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SCHOOL OF MANAGEMENT STUDIES

UNIT – I – Financial Accounting – SBA1102

UNIT-1 INTRODUCTION TO ACCOUNTING

Introduction to Accounting, Meaning, Concept and conventions of Accounting –Accounting cycle – Trial Balance and Final Accounts (Simple problems)

Accounting

Every day we, generally, exchange money and goods in our private and family life and also in institutions. It is necessary to keep record of accounts of monetary transactions to know how much money has come in or how much money has gone out, what are the sources the income from or what purpose the expenditure has been incurred for. In the stream of social and economic activities of today, each and every person or institution in accountable to someone or to other for his or its economic activities or the wealth acquired, income earned and the expenditure incurred. Different types of transactions occur in business. Without maintaining proper accounts, it is neither possible to ascertain profit or loss of the business nor to know the financial position of the business at any particular date.

Meaning of accounting

The systematic and comprehensive recording of financial transactions pertaining to a business. Accounting also refers to the process of summarizing, analyzing and reporting these transactions. The financial statements that summarize a large company's operations, financial position and cash flows over a particular period are a concise summary of hundreds of thousands of financial transactions it may have entered into over this period.In other words, wherever money is involved, accounting is required to account for it. Accounting is often called the language of business.

Definition of Accounting:

Accounting is both the science and art of correctly recording in books of accounts all those business transactions that result in the transfer of money or money's worth. It may also be defined as the art of recording mercantile transactions in a regular and systematic manner; the art of keeping accounts in such a manner that a man may ascertain correct result of his business activities at the end of a definite period and also can know the true state of affairs of his/her business and properties by an inspection of his/her books.

Accounting has been defined as, ―the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof. ‖ this definition has given by the AICPA. Now we do the following activity:

Scope of Accounting

The scope of field of accounting is very wide. Accounting is needed not only by business class but also by non-business class. Starting from the private life of a man, the financial activities of school, college, club, society, hospitals and government institutions come within the purview of accounting.

1. The monetary transactions which take place in the private life of a man are recorded properly in the books of accounts;
2. It becomes possible to ascertain his receipts and expenditure as well as personal assets and properly in the books of accounts,
3. It becomes to ascertain his receipts and expenditure as well as his personal assets and liabilities. When the financial transactions of a business.
4. To ascertain their incomes and calculation of income-tax on the basis of those incomes. Maintaining accounting is practiced to determine the income and expenditure of different government offices and public bodies as well as to run those offices and organizations properly.
5. By preparing and evaluating national plan and budget with the help of accounting it is possible to know the development and deterioration of the country. Hence, in a nutshell, we can say that the scope of accounting is wide enough to cover all the fields of the society.

Objectives of accounting:

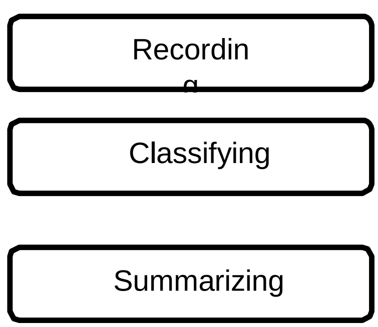
The principal object of accounting is to keep permanent record of all monetary transactions effected by a person ort enterprise during a definite period and ascertainment of results of those transactions at the end of the said period,. The main objects of accounting are enumerated bellow:

1. Proper recording of transactions: The first and foremost object of accounting is to keep record of monetary transactions in a systematic manner.
2. Determination of results: Every person or institution is always interested to know the results of his/its monetary transactions at the end of a definite period. So, ascertainment of result of financial transactions is an important object of accounting.
3. Ascertainment of financial position: another object of accounting is the ascertainment of debtors and creditors, assets and liabilities and the overall financial position.
4. Supplying financial information: another important object of accounting is to make available all sorts of financial reports and statement to all parties interested in the affairs of the concerned institution as soon as possible after preparing those reports and statements.
5. Defalcation prevented: Another special object of accounting is the prevention of defalcation of money made through fraud by the officials of the institution as well as control of expenditure.

Process of Accounting

The **accounting process** is a series of activities that begins with a transaction and ends with the closing of the books. Because this **process** is repeated each reporting period, it is referred to as the **accounting** cycle and includes these major steps: Identify the transaction or other recognizable event.

This could be classified into 3 stages



Functions:

i. ***Identifying:*** Identifying the business transactions from the source documents.

ii. ***Recording:*** The next function of accounting is to keep a systematic record of all business transactions, which are identified in an orderly manner, soon after their occurrence in the journal or subsidiary books.

iii. ***Classifying:*** This is concerned with the classification of the recorded business transactions so as to group the transactions of similarity peat one place.

iv. ***Summarising: The*** classified information available from the trial balance are used to prepare profit and loss account and balance sheet in a manner useful to the users of accounting information.

v. ***Analysing:*** It establishes the relationship between the items of the profit and loss account a n d the balance sheet. The purpose of analysing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.

vi. ***Interpreting:*** It is concerned with explaining them meaning and significance of the relationship established by the analysis. Interpretation should be useful to the users, to take correct decisions.

vii. ***Communicating:*** There results obtained from the summarized, analysed and interpreted information are communicated to the interested parties.

Functions of Financial accounting:

- Book keeping function (Recording)
- Classification of information:
- Preparation of financial statements
- Segregating financial transactions
- Interpretation of financial data
- Reporting of information
- Providing accurate and reliable information

Limitation of financial accounting:

1. **Historical data:**
It carry all the transaction what it has been done during the accounting period ,but in the business point of view ,they want predetermined information for their future activities and managerial decision . But financial accounting fails to provide the advanced information.
2. **Information as a whole (Bulk amount):**
It provide only the summarized information for the entire organization, specific or particular information is not available in the financial accounts.
3. **It is not help to price fixation:**
Cost of products can be ascertained only after the cost is incurred. So it's not much more useful to fixing the price for the product. Tenders or quotation is preparing based on the future information.
4. **Not useful in the cost control:**
Here it has cost value only the actual cost of production incurred, so there is no use to reduce or control the cost by this financial accounts .financial accounts fails to reveal whether the costs incurred are high or low.
5. **Not useful in evaluating the policy:**
The information is available only at the end of the period, so it is not much more useful to evaluating the policies & business activities .financial accounting fails to be helpful in operating budgetary control and standard costing.
6. **Information is not sufficient to take the decision making :**

- Management has to make the decision regarding
- Mechanization,
- Shutting down of the particular division,
- Discontinue or stop the existing line of production,
- Introducing new product to the market.

So for these decisions, they need a good amount of information from the finance statements, but financial accounting fails to provide information for arriving at this type of critical decisions.

7. **Actual cost only are recorded:**
Financial accounts records costs only after they are incurred. Various assets are recorded at actual cost of acquisition or purchase, whereas the prices of these assets change over a period of time .financial accounting fails to record price level changes.

8. **It is a complicated & technical oriented:**
   Financial statement require accounting knowledge to understand and interpret .A person who not familiar with accounting principles, he can‘t do anything in financial accounting.
9. **Monitory nature:**
   Financial accounting considers only those transactions which are measured in terms of money. Government policies, competitor‘s strategies, method of raising the capital are not placed in financial accounting. So financial accounts fails to convey the impact of such qualitative factors.
10. **Chances for manipulation or window dressing :**
    The profit or loss of the company can influence the activities of the company ,like More profits may be used to increase share price of the company in the market and claim more remuneration , less profit may be shown to save income tax and pay less bonus to workers .chances for manipulation of financial accounts reduce their reliability. So it has lot of chances to alter or manipulate the data in financial accounts.

Importance of accounting

The necessity and importance of accounting is limitless or unbounded to men in their day-to-day personal life, family-life, and intuitional life. The necessity of accounting is described bellow:

(a) Institutional Necessity

- Accounting supplies numerical information to the institution relating to its management and administration
- Exact results of the institution are disclosed through accounting
- The firm can ascertain the financial status of the business operation
- Firm can compare the financial position of two/more years
- Books accounts are very valuable documents
- Proper accounting makes the firm credible to other party
- Tax authority can assess taxes for the firm using the accounting information
- Firm can determine the actual assets and liabilities
- Using accounting data a firm can formulate policy and take many decision on future operation

Basic accounting concepts & conventions

- Business entity concepts
- Going concern concepts
- Money measurement concepts
- Accounting period concepts
- Dual aspect concepts

- Cost concepts
- Matching concepts
- Revenue recognition concepts
- Accrual concepts
- Objective evidence concepts

Business Entity Concepts:

In accounting business is considered to be a separate entity from the proprietor(s).It may appear to be ludicrous that the person can sell goods to himself but this concept is extremely helpful in keeping business affairs separate from proprietor(s).The concepts of separate entity is applicable to all forms of business organizations.

Eg: when a person invest Rs.10,000 inter the business ,it will be deemed that proprietor has given that much of money be the business as a loan which will be shown as a ‘liability‘ in the books of the business as when he withdraws Rs.2000 from business, the net amount payable to him will be shown only as Rs. 8,000.

Going Concern concept:

Accounting to this concept, it is assumed that the business will continue for a fairly long time to come. There is neither the intention nor the necessity to liquidate the particular business venture in the foreseeable future. This is because if the results of the business operations were to be accounted for on the basic of expected for suppliers to supply goods and services other business firms to enter into any economics transactions with the business entity.

Money Measurement Concept:

Accounting records only monetary transactions .Events or transactions which cannot be expressed in money do not find any place in the books of accounts through they may be very useful for the business.

Eg: If a business has got a team of dedicated and trusted employees, it is definitely an asset to the business but since its monetary measurement is not possible, it is not shown in the books of the business.

Cost Concept:

This concept is closely related to going concern concept.

1. An asset is ordinarily entered on the accounting records at the price paid to acquire it and
2. This cost is the basic for all subsequent accounting for the asset cot concept has the advantage of

3. bringing objectivity in the preparation and presentation of financial statements.

Dual Aspect Concept:

This is the basic concept of accounting .Accounting to this concept, every business transaction has a dual effect. For example. A starts 2 aspects of the transactions.On one hand the business has asset of Rs. 10,000 while on the overhand the business has asset of to pay to the proprietors a seen of Rs. 10,000 which is taken as proprietor‟s capital.

Accounting Period Concept:

According to this concept, the life of the business is divided into appropriate segments for studying the results shown by the business after each segment. This is because through the life of the business as considered to be indefinite (according to going concern concept) the measurement of income and studying the financial position after a very long period would not, be helpful in taking proper corrective steps at the appropriate time. At the end of each accounting period an income statement and balance sheet are prepared.

Periodic Matching Of Costs and Revenues:

This concept is based on the accounting period concept. The paramount objective of running a business is to earn profit. In order to ascertain the profit made by the business during a period , it is necessary that ‗revenues‟ they should be matched with the costs (expenses)of the period . Income made by the business during a period can be measured only when the revenue earned during a period is compared with the expenditure increased for earning their revenue.

Realization Concept:

Accounting to this concept, revenues is recognized to be made at the point when the properly in the goods passes to the buyer & seller becomes legally liable to pay. With this convention, accounts recognize transactions (and any profits arising from them) at the point of sale or transfer of legal ownership - rather than just when cash actually changes hands. For example, a company that makes a sale to a customer can recognize that sale when the transaction is legal - at the point of contract. The actual payment due from the customer may not arise until several weeks (or months) later - if the customer has been granted some credit terms.

Eg: B places an order with A for supply of certain goods yet to be manufactured. On receipt of order,a produces and delivers them to B. B makes payment on receipt of goods. In this case sale will be presumed to have been made not at the time of receipt of the order for the goods but at the time when the goods are delivered to B.

Prudence

Profits are not recognized until a sale has been completed. In addition, a cautious view is taken for future problems and costs of the business (the are "provided for" in the accounts" as soon as there is a reasonable chance that such costs will be incurred in the future.

Materiality

An important convention. As we can see from the application of accounting standards and accounting policies, the preparation of accounts involves a high degree of judgment. Where decisions are required about the appropriateness of a particular accounting judgment, the "materiality" convention suggests that this should only be an issue if the judgment is "significant" or "material" to a user of the accounts. The concept of "materiality" is an important issue for auditors of financial accounts.

Accounting Conventions: Conservatism:

In the initial stage of accounting, certain anticipated profit, which wasrecorded, did not materialize. This resulted in less acceptability of accounting figures. On account of this reason,

the accountants follow the rule _anticipate no profit but provide for all possible losses', while recording business transactions.

Full Disclosure:

According to this convention, according reports should disclose fully & fairly the information they support to represent. They should honestly prepare & should sufficiently disclose information which is of material interest to proprietors, present creditors&investors. The contention is going more importance these days because most of big businesses are run by joint stock companies where ownership is delivered from management.

Consistency:

Transactions and valuation methods are treated the same way from year to year, or period to period. Users of accounts can, therefore, make more meaningful comparisons of financial performance from year to year. Where accounting policies are changed, companies are required to disclose this fact and explain the impact of any change.

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Accounting Transactions

A transaction is a business event that has a monetary impact on an entity's financial statements, and is recorded as an entry in its accounting records. Examples of transactions are as follows:

- Paying a supplier for services rendered or goods delivered.
- Paying a seller with cash and a note in order to obtain ownership of a property formerly owned

by the seller.

- Paying an employee for hours worked.
- Receiving payment from a customer in exchange for goods or services delivered.
- Sale in cash to a customer
- Sale on credit to a customer
- Receive cash in payment of an invoice owed by a customer
- Purchase fixed assets from a supplier
- Record the depreciation of a fixed asset over time
- Purchase consumable supplies from a supplier
- Investment in another business

- Investment in marketable securities
- Engaging in a hedge to mitigate the effects of an unfavorable price change
- Borrow funds from a lender
- Issue a dividend to investors
- Sale of assets to a third party

Classification of Accounts

Transactions can be divided into three categories.

i. Transactionsrelatingto individuals and firms
ii. Transactions relating to properties, goods or cash
iii. Transactions relating to expenses or losses and incomes or gains.

