GCM(S1) 02

KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

Patgaon, Rani Gate, Guwahati - 781 017

FIRST SEMESTER

BACHELOR OF COMMERCE

COURSE: 02

Financial Accounting

CONTENTS

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REFERENCES	: For All Units

Subject Experts

Professor Nayan Barua, Gauhati University
Professor H. C. Gautam, Gauhati University
Dr. S. K. Mahapatra, Gauhati University

Course Co-ordinators : Dr. Devajeet Goswami, Dipankar Malakar, Commerce, KKHSOU

SLM Preparation Team

UNITS	CONTRIBUTORS
1, 4, 5, 6 & 9	Dr. Devajeet Goswami, KKHSOU
2 & 3	Sri B. B. Dam, Rtd. Professor, Gauhati Commerce College
7, 8, 10 & 11	Professor H. C. Gautam, Gauhati University
	Sri Rubul Deb, ICON Commerce College

Editorial Team

Content : Professor H. C. Gautam, Gauhati University
Dr. Devajeet Goswami, KKHSOU (Unit 10 & 11)

Structure, Format & Graphics : Devajeet Goswami, Dipankar Malakar, KKHSOU

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Headquarters : Patgaon, Rani Gate, Guwahati-781 017

City Office : Housefed Complex, Dispur, Guwahati-781 006; Web: www.kkhsou.in

COURSE INTRODUCTION

In this Block we will discuss the fundamentals of book-keeping. This includes meaning, objects and need of book-keeping; meaning of Assets, Liabilities, Capital, Drawings, Income, Expanse, Profit, Loss; meaning of transactions, vouchers and their preparation and meaning of Account and its format. We will also discuss meaning and need of double entry system of book-keeping, various types of transactions and their recording in journal, preparation of Cask Book and Bank Reconciliation Statement.

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

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.

BACHELOR OF COMMERCE

Financial Accounting

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UNIT 1: INTRODUCTION TO ACCOUNTING

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Introduction

1.3 Meaning of Book-Keeping

1.4 Meaning and Objectives of Accounting

1.5 Functions of Accounting

1.6 Accounting as a Source of Information

1.7 Characteristics of Accounting Information

1.8 Basic Terms Used in Accounting

1.9 Let Us Sum Up

1.10 Further Reading

1.11 Answers to Check Your Progress

1.12 Model Questions

1.1 LEARNING OBJECTIVES

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

- explain the meaning of book-keeping
- describe the meaning and objectives of accounting
- explain the functions of accounting
- discuss the importance of accounting as a source of information
- explain the characteristics of accounting information
- discuss some terms used in accounting.

1.2 INTRODUCTION

In business, it is very important to keep the records of all the monetary events. It will help the owner of the business to ascertain the profit or loss of the business. Therefore, a systematic procedure is required to be followed in keeping the records of the monetary events.

In this unit we will discuss this aspect of recording. Our topics of discussion will be the meaning of book-keeping and accounting, objectives

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.1: What is book-keeping?

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1.4 MEANING AND OBJECTIVES OF ACCOUNTING

In this section we will discuss about accounting. In recording business transactions, accounting is a step next to book-keeping. We have already discussed book-keeping in the previous section.

Accounting has been defined by The American Institute of Certified Public Accountants as, "The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least, of financial character and interpreting the results thereof."

Thus, accounting is a system of interpreting the results of the business transactions that has been recorded, classified and summarized. It communicates the financial condition of the business to the various interested groups like, owners, creditors, tax authorities etc.

Objectives of Accounting: As accounting deals with business transactions, the objectives of accounting may be stated as under–

- To keep the records of the transactions systematically;
- To evaluate the performance of the business periodically;
- To ascertain the financial position of the business;
- To help the management in taking business decisions;
- To provide information about the business as required by the different outside groups like, financiers, tax authorities, debenture holders etc.
- To control the use of resources and business activities etc.



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

agencies. These reports can be generated only when business transactions are recorded systematically. Thus, accounting helps the business firms in meeting the legal requirements.

- **Communicating Information:** Another function of accounting is to communicate the financial results of the business to the various groups. Theses groups may be the financial institutions, creditors, shareholders, prospective investors etc. On the basis of the financial information provided by accounting, these groups take their decisions like, providing financial assistance, ascertaining profitability, purchase and sale of shares etc. Differences between Book-Keeping and Accounting.

1.6 ACCOUNTING AS A SOURCE OF INFORMATION

Till now we have discussed that accounting is a system to record business transactions and we came to know that it communicates the results of business activities through various reports to the various interested groups. Thus, accounting can be regarded as a source of information. This source can be used to meet the informational requirement of both internal and external users.

Internal users refer to the shareholders, management consisting of the Board of Directors and the employees of the business organization. The external users are investors, creditors, financial institutions, government and the general public. The types of information required by these groups are varied. The following table summarises the informational need of the groups–

External Users	**Information required to take decision on the–**
Shareholders	purchase, sale and holding of shares
	future profitability and prospects of the business etc.
Management	cash position of the business
	purchase of raw-materials
	profit earned
	dividend to be declared and reserves to be made etc.
Employees	profitability and stability of the business for job security

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.

- **Comparability:** The accounting information must be prepared and presented in such a manner that it helps in comparing the accounting results of the organization over different periods of time and with other business organisations engaged in similar business.
- **Consistency:** To represent the true and fair view of the financial position of the organization, the accounting methods must be followed consistently. But it does not mean that the organization can not change the accounting method. The organization can adopt the new method if it is acceptable and preferable. The management must state the reasons for adopting the new method and the effect of such change.
- **Understandability:** Assuming that the users have a minimum level of knowledge of accounting, business and economic activities, the accounting information must be presented in such a way that users can understand the information.



CHECK YOUR PROGRESS

Q.4: Discuss any three characteristics of accounting information.

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1.8 BASIC TERMS USED IN ACCOUNTING

In this section we will discuss some terms which are commonly used in accounting. You will find these terms in various books of accounts. By going through these terms, you will be able to understand their importance in accounting. Let us begin with 'capital'.

a) Capital: In general, capital means the amount of money that a businessman invests in the business. But it not only includes money

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

represents legal rights like, copyrights, trade mark etc. while some may be claim against others like, bills receivable.

Assets can be classified as–

- **Fixed Assets:** It represents those assets which are used in the business for a long period of time covering more than one ***accounting period***. Fixed assets support the production process of the organization. These are not sold during their useful life. Due to continuous use in the business, their usability got reduced in terms of capacity and monetary value. This reduction in value is known as depreciation.
- **Current Assets:** Current assets are those assets which can easily be converted into cash within one accounting period or are consumed during the normal business operation. Examples of current assets are cash, inventory, debtors, prepaid insurance etc.



Accounting Period: The time frame for which accounts are prepared by a firm. For management purpose, the time frame may be one month, a quarter, half-year or the like. For tax purposes or the like, it normally covers twelve months.

c) Liability: Liability means the debts or obligations of the business that it has to meet within a definite time frame. Examples are– bank loan, creditors, bills payable etc.

Liabilities can be classified as–

- **Fixed Liabilities:** These are the long-term liabilities and are not required to be repaid within one accounting period. Example: long- term bank loan, debenture etc.
- **Current Liabilities:** These are the short- term liabilities required to be repaid within one accounting period. Example: trade creditors, bills payable etc.

d) Expense: Expense means the cost incurred by an organization to earn revenue. It may be in the form of actual cash payments (e.g. salaries) or decrease in the value of an asset (e.g. depreciation).

Expenses can be classified as–

- **Revenue Expense:** When the benefit of an expense is consumed by a business organisation during an accounting period, it is called revenue or operating expense. For example, payment of salaries, interest, travelling expenses etc.

- **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

agreed future date. The customer owes money to the creditor and is liable to pay the money. In the above example, where the customer has purchased goods from you without paying cash, the customer is a debtor and you are the creditor.

k) **Transaction:**Transaction means any business event that has influenced the monetary position of the business and the pattern of assets, liabilities and capital. This influence is reflected in the financial statements of the business firm as every transaction is recorded in journal, posted to ledger and then trial balance and final accounts are prepared. For example, purchase of fixed asset for cash, results in increase in the value of fixed assets and decrease in cash. Similarly, goods purchased on credit, results in increase in stock and liability.

l) **Entity:** Entity refers to a business organization or an economic unit. It uses the various economic and non- economic resources, to undertake economic activities. The entities undertake these activities with the economic motive of earning profit.

m) **Bad Debt:** Business organisation makes credit sales to some customers and the customers will make payment in the future. Some of these customers may not be able to return the money. As a result, the business organisation will not be able to collect the debts. These uncollectable debts are known as bad debts. In preparing financial statement, viz, profit and loss account and balance sheet, bad debt is considered as an expense.

n) **Reserve for Doubtful Debt:** It is a provision created by a business organisation to compensate the loss arising from bad debts.

o) **Overdraft:** It is an arrangement with the bank under which the current accountholder can withdraw more money than the balance in the account. It is a loan facility provided by the bank and the customer can withdraw more money up to a certain balance, known as overdraft limit. The bank charge interest on the daily overdraft balance.

p) **Prepaid Expenses:** These are future related expenses. The services from such expenses will be received in future. Initially

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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b) Expense: .....

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c) Liability: .....

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1.9 LET US SUM UP

In this unit we have discussed the following aspects–

- Book-keeping is a system of recording business transactions which are expressed in terms of money.
- The transactions are recorded in a set of books.
- Accounting is a system of interpreting the results of the business transactions that has been recorded, classified and summarized.
- Accounting communicates the financial condition of the business to the various interested groups like, owners, creditors, tax authorities etc.
- The various objectives of accounting are–
  - To keep the records of the transactions systematically;
  - To evaluate the performance of the business periodically;
  - To ascertain the financial position of the business;
  - To help the management in taking business decisions;
  - To provide information about the business as required by the different outside groups like, financiers, tax authorities, debenture holders etc.
  - To control the use of resources and business activities etc.
- The functions of accounting are– record keeping, decision- making, meeting legal requirement etc.
- The accounting is used as a source of information to meet the needs of different groups of users like, creditors, financial institutions, shareholders, management etc.

- 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.

Reliable: Accounting information must be reliable so that users can rely on the information in their decision-making. Therefore, the accounting information must be free from errors and bias.

Comparability: The accounting information must help the organization in comparing its results over different periods of time. It will also help in comparing the results with the competitors.

Ans. to Q. No. 5: a) Asset means the resources owned by a business firm which are used in usual course of the business. The assets are purchased with the motive of using it in the operation of the business and not to sell it immediately. Examples are cash, furniture, machinery etc.

b) Expense means the cost incurred by an organization to earn revenue. It may be in the form of actual cash paymentsor decrease in the value of an asset (e.g. depreciation). Expenses can be classified asrevenue and capital expenses.

c) Liability means the debts or obligations of the business that it has to meet within a definite time frame. Examples are bank loan, creditors, bills payable etc. Liabilities can be classified as Fixed and Current liabilities.



1.12 MODEL QUESTIONS

Q.1: What is book-keeping?

Q.2: What are the functions of accounting?

Q.3: What are the characteristics of accounting?

*** ***** ***

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

Accountants (later on known as American Institute of Certified Public Accountants, AICPA) as,

"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof." (Accounting Terminology Bulletin No. 1). Recording, classifying and summarizing are done on some basic premise which are called accounting principles. In this unit, we will discuss the meaning of accounting principles, concepts, conventions as well as the different accounting principles, like business entity concept, going concern concept etc. We will also deal with the Generally Accepted Accounting Principles, its structure and the use of these principles in recording and presenting accounting statements.

2.3 MEANING OF ACCOUNTING PRINCIPLES, CONCEPTS, CONVENTIONS AND POSTULATES

- **Accounting Principles:** Accounting principles are the principles applied in the preparation of the accounts. These are general decision rules, derived from both the objectives and the theoretical concept of accounting. These principles are the bases which govern the development of accounting technique. Accounting technique means the specific rules derived from accounting principles which are applied while recording transactions.
- **Accounting Concepts:** Accounting Concepts are the accepted notion applied in the field of accounting. A concept finds its place in a belief about the desirability of a method or procedure. Such methods or procedures are the general norms applied by the business entities while recording the transactions and preparing the financial statements.
- **Accounting Convention:** Accounting Convention is an established usage or custom followed in recording and presenting financial data.
- **Postulates:** Postulates are derived from the economic and political environment and from the modes of thought and customs of all segments of business community.



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.

c) Like the principles of natural sciences, accounting principles may not be universally true and cannot be verified by observation.

d) The acceptance of accounting principles may vary from time to time and from country to country.

e) Accounting principles are influenced by the social environment, political environment, economic environment etc. These are the main reasons behind variation in the application of accounting principles from country to country and even in the same country.



LET US KNOW

Accounting information means the financial information provided in the Trading Account, Profit & loss Account, Balance Sheet and other reports of a business organization. Trading Account, Profit & loss Account, Balance Sheet are the basic financial statements. Trading Account and Profit & Loss Account are together called Revenue Statement or Income Statement and the Balance Sheet is known as Position Statement. Reports include directors' report and auditor's report (in case of limited companies). These statements and reports are published in the form of Annual Reports of companies. The basic financial statements provide accounting information on five elements. These five elements are: a) assets, b) liabilities, c) equities (capital), d) incomes and gains and e) expenses and losses. Assets, liabilities and capital are elements of Balance Sheet and incomes & gains and expenses & losses are elements of revenue statement. Information regarding these elements of financial statements is called Accounting Information.

The information disclosed in financial statements is very useful to a number of parties. These are: a) Owners, b) Managers, c) Creditors, d) Bankers and lenders, e) Government and regulatory agency, f) Employees, g) Prospective and existing investors, h) Consumers, i) Researchers, j) Trade association and chambers of commerce.

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:

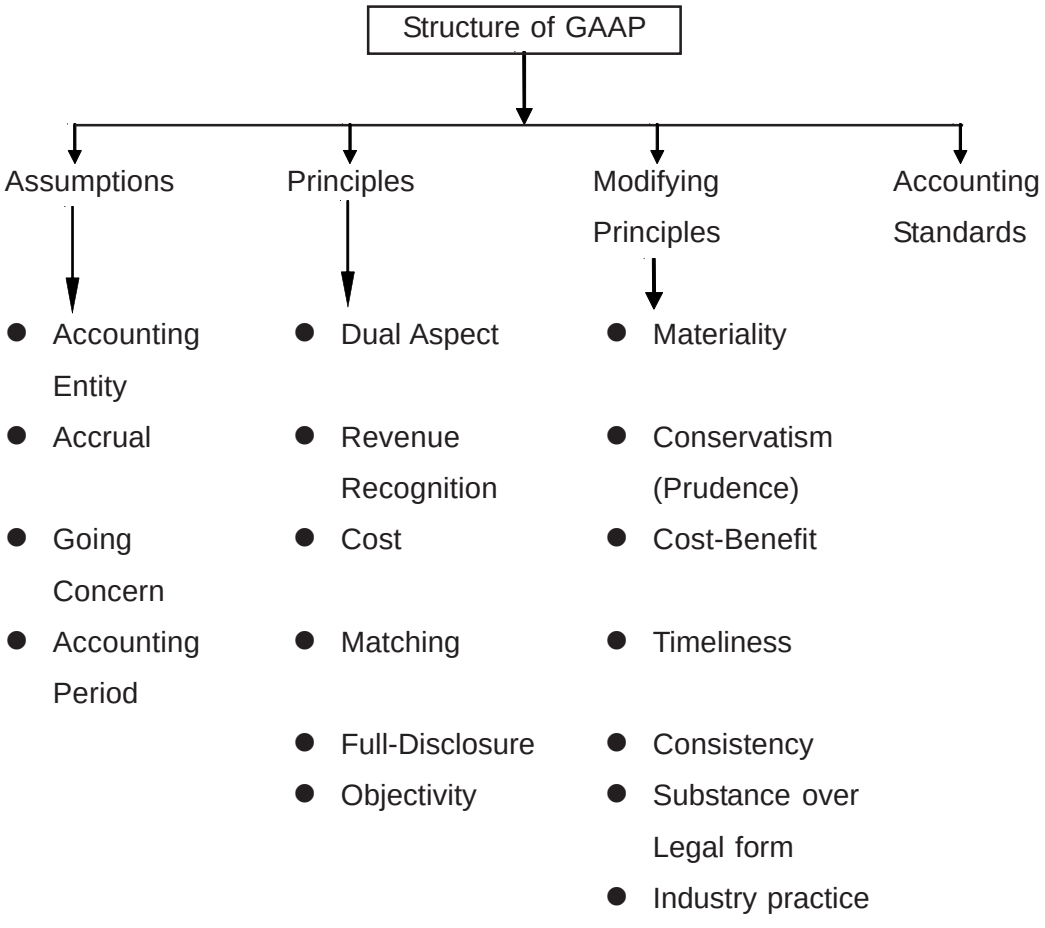


Fig. 2.1: Structure of GAAP

- **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

reporting the same in the financial statements to facilitate their users in forming rational and judicious decision.

Accounting assumptions and accounting principles are traditionally termed as accounting concepts and the modifying principles are considered as accounting conventions.

There has been an effort to distinguish between accounting concepts and accounting conventions. Although theoretically concepts and conventions are different terms, but when applied to accounting practice, no distinguishing features between these two are found. They are interdependent and the demarcation line between the two is very narrow.

It should be keep in mind that principles, concepts, conventions, postulates etc. are all included in Generally Accepted Accounting Principles (GAAP) that are followed in recording business transactions, preparing accounts and presenting them before the users of accounting information.

Now, we will discuss the various assumptions and principles of GAAP.

- **Business Entity or Accounting Entity:** This assumes that the business is separate from its owners or other businesses. Revenues and expenses should be kept separately from personal expenses of the owner.

