FINANCIAL ACCOUNTING

Paper: BC H 1.0(CC-1)

B.com. Honors Semester – I UNIT –I

1.1 MEANING AND DEFINITION OF ACCOUNTING

Accounting is primarily concerned with recording of financial transactions, summarising them and communicating financial information to the users. The users of financial information are proprietors, creditors, debtors, investors, government agencies, employees, etc. Since accounting is a medium of communication, it is called the **language of business.**

"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money; transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."

—American Institute of Certified Public Accountants

"Accounting is the science of recording and classifying business transactions and events, primarily of a financial character, and the art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgment."

—Smith and Ashburne

"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information."

—American Accounting Association

In simple words, accounting is the process of collecting, recording, summarizing and communicating financial information to the users for decision-making.

1.2 ATTRIBUTES (CHARACTERISTICS) OF ACCOUNTING

The definitions of accounting bring to light the following attributes of accounting:

1. Identification of Financial Transactions and Events: Accounting records only those transactions and events which are of financial nature as they bring change in the resources of a firm. The process involves identifying transactions that are of financial nature. For example, purchase of raw material or sale of finished goods by a firm. These transactions are identified with the help of bills and receipts as evidence of the transactions.

2. Measuring the Identified Transactions: Accounting measures the transactions and events in terms of a common measurement unit, *i.e.,* the currency of the country. In other words, *financial transactions and events are measured in terms of money.* For example, purchase of goods, say 10 tonnes of steel for Rs. 2,50,000 and 1,000 bags of cement for Rs. 2,75,000 is measured in terms of money, *i.e.,* Rs. 5,25,000.

3. ***Recording:*** Accounting is an art of recording business transactions in the books of accounts. Recording is the process of recording business transactions of financial character in the book of original entry, *i.e.,* Journal. This book is further sub-divided into subsidiary books such as Cash Journal or Cash Book (for recording cash transactions), Purchases Journal or Purchases Book (for recording credit purchases of goods), Sales Book (for recording credit sales), etc.

4.Classifying: Accounting is an art of classifying business transactions. Classification is the process of collecting similar transactions at one place by opening accounts in the Ledger Book. The transactions recorded in the 'Journal' or the subsidiary books are classified or posted to the main book of account known as **Ledger.** This book contains individual account heads under which all financial transactions of a similar nature are collected. For example, in Rahul's account in the Ledger, all business transactions connected with Rahul are posted so that what is ultimately due to Rahul or due from Rahul can be ascertained.

5. Summarizing: Accounting is an art of summarizing financial transactions. This involves presenting the classified data in a manner which is understandable and useful to internal as well as external users of accounting statements. This process leads to the preparation of the following statements:

(i) Trial Balance, *(ii)* Trading and Profit and Loss Account or Statement of Profit and Loss (in case of companies), and *(iii)* Balance Sheet.

Trading Account, Profit and Loss Account or Statement of Profit and Loss (in case of companies) and Balance Sheet are collectively known as **Final Accounts** or **Financial Statements.**

6. Analysis and Interpretation: Financial data is analyzed and interpreted so that the users of financial data can make a meaningful judgment of the financial performance (profit) and financial position of the business. Analysis helps in planning for the future in a better way.

7.Communicating: Finally, accounting function involves communicating the financial data, *i.e.,* financial statements to its users. The accounting information must be provided in time and presented to the users so that decisions are taken at the appropriate time.

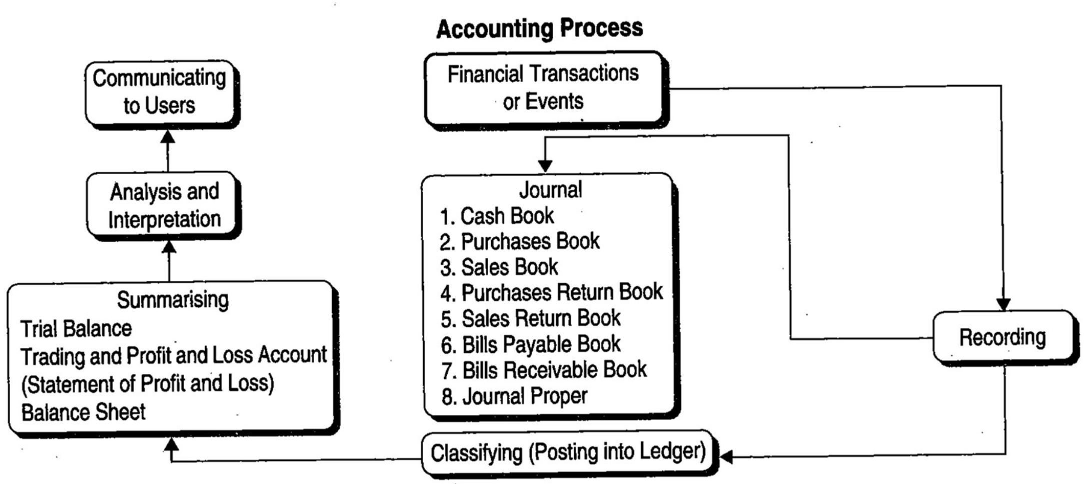
1.3 IS ACCOUNTING A SCIENCE OR AN ART?

Accounting is an Art as well as a Science. Art is the technique which helps us to achieve our desired objectives. Accounting is an art of recording, classifying and summarizing financial transactions. It helps us in knowing the profitability and financial position of the business.

Any organized knowledge based on certain basic principles is a 'science'. Accounting is also a science as it is an organized knowledge based on, certain basic principles.

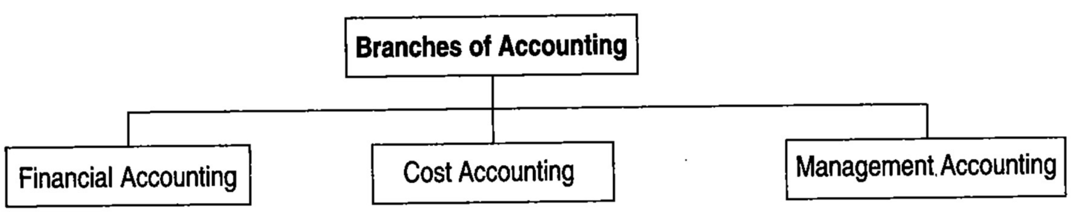
1.4 ACCOUNTING PROCESS

Based on the attributes of accounting, the steps of accounting process are as follows: *(i)* Financial Transactions, *(ii)* Recording, *(iii)* Classifying, *(iv)* Summarizing, *(v)* Analyzing and Interpreting and *(vi)* Communicating. The accounting process may be explained with the help of a diagram:



1.5 BRANCHES OF ACCOUNTING

The changing business scenario through centuries has given rise to specialised branches of accounting which could cater to the changing requirements. These branches are:



Financial Accounting

Financial Accounting is that branch of accounting which records financial transactions and events, summarizes and interprets them and communicates the results to the users. It ascertains profit earned or loss incurred during an accounting period (usually a year) and the financial position on the date when the accounting period ends. The end-product of Financial Accounting is the Profit and Loss Account for the period ended (which shows the profit earned or loss incurred) and the Balance Sheet as on the last day of the accounting period (which shows the financial position). In short, Financial Accounting is mainly confined to the preparation of financial statements, *i.e.,* the Profit and Loss Account and the Balance Sheet, for the users of accounting information.

Cost Accounting

The limitation of Financial Accounting in respect of information relating to the cost of products or services led to the development of a specialized branch, *i.e.,* Cost Accounting. It ascertains the cost of products manufactured or services rendered and helps the management in decision-making (say price fixation) and exercising controls.

Management Accounting

Management Accounting is the most recently developed branch of accounting. It is concerned with generating accounting information relating to funds, costs, profits, etc., as it enables the management in decision-making. We may say that Management Accounting addresses the needs of a single user group, *i.e.,* the management.

1.6 BOOK KEEPING, ACCOUNTING AND ACCOUNTANCY

The terms 'Book Keeping' and 'Accounting' are often considered as same. But it is not so. The two terms are distinct from each other. Accounting is a wider concept and includes Book Keeping.

Meaning of Book Keeping

Book Keeping is a part of accounting being a process of recording of financial transactions and events in the books of accounts. Thus, Book Keeping involves:

1. Identifying financial transactions and events,
2. Measuring them in terms of money,
3. Recording the identified financial transactions and events in the books of accounts, and
4. Classifying recorded transactions and events, *i.e.,* posting them into Ledger accounts.

Definitions of Book Keeping

4. "Book Keeping is an art of recording in the books of accounts the monetary aspect of commercial and financial transactions."

—Northcott

"Book Keeping is an art of recording business dealings in a set of books."

—J.R. Batliboi

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

—R.N. Carter

"Book Keeping is the art of recording business transactions in a systematic manner."

—A.N. Rosen Kampff

Accounting

Accounting is an art of recording, classifying and summarizing the financial data and interpreting the results thereof. Accounting is a wider concept than Book Keeping. It starts where Book Keeping ends. In other words, Book Keeping is a part of accounting.

DIFFERENCE BETWEEN BOOK KEEPING AND ACCOUNTING

Basis	Book Keeping	Accounting
1. Scope	Book keeping is concerned with identifying financial transactions; measuring them in money terms, recording them in the books of accounts and classifying them.	Accounting is concerned with summarizing the recorded transactions, interpreting them and communicating the results.
2. Stage	It is a primary stage. It is the basis for accounting.	It is a secondary stage. It begins where book keeping ends.
3. Objective	The objective of book keeping is to maintain systematic records of financial transactions.	The objective of accounting is to ascertain net results of operations and financial position and to communicate information to the interested parties.
4. Nature of job	This job is routine in nature.	This job is analytical and dynamic in nature.
5. Performance	Junior staff performs this function.	Senior staff performs this function.
6. Special skills	Book keeping is mechanical in nature and, thus, does not require special skills.	Accounting requires special skills and ability to analyse and interpret.

Accountancy

Accountancy is a systematic knowledge of accounting. It explains how to deal with various aspects of accounting. It educates us how to maintain the books of accounts and how to summarize the accounting information and communicate it to the users. In the words of **Kohler,** *accountancy refers to the entire body of the theory and practice of accounting.*

Accounting and Accountancy

Accountancy is an area of knowledge whereas accounting is the action or process used in this area. Accounting depends on the rules and principles framed by accountancy but accountancy does not depend on accounting. Thus, it may be said that accountancy is knowledge of accounting and accounting is the application of accountancy.

1.7 OBJECTIVES OF ACCOUNTING

The objectives of accounting are:

1. Record of Financial Transactions and Events: The objective of accounting is to record financial transactions and events of the organization in the books of accounts following the principles of accounting in a systematic manner.

2. Determine Profit or Loss: Another objective of accounting is to determine the financial performance, *i.e.,* profit earned or loss incurred, for the accounting period. Income Statement or Trading and Profit and Loss Account or Statement of Profit and Loss (by companies) prepared at the end of the accounting year shows the profit earned or loss incurred during the accounting year.

3. Determine Financial Position: Another objective of accounting is to determine financial position. It is known from the Balance Sheet. Financial position of the business is as relevant for the users of financial statements as is the Income Statement.

4. Assisting the Management: Another objective of accounting is to assist the management by providing financial information to it. The management often requires financial information for decision-making, exercising control, budgeting and forecasting.

5. Communicating Accounting Information to Users: Another objective of accounting is to provide accounting information to users who analyze them as per their individual requirements.

6. Protecting Business Assets: Another objective of accounting is to have records of assets owned by the business. Accounting maintains record of assets owned by the business which enables the management to protect them and exercise control.

1.8 FUNCTIONS OF ACCOUNTING

The functions of accounting are:

1. Maintaining Systematic Accounting Records: The primary function of accounting is to maintain systematic accounting records of financial transactions and events. It means that the accounting records should be maintained following the accounting principles and concepts. In other words, the function of Book Keeping is the primary function of accounting. It is so because reliable financial statements can be drawn if Book Keeping is proper. The process of Book Keeping involves recording financial transactions and events in the books of accounts and classifying the recorded transactions. The transactions having been classified, Trial Balance can be drawn to prepare financial statements, *i.e.,* Income Statement and Position Statement.

2. Preparation of Financial Statements: Financial statements means final accounts prepared at the end of the accounting period. It includes Income Statement (Profit and Loss Account or Statement of Profit and Loss, in the case of companies) and Position Statement (Balance Sheet). It is an important function of accounting because the financial statements show the financial performance, *i.e.,* profit earned or loss incurred during the accounting year and the financial position, *i.e.,* Balance Sheet as at the end of the accounting year. Both the statements are important for all the users because users make decisions on the basis of these statements.

3. Meeting Legal Requirements: Accounting records are accepted as evidence by the court of law if they are maintained systematically following the accounting principles and concepts. Besides, the law such as the Companies Act, Income Tax Act, VAT Act, etc., require submissions of returns in the form and period as is prescribed in the law. The returns can be prepared if the accounting records are maintained systematically and timely. Besides, the returns so submitted may have to be proved correct before the authorities. A systematic accounting record maintained following the accounting principles and concepts is accepted by the authorities to be correct. Thus, it is a function of accounting to meet the legal requirements.

4. Communicating the Financial Data: It is yet another function of accounting to communicate the financial data to the users, which may be internal users or external users, such as management, banks, employees, government authorities, etc.

5. Assistance to Management: Management often requires information beyond the information conveyed by the financial data. Accounting records should be maintained in such a manner that the information sought by the management is available, which in turn helps in decision-making. For example, financial statements do not show since when the amount is due from debtors. It is the function of accounting to make such information available to the management. Similarly, accounting record should be maintained in such a manner that the assets owned are known. It will assist the management in protecting the assets and also exercising control.

1.9 ADVANTAGES OF ACCOUNTING

1. Financial Information about Business: Financial performance during the accounting period, *i.e.,* profit or loss and also the financial position at the end of the accounting period is known through accounting.

2. Assistance to Management: The management makes business plans, takes decisions and exercises control over the affairs on the basis of accounting information.

3. Replaces Memory: A systematic and timely recording of transactions obviates the necessity to remember transactions. The accounting record provides the necessary information.

4. Facilitates Comparative Study: A systematic record enables a businessman to compare one year's results with those of other years and locate significant factors leading to change, if any.

5. Facilitates Settlement of Tax Liabilities: *A* systematic accounting record immensely helps in settlement of income tax, sales tax, VAT and excise duty liabilities, since it is a good evidence of the correctness of transactions.

6. Facilitates Loans: Loan is granted by the banks and financial institutions on the basis of growth potential which is supported by the performance. Accounting makes available the information with respect to performance.

7. Evidence in Court: Systematic record of transactions is often accepted by the Courts as good evidence.

8. Facilitates Sale of Business: If someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.

9. Helps in Decision-making: Accounting helps in taking a large number of decisions like the amount to be withdrawn by proprietor, the price at which goods should be sold, etc.

1.10 LIMITATIONS OF ACCOUNTING

1. Accounting is not Fully Exact: Although most of the transactions are recorded on the basis of evidence such as sale or purchase or receipt of cash, yet some estimates are also made for ascertaining profit or loss. Examples of this are providing depreciation on the basis of estimated useful life of an asset, possible bad debts, the probable market price of the stock of goods, etc.

2. Accounting does not Indicate the Realizable Value: The Balance Sheet does not show the amount of cash which the firm may realize by the sale of all the assets. This is because many assets are not meant to be sold; they are meant for use and are shown at cost *less* depreciation that may have been written off.

3. Accounting Ignores the Qualitative Elements: Since accounting is confined to monetary matters only, qualitative elements like quality of staff, industrial relations and public relations are ignored.

4. Accounting Ignores the Effect of Price Level Changes: Accounting statements are prepared at historical cost. Money, as a measurement unit, changes in value. It does not remain stable. Unless price level changes are considered while preparing financial statements, accounting information will not show true financial results.

5. ***Accounting may Lead to Window Dressing:*** The term window dressing means manipulation of accounts so as to conceal vital facts and present the financial statements in such a way as to show better position than what it actually is. In this situation, income statement *(i.e.,* Profit and Loss Account) fails to provide a true and fair view of the result of operations and the Balance Sheet fails to provide a true and fair view of the financial position of the enterprise.

1.11 ACCOUNTING INFORMATION

"Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."

—Accounting Principles Board

As an information system, accounting collects financial data, records it in the books of accounts, classifies and summarizes it to produce financial information that is communicated to its users. Accounting begins with the identification of transactions of financial nature and ends with the preparation of financial statements (i.e., Income Statement and Balance Sheet). Each step in the process of accounting generates information. Generation of information is not an end in itself, it is a way to facilitate the communication of information to users of accounting information.

Types of Accounting Information

Accounting information refers to the financial statements generated through the process of Book Keeping, use of which helps the users to arrive at decisions. The financial statements so generated are the Income Statement, *i.e.,* Profit and Loss Account and the Position Statement, *i.e.,* Balance Sheet. The information made available by these statements can be categorized into the following:

1. Information Relating to Profit or Surplus;
2. Information Relating to Financial Position; and
3. Information about Cash Flow.

Let us now discuss these in detail.

1. Information Relating to Profit or Surplus: The Income Statement makes available the accounting information about the profit earned or loss incurred as a result of business operations or otherwise during an accounting period.

A firm prepares Trading Account, a part of the Profit and Loss Account, which provides information about Gross Profit or Gross Loss and Profit and Loss Account provides information about the Net Profit or Net Loss.

A company prepares Statement of Profit and Loss in the form prescribed in Schedule VI of the Companies Act, 1956.

A Not-For-Profit Organization prepares Income and Expenditure Account instead of Profit and Loss Account because it carries on welfare or charitable activities and not business. The excess of income over expenditure is termed as 'Surplus' while excess of expenditure over income is termed as 'Deficit'.

2. Information Relating to Financial Position: The Position Statement, *i.e.,* the Balance Sheet makes available the information about the financial position of the entity. The Position Statement provides information about the assets owned by the entity, amounts receivable and the cash and bank balance held by it. These are represented in the liabilities by the amounts owed by the entity towards loans, creditors and amounts payable. The difference between the two is represented by capital, *i.e.,* amount due to owners. In the case of Not-For-Profit Organization, difference between assets and liabilities is termed as 'General Fund'.

3. Information about Cash Flow: Cash Flow Statement is a statement that shows flow, both inflow and outflow, of cash during a specific period. It is of immense use as many decisions such as payment of liabilities, payment of dividend and expansion of business, etc., are based on availability of cash.

1.12 USERS OF ACCOUNTING INFORMATION

Users of Accounting Information may be categorized into Internal Users and External Users.

Internal Users

(i) Owners: Owners contribute capital in the business and thus are exposed to maximum risk. Naturally, they are interested in knowing the profit earned or loss suffered by the business besides the safety of their capital. The financial statements give the information about profit or loss and financial position of the business.

(ii) Management: The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, investment into new projects, etc.

(iii) Employees and Workers: Employees and workers are entitled to bonus at the year-end, which is linked to the profit earned by an enterprise. Therefore, the employees and workers are interested in financial statements. Besides, the financial statements also reflect whether the enterprise has deposited its dues into the provident fund and employees state insurance, etc., or not.

External Users

(i) Banks and Financial Institutions: Banks and financial institutions are an essential part of any business as they provide loans to businesses. Naturally, they watch the performance of the business to know whether it is making progress as projected to ensure the safety and recovery of the loan advanced. They assess it by analyzing the accounting information.

(ii) Investors and Potential Investors: Investment involves risk and also the investors do not have direct control over the business affairs. Therefore, they rely on the accounting information available to them and seek answers to questions such as—what is the earning capacity of the enterprise and how safe is their investment?

(iii) ***Creditors:*** Creditors are those parties who supply goods or services on credit. It is a common business practice that a large number of suppliers remain invested in credit sales. Before granting credit, creditors satisfy themselves about the credit-worthiness of the business. The financial statements help them immensely in making such an assessment.

(iv) ***Government and its Authorities:*** The government makes use of financial statements to compile national income accounts and other information. The information available to it enables it to take policy decisions. Government levies varied taxes such as excise duty, VAT, service tax and income tax. These government authorities assess correct tax dues after an analysis of the financial statements.

(v) ***Researchers:*** Researchers use accounting information in their research work.

(vi) ***Consumers:*** Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction in the prices of products they buy. Sometimes, prices of some products are fixed by the government, so it needs accounting information to fix fair prices so that consumers and producers are not exploited.

(vii) ***Public:*** They want to see the business running since it makes substantial contribution to the economy in many ways, *e.g.,* employment of people, patronage to suppliers, etc. Thus, financial accounting provides useful financial information to various user groups for decision-making.

1.13 QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

Qualitative characteristics are attributes that make the accounting information useful to users. The qualitative characteristics are:

1. ***Reliability:*** Accounting information must be reliable. Reliability of information means it is verifiable, free from material error and bias.

2. Relevance: Accounting information must be relevant to the user. Information is relevant if it meets the needs of the users in decision-making.

3. Understandability: Understandability means that the information provided through the financial statements must be presented in a manner that the users are able to understand it.

4. Comparability: Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as **intra-firm comparison** or with the accounting information of other enterprises, known as **inter-firm comparison.**

1.14 SYSTEMS OF ACCOUNTING

The systems of recording transactions in the books of accounts are two namely:

1. Double Entry System and 2. Single Entry System.

1. Double Entry System

Double Entry System of accounting is a system of accounting under which both, debit and credit, aspects of accounting are recorded. A transaction has two aspects—Debit and Credit—and at the time of recording a transaction, it is recorded once on the debit side and again on the credit side, For example, at the time of cash purchases, goods are received and in return cash is paid. In the transaction, two aspects are involved, *i.e.,* receiving goods and paying cash and under the Double Entry System, both these aspects are recorded. One part, *i.e.,* the receipt of goods, is debited and the second part, *i.e.,* payment of cash, is credited. In other words, if only two accounts are affected (as in the purchase of building for cash), one account, Building, is debited and the other account, Cash, is credited for the same amount. If more than two accounts are affected by a transaction, the sum of the debit entries must be equal to the sum of the credit entries. Thus, on any day, total amount debited is equal to the total amount credited.

Thus, we can define Double Entry System as: "The system which recognizes and records both aspects of a transaction. The Double Entry System has proved to be a scientific and complete system of accounting."

Features of the Double Entry System

1. It maintains a complete record of each transaction.
2. It recognizes two-fold aspect of every transaction, *viz.,* the aspect of receiving (value in) and the aspect of giving (value out).
3. In this system, one aspect is debited and the other aspect is credited following the rules of debit and credit.
4. Since one aspect of a transaction is debited and the other is credited, the total of all debits is always equal to total of all credits. It helps in establishing arithmetical accuracy by preparing the Trial Balance.

Stages of Double Entry System

A complete system of double entry book keeping has following three stages:

1. Recording the transactions in the Journal.
2. Classifying transactions in the Journal by posting them to the appropriate ledger accounts and then preparing the Trial Balance.
3. Closing the books and preparing the final accounts.

All these stages shall be discussed one by one in succeeding chapters.

Advantages of the Double Entry System

The advantages of Double Entry System are:

(i) Scientific System: Double Entry System is a scientific system of recording business transactions as compared to other systems of Book Keeping. It helps attain the objectives of accounting.

(ii) Complete Record of Transactions: Under the system, both sides of a transaction are recorded. It is a complete record as it results in showing correct income or loss, assets and liabilities.

(iii) A Check on the Accuracy of Accounts: By the use of this system, accuracy of the accounting work can be established through the Trial Balance.

(iv) Determining Profit or Loss: Profit earned or loss incurred during a period can be determined by preparing Profit and Loss Account.

(v) Knowledge of Financial Position: Financial position of the firm or the institution can be ascertained at the end of each period by preparing the Balance Sheet.

(vi) Full Details for Purposes of Control: The system permits accounts to be maintained in as much detail as necessary and, therefore, provides significant information for purposes of control, etc.

(vii) Comparative Study is Possible: Results of one year may be compared with those of previous years and reasons for the change may be ascertained.

(viii) Helps Management in Decision-making: Management may be able to obtain good information for its work, especially in making decisions.

(ix) Frauds and Misappropriation: Frauds and misappropriation are minimized since complete information about all assets and liabilities is available.

It *is because of these advantages that the Double Entry System has been used extensively in all countries.*

2. Single Entry System

Single entry system of recording transactions in the books of accounts may be defined as an incomplete Double Entry System. In this system, all transactions are not recorded on double entry basis. As regards some transactions, both aspects of the transactions are recorded, as regards others, either one aspects is recorded or not recorded at all. Instead of maintaining all the accounts, only Personal Accounts and Cash Book are maintained under this system. The accounts maintained under this system are incomplete and unsystematic and, therefore, not reliable. The Single Entry System is also known as **Accounts from Incomplete Records.**

Since all transactions are not recorded under double entry principle, it is not possible to prepare a Trial Balance. As a result, the Profit and Loss Account and the Balance Sheet cannot be prepared.

1.15 SUMMARY

Accounting is an art of recording, classifying and summarizing in terms of money transactions and events of a financial nature and interpreting the results thereof. Process of accounting is the sequence of accounting procedure for recording, classifying and summarising transactions. Maintaining systematic records of transactions, ascertain profit & loss, ascertaining financial position, assisting in management, communicating accounting information to users, protecting business assets and facilitation in decision making are the objectives of accounting. Accounting information is the information of financial nature relating to entities. It is useful in taking decisions. Accounting information is provided to the users through financial statements. Advantages of accounting are financial information ,assistance to management, replacement of memory, comparative study, settlement of tax liability, facilitates loan, evidence in court, sale of business, assistance in the event of insolvency and helpful in partnership account. Limitations of accounting are not fully exact, does not indicate realizable value, ignores qualitative elements, ignore the effect of price level changes and lead to window dressing. Single entry system and double entry system are the two systems of accounting.

B.com H Semester – I UNIT –I

1.1 INTRODUCTION

Accounting is commonly described as a language of business. As rules of grammar exist for language, similarly accounting principles exist for accounting.

Accounting principles, concepts and conventions commonly known as **Generally Accepted Accounting Principles** or **GAAPs** are the basic rules that define the parameters and constraints within which accounting operates. These principles are the theory base of accounting, on the basis of which financial statements are prepared. In other words, they are the guidelines for preparing the financial statements. The Institute of Chartered Accountants of India (ICAI) has issued Accounting Standards to standardize the accounting practices adopted to prepare financial statements. The Companies Act, 1956 has made them mandatory for the management and also for the auditors.

2.1 MEANING AND NATURE OF ACCOUNTING PRINCIPLES

"Principles of Accounting are the general law or rule adopted or proposed as a guide to action, a settled ground or basis of conduct or practice."

—The American Institute of Certified Public Accountants

Accounting Principles are the rules of action or conduct adopted by accountants universally while recording accounting transactions. They are the norms or rules which are followed in giving accounting treatment to various items of assets, liabilities, expenses, incomes, etc. For example, Inventory (stock) should be valued at lower of its cost or net realizable value. Fixed assets should be depreciated over their useful life. Accounting Principles are the basic or fundamental propositions generally accepted by accountants as a set of Accounting Principles based on which transactions are recorded and Financial Statements are prepared. These principles are classified into two categories i.e. Accounting Concepts & Accounting Conventions.

1. Accounting Concepts: Accounting Concepts are the basic assumptions or fundamental propositions within which accounting operates. They are generally accepted accounting rules based on which transactions are recorded and financial statements are prepared. It is important to follow the accounting concepts because it enables the users of financial statements to understand them better and in the same manner.

2. Accounting Conventions: Accounting Conventions are the outcome of accounting practices or principles being followed by the enterprises over a period of time. Conventions may undergo a change with time to bring about improvement in the quality of accounting information.

2.2 FEATURES OF ACCOUNTING PRINCIPLES

1. Accounting Principles are Man-Made: Accounting Principles are man-made and, therefore, they do not stand the scrutiny like the principles of natural science. They are the best possible suggestions based on practical experiences. They are recommended for use by all enterprises to ensure uniformity and understandability

2. Accounting Principles are Flexible: Accounting Principles are not rigid but flexible. Whenever a situation arises that requires solution; accountants arrive at a reasoned and reasonable decision which gradually becomes the accepted Accounting Principle. It must be borne in mind that Accounting Principles are not permanent and change with time.

3. Accounting Principles are Generally Accepted: Accounting Principles are the bases and guidelines for accounting and are generally accepted. The general acceptance of an Accounting Principle usually depends on how it meets three criteria: relevance, objectivity and feasibility.

(i) Relevance: Accounting Principles are relevant if they result in information that is useful to the users of accounting information.

(ii) *Objective:* Accounting Principles are objective if they are not influenced by the personal bias of the persons preparing the accounting information.

(iii) *Feasible:* Accounting Principles are feasible if they can be applied without undue complexity and cost.

2.3 NECESSITY OF ACCOUNTING PRINCIPLES

Accounting information is better understood if it is prepared following the set of Accounting Principles uniformly. It means the same Accounting Principles are followed by all entities in preparing their final accounts. Accounting information is meaningful and useful for users of accounting information if the accounting records and financial statements are prepared following generally accepted accounting information in standard forms which are understood.

2.4 FUNDAMENTAL ACCOUNTING ASSUMPTIONS OR CONCEPTS

Fundamental Accounting Assumptions or Concepts are the assumptions which are presumed to have been followed in preparing the annual accounts. The entities which do not follow any of the fundamental accounting assumptions are required to disclose which of these assumptions have not been followed and the reasons for not following them. The Fundamental Accounting Assumptions are:

1. Going Concern Assumption;
2. Consistency Assumption; and
3. Accrual Assumption.

Let us discuss them in detail:

1. Going Concern Assumption: According to this assumption, it is assumed that business shall continue for a foreseeable period and there is no intention to close the business or scale down its operations significantly. This implies that it will not be dissolved in the immediate future unless there is a clear evidence of closure. It is because of this concept that a distinction is made between a capital expenditure, *i.e.,* expenditure that will give benefit for a long period and revenue expenditure, *i.e.,* one whose benefit will be consumed or exhausted within the accounting period. On the basis of this concept, fixed assets are recorded at their original cost and depreciated in a systematic manner without reference to their market value. For example, a machine purchased is expected to last 10 years. The cost of the machinery is spread on a suitable basis over the next 10 years for ascertaining the profit or loss for each year. The total cost of the machine is not treated as an expense in the year of purchase itself.

2. Consistency Assumption: According to the Consistency Assumption, accounting practices once selected and adopted, should be applied consistently year after year. The concept helps in better understanding of accounting information and makes it comparable (a qualitative characteristic of accounting information) with that of previous years. Consistency eliminates personal bias and helps in achieving results that are comparable. The concept is particularly important when alternative accounting practices are equally acceptable. For example, two methods of charging depreciation, Written Down Value Method and Straight Line Method, are equally acceptable. Under the assumption, method once chosen and applied should be applied consistently year after year. But, it does not mean that practice once adopted cannot be changed. The accounting practice may be changed if the law or Accounting Standard requires it or the change will result in more meaningful presentation. If an enterprise desires to adopt an alternative practice, it must disclose the change and its impact on the profit or loss.

3. Accrual Assumption: According to the Accrual Assumption, a transaction is recorded in the books of accounts at the time when it is entered into and not when the settlement takes place.-Thus, revenue is recognized when it is realized, *i.e.,* when sale is complete or services are rendered; it is immaterial whether cash is received or not. Similarly, expenses are recognized as expenses in the accounting period in which the revenue related to it is recognized, whether paid in cash or not.

The concept is particularly important because it recognizes the assets, liabilities, incomes and expenses as and when transactions relating to it are entered into. Under this concept, profit is regarded as earned at the time the goods or services are sold to a customer, *i.e.,* the legal title is passed to the customer, who, in turn, has an obligation to pay for them. Similarly, expense is regarded as incurred when the goods or services are purchased and an obligation to pay for them is assumed.

Let us take examples to understand the Accrual Concept.

M/s. RSM & Co. purchases computers on 1st January, 2013 amounting to Rs. 5,00,000 to be paid on 15th April, 2013. Since the asset has been acquired by the enterprise and has in the process incurred a liability to the extent of that amount on 1st January, 2013, it must record the transaction in its books of accounts on 1st January, 2013. The transaction on recording shall reflect that the enterprise owns assets (computers) worth Rs. 5,00,000 and also owes an equal amount of money to the supplier.

Similarly, if M/s. RSM & Co. makes a sale of goods to M/s. VS & Co. on 27th February, 2013 for Rs. 15,000 on credit of two months, the sale must be recorded on 27th February, 2013 although the amount will be received on 27th April, 2013. The transaction is recorded because the revenue has been earned, although the amount has not been received. M/s. VS & Co. should also record the purchase in its books of accounts on 27th February, 2013 because goods have been purchased although the amount has not been paid

2.5 ACCOUNTING PRINCIPLES

1. Accounting Entity or Business Entity Principle: According to the Business Entity principle, business is considered to be separate and distinct from its owners. Business transactions, therefore, are recorded in the books of accounts from the business point of view and not from that of the owners. Owners being regarded as separate and distinct from business they are considered creditors of the business to the extent of their capital. Their account with the business is credited with the capital introduced and profit earned during the year, etc., and debited by the drawings made. For example, when the proprietor introduces capital, Cash Account or Bank Account is debited and Capital Account is credited. Amount in the credit of the capital is a liability of the enterprise towards the proprietor. This principle applies to every form of enterprise including proprietorship firms.

