PEHAL EDU-CARE

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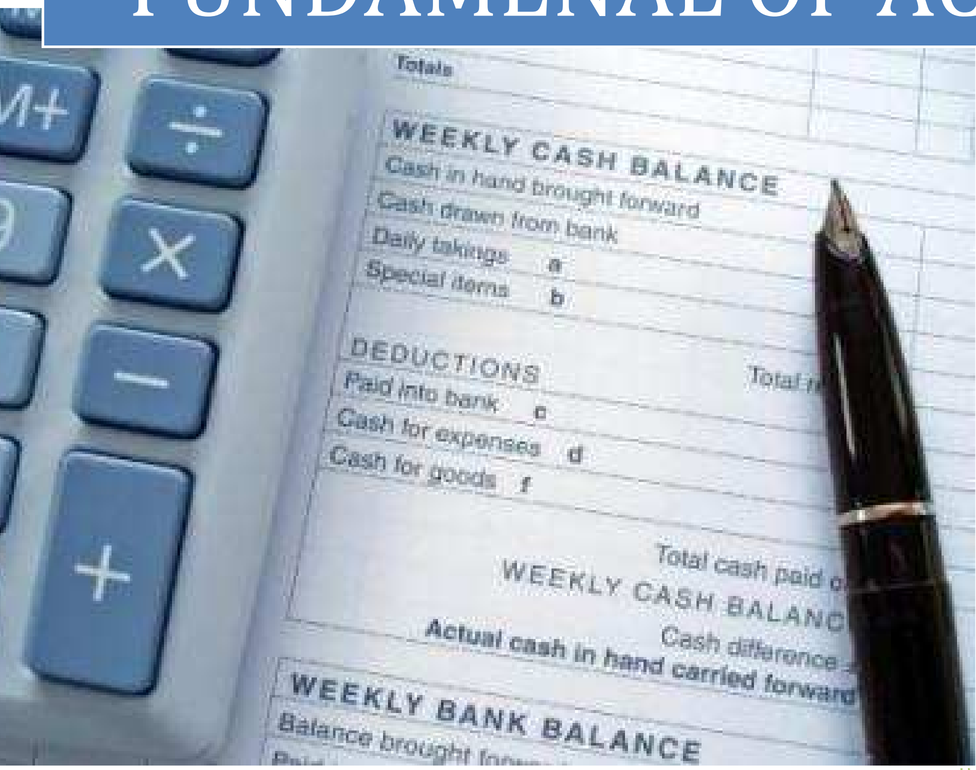
# FUNDAMENAL OF ACCOUNTING




## CPT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# Accounting Concepts, Principles and Conventions

**Accounting Concepts-** Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared.

**Accounting Principles-** Accounting principles are the body of doctrines commonly associated with the theory and procedures of accounting serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternative exists.

**Accounting principles must satisfy the following conditions:**
1. They should be based on real assumptions.
2. They must be sample, understandable and explanatory.
3. They must be followed consistently.
4. They should be able to reflect future predictions.
5. They should be informational for the users.

**Accounting Principles-** Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These conventions are derived by usage and practices.

**1. Entity Concept-** Entity concept states that the business enterprise is a separate identity apart from its owner. Entity concept means that the enterprise is liable to the owner for capital invested by him. Capital invested by the owner is treated by the liability of the business because of this concept and owner has the claim on the profit of the business

**2. Money Measurement Concept**-As per this concept, only those transactions which can be measured in terms of money are recorded. Transactions, even if they affect the results of the business materially, are not recorded if they are not convertible in monetary terms. For the examples employees of the business are the assets of the organizations but their measurement in monetary term is not possible therefore not recorded in the books of account of the organizations. This concept ignores that money is an inelastic yardstick for measurement as it is based on the implicit assumptions that purchasing power of the money is not of sufficient important as to require adjustment. Many transactions and events are not recorded in the books of accounts just because they cannot be measured in monetary terms. Therefore it is recognized by all the accountants that this concept has its own limitations and inadequacies.

**3. Periodicity Concept-** This is also called the period of definite accounting period. According to this concept accounts should be prepared at the end of every accounting period. This period makes the accounting system workable and term accrual meaningful. Accounting concepts is helpful in:
1. Comparing of financial statements of different periods
2. Uniform and consistent accounting treatment for ascertaining the profit and assets of the company
3. Matching periodic revenue with expenses for getting correct results of the business operations.

**4. Accrual Concepts-** under accrual concept, the effects of transactions and other events recognized on mercantile basis i.e. when they occur, they are recoded whether payment has been made or not made. Accrual means recognition of revenue and costs as they are earned or incurred not as money is received or paid. The accrual concept relates to measurement of income, identifying assets and liabilities.

**5. Matching Concept-** In this concept all expenses matched withed the revenue of that period should only be taken into consideration. In the financial if any revenue is recognized, and then expenses related to that revenue should also be recognized. It is necessary that every expense identify every income. This concept is based on accrual concept as it considers the occurrence of the expenses and income and do not concentrate on actual inflow or outflow of cash.

**6. Going Concern Concept-** The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operations for the foreseeable future. The valuation of assets of the business is dependent on this assumption. Traditionally histirical cost is followed.

**7. Cost Concept-** By this concept, the value of van asset is to be determined on the basis of historical cost, in other words acquisition cost. This concept is followed in the interest of *objectivity.*

**8. Realization Concept-** It closely follows the cost concept. Any change in the value of assets is recorded only when it is realized. However under this concept all probable losses are considered any probable gain is not accounted for.

**9. Dual Aspect Concept-** This concept is the core of double entry book-keeping. Every transaction or event has two aspects. It means if the enterprise acquires an asset it has to depart from another in form payment of cash or obligation to pay in future resulting increase in liability. Accounting equation is based on this concept based on which balance sheet is prepared. Accounting equation may be explained as follows:
**Assets= Capital + Liability or Assets-Capital= Liability or Assets- Liability=Capital**
Accounting equation suggests the fact that for every debit there is an equivalent credit.

**10. Conservatism-** This concept suggests that all possible losses should be provided for but any anticipated loss should not be considered. When there are many alternative values of assets lesser value should be recorded in the books. *'Cost price or market price whichever is lower'* is recorded in the books originated from this concept.
For this concept there qualities are required:
1. Prudence 2. Neutrality 3. Faithful presentation of alternative values.

**11. Consistency-**In order to achieve comparability of financial statements of an enterprise through time, accounting policies are followed consistently from one period to another; a change in accounting policies are made only in exceptional cases.
The concept of consistency is applied when accounting method of accounting is equally acceptable. For example a company can adopt straight line or diminishing balance method of depreciation. But following the principles of consistency it is advisable to follow the same method of depreciation over a period of time.
Changes should be made only in the following cases:
1. To bring books of accounts in accordance with the issued Accounting Standard.
2. To compliance with the provision of law.
3. When under changed circumstances it is felt that new method will reflect more true and fair picture it the financial statement.

**12. Materiality-**This principle permits other concepts to be ignored, if the effect is considered material. This principle is an exception of full disclosure. According to this principle, all the items having significant effect on the business should be disclosed in the financial statement and any insignificant item which will only increase the work of the accountant, should not be disclosed. It is on the judgement, common sense and discretion of the accountant which item is material and which is not. For example depreciation on calculator purchased is shown 100% in the year it is purchased. This is because amount of calculator is very small to be shown in the balance sheet though it is an asset of the business.

**<u>Fundamental Accounting Assumptions</u>**
1. Going concern 2. Consistency 3. Accrual

**<u>Four principal qualitative characteristics of financial statements are:</u>**

| | | | |
|---|---|---|---|
| Understandability | Relevance | Reliability | Comparability |

**Other Characteristics:**
1. Materiality 2. Faithful Representation 3. Substance Over Form 4. Neutrality 5. Prudence
6. Full, fair and adequate disclosure 7. Completeness

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## <u>Meaning and Scope of Accounting</u>

The American Institute of Public Accountants formulated definition in 1961

Accounting is an 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 result thereof.

### Procedure of Accounting

| | | | | | |
|---|---|---|---|---|---|
| Recording | Classifying | Summarising | Analysing | Interpreting | Communicating |

**1. Recording-** This is the basic function of accounting. This is the first stage of accounting. Recording is done in the book called *'Journal'*. **2. Classifying-**

Classification is concerned with the systematic analysis of the recorded data. The book containing classified information is called *' Ledger'.* ***3.***

**Summarising-** This process leads to the preparation of the following financial statements:
i) Trial Balance ii) Balance Sheet iii) Profit & Loss A\C iv) Cash-Flow Statement

**4. Analysing-** it means methodical classification of the data given in the financial statements. It is concerned with the establishment of relationship between the items of the Profit & Loss A\C and the Balance Sheet.

**5. Interpreting-** This is the final function of the accounting. The recorded financial data is analysed and interpreted in a manner that will enable the end-users to make a meaningful judgment about the financial condition and profitability of the business.

**6. Communicating-** It is concerned with the transmission of summarized, analysed and interpreted information to the end-users.to make them enable them to take rational decision.

