SYLLABUS

Class – B.Com. I Year

Subject – FINANCIAL ACCOUNTING

UNIT-I	Concept of Double Entry System, Accounting Concepts and Conventions Preparation of Journals, Sub division of Journal, Preparation of Ledger and Trial Balance. Final Accounts with Adjustments.
UNIT-II	Introduction to Indian Accounting Standards. Detail study of accounting standard - 6 and 10, Branch Accounts, Departmental Account.
UNIT-III	Royalty Accounts, Accounting of Non-Profit making Organization.
UNIT-IV	Joint Venture Accounts, Consignment and Investment Account.
UNIT-V	Partnership Accounts – Dissolution with Insolvency of Partner, Amalgamation of Partnership Firms, and Conversion of Partnership Firm into Joint Stock Company.

UNIT-I

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.

Accounting Concepts

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

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

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

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

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

External liabilities + Capital = Total Assets

Total Liabilities = Total Assets

This is called the Accounting or Balance Sheet equation.

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

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

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

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

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

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

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

Accounting Conventions

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

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

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

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

Basic Accounting Terms

Every subject has got its own terminology. Accounting also, as a subject has got its own terms. These terms have their specific meaning in Accounting and used to express financial nature of the business.

1. Business Transactions

The economic event that relates to a business entity is called business transaction.
Every business activity is not an Accounting activity. This is why; every activity is not recorded in the books of accounting. We record only business transactions in financial Accounting. The first step in the accounting process is the identification of business transactions. Every activity of financial nature

having documentary evidence, capable of being presented in numerical, monetary term causing effect on assets, liabilities, capital revenue and expenses is termed as Business Transactions.

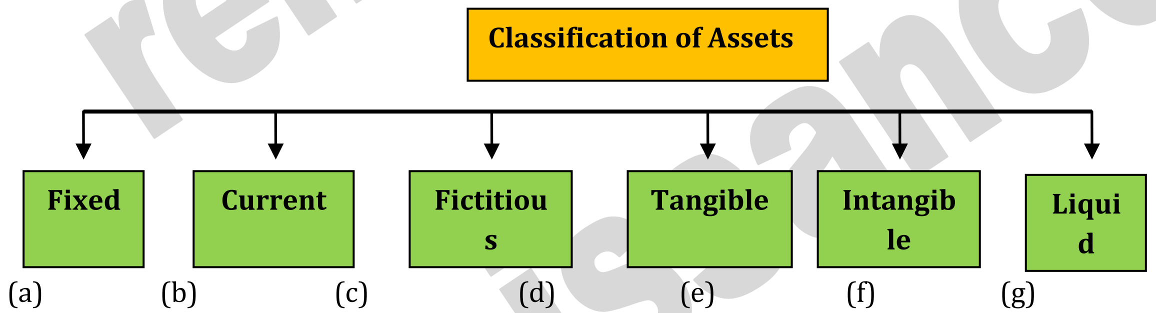
Special features of Business transactions are as above

- **a. Business transactions must be financial in nature.**
- **b. Business transactions must be supported by documentary evidence.**
- **c. Business transactions must be presented in numerical monetary terms.**
- **d. Business transactions must cause an effect on assets, liabilities, capital, revenue and**

Business transactions as such refer to business activities involving transfer of money or goods or services between two parties or two accounts. Purchase and sale of goods, receipts of income etc. are business transactions. Business transactions may be both Cash or Credit.

2. Assets

The valuable things owned by the business are known as assets. These are the properties owned by the business. Assets are the economic resources of a enterprise which can be expresses in monetary terms. In the words of Prof. R.N. Anthony, "Assets are valuable resources owned by a business which were acquired at a measurable money cost." These basic terms are discussed as under:



Liquid Assets = Current Assets – (Stock + prepaid expenses)

3. Capital

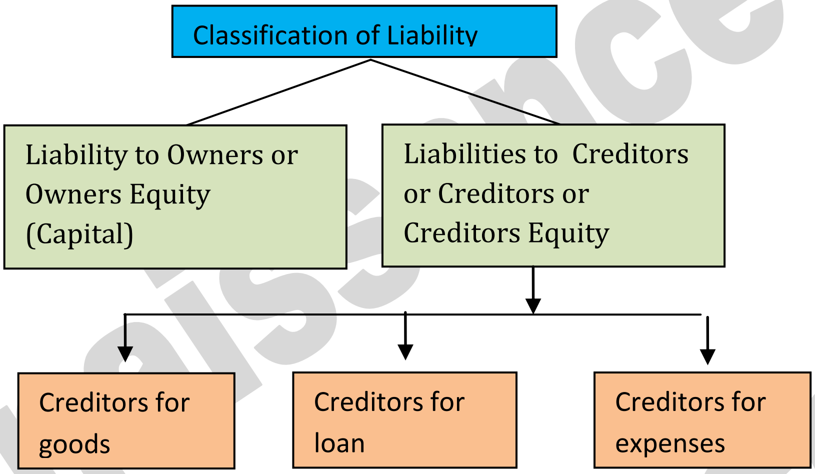
It is that part of wealth which is used for further production and capital consists of all current assets and fixed assets. Cash in hand, Cash at Bank, Building, Plant and Furniture etc. are the capital of the business. Capital should need not necessarily be in cash. It may be in kind als. Capital is classified as fixed capital and working capital:

- **a. Fixed Capital.** The amount invested in acquiring fixed assets is called fixed capital. The money is blocked in fixed assets and not available to meet the current liabilities. The amount spent on purchase or extension or addition to the fixed assets is fixed capital. Plant and machinery, vehicle, furniture and building etc. are some of the examples of fixed capital.
- **b. Floating Capital.** Assets purchased with the intention of sales, such as stock and investments are termed as floating capital.
- **c. Working Capital.** The part of capital available with the firm for day-to-day working of the business is known as working capital. Sufficient funds are required for purchasing goods and incurring direct and indirect expenses. Operational expenses are met with working capital. Current assets and current liabilities constitute working capital. Current assets consist of Cash in hand, Cash at Bank, Bills Receivable, Debtors, Stock in hand etc. and creditors, bills payable, short term loan, income received in advance and outstanding expenses are the current liabilities. Working capital can also be expressed as under:

  Working capital = Current Assets – Current Liabilities

4. Equity or Liability

Liabilities are the obligations or debts payable by the enterprise in future in the form of money or goods. It is the proprietors' and creditors' claim against the assets of the business. Creditors may be classified as creditors for goods and creditors for expenses. The business should have liability. Liabilities can be classified as under:



5. Financial Statement

Statements prepared by an enterprise at the end of accounting year to assess the status of income and assets are termed as Financial statement. It is categorized as Income statement and Position statement traditionally known as Profit and Loss Account and Balance Sheet.

6. Accounting Equation

Accounting rotates around three basic terms. These terms are assets, Liabilities and Capital. The true inter-relationship between these terms is represented as Accounting Equations i.e.,

7. Goods

Articles purchased for sale at profit or processing by the business or for use in the manufacture of certain other goods as raw material are known as goods. In other words, goods are the commodities, in which the business deals. Furniture will be goods for the firm dealing in furniture but it will be an asset for the firm dealing in stationery. Americans use the term 'merchandise' for goods.

8. Purchases

In its routine business, the firm has no either purchase finished goods for sale or purchase raw material for the manufacture of the article, being sold by the firm. The acquisition of these articles is purchases. The purchase of 10,000 metres of silk by Mohan, a cloth merchant is termed as purchases in the business. In the same way, the purchases of ten exhaust fans by Ram, a dealer in electrical appliances for use in the cooler being assembling in his factory will also be the purchases. It is immaterial whether goods have been purchased for cash or on credit. They may be purchased within the country or imported from abroad. Purchases of assets are not the purchases in accounting terminology as these assets are not meant for sale.

9. Sales

The ultimate end of the goods purchased for manufactured by the business is their sales. It includes both cash and credit sales. In accounting terminology, sales means the sale of goods, never the sale of assets, sales should have a regular feature. The sale of ten sets by Ahmad, a furnisher is sales but sale of old furniture by Sarin, a stationery dealer will not be a sale. Sales any be effected within the country or exported adored.

The maintenance of proper and complete record of sales is necessary, because the profit or loss is associated with the amount of sales. It should be the sincere effort of every business to purchase goods at competitive rates and sell at reasonably higher rates to earn more profit.

10. Purchases return or Return outward

It is that part of the purchases of goods, which is returned to the seller. This return may be due to unnecessary, excessive and defective supply of goods. It may also result, if the supplier violates the terms and conditions of the order and agreement. In order to calculate net purchase return is deducted from purchases. Purchases returns are also known as return outward, because it is return of goods outside the business.

11. Sales return or Return inward

It is that part of goods which is actually returned to us by purchasers. This return may also be due to excessive, unnecessary and defective supply of goods or violation of terms of agreement. Sales return, also known as returns inward is deducted from sales, in order to calculate net sales.

12. Stock

The goods available with the business for sale on a particular date is termed as stock. It varies i.e., increases or decreases and goes on changing. In accounting, we use the term stock widely as opening and closing stock. In case of business which is being carried on for the last so many years, the value of goods on the opening day of the accounting year is known as opening stock. In the same way, the value of goods on the closing day of the accounting year will be closing stock. For example, Mohan and Sons started their business on Jan. 1, 1986 and decided to close their books 31st December every year. The firm will not have any opening stock on Jan. 1, 1986, because the business did not exist before Jan. 1, 1986. If the firm has goods worth Rs. 50,000 on 31st December 31, 1986, it will be the closing stock on this date. On January 1, 1987, the closing stock of December 31, 1986 will be the opening stock of the year 1987. it should always be kept in mind that stock is valued at cost price or market price, whichever is lower.

In case of manufacturing enterprises stock is classified as under:

- **a.** Stock of raw material. Raw material required for manufacturing of the product in which the business deals is known as stock of raw material. Cotton in case of cotton mill is its example.
- **b.** Work in progress. It is the stock of party finished or partly manufactured goods just as price of thread and unfinished cloth in case of cotton mill.
- **c.** Stock of finished goods. Manufactured and finished goods for sale are known as stock of finished goods. Finished cloth is its example.

13. Revenue

Revenue in accounting means the amount realised or receivable from the sale of goods. Amount received from sale of assets or borrowing loan is not revenue. In wider sense, revenue is also used to mean receipt of rent, commission and discount etc. such receipts should be revenue receipts. It should be concerned with the day-to-day affairs of the business. It should also be regular in nature. Other titles and sources of revenue are common to many businesses. According to Finney and Miller, “revenue is an inflow of assets which results in an increase of owner’s equity.” Here, the term ‘revenue’ has been used in wider sense and confuses with income.

Welsch and Anthony rightly view that revenue is the amount or goods received or receivable from the sale of goods and services. Revenue should not be confused with income. Revenue is concerned with receipts or receivable in the day-to-day working of the business. Income is calculated by deducting expenses from revenue.

14. Expenses

Expenses are cost incurred by the business in the earning revenues. Generating income is the foremost objective of every business the firm has to use certain goods and services to produce articles, sold by it. Payment for these goods and services is called 'expenses'. Cost of raw material for the manufacture of goods or the cost of goods purchased for sale, expenses incurred in manufacturing or acquiring goods, such as wages, carriage, freight and amount spent for selling and distribution goods such as salaries, rent, advertising and insurance etc. Are known as 'expenses' in accounting terminology. According to Finney and Miller, "Expenses is the cost of use of things or services for the purpose of generating revenue. Expenses are voluntarily incurred to generate income."

15. Expenditure

Expenditure is the amount of resources consumed. It is long term in nature. It is the benefit to be derived in future. It is the amount spent for the purchase of assets. Expenditure can be made through cash, or exchanged for other assets or commodities or a promise to make the payment is made. Expenditure increases the profit earning capacity of the business and profit is expected from them in future. Expenditure are incurred to acquire assets of the business.

16. Losses

Losses are unwanted burden which the business is forced to bear. Loss of goods de to theft or fire, or flood or storm or accidents are termed as 'loss' in accounting. Losses are different from expenses in the sense that expenses are voluntary incurred to generate income where losses are forced to bear.

Losses may be classified as normal and abnormal. Normal loss is due to the inherent weakness in the commodities i.e., coal, cement, oil, ghee, ice, petrol. There will be shortage in their weight due to leakage, melt age, evaporation, spoilage and wastage during the journey. Abnormal loss on the other hand, is an extra ordinary loss due earthquake, fire, flood, dorm, theft and accidents.

Losses adversely affect the profit of the business, so it should be the sincere effort of every firm to adopt preventive measures to minimize losses.

17. Profit

Excess of revenue over expenses is termed as profit. In other words excess of sale proceeds over cost of goods sold is income. Here, sales, means net sales i.e., sales less sales return. Cost of goods sold, also known as cost of sales is opening stock plus net purchases plus direct expenses less closing stock. Income must be regular in nature. It must concern routine activities of the business. It is always the part of revenue receipt. It must relate to the business of the current year. It is shown at the credit side of profit and loss A/c. profit is generated through business activities.

18. Income

Increase in the net worth of the enterprise either from business activities or other activities is termed as income. Income is wider term, which includes profit also. From Accounting point of view income is the positive change in the wealth of the enterprise over a period of time.

19. Gain

Change in the net worth (equity) due to change in the form and place of goods and holding of assets for a long period, whether realized or unrealized is termed as gain. It may either be of capital nature or revenue nature or both.

20. Debtors

The term 'debtor' represents the persons or parties who have purchased goods on credit from us and have not paid for the goods sold to them. They still owe to the business. For example, if goods worth Rs. 20,000 have been sold to Mahesh, he will continue to remain the debtor of the business so far he does not make the full payment, in case, he makes a payment of Rs. 16,000, he will remain to be debtor for Rs. 20,000 – 16,000 = 4,000.

In case, the firm is a service institution and the payment for service still remains to be realize, beneficiaries of the service will also be known as 'debtors'.

21. Creditors

In addition to cash purchases the firm has to make credit purchases also. The seller of goods on credit to the firm is known as its creditors for goods. Creditors are the liability of the business. They will continue to remain the creditors of the firm so far the full payment is not made to them. Liability to creditors will reduce with the payment made to them.

Creditors may also be known as creditors for expenses. In case, certain expenses such as salaries, rent, repairs, etc., remain unpaid during the accounting period, it will be termed as outstanding expenses. Parties rendering these services will be our creditors. Creditors are current liability so the firm should have sufficient current assets to make their timely payment.