  The term 'entity' means 'something that exists independently'. Hence 'business entity' means existence of a business unit independently. When a customer purchases goods, he purchases them from a business firm and not from an individual, family or household. This means a business firm has its separate entity.

  The use of the word 'Separate' is used to separate the business unit from owner. A business firm is formed by the owner who invests money (Capital) to earn profit. His objective is to earn profit from the business. So, he must keep accounts of the business separately, to enable himself to ascertain profit. He must not mix the transactions of household affairs to that of business affairs. To calculate the

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

preparing financial statements. Expenditure incurred in the year 2007-2008 is accounted in that year if the full benefit of this expenditure is received in the year 2007-08. Salary of March 2008 paid in April 2008 is accounted in the year 2007-08 under accrual system. This is because the service of the employee was received and used in the month of March to the tune of the amount of salary.

- **Going Concern Assumption:** This assumption assumes that the business will be in operation indefinitely. This validates the methods of asset capitalization, depreciation, and amortization. This assumption is not applicable only when liquidation is certain.

An existing and running business firm is called going-concern. This assumption is an important assumption on the basis of which transactions are recorded in the books of accounts. While recording business transactions in the books of accounts of an existing and running business firm, it is not assumed that the business will be closed down shortly. Rather it is assumed that the business will be carried on indefinitely. A business entity possesses assets and owes liabilities which are shown in the balance sheet. These assets and liabilities are carried to the next financial (or accounting) year. If it is assumed that the business will be closed down the next day or in the near future, than the assets would not have been shown at the cost price, but at saleable or realisable market value. But since the 'going concern' assumption is applied in recording transactions and preparing financial statements, so the accountant does not take into account the market price or realisable price.

'Going concern' assumption simply states that in the foreseeable future the business will not be liquidated or closed down. This assumption is not applied for the firm which goes into liquidation or is put to sale. Accounts are carried forward to the following year on the presumption that the business will be carried out in the years to come. This is called *'Going Concern'* assumption. For this reason there is no justification to value the assets to be carried forward in realisable value or market value.

- **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.

This relationship between the elements of financial statements: assets, capital, liabilities, income and expenses is called Accounting Equation which is a result of ‘‘Dual ‘Aspect’ ’’ of all business transactions. Thus dual aspect of transaction means, if one side of the equation is affected by a transaction, the other side of the equation is also equally affected. For example, if a loan of Rs. 2,00,000 is taken, then liability and cash (asset) will increase by Rs. 2,00,000 each.

- **The Revenue Recognition Principle:** This principle requires business firms to record when revenue is– 1) realized or realizable and 2) earned, not when cash is received. This way of accounting is called accrual basis of accounting as described above. The revenue recognition principle helps in ascertaining the amount and time of recognising the revenues from the ordinary business activities. This principle is also known as **Revenue Realisation Principle**. In simple words, revenue recognition principle tells us the procedure of determining the income and expense for incorporation in profit and loss account (Revenue statement).
- **Matching Principle:** Expenses have to be matched with Revenues as long as it is reasonable to do so. Expenses are recognized not when the work is performed, or when a product is produced, but when the work or the product actually makes its contribution to revenue. Only if no connection with revenue can be established, may cost be charged as expenses to the current period (e.g. office salaries and other administrative expenses). This principle allows greater evaluation of actual profitability and performance (shows how much was spent to earn revenue). Depreciation and Cost of Goods Sold are good examples of application of this principle.
- **The Cost Principle:** The Cost principle provides a relatively objective foundation for accounting. Cost principle in accounting states that all accounting entries shall be made at cost as and when the transaction takes place. Cost is the amount of money paid or payable for goods and assets acquired or services received.

- **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

statement, inflation adjusted account etc. Because of the application of this principle, companies are allowed to provide abridged financial statements to the shareholders instead of detailed statements.

- **Materiality:** The significance of an item should be considered when it is reported. An item is considered significant when it would affect the decision of a rational individual. The term materiality refers to the relative importance of an item. What is material for one firm may be immaterial for another firm. Again, material in one context may be immaterial in another context. Purchase of a calculator for office use may be accounted for as an asset by a small retail business and as an office expense by a large business. A difference of Rs. 1,000 in provision for doubtful debts is not material but the difference of Rs.1,000 in cash is a serious one.

  Accounting Standard 1, states that financial statements should disclose all "material" items, i.e., the items, the knowledge of which might influence the decisions of the users of the financial statements. Thus materiality is an important guide for the accountants in deciding what should be disclosed in financial statements. It is essentially a matter of personal judgement and can be modified to the best interest of the firm and the users of financial statements.

- **Consistency:** The principle of 'consistency' requires that the accounting policies, which are followed from period to period, should not be changed. If it is assumed that the entity is a 'going concern', the accounting principles, methods, etc., must be consistently followed while recording and preparing financial statements. Users of accounting information draw their conclusions by comparing the financial statements of the current year with that of the previous year. If the accounting policies, techniques and methods applied are changed from year to year, the operating and financial results disclosed through financial statements, will suffer from lack of consistency.

- **Conservatism (Prudence):** When choosing between two solutions, the one that will be least likely to overstate assets and income should

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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Q.3: State whether following statements are True or False:

i) According to going concern concept, the business will be in operation indefinitely.

ii) According to business entity concept business is not separate from its owners or other businesses.

iii) Accounting period is the period for which the accounts are prepared

iv) Cost principle states that all accounting entries shall be made at cost as and when the transaction takes place.



2.6 LET US SUM UP

In this unit we have discussed the following–

- Accounting principles govern the development of accounting techniques.
- Accounting principles, concepts, conventions and postulates are applied in the preparation of accounts.
- Generally Accepted Accounting Principles (GAAP) provides guidelines to the 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 consists of various assumptions, principles, modifying principles and accounting standards.
- GAAP plays an important role in the preparation of financial statements, like trading account, profit and loss account and balance sheet.
- GAAP helps in reducing alternative accounting procedures/ methods.
- GAAP helps in disclosing accounting information.



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.

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.



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



2.9 MODEL QUESTIONS

Q.1: State the accounting principle involved in each of the following situation:

a) Cash Sale Rs. 400 and credit sale Rs. 5,000

b) Inventory valued at cost.

c) Bad debt provided Rs. 600.

d) It is assumed that the business will last for unforeseeable future.

e) The assets are recorded in books at the acquisition cost.

f) Total insurance paid is Rs. 1200 out of which Rs. 500 is prepaid.

g) The cash withdrawn by the owner to meet personal expenses

Q.2: Give a short explanation of the features of Accounting Principles.

Q.3: Explain the term 'Accounting Concept'.

Q.4: What is meant by Generally Accepted Accounting Principles? Explain its needs and importance.

Q.5: Write short notes on the following:

i) Business Entity Concept

ii) Going-Concern Concept

iii) Matching Concept

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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

are continuously engaged in the effort to provide the best acceptable accounting principles. They have conducted research studies, made pronouncements from time to time on the basis of the findings of such research to evolve and improve the principles of accounting, known as 'Accounting Standards'. In the practical application these are generally accepted by all the accounting professionals and that is why these are included in 'Generally Accepted Accounting Principles'

3.3 MEANING AND NEEDS OF ACCOUNTING STANDARDS

Accounting Standards are the established and accepted models which aims at providing excellent, adequate and unbiased treatment of accounting transaction/information and reporting the same in the financial statements to facilitate their users in forming rational and judicious decision.

According to T. P. Ghosh "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.'' Accounting standards provide the prescription for treating accounting events and disclosing the same in an all-accepted, unbiased and fair manner. These relate to accounting rules and procedures applied in measurement, valuation, reporting and disclosure of financial information.

The accounting standard is a standardised practice of accounting which aims to reduce the several alternative practices. 'Accounting standards relate to the codification of generally accepted accounting principles. These are stated to be the norms of accounting policies and practices by way of codes and guidelines to direct as to how the items which go to make the financial statements should be dealt with in accounts and presented in the annual reports'. (ICSI)

Accounting standards must be developed for the development of accounting as a business language. The central idea of accounting standards is to harmonise the diverse accounting policies and practices

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.



CHECK YOUR PROGRESS

Q.1: Define the concept of accounting standard.

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Q.2: Mention any three needs of accounting standards.

i) .....

ii) .....

iii) .....

3.4 OBJECTIVES OF ACCOUNTING STANDARDS

Objectives of Accounting Standards are given below:

- The most important objective of Accounting Standards is to bring uniformity in financial reporting and to ensure consistency and comparability of data contained in the financial statements.
- Another objective of Accounting Standards is to use accounting standards as a tool to enhance corporate governance and responsibility.
- Accounting standards have been formulated to ensure fairness, probity, consistency and transparency in business operation and accounting practices.
- Another objective of Accounting Standards is to develop accounting as a language of business.

3.5 ADVANTAGES OF ACCOUNTING STANDARDS

Accounting Standards provide the accountants those accounting policies which are most suitable in a given situation. The utility of accounting standards may be stated as follows:

- Accounting Standards improve the reliability and credibility of financial statements.

- 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.

The Central Government, under Section 145(2) of the Income Tax Act, 1961, is authorised to notify, from time to time, the accounting standards to be followed by any class of assessees or any class of income.

The Central Government has constituted a 12-member NATIONAL ADVISORY COMMITTEE ON ACCOUNTING STANDARDS under Section 210A (1) of the Companies Act, 1956. Though no accounting standard has been laid down till now under this Act, but it is provided in section 210 of the Act, that the standard of accounting specified by the ICAI shall be deemed to be the Accounting Standards prescribed by the Central Government under this section.

Since the financial audit is performed by qualified chartered accountants in India, therefore, practically the task of setting, issuing and enforcing the implementation of accounting standards have been performed by the ICAI. Therefore the procedure followed by the ICAI in this regard is described hereunder.

The Institute of Chartered Accountants of India (ICAI) was established in the year 1949 under an Act of Parliament mainly to perform the following two basic activities: (a) Conducting Chartered Accountancy examination and preparing CAs to perform accounting and auditing function; and (b) Formulating accounting standards as well as auditing standards and guidelines. The ICAI is a full-fledged member of the International Federation of Accountants (IFAC) and is an associate member of the International Accounting Standard Committee since April 1974. Recognizing the need to harmonize the diverse accounting practices prevalent in India and also to integrate them with the international accounting practices, the Accounting Standards Board (ASB) was constituted on 21st April 1977 by the ICAI. The Accounting Standards Board gives adequate representation to the related and interested groups of bodies, viz., Industry and Commerce, Company Law, Central Board of Direct Taxes, Comptroller and Auditor General of India, Banks, Public Enterprises and practising auditors.



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.’’

Ans. to Q. No. 2: i) Precise and prudent information

ii) Comparability

iii) Global acceptability of accounting information.

Ans. to Q. No. 3: i) To bring uniformity in financial reporting and to ensure consistency and comparability of data contained in the financial statements.

ii) To use accounting standards as a tool to enhance corporate governance and responsibility.

Ans. to Q. No. 4: i) Accounting Standards improve the reliability and credibility of financial statements.

ii) Accounting Standards help in resolving conflict of financial interests among various groups.



3.10 MODEL QUESTIONS

Q.1: What is accounting standard?

Q.2: What are the needs of accounting standard?

Q.3: What are its benefits of accounting standard?

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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.

4.3 MEANING OF ACCOUNT

An account is a summary record of transactions of similar nature for a certain period. Summary record of transactions relating to a particular person is account of that person for the period concerned; summary record of transactions relating to a particular asset is account of that asset for the period concerned and so on. A businessman should classify and summarise all the business transactions of similar nature under respective groups. Each such group or head is known as an 'Account' or 'Account heads'. For example, all dealings with 'Laxmi' will be recorded under the heading 'Account of Laxmi'. Account is abbreviated a 'A/C' or 'a/c'.

Definition of Account: The term 'Account' has been defined by different authorities. One of the most important definitions of account has been given by R. N. Carter.

According to R. N. Carter, 'An account is a ledger record, in summarised form, of all the transactions that have taken place with the particular person and the value specified'. It is a device to record transactions of one single type of item. It may be better explained with the help of its format.

Format of Account: An account is generally prepared in "T" shape having two sides, left hand and right hand side. A specimen form of an account is given below.

Salary Account ('T' Shape)

Dr. Cr.

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

All accounts are divided into two sides. The left hand side of the account is called 'debit side'. It is indicated by 'Dr.' (abbreviation for debit)

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.

Meaning of Credit: Right hand side of the account is called Credit side. Hence, to credit an account means to record the transaction on the right hand side of the account. It is abbreviated as 'Cr.' The word 'Credit' originated from the Latin word 'Credre' which means trust or belief.



CHECK YOUR PROGRESS

Q.1: Explain the meaning of 'Account'.

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4.5 SYSTEM OF BOOK-KEEPING

System of book-keeping refers to the principles and procedure followed for recording of transactions in the books of account. From this point of view, system of book-keeping may be divided into the following:

a) **Double entry system:** The double entry system was first evolved by Fra luca Pacioli, who was a Franciscan Monk of Italy. This system recognises the fact that there are two fold aspects in every business transaction. In order to have a complete record of all the transactions, two-fold aspects of every transactions are recorded in the books of accounts. This system is recognised by the Tax Authorities.

b) **Single entry system:** The single entry system is another method of recording business transactions. Under this system, two-fold aspects of every transaction are not recorded. Only the records of accounts relating to cash, debtors and creditors are maintained. As two-fold aspects of every transaction are not recorded under this system, it fall short of principle of double entry. Therefore, it is referred to as a system of 'impact accounting'.



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

was developed in proper form in Venice at the end of 15th century by Fra Luca Pacioli, a Franciscan monk of Italy. He is considered as the father of modern accountancy. His treatise in Italian, '*De computic at scriptures*' dealt with the use of Memorial(memorandum book) Journal, and Quadirno (ledger). This book became very popular in a short period of time due to its special characteristics. The book was translated into English by Huge old Castle in 1944. Later on, many changes were incorporated in the system and finally a complete book named as 'English system of book-keeping' was written on this system by Edward Jones in 1785.

Practical Application of the Principle of Double Entry: All business transactions involve the transfer of value in the form of money, goods or services from one party to another. So, it involves two parties. One party gives some benefit while another party receives the benefit of an equivalent value. For the purpose of recording, the transactions are analysed further to ascertain the two aspects affected by each transaction. Most important point to be kept in mind at this stage is that for the purpose of recording, a transaction is required to be analysed from the point of view of the party in whose books of accounts the record is to be made. This analysis is required in order to ascertain the accounts affected by the transaction. For example, Mr. A paid Rs. 500 to Mr. B. Most important point to be considered is– in which books of account the recording is to be made? If the recording is to be made in the books of 'A', from his point of view, we find that Cash has gone out and 'B' has received the same. Therefore, the two fold aspects are cash and 'B'. Since an account is maintained for each type of asset and the person to receive the benefit is 'B', the accounts affected are cash account and the account of B. Under double entry system, recording will be made both in cash account and in the account of B.

Thus, every transaction has two aspects, viz.

i) The receiving of value on the one hand and

ii) The giving of the same value on the other hand.

Both the receiving and giving aspects take place between the 'two account heads' of each party involved in the transactions.

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.

Disadvantages of Double Entry System: In fact, there are no disadvantages of double entry system of book-keeping. However, considering the size of the organisation using the system, the following may be regarded as disadvantages of double entry system.

I) **Requirement of Expert Knowledge:** The maintenance of books of accounts under this system requires the book-keeper to have expert knowledge. Hence, it cannot be maintained by a layman. Now a day, accounting is a profession and is being practised by qualified accountants.

II) **Lengthy and Cumbersome Process:** The process of recording, classifying, analysis and interpreting the accounts is cumbersome and tedious.

III) **Expensive:** The system requires an organisation to maintain a large number of books of accounts. Accounts department is also required to be staffed by qualified and trained persons requiring the payment of high salaries. So, it is an expensive system.

IV) **Unsuitable for Small Organisation:** As it is expensive and requires the services of qualified persons, it may not be suitable and economical for small organisations to maintain books of account under this system.

4.7 CLASSIFICATION OF ACCOUNTS

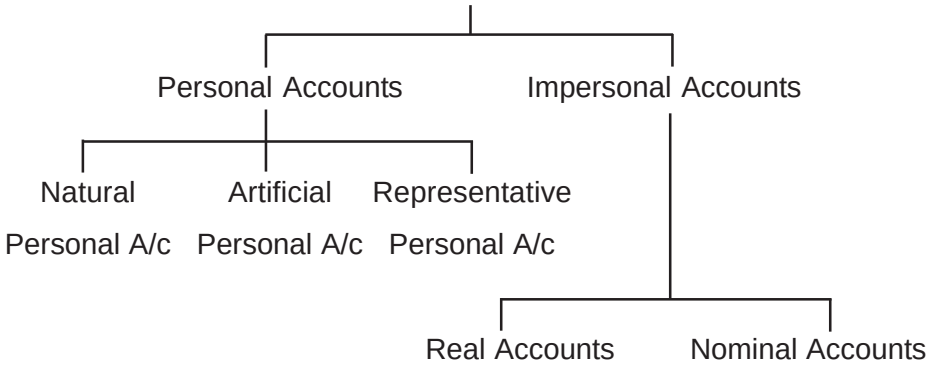
For the purpose of recording transactions, classification of accounts (i.e., account heads) are necessary. There are two approaches for classification of accounts. These are:

1) English Approach or Traditional Approach and
2) American Approach or Modern Approach

These are discussed below:

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.

b) Real Accounts: The 'account heads' recording transactions relating to tangible things (which can be seen, touched or physically exchanged) such as goods, cash, land, building, machinery, etc. are classified as real accounts.

It may be mentioned here that there are some items which do not have a physical shape and which cannot be seen or touched but it can be bought and sold. For example, goodwill, patents, trademarks, copyrights, etc. also fall within the category of real accounts.

c) Nominal Accounts: The accounts recording transactions relating to losses, expenses, incomes and gains are classified as nominal accounts. For example, Salaries, Wages, Rent paid, Discount Allowed, Discount Received, Commission Received, Interest Paid, Interest Received etc.

