



PAPER – 2

**FUNDAMENTALS OF
FINANCIAL AND COST
ACCOUNTING (FFCA)**

CMA FOUNDATION

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I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test series helped a lot in improving my writing speed and presentation skills.

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I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at IndigoLearn.

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Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

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It was only because of IndigoLearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

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Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

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IndigoLearn has been fantastic and brilliant. Helped me a lot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at IndigoLearn. Really grateful. Will go for CA Finals at IndigoLearn For sure. Thank you so much IndigoLearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from IndigoLearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well. Special thanks to the FM faculty, I studied only 2 chapters in economics, and still managed to score exemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi CA Inter

Can't believe I cleared. Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

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Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

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Note – The chapters have been arranged in a different order from the study material to ensure logical sequence and learning.

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Chapter 1 – Meaning & Scope of Accounting

OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:

1.1 Meaning and Scope of Accounting:

- Meaning and significance of Accounting.
- Difference between Book-Keeping and Accounting.
- Limitations of Accounting.

1.2 Accounting Concepts, Conventions and Principles:

- Understanding various accounting concepts, conventions, principles and assumptions which govern Accounting.
- Characteristics of Financial Statements.

1.3 Capital and Revenue Expenditure and Receipts:

- Capital and Revenue Expenditure
- Capital and Revenue Receipts

1.4 Contingent Assets and Contingent Liabilities:

- Contingent Liabilities
- Contingent Liabilities Vs Liabilities
- Contingent Liabilities Vs Provisions
- Contingent Assets

1.5 Accounting Policies:

- Meaning of Accounting Policies
- Selection of Accounting Policies
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1.6 Valuation Principles and Accounting Estimates:

- 4 Valuation Principles
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1.7 Accounting Standards:

- What are Accounting Standards
- Benefits and Limitations of Accounting Standards

1.8 Indian Accounting Standards:

- Need for Convergence towards Global Standards
- International Financial Reporting Standards
- Benefits of Convergence with IFRS
- Indian Accounting Standards (Indian AS)

Meaning of Accounting:

American Institute of Certified Public Accountant defined Accounting as "Accounting is the art of recording, classifying and summarizing in a significant manner and in term of Money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof."

In simple terms Accounting can be stated as the process of recording and maintaining the Financial Information.

Procedures of Accounting:

Broadly the accounting procedures are divided into two categories:

1. Generating Financial Information
2. Using the Financial Information.

Procedure to Generate Financial Information comprises of the following 6 steps:

1. Recording:

This is the first step of accounting. All the transactions are recorded in the respective account book which is called as a "Journal".

For Eg: All the transactions done by the company during a particular month will be recorded in the Journal on a daily basis.

2. Classifying:

Classifying involves systematically analyzing and segregating the transactions recorded in the Journal.

This is done by transferring the journal entries in the Ledger which clubs all the similar transactions to a particular account.

For Eg: All the journal entries related to sales will be recorded in the Sales Ledger.

3. Summarizing:

Under this step all the ledger balances are summarized and prepared in manner that is useful to the users of the Financial Statements.

A company carries on hundreds and thousands of transactions in a financial year and the journal and ledger balances for all the transactions can run into hundreds of pages which will be lot time consuming and confusing for the users of the Financial Statements.

Therefore, to avoid this problem a summary of all the transactions and ledger balances is presented. The preparation of this summary leads to the creation of the Financial Statements which includes the following:

- i) Trial Balance
- ii) Profit and Loss Statement
- iii) Balance Sheet
- iv) Cash Flow Statement

4. Analyzing:

The financial statements need to be presented in a meaningful and usable way for the users whereby they can analyze and draw the relationship among the various items of the Financial Statements.

For Eg: All items relating to a particular type of Asset can be found in the Balance Sheet Asset side such as Fixed Asset, Current Asset, Investments, etc. This classification makes it easier for the users to analyze the information presented in the Financial Statements in a systematical manner and analyze various important ratios and other meaningful information as per their requirement.

5. Interpreting:

This step is stated as the Final Step of Accounting whereby the financial statements are interpreted in a manner that enables the end users of the Financial Statements to derive useful information about the company's Financial Condition and profitability of the Business.

It is important from the point of view of interpretation that the companies provide an in depth explanation the conditions under which the important transactions have happened, the impact of its occurrence, what is the likelihood of its occurrence.

6. Communicating:

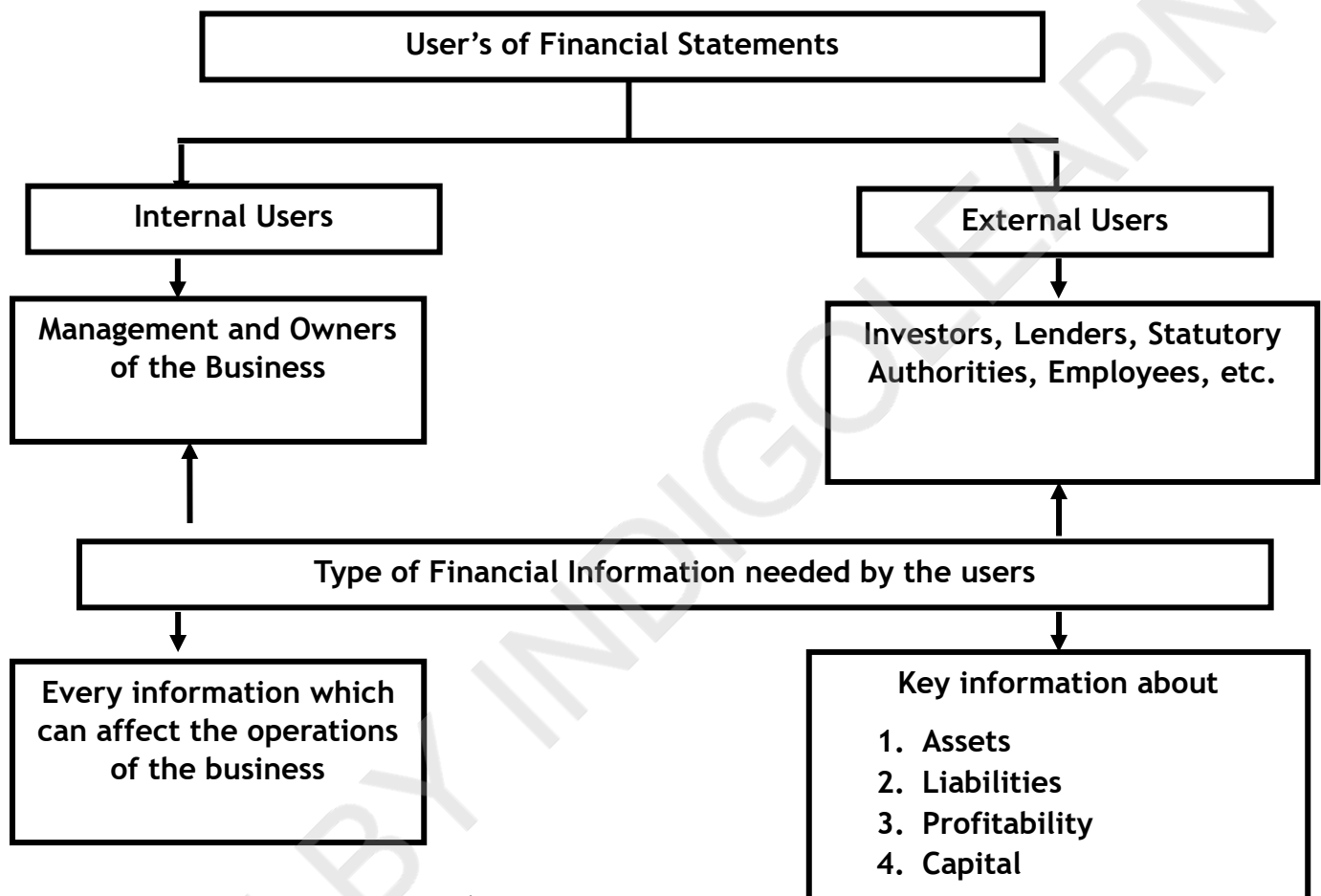
This step is not concerned with the generation of the Financial Statements, but it deals with communicating the Financial Statements prepared using the above steps.

The Financial Statements are communicated through the distribution of annual accounting reports, mandatory filings with the various statutory authorities.

Using the Financial Information and Users of Financial Statements (Accounting Information):

With the advancement of the global trade and rising interest of various parties in an organizations business there has been an increase in the number of stakeholder's who are interested in the using the company's Financial Statements to fulfill their various interests.

Broadly speaking the users of financial statement can be classified into 2 categories:



Users of Accounting Information/Financial Statements:

As seen in the previous diagram the users of the Accounting Information are classified into 2 categories Internal Users and External Users.

Let us try to understand the usability of the Financial Statement to the various users:

Internal Users:

1. Management:

The Management of the entity needs to take various decisions with respect to budgeting, forecasting based on the past trends and market analysis for the sake of which they need to evaluate their financial statements to get an understanding of their business has been performing and the details of their financial position which assist them in taking better decisions.

Also, they need the various financial information to identify the shortcomings and weaknesses in their business so that they can design and act on corrective measures to improve the deficiencies.

External Users:

1. Investors:

The investors of the company want to understand how the company has been performing and how is their investment growing.

Based on that information they can take various investment related decisions such as whether to invest further or disinvest from their existing investment.

2. Employees:

Employees of any company are interested in understanding how the growth of the company is?

This is because their career growth depends on the growth of the organization at least till the time they are associated with the company.

3. Lenders:

Lenders are interested in knowing how profitably the company is performing.

This is to ensure that their loans and interest are safe with the company and will be repaid as per the contracts.

4. Suppliers and Creditors:

Suppliers and Creditors are interested in using the financial information of the company with the same intention as the lenders.

They are keen to know whether the credit balances owed to them by the company will be paid on timely basis.

Also, they try to estimate that how long they can expect to be in business with the company in future.

5. Customers:

Many of customers of any business are probably their repeat customers and if the business goes into trouble and cannot continue then it also causes hassle to the customer who needs to find a replacement of the product.

This is especially true if the customer used the company's product as an input for its own business.

For Eg: If ABC Company was a steel manufacturer and its customer Mr. D had a steel factory. Mr. D used to procure majority of his raw material from ABC Company.

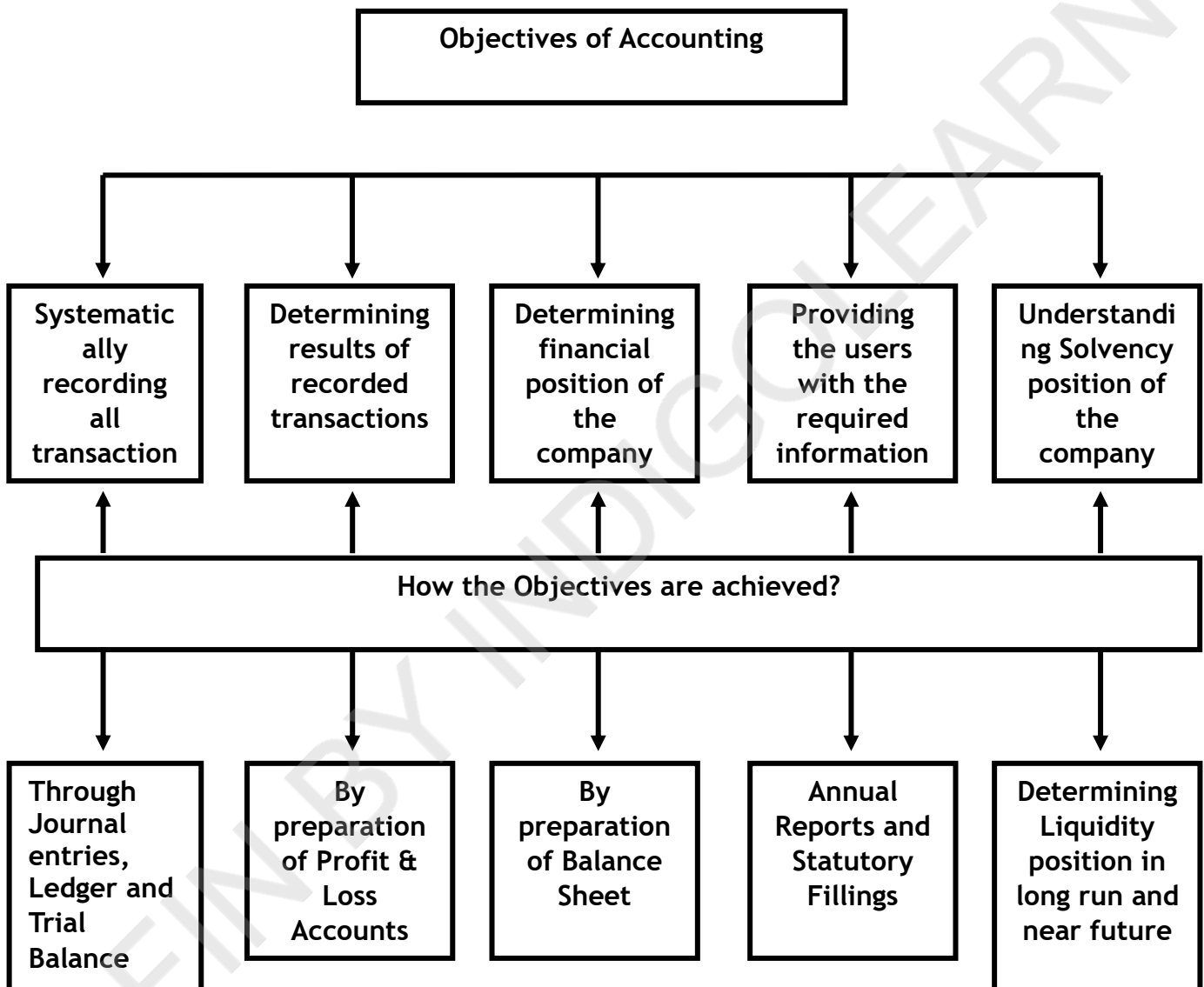
If for some reason ABC Company shuts down, then it would be a lot of hassle for Mr. D to find a new supplier for the same input especially if it was a customizable product.

6. **Statutory Authorities:**

Statutory Authorities make sure that the business is operating within the laws and regulations and defined framework and for accomplishing this objective they need to rely on the Financial Statements submitted by the companies as per the rules and acts.

Objectives of Accounting:

The objectives of Accounting and the method through which they are achieved can be understood with the help of the following diagram:



Book-Keeping:

Book-Keeping can be stated as the process/activity to record the various transactions entered by the entity in a systematic and timely manner.

By properly recording all the transactions in an orderly manner, organizations can prepare the Financial Statements which are true and correct and useful to their users.

The main objective of Book-Keeping is to provide proper summary of all the financial and non-financial transactions entered by the company which would help the company in systematic preparation of the Financial Statements.

The main objective of Book-Keeping is to maintain a Complete Record of all the Transactions in a systematic manner which is useful in determining the Financial Results on the business.

Often, Book-Keeping is confused with Accounting. It is important to note that Book-Keeping is a part of Accounting. Accounting in itself is a big domain and not restricted to Book-Keeping.

The following table will enable you to understand the important points of Distinction between Book-Keeping and Accounting:

Point of Distinction	Book-Keeping	Accounting
Objective	Systematic Recording of Transactions	Summarizing of Recorded Transactions
Basis for	It is basis for preparation of Financial Statements	It is the basis for communicating the results of operations
Are Financial Statements parts of it?	Financial Statements do not form a part of Book-Keeping	Financial Statements are part of Accounting
Basis for Managerial Decisions	Managerial Decisions cannot be made on the basis of Book-Keeping	Managerial Decisions are made based on the statements prepared under Accounting
Sub-Fields	There is no Sub-Field of Book-Keeping	Accounting has various sub-fields such as Managerial Accounting, Financial Accounting, Cost Accounting, etc.

Sub-Fields of Accounting:

Book-Keeping can be stated as the process/activity to record the various transactions entered

Accounting is not just restricted to the preparation and presentation of the Financial Statements to the users. It has various domains which are designed to serve the various purposes:

1. Financial Accounting:

This field of Accounting deals in preparation and presentation of the financial statements to the users. The Financial Accounting main objective is determining profitability and financial position of the business at a particular point of time.

2. Management Accounting:

This field of Accounting is specifically designed to provide customized and specialized information to the managers of the organization which would assist them in planning and taking appropriate steps in achieving the goals of the organization.

3. Cost Accounting:

This field of Accounting is specifically designed to determine the cost and its allocation which is crucial in determining profitability of the business.

4. Social Responsibility Accounting:

With the increasing awareness about the social issues and involvement of the various business houses in view to work for profit and support a cause along with the advancement in the laws relating the CSR there has been a significant increase in the spending towards social causes.

The companies who are spending towards CSR are highly interested in knowing whether the amount spent by them is able to fulfill the cause and generate the impact it had expected through the spending.

The measurement of the social benefits created and the lives impacted is the main objective of the Social Responsibility Accounting.

For Eg: If Company ABC had spent Rs.1.00 Cr during F.Y.2017-2018 for promoting education among the low income kids. It would like to know the number of kids who got enrolled in the schools via their programs for which they had spent amount of Rs.1.00 Cr.

5. Human Resource Accounting:

Of all the expenditure incurred by the businesses they can be measured by using the standards, measurements and valuation principles provided by various laws, regulations and AS.

Except for the Human Resource, which is the only expenditure incurred by the company to develop and maintain the human resource which will be able to provide the company benefits across the years. However, it is written off as expense in the year it is incurred.

Human Resource Accounting attempts to identify measure and report the investment made in the Human Resource of the entity.

Relationship of Accounting with other disciplines:

i.Accounting and Economics:

Accounting	Economics
- It is viewed as a system, which provides data to the users to permit informed judgement and decisions. - Non-accounting data are also relevant for decision-making	It is viewed as a science of rational decision-making about the use of scarce resources.
Contributed a lot improving the management decision-making process.	economic theories influenced the development of the decision-making tools used in accounting.

At the macro-level, accounting provides the database over which the economic decision models have been developed; micro-level data arranged by the accounting system is summed up to get macro-level database.

ii.Accounting and Statistics:

Accounting	Statistics
Accounting information is very precise; it is exact to the last paisa	For decision-making purposes such precision is not necessary for which this is used.
All values are important individually because they relate to business transactions.	It is concerned with the typical value, behavior or trend over a period of time or

	the degree of variation over a series of observations.
It records generally take a short-term view of events and are confined to a year	It is more useful if a longer view is taken for the purpose
Several accounting and financial calculations are based on statistical formulae.	Statistical methods are helpful in developing accounting data and in their interpretation.

The functional relations showing mathematical relations of one variable with one or more other variables are based on statistical work.

iii. Accounting and Mathematics:

- Knowledge of arithmetic and algebra is a pre-requisite for accounting computations and measurements.
- Accounting data are also presented in ratio form.
- The fundamental accounting equation will be discussed in detail under 'Dual Aspect Concept' of this chapter.
- Since accounting is meant for providing information to the users, to be effective, accounting data should feed the information requirements of such statistical, econometric and operations research models.
- Understanding mathematics has become a must to grasp the decision models framed by statisticians, econometricians and the O.R. experts.

iv. Accounting and Law:

- An economic entity operates within a legal environment.
- Transactions and events are always guided by laws of the land. Very often the accounting system to be followed has been prescribed by the law.
- The legal prescription about the accounting system is the product of developments in accounting knowledge.
- Accounting influences law and is also influenced by law.

v. Accounting and Management

- Management is a broad occupational field, which comprises many functions and encompasses application of many disciplines.
- Accountants are well placed in the management and play a key role in the management team.
- A large portion of accounting information is prepared for management decision-making.
- So the accounting system can be molded to serve the management purpose.

Limitations of Accounting:

Accounting has some limitations which are important to be aware of. Since the Financial statements are the basis of communicating the performance and financial position it is important to be aware of the limitations in the presence of which the Financial Statements have been prepared:

The Limitations of Accounting are as follow:

1. Non-Monetary items are not considered:

The most important factor to determine the worth of a business is their employee, their skill and dedication which are nowhere found on the Financial Statements.

2. Balance Sheet is valid only for a particular point of time:

The Balance Sheet which reflects the financial position of the business is valid only for a particular point of time. A single additional transaction can alter the balance sheet drastically.

However, to overcome this limitation the auditors disclose the events occurring after the balance sheet date.

3. Time Value of Money:

The Monetary factors such as Inflation, Time value of Money, etc. are ignored in preparation of Accounting.

4. Use of Estimates:

Some Accounting Estimates such as provision for doubtful debts, useful life of the Fixed Asset, etc. depends on the estimates and judgments made by the management and accounting personnel.

Since human judgment is involved it can lead to error in estimation of the same which can have an impact on the Financial Statements.

Questions:

1. Identify whether the following are transactions which would be recorded in the Financial Statement or not?

i. Mr. A asked for Quotation of goods and received a quotation of Rs.5.00/- Lac from Mr. B. Will this be recorded as purchase in the Books of Mr. A?

Will not be recorded

ii. Mr. B received an order for Rs.10.00/- Lac and raised an invoice to Mr. C for the same. Will this be recorded as sales in the books of Mr. B?

Will be recorded

2. Which of the following is not an internal user of the Company's Financial Statement?

i. CEO of the company

ii. Employees of the company - **Not an internal user**

iii. CFO of the company

iv. Directors of the company

3. Limitation of Accounting is that it:

i. It does not use estimates.

ii. It accounts only for Monetary Items - **Is a Limitation**

iii. Accounts for time value of Money

iv. Balance Sheet is valid throughout the year.

Chapter -2 Accounting for Concepts, Conventions and principles

Need for Accounting Concepts, Conventions and Principles:

Accounting is stated as the Language through which the results of the operations of the company are communicated to the various stakeholders.

How would the Financial Statements of various companies look like when they are prepared by various accountants based on their understanding of the norms and notions of accounting due to absence of any standardized policy? It would literally cause chaos because the result of operations prepared by two different accountants for the same set data would be showing different results rendering it useless.

To avoid this issue and establish uniformity and comparability among the financial statements of various entities and across the period of time for same entity framework of GAAP "Generally Accepted Accounting Principles" have been established.

GAAP provides all the concepts, conventions and principles on the basis of which the Financial Statements of the entity needs to be prepared.

Accounting Concepts:

Accounting Concepts defines the assumptions which form the basis of preparation of Financial Statements.

Accounting Principles:

Accounting principles provide explanation of current practices and a guide for selection of practices where alternative treatments exist.

Accounting Principles need to satisfy the following conditions:

1. They should be based on real assumptions.
2. They must be simple, understandable and explanatory.
3. They must be followed consistently.
4. They should be able to reflect future predictions.
5. They should be informational for the users.

Accounting Conventions:

Accounting Conventions are the conventions which arise in the company Accounting Process due to the application of the principles and practices over a period of time.

Let us look at the Concepts, Conventions and Principles:

1. Entity Concept:

Entity Concepts states that the business enterprise and the owner of the enterprise are two separate entities and have their own identities. The transactions occurring between the two should be clearly recorded as transaction between two different persons.

For Eg: If an amount of Rs.10,000/- is withdrawn by Mr. A from his business, it should be treated as a Drawings from business and not as a Expense of the Business.

2. **Money Measurement Concept:**

As per this Concept only those transactions which can be measured in Monetary Terms are to be recorded.

Any transaction which cannot be measured in monetary terms should not be recorded even though it may be materially significant in value.

For Eg: The Human Resource of any organization is its biggest strength but it will not be recorded anywhere in the Financial Statement because it cannot be measured in Monetary Terms.

3. **Periodicity Concept:**

As per this Concept companies need to prepare their accounts at a regular interval comprising of fixed period of time and not at the end of the life of the business.

Using this concept only the Financial Statements of the company are prepared for every 12 months also known as "Financial Year".

It can be stated that the periodicity concept helps in achieving the following objectives:

- Comparing financial statements of different periods of time.
- Uniform and consistent accounting treatment for ascertaining the profit/loss and assets/liabilities of the business.
- Matching current period revenues with current period expenses for getting correct results of the business operations during a given period of time.

4. **Accrual Concept:**

As per the Accrual Concept of Accounting all transactions and events of business are recognized on a Mercantile Basis.

It means that all expenses and losses are recognized in the period during which they have occurred irrespective of the fact whether they have been paid or not and all income and gains are recognized in the period during which they have been earned irrespective of the fact whether they have been received or not.

5. **Matching Concept:**

As per the Matching Concept all the expenses incurred should be matched to the corresponding revenue earned from those expenses. In Simple words it can be stated that for all the revenue recognized during a period the corresponding expenses should be recorded during that period.

For Eg: ABC Company had purchased 1000 quantity of goods for reselling and had sold 600 of those in the current financial year.

Then at the end of the Financial Year the Cost of Goods Sold will be booked only for 600 units and the balance 400 will be transferred to Ending Inventory which will be transferred to COGS when they are sold.

6. **Going Concern Concept:**

As per the Going Concern Concept it is assumed that the entity intends to continue its operations for the foreseeable future and has no intentions of drastically reducing its scale of operations.

If it has any intention to scale down its operations materially or it is intending to close down its operation then it is liable to disclose the same to the users of the Financial Statements.

7. **Cost Concept:**

As per the Cost Concept the assets are supposed to be measured at their historical cost i.e. their original cost of purchase.

This concept is mainly applied to long term assets such as Fixed Assets. Because current assets are valued at cost or market value whichever is realizable.

For Eg: If ABC company had acquired a Machinery worth Rs.10.00 Lacs 10 years back and had spend Rs.2.00 Lac towards its installation. Then the cost of the machine will be carried over across the years at Rs.12.00 Lac Less Accumulated Depreciation.

8. **Realization Concept:**

As per the Realization Concept any change in the value of the assets is to be recognized only when the asset has been sold and the amount has been realized.

This means that companies do not need to revalue their assets every year as per the realizable value. However, they need to adjust the cost of the asset when they are sold.

For Eg: ABC Company had machinery with book value of Rs.5.00 Lac as on August 2018 whose market value was Rs.6.00 Lac which was sold for Rs.5.50 Lac. In Sep 2018.

Here ABC Co. would not revalue the asset at Rs.6.00 Lac in August 2018 and then record the sale in Sep recognizing a loss of Rs.50 thousand.

ABC Co. would be directly booking the asset value at Rs.5.00 Lac and a gain of Rs.50 thousand when asset is sold in September.

9. **Dual Aspect Concept:**

This concept is the basis on which the Double Entry System of Book-Keeping is based on. As per this concept every transaction has 2 effects.

This can be summarized in the following manner:

Effect of Changes in Asset

In one Asset, in other Asset.

In one Asset, in Liability.

Effect of Changes in Liability

In one Liability, in other Liability.

In one Liability, in Asset.

For Eg: When the business pays of dues to its creditors, it results in reduction of Asset (Cash & Bank) and reduction of liability (Creditors Balance).

10. **Conservatism Concept:**

This Concept states that accountants should not record anticipated income but they need to record the anticipated losses.

As the name itself suggest this concept is based on Conservatism principle which means that all the possible expenses and losses are reported which have not even occurred yet but the income and gains are reported only once they are realized. Resulting in preparation of most conservative Financial Statements.

11. **Consistency Concept:**

This Concept states that the enterprises should follow the accounting policies on a consistent basis from one period to another and should change their accounting policy only when the exceptional circumstances arise.

The intention of this concept is to ensure the comparability of financial statements across a period of time. Financial Statements can be compared across a period of time only when they are prepared using the same accounting policies and principles for the period being compared.

The exceptional circumstances under which the companies can change the accounting policies are as stated below:

- i. To prepare the accounts in line with the newly issued Accounting Standards.
- ii. To comply with the provisions of Law.
- iii. If the circumstances have changed and it is felt that only by the adoption of the New Accounting Standards the company's financial results will be shown in a true and fair manner.

12. **Materiality Concept:**

This Concept allows the accountant to ignore all the other concepts of accounting which have been discussed till now under the condition that the result of ignoring all the other concepts will not make the financial statements materially misstated.

According to the Materiality concept all the items which have significant effect on the financial statements should be disclosed and all the items which are insignificant in value and will only increase the work of the accountant but are not relevant to the users should be ignored.

For Eg: When the business purchases some stationery items such as calculator which are going to be used for a more than a year, they are not classified as Fixed Asset and depreciated accordingly. They are expensed off as a Expense under Printing and Stationery for the year.

This is because the cost of calculator is no material enough to impact the decision of the users of the Financial Statement.

Characteristics of Financial Statements.

The 4 qualitative characteristics of Financial Statement that make them useful to their users are as follow:

1. Understandability:

The Financial Statements should be easily understandable by the users.

It is assumed that the users of these Financial Statements have a basic understanding of the Business and Accounting to study the information presented in them.

The Financial Statements contain information about complex matters that are to be supposed to be reported. However, they should not be omitted just because they are complex in nature to understand.

2. Relevance:

The information presented in the Financial Statement should be relevant to the users.

It means that the users should be able to use the information presented in making their economic decisions.

3. Reliable:

The information presented in the Financial Statements should be reliable.

Quality of reliability is established when the Financial Statements are free from material errors and bias and represents all the information in a faithful manner.

4. Comparable:

The information presented should be comparable. It should be comparable with the entities past performance as well as with the different entities across the same and other industries.

Comparability can be established when the financial statements are presented using the consistent principles and policies across the years.

The other characteristics which enhance the value of the Financial Statements are as follow:

5. Materiality:

The information is said to be material if its misstatement either by way of omission or wrong presentation can influence the economic decision of the user which is based on the financial statements.

Therefore, it is important the Financial Statements present all the material information.

6. Substance over Form:

The information presented should be indicating the true nature or intention of the transactions rather than focusing on the legality of the transaction.

For Eg: if the ABC Co. had purchased an asset of Rs.10.00 Lac by paying an advance amount of Rs.1.00 Lac. However, the official transfer is not made in the name of the ABC Co.

In this situation ABC Co. will record the asset in its balance sheet and create a creditor for the balance amount. Even though the official transfer is not made by considering the substance over the form the asset is recorded in the books of ABC Co.

7. **Neutrality:**

If the financial statement are prepared and presented with a view to influence the decision of the user they are said to be biased and not neutral.

A neutral financial statement is the one which presents the information as it is without any intention to influence the decision of the users.

8. **Prudence:**

Quality of Prudence states that the Financial Statements have been prepared using professional judgment needed in determining the estimates needed in the preparation of the financial statements.

However, by using prudence one should not resort to unethical practices such as creation of hidden reserves, overstatement or understatement of assets and liabilities, incomes and expenses, etc.

9. **Faithful Representation:**

Financial Statements should faithfully represent all the transactions and events related to the period for which the financial statements are being presented.

10. **Full, Fair and Adequate Disclosure:**

Full disclosure states that nothing should be omitted from the Financial Statements.

Fair disclose states that all the transactions should be accounted for in manner that presents the financial statement in a true and fair manner.

Adequate disclosure states that all the information which could influence the decision of the user should be presented in adequate detail.

11. **Completeness:**

To establish reliability it is important that the information presented is complete in all material aspects. Information can be false or misleading and thus irrelevant and reliable if it is not complete in all material aspects.

Questions:

1. Identify the effect on Asset and Liability of the following transactions.
 - i. Mr. A paid outstanding creditors balance of Rs.10,000
Asset decreases, Liability Decreases.
 - ii. Mr. B sold goods worth Rs.10,000 for cash?
Asset decreases (Inventory), Asset Increases (Cash/Bank).
2. Which of the following is not a qualitative characteristic of Financial Statement?
 - i. Comparability
 - ii. Completeness - **Not an qualitative characteristics**
 - iii. Relevance
 - iv. Reliability
3. A company needs to apply same method of depreciation due to which accounting concept:
 - i. Consistency - **For Consistency**
 - ii. Money Measurement
 - iii. Periodicity
 - iv. Accrual
4. What are the situations under which company can change its Accounting Policy?

Chapter-3 Capital and revenue expenditure and receipts

Capital Expenditure:

Capital Expenditure is that expense whose benefits last for more than one accounting period.

For Eg: Purchase of Fixed Assets is a capital expenditure since its benefit is going to be lasting for more than 1 accounting period.

Revenue Expenditure:

Revenue Expenditure is that expense whose benefit is going to expire within a single accounting period or is incurred in relation to the sales made during the accounting period.

For Eg: Cost of Goods Sold in relation to the sales made.

Factors determining whether expenditure is CAPITAL or REVENUE in nature:

1. **Nature of Business:**

The Nature of business is an important factor in determining whether a expense is capital or revenue in nature.

For Eg: For a company dealing in sale of computers, purchase of computer will be a part of revenue expenditure. However, for company dealing in groceries purchase of computer will be capital expenditure.

2. **Is the Expenditure Recurring or Not?**

The expenditure which are recurring on a fixed basis and whose benefit is exhausted within a single accounting period is revenue expenditure. For eg: Salaries paid on monthly basis.

The Expenses which are incurred once in a while such as purchase of Fixed Asset is a capital expenditure.

3. **Purpose of Expense:**

If the expense helps in generating income over more than one accounting period it is a capital expenditure.

If the expense is useful in generating income in the current accounting period, then it is revenue expenditure.

4. **Materiality:**

The most important factor is the materiality of the amount involved. If the amount of expenditure is not material enough to be classified as a capital expenditure it will be written off as a Revenue Expenditure in the current period itself.

Revenue Receipts:

Revenue Receipts are the receipts which are received in the normal course of the business operations. It is important to note that the revenue receipt is not equal to cash receipts.

Revenue receipts are credited to the profit & loss account.

For Eg: Collection from Debtors for the sales made.

Capital Receipts:

Capital Receipts are the receipts which are not revenue in nature. Capital receipts realized from sale of asset are first utilized to reduce the outstanding value of the asset in the company's balance sheet and any surplus or deficit is transferred to Profit & Loss Account.

For Eg: An asset whose value is Rs.1.00 Lac in the books of Accounts is sold for Rs1.10 Lac. Here the Rs.1.00 lac out of the proceeds will be credited to the asset value to make it 0. And the balance Rs.10 thousand will be transferred to credit side of Profit & Loss Account.

Questions:

1. Identify which of the following is Capital/Revenue Expenditure or Capital/Revenue Receipt.
 - i. Purchase of Computer worth Rs.1.00 lac by company dealing in computers for maintaining its accounts.
Capital Expenditure (Even though it is dealing in computers it is purchased the computer for maintaining its accounts and not for sale).
 - ii. Payment of Rent in advance for 2 years.
Rent Expense for current year is revenue expense but the rent paid for the next year is capital expense.
 - iii. Cash Sale of Rs.1.00 Lac
Revenue Receipt
 - iv. Sale of old Fixed Asset by the company at a loss of Rs. 50 thousand.
Capital Receipt

Chapter 4 - Journal Entries

Double Entry System:

The Double Entry System of Accounting is the most commonly used system of Accounting.

According to Double Entry System, Every transaction has two aspects a Debit and a Credit.

For every transaction entered into there will be one or more Debit and one or more Credit and the total of debit will be equal to the total of credit.

Advantages of Double Entry System:

Following are the advantages of Double Entry System due to which it is extensively used in all the countries.

- i. The accuracy of the accounting can be established by the preparation of the trial balance.
- ii. The result of the operations carried on during a period of time i.e. either profit or loss can be ascertained with details.
- iii. The financial position of the organization can be ascertained at the end of each period through the balance sheet.
- iv. The accounts can be kept in as much details as required and provides information for the purposes of control etc.
- v. Result of one year may be compared with those of previous years and reasons for the change may be easily determined.

Debits and Credits:

Debits and Credits are the 2 sides of same coin. For every debit there will always be an equal and corresponding credit.

The Rules of Debit and Credit can be summarized as follow:

- i. Increases in assets = debits & decrease in assets = credits.
- ii. Increases in liabilities = credits & decreases in liabilities = debits.
- iii. Increases in owner's capital = credits & decreases in owner's capital = debits.
- iv. Increases in expenses = debits & decreases in expenses = credits.
- v. Increases in revenue or incomes = credits & decreases in revenue or incomes = debits.

There are 2 methods of recording every transaction by under the Double Entry System.

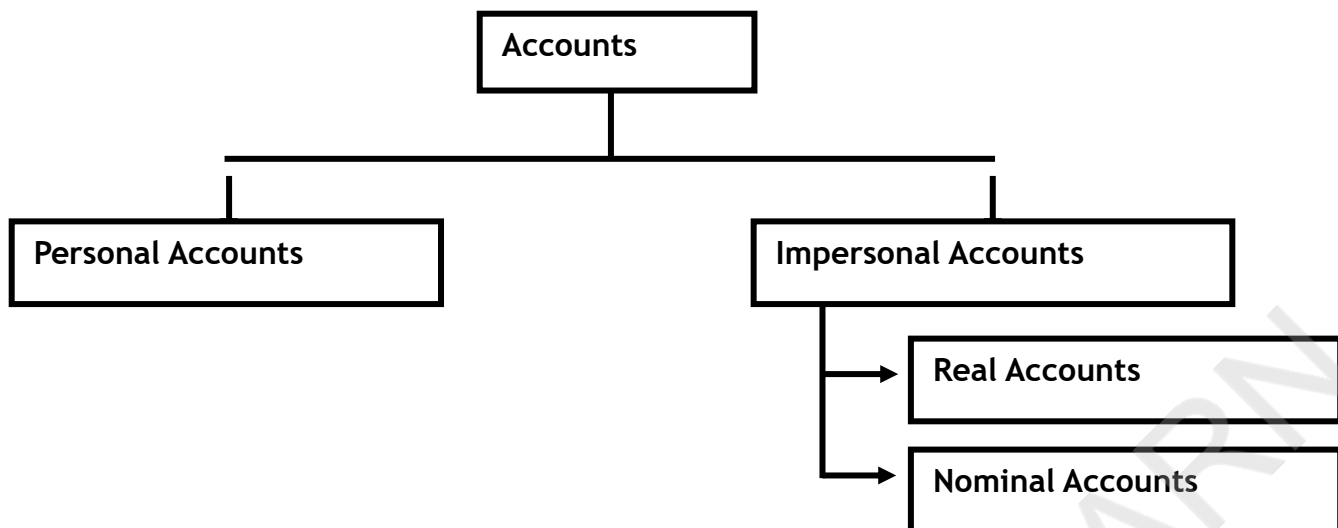
Journal Entry - Traditional Approach:

To understand the traditional approach it is important to understand 2 important factors

- i. Classification of Accounts.
- ii. Golden Rules of Accounting.

Classification of Accounts:

Classification of Accounts under traditional accounts is based on Personal and Impersonal Accounts.



Interpretation of the Accounts:

1. Personal Accounts:

These are the accounts which relate to someone who can be identified. All those accounts that have their own identity either as an individual or as a legal establishment such as Mr.A, ABC &Co, etc. are classified as Personal Accounts.

2. Real Accounts:

These are the accounts which represent the assets of the firm either tangible or intangible such as Cash, Bank, Inventory, Trademark, Goodwill, etc.

3. Nominal Accounts:

These are the accounts which are presented in the Profit & Loss account. This includes all the revenues, expenses, gains & Losses. The important feature of the Nominal Accounts is that they are temporary accounts and are written off by the end of the accounting period by transfer to Profit & Loss Account.

Golden Rules of Accounting:

The Golden Rules of Accounting states the rules of debit and credit for every type of accounts. The summary of Golden Rule of Accounting is as follow:

Type of Account	Debit	Credit
Personal Account	When Receiving	When Giving
Real Account	When it comes in	When it Goes out
Nominal Account	All the Expenses and Losses	All Incomes and gains

Example on Journal Entry:

Prepare the Journal entries for the following transactions:

1. Mr. A Introduced capital of Rs.10.00 lac to start his business.

2. Purchased Machinery worth Rs.2.00 Lac by paying the entire amount.
3. Purchased goods on credit from Mr. B worth Rs. 50 Thousand.
4. Sold goods for Rs. 4.00 Lac to Mr.C and of Rs.1.00 Lac in cash.

The Journal entries for the above transaction are as follow:

Date	Particulars		Debit	Credit
	Bank A/c	Dr.	1,000,000	
	To Mr. A Capital A/c			1,000,000
	(Being capital Introduced by Mr.A)			
	Machinery A/c	Dr.	200,000	
	To Cash/Bank A/c			200,000
	(Being Machinery Purchased)			
	Purchase A/c	Dr.	50,000	
	To Mr.B A/c			50,000
	(Being Goods Purchased on Credit)			
	Mr.C A/c	Dr.	400,000	
	To Sales A/c			400,000
	(Being Goods Sold on Credit to Mr.C)			
	Cash/Bank A/c	Dr.	100,000	
	To Sales A/c			400,000
	(Being cash sales made)			

Accounting Equation - Modern Approach:

The other approach to record the transactions is the Modern Approach of accounting which is based on the Accounting Equation. The relationship among the Assets, Liabilities and Owner's equity can be expressed in terms of an Equation which is known as the "Accounting Equation."

Assets = Liabilities + Owner's Equity

The owner's equity is computed as follow:

Contributed Capital

Add: Beginning Retained Earnings (Opening balance in Profit & Loss)

Add: Profit earned during the period (Revenues - Expenses)

Less: Dividends distributed (Drawings made)

The Modern classification of accounts can be summarized in the following table:

Account Type	Account shown Normal Balance in	Debit when the account is to be	Credit when the account is to be
ASSET	Debit	Increase	Decrease
LIABILITIES	Credit	Decrease	Increase
CAPITAL	Credit	Decrease	Increase
REVENUE	Debit	Decrease	Increase
EXPENSES	Credit	Increase	Decrease
DRAWINGS	Debit	Increase	Decrease

Example on Modern Classification of Accounts:

Prepare the Journal entries for the following transactions:

1. Mr. A Introduced capital of Rs.10.00 lac to start his business.
2. Purchased Machinery worth Rs.2.00 Lac by paying the entire amount.
3. Purchased goods on credit from Mr. B worth Rs. 50 Thousand.
4. Sold goods for Rs. 4.00 Lac to Mr.C and of Rs.1.00 Lac in cash.