22. Receivables

Receivable means, what business has to receive from outside parties on revenue account. When we sell goods on credit, purchases are known as debtors. Certain debtors accept bills drawn by us and become part of bills receivable. The total of Debtors and Bills Receivable is known as Receivable. These are current assets realized within a year. Receivables are shown at the assets side of the Balance Sheet.

23. Payables: -Payable means, what the business has to pay to outside parties. When we purchase goods on credit. Sellers are known as creditors. We accept bills drawn by certain creditors, which becomes a part of Bills Payable. The total of Creditors and Bills Payable is termed as Payables. It is shown at the liabilities side of the Balance Sheet.

24. Proprietor

An individual or groups of persons who undertake the risk of the business are known as 'proprietor'. They invest their funds into the business as capital. Proprietors are adventurous persons who make arrangement of land, labour, capital and organization. They pay wages to labour, rent to land, interest to capital and salary to organization. After meeting all the expenses of business, if there remains any surplus, it is known as profit. The proprietor is rewarded with profit for the risk undertaken by him. If expenses exceed revenue the deficit is a loss to be borne by the proprietor.

In case of profit, proprietor's capital increases and in case of loss, the capital decreases. Proprietor is an individual in case of sole trade, partners in case of partnership firm and shareholders in case of company.

25. Drawings

Amount or goods withdrawn by the proprietor for his private or personal use is termed as 'drawing'. The cost of using business assets for private or domestic use is also drawing. Use of business car for domestic use or use of business premises for residential purpose is also drawing. Acquiring personal assets with business funds ids also drawing. Certain examples of drawings are as under:

- **a.** Amount withdrawn by proprietor for personal use.
- **b.** Goods taken by the proprietor for domestic use.
- **c.** Purchasing pocket transistor for proprietor's son.
- **d.** Using business vehicles for domestic use.
- **e.** Using business premises for residential purpose.

26. Solvent

Solvent are those persons and firms who are capable of meeting their liabilities out of their own resources. Solvent firm have sufficient funds and assets to meet proprietors' and creditors' claim. Solvency shows the financial soundness of the business.

27. Insolvent

All business firms who have been suffering losses for the last many years and are not even capable of meeting their liabilities out of their assets are financially unsound. Only the court can declare the business firm as insolvent if it is satisfied that the continuation of the firm will be against the interest of the public or creditors. No firm can declare itself as insolvent. In case of solvency, the assets of the business are sold and liabilities paid with the funds realized from the sale of assets. If the funds realized fall short of the liabilities creditors are paid proportionately.

28. Vouchers

Accounting transactions must be supported by documents. These documents proofs in support of the transactions are termed as vouchers. It may be a receipt, cash memo, invoice, wages bill, salaries bill, deeds or any document as an evidence of transaction having taken place. The contents of vouchers are date, amount paid, purpose of the payment, payment passed by competent authority, payment made and cancelled the voucher. Vouchers are the basis of accounting records. They facilitate accounting. Vouchers are also used for verification and auditing of business records. Vouchers may also be used for detecting embezzlement and frauds.

29. Accounting year

Books of accounts are closed annually. From the balance of different ledger accounts we prepare income statement an position statement. Income statement shows gross and net income of the business. Position statement, traditionally known as Balance sheet is a mirror, which reflects the true value of assets and liabilities on a particular date. There is no legal restriction about the accounting year of sole proprietorship and partnership firm. They may adopt the accounting year of their choice. It may be between January 1st to December 31st of the same year or July 1st of the year to June 30th of the next year or between two Diwalis or even financial year, i.e., April 1st to March 31st of the next year. The only restriction is that accounting period must consist of 12 months. Companies must adopt financial year as their accounting year.

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

- Full description: Every financial transaction is recorded in two related accounts separately in which full particulars are given for each transaction.
- 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.
- 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.
- 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.
- 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.
- Knowledge of Economic Status: With the help of balance sheet, the economic and financial status of the business can be obtained easily.
- 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

- it is difficult to follow the rules of debit and credit in this system.
- Though this system is fully scientific even then there are chances of errors and mistakes.
- It is necessary to follow the principles and even a small mistake may give errorneous results.
- It is an expensive system for small traders.
- 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) PERSONAL ACCOUNTS

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) REAL ACCOUNTS

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

3) Nominal Accounts: -

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

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

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

RULES OF DOUBLE ENTRY SYSTEM

The rules related to debit and credit of any account in double entry system 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 allowdd 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.

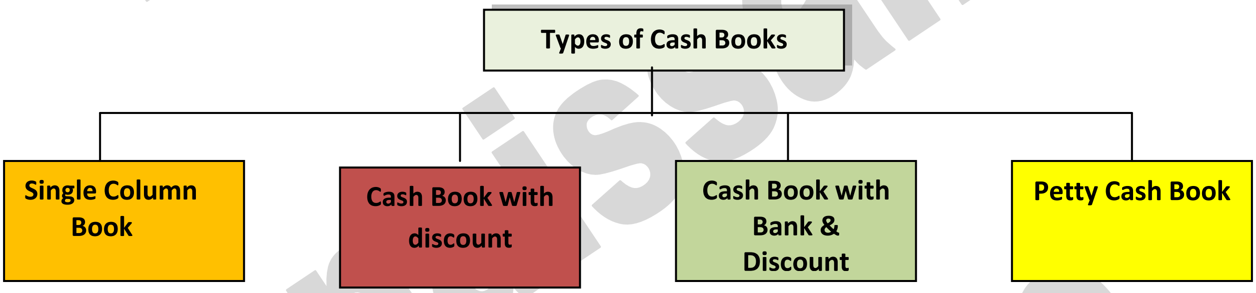
Cash Book is in the form of an account and actually it serves the purpose of Cash Account also. It has two sides-debit and credit side. On the debit side, all receipts of cash are recorded while on the credit side, all the payments of cash are recorded. Items on the debit side of the cash book are posted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

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. Three Column Cash Book

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. Petty Cash Book (Imprest system)

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.

Imperst vs. Non-Imprest System of Petty Cash Book

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

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

Proforma of Account

Name of Account

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

Posting

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

Procedure for Posting

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

Ledger posting o Opening Journal Entry

While making ledger accounts of assets and liabilities appearing in the opening journal entry opening balance as represented in the journal entry must be shown in the beginning of the ledger account a "To Balance b/d" at the debit side for assets and "by balance b/d" at the credit side of liabilities. Remaining posting in the concurred A/c will be made as usual.

Balancing of ledger Accounts

Assets, liabilities and capital accounts have certain closing balance of the end of accounting period, so their values are to be carried forward to the next accounting period. This is why they are closed as "By Balance b/d" or "To Balance c/d. The balance of those accounts carried forward to the next accounting period, because the firm has to carry on tits business with these assets, liabilities and capital in hand. While closing these accounts we write the 'Balance c/d' to show the closing balance of the account.

While closing nominal accounts or those accounts which are either an expense or revenue. we do not use the word balance c/d because the balance of these accounts need be carried forward to the next period. Whatever has been paid on account of expenses has been paid once and forever. This is the expense of the business. so it should be directly posted to the debit side of the profit and loss account or trading account. It the same way, account relating to income or gain or revenues are also closed by transfer to profit and loss account. Receipts i.e. rent, interest and discount are revenue of the business, so while closing these accounts their balance will be transferred to profit and loss account.

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

Posting : 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

Postings : 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.

Postings : 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.

Posting: 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.

TRIAL BALANCE

Meaning

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

Main Characteristics and uses of a Trial Balance

Following are the main characteristics of a trial balance :

1. It is a statement prepared in a tabular form. It has two columns- one for debit balance and another for credit 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 Capital Account)	-
To Audit fees	-		
To Telephone expenses	-		
To General expenses	-		
To Bank Charges	-		
To Discount allowed	-		
To Interest on Capital	-		
To Interest on loan	-		
To Discount of Rebate on bills of exchange	-		
To Carriage outward	-		

To Freight outward To Bad debts To Entertainment expenses To Travelling Expenses To Cost of Samples To Catalogue expenses To Salesmen's salaries To Expenses and commission To Advertising expenses To Depreciation on fixed Assets To Loss on sale of fixed assets To Net Profit (Transferred to capital account)	- - - - - - - - - - - -		
Rs.		Rs.	

Balance Sheet

As on 31 March ……………..

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

Closing Entries

At the end of the year after preparing trial balance a list of unrecorded items is prepared which is called list of adjustment for which adjustment entries are passed. Now closing entries will be passed. The purpose of closing entries is to closed all those accounts which comes in trading and profit & Loss and these accounts are mainly related to goods and expenses and incomes.

Procedure for closing entries- The accounts which are shown on the debit side of trading and profit & Loss account are transferred to these account by writing "By Trading account/Profit and loss account" in all those accounts. Similar in the accounts (appearing on the credit side of trading and profit and loss account) To trading or profit & Loss account is written The major closing entries are as under:

(1) For opening stock, purchase, sales return and all direct expenses

Trading A/c Dr.
To Opening Stock A/c
To Purchases A/c
To Sales return A/c
To Wages a/c
To Carriage Inward A/c

(2) For sales and purchase return
Sales A/c Dr.
Purchase return Dr.
To Trading A/c
(3) For gross profit or loss:
(a) Profit Trading A/c Dr.
To Profit and Loss A/c
(b) loss Profit and loss A/c Dr.
To Trading Account
(4) For indirect expenses
Profit & Loss A/c Dr.
To Salaries A/c
To Commission a/c
To Discount allowed a/c
To Advertisement A/c
(5) For indirect in comes and gains
Interest eared a/c Dr.
Discount a/c Dr.
Commission a/c Dr.
Divident a/c Dr.
To Profit & Loss A/c
(6) For Net profit or net loss
(a) For Net Proift
P & L A/c Dr.
To Capital A/c
(b) For Net loss A/c
Capital A/c Dr.
To P & L Account

Adjustments at a glance

S.No.	Adjustments	Entry	Effects on Trading and Profit & Loss Account	Effects on Balance Sheet
1	Closing Stock	Closing Stock A/c Dr. To Trading A/c	Credited to trading A/c	Shown on assets side.
2	If closing Stock is given in trial balance	-	-	Shown on assets side.
	Outstanding expenses (Expenses still un paid)	Expenses A/c Dr. To O/s Exp. A/c	Add to the concerned exp. on debit side.	Shown on liabilities side.
(i)	O/S Exp. in trial Balance If they are of opening date i.e. of last year	O/S Exp. A/c To Expenses A/c	Deducted form the concerned expenses on debit side.	-
(ii)	If they are of closing date i.e. of current year.	-	-	Shown on liabilities side.

3	Prepaid Expenses: (Expenses of next year paid in advance this year)	P.P. Expenses A/c Dr. To Expenses A/c	Deducted from the concerned expenses on debit side.	Shown on Assets side
(i)	P.P. Exp. in trial balance. If they are of opening date i.e. of last year	Expenses A/c Dr. To P.P. Exp. A/c	Added to the concerned expenses on debit side	-

(i)	If they are of closing date i.e. of last year	-	-	Shown on assets side.
4.	Accrued, Earned or Receivable Income	Acc. Income A/c Dr. To Income A/c	Added to the concerned income on credit side of P & L A/c	Shown on assets side.
(i)	If it is of op. date i.e. of last 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.	Deducted from purchases credited to	Deducted from capital on

		A/c	trading A/c	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 stock.	Op. stock/Trad. A/c Dr. To Capital A/c	The Difference is either added to op. stock or debited to Trading A/c	The difference is added to capital on liabilities side
c.	Over valuation of closing stock.	Trading A/c Dr. To Cost stock A/c	The Difference is either deducted from clo. Stock	The difference is added to closing

			or debited to Trading A/c	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

INDIAN ACCOUNTING STANDARDS (WITH AS-6 & AS-10)

AS 6 (REVISED) : DEPRECIATION ACCOUNTING

1) This statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply –
   a. Forests, plantations and similar regenerative natural resources;
   b. Wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;
   c. Expenditure on research and development
   d. Goodwill;
   e. Live stock.

   This statement also does not apply to land unless it has a limited useful life for the enterprise.
2) Different accounting policies for depreciation are adopted by different enterprises. Disclosure of accounting policies for depreciation followed by an enterprise is necessary to appreciate the view presented in the financial statements of the enterprise.

Explanation –

1) **Importance of deprecation –** Depreciation has a significant effect in determining and presenting the financial position and results of operations of an enterprise. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount, irrespective of an increase in the market value of the assets.
2) **Determination of depreciation –** Assessment of depreciation and the amount to be charged in respect thereof in an accounting period are usually based on the following three factors-
   a. Historical cost or other amount substituted for the historical cost of the depreciable asset when the asset had been revalued;
   b. Expected useful life of the depreciable asset; and
   c. Estimated residual value of the depreciable asset.

3. Historical cost- historical cost of a depreciable asset represents its money outlay or its equivalent in connection with acquisition, installation and commissioning as well as for additions to or improvement thereof. The historical cost of a depreciable asset may undergo subsequent changes arising as a result of increase or decrease in long-term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

4. Useful life of a depreciable asset- The useful life of a depreciable asset is shorter than its physical life and is :

(i) pre-determined by legal or contractual limits, such as the expiry dates of a related leases;
(ii) directly governed by extraction or consumption;
(iii) dependent on the extent of use and physical deterioration on account of wear and tear which again depends on operational factors, such as, the number of shifts for which the asset is to be used, repair and maintenance policy of the enterprise etc; and
(iv) Reduced by obsolescence arising from such factors as :
- **(a)** technological changes;
- **(b)** improvement in production method;
- **(c)** change in market demand for the product or service output of the asset; or
- **(d)** legal or other restrictions.

5. Determination of the useful life- Determination of the useful life of a depreciable asset is a matter of estimation and is normally based on various factors including experience with similar types of assets. Such estimations is more difficult for an asset using new technology or used in the production of a new product or in the provision for a new service but is nevertheless required on some reasonable basis.

6. Addition or extension to an existing asset- Any addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is depreciated over the remaining useful life of that asset. As a practical measure, however, depreciation is sometimes provided on such addition or extension at the rate which is applied to an existing asset. Any addition or extension which retains a separate identity and is capable of being used after the existing asset I disposed of, is depreciated independently on the basis of an estimate of its own useful life.

