



**RKDF University, Bhopal**  
**Open Distance Learning (ODL)**  
**Material**  
**Faculty of Commerce**  
**Semester –I**  
**Subject- Financial Accounting**  
**Syllabus**

<b>Units</b>	<b>Topic</b>	<b>Duration (In Hours)</b>	<b>Marks</b>
I	<b>Accounts:</b> Definition, Objectives, <b>Branches of Accounting</b> , Basic concepts and Principles of Double Entry System, Journal Entry, Ledger, Trial Balance, Introduction to Indian Accounting Standards	16	20
II	<b>Final Accounts (With Adjustments)</b> Accounting for Depreciation (As per Accounting Standard 6) <b>Straight Line Method, Written Down Value Method, Deprecation Fund Method, Annuity Method and Insurance Policy Method.</b>	20	20
III	Departmental Accounts Branch Accounts	18	20
IV	Royalty Accounts Consignment Accounts	18	20
V	<b>Partnership Accounts:</b> Dissolution of Partnership (excluding piecemeal Distribution) (With Insolvency) Amalgamation of Partnership Firms and conversion of partnership firm into joint stock company <b>Computerized Accounting: Tally ERR (Basics of tally ERP)</b>	18	20

## Unit –I

### FUNDAMENTAL PRINCIPLES OF FINANCIAL ACCOUNTING

According to American Institution of Certified Public Accountant Committee:-

“Accounting as the art of recording, classifying and summarizing in a significant manner and in terms of money transactions and events which are in part at least, of a financial character, and interpreting the results thereof”.

From the above definition, it can be said that “Accounting is science of recording and classifying trading transaction of financial nature and is an art in which financial results are summarized and interpreted.”

#### CHARACTERISTICS OF ACCOUNTING

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

#### OBJECTIVES OF ACCOUNTING

##### 1. To Maintain a Systematic Record

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

##### 2. To Ascertain the Performance of the Business

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

##### 3. To Protect the properties of the Business

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

##### 4. To Facilitate Financial Reporting

Accounting is a precursor to finance reporting. The vital liquidity/solvency position is

comprehended through the Cash and fund flow statement calculating the capital transition.

## 5. To Facilitate Decision making

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

### Accounting As Science and Art

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

### BOOK-KEEPING

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

Book-Keeping involves the following process:

### DIFFERENCE BETWEEN BOOK-KEEPING AND ACCOUNTING

S.No	Basis of Difference	Book-Keeping	Accounting
1	Transaction	Trading transactions are recorded in primary books.	Entries written in primary books are checked and verified.
2	Posting	Entries are posted in ledger from journal and subsidiary books	Posting are checked whether correctly posted or not.
3	Total and Balance	It includes totaling of journal and finding of balances of ledger.	On the basis of balances of ledger final accounts are prepared
4	Objects		
	Adjustments and		

5	Rectification of errors	The object of Book-keeping is to write all trading transactions in a reasonable manner.	The object of accounting is to analyse the transactions written in the books.
6	Scope	In Book-keeping entries of adjustments and rectification of errors are not included.	Accounting includes entries of adjustments and rectification of errors.
7	Final Accounts	Scope of Book keeping is narrow. Final Account is not prepared in Book-Keeping.	Scope of Accounting is wide. Final account preparation is must

### Initial record of accounting transactions

### Preparation of ledger accounts

### Balance

#### Accounting Concepts

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

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

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

The concept presumes that the business will continue in operation long enough to charge the cost of

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

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

$$\text{External liabilities} + \text{Capital} = \text{Total}$$

$$\text{Assets Total Liabilities} = \text{Total Assets}$$

This is called the Accounting or Balance Sheet equation.

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

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

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

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

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

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

**10) Verifiable Objective Concept:-** according to this principle, the accounting data should be definite, verifiable and free from personal bias of the accountant. in other words, this principle requires that each recorded transaction/event in the books of accounts should have an adequate evidence to support it. in historical cost

accounting, the accounting data are verifiable since, the transactions are recorded on the basis of source documents such as vouchers, receipts, cash memos, invoices, and the like. the supporting documents form the basis for their verification by auditors afterwards.

## **Accounting Conventions**

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

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

**2) Convention of Consistency :** According to this convention, accounting practices should

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

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

### **Basic Accounting Terms**

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

#### **1. Business Transactions**

The economic event that relates to a business entity is called business transaction.

Every business activity is not an Accounting activity. This is why; every activity is not recorded in the books of accounting. We record only business transactions in financial Accounting. The first step in the accounting process is the identification of business transactions. Every activity of financial nature having documentary evidence, capable of being presented in numerical, monetary term causing effect on assets, liabilities, capital revenue and expenses is termed as Business Transactions. Special features of Business transactions are as above.

**a. Business transactions must be financial in nature.**

**b. Business transactions must be supported by documentary evidence.**

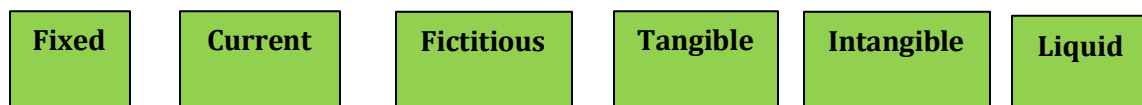
**Transactions must cause an effect on assets, liabilities, capital, revenue and**

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

#### **2. Assets**

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

### Classification of Assets



$$\text{Liquid Assets} = \text{Current Assets} - (\text{Stock} + \text{prepaid expenses})$$

### 3. Capital

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

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

Working capital = Current Assets – Current Liabilities received in advance and outstanding expenses are the current liabilities. Working capital can also be expressed as under:

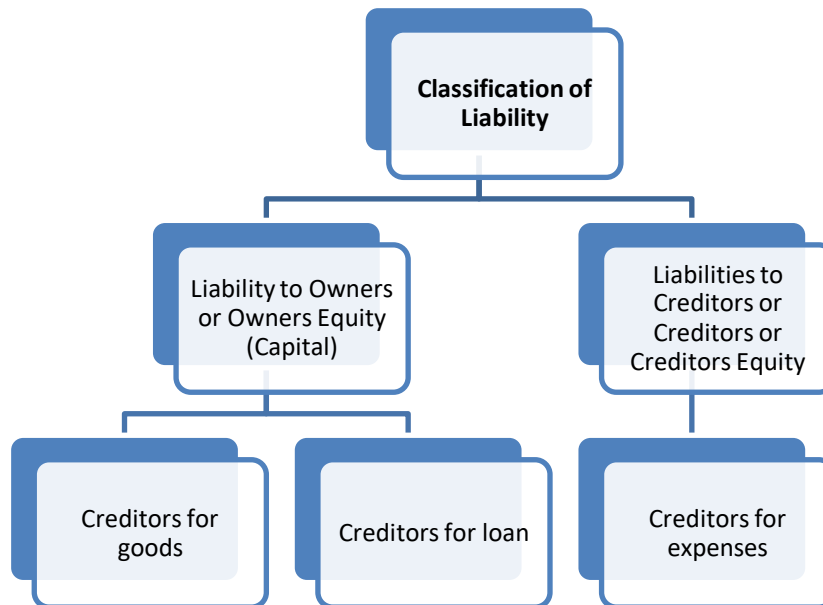
$$\text{Working capital} = \text{Current Assets} - \text{Current Liabilities}$$

### 4. Equity or Liability

Liabilities are the obligations or debts payable by the enterprise in future in the form of money or



goods. It is the proprietors' and creditors' claim against the assets of the business. Creditors may be classified as creditors for goods and creditors for expenses. The business should have liability. Liabilities can be classified as under:



## 5. Financial Statement

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

## 6. Accounting Equation

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

## 7. Goods

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

## 8. Purchases

In its routine business, the firm has no either purchase finished goods for sale or purchase raw material for the manufacture of the article, being sold by the firm. The acquisition of these articles is purchases. The purchase of 10,000 metres of silk by Mohan, a cloth merchant is termed as purchases in the business. In the same way, the purchases of ten exhaust fans by Ram, a dealer in electrical appliances for use in the cooler being assembling in his factory will also be the purchases. It is immaterial whether goods have been purchased for cash or on credit. They may be purchased within

the country or imported from abroad. Purchases of assets are not the purchases in accounting terminology as these assets are not meant for sale.