**Users of Accounting Information:**

| Internal Users | External Users |
|---|---|
| Board of Directors | Investors |
| Partners | Lenders |
| Managers | Suppliers |
| Officers | Government Agencies e.g. Income Tax Department |
| | Employees |
| | Customers |

**Objectives of Accounting**

| | |
|---|---|
| 1. Systematic recording of transactions | Journal, Ledger |
| 2. Ascertainment of transactions | Manufacturing A\C, Trading A\C, Profit & Loss A\C |
| 3. Ascertainment of financial position of the business | Balance Sheet |
| 4. Providing information to the users for rational decision-making | Financial Reports |
| 5. To know the solvency position | ************** |

**Functions of Accounting:**

| | | | | | |
|---|---|---|---|---|---|
| Measurement | Forecasting | Decision Making | Comparison & Evaluation | Control | Government Regulation & Control |

**Book-Keeping-** Book-keeping is an activity concerned with the recording of financial data relating to business operation in a significant and orderly manner.

**Objectives-**

| | |
|---|---|
| Complete recording of transactions | Ascertainment of financial effect on the transactions |

## DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

| S.No. | Book-keeping | Accounting |
|---|---|---|
| 1 | It is a process concerned with recording of transaction. | It is a process concerned with summarizing of the recorded transaction |
| 2 | It is constitutes as a basic of accounting | It is considered as a language of the business |
| 3 | Financial statements do not from part of the process. | Financial statements are prepared in this process on the basic of book-keeping records. |
| 4 | Managerial decisions cannot be taken with the help of this record. | Management takes decision on the basic of this record. |
| 5 | There is no sub-field of book-keeping. | It has sub-fields likes financial accounting, management accounting etc. |
| 6 | Financial position of the business cannot be ascertained though book-keeping records. | Financial position of the business is ascertained on the basic of the accounting reports. |

**Sub-fields of Accounting**

1. Financial Accounting 2. Management Accounting 3. Cost Accounting
4. Social Responsibility Accounting 5. Human Resource

## Accounting Policies

**Basis of selection of accounting policies:**

| | | |
|---|---|---|
| Prudence | Substance over Form | Materiality |

**Space for Important Notes:**

# JOURNAL & LEDGER

## Types of Accounts

**1. Personal Account-** The accounts which are related with the persons and companies are called personal accounts. Ex. Ram A\C, Renu Pvt. Ltd. Co. etc.
**2. Real Account-** Real Accounts which are related with assets (excluding debt) are called real accounts.
Ex. Building A\C , Cash A\C , Goodwill A\C
**3. Nominal Account-** The accounts which are related with expenses & losses and incomes & gains are called nominal accounts. Ex. Salary A\C, Rent A\C etc.

## Golden Rules \ Rules for Debiting and Crediting

**A. Personal Account-** i. Debit the receiver.
ii. Credit the giver.
**B. Real Account-** i. Debit what comes in.
ii. Credit what goes out.
**C. Nominal Account-** i. Debit all expenses and losses.
ii. Credit all incomes and gains.

Journal-It is the book of original entry in which primary record of both aspects of a business transaction is recorded in order in which they arise i.e. *in chronological* order. A journal is called as *books of original records or books of primary entries.*
**Ledger-** For each and every item or group of items of similar nature, an account is opened in a separate Book called ledger. A ledger is a set of accounts.

**Space for Important Notes:**

# Trial Balance

**Trial Balance-** It is a statement in which debit and credit balances of all the accounts of the ledger including cash and bank balances (taken from cash book) are shown to test arithmetical accuracy of the books of the accounts.

**Objectives-**

1. It ensures the arithmetical accuracy of the books.
2. It helps to prepare final accounts.
3. Some mistakes are detected by trial balance.
4. It is just summary of the contents of the ledger.

**Errors disclosed by the Trial Balance**

1. Partial omission of posting an amount in ledger.
2. Wrong totaling of subsidiary books.
3. Errors in extraction of Trial Balance.
4. Debit or credit entries are not entered at all.
5. Same entry enters twice.
6. Debits are entered as credits and vice-versa.
7. Errors in calculating the balance of an account.
8. Balance of an account entered wrongly in Trial Balance.
9. Difference in amount between the entries.

**Errors not disclosed by the Trial Balance**

1. Errors of omission
2. Compensating Error
3. Errors of principles entering both aspects of transaction twice in the books of accounts.
4. Errors in entering a transaction on the correct side of a wrong account (errors of misposting)
5. Entering wrong account bin the books of original entry (errors of commission).

**Suspense Account-** If two sides of Trial Balance do not agree, it implies that there are certain one-sided errors in the books of account. If it is not possible to locate the errors, the amount of difference in Trial Balance is put in the account known as Suspense Account. If debit side of Trial Balance exceeds the credit side the difference in the Trial Balance is transferred to the credit side of the Trial Balance.

# SUBSIDIARY BOOKS

**Sub-division of journal:**

**1. Cash Book-**All cash transactions are recorded in the cash book.

**2. Purchase Day Book-**All credit purchases of goods not assets are recorded in it.

**3. Sales Day Book-** All credit sales of goods not assets are recorded in it.

**4. Purchases Returns Book-**Returns out of credit purchases are recorded in it.

**5. Sales Returns Book-** Returns out of credit sales are recorded in it.

**6. Bills Receivable Book-**Receipt of bills from debtors is recorded in it.

**7. Bills Payable Book-** Issue of bill to creditor is recorded in it.

**8. Journal Proper-** Transactions not recorded in the above books are recorded in this book. It is divided in four parts which are as follows-

**i) Opening Entries ii) Closing Entries iii) Adjustment Entries iv) Rectification Entries**

**Important Points:**

i) Sales tax is calculated on net price i.e. price after deduction of trade discount.

ii) Excise duty and other local taxes are calculated on gross price i.e. the price before deduction of trade discount.

**QUESTIONS:**

1. Credit purchases of goods are recorded in the a) Cash Book b) Purchase Book c) Journal Proper Book d) Journal Book
2. Credit sale of assets is recorded in the a) Cash Book b) Sales Book c) Journal Proper Book d) Sales Return Book
3. Recovery of money earlier written off as bad debt is recorded in the a) Cash Book b) Journal Proper Book c) Sales Book d) Purchases Book
4. Cash paid for return of goods is recorded in the a) Cash Book b) Return Inward Book c) Return Outward Book d) Either a or b
5. A separate column for cash discount is prepared in the a) Purchases Book b) Sales Book c) Cash Book d) Journal Proper Book
6. Sales tax is calculated on a) Gross Price b) Net Price c) Either a or b d) Neither a or b
7. Excise duty is calculated on a) Gross Price b) Net Price c) Either a or b d) Neither a or b
8. A debit note issued by us for goods return is accounted for a) Purchase Return Book b) Sales Return Book c) Journal Proper Book d) Cash Book
9. Salary outstanding is recorded in the a) Purchase Return Book b) Sales Return Book c) Journal Proper Book d) Cash Book
10. Cash received Rs. 1000 in full settlement of a debt of R. 1010. Discount allowed in this case recorded in the a) Purchases Book b) Sales Book c) Cash Book d) Journal Proper Book
11. The purchase day book is a part of a) journal b) Ledger c) Trial Balance d) Balance Sheet

# Cash Book

**Cash Book-** Cash Book is a *Subsidiary Book*. It is also called *Primary Book*. It is also called journalized ledger as it serves the purpose of the Journal and Ledger. It is a Real A\C. Inflow of cash is recorded on the debit side and outflow of cash is recorded on the credit side.

**Kinds of Cash Book**

1. Single Column Cash Book
2. Double Column Cash Book
3. Triple Column Cash Book

**Petty Cash Book-** In big business houses under main cashier a petty cashier is appointed. He is entrusted the task of making small payments.

**Imprest Petty Cash-**Under this system petty cashier is given a fixed amount to make the small payments and at the end of each month he is reimbursed the amount he has paid during the amount so that the minimum amount (called imprest amount) can be maintained.

**Contra Entries-** When entries for the same transactions are recorded on the both side of the cash book, those entries are called contra entries

**Space for Important Notes:**

# Bank Reconciliation State*m*ent

**Bank Reconciliation Statement-**

**Important Points-**

A. Cash Book is maintained by 'The Business'.
Pass Book is maintained by 'The Bank'.
B. Cash Book debit balance means 'Favorable Balance'.
Cash Book credit balance means 'Unfavorable or Overdraft Balance'.
Pass Book debit balance means 'Unfavorable or Overdraft Balance'.
Pass Book credit balance means 'Favorable Balance'.
C. Cash Book-Debited indicates 'Increase in Bank Bal'.
Cash Book-Credited indicates 'Decrease in Bank Bal'.
Pass Book-Debited indicates 'Decrease in Bank Bal'.
Pass Book-Credited indicates 'Increase' in Bank Bal.

**There are four reasons why balance of Cash Book does not agree with the balance of Pass Book:**
1. Entries recorded in the Cash Book but not recorded in the Pass Book.
2. Entries recorded in the Pass Book but not recorded in the Cash Book.
3. Some wrong treatment in Cash Book.
4. Some wrong treatment in Cash Book.

**Amended Cash Book-** Sometimes before preparing B.R.S. an Amended Cash Book is prepared which gives revised bank balance as per Cash Book and with the revised bank balance B.R.S. is prepared.

**Entries to be recorded in the Amended Cash Book-**
1. Wrong entries passed in the Cash Book.
2. Entries not recorded in the Cash Book.

