GCA S2 02

Computer Based Accounting and Financial Management

SEMESTER - II

BACHELOR OF COMPUTER APPLICATION

Block 2

KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

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BLOCK INTRODUCTION

Block 2 comprises of five units. This block will start from unit number 6. In unit 6, we will discuss the meaning of cash- book, its importance, procedure for the preparation of cash- book, petty cash system etc. In unit 7, we will focus on the meaning and features of partnership, advantages and disadvantages of partnership, concept of partnership deed, fixed and fluctuating capital accounts of partners etc. Unit 8 will focus on the consequences of admission and retirement of a partner in partnership business, new profit sharing ratio, gaining ratio, revaluation of assets and liabilities etc. In unit 9, we will discuss the concept and importance of trial balance and the procedure of preparing the trial balance. In unit 10, we will discuss the meaning and components of final accounts as well as the procedure of preparation of final accounts.

The units of Block 2 are given below-

Unit 6 : Cash Book

Unit 7 : Partnership-I

Unit 8 : Partnership-II

Unit 9 : Trial Balance

Unit 10 : Preparation of Final Accounts

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BACHELOR OF COMPUTER APPLICATION

Computer Based Accounting and Financial Management

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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

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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.

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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.

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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.

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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					

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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.

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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

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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–

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

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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

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

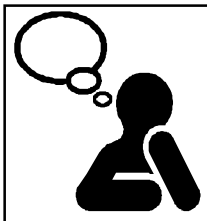
Solution:

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.	Discount
Jan. 1	To Capital			70, 000			J						
June 2	To Cash	C			40, 000		June 2	By Bank	C		40,000		
June 3	To Sales				10, 000	50	June 10	By Purchase			5, 000		100
June 12	To Cash A/c	C			20, 000		June 12	By Bank	C		20,000		
							June 15	By Salaries A/c				2,500	
							June 20	By Rent A/c				10,000	
							June 20	By Balance c/d			5, 000	57, 500	
				70, 000	**70, 000**	**50**					**70,000**	**70, 000**	**100**
June 21	To Balance b/d			5, 000	57, 500								



ACTIVITY 6.1

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

2014

April 1: Cash balance Rs. 10,000

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

April 7: Purchase goods for Rs. 5,000

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

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

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

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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.

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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

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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						

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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,

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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 partnership 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.

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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:** 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

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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.

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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, 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

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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 made 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 drawings, 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

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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		2,00,000	1,00,000
			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
						,, Profit and loss			
31 Dec	To Balance c/d		22,000	6,600	Dec.	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.

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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

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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 Appropriation 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.	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

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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.

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- 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)			

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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)				

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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 Appropriation A/c)		4,000	4,000
	Profit and Loss Appropriation 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.

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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 Appropriation A/c for the year ended 31, Dec.2014

Dr. **Cr.**

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

Calculation of Interest on Drawings:

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

∴ Interest on drawings = 12,000 x 6% x $^{6.5}/_{12}$ = Rs. 390

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

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

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

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

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

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- 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

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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 made 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 drawings, interest on capital, salary to partners, share of profit or loss etc are recorded in Capital Accounts.

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.

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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 Appropriation Account?

Q.5: Distinguish between Profit and Loss Account and Profit and Loss Appropriation 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 drawings 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 drawings 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.

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8.2 INTRODUCTION

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

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

8.3 MEANING OF ADMISSION OF A PARTNER IN A PARTNERSHIP BUSINESS

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

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

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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.

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8.5 NEW PROFIT SHARING RATIO ON ADMISSION OF A PARTNER

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

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

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

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

Solution: Let, the total share be 1

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

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

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

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

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

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

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

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

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Example 2: Arun and Barun are partners sharing profits and losses in the ratio of 4 : 1. They admited Tarun as a new partner 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 = $\frac{4}{5}$

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

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

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

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

$\therefore$ 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 $\frac{4}{5} = \frac{4}{20}$

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

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

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

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

$\therefore$ 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

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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 treatment 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.

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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. Ascertain 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 $\frac{3}{7} = \frac{2}{7}$

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

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

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

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



CHECK YOUR PROGRESS

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

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

Gaining ratio = New share – old share

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

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

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

New ratio among x : z = 5 : 4

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

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

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

∴ 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.

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8.9 ACCOUNTING TREATMENT OF GOODWILL AT THE TIME OF RETIREMENT

As goodwill has been earned 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. 2,000 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 Revaluation A/c				22,000

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	(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. 2,000 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.)
	Memorandum			
	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 revaluation of machinery and creditors credited to revaluation account)			

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	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
	(Being 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.

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Sharing of Profit/Loss upto the Date of Retirement/Death: When a partner retires or dies on the closing day of an accounting year then 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 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.

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

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

$\therefore$ 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 sacrifice 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.

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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 units 4 and 5

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

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

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

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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

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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.

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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.

To recapitulate 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–

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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–

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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;

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- Ø 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;
- Ø The amounts of the ledgers which have shown debit balances are put in the debit column of the list;
- Ø The amounts of the ledgers which have shown credit balances are put in the credit column of the list;
- Ø 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 9.6 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	–		ü
Sales	–		ü
Purchases	–	ü	
Debtors	–	ü	

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

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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

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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

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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–

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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.

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- **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–
  - Ø All the ledger accounts are closed at the end of an accounting period. The ledgers will show either debit or credit balance;
  - Ø 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;
  - Ø The debit amount column and the credit amount column of the trial balance will be calculated;
  - Ø 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.

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9.10 FURTHER READING

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



9.11 ANSWERS TO CHECK YOUR PROGRESS

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

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

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

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

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

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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?

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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

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Ledgers are done, 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 closing date of books of accounts.

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, debentureholders, bankers, shareholders or proprietor, Government, Researchers, Stock Exchange authorities etc. for various purposes.

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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			

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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)	

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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			

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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.

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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

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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.

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Note: 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.

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Solution :

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**

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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**

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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**

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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**

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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 Stock		30,000
Creditors		40,000	Pre-paid Insurance		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	Capital Return outward	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		

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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.

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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			
Add: Outstading wages 500	3,000		
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**

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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.

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- 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?

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