A Balance Sheet of a proprietary firm (imaginary amounts) will appear as follows:

BALANCE SHEET
as at…..

Liabilities	Rs.	Assets	Rs.
Capital account		**Fixed assets**	
Opening Balance	2,50,000	Machinery	2,00,000
Add: introduction during the year	1,00,000	Vehicles	75,000
Profit for the year	1,50,000	**Current assets**	
	5,00,000	Cash in hand	25,000
Less: Drawing	1,26,000	Balance with bank	74,000
	3,74,000		3,74,000

The Accounting Entity principle is a useful principle as from it, responsibility accounting has developed. It has made possible ascertaining the results of each department or division of the enterprise.

2. Money Measurement Principle: According to the Money Measurement Principle, transactions and events that can be measured in money terms are recorded in the books of accounts of the enterprise. In other words, money is the common denominator in recording and reporting all transactions. Consider that an enterprise has Rs. 10,000 cash, 6 tones of raw material, 6 trucks and 10,000 sq. yards land. These assets cannot be added and shown in the Financial Statements unless their monetary value is ascertained. However, the principle suffers from two major limitations:

(a) Transactions and events that cannot be measured in money terms are not recorded in the books of accounts, howsoever important they may be to the enterprise. For example, human resources with the enterprise are important to the enterprise but are not reflected in the financial statements because they cannot be measured and expressed in money terms.

(b) The value of money is considered to have static value as the transactions are recorded at the value on the transaction date.

3. Accounting Period Principle: According to the Accounting Period Principle, the life of an enterprise is broken into smaller periods so that its performance is measured at regular intervals. The accounts of an enterprise are maintained following Going Concern Concept, meaning the enterprise shall continue its activities for a foreseeable future. One may argue that the financial statements of the enterprise should be prepared at the end of its life. It is possible to do so, but a number of users of Financial Statements and many of them, especially the management and bankers, require the information from the accounts at regular intervals so that decisions can be taken at the appropriate time. Management requires information at regular intervals to assess the performance, funds requirement (short-term as well as long-term), banks require accounting information periodically because they have invested money and have to ensure its safety and returns. Similarly, the Government has to assess the tax dues from the enterprise.

In view of the above, the life of the enterprise is broken into smaller periods (usually one year) which are termed as the 'Accounting Period'.

An accounting period is the interval of time at the end of which Income Statement (Profit and Loss Account or Statement of Profit and Loss, in the case of companies) and Balance Sheet are prepared to know the results and resources of the business.

4. Full Disclosure Principle: According to the Principle of Full Disclosure, *"there should be complete and understandable reporting on the financial statements of all significant information relating to the economic affairs of the entity."* Apart from legal requirements, good accounting practice requires all material and significant information to be disclosed. Whether information should be disclosed or not always depends on the materiality of the information. The Companies Act, 1956 provides for disclosures (termed as legally required disclosures) yet there may be many material information which if disclosed will make the financial statements more meaningful. Disclosure of material information will result in better understanding. For example, the reasons for low turnover should be disclosed.

5. Materiality Principle: The Materiality Principle refers to the relative importance of an item or an event. According to the American Accounting Association, *"an item should be regarded as material if there is a reason to believe that knowledge of it would influence the decision of an informed investor."* Thus, whether an item is material or not will depend on its nature and/or amount. It, thus, means that it is a matter of exercising judgment to decide which item is material and which is not. And only those items should be disclosed that have significant effect or are relevant to the user. An item may be material for one enterprise but may not be material for another. For example, amount spent on repairs of building, say Rs. 2,50,000 is material for an enterprise having a turnover of say Rs. 1,50,000 but it is not material for an enterprise having a turnover of say Rs. 15,00,00,000. On the other hand, closure of a production plant, even temporarily, say because of an environmental problem is material.

6. Prudence or Conservatism Principle: The Prudence Principle is many a time described using the phrase *"Do not anticipate a profit, but provide for all possible losses."* In other words, *it takes into consideration all prospective losses but not the prospective profits.* The application of this concept ensures that the financial statements present a realistic picture of the state of affairs of the enterprise and do not paint a better picture than what it actually is. For example, closing stock is valued at lower of cost or net realizable value or making the provision for doubtful debts and discount on debtors in anticipation of actual bad debts and discount. Conservatism does not record anticipated revenues but provides all anticipated expenses and losses, thus, it may overstate liabilities. It has a drawback as it may be used to create secret reserve *(e.g.,* by creating excess provision for doubtful debts, depreciation, etc.), and thus financial statements may not depict a true and fair view of state of affairs of the business. The Concept of Conservatism needs to be applied with more caution and care so that the results reported are not distorted.

7. Cost Concept or Historical Cost Principle: According to the Cost Concept, an asset is recorded in the books of accounts at the price paid to acquire it and the cost is the basis for all subsequent accounting of the asset. Asset is recorded at cost at the time of its purchase but is systematically reduced in value by charging depreciation. The market value of an asset may change with the passage of time but for accounting purposes it continues to be shown in the books of accounts at its book value *(i.e.,* cost at which it was purchased *minus* depreciation provided up-to-date). For example, an asset is purchased for Rs. 5,00,000 and if at the time of preparing the final accounts, even if its market value is say, Rs. 4,00,000 or Rs. 7,00,000, yet the asset shall be recorded at its purchase price of Rs. 5,00,000.

Cost concept brings objectivity in the preparation and presentation of financial statements. They are not influenced by the personal bias or judgments.

8. Matching Concept or Matching Principle: This concept is based on the accounting period concept. An important objective of business is to determine profit periodically. It is necessary to match 'revenues' of the period with the 'expenses' of that period to determine correct profit (or loss) for the accounting period. Profit earned by the business during a period can be correctly measured only when the revenue earned during the period is matched with the expenditure incurred to earn that revenue. It is not relevant when the payment was made or received. Therefore, as per this concept, adjustments are made for all outstanding expenses, prepaid expenses, accrued income, unearned income, etc.

In brief, according to this concept, the expenses for an accounting period are matched against related revenues, rather than cash received and cash paid. This concept should be followed while preparing financial statements to have a true and fair view of the profitability and financial position of a business firm.

9. Dual Aspect or Duality Principle: According to the Dual Aspect Concept, every transaction entered into by an enterprise has two aspects, a debit and a credit of equal amount. Simply stated, for every debit there is a credit of equal amount in one or more accounts. It is also true *vice versa.* For example, Rahul starts a business with a capital of Rs. 1,00,000. There are two aspects to the transaction. On one hand, the business has an asset of Rs. 1,00,000 (cash) while on the other hand, it has a liability towards Rahul of Rs. 1,00,000 (capital of Rahul). Thus, we can say

Capital (Equities) = Cash (Asset)

Rs. 1,00,000 = Rs. 1,00,000

Suppose further, the enterprise borrows amount from a bank; its assets will increase but this will mean that out of the total assets, amount equal to borrowing is payable to the outsiders. Thus, we can say

Owner's equity or capital + Claims of outsiders = Assets

Or

Assets = Owner's equity + Claims of outsiders

This fundamental equation will always remain good. In other words, accounting equation demonstrates the fact that for every debit there is an equivalent credit. As a matter of fact the entire system of Double Entry Book Keeping is based^ on this concept.

10. Revenue Recognition Concept: According to the Revenue Recognition Concept, revenue is considered to have been realized when a transaction has been entered into and the obligation to receive the amount has been established. It is to be noted that recognizing revenue and receipt of an amount are two separate aspects. Let us take an example to understand it. An enterprise sells goods in February 2013 and receives the amount in April 2013. Revenue of this sales should be recognized in February 2013, ***i**.e.,* when the goods are sold. It is so because the legal obligation has been established (upon sales) in February 2013. Let us take another example. Suppose, an enterprise has received an advance in February 2013 for the sales to be made in May 2013, revenue shall be recognized in May 2013, upon sales having been made because the legal obligation to receive the amount has been established in May 2013.

11. Verifiable Objective Concept: The Verifiable Objective Concept holds that accounting should be free from personal bias. Measurements that are based on verifiable evidences are regarded as objectives. It means all accounting transactions should be evidenced and supported by business documents. These supporting documents are cash memo, invoices, sales bills, etc., and they provide the basis for accounting and audit.

2.6 SUMMARY

Accounting is the language of business. Every language has certain rules of grammar, similarly in order to understand accounting information and for maintaining uniformity and consistency certain principles are needed in accounting. Accounting principles are the norms or rules which are to be followed in treating various items of assets, liabilities, expenses, incomes, etc. Generally accepted accounting principles (GAAP) refers to the rules or guidelines adopted for recording and reporting business transactions, in order to bring uniformity and consistency in the preparation and presentation of financial statements. Accounting principles are man-made, flexible and are generally accepted. Accounting principles are classified into two categories i.e. accounting concepts and accounting conventions. Accounting concepts includes going concern assumption, consistency assumption and accrual assumption. Whereas accounting principles embraces accounting entities, money measurement, accounting period, full disclosure, materiality, prudence or conservatism, cost, matching, dual aspect, revenue recognition and verifiable objectives.

CONCEPT OF ACCOUNTING STANDARDS

Accounting is the language of business. All financial information (i.e. nature of financial activities, financial position, financial results, present trend and further prospects etc.) are available through accounting. The so-called financial information is communicated to the users (both internal as well as external) of accounting information by preparing and presenting the financial statements. As such, it becomes necessary to develop some Generally Accepted Accounting Principles (GAAP) while preparing the financial statements by which the language of the business can be communicated to the users.

As per section 129 of Companies Act, 2013 the financial statements of a company must present a true and fair view of the income and financial position of the company. However, it does not define what constitutes a true and fair view of a company. Since the beginning of accounting, a number of Generally Accepted Accounting Principles have been developed consisting of accounting concepts and conventions so as to bring comparability and uniformity in the financial statements of various business organizations. However, even these GAAP allow many alternatives for the treatment of same item that can be followed by the business organizations while preparing financial statements which leads to lack of consistency, uniformity and comparability among the financial statements of different originations. In addition, there must not be any ambiguity and uncertainty relating to the facts, figures and terms which are contained in the financial statements and will be presented to the users of accounting information.

Hence, there is a need to develop some standards which must be followed by all the organizations so as to achieve uniformity in the financial statements. For this purpose, International Accounting Standards Committee (IASC) was established on 29th June, 1973. The Institute of Chartered Accountants of India and Institute of Cost Accountants of India are members of IASC. ICAI is also developing its own accounting standards patterned on International Accounting Standards modified to the requirements of Indian accounting community.

Definition

In the words of Kohler, an accounting standard may be defined as 'a code of conduct imposed on accountants by custom, law or professional body.'

Thus, accounting standards may be defined as the accounting principles and rules which are to be followed for various accounting treatments while preparing financial statements on uniform basis and which will reveal the same meaning to all the interested groups who will use the same. Thus, the Standards are considered as a guide for maintaining and preparing accounts.

Nature of Accounting Standards

On the basis of forgoing discussion, we can say that accounting standards are guide, dictator, service provider and harmonizer in the field of accounting process.

Serve as a guide to the accountants: Accounting standards serve the accountants as a guide in the accounting process. They provide basis on which accounts are prepared. For example, they provide the method of valuation of inventories.

Act as a dictator: Accounting standards act as a dictator in the field of accounting. Like a dictator, in some areas accountants have no choice of their own but to opt for practices other than those stated in the accounting standards. For example, Cash Flow Statement should be prepared in the format prescribed by accounting standard.

Serve as a service provider: Accounting standards comprise the scope of accounting by defining certain terms, presenting the accounting issues, specifying standards, explaining numerous disclosures and implementation date. Thus, accounting standards are descriptive in nature and serve as a service provider.

Act as a harmonizer: Accounting standards are not biased and bring uniformity in accounting methods. They remove the effect of diverse accounting practices and policies. On many occasions, accounting standards develop and provide solutions to specific accounting issues. It is thus, clear that whenever there is any conflict on accounting issues, accounting standards act as harmonizer and facilitate solutions for accountants.

BENEFITS OF ACCOUNTING STANDARDS

There are many benefits of accounting standards. Let us discuss the main benefits of Accounting Standards one by one.

1) **Standardized Accounting:** Perhaps the most important advantage of the FASB standard setting for businesses is the uniform set of accounting principles it promotes. The FASB clearly states the generally-accepted accounting principles that businesses must follow to avoid confusion. For example, the FASB prevents businesses from using one method for calculating inventory at the beginning of a fiscal year and finishing the year with another method. Without the accounting standards set forth by the FASB, businesses could use accounting methods that portray financial data inaccurately to investors.

2) **Problem Identification:** The FASB standard setting provides a framework upon which potential accounting problems are identified and corrected. Because all businesses in the US use the same accounting principles, any problems or inadequacies in the accounting process are quickly identified and reported to the FASB. The FASB then investigates the problem and, if needed, modifies or writes a new accounting rule for the accounting process. For example, if businesses find that reporting a certain type of liability on their income statement unfairly lowers their net income, they can appeal to the FASB so that it can identify problems with the standard setting.

3) **Private Regulation:** The FASB is a private entity with no affiliation to the US government. Despite this, the Securities and Exchange Commission relies on the FASB to set the accounting rules that all companies in the US must follow. The SEC can technically create an accounting oversight board or government agency to set accounting rules. However, using the FASB eases the burden on the US government and lets the private sector dictate accounting rules.

4) **International Accounting Standard:** The FASB is advantageous because it actively promotes an internationally recognized set of accounting rules. Globalization has deeply connected foreign financial markets; a standard set of accounting rules would make financial reporting more accurate and fair between countries. One of the goals of the FASB is to make financial reporting more uniform globally with the cooperation of the International Accounting Standards Board (IASB).

PROCEDURE FOR ISSUING AS IN INDIA

There is a set procedure for issuing AS in India. Let us discuss this prodedure in detail.

1) Determination of the need of an AS

First, the Accounting Standard Board determines the broad areas in which accounting standards needs to be formulated.

2) **Constituting Study Group**

Study Group will be constituted consisting the members of the Institute of Chartered Accountants of India. The motive behind constitution of this group is to assist the accounting Standard Board in its activities.

3) **Drafting the Standard**

The Study Group Prepares draft of the proposed Standard. The proposed draft enlists the following areas:

a) Objective of the standard.

b) Scope of the Standard.

c) Definitions of the terms used in the standard

d) Recognition & Measurement Principles

e) Presentation & Disclosure requirements.

4) **Analyzing the Draft**

ASB in this stage considers the Preliminary draft prepared by the Study Group. In case anything needs to be revised than Accounting Standard Board takes the following steps.

a) ASB makes the revision

b) ASB refers the same to the study Group

5) **Circulation of the Draft**

In this step, the ASB circulates the AS draft to the council members of the Institute of Chartered Accountants of India and the following specifies bodies for their comments.

a) The Institute of Works & Cost Accountants of India

b) The Institute of Company Secretaries of India.

c) Ministry of Company Affairs.

d) Comptroller & Auditor General of India

e) Central Board of Direct Taxes

f) Standing Committee of Public Enterprises

g) Reserve Bank of India

h) Indian Banks Association.

i) Securities & Exchange Board of India.

j) Associated Chamber of Commerce & Industry, Confederation of Indian Industry and Federation of Indian Chambers of Commerce & Industry.

k) Any other body considered relevant by the ASB.

6) Holding Discussion and Finalizing Exposure Draft

ASB holds meeting with the representatives of above mentioned bodies for the purpose of determining their views on the Draft Accounting Standard. Based on analyses of the discussion, ASB finalizes the exposure draft of proposed accounting standards.

7) Circulation of Exposure Draft

The exposure Draft of the proposed standards is issued for comments the members of the ICAI and the public.

8) Finalizing the Exposure Draft

Based on the comments received, the ASB finalizes the draft of the proposed standards. Finally ASB submits the same to the council of the ICAI.

9) Modifying & Issuing the Accounting Standard

The council of the ICAI then considers the finalized draft standard and if necessary modifies the same in consultation with the ASB. The ICAI then issues the Accounting Standard after modification if any on the relevant subject.

SALIENT FEATURES OF FIRST TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS (Ind-AS):101

Ind-AS 101 lays out the accounting principles for first-time adoption of Ind-AS. It prescribes the various requirements to be fulfilled during the transition period when a company adopts Ind-AS for the first time, i.e., when it moves from making the financial statements in accordance with Accounting Standards (Indian GAAP) to make them in accordance with Ind-AS.

Conceptually, the accounting under Ind-AS should be applied retrospectively at the time of transition of companies from applying Accounting Standards (Indian GAAP) to Ind-AS. However, for and easy transition, Ind-AS 101 has provided some exemptions for retrospective application of Ind-AS. The exemptions are clearly categorised into those which are mandatory in nature (i.e., cases where the company is prohibited to apply Ind-AS retrospectively) and those which are voluntary in nature (i.e., it is upto the company to apply or not to apply certain requirements of Ind-AS retrospectively).

Ind-AS 101 also lists out presentation and disclosure requirements to explain the transition to the users of financial statements. It also requires a company to explain how the transition will affect its reported balance sheet, financial performance and cash flows. It does not provide any exemption from the disclosure requirements in other Ind-AS.

Objective of Ind-AS 101

The objective of Ind-AS 101 is to ensure that the entity's first Ind-AS Financial Statements, and its interim financial reports for the period covered by those financial statements, contain high quality information that:

1. Is transparent for users and comparable over all periods presented,
2. Provide a suitable starting point for accounting in accordance with the Indian Accounting Standards (Ind-AS), and
3. Can be generated at a cost that does not exceed benefits.

Scope of Ind-AS 101

An entity shall apply the Indian Accounting Standard-101 (first time adoption of Indian Accounting Standards) in:

a) First Financial Statements after implementing Ind-AS.

b) Each Interim Financial Report in accordance with Ind-AS 34 *Interim Financial Reporting* for the part of the period covered by its first IndAS financial Statements.

CURRENTLY PREVAILING ACCOUNTING STANDARDS IN INDIA

Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2016 there are 32 accounting standards specified by ICAI, all of which are mandatory to be complied by the companies. Following is the list of these standards:

- AS 1 Disclosure of Accounting Policies
- AS 2 Valuation of Inventories
- AS 3 Cash Flow Statements
- AS 4 Contingencies and Events Occurring after the Balance Sheet Date
- AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies
- AS 6 Depreciation Accounting
- AS 7 Construction Contracts (revised 2002)
- AS 8 Accounting Policies, Chanages in Accounting estimates and Errors. AS 9 Revenue Recognition
- AS 10 Accounting for Fixed Assets
- AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003),
- AS 12 Accounting for Government Grants
- AS 13 Accounting for Investments
- AS 14 Accounting for Amalgamations

- AS 15 Employee Benefits (revised 2005)
- AS 16 Borrowing Costs
- AS 17 Segment Reporting
- AS 18 Related Party Disclosures
- AS 19 Leases
- AS 20 Earnings Per Share
- AS 21 Consolidated Financial Statements AS 22 Accounting for Taxes on Income.
- AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
- AS 24 Discontinuing Operations
- AS 25 Interim Financial Reporting
- AS 26 Intangible Assets
- AS 27 Financial Reporting of Interests in Joint Ventures
- AS 28 Impairment of Assets
- AS 29 Provisions, Contingent Liabilities and Contingent Assets
- AS 30 Financial Instruments: Recognition and Measurement
- AS 31 Financial Instruments: Presentation
- AS 32 Financial Instruments: Disclosure

INTERNAT1IONAL FINANCIAL REPORTING STANDARDS

Accounting provides companies, investors, regulators and others with a standardized way to describe the financial performance of an entity. Accounting standards present and prepares of financial statements with a set of rules to abide by when preparing an entity's accounts, ensuring this standardization across the market. Companies listed on public stock exchanges are legally required to publish financial statements in accordance with the relevant accounting standards.

International Financial Reporting Standards (IFRS) is a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis — by developed, emerging and developing economies.
Thus, providing investors and other users of financial statements with the ability to compare the financial performance of publicly listed companies on a like for-like basis with their international peers.

IFRS are now mandated for use by more than 100 countries, including the European Union and by more than two-thirds of the G20. The G20 and other international organisations have consistently supported the work of the Board and its mission of global accounting standards.

NEED AND PROCEDURE OF IFRS

With the increasing globalization of financial markets and of companies, the use of a single set of financial reporting standards across countries is viewed as having increased the comparability of financial statements across borders. It also reduces the cost of preparing the consolidated financial statements of groups made up of companies conducting business all around the world.

Financial reporting standards have been in the spotlight since the banking crisis, more specifically those requiring the measurement of financial assets and liabilities at fair value. In September 2009, G20 leaders in Pittsburgh asked the accounting standard setters IASB and, its US counterpart, the FASB to work towards a single set of high quality global accounting standards by June 2011. Convergence, however, is proving challenging and is likely to be pushed back.

Initially, IFRS begun as an academic project aimed at creating a single set of global standards, their actual use was kick-started by the European Union.

An EU regulation requires listed companies in Europe to adhere to International Financial Reporting Standards (IFRS) from financial years commencing on or after 1 January 2005 when preparing their consolidated accounts. In implementing this in UK legislation, the Government has not yet made the use of IFRS compulsory for any further categories of accounts, but the legislation permits all companies to use them for individual and consolidated accounts if they wish.

Changes have been made to UK tax legislation to accommodate these new rules for tax purposes.

International Financial Reporting Standards (IFRS) are developed through an international consultation process, the “due process”, which involves interested individuals and organisations from around the world.

The due process comprises six stages, with the Trustees of the IFRS Foundation having the opportunity to ensure compliance at various points throughout:

1. Setting the agenda
2. Planning the project
3. Developing and publishing the Discussion Paper, including public consultation 4. Developing and publishing the Exposure Draft, including public consultation

5. Developing and publishing the Standard. 6. Procedures after a Standard are issued.

The IFRS issued by IASB and the corresponding Ind- AS are given below:

S. No.	IFRS No.	Title	Corresponding converged Ind-AS
1)	IFRS 1	First-time Adoption of Indian Accounting Standards	Ind-AS 101
2)	IFRS 2	Share based Payment	Ind-AS 102
3)	IFRS 3	Business Combinations	Ind-AS 103
4)	IFRS 4	Insurance Contracts	Ind-AS 104
5)	IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	Ind-AS 105
6)	IFRS 6	Exploration for and Evaluation of Mineral Resources	Ind-AS 106
7)	IFRS 7	Financial Instruments: Disclosures	Ind-AS 107
8)	IFRS 8	Operating Segments	Ind-AS 108
9)	IFRS 9	Financial Instruments	Exposure Draft Issued
10)	IFRS 10	Consolidated Financial Statements	Exposure Draft Issued
11)	IFRS 11	Joint Agreements	Exposure Draft Issued
12)	IFRS 12	Disclosure of Interests in Other Entities	Exposure Draft Issued
13)	IFRS 13	Fair Value Measurement	Exposure Draft Issued

B. com H SEM. I **UNIT I**

INTRODUCTION

Business transactions are recorded in the books of accounts which are customarily divided into two classes (1) Journal and (2) Ledger. Journal is a book in which transactions are recorded in the order in which they occur, i.e., in chronological order. Journal is called the Book of Original Entry since all transactions are initially recorded in it.

1. **JOURNAL**

Meaning of a Journal: A Journal is the primary book of accounts in which transactions are first recorded in a chronological order, i.e., as they are entered into. Transactions are recorded in the Journal book from the accounting voucher that is prepared on the basis of source documents, i.e., cash memo, invoices, purchase bills, etc.

Definitions

"The basic book of accounting is called Journal. Precisely it is the book of prime entry which means—Day Book. Trader records his total daily transactions in it. The process of recording the transactions into Journal is called Journalizing." —Rowland

"A Journal is a book, employed to classify or sort out transactions in a form convenient for their subsequent entry in the Ledger." —Cropper

"A Journal is a chronological record of financial transactions of a business." —M.J. Keeler

Journal makes it possible to review the effect of a transaction on the business. It shows for each transaction the transaction date, name of accounts that are to be; debited or credited, Ledger page number (Ledger folio) of the accounts, the amount of; debit and credit.

All business transactions can be recorded in a simple Journal. Alternatively, an enterprise may use separate Journals to record particular type of transactions, e.g., credit purchases may be recorded in Purchases Journal; credit sales, may be recorded in Sales Journal, purchases return may be recorded in Purchases Return Journal, and so on. These Journals are called Special Journals.

Terms or Expressions Associated with Journal

(i) Book of Original Entry: Journal is called a Book of Original Entfy (also called Book of Prime Entry) because a transaction is first recorded or written in this book and thereafter transferred, i.e., posted into the Ledger Account.

(ii) Journal Entry: An entry recorded in the Journal is called a Journal Entry.

(iii) Journalising: The process of recording a transaction in a Journal is known as Journalising.

(iv) Posting: The transfer of Journal entry to a Ledger Account is called Posting.

CHARACTERISTICS OR FEATURES OF A JOURNAL

Day-to-day transactions are recorded in a Journal in chronological order.

It is a book of original entry in which transactions **are written before they are posted in** the Ledger.

3. It records both the debit and credit aspects of a transaction by using the Double Entry System of Book Keeping.

4. A Journal is a record which shows- complete details of a transaction in one entry. Journalising means recording a transaction in the Journal and the form in which it is recorded is known as a Journal Entry.

ADVANTAGES OF A JOURNAL

Advantages of a Journal are:

Journal Reduces the Possibility of Error: The possibility of errors is reduced as the amounts to be debited and credited are written side by side and the two can be compared to see that they are equal. If the accounts are written up directly, it is possible that a wrong amount may be written or the amount written on the debit side may be more or less than on the credit side.

Journal Provides an Explanation of the Transaction: Along with the entry in the Journal, a complete explanation (narration) is written so that it is possible to understand the entry properly later.

Journal Provides a Chronological Record of All Transactions: Transactions are entered in the Journal in a chronological order, hence, the order in which they occur enters the record permanently.

FORMAT OF A JOURNAL

The format of a Journal is as follows:

JOURNAL

Date	Particular	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(1)	(2)	(3)	(4)	(5)

L.F. stands for Ledger Folio

Date: In this column, the transaction date is written.

2. Particulars: In this column, two aspects of transactions are recorded, i.e., the name of the two accounts affected by the transaction. The name of the account to be debited is followed by the word 'Dr.' written close to the Eight-hand margin line, while the name of the account to be credited preceded by the word 'To' is written in the next line, a little to the right. Narration, i.e., a brief description of the transaction is also written.

3. Ledger Folio: In this column, the number of the Ledger page is written to which the amount is posted in the Ledger.

4. Debit Amount: In this column, the amount debited is written.

5. Credit Amount: In this column, the amount credited is written.

Note: All the columns, except the Ledger Folio column, are completed at the time of Journalising. The Ledger Folio column is filled in at the time of posting.

STEPS IN JOURNALISING

Steps involved in Journalising are:

Step 1: Ascertain the accounts that are affected by a transaction.

Step 2: Ascertain the nature of the accounts affected.

Step 3: Ascertain the account to be debited and credited by applying the rules of debit and credit.

Let us, at this point, recapitulate the rules of debit and credit. Rules of Debit and Credit

Types of Account	Debit	Credit s
1. Assets Account	Increase ↑	Decrease ↓
2. Liabilities Account	Decrease ↓	Increase ↑
3. Capital Account	Decrease ↓	Increase ↑
4. Revenue Account	Decrease ↓	Increase ↑
5. Expense Account	Increase ↑	Decrease ↓

Step 4: Ascertain the amount by which the accounts are to be debited and credited.

Step 5: Write the date and month of the transaction in the 'Date' column and the year at the top.

Step 6: Write in the 'Particulars' column name of the account to be debited. Along with the name of the account, abbreviation 'Dr.' is written in the same line against the name of the account. Write the amount to be debited in the 'Debit Amount' column.

Step 7: Write in the 'Particulars' column name of the account to be credited. Name of the account to be credited is written in the next line preceded by the word 'To'. The word 'To' is written towards the right after leaving a few spaces. Write the amount to be credited in the 'Credit Amount' column.

Step 8: Write brief description of the transaction starting from the next line in the 'Particulars' column. This brief description of the transaction is called narration.

Step 9: Draw a line across the 'Particulars' column to separate one Journal entry from the other.

Journal columns will become clear from an imaginary entry given below:

Date	Particular		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2014	Cash A/c	Dr.	53*	2,500	
May 5	To Mohan		37*		2,500
	(Being the cash received from Mohan in payment of the amount due from him)				

*53 is the folio/page in the Ledger which is Cash Account where the posting off 2,500 will be found; 37 is the folio/page in the Ledger which is Mohan's Account where the posting of 2,500 will be found.

TOTALLING AND CARRY FORWARD

Usually, the number of transactions in a business are voluminous and require a number of pages of a Journal. Amounts of the debit and credit columns on each page are totalled and carried forward to the next page. In the Particulars column, against the total, the words 'Total c/f (carried forward) are written. It indicates that the total has been carried forward to the next page. In the next page, in the Particulars column, against the amount brought forward, the words 'Total b/f (brought forward) are written. It indicates that the total has been brought forward from the previous page. Further, transactions are recorded and amounts in the two columns are totalled again. This process is followed till recording of the last transaction. Each page of the Journal is totalled to ensure correctness in recording the amounts. Remember, under the dual aspect concept, every debit has a corresponding credit of equal amount. It means amounts debited in a transaction should be equal to the amounts credited. Thus, totals of debit column and credit column should match.

Important Considerations

If a transaction relates to sales or purchases of goods and the name of the seller or purchaser is given and it is not stated as a cash transaction, it is considered to be a credit transaction. For example, 'Goods sold to Mohan' means that it is a credit transaction. Accordingly, Mohan's Account will be debited and the Sales Account credited.

If a transaction relates to sales or purchases and the name of seller or purchaser is given along with cash, it is taken as cash transaction. For example, 'Goods sold to Mohan for cash', it is sales of goods in cash. Accordingly, Cash Account will be debited and Sales Account credited.

If a transaction relates to sales or purchases and the name of the seller or purchaser is not given, it is considered as a cash transaction. For example, goods sold for Rs. 10,000.

In Expenses Accounts, even if the name of the party receiving or making payment is given, it is still treated as a cash transaction. Personal Account will not be opened. For example, if a salary of Rs.

5,000 is paid to Ranjan, the transaction will not be recorded in the account of Ranjan, instead Salary Account and Cash Account will be affected.

Introduction of funds in the business by the proprietor known as capital is credited to his Capital Account whereas withdrawal of cash or goods for personal use is debited to Drawings Account.

RECORDING IN JOURNAL

Transactions are recorded in the Journal on the basis of source documents following the rules of debit and credit. Let us take some examples to understand how a transaction is recorded in a Journal.

Example 1. Shri Dutta started business and introduced capital of Rs. 1,00,000. The transaction is recorded by passing the following Journal entry:

Date	Particulars	LF.	***Dr. (Rs.)***	Cr. (Rs.)
	Bank/Cash A/c ...Dr. To Capital A/c (Being the amount invested in business)		1,00,000	1,00,00 0

Reason for Debit and Credit:

(i) Bank/Cash Account is debited because it is received by the firm. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

(ii) Dutta's Capital Account is credited because capital is increasing. It being a Capital Account, the rule 'Increase in capital is credited and decrease debited is applied.

Example 2. Purchased furniture from Raj Furniture for Rs. 10,000, paid in cash. The transaction is recorded by passing the following Journal entry:

Date	*Particulars*	*L.F.*	*Dr.(Rs.)*	*Cr. (Rs.)*
	Furniture A/c ...Dr. To Cash A/c (Being the furniture purchased against cash)		10,000	10,00

Reason for Debit and Credit:

(i) Furniture Account is debited because the firm has purchased furniture, i.e., has received it. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

(ii) Cash Account is credited because the firm has paid cash for purchase of furniture. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

Example 3. Paid rent Rs. 3,000 in cash. The transaction is recorded by passing the following Journal entry:

Date	Particulars	LF.	Dr. (Rs.)	Cr.(Rs.)
	Rent A/c ...Dr. To Cash A/c (Being the rent paid in cash)		3,000	' 3,00 0

Reason for Debit and Credit:

(i) Rent Account is debited because it is an expense. It being an Expense Account, the rule 'Increase in expenses is debited and decrease credited' is applied.

(ii) Cash Account is credited because the firm has paid cash towards the expenses. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

Example 4. Purchased goods for Rs. 50,000 for cash. The transaction is recorded by passing the following Journal entry:

Date	Particulars	LF.	Dr.(Rs.)	Cr.(Rs.)
	Purchases A/c ...Dr. To Cash A/c (Being the goods purchased for cash)		50,000	50,00 0

Reason for Debit and Credit:

(i) Purchases Account is debited because the firm has purchased goods for the purpose of sale. It being an Expense Account, the rule 'Increase in expenses is debited and decrease credited' is applied.

(ii) Cash Account is credited because the firm has paid cash for purchases of goods. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

Example 5. Interest received Rs. 1,000 in cash. The journal entry is passed is:

Date	Particulars	LF.	Dr.(Rs.)	Cr.(Rs.)
	Cash A/c ...Dr. To Interest received A/c (Being the interest received)		1,000	1,000

Reason for Debit and Credit:

Cash Account is debited because the firm has received cash. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

Interest Received Account is credited because the firm has received an income. It being a Revenue Account, the rule 'Increase in revenue is credited and decrease debited' is applied.