**Space for Important Notes:**

## BILLS OF EXCHANGE

**Bills of exchange-** A bill of exchange is an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

**Features of bill of exchange**

1. It must be in writing.
2. It must contain an order to pay which is express or unconditional.
3. It must be signed by the drawer.
4. The drawer, drawee and payee must be certain, definite and individual.
5. The amount of the bill must be certain
6. The amount must be payable to a definite person or according to his order to the bearer of the bill.
7. The bill must be accepted by the party (drawee) on whom bill is drawn.
8. There must be definite date of payment.
9. It must be properly stamped and dated.
10. It is made by the drawer.
11. Basically there are three parties- drawer, drawee and payee.

**Promissory Notes-** A promissory note is an instrument in writing, not being a bank note or a currency note containing an unconditional undertaking signed by the banker to pay a certain sum of money only to the bearer of certain person.

**Features of the promissory notes**

1. It must be in writing.
2. It must contain clear promise to pay.
3. The promisor, the maker must sign the promissory note.
4. Maker must be a certain person.
5. The payee (one who is to receive money) must also be certain person.
6. The sum payable must be certain.
7. Promissory note must not be payable to bearer.
8. It must be properly stamped.

9. There are two parties of the promissory note – maker and payee.
10. It is made by the promisor.

**Parties of a bill of exchange**

**1. Drawer-** Drawer is the creditor who draws the bill. For him bill is the Bill Receivable.
**2. Drawee-** Drawee is the debtor who accepts to pay the bill. For him bill is the bill payable.
**3. Endorser-** Endorser is one who endorses the bill to settle his account with his creditor.
**4. Endorsee-** Endorsee is one who receives the bill from the endorser.
**5. Payor-** Payor is the drawee who pays the bill.
**6. Payee-** Payee is one who receives the payment from the drawee. One who holds the bill at the time of maturity, receives the payment.

**Different treatment of the bill**

**1.Honour of the bill-** When bill is paid at the maturity, it is called honour of the bill.
**2.Dishonour of the bill-** When bill is not paid at the maturity, it is called dishonor of the bill.
**3.Discounting of the bill-** Sometimes holder of the bill being in need of money before the due approaches his banker to pay against the bill. Bank pays the amount of bill after deducting the interest for that period. This process of raising fund from the bank called discounting of bill.
**4.Endorsement of bill-** Sometimes holder of the bill sends the bill to his creditor to pay his dues. It is called endorsement of bill.
**5.Bill sent for collection-** Sometimes holder of the bill sends the bill to his banker for collection. This is called bill sent for collection. On due date bill collects the amount on behalf of the party and credits his account with the amount.
**6.Renewal of the bill-** In case drawee is not able to pay the bill on the due date sometimes he requests the holder of the bill to give him further time. At his request holder of the bill sometimes cancelles the old bill and draws a new bill. It is called renewal of the bill. New bill may include interest for the further period and noting charges, if any.
**7.Retiring of the bill-** Sometimes drawee having sufficient fund pays the bill before the due date. For making early payment he gets some rebate on the bill. So payment of the bill before the due date is called retiring of the bill.

**Distinguish between Bill of Exchange and Promissory Note.**

| Bills of Exchange | Promissory Note |
|---|---|
| 1.In a bill there are three parties | In a promissory note there are two parties |
| 2. In a bill there is an unconditional order to pay. | In a promissory note there an unconditional promise to pay. |
| 3. The liability of the drawer of a bill is secondary and conditional. | The liability of the maker of a promissory note is primary and absolute. |
| 4. The drawer of an accepted bill stands in | The maker of a promissory note stands in |

| | |
|---|---|
| immediate relation with the acceptor not the payee | immediate relation with the payee. |
| 5. A bill must be accepted by the drawee or someone else on behalf of the drawee. | A promissory note does not require any acceptance. |
| 6. In a bill of exchange drawer (maker) and the payee may be the same person. | In a promissory note maker and the payee will never be the same person. |

**JOURNAL ENTERIES**

| TRANSACTIONS | BOOKS OF DRAWER | BOOKS OF DRAWEE |
|---|---|---|
| **A. When bill is retained by the drawer**<br>1.For bill drawn | Bills Receivable A\C Dr.<br>To Drawee A\C | Drawer A\C Dr.<br>To Bills Payable A\C |
| **2. For interest*** | Drawee A\C Dr.<br>To Interest A\C | Interest A\C Dr.<br>To Drawer A\C |
| 3. For maturity of bill | Cash A\|C Dr.<br>Rebate on bill A\C ** Dr.<br>To B\R A\|C | B\P A\C Dr.<br>To Cash A\C<br>To Rebate on bill A\C |
| 4.For dishonor of the bill | Drawee A\C Dr.<br>To B\R A\C | B\P A\C Dr.<br>To Drawer |
| | | **BOOKS OF BANK** |
| **B. When bill is discounted**<br>5. For discounting of the bill | Bank A\C Dr.<br>Discount bon bill A\C Dr.<br>To B\R A\C | Discounting of bill A\C Dr.<br>To Drawer A\C<br>To Discounting Charge A\C |
| 6. For maturity of bill | NO ENTRY | Cash A\C Dr.<br>To Discounting of bill |
| 7. For dishonor of bill | Drawee A\C Dr.<br>To Bank A\C<br>( including noting charge, if any) | Drawer A\C Dr.<br>To Discounting of bill A\C<br>To Noting Charges A\C |
| **C. When bill is sent for collection**<br>8. For bill sent for collection | Bill sent for collection A\C Dr.<br>To B\R A\C | NO ENTRY |
| 9. For maturity of bill | Bank A\C Dr.<br>Collection Charges A\C Dr.<br>To Bill sent for collection A\C | Cash A\C Dr.<br>To Drawer A\C<br>To Collection Charges A\C |
| 10. For dishonor of bill | Drawee A\C<br>To Bill sent for collection A\C | NO ENTRY |
| | **Books of Endorser or Drawer** | **Books of Endorsee** |

| | | |
|---|---|---|
| **D. When bill is endorsed**<br>11. For endorsement of bill | Endorsee A\C Dr.<br>To B\R A\C | B\R A\C Dr.<br>To Endorser A\C |
| 12. For maturity of bill | NO ENTRY | Cash A\C Dr.<br>To B\R A\C |
| 13. For dishonor of bill | Drawee A\C Dr.<br>To Endorsee A\C | Endorser A\C Dr.<br>To B\R A\C |
| | | |

**NOTES-** * Interest on bill is generally added in the case of renewal of the bill.
** Rebate on bill is generally allowed in the case of retiring of bill.

**Some More Important Terms**

**Grace Period-** Additional period of three days given to the drawee to pay the bill, is called grace period.

**Noting Charges-** whenever a bill is dishonored, it is the customary for the holder of such bill to have the fact of dishonor noted and certified by an officer called Notary. The charges payable to the Notary for this services is called noting or protesting charges.

**Rebate on bill-** It is given to the drawee when bill is paid before the due date.

**Accomodation of bill-** Generally a bill is drawn when sum is due. But sometimes a bill is drawn not to settle amount due but for the financial accommodation of the drawer as well as drawee. Then the bill is discounted, and the proceeds are utilized. Then on due date the drawer remits the fund to the drawee to honour of bill.

**Examples of Foreign Bill**

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

# DEPRECIATION

**Depreciation-**Depreciation is a permanent, continuing and gradual shrinkage in the book value of a fixed asset.

**Objectives of providing depreciation**

1. Correct income measurement
2. True financial position of business
3. Funds for replacement of new assets
4. Ascertainment of true cost of production

**Methods of charging depreciation**

**1. Straight Line Method**- Under this method depreciation is charged on original cost of the assets every year. Original cost includes purchase price, carriage on asset, installation cost and all other expenses regarding asset till it is installed. If the rate of depreciation is not given, depreciation is calculated as follows-

Depreciation= Purchase Price + carriage + Installation Cost- Scrap Value (Residual Value)\ Life
Of assets (No. of years)

**Features- 1**. Depreciation is charged on the original cost of the asset.
2. Amount of depreciation remains same every same every year.
3. Value of assets may become nil at the end of the life of the assets.
4. Calculation of depreciation is easy.

**2. Diminishing Balance Method-**Under this method depreciation is charged on the book value or written down value of assets i.e. the value cost less depreciation till last year.

**Features-**1. Depreciation is charged on book value of assets.
2. Amount of depreciation reduces every year.
3. Value of assets never becomes nil.
4. Calculation of depreciation is complex.

**Journal Entries**

1. For Purchase of assets
Assets A\C Dr.
To Cash\ Bank\ Creditors
2. For charging depreciation
Depreciation A\C Dr.
Assets A|C
3. For transfer of depreciation
Profit &Loss A\C Dr.
To Depreciation
4. For sale of assets

Cash\ Bank\ Debtors A\C Dr.

To Assets A\C

5. For loss on sale of assets

Profit &Loss A\C Dr.

To Assets A\C

6. For Profit on sale of assets

Assets A\C Dr.

To Profit & Loss A\C

**Other Methods**

**3. Sum of year's digits method-** in this method charge for depreciation for an accounting period is calculated in proportion of the remaining life of the asset at the beginning of every accounting period. Depreciation goes on decreasing every year.**Formula-**

Remaining life of the asset\ sum of the digits of the life of an asset X cost of asset-scrap value

**4. Sinking Fund Method-** Under this method annual depreciation is not deducted from asset but sinking fund is created with the annual depreciation. Apart from it amount of annual depreciation is invested every year outside the business. At the end investment is sold and the proceed is utilized to purchase a new asset to replace the old one.

