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Admission of a Partner; Meaning of Retirement of Partner; New Profit Sharing Ratio and Gaining Ratio on Retirement of a Partner; Differences between Sacrificing Ratio and Gaining Ratio; Accounting Treatment of Goodwill at the Time of Retirement of Partner; Revaluation of Assets and Liabilities

UNIT 9: Trial Balance **149-166**

Concept of Trial Balance; Objects of Trial Balance; Format of a Trial Balance; Preparation of Trial Balance

UNIT 10: Preparation of Final Accounts **167-184**

Meaning of Final Accounts, Trading Account; Profit and Loss Account Balance Sheet

UNIT 11: Consignment Account **185-210**

Concept of Consignment; Important Terms related to Consignment Business; Features of Consignment Advantages of Consignment; Distinctions between Consignment and Sale; Accounting for Consignment Business; Valuation of Unsold Stock; Meaning of Normal and Abnormal Loss; Differences Between Normal and Abnormal Loss; Consigning Goods at Invoice Price

UNIT 12: Joint Venture **211-233**

Meaning of Joint Venture; Features of Joint Venture; Advantages of Joint Venture; Distinction Between Joint Venture and Partnership; Distinction Between Joint Venture and Consignment; Accounting Treatment for Joint Venture: When separate set of books are maintained, When no separate set of books are maintained, When each Co-venturer Keeps records of their own transactions only.

Unit 13: Hire Purchase and Instalment Purchase System **234-284**

Meaning and Features of Hire Purchase System, Advantages and Disadvantages of Hire Purchase System, Rights and Obligations of Hire Purchaser and Seller Accounting for Hire Purchaser System, Meaning and Features of Instalment Purchase System, Differences between Hire Purchase and Instalment Purchase Systems, Accounting for Instalment Purchase System.

COURSE INTRODUCTION

In this course we will discuss the fundamentals of accounting. This includes the basic concepts of accounting, meaning and importance of accounting standards, the process of journal and ledger preparation, cash book, trial balance and the final accounts etc. We will also discuss certain special types of accounting system followed in case of hire purchase and instalment purchase, branch accounts and departmental accounts.

UNIT 1 : Introduction to Accounting
UNIT 2 : Generally Accepted Accounting Principles
UNIT 3 : Accounting Standards
UNIT 4 : Accounting Process-I
UNIT 5 : Accounting Process-II
UNIT 6 : Cash Book
UNIT 7 : Partnership-I
UNIT 8 : Partnership-II
UNIT 9 : Trial Balance
UNIT 10 : Prepatration of Final Accounts
UNIT 11 : Consignment Account
UNIT 12 : Joint Venture
UNIT 13 : Hire Purchase and Instalment Purchase System
UNIT 14 : Branch Account
UNIT 15 : Department Accounts

While going through a unit, you will notice some along-side boxes, which have been included to help you know some of the difficult, unseen terms. Again, we have included some relevant concepts in ‘‘LET US KNOW’’ along with the text. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be better if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PPROGRESS” given at the end of each unit.

of accounting, functions of accounting etc. The business uses accounting as a source of information in taking business decisions. So, it must possess certain characteristics and all these will be discussed in this unit.

This unit will help you in gaining knowledge on the basics of accounting and its importance in a business. You will also come to know some basic terms used in accounting.

1.3 MEANING OF BOOK-KEEPING

A business is started with a motive to earn profit. But at the same time there is a risk that it may face loss. Therefore, it is very important to keep track of the various transactions of the business. The owner is keen to know the amount of profit or loss suffered; the assets that the business possesses or the liabilities that the business has to discharge etc. All these information can be obtained only through the accounting records. It makes it essential to record the transactions of the business. The system of keeping records of monetary transactions in business is known as book- keeping. On the basis of these records, certain reports will be prepared which will provide information as required by the owner or other ***stokeholders***.



Stokeholders: A person or group or organisation having interest in a business cancer like, creditors, suppliers, customers, employers, directors, sharcholders and the society as a whole.

R. N. Carter defined book-keeping as, “Book-keeping is the science and art of correctly recording in books of account all those business transactions that result in the transfer of money or money’s worth.”

Therefore, the various aspects associated with book-keeping can be stated as under–

- A process of recording business transactions on a day to day basis;
- The business transactions must be expressed in terms of money;
- These transactions are recorded in a set of books, known as books of account;
- It provides the basis for generating summarized reports of business affairs during a particular period of time.



CHECK YOUR PROGRESS

Q.2: What is accounting?

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Q.3: State any three objectives of accounting.

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1.5 FUNCTIONS OF ACCOUNTING

On the basis of the above discussion, the functions of accounting may be stated as under–

- **Record Keeping:** The primary function of accounting is to keep records of the business transactions and then classify and summarized these transactions. It starts with recording the transactions in the primary book, known as journal book, and then transactions are posted to the secondary book, known as ledger book. On the basis of the ledger book, another statement is prepared, known as Trial Balance. At the end of the accounting period, on the basis of the information of trial balance, final accounts are prepared.
- **Decision-Making:** Accounting aids decision- making function of the management. Accounting provides varied information like, profit earned or loss suffered; assets and liabilities of business; cash and bank balances etc. All these information are supplied by accounting to enable the management in making business decisions.
- **Meeting Legal Requirement:** The business organisations are required to furnish various financial reports to the government

External Users	
Investors	amount of money to be invested or not to be invested in the business
Banks	Amount of loan to be provided and the ability to repay the loan along with interest
Creditors	ability of the business to return their money
Government	tax liability
General Public	company's policies to discharge social responsibility etc.



ACTIVITY 1.1

Discuss the importance of accounting as a source of information.

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1.7 CHARACTERISTICS OF ACCOUNTING INFORMATION

You are aware that accounting records are considered as source information to communicate business information. Accounting information must satisfy the informational need of different users. Hence, accounting information must possess certain characteristics to be able to satisfy the need of different user groups. The characteristics of accounting information may be discussed as under–

- **Relevance:** The accounting must provide relevant information to the users to enable them to make sound decisions. The information must be communicated timely so that users can make best use of it.
- **Reliable:** Accounting must assure the users that they can rely on the information in their decision- making. The information must be verifiable and free from errors and bias.

but also other assets or properties, for example, furniture, machinery etc. These are used in the business to run the business. The money brought in by the businessman will not be withdrawn from the business unless the business is closed down. Likewise, the other assets, which are brought in the business as capital will not be sold in the short- run. Let us assume that you are going to start a business by investing Rs. 50,000 in cash. You have also brought furniture amounting to Rs. 10,000 and a car costing Rs. 40,000. Now, your capital will be Rs. 1,00,000 (Cash Rs. 50,000 + Furniture Rs. 10,000 + Car Rs. 40,000 = Rs. 1,00,000.) and with these you will start your business. You will not withdraw this amount or sell the assets till you decide to close down the business. If in future, you decide to close down the business, first of all you have to meet the liabilities of outsiders, for example, bank loan, creditors for merchandise etc., which you may obtain during the course of the business. After meeting all such liabilities, the residual amount will be your capital. This can be explained with the help of the following equation–

Capital = Total Assets – Total Outside Liabilities

Capital can be classified as–

- **Fixed Capital:** Fixed capital represents investment in those assets which are required to continue the business. These are not sold during the usual course of business and will be used in the business for a longer period of time.
- **Working Capital:** It represents the investment made in those assets which are circulating in nature and their amount increases or decreases during the usual course of the business.

b) Assets: Assets means the resources owned by a business firm. These are used in usual course of the business to support functions of the business firm. The assets are purchased with the motive of using it in the operation of the business but not to sell it immediately. Where some assets are tangible like, cash, furniture, machinery etc., some other assets are intangible like, goodwill. Some assets

- **Capital Expense:** The expenses, whose benefits extend beyond one accounting period, are called capital expense. For example, purchase of a machine, furniture etc.

e) Revenue: Revenue means the amount received by a business firm from its regular business activities before deducting any expense during a particular period of time. As it is generated from the regular business activities, like sales, rent, interest etc., it is also known as operating revenue. A business organization records revenue when it is earned and it is immaterial whether cash is received or not.

f) Profit: Profit is the excess of total revenue over total expenses. It is reflected by–

- Increase in the value of assets;
- Increase in owners' equity;
- Decrease in liabilities.

g) Loss: Loss may be defined in different ways-

- the excess of expense over revenue;
- decrease in the value of an asset;
- cost that fails to earn revenue.

h) Depreciation: Depreciation means reduction in the value of an asset. The asset depreciates because of wear and tear, obsolescence etc. It is a non- cash expense charged against the profit of the company.

i) Debtor: A debtor is a person or an entity who owes money to someone. For example, if a customer has purchased goods from you without paying cash but undertakes to pay the money at a certain date in the future, that customer is a debtor for you.It means you have sold goods to the customer on credit. The customer is liable to pay money to you and you have a claim against him. On the agreed date, you will realize cash from him.

j) Creditor:A creditor is a person or an entity that has sold goods to a customer but has not received cash for the goods sold. The creditor has a claim against the customer and can realize the money on the

prepaid expense is treated as asset and appears in the balance sheet. The services to be received from such expenses spread over the different accounting periods. The expired portion is treated as expense of the particular accounting period.

q) **Outstanding Expenses:** The expenses which are incurred in a particular accounting period but not paid during that particular accounting period are known as outstanding expenses. For example, salaries, rents etc. of a particular month are paid in the next month. Assuming that the accounting period of an organisation starts from 1st April, 2014 and ends on 31st March, 2015. The salary to be paid to the employees of the organisation for the month of March, 2014 will be paid in the month of April, 2015, which is also the beginning of the next accounting period. The salaries of the previous accounting period have to be brought into account in that period. These expenses are known as outstanding expenses.

r) **Bills Payable:** These are the documents indicating the amount owed to other on account of purchase of goods or availing services on credit. For example, credit purchase of goods by a retailer, monthly electricity bill etc. These are short- term liability and recorded as current liability in the 'liability' side of balance sheet. The bills are required to be paid on maturity i.e. the date of payment mentioned on the bill.

s) **Bills Receivable:** These documents indicate the amount to be received from the parties on account of credit sale of goods. The bills receivable becomes due on the date of maturity i.e. the date of payment mentioned on the bill. These are short-term asset recorded as current asset in the 'assets' side of balance sheet.



CHECK YOUR PROGRESS

Q.5: Define the following terms–

a) Assets: .....

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- The characteristics of accounting information are– relevance, reliable, comparability etc.
- Some basic terms used in accounting are– fixed assets, liabilities, expenses, profit, outstanding expenses, bills payable etc.



1.10 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



1.11 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Book-keeping is the system of recording business transactions. These transactions are recorded systematically on a day to day basis in a set of books of accounting.

Ans. to Q. No. 2: Accounting is a system of interpreting the results of the business transactions which has been recorded, classified and summarized. Accounting communicates the financial information of the business to various parties.

Ans. to Q. No. 3: a) To keep the records of the transactions systematically;
b) To evaluate the performance of the business periodically;
c) To ascertain the financial position of the business.

Ans. to Q. No. 4: Relevance: The accounting information must provide relevant information of the business organisationto the users. This will help the users make decisions.

UNIT 2: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

UNIT STRUCTURE

2.1 Learning Objectives

2.2 Introduction

2.3 Meaning of Accounting Principles, Concepts, Conventions and Postulates

2.4 Meaning and Features of Generally Accepted Accounting Principles (GAAP)

2.5 Structure of GAAP

2.6 Let Us Sum Up

2.7 Further Reading

2.8 Answers to Check Your Progress

2.9 Model Questions

2.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- define the accounting principles, concepts, conventions and postulates
- discuss the different accounting principles, concepts and conventions
- explain the meaning and features of Generally Accepted Accounting Principles
- discuss the structure of Generally Accepted Accounting Principles.

2.2 INTRODUCTION

'Accounting' in business is considered as a system that provides information about the transactions that have taken place and the financial condition of the business. This system starts with recording of business transactions and ends with interpreting the results thereof. Accounting is defined by the Committee on Terminology of the American Institute of



CHECK YOUR PROGRESS

Q.1: Define accounting principles. (In three lines)

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2.4 MEANING AND FEATURES OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

GAAP are the buildings blocks of the accounting language. Whole accounting framework is built on GAAP. To understand and use accounting information, the users should know this conceptual framework beforehand. Generally Accepted Accounting Principles (GAAP) are guides to the accounting profession in the choice of accounting techniques and the preparation of financial statements. These principles have been developed gradually through practice. Experience, reason, custom, usage and practical necessity have contributed significantly in the evolution of GAAP.

GAAP incorporate the consensus at a particular time as to which economic resources and obligations should be recorded as assets and liabilities in financial accounting, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and which financial statement should be prepared. GAAP thus help to bring about uniformity in the reporting of financial events of the entities across the industry.

As of now, we have discussed the meaning of Generally Accepted Accounting Principles. Now, we will discuss the basic features of these accounting principles–

a) Accounting principles are not rigid. A considerable amount of flexibility is expected in the application of these principles.

b) Such principles are man-made and are the result of evolutionary process in accounting.

2.5 STRUCTURE OF GAAP

The structure of GAAP refers to the forms of elements of GAAP. Traditionally, these are known by various names, viz., assumptions, principles, concepts, conventions, etc. Based on the recent development in the theory base of accounting, the traditional structure of GAAP has been modified as under:

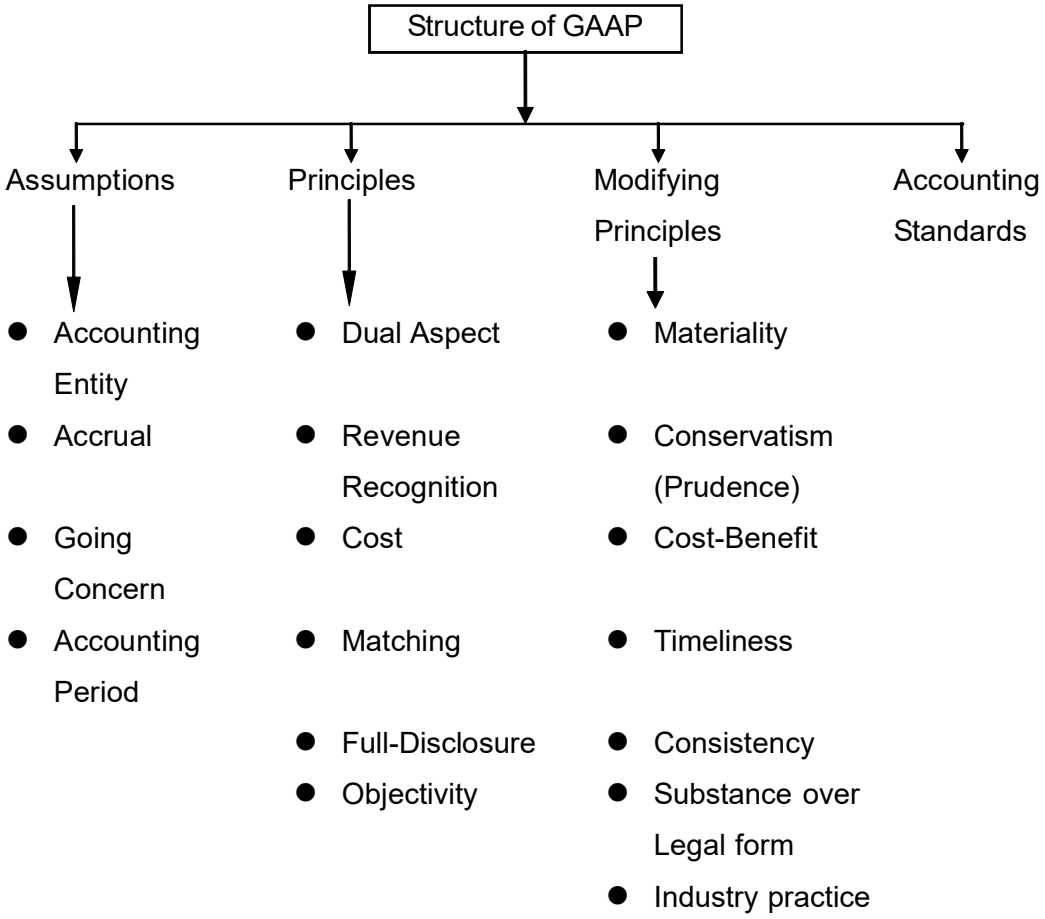


Fig. 2.1: Structure of GAAP

- **Modifying Principles:** Due to difficulties faced in the application of certain accounting principles in certain situations these are modified in the application stage. These are referred to as modifying principles which are given below:
- **Accounting Standards:** Accounting Standards are the established and accepted models which aim at providing excellent, adequate and unbiased treatment of accounting transaction/information and

profit of the business, accounts of the business must be kept distinctly separate from the household or other personal transactions of the owner. Every transaction is analysed from the point of view of the business and not from the point of view of the persons who own them. This is called Separate Business Entity or Accounting Entity Concept.

