}} \times 100$$

2. Written down Value method (WDV)

- In this method, a **fixed % of the diminishing value** of the asset is written off each year
- **repairs and small renewals** being **charged to revenue**
- Annual **depreciation decreases from year to year**, so that the earlier years suffer to the benefit of the later years.
- Here, value of **asset can never be completely extinguished**
- However, it is very **simple to operate**.
- **TOTAL charge to revenue is uniform** when the depreciation is high, repairs are negligible; and as the repairs increase, the burden of depreciation gets lesser and lesser

The **rate of depreciation** under this method may be determined by

$$1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of asset}}} \times 100$$

WDV method depreciation calculations:

Year	Opening balance	Depreciation @25%	Closing balance
2010	50.00	12.50	37.50
2011	37.50	9.38	28.13
2012	28.13	7.03	21.09
2013	21.09	5.27	15.82
2014	15.82	3.96	11.87
2015	11.87	2.97	8.90
2016	8.90	2.22	6.67
2017	6.67	1.67	5.01
2018	5.01	1.25	3.75
2019	3.75	0.94	2.82

ACCOUNTING TREATMENT OF DEPRECIATION:

When the depreciation is directly charged to asset account

Date	Particular	Dr. (₹)	Cr. (₹)
1	To record purchase of assets: Assets A/c Dr. To cash/Bank A/c		
2	To provide Depreciation: Depreciation A/c Dr. To Assets A/c		
3	To transfer depreciation to P&L A/c: P&L A/c Dr. To Depreciation A/c		
4	To record sale of assets: Cash/Bank A/c Dr. To Assets A/c		
5	To record Profit on sale: Assets A/c Dr. To P&L A/c		
6	To record Loss on sale: P&L A/c Dr. To Assets A/c		

Recording depreciation by creating Provision for Depreciation A/c:

Date	Particular	Dr. (₹)	Cr. (₹)
1	To record purchase of assets: Assets A/c Dr.		

	To cash/Bank A/c		
2	To provide Depreciation: Depreciation A/c Dr. To Provision for Depreciation A/c		
3	To transfer depreciation to P&L A/c: P&L A/c Dr. To Depreciation A/c		
4	On Disposal of an assets: (a) Transfer of Original cost of asset to Asset Disposal A/c Asset Disposal A/c Dr. To Asset A/c (b) Transfer of Accumulated depreciation on asset to Asset Disposal A/c Provision for Depreciation A/c Dr To Asset Disposal A/c (c) For recording Sale proceeds Cash/ Bank A/c Dr. To Assets Disposal A/c (d) Transfer of balance in asset disposal A/c <u>In case of Profit:</u> Asset Disposal A/c Dr. To P&L A/c <u>In case of Loss:</u> P&L A/c Dr. To Asset Disposal A/c		

In this method, the **asset account is not affected** by the amount of depreciation and the value of asset appears in the ledger and the balance sheet at its **original cost until it is sold or discarded**. The amount of depreciation written off is **accumulated** in provision for depreciation account.

THUS;

In the Assets Side of the Balance Sheet:

Relevant Asset -----

Less: Provision for Depreciation -----

OR

Alternatively the **Asset Account** is shown at its **original cost** in the **assets side** and **Provision for Depreciation Account** in the **Liability Side** until the depreciation provision is equal to the original cost of the asset.

PROFIT OR LOSS ON SALE (DISPOSAL) OF DEPRECIABLE ASSETS:

- A. Selling Price
- B. (-) Book Value on the Date of Sale (Cost-Depreciation till date of sale)
- C. (-) Selling Expenses if any
- D. (=) Profit / (Loss)

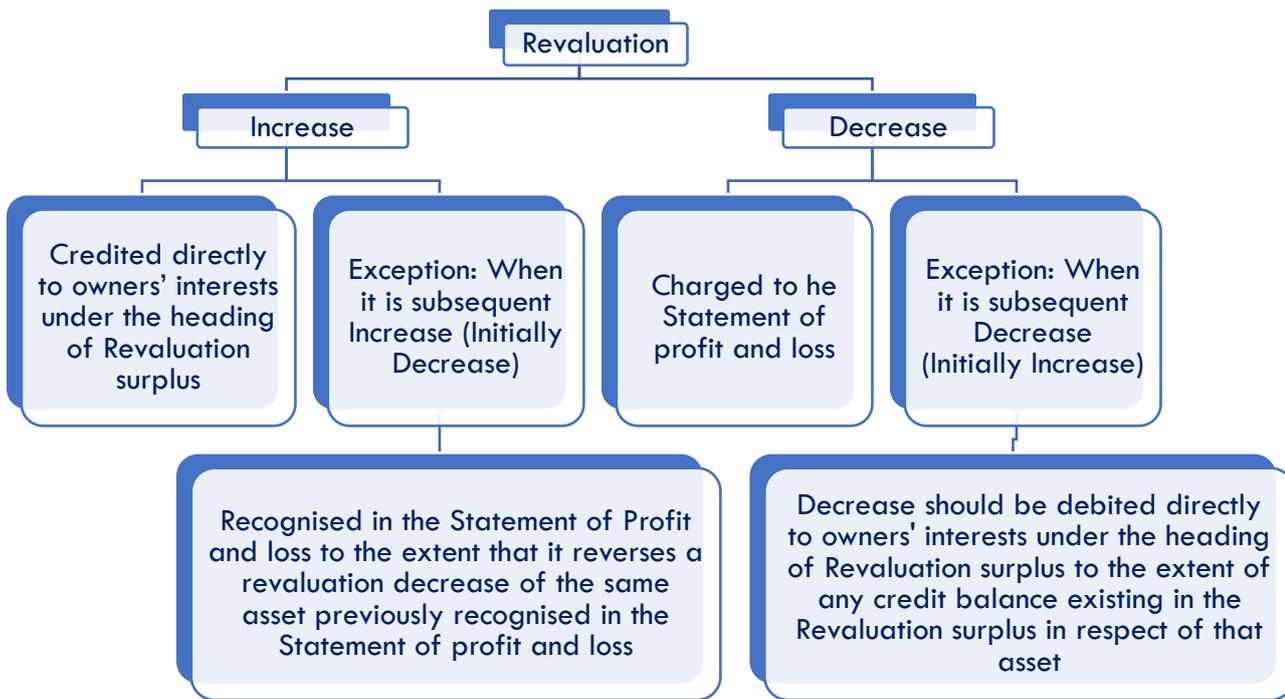
CHANGE IN METHOD OF DEPRECIATION

- The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there is significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern.
- Whenever any change in depreciation method is made, such change in method is treated as change in accounting estimate as per Accounting Standards. Its effect needs to be quantified and disclosed separately.
- A change in an accounting estimate may affect the current period only or both the current period and future periods.

REVISION OF THE ESTIMATED USEFUL LIFE OF PROPERTY, PLANT AND EQUIPMENT

The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with Accounting Standards. Whenever there is a revision in the estimated useful life of the asset, the unamortised depreciable amount should be charged over the revised remaining estimated useful life of the asset.

REVALUATION OF PROPERTY, PLANT AND EQUIPMENT



Methods of Depreciation	Fixed Instalment method/equal Instalment method/ Original cost method/Straight line method	=	A fixed percentage on original cost	$\text{Depreciation} = \frac{\text{Cost of Asset} - \text{Residual Value}}{\text{Expected life of Asset (in year)}}$
	Diminishing balance method/written down value method/reducing balance method	=	A fixed percentage on reducing balance of asset	$\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation} \times 100}{\text{Original cost of the Asset}}$
	Annuity method	=	Interest of investment on Asset is taken into Consideration	$\text{Depreciation} = \text{Cost} / \text{WDV of Asset} \times \text{Rate of Depreciation}$
	Depreciation fund/Sinking fund method	=	Interest earned on investments made with Depreciation is taken into Calculations	$\text{Rate of Depreciation} = 1 - n \sqrt[n]{\frac{\text{Net Residual Value}}{\text{Cost of Acquisition}}} \times 100$
	Depletion method	=	On Wasting Assets Like mines, quarries, oil wells	<p>Where n = Life of the Asset in Years</p> $\text{Depreciation} = \frac{[\text{Cost of Asset} - \text{Residual Value}]}{\text{Annuity Factor}}$
	Machine hour rate method/Service hours method	=	Application on plant & Machinery, Vehicles etc.	$\text{Depreciation} = \frac{[\text{Cost of Asset} - \text{Residual Value}]}{\text{Present Value of Re. 1 at sinking fund Tables, for given rate of Interest}}$
	Production units method	=	On machinery, Projects	$\text{Depreciation} = \frac{\text{Estimated Total Cost} - \text{Scrap Value}}{\text{Estimated Total Output (Units)}} \times \text{Actual output during the Year (units)}$
	Sum of Years Digits method	=	A Variant of the reducing balance method	$\text{Depreciation} = \frac{\text{Original Cost of Assets} - \text{Scrap Value}}{\text{Life of Assets in Hours}} \times \text{Actual hours used during the year}$

Depreciation = $\frac{\text{Estimated Total cost} - \text{Scrap Value}}{\text{Estimated Total Output (Units)}} \times \text{Actual Output used during the year (in Unit)}$

Depreciation = $[\text{Original Cost} - \text{Scrap Value}] \times \frac{\text{No. of years of the Remaining Life of the Asset}}{\text{Sum of the Years' digits}}$

Note = Sum of years' digits = $\frac{N(N+1)}{2}$

RECTIFICATION OF ERRORS

INTRODUCTION

WHAT IS AN ERROR?

Error is an accounting mistake. When a business transaction is not recorded in accordance with well accepted accounting principles and practices, it is said there is an error.

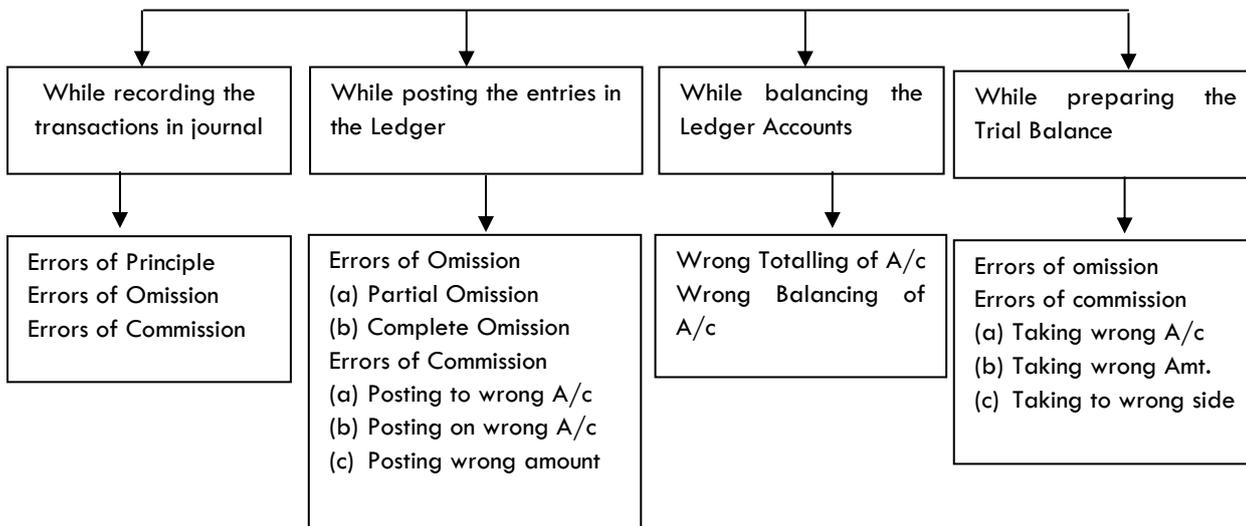
EXAMPLES OF ERRORS:

Goods Purchased from Gopi for Rs. 68,000

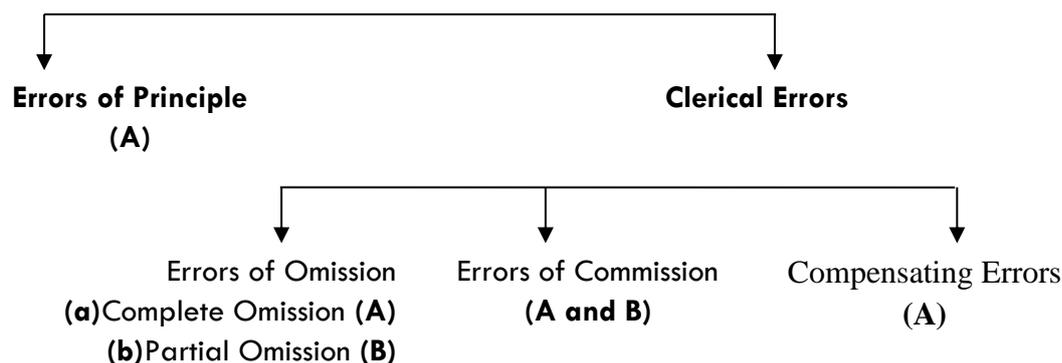
This transaction may be recorded in the books of accounts wrongly by one of the following ways-

1. Omitted to be recorded in Purchase Day Book.
2. Recorded in Purchase Day Book twice.
3. Recorded in Purchase Day book as Rs. 86,000.
4. Recorded in sales Returns Day book.
5. Posted to the GopiRs. s Account as Rs. 86,000.
6. Posted to the account of Gopika.
7. Posted to the Debit side of GopiRs. s Account.

#STAGES OF ERRORS



TYPES OF ERRORS:



Imp Note: Type A Error = Trial Balance will still agree.
Type B Error = Trial Balance will not agree.

Errors of Principle

Meaning	It arises when a financial transaction is recorded in the books in an incorrect manner . i.e. Journal Entry is not as per Accounting Principles .
Example	Capital Expenditure is treated as revenue expenditure or vice versa, E.g. Repairs to machinery wrongly treated as capital expenditure and debited to Machinery Account instead of Machinery Repairs A/c.
Types	They may be analysed into – <ul style="list-style-type: none"> • Errors which affect profits: e.g. Treating Rent Paid as a Debtor instead of as Expenses, or when Capital Expenditure is treated as revenue and debited to P & L Account. • Errors which do not affect profits: e.g. Manufacturing Wages posted to Trade Expenses Account or wrong classification of assets or liabilities.
Stage	Such errors are normally committed while recording in the Journal .
Effect on T.B.	Such errors WILL NOT affect the Trial Balance.
Effect on profits	Errors of principle, which involve income and expenditure accounts , e.g. wrong distinction between capital & revenue expenditure, will affect profit .

Errors of Omission

Meaning	Error of Omission means that a transaction is not recorded / Posted / transferred either wholly or partially, in the books of accounts.	
Types	They may be further analysed into –	
	Partial Omission	Complete Omission

	(a) One aspect of the transaction, either debit or credit, is omitted to be recorded / posted	Both aspects of the transaction, debited and credited, are omitted to be recorded / posted.
	(b) Trial Balance will not agree.	Trial Balance will still agree.
	(c) Arises from posting errors – one-sided posting and omission of other side entry.	Arises from omission – either in the book of original entry or in the ledger.
Stage	(a) Complete Omission: (i) while recording in Journal (ii) Posting to Ledger (b) Partial Omission: (i) While posting to ledger	
Effect on T.B.	(a) Complete Omission – will NOT affect the Trial Balance (As both aspects of equal amounts omitted) (b) Partial Omission in posting – will affect the Trial Balance (as one of the aspects are recorded)	
Effect on profit	Effect of errors of omission on Profit cannot be generalized. If errors involve Nominal Account, i.e. income and expenditure items, profits are affected.	

#Errors of Commission

Meaning	A transaction is recorded wrongly or incorrectly in the books. It also includes all clerical errors during the Accounting Process.	
Types and Effect on T.B.	These may be categorized into – (a) Posting Errors: wrong account, wrong amount, wrong side, etc. This affects Trial Balance. (b) Casting Errors: wrong totaling or balancing. This affects Trial Balance. (c) Carry Forward Errors: carrying forward a wrong amount, wrong side, etc. This affects Trial Balance. (d) Duplication Errors: recording the same transaction twice in the original book of entry and also posting it to the Ledger. This does not affect TB.	
Effect on T.B.	One-Sided Errors will cause difference in Trial Balance, E.g. Wrong Posting, Wrong amount, Account etc. Two-Sided errors will not affect the Trial Balance.	
Effect on profit	Effect of errors of commission on Profit cannot be generalized. If errors involve Nominal Accounts i.e. income and expenditure items, profits are affected.	