7. Determination of residual value- Determination of residual value of an asset is normally a difficult matter. If such value is considered as insignificant, it is normally regarded as nil. On the contrary, if the residual value is likely to be significant, it is estimated at the time of acquisition/installation, or at the time of subsequent revaluation of the asset. One of the bases for determining the residual value would be the realizable value of similar assets which have reached the end of their useful lives and have operated under conditions similar to those in which the asset will be used.

8. The amount of depreciation- The amount of depreciation to be provided in an accounting period involves the exercise of judgment by management in the light of technical, commercial accounting and legal requirements and accordingly may need periodical review. If it is considered that the original estimate of useful life of an asset requires any revision, the unamortized depreciable amount of the asset is charged to revenue over the revised remaining useful.

9. Methods of depreciation- there are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the strainghtline method and the reducing balance method. The management of a business selects the most appropriate method (s) based on various important factors, e.g. (i) type of asset, (ii) the nature of the use of such asset, and (iii) circumstances prevailing in the business. A combination of more than one method is sometimes used. In respect of depreciable assets which do not have material value depreciation is often allocated fully in the accounting period in which they are acquired.

10. Statutory restrictions- The statute governing an enterprise may provide the basis for computation of the depreciation. For example, the Companies Act, 1956 lays down the rates of depreciation in respect of various assets. Where the managements' estimated of the useful life of an assert of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying a higher rate. If the management's estimate of the useful life of the asset is longer than that envisaged under the statue, depreciation rate lower than that envisaged by the statue can be applied only in accordance with requirements of the statute.

11. Disposal of asset- Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, is disclosed separately.

12. Change in the method of depreciation- The method of depreciation is applied consistently to provide comparability of the results of the operations of the enterprise from period to period. A change from one method of providing depreciation to another is made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method is adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency is charged in the statement of profit and loss. In case the change in the method result in surplus, the surplus is credited to the statement of profit and loss. Such a change is treated as a change in accounting policy and its effect is quantified and disclosed.

13. Change in historical cost- Where the historical cost of an asset has undergone a change due to circumstances specified in Para 3 above, the depreciation on the revised unamortized depreciable amount is provided prospective over the residual useful life of the asset.

Disclosure

1. The depreciation methods used, the total depreciation for the period for each class of assets, the gross amount of each class of depreciable assets and the related accumulated depreciation are

disclosed in the financial statements along with the disclosure of other accounting policies. The depreciation rates or the, useful lives of the assets are disclosed only if they are different from the principal rates specified in the statute governing the enterprise.

2. In case the depreciable assets are revalued, the provision for depreciation is based on the revalued amount on the estimate of the remaining useful life of such assets. In case the revaluation has a material effect on the amount of depreciation, the same is disclosed separately in the year in which revaluation is carried out.
3. A change in the method of depreciation is treated as a change in an accounting policy and is disclosed accordingly.

AS 10: ACCOUNTING FOR FIXED ASSETS

The following is the text of the Accounting Standard 10 (AS 10) issued by the institute of Chartered Accountants of India on "Accounting for fixed assets".

In the initial years, this accounting standard will be recommendatory in character. During this period, this standard is recommended for use by companies listed on a recognized stock exchange and other large commercial, industrial and business enterprises in the public and private sectors.

Introduction

Financial statements disclose certain information relating to fixed assets. In many enterprises, these assets are grouped into various categories, such as land and buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trademark and designs. This statements deals with accounting for such fixed assets with the following exceptions-

(a) This statement does not deal with the specialized aspects of accounting for fixed assets reflecting the effects of changing prices but supplies to financial statements prepared on historical cost basis.

(b) This statement does not deal with accounting for the following items to which special consideration apply ;

(i) forests, plantations and similar regenerative natural resource:

(ii) wasting assets including material rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;

(iii) expenditure on real estate development; and

(iv) livestock.

Definitions:

The following terms are used in this statement with their meanings specified :

1. **Fixed assets-** Fixed assets is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.
2. **Fair market-** Fair market value is the price that would be agreed to in an open and unrestricted market-between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.
3. **Gross book-** gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value.

Explanation

1. Fixed assets often comprise a significant portion of the total assets of an enterprise and therefore, are important in the presentation of financial position. Furthermore, the determination of whether an expenditure presents an asset or an expense can have a material effect on an enterprise's reported results of operations.

2. Identification of fixed assets

(a) Aggregation- The above mentioned definition of fixed asset gives criteria for determining whether items are to be classified as fixed assets. It may be appropriate to aggregate individually insignificant items, and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been included as fixed assets, because the amount of the expenditure is not material.

(b) Stand-by equipment- Stand-by equipment and servicing equipment are normally capitalized. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed assets and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.

(c) Segregation- in certain circumstances, the accounting for an item of fixed asset may be improved if the total expenditure thereon is allocated to its component parts, provided they are in practice separable, and estimates are made of the useful lives of these components. For example, rather than treat an aircraft and its engines as on unit , it may be better to treat the engines as a separate unit if it is likely that their useful life is shorter than that of the aircraft as a whole.

3. Components of cost

(i) The cost of an item of fixed assets comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Example of directly attributable cost are :

- **(a) site preparation;**
- **(b) initial delivery and handling costs;**
- **(c) installation cost, such as special foundations for plant; and**
- **(d) Professional fees, for example fees of architects and engineers.**

(ii) Financing costs relating to differed credits or to borrowed funds attributable to construction or acquisition of fixed assets for the period up to the completion of construction or acquisition of fixed assets are also sometimes included in the gross book value of the asset to which they relate. However, post construction or acquisition financing costs (including interest) are not capitalized.

(iii) Administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset except the cases where they are directly attributable to fixed asset.

(iv) The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost.

(v) If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement.

4. Self-constructed fixed assets

In arriving at the gross book value of self-constructed fixed assets, the same principles apply as those described earlier. Included in the gross book value are costs of construction that relate directly to the specific asset and costs that are attributable to the construction activity in general and can be allocated to the specific asset. Any internal profits are eliminated in arriving at such costs.

5. Non-monetary consideration (i.e. Exchange of fixed asset)

(a) When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the market value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of asset given up. In each case one an adjustment is made for any balancing receipt or payment of cash or other consideration.

(b) When a fixed asset is acquired in exchange for shares or other securities in the, enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued whichever is more clearly evident.

6. Improvements and repairs

(a) Only expenditure that increase the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g. an increase in capacity.

(b) The cost of an addition or extension to an existing asset which is of a capital nature is usually added to its gross book value.

7. Amount substituted for historical cost (i.g. Revaluation of fixed asset)

(i) Sometimes financial statements are prepared on a revalued amount of fixed asset and depreciation is calculated accordingly. Such financial statements are different from those prepared to reflect the effects of changing prices.

(ii) A commonly accepted and preferred method of revaluing fixed asset is by appraisal, normally undertaken by competent valuers. Other methods sometimes used are indexation and reference to current prices.

(iii) The revalued amounts of fixed assets are presented in financial statements, either by restating both the gross book value and accumulated depreciation so as to give a net book value equal to the net revalued amount or by restating the net book value by adding therein the net increase on account of revaluation. An upward revaluation does not provide a basis for crediting to the profit and loss statement the accumulated depreciation existing at the date of revaluation.

(iv) Different bases of valuation are sometimes used in the same financial statements to determine the book value of the separate items within each of the category of fixed assets of for the different categories of fixed assets. In such cases, it is necessary to disclose the gross book …….. included on each basis.

(v) Selective revaluation of assets can lead to unrepresentative amounts being reported in financial statements. Accordingly, when revaluation do not cover all the assets of a given class, it is appropriate that the selection of assets to be revalued be made on a systematic basis.

(vi) It is not appropriate for the revaluation of class of assets to result in the net book value of that class being greater than the recoverable amount of the assets of that class.

(vii) An increase in net book value arising on revaluation of fixed assets is normally credited directly revaluation reserves and is regarded as not available for distribution. A decrease is charged to such reserve. If such reserve does exist the decrease may be charged to profit & loss statement.

8. Retirements and disposals

(a) An item of fixed asset is eliminated from the financial statements on disposal.

(b) Fixed assets retired and held for disposal are stated at the lower of there net book value and net realizable value and are shown separately in the financial statements.

(c) In historical cost financial statements, gains or losses arising on disposal are generally recognized in the profit and loss statement.

(d) On disposal of a previously revalued item of fixed asset, the deference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the such a loss is related to an increase which was previously recorded as a credit to revaluation reserve it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

9. Valuation of fixed assets in special cases

(a) in the case of fixed assets squired on hire purchase terms, although legal ownership does nor vest in the enterprise, such assets are recorded at their cash value, which if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

(b) Where an enterprise owns fixed assets jointly with other (otherwise than as partner in a firm) the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet.

(c) Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers.

10. Fixed assets of special types

(i) Goodwill in general, is recorded in the books only when some consideration in money or inoney's worth has been paid for it. Goodwill is the excess of purchase consideration of a business over it's networth.

(ii) As a matter of financial prudence, goodwill is written off over a period. However, many enterprise do not write off goodwill and retain it as an asset.

(iii) Patents are normally written off over their legal terms of validity or over their working life whichever is shorter. Patents are legally valid for 12 years.

(iv) Know-how in general is recorded in the books only when some consideration in money or inoney's worth has been paid for it. Know-how is generally of two types:

(a) Relating to manufacturing processes; which is usually expensed in the year of incurrence.

(b) Relating to plans, designs and drawings of buildings or plant and machinery, which is capitalized under the relevant asset heads and depreciation is calculated on the total cost.

(v) Where the amount paid for know-how is a composite sum in respect of both the types such consideration is apportioned amongst them on a reasonable basis.

(vi) Where the consideration for the supply of know-how is a series of recurring annual payments as royalties, technical assistance fees, contribution to research, etc., such payments are charged to the profit and loss statement each year.

'DEPRECIATION ACCOUNTING'

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

Meaning

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

Definition

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

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

Features or Characteristics of Depreciation

1. Depreciation is charged on fixed assets except land.
2. Depreciation is calculated on the book value (as shown in the books after charging of depreciation) and not on market value of assets.

3. Depreciation is charged on permanent basis. Once the depreciation is charged, it reduces the value of the asset permanently.
4. Depreciation is charged on a continuous basis. Once the depreciation is charged, it must be charged on regular basis in the succeeding period also.
5. The charge of depreciation will decrease the value of asset gradually. In other words, it must reduce the value of assets slowly and steadily.
6. The process of computation of depreciation implies allocation of cost of an asset over the effective and useful life of the assets.

Causes of Depreciation

The principal causes of depreciation are as follows:

1. **By Constant use:** Wear and tear of an asset due to its constant use is a cause of decline in the value of an asset. A fixed asset begins to lose its value when it is used in the business e.g. plant & machinery, building, furniture etc.
2. **By expiry of time**: Certain assets get decreased in their value with the expiry of time whether they are used in the business or no. this is true in case of assets like leasehold properties, patents or copyrights etc. For example, if a lease is obtained for 25 years for Ts. 1,00,000, it will lose 1/25th i.e. Rs. 4,000 of its value every year whether it is used in the business or not. So at the end of 25th year, its value will be reduced to zero.
3. **By Obsolescence:** Some assets are discarded before they are worn out because of changed conditions. For example, an old machine which is still workable may have to be replaced by a new machine because of the later being more efficient and economical. Such a loss on account of new inventions or charged fashions is termed as loss on account of obsolescence.
4. **By Depletion:** Some assets like mineral mines, oil wells etc. get exhausted or depleted through working. On account of continuous extraction of minerals or oil, a stage comes when the mine or oil gets completely exhausted and nothing is left.
5. **By Accidents:** An asset may meet an accident and therefore, it may get depreciated in its value.
6. **By Permanent fall in market price:** Though the fall in the market value of fixed assets is not recorded because such assets are not resale for use in the business. Sometimes, the fall in the value of certain fixed assets is treated as depreciation e.g. permanent fall in the value of investment.
7. **Changes in economic environment:** There may be instances when slackening of demand for the services of an asset may bring about a fall in its value. Such a change in conditions arises due to a number of factors e.g. technological changes within an industry, changes in tastes and habits of consumers, changes in availability of natural resources and so on.

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

The following are the objectives of providing depreciation:

1. **Ascertainment of true profit or loss:** Depreciation being a loss, will certainly affect the business profits. Therefore, to arrive at the true profit or loss, depreciation must be provided for and records in the books of accounts.
2. **Presentation of true financial position**: In a balance sheet, assets must be shown at their true values. This is not possible unless depreciation is provided and deducted from the values of these assets.
3. **Replacement of assets:** Some assets used in the business need replacement after the expiry of their service life. By providing depreciation, a part of the profit of the business is kept in the business which can be used for purchase of new asserts when the old fixed asserts become useless.

4. **Calculation of correct cost of production**: Correct cost of production cannot be calculated unless depreciation is properly provided and accounted for an item of cost of production.
5. **Prevention to withdrawal of capital:** Capital of a business remains invested in different assets. If no depreciation is charged, assets and capital are shown at enhanced figures due to such misrepresentation; capital itself may be withdrawn in the guise of imaginary profit.
6. **Excess payment of income tax**: Depreciation accounting is required for correct computation of profit for tax purposes and for computation of tax liability, otherwise more income tax will be paid on account of excess profit.
7. **To prevent distribution of profit out of capital:** If no depreciation is charged, it will result in showing more profit. Such excess profit may either be withdrawn by the owner or may be distributed among shareholders of the company as dividend. This will mean payment out of capital to the shareholders.
8. **Other objectives:** The workers may demand an increase in the wages or salary or in the payment of bonus as more profit will be shown if depreciation is not provided.

Factors Affecting Depreciation

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

1. **Total cost of the assets:** The cost of the asset includes the invoice price of the asset, less any trade discount plus all costs essential to bring the asset to a useable condition. In other words, cost includes all expenses 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:
   $$\text{Each years Dep.} = \frac{\text{Original cost of the asset} - \text{Its estimated resident value}}{\text{Number of years of estimated life of the asset}}$$
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 depreciation amount	Amount of annual depreciation remains same.	Amount of annual depreciation keeps decreasing.
3. Balance at the end of life	Under this method, balance of asset account is either equal to zero or is equal to scrap value at the end of life of an asset.	According to this method balance of the asset can never be equal to zero.
4. Rate of Depreciation	Rate of depreciation is not kept high.	Rate of depreciation is normally kept high.
5. Burden on Profit & Loss	Burden of repairs and depreciation is not equitable under this method.	Burden to total cost of running the asset is almost equitable.