**Journal Entries**

**First Year-**

For annual contribution

Depreciation A\C Dr.

To Sinking Fund A\C

2. For transfer of depreciation

Profit & loss A\C Dr.

To Depreciation A\C

3. For investing amount of depreciation

Sinking Fund Investment A\C Dr.

To Bank A\C

**Second Year**

For interest received

Bank A\C Dr.

To Interest on SFI A\C

For transfer of interest

Interest on SFI A\C Dr.

To Sinking Fund A\C

**Note- All three entries as in case of the first year will also be passed.**

**Last Year**

For sale of investment

Bank A\C Dr.

To SFI A\C

For profit

SFI A\C Dr.

To Sinking Fund A\C

For loss

Sinking Fund A\C Dr.

To SFI A\C

For sale of asset

Bank A\C Dr.

To Asset A\C

For transfer of sinking fund to asset account

Sinking Fund A\C Dr.

To Asset (old) A\C

**Balance of Old Asset A\C represents profit ( credit side being higher) or loss ( debit side being higher) which is transferred to P\L A\C.**

For purchase of new asset

Asset (new) A\C Dr.

To Bank A\C

**5. Provision for Depreciation Method-** Under this method depreciation is not deducted from asset a\c but it is credited to provision for depreciation a\c. Under this method asset is maintained at cost price. At the time of sale asset a\c is credited with the cost of asset sold

**Journal Entries**

For providing depreciation

1. Depreciation A\C Dr.

To Provision for Depreciation A\C

2. For transfer of depreciation

Profit & Loss A\C Dr.

To Depreciation A\C

3. For transfer of asset to asset disposal a\c

Asset Disposal A\C Dr.

To Asset A\C

4. For transfer of accumulated depreciation on asset sold to asset disposal a\c

Provision for Depreciation A\C Dr.

To Asset Disposal A\C

5. For sale of asset

Bank A\C Dr.

Profit & Loss A\C (if sold at loss)Dr.
To Asset Disposal A\C
To Profit & Loss A\C (if sold at profit)

**Note-** Asset Disposal A\C may alternatively not be opened; in that case, sale of asset will be credited to Asset A\C which will finally disclose the profit or loss.

**6. Machine Hour Method-** Depreciation is calculated after estimating the total number of hours that a machine would work during the year.

Depreciation= Cost X Total Machine Hours In a Year\Total Machine Hours in Life Time of the Machine

**7. Depletion Method-**This method is used in case of mines, quarries etc. containing only a certain quantity of product.

Depreciation= Cost X Total Quantity Extracted \ Total Quantity Stored

**8. Production Units Method-**Under this method depreciation is determined based on the total production during the year.

Depreciation= Total Cost- Scrap Value= Total Production during the year\ Total estimated production

**9. Provision for Repairs and Renewals-** Under this method estimated amount pof depreciation of entire life of the asset is added to the cost of asset and then based on this figure depreciation is calculated.

**<u>Change in the methods of depreciation</u>**

1. Prospective Method- Under this method change is effective when and from decision of change is decided.
2. Retrospective Method- Under this method change takes place from the very first year.

Steps-1. First compute depreciation under new method.
2. Then compute depreciation under old method.
3. Deduct depreciation calculated in step 2 from the depreciation calculated in step 2; if there is any surplus that should be debited to P\L A\C and if there is any deficit that should be credited to P\L A\C.

**Space for Important Notes:**

# Rectification of Errors

## Types of errors

**1. Errors of Principles-** These errors arise because of wrong application of accounting principles and failure to differentiate between capital and revenue and capital expenditure.

**Examples-** Wages paid for erection of machinery but wrongly debited to Wages A\C .
Sale of an asset but wrongly entered in sales book.
Purchase of an asset but wrongly entered in purchases day book etc.
Registration charges paid for a land but wrongly debited to Legal Expenses A\C.

**2. Compensating Errors-** These are a group of errors, the total effect of which are not reflected in the Trial Balance.

**3. Errors of Commission-** If an amount is recorded on the wrong side or in wrong account or the totals are wrong or a wrong balance is struck, it will be a case of error of commission.

**4. Errors of Omission-** If a transaction is completely or partly is omitted to be recorded, it is called error of omission.

## Stages of Rectifying Errors

1. Rectification before preparation of Trial Balance.
2. Rectification after preparation of Trial Balance.
3. Rectification after preparation of Final Accounts.

**Notes-** 1. In case of rectification of a single sided error, before preparation of Trial Balance, no entry is required is required, just a note called *Blank Entry* is written.

2. In case of rectification of a single sided error, after preparation of Trial Balance, Suspense A\C is opened to give effect double entry system.

**Space for Important Notes:**

# CAPITAL AND REVENUE EXPENDITURE

**Capital Expenditure-** Capital Expenditures are those expenses which are paid to acquire fixed assets (both tangible and intangible) benefit of which does not end in a financial year but the business uses it for many years.

**Revenue Expenditure-** Revenue expenditures are incurred to meet the expenses which are essential to run the business. Benefit of it may extend maximum for a period of 1 year.

**Deferred Revenue Expenditure-**Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is carried forward on the assumption that benefit of it will be received in a subsequent period.

**Capital Receipt-** Capital receipt is the money received other than the normal business activities

**Examples-** Issue of shares and debentures, sale of shares etc.

**Capital Profit-** Capital profit is the profit which arises out of sale of fixed assets. Another example of capital profit is premium received on issue of shares and debentures.

**Revenue Profit-** Revenue profit is the profit which arises out of normal and regular business activities.

**Some Examples of Capital Expenditure**

1. Purchase of any fixed asset including trade mark, patent right goodwill.
2. Payment of carriage to bring the asset.
3. Installation cost.
4. Repairing or overhaul expenses on any second hand asset.
5. Legal expenses to acquire fixed asset such as registration expenses, fees paid to lawyer.
6. Brokerage paid to acquire any fixed asset.
7. License fee to run a cinema hall.
8. Extension of fixed assets such as addition to building.
9. Change of mazor part of the machine.
10. Cost of temporary hut necessary at the site in the process of the construction of the premises.

**Some important examples of revenue expenditure**

1. Interest on loan taken for acquisition of a fixed asset.
2. Legal expenses to defend a suit claiming against the fixed property of the company
3. Repairs on existing assets.

**Some examples of deferred revenue expenditure**

1. Heavy advertising expenses
2. Preliminary expenses
3. Discount on issue of shares and debentures
4. Underwriting commission

## STOCK VALUATION

**Types of Inventories**

1. Raw Materials 2.Work-in-Progress or Semi-Finished Goods 3. Finished Goods

**Need of stock valuation**

1. Determination of Income 2.Ascertainment of Financial Position
3.Liquid Analysis 4.Statutory Compliance

**Inventory Record System**

1. Periodic Inventory System-Under this method, stock is ascertained physically. Under this system valuation is done at the end of the period.
2. Perpetual Inventory System- Under this system valuation of stock is done after each issue and receipt. Physical valuation is not done here.

Difference between periodic inventory system and perpetual inventory system

| Periodic Inventory System | Perpetual Inventory System |
|---|---|
| 1. This system is based on physical verification. | 1. It is based on book record. |
| 2. This system does not provide continuous information about stock and cost of sales. | 2. 2. This system provides continuous information about stock and cost of sales. |
| 3. This system determines inventory and considers cost of goods sold as residual value. | 3. It directly determines cost of goods sales and balancing figure is taken as closing stock. |
| 4. Cost of goods sold includes loss of goods as goods not in stock are assumed to be sold. | 4. Closing inventory includes loss of goods as all unsold goods are assumed to be in inventory. |
| 5. Under this method inventory control is not possible. | 5. Inventory control can be exercised easily. |
| 6. It requires closing of business for counting of stock. | 6. Stock can be valued without hampering the normal business activities. |

**Methods of Stock Valuation**

**1. FIFO Method-** Under this method, for the purpose of pricing the issues, it is assumed that materials received first are issued first.

**2. LIFO Method**- Under this method, for the purpose of pricing the issues, it is assumed that materials received lat are issued first.

**3. Simple average Method-** Under this method the rates of purchases represented by stock at the time of issue are added and then divided by the number of such rates to obtain the simple average rate at cost.

**4. Weighted Average Method-** Under this method total cost of materials in stock at the time of issue is divided by the total quantity of materials in stock to obtain the weighted average rate.

**5. Periodic Simple Average Method-** In this case the rates of purchases during a given period are added and then divided by number of such purchases during that period. Opening stock representing last year's purchases is not considered.

**6. Periodic Weighted Average Method-** In this case, to obtain rate of issues, all purchases during a given period in value (cost) are added and then it is divided by total quantity purchased. Here also opening stock representing last year's purchases is not considered.

