Paper 5 Group I Financial Accounting

SN 1 Fundamentals of Accounting

1) Book Keeping: It is a daily recording of the transactions in the books of accounts. Only those transactions which have monetary implication are recorded. All transactions are recorded in the local currency.
2) Accountancy is a wider concept. It starts where the book keeping ends. Includes classifying, summarizing & interpreting the transactions.
3) 3 main Branches of Accounting:
   a) Financial Accounting – Objective is to know the financial health of the organisation. Includes Journal, Ledger, TB & Final Accounts
   b) Cost Accounting – Objective is to know product-wise costs. Includes Cost Sheet, Process Costing, Batch Costing, Contract Costing, Operating Costing.
   c) Management Accounting – Caters to the decision making of the managers. Facilitates reporting to the management. Includes Ratio Analysis, BE Analysis, Budgetary Control & Analysis of Financial Statements.
4) Stakeholders of Accounting information:
   a) Investors
   b) Employees
   c) Lenders
   d) Suppliers & Creditors
   e) Customers
   f) Government
   g) Public
   h) Management
5) Components of Financial Statements: Balance Sheet (Financial Position), Statement of P&L (Financial Performance), Cash Flow Statement
6) Accounting Terminologies:
   a) Transaction: Any activity involving exchange of money or money's worth in the business.
   b) Assets: A resource owned by the business that gives future economic benefits.
      i) Current Asset: Assets which are going to get converted into cash or consumed in the short period of time (within 1 year).
      ii) Fixed Assets: Assets held over a long period of time (more than 1 year), not held for resale but for using in the business.
         (1) Tangible: Which have physical existence. Plant, Machinery, Land, Building etc.
         (2) Intangible: Assets which do not have physical existence. Goodwill, Patent, Copyright etc.

c) Depreciation: Reduction in the value of fixed asset over a period of time.

d) Liabilities: Amount owed by the business. These are financial obligations other than owner's money.

   i) Current Liabilities: To be repaid within 1 year.

   ii) Non-current liabilities: to be repaid over a longer period.

e) Contingent Liability: Liability which may or may not arise depending upon the happening of an event which is uncertain at the present moment. E.g. pending court matter. This liability is never provided for in the books but only disclosed as an additional information.

f) Net Worth: It is same as Owner's equity or Shareholders' Funds. Share Capital + Reserves & Surplus net of fictitious assets.

g) Working Capital: It can be gross working capital or net working capital.

   i) Gross working capital is same as Current Assets.

   ii) Net Working Capital = Current Assets – Current Liabilities

h) Capital: Owner's money in the business. Opposite is called Drawings. Amount of profit increases Capital & loss reduces Capital.

i) Goods: Commodity, the business deals in. Fixed Assets are not goods. For a machinery dealer, is machine goods? Raw Material is not goods.

j) Purchases: Goods purchased for resale or material purchased for use in the production of goods or rendering of services.

k) Expenditure: Cost incurrent by the business.

   i) Capital Expenditure: Results in Asset. This goes to Balance Sheet.

   ii) Revenue Expenditure (expenses): The benefit is exhausted in the same period. This goes to P&L Account.

l) Revenue: Includes income for the business. It may be by sale of goods or services or other income such as interest on deposits, commission/rent received, dividend received etc.

m) Trade Discount: Discount given for bulk buying. Revenue is recorded net of trade discount. Hence trade discount never appears separately in the books.

n) Cash Discount: Discount given for early payment. This is shown separately in the P&L as expense. Revenue shown is gross of cash discount. Cash Discount will be calculated on the amount net of trade discount.

o) Inventory: Stock which is unsold. This can be of Material, WIP, Finished Goods, Consumable stores.

p) Trade Debtors: Amounts receivable from the customers to whom the goods are sold or services are rendered on credit earlier.

q) Trade Creditors: Amounts payable to suppliers who supplied materials or goods to us on credit earlier.

r) Bad Debts: Amount which is irrecoverable from the customers. It has to be reduced from debtors & is a loss to the organisation.