6.	Applicability	This method is adopted on the assets which are of less value and shorter life.	This method is more suitable for those assets which lose their utility gradually and heavy repair cost is incurred on them.
7.	Validity	This method is not approved by income tax laws.	This method is approved by tax laws and tax rebate is given on depreciation calculated by this method.
8.	Practicability	Same depreciation is charged even when the asset is of less value.	As the utility of the asset reduces, the amount of depreciation keeps on decreasing.

Journal entries in case of Depreciation

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

Journal entries for Depreciation when provision of Depreciation is made.

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

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

Alternately, on sale asset, an asset disposal account may be opened.
Change of Method:

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

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

Change of method from previous date (Retrospective effect)

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

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

BRANCH ACCOUNT

Branch Account: - Account which are opened in the book Head office and branches related to Branches are called branch account. The main objective of these branches Account is to know the working ability and profit and loss of branches. The also include the financial account related to them by which their financial condition is known.

Kinds of Branches :-

Dependents Branches:- These branches do not prepare any accounts their accounts are prepared by the H.O. These braches cash book, sales boo and stock book only for money. They do not keep any journal entries of ledger accounts. Dependent branches may be any of the following three kinds (a)

branches making cash sales only (b) Branches making cash and credit sales (c) Branches to when goods are sent on sale price.
Stock & Debtors Method:- The branches which under take both cash & credit sales and whole sale is more due to expanded business area then it is difficult to prepare branch A/c only and these are more possibilities of errors due to more transaction amount.
When goods sent to branch at cost price:- The following accounts are prepared under this method:- (1) Branch stock A/c (2) Goods sent to Branch (3) Branch Debtors A/c (4) Branch expenses (5) Branch P & L A/c
When goods sent to Branch at invoice price:- The following accounts as prepare under this method. (1) Branch stock A/c (ii) Goods sent to Branch A/c (iii) Branch Debtors (iv) Branch Expenses (v) Branch stock Reserve A/c (vi) Branch adjustment a/c
Simple system or Debtors system:- When branch are very small than this method is adopted in this method only branch account is prepared in the bank of H.O. whose credit balancer indicate profit and debit balance indicates the loss. The method is also called debtor method. The branch account prepared under this method is of the nature of nominal account.
Financial account system:- In this method branch trading account & profit & loss of H.O. along with Branch A/c. The Branch account prepared under this method is of the nature of personal a/c.

Whole sale Branch method:- This is method applied when the manufacturers supplier the goods to the whole seller and also to the consumer a from their own branch. The goods use transferred to the branch at the same value at which it is transferred to whole sellers.
Multiple Account Method or
Stock and Debtor Method
In this method for ascertaining trading results many accounts are opened in the books of branch instead of only branch account.

(+) **Branch Stock A/c (I.P.)** (-)

To Bal. b/d		By B. Cash A/c (Cash Sales)	
To Goods sent to Br. A/c		By B. Debtors A/c (Credit Sales)	
To B. Debtors A/c (S.R.)		By Goods to Br. A/c (Ret. To H.O.)	
To B. Stock Res. (loading) } (Surplus)		By B. Stock Res. (loading) } (Shortage)	
To B. P & L. A/c (Cost) } (Surplus)		By B. P & L. A/c (Cost) } (Shortage)	
To ……. B. Stock a/c (Trans. Recd.)		By Goods in transit a/c	
To B.P. & L A/c (B.F.)		By… B Stock A/c (transfer given)	
		By Bal. c/d	

The converted trail balance is prepared as under:
(i) **Fixed assets-** Fixed assets are converted at the rate prevailing at the date of its purchase. If this rate is not in the opening rate may be applied.
(ii) **Fixed Liabilities:-** The are converted at the rate prevailing when these liabilities arose. If nothing is given, opening rate may be applied.
(iii) **Current assets and current liabilities:-** These are converted at the closing rate.
(iv) **Opening and closing stock:-** Opening rate is applied for opening stock and closing rate is applied for closing stock.
(v) **Depreciation-** The rate applied for the concerned asset, is used to convert the deprecation also.
(vi) **Provision for bad & doubtful debts-** This is converted at the rate at which debtors are converted i.e. closing rate.
(vii) **Revenue items:-** Except, deprecation, provision for doubtful debts, opening and closing stocks, all the revenue items are converted at average rate.
(viii) **Remittance by branch-** No rate is applied for this item, but the amount standing in the books of H.O. in this respect is considered.
(ix) **H.O. account-** This is also not converted by any rate, but the balance of branch account in H.O.'s books is considered.

Conversion Table

Particulars	Rate to be applied
Fixed Assets	Opening Rate
Fixed Liabilities	Opening Rate
Current Assets	Closing Rate
Current Liabilities	Closing Rate
Goods, Expanses and Income	Average Rate

Exchange suspense or reserve account- When the branch trial balance is converted as per the above mentioned rules, obviously the totals of converted trial balance do not agree. So the difference in converted trial balance is transferred to a newly opened 'exchange suspense or exchange reserve account'. This account is shown in balance sheet. If it is one the credit side, it is shown on liabilities side or vice versa.
For incorporation of branch trail balance, at first the trial balance is converted and then final accounts are prepared.
Note:- Some authors prefer to transfer 'exchange suspense account' to profit & loss A/c if the amount of this account is more or less equal to the other revenue accounts.

Incorporation of Branch Trial Balance in H.O. Books

Every Branch is an integral part of the business of its Head Office. The Assets and Liabilities of the Branch are a part of the Assets & Liabilities of the Head Office. Hence it is essential that a Joint Balance Sheet be prepared for the Head Office and all its Branches which may show a clear & complete position of the business organisation. For this Joint Balance sheet, the adjustment of Trial Balances of all the Branches is to be made in the books of the Head Office. Its procedure is as follows:-
First Method- According to this method, the incorporation of the Trial Balance of the Branch is done once together i.e. only one entry is made for all the items of debit side and credit side as given below:
(1) All items in the Dr. side of branch Trial Balance Dr.
To Branch A/c
(Being all the Dr. balance of Branch incorporated)

Specimen of Branch Account in Head Office Books

	Rs.		Rs.
To Balance b/d:		By Balance b/d (Op. Liabilities)	
Opening Stock		By Cash A/c	
Opening Pettry Cash		By Goods Supplied to Branch (Return)	
Opening Assets		By Assets (Closing Balance)	
To Goods Supplied to Br.		Stock at Branch A/c	
To Cash (Exps.) A/c		Petty Cash at Branch A/c	
To Liabilities (Closing)		By General P & L A/c (if loss)	
To General P & L A/c (if profit)			

Branch B/R a/c

To Bal. b/d		By B. Cash a/c	
To B. Debtors a/c		By Bal. c/d	

Branch Debtors a/c

To Bal. b/d		By B. Cash a/c	
To B. Stock a/c (credit sales)		By B. B/R a/c	
		By B Stock a/c (S/R)	
		By B.P & L a/c (BD. Dis. etc.)	
		By Bal. c/d)	

Branch Cash a/c

To Bal. b/d		By Bank a/c (cash sales)	
To B. Stock a/c (cash sales)		By Bank a/c (cash on (B/R)	
To B. B/R a/c (cash on B/R)		By Bank a/c (cash from debtors)	
To B. Debtors a/c (cash from debtors)		By B P & L a/c (rent, salary incurred)	
To Bank a/c (cheque for rent, salary)		By B. P & L a/c (petty exp. incurred)	
To Bank a/c (cheque for petty exp.)		By Bal. c/d	

Goods sent to Branch a/c

To B. Stock a/c (ret. to H.O.)		By B. Stock a/c (Goods sent)	
To B. Stock Res. (net loading)			
To General Trading a/c (B.F.) (C.P.)			

Branch Stock Reserve a/c (Loading)

To B. Stock a/c (shortage)		By Bal. b/d (op. stock)	
To .... B. Stock (transfer given)		By Goods sent to Br. (net loading)	
To B. P & L a/c (B.F.)		By B. Stock a/c (surplus)	
To Bal. c/d (closing stock + transit)		By .... B. Stock-Res. (trans. recd.)	

Branch P & L a/c

To B. Stock a/c (shortage)		By B. Stock a/c	
To B. debtors a/c (B.D., Dis. etc.)		By B. Stock – Res. a/c	
To B. cash a/c (Rent, Salary)		By B. Stock a/c (surplus)	
To B. Cash a/c (petty exp.)			
To B. Fixed assets a/c (dep.)			
To Outstanding commission a/c			
To General P & L a/c (B.F.)			

(2) Branch a/c Dr.
To All items in the Cr. side of Branch Trial Balance
(Being all the Cr. Balances of the Branch incorporated.)

Second Method – According to this method, the incorporation of the Trading a/c, Profit & Loss a/c and Assets & Liabilities of the Branch is done separately. The following entries are made in the books of the Head Office according to this method :

(1) For the Debit Side items of Trading a/c :

Branch Trading a/c Dr.
To Branch a/c
(Being the Branch Opening Stock, Purchases, Sales Returns, Wages etc. incorporated.)

(2) For the Credit Side Items of Trading a/c :

Branch a/c Dr.
To Branch Trading a/c
(Being the Branch Sales, Purchases Returns, Closing Stock etc. incorporated.)

(3) To Close the Trading a/c of the Branch :

(i) In case of Gross Profit :

Branch Trading a/c Dr.
To Branch Profit & Loss a/c
(Being the Branch Gross Profit incorporated)

(ii) In case of Gross Loss :

Branch Profit & Loss a/c Dr.
To Branch Trading a/c
(Being the Branch Gross Loss incorporated)

(4) For the debit side items of Branch Profit & Loss a/c :

Branch Profit & Loss a/c Dr.
To Branch a/c
(Being all the expenses & losses of Branch incorporated)

(5) For the credit side items of Branch Profit & Loss a/c :

Branch a/c Dr.
To Branch Profit & Loss a/c
(Being all the gains & incomes of Branch incorporated)

(6) To close the Profit & Loss a/c of the Branch :

(i) In case of Profit

Branch Profit & Loss a/c Dr.
To General Profit & Loss a/c
(Being the net profit of Branch incorporated)

(ii) In case of Loss :

General Profit & Loss a/c Dr.
To Branch Profit & Loss a/c
(Being the net loss of Branch incorporated)

(7) For the Liabilities of Branch :

Branch a/c Dr.
To Branch Liabilities a/c
(Being Branch Liabilities incorporated)

(8) For the Assets of Branch :

Branch Assets a/c Dr.
To Branch a/c
(Being Branch assets incorporated)

Third Method – This method is used when Profit or Loss and Assets and Liabilities are given. Under such condition, the same entries which are made in the First Method are done for the incorporation of Assets & Liabilities, *i.e.*

(1) For Profit

Branch a/c Dr.
To General P. & L. a/c
(Being the Branch Profit incorporated)

(2) For Loss

General P. & L. a/c Dr.
To Branch a/c
(Being Branch loss incorporated)

(3) For Assets

Branch Assets a/c Dr.
To Branch a/c
(Being Branch assets incorporated)

(4) For Liabilities

Branch a/c Dr.
To Branch Liabilities a/c
(Being Branch liabilities incorporated)

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-

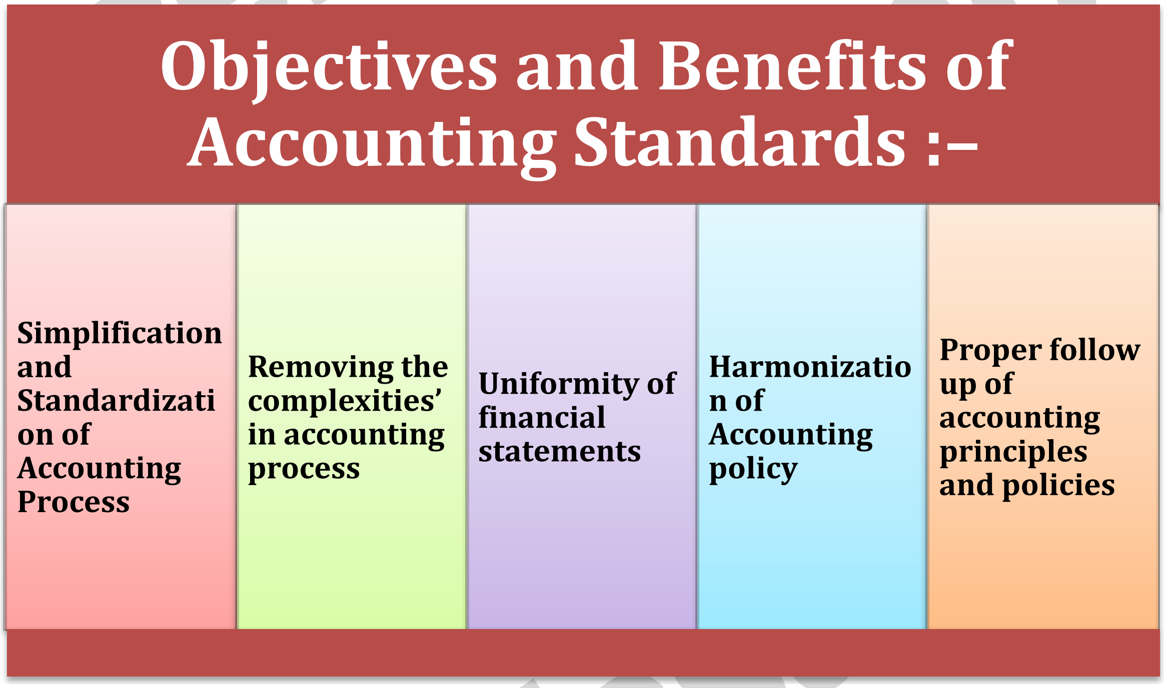
$$\text{Stock Reserve} = \frac{\text{Percentage}}{100 + \text{Rate of Profit}} \times \text{Amount of stock on which reserve is required}$$

Meaning of Accounting Standards –

In order to ensure transparency, consistency, comparability, adequacy and correctness of financial statements, it is essential that the financial process of accounting is well regulated. The main aim and objective of framing accounting standards this to ensure that the financial statements are adequate in disclosure, transparent without being shrouded in mystery consistent year after year and comparable between periods and firms and are reliable. It is for this purpose accounting standards have been framed by national and international accounting, accounting bodies and have assumed great importance in recent times.

According to Mr. T.P. Ghosh, "Accounting standards are the policy documents issued by the recognized expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events."

