SYLLABUS

Class – B.Com. (Hons) I Year

Subject – Financial Accounting

UNIT – I	Introduction to Basic accounting – double entry system, journal, subsidiary books, ledger and trial balance. Final accounts with adjustment.
UNIT – II	Concept of depreciation, accounting for depreciation (as per accounting standard-6) fixed installment method, diminishing balance method, annuity method and depreciation fund method, hire purchase system (Except hire purchase trading account)
UNIT – III	Single entry system, Bank reconciliation statement.
UNIT – IV	Branch accounts, departmental account
UNIT – V	Accounting for admission of partners, accounting for retirement of partners and death of partners. Dissolution of partnership Firm (with insolvency).

Unit 1

FUNDAMENTAL PRINCIPLES OF FINANCIAL ACCOUNTING

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.

BOOK-KEEPING

Book-Keeping is the proper and systematic keeping or maintenance of the books of accounts. Book-Keeping starts from the identification of business transactions. These transactions must be supported by the documents and they must be financial in nature. For example, selling goods for cash in an accounting transaction, because cash is received and goods are going outside the business. The transaction will increase cash and reduce goods.

Book-Keeping involves the following process:

1. Identifying accounting transactions
2. Initial record of accounting transactions
3. Preparation of ledger accounts
4. Balance Ledger accounts
5. Preparation of trial balance

DIFFERENCE BETWEEN BOOK-KEEPING AND ACCOUNTING

S.No	Basis of Difference	Book-Keeping	Accounting
1	Transaction	Trading transactions are recorded in primary books.	Entries written in primary books are checked and verified.
2	Posting	Entries are posted in ledger from journal and subsidiary books	Posting are checked whether correctly posted or not.
3	Total and Balance	It includes totaling of journal and finding of balances of ledger.	On the basis of balances of ledger final accounts are prepared
4	Objects	The object of Book-keeping is to write all trading transactions in a reasonable manner.	The object of accounting is to analyse the transactions written in the books.
5	Adjustments and Rectification of errors	In Book-keeping entries of adjustments and rectification of errors are not included.	Accounting includes entries of adjustments and rectification of errors.
6	Scope	Scope of Book keeping is narrow.	Scope of Accounting is wide.
7	Final Accounts	Final Account is not prepared in Book-Keeping.	Final account preparation is must.

<u>Accounting Concepts</u>

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) <u>Business Entity Concept</u> : 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) <u>Going Concern Concept</u> : 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.

ACCOUNTING SYSTEMS

The main systems of Financial Accounting are as under:

(1) Cash system – In this system, only cash entries are recorded in the accounts. All credit entries are written in a handbook and are entered in Cash Book only when they are paid or received. This system is kept by small trades, professional persons or non-trading institutions where most of the transactions are in cash.

(2) Mahajani system – It is oldest method of keeping accounts in India. Long Bahis are used for recording transactions and entries can be made in Mudia, Urdu, Sarafi, Hindi and any regional language. This system is completely scientific system as it is based on certain principles.

(3) Single entry system – Under it, some transactions are recorded at one place, some other transactions at two places and some transactions are recorded at all. Cash book and personal accounts are kept in it. It is an incomplete and unscientific system. Hence it is rarely used.

(4) Double entry system – Under it, every entry is recorded at two sides of the account so that the effect on each side of the account may remain equal. There are debit and credit side in it. This system was originated in Italy. Being a complete and scientific method, it is widely used and is more popular.

CONCEPT OF DOUBLE ENTRY SYSTEM

There are many systems of presenting business transactions in accounting books e.g., Mahajani system, Cash system, Double entry system etc. The use of these systems depends upon the size and type of business and nature of transactions. But in modern business world, double entry system of book-keeping is more popular and widely used.

The focus of the double entry system is that every business transaction has two aspects, i.e., when we receive something, we give something else in return. This approach of writing both the aspects of the transactions is known double entry system of accounting. Of the two accounts one account is given debit while the other is given credit with an equal amount. Thus, on any date the debits must be equal to the credits.

Evolution of Double Entry system:

The double entry system was originated in Itlay in 15th century. First of all in 1494 Lucas Pacioli, the famous mathematician of Venus of Venus city of Italy wrote his first book "De Computiset Scripturise' and mentioned method of accounting in one of its part. Emphasis was given on division and utility of waste book. Journal, Ledger etc. In 1543 Huge Old Castle translated it in English and after that many learned persons showed their views and gave it a new shape.

The following are the three distinct stages of a complete system of double entry :

a) Recording the transactions in the journal.
b) Classifying the transactions in the journal by posting them to the appropriate ledger accounts and then preparing a trial balance.
c) Closing the books and preparing the final accounts

Merits of Double Entry System

1. Full description: Every financial transaction is recorded in two related accounts separately in which full particulars are given for each transaction.
2. Knowledge of some important information regarding business: In Double entry system, real and nominal accounts are also maintained together with personal accounts. The information about capital employed, assets and liabilities can be obtained easily.
3. Testing of Mathematical Accuracy: Under this system, each debit entry has a credit entry due to which arithmetical accuracy can be checked with the help of trial balance.
4. Less chances of fraud: Under this system, double entry of each transaction reduces the possibility of forgery and fraud. Fraud can be avoided and traced easily.
5. Information of Profit and Loss: under this system, profit and loss account is prepared at the end of the certain period to find profit and loss.
6. Knowledge of Economic Status: With the help of balance sheet, the economic and financial status of the business can be obtained easily.
7. Comparatively Study and useful results: Trading, profit and loss account and balance sheet of current year can be compared with trading, profit & loss account and balance sheet of previous year to obtain useful analysis and conclusions.

Demerits and Limitations of Double Entry system

1. it is difficult to follow the rules of debit and credit in this system.
2. Though this system is fully scientific even then there are chances of errors and mistakes.
3. It is necessary to follow the principles and even a small mistake may give errorneous results.
4. It is an expensive system for small traders.
5. In order to get full efficiency in the system, it is necessary to have education, training and practical knowledge of accounts.

CLASSIFICATION OF ACCOUNTS

1) <u>PERSONAL ACCOUNTS</u>

a) Natural Personal Account : The term Natural persons means 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) <u>REAL ACCOUNTS</u>

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) <u>Nominal Accounts</u>: -

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

<u>RULES OF DOUBLE ENTRY SYSTEM</u>

The rules related to debit and credit of any account in double entry system are 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.
Capital and revenue

Classification of capital and revenue

The Going Concern Assumption allows the accountant to classify the expenditure and receipts as Capital expenditure, Revenue expenditure, Deferred Revenue expenditure, Capital Receipts, Revenue Receipts. The expenditure and receipts may be classified as follows:

Capital Expenditure: Capital Expenditure is that expenditure which is incurred (a) for acquiring or bringing into existence an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset or (c) for substantial replacement of an existing fixed asset. An asset of advantage of an enduring nature does not mean that it should last forever, it should not at the same time be so transitory and ephemeral that it can be terminated at any time. Basically, the capital expenditure is incurred with a view to brining in improvement in productivity or earring capacity. The examples of capital expenditure include cost of land and building, plant and machinery, furniture and fixtures etc. Such expenditure normally yields benefits which extended beyond the current accounting period.

Revenue Expenditure: Revenue Expenditure is that expenditure which is incurred for maintaining productivity or earning capacity of a business. Such expenditure yields benefits in the current accounting period. The examples of revenues expenditure include Office and Administrative expenses such as Salaries, Rent, Insurance, Telephone Exp., Electricity Charges, etc. Selling and Distribution Expenses such as Advertising, Travelling expenses, Commission to Salesman, Sales Promotion Expenses etc. Non-operating expenses and losses such as interest on loan taken, loss by theft etc.

Deferred Revenue Expenditure: Deferred Revenue Expenditure is that expenditure which yields benefits which extend beyond a current accounting period, but to relatively a short period as compared to the period for which a capital expenditure is expected to yield benefits. Such expenditure should normally be written-off over a period of 3 to 5 years. The examples of such, expenditure include heavy Advertising Campaign, Research and Development Expenditure.

Capital Receipts Vs Revenue Receipts There is no specific test to draw a clear cut demarcation between a capital receipt and a revenue receipt. In order to determine whether a receipt is capital or revenue in nature, one has to look into its true nature and substance over the form in the hands of its receipts. For example, sale proceeds of a land in the hands of a dealer in real estate is revenue receipt whereas the same in the hands of a dealer in cars is a capital receipt.
The examples of capital receipts include sale of fixed assts, capital contribution, loaned receipts, and the examples of revenue receipts include sale of stock-in-trade, revenue from services rendered in the normal course of business, revenue from permitting other to use the assets of the enterprise, such as interest, rent royalty.

ACCOUNTING STANDARDS

Accounting as a 'language of 'business' communicates the financial performance and position of an enterprise to various interested parities by means by financial statements which have to exhibit a 'true and fair' view of financial results and its state of affairs. As a result a wide variety of accounting methods were used by different companies. It was, then, felt that there should be some standardized set of rules and accounting principles to reduce or eliminate confusing variation in the methods used to prepare financial statements. However, such accounting rules should have a reasonable degree of flexibility in view of specific circumstances of an enterprise and also in line with the changes in the economic environment, social needs, legal requirements and technological developments. The setting of accounting standards is a social decision. Standards place restrictions on behaviour and therefore they must be accepted by affected parties.