7) Accounting Concepts, Principles & Conventions: These terms are mostly used interchangeably. However, they have a subtle difference as follows.
   a) Concept means idea or notion. This has universal application. They are the basic assumptions. They are the foundation based on which principles are formulated.
   b) Principles are a body of doctrine as an explanation of current practices which serve as a guide for selecting a procedure/convention among alternatives.
   c) Conventions: They emerge out of the principles. Conventions need not have universal application. These are adopted over a period of time.
      i) Entity Concept: Business is a separate entity than its owner. Personal transactions are not recorded in the books of accounts.
      ii) Money measurement concept: Only those transactions which can be measured in money are recorded. These are recorded in the local currency of the country.
      iii) Periodicity (Accounting Period) Concept: Business life is divided into periodic intervals (usually one year, quarter or 6 months). Concept of accrual comes because of this concept. This concept helps in comparisons, matching the revenues & expenses.
      iv) Accrual concept: Transactions are recorded as & when they occur. Not when cash is received or paid. Questions of outstanding, prepaid arise because of this concept. Alternate is Cash basis (which is followed by the government).
      v) Matching concept: Expenses matching with the revenue of that period only should be considered. Thus periodicity concept also gets followed here.
      vi) Going concern concept: Financial statements are prepared assuming that the business will continue in future. Valuation of asset is dependent on this concept. They are recorded on historical cost basis & not on liquidation cost basis.
      vii) Cost concept: Value of the asset is determined on the basis of historical cost. This provides objectivity. Other methods are subjective. Limitations: Assets do not show the true value as on today (e.g. land purchased 10 years back may be of a much higher value today). Comparison may become meaningless (machine purchased 10 years back for Rs. 50,000 giving returns of Rs. 10,000 today & another identical machine purchased last year for Rs. 4,00,000 giving returns of Rs. 10,000 today. Does it mean second machine is less efficient than first?)
      viii) Verifiable Objective Evidence concept: Every transaction should have some verifiable, objective evidence to show that the transaction happened in reality. This leaves audit trail which is important to ensure authenticity of the transactions.

ix) Realisation concept: One is supposed to show the gain only when it is actually realised. E.g. i) Asset value has increased in the present scenario may not be shown at an increased amount since it is not realised. ii) Mere promise given by customer of buying the goods is not shown as sales since it is not actually realised.

x) Dual Aspect Concept: Every transaction has 2 sides. Both the sides are recorded. That forms the basic accounting equation i.e. Equity + Liabilities = Assets.

xi) Balance Sheet Equation Concept: Assets = Equity + Liabilities. Every transaction can be put into this equation.

xii) Conservatism (Prudence): Anticipated income should not be recorded but possible losses should be provided for.

xiii) Consistency: Accounting policies are to be followed consistently. Those should be changed only if a) law or accounting standard demands or b) it results in more appropriate presentation of the financial statements.

xiv) Materiality: Only the important transactions should be disclosed. Those not having significant impact should not be disclosed. Hence stationery purchased is expensed out though it is still in the stock. Similarly, small value assets such as calculators, bottles etc. will not be depreciated over a period of time. Materiality is subjective. Anything that can influence the decision making of the user should be disclosed properly.

xv) Industry Practice Concept: Every firm follows what is usually followed in its industry. E.g. Insurance companies prepare the accounts in a specific manner. NPO prepares Income & Expenditure Account instead of P&L Account.

xvi) Some other principles are Disclosure (full & fair disclosure keeping substance over form in mind), Revenue Recognition (only the revenue that is earned should be recorded. Collection Agent should not show the amount of receivables as his revenue), Timeliness (reporting should not be delayed),

8) Vouchers –
   a) Supporting Vouchers – Cash Memo, Invoices, Receipts etc.
   b) Accounting Vouchers –
      i) Non Cash Transaction – JV
      ii) Cash Transaction –
         (1) Payments – Debit Voucher
         (2) Receipts – Credit Voucher

9) 3 types of accounts –
   a) Real, Personal & Nominal

b) Golden Rules as per traditional approach & modern approach

10) Journal -> Ledger -> Trial Balance -> Adjustment entries -> Adjusted Trial Balance -> Closing Entries -> Financial Statements.