Date	Transaction	Accounts Involved	Nature of Accounts	Affected	Debit (Rs.)	Credit (Rs.)
	Capital introduced in Business	Bank	Asset	Increased	1,000,000	
		Capital	Capital	Increased		1,000,000
	Machinery Purchased	Machinery	Asset	Increased	200,000	
		Bank	Asset	Decreased		200,000
	Goods Purchased on Credit	Purchases	Expense	Increased	50,000	
		Creditor	Liability	Increased		50,000
	Sold Goods on Credit	Debtor	Asset	Increased	400,000	
		Sales	Revenue	Increased		400,000
	Sold Goods on Cash	Bank	Asset	Increased	100,000	
		Sales	Revenue	Increased		100,000

Accounting for GST

GST is a comprehensive Indirect Tax which has subsumed multiple Indirect Taxes such as Value added Tax (VAT), Excise Duty, Service Tax etc.

GST is a single tax on the supply of goods and services, right from the manufacturer to consumer.

On introduction of GST, the tax to be levied at all stages right from the manufacture up to final consumption was a single tax-GST, with credit of taxed paid at previous stages available as setoff.

Salient features of GST

- a. GST is levied on supply.
- b. Tax is levied only the value added at each stage of the supply chain.
- c. GST is a destination-based consumption tax.
- d. There is no tax on tax or cascading of taxes under GST system.
- e. There is a harmonization of laws, procedures and rates of tax across the country.

Types of Taxes under GST

- a. Intra-state supply: The location of the supplier and the place of supply of goods or services are in the same state/union territory.
- b. Inter-state supply: The location of the supplier and the place of supply of goods or services are in two different states or two different union territories or a state and a union territory.
1. **Central Goods and Service Tax (CGST):** Levied and collected by the centre on the Intra-state supply of goods and services.
2. **State Goods and Service Tax (SGST):** Levied and collected by the state governments on Intra State supply of goods and services.
3. **Union Territory Goods and Service Tax (UTGST):** Levied and collected by Union Territories without legislatures on Intra-state supply of goods and services.

Union Territories - Andaman and Nicobar Islands, Lakshadweep, Ladakh, Dadra and Nagar Haveli & Daman and Diu and Chandigarh
4. **Integrated Goods and Service Tax (IGST):** Levied on the inter state supply of goods and services and is collected by centre. IGST is equivalent to the sum total of CGST and SGST.

Input and Output GST

Input tax - The tax paid by the recipient on procurement of goods/services.

Entity at each stage is permitted to avail credit of GST paid on the purchase of goods and/or avilment of services and can setoff this credit against the GST payable on the goods and/or services supplied by him.

Thus, the final consumer bears the GST charged in the supply chain, with set-off benefits at all the previous stages.

Output tax - The GST charged on supply of goods or services made by the supplier.

Input tax - The credit of Input tax already paid.

Utilisation of Input Tax Credit under GST

Tax credit of CGST, SGST and IGST can be utilized in the following manner:

Utilization of IGST credit:

- First utilized against IGST liability
- If any balance is still available - Utilized against CGST or/and SGST in any order and in any proportion

Utilization of CGST credit:

- First utilized against CGST liability
- If any balance available - Same can be utilized against IGST.
- CGST credit cannot be utilized against SGST.

Utilisation of SGST credit

- First utilized against SGST liability.
- If any balance available - Same can be utilized against IGST.
- SGST credit cannot be utilized against CGST.

	Input GST	Output GST
Nature	At the time of purchase of goods or services Input GST A/c is debited.	At the time of sale of goods/assets or supply of services Output GST A/c is credited.
Intra-state transaction	CGST paid is debited to Input CGST A/c SGST paid is debited to Input SGST	CGST charged is credited to output CGST A/c SGST charged is credited to Output SGST A/c
Inter-state transaction	IGST paid is debited to Input IGST A/c	IGST charged is credited to Output IGST A/c
Reversal of GST	Input GST paid at the time of purchase are reversed in following situations - Purchase Return - Drawings - Free samples distribution - Goods distributed as gift - Goods lost in fire or theft - Input tax credit not allowed to be availed by recipient	Reversed when the goods are returned by the purchaser.
Utilization of Input tax credit	Input GST A/c is credited when tax is paid by utilizing input tax.	

Journal entries

The Double entry book-keeping records need to show the GST values separately so that the purchases, expenses and sales are posted without the addition of GST.

Sale of Goods or Services

Account Receivable/Debtors A/c	Dr	Gross Amount(Include GST)
To sales A/c		Net Amount
To Output GST		Amount of GST

Purchase of Goods or Services

Purchases A/c	Dr	Net Amount
Input GST A/c	Dr	Amount of GST
To Account payable/Creditors		Gross Amount

Utilization of Input Tax Credit towards payment of Output Tax

Output CGST A/c	Dr	Amount of GST liability
Output SGST A/c	Dr	Amount of GST liability
Output IGST A/c	Dr	Amount of GST liability
To Input CGST A/c		Amount of output GST liability paid utilizing input CGST
To Input SGST A/c		Amount of output GST liability paid utilizing input SGST
To Input IGST A/c		Amount of output GST liability paid utilizing Input IGST

Questions:

Show the effect of the following transactions using the Traditional approach as well as the Modern Approach.

- Mr. A Introduced capital of Rs.25.00 lac to start his business.
- Purchased Machinery worth Rs.10.00 Lac by paying the Rs.5.00 Lac in cash and balance in credit from XYZ &Co.
- Purchased goods on credit from Mr. C worth Rs. 50 Thousand and in cash for Rs.1.50 Lacs
- Sold goods for Rs. 2.00 Lac to Mr.D and received amount of Rs.1.00 lac from him after 20 days.
- Mr. A asked deposited amount of Rs.2.00/- Lac from his savings in Bank.

Illustration 1

Develop the accounting equation from following information available at the beginning of accounting period:

Particulars	Amount (Rs.)
Capital	51,000,000
Loan	11,500,000
Trade payables	5,700,000
Fixed Assets	12,800,000
Inventory	22,600,000
Trade receivables	17,500,000
Cash and Bank	15,300,000

At the end of the accounting period the balances appear as follows:

Particulars	Amount (Rs.)
Capital	?
Loan	11,500,000
Trade payables	5,800,000
Fixed Assets	12,720,000

Inventory	22,900,000
Trade receivables	17,500,000
Cash and Bank	15,600,000

- Reset the equation and find out profit.
- Prepare Balance Sheet at the end of the accounting period.

Illustration 2

Mr. Dravid has provided following details related to his financials. Find out the missing figures-

Particulars	Amount (Rs.)
Profits carved during the year	5,000,000
Assets at the beginning of year	A
Liabilities at the beginning of year	12,000,000
Assets at the end of the year	B
Liabilities at the end of the year	C
Closing capital	35,000,000
Total liabilities including capital at the end of the year	50,000,000

Illustration 3

From the following information, state the nature of account and state which account will be Debited and which will be Credited.

- Started business with a capital of Rs. 50,00,00
- Wages and salaries paid Rs. 50,000
- Rent received Rs. 2,00,000
- Purchased goods on credit Rs. 9,00,000
- Sold goods for Rs. 8,16,000 and received payment in cheque.

Illustration 4

Pass journal entries for the following:

Mohan Brought in Capital of Rs. 50,00,000
Out of the above, Rs. 25,000 is withdrawn from the bank.
Furniture is purchased for Rs. 12,00,000.
Purchased goods for cash Rs. 4,00,000.
Purchased goods for Rs. 10,00,000 on credit from M/s Ram Narain Bros.
Sold goods to Ramesh on credit for Rs. 13,00,000.
Received cheque from Ramesh Rs. 13,00,000.

Illustration 5

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.

Following figures are given in ('000)
Ajith started business with capital Rs. 4,00,000
He withdrew cash for business from the Bank Rs. 2,000
He purchased goods making payment through bank Rs. 15,000
He sold goods Rs. 16,000 and received payment through bank.

He purchased furniture and paid by cheque Rs. 2,500

Illustration 6

Journalise the following transactions in the books of Mr. Rohit:

- (i) Purchased goods from Sahil for ` 50,000 plus CGST and SGST @ 9% each.
- (ii) Purchased goods from Sam for ` 40,000 at a trade discount of 10% plus CGST and SGST @ 9% each. ` 20,000 was paid immediately and balance payable after 3 months.
- (iii) Goods costing ` 20,000 withdrawn for personal use. Such goods were purchased by paying CGST and SGST @ 9% each.
- (iv) Paid rent to Gagandeep for ` 30,000 plus CGST and SGST @ 6% each.
- (v) Goods costing ` 5,000 (before trade discount of 10%) returned to Sam. Such goods were purchased by paying CGST and SGST @ 9% each.
- (vi) Purchased furniture for ` 44,800 including IGST @ 12%.
- (vii) Purchased machinery from M/s Symphony industries for ` 1,40,000 plus CGST and SGST @ 9% each. Paid ` 1,00,000 immediately and balance to be paid after two months.

Illustration 7

Journalise the following transactions in the books of Ms. Nidhi traders July, 2022

- 3 Sold Goods for ` 50,000, charged CGST and SGST @ 6% each.
- 4 Sold goods to Surjeet for ` 28,000 including CGST and SGST @ 6% each.
- 5 Received ` 25,200 from Surjeet in full settlement of his account of ` 28,000.
- 6 Sold goods to Kapil for ` 30,000 charged IGST @ 12%. Received ` 12,000 immediately and balance to be received after one month.
- 10 Kapil was allowed rebate of ` 5,000 as goods supplied to him were defective. These goods were sold by charging IGST @ 12%.
- 12 Sold goods to Manpreet for ` 1,00,000 at trade discount of 20% and charged IGST @ 12%
- 13 Goods of list price ` 20,000 returned by Manpreet.
- 17 Received commission of ` 15,000, charged CGST and SGST @ 6% each.

Illustration 8

Record the following transactions in a Journal, assuming CGST and SGST@ 6% each.

- (i) Sold goods to Mukesh at the list price of ` 50,000 less 20% trade discount.
- (ii) Sold goods to Mukesh at the list price of ` 1,00,000 less 20% trade discount and 5% cash discount.
- (iii) Sold goods to Mukesh at the list price of ` 1,50,000 less 20% trade discount. Out of the amount due 60% is received out of which three-fourth is received by cheque.

Chapter 5 - Subsidiary Books

What is Subsidiary Book?

All the transactions incurred by business on a daily basis can be classified into few major activities which are Receipt and Payment of Cash, Sale of Goods and Purchase of Goods.

To facilitate ease of work a separate register is maintained which records all the transactions for each such class of transactions. For the entries mentioned in such registers there wouldn't be any Journal Entries. The balances from these registers in respect of the particular items will be directly posted in the Ledger.

This separate registers where the entries are first made are known as "**SUBSIDIARY BOOKS**".

The following Subsidiary Books are commonly prepared and maintained by the businesses:

1. **Cash Book:**
Records all transactions related to receipts and payments.
2. **Purchase Book**
Records credit purchase of goods which are required by the entity in its daily operations.
3. **Purchase Return Book**
Records the return of the goods purchased on credit.
4. **Sales Book**
Records Credit sales of goods made by the entity.
5. **Sales Return Book**
Records sales return made by the customers.
6. **Bills Receivable & Bills Payable**
If the entity deals in promissory notes they record it in a separate subsidiary book for all the Bill Receivable and Bills Payable.
7. **Journal Book**
This is the book where if any transaction cannot be recorded in the above 7 books they are recorded in this book.

Advantages of Subsidiary Book:

The following are the advantages of the Subsidiary Books:

1. **Division of Work:**
Every Subsidiary book deals in a specific area of business. Therefore, it is possible to allocate resources on a specific of work based on the volume
2. **Specialization of Work:**
Since the work is divided into different areas of business, it can be specialized by allocating and training resources on a particular domain.

3. Time Saving:

Since the need to maintain the Journal is eliminated for the transactions entered into the subsidiary books and there are various accountants involved for different work areas, it leads to Time Savings.

4. Information Availability:

Since all the common areas of work are identified and maintained in separate books it is easy to access information about a specific area of work without going through all the different records.

5. Easiness in Locating errors:

If the Trial Balance does not agree, it is easy to identify the area where there might be an issue due to the maintenance of various subsidiary books.

Difference between Principal Books and Subsidiary Books:

The book in which transactions are recorded first for further processing is called Subsidiary Books. The details entered into subsidiary books are transferred to the Ledgers and from the Ledgers to the trial balance and ultimately to the Financial Statements.

The Ledger and the Cash Book are called the Principal Books. This is because they facilitate the information needed to prepare the trial balance and financial statements.

Example on Subsidiary Book (Purchase Books):

Prepare the Purchase Book from the following transactions and post their balances in Ledger.

Date	Transaction
01-08-18	Purchased from ABC & Co. 10,000 units @ Rs.10 each
	Received Trade Discount of 5% on the above purchases
	Paid Freight Charges for Rs.7000/- on the above purchases
10-08-18	Purchased from XYZ & Co. 5,000 units @ Rs.15 each
	Received Trade Discount of 10% on the above purchases
	Paid Freight Charges for Rs.1000/- on the above purchases

The purchase book for the above transactions is as follow:

PURCHASE BOOK						
DATE	PARTICULARS	GROSS AMOUNT	TRADE DISCOUNT	NET PRICE	FREIGHT	TOTAL
01-08-18	ABC & Co.					
	10,000 units @ Rs.10 each, Trade Discount 5%	100,000	5,000	95,000	7,000	102,000
10-08-18	XYZ & Co.					
	5,000 units @ Rs.15 each, Trade Discount 10%	75,000	7,500	67,500	1,000	68,500
	TOTAL	175,000	12,500	162,500	8,000	170,500

The ledger posting for the above transactions recorded in the Purchase Book is as Follow:

PURCHASE ACCOUNT							
DR.				CR.			
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18	To Amt. as per Purchase Book		162,500				

FREIGHT ACCOUNT							
DR.				CR.			
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18	To Amt. as per Purchase Book		8,000				

ABC & Co.							
DR.				CR.			
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18				31-08-18	By Purchase A/c		95,000
				31-08-18	By Freight A/c		7,000

XYZ & Co.							
DR.				CR.			
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
31-08-18				31-08-18	By Purchase A/c		67,500
				31-08-18	By Freight A/c		1,000

Questions:

1. Prepare the Sales Subsidiary Books for the following transactions and prepare the Ledger posting for the same.

Date	Transaction
01-08-18	Sold 20,000 units @ Rs.25 each to ABC & Co. Provided Trade Discount of 2% on the above sales
10-08-18	Sold 15,000 units @ Rs.15 each for cash to XYZ & Co. Provided CASH Discount of 3% on the above sales
10-08-18	Sold old Computer for Rs.50,000 for Cash

Hint:

1. The sale of Computer is a sale of Fixed Asset and not normal sale made in the course of business.
2. The Cash Sales will be recorded in Cash Book. Only credit sales are recorded in Sales Book.

Chapter 6 - Cash Books

What is CASH Book?

As discussed in the Subsidiary Books, Under Cash Book all the transactions wherein cash has been received or paid are recorded.

Cash Book plays a dual role as a Principal as well as a Subsidiary Book also.

This is because all the transactions related to payment and deposit of cash is recorded in the cash book directly. Therefore, it is treated as Subsidiary Book. But cash book also serves as a basis for preparing the trial balance thereby serving as a Ledger also. Hence, it is a principal book.

Different Kinds of Cash Book.

There are mainly 3 kinds of Cash Book.

- i. Simple Cash Book
- ii. Two Column Cash Book
- iii. Three Column Cash Book

Some organizations also maintain another form of cash book known as Petty Cash Book.

1. Simple Cash Book:

This is like a simple Cash Ledger Account. Wherein the deposits are recorded on the debit side and the payments are recorded on the credit side.

Important points to be noted in this regard are:

- i. Only Cash receipts and payments are recorded.
- ii. The cash receipts total is always greater than cash payments total. Since payments cannot be greater than the amount of cash available.
- iii. Simple cash book is the ordinary cash ledger account.

Example on Simple Cash Book:

Record the following transactions in the simple cash book:

Date	Transaction	Amount Rs.
01-08-18	Cash in Hand	50,000
05-08-18	Received from Mr. A	5,000
07-08-18	Paid for Salaries of July 2018	30,000
08-08-18	Paid for Rent for August 18	5,000
09-08-18	Received amount due from Mr. B	25,000
15-08-18	Received amount due from Mr. D	45,000
20-08-18	Purchased Office Equipments	20,000
29-08-18	Purchased Stationery	15,000

DR.		CASH BOOK				CR.	
DATE	Receipts	L.F.	AMOUNT (Rs.)	DATE	Payments	L.F.	AMOUNT (Rs.)
01-08-18	To Balance b/d		50,000	07-08-18	By Salaries		30,000
05-08-18	To Mr. A		5,000	08-08-18	By Rent		5,000
09-08-18	To Mr. B		25,000	20-08-18	By Office Equipments		20,000
15-08-18	To Mr. D		45,000	29-08-18	By Stationery		15,000
				31-08-18	By Balance c/d		55,000
	TOTAL		125,000		TOTAL		125,000

2. Double Column Cash Book:

When an additional column is added to the simple cash book which shows either discount allowed or discount received. Alternatively, the new column can also show payments made through the Bank and deposits received in the bank. It is known as a Double Column Cash Book.

Important points to be noted in this regard are:

- The discount columns if prepared are not balanced. They are just totaled to reflect the total discount received and total discount given.
- If the bank Column is prepared then the cash and bank column are recorded in the same manner as the simple cash book. The balancing figure of the bank balance will be the Balance in the Bank.

Example on double Column Cash Book:

Record the following transactions in the Double Column cash book preparing the discount column:

Date	Transaction	Amount Rs.
01-08-18	Cash in Hand	50,000
05-08-18	Cash Sales made to Mr. A	100,000
05-08-18	Cash Discount allowed	5,000
07-08-18	Paid for Salaries of July 2018	30,000
08-08-18	Paid for Rent for August 18	5,000
09-08-18	Received amount due from Mr. B	25,000
09-08-18	Cash Discount allowed	1,000
15-08-18	Amount paid to Mr. D	40,000
15-08-18	Cash Discount Received	2,000
20-08-18	Purchased Office Equipments	20,000
29-08-18	Purchased Stationery	15,000

DR.					CASH BOOK					CR.				
DATE	Receipts	L.F.	Discount	AMOUNT (Rs.)	DATE	Payments	L.F.	Discount	AMOUNT (Rs.)					
01-08-18	To Balance b/d			50,000	07-08-18	By Salaries			30,000					
05-08-18	To Mr. A		5000	100,000	08-08-18	By Rent			5,000					
09-08-18	To Mr. B		1000	25,000	15-08-18	By Mr. D		2000	40,000					
					20-08-18	By Office Equipments			20,000					
					29-08-18	By Stationery			15,000					
					31-08-18	By Balance c/d			65,000					
	TOTAL		6000	175,000		TOTAL		2000	175,000					
01-09-18	To Balance b/d			65,000										

3. Three Column Cash Book:

Most of the organizations keep most of their balances in the Bank and the money can be deposited and withdrawn at any point of time as per their requirements.

The only difference between cash in hand and money in bank is the location of the cash amount. But it is important to track the moment in both of them. That purpose is served by the three column cash book.

Another column is added to the Cash and discount column which is the Bank Column. All the deposits and payment made in Bank are entered in the Bank Column.

The most important factor to be noted in the three column cash book is the method of recording contra entries.

For instance when cash is deposited in the bank the Receipt Column on the bank side is debited and the cash column on the credit side is credited. This shows the increase in the bank balance and decrease in the cash balance due to depositing cash in Bank.

Example on Three Column Cash Book:

Record the following transactions in the Three Column cash book:

Date	Transaction	Amount Rs.
01-08-18	Cash deposited in bank for commencing business	50,000
04-08-18	Cash deposited in current account	10,000
05-08-18	Cash Collected from Mr. A	40,000
05-08-18	Cash Discount allowed	2,000
10-08-18	Amount paid to Mr. D	50,000
10-08-18	Cash Discount Received	3,000
25-08-18	Amount withdrawn from Bank	10,000

DR.		CASH BOOK										CR.	
DATE	Receipts	L.F.	Discount	Cash	Bank	DATE	Payments	L.F.	Discount	Cash	Bank		
01-08-18	To Capital A/c				50,000								
04-08-18	To Cash A/c	C			10,000	04-08-18	By Bank A/c	C		10000			
05-08-18	To Mr. A A/c		2000		40,000	10-08-18	By Mr. D A/c		3000		50,000		
25-08-18	To Bank	C		10000		25-08-18	By Cash A/c				10,000		
						31-08-18	By Balance c/d				40,000		
	TOTAL		2000	10000	100,000		TOTAL		3000	10000	100000		
01-09-18	To Balance b/d				40,000						-		

IMPEREST SYSTEM OF PETTY CASH BOOK:

Sometimes business have to make a lot of petty payments in cash as a part of their operational and miscellaneous expenses.

It would be highly inconvenient for the main cashier to deal in such transactions on a daily basis. For the sake of convenience companies install the Petty Cash System.

Under the system of petty cash, a small imprest amount of cash is always maintained in the petty cash balance. The petty cashier pays all the petty expenses during the given period and at the beginning of the next period may be a week or month the petty cashier is provided the deficit to bring the petty cash balance to the originally decided amount.

For instance, if the company decides to maintain a petty cash balance of 10,000 on a weekly basis. And the petty cashier incurs an expense of Rs. 5,000 during the given week. Then at the beginning of the next week he will be reimbursed Rs.5,000 of the expenses incurred by him to bring the petty cash balance to the decided amount of Rs.10,000.

Example on Petty Cash Book:

Record the following transactions in the Petty cash book:

Record the following transactions in the Petty cash book:

Date	Transaction	Amount Rs.
01-08-18	Received Rs.1000 for Petty Cash	1,000
04-08-18	Paid to office boy for travel reimbursement	100
05-08-18	Paid for Postage & telegram	150
07-08-18	Paid for Stationery	50

PETY CASH BOOK

Receipts	Date	V.No.	Particulars	Total	Travel	Postage	Stationery
1,000	01-08-18		To Cash				
	04-08-18		By Travel	100	100		
	05-08-18		By Postage	150		150	
	07-08-18		By Stationery	50			50
				300	100	150	50
			By Balance c/d	700			
1,000			TOTAL	1,300	200	300	100
700			To Balance b/d				
300	08-08-18		To CASH				

Chapter 3 - Ledgers

What is a Ledger?

Once all the transactions are recorded through Journal Entries, they need to be classified and grouped by preparing the accounts. The book in which all the accounts are prepared is known as "LEDGER".

Format of LEDGER:

DR.		ACCOUNT				CR.	
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)

The process of transferring the Journal Entries in the Ledger is known as "POSTING".

Important rules to be noted while posting:

1. All the Accounts which have been entered in the Journal should have Ledger Account.
2. Whenever any account is mentioned in the Debit side of the Ledger it is supposed to use the word "TO" before the name of the account
3. Whenever any account is mentioned in the Credit side of the Ledger it is supposed to use the word "BY" before the name of the account
4. At a fixed interval of time the accounts needs to be balanced. Wherein the accounts are totaled and the balance on either side is carried forward to the next period for assets and liabilities. (Refer example to understand the concept of Balancing a Ledger). The balance in income and expenses ledgers are transferred to final accounts.

Example on Ledger:

Prepare the Purchase Account for the following transactions:

1. 10/08/2018 - Purchased goods of Rs.5.00 lac on credit from Mr. A.
2. 12/08/2018 - Purchased goods of Rs.1.00 lac in cash.
3. 15/08/2018 - Returned goods of Rs.1.00 lac Purchased from Mr. A

DR.				PURCHASE ACCOUNT				CR.			
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)				
10-08-18	To Mr.A A/c		500,000	15-08-18	By Mr.A A/c		100,000				
12-08-18	To Cash A/c		100,000								
				31-08-18	By Balance c/d		500,000				
	TOTAL		600,000		TOTAL		600,000				
01-09-18	To Balance c/d		500,000								

Note:

1. Whenever the Purchase account was debited in the Journal the corresponding credit account is mentioned on the debit side of the journal with the word "TO" before it.
2. Whenever the Purchase account was credited in the Journal the corresponding credit account is mentioned on the debit side of the journal with the word "BY" before it.
3. At the end of the month the total of both the sides is done. The deficit amount on the lower side is mentioned as Balance c/d which is known as Balancing of the Account.

Questions:

1. Prepare the Ledgers for the various transactions entered into by the company as follow:
 - i.Mr. A Introduced capital of Rs.25.00 lac to start his business.
 - ii.Purchased Machinery worth Rs.10.00 Lac by paying the Rs.5.00 Lac in cash and balance in credit from XYZ &Co.
 - iii.Purchased goods on credit from Mr. C worth Rs. 50 Thousand and in cash for Rs.1.50 Lacs
 - iv.Sold goods for Rs. 2.00 Lac to Mr.D and received amount of Rs.1.00 lac from him after 20 days.
 - v.Mr. A asked deposited amount of Rs.2.00/- Lac from his savings in Bank.

(Hint - Use the Journal entries created while solving the exercise for chapter 2.1)

Chapter - 8 Trial Balance

What is a Trial Balance?

After the entire ledger accounts for the various transactions which were recorded via Journal Entries is completed. The Next step is the creation of the Trial balance.

Trial Balance contains the debit and credit balance of the various ledgers. It is important to note that the total of debit column and credit column needs to be equal for the trial balance to be complete.

Objectives of Preparing a Trial Balance:

The Objectives of preparing a Trial Balance are as mentioned below:

- i. Trial balance helps to establish arithmetical accuracy of the books of Accounts.
- ii. Financial statements are normally prepared on the basis of agreed trial balance otherwise the work may be cumbersome. So it can be stated that the preparation of trial balance eases the preparation of Financial Statements.
- iii. The trial balance serves as a summary of all the ledger balances.

LIMITATIONS OF TRIAL BALANCE:

The agreement of Trial Balance is not a final evidence of the accuracy of the trial balance. The Arithmetical accuracy shows the fact that all the debit balance equals the credit balances. However, there are certain possibilities whereby even though the trial balance is agreed upon it is still inaccurate.

It is possible that the following types of errors still exist and the trial balance is agreed upon.

- i. Transaction has not been entered at all in the journal. Hence, is not entered in Ledger and not accounted for in Trial balance.
- ii. A journal recorded with wrong Amount.
- iii. A journal recorded with wrong Accounts.
- iv. Omitting to record a Journal entry in the Ledger.
- v. Posting the same journal entry twice in the ledger.

It is to be noted that the preparation of trial balance still cannot be omitted due to the above mentioned limitations.

Format of TRIAL BALANCE:

Trial Balance as at _____				
Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount

Adjusted Trial Balance:

Sometimes it may happen that the trial balance does not agree even after entering all the amounts correctly from the Ledgers. In such situations the entities use suspense account to balance the trial balance. Wherein they transfer the difference in the suspense account and agree the trial balance. This kind of trial balance which has suspense account in it is known as Agreed Trial Balance.

Methods of preparing Trial Balance:

There are 3 different methods of preparing Trial Balance. The only difference in these 3 methods is the manner of presenting the ledger balances.

1. TOTAL METHOD:

Under this method, every ledger account is totaled and that total amount of debit side and credit side is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger accounts are totaled. There is no need to balance the ledger Accounts.

2. BALANCE METHOD:

Under this method, only the ledger balances of the various ledger accounts are transferred to trial balance. This is the most commonly used method of creating trial balance. Also, it is to be noted that the Financial Statements are prepared on the basis of the Ledger Account Balances.

3. TOTAL AND BALANCE METHOD:

This is a combination of the above mentioned 2 methods. Under this method the trial balance shows the total columns as well as the balance columns.

Example on Trial Balance:

The Balances of the various ledgers and the total of the ledger columns are as presented below: Prepare the Trial Balance for the following Ledger Accounts as per the 3 different methods.

Sr.No.	Account Name	Balance Amount (Rs.)	Total Amount (Rs.)
1	Cash A/c	10,000	50,000
2	Furniture A/c	25,000	25,000
3	Salaries A/c	20,000	60,000
4	Mr.A Capital A/c	100,000	370,000
5	Debtors A/c	50,000	150,000
6	Creditors A/c	80,000	100,000
7	Bank A/c	40,000	120,000
8	Sales A/c	130,000	145,000
9	Purchases A/c	155,000	200,000
10	Trade Discounts Given A/c	10,000	10,000

Note:

1. The Total Amount represents the total of the Ledger Accounts.
2. The Balance Amount represents the amounts remaining after the balancing of the respective ledgers which are carried forward.

TRIAL BALANCE AS PER TOTAL METHOD:

Table image

Note: Here we have considered only the amount from the total column.

TOTAL METHOD

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount
1	Cash A/c		50000	
2	Furniture A/c		25000	
3	Salaries A/c		60000	
4	Mr.A Capital A/c			370000
5	Debtors A/c		150000	
6	Creditors A/c			100000
7	Bank A/c		120000	
8	Sales A/c			145000
9	Purchases A/c		200000	
10	Trade Discounts Given A/c		10000	
	TOTAL		615000	615000

TRIAL BALANCE AS PER BALANCE METHOD:**BALANCE METHOD**

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Amount	Credit Amount
1	Cash A/c		10000	
2	Furniture A/c		25000	
3	Salaries A/c		20000	
4	Mr.A Capital A/c			100000
5	Debtors A/c		50000	
6	Creditors A/c			80000
7	Bank A/c		40000	
8	Sales A/c			130000
9	Purchases A/c		155000	
10	Trade Discounts Given A/c		10000	
	TOTAL		310000	310000

Note: Here we have considered only the amount from the BALANCE column.

TRIAL BALANCE AS PER TOTAL & BALANCE METHOD:**TOTAL & BALANCE METHOD**

Trial Balance as at _____

Sr.No.	Ledger Account	L.F.	Debit Total	Credit Total	Debit Balance	Credit Balance
1	Cash A/c		50000		10000	
2	Furniture A/c		25000		25000	
3	Salaries A/c		60000		20000	
4	Mr.A Capital A/c			370000		100000
5	Debtors A/c		150000		50000	
6	Creditors A/c			100000		80000
7	Bank A/c		120000		40000	
8	Sales A/c			145000		130000
9	Purchases A/c		200000		155000	
10	Trade Discounts Given A/c		10000		10000	
	TOTAL		615000	615000	310000	310000

Chapter 9 - Concept and Accounting of Depreciation

What is Depreciation?

Concept of Depreciation

Fixed Assets includes Property, plant and equipment that are tangible and which are used in the production or supply of goods or services or for administrative purposes and are expected to be used during more than a period of one accounting year i.e. more than twelve months.

Value of such assets decreases with passage of time due to following reasons.

- i. Wear and tear due to its use in business.
- ii. Passage of time even when it is not being used.
- iii. Obsolescence and outdating due to technological or other changes.
- iv. Decrease in market value.
- v. Depletion of the assets especially in case of mines and other natural reserves.

To arrive at the correct income for the current accounting period it is important to account for value of portion of property, plant and equipment utilized for generating revenue during that period. The portion of Property, Plant & Equipment allocated to an accounting year is called depreciation.

As per Schedule II under the Companies Act, 2013, Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

The 3 important factors affecting the amount of depreciation are:

- i. Estimated useful life of the asset
- ii. Cost of the asset
- iii. Residual value of the asset at the end of the of its estimated useful life

Objectives of Providing Depreciation:

The basic objectives for providing depreciation are as follow:

- i. Correct income measurement.
- ii. To find True Asset value.
- iii. To Ensure Sufficient Funds are available for replacement.
- iv. To determine the true cost of production.

Factors affecting Measurement of Depreciation:

Following factors are taken into consideration while computing the depreciation.

- i. Cost of the asset
- ii. Estimated useful life of the asset.
- iii. Estimated scrap value at the end of useful life of the asset.

Example on computing the depreciable amount per annum:

For example, a machinery is purchased for Rs.5,00,000. The residual value is estimated at Rs.50,000. It is estimated that the machinery will work for 10 years. The cost to be allocated as depreciation in the accounting periods will be calculated as:

Acquisition	Cost
	Rs.5000
00 Less: Residual Value (Rs.50000)	
Depreciable Amount	Rs. 450000
(÷)Estimated Useful Life	5 years

Depreciation =	Depreciable Amount	Rs450000	= Rs.90000/- Per
	Estimated Useful Life	5 Years	Year

Cost of the Fixed Asset (i.e. Property, Plant and Equipment) comprises of the following:

- i. The purchase price including import duties and taxes and deducting the trade discounts and rebates.
- ii. Any cost incurred to bring the asset to its present condition to put it to its intended usage
- iii. The costs of preparing the site on which an asset is to be located.

Examples of costs directly attributable costs are:

- i. Cost of labor for bringing the asset to its present condition.
- ii. Cost to prepare the site.
- iii. Delivery and Handling costs
- iv. Installation costs
- v. Cost of testing
- vi. Professional fees e.g. engineers & technicians hired to install the equipment

Thus, all the expenses which are necessary for asset to bring it in condition and location of desired used will become part of cost of the asset.

Methods of Computing Depreciation:

There are several methods of computing depreciation, in this chapter we are going to focus on 3 methods which are as follow:

- i. Straight-Line Method
- ii. Diminishing Balance Method
- iii. Sum of Years of Digits Method
- iv. Annuity Method
- v. Sinking Fund Method
- vi. Machine Hour Method
- vii. Units of Production Method
- viii. Depletion Method

1. Straight-Line Method:

This method is also known as Fixed Installment Method. According to this method, an equal amount of depreciation is written off every year so as to reduce the cost of the asset to nil or its salvage value at the end of its useful life.

The advantage of this method is that it is the easiest methods to apply and gives accurate results in case of leases and also in case of plant and machinery are assumed to have a constant usage across years.

The formula to compute the depreciation and the rate of depreciation under straight line method is as follow:

$$\text{Straight Line Depreciation} = \frac{\text{Cost of Asset} - \text{Salvage Value}}{\text{Useful Life of the Asset}}$$

$$\text{Straight Line Depreciation Rate} = \frac{\text{Straight Line Depreciation}}{\text{Cost of the Asset}} \times 100$$

2. Diminishing Balance Method:

This method is also known as Reducing Balance Method. According to this method, a Fixed Percentage of depreciation is computed on the Asset Value every year so as to reduce the asset value to Nil or it's Salvage Value at the end of its useful life.

Under this method, the depreciation amount decreases from year to year due to which the earlier years suffer incur a higher depreciation expense as compared to the later years.

Under this method, the value of asset can never be completely extinguished, which happens in the earlier explained Straight Line Method. This method assumes that the cost of repairs will increase with the passage of time. Therefore, depreciation is higher in earlier years and lower in the later years when the cost of the asset is

expected to be lower in the later years.

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The formula to compute the depreciation under the diminishing balance method is as follow:

$$\text{Diminishing Balance Depreciation} = 1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of Asset}}} \times 100$$

Here, n = useful life of the asset

Accounting Entries under Straight Line and Diminishing Balance Method:

There are two approaches to account for depreciation. The entity can either opt to have a provision for depreciation account and credit the annual depreciation in that provision account, thereby the asset account remains at the same historical cost or else it can directly credit the depreciation amount to the asset account and reduce the asset balance on an annual basis.

Accounting Entries under the Provision Method:	
For Charging Depreciation	Depreciation Account Dr. To Provision for Depreciation Account
Transferring Depreciation to Profit & Loss Account	Profit & Loss Account Dr. To Depreciation Account
Accounting Entries under the Direct Method:	
For Charging Depreciation	Depreciation Account Dr. To Asset Account
Transferring Depreciation to Profit & Loss Account	Profit & Loss Account Dr. To Depreciation Account

Example:

ABC Co. acquired a equipment on 1st July, 2016 at a cost of Rs.9,00,000 and spent Rs.1,00,000 on its installation. The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2016 & 2017 using:

- Straight Line Method @ 10% Depreciation per annum
- Diminishing Balance Method @ 15% Depreciation per annum

i. Machinery and Depreciation Account under Straight Line Method:

Dr.			Machinery Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2016			2016			
Jul-01	To Bank A/c	900,000	Dec-31	By Depreciation A/C	50,000	
	To Bank A/c (Installation)	100,000		10% on 10,00,000 for 6 months		
			Dec-31	By Balance c/d	950,000	
	TOTAL	1,000,000		TOTAL	1,000,000	
2017			2017			
Jan-01	To Balance b/d	950,000	Dec-31	By Depreciation A/C	100,000	
				10% on 10,00,000 for 12 months		
			Dec-31	By Balance c/d	850,000	
	TOTAL	950,000		TOTAL	950,000	

Dr.			Depreciation Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2016			2016			
Dec-31	To Machinery A/c	50,000	Dec-31	By Profit & Loss A/C	50,000	
	TOTAL	50,000		TOTAL	50,000	
2017			2017			
Dec-31	To Machinery A/c	100,000	Dec-31	By Profit & Loss A/C	100,000	
	TOTAL	100,000		TOTAL	100,000	

i. **Machinery and Depreciation Account under Diminishing Balance Method:**

Dr.			Machinery Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2016			2016			
Jul-01	To Bank A/c	900,000	Dec-31	By Depreciation A/C	75,000	
	To Bank A/c (Installation)	100,000		15% on 10,00,000 for 6 months		
			Dec-31	By Balance c/d	925,000	
	TOTAL	1,000,000		TOTAL	1,000,000	
2017			2017			
Jan-01	To Balance b/d	925,000	Dec-31	By Depreciation A/C	142,500	
				15% on 9,50,000 for 12 months		
			Dec-31	By Balance c/d	782,500	
	TOTAL	925,000		TOTAL	925,000	

Dr.			Depreciation Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2016			2016			
Dec-31	To Machinery A/c	75,000	Dec-31	By Profit & Loss A/C	75,000	
	TOTAL	75,000		TOTAL	75,000	
2017			2017			
Dec-31	To Machinery A/c	142,500	Dec-31	By Profit & Loss A/C	142,500	
	TOTAL	142,500		TOTAL	142,500	

3. Sum of Years Digit Method:

This method is also known as Reducing Balance Method. According to this method, the depreciation formula is derived based on the number of years of the asset.

The formula to compute the depreciation under the sum of year's method is as follow:

$$\frac{\text{The number of years of remaining life of the asset}}{\text{Total of all digits of the life of the asset}}$$

Example:

ABC Co. acquired a equipment on 1st January, 2010 at a cost of Rs.20,00,000 which had a life of 10 years and scrap value of Rs2,40,000/- . The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2015 using Sum of Digits method of depreciation:

Dr.		Machinery Account				Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2015			2016			
Jan-01	To Balance b/d	720,000	Dec-31	By Depreciation A/C	160,000	
	(As per the working note)					
			Dec-31	By Balance c/d	560,000	
	TOTAL	720,000		TOTAL	720,000	
2016						
Jan-01	To Balance b/d	560,000				

Working Notes for the above computation:

1. Computation of Depreciation for 2010-2014:

$$\frac{(10+9+8+7+6)}{10(10+1)/2} \times (2000000 - 240000) = 40/55 \times 1760000 = 1280000$$

2. Computation of WDV as on 1-1-2015:

$$2000000 - 1280000 = \text{Rs.}720000/-$$

3. Depreciation for 2015:

$$(2000000 - 240000) \times 5/55 = \text{Rs.}160000/-$$

4. Annuity Method:

Under this method of depreciation, the interest which is lost on capital invested on the asset and is written off. It is based on the assumption that the amount invested in acquiring the asset, if would have been invested elsewhere, would have earned interest which must be recorded as part of the cost of asset.

This method is suitable for writing off the amounts paid for long leases which involve a considerable capital outlay. It is not practicable to adopt this method for writing off depreciation of plant and machinery on account of frequent changes in the value of such assets which would necessitate the recalculation of the amount of depreciation to be written off annually.

The relevant Journal Entries involved in this method are as follow:

Accounting Entries under the Annuity Method:	
For charging interest on asset account	Asset Account Dr. To Interest Account
For charging depreciation on asset	Depreciation Account Dr. To Depreciation\Provision for depreciation Account
For transferring depreciation to Profit and Loss Account	Profit & Loss Account Dr. To Depreciation Account
For transferring interest to Profit and Loss Account	Interest Account Dr. To Profit & Loss Account

Example:

ABC Co. acquired a lease is purchased on 1st April, 2013 for 4 years at a cost of Rs. 4,00,000. It is proposed to depreciate the lease by the annuity method charging 5 percent interest. A reference to the annuity table shows that to depreciate Rs.1 by annuity method over 4 years charging 5% interest, one must write off a sum of Rs.0.282012 [To write off Rs.2,00,000 one has to write off every year Rs. 112,804.80 i.e. $0.282012 \times 4,00,000$].

Prepare the Lease Account for four years and also the relevant entries in the profit and loss account.

Lease Account					
Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
2013-2014					
Apr-01	To Bank A/c	400,000	Mar-31	By Depreciation A/C	112,804
Mar-31	To Interest A/c	20,000	Mar-31	By Balance b/d	307,196
	(5% on Rs.400000)				
	TOTAL	420,000		TOTAL	420,000
2014-2015					
Apr-01	To Balance b/d	307,196	Mar-31	By Depreciation A/C	112,804
Mar-31	To Interest A/c	15,360	Mar-31	By Balance b/d	209,752
	(5% on Rs.307196)				
	TOTAL	322,556		TOTAL	322,556
2015-2016					
Apr-01	To Balance b/d	209,752	Mar-31	By Depreciation A/C	112,804
Mar-31	To Interest A/c	10,488	Mar-31	By Balance b/d	107,435
	(5% on Rs.209752)				
	TOTAL	220,239		TOTAL	220,239
2016-2017					
Apr-01	To Balance b/d	107,435	Mar-31	By Depreciation A/C	112,804
Mar-31	To Interest A/c	5,369			
	TOTAL	112,804		TOTAL	112,804

Dr.		Profit & Loss Account				Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2013-2014			2013-2014			
Mar-31	To Depreciation A/c	112,804	Mar-31	By Interest A/C	20,000	
2014-2015			2014-2015			
Mar-31	To Depreciation A/c	112,804	Mar-31	By Interest A/C	15,360	
2015-2016						
Mar-31	To Depreciation A/c	112,804	Mar-31	By Interest A/C	10,488	
2016-2017						
Mar-31	To Depreciation A/c	112,804	Mar-31	By Interest A/C	5,369	

5. Sinking Fund Method:

When a large sum of money is required for replacement of the fixed asset at the end of its effective life, organizations invest the amount equal to depreciation and the amount earned on that investment is re-invested. The account in which the amount is kept aside is referred to as Sinking Fund Account.

