SYLLABUS

B.B.A. I SEM

Subject – Basic Accounting

UNIT – I	Purpose of Accounting and its. Place in Business, Limitations, Relationship with other Financial Areas. Advantages & Importance.
UNIT – II	Basic Accounting Concepts and convensions : Money Measurement Concept, Entity Concept, Going Concern Concept, Cost Concept, Dual Aspect Concept, Accrual Concept, Conservatism, Materiality Concept, Consistency concept, and accounting convensions
UNIT – III	Accounting Structure : Process of Accounting Journal, Ledger and Trial Balance Errors & their rectification based on Double Entry Book-Keeping System,
UNIT – IV	Bank Reconciliation statement.
UNIT – V	Preparation of Financial Statements : Form and Preparation of Income Statement and Statement of Financial Position, Adjustments.
UNIT – VI	Accounting for Deprecation and its importance in decision making.-Fixed Installment Methods & Reducing Balance Methods.
UNIT- VII	Preparation of final accounts of Joint stock companies and overview of Indian and International accounting standards.

UNIT-I

According to American Institution of Certified Public Accountant Committee:-
"Accounting as the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least, of a financial character, and interpreting the results thereof".
From the above definition, it can be said that "Accounting is science of recording and classifying trading transaction of financial nature and is an art in which financial results are summarized and interpreted."

Characteristics of Accounting

1) Accounting is science as well as an art.
2) The transaction and events relating to financial nature are recorded in it.
3) All transaction and events are recorded in monetary terms.
4) It maintain complete, accurate, permanent and legible records of all transaction in a systematic manner.
5) It analyses the results of all the transaction in detail.

Objectives of Accounting

1. To Maintain a Systematic Record

Accounting is done to maintain a systematic record of the monetary transactions of the firm which is the initial step leading to the creation of the financial statements. Once the recording is complete, the records are classified and summarized to depict the financial performance of the enterprise.

2. To Ascertain the Performance of the Business

The income statement also known as the profit and loss account is prepared to reflect the profits earned or losses incurred. All the expenses incurred in the course of conducting the business are aggregated and deducted from the total revenues to arrive at the profit earned or loss suffered during the relevant period.

3. To Protect the properties of the Business

The information about the assets and liabilities with the help of accountancy, provides control over the resources of the firm, because accounting gives information about how much the business has to pay to others ? And how much the business has to recover from others?

4. To Facilitate Financial Reporting

Accounting is the precursor to finance reporting. The vital liquidity/solvency position is comprehended through the Cash and Funds Flow Statement elucidating the capital transactions.

5. To Facilitate Decision making

Accounting facilitates in decision making. The American Accounting Association has explained this while defining the term accounting, it says accounting is, the process of identifying measuring and communicating economic information to permit informed judgments and decisions by users of the information.

Accounting As Science and Art

Accounting is both a science and an art. Science as well we know is the systematical body of knowledge establishing relationship between causes and their effects. In other words, science has its own concepts, assumptions and principles which are universal and verifiable. Accounting as discipline has also its own assumptions, concepts and principles, which have got universal application. Accounts have systematically and scientifically developed accounting equation and rules of debit and credit. It makes accounting, Science.
Art is the practical application of the knowledge. Accounting as discipline is used in the maintenance of books of accounts practically in the real life situations and day-to day affairs of the business, so it is an art also. It can now be safely concluded that Accounting is both science and an art.

Advantages, importance or necessity of Book-Keeping & Accountancy

Advantages to Businessmen

1) To raise loan for business – It helps the proprietor to raise loan for business. Property maintained accounts are good security for loan.
2) Important information – It helps in acquiring importance information about the profit/loss, debtors, creditors, assets and liabilities of business.
3) To control – It helps in controlling and checking the employees.
4) To compare the progress of business – It helps the proprietor to compare the progress of business in various years and to get important information.
5) Disputes – In the case of incoming and outgoing partnership firms or its dissolution disputes can easily be stored out if the accounts are properly kept.
6) Good evidence – It helps the proprietor to produce a good evidence in the court of law as and when dispute arises.
7) Large scale business – For large scale business, it is almost necessary.
8) Tax-liability – It helps in the assessment of tax liability.
9) Valuation of goodwill – Properly kept accounts act as a good basis for valuation of goodwill of business.
10) Take over a business concern – It helps in buying and selling of going business concern.

Advantages to Employees –

1) Assessing the efficiency – Systematically kept accounts, help in assessing efficiency of workers.
2) To settle the disputes – Accounting records help the employees to settle the disputes.

Advantages to Government –

1) Tax-liability – Properly kept accounts helps the government in deciding the tax liability.
2) Amendments in laws – It helps the government in making amendments in law pertaining to business.
3) Progress of Business – The progress of business can be ascertained with the help of properly kept account. On the basis of this progress the trend of business and industrial growth can be measured on national level.
4) Drafting policy – It helps the government in drafting the policy for granting license.
5) Financial assistance – Properly kept accounts help the government in deciding the financial assistance to the business concerns applying for it.

Advantages to Consumers –

Accurate accounting records enable the proprietor to ascertain the cost of production and to fix the selling price. Hence, the consumer may get the articles at reasonable prices.

Advantages to Investors and creditors –

1) Authentic information – Potential investors, suppliers and financiers may get adequate and authentic information from the books of accounts.
2) Setting disputes – Properly kept accounts helps in setting disputes arising in any dealing.

Advantages to other groups –

Properly kept accounts are beneficial to management of a concern for chalking out future plan and policies. New entrepreneurs, desirous of setting up a business are also benefitted by accounting system. Similarly, research scholars, competitive concerns and political parties are also benefitted by properly kept accounts.

Limitations of Accountancy –

In spite of utility or importance or advantages of accounting for profit or loss and financial position of business and for taking decision in future, there are certain limitations or drawbacks of accounting which are under –

1) Not free from bias – There are a number of incidents when the accountant has to decide any one of the given options, for example selection of methods of charging depreciation on fixed assets, valuation of closing stock etc.
2) Danger of window dressing – When the management uses fictitious data to show exaggerated profit, assets and liabilities, the income statement does not disclose correct profit or loss and the position statement does not disclose the correct financial positions of business.
3) Ignoring qualitative elements – Accounting takes into consideration only quantitatively expressed financial transactions. Qualitative aspects are totally ignored like efficiency of management and labour, government policy, competition in market, economic and political scenario, and change in the taste of consumers etc. which do affect the financial matters.
4) Ignoring price level changes – The financial statements are prepared on the basis of historical cost of fixed asset whereas its replacement values are more than the historical cost. Unless and until we take into consideration the changes in price level, we cannot draw accurate conclusions for comparison.
5) Uncertainly of accounting traditions – Different business concerns adopt different accounting customs and traditions according to their interest, for example valuation of closing stock, deprecation or fixed assets, reserve for bad debts etc.
6) Ignorance about the value of business assets – The financial position shows the value of fixed assets at cost less depreciation which always varies from actual market price. Thus the financial position exhibits the estimated value and not actual market value.
7) Showing of value less assets in balance sheet – There are certain assets which have no value but they are written in balance sheet, for example, preliminary expenses, underwriting expenses etc.

UNIT-II
Accounting Concepts

Meaning and Significance: - Accounting concepts are those basic assumptions or conditions upon which the accounting system is based. Some of the important accounting concepts are as follows :

1) Business Entity Concept : As per this concept, business is treated as a separate entity or unit distinct from that of the proprietor. The significance of this concept is that without such a distinction the affairs of the business will be mixed up with the private affairs of the proprietor and the true picture of the business will not be available. The transactions between the proprietor and the business will be recorded in the business books separately and shown separately under the heading capital account. For example, if when the proprietor invests Rs. 50000 in this business, it will be assumed that the owner has given that much money to the business and will be shown as a liability for the business. When he withdraws, say Rs. 10000 from the business it will be charged to his capital account and the net amount due to him will be only Rs. 40000.

2) Going Concern Concept : As per this concept it is assumed that a business unit has a perpetual succession or continued existence and transactions are recorded from this point of view. Hence, while valuing the business assets, the accountant does not take into account the realizable or market values of the assets. Assets are valued at cost at which they were originally purchased less depreciations till date, which is calculated on the basis of the original cost only.