Example 6. Paid a creditor Rs. 5,000. The Journal entry passed is:

Date	Particulars	LF.	Dr.(Rs.)	Cr.(Rs.)
	Creditors A/c ...Dr.		5,000	

	To Cash A/c (Being the amount paid to a creditors)			5,000

Reason for Debit and Credit:

(i) Creditor's Account is debited because the firm has paid the liability towards a creditor. It being a Liability Account, the rule 'Increase in liability is credited and decrease debited' is applied.

(ii) Cash Account is credited because the firm has paid cash to a creditor. It being an Asset Account, the rule 'Increase in assets is debited and decrease credited' is applied.

A transaction entered into by the business can be recorded by applying the rules of debit and credit to each aspect of it. Let us take an illustration for better understanding.

Illustration 1. You are required to give (a) Journal Entries, (b) Nature of Account (Whether Asset, Liability, Capital, Expense, or Revenue), (c) Nature of change, and (d) Appropriate rule for recording the change for the following transactions:

Nitin invested Rs. 5,00,000 cash in the business.

Purchased building for Rs 2,50,000 in cash.

Purchased merchandise (goods) on account for Rs 50,000.

Sold merchandise for cash Rs 75,000.

Nitin withdrew cash Rs 12,500 for personal use.

Paid Rent Rs 2,000; Salary Rs 4,000.

Cash sales Rs 10,000.

Cash deposited in bank Rs 20,000.

JOURNAL

Date	Particulars	L. F.	Dr. **Rs**	Cr. **Rs**	Nature of Account	Nature of Change	Appropriate Rule
1.	Cash A/c ...Dr. To Capital A/c (Being the amount invested in business)		5,00,000	5,00,000	Asset Capital	Increase Increase	Increase in asset is debited Increase in capital is credited
2.	Building A/c ...Dr. To Cash A/c (Being the building purchased for cash)		2,50,000	2,50,000	Asset Asset	Increase Decrease	Increase in asset is debited Decrease in asset is credited
3.	Purchases A/c ...Dr. To Supplier (Party) (Being the goods bought on credit)		50,000	50,000	Expenses Liability	Increase Increase	Increase in expense is debited Increase in liability is credited
4.	Cash A/c ...Dr. To Sales A/c (Being the cash sales)		75,000	75,000	Asset Revenue	Increase Increase	Increase in asset is debited Increase in revenue is credited
5.	Drawings A/c ...Dr. To Cash A/c (Being the cash withdrawn from business)		12,500	12,500	Capital Asset	Decrease Decrease	Decrease in capital is debited Decrease in asset is credited
6.	Rent A/c ...Dr. Salary A/c ...Dr. To Cash A/c (Being the expenses paid for the month)		2,000 4,000	6,000	Expenses Expenses Asset	Increase Increase Decrease	Increase in expenses is debited Increase in expenses is debited Decrease in asset is credited
7.	Cash A/c ...Dr. To Sales A/c (Being the cash sales)		10,000	10,000	Asset Revenue	Increase Increase	Increase in asset is debited. Increase in revenue is credited
8.	Bank A/c ...Dr. To Cash A/c -. (Being the cash deposited into bank)		20,000	20,000	Asset Asset	Increase Increase	Increase in asset is debited; Decrease in asset is credited

Solution:

Illustration 2. Transactions of Ramesh for April are given below. Journalise them.

2015		Rs.
April 1	Ramesh started business with cash	1,00,000
April 2	Paid into bank	70,000
April 3	Bought goods for cash	5,000
April 4	Drew cash from bank for office	1,000
April 13	Sold goods to Krishna	1,500
April 20	Bought goods from Shyam	2,250
April 24	Received from Krishna	1,500
April 28	Paid cash to Shyam	2,150

April 30	Cash sales for the month	8,000
April 30	Paid salary to Ram	3,000

Solution:

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2015				
April 1	Cash A/c …..Dr.		1,00,000	
	To Capital A/c			1,00,000
	(Being the amount invested by Ramesh in the business as capital)			
April 2	Bank A/c …..Dr.		70,000	
	To Cash A/c			70,000
	(Being the amount paid into the bank)			
April 3	Purchases A/c …..Dr.		5,000	
	To Cash A/c			5,000
	(Being the goods purchased for cash)			
April 4	Cash A/c …..Dr.		1,000	
	To Bank A/c			1,000
	(Being the cash withdrawn from the bank)			
April 13	Krishna A/c …..Dr.		1,500	
	To Sales A/c			1,500
	(Being the goods sold to Krishna on credit)			
April 20	Purchases A/c …..Dr.		2,250	
	To Shyam			2,250
	(Being the goods bought from Shyam on credit)			
April 24	Cash A/c…..Dr.		1,500	
	To Krishna			1,500
	(Being the cash received from Krishna)			
April 28	Shyam …..Dr.		2,150	
	To Cash A/c			2,150
	(Being the amount paid to Shyam)			
April 30	Cash A/c …..Dr.		8,000	
	To Sales A/c			8,000
	(Being the goods sold for cash)			
April 30	Salaries A/c …..Dr.		3,000	
	To Cash A/c			3,000
	(Being the amount paid for salary)			
	Total		1,94,400	1,94,400

Illustration 3. Journalize the following transactions:

2015		Rs.
Jan. 1	Started business with cash	**50,000**
Jan. 3	Paid into bank	**40,000**
Jan. 5	Sold goods to Mohan	**22,000**
Jan. 9	Goods returned by Mohan	**2,000**
Jan. 11	Goods purchased from Shyam	**31,500**

Jan. 15	Goods returned to Shyam	**1,500**
Jan. 18	Bought furniture for office use by cheque	**9,000**
Jan. 22	Purchased goods for cash	**1,000**
Jan. 22	Paid cartage	**50**
Jan. 30	Paid interest on loan	**500**

SIMPLE AND COMPOUND JOURNAL ENTRIES

Solution: JOURNAL

Date	Particulars	LF.	Dr.(Rs.)	Cr.(Rs.)
2015 Jan. 1	Cash A/c ...Dr. To Capital A/c (Being the business started with cash)		50,000	 50,000
Jan. 3	Bank A/c ...Dr. To Cash A/c (Being the amount deposited into the Bank)		40,000	 40,000
Jan. 5	Mohan ...Dr. To Sales A/c (Being the goods sold to Mohan)		22,000	 22,000
Jan. 9	Sales Return A/c ...Dr. T&JWohan (Being to goods returned by Mohan)		2,000 !	 2,000
Jan. 11	Purchases A/c ...Dr. To Shyam ' (Being the goods purchased from Shyam)		31,500	 31,500
Jan. 15	Shyam ...Dr. To Purchases Return A/c (Being the goods returned to Shyam)		1,500	 1,500
Jan. 18	Furniture A/c ...Dr. To Bank A/c (Being the furniture bought and paid by cheque)		9,000	 9,000
Jan. 22	Purchases A/c ...Dr. To Cash A/c . (Being the goods purchased against cash)		1,000	 1,000
Jan. 22	Cartage A/c ...Dr. To Cash A/c (Being the cartage paid)		50	 50
Jan. 30	Interest on Loan A/c, ...Dr. To Cash A/c (Being the payment of interest on loan)		500	 500
	Total		1,57,550	1,57,558

Entries in a Journal are of two types:

1. Simple Journal Entry and 2. Compound Journal Entry.

1. Simple Journal Entry: Simple Journal Entry is an entry in which only two accounts| are affected, i.e., one account is debited and another is credited with an equal amount. The entries in Illustrations 2 arid 3 above are examples of Simple Journal Entry.

2. Compound Journal Entry: Compound Journal Entry is an entry in which two or more accounts are debited and one or more accounts are credited or vice versa. For example, a debt of Rs. 5,000 due from Satish (Debtor) has been discharged by receipt of Rs. 4,850 cash, Rs. 150 allowed as discount. The transaction affects three accounts as follows:

Cash A/C	Asset a/c:	Cash a/c (RS.4,850) to be debited because cash, ***i.e.,*** an asset has increased.
Discount allowed a/c	Expense a/c :	Discount allowed a/c (RS. 150) to be debited because it is an expense or loss for business.
Satish (debtor)	Asset a/c:	Satish (debtor) (RS. 5,000) to be credited because it is an asset.

The entry for the transaction is a Compound Entry as follows:

		Rs.	Rs.
Cash A/c	...Dr.	4,850	
Discount Allowed A/c	...Dr.	150	
To Satish			5,000
(Being the amount received from Satish and allowed him discount)			

Let us take another example of a Compound Entry. Salary of Rs. 5,000 and trade expenses of Rs.3,000 are payable for the year ended 31st March, 2015. These expenses can be recorded in the books of accounts with the following compound Journal entry:

		Rs.	Rs.
Salary A/c	...Dr.	5,000	
Trade expenses A/c	...Dr.	3,000	
To Expenses payable			8,000
(Being the salary and trade expenses payable provided)			

Illustration 4 (Compound Journal Entries). Record the following transactions in a Journal:

2015		Rs.
Jan 1	Paid to Mohan in full settlement of his account of Rs. 10,000	9,500
Jan 5	Received from Ram Rs. 12,000 in cash and allowed him discount	100
Jan 7	Paid salaries	5,000
Jan 7	Paid rent	3,000

Jan7	Paid wages	1,000
Jan 10	Purchased goods of Rs. 20,000 out of which goods of Rs. 12,000 were on credit from Shayam Lal	

Solution: In the Books of

Journal

S..No.	Particulars	L.F.	Dr. Rs.	Cr. Rs.
1	Mohan		10,000	
	To Cash A/c			9,500
	To Discount Received A/c			500
	(Being the payment to Mohan in full settlement of his account)			
2	Cash A/c		12,000	
	Discount Allowed A/c		100	
	To Ram			12,100
	(Being the receipt of money from Ram and allowed him discount)			
3	Salaries A/c		5,000	
	Rent A/c		3,000	
	Wages A/c		1,000	
	To Cash A/c			9,000
	(Being the payment of salaries, rent and wages)			
4	Purchases A/c		20,000	
	To Cash A/c			8,000
	To Shyam Lal			12,000
	(Being goods purchased for cash Rs. 8,000 and on credit from Shyam Lai for Rs. 12,000).			

Entries of Some Specific Transactions

1. Bad Debts: In a business, if an amount is not realised or is partially realised, the amount not realised is a loss and is termed as Bad Debt. The following Journal entries are passed in such a case:

(i) When the amount is not recovered:

Bad Debts A/c ...Dr. [With the amount not received]
To Debtor's Personal A/c
(Being the amount not recoverable written off as bad debt)

(ii) When a part of debt is not recovered: If a debtor becomes bankrupt and is unable to pay his debt in full, the unrealised amount is a loss to the business, i.e., a bad debt. The Journal entry passed is:

Cash or Bank A/c ...Dr. [With the amount received]
Bad Debts A/c ...Dr. [With the amount not recovered]
To Debtor's Personal A/c [Total amount of debtor]
(Being the amount received and balance written off as bad debt, not recoverable)

2. Bad Debts Recovered: Sometimes a debtor whose account had been earlier written off as a Bad Debt pays some amount. The amount so received is a gain to the business because the amount was earlier written off as a loss, i.e., bad debt. The entry of bad debts recovered is:

Cash or Bank A/c ...Dr.
To Bad Debts Recovered A/c
(Being the amount earlier written off as bad debt, now recovered)

Amount earlier written off as Bad Debt and recovered (in part or full) is credited to Bac Debts Recovered

Illustration 5 (Insolvency and Bad Debts). Journalise the following transactions:

(i) Sohan is declared insolvent. Received from his Official Receiver a dividend of 60 paise in the rupee on a debt of Rs. 1,000.

(ii) Mohan who owed Rs. 2,000 has become insolvent. He pays 50 paise in a rupee in full and final settlement.

(iii) Received cash for a bad debt written off last year Rs. 700.

Solution: In the Books of Journal ...

S..No.	Particulars	L.F.	Dr. Rs.	Cr. Rs.
1	Cash A/c ...Dr.	.	600	
	Bad Debts A/c ...Dr.		400	
	To Sohan			1,000
	(Being the cash dividend of 60 paise in the rupee out of his debt of Rs. **1,000** received from Sohan on his insolvency)			
2	Cash A/c ...Dr.		1,000	
	Bad Debts A/c . ..Dr.		1,000	
	To Mohan			2,000
	(Being 50 paise in rupee received from Mohan out of a debt of Rs. **2**,000 in full and final settlement)			
3	Cash A/c ...Dr.		700	
	To Bad Debts Recovered A/c*			700
	(Being the cash received on account of recovery of a bad debt which was previously written off)			

*Recovery of bad debt written off last year is a gain, therefore, it is credited to the Bad Debts Recovered Account.

3. Cash Withdrawn for Personal Use: Cash withdrawn for personal use is termed as 'Drawing'. The entry passed is:

Drawings A/c ...Dr.

To Cash A/c

(Being the cash withdrawn for personal use)

4. Banking Transactions: Businesses have a Bank Account through which most of the payments are received and paid. Payment by cheque, cheque received, withdrawal of cash from bank, deposit into bank, bank charges charged by bank and interest charged on overdraft by bank, etc., are examples of banking transactions. If the books of accounts show a debit balance in the Bank Account, it means that such amount is lying deposited in the bank. And if the books of accounts show a credit balance in the Bank Account, it means that such amount is overdrawn and is payable to the bank. At the time of recording banking transactions, following important considerations should be kept in mind:

Bank Account is an asset account and rule of debit and credit for an asset account, i.e., 'Increase is debited and decrease is credited' will apply. When amount is deposited in a bank, Bank Account is debited and when amount is withdrawn Bank Account is credited.

For example, cash deposit into bank increases the bank balance. Thus, Bank Account is debited. Cash withdrawal from the bank reduces the bank balance. Thus, the bank is credited.

If a cheque is received and is not deposited in the bank on the same day, it is debited to Cheques-in-Hand Account. When the cheque is deposited, Bank Account is debited and Cheques-in-Hand Account credited. If the cheque is deposited on the day it is received, Bank Account is debited instead of Cheques-in-Hand Account.

Let us take the Journal entries relating to banking transactions:

S:No.	*Transaction.*	*Entry*	Nature of *Account*	*Rule of Dr. & Cr.*
1.	Cash deposited for opening an account	Bank A/c ...Dr. To Cash A/c	Asset Inc. Asset Dec.	Dr the Inc. in asset Cr. the Dec. in asset
2.	Cash withdrawn	Cash A/c ...Dr. To Bank Ac	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset
3.	Cash withdrawn for personal use	Drawings A/c ...Dr. To Bank A/c	Capital Dec. Asset Dec.	Dr. the Dec. in capital Cr. the Dec. in asset
4.	Payment by cheque to a creditor (say Rakesh)	Rakesh ...Dr. To Bank A/c	Liability Dec. Asset Dec.	Dr. the Dec. in liability Cr. the Dec. in asset

5.	Payment by draft to a creditor (say Vikas)	Vikas Dr Bank Charges A/...Dr. To Bank A/c	Liability Dec. Expenses Inc. Asset Dec.	Dr. the Dec. in liability Dr. the Inc. in expense Cr. the Dec. in asset
6.	Payment of expenses	Expenses A/c ...Dr. To Bank A/c	Expenses Inc. Asset Dec.	Dr. the Inc. in expense Cr. the Dec. in asset
7.	Charges paid to or charged by Bank	Bank Charges A/c ...Dr. To Bank A/c	Expenses Inc. Asset Dec.	Dr. the Inc. in expenses Cr. the Dec. in asset
8.	Cheque or draft received from a debtor (say Rahul) and deposited into bank the same day	Bank A/c / ...Dr. To Rahul	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset
9.	Cheque received from a debtor (say Ankur) and not deposited into bank the same day	Cheques-in-Hand A/c* .Dr. To Ankur '•	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset ,
10.	Above cheque/draft deposited into the bank	Bank A/c ...Dr. To Cheques-in-Hand A/c*	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset
11-	Deposited cheque dishonoured (say of Ankur). .	Ankur ...Dr. To Bank A/c	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset
.12.	Interest charged by the bank	Interest A/c ...Dr. To Bank A/c	Expenses Inc. Asset Dec.	Dr. the Inc. in expense Cr. the Dec. in asset
13.	Interest allowed by the bank	Bank A/c ...Dr. To Interest Received A/c	Asset Inc. Revenue Inc.	Dr, the Inc. in asset Cr. the Inc. in revenue
14.	Bank makes payment on firm's behalf (say insurance premium)	Insurance Premium A/c..Dr. To Bank A/c	Expenses Inc. Asset Dec.	Dr. the Inc. in expense Cr. the Dec. in asset
15.	Collection by bank on our behalf (say dividend)	Bank A/c ...Dr. To Dividend A/c	Asset Inc. Revenue Inc.	Dr. the Inc. in asset Cr. the Inc. in revenue.
16.	Repayment of bank loan in cash	Bank Loan A/c ...Dr. To Cash A/c	Liability Dec. Asset	Dr. the Dec. in liability Cr. the Dec. in asset

			Dec.	
17.	Repayment of bank loan by issue of cheque	Bank Loan A/c ...Dr. To Bank A/c	Liability Dec. Asset Dec.	Dr. the Dec. in liability Cr. the *Dec.* in asset
18.	Transfer of funds from one bank to another (say from SBI to PNB)	Bahk (PNB) A/c ...Dr. To Bank (SBI) A/c	Asset Inc. Asset Dec.	Dr. the Inc. in asset Cr. the Dec. in asset

* Cheques-in-Hand Account is debited because the cheque received has not been deposited into bank on the same day. On deposit of cheque into bank, this account is credited.

Illustration 6 (Banking transaction). Journalise the following transactions.

2015		Rs.
Jan. 1	Paid into bank for opening a current account	20,000
Jan. 2	Withdrawn cash for private expenses	1,000
Jan. 3	Withdrawn from bank	3,000
Jan. 4	Withdrawn from bank for private use	2,000
Jan. 5	Placed in fixed deposit account at bank by transfer from current	5,000
Jan. 10	account Goods purchased and amount paid by cheque	2,500

Solution: Journal

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2015 Jan. 1	Bank A/c...Dr. To Cash A/c (Being the cash deposited into the bank)		20,000	20,000
Jan. 2	Drawings A/c ...Dr.. To Cash A/c (Being the cash withdrawn.for personal use)		1,000	1,000
Jan. 3	Cash A/c -...Dr. To Bank A/c (Being the cash withdrawn for office use)		3,000	3,000
Jan. 4	Drawings A/c " ...Dr To Bank A/c (Being the cash withdrawn from bank for personal use)		2,000	2,000
Jan. 5	Fixed Deposit A/c Dr…. To Bank A/c (Being the transfer from Current Account to Fixed Deposit Account)		5,000	5.000
Jan. 10	Purchases A/c. ..Dr. To Bank A/c (Being the goods purchased and payment made through cheque)		2,500	2,500

5. Discount: A reduction in amount, either to encourage more purchase or prompt payment is called a Discount. A discount may be classified into:

(i) Trade Discount and (ii) Cash Discount.

(i) Trade Discount: Trade Discount is allowed when the goods are-sold to the purchaser for resale to the ultimate consumer or when the goods are purchased in large quantity. Trade Discount is allowed as a deduction from the sale value and the sale is recorded in the books of accounts at net amount, i.e., sale value less trade discount. The purchaser records it in the Purchases Book at the net purchase value.

(ii) Cash Discount: Cash Discount is an allowance or deduction allowed when amount is received promptly or before its due date. It is usually allowed as a per cent (say 2%) of the amount received.

Cash Discount, received or allowed, is recorded separately in the books. Obviously, Cash Discount is allowed when payment is received and Cash Discount is received when a payment is made. Cash discount allowed is debited to Discount Allowed Account and cash discount received is credited to the Discount Received Account.

If both Trade Discount and Cash Discount are allowed, Trade Discount is allowed first and thereafter, Cash Discount is allowed. In other words, Cash Discount is calculated on the net amount.

Illustration 7. Pass the Journal entries for the following transactions:

Purchased goods from Sanjiv of Rs. 40,000 at terms 10% Trade Discount and 5% Cash Discount. Paid amount at the time of purchase itself.

Purchased goods from Vijay of Rs. 40,000 on 10% Trade Discount and 5% Cash Discount. Half of the amount was paid at the time of purchase.

Sold goods to Anil for Rs. 20,000, allowed him 10% Trade Discount and 10% Cash Discount. Received half of the amount by cash and balance half by cheque within specified time.

Sold goods to Ajay for Rs. 50,000 allowing 5% Cash Discount and 10% Trade Discount. Half of the amount was received by cheque within specified time.

Date	**Particulars**	**L.F.**	**Dr. (Rs.)**	**Cr. (Rs.)**
1.	Purchases A/c		36,000	
	………Dr.			34,200
	To Cash A/c			1,800
	To Discount Received A/c			
	(Being the goods purchased from Sanjiv @ 10% Trade Discount and 5% Cash Discount)			
2.	Purchases A/c		36,000	
	…………..Dr.			18,000
	To Vijay			17,100
	To Cash A/c			900
	To Discount Received A/c			
	(Being the goods purchased from Vijay @ 10% Trade Discount and 5% Cash Discount. Half of the amount paid)			
3.	Cash A/c		8,100	
	……Dr.		8,100	
	Bank A/c		1,800	
	…...Dr.			18,000
	Discount Allowed A/c			
	……Dr.			
	To Sales A/c			
	(Being the goods sold to Anil at 10% Trade Discount and 10% Cash Discount on Cash basis)			
4.	Cash A/c		22,500	
	…….Dr.		21,375	
	Bank A/c		1,125	
	…….Dr.			45,000
	Discount Allowed A/c			
	……Dr.			

To Sales A/c
(Being the goods sold to Anil at 10% Trade Discount and 10% Cash Discount on Cash basis)

Working Notes:
Calculation of Trade Discount and Cash Discount Rs.

(i) Invoice Price of Goods 40,000
Less: Trade Discount § 10% 4,000
36,000
Less: Cash Discount @ 5% 1,800
Amount Paid 34,200

*(ii)*Invoice Price of Goods 40,000
Less: Trade Discount @ 10% 4,000
Net Value of Goods 36,000
A. Cash Transaction (Rs.36,000 x1/2) 18,000
B. Credit Transaction (Rs.36,000 x *1/2)* *18,000*
Cash Transaction 18,000
Less: Cash Discount 5% 900
17,000

(//'/) Gross Value of Sales 20,000
Less: Trade Discount @ 10% 2,000
18,000
Less: Cash Discount @ 10% 1,800
Amount Paid 16,200

(Cash) 8,100 *(i.e.,1/2 of Rs.* 16,200) (Cheque) 8,100 (1/2)
(iv) Gross Value of Sales 50,000
Less: Trade Discount @ 10% 5,000
Net Value of Sales 45,000

A. Cash Transaction (Rs. 45,000 x 1/2*)* *22,500*
Less: Cash Discount 5% 1,125
21,375

B. Credit Transaction
1/2 of Rs. 45,000 22,500

Illustration 8 (Payments on Account and Payments in Full Settlement). Journalise the following transactions in the books of K.G. Gupta:

(i) Received Rs.9,750 from Hari Ram in full settlement of his account for Rs.10,000.

(ii) Received Rs. 9,750 from Shyam on his account for Rs.10,000.

(iii) Received first and final dividend of 60 paise in the rupee from the Official Receiver of Mr. Ashok who owed Rs. 10,000.

(iv) Paid Rs. 4,800 to Sohan in full settlement of his account for Rs. 5,000.

(v) Paid Rs. 4,800 to Mohan on his account against Rs. 5,000 due.

Solution Journal

	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1.	Cash A/c ...Dr. Discount Allowed A/c ...Dr. To Hari Ram (Being the cash received from Hari Ram after allowing him discount of Rs. 250)		9,750 250	10,000
2.	Cash A/c To Shyam ..Dr. (Being the cash received from Shyam on account)		9,750	9,750
3.	Cash A/c ...Dr. Bad Debts A/c ...Dr. To Ashok (Being the 60 paise in the rupee received from Ashok) v		6,000 4,000	10,000
4.	Sohan ....Dr. To Cash A/c To Discount Received A/c (Being the cash paid to Sohan after receiving discount of f 200)		5,000	4,80 0 200
5.	Mohan ...Dr. To Cash A/c (Being the cash paid to Mohan on account)		4,800	4,800

DISTINCTION BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

Basis	*Trade Discount*	Cash *Discount*
Nature	It is allowed on purchases made in large quantity.	It is allowed on payment being made promptly on or before an agreed date.
Recording	It is hot recorded separately in the books of accounts .	Cash Discount is recorded separately in the books of accounts.
Deduction from Invoice	It is deducted from the invoice.	It is not deducted from the invoice.
Nature of Transaction	It is allowed on' both credit and cash transactions.	It is allowed only on payment.
Consideration	The consideration for allowance, is purchases.	The "consideration for allowance is payment.
Relation	It is related to sales and purchases of goods.	It is related to payment.

6. Goods Taken for Personal Use: **Goods taken for personal use is also a drawing. The entry passed is:**

Drawings A/c ...Dr.
To Purchases A/c
(Being the goods taken for personal use)

Note: Cost of goods withdrawn is debited to Drawings Account and credited to Purchases Account. It is not considered as a sale but a decrease in purchases as no profit is earned on such goods.

7. Goods Given as Charity: Goods given as charity is not sale of goods since it is not for a consideration. The amount of purchases is reduced with the cost of goods given as charity. The entry passed is:

Charity A/c ...Dr.
To Purchases A/c
(Being the goods given as charity, hence credited to Purchases Account)

8. Illustration 9. Record the following transactions in a Journal:

9. Withdrawn goods for personal use (Cost Rs. 500, Sales Price Rs. 700).

10. Goods costing Rs. 500 given as charity.

11.(iii) Received Rs. 975 from Hari in full settlement of his account for Rs. 1,000.

12. Paid Rs. 1,400 to Guri in cash in full settlement of his account for Rs. 1,500.

13.A cheque for Rs. 5,000 received from Rajiv deposited into bank was returned dishonoured.

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
1	Drawings A/c	…..Dr.		500	
	To Purchases A/c				500
	(Being the goods withdrawn for personal use)				
2	Charity A/c	…..Dr		500	
	To Purchases A/c				500
	(Being the goods given as charity)				
3	Cash A/c	…..Dr		975	
	Discount Allowed A/c			25	
	…..Dr				1,000
	To Hari				
	(Being the amount received from Hari and allowed him discount)				
4	Guri .	…..Dr		1,500	
	To Cash A/c				1,400
	To Discount Received A/c				100
	(Being the amount paid in full settlement)				
5	Rajiv			5,000	
	…..Dr				5,000
	To BankA/c				
	(Being the cheque deposited into bank returned dishonoured)				

8. Distribution of Goods as Free Samples: Goods may be distributed as free samples to increase sales. It is in the nature of advertisement expense. Hence, it is debited to the Advertisement Account or Samples Account and deducted from purchases:

Advertisement A/c or Samples A/c ...Dr.
To Purchases A/c
(Being the goods distributed as free samples)

9. Loss by Theft or Fire: In both the cases, it is loss to business. The entry passed is:

Loss by Theft or Fire A/c ...Dr.
To Purchases A/c
(Being the loss of goods by theft or fire)

Note: Loss by Theft or Fire Account is debited because the loss is an expense account and the Purchases Account is credited because the purchases decrease. The loss will be treated in accounts as follows:

(i) When goods (stock) are fully insured, loss is to be borne by the Insurance Company. The entry passed is:

Insurance Co. or Insurance Claim A/c ...Dr.
To Loss by Theft or Fire A/c
(Being the loss of goods recoverable from the insurance company)

Insurance claim is an asset and will be shown as an asset in the Balance Sheet till the amount is received.

(ii) When the goods are partly insured:

Insurance Co. A/c	...Dr.	[Claim admitted]
Profit and Loss A/c	...Dr.	[Loss - claim not admitted]
To Loss by Theft or Fire A/c		[Total loss]
(Being the insurance claim partially admitted. Balance amount transferred to Profit and Loss A/c)		

(iii) When claim is received from the Insurance Company:

Bank A/c ...Dr.
To Insurance Co.
(Being the insurance claim received)

(iv) When the stock is not insured, loss is borne by the firm. At the end of the year, balance in loss by Theft or Fire Account is transferred to Profit and Loss Account:

Profit and Loss A/c ...Dr.
To Loss by Theft or Fire A/c
(Being the loss transferred to Profit and Loss Account)

10. Goods used to make an Asset: When goods are used to make/construct an asset, value of the asset increases. Therefore, Asset Account is debited. The entry is:

Asset A/c ...Dr.
To Purchases A/c
(Being the goods used for making an asset)

Illustration 10. Journalise the following in the books of a timber merchant:

(i) Goods costing Rs. 500 were used by the proprietor for domestic purposes.

(ii) Rs. 200 due from Hari are bad debts.

(i) Goods costing Rs. 3,000 were destroyed by fire. They were not insured.

(iv) Goods damaged by fire Rs. 1,000 and Insurance Co. accepted claim of Rs. 800.

(v) Goods costing Rs. 500 given as charity (Sales Price Rs. 600).

(vi) Paid landlord Rs. 1,500 for rent. One third of the premises is occupied by the proprietor for his own residence.

(vii) Sold household furniture for Rs. 5,000 in cash and paid the money into business.

(viii) Wood used for making office furniture Rs.2,000.

Solution

oks of.

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1	Drawings A/c ….Dr. To Purchases A/c (Being the goods used for domestic purpose)		500	500
2	Bad Debts A/c ..Dr. To Hari (Beinglhe bad debts written off) •		200	200
3	Loss by Fire A/c ..Dr. To Purchases A/c (Being the goods destroyed by fire, they being not insured, it was a loss)		3,000	3,000
4	Loss by Fire A/c ..Dr. To Purchases A/c (Being the goods destroyed by fire, claim was lodged, they being insured)		1,000	1,000
5	Insurance Co. ..Dr. To Loss by Fire A/c (Being the insurance claim lodged with the Insurance Co.)		1,000	1,000
6	BankA/c ..Dr. Profit and Loss A/c ..Dr. To Insurance Co. (Being the insurance claim of ? 1,000 accepted by the Insurance Co. at? 800)		800 200	1,000
7	Charity A/c .Dr. To Purchases A/c (Being the goods costing ? 500 given as charity)		500	500
8	Rent A/c (2/3rd oft 1,500) ...Dr. Drawings A/c ...Dr. To Cash A/c (Being the.rent paid to landlord, 1/3rd of rent debited to Drawings Account, as 1/3rd of the premises is occupied by the proprietor for personal residence)		1,000 500	1,500

11. Purchase and Sale of Fixed Assets: Fixed assets include land, building, plant, machinery, furniture and fixtures, motor car, etc., when fixed asset is purchased, the asset account (individually) is debited. It is not debited to Purchases Account as fixed asset is not for the purpose of sales. Similarly, when fixed asset is sold, it is credited to Asset Account and not to Sales Account. Accounting entries are as follows:

(i) On Cash Purchase of Asset:	***(ii) On Cash Sale of Asset:***
Asset A/c ...Dr.	Cash or Bank A/c ….Dr.

To Cash or Bank A/c (Being the asset purchased against payment)	To Asset A/c (Being the asset sold against payment)
(iii) On Credit Purchase of Asset: Asset A/c. Dr. To Supplier's A/c (Being the asset purchased on credit)	***(iii) On Credit Sale of Asset-*** ***Purchaser's*** A/c …. Dr. To Asset A/c (Being the asset sold on credit)

12. Expenditure on the Installation of Machinery and on the Construction of Building: Machinery and Building are the assets of a business. Any expenditure incurred on carriage and installation of machinery, e.g., freight, wages paid for the installation, etc., is 'capital expenditure' and therefore, is debited to the Machinery Account. In other words, all expenses incurred on the purchase of an asset increase the cost of the asset and is debited to the particular Asset Account and not to Expense Account. For example, expenditure incurred for the construction of building such as purchase of construction materials and payment of wages are also capital expenditure and debited to the Building Account.

Illustration 11. Journalise the following transactions in the books of Gopal, a trader:

2015		Rs.
May 1	Purchased building and issued cheque	15,00,000
May 10	Purchased machinery from Remson on credit	2,00,000
May 15	Bought furniture from Hind Traders for cash	10,000
May 20	Bought a motor van and issued cheque	5,00,000
May 21	Paid for installation of machinery	2,500
May 25	Bricks, cement, etc., for Rs. 1,50,000 and timber for Rs. 2,00,000 purchased and used for the construction of building. Payment was made by cheque	

Solution Journal

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2015				
May 1	Building A/c To Bank A/c (Being the building purchased and cheque issued)		15,00,000	15,00,000
May 10	Machinery A/c To Remson (Being the machinery purchased on credit from Remson)		2,00,000	2,00,000
May 15	Furniture A/c To Cash A/c (Being the furniture purchased on cash)		10,000	10,000
May 20	Motor Van A/c To Bank A/c (Being the motor van purchased and issued cheque)		5,00,000	5,00,000

May 21	Machinery A/c To Cash A/c (Being Rs. 2,500 paid for installation of machinery)	2,500	2,500
May 25	Building A/c _ To BankA/c (Being the bricks, cement, etc., for Rs. 1,50,000 and timber for Rs. 2,00,000 purchased and used for. the construction of building)	3,50,000	3,50,000

13. Central Sales Tax (CST): It is charged by the seller on inter-state sale, i.e., sale made outside the state. For example, sale made by a dealer (seller) in Rajasthan to a dealer (purchaser) in Delhi, it is a case of inter-state sale.