When the asset is due for replacement, the securities are sold and the new asset is purchased with the proceeds of their sale. The book value of the old asset, at the time, is transferred to the Sinking Fund Account. Any amount realized on sale of the old asset, as well as the profit or loss on sale of securities is transferred to the Sinking Fund Account and it is closed off by transfer of the balance of the Profit and Loss Account or General Reserve.

Accounting Entries under the Sinking Fund Method in First Year	
For transfer of depreciation to Sinking Fund	Depreciation Account Dr. To Sinking Fund Account
For charging depreciation to profit and loss account	Profit & Loss Account Dr. To Depreciation Account
For investment of amount of depreciation	Sinking Fund Investment Account Dr. To Bank Account
For interest earned on sinking fund investment	Bank Account Dr. To Interest on Sinking Fund Investment Account Interest on Sinking Fund Investment Account Dr. To Sinking Fund Account
Accounting Entries under the Sinking Fund Method in Subsequent Year	
For transfer of depreciation to Sinking Fund	Depreciation Account Dr. To Sinking Fund Account

For charging depreciation to profit and loss account	Profit & Loss Account Dr. To Depreciation Account
For investment of amount of depreciation	Sinking Fund Investment Dr. Account To Bank Account

investment at the end of useful life of the asset	Bank Account Dr. To Sinking Fund Investment Account
If Sale is Profit	Sinking Fund Investment Account Dr. To sinking Fund Account
If Sale is Loss	Sinking Fund Account Dr. To Sinking Fund Investment Account
For transfer of the amount to the extent of book value of the asset from asset account to Sinking Fund	Sinking Fund Account Dr. To Asset Account
Any surplus in Sinking fund account to be transferred to General Reserve Account	Sinking Fund Account Dr. To General Reserve Account
Any deficit, may be transferred to Profit and Loss Account	Profit & Loss Account Dr. To Sinking Fund Account

Example:

On 1st April, 2013, ABC & Co. purchased the Equipment for Rs.20,00,000. The life of the asset was only 3 years and would expire on 31st March, 2016. ABC & Co. decided to set up a sinking fund.

During the three years following transactions took place:

2014 31st March: A contribution from profits of Rs. 6,40,000 was made and this sum was invested.

2014 5th Oct.: Investments which originally costed Rs. 2,20,000 were sold for Rs. 2,40,000 and the proceeds of sale were re-invested.

2015 31st March: A contribution from profits of Rs. 6,40,000 was made; interest on investments of Rs. 32,000 was received and these amounts were reinvested.

2015 15th September: Investments which originally costed Rs. 4,20,000 were sold at a profit of Rs. 40,000 and proceeds of sale were re-invested.

2016 31st March: Interest on investments Rs. 96,000 was received which was not invested. All existing investments were sold for Rs. 13,20,000. A contribution from profit of an amount required to make up the sinking fund to Rs. 20,00,000 was made and this amount was not invested.

Prepare Sinking Fund and Sinking Fund Investment Account for the years 2013-14, 2014-15, 2015-16.

Dr.			Sinking Fund Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2014			2014			
Mar-31	To Balance c/d	640,000	Mar-31	By Depreciation A/c	640,000	
	TOTAL	640,000		TOTAL	640,000	
2015			2015			
Mar-31	To Balance c/d	1,332,000	Apr-01	By Balance b/d	640,000	
			Oct-05	By Sinking Fund Investment A/c	20,000	
				By Interest on Sinking Fund		
			Mar-31	Investment A/c	32,000	
			Mar-31	By Depreciation A/c	640,000	
	TOTAL	1,332,000		TOTAL	1,332,000	
2016			2016			
Mar-31	To Sinking Fund Investment A/c	52,000	Apr-01	By Balance b/d	1,332,000	
Mar-31	To Asset A/c	2,000,000	Sep-15	By Sinking Fund Investment A/c	40,000	
				By Interest on Sinking Fund		
			Mar-31	Investment A/c	96,000	
			Mar-31	By Depreciation A/c	584,000	
				(Balancing Figure)		
	TOTAL	2,052,000		TOTAL	2,052,000	

Dr.			Sinking Fund Investment Account			Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
2014			2014			
Mar-31	To Bank A/c	640,000	Mar-31	By Balance c/d	640,000	
	TOTAL	640,000		TOTAL	640,000	
2015			2015			
Apr-01	To Balance c/d	640,000	Oct-05	By Bank A/c (Sales)	240,000	
Oct-05	To Sinking Fund A/c (Profit on Sale)	20,000	Mar-31	By Balance c/d	1,332,000	
Oct-05	To Bank A/c (Investment of Sales Proceeds)	240,000				
2016						
Mar-31	To Bank A/c (Investment of Depreciation amount and interest)	672,000				
	TOTAL	1,572,000		TOTAL	1,572,000	
2016			2016			
Apr-01	To Balance b/d	1,332,000	Sep-15	By Bank A/c	460,000	
Sep-15	To Sinking Fund A/c (Profit on Sale)	40,000	Mar-31	By Bank A/c	1,320,000	
Sep-15	To Bank A/c (Investment of Sales Proceeds)	460,000	Mar-31	By Sinking Fund A/c (Loss on Sale)	52,000	
	TOTAL	1,832,000		TOTAL	1,832,000	

1. Machine Hours Method:

Under this method, Depreciation is calculated on the basis of hours that the concerned machine worked. The machine hour rate of the depreciation is calculated after estimating the total number of hours that machine would work during its whole life.

Example:

A machine was purchased for Rs. 20,00,000 having an estimated total working of 30,000 hours. The scrap value is expected to be Rs. 4,00,000 and anticipated machine hours usage is as follows :

Year

- 1 - 2 3,000 hours per year
- 3 - 5 4,000 hours per year
- 6 - 7 6,000 hours per year

Compute the Annual Depreciation under Machine Hour Rate Method.

Statement showing the Annual Depreciation under Machine Hours Method

Year	Annual Depreciation
1-2	$3000/30000 \times (2000000 - 400000) = \text{Rs.}160000/- \text{ Per Year}$
3-5	$4000/30000 \times (2000000 - 400000) = \text{Rs.}213333/- \text{ Per Year}$
6-7	$6000/30000 \times (2000000 - 400000) = \text{Rs.}320000/- \text{ Per Year}$

2. Production of Units Method:

Under this method depreciation of the asset is determined by comparing the annual production with the estimated total production. The amount of depreciation is computed by the use of following method:

$$\text{Depreciation for the period} = \text{Depreciable Amount} \times \frac{\text{Production during the period}}{\text{Estimated total production}}$$

The method is applicable to machines producing product of uniform specifications.

Example:

A machine is purchased for Rs. 10,00,000. Its estimated useful life is 8 years. The machine is expected to produce 10 lakh units during its life time. Expected distribution pattern of production is as follows:

Yearly Production

- 1-3 100,000 units per year
- 4-6 150,000 units per year
- 7-8 125,000 units per year

Required

Determine the value of depreciation for each year using production units method.
Statement showing the Annual Depreciation under Yearly Production Method

Year	Annual Depreciation
1-2	$100000/1000000 \times 1000000 = \text{Rs.}100000/-$ Per Year
3-5	$150000/1000000 \times 1000000 = \text{Rs.}150000/-$ Per Year
6-7	$125000/1000000 \times 1000000 = \text{Rs.}125000/-$ Per Year

1. Depletion Method:

This method is used in industries where only a certain quantity of product is available. This is used in case of mines, quarries etc. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available. Annual depreciation will be the quantity extracted multiplied by the rate per unit.

Example:

ABC & Co. took a quarry on 1-1-2015 for Rs. 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 5,000 tonnes. Depreciation was charged on the basis of depletion method.

Extraction pattern is as follows:

Year Quantity of Mineral extracted

2015 1,000 tonnes

2016 2,000 tonnes

2017 2,000 tonnes

Statement showing the Annual Depreciation under Depletion Method

Year	Annual Depreciation
2015	$1000/5000 \times 10000000 = \text{Rs.}2000000/-$
2016	$2000/5000 \times 10000000 = \text{Rs.}4000000/-$
2017	$2000/5000 \times 10000000 = \text{Rs.}4000000/-$

Profit or Loss on the sale or disposal of Property, Plant & Equipment:

Whenever any depreciable asset is sold during the year, depreciation is charged on it for the period it has been used in the sale year. The written down value after charging such depreciation is used for calculating the profit or loss on the sale of that asset. The resulting profit or loss on sale of the asset is ultimately transferred to profit and loss account.

Example:

The book value of the asset as on 1st April, 2017 is Rs.25,00,000. Depreciation is charged on the asset @20%. On 1st October 2017, the asset is sold for Rs.10,00,000. In such a situation, profit or loss on the sale will be calculated as follows:

Particulars	Amount
Book Value as on 1 st April 2017	2500000
Less: Depreciation for 6 months @ 15% (1 st April to 1 st October)	187500
Written Down Value as on 1 st October 2017	2312500
Less: Sales Proceeds as on 1 st October 2017	1000000
Loss on Sale of the Asset	1312500

Change in the Method of Depreciation:

If there has been a significant change in the expected consumption pattern of the asset the method should be changed to reflect the changed pattern.

Whenever any change in depreciation method is made. Such change in method is treated as change in accounting estimate as per Accounting Standards whose effect needs to be quantified and disclosed. A change in an accounting estimate may affect the current period or both the current period and future periods.

Example:

Cost of Machine: Rs. 20,00,000
 Residual Value: NIL
 Useful life: 10 years.

The company charges depreciation on straight line method for the first four years and thereafter decides to adopt written down value method by charging depreciation @ 15%. (Calculated based on useful life).

Compute the depreciation for the 5th year. Depreciation already charged for the first 4 years as per straight line method is Rs. 8,00,000. Therefore, WDV for 5th year is Rs. 3,00,000. Therefore in the profit and loss account of the 5th year, the depreciation of Rs. 3,00,000 (25% of Rs. 12,00,000) should be debited.

Revision of the Estimated Useful Life of Property, Plant & Equipment:

The residual value and the useful life of an asset needs to be reviewed every financial year-end and, if the company expects a change in an estimated useful life of the asset in accordance with Accounting Standards then the unamortized depreciable amount needs to be charged over the remaining estimated useful life of the asset.

Example:

A Machine costing Rs. 10,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for five years. The estimate of remaining useful life after fifth year was re-evaluated for 8 years only.

Calculate depreciation for the sixth year.

Particulars	Amount
Depreciation per year = Rs. 10,00,000 / 10	Rs.1000000/-
Depreciation on SLM charged for five years = Rs. 100,000 x 5 years = Rs.500000	Rs.500000/-
Book value of the asset at the end of fifth year = Rs. 10,00,000 - Rs. 5,00,000	Rs.500000/-
Remaining useful life as per previous estimate	5 Years
Remaining useful life as per revised estimate	3 Years
Depreciation from the sixth year onwards = Rs.5,00,000 / 3	Rs.166667/-

Re-Evaluation of the Fixed Asset:

As a Result of Re-evaluation of the fixed asset there can either be an increase in the value of the Fixed Asset or a Decrease in the Fixed Asset.

If there is an increase in the fixed asset, in case revaluation is done first time then the increase is credited directly to revaluation surplus. In case of Subsequent Reevaluation, it is recognized in the Statement of Profit and loss to the extent it was initially reduced and it also decreases the asset previously recognized in the Statement of profit and loss.

If there is an increase in the fixed asset, Charged to the Statement of profit and loss and if the subsequent revaluation decreases the asset value when it was increases during the previous revaluation then the Decrease should be debited directly to owners' interests under the heading of Revaluation surplus to the extent of any credit balance existing in the Revaluation surplus in respect of that asset.

Example:

A machine of cost Rs.15,00,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. At the end of fourth year, the machine was revalued upwards by Rs. 200,000 the remaining useful life was reassessed at 8 years.

WDV of the machine at the end of third year = 15,00,000 —

Particulars	Amount
Depreciation per year for the 3 years = Rs. 15,00,000 / 10 X 3	Rs.450000/-
Rs. Rs. 4,50,000	Rs.1050000/-
Rs. Rs. 200,000	Rs.1250000/-
Remaining useful life as per previous estimate	6 Years
Remaining useful life as per revised estimate	8 Years
Depreciation from the fifth year onwards = Rs.12,50,000 / 8	Rs.156250/-

Provision for Repairs and Renewals:

Expenditure incurred for repairs, renewals and maintenance on Fixed Assets varies over the life of the asset. Therefore, to equalize the charge of repairs and renewals, sometimes a Provision for Repairs and Renewals Account is opened.

Total of such expenses that may be incurred over the working life is estimated beforehand and the Average amount of the expenditure is debited to Profit and Loss Account and credited to Provision for Repairs and Renewals Account irrespective of actual expenses incurred.

Annually the Provision for Repairs and Renewals Account is debited and Repairs Account is credited for actual expenses incurred. The balance in provision for Repairs and Renewals Account is carried forward and in the end or on sale of the asset, the account is closed by transfer to the Asset Account for any balance left.

Example:

The following particulars are available with regard to company's Fixed Assets:

Balance in Prov. for Repairs and Renewals Account as on 31.3.2015 Rs. 10,00,000

Actual repairs charged/incurred during the year ended

31.3.2016 Rs. 5,00,000

31.3.2017 Rs. 3,00,000

The company makes an annual provision of Rs.2,00,000 on repairs and renewals.

Prepare the Provision for Repairs and Renewals Account for the years 2015-2016 and 2016-2017.

Questions:

Question 1:

ABC Co. acquired a equipment on 1st July, 2016 at a cost of Rs.20,00,000 and spent Rs.5,00,000 on its installation. The books are closed on 31st December every year.

Prepare the Machinery Account and Depreciation Account for 2016 & 2017 using:

- ii. Straight Line Method @ 20% Depreciation per annum
- iii. Diminishing Balance Method @ 25% Depreciation per annum

Question 2:

On 1st April, 2013, ABC & Co. purchased the Equipment for Rs.10,00,000. The life of the asset was only 3 years and would expire on 31st March, 2016. ABC & Co. decided to set up a sinking fund.

During the three years following transactions took place:

2014 31st March: A contribution from profits of Rs. 5,00,000 was made and this sum was invested.

2014 5th Oct.: Investments which originally costed Rs. 1,00,000 were sold for Rs. 1,50,000 and the proceeds of sale were re-invested.

2015 31st March: A contribution from profits of Rs. 7,00,000 was made; interest on investments of Rs. 50,000 was received and these amounts were reinvested.

2015 15th September: Investments which originally costed Rs. 6,00,000 were sold at a profit of Rs. 50,000 and proceeds of sale were re-invested.

2016 31st March: Interest on investments Rs. 100,000 was received which was not invested. All existing investments were sold for Rs. 15,40,000. A contribution from profit of an amount required to make up the sinking fund to Rs. 25,00,000 was made and this amount was not invested.

Prepare Sinking Fund and Sinking Fund Investment Account for the years 2013-14, 2014-15, 2015-16.

Illustrations

Question: 1

Jain Bros. acquired a machine on 1st July, 2015 at a cost of Rs. 14,00,000 and spent Rs. 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. of the original cost every year. The books are closed on 31st December every year

Show the Machinery Account and Depreciation Account for the year 2015 and 2016.

Question: 2

Jain Bros. acquired a machine on 1st July, 2015 at a cost of Rs. 14,00,000 and spent Rs. 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. every year. The books are closed on 31st December every year.

Show the Machinery Account on diminishing balance method for the year 2015 and 2016.

Question: 3

M/s Akash purchased a machine for Rs. 10,00,000. Estimated useful life and scrap value were 10 years and Rs. 1,20,000 respectively. The machine was put to use on 1.1.2010.

Show Machinery Account and Depreciation Account in their books for 2015 by using sum of years digits method.

Question: 4

A machine was purchased for Rs. 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be Rs. 2,00,000 and anticipated pattern of distribution of effective hours is as follows

Year	Particulars
1 - 3	3,000 hours per year
4 - 6	2,600 hours per year
7 - 10	1,800 hours per year

Determine Annual Depreciation under Machine Hour Rate Method.

Question:5

A machine is purchased for Rs. 20,00,000. Its estimated useful life is 10 years with a residual value of Rs. 2,00,000.

The machine is expected to produce 1.5 lakh units during its lifetime. Expected distribution pattern of production is as follows:

Year	Units of Production per year
1 - 3	20,000 units
4 - 7	15,000 units
8 - 10	10,000 units

Determine the value of depreciation for each year using production units method.

Question: 6

M/s Surya took lease of a quarry on 1-1-2013 for Rs. 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes

Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year	Quantity of Mineral extracted (in Tonnes)
2013	2,000
2014	10,000
2015	15,000

Show the Quarry Lease Account and Depreciation Account for each year from 2013 to 2015.

Question: 7

A firm purchased on 1st January,2015 certain machinery for Rs. 5,82,000 and spent Rs. 18,000 on its erection. On July 1,2015 another machinery for Rs. 2,00,000 was acquired. On 1st July,2016 the machinery purchased on 1st January,2015 having become obsolete was auctioned for Rs.

3,86,000 and on the same date fresh machinery was purchased at a cost of Rs. 4,00,000.

Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value

Prepare Machinery Account.

Question: 8

M/s Anshul commenced business on 1st January 2011, when they purchased plant and equipment for Rs. 7,00,000. They adopted a policy of charging depreciation at 15% per annum on diminishing balance basis and over the years, their purchases of plant have been:

Date	Amount (Rs.)
01-01-2012	1,50,000
01-01-2015	2,00,000

On 1-1-2015 it was decided to change the method and rate of depreciation to straight line basis.

On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2015 and 10 years for the asset purchased on 1.1.2015 with no scrap value.

Calculate the difference in depreciation to be adjusted in the Plant and Equipment Account for the year ending 31st December, 2015.

Question: 9

A Machine costing Rs. 6,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years.

Calculate depreciation for the fourth year

Question: 10

The following particulars are available from the books of a public company having a large fleet of vehicles:

Particulars	Amount (Rs.)
Balance in Provision for Repairs and Renewals Account as on 31.03.2016	
Actual repairs charged/incurred during the year ended 31.03.2016	11,50,000
31.03.2017	7,50,000
	3,20,000

The company makes an annual provision of Rs. 4,00,000 on repairs and renewals.

Draw up the Provision for Repairs and Renewals Account for the years 2015-2016 and 2016-2017.

Question: 11

On 1st April, 2013, Z Limited purchased the lease of property for Rs. 10,00,000. The lease would expire on 31st March, 2016. Z Ltd. decided to set up a sinking fund. The Sinking Fund was to be credited (or debited) with an annual contribution from profit, the interest on the investments and any profits (or losses) made on the realisation of the sinking fund investments. The sinking fund was to be represented by specific investment, and any sums made available to the sinking fund were to be immediately invested, except at the termination of the fund.

During the three years following transactions took place:

- 31st March, 2014 A contribution from profits of Rs. 3,20,000 was made and this sum was invested
- 13th Oct, 2014 Investments which originally costed Rs. 1,10,000 were sold for Rs. 1,20,000 and the proceeds of sale were re-invested
- 31st March, 2015 A contribution from profits of Rs. 3,20,000 was made; interest on investments of Rs. 16,000 was received and these amounts were reinvested
- 9th August, 2015 Investments which originally costed Rs. 2,10,000 were sold at a profit of Rs. 20,000 and proceeds of sale were re-invested
- 31st March, 2016 Interest on investments Rs. 48,000 was received which was not invested
- All existing investments were sold for Rs. 6,60,000

- A contribution from profit of an amount required to make up the sinking fund to Rs. 10,00,000 was made and this amount was not invested

Prepare Sinking Fund and Sinking Fund Investment Account for the years 2013-14, 2014-15, 2015-16.

Question: 12

On 1st April, 2013, Z Limited purchased the lease of property for Rs. 10,00,000. The lease would expire on 31st March, 2016. Z Ltd. decided to set up a sinking fund. The Sinking Fund was to be credited (or debited) with an annual contribution from profit, the interest on the investments and any profits (or losses) made on the realisation of the sinking fund investments. The sinking fund was to be represented by specific investment, and any sums made available to the sinking fund were to be immediately invested, except at the termination of the fund.

During the three years following transactions took place:

- 31st March, 2014 A contribution from profits of Rs. 3,20,000 was made and this sum was invested
- 13th Oct, 2014 Investments which originally costed Rs. 1,10,000 were sold for Rs. 1,20,000 and the proceeds of sale were re-invested
- 31st March, 2015 A contribution from profits of Rs. 3,20,000 was made; interest on investments of Rs. 16,000 was received and these amounts were reinvested
- 9th August, 2015 Investments which originally costed Rs. 2,10,000 were sold at a profit of Rs. 20,000 and proceeds of sale were re-invested
- 31st March, 2016 Interest on investments Rs. 48,000 was received which was not invested. All existing investments were sold for Rs. 6,60,000
- A contribution from profit of an amount required to make up the sinking fund to Rs. 10,00,000 was made and this amount was not invested

Prepare Lease A/c and Depreciation A/c for the years 2013-2014, 2014-2015, 2015-2016.

Chapter 10 - Rectification of Errors

What are ERRORS?

Since Accounting involves a huge amount of recurring and record-keeping task it is highly possible that sometimes unintentional omission or commission of amounts and accounts may happen during the preparation of the accounts while recording them. This is known as ERROR in ACCOUNTING.

It is also possible that there may be due to mathematical mistake due to which the trial balance may not agree.

Whatever kind of error has occurred it is important to rectify the error that have occurred and been detected so that the Financial Statements show a True and Fair view of the various transactions and events.

How the errors can occur?

1. **Wrong Entry of amounts in the books of accounts.**
For Eg: Sales of Rs. 15650/- recorded as sales of Rs.15065/-
2. **Wrong posting of the Subsidiary Books.**
For Eg: As per the Purchase Books the total purchases for the month of August 18 was of Rs. 19250/- recorded as purchases of Rs.19520/- while posting it in the Ledger.
3. **Posting the entries in the wrong account:**
For Eg: Purchases from Mr. A are posted as purchases from Mr.B

STAGES OF ERRORS:

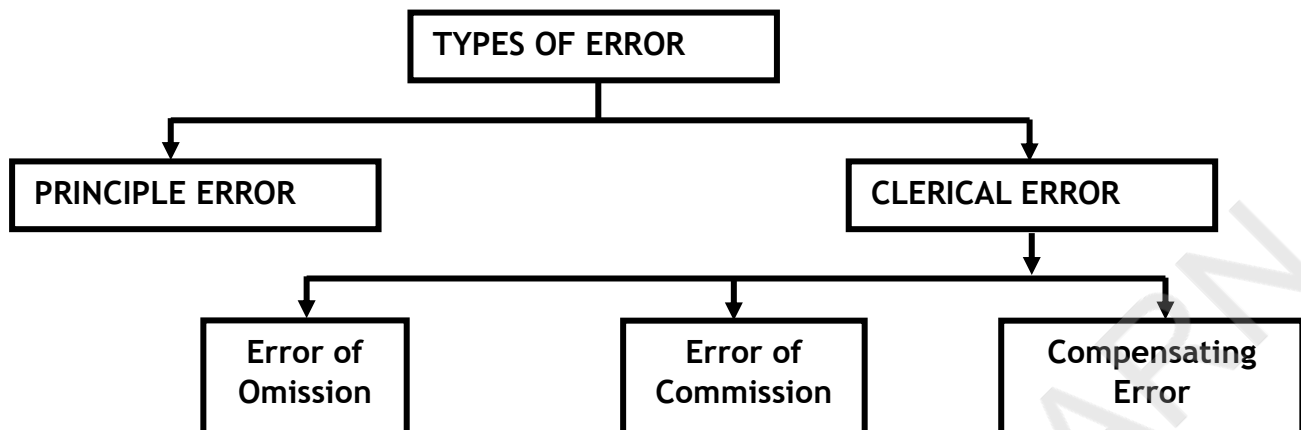
Till now we have been able to see that accounting involves multiple processes from recording a transaction to posting ledger to preparation of the Financial Statements.

An error can occur at any stage; broadly speaking the error can occur during any of the following stages based on the flow of the process:

1. When recording the transaction in Journal.
2. While posting entries in the Ledger.
3. Balancing the Ledger Accounts.
4. Preparing the Trial Balance.

TYPES OF ERRORS:

Classification of errors can be understood from the following table:



Error of Principle:

This error occurs when the transactions are recorded in a fundamentally wrong manner ignoring the principles of Accounting.

For Eg: When the purchase of Computer (Fixed Asset) is recorded as office expense.

Clerical errors:

1. Error of Omission:

This error occurs when the recording of transactions is omitted from the books of accounts.

For Eg: Omitting to record a purchase entry from the journal or omitting to record the journal entry in the ledger.

2. Error of Commission:

This error occurs when the amounts are posted in the wrong account, or a debit amount is written on the credit side, or the amounts are written wrong.

3. Compensating Errors:

These are the errors whose combine effect cancels out each other. For Eg: if salaries account is overbooked by Rs. 1000/- and the office expense is under booked by the same amount i.e. Rs.1000/- then the final profit remains unaffected. These types of errors are known as "COMPENSATING ERRORS".

Apart from the above mentioned classification based on principle of error or clerical error there is also another category of error which can occur which is based on whether they affect the trial balance or not.

The errors which affect the trial balance are as stated below:

- i. Wrong casting of the subsidiary books.
- ii. Wrong balancing of an account.
- iii. Posting an amount on the wrong side.
- iv. Posting the wrong amount.
- v. Omitting to post an amount from a subsidiary book.

- vi. Omitting to post the totals of subsidiary book.
- vii. Omitting to write the cash book balances in the trial balance.
- viii. Omitting to write the balance of an account in the trial balance.
- ix. Writing a balance in wrong column of the trial balance.
- x. Totaling the trial balance wrongly.

The errors which do not affect the trial balance are as stated below:

- i. Omitting an entry altogether from the subsidiary book.
- ii. Making an entry with the wrong amount in the subsidiary book.
- iii. Posting an amount in a wrong account but on the correct side, e.g., an amount to be debited to A debited to B, the trial balance will still agree.

Steps to Locate the Error:

If the trial balance does not agree then it is a first indicator that there are errors in the accounts and there can be various reasons the existence of errors which needs to be enquired upon and rectified.

The following steps helps in identifying the errors:

1. The two columns of the Trial Balance should be verified and if there are multiple amounts which are represented by a single amount in the trial Balance then even those amounts should be verified again.
For eg: if the trial balance shows only a single amount for Trade Payables for the various accounts then the list of the trade payables should also be verified.
2. Verify the Cash and Bank Balances written in the trial balance.
3. The exact difference in the trial balance should be determined. All the ledgers should be scrutinized thoroughly to verify whether any amount of the exact difference has been omitted from recording in the trial balance.
4. The Ledger accounts should be re balanced.
5. Recheck the casting of subsidiary books.
6. Posting of the amount equal to the difference in the trial balance or the half amount of the difference should be checked. If the amounts are posted on the wrong side the difference doubles up.
For Eg: If the amount of Rs.1000 to be posted in the debit side is posted on the credit side then the trial balance would be showing a difference of Rs. 2000/-. The omission of Debit of Rs.1000/- and additional credit of Rs.1000/-
7. If the difference still exists a complete checking of the entire books of accounts would be necessary.

Rectification of an Error:

Errors always need to be corrected in a systematic way such that the effect of the error is nullified and the correct entry is also shown in the accounts.

The rectification of error depends on which stage the error is detected. The stage at which the rectification needs to happen depends on the following stages:

1. Before Preparation of Trial Balance
2. After the preparation of Trial Balance but before the preparation of the Final Accounts.
3. After preparation of Final Accounts.

Rectification of error before preparation of trial balance:

These categories of errors are identified during or before preparation of the Trial Balance and corrective entries need to be made to rectify the same.

The Rectification has to be done in 2 steps:

- i. Pass a reverse entry of the wrong entry. This will nullify the effect of the wrong entry.
- ii. Pass the correct Journal entry to ensure that proper effect of transactions is accounted.

Example:

Purchase of Fixed Asset for Rs. 1,00,000/- from ABC & Co. has been booked under Purchases. Rectify the same.

The following states the wrong entries made and the correct entry to be passed for the rectification.

Wrong Entry	Reversal of Wrong entry	Correct Entry
Purchase A/c Dr. 100000 To ABC & Co. A/c 100000	ABC & Co. A/c Dr. 100000 To Purchases 100000	Fixed Assets A/c Dr. 100000 To ABC & Co. A/c 100000

Rectification of error after preparation of trial balance but before preparation of Final Accounts:

Sometimes when the trial balance does not agree it is made to agree artificially by opening a Suspense Account. If the debit total of the trial balance is higher than the suspense account is credited, and it is debited if the total of the credit side of the trial balance is higher.

All those errors which needs to be rectified by a Journal entry but were not able to be rectified due to the absence of complete journal entry will be rectified with the use of Journal Entry by using suspense account as the other part of the Journal.

Example:

Pass the rectification entry for the following errors using a Suspense Account:

1. The Sales book total is under casted by Rs.10,000/-
2. Goods Sold to Mr. B for Rs.2000/- But the accountant credited Mr. B instead of Debiting.
3. Discount received from Mr. C for Rs.500/- has been omitted from the discount column of the cash book. However, the discount is properly accounted in Mr. C Account.

DATE	PARTICULARS	L.F.	DEBIT (Rs.)	CREDIT (Rs.)
	Suspense A/c Dr.		10,000	
	To Sales A/c			10,000
	(Being Sales increased for the amount undercasted)			
	Mr. B A/c Dr.		4,000	
	To Suspense A/c			4,000
	(Being Amount wrongly credited to Mr. B rectified)			
	Suspense A/c Dr.		500	
	To Discount Received A/c			500
	(Being Discount Received not recorded previously accounted for)			

DR.		SUSPENSE ACCOUNT				CR.	
DATE	PARTICULARS	J.F.	AMOUNT (Rs.)	DATE	PARTICULARS	J.F.	AMOUNT (Rs.)
	To Sales A/c		10,000		By Difference in Trial Balance		6,500
	To Discount Received A/c		500		By Mr. B A/c		4,000
	TOTAL		10,500		TOTAL		10,500

Rectification of error in the next accounting Period:

All the errors discussed so far were on the assumption that these errors have taken place during the current year. However, sometimes the books of accounts for a particular period are prepared along with the errors itself. These errors however, need to be rectified in the following year.

For instance the purchase for the year 2017 were over stated by Rs.10000/- but the Financials of the year 2017 were finalized along with the errors itself and it was only in 2018 the company realized the presence of error in 2017 financial statements and intended to rectify it.

If the company rectifies the error by reducing the purchases in 2018 by Rs. 10000/- then it would be reducing the purchases for the year 2018 instead of 2017. It is to avoid these situations a special account named "PROFIT & LOSS ADJUSTMENT ACCOUNT" is used to rectify the errors of previous years.

It is to be noted that at the end of the current accounting period the balance of Profit & Loss Adjustment Account will be transferred to the Profit & Loss Account itself.

Rectification of error in the next accounting Period:

All the errors discussed so far were on the assumption that these errors have taken place during the current year. However, sometimes the books of accounts for a particular period are prepared along with the errors itself. These errors however, need to be rectified in the following year.

For instance the purchase for the year 2017 were over stated by Rs.10000/- but the Financials of the year 2017 were finalized along with the errors itself and it was only in 2018 the company realized the presence of error in 2017 financial statements and intended to rectify it.

If the company rectifies the error by reducing the purchases in 2018 by Rs. 10000/- then it would be reducing the purchases for the year 2018 instead of 2017. It is to avoid these situations a special account named "PROFIT & LOSS ADJUSTMENT ACCOUNT" is used to rectify the errors of previous years.

It is to be noted that at the end of the current accounting period the balance of Profit & Loss Adjustment Account will be transferred to the Profit & Loss Account itself.

Example:

Mr. A was unable to agree the trial balance for 2017 and directly posted the differences in the Profit and Loss account. In 2018, the Auditors of the company revealed the following errors committed in 2017.

Rectify the mistakes noted above and use the Profit & Loss Adjustment Account wherever necessary:

- i. Purchase of a Fixed Asset was debited to Printing & Stationery Account for Rs.5,000.
Depreciation on Fixed Assets is levied at 10%.
- ii. Sales account was overstated by Rs.20,000.
- iii. A credit sale of goods to Mr. A for Rs.5,000 entered as a purchase.
- iv. Rs. 1000 due by Mr. C was omitted from recording into the trial balance.
- v. Purchase of goods from Mr. R for 5,000 was omitted to be recorded.
- vi. Amount of Rs.2525 of purchase was wrongly posted as Rs.5252.

DATE	PARTICULARS	L.F.	DEBIT (Rs.)	CREDIT (Rs.)
	Fixed Assets A/c Dr.		4,500	
	To Profit & Loss Adjustment A/c			4,500
	(Being Purchase of Fixed Asset wrongly debited to Printing & Stationery rectified and asset is capitalised at the Depreciated value)			
	Profit & Loss Adjustment A/c Dr.		20,000	
	To Suspense A/c			20,000
	(Being Sales account overstated in previous year rectified)			
	Mr. A A/c Dr.		5,000	
	To Profit & Loss Adjustment A/c			5,000
	(Being Credit sales made to Mr.A recorded as Purchases now rectified)			
	Account Receivable A/c Dr.		1,000	
	To Suspense A/c			1,000
	(Being Accounts receivable not recorded last year now accounted)			
	Profit & Loss Adjustment A/c Dr.		5,000	
	To Mr.R A/c			5,000
	(Being Purchases made from Mr. R not recorded last year now accounted for)			
	Suspense A/c Dr.		2,727	
	To Profit & Loss Adjustment A/c			2,727
	(Being excess posting of purchases of Rs.5252 instead of Rs.2525 now rectified)			
	Mr. A Capital A/c Dr.		12773	
	To Profit & Loss Adjustment A/c			12773
	(Being Balance of Profit & Loss Adjustment Account trnasferred to Capital Account)			
	Suspense A/c Dr.		18273	
	To Mr. A Capital A/c			18273
	(Being balance of Suspense Account trnasferred to Mr.A Capital A/c)			

Chapter 11 – Bank Reconciliation System

OBJECTIVES

The lists of topics which will be covered in this chapter are as follows:

3.1 Understand Pass book

3.2 Understand the differences between cash book and bank pass book

3.3 Reconcile the difference between the cash book and bank pass book.

3.4 Intention of preparing the bank reconciliation system and its utility.

SERVICES PROVIDED BY BANK:

In the present time nearly all of the transactions of the organizations are performed through the banks whether it is a receipt or a payment at local, regional, national or international level. In Fact, it is legally necessary to carry out the transactions through bank after a certain limit.

Apart from receiving collections and making payments, the following services are also performed by the bank:

- i. Discounting of promissory notes or hundies which enables the entities to receive the cash before the due date in exchange for a small charges.
- ii. Allowing overdraft facilities to their credible customer which enables them to make payments even when they do not have sufficient balance in their account. These overdraft balances need to be cleared within a certain period of time.
- iii. Providing loans to their customers which provide great financial assistance for their businesses.
- iv. Collecting on behalf of the customer the amount of dividends, interest on securities etc.
- v. Making Utility payments such as insurance premium, rent etc. on the due dates as instructed by their customers.
- vi. Remitting money to another place or persons at a low cost.
- vii. Providing security or guarantee for its customers whose credit is good, in return for a consideration,
- viii. Issuing letter of credit or traveller's cheque which facilitates commerce as well as travel.
- ix. Provides international banking services.

BANK PASS BOOK AND BANK STATEMENT:

Bank pass book and Bank Statements provides the details of the customer's account in the bank. Through the Bank Pass Book and Bank Statement the bank keeps its customers informed of the

entries made in their account. It is the customer's duty to check the entries and immediately inform the bank of any error that he may notice.

The bank balance shown in the passbook or the statement is known as pass book balance for reconciliation purpose. The credit balance as per pass book at a particular point of time is the deposit made by the customer while debit balance as per pass book is the overdraft balance for the customer.

BANK RECONCILIATION STATEMENT:

The Bank Reconciliation Statement reconciles the difference between the Bank Pass Book and Bank Balance as per the organization record eliminating any differences arising between them.

Whenever any deposit or withdraws is made from banks, it is always recorded at two places: -

1. Bank column of the cash book and
2. Bank statement or Bank pass book

The cash book is maintained by the customer having who has the bank account and the bank statement is prepared by the bank.

The balance in both the accounts should be equal and opposite in nature ideally. For e.g. If Mr. Z deposited 1,000 in his bank account, it should be recorded as Debit entry on the cash book of Mr. Z. And the same should be recorded as Credit Entry on the Customer Account maintained by the Bank.

In an Ideal world both the accounts should always match but it does not happen in most of the cases due to several reasons.

There are many reasons for these differences in balances which are explained later. These differences are reconciled by considering the various facts and figures on the two statements.

The process of reconciling the difference and bringing the two accounts in line with each other is known as "Reconciliation", and the statement in which the reconciliation is done is known as "BANK RECONCILIATION STATEMENT".

IMPORTANCE OF BANK RECONCILIATION STATEMENT:

Bank reconciliation statement acts as a tool for internal control of cash flows by detecting if any errors, frauds and irregularities have occurred at the time of passing entries in the cash book or in the passbook, whether intentionally or unintentionally. The important features of bank reconciliation statement can be summarized as follow:

- i. The reconciliation identifies any errors that may have been committed either in the cash book or in the pass book.
- ii. Any unreasonable delay in the clearance of cheques will be shown up by the reconciliation
- iii. A regular reconciliation discourages the accountant of the bank from embezzlement. There have been many cases when the cashiers merely made entries in the cash book but never deposited the cash in the bank they were able to get away with it only because of lack of reconciliation.
- iv. It helps in finding out the actual position of the bank balance.

v. It will ensure accounting of all the financial transactions incurred by the company during a particular financial year.

CAUSES OF DIFFERENCES:

The differences between the balance as per the Bank Pass Book and the Bank Balance as per the company's cash book arise mainly due to the following reasons:

1. Timing of recording the transactions:

Due to the difference in the timing of recording the transaction.

For e.g., If M has issued a cheque on 30th March, it will be recorded in the bank column of cash book on 30th March itself, but it will be recorded by the Bank only when it is presented for clearance giving rise to the difference.

2. Transactions:

Some transactions are carried out by the bank directly and the customer becomes aware of it only when they perform the reconciliation.

For e.g. crediting the interest in the customer's account directly.

3. Errors:

Any kind of Mistake or error made either by the customers or the bank results in differences.

TRANSACTIONS OR EVENTS THAT FREQUENTLY CAUSE DIFFERENCES:

The following are the transactions and events that frequently cause a difference between the balance as per the bank records and the organization records due to the difference in the timing of recording these transactions.

1. Cheques issued but not presented for payment.
2. Cheques paid into the bank but not cleared.
3. Interest allowed by bank.
4. Interest and expenses charged by the bank.
5. Interest and dividends collected by the bank.
6. Direct payments by the bank.
7. Direct payment into the bank by a customer.
8. Dishonor of a bill discounted with the bank.
9. Bills collected by the bank on behalf of the customer.
10. Errors (This is not a timing difference)

Following is the table summarizing in brief the timings of different transactions

Sr.No.	Transaction	Time of recording in cash Book	Time of recording in pass book
1	Issue of a cheque by the account holder	When the cheque is issued	When it is presented to the bank for payment.
2	Depositing a cheque in the account	When deposited in the Bank Account	When collected from the issuing party
3	Collection of bills/cheque directly by the bank	When referring the bank pass book	When it is collected by the bank.
4	Direct payment to the account holder	When referring the bank pass book.	When the amount is made in the account
5	Dishonor of cheque/bills Receivable.	When referring the bank pass book	When the cheque is Dishonored.
6	Bank charges levied by the Bank	When referring the bank pass book	When charges are levied by the bank
7	Interest and dividend credited by the bank	When referring the bank pass book	When interest or dividend is collected by the bank.
8	Interest debited by the bank	When referring the bank pass book	When interest is charged by the bank

Example on Reconciliation of Timing Differences:

The following is the bank passbook and bank balance as per the cash book maintained by Mr. A. for the month of September 2018.

Bank Pass Book

Date	Particulars	Deposits	Withdrawls	Balance
01-09-18	By Cash	100,000	-	100,000
03-09-18	To ABC & Co.	-	10,000	90,000
05-09-18	To XYZ & Co.	-	15,000	75,000
08-09-18	By MR. D	50,000	-	125,000
15-09-18	By Cash	10,000	-	135,000
17-09-18	By Cash	5,000	-	140,000
20-09-18	To Bank Charges	-	1,000	139,000
22-09-18	By Interest	500	-	139,500
25-09-18	By Interest on Govt. Securities	750	-	140,250

Cash Book (Bank Column)					
Dr.			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
01-09-18	By Cash	100,000	01-09-18	To ABC & Co.	10,000
06-09-18	By Mr.D	50,000	04-09-18	To XYZ & Co.	15,000
15-09-18	By Cash	10,000			
17-09-18	By Cash	5,000	30-09-18	To Balance c/d	140,000
	TOTAL	165,000		TOTAL	165,000

As can be noted above the balance as per the bank pass book is Rs.140250/- However, as per the Bank Column of the cash book it is Rs. 140000/-. The difference between the same is reconciled as follow:

The reconciliation can be done by 2 ways.

- i. Arriving at the pass book balance from cash book or
- ii. Arriving at the cash book balance from pass book.

We will reconcile the balance by arriving at the cash book balance from the pass book balance.

Particulars	Amount	Amount
Amount as per Pass Book		140,250
Add		
Bank Charges levied by bank	1,000	1,000
Less:		
Bank Interest credited in pass book	(500)	
Interest on Govt Securities credited in pass book	(750)	(1,250)
Amount as per Cash Book		140,000

Thus the balances have been reconciled.

PROCEDURE FOR RECONCILING THE CASH BOOK BALANCES WITH THE PASS BANK BALANCE:

Understanding the following debit and credit balances presented in the cash book and bank pass book is important in reconciling the differences:

Debit Balance as per Cash Book - Excess of Deposit over Withdrawals in Bank

Credit Balance as per Cash Book - Excess of Withdrawals over Deposit in Bank

Debit Balance as per Bank Pass Book - Excess of Withdrawals over Deposit in Bank

Credit Balance as per Bank Pass Book - Excess of Deposit over Withdrawals in Bank

The reconciliation can be done by using any of the four balances given in the question.