The concept presumes that the business will continue in operation long enough to charge the cost of fixed assets over their useful life against the business income. It is only on the basis of this concept that a distinction is made between capital expenditure and revenue expenditure. If it is expected that the business will exist only for a limited period, the accounting records will be kept accordingly.

3) Dual Aspect Concept : Each business transaction has two aspects, i.e., the receiving of a benefit [debit] and giving of a benefit [credit]. For example, if a business purchases furniture, it must have given up cash or have incureed an obligation to pay for it in future. Technically speaking, for every debit, there is a credit this concept is the core of accountancy and upon this the whole superstructure of Double entry system of book keeping has been raised. As each transaction has giving account and receiving account equally, the total assets of a business firm will always be equal to its total equities [i.e. liabilities]. That is

External liabilities + Capital = Total Assets

Total Liabilities = Total Assets

This is called the Accounting or Balance Sheet equation.

4) Historical Cost Concept : This concept is based on the going concern concept According to this concept, assets purchased are normally entered in the accounting books at the cost at which they are purchased and this cost is the basis for all subsequent accounting for asset. The market value is immaterial for accounting purpose since the business is not going to be liquidated but is to be continued for a long time to come. This concept also prevents arbitrary values being used for recording purposes, mainly those resulting in the acquisition of assets.

5) Money Measurement Concept : According to this concept, accounting records only those transactions, which can be expressed in terms of money. Events or transactions, which cannot be expressed in terms of money cannot find place in the books, however important they may be. Qualitative or non monetary transactions are either omitted or recorded separately. For example a strained relationship between production manager and sales manager, which may affect directly the operating results of the business, does not find place in accounting records.

6) Realization Concept : According to this concept, the revenue is recognized only when the sale is made. But the sale is a gradual process, which starts with the purchase of raw materials for production and ends with the sale. If no sale is effected, no revenue is recognized. This is important to stop business firms from inflating their profits. However, there are certain exceptions to this concept like hire purchase sale, or contract etc.

7) Accrual Concept : This concept is based on the economic that all transactions are settled in cash but even if cash settlement has not yet taken place, it is proper to bring the transaction or event concerned into the books. Expenditure incurred during the year but not paid and Income earned but not received is called as accrued items. According to this concept these items will be taken into consideration while arriving at profit or loss. This concept enables to define income and expense.

8) Matching Concept : The matching concept provides the guidelines as to how the expense be matched with revenues. In other words, costs are reported as expenses in the period in which the associated revenue is reported. Note that costs are matched with, revenues, not the other way round. The expense shown in an income statement must refer to the same accounting period, production units, division or department of business unit to which revenue refers.

9) Accounting Period concept: - It is also known as periodicity concepts or time period assumption. According to this assumption, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which financial position. The use of this assumption further requires the allocation of expenses between capital and revenue. That portion of capital expenditure which is consumed during the current period is charged as an expense to income statement and t he unconsumed during the current period is charged as an expense to income statement and the unconsumed portion is shown in the balance sheet as an asset for future consumption. Truly speaking, measuring since, actual income can be determined only on the liquidation of the enterprise. It may be noted that the custom of using twelve month period applied only for external reporting. For internal reporting, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

10) Verifiable Objective Concept:- according to this principle, the accounting data should be definite, verifiable and free from personal bias of the accountant. in other words, this principle requires that each recorded transaction/event in the books of accounts should have an adequate evidence to support it. in historical cost
accounting, the accounting data are verifiable since, the transactions are recorded on the basis of source documents such as vouchers, receipts, cash memos, invoices, and the like. the supporting documents form the basis for their verification by auditors afterwards.

Accounting Conventions

Meaning and Significance :- Accounting conventions, are those customs, usage and traditions that are being followed by the accountant for along time while preparing the accounting statements.

1) Convention of Conservatisms : According to this convention, financial statements are usually drawn up on a conservative basis. While preparing accounts and statements, the accountants are expected not to take into account anticipated profits but to provide for all possible anticipated losses. It is only on the basis of this convention, the inventory is valued at cost or market price whichever is lower. Similarly provision for bad and doubtful debts is made in the books before ascertaining profits.

2) Convention of Consistency : According to this convention, accounting practices should remain unchanged for a fairly long time. And they should not be changed unless it becomes absolutely essential to change them. For example, if a particular method of charging depreciation on a particular asset is followed, it should be followed consistently. However, consistency does not prevent the introduction of new improved accounting methods or techniques. If any change is required, such change and its effects should be stated clearly. The aim of this convention is to provide for continuity in accounting practices and methods and enable meaningful comparison of accounting statements over a period or between different firms.

3) Convention of Material Disclosure : Apart from the legal requirements, good accounting practice demands that all vital information should be disclosed. For example, in addition to asset values, the mode of valuation should also be disclosed. The practice of giving footnotes, references, and parentheses in the statements is in accordance with this convention only. Accountants should report only material information and ignore insignificant details while preparing the accounting statements. What is material depends upon the circumstances and the discretion of the accountant.

Unit-III

JOURNAL

It is the fundamental book of account which is necessarily used by each organization whether it is a small or large institution. It can be known as foundation stone of accounting palace.
A journal may be defined as the book of original entry containing a chronological record of the transactions. The process of recording the transactions in a journal is called Journalizing.

Date	Particulars	L/F	Debit amount	Credit Amount
2009 July,25	………………………..A/c Dr To ……………………A/c (…………………………………)			

COMPOUND JOURNAL ENTRY
If two or more transactions of the same nature occur on the same day and either debit account and/or credit account are common in them, instead of passing a separate entry for each such transaction, one combined entry may be passed. Such type of entry is known as compound journal entry.

Example: Postage a/c Dr.
Stationary a/c Dr.
Cartage a/c Dr.
To Cash a/c

<u>DISCOUNT</u>
Types of Discount:-

1) **<u>Trade discount</u>**: is allowed at the time of purchase or sale of goods by one trader another in order to promote sales. For example, a manufacturer may allow discount on sale goods to wholesaler or wholesaler may allow discount to a retailer. It is always allowed a certain percentage on sale price i.e., invoice price. The trade discount is not normally record in the books of account. In other words, only the net amount of purchase or sale i.e., invoice price minus trade discount is recorded in the journal.
2) **<u>Cash discount</u>**: is a discount allowed at the time of making payments or receipts of cash. It is allowed as certain percentage the amounts due. It is allowed to a debtor by a creditor in order to induce him to pay on time. As the cash discount is calculated on the amounts already recorded in the books, it is shown in the book. Cash discount allowed to a debtor is a loss and it should be debited to discount a/c. Cash discount received from a creditor is a gain and it should be credited to discount a/c.

DISTINCTIONS BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

S.No.	Trade Discount	Cash Discount
1.	It is allowed at the time of making purchases or sales.	It is allowed at the time of making payments or receipts of cash.
2	It is calculated as certain percentage on the invoice price of goods purchased or sold.	It is calculated as certain percentage on the amounts due to creditors or amounts due from debtors.
3	It is not shown in the books of accounts. Only the net amount of purchase or sale is recorded in the books.	It is shown in the books: discount allowed as debit entry and discount received as a credit entry.
4	It is allowed in order to promote more sales of purchases	It is allowed in order to encourage parties to make payments on time.

CLASSIFICATION OF ACCOUNTS

1) PERSONAL ACCOUNTS

a) Natural Personal Account: The term Natural persons mean persons who are created by the almighty. For example: Shyam's Account, Gopals's Account etc.

b) Artificial Personal Account: These accounts include accounts of institutions or companies which are recognized as persons in business dealings. For example, the account of a Club, the account of an Insurance Company, Banking Company.

c) Representative Personal Account: These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an account for the outstanding amount will be opened. Likewise for salaries due to the employees (not paid) an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the account of the person to whom the salaries have to be paid therefore such accounts are called as representative personal accountant.

2) REAL ACCOUNTS

a. Intangible Assets: These accounts represent things which cannot be touched. However, they can be measured in terms of money, for example goodwill account, patents accounts.
b. Tangible Accounts: Tangible accounts are those which relate to things which can be touched, felt, measured etc. Examples of such accounts are furniture account, stock account, building account etc.

3) Nominal Accounts: -

Accounts related to income and gain or expenditure and loss are known as Nominal Accounts, e.g. Rent A/c, Interest A/c, Salary A/c, discount A/c, etc.