Therefore, accounts can also be classified into Personal, Real and Nominal. The classification maybe illustrated as follows

I. Personal Accounts : The accounts which relate to persons. Personalaccounts include the following.

i. **Natural Persons :** Accounts which relate to individuals. For example, Mohan's A/c, Shyam's A/c etc.

ii. **Artificial persons :** Accounts which relate to a group of persons or firms or institutions. For example, HMT Ltd., Indian Overseas Bank, Life Insurance Corporation of India, Cosmopolitan clubetc.

iii. **Representative Persons:** Accounts which represent a particular person or group of persons. For example, outstanding salary account, prepaid insurance account, etc.

The business concern may keep business relations with all the above personal accounts, because of buying goods from them or selling goods to them or borrowing from them or lending to them. Thus they become either Debtors or Creditors.

The proprietor being an individual his capital account and his drawings account are also personal accounts.

II. Impersonal Accounts: All those accounts which are not personal accounts. This is further divided intotwotypes viz. Realand Nominal accounts.

i. **Real Accounts:** Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. For example, Land, Building, Goodwill, Purchases, etc.

ii. **Nominal Accounts:** These accounts do not have any existence, formor shape. Theyrelateto incomes and expenses and gains and losses of a business concern. For example, Salary Account, Dividend Account,etc.

Golden Rules of Accounting

All the business transactions are recorded on the basis of the followingrules.

S.No.	Name of Account	Debit Aspect	Credit Aspect
1.	Personal	The receiver	The giver
2.	Real	What comes in	What goes out
3.	Nominal	All expenses and losses	All incomes and gains.

Double Entry System

The **double entry system** of accounting or bookkeeping means that every business transaction will involve two accounts (or more). For example, when a company borrows money from its bank, the company's Cash account will increase and its liability account Loans Payable will increase.

Definition

According to **J.R.Batliboi** –Every business transaction has a two-fold effect and that it affects two accounts in opposite directions and If a complete record were to be made of each such transaction, it would be necessary to debit one account and credit another account.

Features

i. Every business transaction affects two accounts.
ii. Each transaction has two aspects, i.e., debit and credit.
iii. It is based up on accounting assumptions concepts and principles.
iv. Helps in preparing trial balance which is a test of arithmetical accuracy in accounting.
v. Preparation of final accounts with the help of trial balance.

Book-keeping

Book-keeping is that branch of knowledge which tells us how to keep a record of business transactions. It is often routine and clerical in nature. It is important note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

Definition

R.N. Cartersays, –Book-keeping is the science and art of correctly recording in the books of account all those business transactionsthatresultinthetransferofmoneyormoney‛sworth‖.

Objectives

The objectives of book-keeping are

i. To have permanent record of all the business transactions.

ii. To keep records of income and expenses in such a way that the net profit or net loss may be calculated.

iii. To keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.

iv. To keep control on expenses with a view to minimize the same in order to maximize profit.

v. To know the names of the customers and the amount due from them.

vi. To know the names of suppliers and the amount due to them.

vii. To have important information for legal and tax purposes.

Advantages

From the above objectives of book-keeping, the following advantages can be noted

i. Permanent and Reliable Record .

Arithmetical Accuracy of the Accounts. iii.Net Result of Business Operations

iv. Ascertainment of Financial Position

v. Ascertainment of the Progress of Business

vi. Calculation of Dues.

vii. Control over Asset

viii. Control over Borrowings

ix. Identifying Do‘s and Don‘ts

x. Fixing the Selling Price

xi. Taxation

xii. Management Decision-making.

xiii. Legal Requirements

Journal

when the business transactions take place, the first step is to record the same in the books of original entry or subsidiary books or books of prime or journal. Thus journal is a simple book of accounts in which all the business transactions are originally recorded in chronological order and from which they are posted to the ledger accounts at any convenient time. Journaling refers to the act of recording each transaction in the journal and the form in which it is recorded, is known as a journal entry.

ADVANTAGES OF JOURNAL

The following are the inherent advantages of using journal, though the Transactions can also be directly recorded in the respective ledger accounts;

1. As all the transactions are entered in the journal chronologically, a date Wise record can easily be maintained;

2. All the necessary information and the required explanations regarding all transactions can be obtained from the journal; and

3. Errors can be easily located and prevented by the use of journal or book of prime entry.

Ledger

A company's main **accounting** records. A general **ledger** is a complete record of financial transactions over the life of a company. The **ledger** holds account information that is needed to prepare financial statements, and includes **accounts** for assets, liabilities, owners' equity,

revenues and expenses.A Ledger is a book which contains all the accounts whether personal,realornominal,whicharefirstenteredinjournalorspecial purposesubsidiarybooks.

According to **L.C.Cropper**,‗ the book which contains a classified and permanent record of all the transactions of a business is called the Ledger‘.

Advantages of Ledger

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i. **Complete information at a glance:**

All the transactions pertaining to an account are collected at one place in the ledger. By looking at the balance of that account, one can understand the collective effect of all such transactions at a glance.

ii. **Arithmetical Accuracy**

With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. **Result of Business Operations**

It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. **Accounting information**

The data supplied by various ledger accounts are summarized, analysed and interpreted for obtaining various accounting information.

Preparation of Trial Balance

Trial balance is a statement which shows debit balances and credit balances of all accounts in the ledger. Since, every debit should have a corresponding credit as per the rules of double entry system, the total of the debit balances and credit balances should tally (agree). In case, there is a difference, one has to check the correctness of the balances brought forward from the respective accounts. Trial balance can be prepared in any date provided accounts are balanced.

Definition

–**Trial balance** is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books‖ – **J.R. Batliboi**. **Objectives**

The objectives of preparing a trial balance are:

i. To check the arithmetical accuracyof the ledger accounts. ii. To locate the errors.
iii. To facilitate the preparation offinal accounts.

Advantages

The advantages of the trial balance are

i. It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
ii. It supplies in one place ready reference of all the balances of the ledger accounts.
iii. If any error is found out by preparing a trial balance, the same can be rectified before preparing final accounts.
iv. It is the basis on which final accounts are prepared.

Cash book

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side.

Advantages

1. **Saves time and labour:** When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.

2. **To know cash and bank balance:** It helps the proprietor to know the cash and bank balance at any point of time.

3. **Mistakes and frauds can be prevented:** Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

4. **Effective cash management:** Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated

Types:

Single Column Cash Book

Single column cash book (simple cash book) has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a CashAccount.

Double Column Cash Book

The most common double column cash books are

i. Cash book with discount and cash columns
ii. Cash book with cash and bank columns.

i. Cash Book with discount and cash columns

On either side of the single column cash book, another column is added to record discount allowed and discount received.

ii. Cash book with cash and bank columns

When bank transactions are more in number, it is advisable to open a cash book by providing a separate column on either side of the cash book to record the bank transactions therein.

Triple Column Cash Book

Large business concerns receive and make payments in cash and by cheques. Where cash discount is a regular feature, a Triple Column Cash Book is more advantageous. This cash book has three amount columns (cash, bank and discount) on each side. . All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

PETTYCASHBOOK

In order to make the task of the cashier easy, these small and recurring expenses are recorded in a separate cash book called –**Petty Cash Book**‖ and the person who maintains the petty cash is called the –**Petty Cashier**‖.

Petty means ‗small'. The petty cash book is a book where small recurring payments like carriage, cartage, postage andtelegram, printing and stationery etc., are recorded bythe pettycashier, a person other than the main cashier.

Advantages

The advantages of analytical pettycash book is given below:

i. ***Simple Method:*** It is a simple method of recording petty expenses. The maintenance ofpettycash bookdoes not require specialised knowledge ofaccounting.

ii. ***Economy of Time:*** It requires lesser time in recording and also saves the time of the main cashier

iii. ***Lesser chances of mistakes:*** The petty cash book is checked by the main cashier at the end of the specified period. This process minimises the chances of mistakes.

iv. ***Frauds can be minimised*:** Recording transactions on the basisofvouchersand checkingofcash bookbythe maincashier minimises the chances of fraud.

SUBSIDIARY BOOKS

Generally, **transactions are of two types: Cash and Credit**. Cash transactions can be grouped in one category whereas credit transactions can be grouped in another category. Thus, in practice, the main journal is sub-divided in such a way that a separate book is used for each category or group of transactions which are repetitive and sufficiently large in number.

Purpose

i. Purchases Book records only credit purchases of goods by the trader.
ii. Sales Book is meant for entering only credit sales of goods by the trader.
iii. Purchases Return Book records the goods returned by the trader to suppliers.
iv. Sales Return Book deals with goods returned (out of previous sales) by the customers.
v. Bills Receivable Book records the receipts of bills (Bills Receivable).
vi. Bills Payable Book records the issue of bills (Bills Payable). vii.Cash Book is used for recording only cash transactions i.e.,

receipts and payments of cash.
viii. Journal Proper is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

Advantages

The advantages of maintaining subsidiary books can be summarised as under :

i. **Division of Labour :** The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

ii. **Efficiency :** The division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialisation leading to efficiency.

iii. **Prevents Errors and Frauds :** The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrance of errors and frauds may be avoided.

iv. **Easy Reference :** It facilitates easy references to any particular item. For instance total credit sales for a month can be easily obtained from the Sales Book.

v. **Easy Postings :** Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

Purchases Book

Purchases book also known as **Bought Day Book** is used to record all credit purchases of goods which are meant for resale in the business. **Cash purchases of goods, cash and credit**

purchases of assets are not entered in this book. Before discussing the Purchase Day Book, in detail we are to explain the most significant terms, Trade Discount and Cash Discount.

Sales Book

The sales book is used to record all credit sales of goods dealt with by the trader in his business. **Cash sales, cash and credit sales of assets are not entered in this book**. The entries in the sales book are on the basis of the invoices issued to the customers with the net amount of sale.

Purchases Return Book

This book is used to record all returns of goods by the business to the suppliers. The entries in the Purchases Returns Book are usually made on the basis of debit note issued to the suppliers or credit note received from the suppliers. We call it a debit note because the party‗s (supplier) account is debited with the amount written in this note. The same note is termed as credit note from the receiving party‗s point of view because he will credit the account of the party from whom he has received the note together with goods.

Sales Return Book

This book is used to record all returns of goods to the business by the customers. The entries in the sales return book are usually on the basis of credit notes issued to the customers or debit notes issued by the customers.

Bill of exchange

When one wants to increase the business transactions, credits may be allowed and the amounts are received after some time. If the amount involved in the credit transaction is large, the seller needs security and evidence over the dealings. Here the Bill of Exchange solves the problems of the seller.

Bills Books

When the number of bills received or issued is large journalising of all bill transactions will result in enormous waste of time. Hence, suitable registers like bills receivable book and bills payable book are maintained to record the receipt of bills receivable and issue of bills payable respectively. These books are also called Bills Journals / Books.

Bills Receivable Book

Bills receivable (B/R) book is used for the purpose of recording the details of bills receivable. The individual accounts of parties from whom bills are received will be credited with the amount in the bills receivable book. The periodic total is posted to the debit of bills receivable account in the ledger by writing –To sundries as per Bills Receivable Book‖.

Bills Payable Book

Bills payable (B/P) book is used for the purpose of recording the details of bills payable. The individual accounts of the parties to whom the bills are issued will be debited with the corresponding amount in the bills payable book. The periodic total is posted to the credit of bills payable account in the ledger by writing –By Sundries as per Bills Payable Book‖.

Journal& Ledger Problem no:-1

Journalize the following transactions in the books of Balan:

1999		Rs.
Dec.1	Balan commenced business with a capital of	1, 00,000
3	Bought goods for cash	60,000
4	sold goods for cash	50,000
5	Deposited in IOB	40,000
6	Bought goods from Ravi	30,000
7	Bought furniture for cash	4,000
8	Sold goods to Nathan	40,000
9	Paid cash to Seenu	10,000
10	Nathan returned goods worth	2,000
11	Paid advertisement charges	4,000
12	Returned goods to Ravi	3,000
13	withdrew cash from bank	10,000
15	Brought a bicycle for office use	3,000
16	Received commission	1,000
18	Drew cash for personal use	6,000
19	Electricity charges paid	600
20	Paid insurance premium	1,500
	Interest received	300

Paid rent	1,200
Paid salaries	9,600
Interest accrued	600
Salary due	1,000
Prepaid insurance	500
Commission received in advance	100

Problem no:-2
On 1st march 1999 , the books of accounts of Mr. Raja Rajan disclosed the following position: cash in hand rs.20,000;cash at bank Rs.66,000;Stock of goods Rs.42,000;Machinery rs.1,00,000;Furniture Rs.15,000;Debtors:Mahesh Bros.:Rs.15,000;Balu Bros.:Rs.25,000;Sundry creditors: Johnny Bros:Rs.20,000;Loan Rs.50,000.
Transactions during the month.

Date particulars 1999	Rs
March 3 Purchased goods on credit form Sishya &co.,	10,000
5 Sold goods for cash	5,000
Sold goods to Mahesh Bros.	10,000
6 Received from Mahesh Bros.in full settlement of amount due	
on March 1.	14,500
7 Payment made to Johnny Bros.by cheque	9,800
They allowed discount	200
10 Sold old furniture for cash	500
12 Purchased goods for cash	1,200
13 Balu Bros.paid by cheque; cheque deposited in bank	25,000
20 Paid repairs to machinery	400

15 Purchased goods of Johnny Bros.	10,000
15 Freight paid on the goods form Johnny Bros.	100
18 Received cheque from Mahesh Bros. cheque deposited in bank	9,600
Discount allowed to them	400
18 Paid by cheque to Johnny Bros.	10,000
19 Bank intimated that cheque of Mahesh Bros. has been returned unpaid.	
20 cash sales	6,000
21 cash deposited in bank	7,000
22 Paid municipal taxes in cash	1,000
23 Old newspapers old	50
24 Drew cash from bank for office use	1,000
25 Purchased furniture	2,000
25 Purchased adding machine & typewriter (Payment in all cases made by cheque)	8,200
26 Received interest from Bank (Amount credited in bank account)	500
27 Paid for advertisement	5,000
31 Paid rent by cheque	500
Paid salaries for the month	3,000
Drew out of bank for private use.	2,000
Mahesh Bros. becomes insolvent, a dividend of 60 paise in the rupee is received.	
An old debt, written off as bad debt in 1998, is recovered	200

Enter the above transactions in the journal of Raja Rajan.