Compensating Errors

Meaning	One set of errors on the debit side for a specified amount is counter – balanced by another set of errors for the same amount on the credit side. Due to this, the Trial Balance is not affected.
----------------	---

Nature	<ul style="list-style-type: none"> • It is difficult to detect as such. It may or may not affect the profit. • If the Original Error and the Compensating Error both arise in Incomes / Expense Accounts, the profit will not be affect, but if one arises in a Revenue Account and the other in an Asset or Liability Account, although the Trial Balance will agree, profit will be incorrectly stated. • Such errors arises in various ways, but most frequently casting (totaling), e.g. the cast of expenditure account may be Rs. 9,600 less, and the cost of asset account Rs. 9,600 extra, the profit and the asset being thereby increase improperly.
Effect on T.B.	Such errors will not affect the Trial Balance.
Effect on profits	Compensating Errors, which involve Income and Expenditure Accounts, will affect profit. However if the error occurs in Asset and Liability Accounts only, profits may not be affected.

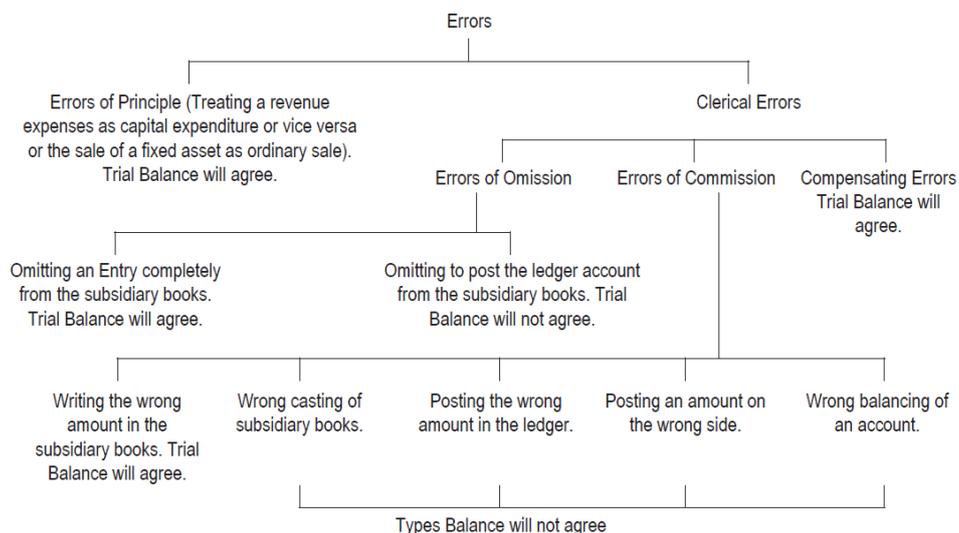
Another point of view, error may be divided into two categories:

(a) Those that affect the trial balance - because of these errors ,trial balance does not agree; these are the following:

- (i) Wrong casting of the subsidiary books.
- (ii) Wrong balancing of an account.
- (iii) Posting an amount on the wrong side.
- (iv) Posting the wrong amount.
- (v) Omitting to post an amount from a subsidiary book.
- (vi) Omitting to post the totals of subsidiary book.
- (vii) Omitting to write the cash book balances in the trial balance.
- (viii) Omitting to write the balance of an account in the trial balance.
- (ix) Writing a balance in wrong column of the trial balance.
- (x) Totalling the trial balance wrongly.

(b) The errors that do not affect the trial balance are the following:

- (i) Omitting an entry altogether from the subsidiary book.
- (ii) Making an entry with the wrong amount in the subsidiary book
- (iii) Posting an amount in a wrong account but on the correct side, e.g., an amount to be debited to A is debited to B, the trial balance will still agree.



Tools for identifying errors

Particulars	Errors identifiable	Errors not identifiable
1. Trial Balance	Totals of Debit Column & Credit Column do not match.	Totals of Dr. & Cr. Columns may match even if some errors exist.
2. Bank Reconciliation Statement	Identifies errors in Cash Book / Pass Book / Omission to record	Names of debtors and Creditors may not be verifiable from Bank Statement
3. Stock Reconciliation Statement	Identifies errors in Stock as per books, omission of stock losses etc.	When the same error is committed while physical verification of stock and computation as per books.
4. Debtors and Creditors Reconciliation	Identifies errors in recording the entries involving debtors / creditors.	When collusion is involved with the relevant debtors / creditors
5. Ratio Analysis	Indicates the possibility of errors on an overall basis.	Not possible to identify the exact error. It is not only an indication and not a confirmation of errors.

Suspense Account

- Meaning:** When the Trial Balance does not tally, then it is essential to create an account named "Suspense Account" on the **column whose total is lower**.
- Purpose:**
 - The Suspense Account is opened for the **differential amount on the column** which is lower to make the trial balance **artificially tally**. (i.e. Trial Balance is temporarily tallied by opening the suspense account).
 - It is kept till the errors are identified and rectified. After the rectification, **Suspense A/c balance will become zero**.

3. **Type:** Suspense A/c is a combination of Real, Personal and Nominal Accounts. It is a temporary Account.

4. **Nature of balance in Suspense Account:**

Situation	Suspense A/c will appear on	Nature of Balance
If Debit Column Total < Credit Column Total	Debit Column	Debit Balance
If Credit Column Total < Debit Column Total	Credit Column	Credit Balance
IMP Note: Suspense account will appear on the Column whose total is lower		

5. Hence, Suspense Account will appear only when an error affects the Trial Balance.

6. **Disclosure in Balance Sheet:**

Nature of Suspense A/c Balance	Show in	Side
Debit Balance in Suspense A/c	Balance Sheet	Assets
Credit Balance in Suspense A/c	Balance Sheet	Liabilities

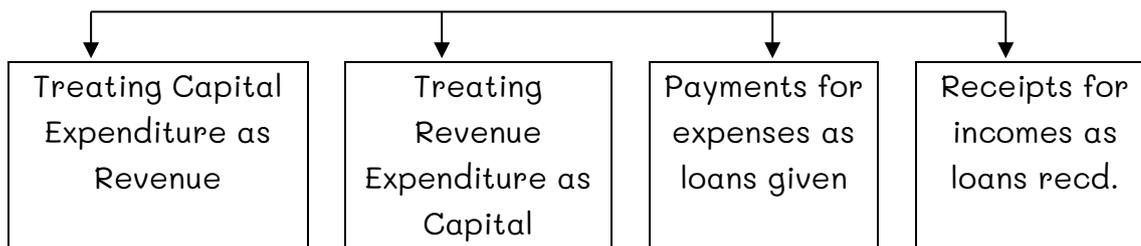
Stage of Rectification of Errors

Error in the accounts can be detected and rectified in any of the following stages –

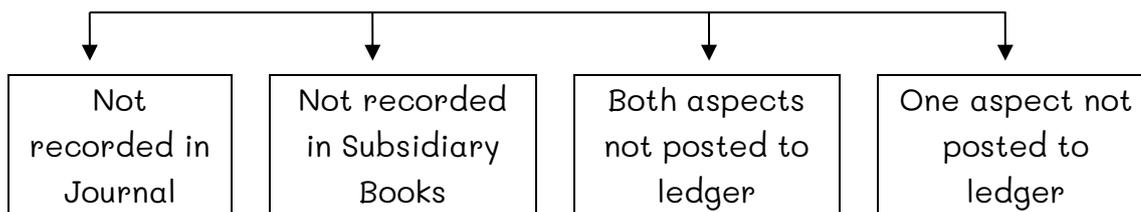
Stage	Treatment
1. Before preparation of Trial Balance	<ul style="list-style-type: none"> Errors of Complete Omission are rectified by recording the same fully and properly Errors of Partial Omission are rectified by making relevant posting. Errors of Principle rectified by making rectification Journal Entry. <i>Suspense Account shall not be opened. Direct rectification is done.</i>
2. After Trial Balance but before Final Accounts are prepared	<ul style="list-style-type: none"> Errors of Complete Omission are rectified by recording the same fully and properly. Errors of Partial Omission are rectified by rectification Journal Entry, by using the Suspense Account. Errors of Principle are rectified by making the rectification Journal Entry. Errors of Commission are rectified based on the nature of error.
3. After Final Accounts i.e. in the next a/cing period	<ul style="list-style-type: none"> Errors of Partial Omission are rectified by way of rectification Journal Entry, by using the Suspense Account. Errors which have an impact on Profit (Nominal Accounts) are rectified by using the P & L Adjustment Account. Instead of Nominal Accounts, P & L Adjustments A/c is debited or credited.

ERRORS:

(a) Error of Principle



(b) Error of Omission



(c) Error of Commission

Recording in Journal	Recording in Subsidiary Book	Posting entries in the Ledger	Balancing Ledger A/cs / Subsidiary Books	Preparing the Trial Balance
↓	↓	↓	↓	↓
(a) Wrong Amt.	(a) Wrong Book	(a) Wrong Amount (Correct A/c)	Overcasting – Dr. Side	Taking wrong A/c
(b) Wrong A/c	(b) Wrong Amt.	(b) Wrong Account (Correct Side)	Overcasting – Cr. Side	Taking wrong Amt.
	(c) Wrong Casting	(c) Wrong Side of a Correct A/c	Undercasting – Dr. Side	Taking to wrong side
		(d) Wrong Amt. to a Wrong A/c	Undercasting – Cr. Side	
		(e) Wrong Side of a Wrong A/c	Wrong Balancing of Dr. balance A/c	
		(f) Wrong Amt. to Wrong Side of a Correct A/c		
		(g) Wrong Amt. to Wrong Side of a Wrong A/c	Wrong Balancing of Cr. balance A/c	

Opening Entries: The opening entry is an item which is passed in the Journal proper or General Ledger. The purpose of passing this entry is to record the opening balances of the accounts transferred from the previous year to the New Year. The accounts which are appearing on the assets side of balance sheet are debited in the opening entry while the accounts that are appearing in the liabilities side are credited. At the end of each accounting period, the books of accounts need to be closed for preparation of final accounts. Also, in the beginning of the new accounting period, new books of accounts are to be opened. For this purpose, opening and closing entries need to be passed. These entries are passed in journal proper.

The entry can be given as:

All Asset A/c's Dr

To All Liabilities A/c

To Owners' Capital A/cs

Que. 1

Consider the following balances in the Balance Sheet as on 31st March 2014. Pass the opening entry on 1st April, 2015.

Subodh's Capital A/c	2,75,000
Loan from HH bank	4,25,000
Plant and machinery	3,30,000
Cash in hand	20,000
Balance at CC bank	1,75,000
Trade Debtors	3,55,000
Closing stock	1,35,000
Trade Payables	2,95,000
Outstanding Expenses	40,000
Prepaid Insurance	20,000

CLOSING ENTRIES: All the expenses and gains or income related nominal accounts must be closed at the end of the year. In order to close them, they are transferred to either Trading A/c or Profit and Loss A/c. Journal entries required for transferring them to such account is called a 'closing entry'. The Closing Entries are passed on the basis of trial balance for transferring the balances to Trading and profit and loss A/c. These entries are mainly for:

- For transferring purchases and direct expenses (goods related) to Trading A/c
Trading A/c Dr To Opening stock A/c To Purchases A/c To Factory expenses A/c To Freight & carriage inward A/c
- For transferring sales and closing stocks
Sales A/c Dr Closing Stock A/c Dr To Trading A/c
- For transferring gross profit or gross loss to P & L A/c
For Gross Profit Trading A/c Dr

To P & L A/c For Gross Loss P & L A/c Dr To Trading A/c

(d) For transferring expenses P & L A/c Dr To Respective expense A/c

(e) For transferring Incomes Respective income A/c's Dr To P & L A/c

(f) For transferring Net profit or Net loss For Net Profit P & L A/c Dr To Capital A/c For Net Loss Capital A/c Dr To P & L A/c

Que. 2

Pass closing entries for the following particulars as on 31st March 2015 presented by X Ltd.

Particulars	Amount (₹)
Opening stock	10,000
Purchases	50,000
Wages	5,000
Returns outward	5,000
Sales	1,00,000
Returns inward	10,000
Salaries	8,000
Insurance	1,000
Bad debts	3,000
Interest received	3,000
Discount allowed	4,000
Discount received	3,000
Closing stock	15,000

Transfer Entries: When it is necessary for an amount or balance of one account to be transferred to some other account, it is done by means of a transfer journal entry in the Journal Proper.

i.e., Amount withdrawn from Capital

Capital A/c Dr.

To, Drawings A/c

Que. 3

Following Balances appeared in the books of Patnayak on 31st March, 2014. Pass the necessary opening entry for 2014-15:

Credit balances: Capital ₹30,000; Bills Payable ₹5,000; Creditors ₹10,000

Debit balances: Furniture ₹4,000; Machinery ₹18,000; Debtors ₹12,000; B/R ₹9,000; Cash ₹2,000

ADJUSTMENT ENTRIES

Under accrual basis of accounting, incomes are recognized when these are earned and not when cash is actually received. Similarly, expenses are recognized when these are incurred

and not when actual payments are made. This means at the end of the accounting year, there may be certain incomes earned but not received (i.e., accrued income) and incomes received but not earned (i.e. income received in advance). Similarly, there may be certain expenses like wages and salaries which are due but not actually paid (i.e. outstanding expenses) and certain expenses may have been paid but not due (i.e. prepaid expenses). These accrued incomes, incomes received in advance, outstanding expenses and prepaid expenses etc. require adjustments at the end of the year so that true net income is determined on accrual basis. Besides these, there are other items like closing stock, depreciation etc. which need adjustment.

Adjustment entries are passed either before or after preparation of trial balance. But generally adjustments are made after trial balance has been prepared. In such a case, i.e., when adjustments are given outside the trial balance, the dual effect of the adjustment will be in the final accounts itself. In other words, each adjustment will be treated twice while preparing trading and profit and loss account and balance sheet. For example, if wages are outstanding, and it is given outside the trial balance, it will be shown on the debit side of the trading account as an expense and then as a liability in the balance sheet.

However, adjustments are sometimes made before the preparation of the trial balance, in which case adjustments appear in the trial balance. In such a case, in the preparation of final accounts, these adjustments appear only once.

Principal type of transactions requiring adjustments are given below along with their adjustment entries.

Common Adjustments

- | | |
|---|---|
| 1. Closing stock | 11. Interest on capital |
| 2. Outstanding expenses | 12. Interest on drawings |
| 3. Prepaid | 13. Interest on loan/investments/ deposits |
| 4. Accrued incomes | 14. Manager's commission |
| 5. Income received in advance | 15. Drawing of goods by proprietor for personal use |
| 6. Depreciation on fixed assets | 16. Goods on sale or approval |
| 7. Bad debts | 17. Goods distributed as free samples |
| 8. Provision for bad and doubtful debts | 18. Loss of stock by fire, theft, etc. |
| 9. Provision for discount on debtors | |
| 10. Provision for discount on creditors | |

Que. 4

The following items appear in the Trial Balance as on 31st March, 2015.

Particulars	Dr. ₹	Cr. ₹
Sundry debtors	42,000	
Bad debts	3,500	

Adjustments:

- After the trial balance was prepared, it was found that a debtor Z will not be able to pay ₹ 2,000 because of his insolvency.
- Create 6% provision for bad debts.

Pass the necessary adjustment entries in journal and show how these would appear in the profit and loss Account and Balance sheet as on 31st March, 2015

Que. 5

The following extracts from the trial balance as on 31st March, 2015 are given

Particulars	Dr. ₹	Cr. ₹
Sundry debtors	42,000	
Bad debts	3,500	
Provision for bad debts		3,800

Adjustments:

1. Additional bad debts ₹ 2,000
2. Maintain the provision for bad debts at 10% of debtors.

Show the relevant entries in the profit and Loss Account and Balance Sheet as on 31st March, 2015.

Que. 6

Debtors as per trial balance ₹ 31,000

Adjustments: Provide ₹1,000 for bad debts, Create 5% provision for bad debts and 2% provision for discount on debtors. Pass Journal entry for provision for discount on debtors and show how it will appear in the balance sheet.