There can be 2 different kinds of reconciliation based on the details provided which can be categorized as follow:

- i. When the causes of differences are known
- ii. When the causes of differences are not known

When causes of differences are known the reconciliation can be done by taking any of the balance stated above and analyzing the causes and accordingly reconciling the transactions to eliminate the effects of the various differences.

If the balance of the other book is more on account of the said causes then add the amount. If the balance of the other book is less on account of the said causes then subtract the amount.

For example, if the reconciliation is initiated with Dr. Balance as per the cash book and there is a cheque deposited in the bank but not cleared, then on account of non-clearance of the cheque, the Cr. balance of the pass book would be less. In this case, the amount of cheque should be subtracted from the cash book balance to arrive at the balance as per the pass book.

When causes of differences are not known then a comparison needs to be done of the debit entries of cash book with the credit entries of the pass-book and vice-versa.

The entries which do not tally are the causes of difference in the balances of both the books. Once the causes are located their effects on both the books are analyzed and then reconciliation statement is prepared to arrive at the actual bank balance. However, one should take care that whether opening balance of both the books tallies or not. If opening balances are not same then the reconciliation items are divided into two categories i.e., one relating to reconciliation of opening balance and other relating to reconciliation of closing balance.

METHODS OF RECONCILIATION:

There are 2 methods of reconciliation:

- i. Without preparation of the Adjusted Cash-Book and
- ii. With the preparation of the Adjusted Cash-Book

Without preparation of the Adjusted Cash-Book

The reconciliation under this method can be done by taking any of the four balances as the starting point and reconciling the causes of differences. The following table (Extracted from the ICAI Study Material) provides the detailed analysis of how to reconcile the difference by using the various starting point.

Causes of differences	Favorable balance (Dr.) as per cash book	Unfavorable balance (Cr.) as per cash book	Favorable balance (Cr.) as per pass book	Unfavorable balance (Dr.) as per pass book
Cheque deposited but not cleared	Subtract	Add	Add	Subtract
Cheque issued but not presented to bank	Add	Subtract	Subtract	Add
Cheque directly deposited in bank by a customer	Add	Subtract	Subtract	Add
Income (e.g., interest from UTI) directly received by bank	Add	Subtract	Subtract	Add
Expenses (e.g., telephone bills, Insurance charges) directly paid by bank on standing instructions	Subtract	Add	Add	Subtract
Bank charges levied by bank	Subtract	Add	Add	Subtract
Locker rent levied by bank	Subtract	Add	Add	Subtract
Wrong debit in the cash book	Subtract	Add	Add	Subtract
Wrong credit in the cash book	Add	Subtract	Subtract	Add

Wrong debit in the pass book	Subtract	Add	Add	Subtract
Wrong credit in pass book	Add	Subtract	Subtract	Add
Under casting of Dr. side of bank account in the cash book	Add	Subtract	Subtract	Add
Overcasting of Dr. side of bank account in the cash book	Subtract	Add	Add	Subtract
Under casting of Cr. side of bank account in the cash book	Subtract	Add	Add	Subtract
Over casting of Cr. side of bank account the cash book	Add	Subtract	Subtract	Add
Bill receivable collected directly by bank	Add	Subtract	Subtract	Add
Interest on bank overdraft charged	Subtract	Add	Add	Subtract
	If answer is positive then it is favorable balance as per pass book i.e. Cr. Balance as per Pass Book, if it is negative then it is Unfavorable balance i.e.. Dr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per pass book i.e. Dr. Balance as per Pass Book, if it is negative then it is Favorable balance i.e.. Cr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per pass book i.e. Dr. Balance as per Pass Book, if it is negative then it is Favorable balance i.e.. Cr. Balance as per Pass Book	If answer is positive then it is Unfavorable balance as per cash book i.e. Cr. Balance as per Cash Book, if it is negative then it is Favorable balance i.e.. Dr. Balance as per Cash Book
Final Balance				

Note: The reconciliation statement can be presented as per the two methods:

- i. Balance Presentation
- ii. Plus-Minus Presentation

With preparation of the Adjusted Cash-Book:

Adjusted Cash Book:

When the balance in the cash book is first adjusted for certain adjustments before taking it to the bank reconciliation statement, then it is known as adjusted cash book balance. Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months. But if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

While adjusting the cash-book the following adjustments are considered: -

1. All the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/ under casting of the balance etc.) and omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonor of cheques/bills etc.) by the cash-book are taken into care

2. Only these transactions are considered for adjusting cash book, apart from this delay in recording in the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.

EXAMPLE 1:

On 30th September, 2018, the bank account of Mr. A, according to the bank column of the Cash-Book, was overdrawn to the extent of Rs 10,000. On the same date the bank statement showed a debit balance of 15,000 in favor of A.

An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for Rs.50,000 deposited on 28th September, 2018 was credited by the bank only on 2nd October, 2018
2. A payment by cheque for Rs.20,000 has been entered twice in the Cash Book.
3. On 29th September, 2018, the bank credited an amount of Rs.75,000 received from a customer of A, but the advice was not received by A until 2nd October, 2018.
4. Bank charges amounting to Rs. 1500 had not been entered in the Cash Book.
5. On 6th September, 2018, the bank credited Rs.10,000 to A in error.
6. A bill of exchange for Rs.90,000 was discounted by X with his bank. This bill was dishonored on 28th September, 2018 but no entry had been made in the books of A.
7. Cheques issued up to 30th September, 2018 but not presented for payment up to that date totaled Rs.100,000.

Prepare the following details based on the above mentioned transactions:

1. Present appropriate rectifications in the Cash Book of Mr. A to arrive at the correct balance as on 30th September 2018 and
2. Bank Reconciliation Statement

Cash Book (Bank Column) of Mr. A for September 30, 2018

Dr.		Cash Book (Bank Column)				Cr.
Date	Particulars	Amount	Date	Particulars	Amount	
Sept 30	To Customer A/c	20,000	Sept 30	By Bank Charges	1,500	
	To Customer A/c	75,000		By Customer A/c		
				(Bill Dishonored)	90,000	
				By Balance c/d	3,500	
	TOTAL	95,000		TOTAL	95,000	

Bank Reconciliation Statement for September 30, 2018		
Particulars	Amount	Amount
Balance as per Cash Book		3,500
Add		
Cheques deposited but not collected upto 30 september 2018	50,000	50,000
Less:		
Cheques issue but not presented for payment till september 30 2018	(100,000)	(100,000)
Amount as per Bank Pass Book		(46,500)

EXAMPLE 2:

From the following information (as on 31.3.2018), prepare a bank reconciliation statement after making necessary amendments in the cash book

Particulars Amount Bank balances as per the cash book (Dr.) 800,000

Cheques deposited, but not yet credited 45,000

Cheques issued but not yet presented for payment 35,000

Bank charges debited by bank but not recorded in the cash-book 2,500

Dividend directly collected by the bank 20,000

Insurance premium paid by bank as per standing instruction
Not intimated 18,000

Cash sales wrongly recorded in the Bank column of the cash-book 2,00,000

Customer's cheque dishonored by bank not recorded in the cash-book 1,00,000

Wrong credit given by the bank 1,10,000

Also show the bank balance that will appear in the trial balance as on 31.3.2018.

Dr. Cash Book (Bank Column) - After necessary adjustments Cr.					
Date	Particulars	Amount	Date	Particulars	Amount
31-03-18	To Balance b/d	800,000	31-03-18	By Bank Charges	2,500
	To Dividend	20,000		By Insurance Premium	18,000
				By Acc. Receivable	100,000
				(Cheque Dishonored)	
				By Cash (Wrong recorded cash sales)	200,000
				By Balance c/d	499,500
	TOTAL	820,000		TOTAL	820,000

Bank Reconciliation Statement for March 31, 2018		
Particulars	Amount	Amount
Balance as per Cash Book		499,500
Add		
Cheques issued but not presented for payment	35,000	
Amount wrongly credited by bank	110,000	145,000
		644,500
Less:		
Cheques deposited but not yet credited by bank	(45,000)	(45,000)
Amount as per Bank Pass Book		599,500

The balance of Rs. 499,500/- will appear on the trial balance of 31st March 2018.

Questions:

From the following information (as on 31.3.2018), prepare a bank reconciliation statement after making necessary amendments in the cash book

Particulars Amount Bank balances as per the cash book (Dr.) 600,000

Cheques deposited, but not yet credited 85,000

Cheques issued but not yet presented for payment 70,000

Bank charges debited by bank but not recorded in the cash-book 1,000

Dividend directly collected by the bank 50,000

Insurance premium paid by bank as per standing instruction
Not intimated 45,000

Cash sales wrongly recorded in the Bank column of the cash-book 1,50,000

Customer's cheque dishonored by bank not recorded in the cash-book 3,00,000

Wrong credit given by the bank 10,000

Also show the bank balance that will appear in the trial balance as on 31.3.2018.

Illustrations

Question: 1

From the following particulars, prepare a Bank Reconciliation Statement for Jindal offset Ltd.

- (1) Balance as per cash book is Rs. 2,40,000
- (2) Cheques issued but not presented in the bank amounts to Rs. 1,36,000.
- (3) Cheques deposited in bank but not yet cleared amounts to Rs. 90,000.
- (4) Bank charges amounts to Rs. 300.
- (5) Interest credited by bank amounts to Rs. 1,250.
- (6) The balance as per passbook is Rs.2,86,950

Question: 2

On 31st March 2017, the Bank Pass Book of Namrata showed a balance of Rs.1,50,000 to her credit while balance as per cash book was Rs.1,12,050. On scrutiny of the two books, she ascertained the following causes of difference:

- i. She has issued cheques amounting to Rs. 80,000 out of which only Rs. 32,000 were presented for payment.
- ii. She received a cheque of Rs.5,000 which she recorded in her cash book but forgot to deposit in the bank.
- iii. A cheque of Rs.22,000 deposited by her has not been cleared yet.
- iv. Mr. Gupta deposited an amount of Rs.15,700 in her bank which has not been recorded by her in Cash Book yet.
- v. Bank has credited an interest of Rs. 1,500 while charging Rs. 250 as bank charges.

Prepare a bank reconciliation statement.

Question: 3

From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st December 2017.

1. The bank overdraft as per Cash Book on 31st December 2017 Rs. 6,340.
2. Interest on overdraft for 6 months ending 31st December 2017 Rs. 160 is entered in Pass Book.
3. Bank charges of Rs. 400 are debited in the Pass Book only.
4. Cheques issued but not cashed prior to 31st December, 2017, amounted to Rs.11,68,000.
5. Cheques paid into bank but not cleared before 31st, December 2017 were for Rs. 22,17,000.
6. Interest on investments collected by the bank and credited in the Pass Book Rs.12,00,000.

Question: 4

On 30th September 2017, the bank account of X, according to the bank column of the Cash- Book, was over drawn to the extent of Rs. 4,062. On the same date the bank statement showed a debit

balance of Rs.20,758 in favour of X. An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for Rs.13,14,000 deposited on 29th September 2017 was credited by the bank only on 3rd October 2017
2. A payment by cheque for Rs.16,000 has been entered twice in the Cash Book.
3. On 29th September 2017, the bank credited an amount of Rs.1,17,400 received from a customer of X, but the advice was not received by X until 1st October 2017.
4. Bank charges amounting to Rs.580 had not been entered in the Cash Book.
5. On 6th September 2017, the bank credited Rs.20,000 to X in error.
6. A bill of exchange for Rs.1,40,000 was discounted by X with his bank. This bill was dishonoured on 28th September 2017, but no entry had been made in the books of X.
7. Cheques issued up to 30th September 2017 but not presented for payment up to that date totalled Rs.13,26,000.

You are required:

- a. to show the appropriate rectifications required in the cash Book of X, to arrive at the correct balance on 30th September 2017. And
- b. to prepare a bank reconciliation statement as on that date.

Question: 5

On 30th December 2017 the bank column of A. Philip's cash book showed a debit balance of Rs. 4,610. On examination of the cash book and bank statement you find that:

1. Cheques amounting to Rs. 6,30,000 which were issued to trade payables and entered in the cash book before 30th December 2017 were not presented for payment until that date.
2. Cheques amounting to Rs. 2,50,000 had been recorded in the cash book as having been paid into the bank on 30th December 2017 but were entered in the bank statement on 1st January 2018.
3. A cheque for Rs. 73,000 had been dishonoured prior to 30th December 2017, but no record of this fact appeared in the cash book.
4. A dividend of Rs. 3,80,000, paid direct to the bank had not been recorded in the cash book.
5. Bank interest and charges amounting to Rs.4,200 had been charged in the bank statement but not entered in the cash book.
6. No entry had been made in the cash book for a trade subscription of Rs. 10,000 paid vide banker's order in November 2017.
7. A cheque for Rs.27,000 drawn by B. Philip had been charged to A. Philip's bank account by mistake in December 2017.

You are required:

- a. to make appropriate adjustments in the cash book bringing down the correct balance, and
- b. to prepare a statement reconciling the adjusted balance in the cash book with the balance shown in the bank statement.

Question: 6

From the following information, prepare a Bank reconciliation statement as at 31st December 2017 for Messrs New Steel Limited:

(1)	Bank overdraft as per Cash Book on 31 st December, 2017	22,45,900
(2)	Interest debited by Bank on 26 th December 2017, but no advice received	2,78,700

(3)	Cheque issued before 31 st December 2017 but not yet presented to Bank	6,60,000
(4)	Transport subsidy received from the State Government directly by the Bank but not advised to the company	14,25,000
(5)	Draft deposited in the Bank, but not credited till 31 st December, 2017	13,50,000
(6)	Bills for collection credited by the Bank till 31 st December 2017 but no advice received by the company	8,36,000
(7)	Amount wrongly debited to company account by the Bank, for which no details are available	7,40,000

Question: 7

The Cash Book of Mr. Gadbadwala shows Rs.8,36,400 as the balance at Bank as on 31st December 2017, but you find that it does not agree with the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies:

1. On 15th December 2017 the payment side of the Cash Book was undercast by Rs.10,000.
2. A cheque for Rs.1,31,000 issued on 25th December 2017 was not taken in the bank column.
3. One deposit of Rs.1,50,000 was recorded in the Cash Book as if there is no bank column therein.
4. On 18th December 2017 the debit balance of Rs.15,260 as on the previous day, was brought forward as credit balance.
5. Of the total cheques amounting to Rs.11,514 drawn in the last week of December 2017, cheques aggregating Rs.7,815 were encashed in December.
6. Dividends of Rs.25,000 collected by the Bank and subscription of Rs.1,000 paid by it were not recorded in the Cash Book.
7. One out-going Cheque of Rs.3,50,000 was recorded twice in the Cash Book.

Prepare a Reconciliation Statement

Question: 8

When Nikki & Co. received a Bank Statement showing a favourable balance of Rs.10,39,200 for the period ended on 30th June 2017, this did not agree with the balance in the cash book.

An examination of the Cash Book and Bank Statement disclosed the following:

1. A deposit of Rs.3,09,200 paid on 29th June 2017 had not been credited by the Bank until 1st July 2017.
2. On 30th March 2017 the company had entered into hire purchase agreement to pay by bank order a sum of Rs.3,00,000 on the 10th of each month, commencing from April 2017. No entries had been made in Cash Book.
3. A customer of the firm, who received a cash discount of 4% on his account of Rs.4,00,000 paid the firm a cheque on 12th June. The cashier erroneously entered the gross amount in the bank column of the Cash Book.
4. Bank charges amounting to Rs.3,000 had not been entered in Cash Book.
5. On 28th June, a customer of the company directly deposited the amount in the bank Rs. 4,00,000, but no entry had been made in the Cash Book.
6. Rs.11,200 paid into the bank had been entered twice in the Cash Book.
7. A debit of Rs. 11,00,000 appeared in the Bank Statement for an unpaid cheque, which had been returned marked 'out of date'. The cheque had been re-dated by the customer and paid into Bank again on 5th July 2017.

Prepare Bank Reconciliation Statement on 30 June 2017.

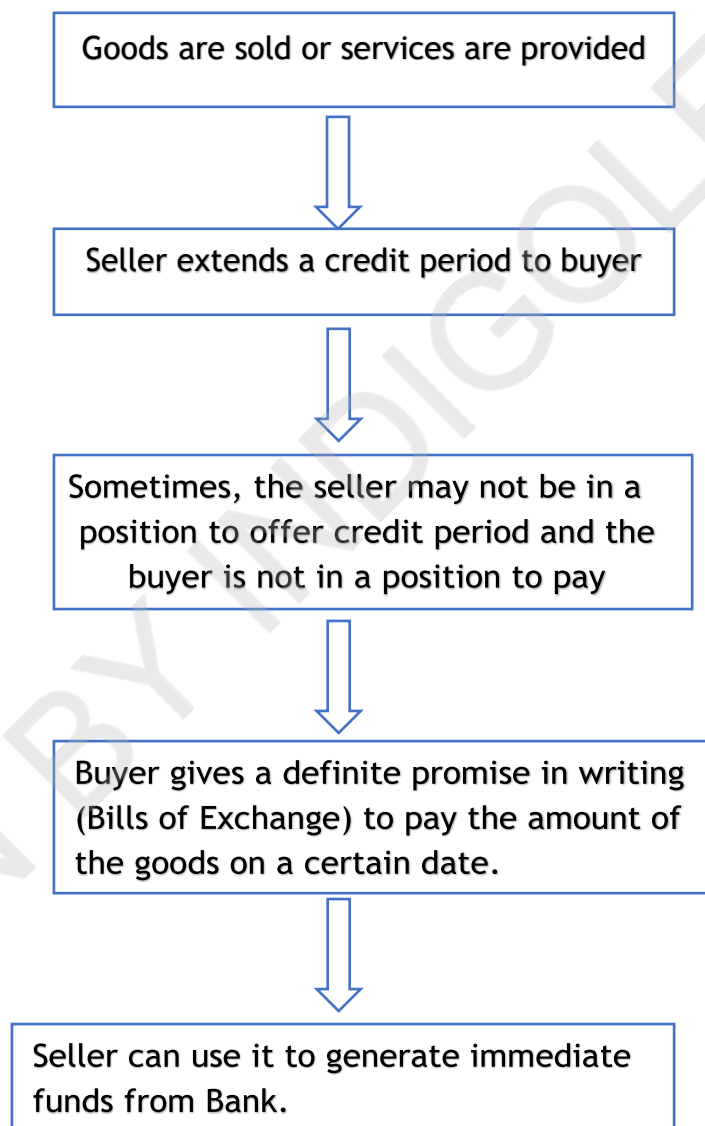
Chapter 12 - Bills of Exchange and Promissory Note

1. BILLS OF EXCHANGE

❖ Definition

- Instrument in **writing**,
- Containing an **unconditional order** signed by the maker,
- **Directing** certain person to pay a certain sum of money
- Only to or to the order of a **certain** person or to the bearer of the instrument.
- When such an order is **accepted** in writing on the face of the order itself,
- It becomes a valid bill of exchange.

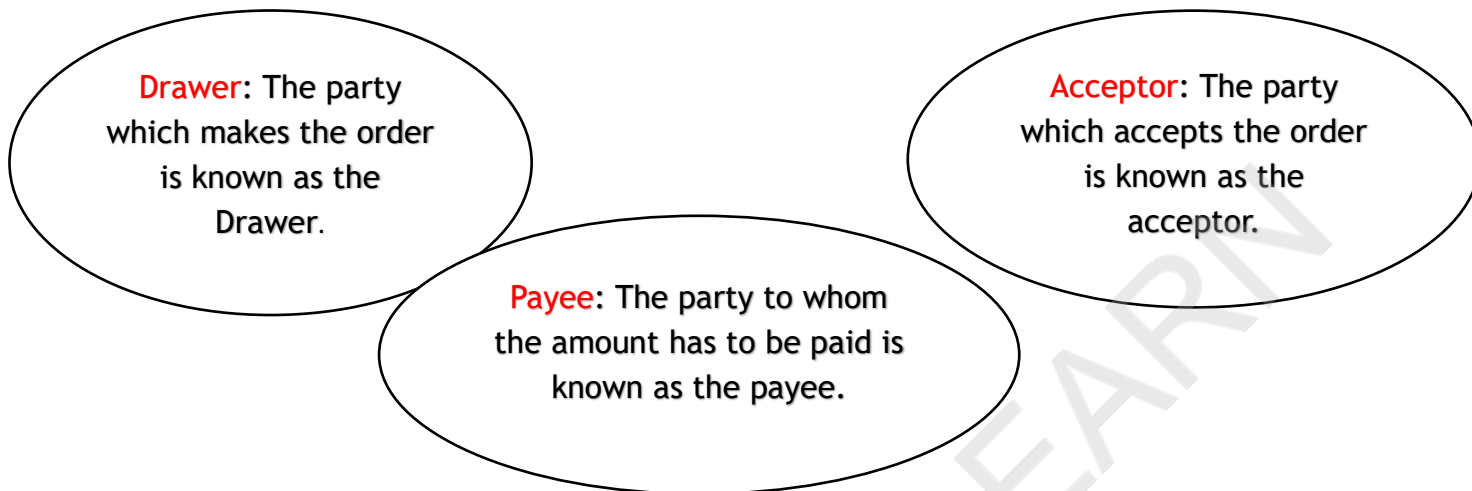
❖ Concept



• Characteristics

- It must be in **writing**.
- It must be **dated**.
- It must contain an **order** to pay a certain sum of money.
- The promise to pay must be **unconditional**.
- The money must be payable to a **definite person** or to his order to the bearer.

- The draft must be **accepted for payment** by the party to whom the order is made.
- It should be properly **stamped**.
- Payment must be in **legal currency** of the country.
- A Bill of Exchange can be passed on to another person by **endorsement**.



- **Foreign Bill of Exchange**

- A bill of exchange drawn for **foreign trade operations** known as Foreign Bill of Exchange.
- A foreign bill of exchange is one which is drawn in one country and is payable in another.
- It is generally drawn up in **triplicate** wherein each copy is sent by separate post so that at least one copy reaches the intended party.
- Payment will be made only on **one of the copies** and when such payment is made the other copies become useless.

Example

1. A bill drawn in India on a person resident outside India and made payable outside India.
2. A bill drawn outside India on a person resident outside India.
3. A bill drawn outside India and made payable in India.
4. A bill drawn outside India and made payable outside India.

2. PROMISSORY NOTES

- **Definition**

- A promissory note is an **instrument in writing**,
- Not being a bank note or currency note
- Containing an **unconditional undertaking** signed by the maker to pay a certain sum of money
- Only to or to the order of a **certain person**.

- **Characteristics**

- It must be in **writing**.
- It must contain a clear **promise to pay**. Mere acknowledgement of a debt is not a promissory note.
- The promise to pay must be **unconditional** "I promise to pay 50,000 as soon as I can" is not an unconditional promise.

- The promiser or maker must **sign** the promissory note.
- The maker must be a **certain person**.
- The payee (the person to whom the payment is promised) must also be **certain**.
- The sum payable must be **certain**. "I promise to pay 50,000 plus all fine" is not certain.
- Payment must be in **legal currency** of the country.
- It should not be made payable to the **bearer**.
- It should be properly **stamped**.
- It does not require any **acceptance**.

3. BILLS OF EXCHANGE V/S PROMISSORY NOTES

BILLS OF EXCHANGE	PROMISSORY NOTE
A bill contains an unconditional order to pay.	A promissory note contains only a promise to pay certain sum of money.
There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange.	There are 2 parties (Maker and Payee) in promissory note.
A bill is paid by Acceptor.	A promissory note is paid by maker.
A bill is drawn by creditor.	A promissory note is made by debtor.
The drawer and payee may be same person in case of bill of exchange	In promissory note maker and payee cannot be same person.
In a bill of exchange the liability of drawer is secondary and conditional.	In a promissory note the liability of a maker is primary and absolute.
A bill of exchange can be accepted conditionally.	A promissory note cannot be made conditionally.
In a bill of exchange, notice of dishonor must be given.	Notice of dishonor is not required in case of promissory note.
In case of dishonor, a bill of exchange must be noted and protested.	Noting and protest is not required in case of dishonor of a promissory note.

4. TERM OF A BILL

1) When a bill is drawn **after sight**

Term of the bill: Begins from the date of 'sighting' i.e. when the bill is accepted.

2) When a bill is drawn **after date**

Term of the bill: Begins from the date of drawing the bill.

5. EXPIRY /DUE DATE OF BILL

- The date on which the term of the bill terminates is called as '**Expiry/Due Date of the bill**'.

6. DAY OF GRACE

- Every instrument payable otherwise than on demand entitled to **three days** of grace.

7. DATE OF MATURITY OF BILL

- The date which comes after adding **three days** to the expiry/due date of a bill, is called the **date of maturity**.
- The maturity of a promissory note or bill of exchange is the date at which it **falls due**.
- Every promissory note or bill of exchange gets matured on the third day after the day on which it is expressed to be payable, except when it is expressed to be payable
 - i. on **demand**,
 - ii. at **sight**, or

8. BILL AT SIGHT

- Bill at Sight means the instruments in which **no time** for payment is mentioned.
- A promissory note or bill of exchange is payable **on demand**-
 - when **no time** for payment is specified, or
 - when it is **expressed** to be payable on demand, or at sight or on presentment.

Point to be remember

- ❖ At sight' and 'presentment' means **on demand**.
- ❖ An instrument payable on demand may be **presented for payment** at any time.
- ❖ **Days of grace** is not to added to calculate maturity for such types of bill.
- ❖ A **cheque** is always payable on demand.

9. BILL AFTER DATE

- Bill after date means the instrument in which **time for payment** is mentioned.
- A promissory note or bill of exchange is a time instrument when it is expressed to be payable-
 - After a **specified period**.
 - on a **specific day**
 - after **sight**
 - on the happening of event
Which is **certain to happen**.

Point to be remember

The expression 'after sight' means-

- ❖ *In a promissory note, after presentment for sight.*
- ❖ *In a bill of exchange, after acceptance or noting for non-acceptance or protest for non-acceptance.*

- A cheque cannot be a time instrument because the cheque is always payable on demand.
- Though a cheque can be postdated and which can be presented on or after such date.
- A cheque has validity of 90 days from its date after that it becomes void, normally termed as 'Stale Cheque' as bank will not honour such cheque.

9. BILL AFTER DATE

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10. CALCULATION OF DUE DATE OF A BILL

When the bill is made payable on a specific date.

That specific date will be the due date

When the bill is made payable at a stated number of months(s) after date.

That date on which the term of the bill shall expire will be the due date.

When the bill is made payable at a stated number of days after date.

That date which comes after adding stated number of days to the date of bill, shall be the due date.

Note : the date of bill is excluded

When the due date is a public holiday.

The preceding business day will be the due date.

When the due date is an emergency/due unforeseen holiday.

The next following day will be the date.

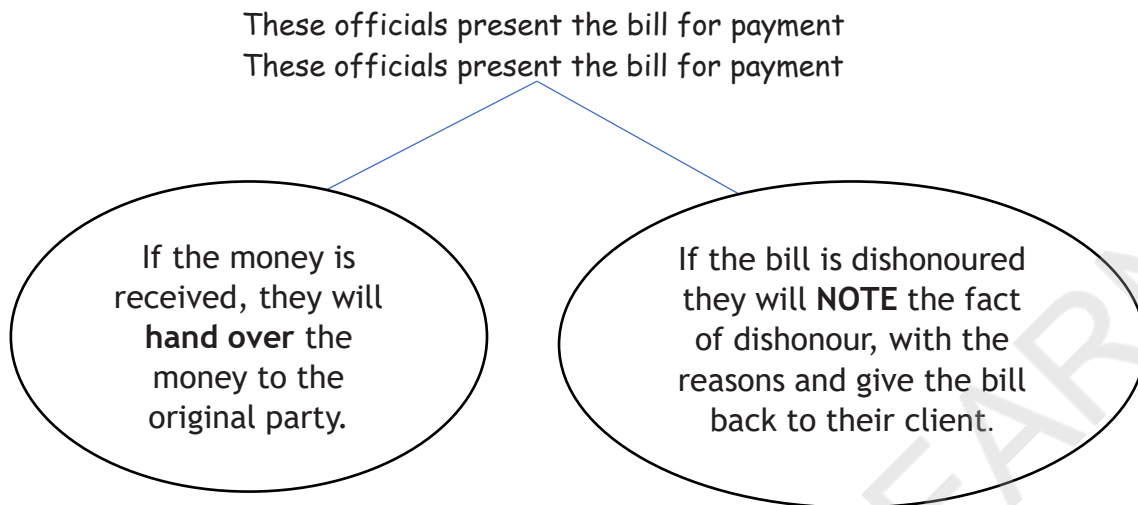
Point to be remember

1) When the bill is made payable at a stated number of months(s) after date, the **term** shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month. For example, a bill signed on January 31st payable after 3 months will be due on April 30th.

2) The term of a **Bill after sight** commences from the date of acceptance of the bill whereas the term of a bill after date commences from the date of drawing of bill.

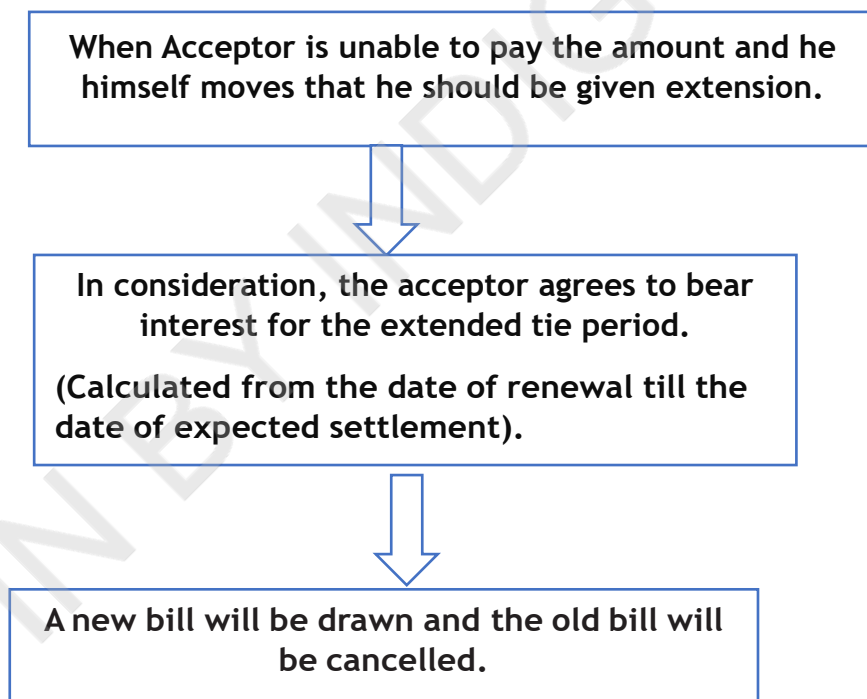
11. NOTING CHARGES

- When the acceptor denies the payment of bill then it leads to dishonor of bill.
- If there is dishonour, or fear of dishonour, the bill will be given to a public official known as "**Notary Public**".



- For doing this activity, the officer charges a small fee known as **noting charges**. The amount of noting charges is recoverable from the party which is responsible for dishonour.

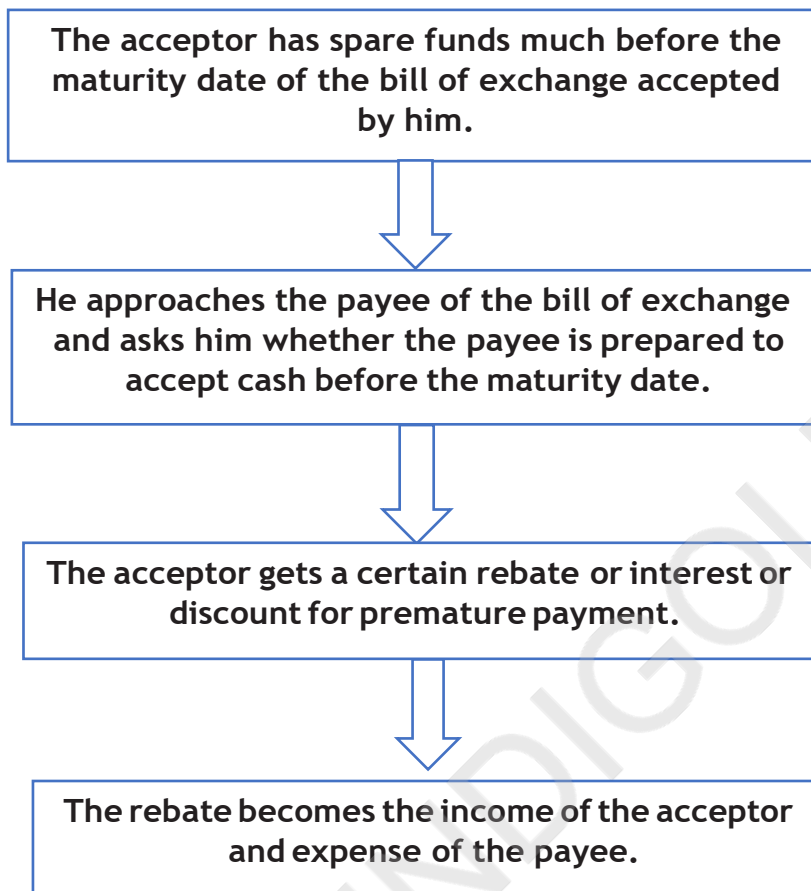
12. RENEWAL OF BILL



The amount of the new bill may represent any of the following

- 1) Where the drawee pays nothing: **Total of amount of original bill as well as the interest for the extended time period.**
- 2) Where the drawee pays the interest amount at the time of renewal: **Amount of the Original bill.**
- 3) Where the drawee makes part payment of the original bill: **that part of total of amount of original bill remain unpaid as well as the interest for the extended**

13. RETRIEMENT OF BILLS OF EXCHANGE AND REBATE



14. ACCOMODATION BILLS

- The mechanism of bill can be used to raise finance without doing any trading activity.

For example: Sanju and Manju are two friends. Sanju needs fund for three months. . In that case he may persuade his friend Manju to accept his draft. The bill of exchange may then be taken by Sanju to his bank and get it discounted there. Thus, Sanju will be able to make use of funds.

When the three months period expires Sanju will send the requisite amount to Manju and Manju will meet the bill.

- The same mechanism can be use when both the party needs money. In that case the proceeds divided between the drawer and drawee according to mutual concern. The discounting charges must also be borne by the two parties in the same ratio in which the proceeds are divided.
- It may so happen that the drawer is not able to remit the proceeds to drawee on the due date.

In such a case, the drawee may draw a bill on the drawer, and get it discounted with the bank to honour the first bill.

15. BILL RECEIVABLE AND BILL PAYABLE BOOKS

- Bills receivable and bills payable books are **journals** (Day Books) to record in a **chronological order** the details of bills receivable and bills payable.
- When **large number** of bill transactions take place in an organization, it is convenient to maintain these books.
- Wherein any bill transaction takes place, the same is entered in the Day Books in the first instance and then the posting to respective debtor or creditor and to Bills Receivable or Bills Payable account done from the day book.
- Useful for **following up** the status of outstanding bills.

16. JOURNAL ENTRIES IN BOOKS OF DRAWER

Particular	Amount
<u>On receipt of Bill</u>	
Bills Receivable Account Dr.	
To Drawee/Maker of the note	
<u>On Endorsement in favour of another Party(say Z)</u>	
Z A/c Dr.	
To Bills Receivable Account	
<u>On discounting with bank</u>	
Bank Account Dr. (with the amount actually received	
Discount Account Dr. (with the amount of loss or discount)	
To Bills Receivable Account	
<u>On the date of maturity (Bill is honoured)</u>	
Cash Account Dr.	
To Bills Receivable Account	
<u>On the date of maturity (Bill is dishonoured)</u>	
1. If the bill was kept till maturity then	
Drawee / Maker of the note Dr.	
To Bills Receivable Account	
2. If the bill was endorsed in favour of a creditor, the entry is :	
Drawee / Maker of the note Dr.	
To Bill payables	
3. If the bill was discounted with the bank :	
Drawee / Maker of the note Dr.	
To Bank A/c	
<u>Entry for Noting charges</u>	

1. Suppose X received from Y a bill for 1,000. On Maturity the bill is dishonoured and 10 is paid as noting charges. The entry in this case will be	
Y A/c Dr.	1,010
To Bills Receivable Account To Bank A/c	1,000 10
2. Suppose X had endorsed this bill in favour of Z	
Y A/c Dr.	1,010
To Z <i>This is because Z will claim 1,010 from X and X has the right of recovering 1,010 from Y.</i>	1,010
3. If the bill has been discounted with a bank, entry will be	
Y Dr.	1,010
To Bank A/c	1,010
<u>In case of Insolvency</u>	
1. When drawee become insolvent	
Drawee A/c Dr.	
To Bills Receivable A/c	
2. When something received from estate	
Cash A/c Dr.	
To Drawee A/c	
3. Entry for Irrecoverable Amount	
Bad debt A/c Dr.	
To Drawee A/c	
• <u>In case of Renewal of bill</u>	
1. Cancellation of original Bill	
<i>Entries are same as explained for dishonour of bill.</i>	
2. Entry for New bill	
Bills Receivable A/c Dr.	
To Drawee A/c	
3. In case of interest charged for new period	

Bills Receivable A/c	Dr.	
To Drawee A/c		
To Interest Income A/c		
<u>In case of Retirement of Bill</u>		
Cash/ Bank A/c	Dr.	
Rebate on bills account	Dr.	
To Bills Receivable A/c		

17. JOURNAL ENTRIES IN BOOKS OF DRAWEE

Particular	Amount
On acceptance of Bill	
Drawer A/c	Dr.
To Bills Payable A/c	
On the date of maturity (Bill is honoured)	
Bills Payable A/c	Dr.
To Cash/Bank A/c	
On the date of maturity (Bill is dishonoured)	
Bills Payable A/c	Dr.
To Drawer A/c	
Entry for Noting charges	
Legal expense A/c	Dr.
To Drawer A/c	
In case of Insolvency	
1. When drawee become insolvent	
Bills Payable A/c	Dr.
To Drawer A/c	
2. When final settlement Made	
Drawer A/c	Dr.
To Cash/Bank A/c	
3. Entry for short payment	
Drawer A/c	Dr.
To Deficiency A/c	
<u>In case of Renewal of bill</u>	
Cancellation of original Bill	
Bills Payable A/c	Dr.

To Drawer A/c	
Entry for New bill	
Drawer A/c	Dr.
To Bills Payable A/c	
In case of interest charged for new period	
Drawer A/c	Dr.
Interest Charged A/c	Dr.
To Bills Payable	
In case of Retirement of Bill	
Bills Payable	Dr.
To Cash / Bank	
To Rebate on bill discount	

18. BILLS OF COLLECTION

Particular	Amount
Entries for Bills for Collection Process	
Bills for Collection Account	Dr.
To Bills Receivable Account	
When the amount is realized the entry will be	
Bank Account	Dr.
To Bills for Collection Account	
When the amount is not honoured, the entry will be	
Party (from whom the bill was received)	Dr.
To Bills for collection A/c	

Question: 1

Vijay sold goods to Pritam on 1st September 2016 for Rs. 1,06,000. Pritam immediately accepted three months bill. On due date Pritam requested that the bill be renewed for a fresh period of two months. Vijay agrees provided interest at 9% was paid immediately in cash. To this Pritam was agreeable. The second bill was met on due date.

Give Journal entries in the books of Vijay and Pritam.

Question: 2

On 1st January 2016, Ankita sells goods for Rs 5,00,000 to Bhavika and draws a bill at three months for the amount. Bhavika accepts it and returns it to Ankita. On 1st March 2016, Bhavika retires her acceptance under rebate of 12% per annum.

Record these transactions in the journals of Ankita and Bhavika.

Question: 3

Journalize the following transactions in K. Katrak's books
--

1	Katrak's acceptance to Basu for Rs 2,500 discharged by a cash payment of Rs 1,000 and a new bill for the balance plus Rs 50 for interest
2	G. Gupta's acceptance for Rs 4,000 which was endorsed by Katrak to M. Mehta was dishonored. Mehta paid Rs 20 noting charges. Bill withdrawn against cheque
3	D. Dalal retires a bill for Rs 2,000 drawn on him by Katrak for Rs 10 discount
4	Katrak's acceptance to Patel for Rs 5,000 discharged by Patel. Mody's acceptance to Katrak for a similar amount

Question: 4

On 1st January, 2016, Vilas draws a Bill of Exchange for Rs. 10,000, due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2016, Eknath retires the bill of exchange at a discount of 12% p.a.

You are asked to show the journal entries in the books of Vilas.

Question: 5

Mr. David draws two bills of exchange on 1.1.2016 for Rs 6,000 and Rs 10,000. The bills of exchange for Rs 6,000 is for two months while the bill of exchange for Rs 10,000 is for three months. These bills are accepted by Mr. Thomas.

On 4.3.2016, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of two months. Mr. David agrees to this proposal. On 20.3.2016, Mr. Thomas retires the acceptance for Rs 10,000, the interest rebate i.e. discount being Rs 100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

Question: 6

Rita owed Rs. 1,00,000 to Siriman.

- On 1st October, 2016, Rita accepted a bill drawn by Siriman for the amount at 3 months
- Siriman got the bill discounted with his bank for Rs. 99,000 on 3rd October, 2016
- Before the due date, Rita approached Siriman for renewal of the bill.
- Siriman agreed on the conditions that Rs. 50,000 be paid immediately together with interest on the remaining amount at 12% per annum for 3 months and for the balance, Rita should accept a new bill at three months
- These arrangements were carried out
- But afterwards, Rita became insolvent and 40% of the amount could be recovered from his estate

Pass journal entries (with narration) in the books of Siriman.

Question: 7

On 1st July, 2016 Gorge drew a bill for Rs. 1,80,000 for 3 months on Harry for mutual accommodation.

- Harry accepted the bill of exchange
- Gorge had purchased goods worth Rs. 1,81,000 from Jack
- On the same date Gorge endorsed Harry's acceptance to Jack in full settlement
- On 1st September, 2016, Jack purchased goods worth Rs. 1,90,000 from Harry
- Jack endorsed the bill of exchange received from Gorge to Harry and paid Rs. 9,000 in full settlement of the amount due to Harry

- On 1st October, 2016, Harry purchased goods worth Rs. 2,00,000 from Gorge
- Harry paid the amount due to Gorge by cheque

Give the necessary Journal Entries in the books of Harry and Gorge.