Problem no:-4

Form the following transaction of Mr. Velmurugan, you are required to write up his Journal, post the entries in the ledger accounts and balance the accounts at the end of the month

1999		Rs.
Mar.1	Velumurugan commenced business with furniture	2,000
	stock Rs.12,000 and cash	6,000
2	Purchased from Sathya	12,000
4	Sold goods for cash	6,000
5	Return goods for cash	1,400
7	Purchased goods for cash	6,000
8	Sold goods to Anand	8,000
11	Anand returned goods	1,200
13	Paid cash to Satya Rs.4,120 and he allowed us	
	discount	80
15	Sold goods to Balaji	5,200
17	Received cash form Anand Rs.2,160 and allowed	
	him discount	50
18	Purchased stationery	600
19	Received cash form Balaji	3,200
21	Sold old furniture for cash	200
23	Paid commission	2,000
25	Velumurugan withdrew cash	200
27	Postage stamps purchased	100
30	Received cash form Balaji	2,000
31	Paid salary Rs.1,800 and office rent	600

Problem no:-5

At the end of an accounting year, a trader finds that no entry has been passed in the books of accounts in respect of the following transactions

Stock- in –hand at the end of the year Rs.35,000

Outstanding salary at the end of the year Rs.4,000

Charge interest on capital(Rs.1,00,000)at 10% p.a. for nine months

Interest to be charged on drawings @ 6% when total drawings were Rs.30, 000.

Unsold machinery appearing in the books at Rs.10, 000 is exchanged for new machinery of Rs.10, 000. The old machinery has been valued at Rs.1, 600 for exchange purpose.

Prepaid Insurance Premium Rs.450

Charge depreciation on furniture @ 8% for six months (Furniture Rs.16,000)

Simple cash book or Single column Cash book Problem no:-6

Anand starts business with Rs.10, 000 on 1.7.86. Of this, he pays Rs.9, 000 into his bank account. His cash transactions during the first week were:-

			Rs.
July	1	Purchased stationery, paid cash	40
		Purchased goods for cash	650
		Purchased office table and chair	200
	2	cash sales	150
	3	Received from Gopal, as advance for consignment of goods	200
	4	Paid Sethi & Co., cash	140
	5	Paid for sign board	130
	6	Cash sales	160
		Purchased old typewriter	300

Prepare cash book for the period.

Problem no:-7

Prepare a simple cash book from following transactions of Mr.Gopal of Chennai.

2000				Rs.
Jan	1	Cash balance	16,000	
	2	he bought goods for cash		10,000
	4	Sold goods for cash		200
	5	Received cash form Manohar	720	
	10	Paid into Bank	6,000	
	12	paid cash to Honest Raj		430
	15	Sold goods for cash	3000	
	17	paid for stationery		30
	19	Paid for office furniture		370

20	Received for office furniture	1,360	
24	Paid for advertising		180
26	Purchased postage stamps	16	
29	Paid rent		200
31	paid electricity charges		30

Cash Book with Cash and Discount Columns (Two Column Cash Books) Problem no:-8

Enter the following transaction in two column cash book of Nanda

2000				Rs.
Mar.	1	Mr.Nanda started business with cash	13,000	
	2	Bought goods for cash		1,370
	3	Paid Mohan cash		190
		Discount allowed by him		10
	5	Deposited in bank		8,000
		Paid for office furniture in cash		930
	10	Sold goods for cash		6,000
	13	Paid wages in cash		240
	14	Paid for Stationery		80
	16	Sold goods for cash		5,000
	18	Paid for miscellaneous expenses		90
	20	Received cash form Jamuna	970	
		Allowed her discount	30	
	22	Purchased a radio set	500	
	23	Paid electricity bill		70
	25	Paid for advertising		80
	26	Paid into bank	5,000	
	30	Paid rent		180
	31	Paid salary		800

Problem no:-9

Niveditha maintains a two columnar Cash Book which she balances every week.

2000				Rs.
Mar	25	Her Cash Book showed balance of	6,900	
	26	Paid Cash to Kailash	1,428	
		Discount received		72
	29	Paid Salaries		5,025
	30	Cash sales		11,370
30		Withdrew cash for private expenses	1,020	
31		Received as compensation from Railway authority	4,380	
Received cash from Shanthi Lal				3975
Allowed him discount			75	

Triple Column Cash Book or Three Columnar Cash Book. Problem no:-10

Prepare a three column cash book from the following

2000			Rs.
Mar.	1	Cash in hand	90,000
Cash at bank			75,000
Cash sales deposited in Bank			3,000
Amount deposited by a customer directly in Bank			4,500
Sold goods to Rakesh on credit			9,000
Deposited cash for opening a fixed deposit account			15,000
Received a cheque from Jagan for			1,500
Discount allowed			100
The cheqeue was sent to Bank for collection			
paid to Vivek by cheque			4,500
Goods returned by Rakesh			1,500
Interest allowed by Bank			3,000

Cheque received from Jagan is dishonoured Bank charges Rs.10 for dishonor of the cheque
A bill received for Rs.15, 000 discounted in Bank at 10%
Received a cheque from Rakesh for Rs.7, 000 in full and final settlement
Withdrew from Bank for paying Medical Expenses
of the owner of 3,000
Rakesh‘s cheque deposited in bank
Purchased building and payment made by cheque 1, 00,000
Bad debts recovered 1,000
An insolvent debtors pays 40% of Rs.5, 000 due from him
{Hint: March14: On credit side show _By Jagan Rs.1, 510 in bank column. A separate Journal entry is needed to cancel discount allowed of Rs.100}

Problem no:-11

Enter the following transactions of a trader in a triple column cash book 1987

Nov.	1	Nizam started business with Rs.1, 00,000
2		Deposited into bank of Bodi Rs.95, 000
5		Purchased a building for Rs.70, 000 and paid by cheque
10		Purchased merchandise Rs.20, 000 and paid by cheque
25		Paid freight Rs.50

Withdrew from bank for personal use Rs.500
Cleared electricity bill Rs.90

Petty cash Book Problem no:-12

Prepare petty cash book on imprest system for the week ended 31.12.1985

Dec	25	Balance on hand Rs.950
	26	Received from the Head Cashier, amount required to make an imprest of Rs.100
	27	Paid local conveyance Rs.6
	28	Paid Cartage Rs.3; Postage Rs.2.25
	29	Stationery Rs.11, 25; Stamps Rs.2, 00; Refreshments to customers Rs.5, 75
	30	Office cleaning Rs.4; Wages to Coolie Rs.1.25; Typewriter repairs Rs.15
	31	Cartage Rs.1.75; Postage Rs.4.75; Conveyance Rs.1.25; Entertainment Rs.2.50.

Problem no:-13

A trader maintains petty cash book under imprest system. Record the following transactions in his Petty cash Book.

1985				Rs.
Sep	1	Received for Petty Payments	500	
	2	Postage		40
	5	Stationery		25
	8	Advertising		50
	12	Wages paid		20
	16	Carriage		15
	20	Conveyance		22
	25	Travelling Expenses	80	
	27	Postage	50	
	28	Wages Paid for office cleaning	10	
	30	Telegram	20	
	30	Registered Postage	5	

Trial Balance Problem no:-14

The following balances were extracted from the ledger of Ramakrishna Engineering Works on 31st March 1997. You are required to prepare a trial balance as on that date in proper form.

	Rs.		Rs.
Drawings	6,000	Salaries	9,500
Capital	24,000	Sales returns	1,000
Sundry creditors	43,000	Purchase returns	1,100
Bills payable	4,000	Travelling expense	4,600
Sundry debtors	50,000	Commission paid	100
Bills receivable	5,200	Trading expenses	2,500
Loan form Karthik	10,000	Discount earned	4,000
Furniture & fixtures	4,500	Rent	2,000
Opening stock	47,000	Bank overdraft	6,000
Cash in hand	900	purchases	70,800
Cash at bank	12,500		
Tax	3,500		
sales	1,28,000		

Problem no:-15

Journalise the following transactions and post them into ledger of Mr.Akilan and also prepare trial balance.

1997		Rs.	
April 1	Started business with cash	80,000	
3	Purchased goods for cash	40,000	
5	Purchased goods from Kalyan	16,000	
7	Sold goods for cash	32,000	
10	Goods sold to Pathy	16,000	10
	Purchased furniture for cash	12,000	

18	Sale of furniture	4,000
23	Paid carriage	4,000
25	Settled Kalyan's account with	15,000
27	Paid Rent	2,400
28	Pathy settled his account	15,400
30	Paid salary	2,000

Problem no:-17

Amend the following trial balance as you think necessary to correct the same.

Trial balance as on 30.11.1997

	Dr.(Rs.)	Cr.(Rs)
Jayanthan's capital	-	1,00,000
wages	26,800	-
Purchases	1,24,900	-
Sales	-	3,10,800
Rent paid	-	5,000
Discount received	-	1,200
Electricity	-	1,600
Salaries	5,200	-
carriage	500	-
Plant and machinery	1,20,100	-
Bank overdraft	4,700	-
Cash in hand	600	-
Sundry creditors	-	8,000
Sundry debtors	14,900	-
Stock on 1.12.96	-	62,600
Furniture & fixtures	-	32,500
	2,97,700	5,51,700

Unit I Questions

1. Define and elaborate the meaning of Accounting.
2. Discuss the scope and objectives of accounting.
3. Explain the accounting process with diagram.
4. List and enumerate the various functions of functions of financial accounting.
5. “Even though financial accounting brings out the facts and figures of an organization, it is also
   having its own limitations” Discuss.
6. Highlight the various accounting concepts and conventions.
7. Write and ex[plain the golden rules of accounting.
8. Draw the perform of trail balance and explain the important entries.
9. Write a detailed note on subsidy ledger.
10. Explain petty cash book and its advantages.

SCHOOL OF MANAGEMENT STUDIES

UNIT – II – Financial Accounting – SBA1102

UNIT-2 DEPRECIATION ACCOUNTING

Depreciation Accounting, Meaning, Causes and objectives of Depreciation- Methods of providing Depreciation – Straight Line and Diminishing Balance Method

DEPRECIATION

Every business acquires some non-trading fixed assets. These fixed assets are used in the business for facilitating its trading activities and enhancing its revenue earning capacity. These assets are basically purchased for the business with the intention of permanent use and not for resale.

All fixed assets except the value of land decreases with the passage of time. The value of these assets decrease each year. Such gradual reduction or decrease in the value of fixed assets for the purpose of earning revenue is called depreciation. Depreciation is closely related with the determination of profit or loss for the period. Unless depreciation is charged to the revenues, the true income of the business cannot be ascertained properly. As such, depreciation is a revenue expense.

The characteristics of depreciable assets are as follows.

The expected life of the asset is more than one accounting period.

Those assets have a limited useful life.

Those assets are held by the business for use in production of goods and services.

Those assets are not for the purpose of sale in the ordinary course of business.

The cost of fixed asset indicates 'the price for the future service of the assets'. It is necessary to spread its cost over a number of years during which benefit of the asset is received. This process of allocating the cost of fixed assets is termed as 'depreciation'.

Definition

According to ICMA (Institute of Cost and Management Accountants - London) Terminology "Depreciation is the diminution in intrinsic value of asset due to use and / lapse of time".

Carter defines depreciation as "the gradual and permanent decrease in the value of an asset from any cause".

Need for Providing Depreciation:

The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss

For proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.

2. To present a true and fair view of the financial position

If the amount of depreciation is not provided on fixed assets in the books of account, the value of fixed assets will be shown at a higher value than it's real value in the balance sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.

3. To ascertain the real cost of production

For ascertaining the real cost of production, it is necessary to provide depreciation.

4. To comply with legal requirements

As per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.

5. To replace assets

Depreciation is provided to replace the assets when it becomes useless.

The causes of depreciation may be internal or external. The internal causes arise from operation of any cause natural to or inherent in the asset itself. External causes arise from the operation of forces outside the business. These are being discussed below:

I. Internal Causes

1. Wear and tear:

Wear and tear is an important cause of depreciation in case of tangible fixed asset. It is due to use of the asset.

2. Disuse:

When a machine is kept continuously idle, it becomes potentially less useful.

3. Maintenance:

The value of machine deteriorates rapidly because of lack of proper maintenance.

4. **Depletion:**
   It refers to the physical deterioration by the exhaustion of natural resources eg., mines, quarries, oil wells etc.

II. External Causes

1. **Obsolescence:**
   The old asset will become obsolete (useless) due to new inventions, improved techniques and technological advancement.

2. **Effluxion of time:**
   When assets are exposed to forces of nature, like weather, wind, rain, etc., the value of such assets may decrease even if they are not put into any use.

3. **Time Factor:**
   Lease, copy-right, patents are acquired for a fixed period of time. On the expiry of the fixed period of time, the assets cease to exist.

Factors Determining the Amount of Depreciation

1. **Original cost of the asset**
   It implies the cost incurred on its acquisition, installation, commissioning and for additions or Improvements thereof which are of capital nature.
2. **Estimated life:**
   It implies the period over which an asset is expected to be used.

3. **Residual value:**
   It implies the value expected to be realized on its sale on the expiry of its useful life. This is otherwise known as scrap value or turn-in value.

Methods of Calculating Depreciation

1. Straight line method or fixed installment method.
2. Written down value method or diminishing balance method
3. Annuity method.
4. Depreciation Fund method.