14. CST Collected on Sales: Sales Tax collected on sales is a liability as it is collected on behalf of the Government. It must be deposited in the Government Account by the due date. The entries passed are:

15. (i) Cash or Debtors'A/c ...Dr.

16. To Sales A/c

17. To Central Sales Tax A/c

18. (Being the sales made and Central Sales Tax collected)

19. (ii) At the time of depositing Sales Tax in the Government Account, the entry passed is:

20. Central Sales Tax A/c ...Dr.

21. To Cash or Bank A/c

22. (Being the Central Sales Tax collected and deposited in Government Account)

23. CST paid on Purchases: CST paid on purchases is a cost, it being not recoverable. Therefore, it is debited to Purchases Account.

24. Value Added Tax (VAT): VAT is the tax levied on sale made within the state. VAT paid on purchases is adjustable against VAT collected on sale. Thus, VAT paid is an asset while VAT collected is a liability of the business. VAT paid is adjusted against VAT collected. If the balance in VAT Collected Account is more than the balance in VAT Paid Account, the difference is deposited in the Government Account. In case the balance in VAT Paid Account is more than the balance in VAT Collected Account, it is carried forward to the next year as recoverable.

25. When VAT is paid at the time of purchases:

26. Purchases A/c …..Dr.

27. VAT Paid A/c …..Dr.

28. To Cash or Bank or Creditor's A/c

29. (Being the purchases made and VAT paid recorded)

30. When VAT is collected at the time of sales:

31. Cash or Bank or Debtor's A/c ..…Dr.

32. To Sales A/c

33. To VAT Collected A/c

34. (Being the sales made and VAT collected recorded as liability)

35. (iiii) When VAT is paid to the Government:

36. VAT Collected A/c

37. To VAT Paid A/c

38. (Being the balance in VAT Paid A/c transferred to VAT Collected A/c)

39. VAT Collected A/c

40. To Cash or Bank A/c

41. (Being the balance in VAT Collected A/c after transfer of balance in VAT Paid A/c deposited)

42.

43. ***15.*** Sundry Expenses: Often petty expenses are incurred in a business such as on refreshment, postage, conveyance, etc. Such expenses are normally debited in one account, i.e., Sundry Expenses Account. The Journal entry passed is:

44. Sundry Expenses A/c ...Dr.

45. To Cash A/c

46. (Being the miscellaneous expenses incurred)

47.

Important Note

Adjustment Entries (16 to 21). These entries are passed at the end of the year to make necessary adjustments in accounts so that the final accounts show true and fair result of the business.

16. Closing Stock or Inventory: Closing Stock or Inventory is the goods unsold at the end of the year. It is not given in Trial Balance but is given as an additional information. In order to calculate the correct gross profit or gross loss, it should be brought into the books. Adjustment entry for Closing Stock is as follows:

Closing Stock A/c ...Dr.
To Trading A/c
(Being the Closing Stock recorded)

Remember: ***Closing Stock is to be valued at cost or net realisable value*** **(i.e., market price) whichever is lower.**

17. Outstanding Expenses: Outstanding expenses are the expenses that relate to the current accounting year but have not been paid till the year end. They are accounted in the books of accounts as expense and also payable. Example: Wages for the year ended 31st March, 2015 are Rs. 60,000. Out of this, Rs. 5,000 for the month of March, 2015 have been paid in April, 2015. Since, Rs. 5,000 as on 31st March, 2015 is yet to be paid it should be recorded in the books by passing the following Journal entry:

Wages A/c ...Dr. 5,000
To Outstanding Wages A/c 5,000
(Being the outstanding wages accounted)

18. Prepaid Expenses: Payment of expenses like Insurance, Rent of Shop, etc., are paid in advance, benefit of which may expire in the next accounting year. Such expenses are termed as prepaid expenses. Example: On 1st July, 2014, Rs. 1,200 were paid as insurance premium for the shop for the whole year. Final accounts have to be prepared on 31st March, 2015. It mean" advance payment has been made for the period 1st April, 2015 to 30th June, 2015. Since, payment relating to the period 1st April, 2015 to 30th June, 2015 relates to the next year, it should be recorded in the books for the year ended 31st March, 2015 a prepaid expenses. Journal entry passed is:

Prepaid Insurance Premium A/c ...Dr. 300
To Insurance Premium A/c 300
(Being the amount transferred to Prepaid Insurance Premium A/c
for the period 1st April, 2015 to 30th June, 2015)

Note: Prepaid Insurance Premium A/c is an asset.

19. *Depreciation:* Due to efflux of time or obsolescence or use of fixed assets, value of these assets decreases every year. This fall in value is called Depreciation. It is an expense, hence, a loss. The Journal entry passed is:

Depreciation A/c ...Dr.
To Asset A/c
(Being the depreciation on asset provided)

20. *Accrued Income or Income Accrued but not Due:* The income which is earned but not received is called accrued income. For example, interest on investment has become due but not received. For accrued income, following adjustment entry is passed:

Accrued Income A/c ...Dr.
To Income A/c
(Being the income earned but not yet received)

Accrued Income is an asset for the firm. Any increase in asset is always debited.

21. *Income Received in Advance or Unearned Income:* Income received but not earned during the accounting period is called income received in advance. For example, if Building has been given to a tenant on rent for Rs. 2,40,000 p.a. but during the year Rs. 3,00,000 has been received, then Rs. 60,000 will be the income (rent) received in advance. The Journal entry passed is:

Rent A/c	...Dr. 60,000	
To Rent Received in Advance A/c		60,000
(Being the rent received in advance)		

Unearned Income is a liability for the-firm. Any increase in liability is always credited.

22. *Interest on Capital:* Interest may be allowed on proprietor's capital. It is an expense for the firm. If interest is allowed on capital, the entry passed is:

Interest on Capital A/c ...Dr.
To Capital A/c
(Being the interest on capital allowed @... %)

23. Interest on Drawing: Drawing means withdrawal of cash or goods for personal use by the proprietor. If interest is charged on drawing, it is an income. The entry passed is:

Drawing A/c …..Dr.
To Interest on Drawing A/c
(Being the interest on drawing charged @.....%)

Illustration 11. Pass the Journal entries for the following adjustments as on 31st March, 2015:

(i) Stock at the end of the year Rs. 20,000.
(ii) Salaries due to Administrative Staff Rs. 7,500.
(iii) Out of the rent paid this year, Rs. 2,000 relates to the next year.
(iv) Provide 10% depreciation on furniture costing Rs.5,000.
(v) Provide 10% interest on capital amounted to Rs. 1,00,000.
(vi) Charge interest on drawings Rs. 1,000.
(vii) Paid Rs. 200 for refreshment for a customer.
(viii) Rent due to landlord Rs. 500.
(ix) Interest due but not received Rs. 5,000.

Solution: Journal

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1	Closing Stock A/c		20,000	
	To Trading A/c			20,000

	(Being the closing stock brought into account)		
2	Salaries A/c	7,500	
	To Outstanding Salaries A/c		7,500
	(Being the salaries due to Administrative Staff)		
3	Prepaid Rent A/c	2,000	
	To Rent A/c		2,000
	(Being the rent paid in advance)		
4	Depreciation A/c	500	
	To Furniture A/c		500
	(Being the depreciation provided on furniture)		
5	Interest on Capital A/c	10,000	
	To Capital A/c		10,000
	(Being the interest provided on capital)		
6	Drawings A/c	1,000	
	To Interest on Drawings A/c		1,000
	(Being the interest charged on drawings)		
7	Sundry Expenses A/c	200	
	To Cash A/c		200
	(Being the amount incurred on refreshment for a customer)		
8	Rent A/c	500	
	To Outstanding Rent A/c		500
	(Being the outstanding rent during the year)		
9	Accrued Interest A/c	5,000	
	To Interest A/c		5,000
	(Being the interest due but not received)		

Opening Entry

Books of accounts are closed at the end of each year and a new set of books in the beginning of the new year is started. First entry in the Journal is to record the closing; balances of the previous year as they become the opening balances of the new year. The entry passed to record closing balances of the previous year is called the Opening Entry. The Balance Sheet prepared at the end of the year reflects the closing balances of each asset and liability and is the basis for the opening entry. *While passing an Opening Entry, all Assets Accounts are debited and Liabilities Accounts are credited.*

The following example will make it more clear:

BALANCE SHEET
as at 31st March, 2015

Liabilities	Rs.	Assets	Rs.
Mahendra & Sons	5,600	Cash in Hand	430
Capital	20,000	Cash at Bank	2,675
		Sundry Debtors	7,495
		Closing Stock	9,000
		Machinery and Equipment	6,000
	25,600		25,600

Now, based on the above Balance Sheet, the Opening Entry will be:

Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
Cash A/c	….Dr.		430	
Bank A/c	….Dr.		2,675	
Sundry Debtors A/c	….Dr.		7,495	
Stock A/c	…Dr.		9,000	
Machinery and Equipment A/c	….Dr.		6,000	
To Mahendra & Sons				5,600
To Capital A/c				20,000
(Being the balance brought forward)				

2. LEDGER

Meaning of a Ledger: Earlier, we discussed the term Account. In an account, transactions of one nature are posted or summarised. All the accounts put together becomes a 'Ledger'. A Ledger may be defined as a *"book or register which contains, in a summarised and classified form, a permanent record of all transactions."* It is the most important book of accounts, since the Trial Balance is drawn from it and from the Trial Balance, Financial Statements are prepared. Hence, the Ledger is called the Principal Book.

Features of a Ledger

(i) The Ledger is a master record of all the accounts of a business firm.

(ii) It is prepared from Journal.

(iii) Ledger Accounts show the current balance in all accounts.

(iv) Trial Balance and Final Accounts are prepared from Ledger Accounts.

(v) Ledger Accounts summarise the effect of transactions upon assets, liabilities, capital, incomes and expenditures.

Utility of a Ledger: Ledger is the Principal Book of accounts which contains information regarding business transactions in the form of an account. Information about any account, cannot be extracted from the Journal, as it is a chronological record of business transactions. It can be extracted from a ledger account because all transactions relating to that account are written in that particular account. Generally, information required in business from time to time is:

- How much amount is due from a particular customer?
- How much amount is owed to a particular supplier?
- How much is the amount of purchase and sales during a given period?
- How much amount has been incurred on a particular head of expenditure?
- How much amount has been earned under a particular head of income?

Ledger, being the classified record of transactions can provide answer to the above, questions.

Liability Account in a Ledger shows the amount that the firm owes to creditors and others and Asset Accounts show the amount receivable from debtors or values of: assets and stock. Revenue Accounts show the sources of income and Expenses Account shows the amount of expenses incurred under various heads.

Ledger is the basis of preparing the Trial Balance which helps in ascertaining the; arithmetical accuracy of the accounts. Trial Balance is the basis for preparing the' Final Accounts. Thus, without Ledger, it is difficult to prepare Profit and Loss Account; and Balance Sheet.

Format of a Ledger: The format of ledger account is as follows:

Dr. NAME OF THE ACCOUNT, e,g,, Wages a/c Cr.

Date	Particulars	Folio (J.F.)	Amount (Rs.)	Date	Particulars	Folio (J.F.)	Amount (Rs.)
Date of the transaction	Name of the other account	Page or Reference Number of Subsidiary Book, where the entry was first ' recorded, *e.g.,* Cash Book	Amount of the transaction	Date of the transaction	Name of the other account	Page or Reference Number of Subsidiary Book, where the entry. was first recorded, e.g., Cash Book	Amount of the transaction

Posting the Entries

The process of transferring the transactions written in the Journal to the Ledger Account is called Posting. In other words, the process of transferring entries from the Journal to the Ledger Accounts is termed as posting. Posting is necessary as it summarises all transactions relating to that account at one place.

Mechanics of Posting

Following procedure is followed for posting the debit and credit aspects of the transaction recorded in a Journal:

1. *Posting of an Account debited in a Journal entry:* The steps to be followed are:

First. Identify the account to be debited in the Ledger.

Second. Enter the date of the transaction in the 'Date' column on the debit side of the account.

Third. Write the name of the account which has been credited in the respective entry in the 'Particulars' column on the debit side of the account as 'To' (name of account credited).

Fourth. Record the page number of the Journal where the entry exists in the 'Journal Folio (J.F.)' column.

Fifth. Enter the relevant amount in the 'Amount' column on the debit side.

2. *Posting of an Account credited in a Journal entry:* The steps to be followed are:

First. Identify the account to be credited in the Ledger.

Second. Enter the date of the transaction in the 'Date' column on the credit side.

Third. Write the name of the account which has been debited in the respective entry in the 'Particulars' column on the credit side of the account as 'By' (name of account debited).

Fourth. Record the page number of the Journal where the entry exists in the Journal Folio (J.F.) column.

Fifth. Enter the relevant amount in the 'Amount' column on the credit side.

For example, furniture of Rs. 1,200 is purchased from Modern Furnishers on March 6.

The Journal entry is:

		Rs.	Rs.
Furniture A/c	...Dr.	1,200	
To Modern Furnishers			1,200
(Being the furniture purchased on credit from Modern Furnishers)			

The process of posting will be: in the Furniture Account in the 'Particulars' column we shall write 'To Modern Furnishers'. In the account of Modern Furnishers will be written: 'By Furniture Account'. The two accounts will, thus, appear as under:

Dr. FURNITURE ACCOUNT *Cr.*

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
March,6	To Modern Furnishers	57*	1,200				

Dr. MORDERN FURNITURE Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				March, 6	By Furniture A/c	57*	1,200

*Journal Folio is imaginary.

The process of posting is also illustrated in the following chart:

JOURNAL

Date	Particular	L.F.	Dr. (Rs.)	Cr. (Rs.)

2015 May 5	Cash A/c ….Dr. To Sales A/c (Being the sales of goods for cash vide Cash Memo No….).	600	 600
May 8	Mohan …..Dr. To Cash A/c To Discount Received A/c (Being the cash paid to and discount allowed by Mohan)	425	 410 15
May 10	Purchases A/c ……Dr. To Dutt (Being the goods purchased from Dutt on credit	800	 800

Ledger

Dr. CASH ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015 May 5	To Sales A/c		600	2015 May 8	By Mohan		410

Dr. SALES ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015 May 5	By Cash A/c		600

Dr. PURCHASE ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015 May 10	To Dutt		800				

Dr. DISCOUNT RECEIVED ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015 May 8	By Mohan		15

Dr. MOHAN Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015 May 8	To Cash A/c To Discount Received A/c		410 15				

Dr. DUTT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015 May 10	By Purchases A/c		800

Posting of Opening Entry

As discussed earlier, all assets will show a debit balance. Such accounts will be opened and the relevant amount will be written on the debit side as 'To Balance brought down *(b/d)'*. On the contrary, the accounts of liabilities show credit balance. An account for each liability will be opened and the relevant amount will be written on the credit side as 'By Balance brought down *(b/d)'*.

Illustration 12. Pass the Opening Entry on 1st April, 2015 on the basis of the following information taken from the books of Mr. Ashok. Also, post the opening entry:

	Rs.
Cash in Hand	20,000
Sundry Debtors	60,000
Stock of Goods	40,000
Plant	50,000
Land and Building	1,00,000
Sundry Creditors	1,00,000

Solution JOURNAL

Date	Particular		L.F.	Dr. (Rs.)	Cr. (Rs.)
2015					
April 1	Cash A/c	….Dr.		20,000	
	Sundry Debtors A/c	…..Dr.		60,000	
	Stock A/c	……Dr.		40,000	
	Plant A/c	……Dr.		50,000	
	Land and Building A/c	….. Dr.		1,00,000	
	To Sundry Creditors' A/c				1,00,000
	To Capital A/c				1,70,000

Note: The excess of assets over liabilities is the proprietor's capital and is credited to his Capital account.

Ledger of Mr. Ashok

Dr. CAPITAL ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 1	To Balance B/d		20,000				

Dr. SUNDRY DEBTORS ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 1	To Balance B/d		60,000				

Dr. STOCK ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							

April 1	To Balance B/d		40,000				

Dr.		PLANT ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 1	To Balance B/d		50,000				

Dr.		LAND & BUILDING ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 1	To Balance B/d		1,00,00 0				

Dr.		SUNDRY CREDITORS ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015			
				April 1	To Balance B/d		60,00 0

Dr.		CAPITAL ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015			
				April 1	To Balance B/d		1,70,00 0

Use of the words ‘To’ and ‘By’: It is customary to use the word 'To' with accounts which appear on the debit side of a Ledger Account. Similarly, the word 'By' is used with accounts which appear on the credit side of a Ledger Account. The words 'To' and 'By' do not have any specific meaning. Modern accountants, therefore, ignore the use| of these words.

BALANCING OF ACCOUNTS

Balance of an account is the difference between the total of debit and credit sides of at account. After posting the transactions, accounts are balanced every year or after a certain period to ascertain the net effect of entries in the accounts. The difference in total of the two sides is written on the side whose total is short. For example, if the total of credit side is Rs. 50,000 and that of debit side is Rs. 40,000, the difference, *i.e. Rs.* 10,000 is written as Balance *c/d* on the debit side. It means the account has a credit balance of Rs. 10,000. On the other hand, if total of debit side is Rs. 75,000 and that of credit side is Rs. 55,000, the difference, *i.e.,* Rs. 20,000 is written as Balance *c/d* on the credit side. It means, the account has a debit balance of Rs. 20,000. Debit balance is then written on the debit side as *'To balance brought down'* or 'To Balance *b/d',* which is the opening balance for the new period. Credit balance is then written on the credit side as *'By Balance brought down',* or 'By Balance *b/d'.* This is the opening balance for the new period. The total of the debit and credit sides of some accounts may be equal those accounts will not show any balance. The concept of balancing is illustrated in the following diagram:

Total the Two Sides of Ledger Account

Find the Difference

If the Debit Side Total is more than the Credit Side Total write the Difference on the Credit Side as 'By Balance c/d'

If the Credit Side Total is more than the Debit side Total write the Difference on the Debit side as 'To Balance c/d'

Make the total of the Debit Side equal to the Total of the Credit

Draw a Double Line after the Totals

Bring forward the Balance on the Next Date

If Debit Balance, write on the Debit Side as 'To Balance b/d

he total of r

, the accour

If Credit Balance write on the Credit Side as 'By Balance b/d'

Cash-in-Hand.

Types of Accounts that are Balanced: Normally, Assets, Liabilities and Capital Accounts are balanced. Revenue and Expenses Accounts are not balanced. These accounts are closed by transferring to Trading or Profit and Loss Account at the end of the accounting year.

The Ledger Accounts based on Journal entries in Illustration 2 will be opened as follows:

LEDGER

Dr. CASH ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015				2015			
April 1	To Capital A/c		1,00,000	April 2	By Bank A/c		70,000
April 4	To Bank A/c		1,000	April 3	By Purchases		5,000
April	To Krishna		1,500	April 28	A/c		2,150
24	To Sales A/c		8,000	April 30	By Shyam		3,000
April				April 30	By Salaries A/c		30,350
30			1,10,500		By Balance *c/d*		1,10,500
	To Balance *b/d*						
			30,350				

Dr. CAPITAL ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015				2015			
April 30	To Balance c/d		1,00,000	April 1	By cash a/c		1,00,000
				May 1	By balance b/d		1,00,000

Dr. BANK ACCOUNT Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015				2015			
April 2	To Cash a/c		70,000	April 4	By Cash a/c		1,000
				April 30	Balance c/d		69,000
			70,000				70,000
May 1	By balance b/d		69,000				

Dr. PURCHASE ACCOUNT* Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 3	To Cash a/c		5,000				
April 20	To Shyam		2,250				

Dr. SALES ACCOUNT* Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2015			
				April 13	By Krishna		1,500
				April 30	By Cash a/c		8,000

Dr. KRISHNA Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015				2015			
April 13	To Sales a/c		1,500	April 24	By cash a/c		1,500
			1,500				1,500

Dr. SHYAM Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015				2015			
April 28	To Cash a/c		2.150	April 20	By Purchases a/c		2,250
April 30	To Balance c/d		100				
			2,250				2,250
				May 1	By Balance b/d		100

Dr. SALARIES ACCOUNT*** Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2015							
April 30	To Cash a/c		3,000				

Note: At the end of an accounting period, accounts marked(*) are closed by transfer to the Trading Account' and accounts marked(**) are closed by transfer to the 'Profit and Loss Account'. In other words, balance of accounts related to Goods Account, *(e.g.,* Purchases Account, Sales Account, Purchases Return Account and Sales Return Account) and Direct Expenses Accounts are transferred to the Trading Account and accounts being indirect expenses or incomes are transferred to the Profit and Loss Account. Such accounts are balanced only for Trial Balance purpose. Account balances in the nature of assets and liabilities appear in the Balance Sheet which are not closed but carried forward to the next accounting period.

Distinction between Journal and Ledger

Point *of Distinction*	*Journal*	*Ledger*
1. Nature of Book	It is a book of primary entry.	It is a book of final entry.
2. Basis for Preparation	Primary documents (such as vouchers, receipts, etc.) are the basis for recording transactions in the Journal.	Journal is the basis for recording transactions in the Ledger.
3. Stage of Recording	Recording in the Journal is the first stage.	Recording in the Ledger is the second stage.
4. Object	It is prepared to record all transactions in chronological order.	It is prepared to see the net effect of various transactions affecting a particular account;
5. Format	Journal has five columns: 1. Date, 2. Particulars, 3. Ledger Folio, 4. Debit Amount, 5. Credit Amount.	Ledger has four identical columns on debit and credit side: 1. Date, 2. Particulars, 3. Journal Folio, 4. Amount.
6. Balancing	Journal is not balanced.	. All Ledger accounts (except Nominal Accounts) are balanced in the Ledger.
7. Process	The process of recording in Journal is called Journalising.	The process of recording in the Ledger is called Posting.
8. Basis of Preparation m Filial Accounts	Journal directly does not serve as basis for the preparation of final accounts.	Ledger serves as the basis for the preparation of final accounts.

3. TRIAL BALANCE

After posting the transactions in the accounts and balancing them, a statement is prepared to show separately the debit and credit balances. Such a statement is known as Trial Balance. The total of the debit side of Trial Balance must be equal to that of its credit side. This is based on the principle that in double entry system, for every debit there is a corresponding credit of equal amount. The agreement of Trial Balance shows arithmetical accuracy of the accounting process. If the two sides do not agree, there is definitely some error or errors. *It must be remembered that equalising the two sides of a Trial Balance is not the sole and conclusive proof of the correctness of accounting work.*

Meaning of Trial Balance

"A Trial Balance is a statement, prepared with the debit and credit balances of the Ledger Accounts to test the arithmetical accuracy of the books." —J.R. Batliboi.

"A Trial Balance is the list of debit and credit balances, taken out from the Ledger, ft also includes the balances of cash and bank taken from the Cash Book." —Carter.

A Trial Balance is prepared after having posted the Journal entries into the Ledger; and balancing the accounts. The balance of an account is the difference between the total of the debit entries and the total of the credit entries in an account. If the total of debit entries is greater, it is called a Debit Balance. Likewise, if the total of credit entries is greater, it is called a Credit Balance. All Ledger Accounts showing debit balances are posted in one column and those showing credit balances are posted in the other. We have already discussed that under the Double Entry System, for every debit there is an equal and corresponding credit. Therefore, the total of debit balances in different accounts in the Ledger must be equal to the total of credit balances in different accounts, *i.e.,* the total of the two columns should agree. If they agree, it means that both the aspects of each transaction have been recorded in the correct side of the Ledger.

Characteristics or Features of a Trial Balance

1. It is a list of balances of Ledger Accounts and Cash Book.
2. It is not a part of the Double Entry System of Book Keeping. It is a result of Double Entry System of Book Keeping. It is only a working paper.
3. It can be prepared on any date.
4. It verifies the arithmetical accuracy of posting of entries from the Journal to the Ledger.
5. It is not a conclusive proof of the accuracy of the books of accounts since some errors are not disclosed by the Trial Balance, for example, error of principle.

Objectives or Functions of a Trial Balance

(i) To Ascertain the Arithmetical Accuracy of Ledger Accounts: The Trial Balance enables one to establish whether posting and other accounting processes have been carried out without committing arithmetical errors.

(ii) To Help Prepare the Final Accounts: Financial Statements are prepared from, the Trial Balance. Preparation of Financial Statements, therefore, is the second: objective of preparing a Trial Balance.

(iii) Summary of Each Account: The Trial Balance offers a summary of the Ledger. The Ledger may have to be referred to only when more detail is required in respect of an account.

(iv) To Help in Locating Errors: The Trial Balance helps in locating errors in Boo Keeping work. It should, however, be borne in mind that it does not disclose all the errors in Book Keeping but only the arithmetical inaccuracies.

Preparing a Trial Balance

A Trial Balance is prepared by placing the debit or credit balances separately in the two columns. Debit balances are placed in the 'Debit Column' and credit balances in the 'Credit Column'.

Format of a Trial Balance is as follows:

TRIAL BALANCE
as on

Heads of Account	LF.	Dr. (Rs.)	Cr. (Rs.)

While preparing a Trial Balance, the following points should be borne in mind:

(i) It is prepared on a particular date which should be written on the top.

(ii) In the first column, the name of the account is written.

(iii) In the second column, Ledger Folio, *i.e.,* the page number of the Ledger where the balance appears is written.

(iv) In the third column, the debit balance, if any, is written.

(v) In the fourth column, the credit balance is written.

(vi) The two columns are totalled at the end.

Consider the following Ledger account:

Dr.	RAMESH						Cr.
Date	Particulars	JF	*Rs.*	Date	Particulars	J.F.	Rs.
2013				2013			
April 1	To Balance b/*d*		20,000	April 5	By Bank A/c		19.800
April 6	To Sales A/c		18 500	April 5	By Discount A/c		200
April 27	To Sales A/c		11,300	April 11	By Sales Return A/c		2,500
				April 30	By Balance *c/d*		27,300
			49,800				49,800
May 1	To Balance c/d		27.300				

In the Trial Balance, the account will appear as follows:

Heads of Account	LF.	Dr. (Rs.)	Cr. (Rs.)
Ramesh		27,300	

Hints for Preparing a Trial Balance

1. A Trial Balance is prepared with the help of Ledger and Cash Book.
2. While preparing a Trial Balance all Accounts *i.e.,* Assets, Liabilities, Capital, Expenses and Revenue Accounts are considered. These Ledger Accounts except cash and bank balances are taken from the ledger.
3. In addition to these, the cash balance and bank accounts are also taken from the Cash Book.

4. If an account does not have a balance, it is ignored.
5. The Ledger Accounts showing debit balances are shown in the debit column of a Trial Balance and the Ledger Accounts showing credit balances are shown in the credit column of a Trial Balance.
6. Purchases Account always has a debit balance which is shown in the debit column of a Trial Balance.
7. Sales Account always has a credit balance which is shown in the credit column of a Trial Balance.
8. Returns Inward Account or Sales Return Account always has a debit balance and hence is shown in the debit column of a Trial Balance.
9. Returns Outward Account or Purchases Return Account always has a credit balance and hence is shown in the credit column of a Trial Balance.
10. Opening Stock Account has a debit balance which is shown in the debit column a Trial Balance.
11. Generally, closing stock does not appear in the Trial Balance. It is usually give as an additional information or adjustment outside the Trial Balance. It represents the balance of goods unsold out of opening stock and purchases. To incorporate the closing stock in the books, Closing Stock Account is debited and the Trading Account is credited by the amount of unsold stock at the end. Closing stock appears as an asset on the assets side of the Balance Sheet.

If the closing stock appears in the Trial Balance, it means that it has already been adjusted through purchases by debiting the closing stock and crediting the Purchase Account. In this case, closing stock will not be shown on the credit side of the Trading Account but will be shown as an asset on the assets side of the Balance Sheet.

12. Accounts of assets such as Plant and Machinery, Furniture and Fixtures, Land Building, Motor Car, Bills Receivable, Goodwill, Trade Marks, Patents an Copy Right, Cash in Hand, etc., have a debit balance and are shown in the deb' column of a Trial Balance.
13. Bank balance may be debit or credit. If bank balance is debit, it is shown in the debit column of a trial balance. If it is credit, it is shown in the credit column of a trial balance.
14. Accounts of incomes and gains have credit balances and are shown in the credit column of a Trial Balance.
15. Accounts of expenses and losses have debit balances and are shown in the deb column of a Trial Balance.

Debit Balances: Assets, drawings, debtors, expenses and losses.
Credit Balances: Liabilities, capital, creditors, incomes and gains.

Illustratio ... oks of Mohan &

Date	Particulars	Rs.
2012		
Jan. 1	Mohan started business with cash	80,000
Feb. 5	Purchased goods	25,000
Feb. 20	Sold goods	30,000
May 10	Purchased goods from, Sohan	18,000
May 25	Sold goods to Ramesh	20,000
June 15	Cash given to Sohan	18,000
June 28	Cash received from Ramesh	20,000
Aug. 2	Purchased goods for cash from Sohan	19,000
August 29	Withdrew for personal use	1,500
Oct. 10	Purchased goods from Dinesh	17,000
Nov. 20	Cash paid to Dinesh	16,800
	Discount allowed by him	200
Dec. 31	Paid salaries	2,000

Solution:

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2012				
Jan. 1	Cash A/c ...Dr.		80,000	
	To Capital A/c			80,000
	(Being the cash brought in for capital)			
Feb. 5	Purchases A/c ..Dr.		25,000	
	To Cash A/c			25,000
	(Being the goods purchased for cash)			
Feb. 20	Cash A/c ...Dr.		30,000	
	To Sales A/c			30,000
	(Being the sales of goods for cash)			
May 10	Purchases A/c ...Dr	.	18,000	
	To Sohan			18,000
	(Being the purchases of goods from Sohan)			
May 25	Ramesh ...Dr	.	20,000	
	To Sales A/c			20,000
	(Being the sales of goods to Ramesh)			
June 15	Sohan ...Dr.		18,000	
	To Cash A/c			18,000
	(Being the cash paid to Sohan)			
June 28	Cash A/c ….Dr.		20,000	
	To Ramesh			20,000
	(Being the cash received from Ramesh)			
Aug. 2	Purchases A/c* ...Dr.		19,000	
	To Cash A/c			19,000
	(Being the purchases of goods for cash)			
August 29	Drawings A/c ...Dr.		1,500	

	To Cash A/c (Being the cash withdrawn for personal use)		1,500
Oct. 10	Purchases A/c ...Dr. To Dinesh (Being the goods purchased from Dinesh)	17,000	17,000
Nov. 20	Dinesh ...Dr. To Cash A/c To Discount Received A/c (Being the cash paid to the extent of 716,800 to Dinesh and he allowed discount of 7 200)	17,000	16,800 200
Dec. 31	Salaries A/c ...Dr. To Cash A/c (Being the salaries paid)	2,000	2,000
	Total	2,67,500	2,67,500

* As it is a cash transaction, hence name of Sohan has not been recorded.

Dr. CASH ACCOUNT Cr.

Date	Particulars	L.F.	Rs.	Date	Particulars	L.F.	Rs.
2012				2012			
Jan. 1	To Capital a/c		80,000	Feb. 5	By Purchase a/c		25,000
Feb. 20	To Sales a/c		30,000	June 15	By Sohan		18,000
June 28	To Ramesh		20,000	Aug. 2	By Purchase a/c		19,000
				Aug. 29	By Drawing a/c		1,500
				Nov. 20	By Dinesh		16,800
				Dec. 31	By Salaries a/c		2,000
				Dec. 31	By Balance c/d		47,700
			1,30,000				1,30,000
2013							
Jan. 1	To balance b/d		47,700				

Dr.		CAPITAL ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 Dec. 31	To Balance *c/d*		80,000	2012 Jan. 1	By Cash A/c		80,000
				2013 Jan. 1	By Balance *b/d*		80,000

Dr.		PURCHASES ACCOUNT					*Cr.*
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 Feb. 5	To Cash A/c		25,000				
May 10	To Sohan		18,000				
Aug. 2	To Cash A/c		19,000				
Oct. 10	To Dinesh		17,000				
			79,000				

Dr.		SALES ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2012 Feb. 20	By Cash A/c		30,000
				May 25	By Ramesh		20,000
							50,000

Dr.		SOHAN					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 June 15	To Cash a/c		18,000	2012 May 10	By Purchases a/c		18,000

Dr.		RAMESH					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 May 25	To Sales a/c		20,000	2012 June 28	By Cash a/c		20,000

Dr.		DRAWING ACCOUNT					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 Aug. 29	To Cash a/c		1,500	2012 Dec. 31	By Balance c/d		1,500
2013 Jan. 1	To balance b/d		1,500				

Dr.		DINESH					Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012 Nov. 20	To Cash a/c		16,800	2012 Oct. 10	By Purchases a/c		17,000
Nov. 20	To Discount receive a/c		200				
			17,000				17,000

DISCOUNT RECEIVED ACCOUNT

Dr.							Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
				2012			
				Nov.20	By Dinesh		200

SALARIES ACCOUNT

Dr.							Cr.
Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2012							
Dec. 31	To Cash a/c		2,000				

TRIAL BALANCE
as on 31st December, 2012

Heads of Accounts	L.F.	Debit Balance	Credit Balance
Capital a/c		....	80,000
Cash a/c		47,700	.....
Purchases a/c		79,000	.....
Sales a/c		.....	50,000
Drawing a/c		1,500	....
Discount received a/c		....	200
Salaries a/c		2,000	.....
Total		1,30,200	1,30,200

Notes:

1. At the end of the year, balance of Purchases Account will be transferred to the debit of Trading Account and balance of Sales Account will be transferred to the credit of Trading Account.
2. Balance of Salary Account will be transferred to the debit of Profit and Loss Account and balance of Discount Received Account will be transferred to the credit of Profit and Loss Account.