- **Accrual Assumption:** In business, all transactions are not cash transactions. Accrual is the accounting process of recognising non-cash events and circumstances as they occur. Accrual assumption is used to facilitate measurement of cash and non-cash incomes and expenses of a period. Income and expenses are accounted in the period to which these are related. In accrual system of accounting, revenue is recognised as follows:

  In case of sale:

  i) When cash is received, or
  ii) When an obligation is received from the buyer for the payment within a certain future period, or
  iii) When the consideration is received in settlement in any form other than cash, which can be expressed in definite money value.

  In case of purchase:

  i) When cash is paid, or
  ii) When an obligation is given to the seller to pay the amount within a certain future period, or
  iii) When a consideration other than cash is given in settlement of the due.

  Thus, in accrual system, income or expenses of a period are accounted in the period to which the income or expense is related applying the Matching Principle irrespective of the fact that whether cash is received or paid or the payment is deferred. The objective of accrual system is to determine the operating result (profit/Loss) in an accurate manner. As a result of this assumption, outstanding items of expenses and incomes are taken into consideration while

- **Money Measurement:** It is assumed that a stable currency is going to be the unit of record. The FASB accepts the nominal value of the US Dollar as the monetary unit of record unadjusted for inflation. In India, Rupee is accepted as the monetary unit of record without adjusting for inflation. Purchases, sales, plant, furniture, capital, bank loan, salaries, expenses all are recorded in the books of account in money value. Recording of transactions does not mean recording of qualitative or quantitative feature of these elements. Monetary value of purchases and sales are recorded and not the quantities. Assets and liabilities are shown at their respective money values. This is known as 'money measurement' concept.
- **Accounting Period:** It implies that the economic activities of an enterprise can be divided into artificial time periods. Accounting period means the period for which the accounts are prepared. This refers to the period of time at the end of which books of accounts of business entity are to be closed and financial statements are to be prepared. The going concern assumption tells that a business firm has an indefinite life or very long life. If this is the case then the result of business operation can be known only after the end of the life of business, i.e., when the business is liquidated. But to take decisions on various aspect concerning the business operation and its financial matter, information on periodic basis is required. To facilitate supply of accounting information, the life span of the entity is divided into shorter and convenient period known as accounting period. This assumption has also received legal sanction from the Indian income tax laws under which the books of accounts are required to be closed by a business entity on 31st March, every year.
- **Dual-Aspect:** Dual Aspect is another important concept applied in recording and presenting accounting information. This concept is the very foundation of double-entry system of book-keeping. According to this concept, every business transaction has double effect, i.e., it has two sides – Debit and Credit.

- **The Objectivity Principle:** The Objectivity Principle states that accounting should be definite, verifiable, reliable and free from manipulation and personal bias of the persons engaged in the process of recording and presenting accounting data. For this reason, accounting must be carried out on an objective and factual basis. Every entry in the books of account must be based on documentary evidence i.e. source documents viz., vouchers and receipts. Historical cost recorded in the books is on the basis of original documents, which contain the information about the transaction. Where no voucher/ receipt is available as in the case of provision for doubtful debt, a certificate from the competent authority of the business firm must be obtained.
- **The Principle of Full Disclosure:** Amount and kinds of information disclosed should be decided based on trade-off analysis as a larger amount of information costs more to prepare and use. Information disclosed should be enough to make a judgment while keeping costs reasonable. Information is presented in the main body of financial statements, in the notes or as supplementary information. Accounting information is required for decision making purpose by various users. Therefore, to be useful as the basis of decision-making process, there should be full disclosure in the financial statements of all significant information. Full Disclosure Principle specifies that there should be complete and understandable reporting relating to the economic affairs of the entity.
- **Cost-Benefit:** The benefit of providing the financial information should also be weighed against the cost of providing it. This modifying principle states that the cost of applying a particular principle should not exceed the benefits derived from it. This does not mean that effort should be taken to save cost by providing lesser information. It stresses that undue heavy expenses must not be incurred in supplying information which are not relevant. Cost benefit principle is generally applied to the supply of supplementary information, viz., human resource, value added

be picked up. The term conservatism implies that all probable or anticipated losses should be provided for and all anticipated or unrealized gains should be ignored and the profit should not be overstated. In other words, accountants should preferably report the highest values of liabilities and expenses, and the lowest values of assets and revenues.

- **Timeliness:** Information is useful for a decision maker if it is relevant and reliable. Information becomes useful, relevant and reliable if it is made available in time. The principle of timeliness states that information should be disclosed timely.
- **Substance over Legal Form:** According to this modifying principle, the transactions and events recorded in the books of accounts and presented in the financial statements should be governed by the 'substance of such transactions and not by the legality of such transactions'. In certain cases, the transactions recorded may not represent the true legal position. Therefore, under 'substance over legal form' principle, substance of the transaction gets preference over legal position.
- **Industry Practice:** Accounting procedures should follow industry practices. Industries have to work under various situations. Some situation may be unique to only one industry. Therefore, sometimes practice prevailing in a particular industry is given precedence over generally accepted accounting principles.



CHECK YOUR PROGRESS

Q.2: Explain the meaning of Generally Accepted Accounting Principles. (In three lines)

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2.7 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
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4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



2.8 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Accounting principles are the principles applied in the preparation of the accounts. They help in the development of accounting technique. They are derived from the objectives and the theoretical concept of accounting.

Ans. to Q. No. 2: Generally Accepted Accounting Principles are the guide to the accounting profession in the choice of accounting techniques and the preparation of financial statements. GAAP brings uniformity in the reporting of financial events of the entities across the industry. The main elements of GAAP are as under:

a) Assumptions
b) Principles
c) Modifying Principles, and
d) Accounting Standards.

Ans. to Q. No. 3: i) True, ii) False, iii) True, iv) True

UNIT 3: ACCOUNTING STANDARDS

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 Meaning and Needs of Accounting Standards

3.4 Objectives of Accounting Standards

3.5 Advantages of Accounting Standards

3.6 Authorities for Setting Accounting Standards in India

3.7 Let Us Sum Up

3.8 Further Reading

3.9 Answers to Check Your Progress

3.10 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- define the meaning and importance of accounting standards
- explain the objectives and advantages of accounting standards
- describe the authorities for setting accounting standards.

3.2 INTRODUCTION

In the preceding unit (Unit-2), we have discussed the accounting principles applied in the framing of accounting information. These principles are generally applied in accounting. Some accountants may not follow these when most of the accounting professionals in general do not welcome variations in the application of accounting principles. This is because such a situation creates confusion in preparing the accounts. In the same way, the users of financial statements do not like variation in the application of accounting principles by the preparers of financial statements because it creates problem in their decision making process. Hence, there is always an effort from both sides to minimise these variations in the application of accounting principles. The accounting bodies and associations world over

followed by business enterprises. Endeavour in this regard is needed at national as well as international level. Thought on standardization of accounting events and disclosure of the same in the financial statements was developed when the limitations of conventional GAAP were felt. Availability of alternative treatment of the event/transaction and reporting the same in any manner the accountant or the manager likes, have made the financial statements less useful to the decision makers since they can not make inter-firm comparison. This has reduced the investors' confidence on the audited accounts and thus has damaged the dignity of accounting profession.

Needs of Accounting Standards: Accounting Standards are primarily required for harmonizing the accounting practices. In this connection the statement provided by David Solomons (1983) is mentionable. He has identified the following reasons for setting accounting standards:

- The corporations cannot be granted absolute freedom of choice regarding what to report and how to report on market principles. For, this might cause damage to the interest of the investors and creditors.
- Comparability of financial information generated and disclosed by several enterprises will become easier through the adoption of a uniform accounting standard. The value of information would be enhanced if this can be compared from entity to entity.
- The third argument says that an accounting standard appeals to the limited capacity of receivers of information to interpret and use it for their economic decision making purpose. The accounting standards recognise the principle of equity in information dissemination.
- Moreover, in view of the globalization and internationalization of business, it has become a necessity to adopt globally acceptable treatment of accounting issues and their reporting methods.

- Accounting Standards ensure the consistency and comparability of Financial Statements.
- Accounting Standards help in resolving conflict of financial interests among various groups.
- Accounting Standards reduce the chances of manipulations and frauds.
- Accounting Standards are aid to Auditors. In case of companies, it is the duty of the auditors to ensure that the accounting standards have been followed in the preparation of financial statements. In case of deviations, it is also their duty to make adequate disclosure in their reports so that the users of such statements may be aware of such deviations. Such disclosure by the auditors helps them to avoid penal actions which may be taken against them under the company law.



CHECK YOUR PROGRESS

Q.3: Mention two objectives of Accounting Standards.

i) .....

ii) .....

Q.4: Mention two advantages of Accounting Standards.

i) .....

ii) .....

3.6 AUTHORITIES FOR SETTING ACCOUNTING STANDARDS IN INDIA

In India there are three authorities that can set and issue Accounting Standards under their respective legislative powers. These authorities are:

- The Council of the Institute of Chartered Accountants of India,
- The Central Government under the Income Tax Act, 1961; and
- The Central Government under the Companies Act, 1956.



3.7 LET US SUM UP

In this unit we have discussed the following aspects–

- Accounting standards are the established rules which are used in the preparation of financial statements.
- Accounting standards brings uniformity in financial reporting
- Accounting standards makes the comparison of financial statements easy
- Accounting standards are the aids to the auditors.
- The Institute of Chartered Accountants of India (ICAI) was established to conduct Chartered Accountancy examination and preparing CAs to perform accounting and auditing function; and to formulating accounting as well as auditing standards and guidelines.



3.8 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



3.9 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: "Accounting standards are the policy document issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events."

UNIT 4 : ACCOUNTING PROCESS-I

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Meaning of Account

4.4 Meaning of Debit and Credit

4.5 System of Book-Keeping

4.6 Double-Entry System

4.7 Classification of Accounts

4.8 Rules for Debit and Credit

4.9 Let Us Sum Up

4.10 Further Reading

4.11 Answers to Check Your Progress

4.12 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- explain the meaning of account
- explain the meaning of Debit and Credit
- define the Double Entry System Book-keeping
- apply the Double Entry System of Book-keeping in recording business transactions
- describe the advantages of Double Entry System of Book- keeping.

4.2 INTRODUCTION

In the first unit, we have discussed the meaning and objectives of accounting. Then we have discussed the functions of accounting. In this unit, we are going to discuss about account, the different classes of accounts, the double entry system and the rules of debit and credit.

on the top corner of the left hand side. Right hand side of the account is called 'credit side'. It is indicated by 'Cr.' (abbreviation for credit) on the top corner of the right hand side of the account. The name of the account is written at the top in the centre. The word 'Account' or its abbreviation A/c is added to the name of the account. For example, Building A/c, Furniture A/c, Salary A/c, etc. In case of account of a natural person the word Account (A/c) should not be used after the 'account head'. For example, the account of Laxmi is written as Laxmi and not as Laxmi A/c. It may be written as account of Laxmi. The term 'J. F' means 'Journal Folio', i.e., the concerned folio (page) number in the Journal.

There is another type of format used generally by the businessman to record transactions. This format is called 'horizontal format'.

This is shown below.

Salary Account (Horizontal Type)

Date	Particulars	J.F.	Dr. Amount Rs.	Cr. Amount Rs.	Balance Amount Rs. Dr Cr	Remark

4.4 MEANING OF DEBIT AND CREDIT

Debit and Credit are two important terms used in Book-keeping and Accountancy. These two terms form the very basis of recording transactions in the books of account.

Meaning of Debit: Left hand side of the account is called debit side. Hence, to debit an account means to record the transaction on the left hand side of the account. It is abbreviated as 'Dr.' The word 'debit originated from the Latin word 'Debitum' and it means what is due.



CHECK YOUR PROGRESS

Q.2: Explain the meaning of Debit and Credit.

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4.6 DOUBLE-ENTRY SYSTEM

The **Double-entry system** of accounting is based on Dual Aspect concept. According to this concept, every financial transaction involves two fold aspects – (a) receiving of a benefit (b) giving of a benefit. For example, if a business has acquired an asset, it must have given up some other asset such as cash. Thus a giver necessarily implies a receiver and a receiver necessarily implies a giver.

Thus, double entry system states that each transaction has two fold aspects and the effects of these two fold aspects are opposite in nature. If one aspect, called account, receives a benefit; there must be another aspect or an account to impart that benefit. *The system of book-keeping under which both the aspects of every transaction is recorded in the books of account is known as 'Double-entry system of Book-Keeping'*. Under this system, every transaction is recorded in an accounting format having two sides namely left hand side and right hand side. For a transaction, the account which receives the benefit is called a debtor and it is recorded on the left hand side of the format which, in book-keeping, is known as debit side. At the same time, the other account of the transaction, which imparts the benefit is known as a creditor and is recorded on the right hand side of the accounting format which, in book-keeping, is known as credit side. That is why this system is known as Double entry system. Under this system of book keeping for each transaction the debit amount must be equal to the credit amount.

Double entry system was first propounded in 1940, in Genoa, in Italy, and was used by Stewards for rendering accounts in the state, but it

Features of Double Entry System:

i) Transaction takes place only if there are two parties– one party receiving the benefit and the other party giving or imparting the benefit.

ii) Each party is affected (by the transaction) in opposite direction but with the same amount.

iii) Changes are recognised from the point of view of the party in whose books recording is being done.

iv) Changes are recorded in two related accounts in the books of the party in whose books recording is being done.

Advantages of Double Entry System: Double entry system has a good number of advantages. They are—

i) Scientific System: Double entry system is a scientific system of recording business transactions as compared to other systems.

ii) Complete Eecord: Under this system, two aspects of every transaction are recorded in their concerned accounts. Thus, it makes a complete record of business transactions because records of both the aspects are made.

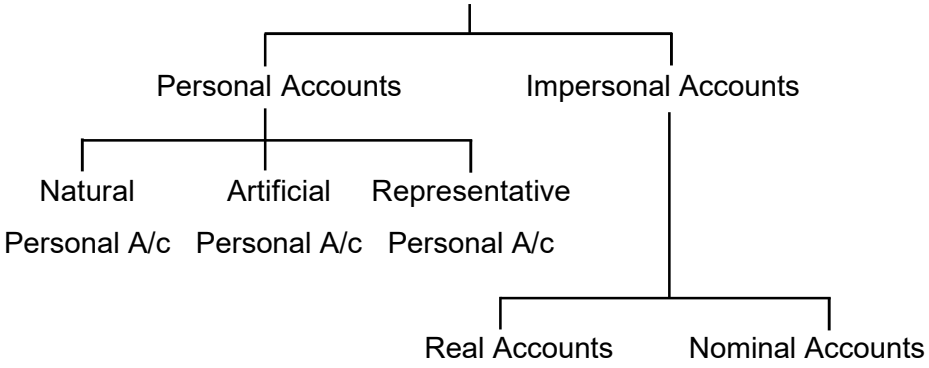
iii) Check Arithmetical Accuracy: Since, two aspects of each transaction are recorded in two accounts in opposite direction with equal amount, there will be an equal amount of debit and credit. Thus, the total debits and total of credits at any point of time will be equal and this is proved by preparing a Trial Balance. If the Trial Balance agrees, it proves that the books of accounts are arithmetically correct.

iv) Ascertainment of the Result of Business Activities: Under this system, as the accounts of revenue and expenses are maintained, a trading and profit and loss account can be prepared and gross profit/gross loss and net profit/net loss can be ascertained.

v) Ascertainment of Financial Position: Under this system, as the accounts of assets, liabilities and capital are also maintained, a balance sheet can be prepared in order to ascertain the financial position of the business on a given date.

A) English Approach or Traditional Approach:

English/Traditional Classification of Accounts



The above classification is explained below:

a) Personal Accounts: Account heads relating to persons, firms, companies, etc. are classified into the following categories.

i) Accounts of Natural Persons: Account heads that records the transactions of individual human beings fall into the category of natural persons, for example, accounts of Hem, Vikash, Suresh, Jayanata, Raju etc.

ii) Accounts of Artificial Persons: Accounts recording the transactions concerning a firm, company, institution, association, organisation etc. fall into this category. For example, Guwahati College A/c, Oil India Ltd. A/c, State Bank of India A/c, N.F Railway A/c, Guwahati Club A/c, etc.

iii) Representative Personal Accounts: Representative personal accounts are the accounts which represent a certain person or a group of persons although the name of the concerned person or persons are not mentioned in the account head. Such type of account head occurs in cases of outstanding expenses, prepaid expenses, income receivable and income received in advance. For example, outstanding Salary, Salary Prepaid, Unexpired Insurance or Insurance paid in advance, Commission Received in Advance etc.

Note: when any 'Prefix or Suffix' is used before/after any nominal account head, such account is classified as Representative Personal Account under Traditional approach.

purchases, wages paid, depreciation, rent paid, rates and taxes, etc. However, in case of sole proprietorship or partnership form of business, another account called 'Drawings Account' is also maintained in order to record the transactions relating to withdrawals of cash or goods made by the proprietor or partners for their personal use.