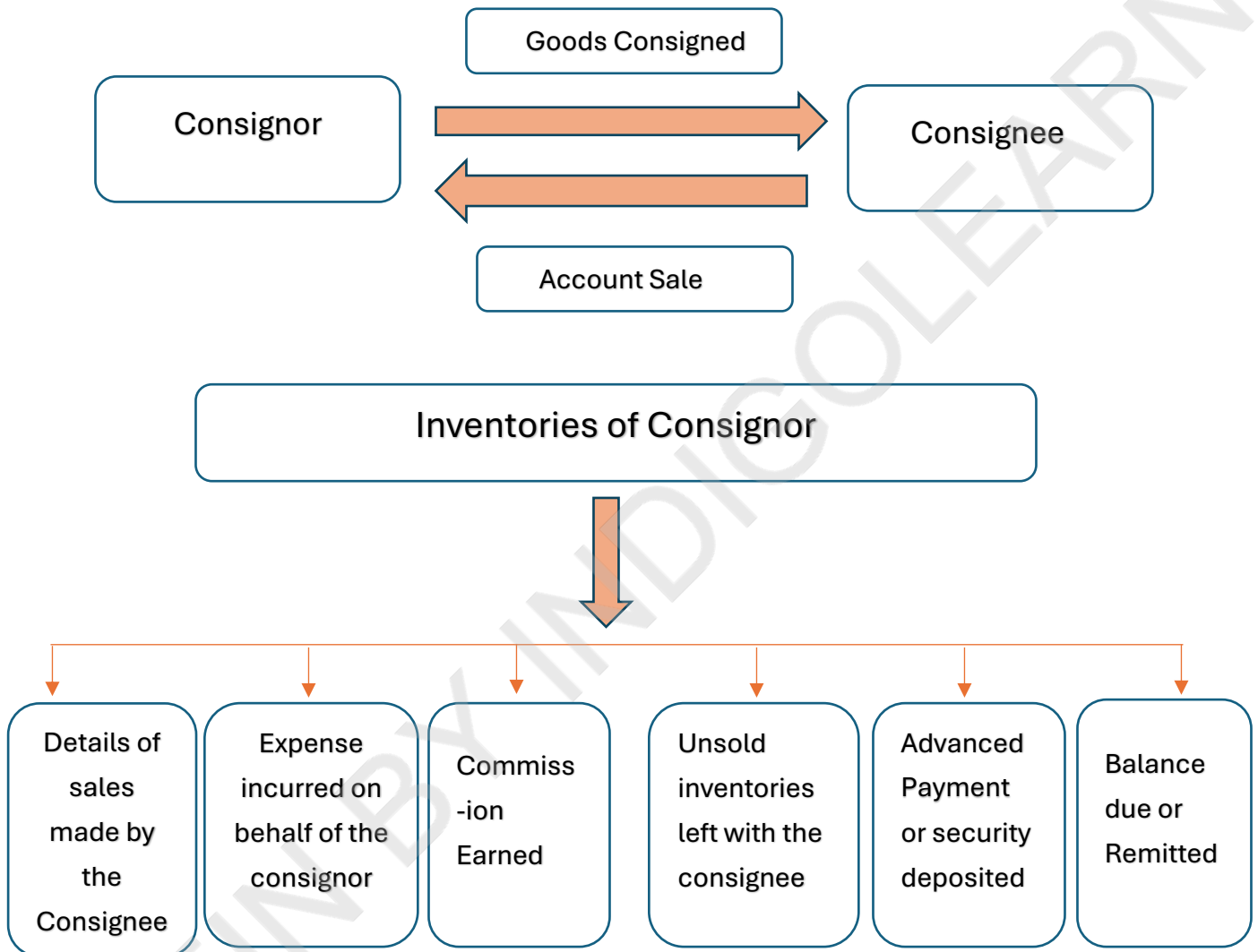
Question: 8

For the mutual accommodation of 'X' and 'Y' on 1st April, 2016, 'X' drew a four month's bill on 'Y' for Rs. 4,000

- 'Y' returned the bill after acceptance of the same date
- 'X' discounts the bill from his bankers @ 6% per annum and remit 50% of the proceeds to 'Y'
- On due date 'X' is unable to send the amount due and therefore 'Y' draws a bill for Rs. 7,000, which is duly accepted by 'X'
- 'Y' discounts the bill for Rs. 6,600 and sends Rs. 1,300 to 'X'
- Before the bill is due for payment 'X' becomes insolvent. Later 25 paise in a rupee received from his estate

Record Journal entries in the books of 'X'.

Chapter 13 - Consignment



2. MEANING OF CONSIGNMENT ACCOUNT

❖ Definition



Ram Send good to Shyam

On a condition that the goods



To Consign
means to Send

Principal
(Mr. Ram)

Will be sold on behalf of and at
the risk of Ram.

Agent
(Mr. Shyam)

Ownership: Remains with the consignor or the **principal**.

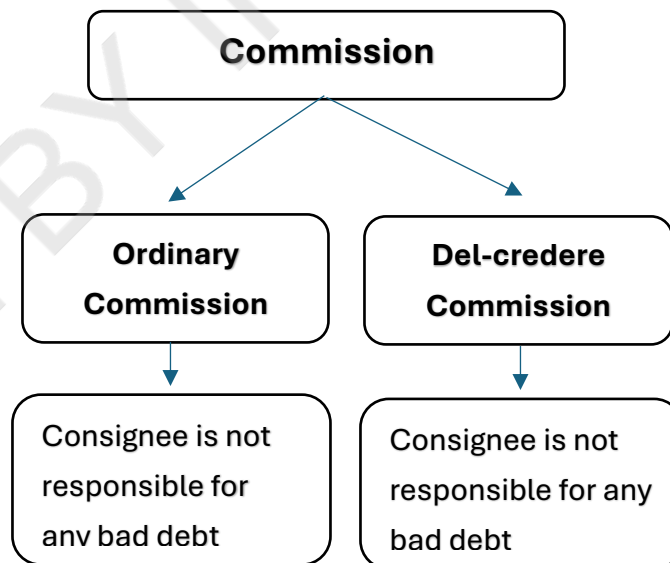
Invoicing : Consignor does not send an invoice. He only sends a **proforma invoice**.

What is Proforma Invoice?

It is a statement conveying information to the consignee regarding **particulars of the good sent**. It looks like an invoice.

❖ Features

- The consignee recovers from the consignor all **expenses** incurred by him on the consignment. This however can be changed by agreement between the two parties
- It is also usual for the consignee to give an **advance to the consignor** in the form of cash or a bill of exchange.
- The consignee receives a commission calculated on the basis of **gross sale**. It is calculated on total sale and not merely on credit sale.



- Periodically, the consignees send to the consignor a statement called **Account Sales**.

What is Account Sales?

- It sets out the **sales** made by the consignee
- The **expenses** incurred on behalf of the consignor

- The **commission earned** by the consignee and
- The **balance** due to the consignor.

Firms usually like to ascertain the profit or loss on each consignment or consignments to each consignee.

3. DISTINCTIONS

❖ Consignment And Sale

S.No.	Consignment	Sale	Basis
1.	Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee.	The ownership of the goods transfers with the transfer of goods from the seller to the buyer.	Ownership
2.	The consignee can return the unsold goods to the consignor.	Goods sold are the property of the buyer and can be returned only if the seller agrees	Return
3.	Consignor bears the loss of goods held with the consignee.	It is the buyer who will bear the loss if any, after the transfer of goods.	Onus of loss
4.	The relationship between the consignor and the consignee is that of a principal and agent.	The relationship between the seller and the buyer is that of a creditor and a debtor.	Relationship
5.	Expenses done by the consignee to receive the goods and to keep it safely are borne by the consignor unless there is any other agreement.	Expenses incurred by the buyer are to be borne by the buyer itself after the transfer of goods.	Expenses

❖ Commission and Discount

Commission

Discount

Commission may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved. Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.

The term discount refers to any reduction or rebate allowed and is used to express one of the following situations:
An allowance given for the settlement of a debt before it is due i.e., cash discount. An allowance given to the whole sellers or bulk buyers on the list price or retail price, known as trade discount. A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.

4. ACCOUNTING IN BOOKS OF CONSIGNOR

- A separate consignment account has to be prepared for **each consignment**.
- Each consignment account is a **nominal-cum-personal account**.
- Each consignment account constitutes a **profit and loss account** in respect of the transactions to which it relates.

PARTICULAR	AMOUNT	COMMENTS
1. When goods are consigned or dispatched		
Consignment Account Dr.		The personal account of consignee is not debited and also sales account is not credited.
To Goods Sent on Consignment Account		
2. Expenses incurred by consignor		
Consignment Account Dr.		Unlike normal practice to debiting expense accounts first and then transferring to profit and loss account, expenses are directly debited to consignment account
To Supplier Account/Bank/Cash		

3. When advance is received from the consignee		The consignee may remit some advance to consignor.
Bank/Cash Account	Dr.	
To Consignee's Personal Account		
4. On receipt of account sales from the consignee		
For sales proceeds		
Consignee's Personal Account	Dr.	Account sales contains details of sales made by consignee.
To Consignment Account		
For expenses incurred by consignee		
Consignment Account	Dr.	expenses incurred by consignee
To Consignee's Personal Account		
5. Cash or cheque or bank draft or bill of exchange/promissory note received from the consignee as settlement		
Cash/Bank/Bills Receivable Account	Dr.	
To Consignee's Personal Account		
6. For bad debts		
When del-credere commission is not paid to the consignee		
Consignment Account	Dr.	Entry is for Bad debt and not for commission
To Consignee's Personal Account		
When del-credere commission is paid to the consignee		
No entry is recorded as bad debts is to be borne by consignee		
7. For the goods taken over by the consignee		
Consignee's Personal Account		
Dr.		
To Consignment Account		
8. For unsold consignment stock		
Consignment Stock Account		
Dr.		

To Consignment Account		
9. For commission payable to consignee		
Consignment Account	Dr.	
To Consignee's Personal Account		

5. VALUATION OF INVENTORIES

Principle: Inventories should be valued at cost or net realizable value whichever is lower.

In the case of consignment

Cost means cost of the goods to the consignor + all expenses incurred till the goods reach the premises of the consignee

Examples of expense

- | | |
|--------------|-------------------------|
| 1) Packaging | 2) Freight |
| 3) Cartage | 4) Insurance in transit |
| 5) Octroi | 6) Import duty |

What is not include?

Expenses incurred after the goods have reached the consignee's godown.

Examples: Godown rent
Insurance of godown
Delivery charges
Salesman salaries.

If the expected selling price of inventories on hand is lower than the cost, the inventories should be valued at expected net selling price only, i.e. expected selling price less delivery expenses, etc.

6. GOODS INVOICED ABOVE COST

Scenario: The proforma invoice is made out at a value higher than the cost. Entries in the books of the consignor are made out on that basis.

Additional entries (before ascertaining profit) to remove the effect of loading:

PARTICULAR	AMOUNT	COMMENT
Goods sent on Consignment Account Dr.		reversed to the extent of loading in order to debit the Consignment A/c on cost basis
To Consignment Account		
Consignment Account Dr.		The amount of loading included in the value of the closing Inventories is unrealized profit - hence reserve is created by debit to the Consignment Account
To Inventory Reserve Account		

7. NORMAL LOSS

- Normal loss would be spread over the entire consignment while valuing inventories.
- No entry is recorded for normal loss.
- Normal loss considered as an expense for valuation of remaining inventory.

Cost per unit: $(\text{total cost} + \text{normal loss}) / \text{total quantity}$.

8. ABNORMAL LOSS

- Abnormal loss is any accidental or unnecessary loss occurs.
- This amount should be credited to the Consignment Account and debited to the P&L A/c.
- Abnormal loss cannot be considered in valuing the stock.
- Abnormal loss is valued just like inventories in hand.
- For the purpose of valuation of inventory in hand, it should be noted that while normal loss is considered as part of cost of remaining goods, whereas abnormal loss is ignored.

Special case

Valuing goods lost in transit : Consignee's non-recurring expenses are not included.

Valuing goods lost in consignee's godown : Consignee's non-recurring expenses are included.

❖ Distinction between Normal loss and abnormal loss

Basis	Normal loss	Abnormal loss
Occurrence	Normal loss occurs due to inherent nature of the goods being shipped e.g. leakage, evaporation, loss of perishable goods etc.	Abnormal loss occurs mainly because of unforeseen events e.g. accident or natural calamity etc.
Time of Accounting	Normal loss is not accounted for immediately and is loaded on the remaining goods. It gets accounted for as cost of remaining goods as and when they are sold.	Abnormal loss is accounted for immediately in profit and loss account.
Impact on gross profit	As normal loss is added to cost of remaining goods, it impact gross profit.	Abnormal loss does not impact gross profit.
Coverage by Insurance Co.	Insurance companies generally do not cover normal loss as it is expected to be incurred on each consignment or storage of goods.	Insurance is generally available for abnormal losses.
Certainty	Normal loss is almost certain however it may vary from time to time.	Abnormal loss is because of unforeseen events and is not certain.

❖ Journal Entries

PARTICULAR	AMOUNT	COMMENT
Abnormal Loss Account Dr.		
To Consignment Account		
Insurance Company's Account Dr.		If abnormal loss is recoverable from the insurance company.
To Abnormal Loss Account		

<i>Consignee's Personal Account</i>	<i>Dr.</i>	If abnormal loss is recoverable from the consignee.
<i>To Abnormal Loss Account</i>		
<i>Profit & Loss Account</i>	<i>Dr.</i>	If abnormal loss is not recoverable
<i>To Abnormal Loss Account</i>		

9. COMMISSION

- ❖ **Definition:** Commission is the remuneration paid by the consignor to the consignee for the services rendered to the former for selling the consigned goods.

Three Types of Commission

ordinary commission

- It is based on fixed percentage of the gross sales proceeds made by the consignee.
- It is given by the consignor regardless of whether the consignee is making credit sales or not.
- This type of commission does not give any protection to the consignor from bad debts and is provided on total sales.

Del-credere Commission

- To increase the sale and to encourage the consignee to make credit sales, the consignor provides an additional commission generally known as del-credere commission.
- This additional commission when provided to the consignee gives a protection to the consignor against bad debts.
- It is calculated on total sales unless there is any agreement between the consignor and the consignee to provide it on credit sales only.

Over-riding Commission

- It is an extra commission allowed by the consignor to the consignee to promote sales at higher price than specified.
- Depending on the agreement it is calculated on total sales or on the difference between actual sales and sales at invoice price or any specified price.
- In order to encourage the consignee to earn higher margins, it can also be in the form of share of additional profits made by consignee on sale of goods.

10. RETURN OF GOODS FROM THE CONSIGNEE

Consigned goods can be returned by the consignee because of many reasons like

- ◆ poor quality
- ◆ not upto the specimen
- ◆ Destroyed in transit etc.

What is the value of returned goods?

Valued at the price at which it was **consigned to the consignee**.

Special Point

Expenses incurred by the consignee to send those goods back to the consignor are not taken into consideration. This is generally called secondary freight in accounting terms.

11. ACCOUNT SALES

❖ **Definition:** An account sale is the periodical summary statement sent by the consignee
to the consignor

It contains details regarding:

- 1) sales made
- 2) Expenses incurred on behalf of the consignor.
- 3) Commission earned.
- 4) Unsold inventories left with the consignee.
- 5) Advance payment or security deposited with the consignor and the extent to which it has been adjusted.
- 6) Balance payment due or remitted.

It is a summary statement and is different from Sales Account

PARTICULAR	AMOUNT
1. On making sales	
Cash/Bank Account/Debtors Dr.	
To Consignor's Personal Account	
2. For expenses incurred and his commission	
Consignor's Personal Account Dr.	
To Bank Account	
3. For advance paid to consignor	
Consignor's Personal Account Dr.	
To Bank Account	
4. For recording bad debts	
Bad Debts Account Dr.	
To Customer's Account	
5. For writing out bad debts	
When del-credere commission is not allowed	
Consignor's Personal Account Dr.	
To Bad Debts Account	
When del-credere commission is allowed	
Commission Account Dr.	
To Bad Debts Account	

12. ACCOUNTING IN THE BOOKS OF CONSIGNEE

PARTICULAR	AMOUNT
1. On making sales	
Cash/Bank Account/Debtors Dr.	
To Consignor's Personal Account	
2. For expenses incurred and his commission	
Consignor's Personal Account Dr.	
To Bank Account	
3. For advance paid to consignor	
Consignor's Personal Account Dr.	
To Bank Account	
4. For recording bad debts	
Bad Debts Account Dr.	

To Customer's Account	
5. For writing out bad debts	
<i>When del-credere commission is not allowed</i>	
Consignor's Personal Account	Dr.
To Bad Debts Account	
<i>When del-credere commission is allowed</i>	
Commission Account	Dr.
To Bad Debts Account	

13. ADVANCE BY THE CONSIGNEE VS SECURITY AGAINST CONSIGNMENT

- The consignor insists the consignee for some advance payment for the goods consigned at the time of delivery of goods.
- This advance payment is adjusted in full against the amount due by the consignee on account of the goods sold.

Special case

If the advance money deposited by the consignee is in the form of security against the goods consigned.

- Then the full amount is not adjusted against the amount due by the consignee to the consignor on account of goods sold if, **there is any unsold inventory left with the consignee.**

In that case proportionate security in respect of **unsold goods** is carried forward till the time the respective goods held with the consignee are sold.

Chapter 14 – Joint Ventures

Introduction:

Joint venture is a short term business undertaking jointly by two or more persons who share the profits and losses in an agreed ratio. Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multi-skills. In such cases, an individual person may not be able to muster all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

Concept

A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity.

Characteristics

Following are the salient features of a joint venture form of business:

1. There is an agreement between two or more persons.
2. Joint venture is made for the specific execution of a business plan/project.
3. It is a temporary partnership without the use of a firm name.
4. Profit & Share are shared on the same terms and conditions agreed upon. However, in the absence of any agreement, profit & share will be divided equally.
5. The terms of the joint ventures are executed on a written agreement signed by all parties involved. This document will state that the parties are willingly assisting each other and will contain other terms as such durations, model of association, liabilities etc.
6. Joint ventures are of short duration. Such associations are temporary and comes to an end when the purpose of the agreement is served.

Parties in a Joint Venture

The parties who have agreed to undertake the joint venture are called Co-venturers or Joint venturers. It is exactly same as partnership, with the exception that it is one of the business that is to be terminated after the venture period is over, counting from the time from when it has started. Since it is to be terminated after the period of completion of the venture, the firm name is not generally used. It is a temporary partnership with or without firm name. If there is no agreement concerning the sharing of profits or losses between the co-venturers, it is shared equally by all the parties.

Difference between Joint Venture and Partnership

Partnership	Joint Venture
Always carried on with firm's name	No such firm's name is required
The persons who run the business are called as partners	The persons who agreed to take the project are called as co-venturers
Normally, a partnership is constituted for a long period	A joint venture is formed to complete a specific job/project.
Partnership is governed under the Partnership Act, 1932	There is no enactment of such kind for the joint ventures However, as a matter of fact in

	law, a joint venture is treated as a partnership
The number of partners is limited to 10 under banking business and 20 for any other trade or business.	There is no limit specified for the numbers of co-venturers
Liability of a partner is unlimited and may extent to his business and personal estate	Liabilities of co-venturers are limited to the particular assignment or project agreed upon.

Difference between Joint Venture and Consignment

	Consignment	Joint Venture
Relationship	Relationship of a consignor and consignee is of owner and agent	The co-venturers of a Joint venture are the owners of a Joint venture
Sharing of Profits	There is no distribution of profit between a consignor and consignee, consignee only gets commission on sale made by him	The co-venturers of a joint venture share profits as per the agreed profit-sharing ratio.
Ownership of Goods	Ownership of the goods remains with the consignor. Consignor transfers only possession to the consignee	Every co-venturer of a joint venture is the co-owner of the goods/project
Contribution of Funds	Investment is done by the consignor only	Funds are contributed by all co-ventures in a certain agreed proportion.
Continuity of Business	Everything goes smooth, consignment is a continuous process.	There is no continuity of the business once project is completed

Accounting of Joint Venture

There are different methods of recording joint venture transactions. They can be broadly classified into two following methods:

1. When separate set of books are maintained
2. When separate set of books are not maintained.

Method I: When Separate Set Books are Maintained for the Joint Venture

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to ascertain the profit or loss on account of the joint venture. Generally, under this approach, the following accounts are maintained:

- a) Joint Venture account,
- b) Joint Bank account; and
- c) Co-venturers account.

- a. **Joint Venture account:** In this account, in the debit side all expenses (paid personally by the co venturers or out of join bank) irrespective of its nature (i.e capital or revenue) are recorded. In the credit side, all sales (to outsiders as well as to the co-venturers) are recorded. It records all transactions related to the activities carried out. The net result of this account will be either profit or loss.

- b. Joint Bank account:** To record cash/bank transactions a Joint Bank A/c is maintained. This is basically the cash book of the business. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution: of the venture All cash inflows are recorded in the debit side and the outflows are recorded in the credit side, Final settlement of the co venturers are lastly put into this account so that it tallies..
- c. Co-venturers account:** Co-Venturer's personal Accounts are maintained to record transaction related to co- venturers. It is like the capital account in the partnership business. Balance in this account refer to the claim of a co venture to/ from the business and is settled through the joint bank account.

The accounting entries are normally as follows:

1. Contribution made by the co Ventures
 Joint Bank A/c Dr.
 To, Co-Venturer Alc
2. Expenses paid through Joint Bank Account
 Joint Venture A/c Dr.
 To, Joint Bank A/c
3. Expenses paid or goods supplied by the co-venturers from private account
 Joint Venture A/C Dr.
 To Co-Venturer A/c
4. Sale proceeds or collections
 Joint Bank A/C Dr.
 To, Joint Venture A/c
5. Collections received by co-venturer
 Co-Venturer A/C Dr.
 To, Joint Venture A/C
6. Assets taken over by the co-venturer
 Co-Venturer A/c Dr.
 To, Joint Venture A/C
7. Liabilities taken over by the coventurers
 Joint Venture A/C Dr.
 To, Co-Venturer A/C
8. Profit on joint venture
 Joint Venture A/C Dr.
 To, Co-Venturer A/C
9. Loss on joint venture
 Co-Venturer A/c Dr.

To, Joint Venture A/c

10. Final settlement made to co-venturer

Co-Venturer A/c Dr.

To, Joint Bank A/c

Method II: When Separate Set of Books are Not Maintained for the Joint Venture

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank A/c is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also settled the same way.

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e. done by himself and by his co-venturer as well.

This method is generally applicable when the size of the business is small and co-venturers are operating from distant places.

(a) When each co-venturer keeps record of all transactions

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into account all transactions i.e. done by himself and by his co-venturer as well

The accounting entries (considering two co-venturers-A and B) are presented as under:

	In books of co-venturer A	In books of co-venturer B
When goods are supplied and expenses paid by A	Joint Venture A/c Dr. To, Purchases A/c To, Cash/ Bank A/c	Joint Venture A/c Dr. To, A's A/c
When goods are supplied by B and expenses paid by B	Joint Venture A/c Dr. To, B's A/C	Joint Venture A/c Dr. To, Purchases A/c To, Cash / Bank A/c
When advance is given by A to B or bill accepted by A	B's A/c Dr. To, Cash / Bank A/c To B/P A/C	Cash/ Bank A/c Dr. To, B/R A/C To, A's A/c
When sale proceeds are received by A	Cash/ Bank A/C Dr. To, Joint Venture A/c	A's A/C Dr. To, Joint Venture A/c
When sale proceeds are received by B	B's A/c Dr. To, Joint Venture A/c	Cash / Bank A/C Dr. To, Joint Venture A/c
For unsold goods taken over by A	Goods A/c Dr. To, Joint Venture A/c	A's A/c Dr. To, Joint Venture A/c
For unsold goods taken over by B	B's A/c Dr. To, Joint Venture A/C	Goods A/C Dr. To, Joint Venture A/c
For profit on joint venture business	Joint Venture A/c Dr. To, B's A/c To, P& LA/C	Joint Venture A/c Dr. To, A's A/c To, P&LA/c
For loss on joint venture business	B's A/C Dr. P&LA/C Dr. To, Joint Venture A/c	A's A/c Dr. P&LA/C Dr. To, Joint Venture A/c

(b) When each co-venturer keeps record of its own transactions (Memorandum method)

As a variation from this system, the co-venturers may decide to maintain a separate 'Memorandum Joint Venture A/c' in joint books. In this transactions made by each co-venturer is shown against their name, This account will reflect the profit or loss of the joint venture. The co-venturers will keep an account called "Joint venture with co-venturer A/c" wherein all transactions done by him only are recorded.

Each co-venturer sends a periodic statement of transactions effected by him for the joint venture to the other co-venturer. On the receipt of the above statement, each co-venturer prepares Memorandum Joint Venture Account for determining the profit/ loss from the joint venture. This account is not a double entry account by nature.

The journal entries which are required to be passed are as follows:

Particulars	Journal Entries
Amount received from co-venturer in cash / cheque or B/R	Cash/ Bank/ B/RA/C Dr. To, Joint Venture with Co-Venture's A/c
Discounting of Bills Receivable	Bank A/C Dr. Joint Venture with Co-venturer..A/c (Discount) Dr. To, B/RA/C
Purchase of goods	Joint Venture with Co-venturer...A/C Dr. To, Cash/ Bank Alc To, JV Creditors A/c
Making payment to Creditors (including discount received)	JV Creditors A/c Dr. To, Cash/ Bank/ B/P A/C To, Joint Venture with Co-venturer.... A/c
Goods supplied by co-venturer from own stock	Joint Venture with Co-venturer.. A/c Dr. To, Purchases A/c/ Goods sent to JV A/c
Payment of expenses	Joint Venture with Co-venturer... A/c Dr. To, Cash/ Bank A/c
Sale of goods	Cash/ Bank/ JV Debtors A/c Dr. To, Joint Venture with Co-venturer... A/c
Collection from customer (including bad debts discount allowed)	Cash/ Bank A/C Joint Venture with Co-venturer.... A/C (Amount of bad debts and discount allowed) To, JV Debtors A/c
Taking away of unsold goods	Goods sent to JVA/C Dr. To, Joint Venture with Co-venturer....A/c
Co-venturer entitled to commission/ salary etc	Joint Venture with Co-venturer... A/c Dr. To, Commission/ Salary A/c
Share of profit on joint venture	Joint Venture with Co-venturer.... A/c Dr. To, Profit & Loss A/c
Share of loss on joint venture	Profit & Loss A/C Dr. To, Joint Venture with Co-venturer.... A/c
Settlement of balance of JV with.... A/c	In case of debit balance Cash/ Bank A/c Dr. To, Joint Venture with Co-venturer....A/c

Chapter 15 - Final Accounts of Non-Manufacturing Entities

Financial Accounts of Non-Manufacturing Entities:

What is a Non-Manufacturing Entity?

Non-manufacturing entity is the entity, which is engaged in the purchase and sale of goods at profit without processing of those goods. Non-manufacturing entities sell the goods in its original form.

To ascertain the results of the business the entity prepares the income statement i.e. the Profit & Loss Statement and financial position i.e. Balance Sheet at the end of the accounting year.

Important Principles to be followed in preparation of Final Accounts:

The important principles to be followed in the preparation of the Final Accounts are as follow:

- i. Distinction should be made between capital and revenue receipts and payments.
- ii. Only the Income earned and Expense incurred in the current accounting period should be accounted for in the current accounting period.
- iii. All the different items of income and expenditure should be accumulated under major heads of income and expense to disclose the sources from which capital has been raised and the liabilities, which are outstanding for payment.
- iv. Distinction between Personal and Business Income should be maintained.
- v. All material information needs to be disclosed which can impact the decision of the users.

Matching Principle:

As per this principle the expenses incurred to earn the revenue should be properly matched in the same accounting period. The following point's needs to be taken care while recording the revenue and expense for the current period:

- i. If an item of revenue or income is recorded in the Trading or Profit and Loss Account then all the expenses relating to those revenue or income needs to be recorded in the same period Trading and Profit & Loss Account irrespective of the fact whether or not payment has been actually made.
- ii. If some expense has been incurred but the revenue for it will be received in the next year, the expense should be carried forward as an asset and shown in the Balance Sheet.

It will be debited to the Profit and Loss Account only when the relevant income will also be credited. This is the same logic based on which the depreciation on assets is charged.

- iii. In the similar manner if some income has been received but the expense for the same will be incurred in the next year, the income should be recorded as liability and shown in the Balance Sheet.

It will be credited to the Profit and Loss Account only when the relevant expense is debited.

- iv. Exception to the above rule is that costs which have been incurred or is expected to be incurred should only be debited to Profit and Loss Account. For example, if a fire has occurred and has damaged the firm's property the loss must be debited to the Profit and Loss Account to the extent it is not covered by insurance.

Trading Account:

Trading Account enables to compute the Gross Profit or Gross Loss occurred due to carrying out the business operations during the accounting period.

Gross Profit/Gross Loss is computed as the difference between the selling price and the Cost of Goods Sold. The Cost of Goods sold is computed using the following formula:

Opening Stock

Add: Purchases

Add: Direct Expenses

Less: Closing Stock

Cost of Goods Sold

Dr.	Trading Account for the year ended.....				Cr.
	Amount	Amount		Amount	Amount
To Opening Stock		XXX	By Sales	XXX	
To Purchases	XXX		Less: Sales Return	(XXX)	XXX
Less: Purchase Return	(XXX)	XXX			
			By Closing Stock		XXX
To Direct Expenses			By Gross Loss c/d (Either profit or loss)		
Freight & Carriage	XXX				
Insurance	XXX				
Wages	XXX				
Fuel	XXX				
Factory Expense	XXX				
Depreciation on Factory Equip	XXX	XXX			
By Gross Profit c/d (Either profit or loss)					
TOTAL		XXX	TOTAL		XXX

Accounting Entries related to Trading Account:

1. Opening Inventory:

Trading A/c Dr.

To Opening Stock

2. Purchases:

Purchase A/c Dr.

To Vendor/Cash A/c

Trading A/c Dr.

To Purchases

3. Purchase Return:

Purchase Return A/c Dr.

To Purchases

4. **Carriage, Freight Inwards:**

Trading A/c Dr.

To Carriage, Freight Inwards A/c

5. **Wages:**

Trading A/c Dr.

To Wages A/c

6. **Sales:**

Debtors/Cash A/c Dr.

To Trading A/c

Sales A/c Dr.

To Trading A/c

7. **Sales Return:**

Trading A/c Dr.

To Sales Return A/c

8. **Closing Inventory:**

Closing Inventory A/c Dr.

To Trading A/c

Note:

If Closing Stock appears in the Trial balance then the closing inventory is not recorded in the trading account, it is directly presented in the balance sheet.

This is due to the fact that the entry has already been recorded to arrive at Cost of Goods Sold.

As per the valuation principle closing inventory is recorded at cost or net realisable value whichever is less.

Profit & Loss Account:

Trading Account enables to determine the gross profit or loss derived from carrying out the trading activities in which the organization is engaged in.

All the expenses which have not been recorded in the trading account form a part of the Profit & Loss Account. All the income and gains except for sales form a part of the Profit & Loss Account.

Format of Profit & Loss Account:

Format of Profit & Loss Account:

Dr.	Profit & Loss Account for the year ended.....				Cr.
	Amount	Amount		Amount	Amount
To Gross Loss b/d			By Gross Profit b/d		
Management expenses			Other Income		
To Salaries (administrative)			By Discount Received		
To Office rent, rates and taxes			By Commission Received		
To Printing and stationery					
To Telephone charges			Non-trading Income		
To Postage and telegrams			By Bank Interest		
To Insurance			By Rent of property let-out		
To Audit Fees			By Dividend from shares		
To Legal Charges					
To Electricity Charges			Abnormal Gains		
			By Profit on sale of machinery		
Maintenance expenses			By Profit on sale of investment		
To Repairs & renewals					
			By Net Loss (transferred to capital A/c)		
To Depreciation on:					
Office Equipment					
Office Furniture					
Office Buildings					
Selling and Distribution expenses					
To Salaries (selling staff)					
To Advertisement					
To Godown rent					
To Carriage Outward					
To Bad Debts					
To Provision for bad debts					
To Selling commission					
Financial expenses					
To Bank charges					
To Interest on loans					
To Discount on bills					
To discount allowed to customers					
Abnormal Losses					
To Loss on sale of machinery					
To Loss on sale of investment					
To loss by fire					
To Net Profit (transferred to Capital A/c)					
TOTAL		XXX	TOTAL		XXX

Accounting Entries related to Profit & Loss Account:

- Drawings:**
Capital A/c Dr.
 To Drawings

- Income Tax**

Capital A/c Dr.
To Income Tax A/c

3. Discount received

Profit/Loss A/c Dr.
To Discount Allowed A/c

4. Discount allowed

Discount Received A/c Dr.
To Profit/Loss A/c

5. Bad Debts

Bad Debts Account Dr.
To Debtor's Account

Profit/Loss Account Dr.
To Bad Debts A/c

In case of Provision for Bad Debts is prepared then the bad debts are first recorded against the provision

Bad Debts Account Dr.
To Debtor's Account

Provision for Bad Debts A/c Dr.
To Bad Debts A/c

6. Bad Debts Recovery

Bad Debts Recovered Account Dr.
To Profit/Loss Account

Closing Entries

The journal entries that are made for transferring various account to the trading and Profit & Loss Account are known as Closing Entries.

1. For expenses to be recorded to Profit & Loss Account.

Profit and Loss Account Dr.
To Salaries Account
To Rent Account
To Interest Account
To Other Expenses Account

2. For revenues and gains to be recorded to Profit & Loss Account.

Discount Received Account Dr.
Bad debts Recovered Account Dr.
To Profit and Loss Account

3. Net Profit or Loss transferred to Capital Account

Net Profit

Profit and Loss Account Dr.

To Capital Account

Net Loss

Capital Account Dr.

To Profit and Loss Account

Other Adjustments and their treatment:

1. Abnormal loss of Inventory by accident or fire

Loss by Fire Account Dr.

To Purchases/Trading Account

Claim received from Insurance Company

Profit & Loss A/c Dr.

To Loss by Fire A/c

2. Goods sent on Approval basis

Sales A/c Dr.

To Trade receivables A/c

Sale on approval A/c Dr.

To Trading A/c

3. Goods used other than for sale

When goods are given away as donation

Donation A/c Dr.

To Purchases A/c

When goods are used by the proprietor for his personal use

Drawings A/c Dr.

To Purchases A/c

When goods are distributed as free samples:-

Advertisement A/c Dr.

To Purchases A/c

When goods are used in business for construction of Fixed Asset:-

Fixed Asset A/c Dr.

To Purchases A/c

When goods are used for maintenance of Fixed Asset: -

Repair & Maintenance A/c Dr.

To Purchases A/c

4. Commission based on profit

Sometimes organizations offer the Managers and high level authorities a part of profit via commission as a part of their compensation. The computation involved in the computation of these commission and the journal entries to record the same are as stated below.

Commission based on Net Profit before charging such commission:

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate of Commission}}{100}$$

Commission based on Net Profit after charging such commission:

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

Recording Commission in the Books of Accounts:

Commission A/c Dr.
To Commission Payable A/c

Profit/Loss Account Dr.
To Commission A/c

Example:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Trading and Profit & Loss Account from the Trial Balance after passing the closing entries.

Particulars	Debit Rs.	Credit Rs.
Capital		1,500,000
Inventory	357,500	
Cash	55,000	
Machinery	800,000	
Purchases	800,000	
Wages	250,000	
Salaries	175,000	
Discount Received		10,000
Discount Allowed	7,500	
Office Expense	15,000	
Sales		1,000,000
Debtors	500,000	
Creditors		450,000
TOTAL	2,960,000	2,960,000
Value of Closing Inventory on December 31, 2017 was Rs.625000/-		

Date	Particulars		Debit	Credit
Dec-31	Trading A/c	Dr.	1,407,500	
	To Inventory A/c			357,500
	To Purchases A/c			800,000
	To Wages A/c			250,000
	(Being balances appearing in trial balance transferred to trading account)			
Dec-31	Sales A/c	Dr.	1,000,000	
	To Trading A/c			1,000,000
	(Being Sales balance transferred to trading account)			
Dec-31	Closing Inventory A/c	Dr.	625,000	
	To Trading A/c			625,000
	(Being Closing Inventory recorded)			
Dec-31	Trading A/c	Dr.	217,500	
	To Profit & Loss A/c			217,500
	(Being gross profit transferred to Profit & Loss Account)			

Dec-31	Profit & Loss A/c	Dr.	197,500	
	To Salaries A/c			175,000
	To Discount Allowed A/c			7,500
	To Office Expenses A/c			15,000
	(Being expenses appearing in trial balance transferred to P&L account)			
Dec-31	Discount Received A/c	Dr.	10,000	
	To Profit & Loss A/c			10,000
	(Being expenses appearing in trial balance transferred to P&L account)			
Dec-31	Profit & Loss A/c		30,000	
	To Capital A/c			30,000
	(Being Profit & Loss Account Balance transferred to Capital)			

Dr.	Trading Account for the year ended December 31, 2018				Cr.
	Amount	Amount		Amount	Amount
To Opening Stock		357,500	By Sales		1,000,000
To Purchases		800,000	By Closing Stock		625,000
To Wages		250,000			
To Gross Profit c/d		217,500			
TOTAL		1,625,000	TOTAL		1,625,000

Dr.	Profit & Loss Account for the year ended December 31, 2018				Cr.
	Amount	Amount		Amount	Amount
To Salaries		175,000	By Gross Profit b/d		217,500
To Discount Allowed		7,500	By Discount Received		10,000
To Office Expenses		15,000			
To Net Profit (Transferred to Capital A/c)		30,000			
TOTAL		227,500	TOTAL		227,500

Balance Sheet:

Balance Sheet is the statement which presents an organization Assets and Liabilities position on a particular date.

Important points with regard to Balance Sheet:

1. It is valid only for a particular date and not later. For Example, if the closing inventory for December 31, 2018 was valued at Rs.1,00,000/- and the entity purchased inventory worth Rs.50,000 on 1st January 2019 the Balance Sheet on 1st January 2019 would be different as compared to 31st December 2018.

2. Balance sheet is prepared only after the preparation of the Profit and Loss Account.

Format of Balance Sheet:

Balance Sheet as at					
Liabilities	Amount	Amount	Assets	Amount	Amount
Capital A/c			Tangible Fixed Assets		
Opening Balance	XXX		Land and Building	XXX	
Add : Net Profit/Less: Net Loss	XXX		Plant and Machinery	XXX	
Less : Drawings	(XXX)	XXX	Furniture and Fixture	XXX	
			Vehicles	XXX	XXX
Long Term Loans					
Term Loans	XXX		Intangibles		
Other Loans	XXX	XXX	Goodwill	XXX	
			Patent Rights	XXX	
Short Term Loans			Designs and Brand Names	XXX	XXX
Cash Credit	XXX				
Overdrafts	XXX		Investments		
Other Loans	XXX	XXX	Long term investments	XXX	XXX
Current Liabilities			Current Assets		
Trade payables	XXX		Inventory in Trade	XXX	
Outstanding Expenses	XXX		Trade receivables	XXX	
Advances Taken	XXX	XXX	Short term investments	XXX	
			Prepayments	XXX	
Provision			Advances	XXX	
Provision for Bad debts	XXX		Bank Balances	XXX	XXX
Provision for Retirement Benefits	XXX	XXX			
TOTAL		XXXX	TOTAL		XXXX

CLASSIFICATION OF ASSETS AND LIABILITIES

Assets are classified into the following categories:

1. Current Assets

These are the assets which are meant to be used or converted into cash as within the next operating cycle or one year whichever is longer.

For Eg: Cash, Bank, Debtors, Closing stock, etc.

2. Long Term Assets: -

These are the assets which are meant for long term usage and are expected to last for more than a year or the accounting cycle whichever is longer.

Long Term Assets are classified as Intangible Assets or Tangible Assets.

Intangible Assets are those Assets which have no physical existence i.e. which cannot be touched, felt or seen. For Eg, Patents, Copyrights, etc.

Tangible Assets are those assets which have their physical existence and can be identified. For Eg, Furniture, Equipments, Machinery, etc.

Liabilities can be classified into the following categories:

1. Current Liabilities:

These are the liabilities which must be settled or paid within in one year or operating cycle whichever is higher. Current Liabilities are also known as Short Term Liabilities. For Eg, Creditors, Bills Payable etc.

2. Long Term Liabilities:

These are the liabilities which are to be paid or settled at least after a year or the operating cycle whichever is longer. For Eg, Long term loans, Borrowings, etc.

Example:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Balance Sheet.

Particulars	Debit Balance	Credit Balance
Capital A/C		1,235,000
Machinery	100,000	
Long Term Loan		50,000
Creditors		24,000
Debtors	40,000	
Cash	5,000	
Closing Stock	15,000	
Building	1,500,000	
Short Term Borrowings		175,000
Advances to Suppliers	55,000	
Profit for Current year		256,000
Drawings	25,000	
TOTAL	1,740,000	1,740,000

Balance Sheet as at 31st December 2018					
Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	1,235,000		Machinery		100,000
Add: Profit	256,000		Building		1,500,000
Less: Drawings	(25,000)	1,466,000			
			Debtors		40,000
Long Term Loan		50,000	Cash		5,000
			Closing Stock		15,000
Creditors		24,000	Advance to Suppliers		55,000
Short Term Borrowings		175,000			
TOTAL		1,715,000	TOTAL		1,715,000

Questions:

Question 1:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Trading and Profit & Loss Account from the Trial Balance after passing the closing entries.

Particulars	Debit Rs.	Credit Rs.
Capital		1,381,500
Inventory	256,500	
Cash	49,000	
Machinery	550,000	
Purchases	851,000	
Wages	355,000	
Salaries	475,000	
Discount Received		25,000
Discount Allowed	20,000	
Office Expense	150,000	
Sales		1,355,000
Debtors	400,000	
Creditors		345,000
TOTAL	3,106,500	3,106,500

Value of Closing Inventory on December 31, 2017 was Rs.89500/-

Question 2:

The following is the Trial Balance of ABC Co. on 31st Dec. 2018. Prepare the Balance Sheet.