Expenses and Revenue Accounts are not balanced but are closed at the end of the accounting period by sterling their balances to Trading and Profit and Loss Account

LIMITATIONS OF A TRIAL BALANCE

Trial balance is not a conclusive proof of accuracy. There are many errors which may remain undetected even if the trial balance agrees. These are :

i. Error of complete omissions: An error of omission is an error when a transaction is completely or partially omitted from being recorded in the books of accounts.

ii. Errors of principles: When a transaction is recorded in contravention of accounting principle, it is known as an Error of Principle. Such an error does not affect the trial balance as amounts are placed on the correct side but in a wrong account.

iii. Compensating errors: These are those errors whose effect of which is nullified by another error of equal amount.
iv. Incorrect amount entered in journal.
v. Posting to the wrong account and
vi. An entry posted twice in the ledger.

SUMMARY

Journal is the primary book of accounts in which transactions are first recorded in a chronological order. Journal entry may be simple journal entry or compound journal entry. In case of existing business, assets and liabilities appearing in the previous year's balance sheet will have to be brought forward to the current year. This is done by means of a journal entry termed as 'opening entry'. Ledger is a principal book in which all the accounts are put together. Being the principal book of accounts, a ledger contains all the information regarding various accounts. It helps in preparing the final accounts. Posting to the ledger is the process of transferring information contained in the journal to the ledger. Trial balance is a statement in which the debit and credit balances of all accounts are written with a view to ascertain the arithmetic accuracy of the books of accounts.

UNIT-II

2. Accounting for Fixed Assets & Depreciation

Every business entity requires various types of assets for conducting its operations. These assets are classified on the basis of their usage into current assets and non-current assets. One of the important components of the non-current assets are the fixed assets. Fixed assets are those assets that are used by an entity for performing its operations. These assets are acquired not primarily for resale but in anticipation that these assets will benefit the business in the form of generating revenue over a number of future accounting periods. Importantly the cost of the fixed assets is usually incurred in one accounting period, but it has to be charged over more than one accounting periods. In other words, this requires splitting up of the cost of such fixed asset over the periods during which benefits will be derived from such assets. This breaking up of the total cost over the different accounting periods leads to the concept of Depreciation.

The fixed asset is recorded in the books at its acquisition cost i.e. the price paid to acquire it. This acquisition cost is capitalized, which is regarded as a prepayment for the services to be enjoyed by the business concern over the estimated useful life of the asset. Therefore the acquisition cost should be written off as an expense during its useful life i.e. a portion of the cost should be charged against profit as an expense in each of the accounting periods in which the asset is gainfully used.

2.1. Accounting standards in relation to Fixed Assets and depreciation:

Presently the accounting for fixed assets and depreciation is governed by AS-10(Revised), Property, Plant and Equipment and Ind AS16 'Property, Plant and Equipment', as the case may be.

As per Ind AS 16, Property, Plant and Equipment are tangible items that

i. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
ii. are expected to be used during more than one period

2.1.1.Accounting for Fixed Assets:

The basic accounting for Fixed Assets involves-

Acquisition of the fixed assets; and
Disposal of the fixed assets

Acquisition of Fixed assets:- The entity may acquire the fixed assets in various ways i.e. purchase, exchange and construction. The depreciation is charged from the date of acquisition of the fixed asset.

Purchase of Fixed assets:

On Cash basis: Fixed assets a/c Dr.
To Bank A/c

On Credit basis: Fixed assets a/c Dr.
To Creditors for Fixed assets A/c

Acquisition by Exchange:- By exchanging existing fixed assets

If agreed value > WDV: it results in gain
If agreed value < WDV: it results in loss
If agreed value = WDV: no gain no loss

Fixed Assets A/c Dr.
Loss on Exchange A/c Dr. (if any)
To Fixed assets (Old) A/c
To Bank A/c/Creditors for Fixed Assets A/c
To Gain on Exchange A/c (if any)

Construction of Fixed Assets:

The business entity sometimes constructs fixed assets on their own with the use of of its own materials, labour force and other resources. These fixed assets are shown in the books at their total cost of construction. Sometimes these fixed assets may not have been fully developed on the date of Balance Sheet; they are shown in the Balance Sheet as Capital Work –in- Progress.

During the Construction of Fixed Assets

Capital WIP A/c Dr.
To Purchases A/c (For materials Used)
To Wages A/c (For Labour Cost)
To Other Expenses A/c (for other Expenses)

On Completion of the Construction

Fixed Assets A/c Dr.
To Capital WIP A/c

Extension of Fixed Assets:

The existing fixed asset may require addition/extension. This addition may be of two types.

- When this addition forming an integral part of the existing asset, it is added to the existing asset and it is depreciated over the remaining useful life of the existing asset.
- When this addition retains a separate identity, it is considered a separate asset and it is depreciated independently on the basis of an estimate of its own useful life.

Disposal of Fixed Assets:
The fixed assets are not acquired with the intention for resale. But sometimes it becomes necessary to dispose of a fixed asset. The asset can be disposed by sale or exchange with the new asset. Depreciation on such assets is to be provided till the date of sale. The profit/loss on the date of sale is to be calculated by comparing the sale proceeds with the WDV/Book value at the time of sale. Such profit/loss is transferred to the P&L A/c.

2.2. Method of accounting for disposal of Fixed Assets

2.2.1. Without involving Asset Disposal A/c.

Transaction	**When Depreciation is Charged against Asset**	**When depreciation is charged to** **Provision for depreciation A/c**
Current period's depreciation	Depreciation A/c Dr. To Fixed asset A/c	Depreciation A/c Dr. To Provision for Depreciation A/c
Transferring of accumulated	Not Applicable	Provision for Depreciation A/c Dr.

depreciation on disposal		To Fixed Assets A/c
Disposal of Fixed Assets	Bank A/c Dr. To Fixed asset A/c	Bank A/c Dr. To Fixed asset A/c
Recognising profit on disposal (if any)	Fixed Asset A/c Dr. To Profit on Disposal of Fixed Asset A/c	Fixed Asset A/c Dr. To Profit on Disposal of Fixed Asset A/c
Recognising Loss on disposal (if any)	Loss on disposal of Asset A/c Dr. To Fixed Asset A/c	Loss on disposal of Asset A/c Dr. To Fixed Asset A/c
Transfer of Profit on disposal A/c	Profit on Disposal of Asset A/c Dr. To P/L A/c	Profit on Disposal of Asset A/c Dr. To P/L A/c
Transfer of Loss on Disposal A/c	P/L A/c Dr. To Loss on disposal of Fixed Asset A/c	P/L A/c Dr. To Loss on disposal of Fixed Asset A/c

2.2.2. Involving asset Disposal A/c

Transaction	**When Depreciation is Charged**	**When depreciation is charged to**

	against Asset	Provision for depreciation A/c
Current period's depreciation	Depreciation A/c Dr. To Fixed asset A/c	Depreciation A/c Dr. To Provision for Depreciation A/c
Transferring of accumulated depreciation on disposal	Not Applicable	Provision for Depreciation A/c Dr. To Asset Disposal A/c (Accumulated Dep. till date)
Transfer of Fixed Asset A/c	Asset Disposal A/c Dr. To Fixed Asset A/c (at WDV on the date of disposal)	Asset Disposal A/c Dr. To Fixed Asset A/c (at Original Cost)
Disposal Of Fixed Asset	Bank A/c Dr. To Asset Disposal A/c	Bank A/c Dr. To Asset Disposal A/c
Recognising profit on disposal (if any)	Asset Disposal A/c Dr. To Profit on Disposal of Fixed Asset A/c	Asset Disposal A/c Dr. To Profit on Disposal of Fixed Asset A/c
Recognising Loss on disposal (if any)	Loss on Disposal of Asset A/c Dr. To Asset Disposal A/c	Loss on Disposal of Asset A/c Dr. To Asset Disposal A/c
Transfer of Profit on disposal A/c	Profit on Disposal of Asset A/c Dr. To P/L A/c	Profit on Disposal of Asset A/c Dr. To P/L A/c
Transfer of Loss on Disposal A/c	P/L A/c Dr. To Loss on disposal of Fixed Asset A/c	P/L A/c Dr. To Loss on disposal of Fixed Asset A/c

2.3. Meaning of Depreciation:

Matching principle requires that the revenue of a given period is matched against the expenses for the same period. This ensures ascertainment of the correct amount of profit or loss. If some cost is incurred whose benefit extend to more than one accounting period, it is not justified to charge the entire cost as expense in the year in which it is incurred. In fact, such a cost must be spread over the periods in which it provides benefits. Depreciation is an attempt to spread the cost of a long lived asset, as an expense to the P/L A/c, over its useful economic life.
Depreciation means a gradual and permanent decline in the value of a tangible fixed asset due to its use, wear and tear, obsolescence, effluxion of time, expiration of legal rights or other similar causes.
It is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner.
It is a process of allocation not of valuation. It is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.

As per schedule II under 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.

2.3.1. Features/characteristics of Depreciation:

The salient features of depreciation are as under:

- It is related to depreciable fixed assets only.
- It is a gradual and continuous decline in the value of fixed assets.
- It is permanent decrease i.e. it is an irreversible loss.
- It is a measure of the loss in service potential of fixed asset.
- It is the systematic distribution of the depreciable amount of an asset over its useful life.
- It is revenue item by nature.
- It is a charge against profit, i.e. it has to be accounted for even if there is loss or inadequate profits.

2.3.2. Causes of Depreciation:

The following factors leads to depreciation in the value of fixed assets.

- Physical Wear & tear: The regular usage of an asset results in its wear and tear, which leads to the fall in the value of an asset.
- Physical deterioration: Decrease in the value of an asset due to the dis-use or non-use of the physical capacities of an asset.
- Exhaustion: decrease in the value of an asset being a non-renewable natural resource due to extraction from the asset.
- Effluxion/Passage of Time: The value of assets may decrease even if they are not put to use due to the passage of time.

- Expiration of legal rights of an asset: The fall in the value of certain intangible assets (e.g. patents, Copyrights, leases) as they are acquired for pre-determined specified time period.
- Obsolescence: The value of an asset may decrease due to invention of a new asset, new technique, new process or change in tastes and preferences of people.

2.3.3. Objectives of Providing Depreciation:

Prime objectives for providing of depreciation are:

- To ascertain the true cost of production
- To determine the true operating result
- To disclose the true value of the asset
- To disclose true financial position
- To provide funds for replacement of an asset

2.3.4. Factors considered in the measurement of depreciation:

The amount of depreciation to be charged for a particular asset will depend on the following factors.

Cost of an asset: cost of a depreciable asset refers to the cost incurred on its acquisition, installation, erection, commissioning and the expenses incurred on its acquisition. It also includes additions/improvements made thereof for increasing the efficiency of the asset.

Useful life of the Asset: Useful life of an asset is the estimated economic or commercial life of the asset. Physical life is not important for this purpose because an asset may still exist physically but may not be capable of commercially viable production. Useful life is either (i) the period over which a depreciable asset is expected to be used by an enterprise or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

Residual/Scrap Value/Salvage Value: it is the estimated value of a fixed asset at the end of its economic life after deducting the estimated costs of disposal. It helps in ascertaining the depreciable amount of the asset, which is allocated to different accounting periods during which the asset is gainfully employed.

Depreciable Amount: it is the historical cost of an asset or the amount substituted for historical cost (viz. revalued figure) in the financial statements less the estimated residual value.

2.3.5. Methods of Accounting for Depreciation:

Asset-Depreciation/charge against Asset Method

Depreciation is directly recorded in the respective Fixed Assets Account.

The fixed assets A/c appears at its book value/WDV.

In the income statement, current periods depreciation is debited.

In the Balance Sheet, Fixed Assets a/c is disclosed after deducting the current period's depreciation.

Asset-Provision/Accumulated Depreciation/ Provision for Depreciation Method

Depreciation is separately recorded in Provision for Depreciation/ Accumulated Depreciation A/c.
Fixed Assets A/c appears at its original cost/ capitalized value.
In the income statement, current periods depreciation is debited.
In the Balance Sheet, Fixed Assets a/c is disclosed after deducting the Accumulated Depreciation, i.e. Depreciation till the Balance Sheet date from the original cost.

2.3.6. Methods of Calculating Depreciation:

1. **Straight Line Method/equal Installment Method/Fixed Percentage Method**

The depreciation is calculated on the Original Cost of the fixed asset.
A fixed and equal amount in the form of depreciation, according to a fixed percentage on the original cost, is written off during each accounting period over the expected useful life of the asset.
The book value/WDV of the asset becomes Zero or equal to its scrap value at the expiry of its useful life.
This method is based on the faulty assumption of same amount of utility of an asset in different accounting years.
This method ignores the fact that the service yielding ability of the assets fall while the repairs and maintenance costs increase with the passage of time. Though each year's charge for depreciation is the same, the charge for repairs and renewals goes on increasing as the asset becomes older.

Formula:

Annual Depreciation= $\frac{\text{original Cost of Fixed Asset}+\text{Other Expenses}-\text{Residual Value}}{\text{Expected usefull life of the asset}}$

Rate of Depreciation= $\frac{\text{Annual Depreciation}}{\text{Original Cost}}\times 100$

2. **Written Down Value Method/ Diminishing Balance Method/Reducing Balance Method**

The depreciation is calculated on the Book Value of the Fixed Asset. In the first year, depreciation is calculated on the Original cost of the asset and in the subsequent years it is calculated on the written down value of the asset.
Instead of a fixed amount, a fixed rate on the reduced balance of the asset is charged as depreciation every year.
The amount of depreciation goes on decreasing over the years.
It is one of accelerated methods of depreciation.
The WDV of a fixed asset can never get reduced to a scrap value.
This method is based on the assumption that cost of repairs will increase as the asset gets old and depreciation in later years should be low when the repair cost is expected to be high.
Therefore, this method will result in almost equal burden in all the years of use of the asset as depreciation will reduce with increase in repair costs.
Formula:

Annual Depreciation = Newly acquired Fixed Asset: Original Cost × Rate of Depreciation
Existing Fixed Asset: Opening WDV × Rate of Depreciation

Rate of Depreciation= $\left[\sqrt[n]{\frac{S}{C}} \right] \times 100$

S= Scrap Value
C= Cost of the asset
N= useful life of the asset

Illustration 1: ABC ltd. acquired a plant for ₹40,000 on Jan.1st 2013 and paid installation charges ₹2,000 for it. It purchased another Plant on May1, 2014 for ₹24,000. Depreciation is provided @10%p.a on the original cost of each asset. You are record to:

Pass journal entries
Prepare necessary ledger accounts
Show the extract of P/L A/c and Balance Sheet, for the years 2013 and 2014 under each of the following independent cases:
1. Charge against Asset method 2. Provision for Depreciation method

Solution:
1. Charge against Asset method

Books of ABC Ltd.
JOURNAL

Date	Particulars	Dr.(₹)	Cr.(₹)
1.1.13	Plant A/c Dr.	42,000	
	To Bank A/c(40000+2000)		42,000

	(Being plant acquired and installation charges paid)		
31.12.13	Depreciation A/c Dr.	4,200	
	To Plant A/c		4,200
	(Being Dep. Charged @10% on original cost) WN:1		
31.12.13	P/L A/c Dr.	4,200	
	To depreciation A/c		4,200
	(Being annual depreciation tfd. to P/L A/c.)		
1.5.14	Plant A/c Dr.	24,000	
	To Bank A/c		24,000
	(Being new plant acquired)		
31.12.14	Depreciation A/c Dr.	5,800	
	To Plant A/c		5,800
	(Being dep. Charged @105p.a on original cost) WN:2		
31.12.14	P/L A/c Dr.	5,800	
	To depreciation A/c		5,800
	(Being annual depreciation tfd. to P/L A/c.)		

LEDGER

Dr. Plant A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.13	To Bank A/c	42,000	31.12.13	By Depreciation A/c	4,200

			31.12.13	By Balance c/d	37,800
		42,000			42,000
1.1.14					
	To Balance b/d	37,800	31.12.14	By Depreciation A/c	5,800
	To Bank a/c	24,000		By Balance c/d	56,000
		61,800			61,800

Dr. Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.13	To Plant A/c	4,200	31.12.13	By P/L A/c (Transfer)	4,200
		5,800			5,800
31.12.14	To Plant A/c		31.12.14	By P/L A/c (Transfer)	

Extracts of Final Accounts for 2013

Dr. P/L A/c for the year ended Dec. 31, 2013 Cr.

Particulars	₹	Particulars	₹
To Depreciation on Plant	4,200		

Balance Sheet as on 31.12.2013

Liabilities	₹	₹	Assets	₹	₹
			Plant on 1.1.13	42,000	
			Less: Depreciation for 2013	4,200	37,800

Extracts of Final Accounts for 2014

Dr. P/L A/c for the year ended Dec. 31, 2014 Cr.

Particulars	₹	Particulars	₹
To Depreciation on Plant	5,800		

Balance Sheet as on 31.12.2014

Liabilities	₹	₹	Assets	₹	₹
			Plant on 1.1.14	37,800	
			Add: Plant Acquired on May 1,14	24,000	
				61,800	
			Less: Depreciation for 2014	5,800	56,000

2. Provision for Depreciation Method

Books of ABC Ltd.
JOURNAL

Date	Particulars	Dr.(₹)	Cr.(₹)
1.1.13	Plant A/c Dr.	42,000	
	To Bank A/c(40000+2000)		42,000
	(Being plant acquired and installation charges paid)		
31.12.13	Depreciation A/c Dr.	4,200	
	To Provision for Depreciation A/c		4,200
	(Being Dep. Charged @10% on original cost) WN:1		
31.12.13	P/L A/c Dr.	4,200	
	To depreciation A/c		4,200
	(Being annual depreciation tfd. to P/L A/c.)		
1.5.14	Plant A/c Dr.	24,000	
	To Bank A/c		24,000
	(Being new plant acquired)		

31.12.14	Depreciation A/c Dr.	5,800	
	To Provision for Depreciation A/c		5,800
	(Being dep. Charged @10%p.a on original cost) WN:2		
31.12.14	P/L A/c Dr.	5,800	
	To depreciation A/c		5,800
	(Being annual depreciation tfd. to P/L A/c.)		

LEDGER

Dr. Plant A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.13	To Bank A/c	42,000	31.12.13	By Balance c/d	4,2000
			31.12.13		
		42,000			42,000
1.1.14	To Balance b/d	42,000	31.12.14	By Balance c/d	66,000
	To Bank a/c	24,000			
		66,000			66,000

Dr. Depreciation A/c
Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.13	To Provision for Depreciation A/c	4,200	31.12.13	By P/L A/c (Transfer)	4,200
31.12.14	To Provision for Depreciation A/c	5,800	31.12.14	By P/L A/c (Transfer)	5,800

Dr. Provision for Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.13	To Balance c/d	4,200	31.12.13	By Depreciation A/c	4,200
					4,200
			1.1.14	By Balance b/d	5,800
		10,000	31.12.14	By Depreciation A/c	
31.12.14	To Balance c/d				10,000

Extracts of Final Accounts for 2013

Dr. P/L A/c for the year ended Dec. 31, 2013 Cr.

Particulars	₹	Particulars	₹
To Depreciation on Plant	4,200		

Balance Sheet as on 31.12.2013

Liabilities	₹	₹	Assets	₹	₹
			Plant on 1.1.13	42,000	
			Less: Provision for Depreciation	4,200	37,800

Extracts of Final Accounts for 2014

Dr. P/L A/c for the year ended Dec. 31, 2014 Cr.

Particulars	₹	Particulars	₹
To Depreciation on Plant	5,800		

Balance Sheet as on 31.12, 2014

Liabilities	₹	₹	Assets	₹	₹
			Plant on 1.1.14	42,000	

Add: Plant Acquired on May 1,14	24,000	
	66,000	
Less: Provision for Depreciation	10,000	56,000

Illustration 2: P Ltd. Purchased eight motor vans on Jan.1st , 2012 at a cost of ₹24,00,000. On April 1st, 2013, the company acquired another van at a cost of ₹4,00,000. On June 30, 2014, one of ₹36,000. P Ltd. Charges depreciation @10%p.a on the written down value. The company closes its books on Dec. 31 every year. You are required to:

Pass journal entries
Prepare necessary Ledger accounts, under each of the following methods:
Asset-Charge Method
Asset Provision Method

Solution:

1. Asset-Charge Method

Books of P Ltd.
JOURNAL

Date	Particulars	Dr.(₹)	Cr.(₹)
1.1.12	Motor Van A/c Dr.	24,00,000	
	To Bank A/c		24,00,000
	(Being eight motor vans purchased)		
31.12.12	Depreciation A/c Dr.	2,40,000	
	To Motor Van A/c		2,40,000
	(Being Dep. Charged @10% on original cost) WN:1		
31.12.12	P/L A/c Dr.	2,40,000	
	To depreciation A/c		2,40,000
	(Being annual depreciation tfd. to P/L A/c.)		
1.4.13	Motor Van A/c Dr.	4,00,000	
	To Bank A/c		4,00,000
	(Being new Motor Van acquired)		
31.12.13	Depreciation A/c Dr.	2,46,000	
	To Motor Van A/c		2,46,000

	(Being dep. Charged for 2013) WN:1		
31.12.13	P/L A/c Dr.	2,46,000	
	To depreciation A/c		2,46,000
	(Being annual depreciation tfd. to P/L A/c.)		
30.6.14	Brokerage on Sale A/c Dr.	3,000	
	To Bank A/c		3,000
30.6.14	Bank A/c Dr.	36,000	
	Depreciation A/c Dr.	12,150	
	Loss on Sale of Motor Van A/c Dr.	1,94,850	
	To Motor Van A/c		2,43,000
	(Being Motor Van sold at a loss) WN-2		
31.12.14	Depreciation A/c Dr.	2,07,100	
	To Motor Van A/c		2,07,100
	(Being annual depreciation for 2014 provided) WN-3		
31.12.14	P/L A/c Dr.	4,17,100	
	To Depreciation A/c		2,19,250
	To Loss on sale of Motor Van A/c		1,94,850
	To Brokerage on Sale A/c		3,000
	(Being Dep., Loss on sale and brokerage tfrd to P/L A/c)		

LEDGER

Dr. Motor Van A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.12	To Bank A/c	24,00,000	31.12.12	By Depreciation A/c	2,40,000
				By Balance c/d	21,60,000
		24,00,000			24,00,000

1.1.13	To Balance b/d	21,60,000	31.12.13	By Depreciation A/c	2,46,000
	To Bank A/c (New)	4,00,000	31.12.31	By Balance c/d	23,14,000
		25,60,000			25,60,000
1.1.14		23,14,000			12,150
	To Balance b/d		30.6.14	By Depreciation A/c	36,000
				By Bank A/c	1,94,850
				By Loss on sale of Motor van A/c	2,07,100
				By Depreciation A/c	18,63,900
				By Balance c/d	
		23,14,000			23,14,000

Dr. Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Motor van A/c	2,40,000	31.12.12	By P/L A/c (Transfer)	2,40,000
		2,46,000			2,46,000
31.12.14	To Motor Van A/c		31.12.13	By P/L A/c (Transfer)	
		12,150	31.12.14		2,19,250
30.6.14	To Motor Van A/c	2,07,100		By P/L A/c (Transfer)	
31.12.14	To Motor van A/c	2,19,250			2,19,250

2. Asset Provision Method:

Books of P Ltd.
JOURNAL

Date	Particulars	Dr.(₹)	Cr.(₹)
1.1.12	Motor Van A/c Dr.	24,00,000	
	To Bank A/c		24,00,000
	(Being eight motor vans purchased)		
31.12.12	Depreciation A/c Dr.	2,40,000	
	To Provision for Depreciation A/c		2,40,000
	(Being Dep. Charged @10% on original cost)		
31.12.12	P/L A/c Dr.	2,40,000	
	To depreciation A/c		2,40,000
	(Being annual depreciation tfd. to P/L A/c.)		
1.4.13	Motor Van A/c Dr.	4,00,000	
	To Bank A/c		4,00,000
	(Being new Motor Van acquired)		
31.12.13	Depreciation A/c Dr.	2,46,000	
	To Provision for Depreciation A/c		2,46,000
	(Being dep. Charged for 2013) WN:1		
31.12.13	P/L A/c Dr.	2,46,000	
	To depreciation A/c		2,46,000
	(Being annual depreciation tfd. to P/L A/c.)		
30.6.14	Brokerage on Sale A/c Dr.	3,000	
	To Bank A/c		3,000

30.6.14	Depreciation A/c Dr.		12,150	
	To Provision for Depreciation A/c			12,150
	(Being Depreciation provided on Motor Van sold) WN:2			
30.6.14	Bank A/c Dr.		36,000	
	Provision for Depreciation A/c Dr.		69,150	
	Loss on Sale of Motor Van A/c Dr.		1,94,850	
	To Motor Van A/c			3,00,000
	(Being Motor Van sold at a loss) WN-2			
31.12.14	Depreciation A/c Dr.		2,07,100	
	To provision for Depreciation A/c			2,07,100
	(Being annual depreciation for 2014 provided) WN-3			
31.12.14	P/L A/c Dr.		4,17,100	
	To Depreciation A/c			2,19,250
	To Loss on sale of Motor Van A/c			1,94,850
	To Brokerage on Sale A/c			3,000
	(Being Dep., Loss on sale and brokerage tfrd to P/L A/c)			

LEDGER

Dr. Motor Van A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.12	To Bank A/c	24,00,000	31.12.12	By Balance c/d	24,00,000
		24,00,000			24,00,000

1.1.13	To Balance b/d	24,00,00	31.12.13	By Balance c/d	28,00,000
	To Bank A/c (New)	4,00,000			
		28,00,000			28,00,000
1.1.14		28,00,000	30.6.14		36,000
	To Balance b/d			By Bank A/c	1,94,850
				By Loss on sale of Motor van A/c	
				By Provision for Depreciation A/c	69,150
				By Balance c/d	25,00,000
		28,00,000			28,00,000

Dr. Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Provision for Depreciation A/c	2,40,000	31.12.12	By P/L A/c (Transfer)	2,40,000
		2,46,000			2,46,000
31.12.13	To Provision for Depreciation A/c		31.12.13	By P/L A/c (Transfer)	
30.6.14	To Provision for Depreciation A/c	12,150			2,19,250
			31.12.14	By P/L A/c (Transfer)	
31.12.14	To Provision for Depreciation A/c	2,07,100			
		2,19,250			2,19,250

Dr. Provision for Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.12	To Balance c/d	2,40,000	31.12.12	By Depreciation A/c	2,40,000
					2,40,000

		4,86,000	1.1.13	By Balance b/d	2,46,000
31.12.13	To Balance c/d		31.12.13	By Depreciation A/c	
		4,86,000			4,86,000
		69,150			4,86,000
30.6.14	To Motor Van A/c		1.1.14	By Balance b/d	12,150
	(Accumulated Dep. On Sold part tfd.)		30.6.14	By Depreciation A/c	2,07,100
		6,36,100	31.12,14	By Depreciation A/c	
31.12.14	To Balance c/d				
		7,05,250			7,05,250

Working Notes:

Annual Depreciation @10% for 2013

Particulars	8 Motor Vans	New Motor van
Date of acquisition	Jan 1,2012	April 1,2013
Original Cost	₹24,00,000	₹4,00,000
Less: Depreciation @ 10% for 2012	2,40,000	
WDV on Dec.312012/ Jan1,2013	21,60,000	
Less: Depreciation @ 10% for 2013	2,16,000	30,000
		(4,00,00×10%×$\frac{9}{12}$
WDV on Dec. 31,2013/ Jan 1, 2014	19,44,000	3,70,000

Total Depreciation for 2013= ₹2,16,000+₹30,000= ₹2,46,000

Sale of Motor Van on June30,2014

Particulars	₹
Original Cost on Jan. 1, 2012 (24,00,000×1/8)	3,00,000
Less: Depreciation @ 10% p.a. for 2012 (3,00,000* 10%)	30,000

WDV on Dec31,2012/Jan. 1,2013	2,70,000
Less: Depreciation @ 10% p.a. for 2013 (2,70,000 * 10%)	27,000
WDV on Dec31,2013/Jan. 1,2014	2,43,000
Less: Depreciation @ 10% p.a for 6 months i.e. till june 30, 2014 (243000*10%*6/12)	12,150
WDV on June 30, 2014	2,30,850
Sale Proceeds	36,000
Loss On Sale	1,94,850

Annual Depreciation @ 10% p.a. for 2014

	Old Motor Van(₹)	New Motor Van(₹)
WDV on Jan. 1, 2014	17,01,000 [19,44,000*7/8]	3,70,000
Depreciation @10% for 2014	1,70,100	37,000

Total dep. For 2014= 1,70,000+ 37,000= ₹2,07,100

2.3.7.Change in the Method of Depreciation:

Every entity follows a particular method of calculating the amount of depreciation on a fixed asset. The depreciation method applied to an asset should be reviewed at each financial year end and if there has been a 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 (Ind AS16). As per Ind AS 16, the selected depreciation method should be applied consistently from one period to another.

Ind AS 16 requires that change in depreciation method should be considered as a change in accounting estimate and treated accordingly as per Ind AS 8 'Accounting Policies, changes in Accounting Estimates and Errors'.

According to Ind AS 8, change in accounting estimate is treated prospectively, i.e. if depreciation method is changed, then carrying amount of the asset on the date of change will be depreciated on the basis of the new method.
It is to be noted that retrospective effect is no more accepted in the event of change in method of depreciation.

Accounting procedure:
Up to the date of change, depreciation is provided under the existing/old method.
From the date on which the resolution of change was made, depreciation is to be calculated under the revised/new method on the existing WDV of the asset.

2.4. Capital and Revenue Expenditures and Receipts

Overview

Capital:

- Payments
- Receipts

Revenue:

- Payments
- Receipts

Accounting aims in ascertaining and presenting the results of the business for an accounting period. The transactions should be evaluated whether they are of capital and revenue nature to ascertain the true periodical business results. The purpose of making distinction between capital and revenue transactions is done to ensure proper accounting of transactions, determination of true operating results and proper disclosure of financial position. Revenue expenditures are transferred to P/L A/c in the year of spending while capital expenditures are transferred to P/L A/c in the year in which their benefits are utilized. Therefore we can conclude that it is the time factor, which is the main determinant for transferring the expenditure to P/L A/c. also expenses are recognized in P/L a/c on the basis of Matching Concept which tells when and how much of expenses is to be charged against revenue. Following are some of the important points which helps in making distinction between capital and revenue transactions.

i. Nature of business
ii. Recurring nature of expenditure
iii. Purpose of expense : e.g. Normal maintenance of machinery(R) and major repairs for increasing the productive capacity of machinery(C)
iv. Effect on revenue generating capacity of business
v. Materiality of the amount involved

2.4.1. Expenditure:

Expenditure (or cost) refers to the sacrifice of economic resources or incurrence of liability to obtain some form of benefit in return. If no benefit arises out of the sacrifices made or liabilities incurred, it is referred to as loss.

2.4.1.1. Capital Expenditure:

When the benefit from expenditure can be enjoyed, consumed, or used over multiple accounting periods. It contributes to the revenue earning capacity of a business over more than one accounting periods. It is recognized as a Fixed Asset in the balance sheet. Gradually they are moved from balance sheet to income statement over the period of asset use. E.g. acquisition of fixed assets, addition to existing fixed assets, heavy repairs to overhaul an existing fixed asset.

Features:

- It is of enduring in nature i.e. provides benefit over a number of accounting periods.
- It is non-recurring in nature.
- Normally it involves heavy cash outlay.
- It helps to increase the revenue earning capacity or reduce the operating expenses of the firm.

2.4.1.2. Revenue Expenditure:

When the benefit from expenditure can be enjoyed, consumed, or used for the current accounting period. It is incurred to generate revenue for a particular accounting period. It is also referred as expired cost and hence also called as Expense. The revenue expenses either occur in direct relation with the revenue or in relation with accounting periods. Cost o goods sold is directly related with the sales where as rent is related with the accounting period. It is charged against the revenue i.e. it is recorded on the debit side of P/L A/c.

Features:

- It relates only to the current accounting period.
- It is recurring in nature.
- Normally, it involves lower cash outlay.