Simply, Accounting standards are such standards which are issued by the recognized expert accountancy body for harmonization of accounting policies and practices followed by business to standardize the diverse accounting practices.
In India, Institute of Chartered Accountants of India prepares and issued Accounting Standards considering the business environment of India.



Objectives and Benefits of Accounting Standards –

1) Simplification and Standardization of Accounting Process
2) Removing the complexities' in accounting process
3) Uniformity of financial statements
4) Harmonization of Accounting policy
5) Proper follow up of accounting principles and policies

Necessity of accounting standards –

1) Logical view
2) Globalization of business
3) Uniform accounting principles
4) Logical disclosure presentation and publication of financial statements
5) Standardized publication
6) To remove rigidity
7) Simplification of terminology

Salient features of accounting standards –

1) Logical explanation
2) Appropriate views
3) Practical application
4) Uniformity
5) Meaningful terminology
6) Similarity

Advantages/need of accounting standards –

1) Uniform and standard presentation of accounts
2) Removal of ambiguity
3) Prevention of accounting scandals
4) Globalization of business
5) Internationalization of financial institutions

Nature of Accounting Standards –

1) Policy document
2) Interpretation of procedure
3) Flexibility
4) Advisory
5) Trust and authenticity
6) Specifying the limits
7) Transparency
8) Coinciding with business environment
9) No over-riding
10) Dynamic

UNIT-III

ROYALTY ACCOUNTS

Royalty mean the sum payable by one person to another person for using right i.e. it is the periodic payment to the owner of some form of privilege or monopoly for being allowed to use such right or privilege.

Definition of Royalty

"Royalty refers to the amount paid by one person to another for granting the some special rights by the former to the latter".

Difference between Royalty and Rent

1. Use- Consideration received from using some tangible assets like building, factory etc. is known as rent. While consideration which is received from using both tangible and intangible assets like patent, copyright etc. is known as royalty.
2. Basis of payment- Payment of rent is based on period like yearly, half-yearly, monthly , weekly etc. while payment of royalty is based upon the limit of using it like per item, per ton production or sale basis.

KINDS OF ROYALTY

1. Mining royalty
2. Bricks making royalties
3. Royalties in connection with ail-wells
4. Patent royalty
5. Copy right royalty
6. Royalties in connection with machine, secret instruments and technical knowledge etc.

TERMS IN RESPECT OF ROYALTY

1. Landlord or lessor- This person is owner of the property and gives his property to other for use and has the right in return to receive a royalty.
2. Lessee- This person takes a property from other land has a right to use it and in return, he has to pay royalty to the owner of the property.
3. Minimum rent- Payment of amount of royalty is decided on the basis of production or on sale of such property. As production or sale fluctuate, owner of property calculate the minimum rent at the beginning of the year which has to paid to him in any condition i.e. if there is reduction in production or sale even the owner will receive a minimum rent. When royalty is equal to or more than minimum then payment should be made of royalty only, not of minimum rent.
4. Short working- The excess of minimum rent over royalty is called short-working .i.e. short working= Minimum rent-Royalty.

5. Recouping or writing off short-working- When actual royalty is lower than minimum rent, then it give rise to recouping or writing off short-working. For compensating the loss arising from short-working lessee can make the contract with landlord, according to which he will be allowed to recoup or recover the short working., from the future surplus (i.e. excess of actual royalty over minimum rent subject to certain conditions. It may be recouped without any time limit or within prescribed time limits.

CALCULATION OR ANALYSIS TABLE

1 years	2 Output or sale	3 Actual Royalty	4 Minimum Rent	5 Short Working	6 Surplus	7 Recoup	8 Lapse	9 Payment (3+5-7)

ACCOUNTING FOR ROYALTY

Journal Entries

In the books of Lessee	In the books of lessor
(1) For royalty and short working Royalty (Payable) A/c Dr. short working (Recoupable)A/c Dr. To Lessor [Being amount payable]	(1) For royalty and short working Lessee A/c Dr. To Royalty (Receivable) A/c To Short working (Allowable) [Being amount receivable]
(2) For short working recouped Lessor Dr. To short working A/c [Being short working recouped]	(2) For short working recouped Short working Dr. To Lessee [Being short working allowed to recouped]
(3) For Payment Lessor Dr. To Bank A/c [Being payment made]	(3) For Payment Bank A/c Dr. To Lessee [Being payment received]
(4) For transfer of royalty Manufacturing A/c P&L A/c Dr. To Royalty A/c [Being transfer of Royalty]	(4) For transfer of royalty Royalty A/c Dr. To P&L A/c [Being transfer of Royalty]
(5) For recoupable short working P&L A/c Dr, To Short working A/c [Being recoupable S.W.)	(5) For recoupable short working Short working A/c Dr. To P&L A/c [Being recoupable S.W.)

SUB-LEASE

If the lessee again leases out to other person some part of assets taken by him on lease, it is called 'sub-lease'. The other person is called sub-lease. Suppose A has given 500 acres of land to B on lease and B has given 100 acres of land (out of 500 acres) to C on lease, then A is called main lessor, B is called main lessee as well as sub-lessor and C is called sub-lessee. There will be two separate agreements, the first one is between A and B and second one is between B and C. A will receive the royalty on the total production of A and B, while B will receive the royalty on the production by Conly. Two analysis Table will be prepared accordingly.

Accounts of non-profit organizations and professionals

In many countries, besides profit making organization, there are many such organizations whose main motto is not to earn profit but to serve for the benefit of the society or for entertaining its members or to safeguard the interest of the society. Such type of organizations are known as 'non-profit organizations'. For example, club, education institutions, schools, trade unions, consumer co-operatives, political associations, automobile association, hospital etc.

Need for maintaining accounts of non-profit organizations and professional:
1) For the information
2) Balancing the expenditure
3) Calculation of surplus or deficit
4) To find the financial position
5) Information regarding assets
6) Calculation of tax

Final Accounts
a) Receipts and payments accounts
b) Income and expenditure accounts
c) Balance sheet

Difference between receipts & payments account and cash book –

S.No.	Basis of difference	Receipts & payments accounts	Cash Book
1	Datewise	Receipts and payments are not recorded datewise.	Receipts and payments are recorded date wise.
2	Fixed date	It is prepared on some fixed date in a year.	The transaction goes on for the full year.
3	Base	Cash book is the base for the payments a/c.	It is prepared on the basis of cash transactions.
4	Form	It is a brief statement of cash book.	It is the detailed record of cash transactions.
5	Items	Analysis of each receipts & payments are made item wise & the it is written.	Each item is differently written in the book.
6	Nature	It is a memorandum book.	It is a main and most important book.

Following points are taken into consideration while preparing income & expenditure account and balance sheet of non-profit organization –

1) **Life membership fees –** Instead of paying membership fees annually, some members deposit a lump sum membership fees i.e. deposit the life time membership fees. This fees are not related to one year but it is related to life time of the member.
2) **Entrance fees –** At the time of admission of members entrance fees is taken from them. It is taken only once from the members. After that normal annual membership fees are taken from members. Since it is paid once for ever by a member, it is not f recurring nature hence it should be considered as capital receipts and will appear on the liability side of balance sheet.
3) **Endowment Fund –** Some people donate a huge amount for some religious or for some social purpose or donate some valuable fixed assets. Such a huge amount forms a base for the working of organizations. Since it is not a recurring amount it is treated as of capital nature and hence taken into balance sheet.
4) **Donation –** Gift received from any person, firm, company etc. his known as donation. It depends upon type of donation whether to credit in income & expenditure account or to treat it as capital income & take it to balance sheet. For this, following points should be kept in mind.
   a) **Specific donation –** If organization receives donation for some specific purpose then it is treated as capital income & written on the liability side of balance sheet. For example, donation for library, sports ground, building etc.
   b) **General donation –** When donation is not received for some specific purpose then it is known as general donation. If huge amount is received then it should be taken to the liability side of balance sheet as there are small changes of its recurring. But if the amount received is small then it should be credited to income & expenditure account

because there are more changes of its recurring every year. Whether the amount is smaller or higher is decided by comparing this item with other items in the question or by some related circumstances.

5) **Legacy –** Legacy received by organization is such type of donation which is rarely received, hence it is treated as capital income and written on the liability side of balance sheet. But if the amount received is smaller in size then it is treated as revenue income and credited to income and expenditure account.

6) **Income or expenses from specific fund –** To fulfil certain specific object, non-profit organizations open specific funds. Like match fund, sports fund, tournament fund, prize fund, charity fund, etc. If any income is earned from such fund, then it is written on liability side of balance sheet and if any expenditure is related to it than it should be deducted.

7) **Subscription –** Main source of income of non-profit organization is from subscription. Total subscriptions of previous year is treated as revenue and written on the credit side of income & expenditure account.

8) **Sale of old assets –** Amount received on sale of old asset is debited to receipts and payments account. If there is profit on sale of assets, it should be credited and if there is a loss then it should be debited to income & expenditure account. Book value of sold asset should be deducted from the assets.

9) **Sale of sports equipment –** Sale of sports equipment is usually made by club. Hence it should be property accounted for.

10) **Sale of old newspaper –** It is an income which can occur frequently, hence it is credited to income and expenditure a/c.

11) **Subsidies from government and other institution –** If non-profit organization received some subsidy from government or other institution then it should be credited to income expenditure account. If it is of capital nature it should be recorded on liabilities side.

Difference between receipts & payments account and income & expenditure account

S.No.	Basis of Difference	Receipt & Payment A/c	Income & Expenditure A/c
1	Nature	It is a cash account of a non-trading concern.	It is like a profit & loss account of a non-trading concern.
2	Account	It is a real account.	It is a nominal account.
3	Side	Receipts are debited and payments are credited to this account.	Expense are debited and income are credited to his account.
4	Capital & revenue	It records receipts & payments of both capital & revenue nature.	It records income & expenditure of only revenue nature.
5	Period of income & expenses	It shows the receipts & payments made during the year whether they belong to past, current or subsequent year.	It shows incomes & expenditure of the current year only whether received or not received/paid.
6	Opening Balance	Balance in the beginning represents cash in hand in the beginning.	There is no balance in the beginning.
7	Closing Balance	Balance at the end represents cash in hand at the end.	Balance at the end represents excess of income over the expenditure or *vice versa*.
8	Adjustment	There is no place for adjustment.	Here adjustments are made.
9	Balance sheet	It is not essential that balance sheet should accompany this account.	Balance sheet must accompany this account.

UNIT-IV

JOINT VENTURE ACCOUNT

Joint venture is a partnership without the use of a firm name. It is a temporary partnership between two or more persons to a particular venture or piece of business. A joint venture is an association of two or more person who combine for the execution of a particular transaction. It may consist of a joint consignment of goods, an underwriting transaction, a speculation in shares; or any other similar form of enterprise. Conventurers bring into the business their share of capital and divide the profit of the venture in an agreed ratio. Joint venture business comes to an end as soon as the venture is over.

Salient features or characteristics of Joint Venture

1) Agreement
2) Necessity of name
3) Object
4) Ratio
5) Temporary nature
6) Simultaneous personal business

Need of Joint Venture

1) Capital
2) Limited Capacity
3) Risk sharing
4) Use of different caliber
5) Encashing opportunity
6) Psychology

Difference between partnership and joint venture

S.No.	Base	Partnership	Joint Venture
1	Name	A firm is run under a particular name.	No name of joint venture is compulsory.
2	Nature	It is of permanent nature.	It is of temporary nature because of a specific purpose venture.
3	Accounting	A complete double entry system is followed maintaining complete set of books on permanent basis.	Due to short duration and temporary nature the accounting is reduced to the minimum requirement.
4	Number of members	Maximum number of members is 20 but in banking business 10.	No restriction on maximum number of member.
5	Drawing of bill	Partners can not draw bills on each other.	Conventurers can draw or rather correctly usually draw bills on each other.
6	Place of accounting	Accounting is done and books are kept a fixed one place only.	Account books are kept at different places as convenient.
7	End	It can be wound up mutually or under special cases by court.	On completing the specific business activities, the joint venture automatically comes to an end.

Accounting for Joint Venture

i) Separate set of books method.
ii) Records in each conventurer's book smethod.
iii) Memorandum joint venture account method.

i) Separate set of books method -

When all the conventurers live at one place and the size of the venture is comparatively small, this method is adopted. Here the joint venture is treated as a separate independent entity. As in case of other business entities, a separate set of books is maintained and full double entry system is applied. The following three accounts are mainly opened:

1) Joint venture account (*for ascertainment of profit or loss on joint venture)*
2) Conventurer's capital accounts
3) Joint bank account

Journal Entries

Normally the following entries are passed –

S.No.	Transactions	Journal Entries
1	On introducing capital	Joint Bank A/c………… Dr. To Conventurer's Capital A/c
2	On cash purchase or payment of expenses	Joint Venture A/c………… Dr. To Joint Bank A/c
3	On credit purchase of goods	Joint Venture A/c………… Dr. To Creditors A/c
4	On giving goods from own stock of purchase by conventurer	Joint Venture A/c………… Dr. To Conventurer's Capital A/c
5	On cash sales being deposited in joint bank	Joint Bank A/c………… Dr. To Joint Venture A/c
6	On credit sales	Debtor's A/c………… Dr. To Joint Venture A/c
7	Interest, commission etc payable to conventurers	Joint Venture A/c………… Dr. To Conventurer's Capital A/c
8	For closing stock or stock retained by conventuers	StockA/c / Dr. Conventuer's Capital A/c ………. To Joint Venture A/c
9	Profit on joint venture distributed	Joint Venture A/c………… Dr. To Conventurer's Capital A/c (Note: In case of loss the entry will be reversed)
10	Final Settlement: (a) Refund of surplus (b) Bringing shortage	 Conventurer's Capital A/c………… Dr. To Joint Bank A/c Joint Venture A/c………… Dr. To Conventurer's Capital A/c

Joint Venture Account

To Joint Bank A/c	*(Cash Purchases)*	………	By Joint Bank A/c	*(Cash Sales)*	………
To Joint Bank A/c	*(Expenses)*	………	By Debtors A/c	*(Credit Sales)*	………
To Creditors A/c	*(Credit purchases)*	………	By Capital A/cs	*(Sales by conventurers)*	………
To Capital A/cs	*(purchase and expenses by conventurer*	………	By Capital A/cs	*(Stock taken by conventurers)*	………
To Capital A/cs	*(Interest, commission etc. allowed to coventurers)*	………	By Capital A/cs	*(Interest changed to conventurers)*	………
To Capital A/cs	*(Profit)*	………	By Capital A/cs	*(Loss)*	………
		………			………

Capital Accounts of Conventurers

Particular		A	B	Particular		A	B
To Joint Venture A/c	*(Sales)*	………	………	By Joint Bank A/c	*(Capital introduced)*	………	………
To Joint Venture A/c	*(Interest)*	………	………	By Joint Venture A/c	*(Purchase and expenses)*	………	………
To Joint Venture A/c	*(Stock Taken)*	………	………	By Joint Venture A/c	*(Interest, Commission etc.)*	………	………
To Joint Venture A/c	*(Loss)*	………	………	By Joint Venture A/c	*(Profit)*	………	………
To Joint Bank A/c *(Final Settlement)*	*(Bal. Fig.)*	………	………	By Joint Bank A/c *(Final Settlement)*	*(Bal. Fig.)*	………	………
		………	**………**			**………**	**………**

Joint Bank Account

Receipts	Amount	Payment	Amount
To Capital A/cs (Capital introduced)	………	By Joint venture A/c (Cash purchases)	………
To Joint Venture A/c (Cash Sales)	………	By Creditors A/c (Payment)	………
To Debtors (Realisation)	………	By Joint Venture A/c (Expenses)	………
To Capital A/c (Final settlement)	………	By Capital A/c (Final settlement)	………
	………		**………**

ii) Records in each conventurer's books method –

Unlike 'separate set of books' method under this method joint venture is not treated as a separate independent entity. So no separate set of books can be maintained. As a solution to this, each party records the transactions of joint venture in his books. Two accounts are prepared by each of the conventurer i.e. first 'Joint venture account' prepared to find the result of joint venture and second the personal account of other conventurer(s).