ACCOUNTING STANDARDS ISSUED BY THE ICAI

The Institute of Chartered Accountants of India has thus far issued the following standard effective from the date noted against them.

(i)	AS-1	Disclosure of Accounting Policies	(1-4-1991)
(ii)	AS-2	Valuation of Inventories	(1-4-1991)(Revised)
(iii)	AS-3	Cash Flow Statement	(1-6-1991)(Revised)
(iv)	AS-4	Contingencies and events occurring after the Balance Sheet Date	(1-4-1995)
(v)	AS-5	Net Profit or Loss for the period, prior items and changes in Accounting Policies	(1-4-1996)
(vi)	AS-6	Depreciation Accounting	(1-4-1995)
(vii)	AS-7	Accounting for Construction contracts	(1-4-1991)
(viii)	AS-8	Accounting for Research and Development	(1-4-1991)
(ix)	AS-9	Revenue Recognition	(1-4-1991)
(x)	AS-10	Accounting for Fixed Assets	(1-4-1991)
(xi)	AS-11	Accounting for the effects of changes in Foreign Exchange Rates	(1-4-1995)
(xii)	AS-12	Accounting for Government Grants	(1-4-1994)
(xiii)	AS-13	Accounting for Investments	(1-4-1995)

(xiv)	AS-14	Accounting for Amalgamation	(1-4-1995)
(xv)	AS-15	Accounting for retirement benefits in the financial statements of employers	(1-4-1995)
(xvi)	AS-16	Borrowing Costs	(1-4-2000)
(xvii)	AS-17	Segment Reporting	(1-4-2001)
(xviii)	AS-18	Related Party Disclosures	(1-4-2001)
(xix)	AS-19	Leases	(1-4-2001)
(xx)	AS-20	Earning per share	(1-4-2001)
(xxi)	AS-21	Consolidated Financial Statements	(1-4-2001)
(xxii)	AS-22	accounting for Taxes on Income	(1-4-2002)
(xxiii)	AS-23	Accounting for Investments in Associates in consolidated Financial Statements	(1-4-2002)
(xxiv)	AS-24	Discontinuing Operations	(1-4-2002)
(xxv)	AS-25	Interim financial Reporting	(1-4-2002)
(xxvi)	AS-26	Intangible Assets	(1-4-2003)
(xxvii)	AS-27	Financial Reporting of Interest in Joint Ventures	(1-4-2002)
(xxviii)	AS-28	Impairment of Assets	(1-4-2004)
(xxix)	AS-29	Provisions, Contingent Liabilities and Contingent Assets	(1-4-2004)

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

DISCOUNT

Types of Discount :-

1) **Trade discount**: 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) **Cash discount**: 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 hirt 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.

Cash Book

Meaning of Cash Book

Cash book may be defined as the record of transactions concerning cash receipts and cash receipts and cash payments. In other words in Cash Book, all transactions (i.e., receipts and payments of cash) are recorded as soon as they take place.

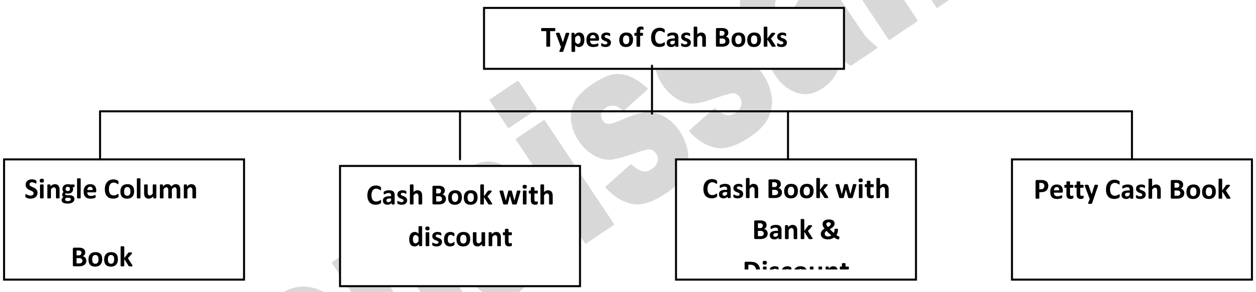
Cash Book is in the form of an account and actually it serves the purpose of Cash Account also. It has two sides-debit and credit side. On the debit side, all receipts of cash are recorded while on the credit side, all the payments of cash are recorded. Items on the debit side of the cash book are posted on the credit side of the ledger accounts and items on the credit side are posted on the debit side of the ledger accounts.

Features of cash book:

a. Only cash transactions are recorded in the cash book.
b. It performs the functions of both journal and ledger at the same time.
c. All cash receipts are recorded in the debit side and all cash payments are recorded in the credit side.
d. It records only one aspect of transactions i.e. cash.
e. All cash transactions are recorded chronologically in the cash book.

Types of Cash Book

The various types of cash book from the point of view of uses may be as follows:



1 Single Cash Book

Single Column Book has one amount column on each side. All cash receipts are recorded on the side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no needed to open this account in the ledger.

Format of Single Column Cash Book:

Dr. **Single Column Cash Book** Cr.

Date	Particulars	L.F.	Amount Rs	Date	Particulars	L.F.	Amount Rs

2 <u>Cash Book with Discount Column</u>

Cash book with discount Column has two amount columns (one for cash and another for discount) as each side. All cash receipts and cash discount allowed are recorded on the debit side and all cash payments and cash discount received are recorded on the credit side.

Format of Cash Book with Discount Column:

Dr. **Cash Book with Discount Column** Cr.

Date	Particulars	L.F.	Dis.	Cash	Date	Particulars	L.F.	Dis.	Cash

3. <u>Three Column Cash Book</u>

Three Column Book has three amount columns (one for cash, one for Bank, and one for Discount) on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on the credit side. In fact, a three-column cash book serves the purposes of Cash Account and Bank Account. Hence, there is no open these two accounts in the ledger.

Contra Entries

Format of Cash Book with Discount Column

Dr. **Three Column Cash Book** Cr.

Date	Particulars	L.F.	Dis.	Cash Rs	Bank Rs	Date	Particulars	L.F.	Dis.	Cash Rs	Bank Rs

4. <u>Petty Cash Book (Imprest system)</u>

Petty Cash Book is the book which is used for the purposes of recording the payment of petty cash expenses.

Meaning of Petty Cashier

Petty Cashier is the person who is authorized to make payments of petty cash expenses and to record them in petty cash book.

Features of Petty Cash Book

1. The amount of cash received from the main cashier is recorded on the left hand side column.
2. The payments of petty cash expenses are recorded on the right hand side in the respective columns.
3. It can never show a credit balance the cash payments can never exceed the cash receipts.
4. Its balance represents unspent petty cash in hand.

5. Recording is done on the basis of internal as well as external vouchers.
6. All the column of expenses are totaled periodically and such periodic totals are individually posted.
7. Petty Cash Book is both a book of original entry as well as a book of final entry.

Receipts				Payment								
Date	Particular	Cash Book Folio	Total Rs.	Date	Particular	Voucher No.	Postage Rs.	Conveyance Rs.	Cartage Rs.	Printing & Stationery Rs	Misc. items Rs	Total Rs.

Advantages of Petty Cash Book

1. Economy of time: The time of chief cashier is saved when petty expenses are recorded in petty cash book.
2. Saving of labour in posting : There is saving in labour in posting because :
   a. Limited number of accounts are opened for heads of petty expenses only,
   b. Periodical totals (say monthly) of each column of expenses are posted to the debit of the respective ledger accounts.
3. Lesser chance of mistakes: The chances of mistakes are reduced since the chief cashier regularly examines the petty cash book.
4. Control over petty expenses: Petty expenses are kept within the limits of imprest since the petty cashier can never spend more than the available petty cash.
5. Control over fraud: Misappropriation if any, is always kept within the limits of imprest.
6. Benefits of specialization: The benefits of specialization are available since recording of cash transactions is divided between main cash book and petty cash book.

Posting of Petty Cash Book in ledger

1. Petty Cash Book as a part of Journal or Double Entry system
2. Petty Cash Book as a Memorandum book.

<u>Imprest vs. Non-Imprest System of Petty Cash Book</u>

The amount which the main cashier hands over to the petty cashier in order to meet the petty cash expenses of a given period is known as 'Imprest' or 'Float'.

Petty cash book may be maintained on imprest system on non-imprest system.

Features of imprest system of petty cash

1. Estimation by chief cashier: The Chief Cashier estimates the total petty cash expenses for a particular fixed period.
2. Advances by chief cashier: The Chief Cashier advance the estimated amount to the petty cashier in the beginning of the period.
3. Submission of petty cash book by petty cashier: The Petty Cashier submits the petty cash book along with supporting vouchers to the chief cashier at the end of the period.
4. Examination of petty cash bank by chief cashier: The Chief Cashier examines the petty cash book.
5. Reimbursement of amount spent: The Chief Cashier makes the reimbursement of the amount spent by the Petty Cashier.

6. Availability of same amount of petty cash: The Petty Cashier again has the same amount of petty cash in the beginning of new period.

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

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.

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.

Subsidiary Book
Preparation of Purchase Day Book

This book is maintained mainly to record credit purchases of goods. The term goods refers to all such commodities and services in which we deal.