Nominal Accounts are divided into two parts as:

i. Revenue Account: - Such as rent received, interest received, commission paid, salary paid, discount allowed, etc.
ii. Expenditure Account: - Such as rent paid, interest paid, commission paid, salary paid, discount received, etc.

At the end of each financial year, the balances of nominal accounts are transferred to Trading A/c or Profit & Loss A/c

RULES OF DOUBLE ENTRY SYSTEM

The rules related to debit and credit of any account in double entry system is as under:

Personal accounts	:-	**Debit the receiver, and credit the giver**.
Real accounts	:-	**Debit what comes in, and credit what goes out**
Nominal accounts	:-	**Debit all expenses and losses and credit all incomes and gains**.

Ledger

Ledger is the principal book or final book under double entry system of accounting in which the transactions recorded in subsidiary books are classified in various accounts chronologically with a view to knowing the position of business account-wise in a particular period.

Characteristics of Ledger

1. Major or principal book of accounts.
2. Index- The initial pages of ledger are left for indexing. These pages are not numbered. With the help of index one can find on which page of ledger a particular account is opened.
3. Pages booked- For every account one separate page or pages called folio is engaged in ledger.
4. One debit one credit- For every transaction one account is debited and other account is credited.
5. Books of final entry- Ledger is the last stage of daily accounting or book keeping.
6. Classification of transactions- While journal a bunch of various accounts, ledger is the classification of these accounts.

Utility or importance or Advantages of Ledger

1. Knowledge of account
2. Details of income and expenditure
3. Assessment of financial position
4. Text of accuracy
5. Knowledge of profit and loss
6. Economy of time
7. Knowledge of assets
8. Knowledge of liabilities
9. Assessment of overall position of business
10. Evidence in business disputes-

Difference between journal and Ledger

S. No.	Basic of Differences	Journal	Ledger
1	Nature of book	It is the book of first or original entry	It is the book of final entry
2	Record	It is the book for chronological record	It is the book of analytical record
3	Weight in legal evidence	It is the book of source entry and has a greater weight as legal evidence	It has a lesser weight us legal evidence as it is based on journal
4	Unit of classification of data	The unit of classification of data within the journal is transaction	The unit of classification of data within the ledger is account
5	Process of recording	The process of recording in the journal is called 'journaling'	The process of recording in the ledger is called 'posting'
6	Place	More than one transactions regarding one account are written at different places date-wise	More than one transaction regarding one account are written at one place

Performa of Account

Name of Account

Dr. Date	Particular	J.F.	Account	Date	Particular	J.F.	Cr. Amount
	To				By		

Posting

When the transactions entered in journal are recorded in the ledger, it is called posting. It other words, posting is the process transferring the debits and credits of journal entries to the ledger account. The subject of such posting to have a fixed classified record of various transactions pertaining to each account.

Procedure for Posting

1. Opening of separate account – Since each transaction affect two accounts. separate accounts. Therefore, will be opened in the ledger in the ledger, such accounts may be personal, real and nominal.
2. Posting journal entry to the concerning side – the debit side of the journal is posted to the debit side of the account and on the side the reference is given of the fact which is put on the credit side of the journal entry.
3. Sides to the posted - The credit side of the journal entry is posted to he credit side of the account and on that side the reference is given of that fact which put on the debit side of the credit side of the journal entry
4. use of ward," To" and "By" – The word "To" is prefixed to the posting of debit side and the ward " By" is prefixed to the credit side in each account.

Ledger posting o Opening Journal Entry

While making ledger accounts of assets and liabilities appearing in the opening journal entry opening balance as represented in the journal entry must be shown in the beginning of the ledger account a "To

Balance b/d" at the debit side for assets and "by balance b/d" at the credit side of liabilities. Remaining posting in the concurred A/c will be made as usual.

Balancing of ledger Accounts

Assets, liabilities and capital accounts have certain closing balance of the end of accounting period, so their values are to be carried forward to the next accounting period. This is why they are closed as "By Balance b/d" or "To Balance c/d. The balance of those accounts carried forward to the next accounting period, because the firm has to carry on tits business with these assets, liabilities and capital in hand. While closing these accounts we write the 'Balance c/d' to show the closing balance of the account.
While closing nominal accounts or those accounts which are either an expense or revenue. We do not use the word balance C/D because the balance of these accounts need be carried forward to the next period. Whatever has been paid on account of expenses has been paid once and forever. This is the expense of the business. So it should be directly posted to the debit side of the profit and loss account or trading account. It the same way, account relating to income or gain or revenues are also closed by transfer to profit and loss account. Receipts i.e. rent, interest and discount are revenue of the business, so while closing these accounts their balance will be transferred to profit and loss account.

Trial Balance

Meaning

When all the accounts of a concern are balanced off they are put in a list, debit balances on one side and credit balances on the other side. The list so prepared is called trial balance. The total of the debit side of the trial balance must be equal to that of its credit side. This is based on the principle that in double entry system. For every debit there must be a corresponding credit. The preparation of a trial balance is an essential part of the process because if totals of both the sides are the same then it is proved that book is at least arithmetically correct.

Main Characteristics and uses of a Trial Balance

Following are the main characteristics of a trial balance:

1. It is a statement prepared in a tabular form. It has two columns- one for debit balance and another for credit balance.
2. Closing balance, i.e., balance at the end of the period as shown by ledger accounts, are shown in the statement.
3. Trial balance is not an account. It is only a statement of balance.
4. It can be prepared on any date provided accounts are balanced.
5. It is a consolidated list of all ledger balances at the end of a period at one place.
6. It is a method of verifying the arithmetical accuracy of entries made in the ledger. The agreement of the trial balance means that the total of the debit column agrees with the total of the credit column of the trial balance.
7. It is a big help in preparation of Trading A/c, Profit and Loss A/c and Balance Sheet at the end of the period which exhibit the financial position of the firm.

Objects of preparing a Trial Balance

The following are the important objects or purposes of preparing a trial balance:

1. If the two sides of the trial balance are equal, it is proved that the books are at least arithmetically correct.
2. Error in casting the books of subsidiary records in immediately known.
3. Error in posting from the books of subsidiary records to ledger is found out.
4. Error in balancing the ledger accounts is found out.
5. Schedules of debtors and creditors are verified to be correct.

Limitations of a Trial Balance

A trial balance is not a conclusive proof of the absolute accuracy of the accounts books. If the trial balance agrees, it does not mean that now there are absolutely no errors in books. Even if trial balance agrees, some errors may remain undetected and will not be disclosed by the trial balance. This is the limitation of a trial balance. The errors which are not disclosed by a trial balance are as under:

Errors of Omission: - If an entry has not been recorded in the original or subsidiary book at all, then both the aspects of the transaction will be omitted and the trial balance will not be affected.

1. **Errors of Commission: -** Posting an item on the correct side but to the wrong account.
2. **Error it subsidiary books-** Wrong amount entered in the subsidiary book.
3. **Compensating errors-** These are errors arising from the excess-debits on under debits of accounts being neutralized by excess credit or under credit to the same extent of some other accounts.
4. **Error of principle-** Whenever any amount is not properly allocated between capital and revenue or some double entry principles are violated the error so made is known as error of principle.
5. **Compensatory Errors-** Under it, the errors on one side of the ledger account are compensated by errors of the same amounts on the other side or on the same side.

Methods of Preparation of Trial Balance –

1. **Total Method –** Under this method debit and credit total of each account of ledger are recorded in trial balance.

Trial Balance
(As on …………….)

Title of Accounts	L.F.	Debit Total Rs.	Credit Total Rs.
Total			

2. **Balance Method-** Under this method only balance of each account of ledger is recorded in trial balance.

Trial Balance
(As on …………….)

Title of Accounts	L.F.	Debit Balance Rs.	Credit Balance Rs.
Total			

3. **Total Cum Balance Method-** This method is a combination of Total method and Balances method.

Trial Balance
(As on …………….)