5. Insurance Policy method.
6. Revaluation method.

Straight line method or fixed installment method

The simplest and most commonly used method, straight-line depreciation is calculated by taking the purchase or acquisition price of an asset, subtracting the salvage value (value at which it can be sold once the company no longer needs it) and dividing by the total productive years for which the asset can reasonably be expected to benefit the company. Depreciation under this method may be calculated as follows:

Depreciation per annum = (Net Book Value - Residual Value) / Life time

Written down value method or diminishing balance method

Reducing Balance Method charges depreciation at a higher rate in the earlier years of an asset. The amount of depreciation reduces as the life of the asset progresses. Depreciation under reducing balance method may be calculated as follows:

Depreciation per annum = (Net Book Value - Residual Value) x Rate%

Annuity method.

Annuity depreciation methods are not based on time, but on a level of Annuity. This could be miles driven for a vehicle, or a cycle count for a machine. When the asset is acquired, its life is estimated in terms of this level of activity.

The annuity method considers that the business besides loosing the original cost of the asset in terms of depreciation and also looses interest on the amount used for buying the asset. This is based on the assumption that the amount invested in the asset would have earned in case the same amount would have been invested in some other form of investment. The annual amount of depreciation is determined with the help of annuity table. This method is used to calculate depreciation amount on lease.

Depreciation Fund Method or Sinking Fund Method:

Under this method, funds are made available for the replacement of asset at the end of its useful life. The depreciation remains the same year after year and is charged to Profit and Loss account every year through the creation of depreciation fund. The amount of annual depreciation is invested in good securities bearing interest at a specified rate. The aggregate amount of interest and annual provision is invested every year. When the asset is completely written off or is to be replaced, the securities are sold and the amount so realized by selling securities is used to replace the old asset.

Insurance Policy Method:

According to this method, an Insurance policy is taken for the amount of the asset to be replaced. The amount of the policy is such that it is sufficient to replace the asset when it is worn out. A sum equal to the amount of depreciation is paid as premium every year. The amount goes on accumulating at a certain rate of interest and is received on maturity. The amount so received is used for the purchase of new asset, replacing the old one.

Revaluation Method:

Under this method, the assets like loose tools are revalued at the end of the accounting period and the same is compared with the value of the asset at the beginning of the year. The difference is considered as depreciation.

Depreciation

Straight line method:-

1. Hasan purchased a machine on 1sr jan. 1992 at Rs.14400. The scrap value after ten years, time is expected to be Rs.3400. If depreciation is written off by equal instalments every dec.31, show the machinery A/c for the first thee years. Calculate the rate of depreciation.
2. An asset is purchased for Rs.25000. Depreciation is to be provided annually according to the to the straight line method. The useful life of the asset is 10 years and the residual value is Rs.5000. You are required to find out the rate of depreciation and prepare the Asset A/c for the first three years.
3. A company purchased a machine on 1-1-8 for Rs.80000. On 1stjuly 1984, it purchased another machine for Rs.20000. On 1stjuly 1985, it sold off the first machine purchased in 1983 for Rs.56000. On the same date, it purchased further machinery for Rs.50000. On 1stjuly 1986, the second machine purchased for Rs.20000 was also sold off for Rs.4000. Accounts are closed every year on 31st December. Depreciation is written off at 10% per annum on original cost. Prepare the machinery A/c for four years ending 31-12-86.
4. A limited company purchased a plant for Rs.10000 on 1-1-91. On 1-7-91 an additional plant was bought costing Rs.5000. on 1-7-92 the plant bought on 1-1-91 was sold off for Rs.4000. On 1-7-93 a fresh plant was purchased for Rs.12000 and the plant bought on 1- 7-91 was sold at Rs.4200. Depreciation is provided at 10% p.a. on original cost on 31st December every year. Draw up the plant A/c and provision for depreciation account till the end of 31-12-93.

5. A second-hand machine was purchased on 1.1.90 for 40000. Overhauling and installation expenses for thee same machine amounted to Rs.10000. Another machine was purchased on 1.7.90 for Rs.20000.

   On 1.7.92, the machine installed on 1.1.90 was sold for 25000. Dismantling charges for the machine sold on 1.7.92 were Rs.1000. on the same date another machine was purchased for Rs.80000 and commissioned on 30.9.92. the company has adopted calendar year as its financial year. Under the existing practice, the company provides depreciation @10% p.a. on original cost. In 1993, it has been decided that depreciation will be charged on the diminishing balance @15% p.a. the charge is not to be made with retrospective effect. Show machinery A/c from 1990 to 1994.

Diminishing Balance Method / written down value method:-

6. A machine is purchased for Rs.51200. Its life is expected to be 4 years and the scrap value is expected to be Rs.16200. You are required to determine the rate of depreciation when diminishing balance method of depreciation is adopted.
7. A company purchased a second hand plant for Rs.30000 and immediately spent Rs.5000 on repairs. The plant was put to use on January 1985. After using it for six years it was sold for Rs.15000. You are required to prepare the plant A/c for 6 years providing depreciation at 10% on diminishing balance method. Accounts are closed on 31^{st} December.
8. Machinery account in the books of a company was as follows; Balance as at 1.1.86Rs.14900
   Purchase of machinery on 1.7.86 Rs. 4400
   Sale of machinery on 1.10.86 Rs. 1000
   The original cost of machinery sold was Rs.6000 on 1.7.83
   Machinery is being depreciated at 10% p.a. on diminishing balance of the asset. Show the machinery A/c in the books of the company for year 1986. The books are closed on 31^{st}dec. each year.
9. On 1.1.92 a plant was purchased for Rs.4000. On 1.7.1994 the plant was replaced by a new plant costing Rs.3000, the vendor taking the old machine in part exchange at a valuation of Rs.800. show the plant account upto 31^{st}dec. 1994 assuming and the plant employed at the end of each year.

10. Machinery was purchased for Rs.60000 on 1.1.90. On 1.1.91 another machine was purchased for Rs.120000. On 1.7.1992 one more plant was purchased for Rs.60000 (including the cost of installation of Rs.3000) by disposing off the machinery which was purchased on 1.1.90 for Rs.21000. On 1.4.1993, another machinery was purchased for Rs.105000 by disposing off the machinery which was purchased on 1.1.1991 for 105000. Show the machinery A/c upto 31.12.1993 assuming that the rate of depreciation was @ 10% on diminishing balance method.

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SCHOOL OF MANAGEMENT STUDIES

UNIT –III – Financial Accounting – SBA1102

UNIT- 3 SINGLE ENTRY SYSTEM

Single Entry System: Meaning, Merits and Demerits – Distinguish between Single Entry and Double Entry system – Statement of Affairs Method.

Meaning

Single entry system records each accounting transaction with a single entry to the accounting records, rather than the vastly more widespread double entry system. The single entry system is centered on the results of a business that are reported in the income statement. The core information tracked in a single entry system is cash disbursements and cash receipts. Asset and liability records are usually not tracked in a single entry system; these items must be tracked separately. The primary form of record keeping in a single entry system is the *cash book*, which is essentially an expanded form of a check register, with columns in which to record the particular sources and uses of cash, and room at the top and bottom of each page in which to show beginning and ending balances.

Definition:

According to Kohler "Single Entry System is a system of bookkeeping in which as a rule, only records of cash and personal accounts are maintained. It is always incomplete double entry varying with circumstances".

Features of Single Entry

1. **Suitable for sole traders and partnership firms:**
   The single entry system is suitable only for sole traders and partnership firms. Companies cannot keep books on single entry system because of legal provisions.

2. **Only personal accounts and cash accounts are kept:**
   In this system it is very common to keep only personal accounts and toavoid real and nominal accounts. It also keeps one cash book which mixes up business as well as private transactions.

3. All transactions are not recorded:
All business transactions are not recorded in the books of account. Some of them are recorded in the books of accounts, certain transactions are noted in the diary and some of them are in the memories.

4. Lack of uniformity:
This system lacks uniformity as it is a mere adjustment of double entry system, according to the convenience of the individual.

5. Collection of information from original documents:
It is quite often seen that for information one has to depend on original vouchers. For example to know total purchases and sales, one has to depend on copies of invoices.

6. Profit only an estimate:
Profit under this system is only an estimate.

7. True financial position cannot be ascertained:
True financial position cannot be ascertained as Balance Sheet is not prepared due to the absence of nominal and real accounts.

8. Not accepted by Tax Authorities:
Due to incompleteness, inaccuracy, and unsystematic nature, it is not accepted by tax authorities**.**

Defects or Limitations of Single Entry:

1. Incomplete and unscientific method:
This system is incomplete, because real and nominal accounts are not prepared and also due to the fact that the debit and credit aspect of all transactions are not recorded.

2. Trial Balance cannot be prepared:
Quite often this system does not record both the aspects of transactions; therefore, at the end of the year arithmetical accuracy of the books cannot be checked by preparing a trial balance.

3. Performance of the business cannot be ascertained:
Trading, profit and loss account cannot be prepared and hence the gross profit, net profit and rate of net profit on sales cannot be known.

4. True financial position cannot be ascertained:
It is very difficult to prepare balance sheet, so the true financial position cannot be ascertained.

5. **Comparison with previous year's performance is not possible:**
Due to incomplete information and non-availability of previous years' information, comparison between the current and previous years' performance cannot be made. Comparison is required to identify the areas of weakness and rectification.

6. **Unacceptable to tax authorities:**
Tax authorities (income tax and sales tax) do not accept accounts prepared according to single entry system for computation of taxes.

7. **Difficulty in obtaining loan:**
Accounts prepared according to this system are not accepted by banks and other money lending institutions, so it is very difficult to obtain loan.

8. **Difficult to locate frauds:**
It is difficult to locate frauds under this system and so employees may become dishonest and negligent. It encourages misappropriation, fraud and carelessness.

9. **Difficult to determine the price of the business:**
Due to the absence of true and reliable net profit or assets and liabilities, it is Difficult to determine the price of the business at the time of its sale.

Difference between Single entry and Double System

Single entry *system* records each accounting transaction with a single entry to the accounting records, rather than the vastly more widespread double entry system. The single entry system is centered on the results of a business that are reported in the income statement. The core information tracked in a single entry system is cash disbursements and cash receipts. Asset and liability records are usually not tracked in a single entry system; these items must be tracked separately.

Double entry accounting is a record keeping system under which every transaction is recorded in at least two accounts. There is no limit on the number of accounts that may be used in a transaction, but the minimum is two accounts. There are two columns in each account, with debit entries on the left and credit entries on the right. In double entry accounting, the total of all debit entries must match the total of all credit entries. When this happens, the transaction is said to be "in balance." If the totals do not agree, the transaction is said to be "out of balance," and you will not be able to use the resulting information to create financial statements.

The following are the differences between single entry and double entry system:

Basis of Distinction	**Double Entry System**	**Single Entry System**
1. Principle	**For every debit there is a corresponding credit and vice versa**	**Debit and credits do not agree.**
Recording of transaction	**Debit and credit aspects of all transactions are recorded.**	**Debit and credit aspects of all transactions are not recorded.**
Nature of accounts maintained	**Maintains complete record of personal, real and nominal accounts.**	**An incomplete record. Only personal and cash accounts are maintained.**
4. Trial Balance	**Arithmetical accuracy of the records can be checked by preparing a Trial Balance**	**Trial Balance cannot be prepared.**
5. Determination of profit or loss and financial position	**A Profit and Loss Account and Balance sheet can be conveniently prepared since the book of accounts present a complete picture.**	**A Profit & Loss Account and Balance sheet cannot be conveniently prepared since the accounting records are incomplete.**
6. Suitability	**It is suitable for all types of traders.**	**It is suitable for only small traders.**
7. Dependability	**It is the only scientific system of keeping books of accounts.**	**It is not a system. It is incomplete and unscientific**
8. Acceptability	**Records are acceptable for the purpose of tax, loans etc.**	**Records are not acceptable for the purpose of tax claims, loans etc.**
9. Internal check	**Internal check is possible**	**Internal check is not possible.**

1. **Meaning**
Single entry system is an incomplete system of recording financial transactions. Double entry system is a complete system of recording and reporting financial transactions.
2. **Duality**
Single entry system is not based on the concept of duality. Double entry system is based on the concept of duality.
3. **Accounts**
Single entry system maintains only personal accounts of debtors and creditors and cash book. Double entry system all personal, real and nominal accounts.
4. **Trial Balance**
Single entry system can not prepare a trial balance and hence, arithmetical accuracy of books of accounts can not be checked. Double entry system prepares trial balance and hence, arithmetical accuracy of the books of accounts can be checked.
5. **Profit Or Loss**
Single entry system can not ascertain the true amount of profit or loss of the business as it does not maintain nominal accounts. Double entry system ascertains true profit or loss of the business as it maintains all nominal accounts.
6. **Financial Position**
Single entry system can not ascertain the true financial position of the business because it does not maintain real accounts except cash book. Double entry system ascertains financial position of the business as it maintains all personal and real accounts.
7. **Suitability**
Single entry system is suitable to a small business where only limited number of transactions are performed. Double entry system is suitable for a large business.
8. **Tax Purpose**
Single entry system is not acceptable for the purpose of assessment of tax. Double entry system is acceptable for the purpose of assessment of tax.

Methods of ascertaining profit or loss:

When accounts are kept under single entry system, the following methods are adopted to find out profit or loss of the business.

1. Statement of affairs method or Net worth method or Capital comparison method
2. Conversion method

Statement of Affairs Method

The statement of affairs method resembles your company's balance sheet in that it shows the company's net worth at a point in time. The statement of affairs method compares transactions at the beginning period to transactions at the ending period to calculate profit and loss. If assets exceed liabilities, this represents a positive capital position for the company, which is a profit. A loss has occurred if liabilities surpass assets when comparing the beginning and ending affairs of the business.