Que. 7

Pass the necessary entries to make the following adjustment as on 31st Dec. 2015

1. Stock on 31st Dec. 2015 was ₹ 12,000.
2. Depreciation at 10% on furniture valued at ₹ 4,500 and machinery valued at ₹ 50,000.
3. Interest accrued on securities ₹ 650.
4. Bad debts during the year amounted to ₹ 450.
5. Unexpired insurance as on 31st Dec. 2015 was ₹ 290.
6. Salaries outstanding on 31st Dec., 2015 were ₹ 600.
7. Make provision for discount on debtors and creditors @ 2.5%. The debtors and creditors at the end of the year were ₹ 35,000 and ₹ 24,000.

BANK RECONCILIATION STATEMENT (BRS):

BRS is a Statement (not Account), which help us to know the causes of difference between balance as per bank column of cash book and pass book.

WHY BRS IS PREPARED?

Transaction	Entry in Bank's Books	Entry in our Books
1. Opened a bank account with Rs. 5,000/-	Cash A/c Dr. 5000 To Customers A/c 5000 (PB Bal.: 5000)	Bank A/c Dr. 5000 To cash A/c 5000 (CB Bal.: 5000)
2. Goods sold & cheque received Rs.2000/-	No Entry in Bank Books at time of receipt of cheque (PB Bal.: 5000)	Bank A/c Dr. 2000 To Sales A/c 2000 (CB Bal.: 7000)
3. Cash receipt of Rs. 500 at time of sales wrongly recorded in bank column	No Entry in Bank Books since its an error in CB (PB Bal.: 5000)	Bank A/c Dr. 500 To Sales A/c 500 (CB Bal.: 7500)

CASH BOOK INCREASE ↑	CASH BOOK DECREASE ↓
Cash Deposited in to bank	Cash withdrawal from bank
Cheque received (& or deposited)	Cheque issued
Bill Receivable discounted with bank	Due to Errors or Omission
Due to Errors or Omission	

RULE 1: DIRECT ENTRY IN PB EFFECT IN CASH BOOK IS PENDING

RULE 2: IF THERE IS AN ERROR / OMISSION IN CB RELATED TO CHEQUE, THEN EFFECT OF SUCH CHEQUE HAS BEEN CLEARED IN PB

PASS BOOK INCREASE ↑	PASS BOOK DECREASE ↓
Cash Deposited in to bank	Cash withdrawal from bank
Cheque received & cleared	Cheque issued & cleared
Bill Receivable discounted with bank	Any payment made by bank on behalf of customer
Any payment collected by bank	Any charges charged by Bank
Direct deposit by our customer into our bank	Due to Errors or Omission
Interest allowed by Bank	
Due to Errors or Omission	

✚ INTRODUCTION -BANK

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

✚ Activities undertaken by Bank

- 1) **Acceptance of Deposits:** Bank accepts various deposits like Term Deposits, Fixed Deposits, Current Deposit, Recurring Deposit, etc.
- 2) **Loans:** Lending of money is the major revenue earning activity for a Bank, e.g. Machinery Loan, Building Loan, Vehicle Loan, Personal Loan, etc.
- 3) **Discounting:** Discounting is a process by which the Bank enables its customer to receive the cash before the due date, in consideration of a small charge called Discount, e.g. Bills / Hundi / Pro-Note Discounting.
- 4) **Overdraft:** Bank allows overdrafts to its good customers so that they can make payment even when they do not have sufficient balance in their account at the Bank.
- 5) **Guarantee:** The Bank furnishes securities or guarantee for its customers whose credit is good. The Bank charges commission for this service.
- 6) **Letter of Credit:** Banks can issue Letter of Credit to facilitate commerce. LC Facility is used by businessmen to make payments to Suppliers, etc.
- 7) **Standing Instructions:** As per the instructions of the customer and on his behalf, a Bank makes payment to various parties on the due date, e.g. Telephone Bills, Insurance Premium, Credit Card Dues, etc.
- 8) **Demand Draft:** Banks issue Demand Draft based on its customer's request. Demand Draft is also called as Banker's Cheque, Pay Order, etc. in some cases.
- 9) **Travellers' Cheque:** For frequent travellers, to avoid the risk of carrying cash, the Bank can issue Travellers Cheque, which can be encashed by the traveller in a Bank at the destination.

✚ Bank Pass Book or Statement

- 1) Bank Pass Book (also known as Bank Statement), is an extract of the Ledger Account of the customer, as per the Bank's Books of Accounts.
- 2) It is a periodical statement of account in which all transactions, i.e. deposits and withdrawals made by the customer during the particular period is recorded.
- 3) A comparative analysis of the Bank Pass Book and Cash Book (Bank Column) is given below.

PASS BOOK FORMAT

Messers

in account with
State Bank of India

Date	Particulars	Withdrawals Dr. (Rs.)	Deposits Cr. (Rs.)	Dr. or Cr. (Rs.)	Balance (Rs.)

IMP POINTS:

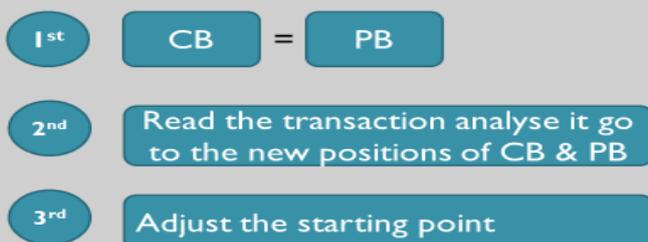
Point	In Bank Pass Book	In Cash Book of the Customer / Business Entity
Debit Entries in Bank Pass Book	<ul style="list-style-type: none"> Withdrawal of Cash, Payment of cheques to Creditors, Expenses, etc. Bank Interest, Commission and Charges for various services rendered by the Bank. Payment by Bank under Standing Instructions. 	These are recorded as "Payments" in the Cash Book, i.e. on the Credit Side of the Cash Book (Bank Column).
Credit Entries in Bank Pass Book	<ul style="list-style-type: none"> Deposit of Cash into Bank Receipt / Collection of cheques from Debtors, Other Incomes / Receipts, e.g. Interest, Dividend, Capital introduced, Loans taken, etc. Direct collection of Bills Receivable (B/R), Income on Investments, etc. by the Bank. 	These are recorded as "Receipts" in the Cash Book, i.e. on the debit side of the Cash Book (Bank Column).
Favourable Bank Balance	Credit Balance in the Bank Pass Book represents a favourable balance, i.e. Normal Balance.	Such favourable balance will normally appear in the Debit Side of Cash Book (Bank Column).
Overdraft Balance	Debit Balance in the Pass Book represents an unfavourable balance, i.e. Overdraft Balance.	Such overdraft balance will normally appear in the Credit Side of Cash Book (Bank Column).

BANK RECONCILIATION STATEMENT

- ✓ The bank pass book and bank columns of the cash book record the **same transactions**
- ✓ Of course in the pass book the transactions are recorded from the **point of view** of the **bank** whereas in cash book they are recorded from the point of view of the **client**. The bank balance as per pass book can therefore, be expected to be equal to the bank balance as revealed by the cash book.

- ✓ However, in **actual practice the two balances rarely agree** because of the **time lag** of a few days between the entries made by the firm in cash book and by the bank in the pass book.
- ✓ Thus a comparison is necessary to find out the items on account of which differences have arisen and a need to reconcile the two balances.
- ✓ Thus a bank reconciliation statement **is a statement which is prepared as on a particular date to reconcile the bank balance as per cash book with balance as per pass book by showing all causes of difference between the two.**

IMP STEPS IN BRS:



CAUSES OF DIFFERENCE BETWEEN BANK BALANCE SHOWN BY CASH BOOK AND BANK PASS BOOK:

1. Timing difference
2. Differences arises due to errors in recording entries

Causes of differences:

- i. Cheques issued but not presented for payment
- ii. Cheques deposited for collection but not yet collected
- iii. Bank charges not entered in the cash book
- iv. Interest credited or debited by bank not entered in the cash book:
- v. Direct collections on behalf of customers:
- vi. Direct payment by bank
- vii. Dishonour of cheques/bills
- viii. Cheques received and entered in the cash book but omitted to be deposited into the bank.
- ix. Errors
- x. Direct Payment in to bank by a customer
- xi. Bill collected by bank on behalf of customer
- xii. Bill Discounted with bank

Importance or significance of Bank Reconciliation statement:

- ✓ It highlights the **causes of difference** between the bank balance as per cash book and the balance as per pass book. Necessary adjustments can, therefore, be carried out at an early date.
- ✓ It reduces the **chance of fraud** by the staff dealing in cash.
- ✓ It acts as a **moral check** on the staff of the organization to keep the cash records always up to date.
- ✓ Bank balance as per cash book cannot be accepted as final unless it is supported by statement of passbook. When these two balances do not tally, reconciliation becomes **essential to determine the correct bank balance** that can be used while finalizing the accounts.
- ✓ It helps in finding out **actual position of the bank balance**.

Following is the table summarising in brief the timings of different transactions:

1	Payment done by the account holder through issuing a cheque	At the time of issuing the Cheque	At the time presenting the cheque to the bank for payment.
2	Receipt by the account holder through a cheque	At the time of depositing the cheque into the bank	At the time of collection of amount from the account of the issuing party.
3	Collection of bills/cheque directly on behalf of the account holder	When the entry is posted in the pass book.	When the amount is collected by the bank.
4	Direct payment to the third party on behalf of the account holder	When the entry is posted in the pass book	When the amount is paid by the bank
5	Dishonour of cheque/bills receivable.	When the entry is posted in the pass book	When the cheque is dishonoured.
6	Bank charges levied by the Bank	When the entry is posted in the pass book	When charges are levied by the bank
7	Interest and dividend credited by the bank	When the entry is posted in the pass book	When interest or dividend is allowed or collected by the bank.
8	Interest debited by the bank	When the entry is posted in the pass book	When interest is charged by the bank

✚ METHOD OF BANK RECONCILIATION STATEMENT:

- i. Without preparing adjusted cash book

ii. After preparing adjusted cash book

Bank Reconciliation Statement after the Preparation of adjusted Cash-Book

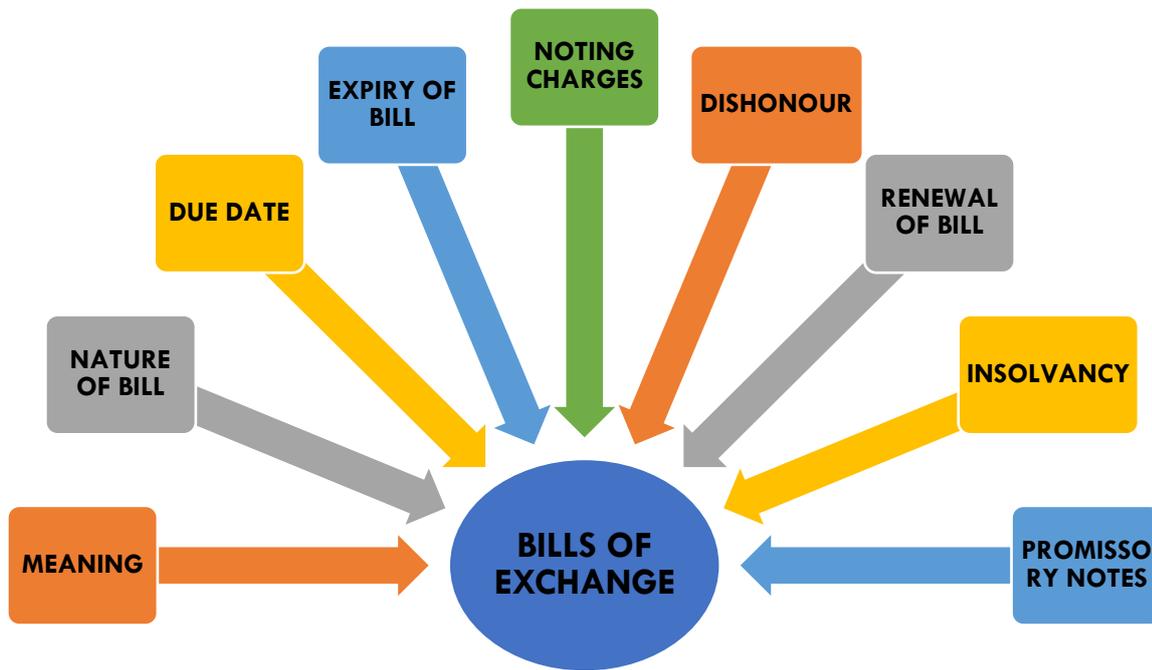
Meaning of adjusted cash book

When the balance in the cash book is first adjusted for certain adjustments before taking it to the bank reconciliation statement, then it is known as adjusted cash book balance. Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months. But if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

While adjusting the cash-book the following adjustments are considered:-

1. all the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/ undercasting of the balance etc.) and
2. omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonour of cheques/bills etc.) by the cash-book are taken into care Only these transactions are considered for adjusting cash book, apart from this delay in recording in the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.

Note: Errors occurring in the pass-book are not to be adjusted in the cash book. All the adjustments considered in the adjusted cash-book are not carried again to the bank reconciliation statement.



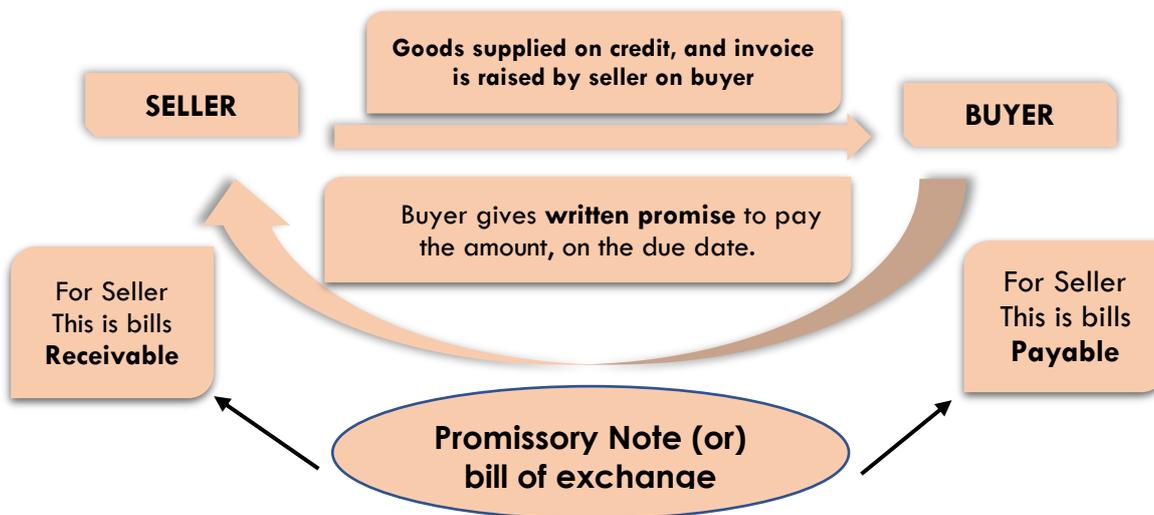
INTRODUCTION:

Commercial transactions are entered into on the basis of **written promise to pay definite sum** of money at definite point of time.

These written promises can **also be passed from one person to another**. (Negotiable Instruments or Bills of Exchanges)

These instruments are **means of creating credit**.

1. Promissory Note
2. Bills of Exchange
3. Cheque



✚ PROMISSORY NOTE

1. **Meaning:** As per section 4 of the instruments Act, 1881, a promissory note (P/N or pro – Note) is –

- An instrument in **writing** (not being a bank note or currency Note),
- Containing an **unconditional undertaking**,
- **Signed** by the maker,
- To pay a **certain sum of money** only,
- To, or **to the order of a certain or to the bearer** of the instrument

Note: A **promissory Note cannot be made payable to bearer**. Section 31 of the RBI Act, 1934, permits only RBI and central government to make a PROMISSORY NOTE payable to bearer on demand.

2. Features of a promissory Note:

- PROMISSORY NOTE must be in **writing**.
- Generally, the **consideration, place and date** of making need to be maintain on the PROMISSORY NOTE.
- A PROMISSORY NOTE **must contain an undertaking / promise** to pay. Mere acknowledgement of debt is not sufficient.
- The undertaking / **promise to pay should be unconditional and definite** (and not vague).
- PROMISSORY NOTE should be **signed by the maker** himself.
- PROMISSORY NOTE should **have specified the payee** in clear terms i.e. by name, son of, and resident of, etc. the payee can also be identified by description, e.g. a promissory note shall be made payable to the managing director of Ram industries Ltd.
- Sum** payable must be **certain or capable of being made certain**. Along with principle
- There must be a promise to pay **only money** and not other consideration.
- PROMISSORY NOTE must be **duly stamped and dated**. If the PROMISSORY NOTE is not dated, it is presumed to have been made on the date of its delivery.