## **9. Sales**

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

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

## **10. Purchases return or Return outward**

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

## **11. Sales return or Return inward**

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

## **12. Stock**

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

In case of manufacturing enterprises stock is classified as under:

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

### **13. Revenue**

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

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

### **14. Expenses**

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

### **15. Expenditure**

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

## **16. Losses**

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

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

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

## **17. Profit**

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

## **18. Income**

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

## **19. Gain**

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

## **20. Debtors**

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

$$= 4,000.$$

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

## **21. Creditors**

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

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

## **22. Receivables**

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

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

## **24. Proprietor**

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

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

## **25. Drawings**

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

### **Amount withdrawn by proprietor for personal use.**

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

## **ACCOUNTING SYSTEMS**

The main systems of Financial Accounting are as under:

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

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

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

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

### **CONCEPT OF DOUBLE ENTRY SYSTEM**

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

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

### **Evolution of Double Entry system:**

The double entry system was originated in Italy in 15<sup>th</sup> century. First of all in 1494 Lucas Pacioli, the famous mathematician of Venice of Venice city of Italy wrote his first book “De Computis et Scripturis” and mentioned method of accounting in one of its part. Emphasis was given on division and utility of waste book, Journal, Ledger etc. In 1543 Hugo Oldcastle translated it in English and after that many learned persons showed their views and gave it a new shape.

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

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

### **Merits of Double Entry System :-**

The double-entry system of accounting is a standard method used by businesses to record and manage their financial transactions. It involves recording each transaction in two accounts, ensuring that the accounting equation (Assets = Liabilities + Equity) always remains balanced. Here are the key merits of the double-entry system:

#### **1. Accuracy and Completeness:**

- **Balanced Accounts:** Each transaction affects at least two accounts, providing a complete record. This ensures that the books are always balanced, reducing the risk of errors.
- **Error Detection:** The double-entry system makes it easier to detect errors. If the books don't balance, it indicates that there might be a mistake somewhere in the entries.

#### **2. Financial Control:**

- **Comprehensive Tracking:** It provides a detailed record of all transactions, helping in tracking financial activities comprehensively.
- **Fraud Prevention:** The system makes it difficult to conceal fraud as every entry has a corresponding and balancing entry, providing a clear audit trail.

#### **3. Financial Statement Preparation:**

- **Accurate Financial Statements:** It facilitates the preparation of accurate financial statements such as the balance sheet, income statement, and cash flow statement, providing a clear financial picture of the business.
- **Standardization:** The system follows standardized accounting principles, making it easier to compare financial statements over different periods and across different companies.

#### **4. Decision Making:**

- **Informed Decisions:** Accurate and comprehensive financial records help management make informed decisions regarding budgeting, forecasting, and strategic planning.
- **Performance Analysis:** It aids in analyzing the financial performance and health of the business over time, helping in identifying trends and making necessary adjustments.

#### 5. **Legal Compliance:**

- **Regulatory Requirements:** Most regulatory bodies and financial institutions require businesses to maintain records using the double-entry system, ensuring compliance with legal standards.
- **Audit Facilitation:** It provides a clear and organized record that simplifies the auditing process, making it easier for auditors to verify financial statements.

#### 6. **Historical Record:**

- **Long-term Tracking:** It maintains a historical record of all financial transactions, which is useful for long-term tracking and analysis.
- **Reconciliation:** Facilitates the reconciliation of accounts, ensuring that the recorded financial information matches the actual financial situation.

#### 7. **Investment and Creditworthiness:**

- **Credibility:** Provides a reliable and transparent financial record that enhances the credibility of the business with investors, creditors, and stakeholders.
- **Loan Approvals:** Helps in obtaining loans and investments as it provides a clear picture of the financial stability and performance of the business.

### **Demerits of Double Entry System :-**

While the double-entry system of accounting offers numerous benefits, it also has some drawbacks. Here are the key demerits of the double-entry system:

#### 1. **Complexity:**

- **Technical Knowledge:** Requires a good understanding of accounting principles and conventions, making it difficult for individuals without an accounting background to use effectively.
- **Detailed Process:** The process involves multiple steps for recording each transaction, which can be complex and time-consuming.

#### 2. **Cost:**

- **Implementation Costs:** Setting up a double-entry accounting system can be expensive, especially for small businesses, as it might require hiring professional accountants or purchasing accounting software.



- **Maintenance Costs:** Ongoing costs include training staff, maintaining the system, and potentially consulting with accounting professionals.
3. **Time-Consuming:**
- **Record-Keeping:** The requirement to make multiple entries for each transaction increases the time needed for record-keeping.
  - **Reconciliation:** Regular reconciliation of accounts to ensure accuracy can be a time-consuming process.
4. **Resource-Intensive:**
- **Personnel:** Businesses may need to employ qualified accountants or additional staff to manage the double-entry system, increasing personnel costs.
  - **Training:** Continuous training is necessary to keep up with changes in accounting standards and software updates.
5. **Potential for Errors:**
- **Human Error:** Despite its accuracy, the system is still prone to human errors in data entry or misclassification of accounts.
  - **Complex Transactions:** Complex transactions might be difficult to record correctly, leading to potential inaccuracies.

## CLASSIFICATION OF ACCOUNTS

### 1. PERSONAL ACCOUNTS

- a) **Natural Personal Account :** The term Natural persons means persons who are created by the almighty. For example : Shyam's Account, Gopals's Account etc.
- b) **Artificial Personal Account :** These accounts include accounts of institutions or companies which are recognized as persons in business dealings. For example, the account of a Club, the account of an Insurance Company, Banking Company.
- c) **Representative Personal Account :** These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an account for the outstanding amount will be opened. Likewise for salaries due to the employees (not paid) an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the account of the person to whom the salaries have to be paid therefore such accounts are called as representative personal accountant.

### 2. REAL ACCOUNTS

- a. **Intangible Assets :** These accounts represent things which cannot be touched. However, they can be measured in terms of money, for example goodwill account, patents accounts.

- b. **Tangible Accounts** : Tangible accounts are those which relate to things which can be touched, felt, measured etc. Examples of such accounts are furniture account, stock account, building account etc.

### **3.Nominal Accounts: -**

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

Nominal Accounts are divided into two parts as:

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

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

## **RULES OF DOUBLE ENTRY SYSTEM**

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

**Personal accounts** :- **Debit the receiver, and credit the giver.**

**Real accounts** :- **Debit what comes in, and credit what goes out**

**Nominal accounts** :- **Debit all expenses and losses and credit all incomes and gains.**

**Capital and revenue**

### **Classification of capital and revenue**

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

**Capital Expenditure:** Capital Expenditure is that expenditure which is incurred (a) for acquiring or bringing into existence an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset an asset or advantage of an enduring benefit or (b) for extending or improving a fixed asset or

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

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

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

**Capital Receipts Vs Revenue Receipts** There is no specific test to draw a clear cut demarcation between a capital receipt and a revenue receipt. In order to determine whether a receipt is capital or revenue in nature, one has to look into its true nature and substance over the form in the hands of its receipts. For example, sale proceeds of a land in the hands of a dealer in real estate is revenue receipt whereas the same in the hands of a dealer in cars is a capital receipt.

The examples of capital receipts include sale of fixed assts, capital contribution, loaned receipts, and the examples of revenue receipts include sale of stock-in-trade, revenue from services rendered in the normal course of business, revenue from permitting other to use the assets of the enterprise, such as interest, rent royalty.

**JOURNAL**

**It is the fundamental book of account which is necessarily used by each organization whether it is a small or large institution. It can be known as foundation stone of accounting palace.**

A journal may be defined as the book of original entry containing a chronological record of the transactions.

The process of recording the transactions in a journal is called Journalizing

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

**COMPOUND JOURNAL ENTRY**

If two or more transactions of the same nature occur on the same day and either debit account and/or credit

account are common in them, instead of passing a separate entry for each such transaction, one combined entry may be passed. Such type of entry is known as compound journal entry.

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

## DISCOUNT

### Types of Discount :-

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

### DISTINCTIONS BETWEEN TRADE DISCOUNT AND CASH DISCOUNT

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

## LEDGER

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

### Characteristics of Ledger

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

### Utility or importance or Advantages of Ledger

The ledger, often referred to as the General Ledger, is a crucial component of the accounting system. It serves as the central repository of all financial transactions and balances, systematically organized by accounts. Here are the key reasons why the ledger is important:

#### 1. Comprehensive Record Keeping:

- **Detailed Information:** The ledger provides a detailed record of all financial transactions, ensuring that every financial activity is documented.
- **Account Organization:** Transactions are categorized into specific accounts, such as assets, liabilities, equity, revenues, and expenses, providing a clear structure for financial data.