When companies keep detailed financial records with a single entry system, the final records are an incomplete accounting. When this occurs, the statement of affairs method can be used to determine profit and loss. In order to complete the statement of affairs method, a statement of affairs for the beginning of the period and a statement of affairs for the end of the period are required.

The following procedures are adopted to calculate profit.

***Step 1*- Ascertain opening capital:** A statement of affairs at the beginning of the year is prepared to find out the amount of capital in thebeginning. A statementaffairs is like a Balance sheet. The difference between assets and liabilities side represents “Opening Capital”.

***Step 2*- Ascertainment Closing Capital:** Prepare a statement of affairs (after all adjustments*) at the end of the accounting period, to ascertain closing capital.

***Step 3* -Add** the amount of **drawings** (whether in cash or in kind) to the closing capital.

***Step 4*- Deduct** the amount of **Additional Capital** introduced, from the above, to get adjusted capital.

***Step 5* - Ascertainment profit or loss** by deducting opening capital from the adjusted closing capital.

Conversion Method

If it is desired to calculate profit by preparing Trading and Profit and Loss account under single entry then it is called conversion method. Following steps are necessary to prepare Trading and Profit and Loss account and Balance Sheet from the incomplete information.

***Steps 1* -** Opening Statement of Affairs: Prepare statement of affairs in the beginning so as to calculate capital in the beginning.

***Step 2* -** Other Accounts: Then prepare (i) Total debtors account, and (ii) Total Creditors account, to find out credit sales, credit purchases, creditors or debtors balance either in the beginning or at the end.

Step 3 **-** Total sales and total purchase: After preparing these accounts, calculate

Total sales, by adding cash sales and credit sales, and

Total purchases by adding cash purchases and credit purchases.

Step 4 **-** Final Account: Now prepare Trading, Profit and Loss account and Balance Sheet.

Unit – 5

Net worth (or) Statement of affairs method

1. Mr. Rafi maintains his books on single entry system. He gives you the following information:-

Capital as on 1.1.92	32000
Capital as on 1.1.93	36000
Drawings during the year 1992	10000
Capital introduced on Aug. 1992	6000

You are required to calculate profit made by Rafi during 1992.

2. Calculate the capital at the beginning of the yearRs.

Capital at the end of the year	35000
Drawings during the year	5000
Capital introduced during the year	2500
Profit during the year	10000

3. Calculate the missing figure:-Rs.

Profit made during the year	2400
Capital at the end	8000
Capital introduced during the year	2000
Drawings	1200
Capital in the beginning	?

4. Mr.janaki Raman keeps his books by single entry. He started business on 1st jan 1991 with Rs.100000. On 31st Dec. 1991 his position was as under:-

Assets	Rs.	Liabilities	Rs.
Cash in hand	2500	Sundry creditors Bills	20000
Cash at bank	5000	payable Outstanding	2500
Furniture	12500	creditors	2500
Plant	50000		
Sundry debtors	25000		
Stock	45000		
Bills receivable	5000		

Ascertain the profit or loss made by mr.janakiraman during 1991.

5. A trader has not kept proper books of accounts. The following balances are placed before you and you are required to prepare a statement of gross profit and net profit for the year ended 31st march 1971, and a statement of affairs as at that date.
6.

	1-4-1970 Rs.	31-3-1971 Rs.
Cash in hand	5350	5400
Bank overdraft	45000	40000
Stock in trade	59350	62200
Sundry creditors	38600	37200
Sundry debtors	38200	29800
Bills receivable	42400	40800
Land and buildings	53000	53000
Furniture	4600	4600
Bills payable	62000	58000

Drawings during the year amounted to Rs.6000. Depreciation is to be calculated on land and buildings at 2% and on furniture and fittings at 10%. Provide for doubted debts at 2 ½ %.

7. X and Y are partners, they share profits and losses in the ratio of 3:2. The accounts are maintained on single entry system. On 31st December 1995, their position was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	25000	Cash at bank	5000
Loan	10000	Debtors	40000
Capital: X	20000	Stock	10000
Y	15000	Plant and machinery	15000
	70000		70000

The position of the firm on 31.12.1996 was as follows Creditors Rs.30000, Stock Rs.20000, plant and machinery Rs.20000, Sundry debtors Rs.48000, Loan A/c Rs.5000, Cash at bank Rs.15000.

Additional Information:-
Depreciate plant at 6% create reserve on sundry debtors at 2 ½ %. Provide interest on loan (Opening balance) at 6%.
Drawings; X Rs.1500, Y Rs.1200

Find out the profit or loss made by the firm during the year and write up the partners capital A/c.

7.Mr.Ajay keeps his books of account under single entry system. His financial position on 31.12.1977 and 31.12.1978 was as follows:

Particulars	1977 Rs.	1978 Rs.
Cash in hand	250	300
Cash at bank	2,750	2,200
Stock in trade	21,000	18,000
Sundry Debtors	7,500	12,000
Furniture	1,750	1,575
Machinery	15,000	25,000
Sundry Creditors	18,000	23,000

During the year he introduced additional capital of Rs. 5,000 and he withdraw Rs.600 pm

From the above particulars prepare a statement of profit and Loss made by him for the year ended 31.12.1978.

8.From the following details, prepare a statement of profit or Loss for the year ended December 31,1989.

Particulars	1.1.89 Rs.	31.12.89 Rs.
Machinery	15,000	20,000
Furniture	2,000	2,000
Debtors	90,000	70,000
Cash	2,700	4,800
Prepaid expenses	500	-
Accrued income	-	800
Outstanding expenses	3,000	5,300

Provide 10% depreciation on machinery and furniture and 5% for bad debts on sundry debtors. Interest on capital to be provided at 6% per annum. After 3 months from the beginning of the year the proprietor had to bring in Rs.5,000 by way of additional capital. He drew salary at Rs. 500 pm. In addition he drew Rs.3,000 in anticipation of profit. Rs. 2,000 income tax was paid.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – IV- Financial Accounting – SBA1102

UNIT- 4 DEPARTMENTAL ACCOUNTS

Departmental Accounting: Meaning, Merits –Basis for Allocation of Expenses – Interdepartmental Transfers

MEANING OF DEPARTMENTS AND DEPARTMENTAL ACCOUNTING

An organization may produce or buy and sell several products on perform different services under the same roof or form the same enterprise. The modern practice is to divide the organization into independent departments each of which may deal in a particular class of goods or render a specified type of service. For example a readymade garments firm may be divided into tailoring and selling departments, a departmental store may be divided into textiles, provisions, durable goods departments etc.

When accounts are finalized at the end of the year the usual met had of trading and profit and loss account is not suitable for such organizations. The owners or the managements may desire to ascertain the trading results of each department and the overall result of the organization. The method of accounting which is followed to obtain such results is known as departmental accounting

Need for departmental accounting

An account which reveals expenses, incomes, sales stocks, gross profit and net profit separately for each department are needed.

i) To compare the results of each department with the results of previous years and ascertain the trend

ii) To know the comparative results of different departments in the same year

iii) To assess the position of stocks in each departments

iv) To identify areas of weakness for cost control and improvement of efficiency.

v) To decide upon expansion, discontinuation and investment policies

Advantages of departmental accounting

The following are the benefit derived by business firms through departmental accounting

i) **Ascertainment of profit:-**

Gross profit and net profit can be ascertained for each department separately on reliable basis

ii) **Comparative performance:-**

The results of different departments can be compared in terms of profit, expenses, inventories, percentage of growth, return on investment etc.

iii) **Appraisal of personnel:-**

Individual responsible for improved results or decline in performance can be identified. This is useful in implementing incentive systems.

iv) **Remedial measures:-**

Areas of poor performance can be identified for implementing remedial measures. If situation warrants, decisions to discontinue some products on closing a department may be taken accurately.

v) **Expansion and diversification:-**

Decisions to expand and diversify profitable lines of business become easier.

vi) **Policy formulation:-**

Management policies towards inventories extending credit, additional investment etc, are facilitated

Methods techniques of departmental accounting

i) When accounts are finalized, departmental trading and profit and loss account is prepared in columnar form to find gross profit and net profit of each department

A general profit and loss account is also prepared to find the overall profit or loss of the firm. The balance sheet is common and shows the position of the business as a whole.

ii) **Maintenance of records:-**

Firms which huge turnover and large number of transactions can maintain separate subsidiary books for each department. Medium and small sized firms can maintain purchase book, sales book and the returns books with appropriate columns for each department. Even the cash book can be similarly bifurcated. In the ledger separate accounts are opened for sales purchases, wages etc of each department. Closing stock can be separately ascertained at the time of stock taking. The following is the model sales book with column for different departments

Sales book

Date	Particulars	Name of customers	Outward invoice no	Lf	Total amount	Departments A B C

The same pattern of ruling can be made for purchase books, returns books etc.

iii) Departmentalization of expenses:-

In order to find out profit or loss of each department apart from sales, purchases, returns and stocks, various expenses must be charged to the departments appropriately

Business expenses are usually divided into two types' direct expenses and indirect expenses.

a) Direct expense:-

Expenses which can be directly identified with or incurred for particular departments are called direct expense Examples are wages, carriage, inwards, salary to the departmental staff, and insurance of stock.

These expenses are charged directly to the respective departments, either in the trading account or in the profit and loss account as the case may be

b) Indirect expenses(common/joint expenses)

Expense which cannot be identified with a particular department, but incurred for their common benefit are called indirect expenses

Indirect expenses are further sub-divided into:-

i) Expenses which cannot be apportioned
ii) Expenses which can be apportioned

1) **Expenses which cannot be apportioned:-**

Expenses which have no connection with the departments or those which have no reasonable basis for apportionment must be shown in the general profit and loss account. Any forced division of such expenses will distort the results of the departments unnecessarily.

Examples:

Debentures interest, income tax, dividends paid, directors fees, bank charges legal expenses etc.

iii) Expenses which can be apportioned:-

All indirect expense which are amenable for division on some logical or appropriate basis among the departments should be charged to the departments after dividing them on a suitable basis.

Examples;-selling expense, salaries, rent, depreciation, lighting, power, repairs etc. The following table provides guidelines for logical apportionment of such expenses.

s.no	Expenses	Basis of apportionment
1.	Selling expenses like sales, commission, salesmen's salaries advertising, bad debts, carriage outwards etc	Sales ratio or turnover ratio of different departments. It can be the ratio of sales value or sales quantity
2.	Rent and rates, repairs and buildings , maintenance of premises building insurance, depreciation etc.	Floor area or space occupied by each department
3.	Depreciation of fixed assets like furniture , fixtures machinery fire insurance , repairs on such assets	Value of each asset possessed by different department
4.	Lighting	Light points in the departments if this is not available floor area occupied.
5.	Carriage inward	Purchase value
6.	Power	Consumption as per 1 meter otherwise, horses power of the machines and the working time in hours or days
7.	Workmen's amenities, and welfare expenses	Number of workers in each departments
8.	Workmen's compensation insurance, ESI.PF etc, payable by employer	Wages of each department
9.	Factory manager's salary	Time devoted to each department
10	Premium for loss of profit insurance	Profit of each department in the previous year

iv) Inter-departmental transfers:

Goods may be transferred from one department to another similarly; services of one department may be used by another department. In such cases, the transfer may be may be made at cost price or at usually selling price.

a) **Inter departmental transfer at cost price:**

For the department which receives the transfer it is like a purchase or expenditure. The trading account of the receiving department is debited with the value of the transfer.

For the department which makes the transfer it is like a sale or an income. The trading account of transferring department must be credited with the amount of transfer. No further adjustment is required is relation to the transfer.

b) **Inter departmental transfer at selling price or loaded price;-**

When goods or services are transferred at a price above cost, the receiving department must be debited with the amount of transfer in the departmental trading account and thetransferring department must be credited is the departmental trading account with the same amount

In case of service rendered no further adjustment is needed. If gods are transferred and all the goods transferred are sold, them also no adjustment is required

Stock reserve:

If a part of the goods transferred is still n the closing stock of the receiving department at the time of finalization of accounts, provision must be made from unrealized profit is the stock of the receiving department.

Note:

1) The unrealized profit in the stock of the receiving department must be ascertained. Such profit included in the closing stock must be debited to the general profit and loss account as closing stock reserve similarly profit included in the opening stock must be credited to the general profit and loss account as opening stock reserve
2) In the balance sheet, the closing stock reserve must be reduced from the closing stock of the receiving departments
3) Adjustment for stock reserve is made in the general profit and loss account because as for as transferring department is concerned, it has earned that profit. From the point of view of the firm only it is unrealized.
4) If profit added by the transferring department is not given separately closing stock reserve must be found on the basis of gross profit to sales and transfer of the transferring department.
5) Information about opening stock reserve may be given in the form of gross profit percentage to sales of the previous year if this is not given it can be assured that provision was not made in the previous year.

6) If receiving department stock includes some other purchased fromoutside, stock reserve is needed only for the transferred stock. The rest of the stock should be ignored for the purpose of stock reserve.

Difference between branch accounts and departmental accounts

Basis of distinction	**Branch accounts**	**Departmental accounts**
Place at which accounts may be maintained	Branch accounts may be maintained at head office or branch	Departmental accounts are maintained at one place.
Allocation of common expenditure	There is usually no problem in allocation of common expenditure (except for H.O expenditure) since the amount of expenses in resects of each branch can be identified	There is problem of allocation of common expenditure among different departments
Problem of reconciliation	In case of independent branch reconciliation of head office and branch accounts is necessary	No such problem arises.
Problem of conversion of foreign branch figures	In case of foreign branch the problem of conversion of foreign branch figures arises	No such problem arises
Location	Branches are located in different geographical area, physically separated from the head office and one another	All the department are located within a single premises
Growth	Branches cater to a wider market and can expand and grow geographically	Departments are confined to local business and can grow vertically within the same roof

Accounting	Branches keep records of their operations separately. The head office consolidates the accounts of all the branches.	All the accounting records are centralized and maintained within the same premises for all the departments
International operations	Branches can be started anywhere is the world. So there can be local and foreign branches	Departments are confined to a single place unless similar organization are opened elsewhere.