B) American Approach or Modern Approach: According to the American approach or Modern approach, accounts are classified into five categories as under.

a) Assets Account: The meaning of asset is property. Assets account are the accounts of properties such as land, building, plant, machinery, stock, patents, cash in hand, cash at bank, investments, inventory, etc. held by an entity. This category also includes the accounts of debtors.

b) Liabilities Account: Liability means obligation to pay. Liabilities accounts are the accounts pertaining to the obligation of the entity to lenders, creditors for goods, creditors for assets, creditors for expenses, etc.

c) Capital Account: Capital is the amount with which the business is started. It is the account of the owner who invests money in the business as capital.

d) Revenue Accounts: Revenue accounts are the accounts of incomes and gains. For example, sales, discount received, interest received, commission received etc.

e) Expense Accounts: Expense accounts are the accounts of expenses incurred and losses suffered by an entity. For examples,

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'

d) Revenue Account:

i) When there is an increase in Revenue, it is 'Credited'

ii) When there is a decrease in Revenue, it is 'Debited'

e) Expense Account:

i) When there is an increase in the Expense, it is 'Debited'

ii) When there is a decrease in Expense, it is 'Credited'

f) Withdrawal/Drawings Account:

i) When any withdrawal or drawings is made by the proprietor/ partner, it is 'Debited'

ii) When any interest is charged on withdrawal or drawings made by the proprietor/ partner, it is 'Debited'

iii) When the balance of the drawings is closed by transfer to Capital account, drawings account is 'Credited'.

The rules for 'Debit' and 'Credit' as applicable under Modern approach is summarised below.

Sl. No.	Type of Account	To be debited When	To be Credited When
a)	Assets Account	Increase	Decrease
b)	Liabilities Account	Decrease	Increase
c)	Capital Account	Decrease	Increase
d)	Revenue Account	Decrease	Increase
e)	Expense Account	Increase	Decrease
f)	Drawings Account	Increase	Decrease

Illustration: Give five examples of each of Assets Account, Liabilities Account, Revenue Account and Expense Account

a) Asset Account

i) Building Account

ii) Investment Account

iii) Furniture Account

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

(xiii) Creditors (xiv) Loan to Ram (xv) Loan from Madhu (xvi) Capital (xvii) Bank (Loan) (xviii) Assam Co. Ltd. a supplier (xix) Brun Kumar (a customer to whom, goods were sold on credit) (xx) Withdrawal by the proprietor for personal use (xxi) Copyright.

Solution:

i) Cash in hand– Assets Account
ii) Furniture– Asset Account
iii) Investment– Assets Account
iv) Building– Asset Account
v) Machinery– Asset Account
vi) Trademark– Asset Account
vii) Land– Asset Account
viii) Cash in Bank– Asset Account
ix) Leasehold property– Asset Account
x) Goodwill– Asset Account
xi) Closing Stock (closing inventory)– Asset Account
xii) Debtors– Asset Account
xiii) Creditors– Liability Account
xiv) Loan to Ram– Asset Account
xv) Loan from Madhu– Liability Account
xvi) Capital A/c– Liability Account
xvii) Bank (Loan)– Liability Account
xviii) Assam Co. Ltd., a supplier– Liability Account
xix) Brun Kumar (a customer to whom goods sold on credit)– Assets Accounts
xx) Withdrawal by the proprietor for personal use– Drawing Account
xxi) Copyright– Assets Account.

Illustration: Classify the following accounts:

(i) Sales (ii) Purchase (iii) Returns outward (iv) Returns inward (v) Carriage inward (vi) Carriage outward (vii) Discount Allowed (viii) Interest received (ix) Discount Received (x) Interest paid (xi) Rent paid (xii) Rent Payable (xiii) Rent paid in advance (xiv) Rent of premises sub-let (xv) Bad Debt (xvi) Import duty (xvii) Salary paid (xviii) Outstanding Salary (xix) Salary

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

Illustration: State on which side of the account, the following will be recorded. State also the nature of the accounts.

1) When there is an increase in the account because of a transaction:
   (a) Rent Received (b) Salaried Paid (c) Motor Vehicle Account (d) Proprietor's Account (e) Ramesh Account (Debtor) (f) Jayanta Account (creditor) and (g) Salary Outstanding Account
2) When there is a decrease in the account because of a transaction:
   (a) Insurance Premium Paid (b) Proprietor's Account (c) Commission Received (d) Furniture Account (e) Rent Outstanding Account (f) Ratan Account (creditor) and (g) Dinesh Account (Debtor)

Solution: Table showing the account to be Debited/ Credited–

Account Head	Class of Account	Debit/Credit
I) Increase the Balance of Account		
a) Rent Received	Revenue	Credit
b) Salary paid	Expense	Debit
c) Motor Vehicle A/c	Assets	Debit
d) Proprietor A/c	Capital	Credit
e) Jayanta (creditor)	Liability	Credit
f) Ramesh (Debtor)	Assets	Debit
g) Salary outstanding A/c	Liability	Credit
II) Decrease the Balance of Account		
a) Insurance Premium Paid	Expense	Credit
b) Proprietor Account	Drawings	Debit
c) Commission Received A/c	Revenue	Debit
d) Furniture A/c	Assets	Credit
e) Rent Outstanding A/c	Liability	Debit
f) Ratan (creditor)	Liability	Debit
g) Dinesh (debtor)	Assets	Credit

Illustration: Ascertain the account to be Debited/Credited with reasons:

i) Started business with capital of Rs. 30,000

ii) Purchased machinery on credit from Hari Bora for Rs. 35,000

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



4.9 LET US SUM UP

In this unit we have discussed the following points–

- Account is a summarised record of transactions relating to person, property, expense or gain.
- The terms 'Debit' and 'Credit' and their rules.
- Two approaches regarding classification of accounts.
- According to English approach the accounts are classified into three types– Personal, Real, Nominal.
- According to American approach the accounts are classified into five types– Assets, Liabilities, Capital, Revenue and Expense.
- Two system of Book-keeping: Single Entry and Double Entry systems.
- Application of Double Entry principles in recording business transactions.



4.10 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.



4.11 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: An account is a summary record of transactions of items of similar nature for a certain period.

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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UNIT 5: ACCOUNTING PROCESS-II

UNIT STRUCTURE

5.1 Learning Objectives

5.2 Introduction

5.3 Meaning of Books of Account

5.4 Meaning of Journal

5.5 Journalising

5.6 Subsidiary Books of Account

5.7 Meaning of Ledger

5.8 Meaning of Ledger Posting

5.9 Rules Regarding Posting

5.10 Balancing of an Account

5.11 Illustrations

5.12 Let Us Sum Up

5.13 Further Reading

5.14 Answers to Check Your Progress

5.15 Model Questions

5.1 LEARNING OBJECTIVES

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

- explain the meaning of Books of Account
- explain the meaning of 'Journal'
- discuss the process of recording transactions in journal book
- discuss the various subsidiary books.
- explain the meaning and importance of ledger
- differentiate between journal and ledger
- explain the meaning of ledger posting
- discuss the rules of ledger posting
- prepare ledger accounts.

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.

5.4 MEANING OF JOURNAL

The word 'Journal' has been derived from the French word 'JOUR' means daily records. Journal is a book of original entry in which transactions are recorded as and when they occur in chronological order (in order of date) from the source documents. Recording in journal is made showing the accounts to be debited and credited in a systematic manner. Thus, the journal provides a date-wise record of all the transactions with details of the accounts and amounts debited and credited for each transaction with a short explanation, which is known as narration.

Firms having limited number of transactions record those in journal and from there post these to the concerned ledger accounts. Firms having large number of transactions, maintain some special purpose journals such as, Purchase Book, Sales Books, Returns books, Bills Book, Cash Book, Journal proper etc.

Format of Journal: The following is the format of Journal.

Format of Journal

Date	Particulars	L.F.	Amount	
			Debit Rs.	Credit Rs.
(i)	(ii)	(iii)	(iv)	(v)

The format of Journal is sub-divided into five columns. These five columns are (i) Date (ii) Particulars (iii) Ledger Folio (L/F) (iv) Debit amount and (v) Credit amount.

Ledger Folio (L.F): Journal is the original record of the business transactions. All entries from the journal are posted in the ledger accounts. **The page number or folio number of the ledger** account where the posting has been made from the journal is recorded in the L.F column of the Journal. Each entry in the journal must be explained in brief. This brief explanation of the entry is called **Narration.** Thus, Narration gives a brief explanation of the transaction for which the entry has been passed is given. It enables

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.



CHECK YOUR PROGRESS

Q.2: Discuss the steps of journalising.

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Let us journalise the transactions relating to receipts and payments in cash or by cheque, transactions relating to goods, then transactions relating to purchase and sale of assets, incomes and expenses and finally transactions between the business and the proprietor.

Transactions relating to receipts and payments in cash or by cheque: A business organization settles its accounts with the parties by receiving or making payments either in cash or by cheques. The recording of such transactions may be illustrated as under:

Example 1:

2008

July 1: Cash received from Ramesh Rs. 5,000.

July 2: Received from Sita Rs. 1,000 in cash and Rs. 10,000 by cheque.

Solution:

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008				
July 1	Cash A/c Dr.		5,000	
	To Ramesh			5,000
	(Being cash received)			
July 2	Cash A/c Dr.		1,000	
	Bank Dr.		10,000	
	To Sita			
	(Being the amount received in cash and by cheque)			11,000

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. 7:	Rani Dr. To Returnd Outward A/c (Being goods returned to Rani)		1,000	 1,000
Aug. 8:	Returns Inward A/c Dr. To Jadu (Being goods returned by Jadu)		500	 500

The transactions have been recorded by following the steps of journalizing. Transactions of August 1 and 2 are cash transactions. In case of transaction of Aug. 3, the name of the party is recorded because it is a credit transaction. The transaction of August 4 is a cash sale transaction. The transaction of Aug. 6 is a credit sale transaction and therefore, the name of the party has been recorded. In case of transaction of Aug. 7 "Returns Outward A/c" records the goods returned to the party from whom they were purchased on credit. In case of transaction of Aug. 8 "Return Inward A/c" records the goods returned by the party to whom they were sold on credit.

Transactions relating to purchase and sale of assets of the business: These transactions can be discussed with the help of the following example:

Example 3:

2008

Aug. 9: Purchased a plot of land for Rs. 1,00,000

Aug. 10: Purchased furniture on credit from MM Company for Rs. 50,000

Aug. 11: Old computer sold for Rs. 5,000

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008 Aug. 9:	Land A/C Dr. To Cash A/C (Being a plot of land purchased)		1,00,000	 1,00,000

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.14:	Cash A/c Dr.		1,000	
	To Interest Receivable A/c (Being interest on investment received)			1,000
Aug.15:	Cash A/c Dr. To Commission Receivable A/c (Being commission received)		500	500

In the above transactions, the expenses have been debited and incomes have been credited by applying the rule of nominal account.

Transactions between the proprietor and the business: The transactions that take place between the proprietor and the business are recorded in the books of accounts of the business. These transactions may relate to introducing capital in the business, withdrawing of cash from business for personal use of the proprietor etc. Withdrawing of cash or goods for personal use of the proprietor is known as drawings.

Example 5:

2008

Aug. 16: Mr. Ram started business with Cash Rs. 10,000; Furniture Rs. 15,000; Machinery Rs. 50,000.

Aug. 17: Mr. Ram withdraws Rs. 2,000 for personal use.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008				
Aug. 16:	Cash A/c Dr.		10,000	
	Furniture A/c Dr.		15,000	
	Machinery A/c Dr.		50,000	
	To Capital			75,000
	(Being business started with cash, furniture and machinery)			

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.

5.6.2 Purchase Returns Book

The transactions relating to return of goods to the supplier which were purchased on credit are recorded in Purchase Return Book. The goods may be returned due to not confronting to the specifications or defective goods or for any other reason. It is also known as Returns Outward Book. The total of this book, after a certain period, is credited to Returns Outward Account and the suppliers' accounts, to whom goods were returned, are debited with the respective amounts.

5.6.3 Sales Book

This book is meant for recording credit sale of goods. Cash sale of goods and sale of articles other than goods are not recorded in this book. This book is also known as Sales Journal or Sold Day Book. At the end of a certain period, the total of Sales Book is posted to the credit side of Sales Account and the customers' accounts will be debited with the respective amounts.

5.6.4 Sales Return Book

When goods sold on credit are returned by the customers, they are recorded in Sales Return Book or Returns Inward 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.



LET US KNOW

When goods are returned to the supplier, a debit note is sent to him indicating that his account has been debited with the amount mentioned in the debit note. On the other hand, when goods are returned by the customer, the seller sent a credit note indicating that customer's account has been credited with the amount mentioned in the credit note.

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

due from a particular customer, he will have to go through the whole journal. It would be a tedious and time consuming process. To overcome this difficulty, another book of account, in addition to Journal/special purpose books, is maintained. This book is called 'Ledger'.

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.** In other words, the book, which contains accounts, is known as the ledger or Principal Book. Ledger provides necessary information regarding various accounts. Personal accounts in ledger show how much money firm owes to the creditors and the amount it can recover from its debtors. The real accounts show the value of properties and also the value of stock. Nominal accounts reflect the sources of income and also the amount spent on various items.

In accounting all transactions are ultimately recorded in the ledger. In this book, separate accounts are opened for each 'account head' and all transactions relating to a particular 'account head' will be posted in the concerned account. An account for each person, each type of revenue, expense, asset and liability is opened in the ledger. For example, all transactions relating to a particular supplier; say Vivek will be posted to the account of Vivek. This helps in ascertaining the amount due to Vivek.

Ledger is generally maintained in the form of a bound register. First few pages of the ledger has ordinary horizontal ruling for indexing. Remaining pages are ruled like an account and is consecutively numbered. The index pages are used for writing the names of accounts and the Folio No. (Page No.) where a particular account has been opened for easy location. The ledger may also be maintained in loose-leaf form instead of one bound book.

Ledger is the 'King of all the Books of Accounts': Ledger is called the king of all the books of account, because it is the book which alone can exhibit the position of each 'account head' in a convenient form. It can supply all the useful information such as the net result of various transactions involving an asset, a liability, capital, revenue and an expense.

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.



CHECK YOUR PROGRESS

Q.5: What is ledger book?

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Q.6: State any two points of importance of ledger.

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Purpose of Ledger: A businessman requires various information to ascertain the net results, financial position and progress of the business. Ledger can provide various information, which are given below.

a) **Information Regarding Debtors :** A trader can know the amount of money receivable from various customers and others who are known as debtors.

b) **Information Regarding Creditors :** A trader can know the amount of money payable to various suppliers and others who are known as creditors.

c) **Information Regarding Purchases and Sales :** The total purchase of goods and the total sale of goods during a specific period can be known by preparing Purchase A/c and Sales A/c.

d) **Information Regarding Revenue and Expenses :** The amount of revenue earned from different sources and the amount of expenses incurred on different account heads for a particular period may be known from the ledger.

e) **Information Regarding Assets and Liabilities :** The amount of various types of assets such as Land, Building, Machinery, cash in hand, cash at bank, etc. and the amount of various liabilities can be obtained from ledger.

Sub-divisions of Ledger: Ledgers may be sub-divided in the following manner:

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.

Sl. No.	Points of Distinction	Journal	Ledger
i)	Nature	Journal is a book of primary entry	Ledger is a book of final entry.
ii)	Basis of Recording	In Journal, transactions are recorded on the basis of voucher	Here transactions are recorded from the journal
iii)	Manner of Recording	Here transactions are recorded in order to happening i.e. date-wise	Here transactions are recorded on the basis of 'account heads'
iv)	Narration	Every entry in the journal is followed by a narration	Posting in the Ledger is not followed by any narration
v)	Form of Information	It provides information in scattered form	It provides information in a summarised and classified form

Format of a Ledger Account: There are two types of forms for writing up Ledger Accounts namely– (a) Horizontal form and (b) Vertical or 'T' form. These are discussed below.

a) Horizontal Ledger Account is Ruled out as follows:

"AB & Co" Account

Date	Particulars	J.F.	Debit Amount (Rs.)	Credit Amount (Rs.)	Debit Or Credit	Blance (Rs.)

In this form of ledger, balance is ascertained after every transaction. This method is generally used in bank. Where the accounts are maintained in computers through the use of accounting software like Tally, accounts are also prepared in this from.

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.



CHECK YOUR PROGRESS

Q.7: What are the functions of a ledger account?

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Q.8: State any two points of differences between journal and ledger.

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5.8 MEANING OF LEDGER POSTING

Ledger posting means making entries of the transactions in the ledger books from the journal. Posting is a process of transferring debit and credit aspects of the entries appearing in the journal and other books of original entry to the debit and credit sides of the relevant accounts in the ledger. Postings are made using the word 'To' and 'By' as a prefix. For debit side entry 'To' prefix is used and for credit side entry 'By' prefix is used. The aim of posting is to make a classified and summarised record of all business transactions under appropriate account heads.

5.9 RULES REGARDING POSTING

Rules generally followed while posting the transactions in the Ledger: The following basic rules are to be followed while posting the transactions in the ledger:

a) Separate accounts should be opened in the ledger for posting the different transactions recorded in the journal.

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.

Procedure for posting into an account:

a) Which has been debited in the journal–

Step 1: Concerned account in the ledger should be located. If no account appears in the ledger for that account head, a new account should be opened and the name of the new account head along with the Folio No. should be recorded in the index page.

Step 2: In the 'Date column' on the debit side, date of the transaction should be recorded.