Title of Accounts	L.F.	Debit Total Rs.	Credit Total Rs.	Debit Balance Rs.	Credit Balance Rs.
Total					

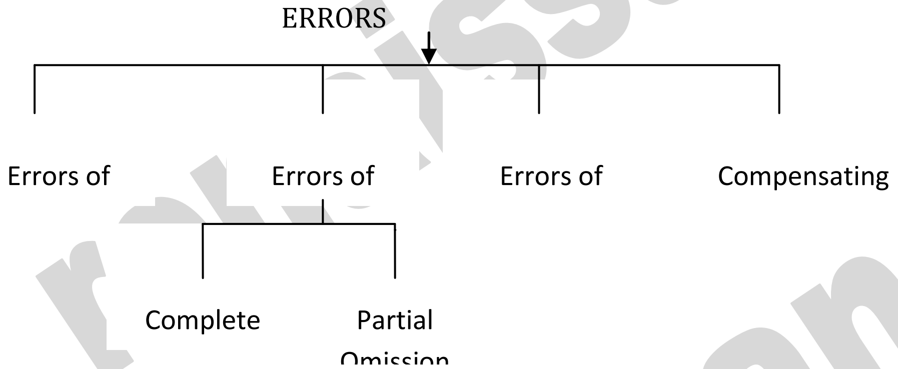
Rectification of Errors

Financial Accounts are prepared at the final stage to give the financial position of the business on the basis of information supplied by the trail balance. Thus, the accuracy of the trail balance determines to a great extent. Trial balance provides only proof of the arithmetical accuracy of the books of accounts. But it is not a conclusive proof.

It can be concluded, therefore, that if the trial balance does not agree, there are errors, and if trial balance does agree there may be errors in the account books.

TYPES OF ERRORS

The types of errors can be illustrated in the following chart:



Rectification of Errors –

The errors must be rectified at the earliest from the point of view of rectification; the errors may be classified into the following two categories:

(a) Error which do not affect the Trail balance
(b) Errors which affect the Trail balance

This distinction is relevant because the errors which do not affect the trial balance usually take place in two accounts in such a manner that is can be easily rectified through a journal entry whereas the errors which affect the trial balance usually affect one account and a journal entry is not possible for rectification unless a suspense account has been appended.

(1) Rectification of Errors which do not affect the trail Balance –

These errors are committed in two or more accounts. Such errors are also known as two sided errors. They can be rectified by recording a journal entry giving the correct debit and credit to the concerned accounts.

These errors are explained below:

1. Errors of Omission- An error of omission is one where a transaction has not been recorded in the books of account.

For example omission to record goods sold to Rajesh, the rectify entry is

Rajesh	A/c	Dr.	
	To Sales		

(Being goods sold was not passed through books)

2. Error of Recording – Errors of recording means a wrong amount is recorded in the subsidiary books.

For e.g. a purchase of Rs. 8,000 to Mahesh is recorded as Rs. 800.

The rectifying entry will be –

Purchases	A/c	Dr.	7,200	
To Mahesh				7200

3. Errors of Posting to wrong Account- Following are the errors of posting to

Wrong account.

(a) Correct Amount on the correct side to wrong account
(b) Wrong Amount on the correct side to wrong account
(c) Wrong Amount on the wrong side to wrong account
(d) Correct Amount on the wrong side to wrong account

For e.g. Sales to Ravina Rs. 10,000 is posted to Ravi's A/c Rectify entry is

Ravina	Dr.	10,000	
To Ravi			10,000

4. Error of Principle- Sometimes errors of recording are made due to ignorance of principles, i.e., correct distinction is not made between capital receipt and revenue receipt, between capital expenditure and revenue expenditure, between capital losses and gains and revenue losses and gains etc.

For e.g. Furniture purchased on credit wrongly recorded in purchases book

Rectify entry is –

Furniture A/c Dr.
To Purchases A/c

(2) Rectification of Errors which affect the trial balance:-.

There are some errors due to which the trail balance does not agree. These are the errors which are disclosed by the trial balance. These errors are also called one-sided errors.

Such errors should first be located and then rectified by giving an explanatory note or by giving a journal entry with the help of a suspense account

Following are some errors responsible for disagreement of trial balance

(1) **Errors of Casting** – Casting is the process of totaling the transactions at the end of a period. An error of casting may be due to over casting or under casting. This type of errors may arise in any subsidiary book.

For e.g. If the sales book has been under cast by Rs. 100 The rectification of the error will be done by crediting sales account.

(2) **Errors of Posting –** Errors of posting means a posting of wrong amount or posting in the wrong side.

For e.g. Raj's account is debited with Rs. 750 instead of Rs. Rs. 705 the mistake lies only in this account. This will rectified by crediting Raj's A/C with 45. If there is a suspense A/c, the entry will be

Suspense A/c	Dr.	45	
To Raj			45

(3) **Errors of Carry forward -** The errors occurs when total of one page is wrongly copied on the next page. In order to rectify such errors, an explanatory note is given and if the suspense A/c is opened, then the correction is through a journal entry with the help of a suspense Account.

SUSPENSE ACCOUNT

When the Trial Balance does not tally, efforts are made to make the trail balance tally, but if these efforts fail, then temporarily the difference of Trail Balance is transferred to an account which is called "Suspense Account". Suspense Account. Will be shown in the Balance Sheet on asset aside if debit balance or on the liabilities side if credit balance.

During the course of preparation of final accounts errors are located, they are corrected through the suspense A/c

Effect on Profit and Losses Account

All such rectifying entries which are related to normal account, affect profit or loss, hence after making rectifications, all nominal account which are affected should be taken into consideration and their amounts be considered for assessing the exact amount of loss or profit.

Effect on Balance Sheet

All such rectifying entries which are related with personal and real accounts affect the Balance Sheet. Rectifying entries related with nominal account affect profit or loss and this profit or loss is taken to Balance Sheet. Hence, these entries also affect Balance Sheet

Unit-IV

Bank Reconciliation Statement

Every businessman maintains a bank account irrespective of their size of business. Businessman and bank both maintain proper accounting of the transactions which take place between them. Businessman records these transactions in the bank column of his cash book and bank records the same in pass book also. Therefore the balance of cash book and pass book should be equal after recording every transaction, but practically on any specific date the Balances of both are not equal. To reconcile both these balances, a businessman prepares a Bank Reconciliation Statement. For agreement of both these balances a statement is prepared which is called 'Bank Reconciliation Statement. In other words Bank Reconciliation statement is a statement which is prepared for reconciling the difference in balances of bank column of cash book and pass boom on a particular date. Preparation of Bank Reconciliation is not mandatory.

Characteristics

1. To find actuality of differences – Bank Reconciliation statement is prepared to find out the actuality of difference in the balance of cash book bank column and pass book.
2. A statement and not an account – Bank Reconciliation is not an account. It is a statement only.
3. Prepared for reconciling the balances – Bank reconciliation is prepared only when there is difference between the balances of cash book (bank Column_ and pass book.
4. Trace out mistake and fraud – Bank reconciliation traces out the various types of mistake and fraud like cash and cheque deposited into bank and cash withdrawn from bank. These help to effective control on employees.
5. Prepared by Customer of bank – Bank reconciliation is prepares by customer of bank i.e. businessman.
6. Prepared on specific date – Bank reconciliation is prepared on specific date when required.

Utility or importance

Preparation of bank reconciliation is not necessary as per law but it is very useful for every business. The utility of preparing bank reconciliation statement is as under –

1. To know the position of overdraft.
2. To know amount of interest credited by bank and amount of expenses debited by bank
3. To know whether the difference of balances are reasonable or unreasonable.
4. Bank reconciliation statement helps to know the actual balances of cash bank deposit which helps in operation of business activities.
5. Bank reconciliation statement shows total amount of cheques issued and out of issued cheques total amount of cheques presented for payment.
6. With the help of bank reconciliation businessman can find the errors of accounting by the bank.
7. With the help of bank reconciliation businessman can find the cheques deposited into bank for collection and dishounoured out of them.
8. Bank reconciliation statement is helpful to know about fraud of cash.
9. We can know the time taken by bank to collect the deposited cheques.
10. It helps to decide future financial policies and decision making about cash.
11. We can know the ignorance and mistake done by employees towards cash ana bank transactions.
12. We can know the actual bank balance which helps for issuing cheques in future.