Date	Particulars (Names of suppliers)	Invoice No.	L.F.	Amount Rs.	Net Amount Rs

<u>Posting :</u> Each suppliers personal account is credited in the ledger with its respective amount with the words " *By purchases a/c*". The monthly total of this book is debited to purchases a/c in the ledger with the words *"To sundries as per Purchases Book"*

Preparation of Sales Book

This book is maintained mainly to record credit sales of goods. Hence the cash sales of goods and assets sold are not entered in this book. Entries in this book are made from the outward invoice of credit sales.

Date	Particulars (Names of Customer /Party)	Invoice No.	L.F.	Amount Rs.	Net Amount Rs

<u>Postings :</u> Each Customer's personal account is debited in the ledger with its respective amount with the words *"to Sales a/c"* . The periodical total of this book is credited to sales a/c with the words " *By sundries as per sales book".*

Preparation of Returns Outward of Purchase Return Book

This book is maintained to record the return of goods purchased earlier from the suppliers on credit. When goods are returned a debit note is made out and sent to the supplier to whom goods are returned.

Date	Particulars	Debit Note No.	I.F.	Amount Rs.

<u>Postings :</u> Each suppliers account mentioned in the purchased earlier from the suppliers on credit. When goods are returned a debit note is made our and sent to the supplier to whom goods are returned

Preparation of Return inward or Sales Return Book

This Book is maintained manly the returns of goods sold to customers on credit. On receipt of the goods the firm prepares a Credit Note in the name of the customer and sends its original copy to the customer. Entries are made from credit note book into the sales returns books.

Date	Particulars	Credit Note No.	I.F.	Amount Rs.

<u>Posting:</u> Each customer's personal account {as given in the sales returns book} is credited with the amount of goods returned by him with the words" *By Sales a/c''.* The sales return A/c in the ledger gets the debit with the periodical total of Sales Returns Book with the words *"To sundries as per Sales returns Book"*

Preparation of Bills Receivables Book

This books is maintained to keep a detailed record of the bills receivable received by the firm. This book provides a medium for posting bills receivable transactions. The ruling of this book is given below:

Date When received	Drawer	Acceptor	Where Payable	Date of bill	Term	Due date	I.F.	Amount Rs.	Remark

Posting: - The personal account of the person from whom the bill is received is credit with the amount of that bill and the periodical total of the Bills Receivable Book is debit to Bills Receivable a/c in the ledger.

Preparation of Bills Payable Book

This book is maintained to keep a detailed record of all bills payable accepted by firm.

Date of Acceptance	To whom given	Payee	Where payable	Date of bill	Term	Due date	L/F	Amount Rs.	Remark

Posting: The person account of the person whose bill as accepted is debited with the amount of that bill and the periodical total of the Bills Payables Book is credited to Bills Payables in the ledger.

<u>TRIAL BALANCE</u>

<u>Meaning</u>

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 are at least arithmetically correct.

<u>Main Characteristics and uses of a Trial Balance</u>

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 balances.
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 book 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					

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. These expenditure are 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 prepare 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	-	By Sales -	
To Purchase -		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

Profit and loss accounts 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 & Maintanance	-	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	-
To Audit fees	-	Capital Account)	
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 year	Income A/c Dr. To Acc. Income a/c	Deducted from 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 & L A/c	Rs. 6,000 shown on assets side as Insurance Co.
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	Op. stock/Trad. A/c	The Difference is either	The difference is

	stock.	Dr. To Capital A/c	added to op. stock or debited to Trading A/c	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 business car is for personal purposes. Car exp. Rs. 2000 and deprecation Rs. 800	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 To Car Dep. (800×75%)600	i. Liab. Rs. 700 deducted from Cap. 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-II
'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 valure 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 upto 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 fastioned, 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. **Diminishing Balance Method/ Reducing balance method/ Written down value method**:
   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 dep. 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.

3. **Annuity Method:** In annuity method the amount invested in an asset is considered as an investment and interest is calculated on such amount. Every year the amount of interest is calculated and same is transferred to debit side of the asset A/c and depreciation A/c is credited. Thus the effect of depreciation and interest keeps increasing on the P & L A/c because every year the P & L A/c is debited with the amount of depreciation and credited with the interest.
   Under this method amount of depreciation is found out from annuity table. When as asset is purchased, the purchaser not only loses the amount spent in purchasing the asset but he also loses the expected amount of interest which he would have earned had he invested this amount elsewhere instead of purchasing this asset. Under this method amount of depreciation includes some portion of the asset and some portion of this expected amount of interest also.
4. **Depreciation Fund Method:** In this method, Govt. Investments are purchased every year by the amount of depreciation. More securities are purchased by the return on previous securities. Thus the depreciation is invested in securities. Compound interest is received on such securities. Investments are not made in the last year; instead all securities are sold out and the return is used for renewal. Amount of depreciation is not deducted from the value of the asset;

instead it is transferred to the credit side of Depreciation Fund A/c. Asset is shown on the original cost every year.

5. **Depreciation Repairs & Renewals Fund Method**: In this method, the life of the asset, depreciation thereon, scrap value at the end of its life and repairing expenses of the asset are estimated in advance. Such estimated amount is transferred to the P & L A/c in equal parts. In this method a Depreciation Repairs and Renewals Fund a/c is opened. In this account, the estimated installment calculated in the above mentioned manner is transferred to the P & L A/c every year. When the life of the asset is over, it is disposed of. The balance of Fund A/c is transferred to the asset A/c and both accounts are closed. If some balance remains in the Asset A/c it is transferred to the P & L A/c.
6. **Insurance Policy Method:** In Insurance Policy Method the amount of depreciation is not invested in external securities. Instead, an insurance policy is taken for renewal of the asset. Every year a fixed amount is paid as premium of the policy and after a certain period the insurance company pays back in lump sum, which is used for renewal.
7. **Revaluation Method:** In this method at the end of each year the asset is revalued by an expert before the preparation of final accounts and any reduction in the value of the asset is assumed as depreciation and is duly charged. If there is an appreciation in the value of such asset, it is overlooked. When the asset is revalued at a lower price, the amount by which it is reduced is assumed as depreciation. The Depreciation A/c is debited with this amount and asset A/c is credited with the same.
8. **Sum of the year digits method**: First of all the estimated cost of assets is calculated by deducting scrap value from original cost. The total of digits of the assets is made in an order. If the life of a company is five years – 5 + 4 + 3 + 2 + 1 = 15 will be sum of the digits. For calculation of depreciation assets of first year will be assumed to be equal in use of the asset throughout its life. In the following years the period will gradually be reduced. The following formula is used to calculate depreciation:

$$\text{First year} = \frac{\text{Estimated value of the asset x Total life of asset}}{\text{Total of all years}}$$

In second and following years one year respectively will be reduced from the total number of years.

9. **Machine hour rate method:** In this method the life of machinery is estimated in hours and the whole loss on the machinery (Cost - Scrap Value) is divided by such hours. Thus the depreciation is calculated on per hour use of the machinery.
10. **Depletion Method :** In this method, an estimate of the profits which the assets is supposed to yield in the future is made and the amount invested in the asset is divided in such profit and depreciation per unit is calculated.

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	The object of making provisions is arrangement made to provide funds for known liability.

		capital.	
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.

Accounting For Hire Purchase

Accounting for Hire Purchase

Hire purchase system is a special system of purchase and sale. When goods are purchased on hire purchase system, purchasers pay the price in instalments, these instalments may be monthly, quarterly, six monthly or yearly or of any other period as mentioned in hire-purchase agreement.

Definition of Hire Purchase System

"Under the hire purchase system, goods are delivered to a person who agrees to pay the owner by equal periodical instalments, such instalments are to be treated as hire of these goods until a certain fixed amount has been paid, when these goods become the property of hirer"

----- J.R. Baltiboi

Content of hire purchase agreement

Every hire-purchase agreement shall state – (a) the hire purchase price of the goods to which the agreement relates; (b) the cash price of the goods, that is to say, the price at which the good may purchased by the hirer for cash; (c) the date on which agreement shall be deemed to have commenced ; (d) the number of instalments by which the hire purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and (e) the goods to which the agreement relates, in a manner sufficient to identify them.

Hire Purchase Price: Hire Purchase price means the total sum payable by the hirer under a hire-purchase agreement in order to complete the purchase of, or the acquisition of property in the goods to which the agreement relates; and include any sum, so payable by the hirer under the hire purchase agreement by way of a deposit or other initial payment or credited or to be credited to him under such agreement on account of any such deposit or payment, but does not include any sum payable as penalty or as compensation or damages for a breach of the agreement.

Hirer: Hirer means the person who obtains or as obtained possession of goods from the owner under a Hire-Purchase Agreement and include a person to whom the hirer's right of liabilities under the Agreement have passed the assignment or by operation of law.

Contract of Guarantee in relation to any Hire: Purchase agreement means contract whereby a person guarantees the performance of all or any of the hirer's obligations under the Hire-Purchase Agreement.

Owner: Owner means the person who lets or has let, delivers or as delivered possession of goods, to a hirer.

Characteristics of Hire Purchase System:

- ✓ Purchase is credit purchase.
- ✓ Purchase price is paid in instalments.
- ✓ Goods are delivered to the buyer.
- ✓ Buyer has a right to use these goods.
- ✓ Hirer has a right to terminate agreement at any time.