2.4.1.3. Deferred Revenue Expenditure:

It is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. In other words, it is an expenditure which is primarily of revenue nature but it is not written off in one accounting period as its benefit is not completely consumed/used-up/exhausted in that one accounting period . The recognition of the revenue expenditure is postponed/deferred to subsequent accounting periods. It is also known as Capitalized Revenue Expenditure as the portion of such expenditure is capitalized even though it is revenue in nature. It does not bring into existence any real asset.

2.4.2. Receipts:

Refer to the inflows of cash or cash equivalents that an entity receives from some external entity.

2.4.2.1. Capital Receipts:

The receipts which are obtained otherwise than the regular operations of an entity. E.g. sale proceeds of fixed assets/investments, Raising of Capital etc.

Features:

- It is non-recurring in nature.
- It does not arise from regular operations of an entity.
- It is not recognized as income.
- It does not affect the operating result of an entity.

2.4.2.2. Revenue Receipts:

Receipts which are obtained in course of normal business activities. E.g. sale proceeds of goods, fees received for services rendered, bad debt recovery etc.

Features:

- It is recurring in nature.
- It arises from the regular operation of the business.
- It is recognized as income of the current accounting period.
- It always affects the operating results of an entity.

2.5. References

1. *Soumya Mukherji, abhik Mukherjee. Financial Accounting, Oxford University Press.*
2. *Hanif, Mukherjee. Financial Accounting, McGraw Hill Education.*
3. *P.C. Tulsian. Financial Accounting, Pearson Education.*
4. *Guidance Notes on Terms used in Financial Statements issued by ICAI.*

B. Com. Honors programme session 2020-21

UNIT 3 ACCOUNTING FOR HIRE-PURCHASEAND INSTALMENT SYSTEMS, CONSIGNMENT AND JOINT VENTURE

I- ACCOUNTING FOR HIRE PURCHASE

HIRE PURCHASE:

CONCEPT

When any person wants to acquire an asset, but is not sure to make payment within a stipulated period of time he may pay in installments if the vendor agrees. This enables the purchaser to use the asset while paying for it in installments over an agreed period of time. This type of a business deal is known as HIRE PURCHASE. Here, the customer pays the entire amount either in monthly or quartly or yearly installments, while the asset remains the property of the seller until the buyer pays his entire liability. For the seller, the agreed installment includes his interest on the assets given on credit to the purchaser. Therefore, when the total amount is paid in installments over a period of time is certainly higher than the cash down price of the article because of interest charges. Obviously, both the parties gain in the bargain. By virtue of this, the purchaser has the right of immediate use of the asset. By this, he gets both credit and product from the same seller. From sellers view point, he derives the benefit by increase in sale and also he recovers his own cost of credit.

DEFINITION

The higher purchase system is regulated by the Higher Purchase Act 1972. This Act defines a higher purchase as an agreement under which goods are let on hire and the hirer has an option to purchase them in accordance with the terms of agreement and includes an agreement under which

1- The owner delivers possession of goods/asset thereof to a person on condition that such person pays the agreed amount in periodic installments.

2- The property in the goods/asset is to pass to such person on the payment of the last installment.
3- Such person has a right to terminate the agreement at any time before the property passes to the purchaser.

Thus, higher purchase transaction involves an agreement between Higher Vendor and Higher Purchaser, whereby hire vendor gives the delivery of goods to hire purchaser on signing of an agreement and after down payment. The higher purchaser undertakes to pay the balance amount in agreed number of installments together with interest. The ownership of goods shall be transferred from hire vendor to hire purchaser only when all the agreed number of installments have been paid by the purchaser or when the last installment is paid. Hire vendor has the right to repossess the goods on the failure to pay any installment by hire purchaser.

MEANING

Hire purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and include the agreement under which:

1- Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments;
2- The property in the goods/assets (i.e. ownership) is to pass to such person on payment of last installment; and
3- Such a person has a right to terminate the agreement at any time before the property so passes.

CONTENTS OF HIRE PURCHASE AGREEMENT

According to Section 4 of the Hire Purchase Act 1972, every hire purchase agreement must state:

i- The hire purchase price of the goods to which the agreement relates.
ii- The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash.
iii- The date on which the agreement shall be deemed to have commenced.
iv- The number of installments by which the hire purchase price is to be paid, the amount of each of those installment and the date or the mode of determining the date, upon which it is payable and the person to whom and the place where it is payable.
v- The goods to which the agreement relates, the manner sufficient to identify them.

SPECIAL FEATURES OF HIRE PURCHASE AGREEMENT

1-Possession: The hire vendor transfers only the possession of the property to the hire purchaser immediately after the contract of hire purchase is made.

2-Instalments: The goods are delivered by the hire vendor on the condition that a hire purchaser should pay the amount in periodical installments.

3-Down payment: The hire purchaser generally makes a down payment i.e. an amount on signing the agreement.

4-Constituents of hire purchase installment: Each installment consists partly of a finance charge (interest) and partly of a capital payment.

5-Ownership: The property in goods is to pass to the hire purchaser on the payment of the last installment and exercising the option conferred upon him under the agreement.

6-Repossession: In case of default in respect of even the last installment, the hire vendor has the right to take the goods back without making any compensation.

SOME MAIN TERMS OF HIRE PURCHASE SYSTEM

Hire purchase price: hire purchase price means an initial payment payable by the hirer under a hire purchase agreement in order to complete the purchase of or acquisition of property in the goods to which the agreement relates and includes any sum so payable by the hirer under the hire purchase agreement by way of deposit or other initial payment. In the form of an equation, hire purchase price may be shown as follows:

Hire Purchase Price = Cash Price + Interest on outstanding Balance

HIRER: a hirer means a person who obtains or has obtained possession of the goods from an owner under a hire purchase agreement.

HIRE VENDOR: hire vendor means a person who delivers or has delivered the possession of of goods to the hirer under a hire purchase agreement.

CASH PRICE: cash price means the price at which the goods may be purchased by the hirer for cash.

HIRE: it means the sum payable periodically by the hirer under a higher purchase agreement.

OWNER: it means the person who lets, or has let, delivers or has delivered possession of goods, to a hirer under the hire purchase agreement.

DOWN PAYMENT: it is an initial payment payable by the hirer at the time of entering into a hire purchase agreement.

HIRE PURCHASE CHARGES: hire purchase charges means the difference between hire purchase price and the cash price as stated in the hire purchase agreement. These hire purchase charges are popularly known as interest.

DIFFERENCE BETWEEN HIRE PURCHASE AND INSTALMENT SALES

HIRE PURCHASE SALE	INSTALMENT SALE
1- Ownership in the goods is transferred only after the payment of last installment.	1-ownership is transferred at the moment of purchase.
2- The remittance is made by the buyer	2-payment of price is generally made in

through installment.	installments or according to agreement.
3- On default, the goods will be seized by the seller.	3-on default, the seller cannot take back the goods but recovery may be made through the court of law.
4- If the buyer sells the goods before making the last installment, the new buyer does not get a better title than the purchaser under credit purchase.	4-if the buyer sells the goods before full payment of price; the new buyer gets better title than the hire purchaser.
5- The buyer has no right to dispose the goods.	5-the buyer the right of disposing the goods in any manner he likes.

ACCOUNTING PROCEDURE FOR HIRE PURCHASE

The following are the methods of recording hire purchases transactions……

Method I: Cash Price Method:-

This method is based on the following..

(1) Full Cash Price
(2) Down Payment/Accrual Method

Method II :

It includes the following methods…

(1) Debtor System/Method
(2) Stock & Debtors System/Method

METHOD I: CASH PRICE METHOD

The accounting entries of the hire purchase transaction under the two methods of cash price method are discussed as follows…

(1) FULL CASH PRICE METHOD: the asset is recorded at full cash price under this method. The following journal entries will be passed…

In the books of Hire Purchase

First Year

(i) On purchase of the asset
Asset on hire purchase a/c Dr.

To hire vendor 's a/c

(ii) On making down payment on delivery
Hire vendor's a/c dr.
To bank/cash a/c

(iii) For interest due on installment
Interest on hire purchase a/c Dr.
To hire purchase a/c

(iv) On payment of hire purchase installment
Hire vendor's a/c Dr.
To cash/bank a/c

(v) For depreciation charged on the asset
Depreciation a/c Dr.
To asset on hire purchase a/c

(vi) For transfer of interest
P/L a/c Dr.
To interest on hire purchase a/c

(vii) For transfer of depreciation
P/L a/c Dr.
To depreciation a/c
Or
P/L a/c Dr.
To interest on hire purchase a/c
To depreciation a/c

In second and subsequent year's entries iii, IV, VI, and vii will be repeated with their respective amount of interest and depreciation provided.

IN THE BOOKS OF HIRE VENDOR

First Year

i- On sale of asset under hire purchase
Hire purchaser's a/c Dr
To hire purchase sale a/c

ii- On receiving down payment
Cash/bank a/c Dr.
To hire purchaser's a/c

iii- For interest due on installment
Hire purchaser's a/c Dr.
To interest on hire purchase sales a/c

iv- On receipt of hire purchase installment
Cash/bank a/c Dr.
To hire purchaser's a/c

v- For transfer of interest
Interest on hire purchase sales a/c Dr.

To P/L a/c

In second and subsequent years, entries iii, iv, and v will be repeated with their respective amount of interest and depreciation provided.

2-DOWN PAYMENT/ACCRUAL METHOD:- When asset is recorded at cash actually paid, the following journal entries will be passed:

IN THE BOOKS OF Hire Purchase

First Year

i- On purchase of the asset
Asset on hire purchase a/c Dr.
To hire vendor's a/c

ii- On making down payment on delivery of asset
Hire vendor's a/c
To cash/bank a/c

iii- When installment becoming due
Asset on hire purchase a/c Dr.
Interest on hire purchase a/c Dr.

To hire vendor's a/c

iv- On payment of installment
Hire vendor's a/c Dr.
To cash/bank a/c

v- For depreciation charged on asset
Depreciation a/c Dr.
To asset on hire purchase a/c

vi- For transfer of interest and depreciation
P/L a/c Dr.
To depreciation a/c
To interest on hire purchase a/c

In second and subsequent years entries iii, iv, v and vi will be repeated with their respective amount of interest and depreciation provided.

IN THE BOOKS OF HIRE VENDOR

There is no change in the accounting treatment in the books of hire vendor under accrual system.

DEFAULT AND RE-POSSESSION

When a hire purchaser makes default and fails to pay installments, the hire vendor has the right to take back the goods under hire purchase agreement. In case of non payment of installment by the purchaser, the hire vendor not only re-possess goods but also forfeits the amount of installments already received , thus treating the installments already paid as hire charges. There are two cases..

i- Full possession: when the hire vendor takes back all the goods sold to hire purchaser.
ii- Partial repossession: in such a case, the hire vendor takes the possession of only some of the total assets sold to hire purchaser and balance of goods are retained by hire purchaser.

ACCOUNTING TREATMENT IN CASE OF FULL REPOSSESSION

IN THE BOOKS OF HIRE PURCHASER

When the goods are repossessed by hire vendor, then the hire purchaser closes both hire vendor account and asset on hire purchaser account on the date of default by making the following entries…

i- Hire vendor's a/c Dr
To asset on hire purchase a/c
ii- Any balance left in the asset is transferred to P/L account
P/L a/c Dr.
To asset on hire purchase a/c

IN THE BOOKS OF HIRE VENDOR

On the date of default the hire vendor closes hire purchaser account by transferring the balance to goods repossessed account

Goods repossessed a/c

To hire purchaser's a/c

The newly opened goods repossessed account is further debited with expenses incurred on the repairs of goods repossessed and credited with cash received from resale of goods. Any balance left in goods repossession account, being profit or loss on resale, is transferred to profit and loss account.

a- Goods repossessed a/c Dr.
To cash a/c
b- Cash a/c Dr.
To goods repossessed a/c
c- P/L a/c Dr.
To goods repossessed a/c
Or
Goods repossessed a/c Dr.
To P/L a/c

ACCOUNTING TREATMENT IN CASE OF CAPITAL REPOSSESSION

In partial repossession, only some of the total assets sold to hire purchaser are repossessed and balance of goods are retained by the hire purchaser. All the journal entries are same in case of full possession except the following difference. In case of default i.e., in case of non-payment of installments, goods on hire purchase are divided into parts:

= goods retained with hire purchaser

= goods repossessed by vendor

Goods retained with hire purchaser are valued at cost less normal rate of depreciation to the date and shown as closing balance of the asset on hire purchase account in the books of hire vendor. Goods taken back by hire vendor are valued at agreed price. Agreed price can be calculated on either of the following basis:

i- goods repossessed may be valued on the basis of enhanced rate of depreciation i.e., agreed value of goods repossessed is calculated after charging rate of depreciation higher than normal rate applied by hire purchaser.

ii- any amount determined by mutual agreement between hire purchaser and hire vendor may be taken as agreed value.

iii- agreed value may also be taken as a certain percentage of cash price or hire purchase price.

The hire purchaser does not close the account of hire vendor and hire vendor does not close the account of hire purchaser in their respective books. However, following entries are made.

IN THE BOOKS OF HIRE PURCHASER

A- hire vendor's a/c Dr.
to asset on hire purchase a/c

B- the value of good-s retained by the purchaser is shown as closing balance in the goods on hire purchase account and balance is transferred to P/L account.

IN THE BOOKS OF HIRE VENDOR

Goods repossession a/c Dr.

To hire purchase a/c

The balance of hire purchaser's account will be carried forward to next year. However, all the entries relating to repairs and resale of goods repossessed will be same as in case of full repossession.

METHOD II

4- DEBTORS SYSTEM/METHOD (also called as hire purchase trading account method)
Sometimes, business sells goods both on cash basis and hire purchase based. When numerous items of the sale value such as cycles, fans, radios, TV sets, etc. are sold on hire purchase basis involving many transactions during an accounting year, it becomes very difficult to maintain separate accounts for each customer, calculation of interest and profit and loss. It will involve lot of cost, efforts and time. Under such circumstances, hire purchase trading account is adopted. For keeping records of hire purchase method transactions a separate book called hire purchase register or hire purchase sales book is maintained to record date of contract, name of hire purchaser, cost price, hire purchase price, down payment, number of installments and amount of each installment with dates when they become due. At the end of the year, profit or loss on hire purchase is calculated by extracting the following information from accounting records:

1- Cost of goods sold on hire purchase,

2- Total cash received from hire purchase customer (down payment + installment) during the year.
3- Installment due but not paid by the hire purchase customer.
4- Installments not yet due. It is also known as stock lying with hire purchase customers

Hire purchase trading account may either be prepared at cost or at hire purchase price.

(A) HIRE PURCHASE TRADING ACCOUNT AT COST:

Under this method all transactions are recorded at cost. The following entries will be made in this method…

1- For recording opening balance:
   Hire purchase trading a/c Dr.
     To stock with HP customers a/c/installment not due a/c
     To installment due a/c
2- For goods sold on hire purchase basis during the year
   Hire purchase trading a/c Dr.
     To goods sold on hire purchase a/c
3- On receipt of cash from HP customers including cash down payment
   Cash/bank a/c Dr.
     To hire purchase trading a/c
4- On repossession of goods due to non payment of installment due
   Goods repossessed a/c Dr.
     To hire purchase trading a/c
5- For recording closing balances
   Installment due a/c Dr.
   Stock with HP customer a/c Dr.
   Installment not due a/c Dr.
     To hire purchase trading a/c
6- In case of profit
   Hire purchase trading a/c
     To profit and loss a/c
7- In case of loss
   P/L a/c Dr.
     To hire purchase trading a/c

HIRE PURCHASE TRADING ACCOUNT (at cost)

-Balance b/d	--	-Cash received from HP customer	--
-Stock with HP customer (at cost)	--	-Goods repossessed (agreed value)	--
-Installment due (at HP price)	--	-Balance c/d	--
-Goods sold on HP basis (cost)	--	-Stock with HP customer (at cost)	--
-Profit & loss a/c (profit) (balancing figure)	--	-Installment due (at HP price)	--
		-Profit and loss a/c (loss) (balancing figure)	--

- Cost of goods sold on HP is arrived as:
  Stock at shop in the beginning (at cost)
  Add: purchases during the year
  Less: stock at shop at the end

(B) HIRE PURCHASE TRADING ACCOUNT (at selling price)
The entries are same in hire purchase trading at cost, but for elimination of profit margin from opening stock with HP customer, goods sold on hire purchase and closing stock with HP customer, the following additional entries are made..

(i) For adjustment/removing loading on goods sold on HP basis
Goods sold on HP a/c DR.
To hire purchase trading a/c

(ii) For adjustment/removing loading on opening stock with HP customer
Stock reserv3e a/c Dr.
To Hire purchase trading a/c

(iii) For adjustment/removing loading on closing stock with HP customer
Hire purchase trading a/c Dr.
To stock Reserve a/c

(C) STOCK AND DEBTOR SYSTEM/METHOD:
This is an alternative method of calculating profit or loss on hire purchase transactions. Under this method, in addition to the three ledger accounts namely shop stock account, installment not due account, and installment due account, hire purchase adjustment account is prepared (instead of hire purchase trading account) for calculation of profit or loss on hire purchase transactions. Goods repossessed a/c should also be prepared, if goods have been repossessed.

The following journal entries are made under this method:

i- When goods are purchased
Shop Stock A/c Dr.
To Purchases A/c

ii- When goods are sold on hire purchase
Hire Purchase A/c Dr.
To Shop Stock A/c
To Hire Purchase Adjustment A/c

iii- When installment becomes due
Installment Due A/c Dr.
Hire Purchase Debtors A/c Dr.
To Hire Purchase Stock A/c

iv- When cash is received from hire purchase debtors
Cash A/c Dr.
To Installment Due/Hire Purchase Debtors A/c

v- When goods are repossessed on default
Goods Repossessed A/c Dr.
HP Adjustment A/c Dr.
To Hire Purchase Debtors A/c

vi- For reserve on opening stock with hire purchase customers
Stock Reserve A/c Dr.
To Hire purchase Adjustment A/c

vii- For reserve on closing stock on hire purchase
Hire Purchase Adjustment A/c Dr.
To P/L A/c

viii- For profit on hire purchase
Hire Purchase Adjustment A/c Dr.
To P/L A/c
For loss on hire purchase
P/L A/c Dr.
To Hire Purchase Adjustment A/c

HIRE PURCHASE ADJUSTMENT ACCOUNT

Dr. Cr.

Particulars	Amount	Particulars	Amount
= Stock Reserve A/c (loading of closing stock)	--	= Stock Reserve A/c (loading of opening stock)	--
= loss on Goods Repossessed	--	= Goods on HP basis/ Hire Purchase Stock A/c (load)	--
= Hire Purchase Expenses	--	= Profit on Repossession	--
= P/L A/c (profit) (balancing figure)	--	= P/L A/c (loss) (balancing Figure)	--

II- CONSIGNMENT ACCOUNTS
DEFINITION

Consignment is the dispatch of goods (or transfer of goods) to an agent for the purpose of storage and sales. The person dispatching the goods is known as consignor and the agent to whom the goods is sent, is called consignee. The consignee undertakes to sell the goods for a consideration, which is called commission.

MEANING

Consignment is an agency arrangement under which the manufacturer or the wholesaler sends his goods at his own risk to his agent in a different place for the purpose of sales on commission basis. The person who sends the goods is known as the consignor or the principal. The ownership of the goods remains with the consignor. The person to whom the goods are sent for sale is known as the consignee or the agent. Sending of goods from consignor to consignee is known as consignment and the goods so sent are termed as goods sent on consignment. The sender is the consignor and the receiver is the consignee. Sending of goods b the consignor is outward consignment and to the consignee it is inward consignment.

CONSIGNMENT	SALES
1-consignment is a dispatching of goods from one person to another on commission basis.	1-sales refer to the transfer of property from the seller to the buyer.
2-legal ownership is not passed on to the agent, but is within the consignor.	2-legal ownership of the goods is passed on to the buyer.
3-the relationship between the consignor and consignee is that of principal and agent. The reason is that the consignee sells goods on behalf of consignee.	3-the relationship between the seller and buyer is that of creditor and buyer.
4-the expenses incurred by the consignee when goods are consigned to him are met by the consignor.	4-expenses after sale are met by buyer.
5-an order is not essential for consignment.	5-an order is essential for sales.
6-the contract of consignment must be in writing and it is called consignment deed.	6-as soon as the offer is accepted, the contract of sale is complete. The contract may be oral or in writing.
7-the chief consideration of consignment is commission.	7-the chief consideration of a sale is profit.
8-the risk of goods is not transferred to the consignee. It rests with the consignor.	8-the risk is transferred along with goods to the buyer.
9-the goods sent on consignment may be called back by the consignor.	9-calling back of sold goods is impossible.
10-the consignee has to send a statement of sales, called as Account Sales to the consignor.	10-the buyer need not send such statement.

SOME SPECIFIC TERMS USED IN CONSIGNMENT

PROFORMA INVOICE

When the consignor sends the goods to the consignee, he forwards a statement showing the particulars of goods such as quality, quantity, price, markings, packing, etc, and this statement is called the

Proforma Invoice. But in case of regular sale, an invoice is prepared and sent along with the goods. It implies that a sale has taken place.

RECURRING AND NON RECURRING EXPENSES

Consignor and consignee have to incur some expenses for dispatching and selling the goods. The expenses may be either recurring or non-recurring expense.

RECURRING EXPENSES

Recurring expenses are the expenses which are incurred on regular basis in the normal sale of goods and services. These expenses are incurred after the goods have been received at consignee's godown. These expenses are incurred regularly at fixed intervals. Generally these expenses are incurred after the goods have reached the place of business by consignee. They does not increase the value of goods,.

Non-recurring expenses

Non-recurring expenses are incurred for bringing the goods from the place of the consignor to the place of consignee. Hence, all the expenses incurred till the goods reach the godown of the consignee. Hence, all the expenses incurred till the goods reach the godown of the consignee are non-recurring expenses. These expenses are incurred only once on a particular consignment. It will increase the value of goods. These expenses are paid by the consignor or by the consignee on behalf of consignor.

Examples of non-recurring expenses:

Non recurring expenses of the consignor

1- Packing
2- Transport or carriage
3- Forwarding
4- Dock dues
5- Landing charges
6- Freight
7- Insurance

Non recurring expenses of the consignee

1- unloading charges
2- railway dues
3- dock dues
4- import duty or customs duty
5- octroi
6- carriage to godown/shop

The above listed expenses do not occur again like recurring expenses. These expenses are met on the whole consignment. These expenses are added to the cost of the consignment so as to arrive at the cost price of goods at the point of sale. Again these are taken into consideration when the value of closing stock and abnormal losses are calculated.

ADVANCE:

Sometimes, consignor may ask the consignee to pay an advance for the part of the value of goods consigned. Consignee may send the advance in the form of a draft or cheque. If the consignee is not in a position to advance money, a bill may be drawn on consignee. Consignor discounts the bill and gets the money. The amount of discount on the bill may be debited to consignment account or debited to discount account. Advance given by the consignee will be deducted from the sale proceeds.

ACCOUNT SALES:

Periodically or when the goods consigned are sold by the consignee, the consignee will send to the consignor a statement, which is called account sales, showing the amount received by way of sale of goods, expenses incurred, commission charged, advance payment and balance due to consignor and stock still in hand. From the account sales, the consignor closes his entries in the books regarding the consignment for that year. He can ascertain the profit or loss resulting from the transactions.

COMMISSION:

Consignor pays commission to consignee for selling his goods. Commission is generally calculated at fixed percentage of total sales as per the laid down by the consignor. These commissions may be simple or ordinary or special or overriding or del credere. Ordinary commission is calculated as per the terms laid down by the consignor, usually calculated on the basis of the total sales. Special commission is to be paid to to give further incentives for increasing sales. Overriding commission is paid to consignee when he overrides the specified amount of sales. Del Credere commission is the extra commission given to the consignee to avid credit risk that may arise on account of credit sales and consequent bad debts.

ACCOUNTING ENTRIES FOR CONSIGNMENT TRANSACTIONS

A: COST PRICE METHOD…

In the books of consignor:

The consignor wants to know two things which are:-

(1) To ascertain profit or loss when goods on consignment are sold by the consignee.
(2) To know the settlement odf account by the consignee i.e. to know the amount due by or due to consignee.

The consignment account is opened by the consignor to know profit or loss on each consignment. Each consignment is distinguished from the other by naming it in respect to place, like Consignment to Ladakh, etc. if there is a number of consignments in one place, then the name of the consignee is added to the consignment account, like Consignment to Shahid Account, etc. for that consignor opens a consignment account for each consignment. It is a revenue (Nominal) account. It is a special trading and profit and loss account. Consignee account is prepared to know the amount due by or due to the consignee. It is a personal account.

Following entries are the set of journal entries in the books of consignor….

(1) When the goods are sent on consignment:

Consignment Account Dr.
To Goods sent on Consignment Account

(2) When expenses are incurred by the consignor:
Consignment Account Dr.
To Bank/cash Account

(3) When advance is received from the consignee:
Cash/Bank/ B.R. Account Dr.
To Consignee Account

(4) When the bill is discounted by the consignor with his banker:
Bank Account Dr.
Discount Account Dr.
To B/R Account

After consignee sends the account sales:

(5) When the gross sale proceeds are reported by the consignee:
Consignee Account Dr.
To Consignment Account

(6) For expenses incurred by the consignee:
Consignment Account Dr.
To Consignee Account

(7) For commission payable to the consignee:
Consignment Account Dr.
To Consignee Account

(8) For unsold stock remaining with the consignee:
Consignment Stock Account Dr.
To Consignee Account

(9) For transferring profit or loss to profit and loss account:
For profit… Consignment Account Dr.
To P/L Account
For loss…… P/L Account Dr.
To consignment Account

(10) For settlement of account by the consignee:
Bank/Cash/B.R Account dr.
To Consignee Account

(11) When goods sent on consignment account is closed:
Goods Sent on Consignment Account Dr.
To Trading/Purchase Account

VALUATION OF UNSOLD STOCK (AT COST PRICE)

If all the goods are not sold by the consignee within the accounting period, then the unsold stock is brought into account by the consignor. As usual, the unsold stock in the hands of the consignee should be valued on cost price or market price whichever is less. Here the cost means the cost at the moment when the goods reached the consignee's godown. The cost includes by adding proportionate non-recurring expenses incurred by the consignor as well as the consignee. It is calculated as follows

(a) The proportionate cost price, and
(b) Proportionate direct expenses i.e. the expenses incurred y the consignor and consignee till the goods reached the godown of the consignee.

Expenses incurred by the consignee after the goods have been brought to the shop/godown are not considered. Correct profit or loss can be ascertained by the proper valuation of unsold stock which is credited to Consignment Account.

Value of unsold stock = cost of closing stock + proportionate non- recurring expenses

IN THE BOOKS OF CONSIGNEE

The consignee receives the goods from the consignor. It is an inward consignment to the consignee. An inward consignment is the receipt of goods by the consignee from the consignor for the purpose of sale on commission basis. Consignee is not the owner of the goods. Following are the set of journal entries recorded in the books of the consignee:

(1) When the goods are received:
No entry
(2) When expenses are incurred by the consignee:
Consignor Account Dr.
To Bank Account
(3) Advance remitted to consignor by cash/cheque/bills payable
Consignor Account Dr.
To cash/Bank/Bills Payable Account
(4) When consignee sold the goods:
(a) For cash sales:
Bank Account Dr.
To consignor Account
(b) For credit sales:
Consignment Debtors Account Dr.
To Consignor Account
(5) When the commission is due:
Consignor Account Dr.
To Commission Account
(6) When the consignee collected the debt from consignment debtors:
Bank Account Dr.
To Consignment Debtors Account
(7) For bad debts if any:
(a) If del credere commission is not paid…
Consignor Account Dr
To consignment Debtors Account
(b) If del credere commission is paid
Bad debts Account Dr.

To Consignment Debtors Account

(c) Bad debts are transferred to his P/L Account..
Del Credere Commission Account Dr.
To Bad Debts Account

(8) Closing of del credere commission and commission account:
Commission Account Dr.
Del Credrer Commission Account Dr.
To P/L Account

(9) Settlement of account with consignor:
Consignor Account Dr.
To cash/Bank/ Bills Payable Account

INVOICE PRICE METHOD

The consignor, instead of sending goods on consignment at cost price, may send it at a price higher than the cost price. This is known as Invoice Price over Selling Price. The difference between the cost price and the invoice price of goods is known as loading over the higher price over the cost. This is done with a view to keep the profits on consignment secret. As such, consignee could not know the actual profit made on consignment. Hence the consignor sends the Proforma Invoice at a higher price than the cost price. When the consignor records the transaction in his books at an invoice price, some additional entries have to be passed in order to eliminate4 the excess price and to arrive at the correct profit or loss on consignment.

Excess price or loading is to be calculated on the following items:

1- Consignment stock at the beginning
2- Goods sent on consignment
3- Goods returned by the consignee
4- Consignment stock at the end of the period

(a) To remove the excess price in the opening stock:
Consignment Stock Reserve Account Dr.
To consignment Account

(b) To remove the excess price in the goods sent on consignment:
Goods Sent on Consignment Account Dr.
To Consignment Account

(c) To remove the excess price in goods return:
Consignment Account Dr.
To Goods Sent on Consignment Account

(d) To remove the excess price in closing stock:
Consignment Account Dr.
To Consignment Stock Reserve Account

But these adjustments are not needed in consignee’s book. Invoice price does not affect the consignee. When the stock is shown in the Balance Sheet, in Consignor’s Book, the Consignment Stock Reserve Account is deducted.

ACCOUNTING FOR LOSSES

When the consignor sends the goods, losses may arise during consignment transactions. Such losses affect consignor account and not consignee account. So consignor makes some entries to adjust the loss. The adjustment depends upon the type of losses. These losses are of two types:

(1) Normal Losses: when goods are lost or damaged due to normally expected but unavoidable causes such as losses due to evaporation, leakage, dusting, drying, sublimation of goods, etc., these losses are called Normal Losses. These losses cannot be avoided. Such inherent and unavoidable losses form part of the cost of goods. That is, the loss on account of normal loss is borne by good units. When calculating the cost of unsold stock, this normal loss is to be considered. The cost of unsold stock increases proportionately due to normal loss. When there is normal loss the following formula is used for calculating the consignment stock:-

$$\text{Value of closing stock} = \frac{\text{total cost of goods sent} + \text{total non-recurring expenses}}{\text{Total units of goods sent} - \text{normal loss units}}$$

Normal loss is not shown in the consignment account. There is no need to pass any entry in the books of account.

(2) Abnormal Loss:-when loss or damage of goods is caused by unnatural and unexpected reasons, loss is treated as abnormal loss. It is expected loss and beyond the control of the human beings. Loss of goods due to fire, flood, earthquake, war, theft, accidents in transit, etc., are abnormal losses.

It is calculated just like the unsold stock on consignment and credited to consignment account and debited to abnormal or accidental loss account and then transferred to general profit and loss account, so as to arrive at the correct profit or loss of consignment. Some businesses take insurance policy in respect of the goods sent or received on consignment by the consignor or the consignee. Such a policy is obtained only in respect of abnormal loss which may be caused to the goods. If the insurer is liable for the loss, then the amount of claim admitted by the insurer should be debited to the insurer and balance of the loss should be debited to profit and loss account.

The journal entries required to be pass are:-

(a) When the loss is irrecoverable:

Abnormal (Accidental) Loss Account Dr.
    To consignment Account
Profit And Loss Account Dr.
    To Abnormal (Accidental) Loss Account

(b) When the loss is insured and full amount is recoverable:

Accidental Loss Account Dr.
    To Consignment Account
Insurance Company Account Dr.
    To Abnormal Loss Account

(c) When the loss is partly recoverable:

Accidental Loss Account Dr.
    To consignment Account
Insurance company/Bank Account Dr
P/L Account Dr.
    To Abnormal Loss Account

MEMORANDUM COLUMN METHOD

Memorandum column method is a combination of cost price method and invoice price method. Under this method, there are two columns on each side of the consignment account. These two columns are used to record both cost and invoice prices of goods sent on consignment, opening stock, closing stock, etc. the extra column used to record invoice price is known as memorandum column. Hence the method is called memorandum column method. From the accounting point of view it is not important. It is provided to know and show the profits if the consignments are recorded at invoice prices

III: JOINT VENTURE ACCOUNTS

JOINT VENTURE: Meaning

Joint venture is a business activity under which two or more persons agree to undertake jointly a particular venture/business activity. Joint venture is a sort of particular partnership. Joint venture is defined as a kind of business proposition where two or more persons jointly venture to complete a specific business undertaking on agreed conditions, to share the profits or losses arising there from, on a temporary partnership basis until its completion. A joint venture is also known as joint adventure or joint trade. It is a temporary partnership. It has no firm name. Hence is a partnership without name. The partners or parties of a joint venture are called the co-venturers. They agree to contribute capital to carry on a particular job. The capital may be in cash or in kind with a view to sharing profits or loss in an agreed ratio. If there is no agreement regarding the profit sharing ratio, they share the profits or losses equally, as in the partnership. As soon as the business is completed, the joint venture comes to an end. Examples of joint venture businesses..

i- joint consignment of goods,
ii- construction or contract business,
iii- purchase and sale of properties and stocks of liquidated business
iv- underwriting shares or debentures of joint stock companies,
v- Speculation in shares, etc.