Problem No: 2

A company carries on its business through five departments viz A, B, C, D andE. The trial balance on 31-12-2004 was as follows:-

Particular	A	B	C	D	E
Opening stock	5000	3000	2500	4000	4500
Purchase	50000	30000	10000	26000	30000
Sales	48000	21000	9500	23000	30000
Closing stock	6000	4000	3500	3500	3500

The opening and closing stock have been valued at cost the expenses which are to be charged to each department is proportion to the cost of goods sold is the respective departments are as follows.

Salaries and commission	5510
Rent and rates	1450
Miscellaneous expenses	1305
Insurance	580

Shown the final result and the percentage on sales in each department and also the combined result with percentage on sales.

Problem No:-4

From the information given below prepare the department trading p&l a\c and balance sheet of a business man.

Trial balance as at 31-12-2010

Particulars		Debit	Credit
Capital		-	15800
Drawings a\c		758	
Stock (1-1-2010):-	Dept A	9000	
	Dept B	3500	
Purchases :-	Dept A	20000	
	Dept B	8500	
Sales:-	Dept A	-	30000
	Dept B	-	10000
wages:-	Dept A	300	
	Dept B	650	
Freight and carriage:-	Dept A	250	
	Dept B	65	
Sundry debtors		4800	

Sundry creditors	-	5700
Furniture	500	
Bills payable	-	1125
Bills receivable	1000	
machinery	10000	
Salaries	1200	
Advertisement	240	
commission	80	
Power and water	640	
Rent , rates and insurance	100	
Discount allowed	-	
Bank overdraft	300	
Printing and stationary	400	
Fuel and water	132	
General expenses	360	
Cash in hand	150	
	65625	65625

Additional information

1) The stock on 31-12-2010 Dept A 8500 ; Dept B 3000
2) Provide 2 % reserve for doubtful debts
3) Write off 5% depreciation on machinery
4) Fire insurance Rs 80 has been paid for the year ending 31-3-2011
5) Provide for wages due Rs 150(Dept A) and Rs 70(Dept B) salaries Rs 100 outstanding The expenses are to be borne by each department in proportion to its turnover.

Problem No: 5

The trading and profit and loss account of Hindustan electronics for the year ending 31st march 2005 is as under.

Particulars	Amount	Particulars	Amount
Purchases:		Sales:	
Transistors(x)	160000	Transistors(x)	175000
Tape recorders(y)	125000	Tape recorders(y)	140000
Space parts for servicing and repair		servicing and repair job(z)	35000

job(z)	80000	stock on 31st march 2005	
Salaries and wages	48000	Transistors(x)	60100
Rent	10800	Tape recorders(y)	20300
Sundry expenses	11000	Space parts for servicing and	
profit	40200	repair job(z)	44600
	475000		475000

Prepare departmental account for each of the three departments X, Y and Z mentioned above after taking into consideration the following

a) Transistors and tape recorders are sold at the showroom, servicing and repairs are carried out at the workshop

b) Salaries and wages comprise as follows Showroom ¼ th and workshop ¾ th.

It has decided to allocate the showroom salaries and wages is ratio 1:2 between departments X and Y.

c) The workshop rent is Rs 500 per month. The rent of the showroom is to be divided equally between the departments X and Y.

d) Sundry expenses are to be allocated in the basis of the turnover of each department.

Inter departmental transfer at selling price
Problem No: 6

Modern company has two departments X and Y department X sells goods to Y department at normal market price. From the following particulars, prepare departmental trading and profit and loss account for the year ended 31-12-2009.

Particulars	Department X	Department Y	Departments Z
Stock on 1-1-96	15000	-	-
Purchases	250000	40000	-
Goods from department X	-	40000	-
Wages	15000	20000	-
Salaries (department)	7000	5000	-
Closing stock at cost to the	80000	20000	-
dept	260000	145000	-
Sales	2500	1500	-

Printing and stationary	-	15000	12000
Machinery	-	-	18000
Advertisement	-	-	
Salaries (general)			

Depreciate machinery by 10% the general unallocated expenses are to be apportioned in the ratio of 2:1 to the departments X and Y. Half of the closing stock of department Y represents goods received form department.

Ascertainment of departmental costs Problem No: 7

Kamal nayan of kamlangaer purchased goods for his three departments as follows:

Dept A 2000 pieces

Dept B 14000pieces total cost Rs 51000

Dept C 4000 pieces

Sales of three departments were as follows

Dept A 1800 pieces at Rs 15 per piece

Dept B 15000 pieces at Rs 18 per piece

Dept C 4500 piece at Rs 6 per piece

Other information about stock in the beginning was as follows

Dept A 1000 pieces

Dept B 4000 pieces

Dept C 600 pieces

Kamal Nayan informs you that the rate of gross profit is the same in all departments. You are required to prepare trading account for the three departments.

Problem No: 8

The following purchase were made by good luck having three department

Dept A 1500 units

Dept B 2500 units at a total cost of Rs 118000

Dept C 3000 units

Stock on 1st April 2004 Dept A 150 units

Dept B 200 units

Dept C 250 units Sales during 2004-2005

Dept A 1400 units @ Rs 18 each Dept B 2400 units @ Rs 24 each Dept C 2700 units@ Rs 30each

The rate of gross profit is the same in each case Other expenses were

Salaries	18200
Printing & stationery	4550
Rent	2000
Interest paid	2730
Depreciation	3640

Allocate rent is the ratio of 2:2:1 and other expenses in the ratio of department gross profit prepare departmental trading and trading and profit and loss account.

Problem No: 10

Mr.X the proprietor of a departmental store, decided to calculate separate profit for his first two departments A and B for the month ending 31-1-94. Stock on 31stJan could not be valued for certain unavoidable reasons but his rates of gross profit (calculated without reference to direct expenses) on sales for the two departments are 40% and 30%.

The following figures are given

Particulars	Dept A	Dept B
Stock on (1-1-91)	9000	8400
Sales	42000	36000
Purchases	27000	21600
Direct expenses	5490	8520

Indirect expenses for the whole business (containing five departments) are Rs10800 which are to be charged in proportion to departmental sales except as to 1/6 which is to be divided equally. Sales for the remaining 3 departments were Rs 102000. Prepare a departmental trading a\c showing the gross profit for the two departments and show also the net profit by preparing a statement only.

Problem No:-11

Following is the profit and loss a\c of Hindustan electronics for the year ending 31-1-1994.

Purchase	Amount	Sales	Amount
Transistors (X)	160000	Transistors (X)	175000
Tape recorders(Y)	125000	Tape recorders(Y)	140000
Repairs(Z)	80000	Repairs(Z)	35000

Salaries and wages	48000	Stock at 31-3-94	
Rent	10800	Transistors (X)	60100
Sundry expenses	11000	Tape recorders(Y)	20300
profit	40200	Repairs(Z)	44600
	475000		475000

Other particulars are given below

a) Transistors and tape recorders have been sold in showroom and repairs are made in the factory

b) Apportionment of salaries and wages in showroom ¾ and factory ¼ salaries and wages of showroom are to be divided in 1:2 ratio in X and Y department

c) Rent of factory is Rs 500 pm Rent of showroom is apportioned equally in X and Y departments

d) Sundry expenses are apportioned in the sales ratio of the departments Prepare departmental trading and P&L a\c.

Problem No: 12

Mr. Senthil carries on cloth business. Following is the list of balance as on 31-12-2011.

Particular	Rs	Particular	Rs
Capital a/c	30000	purchases	
Sales	70000	Dept I	43000
Dept I	30000	Dept II	25000
Dept II	12000	Salaries	5400
Sundry creditors	1500	Office expenses	2800
Bills payable	750	Commission	2200
General reserve		Advertisement	5800
Opening stock	3400	Bank charges	120
Dept I	1100	Stationery	2700
DeptII	23000	Telegrams	600
Sundry debtors	5000	Discount(dr)	1500
Bills receivable	1080	Miscellaneous expenses	900
Furniture	1800	Investment	6900
Rent	2400	Cash in hand	2500
Marine insurance		Cash at bank	7050

The business is divided into two departments apportion the expenses in proportion to the turnover of each departments

Adjustment:-

A) Write off 10% depreciation on furniture
B) Prove Rs 300 for bad debts and 2% on debtors for discount
C) The closing stocks were Dept I =Rs 4000 Dept II =Rs1680
D) Increase general reserve by Rs 300
E) Allocate provision for bad debts also in the ratio of 7:3 for the above particulars; prepare departmental trading and P&L a\c and balance sheet as on 31-12-2001.

Inter – departmental transfer at selling price

Problem No: 13

M/S Maruthu& son s has two departments, cloth and readymade, readymade clothes are manufactured by the firm itself out of cloth supplied by the cloth department at its usual selling rate. From the following figures, prepare departmental trading and P&L a\c and general P&L a\c for the year ending 31-12-1991.

Particulars	Cloth Dept	Readymade Dept
Opening stock on 1-1-1991	360000	60000
Purchases	2900000	20000
Sales	3500000	700000
Transferto readymade dept	450000	-
Manufacturing expenses	-	140000
Closing stock on 31-12-1991	100000	48000

General expenses incurred for both the departments were Rs 120000.
The stock is the readymade department may be considered as consisting of 66⅓% cloth and 33⅓% other expenses. The cloth department earned profit at the rate of 18% in 1990. Inter departmental transfers at selling price

Problem No:-14

From the following data prepare departmental trading and P&L a\c and thereafter the combined income account revealing the concern's true results for the year ended 31-12-2012.

Particulars	Dept A	DeptB
stock (January 1)	40000	-
Purchases from outside	200000	20000
wages	10000	1000

Transfer of goods form Dept A	-	50000
Stock (December 31 st at cost to the Dept)	30000	10000
Sales to outside	20000	71000

B's entire stock represents goods form dept A which transfers them at 25% above cost administrative expenses came to Rs 15000 to be allocated to A and B in the ratio of 4:1 respectively.

Problem no:-15

Trading and P&L a\c of janaki radio and gramophone equipment co. Jon the six months ended31-3-2003 presented to you in the following form

Particulars	Amount	Particulars	Amount
Purchase		Sales	
Radios(A)	140700	Radios(A)	150000
Gramophones(B)	90600	Gramophones(B)	100000
Spare parts©	64400	Spare parts©	25000
Salaries &wages	48000	Stock as on 31-3-2003	
Rent	10800	Radios(A)	60100
Sundry expenses	11000	Gramophones(B)	20300
Profit	34500	Spare parts©	44600
	400000		400000

Prepare departmental accounts for each of the three departments A,B and C mentioned above after taking into account the following

i) Radio and gramophones are sold at the show room and spare parts at workshop
ii) Salaries and wages comprise as follows showroom ¾ and workshop ¼
It was decided to allocate the show room salaries and wages in the ratio of 1:2 between the departments A and B.
iii) The workshop rent is Rs 500 per month. The rent of showroom is to be divided equally between the departments A & B
iv) Sundry expenses are to be allocated on the basis of turnover of each department

Problem No: 16

Inter –departmental transfers at cost price on 31-12-2005 the trial balance of shyan, a merchant was extracted and form it the following balances are taken

Stock (1-1-05) DeptX	14000	Sales DeptX	52000

DeptY	10000	DeptY	26000
Purchases		Inter-dept transfer	
DeptX	20000	DeptY	1000
DeptY	16000		
Inter dept-transfer			
DeptX	1000		
Return inward			
DeptX	800		
DeptY	1200		
Rent, rates and taxes	2000		
General expenses	2400		
Salaries	2200		
Carriage inwards	1800		
Wages			
DeptX	4000		
DeptY	3600		
	79000		79000

Stock on 31-12-2005 were Dept X Rs 6000 DeptY Rs 4000

Make out departmental accounts for the year ended 31-12-2005 from the above information, assuming that the departments occupy similar floor area.

QUESTION BANK

UNIT –II

SECTION –A

1. What do you mean by Departmental Accounting?
2. What is a direct expense?
3. What do you understand by 'Inter- departmental transfer'?
4. Write short note on Stock Reserve?
5. What is basis for allocation of expenses?
6. Write short notes on Indirect expenses
7. Which expenses cannot be allocated?
8. Any three needs for Departmental accounts.

9. Allocate the following expenses on the basis of cost of goods ratio among the four departments, A,B,C,&D:

   Sales (Rs : A :2,00,000 ; B : 1,50,000 ; C : 1,00,000 ; D :50,000
   G.P : 20% on sales.
   Expenses : Salaries Rs.6,000; Rent & taxes Rs. 1,500 ; Insurance Rs. 1,300.

10. Mixed goods were purchased for Rs. 1,00,000 and later they were allocated into three categories X,Y,Z as follows:

    X 1,000Selling price Rs.20 each.
    Y 2.000Selling price Rs. 22.50 each
    Z 2,400Selling price Rs. 25 each

    All categories yield the same rate of profit. Calculate the purchase price of each categories.

SECTION –B

1. What are the advantages of preparing Departmental Accounting?
2. Distinguish between Departments and Branch.
3. What are the bases on which common expenses are allocated among departments?
4. Explain the procedure for preparation of Departmental accounts?
5. Ram purchased goods for his three departments as follows: Dept X - 200 units

   Dept Y - 1,400 units
   Dept Z - 400 units Total cost of three departments Rs.5,100.

Sales of the three departments were as follows: Dept X - 180 units @ Rs. 15 per unit Dept Y - 1,500 units @ Rs.18 per unit Dept Z - 450 unit @ Rs. 6 per unit

Other information about stock in the beginning was as follows: Dept X - 100 unit

Dept Y - 400 unit Dept Z - 60 unit

Ram informs you that the rate of gross profit is the same in all departments. You are required to prepare Departmental Accounts.