Unit -3

Bank Reconciliation Statement

Bank **reconciliation** is a process that explains the difference between the bank balance shown in an organisation's bank statement, as supplied by the bank, and the corresponding amount shown in the organization's own accounting records at a particular point in time.
Such differences may occur, for example, because a cheque or a list of cheques issued by the organization has not been presented to the bank, a banking transaction, such as a credit received, or a charge made by the bank, has not yet been recorded in the organisation's books, or either the bank or the organization itself has made an error.
It may be easy to reconcile the difference by looking at very recent transactions in either the bank statement or the organisation's own accounting records (cash book) and seeing if some combination of them tallies with the difference to be explained. Otherwise it may be necessary to go through and match every single transaction in both sets of records since the last reconciliation, and see what transactions remain unmatched. The necessary adjustments should then be made in the cash book, or any timing differences recorded to assist with future reconciliations.
For this reason, and to minimise the amount of work involved, it is good practice to carry out such reconciliations at reasonably frequent intervals. Reconciliations are generally performed by specialised accounting software though the understanding of what occurs is important for a successful reconciliation. Also, **Bank reconciliation statement** is a statement prepared on a particular day to reconcile the bank balance as per *Cash book* or *Bank statement* showing entries causing difference between the two balances.

BANK RECONCILIATION STATEMENT

A. Purpose of a bank reconciliation

It should be prepared regularly as part of the internal control system of the business to check:

a) The accuracy of the cash book
b) The accuracy of the bank statement
c) That undue delay is not occurring between payments, receipts and their clearance by the bank
d) To discover payments made and items received by the bank not entered in the cash book

B. Reasons for difference in bank statement and cash book

The causes of difference will fall into one of the following classes:

a) Items (not consisting of errors) which appear in the bank statement but which are not in the cash book, e.g., dishonored cheques or bills, interest and bank charges, standing order (an order made to the bank to make a regular payment), dividends or interest income credited direct to the bank and payments by customers which are paid direct to the bank.
b) Items (not consisting of errors) which appear in the cash book but which do not appear in the bank statement. These are confined to outstanding cheques and outstanding deposits.
c) Errors made in the compilation of the cash book or the bank statement.

C. Two different formats of bank reconciliation statement

1) The bank balance in the cash book is reconciled to the balance in the bank statement. (Or the balance in the bank statement to the bank balance in the cash book.)
2) Both the bank balance in the cash book and the balance per bank statement are reconciled to a common corrected balance.

Why Balance of Cash Book and Pass Book Are different?

- No Intimation of Bank Action: For some transactions, the bank has earlier knowledge and it adjusts its record before the business. Some differences may arise from the bank's action that has not been intimated to the customer.
- Time Lag: There may be a time gap between recording transactions in the customer's book and bank's book.
- Errors from both the parties: Some differences in balance may arise owing to errors committed by the bank or by the person responsible for preparing the Cash Book.

Causes of difference between the balances of Cash book and Pass Book:

- Transactions which have been recorded in cash book but not in pass book.
- Transactions which have been recorded in pass book but not in cash book.
- Errors in cash book.
- Errors in pass book.

Single entry system

Meaning of accounts from incomplete records:

Accounting records, which are not strictly kept according to double entry system are knows as incomplete records. Under this system, for certain transaction (for example cash paid to creditor) both the aspects (payment side of cash book are debited to personal account of the creditors) are recorded while for others only one aspects is recorded (for example, payment of rent) or no entry is made (for example, depreciation for fixed assets) . Normally under this system records of cash and personal accounts of debtors and creditors are properly maintained, while the information relating to assets, liabilities, expenses, and revenue is partially recorded. Hence, these are usually referred as incomplete records.

Definitions of Accounts from incomplete records:

According to Kohler, " A system of book-keeping in which as a rule only records of cash and of personal accounts are maintained, it is always incomplete double entry system, varying with circumstances."

According to M.M. Choksi, "Accounts from incomplete records is an incomplete, inaccurate, unscientific, and unsystematic style of account keeping."

Main features /characteristics of accounts from incomplete records

- Maintanace of Personal Accounts : if there are credit sales and credit purchases the personal accounts of customers(debtors) and suppliers (creditors) are maintained. But the real and nominal accounts are avoided. In other words, the accounts of fixed assets, liabilities expenses and incomes are not maintained.
- Dependences on original vouchers: to calculate profit or loss or to collect purposeful information, necessary figures can be collected only from the original vouchers such as purchase invoice, sale invoice, etc. Thus dependence on original voucher is inevitable.
- Lack of legal recognition: this sytem of accounting is not acceptable by tax authorities.
- Less expensive: under this system, fewer books are maintained hence it is less costly in comparison to double entry system.

Advantages of Accounting from Incomplete Records

- Simple method: it is a simple and easy method of recording business transaction.
- Economical: this system is less expensive, because it requires lesser books of accounts.
- Suitable for small traders: it is suitable for small traders and professionals because they can not spend large amount on keeping records.
- Tax evasion: this system is used to evade the tax as full details are not available under this system.

Disadvantages

- No records of impersonal accounts: under this methods only personal accounts are opened, impersonal accounts are not opened.
- No trial balance: for some transactions both aspects are recorded while for others only one aspects is recorded . Hence, trial balance is not prepared.
- Lack of business statistics: full records of all transactions is not kept, hence it encourages fraud, misappropriation and embezzlement.

Difference between double entry system and accounts from incomplete records

S.No.	Basis of difference	Double entry system	Accounts from incomplete records
1	Recordings of both aspects	Both aspects of every transaction are recorded in it.	In some cases both in other cases only one aspect is recorded.
2	Types of accounts	All personal, real, nominal accounts are opened	Only personal accounts and cash accounts are opened.
3	Trial balance	Trial balance is prepared	Trial balance cannot be prepared.
4	adjustments	Adjustments are mades	No adjustments
5	proof	In case of necessity, records is treated as proof.	In case of necessity, record is not treated as proof.
6	Expensive	Very expensive	Less expensive

UNIT-IV
DEPARTMENT ACCOUNTS

When activities of a big organization are divided into different processes or divisions or unit or functions than there process or functions are performed in different departments all though all these departments are part of a business it is necessary to that which department is earning profit and which one is suffering loss. So separate accounts are made for each department and at the end of the year their separate P&l a/c are prepared.

Method of keeping departmental accounts:

For preparing departmental trading and profit & loss account the books of original records are also ruled out accordingly. There are two methods of departmental accounting .

(i) **Unit wise method**: in this method each department is treated as an independent unit and separate books of accounts are maintained for each of them and final accounts are prepared at the end of the year.

(ii) **Columnar method** : under this method entries of each department are made jointly and separate column of each department is given and one column is made for the total of all the department

Departmental final accounts: departmental trading and Profit & Loss account is prepared on the basis of same rules of which are followed for preparation of general trading and profit & loss a/c. under departmental trading and profit & loss account a separate column is drawn for each department on debit and credit side and a total column is also drawn on both the side. Each item of related department is shown in that column and total of those columns will be shown in total column this profit or loss of each department and total profit or loss of business can be found out.

Balance sheet: - this is not prepared departmental wise but only one B.S. is made for whole the business as usual.

Allocation of departmental expenses: -

In Practice the following general rules are usually applied for allocation and apportionment of expenses. Expenses directly related is a particular department should be changed to that department, but is any exp is not particularly belongs to a particular department can be apportionment on the following basis table. Some of the expenses such as interest on debentures loan, capital, director's fees, salary of general manager office exp etc. can not be apportioned to different department on any equitable basis. Thus such expenses are debited in general profit & loss account only. These may be some income e.g. interest as dividend received on investment transfer fees, etc are not related to any department these incomes are credited in general profit & loss a/c

Sl.	Expenses	Basis
1.	(a) Travelling salesman's salary and commission (b) Selling expenses (c) After–sales service (d) Discount allowed (e) Freight outwards (f) Provision for discounts on debtors (g) Sales manager's salary and other benefits	Sales of each department
2.	(a) Rent, rates and taxes (b) Air conditioning expenses (c) Heating	Area
3.	Lighting	Light points Area
4.	Insurance of Stock	Average stock carried
5.	Insurance of Building	Area
6.	Insurance of Plant & Machinery	Value of Plant & Machinery
7.	Group insurance premium	Direct wages
8.	Power	H.P. or H.P. x Hours worked
9.	(a) Depreciation (b) Repairs and renewals	Value of assets in each department
10.	(a) Canteen expenses (b) Labour welfare expenses	Number of employees
11.	Works manager's salary	Time spent in each department
12.	Carriage inwards	Purchases of each department.

Inter departmental transfers:-

Generally a department may transfer its products or services to other department such transfers are treated like normal sales and purchases of the departments while preparing departmental trading account. Transfer will be shown as sales of Transferor department and purchases of transferee department. Reverse treatment will be made in the case of return.

If inter-departmental transfers are made at cost price then no adjustment will be required for unrealized profit included in the stock of transferee department taken from transferor department.

If the goods are transferred at selling price, then such adjustment will be required. Reserve for unrealized profit will be shown in general profit & loss account. This will be equal to the profit added by the transferor department. It will be adjusted in the next year as opening balance in general profit & loss account.

Journal entries for unrealized profit –

General profit & loss a/c Dr.
To Reserve /Provision for unrealized profit
Or
To Stock Reserve

The reverse entry will be made at the beginning of the next year.