Format of Bank Reconciliation Statement

S.No	Particulars	Plus items	Minus Items
1 2	Balance (Deposite/Overdraft) as per cash Book or Pass Book (Dr./Cr.) Add: …………………………………………………………………………	Deposit Balance ………………	Overdraft Balance …………………

3 4	Less: …………………………………………………………………… Less: …………………………………………………………………… Add: ……………………………………………………………………..	………………	………………
	Total	………………	………………
	Balance (Deposit/Overdraft) as per Pass Book or Cash Book (Dr. /Cr.)	Difference	Difference

Unit-V
Final Accounts

The final object of every businessman is to earn profit. He is interested to know how much profit he has earned or how much loss he has incurred during the year. For the purpose income tax payment, financial position, distribution of dividend and for the future planning it becomes necessary to ascertain the profit or loss for the year. At the end of the year a trial balance is extracted from the ledger balances and then on the basis of the trial balance, closing entries are passed and final Accounts are prepared. The process of preparing Final Accounts from the original records is as under.

Recording of transaction in Journal or Subsidiary books
↓
Postings into ledger from Journal or subsidiary books.
↓
Preparation of Trial balance from ledger accounts
↓
Preparation of Final Accounts on the basis of Trial balance and other information

To know the trading results (Profit or loss) for the accounting period and the financial position as it the end of accounting period the final accounts are prepared. The final accounts consists of :

1. Manufacturing Account
2. Trading and Profit & Loss Account
3. Balance sheet

The followings points must be considered while preparing final accounts from trial balance

1. Debit items of Trial Balance: - The items of expenses or assets appear on debit side of Trial balance. The expenses (the benefit of which is derived within the accounting year in which they are incurred are called revenue expenses. These are debited either to trading account or profit & Loss Account.) Direct expenses such wages. Carriage inwards, freight etc. are debited to trading and indirect exp. such as salaries, rent repairs etc. are debited to profit & Loss account.
The expenses the benefit of which is derived in many years are called capital expenditure. This expenditure is called assets and they appear in the assets side of Balance sheet e.g. Building, Machinery, Furniture, Vehicle etc.

2. Credit items of Trial Balance: The items of incomes, gains or liabilities appear in the credit side of trial balance. The receipts are divided into two parts capital receipts and revenue receipts. Capital receipts are liabilities items they are mentioned in the liabilities side or deducted from the assets side of Balance sheet. Revenue receipts are called incomes. It is again divided into direct and indirect incomes. Direct incomes means sale proceeds of the goods which is credited to Trading Account. Indirect incomes are other incomes not directly related to the main business activities such as rent commission, interest, dividend etc received. These are credited to profit and loss account.

Trading Account

Trading Account is prepared to calculate gross profit. It can be prepared separately or combined with profit and loss account. Normally it is prepared jointly with profit and loss account. It is the first part of profit and loss account.

Trading Account A/c

For the Year ending…………………..

	Rs.		Rs.
To Opening Stock To Purchase -	-	By Sales - Less: Returns Inward -	 -

Less: Ret. Outward -	-	--------	
------		By Goods Sent on Consignment	
To Wages	-	By Closing Stock	-
To Carriage	-	By Gross Loss c/d	-
To Fuel	-	(Balancing figure)	
To Motive Power	-		
To Octroi	-		
To Import Duty	-		
To Clearing Charges	-		
To Dock Charges	-		
To Stores Consumed	-		
To Royalty based on Production -	-		
To Manufacturing Exp.			
To Gross Profit c/d (Balancing figure) -	-		
Rs.	-	Rs.	-

Profit and Loss Account

A profit and loss account is prepared to ascertain net profit or loss. This is the second stage of ascertaining trading results. Gross Profit calculated as per trading account is credited to Profit and loss account then all the indirect expenses are debited and all the indirect incomes are credited. The excess of credits side over debit side is called net Profit and vice versa. The format of P & L account is as under:

Profit and Loss A/c
(For the year ending)

To Gross Loss	-	By Gross Profit	-
To Office Salaries & Wages	-	By Discount received	-
To Office Rent, Rates and Taxes	-	By Bad debts recovered	-
To Office Printing and Stationery	-	By Income from Investment	-
To Office Lighting	-	By Commission received	-
To Insurance Premium	-	By Interest on Deposits	-
To Repairs & Maintenance	-	By Profit on sale of fixed assets	-
To Postage & Telegram	-	By Apprenticeship Premium	-
To Legal expenses	-	By Interest on Drawings	-
To Trade expenses	-	By Net Loss (Transferred to Capital Account)	-
To Audit fees	-		
To Telephone expenses	-		
To General expenses	-		
To Bank Charges	-		
To Discount allowed	-		
To Interest on Capital	-		
To Interest on loan	-		
To Discount of Rebate on bills of exchange	-		
To Carriage outward	-		
To Freight outward	-		
To Bad debts	-		
To Entertainment expenses	-		
To Travelling Expenses	-		
To Cost of Samples	-		
To Catalogue expenses	-		
To Salesmen's salaries	-		
To Expenses and commission	-		

To Advertising expenses To Depreciation on fixed Assets To Loss on sale of fixed assets To Net Profit (Transferred to capital account)	- - - -		
Rs.		Rs.	

Balance Sheet
As on 31 March ……………..

Liabilities	Rs.	Assets	Rs.
Capital	-	Fixed Assets:	-
Long term liabilities	-	Patent	-
Debentures	-	Goodwill	-
Bank Loan	-	Land and Building	-
Current Liabilities:	-	Plant & Machinery	-
Advance Income	-	Furniture and fixtures	-
Outstanding expenses	-	Current Assets:	-
Bank overdraft	-	Short terms Investment	-
Bills Payable	-	Prepaid expenses)	-
Creditors	-	Accrued Income	--
Unearned Income	-	Debtors	-
		Closing Stock	-
		Bank Balance	-
		Cash Balance	-

Closing Entries

At the end of the year after preparing trial balance a list of unrecorded items is prepared which is called list of adjustment for which adjustment entries are passed. Now closing entries will be passed. The purpose of closing entries is to closed all those accounts which comes in trading and profit & Loss and these accounts are mainly related to goods and expenses and incomes.
Procedure for closing entries- The accounts which are shown on the debit side of trading and profit & Loss account are transferred to these account by writing "By Trading account/Profit and loss account" in all those accounts. Similar in the accounts (appearing on the credit side of trading and profit and loss account) to trading or profit & Loss account is written. The major closing entries are as under:

(1) For opening stock, purchase, sales return and all direct expenses
Trading A/c Dr.
To Opening Stock A/c
To Purchases A/c
To Sales return A/c
To Wages a/c
To Carriage Inward A/c

(2) For sales and purchase return
Sales A/c Dr.
Purchase return Dr.
To Trading A/c

(3) For gross profit or loss:
(a) Profit Trading A/c Dr.
To Profit and Loss A/c

(b) loss Profit and loss A/c Dr.
To Trading Account

(4) For indirect expenses
Profit & Loss A/c Dr.
To Salaries A/c
To Commission a/c
To Discount allowed a/c
To Advertisement A/c

(5) For indirect in comes and gains
Interest eared a/c Dr.
Discount a/c Dr.
Commission a/c Dr.
Divident a/c Dr.
To Profit & Loss A/c

(6) For Net profit or net loss
(a) For Net Proift
P & L A/c Dr.
To Capital A/c
(b) For Net loss A/c
Capital A/c Dr.
To P & L Account