PRINCIPAL CHARACTERISTICS OF A JOINT VENTURE

1- Joint venture is a partnership without name.
2- It is based on agreement between two or more persons to share profits or losses in an agreed proportion. In the absence of agreement, they share profits or losses equally.
3- The agreement is valid only for a specific venture alone.
4- The members of the venture are known as co-ventures.
5- As soon as the task is completed, agreement of the venture comes to an end.

DISTINCTION BETWEEN JOINT VENTURE AND PARTNERSHIP

JOINT VENTURE	PARTNERSHIP
1- There is no necessity for a trade name.	1-the firm has a specific trade name.
2- The parties in joint venture are known as co-venture.	2-the parties in partnership are known as partners.
3- The minimum number of co-venture is two and there is no limit for maximum.	3-minimum number is two and maximum number is twenty in case of banking business and 100 in case of general business.
4- It is temporary in name. It is formed for special purpose and it ceases to exist on completion of particular business.	4-it is a continuous business operation and it is not restricted to a particular operation.
5- The agreement is not registered in order to make it enforceable against the third parties.	5-it must be registered in order to make claim of partnership against the third parties.
6- Co-venturers are free to have their own independent business of the same type.	6-partners cannot independently undertake a business of similar nature.
7- The profit is ascertained for each venture.	7-the profit is ascertained annually.
8- Co-venturers have no implied authority.	8-partners have implied authority.
9- There is no joint and several liabilities unless there is special agreement.	9-there is joint and several liabilities on partners.
10- There is no special act for joint venture.	10-there are separate acts for regulation of partnerships known Indian Partnership Act 1932, and Limited Liability Partnership Act, 2008.
11- It is not necessary to maintain separate and permanent record of accounts.	11-the firm must maintain a separate set of books of account on a permanent basis.

COMPARISON BETWEEN JOINJT VENTURE AND CONSIGNMENT

Joint venture and consignment are different methods of doing business. If co-ventures consign goods to each other or to third parties, then such transaction can be called as joint consignment. It is different from consignment. The difference between joint venture and consignment are:

JOINT VENTURE	CONSIGNMENT
1-the parties involved in joint venture are called co-venturers.	1-the parties are called consignor and consignee or agent.

2-the relationship between the co-venturers is like that of partners.	The relationship between the consignor and consignee is that of principal and agent.
3-it is a temporary partnership.	3-it is not a partnership. The agent need not be a partner.
4-the profits or losses are shared equally or in some agreed ratio.	4-the agent has no right to share the profits, but he receives commission.
5-all the co-venturers has equal rights to buy and sell the goods, to collect the dues, etc.	5-the agent does not have any power. He has to follow the principal's orders.
6-capital in cash or in kind is contributed by co-ventures.	6-here capital in cash or in kind is contributed by consignor only.
7-it ceases to exist when the specific business is completed by the co-venturers.	7-it continues for any length of time as long as the relationship between the consignor and consignee exists.
8-the business may be concerned with buying or selling or with any contract work, etc.	8-consignments are meant for sale of goods alone.

METHODS OF ACCOUNTING FOR JOINT VENTURE

Methods of accounting

When a separate set of books is kept

1- Joint Bank Account
2- Joint Venture Account
3- Co-Venturer's Account

Each venturer maintains a complete record of all joint venture transactions:
(Complete Record Method)
1-Joint Venture Account
2-Account of Other Ventures

when a separate set of books is not kept

Each co-venturer maintains a record of only his own transactions/partial records:
(Memorandum Joint Venture Account)
1- Joint Venture with ………. Account
2- Memorandum Joint Venture Account

The following are the methods generally followed where joint venture transactions take place:

I- Where separate asset of books is kept;
II- Where nom separate set of books is kept; and
III- Where memorandum joint venture account is kept

(i)WHERE SEPARATE SET OF BOOKS IS KEPT

This method is particularly followed where there are large transactions, that is, the venture is a large one and is continued for a comparatively long period. Accounts are prepared under double entry principle. The following three accounts are prepared under this method:

1- JOINT VENTURE ACCOUNT
2- JOINT BANK ACCOUNT,&
3- CO-VENTURER'S ACCOUNT (Venturer's Capital Account)

(1): Joint Venture Account: this account represents the results of the business, that is, profit or loss. It is like a trading/profit & Loss Account of a trading concern. This account is debited by the cost of goods , expenses, goods supplied by the venturers, etc and is credited by sale proceeds, unsold stock, stock taken by venturers, etc. if credit side is of this account is greater than the debit side, the difference represents profit on joint venture and vice versa in the opposite case. The profit or loss so made is transferred to co-venturer's account.

(2): Joint Bank Account: it is like an ordinary Cash Book or Bank Account. All incomes including the capital contribution by the ventures appear on the debit side of this accont whereas all expenses of the venture appear on the credit side of this account. It is finally closed by payment to the co-venturers, leaving no balance either side.

(3): Co-Venturer's Account: this is the capital account of the venturers relating to venture. This account is credited by the capital contributed by the venturers, goods supplied by them from their own stock, expenses made personally by them, etc. Whereas, this account is debited by withdrawals or any asset taken from the venture. The profit or loss so made on venture is transferred to this account in profit sharing ratio and this account is closed by cash payment from the joint bank account and vice versa in the opposite case.

Journal entries that may be passed under this method

Case	Journal Entries
= When cash contributed or invested or paid in by co-venturers	Joint Bank Account Dr. To Respective Co-venturer Account
= When goods purchased for joint venture	Joint Venture Account Dr. To Joint BankAccount
= When goods are purchased on credit	Joint Venture Account Dr. To Supplier's Account
= when goods are contributed by co-venturer	Joint Venture Account Dr. To Respective Joint Venturer Account
= When suppliers are paid off	Supplier's Account Dr. To Joint Bank Account
= When expenses are incurred	Joint Venture Account Dr. To joint Babnk Account
= When expenses are paid by co-venturer	Joint Venture Account Dr. To Respective co-venturer Account
= When goods are sold for cash	Joint Bank Account Dr. To Joint venture Account
= When goods are sold oncredit	Debtor's Account Dr. To Joint Venture Account
= When cash received from debtors/bills receivable	Joint Bank Account Dr. To Debtors/B.R Account
= When goods taken byb co-venturer	Respective co-venturer Account Dr.

	To joint Venture Account
= When commission or salary is payable to co-venturers	Joint Bank Account Dr. To Respective co- Venture Account
= When discount received from creditors	Creditors Account Dr. To Joint Venture Account
= When discount allowed or bad debts are incurred	Joint Venture Account Dr. To Sundry Debtors Account
= When cash is paid to creditors/ bills payable	Creditors/BILLS Payable Account Dr. To Joint Venture Accunt
= Result of the joint venture	
i- Profit ii- Loss	i- Joint Venture Account Dr. To Each Co-Venturer's Account ii- Each Co-Venturer's Account To Joint Venture Account

(ii) WHERE NO SEPARATE SET OF BOOKS IS KEPT

This method is applicable where the joint venture transactions are limited and the ventures reside at two different places. Under this method each venture will record his own transactions plus the transactions relating to other co-venturer's capital whereas the other venture will prepare a Joint Venture Account and the capital of the others, that is, two accounts are prepared in each party's ledger. For instance, there are two venturers, namely, A and B. so, A will prepare a Joint Venture Account and B's Capital Account in his books while B will also prepare A joint V enture and A's Capital Account in his book.

(1) JOINT VENTURE ACCOUNT: it should be prepared like the previous one (when separate set of books is kept) which reveals the result of the business, that is, profit or loss which ultimately be transferred to Venturers Capital. But in this case one's share of profit or loss should be transferred to his Profit or Loss Account, and co-venturer's share of profit should be transferred to his personal account.
(2) Other Co-venturer's Accoount: sine this is a personal account of the co-venturer, his account will be debited with the amount of sale proceeds, unsold stock taken,etc. the balance of this account will go to either(i) Balance Sheet, if it is so prepared, or (ii) the same will represent the final payment of Receipts and Payments between the venturers.

Journal entries that may be passed under this method

case	In X's books	In Z's books
When goods are supplied by X	Joint Venture Account Dr. To Purchase Account	Joint Venture Account Dr. To X's Account
When expenses are paid by X	Joint Venture Account Dr. To Cash Account	Joint Venture Account Dr. To X's Account
When goods are supplied by Z	Joint Venture Account Dr. To Z's Account	Joint Venture Account Dr. Tom Purchase Account
When expenses are paid by Z	Joint Venture Account Dr. To Z's Account	Joint Venture Account Dr. To Cash Account
When cash is contributed by X	Joint Venture Account Dr. To Cash Account	Joint Venture Account Dr. To X's account
When cash is contributed by Z	Joint Venture Account Dr. To Z's Account	Joint Venture Account Dr. To Cash Account
When bill is drawn by x and accepted by Z	Bills Receivable Account Dr. To Z's Account	X's Account Dr. To B/R Account
When bill is discounted by X	Cash Account Dr. Joint Venture Account Dr. To B/R Account	Joint Venture Account Dr. To X's Account
When commission is allowed to Z	Joint Venture Account Dr. To Z's Account	Joint Venture Account Dr. To Commission Account
When salary is allowed to X	Joint Venture Account Dr. To Salary Account	Joint Venture Account Dr. To X's Account
When goods are sold by X	Cash Account Dr. To Joint Venture Account	X's Account Dr. To Joint Venture Account
When credit sales are made by X	Sundry Debtors Account	X's Account Dr.

	Dr. To Joint Venture Account	To Joint Venture Account
When bad debts arise(sales made by X)	Joint Venture Account Dr. To Sundry Debtors Account	Joint Venture Account Dr. To X's Account
When unsold stocks taken by X	Purchase Account Dr. To Joint Venture Account	X's Account Dr. To Joint Venture Account
When joint venture shows profit	Joint Venture Account Dr. To Z's Account To P/L Account	Joint Venture Account Dr. To X's Account To P/L Account
When joint venture shows loss	P/L Account Dr. Z's Account Dr. To Joint Venture Account	P/L Account Dr. X's Account Dr. To Joint Venture Account

Note: the balance in personal account shows the amount due to or due from him.

(iii) WHERE EACH CO-VENTURER MAINTAINS A RECORD OF HIS TRANSACTIONS (MEMORANDUM JOINT VENTURE METHOD)

Under this method each co-venturer keeps a record of joint venture transactions in which he is involved i.e. each venturer records his own book only the transactions of joint venture which relate to him. Each party keeps his account in his own books. He will not record the transactions of other co-venturer. Hence, it is a partial record…

1- Each co-venturer will open one account in his books and will be headed: joint venture with ___ (Name of other co-venturer) account. This is a personal account. It is not a Nominal Account as joint venture. It does not disclose the profit or loss on joint venture. Each co-venture debits the account with the amount paid by him or loss on joint venture. Each co-venturer debits the account with the amount paid by him and credits thev account when he receives amounts.
2- In this account, the concerned party records only his transactions. No account whatsoever is taken of the supplies made, expenses incurred etc, by the co-venturer.

Journal entries in the books of one party, say, Mr X and the other co-ventuirwer Mr. Z

1- When goods are purchased by X:
   Joint venture with Z Account Dr.
   To Cash Account
2- When goods are sold by X:

Cash Account Dr.
To joint venture with Z Account

3- When commission is received by X
Joint venture with Z account Dr.
To commission account

4- When X meets the expenses:
Joint venture with Z account Dr.
To cash account

5- When unsold stock is taken by X
Purchase account Dr.
To joint venture with Z account

UNIT 4

A- Accounting for Inland Branches

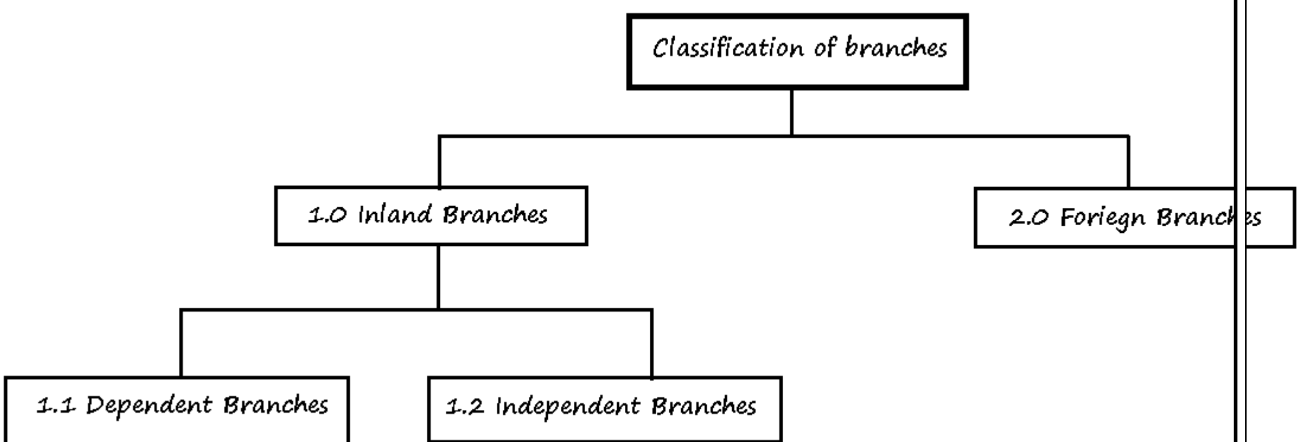
Accounting for Branches

MEANING OF A BRANCH

A branch is a subordinate of an office. The concept of branch *presupposes* the existence of a head office. According to Sec. 29 of the Companies Act , a branch is any establishment carrying on either the same or substantially the same activity that carried on by the head office of the company.

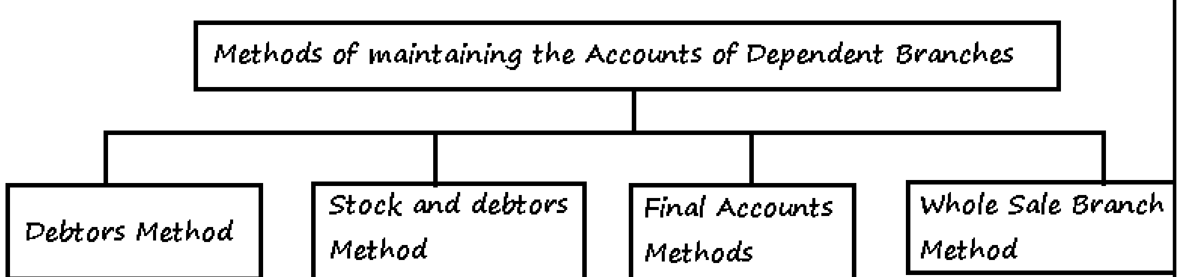
CLASSIFICATION OF BRANCHES

From the accounting point of view, branches may be classified as follows:



ACCOUNTING FOR DEPENDENT BRANCHES

The branch which does not maintain a complete record of its transactions is said to be dependent one. The head office may maintain the accounts of such branches according to anyof the following methods.



DEBTORS METHOD

Debtors method is usually adopted when the branch is of small size. Under this method, the head office maintains separate Branch Account for each branch. Such Branch Account is of nominal nature. Its purpose is to ascertain profit or loss made by the branch. The journal which are passed to record different branch transactions are given below:

JOURNAL ENTRIES UNDER DEBTORS METHOD

1.	**To record opening balances of Branch Assets**	Branch A/c To Branch Assets (Individually)	Dr.
2.	**To record opening balances of Branch Liabilities**	Branch Liabilities (Individually) To Branch A/c	Dr.
3.	**When goods are supplied by the Head Office/ another branch to Branch**	Branch A/c To Goods sent to Branch A/c	Dr.
4.	**When goods are returned by the branch/ branch customers directly to the Head Office**	Goods Sent to Branch A/c To Branch A/c	Dr.
5.	**When goods are supplied by the branch to another branch under instructions of Head office**	Goods Sent to Branch A/c To Branch A/c	Dr.
6.	**When goods are supplied by the head office but not received by the Branch**	Goods in Transit A/c To Branch A/c	Dr.
7.	**When the Head Office meets the branch expenses or sends cash to the branch for meeting its expenses**	Branch A/c To Cash/Bank A/c	Dr.
8.	**When remittances are received by the Head Office from the Branch/Branch Customers**	Cash/Bank A/c To Branch A/c	Dr.
9.	**When remittances are sent by the Branch but not received by the Head Office**	Cash-in-transit A/c To Branch A/c	Dr.
10.	**When balance in Goods sent to Branch Account is transferred**	Goods sent to Branch A/c To Purchases A/c (in case of Trading concerns) or To Trading A/c (in case of manufacturing concerns)	Dr.
11.	**To record the closing balances of Branch Assets**	Branch Assets A/c (Individually) To Branch A/c	Dr.
12.	**To record the closing balances of Branch Liabilities**	Branch A/c To Branch Liabilities (Individually)	Dr.
13.	**To record Profit or Loss** (*i*) *If credit side exceeds the debit side* (*ii*) *If debit side exceeds the credit side*	Branch A/c To General Profit and Loss A/c General Profit and Loss A/c To Branch A/c	Dr.

Format of Branch Account A format of branch account is given below:

Dr. **Branch Account** Cr.

Particulars	Rs	Particulars	Rs
To Balance b/d:		By Balance b/d:	
Stock	xxx	Creditors	xxx
Debtors	xxx	Outstanding Expenses	xxx
Petty Cash	xxx	By Bank (remittances to H.O.):	
Fixed Assets	xxx	by Branch	xxx
Prepaid Expenses	xxx	by Branch Debtors directly to H.O.	xxx
To Goods sent to Branch A/c:		By Goods Sent to Branch A/c:	
Goods sent by H.O.	xxx	Returned by Branch	xxx
Goods sent by other Branches	xxx	Returned by Branch debtors directly to H.O.	xxx
To Bank (Remittances by H.O.)	xxx	Sent to other Branches	xxx
To Balance c/d:		By Balance c/d:	
Creditors	xxx	Stock	xxx
Outstanding Expenses	xxx	Debtors	xxx
Manager's Commission		Petty Cash	xxx
*To Net Profit t/f to General P&L A/c	xxx	Fixed Assets	xxx
		Prepaid Expenses	xxx
		*By Net Loss t/f to General P&L A/c	xxx
	xxx		xxx

*Only one figure shall appear.

Notes

1) The following transactions do not appear in the branch account:
    a) Expenses met by branch out of cash, since *either* reduced cash balance at the end is decreased *or* the liability at the end is increased.
    b) Purchase of goods/fixed assets by branch since book value of goods/fixed assets at the end is increased and *either* the amount of remittances is reduced *or* the creditors at the end are increased.

c) Sale of goods/fixed assets by branch since book value of goods/fixed assets at the end is decreased and *either* the amount of remittances is increased *or* the debtors at the end are increased.

d) Bad debts, discount allowed, sales returns by customers to branch, cash received by branch from branch debtors, etc., since the debtors at the end appear at the adjusted figure.

e) Depreciation and profit/loss on sale of fixed assets since fixed assets at the end appear at the adjusted figure.

f) Abnormal losses since stock at the end appears at the adjusted figure.

2) When the branch is not authorised to keep any sum out of collection, expenses met by branch out of petty cash maintained may be dealt with as follows:

a) In case the petty cash is maintained on Imprest system, the expenses met by the branch are to be shown in the same manner as the branch expenses met by the Head Office. In such a case, petty cash balance at the end appears at the same amount at which it appears in the beginning.

b) In case the petty cash is not maintained on Imprest system, the expenses met by the branch are automatically charged to the branch account since the petty cash at the end appears at the adjusted figure.

3) When goods are returned either by Branch Debtors to the H.O. directly or are sent by one branch to another branch, the entry is made in the same manner as in the case of goods returned by the branch to the H.O.

4) In case any insurance claim is admitted and paid to the branch *either* the bank balance at the end will increase *or* remittances to H.O. will increase. In case, the insurance claim is admitted but not paid, the insurance company will appear as debtor at the end.

5) To ascertain any missing figure relating to stock and/or Debtors, Memorandum Branch Stock Account and Memorandum Branch Debtors Account may be prepared.

ACCOUNTING TREATMENT OF GOODS RETURNED AND CASH REMITTED BY BRANCH CUSTOMERS DIRECTLY TO HEAD OFFICE

	Item	*Treatment in Branch A/c*	*Treatment in Memorandum A/c*
1.	**Goods returned by Branch customers directly to H.O.**	Treat like goods returned by Branch to H.O. and thus, show the Cost/Invoice price (as the case may be) of these goods on credit side of Branch Account.	Treat like goods returned by Branch to H.O. and thus, show the Cost/Invoice price (as the case may be) of these goods on credit side of Branch Stock Account.
2.	**Cash remitted by Branch customers directly to H.O.**	Treat like cash remitted by branch to H.O. and thus, show on the credit side of Branch Account.	Treat like cash collected from debtors and thus, show on the credit side of Branch Debtors Account.

ACCOUNTING TREATMENT OF GOODS SENT TO ANOTHER BRANCH AND GOODS RECEIVED FROM ANOTHER BRANCH

	Item	*Treatment in Branch A/c*	*Treatment in Memorandum A/c*
1.	**Goods sent to another branch.**	Treat like goods returned to H.O. and thus, show on the credit side of Branch Account.	Treat like goods returned to H.O. and thus, show on the credit side of Branch Stock Account.
2.	**Goods received from another branch**	Treat like goods received from H.O. and thus, show on the debit side of Branch Account	Treat like goods received from H.O. and thus, show on the debit side of Branch Stock Account

ACCOUNTING TREATMENT OF NORMAL LOSS, ABNORMAL LOSS, INSURANCE CLAIM AND AGREED ALLOWANCE/TRADE DISCOUNT

Item	Treatment in Branch A/c	Treatment in Memorandum A/c
1. **Normal loss**	Normal loss does not appear in the Branch Account since the Closing Stock appears at the adjusted figure.	Cost/Invoice price (as the case may be) of *normal* loss appear on the credit side of Branch Stock Account in order to reduce the figure of Closing Stock.
2. **Abnormal loss**	Abnormal loss does not appear in the Branch Account since the Closing Stock appears at the adjusted figure.	Cost/Invoice price (as the case may be) of abnormal loss appear on the credit side of Branch Stock Account in order to reduce the figure of Closing Stock.
3. **Insurance claim**		
(*a*) *Admitted and received*	Show on the credit side of Branch Account by way of increased Closing *either* cash/Bank Balance *or* remittance to H.O.	No Treatment
(*b*) *Admitted but not yet received*	Show Insurance Co. as a debtor at the end on the credit side of Branch Account.	No Treatment
4. **Agreed allowance/Trade discount**	Agreed Allowance/Trade Discount does not appear in the Branch Account since the closing debtors appear at the adjusted figure.	Cost/Invoice Price (as the case may be) of Agreed Allowance/Trade Discount appears on the credit side of Branch Stock Account.

ACCOUNTING TREATMENT OF BRANCH MANAGER'S COMMISSION

Calculation of Commission to Branch Manager

Commission may be allowed as percentage of Net Profit before charging such commission orafter charging such commission.

(*i*)	Commission as % of Net Profit before charging such Commission	$= \text{Net Profit before Commission} \times \dfrac{\text{Rate of Commission}}{100}$
(*ii*)	Commission as % of Net Profit after charging such Commission	$= \text{Net Profit before Commission} \times \dfrac{\text{Rate of Commission}}{100 \times \text{Rate of Commission}}$

Outstanding Branch Manager's Commission appears on the debt side of Branch Account.

WHEN GOODS ARE SENT TO BRANCH AT COST *PLUS* PROFIT

Meaning of Invoice Price and Loading

Sometimes, the Consignor does not want to reveal the cost of goods to the Consignee and therefore invoices goods at a price which is higher than the Cost Price (CP). Such price is known as **"Invoice Price (IP)"** and the difference between Invoice Price (IP) and Cost Price (CP) is called '**Loading**'.

How to Eliminate/Remove loading

When goods are sent at invoice price, to ascertain correct profit/loss on consignment, the items recorded at invoice price should be brought down to Cost Price level. For this purpose, the loading included in various items (like Opening Stock, Goods Sent to Branch, Goods Returned by Branch, Closing Stock) should be eliminated by passing the following adjusting entries.

1. **To remove loading from the amount of Net Goods sent to Branch [i.e., Goods Sent to Branch *less* Returns by Branch (or Branch Customers) to H.O.]**

2. **To remove loading from the amount of Closing Stock at Branch**

   Branch A/c ... Dr.

   To Branch Stock Reserve A/c

   The closing stock at the end of current accounting period becomes the opening stock of the next accounting period. The aforesaid entry will be reversed in the beginning of the next accounting period as follows:

   Branch Stock Reserve A/c ... Dr.

   To Branch A/c

How to Disclose relevant items after adjusting entries?

After passing the aforesaid adjusting entries, the relevant items will appear in The Branch Account as follows:

Particulars	Rs	Particulars	Rs
To Opening Stock (at invoice price)	xxx	By Stock Reserve A/c (Loading on Opening Stock)	xxx
To Goods sent to Branch (at invoice price)	xxx	By Goods Sent to Branch A/c (Returns at Invoice Price)	xxx
To Stock Reserve A/c (loading on Closing Stock)	xxx	By Goods Sent to Branch A/c (Loading on net Goods sent to Branch	xxx
		By Closing Stock (at Invoice Price)	xxx

STOCK AND DEBTORS METHOD

Under Stock and Debtors Method, in order to exercise more control over the working of a branch, the head office usually maintains the following accounts:

	Accounts	*Purpose*
1.	Branch Stock Account at Invoice Price	To ascertain any shortage or surplus
2.	Branch Debtors Account	To ascertain the closing debtors
3.	Branch Expenses Account	To ascertain the total expenses incurred at the Branch
4.	Branch Adjustment Account	To ascertain Gross Profit/Gross Loss
5.	Branch Profit and Loss Account	To ascertain Net Profit/Net Loss
6.	Goods Sent to Branch Account	To ascertain the net cost of goods sent to branch
7.	Branch Cash Account	To record all cash transactions of the branch
8.	Branch Fixed Assets Account	To record all transactions relating to branch fixed assets

Journal Entries The journal entries which are passed to record different branch transactions are given below:

JOURNAL ENTRIES UNDER STOCK AND DEBTORS METHOD

1.	**When goods are supplied by the H.O./another branch**	Branch Stock A/c To Goods sent to Branch A/c	Dr.	
2.	**When goods are returned by the Branch/or when goods are supplied to another branch**	Goods Sent to Branch A/c To Branch Stock A/c	Dr.	
3.	**When goods are returned by branch Customers directly to H.O.**	Goods sent to Branch A/c To Debtors A/c	Dr.	
4.	**When goods are sold on credit**	Branch Debtors A/c To Branch Stock A/c	Dr.	
5.	**When goods are sold for cash**	Branch Cash A/c To Branch Stock A/c	Dr.	
6.	**When goods are returned by Branch Debtors to branch**	Branch Stock A/c To Branch Debtors A/c	Dr.	
7.	**When cash is received by branch from its debtors**	Branch Cash A/c To Branch Debtors A/c	Dr.	
8.	**To record bad debts, discount allowed etc.**	Branch Expenses A/c To Branch Debtors A/c	Dr.	
9.	**To record branch expenses paid by branch**	Branch Expenses A/c To Branch Cash A/c	Dr.	
10.	**To record abnormal loss of Stock [Due to abnormal factors like fire, flood, theft etc.]**	Branch Adjustment A/c Branch Profit and Loss A/c To Branch Stock A/c	Dr. Dr.	[Loading] [Cost] [Invoice Price]
11.	**To record normal loss of stock**	Branch Adjustment A/c		

12.	To record surplus representing excess of selling price over invoice price	Branch Stock A/c To Branch Adjustment A/c	Dr. [Invoice Price]
13.	To remove loading from the net amount of goods sent to branch (i.e., goods sent *less* returns by branch)	Goods sent to Branch A/c To Branch Adjustment A/c	Dr. [Loading]
14.	To remove loading from the amount of closing stock	Branch Adjustment A/c To Stock Reserve A/c	Dr. [Loading]
15.	To remove loading from the amount of opening stock	Stock Reserve A/c To Branch Adjustment A/c	Dr. [Loading]
16.	To record gross profit made by branch	Branch Adjustment A/c To Branch Profit and Loss A/c **Note** *The entry will be reversed in case of gross loss*	Dr.
17.	To record the transfer of branch expenses	Branch Profit and Loss A/c To Branch Expenses A/c	Dr.
18.	To record net profit made by branch	Branch Profit and Loss A/c To General Profit and Loss A/c **Note** *The entry will be reversed in case of net loss*	Dr.
19.	To transfer the balance in Goods sent to Branch A/c	Goods Sent to Branch A/c To Trading A/c/Purchases A/c	Dr.

The formats of Branch Stock Account, Branch Adjustment Account, Branch Expenses Account, Branch Profit and Loss Account, Branch Debtors Account and Goods Sent to Branch Account are given below:

Dr **1. BRANCH STOCK ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Balance b/d	xxx	By Branch Cash A/c (Cash Sales)	xxx
To Goods sent to Branch A/c	xxx	By Branch Debtors A/c (Credit Sales)	xxx
To Branch Debtors A/c (Return by Customers to Branch)	xxx	By Goods Sent to Branch A/c (Returns to H.O.)	xxx
To Goods sent to Branch A/c (T/f of goods from other Branch)	xxx	By Goods sent to Branch A/c (T/f of Goods to other Branch)	xxx
To Branch Adjustment A/c (Excess of Selling Price over Invoice Price) (i.e., surplus)	xxx	By Branch Adjustment A/c (Load on Abnormal Loss due to fire etc.)	xxx
		By Branch Profit and Loss A/c (Cost of Abnormal Loss due to fire etc.)	xxx

Dr **2. BRANCH ADJUSTMENT ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Branch Stock A/c (Load on Abnormal Loss due to Fire, etc.)	xxx	By Stock Reserve A/c (Load on Opening Stock)	xxx
To Branch Stock A/c (Normal Loss)	xxx	By Goods Sent to Branch A/c (Load on Net Goods Sent)	xxx
To Stock Reserve A/c (Load on Closing Stock)	xxx	By Branch Stock A/c (Excess of Selling Price over Invoice Price) (Surplus)	xxx
To Gross Profit t/f to Branch P&L A/c	xxx		
	xxx		xxx

Dr **3. BRANCH EXPENSES ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Salaries	xxx	By Branch Profit and Loss A/c	xxx
To Rent	xxx		
To Petty Expenses	xxx		
To Bad Debts	xxx		
To Discount	xxx		
To Depreciation	xxx		
	xxx		xxx

Dr **4. BRANCH PROFIT AND LOSS ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Branch Stock A/c (Cost of Abnormal Loss)	xxx	By Branch Adjustment A/c (Gross Profit b/d)	xxx
To Branch Expenses	xxx	By Branch Cash A/c (Insurance claim received)/Insurance Co. (claim admitted but not received)	xxx
* To Net Profit t/f to General Profit and Loss A/c	xxx	*By Net Loss t/f to General P&L A/c	xxx

Dr **6. BRANCH DEBTORS ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Balance b/d	xxx	By Branch Cash A/c (Cash paid to branch)	xxx
To Branch Stock A/c (Credit Sales)	xxx	By Bills Receivable A/c	xxx
To Bills Receivable A/c (B/R dishonoured)	xxx	By Cash A/c (Cash paid directly to H.O.)	xxx
		By Branch Stock A/c (Returns to Branch)	xxx
		By Goods Sent to Branch A/c (Goods returned directly to H.O.)	xxx
		By Discount A/c	xxx
		By Bad Debts A/c	xxx
		By Balance c/d	xxx
	xxx		xxx

Dr **6. GOODS SENT TO BRANCH ACCOUNT** Cr

Particulars	Rs	Particulars	Rs
To Branch Stock A/c (Returns)	xxx	By Branch Stock A/c (goods sent)	xxx
To Branch Adjustment A/c (Load on net goods sent)	xxx		
To Purchases/Trading A/c	xxx		
	xxx		xxx

FINAL ACCOUNTS METHOD

Under this method, the profit or loss at the branch is ascertained by preparing the Memorandum Branch Trading and Profit and Loss Account in place of branch account. Under this method, if branch account is prepared, this is of personal nature and not of nominal nature (as in case of debtors method). The Branch Trading and Profit and Loss Account is prepared exactly on the same basis as in case of other normal concerns. It is to be noted that Opening Stock, Goods Sent to Branch, Goods Returned by Branch and Closing Stock are to be shown at Cost (i.e., excluding loading, if any, charged). The format of branch trading and profit and loss account is given below:

Dr Branch trading and profit and loss account for the year ending on.... Cr

Particulars	Rs	Particulars	Rs
To Opening Stock (at Cost)	xxx	By Sales	
To Goods sent xxx		Cash xxx	
Less: Returns to H.O. xxx	xxx	Credit xxx	
To Direct Purchases	xxx	*Less*: Returns from	
To Gross Profit c/d		Branch Debtors xxx	xx
	xxx	By Abnormal Loss due to fire etc.	xx
		By Closing Stock:	
		Direct Purchases	xx
		Supplied by H.O.	xx
		In transit	xx
	xxx		xx
To Branch Expenses	xxx	By Gross Profit b/d	xx
To Abnormal Loss due to Fire etc.	xxx	By Bank A/c/Insurance Co.	
To Net Profit t/f to General P&L A/c	xxx	(Insurance Claim)	xx
	xxx		xx

WHOLE SALE BRANCH METHOD

Under this method, the head office supplies goods to owned retail branches as well as other retailers at wholesale price which is cost ***plus*** wholesale profit. The owned retail branches sell those goods to customers at list or catalogue price which is wholesale price ***plus*** retail profit. In such a case the head office is interested in knowing the additional profit which has been earned by opening retail branch. For this purpose, Trading and Profit and Loss Account of the branch should be prepared in the usual manner taking the opening stock, goods sent by/returned to H.O., closing stock, Losses of Goods at wholesale price. However, while preparing Trading and P&L, account of H.O., stack reserve (i.e., Loading equal to difference between wholesale price and its cost to H.O.) in respect of opening and closing stock at branch should be credited and debited respectively to Head Office Profit and Loss Account. In such type of problems first the relationship between cost, wholesale profit and retail profit should be ascertained as follows.