Amount of stock reserve will be computed as under-

(a) If the Profit percentage is given on selling/transfer/invoice price-

$$\text{Stock reserve} = \frac{\text{Percentage}}{100} \times \text{amount of stock on which reserve is required}$$

(b) if the profit percentage is given on cost price-

$$\text{Stock Reserve} = \frac{\text{Percentage}}{100 + \text{Rate of Profit}} \times \text{Amount of stock on which reserve is required}$$

BRANCH ACCOUNTS

Many business concerns open branches at various places for selling their goods. These branches may be opened in the town, in the state and in the country at various places and also in foreign countries.

Meaning of Branch Accounts : Account which are opened in the books of head office and branches, related to branches are called Branch Accounts.

Objects of maintaining Branch Accounts : (i) Profit or loss of each branch can be found out; (ii) They help in controlling branches; (iii) Actual financial position of the business can be found out on the basis of Head Office and Branch accounting records; (iv) Branch requirements of goods and cash can be estimated; (v) Suggestions for increasing the efficiency of the Branch can be made on the basis of Branch Accounts;(iv) They help in complying the requirements of law because according to the Companies Act, 1956, maintenance of accounting record of branches by companies is essential.

Specimen of Branch Account in Head Office Books

	Rs.		Rs.
		By Balance b/d (op. Liabilities	
To Balance b/d		By Cash A/c	
Opening stock		By goods Supplied to Branch	
Opening Petty Cash		(Return)	
Opening Assets		By Assets (Closing Balance)	
To Goods Supplied to Br.		Stock at Branch a/c	
To Cash (Exp.) a/c		Petty Cash at Branch a/c (Closing)	
To Liabilities (Closing)		By General P & L A/c (Closing)	
To General P & L A/c		(if Loss)	
(if profit)			

INCORPORATION OF BRANCH TRIAL BALANCE
IN HEAD OFFICE BOOKS

Each branch sends its Trial Balance to Head Office. With the help of this Trial Balance Head Office makes record in its books regarding Branch. It is known as Incorporation of Branch Trial Balance. In order to incorporate Branch Trial Balance in Head office books, it should be divided in two parts :

STOCK AND DEBTORS METHOD

Under this method following accounts are opened in the books of Head Office for Branch :

1. Branch Stock Account.
2. Goods sent to Branch Account
3. Branch Debtors' Account
4. Branch Expenses Account
5. Branch Adjustment Account
6. Stock Reserve Account
7. Branch P & L Account.

INDEPENDENT BRANCH

These branches receive goods from Head Office but they are allowed to manufacture and purchase goods also. They are completely independent for all the activities but their owner is Head Office and they have to follow the instructions of Head Office.

(a) Items related with Trading and Profit and Loss Account '

(i) Opening Stocks, Purchases and Direct Expenses :

Branch Trading A/c ... ...Dr.
To Branch A/c
(Being incorporation of the following items from Branch Trial Balance:

	Rs.
Opening Stock	...
Purchases	...
Goods from Head Office	...
Carriage, etc.	...)

(i) Sales and Closing Stock :

Branch A/c ... ...Dr.
To Branch Trading A/c
(Being incorporation of the following items from Branch Trial Balance:

	Rs.
Sales less Returns	...
Closing Stock	...)

(ii) Gross Profit and Loss :

Branch Trading A/c ... ...Dr.
To Branch P & L A/c
(Being transfer of gross profit)
Branch P & L A/c
To Branch Trading A/c
(Being transfer of gross loss)

(iii) Indirect expenses like Salaries and Rent, etc. :

Branch P & L A/c ... ...Dr.
To Branch a/c
(Being incorporation of the following items from Branch Trial Balance:

Rs.
Salaries ...
Rent ...
Bad Debts ...)

(iv) Items of Revenue Income :
Branch A/c ... ...Dr.
To Branch P & L A/c
(Being incorporation of the following items of revenue income from Branch Trial Balance)

(iv) Net Profit and Loss :
Branch P & L A/c ... ...Dr.
To General P & L A/c
(Being transfer of net profit)
General P & L A/c ... ...Dr.
To Branch P & L A/c
(Being transfer of branch loss)

(b) Amount related with Branch Assets and Liabilities

(v) For Assets :
Branch Cash A/c ... .Dr.
Branch B/R A/c ... ...Dr.
Branch Debtors A/c ... ...Dr.
Branch Furniture A/c ... ...Dr.
Branch Stock in Trade A/c ... ...Dr.
To Branch A/c
(Being incorporation of the following above mentioned assets From Branch Trial Balance)

(vi) For Liabilities :
Branch A/c ... .Dr.
To branch Liabilities A/c
(Being the incorporation of Branch Liabilities from the Branch Trial Balance).

When Branch Account is closed after transferring all assets and Liabilities in the beginning of new year in the Head Office books following entry is made. This entry is called opening entry

Branch A/c ... ...Dr.
To Branch Assets A/c
Branch Liabilities A/c ... .Dr.
To Branch A/c ... ...Dr.

UNIT-V
ADMISSION OF A NEW PARTNER

Introduction

In partnership firm the number of partners in **banking business** has been specified as minimum 2 and maximum 10 and in other partnership business minimum 2 and maximum 20. The new partner is admitted into the business with free consent of the other partners. While admitting the new partner he is paid a share in the total profit of the firm.

Need for Admission of a New Partner

A new partner may be admitted for any one or more of the following reasons:

(i) For procuring more capital for expanding business.
(ii) For acquiring more ability for efficient management and administration of business.
(iii) For looking after the increased business of the firm.
(iv) For progress of the firm.
(v) For reducing competition.
(vi) For various other reasons.

ACCOUNTING PROBLEMS AT THE TIME OF ADMISSION OF A PARTNER

(1) Determination of new profit sharing ratio and sacrificing ratio at the time of admission of new partner.
(2) Valuation and accounting of goodwill of the firm.
(3) Revaluation of the assets and liabilities of the firm.
(4) Transfer of reserves, undistributed profit and profit and loss of the firm.
(5) Writing off of fictitious assets of the firm.
(6) Adjustment of capital or calculation of old partners capitals on the basis of new partners capital account.
(7) Calculation of new partner capital on the basis of old partners capital jointly.
(8) Adjustment of joint life insurance policy.

In partnership business, at the time of admission of a new partner he is paid a certain share out of the total profit. Thereafter, the remaining profit is distributed to the old partners. The profit sharing ratio of the old partners is changed due to the admission of new partner.

Meaning of New profit Sharing Ratio : The ratio calculated to distribute the future profits of the partnership business among all the partners (old & new) is known as new profit sharing ratio. On the admission of a new partner, the old partners sacrifice a part of their profit in favour of new partner.

New Profit Sharing Ratio = Old Profit Sharing Ratio – Sacrificing Ratio

Meaning of Sacrificing Ratio : The old partners either jointly or any of the partner individually may sacrifice a share of their profit in order to give a share of profit to the new partner.

Sacrificing Ratio = Old Profit Sharing Ratio – New Profit Sharing Ratio

Use of Sacrificing Ratio : It is necessary to determine the sacrificing ratio of the old partners at the time of bringing goodwill in cash by the new partner because the cash brought in by the new partner in form of goodwill has to be distributed among the old partners sacrificing ratio. If only a single partner has sacrificed his share of profit in favour of new partner then the entire amount of goodwill brought in cash will be received by him.

Difference between New Profit Sharing Ratio and Sacrificing Ratio :

Basis of Difference	New Profit Sharing Ratio	Sacrificing Ratio
1. Meaning	The new profit sharing ratio is the ratio used to distribute the future profit of business among all the partners (old &	The share of profit sacrificed by the old partners in favour of new partner is sacrificing ratio.

	new).	
2. Scope	In new profit sharing ratio both old and new partners are included.	Only old partners are included in it.
3. Objects & Use	The new profit sharing ratio is used to distribute the future profit among all partners.	The share of goodwill brought in cash by the new partner is distributed among the old partners by sacrificing ratio.
4. Calculation	New profit sharing ratio = Old profit sharing ratio = Sacrificing ratio.	Sacrificing ratio = Old profit sharing ratio – New profit sharing ratio.

Calculation of sacrificing ratio old profit sharing ratio & new profit sharing ratio

Old partners can give share to the new partner in the following way :

(1) In their old profit sharing ratio.
(2) In equal ratio.
(3) In unequal ratio.
(4) By sacrifice of any partner.

(1) IN THEIR OLD PROFIT SHARING RATIO

Example – Ram, Shyam and Mohan are partners. Sharing in the ratio of 3:2:1. They admit Hari for 1/8 share. Calculate new ratio.

(2) By sacrifice of any partner
e.g. If Hari gets his entire share from Ram:

(3) In equal ratio
e.g. If Hari gets his share in equal ratio from all the partners :

(4) In Unequal ratio
e.g. When Hari gets 2/3 from Ram and 1/3 from Shayam:

GOODWILL

Goodwill is an intangible fixed asset by which business organization attains a position to earn excess earnings in future. Goodwill is created by various factors and its form and value may vary in difference trades and even in different business of the same trade. In short, 'Capacity to earn additional profit is termed as Goodwill'.

Characteristics

Generally goodwill has following characteristics :

(i) Goodwill is an intangible fixed asset.
(ii) Goodwill can't be touched or seen but can be fell.
(iii) Value of goodwill depends upon the name and popularity of business.
(iv) Goodwill is created by various elements.
(v) It can't be separated from business.
(vi) It is created along with business and it comes to an end with closure of business.
(vii) Sound goodwill attracts customers, it increase their business contacts.
(viii) In fact, goodwill is not a fictitious asset as it can purchased or sold like any other asset.
(ix) Goodwill depends upon the position of business, owner reputation, capabilities of employees, popularity of product and good name of business.
(x) It is marketable asset.