#### 2. Facilitation of Financial Statements:

- **Basis for Financial Reports:** The ledger is the primary source for generating key financial statements, including the balance sheet, income statement, and cash flow statement.
- **Accuracy and Reliability:** Accurate ledger entries ensure the reliability of financial statements, which are essential for internal and external stakeholders.

#### 3. Financial Analysis and Decision Making:

- **Performance Monitoring:** The ledger allows for detailed tracking and analysis of financial performance over time, helping management make informed decisions.

- **Trend Analysis:** By examining ledger entries, businesses can identify trends, patterns, and anomalies in financial performance, aiding strategic planning.

**4. Internal Control and Error Detection:**

- **Audit Trail:** The ledger provides a clear audit trail, making it easier to trace transactions back to their source documents and verify their accuracy.
- **Error Identification:** Regular reconciliation and review of ledger accounts help in detecting and correcting errors promptly, ensuring the integrity of financial records.

**5. Compliance and Regulatory Requirements:**

- **Regulatory Adherence:** Maintaining an accurate ledger is often a legal requirement, ensuring compliance with accounting standards and regulations.
- **Audit Preparedness:** A well-maintained ledger simplifies the audit process, as auditors can easily verify transactions and account balances.

**Difference between journal and Ledger**

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

## Proforma of Account

### Name of Account

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

### Posting

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

### Procedure for Posting

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

### Ledger posting of Opening Journal Entry

While making ledger accounts of assets and liabilities appearing in the opening journal entry, the opening balance as represented in the journal entry must be shown in the beginning of the ledger account as "To Balance b/d" at the debit side for assets and "by balance b/d" at the credit side of

liabilities. Remaining posting in the concurred A/c will be made as usual.

### **Balancing of ledger Accounts**

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

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

### **Meaning of Cash Book**

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

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

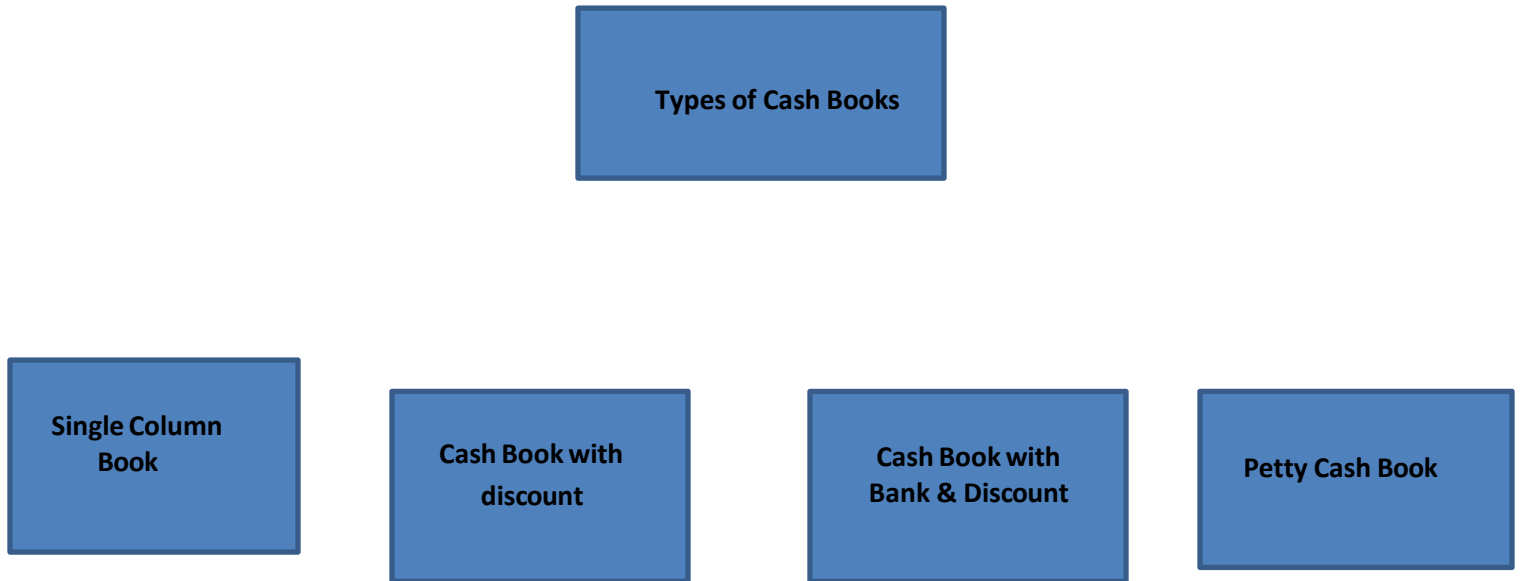
### **Features of cash book:**

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

### **Types of Cash Book**



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



## **TRIAL BALANCE**

### **Meaning**

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

### **Main Characteristics and uses of a Trial Balance**

Following are the main characteristics of a trial balance :

1. It is a statement prepared in a tabular form. It has two columns- one for debit balance and another for credit balances.
2. Closing balance, i.e., balance at the end of the period as shown by ledger accounts, are shown in the statement.
3. Trial balance is not an account. It is only a statement of balance.
4. It can be prepared on any date provided accounts are balanced.
5. It is a consolidated list of all ledger balances at the end of a period at one place.

## Objects of preparing a Trial Balance

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

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

## Limitations of a Trial Balance

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

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

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

## Methods of Preparation of Trial Balance –

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

## Trial Balance

(As on..... )

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

		<b>Rs.</b>	<b>Rs.</b>
<b>Total</b>			

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

**Trial Balance**

( As on..... )

<b>Title of Accounts</b>	<b>L.F.</b>	<b>Debit Balance Rs.</b>	<b>Credit Balance Rs.</b>
<b>Total</b>			

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

**Trial Balance**

(As on..... )

<b>Title of Accounts</b>	<b>L.F.</b>	<b>Debit Total Rs.</b>	<b>Credit Total Rs.</b>	<b>Debit Balanc e Rs.</b>	<b>Credit Balanc e Rs.</b>
<b>Total</b>					

**ACCOUNTING STANDARDS**

Accounting as a ‘language of ‘business’ communicates the financial performance and position of an enterprise to various interested parties by means of financial statements which have to exhibit a ‘true and fair’ view of financial results and its state of affairs. As a result a wide variety of accounting methods were used by different companies. It was, then, felt that there should be some standardized

set of rules and accounting principles to reduce or eliminate confusing variation in the methods used to prepare financial statements. However, such accounting rules should have a reasonable degree of flexibility in view of specific circumstances of an enterprise and also in line with the changes in the economic environment, social needs, legal requirements and technological developments. The setting of accounting standards is a social decision. Standards place restrictions on behaviour and therefore they must be accepted by affected parties.