Particulars	Debit Rs.	Credit Rs.
Capital A/C	-	2,470,000
Machinery	200,000	-
Long Term Loan	-	100,000
Creditors	-	48,000
Debtors	80,000	-
Cash	10,000	-
Closing Stock	30,000	-
Building	3,000,000	-
Short Term Borrowings	-	350,000
Advances to Suppliers	110,000	-
Profit for Current year	-	512,000
Drawings	50,000	-
TOTAL	3,480,000	3,480,000

Illustrations

Question: 1

Trial Balance for financial the year (FY) ended 31st March 2017 of M/s Deepakshi shows following details:

Particulars	Debit (Rs.)	Credit (Rs.)
Purchases and sales	10,00,000	12,00,000
Debtors and Creditors	5,00,000	4,00,000
Opening Stock	2,00,000	
Closing Stock	3,00,000	
Other Expenses and Incomes	7,00,000	9,00,000
Fixed Assets and Long-term Liabilities	25,00,000	6,00,000
Capital		21,00,000
Total	52,00,000	52,00,000

Additional Information:

- Creditors balance as on 1st April 2016 is Rs. 3,00,000.
- You are required to calculate cost of goods sold and amount paid to creditors during the year.

Question: 2

Particulars	Amount (Rs.)
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

From the above information, prepare a Trading Account of M/s. ABC Traders for the year ended 31st March 2017 and Pass necessary closing entries in the journal proper of M/s. ABC Traders.

Question: 3

Revenue, Expenses and Gross Profit Balances of M/s ABC Traders for the year ended on 31st March 2016 were as follows:

Particulars	Amount (Rs.)
Gross Profit	4,20,000
Salaries	1,10,000
Discount (Cr.)	18,000
Discount (Dr.)	19,000
Bad Debts	17,000
Depreciation	65,000
Legal Charges	25,000
Consultancy Fees	32,000
Audit Fees	1,000
Electricity Charges	17,000
Telephone, Postage and Telegrams	12,000
Stationery	27,000
Interest paid on Loans	70,000

Prepare Profit and Loss Account of M/s ABC Traders for the year ended on 31st March. Show necessary closing entries in the Journal Proper of M/s. ABC Traders also.

Question: 4

On 1st Jan. 2017 provision for Doubtful Debts existed at Rs. 40,000. Trade receivables on 31.12.2017 were Rs. 15,00,000. Bad debts totalled Rs. 1,00,000. It is required to write off the bad debts and create a provision equal to 5% of the Trade receivable's balance.

Question: 5

The following is the Trial Balance of C. Wanchoo on 31st Dec. 2017

Trial Balance on 31st December

Particulars	Amount (Rs.)	Amount (Rs.)
Capital Account		10,00,000
Inventory Account	2,00,000	
Cash in hand	1,44,000	
Machinery A/c	7,36,000	
Purchases A/c	18,20,000	
Wages A/c	10,00,000	
Salaries A/c	10,00,000	
Discount Allowed A/c	50,000	
Discount Received A/c		30,000
Sundry Office Expenses A/c	6,00,000	
Sales A/c		50,00,000
Sums owing by customer (Trade receivables)	8,50,000	
Trade payables (sums owing to suppliers)		3,70,000
Total	64,00,000	64,00,000

Value of Closing Inventory on 31st Dec. 2017 was Rs. 2,70,000

Prepare Trading and Profit and Loss Account.

Question: 6

The balance sheet of Thapar on 1st January 2017 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Trade Payables	15,00,000	Plant and Machinery	30,00,000
Expenses Payable	1,50,000	Furniture and Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	13,00,000
Total	66,50,000	Total	66,50,000

During 2017, his Profit and Loss Account revealed a net profit of Rs. 15,30,000. This was after allowing for the following:

- (a) Interest on capital @ 6% p.a.
 - (b) Depreciation on Plant and Machinery @ 10% and on Furniture and Fixtures @ 5%
 - (c) A provision for Doubtful Debts @ 5% of the trade receivables as at 31st December 2017
- But while preparing the Profit and Loss Account he had forgotten to provide for

- (1) Outstanding expenses totalling Rs. 1,80,000
- (2) Prepaid insurance to the extent of Rs. 20,000

His current assets and liabilities on 31st December 2017 were:

- a. Inventories Rs. 14,50,000
- b. Trade receivables Rs. 20,00,000
- c. Cash at Bank Rs. 10,35,000
- d. Trade payables Rs. 11,40,000

During the year he withdrew Rs. 6,00,000 for domestic use.

Draw up his Balance Sheet at the end of the year.

Question: 7

Balance Sheet as at 31st December 2017

Capital and Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Mahindra & Sons Capital	5,60,000 20,00,000	Cash in Hand Cash at Bank Trade Receivables Closing Inventory Machinery and Equipment	43,000 2,67,500 7,49,500 9,00,000 6,00,000
Total	25,60,000	Total	25,60,000

From the above given balance sheet prepare the relevant opening entry.

Question: 8

Shri Mittal gives you the following Trial Balance and some other information

Trial Balances as on 31st March 2017

Particulars	Amount (Rs.) Dr.	Amount (Rs.) Cr.
Capital		8,70,000
Purchases and Sales	6,05,000	12,10,000
Opening Inventory	72,000	
Trade receivables and Trade payables	90,000	1,70,000
14% Bank Loan (loan taken at year end)		2,00,000
Overdrafts (overdraft taken at year end)		1,12,000
Salaries	2,70,000	
Advertisements	1,10,000	
Other expenses	60,000	
Returns	40,000	30,000
Furniture	4,50,000	
Building	8,90,000	
Cash in Hand	5,000	
Total	25,92,000	25,92,000

Closing Inventory on 31st March 2017 was valued at Rs. 1,00,000.

Prepare final accounts of Shri Mittal for the year ended 31st March 2017.

Question: 9

Mr. Mohan gives you the following trial balance and some other information

Particulars	Amount (Rs.)	Amount (Rs.)
Capital		6,50,000
Sales		9,70,000
Purchases	4,30,000	
Opening Inventory	1,10,000	
Freight Inward	40,000	
Salaries	2,10,000	
Other Administrative Expenses	1,50,000	
Furniture	3,50,000	
Trade receivables and Trade Payables	2,10,000	1,90,000
Returns	20,000	12,000
Discounts	19,000	9,000

Bad debts	5,000	
Investments in Government Securities	1,00,000	
Cash in Hand and cash at Bank	1,89,000	
Input CGST	10,000	
Input SGST	10,000	
Output CGST		
Output SGST		8,000
Output IGST		8,000
		6,000
Total	18,31,000	18,31,000

Other Information:

(i) Closing Inventory was Rs. 1,80,000

(ii) Depreciate Furniture @ 10% p.a

Prepare Trading and Profit and Loss Account for the year ended on 31.3.2017. Balance Sheet of Mr. Mohan as on that date.

Question: 10

The Balance Sheet of Mr. Popatlal, a merchant on 31st March, 2017 stood as below

Capital and Liabilities	Amount (Rs.)	Assets	Amount (Rs.)	Amount (Rs.)
Capital	2,40,000	Fixed Assets		1,25,600
Trade payables	1,64,000	Inventories		2,06,400
Bank Overdraft	1,46,000	Trade Receivables		
		Less Provision	1,88,000	
			6,200	
		Cash		1,81,800
				36,200
Total	5,50,000	Total		5,50,000

Show opening journal entry on 1st April, 2017 in the books of Mr. Popatlal.

Question: 11

The following is the schedule of balances as on 31.3.17 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Bombay

Particulars	Amount (Rs.) Dr.	Amount (Rs.) Cr.
Cash in Hand	14,000	
Cash at Bank	26,000	
Sundry Debtors	8,60,000	
Stock on 01.04.2016	6,20,000	
Furniture & fixtures	2,14,000	
Office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	

Sundry Creditors		4,30,000
Loan from Viswanath		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	
Salaries	1,10,000	
Rent for Go down	55,000	
Interest on loan from Vishwanath	27,000	
Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount Received from creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General office expenses	30,000	
Bad debts	20,000	
Bank Charges	16,000	
Motor car expenses	36,000	
Capital a/c		16,20,000
Total	47,22,000	47,22,000

Prepare Trading and Profit and Loss Account for the year ended 31st March 2017 and the Balance Sheet as at that date after making provision for the following:

I. Depreciate:

(a) Building used for business by 5 %

(b) Furniture and fixtures by 10 %:

One steel table purchased during the year for Rs. 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account

(c) Office equipment by 15 %:

Purchase of a typewriter during the year for Rs. 40,000 has been wrongly debited to purchase

(d) Motor car by 20%

II. Value of stock at the close of the year was Rs. 4,40,000

III. Two month's rent for Go down is outstanding

IV. Interest on loan from Viswanath is payable at 12 % per annum, this loan was taken on 01.05.2016

V. Reserve for bad debts is to be maintained at 5 % of Sundry Debtors

VI. Insurance premium includes Rs. 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 01.04.2016 to 30.06.2017.

Question: 12

Crimpsom Ltd.'s profit and loss account for the year ended 31st March 2016 includes the following information

Particulars	Amt (Rs.)
(i) Depreciation	57,500

(ii) Bad debts written off	21,000
(iii) Increase in provision for doubtful debts	18,000
(iv) Proposed dividend	15,000
(v) Retained profit for the year	20,000
(vi) Liability for tax	4,000

Required:

State which one of the items (i) to (vi) above are -

- (a) transfer to provisions;
- (b) transfer to reserves; and
- (c) neither related to provisions nor reserves.

Question 12

From the following particulars extracted from the books of Ganguli, prepare trading and profit and loss account and balance sheet as at 31st March, 2022 after making the necessary adjustments:

Particulars	Amount	Particulars	Amount
Ganguli's capital account(Cr.) as on 1.4.2021	5,40,500	Interest received	7,250
Stock on 1.4.2021	2,34,000	Cash with Traders Bank Ltd.	40,000
Sales	14,48,000	Discounts received	14,950
Sales return	43,000	Investments (at 5%) as on 1.4.2021	25,000
Purchases	12,15,500	Furniture as on 1-4-2021	9,000
Purchases return	29,000	Discounts allowed	37,700
Carriage inwards	93,000	General expenses	19,600
Rent	28,500	Audit fees	3,500
Salaries	46,500	Fire insurance premium	3,000
Sundry debtors	1,20,000	Travelling expenses	11,650
Sundry creditors	74,000	Postage and telegrams	4,350
Loan from Dena Bank Ltd.(at 12%)	1,00,000	Cash in hand	1,900
Interest paid	4,500	Deposits at 10% as on 1-4-2021 (Dr.)	1,50,000
Printing and stationery	17,000	Drawings	50,000
Advertisement	56,000		

Adjustments:

- (1) Value of stock as on 31st March, 2022 is ` 3,93,000. This includes goods returned by customers on 31st March, 2022 to the value of ` 15,000 for which no entry has been passed in the books.
- (2) Purchases include furniture purchased on 1st January, 2022 for ` 10,000.
- (3) Depreciation should be provided on furniture at 10% per annum.

(4) The loan account from Dena bank in the books of Ganguli appears as follows:

		Rs.			Rs.
31.3.2022	To Balance c/d	1,00,000	1.4.2021	By Balance b/d	50,000
			31.3.2022	By Bank	50,000
		1,00,000			1,00,000

(5) Sundry debtors include ` 20,000 due from Robert and sundry creditors include ` 10,000 due to him.

(6) Interest paid include ` 3,000 paid to Dena bank.

(7) Interest received represents ` 1,000 from the sundry debtors (due to delay on their part) and the balance on investments and deposits.

(8) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.

(9) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Question 13

Sengupta & Co. employs a team of eight workers who were paid ` 30,000 per month each in the year ending 31st March, 2021. At the start of financial year 2021-2022, the company raised salaries by 10% to ` 33,000 per month each.

On October 1, 2021 the company hired two trainees at salary of ` 21,000 per month each. The work force are paid salary on the first working day of every month, one month in arrears, so that the employees receive their salary for January on the first working day of February etc.

You are required to calculate:

- Amount of salaries which would be charged to the profit and loss for the year ended 31st March, 2022.
- Amount actually paid as salaries during 2021-22
- Outstanding Salaries as on 31st March, 2022.

Question 14

Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2022 has been given below:

On 1.4.2021 he had a balance of ` 2,00,000 advance from customers of which ` 1,50,000 is related to year 2021-22 while remaining pertains to year 2022-23. During the year 2021-22 he made cash sales of ` 5,00,000. You are required to compute:

- Total income for the year 2021-22.
- Total money received during the year if the closing balance in advance from customers account is ` 1,70,000.

Question 15

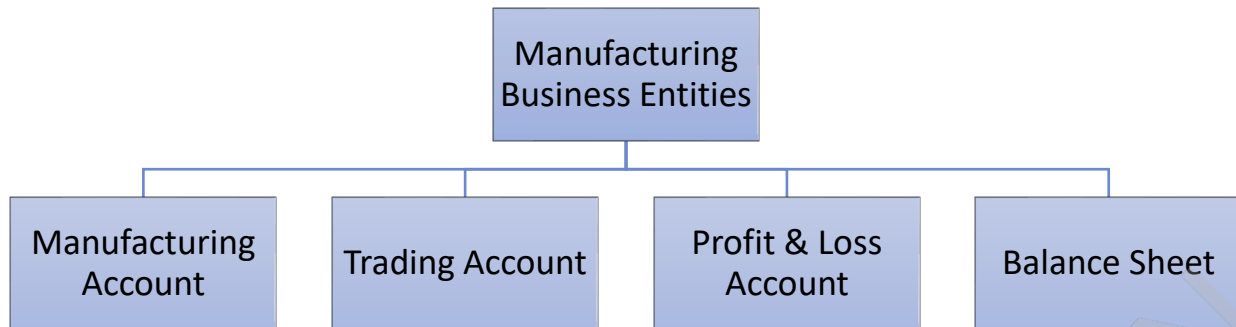
Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Particulars	`	Particulars	`
To Cost of Goods Sold	45,00,000	By Sales	C
To Gross Profit c/d	<u>D</u>		
	E		E
To Rent A/c	26,00,000	By Gross Profit b/d	<u>D</u>
To Office Expenses	13,00,000	By Miscellaneous Income	E
To Selling Expenses	B		
To Commission to Manager (on Net Profit before charging such commission)	2,00,000		
To Net Profit	<u>A</u>		
	G		<u>60,00,000</u>

Commission is charged at the rate of 10%.

Selling Expenses amount to 1% of total sales. You are required to compute the missing figures.

Chapter 16 : Final accounts of Manufacturing entities



Introduction

The manufacturing entities generally prepare a separate Manufacturing Account as a part of Final accounts in addition to Trading Account, Profit and Loss Account and Balance Sheet. The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities. Manufacturing costs of finished goods are then transferred from the Manufacturing Account to Trading Account.

Purpose

A manufacturing account serves the following functions:

1. It shows the total cost of manufacturing the finished products and sets out in detail, with appropriate classifications, the constituent elements of such cost. It is, therefore, debited with the cost of materials, manufacturing wages and expenses incurred directly or indirectly on manufacture.
2. It provides details of factory cost and facilitates reconciliation of financial books with cost records and also serves as a basis of comparison of manufacturing operations from year to year.
3. The Manufacturing Account may also be used for various other purposes. For example, if the output is carried to the Trading Account at market prices, it discloses the profit or loss on manufacture. Similarly, it may also be used to fix the amount of production of profit sharing bonus when such schemes are in force.

Manufacturing costs are classified into :

+ Raw Material Consumed	
+ Direct Manufacturing Wages	
+ Direct Manufacturing Expenses	
+ Direct Manufacturing Cost	
+ Indirect Manufacturing expenses or	
+ Manufacturing Overhead	
Total Manufacturing Cost	

Direct Manufacturing Expenses

Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.

Examples of direct manufacturing expenses are (i) Royalties for using license or technology if based on units produced, (ii) Hire charge of the plant and machinery used on hire, if based on units produced, etc.

When royalty or hire charges are based on units produced, these expenses directly vary with production.

INDIRECT MANUFACTURING EXPENSES OR OVERHEAD EXPENSES

These are also called Manufacturing overhead, Production overhead, Works overhead, etc. Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

$\text{Overhead} = \text{Indirect Material} + \text{Indirect Wages} + \text{Indirect Expenses}$

Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.

Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.

Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

Accordingly, indirect manufacturing expenses comprise indirect material, indirect wages and indirect expenses of the manufacturing division.

BY-PRODUCTS

In most manufacturing operations, the production of the main product is accompanied by the production of a subsidiary product which has a value on sale. For example, the production of hydrogenated vegetable oil is accompanied by the production of oxygen gas and the production of steel yields scrap. The subsidiary product is termed as a by-product because its production is not consciously undertaken but results out of the production of the main product. It is usually very difficult to ascertain the cost of the product. Moreover, its value usually forms a very small percentage of the main product.

By-product is a secondary product. This is produced from the same raw materials, which are used for producing the main product and without incurring any additional expenses from the same production process in which the main product is produced. Some examples of by-product are given below:

- i. Molasses is the by-product in sugar manufacturing;
- ii. Butter milk is the by-product of a dairy which produces butter and cheese, etc.

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realizable value**, if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product

Question: 1

1,00,000 units were produced in a factory Per unit material cost was Rs.10 and per unit labour cost was Rs.5. That apart it was agreed to pay royalty @ Rs.3 per unit to the Japanese collaborator who supplied technology.

Required: Calculate Manufacturing Cost.

Question: 2

Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for year ended on 31.03.2016.

Particulars	Amt. (Rs.)
Opening Work-in-Process (10,000 units)	16,000
Closing Work-in-Process (12,000 units)	20,000
Opening inventory of Raw Materials	1,70,000
Closing inventory of Raw Materials	1,90,000
Purchases	8,20,000
Hire charges of machine @ Rs. 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ Rs.0.80 per unit manufactured and @ Rs.0.40 per unit of	
Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced - 5,00,000 units	

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2016.

Chapter 17 - Financial Statements of Not-For-Profit Organizations

What is a Not-for-Profit Organization?

A Not-for-Profit Organization is an entity which is not being operated for the purpose of earning profit but for the benefit for the society. It is brought into existence with a view to serve a social cause, not to earn profits for its owners.

Following are some of the forms of Not-For-Profit Organization:

1. Public Hospitals
2. Public Educational Institutions
3. Government Clubs
4. Temples, etc.

Receipt and Payment Account:

A Receipt and Payment Account is similar to cash book except it does not include the date column. The key features of the Receipt and Payment account are as stated below:

1. It presents the summary of cash and bank transactions.
2. All the receipts and payments irrespective of the fact whether they are capital or revenue in nature are accounted for.
3. This account is not maintained as part of the double entry system of accounting.
4. Surplus for the period i.e. Excess of Income over expenditure or Deficit i.e. Excess of Expenditure over income for the period cannot be determined from this account since it excludes all non-cash transactions. This is the limitation of the Receipt and Payment Account.

Example on Receipt and Payment Account:

The receipts and payments for the ABC, NPO for the year ended March 31, 2018 were:

Particulars Amount (INR)

Entrance fees	1000
Membership Fees	5000
Donation for Club Building 1	5000
Food sales	3500
Salaries and Wages	5500
Purchase of Food	2000
Construction of Club Pavilion	13000
General Expenses	1000
Rent and Taxes	500
Bank Charges	250
Opening Cash in hand Balance	5000
Closing Cash in hand Balance	1500
Opening Cash in Bank Balance	2000
Closing Cash in Bank Balance	3500

Prepare the Receipts and Payment Account.

Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount	Payments	Amount
To Balance b/d (Op. Bal)		By Salaries and Wages	5,500
- Cash	5,000	By Purchase of Food	2,000
- Bank	2,000	By Construction of Club Building	13,000
		By General Expenses	1,000
To Entrance fees	1,000	By Rent and Taxes	500
To Membership Fees	5,000	By Bank Charges	250
To Donation for Club Building	15,000		
To Food sales	3,500	By Balance c/d	
		- Cash	3,500
		- Bank	5,750
TOTAL	31,500	TOTAL	31,500

Income and Expenditure Account:

Income and Expenditure account can be considered as the **PROFIT AND LOSS ACCOUNT** for the NPO. The key features of the Receipt and Payment account are as stated below:

1. It is the revenue account for the NPO which is prepared at the end of the accounting period of the NPO.
2. It is prepared using the Matching Principle i.e. current year revenue and expenses are recorded in the current accounting period only irrespective of the status of their payment.
3. Cash as well as Non-Cash items are taken into consideration.
4. Income and Expenses which are capital in nature are excluded.

Preparing the Income and Expenditure Account from the Receipt and Payment Account:

Income and Expenditure account and the Balance Sheet for the NPO can be prepared from the Receipt and Payment Account by making necessary adjustment with respect to the income earned and expense incurred during the current period.

The following steps needs to be followed to prepare the income and expenditure and balance sheet using the Receipt and Payment Account.

1. Prepare the Opening Balance Sheet to arrive at the opening balance of the accumulated fund.
2. Prepare Ledger Accounts for the various income and expenses through which the accruals and outstanding at the beginning and end of the period needs to be adjusted to arrive at the income and expense for the current period.
3. Post the debit and credit of the Receipt and Payment to the Credit of the Income and Expenditure Account for adjusting the accrual and outstanding.
4. Transfer the balance of the income and expenditure to the Accumulated/Capital Fund Account.

5. Transfer the amounts which are capital in nature from the Receipt and Payment to the Balance Sheet of the NPO.

6. Prepare the Closing Balance Sheet.

Example on Computing and Preparing a particular Income Account from the Receipt and Payment information:

During 2018, Subscription received in cash is Rs. 70000.

It includes Rs.15000 for 2017 and Rs.10000 for 2019.

Also Rs.20000 has still to be received for 2018.

Prepare the Subscription Outstanding, Subscription and Advance Subscription Account for the year ended March 31, 2018.

Dr. Subscription Outstanding Account for the year ended 31st March 2018			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
2018					
Apr - 1	To Balance b/d	15,000	Mar - 31	By Subscription A/c	15,000
Mar - 31	To Subscription A/c	20,000	Mar - 31	By Balance c/d	20,000
	TOTAL	35,000		TOTAL	35,000
2019					
Apr - 1	To Balance b/d	20,000			

Dr. Subscription Account for the year ended 31st March 2018			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
2018					
Mar - 31	To Subscription Outstanding A/c	15,000	Mar - 31	By Cash/Bank A/c	70,000
Mar - 31	To Advance Subscription A/c	10,000	Mar - 31	By Subscriptions Outstanding A/c	20,000
Mar - 31	To Income & Expenditure A/c	65,000			
-	TOTAL	90,000		TOTAL	90,000

Dr. Advance Subscription Account for the year ended 31st March 2018			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
2018			2018		
Apr - 1	To Balance b/d	10,000	Mar - 31	By Subscription A/c	10,000
	TOTAL	10,000		TOTAL	10,000
			2019		
			Apr - 1	By Balance c/d	10,000

The balance in Advance Subscription Account of Rs.10000/- will appear on the liabilities side and in Outstanding subscription Account of Rs.20000/- will appear on the Asset Side.

Balance Sheet:

A Balance Sheet is the statement which presents the balance of the assets and liabilities of an accounting period at a given date. Normally it is prepared at the end of an accounting period after the Income and Expenditure Account has been prepared. In NPO Accounting, the excess of total assets over total outside liabilities is known as Capital Fund which presents the amount contributed by the Members, receipt of special donations and surplus accumulated over the years.

Example on preparing the Income and Expenditure account and Balance Sheet from the receipt and Payment Account.

Following is the Receipt and Payment Account of Club XYZ, an NPO for the year ended March 31, 2018 along with the details of the opening and closing balance of Assets and Liabilities for the year ended.

Prepare the Income and Expenditure and Balance Sheet for the year ended March 31, 2018.

Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount	Payments	Amount
To Balance b/d (Op. Bal)	10,000	By Salaries and Wages	13,000
		By Rent	5,000
To Membership fees	25,000	By Utilities	7,000
To Miscellaneous Income	5,000	By Magazines and Periodicals	2,500
To Interest on Secured Deposit	2,500	By Miscellaneous Expenses	3,000
		By Balance c/d (Cl. Bal)	12,000
TOTAL	42,500	TOTAL	42,500

Particulars	31-Mar-17	31-Mar-18
Salaries outstanding	5,000	8,000
Outstanding Rent	5,000	10,000
Outstanding Utilities	500	1,000
Outstanding Magazines and Periodicals	250	500
Fixed Deposit	50,000	50,000
Accrued Interest	1,000	1,000
Fees Receivable	1,250	1,500
Prepaid Expenses (Miscellaneous)	450	600
Computers	7,000	
Equipment	4,000	
TOTAL		

Depreciation on the Computers is charged at 15% and on Equipment is charged at 10%.
The Opening Balance Sheet is as presented below:

Balance Sheet as on 31st March 2017

Liabilities	Amount	Amount	Assets	Amount	Amount
Outstanding Expenses:			Fixed Deposits		50,000
- Salaries		5,000	Accrued Interest		1,000
- Rent		5,000	Fees Receivable		1,250
- Utilities		500	Prepaid Expenses		450
- Magazines & Periodicals		250	Computers		7,000
			Equipments		4,000
Capital Fund (Bal. Fig)		52,950			
TOTAL		63,700	TOTAL		63,700

The Income and Expenditure Account is as presented below:

Dr.		Income and Expenditure Account for the year ended March 31, 2018		Cr.	
Particulars	Amount	Amount	Particulars	Amount	Amount
To Salaries and Wages		16,000	By Membership Fees		25,250
To Rent		10,000	By Miscellaneous Income		5,000
To Utilities		7,500	By Interest on Security Deposit		2,500
To Magazines & Periodicals		2,750			
To Misc. Expenses		2,850			
			By Excess of Expenditure over Income		7,800
To Depreciation:					
- Computers (@ 15%)	1050				
- Equipments (@ 10%)	400	1,450			
TOTAL		40,550	TOTAL		40,550

The computations done in arriving at the amounts mentioned in the above income and expenditure account are as follow:

Particulars	Salaries	Rent	Utilities	Mag & Periodicals	Misc. Exp
1. Expense Computation					
Paid during the year	13,000	5,000	7,000	2,500	3,000
Add: O/s as on 31.03.2018	8,000	10,000	1,000	500	
Add: Prepaid on 31.03.2017					450
	21,000	15,000	8,000	3,000	3,450
Less: O/s as on 31.03.2017	(5,000)	(5,000)	(500)	(250)	
Less: Prepaid on 31.03.2018					(600)
Expenditure for the Year	16,000	10,000	7,500	2,750	2,850

Particulars	
2. Membership Income Computation	
Received in Cash/Bank	25,000
Add: Receivable in 2018	1,500
Less: Receivable in 2017	(1,250)
Membership Income	25,250

The Balance Sheet is as presented below:

Club XYZ Balance Sheet as on 31st March 2018

Liabilities	Amount	Amount	Assets	Amount	Amount
Outstanding Expenses:			Fixed Deposits		50,000
- Salaries		8,000	Accrued Interest		1,000
- Rent		10,000	Fees Receivable		1,500
- Utilities		1,000	Prepaid Expenses		600
- Magazines & Periodicals		500	Computers	7,000	
			Less: Depreciation (@ 15%)	(1,050)	5,950
Capital Fund					
Opening Balance	62,950		Equipments	4,000	
Less: Excess of Expenditure over Income	(7,800)	55,150	Less: Depreciation (@ 10%)	(400)	3,600
			Cash in Hand/Bank		12,000
TOTAL		74,650	TOTAL		74,650

Accounting treatment of some special items

Donations: These may have been raised either for meeting some revenue or capital expenditure; those intended for the first mentioned purpose are credited directly to the Income and Expenditure Account but others, if the donors have declared their specific intention, then they are credited to special fund account and in the absence thereof, to the Capital Fund Account.

If any investments are purchased out of a special fund or an asset is acquired therefrom, these are disclosed separately. Any income received from such investments or any donations collected for a special purpose are credited to an account indicating the purpose and correspondingly the expenditure incurred in carrying out the purpose of the fund is debited to this account. On no account any such expense is charged to the Income and Expenditure Account. **The term "Fund" is strictly applicable to the amounts collected for a special purpose when these are invested, e.g. Scholarship Fund, Prize Fund etc.**

Entrance and admission fees: Such fees which are payable by a member on admission to club or society are normally considered capital receipts and credited to Capital Fund. This is because these do not give rise to any special obligation towards the member who is entitled to the same privileges as others who have paid only their annual subscription. Nevertheless, where the amount is small, meant to cover expenses concerning admission, or the rules of the society provided that such fees could be treated as income of the society, these amounts may be included in the Income and Expenditure Account. The treatment depends upon the requirement of question. If the question is silent then always take it to be capital receipt.

Subscription: Subscriptions being an income should be allocated over the period of their accrual. For testing the knowledge of candidates of this important accounting principle, questions are often set in examinations wherein figures of subscription collected by a society during the year as well as those outstanding at the beginning of the year and at its close are given. If some subscriptions have been received in advance, their amount is also indicated. In such cases, it is always desirable to set up a Subscription Account for determining the amount of subscription pertaining for the period for which accounts are being prepared

Life membership fee: Fees received for life membership is a **capital receipt** as it is of non-recurring nature. It is **directly added to capital fund** or general fund.

For adjusting lump sum subscription collected from the life members, one of the following methods can be adopted:

- (1) The entire amount may be carried forward in a special account until the member dies, after which the same may be transferred to the credit of the Accumulated Fund.
- (2) An amount equal to the normal annual subscription may be transferred every year to the Income and Expenditure Account and balance carried forward till it is exhausted. If, however, the life member dies before the whole of the amount paid by him has been transferred in this way, the balance should be transferred to the Accumulated Fund on the date of his death.
- (3) An amount, calculated according to the age and average life of the member, may annually be transferred to the credit of Income and Expenditure Account.

Other Concepts:

1. **Donation:** it is **gift** in **cash** or **kind** from some person. It may be of two types:
 - (a) **Specific Donation:** It is received for certain specific purpose like Building Donation, Library Books donation etc. It should be capitalized and shown on the liabilities side of the balance sheet.
 - (b) **General Donation:** It is not received for any specific purpose and shown on the credit side of Income and Expenditure Account.
2. **Entrance Fees:** It may also be known as admission fees. **Entrance Fees should be capitalized** and added to the capital fund for all organization. If the question gives any specific treatment of Entrance fees, then it should be followed accordingly.
3. **Legacy:** It is an amount received by an organization as per the will of the person after the death of the person. It should be capitalised and shown on the liabilities side of the balance sheet by adding to the Capital Fund.
4. **Life Membership Fees:** It should **be capitalized** and shown on the liabilities side of the balance sheet. If the question gives any specific treatment of Life membership Fees, then it should be followed accordingly.
5. **Endowment Fund Donation:** It is a donation received and **only income from that donation is to be used for certain specific purpose**. In such cases income relating to special funds should be added to these funds on the liabilities side of the Balance sheet. All the expenses should be deducted from that fund on the liabilities side of the Balance sheet.
6. **Treatment of Sale of Old Newspaper and Periodicals:** The amount received on such sale is shown as Income on the credit side of income and expenditure account.
7. **Sale of old Fixed Assets:** The Sale proceeds of old Fixed Assets are treated as **capital receipts**. The profit or loss on sale of fixed asset is shown in the Income and Expenditure A/c
8. **Honorarium:** It is paid to someone for receiving any services from person who are **not the employees** of the Not for Profit Organisation.

Questions:

Question 1:

Following is the Receipt and Payment Account of Club ABC, an NPO for the year ended March 31, 2018 along with the details of the opening and closing balance of Assets and Liabilities for the year ended.

Prepare the Income and Expenditure and Balance Sheet for the year ended March 31, 2018.

Receipt and Payment Account for the year ended 31st March 2018

Receipts	Amount		Payments	Amount
To Balance b/d (Op. Bal)	15,000		By Salaries and Wages	17,000
			By Rent	12,000
To Membership fees	35,000		By Utilities	7,500
To Miscellaneous Income	7,000		By Magazines and Periodicals	2,500
To Interest on Secured Deposit	4,000		By Miscellaneous Expenses	3,500
			By Balance c/d (Cl. Bal)	18,500
TOTAL	61,000		TOTAL	61,000

Particulars	31-Mar-17	31-Mar-18
Salaries outstanding	7,000	9,500
Outstanding Rent	5,500	7,500
Outstanding Utilities	750	500
Outstanding Magazines and Periodicals	450	150
Fixed Deposit	75,000	75,000
Accrued Interest	1,500	1,250
Fees Receivable	850	1,400
Prepaid Expenses	950	1,200
Computers	15,000	
Equipment	9,000	
TOTAL		

Depreciation on the Computers is charged at 25% and on Equipment is charged at 15%.

Illustrations

Question: 1

The receipts and payments for the Swaraj Club for the year ended March 31, 2016 were:

- Entrance fees Rs.300;
- Membership Fees Rs.3,000;
- Donation for Club Pavilion Rs.10,000,
- Foodstuff sales Rs.1,200;
- Salaries and Wages Rs.1,200
- Purchase of Foodstuff Rs.800;
- Construction of Club Pavilion Rs.11,000;
- General Expenses Rs.600;
- Rent and Taxes Rs.400;
- Bank Charges Rs.160.
- Cash in hand-April. 1st Rs.200, March. 31st Rs.350
- Cash in Bank-April. 1st Rs.400; March. 31st Rs.590

You are required to prepare Receipts and Payment Account.

Question: 2

During 2016, subscription received in cash is Rs.42,000. It includes Rs.1,600 for 2015 and Rs.600 for 2017. Also, Rs.3,000 has still to be received for 2016.

Calculate the amount to be credited to Income and Expenditure Account in respect of subscription.

Question: 3

Suppose salaries paid during 2016 were Rs 23,000. The following further information is available:

Salaries unpaid on 31st March, 2015	1,400
Salaries pre-paid on 31st March, 2015	400
Salaries un-paid on 31st March, 2016	1,800
Salaries pre-paid 31st March, 2016	600

Required: Calculate the amount to be debited to Income and expenditure account in respect of salaries and also, show necessary ledger accounts.

Question: 4

The following was the Receipts and Payments Account of Exe Club for the year ended March. 31, 2016 (All the figures in thousands)

Receipts	Rs	Payments	Rs
Cash in hand	100	Groundsman's Fee	750
Balance at Bank as per Pass Book:		Moving Machine	1,500
Deposit Account	2,230	Rent of Ground	250
Current Account	600	Cost of Teas	250
Bank Interest	30	Fares	400
Donations and Subscriptions	2,600	Printing & Office Expenses	280
Receipts from teas	300	Repairs to Equipment	500
Contribution to fares	100	Honorarium to Secretary and	
Sale of Equipment	80	Treasurer of 2015	400
Net proceeds of Variety		Balance at Bank as per Pass Book:	
Entertainment	780	Deposit Account	3,090
Donation for forth coming		Current Account	150
Tournament	1,000	Cash in hand	250
	7,820		7,820

You are given the following additional information:

Particulars	April.1.2015 (Rs.)	March.31.2016 (Rs.)
Subscription due	150	100
Amount due for printing etc.	100	80
Cheques unpresented being payment for repairs	300	260
Estimated value of machinery and equipment	800	1,750
Interest not yet entered in the Pass book		20
Bonus to Groundsman o/s.		300

For the year ended March. 31, 2016, the honorarium to the Secretary and Treasurer are to be increased by a total of Rs 200.

Required: Prepare Income & Expenditure Account for period ending 31-03-2016 and the relevant Balance Sheet.

Question: 5

The Income and Expenditure Account of the Youth Club for the Year 2016 is as follows:

Expenditure	Rs.	Income	Rs.
To Salaries	4,750	By Subscription	7,500
To General Expenses	500	By Entrance Fees	250
To Audit Fee	250	By Contribution for annual dinner	1,000
To Secretary's Honorarium	1,000	By Annual Sport meet receipts	750
To Stationery & Printing	450		
To Annual Dinner Expenses	1,500		
To Interest & Bank Charges	150		
To Depreciation	300		
To Surplus	600		
	9,500		9,500

This account had been prepared after the following adjustments:

Particulars	Amount (Rs.)
Subscription outstanding at the end of 2015	600
Subscription received in Advance on 31st December, 2015	450
Subscription received in advance on 31st December, 2016	270
Subscription outstanding on 31st December, 2016	750

Salaries Outstanding at the beginning and the end of 2016 were respectively Rs.400 and Rs.450. General Expenses include insurance prepaid to the extent of Rs.60. Audit fee for 2016 is yet unpaid. During 2016 audit fee for 2015 was paid amounting to Rs.200.

The Club owned a freehold lease of ground valued at Rs.10,000. The club had sports equipment on 1st January 2016 valued at Rs.2,600. At the end of the year, after depreciation, this equipment amounted to Rs.2,700. In 2015, the Club has raised a bank loan of Rs.2,000. This was outstanding throughout 2016. On 31st December 2016 cash in hand amounted to Rs.1,600.

Required: Prepare the Receipts and Payments Account for 2016 and Balance Sheet as at the end of the year.

Question: 6

From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account and Subscription Account for the year ended 31st March 2016:

Income & Expenditure Account for the year 2015-16

Expenditure	Rs.	Income	Rs.
Upkeep of Ground	10,000	By Subscriptions	17,320
Printing	1,000	By Sale of Newspapers (Old)	260
Salaries	11,000	By Lectures	1,500
Depreciation on Furniture	1,000	By Entrance Fee	1,300
Rent	600	By Misc. Income	400
		By Deficit	2,820
	23,600		23,600

Balance Sheet as at 31st March 2016

Liabilities		Rs.	Assets	Rs.
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Subscription in Advance (2016-17)		100	Furniture	9,000
Prize Fund: Opening Balance			Ground and Building	47,000
Add: Interest	25,000		Prize Fund	
	<u>1,000</u>		Investment	
Less: Prizes	26,000		Cash in Hand	20,000
General Fund: (2,000)		24,000	Subscription (outstanding) (2015-16)	2,300
Opening Balance				
Less: Deficit	56,420			700
	<u>(2,820)</u>			
Add: Entrance Fee	53,600			
	1,300	54,900		
		79,000		79,000

The following adjustments have been made in the above accounts:

1. Upkeep of ground Rs.600 and Printing Rs. 240 relating to 2014-2015 were paid in 2015-16.
2. One-half of entrance fee has been capitalised by transfer to General Fund.
3. Subscription outstanding in 2014-15 was Rs.800 and for 2015-16 Rs.700.
4. Subscription received in advance in 2014-15 was Rs.200 and in 2015-16 for 2016-17 Rs. 100.

Question: 7

The Sportswriters Club gives the following Receipts and Payments Account for the year ended March 31, 2016:

Receipts and Payments Account

Receipts	Rs.	Payments	Rs.
To Balance b/d	4,820	By Salaries	12,000
To Subscriptions	28,600	By Rent and electricity	7,220
To Miscellaneous income	700	By Library books	1,000
To Interest on Fixed deposit	2,000	By Magazines and newspapers	2,172
		By Sundry expenses	10,278
		By Sports equipment's	1,000
		By Balance c/d	2,450
	36,120		36,120

Figures of other assets and liabilities are furnished as follows:

Particulars	As at March 31	
	Rs.	Rs.
	2015	2016
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines and newspapers	226	340
Fixed Deposit (10%) with bank	20,000	20,000
Interest accrued thereon	500	500
Subscription receivable	1,263	1,575

Prepaid expenses	417	620
Furniture	9,600	
Sports equipment's	7,200	
Library books	5,000	

The closing values of furniture and sports equipment's are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The Club's library books are revalued at the end of every year and the value at the end of March 31, 2016 was Rs. 5,250.

Required: From the above information you are required to prepare:

- The Club's Balance Sheet as at March 31, 2015;
- The Club's Income and Expenditure Account for the year ended March 31, 2016.
- The Club's Closing Balance Sheet as at March 31, 2016.

Question: 8

From the following balances and particulars of Republic College, prepare Income & Expenditure Account for the year ended March 2016 and a Balance Sheet as on the date:

	Rs.	Rs.
Seminars & Conference Receipts		4,80,000
Consultancy Receipts		1,28,000
Security Deposit - Students		1,50,000
Capital Fund		16,06,000
Research Fund		8,00,000
Building Fund		25,00,000
Provident Fund		5,10,000
Tuition Fee Received		8,00,000
Government Grants		5,00,000
Donations		50,000
Interest & Dividends on Investments		1,85,000
Hostel Room Rent		1,75,000
Mess Receipts (Net)		2,00,000
College Stores-Sales		7,50,000
Outstanding expenses		2,25,000
Stock of-stores and Supplies (opening)	3,00,000	
Purchases - Stores & Supplies	8,00,000	
Salaries - Teaching	8,50,000	
Research	1,20,000	
Scholarships	80,000	
Students Welfare expenses	38,000	
Repairs & Maintenance	1,12,000	
Games & Sports Expenses	50,000	
Misc. Expenses	65,000	
Research Fund Investments	8,00,000	
Other Investments	18,50,000	
Provident Fund Investment	5,10,000	
Seminar & Conference Expenses	4,50,000	
Consultancy Expenses	28,000	
Land	1,00,000	
Building	16,00,000	

Plant and Machinery	8,50,000	
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Furniture and Fittings	6,00,000	
Motor Vehicle	1,80,000	
Provision for Depreciation:		
Building		4,80,000
Plant & Equipment		5,10,000
Furniture & Fittings		3,36,000
Cash at Bank	6,42,000	
Library	3,60,000	
	1,03,85,000	1,03,85,000

Adjustments:

	Particulars	Rs.
(1)	Materials & Supplies consumed: (From college stores)	
	Teaching	50,000
	Research	1,50,000
	Students Welfare	75,000
	Games or Sports	25,000
(2)	Tuition fee receivable from Government for backward class Scholars	80,000
(3)	Stores selling prices are fixed to give a net profit of 10% on selling price	
(4)	Depreciation is provided on straight line basis at the following rates:	
	(1) Building	5%
	(2) Plant & Equipment	10%
	(3) Furniture & Fixtures	10%
	(4) Motor Vehicle	20%

Chapter 18 – INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

Overview

- *Meaning and Objective of Cost Accounting*
- *Importance of Cost Accounting*
- *Elements of Cost Accounting*
- *Scope of cost Accounting*
- *Difference between Cost Accounting and Financial accounting and Management Accounting*
- *Methods to separate Variable, Semi variable and Fixed costs.*
- *What is Cost control and Cost reduction?*
- *Methods and Techniques of Cost Accounting*
- *Essentials of Good Cost Accounting system*
- *Installation of Coding Systems*

INTRODUCTION

Financial accounting is mostly concerned to record the business transactions in books of accounts so that final accounts can be prepared. Cost accounting developed to help the internal management in decision making. The Information provided by Cost Accounting acts as a managerial tool so that business can utilize the available resources at optimum level. Management Accounting is an extension of management aspects of Cost Accounting. It provides the information to management so that planning, organizing, directing, and controlling of business operations can be done in an orderly manner. Therefore, the objective of the lesson is to enable the student to understand the meaning and purpose of cost and management accounting and its application in different manufacturing and service environment.