Types of Goodwill :

(a) Cat Goodwill
(b) Dog Goodwill
(c) Rat Goodwill
(d) Goodwill of Strange Nature

Factors affecting value of Goodwill

1. Place of Business
2. Nature of Business
3. Risk and uncertainty of Business
4. Monopolistic Business
5. Management of Business
6. Personality of Businessmen
7. Volume of Capital
8. Popularity of Trade Mark
9. Volume of profit.
10. Other factors like :Government policy, License policy, National peace, conditions of market, Consumerism, Purchasing power of customers, etc.

Recommendations as per AS-10 And AS-26 Issued by ICAI

Goodwill should be **recorded in the books only when some consideration in money or moneys worth has been paid for it**. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business takeover, the excess should be termed as goodwill.

Thus

(1) Only purchased goodwill to be recorded in the books of accounts.
(2) Non purchased goodwill (Self generated goodwill) will have to be adjusted through partners capital accounts. Hence, this goodwill now cannot be shown in balance sheet of partnership business.

METHODS OF VALUATION OF GOODWILL

Partnership deed requires the disclosure of method used for valuation of goodwill. Goodwill can be valued by any one of the following methods :

(1) **Average Profit Method**

$$\text{Goodwill} = \frac{\text{Total Profit}}{\text{Number of Years}} \times \text{Number of years of purchase}$$

(2) **Super Profit Method**

Average profit of the firm is compared with the normal yield on the invested capital in the firm. Excess of average profit over normal yield or profit is known as super profit.

$$\text{Normal Profit} = \frac{\text{Capital invested} \times \text{Rate of profit generally earned}}{100}$$

Super Profit = Actual profit – Normal profit

Goodwill = Super profit x No. of years purchased

(3) Annuity Method

If a firm is making super profits, it is estimated as to how many years firm will continue to get this super profit. Present value of super profits of these years is found out by Annuity Method.

Goodwill = Super profit x Present Value of Re. 1 by Annuity Method

(4) Capitalization Method

Average profits are first capitalized on the basis of normal rate of return, and then excess of this capitalized amount over net assets of the firm is goodwill.

Total value of firm = Average profit/normal rate of return x 100

Net Assets = Total Assets (excluding Fictitious Assets) – Outside Liabilities

Goodwill = Value of Firm – Net Assets

Journal Entries For Bringing Capital by new partner

1. Capital brought in cash :
   Cash/Bank A/c Dr.
   To New Partner's Capital A/c
   (Being cash brought in by new partner as capital)
2. Capital brought in kind (asset) :
   Assets A/c Dr.
   Purchase (Goods) A/c Dr.
   To New Partners Capital A/c
   (Being assets and goods brought in by new partner as capital)

Accounting Treatment of Goodwill on admission of Partner

Transactions	Journal Entries
1. New partner giving share of goodwill to old partners privately	No journal entry (Due to payment of amount of goodwill outside the firm this amount doesn't come in the business. Therefore, it will not be entered in firms books of accounts)
2. (a) New partner bringing his share of goodwill in cash	(a) Cash/Bank A/c To Premium A/c ..Dr. (Being cash brought in by new partner as goodwill/premium for his share of profit)
(b) Distributing the amount of goodwill by old partners in their sacrificing ratio.	(b) Premium A/c ..Dr. To Old Partners Capital A/cs (in sacrificing ratio) (Being premium credited to old partners capital accounts in their sacrificing ratio)
3. As per question, withdrawal of their share of goodwill by a old partners in full or part.	Old Partners Capital A/cs ..Dr. To Cash/Bank A/c (Being amount of premium fully/partially withdrawn by old partners)
4. If new partner doesn't bring his amount of goodwill in cash then calculating his share of goodwill on the basis of his profit sharing ratio out of valuation of total goodwill. 4.1 No goodwill account is raised.	New Partners Capital A/c (with his share of goodwill) To Old Partners Capital A/Cs (in sacrificing ratio) (Being new partners share of goodwill debited to his capital account and credited to Old Partners Capital accounts in their sacrificing ratio)
4.2 When goodwill a/c is raised. When goodwill a/c is closed.	Goodwill a/c Dr. To Partner Capital A/c (old ratio) (being goodwill a/c raised on admission of new partner) All partners capital A/c Dr. To Goodwill A/c (being goodwill a/c written off in new profit sharing ratio)

5. Writing off goodwill shown in balance sheet by old partners in their old profit loss ratio.	Old Partners Capital A/c ..Dr. (in old profit sharing ratio) To Goodwill A/c (in Balance Sheet) (Being existing goodwill in balance sheet written off by old partners in their profit sharing ratio)
6. In place of 2(a) and 2(b), a combined entry can be passed as	Cash/Bank A/c ..Dr. To Old Partners Capital A/c (Being amount of premium brought in by new partner, directly credited to old partners capital accounts in their sacrificing ratio)

REVALUATION ACCOUNT

When a new partner is admitted sometimes revaluation is made of all the assets and liabilities of the old firm. Excesses and deficits of assets and liabilities are transferred to an account known as Revaluation Account or Profit and Loss Adjustment account.

Revaluation Account or Profit and Loss Adjustment account

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Decrease in the value of Assets (Individually)	√	By Increase in the value of Assets (Individually)	√
To Reserve for Bad and Doubtful debts (Individually)	√	By Decrease in the value of Liabilities (Individually)	√
To Increase in the value of Liabilities (Individually)	√	By Unrecorded Assets (viz. Unrecorded Investment prepaid expenses etc.)	√
To Unrecorded Liabilities (viz. Outstanding expenses)	√	By Cash/Bank A/c (Sale of unrecorded asset)	√
To Cash/Bank A/c (Payment of unrecorded liability)	√	To Reserve for Discount on Creditors A/c	√
To Profit transferred to Old Partners Capital A/cs (In old ratio)	(Balancing figure)	By Loss transferred to Old Partners capital A/cs (in old ratio)	(Balancing figure)

Journal entries : On revaluation of assets and liabilities following journal entries are made :

(1) For depreciation in assets reserve for doubtful on debtors outstanding exp.
Profit and Loss adjustment A/c Revaluation A/c .Dr.
To Various assets A/c (write individually)
To Reserve for bad and doubtful debate A/c
To Outstanding expenses A/c
(Being depreciation in the value of assets provision for reserve and bad and doubtful debts and outstanding expenses adjusted)

(2) For appreciation in assets prepaid expenses, reserve for discount on creditors decrease in reserve for for doubtful debts
Various Assets A/c (write individually) .Dr.
Prepaid/Unexpired expenses A/c .Dr.
Reserve for discount on creditors A/c .Dr.
To Profit and loss adjustment A/c Revaluation A/c
(Being appreciation in the value of assets, prepaid expenses reserve for discount on creditors and reserve for doubtful debts adjusted)

(3) For reduction in value of liabilities
Particular Liabilities A/c .Dr.
To Profit and loss adjustment A/c Revaluation A/c
(Being decrease in the value of liabilities adjusted)

(4) For increase in value of liabilities — Profit and Loss Adjustment A/c Revaluation A/c .Dr.
To Particular Liabilities A/c
(Being increase in the value of liabilities adjusted)

(5) Entry for unrecorded asset — Particular Unrecorded Asset A/c .Dr.
To Profit and Loss Adjustment A/c Revaluation A/c
(Being unrecorded assets adjusted)

(6) Sale of unrecorded asset — Cash/Bank A/c .Dr.
To Profit and Loss Adjustment A/c Revaluation A/c
(Being unrecorded asset sold)

(7) Entry for unrecorded liability — Profit and Loss Adjustment A/c / Revaluation A/c .Dr.
To Particular Unrecorded Liabilities A/c
(Being unrecorded liabilities adjusted)

(8) Payment of unrecorded liability — Profit and Loss Adjustment A/c / Revaluation A/c .Dr.
To Cash/Bank A/c
(Being payment made on unrecorded liability)

Now Profit and Loss Adjustment account or Revaluation Account is opened and above entries are posted in the account. After posting, balance of this account is found out. If total of credit side is more than the total of debit side then such difference is termed as profit. If total of debit side is more than total of credit side then such difference is known as loss. The profit or loss is distributed among old partners in old profit-loss ratio for which following journal entries is made :

(7) Profit on revaluation — Profit and Loss Adjustment A/c / Revolution A/c .Dr.
To Old Partners' Capital A/c
(Being profit on revaluation transferred to Old Partners' Capital A/c in their profit sharing ratio

(8) Loss on revaluation — Old Partners' Capital A/c .Dr.
To Profit and Loss Adjustment A/c /Revaluation A/c
(Being loss on revaluation transferred to old Partners' Capital A/cs in their profit-sharing ratio)

Opening of necessary Ledger Accounts : At the time of admission of new partner following accounts are opened :
(i) Profit and Loss Adjustment A/c or Revaluation A/c
(ii) Old Partners' Capital A/c
(iii) New Partner's Capital A/c
(iv) Goodwill A/c
(v) Cash/Bank A/c

On the basis of above accounts and keeping the old balance sheet into consideration the new balance sheet is prepared after the admission of new partner.

TRANSFER OF RESERVES, UNDISTRIBUTED PROFIT & LOSS IN TO PARTNERS CAPITAL A/C

This account is closed and not shown in balance sheet of the new firm.