4.8 RULES FOR DEBIT AND CREDIT

A) Under English Approach or Traditional Approach *the rules for debit and credit* are as under:

i) In Case of Personal Accounts:

Debit the Receiver of the benefit

Credit the Giver of the benefit

ii) In Case of Real Account:

Debit What comes in.

Credit What goes out.

iii) In the Case of Nominal Accounts:

Debit Expenses and Losses.

Credit Gains and Incomes.

B) Under American or Modern Approach *the rules for Debit and Credit* are as under:

a) Assets Account:

i) When there is an increase in the value of Asset, it is 'Debited'

ii) When there is a decrease in the value of Asset, it is 'Credited'

b) Liabilities Account:

i) When there is an increase in the amount of Liability, it is 'Credited'

ii) When there is a decrease in the amount of Liability, it is 'Debited'

c) Capital Account:

i) When there is an increase in the amount of Capital, it is 'Credited'

ii) When there is a decrease in the amount of Capital, it is 'Debited'

iv) Machinery Account

v) Cash Account

b) Liability Account:

i) Creditors Account

ii) Loan from Madhu Account

iii) Capital Account

iv) Bank (Loan) Account

v) Rent payable Account

c) Revenue Account:

i) Sales Account

ii) Returns inward Account (Sales decreases)

iii) Discount Received Account

iv) Interest received – Revenue Account

v) Rent of premises sub-let – Revenue Account

d) Expense Account:

i) Purchase Account

ii) Carriage inward Account

iii) Carriage outwards Account

iv) Discount Allowed Account

v) Interest paid Account



CHECK YOUR PROGRESS

Q.3: Explain the meaning of Double-entry system of Book-Keeping.

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Let us have some more Practice:

Identify the following accounts:

(i) Cash in hand (ii) Furniture (iii) Investment (iv) Building (v) Machinery (vi) Trademark (vii) Land (viii) Cash at Bank (ix) Leasehold property (x) Goodwill (xi) Closing Stock (closing inventory) (xii) Debtors

paid in advance (xx) Insurance premium (xxi) Prepaid Insurance (xxii) Depreciation (xxiii) Commission paid (xxiv) Commission Received (xxv) Commission Received in Advance (xxvi) Royalty Paid (xxvii) Dividend Received

Solution:

i) Sales– Revenue Account
ii) Purchase– Expense Account
iii) Returns Outward– Expense Account (purchase decreases)
iv) Returns inward– Revenue Account (Sales decreases)
v) Carriage inward– Expense Account
vi) Carriage outwards– Expense Account
vii) Discount Allowed– Expense Account
viii) Interest received– Revenue Account
ix) Discount Received– Revenue Account
x) Interest paid– Expense Account
xi) Rent Paid– Expense Account
xii) Rent payable– Liability Account
xiii) Rent paid in advance– Assets Account
xiv) Rent of premises sub-let– Revenue Account
xv) Bad debt– Expense Account
xvi) Import duty– Expense Account
xvii) Salary paid– Expense Account
xviii) Outstanding salary– Liability Account
xix) Salary paid in advance– Assets Account
xx) Insurance premium– Expense Account
xxi) Prepaid insurance– Assets Account
xxii) Depreciation– Expense Account
xxiii) Commission paid– Expense Account
xxiv) Commission received– Revenue Account
xxv) Commission received in advance– Liability Account
xxvi) Royalty paid– Expense Account
xxvii) Dividend received– Revenue Account

iii) Purchased goods for cash Rs. 12,000

iv) Sold goods to Ratan Rs. 15,000

v) Paid rent for the month of January '08 Rs. 500

vi) Received commission Rs. 2,000

Solution:

Statement showing the Account heads to be Debited/Credited

Sl. No.	Transaction	Aspects/ Accounts involved	Debit/ Credit	Reasons
i)	Started business with capital of Rs. 30,000	Cash Capital	Debit Credit	Assets increases Capital Increases (liability)
ii)	Purchased machinery on credit from Hari Bora for Rs. 35,000/-	Machinery Hari Bora	Debit Credit	Assets increases Libility Increases
iii)	Purchased goods for cash Rs. 12,000/-	Purchases Cash	Debit Credit	Expenses increases Assets Decreases
iv)	Sold goods to Ratan Rs. 15,000/-	Ratan Sales	Debit Credit	Assets increases Revenue Increases
v)	Paid rent for the month of July, 04 Rs. 500/-	Rent Cash	Debit Credit	Expenses increases Assets Decreases
vi)	Received commission Rs. 2,000/-	Cash Commission Received	Debit Credit	Assets increases Revenue Increases

Ans. to Q. No. 2: To debit an account means to record the transaction on the left hand side of the account. To credit an account means recording the transaction on the right hand side of the account.

Ans. to Q. No. 3: The system of book-keeping under which both the aspects of every transaction is recorded in the books of account is known as 'Double-entry system of Book-Keeping'.



4.12 MODEL QUESTIONS

Q.1: Explain the meaning of Double Entry System and describe its advantages.

Q.2: What do you mean by an account? What are the different types of account?

Q.3: What are the rules regarding debit and credit.

Q.4: Classify the following items:

Cash– Rs. 5,000

Machinery– Rs. 50,000

Loan Taken from Bank– Rs. 1, 00,000

Creditors– Rs. 10,000

Purchase of goods– Rs. 15,000

Sale of goods– Rs. 1, 00,000

Salaries paid– Rs. 10,000

X Co.– Rs. 10,000

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5.2 INTRODUCTION

In the earlier unit, we have discussed about account and the rules of debit and credit. We have discussed the double entry system of book-keeping. In this unit, we are going to discuss the steps of recording business transactions in journal. In journal book, transactions are recorded first by following the rules of double entry system. In the process of accounting, after entering the transactions in journal, the next step is to transfer these entries to another book of account. This book is known as ledger book. In this unit we will discuss about this book.

This unit will help you in gaining an understanding of journal book and the process of recording the transactions in journal besides the different subsidiary books that are important for a business organisation. Our discussion will also cover meaning of ledger, its importance in record keeping, the process of transferring the journal entries to ledger book etc. You will also come to know the steps of entering the transactions in ledger book and how the ledger accounts are balanced.

5.3 MEANING OF BOOKS OF ACCOUNTS

The book, which contains accounts, is known as the Books of Accounts. In other words, it means the khata or books in which the businessman keeps the records of business transactions. Recording of transactions in books of account is a process of entering the transactions in the proper books of accounts in a systematic manner. It means putting into black and white the transaction that takes place in course of business activities.

Normally transactions are recorded in two sets of books step by step. Transactions are first recorded in **Journal,** which is also known as **'book of original entry'** or '**Primary Book'**. In the next step, transactions are recorded in Ledger, which is also known as **'book of final entry'** or '**Secondary Book'**. These Books of accounts are specially printed and ruled books where the accounts of a firm can be written up.

the persons going through the journal entry to have an idea about the transaction.



CHECK YOUR PROGRESS

Q.1: What is journal?

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5.5 JOURNALISING

Journalising is the process of recording the aspects of the transactions in Journal. In other words, recording of entries in the 'journal' is known as journalising.

Process of Journalising: The process of journalising means the steps to be followed for ascertaining the account heads to be debited/ credited for a particular transaction. There are three steps involved in the process of journalising a transaction.

Step 1: Identification of accounts or 'account heads' affected by the transaction.

Step 2: Classification of accounts or accounts heads.

Step 3: Application of Rules for Debit and Credit

Types of Journal Entries: Entries recorded in the journal may be of two types.

a) Simple Journal Entry and

b) Compound Journal Entry

Simple Journal Entry: When a transaction affects only one aspect/ account in the debit and one aspect/account in the credit, it is known as simple journal entry.

Compound Journal Entry: When a transaction affects more than two accounts at a time– one or more accounts being debited/ one or more accounts being credited, such entry is known as compound journal entry.

Transactions Relating to Goods: The transactions relating to goods are: purchase and sale of goods for cash or on credit and the return of goods.

Example 2:

2008

Aug. 1: Purchased goods for Rs. 4,000

Aug. 2: Purchased goods for Rs. 3,000

Aug. 3: Purchased goods on credit from Rani for Rs. 2,000

Aug. 4: Goods sold for Rs. 5,000

Aug. 5: Goods sold for Rs. 10,000

Aug. 6: Goods sold to Jadu for Rs. 1,000 on credit

Aug. 7: Goods returned to Rani Rs. 1,000

Aug. 8: Goods returned by Jadu Rs. 500

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008				
Aug. 1:	Purchase A/c Dr.		4,000	
	To Cash A/c			4,000
	(Being goods purchased)			
Aug. 2:	Purchase A/c Dr.		3,000	
	To Cash A/c			
	(Being goods purchased)			3,000
Aug. 3:	Purchase A/c Dr.		2,000	
	To Rani			
	(Being goods purchased on credit)			2,000
Aug. 4:	Cash A/c Dr.		5,000	
	To Sales A/c			5,000
	(Being goods sold)			
Aug. 5:	Cash A/c Dr.		10,000	
	To Sales A/c			10,000
	(Being goods sold)			
Aug. 6:	Jadu Dr.		1,000	
	To Sales A/c			1,000
	(Being goods sold on credit)			

Aug.10:	Furniture A/c Dr. To MM Co. (Being furniture purchased on credit)		50,000	50,000
Aug. 11:	Cash A/c Dr. To Computer A/c (Being old computer sold)		5,000	5,000

In recording the transactions of Aug. 9 and Aug. 10 the assets have been debited by applying the rule of real account i.e. Debit– what comes in. The asset has been credited in recording the transaction of Aug. 11 as the asset is sold out i.e. Credit– what goes out.

Transactions relating to expenses and incomes: The expenses of business may relate to payment of salaries, rent, advertisement expenses, printing and stationery expenses etc. Business may earn income by way of commission, interest on investment etc. The following example will help you in recording such transactions:

Example 4:

2008

Aug. 12: Rent paid Rs. 5,000

Aug. 13: Advertisement expenses paid Rs. 4,000

Aug. 14: Interest on investment received Rs. 1,000.

Aug. 15: Commission received Rs. 500

Solution:

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008 Aug. 12:	Rent A/c Dr. To Cash A/c (Being rent paid)		5,000	5,000
Aug.13:	Advertisement A/c Dr. To Cash A/c (Being advertisement expenses paid)		4,000	4,000

Aug.17:	Drawings A/c Dr. To Cash A/c (Being cash withdrawn for personal use)		2,000	2,000



ACTIVITY 5.1

Enter the following transactions in journal

Purchase goods for Rs. 5, 000

Goods sold for Rs. 3,000

Purchase goods for Rs. 4,000 from Mr. Hari on credit

Rent paid Rs. 500

5.6 SUBSIDIARY BOOKS OF ACCOUNTS

So far we have discussed some of the transactions that are recorded in journal. Journal is the primary book of account where transactions are recorded date-wise. In case of large organizations where there are numerous transactions, it will be difficult to record all the transactions through journal. Hence, for convenience of recording, the journal is divided into a number of special journals. These are known as subsidiary books. The number of subsidiary books maintained by a business organization depends on the size of the organization and the nature of transactions. Now, we will discuss some subsidiary books maintained by a business organization in general.

5.6.1 Purchase Book

In purchase book the transactions relating to credit purchase of goods are recorded. But cash purchases and purchase of fixed assets are not recorded in this book. This book is also known as Purchase Journal or Bought Day Book. At the end of a certain period, the total of Purchase Book is posted to the debit side of Purchase Account and the suppliers' accounts will be credited with the respective amounts.

5.6.5 Bills Receivable Book

This book is used to record all promissory notes receivedand Bills of Exchange accepted by customers for the amounts due from them. A promissory note contains an unconditional promise in writing, to pay a certain sum of money only to a certain person on a specific future date.

5.6.6 Bills Payable Book

This book is used to record all promissory notes given and Bills of Exchange accepted by the business for the amounts due to suppliers. A bill of exchange is an instrument in writing, containing an unconditional order to pay a certain sum of money only to a certain person on a specific future date.



CHECK YOUR PROGRESS

Q.3: What is Purchase Book?

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Q.4: What is Sales Return Book?

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5.7 MEANING OF LEDGER

Although Journal is chronological record of all business transactions, yet it cannot provide all information regarding a particular account at one place. The journal cannot show the net effect of various transactions affecting a particular person, asset, revenue and expense. For example, if a trader wants to know the amount due to a particular supplier or the amount

Ledger is the ultimate destination of all transactions because posting is made from the journal to the ledger. The information available in the ledger in classified and summarised form also facilitates the preparation of a Trading and Profit and Loss Account and a Balance Sheet. Thus, Ledger is called the King of all books because no other book of account can supply all the information like ledger.

Utility/Importance/ Advantages: The utility/importance of 'Ledger' can be summarised as follows:

a) **Consdensed Scattered Information:** The ledger brings out the scattered information from the 'Journal'. It shows the condensed information under each account head.

b) **Full Information at a Glance:** As the ledger records both the debit and credit aspects in two different sides, the complete position of an account can be ascertained at a glance.

c) **Balance:** At the end of a specified period, the net effect of transactions of a particular 'account head' can be ascertained by finding out the balance of that account. For example, how much is due from a customer or how much is payable to a creditor or what is the total amount of purchases or what has been the expenditure on different heads, all these information can be ascertained by balancing the accounts appearing in the ledger.

d) **Trial Balance:** As both the aspects are recorded, the net debit effect and the net credit on the accounts must be equal on a particular date. This is verified by preparing a statement called Trial Balance. This is possible only if the ledger accounts are maintained.

e) **Preparation of Final Accounts:** Ledger is the 'store-house' of all information relating to the transactions. It facilitates the preparation of a 'Profit and Loss Account' from the balances of revenue and expenses accounts. It also, facilitates the preparation of a 'Balance Sheet' from the balances of assets, liabilities and capital accounts.

A) Personal Ledger

i) Debtors' ledger or Sales Ledger and

ii) Creditors' ledger or Bought Ledger.

B) General or Nominal Ledger: These are explained below:

a) Personal Ledger: The ledger which contains the accounts of persons, firms or organisations to whom goods are sold on credit or from whom goods are bought on credit, is known as personal ledger. Generally personal ledgers are sub-divided into

i) Debtors' ledger or Sales Ledger and

ii) Creditors' ledger or Bought Ledger.

i) Debtors' Ledger or Sales Ledger: In this ledger, the accounts of all Debtors for goods sold are maintained. Posting is made from Sales Day Book, Purchase Returns Book, Cash Book, Bills Receivable Book and Journal Proper for the transactions affecting the accounts of Debtors.

ii) Creditors' Ledger or Bought Ledger: In this ledger, the accounts of all Creditors for goods purchased are maintained. Posting is made from Purchase Day Book, Purchase Returns Book, Cash Book, Bill Payment Book and Journal proper for the transactions affecting the accounts of Creditors.

b) General Ledger: This ledger contains all accounts other than the accounts of Debtors and Creditors for goods. All accounts falling in the category of Assets, Liabilities (except debtors and creditors for goods), Capital, Revenue and Expense are maintained in this ledger. For example, if a machine is sold to Ram on credit, his account will appear in General Ledger; again, if goods are sold to him on credit, his account will appear in the Debtors' Ledger. General Ledger is also known as Impersonal Ledger or Nominal Ledger.

Distinctions between Journal and Ledger: Following are the distinctions between a Journal and a Ledger.

b) A vertical or 'T' shaped form is ruled as under:

"AB & Co" Account

Dr. **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
1	2	3	4	1	2	3	4

J.F. (Journal Folio): In this column, the page number of the Journal where the transaction was originally recorded is mentioned. It helps in locating the entry in the Journal. Again, in Journal the page number of the Ledger where the account appears is written in the Ledger Folio column.

Features of Ledger Accounts: In 'T' shaped form of writing up a ledger account, balance is ascertained periodically. In this book 'T' shaped form of Ledger Account has been used. Such Ledger Account has the following features:

a) **Two Sides:** A Ledger Account has two sides, namely Left hand and Right hand side. Left hand side is called the Debit side while the right hand side is called the Credit side.

b) **Recording of Two Aspects:** Posting is made on the debit side of the ledger account which has been debited in the journal and the account which has been credited in the journal is posted on the credit side of the ledger account

c) **Balancing:** Each account in the ledger is balanced independently. This is done by ascertaining the difference between the total of the Debit side and total of the Credit side.

Closing and Opening Balance: The balances of account ascertained at the end of a particular period are known as closing balances. These balances become the opening balances in the next period.

b) All the transactions pertaining to one account head should be posted to that account.

c) Two aspects of the business transaction namely – debit and credit aspects– should be posted on the debit side and credit side of the account respectively.