1. Meaning of Cost, Costing, Cost Accounting, Cost Management and Cost Accountancy

A. Cost

- In business and accounting, cost is the monetary value which a company has spent to produce something.
- Cost indicates the amount of money which a company spends on the creation or production of goods or services. It does not include the profit markup.

Cost v/s Value v/s Price

BASIS	COST	VALUE	PRICE
Meaning	Expenditure incurred in producing a product or rendering a service	Relative worth of a commodity to an individual at a particular point of time	Amount paid by a consumer for a product or service
Viewpoint	Producer	User	Consumer
Inference	It is a fact	It is an opinion	It is a policy

B. Costing

- The Institute of Cost and Management Accountants (ICMA) defines costing as “the techniques and process of ascertaining costs”.

C. Cost Accounting

According to definition given by CIMA, London “Cost Accounting is the process of accounting for cost from the point at which expenditure is incurred to the establishment of its ultimate relationship with cost centres and cost units”.

- It includes the presentation of information derived there from for the managerial decision-making purpose.
- It is that branch of accounting which deals with the classification, recording, summarization, allocation, and reporting of current and prospective costs.

D. Cost Management

- To provide less expensive products or services to consumers cost management is done to reduce operating or production expenses.
- It is the process management uses to analyse its production and streamline its operations to manage expenses in the future by keeping the cost low.
- It is very much essential for a company to employ proper cost management, or else it will have difficulty consistently generating a profit.

1.1 Cost Unit

- It is a unit of product, service, or time (or combination of these) in relation to which costs may be ascertained or expressed.
- Cost units are usually the units of physical measurement like number, weight, area, volume, length, time, and value.

Product / Service	Cost Unit	Product / Service	Cost Unit
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Soaps	Number / Carton	Brickworks	Per 1000 brick
Wire / Cable	Meter / Kilometer	Building	Square foot
Dairy (Milk)	Liter / Bag	Cement	Ton
Goods transport	Ton kilometer	Power	Kilowatt hour
Passenger transport	Passenger Kilometer	Paper	Rim
Wood / Gas	Cubic Feet (cft)	Textiles	Meters
Food grains	Kg. / Quintal / Ton	Road contractors	Per mile / kilometer
Sugar	Per Ton	Bicycle	Number
Hospital	Per patient day	Pharmaceuticals	1000 tablets
Automobile	Per vehicle / Number	Steel	Ton

The following are examples in certain cases:

Brick Industries	Cost Unit per 1000 bricks.
Coal Mines	Cost Unit per quintal.
Cotton Mills	Cost Unit per meter.
Electric Company	Cost Unit per unit.
Transport Companies	Cost Unit per kilometre.
Steel Companies	Cost Unit per ton.
Water Supply	Cost Unit per 1000 litres
Furniture Industries	Cost Unit per number
Oil Companies	Cost Unit per litre.
Soap Factory	Cost Unit per dozen, per, kilogram or per tablet.

1.2 Cost Centres

- It is defined as a location, person, or an item of equipment (or group of these) for which cost may be ascertained and used for the purpose of Cost Control.
- Cost Centres are of two types,
 - Personal Cost Centre:** It consists of a person or group of persons e.g., Mr. X, supervisor, foreman, accountant, engineer, process staffs, mining staffs, doctors etc.
 - Impersonal Cost Centre:** It consists of a location or an item of equipment (or group of these) e.g., Ludhiana branch, boiler house, cooling tower, weighing machine, canteen, and generator set etc.
- Cost Centers in a manufacturing concern:**

Two main types of Cost Centres are indicated as below:

- Production Cost Centre:** It is a cost Centre where raw material is handled for conversion into finished product. Here both direct and indirect expenses are incurred. Machine shops, welding shops and assembly shops etc. are examples of production Cost Centres.
 - Service Cost Centre:** It is a cost Centre which serves as an ancillary unit to a production cost Centre. Payroll processing department, HRD, Powerhouse, gas production shop, material service Centres, plant maintenance Centres etc. are examples of service cost Centres.
- Profit Centres and investment Centres**
 - A profit Centre is a Centre where the manager has the responsibility of generating and maximizing profits. In such Centres, the manager is responsible for revenue and cost.
 - Investment Centres are those Centres which are concerned with earning an adequate ROI. In such Centres, the manager is responsible for investment, revenue, and cost.

Types of Responsibility Centres:

Particulars	Cost Centers	Revenue Centers	Profit Centers	Investment Centers
Meaning	A Center for which a standard amount of cost is pre-determined and used for control.	A Center devoted to raising revenue (no responsibility for production).	A Center whose performance is measured in terms of income earned and cost incurred (profit earning).	A Center responsible for earning profits and for asset utilization.
Primary responsibility	Cost reduction and cost control	Generation of sale revenue.	Profit earning.	Earning return on investments.
Performance evaluation	Standard cost Less: Actual cost	Budgeted revenue Less: Actual revenue	Budgeted profits Less: Actual profits	Budgeted ROI Less: Actual ROI
Other points	Control of cost is subject to – Time Location Product	Also responsible for some expenses related with marketing of products.	It may mean that one division sells its output to another division within the organization – i.e., inter-divisional transfer pricing.	Value of Investment in this responsibility Center needs to be carefully defined and return on investment to be defined as before tax or after tax, before interest or after interest etc.

1.3 Cost Object

A cost object is any item for which costs are being separately measured. It is one of the key concepts used in managing the costs of a business concern. Here are some types of cost objects.

- **Output:** The Company's products and services are the most common cost objects since it wants to know its output cost for analysis of profitability and price setting.
- **Operational:** Most of the times a cost object can be within a company, for example a department, machining operations, production line, or process. For example, you could be able to track the cost of designing a new product, or a customer service call, or of reworking a returned product.
- **Business relationship:** A cost object can be outside of a company - there may raise a need to accumulate costs for a customer or supplier, to determine the cost of dealing with that of the entity. Another variation we can say on the concept is the cost of renewing a license with a government agency.

Examples of Cost Object are:

• Product	Smart phone, Tablet computer, SUV car, Book etc
• Services	An Airline flight from Delhi to Mumbai, Concurrent Audit assignment, Utility bill payment facility etc.

• Project	Metro Rail project of DMRC, Road Projects of NHAI etc.
• Activity	Quality inspection of materials, Placing of orders etc.
• Process	Refinement of crudes in oil refineries, melting of billets or ingots in rolling mills etc.
• Department	Production department, Finance & Accounts, Safety etc.

1.4 COST ACCOUNTING WITH THE USE OF INFORMATION TECHNOLOGY (IT)

With the expansion of e-commerce and increasing competitive business environment, information technology is becoming an integral part of each activity in an organisation including Cost and Management Accounting. Information technology has changed the Cost and Management Accounting functions dramatically with the introduction of Enterprise Resource Planning (ERP) system. Cost Accounting and Management Information System has become automated and improved. The new industrial revolution in the form of digital innovation which is popularly known as Industry 4.0, has more emphasis on digitisation and automation of business process to have a better control over cost to maintain market competitiveness. Cost Accounting System has seen lots of savings in terms of time, money and efforts. The impact of IT in Cost Accounting may include the following:

- (i) After the introduction of ERPs, different functional activities get integrated and as a consequence, a single entry into the accounting system provides custom made reports for every purpose and saves an organisation from preparing different sets of documents. Reconciliation process of results of both cost and financial accounting systems becomes simpler and less cumbersome.
- (ii) A move towards paperless environment can be seen where documents like Bill of Material, Material Requisition Note, Goods Received Note, labour utilisation report etc. are no longer required to be prepared in multiple copies, the related department can get e-copy from the system.
- (iii) Information Technology with the help of internet (including intranet and extranet) are helping in resource procurement and mobilisation. For example, production department can get materials from the stores without issuing material requisition note physically. Similarly, purchase orders can be initiated to the suppliers with the help of extranet. This enables an entity to shift towards Just-in-Time (JIT) approach of inventory management and production.
- (iv) Cost information for a cost centre or cost object is ascertained with accuracy in timely manner. Each cost centre a cost object is codified and all related costs are assigned to the cost objects or cost centres using assigned codes. This automates the cost accumulation and ascertainment process. The cost information can be customised as per the requirement. For example, when an entity manufactures or provides services, managers are able to receive information job-wise, batch-wise, process-wise, cost centre wise etc.
- (v) Uniformity in preparation of report, budgets and standards can be achieved with the help of IT. ERP software plays an important role in bringing uniformity irrespective of location, currency, language and regulations.
- (vi) Cost and revenue variance reports are generated in real time basis which enables the management to take control measures immediately.
- (vii) IT enables an entity to monitor and analyse each process of manufacturing or service activity closely to eliminate non value-added activities.

The above are examples of few areas where Cost Accounting is done with the help of IT.

Digital Costing System

Like the conventional cost accounting system, Digital costing system too collects data, classify the data, account the data to get and process information to make decisions, but the difference is the method of collection,

medium of storage, forms of analysis and reporting. Digital costing system links different business functions such as production, procurement, inventory management with the digital costing system of its suppliers, customers and the market through data sharing and network interaction.

Digital Costing System provides data to get the following information:

- (i) Cost incurred on a cost object.
- (ii) Data on time spent.
- (iii) Data on resource consumption.
- (iv) Data on current market price of final product and raw materials.

(v) Data on lead time and availability of materials.

(vi) Data on product demand and trend.

Benefits of Digital Costing System

With the help of Artificial Intelligence (AI) and Machine learnings (ML) which helps in analysis of the Big data and apprehend the consumption and demand pattern, the following benefits can be achieved:

- (i) Ascertainment of cost with certainty on a cost object (the cost object is discussed in later paragraph). This helps to analyse the activities for cost allocation and apportionment.
- (ii) Analysis of data on time spent on each activity to study and formulate incentive plans.
- (iii) Helps in material requirement planning and scheduling the material procurement. Data on resource consumption can be analysed for resource optimisation and finding the possibilities for zero wastage and Just-in Time (JIT).
- (iv) Helps to identify and eliminate the non-value-added activities.
- (v) Data on resource consumption is helpful in setting the standards and measurement of variances on real time basis.
- (vi) Data on current market prices of material and consumables helps to estimate cost and setting standards on Marked to Market (M2M) basis.
- (vii) Extrapolation of data on customer behaviour towards the products to predict the market demand. It is helpful in preparation of budgets and planning of production.
- (viii) A better analysis of cost behaviour improves the cost benefit analysis and equipping the management in informed decision making.

2. Objectives of Cost Accounting



Objectives of costing

- Ascertainment of cost
- Determination of profitability
- Cost control
- Cost reduction
- Assisting management in decision making

- The main objective of the cost accounting is the ascertainment and accumulation of cost. Cost is accumulated, assigned, and ascertained for each individual cost object.
- The profit of any activity can be ascertained by matching cost with the revenue of that activity. The purpose under this step is to determine costing profit or loss of any activity on an objective basis.
- **Cost reduction** may be defined "as the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for the use intended or diminution in the quality of the product."
- **Cost control:** Determine clearly the objective Measure the actual performance, investigate into the causes of failure and Institute corrective action should be observed to exercise cost control.
- The target cost and/ or targets of performance should be laid down in respect of each department or operation and these targets should be related to individuals who, by their action, control the actual and bring them into line with the targets.
- **Decision making** is defined as a process of selecting a course of action out of two or more alternative courses.

3. Scope of Cost Accounting

- **Cost Analysis:** Cost accounting determines the deviation of the actual cost by comparing it to the planned expense, and accordingly fixation of responsibility for cost differences.
- **Cost Audit:** cost audit is necessary to verify the cost sheets and to check whether efficient application of accounting principles in the industries, cost audits done.
- **Cost Report:** Cost reports are prepared from the which we have acquired through cost accounting to analysed by the management for strategic decision
- **Cost Ascertainment:** To ascertain the price of a or service, it is necessary to know the actual total involved in the generation of that product or
- **Cost Bookkeeping:** we prepare journal entries, balance sheet and profit and loss account in financial accounting. The same is prepared in cost accounting Here, the different cost incurred is debited, and or service income is credited.
- **Cost System:** It provides for time-to-time monitoring and evaluation of the cost incurred in the production of goods and services for the generation reports for the management.
- **Cost Comparison:** It examines the other alternative line or activities and the cost involved in it, to seek a better opportunity for generating high revenue.
- **Cost Control:** Sometimes, the actual cost of a product or service will be higher than its standard cost. To control the actual cost and eliminate the difference, cost accounting is required.
- **Cost Computation:** When the company is engaged in the production of bulk units of a particular product or commodity, the actual per-unit cost is derived through cost accounting.
- **Cost Reduction:** It acts as a tool in the management's hands to find out whether there is any scope to reduce the standard cost involved in the production of goods and services. Purpose of it is to obtain additional gain.



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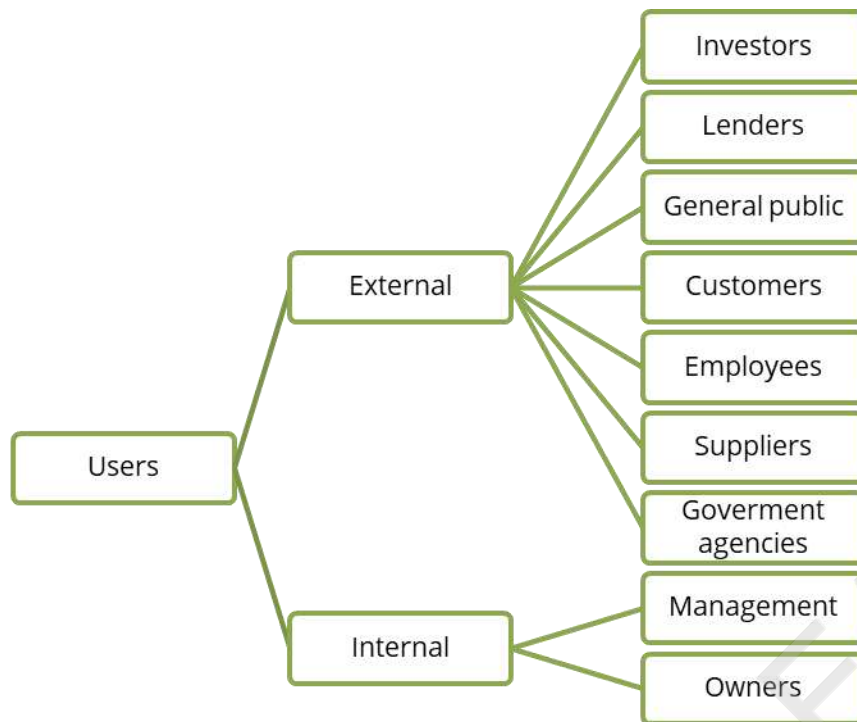
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4. Users of Cost and Management Accounting

Accounting information of a business enterprise is used by many stakeholders. We can broadly divide the users of accounting information into two groups – internal users and external users.



Internal users: Internal users use a mix of financial accounting and management information. Some of the internal users of accounting information and their basic needs are discussed below shortly:

A. Management:

- Accounting information are used by the management for evaluation and analyzation organization's financial performance and position, to take important decisions and appropriate actions for the improvement of the business performance in terms of profitability, financial position, and cash flows.

B. Owners

- Capital is invested by the owners to start and run business with the primary objective of earning profit.
- They need accurate financial information to know what they have earned or lost during a particular period.

External users: External users only use financial accounting information normally. Some of the external users of the accounting information and their needs are discussed below shortly:

C. Investors

- In corporate form of business, the management is often separated from the ownership.
- Normally capital is provided by the investors and the business operated by the management. The accounting information is used by both actual and potential investors.
- Actual investors use this information to know how their funds are used by the management and what is the performance of business we can expect in future in terms of profitability and growth.

D. Lenders

- Lenders are individuals or financial institutions which normally lend money to businesses and earn income by way of interest on it.
- Lenders need accounting information to assess the financial performance and position and they need accounting information to have a reasonable assurance that the business to whom they are going to lend money would be able to return the principal amount as well as the interest there on.

E. Suppliers

- Suppliers are business individuals or organizations who sell merchandise or raw materials to other businesses on credit normally.
- Accounting information are used by them to have an idea about creditworthiness of the business in future and to decide whether to continue providing goods on credit.

F. Government agencies

- Government agencies generally use business's financial information for the purpose of imposing taxes and regulations.

G. General public

- Accounting information of business organizations are used by public also. For example, accounting information acts as:
 - A good source of education for students of accounting and finance.
 - A source of valuable data for those people researching on organizational impacts on individuals and economy.

H. Customers

- Customers are aware of current position of a business organization through the accounting information, and it helps to make a judgment about its future.
- Customers can be classified into three groups – manufactures or producers at various stages of production, wholesalers and retailers and end users or final consumers.

I. Employees

- External users (of accounting information) are those who do not have a hand in core management of the business.
- Those users are interested in financial information because their present and future is tied up with the success or failure of the business.
- Job security, better remuneration, job promotion and retirement benefits are ensured by the success and profitability of business.

5. Difference between Cost Control and Cost Reduction

Basis of Comparison	Cost Control	Cost Reduction
Meaning	A Technique used for maintaining the cost as per the set standards is known as Cost Control.	A Technique used to economize the unit cost without lowering the quality of the product is known as Cost Reduction.
Savings in	Total Cost	Cost per unit
Retention of Quality	Not guaranteed	Guaranteed
Nature	Temporary	Permanent
Emphasis on	Past and Present cost	Present and Future Cost
Ends when	The pre-determined target is achieved	No end
Type of Function	Preventive	Corrective

6.

Difference between Cost Accounting and Financial Accounting

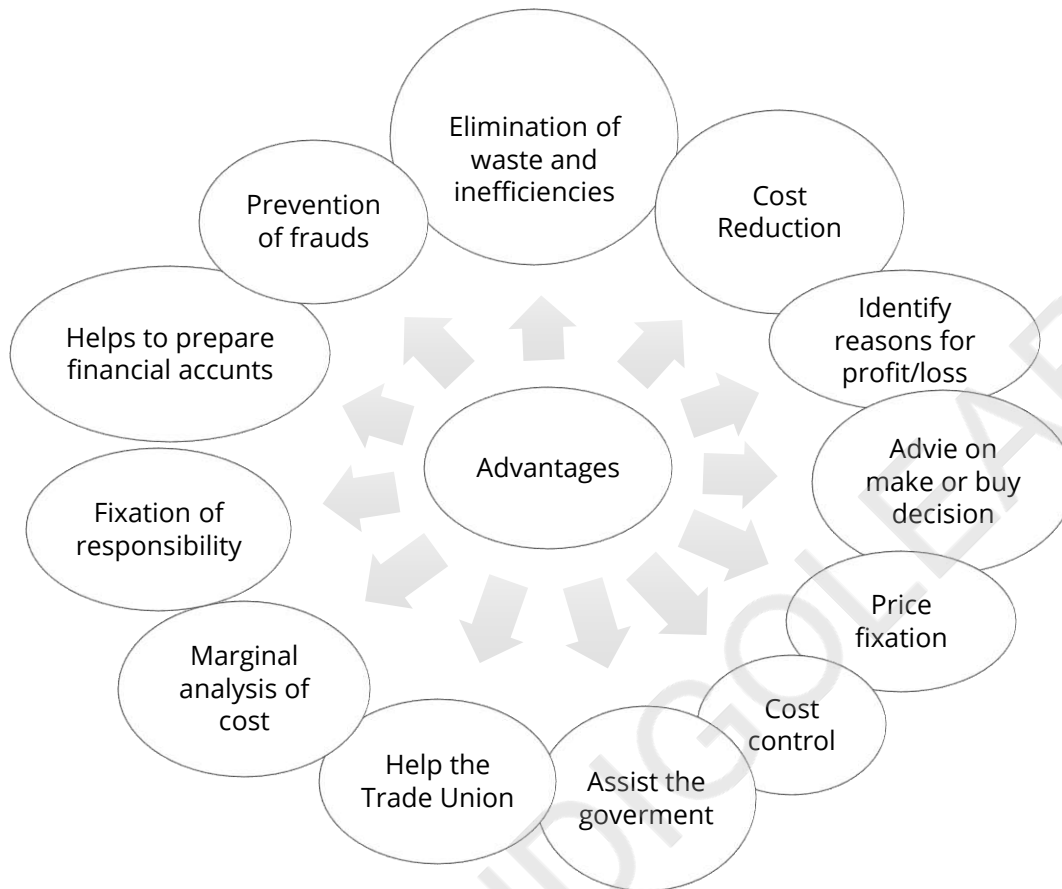
Sr. No.	Particulars	Cost Accounting	Financial Accounting
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1.	Meaning	It is the application of costing and cost accounting principles, methods & techniques to the science, art and practice of cost control and the ascertainment of profitability. It includes the presentation of information derived there from for the purpose of managerial decision making.	It is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of a financial character and interpreting the results thereof.
2.	Details Provided	It provides financial analysis of the business affairs product wise, service wise, element wise, or activity wise.	It gives financial picture and the situation of a business in totality.
3.	Users of Information	It renders information for the guidance of management, proper planning, operation control and decision making.	It safeguards the interests of the business, its properties and other concerned like creditors, shareholders, tax authorities.
4.	Main Objective	The main object is to ascertain the correct cost of production / Services.	The main object is to ascertain correct profit / loss position and to give a true and fair view of the state of affair of business.
5.	Time Period	It is future oriented activity.	It is a post – mortem activity.
6.	Usefulness	It forms the basis for managerial decision making like make or buy, continue or shutdown, product mix, etc.	It forms the basis for fulfilling the legal requirements like Income-tax Act, Companies Act, Excise & Customs Act, etc.
7.	Final Output	The final output is in the form of a Cost-Sheet.	The final output is in the form of Profit and Loss A/c and Balance Sheet.
8.	Objective	Profit Maximization is the objective.	Profit / Loss Ascertainment is the objective.
9.	Stock Valuation	Stocks are valued generally at cost.	Stocks are valued at Cost or Net Realizable Value whichever is less.
10.	Nature of costs	It considers both historical costs and pre-determined costs and extends to plans and policies to improve future performance.	Generally historical costs are used for recording purposes. Projected financial statements may also be drawn for budgeting purposes.

Difference between Cost Accounting and Management Accounting

Basis	Cost Accounting	Management accounting
Nature	Records the quantitative aspect only.	Records both qualitative and quantitative aspect
Objective	Records the cost of producing a product and providing a service.	Provides information to management for planning and coordination.
Area	Deals with cost ascertainment only.	wider in scope as it includes financial accounting, budgeting, taxation, planning etc.
Recording of data	uses both past and present figures	Focused with the projection of figures for future.
Development	Related to industrial revolution.	Developed in accordance with the need of modern business world.
Rules and regulation	Follows certain principles and procedures for recording costs of different products.	does not follow any specific rules and regulations

8. Advantages of Cost Accounting



The extent of advantages derived from the cost accounting is based on the type, adequacy, and efficiency of cost accounting system installation. Moreover, the management at the maximum should accept the advice given by the cost accounting system. If so, the following advantages may be available to an organization.

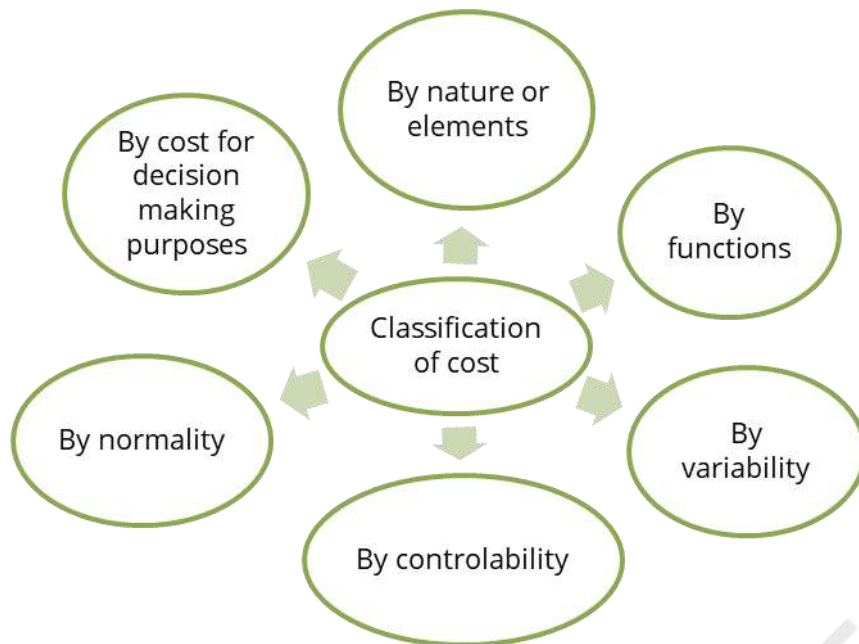
- **Elimination of Wastes, Losses, and Inefficiencies:** A good cost accounting system eliminates wastes, losses, and inefficiencies by fixing standard for everything.
- **Cost Reduction:** Under cost accounting system, new and improved methods of production are followed which leads to cost reduction.
- **Identify the reasons for Profit or Loss:** The reasons for increasing or decreasing profit will be identified by the good cost accounting system. If identified, then the management can take remedial action to maintain the concern's profitability. There is no possibility of shutting down of any product or process or department.
- **Advise on Make or Buy Decision:** The management can decide whether to make or buy a product in open market based on cost information. The management can be able to choose the best out of many alternatives rightly. Sometimes, even spare capacity can be used profitably.
- **Price Fixation:** Costing records provides the total cost of a product available which is highly useful for price fixation of a product.
- **Cost Control:** Under cost accounting system, Budgets are prepared, and standards are fixed. The expenses are not allowed to go beyond the budgeted amount. The actual performance is compared with standard to find the variation. If any variations are found, reasons will be found out and the management can exercise control.
- **Assist the Government:** Government can collect reasonable tax from the company and exercise price control.

9. Limitations of Cost Accounting

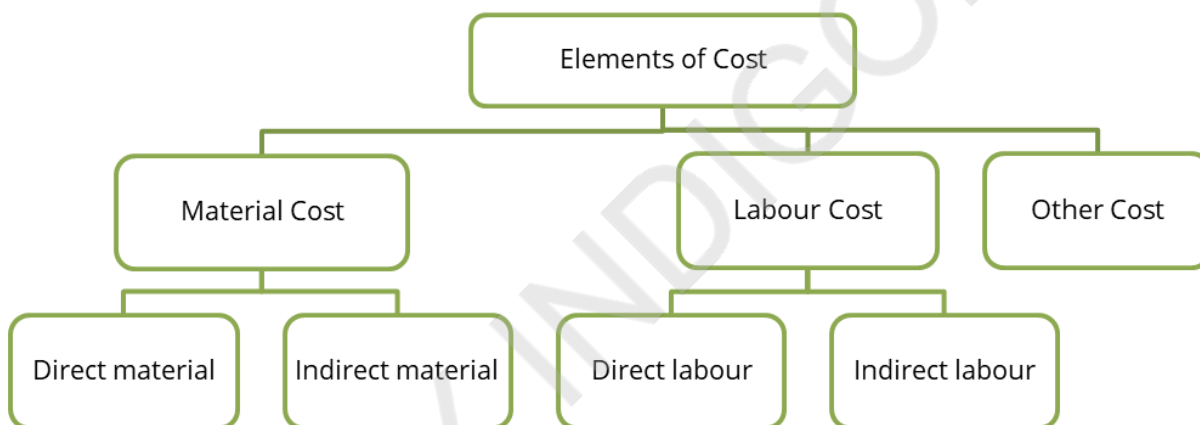


- **Lack of Uniformity:** Cost Accounting has a lack of a uniform procedure. Different results from the same data can be brought out. So, it means that Costing system itself does not control costs, but its usage does.
- **Costly:** It is expensive because analysis, allocation and absorption of overheads require considerable amount of additional work, and hence additional money.
- **Ignores Futuristic Situation:** Cost Accounting ignores the future situation of the product cost. It only records past cost records on the other hand management is taking future decision. Therefore, cost data are not very useful.
- **Uses Secondary Data:** Cost Accounting uses secondary data from financial statements for various calculations like standard cost. It does not include primary data or short-term data. That is why cost accounting does not provide effective results.
- **Only Bring out the Cost of Goods:** It is unable to find the financial status of the company in the cost accounting. It cannot determine the operational efficiency of a business and it can ascertain only the cost of goods. For assessment of the financial position, we must depend upon the financial accounting.
- **Unable to Determine Tax Liability:** Tax liability of the company cannot be found out in the cost accounting. So, it cannot be treated as a basis for calculating it. Therefore, financial accounting will be needed for finding out the tax liability.

10. Classification of cost



10.1 By Nature or Elements



A. Direct Material:

- Direct materials are the materials from which a product is produced or manufactured.
- The cost of direct material will vary according to the level of output derived.
- For example: Milk is the direct material of butter.

B. Indirect Material:

- Materials which do not normally form part of the finished product (cost object) are known as indirect materials.
- For example: Nails are used in furniture.
- The cost of indirect material will not vary according to the level of output derived.

C. Direct Labour:

- It refers to the amount paid to the workers who are directly engaged in the production of goods.
- Cost object is called direct labour.

D. Indirect Labour:

- Indirect labour is the amount paid to the workers who are engaged in the production of goods indirectly.
- It does not vary directly with the output.

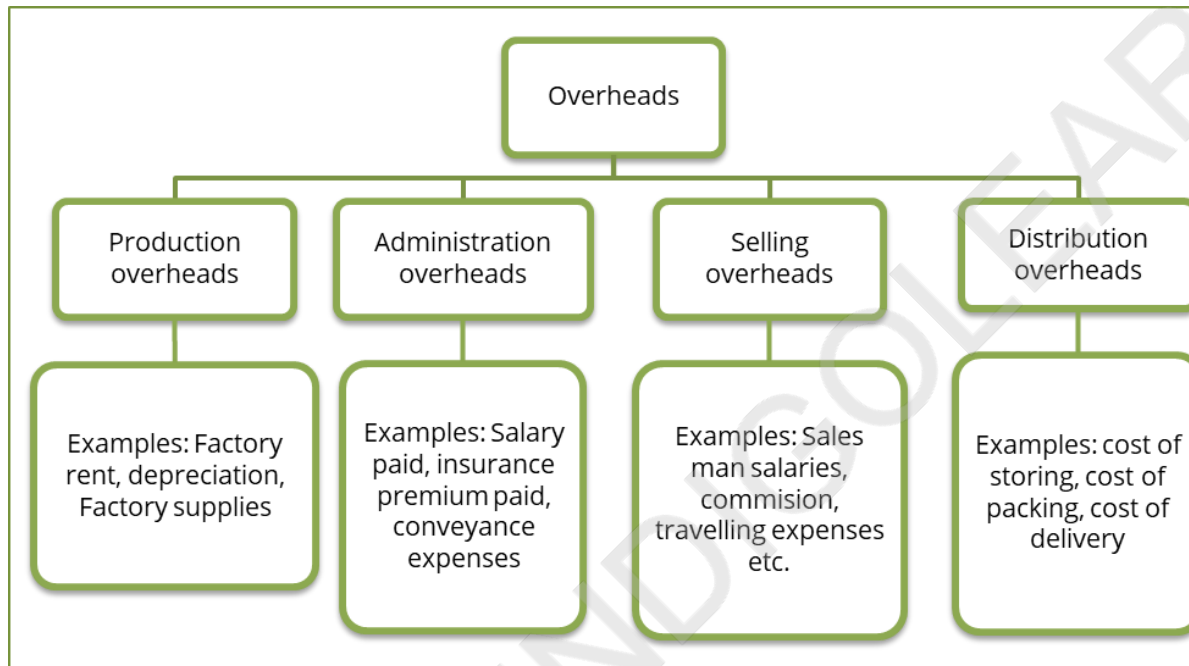
E. Direct expenses:

- It includes all expenses other than direct material or direct labour.
- Which are specially incurred for a particular cost object and can be identified in an economically feasible way.
- For example, hire charges for some special machinery, cost of defective work.

F. Indirect expenses:

- Expenses other than direct expenses are known as indirect expenses.
- Factory rent and rates, insurance of plant and machinery, power, light, heating, repairing, telephone etc., are some examples of indirect expenses.

G. Overheads:

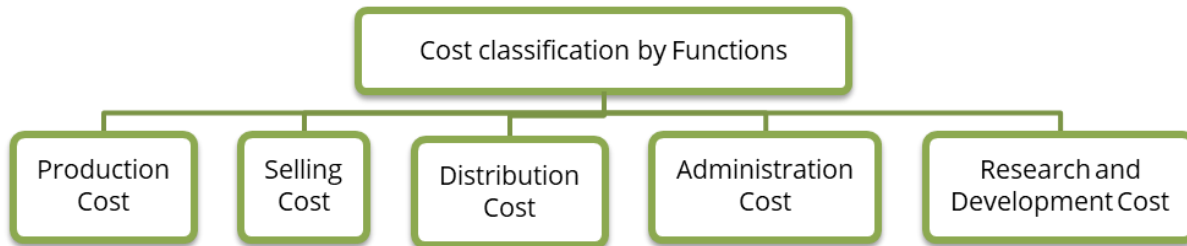


It is the aggregate of indirect material costs, indirect labour costs and indirect expenses.

- **Production Overheads:** It is otherwise known as manufacturing overhead, works overhead or factory overhead. All the indirect expenses, which are incurred in the factory and for the running of the factory, are treated as production overhead.
- **Administration Overheads:** The term administration refers to the formulation of policy, direction, and management of affairs. Indirect expenses related to management and administration of business come under administration overheads.
- **Selling Overhead:** The selling overhead refers to the cost of selling expenses i.e., indirect expenses incurred for marketing of a commodity E.g.: Advertisement expenses, commission to salespersons etc.
- **Distribution Overhead:** Indirect expenses incurred in dispatch of the goods are termed as distribution overheads.

E.g.: warehouse charges, packing and loading charges.

10.1 By Functions



A. Production Cost:

- Production cost comprises of all the direct and indirect costs incurred in the production of goods and services.

B. Administration Cost:

- Cost of formulating policy, controlling the organization, costs not directly related to production. Ex - Salary of Office Staff. These are also known as administrative overheads.

C. Selling Cost:

- The indirect costs incurred which is related to the sales function of the goods and services or Cost for creating demand of the product produced like an advertisement; promotion, research, customer service, etc. are the selling costs.

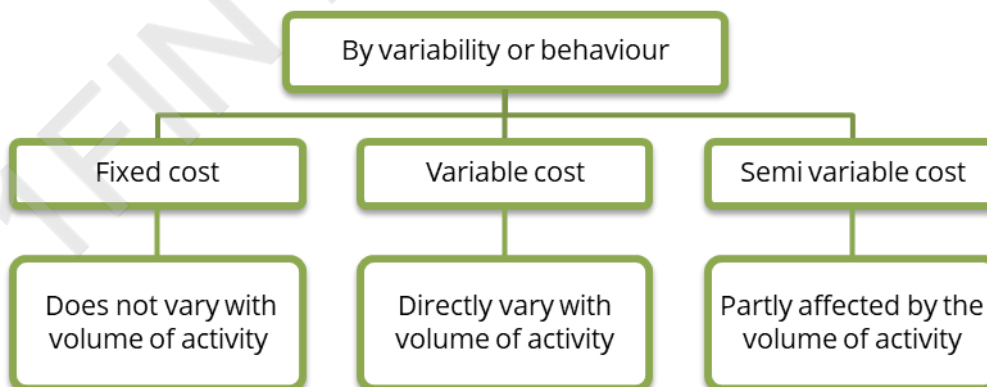
D. Distribution Cost:

- Costs starting from packing of the product till reconditioning of empty product. These are warehousing, delivery service, transportation, etc.

E. Research and Development Cost:

- Research is essential to develop a new product or modify an existing one. The cost relating to the research team, research implementation, findings, etc. comes under the research and development cost.

10.2 By Variability or Behaviour



A. Fixed Cost:

- Cost which does not vary with the change in the volume of activity in the short run is called fixed cost.
- These costs are not affected by temporary changes in activity of a business concern.

- These are also known as period costs.
- Ex: Rent, Insurance of factory building etc.

B. Variable Cost

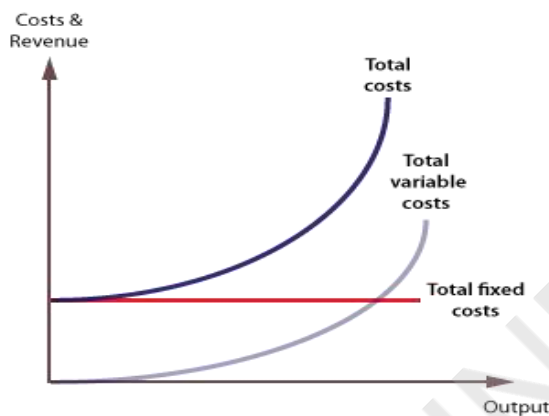
- Variable cost is the cost which directly varies with the volume of activity.
- Variable cost can be divided into – (a) Variable direct cost; and (b) Variable indirect costs.
- Variable indirect costs are known as variable overhead.
- Any increase in the activity results in increase in the Variable cost and vice versa. For example, cost of Direct Labour etc

C. Semi Variable Costs:

- Semi variable cost contains both fixed and variable cost.
- They are partially affected by changes in the level of activity.
- For example, telephone bills, gas, and electricity etc.

Methods of segregating Semi variable cost into fixed cost and variable cost

Segregation of Semi – variable cost in fixed cost and variable cost can be carried out by using following methods.



1. Graphic method

- Under this method, output in various levels and the semi-variable overhead of corresponding levels are considered.
- A scatter graph can be drawn with the help of these data. X-axis is taken as output and Y-axis is taken as semi-variable overhead in total.
- The costs at a various level of output are plotted on a graph.
- Then, a straight line should be drawn between the plotted points.
- Line of best fit touches the ordinate at one point. It indicates the fixed component of the total cost.
- The slope of the line indicates the degree of variability of costs.

Following example illustrates the graphic method.

Month	Direct labour hrs	Cost (Rs)
January	17000	320000
February	15000	310000
March	17000	310000
April	19500	295000
May	21000	250000
June	16000	265000
July	13000	250000

August	13000	250000
September	15500	265000
October	17500	275000
November	21500	290000
December	24000	340000
	210000	3420000

- Plot each of the observation on the graph paper
- Fit the regression line or trend line to the data.
- Plot line B by visual inspection
- Draw a line parallel to the base line from the point of intersection on the y axis which will be at Rs.220000.
- Line A represents fixed portion of the expenses.
- Triangle formed by the line A and B shows the increase in the expenses.

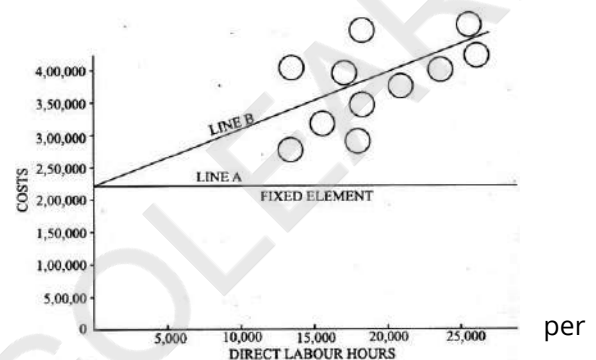
Fixed expenses per month = RS 220000

Fixed expenses per year = 220000 * 12 = Rs 2640000

Variable portion = Total expenses - Fixed portion

Variable portion = 3420000 - 2640000 = 780000

Variable cost per hour = Rs 780000 / 210000 = Rs 3.7
Hour.



2. High points and low points method

- This method is also called as Range Method. Under this method, two levels of expenses are considered.
- One level of expenses is high, and another level of expenses is low. Besides, output of these level periods is considered.
- Find the difference in output and expenses.
- Variable element is the reason for the difference in expenses.
- Moreover, it is assumed that the fixed element of semi-variable overhead is expected to remain fixed for two levels of expenses.
- In this way, both fixed and variable overheads are found out.

Example 1

Months	Output (units)	Semi variable overheads
January	100	210
February	90	190
March	140	290
April	150	310
May	100	220
June	180	370

Calculate the amount of fixed, variable, and total semi variable expenses for the month.

Solution

Months	Production	Total semi variable expenses (Rs)	Fixed (Rs)	Variable (Rs)

February	90	190	10	180
June	180	370	10	360
Difference	90	180	20	520

Variable element is Rs 2, i.e., $180/90$

Variable overhead for February = (90×2.00) Rs 180 and fixed overhead is Rs 10 ($190-180$)

Variable overhead for June = (180×2.00) Rs 360 and fixed overhead is Rs 10 ($370-360$).

3. Analytical method

- Under this method, for each item of semi variable overhead degree of variability is found out in percentage.
- Percentage of his/her experience and past data is determined by the cost accountant.
- With the help of the percentage information semi variable overheads are segregated into fixed and variable components.

4. Level of activity method

- In this method, we compare two level of production with the amount of expenses in these levels. Variable cost can be calculated with the help of the following method.