Journal Entries (in the books of 'A')

S.No.	Transactions	Journal Entries
1	Advance from B	Cash/Bank A/c Dr. To B
2	Goods purchased or expenses paid for joint venture	Joint Venture A/c Dr. To Cash/Creditor's A/c
3	Taking goods from self stock for joint venture	Joint Venture A/c Dr. To Purchase A/c
4	Goods purchased or expenses paid 'B' for joint venture	Joint Venture A/c Dr. To B A/c
5	Drawing bill of exchange on B	Bills Receivable A/c Dr. To B
6	Discounting of bill and discount treated as joint expenses	Joint Venture A/c Dr. To Bills receivable A/c
7	Sales by self	Cash/Bank/debtors A/c Dr. To Joint Venture A/c
8	Sales by B	B Dr. To Joint Venture A/c
9	Commission : (a) Self	Joint Venture Dr. To Commission A/c
	(b) Payable to B	Joint venture A/c Dr. To B

10	Profit on joint venture	Joint Venture A/c Dr. To Profit Loss A/c (Own share) To B (B's share) (Note: In case of loss the entry will be reversed)
11	Payment to B as final settlement	B Dr. To Bank/Cash A/c (Note: If payment is received, the entry will be reversed.)

In the books of A

(1) Joint venture account – This account is made to find the profit or loss on joint venture. So purchases and expenses are debited and sales and stock taken by conventurers are credited.

Joint Venture Account

To Bank A/c (purchase by A)	………	By Bank A/c (Sales by A)	………
To Bank A/c (Expenses by A)	………	By B (Sales by B)	………
To B (Purchase by B)	………	By Purchases A/c (Stock taken by A)	………
To B (Expenses by B)	………	By B (Stock taken by B)	………
To Interest/Commission A/c (Payable to A)	………	By Profit and loss A/c (A's share of loss)	………
To B (Interest/Commission payable to B)	………	By B (B's share of loss)	………
To Profit and Loss A/c (A's share of profit)	………		
To B (B's Share of profit)	………		
	………		………

B's Personal A/c

B

To Joint venture A/c (Sales by B)	………	By Joint venture A/c (Purchase by 'B')	………
To Joint venture A/c (Stock by B taken)	………	By Joint venture A/c (Expenses by B)	………
To Joint venture A/c (B's share of loss)	………	By Joint Venture A/c	
To Bank A/c Balance c/d (Bal. Fig.)	………	*(Interest, Commission to B)*	………
	………	By Joint venture A/c *(B's share of capital)*	………
	………	By Bank A/c/Balance c/d (Bal. Fig.)	………
	………		………

In the books of B

Joint Venture Account

To Bank A/c (purchase by B)	………	By Bank A/c (Sales by B)	………
To Bank A/c (Expenses by B)	………	By B (Sales by A)	………
To A (Purchase by A)	………	By Purchases A/c (Stock taken by B)	………
To A (Expenses by A)	………	By B (Stock taken by A)	………
To Interest/Commission A/c (Payable to B)	………	By Profit and loss A/c (B's share of loss)	………
To A (Interest/Commission payable to A)	………	By A (B's share of loss)	………
To Profit and Loss A/c (B's share of profit)	………		
To A (A's Share of profit)	………		
	………		………

Note: It should be noted carefully that the amount columns of debit and credit are exactly same as the joint venture account made in the books of A (Explained earlier) but columns of particular differ to a great extent. Transactions of A are recorded in A's name those of B in the nae of different related accounts.

A

To Joint venture A/c (Sales by B)	………	By Joint venture A/c (Purchase by 'A')	………
To Joint venture A/c (Stock taken by A)	………	By Joint venture A/c (Expenses by A)	………
To Joint venture A/c (A's share of loss)	………	By Joint Venture A/c	
To Bank A/c Balance c/d (Bal. Fig.)	………	*(Interest, Commission to A)*	………
	………	By Joint venture A/c *(B's share of capital)*	………
	………	By Bank A/c/Balance c/d (Bal. Fig.)	………
	………		………

CONSIGNMENT ACCOUNTS

When a businessman appoints an agency (may be a person, firm, company or any other institution) as his representative or agent to sell his goods through such agency, such a business relation is known as consignment transaction.' The businessman sending the goods is called 'Principal' or 'Consignor'; the person receiving and selling the goods on behalf of principal is called representative, 'agent' or 'consignee' and the such goods are called 'goods sent on consignment'.

Consignment Procedure –

1) An agreement between both the parties
2) Dispatch off goods by principal
3) Advance or security
4) Receipt of goods by consignee
5) Sale of consigned goods
6) Payment of balance amount

Terminology

Some typical terms are used in consignment transaction and one should know the meaning of such terms. Some of them are as under –

1) Agency – The transaction between the owner of goods and the agent are called 'agency transitions' and such relation is called agency.
2) Consignment – The goods sent to the agent for sales is called consignment also known as 'Challan'. For consignment it is 'consignment outward' and for consignee it is 'consignment inward'.
3) Consigner – The principal or owner of the consigned goods on whose behalf and risk such goods are sold by agent is called 'consignor' also known as 'Challaner'.
4) Consignee – He is the agent whom goods are consigned for sale at pre-decide amount or rate of remuneration. He is also known as 'challance'.
5) Goods sent on consignment – The goods dispatched to the agent for sale are called 'goods sent on consignment'. This is recorded by the consignor in his books in separate account 'goods sent on consignment account' which is real account. Consignee passes no entry for such goods.
6) Pro-forma invoice – For the goods consigned, the consignor makes and sends an invoice mentioning therein the quantity and quality of the goods consigned. The price of the goods mentioned in such invoice is called 'invoice price' Sometime the proposed selling price is also mentioned. Such an invoice is called 'Pro-forma invoice'.
7) Consignment expenses – The expenses incurred by consignor and consignee for consignment are called consignment expenses. Consignor's expenses are packing, loading, carriage, freight, transit insurance, export duty etc. Consignee's expenses for receiving goods are octroi, entry tax, import duty, custom duty, dock dues, clearing charges, unloading carriage upto his godown. Consignee's expenses for storing the goods are godonw rent, godown insurance, godown depreciation etc. Consignees expenses for selling the goods are advertisement, publicity, free samples, demonstrations, brokerage, his own commission etc.
8) Consignment transactions – The transactions concluded by the consignor and consignee for consignment are called 'Consignment transactions'.
9) Remuneration or commission of consignee – For his services to the consignor, a consignee is compensated by consignor. Such compensation or consideration is called remuneration or commission of consignee.
10) Account Sale – This is a statement of sales prepared and sent by the consignee to consignor periodically. In this statement sales realization by consignee his expenses and commission and balance to be remitted are mentioned.
11) Consignment stock – The goods lying unsold with consignee at the end of the accounting period are called 'consignment stock' or 'stock with agent' to be valued at the lower of its cost price or market price. The consignor makes accounting for such stock in his books but consignee does not show such stock in his books.

12) Consignment account – It is account prepared by the consignor, at the end of his accounting period, to ascertain profit or loss on consignment called 'consignment account'. Consignee does not make any such account.

Difference between Consignment and Sale

S.No.	Base	Consignment	Sale
1	Relation	The relation is that of 'consignor' and consignee. Consignee becomes the debtor of consignor on sale of goods and not on receipt of consigned goods.	The relation is that of buyer and seller or debtor and creditor. The buyer becomes the debtor of seller as soon as the sale is made.
2	Remuneration	Commission is the remuneration by the consignor to consignee.	No such remuneration is given or taken.
3	Profit/Loss	Consignor is entitled to profit or responsible for loss on goods sold by consignee.	On the profit or loss on the resale of the goods, buyer is entitled or liable.
4	Invoice	Here pro forma invoice is sent on consignment as it is merely shifting the place of goods.	Here invoice is sent on sale of goods as it is sale of goods i.e. transfer of place as well as ownership of goods.
5	Transfer	Here the risk of the goods sent continues to be on the consignor.	Here the risk of the goods sold is shifted on to the buyer.
6	Consignment expenses	Expenses paid by consignee for consignment are reimbursed by the consignor.	Expenses paid by the buyer for the goods are not reimbursed by seller.
7	Ownership	On the goods sent the consignor continues to be the owner of goods till they are sold by the consignee.	On goods sold, the seller ceases to be the owner as it is sold by the seller.
8	Return of goods	Goods remained unsold with consignee may be returned to consignor.	Goods lying unsold with the buyer cannot be returned to the seller without seller's consent.
9	Discount/ allowance	No discount or allowance is given by the consignor on the goods sent.	Seller gives attractive discount and allowances on the goods sold.
10	Bad debts	Consignor is liable for bad debts unless del credere commission is given.	Buyer only will be liable of for bad debts as he becomes the owner of goods.
11	Account sale	Periodical submission of account sale by consignee is compulsory along with the remittance.	Once the goods are sold, buyer is at no obligation for any periodical submission of any such statement.

Remuneration of Consignee

1) **General or ordinary commission –** This is the usually given to every consignee on the sales affected by him. Higher the sales greater is the amount of commission.

2) **Del credere commission –** Consignee sells the goods on behalf and risk of consignor. So for the credit sales the consignor himself is liable in case of bad debts. But if the consignor wants to shift this liability on consignee he will have to give additional commission to consignee which is called del credere commission. So del credere commission is a special commission given in addition to normal omission to the consignee against which consignee agrees to bear the loss due to bad debts. This reduces the commission income of consignee.

3) Overiding Commission – Normally the consignee sales the goods at invoice price mentioned in the proforma invoice sent by consignor. The consignee does not make special efforts to sell the goods over invoice price. To encourage the consignee to sell the goods over invoice price the consignor gives him a special commission on the excess of selling price over invoice price of the goods sold. Such a type of commission is called overriding commission. As the name itself suggests this is a commission given to him to make special effort (override) to sell the goods over and above the invoice price (again override). This is a motivational commission to the consignee. In the absence of any different instruction in the question, overriding commission is calculated on the difference between the actual selling price and invoice price of the goods sold.

Difference between ordinary and del credere commission

S.No.	Base	Ordinary commission	Del credere commission
1	Receiver	This is given to all agents.	This is given to the agent(s) ready to bear the loss of bad debts.
2	Guarantee	Here the agent guarantees the amount of cash sales only.	Here the agent guarantees the realization from credit sales.
3	Calculation	It is calculated on total sales i.e. cash sales plus credit sales.	It is also calculated on total sales if otherwise specifically asked.
4	Net commission	Gross and net commission income of agent is same.	Gross commission is reduced by the amount of bad debts.

Difference between del credere and overriding commission

S.No.	Base	Del credere commission	Overriding commission
1	Meaning	It is given to agent to take the liability of bad debts.	It given to motivate the agent to sell the goods over invoice price.
2	Responsibility	Agent is liable for credit collection.	Agent is not liable for debt collection.
3	Motivation	This element is absent here.	It is only to motivate the agent.
4	Calculation	It is calculated on total sales.	It is calculated on the excess of selling price over invoice price.

In the books of Consigner

Consignment Account

Step No.	Particular	Rs.	Step No.	Particular	Rs.
1	To Goods sent on consignment a/c	CP/IP	4	By Consignee (Sales):	
2	To Bank A/c (Consignor's exps.):			Cash Sales ………	
	Carriage ………			Credit Sales ………	………
	Frieght ………		5.1	By Bank A/c / Ins. Claim A/c	………
	Insurance etc. ………	………	5.2	By Profit & Loss A/c (Actual Loss)	………
3	To consignee (Expenses)		9	By Consignment Stock A/c	CP/IP
	Octrol ………		10	By Goods sent on Con. A/c (Loading)	………
	Carriage ………		12	By Profit & Loss A/c (Loss)	………
	Godown Rent ………				
	Selling expenses ………	………			
6	To Consignee (Commission)	………			
7	To Consignee (Bad debts)	………			
8	To Bills receivable (Discount)	………			
11	To Con. Stock-res.1 A/c (Loading)	………			
12	To Profit & Loss A/c (Profit)	………			
		………			………

Consignee

Step No.	Particular	Rs.	Step No.	Particular	Rs.
2	To Consignment A/c (Sales)	……….	1	By Cash A/c / Bank A/c / B/R A/c (Advance)	……….
			3	By Consignment A/c (Exps.)	……….
			4	By Consignment A/c (Comm.)	……….
			5	By Consignment A/c (Bad Debts)	……….
6	To Balance c/d *(Proportionate advance)*		7	By Cash/Bank/B/R/Bal. c/d (Bal.fig.)	……….
		………			………

Goods sent on Consignment Account

Step No.	Particular	Rs.	Step No.	Particular	Rs.
2	To Consignment A/c (Loading)	……….	1	By Consignment A/c	CP/IP
3	To Trading A/c / Purchases (Cost)	……….			
		………			………

In the books of Consignee
Consignor

Step No.	Particular	Rs.	Step No.	Particular	Rs.
1	By Cash A/c / Bank A/c / BP A/c (Advance)	……….	2	By Cash/Bank A/c (Cash sales)	……….
3	By Cash A/c/Bank A/c (Exps.)	……….	2.2	By Con. Debtors A/c (Credit Sales)	……….
4	By Commission A/c	……….	6	By Balance c/d *(Proportionate advance)*	……….
5	By Con. A/c/Bank A/c/BP A/c	……….			
7	By Cash/Bank/B/P/Bal. c/d (Bal.fig.)	……….			
		………			………

Commission Account

Step No.	Particular	Rs.	Step No.	Particular	Rs.
2	To Con.Debtors A/c (Bad Debts)*	……….	1	By Consignor (Commission)	……….
3	To Cash A/c / Bank A/c *(Disallowed expenses)*	……….	4	By Profit & Loss A/c (Bal.fig.)	……….
		………			………

Bill Payable Account

Step No.	Particular	Rs.	Step No.	Particular	Rs.
2	To Cash a/c Bank a/c *(Payment on due date)*	……….	1	By Consignor (advance)	……….
3	To Balance c/d	……….			
		………			………

Difference between normal and abnormal loss

S.No.	Base	Normal Loss	Abnormal Loss
1	Avoidance	This loss cannot be avoided	With due care, such losses, can be avoided.
2	Nature	These are quite common and natural.	They are uncommon and not natural.
3	Accounting	These are not accounted for.	They are accounted for.
4	Quantity of Loss	Here lost quantity is less and negligible.	Here loss is considerable.