Basic Points Regarding Posting: Basic points to be kept in mind before posting are:

1) **Opening of Separate Accounts:** Separate accounts should be opened for different 'account heads' in the ledger for posting the different transactions recorded in the journal. For example: Cash A/c, salary A/c, purchases A/c etc.

2) **One Account for each kind of Transaction:** One account should be opened for each kind of transaction. Transactions taking place during an accounting period relating to that particular account should be posted to that account only. If more than one account is opened for one kind of transactions, the object of summarisation of transactions of similar nature will not be achieved. For example, it may be found that in the journal, Cash A/c has been debited during a week, say on six different dates and the same account has been credited on four different dates. For recording these transactions in ledger, only one Cash A/c will be opened in ledger for transactions taking place on all the days and posting of all entry relating to Cash A/c will be made in that account only.

Methods of Posting: There are three methods of posting from Journal to Ledger:

a) **Entry-wise Posting:** Posting of each journal entry in the affected 'account heads' may be made before proceeding to the next entry.

b) **Account Head-wise Posting:** Posting may be made 'account head' wise i.e. posting of all Debits and Credits relating to one particular account head may be made before taking up another account head.

c) **Page-wise Posting:** Posing may be made in all account heads appearing in one particular page of the journal before taking up the next page.

"By … … … (name of the account credited) … … …"

Step 4: In the 'J.F. column' on the credit side, the Folio (page) number of the Journal where the transaction has been originally recorded should be entered'. Also the Folio (page) number of the ledger in which the concerned account appears, should be entered in the 'Ledger folio column' of the Journal for cross reference.

Step 5 : In the 'Amount column' on the credit side, the amount as recorded in the journal against the account where the posting has been made should be entered.

Note: When the debit aspect of a transaction entered in the journal is posted in the ledger, only the debit side of that account is affected; when the credit aspect of a transaction entered in the journal is posted in the ledger, only credit side of that account is affected. In order to have a complete record of each transaction, both the aspects will have to be posted.

Posting of simple Journal Entry:

Example: On 1st January 2008, Mr. X started business with a capital Rs. 18,000s

Journal of Mr. X

Date	Particulars	L. F.	Dr. Amount (Rs.)	Cr. Amount (Rs.)
2008 Jan1	Cash A/c Dr. To Capital (Being cash brought in as capital)		18,000	 18,000

In the above entry, the accounts affected are Cash A/c and Capital A/c. Therefore, in the ledger, Cash A/c and Capital A/c will be opened. Posting in both the accounts are shown as under.

account which has caused an effect in the Capital will be written. As per the entry in the journal, Cash A/c has caused an effect in the Capital. Therefore, Cash A/c will be written in the 'particulars column' with a prefix 'By'. In the 'J.F column', the Folio number (page number) where, the entry appears in journal will be written. In the 'amount column' in the ledger, the figure stated against Capital in the journal, as shown above, will be entered.

Example: Purchase of furniture from Modern Furnisher on credit for Rs.12,000 on January 1, 2008.

Journal Entry

Furniture A/c	Dr.	12,000	
To Modern Furnisher			12,000
(Being furniture purchased on credit)			

The amount of Rs. 12,000 will be debited to the Furniture A/c and credited to Modern Furnisher in the following way–

Ledger

Furniture Account

Dr. **Cr.**

Date	Particulars	L. F.	Amount (Rs.)	Date	Particulars	L. F.	Amount (Rs.)
2008	To Modern Furnisher		12,000				

Ledger

Modern Furnisher

Dr. **Cr.**

Date	Particulars	L. F.	Amount (Rs.)	Date	Particulars	L. F.	Amount (Rs.)
				2008 Jan1	By Furniture Account		12,000

cash receipts are equal to the cash payments then the cash account will not show any balance. Thus, it never shows credit balance.

2) **Liability Account:** Liability accounts will always show credit balance. For example Creditors Account, Bills Payable Account, Outstanding expense Account, Loan from Gauri Account etc.
3) **Capital Account:** Capital account will always show credit balance.
4) **Revenue Account:** Revenue accounts will always show credit balance. For example, Sales Account, Commission Received Account etc.
5) **Expense Account:** Expense account will always show debit balance. For example, Sales Account, Commission Allowed Account, Wags Account etc.
6) **Drawings Account:** Drawings account will always show debit balance.



CHECK YOUR PROGRESS

Q.9: What is the object of balancing an account?

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5.11 ILLUSTRATIONS

Illustration 1: Enter the following transactions in the respective ledger accounts in the books of XY Company

2008

Aug. 1: Purchase goods for Rs. 1, 000.

Aug. 10: Goods sold for Rs. 7, 000.

Aug. 12: Salary paid Rs. 4, 000.

Aug. 15: Rent paid Rs. 1, 000.

Solution: *Workings*

Dr. Sales Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Aug.15	To By Balance c/d		7,000	Aug.10	By Cash A/c		7,000
			7,000				7,000
				Aug.16	By Balance b/d		7,000

Dr. Salary Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Aug.12	To Cash A/c		4,000				
				Aug.15	By Balance c/d		4,000
			4,000				4,000
Aug.16	To Balance b/d		4,000				

Dr. Rent Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Aug.15	To Cash A/c		1,000				
				Aug.15	By Balance c/d		1,000
			1,000				1,000
Aug.16	To Balance b/d		1,000				

Dr. Cash Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Aug.10	To Sales A/c		7,000	Aug.1	By Purchase A/c		1,000
				Aug.12	By Salary A/c		4,000
				Aug.15	By Rent A/c		1,000
				Aug.15	By Balance c/d		1,000
			7,000				7,000
Aug.16	To Balance b/d		1,000				

Jan. 17	Travelling Expense A/c Dr. To Cash A/c (Being travelling expenses paid)		3,000	3,000
Jan. 20	ABC Company Dr. To Cash A/c (Being cash paid)		5,000	5,000
Jan. 22	Cash A/c Dr. To Assam Company (Being cash received)		5,000	5,000

In the books of Amir Enterprise

Ledger Accounts

Dr. Capital Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.31	To Balance c/d		50,000	Jan.1	By Cash A/c		50,000
			50,000				50,000
				Feb.1	To Balance b/d		50,000

Dr. Purchase Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.2	To ABC Company		10,000	Jan.31	By Balance b/d		10,000
			10,000				10,000
Feb.1	To Balance b/d		10,000				

Dr. **Assam Company** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.4	To Sales A/c		15,000	Jan.22	By Cash A/c		5,000
				Jan.31	By Cash c/d		10,000
			15,000				15,000
Feb.1	To Balance b/d		10,000				

Dr. **Cash Account** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.1	To Capital		50,000	Jan.17	By Travelling Expenses A/c		3,000
Jan.10	To Commission		1,000	Jan.20	By ABC Company		5,000
Jan.22	To Assam Company		5,000	Jan.31	By Balance c/d		48,000
			56,000				56,000
Feb.1	To Balance b/d		48,000				



ACTIVITY 5.1

Prepare ledger accounts from the following in the books of Assam company–

Cash paid to Mr. Ram Rs. 5,000

Interest received Rs. 500.

Telephone charges paid Rs. 500.

Wages paid Rs. 1,000.

Electricity charges paid Rs. 500

Ans. to Q. No. 2: Step 1: Identification of accounts or 'account heads' affected by the transaction.

Step 2: Classification of accounts or accounts heads.

Step 3: Application of Rules for Debit and Credit

Ans. to Q. No. 3: The transactions relating to credit purchase of goods are recorded in purchase book.

Ans. to Q. No. 4: When goods sold on credit are returned by the customers, they are recorded in Sales Return Book. At the end of a certain period, the total of this book is debited to Returns Inward Account and the customers' accounts, who have returned the goods, are credited with the respective amounts.

Ans. to Q. No. 5: Ledger is a book of account which contains a condensed and classified record of all transactions of the business posted from the journal. It is also called the book of final entry.

Ans. to Q. No. 6: i) Consdensed scattered information

ii) Full information at a glance

Ans. to Q. No. 7: Functions of ledger account are to provide: (a) Information regarding Debtors (b) Information regarding Creditors (c) Information regarding Purchases and Sales (d) Information regarding Revenue and Expenses (e) Information regarding Assets and Liabilities.

Ans. to Q. No. 8: i) Journal is a book of primary entry whereas ledger is a book of final entry.

ii) In Journal, transactions are recorded on the basis of voucher. But in ledger transactions are recorded from the journal.

Ans. to Q. No. 9: The object of balancing of account is to know periodical balance of an account.



5.15 MODEL QUESTIONS

Q.1: Describe different types of Books of Account.

Q.2: What do you mean by journal?

Q.3: What is Journalising? How is it done?

UNIT 6: CASH BOOK

UNIT STRUCTURE

6.1 Learning Objectives

6.2 Introduction

6.3 Meaning of Cash Book and Pass Book

6.4 Importance of Cash Book

6.5 Different Types of Cash Book

6.6 Illustrations

6.7 Petty Cash Book and Imprest System

6.8 Let Us Sum Up

6.9 Further Reading

6.10 Answers to Check Your Progress

6.11 Model Questions

6.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- explain the meaning of cash book
- discuss the differences between cash book and pass book
- analyse the importance of cash book
- explain the different types of cash book
- record the transactions in cash book
- explain the meaning of petty cash book.

6.2 INTRODUCTION

In the earlier units we have come across the meaning of journal and ledger books. You are also aware about the meaning of debit and credit and the rules for recording the transactions in journal book and the rules for ledger posting. The rules of debiting and crediting an account are also applied in preparing a cash book.

In this unit we will discuss the meaning, importance and different types of cash book. We will also focus on the preparation of cash book by following the rules of debit and credit.

6.4 IMPORTANCE OF CASH BOOK

Cash book is the most important subsidiary book, because it keeps the record of cash transactions of the business. The following are the importance of cash book:

a) **Helpful in Ascertaining the True Cash Position:** If Cash Book is not maintained the true position of cash can not be known. The Cash Book gives the true position of cash transactions. At any time the balance of cash as shown by the cash book must agree with the physical balance of cash in hand in the cash book.

b) **Helps in Cash Management:** Cash Book helps in the control of cash transactions. It is maintained by every business, whether big or small in size. It is simply because every business must be very cautious about its cash management i.e. cash receipts and cash payments. The business must know the amount of cash that has been collected/payments that have been made daily, weekly and monthly and also the periodic balance of cash in hand, so that effective steps for utilisation of cash balance can be taken.

c) **Helpful in Preventing Embezzlement:** The maintenance of cash book help in preventing embezzlement and manipulation. Unless cash book is maintained, the business will be in the dark about the daily cash position and this may increase the chance of committing frauds by the concerned staff.

d) **Serves as a Documentary Evidence for Cash Balance:** Cash Book serves as a documentary evidence for the available cash balances because the actual cash balance is compared by the cash balance as shown by Cash Book daily.

e) **Ascertainment of Daily Cash Transactions:** Since all cash transactions are recorded in cash book, it is easy to ascertain the cash receipt and cash payment on daily basis from the cash book.

f) **Ascertainment of Cash Balance:** Cash balance can be known at any time by ascertaining the balance of the cash book at that point of time. There is no need of calculating actual cash in the box.

D) Multiple Columns Cash Book: Cash book having columns for different categories of receipts and payments, Receipts from Merchandise Sales, Debtors, Bills Receivables, Interest, and other Receipts are entered in the Receipts side under respective columns. Payment for purchases for merchandise, Creditors, Bill Payables, Salary, Wages, Interest, Rent, etc. are entered under respective columns in the payment side.

6.6 ILLUSTRATIONS

Illustration 1: Prepare single column cash book from the following information in the books of AB Enterprise–

Date	Particulars	Amount (Rs.)
May, 2011 1	Cash in hand	5,000
2	Cash purchase	10,000
3	Cash sales	20,000
4	Cash paid to Ram	2,000
7	Cash received from Hari	1,000
10	Purchase Stationery	500

Solution:

In the books of

AB Enterprise

Dr. Cash Book Cr.

Date 2011	Receipts	L/F	R/N	Amount Rs.	Date 2011	Payments	L/F	V/N	Amount Rs
May 1	To Balance b/d			5,000	May 2	By Purchase A/c			10, 000
May 3	To Sales			20, 000	May 4	By Ram			2, 000
May 7	To Hari			1, 000	May 10	By Stationery A/c			500
					May 10	By Balance c/d			13, 500
				26, 000					**26, 000**
May 11	To balance b/d			13, 500					



CHECK YOUR PROGRESS

Q.4: Prepare a SINGLE COLUMN CASH BOOK from the following.

2007		Rs.
April 1	Cash in hand (Opening balance)	5,400
April 2	Bought goods for cash	750
April 4	Paid to Madan Kumar	105
April 7	Sold goods for cash	2,750
April 8	Deposited in the bank	5,200
April 9	Paid wage in cash	130
April 14	Paid for office furniture	395
April 14	Received cash from Dipak	525

Illustration 3: Prepare double column cash book from the following information in the books of Abhijit Enterprise–

Date	Particulars	Amount (Rs.)
June, 2013		
1	Cash in hand	20,000
	Cash at Bank	15,000
3	Cash paid to Imran	10,000
5	Rent Paid	1,000
10	Goods purchased	5,000
12	Cash deposited into Bank	2,000
15	Furniture purchased and payment made by cheque	1,500

Date	Particulars	Amount (Rs.)
June, 2014		
1	Cash in hand	50,000
	Cash at Bank	50,000
3	Payment made to Amar by cheque	10,000
5	Commission received	1,000
10	Goods purchased and payment made by cheque	5,000
12	Cash deposited into Bank	20,000
15	Cash withdrawn from bank for office use	2,500

In the books of

Abhijit Enterprise

Dr. **Cash Book** **Cr.**

Date 2014	Receipts	L/F	R/N	Amount Cash Rs.	Amount Bank Rs.	Date 2014	Particulars	L/F	V/N	Amount Cash Rs.	Amount Bank Rs.
June 1	To Balance b/d			50, 000	50,000	June 3	By Amar				10,000
June 5	To Commission			1,000		June 5	By Purchase A/c				5,000
June12	To Cash	C			20,000	June 12	By Bank A/c	C		20,000	
June15	To Bank	C		2,500		June 15	By Cash	C			2,500
						June 15	By Balance c/d			32, 000	53, 500
				53, 500	**70, 000**					**53, 500**	**70, 000**
June16	To Balance b/d			33, 500	52, 500						

Note: Discount column is not balanced. Periodical total is posted to respective ledger account in the ledger.

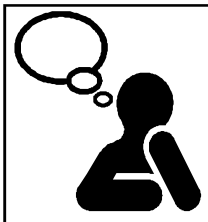
Solution:

In the books of

Abhijit Enterprise

Dr. **Cash Book** **Cr.**

Date 2014	Receipts	L/F	R/N	Amount Cash Rs.	Amount Bank Rs.	Amount Dis-count	Date 2014	Particulars	L/F	V/N	Amount Cash Rs.	Amount Bank Rs.	Amount Discount
Jan. 1	To Capital			70, 000			J						
June 2	To Cash	C			40, 000		June 2	By Bank	C		40,000		
June 3	To Sales				10, 000	50	June 10	By Purchase			5, 000		100
June 12	To Cash A/c	C			20, 000		June 12	By Bank	C		20,000		
							June 15	By Salaries A/c				2,500	
							June 20	By Rent A/c				10,000	
							June 20	By Balance c/d			5, 000	57, 500	
				70, 000	**70, 000**	**50**					**70,000**	**70, 000**	**100**
June 21	To Balance b/d			5, 000	57, 500								



ACTIVITY 6.1

Prepare cash book from the following information in the books of YY Enterprise–

2014

April 1: Cash balance Rs. 10,000

April 5: Cash deposited into bank Rs. 15,000

April 7: Purchase goods for Rs. 5,000

April 8: Goods sold for Rs. 20,100 and discount allowed Rs. 100

April 10: Goods sold for Rs. 5,000 and payment received by cheque

April 12: Goods purchased for Rs. 600 and discount received Rs. 50



6.8 LET US SUM UP

In this unit we have discussed the following points–

- Cash book records all cash receipts and cash payments.
- Cash book are of three types- Single column cash book, Double column cash book and Triple column cash book.
- Petty cash book is maintained to record small payments.



6.9 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



6.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Records of bank deposits and withdrawals are made in a small book by the bank and given to the accountholder, this book is called Pass Book.

Ans. to Q. No. 2: Cash Book is a subsidiary book maintained by business firms to record cash and bank transactions. It records all receipts and payment whether in cash or by cheque.

Ans. to Q. No. 3: i) Helpful in ascertaining the true cash position
ii) Helps in cash management



6.11 MODEL QUESTIONS

Q.1: What is cash book?

Q.2: What are the different types of cash book?

Q.3: Discuss the importance of cash book.