11) Division of Journal –
   a) Journal Proper, Purchase/Sales/PR/SR Book, Bills Receivable/Payable Book, Cash Book

12) Division of Ledger – Division required for convenience, better control, minimize errors, fixing responsibility
   a) Personal Ledger –
      i) For Debtors & Creditors
   b) Impersonal Ledger –
      i) Cash Book
      ii) General Ledger
         (1) Nominal Ledger (for expenses & income)
         (2) Private Ledger (assets & liabilities)

13) Rectification of Errors –
   a) Types of errors:
      i) Errors of Omission: It can be partial omission (TB does not tally) or complete omission (TB tallies).
      ii) Errors of Commission: It can be one sided (TB does not tally) or two sided (TB tallies)
      iii) Errors of Principle: Capital expenditure is recorded as Revenue Exp or vice versa.
      iv) Compensating Errors
   b) Error can be one sided error or Two sided error. One sided error affects the agreement of the Trial Balance. Two sided error does not affect the agreement of the Trial Balance.
   c) Error can be rectified before preparation of Trial Balance, after preparation of Trial Balance or after preparation of Final Accounts.
      i) Before preparation of Trial Balance:
         (1) One sided error -> Show the remaining effect.
         (2) Two sided error -> Post the rectification entry.
      ii) After preparation of Trial Balance:
         (1) One sided error: Post the rectification entry with one effect in Suspense Account.
         (2) Two sided error: Post the rectification entry.
      iii) After final accounts:
         (1) One sided error: Post the rectification entry with one effect in Suspense Account. If there is a nominal account, instead of that account P&L Adjustment account is used.
         (2) Two sided error: Post the rectification entry. If there is a nominal account, instead of that account P&L Adjustment account is used.

14) Accounting for Depreciation

a) Depreciation is a proportionate amount of Fixed Asset charged to the period.

b) Different Causes of Depreciation: Wear & Tear, Passage of Time, Obsolescence, Abnormal reasons, Depletion.

c) Different Terms used:

   i) Amortisation:

      (1) Writing off the intangible assets like goodwill, patent etc.

   ii) Depletion:

      (1) Used for mines, quarries, oil fields etc.

      (2) It means reduction in the material quantity to be extracted from the asset.

   iii) Obsolescence:

      (1) Out of date

      (2) Due to technological improvements, changes in demand pattern, changes in law etc.

      (3) It does not mean reduction in the capacity of the asset but simply means the asset has reduced its value due to external reasons.

d) Reasons for booking depreciation:

   i) Correct Cost & Profit Calculation

   ii) True value of fixed assets

   iii) Providing for replacement cost

   iv) Legal requirement

   v) Maintenance of capital/net worth

e) Factors to be considered for calculating depreciation:

   i) Cost of the asset

   ii) Additions made

   iii) Useful life

   iv) Scrap value

   v) Technological changes

   vi) Law

   vii) Repairs

f) Methods of charging depreciation:

   i) Sources of Funds:

      (1) Sinking Fund:

         (a) Amount of depreciation charged is invested outside in such a way that at the end of the useful life of the asset, the amount invested plus interest will provide for the replacement cost less realizable value.

(b) Calculated based on sinking fund table. This table shows how much we need to invest every year if we want 1 rupee at the end of certain number of years at a prevailing rate of interest.

(2) Insurance Policy: Difference between this & Sinking Fund method is, here premium is paid at the beginning of the year & there is no interest on it. When the asset needs to be replaced, the policy will be encashed & money received will be used to buy a new asset.