Adjustments at a glance

S.No.	Adjustments	Entry	Effects on Trading and Profit & Loss Account	Effects on Balance Sheet
1	Closing Stock	Closing Stock A/c Dr. To Trading A/c	Credited to trading A/c	Shown on assets side.
2	If closing Stock is given in trial balance	-	-	Shown on assets side.
	Outstanding expenses (Expenses still un paid)	Expenses A/c Dr. To O/s Exp. A/c	Add to the concerned exp. on debit side.	Shown on liabilities side.
(i)	O/S Exp. in trial Balance If they are of opening date i.e. of last year	O/S Exp. A/c To Expenses A/c	Deducted form the concerned expenses on debit side.	-
(ii)	If they are of closing date i.e. of current year.	-	-	Shown on liabilities side.
3	Prepaid Expenses: (Expenses of next year paid in advance this year)	P.P. Expenses A/c Dr. To Expenses A/c	Deducted from the concerned expenses on debit side.	Shown on Assets side
(i)	P.P. Exp. in trial balance. If they are of opening date i.e. of last year	Expenses A/c Dr. To P.P. Exp. A/c	Added to the concerned expenses on debit side	-
(i)	If they are of closing date i.e. of last year	-	-	Shown on assets side.
4.	Accrued, Earned or Receivable Income	Acc. Income A/c Dr. To Income A/c	Added to the concerned income on credit side of P & L A/c	Shown on assets side.
(i)	If it is of op. date i.e. of last	Income A/c Dr.	Deducted from	-

	year	To Acc. Income a/c	concerned income on credit side of P & L a/c.	
(ii)	If it is of closing date i.e. of current year	-	-	Shown on assets side.
5.	Uncured, unearned or advanced income (Income of next year received in advance this year.)	Income A/c Dr. To Unacc. Income a/c	Deducted from the concerned income on the credit side of P & L a/c	Shown on liabilities side.
(i)	Unacc. Income in trial balance- If it is of op. date i.e. of last year	Unacc. Income A/c Dr. To Income a/c	Added to concerned income on credit side of P & L A/c	-
(ii)	If it is of closing date i.e. of current year	-	-	Shown on liabilities side.
6.	Depreciation	Depreciation A/c Dr. To Assets a/c	Shown on the debit side of P & L A/c	Deducted from the concerned assets side.
	Dep. in trial balance	-	Debited to P & L A/c	-
7.	Interest on Capital/Loan	Int. on Cap./loan A/c Dr. To Cap./loan A/c	Shown on the debit side of P & L A/c	Added to capital/Loan on liabilities side.
	Interest on capital/Loan in trial balance	-	Shown on the debits side of P & L a/c	-
8.	Interest on Drawings.	Drawings. A/c Dr. To Int. on Drawings	Shown on the credit side of P & L A/c	Deducted from capital on liabilities side.
9	Credit purchases not recorded	Purchase A/c Dr. To Creditor's A/c	Added to purchases on the debit side of Trading A/c	Added to creditors on liabilities side.
10.	Credit purchases return not recorded.	Creditor's A/c Dr. To P/R a/c	Deducted from purchases on the debit side	Deducted from creditors on liabilities side.
11	Credit sales not recorded	Debtor's A/c Dr. To Sales A/c	Added to sales on the credit side of Trading A/c.	Added to debtors on assets side.
12.	Credit sales returns not recorded.	S/R A/c Dr. To Debtor's A/c	Deducted from sales on the credit side of Trading A/c.	Deducted form debtors on assets side.
13.	Goods given as charity or free samples	Charity/Adv. A/c Dr. To Purchases Trading A/c	i. Deducted from purchases/credited to trading A/c	-
			ii. Shown on the debit side of P & L A/c	
14.	Drawings of goods by owner	Drawings A/c Dr. To Purchases/Trad. A/c	Deducted from purchases credited to trading A/c	Deducted from capital on liabilities side.
15.	Goods stolen/damaged by fire: Example : Goods of Rs. 10,000 stolen, claim accepted 6,000	Ins. Co. A/c Dr. 6000 P & L A/c Dr. 4000 To Purchases/ Trad. A/c 10,000	i. Rs. 10,000 deducted from purchases/credited to Trading A/c ii. Rs. 4,000 debited to P	Rs. 6,000 shown on assets side as Insurance Co.

			& L A/c	
16.	Goods in transit: (Goods bought yet in transit)			
	i. If it is already included in purchases	Goods in transit A/c Dr. To Trading A/c	Credited to Trading A/c	Shown on assets side.
	ii. If it is not already included in Purchases. (Note: If nothing is cleared in the sum, a note must be given.	i. Purchases A/c Dr. To Creditor's A/c ii. Goods in trans. A/c Dr. To Trading A/c	ii. Credited to Trad. A/c	ii. Shown on asse. Side.
17.	Goods sold on approval basis: Example- Goods costing Rs. 500 sold on approval for Rs. 600 which is recorded as actual sales.	i. Sales A/c Dr. 600 To Customer 600 Note- This entry is passed by sale price.	i. Rs. 600 deducted from sales on credit side of Trading A/c	i. Rs. 600 deducted from debtors on assets side.
		ii. Stock on approval a/c Dr. 600 To Trading A/c 600 Note- This entry is passed by lower of the cost or market price of the goods sold.	ii. Rs. 500 (Being lower of cost or market price) are shown on credit side of Trading A/c	ii. Rs. 500 (Being lower of cost or market price) are shown on assets side.
18. a.	Purchase of assets: Not rerecorded at all	Assets A/c Dr. To vendor	-	i. Shown on assets side. ii. Shown on lib. Side
b.	Wrongly included in purchases A/c	Asset A/c Dr. To Purchases A/c	Deducted from purchases on debit side of Trad. A/c	Shown on assets side.
c.	Installation charges included in wages A/c	Asset A/c Dr. To Wages A/c	Deducted from wages on debit side of Trad. A/c	Added to the concerned asset on assets side.
d.	Depreciation on the above asset.	Depreciation A/c Dr. To Asset A/c	Debited to P & L A/c	Deducted from the asset on assets side.
19 a.	Over/under valuation of stock: Over valuation of Opening Stock.	Capital A/c Dr. To Op. Stock/Trad. A/c	The Difference is either deducted from op. stock or credited to Trading A/c	The Difference is deducted from capital on liabilities side.
b.	Under valuation of opening stock.	Op. stock/Trad. A/c Dr. To Capital A/c	The Difference is either added to op. stock or debited to Trading A/c	The difference is added to capital on liabilities side
c.	Over valuation of closing stock.	Trading A/c Dr. To Cost stock A/c	The Difference is either deducted from clo. Stock or debited to Trading A/c	The difference is added to closing stock.
20.	Personal use of business assets: Example- 25% of the use of	Drawings A/c Dr. 700 To Car Exp. A/c 500 To Car Dep. A/c 200	P & L A/c – To Car Exp. (2000×75%) 1500	i. Liab. Rs. 700 deducted from Cap.

	business car is for personal purposes. Car exp. Rs. 2000 and deprecation Rs. 800		To Car Dep. (800×75%)600	ii. Assets: Rs. 800 deducted from car.
21.	Cheque/B/R/ received from debtors:	Bank/B/R/ A/c Dr. To Debtor's A/c		Assets Side: i. Deducted from deb. ii. Added to Bank/B/R.
22.	Dishonour of Cheque/ B/R received from debtors	Debtor's A/c Dr. To Bank/B/R A/c	-	Assets Side: Add to debtor deducted from Bank.
23.	Dishonour of discounted/endorsed B/R	Debtor's A/c Dr. To Bank/Creditors'	-	i. Assets side : added to debtors ii. Deducted from bank on assets side/added to creditors on liabilities side.
24.	Discounting of a B/R due next year.	-	-	Liabilities side : shown below total in inner column as contingent liabilities.
25.	Deposit from debtor wrongly deducted from debtor's A/c	Debtor's A/c Dr. To Deposit from debtors A/c	-	i. Assets side : Added to debtors. ii. Liabilities side : Added to creditors
26.	Settlement with creditors: Example: A creditor for Rs. 400 is settled at Rs. 320.	-	-	-
a.	If it is assumed that payment of Rs. 320 is recorded but discount is not recorded.	Creditors A/c Dr. 80 To Discount 80	P & L A/c: By Discount A/c 80	Liabilities side: Rs. 400 deducted from creditors.
b.	If it assumed that whole the transaction is omitted.	Creditors A/c Dr. 400 To Bank A/c 320 To Discount 80	P & L A/c: By Discount A/c 80	Liabilities side: Rs. 400 deducted from creditors. Asset side : Rs. 320 deducted from bank

Unit-VI
'Depreciation Accounting'

On the basis of accounting concept of going concern, assets are classified as fixed assets and current assets. Fixed assets are used in the business to derive benefits for more than one accounting period. Periodic profit is measured by charging cost against periodic revenue. Since fixed assets are used to generate periodic revenue, an appropriate proportion of the cost of fixed assets which is believed to be used or expired for generation of periodic revenue needs to be charged as cost. Such an appropriate proportion of the cost of fixed assets is termed as 'Depreciation'.

Meaning

Depreciation means a fall in the value of an asset because of usage or efflux of time due to obsolescence or accident. It is the permanent and continuing diminution in the quality, quantity of value of an asset.

Definition

1. **According to Spicer & Pegler**, **"**Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period."