Step 3: In the 'Particulars column' on the debit side, the name of the 'account head' credited in the journal, should be recorded as:

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

Step 4: In the 'J.F column' on the debit 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 debit side, the amount as recorded in the journal against the account where the posting has been made should be entered.

b) Which has been credited in the journal?

Step 1: Concerned account in the ledger should be located. If no account appears in the ledger for that account head, a new account should be opened and the name of the new account head along with the Folio No. should be recorded in the index page.

Step 2: In the 'Date column' on the Credit side, the date of the transaction should be recorded.

Step 3: In the 'Particular column' on the credit side, the name of the 'account head' debited on the journal, should be recorded as:

"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.

Posting in Cash Account:

In the Books of Mr. X

Ledger Accounts

Cash Account

Dr. **Cr.**

Date	Particulars	L. F.	Amount (Rs.)	Date	Particulars	L. F.	Amount (Rs.)
2008 Jan 1	To Capital		18,000				

As the Cash A/c has been debited in the Journal, Cash account will also be debited in the Ledger. This means that posting will be made in the debit side of the Cash A/c. On the debit side, in the 'date column', date of the transaction will be written, i.e. Jan. 1, 2008. In 'particulars column', the account which has caused an effect in the Cash A/c will be written. As per the entry in the journal, Capital will be written in the 'particulars column' with 'To' as prefix. 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 Cash account in the journal, as shown above, will be entered.

Posting in the Capital Account:

In the Books of Mr. X

Ledger Accounts

Capital

Dr. **Cr.**

Date	Particulars	L. F.	Amount (Rs.)	Date	Particulars	L. F.	Amount (Rs.)
				2008 Jan 1	By Cash A/c		18,000

As the Capital has been credited in the journal, Capital will also be credited in the Ledger. This means that posting will be made on the credit side of the Capital. On the credit side, in the 'date column', the date of the transaction i.e. Jan. 1. 2008, will be written. In the 'particulars column', the

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

5.10 BALANCING OF AN ACCOUNT

The 'balance' is a term used in accounting which means the difference between the two sides of an account, or the total of the account containing only debits and only credits. Balancing of an account is an important aspect of accounting. It implies the process of ascertaining the net difference of an account after totalling of both sides – viz. debit side and credit side.

In simple words, balancing means the insertion (writing) of the difference between the two totals, debit side total and credit side total, in the smaller (smaller total) side, so that the (grand) totals of the two sides become equal.

Balancing is done periodically, i.e. weekly, monthly, quarterly, half-yearly or yearly, depending on the requirements of the business.

A computerised system will usually print the balance of the account after each transaction, but in a manual system we must calculate the balance. The balance of an account shows the position of an account on a particular day. Such balance of an account may be **'Debit balance' or 'Credit balance'**.

Basic Points of Balancing an Account:

a) *The total of both the sides of an account may be equal. In that case, the account does not show any balance.*
b) *The total of the debit side may be more than the total of the credit side. In that case, the account shows debit balance.*
c) *The total of the credit side may be more than the total of the debit side. In that case the account shows credit balance.*

Nature of Ledger Account Balances: The nature of balances of different classes of ledger accounts will be as under.

1) **Asset Account:** Assets account will always show debit balance. For example, Cash Account will always show debit balance, because all cash receipts are shown on the debit side and all cash payments are shown on the credit side. Since cash payments cannot be more than the receipts, cash account will show the debit balance. When

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*

In the books of XY Company

Journal entries

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2008				
Aug. 1	Purchase A/c Dr.		1,000	
	To Cash A/c			1,000
	(Being goods purchased)			
Aug. 10	Cash A/c Dr.		7,000	
	To Sales A/c			7,000
	(Being goods sold)			
Aug 12	Salary A/c Dr.		4,000	
	To Cash A/c			4,000
	(Being salary paid)			
Aug 15	Rent A/c Dr.		1,000	
	To Cash A/c			1,000
	(Being rent paid)			

In the Books of XY Company

Ledger Accounts

Dr. **Purchase Account** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
Aug.1	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. 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				

Illustration 2: Enter the following transactions in the respective ledger accounts in the books of Amir Enterprise for the month of January, 2013

2013

January 1: Capital introduced into business Rs. 50, 000

January 2: Purchase goods from ABC Company on credit for Rs. 10, 000.

January 4: Goods sold to Assam Company on credit for Rs. 15, 000.

January 10: Commission received Rs. 1, 000.

January 17: Travelling expenses paid Rs. 3, 000.

January 20: Cash paid to ABC Company Rs. 5, 000

January 22: Cash received from Assam Company Rs. 5, 000

Solution: *Workings*

In the books of Amir Enterprise

Journal entries

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2013 Jan. 1	Cash A/c Dr. To Capital (Being capital introduced into business)		50,000	50,000
Jan. 2	Purchase A/c Dr. To ABC Company (Being goods purchased on credit)		10,000	10,000
Jan. 4	Assam Company Dr. To Sales A/c (Being goods sold on credit)		15,000	15,000
Jan. 10	Cash A/c Dr. To Commission A/c (Being commission received)		1,000	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. **Sales Account** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.31	To Balance b/d		15,000	Jan.4	By Assam Company A/c		15,000
			15,000				15,000
				Feb.1	To Balance b/d		15,000

Dr. **Commission Account** **Cr.**

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

Dr. **Travelling Expenses Account** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.17	To Cash A/c		3,000	Jan.31	By Balance b/d		3,000
			3,000				3,000
Feb.1	To Balance c/d		3,000				

Dr. **ABC Company** **Cr.**

Date	Particulars	J. F.	Amount (Rs.)	Date	Particulars	J. F.	Amount (Rs.)
2013				2013			
Jan.20	To Cash A/c		5,000	Jan.2	By Purchase A/c		10,000
Jan.31	To Balance c/d		5,000				
			10,000				10,000
				Feb.1	To Balance b/d		5,000

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



5.12 LET US SUM UP

In this unit we have discussed the following points–

- Journal is the primary book to record business transactions
- Steps involved in the process of journalising
- Journal entries relating to purchase and sale of goods, receipts and payment of cash etc.
- The various subsidiary books like purchase book, sales book, sales return book etc.
- Ledger contains all the accounts and known as principal book.
- Various advantages of ledger and sub- division of ledger.
- Differences between journal and ledger.
- The process of transferring journal into ledger which is known as ledger posting.
- Basic points regarding ledger posting and balancing of accounts.



5.13 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.



5.14 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Journal is a book of original entry in which transactions are recorded as and when they occur in chronological order from source documents.

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?

Q.4: Journalise the following transactions-

i) Cash paid to Mr. X– Rs. 5,000

ii) Purchased goods for– Rs. 15,000

iii) Sale of goods for cash– Rs. 1,00,000

iv) Wages paid in Cash– Rs. 10,000

v) Amount paid to XY Company– Rs. 10,000

Q.5: What do you mean by ledger? What are the main purposes of ledger?

Q.6: Prepare relevant accounts in the ledger book from then following information–

i) Furniture purchased– Rs. 10, 000

ii) Purchase goods on credit from X Co.– Rs. 15,000

iii) Sale of goods for cash– Rs. 1,00,000

iv) Salaries paid in Cash– Rs. 10,000

v) Amount paid to X Co.– Rs. 10,000

Q.7: What is meant by ledger posting?

Q.8: What is meant by balancing of an account?

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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.

In this unit you will gain an understanding on the importance of cash book in a business organisation and the method of preparing the cash book.

6.3 MEANING OF CASH BOOK AND PASS BOOK

Cash Book is a subsidiary book maintained by business firms to record cash and bank transactions. The basis of any business is finance and that is why cash and bank balance are the most important aspects in accounting. In business most of the transactions relate to receipt of cash, payments of cash, sale of goods and purchase of goods. So it is necessary to have proper books for each of such transactions. Cash book is a subsidiary book which records the receipts and payment of cash. With the help of cash book, cash and bank balance can be checked at any point of time.

In order to deposit, receive, withdraw, pay any amount through a bank, an account is opened in the bank. The accountholder as well as the bank keeps records of all such deposits and withdrawals. Records of such deposits and withdrawals are made known to the accountholder by the bank through a book. This book is called Pass Book. The accountholder cannot make entries in the pass book but he can verify the entries with his records in the cash book.



CHECK YOUR PROGRESS

Q.1: Explain the meaning of Pass Book.

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Q.2: What is cash book?

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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.

g) Guard Against Defalcation: The balance of cash as shown by the cash book can be verified with physical balance of cash in the cash book. This process of verification acts as a guard against defalcation of cash.

h) Rectification of Errors: Any mistake or error can be detected at the time of verification of cash book. If there is a difference between the actual cash and the balance as per Cash Book, it means there is some error.



CHECK YOUR PROGRESS

Q.3: State any two points of importance of cash book.

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6.5 DIFFERENT TYPES OF CASH BOOK

The type of cash book is dependent upon the type of transactions we want to record in it. Thus, the types of cash book may be as below-

A) Single column Cash Book:
   1) Cash book having one column for Cash
   2) Cash book having one column for Bank

B) Double Column Cash Book:
   1) Cash Book having two columns– one for cash and another for bank.
   2) Cash book having two columns– one for cash, another for discount.
   3) Cash book having two columns– one for bank, another for discount.

C) Triple Column Cash Book:
   1) Cash book having three columns– first for cash, second for bank and third for discount.

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					

Illustration 2: Prepare single column cash book from the following information in the books of MM Enterprise–

Date	Particulars	Amount (Rs.)
April, 2012 1	Cash in hand	20,000
2	Cash received from Gautam	10,000
3	Salary Paid	2,000
4	Goods purchased from Ram on credit	2,000
7	Cash purchase	1,000
12	Advertisement Expenses paid	1,500

Solution:

In the books of

MM Enterprise

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

Date 2012	Particulars	L / F	R / N	Amount Rs	Date 2012	Particulars	L / F	V / N	Amount. Rs
April 1	To Balance b/d			20,000	April 3	By Salary			2, 000
April 2	To Gautam			10, 000	April 7	By Purchase A/c			1, 000
					April 12	By Advertisement Expenses A/c			1, 500
					April 12	By Balance c/d			25, 500
				30, 000					**30, 000**
April 13	To balance b/d			25, 500					

Transaction of April 4 is a credit transaction and therefore it is not recorded in cash book.



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

Solution: **In the books of**

Abhijit Enterprise

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

Date 2013	Receipts	L / F	V / N	Amount Cash Rs.	Amount Bank Rs.	Date 2013	Particulars	L / F	V / N	Amount Cash Rs.	Amount Bank Rs.
June 1	To Balance b/d			20,000	15,000	June 3	By Imran			10,000	
June 12	To Cash	C			2,000	June 5	By Rent A/c			1,000	
						June 10	By Purchase A/c			5,000	
						June 12	By Bank	C		2,000	
						June 15	By Furniture A/c				1,500
						June 15	By Balance c/d			2,000	15,500
				20, 000	**17, 000**					**20,000**	**17,000**
June 16	To Balance b/d			2, 000	15, 500						



LET US KNOW

Contra Entry: In a cash book having cash and bank columns as shown in Illustration 3, you will often find the letter 'C' in Ledger Folio (L/F) columns. When a transaction involves both cash and bank account, e.g., cash deposited into bank or cash withdrawal from bank for office use; then the entry is made in both side of the same folio (page) of the cash book. This is commonly known as Contra Entry.

Illustration 4: Prepare double column cash book from the following information in the books of Abhijit Enterprise–

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

Solution:

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/ V/ F 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					



CHECK YOUR PROGRESS

Q.5: From the following transactions prepare a double column Cash Book with cash and bank columns.

01-01-07	Cash in hand Rs. 100 Cash at Bank Rs. 400
02-01-07	Cash purchase Rs. 50
03-01-07	Cash sales Rs. 200
04-01-07	Received Rs.100 from X
05-01-07	Received a cheque of Rs.200 from Y
06-01-07	Cheque was deposited into Bank
07-01-07.1	Purchase furniture and payment was made by cheque Rs. 220
08-01-07	Withdraw Rs. 100 from bank for office use
09-10-07	Paid Rs.50 into bank.
10-10-07	Withdraw Rs. 100 from bank for personal use

Illustration 5: Prepare triple column cash book from the following information in the books of Assam Enterprise–

Date	Particulars	Amount (Rs.)
January, 2014 1	Capital introduced in business	70,000
2	Cash deposited into Bank	40,000
3	Goods sold and payment received by cheque and the cheque was deposited into bank on the same day	10,000
3	Discount allowed	50
10	Goods purchased for Rs. 5,100 and discount received Rs. 100	
12	Cash deposited into Bank	20,000
15	Salaries paid by cheque	2,500
20	Rent paid by cheque	10,000

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			Date 2014	Particulars	L / F	V / N	Amount		
				Cash Rs.	Bank Rs.	Dis-count					Cash Rs.	Bank Rs.	Dis count
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

6.7 PETTY CASH BOOK AND IMPREST SYSTEM

In a situation where all receipts are paid into bank and all payments are made by cheques; or where there are large as well as small cash transactions, it becomes necessary to maintain another subsidiary book known as Petty Cash Book. This book is maintained with separate column for each normal head of expenditure and contains a record of payments made out of cheque drawn periodically for the purpose. There are several small payments a business entity has to make which are insignificant to be paid by cheques.

The cheques are drawn periodically for petty expenses and debited to petty cash account from the cash book. The amount paid by the petty cashier indicates the summary of expenses which are debited and petty cash account is credited. The heads of expenditure are not required to be separately posted in the ledger. This book is known as Analytical Petty Cash Book as various payments are automatically analysed being recorded separately in respective columns. The excess of petty cash amount over payment implies unspent balance laying with petty cashier.

The Imprest System of Petty Cash: The best system of maintaining petty cash is the imprest system. Under this system, having estimated the requirement of petty expenses for a certain period usually a month, such amount is withdrawn from the bank and handed over to the petty cashier to start with. The sum of money so advanced is known as imprest.

At the end of the month, the petty cashier will submit an account of disbursements made and a cheque for the exact sum spent by the petty cashier will be issued to him so that he may begin his new period with the original amount. Thus the original balance is restored.

This system provides an advantage because it facilitates conduct of an internal check over the petty cashier. The petty disbursement will be scrutinised by the head cashier. Every time he issues a fresh cheque for the exact amount spent. Secondly, the imprest being paid periodically from time to time, prevents accumulation and chance of defalcation of cash. All items of transactions having been recorded in analytical order under different heads, eventual clerical work of ledger posting had been reduced.



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

Ans. to Q. No. 4:

Date 2007	Receipts	L / F	R / N	Amount Rs	Date 2007	Payments	L / F	V / N	Amount. Rs
Apr 1	To Balance b/d			5,400	Apr 2	By Purchase A/c			750
Apr 7	To sales A/c			2,750	Apr 4	By Madan Kumar			105
Apr 14	To Dipak			525	Apr 8	By Bank			5,200
					Apr 9	By Wages A/c			130
					Apr 14	By Furniture A/c			395
					Apri 14	By Balance c/d			2,095
				8,675					**8,675**
Apr 15	To Balance b/d			2,095					

Ans. to Q. No. 5:

Cash Book with Cash and Discount Column

Date 2007	Receipts	L / F	R / N	Amount		Date 2007	Particulars	L / F	V / N	Amount	
				Cash Rs.	Bank Rs.					Cash Rs.	Bank Rs.
1 Jan	To Balance b/d			100	400	2 Jan	By purchase A/c			50	
3 Jan	To Sales…			200		6 Jan	By Bank	C		200	
4 Jan	To X			100		7 Jan	By Furniture				220
5 Jan	To Y			200		8 Jan	By Cash A/c	C			100
6 Jan	To Cash A/c	C			200	9 Jan	By Bank	C		50	
8 Jan	To Bank	C		100		10 Jan	By Drawings A/c				100
9 Jan	To cash A/c	C			50						
10 Jan						11 Jan	By Balance c/d			400	230
				700	**650**					**700**	**650**
12 Jan	To Balance b/d			400	230						



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

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UNIT 7: PARTNERSHIP-I

UNIT STRUCTURE

7.1 Learning Objectives

7.2 Introduction

7.3 Meaning and Features of Partnership Business

7.4 Advantages and Disadvantages of Partnership

7.5 Meaning of Partnership Deed

7.6 Capital Accounts of Partners

7.7 Distinctions between Fixed and Fluctuating Capital Accounts

7.8 Profit and Loss Appropriation Account

7.9 Interest on Capital

7.10 Interest on Drawings

7.11 Let Us Sum Up

7.12 Further Reading

7.13 Answers to Check Your Progress

7.14 Model Questions

7.1 LEARNING OBJECTIVES

After going through this unit, you will able to:

- discuss the meaning of the partnership business
- discuss the advantages and disadvantages of the partnership business
- explain the meaning and importance of partnership deed
- differentiate between fixed capital and fluctuating capital methods
- explain the profit and loss appropriation account
- discuss the process of calculating interest on capital and drawings.

7.2 INTRODUCTION

In a partnership business two or more persons join together to carryon business. They decide to share the profit or loss of the business. All these arrangements depend on the agreement between the partners,

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.

iii) **No Separate Legal Entity:** The partnership firm has no separate legal entity apart from the partners.

iv) **Sharing of Profits:** There must be an agreement among all the partners to share profits and contribute to the losses of the business in the ratio agreed upon.

v) **Membership /Number:** The minimum number of partners in a partnership firm is 2 and maximum 20 and 10 in case of banking business. A partnership business can be started with a minimum of two partners and the maximum number of partners cannot exceed 20. In case of banking business, the maximum number of partners is 10.

7.4 ADVANTAGES AND DISADVANTAGES OF PARTNERSHIP

After discussing the features of partnership business, now we will discuss the advantages and disadvantages of partnership business. The following are the **advantages** of partnership :

i) It is quite easy to start a partnership firm because, registration of a firm is not compulsory.

ii) The business risk is shared by all the partners. Hence in case of loss, burden will be comparatively less.

iii) The partners can take quick decisions on important matters and implement them accordingly.