(3) Annuity:

(a) It considers the interest lost by blocking the funds in the fixed asset.

(b) This notional Interest is debited in asset account & credited to interest account.

(c) Depreciation depends on rate of interest & life of asset.

(d) It is calculated based on annuity tables.

(e) It shows the equivalent amount every year for 1 rupee available in the beginning at a given rate of interest & for a specific time period.

ii) Time Basis:

(1) SLM

(2) RBM

(3) Sum of Years' digit method: Each depreciation is calculated by the formula: Remaining life in years including the current year/sum of digits of life of the asset in ye ars x cost of the asset.

(4) Double Declining: Here the rate of depreciation is taken as double the straight-line method rate. But the depreciation is calculated on written down value instead of on the cost. E.g. If the life of the asset is 5 years, the depreciation rate under SLM will be 20% each year. In this method we take 40% rate. But this 40% is taken on the written down value.

iii) Usage base:

(1) Mileage

(2) Depletion Service Hours:

(a) For mines, quarries etc.

(b) (Cost – Residual value)/estimated quantity to be extracted x actual qty extracted.

(3) Working hours:

(a) Similar to Depletion Method

(b) Instead of Estimated qty to be extracted we use estimated hours.

(c) (Cost – Residual value)/estimated hours x actual hours worked.

(4) Unit Method: Used in case of assets like machinery which is expected to produce certain goods. Life of the machinery will be considered in terms of the units it is expected to manufacture. Depreciation each year will be Cost – Residual value) / estimated quantity of production. This rate is then multiplied to the actual quantity of production each year to arrive at the depreciation amount.

iv) Price Base:
   (1) Revaluation Method:
      (a) Used when there are many small value items (loose tools, livestock etc)
      (b) So not possible to depreciate each individual item
      (c) At the end of the year the assets which are still workable are valued (by the valuation expert). Difference between opening + purchases & closing value is considered as depreciation.
   (2) Repairs Provision Method:
      (a) (Cost – Scrap Value + estimated repairs cost)/Useful life
      (b) The above amount is debited to P&L. Credit for depreciation goes to Depn Provision A/C & credit for repairs goes to Repairs Provision A/C.
      (c) Actual Repairs will be debited to Repairs Provision A/C.

g) Provision for Depreciation Account: If this account is maintained, the depreciation is recorded in this account & the asset account continues to be at cost. Only when the asset is sold, the accumulated depreciation for such asset is transferred from this account to the Asset A/C.

h) Asset Disposal A/C:
   i) When asset is sold for any reason, the company may maintain this account. In that case all the entries related to the disposal will be recorded in this account. Any profit or loss on the sale will be recorded in this account & transferred to P&L.

i) Change in the method of depreciation:
   i) Only when it is required by law or accounting standard or for more appropriate presentation of the financial statements.
   ii) Since this is change in the accounting policy, its effect should be disclosed separately.
   iii) Depreciation with the new method needs to be calculated with retrospective effect i.e. from the time the asset came into the business. Any deficiency or surplus till the date of change should be recorded through P&L.