Q.4: Prepare cash book from the following information-

2014

April 1: Cash balance Rs. 1,00,000

April 5: Cash deposited into bank Rs. 50,000

April 7: Purchase goods for Rs. 15,000

April 8: Goods sold for Rs. 20,000

April 10: Goods sold for Rs. 5,000 and payment received by cheque

April. 12: Goods purchased for Rs. 600

April. 15: Cash paid to Ram Rs. 1,000

*** ***** ***

which is known as partnership deed. There are various advantages and disadvantages of the partnership business. All these topics will be discussed in this unit.

7.3 MEANING AND FEATURES OF PARTNERSHIP BUSINESS

A partnership is an agreement between two or more persons to carry on a business and to share profits and losses arising therefrom in the ratio as decided earlier, Partnership is defined by the Partnership Act, 1932 as "The relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually, "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm name".

The above definition of partnership as given consists of the following basic elements–

a) There must be an association of two or more persons.
b) There must be an agreement between all the persons concerned.
c) The object of the agreement must be to share the profits and contributes to the losses of the business.
d) The business must be carried on by all or any of them acting for all.

It should be noted that, the person who takes active part in the day to day working of the business is known as active partner whereas the person who just contributes capital, share profits or losses of the business but does not take active part in the working of the business is known as sleeping or dornant partner.

Features of Partnership Firm: The features of paertnership business are discussed below–

i) **Easy Formation:** The formation of partnership business is comparatively easy as its registration is purely optional.
ii) **Agreement:** There must be an agreement between all the partners of the partnership firm. The agreement may be express or implied.

or contract may be either oral or written. Though the law does not make it compulsory to have a written agreement, but in order to avoid disputes and mistrusts among the partners in the course of time, it is always desirable to have the agreement in writing. The document containing the terms and conditions in writing among the partners is called Partnership Deed.

Such a document should be properly drafted on Government Non Judicial Stamp Paper as per the Stamp Act, signing by all the partners and contains the following particulars:

i) Name and address of the partners.
ii) Description of the firm.
iii) The type and nature of the business the firm proposes to do.
iv) Amount of capital to be contributed by each partner and whether the capital accounts will be fixed or fluctuating.
v) Interest on capital: Rate of interest on capital, if allowed.
vi) Drawings: The maximum amount a partner is entitled to withdraw from the firm for personal use.
vii) Interest on drawings: Rate of interest, if to be charged, on drawings.
viii) Profit sharing ratio: The ratio in which the partners are going to share the profits and losses arrising from the business.
ix) Interest on Loan: Rate of interest on loan by a partner to the firm.
x) Salary: Amount of salary, commission etc. if agreed to be paid to partners.
xi) Valuation of Assets: In case of reconstitution, the manner in which the assets of the firm shall be valued.
xii) Rules to be followed in case of admission of a partner.
xiii) Settlement of Account: In case of retirement or death or dissolution of the firm, the manner in which the accounts of partners shall be settled down.
xiv) Accounting period: The date on which accounts shall be closed every year.
xv) Right and duties of partners.
xvi) Duration of partnership: The period for which the partnership has been established.

Account for each partner are maintained. Since original capital invested by the partners remain constant, hence all entries relating to drawings, interest on drawings, interest on capital, salary to partners, share of profit or loss etc. are mode in Current Account.

Fluctuating Capital Accounts Method: Fluctuating capital means where capital of the partners go on changing from time to time. Unlike fixed capital method, only capital account for each partner are maintained under this method, where all the entries relating to drawings, interest on drewings, interest on capital, salary to partners, share of profit or loss etc are recorded in Capital Accounts. In the absence of any instructions, the Capital Accounts should be prepared under this method.

Example 1: Record the following items in the Capital Accounts of A and B assuming that–

i) Fluctuating Capital Method is followed.

ii) Fixed Capital Method is followed.

	A	B
Capital on 1st Jan	2,00,000	1,00,000
Drawings during the year	25,000	20,000
Interest on partners loan	3,000	–
Partner's salary	12,000	9,600
Partner's Commission	–	4,000
Share of profit	30,000	15,000
Current Account balance	5000 (Cr.)	2000 (Dr.)

i) As per Fluctuating Capital Method:

Dr. **Partner's Capital A/C** **Cr.**

Date	Particulars	J.F.	A	B	Date	Particulars	J.F.	A	B
1 Jan	To, Drawings A/c		25,000	20,000	1 Jan	By Balance B/d		2,00,000	1,00,000
to					1 Jan	,, salary A/c		12,000	9,600
31					to	,, Commission			4,000
Dec	To, Balance c/d		2,17,000	1,08,600	31	,, Profit and loss			
					Dec.	Appropriation A/c		30,000	15,000
						(share of profit)			
			2,42,000	1,28,600				2,42,000	1,28,600

Adjustment to be made	All adjustment entries (in respect of interest on capital and drawings, share of profit etc.) relating to partners are to be made in Current Account of each partner.	The adjustment entries are to be made to the Capital Account of each partner.
Position of balance	It can never show a negative balance.	In case of heavy losses or huge drawing of partners the Capital Account may show negative balance.



CHECK YOUR PROGRESS

Q.3: What is fixed capital A/c method?

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Q.4: What is fluctucting capital A/c?

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7.8 PROFIT AND LOSS APPROPRIATION ACCOUNT

In a partnership, there are certain transactions (such as interest on capital, interest on drawing, interest on partners loan, transfer to Reserve. Fund or any other fund, partner's salary, commission etc.) which are neither charged against profit nor to be mixed up with other general trading transactions. Hence, a new account which is just an extension of Profit

respect to the time, rate of interest and the amount of capital. It is to be noted that, as per sec 13(c) of the Partnership Act, where interest on capital is payable by agreement, it can be paid only out of profit. It means if in any year the business suffer losses, no interest on capital is allowed. The main aim of providing interest on capital is to bring out an equitable distribution of profit among the partners, where partners share profits and losses equally but their capital contributions are unequal and vice versa. The entries to be passed for allowing interest on capital are given below:

When Capital Accounts are fluctuating:

For allowing interest on capital–

Interest on Capital A/c Dr.

To Partner's Capital A/c

When Capital Accounts are fixed:

Interest on Capital A/c Dr.

To Partner's Current A/c

For closing the interest on capital account:

Profit and Loss Appropriation A/c Dr.

To Interest on Capital A/c

7.10 INTEREST ON DRAWINGS

Drawings means the amont withdrawn by partners (either in cash or in kind) for their personal use. No interest is charged on drawings made by partners unless the partnership deed provide for such interest. The main object of charging interest on drawings is to discourage partners to draw excessive amount of money from the firm. The calculation of interest on drawings under different situation may be as follows:

- When a fixed amount is withdrawn at the begining of each month, interest will be calculated at the agreed rate for an average period of $6\frac{1}{2}$ months on the total amount withdrawn.
- When a fixed amount is withdrawn at the middle of each month, interest will be calculated at the agreed rate for on average period of 6 months on the total amount withdrawn.

Dec.31	Profit and Loss Appropriation A/c Dr.		4,000	
	To Interest on Capital A/c			4,000
	(Being the transfer of interest on capital to Profit and Loss Appropriation A/c)			
	Profit and Loss Appropriation A/c Dr.		12,000	
	To X's Capital A/c			6,000
	To Y's Capital A/c			6,000
	(Being the balance of profit distributed in their profit sharing ratio)			

Profit and Loss Appropriation A/c for the year ended 31, Dec. ...

Dr. **Cr.**

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Interest on Capital		By Profit and Loss A/c	16,000
x = 2,000		(Net profit)	
y = 2,000	4,000		
To Partner's Capital A/c			
x = ½ of 12,000 = 6,000			
y = ½ of 12,000 = 6,000			
	12,000		
	16,000		16,000

Where the capital of the partner's is fixed:

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
Dec.31	Interest on Capital A/c Dr.		4,000	
	To X's Current A/c			2,000
	To Y's Current A/c			2,000
	(Being interest on capital @ 5% credited to partner's current account)			

The net profit of the firm before considering the above mentioned adjustments for the year was Rs 20,400. Show the distribution of profits and prepare the partners Capital Accounts.

Solution:

Profit and Loss Appropreation A/c for the year ended 31, Dec.2014

Dr. **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Interest on Capital		By Net profit b/d	20,400
Arun = 10% of 40,000 = 4,000		Less: Interest on Arun's	
Barun = 10% of 20,000 = 2,000	6,000	loan (6% of 10,000 $^{7}/_{12}$)	350
			20, 005
To Partner's Current A/c		**By Interest on drawings**	
x = $^{3}/_{5}$ x 14,770 = 8862		Arun = 390	
y = $^{2}/_{5}$ x 14,770 = 5908		Barun = 330	720
	14,770		
	20,770		20,770

Calculation of Interest on Drawings:

Arun's drawings for the year = 1000 x 12 = Rs. 12,000

$\therefore$ Interest on drawings = 12,000 x 6% x $^{6.5}/_{12}$ = Rs. 12,000

Barun's drawing during the year = 1000 x 12 = Rs. 12,000

$\therefore$ Interest on drawings = 12,000 x 6% x $^{5.5}/_{12}$ = Rs. 330

Note : When partner provides loan to the firm and the rate of interest on such loan has not given in the question, then under the Partnership Act, interest @ 6% p.a. is to be allowed on such loan. Besides that, the amount of partner's loan and the interest on it, is not recorded in the capital account of the partner.

- The Capital Accounts of partners may be maintained as (a) Fixed Capital Accounts or (b) Fluctuating Capital Accounts Method;
- Under fixed capital account method two accounts are maintained for each partner viz., Capital Account and Current Account;
- Under fluctuating capital account method only Capital Account for each partner is maintained;
- Profit and Loss account is prepared to ascertain net profit earned or loss suffered by the firm during the year.
- Profit and Loss Appropriation account is prepared to share net profit or loss among the partners.
- The Indian Partnership Act 1932, does not lay down any provision for allowing interest on Partner's Capital. However, interest on capital is to be allowed only when it is expressly agreed to among the partners.
- If the partnership deed provides the interest on drawings can be charged.



7.12 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



7.13 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: A partnership is established by an agreement between the partners who have agreed to carry on a business. The agreement



7.14 MODEL QUESTIONS

Q.1: What is a Partnership Deed?

Q.2: What is Partner's Current Account?

Q.3: Distinguish between Fixed and Fluctuating Capital Account.

Q.4: What is the Profit and Loss Appropreation Account?

Q.5: Distinguish between Profit and Loss Account and Profit and Loss Appropreation Account.

Q.6: P. Q. and R are partners (sharing profits equally) in a firm. Calculate interest on partner's drawings if :

i) P draws Rs. 2000 from the firm in the begining of every month.

ii) Q draws Rs 2000 from the firm in the middle of every month.

iii) R draws Rs 2000 from the firm at the end of every month.

Interest on drawing is to be charged @ 5% p.a.

Q.7: A and B are partners in a firm having capital of Rs 3,00,000 and Rs 2,00,000 respectively. The terms of the partnership agreement are–

i) Partners shall be entitled to interest on capital @ 6% p.a.

ii) Interest on drawings shall be charged @ 8% p.a.

iii) Transfer Rs 20,000 from the distributable profits to the Reserve.

iv) The profit made by the firm during the year before considering interest on capital and drawing is Rs 1,96,800.

The partners withdraw Rs. 30,000 each during the year from the firm. You are required to prepare the Profit and Loss Appropriation Account and Capital Account of the partners assuming that the capital of the partners are fluctuating for the year.

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8.2 INTRODUCTION

As we have already discussed in the previous unit that a partnership is a mutual agreement among two or more persons to carry on some legal business. The partners share the profit or loss of the business at an agreed ratio. Due to the expansion of the business or other requirements, the partners may admit a new partner in the partnership firm, resulting in reconstitution of the partnership. You are aware that the existing partners have to sacrifice a part of their share in favour of the new partner and a new profit sharing ratio come into existence among all the partners.

Now let us consider a situation just opposite to it. A partner wants to leave the partnership firm. In this case also there will be some changes in the agreement of the partnership, resulting in reconstitution of the partnership. The partners will face some issues like, share of the outgoing partner, how they will share the part of the outgoing partner etc. In this unit we will discuss these issues that arises when a partner leave the firm.

8.3 MEANING OF ADMISSION OF A PARTNER IN A PARTNERSHIP BUSINESS

When a new partner joins an existing sole trade firm it becomes a partnership firm and the owners of the business enters into an agreement of partnership. Similarly, when a new partner join an existing partnership firm, the existing agreement of partnership have to change to incorporate new changes. This is known as reconstitution of partnership. When a new partner joins a business, the old partners have to sacrifice a part of the future profit and the reputation that they have earned during the course of time. The new partner has to compensate the old partners for their sacrifice. This takes place in the form of payment for goodwill by the new partner.

A partnership is a relation arising out of an agreement among some definite persons who are involved in the agreement. Any change in the agreement changes the relationship between the partners and such change in the relationship is knwon as Reconstitution of Partnership. Reconstitution of partnership may takes place in any of the following modes :

8.5 NEW PROFIT SHARING RATIO ON ADMISSION OF A PARTNER

We have already discussed that when a new partner is admitted in a partnership firm, the old partners have to sacrifice a portion of their share. The proportion, in which the old partner sacrifices his share in favour of the incoming partner, is known as sacrificing ratio. As the firm has been reconstituted as a consequence of admission of the partner, now all the partners will have a new arrangement to share the profit and loss of the firm. This new set of ratio is the new profit sharing ratio.

The calculation of the new profit sharing ratio depends upon the agreement between the existing partners and the incoming partners. Following situations will explain how a new profit sharing ratio is calculated:

Situation No. 1: When the share of the incoming partner is given without mentioning any changes in the shares of the existing partners.

Example 1: Arun and Barun are partners sharing profits and losses in the ratio of 4 : 1. They admited Tarun as a new partner for $\frac{1}{5}^{th}$ share in future profits. Calculate the new profit sharing ratio of the partners.

Solution: Let, the total share be 1

Tarun's share = $\frac{1}{5}^{th}$

$\therefore$ Remaining share = $= 1 - \frac{1}{5} = \frac{5-1}{5} = \frac{4}{5}^{th}$

$\therefore$ The remaining share $\frac{4}{5}$ will be shared by Arun and Barun in their old ratio i.e., 4 : 1

$\therefore$ Arun's new share = $\frac{4}{5}$ of $\frac{4}{5} = \frac{16}{25}$

$\therefore$ Barun's new share = $\frac{1}{5}$ of $\frac{4}{5} = \frac{4}{25}$

$\therefore$ Tarun's share = $\frac{1}{5} \times \frac{5}{5} = \frac{5}{25}$

$\therefore$ The new profit sharing ratio among Arun : Barun : Tarun = 16 : 4 : 5

Situation No. 2: When the incoming partners takes his share from the existing partners in certain proportions.

8.6 MEANING OF RETIREMENT OF PARTNER

When a person/partner ceases to be partner in a firm due to his/her ill health, old age or any other reason it is known as retirement of a partner. In case of retirement, the retiring partner must serve a notice, at least six months before, to other partners of his intention of retirement.

According to section 32(1) of the Indian Partnership Act 1932, a partner can retire in the following ways :

a) With the consent of all the partners.
b) As per an express agreement.
c) Serving notice in writing to all the existing partners regarding his intention to retire from the firm when the partnership is at will.

In case of retirement/death the existing partnership firm is legally dissolved and the remaining partners may agree to form a new partnership firm immediatly after such retirement/death of a partner. But as soon as a partner retires or dies the following questions may arise :

a) The amount due to the outgoing partner on his retirement.
b) The amount due to the executors or legal representatives in case of death of a partner.
c) The mode of repayment of the retiring or deceased partners balance of capital.

Matters Requiring Attention at the Time of Retirement/Death: In case of retirement/death the following matters are to be taken into consideration:

1) Calculation of new profit sharing ratio and gaining ratio.
2) Accounting tratment of goodwill.
3) Revaluation of assets and liabilities.
4) Distribution of reserve and accumulated profit or loss.
5) Sharing of profit or loss upto the date of retirement.
6) Adjustment of capital if required.
7) Payment of the amount due to the retiring partner.

R gains = $\frac{1}{3}$ of $\frac{3}{7} = \frac{1}{7}$

$\therefore$ Q's new ratio = $\frac{2}{7} + \frac{2}{7} = \frac{2+2}{7} = \frac{4}{7}$

$\therefore$ R's new ratio = $\frac{2}{7} + \frac{1}{7} = \frac{2+1}{7} = \frac{3}{7}$

$\therefore$ New profit sharing ratio = 4 : 3



CHECK YOUR PROGRESS

Q.2: X, Y and Z are partners in a firm who share profits and losses in the ratio of 2:2:1. Y retires and his share is acquired by X and Z equally. Calculate the new profit sharing ratio of X and Z.

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Gaining Ratio: Gaining ratio or benefit ratio is the portion of the share of the retiring or deceased partner, taken over by the continuing/ remaining partners. It is the difference between the new ratio and old ratio of the remaining partners. This ratio is necessary for the distribution of goodwill. Gaining ratio is calculated by applying the following formula :

Gaining ratio = New share – old share

It is to be noted that when the new ratio is not given, in that case old profit sharing ratio and gaining ratio would be same.