Format of a promissory Note

Rs. 1,00,000 only	Mr. Harish, 30, MG Rd., Pune
Three Months after date, I promise to pay Krishna or his order, a sum of Rs. 1,00,000 only, for value received.	
To, Sri Krishna 13, New Street, Dwarka.	Signature of Mr. Harish Dated: 22 nd February 2014
<div style="border: 1px solid black; display: inline-block; padding: 5px 15px;">Stam</div>	

Note: Here, **maker** = Mr. Harish, **Payee** = Krishna.

BILLS OF EXCHANGE

1. **Meaning:** As per sec. 5 of the Negotiable Instruments Act, 1881, a Bill of Exchange (B/E) is –

- As instrument in **writing**,
- Containing as **unconditional order**,
- **Signed** by the Maker,
- **Directing** a certain person,
- To pay a certain sum of **money only**,
- To, or the order of a certain **person or to the bearer** of the instrument.

Note: when prepared by the Maker (i.e. seller of goods), it is called draft. Once it is accepted by the Acceptor (i.e. buyer of goods), it becomes a valid bill of exchange.

2. **Features of Bill of Exchange:**

- a) It must be in **writing**.
- b) It must be **dated**
- c) It must contain an **order** to pay. **Order** must be **unconditional**.
- d) It must be **dated**
- e) The instrument must be to pay **money only** and the amount of money payable must be **certain**.
- f) The party must **sign** the instrument.
- g) It must be properly **stamped** and all the three **parties** to a bill (i.e. drawer, drawee and Payee) must be specified with reasonable **certainty**.
- h) Payment must be in **legal currency** of the country

3. **Parties involved:**

- a) Person who **makes** the order is known as the **Drawer** (or maker), i.e. seller of goods.
- b) person who accepts the order is known as the **Acceptor / Drawee**, i.e. Buyer of goods.
- c) The person to whom the amount is payable is known as the **payee**. [**Note:** the drawer and payee may be the same person]

4. **Example:** Ram sold goods to Bahubali on credit for Rs. 50,000 on 1st January, payable after credit period of three months. On the same date, Ram draws a bill of exchange to be paid 3 months after date and sends the draft to Bahubali for acceptance. After Bahubali's acceptance, this draft becomes a valid bill of exchange (i.e. bills receivable for ram, and bills payable for Bahubali). In the following bill of exchange, ram is the **drawer**, Bahubali is the **Acceptor**, and Kattappa is the **payee**.

Format of a bill of exchange

Rs. 1,00,000
2009

Pune, 22nd February

Three Months after date pay to Kattappa or his order, a sum of Rs. 1,00,000 only, for value received.

To,

Accepted by me

Stamp

Sri Bahubali

43, Old Street, Madurai.

Signature of Bahubali

Signature of Ram

FOREIGN BILL

Sometimes, it may happen that a bill of exchange is **drawn for foreign trade operations**. Such a bill is known as “**Foreign Bill of Exchange**”.

A foreign bill of exchange is one which is **drawn in one country and is payable in another**.

It is generally **drawn up in triplicate** wherein each copy is sent by separate post so that at least one copy reaches the intended party. **Payment will be made only on one of the copies** and when such payment is made the other copies become useless.

Section 12 of the Negotiable Instruments Act provides that all instruments, which are not inland instrument, are foreign. **Examples** of foreign bills –

1. Bill of exchange in India on person resident **outside** India and made payable **outside** India.
2. Bill of exchange **Outside** India on a person resident **outside** India.
3. Bill of exchange **outside** India and made payable in India.
4. Bill of exchange **outside** India and made payable **outside** India.

POSSIBLE WAYS A DRAWER CAN DEAL WITH A BILL OF EXCHANGE:

After its acceptance, the drawer of the bill of exchange, has the following options,

	Treatment	Explanation
1.	Retention (HTM)	Drawer may retain the bill up to the date of maturity with him.
2.	Discounting with Bank	<ul style="list-style-type: none"> • Drawer may discount the bill his Bank, to get funds immediately. “Bank may levy Discounting Charge”
3.	Endorsement	Drawer may endorse the bill of exchange in favour of a third party (i.e. his own creditor), by signing on the back of the instrument. The person who endorses is called as the endorser , and the person so entitled to payment is called endorsee .
4.	Sent for collection	<ul style="list-style-type: none"> • For safety purposes, the drawer may deposit the bill of exchange with his bank with clear instruction that the bill of exchange should be retained till maturity, and should be realized on the due date. There is no discounting, only deposit of the bill with bank.

5	Pledge	Drawer may pledge the bill of exchange with any Bank or other party for taking a loan.
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✚ MATURITY DATE FOR PROMISSORY NOTE AND BILL OF EXCHANGE

1. **Maturity:** The maturity of a promissory note or bill of exchange is the **date on which it falls due.**
2. **Days of Grace:** In calculating the maturity of a PROMISSORY NOTE or a bill of exchange which is not payable on demand, at sight or on presentment, 3 days of grace shall be added to the date on which the instrument is expressed to be payable.
3. **Instrument entitled to days of grace:**
 - a) A Note or Bill payable on a specified date.
 - b) A Note or Bill payable after sight.
 - c) A Note or Bill payable after certain of time.
 - d) A Note or Bill payable after a certain period or after the happening of a certain event.
 - e) Where a Note or Bill is payable in installments, days of grace are allowed on each installment.
4. **Meaning of “At Sight”, “On presentment” and “After Sight”:**
 - a) In a PROMISSORY NOTE or bill of exchange, the expressions at “at sight” and “on presentment” mean, “**on demand**”.
 - b) In a PROMISSORY NOTE, the expression “after sight” means, **after** presentment for sight.
 - c) In a bill of exchange expression “after sight” means, **after acceptance**, or noting for non – acceptance or protest for non – acceptance.

5. Provisions as to calculation of maturity:

Payable After	Maturity is at -
Stated number of months – • After date, or • After sight, or • After a certain event.	<ul style="list-style-type: none"> • 3 days after the corresponding date of the stated number of months. Example: bill of exchange dated 30th August, is made payable 3 months after date. It matures on 3rd December. 3 days of grace is added.
A certain number of days – • After date, or	<ul style="list-style-type: none"> • It shall be at maturity on the 3rd day after the specified day. • While calculating the date at which a PROMISSORY NOTE or bill of exchange made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or of presentment for acceptance or sight, or of

<ul style="list-style-type: none"> • After sight, or • After a certain event. 	<p>protest for non – acceptance, or on which the event happens shall be excluded.</p>
<p>On a day when day of maturity is a public holiday.</p>	<ul style="list-style-type: none"> • Public holiday includes Sundays and any day declared by the central Government, by notification in the official gazette, to be a public holiday. • A PROMISSORY NOTE or bill of exchange which matures on a public holiday shall be deemed to fall due on the preceding business day, e.g. if a bill of exchange falls due on Sunday, it shall be deemed to be due in Saturday. • A bill of exchange which falls due on emergency holiday shall be deemed to be due on the next succeeding business day.

✚ DISHONOUR OF BILL OF EXCHANGE AND PAYMENT OF NOTING CHARGES

Dishonour: non – payment of bill of exchange on the due date is called **Dishonour**.

1. **Noting:** in case of Dishonour of a bill of exchange on the due date, the fact of Dishonour, and the causes of Dishonour should be ascertained and recorded on the bill of exchange itself. Otherwise, the Acceptor may prove that the bill of exchange was not properly presented to him on the due date hence can escape from his liability.
2. **Charges:** Noting charges refers to the fees paid to a public official known as “**Notary Public**”, who records the facts and causes of Dishonour of bill of exchange.
3. **Accounting:** Nothing charges is incurred by the person presenting the bill of exchange on the due date, and is recoverable from the person causing the Dishonour, i.e. the acceptor.

✚ RENEWAL OF BILL OF EXCHANGE

Reason for renewal	Accounting for renewal
<ul style="list-style-type: none"> • Sometimes, the Acceptor of a bill of exchange is unable to pay the amount on the due date. • In such case, the acceptor may request the drawer for an extension of time period. • This constitutes renewal of bill. 	<ul style="list-style-type: none"> • Old bill of exchange will be cancelled. So, the earlier journal entry relating to acceptance of old bill of exchange will be reversed. • Sometimes, the value of new bill of exchange = value of old bill of exchange + interest, if any.

✚ RETIREMENT OF BILL OF EXCHANGE

Reason for renewal	Accounting for renewal
<ul style="list-style-type: none"> • Sometimes, the Acceptor of a bill of exchange is ready to pay the amount, even before the due date. 	<ul style="list-style-type: none"> • Acceptor is entitled to receive certain interest or discount (called rebate) for making payment before the due date.

- | | |
|--|---|
| <ul style="list-style-type: none"> • So, the acceptor may request the payee, for setting the payment before due date. • This constitutes retirement of bill. | <ul style="list-style-type: none"> • This Rebate on bills retired before due date, constitutes income of Acceptor, and expense of payee. |
|--|---|

✚ ACCOMMODATION BILLS

1. Meaning:

- Generally, bill of exchange is drawn in support of a traded transaction, i.e. credit sales. However, bill of exchange can also be utilized for raising finance (i.e. without a trade transaction).
- When bill of exchange is used for financing purpose, it is called as Accommodation Bill. (Note: A Accommodation bill is also referred to as “Kite”)

2. Example:

- Assume Abhinav & Balram are in need of funds, say Rs. 3,00,000 and Rs. 2,00,000, temporarily in business (3 months).
- Both draw a bill of exchange on each other for Rs. 3,00,000 and Rs. 2,00,000 respectively, and discount the same with their respective bankers. (sometimes, a single bill of exchange may also be drawn by one party on the other and discounted with the bank, the proceeds will be shared by both parties in agreed ratio)
- On the respective due dates of the bill of exchange, both parties their respective dues to the bank.

✚ DEALING WITH INSOLVENCY OF DRAWEE

- Meaning:** Insolvency of the drawee means that will be unable to pay his liabilities. This means that bill accepted by him will be dishonoured on the due date.
- Accounting:** In the books of the drawer, the following journal entries have to be passed –

a) For dishonour of bills receivable	Drawee A/c Dr. To Bills Receivable A/c
b) For recording final amount, if any, received	Cash A/c Dr. (amount actually received) Bad debts A/c Dr. (Balancing figure) To Drawee A/c (Total Amount due)

JOURNAL ENTRIES ON THE BOOKS OF THE DRAWER.

	Transaction	Journal Entry
1.	Basic Trade transaction, if any, i.e. credit sales	Acceptor (Sundry debtors) A/c Dr. To sales A/c
2.	Bill accepted by debtor, and received by seller	Bills receivable A/c Dr. Discount A/c Dr. To Bills receivable A/c
3.	a) If bill retained till, maturity	No further journal entry till date of maturity.
	b) If bill discounted with bank	Bank A/c Dr.

		Discount A/c To bill receivable A/c	Dr.
	c) If bill endorsed in favour of another party (creditor)	Sundry creditors A/c To bills receivable A/c	Dr.
	d) If bill sent to bank for collection	Bill sent for collection A/c To Bills Receivable A/c	Dr.
4.	Payment received, i.e. Bill honoured		
	a) If bill retained till maturity	Cash/ Bank A/c To Bills Receivable A/c	Dr.
	b) If bill discounted with bank c) If bill endorsed in favour of another party (creditor)	No entry if bill honoured on maturity, since the bank / creditor will receive payment.	
	d) If bill sent to bank for collection	Bank A/c To bills sent for collection A/c	Dr.
5.	Payment not received, i.e. Bill Dishonoured		
	a) If bill retained till maturity	Acceptor A/c (Bill amount + Charges) To Bills Receivable A/c (bill amount) To cash / Bank (Noting Charges)	Dr.
	b) If bill discounted with bank	Acceptor A/c (Bill amount + Charges) To Bank A/c (bill amount+ Noting charges)	Dr.
	c) If bill endorsed in favour of another part (creditor)	Acceptor A/c (Bill amount + Charges) To creditor A/c (bill amount + Noting charge)	Dr.
	d) If bill sent to bank for collection	Acceptor A/c (Bill amount + Charges) To Bills sent for collection A/c To cash / Bank (Noting Charges)	Dr.
6.	Renewal of bill before its due date		
	a) Cancellation of old bill exchange	Acceptor A/c To Bills Receivable A/c	Dr.
	b) Recording Interest income for renewal / extension	Acceptor A/c To Interest Income A/c	Dr.
	c) Acceptance received for new bill of exchange (Note: sometimes, this new bill of exchange may be for the amount of old bill of exchange + interest thereon. In other cases, interest may be separately settled in cash by the Acceptor)	Bill Receivable A/c To Acceptor A/c	Dr.

7.	Retirement of bill under rebate, before due date	Cash / Bank A/c Rebate / interest on bills A/c To Bills receivable A/c	Dr.
8.	Insolvency of Drawee	This is similar to dishonour of bill of exchange. Amount due from acceptor has to be written off as bad debt , to the extent not recoverable.	

Note: In case of PROMISSORY NOTE, the above entries are recorded in the books of the maker of PROMISSORY NOTE.

✚ JOURNAL ENTRIES IN THE BOOKS OF THE DRAWEE / ACCEPTOR

	Transaction	Journal Entry	
1.	Basic Trade Transaction, if any, i.e. credit purchases	Purchases A/c Dr. To Drawer (sundry Debtors) A/c	
2.	Acceptance given for Bill exchange	Drawer A/c To Bills Payable A/c	Dr.
3.	If bill – (a) retained till maturity, or (b) discounted with bank, or (c) endorsed in favour of another party (creditor), or (d) sent to bank for collection, by drawer	No journal entry in the books of the drawee / Acceptor	
4.	Payment made, i.e. bill honoured on due date	Bills payable A/c To cash / Bank A/c	Dr.
5.	Payment not made, i.e. bill honoured on due date	Bills Payable A/c Noting Charges (expense) A/c Dr. To Drawer A/c	Dr.
6.	Renewal of bill before its due date		
	a) Cancellation of old bill of exchange	Bill payable A/c To Drawer A/c	Dr.
	b) Recording interest income for renewal / extension	Interest expense A/c Dr. To drawer A/c	
	c) Acceptance given for new bill of exchange (Note: sometimes, this new bill of exchange may be for the amount of old bill of exchange + interest thereon. In other cases, interest may be separately settled in cash by the	Drawer A/c Payable A/c	Dr. To Bills

	acceptor)	
7.	Retirement of bill under rebate, before due date	Bills payable A/c (full amount) Dr. To cash / Bank A/c (net amount paid) To Rebate / Interest Income (Rebate)
8.	Insolvency of drawee	
	a) For non-payment of bill	Bills payable A/c Dr. Noting Charges (expense) A/c Dr. To drawer A/c
	b) Final settlement, if any, made to drawer	Drawer A/c (Total amount due) Dr. To cash / Bank / (amount finally settled) To deficiency A/c (amount not paid)

✚ **BILLS RECEIVABLE BOOK AND BILLS PAYABLE BOOK**

Point	Bills Receivable Book	Bills Payable Book
Purpose	To record all the bills received from debtors	To record all the bills issued to the creditors
Dishonour	Dishonour of bill of exchange shall be recorded	Dishonoured of bill of exchange shall be recorded

CONSIGNMENT

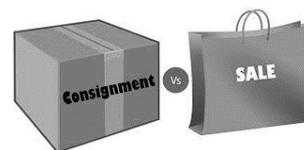
- ✓ **Meaning:** To consign means “to send”. Consignment refers to a Situation where a person (Called Consignor), **SENDS goods to consignee** for the **purpose of selling** the goods on behalf of, and at the risk of the Consignor.
- ✓ **In Accounting,** the term “consignment account” relates to accounts dealing with a situation where one person (or firm) sends goods to another person (or firm) on the basis that the **goods will be sold on behalf of and at the risk of the Consignor.**
- ✓ **Parties: (2 Parties)**
 - **Consignor:** The person sending the goods — also called as **Principal.**
 - **Consignee:** The person to whom the goods are sent — also called as **Agent.**
- ✓ **Example:** Harish of Akola sent 100 Mobile phone sets at Rs. 5,000 each, on consignment basis to Ritesh of Pune, on the agreement that Ritesh should sell them in Pune, on Harish’s behalf.