SN 2 Accounting for Special Transactions – Bills of Exchange

1) Most of the times Trade happens based on written promises to pay certain sum of money to someone. These instruments are called negotiable instruments.
2) Definition of bill of exchange: A bill of exchange is an <u>instrument in writing</u> containing an <u>unconditional order</u> <u>signed</u> by the maker directing a <u>certain</u> person <u>to pay a certain sum of money</u> only <u>to or to the order</u> of a certain person or <u>the bearer</u> of the instrument.
3) Other Feature: It must be dated, 3 extra days as a grace period for making payment except when the bill is payable on demand or at sight. However, parties may disallow this grace period, must be accepted by drawee. Has to be signed by the drawer & drawee. Stamp not required on bills payable on demand.
4) Format of BoE page 99 of the study module.
5) Permanent Parties to the Bill:
   a) Drawer: He is the one who draws the bill i.e. Creditor
   b) Drawee: He is the one on whom the bill is drawn. He is a debtor by whom the money is payable.
   c) Payee: Party to whom the bill is made payable.
6) Additional parties: (May or may not be there)
   a) Endorsee: Person in whose favour the bill is endorsed by the holder of the bill.
   b) Drawee in case of need: The person whose name is mentioned in case the drawee refuses to accept the bill.
7) Holder:
   a) The person entitled in his own name to the possession of the bill & to receive the money due thereon from the parties to it.
8) Acceptance of the bill: -
   a) Drawee signifies acceptance of the bill by signing it. He may or may not write the word ‘accepted.’
   b) Types of Acceptance –
      i) General – Unconditional Acceptance. Just puts his signature with or without the words ‘Accepted’.
      ii) Qualified Acceptance – Adds some conditions along with signature for the acceptance.
9) Accommodation Bill – (opposite is Trade Bill)
      i) Any bill which is drawn/accepted or endorsed without consideration. This is to accommodate one or both the parties’ financial needs. If both the parties are in need then the discount charges are proportionately borne by both of them.
10) Term of the Bill: Period between the date on which the bill is drawn & date on which it becomes due.
11) Due Date/Date of maturity – Date on which the term expires. This is after considering 3 days grace period.
   a) Counting will start from the date of the bill if the bill is ‘after date’ bill. It will start from the date of acceptance of the bill by the Drawee if it is ‘after sight’ bill.
   b) The date on which the bill is drawn or accepted is excluded in counting days.

c) For Bills payable on demand there is no grace period allowed.

d) If the period of the bill is mentioned in months then calendar months are to be counted keeping the date constant. If it is mentioned in days then actual number of days will need to be counted.

e) In case the month does not have that date, it matures on the last date of the month. E.g. Bill drawn on 31^{st} Jan payable a month after date would mature on 28^{th} Feb.

f) If the maturity date falls on Sunday or any other Public holiday, the due date will be considered as an immediate previous working day. In case of unplanned holiday, it is the next working day.

12) Honouring of Bill – It means drawee has made the payment by the due date.

13) Dishonour of bill – Drawee not making payment by the due date.

a) Effects –

i) Original position of debtor & creditor is restored.

ii) Holder can take legal action against drawee or previous endorser.

iii) In order to provide a legal evidence of the fact of the dishonour, the fact of dishonour has to be noted by a person called Notary Public. (He is the Legal Practitioner or other public servant appointed by Central or State Govt under Notaries Act 1952.) This process is called 'Noting'.

iv) Expenses incurred for establishing the fact of dishonour (noting charges) are recovered from the drawee.

14) Discounting –

a) Holder can go to the bank & encash the bill immediately before the due date in case he is need of money.

b) Bank pays him the amount of the bill less of some amount which is called Discount. This is normally the interest for the period for which the bill is being paid early.

c) Effects –

i) Position of Drawee unaffected.

ii) Drawer immediately gets the payment.

iii) Discount charged is an expense for the Drawer & income for the Bank.

d) This is different than Sending the Bill to The Bank for Collection in which case Bank merely acts as an agent.

15) Renewal of a Bill – In case Drawee makes a request before the due date for extension of the period for payment, Drawer may cancel the original bill & make a new bill with an extended period. He may charge interest for this extended period & recover noting charges & stamp duty from the Drawee.

16) Retirement of a Bill – In case the amount is paid before the due date, the bill is settled & withdrawn. Drawer may allow some concession in the amount to the Drawee in such case. This concession is an expense for the Drawer & gain for the Drawee.

17) If the question mentions about insolvency, it means the bill is dishonoured. Hence pass the entries for the dishonour first & then pass insolvency entries.