## ACCOUNTING STANDARDS ISSUED BY THE ICAI

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

(i)	AS-1	Disclosure of Accounting Policies	(1-4-1991)
(ii)	AS-2	Valuation of Inventories	(1-4-1991)(Revised)
(iii)	AS-3	Cash Flow Statement	(1-6-1991)(Revised)
(iv)	AS-4	Contingencies and events occurring after the Balance Sheet Date	(1-4-1995)
(v)	AS-5	Net Profit or Loss for the period, prior items and changes in Accounting Policies	(1-4-1996)
(vi)	AS-6	Depreciation Accounting	(1-4-1995)
(vii)	AS-7	Accounting for Construction contracts	(1-4-1991)
(viii)	AS-8	Accounting for Research and Development	(1-4-1991)
(ix)	AS-9	Revenue Recognition	(1-4-1991)
(x)	AS-10	Accounting for Fixed Assets	(1-4-1991)
(xi)	AS-11	Accounting for the effects of changes in Foreign Exchange Rates	(1-4-1995)
(xii)	AS-12	Accounting for Government Grants	(1-4-1994)
(xiii)	AS-13	Accounting for Investments	(1-4-1995)
(xiv)	AS-14	Accounting for Amalgamation	(1-4-1995)
(xv)	AS-15	Accounting for retirement benefits in the financial statements of employers	(1-4-1995)
(xvi)	AS-16	Borrowing Costs	(1-4-2000)
(xvii)	AS-17	Segment Reporting	(1-4-2001)
(xviii)	AS-18	Related Party Disclosures	(1-4-2001)
(xix)	AS-19	Leases	(1-4-2001)

(xx)	AS-20	Earning per share	(1-4-2001)
(xxi)	AS-21	Consolidated Financial Statements	(1-4-2001)
(xxii)	AS-22	accounting for Taxes on Income	(1-4-2002)
(xxiii)	AS-23	Accounting for Investments in Associates in consolidated Financial Statements	(1-4-2002)
(xxiv)	AS-24	Discontinuing Operations	(1-4-2002)
(xxv)	AS-25	Interim financial Reporting	(1-4-2002)
(xxvi)	AS-26	Intangible Assets	(1-4-2003)
(xxvii)	AS-27	Financial Reporting of Interest in Joint Ventures	(1-4-2002)
(xxviii)	AS-28	Impairment of Assets	(1-4-2004)
(xxix)	AS-29	Provisions, Contingent Liabilities and Contingent Assets	(1-4-2004)

## Final Accounts

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

Recording of transaction in Journal or Subsidiary books

Postings into ledger from Journal or subsidiary books.

Preparation of Trial balance from ledger accounts

**Preparation of Final Accounts on the basis of Trial balance and other information**

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

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

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

1. Debit items of Trial Balance:- The items of expenses or assets appear on debit side of Trial balance. The expenses (the benefit of which is derived within the accounting year in which they are incurred are called revenue expenses. These are debited either to trading account or profit & Loss Account.) Direct expenses such wages. Carriage inwards, freight etc. are debited to trading and indirect exp. such as salaries, rent repairs etc. are debited to profit & Loss account. The expenses the benefit of which is derived in many years are called capital expenditure. These expenditure are called assets and they appear in the assets side of Balance sheet e.g. Building, Machinery, Furniture, Vehicle etc.
2. Credit items of Trial Balance: The items of incomes, gains or liabilities appear in the credit side of trial balance. The receipts are divided into two parts capital receipts and revenue receipts. Capital receipts are liabilities items they are mentioned in the liabilities side or deducted from the assets side of Balance sheet. Revenue receipts are called incomes. It is again divided into direct and indirect incomes. Direct incomes means sale proceeds of the goods which is credited to Trading Account. Indirect incomes are other incomes not directly related to the main business activities such as rent commission, interest, dividend etc received. These are credited to profit and loss account.

### Trading Account

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

### Trading Account A/c

For the Year ending.....

	Rs.		Rs.
To Opening Stock	-	By Sales	-
To Purchase	-	Less: Returns Inward	-
Less: Ret. Outward	-	-----	
-----		By Goods Sent on	
		Consignment	
To Wages	-	By Closing Stock	-
To Carriage	-	By Gross Loss c/d	-
To Fuel	-	(Balancing figure )	
To Motive Power	-		

To Octroi	-		
To Import Duty	-		
To Clearing Charges	-		
To Dock Charges	-		
To Stores Consumed	-		
To Royalty based on Production	-		
To Manufacturing Exp.	-		
To Gross Profit c/d (Balancing figure) -	-		
Rs.	-	Rs.	-

### Profit and Loss Account

Profit and loss accounts is prepared to ascertain net profit or loss. This is the second stage of ascertaining trading results. Gross Profit calculated as per trading account is credited to Profit and loss

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

To Gross Loss	-	By Gross Profit	-
To Office Salaries & Wages	-	By Discount received	-
To Office Rent, Rates and Taxes	-	By Bad debts	-
To Office Printing and Stationery	-	recovered	-
To Office Lighting	-	By Income from Investment	-
To Insurance Premium	-	By Commission received	-
To Repairs & Maintenance	-	By Interest on Deposits	-
To Postage & Telegram	-	By Profit on sale of fixed	-
To Legal expenses	-	assets By Apprenticeship	-
To Trade expenses	-	Premium By Interest on	-
To Audit fees	-	Drawings	-
To Telephone expenses	-	By Net Loss (Transferred to	-
To General expenses	-	Capital Account)	-
To Bank Charges	-		
To Discount allowed	-		

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

## Balance Sheet

As on 31 March .....

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



Income		Balance Cash Balance	-

## UNIT-II

### Final Account (With Adjustments)

#### DEPRECIATION ACCOUNTING'

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

#### Meaning

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

#### Definition

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

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

#### Features or Characteristics of Depreciation

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

#### Causes of Depreciation

The principal causes of depreciation are as follows:

1. **By Constant use:** Wear and tear of an asset due to its constant use is a cause of decline in the value of an asset. A fixed asset begins to lose its value when it is used in the business e.g. plant & machinery, building, furniture etc.  
**By expiry of time:** Certain assets get decreased in their value with the expiry of time whether they are used in the business or no. this is true in case of assets like leasehold properties, patents or copyrights etc. For example, if a lease is obtained for 25 years for Ts. 1,00,000, it will lose  $1/25^{\text{th}}$  i.e. Rs. 4,000 of its value every year whether it is used in the business or not. So at the end of  $25^{\text{th}}$  year, its value will be reduced to zero.
2. **By Obsolescence:** Some assets are discarded before they are worn out because of changed conditions. For example, an old machine which is still workable may have to be replaced by a new machine because of the later being more efficient and economical. Such a loss on account of new inventions or changed fashions is termed as loss on account of obsolescence.
3. **By Depletion:** Some assets like mineral mines, oil wells etc. get exhausted or depleted through working. On account of continuous extraction of minerals or oil, a stage comes when the mine or oil gets completely exhausted and nothing is left.
4. **By Accidents:** An asset may meet an accident and therefore, it may get depreciated in its value.

**The following are the objectives of providing depreciation:**

1. **Ascertainment of true profit or loss:** Depreciation being a loss, will certainly affect the business profits. Therefore, to arrive at the true profit or loss, depreciation must be provided for and records in the books of accounts.
2. **Presentation of true financial position:** In a balance sheet, assets must be shown at their true values. This is not possible unless depreciation is provided and deducted from the values of these assets.
3. **Replacement of assets:** Some assets used in the business need replacement after the expiry of their service life. By providing depreciation, a part of the profit of the business is kept in the business which can be used for purchase of new assets when the old fixed assets become useless.
4. **Calculation of correct cost of production:** Correct cost of production cannot be calculated unless depreciation is properly provided and accounted for an item of cost of production.
5. **Prevention to withdrawal of capital:** Capital of a business remains invested in different assets. If no depreciation is charged, assets and capital are shown at enhanced figures due to such misrepresentation; capital itself may be withdrawn in the guise of imaginary profit.

## Factors Affecting Depreciation

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

1. **Total cost of the assets:** The cost of the asset includes the invoice price of the asset, less any trade discount plus all costs essential to bring the asset to a useable condition. In other words, cost includes all expenses upto the installation of the assets e.g. freight, carriage, installation charges etc.
2. **Estimated useful life of an asset:** This is represented by the number of years of the estimated serviceable life span of an asset. Thus, if an asset is expected to last for 15 years before completely losing its usefulness for business operations, its life is taken to be 15 years. If a machine can work for 15 years but it is likely to become obsolete in 10 years due to availability of better type of machine, its useful life will be considered as 10 years.
3. **Estimates scrap value of an asset:** The term scrap value means the residual or break up or salvage value which is estimated to be realized on account of the sale of the asset at the end of its useful life. An important part in this connection is that an asset may not necessarily have a scrap value e.g., leasehold property.