Features of a Consignment transaction

- a **Goods:** Goods sent under consignment agreement are called “Goods Sent on Consignment”.
- b **Ownership:** Though the goods are actually sold by the Consignee, the ownership of the goods, till it is sold, will remain with the Consignor only. However, on sale by Consignee, the Buyer will become the owner.
- c **Proforma Invoice:** The Consignor does not send a Sales Invoice to the Consignee. Instead, he will send a **Proforma Invoice**, which is a statement that looks like invoice. Proforma Invoice is sent to convey the information about the goods consigned.
- d **Expenses of Sale:** Generally, expenses relating to consignment incurred by Consignee will be recovered from the Consignor. However, such Expenses can be shared, by **mutual agreement** between the parties.
- e **Advance Money:** Usually, the Consignee gives an advance to the Consignor in the form of Cash or Bill of Exchange. This Advance Money will be adjusted against the sale proceeds of the goods.
- f **Commission:** The Consignee is entitled to a Commission, which is calculated on the basis of Gross Sales made by him.

- g **Bad Debts:** Generally, the Consignee will **not** be responsible for Bad Debts. If the Consignee is to be made responsible for Bad Debts, he shall be paid an extra commission called **Del-Credere Commission**. This Commission is calculated on the Total Sales, and not merely on the Credit Sales.
- h **Account Sales:** The Consignee sends a periodic statement of account, to the Consignor. This Statement is called Account Sales. This Statement contains details of—
- (i) Sales made by the Consignee,
 - (ii) Expenses incurred on behalf of the Consignor (and reimbursable to the Consignee),
 - (iii) Commission earned by the Consignee,
 - (iv) Unsold Stock, if any, left with the Consignee, and
 - (v) Net Balance due to / due from the Consignor.



✚ Consignment and Sale

Basis	Consignment	Sale
1) Parties	Consignor and Consignee.	Seller , and Buyer .
2) Ownership of Goods	Ownership remains with Consignor till goods are sold. (no transfer of ownership to the Consignee.	Ownership of goods will be transferred to the Buyer immediately upon sale.
3) Risk	Risk of loss or damage of goods lies with the Consignor only.	Risk of loss of goods lies with the Buyer once the goods are sold.
4) Return of Goods	Consignee can return the unsold goods to the Consignor.	Generally, Buyer cannot return goods once it is sold to him.
5) Relationship between Parties	Principal – Agent relationship . Consignor = Principal. Consignee = Agent.	Creditor – Debtor relationship Seller = Creditor (in Buyer's Books). Buyer = Debtor (in Seller's Books).
6) Expenses	Expenses are borne by the Consignor.	After sales, the expenses are borne by Buyer.
7) Invoice	A Proforma Invoice is prepared.	Original Sale Invoice is prepared.

✚ Commissions in a Consignment Transaction

There are three types of Commission paid by the Consignor to the Consignee for the services rendered —

1) Ordinary Commission or Normal Commission	<ul style="list-style-type: none"> • It is computed at a fixed percentage of Gross Sales Proceeds made by the Consignee. • There is no distinction between a Cash Sale and a Credit Sale for computing the Ordinary Commission. • The Normal Commission constitutes the remuneration of the Consignee, for the agency services rendered by him.
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	<ul style="list-style-type: none"> When only Normal Commission is paid, the Consignor bears the risk of Bad Debts.
2) Del Credere Commission	<ul style="list-style-type: none"> To increase sales and to encourage the Consignee, the Consignor provides an additional commission known as Del-Credere Commission. When Del-Credere Commission is paid, the Consignee bears the risk of Bad Debts. Del-Credere Commission is calculated on Total Sales, unless there is any agreement between the parties, to calculate it on Credit Sales only.
3) Over-riding Commission	<ul style="list-style-type: none"> It is an extra commission paid by the Consignor – (a) to promote sales at a higher price than specified, or (b) to encourage the Consignee to put in extra efforts in introducing the new product in the market. Depending on the agreement, such Commission will be calculated on Total Sales or on the difference between Actual Sales and Sales at Invoice Price.

✚ Valuation of stock with consignee:

- Stock should be valued at **Cost or Net Realizable Value, whichever is lower.**
- Calculation of Cost:** All Cost incurred till the goods reach the premises of the Consignee must be taken into account. So, for the purposes of Consignment Stock Valuation

Cost of Goods sent by Consignor	+	Proportionate Direct Expenses incurred by Consignor	+	Proportionate Direct (Non-Recurring) Expenses incurred by Consignor
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- Goods are valued on the well accepted principle of “Cost or Net Realisable Value whichever is lower”. The word ‘Cost’ is interpreted as cost inclusive of proportionate non – recurring expenses e.g. loading charges, freight, transit insurance, unloading charges, custom duty. All the expenses incurred by the consignor are of this nature. However, consignee incurs recurring as well as non – recurring expenses. Recurring expenses are incurred while the consignment is being disposed off and these expenses do not increase the valuation of goods e.g. Godown Rent, Advertisement, Salaries of salesman, Office expenses etc.

∴ Stock valuation = Cost Price + Proportionate expenses of consignor + Proportionate non-recurring expenses of consignee.

When goods are invoiced by the consignor at inflated price, it is usual to first value the stock at Invoice Price + Proportionate expenses of consignor + proportionate non- recurring expenses of consignee. In this case it is necessary to account for loading on stock with consignee separately.

4. Other Points:

- When goods are **invoiced above cost**, Closing Stock should first be valued including loading, i.e. Profit element. Thereafter, the loading thereon must be reversed by creating Stock Reserve.

- (b) **Indirect Expenses** incurred by Consignor, e.g. Discount on B/R, other expenses not related to sending the goods, etc. should not be considered in Stock Valuation.
- (c) Expenses incurred **after** the goods have reached the Consignee's Godown should **not** be taken account for Stock Valuation.
- (d) Commission Due to Consignee and Bad Debts, should **not** be included for Stock Valuation.
- (e) If the question is silent, al Expenses incurred by Consignor will be included for Stock Valuation, and all Expenses incurred by the Consignee will be excluded.

✚ Non recurring expenses

Sr. No.	Consignor's (All expenses related to sending of goods are treated as non-recurring)	Sr. No.	Consignee's (Expenses incurred for bringing Stock to the expenses present location and condition are only considered as non-recurring expenses)
1.	Packing charges	1.	Freight (consignment sent by consignor on freight to pay basis)
2.	Freight paid	2.	Unloading charges
3.	Transit insurance	3.	Clearance charges
4.	Loading charges	4.	Custom Duty, Octroi Duty
		5.	Transportation to godown

VALUATION OF GOODS IN TRANSIT:

If consignment goods are in transit, the valuation is done like stock with consignee. However, this stock valuation will include consignor's proportionate expenses only. Consignee's expenses are not attributable to goods in transit. Hence consignee's proportionate non-recurring expenses are not included in valuation of goods in transit.

TREATMENT OF NORMAL AND ABNORMAL LOSS:

- i. **Normal Loss:** Loss which is inherent or unavoidable or beyond control is 'Normal Loss', e.g. conversion of coal into dust, evaporation of liquids, normal leakage etc.

As the loss is uncontrollable and of a recurring nature, it is treated as consignment loss. While calculating the cost of the stock on hand, the cost of normal loss should be spread on goods sold as well as on stock e.g. 10,000 litres. Of chemical is consigned @ Rs. 25 per litre, freight being Rs. 5,000. Suppose a normal wastage is 100 litres, if the quantity unsold at the end of the year is 1980 litres, the valuation of stock will be

$$\frac{\text{Rs. } 2,50,000 + \text{Rs. } 5,000}{10,000 \text{ ltrs.} - 100 \text{ ltrs.}} \times 1980 \text{ Litres.}$$

$$= \frac{\text{Rs. } 2,55,000}{9,900 \text{ ltrs.}} \times 1980 \text{ Litres.} = \text{Rs. } 51,000$$

Thus normal loss affects stock valuation. Separate accounting entry to account for normal loss is not required.

ii. **Abnormal Loss:** A loss which could have been avoided or which is within the control or would have been reduced is known as 'Abnormal Loss'. This loss is accidental or may arise due to carelessness e.g. theft of goods, goods destroyed or damaged by fire, goods damaged due to bad packing.

As the losses are controllable and of a non-recurring nature, it is treated as abnormal loss and written off to Profit and Loss Account directly. In other words, such loss neither affects the value of goods nor the profit on consignment.

iii. Valuation of Abnormal Loss:

Particulars	Rs.
Cost of the goods lost due to Abnormal Loss	Xxxx
Add : Proportionate expenses of Consignor	<u>Xxxx</u>
Sub-total	Xxxx
Add: Proportionate non-recurring expenses of Consignee (If abnormal loss occurs at consignee's end)	Xxxx
Value of Abnormal Loss	Xxxx

Accounting Entries:

1. Valuation of abnormal loss:

Abnormal Loss A/c. Dr

To Consignment A/c.

(Cost + Proportionate non-recurring expenses attributed thereto)

2. Sale of damaged goods/settlement of claim from insurance Co. or Transporter

Bank A/c. Dr

To Abnormal Loss A/c

3. Transfer of un-recouped loss

Profit and Loss A/c Dr

To Abnormal Loss A/c

Note: If goods are lost in transit, consignee's expenses are not attributable thereto and hence consignee's proportionate non-recurring expenses are not considered for valuation of loss in transit.

Journal Entries in the books of the Consignor

	Transaction	Journal Entry
1)	Goods sent on Consignment	Consignment Account Dr. To Goods sent on Consignment A/c
2)	Expenses incurred by Consignor, for goods sent on Consignment (e.g. Transportation, Insurance, etc.)	Consignment Account Dr. To Cash / Bank
3)	Advance given by Consignee, by way of	Cash / Bank / Bill Receivable A/c

	Cash or Cheque or Bill of Exchange	Dr. To Consignee A/c
4)	Bills Receivable given by Consignee, discounted with Bank	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c
5)	Expenses incurred by the Consignee on behalf of Consignor (e.g. Unloading, Advertisement)	Consignment A/c Dr. To Consignee A/c
6)	Goods sold by the Consignee (as per Account Sales received from him)	Consignee A/c Dr. To Consignment A/c
7)	Commission on sales due to Consignee	Consignment A/c Dr. To Consignee A/c
8)	Bad Debts as per Account Sales reported by Consignee (This Entry is not applicable if the Consignee himself bears the risk of Bad Debts, i.e. if Del Credere Commission paid)	Consignment A/c Dr. To Consignee A/c
9)	Goods received back from the Consignee	Goods Sent on Consignment A/c Dr. To Consignment A/c
10)	Goods taken over by Consignee or goods lost through Consignee's negligence, and is chargeable to him	Consignee's A/c Dr. To Consignment A/c
11)	Closing Stock lying with the Consignee	Consignment Stock A/c Dr. To Consignment A/c
12)	Sundry Debtors, if any, at the end of the period	Consignment Debtors A/c Dr. To Consignment A/c
13)	Profit from Consignment transfer to P&L A/c	Consignment A/c Dr. To Profit and Loss A/c
14)	Loss from Consignment, if any, transfer to P&L A/c	Profit and Loss A/c Dr. To consignment A/c
15)	Remittance received from Consignee along with Account sales	Cash / Bank / Bill Receivable A/c Dr. To Consignee A/c
16)	Removal of loading on Goods sent on Consignment (applicable only when goods are invoiced above cost)	Goods sent on Consignment A/c Dr. To Consignment A/c
17)	Removal of loading on Closing Stock (applicable only when goods are invoiced above cost)	Consignment A/c Dr. To Stock Reserve A/c
18)	Goods sent on Consignment A/c – balance	Goods sent on Consignment A/c Dr.

transferred to Trading Account	To Trading A/c
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✚ Format of Consignment Account

Dr.		Consignment Account		Cr.
Particulars	Rs.	Particulars	Rs.	
To Goods sent on Consignment A/c		By Consignee A/c (Sale Proceeds)		
To Bank (Expenses of the Consignor)		By Consignment Stock A/c		
To Consignee A/c (Expenses of Consignee)		By Goods sent on Consignment (Reversal of loading on Goods sent)		
To Consignee A/c (Commission due)		By Abnormal Loss, if any		
To Stock Reserve (reversal loading on stock)		By Profit & Loss A/c (Loss, if any)		
To Profit & Loss A/c (Profit)				
Total		Total		

✚ Journal Entries in the books of the Consignee:

	Transaction	Journal Entry
1)	Advance sent as Cash / Cheque / Bill of Exchange	Consignor A/c Dr. To Cash / Bank / Bills Payable A/c
2)	Expenses incurred by Consignee	Consignor A/c Dr. To Cash / Bank A/c
3)	Own Acceptance (B/P) honoured on due date	Bills Payable A/c Dr. To Cash / Bank A/c
4)	Sales made on Consignment Basis	Cash / Bank / Sundry Debtors A/c Dr. To Consignor A/c
5)	Bad Debts (if borne by Consignor)	Consignor A/c Dr. To Sundry Debtors A/c
6)	Bad Debts (if borne by Consignee, for Del-Credere Commission)	Bad Debts (Expense) A/c Dr. To Sundry Debtors A/c
7)	Commission earned by Consignee	Consignor A/c Dr. To Commission Income A/c
8)	Final settlement amount paid to Consignor	Consignor A/c Dr. To Cash / Bank A/c

Meaning — Joint Venture

- 1) Joint venture refers to an agreement whereby two or more persons undertake a **specified activity** / particular venture (e.g. construction of a building, sale of crackers during Deepavali season) and to share the profits and losses in an agreed ratio.
- 2) Joint Venture is a **temporary** / short-term agreement between two or more persons, for limited / specific purpose, without the use of the Firm Name.
- 3) The persons carrying out the venture are called as **CO-Ventures**.

Features of Joint Venture

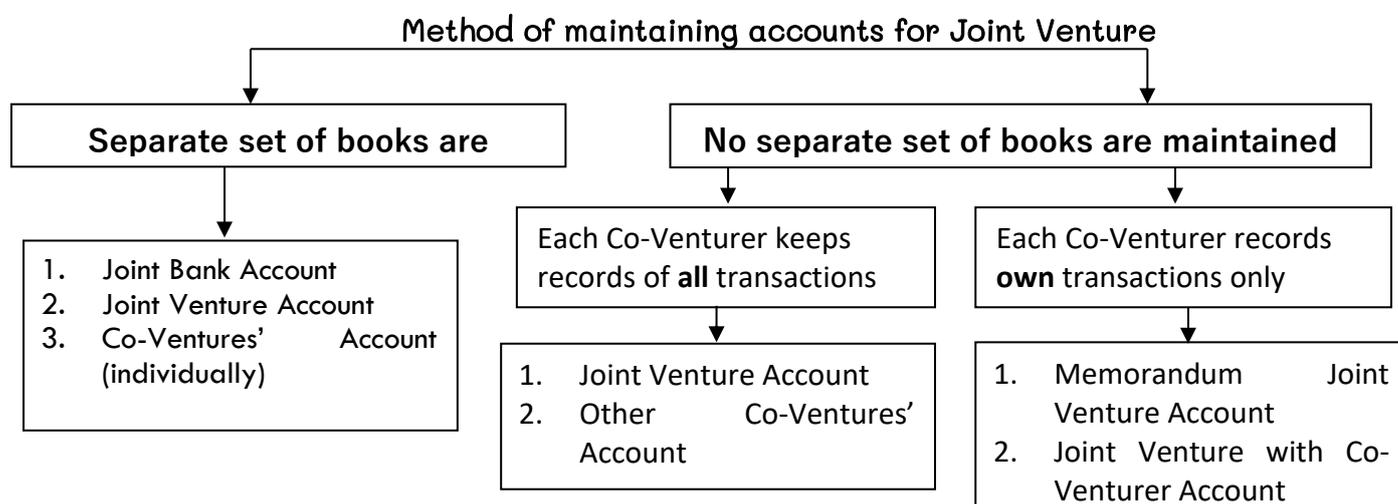
- 1) Co-Venturers join together to execute a **specific activity** / particular purpose.
- 2) Co-Venturers **share the profit / loss** of the venture at an agreed ratio. If there is no agreement, it is assumed that they share the profit / loss equally.
- 3) Co-Venturers **contribute funds** and / or supply stock / goods for running the venture.
- 4) Once the activity / venture is completed, e.g. construction of building, the relationship among the Co-Venturers automatically gets terminated. Hence, Joint venture is referred to as **special purpose partnership**.
- 5) Joint Venture is generally for a **short duration** and has a **definite life**.
- 6) Going Concern Assumption is **not appropriate** for Joint Venture accounting.
- 7) The question of **Capital-Revenue Distinction does not arise** in Joint Venture, and hence all Fixed Assets used on the Venture are charged as Cost. The Disposal Value / Revised Value at the end of the Venture is regarded as Revenue of the Venture.