(1) Profit & Loss A/c. Reserve, General Reserve, Reserve Fund, Contingency Fund, etc. shown in liabilities side of balance sheet divided in old partners in old profit loss ratio —
Profit and Loss A/c .Dr.
Reserve A/c .Dr.
General Reserve A/c .Dr.
Reserve Fund A/c .Dr.
Contingency Fund A/c .Dr.
To Old Partners Capital A/c
(Being profit and loss A/c, Reserve, General Reserve, Reserve Fund, Contingency Fund credited to old partners

		Capital accounts in the old profit sharing ratio)
(2)	Loss shown in assets side of balance sheet distributed among old partners in profit loss ratio.	Old Partners Capital A/c .Dr. To Profit and Loss A/c (Being old losses debited to old partners capital accounts in Old profit sharing ratio)

AMORTIZATION OF FICTITIOUS ASSETS

Journal entry for Amortization of Fictitious Assets : (i.e. differed revenue exp. preliminary exp. etc.)

Fictitious Assets shown in assets side of Balance sheet distributed among old partners In old profit loss ratio.	Old Partners Capital A/c .Dr. To Fictitious Assets A/c (Being writing off fictitious assets by debiting Old partners capital accounts in old profit Sharing ratio)

RETIREMENT OF A PARTNER

Introduction :

A legal partnership is a mutual contract between partners. Partnership can be established with by at least two persons any time, and it can be dissolved any time with the consent of all the partners. Any partner engaged in partnership business can retire from partnership business the anytime due to any reason. For this purpose he will have to give six months prior intimation to the firm about his retirement and can retire from the firm in accordance with the provisions of partnership Act. At the time of retirement, retiring partner receives his share of interest from the firm. The partner who retires from the firm is known as 'Retiring Partner' while other remaining partners in firm are known as 'Continuing Partners'.

MEANING AND REASON FOR RETIREMENT OF A PARTNER

According to section 32 of Indian Partnership Act, 1932, a partner may retire from partnership (a) with consent of all other partners (whether implied or expressed); or (b) in accordance with an express agreement by the partners; or (c) conveying his intention to retire (in case of partnership at will) by a written notice.

When a partner wants to leave the firm due to any of the following reasons then it is termed as retirement from partnership :

(a) due to a disease or physical weakness.
(b) Due to old age.
(c) Due to dispute with any partner.
(d) A desire to do some more profitable business or work.
(e) Due to any other reason by which he doesn't want to continue in partnership.

CALCULATION OF TOTAL AMOUNT PAYABLE TO RETIREING PARTNER

In order to determine the total amount due to retiring partner, his capital account is prepared on the date of his retirement. Retiring partner is entitled to get his share of interest out of the following items or following items are recorded in credit side at his capital account after writing the amount of his capital as per balance sheet :

(i) His share in total goodwill of the firm at the date of retirement.
(ii) His share in undistributed profit, profit and loss account (credit balance), reserve, reserve fund, general reserve, etc. shown in liabilities side of balance sheet.
(iii) His share in profit in case of revaluation of assets and liabilities of the firm on the date of retirement as reflected by profit & loss Adjustment Account or Revaluation Account.
(iv) Any interest on his capital, salary, commission, remuneration, etc. either due or outstanding.

(v) His share in estimated net profit from the last balance sheet date till the date of retirement.
(vi) His share in surrender value of Joint Life Insurance Policy.

Following items are recorded in the debit side of retiring partners capital account at the time of retirement.
(i) His share in profit and loss account as shown in assets side of balance sheet.
(ii) His share in loss in case of revaluation of firm's assets and liabilities on the date of retirement as reflected by profit & loss Adjustment Account or Revaluation Account.
(iii) His drawings and interest on drawings.
(iv) His share in net estimated loss from last balance sheet date till the date of retirement.
After writing all the above items in the capital account of the retiring partner on the date credit balance which is paid in full or in part in cash or in case of lack of cash the balance is transferred to his loan account.

Dr. Retiring Partners Capital Account Cr.

Date	Particulars	J.F.	Amount	Date	Particulars	J.F	Amount
			Rs.				Rs.
	To Profit and loss a/c(Dr.)				By Balance b/d		Capital
	To Profit and loss Adjustment a/c or Revaluation a/c (Loss)				By Profit and loss a/c (Cr.)		
	To Drawing a/c				By Undistributed profit		
	To Interest on drawing a/c				By Reserve		
	To Retiring partners Loan a/c or To Cash or Bank a/c		(Balance - ing figure)		By Reserve fund		
					By General reserve		
					By Profit & loss adjustment a/c or Revaluation a/c (Profit)		
					By Interest on Capital a/c		(if due)
					By Joint life policy a/c		(Share in surrender value)

ACCOUNTING TREATMENT/SETTLEMENT OF TOTAL AMOUNT PAYABLE TO RETIRING PARTNER

The credit balance of retiring partner's capital account is the total amount payable to retiring partner, whose liability for payment depends upon the firm. The total amount payable to the retiring partner can be paid by any of the following mode and its accounting will be done as under :

(A) Full payment to retiring partner :

1. Full payment in cash or from bank balance
   Retiring Partner's Capital A/c Dr.
   To Cash/Bank A/c
   (Being full payment made to Retiring Partner)

2. Full payment by taking loan from bank by the firm :

   (a) On taking loan from the bank
   Bank A/c Dr.
   To Bank Loan A/c
   (Being loan taken from bank for payment to Retiring partner)

   (b) Full payment to retiring partner
   Retiring Partner Capital A/c Dr.
   To Cash/Bank A/c
   (Being full payment made to Retiring Partner)

(B) Incase of inadequate cash balance or bank balance, full payment to retiring partner from available cash and bank balance and remaining amount brought by continuing partners in their profit sharing ratio or adjusted capital ratio :

3.(a)	On bringing additional capital by continuing partners	Cash/Bank A/c Dr. To Remaining Partners Capital A/cs (Being additional amount brought in by remaining partners to make payment to retiring partner)
(b)	On making full payment to retiring partner	Retiring Partners Capital A/c Dr. To Cash/Bank A/c (Being full payment made to Retiring Partner)

(c) Part payment to retiring partner : In case of inadequate cash and bank balance retiring partner may be paid partially in cash and remaining amount is transferred to his loan account.

4.	On making part payment in cash and transferred remaining amount to his loan account	Retiring Partner's Capital A/c Dr. To Cash/Bank A/c To Retiring Partner's Loan A/c (Being part payment made and balance transferred to his loan account)

(D) Transferring the total amount payable to retiring partner to loan account : Sometimes, due to lack of cash, it may be possible that amount due to retiring partner may entirely be transferred to his loan account. The firm will provide interest on the amount of loan at a prescribed rate or @ 6% increase if no rate has been determined.

5.	On transferring total amount payable to his loan account	Retiring Partner's Capital A/c Dr. To Retiring Partner's Loan A/c (Being balance of capital account transferred to his loan account)
6.	Interest being due on loan	Interest A/c Dr. To Retiring Partner's Loan A/c (Being interest due on retiring partners loan account)
7.	Payment of above interest	Retiring Partner's Loan A/c Dr. To Cash/Bank A/c (Being interest paid to retiring partner on due amount)

(E) Payment in installments to retiring partner : After transferring the balance of retiring partners capital account to his loan account, if this balance is paid in installments with interest then interest is calculated on the opening balance and added to amount of installments; thereafter amount of installment is paid. Interest is calculated till the entire amount of loan is paid off. On payment of installments the due amount as well as amount of interest decreases. After payment of last installment retiring partners loan account is closed.

8. (a)	Interest being due on outstanding amount payable	Interest A/c Dr. To Retiring Partner's Capital A/c (Being interest due on balance of Partner's Loan a/c)
(b)	Payment of installment along with interest	Retiring Partner's Capital A/c Dr. To Cash/Bank A/c (Being installment money including interest paid)

Note: The above two entries will be made upto the payment of last installment.

(F) Payment by annuity to retiring partner : In case of payment if due amount by annuity to retiring partner in limited number of years, then balance of retiring partners capital account is transferred to

Annuity Suspense Account. Amount of interest is credited in this account from time to time and at the time of annual payment. Annuity account is debited while Cash/Bank account is credited.

9.(i)	Balance of capital account of retiring partner transferred to Annuity Suspense account	Retiring Partner's Capital A/c Dr. To Annuity Suspense A/c (Being balance of Retiring Partners Capital A/c Transferred to Annuity Suspense A/c)
(ii)	On interest being due	Interest A/c Dr. To Annuity Suspense A/c (Being interest due on balance amount)
(iii)	On payment	Annuity Suspense A/c Dr. To Cash/Bank A/c (Being payment made by Annuity)

It is noteworthy that in case of death of retiring partner before full payment by annuity, the outstanding balance of annuity suspense account is considered as capital profit and it is distributed among the remaining partners in their profit loss sharing ratio. As against this, if retiring partner remains alive even after the entire payment of amount of Annuity Suspense Account even then he is paid the amount of annuity till he is alive (until he dies) and profit and loss account is debited by the amount of this payment.

ACCOUNTING PROBLEMS AT THE TIME OF RETIREMENT OF A PARTNER

At the time of retirement of a partner following accounting problems require adjustments :

1. Calculation of Goodwill.
2. Accounting of Goodwill.
3. Revaluation of assets and liabilities of the firm.
4. Transfer of reserve, undistributed profit and profit and loss account to capital a/c.
5. Writing off fictitious assets.
6. Adjustment of capital.
7. Adjustment of joint life insurance policy.
8. Payment in installments.