The following are the **disadvantages** of partnership :

i) The liability of the partners are unlimited. Even their private property can be attached for the payments of the debt of the firm.

ii) In case of large- scale business or industry the limited resources of the partners may not be sufficient.

iii) Absolute secrecy and privacy of the business can not be maintained.

7.5 MEANING OF PARTNERSHIP DEED

A partnership is established by an agreement or contract between two or more persons who agreed to carry on a business. The agreement

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.

xvii) Bank Accounts: Whether the bank account shall be operated by any one of the partner or jointly.

xviii) Settlement of Disputes: In case of dispute among the partners, how the dispute will be solved.



CHECK YOUR PROGRESS

Q.1: What is partnership deed?

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Q.2: State two advantages and two disadvantages of partnership business.

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7.6 CAPITAL ACCOUNTS OF PARTNERS

You are aware that in a partnership business all the partners require to contribute capital to the firm. Hence, a separate Capital Accounts are maintained for each of the partner. For example, if there are three partners viz., A, B and C in a firm, there shall be three separate Capital Accounts for each of the partners. The Capital Accounts of partners may be maintained in any one of the following two methods :

a) Fixed Capital Accounts Method;

b) Fluctuating Capital Accounts Method.

Fixed Capital Accounts Method: Fixed capital means where capital of the partners shall remain fixed except in extraordinary circumstances. Under this method, two accounts viz., a Capital Account and a Current

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

ii) As per Fixed Capital Method:

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

Date	Particulars	J.F.	A	B	Date	Particulars	J.F.	A	B
31 Dec	To, Balance c/d		2,00,000	1,00,000	1 Jan 1 Jan	By Balance b/d ,, Salary A/c		2,00,000 12,000	1,00,000 9.600
			2,00,000	1,00,000				2,00,000	1,00,000

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

Date	Particulars	J.F.	A	B	Date	Particulars	J.F.	A	B
1 Jan	To, Balance b/d			2,000	1 Jan	By Balance b/d		5,000	
1 Jan to 31 Dec	To Drawings		25,000	20,000	1 Jan to 31 Dec	,, Salary A/c		12,000	9,600
						,, Commission			4,000
			2,17,000	1,08,600		,, Profit and loss			
31 Dec	To Balance c/d		22,000	6,600	Dec. 31	Appropriation A/c (share of profit)		30,000	15,000
			47,000	28,600				47,000	28,600

Note: Interest on partner's loan is neither recorded in partner's Capital Account nor in partner's Current Account. It is infact recorded to partner;s loan A/c. The question is silent about interest on capital and drawings hence no treatment is made here. Interest on partner's capital and drawings and its accounting treatment is discussed in the later pages.

7.7 DISTINCTIONS BETWEEN FIXED AND FLUCTUATING CAPITAL ACCOUNTS

Basis	Fixed Capital Account	Fluctuating Capital Account
No. of Accounts	Under this method two accounts are maintained for each partner viz., Capital Account and Current Account.	Only Capital Account for each partner is maintained under fluctuating capital account method.
Change in capital	Capital is unchanged from year to year.	Capital is changed from period to period.

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

and Loss Account is made where all the above transactions is to be shown and this extention of Profit and Loss Account is known as Profit and Loss Appropriation Account.

Features of Profit and Loss Appropreation Account:

i) It is prepared just after the completion of Profit and Loss Account.
ii) It is only prepared by partnership firm and Joint Stock companies.
iii) Preparation of this account is solely depends on partnership agreement and Partnership Act, 1932.

Distinctions between Profit and Loss Account and Profit and Loss Appropriation Account:

Profit and Loss Account	**Profit and Loss Appropriation Account**
It is prepared after Trading Account.	It is prepared after the preparation of Profit and Loss Account.
Profit and Loss Account starts with the gross profit or loss disclosed by Trading Account.	Whereas Profit and Loss Appropriation Account starts with net profit or loss disclosed by Profit and Loss Account.
It is prepared to ascertain net profit earned or loss suffered by the firm during the year.	It is prepared to share net profit or loss (as the case may be) among the partners.
The preparation of Profit and Loss Account is not based on partnership agreement except for interest on loan from partners.	The preparation of Profit and Loss Appropriation Account is completly based on partnership agreement.

7.9 INTEREST ON CAPITAL

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 interest on capital is to be allowed as per agreement, it should be calculated with

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.

- When a fixed amount is withdrawn at the end of each month, interest will be calculated at the agreed rate for an average period of $5\frac{1}{2}$ months on the total amount withdrawn.
- When a fixed amount is withdrawn at the begining of each quarter, interest will be calculated at the agreed rate for $7\frac{1}{2}$ months on the total amount withdrawn.
- When a fixed amount is withdrawn at the end of each quater, interest will be calculated at the agreed rate for $4\frac{1}{2}$ months on the total amount withdrawn.
- When a fixed amount is withdrawn at the beining of each half year then interest will be calculated on the total amount withdrawn for an average period of 9 months.
- When a fixed amount is withdrawn at the end of each half year then interest will be calculated on the total amount withdrawn for an average period of 3 months.

Example 2: On 1st Jan x and y started a partnership business with capital of Rs. 40,000 each sharing profits and losses equally. They are entitled to interest on capital @ 5% p.a. Profit for the year before charging up interest on capital amounted to Rs. 16,000.

Pass journal entries for interest on capital and distribution of profits at the end of the year where capital of the partners are (i) Fixed and (ii) Fluctuating.

Solution:

Where the capitals of the partners are fluctuating

Journal Entries in the books of the firm

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

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
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)				

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

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 Current A/c			
x = ½ of 12,000 = 6,000			
y = ½ of 12,000 = 6,000			
	12,000		
	16,000		16,000

Example 3: Arun and Barun started business on 1st Jan. 2014 with capital of Rs. 40,000 and Rs. 20,000 respectively. They agreed to share profits and losses in the ratio of 3 : 2. They are allowed interest on capital @ 10% p.a. and interest on drawings @ 6% p.a. Arun also advanced a loan of Rs. 10,000 to the firm on 1st June 2014.

During the year Arun withdrew Rs. 1000 p.m. in the begining of every month, whereas Barun withdrew Rs. 1000 p.m. at the end of each month.

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 $\frac{7}{12}$)	350
			20, 005
To Partner's Current A/c		**By Interest on drawings**	
x = $\frac{3}{5}$ x 14,770 = 8862		Arun = 390	
y = $\frac{2}{5}$ 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

· Interest on drawings = 12,000 x 6% x $\frac{6.5}{12}$ = Rs. 12,000

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

· Interest on drawings = 12,000 x 6% x $\frac{5.5}{12}$ = 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.

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

Date	Particulars	J.F.	Arun	Barun	Date	Particulars	J.F.	Arun	Barun
1 Jan	To Balance B/d		12,000	12,000	1 Jan	By Balance b/d		40,000	20,000
to					1 Jan	,, Interest, on		4,000	2,000
31	To Interest on		390	330	to	capital, A/c			
Dec	drawings A/c				31	,, Profit and Loss			
31					Dec.	Appropriation A/c		8,862	5,908
Dec	To Balance c/d		40,472	15,578	31				
			52,862	27,908	Dec.			52,862	27,908
					1 Jan	By balance b/d		40,472	15,578



CHECK YOUR PROGRESS

Q.5: State two differences between profit and loss Account and Profit and loss Appropriation Account.

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7.11 LET US SUM UP

In this unit we have discussed the following aspects–

- The partnership is a form of business carried on by the partners;
- The partners have agreed to share the profits or loss of the business;
- The partnership firm has no separate legal existence apart from the partners;
- The risk of the business is shared by the partners;
- The liability of the partners is unlimited;
- The agreement on the basis of which partners carry on the business is known as partnership deed.

- 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

may be either oral or written. The document contains the terms and conditions, agreed by the partners is called partnership deed.

Ans. to Q. No. 2: The advantages of partnership business are–

i) It is quite easy to start a partnership firm because, registration of a firm is not compulsory.

ii) The business risk is shared by all the partners. Hence in case of loss, burden will be comparatively less.

The disadvantages of partnership business are–

i) The liability of the partners are unlimited. Even their private property can be attached for the payments of the debt of the firm.

ii) In case of large- scale business or industry the limited resources of the partners may not be sufficient.

Ans. to Q. No. 3: Fixed capital means where capital of the partners shall remain fixed except in extraordinary circumstances. Under this method, two accounts viz., a Capital Account and a Current 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.

Ans. to Q. No. 4: 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.

Ans. to Q. No. 5: i) Profit and Loss Account is prepared after Trading Account. Profit and Loss Appropriation Account is prepared after the preparation of Profit and Loss Account.

ii) Profit and Loss Account starts with the gross profit or gross loss disclosed by Trading Account.

Profit and Loss Appropriation Account starts with net profit or net loss disclosed by Profit and Loss Account.



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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UNIT 8: PARTNERSHIP-II

UNIT STRUCTURE

8.1 Learning Objectives

8.2 Introduction

8.3 Meaning of Admission of a Partner in a Partnership Business

8.4 Matters Requiring Attention on the Reconstitution of Partnership

8.5 New Profit Sharing Ratio on Admission of a Partner

8.6 Meaning of Retirement of Partner

8.7 New Profit Sharing Ratio and Gaining Ratio on Retirement of a Partner

8.8 Differences between Sacrificing Ratio and Gaining Ratio

8.9 Accounting Treatment of Goodwill at the Time of Retirement of Partner

8.10 Revaluation of Assets and Liabilities

8.11 Let Us Sum Up

8.12 Further Reading

8.13 Answers to Check Your Progress

8.14 Model Questions

8.1 LEARNING OBJECTIVES

After going through this unit, you will able to-

- discuss the meaning of admission of a partner in a partnership firm
- calculate the new profit sharing ratio at the time of admission of a partner
- discuss the meaning of retirement of a partner from a partnership firm
- calculate the new profit sharing ratio at the time of retirement of a partner
- differentiate between sacrificing ratio and gaining ratio
- discuss the accounting treatment of goodwill at the time of retirement of partner
- explain the revaluation of assets and liabilities.

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 :

A) Admission of a New Partner: Admission of a partner means admitting a new person as a partner of the partnership firm. The new partner brings additional capital which helps in expansion of the business.

B) Retirement of a Partner: Whenever a partner due to his ill health or old age or any other reason decides to end up his relationship with firm, retirement of a partner takes place.

C) Death of a Partner: When a partner dies, it brings about a change in the relationship among the continuing partner. The profit sharing ratio of the existing partners will change and therefore the reconstitution will take place.

D) Amalgamation of Firms: When a partnership firm merge with another partnership firm or a sole trading firm and forms a new partnership firm. It is called amalgamation of firms. It leads to reconstitution of partnership. In this unit we will focus our discussion on the admission of a new partner.

8.4 MATTERS REQUIRING ATTENTION ON THE RECONSTITUTION OF PARTNERSHIP

- **Valuation of Goodwill:** The established popularity of a business is known as goodwill. When there is a change in the existing profit sharing ratio, it enables some partners to gain while others may sacrifice in their profit sharing ratio. In such a situation the amount of compensation paid by the partners who gains is known as goodwill. In case of partnership business the need for valuation of goodwill arises:
  - i) When there is a change in profit sharing ratio of existing partners.
  - ii) On the admission of a new partner.
  - iii) On the retirement or death of a partner.
  - iv) When two or more firms are amalgamated.
  - v) When the business is dissolved.
  - vi) When the business is sold.
  - vii) When the partnership firm is converted into limited company.

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 = $\frac{1}{5}^{th}$

- Remaining share = $= 1 - \frac{1}{5} = \frac{5 - 1}{5} = \frac{4}{5}^{th}$
- The remaining share $\frac{4}{5}$ will be shared by Arun and Barun in their old ratio i.e., 4 : 1
- Arun's new share = $\frac{4}{5}$ of $\frac{4}{5} = \frac{16}{25}$
- Barun's new share = $\frac{1}{5}$ of $\frac{4}{5} = \frac{4}{25}$
- Tarun's share = $\frac{1}{5} \times \frac{5}{5} = \frac{5}{25}$
- 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.

Example 2: Arun and Barun are partners sharing profits and losses in the ratio of 4 : 1. They admited Tarun as a new partners for $\frac{3}{10}^{th}$ share, which he acquired $\frac{2}{10}^{th}$ from Arun and $\frac{1}{10}$ from Barun, Calcutate the new profit sharing ratio.

Solution: Arun's old share = $\frac{4}{5}$

∴ Arun's new share = $\frac{4}{5} - \frac{2}{10} = \frac{8-2}{10} = \frac{6}{10}$

Barun's old share = $\frac{1}{5}$

∴ Barun's new share = $\frac{1}{5} - \frac{1}{10} = \frac{2-1}{10} = \frac{1}{10}$

and Tarun's share = $\frac{3}{10}$

∴ New profit and loss ratio between Arun : Barun : Tarun = 6 : 1 : 3

Situation No. 3: When the existing partners surrender a fraction of their share for the new partners.

Example 3: Arun and Barun are partners sharing profits and losses in the ratio of 4 : 1. Arun surrender $\frac{1}{4}^{th}$ of his share and Barun surrendered $\frac{1}{3}^{rd}$ of his share in fovour of Tarun who is a new partner. Calculate the new profit sharing ratio.

Arun surrendered = $\frac{1}{4}$ of $\frac{4}{5} = \frac{4}{20}$

∴ Arun's new share = $\frac{4}{5} - \frac{4}{20} = \frac{16-4}{20} = \frac{12}{20}$

Barun surrendered = $\frac{1}{3}$ of $\frac{1}{5} = \frac{1}{15}$

∴ Barun's new share = $\frac{1}{5} - \frac{1}{15} = \frac{3-1}{15} = \frac{2}{15}$

and Tarun's share = $\frac{4}{20} + \frac{1}{15} = \frac{12+4}{60} = \frac{8}{60}$

∴ New profit sharing sharing ratio among Arun : Barun : Tarun

$= \frac{12}{20} : \frac{2}{15} : \frac{8}{60} = \frac{36}{60} : \frac{8}{60} : \frac{8}{60}$

= 9 : 2 : 2

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.



CHECK YOUR PROGRESS

Q.1: What is meant by retirement of a partner?

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8.7 NEW PROFIT SHARING RATIO AND GAINING RATIO ON RETIREMENT OF A PARTNER

After the death or retirement of a partner the remaining partners will share the profit or loss of the partnership firm in the new profit sharing ratio. The calculation of new profit sharing ratio of the remaining partners depends upon the following situation:

a) The remaining partners may strike out the share of the retiring or deceased partner and find out the ratio of the continuing partner.

Example 1: Q. R and S are partners in a firm sharing profits as 3 : 2 : 2. S retires. A scertain the new profit sharing ratio of the remaining partners.

Solution: Since, nothing has been mentioned about the new profit sharing ratio of the remaining partners, therefore Q and R will share profits or losses in the same ratio as between themselves.

∴ The new profit sharing ratio between Q an R = 3 : 2

b) The continuing partners may agree to share the retiring or deceased partner's share in an agreed proportion.

Example 2: Q, R and S are partners in a firm sharing profits as 2 : 2 : 3. S retires and his share was taken up by Q and R in the ratio of 2 : 1. Calculate the new profit sharing ratio.

Solution :

Q gains = $\frac{2}{3}$ of $\frac{3}{7} = \frac{2}{7}$ = see copy

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

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

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

∴ 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

∴ Gaining ratio = New ratio – Old ratio

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

$$z = \frac{4}{9} - \frac{1}{3} = \frac{4 - 3}{9} = \frac{1}{9}$$

∴ Gaining ratio = 2 : 1



ACTIVITY 8.1

A, B and C are partners sharing profits and losses in the ratio of 2 : 2 : 1. B retires and A and C decided to share future profits and losses in the ratio of 4 : 1. Calculate gaining ratio.

8.8 DIFFERENCES BETWEEN SACRIFICING RATIO AND GAINING RATIO

The differences between sacrificing ratio and gaining ratio are discuss below:

	Basis	Sacrificing ratio	Gaining ratio
1.	Meaning	It is the ratio in which the old partners agreed to sacrifice their share of profit in favour of incoming partner.	It is the ratio in which the remaining partners acquires the share of retired/ deceased partner.
2.	Situation	It is calculated at the time of admission of a new partner.	It is calculated at the time of retirement or death of an existing partner.
3.	Objective	It is calculated to determine the amount of compensation to be paid by the incoming partner to the existing partners who have sacrificed their share of profit in fovour of him.	It is calculated to determine the amount of compensation to be paid by the remaining partners to the retired or deceased partner.
4.	Method of Calculation	It is calculated by deducting new profit sharing ratio from old profit sharing ratio.	It is calculated by deducting old profit sharing ratio from new profit sharing ratio.

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

	(Being gain on revaluation of machinery and creditors credited to revaluation account)			
	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 capital A/c in old profit sharing ratio)			

When the assets and liabilities are to be shown in the books at the old values even after revaluation.

Example 6: A. B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. A retires and the value of machinery of Rs. 60,000 was valued at Rs. 80,000, while creditors and stock, decreased by Rs. 2000 and Rs. 4,000 respectively. B and C decided to show the assets and liabilities at their original values in the books.

Pass necessary journal entries for the above.

Solution:

Journal entries in the books of the firm

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
	Memorendum			
	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 Memorandum Revaluation A/c			22,000
	(Being gain on revoluation of machinery and creditors credited to revaluation account)			

	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.

Sharing of Profit/Loss upto the Date of Retirement/Death: When a partner retires or dies on the closing day of an accounting year than the profit / loss of that year has been adjusted into the capital accounts of the partners. But, if the partner retires or dies in any day within the accounting year, then profit / loss from the date of last balance sheet to the date of his / her retirement / death is calculated.