5	Insurance	These losses can not be insured.	They can be insured.
6	Reasons	They occur due to shrinkage, seepage, sublimation, evaporation etc.	They occur due to theft, pilferage, accident, floods etc.
7	Men or God	They are God made	They may be God made or manmade.
8	Expectancy	They are expected	These are always unexpected.

INVESTMENT ACCOUNTS

Meaning of Investment

When a person introduces his capital for earning more income it is known as investment. It can be done in any way like investing in business or in fixed assets or investment in such assets through which interest, dividend can be earned.

1) **Fixed Income Bearing Securities –** It includes those types of securities from which there would be fixed source of income/interest like government securities, debentures, bonds etc.
2) **Variable income bearing securities –** It includes those type of securities from which there is no fixed source of income like equity shares or stock of the company Dividend on shares or stock is distributed only when there is a profit in the company.

Interest on Investments –

Interest on Government Securities, Semi government securities or securities of private sector companies are distributed twice in a year at every six months interval. Interest on investment is calculated on the face value of the securities Interest of 6 months is payable to the person whose name is registered at the time of distributing interest irrespective of the period for which he holds the security. Now if a person after receiving interest of 6 months but before receiving the interest of next 6 months, sells his securities then he will take from the buyer both value of investment as well as interest which has been accrued.

Cum-interest and ex-interest purchase and sale

Market value of the securities may be quoted cum-interest or ex-interest. In case of cum-interest quotation, the price quoted is inclusive of interest which is accrued from the last date of payment of interest to the date of transaction, and in case of ex-interest, the price quoted is exclusive of interest from the last date of interest payment to the date of transaction i.e. in this case buyer has to pay to the seller the accrued in addition to the price paid for the investment. In case of cum-interest quotations the accrued interest will be deducted from the price and the remaining amount will be recorded in investment account. In case of ex-interest quotations the price (without deducting accrued interest) will be recorded in investment account. But in both the cases interest account will be recorded by the same amount.

Accounting of investments

A person who does the trading of investment, i.e. does the business of purchase and sale of investment of different types, keeps the record of transactions systematically where the investment are not many , they can be recorded in the "general ledger" itself. But where the investments are substantial, a separate ledger may be kept for recording the investments. Such a ledger is known as investment ledger. Separate account will be kept for each scrip. Traders of investment earns income from investment in two ways –

1) By purchasing and selling the investment and
2) By way of interest from holding the investment.

Profit from purchase and sale of investment is derived from investment account while income from interest is derived from interest account. Accounting for investment is done in the following manner:

Journal entries

1) Investments purchase –

Investment A/c Dr.
Interest / Dividend A/c Dr.
To Bank A/c
(Being investments purchased)

2) Investments Sold –

Bank A/c Dr.
To Investment A/c
To Interest / Dividend A/c
(Being investments sold)

3) Interest / Dividend received on due date –

Bank A/c Dr.
To Interest / Dividend A/c
(Being interest sold)

4) Amount of interest or dividend transfer to profit & loss account at the end of year –

Interest / Dividend A/c Dr.
To Profit and Loss A/c
(Being Interest transferred)

5) Profit or loss on sale of investment transferred to profit & loss account –

i) for profit –

Investment A/c Dr.
To Profit and Loss A/c
(Being profit transferred)

ii) For loss –

Profit and Loss A/c Dr.
To Investments A/c
(Being loss transferred)

6) For accrued interest of previous year at the beginning of the year –

Interest A/c Dr.
To Accrued Interest A/c
(Being accrued interest transferred)

7) For accrued interest at the end of the year –

Accrued interest A/c Dr.
To Interest A/c
(Being accrued interest)

Ledger

For every investment, a separate investment account is prepared as under –

Investments Account

(Interest payable on….)

Date	Particulars	Face Value	Amount	Date	Particulars	Face Value	Amount
Closing date	To Bank A/c (purchases) To P&L A/c (Profit on sale)	Rs.	Rs.	Closing Date	By Bank A/c (Sale (By P&L A/c) (Loss on sale) By Balance c/d (Closing balance)	Rs.	Rs.

For all the investments only one interest account is prepared as under –

Interest Account

Date	Particulars	Amount	Date	Particulars	Amount
Op. Date	To Accrued Interest A/c (Previous year) To Bank A/c (interest paid on purchase)	Rs.		By Bank A/c (Interest received on sale) By Bank A/c (Interest received on interest dates)	
Closing Date	To P&L A/c (Bal. fig. transferred)		Closing Date	By Accrued interest A/c (Current year)	

Accrued Interest Account

Date	Particulars	Amount	Date	Particulars	Amount
Opening Date	To Balance b/d	Rs.	Opening Date	By Interest A/c	Rs.
Closing Date	To Interest A/c	Rs.	Closing Date	By Balance c/d	Rs.

UNIT-V

DISSOLUTION OF PARTNERSHIP FIRM WITH INSOLVENCY

Dissolution of firm – The dissolution of partnership between all the partners of a firm is called the dissolution of the firm. In the case of dissolution of a firm, the business of the firms is closed down and its affairs are wound up. The assets are realized and the liabilities are paid off.

Model of dissolution of firm –

1) Dissolution without the intervention of the court

a) Dissolution by agreement
b) Compulsory dissolution
c) Dissolution on the happening of certain contingencies.
d) Dissolution by notice

2) Dissolution by the court

a) Insanity
b) Permanent incapacity
c) Misconduct
d) Breach of agreement
e) Transfer of interest
f) Loss in business
g) Just and equitable

Steps in the dissolution process –

Step 1	Prepare a balance sheet of the firm as on the date of the dissolution of the firm.
Step 2	Realize the non-cash assets which are not acceptable for distribution in their present form, pay the debts of the firm to third parties. Realization account is prepared to calculate the loss or profit on realization of assets and settlement of liabilities. Loss or profit on realization of assets and settlement of liabilities is transferred to partners' capital accounts.
Step 3	Pay the amount due to each partner ratably for advances (or Loan)
Step 4	Pay the available cash to the partners.

Accounting treatment on dissolution of firm –

In case of dissolution of firm the following accounts are prepared to close the books of the firm –

1) Realisation Account
2) Partners' loan account
3) Parnters' capital account
4) Cash or bank account

1) **Realization account –** This is a special type of account. It is a nominal account. The purpose of preparing this account is to find out the result of realization of assets and discharge of liabilities. The following steps involved in preparing this account.

Step 1. For Transfer of all accounts given in the balance sheet

a. **For transfer of assets –** All the assets except cash in hand, cash at bank, debit balance of current accounts of partners and fictitious assets are transferred to debit of this account at book values as under –

Realisation A/c Dr.
To Various assets (individually)
(For transfer of various assets to realization a/c)

b. **For transfer of outside liabilities –** All the external liabilities including partners loan are transferred to the credit of realization account at book value as under –

Various Liabilities A/c Dr.
To Realisation A/c
(For transfer of various liabilities to realisation a/c)

Note: Liabilities have got credit balance, so debiting to close them.

Step 2. Disposal of assets

a. For sale of assets

Cash / Bank A/c Dr.
To Realisation A/c
(For assets realised in cash)

b. Asset taken over by partner

Partner's Capital A/c Dr.
To Relisation A/c
(For assets taken over by a partner)

Step 3. Entry for payment of dissolution expenses

a. For cash payment

Realisation A/c Dr.
To Cash / Bank A/c
(For payment of dissolution expenses)

b. For payment made by a partner

Realisation A/c Dr.
To Partner's Capital A/c
(For dissolution expenses paid by a partner)

Note : if any partner is to bear all expenses of realisation, no journal entry is required in the books of the firm but in this case if the partner is paid the realisation expenses, the following entry will be made :

Partner's Capital A/c Dr.
To Cash / Bank A/c
(For dissolution expenses paid on behalf of a partner.)

Step 4. Entry for payment of outside liabilities :

a. For cash payment

Realisation A/c Dr.
To Cash / Bank A/c
(For payment to outside liabilities)

b. For liabilities taken over by a partner

Realisation A/c Dr.
To Partner's Capital A/c
(For liabilities taken over by a partner)

Step 5. Entry for closing realisation account

a. In case of profit

Realisation A/c Dr.
To Partners' Capital A/c
(For profit on realisation transferred to partner's capital a/cs in their profit sharing ratio)

b. In case of loss

Partners' capital A/cs Dr.
To Realisation A/c
(For loss on realisation transferred to partners' capital a/cs in their profit sharing ratio)

Note : (1) Intangible assets such as goodwill, patents, copyrights, prepaid expense are normally value less in case of dissolution. So if a question is silent it should be presumed that nothing could be realised from such assets.

(2) If question is silent about the realisation of tangible assets it is presumed that their book values have been realised.

2) **Partner's loan Account –** This are transferred to the credit side of realization account and the payments there of are shown on debit side of realization account. Alternatively the payment can be credited directly to cash account.

3) **Partner's capital accounts –** All the reserved and undivided profit or loss, realization profit or loss, balance of current accounts. Now the difference is adjusted in cash if there is credit balance it is surplus to be withdrawn by the concerned partner from their personal resources. Entry for surplus withdrawn or deficiency brought in by the concerned partner from their personal resources. Entry for surplus withdrawn or deficiency brought in are as under –
   a. Cash/Bank A/c Dr.
      To Partner's capital A/c
   (For deficit amount of capital brought in cash)
   b. Partner's Capital A/c
      To cash/Bank A/c
   (For final payment made to a partners)

4) **Cash account –** At first opening balance is written. Then cash at bank is also transferred to this account. Amount realized from assets and deficiency brought in by partners is debited to this account and payment of liabilities, realization expenses and surplus withdrawn by partners are credited. Now both side of cash account will be equal. The agreement of both the sides of cash account is the cross checks of accounting and arithmetical accuracy.

Format of Accounts
Realisation A/c

Particulars	Amount	Particulars	Amount
To land and Building A/c		By Creditors a/c	
To Plant Machinery A/c		By B/P A/c	
To furniture A/c		By Bad Debts Reserve A/c	
To investment A/c		By Bank Loan A/c	
To stock A/c		By Bank Overdraft A/c	
To Debtors a/c		By Loan A/c	
To B/R A/c		By Cash A/c (Assets Realised)	
To cash A/c (Payment of Liabilities)		By Capital A/c (Assets taken)	
To Capital A/c (Liab. Taken by Partners)		By Capital A/cs (Loss):	
To Cash A/c (Realization Exps.)			
To Capital A/cs (Profit):			

Partner's Capital A/cs

Particulars				Particulars			
To Balance b/d				By Balance b/d			
To Current A/c				By current A/c			
To P & L A/c (Loss)				By P & L A/c (Profit)			
To Realisation A/c (Assets taken)				By General Reserve A/c			
To Realisation A/c (Loss)				By Realisation (Liab. Taken)			
To cash A/c (Surplus) (Bal. fig)				By Realisation A/c (Profit)			
				By Cash A/c (Deficiency) (Bal. fig)			

Cash A/c

Particulars	Amount	Particulars	Amount
To Balance b/d (cash in hand) To Bank A/c (Cash at bank) To Realisation A/c (Assets Realised) To Capital A/c (Deficiency brought)		By Realisation A/c (Paymnet of Liab.) By Realisation A/c (Exp.) By Capital A/c (Surplus Refund)	

Insolvency of Partners

At the time of dissolution of a partnership firm, the capital account of a partner may show a debit balance after his share of realisation loss or profit and accumulated profits or losses etc. have been transferred to his capital account. In such a case, the partner is a debtor of the firm to the extent of debit balance in his capital account and he has to bring in the necessary cash to make up the deficiency in his capital account. If the partner is unable to bring in the necessary cash, e.g. when he cannot pay in full the amount of debit balance in the capital account, he is said to be insolvent. The solvent partners have to bear the capital deficiency of the insolvent partner. There is no provision in the Indian Partnership Act., 1932 regarding this matter. Therefore, if there is a provision regarding this matter in the partnership deed it would be decisive. The partners may provide in partnership deed that loss due to insolvency of a partner will be shared by the solvent partners in their profit sharing ratio or any other ratio. But the problem arises when there is no provision in the partnership deed regarding this matter.

Decision in Garner V/s Murray

In this case Garner, Murray and Wilkins were equal partners in England. Their capitals were unequal. The Balance Sheet of the firm after satisfying all the liabilities were as follows:

Balance Sheet

Liabilities	£	Asset	£
Capital Accounts:		Cash	1,916
Garner	2,500	Wilkins— Overdrawn	263
Murray	314	Deficiency (Realisation loss)	635
	2,814		2,814

Wilkins was insolvent and unable to pay anything. Thus the assets of the firm were not sufficient to repay the capitals in full. There was a dispute between the solvent partners regarding the method of sharing of loss due to insolvency of Wilkings. Justice Joyce held in 1904 as follows:

"The solvent partners are only liable to make good their share of the deficiency, and that the remaining assets should be divided among them in proportion to their capitals,"

In other words, the learned judge held as follows:

1. The solvent partners should bring in cash their share of the realisation loss.
2. The loss due to insolvency of a partner should be borne by the solvent partners in proportion to their last agreed capitals.