**Note- Under both periodic simple average method and weighted average method all issues are made at a single rate.**

**Difference between LIFO and FIFO Method of Pricing**

| FIFO Method | LIFO Method |
|---|---|
| 1. In this case first receipts are issued first. | 1. In this case last receipts are issued first. |
| 2. In condition of rising prices, FIFO gives greater profit. | 2. In condition of falling prices, LIFO gives greater profit. |
| 3. FIFO puts emphasis on the balance sheet. | 3. LIFO puts emphasis on the income statement. |

**For B. Com Only-**

**Stock Level of Materials**

Maximum Level= Re-order level + Re-order quantity-(Minimum Consumption X Minimum order period)

Or, = Re-order level + Re-order quantity- Minimum Consumption in Given Period

Minimum level= Re-order level-( Average Consumption X Average re-order period) or,
Re-order Level-(Average Consumption Rate X Average Lead Time)

Re-ordering Level= Maximum Consumption X Maximum re-order period) or,
Average Consumption X( Minimum Stock for emergency + Avg. Lead Time) or,
Safety Stock + Lead Time Consumption

Average Level= Minimum Level + Maximum Level\ 2

Danger Level= Average Consumption X Lead Time For Emergency Purchases

**Economic Order Quantity=** 2AO\C **?**

Number of orders= Annual Consumption\ EOQ ( Order Size)

Time gap between two consecutive orders= 12 Months or 365 Days\ Number of Orders

Here ,A= Annual Consumption O= Ordering Cost C= Carrying Cost

## CONSIGNMENT

**Consignment-** It is a form of the business under which the entrepreneur appoints an agent to sell the goods. In consideration the agent gets commission.

### RELATED PARTIES

**Consignor:** He is the owner of the goods. He consigns the goods to the agent to sell on his behalf.

**Consignee:** He is the agent appointed by the consignor to sell the goods on his behalf. He gets commission on sales at a specified rate.

### TYPES OF COMMISSION

**Ordinary commission:** This commission is paid in each case. It is generally paid on sale price. But sometime it is paid on invoice price (I.P.).

**Del-credre commission:** This commission is paid when consignee agrees to bear bad debts. In this case bad debt is the loss of the consignee not of the consignor. So bad debt is not shown in the Consignment A\C. But consignee shows it in his book by passing the following entry-

Commission Earned A\C Dr.

To Bad Debt A\C

**Special commission:**

**i. Based on profit -**Sometime consignee is paid some portion of profit as commission.

**ii. Over-riding commission -**Some time consignee gets extra commission if he sells the good over and above I.P.

### Types of losses

**Normal Loss-** No accounting treatment is required for it . It is just deducted (in quantity) from total quantity to calculate the value of consignment stock (closing stock).It occurs regularly in the business.

**Abnormal Loss-**This is the loss which occurs accidentally and which does not occur regularly.

### Types of Expenses

**Recurring Expenses-** Expenses which are incurred for more than once on any particular lot of goods are called recurring expenses. In other words, expenses incurred after the goods arrive at the consignee's godown are called recurring expenses. Ex. Godown rent, selling expenses, advertisement, carriage outward, salesmen's commission etc.

**Non-recurring Expenses-** Expenses which are incurred only once on any particular lot of goods, are called non-recurring expenses. In other words, expenses incurred till the goods arrive at the consignee's godown. Ex. Loading expenses, unloading expenses, handling expenses, carriage to godown, dock dues, custom duty and clearing charges etc.

Note- Accounting treatment for it has been discussed later.

**Books of Consignor**- In the books of consignor following accounts are prepared

1. Consignment A\c ( Nominal A\C)
2. Consignee A\C ( Personal A\C)
3. Abnormal Loss A\C ( nominal A\C)
4. Goods Sent on Consignment A\c ( Nominal A\C)
5. Consignment Stock A\c (Real A\C)
1. 6. Stock Reserve A\c ( Nominal A\C)

**Books of Consignee**

1.Consignee A\C
2. Commission A\C

| **Computation of abnormal loss and value of closing stock** | Rs. |
|---|---|
| Cost of goods sent | **** |
| Add.Cosignor's Expenses | **** |
| | **** |
| Less- Abnormal loss | **** |
| | **** |
| Add. Consignee's non-recurring expenses | **** |

**JOURNAL ENTERIES:**
**Books of Consignor**

i. For goods sent on consignment -
Consignment a/c Dr
To Goods sent on consignment a/c
ii. For expenses paid by the consignor.
Consignment a/c Dr
To Bank a/c
iii. For exp. paid by the consignee
Consignment a/c Dr
To Consignee
iv. For commission payable to consignee
Consignment a/c Dr

To Consignee

v. For sale

Consignee a/c (cash) Dr

Consignment Debtros (credit) Dr

To consignment a/c

vi. For Bad debts

Consinment a/c Dr

To Consignee ( If no consignment debtor a\c is maintained)

To Consignment debbts A/c ( If consignment debtor a\c is maintained)

vii. For Abnormal Loss

Abnormal Loss a\c Dr.

To Consignment a\c

viii. For Insurance Claim Received

Consignee a\c Dr. (If received by the consignee)

Bank a\c Dr. ( If received by the consignor)

ix. For discount on bill transfer to consignment a\c

Consignment a\c Dr.

To Discount on bill a\c

**Note: Discount on bill may alternatively be debited to Profit & Loss A\C in place of debiting to Consignment A\C.**

**<u>CLOSING ENTRIES</u>**

x. For transfer of goods sent on consignment

Trading a/c Dr (if consignor is a manufacturer)

Purchases a/c Dr (if consigner is not a manufacture)

To Goods sent on consignment a/c

xi. For abnormal coss

Profit & Loss a\c Dr

To Abnormal Loss a\c

xii. For closing stock

Consignment stock a/c Dr

To consignment a/c

xiii. For profit on consignment

Consignment a/c Dr

To Profit & Loss a/c

xvi. For loss on consignment a/c

Profit & Loss a/c Dr

To Consignment a/c

**<u>Some more entries only in case of goods are sent at I.P.</u>**

xvii. For cancellation of loading on goods sent

Goods sent on consignment a/c Dr

To Consignment a/c

xviii. For cancellation of loading on abnormal loss

consignment a/c Dr

To Abnormal loss

xix. For stock reserve (Loading on consignment stock)

Consignment a/c Dr

To Stock recerve a/c

**Some more enteries in case, Consignment Debtors a\c is maintained**

xx. For collection from debtors

Consignee a\c Dr. (If received by the consignee)

Bank a\c Dr. (If received by the consignor)

To Consignment Debtors a\c

xxi. For bad debts

Consignment a\c Dr.

To Consignment Debtors a\c

xxii. For bill receivable received by from the debtor

Bills receivable a\c Dr.

To Consigmnment Debtors a\c

**Note: If consignee is paid del-credre commission, Consignment Debtor A\c is not maintained in the book of the consignor but it is maintained in the books of the consignee.**

**Books of Consignee**

i. For goods received

No Entry

ii. For payment of consignment of consignment of consignment expenses

Consignor a\c Dr.

To Baqnk

iii. For commission receivable

Consignor a\c Dr.

To Commission a\c

iv. For collection from debtors

Bank Dr.

To Consignor a\c

v. For bad debts

Consignor a\c Dr. ( if del-credre commission is not paid)

Bad Debts a\c Dr. (if del-credre commission is paid )

To Consignment Debtors a\c

vi. For final remittance to consignor

Consignor a\c Dr.

To Bank a\c

To Bills payable a\c

# Joint venture

**Joint venture-** It is a very short duration business entered into by two or more than two persons jointly. It may be limited to one transaction or may extend to a number of transactions. It may be even for specified period of time.

**Separate set of books:-**Under this method three accounts are opened. Accounts are maintained jointly in the book of ventures.

**Journal entries**

i. For capital invested by ventures
Joint Bank a/c Dr
To co- venture's a/c

ii. For expenses paid and purchase of goods.
Joint venture a/c Dr
To joint Bank a/c (if paid through joint Bank)
To co-venture's a/c (if paid personally) Dr

iii. For purchase of goods on credit
Joint venture a/c Dr
To creditor's a/c

iv. For purchase returns
Creditors a/c Dr (if return out of credit purchase)
Joint Bank a/c Dr (if return out of cash purchase)
To joint venture a/c

v. For Cash paid to creditors
Creditors a/c Dr
To J/B (if paid through J/B)
To co-venture (if paid by co-venture)

vi. For sale
J/B a/c Dr (cash sale)
Debtor a/c Dr (credit sale)
To J/V

vii. For sales return
J/V a/c Dr
To J/B (if return out of cash sale)
To Debtors (if return out of credit sale)

viii. For payment received from debtors
J/B a/c Dr (if receipt deposited into J/B)
Co-venture a/c Dr (if received by co- venture)
To Debtors a/c

ix.For discount Allowed or bad debts

J/V a/c Dr.

To Debtors a/c

x. For insurance claim received

J/B a/c Dr.

To J/v a/c

xi. For goods or assets taken over by the venturers

Venturer's a/c Dr

To J/V a/c

xii. For commission or interest payable to venturers

J/V a/c Dr

To venture's a/c

xiii. For profit

J/V a/c Dr

To Venturer's a/c

xiv. For loss

Venturer's a/c Dr

To J/V a/c

xv. For refund of capital

Venturer's a/c Dr

To J/B a/c

xvi. For cash remittance by one venture to another.

Receiving venturer a/c Dr

To paying venturer a/c

xvii. For B/R drawn on debtor.