Adjustment of Capital: Sometimes after retirement or death of a partner the remaining partners may decide to adjust their capital in proportion to their new profit sharing ratio. In that case, each partner's capital is to be calculated first on the basis of his new profit sharing ratio and the amount of shortage in capital , if any, is paid by the partners to the firm and if there is any surplus in the capital, the same is paid to the partner.

Payment of the Amount due to the Retiring Partner or Executor of the Deceased Partner: When the amount due to the retiring partner or deceased partner is ascertained after all adjustments, it can be settled in any of the following ways:

a) Full payment in cash

b) The amount due may be treated as a loan to the firm and the firm may pay intirest at a fixed rate according to the terms of agreement. But in the absence of an agreement the retiring partner or the executor of the deceased partner is entitled to interest @ 6% p.a. till the loan is paid off.



CHECK YOUR PROGRESS

Q.3: State any two differences between sacrificing ratio and gaining ratio.

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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 READINGS

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.



8.13 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: When a 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. In case of retirement the existing partnership firm is legally dissolved and the remaining partners may agree to form a new partnership firm immediatly after such retirement of the partner.

Ans. to Q. No. 2: X's gain $= \frac{2}{5} \times \frac{1}{2}$

$= \frac{2}{10} = \frac{1}{5}$

Z's gain $= \frac{2}{5} \times \frac{1}{2}$

$= \frac{2}{10} = \frac{1}{5}$

X's new share $= \frac{2}{5} + \frac{1}{5}$

$= \frac{2+1}{5} = \frac{3}{5}$

Z's new share $= \frac{1}{5} + \frac{1}{5}$

$= \frac{1+1}{5} = \frac{2}{5}$

∴ New Ratio of X and Z is 3 : 2

Ans. to Q. No. 3: i) Sacrificing ratio is the ratio in which the old partners agreed to sacrifiec their share of profit in favour of incoming partner.

Gaining ratio is the ratio in which the remaining partners acquires the share of retired or deceased partner.

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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UNIT 9: TRIAL BALANCE

UNIT STRUCTURE

9.1 Learning Objectives

9.2 Introduction

9.3 Concept of Trial Balance

9.4 Objects of Trial Balance

9.5 Format of a Trial Balance

9.6 Preparation of Trial Balance

9.7 Illustrations

9.8 Limitations of Trial Balance

9.9 Let Us Sum Up

9.10 Further Reading

9.11 Answers to Check Your Progress

6.12 Model Questions

9.1 LEARNING OBJECTIVES

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

- explain the concept of trial balance
- discuss the objects of trial balance
- explain the format of trial balance
- prepare trial balance
- analyse the limitations of trial balance.

9.2 INTRODUCTION

You are aware that whenever a transaction takes place, it is first recorded in journal, and then it is posted in ledger. After that all ledger accounts are balanced. We have discussed these topics in the 1st Year 'Accountancy' course.

In this unit, we will discuss trial balance, which is prepared after balancing all the ledger accounts. Trial balance is a statement which is prepared with the ledger balances. Trial balance helps in detecting the

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

as entered in the journal. After balancing the accounts in the ledger book, when all closing balances are placed in trial balance, then debit side and the credit side of the trial balance becomes equal. If debit side and the credit side of the trial balance become equal, it implies that journalising and ledger posting are arithmetically correct.



CHECK YOUR PROGRESS

Q.1: What is trial balance? (Answer within 50 words)

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9.4 OBJECTS OF TRIAL BALANCE

The main objectives of preparing trial balance may be discussed as under–

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.

c) To Detect Errors: Trial balance helps in detecting and locating some of the errors that may have been committed in journalising the transactions and while posting them into ledger or balancing the ledgers or while preparing the trial balances itself.

d) To Summarise the Financial Transactions: Trial balance helps in summarising the business transactions. As the business transactions are recorded in the journal book date-wise and these are posted

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.

Credit Amount Column: In this column, the credit amount of the particular ledger is written.

9.6 PREPARATION OF TRIAL BALANCE

The trial balance is an important statement that is prepared in order to prepare the final accounts. Trial balance contains balances of all ledger accounts, which may be related to incomes, expenses, assets, liabilities and capital of the business. The trial balance is generally prepared at the end of the accounting period. However, an organisation may prepare its trial balance monthly, quarterly, half yearly.

There are two different methods to prepare trial balance which we will discuss in this section. Let us first go through the steps of preparing the trial balance.

The preparation of trial balance involves the following steps:

- 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 other hand, the ledgers which show credit balances will be put on the credit side of the trial balance with the respective amounts;
- The debit amount column and the credit amount column of the trial balance will be calculated;
- If both the columns show the same results, the trial balance is complete.

In the course 'Accountancy-I' in BPP 1st Year, we have discussed in detail the preparation of ledgers in Unit 6. To recapitulate it, the journal entries are posted from the journal book in the respective ledgers maintained in the ledger book. The accounts which have been debited in journal will be posted on the debit side of that particular ledger and the account which have been credited in the journal will be recorded in 'Particulars' column as– "To ... ... (Name of the Account Credited). For example, for the transaction- Goods purchased for Rs. 5, 000 from XY Co. on credit, will be recorded in journal as–

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–

Trial Balance of ..... as on .....

Account Heads	L.F.	Debit (Rs.)	Credit (Rs.)
Purchase	–	5, 000	
XY Co.	–		5,000
–	–		
–	–		
–	–		
–	–		
Total		5,000	5, 000

Let us move to the next important topic i.e. the different methods of preparing trial balance.

In general, trial balance can be prepared in any of the following methods–

- Total or Gross Trial Balance;
- Net or Balance Trial Balance.

  Now we will discuss these three methods–

- **Total or Gross Trial Balance:** Under this method, the steps followed for the preparation of trial balance are stated below-
  - The amount columns of each ledger and the cash book is totalled up;
  - A list is prepared by placing the names of the ledgers along with two amount columns - one for debit amounts and the other for the credit amounts;
  - The debit total and the credit total of each ledger is put in the debit amount column and the credit amount column against the names of the accounts in the list;
  - The amount columns are added up separately to ascertain whether the columns agree or not.

  This method is not generally followed in practice.
- **Net or Balance Trial Balance:** Under this method, the steps followed for the preparation of trial balance are as under-
  - Each ledger account and the cash book is balanced at the end of a certain period;

- 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	–	✓	

Creditors	–		✓
Bills Receivable	–	✓	
Bills Payable	–		✓
Plant and Machinery	–	✓	
Furniture	–	✓	
Land and Buildings	–	✓	
Cash in Hand	–	✓	
Cash at Bank	–	✓	
Carriage Inward	–	✓	
Carriage Outward	–	✓	
Sales Return	–	✓	
Purchase Return	–		✓
Salaries	–	✓	
Wages	–	✓	
Insurance	–	✓	
Rent paid	–	✓	
Rent received	–		✓
Bad Debt	–		✓
Total		XXX	XXX

Illustration 1: The following ledger balances are extracted from the books of Mr. X as on 31st December, 2014. Prepare a trial balance.

Ledger	**Amount (Rs.)**
Machinery	5,000
Building	7,000
Capital	25,000
Purchases	10,000
Sales	5,000
Salaries	3,000
Rent paid	2,000
Advertisement Expenses	3,000

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

Solution:

Account Heads	L.F.	Debit (Rs.)	Credit (Rs.)
Wages	–	10,000	
Furniture	–	70,000	
Cash in hand	–	25,000	
Interest received	–		10,000
Sales return	–	5,000	
Carriage inward	–	3,000	
Debtors	–	24,000	
Discount allowed	–	3,000	
Sales	–		1,00,000
Discount received	–		10,000
Bills payable	–		20,000
Total		1,40,000	1,40,000



ACTIVITY 9.1

Prepare a trial balance from the following information in the books of Mr. Y as on 31-12-2014.

Ledger	Amount (Rs.)
Salaries	7,000
Wages	3,000
Creditors	20,000
Printing expenses	5,000
Sales	50,000
Sales Returns	5,000
Purchases	50,000
Purchases Returns	6,000
Interest paid	2,000
Bills Receivable	4,000



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–

Journal

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

While recording the transaction, if the book-keeper does not record the transaction in the books at all, it is the error of complete omission. This type of error will not affect the trial balance. On the other hand, if the book-keeper records only one aspect of the transaction, say, the Purchase aspect, then it is the error of partial omission.

- **Errors of Commission:** Error of commission may take place on account of incorrect posting, incorrect additions, wrong balancing of accounts etc. These types of errors affect the trial balance. However, wrong entry in original record and will not affect the trial balance. For example, if a credit sale of goods to Rakesh amounting to Rs. 2,000 is recorded in the books as Rs. 200 against Purchase account and Rakesh account, it will not affect the trial balance. Similarly, posting to wrong head of account will not affect the trial balance. Let us take the above example. If the book- keeper posted the above transaction to Purchase account and Rahim account instead of Rakesh Account, then the trial balance will not be able to detect that error. This error will increase the credit balance of Rahim but will trial balance will not be affected. This is because both Rakesh and Rahim are the creditors and their accounts appear on the credit side of the trial balance.
- **Errors of Principle:** This type of error occurs due to non-compliance of double entry principle in recording the transactions. Errors of principle will affect the financial statements but the trial balance will not be affected. For example, if the rent paid to the landlord is wrongly debited to landlord account instead of rent account, it is an error of principle but there will be no impact on trial balance.

- **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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9.9 LET US SUM UP

In this unit we have discussed the following aspects–

- Trial balance contains the balances of ledge accounts;
- It ensures that no journal entry is left without posting it to the respective ledger and no ledger remains unbalanced;
- The different objects of trial balance like, testing of arithmetical accuracy, ensuring the recording of two aspects of a transaction, detecting the accounting errors, summarising financial transactions, facilitating the preparation of final accounts.
- The steps involved 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 other hand, the ledgers which show credit balances will be put on the credit side of the trial balance with the respective amounts;
  - The debit amount column and the credit amount column of the trial balance will be calculated;
  - If both the columns show the same results, the trial balance is complete.
- The methods of preparation of trial balance like, total or gross trial balance and net or balance trial balance.
- The different types of errors which can not be detected by trial balance are– Errors of Omission; Errors of Commission; Errors in Principle; Compensating Errors; Duplicating Errors.



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

other hand, the ledgers which show credit balances will be put on the credit side of the trial balance with the respective amounts;

- The debit amount column and the credit amount column of the trial balance will be calculated;
- If both the columns show the same results, the trial balance is complete.

Ans. to Q. No. 4: Trial Balance

Account Heads	L.F.	Debit (Rs.)	Credit (Rs.)
Machinery	–	10,000	
Building	–	20,000	
Capital	–		50,000
Purchase	–	20,000	
Sales	–		14,000
Salaries	–	5,000	
Rent Paid	–	5,000	
Advertisement Expenses	–	4,000	
Total		64,000	64,000

Ans. to Q. No. 5: The different types of errors are– Errors of Omission; Errors of Commission; Errors in Principle; Compensating Errors; Duplicating Errors.



9.12 MODEL QUESTIONS

Q.1: What is trial balance?

Q.2: Discuss the steps involved in the preparation of trial balance.

Q.3: Discuss the objects of trial balance.

Q.4: Discuss the limitations of trial balance.

Q.5: What are the different types of errors that can not be disclosed by trial balance?

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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UNIT 10: PREPARATION OF FINAL ACCOUNTS

UNIT STRUCTURE

10.1 Learning Objectives

10.2 Introduction

10.3 Meaning of Final Accounts

10.4 Trading Account

10.5 Profit and Loss Account

10.6 Balance Sheet

10.7 Let Us Sum Up

10.8 Further Reading

10.9 Answers to Check Your Progress

10.10 Model Questions

10.1 LEARNING OBJECTIVES

After going through this unit you will be able to:

- explain the meaning of Final Accounts
- explain the meaning of trading, profit and loss account and balance sheet
- prepare the trading, profit and loss account and balance sheet.

10.2 INTRODUCTION

In the earlier unit, we have discussed the preparation of trial balance. The preparation of trial balance facilitates the preparation of final accounts. In this unit we will discuss about trading account, profit and loss account and balance sheet which together are called final accounts. After going through the illustrations of this unit you will come to know the process of preparation of final accounts.

10.3 MEANING OF FINAL ACCOUNTS

Preparation of Final Accounts is the final stage of accounting function in a business entity. After the trial balance and necessary rectification of errors or omissions in the recording stages, i.e. Journal and

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.

10.4 TRADING ACCOUNT

Immediately after completion of trial balance, results of business transactions can not be known. This is why necessary final statements and accounts are prepared to ascertain– a) the profit or loss accruing from business operations and b) position of its assets and liabilities at the end of the financial year.

The first task is to prepare a **Trading account**. Trading account is prepared to measure the result of direct business operations by way of sale and purchase. Trading account shows gross profit or gross loss. Differences between sales and cost of goods sold is called gross profit or gross loss. While doing so, general distribution and administration expenses are not considered. When sales exceed cost of goods sold it results in gross profit and when cost of goods sold exceeds sales it results in gross loss. Specimen of Trading Account is given below:

Trading Account for the year ended

31st March … … … … 200...

Particulars	Rs.	Particulars	Rs.
To opening inventory			
To Purchase		By sales	
Less: Returns outward		Less: Returns inward	
To Carriage inward			
To Wages		By Closing inventory	
To Fuel			
To Gas and water			
To Freight			
To Power			
To Octroi duty			
To Excise duty			
To Import duty			
To Clearing Charges			
To Coal			
To Gross profit c/d			



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 Salaries		By Interest received	
To Salaries and Wages.		By Discount received	
To Rent		By Rebate received	
To Rates and taxes		By Commission received	
To Stationary and Printing.		By Dividend received	
To Postage, Telegrams and Telephones		By Profit on Sale of assets	
To General expenses		By Interest on Drawings	
To Office expenses		By Rent, Royalty etc. received	
To Lighting and electricity		By Bad debts recovered	
To Insurance of office		By Provision for discount on creditors	
To Trading expenses		By Miscellaneous incomes	
To Repairs and Renewals		By Net Loss, if any	
To Travelling expenses.			
To Carriage Outward			
To Audit fee			
To Bad debts			
To Law charges, Legal fees			
To Provision for Doubtful and bad debt			
To Provision for Depreciation			
To Distribution expenses			
To Provision for discount on Debtors			

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.

Marshalling of Balance Sheet: While presenting various assets and liabilities in the balance sheet of an entity we have to ascertain the order of presentation. Assets and liabilities for the purpose may be grouped into categories, namely– a) in order of liquidity and b) in order of permanence. By and large, current assets and current liabilities ought to be presented in order of liquidity. Current assets are held for converting into cash and cash equivalents within a period of one year. Likewise current liabilities are required to be repaid within one accounting year. Hence, they are influenced by the dictum of liquidity. Contrary to this, fixed assets are used in the business for a long period of time for generating income and creating utility. Non-current liabilities are undertaken for use over a relatively longer period of time and are not required to be repaid within one accounting year. The presentation of items may be done as follows—

Order of Liquidity

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

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

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.

Solution: The learners should ascertain the items that will be debited or credited in the Trading account first, then in the P/L account and then in which side of the Balance Sheet those will be shown. The following list may be helpful to you for this exercise—

Accounts	**Where will appear**	**To be Debited / Credited or To show in the Asset side / Liability side**
Cash	Balance Sheet	Asset side
Furniture	Balance Sheet	Asset side
Computer	Balance Sheet	Asset side
Insurance	P/L A/c	To be Debited
Wages	Trading A/c	To be Debited
Carriages inward	Trading A/c	To be Debited
Purchase	Trading A/c	To be Debited
Debtors	Balance Sheet	Asset side
Drawings	Balance Sheet	Liability side
Salary	P/L A/c	To be Debited
Creditors	Balance Sheet	Liability side
Sales	Trading A/c	To be Credited
Capital	Balance Sheet	Liability side
Commission received	P/L A/c	To be Credited
Bank Loan	Balance Sheet	Liability side

- If closing stock appears only in trial balance, it is shown only on the asset side of the balance sheet.
- If closing stock appears in adjustment, firtst it is credited in trading account and then it is shown on the asset side of the balance sheet.

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**

Balance Sheet of M/S ..... as on 31-03-15

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Capital	50,000		Cash	46,700
Add,			Furniture	11,000
Net Profit	50,200		Computer	42,000
	1,00,200			
Less, Drawing	12,000	88,200	Debtors	12,000
Bank Loan		12,500	Closing Stock	5,000
Creditors		16,000		
		1,16,700		**1,16,700**

Illustration 2: From the following trial balance of M/S ABC prepare–

Trading 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

Particulars	Debit Balance (Rs.)	Particulars	Credit Balance (Rs.)
Opening Stock	25,000	Creditors	40,000
Salaries	6,000	Sales	1,40,000
Insurance	400	Capital	25,000
Carriage Inward	1,700	Discount	100
Commission	4,400	Bills Payable	6,200
Stationery	2,300	Return outward	1,000
Purchases	75,000		
Return inward	3,200		
Rent & Taxes	2,000		
Bills Receivable	4,000		
Drawings	2,800		
Office Furniture	8,000		
Debtors	67,000		
Cash in hand	500		
Cash in Bank	10,000		
	2,12,300		**2,12,300**

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**

Profit and Loss Account of M/S ABC

for the year ended 31-03-15

Dr. **Cr.**

Particulars		**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Salary	6,000		To Gross Profit b/d	66,100
Add.: outstanding	200	6,200		
To Insurance	400		By Discount	100
Less: Prepaid	100	300		
To Commission		4,400		
To Stationery		2,300		
To Rent & Taxes		2,000		
To Depreciation on Furniture (10% on 8,000)		800		
To Provision for Doubtful debt (2% on 67,000)		1,340		
To Net Profit c/d (transfered to Capital)		48,860		
		66,200		**66,200**

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		

Particulars	Debit Balance (Rs.)	Particulars	Credit Balance (Rs.)
Purchases	1,50,000		
Rent & Taxes	4,000		
Bills Receivable	8,000		
Drawings	5,600		
X : 2,000 Y : 3,600			
Furniture	16,000		
Trade Expenses	4,500		
Debtors	60,000		
Cash in hand	1,000		
Cash at Bank	20,000		
Land & Building	83,500		
	4,41,100		**4,41,100**

Adjustments:

1) Closing Stock is valued at Rs. 30,000.
2) Prepaid rent Rs. 500
3) Furniture to be depreciated at 10%.
4) Provision for doubtful debt to be provided for Rs. 1,000 on Debtors.
5) Wages outstanding Rs. 5006.
6) Partners share profit in the ratio of 3 : 2.