18) Accounting Entries:

	In the Books of Drawer	In the books of Drawee
Sale of Goods	Debtor Dr. To Sales	Purchases Dr. To Creditor
Bill Drawn & Accepted	Bills Receivable Dr. To Debtor	Creditor's Dr. To Bills Payable
Honoured	Bank Dr. To BR	Bills Payable Dr. To Bank
Dishonour	Drawee Dr. To BR To Cash (Noting Charges)	Bills Payable Dr. Noting Charges Dr. (if any) To Drawer
Insolvency	Bad Debts Dr. Bank Dr. To Drawee	Drawer Dr. To Bank To Deficiency
Endorsement	Endorsee's Dr. To BR	No Entry
Bill Honoured	No entry	Same as Honoured entry above
Dishonour	Drawee's A/C Dr. (Bill + NC) To Endorsee's A/c	Same as Dishonour
Insolvency	Same as Insolvency	Same as Insolvency
Discounting	Bank Dr. Discount Dr. To BR	No Entry
Honoured	No Entry	Same as Honoured.
Dishonoured	Drawee Dr. (Bill + NC) To Bank	Same as Dishonour above
Insolvency	Same as Insolvency above	Same as Insolvency above
Sending to Bank for Collection	Bills for Collection Dr. To BR	No entry
Honoured	Bank Dr. To Bills for Collection	Same as Honoured above
Dishonoured	Drawee Dr. To Bills for Collection To Bank (NC)	Same as Dishonour above
Insolvency	Same as Insolvency above	Same as Insolvency above
Renewal	Drawee Dr. To BR (Old Bill) Drawee Dr. (NC+Stamp Duty) To Bank To Interest BR Dr. (New Bill) To Drawee	Bills Payable Dr. To Drawer Noting Charges Dr. Stamp Duty Dr. Interest Dr. To Drawer Drawer Dr. To Bills Payable (New Bill)

SN 2 Accounting for Special Transactions – Consignment

1) Goods are transferred from one party to another without transfer of ownership. Transferor is called Consignor (Principal) & Transferee is called Consignee (Agent).
2) Since it is not a sale, Consignor does not send invoice. Only proforma invoice is sent.
3) Agreement between 2 parties.
4) Consignee normally recovers all expenses from the Consignor.
5) Usually Consignee gives advance or BoE to Consignor which is later adjusted against the sale.
6) Consignee receives commission as a % of **Total Sales.**
   a) Ordinary Commission – Consignee is not responsible for bad debts.
   b) Del Credere Commission – Bad Debts is Consignee's loss. Normally this is also calculated on **Total Sales.**
   c) Additional Commission – To incentivise Consignee to sale at higher price or promote new product etc.
7) Account Sales – Just a periodic statement sent by Consignee to Consignor detailing the sales made, expenses incurred, goods remaining, Commission earned etc. This is not same as Sales Account.
8) For each consignment or consignment agent, separate account is prepared.
9) Distinction between Sale & Consignment –
   a) Ownership does not pass on in consignment
   b) Left over goods can be returned in consignment
   c) Consignor bears the loss of goods held with the consignee
   d) In Consignment: It is principal & agent vs debtor/creditor in Sales
   e) Consignor bears the expenses
10) Golden Rule –
    a) Debit Consignment Account for whatever goes in the consignment including the opening balance of goods with him & expenses incurred. Credit whatever comes from the Consignee including Sales, Closing Stock lying with him.
    b) Balance in the account is profit or loss.
11) Closing Stock Valuation –
    a) Cost or Net Realisable Value whichever is lower.
    b) All Expenses incurred on the goods to be included while valuing the stock.
    c) But the expenses incurred by Consignee after he has taken the delivery of the goods (mostly recurring expenses; e.g. rent of consignee's warehouse, electricity) to be excluded. Any expense incurred by him while taking over possession should be included in the value of the goods.
    d) If details are not given about whether Consignee's expenses are before or after the delivery, then we should ignore those while valuing the closing stock.
12) Journal Entries in the books of the Consignor –
    a) Opening Balance on the debit side of Consignment Account
    b) Goods sent: Consignment Account debited & Goods sent on Consignment Account credited.
    c) Expenses incurred by Consignor: Consignment Account debited & Cash or Bank Credited.
    d) Expenses incurred by Consignee: Consignment account debited & Consignee account credited.
    e) Sales: Consignee Account debited & Consignment Account credited.
    f) Commission to Consignee: Consignment Account debited & Consignee account credited.
    g) Bad Debts:
       i) Ordinary Commission: Consignment Account debited & Consignee Account credited.
       ii) Del Credere Commission: No entry in the books of Consignor.
    h) Closing Stock: Stock on consignment account debited & Consignment Account credited. This appears as Closing Stock in Balance Sheet of Consignor.