## Depreciation and other Related Concepts

- i. **Depreciation and Depletion:** Depreciation refers to a reduction in the value of all kinds of fixed assets arising from then wear and tear. Depletion is used in respect of the extraction of natural resources like quarries, mines, etc. that reduces the availability of the quantity of material or asset.
- ii. **Depreciation and Obsolescence:** Obsolescence refers to decrease in usefulness caused on account of the asset becoming out of date, old fashioned, etc, and it is one of the causes of depreciation. Depreciation is the loss in the value of an asset on account of wear and tear.
- iii. **Depreciation and Amortization:** Amortization refers to writing off of the proportionate value of the intangibles such as goodwill patents, copyrights while depreciation refers to writing off of the expired cost of the tangible assets like machinery, building, etc.
- iv. **Depreciation and Fluctuation :** The points of difference are as follows :

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

Use of word per annum for calculation of amount of depreciation

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

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

### Methods of Charging Depreciation:

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

i. When the asset has no residual value:

Original cost of asset

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

ii. When the asset has residual value:

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

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

### Difference between Fixed Installment and Reducing Balance Method

Basis of different	Fixed Installment Method	Reducing Balance Method
1. Calculation of Depreciation	Depreciation is calculated on the original cost.	Depreciation is calculated on the remaining balance or opening book

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

### Journal entries in case of Depreciation

- On asset purchase Asset A/c

Dr

To cash/ Bank

2. On depreciation charged

Depreciation on asset A/c Dr

To asset A/c

3. On Transfer of depreciation to P&L

A/c P&L A/c Dr

To depreciation

4. On sale of asset at profit Cash/ Bank A/c Dr

To P&L

A/c To

asset A/c

On sale of asset at loss Cash/ Bank a/c Dr

5. P&L A/c Dr

To asset A/c

Journal entries for Depreciation when provision of Depreciation is made.

1. For providing depreciation

Depreciation a/c

Dr

To provision For Depreciation A/c

2. For transfer of depreciation to P&L

A/c P&L A/c Dr

To Depreciation A/c

3. On sale of asset

- a. Provision for Depreciation

A/cDr To Assets A/c

- b. In case of profit or loss on sale of

4. asset If Profit:

Asset A/c Dr

To P&L A/c

If Loss: P&L A/c Dr

To asset A/c

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

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

Change of method from previous date (Retrospective effect)

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

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



Every year a fixed amount is paid as premium of the policy and after a certain period the insurance company pays back in lump sum, which is used for renewal.

## Unit- III

### DEPARTMENTAL ACCOUNTS

Departmental accounting is a method of organizing and managing financial information within an organization by tracking the financial activities of individual departments. This approach provides a detailed insight into the financial performance of each department, facilitating effective budgeting, resource allocation, and decision-making processes.

In a departmental accounting system, each department within an organization maintains its own set of accounts to record revenues, expenses, assets, and liabilities specific to its operations. These accounts are separate from the organization's overall financial accounts and are used to monitor the financial performance of each department independently.

The primary purpose of departmental accounting is to provide management with accurate and relevant financial information to assess the performance of individual departments and make informed decisions regarding resource allocation, cost control, and strategic planning. By analyzing departmental financial data, managers can identify areas of strength and weakness, allocate resources efficiently, and take corrective actions when necessary.

#### **Importance of Departmental Account:-**

The importance of departmental accounting lies in its ability to provide detailed insights into the financial performance of individual departments within an organization. Here are some key reasons why departmental accounting is important:

1. **Performance Evaluation:** Departmental accounting allows managers to assess the financial performance of each department independently. By tracking revenues, expenses, and other financial metrics on a department-by-department basis, managers can identify areas of strength and weakness, evaluate profitability, and measure efficiency and effectiveness.
2. **Resource Allocation:** Effective resource allocation is critical for maximizing productivity and achieving organizational goals. Departmental accounting provides managers with the information they need to allocate resources such as funds, manpower, and equipment efficiently. By understanding the financial needs and performance of each department, managers can prioritize investments and allocate resources to areas with the greatest potential for return.
3. **Budgeting and Forecasting:** Departmental accounting supports the budgeting and forecasting processes by providing historical financial data and insights into future trends. Managers can use this information

to develop realistic budgets for each department, set performance targets, and identify opportunities for growth and improvement. By aligning departmental budgets with organizational objectives, managers can ensure that resources are allocated effectively and that departments operate within their financial constraints.

4. **Cost Control:** Controlling costs is essential for maintaining profitability and competitiveness. Departmental accounting helps managers identify cost-saving opportunities, eliminate inefficiencies, and optimize resource utilization within each department. By tracking expenses and analyzing cost drivers, managers can implement strategies to reduce costs without compromising quality or productivity.
5. **Decision Making:** Departmental accounting provides managers with the financial information they need to make informed decisions. Whether it's evaluating investment opportunities, prioritizing projects, or assessing the impact of strategic initiatives, managers rely on departmental accounting data to weigh the potential risks and rewards and make decisions that align with organizational objectives.
6. **Performance Measurement and Accountability:** Departmental accounting enables managers to measure departmental performance against predefined targets and benchmarks. By comparing actual performance to budgeted targets and historical data, managers can identify variances, analyze the underlying causes, and take corrective actions when necessary. This fosters accountability and transparency within the organization, as departments are held accountable for their financial performance.
7. **External Reporting and Compliance:** Departmental accounting supports external reporting requirements by providing accurate and reliable financial information for regulatory compliance, investor relations, and other stakeholders. Whether it's preparing financial statements, tax filings, or regulatory disclosures, departmental accounting ensures that the information presented is compliant with applicable accounting standards and regulations.

### **Process of Departmental Account**

The process of departmental accounting involves several steps to accurately track and manage the financial activities of individual departments within an organization. Here's a general overview of the process:

1. **Identify Departments:** The first step is to identify the various departments or cost centers within the organization. Common departments may include sales, marketing, finance, operations, human resources, etc. Each department should represent a distinct area of the organization's operations.
2. **Establish Chart of Accounts:** Develop a chart of accounts specifically tailored to the needs of departmental accounting. This chart should include separate accounts for revenues, expenses, assets, and

liabilities for each department. The chart of accounts should be structured in a way that allows for easy tracking and reporting of departmental financial data.

3. **Allocate Expenses:** Allocate shared expenses to individual departments based on a predetermined allocation method. Shared expenses may include overhead costs such as rent, utilities, administrative salaries, etc. Common allocation methods include allocating expenses based on square footage, headcount, revenue contribution, or usage of resources.
4. **Record Transactions:** Record all financial transactions related to each department in the appropriate accounts. This includes revenues generated by the department (e.g., sales revenue), as well as expenses incurred (e.g., salaries, supplies, marketing expenses). Ensure that transactions are accurately categorized and recorded in accordance with the chart of accounts.
5. **Generate Departmental Reports:** Periodically generate departmental financial reports to track the performance of each department. These reports should include key financial metrics such as revenues, expenses, net income, budget variances, and performance indicators. Departmental reports help managers assess the financial health of each department and make informed decisions.
6. **Budgeting and Forecasting:** Develop departmental budgets and forecasts based on historical financial data, market trends, and organizational objectives. Budgets should outline the expected revenues, expenses, and resource requirements for each department over a specified period. Regularly monitor actual performance against budgeted targets and adjust forecasts as needed.
7. **Performance Analysis:** Analyze departmental performance by comparing actual financial results to budgeted targets and historical data. Identify areas of variance and analyze the underlying factors contributing to performance discrepancies. Use performance analysis to assess efficiency, identify opportunities for improvement, and make data-driven decisions.
8. **Cost Allocation:** Review and refine the allocation of shared expenses to ensure accuracy and fairness. Adjust allocation methods as needed based on changes in departmental operations or resource usage. Transparent and equitable cost allocation methods help ensure that departments are held accountable for their fair share of expenses.
9. **Strategic Planning:** Use departmental financial data to inform strategic planning initiatives and decision-making processes. Identify areas of opportunity for growth, investment, or cost reduction based on departmental performance and market trends. Align departmental objectives with organizational goals to drive overall success and sustainability.
10. **Compliance and Reporting:** Ensure compliance with applicable accounting standards, regulations, and reporting requirements. Prepare and submit financial reports to internal stakeholders, external auditors, regulatory agencies, and other relevant parties as necessary. Maintain accurate and reliable financial records to support transparency, accountability, and legal compliance.

### **Method of keeping departmental accounts:**

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

- (i) **Unit wise method:** in this method each department is treated as an independent unit and separate books of accounts are maintained for each of them and final accounts are prepared at the end of the year.
- (ii) **Columnar method :** under this method entries of each department are made jointly and separate column of each department is given and one column is made for the total of all the department

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

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

Allocation of departmental expenses: - In

Practice the following general rules are usually applied for allocation and apportionment of expenses. Expenses directly related is a particular department should be charged to that department, but is any exp is not particularly belongs to a particular department can be apportionment on the following basis table.