Thus, depreciation may be defined as continuing and gradual shrinkage in the value of fixed asses. It has a significant impact in presenting the financial position and result of operations of a business enterprise. It is charged in every accounting period as an expense/ loss to the extent of shrinkage in the value of fixed assets so that cost of production can be determined properly.

Features or Characteristics of Depreciation

1. Depreciation is charged on fixed assets except land.
2. Depreciation is calculated on the book value (as shown in the books after charging of depreciation) and not on market value of assets.
3. Depreciation is charged on permanent basis. Once the depreciation is charged, it reduces the value of the asset permanently.
4. Depreciation is charged on a continuous basis. Once the depreciation is charged, it must be charged on regular basis in the succeeding period also.
5. The charge of depreciation will decrease the value of asset gradually. In other words, it must reduce the value of assets slowly and steadily.
6. The process of computation of depreciation implies allocation of cost of an asset over the effective and useful life of the assets.

Causes of Depreciation

The principal causes of depreciation are as follows:

1. **By Constant use:** Wear and tear of an asset due to its constant use is a cause of decline in the value of an asset. A fixed asset begins to lose its value when it is used in the business e.g. plant & machinery, building, furniture etc.
2. **By expiry of time**: Certain assets get decreased in their value with the expiry of time whether they are used in the business or no. this is true in case of assets like leasehold properties, patents or copyrights etc. For example, if a lease is obtained for 25 years for Ts. 1,00,000, it will lose 1/25th i.e. Rs. 4,000 of its value every year whether it is used in the business or not. So at the end of 25th year, its value will be reduced to zero.
3. **By Obsolescence:** Some assets are discarded before they are worn out because of changed conditions. For example, an old machine which is still workable may have to be replaced by a new machine because of the later being more efficient and economical. Such a loss on account of new inventions or charged fashions is termed as loss on account of obsolescence.

4. **By Depletion:** Some assets like mineral mines, oil wells etc. get exhausted or depleted through working. On account of continuous extraction of minerals or oil, a stage comes when the mine or oil gets completely exhausted and nothing is left.
5. **By Accidents:** An asset may meet an accident and therefore, it may get depreciated in its value.
6. **By Permanent fall in market price:** Though the fall in the market value of fixed assets is not recorded because such assets are not resale for use in the business. Sometimes, the fall in the value of certain fixed assets is treated as depreciation e.g. permanent fall in the value of investment.
7. **Changes in economic environment:** There may be instances when slackening of demand for the services of an asset may bring about a fall in its value. Such a change in conditions arises due to a number of factors e.g. technological changes within an industry, changes in tastes and habits of consumers, changes in availability of natural resources and so on.

Thus, depreciation applies to fixed assets, depletion to wasting assets, amortization to intangible assets and damage due to dilapidations of building or other property during tenancy.
Need or Objects or Significance of Providing Depreciation
The following are the objectives of providing depreciation:

1. **Ascertainment of true profit or loss:** Depreciation being a loss, will certainly affect the business profits. Therefore, to arrive at the true profit or loss, depreciation must be provided for and records in the books of accounts.
2. **Presentation of true financial position**: In a balance sheet, assets must be shown at their true values. This is not possible unless depreciation is provided and deducted from the values of these assets.
3. **Replacement of assets:** Some assets used in the business need replacement after the expiry of their service life. By providing depreciation, a part of the profit of the business is kept in the business which can be used for purchase of new asserts when the old fixed asserts become useless.
4. **Calculation of correct cost of production**: Correct cost of production cannot be calculated unless depreciation is properly provided and accounted for an item of cost of production.
5. **Prevention to withdrawal of capital:** Capital of a business remains invested in different assets. If no depreciation is charged, assets and capital are shown at enhanced figures due to such misrepresentation; capital itself may be withdrawn in the guise of imaginary profit.
6. **Excess payment of income tax**: Depreciation accounting is required for correct computation of profit for tax purposes and for computation of tax liability, otherwise more income tax will be paid on account of excess profit.
7. **To prevent distribution of profit out of capital:** If no depreciation is charged, it will result in showing more profit. Such excess profit may either be withdrawn by the owner or may be distributed among shareholders of the company as dividend. This will mean payment out of capital to the shareholders.
8. **Other objectives:** The workers may demand an increase in the wages or salary or in the payment of bonus as more profit will be shown if depreciation is not provided.

Factors Affecting Depreciation
Calculation of depreciation is a difficult work. Following three basic factors are of utmost importance in the calculation of depreciation:

1. **Total cost of the assets:** The cost of the asset includes the invoice price of the asset, less any trade discount plus all costs essential to bring the asset to a useable condition. In other words, cost includes all expenses up to the installation of the assets e.g. freight, carriage, installation charges etc.
2. **Estimated useful life of an asset:** This is represented by the number of years of the estimated serviceable life span of an asset. Thus, if an asset is expected to last for 15 years before completely losing its usefulness for business operations, its life is taken to be 15 years. If a

machine can work for 15 years but it is likely to become obsolete in 10 years due to availability of better type of machine, its useful life will be considered as 10 years.

3. **Estimates scrap value of an asset:** The term scrap value means the residual or break up or salvage value which is estimated to be realized on account of the sale of the asset at the end of its useful life. An important part in this connection is that an asset may not necessarily have a scrap value e.g., leasehold property.

Example: if a machine is bought for Rs. 50,000; Rs. 3,000 are spent on its freight, Rs. 2,000 for its installation, it is estimated by the expert that its working life will be 10 years and at that time residual value will be Rs. 2,500. In such case, depreciation will be calculated as follows:

Cost of the asset = Rs. 50,000 + Rs. 3,000 + Rs. 2,000 = Rs. 55,000
Working life of the asset = 10 years
Scrap value of asset Rs. 2,500

It means Rs. 52,500 (Rs. 55,000 – Rs. 2,500) will be written off in the time span of 10 year i.e. Rs. 5,250 every year as depreciation.

Depreciation and other Related Concepts

i. **Depreciation and Depletion:** Depreciation refers to a reduction in the value of all kinds of fixed assets arising from then wear and tear. Depletion is used in respect of the extraction of natural resources like quarries, mines, etc. that reduces the availability of the quantity of material or asset.

ii. **Depreciation and Obsolescence:** Obsolescence refers to decrease in usefulness caused on account of the asset becoming out of date, old fashioned, etc, and it is one of the causes of depreciation. Depreciation is the loss in the value of an asset on account of wear and tear.

iii. **Depreciation and Amortization:** Amortization refers to writing off of the proportionate value of the intangibles such as goodwill patents, copyrights while depreciation refers to writing off of the expired cost of the tangible assets like machinery, building, etc.

iv. **Depreciation and Fluctuation :** The points of difference are as follows :

Depreciation	Fluctuation
1. Charged on fixed assets.	1. It appears in respect of current assets
2. It is consistent in nature	2. It is inconsistent in nature.
3. It has a virtue of continuity.	3. It has no continuity
4. It always reduces the value of the asset.	4. It may cause increase in the value of asset.

Use of word per annum for calculation of amount of depreciation

In case the word “per annum” is given with the rate of deprecation than the amount of deprecation is calculated for the number of months the asset is used in business. When sale or purchase of asset takes place in between the year the deprecation is calculated for the period for which the asset was used.

In case per annum word is not given than the concept of number of months for which asset is used is over looked and depreciation is charged for whole year irrespective of asset being purchased in between the year and in case of sale of asset in between the year no deprecation is charged in selling year.

Methods of Charging Depreciation:

1. **Fixed Installment Method/ Original Cost Method:** In fixed installment method, a fixed part of the original cost of the asset is transferred to P & L A/c every year as depreciation. The amount transferred as depreciation is fixed or the same. In this method when the asset becomes useless, its value becomes zero.

   i. When the asset has no residual value:

$$\text{Each year's Dep.} = \frac{\text{Original cost of asset}}{\text{Number of years of estimated life of the asset}}$$

   ii. When the asset has residual value:

$$\text{Each years Dep.} = \frac{\text{Original cost of the asset – Its estimated resident value}}{\text{Number of years of estimated life of the asset}}$$

2. <u>Diminishing Balance Method/ Reducing balance method/ Written down value method:</u> In this method, depreciation is charged on the residual balance of the asset by a fixed rate of percentage. Thus, as the value of asset keeps going down year by year, depreciation also goes down in proportion. In this method the amount of depreciation is decreased every year.
   Rate of depreciation is fixed in this method, but depreciation at this rate is calculated on the balance of the asset standing in the books on the first day of each year.
   This method is suitable in case of those assets whose repair charges increase as they become old, e.g., Machinery. Also known as Reducing Balance method and written down value method.