6. A company carries on its business through five departments viz A,B,C,D and E. The expenses were as follows:

Particulars	A(Rs)	B(Rs)	C(Rs)	D(Rs)	E(Rs)
Opening stock	5,000	3,000	2,500	4,000	4,500
Purchases	50,000	30,000	10,000	26,000	30,000
Sales	48,000	21,000	9,500	23,000	30,000
Closing stock	6,000	4,000	3,500	3,500	5,500

The opening and closing stock have been valued at cost. The expenses, which are to be charged to each department in proportion to the cost of goods in the respective departments areas follows:

	Rs.
Salaries and commission	5,510
Rent and taxes	1,450
Miscellaneous expenses	1,305
Insurance	580

Show the final results and the percentage of sales in each departments.

7. A firm had two departments, cloth and readymade garments. The garments were made by the firm itself out of cloth supplied by the cloth department at its usual selling price. From the following data, prepare departmental trading and profit and loss account for the year ended 31-3-2012.

	Cloth dept (Rs)	Readymade (Rs)
Opening stock on 1-4-2011	3,00,000	50,000
Purchases	20,00,000	15,000
Sales	22,00,000	4,50,000
Transfer to readymade garment dept.	3,00,000	-
Expenses - manufacturing	-	60,000
- Selling	20,000	6,000
Stock 31-3-2012	2,00,000	60,000

The stock in the readymade garment department may be considered as consisting of 75%

cloth and 25% of other expenses. The cloth department earned gross profit @ 15% in 2000-2011. General expenses of the business as a whole came to Rs. 1,10,000.

8. From the following data prepare Departmental trading and profit and loss account and thereafter the combined income account revealing the concern's true results for the year ended 31-12-2012.

	Dept. A (Rs)	Dept. B (Rs)
Stock (January 1)	40,000	-
Purchases from outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of goods from Dept A	-	50,000
Stock (December 31 at cost to the dept)	30,000	10,000
Sales to outside	2,00,000	71,000

B' s entire stock represents goods from Dept. A which transfer them at 25% above cost. Administrative expenses came to Rs. 15,000 to be allocated to A and B in the ratio of 4:1 respectively.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – V-Financial Accounting – SBA1102

UNIT 5 **PARTNERSHIP**

Partnership Accounting: Partnership – Meaning, Deed and its contents – Types of Partners – Admission and Retirement of a partner Application Oriented Problems is Mandatory

Definition:

According to section 4 of the Indian Partnership Act 1932, partnership is defined as *"the relationship between persons who have agreed to share profit of a business carried on by all or any of them acting for all".* Persons making an agreement to carry business for common purposes are called partners individually and form collectively. The name under which their business is carried on is called the firm name.

According, the essential features of partnership are:

- There must be an agreement entered into between two or more persons.
- The object of the agreement must be to share the profit of a business.
- The business must be carried on by all or any of the persons concerned acting for all.
- It is format to carry on a lawful business.
- It is an association of two or more persons i,e., the number of persons constituting a partnership must not exceed ten, in case of a banking business and twenty in other business.

PARTNERSHIP DEED:

Partnership is, therefore the result of an agreement between two
ort more persons to carry on a business jointly for the common benefit of all. It is not legally necessary for a partnership agreement to be in writing. However that there be written agreement between the partners. The document ort the instrument containing the agreement between partners is known as partnership deed.

Although no two partnership deeds are alike, every partnership deed should contain the following clauses:

1. Name of the form and nature of the business.
2. Name and addresses of the partners.
3. The duration, if any, of partnership form.
4. The total capital of the form and the share of each partner.
5. The ratio of sharing profits and losses.
6. Whether capitals are to be fixed or fluctuating.
7. Whether any interest is to be allowed on partners capitals and if so at what rate.
8. Rate of interest on advance.
9. Whether any interest is to be charged in drawings and if so, at what rate.
10. The amount of salaries or some allowance, if any, payable to the partners.
11. The amount which each partner can withdraw for his private expenses.
12. The provision relating to keeping of proper books of accounts.
13. The period after which the final accounts area to be prepared.
14. The audit of the accounts.
15. Admission of new partners and expulsion of the existing ones.
16. The methods of ascertaining the share of goodwill of a partner on his retirement or death.
17. Whether decision in the case of Garner vs. Murray is to apply in the case of insolvency of a partner.

CAPITAL ACCOUNTS OF PARATNERS:

In partnership there will be as many capital accounts as the number of partners. Partners capital is the amount invested or contributed by the partners in the business. Whenever a partner contributes towards his capital, cash accounts or property account is debited and separate capital account of such partner is credited with such contribution.

The capital accounts may be prepared under the following two methods:

- Fixed Capital Method and
- Fluctuating Capital Method

FIXED CAPITAL METHOD:

Under this method there are two accounts for each partner:

- Partners capital account
- Partners current account

Partners' capital account:

The partners' capital account is credited with the original amount of capital introduced by the partner into the business. It is to be credited subsequently with extra capital introduced by the partner or debit with the amount of capital permanently withdrawn by the partner. No other adjustments are made in this account.

Partners' current account:

The partners' current account is maintained for making all entries relating to interest on partners capital, drawing and loan, share of profit. Partners' salary and commission etc. The balance in this account will go on fluctuating but the balance of the capital account will remain fixed. That is why the method is termed as "fixed capital system"

FLUCTUATING CAPITAL METHOD:

Under this method the capital account of a partner dies not remain at its original balance but fluctuated quite frequently. The reason is that all adjustments in respect of drawing, interest on capital, interest on drawing; salary or commission to partners, share of profit or loss etc., therefore it is different at the end. The balance in the capital account goes on fluctuating. The method is, therefore, called "fluctuating capital system"

ADMISSION OF A PARTNER

Meaning:

A partnership firm suffering from shortage of funds or administrative incapability may decide to admit a partner. Such a person who is admitted to the firm is known as an incoming or a new partner. A new partner, on becoming a partner in the firm, becomes liable for all the acts of the firm done after his admission.

Definition:

According to Section 31(1) of the Indian Partnership Act 1932, a new partner can be admitted only with the consent of all the existing partners. On admission of a new partner, the existing partnership agreement comes to an end and a new agreement comes into effect.

WHEN A NEW PARTNER IS ADMITTED AS PARTNER, THE FOLLOWING ACCOUNTING ADJUSTMENT:

1. Adjustment in the profit sharing ratio.
2. Adjustment for goodwill.
3. Adjustment for revaluation of assets and liabilities.
4. Adjustment of reserve and other accumulated profits.
5. Adjustment for capital.

1. Adjustment in the profit sharing ratio:

Whenever a partner is admitted into the firm, he will get some share in the profits of the form and he old partners are required to sacrifice some share of profit in favour of the new partner. It becomes essential to calculate the new profit sharing ratio of all partners. The share of profit for the new partner will obviously be determined by agreement. The partners are supposed to divide the future profits and losses equally.

2. Adjustment for Goodwill:

Meaning: Some accountants are of the opinion that attachment of customer to a particular business is called GOODWILL. It may be described as a value of all favourable attributes relating to a business enterprise. This reputation enables the business to earn more than the normal profits earned by the other businesses. "The Present value of a firms anticipated excess earnings."

Definition: The whole advantage whatever it may be, of the reputation and connection of the firm which may have built up by years of honest work or gained by lavish expenditure of money". – Trego vs. Hunt.

METHODS OF GOODWILL:

1. Average Profit Method
- Average profit
- Number of years
2. Super Profit Method
3. Capitalisation Method

1. **Average Profit Method:**

In this method, profits of some past years, preferable three to five years are added and this total is divided by the number of years whose profits have been added and thus average profit is found out. The average profit multiplied by the number of years in which the anticipated profit will available, to arrive at the value of goodwill.

Average Profit= Total Profit/ No. of years

Average profit:

Average profits are calculated on the basis of past performance of the business adjusted in the light of future possibilities.

Number of years:

It refers to the average period which a new business would take in business to a stage where it will be in a position to give the average profit as referred in point.

2. **Super Profit Method:**

Super profit means the profit earned by a firm over and above the normal profit earned by the other firms in the same business. It is calculated by deducting from the profit in any year:

- Interest on capital at market rate
- Reasonable salary of the proprietors or the partners.

Formula:

Normal Profit= Capital employed x Normal rate of return Super Profit = Average Profit – Normal Profit

Goodwill = Super Profit x No. of years of purchase

3. **Capitalisation Method:**

This method is useful when the actual profit is less than normal profit. Under this method the actual profit is divided by the normal rate of profit which can be earned in that particular type of business in order to find out the total amount which should have been invested as capital.

Capitalised value of profit = Profit / Normal rate of return x 100 Value of Goodwill = Capitalised value of profit- Net tangible Asset

Net tangible Assets= Total assets expect goodwill- Liabilities to outsiders

TREATMENT OF GOODWILL ON THE ADMISSION OF A PARTNER

The new partner is getting some share in the profits of the firm, it is but natural that he will bring some amount as goodwill in order to compensate the old partners for the loss hey have to bear on account of loss of share in profits.

(A) PREMIUM METHOD:

Under this method, the new partner brings cash for his share of goodwill and the same is share by the old partners in their sacrificing ratio.

(a) When goodwill is received in cash and retained in the business. Cash A/c Dr.

To Goodwill A/c
(Amount of goodwill brought in by new partner)

Goodwill A/c Dr.
To Old Partners Capital A/c (Shared in the sacrificing ratio)

(b) When goodwill is received in cash and with drawn by old partners in part or full.

Cash A/c Dr.
To Goodwill A/c.
(Amount of goodwill brought in by new partner)

Goodwill A/c Dr.
To Old Partners Capital A/c (Shared in the sacrificing ratio)

Old Partner's Capital A/c Dr.
To Cash A/c
(To the extent of withdrawn)

(c) When the amount of goodwill is paid privately.
No entry is required

(B) Revaluation Method:

1. When The value of goodwill is understand in the books:
Goodwill A/c Dr.
To old partner's capital A/c
(D/w new value of goodwill and old value)

2. When the value of goodwill is overstated in the books:

Old partner's capital A/c Dr.
To Goodwill A/c
(Reduction in the value of goodwill debited to old partners in the old profit sharing ratio)

(C) Memorandum Revaluation Method:

When the new partner does not bring his share of goodwill in cash the goodwill should be raised at full value as per revaluation method and thereafter it has to be written off among all the partners debiting their capital accounts in the new profit sharing ratio.

(I) Goodwill A/c Dr.
To Old Partner's capital A/c
(The amount of goodwill at full value)

(II) All Partner's capital A/c Dr.
To Goodwill A/c
(Amount of goodwill written off)

(D) Inferred or Hidden Goodwill:

Sometimes, the value of goodwill has to be inferred on the basis of total capital of the firm

3. Adjustment for revaluation of assets and liabilities:

(A) When revised values are to be recorded:

Before admitting a new parson as Partner into the partnership, the assets and liabilities may have to be revalued for the benefit of all the partners. The value of some assets will fall and of some others will rise. The changes in the value of assets and liabilities are recorded in Revaluation A/c.

The journal entries for this purpose are:

(i) When the values of assets are increased:

Assets A/c Dr.

To Revaluation A/c

(ii) When the values of assets are reduced:

Revaluation A/c Dr.

To Assets A/c

(iii) When the values of liabilities are increased:

Revaluation A/c Dr.

To Liabilities A/c

(iv) When the values of liabilities are reduced:

Liabilities A/c Dr.

To Revaluation A/c

(v) For profit on Revaluation:

Revaluation A/c Dr.

To Old Partner's Capital A/c

(vi) For Revaluation:

Old Partner's Capital A/c Dr.

To Revaluation A/c.

(B) When revised values are not be recorded:

The first part of the 'Memorandum Revaluation A/c' is debited with losses on revaluation of assets and liabilities and credited with gains on revaluation and any resultant profit or losses.

The assets and liabilities at the time of admission of a partner, the partners may prefer to retain the old values in the books. This is done by opening an account called MEMORANDUM REVALUATION ACCOUNTs

4. **Adjustment of Reserves and other accumulated Profits& Losses**:

At the time of admission of a new partner, if there are any reserve and undistributed profits and losses lying in the books, these should be distributed amongst the old partners in the old profit sharing ratio.

Journal Entries for accumulated profit:
General Reserve A/c Dr. Profit & losses A/c Dr.

Any other Accumulated Reserve A/c Dr.
To Old Partner's Capital/Current A/c
Journal Entries for accumulated losses:
Old Partner's Capital/Current A/c Dr.
To Profit & losses A/c

5. **Adjustment for capitals:**

i. When the capital are to be adjusted on the basis of New partner's capital
ii. When the new partner is required to bring in the amount of capital on proportion to his share in the firm.

Calculation of New Profit Sharing Ratio and Sacrificing Ratio

1) A and B partners in a business sharing profit in the ratio of 5:3. They decide to admit C into the firm giving him $1/6^{th}$ share. Calculate the new profit sharing ratio and sacrificing ratio of the partners.

2) A, B and C are partners sharing profit in ratio of 4:3:2. D was admitted on 21^{st} January with $1/3^{rd}$ interest in the business. Calculate the new ratio and sacrificing ratio.

3) A and B are partners sharing profit and losses in the ratio of 5:3. They admit C as a partner. C acquires his share 4/20 from A and 2/20 from B. Find out the new profit sharing ratio and sacrificing ratio.

4) A and B are partners sharing profit and losses in ratio of3:1. They agree to admit C into partnership who is to get $1/8^{th}$ share. He acquires this share as to 1/32 from A and 3/32 from

B. Calculate the new profit sharing ratio.

5) Prem and Chandra share profit in the ratio of 7:3. Rama was admitted as a partner. Prem surrendered $1/7^{th}$ of his share and Chandra 1/3 of his share in favour of Rama. Calculate new ratio.

6) Akila and Banu are partners sharing profits in the ratio of 3:2. A new partners Chandra is admitted. Akila surrenders $1/5^{th}$ share of her profit in favour of Chandra and Banu $2/5^{th}$ of her share in favour of Chandra. Calculate new ratio.