Example 4: X, Y and Z are equal partners in a firm. Y retires and the remaining partners decide to share the profits of the new firm in the ratio of 5 : 4. Calculate the gaining ratio.

Solution: Old ratio among x : y : z = 1 : 1 : 1

New ratio among x : z = 5 : 4

$\therefore$ Gaining ratio = New ratio – Old ratio

$\therefore x = \frac{5}{9} - \frac{1}{3} = \frac{5-3}{9} = \frac{2}{9}$

8.9 ACCOUNTING TREATMENT OF GOODWILL AT THE TIME OF RETIREMENT

As goodwill has been carned by the firm with the collective efforts of all the partners, therefore a retiring or deceased partner is also entitled to his share of goodwill at the time of his retirement or death. In such a case, valuation of goodwill is done as per the terms of the agreement amongst the partners. After ascertaining the value of goodwill, necessary entry is to be passed in the books of accounts of the partnership firm to give benefit to the retiring partner or executors of the decased partner.

8.10 REVALUATION OF ASSETS AND LIABILITIES

Revaluation of assets and liabilities is also necessary at the time of retirement or death of a partner. To give effect to this, Revaluation Account or profit and loss adjustment accunt is opened. The entries to be passed for revaluation depends on the following two heads :

When assets and liabilities are to be shown at the revised values in the balance sheet after revaluation.

Example 5: A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. When A retires, the value of machinery of Rs. 60,000 was valued at Rs. 80,000, while creditors and stock deereased by Rs. 2000 and Rs. 4,000 respectively.

Pass necessary journal entries for the above.

Solution:

Journal Intries in the books of the firm

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
	Revaluation A/c	Dr.		4,000	
	To stock A/c				4,000
	(Being fall in the value of stock debited to revaluation account)				
	Machinery A/c	Dr.		20,000	
	Creditors A/c	Dr.		2,000	
	To Revoluation A/c				22,000

	Memorandum			
	Revaluation A/c	Dr.	18,000	
	To A's capital A/c			9,000
	To B's capital A/c			6,000
	To C's capital A/c			3,000
	(Being profit on revaluation transfred to all partners capital A/c in their old profit sharing ratio)			
	Stock A/c	Dr.	4,000	
	To, Memorandum			
	Revaluation A/c			4,000
	(Being reversal of the entry)			
	Memorendum			
	Revaluation A/c	Dr.	22,000	
	To Machinery A/c			20,000
	To Creditors A/c			2,000
	(Bring reversal of the entry)			
	B's Capital A/c	Dr.	12,000	
	C's Capital A/c	Dr.	6,000	
	To Memorandum Revaluation A/c			18,000
	(Being reversal of the entry)			



LET US KNOW

As we already discussed in the previous unit that Reserve Fund and profit and loss account appearing in the liability side of the balance sheet indicates undistributed reserves and profits while profit and loss account appearing on the assets side of the balance sheet indicates accumulated losses. So, if there is any Reserve Fund or any amount of accumulated profit or loss appearing in the balace sheet at the time of retirement/death of a partner, it belongs to all the partners and should be transferred to the capital account of all the partners in their old profit sharing ratio.



8.11 LET US SUM UP

In this unit we have discussed the following aspects–

- When a partner leave a partnership firm due to ill health, old age or any other reason, it is known as retirement of partner.
- A partner can retire–
  - with the consent of all partners;
  - as per an expressed agreement;
  - by serving notice in writing to all existing partners regarding his intension to retire.
- Matters requiring attention at the time of retirement or death–
  - Accounting treatment of goodwill;
  - Revaluation of assets and liabilities;
  - Sharing of profit or loss upto the date of retirement.
- After retirement or death, the existing partners share profit or loss in the new profit sharing ratio.
- Gaining ratio is that portion of the share of the retiring or deceased partner takenover by the continuing or remaining partners.
- Revaluation of assets and liabilities are done at the time of retirement or death of a partner.
- The share of the retiring or deceased partner is paid to the retiring partner or executor of the deceased partner either in cash or may be considered as a loan from the partner to the partnership firm.



8.12 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.

ii) Sacrificing ratio is calculated at the time of admission of a new partner. Gaining ratio is calculated at the time of retirement or death of an existing partner.



8.14 MODEL QUESTIONS

Q.1: Why the assets and liabilities revalued at the time of retirement or death of a partner?

Q.2: What is gaining ratio? How is it calculated of the time of retirement of a partner?

Q.3: A, B and C are partners sharing profits and losses as 4 : 3 : 2. A retires and his share is taken by B and C equally, Calculate the new profit sharing ratio and gaining ratio.

Q.4: P, Q and R are partners sharing profits equally. R retires. P took 2/3rd and Q took 1/3rd of R's share. Calculate the new profit sharing ratio and the gaining ratio.

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errors which may have been committed in recording or posting the transactions. At the same time, it facilitates the preparation of final accounts at the end of the accounting period.

This unit will help you in gaining knowledge about the preparation of trial balance and the importance of preparing it. At the same time you will come to know certain limitation of trial balance.

9.3 CONCEPT OF TRIAL BALANCE

You are aware that every business transaction is first recorded in the journal book and then these are transferred to ledger book. The cash transactions are recorded in the cash book directly which serves the purpose of recording the cash transactions both in journal and ledger.

In the process of recording the transactions in the books of accounts, the next job of the book-keeper is to ensure error free journal and ledgers. To a large extent, this can be ensured by preparing the trial balance.

Let us go through some of the definitions of trial balance–

Cropper defined trial balance as, “A Trial Balance is a classified list of the balances appearing, at any given date, in the Ledger or Ledgers before the closing entries have been made.”

Thus, the trial balance is a statement which contains the ledge balances. It is prepared at the end of an accounting period. It ensures that no journal entry is left without posting it to the respective ledger and no ledger remains unbalanced. The book-keeper assures that journal and ledger books are arithmetically correct.



LET US KNOW

In the double entry system of book-keeping, at least two accounts are involved in a transaction. In other words, for every debit entry or for every series of debit entries there is a credit entry or a series of credit entries with equal amounts. From the journal, each and very debit account and credit account is posted to the respective ledger accounts with the same amount

into the ledger periodically, transactions in the summarised form is available only in trial balance.

e) **To Facilitate Preparation of Final Accounts:** Final accounts help in ascertaining the financial position of a business concern. Trial balance facilitates the preparation of final accounts.



CHECK YOUR PROGRESS

Q.2: State any two objects of trial balance.

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9.5 FORMAT OF A TRIAL BALANCE

A trial balance is usually prepared in the following format–

Trial Balance of M/S ..... as at .....

Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Account Head 1	—	—	—
Account Head 2	—	—	—
Account Head 3	—	—	—
Account Head 4	—	—	—
Account Head 5	—	—	—
Total		—	—

Particulars Column: In the 'particulars' column, the names of the account heads are written.

L.F. Column: In the 'ledger folio' column, the page numbers are written from where the information of a particular ledger is taken.

Debit Amount Column: In this column, the debit amount of the particular ledger is written.

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
	Purchase A/c Dr. To XY Co. (Being goods purchased on credit)	5,000		5,000

The journal entry will be posted in the respective ledgers of Purchase and XY Co. and will be balanced as under–

Dr. Purchase Account Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To XY Co.		5,000		By Balance c/d		5,000
			5,000				5,000
	To Balance b/d		5,000				

Dr. XY Co. Cr.

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
	To Balance c/d		5,000		By Purchase A/c		5,000
			5,000				5,000
					By Balance b/d		5,000

In the above example, Purchase account is showing debit balance whereas the account of XY Co. is showing credit balance. Therefore, in the trial balance, purchase account will be placed on the debit side and the account of XY Co. will be placed on the credit side. In this case, both the debit and credit amount columns will show the same result indicating that the trial balance is agreed. This procedure is followed for all the accounts. The trial balance will be look as under–

- A list is prepared by inserting the names of the ledgers with two amount columns– one for debit amounts and the other for the credit amounts;
- The amounts of the ledgers which have shown debit balances are put in the debit column of the list;
- The amounts of the ledgers which have shown credit balances are put in the credit column of the list;
- The debit and the credit amount columns are added up to see whether the two columns show the same result.

This method is generally followed in the preparation of trial balance. In this unit we will follow this method.



CHECK YOUR PROGRESS

Q.3: Discuss the steps in the preparation of trial balance.

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9.7 ILLUSTRATIONS

In this section we will discuss the preparation of trial balance by following the steps discussed in section 6.6 above. It is important to note that all the assets, expenses and receivables accounts show debit balance whereas all liabilities, revenues and payables accounts show credit balance. A list is given below with some of the ledgers with their usual balances.

Account Heads	L.F.	Debit (Rs.)	Credit (Rs.)
Capital	–		✓
Sales	–		✓
Purchases	–	✓	
Debtors	–	✓	

Solution:

Account Heads	L.F.	Debit (Rs.)	Credit (Rs.)
Capital	–		25,000
Sales	–		5,000
Debtors	–		
Creditors	–		
Bills Receivable	–		
Bills Payable	–		
Plant and Machinery	–	5,000	
Buildings	–	7,000	
Purchases	–	10,000	
Salaries	–	3,000	
Rent paid	–	2,000	
Advertisement expenses	–	3,000	
Total		30,000	30,000

Illustration 2: Prepare a trial balance from the following ledger balances which are extracted from the books of ABC Company as on 31-3-2014.

Ledger	Amount (Rs.)
Wages	10,000
Furniture	70,000
Cash in hand	25,000
Interest Received	10,000
Sales Returns	5,000
Carriage Inward	3,000
Debtors	24,000
Discount Allowed	3,000
Sales	1,00,000
Discount Received	10,000
Bills Payable	10,000



CHECK YOUR PROGRESS

Q.4: Prepare a trial balance from the following information–

Ledger	Amount (Rs.)
Machinery	10,000
Building	20,000
Capital	50,000
Purchases	20,000
Sales	14,000
Salaries	5,000
Rent paid	5,000
Advertisement Expenses	4,000

9.8 LIMITATIONS OF TRIAL BALANCE

In this section we will discuss the limitations of trial balance. We are aware that trial balance checks the arithmetical accuracy of journalising and ledger posting. If the debit and credit amount columns of trial balance do not agree, it indicates the presence of errors during the book- keeping process. However, trial balance suffers from certain limitations and thereby may not detect some errors. It means some errors may have been committed in the process of recording and posting the transactions but the trial balance is not capable to detect those errors. This limits the scope of trial balance.

Let us discuss these errors–

- **Errors of Omission:** Errors of omission are committed at the time of recording the transactions in the journal book or during the posting of entries in ledger. Error of omission may take place in the form of complete omission or partial omission. Let us go through the following example–

  Purchase goods from Ram on credit for Rs. 5,000. The journal entry fro the transaction is given below–

- **Compensating Errors:** When an error or a series of errors are committed but they are compensated by another error or series of errors, they are called compensating errors. These errors do not affect the trial balance. Let us go through the following example-

A) Goods sold to Mr. X on credit for Rs. 1,000

B) Goods sold to Mr. Y on credit for Rs. 100.

Let us assume that Mr. X account is wrongly debited with Rs. 100 and Mr. Y's account is debited with Rs. 1,000.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
	Mr. X Dr.		100	
	To Sales A/c			100
	(Being goods sold on credit)			
	Mr. Y Dr.		1,000	
	To Sales A/c			1,000
	(Being goods sold on credit)			

Thus, under debit of Rs. 900 in X account is compensated by over debit of Rs. 900 in Mr. Y's account. Sales account is credited with a total of Rs. 1,100. As Mr. X and Mr. Y's account will appear on the debit side and Sales account will appear on the credit side of the trial balance, therefore, trial balance will agree in spite of the error.

- **Duplicating Errors:** Duplicating error takes place when a transaction is recorded twice in the journal or posted twice in the ledger. For example, a credit sale of goods amounting to Rs. 500 to Mr. X, if recorded twice or posted twice in the ledgers, will not affect trial balance.



CHECK YOUR PROGRESS

Q.5: What are the different types of errors?

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9.10 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.

2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.

3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.

4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



9.11 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Trial balance is a statement which contains the ledge balances. It is prepared at the end of an accounting period. It ensures that no journal entry is left without posting it to the respective ledger and no ledger remains unbalanced. It checks the arithmetical accuracy of the ledger postings.

Ans. to Q. No. 2: **a) To Test Arithmetical Accuracy:** The trial balance is prepared to test the arithmetical accuracy of the transactions entered in journal and posted in the ledger.

b) To Ensure Recording of Two Aspects: Preparation of trial balance ensures the fulfilment of the principles of double entry system while recording transactions i.e. both the aspects of the transactions (debit and credit) are recorded and posted.

Ans. to Q. No. 3: **The Steps in the Preparation of Trial Balance are–**

- All the ledger accounts are closed at the end of an accounting period. The ledgers will show either debit or credit balance;
- The ledgers which show debit balances will be put on the debit side of the trial balance with the respective amounts. On the

Q.6: Prepare trial balance from the following–

Ledger	**Amount (Rs.)**
Wages	5,000
Furniture	17,000
Cash in hand	5,000
Interest Received	1,000
Carriage Inward	500
Debtors	24,000
Discount Allowed	3,000
Sales	570,000
Discount Received	1,500
Bills Receivable	5,000

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Ledgers, the Final Accounts are prepared. Generally, there are three constituents of Final Accounts—

1) Trading Account
2) Profit and Loss Account
3) Balance sheet.

In manufacturing organisations, before preparing Trading Account, Manufacturing Account is prepared. In case partnership firm and company organisations, Profit and Loss Appropriation Account is prepared after the preparation of Profit and Loss Account. Thus, in all, there are five constituents of final accounts. These are also known as **Financial Statements.** These statements serve different purposes:

- **Manufacturing Account shows** the cost of production and the proportional relationship among the items in it. This helps to control cost of production.
- **Trading Account shows** the Gross Profit earned and the cost of goods sold.
- **Profit and Loss Account shows** the net profit earned after covering administrative, selling and distribution expenditure.
- **Profit and Loss Appropriation Account** shows the amount of profit available to the owner or proprietor. From the net profit earned as per Profit and Loss account, some appropriation is made for General Reserve, Manager's commission etc. in it.
- **Balance Sheet** is the Financial Statement which shows the financial position of the business firm on the accounts closing date.

Except Balance Sheet, all other statements are prepared with items of nominal accounts having two elements– expenses and incomes.. Balance Sheet has three elements– a) Assets, b) Capital and c) Liabilities

These final accounts, i.e., financial statements are general purpose statements which are prepared keeping in view the general requirement of the users. These statement are used by the various interested groups, viz. management, creditors, debenture holders, bankers, share holders or proprietor, Government, Researchers, Stock Exchange authorities etc. for various purposes.



CHECK YOUR PROGRESS

Q.1: What is the purpose of preparing trading account?

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10.5 PROFIT AND LOSS ACCOUNT

Profit and Loss Account is the second part of the final account. It shows the net profit earned or net loss sustained by the firm during a given period. All indirect expenses like administrative, selling and distribution are charged i.e. debited in this account.

Purpose of Profit and Loss Account:

1) The primary purpose of the Profit and Loss Account is to ascertain the net profit available to the proprietor.
2) Calculation of expense ratios to sales for judging the cost effectiveness and efficiency is another purpose of Profit and Loss Account.
3) Providing for reserve and provision is another purpose of Profit and Loss Account. Provision for Depreciation, Bad and doubtful debt, transfer to reserve fund etc. are done through Profit and Loss Account.
4) The ratio between Net Profit and Sales is one of the important profitability ratios calculated after preparing Profit and Loss Account.

Profit and Loss Account for the year ended

31st March … … … … 200...

Particulars	Rs.	Particulars	Rs.
To Gross Loss (Transferred from Trading Account)		By Gross Profit (Transferred from Trading Account)	

Particulars	Rs.	Particulars	Rs.
To Selling expenses			
To Commission Paid			
To Rebate and discount allowed			
To Interest paid			
To Bank charges			
To Publicity and advertisement expenses			
To Donation			
To Net profit c/d			



CHECK YOUR PROGRESS

Q.2: Explain any two purpose of profit and loss account.

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10.6 BALANCE SHEET

Balance Sheet is known as Position Statement as it reflects the financial position of the organisation as at a certain date, generally, accounts closing date. The various items of real account and personal account are taken from the trial balance, net profit (or net loss) figure is taken from Profit and Loss (P/L Appropriation) Account and adjustment entries/items from the additional information provided are taken to prepare Balance Sheet.

The real accounts represents assets and personal accounts represents liabilities and capital. Thus, Balance Sheet gives the picture of assets owned and liabilities owed by the firm and the proprietor's or owner's share or net worth which is the difference between assets and liabilities.

Order of Permanence

Balance Sheet of ... ... as on ... ...