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 of M/s X and Y

as on 31-03-15

Dr. **Cr.**

Liabilities		**Amount (Rs.)**	**Assets**		**Amount (Rs.)**
Capital			Land & Building		83,500
X :	30,000				
Add: Net Profit	37,560		Furniture	16,000	
	67,560		Less: dep :	1,600	14,400
Less: Drawing	2,000		Debtors	60,000	
		65,560	Less: Prov.	1,000	59,000
Y :	20,000		Closing Stock		30,000
Add: Net Profit	25,040				
	45,040		Cash in hand		1,000
Less: Drawing	3, 600				
		41,440	Cash at Bank		20,000
			Bills Receivable		8,000
			Prepaid rent		500
Creditors		80,000			
Bank Loan		20,500			
Bills Payable		8,400			
Wages outstanding		500			
		2,16,400			**2,16,400**



10.7 LET US SUM UP

In this unit we have discussed that–

- Final accounts consists of Trading account, Profit and Loss account and Balance Sheet.
- Trading account shows gross profit earned or gross loss suffered by a business firm during a particular period.
- Profit and loss account shows net profit earned or net loss suffered by a business firm during a particular period.

- 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?

*** ***** ***

UNIT 11: CONSIGNMENT ACCOUNT

UNIT STRUCTURE

11.1 Learning Objectives

11.2 Introduction

11.3 Concept of Consignment

11.4 Important Terms Related to Consignment Business

11.5 Features of Consignment

11.6 Advantages of Consignment

11.7 Distinctions between Consignment and Sale

11.8 Accounting for Consignment Business

11.9 Valuation of Unsold Stock

11.10 Meaning of Normal and Abnormal Loss

11.11 Differences Between Normal and Abnormal Loss

11.12 Consigning Goods at Invoice Price

11.13 Let Us Sum Up

11.14 Further Reading

11.15 Model Questions

11.1 LEARNING OBJECTIVES

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

- explain the concept of consignment business
- elaborate the features and advantages of consignments business
- differentiate between consignment business and sale
- ascertain the profit or loss on consignment business
- ascertain the value of closing stock/unsold stock
- differentiate between normal loss and abnormal loss.

11.2 INTRODUCTION

Now a days where there is stiff competition in the market, any business concern tries to capture more market for the business. The business may decide territorial expansion of business by crossing the local

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.

11.4 IMPORTANT TERMS RELATED TO CONSIGNMENT BUSINESS

In this section, we will discuss certain terms related to consignment business which will help you in gaining knowledge about the process of consignment business.

- **Consignor:** A consignor is a person, who forwards the goods to an outside agent for sale.
- **Consignee:** The trader/agent to whome goods are forwarded for sale is known as consignee.
- **Consignment Outward:** When goods are despatched by the consignor to the consignee for sale, such despatch of goods is known as consignment outward.
- **Commission:** It is the amount of remuneration given by the consignor to the consignee for sale of the consigned goods on behalf of the consignor in the outside market. Commission may be:
  - **Simple or General Commission:** It is a remuneration given by the consignor to the consignee for sale of the consigned goods.
  - **Special or Over-Riding Commission:** It is an extra commission allowed by the consignor to the consignee after attaining the targeted sales or effecting sales at a higher price.
  - **Del Credere Commission:** It is a type of commission allowed by the consignor to the consignee where the consignee agrees to bear any loss arising due to bad debt. Thus, the risk of bad debt is shifted from the consignor to the consignee with the payment of del credere commission.
- **Invoice:** It is a statement prepared by the consignor and sent to the consignee along with the goods despatched on consignment. In this statement information regarding the consigned goods such as price, quantity, quality, grade, weight, measurement, transport and other related expenses are mentioned.
- **Accounts Sale:** It is a statement prepared and sent by the consignee to the consignor either on the completion of sale of the consigned

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,

purchasing power etc. of the customers of the locality. It will help the consignor to take various decisions without any cost in respect of market research.

11.7 DISTINCTIONS BETWEEN CONSIGNMENT AND SALE

The points of distinctions between consignment and sale are mentioned below :

i) **Ownership of Goods:** In case of consignment, ownership of the goods rests with the consignor till the time they are sold by the consignee. But in case of sale, the ownership of the goods transfers from the seller to the buyer as soon as the contract for sale is completed.

ii) **Right to Return:** In case of consignment, the consignee can return the unsold goods to the consignor if he finds that the goods are not marketable. On the other hand, the buyer cannot return the goods in case of sale as he is the owner unless otherwise agreed upon.

iii) **Transfer of Risk:** As the ownership of the goods is not transfered in consignment, hence any loss arising from holding, transmitting or disposing off the goods lies with the consignor. But in case of sale, any risk arising from the purchase will be borne by the purchaser as he is the owner of the goods.

iv) **Relationship:** The relationship between the consignor and the consignee is that of a principal and agent. Whereas the relationship between the seller and the buyer is that of a creditor and a debtor.

v) **Price of Goods:** Consignor sends goods to the consignee either at cost price or at invoice price. On the other hand, goods are sold at selling price only.

Exercise 11.1

On 1st January 2016 KPT electronics of Kharupatia sent 1500 calculators costing Rs. 120 each on consignment basis to Tezpur electricals with the following terms :

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:

200 stoves @ Rs. 500 each = Rs. 1,00,000
250 stoves @ Rs. 600 each = Rs. 1,50,000
450 = Rs. 2,50,000
Ans.: Total commission payable Rs. 13,750

11.8 ACCOUNTING FOR CONSIGNMENT BUSINESS

Both consignor and consignee records the transaction of their consignment business in their own set of books. The consignor records the transactions in order to ascertain the profit or loss arising from the consignment business and to ascertain the amount due from the consignee. Therefore, the consignor usually maintains the following four accounts :

a) Consignment Account
b) Consignee's Personal Account
c) Goods sent on consignment Account
d) Stock on consignment Account.

The journal entries in the books of consignor are given below:

i) At the time of sending the goods:

a) **For sending goods–**

Consignment to ..... A/c Dr.
To Goods sent on consignment A/c

b) **For expenses incurred on sending the goods–**

Consignment to ..... A/c Dr.
To Cash / Bank / Creditors A/c

ii) At the time of receipt of advance:

a) **For receipt of cheque/draft/bill–**

Bank / Bills Receivable A/c Dr.
To Consignee A/c

b) **For discounting the bill–**

Bank / Discount on bills discounted A/c Dr.
To Bills Receivable A/c

c) **For transfer of amount of discount–**

Profit and loss / Consignment to ..... A/c Dr.
To Discount A/c

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 /

due to the consignor / amount of advance carried forward by the consignor where a part of the goods sent has remained unsold.

Entries in the books of consignee:

i) At the time of payment of advance / acceptance given–

With the money paid as advance–

Consignor's A/c Dr.

To Bank / Bills Payable A/c

ii) On the date of incurring expenses –

Consignor's A/c Dr.

To Bank / Cash A/c

(with the amount of expenses)

iii) On the date of sales–

a) **With cash sales**

Bank / Cash A/c Dr.

To Consignor

b) **With credit sales–**

Consignment Debtors A/c Dr.

To Consignor

c) **With the cash realised from consignment debtors–**

Cash / Bank A/c Dr.

To Consignment Debtors A/c

iv) At the time of sending Account sales–

a) **For commission receivable from the consignor–**

Consignor Dr.

To Commission A/c

b) **For the money or draft sent to the consignor–**

Consignor Dr.

To Bank

Exercise 2: On 1st January 2015, Gautam of Guwahati sent 200 cases of a cosmetic item to Debu of Dibrugarh @ Rs. 400 each. Gautam paid Rs. 1200 for freight and Rs. 1800 for insurance. On 6th January 2015, Debu received the goods and sent Rs. 1, 000 as an advance to Gautam. On 7th March 2015 Gautam received an account sales alongwith a bank

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

7/3/15	Consignment to Dibrugarh A/c Dr. To Debu (1000 + 1200) (Being the expences on carriage and insurance incurred by Debu)		2,200	 2,200
,,	Consignment to Dibrugarh A/c Dr. To Debu (Being the commission payable @ 10% on total sales of Rs. 1,05,200)		10,520	 10,500
,,	Bank A/c Dr. To Debu (Being the balance amount due from the consignee received)		*82,480	 82,480
,,	Goods sent on Consignment A/c Dr. To Purchases A/c (Being the goods sent on consignment transfered)		80,000	 80,000
,,	Consignment to Dibrugarh A/c Dr. To, Profit and loss A/c (Being the profit on consignment transfered)		**9,480	 9,480

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

Solution:

Journal Entries in the books of

Debu (Consignee)

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
6/1/15	Gautam Dr. To Bank A/c (Being the amount paid as advance against consignment)		10,000	 10,000
7/3/15	Gautam (1000 + 1200) Dr. To Cash A/c (Being the carriage and insurance charges paid for consignment)		2,200	 2,200
,,	Bank Dr. To Gautam (Being the sale proceeds of 200 cases of goods on consignment)		1,05,200	 1,05,200
,,	Gautam (10% of 1,05,200 Dr. To Commission A/c (Being the commission earned on sale of goods on consignment)		10,520	 10,520
,,	Gautam Dr. To, Bank A/c (Being the balance amount due to Gautam, sent by bank draft No. ..... dated .....)		*82,480	 82,480

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

profit or loss on consignment could be ascertained. According to the principle of conservativeness the valuation of stock lying with the consignee is done either at cost price or at market price whichever is lower. Here cost price means cost of the goods plus all those direct expenses which are incurred both by the consignor and consignee to move the goods from the consignor's premises to consignee's premises. Some of the example of direct expenses are carriage, freight, custom duty, Octroi, loading and unloading expenses, reconditioning expenses etc. However, there may be some other expenses which are of recurring nature but do not increase the value of goods. Such expenses are known as indirect expenses which are not taken into consideration while valuing the unsold stock.

Exercise 11.2



On 1st January 2015, Jaganath Engineering Co. consigned 10 Geyser to M/s Geridhary and Sons of Kohima @ Rs. 10,000 each. Freight and carriage incurred by Jaganath. Engineering Co. were Rs. 8,500 and insurance Rs. 5,000. Jaganath Engineering Co. received an acceptance of Rs. 20,000 on 20th January from M/s Geredhary and Sons and the same was discounted at Rs. 19,800. On 30th April M/s Geridhary and Sons sent an account sales which showed the following information :

i) Sale of 8 Geyser @ Rs. 18,000 each
ii) Octroi duty Rs. 1,500
iii) Carriage Rs. 4,000
iv) Clearing charges Rs. 500
v) Godown rent Rs. 2,000
vi) Selling expenses Rs. 1,500
vii) Selling commission @ Rs. 1,500

Show consignment to Kohima Account and M/s Geridhary and Sons Account in the books of consignor at the end of the year 31st December 2015.

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

Calculation of value of unsold stock:

Original cost of 10 Geyser (10,000 x 10) = Rs. 1,00,000

i) Direct expenses of consignor–

Freight and carriage = 8,500

Insurance = 5,000 = Rs. 13,500

ii) Direct expenses of consignee–

Octroi duty = 1,500

Carriage = 4,000

Clearing charges = 500 = Rs. 6,000

∴ Cost of 10 Geyser to consignee = Rs. 1,19,500

∴ Value of 2 unsold geyser = $\frac{1,19,500}{10} \times 2$ = 23,900



ACTIVITY 11.3

Mr. Amar of Guwahati consigned 100 tins of powder milik to Mr. Budha of Silchar. Each tin costs Rs. 1000.

Mr. Amar incurred the following expenses :

Carriage Rs. 800, Freight Rs. 2,800

Mr. Budha incurred the following expenses :

Custom Duty Rs. 4,000, Octroi duty Rs. 1,000

Clearing charges Rs. 1,200, Carriage Rs. 200

Godown Rent Rs. 3,000, Salesman's salary Rs. 4,000

At the end of the year 20 tins remained unsold with Budha. The market value of each tin is Rs. 1,200. You are required to calculate the value of unsold stock with Budha.

Ans: Cost of 20 tins Rs. 22,000

Net realisable value Rs. 24,000

∴ Value of unsold stock = 22,000

11.10 MEANING OF NORMAL AND ABNORMAL LOSS

When the consignor send goods to consignee there is a possibility of loss of goods either in transit or in the godown of the consignee. Such loss may be classified into two categories :

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.

Exercise: Jyoti consigned 100 tins of powder milk each costing Rs. 300 to his agent Gautam. Jyoti paid Rs. 500 towards freight and insurance. 15 tins were destroyed by fire at the godown of Gautam.

Gautam spent Rs. 700 as godown rent and Rs. 1700 as clearing charges. 70 tins were sold by Gautam at Rs. 500 each.

Calculate the value of abnormal loss and the value of stock.

Solution: Calculation of value of abnormal loss–

Cost price of 15 tins @ Rs. 300 each = Rs. 4,500

(+) Proportionate direct expenses incurred = Rs. 75

by consignor $\left(\frac{500}{100}\times 15\right)$

(+) Proportionate diret expenses incurred = Rs. 255

by consignee $\left(\frac{1700}{100}\times 15\right)$

∴ Value of abnormal loss = Rs. 4,830

Calculation of value of abnormal loss–

Goods sent = 100 tins

(-) Abnormal loss = 15 ,,

= 85 ,,

(-) Goods sold = 70 ,,

∴ Unsold goods = 15 tins

Cost price of 15 tins @ Rs. 300 each = Rs 4,500

(+) Proportionate direct expenses incurred

by consignor $\left(\frac{500}{100}\times 15\right)$ = Rs. 75

(+) Proportionate direct expenses incurred

by consignee $\left(\frac{1700}{100}\times 15\right)$ = Rs. 255

∴ Value of unsold stock = Rs. 4,830

(Net Realisable value not given)

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

added with the cost price is known as loading. In other words, loading is the difference between the invoice price and cost price of the goods.

Unloading: In order to ascertain the actual profit or loss on consignment, the sale proceeds must be compared with the actual cost. Hence, the following items must be the actual cost. Hence, the following items must be suitably adjusted to arrive at the cost price. Thus this process of adjusting price to the cost price is known as unloading.

Methods of Calculation of Loading:

i) **Where both invoice price and cost price are given–** In this case loading is the difference between invoice price and cost price. For example, suppose the invoice price of the goods sent is Rs. 1,80,000 and cost price is Rs. 1,72,000, therefore, the loading is (Rs. 1,80,000 – Rs. 1,72,000) Rs. 8,000.

ii) **When the cost price is given and the invoice price is fixed as a certain percentage above the cost price–** In such case, the percentage itself is the loading. For exmple, if the cost price is Rs. 2,000 and the invoice price is 10% of the cost price, then the loading is Rs. 200.

iii) **When cost price is given and loading is fixed as a percentage on Invoice price–** Suppose the cost price is Rs. 2,000 and the goods are to invoiced at a profit of 20% on invoice price then the loading is to be calculated as follows:

Let, the invoice price = Rs. 100
Less loading = Rs. 20
∴ Cost price = Rs. 80

∴ The loading is $\frac{20}{80}$ or $\frac{1}{4}$ or 25% on cost.

∴ Loading = 25% of 2,000 = Rs. 500

iv) **When invoice price is given and loading is calculated of a certain percentage of cost price–** Suppose the invoice price is Rs. 2,000 and the loading is 25% on the cost price. Loading is calculated as follows:

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.

Solution:

In the books of Ganesh

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

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Goods sent on consignment A/c (200 x 500)		1,00,000		By Pallav (Sales) (160 x 500)		80,000
	To Cash A/c (freight and insurance)		3,600		By Goods sent on consignment A/c (load on goods sent)		20,000
	To Pallav (expenses)		3,500		By stock on consignment A/c		10,588
	To Pallav (commission) (10% of 80,000)		8,000		By Abnormal loss A/c		8,360
	To Stock Reserve A/c (load on closing stock)		2,000				
	To Profit & loss A/c		1,798				
			1,18,898				1,18,898

Dr. **Pallav A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Consignment to Sivsagar A/c		80,000		By Consignment to Sivsagar A/c		11,500
					Expenses 3,500		
					Commission 8,000		
					By Bank (remittance)A/c		68,500
			80,000				80,000

Pallav, the consignee paid Rs. 900 as clearing charges, Rs. 700 as carriage and selling expenses Rs. 1900. It was found that 20 boxes were lost in transit and the consignee was able to sell only 160 packets and sent a bank draft for the amount due

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)



11.13 LET US SUM UP

In this unit we have discussed the following aspects–

- In accounting, consignment means goods despatched by the owner to agent for the purpose of sale.
- The consignor gives commission to the consignee for sale of the consigned goods.
- An account sale is a statement prepared and sent by the consignee to the consignor, stating all details relating to the consignment business.
- The valuation of unsold stock is done either at cost price or at market price whichever is less.
- Normal loss is a type of loss which is natural, inherent and unavoidable.
- Abnormal loss is a type of loss which occurs due to carelessness accident or mischief.