Meaning of New Profit & Loss Ratio, Gaining Ratio of the Partners

New Profit and Loss Ratio : The ratio in which the future profit or loss shall be distributed among the continuing partners after retirement of a partner, is called as new profit and loss ratio. New profit and loss sharing ratio is calculated to avoid mutual conflicts and disputes.

Gaining Ratio : Ratio in which continuing partners receive share of retiring partners is called gaining ratio. Gaining ratio can be determined by subtracting old profit and loss sharing ratio from new profit and loss sharing ratio.

Gaining Ratio=New Profit & Loss Sharing Ratio – Old Profit & Loss Sharing Ratio

Gaining ratio is calculated after retirement or death of a partner in partnership firm. In case of retirement, it is necessary to calculate gaining ratio for opening goodwill account with the share of retiring partner or accounting for goodwill without opening goodwill account. The calculation of new profit and loss ratio and gaining ratio is shown in the following table :

Distinction between Sacrificing Ratio and Gaining Ratio

Thee are following theoretical and practical differences between sacrificing ratio and gaining ratio :

Basis of Difference	Sacrificing Ratio	Gaining Ratio

1. Meaning	Old partners sacrifice their share in favour of New partner. Ratio of such sacrifice is termed as 'Sacrificing Ratio'	In case of death or retirement of a partner, there is an increase in share of profits of remaining partners. Such increase in profit sharing ratio is termed as Gaining Ratio.
2. Calculation	Sacrificing Ratio = Old Profit Loss ratio – New Profit loss ratio.	Gaining Ratio = New profit loss ratio – Old profit loss ratio.
3. Time of computation	Sacrificing ratio is computed at the time of admission of a partner.	Gaining ratio is computed at the time of death or retirement of any partner.
4. Objective	Objective of calculating this ratio is to distribute the amount of goodwill brought in cash by the new partner among the old partners in their sacrificing ratio.	Objective of calculating this ratio is for make payment to the retiring partner his share of goodwill by the continuing partners.
5. Adjustment of Goodwill	For adjustment of goodwill account of partners are credited	For adjustment of goodwill account of continuing partners is debited.

TREATMENT OF GOODWILL: APPLICATION OF ACCOUNTING STANDARD-10

"According to Paragraph-16 of Accounting Standard-10, 'In case of admission or retirement or death of a partner or in case of change in profit sharing ratio among partners, Goodwill Account cannot be raised in the books of firm because no consideration in money or moneys worth is paid for it. Goodwill can be recorded in the books only when some consideration in money or money worth has been paid for it. Therefore, only purchased Goodwill should be recorded in the books of account".

Retiring partner gets his share in his profit and loss sharing ratio in internally generated inherent goodwill of the firm. According to Accounting Standard-10, goodwill will be shown in books of accounts only if cash is paid in consideration of goodwill. According to this Standard, goodwill will recorded in the books of accounts by the share of retiring partner through remaining partners capital accounts. In no case goodwill account can be raised.

ADJUSTMENT OF JOINT LIFE POLICY

Meaning of Joint Life Policy

Joint Life Policy means that life insurance policy which is taken by partnership firm on joint life of all the partners from Life Insurance Corporation. The sum insured on such policy is paid by the Life Insurance Corporation on the expiry of period of policy of term or on death of any partner, whichever is earlier. Accounting Treatment of Joint Life Policy

At the time of retirement of partner, partnership firm inquires about the surrender value of Joint Life Policy from Life Insurance Corporation. *Surrender value refers to that value which will be paid by Life Insurance Corporation on surrendering the policy to LIC before completion of term of policy or at the time of insured being alive.* Thereafter, Partnership firm make entry for adjustment of surrender value at the time of retirement of any partner.

Before making any record of JLP in the books of accounts it is necessary to know whether the premium paid on JLP is a revenue or trade expense or it is a capital expenditure.

I Case I: When Premium paid is treated as Trading Expenses/Revenue Expenditure]

What partnership firm treat premium paid on JLP as expenses like—Salaries, Rent, Electricity charges, etc. then it is recorded in debit side of profit & loss account, then there will be no Joint Life Policy appearing in Balance Sheet.

At the time of retirement of any partner, partnership firm inquires about the surrender value of Joint Life Policy from Life Insurance Corporation. Accounting of surrender value is done as follows at the time of retirement of a partner :

(a) *When amount of surrender value is not received from Life Insurance Corporation and Joint Life Policy Account is open.*

Opening Joint Life Policy Account with	Joint Life Policy A/c (Surrender value) Dr. To All Partners' Capital A/c (Profit sharing ratio) (Being surrender value of Joint Life Policy credited to all partners' capital accounts in their profit sharing ratio on retirement of a partner)

Treatment in Balance Sheet: Now joint life policy account is prepared and its debit balance is shown in assets side of balance sheet. In such case, joint life policy account remains opened.

(b) *When amount of surrender value is not received from Life Insurance Corporation and Joint Life Policy Account is closed.*

(i) Opening Joint Life Policy Account with surrender value	Joint Life Policy A/c (Surrender Value) Dr. To All Partners' Capital A/c (Profit Sharing Ratio) (Being surrender value of Joint Life Policy credited to all partners' capital accounts in their profit sharing ratio on retirement of a partner)
(ii) Closing of Joint Life Policy Account by	Remaining partnership A/c Dr. To Joint Life Policy A/c (Surrender value) (Being surrender value of Joint Life Policy written off by remaining partners in their new profit sharing ratio)

Treatment in Balance Sheet : In above condition Joint Life Policy Account is closed automatically. Therefore, it is not shown is Balance Sheet.

(c) *When surrender value of Joint Life Policy is not to be shown and surrender value is to be entered through capital account of partners.*

On entering surrender value of Joint Life Policy through Partners' Capital Accounts.	Gaining Partners' Capital A/c Dr. (In gaining ratio) To Retiring Partner's Capital A/c (With his share in Surrender Value) (Being retiring partner's share in surrender value _payable gaining partners in their gaining ratio)

Case II: When Premium paid is treated as Capital Expenditure (Asset)1

In case of premium of Joint Life Policy being treated as a capital expenditure (asset) then Joint Life Policy appears in assets side of Balance Sheet at surrender value. In such condition, at the time of a partner it has to be decided that whether joint life policy appearing in Balance Sheet should be written off or continued as it is.

(a) *When Joint Life Policy is kept in Balance Sheet :* In such case, there is no entry made for adjustment of Joint Life Policy because the amount (surrenders value) of Joint Life Policy has already been credited to capital account of all the partners.

(b) *When Joint Life Policy is not to be kept in Balance Sheet:* Sometimes remaining partners may decide to close the JLP Account after retirement of a partner.

On closing Joint Life Policy Account by remaining partners	Remaining Partners' Capital A/cs Dr. (In new ratio) To Joint Life Policy A/c (Given in B/S) (Being existing Joint Life Policy in Balance Sheet written off by remaining partners in their new profit sharing ratio)

PARTNERSHIP ACCOUNTS: DEATH OF A PARTNER
(INCLUDING JOINT LIFE POLICY]

INTRODUCTION

Man knows that death is inevitable but when he does not know. Any partner may die any time in partnership firm. After his death, partnership firm continues to operate business as per provisions laid down in partnership deed, In fact, death of a partner dissolves the partnership but it results in reconstitution of the partnership firm.

In case of death of a partner, his executor is eligible to receive the amount due to deceased partner from partnership firm. It is already prescribed in partnership deed that how the amount due to deceased partner will be calculated and how it will be paid. In absence of partnership deed, section 37 of Indian Partnership Act, 1932 is applied.

Death of a partner from accounting point of view implies permanent retirement. Thus all entries, adjustments and accounting rules which are followed at the time of retirement are also applied in case of death of partner. It also includes problems as to share of profit for the period between last balance sheet date and the date of death of partner along with share in joint life policy. These are discussed in detail in this chapter.

CALCULATION OF TOTAL AMOUNT PAYABLE TO THE EXECUTORS OF THE DECEASED PARTNER

In case of death of a partner, amount due to executors is calculated and journal entries are made and books of accounts are maintained in the same manner as in case of retirement.

In partnership firm, executors of deceased partner are authorized to receive payment of following items (these items are written in the credit side of the capital account of deceased partner):

1. Credit balance of capital and current accounts of deceased partner.
2. His share in total goodwill (calculated on the date of death).
3. His share in undistributed profit (retained earning), profit & loss account, reserve, reserve fund, general reserve etc. shown in liabilities side of balance sheet.
4. His share in profit on revaluation of assets and liabilities at the date of death.
5. If interest on capital, salary, commission, remuneration, etc. is outstanding or due to him.
6. His share in net estimated profit for the period between balance sheet date and date of death.
7. His share in joint life policy.
8. Loan given to partnership firm and interest due thereon.

Following items are subtracted while calculating amount due to executors of deceased partners :

1. Debit balance of capital or current accounts of deceased partner.
2. His share in undistributed accumulated loss or profit-loss account shown in assets side of balance sheet.
3. His share in loss of revaluation of assets and liabilities at the date of death.
4. Drawings and interest on drawings on deceased partner.
5. His share in firm's net estimated loss for the period between last balance sheet date and date of death.
6. Loan given to deceased partner by firm and interest due thereon.