Difference between Fixed Installment and Reducing Balance Method

Basis of different	Fixed Installment Method	Reducing Balance Method
1. Calculation of Depreciation	Depreciation is calculated on the original cost.	Depreciation is calculated on the remaining balance or opening book value of the asset.
2. Variation in depreciation amount	Amount of annual depreciation remains same.	Amount of annual depreciation keeps decreasing.
3. Balance at the end of life	Under this method, balance of asset account is either equal to zero or is equal to scrap value at the end of life of an asset.	According to this method balance of the asset can never be equal to zero.
4. Rate of Depreciation	Rate of depreciation is not kept high.	Rate of depreciation is normally kept high.
5. Burden on Profit & Loss	Burden of repairs and depreciation is not equitable under this method.	Burden to total cost of running the asset is almost equitable.
6. Applicability	This method is adopted on the assets which are of less value and shorter life.	This method is more suitable for those assets which lose their utility gradually and heavy repair cost is incurred on them.
7. Validity	This method is not approved by income tax laws.	This method is approved by tax laws and tax rebate is given on depreciation calculated by this method.
8. Practicability	Same depreciation is charged even when the asset is of less value.	As the utility of the asset reduces, the amount of depreciation keeps on decreasing.

Journal entries in case of Depreciation

1. On asset purchase
   Asset A/c Dr
   To cash/ Bank
2. On depreciation charged
   Depreciation on asset A/c Dr
   To asset A/c
3. On Transfer of depreciation to P&L A/c
   P&L A/c Dr
   To depreciation
4. On sale of asset at profit
   Cash/ Bank A/c Dr
   To P&L A/c
   To asset A/c

5. On sale of asset at loss
   Cash/ Bank a/c Dr
   P&L A/c Dr
   To asset A/c

Journal entries for Depreciation when provision of Depreciation is made.

1. For providing depreciation
   Depreciation a/c Dr
   To provision For Depreciation A/c
2. For transfer of depreciation to P&L A/c
   P&L A/c Dr
   To Depreciation A/c
3. On sale of asset
   a. Provision for Depreciation A/cDr
      To Assets A/c
   b. In case of profit or loss on sale of asset

If Profit: Asset A/c Dr
To P&L A/c

If Loss: P&L A/c Dr
To asset A/c

Alternately, on sale asset, an asset disposal account may be opened.

Change of Method:

i. In case of change of method of charging depreciation from straight line method to diminishing balance method, the depreciation is charged on the reduced balance of asset on the date when change is applicable.
ii. In case of change of method of charging depreciation from diminishing balance to straight line method, the depreciation is charged on the original cost of asset when change is applicable.

Change of method from previous date (Retrospective effect)

The change of method from straight line to diminishing balance and from diminishing to straight line can be made effective from the original/ previous date. In such a case there might be extra depreciation already charged or to be charged as change is to be made effective from previous date. The treatment of this extra of less depreciation is to be made. Such change of method is known as change of method from previous date i.e. retrospective effect. As per AS-6 when any change of method of depreciation is recommended, then the change is to be made effective from retrospective effect and not immediate effects.

Difference between Reserves & Provisions

S. No	Basis of Difference	Reserve	Provision
1	Meaning	A reserve is meant for meeting an unanticipated situation.	A provision is created for some specific object
2	Mode of creation	A reserve is created only out of profit. If there is no sufficient profit, a reserve cannot be created.	A provision is a charge against profit. It is created even though there is no profit.
3	Time of creation	A reserve is created after ascertaining the profit	A provision is created before ascertaining the profit or loss of a business.
4	Object	The object of creating such reserves is to strengthen the financial position of the business and to increase the working capital.	The object of making provisions is arrangement made to provide funds for known liability.

5	Utilization	Reserve can be used in the payment of any liability or loss.	Provision can be utilized only for the purpose for which it is meant.
6	Distribution	General reserve are always available for distribution of profits e.g. as dividend.	A provision cannot be utilized for the distribution of profit e.g. as dividend.
7	Place in accounting	Reserves show excess of assets over liabilities.	A provision is not shown as excess of asset over liabilities but it is helpful for determining the real valuation of assets.
8	Presenting in balance sheet	Reserves are always on the liabilities side in the balance sheet.	A provision is shown as an item of deduction from its related asset or shown on liability side.

Unit- Under section 209 of Companies (Amendment 1988) Act, 1956 every company is required to keep proper books of accounts and to prepare final accounts in proper form. Every company will keep at his registered office proper books of accounts with respect to –

1. All sums received and expanded by the company and the matters in respect of which there receipts and expenditures take place;
2. The sales and purchases of goods by the company;
3. The assets and liabilities of the company; and in case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to (i) utilization of materials or (ii) Labour or (iii) other items of cost as may be prescribed if such class of companies is required by the central Government i\to include such particulars in the book of accounts.

Annual Accounts & Balance Sheet

U/s 210 of Companies Act 1956, the Board of directors of every company is required to present in the Annual General Meeting the profit and loss a/c and the balance sheet on the last day of the financial year. If company is not engaged in profit making business income and expenditure account will be presented in place of profit and loss a/c. In the meeting, the director's reports and auditor's reports too will be presented.

The profit and loss account ad balance sheet shall relate (a) in case of first annual General Meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than 9 months; and

(b) In case of subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the accounts were last submitted and ending with a day which shall not precede the day of the meeting by more than 6 months, or in cases where extension of time has been granted for holding the meeting under the second provision to sub section (1) of section 166 by more than 6 months and the extension so granted. The period to which accounts aforesaid relate is referred to in this act as a financial year and if may be less than or more than calendar year but it shall not exceed 15 months, provided that it may extend to 18 months where special permission has been granted in that behalf by the register.

Unit-VII

As per section 129 of companies Act 2013, board of directors of every company is required to keep proper books of accounts and to prepare final accounts in proper form. Every company will keep at his registered office proper books of accounts.

The Board of directors of every company is required to present in the Annual General Meeting the profit and loss a/c and the balance sheet on the last day of the financial year. If company is not engaged in profit making business income and expenditure account will be presented in place of profit and loss a/c. In the meeting, the director's reports and auditor's reports too will be presented.

The profit and loss account ad balance sheet shall relate (a) in case of first annual General Meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than 9 months; and

(b) In case of subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the accounts were last submitted and ending with a day which shall not precede the day of the meeting by more than 6 months, or in cases where extension of time has been granted for holding the meeting under the second provision to sub section (1) of section 166 by more than 6 months and the extension so granted. The period to which accounts aforesaid relate is referred to in this act as a financial year and if may be less than or more than calendar year but it shall not exceed 15 months, provided that it may extend to 18 months where special permission has been granted in that behalf by the register.

Proforma of balance sheet

As per of Companies Act 2013, every company has to present a true and fair view of company's state of affairs relating to the last day of the financial year to which the company's balance sheet is related. The proforma for this should be as per part I of schedule III of the Act or as may be prescribed by the Central Government. Similarly a true and fair view of the profit or loss for the period corresponding to the period of the statement of profit and loss, should be presented in the form as prescribed in part II of schedule III. It should be noted that the statement of profit and loss is the annexure of balance sheet and always presented after the balance sheet. Balance sheet of a company shall be presented in the following form-

PART I – FORM OF BALANCE SHEET

Name of the Company….

Balance sheet (as at…) **(Rupees in……)**

Particulars	Notes No.	Figure as at the end of current reporting period	Figure as at the end of the reporting period
I. EQUITY AND LIABILITIES			
(1) Shareholder's funds			
(a) Share capital			
(b) Reserves and surplus			
(c) money received against share Warrants			
(2) Share application money pending allotment			
(1) Non-current liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities (net)			
(c) Other long term liabilities			
(d) Long-term provisions			
(4) Current liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
TOTAL			
II. ASSETS			
(1) Non-current assets			
(a) fixed assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) Other non-current assets			
(2) Current assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivable			
(d) Cash and cash equivalents			
(e) short-term loans and advances			
(f) Other current assets			
TOTAL			