7) P and Q were partners sharing in 4:2 ratios. R was admitted for $1/4^{th}$ share which he acquired equally from both P and Q. Calculate the new profit sharing ratio.

8) A and B are partners sharing profit in 3:2 ratio. C admitted for share which he acquires equally from both A and B. Find out the new ratio of partners.

Adjustment Regarding Goodwill of the Firm Method of Valuation of Goodwill

A) Simple Profit Method or Average Profit Method:

9) Calculate the amount of Goodwilll in the following in the following case:

Three years purchase of the last four years average profit is agreed as the goodwill value. The profit and losses for the last four years are:

I.Year – Rs.5,000 II.Year - Rs.8,000

III.Year - Rs.3,000(loss) IV.Year - Rs.6,000

10) Calculate the amount of goodwill at three years purchase of last five years average profits. The profits were:

I.Year – Rs.9,600 II.Year – Rs.14,400 III.Year – Rs.20,000 IV.Year – Rs.6,000 V.Year – Rs.10,000

B) Super Profit Method:

11) From the following information, calculate the value of goodwill, at 3 years purchase of super profit:

i. Average capital employed in the business Rs.6,00,000
ii. Net trading profits of the firm for the past three years were Rs.1, 07,600, Rs.90, 700 and Rs.1, 12,500.
iii. Rate of interest expected from capital having regard to the risk involved is 12%.
iv. Fair remuneration to the partners for their service Rs.12, 000 p.a

12) A firm earned net profit during the last three years as follows:

I.Year – Rs.36,000 II.Year – Rs.40,000 III.Year – Rs.44,000

The capital investment of the form is Rs.1, 20,000. A fair return on the capital having regard to the risk involved is 105. Calculate the value of goodwill on the basis of 3 years purchases of super profits.

C) Capitalization Method:

13) A firm earns Rs.1, 20,000 as its annual profits, the rate of normal profit being 10%. The assets of the form amount to Rs.14, 40,000 and liabilities to Rs.4, 80,000. Find out the value of goodwill by capitalization Method.

Accounting Treatment of Goodwill at the time of admission of a partner

A) Premium Method:

14) X and Y are partners sharing profits in the ratio of 3:2. They admit Z into partnership, Z paying a premium of Rs.2, 000 for 1/4th share of profit. The new ratio is 3:3:2. Goodwill account appears in the books at Rs.2, 000. It was decided that goodwill should continue to appear in book at Rs.1,600. Journalise.

B) Revaluation Method :

15) A, B and C are partners sharing profits in the ratio of 5:5:4. D is admitted as a partner. D introduced Rs.40, 000 as capital for his 1/4th share. Goodwill of the form is to be valued at

years purchase of 3 years profits which have been Rs.15, 000, Rs.26, 000 and Rs.22, 000.

Give journal entries if:

a) There is no Goodwill in the books of the firm.
b) There Goodwill Account appears at Rs.14,000 and
c) There Goodwill already standing in the books is Rs.56, 000.

C) Memorandum Revaluation Method:

16) A and B are in partnership sharing profit and losses on the ratio of 3:1. They took 'K' into partnership for 1/4th share. But K was unable to bring any amount for goodwill. Goodwill was raised in the books for Rs.48,000 and was written off after the admission. Journalise. **Revaluation of Assets and Liabilities**

17) A and B are partners sharing profits in the ratio of 3:1. Their Balance sheet stood as under on 31.12.95.

Liabilities		Rs.	Assets		Rs.
Capital			Stock		10,000
A:	30,000		Prepaid Insurance		1,000
B:	20,000	50,000	Debtors	8,000	
Salary due		5,000	(-) Provision	500	7,500
Creditors		40,000	Cash		18,500
			Machinery		22,000
			Building		30,000
			Furniture		6,000
		95,000			95,000

C is admitted as a new partner introducing a capital of Rs.20, 000, for his 1/4th share in future profit. Following revaluations area made:

i.Stock be depreciated by 5% ii.Furniture be depreciated by 10% iii.Building be revalued at Rs.45,000

iv.The provision for doubtful debts should be increased to Rs.1, 000.
Pass Journal entries; prepare Revaluation A/C and Balance Sheet after admission.

18) Ramu and Gopu are partners sharing profits in the ratio of 2:1. Following is the Balance Sheet of the firm as on 31.12.93.

Liabilities		Rs.	Assets		Rs.
Capital a/c			Cash in Hand		22,000
Ramu		60,000	Cash at Bank		2,000
Gopu		35,000	Debtors	30,000	
Wages due		5,000	(-) Provision	2,000	28,000
Sundry Creditors		48,000	Bills Receivable		12,000
			Stock		18,000
			Invstments		12,000
			Furniture		4,000
			Building		50,000
		1,48,000			1,48,000

On 1.1.94 Somu was admitted as a partner. Somu brings in Rs.25,000 as Capital for $1/4^{th}$ share in profits.

i.Provision for doubtful debts be increased to Rs.3,500 ii.Furniture be reduced to Rs.3,500

iii. Building be increased by Rs.10,000
iv. An investment of Rs.1,500 not recorded in the books, now brought in to account
v. A contingent liability of Rs.800 has become a certain liability. It has been agreed among the partners that assets and liabilities are to be shown at old values.

Prepare Memorandum Revaluation A/C and new Balance Sheet after admission

19) A and B are partners in a firm. They share profits and losses in the ratio of 3:1. Their Balance Sheet is as follows:

Liabilities		Rs.	Assets		Rs.
Capital A		80,000	Building		1,00,000
B		40,000	Plant		25,000
Reserve		40,000	Stock		40,000
Creditors		60,000	Debtors		70,000
Bills Payable		20,000	Cash		5,000
		2,40,000			2,40,000

C admitted into partnership for $1/5^{th}$ share of the business on the following terms:

a) Building is revalued at Rs.1, 20,000.

b) Plant is depreciation to 80%.
c) Provision for bad debts is made at 5%.
d) Stock is revalued at Rs.30,000
e) C should introduce 50% of the adjusted capitals of both A and B. Open various accounts and the new Balance Sheet after the admission of C.

20) A and B are partners sharing profit and losses in their ratio of 3:2. Their Balance Sheet is as under:

Liabilities		Rs.	Assets		Rs.
Capital A/C			Plant & Machinery		30,000
A		30,000	Stock		24,000
B		22,500	Debtors		22,500
Reserve a/c		11,500	Bank		9,000
Sundry Creditors		11,250	Cash in Hand		750
		86,250			86,250

B retires and the following revaluations were made:

a. The goodwill of the firm is valued at Rs.37,500
b. Depreciate Plant & Machinery by 7 ½ % and Stock by 15%.
c. A bad debts provision is raisd against debtors at 5% and a discount reserve against creditors at 2% . Prepare profit and loss adjustment A/C. Partner's Capital accounts and new balance sheet as on 1st January 1988.

21) The Balance Sheet of P, Q and R who are sharing profits and losses in the ratio of 2:2:1 respectively was as follows on 31.12.93.

Liabilities		Rs.	Assets		Rs.
Bills Payable		3,200	Cash		12,825
Creditors		6,250	Bills receivable		2,700
Capital A/C			Debtors		8,900
P		20,000	Stock		11,150
Q		12,500	Furniture		1,750
R		10,000	Machinery		4,875
Profit / loss		2,250	Building		12,000
		54,200			54,200

P retires from the business from 1.1.94 and his share in the firm is to be ascertained on an revaluation of the asset as follow:

Stock Rs.10, 000, Furniture Rs. 1,500, Machinery Rs. 4,500, Building Rs.10,000 and 425 is to be provided for doubtful debts. The goodwill of the firm is to be valued at Rs. 3000. 'P' is to paid Rs. 5,525 in cash on retirement and balance in 3 equal yearly instalments with interest at 5%p.a. Pass Journal entries and show the necessary ledger accounts and new balance sheet of Q and R and P's loan A/C for three years.

22) A and B were carrying on partnership business sharing profits and losses in the ratio of 3:2 respectively. They closed their books of account every year on 31.12.93

Their Balance Sheet was a follows:

Liabilities		Rs.	Assets		Rs.
Sundry Creditors		5,000	Cash		7,500
Reserve Fund		7,500	Sundry Debtors		12,500
Capital A/C			Stock		5,000
A		22,500	Machinery		25,000
B		15,000			
		50,000			50,000

B died on 1.5.94 under the terms of partnership deed, the executors of deceased partner were entitled to be paid out:

a. Capital to his credit at the date of death

b. His share of reserve at the date of the last Balance Sheet

c. His share of profits to the date of his death based on the average profits of the last three accounting years.

d. By way of goodwill his share of total profit for the preceding three accounting years

The profits for the three preceding accounting years were as follows 1991:Rs.10, 450

1992:Rs. 9,800
1993:Rs.11, 250
Prepare B's capital A/C transferring amount due to B's executors A/C

QUESTION BANK

SECTION – A

1. What is Revaluation account?
2. Define the term 'Goodwill'.
3. What is Sacrificing ratio?
4. What is admission of partners?

5. Write short notes on Gaining ratio
6. State the meaning of retirement of partners
7. A ,B and C were sharing profits in the ratio of 4:3:2 . D was admitted on 1^{St} January with $1/3^{RD}$ interest in the business. Calculate the new ratio.
8. X and Y are sharing profit and losses in the ratio of 7:3 . They admit Z for $3/7^{TH}$ share in the New firm which he takes 2/7 from X and 1/7 from Y . Calculate the new profit sharing ratio of partners.
9. Ram , Gopal and Kannan were partners sharing profits in the ratio 3/6, 2/6 and 1/6 . Find out new ratio when (i) Ram retires and (ii) Gopal retires.
10. K,M and S are three partners sharing profits in the ratio of 4:3:2. K retires. Assuming M and S will share profit in future in the ratio of 5:3, determine new the gaining ratio.

SECTION –B

1. Explain the different methods of valuation of goodwill?
2. Describe the accounting adjustment for partners at the of admission of new partners.
3. What is Memorandum Revaluation?. What is its purpose?
4. Explain the methods of treatment of goodwill on retirement of partners.
5. X and Y are partner sharing profit in the ratio of 3: 2. Z is admitted and new profits sharing ratio is2:2:1 . C brings in cash Rs. 8,000 for capital and 2,000 for goodwill . The Balance sheet of X andY is as follows:

Liabilities	Rs	Assets	Rs
Capital : X Y	8,000 8,000	Goodwill	2,500
Reserve	4,000	Assets	17,500
	20,000		20,000

Partners decided that goodwill account should appear in the new firm's book at Rs.6,000 . Give journal entries and prepare Balance sheet of the new firm.

1. Ramu and Gopu are partners sharng profits in the ratio of 2:1 . From the following the Balance sheet of the firm as on 31-.12-2012.

Liabilities	Rs	Assets	Rs
Capital : Ramu Somu	60,000 35,000	Cash in hand	2200
Wages due	5,000	Cash at bank	2,000

Creditors	48000	Debtors 30,000 Less: provision 2,000	28,000
		Bills receivable	12,000
		Stock	18,000
		Investment	12,000
		Furniture	4,000
		Building	50,000
	1,48,000		1,48,000

On 1-1-2012 Somu was admitted as a partner. Somu brings in Rs.25,000 as Capital for 1/4TH share in profits.

(i) Provision for doubtful debts be increased to Rs. 3,500
(ii) Furniture be reduced to Rs.3,500
(iii) Building be increased by Rs. 10,000
(iv) An investment of Rs. 1,500 not Recorded in the books, now brought into account.
(v) A contingent liability Rs. 800 has become a certain liability. It has been agreed among the partners that assets and liabilities are to shown at old values. Prepare Memorandum revaluation account and Balance sheet.

8. Anbu and Balu are partners in a firm. They share profit and loss in the ratio of 3:1. Their balance sheet is as follows:

Liabilities	Rs	Assets	Rs
Capital : Anbu Balu	80,000 40,000	Building	1,00,000
Reserve	40,000	Plant	25,000
Creditors	60,000	Stock	40,000
Bills payable	20,000	Debtors	70,000
		Cash	5,000
	2,40,000		2,40,000

Chandru is admitted into partnership for 1/5TH share of the business on the following terms:

(i) Building is revalued at Rs. 1,20,000 (ii) Plant is depreciated to 80% (iii) Provision for bad Debts is made at 5% (iv) Stock is revalued at Rs. 30,000 (v) Chandru should introduce 50% of the adjusted capitals of both Anbu and Balu. Prepare Revaluation account and Balance sheet.

9. Arul and Balan sharing profit and losses in the ratio of 3:2 . Their balance sheet is as under:

Liabilities	Rs	Assets	Rs
Capital : Arul Balan	30,000 22,500	Plant and Building	30,000
Reserve A/C	22,500	Stock	24,000
Creditors	11,250	Debtors	22,500
		Bank	9,000
		Cash in hand	750
	86,250		86,250

Balan retires and the following revaluations were made:

i) The goodwill of the firm is valued at Rs. 37,500 (ii) Depreciate Plant & Machinery by 71/2% and stock by 15%. A bad debts provision is raised against debtors at 5% and a discount reserve against creditors at 2%. Prepare Revaluation account and balance sheet.

10. Sunil, Devan and Ravi are equal partners in a firm and their Balance sheet as on 31-12- 2012 Is given below:

Liabilities	Rs	Assets	Rs
Creditors	40,500	Machinery	43,500
Reserve	4,500	Furniture	1,500
Capital: Sunil Deven Ravi	15,000	Debtors	30,000
	12,000	Stock	15,000
	18,000		
	90,000		90,000

Ravi retired on 31-12-2012 and assets were revalued as under:

Machinery Rs.51,000. Furniture Rs. 1,200, Debtors Rs.28,500, Stock Rs. 14,700. Goodwill of the firm is valued at Rs. 9,000 and Ravi's share of goodwill is to be adjusted to continuing partners' capital without raising goodwill account.

Prepare Revaluation account and Balance sheet.