Joint Venture and Partnership

Particulars	Joint Venture	Partnership
1) Purpose	It is for a specific activity / venture.	It is not limited to a specific venture.
2) Life	It has a definite life. Once the venture is complete, the relationship among the Co-Venturers gets terminated.	It is an ongoing activity. The Partnership continues till the Members decide to wind up the same, e.g. Partnership at Will.
3) Members	Members are called Co-Venturers.	Members are individually called Partners, and collectively called Firm.
4) Governing Law	There is no specific statute for Joint Venture activities.	Partnership Firms are governed by the Indian Partnership Act, 1932.
5) Name	There is no need for Firm Name.	A Partnership Firm has a specific Firm Name

6) Competing Business	Co-Venturers may carry on the same business in their own individual capacity also.	Partners cannot do the same business in their individual capacity, i.e. competing business not permissible.
7) Books of Accounts	There is no need for a separate set of books. The accounts can be maintained even in one of the Co-Venture's books itself.	Separate set of books have to be maintained for the Firm.
8) Ascertainin g Profit / Loss	Profit / Loss shall be ascertained at the end of specific venture (if the venture is for a short period) or on interim basis, i.e. annually if the venture is for a longer period	Profit / Loss of the business is ascertained on annual basis.
9) Admission of minor	Minor, being incompetent to contract, cannot be admitted as a Co-Venturer.	A Minor can be admitted to the benefits / Profits of the Firm.
10) Accounting	Accounting for Joint Venture is done on liquidation basis.	Accounting for Partnership is done on going concern basis.

Method of maintaining accounts in respect of Joint Venture.



A. Journal Entries when separate set of books are maintained for JV.

When separate set of books are maintained for Joint Ventures, three major accounts are prepared –

		To Co-Venturers' A/c (Co-Venturers' Share)
2)	Loss on Joint Venture	Co-Venturers' A/c (Others' Share) Dr. Profit & Loss A/c (Own Share) Dr. To Joint Venture A/c
D.	Final Settlement	
1)	Payment of Final Settlement due to Co-Venturer	Co-Venturers' A/c Dr. To Bank A/c
2)	Receipt of Final Settlement due from Co-Venturer	Bank A/c Dr. To Co-Venturers' A/c

In the above case, the following accounts are prepared –

Account	Description
Joint Venture Account	<ul style="list-style-type: none"> This is a Nominal Account prepared for ascertaining the profit / loss out of Joint Venture. All Expenses are debited and all Sales / Revenues / Collections will be credited to this A/c. Profit / Loss will be transferred – (a) to Own P&L A/c (Own Share), and (b) to Other Co-Venturers' A/c for their respective shares.
Co-Venturers' Account	<ul style="list-style-type: none"> It is a Personal Account. This Account is – (a) credited for all contribution of money, stock, etc. made by Other Co-Venturers, their share of JV Profit, and (b) debited in case of sale proceeds directly received by them. This Account is closed on completion of Joint Venture, by paying or receiving the net amount due to / from the other Co-Venturer.

Illustrations 2: Each Co-Venturer records all transactions

Navin and Nagin entered into a joint venture with a condition to share profits and losses in the proportion of 3:2. They undertook the subscription of 1,00,000 equity shares of Rs. 10 each at par in public and agreed to pay all the expenses upto the allotment. The company accepted to issue other [other than 1,00,000 shares to be issued to public] 4,000 shares at par as underwriter's commission.

The details of the expenses paid by both the partners are as under:

Items of Expenses	Paid by Navin	Paid by Nagin
Registration Fees	Rs. 3,000	-----
Solicitor's fees	—	Rs. 1,000
Stationery and Printing	Rs. 1,500	-----
Office Rent	Rs. 2,000	-----
Salary to staff	—	Rs. 1,500

Postage	—	Rs. 500
Advertisement expenses	Rs. 7,500	Rs. 5,200

When the subscription list was closed, it was found that share applications for 90,000 shares only were received from the public. The shares not subscribed by the public were purchased by the joint venturers. For this purpose Navin paid 60% money of necessary amount and Nagin paid the remaining amount. The company issued 4,000 shares in consideration of underwriter's commission as agreed upon.

Navin sold 10,000 shares at a price of Rs. 11 each and Nagin sold the remaining shares at a price of Rs. 12 each. The co-venturers are entitled to get commission at the rate of 10% on the sale proceeds of the shares realised by them. The joint venture business was closed on completion of underwriting work. Both the partners settled their accounts.

From the above information, prepare:

- In the books of Navin:
(1) Joint Venture Account and (2) Nagin's Account
- In the books of Nagin:
(1) Joint Venture Account and (2) Navin's Account

C. SCHEME OF JOURNAL ENTRIES WHEN NO SEPARATE BOOKS ARE MAINTAINED FOR JV

[Each Co-Venturer records his own transaction]

	Transaction	Journal Entry
1)	Supply of Materials / Stock from own stores for Joint Venture purpose	Joint Venture with (Co-Venturer's Name) Dr. To Purchases A/c
2)	Expenses of Joint Venture met from own Bank	Joint Venture with A/c Dr. To Bank A/c
3)	Sale Proceeds or Revenue of JV received	Bank A/c Dr. To Joint Venture with A/c
4)	Own share of Profit on Venture (ascertained by preparing Memorandum Joint Venture A/c)	Joint Venture with A/c (Own Share) Dr. To Profit & Loss A/c (Own Share)
5)	Own share of Loss on Venture (ascertained by preparing Memorandum Joint Venture A/c)	Profit & Loss A/c (Own Share) Dr. To Joint Venture with A/c
6)	Payment of Final Settlement due to Co-Venturer	Joint Venture with A/c Dr. To Bank A/c
7)	Receipt of Final Settlement due from Co-Venturer	Bank A/c Dr. To Joint Venture with A/c

In the above case, the following accounts are prepared –

Account	Description
Joint Venture Account	<ul style="list-style-type: none"> This Account is – (a) debited for al stock supplied, expenses incurred, and share of losses, if any, on the JV, and (b) credited with sale proceeds received, and share of profits. This Account is closed on completion of Joint Venture, by paying or receiving the net amount due to / from the other Co-Venturer.
Joint Venture Account	<ul style="list-style-type: none"> This is a Nominal Account prepared for ascertaining the profit / loss out of Joint Venture. All Expenses are debited and all Sales / Revenues / Collections will be credited to this A/c. Such posting will be done on memorandum basis, i.e. without any contra entry. Profit / Loss will be distributed to Co-Venturers Account in the agreed ratio.

- When each Co-Venturer keeps record of his own transactions only, the Memorandum JV A/c should be prepared in order to ascertain profit / loss on the venture.

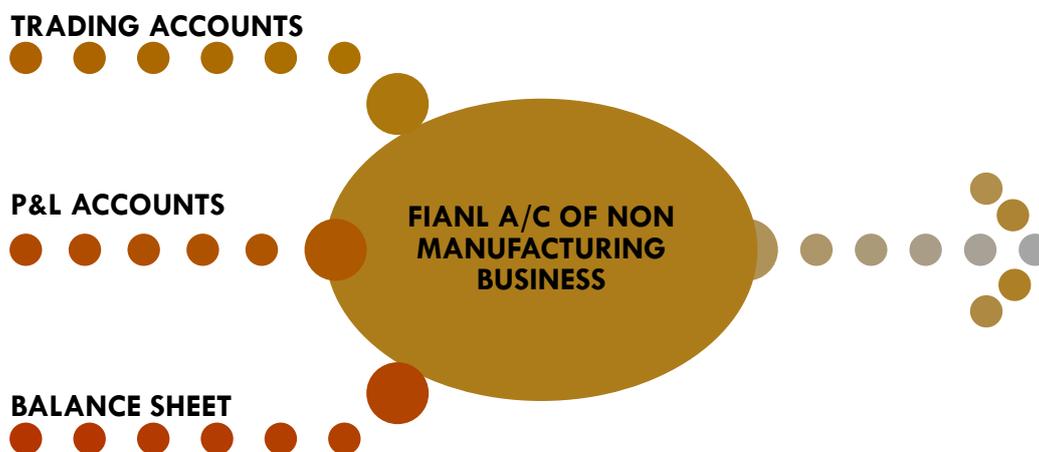
Illustration 3: Each Co-Venturer records all transactions

Hari, an architect and Ram, a real estate dealer entered into an agreement for the purpose of purchasing a large land and converting it into plots. The purchase price (Rs. 1,60,000) and the legal expenses (Rs. 11,100) are paid by Hari, who borrowed the money from bank.-

Ram provides the materials costing Rs. 58,000 for the levelling of land and the development of plots. 10 plots of 200 sq. mts. each and 5 plots of 400 sq. mts each are sold respectively @ Rs. 75 per sq. mt. and @ Rs. 70 per sq. mt. The sales proceeds of 5 plots of 200 sq. mts. each are received by Ram. The balance is received by Hari, who paid Rs. 15,000 for sales expenses. Hari repaid the loan and interest thereon amounting to Rs. 9,600. The agreement provides that after crediting Hari with interest charged on the borrowed money and allowing 15% on the cost of the levelling to cover over-head expenses, Hari is to receive two-third of the profit and Ram one-third.

Each party's ledger contains records of his own receipts and payments on the Joint account. You are required to prepare.

- (a) A statement showing the result of ventures i.e. Memoranda Joint Venture Account
The accounts of the venture in each parties ledgers as it will finally appear



FINANCIAL STATEMENTS

Meaning of Financial Statements

1. **Financial Statements** (also called General Purpose Financial Statements) consist of the following –

- (a) Statement of Performance – Profit and Loss Account,
- (b) Statement of Financial Position – Balance Sheet,
- (c) Statement of Movement of Funds – Funds Flow and Cash Flow Statement.

2. **Meaning:** The above terms are explained below –

Item	Description
(a) Statement of Performance	<ul style="list-style-type: none"> • This Statement / Account shows the result of operations, i.e. Profit or Loss of the Entity for the period. • It is also called “Performance Statement”, or “Income Statement”. • Income Statement consists of – (i) Manufacturing Account, (ii) Trading Account, and (iii) Profit and Loss Account. • For Not – for –Profit Entities, it is referred as “Income and Expenditure Account”.
(b) Statement of Financial Position	<ul style="list-style-type: none"> • This Statement (not an Account) shows the financial position, i.e. Assets and Liabilities of the entity as on a particular date. • It is also “Position Statement”, or “Balance Sheet”.
	<ul style="list-style-type: none"> • These Statements (Funds Flow and Cash Flow Statements) are prepared in the case of Corporate Entities, for better understanding of financial position.

4. Freight Inwards	These are the expenses incurred to bring the material to the Firm's godown and make them available for use. This expenditure may be known by different names like Transportation, Carriage Inwards, Cartage and Coolie, Loading & Unloading, etc.	Debit in Trading Account.
5. Wages	Wages paid to workers in Godown / Stores- Revenue Expenditure, should be debited to Trading A/c.	Debit in Trading Account.
6. Sales	Total Sales made (Cash and Credit) during the period, should be credited to the Trading Account.	Credit in Trading Account.
7. Sales Returns	Amount of goods returned by the Customers is reduced from the Sales Amount.	Subtract from Sales on Cr. Side.
8. Closing Stock	Goods that are unsold at the last day of the accounting period is posted to the credit of the Trading Account. [Note: Refer to alternative accounting treatments in respect of Closing Stock.]	Credit in Trading Account
9. Abnormal Loss	Value of Abnormal Loss of goods, if any, is credited to Trading Account. Net Loss (after deducting Insurance Claim receivable, if any) is debited to the Profit and Loss Account. Note: Abnormal Loss can also be credited / adjusted against Purchase A/c. In such case, it will not be separately credited in Trading A/c.	Credit in Trading Account.
10. Goods and Services Tax (GST)	GST (on Sales) is an indirect tax, collected by the Seller from his customers on Sales made to them. The amount so collected is paid to the Government. There are two methods of recognizing GST in the Financial Statements, i.e. – (a) Inclusive Method , where Sales and Purchases are shown inclusive of GST thereon, and (b) Exclusive Method , where Sales and Purchases are shown net of GST thereon.	Considered under two alternative methods.
11. Gross Profit / Loss	It is the balancing figure in the Trading Account, which is transferred to the Profit and Loss Account.	GP on Dr. Side. Gross Loss, if any, on Cr. Side

Closing Entries for Trading Account

	Transaction	Journal Entry	Remarks
1.	Transfer of Purchase Returns (i.e. Returns Outwards) to Purchases	Purchase Returns A/c Dr. To Purchases A/c	In Trading Account, Purchases & Purchase Returns are shown in inner

Trading A/c	Trading A/c.	Trading A/c, since Purchases A/c is already adjusted .
Treatment in Balance Sheet	Closing Stock is shown on the Assets Side of the Balance Sheet, under "Current Assets".	Closing Stock is shown on the Assets Side of the Balance Sheet, under "Current Assets".

Notes:

1. Method 1 (crediting Trading A/c separately) is generally adopted by most entities.
2. Under Method 2, Opening Stock will also be transferred to Purchases Account, by passing the journal entry "Dr. Purchase A/c, and Cr. Opening Stock A/c". Hence, the value of Purchases in such cases will effectively reflect the Cost of Goods Sold during the period.

Significance of Trading Account

1. The Trading Account shows the surplus of the Sale Value over the Cost of Goods Sold. This is called as the **Gross Profit**. Since the Gross Profit is the basic indicator of business profitability, the preparation of the Trading Account assumes significance.
2. $\text{Gross Profit Ratio} = \text{Gross Profit} \div \text{Sales}$. A fall in the GP Ratio requires investigation and prompt corrective action. Hence, the preparation of Trading Account is useful for analyzing the GP Ratio.

PROFIT AND LOSS ACCOUNT

1. The Profit and Loss Account shows the net result of operations, i.e. Profit or Loss during the period.
2. From the Gross Profit, the other expenses (i.e. Administrative, Selling and Distribution, Financing, Losses, Provisions, etc.) are deducted and the Net Profit / Loss is arrived at.
3. The P & L Account should facilitate the user to make informed decisions. Hence, too much information loading is not warranted. Wherever necessary, separate supporting schedules in respect of various expenses may be added.
4. Capital Expenditure and Personal Expenditure should **not** be debited to this account. However, a suitable share of Deferred Revenue Expenditure written off is debited.
5. Care should be taken to adjust expenses for prepaid / unpaid items. Incomes should also be suitably adjusted for amounts not yet received / amounts received in advance.

Format of Profit and Loss Account

Profit and Loss Account of for the year ended

Particulars	Rs.	Particulars	Rs.
To Gross Loss, if any, b/d from Trading A/c		By Gross Profit b/d from Trading A/c	
To Administrative Expenses (individually)		By Other Income items	
To Selling & Distribution Expenses (individually)		By Net Loss, if any, transferred to Capital A/c	

To Financing Expenses (individually)			
To Depreciation			
To Other Items, Adjustments & Provisions			
To Income Tax			
To Net Profit, transferred to Capital A/c			

Note: For examples in respect of the above items in P & L A/c, refer next question.