i) Return of Goods by Consignee: Goods sent on Consignment account debited & Consignment Account credited. (Expenses incurred by Consignee in returning the goods to the Consignor are not included in the value of such returns. These are debited to Consignment account)
j) Balance in Goods sent on consignment account transferred to Trading Account.
k) Balance in Consignee Account is settled in cash.

13) If bill of exchange is discounted, discount will not be debited to consignment account. It will be debited to P&L account.
14) Normal Loss:
    a) One which is unavoidable.
    b) Cost of goods is divided by net units i.e. units after deducting normal loss. This rate is used to value the closing stock.
15) Abnormal Loss:
    a) Just like any other abnormal loss the value of this loss is credited to consignment account & debited to P&L account.
    b) Expenses incurred till the stage of abnormal loss are included while computing the value of the abnormal loss. E.g. If goods are lost in transit then expenses incurred by Consignee are not included but if the goods are lost in Consignee's warehouse then his **non-recurring expenses** are also included in the value of the abnormal loss. But consignee's recurring expenses are **not** included in the value of the abnormal loss just like closing stock.
16) Journal Entries in the books of Consignee –
    a) Expenses incurred by Consignee: Consignor A/C debited & Cash or Bank credited.
    b) Advance given to Consignor: Consignor account debited & cash or bank account credited.
    c) Goods sold
        i) for Cash: Cash or Bank debited & Consignor A/C credited.
        ii) On credit: Consignment Debtors account debited & Consignor account credited
    d) Commission earned: Consignor account debited & commission account credited.
    e) Bad debts –
        i) Ordinary commission: Consignor account debited & Consignment Debtors account credited.
        ii) Del Credere commission: Commission earned account debited & Consignment debtors account credited.
    f) Settling account by paying to Consignor: Consignor account debited & cash or bank credited.
17) Goods invoiced above Cost: The consignor may send the goods in the proforma invoice at a rate higher than his cost. The difference between his cost & the proforma invoice price is called 'loading'. This loading gets included in opening stock, goods sent on consignment & closing stock. Hence this needs to be removed from the Consignment Account. Reverse entry is passed for goods sent on consignment. For Closing Stock on Consignment, the loading is removed by debiting Consignment A/C & crediting Consignment Stock Reserve A/C.

SN 3 Preparation of Financial Statement for Profit oriented organisations

1) After Trial Balance is prepared, there are certain further entries which need to be passed before preparing the final accounts. These entries are called adjustment entries.

2) Adjustment entries typically include:
   a) Any rectifications needed
   b) Closing Stock entry
   c) Depreciation
   d) Outstanding, pre-paid, advance income or income receivable adjustments
   e) Provision for doubtful debts, discount on debtors/creditors
   f) Interest on capital or on drawings
   g) Abnormal loss

3) Final Accounts include Manufacturing Account (in case of manufacturing concerns), Trading Account, Profit & Loss Account & Balance Sheet.