It should noted that a partner having a debit balance or nil balance, will not have to bear the loss due to insolvency of a partner.

The decision in the above case has taken into consideration only the book capital of the partners. It ignores the private estate of the solvent partners.

Meaning of last agreed capitals

In case of fixed capital method, the expression, "Last Agreed Capitals" means the fixed capital. In case of fluctuating capital method, it means the capitals after malting adjustment for accumulated profits and losses, drawings, interest on capital, salary to a partner etc. to the date of dissolution but before transferring realisation loss or profit.

Applicability of Garner V/s Murray to India

It is reasonable to assume that Garner v. Murray case will also apply to India as S. 48 of the Indian Partnership Act., 1932 is almost identical with S.44 of the English Partnership Act and there has been no case law which has examined the question of sharing of loss due to the insolvency of a partner. However, some Accountants contend that the above decision is not inconformity with S.48 (a) of the Indian Partnership Act., 1932. The students, in an examination problem, should indicate whether or not the ruling in Garner v. Murray has been applied.

Piecemeal distribution of cash

It has been presumed so far that all the assets are realised on the date of dissolution and all the liabilities are also simultaneously discharged on the same day itself. But usually this is not true in practice. In actual practice, assets are realised gradually and liabilities are paid gradually depending upon the amount realised from the sale of assets. Therefore, the realsiation loss or profit can be ascertained only after the realisation of all assets and payment of all liabilities. Available cash is used in the following order:

1. Payment of realisation expenses or a provision is made for realisation expenses.
2. Payment of outside liabilities i.e., bank loan, sundry creditors, bills payable, outstanding expenses etc. It must be noted here that a secured creditor has priority whenever an asset provided by way of security to the concerned creditor is realised. After satisfying the claim of the secured creditor the surplus, if any, is paid to unsecured creditors. Amount realised from an asset which is not charged or mortgaged is used to pay all the creditors, whether secured or unsecured in the ratio of their claims.
3. Payment of partners' loan in the ratio of their respective loans.
4. Payment of partners capitals.

If there is any contingent liability an account of bills discounted, a provision should be made in the beginning for the same and when provision is no longer required, the amount should be distributed.

Basis of distribution of cash among partners

The following are the two basis of distribution of cash among partners:

1. Proportionate or surplus capital method
2. Maximum loss method

Proportionate or surplus capital method

Under this method, the partner who have contributed more capital than his proportionate share are paid off first. In other words, the partners who have surplus capital are given the payment first. The following procedure should be adopted for calculation of surplus:

Step 1 Calculate adjusted capitals of all the partner after making adjustment for accumulated profits and losses and transfer of balances of current accounts etc.
Step 2 Divide the adjusted capitals of all partners by their respective profit sharing ratio and treat the smallest quotient as base capital.
Step 3 Calculate proportionate capitals by multiplying base capital and profit shaft ratio.
Step 4 Calculate surplus capitals by subtracting proportionate capital (step 3)from adjusted capital (Step 1)

Step 5 If there is only one partner having surplus capital make payment to that partner first to the extent of surplus capital. If there are two or more partner having surplus capitals and surplus capitals are in profit sharing ratio, distribute cash among such partners to the extent of surplus capitals in the profit sharing ratio. If there are two or more partners having surplus capitals and the surplus capitals are not in profit sharing ratio, go to the next step.
Step 6 Divide surplus capital of the concerned partners (Step 4) by their profit sharing ratio and treat the smallest quotient as revised base capital.
Step 7 Calculate the proportionate surplus by multiplying the revised base capital (Step 6).
Step 8 Calculate the excess surplus capital by subtracting revised proportionate surplus (Step 7) from surplus capital (Step 4)
Step 9 See step 5 and repeat the process until there is only one partner having excess surplus.

The partner or partners having excess surplus are paid off first to the extent of excess surplus and after that payment is made to the partners having surplus capitals to the extent of surplus capitals and lastly payment is made to all the partners in the profit sharing ratio.

Maximum Loss Method

Under this method, it is assumed that every installment realised is a final realisation, i.e., the remaining assets will realise nothing. The following procedure is adopted for distribution of cash among the partners after the payment has been made for outside liabilities and partners' loan :
Step 1. Calculate the adjusted capitals of the partners after making adjustments for accumulated profits and losses, transfer of balance of current accounts etc.
Step 2. Calculate the maximum possible loss assuming that the remaining assets are worthless. Maximum possible loss is calculated by subtracting cash available from the total of the balances of adjusted capital accounts.
Step 3. Distribute the maximum possible loss among the partners in their profit sharing ratio.
Step 4. Calculate the balances of capital accounts of partners after distribution of maximum possible loss.
Step 5. If the balances of capital accounts of all the partners (Step 4) show positive balances, distribute the available cash among the partners equal to their respective balances of capital accounts (Step 4). On the other hand, if balance of capital account of any partner (Step 4) shows a negative balance, transfer the negative balance of that partner to the capital accounts of other partners having positive balances in the ratio of capitals just before dissolution assuming the partner having negative balance as insolvent. If the capitals are fixed the negative balance should be transferred in the fixed capital ratio and in case of fluctuating capitals after adjusting for accumulated profits and losses. This process is repeated till the negative balance is completely transferred. Distribute the available cash to the partners whose capital balances after transfer of negative balance, show positive balances and the amount paid will be equal to their respective balances of capital accounts.
Step 6. Calculate the balances due after subtracting the amount paid (Step 5) from the adjusted capitals (Step 2)
Step 7. Calculate the maximum possible loss at the time of next realisation. Maximum possible loss at this stage will be calculated by subtracting the available cash at this stage from the balances due (Step 6)
Step 8. Go to Step 5.
Step 9. Calculate the balance due at this stage after subtracting the amount paid (Step 8) from the balances due (Step 6) and repeat the process till the final realisation.
This method is suitable when a partner is insolvent or is likely to be insolvent.

Amalgamation of Partnership Firms

Meaning:

When two or more businesses (run under sole proprietorship or partnership) engaged in the similar types of activities, decide to join or combine their businesses, it is called amalgamation. The purpose may be to reduce competition, to take advantage of internal and external economies derived due to large scale production, or to make expansion of business. On amalgamation the existence of the old firms ceases. The amalgamation is carried out on the basis of mutual agreement. A new partnership deed is framed for the newly constituted firm.

Accounting

In the books of old firms:

The following procedure is adopted to close the books of old firms:

1. The old firms prepare their balance sheets on the date of amalgamation.
2. Both the firms verify the values of assets and liabilities of each other and if necessary suggest the revaluation of assets and liabilities. For this purpose a revaluation account is opened and the increase or decrease in the value of assets and liabilities are passed through this account.

The result of this account (profit or loss) is transferred to the capital accounts of the partners of the respective firms in the profit sharing ratio.

Entry

Profit on revaluation Revaluation A/c Dr. To Partners' Capital A/c (Being profit on revaluation)	Loss on revaluation Partner's Capital A/c Dr. To Revaluation A/c (being loss on revaluation)

3. The goodwill account is raised by the agreed amount as under:
   Goodwill A/c Dr.
   To Partners' Capital A/c
   (Being goodwill A/c reified)
4. All the reserves and credit balance of profit & loss account is credited to the partners in their profit sharing ratio. Similarly the debit balance of profit & loss account and other fictitious assets are debited to partners' capital accounts.

Profit & Loss A/c Dr. General reserves A/c Dr. To Partners' Capital A/c (Being transfer to capital A/cs)	Partner's Capital A/c Dr. To Profit & Loss A/c (Being transfer to capital A/cs)

5. All the assets not taken over by the new firm are disposed of. Similarly all the liabilities not assumed by the new firm are paid off or otherwise settled. Alternatively such assets and liabilities and transferred to partners' capital accounts in the capital ratio (according to some accountants in the profit sharing ratio too)

   a. Assets taken by partners:
      Partners' Capital A/c Dr.
      Revaluation A/c (loss) Dr.
      To Assets A/c .
      To Revaluation A/c (Profit)
      (Being asset taken over)

   b. Liabilities taken over by partners :
      Liabilities A/c (Agreed value) Dr.
      Revaluation A/c (Loss) Dr.
      To Partners' Capital A/c
      To Revaluation A/c (Profit)
      (Being liabilities taken over)

   c. Assets sold :

Cash A/c Dr.
Revaluation A/c (Loss) Dr.
To Assets A/c (Book Value)
To Revaluation A/c
(Profit) (Being assets sold)

d. Liabilities paid :
Liabilities A/c (Book value) Dr.
Revaluation A/c (Loss) Dr.
To Cash A/c To Revaluation A/c (Profit)
(Being liabilities paid off)

6. The following entries are made for assets and liabilities taken over by the new firm
a. Assets taken :
New firm's A/c Dr.
To Assets A/c (agreed values)

b. Liabilities taken:
Liabilities A/c (agreed values) Dr.
To New Firm's A/c

Accounting in the books of new firm

The new firm will record only those assets and liabilities which are taken over by it. T entries will be passed by the agreed values.

Assets (Individually) A/c Dr. To Liabilities (Individually) To Partners Current A/c To Partners Capital A/c [Being Assets & Liabilities recorded.]	(Agreed values)	Agreed values

Conversion of Partnership Firm into Joint Stock Company

Meaning:

To avail the facilities and advantages available to joint stock companies under Companies Act 1956, some partnership firms convert themselves into company. A company is formed to purchase the business of the firm. The purchase consideration is discharged by the company in the agreed mode. The shares and debentures received in the payment of purchase consideration are divided amongst partners. The partners become the shareholders of the company. Thus the firm is dissolved and a new company comes into being. The following are the two major advantages of conversion:

1. Number of members can exceed 20.
2. Member's liabilities become limited.

Purchase Consideration

Meaning:

The value paid by the company to the firm for taking over the business of the firm is called purchase consideration which can be calculated by the following methods:

1. Lumpsum method – Here the purchase price is clearly given in the question.
2. Net Payment method – Here the purchase price is the total of all the payments given by the company to the firm in discharge of purchase consideration.
3. Net Assets Method – In this method the purchase price is calculated by the following formula : Purchase consideration = Assets taken over at agreed values-Liabilities taken over at agreed values.

The following points should be considered while calculating purchase consideration:

1. Only those assets will be considered which are taken over by the company. The agreed values of such assets are added.
2. Only those liabilities are considered which are assumed by the company. The agreed values of such liabilities are deducted.
3. Normally cash and bank balance are included in purchase price but if they are not taken over, they will be ignored. Goodwill and prepaid expenses are also included in the assets taken over.
4. Fictitious assets and debit balance of P & L account are never included in the assets.
5. If it is given that business is taken over it means assets as well as liabilities both are taken over. But if it is given that asset are taken over then only assets are considered and liabilities are ignored.

Distribution of purchase price amongst partners

The shares and debentures received from the company are divided amongst the partners in their final capital ratio. According to some author these are divided in the profit sharing ratio also. For this purpose if any ratio is given in the agreement of the partnership deed, it should be followed.

Note: If the question is silent about the ratio, the student can use any of the two ratio i.e. final capital ratio or profit sharing ratio and a note must be appended to this effect.

Accounting treatment

Entries in the books of vendor firm

The following entries are passed to close the books of vendor firm:

1. Transfer of assets to realisation account:

    Realisation A/c Dr.
    To Assets (individually) A/c
    (Being assets transferred)

The following points must be remembered while passing this entry:

- All the assets whether or not taken over by the company are transferred to relisation account at book value.
- Cash and bank balance are transferred to realisation account only when they too are taken over by the company along with the other assets.
- Fictitious assets such as debit balance of P & L account and other unwritten off expenses are not transferred to realisation account. They are debited to partners' capital account in their profit sharing ratio.
- Goodwill and other intangible assets such as prepaid expenses, trademarks, patent etc. are also debited to realisaion account.
- If any provision is made against any assets the gross value of the assets is debited to realisation ccount and the provisions are credited to realisation account:

2. Transfer of liabilities to realisation account:

    Liabilities (individually) A/c Dr.
    To Realisation A/c
    (Being Liabilities transferred)

Note: All the liabilities whether or not taken over by the, company are transferred to realization account with the exception of reserves and surplus, Capital and current accounts of partners.

3. For purchase consideration

    Purchasing Company Dr.
    To Realisation A/c
    (For purchase consideration due.)

4. On receipts of purchase price

Cash/Bank A/c Dr.
Shares in purchasing co. A/c Dr.
To Purchasing company
(For purchase consideration received)

5. Realisation of assets not taken by company :

Bank A/c Dr.
To Realisation A/c
(For cash recovered on sales of assets)

6. Payment of Liabilities not assumed by the company:

Realisation A/c Dr.
To Bank A/c
(Being payment made)

7. Realisation expenses (if borne by the firm)

Realisation A/c Dr.
To Bank A/c
(For payment of expenses of liquidation)

Note : If realisation expenses are borne by the company no entry is passed.

8. Payment of contingent liability :

Realisation A/c Dr.
To Bank A/c
(For the payment of contingent liabilities)

9. Profit on realisation :

Realisation A/c Dr.
To Partner's Capital A/c
(For profit on realisation transferred to partner's capital a/c)

10. Loss on realisation :

Partners' Capital A/c Dr.
To Realisation A/c
(For loss on realisation transferred)

11. Payment to partners :

Partner's Capital A/c Dr.
To Bank A/c
To Shares in purchasing co.
(For cash and shares distributed amongst partners).

Entries in the books of purchasing company

1. For Purchase consideration:

Business Purchase A/c Dr.
To Vendor's firm A/c
(For purchase consideration becoming due.)

2. For assets and liabilities taken over :

	Sundry Assets (individually) A/c Dr. Goodwill A/c Dr. To Sundry Liabilities (individually) To Vendor firm A/c To Capital Reserve A/c (Being assets and liabilities taken over)	Agreed Value (Balancing figure)	 Agreed value Purchase consideration Balancing figure

3. For discharge of purchase price:
   Vendor firm A/c Dr.
   To Share Capital A/c
   To Bank A/c
   (Being payment made)

4. For bearing realisation expenses of Vendor:
   Goodwill A/c or Capital Reserve A/c Dr.
   To Bank

5. For formation expenses:
   Preliminary Expenses A/c Dr.
   To Bank