11.14 FURTHER READING

1) Dam, B.B.; Sarda, R. A.; Barman, Ramen; Kalita, Bijoy (2006); *Theory and Practice of Accountancy*; Guwahati: Capital Publishing Company.
2) Das. K.R.; Singha, K. M.; Paulchoudhury, K. S.; Banik, G. G.; Chakraborty, D. (2006); *Accountancy* (Volume II); Guwahati: LBS Publications.
3) Grewal, T.S. (2007); *Introduction to Accountancy*; New Delhi: Chand and Co. Ltd.
4) Rao, Thukaram; *Advanced Accounting*; New Delhi: New Age International Publishers.
5) Sikidar, Dr. Sajit; Nath, Dr. Ghanshyam (2006); *Accountancy*; (Part II) Guwahati: Modern Publishers.



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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UNIT 12: JOINT VENTURE

UNIT STRUCTURE

12.1 Learning Objectives

12.2 Introduction

12.3 Meaning of Joint Venture

12.4 Features of Joint Venture

12.5 Advantages of Joint Venture

12.6 Distinction Between Joint Venture and Partnership

12.7 Distinction Between Joint Venture and Consignment

12.8 Accounting Treatment for Joint Venture

- 12.8.1 When Separate Set of Books are Maintained
- 12.8.2 When no Separate Set of Books are Maintained
- 12.8.3 When each Co-venturer Keeps Records of their own Transactions only

12.9 Let Us Sum Up

12.10 Further Reading

12.11 Model Questions

12.1 LEARNING OBJECTIVES

After going through this unit, you will able to:

- explain the meaning and features of joint venture
- discuss the adventages of joint venture
- differentiate between joint venture and consignment business
- differentiate between joint venture and partnership business.
- discuss the different methods of accounting treatment of joint venture.

12.2 INTRODUCTION

In unit 11 we have already discussed how various transactions related to the consignment business are recorded in the books of both consignor and consignee. In the previous unit, we have also learn how to

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.

12.5 ADVANTAGES OF JOINT VENTURE

Following are the advantages of joint venture business:

i) **Easy Establishment and Liquidation:** A joint venture business can be easily establish because it does not require any legal formalities. Further more, it gets automatically dissolved as soon as the venture is completed.

ii) **Low Cost of Establishment:** The establishment cost in case of this type of business is low as no permanent establishment is needed.

iii) **Combination of Capital and Skill:** It provides a combined plat form for the persons having capital combining together with persons having skill to perform a venture in order to earn maximum profit.

iv) **Spreading of Risk** The co-venturers agreed to share profits and losses arrising there of in an agreed ratio. Hence, it implies that the risk is also borne by them in the same manner.

v) **Actual Profit:** In joint venture, cash basis of accounting is adopted. Therefore, the profit earned or loss suffered in the business is actual.

12.6 DISTINCTION OF JOINT VENTURE WITH PARTNERSHIP

Joint venture differs from partnership in the following respects:

	Joint Venture	Partnership
1)	**Name** It is carried out without any name.	On the other hand a partnership business is pursued in the name of the firm.
2)	**Nature of entity** It is a temporary nature.	On the other hand a partnership business is a going concern.
3)	**Separate set of books** There is no need for a separate set of books. The accounts can	But in case of partnership business separate set of books

	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.

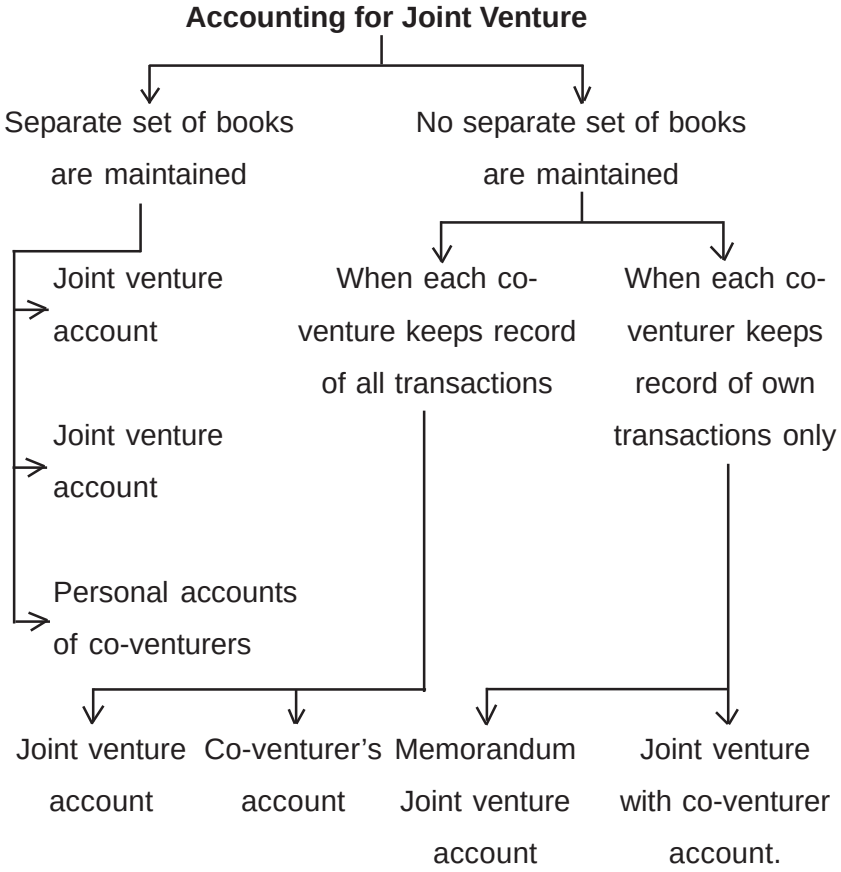
5)	**Capital contribution** Capital is contributed by all the co-ventures to carry out joint venture business.	On the other hand, the consignee does not contribute capital in a consignment business, as he just an agent.

12.8 ACCOUNTING TREATMENT FOR JOINT VENTURES

In order to ascertain the profits or losses of the venture and to settle the accounts with other co-venturers the co-venturers can maintain the accounts in any of the following two ways :

i) When separate set of books are maintained.

ii) When no separate set of books are maintained.



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	

3) When expenses are incurred for the venture–

Joint venture A/c Dr.

To, Joint Bank A/c

4) When goods are supplied by a venturer–

Joint venture A/c Dr.

To, Personal A/c (of the co-venturers)

5) When any expense on the joint venture is met by a venturer–

Joint Venture A/c Dr.

To, Personal A/c (of the co-venturer

6) When goods are sold in cash–

Joint Bank A/c Dr.

To, Joint Venture A/c

7) i) When goods are taken by one or more co-venturers on completion of the venture–

Personal A/c Dr. (of the co-venturers)

To, Joint Venture A/c

ii) When some goods are left unsold but the venture is continued and interism accounts are prepared–

Joint Venture Stock A/c Dr.

To, Joint Venture A/c

8) i) When there is a profit on joint venture–

Joint Venture A/c Dr.

To, Personal A/c (of the co-venturers)

ii) When there is a loss on joint venture–

Personal A/c Dr. (of the co-venturers)

To, Joint Venture A/c

9) Settlement of accounts of the co-venturers on the completion of the joint venture–

Personal A/c Dr. (of the co-venturers)

To, Joint Bank A/c

Exercise No. 1: Raj and Payal entered into a joint venture sharing profits and losses equally to construct a bike shed for Icon Com. College at an agreed amount of Rs. 2,00,000. On 1.1.15 they

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

	Joint Venture A/c Dr. To, Joint Bank A/c (70,000 + 12,000) (Being wages, carriage and other expenses paid for the venture)		82,000	 82,000
	Joint Bank A/c Dr. To, Joint Venture A/c (Being the agreed contract price received on completion of venture)		2,00,000	 2,00,000
	Joint Venture A/c Dr. To, Raj To, Payal (Being the profit on joint venture shared by the co-venturers equally)		45,000	 22,500 22,500
	Raj Dr. Payal Dr. To, Joint Bank A/c (Being the amount paid to the co-venturers on closure of the venture)			

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

Date	**Particulars**	**J.F.**	**Amount (Rs.)**	**Date**	**Particulars**	**J.F.**	**Amount (Rs.)**
1.1.15	To, Payal (materials supplied)		20,000		By Joint Bank A/c (contract price received)		2,00,000
,,	To, Raj (artihitects fees paid)		3,000				
	To, Joint Bank A/c (materials purchased)		50,000				
	To, Joint Bank A/c (Expenses paid)		82,000				

	To, Raj = 22,500 (½ of 4500) To, Payal = 22,500 (½ 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



ACTIVITY 12.1

A and B undertook jointly to construct a building for a contract price of Rs. 3,00,000. A joint bank account is opened. A paid into it Rs. 1,00,000 and B Rs. 50,000. The share profits or losses in the ratio of 2 : 1. The details of transactions made are given below :

Wages Rs. 80,000, Materials purchased Rs. 1,60,000, Materials supplied by A Rs. 10,000 and B Rs. 8,000, A paid architect's fees Rs. 4,000.

After the completion of contract, the price was duly received. Prepare joint venture account and capital accounts of A and B in separate books of the venture.

(**Ans:** Share of profit of A : Rs. 25,333, B : Rs. 12,667)

12.8.2 Whom no Separate Set of Books are Maintained

Under this system, each venturer maintains accounts independently for the venture transactions. Sometimes one of the co-venturers is entrusted with the work of recording the transactions of the joint venture against an extra commission. Usually, a co-venturer in whose place the venture is executed is entrusted with the work of recording transactions and the other co-venturers may take the venture as a form of investment. Such recording of transactions is called 'Recording at the place of Business', Thus, the following journal entries are passed in the books of the venturer in whose place the venture is executed–

i) For receipt of contribution from other co-venturers–

Bank / Cash A/c Dr.

To, Accounts of co-venturers

ii) For purchase of goods for the venture–

Joint Venture A/c Dr.

To, Cash / Bank A/c (if purchased on cash)

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

business. Ajoy incurred Rs. 4,000 as expenses and sold the goods on joint venture for Rs. 60,000. Ajoy is entitled to a commission of 5% on sales for his services. Ajoy sent a statement of the joint venture to Bijoy along with his balance. Pass journal entries and show joint venture account and other co-venturer account in the books of Ajoy.

Solution:

Journal Entries In the books of Ajoy

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
	Joint Venture A/c Dr. To, Cash A/c (Being the goods purchased for the venture in cash)		40,000	40,000
	Joint Venture A/c Dr. To, Purchases A/c (Being goods supplied for the joint venture from his own stock)		8,000	8,000
	Bank A/c Dr. To, Bijoy (Being the amount received from Bijoy)		30,000	30,000
	Joint Venture A/c Dr. To, Cash A/c (Being the expenses incurred on purchase)		4,000	4,000
	Cash A/c Dr. To, Joint Venture A/c (Being the sale proceeds)		60,000	60,000
	Joint Venture A/c Dr. To, Commission A/c (5% of 60,000) (Being commission on sales charged)		3,000	3,000

	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

Dr. **Bijoy A/c** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To, Bank A/c		32,500		By Bank A/c (Contribution)		30,000
					By Joint Venture A/c (Share of profit)		2,500
							22,500
			32,500				32,500



ACTIVITY 12.2

Ram and Sham entired into an agreement for joint venture sharing profits and losses in the proportion of 4 : 1 respectively. Ram supplied goods to the value of Rs. 5,400 and sham supplied goods to the value of Rs. 4,000. Sha, incurred expenses on purchase amounted to Rs. 400 and is entitled to a commission of 5% on sales. Amount realised on sales is Rs. 14,000. Sham settled Ram's account by sending a bank draft to him.

Prepare necessary ledger accounts in the books of sham.

(**Ans:** Profit on venture Rs. 3,500, Remittance to Ram Rs. 8,200)

12.8.3 When each Co-venturer Keeps Records of their Own Transactions

Under this method the venturers find if more convenient to keep record of their own transactions rather than keeping fall record of venture transactions. So, on completion of the venture, each co-venturer have to furnish information of the venture related to them and a combined record of all the transaction of all the co-venturers is prepared by opening a 'Memorandum Joint Venture Account' to determined the profit or loss on joint venture. Hence, this method is also known as 'Memorandum Method'. The following journal entries are to be passed : (in the books of each co-venturer)

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 ,,

j) For sattlement with the co-venturer–

If co-venturer has credit balance and if payment made:

Joint Venture with co-venturer A/c Dr.

To, Cash / Bank A/c

Or

If co-venturer has debit balance and if cash is received:

Cash / Bank A/c Dr.

To, Joint Venture with co-venturer A/c

Exercise 3: Preetam and Trideep were partners in a joint venture sharing profits and losses equally. Preetam supplied goods to the value of Rs. 500 and incurred expenses amounting to Rs. 60. Trideep supplied goods to the value of Rs 400 and his expenses amounted to Rs. 40. Trideep sold the entire goods on behalf of the joint venture and realised Rs. 1200. Trideep was entitled to a commission of 5% on sales. Trideep settled his account by a bank draft.

Pass journab entries and prepare co-venturer's account and memorandum joint venture account in the books of Preetom and Trideep.

Solution:

Journal Entries In the books of Preetam

Date	Particulars	L.F.	Amount Dr. (Rs.)	Amount Cr. (Rs.)
	Joint Venture with Trideep A/c Dr. To, Purchases A/c (Being goods supplied to joint venture)		500	500
	Joint Venture with Trideep A/c Dr. To, Cash A/c (Being expenses incurred on joint venture)		60	60

	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

	Bank A/c Dr. To, Joint Venyure with Preetam A/c (Being goods on joint venture sold for cash)		1,200	 1,200
	Joint Venture with Preetam A/c Dr. To, Commission (f% of 1200) A/c (Being commission on sales charged)		60	 60
	Joint Venture with Preetam A/c Dr. To, Profit and loss A/c (Being profit on joint venture shared)		70	 70
	Joint Venture with Preetam A/c Dr. To, Bank A/c (Being bank draft sent to Preetam on final sattlement)		630	 630

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



ACTIVITY 12.3

X and Y were in partners in a joint venture sharing profits and losses equally. X supplied goods to the value of Rs. 10,000 and incurred expenses amounting to Rs. 1,200. Whereas Y supplied goods to the value of Rs. 8,000 and his expenses amounted to Rs. 800. Y sold the entire goods on behalf of the joint venture and realised Rs. 24,000. Y was entitled to a commission of 5% on sales. Y settled his account by a bank draft.

Pass journal entries and prepare co-venturer's Account and Memorandum Joint Venture Account in the books of X and Y.

(Profit on joint venture Rs. 2,800, Remittance to X Rs. 12,600)



12.9 LET US SUM UP

In this unit, the following points have been discussed:

- Joint venture is an association of two or more persons.
- It is carried out for a short period of tims.
- As soon as the venture is complete the relationship comes to an end.
- The parties to the joint venture is known as co-venturers.
- The main object is to execute a particular project and earn some profit.
- The co-venturers share profits and losses either equally or in an agreed ratio.



12.10 FURTHER READING

1) Dam, B.B.; Sarda, R. A.; Barman, Ramen; Kalita, Bijoy (2006); *Theory and Practice of Accountancy*; Guwahati: Capital Publishing Company.

2) Das. K.R.; Singha, K.M.; Paulchoudhury, K.S.; Banik, G.G.; Chakraborty, D. (2006); *Accountancy* (Volume II); Guwahati: LBS Publications.
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6) Rao, Thukaram; *Advanced Accounting*; New Delhi: New Age International Publishers.
7) Ras, Thukaram. Advanced Accounting. New Delhi, New Age International Publishers.
8) Sikidar, Dr. Sajit; Nath, Dr. Ghanshyam (2006); *Accountancy*; (Part II) Guwahati: Modern Publishers.

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,

Materials supplied by –

Ram Rs. 10,000

Rangav Rs. 8,000

After completion of contract, the price was duly received.

Prepare joint venture account and capital accounts of Ram and Ragv in separate books of the venture.

(**Ans :** Profit on joint venture 58,000)

Q.7: Subham and Sumit were partners in a joint venture sharing profits and losses in the ratio of 3:2. Sabham supplied goods of the value of Rs. 12,000 and incurred an expenditure of Rs. 400. Sumit supplied goods of the value of Rs. 10,000 and his expenses amounted to Rs. 600. Sumit sold all the goods on behalf of the joint venture for a sum of Rs. 36,000 and is entilted to a commission of 4% on sale. Sumit settled his account by sending a bank draft to Subham.

You are required to show joint venture account and sumit account in the books of Subham.

(**Ans:** Profit on joint venture Rs. 11,560)

Q.8: Jadu and Madhu are partners in a joint venture sharing profits and losses equally. Jadu supplied goods to the value of Rs. 12,000 and incurred expenses amounting to Rs. 1,200. Madhu supplied goods to the value of Rs. 8,000 and his expenses amounted to Rs. 1,000 only. Madhu sold the entire goods on behalf of the joint venture and realised Rs. 30,000. Madhu is entitled to a commission of 5% on sales. Madhu settled his account by a bank draft.

Prepare co-venturer's account and memorandum joint venture account in the books of Jadu and Madhu.

(**Ans:** Jadu's share of profit Rs. 3,150, Madhu's share of profit Rs. 3,150).

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1) Bhattacharya, Ashis; *Financial Accounting*; New Delhi: Prentice Hall of India Pvt. Ltd.
2) Dam, B.B. & Theory and Gautam, H.C.; *Practice of Financial Accounting*; Guwahati: Capital Publishing Company.
3) Dam, B.B.; Sarda, R. A.; Barman, Ramen; Kalita, Bijoy (2006); *Theory and Practice of Accountancy*; Guwahati: Capital Publishing Company.
4) Das. K.R.; Singha, K.M.; Paulchoudhury, K.S.; Banik, G.G.; Chakraborty, D. (2006); *Accountancy* (Volume II); Guwahati: LBS Publications.
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