Items in Profit and Loss Account

	Item	Examples	
1.	Administrative Expenses	<ul style="list-style-type: none"> Salaries of General Office Staff, Executives, etc. Rent, Rates and Insurance for Office Premises, Lighting and Electricity in Office, Printing and Stationery, Postage and Telegrams, Repairs & Maintenance of Office Building / Furniture, 	<ul style="list-style-type: none"> Telephone & Mobile Phone Expenses, Books and Periodicals, Legal Expenses (of revenue nature), Audit Fees, etc.
2.	Selling and Distribution Expenses	<ul style="list-style-type: none"> Salesmen Salaries and Commission, Agents' and Dealers' Commission, Advertising, Publicity and Sales Promotion, Insurance of Finished Goods Stock and Goods – in – Transit, Fuel, Repairs and Maintenance of Delivery Vans, Vehicles, etc. 	<ul style="list-style-type: none"> Carriage / Freight outwards, / Cartage on Sales, Warehousing Expenses, Packing and Forwarding (on Sales), Export Duties, if any, Bad Debts, etc.
3.	Financing Expenses	<ul style="list-style-type: none"> Interest paid on Term Loans, Working Capital Loans, Unsecured Loans, etc. Discount on Bills Discounted with Bank. Discount Allowed to Customers (Cash Discount for early payment by Customers.) 	
4.	Depreciation	Depreciation on various assets is generally shown as a separate line item in the P & L A/c. But, Depreciation on Machinery only,	

		is taken to Manufacturing A/c, if separately given.
5.	Other Items, Adjustments & Provisions	Adjustments and write – offs in respect of Goodwill, Preliminary Expenses, portion of Deferred Revenue Expenditure, etc. Provision for Bad and Doubtful Debts, Provision for Discount Allowed to Debtors, Provision for Repairs and Renewals, etc. Items like Loss on Sale of Fixed Assets / Investments, Loss (net of Insurance Claim) in respect of abnormally lost goods, etc.
6.	Other Income	<ul style="list-style-type: none"> • Rent from Properties and Buildings let – out, or sub – let, etc. • Interest on Investments in Fixed Deposits, Government Securities, • Dividend from Shares, Mutual Funds, etc. • Profit / Gain on Sale of Fixed Assets (or) Investments, • Discount and Rebate Received from Suppliers / Creditors, • Sale of Old Newspapers, Junk Materials, etc. • Bad Debts Recovered, if any, • Income from specific activities, like Consignment, Joint Venture, etc.

Closing Entries for Profit and Loss Account

SN	Transaction	Journal Entry	Remarks
1.	Transfer of Gross Profit from Trading A/c	Trading A/c Dr. To Profit & Loss A/c	The amount of GP is written on the Credit Side of the P & L A/c.
2.	Transfer of Gross Loss, if any, from Trading A/c	Profit & Loss A/c Dr. To Trading A/c	Gross Loss, if any, is written on the Debit Side of the P & L A/c.
3.	Transfer of Indirect Expenses to P & L A/c	Profit & Loss A/c Dr. To Various Expense A/cs individually	Each Expense is shown as a separate line item. However, if the items of expenses are numerous, a separate supporting schedule may be prepared.
4.	Transfer of Indirect Incomes to P & L A/c	Indirect Incomes A/c Dr. To Profit & Loss A/c	Each Income is shown as separate line item in the P & L A/c.
5.	Transfer of Net Profit from P & L A/c to Capital A/c	Profit & Loss A/c Dr. To Capital A/c	If Cr. Side Total > Dr. Side Total, the difference is called Net Profit.
6.	Transfer of Net Loss,	Capital A/c Dr.	If Dr. Side Total > Cr. Side

if any, from P & L A/c to Capital A/c	To Profit & Loss A/c	Total, the difference is called Net Loss.
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Profit and Loss Appropriation Account

1. Appropriation of Profit means utilizations of profit for specified purposes.
2. P & L Appropriation A/c is that segment / portion of the P & L Account wherein the **appropriations** of profit, are expressed, e.g. Transfer to Reserves, Excess Provisions, Dividends, etc.
3. In this account, in addition to the balance of profits brought forward from the previous period, the current year profits / losses are also shown.
4. Appropriation of Profits, e.g. Transfer to Reserves, Interest on Capital, Salaries of Partners or for payment of Dividends in case of a Company, are shown herein.
5. The Closing balance is transferred to Capital Account in case of Sole Proprietor and Partnership Businesses. However, in case of Company, the unappropriated balance is carried forward to the following year and is shown in the Balance Sheet under the head "Reserves and Surplus".

Above the line and Below the line items

Above the Line	Below the Line
It is the segment of the P & L Account wherein the Net Profit or Loss is determined after – (a) crediting all the Revenues, Gains and Profits, and (b) debiting all the expenses and working charges attributable to the period.	It is the segment of the P & L Account wherein the adjustments, appropriations, utilizations of profit are expressed, e.g. Transfer to Reserves, Excess Provisions, Dividend, etc.
The Manufacturing, Trading and Profit and Loss Account constitute the " above the line " segment.	The Profit and Loss Appropriation Account and P & L Adjustment account, if any, constitute the " below the line " segment.
Provision is a necessary charge against Revenue, & is hence shown "above the line".	Reserve is an appropriation of Profit, hence shown "below the line".

BALANCE SHEET

Format of Balance Sheet

1. **Meaning:** The Balance Sheet is a statement of financial position which sets out the Assets and Liabilities of an enterprise as at a certain date.
2. **Features:**
 - (a) Assets on the Right Hand Side (RHS) & Liabilities on the Left Hand Side (LHS) B/S
 - (b) It is prepared as at a particular date, (not for a period) So, it is a Position Statement,
 - (c) It will be meaningful only when it is accompanied by the Profit and Loss Account
 - (d) Balance Sheet is not an account, its two sides represent Liabilities and Assets
 - (e) The Balance Sheet represents the confirmation of the basic accounting equation

- (f) Balance Sheet shows only result of all transactions, i.e. the balances of accounts
- (g) Ledger Account Balances of all Personal & Real Accounts will flow into Balance Sheet.

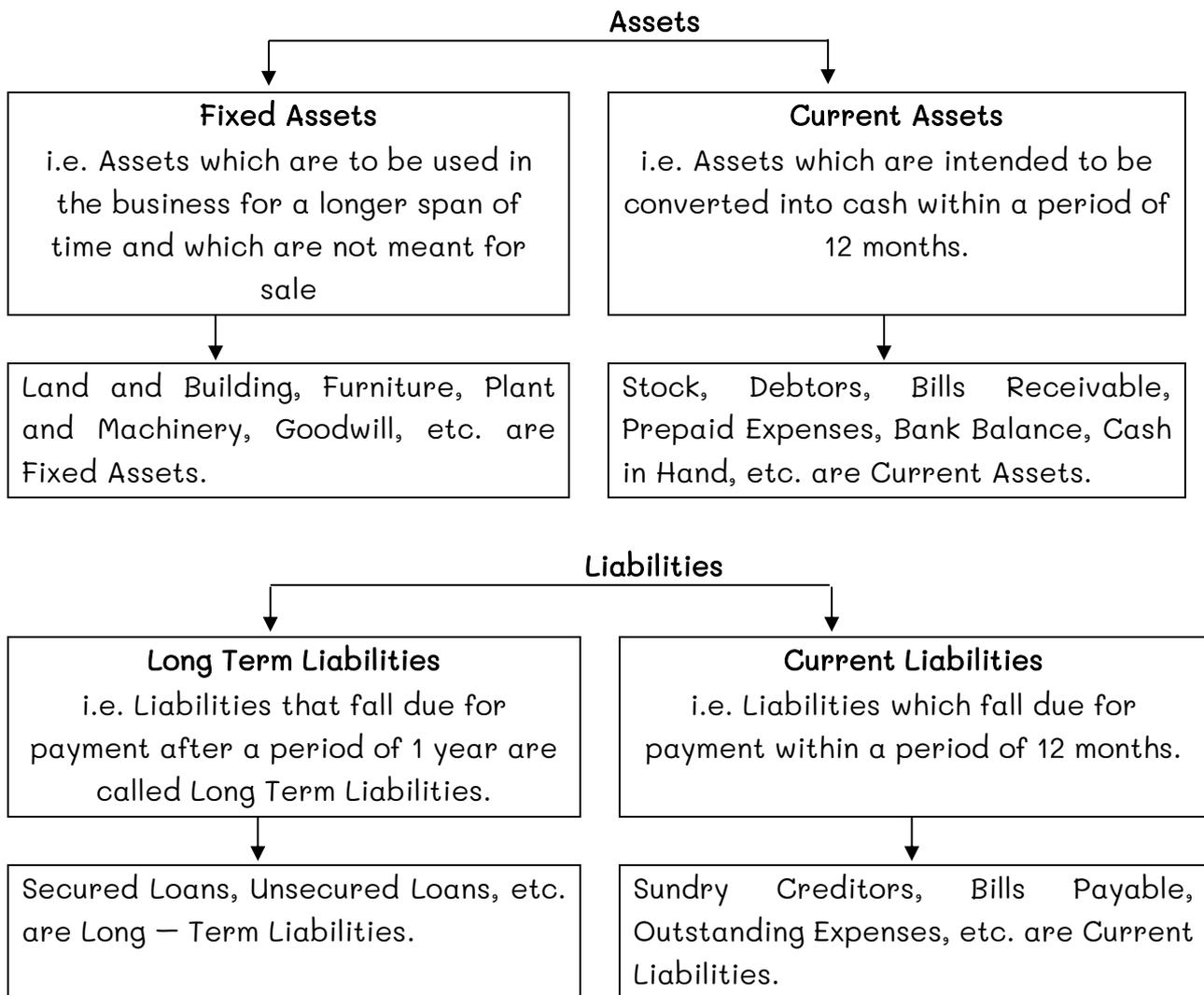
3. **Format:** The Format / Ruling of the Balance Sheet is as under –

Balance Sheet of as at

Liabilities	Rs.	Assets	Rs.
Capital Loans: Secured Unsecured Current Liabilities: Sundry Creditors Outstanding Expenses		Fixed Assets (Net Block, i.e. after depreciation) Investments , (if any) Current Assets: Stock Debtors B/R, Cash at Bank, Cash in Hand	
Total		Total	

Note: Though the LHS is titled as “Liabilities” Side, in effect, it represents “Capital (i.e. Equity) + Liabilities”.

Assets and Liabilities



Limitations of Financial Statements

- Historical Costs not Current Values:** Fixed Assets appear in the Balance Sheet at Historical Cost less Depreciation till date. A conventional Balance Sheet cannot give the correct value or current market value of such assets.
- Intangible Assets:** Intangible Assets appear in the Balance Sheet at Book Values, which has no relationship with the market values. Further, certain intangible strengths like loyalty and caliber (talent) of the Employees and Officers, are not reflected at all.
- Inflation:** Since only Historical Costs / Book Values are shown in Balance Sheet, it may not guide the readers properly in inflationary conditions.
- Assets vs Asset Side Items:** Balance Sheet may show some Asset – side Items like Preliminary Expenses, Debenture Discount, Deferred Revenue Expenditure, etc. which have **no market value**. These Fictitious Assets unnecessarily increase the total value of the Assets.
- Estimated Position:** Values of most Current Assets are found from **estimates**, and hence the Balance Sheet does not present the true financial position of the business.
- Different Accounting Policies:** Different accounting policies followed by management of the entity, e.g. depreciation, writing off Goodwill, Deferred Revenue Expenditure, etc. may not promote comparability of Financial Statements.

MANUFACTURING ACCOUNT

FORMAT OF MANUFACTURING ACCOUNT

Manufacturing Account of..... for the year ended

Particulars	Rs.	Particulars	Rs.
To Materials Consumed:		By Net Factory Cost of production,	
Opening Stock of Raw Materials		transferred to Trading A/c (bal. fig.)	
Add: Purchases of Raw Materials		By NRV / Sale Value of By – Products,	
		if any.	
Sub – Total			
Less: Closing Stock of Raw Materials			
Net balance = Materials Consumed			
To Direct Manufacturing Wages			
To Direct Expenses, if any			
Sub – Total Prime Cost			
To Production Overheads			
Sub – Total Gross Factory Cost			
Add: Opening Stock of WIP			
Less: Closing Stock of WIP			
Total		Total	

Trading Account is prepared as under in this case:

TRADING ACCOUNT OF..... FOR THE YEAR ENDED.....

Particulars	Rs.	Particulars	Rs.
To Opening Stock of Finished Goods		By Sales	
To Manufacturing Account, i.e. Cost of Production		By Closing Stock of Finished Goods	
To Gross Profit c/d to P & L Account			
Total		Total	

Significance of Manufacturing Account

1. Meaning:

- The Manufacturing Account shows the total cost of manufacturing the finished products, with appropriate details and classifications of **Cost**.
- The debits to this account consist of the Cost of Materials Consumed, Manufacturing Wages and Expenses incurred directly or indirectly on manufacture.
- This Account is relevant only for Manufacturing Entities, and is not applicable for Trading Entities.

2. Purposes:

- This Account provides details of Factory Cost and facilitates **reconciliation** of Financial Books with Cost Records.
- It also serves as a basis of **comparison** of manufacturing operations from year to year.
- Separate Columns provided for **Quantity and Values**, will enable the entity to ascertain the cost of production per unit of the production.
- It may be useful to have a **column for percentage** in the Manufacturing A/c showing the cost of each item as a percentage of the total.
- Where the output is carried to the Trading A/c at above cost, e.g. market prices, the Manufacturing Account discloses the Profit or Loss on manufacture, which is transferred to P & L A/c. this will be used to fix the amount of production or **profit sharing bonus** when such schemes are in force. [**Note:** In such cases, there is a necessity to reverse the unrealized profit on goods not yet sold, by creating Stock Reserve.]

Items in Manufacturing Account

Item	Explanation	Treatment
1. Materials Consumed	Cost of Raw Materials Consumed during the period = Opening Stock of Raw Materials Add: Purchases of Raw Materials Less: Closing Stock of Raw Materials	Debit in M/F Account
	Wages paid to workers engaged in production	Debit in M/F

2. Direct Wages	process, (i.e. in Factory Departments) is debited to the Manufacturing Account.	Account
3. Direct Expenses	<ul style="list-style-type: none"> • Direct Manufacturing Expenses are costs, other than Materials and Wages, which are incurred for a specific product / service. • Examples: (a) Royalty for use of licence / technology, (b) Hire Charges of Plant / Equipment, if based on units produced. 	Debit in M/F Account
4. Prime Cost	Prime Cost (or Direct Cost) = Raw Materials Consumed + Direct Wages + Direct Expenses.	Sub – Total in Dr. Side.
5. Indirect M/F Expenses	<ul style="list-style-type: none"> • These are called Factory Overheads / Production Overheads / Works Overheads / Manufacturing Overheads, etc. • It is the total Indirect Costs (Indirect Materials + Indirect Labour + Indirect Expenses) which cannot be linked directly to units produced. • Examples: Factory, Rent, Rates & Insurance, Depreciation on Machinery, Supervisor's Salary, Consumables like Oils, Lubricants, etc. 	Debit in M/F Account
6. By –Product Revenues	<ul style="list-style-type: none"> • By – Product is an incidental product, arising during the production operations, having some saleable value. • Examples: Molasses is the by – product in sugar manufacturing. • Net Realizable Value of By – Product is credited to Manufacturing A/c. 	Credit in M/F Account
7. Factory Cost	<p>It is the Net Cost of Production as shown by Manufacturing A/c, and is computed as under –</p> <p>Prime Cost (as per 4 above)</p> <p>Add: Production Overheads (as per 5 above)</p> <p>Add: Opening Stock of Work-in-Progress</p> <p>Less: Closing Stock of Work-in –Progress</p> <p>Less: NRV of By-Products, if any.</p> <p>Net Factory Cost</p>	Balancing Figure in Manufacturing Account, and is transferred to Trading Account.

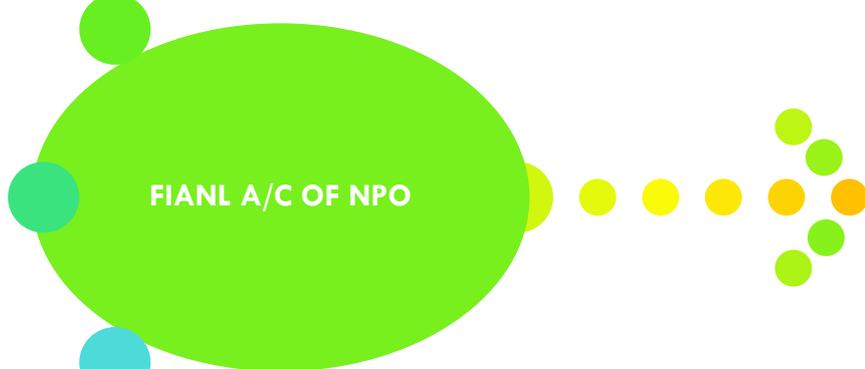
RECEIPT & PAYMENT A/C



INCOME & EXP. A/C



BALANCE SHEET



NOT FOR PROFIT ORGANIZATIONS

Introduction

- Meaning:** Organizations which are managed and run **without the motive of making profits** are called as Non – Profit Organizations / Not – For – Profit Organizations (NPOs). [It may be noted that such Organizations **may incidentally have a Surplus** from their activities, but their objective / motive is not to earn such Surplus.]
- Examples:** Clubs, Charitable Institutions, Schools, Colleges, Chambers of Commerce, Associations of Manufacturers or Traders of different lines, Sports Associations, Professional Institutions, Trusts, Trade Unions, etc. operate for the benefit of Members and other and are not run with profit motive.
- Final Statements:** Final Statements of NPOs consist of –
 - Receipts & Payments A/c:** To highlight the Total Receipts and Total Payments
 - Income & Expenditure A/c:** To show **expenditure incurred & income generated during** period. (If Income > Expenditure **Surplus**, otherwise **Deficit**).
 - Balance Sheet:** To show the financial position at the end of the period, in terms of Assets and Liabilities.