4) Manufacturing account is rarely prepared (in case of manufacturing concerns).
   a) It shows cost of goods manufactured on the debit side. This includes expenses of manufacturing on the debit side such as Opening WIP, Raw material consumed, power, fuel, royalty, depreciation on plant/machinery/factory building, insurance of plant/machinery/factory land & building.
   b) Credit side shows closing WIP, sale of scrap if any, balance transferred to Trading Account.

5) Trading Account:
   a) It includes:
      i) Opening (debit side) & Closing Stock (credit side)
      ii) Purchases (debit side)
      iii) Wages (debit side)
      iv) Customs Duty (debit side)
      v) Power & Fuel (debit side)
      vi) Carriage/Freight Inward (debit side)
      vii) Royalty (debit side)
      viii) Sales (credit side)
      ix) Goods lost by abnormal loss (credit side)
      x) Goods withdrawn for personal use (credit side)
      xi) Goods distributed as free samples (credit side)
   b) If credit side is higher it is called Gross Profit. Opposite is called Gross Loss. It is transferred to P&L Account.

6) P&L Account:
   a) Includes indirect expenses & income.
   b) Gross Profit or Gross Loss is carried from Trading account.
   c) Expenses on the debit side typically include:
      i) Salaries
      ii) Rent, Rates & Taxes

iii) Office Insurance Premium
iv) Depreciation
v) Repairs & Maintenance
vi) Audit Fees
vii) Bad Debts
viii) Bank Charges
ix) Legal expenses
x) Discount allowed
xi) Carriage outward
xii) Salesman's commission
xiii) Travelling, entertainment expenses
xiv) Advertisement expenses
xv) Finance expenses including interest on loans
xvi) Abnormal loss

d) Income on the credit side include:
   i) Interest/commission/discount received
   ii) Miscellaneous income
e) End result is either net profit (if credit side is higher) or net loss (if debit side is higher). This is adjusted in Capital. Net profit is added & net loss is reduced from capital.

7) Balance Sheet:
   a) Consists of Real & Personal Accounts.
   b) Liabilities Side: Capital, Reserves, Long Term Liabilities & Short Term i.e. Current Liabilities.
   c) Assets Side: Fixed Assets, Investments (Non-Current or Current), Current Assets.
   d) Normally the items are shown in the order of permanency.

SN 3 Preparation of Financial Statement for Not for Profit organisations

1) Objective of such organisations is to render service & not to create profit. They do not distribute dividend.
2) Income & Expenditure Account (instead of Profit & Loss Account), Receipts & Payments Account (Similar to Cash Book) & Balance Sheet.
3) Income & Expenditure Account:
    a. Based on accrual concept
    b. Records only revenue expenses & revenue income.
    c. Balance i.e. Surplus or Deficit is transferred to Capital Fund.
4) Receipts & Payments Account:
    a. It is prepared based on Cash/Actual concept.
    b. All receipts & payments are recorded in this. This is a summary of Cash Book.
    c. No relation to Accrual concept.
    d. Balance in this account is carried forward.
    e. Even Capital Receipts & Payments are recorded in this in addition to Revenue Receipts & Payments.
5) Certain unique items:
    a. Entrance Fees: It may be treated as Capital (because these are non-recurring) or Revenue (admission of member is a recurring phenomenon) Receipt depending upon the rules of the institution.
    b. Donations: General Purpose donations are considered as Revenue Receipts. Special Purpose ones are created as Special Funds. If these special funds are invested, interest on the same is credited to the Special Fund.
    c. Legacy: The wealth that is donated to the NPO after the demise of a member. This is credited to Capital Fund.
    d. Endowment Fund: It is created for specific purpose & the income from the same is used only for the specific purpose. It is treated as a special fund. E.g. Prize Fund.
    e. Life Membership Fees: Considered as Capital Receipt & hence added to the Capital Fund. Every year, some amount may be taken to the Income & Expenditure Account.
    f. Subscriptions: These are recurring revenue. Hence taken in Income & Expenditure Account.