B/R a/c Dr

To Debtors a/c

xviii. For Bill discounted

J/B a/c Dr

Discount on bill a/c Dr

To B/R a/c

xix. For transfer of discount on bill

J/V a/c Dr

To discount on bill a/c

**<u>Notes-</u>** No entries are required for (i) Goods remittance from one venturer to another. (ii) Goods destroyed or spoilage

**<u>Same set of books</u>**

1. Recording own transactions and transactions of co-venturer as well:-

Under this method each venture maintains his own book preparing two accounts

(i) Joint venture a/c (ii) Co-venturer a/c

**Note**:- No joint bank a/c is opened but all the payments are made by the ventures personally.

**Journal entries :-**

1. For payment of expenses and goods purchased.

J/V a/c Dr
To Bank (own transactions)
To Co- venturer's a/c (co-venture's transaction)

2. For goods supplied out of existing business.

J/V a/c Dr
To Purchases a/c (own)
To Co-venturers a/c

3. For sale of goods

Bank a/c Dr
Co-venturer a/c Dr
To J/v a/c

4. For cash remitted to co-venturer.

Co-venturer a/c Dr
To Bank a/c

5. For cash received from co-venturer.

Bank a/c Dr
To Co-venturer a/c

6. For B/R drawn on co-venturer

B/R a/c Dr
To Co-venturer a/c

7. For B/P drawn by co-venturer

Co-venturer a/c Dr
To B/P a/c

8. For B/R discounted.

Bank a/c Dr.
J/V a/c (amount of discount) Dr.
To B/R a/c

9. For goods or assets drawn by self

Purchases a/c Dr.
Assets a/c Dr.
To J/V a/c

10. For goods or assets drawn by co-ventures

Co-venturer a/c Dr.
To J/V

II. For interest or commission payable to ventures

J/V a/c Dr.

To Interest/Commission a/c (own)

To Co-venturer a/c

12. For insurance claim received

Bank a/c Dr.

Co-venturer A/c Dr.

To J/V a/c

13. For profit

J/V a/c Dr.

To P/L a/c (own)

To Co-venturer a/c

14. For Loss

P/L a/c Dr.

Co-venturer a/c Dr.

To J/V a/c

15. For final remittance to co-venture.

Co-venturer a/c Dr.

To Bank

15. For final receipt from co-venturer.

Bank a/c Dr.

To Co-venturer a/c

**<u>Memorandum Joint Venture</u>**

Under this method accounts are maintained under same set of books. But venturers record own transactions only. They do not record the transactions made by the co-venturer. At the end they prepare Memorandum Joint Venture jointly putting all the transactions made by all the venturers.

**Note- Journal entries are passed under same set of books as above.**

**Space For Important Notes:**

## Profit and Loss Appropriation Account

**Profit & Loss Appropriation A\C-** This account is prepared to show the distribution of net profit between or among the partners.

Provisions of Partnership Act-

i. No interest on capital is payable.
ii. No interest on drawing is chargeable.
iii. No any type of remuneration is payable to the partners.
iv. Profit or loss is to be divided equally.
v. Interest @ 6% is payable on the loan provided by the partners to the firm.
vi. No any new partner can be admitted to the firm without the consent of all the partners.

**Note-** Above provisions are applicable only if there are no agreements regarding all these.

**Interest on monthly drawings:**

1. If drawings are made at the beginning of each month, interest is charged for 6.5 months.
2. If drawings are made in the middle of each month, interest is charged for 6 months.
3. If drawings are made at the end of each month, interest is charged for 5.5 months.

**Note-** If date of drawing is not mentioned, interest is charged for 6 months.

**Types of Capital**

**Fluctuating Capital** | **Fixed Capital**

**Fixed Capital**: **Capital A\C** | **Current A\C**

**Adjustments to be posted in fixed capital accounts:**

.

| | |
|---|---|
| 1. Introduction of capital is credited to Capital A\C | 2. Withdrawn of capital is debited to Capital A\C |

**In the books of the partnership firm**

**Profit & Loss Account**

**For the year ended……….**

**Dr** **Cr.**

| Particulars | Rs. | Particulars | Rs. |
|---|---|---|---|
| | **** | By Profit & Loss A\C | **** |
| To Interest on Capital | **** | -Net Profit | |
| To Partners' commission, salary etc. | **** | By Interest on drawings | **** |
| To Interest on partners' loan* | **** | | |
| To General Reserve & Other Reserves | | | |
| To Divisible Profit | | | |
| | | | |

# Treatment For Goodwill

## A) When Premium for goodwill is brought

i) For premium for goodwill brought by the new partner

Bank A/C Dr.

To Premium for Goodwill (PFG)

(Being PFG brought by new partner)

ii) For PFG shared by the old partners

PFG A/C Dr.

To Old Partners' Capital A/Cs ( In sacrificing ratio)

(Bing PFG credited to old partners' capital A/C)

iii) For amount of PFG withdrawn by the partners

Old Partners' capital A/Cs Dr.

To Bank A/c

(Being amount of PFG withdrawn)

## B) When PFG is not brought

i) For raising goodwill

Goodwill A/c Dr.

To Old Partners' Capital A/Cs (In Old Ratio)

(Being goodwill raised crediting partners' capital A/Cs)

ii) For writing off goodwill

All partners' capital A/C Dr.

To Goodwill A/C (In New Ratio)

(Being goodwill written off after admission of new partner)

iii) For adjustment to be of made though Capital A\Cs

New Partner's Capital A/C Dr.

To Old Partners' Capital A/Cs (In Sacrificing Ratio)

(Being treatment for goodwill made through capital A/Cs)

iv) For PFG not brought temporarily

New Partner's Loan A/C Dr.

To Old Partners' Capital A/Cs (In S/R) (Being PFG due from new partner)

C For PFG paid privately – **No Entry**

## Method of Calculating Goodwill

i) Average profit method= Average profit X No. of years purchase

ii) Super profit method= Super profit X No. of years purchase

**NOTE-** Super profit = Avg. /Actual profit – Normal profit

Annuity method= Super profit X Annuity factor

Super profit capitalisation method= $\frac{\text{Super profit}}{\text{Normal rate of return}} \times 100$

Average Profit Capitalisation Method= $\frac{\text{Average Profit X 100}}{\text{Normal Rate of Return}}$

**What is Goodwill?**
It is the reputation earned by the business by establishing faith among the customers.

**Premium for Goodwill –** PFG is the amount brought by the incoming partner in addition to his capital to be shared by the old partners in sacrificing ratio for the reputation or goodwill earned by them for the business.

## Circumstances when goodwill need to be valued.

i) At the time of admission of a partner.
ii) At the time of retirement of a partner.
iii) At the time of death of a partner.
iv) At the time of dissolution of the firm.
v) When profit sharing ratio among the partner changes.

## Admission of a partner

i) For capital brought by the new partner.

| | |
|---|---|
| Bank A/c | Dr. |
| To New Partner's Capital A/c | |

ii) For transfer of retained earnings.

| | |
|---|---|
| Profit & loss A/C | Dr. |
| General Reserve | Dr. |
| Other Reserves & Funds A/C | Dr. |
| To Old Partners' Capital A/Cs | |

(Being transfer of retained earnings)

iii) For transfer of retained loss

Old Partners' Capital A/C Dr.

To Profit & Loss A/C

To Advertisement Suspense A/C

iv) For increase in value of eases

Assets A/C Dr.

To Revaluation A/C

v) For decrease in value of assets

Revaluation A/C Dr.

To Assets A/C

vi) For increase in liabilities

Revaluation A/C Dr.

To Liabilities A/C

vii) For decrease in liabilities

Liabilities A/C Dr.

To Revaluation A/C

viii) For loss on revaluation

Old partners' Capital A/Cs Dr.

To Revaluation A/C

ix) For profit on revaluation

Revaluation A/C Dr.

To Old Partners' Capital A/Cs

## Retirement or Death of a Partner

**What does a retiring partner or deceased partner takes away?**

i. His capital

ii. His share of retained earnings or loss

iii. His share of goodwill

iv. His share in joint life policy

v. His share of profit up to the date of retirement or death

**NOTE- All the above entries (except no. 1) are same in case of retirement and death.**

x) For share of profit up to the date of death or retirement.

Profit & Loss Suspense A/C Dr.

To Retiring / Deceased Partner's Capital A/C

**Settlement of Retiring or Deceased Partner's Dues**

i. By payment of whole amount at the time of retirement

ii. By transferring the full amount to Loan A\C to be paid later

iii. Part payment at the time of retirement and balance is transferred to Loan A\C to be paid later.

## *Joint Life Policy*

**Joint Life Policy-** The partnership firm takes joint life policy on lives of the partners sometimes jointly ii) sometimes individually.

Joint Life Policy may be dealt with in the following manner:

i) When LJP A\C is not maintained

ii) When JLP A\C is maintained

i. When JLP A\C is not maintained

Under this method premium paid for the policy is treated as an expense of the business thus debited to P\L A\C. No Joint Life Insurance Policy is shown in the balance sheet.

**Journal Entries**

1. For payment of premium

JLP Premium A\C Dr.

To Bank A\C

2. For charging prm.

P\L A\C Dr.

To JLP Prm. A\C

3. For JLP realized

Bank A\C Dr.

To Partners' Capital A\C

2. When JLP A\C is maintained

**a. Joint Life Method-** Under this method JLP is maintained at its surrender value.

1. For payment of prm.

JLP A\C Dr.

To Bank A\C

2. For adjustment of book value of JLP with its surrender value

P\L A\C Dr.