Some of the expenses such as interest on debentures loan, capital, director's fees, salary of general manager office exp etc. can not be apportioned to different department on any equitable basis. Thus such expenses are debited in general profit & loss account only. These may be some income e.g. interest as dividend received on investment transfer fees, etc are not related to any department these incomes are credited in general profit & loss a/c

### **BRANCH ACCOUNT**

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

**Kinds of Branches :-**

**Dependents Branches:-** These branches do not prepare any accounts their accounts are prepared by the H.O. These braches cash book, sales boo and stock book only for money. They do not keep any journal entries of ledger accounts. Dependent branches may be any of the following three kinds (a) branches making cash sales only (b) Branches making cash and credit sales (c) Branches to when goods are sent on sale price.

**Stock & Debtors Method:-** The branches which under take both cash & credit sales and whole sale is more due to expanded business area then it is difficult to prepare branch A/c only and these are more possibilities of errors due to more transaction amount.

**When goods sent to branch at cost price:-** The following accounts are prepared under this method:-

- (1) Branch stock A/c (2) Goods sent to Branch (3) Branch Debtors A/c (4) Branch expenses (5) Branch P & L A/c

**When goods sent to Branch at invoice price:-** The following accounts as prepare under this method.

- 1. Branch stock A/c (ii) Goods sent to Branch A/c (iii) Branch Debtors (iv) Branch Expenses (v) Branch stock Reserve A/c (vi) Branch adjustment a/c

**Simple system or Debtors system:-** When branch are very small than this method is adopted in this method only branch account is prepared in the bank of H.O. whose credit balancer indicate profit and debit balance indicates the loss. The method is also called debtor method. The branch account prepared under this method is of the nature of nominal account.

**Financial account system:-** In this method branch trading account & profit & loss of H.O. along with Branch A/c. The Branch account prepared under this method is of the nature of personal a/c.

**Whole sale Branch method:-** This is method applied when the manufacturers supplier the goods to the whole seller and also to the consumer a from their own branch. The goods use transferred to the branch at the same value at which it is transferred to whole sellers.

**Multiple Account Method or Stock and Debtor Method**

In this method for ascertaining trading results many accounts are opened in the books of branch instead of only branch account.

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

To B.P. & L A/c (B.F.)		By... B Stock A/c (transfer given)	
		By Bal. c/d	

The converted trail balance is prepared as under:

- (i) **Fixed assets-** Fixed assets are converted at the rate prevailing at the date of its purchase. If this rate is not in the opening rate may be applied.
- (ii) **Fixed Liabilities:-** The are converted at the rate prevailing when these liabilities arose. If nothing is given, opening rate may be applied.
- (iii) **Current assets and current liabilities:-** These are converted at the closing rate.
- (iv) **Opening and closing stock:-** Opening rate is applied for opening stock and closing rate is applied for closing stock.
- (v) **Depreciation-** The rate applied for the concerned asset, is used to convert the deprecation also.
- (vi) **Provision for bad & doubtful debts-** This is converted at the rate at which debtors are converted  
i.e. closing rate.
- (vii) **Revenue items:-** Except, deprecation, provision for doubtful debts, opening and closing stocks, all the revenue items are converted at average rate.

(2) **Exchange suspense or reserve account-** When the branch trial balance is converted as per the above mentioned rules, obviously the totals of converted trial balance do not agree. So the difference in converted trial balance is transferred to a newly opened 'exchange suspense or exchange reserve account'. This account is shown in balance sheet. If it is one the credit side, it is shown on liabilities side or vice versa.

(3) For incorporation of branch trail balance, at first the trial balance is converted and then final accounts are prepared.

### Specimen of Branch Account in Head Office Books

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

**UNIT – IV**  
**ROYALTY ACCOUNTS**

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

**Definition of Royalty**

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

**Difference between Royalty and Rent**

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

**KINDS OF ROYALTY**

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

**TERMS IN RESPECT OF ROYALTY**

1. Landlord or lessor- This person is owner of the property and gives his property to other for use and has the right in return to receive a royalty.
2. Lessee- This person takes a property from other land has a right to use it and in return, he has to pay royalty to the owner of the property.
3. Minimum rent- Payment of amount of royalty is decided on the basis of production or on sale of such property. As production or sale fluctuate, owner of property calculate the minimum rent at the beginning of



the year which has to be paid to him in any condition i.e. if there is reduction in production or sale even the owner will receive a minimum rent. When royalty is equal to or more than minimum then payment should be made of royalty only, not of minimum rent.

4. Short working- The excess of minimum rent over royalty is called short-working

short working = Minimum rent - Royalty.

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

### CALCULATION OR ANALYSIS TABLE

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

### ACCOUNTING FOR ROYALTY

#### Journal Entries

In the books of Lessee	In the books of lessor
(1) For royalty and short working Royalty (Payable) A/c     Dr. short working (Recoupable) A/c Dr. To Lessor [Being amount payable]	(1) For royalty and short working Lessee A/c     Dr. To Royalty (Receivable) A/c To Short working (Allowable) [Being amount receivable]
(2) For short working recouped Lessor                     Dr. To short working A/c [Being short working recouped]	(2) For short working recouped Short                     working Dr . To Lessee

	[Being short working allowed to recouped]
(3) For Payment Lessor Dr. To Bank A/c [Being payment made]	(3) For Payment Bank A/c Dr. To Lessee [Being payment received]
(4) For transfer of royalty Manufacturing A/c P&L A/c Dr To Royalty A/c [Being transfer of Royalty]	(4) For transfer of royalty Royalty A/c Dr To P&L A/c [Being transfer of Royalty]
(5) For recoupable short working P&L A/c Dr, To Short working A/c [Being recoupable S.W.)	(5) For recoupable short working Short working A/c Dr. To P&L A/c [Being recoupable S.W.)

## SUB-LEASE

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

## Consignment Accounts

A consignment account is a financial arrangement between a consignor (seller) and a consignee (agent) whereby goods are sent by the consignor to the consignee for the purpose of sale. The consignee then sells the goods on behalf of the consignor and receives a commission for the service rendered. The consignee does not take ownership of the goods but acts as an intermediary in the sale process.

In a consignment account, both the consignor and the consignee maintain separate sets of accounts to record the transactions related to the consigned goods. Let's delve deeper into the concept and workings of a consignment account:

### 1. Nature of Transactions:

- **Consignor's Perspective:** The consignor dispatches the goods to the consignee and records it as a consignment outwards in their books. However, they do not recognize the sale until the consignee sells the goods to a third party.
- **Consignee's Perspective:** The consignee receives the goods and records it as consignment inwards. They recognize revenue only when the goods are sold to the end customer.

### 2. Accounting Entries:

- **Consignor's Books:** The consignor records the consignment outwards as a debit to consignment account and credits the stock account. When the consignee sends the sales proceeds or unsold goods back, the consignor records the consignment account as a credit and debits the consignment account.
- **Consignee's Books:** The consignee records consignment inwards as a debit to the consignment account and credits the consignor's account. When sales are made, they debit cash or account receivables and credit the consignment account for the sales value.

### 3. Treatment of Expenses and Commissions:

- **Expenses:** Any expenses incurred in relation to the consigned goods, such as transportation or storage, are typically borne by the consignor.
- **Commissions:** The consignee earns a commission on the sales, which is a percentage of the selling price. This commission is recorded as revenue in the consignee's books and as an expense in the consignor's books.

### 4. Risks and Benefits:

- **Consignor:** The consignor retains ownership of the goods until they are sold, thus bearing the risk of loss or damage during transit or while in the consignee's possession. However, they also have the potential benefit of reaching new markets through the consignee's network.
- **Consignee:** The consignee earns a commission for selling the goods but does not bear the risk of ownership. However, they may invest time and effort into selling the goods without a guaranteed profit if the goods do not sell well.

## **5. Reporting and Settlement:**

- Settlement between the consignor and consignee usually occurs periodically, often monthly or quarterly, where the consignee remits the proceeds from sold goods to the consignor and provides an account of sales and expenses.

In conclusion, a consignment account facilitates a mutually beneficial arrangement between a consignor and a consignee, allowing the consignor to reach new markets and the consignee to earn commissions for selling goods without taking ownership. Proper accounting and reporting ensure transparency and smooth operation of the consignment process.