A.	Cost	xxx
B.	Wholesale Profit	xxx
C.	Wholesale Price $(A + B)$	xxx
D.	Retail Profit	xxx
E.	Retail Price $(C + D)$	xxx

The formats of branch Stock Account/Branch Trading Account, Branch Profit and Loss Account, Branch Stock Reserve A/c, H.O. Profit and Loss Account are given below

(a)Branch Stock Account

Particulars		Rs	Particulars		Rs
To Balance b/d (at Wholesale Price)		xxx	By Sales (at Retail Price/list)		
To Goods sent to Branch		xxx	(Price/Catalogue Price)		
(at wholesale price)			Cash	xxx	
Sent	xxx		Credit	xxx	
Less: Returns to H.O.	xxx	xxx	*Less*: Returns	xxx	xx
To Gross Profit t/f to P&L A/c		xxx	By Abnormal Loss (at wholesale Price)		xx
			By Balance c/d (at wholesale Price)		xx
		xxx			xx

Dr. **(*b*) Branch Profit and Loss Account** Cr.

Particulars	Rs	Particulars	Rs
To Branch Expenses	xxx	By Gross Profit b/d	xx
To Abnormal Loss (at wholesale Price)	xxx	By Claim from Insurance Co. (if any)	xx
To Net Profit t/f to H.O. P&L A/c	xxx		
	xxx		xx

Dr. **(*c*) Branch Stock Reserve Account** Cr.

Particulars	Rs	Particulars	Rs
To H.O. P&L A/c (T/F of Opening Stock reserve)	xxx	By Balance b/d [Wholesale profit included in Opening Stock]	xx
To Balance c/d [Wholesale profit included in Closing Stock]	xxx	By H.O. P&L A/c [Wholesale profit included in Closing stock]	xx
	xxx		xx

Dr. **(*d*) An Extract of H.O. Profit and Loss Account** Cr.

Particulars	Rs	Particulars	Rs
To Stock Reserve A/c [Provision made for unrealised wholesale profit included in Closing Stock]	xxx	By Branch Profit and Loss A/c (Net Profit)	xxx
		By Stock Reserve A/c [Transfer of Provision for unrealised profit included in opening stock, now no longer required]	xxx

ACCOUNTING FOR INDEPENDENT BRANCHES

The branch which maintains a complete record of its transactions is said to be an independent one. In such a case the connection between the branch and the head office is maintained through a medium of Branch Account in the books of Head Office and Head Office account in the books of branch. The transactions involving the remittance of fund by/to branch and goods sent by/to branch are passed in usual manner as in case of other methods explained earlier. However, the treatment of the following transactions is worth nothing.

1. Accounting for Fixed Assets
2. Accounting for Head Office Expenses to be charged to Branch
3. Accounting for Inter-Branch Transactions
4. Accounting for Goods-in Transit and Cash-in Transit

1. ACCOUNTING FOR FIXED ASSETS

The accounts of Branch Fixed Assets may be maintained *either* at the head office *or* at the Branch.

	If the accounts are maintained at H.O.		*If the accounts are maintained at Branch*	
Transaction	*Branch Books*	*H.O. Books*	*Branch Books*	*H.O. Books*
(*a*) **On Purchase by Head Office**	No Entry	Branch Assets A/c Dr. To Cash A/c	Assets A/c Dr. To H.O. A/c	Branch A/c Dr. To Cash A/c
(*b*) **On Purchase by Branch**	Head Office A/c Dr. To Cash A/c	Branch Assets A/c Dr. To Branch A/c	Assets A/c Dr. To Cash A/c	No Entry
(*c*) **On Providing Depreciation**	Depreciation A/c Dr. To H.O. A/c	Branch A/c Dr. To Branch Assets A/c	Depreciation A/c Dr. To Assets A/c	No Entry

2.ACCOUNTING FOR HEAD OFFICE EXPENSES TO BE CHARGED TO BRANCH

When the head office decides to raise a charge against the branch in respect of services rendered to the branch, the following journal entry should be passed:

In the books of branch	*In the books of H.O.*
H.O. expenses A/c Dr To H.O. A/c	Branch A/c Dr To P&L A/c/Respective expenses A/c

3. ACCOUNTING FOR INTER-BRANCH TRANSACTIONS

The transactions taking place in various branches of head office are said to be in Inter-Branch transactions. These transactions may be recorded *either* through the Respected Branch A/c. *or* Head Office A/c. While recording the Inter-Branch transactions **in the books of the head office, the receiving branch is debited and supplying branch is credited.**

4.Accounting for Goods-in Transit and Cash-in Transit

If the balance of branch account in the Head Office books and that of Head Office Account in the Branch Books do not tally, these must be reconciled before the preparation of the final accounts of the concern as a whole. Practical steps for reconciliation are shown below:

PRACTICAL STEPS FOR RECONCILIATION

1. Calculate the difference between the balance of Branch Account (given in the trial balance of H.O.) and H.O. Account(given ion the trial balance of Branch), if one Account shows the debt balance and other Account shows the credit balance.

OR

Calculate the aggregate of the balance of branch Account and that of the H.O. Account if both these Accounts show either the debt or credit balance.

2. Calculate the Goods-in-Transit by comparing 'Goods sent to Branch Account' with 'Goods received by Branch Account' or 'Goods returned by Branch Account' with 'Goods received by H.O. Account'.
3. Calculate the Cash-in-Transit by comparing Cash Remitted Account.
4. Pass the Adjusting either in the books of Head Office or Branch as under.

In the Books of Head Office			*in the Books of Branch*		
(a)	Goods-in-transit A/c	Dr.	(a)	Goods-in-transit A/c	Dr.
	To Branch A/c			To Head Office A/c	
(b)	Cash-in-transit A/c	Dr.	(b)	Cash-in-transit A/c	Dr.
	To Branch A/c			To Head Office A/c	

IMCORPORATION OF BRANCH RESULTS IN THE BOOKS OF HEAD OFFICE

The branch result may be incorporated in the books of Head Office by adopting any of the following three methods

1. Separate Final Accounts Method
2. Abridged Consolidated Method
3. Detailed Consolidated Method

❖ **Separate Final Accounts Method**The practical steps to be taken under this method are shown below

Step1 Prepare separate Trading and Profit and loss Account and balance sheet of the branch in the books of the respective branch.

Step2 Transfer only the amount of net profit/loss as shown by branch Profit and Loss Account to Head Office by passing the following journal entry.

Profit and loss A/c.	Dr
To Head Office A/c.	

Note *a reverse entry is passed in case of net loss*

Step3 incorporate only the net profit of the branch in the books of head office by passinf the following journal entry.

Profit and loss A/c. Dr
To Head Office A/c.

Note *a reverse entry is passed in case of net loss*

Step4 Prepare separate trading and profit and loss account and the balance sheet of the head office in its books

- **Abridged Consolidated Method** The practical steps to be taken under this method are shown below.

Step1 Prepare separate trading and profit and loss account of the branch in the books of respective branch

Step2 Transfer only the amount of net profit/loss, the assets and the liabilities of the Branch to the Head Office Account

Step3 Incorporate the net profit/loss, the assets and the liabilities of the branch in the books of Head Office

Step4 Prepare trading profit and loss account after incorporating branch net profit loss and consolidated balance sheet in the books of head office.

JOURNAL ENTRIES under this method the journal entries which are passed by the branch to transfer its net profit/loss, assets and liabilities by the head office to incorporate the net profit/loss, assets and liabilities of the branch are shown below:

JOURNAL ENTRIES IN THE BOOKS OF BRANCH AND H.O. UNDER ABRIDGED CONSOLIDATED METHOD

	Item	In the Books of Branch	In the Books of H.O.
1.	For Transfer of Branch	Profit and Loss A/c Dr.	Branch A/c Dr.
2.	**For Transfer of Branch Assets**	Head Office A/c Dr. To Branch Assets A/c (Individually)	Branch Assets A/c Dr. To Branch A/c (Individually)
3.	**For Transfer of Branch Liabilities**	Branch Liabilities A/c Dr. (Individually) To Head Office A/c	Branch A/c Dr. To Branch Liabilities A/c (Individually)

- **Detailed Consolidated Method** The practical steps under this method are shown below

Step1 Transfer all revenue items, assets and liabilities of the Branch to the Head Office Account in the books of the Branch

Step2 Incorporate all the revenue items, assets and liabilities transferred by the Branch in the books of Head Office

Step3 Prepare consolidated Trading and Profit and Loss Account and Consolidated Balance Sheet in the books of H.O.

JOURNAL ENTRIESunder this method the journal entries which are passed by the Branch to transfer its trial balance to H.O. and by the head office to incorporate the trial balance of branch in its books are shown below

JOURNAL ENTRIES IN THE BOOK OF BRANCH AND H.O. UNDER CONSOLIDATED FINAL ACCOUNTS METHOD

	Item of Trial Balance	*In the Books of Branch*	*In the Books of H.O.*
1	**For items which are shown on the debit side of Trading A/c (after adjustments relating to outstanding and prepaid expenses)**	Head Office A/c Dr. To Opening Stock To Purchases To Goods received from H.O. To Direct expenses To Sales Returns	Branch Trading A/c Dr. To Branch A/c
2.	**For items which are shown on the credit side of Trading A/c (after adjustments relating to outstanding and prepaid expenses)**	Sales A/c Dr. Closing Stock Dr. Purchase Returns Dr. To Head Office A/c	Branch A/c Dr. To Branch Trading A/c
3.	**For Transfer of Gross Profit**	No Entry	Branch Trading A/c Dr. To Branch P&L A/c
4.	**For items which are shown on the debit side of Profit and Loss A/c (after adjustments relating to outstanding and prepaid expenses)**	Head Office A/c Dr. To Office & Adm. Exp. A/c To Selling & Dist. Exp. A/c To Depreciation A/c etc.	Branch P&L A/c Dr. To Branch A/c
5.	**For items which are shown on the credit side of Profit and Loss A/c (after adjustments relating to outstanding and prepaid expenses)**	Interest Received Dr. Discount Received etc. Dr. To Head Office A/c	Branch A/c Dr. To Branch P&L A/c
6.	**For transfer of Net Profit**	No Entry	Branch P&L A/c Dr. To H.O. P&L A/c
7.	**For transfer of Branch Assets (after adjustments)**	Head Office A/c Dr. To Branch Assets (Individually)	Branch Assets A/c (Individually) Dr. To Branch A/c
8.	**For Transfer of Branch Liabilities (after adjustments)**	Branch Liabilities (Individually) Dr. To Head Office A/c	Branch A/c Dr. To Branch Liabilities A/c (Individually)

NOTES

1. *In case of gross loss, the entry no. 3 will be reserved*
2. *In case of net loss, the entry no. 6 will be reserved*
3. *As a result, these entries, the H.O. A/c in the books of Branch and Branch A/c in the books of H.O. will be completely closed.*
4. *In the beginning of the next accounting year the entry no. 7 & 8 will reserved.*

ILLUSTRATION 1

] **[Calculation of Cash-in-transit when both H.O. Account and Branch Account have Debit Balances]**

From the following particulars, reconcile the H.O. Account with Branch Account.

Particulars	*H.O.*		*Branch*	
	Dr. (Rs)	*Cr. (Rs)*	*Dr. (Rs)*	*Cr. (Rs)*
Goods sent to Branch	—	13,02,400	—	—
Goods received by Branch	—	—	12,80,400	—
Branch A/c	4,11,100	—	—	—
H.O. A/c	—	—	3,01,600	—

Solution

A. Total Difference = Rs 4,11,100 + Rs 3,01,600 = Rs 7,12,700

B. Goods not yet received by branch = Rs 22,000

C. Cash not yet received by H.O. = Rs 7,12,700 – Rs 22,000 = Rs 6,90,700

D. Journal Entry to reconcile in the books of H.O.:

Goods in transit A/c	Dr.	Rs 22,000	
Cash in transit A/c	Dr.	Rs 6,90,700	
To Branch A/c			Rs 7,12,70

Dr. **Branch Account in the Books of H.O.** *C*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	4,11,100	By Goods in transit A/c	22,00
To Balance c/d	3,01,600	By Cash in transit A/c	6,90,70
	7,12,700		7,12,70

ILLUSTRATION 2

Rocky (India), Khandwa, opened a Branch at Delhi on 1st April 20X1. The goods were sent by the Head Office to the Branch and invoiced at selling price of the Branch which was 125% of the cost price of the head office.

The following are the particulars relating to the transactions of Delhi Branch:

		Rs
Goods sent to branch (at cost to Head Office)		2,80,800
Sales:		
Cash		1,25,000
Credit		1,75,000
Cash collected from Debtors		1,56,000
Discounts allowed		4,000
Returns from Debtors		5,000
Cash sent to branch for:		
Wages	3,000	
Freight	11,000	
Other Expenses	6,000	20,000
Spoiled cloth in bales written off at invoice price		500
Closing Stock in hand		54,500
Goods received by Branch till date at invoice price		3,50,000

Required Ascertain the profit or loss for the Delhi Branch for the year ended 31st March 20X2 after preparing Branch Stock Account and Branch Debtors Account.

Solution

Dr. **Delhi Branch Stock Account** Cr.

Particulars	Rs	Particulars	Rs
To Goods Sent to Branch A/c [Rs 2,80,800 + Rs 70,200]	3,51,000	By Branch Debtors A/c (Credit Sales)	1,25,000
To Branch Debtors A/c —Returns	5,000	By Branch Cash A/c (Cash Sales)	1,75,000
		By Branch Adjustment A/c [Rs 500 × 25/125]	100
		By Branch Profit and Loss A/c (Cost of spoiled cloth)	400
		By Balance c/d:	
		Stock-in-hand	54,500
		Stock-in-transit [Rs 3,51,000 – Rs 3,50,000]	1,000
	3,56,000		3,56,000

Dr. **Delhi Branch Debtors Account** Cr.

Particulars	Rs	Particulars	Rs
To Branch Stock A/c (Cr. sales)	1,75,000	By Cash A/c	1,56,000
		By Discounts A/c	4,000
		By Branch Stock A/c (Returns)	5,000
		By Balance c/f	10,000
	1,75,000		1.75,000

Dr. **Delhi Branch Adjustment Account** Cr.

Particulars	Rs	Particulars	Rs
To Branch Stock A/c—Loading	100	By Goods sent to Branch A/c	70,200
To Wages (treated as Direct)	3,000	[Rs 3,51,000 × 25/125]	

Particulars	Rs	Particulars	Rs
To Freight (treated as Direct)	11,000		
To Stock Reserve A/c	11,100		
To Gross Profit transferred — to Branch Profit and Loss A/c	45,000		
	70,200		70,200

Dr. **Delhi Branch Profit and Loss Account** Cr.

Particulars	Rs	Particulars	Rs
To Expenses	6,000	By Branch Adjustment A/c (Gross Profit)	45,000
To Discounts	4,000		
To Branch Stock A/c (Cost of Spoiled cloth)	400		
To Profit and Loss A/c (Net Profit)	34,600		
	45,000		45,000

ILLUSTRATION 3 **When goods-in-transit are there**

CSFDIE Ltd. had a branch at Kolkata. Goods are invoiced to the branch at cost *plus* 25%. Branch is instructed to deposit cash every day in the head office account with the bank. All expenses are paid by cheques by the head office except petty cash expenses which are paid by branch manager. From the following particulars, prepare Branch Account in the books of head office:

	Rs		*Rs*
Opening Stock in hand	2,500	Cash remitted to the head office	15,000
Closing Stock in hand	2,000	Furniture purchased by the branch manager	1,200
Opening Sundry debtors	1,400		
Closing Sundry debtors	1,800	Goods received from the head office	17,200
Cash sales for the year	10,800	Expenses paid by the head office	1,640
Credit sales for the year	7,000	Expenses paid by the branch	120
Cost of goods sent to Branch	14,560		

Branch Manager is entitled to a commission of 5% of profit of the branch after charging such commission.

Solution

Dr. **Kolkata Branch Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d:		By Branch Stock Reserve A/c	
Branch Stock A/c	2,500	[Rs 2,500 × 25/125]	500
Branch Debtors A/c	1,400	By Goods Sent to Branch A/c	
To Goods sent to Branch A/c		[Rs 18,200 × 25/125]	3,640
[Rs 14,560 + Rs 3,640]	18,200	By Cash (remittance)	15,000
To Bank (expenses)	1,640	By Balance c/d:	
To Branch Stock Reserve A/c		Branch Stock in Hand	2,000
[Rs 3,000 × 25/125]	600	Branch Stock in Transit	
To Branch Manager's Commission		[Rs 18,200 − Rs 17,200]	1,000
[Rs 1,880 × 5/105]	90	Branch Debtors	1,800
To Net Profit transfer to General		Branch Furniture	1,200
Profit and Loss A/c	1,790	Branch Cash	1,080
	26,220		26,220

Working Notes

Dr. **(*i*) Memorandum Branch Debtors Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*
To Balance b/d	1,400	By Cash A/c *(Balancing figure)*	6,600
To Sales (credit)	7,000	By Balance c/d	1,800
	8,400		8,400

Dr. **(*ii*) Memorandum Branch Cash Account** *Cr.*

Particulars	*Rs*	*Particulars*	*Rs*

ILLUSTRATION 4 When all the required amounts are given

From the following information, prepare Madras Branch Account in the books of head office for the year ending on 31st March 20X1:

	Rs		Rs
Opening Stock (at cost)	3,56,000	Closing Stock (at cost)	3,76,800
Opening Debtors	28,000	Closing Debtors	1,92,000
Opening Petty Cash	500	Closing Petty Cash	240
Furniture (in the beginning)	12,000	Furniture at the end	?
Opening Creditors	12,000	Closing Creditors	12,000
Goods sent to Branch (at cost)	10,44,000	Cheques sent to Branch for expenses	99,740
Goods returned by Branch to H.O. (at cost)	17,200	Cash received from Debtors	12,78,000
Goods returned by Customers to Branch	13,800	Cash Sales	64,000

Depreciate the furniture @ 10% p.a.

Solution

Dr. **Madras Branch Account in the Books of H.O.** *Cr.*

Particulars	*Rs*	*Particulars*		*Rs*
To Balance b/d:		By Balance b/d: (Creditors)		12,000
Stock	3,56,000	By Bank A/c (Remittance from Branch)		
Debtors	28,000	Cash sales	64,000	
Petty Cash	500	Collection from Debtors	12,78,000	13,42,000
Furniture	12,000	By Goods sent to Branch A/c (Returns)		17,200
To Goods sent to Branch A/c	10,44,000	By Balance c/d:		
To Bank A/c (Remittance to Branch)	99,740	Stock		3,76,800
To Balance c/d (Creditors)	12,000	Debtors		1,92,000
To Net Profit t/f to General P&L A/c	3,98,800	Petty Cash		240
		Furniture (Rs 12,000 – Rs 1,200)		10,800
	19,51,040			19,51,040

ILLUSTRATION 5 Treatment of [Normal Loss, Abnormal Loss, Insurance Claim, Agreed Allowance/Trade Discount]

Taking the same information as given in Illustration 3 along with the following information, prepare the Delhi Branch Account:

(*i*) Goods costing Rs 2,500 were damaged in transit and a sum of Rs 2,000 was recovered from the insurance company in full settlement of claim.

(*ii*) Loss-in-weight (Normal) (at cost) Rs 2,900.

(*iii*) Agreed allowance to customers off selling price Rs 1,000 (already taken into account while invoicing).

Solution

Dr. **Delhi Branch Account in the Books of H.O.** Cr.

Particulars		Rs	Particulars	Rs
To Balance b/d:			By Balance b/d: (Creditors)	6,000
Stock		1,78,000	By Bank A/c (Remittance from Branch)	6,45,000
Debtors		14,000	By Goods sent to Branch A/c: (Returns)	7,800
Petty Cash		250	By Balance c/d:	
Furniture		6,000	Stock	1,82,333
To Goods sent to Branch A/c		5,22,000	Debtors	1,25,200
To Bank A/c (Remittance to Branch)			Petty Cash	120
Salaries	30,000		Furniture (Rs 6,000 – Rs 600)	5,400
Rent and Insurance	12,000			
Petty Cash	7,870	49,870		
To Balance c/d (Creditors)		6,000		
To Net Profit t/f to General P&L A/c		1,95,733		
		9,71,853		9,71,853

Working Notes (*i*) Memorandum Branch Debtors A/c, Memorandum Branch Petty Cash A/c Refer to working Notes (*i*), (*ii*) is given in Illustration 3.

Dr. **(*ii*) Memorandum Branch Stock Account** Cr.

Particulars	Rs	Particulars	Rs
To Balance b/d	1,78,000	By Goods sent to Branch A/c:	
To Goods Sent to Branch A/c	5,22,000	(Returns)	7,800
		By Cost of Net Goods sold	5,04,46
		[(32,000 + 7,29,400 + 1000 (agreed allowance) – 5,700) × 100/150]	

UNIT 4 (B)

ACCOUNTING FOR DISSOLUTION OF PARTNERSHIP FIRMS:

INTRODUCTION

As per Section 39 of the Partnership Act, 1932 dissolution of partnership among all the partners of a firm is called dissolution of firm.Dissolution of partnership does not necessarily end the business but dissolution of firm ends the business. After the dissolution of the firm, all the assets are sold and the amount realised from the sale of such assets are used to disposed of the liabilities and to settle the partners account.

In the case of dissolution of partnership firm, the business of the firm comes to end and there is a complete breakdown of a partnership. Dissolution of partnership may not necessarily end the firm but may bring changes in the relationship of the partner, in such a case the partnership among the partners terminates but the reconstituted firm, continues with the same name.

MEANING OF DISSOLUTION OF PARTNERSHIP FIRM

Dissolving a partnership firm means discontinuing the business under the name of said partnership firm .In this case, all liabilities are finally settled by selling off assets or transferring them to a particular partner, settling all accounts existed with the partnership firm. Any profit\loss is transferred to partners in their profit sharing ratio as agreed by them in the partnership deed.

Dissolving a partnership firm is different from dissolving a partnership .In the former case, the firm ends its name and hence cannot do business in the future .But in case of dissolving a partnership, the existing partnership is dissolved by consent or on happening of a certain event, but the firm can retain its existence if remaining partner's enter into a new partnership agreement.

MODES OF DISSOLUTION

1. When partners are mutually agreed:-It is the easiest way to dissolve a partnership firm since all partners have mutually agreed upon closing the partnership firm. Partners can give a mutual consent or may enter into an agreement for the dissolve.

2. Compulsory dissolution:-A firm may need to be dissolved compulsorily if:

a) All partners or all partners except one partner are declared insolvent.

b) The firm is carrying unlawful activities like dealing in drugs or other illegal products or doing business with alien countries that may harm the interest of India or doing other such activities.

3. Dissolution depending on certain contingent events: Upon happening of certain events, a firm may be required to get dissolved:

a) Expiry of fixed term: Partnership formed for a fixed term will get dissolved once the term gets over.

b) Completion of task: Sometimes, a partnership is formed for a certain task or objective. Once the task is completed, the partnership will automatically get dissolved.

C) Death of the partner: If there are only two partners and one of the partner dies, the partnership firm will automatically dissolve. If there are more than two partners, other partners may continue to run the firm. In such case, only the partnership will get dissolved and other partners will enter into a new argument.

4. Dissolution by notice: If a partnership business is at will, any partner can dissolve the partnership by giving an advanced notice. Notice will contain a date from which dissolution will be effective.

5. Dissolution by court: If any of the partners becomes mentally unstable or misbehaves with the other partner(s) or doesn't abide by the clauses of the agreement, the other partner(s) may file a case in the court to dissolve the firm. But a court can dissolve the firm only if it is registered with the registrar of firms. Hence an unregistered partnership firm can't be dissolved by the court.

6. Transfer of interest or equity to the third party: If any partner transfers control in the form of interest or equity to a third party without consulting other partners, the partner(s) may dissolve the firm.

SETTLEMENT OF ACCOUNTS ON DISSOLUTION

In case of dissolution of a firm, the firm ceases to conduct business and has to settle its accounts. For this purpose, it disposes off all its assets for satisfying all the claims against it. In this context it should be noted that, subject to agreement among the partners, the following rules as provided in Section 48 of the Partnership Act 1932 shall apply.

a) Treatment of Losses, including deficiencies of capital, shall be paid:

- First out of profits,
- Next out of capital of partners, and
- Lastly, if necessary, by the partners individually in their profits sharing ratio.

b) Application of Assets, the assets of the firm: Including any sum contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order.

- Surplus, if any is to be utilized in settlement of the capital in paying the debts of the firm to the third parties.
- In paying each partner proportionately what is due to him\her from the firm for advances as distinguished from capital (i.e. partner loan).
- In paying to each partner proportionately what is due to him on account of capital.
- The residue, if any, shall be divided among the partners in their profit sharing ratio.

Thus, the amount realized from assets along with contribution from partners, if required, shall be utilized first to pay off the outside liabilities of the firm such as creditor, loans, bank overdraft, bill payables, etc. The balance should be applied to repay loans and advances made by the partners to the firm and account balances, after adjusting all profits and losses. Private Debts and Firms Debts:

Where both the debts of the Firm and private debts of a partner co-exist, the following rules, as study in Section 49 of the Act, shall apply.

- The property of firm shall be applied first in the payment of debts of the firm and then the surplus, if any , shall be divided among the parents as per their claims, which can be utilized for payment of their private liabilities .
- The private properties of any partner shall be applied first in payment of his private debts and the surplus, if any, may be utilized for payment of the firm's debts, in case the firm's liabilities exceed the firm's assets. It may be noted that the private property of the partner does not include the personal properties of his wife and children .

ACCOUNTING TREATMENT

To close the books of assets and liabilities and to calculate liabilities, realization account is prepared. Thus, dissolution of firm takes place through the following steps:

- Realization of assets.
- Payment of Realization expenses.
- Disposal of liabilities.
- Distribution of assets\cash among partners.
- Distribution of profits and losses among partners.
- Payment of loan given by the partner.
- Payment of available cash to partners.

DIFFERENCE BETWEEN REVALUATION ACCOUNT AND REALISATION ACCOUNT

Revaluation Account

- It is prepared to record the profit/loss on the revaluation of assets and liabilities.
- It is prepared at the time of admission, retirement, amalgamation or death of a partner.
- The balance of revaluation account is transferred to capital account of old partners.
- Revaluation and closure of the account assets and liabilities are revalued and not to closed.
- There are no revaluation expenses.
- Entries are passed on the basis of the difference between the book value and revalue figure.

Realization Account

- It is prepared to record the profit\loss on the realization of assets and liabilities.
- It is prepared at the time of dissolution of firm only.
- The balance of realization account is transferred to the capital account of all the partners.
- Closing of the accounts of assets and liabilities.

- There are usually some realization expenses which are debited to realization account.
- Entries are passed at their book values and the amount actually realized from assets and amount actually paid to pay off the liabilities.

REALISATION OF ASSETS AND PAYMENT OF LIABILITIES

JOURNAL ENTRIES

- **FOR TRANSFER OF ASSETS\CLOSING OF ASSETS ACCOUNT:**

All asset accounts excluding case, bank and the fictitious assets, if any are closed by transfer to the debit of Realisation Account at their book values .It may be noted that sundry debtors are transferred at gross value and the provision for doubtful debts is transferred to the credit side of Realisation Account along with liabilities. The same thing will apply to fixed assets, if provision for depreciation account is maintained.

Realisation A/c Dr.

To Assets (Individually) A/c

- **FOR TRANSFER OF LIABILITIES/FOR CLOSING OF LIABILITIES ACCOUNT:**

All external liability accounts including provisions, if any, are closed by transferring them to the credit of Realisation account.

Liabilities (individually) Dr.

To Realisation A/c

- **FOR SALE OF ASSETS:**

Bank A/c Dr.

To Realisation A/c

- **FOR AN ASSET TAKEN OVER BY A PARTNER:**

Partner's Capital A/c Dr.

To Realisation A/c

- **FOR PAYMENT OF LIABILITIES:**

Realisation A/c Dr.

To Bank A/c

- **FOR A LIABILITY WHICH A PARTNER TAKES RESPONSIBILITY TO DISCHARGE:**

Realisation A/c Dr.

To Partner's Capital A/c

- For settlement with the creditor through transfer of assets when a creditor accepts an asset in full and final settlement of his account, journal entry needs to be recorded .But , if the creditor accepts an asset only as part payment of his/her dues, the entry will be made for cash payment only. For example, a creditor to whom ₹ 10, 000 was due accepts office equipment worth ₹ 8,000 and is paid ₹ 2,000 in cash, the following entry shall be made for the payment of ₹ 2,000 only.

Realisation A/c Dr.

To Bank A/c

However, when a creditor accepts an asset whose value is more than the amount due to him, he/she will pay cash to the firm for the difference for which the entry will be

Bank A/c Dr.

To Realisation A/c

- **FOR PAYMENT OF REALIZATION EXPENSES:**
  - When some expenses are incurred and paid by the firm in the process of realization of assets and payment of liabilities:

Realisation A/c Dr.

To Bank A/c

- When realization expenses are paid by a partner on behalf of the firm:

Realisation A/c Dr.

To Partner's Capital A/c

- When a partner has agreed to undertake the dissolution work for an agreed remuneration bear the realization expenses:
  - If payment of realization expenses is made by the firm

    Partner's Capital A/c Dr.

    To Bank A/c

  - If the partner himself pays the realization expenses, no entry is required.
  - For agreed remuneration to such partner

    Realisation A/c Dr.

    To Partner's Capital A/c

- **FOR REALIZATION OF ANY UNRECORDED ASSETS INCLUDING GOODWILL, IF ANY:**

  Bank A/c Dr.

  To Realisation A/c

- **FOR SETTLEMENT OF ANY UNRECORDED LIABILITY:**

Realisation A/c Dr.

To Bank A/c

- **FOR TRANSFER OF PROFIT AND LOSS ON REALISATION:**
  - In case of profit on realization

    Realisation A/c Dr.

    To Partner's Capital A/c(individually) A/c

  - In case of loss on realization

    Partner's Capital A/c (individually) Dr.

    To Realisation A/c

- **FOR TRANSFER OF ACCUMULATED PROFITS IN THE FORM OF RESERVE FUND OR GENERAL RESERVE:**

  Reserve Fund/General Reserve A/c Dr.

  To Partner's Capital A/c (individually)

- **FOR TRANSFER OF FICTITIOUS ASSETS, IF ANY, TO PARTNER'S CAPITAL ACCOUNTS IN THEIR PROFIT SHARING RATIO:**

  Partner's Capital A/c (individually) Dr.

  To Fictitious Asset A/c

- **FOR PAYMENT OF LOANS DUE TO PARTNER'S**

  Partner's Loan A/c Dr.

  To Bank A/c

- **FOR SETTLEMENT OF PARTNER'S ACCOUNTS IF THE PARTNER'S CAPITAL ACCOUNT SHOWS A DEBIT BALANCE, HE BRINGS IN THE NECESSARY CASH FOR WHICH THE ENTRY WILL:**

  Bank A/c Dr.

  To Partner's Capital A/c

The balance is paid to partner's whose capital accounts show a credit balance and the following entry is recorded.

Partner's Capitals A/c (individually)

To Bank A/c

It may be noted that the aggregate amount finally payable to the partners must equal to the amount available in bank and cash accounts. Thus, all accounts of a firm are closed in case of dissolution.

REALISATION ACCOUNT

When the firm is dissolved, its books of account are to be closed and the profit or loss arising on realization of its assets and discharge of liabilities is to be computed. For this purpose, a Realisation Account is prepared to ascertain the net effect (profit or loss) of realization of assets and payment of liabilities which may be is transferred to partner's capital accounts in their profit sharing ratio. Hence, all assets and all external liabilities are transferred to this account. It also records the sale of assets, and payment of liabilities and realization expenses. The balance in this account is termed as profit or loss on realization which is transferred to partner's capital accounts in their profit sharing ratio.

References

1-Soumya Mukherji, abhik Mukherjee. Financial Accounting, Oxford University Press.

2- Hanif, Mukherjee. Financial Accounting, McGraw Hill Education.

3-P.C. Tulsian. Financial Accounting, Pearson Education.

4-Guidance Notes on Terms used in Financial Statements issued by ICAI.