Liabilities	Assets
Non-Current or Long-Term	**Fixed Assets**
Capital	Goodwill
Retained earnings	Land and Building
Long-term Loans	Plant and machinery
Debentures	Copyright
	Patent
	Furniture and fixtures
Current Liabilities	**Current Assets**
Creditors	Closing Stock
Bills Payable	Prepaid expense
Short-term Loans	Bills receivable
Outstanding Expenses	Debtors
Provision for taxation	Bank Balance
	Cash

Illustration 1: Prepare Trading Account and Profit and Loss Account for the year ended 31.03.2015 and a Balance Sheet as on that date.

Trial Balance as on 31-03-15

Heads of Accounts	Debit Balance (Rs.)	Heads of Accounts	Credit Balance (Rs.)
Cash	46,700	Creditors	16,000
Furniture	11,000	Sales	86,000
Computer	42,000	Capital	50,000
Insurance	1,500	Commission received	1,000
Wages	2,000	Bank Loan	12,500
Carriages inward	500		
Purchases	36,000		
Debtors	12,000		
Drawings	12,000		
Salary	1,800		
	1,65,500		**1,65,500**

Closing Stock is valued at Rs. 5,000.

Trading Account of M/S .....

for the year ended 31-03-15

Dr. **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Purchases	36,000	By Sales	86,000
To Wages	2,000	By Closing Stock	5,000
To Carriage inward	500		
To Gross Profit Transferred to P/L A/C	52,500		
	91,000		91,000

Profit & Loss Account of M/S .....

for the year ended 31-12-15

Dr. **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Salary	1,800	By Gross Profit transferred from P/L A/c	52,500
To Insurance	1,500	By Commission received	1,000
To Net Profit Transferred to Capital Account	50,200		
	53,500		**53,500**

Adjustments:

1) Closing Stock is valued at Rs. 30,000.
2) Prepaid Insurance Rs. 100
3) Office Furniture to be depreciated at 10%
4) Provision for doubtful debt to be provided at 2% on Debtors.
5) Salary outstanding Rs. 200

Solution:

Trading Account of M/S ABC

for the year ended 31-03-15

Dr. **Cr.**

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Opening Stock	25,000	By Sales: 1,40,000	
		Less: Returns 3,200	1,36,800
To Purchases: 75,000		By Closing Stock	30,000
Less, Returns: 1,000	74,000		
To Carriages inward	1,700		
To Gross Profit c/d	66,100		
	1,66,800		**1,66,800**

Balance Sheet of M/s ABC

as on 31-03-15

Dr. **Cr.**

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Capital	25,000		Off. Furniture,	8,000	
Add:			Less: Dep:	800	7,200
Net Profit	48,860			67,000	
	73,860		Debtors		
			Less: Provision	1,340	65,660
Less: Drawing	2,800	71,060			
			Bills Receivable		4,000
			Closing Strock		30,000
Creditors		40,000	Pre-paid Insurancee		100
Bills Payable		6,200	Cash at bank		10,000
Outstanding Salary		200	Cash		500
		1,17,460			**1,17,460**

Illustration 3: From the following trial balance of M/S X and Y prepare–

Trading, Profit and Loss Account for the year ended 31.03.2015 and a Balance Sheet as on that date.

Trial Balance as on 31-03-15

Particulars	Debit Balance (Rs.)	Particulars	Credit Balance (Rs.)
Opening Stock	50,000	Creditors	80,000
Salaries	12,000	Sales	2,80,000
Wages	2,500	Return outward Capital	2,000
Insurance	800	X : 30,000 Y : 20,000	50,000
Carriage Inward	3,400	Discount	200
Commission	8,800	Bank Loan	20,500
Stationery	4,600	Bills Payable	8,400
Return inward	6,400		

Solution: Trading and Profit & Loss A/c of M/s X and Y for the year ended 31-03-15

Dr. **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Opening Stock	50,000	By Sales 2,80,000	
		Less: Returns 6,400	2,73,600
To Purchases 1,50,000		By Closing Stock	30,000
Less: Returns 2,000	1,48,000		
To Wages 2,500			
To Carriage Inward	3,400		
To Gross Profit c/d	99,200		
	3,03,600		**3,03,600**
To Salaries	12,000	By Gross Profit b/d	99,200
To Commission	8,800	Discount	200
To Stationery	4,600		
To Rent & Taxes 4,000			
Less: Prepaid 500	3,500		
To Trade Expenses	4,500		
To Insurance	800		
To Depreciation on Furniture (10% on 16,000)	1,600		
To Provision for Doubtful Debt	1,000		
To Net Profit c/d	62,600		
	99,400		99,400
To Capital A/c		By Net Profit c/d	62,600
X : 62,600 x 3/5	37,560		
Y : 62,600 x 2/5	25,040		
	62,600		**62,600**

- Balance-Sheet contains Assets, Liabilities and Capital and shows financial position of an organisation at a certain date.



10.8 FURTHER READING

1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Maheshwari, S. N.; *Financial Accounting*; New Delhi: Vikash Publishing House Pvt. Ltd.
3) Dam, B. B. & Theory and Gautam, H. C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
4) Gupta, R. L. & Radhaswamy, M.; *Accountancy*; New Delhi: Sultan Chand & Sons.



10.9 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Trading account is prepared to measure the result of direct business operations by way of sale and purchase. It shows gross profit or gross loss.

Ans. to Q. No. 2: The primary purpose of the Profit and Loss Account is to ascertain the net profit available to the proprietor. Another purpose is calculation of expense ratios to sales for judging the cost effectiveness and efficiency.



10.10 MODEL QUESTIONS

Q.1: What is trading account?

Q.2: What is profit and loss account?

Q.3: What is balance sheet?

*** ***** ***

area of operation. Under such situation, the businessman may choose any one of the following options in order to sell goods at a distant place:

i) Direct sale
ii) Sale through branch
iii) Sale through an agent

Out of the above three options sale through an agent has a distinctive advantage in terms of cost and control. In fact, it is the easyest way of expansion of business with minimum risk. In this system, goods are forwarded (without transferring the ownership) for sale to an outside agent on commission basis. This process of forwarding goods to an outside agent for sale on behalf of the despatcher or producer against commission is known as consignment.

11.3 CONCEPT OF CONSIGNMENT

Let us first discuss some of the definitions of consignment–

According to William Pickles. ‘‘Goods forwarded by an exporter to his agent for the purpose of warehousing and ultimate sale are described as consignment.’’

According to R. N. Carter, ‘‘An outward consignment is the despatch of a quantity of goods from one place to another, usually to some country or place abroad, for the purpose of sale by an agent on commission.’’

According to B. G. Vickery, ‘‘When goods are despatched to an agent for sale and the ownership of such goods remains vested in the sender, they are termed as consignment.’’

Therefore, from the above discussion it is clear that consignment business is a system of transfering goods from the producer to the agent without transfering the ownership but requiring to effect sales thereof. The agent (receiver of the goods) try to sell the goods according to the instructions given by the despatcher and remites the sale proceeds after deducting the expenses incurred by him in order to carry out the sales including his commission.

goods or on the expiry of the specified period whichever is earlier, stating the goods received, destroyed in transit, closing stock, effected sales and the net amount due to the consignor after deducting his commission, expenses and advance.

11.5 FEATURES OF CONSIGNMENT

Let us discuss the features of consignment–

i) **Ownership of the Goods:** Though in consignment business goods are sent by the consignor to the consignee but the ownership of goods still remains with the consignor. Consignment of goods is not a sale but a more transfer of the possession of goods.

ii) **Relationship between the Parties:** The consignee is entitled to receive commission for offering his service in respect of safe custody and sale of the consigned goods.

iv) **Risk of the Goods:** Though the agent or consignee sells the goods on behalf of the consignor but he is not responsible for any loss or damage of the consigned goods.

11.6 ADVANTAGES OF CONSIGNMENT

The following are the advantages of consignment business :

i) **Minimum Selling Cost is Incurred:** Sale through consignment system is comparatively cheaper as because the consignor do not require any establishment for selling his goods in the market.

ii) **No Separate Management and Control Required:** Unlike branch, consignment business can be carried out without any separate management. As separate management is absent, the question of control over it does not arise.

iii) **Problem of Marketing Shifted from the Consignor:** As the consignee is well conversant with the market hence it is easy for him to sell the goods in the outside market.

iv) **Supply of Information:** The consignee can provide various information regarding the taste, preference, buying habits,

i) Normal selling price being Rs. 150 each

ii) Consignee's commission is to be calculated as under :

a) 5% on normal selling price.

b) 10% overiding commission on selling price over the normal selling price.

c) 1% del credere commission on total sales.

Tezpur electricals reported sales as follows:

500 calculators @ Rs.	150	each =	Rs. 75,000
500 calculators @ Rs.	200	each =	Rs. 1,00,000
Total	1,000		Rs. 1,75,000

Ascertain the amount of commission payable to the consignee if an amount of Rs. 1250 could not be realised by the consignee from the consignment debtors.

Solution: Statement showing the calculation of commission payable to Tezpur Electricals

Simple commission (1000 x 150 x 5%) = Rs. 7,500

Overriding commission (500 x 50 x 10%) = Rs. 2,500

Del credere commission (1,75,000 x 1%) = Rs. 1,750

∴ Total commission payable = Rs. 11,750

Since, del credere commission is allowed to the consignee, the amount of bad debts on consignment will be borne by the consignee. Hence, net commission of the consignee will be Rs. 10,500 (Rs. 11,750 – Rs. 1, 250)



ACTIVITY 11.1

Q. Deepak of Dimapur consigned 500 stoves to Atul of Agartala costing Rs. 350 each on the following terms:

i) Normal selling price per stove is Rs. 500.

ii) Consignee's commission to be calculated as follows :

a) 5% on normal selling price.

b) 10% on any surplus over and above normal selling price. Agent reported that he has sold:

iii) On receipt of Account Sales:

a) **With the amount of sale both cash and credit–**

Consignee's A/c Dr.

To Consignment to .....

b) **With the expenses incurred by and the commission payable to the consignee–**

Consignment to ..... A/c Dr.

To Consignee A/c

c) **If bad debts arises and del credere commission is not granted–**

Consignment to ..... A/c Dr.

To Consignee A/c

d) **On receipt of the balance due–**

Bank Dr.

To Consignee A/c

iv) On the date of closing:

a) **With the value of unsold stock–**

Stock on consignment A/c Dr.

To Consignment to ..... A/c

b) **With the profit / loss made on the consignment–**

Consignment to ..... A/c Dr.

To Profit and loss A/c

(When there is profit)

Or

Profit and loss A/c Dr.

To, Consignment to ..... A/c

(When there is loss)

c) **For transfer of the balance of goods sent on consignment–**

Goods sent on consignment A/c Dr.

To Purchases / Trading A/c

Recording in the Books of Consignee: The consignee also prepares an account in the name of the 'consignor' to record the transactions that took place between them in order to ascertain the amount payable /

draft for the balance amount due by Debu after deducting his commission @ 10% on sales.

The account sales reveals the following information.

i) Sales Rs. 1,05,200

ii) Carriage Rs. 1000 and

iii) Insurance Rs. 1200

Pass necessary journal entries and prepare the ledger accounts in the books of both the parties.

Solution:

Journal Entries in the books of

Gautam (Consignor)

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
1/1/15	Consignment to Dibrugarh A/c Dr. (200 x 400) To Goods sent on Consignment A/c (Being the cost of goods sent on consignment)		80,000	 80,000
,,	Consignment to Dibrugarh A/c Dr. To Cash (1200 + 1800) A/c (Being freight and insurance charges paid)		3,000	 3,000
6/1/15	Bank Dr. To Debu (Being the money received as an advance)		10,000	 10,000
7/3/15	Debu Dr. To Consignment to Dibrugarh A/c (Being sale proceeds of 200 cases of goods)		1,05,200	 1,05,200

Dr. **Consignment to Dibrugarh A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
1/1/15	To Goods sent on			7/3/15	By Debu		1,05,200
	Consignment A/c		80,000		(Sale proceeds)		
,,	To Cash A/c		3,000				
7/3/15	To Debu (Expenses)		2,200				
,,	To Debu (Commission)		10,520				
,,	To Profit and Loss A/c		**9,480				
	(Balancing figure)		1,05,200				1,05,200

Dr. **Debu (Consignee) A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
7/3/15	To, Consignment to			6/1/15	By Bank (Advance) A/c		10,000
	Dibrugarh A/c		1,05,200	7/3/15	By Consignment to		
					Dibrugarh A/c		2,200
				,,	By Consignment to		
					Dibrugarh A/c		10,520
					By Bank (draft) A/c		*82,480
			1,05,200		(Balancing figure)		1,05,200

Dr. **Goods sent on Consignment A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
7/3/15	To Purchases A/c		80,000	1/1/15	By Consignment to		80,000
					Dibrugarh A/c		
	(transfered)		80,000				80,000

Dr. **Gautam (Consignor) A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
6/1/15	To, Bank		10,000	7/3/15	By Bank		1,05,200
7/3/15	To Cash A/c		2,200				
	(Expenses)						
,,	To Commission A/c		10,520				
,,	To Bank		*82,480				
	(Balancing figure)		1,05,200				1,05,200



ACTIVITY 11.2

M/s Dutta & Co. of Nalbari consigned 100 cases of goods @ Rs. 100 each to M/s Patgiri of Barpata. M/s Dutta & Co. paid carriage and insurance of Rs. 1,000. M/s Dutta & Co. after two months received an Account sales which reveals the following infarmation:

i) Sales Rs. 25,000

ii) Carriage and other expenses Rs. 300

iii) Commission 4% on total sales

The balance amounts due after deducting consignee's commission, carriage and other expenses was duly recorved by M/s Dutta & Co. Give journal entries and prepare ledger accounts in the books of both the parties.

(**Ans:** Profit on consignment Rs. 12,700, amount received from consignee Rs 23,700.)

11.9 VALUATION OF UNSOLD STOCK

Sometimes some of the goods sent by the consignor to the consignee for sale may remain unsold at the end of the accounting period. These goods that remain unsold are termed as unsold stock. Such unsold goods must be valued and brought into account before the amount of

Solution:

In the books of

Jaganath Engineering Co.

Dr. **Consignment to Kohima A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
1/1/15	To Goods sent on consignment A/c (10,000 x 10)		1,00,000	30/4/15	By M/s Geredhary & Sons (Sale proceeds) (18,000 x 8)		1,44,000
,,	To Cash (expenses)A/c		13,500				
30/4/15	To M/s Geredhary & Sons A/c (expenses of consignee)		9,500	,,	By Stock on consignment A/c		23,900
,,	To M/s Geridhary & Sons A/c (Commission)(1500 x 8)		12,000				
,,	To Profit and Loss A/c (Profit on consignment transfred)		32,900				
			1,67,900				1,67,900

Dr. **M/s Geridhary & Sons A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
30/4/15	To consignment to Kohima A/c (18,000 x 8) (sale proceeds)		1,44,000	20/1/15	By Bills Receivable A/c		20,000
				30/4/15	By Consignment to Kohima A/c (expenses)		9,500
				,,	By consignment to Kohima A/c (1500 x 8) (Commission)		12,000
				,,	By Bank A/c (Balance money received)		1,02,500
			1,44,000				1,44,000

i) Normal Loss

ii) Abnormal Loss

Normal Loss: The loss which is natural, inherent and unavoidable is known as normal loss. Some of the reasons of normal loss are leakage, evaporation, drying etc. Such normal loss would constitute a part of normal cost and no additional accounting treatment is needed.

Exercise: A of Guwahati consigned 2000 tins of oil @ Rs. 50 each to B of Barpeta. He paid Rs. 20,000 as freight. Due to normal wastage only 1950 tins were received by B. The consignee paid Rs. 6,000 as unloading charges. 1300 tins were sold . You are required to calculate the value of closing stock.

Solution: Calculation of number of tins unsold–

Tins sent	=	2,000
(-) Tins lost	=	50
Tins received	=	1,950
(-) Tins sold	=	1,300
∴ Units unsold	=	650

Calculation of value of unsold goods–

Cost of 2000 tins of oil @ Rs. 50 each	= Rs.	1,00,000
(+) Freight paid by consignor	= Rs.	20,000
	= Rs.	1,20,000
(+) Unloading charges paid by consignee	= Rs.	6,000
∴ Total cost	= Rs.	1,26,000

∴ Value of unsold goods =

$$\frac{\text{Total cost of goods consigned}}{\text{Goods received by consignee}} \times \text{Units unsold}$$

$$= \frac{126000}{1950} \times 650 = \text{Rs. } 42{,}000$$

Abnormal Loss: Abnormal loss is a type of loss which occurs over and above the normal loss. Such loss may occurs due to negligence, inefficiency or some accident. The amount of abnormal loss should be debited to Profit and Loss Account and credited to consignment account in order to ascertain the actual profit or loss on consignment.