## **Feature of Consignment Accounts:-**

The features of consignment accounts encompass various aspects of the financial arrangement between a consignor (seller) and a consignee (agent). Here are the key features:

### **1. Non-ownership of Goods:**

- In a consignment arrangement, the consignee does not take ownership of the goods. Instead, they act as an agent to sell the goods on behalf of the consignor.

### **2. Separate Accounting Records:**

- Both the consignor and the consignee maintain separate sets of accounting records to track transactions related to the consigned goods. This separation ensures clarity and transparency in financial reporting.

### **3. Risk and Ownership:**

- The consignor retains ownership of the goods until they are sold to a third party. Therefore, the consignor bears the risk of loss, damage, or obsolescence of the goods during transit or while in the possession of the consignee.

### **4. Revenue Recognition:**

- Revenue is recognized by the consignee only when the goods are sold to the end customer. Until the sale occurs, the consignor does not recognize revenue but may record the consignment as an asset.

### **5. Commissions and Expenses:**

- The consignee earns a commission for selling the goods on behalf of the consignor. This commission is typically a percentage of the selling price. The consignor may also reimburse the consignee for certain expenses incurred in relation to the consigned goods, such as transportation or storage costs.

#### **6. Periodic Settlements:**

- Settlement between the consignor and consignee usually occurs at regular intervals, such as monthly or quarterly. During the settlement, the consignee remits the proceeds from sold goods to the consignor and provides a detailed account of sales and expenses incurred.

#### **7. Potential Market Expansion:**

- Consignment accounts offer the consignor an opportunity to reach new markets and customers through the consignee's network and expertise. This can be particularly beneficial for small businesses or those looking to expand their reach without investing heavily in distribution channels.

#### **8. Flexibility in Inventory Management:**

- Consignment accounts allow the consignor to maintain control over their inventory while still having it available for sale in various locations. This flexibility can help in managing inventory levels and reducing the risk of overstocking or stockouts.

#### **9. Legal and Contractual Agreements:**

- Consignment arrangements are typically governed by legal agreements or contracts between the consignor and consignee. These agreements outline the terms and conditions of the consignment, including responsibilities, commissions, expenses, and termination clauses.

#### **10. Reporting and Transparency:**

- Proper accounting and reporting ensure transparency and accountability in consignment transactions. Both parties must accurately record all transactions related to the consigned goods to facilitate reconciliation and settlement.

#### **Terminology**

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

- 1) Agency – The transaction between the owner of goods and the agent are called ‘agency transitions’

and such relation is called agency.

- 2) Consignment – The goods sent to the agent for sales is called consignment also known as ‘Challan’. For consignment it is ‘consignment outward’ and for consignee it is ‘consignment inward’.
- 3) Consignor – The principal or owner of the consigned goods on whose behalf and risk such goods are sold by agent is called ‘consignor’ also known as ‘Challaner’.
- 4) Consignee – He is the agent whom goods are consigned for sale at pre-decide amount or rate of remuneration. He is also known as ‘challance’.
- 5) Goods sent on consignment – The goods dispatched to the agent for sale are called ‘goods sent on consignment’. This is recorded by the consignor in his books in separate account ‘goods sent on consignment account’ which is real account. Consignee passes no entry for such goods.
- 6) Pro-forma invoice – For the goods consigned, the consignor makes and sends an invoice mentioning therein the quantity and quality of the goods consigned. The price of the goods mentioned in such invoice is called ‘invoice price’ Sometime the proposed selling price is also mentioned. Such an invoice is called ‘Pro-forma invoice’.
- 7) Consignment expenses – The expenses incurred by consignor and consignee for consignment are called consignment expenses. Consignor’s expenses are packing, loading, carriage, freight, transit insurance, export duty etc. Consignee’s expenses for receiving goods are octroi, entry tax, import duty, custom duty, dock dues, clearing charges, unloading carriage upto his godown. Consignee’s expenses for storing the goods are godown rent, godown insurance, godown depreciation etc. Consignees expenses for selling the goods are advertisement, publicity, free samples, demonstrations, brokerage, his own commission etc.
- 8) Consignment transactions – The transactions concluded by the consignor and consignee for consignment are called ‘Consignment transactions’.
- 9) Remuneration or commission of consignee – For his services to the consignor, a consignee is compensated by consignor. Such compensation or consideration is called remuneration or commission of consignee.
- 10) Account Sale – This is a statement of sales prepared and sent by the consignee to consignor periodically. In this statement sales realization by consignee his expenses and commission and balance to be remitted are mentioned.

Consignment stock – The goods lying unsold with consignee at the end of the accounting period are called ‘consignment stock’ or ‘stock with agent’ to be valued at the lower of its cost price or market price. The consignor makes accounting for such stock in his books but consignee does not show such stock in his books.

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

**Difference between Consignment and Sale**

S.No.	Base	Consignment	Sale
1	Relation	The relation is that of ‘consignor’ and consignee. Consignee becomes the debtor of consignor on sale of goods and not on receipt of consigned goods.	The relation is that of buyer and seller or debtor and creditor. The buyer becomes the debtor of seller as soon as the sale is made.
2	Remuneration	Commission is the remuneration by the consignor to consignee.	No such remuneration is given or taken.
3	Profit/Loss	Consignor is entitled to profit or responsible for loss on goods sold by consignee.	On the profit or loss on the resale of the goods, buyer is entitled or liable.
4	Invoice	Here pro forma invoice is sent on consignment as it is merely shifting the place of goods.	Here invoice is sent on sale of goods as it is sale of goods i.e. transfer of place as well as ownership of goods.
5	Transfer	Here the risk of the goods sent continues to be on the consignor.	Here the risk of the goods sold is shifted on to the buyer.
6	Consignment expenses	Expenses paid by consignee for consignment are reimbursed by the consignor.	Expenses paid by the buyer for the goods are not reimbursed by seller.
7	Ownership	On the goods sent the consignor continues to be the owner of goods till they are sold by the consignee.	On goods sold, the seller ceases to be the owner as it is sold by the seller.
8	Return of goods	Goods remained unsold with consignee may be returned to consignor.	Goods lying unsold with the buyer cannot be returned to the seller without seller’s consent.

9	Discount/ allowance	No discount or allowance is given by the consignor on the goods sent.	Seller gives attractive discount and allowances on the goods sold.
10	Bad debts	Consignor is liable for bad debts unless del credere commission is given.	Buyer only will be liable of for bad debts as he becomes the owner of goods.
11	Account sale	Periodical submission of account sale by consignee is compulsory along with the remittance.	Once the goods are sold, buyer is at no obligation for any periodical submission of any such statement.

### Remuneration of Consignee

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

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

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

### Difference between ordinary and del credere commission

S.No.	Base	Ordinary commission	Del credere commission
1	Receiver	This is given to all agents.	This is given to the agent(s) ready to bear the loss of bad debts.
2	Guarantee	Here the agent guarantees the amount of cash sales only.	Here the agent guarantees the realization from credit sales.
3	Calculation	It is calculated on total sales i.e.	It is also calculated on total sales if



		cash sales plus credit sales.	otherwise specifically asked.
4	Net commission	Gross and net commission income of agent is same.	Gross commission is reduced by the amount of bad debts.

### Difference between del credere and overriding commission

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

### In the books of Consigner

### Consignment Account

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

	Consignee (Bad debts)	...			
	To Bills receivable (Discount)	.....			
	To Con. Stock-res.1 A/c	...			
	(Loading) To Profit & Loss	.....			
	A/c (Profit)	...			
		.....			.....
		...			...

### Consignee

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

### Difference between normal and abnormal loss

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

		seepage, sublimation, evaporation etc.	accident, floods etc.
7	Men or God	They are God made	They may be God made or manmade.
8	Expectancy	They are expected	These are always unexpected.

## **UNIT- V**

### **INTRODUCTION**

Apart from the readjustment of rights of partners in the share of profit by way of change in the profit-sharing ratio and admission of a new partner or for retirement/death of a partner, another important aspect of partnership accounts is how to close books of accounts in case of dissolution. In this Unit, we will discuss the circumstances leading to the dissolution of a partnership firm and accounting treatment necessary to close its books of accounts. Also, we will discuss the special problems relating to the insolvency of partners and the settlement of the partnership' liabilities

### **CIRCUMSTANCES LEADING TO DISSOLUTION OF PARTNERSHIP**

A partnership is dissolved or comes to an end on:

- a) the expiry of the term for which it was formed;
- b) completion of the venture for which it was entered into;
- c) death of a partner;
- d) insolvency of a partner

However, the partners or remaining partners (in case of death or insolvency) may continue to do the business. In such a case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved.