To JLP A\C (if book value is higher than surrender value)

JLP A\C Dr.

To P\L A\C (if book value is lower than surrender value)

3. For realization of JLP

Bank A\C Dr.

Partners' Capitals A\Cs (Being loss) Dr.

( If realized below book value)

To JLP A\C

To Partners' Capital A\Cs (Being profit)

(if realized above book value)

**b. JLP Reserve Method**- Under this method a JLP Reserve A\C is maintained at surrender value along with JLP A\C.

1. For payment of JLP prm.

JLP A\C Dr.

To Bank A\C

2. For creation of JLP Reserve

P\L A\C Dr.

To JLP Reserve A\C

3. For bringing down JLP to its surrender value

JLP Reserve A\C Dr.

To JLP A\C (With the amount JLP A\C exceeds its surrender value)

4. For realization of policy money

Bank A\c Dr.

To JLP A\C

5. For transfer of credit balance of JLP

JLP A\C Dr.

To JLP Reserve A\C

6. For transfer of balance of JLP Reserve
JLP Reserve A\C DrTo Partners' Capital A\Cs

## Introduction to Company Accounts

**Features of a company**

1. Artificial Person 2. Incorporated Association 3. Separate Legal Entity
4. Perpetual Existence 5. Common Seal 6. Limited Liability
7. Distinction between Ownership and Management 8. Periodic Audit 9. Not a Citizen 10. Transferability of shares 11. Maintenance of Books

**Types of Companies**

**Statutory Company-** All those company which operates under the special act passed by the state Legislature or parliament are called *statutory company.*

**Government Company-** A Govt. Co. is that co. in which Central Govt. or State Govt.\ Govts. or partly by Central Govt. and partly by State Govt.\ Govts. hold at least 51% shares. Subsidiary of a Govt. Co. is also called a Govt. Co.

**Foreign Company-** A foreign Co. is that co. which is incorporated outside India.

Holding Company and Subsidiary- If any co. holds 51% or more shares of a company the former is called holding co. and later is called subsidiary co.

**Public Company-*Features***

1. A public co. means a company which is not a private co.
2. It must have a minimum paid-up capital of Rs. 500000.

**Private Company- *Features***

1. A private co. means a company which has a minimum paid-capital of Rs. 100000.
2. Non-transferability of shares.
3. Number of members (share holders) is limited to 50.
4. It cannot invite public to subscribe its shares.
5. It cannot accept any deposit from persons other than its members, directors and relatives.

Financial Statements of a Company Includes
1. A profit & Loss A\C 2. A Balance Sheet
But now-a-days Cash Flow Statement is also published by the co.

**Space for Important Notes:**

## ISSUE OF SHARES

**Shares-** The capital of the company is divided into units of equal denominations. Each of the units carries a fixed amount. These units are known as shares.
Types of shares- 1) Equity Share 2) Preference Share

Share Capital

**Authorised Share Capital-** This is also known as Registered Capital or Nominal Share Capital. This is the maximum number of capital which a company can issue.
**Issued Share Capital-**It is the nominal value of that part of the Authorized Capital which has been offered to the public for subscription.
**Subscribed Share Capital-** It is the part of nominal value of issued capital that has been subscribed (applied for) by the public and allotted to the director to the company.
i) Over Subscription- It is the situation when number of the application is more than the number of the shares offered by the company.
ii)- Under Subscription- It is the situation when number of the shares is less than number of shares company offered by the company.
**Called-up Capital-** it is the part of the subscribed capital which the company has called upon its share holders to pay.
**Paid-up Capital-** It is the part of called-up capital which the shareholders have actually paid.
**Reserve Capital-** is the part of uncalled capital which shall not be called up for payment except during its liquidation.

**Issue of Shares**

| At Par | At Premium | At Discount |
|---|---|---|
| (Share issued at Nominal Value) | (Shares issued at a price higher than Nominal Value) | (Shares issued at a price lower than Nominal Value) |

**Calls-in-arrear:** Amount not paid on allotment and call on time is called calls-in-arrear. Interest on calls-in advance is chargeable is @ 5% p.a. (as per Table A).
**Calls-in –advance:** Amount paid on allotment and call before time is called, calls-in-arrear. Company pays interest @6% p.a. on calls-in-advance (as per Table A).

**Conditions of issue of shares at discount as per section 79 of Companies Act, 1956:**
1. Such an issue is being made at least after one year from the date of commencement of business.
2. The company must have resolved at its general meeting and the Central Government must have sanctioned such an issue.
3. The rate of discount should be resolved as above but should not exceed 10 %. However in some special cases discount at higher rate may be offered.
4. The issue at discount must be made within two months from the date of sanctioned or within such date as may be approved by the Central Government.
5. Only such type of shares may be issued at discount which has already been issued.

**Utilsation of Securities Premium as per sec. 78**
1. For issuing fully paid bonus shares.
2. For writing off following
   i) Share issue expenses or commission paid on issue of shares.
   ii) Discount on issue of shares or Debentures.
   iii) Preliminary expenses.
3. For providing premium on redemption of preference shares or debentures.

**Minimum Application as per sec. 79**

**Forfeiture of Shares**

In case of non-payment of allotment money or any of the call money, company after serving a notice may forfeit the shares. Notice is served giving at least 14 days time.

**Re-issue of Forfeited Shares**

Shares may be re-issued at or at premium or at discount.
Maximum amount of discount on re-issue
1. Where shares were originally issued at par or at premium

   Maximum Discount= Amount Forfeited

2. Where shares were issued at discount

   Maximum Discount= Amount Forfeited+ Amount of Original Discount



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**Prospectus-** Prospectus is a document issued before the issue of shares to invite the public for subscription of shares.

**Pro-rata Allotment of Shares-** in case of over subscription of shares, company issues shares to the public in proportion of shares applied by them. This is called pro-rata allotment.

**Journal Entries**

**For receipt of application money**

Bank A\C Dr.
To Share Application A\C

**For application money transfer share capital account**

Share Application A\C Dr.
To Share Capital A\C

**For refund of excess application money**

Share Application A\C Dr.
To Bank A\C

**For adjustment of excess application money with allotment money**

Share Application A\C Dr.
To Share Allotment A\C

**For allotment money due**

Share Allotment A\C Dr.
To Share Capital A\C

**For allotment money received**

Bank A\C Dr.
Calls-in- arrear A\C (if any) Dr.
To Share Allotment A\C

**For call money due**

Share Call A\C Dr.
To Share Capital A\C

**For call money received**

Bank A\C Dr.
To share Call A\C (if any)
To Calls-in-advance A\C

**For forfeiture of Shares**

Share Capital A\C Dr.
Securities Premium A\C (if due) Dr.
To Share Forfeited A\C
To Calls-in-arrear A\C
To Discount on Shares (if any)

**For re-issue of shares**

Bank A\C Dr.
Discount on shares A\C Dr. (Original amount of discount)
Share Forfeited A\C (loss on re-issue) Dr.
To Share Capital A\C

**Space for important notes:**

## Issue of Debentures

**Debentures-** It is a tool used by a company for a long term borrowing. It is actually a certificate for a fixed deposit. It is an acknowledgement of a debt of a uniform rate.

**Types of Debentures**

**1. Mortgage Debenture-** It is issued mortgaging some assets. These debentures have charge on assets.
**2. Naked Debentures-** These debentures have no charge on assets.
**3. Redeemable Debentures-** These debentures are repayable within specified time. Debentures are issued for a maximum period of 20 years.
**4. Irredeemable Debenture-** There is no specified time for redemption of debentures. These are repayable only at the time of liquidation of company. In India irredeemable debentures are not issued.
**5. Unregistered or Bearer Debentures-** These debentures are transferable on mere delivery. It bears no name or address of the holder.
**6. Registered Debentures-** The name and address of the holder are inserted in the register of the company. So transfer of these debentures requires inclusion of the new holder's details in the register of the company removing the details of the existing holder's details.
**7. First Debentures-** These debentures are considered first for repayment.
**8. Second Debentures-** After repayment of the first debentures, these debentures are repaid.
**9. Convertible Debentures-** The whole or part of the debentures are converted into equity shares after a stipulated time.
**10. Non-convertible Debentures-** These debentures have no right to be converted into the shares.