RECEIPTS AND PAYMENTS ACCOUNT

- Meaning:** Receipts & Payments A/c is a classified summary of Cash Receipts and Payments for a certain period, together with the Cash Balances at the beginning and close of the period.
- Features:**
 - Receipts are entered on the Left Hand Side and Payments on the Right Hand Side, i.e. same sides as those on which they appear in Cash Book.
 - All Receipts and Payments, irrespective of whether they are **Revenue or Capital** in nature, are recorded.

- (c) It includes all Receipts and Payments **during the period**, irrespective of whether it is related to current, past or future periods under accrual concept.
 - (d) The Account starts with the Opening Cash and Bank Balances, and also ends with their Closing Balances.
 - (e) This Account is usually **not recorded as part of the Double Entry System**.
 - (f) **Surplus or Deficit cannot be ascertained** from this Account, since it shows only cash position, and excludes all non – cash items, accrual items, etc.
3. **Use:** The Receipts and Payments Account is **useful for analysis**, only if the activities of the NPO are **simple and modest**, and involve no carry over from one period to the next and it has no asset, apart from Cash Balance and no Liabilities.
4. **Limitations:**
- (a) Increase in Cash and Bank Balances at the end of the year, as compared to those in beginning, does **not truly represent the Surplus** for the year. It does not recognize items such as Outstanding Incomes / Expenses, Income / Expenditure in Advance, etc.
 - (b) **No Matching / Accrual:** To ascertain whether a year's Current Income is sufficient to meet the Current Expenses, the Receipts & Payments Account is not useful, since it indicates items relating to all periods.

INCOME AND EXPENDITURE ACCOUNT

1. **Meaning:** Income and Expenditure A/c is **similar to P&L A/c** of trading / business entities. Report the Surplus or Deficit from their activities / operations during the period.
2. **Principles:** Is prepared by following **accounting principles** relating to—(a) **Accrual**, (b) **Matching**, (c) **Periodicity**, (d) **Capital Revenue distinction, etc.**
3. **Features:**
 - (a) Is a **Revenue A/C** prepared, to find out Surplus or Deficit for period
 - (b) It is prepared by **matching** Expenses for that period, against the Revenue of that period.
 - (c) **Both Cash and Non–Cash** Items (Depreciation, Amortization, etc.) and considered.
 - (d) **Only Revenue nature** items are considered, and Capital items are not considered.
 - (e) **Only Current Period** Income and Expenses are considered, after adjusting for Prepaid and Unpaid Expenses, Income Receivable and Received in Advance.
 - (f) **Surplus need not be reflected** as an Increase in Cash and Bank Balances, it could be represented by Increase in Other Assets or Decrease in Liabilities, if any.
4. **Income Items:**
 - (a) **Subscriptions** (subject to adjustments for Subscriptions Receivable and Subscriptions received in Advance, at the beginning and at the end of the accounting year),
 - (b) **Revenue donations** (for revenue purposes, for meeting revenue expenditure, etc.),
 - (c) **Membership Fees** or **Entrance Fees**,
 - (d) Recurring **Revenue Grants** from Local Authorities, Other External Agencies,
 - (e) **Income** from **Investments**,
 - (f) **Net Incomes from special activities**, e.g. Special Shows, Sale of Match Tickets, Annual Day or Founders' Day, etc.

Note: Expenditures are deducted from the Collections of that activity and Net Amount

is shown in the Income and Expenditure A/c (However, if such Income is to be credited to a Special Purpose Fund, e.g. "Building Fund", it shall be credited to that Fund itself.)

5. **Expenses Items:** Incomes generated by the NPO are spent for meeting its expenses, e.g. to promote its objectives, serving the members, and regular administrative expenses. Some expenses are peculiar to the nature of the institution concerned. Examples are –
- (a) **Hospitals** – Medicines, Cost of Tests and Investigations, Specialist Fees, etc.
 - (b) **Sports Club** – Sports Materials, Tournament Expenses, etc.
 - (c) **Drama Club** – Expenses of Staging Plays, Rent of Hall, Payment to Artists, etc.
 - (d) **Educational Societies** – Award of Scholarships, Seminar / Event Management Expenses, etc.
 - (e) **Library Societies** – Newspapers and Magazines, Books purchased, etc.

RECEIPTS & PAYMENTS A/CS INCOME & EXPENDITURE A/C

Basis	Receipts & Payments A/c	Income & Expenditure A/c
1. Similarity	Summary of Cash Book .	Similar to Profit and Loss Account .
2. Balances	Shows both Opening and Closing Balance of Cash in Hand and Balance at Bank.	There is no Opening Balance in this account. This account discloses only either Surplus or Deficit for the period.
3. Revenue / Capital difference	Both Revenue and Capital items are shown.	Here, only revenue items are shown.
4. Period covered	All Receipts and Payments which have taken place during the period are shown. Accruals & Outstanding are not considered here.	All Revenue Expenses and Incomes related to the current year , are shown whether expense has been paid or is outstanding or income is received or accrued.
5. Accrual Adjustments	Accrual Adjustments are not shown in this account.	All adjustments for Prepaid and Unpaid Expenses, Income Receivable and Received in Advance, are show.
6. Debit / Credit items	Debit Side: Receipts Credit Side: Payments	Debit Side: Expenditure Credit Side: Incomes
7. Independence	Receipts and Payments can be analysed on a standalone basis.	Income & Expenditure A/c is accompanied by the Balance Sheet .
8. Cash / Accrual	Only cash transactions are recorded in this Account.	Both Cash and Credit / Accrual transactions are recorded in this A/C
9. Reserves and Provisions	Any Reserve or Provision is not created in this account.	All Reserves & Provisions created during the year show in this

		Account, e.g. Provision for Deprecation.
10. Carry Forward of balance	Closing Balance of this Account becomes Opening Balance of Cash and Bank in the next year .	Closing Balance of this Account is added to or deducted from the Capital Fund .
11. Carry Over to B/s	Closing Balances of Cash and Bank are shown in B/S.	Surplus / Deficit from Income & Expenditure Account is carried to B/S.

IMPORTANT ITEMS

1. **Entrance fees:** This may be treated either as Capital Receipt or as Revenue Income, as discussed under –

(a) **Capital:** Entrance Fees/ Admission Fees payable by a Member on admission to a Club or Society are normally considered as Capital Receipts creditable to Capital Fund. This is because these do not give rise to any special obligation towards the Member who is entitled to the same privileges as other Members, who have paid only their annual subscription.

(b) **Revenue:** However, where the amount is small, and is meant to cover expenses concerning admission, or the Rules of the Society provided that such Fees could be treated as Income, these amounts may be credited to the Income and Expenditure Account.

2. **Donations:** Donations are treated either as Capital or Revenue, as discussed below –

Purpose of Donation	Treatment
For meeting Revenue Expenditure, e.g. Sports Day, Annual Day.	Credit to Income & Expenditure A/c
For meeting Capital Expenditure, e.g. purchase of Library Books.	Credit to Capital Fund
For meeting specific purpose as declared by Donors, e.g. Prizes.	Credit to Special Fund, e.g. Prize Fund

Note: In case of Donations – in – Kind, i.e. Gift / Transfer of a Security or other Asset / Equipment, the value of such asset should be credited to the Fund for which it has been donated. Sometimes, legal requirements may stipulate that such amounts should be simultaneously transferred to the Special Fund by raising a debit of an equivalent amount in the Income and Expenditure Account. Sometimes, such assets may be recorded at a Nominal Value say Rs.1, for control purpose.

3. **Life Membership Fees:** In case of lumpsum Subscription collected from Life Members, one of the following methods can be adopted –

- (a) **Retained in Special Account:** The entire amount may be carried forward in a Special Account until the Member dies, same may be transferred to the credit of the Accumulated Fund / Capital Fund.
- (b) **Accrued Income Trf. to I&E:** An amount equal to the normal Annual Subscription may be transferred every year to the Income and Expenditure Account and the balance carried forward in the Special Account, till it is exhausted. If the Life Member dies before the whole of the amount paid by him has been transferred in this way, the balance shall be transferred to the Accumulated Fund / Capital Fund, on the date of his death.
- (c) **Life Based Transfer:** An amount, calculated according to the age and average life expectancy of the Member, may be annually transferred to the credit of Income and Expenditure Account.
4. **Income from Investments:** Income by way of Interest on Investments, Rents from Properties, etc. should be recognized on accrual basis. Hence, Income to be credited to Income & Expenditure should be computed in the same manner as stipulated for Subscription Income, in **Item 1** above.
5. **Activity Related Receipts / Collections:** Where there are receipts relating to some special activities / events, e.g. Sale of Drama Tickets, Sale of Match Tickets, etc. and Expenses are incurred thereon, the **Net Income** (i.e. Collections less Expenses) may be shown on the Credit Side of Income and Expenditure Account. (**Note:** If there is a Net Expenditure (i.e. Expenses > Collections, it will be shown on the Debit Side.)
6. **Surplus from Sale to Members:** In case of Sale of Items like Provisions, Medicines (in Hospitals), etc. at a profit to Members, the Net Surplus, (i.e. excess of Sale Collections over Cost of Goods Sold) shall be credited to the Income and Expenditure A/c. [**Note:** Alternatively, the Revenues and COGS may be shown separately on the Credit and Debit Side respectively.
7. **Receipt – based Items:** Items of Income which are accounted on receipts basis (e.g. Sale of Old Newspaper) and for which no adjustments are necessary, are directly posted to the credit of Income and Expenditure A/c.
8. **Gain on Sale of Assets / Investments:** Gain, if any, on Sale of Fixed Assets, Investments, etc. is also credited to the Income and Expenditure A/c.
9. **Payment – based items:** Items of Expense which are accounted on payment basis, and for which no adjustments are necessary, are directly posted to the debit of Income and Expenditure A/c.

BALANCE SHEET OF NON – PROFIT ORGANIZATIONS

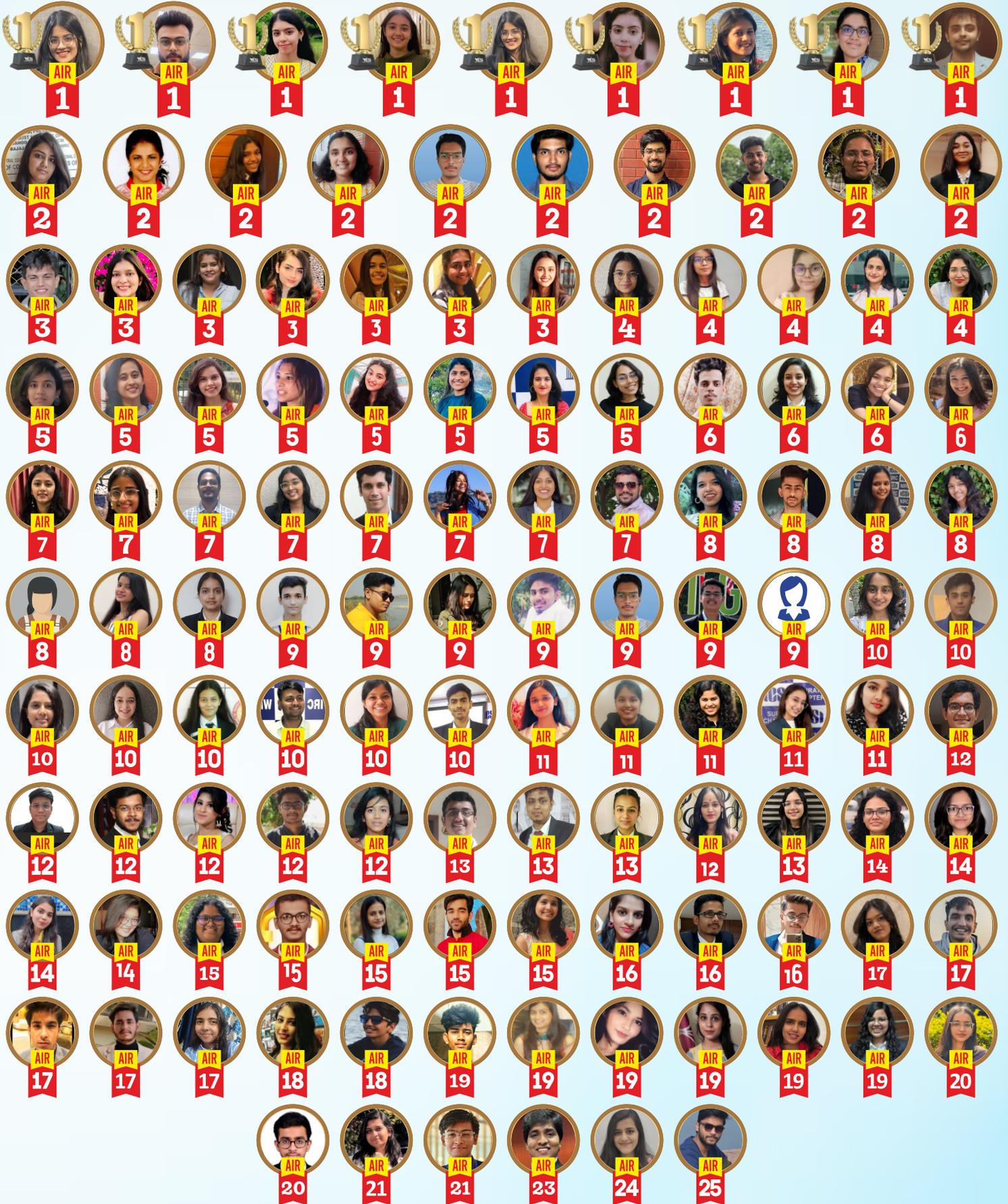
- The Balance Sheet includes Fixed and Current Assets, External Liabilities and the Capital Fund or / Accumulated Fund.
- **Capital Fund:** The Capital Fund represents the amount contributed by Members. If Members have not contributed any amount, it is preferable to use the term “**Accumulated Fund**”. The balance of Income and Expenditure Account, i.e. Surplus or Deficit, is transferred to the Accumulated /Capital Fund Account.

BALANCE SHEET PROCEDURE

1. **Opening Balance Sheet:** Opening Balance of Accumulated Fund or Capital Fund of the NPO, can be obtained by preparing the Opening Balance Sheet, and computing the Net Assets, i.e. Assets Less External Liabilities. All accruals during the preceding year such as Income received in Advance, Prepaid Expenses, Income Accrued, etc. are taken into account while preparing the Opening Balance Sheet.
2. **Fixed Assets:**
 - (a) Assets appearing in previous Balance Sheet should be adjusted for – (i) Addition, (ii) Sale and Wearing Out / disposals, and (iii) Depreciation during the year.
 - (b) New Assets acquired (for which payments are recorded in the Receipts and Payments A/c) will be included in the Balance Sheet. Depreciation should be properly provided, including for those Assets newly acquired.
 - (c) If a part or whole of an asset has been sold, the Capital Profit / Loss if any, is credited / debited in the Income and Expenditure A/c.
3. **Current Assets:**
 - (a) Outstanding and Prepaid Expenses and Income Received in Advance, Subscriptions, etc. pertaining to the current year will be shown in the Balance Sheet.
 - (b) Closing Balance of Cash in Hand and at Bank (as per Receipts & Payments A/c) should be properly recorded in the Assets side of the Balance Sheet.
4. **Liabilities:** Previous year’s Liabilities should be adjusted for payments made, and extra liabilities, i.e. new Loans taken, etc. should be recorded in the Closing Balance Sheet.
5. **Fund Accounts:** Special Capital Receipts as shown by Receipts and Payments Account will be shown in the Balance Sheet. [Refer separate Paragraph for details on Fund Accounting].
6. **Capital Fund:** Capital Fund (as disclosed by the previous Balance Sheet) should be adjusted for Surplus or Deficit that has been determined through the Income and Expenditure Account and then shown in the Balance Sheet. Capital Fund at any date can be ascertained by deducting Liabilities from Assets.

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