11.11 DIFFERENCES BETWEEN NORMAL LOSS AND ABNORMAL LOSS

The points of distinctions between normal loss and abnormal loss are given below:

Points	Normal Loss	Abnormal Loss
1) **Nature**	It is unavoidable in nature	It is avoidable if proper care is taken.
2) **Causes of loss**	Normal loss is caused due to evaporation, drying, rusting etc.	Abnormal loss is caused by accidental happenings.
3) **Relation with cost**	Normal loss is treated as a part of the cost.	It is not a part of cost.
4) **Journal entry**	No journal entry is required for normal loss.	It requires a separate journal.
5) **Insurance coverage**	Normal losses can not covered by insurance.	It can be insured.

11.12 CONSIGNING GOODS AT INVOICE PRICE

Sometimes in consignment business, the consignor supplies goods to the consignee at a price which is higher than the cost price. Such a higher price is known as Proforma Invoice Price. The main purposes of charging invoice price is:

a) to force the consignee to sell the consigned goods at not less than invoice price, and

b) to supress the actual price and the profit from the knowledge of the consignee.

Therefore, invoice price is a price at which the consignor send goods to the consignee which is equal to cost price plus a certain amount of profit. But, it is to be remembered that invoice price may not be the selling price.

Loading: As we know invoice price is obtained by adding a certain amount of profit to the cost price, hence the amount of profit which is

Let, the cost price = Rs. 100

(+) Loading = Rs. 25

∴ Invoice price = Rs. 125

∴ The loading is $\frac{25}{125}$ or $\frac{1}{5}$ or 20%

∴ Loading = 20% of 2,000 = Rs. 400

In consignment account, the loading is found in the following items:

a) Stock on consignment at the begining

b) Goods sent on consignment

c) Goods returned by the consignee

d) Stock on consignment at the end.

Accounting Treatment of Loading:

1) To eliminate the loading on the opening stock–

Stock Reserve A/c Dr.

To Consignment to ..... A/c

2) To eliminate the loading in the goods sent on consignment Account–

Goods sent on consignment A/c Dr.

To, Consignment to ..... A/c

3) To eliminate the loading in the goods returned by the consignee–

Consignment to ..... A/c Dr.

To Goods sent on consignment A/c

4) To eliminate the loading on closing stock

Consignment to ..... A/c Dr.

To Stock Reserve A/c

Exercise: Ganesh of Guwahati consigned 200 packets of cosmatics to Pallav of Sivsagar at a proforma invoice price of Rs. 500 each, which the cost price being Rs. 400 per packet. The consignor incurred Rs. 3600 as freight and insurance and is entitled to a commission of 10% on gross sales.

Prepare consignment to Sivasagar account and Pallav account in the books of Ganesh.

Calculation of Abnormal Loss:

Cost price of abnormal loss (20 x 400)	= Rs. 8,000
(+) Proportionate expenses of consignor $\left(\frac{3600}{200} \times 20\right)$	= Rs. 360
∴ Cost of abnormal loss	= Rs. 8360

Colculation of closing stock

Original cost of unsold stock (500 x 20)	= Rs. 10,000
(+) Proportionate expenses of consignor $\left(\frac{3600}{200} \times 20\right)$	= Rs. 360
(+) Proportionate expenses of consignee $\left(\frac{1600}{180} \times 20\right)$	= Rs. 178
∴ Cost of unsold stock	= Rs. 10,538

∴ Stock Reserve on unsold stock (20 x 100) = Rs. 2,000



ACTIVITY 11.4

Bhaba of Guwahati, consigned 100 packets of cosmatics to Subrata of Bolijan at an invoice price of Rs. 400 each, the cost being Rs. 300 per pocket. Bhaba incurred Rs. 2,000 for freight and insurance. On receiving the consignment a draft for 3 months drawn by Subrata for Rs. 20,000 was received by the consignor. Subrata paid Rs. 900 for various expenses. Subrata had disposed of 80 packets at Rs. 410 each. Subrata charges 6% as commission.

Show the ledger accounts in the books of Bhaba who closses its accounts on 31st December.

(**Ans:** Profit Rs. 4132, value of stock Rs. 8,400 invoice price)



11.15 MODEL QUESTIONS

Q.1: Define consignment. What are its advantages ?

Q.2: State a few important distinctions between consignment and sale.

Q.3: Write the meaning of the following :

i) Consignor ii) Consignee

iii) Account sale iv) Del-credere commission

v) Overriding commission vi) Normal loss

vii) Abnormal loss.

Q.4: Distinguish between normal loss and abnormal loss.

Q.5: M/s Roy & Co. of Jorhat consigned 100 cases of goods @ Rs. 100 each to M/s Barua & Co. of Tezpur. The consignor paid freight and insurance Rs. 1,000. Account sales was received from M/s Barua & Co, the gross sale proceeds being Rs. 25,000. The expenses paid by the consignee were carriage Rs. 70, where housing expenses Rs. 230. The amount due on consignment was duly received by the consignor after deducting consignees commission @ 4% on gross sale. Give journal entries and ledger accounts in the books of consignor.

Ans.: Profit Rs. 12,700, Amount received from consignee Rs. 23,700.

Q.6: A of Allahabad sends 200 machines on consignment to S of surat. The cost of each machines is Rs. 130 but the invoice price is @ Rs. 160 each. A spent Rs. 800 on packing. S received the consignment and immediately accepted A's draft for Rs. 10,000. S able to sell 160 machiness @ Rs. 175 each. S paid Rs. 700 as freight and insurance and Rs. 50 as selling expenses. S is entitled to a commission of 6% on sale and $1\frac{1}{2}\%$ as del credere commission. Prepare necessary ledger accounts in the books of A.

Ans.: Profit Rs. 3830, value of unsold stock Rs. 5480.

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ascertain the profits or losses on consignment. Besides, consignment there is another form of business which is known as joint venture. In this unit we will learn how various transactions related to the joint venture business are recorded when separate set of books are prepared and to ascertain the profits or losses from such type of business.

12.3 MEANING OF JOINT VENTURE

When two or more persons join together to carry out a specific business venture for a short period of time and to share the profits or losses there of in an agreed ratio it is called a joint venture. Such joint relationship or association comes to an end as soon as the venture is completed. Such type of business is quite common in construction business, consignment sale and purchase of property, underwriting of shares and debentures etc. The parties to a joint venture business are called as co-ventures. According to R. N. Carter, 'A joint venture is a partnership without the use of a firm name, limited to a particular speculation in which two or more persons concerned agreed to contribute certain specified amounts of capital and to share profits or losses in the same manner or in any other equitable proportion'. A joint venture is generally undertaken when it is not possible for an individual tp contribute the required capital and to run the business efficiently.

12.4 FEATURES OF JOINT VENTURE

Some of the important features of joint venture business are as follows:

i) It is an association of two or more persons.
ii) It is a special type of partnership business without any firm name.
iii) The purpose is to execute a particular venture or project or project in order to earn profit.
iv) The co-venturers share profits or losses either in an agreed ratio or equally in the absence of any agreed ratio.
v) It is of a temporary nature. The business is liquidated as soon as the venture is completed.

	be maintained even in one of the co-venturer's books only.	have to be maintained.
4)	**Admission of minor** A minor cannot be a co-venturer.	But a minor can be admitted as a partner.
5)	**Ascertainment of profits** The profit or loss is computed at the end of specific venture.	But in case of partnership business profit or loss is ascertained at the end of each financial year.

12.7 DIFFERENCE BETWEEN JOINT VENTURE AND CONSIGNMENT

We now propose to discuss the difference between a consignment and joint venture business:

	Joint Venture	Partnership
1)	**Name** The persons who are involved in a joint venture are known as co-venturer.	On the other hand the persons who are involved in a consign-ment are called consignor and consignee.
2)	**Relationship** The relationship beween co-venurers is that of partners. consignee is that of principal and	Whereas the relationship between the consignor and agent.
3)	**Duration of business** The relationship comes to an end as the venture is completed.	The relation may continue for a long time.
4)	**Sharing of profits** The co-venturers are entitled to share the profits and losses equally or in an agreed proportion.	Profits is exclusively enjoyed by the consignor. Consignee is usually given commission for his services to the principal.

12.8.1 When Separate Set of Books are Maintained

When the size of the venture is quite big and it runs for a longer period, the co-venturers keep separate set of books of accounts for the joint venture. Joints venture transactions are separate from their regular business transactions. In the books of joint venture the following accounts are opened :

i) **Joint Bank Account:** The co-venturers jointly open a bank account and contribute their funds. All the payments form goods and various expenses are made through this bank account. The sale proceeds and collections mode are deposited into this account. On completion of the venture the joint bank account is closed after paying the balance to the co-venturers.

ii) **Joint Venture Account:** The nature of this account is that of a Trading and Profit and loss account. All the venture expenses are debited in this account and is credited for all sales or collections. The balance in this account shows either profit earned or loss suffered and is transfred to the co-venturers capital accounts.

iii) **Accounts of Co-venturer:** Separate account of each venturer or maintained to keep records of their contribution of capital, goods and meeting, venture expenditure directly and direct payment received by them on venture transactions. This account is also closed simultaneously with the closure of joint bank account.

The following journal entries are necessary under this system:

1) **When cash is brought in by co-venturers to finance the joint venture–**

Joint Bank	A/c	Dr.
To, Personal	A/c (of the co-venturers)	

2) **When purchases are made for the venture–**

Joint venture	A/c	Dr.
To, Joint Bank	A/c	

opended a joint bank account and contributed Rs. 1,00,000 each. Payal supplied the excessary materials worth Rs. 20,000 towards the joint venture whereas Raj paid Rs. 3,000 as architect's fees. The details of other transactions made are given below:

Wages	Rs.	70,000
Materiats purchosed	Rs.	50,000
Carriage and other expenses	Rs.	12,000

On completion of the work they received the contract price from the college.

Pass journal entries and prepare necessary ledger accounts assuming that separate set of books were kept for the venture.

Solution:

Journal Entries

In the books of joint venture

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
1/1/16	Joint Bank A/c Dr.		2,00,000	
	To, Raj			1,00,000
	To Payal			1,00,000
	(Being the cash contributed by the co-venturers)			
,,	Joint Venture A/c Dr.		20,000	
	To Payal			20,000
	(Being materials supplied by Payal towards joint venture)			
,,	Joint Venture A/c Dr.		3,000	
	To, Raj			3,000
	(Being the architect's fees paid by Raj on behalf of joint venture)			
	Joint Venture A/c Dr.		50,000	
	To, Joint Bank A/c			50,000
	(Being the materials purchased for the venture)			

	To, Raj = 22,500 ($\frac{1}{2}$ of 4500) To, Payal = 22,500 ($\frac{1}{2}$ of 4500)		45,000				
			2,00,000				2,00,000

Dr. **Joint Bank A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
1.1.15	To, Raj		1,00,000		By Joint Venture A/c		50,000
,,	To, Payal		1,00,000		By Joint Venture A/c		82,000
	To, Joint Venture A/c		2,00,000		By Raj = 1,25,500		
					By Payal = 1,42,500		
							26,8,000
			4,00,000				4,00,000

Dr. **Raj A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Joint Bank A/c		1,25,500	1.1.15	By Joint Bank A/c		1,00,000
					By Joint Venture A/c		3,000
					By Joint Venture A/c		
							22,500
			1,25,500				1,25,500

Dr. **Payal A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Joint Bank A/c		1,42,500	1.1.15	By Joint Bank A/c		1,00,000
					By Joint Venture A/c		2,000
					By Joint Venture A/c		
							22,500
			1,42,500				1,42,500

Or

To, Suppliers (if purchased on credit)

iii) For goods supplied by himself i.e., account keeping venturer–

Joint Venture A/c Dr.

To, Purchases A/c

iv) For expenses incurred for the venture by himself–

Joint Venture A/c Dr.

To, Bank / Cash A/c

v) For sale of goods of the venture–

Bank / Cash A/c Dr. (for cash sales)

Or

Customers A/c Dr. (for credit sales)

To, Joint Venture A/c

vi) For commission earned from joint venture–

Joint Venture A/c Dr.

To, Commission A/c

vii) For Profit made on joint venture–

Joint Venture A/c Dr.

To, Profit & Loss A/c

(for own share of profit)

To, Other Co-venturers

(for other co-ventirers share of profit)

Or **For loss made on joint venture**

Profit & loss A/c Dr.

Other Co-venturer's A/c Dr.

To, Joint Venture A/c

viii) For remittance of cash to other co-venturers–

Account of co-venturers Dr. (individually)

To, Cash / Bank A/c

Exercise 2: Ajoy and Bijoy entered into an agreement for a joint venture sharing profits and losses equally. Ajoy bought goods for cash Rs. 40,000 and took from his stock, goods valued Rs. 8,000. B contributed Rs. 30,000 as his share of investment into the

Joint Venture

	Joint Venture A/c Dr. To, Profit & Loss A/c To, Bijoy (Being Profit on joint venture shared)		5,000	 2,500 2,500
	Bijoy Dr. To, Bank A/c (Being final sattlement of Bijoy account)		32,500	 32,500

Dr. **Joint Venture A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Cash A/c (Materials purchased)		40,000		By Cash A/c (sale proceeds)		60,000
	To, Purchases A/c (Materials supplied from own stock)		8,000				
	To, Cash A/c (expenses on purchase)		4,000				
	To, Commission A/c (o% of 60,000)		3,000				
	To Profit & loss A/c = 2,500 (own share of profit) = 2,500						
	To, Bijoy		5,000				
			60,000				60,000

a) For goods supplied for the joint venture out of main business–

Joint Venture with co-venturer A/c Dr.
To, Purchases A/c

b) For purchase of goods for the joint venture–

Joint Venture with co-venturer A/c Dr.
To, Cash / Bank / Creditors A/c

c) For expenses incurred for the joint venture–

Joint Venture with co-venturer A/c Dr.
To, Cash / Bank / Creditors for expenses A/c

d) For receipts of contribution–

Cash / Bank A/c Dr.
To, Joint Venture with co-venturer A/c

e) For payment of contribution–

Joint Venture with co-venturer A/c Dr.
To, Cash / Bank A/c

f) For goods sold for the joint venture–

Cash / Bank / Debtors A/c Dr.
To, Joint Venture with co-venturer A/c

g) For taking over of unsold goods–

Drawings A/c Dr.
(if taken over for personal use)
Purchoses A/c Dr.
(if taken over for business use)
To, Joint Venture with co-venturer A/c

h) For taking over of assets, if any–

Assets A/c Dr.
To, Joint Venture with co-venturer investment A/c

i) For share of profit or loss on joint venture–

Joint Venture with co-venturer A/c Dr. (In cose of profit)
To, Profit and loss A/c ,,
Or
Profit and loss A/c Dr. (In cose of loss)
To, Joint Venture with co-venturer A/c ,,

	Joint Venture with Trideep A/c Dr. To, Profit and loss A/c (Being profit on joint venture shared)		70	 70
	Bank A/c Dr. To, Joint Venture with Trideep A/c (Being bank draft received as final settlement)		630	 630

Dr. **Joint Venture with Trideep A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Purchase A/c		500		By Bank A/c		630
	To, Cash A/c (expenses)		60		(Final sattlement)		
	To, Profit and loss A/c (Share of profit)		70				
			630				630

Journal Entries In the books of Trideep

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
	Joint Venture with Preetam A/c Dr. To, Purchase A/c (Being goods supplied to joint venture)		400	 400
	Joint Venture with Preetam A/c Dr. To, Bank A/c (Being expenses incurred on joint venture)		40	 40

Dr. **Memorandum Joint Venture A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Purchase of goods				By Sales (Trideep)		1,200
	Preetam – 500						
	Trideep – 400		900				
	To, Expenses						
	Preetam – 60						
	Trideep – 40		100				
	To, Commission to						
	Trideep		60				
	To, Share of Profit						
	Preetam – 70						
	Trideep – 70		140				
			1,200				1,200

Dr. **Joint Venture with Preetam A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Purchase A/c		400		By Bank A/c		1,200
	To, Bank A/c (expenses)		40		(Sale proceeds)		
	To, Commission A/c		60				
	To, Profit loss A/c		70				
	(Share of profit)						
	To, Bank A/c		630				
			1,200				1,200

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12.11 MODEL QUESTIONS

Q.1: Define a joint venture and explain its salient features.

Q.2: State the advantages of joint venture.

Q.3: Distinguish between Joint venture and Consignment.

Q.4: Distinguish between Joint venture and Partnership.

Q.5: Write short note on Joint Bank Account.

Q.6: Ram and Ragav entered into a joint venture to construct a canteen for a college in Guwahati at a contract price of Rs. 3,00,000. They opened a joint bank account where Ram deposited Rs. 1,00,000 and Rangav Rs. 50,000 as his contribution. They decided to share profits and losses in the ratio of 2:1. The details of transactions made are as follows :

Wages Rs. 80,000, Materials purchased Rs. 1,60,000, Architect's feas paid by Ram Rs. 4,000,