**Difference Between a share and a debenture**

| Share | Debenture |
|---|---|
| 1. Share is the part of the capital of the company. | 1. Debenture is the part of the debt of the company. |
| 2. Share holders are the owners of the | 2. Debenture holders are the creditors of the |

| | |
|---|---|
| company. | company. |
| 3. Dividend is paid on the shares. | 3. Interest is paid on the debentures. |
| 4. Dividend is paid only if there is profit. | 4. Interest is paid even if there is loss. |
| 5. Dividend is the appropriation of profit. | 5. Interest is charge against profit. |
| 6. Share may be forfeited for non-payment of allotment or call money. | 6. Debentures cannot be forfeited. |
| 7. Shares are not repayable except in special cases. | 7. Debentures are repayable after the expiry of the term. |
| 8. Share holders enjoy voting rights | 8. Debenture holders enjoy no voting rights. |
| 9. In case of liquidation share holders get their money back if any surplus exists after payment of all debts including debentures. | 9. In case of liquidation amount due to debentures are paid first. |

**Journal Entries**

1. For issue of debentures at par and repayable also at par
   Bank A\C Dr.
   To Debentures A\C

2. For issue of debentures at par but repayable at premium
   Bank A\C Dr.
   Loss on Debentures A\C (amount of premium) Dr.
   To Debentures A\C
   To Premium on Redemption of Debentures A\C

3. For issue of Debentures at premium but repayable at par
   Bank A\C Dr.
   To Debentures A\C
   To Securities Premium A\C

4. For Issue of Debentures at premium and repayable also at premium
   Bank A\C Dr.
   Loss on Debentures A\C Dr.
   (Amount of premium payable on redemption)
   To Debentures A\C
   To Securities Premium A\C (Amount of premium received)
   To Premium on Redemption of Debentures

5. For Issue of Debentures at discount but redeemable at par

Bank A\C Dr.
Discount on Debentures A\C Dr.
To Debentures A\C

6. For issue of Debentures at discount but redeemable at premium
Bank A\C Dr.
Loss on Debentures A\C Dr.
(Amount of discount+ Amount of premium)
To Debentures A\C
To Premium on Redemption of Debentures A\C

## Redemption Of Preference Shares

It means paying back the amount of preference shares to the holders of such shares on a specified date or after the expiry of certain period of time.

**Important Points**

1. A company in India cannot issue irredeemable preference shares.2. Preference Shares are issued for a maximum period of 20 years.
2. A share cannot be redeemed unless it is fully paid.
3.The redemption may be out of any or both i) profit of the company available for dividend* ii) proceeds of fresh issue of shares**.
4. Where shares are redeemed out of profit an equal amount must be transferred to Capital Redemption Reserve.
5. Capital Redemption Reserve can be utilized only for issuing fully paid bonus shares.

*Following profits are available for declaration of dividend:
Profit & Loss A\c, General Reserve, Reserve Fund, Dividend Equalization Reserve, Workmen's compensation fund etc.
Following should not be used while creating CRR:
Securities Premium( but it can be utilized for providing premium on redemption of shares, Capital Reserve, Forfeited Shares A\C, Pre-incorporation Profit and any specific reserve like Investment Allowance Reserve' Development Rebate Reserve.
** The 'term' proceeds should not include any securities premium but if there is any discount on issue, the net proceeds (after deduction of discount) should be considered.

| Proceeds of debentures should not be considered for fresh issue. |
|---|

**Journal Entries**

1. Amount payable on redemption
Redeemable Preference Shares Capital A\C Dr.
Premium on Redemption of Pref. Shares A\C Dr.

To Preference Shares Holders A\C

2. For providing premium on redemption

Securities Prm.\ Profit & Loss A\C \ Other Reserves A\C Dr.

To Prm on Redemption Pref. Shares A\C

3. For payment of redemption money

Pref. Shares Holders A\C Dr.

To Bank A\C

4. For creation of CRR

P\L A\C Or, General Reserves A\C Dr.

Other Free Reserves A\C Dr.

To CRR A\C

**Balance Sheet of… (As per schedule 6)**
**As on …………**

| LIABILITIES | RS. | ASSETS | RS. |
|---|---|---|---|
| **SHARE CAPITAL** | | FIXED ASSETS:- | |
| Authorized share capital | 000 | Goodwill | 000 |
| Issued share capital | 000 | Patent, Trade mark etc. | 000 |
| Subscribed share capital | 000 | Land | 000 |
| Paid-up share capital | 000 | Building | 000 |
| ( Excluding Calls-in-arrear) | 000 | Leasehold | 000 |
| **Reserves and surplus** | | Plant and machinery | 000 |
| Capital reserve | 000 | Furniture and fittings | 000 |
| Capital redemption reserve | 000 | **INVESTMENT** | 000 |
| Other reserves | 000 | **CURRENT ASSETS LOAN AND** | 000 |
| Securities Premium | 000 | **ADVANCES** | |
| Profit & Loss Account | 000 | **1.CURRENT ASSETS** | |
| Sinking fund | 000 | a)Int. accrued on investment | 000 |
| **SECURED LOAN** | | b)Loose tools | 000 |
| Debentures | 000 | c)Stock in trade | 000 |
| Loan and advance from bank | 000 | d)Work in progress | 000 |
| **UNSECURED LOAN** | | e)Sundry debtors | 000 |
| Fixed Deposits | 000 | f)Cash in hands | 000 |
| Short term loan and advances | 000 | g)Cash at bank | 000 |
| Other loan and advances | 000 | **LOANS AND ADVANCES** | 000 |
| **CURREN LIABILITIES AND** | | Bills Receivables | 000 |
| **PROVISIONS:** | | Prepaid Expenses | 000 |
| **CURREN LIABILITIES** | | Loan Given | 000 |
| Acceptance | 000 | **MISCELLANEOUS** | |
| Sundry creditors | 000 | **EXPENDITURE** | |
| Unclaimed dividends | 000 | a)Discount on Shares | 000 |
| Interest accrued on loan | 000 | Debentures | |
| **PROVISIONS** | 000 | b)Preliminary Expenses | 000 |
| Provision for taxation | 000 | | |
| Proposed dividend | 000 | **PROFIT AND LOSS** | |
| Provident fund | 000 | **ACCOUNT** (Debit Bal.) | |
| Other provisions | 000 | | |
| | 000 | | 000 |

# Final Accounts

**Final Accounts-** Accounts which are prepared at the end of the year to know the final results (profit or loss) of the business are called Final Accounts. Final Accounts consist of the following:

**1. Manufacturing A\C** (In case of manufacturing co. only) discloses cost of goods sold.
**2. Trading A\C** discloses us gross profit.
**3. Profit & Loss A\C** discloses net profit.
**4. Profit & Loss Appropriation A\C** (In case of partnership firm only) shows distribution of profit.
**5. Balance Sheet** discloses details of assets of liabilities.

**Journal entries for some important adjustments:**

1. For outstanding expenses
Expenses A\C Dr.
To Outstanding Expenses A\C

2. For prepaid Expenses
Prepaid expenses A\C Dr.
To Expenses A\C

3. For Accrued Incomes
Accrued Incomes A\C Dr.
To Incomes A\C

4. For Pre-received incomes
Incomes A\C Dr.
To Pre-received Incomes A\C

5. Depreciation
Depreciation A\C Dr.
To Assets A\C

6. For bad debts
Bad Debts A\C Dr.
To Debtors A\C

7. For provision for bad debts \ Discount allowed
Profit & Loss A\C
To Provision for Bad Debts\ Discount Allowed A\C

8. For provision for discount received
Provision for discount received A\C Dr.
To Profit & Loss A\C

9. For goods drawn for personal expenses
Drawings A\C
To Purchases A\C

10. For goods distributed as free samples
Advertisement A\C Dr.
To Purchases A\C

11. For writing off intangible assets
Profit & Loss A\C Dr.
To Intangible Assets A\C

12.For set off of due to creditors and due from debtor
Creditors A\C Dr.
To Debtors A\C

13. For closing stock
Closing Stock A\C Dr.
To Trading A\C

14. For cheque or Bill Receivable dishonored
Debtors A\C Dr.
To Bank A\C\ Bills Receivable A\C

15. For goods destroyed by fire
Goods Destroyed by Fire A\C Dr.
Purchases A\C

16. For insurance claim foe above loss
Insurance Claim A\C ( if yet to be received)
Bank A\C Dr.
Profit & Loss A\C (Amount of loss not recovered)
To Goods Destroyed by Fire A\C

17. For life insurance premium included in insurance premium
Drawings A\C Dr.
To Insurance Premium A\C

18. For Interest on capital
Interest on capital A\C
To Capital A\C

19. For Interest on drawings
Capital A\C Dr.
To Interest on drawings A\C

20. For transfer to General Reserve
Profit & Loss (Appropriation) A\C Dr.
To General Reserve A\C

21. For manager's commission due
Manager's Commission A\C
To Outstanding Manager's Commission A\C

## Accounting Standard

| No. | Title |
|---|---|
| AS-1 | Disclosure of Accounting Policies |
| AS-2 | Valuation of Inventories |
| AS-3 | Cash Flow Statements |
| AS-4 | Contingencies and Events Occurring after Balance Sheet Date |
| AS-5 | Net Profit or Loss for the Period, Prior Period items and changes in Accounting Policies |
| AS-6 | Depreciation Accounting |
| AS-7 | Accounting for Construction Contracts |
| AS-8 | Accounting for Research and Development |
| As-9 | Revenue Recognition |
| AS-10 | Accounting for Fixed Assets |
| AS-11 | Accounting for the effects of Changes in Foreign Exchange Rate |
| AS-12 | Accounting for Governments Grants |
| AS-13 | Accounting for Investments |
| AS-14 | Accounting for Amalgamations |
| AS-15 | Accounting for Retirements Benefits in the Financial Statements of Employers |
| AS-16 | Borrowing Costs |
| AS-17 | Segment Reporting |
| As-18 | Related Parties Disclosures |
| As-19 | Leases |
| As-20 | Earnings Per Share |
| As-21 | Consolidated Financial Statements |
| As-22 | Accounting for Taxes on Income |
| As-23 | Accounting for Investments in Associates in Consolidated Financial Statements |
| As-24 | Discounting Operations |
| As-25 | Interim Financial Reporting |
| As-26 | Intangible Assets |
| As-27 | Financial Reporting of Interests in Joint Venture |