Variable cost = Change in semi variable cost / Change in production volume

Take the Example 1 and find out the Fixed, Variable and Total Semi-Variable overheads

Solution

Taking figures of February and April

Months	Production	Total semi variable expenses (Rs)	Fixed (Rs)	Variable (Rs)
February	90	180	10	160
April	150	320	10	300
Difference	60	120	20	460

- Variable element is Rs 2 i.e., $60/120 = \text{Rs } 2$
- Variable overhead for February = $80 \times 2.00 = \text{Rs } 160$ and fixed overhead is Rs 20 ($180-160$)
- And variable overhead for April = $150 \times 2.00 = \text{Rs } 300$ and fixed overhead is Rs 20 ($320-300$)
- Total semi variable expenses = Rs 20+Rs 460 = Rs480

5. Least square method

- This method is also known as Simple Linear Regression Analysis Method.
- Under this method, prevailing relationship between volume of production and expenses is identified.
- It is a statistical method in which we use least square method for calculating a line of best fit.
- The regression line is based on regression equation.

The regression equation is given below.

$Y = a + bx$

Where,

Y = total cost

a = fixed cost

b = variable cost

x = number of units

- By solving this equation mathematically, we can calculate variable cost (B) at different level of production.

Taking the figures of January and February from the previous example, we can compute the fixed Cost as:

$$Y = a + bx$$

$$\text{January} = 210 = 100b + a$$

$$\text{February} = 190 = 90b + a$$

$$\underline{20 = 10b}$$

Subtracting $b = 20/10 = \text{Rs } 2$

Putting the value in (1)

$$210 = 2 \times 100 + a$$

$$a = 10$$

Fixed cost in Rs 10 per unit

10.3 By Controllability

Cost here may be classified into controllable and uncontrollable cost.

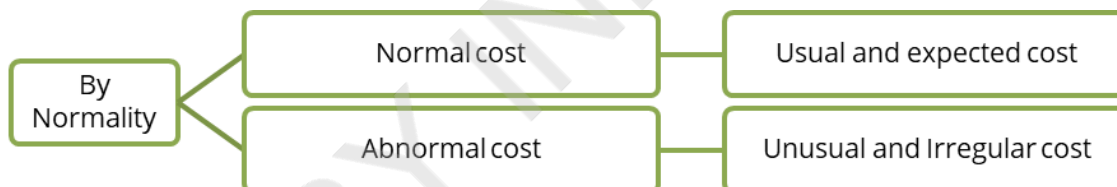
A. Controllable Overhead:

- Overheads, which can be controlled by management typically by a cost, profit, or investment Centre manager, are called controllable overhead.

B. Uncontrollable Overhead:

- Overheads, which cannot be, controlled whatever the steps management takes are called uncontrollable overhead.

10.4 By Normality



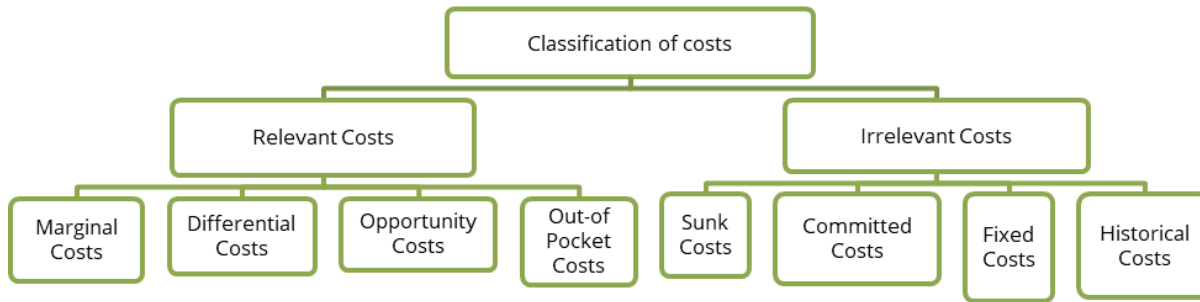
A. Normal Cost:

- The normal cost is normally incurred at a given level of output in the conditions in which that level of output is achieved.
- Normal cost includes those items of cost which occur in the normal situation of production process or in the normal environment of the business.

B. Abnormal Cost:

- It is an unusual cost whose occurrence is abnormal and irregular and due to some abnormal production situation.
- Abnormal cost arises due to idle time for some heavy break down or abnormal process loss.
- Therefore, they are not considered in the cost of production and directly charged to Profit and Loss Account.

10.5 By Cost for Managerial Decision Making



A. Marginal Cost:

- The term 'marginal cost' is defined as the amount at any given volume of output by which aggregate costs are changed if the volume of output is increased or decreased by one unit.
- It is a variable cost of one unit of a product or a service i.e., a cost which can be avoided if the production of that unit is not made.

B. Differential Cost:

- It can also be known as 'incremental cost'.
- It is the difference in total cost which will arise from the selection of one alternative to the other.
- The increase or decrease in total cost or in specific elements of cost because of this decision will be known as incremental cost or decremental cost.

C. Opportunity Cost:

- It is also known as 'incremental cost'. It is the cost refers to the value of sacrifice made, or benefit of opportunity foregone in accepting an alternative course of action. It is an added cost of a change in the level of activity.
- It is the maximum amount that could be obtained at any specified time if a resource were sold or put to the most valuable alternative use that would be practicable.
- Opportunity cost can be defined as the benefit forgone from the next best alternative.
 - **Implicit costs are a specific type of opportunity cost:** The cost of resources which is already owned by the firm which could possibly have been put to some other use.
 - **Imputed Costs:** These costs are a notional cost which is also known as out-of-pocket cost and do not involve any cash outlay. Interest on capital, is an example of Imputed cost. These costs are similar to opportunity costs.

D. Estimated Cost:

- Kohler defines estimated cost as
- "The expected cost of manufacture, or acquisition, often in terms of a unit of product computed on the basis of information available in advance of actual production or purchase".
- Estimated costs are prospective costs since they refer to prediction of costs.

E. Sunk Cost:

- The expenditure which has taken place in the past is known as sunk cost. This cost is not affected by a particular decision under consideration.
- They play no role in decision making in the current period. This cannot change any decision in future.
- The sunk costs are those costs that have been invested in a project and which will not be recovered if the project is terminated.

F. Committed Cost:

- Investment made by the business entity in the past and which cannot be recovered by any means is known as committed cost. And the business cannot get out of those obligations already made.
- The person concerned should be aware of which cost are committed cost and which is not, when reviewing company expenditure
- In committed cost there always be a long-term legal agreement associated with it
- If not, it is much easier to negotiate the termination of an expense.

G. Historical Cost:

- In the historical cost or historical costing concept the assets are valued on their purchase price or the money actually paid for the assets.
- The assets are to be reported on the balance sheet at historical cost according to the GAAP principle.
- Historical cost is the proven method for valuing assets, so it is preferred for the valuation of asset in the balance sheet.
- Historical cost values are standard; it does not change from time to time. So, the consistency concept is not violated.

H. Capitalized Costs:

- These are costs which are initially recorded as assets and subsequently treated as expenses.

I. Product Costs:

- These are the costs which are associated with the purchase and sale of goods (in the case of merchandise inventory).
- In the production scenario, such costs are associated with the acquisition and conversion of materials and all other manufacturing inputs into finished product for sale. Hence,
 - Under marginal costing -> variable manufacturing costs and
 - Under absorption costing -> total manufacturing costs (variable and fixed) constitute inventoriable or product costs.

J. Out-of-pocket Cost:

- It is that portion of total cost, which involves cash outflow.
- This cost concept is a short-run concept and is used in decisions relating to fixation of selling price in recession, make or buy, etc.
- Out-of-pocket costs can be avoided or saved if a particular proposal under consideration is not accepted.
- Explicit costs are out-of-pocket costs for a firm—for example, payments for wages and salaries, rent, or materials.

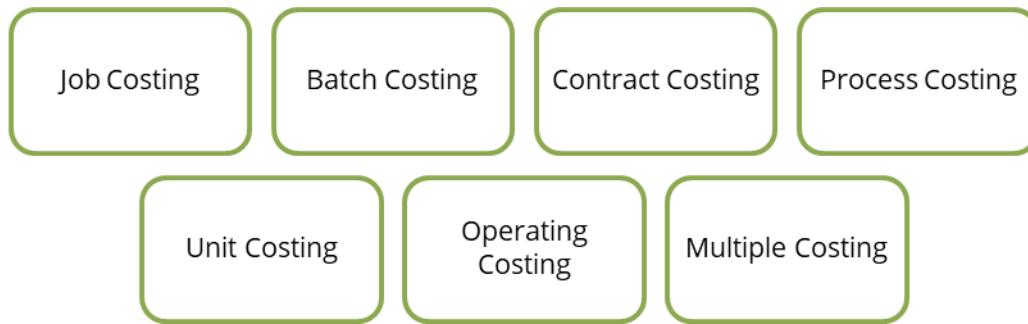
K. Pre-determined Cost:

- A cost which is **computed in advance before production or operations start**, based on specification of all the factors affecting cost, is known as a pre-determined cost.

L. Standard Cost:

- A pre-determined cost, which is calculated from managements 'expected standard of efficient operation' and the relevant necessary expenditure.
- It may be used as a basis for price fixing and for cost control through variance analysis.

11. Methods of Costing



Different industries follow different methods of costing because of the differences in the nature of their work. The various methods of costing are as follows:

A. Job Costing:

- It is otherwise called as specific order costing.
- Industries where there is no standard product and every job or work order is different from the others adopt job costing.
- The job is done according to the specifications given by the customer strictly and usually it takes only a short time for completion of the work.
- To ascertain the cost of each job separately is the ultimate purpose of job costing.

Job costing is used by printing presses, scooter servicing, motor repair shops, ship building, automobile garages, film studios, engineering industries etc.

B. Batch Costing:

- Batch costing is also a specific order costing, but it is the variation of job costing.
- There may be common products among the orders received from the different customers it divided among the batches and production order is issued to them, consisting of the pre-determined quantity of each type of product.
- By dividing the total cost of a batch by number of items produced in that batch cost per unit is ascertained.
- Batch costing sheet is prepared for that purpose.

Biscuit's manufacture, Garment's manufacture, Spare parts and Component manufacture, Pharmaceutical enterprises etc.

C. Contract Costing:

- Contract Costing is an accounting for a long-term contract work applicable on construction work usually.
- Contract costing is a big job. the work is not done inside the factory premises, it is usually done on the contractee's place or site.

Examples: building construction, bridge construction, road construction and other long-run engineering works which take long duration in completion, i.e., a year or more.

D. Process Costing:

- This method is applied where different processes are involved in a sequence to manufacture a particular product.
- Cost for each such process is required to be calculated separately.

E.g., Sugar factories, paper industries, etc.

E. Operating Costing:

- Industries rendering services follow operating costing.
- Composite units like passenger kilometres and tone kilometres are used for ascertaining costs of services.
- For example, in the case of railways, operating costing indicates the cost of carrying a passenger per kilometre.

Operating costing is adopted by airways railways, road transport companies (goods as well as passengers) hotels, cinema halls, power houses etc.

F. Unit Costing:

- This method is also known as single or output costing.
- In the business concern whose production is continuous and units are identical, unit costing is applicable.
- The objective of this method is to ascertain the total cost as well as the cost per unit.

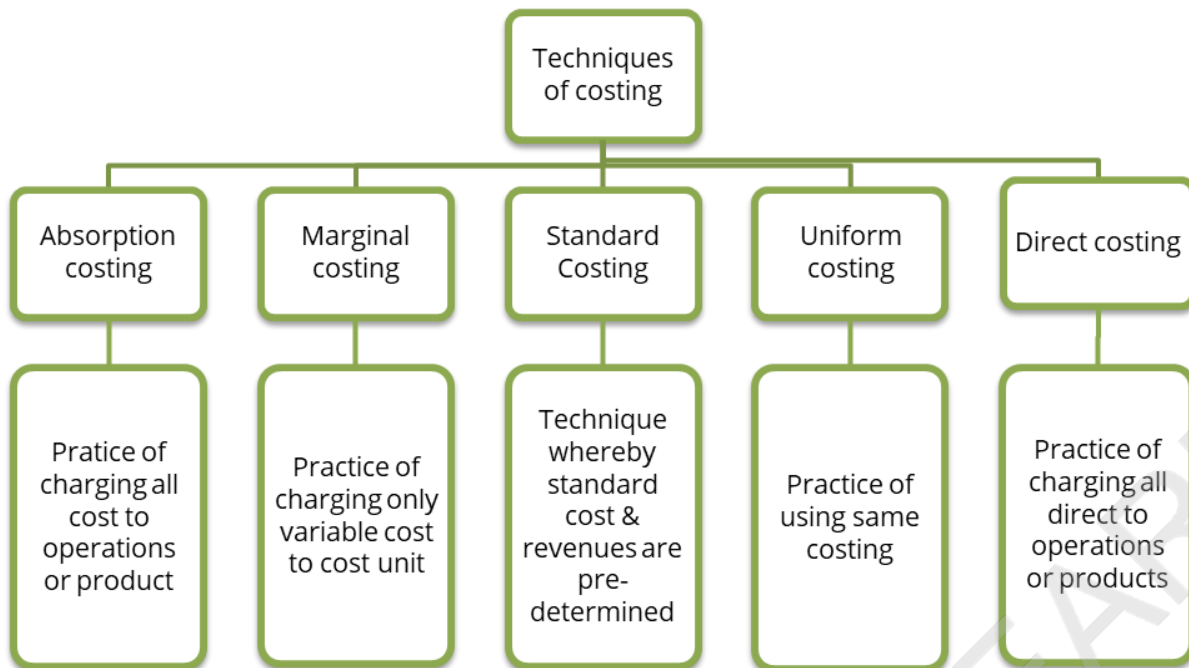
Unit costing is applicable in the case of mines, newspaper printing, scooter manufacturing, cement works, brick works and units manufacturing cycles, radios, washing machines etc.

G. Multiple Costing:

- When the output is comprised of many components such as in ship building, television, motor Car or electronic gadgets, costs must be ascertained for each component as well as the finished product.
- Multiple costing means different methods of costing for different components as per the need and suitability of the organisation. As we see in the above examples, the product produced by them involves so many parts and components.
- Therefore, this type of costing is also called as composite costing or multiple costing.

EX: Ship building, television, motor Car or electronic gadgets

12. Techniques of Costing



A. Absorption Costing:

- It is the practice of charging all costs both variable and fixed to operations, processes, or products.
- It is also referred to as total costing since the total costs are allotted to the cost units.
- It differs from marginal cost where fixed costs are excluded.

B. Marginal Costing:

- It is the practice of charging only the variable cost to cost units and the fixed costs attributable to the relevant period are written off in full against the contribution for that period.
- It is a valuable tool for decisions like product pricing, product mix, preparing budgets etc.

C. Standard Costing:

- It is a technique whereby; standard costs and revenues are pre-determined and later compared with actual costs and revenues.
- Standard costing is extremely helpful for cost control and is generally used along with budgetary control.

D. Uniform Costing:

- It is the practice of using the same costing system.
- i.e., the same basic methods, principles, and techniques, by several firms in an industry.
- This enables comparison of performance of different firms.

E. Direct Costing:

- It is the practice of charging all direct cost to operations, processes or products leaving all indirect cost to be written off against profits of the period in which they are arise.
- The difference between the direct costing and marginal costing is so insignificant that usually both the terms are used inter - changeably.

13. Coding System

Code is defined as

- “a **system of symbols** designed to be applied to a classified set of items to give a brief account reference, facilitating entry collation and analysis”.
- Hence cost classification forms the basis of any cost coding. It helps us understand the characteristic of any cost through a short, symbolized form.

Advantages:

Short and Simple	• Since the code is, most of the times, briefer than a description, it saves time when systems are worked upon manually and in case the system is computerised it reduces the data storage capacity.
Clarity	• A code helps in reducing ambiguity • In case two professionals understand the same item differently a code will help them objectively.
Computer friendly	• Unlike detailed descriptions, a code facilitates data processing in computerised systems

Requirements of an Efficient Coding system

Unique	• Every number used in the code should be unique and certain, i.e. it should be easily identified from the structure of the code.
Flexibility	• Elasticity and comprehensiveness is an absolute must for a well designed coding system. It should be possible to identify a code for every item and the coding system should be capable of expanding to accommodate new items.
Brief	• The code should be brief and meaningful
Centralised	• The maintenance of the coding system should be centrally controlled. It should not be possible for individuals to independently add new codes to the existing coding system.
Similarities	• Codification systems should be of the same length. The lawmakers envisage the needs for bringing out the new legislation for creation of the LLP to meet with the contemporary growth of the Indian economy.

14. Essentials of Good Cost Accounting systems

The essential features, which a good Cost Accounting System should possess, are as follows:



A. Informative and Simple:

- Cost Accounting System should be tailor-made, practical, simple, and capable of meeting the requirements of a business concern.
- The system of costing should not sacrifice the utility by introducing meticulous and unnecessary details.

B. Accuracy:

- The data to be used by the Cost Accounting System should be accurate; otherwise, it may distort the output of the system and a wrong decision may be taken.

C. Support from Management and subordinates:

- Necessary cooperation and participation of executives from various departments of the concern is essential for developing a good system of Cost Accounting.

D. Cost-Benefit:

- The Cost of installing and operating the system should justify the results.

E. Procedure:

- A carefully phased programme should be prepared by using network analysis for the introduction of the system.

F. Trust:

- Management should have faith in the Costing System and should also provide a helping hand for its development and success.

CHAPTER 19 - COST SHEET

Overview

- Functional classification of cost
- Heads of cost in cost sheet
- Format of cost sheet
- Advantages of cost sheet
- Illustrations

INTRODUCTION

Cost Sheet is a statement, which is prepared at given intervals of time that provides information regarding elements of cost incurred in production. It discloses both the total cost and the cost per unit of the product manufactured during the given period. If it is desired to check or goods, the results of the cost sheet of a specific period with any of the preceding periods, comparative columns can be provided within the Cost Sheet.

The cost sheet is prepared to arrive at the cost of product/job/operation, or it is prepared to give quotations or to determine tender price for supply of goods or providing service.

A cost sheet is an exercise in assortment of data regarding all the costs incurred in the industry and arranging them in an exceedingly sure order. The data required to prepare a cost sheet is gathered from many records within the organization.

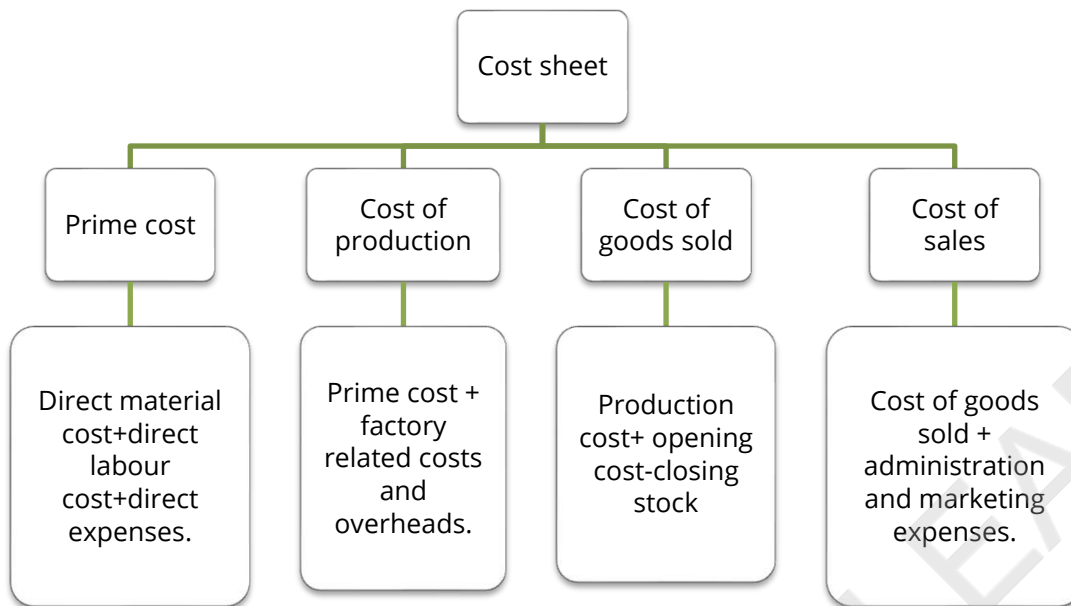
1. Functional classification of elements of cost

Costs are divided according to the function for which they have been incurred. The classifications of cost based on their functions are as follows:

1. Direct material cost
2. Direct employee cost
3. Direct expenses
4. Production or manufacturing overheads
5. Administration or office overheads
6. Selling overheads
7. Distribution overheads
8. Research and development cost etc

2. Heads of cost in a cost sheet

Grouping of the costs incurred based on their functions are as follows.



A. Prime cost

- Prime cost comprises of direct material cost, direct labour cost and direct expenses.
- Each element's total cost is calculated separately and added together to find out prime cost.

Direct Material cost	XX
Direct Labour Cost	XX
Direct expenses	XX

Total: Prime Cost	XX
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a. Direct material cost

- It is the cost of direct material consumed.
- Direct materials are the materials from which a product is produced or manufactured.
- The cost of direct material will vary according to the level of output derived.
- For example: Milk is the direct material of butter.

The cost of direct material consumed is calculated as follows.

Opening Cost of Material	XX
Add: Additions/Purchases	XX
Less: Closing Stock of Materials	XX

Direct Materials consumed	XX
----------------------------------	-----------

b. Direct labour cost

- It refers to the amount paid to the workers who are directly engaged in the production of goods.
- Cost object is called direct labour.

it includes the following.

1. Wages and salary.
2. Allowances and incentives.
3. Payment for overtimes.
4. Employer's contribution to Provident fund and other welfare funds.
5. Other benefits (leave with pay, free or subsidised food, leave travel concession etc.)

c. Direct expenses

- It includes all expenses other than direct material or direct labour.
- Which are specially incurred for a particular cost object and can be identified in an economically feasible way.

The following costs are examples for direct expenses:

1. Hire charges for some special machinery,
2. Cost of defective work.
3. Royalty paid/ payable for production or provision of service.
4. Cost of product/ service specific software.
5. Other expenses which are directly related with the production of goods or provision of service.

B. Cost of Production

- In a conventional cost sheet, this item of cost can be seen.
- It is the total of prime cost and factory related costs and overheads.

	Prime Cost	XX	
	Add: Factory Overhead	<u>XX</u>	
	Gross Works Costs	XX	
	Add: Opening stock of Work in Progress	XX	
	Less: Closing stock of Work-in-process	<u>(XX)</u>	
	Factory or Works Costs	XX	
Stock work	Add: Quality Control Cost	XX	of in
	Add: Research & Development cost (Process related)	XX	
	Add: Administrative Overheads related with Production	XX	
	Less: Credit for recoveries (miscellaneous income)	(XX)	
	Add: Packing Cost (Primary packing)	<u>XX</u>	
	Cost of Production	<u>XX</u>	

process

- The cost of opening and closing stock of work-in process is adjusted to arrive at factory/ works cost.
- The WIP stock is valued based on percentage of completion in respect of each elements of cost.

Quality Control Cost

- This is the cost of resources consumed towards quality control procedures.

Factory overheads

- It is otherwise known as manufacturing overhead, works overhead or production overhead.
- All the indirect expenses, which are incurred in the factory and for the running of the factory, are treated as production overhead.
- Examples of factory overheads
 1. Indirect employees cost connected with production activities.
 2. Drawing and Designing department cost.
 3. Consumable stores and spares.
 4. Depreciation of plant and machinery, factory building etc.
 5. Lease rent of production assets.
 6. Amortized cost of jigs, fixtures, tooling etc.

Research and development cost

- Research and development related cost which with is incurred for the improvement of process, system, product, or services are included in the research and development cost.

Credit for recoveries

- The realised or realisable value of scrap or waste is deducted.

Packing Cost (primary)

- Packing material which is essential to hold and preserve the product for its use by the customer.

C. Cost of goods sold.

- It is the cost of production for goods sold. After adjusting the values of opening and closing stocks of finished goods, cost of goods sold is calculated.
- It is calculated as follows.

Cost of Production	XX
Add: Cost of Opening stock of finished goods	XX
Less: Cost of Closing stock of finished goods	<u>XX</u>
Cost of Goods Sold	<u>XXX</u>

D. Cost of sales

- Cost of the product which is incurred to make available the product to the customer or consumer is known as cost of sales.
- It is the aggregate of cost of goods sold and administration and marketing expenses.

It is calculated as below.

Cost of Goods Sold	XX
Add: Administrative Overheads (General)	XX
Add: Selling Overheads	XX
Add: Packing Cost (secondary)	XX
Add: Distribution Overheads	<u>XX</u>
Cost of Sales	<u>XX</u>

Administration overheads

- The term administration refers to the formulation of policy, direction, and management of affairs.
- Indirect expenses related to management and administration of business come under administration overheads.

Examples of administration overheads

1. Insurance,
2. Rent,
3. Building maintenance,
4. Machine maintenance,
5. Property taxes.

Selling and overheads

Cost incurred on the sale of the products or services is selling overheads.

- Salary and wages of the sales department and employees directly related with selling of goods.
- Rent, depreciation, maintenance, and other cost related with sales department.
- Cost of advertisement, maintenance of website for online sales, market research etc.

Packing cost (secondary)

- Packing material that enables to store, transport, inform the customer, promote, and otherwise make the product marketable.

Distribution Overhead:

- Cost incurred on making product available for sale in the market.

The costs are.

- Salary and wages of employees engaged in distribution of goods.
- Transportation and insurance costs related with distribution.
- Depreciation, hire charges, maintenance and other operating costs related with distribution vehicles etc.

3. Cost sheet / statement

Sl.no	Particulars	Total cost	Cost per Unit
1	Direct materials consumed. - Opening Stock of Raw Material - Add: Additions/ Purchases - Less: Closing stock of Raw Material	XX XX (XX)	XX XX (XX)
2	Direct employee (labour) cost	XX	XX
3	Direct expenses	XX	XX
4	Prime Cost (1+2+3)	XX	XX
5	Works/ Factory Overheads	XX	XX
6	Gross Works Cost (4+5)	XX	XX
7	Add: Opening Work in Process	XX	XX
8	Less: Closing Work in Process	(XX)	(XX)
9	Works/ Factory Cost (6+7-8)	XX	XX
10	Quality Control Cost	XX	XX
11	Research and Development Cost	XX	XX
12	Administrative Overheads (relating to production activity)	XX	XX
13	Less: Credit for Recoveries/Scrap/By-Products / misc. income	(XX)	(XX)
14	Add: Packing cost (primary)	XX	XX
15	Cost of Production (9+10+11+12-13+14)	XX	XX
16	Add: Opening stock of finished goods	XX	XX
17	Less: Closing stock of finished goods	(XX)	(XX)
18	Cost of Goods Sold (15+16-17)	XX	XX
19	Add: Administrative Overheads (General)	XX	XX
20	Add: Marketing Overheads - Selling Overheads - Distribution Overheads	XX XX XX	XX XX XX
21	Cost of Sales (18+19+20)	XX	XX

4. Advantages of cost sheet

- Provides total cost figures as well as cost per unit of production
- Helps in cost comparison
- Facilitates preparation of cost estimates
- Provides sufficient help in arriving at the figure of selling price.
- Facilitates cost control by disclosing operational efficiency.

Illustrations

1. Illustration

The following information has been obtained from the records of ABC Corporation for the period from June 1 to June 30, 2018.

	June 1, 2018 (Rs.)	June 30, 2018 (Rs.)
Cost of Raw materials	60,000	50,000
Cost of Work in Progress	12,000	15,000
Cost of Stock of Finished goods	90,000	1,10,000
Purchase of raw materials during June 2018		4,80,000
Wages Paid		2,40,000
Factory Overheads		1,00,000
Administration overheads (related to production)		50,000
Selling & distribution overheads		25,000
Sales		10,00,000

Prepare a statement giving the following information:

- a) Raw materials consumed;
- b) Prime cost;
- c) Factory cost;
- d) Cost of goods sold; and
- e) Net profit.

Solution:

Statement showing Cost and Profit [June 2018]

Particulars	Amount (₹)
Direct material Purchased	4,80,000
Add: Opening stock of Raw Materials	60,000
Less: Closing stock of Raw materials	(50,000)
Direct Material Consumed	4,90,000
Direct Labour	2,40,000
Direct Expenses	-
Prime cost	7,30,000
Add: Factory Overheads/Works OH	1,00,000
Factory Cost/Works Cost [Gross]	8,30,000

Particulars	Amount (₹)
Add: Opening WIP	12,000
Less: Closing WIP	(15,000)
Factory Cost/Works Cost (Net)	8,27,000
Add: Administration Overheads (Related to Production)	50,000
Cost of Production	8,77,000
Add: Opening stock of Finished Goods	90,000
Less: Closing Stock of Finished Goods	(1,10,000)
Cost of Goods Sold	8,57,000
Add: Selling & Distribution Overheads	25,000
Cost Of Sales	8,82,000
Add: Net Profit (Balancing Figure)	1,18,000
Sales	10,00,000

2. Illustration

The following data relates to the manufacture of a standard product during the month of April, 2018:

Particulars	
Raw materials	Rs. 1,80,000
Direct Wages	Rs. 90,000
Machine hours worked (hours)	10,000 hrs
Machine rate per hour	Rs. 8
Administration Overheads	Rs. 35,000
Selling overhead per unit	Rs. 5
Units Produced	4,000
Units sold	3600
Selling price per unit	Rs.125

You are required to respect of the above

- Cost per unit
- Profit for the

prepare a cost sheet in showing:
month

Solution: Illustration 2

(i) Cost Sheet

Output:4,000 units

Particulars	Total Cost (₹)	Cost per unit (₹)
Raw materials	1,80,000	45.00
Direct wages	90,000	22.50
Prime cost	2,70,000	67.50
Add: Factory overheads (10,000 hrs × ₹8 per hour)	80,000	20.00
Works Cost/Factory Cost	3,50,000	87.50
Add: Other Production Overhead	-	-
Cost of Production	3,50,000	87.50
Less: Closing Stock of finished goods (4,000 – 3,600 units)	(35,000)	-
Cost of Goods Sold	3,15,000	87.50
Add: Administration overheads (general)	35,000	9.72
Add: Selling Overheads (3,600 units × ₹5 unit)	18,000	5.00
Cost of sales (Total Cost)	3,68,000	102.22

(ii) Computation of Profit

Particulars	Total Cost (₹)
Sales revenue (3,600 units @ ₹125)	4,50,000
Less: Cost of sales	3,68,000
Profit	82,000

3. Illustration

The books of Adarsh Manufacturing Company present the following data for the month of April, 2019:

- Direct labour cost Rs. 17,500 being 175% of works overheads.
- Cost of goods sold excluding administrative expenses Rs. 56,000.

	April 1	April 30
Raw materials	8,000	10,600
Work in progress	10,500	14,500
Finished Goods	17,600	19,000
		Rs.
Selling Expenses		3,500
General and Administration expenses		2,500
Sales for the month		75,000

You are required to:

- Compute the value of materials purchased.
- Prepare a cost statement showing the various elements of cost and also the profit earned

Solution: 3

Statement showing Cost and Profits

To find out the value of materials purchased, reverse calculations from the given data can be presented as below:

Particulars	Amount (₹)
Direct Material Purchased) (Balancing Figure)	36,500
Add: Opening stock of raw materials	8,000
Less: Closing stock of raw materials	(10,600)
Direct Material Consumed	33,900
Add: Direct labour cost	17,500
Prime cost	51,400
Add: Factory overheads	10,000
Works cost /Factory cost (Gross)	61,400
Add: Opening work-in-progress	10,500
Less: Closing work-in-progress	(14,500)
Works cost /Factory cost (Net) (Balancing Figure)	57,400
Add: Other Production Overhead	-
Cost of Production	57,400
Add: Opening stock of finished goods	17,600
Less: Closing stock of finished goods	(19,000)
Cost of goods sold	56,000
Add: General and administration expenses	2,500
Add: Selling expenses	3,500
Cost of sales	62,000
Profit (Balance figure ₹75,000 – ₹62,000)	13,000
Sales	75,000

4. Illustration

From the following particulars, you are required to PREPARE monthly cost sheet of Aditya Industries:

Particulars	Amount (Rs.)
Opening Inventories:	
- Raw materials	12,00,000
- Work-in-process	18,00,000
- Finished goods (10,000 units)	9,60,000
Closing Inventories:	
- Raw materials	14,00,000
- Work-in-process	16,04,000
- Finished goods	?
Raw materials purchased	1,44,00,000
GST paid on raw materials purchased (ITC available)	7,20,000
Wages paid to production workers	36,64,000

Expenses paid for utilities	1,45,600
Office and administration expenses paid	26,52,000
Travelling allowance paid to office staffs	1,21,000
Selling expenses	6,46,000

- Machine hours worked ... 21,600 hours
- Machine hour rate Rs.8.00 per hour
- Units sold 1,60,000
- Units produced 1,94,000
- Desired profit 15% on sales

Solution: 4

Cost Sheet of Adithya Industries for the month of.....

Units produced- 1,94,000

Units sold- 1,60,000

Particulars	Amount (₹)	Amount (₹)	Cost p.u. (₹)
Raw materials purchased	1,44,00,000		
Add: Opening value of raw materials	12,00,000		
Less: Closing value of raw materials	(14,00,000)		
Materials consumed		1,42,00,000	73.19
Wages paid to production workers		36,64,000	18.89
Expenses paid for utilities		1,45,600	0.75
Prime Cost		1,80,09,600	92.83
Factory overheads (₹8 × 21,600 hours)	1,72,800		
Add: Opening value of W-I-P	18,00,000		
Less: Closing value of W-I-P	(16,04,000)	3,68,800	19.01
Cost of Production		1,83,78,400	94.73
Add: Value of opening finished stock (10,000 units)	9,60,000		
Less: Value of closing finished stock (₹94.73 × 44,000)	(41,68,120)		
Cost of Goods Sold (1,60,000 units)		1,51,70,280	94.81
Office and administration expenses paid		26,52,000	16.58
Travelling allowance paid to office staffs		1,21,000	0.75
Selling expenses		6,46,000	4.04
Cost of Sales (85%)		1,85,89,280	116.18
Add: Profit (15%)		32,80,461	20.50
Sales (100%)		2,18,69,741	136.68

5. Illustration

Arnav Inspat Udyog Ltd. has the following expenditures for the year ended 31st March, 2020:

Particulars	Amount (Rs.)	Amount (Rs.)
Raw materials purchased		10,00,00,000
GST paid on the above purchases @18% (eligible for input tax credit)		1,80,00,000
Freight inwards		11,20,600
Wages paid to factory workers		29,20,000
Contribution made towards employee's PF & ESIS		3,60,000
Production bonus paid to factory workers		2,90,000
Royalty paid for production		1,72,600
Amount paid for power & fuel		4,62,000

Particulars	Amount (Rs.)	Amount (Rs.)
Amount paid for purchase of moulds and patterns (life is equivalent to two years production)		8,96,000
Job charges paid to job workers		8,12,000
Stores and spares consumed		1,12,000
Depreciation on:		
Factory building	84,000	
Office building	56,000	
Plant & Machinery	1,26,000	
Delivery vehicles	86,000	3,52,000
Salary paid to supervisors		1,26,000
Repairs & Maintenance paid for:		
Plant & Machinery	48,000	
Sales office building	18,000	
Vehicles used by directors	19,600	85,600
Insurance premium paid for:		
Plant & Machinery	31,200	
Factory building	18,100	
Stock of raw materials & WIP	36,000	85,300
Expenses paid for quality control check activities		19,600
Salary paid to quality control staffs		96,200
Research & development cost paid for improvement in production process		18,200
Expenses paid for pollution control and engineering & maintenance		26,600
Expenses paid for administration of factory work		1,18,600
Salary paid to functional managers:		
Production control	9,60,000	
Finance & Accounts	9,18,000	
Sales & Marketing	10,12,000	28,90,000
Salary paid to General Manager		12,56,000
Packing cost paid for:		
Primary packing necessary to maintain quality	96,000	
For re-distribution of finished goods	1,12,000	2,08,000
Interest and finance charges paid (for usage of non- equity fund)		7,20,000
Fee paid to auditors		1,80,000
Fee paid to legal advisors		1,20,000
Fee paid to independent directors		2,20,000
Performance bonus paid to sales staffs		1,80,000
Value of stock as on 1st April, 2019:		
Raw materials	18,00,000	
Work-in-process	9,20,000	
Finished goods	11,00,000	38,20,000
Value of stock as on 31st March, 2020:		
Raw materials	9,60,000	
Work-in-process	8,70,000	
Finished goods	18,00,000	36,30,000

Amount realized by selling of scrap and waste generated during manufacturing process – Rs.86,000/-

From the above data you are required to PREPARE Statement of cost for Arnav Ispat Udyog Ltd. for the year ended 31st March, 2020, showing

- Prime cost,

- Factory cost,
- Cost of Production,
- Cost of goods sold and
- Cost of sales.

Solution: 5

Statement of Cost of Arnav Ispat Udyog Ltd.

Sl. No.	Particulars	Amount (₹)	Amount (₹)
(i)	Material Consumed: Raw materials purchased Freight inwards	10,00,00,000 11,20,600	
(ii)	Add: Opening stock of raw materials Less: Closing stock of raw materials Direct employee (labour) cost: Wages paid to factory workers Contribution made towards employees' PF & ESIS Production bonus paid to factory workers	18,00,000 (9,60,000) 29,20,000 3,60,000 2,90,000	10,19,60,600 35,70,000
(iii)	Direct expenses Royalty paid for production Amount paid for power & fuel Amortised cost of moulds and patterns Job charges paid to job workers Prime Cost	1,72,600 4,62,000 4,48,000 8,12,000	 18,94,600 10,74,25,200
(iv)	Works/ Factory overheads: Stores and spares consumed Depreciation on factory building Depreciation on plant & machinery Repairs & Maintenance paid for plant & machinery Insurance premium paid for plant & machinery Insurance premium paid for factory building Insurance premium paid for stock of raw materials & WIP Salary paid to supervisors Expenses paid for pollution control and engineering & maintenance Gross factory cost	1,12,000 84,000 1,26,000 48,000 31,200 18,100 36,000 1,26,000 26,600	 6,07,900 10,80,33,100
	Add: Opening value of W-I-P Less: Closing value of W-I-P Factory Cost		9,20,000 (8,70,000) 10,80,83,100
(v)	Quality control cost: Expenses paid for quality control check activities Salary paid to quality control staffs	19,600 96,200	 1,15,800
(vi)	Research & development cost paid for improvement in production process		18,200
(vii)	Administration cost related with production: - Expenses paid for administration of factory work - Salary paid to Production control manager	1,18,600 9,60,000	 10,78,600
(viii)	Less: Realisable value on sale of scrap and waste	(86,000)	
(ix)	Add: Primary packing cost	96,000	
	Cost of Production Add: Opening stock of finished goods Less: Closing stock of finished goods Cost of Goods Sold		10,93,05,700 11,00,000 (18,00,000) 10,86,05,700

Sl. No.	Particulars	Amount (₹)	Amount (₹)
(x)	Administrative overheads: Depreciation on office building Repairs & Maintenance paid for vehicles used by directors Salary paid to Manager- Finance & Accounts Salary paid to General Manager Fee paid to auditors Fee paid to legal advisors Fee paid to independent directors	56,000 19,600 9,18,000 12,56,000 1,80,000 1,20,000 2,20,000	
(xi)	Selling overheads: Repairs & Maintenance paid for sales office building Salary paid to Manager- Sales & Marketing Performance bonus paid to sales staffs	18,000 10,12,000 1,80,000	12,10,000
(xii)	Distribution overheads Depreciation on delivery vehicles Packing cost paid for re-distribution of finished goods Interest and finance charges paid Cost of Sales	86,000 1,12,000	1,98,000 7,20,000
	Cost of Sales		11,35,03,300

Note:

GST paid on purchase of raw materials would not be part of cost of materials as it is eligible for input tax credit.

6. Illustration (RTP Nov 22)

CT Limited is engaged in producing medical equipment. It has furnished following details related to its products produced during a month:

	Units	Amount (Rs.)
Raw materials		
Opening stock	1,000	90,00,000
Purchases	49,000	44,10,00,000
Closing stock	1,750	1,57,50,000
Works-in-progress		
Opening	2,000	1,75,50,000
Closing	1,000	94,50,000
Direct employees' wages, allowances etc.		6,88,50,000
Primary packaging cost (per unit)		1,440
R&D expenses & Quality control expenses		2,10,60,000
Consumable stores, depreciation on plant		3,42,00,000
Administrative overheads related to production		3,15,00,000
Selling expenses		4,84,30,800
Royalty paid for production		3,64,50,000
Cost of web-site (for online sale) maintenance		60,75,000
Secondary packaging cost (per unit)		225

There was a normal scrap of 250 units of direct material which realized Rs. 5,400 per unit. The entire finished product was sold at a profit margin of 20% on sales.

You are required to PREPARE a cost sheet showing:

- Prime cost
- Gross works cost
- Factory costs
- Cost of production
- Profit
- Sales

Solution: 6 (RTP NOV22)

Particulars	Units	Amount (₹)
Raw Material		
Opening stock	1,000	90,00,000
Add: Purchases	49,000	44,10,00,000
Less: Closing stock	(1,750)	(1,57,50,000)
	48,250	43,42,50,000
Less: Normal wastage of materials realized @ ₹5,400 per unit	(250)	(13,50,000)
Material consumed		43,29,00,000
Direct employee's wages and allowances		6,88,50,000
Direct expenses- Royalty paid for production		3,64,50,000
Prime cost	48,000	53,82,00,000
Factory overheads - Consumable stores, depreciation etc.		3,42,00,000
Gross Works Cost	48,000	57,24,00,000
Add: Opening WIP	2,000	1,75,50,000
Less: Closing WIP	(1,000)	(94,50,000)
Factory/Works Cost (Net)	49,000	58,05,00,000
Administration Overheads related to production		3,15,00,000
R&D expenses and Quality control cost		2,10,60,000
Add: Primary packaging cost @ ₹1,440 per unit		7,05,60,000
Cost of production	49,000	70,36,20,000
Selling expenses		4,84,30,800
Cost of maintaining website for online sale		60,75,000
Secondary packaging cost @ ₹225 per unit	49,000	1,10,25,000
Cost of sales		76,91,50,800
Add: Profit @ 20% on sales or 25% of cost		19,22,87,700
Sales		96,14,38,500