### **CONSEQUENCES OF DISSOLUTION:-**

On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards, the capital contributed by partners is repaid and, if there is still a surplus, it is distributed among the partners in their profit-sharing ratio.

Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm leftover are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit- sharing ratio.

According to the provisions contained in section 48 of the Partnership Act, upon dissolution of the partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

- (a) Losses including deficiencies of capital are paid, first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.
- (b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:
- (c) In paying the debts of the firm to third parties;
- (d) In paying to each partner ratably what is due to him from the firm in respect of advances as distinguished from capital;
- (e) In paying to each partner what is due to him on account of capital; and

**The residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.**

### **CONSEQUENCES OF INSOLVENCY OF A PARTNER**

If the capital account of a partner is in debit, after his share of loss or profit has been adjusted therein, the firm will not have sufficient cash or assets to pay off the amounts due to the other partners, until the amount is repaid by the partner whose account is in debit. If however, the partner is insolvent, the amount will not be realized. In such a case, the deficiency may be borne by the solvent partners in their profit-sharing ratio or according to the principle settled in the well-known case of *Garner vs. Murray*. In the latter case, the deficiency would be borne by the solvent partners in proportion to their capitals and not in the proportion in which they share profits and losses.

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudications made
2. The firm is dissolved on the date of the order of adjudication unless there is a contract title contrary.
3. The estate of the insolvent partner is not liable for any ac of the firm after the date of the order of, adjudication, and
4. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication

### **LOSS ARISING FROM INSOLVENCY OF A PARTNER**

When a partner is unable to pay his debt due to the firm, he is said to be insolvent and the

share of loss is to be borne by other solvent partners following the decision

According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realization of assets to be borne by all partners (including insolvent partner) in the profit-sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

### **Capital Ratio on Insolvency**

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary, etc. are done through Current Accounts, which may have debit or credit balances, and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and drawings to the date of dissolution but before adjusting profit or loss on Realization Account.

If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear the loss on account of the insolvency of other partner.

### **Insolvency of all Partners:-**

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances, it is better not to transfer the amount of creditors to Realization Account. The balance of the creditors' accounts is transferred to Deficiency Account.
- Creditors may be paid the amount available including the amount contributed by the partners.
- The unsatisfied portion of the creditor account is transferred to the Capital Accounts of the partners in the profit-sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

## **PIECEMEAL PAYMENTS**

Generally, the assets sold upon dissolution of partnership are realized only in small installments over a period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected. Usually, the first course is adopted. In order to ensure that the distribution of cash among the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made.

### **Maximum Loss Method:-**

Each installment realized is considered to be the final payment i.e., outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a distribution is made, following either Garner vs. Murray Rule or the profit-sharing ratio rule.

### **Highest Relative Capital Method**

According to this method, the partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit-sharing ratio, is first paid off. This method is also called as proportionate capital method.

For determining the amount by which the capital of each partner is in excess of his relative capital, partners' capitals are first divided by figures that are in proportion to their profit-sharing ratio; the smallest quotient will indicate the basic capital. Having ascertained the partner who has the smallest basic capital, the amount of capital of other partners proportionate to the profit-sharing ratio of the basic capital is calculated. These may be called as their hypothetical capitals. The amount of hypothetical capital of each partner is then subtracted from the amount of his actual capital; the resultant figure will be the amount of excess capital held by him. By repeating the process once or twice, as may be necessary between the partners having excess capital, the amount by which the capital of each partner is in excess will be ascertained. The partner with the largest excess capital will be paid off first, followed by payment to the other or others who rank next to him until the capital of partners are reduced to their profit-sharing ratio.

## **DISSOLUTION OF PARTNERSHIP FIRM WITH INSOLVENCY**

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

**Model of dissolution of firm** –

### **1) Dissolution without the intervention of the court**

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

**2) Dissolution by the court**

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

**Steps in the Dissolution Process –**

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

**Accounting treatment on dissolution of firm –**

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

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

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

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

**3. Partner's capital accounts** – All the reserved and undivided profit or loss, realization profit or loss,



balance of current accounts. Now the difference is adjusted in cash if there is credit balance it is surplus to be withdrawn by the concerned partner from their personal resources. Entry for surplus withdrawn or deficiency brought in by the concerned partner from their personal resources.

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

#### Format of Accounts Realisation A/c

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

#### Partner's Capital A/cs

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

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

### Insolvency of Partners

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

### Amalgamation of Partnership Firms

#### Meaning:

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

### Conversion of Partnership Firm into Joint Stock Company

#### Meaning:

To avail the facilities and advantages available to joint stock companies under Companies Act 1956, some partnership firms convert themselves into company. A company is formed to purchase

the business of the firm. The purchase consideration is discharged by the company in the agreed mode. The shares and debentures received in the payment of purchase consideration are divided amongst partners. The partners become the shareholders of the company. Thus the firm is dissolved and a new company comes into being. The following are the two major advantages of conversion:

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

### **Purchase Consideration Meaning:**

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

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

The following points should be considered while calculating purchase consideration:

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

### **Distribution of purchase price amongst partners**

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

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

## **Introduction to computerized accounting Tally ERP**

Introduction to Tally ERP 9, a computerized accounting software, marks a significant step forward in streamlining financial management processes for businesses of all sizes. Tally ERP 9, developed by Tally Solutions Pvt. Ltd., offers a comprehensive suite of features designed to automate and simplify accounting, inventory management, taxation, payroll, and various other aspects of business operations. Let's explore the key components and benefits of Tally ERP 9:

### **1. User-Friendly Interface:**

- Tally ERP 9 boasts an intuitive and user-friendly interface, making it accessible to accounting professionals and business owners with varying levels of expertise.

### **2. Accounting Modules:**

- Tally ERP 9 provides robust accounting functionalities, allowing users to efficiently manage ledger accounts, track receivables and payables, reconcile bank transactions, and generate financial statements such as balance sheets, profit and loss statements, and cash flow statements.

### **3. Inventory Management:**

- Businesses can effectively monitor and control their inventory with Tally ERP 9's inventory management module. Users can track stock levels, record stock movements, manage multiple warehouses, and generate reports to analyze inventory performance.

### **4. Statutory Compliance:**

- Tally ERP 9 ensures compliance with various statutory requirements and tax regulations. It supports GST (Goods and Services Tax) compliance in India and enables businesses to generate GST invoices, file GST returns, and reconcile GST data effortlessly.

### **5. Remote Access and Collaboration:**

- With Tally ERP 9's remote access capabilities, users can securely access their accounting data from anywhere, anytime, using a web browser or Tally's mobile app. This facilitates collaboration among team members and allows for real-time data sharing and updates.

### **6. Payroll Management:**

- Tally ERP 9 simplifies payroll processing by automating tasks such as salary calculations, tax deductions, employee attendance tracking, and generation of payslips. It ensures accuracy and compliance with payroll regulations.

### **7. Business Insights and Reporting:**

- Tally ERP 9 offers powerful reporting tools that enable users to gain valuable insights into their business performance. Users can generate customizable reports, analyze financial data, identify trends, and make informed decisions to drive business growth.

## **8. Security and Data Protection:**

- Tally ERP 9 prioritizes data security and provides robust security features to safeguard sensitive financial information. It offers user-level access controls, data encryption, audit trails, and backup and restores capabilities to prevent unauthorized access and data loss.

## **9. Scalability and Integration:**

- Tally ERP 9 is highly scalable and can adapt to the evolving needs of businesses as they grow. It supports integration with third-party applications and services, allowing for seamless data exchange and workflow automation.

## **10. Continuous Updates and Support:**

- Tally Solutions regularly releases updates and enhancements to Tally ERP 9, ensuring that users have access to the latest features and compliance updates. Additionally, users can benefit from Tally's extensive support network, including online resources, forums, and customer support services.

In summary, Tally ERP 9 revolutionizes accounting and financial management by offering a comprehensive and feature-rich solution that empowers businesses to streamline their operations, ensure compliance, and make informed decisions for sustainable growth. Its user-friendly interface, robust functionalities, and continuous support make it a preferred choice for businesses seeking to modernize their accounting processes.